

EMEA | CAPITAL MARKETS  
Q3 2016

# European Investment Market Outlook: A Matter of Perspective



# European Investment Market Ranking: Key Takeaways

As investors seek out the best markets to suit their real estate investment style and strategy, Colliers' analysis of the European investment landscape ranks countries according to those best suited to the risk-averse, stability and growth-led investors, and the yield-hungry.

With over thirty countries to choose from, the report provides an objective view on where best to consider investing at a high level.

## Risk-averse Investors:

Looking for political stability, operational ease and risk-adjusted pricing? The Nordics, Switzerland and the Netherlands are currently the best positioned markets for this strategy. The combination of stable governments and transparent operational frameworks put these markets out on top. Solid yields remain achievable, despite strong competition from local institutions and investors. International investors may find life easier in the €30+ million category.

## Stability & Growth-led investors:

For those looking for the strongest economic growth credentials, against a stable political and operational backdrop, the Tier 1 markets come back to the fore. Germany leads the race, ahead of the UK and France. The Netherlands remains in a strong position in fourth place ahead of the Nordic markets. Spain also moves up the rankings to feature in the top ranking countries.

## Yield-hungry Investors:

For the yield-hungry, it is time to move further east and take on more risk. The top ten markets here comprise markets primarily in the Baltics and Central and Eastern Europe, led by Bulgaria. This is based on the relationship between yields and both short and long-term interest rates. This brings Ukraine into the top ten, as country government bonds yields have started to compress since mid-2016 relative to very high-yielding real estate.

While yields in the more peripheral markets need to be offset by higher risk and much lower liquidity, there are a number of more established markets which feature here. Offering a healthy combination of both yield and market depth are Belgium, the Netherlands, the Czech Republic, Finland and Denmark.

Overall, for those pursuing a combined risk-reward strategy, the Nordics and the Netherlands are the markets of choice for 2017.

**Tab. 1: Top Markets for Risk-averse Investors**

Country	Politics Rank
Norway	1
Sweden	2
Switzerland	3
Finland	4
Denmark	5
Netherlands	6
Austria	7
Germany	8
United Kingdom	9
Belgium	10

Source: Colliers International

**Tab. 2: Top Markets for Stability & Growth-led Investors**

Country	Stability & Growth Rank
Germany	1
United Kingdom	2
France	3
Netherlands	4
Sweden	5
Norway	6
Switzerland	7
Finland	8
Denmark	9
Spain	10

Source: Colliers International

**Tab. 3: Top Markets for Yield-hungry Investors**

Country	Yield-Hungry Rank
Bulgaria	1
Slovakia	2
Lithuania	3
Belgium	4
Netherlands	5
Finland	6
Czech Republic	7
Ukraine	8
Denmark	9
Latvia	10

Source: Colliers International

# Key Trends & Considerations

Based on transaction evidence up to H1 2016, it appears that investors are plugged into the merits of the markets highlighted by this analysis.

For example, a number of the stand-out, higher yielding markets appear amid the busiest investment markets of Europe to date in 2016 – at least in terms of year-on-year change. Croatia, Latvia, Lithuania, Finland and the Netherlands all feature within the top ranking markets across the different investor strategies.

Markets with the weakest yield positions (relative to short and long-term interest rates) and lowest country scores overall were typically the worst performing countries in terms of the registered year-on-year change in investment volume – notably Greece, Russia and Turkey. Although high property yields are a driving force in terms of investment activity, it is clear that investors remain highly selective regarding the risks they are prepared to take, for a price.

Meanwhile, the three major three Tier1 markets all clearly took a hit in H1 2016, led by the UK, then Germany and France – markets where yield pricing has surpassed previous peak levels, at least in the major capital destinations, and where political uncertainty is high on the agenda. Not all markets followed the logic of requiring risk-adjusted yields to drive turnover growth, however. Poland and Romania, for example, posted a strong H1 2016 despite their relatively lower yield positions.

