Market Intelligence

Market Outlook 2022

REPORT

Luxembourg

REAL ESTATE

CBRE RESEARCH

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Investment

OUTLOOK

€1.578 billion was invested in Luxembourg CRE in 2021, which was consistent from the year before. Developers have been particularly active, which shows their belief in the market. Travel restrictions have now eased, so foreign investor activity should pick up.

INVESTMENT OVERVIEW

The investment market has strong momentum entering 2022 from a big fourth quarter that drove CRE investment to €1.578 billion for the year. In terms of volume, this is effectively unchanged year-over-year. However, the distribution of this capital in terms of asset classes and geographic markets is different.

Offices made up just 65% of total investment, which - while dominant - is the lowest proportion in this cycle. Industrial and land investments have contributed more to activity. Capital is also being allocated across geographic markets, particularly to Esch-Belval and Howald, the latter of which was the site of €364 million of investment last year. Developers are also making some of the largest purchases, which underlines their belief in this market.

€1.578 bn

2021 CRE investment volume in Luxembourg supported by large development and land deals

CAPITAL FLOWS

Given pandemic restraints, Belgian investors were able to close the largest volume of deals in Luxembourg in 2021 at €378 million. Domestic capital followed at €288 million. As economies open, German investors are anticipated to be more active, already securing one of the largest deals at the very end of the year.

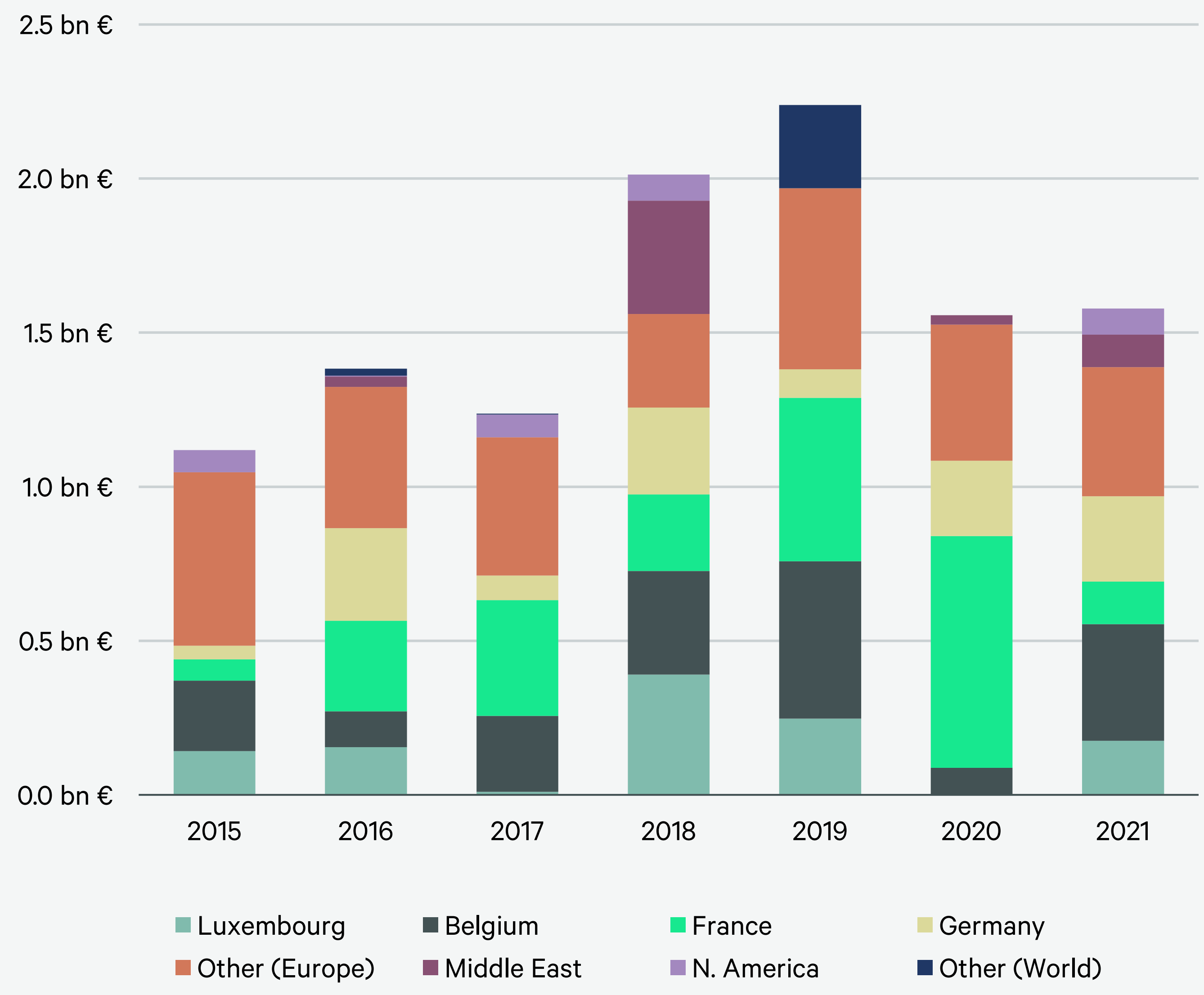
The current pipeline of investment deals is relatively limited for the first half of 2022. Small- and mid-cap assets are overrepresented, and more deals are being negotiated off market given current conditions.

