WHAT'S IN A YIELD?
Creating a Benchmark Comparison for European Markets
Preface

Local European markets have their own way of doing things. When it comes to providing a broader pan-European or EMEA view, it is important to discern these differences in order to compare markets on a like-for-like basis as much as possible.

When it comes to real estate yields there are a myriad of factors that can impact the figures being quoted. Differences can also emerge as a result of descriptions lost in translation – one market’s Gross Yield can be another’s Net Initial and so forth. The purpose of this document is to examine the yields being quoted by a range of markets, in order to generate a set of consistent yield figures with which to compare markets. This takes into account the factors incorporated into the price/cost of acquisition and ownership, the rental level reported and the non-recoverables applicable when calculating NOI (net operating income).

What this report does NOT intend to provide is a comparison of valuation market practise. We fully appreciate that different practices operate in different markets for very valid reasons. There are yields that some countries report that do not feature here. Such as theoretical yield – a gross or net income plus an estimated rental value (ERV) on vacant space as a percentage of purchase price (with or without costs); as well as reversionary yield – the gross or net ERV as a percentage of purchase price (with or without costs). Equally, we know that certain valuation practices will tend to include all capital expenditure (capex) as well as acquisition costs when reporting a Net Initial Yield, but this makes it impossible to compare markets on a consistent basis as capex is often unknown or specific to an individual asset. This is not included because this is not relevant, it is simply because we have tried to simplify the reporting basis for comparison purposes only by sticking to core, prime assets where such capex should be a limited feature of yield pricing.
The challenge when comparing yields across geographies is some markets report net initial yields, while others refer to gross yields or double-net figures. Comparing markets on this basis can generate a distorted view, and as the map opposite highlights there is a significant divergence across the eleven countries we have analysed in this report: Germany, the Netherlands and Poland report gross yields, the UK, Spain, Denmark, Sweden, Czech Republic and Russia report net initial, while France and Italy report ‘double-net’ yields.

To create a like-for-like comparison of different types of yields, we have reviewed the factors considered in each market. This analysis incorporates the variety of cost factors to generate a ‘double net’ yield for each market i.e. Net operating income (thus less all non-recoverable costs) relative to total purchases transaction costs.
What’s in a Yield?

When we compare markets on a gross yield basis, it is clear that those markets reporting on any net yield basis would appear higher priced (or lower risk, or both depending on your view) than is genuinely the case.

So while the Russian markets remain the highest yielding markets overall – when all markets are re-aligned to show a gross figure - the differential to the next highest yielding markets of Poland is far less.

When generating a simple yield average for all these markets, there is a significant 44 basis point increase when all markets are re-aligned to their Gross yield level.

YIELD SPREAD
Gross Yield vs Quoted Yield

GROSS YIELD = First Year’s Headline Rent
Purchase Price

GROSS YIELD VS QUOTED YIELD SPREAD
by City [%]

Source: Colliers International
When we compare markets on a net initial yield basis, we see less of a shift in rates given that the majority of markets currently report on this basis. To be clear, the net effective rent stated is essentially the gross rental income accounting for tenant incentives spread on a straightline basis over the entire lease to first break.

However, there is surprisingly limited movement from ‘gross to net’ for some markets, notably the German cities and Amsterdam. Although very tight office market conditions in these markets put headline rents very close to net effective rents, we had anticipated more of a change. The Russian markets see their relative net yields drop more in-line with other markets.

Generating a simple net initial yield average for all markets, shows only a marginal difference - 9 basis points lower than the quoted yield average.

NET INITIAL YIELD vs QUOTED YIELD SPREAD
by City [%]

Source: Colliers International
Office market conditions remain very tight across most cities, and in favour of landlords. Those markets in red suffer from low vacancy/availability, but relatively high demand pressure, minimising the opportunity for tenants to negotiate lower net effective rents (to headline).
Given all markets are quoted on a gross or net yield basis, we would expect to see a drop in the yield when representing the ‘double-net’ rate inclusive of all transaction costs and NOI (inclusive of all non-recoverables). The double-net yield figure generated drops significantly, by 63 basis points.

However, there is surprisingly limited movement for some markets, notably in Sweden and Spain.
Other factors can impact the costs that need to be considered when assessing a true, net yield. The cost of debt is one, which we do not cover in this short report. The other factor to consider when purchasing assets across borders revolves around deal structures. Notably whether purchases are made for assets directly or as Special Purpose Vehicles (SPVs) on a share basis. Different deal structures can generate different tax obligations and vendor rent coverage guarantees to consider.

Latent capital gains tax liability (LCGT) is a key tax obligation to consider, and tends to feature in markets where SPVs are the dominant form of transaction. In practice, any LCGT liabilities incurred when purchasing an SPV can reduce the yield paid by up to 100 basis points (or more in extreme cases), but this cost is typically shared between buyer and seller on a 50:50 basis reducing the overall impact.

Any rental guarantees from a vendor will also impact the underlying yield, and there is a clear split between markets where this is common practice or not.

Overall, both factors clearly need full consideration when assessing actual yields/income returns but vary so much they are too idiosyncratic to try and fold into any benchmark analysis.

### Deal Structure: SPV or Asset?

<table>
<thead>
<tr>
<th>Country</th>
<th>Asset or SPVs (Shares)</th>
<th>LCGT Liability</th>
<th>Vendor rent free guarantees</th>
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<tbody>
<tr>
<td>Czech Republic</td>
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<tr>
<td>Denmark</td>
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<td>United Kingdom</td>
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Source: Colliers International
Colliers now reports both a local and benchmark European yield to allow clients to compare apples with apples. The benchmark yield is a Gross Yield based on the first year’s gross rent, divided by the purchase price without accounting for other transaction costs. From time-to-time some of our analysis and reports will also compare markets on a net basis, which will clearly have implications for derived capital values and the perceived attractiveness of various markets.

This means that the way yields are reported locally in Germany, Poland and the Netherlands will be consistent with their European benchmark yield. For other locations, at least those included in this analysis, their comparative yield level will rise - this is as high as 54 basis points for the UK and Italy, and 63 basis points for Russia.
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