Colliers INTERNATIONAL

EMEA

CAPITAL MARKETS

QUARTER 2 | 2020

Introduction: Investment volumes vs GDP

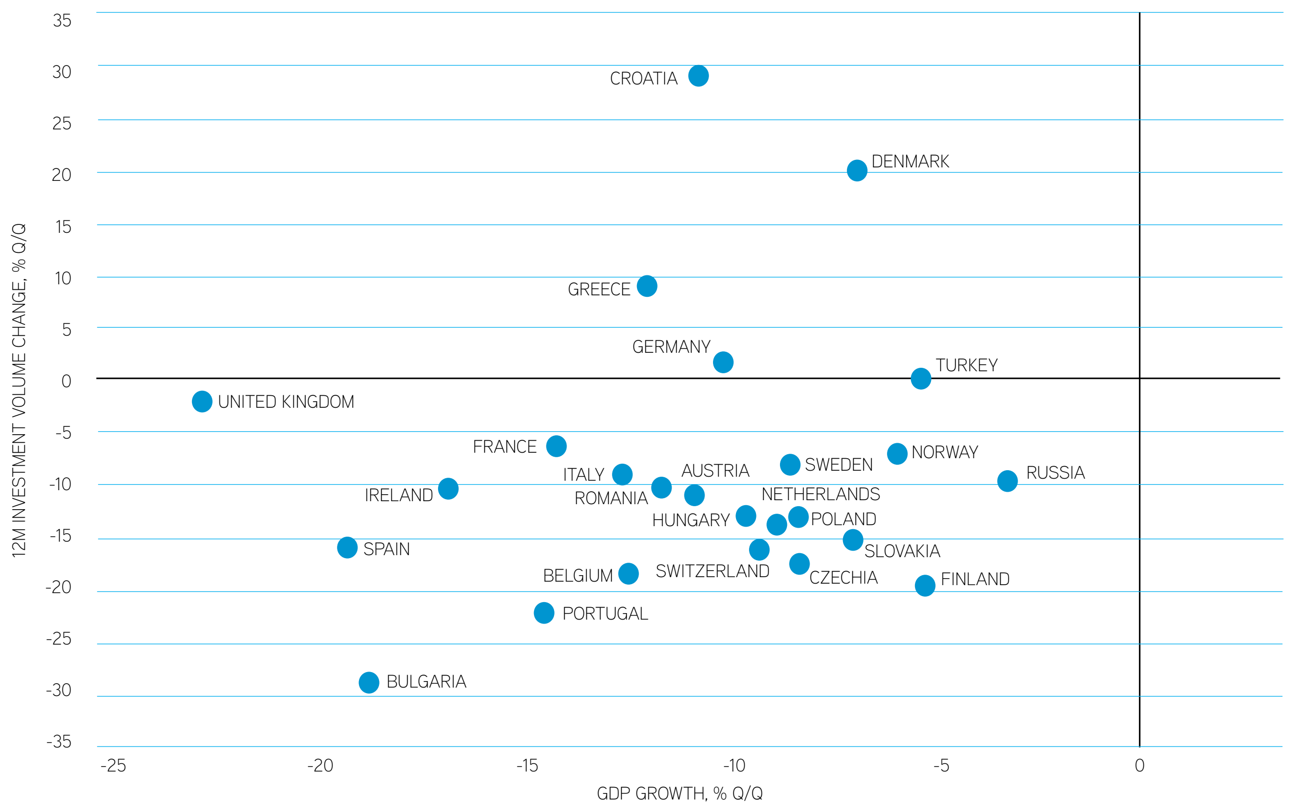
After a very strong Q1 this year, and a more robust Q2 than expected, investment volumes for EMEA have held up markedly well. At only 9% down y/y, EMEA is by far the least affected global region during H1, with volumes in APAC and the Americas down 25% and 27% respectively. There is a similar pattern when looking at the lockdown-quarters alone: while total volumes in EMEA fell by -30% q/q, this compares to a fall of -43% in APAC and -60% in the Americas.

Within EMEA, the significance of the COVID-19 pandemic impact is clear in the Q2 GDP figures (Fig.1, X axis), but the subsequent impact on investment volumes has not been as sharp as expected according to figures from Real Capital Analytics (RCA). At least not for Europe's primary market destinations:

- The UK has taken the biggest GDP hit, posting a drop of around -22% q/q, but investment remains robust at only around -3% down on a 12 month rolling basis.
- French GDP was down by -13% q/q, but rolling investment volumes fell by only -6%.
- German GDP was -10% down q/q, but investment is around 2% up on a rolling basis.

Outside of the big three, there is more of a closer correlation between the economic and investment impact. Yet a number of outliers buck the trend – notably Denmark, Croatia and Greece.

FIG.1
COUNTRY INVESTMENT VOLUMES VS GDP, 2020 Q2
[12M ROLLING VOLUME CHANGE Q/Q VS GDP CHANGE Q/Q]



Source: Colliers International, Oxford Economics, Real Capital Analytics

Cross-border capital: A strong position

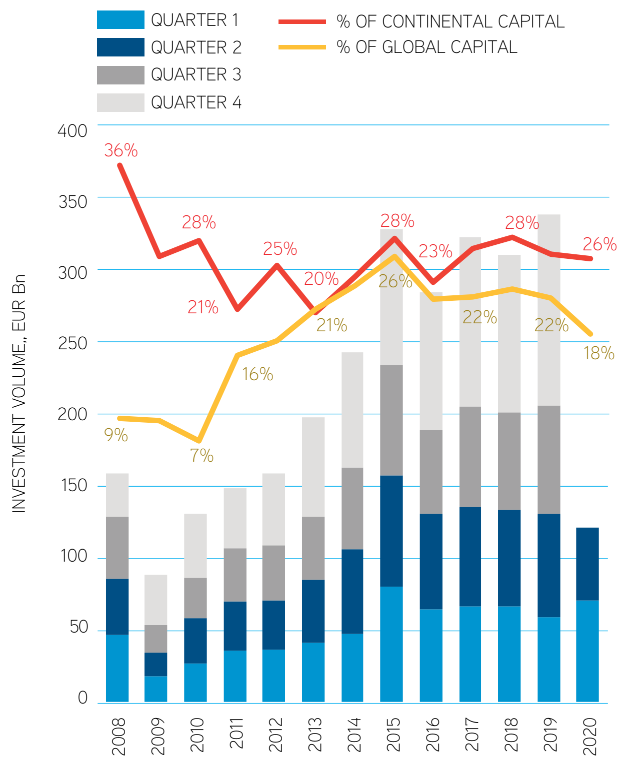
CROSS-BORDER ACTIVITY STRONG

Despite all the limits placed on travel and mobility during the pandemic, and thus restrictions on inspections and due diligence to progress transactions, cross-border capital continued playing a major role in European investment activity during H1 2020. The share of cross-border deals was only 4% down on this position a year ago, accounting for 45% of deals. However, the gap between European and global cross border capital flow widened (Fig.2) and the cross border transactions that took place in Q2 were generally European capital sources or the global capital which has opened offices in Europe and therefore has the ability to transact. We expect global capital to increase their activity in H2 2020 assuming no second waves in Europe.

