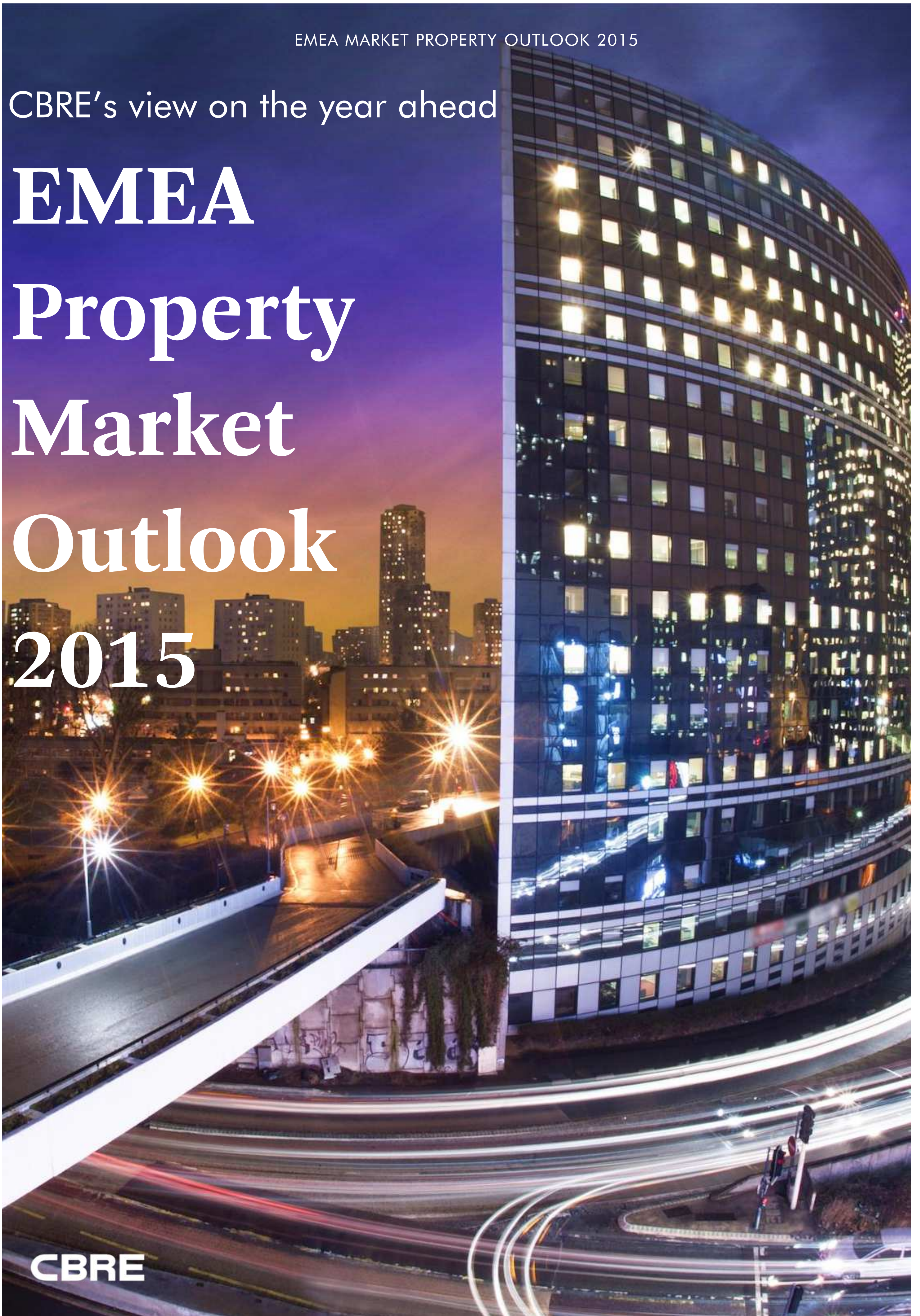
EMEA MARKET PROPERTY OUTLOOK 2015
CBRE's view on the year ahead
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EXECUTIVE SUMMARY

This report sets out CBRE's view on property market prospects for 2015.

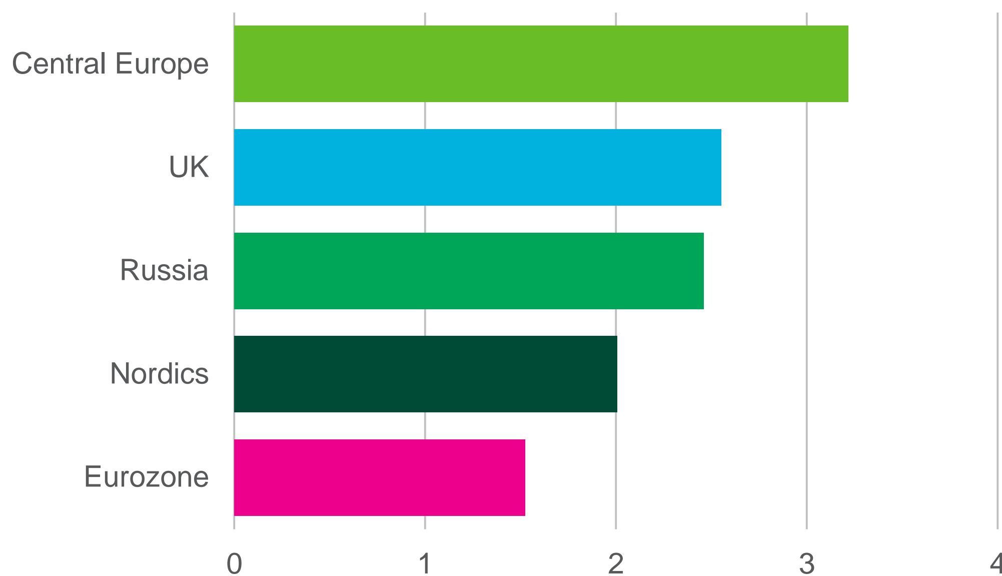
- The major trends in the commercial real estate capital market during 2014 were principally driven by a greater willingness to take risk, by both investors and lenders. This showed up in falling yields and, the surge in investment activity in Spain and Ireland as well as second and third tier towns in UK and Germany. These boosted direct investment activity in 2014 to over €200 billion.

