European Capital Markets
MarketView

Q3 2014

CBRE Global Research and Consulting

TURNOVER Q/Q	TURNOVER Y/Y	CAPITAL VALUES Y/Y	YIELDS Y/Y
9.4%	35.1%	8.1%	-32 BPS

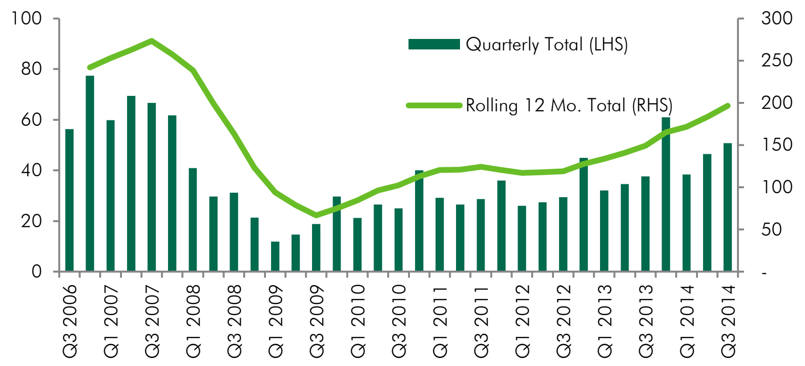
STEADY INCREASE IN EUROPEAN PROPERTY INVESTMENT GROWTH

INDUSTRIAL SECTOR BECOMES INCREASINGLY ATTRACTIVE

Hot Topics

- At €50.8 billion, Q3 2014 continued to see a steady increase in the levels of CRE investment in Europe.
- Exceptional growth was recorded in both Spain and Ireland. Q3 2014 witnessed the highest quarterly total ever achieved in Ireland and the second highest in Spain.
- The other 'recovery markets' of Italy, the Netherlands, and Portugal collectively exhibited healthy growth.
- Steady increase in the core CEE's market share saw investment total €3.1 billion in Q3 – an increase of 29% on the same period the previous year.
- Yield compression was particularly evident in the industrial sector this quarter – with a rise in investor demand also driving up its share of the overall market.

Chart 1: European Investment Turnover (€bn)



Source: CBRE Research

In a continuation of the steady strong growth exhibited since the end of 2012, Q3 2014 saw €50.8 billion transacted in the European commercial real estate (CRE) investment market. A 35% increase on the previous year's performance, this total demonstrated growing investor confidence.

Outstanding Spanish & Irish Q3 growth

Whilst the strength of north-western Europe, particularly the UK and Germany, continued to drive CRE investment, particularly impressive results were observed in both Spain and Ireland – which are both on course to achieve record annual totals.

There has also been strong growth in investment in the other 'recovery play' markets, Italy, the Netherlands, Portugal and the non-core CEE. Nearly all saw substantially higher transactions than in Q3 2013 and are attracting substantial amounts of international capital that is looking to take advantage of the upside in capital values compared other parts of Europe where for core real estate yields are generally much lower.

Comparatively, the performance of the French market in Q3 was relatively subdued, with investment well below both Q3 2013 and Q2 2014. The market outside Paris in particular is being affected by the weak economic outlook. Despite this, for the year as a whole, France is on course to exceed its 2013 total.

Investors target industrial sector

At a sector level the most prominent trend continues to be the increased investment in industrial. Presently accounting for 11% of the European market share, industrial investment totalled €5.3 billion this quarter, driving a sharp fall in prime yields.

This is the continuation of a long term trend which is also seeing alternative sectors – hotels, student housing, nursing homes, etc, also taking an increasing share of the market.

ECONOMIC OVERVIEW

Up to Q1 2014 the Euro area was experiencing moderate growth, but in Q2 2014 that stopped with no growth over the quarter. Recent survey data show momentum slowing further, although H2 2014 should see some expansion. Some of the second quarter weakness can be attributed to one off factors, but there is cyclical slowing in some countries. On the plus side, the ECB's monetary policy and the weaker Euro should be supportive of growth. However, the Ukrainian situation and uncertainty around structural reform implementation is hitting economic sentiment indicators.