ESG WILL TAKE TIME

Demand for ESG assets is present and building, but the supply is not quite there. Many developers are focusing on ESG buildings, but others have had success constructing high-quality offices centered around employee comfort and look to continue to do so. Some structural hindrances exist too, including the added difficulty of achieving ESG certification by building new (versus renovation) and the use of cogeneration heating that can complicate energy scoring.

Luxembourg CRE investment by origin of capital

Source: CBRE



The Arc, Station

ASSET CLASSES

Office assets will continue to perform, supported by the high occupier demand, low vacancy and growing economy. Yields are stable for long-term secured, well located offices, currently estimated at 3.30%.

3.30%

Prime yield for centrally-located office assets in Luxembourg

Luxembourg has not escaped the demand for logistics assets, as the market continues to institutionalize. CBRE IM closed a deal in Leudelange in 2021 for a 13,000 m² facility, for example. Assets are scarce and the market is opaque with a heavy government influence, but quality infrastructure and a strategic position should lift this market amidst positive macro trends.

Investors are interested in multifamily opportunities, though this market remains relatively undeveloped. Prices for traditional apartments are very high in the known markets that investors prefer for such a new sector. As a result, exposure to the residential market is best achieved via operated housing such as furnished or serviced flats and coliving.

The retail investment landscape remains complex. There is value to be had in high streets amidst recent repricing and a milieu of 'post-COVIDness', but demand has shifted from the pandemic and tram. Redevelopment opportunities have emerged, evidenced by the ICN Development acquisition of Avenue de la Gare 15 in 2021. Out-of-town assets will be the most compelling for traditional investors given recent development, acknowledged COVID resilience, and preferred way of shopping in the Grand Duchy.

02

Offices

OUTLOOK

Record take-up activity in 2021 is unlikely to be repeated in 2022, though demand is high. A broad spectrum of tenants are expected to close large deals from 10,000 m^2 to 30,000 m^2, as they search for quality, well-located offices to attract new hires and current staff working from home. Market dynamics will put upward pressure on rents.

LUXEMBOURG OFFICE OVERVIEW

The Luxembourg office market was resilient to many pandemic concerns, closing record take-up of 369,300 m² for 2021. Even net of the EU's 127,000 m² new space in KAD2, activity was in line with recent averages. The banking, finance, and insurance sector secured another 93,000 m² in 2021 to help make up for the Luxembourg public sector's quieter activity. And while take-up is unlikely to reach this past year's lofty figures, the pipeline is indicating another good year for the office market.

