MARKET IN MINUTES
Savills Research

European Themes 2019

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Resilient investments

We are at a late stage of the property cycle. Yet real estate is still sought after by investors. Which assets will be more resilient in the face of the unpredictable?

Record low property yields, slowing rental growth and rising interest rates indicate that we are at a late stage of the property cycle, which makes investors nervous. Geopolitical uncertainty, slowing economic growth, changing tenant expectations and evolving property types, are additional factors to make them feel uneasy .

"Location, location, location" used to be the key factor for a resilient property investment and "Office-Retail-Industrial" the key triptych for a liquid portfolio. Investment strategies have become more complex than that and luckily a prolonged property cycle has allowed investors to gradually come to terms with the disruptions, in a context of healthy occupier demand, constrained supply, cautious lending conditions and positive income growth.

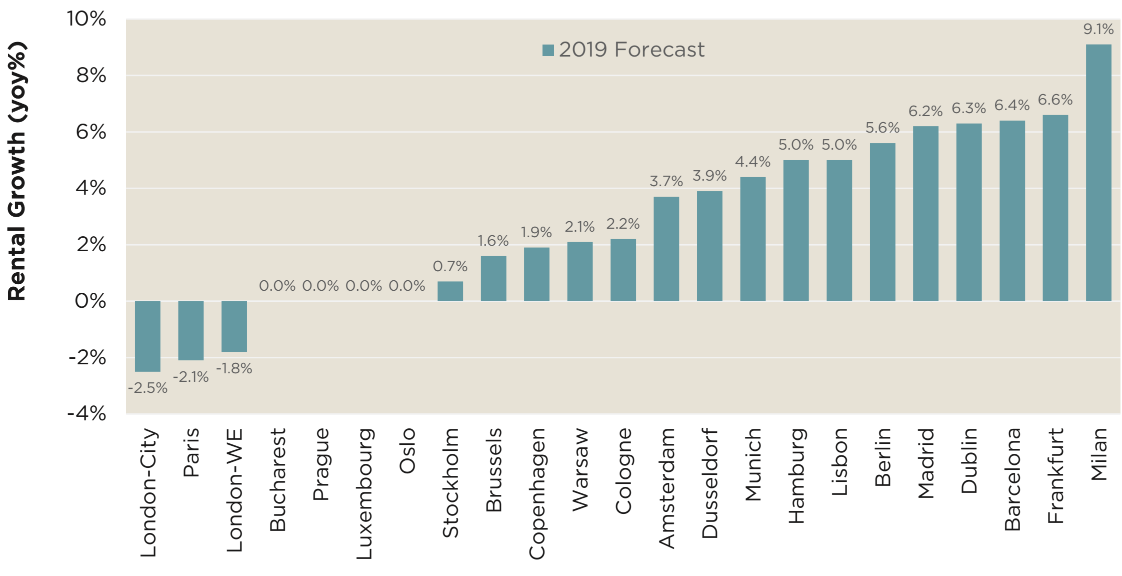
"Unexpected" geopolitical events, are now more or less "expected" and pragmatic investors already have factored in the risks associated with social change and its consequences. It is true that we are going through a period of relatively higher political risks that may have a negative impact on the positive economic path of the world economies. Indeed most economies are revising downwards their projections for economic growth this year.

Predicting the turning of the cycle is not easy, especially when the market fundamentals seem strong. Office vacancy is at all time low, prime office rents are rising and the new supply will be just enough to cover the space required from new employment creation. The situation in the retail sector is more complicated, despite the solid performance of prime High streets and Shopping centres; secondary locations are facing the challengers of the rise of e-commerce. The rising share of online sales continues to underpin demand for both larger/regional and smaller/urban warehouses across Europe.

Despite the fact that this is landlord's market investors are cautious, because in reality it is the tenant that holds the reins of power. The values of the young generation, the impact of technology on daily life, changing lifestyle and personal priorities are affecting the way we relate to the physical space. Office workers require well designed, well located accommodation with services and amenities that enhance their motivation and well-being. Consumers expect physical stores, which offer immersive retail experiences and entertainment. Logistics facilities need to fit in dense urban areas in order to satisfy customer demand for same day delivery. New types of property uses have emerged and expanded responding to the demographic and technological changes and adapting to the evolving user requirements: co-working, co-living, nursing homes, retirement communities, student houses, pop up stores, concept stores, mixed use concepts, business incubators, data-centres are only a few examples.