Chart 2 shows the path of growth since the global recession. Notable, is the immunity of Poland to the downturn. France, whose performance in 2009 looked enviable, has since decelerated with no significant growth expected and substantial structural reforms seem to be required. The UK's growth profile now puts it ahead of France and on a par with Germany when compared against the Q1 2008 peak. Italy has seen sharp declines in sentiment and its output is still well below the past peak. Sweden is outperforming most European economies, but with worryingly low inflation the Riksbank have cut the interest rate to zero.

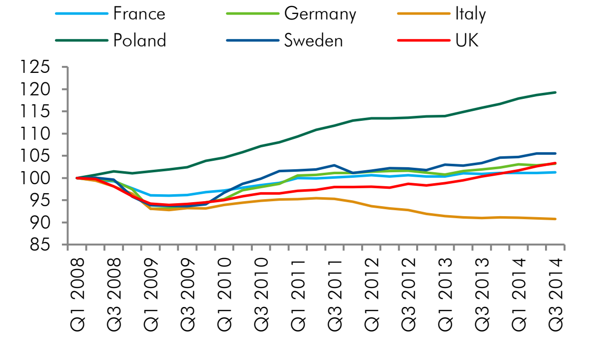
Ireland has seen a surge in its growth position both in 2014 and 2015 (Chart 3), putting it at the top of the GDP growth table. At the other end, Finland, with its ageing population, shrinking workforce and poor export performance is in the doldrums. It is also particularly hard hit by sanctions against Russia. Italy lacks sufficient momentum to take off and has been hit by wider euro area weakness. Both countries' economies will contract in 2014, with only weak growth predicted for 2015.

The CEE countries of Poland, the Czech Republic and Hungary all expect significant GDP growth for 2014 and 2015 except for Hungary, whose outlook is tempered by the Ukraine/Russia tension. Spain and the Netherlands have been more resilient over the last few months and their growth in 2015 should be stronger than in 2014. Overall, the European Commission has slashed its forecasts for Euro Zone and consensus GDP outlook is for 1.2% in 2015.

Jobs growth is forecast to be weaker in most European countries in 2015 relative to 2014 (Chart 4). Countries with poor output outlooks: France, Italy, Russia, Finland, Denmark and Netherlands: will see the lowest job creation, but there are others (Ireland, Poland, Hungary) where stronger output growth is not yet translating into jobs growth. The UK will see continued jobs growth, but at a slower pace in 2015.

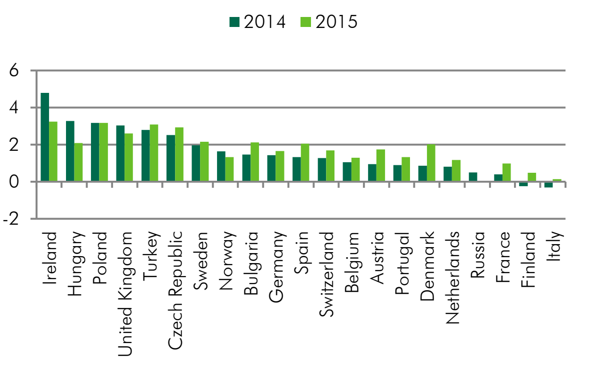
The annual inflation rate in the euro area is remarkably low at 0.3% in September. Inflation excluding energy and food has been broadly stable since late 2013 although relatively weak consumer demand, exchange rate movements and low pricing power of firms has been a downward influence on the overall rate.

Chart 2: Real GDP Indexed to Q1 2008



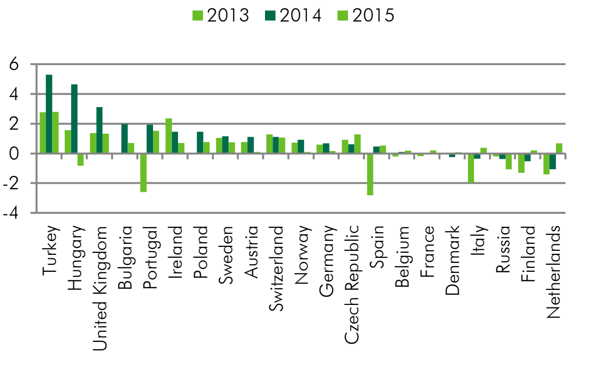
Source: Oxford Economics, CBRE Research

Chart 3: Real GDP Growth by Country (%)