BIG DEALS BEING NEGOTIATED

Activity in 2022 will be carried by a broad sector spectrum of tenants. The European institutions, Luxembourg State and corporates will likely all close deals from 10,000 to 30,000 m² to push take-up north of 250,000 m². Pre-lets will continue to play a dominant role, as vacancy remains very limited. The 129,000 m² of expected 2022 office deliveries with available space should satisfy much of the friction, though.

The competitive market makes it difficult to determine if corporates are searching for actionable space or surveying the market. Landlord's are noticeably more confident and positive about 2022.

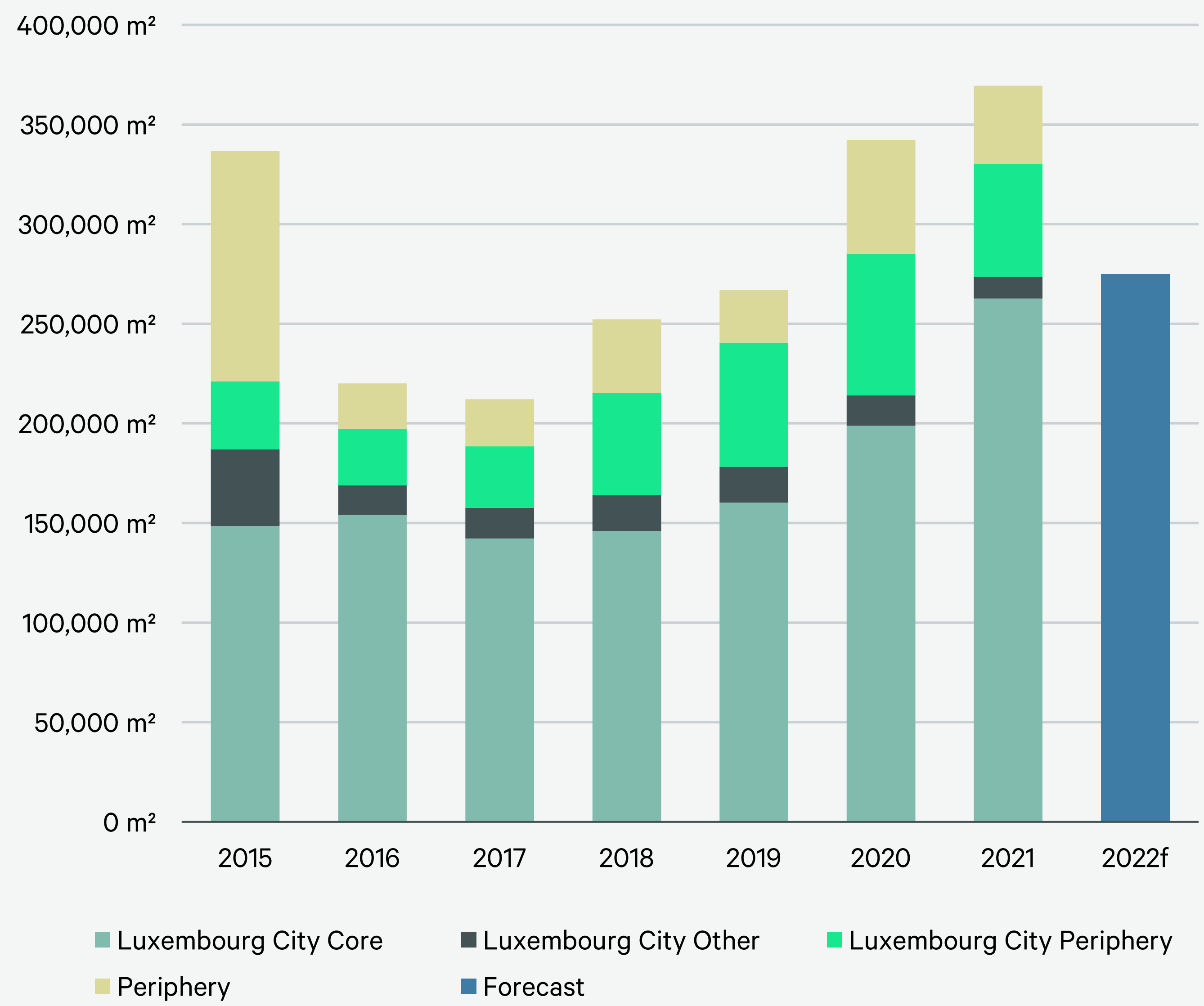
Employees have largely returned to the office and are expected to continue to do so given the March 2022 expiration of the temporary tax rules regarding cross-border workers.