EUROPEAN CURRENCIES OFFER HEDGING GAINS

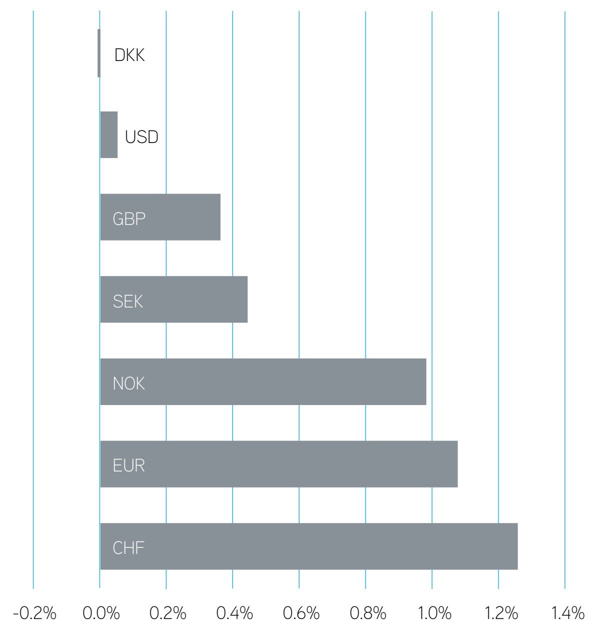
The events of the past six months have significantly changed the global interest rate dynamic. The onset of COVID-19, coupled with geopolitical friction between US and China has seen the Euro rise sharply against most major global currencies. The EU27 agreement to create a 750 billion-euro ($855 billion) 'COVID-19' recovery fund, is a sign of improving internal cohesion, and combined with the EU's collectively strong credit rating, this points to a continued and prolonged euro appreciation and low interest rate regime. While hedging benefits may have diminished since the end of 2019, the region is adopting more of a safe-haven status, and major European currencies continue to offer a positive gain (for a 5yr cross-currency swap) for a basket of global currencies (Fig.3).

FIG.2
EMEA: CROSS-BORDER INVESTMENT VOLUMES



Source: Colliers International, Real Capital Analytics

FIG.3
GLOBAL CURRENCY: AVERAGE 5YR HEDGING GAINS
[AUGUST 2020]



Source: Colliers International, Chatham Financial

Debt

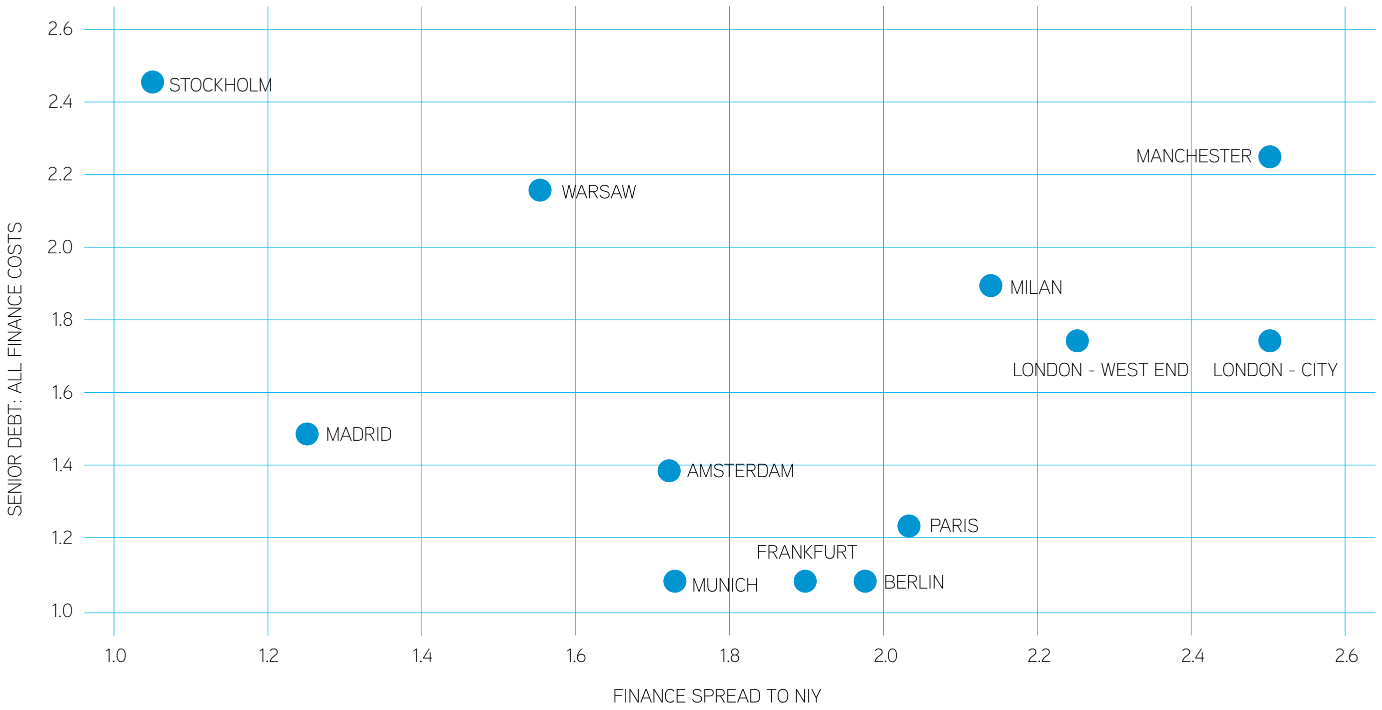
One of the biggest challenges to investment activity has been constraints around the availability and cost of debt. While finance is still widely available for the right product, financing most developments and acquisitions of large assets and portfolios (€250m+) has virtually come to a halt. Similarly, secondary assets with high levels of vacancy, and sectors like retail, hospitality, leisure have great scrutiny and very little debt availablity.

In addition, LTV's have reduced by circa 10% relative to pre-COVID-19 and all in finance costs have risen by 15-40 bps and even higher for risky property sectors or risk profiles, reducing the ability to increase returns through gearing. Figure 4 highlights the typical margin rates and cost of funding of senior debt for prime office assets for a range of key European locations. These rates are based on a five year term, with LTVs of 50%, with assumed prime covenants in place and debt structured with global banks and insurance / pension funds.

There is clearly a range of debt costs in play relative to local currency, interest rate regimes and debt liquidity, with Stockholm, Warsaw, Milan, Manchester and the London sub-markets proving to be most expensive. Debt is available in the key German markets, Paris and Amsterdam for less than half the cost of Stockholm.

When placed in the context of net initial yields (NIY) all these major markets provide at least a 1% finance spread. However, the UK markets offer the biggest finance spread supporting higher cash returns.