Source: Oxford Economics

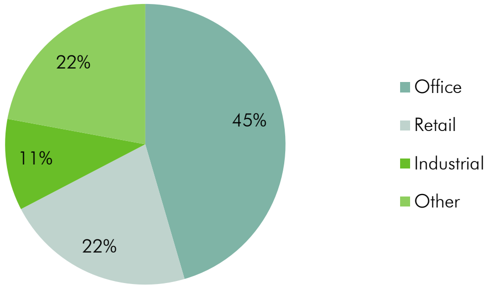
Chart 4: Employment Growth by Country (%)



Source: Oxford Economics

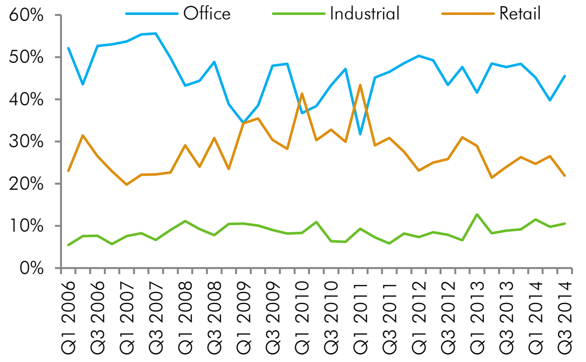
INVESTMENT MARKET

Chart 5: European Investment by Sector (%), Q3 2014



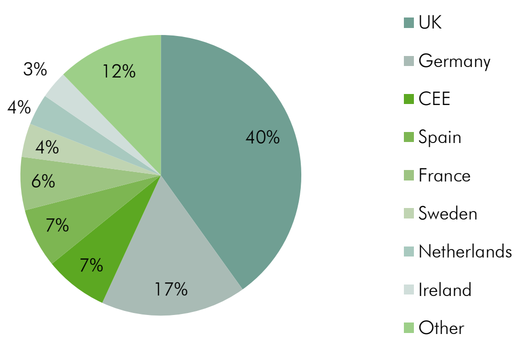
Source: CBRE Research

Chart 6: European Investment by Sector (%)



Source: CBRE Research

Chart 7: European Investment by Country (%), Q3 2014



Source: CBRE Research

By Sector

The sector breakdown of investment activity in Europe shows two significant, and fairly long standing, trends. Investment in industrial continues to grow as a proportion of the European market as a whole. The €5.4 billion in Q3 2014 was a 60% increase on the same quarter last year against the 35% growth for the market overall continuing the steady growth of industrial's share of the market.

There has been a strong increase in the amount of institutional and international interest in the logistics sector in particular in recent years which is the main driving factor in this trend and has also resulted in substantial downward yield shift.

The share of the market made up of property outside the three main sectors is also showing steady growth. There has been a significant increase in hotels transactions in recent years, but the trend is also being driven by 'alternative' uses such as healthcare and student housing.

By Country

The strong growth in CRE investment activity was driven by both continued growth in the core markets of UK and Germany and rapid increases in recovery markets such as Spain and Ireland.

The UK and Germany, Europe's two largest markets, both saw significant increases in activity in Q3. At over €20 billion the UK accounted for 40% of the European total, recording a 29% increase from the same quarter in 2013 which, because of the significant change in the exchange rate, increases to 38% when expressed in euro. The German total of €8.5 billion showed a 30% increase on last year. In both countries there has been a significant shift in the types of property being traded, with activity outside the core markets (London and Germany's 'Big Five') increasing faster than in the market as a whole.

Despite this, the standout performers this quarter were Spain and Ireland, both of which may be on course for record annual investment totals. Spain and Ireland are benefitting from the growing interest in real estate from returns driven investors. The €3.5 billion total in Spain was the second-highest ever and a 173% increase on the same quarter last year. Ireland's €1.6 billion was the country's highest ever quarterly total and a 240% increase on Q3 2013.