+250k m²

Expected take-up in the Luxembourg office market in 2022 from identified and potential deals

Luxembourg office take-up and forecast

Source: CBRE



OCCUPIERS SEARCH FOR QUALITY

The current environment has crystalized the need for occupiers to secure top quality workspace to lure people away from homeworking and back into the office. Design, comfort and services and amenities will be as important as ever. And while we have seen growing interest in peripheral markets that still score well in this department, central Luxembourg simply offers unrivaled services and amenities.

This dynamic is also reflected in the breadth of the real estate portfolio to address office accessibility. Luxembourg occupiers are increasingly considering satellite offices closer to international borders to service employees. And while flexible offices may satisfy some portion of the market, traditional occupiers will look to establish more permanent offices that can compete on design, amenity and comfort.

52 €/m^2

Monthly Luxembourg office prime rent

CONTINUED RENTAL GROWTH

Given these dynamics, prime rents will be well-supported, with some markets seeing increases. New activity will push Cloche d'Or rents to 37 €/m^2/mo in early 2022. Rents in Belval are under upward pressure, but may be too soon to call for increases. This market's evolution from an administrative district to a more diverse and corporate one following the 2021 SocGen deal, however, is noted.

Cloche d'Or and Belval are growing markets with strong prospects for further rental growth

04

Retail

OUTLOOK

High street and out-of-town retail formats recorded strong demand growth in 2021. Private landlords are becoming more flexible, increasing market efficiency and helping to support a renewed optimism for a sector that has struggled.

RETAIL OVERVIEW

Despite the pandemic uncertainty, new letting and sales activity increased 79% year-over-year to 35,000 m² in 2021. High streets were particularly lively, recording more than 11,400 m² of new deals in one of the highest volumes over the last decade. Retailers secured a strong 17,200 m² of space in out-of-town locations, while shopping centres were quiet at 6,400 m², partially due to a lack of space to absorb new retailers. With commuters largely returning to Luxembourg and the belief that the worst of the pandemic is over, there is welcomed optimism in the market.

35k m²

Luxembourg retail take-up in 2021 supported by both high streets and out-of-town

ACKNOWLEDGE AND ADAPT

The Luxembourg retail market is becoming more responsive to a challenging environment. Private landlords are adapting to current conditions after institutional management was quick to renegotiate with retailers in the early days of the pandemic. Thus, prices have come down to meet retailer demands and lease conditions are more flexible. This can take the form of greater capex and incentives for tenants and step-up rents matching the improving conditions.