FIG.4
COST OF SENIOR DEBT (5YR) VS FINANCE SPREAD VS NET INITIAL YIELDS



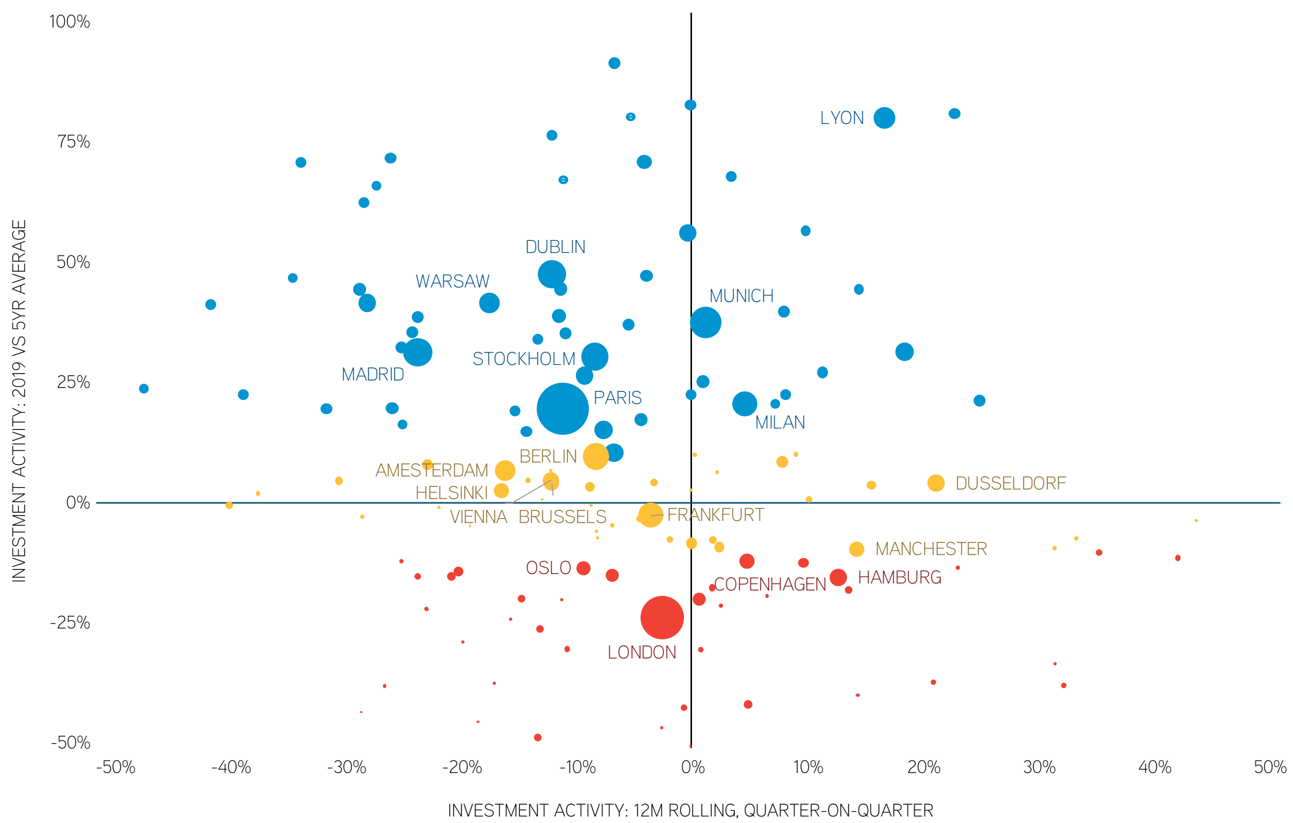
Source: Colliers International

City Momentum

If we review markets at city level there is clearly a mixed-picture in terms of activity and momentum. This isn't a research attempt as Jackson Pollock-meets-Mondrian, the dots represent all European markets covered (the bigger the dot, the bigger the market). The dot colours highlight the market momentum in 2019 vs the 5yr average, leading up to the COVID-19 pandemic (the Y-axis represents 2019 activity as a % of the annual average for the last five years). Blue dots show where 2019 was more than 10% above the LT average, yellow is within the 10% band so relatively stable, and red is where 2019 was more than 10% behind the LT average. This highlights a very mixed bag of fortunes, with most markets at or above average.

When we position markets relative to Q2 performance, on a rolling basis relative to the last 12 months (X axis), it is clear which market have maintained momentum, vs those that have stayed where they were, or have dropped back. Only Munich, Milan, Lyon have maintained growth, Dusseldorf, Manchester have stayed stable, whereas Hamburg, Copenhagen have rebounded. As has London, relative to the 5yr average, following a strong Q1. Paris, Berlin, Stockholm, Dublin and especially Madrid, have dropped back.

FIG.5
CITY INVESTMENT MOMENTUM: JUNE 2020
[RECENT PERFORMANCE VS 5YR AVERAGE & COVID-19 IMPACT BUBBLE SIZE REPRESENT ACTIVITY VOLUMES]



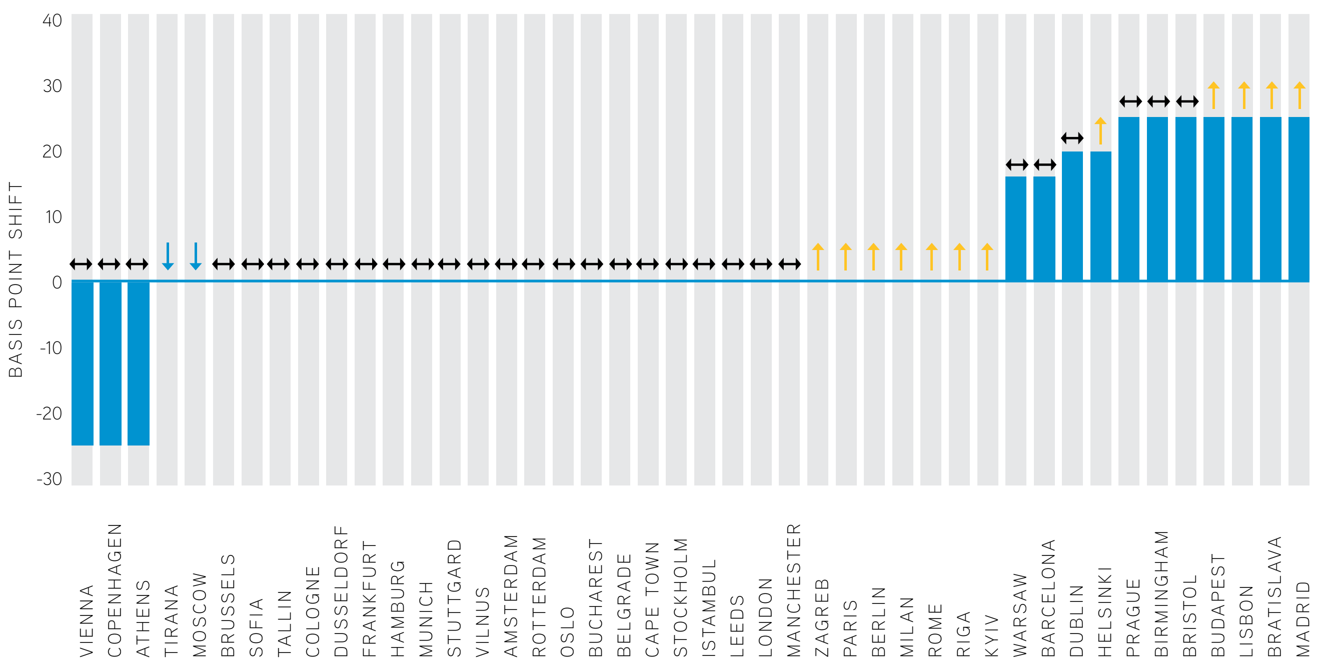
Source: Colliers International, Real Capital Analytics

Office Yields:
Some outward movement

As of end Q2 2020, there was some movement in office yields reflecting the changing office market dynamics. Only 11 key EMEA markets saw prime yields move out, and then only by up to 30 basis points, including Warsaw, Helsinki, Madrid, Barcelona, Prague and Budapest. Equally, and somewhat surprisingly, yields in Copenhagen, Vienna and Athens contracted by 25 bps, with Athens moving in off a high base (Fig.6).