Other 'recovery' markets are also benefitting from the same effect, but not quite to the same effect. Portugal, Italy and Netherlands all saw strong growth, but not at the same impressive levels as in Spain and Ireland. The CEE market is also seeing rapid growth in investment activity. Investment in the core CEE markets (Russia, Poland, Czech Republic and Hungary) was up by 29% on Q3 2013 at €3.1 billion. However, investment in the non-core CEE countries increased by 137% compared to last year to an aggregate €636 million.

Noticeable against the general backdrop of growth is the relative weakness of the French market, which fell by 37% compared to Q3 2013. Although year-to-date, France's 2014 results are an improvement of those achieved in 2013 this is largely due to two very large transactions in Q2 2014 and overall the market in France remains subdued.

EUROPEAN INDICATIVE PRIME YIELDS, Q3 2014

Country	Market	Prime Office	Change on Qtr	Prime Retail	Change on Qtr	Prime Industrial	Change on Qtr
Austria	Vienna	4.65	→	3.90	↓	7.20	↓
Belgium	Brussels	6.00	→	4.25	→	6.75	↓
Bulgaria	Sofia*	9.00	→	9.00	→	11.50	→
Croatia	Zagreb*	8.30	→	8.25	→	9.50	→
Czech Rep	Prague*	6.00	→	6.00	→	7.00	↓
Denmark	Copenhagen	5.00	→	4.00	↓	7.00	↓
Finland	Helsinki	4.60	→	4.75	↓	6.75	↓
France	Paris	3.90	↓	3.50	↓	8.00	→
Germany	Berlin	4.65	→	4.20	→	6.00	↓
Germany	Frankfurt	4.70	→	4.10	→	6.00	↓
Germany	Munich	4.45	→	4.00	→	6.00	↓
Hungary	Budapest*	7.25	↓	7.00	→	9.25	↓
Ireland	Dublin	5.00	→	4.00	↓	7.25	↓
Italy	Milan	5.75	→	5.25	→	8.00	↓
Italy	Rome	6.25	→	5.25	→	8.00	↓
Netherlands	Amsterdam	5.40	↓	4.10	↓	6.25	↓
Netherlands	Rotterdam	5.80	↓	4.60	↓	6.25	↓
Poland	Warsaw*	6.00	→	5.90	→	7.00	↓
Portugal	Lisbon	6.75	↓	6.25	↓	8.75	↓
Romania	Bucharest*	7.75	↓	8.00	↓	10.00	→
Russia	Moscow*	8.63	↑	9.13	↑	11.25	↑
Serbia	Belgrade*	9.50	→	8.50	→	12.00	→
Slovak Rep	Bratislava*	7.00	→	7.00	→	8.00	↓
Spain	Barcelona	5.50	→	4.50	→	10.00	→
Spain	Madrid	5.25	↓	4.50	→	7.75	↓
Sweden	Stockholm	4.25	↓	4.25	↓	6.00	↓
Switzerland	Zurich	3.20	→	3.20	→	6.50	→
Ukraine	Kyiv*	13.50	→	13.50	→	16.00	→
UK	London**	3.75 / 4.50	→	2.50	→	4.90	→
UK	Birmingham	5.75	→	4.75	↓	5.75	→
UK	Edinburgh	5.75	→	4.75	→	7.00	→
UK	Manchester	5.00	↓	5.00	→	6.50	→

Source: CBRE Research

* For retail, data is for shopping centres. Data for the remainder of the locations is for high street retail.

** London office yields relate to West End and City submarkets respectively.

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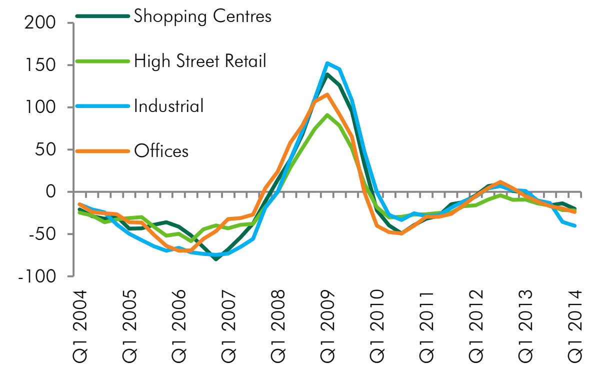
YIELDS & DEBT MARKET