- Aided by a low interest rate environment and the weight of capital from the Far East, the strengthened risk appetite amongst investors will likely persist in 2015. This will result in further growth in investment activity; with Italy and Portugal in particular benefitting from investors looking for the next step on from Spain and Ireland. Secondary property in countries where the prime market recovery is already more established also has significant scope for further improvement.

- With a shortage of prime product, developers may turn increasingly to investors rather than the traditional debt route to fund new projects.

- The economic background to all of this is for an improving recovery in the Eurozone in 2015 with Spain, Ireland and Greece outpacing the rest; France and, particularly Italy lagging behind whilst Germany regains some of its economic mojo. Non-euro EU countries will also continue to out-perform while Russia is expected to suffer a deep recession.

Chart 1: Annual Average GDP growth 2015-19



Source: Oxford Economics / CBRE

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- As usual there are a number of uncertainties facing the European economies with, for once, not all of them being internally generated and not all of them potentially negative. These include:

  - The major general elections in Greece, the UK and Spain where populist or left-wing political parties have the potential to upset the political order.

  - The Russia-Ukraine situation remains unresolved and the rise of ISIS in the Middle East as well as its potential spill over into Europe. These are two areas of conflict which have flared up, unexpectedly, in the last 12 months and we cannot rule out either an escalation of these crises or the appearance of new ones in the next year.

  - The oil price collapse appears supply side driven and the emergent debate over its cause is interesting. However, the impact is expected to be positive for the majority of Europe's real estate markets in terms of the demand for its commercial property and pricing. Uncertainty remains over economic prospects for China, although US growth appears to be consolidating.

- Headline inflation will remain negative through most of 2015 in many countries. This will raise the spectre of deflation but core inflation will remain positive, if low, in most countries.

- Full blown QE from the ECB looks to be imminent but rumours that it was on the way have already produced benefits in the form of low interest rates and a depreciating euro. The final announcement should lock these effects in for some time.

- With the expected improvement in economic activity, office leasing activity will start picking up. The recovery markets of Ireland, Spain and the Netherlands should be among the stronger markets in demand terms but with the German and French markets also improving in 2015.

- The improvement in demand should start to generate upward pressure on rents across a broader swathe of markets than has been the case so far. We expect to see the established growth markets of London, Dublin and parts of Nordics continuing to see the fastest rental growth, with growth also beginning to appear in a range of other cities including Frankfurt, Brussels, Amsterdam, Madrid and Barcelona.

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- There has been a major pick-up in industrial and logistics leasing demand, with rolling 12-month take-up in the major markets up almost 50% in the third quarter compared with the same period last year. In contrast to the office market, some of the largest gains were recorded in CEE particularly Budapest, Warsaw and Prague, although the Netherlands and Ireland also saw healthy gains.

- Most CEE markets are expected to see a strengthening in demand this year, as are a number of strategic Western European markets including London, Paris, Hamburg, Milan and Dublin. In several of these locations there is a growing mismatch between supply and demand. The supply of modern stock in many well-located areas is limited, which is generating pressure for build-to-suit (BTS) projects.

- Retail spending volumes picked up almost everywhere in 2014 and are growing quite strongly in some places. Although retailers continue to seek out new locations they are increasingly selective about their requirements, as many are also trying to navigate and expand their multichannel platforms. As a result, meaningful rental growth is being confined to a handful of locations.

- Investment in technology is becoming increasingly important for many retailers as competition stiffens, on both a physical and virtual sales front. Although investment into online platforms remains a focus, investment in new store openings and in existing stores is also a priority for many retailers. Cross-border expansion will continue at a steady pace.

- Hotel demand will benefit from the general economic recovery. The depreciation of the euro also points to an upturn in demand from US travellers. This will provide a particular boost to occupancy in European capitals and destinations of cultural and historical significance. The recent incidents in Paris, and American warnings about travel vigilance, may cancel out some of the benefits of a weaker euro in the short-term, but we expect that the impact will be transitory and there will still be year-on-year increases in US visitors and spending.

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ECONOMIC AND POLITICAL OUTLOOK IN 2015

The Eurozone economies continued their slow, some would say painfully slow, economic recovery in 2014 and look set to continue to do so in 2015. The big development in 2014 was the role reversal of the core and peripheral countries. In 2014, many of the geographically peripheral Eurozone countries started to show concrete signs of economic recovery, notably Spain and Ireland. Even Greece managed to post economic growth for the first time in seven years. By contrast, the core countries of Germany, France and Italy disappointed. Outside of the Eurozone, the UK, Sweden and most of Central Europe posted solid growth while the Russian economy slowed precipitously under pressure from sanctions and falling oil prices, with the latter doing by far the most damage.