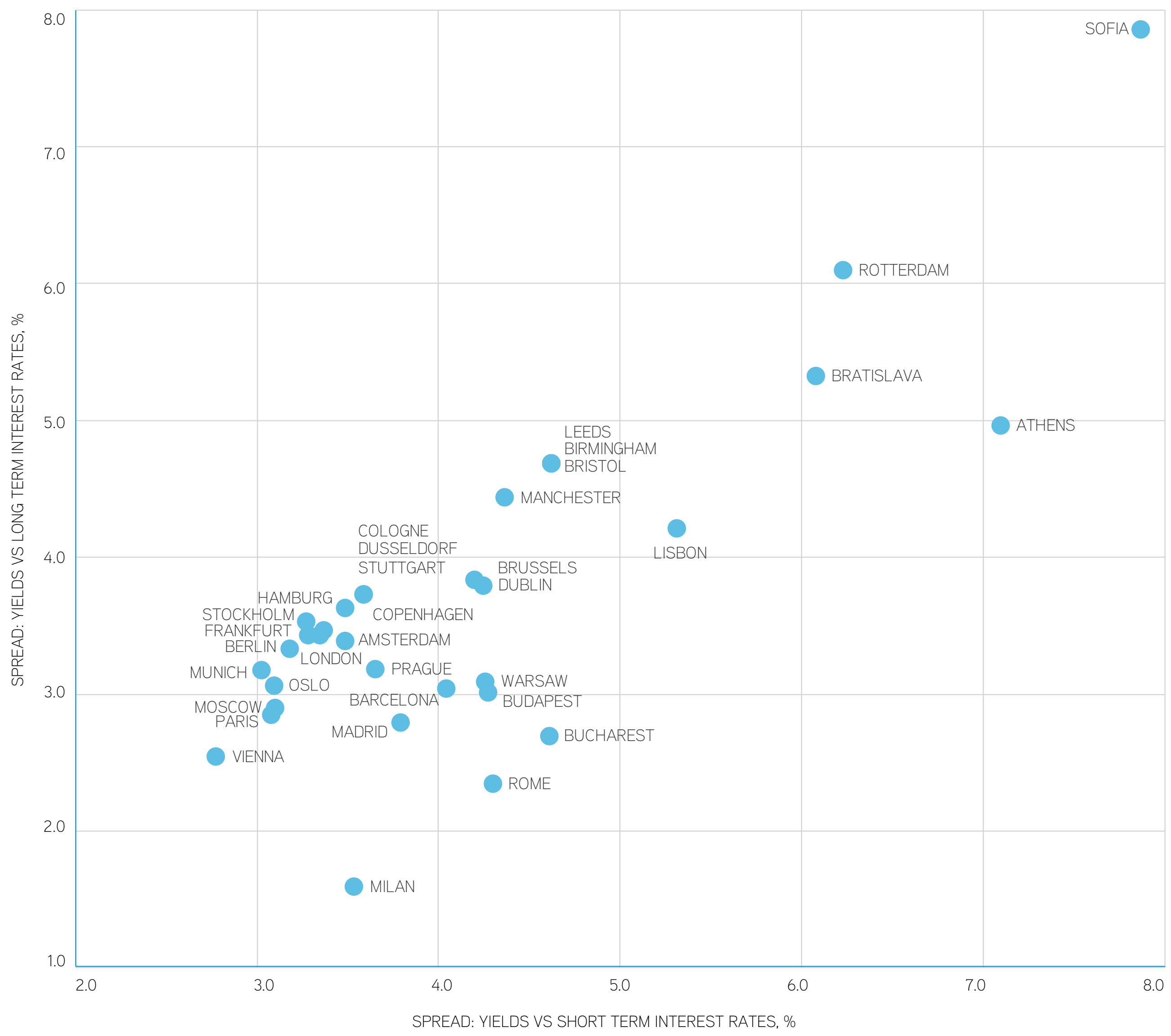
The next 12 months points to either stability in yields, or further outward movement, with many of the markets that have already seen pricing shift expecting this to continue. When compared to long (10yr bonds) and short term interest rates (Fig.7), there is a healthy spread vs risk and the cost of debt, but some markets look relatively expensive – or good value – vs other destinations. UK regional cities look very good value on this basis. Vienna and Milan look pricey.

FIG.6
PRIME CBD OFFICE YIELDS
[6M CHANGE & OUTLOOK]



Source: Colliers International

FIG.7
OFFICE YIELD SPREAD MATRIX



Source: Colliers International, Oxford Economics

Office transactions

QUARTER 1, 2020

Q1 2020 Investment Volumes were strong predominantly because the large market of the UK finally bounced back with Boris Johnson winning the election in December 2019 removing the recent political uncertainty. Both Germany and France continued to have strong quarters with a dominance of local insurance capital acquiring several major assets before lockdowns. There were also record volumes in markets such as Sweden, Netherlands, Poland and Ireland.

In Germany, we saw Hines on behalf of German Insurance companies acquire the 30,169 sqm Lenbach Garten in Munich for €390m reflecting a 2.6% GIY (long leases to Apple, Mckinseys and Zirngibl). DWS Grundbesitz Europa (German Fund) acquire the 22,558 sqm Capricorn, Holzstraße 6 in Dusseldorf for a price of €180m reflecting a 3.51% GIY (WALT of 8.5 years).

In the UK, we saw Legal & General (UK Fund) acquire the 21,000 sqm Sanctuary Buildings in Westminster, London, SW1, for circa £300m from Hana Alternative Asset Management (Korean Syndicated Fund) reflecting a 3.97% NIY (14 years to UK Government). We also saw Union Investments (German Pension Fund) acquire a 50% share in Oxford Properties (Canadian Pension Fund) 50,167 sq m Watermark Place, 1 Angel Lane, London, EC4 for €279m reflecting a 4.62% NIY (9.8 years to Nomura Bank).

In February 2020, DTZ Investors on behalf of CNP Assurances (French Pension Fund) acquired the 33,464 sq m Aquarel office building in Issy Les Moulineaux suburb of Paris for €470m reflecting a 3.61% NIY (years to CapGemini) from AXA Investment Managers (French Insurance).

Elsewhere in Europe, Valesco Group on behalf of AIP Asset Management and Meritz Securities (Korean Securitisation Fund) acquired the 199,995 sqm Finance Tower in Brussels for €1.2bn reflecting a 3.9% NIY (15 years to the Belgian State).

QUARTER 2, 2020

Q2 2020 was a different story as most of Europe remained in lockdowns for the majority of the quarter as investors turned their attention to their existing portfolios and sustaining cashflow and many transactions pausing or being withdrawn whilst investors could evaluate future pricing, debt availability and liquidity in their markets.

There was a steep drop in transactions in all markets and liquidity restricted for the larger single asset and portfolio deals primarily driven by concerns over the availability of debt, travel restrictions and ability to make decisions and inspect the real estate. A refocus on core assets with long sustainable income remained attractive albeit often at smaller equity ticket sizes.

In Germany we saw Luwin Real Estate acquire their first asset known as Neue Mainzer Straße 74+80 (Ma Ro) in Frankfurt for €200m reflecting a 2.8% GIY from Invesco, and Union Investments acquire the Ericus-Contor office in Hamburg for €185m reflecting a 2.85% GIY. The latter transactions helped by both the seller, Patrizia and the buyers transactional teams being based in Hamburg and knowing each other well.

Office transactions

In France, we saw Ivanhoe Cambridge continue with their acquisition of The Joya Building in Val de Fontenay suburb of Paris, a new office development totalling 49,000 sq m with delivery in 2022. The price paid was €233m reflecting €4,755 per sq m demonstrating a continued belief in the strong occupational story in Paris.