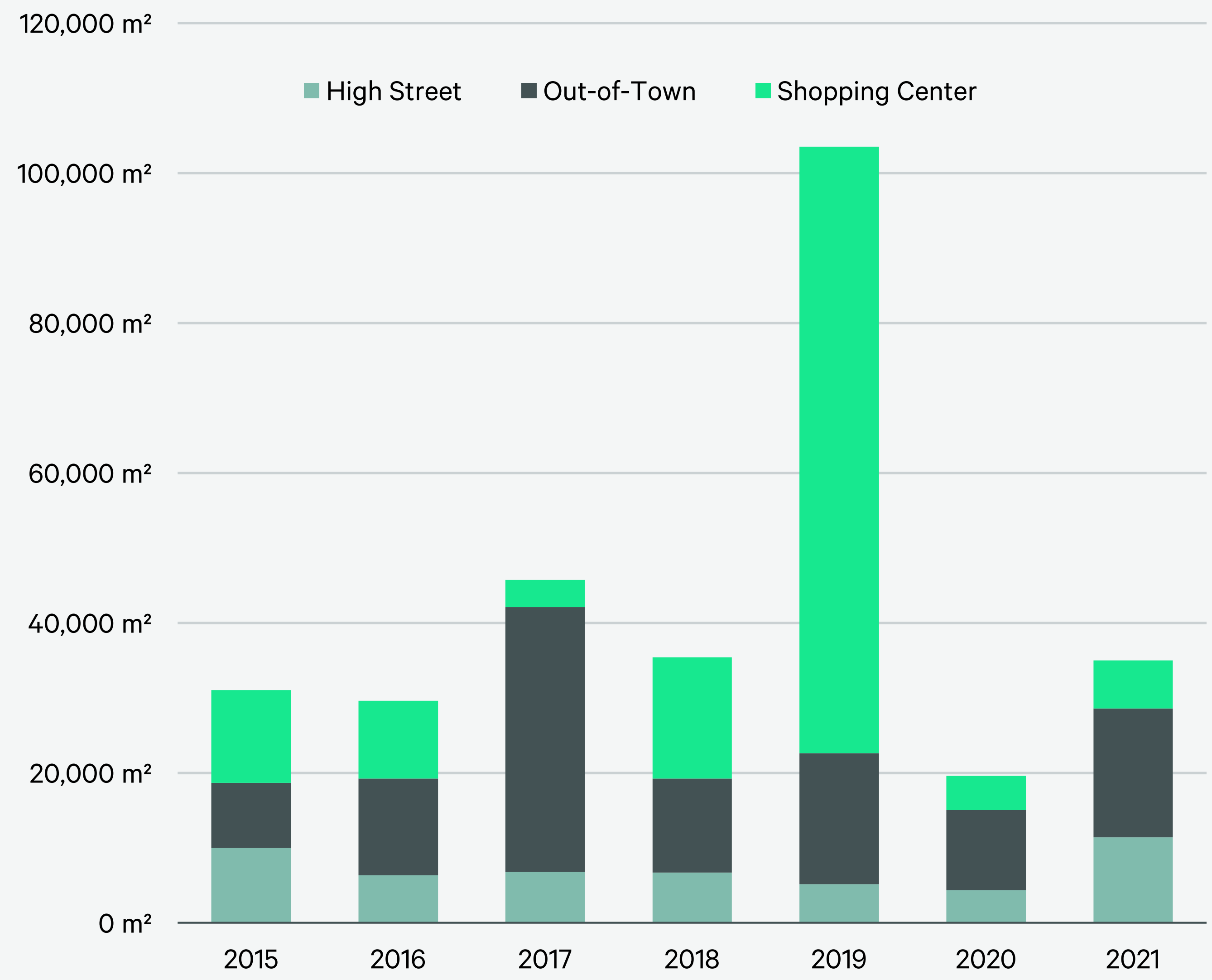
POTENTIAL FOR EXPANSION

High land prices and difficult permitting hinders further retail development. While supportive of values, supply is less responsive to rapidly changing consumer dynamics. The MG Escape in Mamer, for example, took two years to complete from the acquisition of the site.

The construction of the tram is also progressing and altering normal traffic flows. Around the Station, for example, Avenue de la Gare has experienced declining footfall while Avenue de la Liberté - which is on the tram line - has received additional investment. The rapid public transit also helps carry people through the city, rather than travel around it, aiding footfall in the city centre. A more complete picture of the tram's impact will come into play once Cloche d'Or is brought online in 2023.