Chart 8: EMEA Average Prime Yields (12-month yield shift, bps)



Source: CBRE Research

Table 1: Key Lending Terms*: Top Quality Real Estate and Tenant, September 2014

Market	Max Loan**	Max LTV	Margin***
Germany	€300m	75%	110 bps
Ireland	€150m	70%	270 bps
Netherlands	€250m	80%	160 bps
Russia	€150m	65%	550 bps**** 600 bps*****
Spain	€50 m	65%	300 bps
UK	£200m	75%	140 bps
Market Trend	→ / ↑	→	↓

Source: CBRE Research, CBRE Debt Advisory

* New 5-year loan based on the maximum underwriting ability of a single lender

** Max ticket size from a single lender

*** Margin over EURIBOR / LIBOR swap

**** Lending in RUB

***** Lending in US Dollar / €

Yields

The Q3 2014 results for CBRE's EMEA Prime Yields indices show further decline in prime yields, the All Property average falling by 7 bps over the quarter to 5.47%.

Notable was the particularly sharp move in industrial yields, which declined by 13 bps over the quarter, with falls in a high proportion of the markets monitored. In the initial stages of recovery the industrial sector lagged behind the rest of the market. However, growing interest in the sector, particularly from institutional investors, has brought the spread between industrial yields and those for other sectors back into line.

Debt Market

The third quarter saw, if anything, an acceleration in the rate at which lending terms are easing. With the exception of Russia all of the markets listed experienced further relaxation of lending terms. In particular, more countries are reporting greater willingness to lend against secondary assets. However, lending for development remains very restricted, with the exception of the UK where there appears to be greater availability.

It is lending margins that are most reflective of the greater competition in the lending market, with maximum LTV and maximum single ticket loan size having stabilised. Except in Russia, typical lending margins against prime property have fallen by between 50 and 100 bps over the last four quarters.

The signs are also that, rather than continue to compete at ever lower margins to lend against prime, lenders are looking to other parts of the real estate market. Investors are finding it easier to borrow against prime assets in second and third tier cities and against poorer quality assets in first tier cities. It could be, therefore, that lending margins for prime loans are starting to reach a floor and the trend to look for next year will be a closing of the gap between prime and secondary lending.

Particularly notable has been the shift in lender attitudes in Spain and Ireland. As has been noted elsewhere, the underlying markets in these countries have transformed over the last 12-18 months. The lending markets have undergone nearly as much of a change, with more to come. In Spain our team expect to see margins of 200 bps or below before the end of the year for very core transactions and in Ireland we also see margins moving towards 200 bps for the right deal and loan size.

Russia is an exception to nearly all these trends, with our local team reporting downward pressure on maximum loan size and LTV, and upward pressure on margins, particularly for local currency lending reflecting the increasing cost of funds for Russian lenders.

MARKET OUTLOOK

With CRE investment activity growing so strongly over the last few quarters and Spain and Ireland potentially on course for record annual totals it is useful to ask how sustainable this level of activity is and where further growth in investment volume might come from.

On this first question, the overall level of investment across Europe is still nearly 30% below the below the previous peak level and in addition there have been structural changes in recent years that have expanded the market:

New sectors are moving into the mainstream investment market and making up an increasing proportion of turnover. For example, in our investor intentions survey at the start of 2014, 25% of respondents had already invested in student housing and 17% were already invested in the healthcare sector. In addition the industrial sector is also growing as a proportion of the market as it is targeted by more institutional investors.