In the UK, we saw La Francaise pay €56m for 90 Bartholomew Close, London, EC1 In April reflecting a 3.92% NIY (only 7bps less than the previous buyer), and we saw Prince Group from Hong Kong acquire 10 Fenchurch Street, Monument, London, EC3 from Chuang's China Group for €107m reflecting a 4.25% NIY.

Elsewhere in Europe we also saw in April, Kan Am Grund on behalf of a German Pension Fund acquire Kings Square in Copenhagen for €280m reflecting a 3.00% NIY. Kings Square comprises 15 amalgamated offices in the core CBD being vacated by Danske Bank in 2023. We saw GLL /Real Estate (Macquarie) acquire Bishops Square, Stephens Green in Dublin for €180m reflecting a 4.1% NIY. In May we saw Allianz acquire the Credit Agricole Sale & Leaseback of their Italian office at Via Armorari and Via Cantù in Milan for €140m reflecting a 3.1% NIY.

Pricing for core, long income to strong 'new norm' business sectors has remained stable or arguably come in however, during Q2 we saw many core plus and value add transactions either pause or get withdrawn if buyers tried to renegotiate the price. In Q3 we are already starting to see transactions revisited and complete with a more transparent view on any price changes. Core offices remain stable in the main liquid markets however, there is some price movements in secondary European locations such as Warsaw. Offices in secondary locations or with shorter income and vacancy in the Tier 1 markets are starting to see price adjustments between 5%-15%. Q3 will also provide more transparency on what the office occupiers are doing and whether we will see new requirements reducing, existing occupiers looking to dispose of some of their current space which will have affect on rents and pricing.

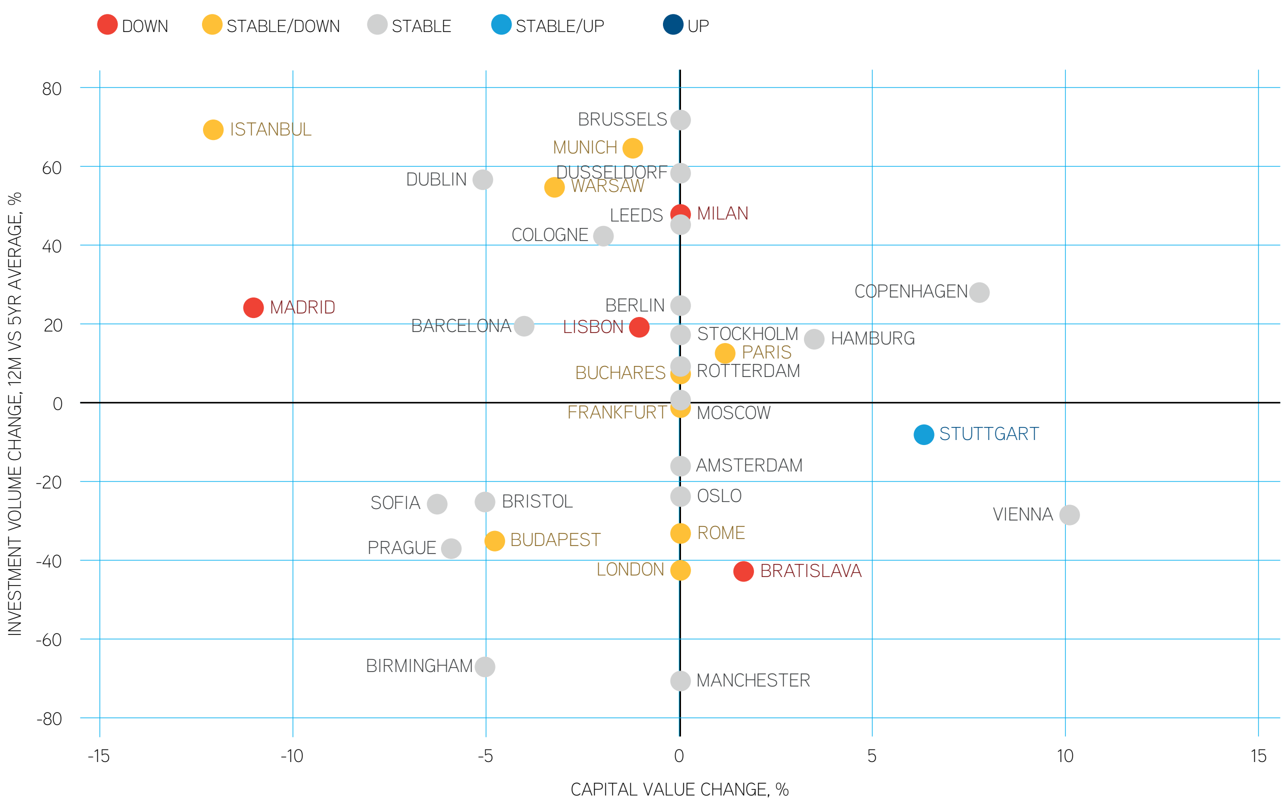
Offices: Pricing & Activity Outlook

If we take account of changes in yields and rents so far in Q2 2020, we can plot changes in prime capital values vs investment market momentum for offices specifically. To date in 2020, most markets have maintained stable pricing, although there are a number of markets that have seen values decline, and a number seeing value improve – albeit this is largely due to rent increase in Q1, pre-pandemic.

Looking forward over the next 12 months, the majority of office markets expect values to remain stable (grey dots) or decline slightly (yellow dots) – as highlighted in our office snapshot (click here to download), office conditions remain very tight, with limited movement in vacancy (up to 2%) and headline rents (of less than -5%) expected by end 2020. We expect prime rents may shift further if there is a bigger fallout in office demand requirements, but this remains to be seen. Bratislava, Madrid, Milan and Lisbon are the markets (red dots) expecting the biggest value declines resulting from falling rents and expansionary yields.

Only one market, Stuttgart, expects office values to increase as very low vacancy and availability due to planning constraints is expected to result in a slight increase in prime rents.

FIG.8
COVID-19 IMPACT: OFFICE VOLUMES, VALUES AND 12 MONTH OUTLOOK
[Q2 2020 VS Q4 2019]