Retail take-up by format in Luxembourg

Source: CBRE



MG Capellen Retail Park

Recent changes to the market have also brough opportunities. Rental revisions have now made Luxembourg more attractive to retailers open to exploring new markets. And retailers that had Luxembourg on their radar are finding now an opportune time to secure space.

RENTS

Retail rents continue to be under downward pressure. In the city centre, prime rents are estimated at 125 €/m^2/mo, while the Station district has been hit harder at 50 €/m^2/mo. However, because Luxembourg is so dependent on international commuters, travel restrictions can have an outsized effect on the market. This fluid situation requires a shorter time horizon for evaluating the market.

Private landlords have become more flexible through the pandemic, allowing for a more efficient market

125 €/m^2

Monthly prime retail rent in Luxembourg CBD

05

Residential

OUTLOOK

Apartment prices continue to increase by double digits, outpacing rental growth. The top end of the market is thus stabilizing and growth cooling. Alternative residential assets such as operated apartments and coliving are attracting interest from investors for their long leases and higher yields, as well as from tenants for their lifestyle.

RESIDENTIAL OVERVIEW

Residential rental markets experienced a recovery in activity in 2021, as international workers began returning to Luxembourg after a long period of homeworking. This is mostly evidenced by the decreasing commercialisation period of rentals, particularly in the 1,300 to 2,500 €/m^2/month range in the city.

Average purchase prices for the Grand Duchy increased 11.8% year-over-year (Q3) to € 651,875 (8,166 €/m^2)[1]. The increase is most apparent in existing apartments (+15.5%) versus new builds (+6.2%). Luxembourg City experienced a 10% increase for existing apartments to 10,897 €/m^2 and 6.1% for new construction to 12,206 €/m^2.

€651,875

Average apartment sale price in Luxembourg through the first 9 months of 2021

PRICES STABILIZING AT THE TOP

The relentless price growth of new apartments is meeting some resistance from investors. Prices pushing 16,000 to 18,000 €/m^2 for the city centre are pushing yields below 2% for unit sales. While we do not expect a re-evaluation, prices are likely to settle and growth at the top of the market to cool.