"Our central economic assumption for 2015 is for more of the same: an improving recovery in the Eurozone with Spain, Ireland and Greece outpacing the rest; France and, particularly Italy lagging behind and Germany regaining some of its economic mojo."

Our central economic assumption for 2015 is for more of the same: an improving recovery in the Eurozone with Spain, Ireland and Greece outpacing the rest; France and, particularly Italy lagging behind and Germany regaining some of its economic mojo. Non-euro EU countries will also continue to out-perform and Russia is expected to suffer a deep recession. As usual there are a number of uncertainties facing the European economies with, for once, not all of them being internally generated and not all of them potentially negative. Given space constraints, we can do little more than list them here.

Europe faces three major elections in 2015. The first of these will be in Greece in late January, the second in the UK in early May and the third in Spain at the end of the year. In each case, there are either left wing or populist parties who threaten to upset the political order. In Greece, the left wing anti-austerity party Syriza is in pole position and is committed to the seemingly inconsistent policies of an end to anti-austerity policies/debt renegotiation and continued membership of the Eurozone. The chances are that, if elected, their anti-austerity rhetoric will be watered down (possibly helped by having to go into coalition with another party) and deals will be done to allow Greece to stay in the euro while making some small face-saving policy changes. That said, the Germans and the Troika (EU, ECB and IMF) are playing hard ball and we can't rule out Greece leaving the euro. We think there is a 30% chance of a "Grexit" but many commentators put it at 50% or more.

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Were Greece to leave the euro, there could be a "genie out of the bottle" effect – once markets see that a country can leave the euro there could be implications for pricing of government debt (and real estate) in other member countries. Again, the reason is that investors will demand a premium if they think that there is a significant chance that their returns will come in a new local and depreciated currency rather than euros. The country most at risk here is Italy – although the markets do not look too concerned at the moment. Ireland is less at risk because of its good recent economic performance and its success in repaying loans and re-entering the bond market. Spain looks to be in a relatively good position too but there could be issues with Catalonian independence and the election later in the year.

In the UK the big issue for investors and others is the prospect of the UK leaving the EU following a post-general election referendum. The anti-EU party UKIP, has done well in by-elections and the European elections and, although it may not win many seats itself, has succeeded in driving the Conservative party into promising a referendum on EU membership if elected. A shallow analysis of UK General Elections indicate that there has been little impact on investor behaviour. However in addition to the UKIP phenomenon the growing strength of the Scottish National Party, despite its failure in the September referendum, means that the result of the May UK election looks to be unusually uncertain. This is especially the case for a country whose "first past the post" electoral system has made it unfamiliar with coalition government despite the experience of the last five years.

Finally, Spain has to go to the polls by the end of the year. It is facing twin uncertainties from Catalan nationalists and the growing challenge in the rest of the country from the left wing populist Podemos party, who now lead both the ruling centre-right and opposition centre-left parties in the opinion polls.

It is ironic that some of the countries that are showing the strongest potential for recovery are facing considerable electoral uncertainty in 2015 and to Greece, the UK and Spain, we can add Sweden which is facing a number of years of minority government. The odds are that the elections will not alter the status quo – Greece will remain in the Eurozone and the UK will remain in the EU, but the possibility that this will not be the outcome is bound to give markets some food for thought in 2015.

Political uncertainty is not confined to general elections. The Russia-Ukraine situation remains unresolved and the rise of ISIS in the Middle East and the potential spill over into Europe highlighted by recent events in Paris continues to cause concern. These are two areas of conflict which have flared up, unexpectedly, in the last 12 months and we cannot rule out either an escalation of these crises or the appearance of new ones in the next year.

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So far, the impact on European markets and economies has been muted, though a potential explanation for the disappointing economic performance of Germany, Finland and Austria in 2014 is exposure to trade with Russia.

Another concern facing Europe is the possibility of deflation and what that might do to the chances of recovery. Headline inflation for the Eurozone as a whole went negative in December but this is largely being driven by the weakness of oil prices (of which, more below). "Core inflation" (excluding food, energy and tobacco) held steady at around 0.9% for most of 2014. Further, the country that is actually seeing "core" deflation, Spain, is one that is seeing some of the best prospects of an economic recovery partly on the back of improved competitiveness just as Ireland has benefited from periods of "core" deflation on and off since 2009. While this process of "internal devaluation" can be painful it does appear to have the benefit of helping to restore the international competitiveness that peripheral countries lost against the core Eurozone countries in the years before the recession. Interestingly, Italy, the country that has seen inflation remain stubbornly above the rest of the Eurozone, is the country that appears to be furthest from economic recovery.

The possibility of deflation and the weakness of the economic recovery have generated a call for the introduction of quantitative easing by the ECB. There is already a policy of QE-lite (the purchase of covered bonds) in place and ECB governor Mario Draghi has hinted heavily at the introduction of full QE (i.e. including the purchase of sovereign bonds) possibly at the next ECB meeting on 22 January. In many ways, the Eurozone already has the obvious measurable benefits of QE in lower interest rates and a weaker exchange rate just as a consequence of Draghi talking about it. If full-blown QE does happen, the Eurozone is likely to be locked into low interest rates and a low exchange rate for longer. The fact that the Germans are likely to be reluctant partners in this might, however, reduce the impact. Either way, a weaker exchange rate benefits real estate by making European exports more competitive and aiding the economic recovery. Lower interest rates also help economic recovery, as well as keeping property yields down. The precise impact of real estate pricing may, however, depend on how investors see the future evolution of the exchange rate. Expectations of a long-term downwards drift in the euro could imply a requirement of higher returns and lower prices by dollar-based investors to offset exchange rate induced capital losses, and vice-versa.