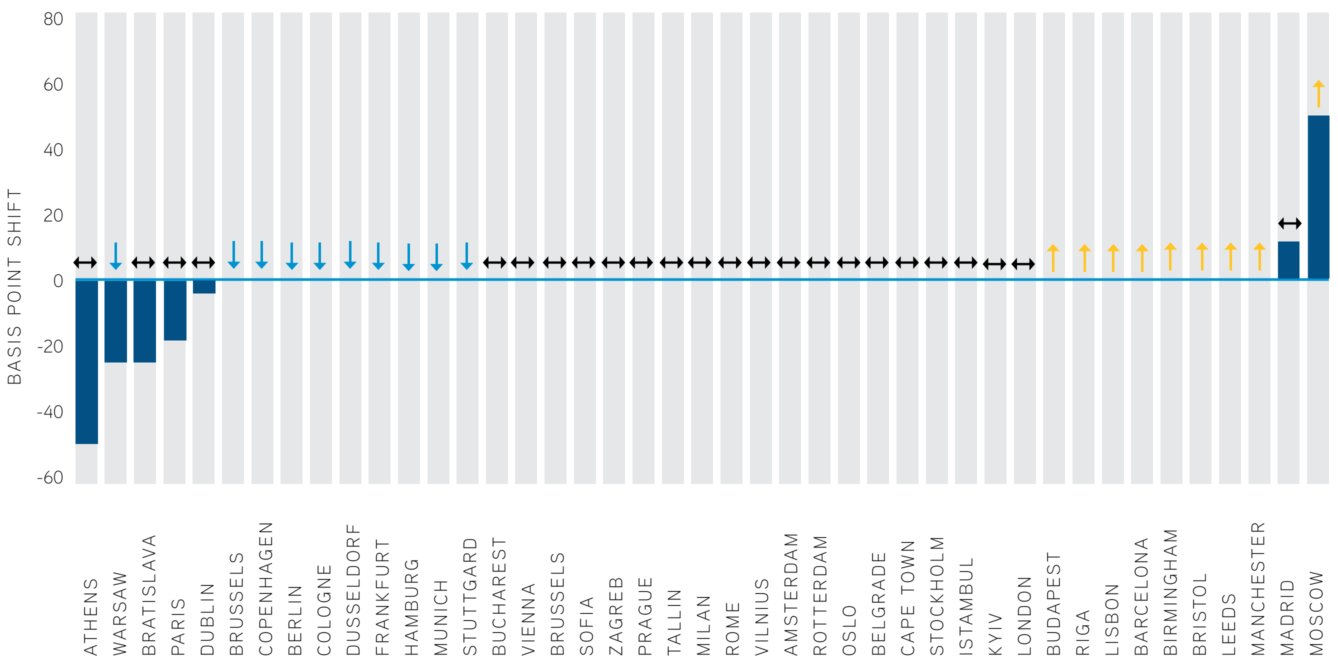
Source: Colliers International

I&L Yields:
Stable, some compression

Market conditions for I&L assets has remained more robust than for offices in H1 2020, with only Madrid and Moscow registering outward movement in yields. As pointed out on Fig.9, a number of markets, including Warsaw, Paris and Dublin saw I&L yields compress, reflecting string appetite for product. The next 12 months points to stability in yields for the majority of markets, but a number of locations expect yields expand and contract. Warsaw, Copenhagen and the key German cities expect yields to contract further; southern and CEE locations including Budapest, Barcelona and Madrid expect yields to move out, as do key northern, regional UK locations Manchester (UK NorthWest) Leeds (UK Yorkshire/North east) and Birmingham (UK West Midlands)

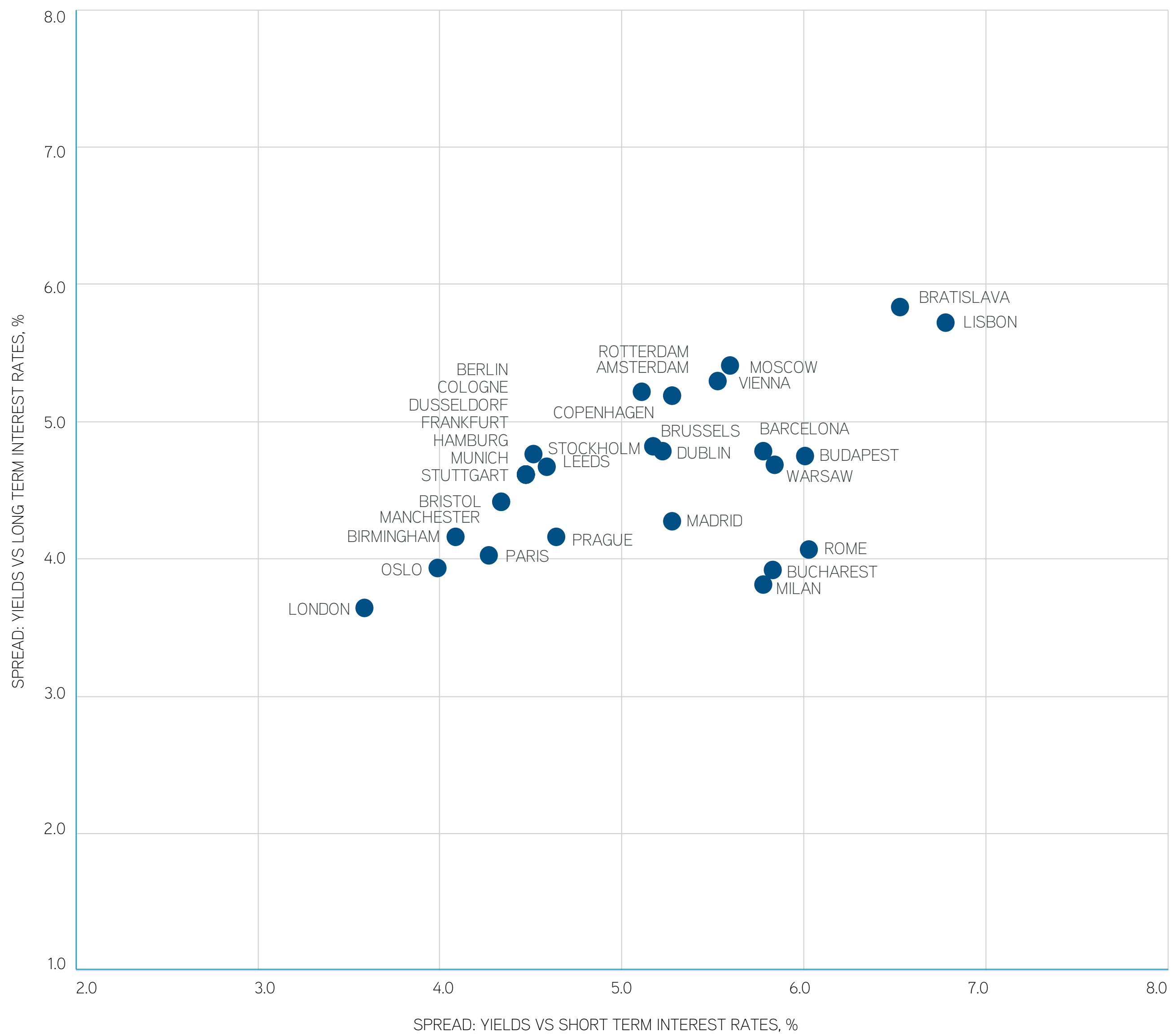
When compared to long (10yr bonds) and short term interest rates, Birmingham does look relatively expensive, as do, Manchester, Prague and Oslo. But most locations look reasonably well positioned from this perspective (Fig.10).

FIG.9
PRIME I&L YIELDS
[6M CHANGE & OUTLOOK]



Source: Colliers International

FIG.10
I&L YIELD SPREAD MATRIX



Source: Colliers International, Oxford Economics

I&L transactions

QUARTER 1, 2020

The Logistics sector has been Europe's most resilient sector during the pandemic and offers the commercial sector that could provide genuine rental growth for investors going forward.

In Q1 2020 Blackstone continued to dominate the sector and it was telling when lockdowns arose, they proceeded with their industrial acquisitions and paused their office acquisitions. In March 2020 they acquired 16 logistics properties totalling 471,000 sq m located primarily in Germany and the Nordics for €572 million (4 year WALT). Blackstone also proceeded in March with their acquisitions of 22 small to medium-sized industrial and logistics assets in suburban, last-mile locations in the UK known as the Cara Portfolio from Clearbell Capital for €136m reflecting a 6.0% NIY (4 year WALT) and a €66m portfolio of light industrial/logistics properties in France, Netherlands & Denmark from Cromwell REIT.