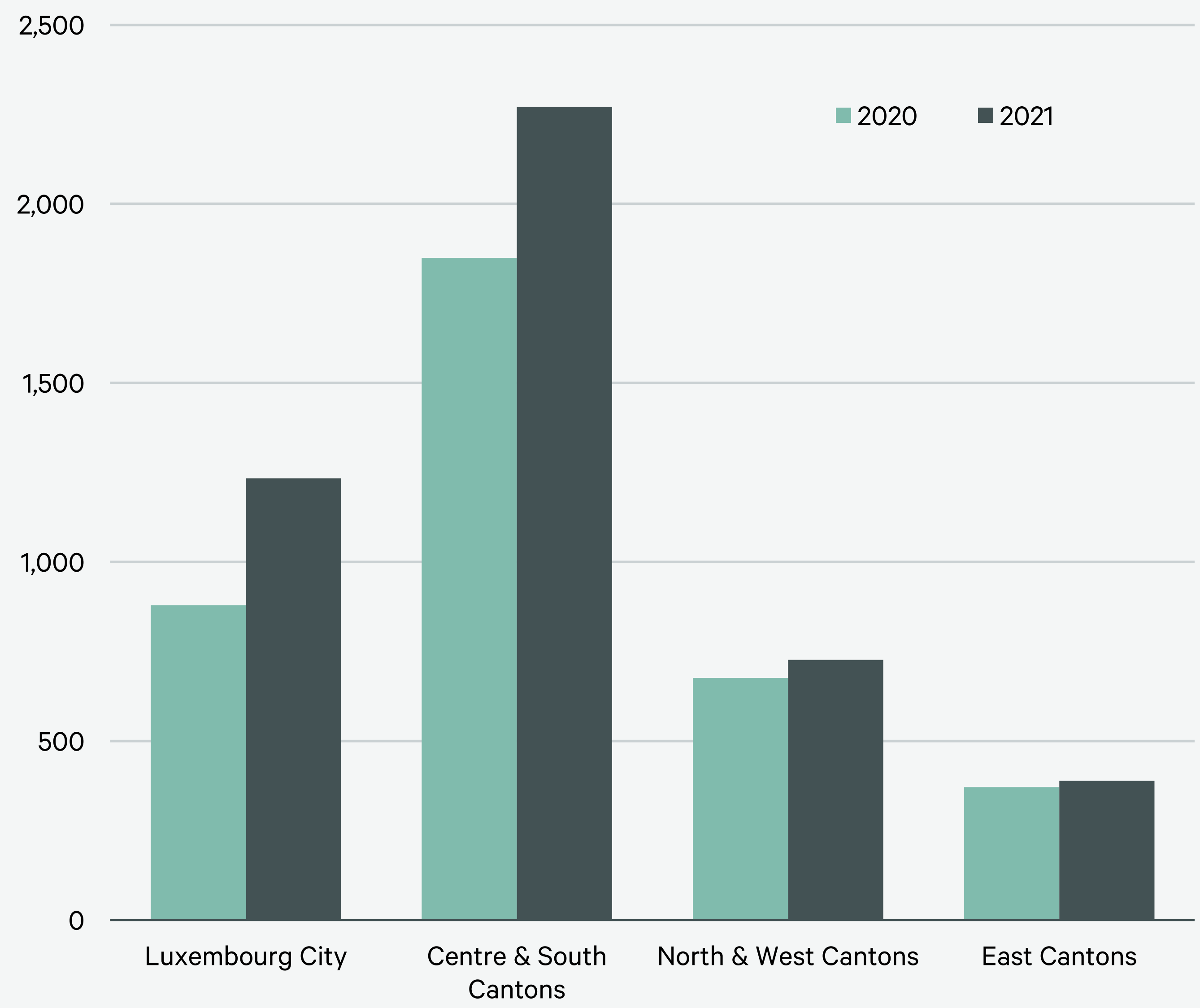
DEVELOPMENT PICKING UP

The number of issued residential apartment permits across Luxembourg increased 25% to 3,208 in the first three quarters of 2021 compared to the same period the year before[2]. Adapting to the pandemic and reopening the economy from lockdowns is clearly reflected in the change.

The biggest increase was seen in Luxembourg City, issuing 40% more permits over this period

Issued residential development permits

Source: STATEC



[1] STATEC

[2] Permits for building with two or more residential dwellings

with 1,234. The Centre and South Cantons (Luxembourg-campagne, Mersch, Esch-sur-Alzette and Capellen) experienced a 23% increase to 2,271. Both general residential projects and PAP development is picking up to meet the high demand for new homes.

THE EVOLUTION OF RENTING

The private rental market is changing in two ways. One is a more widespread acceptance and embrace of renting, particularly among young professionals. Sale prices are prohibitively expensive for many, and the tram offers easy access to the amenities of the city. Therefore, the city centre, Esch and Howald will be attractive locations for tenants.

The other change is the institutionalisation of the letting market outside of traditional apartments. With intial yields compressing to record lows, assets backed by long-term secured operators in the serviced/furnished apartments and coliving are the path of least resistance. Yields are higher than traditional block sales at around 3.50% and income aligns with the duration of commercial leases (9 years) versus the common one-year residential lease. The landscape is varied, with several projects ranging from <20 to >100 units progressing. Still, there is no proven track record yet in this market, so investors are proceeding with caution. Those projects located next to public transport (tram) locations and employment areas are the most likely to succeed.

Institutional investors are searching for yields around 3.50% for residential assets backed by operators

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