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On the positive side, the big development in late 2014 was the collapse in oil prices which fell from over $113 per barrel at the end of June (Brent Blend; €83.1 per barrel) to just $57.5 at the end of the year (€47.4) and which have continued to slide in January. This precipitous decline has not been met with an overwhelmingly positive response in equity markets, which appear to suffer from a combination of concern over the impact on western oil companies and the possibility that the fall may, in part, be due to weakness of demand. All the indicators, however appear to point to the price fall being largely a result of a supply glut driven by the expansion of North American shale oil and the refusal of Saudi Arabia to act as OPEC's swing producer. There are arguments about why this might have happened and conspiracy theories abound, but the bottom line for real estate is that it is hard to see the impact being anything other than positive for the demand for and pricing of commercial property in most European markets.

"There are arguments about the causes of the oil price collapse, but the bottom line for real estate is that it is hard to see the impact being anything other than positive for the demand for, and pricing of, commercial property in most European markets."

The main potential downside for investors is that lower oil prices will drive down inflation with a knock-on impact on rents but this should be at offset by a boost to economic growth and the impact on rents in real terms should be unambiguous. The majority of the boost to economic growth should come through stronger consumption but companies will also benefit from lower input costs. This will benefit retail, in particular, but some impact will be felt across all sectors including residential. The big gain, in most countries, however, is likely to come from the impact on interest rates which will be "even lower for longer" and a consequent impact on property yields.

Occupier markets in oil producing countries will see the other side of the coin. Rents are likely to be adversely affected in Norway and, particularly, in Russia while the Aberdeen market in the UK is also likely to suffer. The other area to consider is the potential impact on capital flows from the major oil producers, largely located in the Middle East. While their financial reserves are big enough to mean that they are unlikely to suffer short-term liquidity issues, it seems inconceivable that they will be able to maintain recent investment levels if the price of their main source of earnings stays low. On the other hand, there will be a benefit to the economies of many Asian investors so aggregate cross border capital flows could well be maintained.

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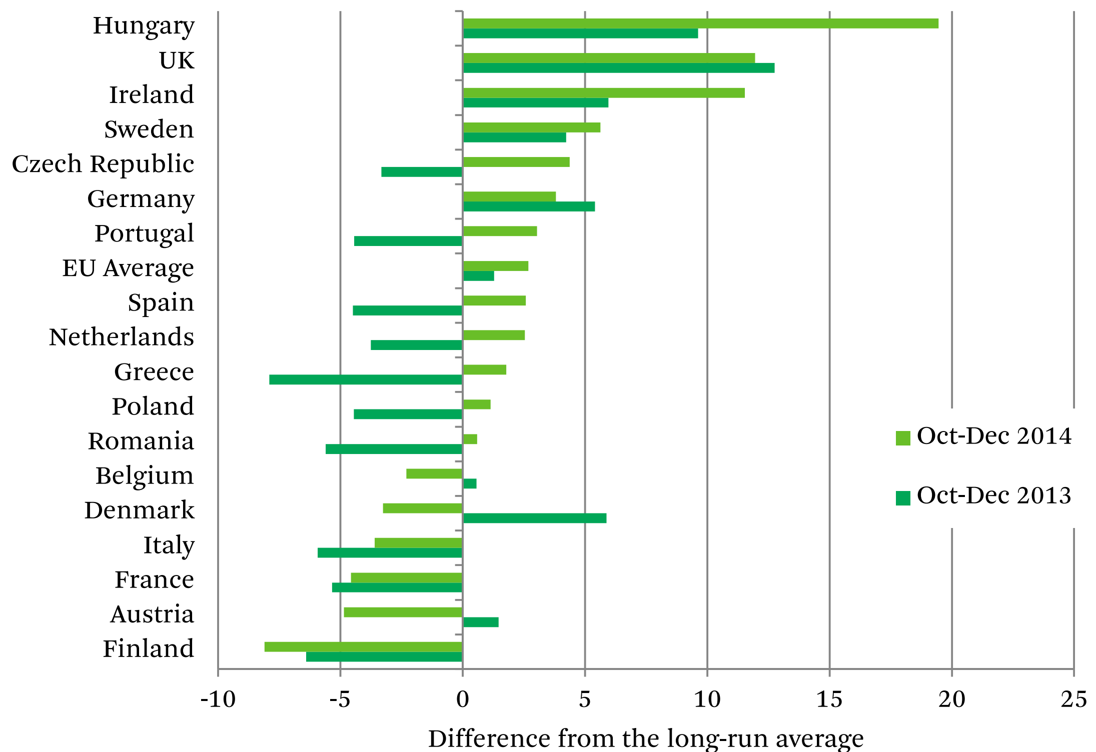
Finally, the rest of the world's economic prospects deserve a mention. China is undoubtedly seeing a structural slowdown in growth, which has the potential of showing up in the occasional financial crisis although it should benefit from lower oil and other commodity prices. Commodity producers, especially oil producers, will face a difficult year as discussed above.

The big gainer is the USA where the recovery appears to be becoming firmly entrenched. There also appears to be an odds-on chance that interest rates will begin to rise well in advance of European rates especially if the ECB does introduce full-blow QE. The results have already been seen in a stronger dollar and, as discussed above, Europe stands to benefit both from a stronger export market in the US, and a more competitive exchange rate.