In February, we also saw Ivanhoe Cambridge acquire the 430,000 sq m Hub&Flow, a portfolio of 17 logistics assets across major Paris and Lyon hubs, from The Carlyle Group for circa €300m.

As the UK entered lockdown at the end of March, Hermes still received bids from over 10 investors for their 58,000 sq m Perivale Park Industrial estate comprising 23 units and 8 acres of developable land. The guide price was circa €180m and Segro was the preferred party bidding in excess of €225m reflecting a 3.5% NIY. Due to the uncertainty, Segro paused their due diligence and Hermes withdrew the sale. In June 2020, Segro returned and acquired the asset in 6 days at the same price.

QUARTER 2, 2020

In April and May we saw several logistics transactions proceed with Amundi acquiring the 130,435 sq m Zalando unit in Lahr, State of Baden-Württemberg, Germany for €207m reflecting a 3.9% GIY, Aviva Investors acquire the Next (fashion retailer) Sale & Leaseback of three distribution centres, located in South Elmsall, between Wakefield and Doncaster in the UK for €120m reflecting a 4.75% NIY and DREAM REIT from Canada proceed with the M7 Real Estate portfolio in The Netherlands comprising 31 assets concentrated in major urban centres including Amsterdam and Rotterdam for €140m.

In June, Nuveen Real Estate in quick succession acquired 3 logistics assets in the Netherlands totalling 210,000 sq m for €215m reflecting a 4.25% NIY and also CityPark in Vienna for €65m reflecting a 5.0% NIY.

Many large scale portfolios have been launched or expected to be launched in Q3 which highlights the return of sellers confidence in the depth of capital chasing logistics portfolios. These include the Prologis / Liberty UK portfolio comprising 22 assets and 2 sites with 5 vacant units being launched with a guide price of €480m reflecting a 5.4% NIY (5 year WALT), The P3 APEX portfolio comprising 14 assets in 5 countries (Czech, Spain, France, Germany & Netherlands) at aguide price of €270m reflecting a 5.5% NIY (5 year WALT) and CBREGI's Montepino portfolio in Spain with a guide price of €400m+.

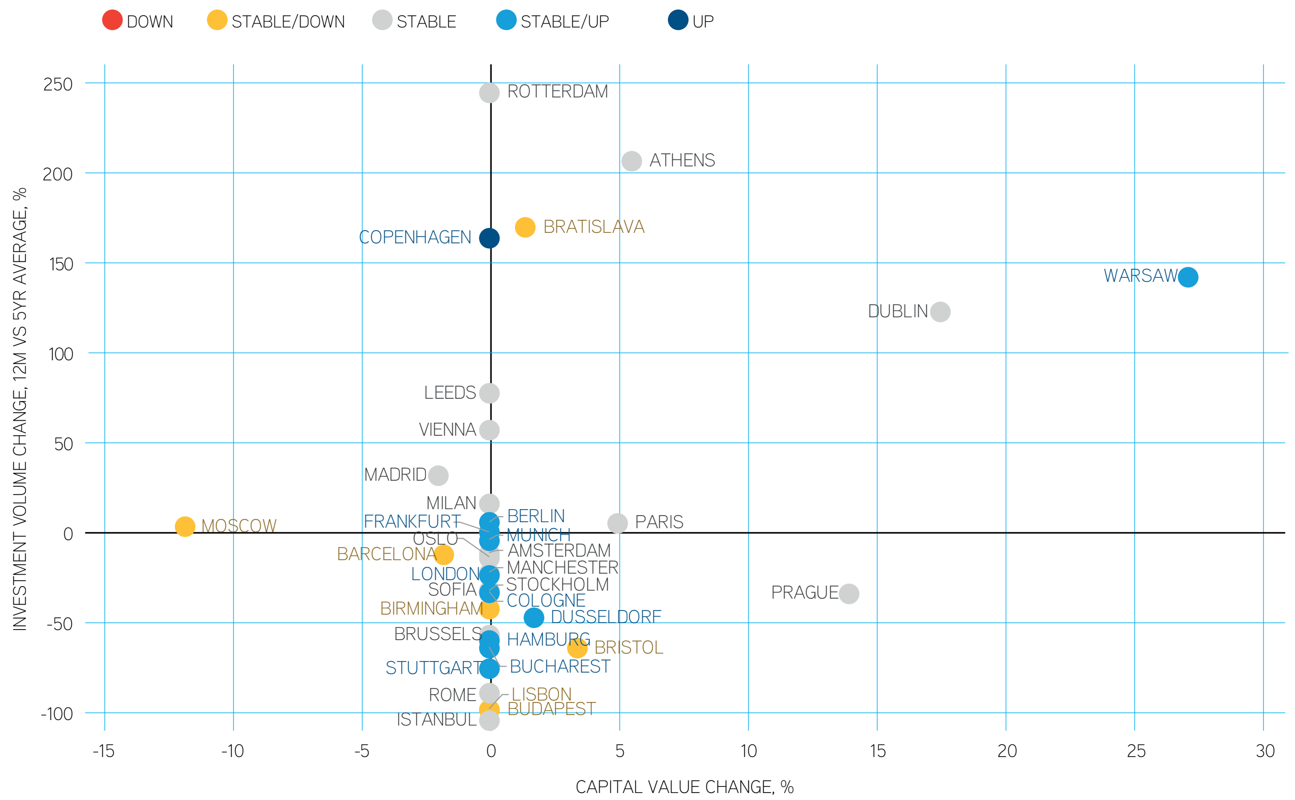
I&L Outlook

If we take account of changes in yields and rents so far in Q2 2020, we can see that values have been very stable for logistics. Plotting changes in investment volumes in the logistics sector can generate distorted changes in volumes over a short time period, given the often lumpy nature of transactions. So while more markets have reported a decline in activity, than an expansion, this can change quickly.

Looking forward over the next 12 months, there is clearly much more positivity around pricing, with many markets expected to remain stable or register an upside in capital values as either yields compress or rents increase. Copenhagen is the only market expecting both these factors to coincide to provide a strong capital value growth outlook.

Decline in capital values for those in yellow are the result of expansionary yields. As our I&L snapshot (click here to download) points out, most markets expect rents to remain stable , while some core locations anticipate further rental growth. This reflects occupier conditions that are expected to remain largely landlord friendly or neutral over the next 12 months.

FIG.11
COVID-19 IMPACT: I&L VOLUMES, VALUES AND 12 MONTH OUTLOOK
[Q2 2020 VS Q4 2019]