From an investor perspective these property types are not just alternatives to the traditional ultra-expensive triptych; they are becoming the new mainstream as they prove to respond successfully to structural changes of the drivers of demand. Resilient investment strategies should take into consideration not only the property cycles but also these structural changes. At a time when no easy gains are to be made from capital appreciation, the sustainability of income streams is the main focus. And this cannot be guaranteed anymore just by a well located building, it requires the understanding of what occupiers want. Lease lengths are

Prime office rental growth outlook Prime rents will continue to rise due to lack of supply



Source Savills Research

TOP PICKS FOR CORE

Prime offices will be in the epicentre of core strategies for another year. Significant shortages of prime office space and robust demand will drive positive rental growth. We forecast the German and Southern European cities to outperform with above 5% yoy prime rental growth in 2019. Dublin should also achieve above average prime rental growth, subject to Brexit risks.

TOP PICKS FOR VALUE-ADD

Transport and Storage is a fast growing sector in Central and Eastern European markets (Poland, Czech Republic, Romania), due to their strategic location, low costs and growing e-commerce, driving demand for logistics space. The yield gap with mature western markets and the office sector is where the opportunity lies for value appreciation in the future.

TOP PICKS FOR OPPORTUNISTIC

Redevelopments and new developments are the only routes to achieve higher returns. In the office markets with the lowest vacancy rates such as the German cities, Paris, and Stockholm the development pipeline is still insufficient. In a number of cities there are also shortages in housing and student housing (Dublin, Amsterdam, German cities).

becoming shorter, tenants demand flexibility and expect professional service. Landlords need to work harder to secure the continuity of their revenues; they need to get involved in the operational side of their business, to cooperate with the users of their assets, to understand what drives demand and adapt in order to create assets that remain relevant and in demand.

Even in a competitive, low supply environment, tenants can still be selective and landlords who make the difference can be rewarded by loyal, returning occupiers who are prepared to pay a premium for a better service.

3.4%
Is our forecast for the average annual growth of prime CBD office rents across 22 cities in Europe

> “Resilient investment strategies should take into consideration not only property cycles but also long term structural changes”

European outlook: six trends for 2019

DEFENSIVE OFFICES
Prime office yields are at record low levels, however this product will remain a top pick n 2019, especially for risk averse strategies. CBD offices will be sought after by occupiers as they boost the companies' profile for attracting and retaining talent. The average European vacancy rate is at an all time low of 6% and we forecast prime CBD office rents to rise by 3.4% pa on average in 2019.

RESIDENTIAL FOR INCOME
Residential has become the fourth largest investment sector, offering solid long term income. The fundamentals of the sector are strong and countercyclical. Urbanisation and affordability issues for the younger generation fuel demand for rental. Professional developers and operators will drive the expansion of the sector.

SMART MIXED USE
European cities are growing under the pressure of urbanisation. Successful cities will be the ones where local governments and market players work together to develop new areas and redevelop existing space in order to create smart and liveable communities. Mixed use buildings and neighbourhoods will satisfy the users need for walkable access to amenities and work.

THE RISE OF LOGISTICS
The share of logistics in investment activity has already risen to almost 14% of the total. Prime industrial yields have dropped to an average of 5.3% across Europe, which is 148 bps below the 10 year average. Occupier demand will remain strong, as the share of e-commerce continues to rise in all European countries. The combination of strong fundamentals and attractive yield gap compared to offices will continue to drive investor interest.

SPACE AS A SERVICE
The values of the users of real estate are changing. The model of On-demand Economy is causing disruption to the industry with occupiers expecting access to services, flexibility and personalisation. New types of space use and management are emerging and investors are increasingly becoming operators, in order to maximise the performance of their assets.

LACK OF PRIME ASSETS
The market will remain competitive for investors in 2019. Lack of supply of prime assets will lead more investors towards niche sectors, secondary cities and development opportunities. As economists do not expect a rise of interest rates this year, we believe that prime yields will remain mostly stable.

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