Chart 2: The Eurostat Economic Indicator



Source: Eurostat, CBRE. *Note that Eurostat do not produce an Economic Sentiment for Ireland. The figures shown have been constructed by CBRE are based on PMI and consumer confidence data.*

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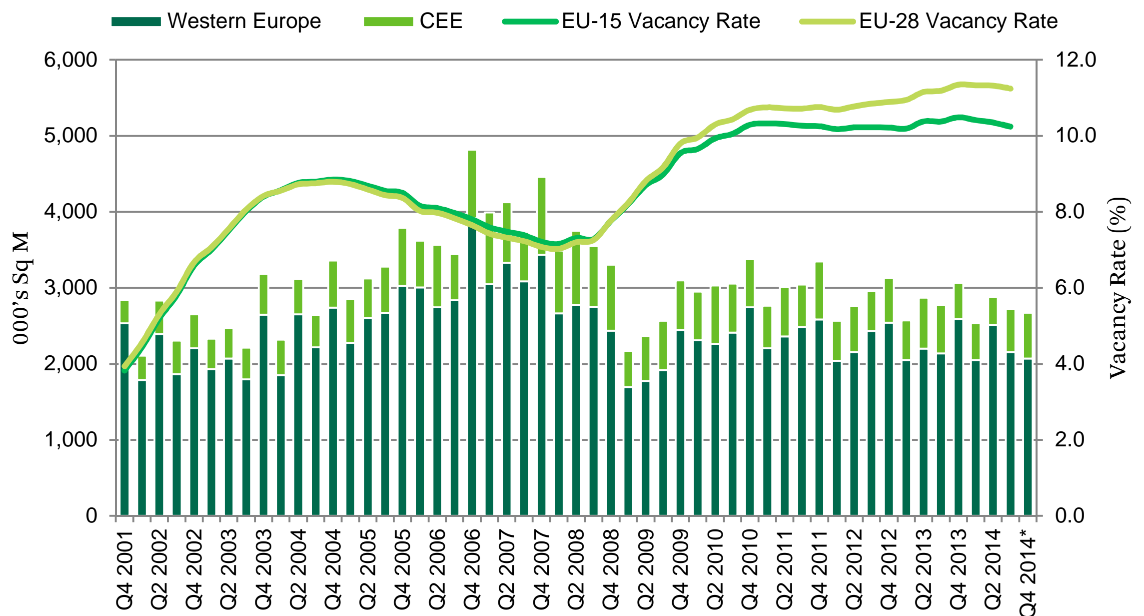
LEASING MARKETS

Offices

Europe's office leasing markets in 2014 broadly reflected the uneven nature of the economic recovery. Clear signs of a broad improvement in leasing demand remain elusive outside of the UK and while aggregate take-up was steady, there are still very large differences in leasing velocity across the major markets.

Across the main markets as a group, gross take-up in 2014 looks likely to have been 3-4% down on the previous year but with very marked variations. Western Europe generally fared better than CEE, although there were large contrasts between cities experiencing strong growth - such as London, Dublin, Barcelona and Milan – and those which declined including Frankfurt and Madrid. Paris saw a very erratic demand profile: 13% up on the year, despite a 40% Q-on-Q decline in the third quarter alone. Geopolitical uncertainty has undoubtedly affected some of the CEE markets, with Moscow in particular sharply down compared with last year and Warsaw also weaker.

Chart 3: European Office Take-Up & Vacancy



Source: CBRE (*Q4 2014 estimate)

With economic growth expected to accelerate this year and next, leasing activity will start picking up. The recovery markets of Ireland, Spain and the Netherlands should be among the stronger markets in demand terms but with the German and French markets also improving relative to 2014.

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In the CEE, Budapest, Bucharest and Istanbul are expected to see good growth. The UK may present a mixed picture with London leasing hampered by a dip in completions, even though pre-lets may help to keep volumes up, and the rest of the UK continuing to see reasonable growth.

"With growth expected to accelerate this year and next, leasing activity will start picking up, generating upward pressure on rents across a broader range of markets."

This general improvement in demand will start to generate upward pressure on rents across a broader swathe of markets than has been the case so far. CBRE's EMEA Prime Office Rent index barely rose in 2014, and growth was confined to a handful of locations including London, Oslo, Stockholm and, most remarkably, Dublin where rents increased by over 40%. This lack of widespread rental growth was mainly the result of a subdued demand side, since supply conditions for prime space mostly tightened. This resulted from continuing low levels of development and, in some cities, conversions of office buildings to alternative uses.

In 2015, we expect to see the established growth markets of London, Dublin and parts of Nordics continuing to see the fastest rental growth, with growth also beginning to appear in a range of other cities including Frankfurt, Brussels, Amsterdam, Madrid and Barcelona. Paris remains at the weaker end of the spectrum along with much of CEE.

Underneath these aggregate trends, we expect to see some clear patterns emerging around the sources and quality-preferences of occupier demand. Technology companies will continue to be prominent absorbers of space in many markets. As occupiers across all sectors become increasingly driven by the needs of the labour force, demand will be more heavily focussed on good-quality buildings in central areas that are most attractive to workforces, and better able to accommodate new workplace strategies.

Industrial and Logistics

The industrial and logistics market is seeing a stronger pick-up in demand, with rolling 12-month take-up in the major markets up almost 50% in the third quarter compared with the same period last year. In contrast to the office market, some of the largest gains were recorded in CEE particularly Budapest, Warsaw and Prague, although the Netherlands and Ireland also saw healthy gains. Expansion into these growing markets by retailers, 3PLs and, to some degree, manufacturers underpins this growth.