Source: Colliers International

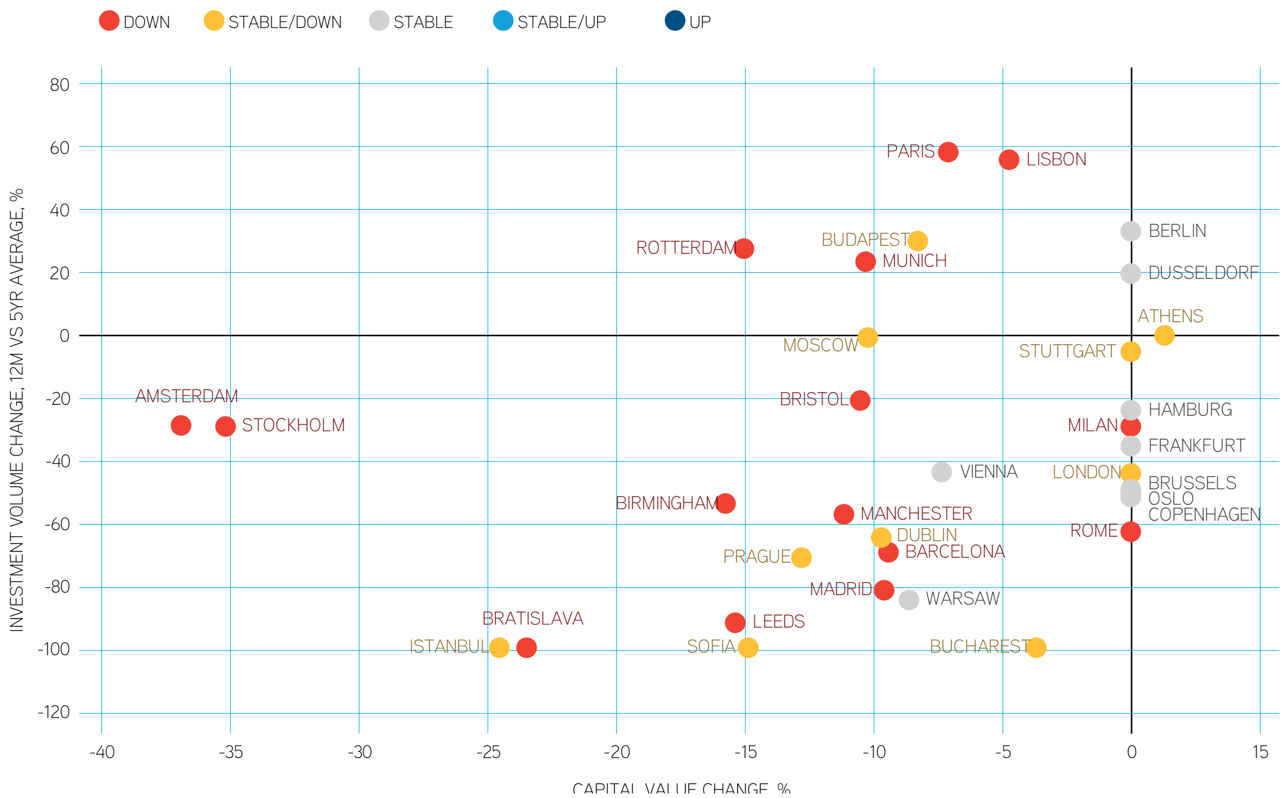
Shopping Centres: Feeling the impact

Retail is clearly feeling the brunt of COVID-19, and this can be seen in the big downward momentum in both investment volumes and capital values year to date.

Only a few markets have maintained some stability in shopping centre values to date – including Berlin, Dusseldorf, Frankfurt, Vienna and London. But most markets expect values to decline further in the next 12 months as both yields and headline rents come under further pressure.

Outward movement in notional values in Amsterdam and Stockholm are stark, and a lack of investment activity makes it difficult to place accurate figures on values give then lack of comparable evidence. But it does give an indication of how far values may contract as retail continues to come under pressure from an acceleration of structural shifts to e-commerce, and a reduction in retail spending as households tighten their belts.

FIG.12
COVID-19 IMPACT: SHOPPING CENTRE VOLUMES, VALUES AND 12 MONTH OUTLOOK
[Q2 2020 VS Q4 2019]



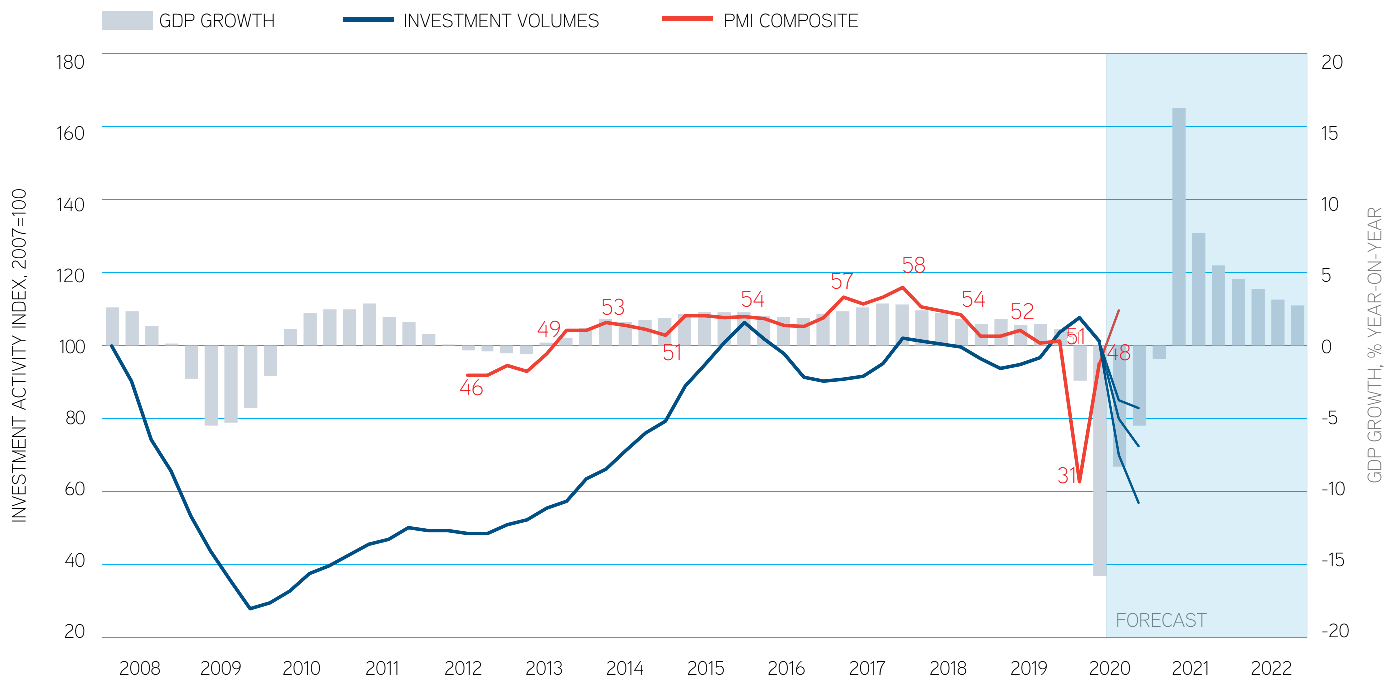
Source: Colliers International

Summary

Despite all of the upheaval that COVID-19 has created, it has also offered the opportunity for a much needed re-set in pricing, whilst accelerating fundamental structural changes in the demand for real estate. We expect much more of an adjustment in the next 12 months. When combined with lower levels of transactions in Q3, as latent deals agreed pre-pandemic dry up, we expect a subdued Q3, followed by a rebound in Q4. We remain confident that the market will be relatively robust this year, but suspect that over the course of 2020 volumes will be down by up to 30%. Provided re-pricing continues, major geo-political events (Brexit transition, EU budget, US election) are favourable and market conditions settle in 2021, we expect markets to get back on track in H2 2021.

FIG.13
COVID-19 IMPACT: INVETMENT OUTLOOK SCENARIOS

Qrtr+	Best-case	Mid-case	Worst-case
Q1	67	67	67
Q2	*50	*50	*50
Q3	*30	*30	*20
Q4	*100	*70	*30
2020	*246 (-20%)	*216(-30%)	*166(-45%)



Source: Colliers International, Oxford Economics, Real Capital Analytics, IHS Markit

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