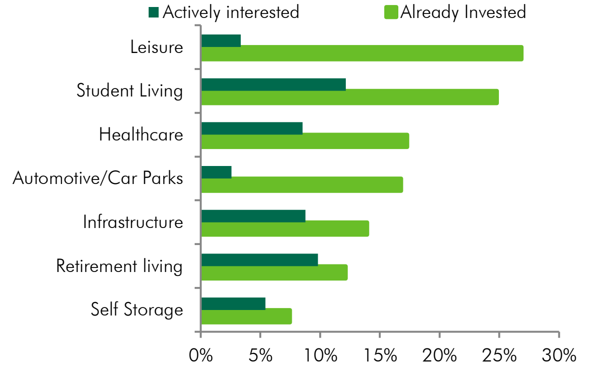
CEE markets are also becoming more investible. Before the Global Financial Crisis (GFC) Russia was only just emerging as a mainstream investment market; total investment turnover in 2013 was about double that in 2007. Although the current level of activity in the Russian CRE market appears to be subdued by the political situation, its potential in the medium term is to be substantially greater than before the GFC. The same could be said of a number of other CEE markets, although perhaps not to the same extent. The investible stock has grown significantly over the last five years and smaller cities that would have been considered too risky are now considered potential targets for international buyers.

Within Western Europe Ireland has already exceeded its previous peak level of investment (looking at the last four quarters) and the UK and Spain are closest behind. Within the UK, the total value of CRE investment has already surpassed that in the 2006/08 peak. The fastest growing part of the UK market (in terms of volume) is that outside London, up by over 60% year on year, but still 20% below the peak level (measured in GBP).

At the other end of the scale, the greatest potential for growth in investment turnover seems to lie in markets such as Italy, Portugal and the smaller CEE countries. Achieving that growth (particularly in Italy) will depend on a significant improvement in the economic outlook, or at least some positive signs that the economy is likely to turn around in the near future.

Also worth watching out for (although in the longer term) is the French market outside the Paris region. Liquidity in this part of the market is extraordinarily low and investment activity in second and third tier French cities is a long way behind that in equivalent cities in the UK and Germany.

Chart 9: Investment in Alternative Sectors



Source: CBRE Investor Intentions Survey 2014

Table 2: CRE Investment Relative to Market High (€m)

Country	12 months to Q3 2014	Highest 12-month total	Difference	Date of high
UK	70,851	95,919	-26%	Q3 2007
UK (in GBP)	57,782	65,351	-12%	Q3 2007
Germany	36,672	58,851	-38%	Q3 2007
Nordics	24,639	31,647	-22%	Q4 2006
France	19,831	27,503	-28%	Q4 2007
Core CEE*	9,986	11,130	-10%	Q2 2007
Spain	8,786	10,088	-13%	Q4 2007
Netherlands	7,874	11,777	-33%	Q3 2007
Italy	4,771	12,285	-61%	Q3 2007
Ireland	3,720	3,232**		Q4 2006**
Austria	2,898	4,107	-29%	Q2 2004
Belgium	2,436	5,930	-59%	Q4 2007
Other CEE	1,604	4,676	-66%	Q3 2008
Portugal	324	1,372	-76%	Q4 2007
Europe	196,511	273,204	-28%	Q3 2007

Source: CBRE Research

* Core CEE = Russia, Poland, Czech Republic and Hungary

** Previous high as last 12 months represents the record high

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CONTACTS

For more information about this Regional MarketView, please contact:

EMEA Research and Consulting

Michael Haddock
Senior Director
EMEA Research and Consulting
CBRE
Henrietta House
Henrietta Place
London W1G 0NB
t: +44 207 182 3274
e: michael.haddock@cbre.com

Iryna Pylypchuk
Director
EMEA Research and Consulting
CBRE
WestendDuo,
Bockenheimer Landstrasse 24
60323, Frankfurt am Main, Germany
t: +49 69 1700 77 92
e: iryna.pylypchuk@cbre.com

Hind Essoussi
Researcher
EMEA Research and Consulting
CBRE
Henrietta House
Henrietta Place
London W1G 0NB
t: +44 207 182 2221
e: hind.essoussi@cbre.com

EMEA Capital Markets

Jonathan Hull
Managing Director
EMEA Capital Markets
CBRE
Henrietta House
Henrietta Place
London W1G 0NB
t: +44 207 182 4706
e: jonathan.hull@cbre.com

John Welham
Executive Director
EMEA Capital Markets
CBRE
Henrietta House
Henrietta Place
London W1G 0NB
t: +44 207 182 2755
e: john.welham@cbre.com

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