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There is also demand emanating from 3PLs and retailers seeking both urban logistics/parcel delivery units, and larger warehouses in internationally-strategic locations, in part to serve the growing needs of e-commerce.

Demand is generally improving, and will be boosted in 2015 by increasing trade levels: imports to and exports from the EU are both expected to rise by 3.7% this year compared with around 3% in 2014. Industrial production and capital investment, while perhaps slower to resume growth, will also support property demand more strongly from 2016.

Most CEE markets are expected to see a strengthening in demand next year, as are a number of strategic Western European markets including London, Paris, Hamburg, Milan and Dublin. In several of these locations there is a growing mismatch between supply and demand. The supply of modern stock in many well-located areas is limited, which is generating pressure for build-to-suit (BTS) projects. Newly-completed space therefore tends to be for these types of schemes although speculative development is starting to be contemplated seriously in some of the larger Western European markets.

Retail

Consumer sentiment showed great improvement over the course of 2014 and trading conditions and occupier demand have also improved. However retail sales again presented a varied picture across Europe in 2014 with some markets still facing challenging conditions. The most buoyant sales growth (see chart 4) has been in Romania, Hungary and the Czech Republic in central Europe and in the UK, Ireland and Sweden in the west, although the "Black Friday" phenomenon may have flattered year-on-year comparisons in some cases. In contrast, a number of countries have seen sub-1% growth and volumes are actually down in Austria and Finland.

The Christmas period has reported a number of key retailers showing upbeat trading performances, such as John Lewis and House of Fraser in the UK both with positive like-for-like growth. However other retailers such as M&S lost out due to logistical problems encountered during a surge in sales on Black Friday. Many European retailers are yet to announce results. The outlook for 2015 is expected to show a strengthening in retail sales growth across most markets. Southern Europe will continue to see growth in sales, in particular in Greece but Italy's performance will be subdued. The UK and Slovakia, Romania, Turkey, Hungary and Ireland are expected to continue to see robust growth in 2015 and Russia is the only market expected to see a significant fall in sales volume in 2015.

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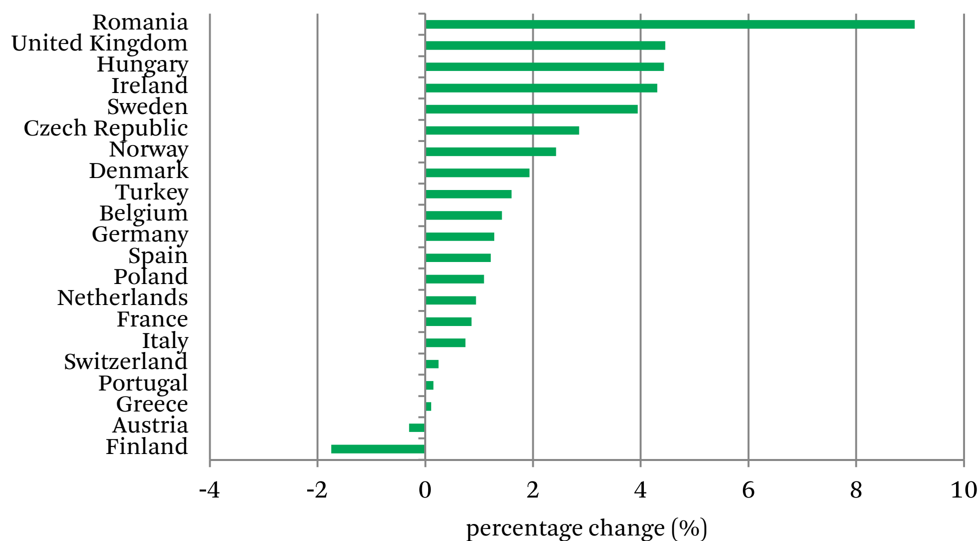
"As retailers evaluate their portfolios, and the size and location of stores are examined more closely, demand for the best and most-established locations will strengthen further."

Chart 4: Retail Sales Volume (exc Fuels), % Change over the Year to the 3mnths Ending November 2014



Source: Eurostat

Despite steady demand for major retail pitches across Europe only a handful of locations witnessed rental growth. Munich and Hamburg saw rents rise by 9% and 10% (2014 YTD) respectively. Increased demand for space from luxury brands in Paris and London in particular has put upward pressure on key streets in both cities. Demand for space in Dublin, Oslo and parts of Spain also picked up putting upward pressure on rents. However in Moscow the geopolitical crisis began to take its toll towards the end of 2014 with demand dropping by around 40-60% on normal levels. As a result rents decreased by circa 5% from the beginning of the year.

Retailers continue to seek out new locations although are increasingly selective about their requirements, as many are trying to navigate and expand their multichannel platforms. Investment in technology is becoming increasingly important for many retailers as competition stiffens, on both a physical and virtual sales front, stiffens. Although investment into online platforms remain a focus, investment in new store openings and in existing stores is also a priority for many retailers. Cross-border expansion will continue at a steady pace.

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As retailers evaluate their portfolios and emphasis on size and location of stores is examined with more rigour, demand for the best and high performing locations will increase putting further upward pressure on these proven locations. Major cities in Germany, London, Barcelona, Paris and Warsaw are all expected to see rental growth over the course of 2015.

Shopping centre development activity in Europe are following the same geographical pattern as last year, with new construction dominated by emerging markets - Russia and Turkey. In Turkey the majority of development, certainly the larger schemes, is taking place in the major cities such as Istanbul with smaller scheme development taking place in the outer regions such as Izmir. The scale of new development is largely to due to economic growth in the region, a growing middle class and the increasing demands of cross-border retailers, many of whom have found that the existing retail space in the region does not meet their requirements. In terms of Western Europe there is very little new space due to enter the market in 2015, the majority of development that is taking place is in Germany and France, elsewhere there is a trend towards refurbishing existing assets to try and refresh schemes.

The major development in the UK has been the teetering of the big supermarket chains under challenge from a combination of low cost, aspirational and convenience competition. This has resulted in a price war and the recent announcement that once-dominant Tesco are to close over 40 stores and shelve the development of a further 49, mostly large out of town, stores. While the Tesco announcement has been well received by the stock market we can expect further changes to the UK food retailing landscape over the coming year.

Hotels

Northern Europe continues its seemingly relentless advances in revenue per available room (RevPAR) with year-on-year growth exceeding 13% YTD in November 2014. These figures are astounding considering the maturity of the market, and reflect growing consumer confidence and a prolonged hike in corporate demand. Looking south to Europe's warmer climes, hotel performance is finally improving, albeit from a very low base. Spain and Greece are benefiting from a boom in tourism, which in turn is aiding economic recovery. Strong domestic demand remains to be seen, however, travellers from prospering economies have helped Southern Europe's RevPAR to gains of over 5%. Western Europe has seen rather slower RevPar growth at 2.9%, largely as a result of a weak economic recovery and there have been falls in CEE as a result of a degree of over-supply and conflict in the Ukraine.

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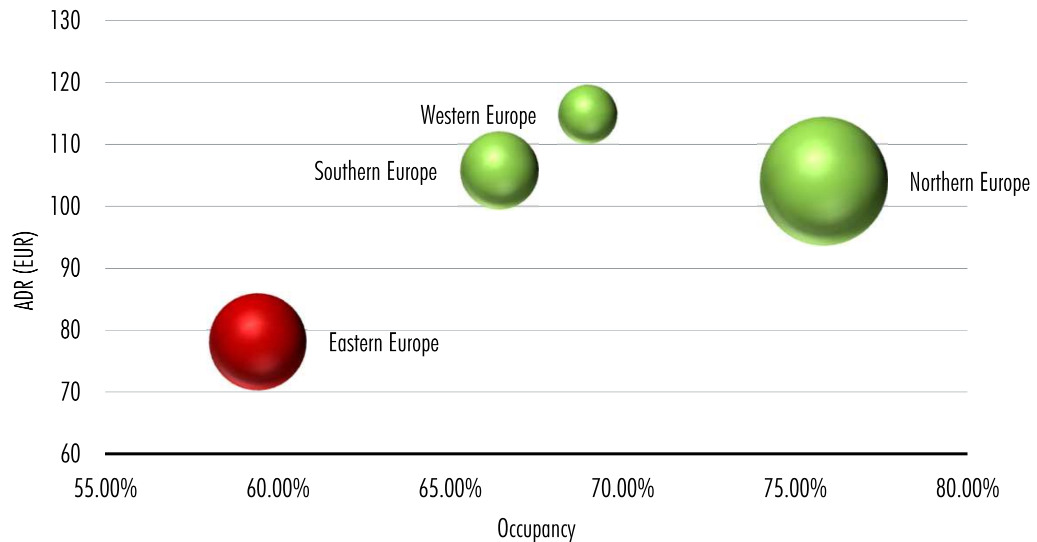
Chart 5: European Regional Hotel Performance, YTD November 2014



**size of bubble represents y-o-y RevPAR growth, red reflects decline*

Source: STR Global, CBRE Hotels Research

"One trend that key cities are likely to share through 2015 is an uptick in demand from US travellers, who will see improved value in travelling trans-Atlantic. This will provide a particular boost to occupancy in European capitals and destinations of cultural and historical significance."

One trend that key cities are likely to share through 2015 is an uptick in demand from US travellers. With the strength of the US dollar to many European currencies, not least the Euro, US travellers are likely to see improved value in travelling trans-Atlantic. Whilst this is unlikely to enhance the performance of many regional, domestic markets, it will help boost occupancy and rate in European capitals and destinations of cultural and historical significance. The recent incidents in Paris and American warnings about travel vigilance may cancel out some of the benefits of a weaker euro in the short-term, but we expect that the impact will be transitory and there will still be year-on-year increases in US visitors and spending.

The collapse in oil prices should not do any harm either. The oil glut of the mid-1980's significantly lowered the cost of travel as transport providers were able to pass on savings in their operating costs to the consumer. Inevitably a tourism boom was the result along with significant hikes in demand for hotels in popular destinations. The exception to this trend is likely to come in oil-producing nations where the economy could be affected by a reduction in oil revenues and damage corporate/consumer confidence as a result.

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Northern Europe is expected to continue on a RevPAR growth trajectory. With many markets sitting at a strong occupancy base future growth is likely to be driven by heightening corporate demand in line with robust economic conditions. Operators are now in a favourable position whereby they can be more selective in the business they take, as a result leisure and tours/groups demand will be increasingly displaced by more lucrative corporate and conference demand.

The recovery in Southern Europe has so far been driven largely by strong leisure demand. The Spanish economy, and an improvement in corporate confidence, will result improving corporate demand for hotels could nudge up rates. However, economic conditions in Italy remain fragile and until this situation improves we are only going to see marginal increases in occupancy and room rates.

Western Europe is likely to benefit from improved international and consumer demand on the one hand and a continued weakness of corporate demand on the other.

CAPITAL MARKETS

The major changes in the commercial real estate capital market during 2014 were principally driven by a greater willingness to take risk by both investors and lenders. Although this was starting to happen towards the end of 2013, there was a much more substantial change in 2014 which set the trend for the year. This was reflected in:

- the surge in investment activity in Spain and Ireland and in second and third tier towns in UK and Germany which has taken CRE investment activity to over €200 billion;
- the sharp falls in yields in these markets;
- the increase in the availability (and fall in the cost) of debt, both generally and more specifically for investors buying in more secondary markets; and
- the sharp rise in loan sale transactions – from around €20 billion in 2013 to over €50 billion in 2014.

"Investors' willingness to take risk in the search for higher returns will continue to increase in 2015, resulting in further growth in investment activity. Italy and Portugal in particular could benefit from investors looking for the next step on from Spain and Ireland."

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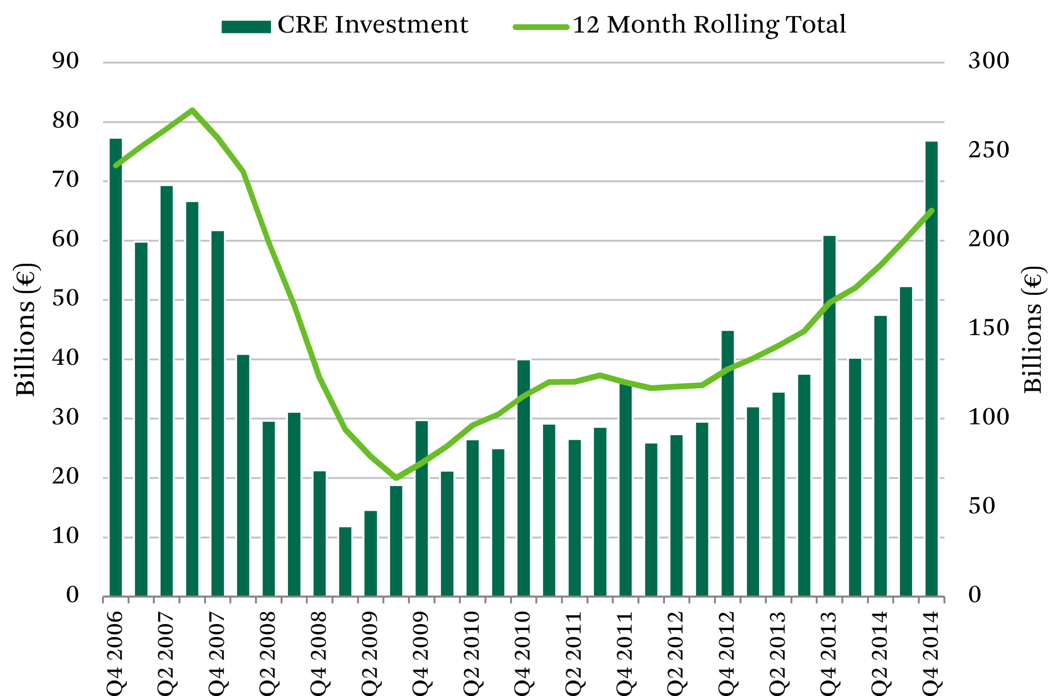
The most likely outcome in 2015 is that investors' willingness to take risk in the search for higher returns will continue to increase. This would result in further growth in investment activity, with Italy and Portugal in particular benefitting from investors looking for the next step on from Spain and Ireland. Secondary property in countries where the prime market recovery is already more established also have significant scope for further improvement. The sharp fall in secondary yields that has already been recorded in the UK has not yet been seen to the same extent elsewhere in Europe, so the spread between prime and secondary yields remains very large by historic standards.

However, the continuation of this trend cannot be taken for granted. Some of the certainty about the economic outlook that has helped drive investors' up-risking has evaporated. The New Year has seen a renewal in fears over the possible exit of Greece from the euro area, although for the moment at least there do not seem to be any fears that other countries would follow. The sharp fall in oil prices – although this will ultimately be positive for Europe – has also added to uncertainty and increased the risk of negative inflation.

A direct consequence of economic uncertainty and speculation about the possible introduction of full QE in the Eurozone has been the fall in government bond yields in the euro area. The 10-year bund yield is currently just 0.5%, down from 1.25% at the end of June.

Chart 6: Commercial Real Estate Investment in Europe



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Prime property yields in most European countries fell slightly in 2014, but seemed to be reaching a floor. However, the fall in bond yields has restored the bond-property yield gap and could reinvigorate interest in core CBD property from investors looking for a bond substitute. It was already evident in Q4 2014 that core investors were more active than earlier in the year, with Asian pension funds and Sovereign Wealth Funds particularly in evidence.

One area to look out for in 2015 will be the willingness of investors and lenders to fund development. Historically in most of Europe development has been funded by debt. This is one of the reasons why the amount of new development remains at very low levels in most cities, London being the main exception. However, difficulty in sourcing core investment product and the low yields available may result in investors funding development as a route to ownership. Occupier demand has yet to show much improvement and so a surge in development risks oversupply.

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This report has been prepared by the CBRE EMEA Research team. For more information about our forecasts and predictions for 2015, please contact us.

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