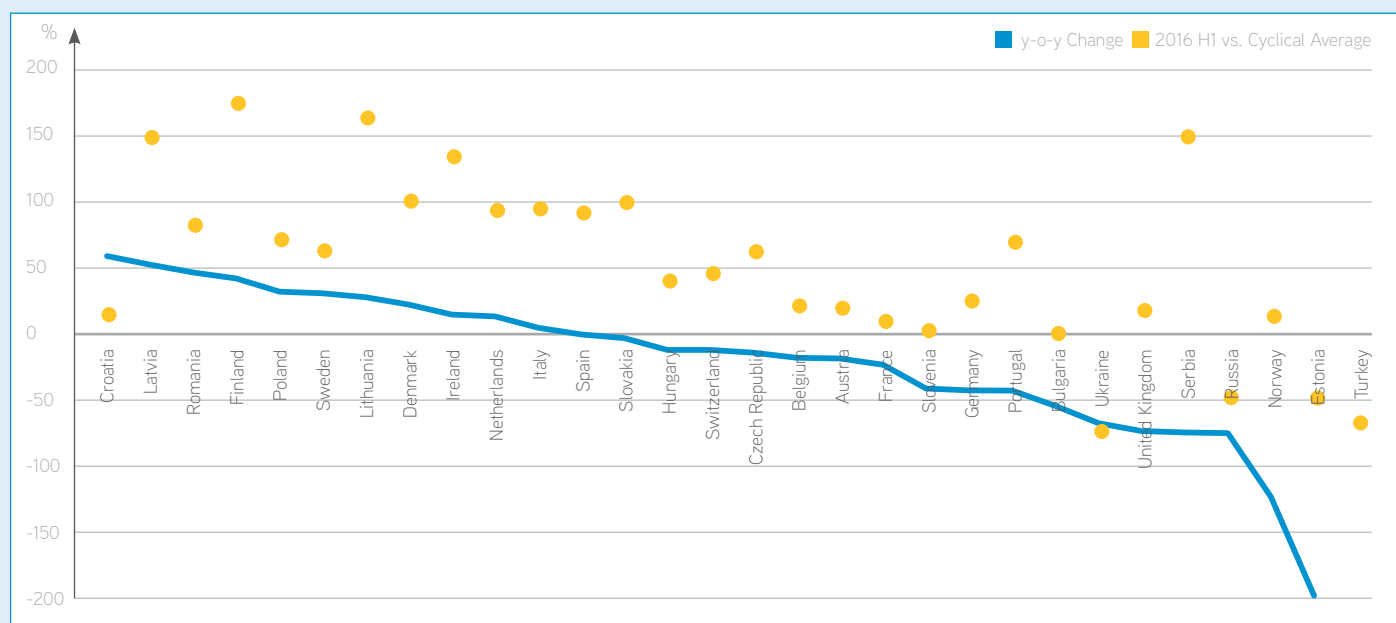
## Outlook:

Overall, it is clear that the combination of political stability, operational transparency and solid yields available in the Nordics and the Netherlands has helped put them at the top of the investment volume growth curve heading into 2017. The Tier 1 markets of Germany, the UK and France remain closely in step, with risk-adjusted pricing opportunities available in core and select CEE countries, slightly behind. That said, it remains to be seen how upcoming political events will pan out across European markets in the coming year, and these country rankings are liable to change.

At least for the Nordics, UK and the Netherlands in particular, the added risk of ‘bad-banks’ will be minimised, given that these countries have worked through these concerns much earlier in the property market cycle. For Southern European countries, and Italy in particular, the outcome could be far more negative for their economic outlook. The more positive flip-side is that this may bring about some significant non-performing loan (NPL) and asset opportunities for private-equity types in due course – the kind of transactions which helped drive the 2012-14 European investment market.

In an environment constrained by opportunities, it will be interesting to see just how the market evolves.

**Fig. 1: H1 Investment Volumes by Country (y-o-y and vs. Cyclical Average)**



Source: Colliers International

# INTRODUCTION

Geo-political change, challenging investment market cycles and a lack of well-priced product/opportunities are forcing investors to reconsider the European investment market. With allocations to real estate continuing on their growth path, the H1 2016 'cause for pause' is not a position investors can prolong, given the rising level of competition for real estate product globally.

With such a mixed picture of prospects facing the European markets at year-end 2016, and going into 2017, where are the best European markets for investors to place their capital?

This decision on where to go will be driven by perspective. Not just in terms of whether an investor feels 'glass half-full or half-empty', but in terms of which markets best suit an investor's style and strategy.

This report gives a high-level, country-by-country comparison of how European countries presently stack-up for different types of investor: from the risk-averse, to the yield-hungry risk-takers.



## THE RISK-AVERSE



## STABILITY & GROWTH-LED INVESTORS



## YIELD-HUNGRY INVESTORS

# THE RISK-AVERSE

For the risk-averse, transparency and liquidity are key. So countries most in favour are those where it is simplest to invest and divest in real estate, where occupiers can set up and trade and where upcoming political, regulatory and trade upheaval are judged to be of least concern.

The result is that the Nordic markets currently sit top of the rankings, as the bastions of European stability. Switzerland, the Netherlands and Austria also make the top seven countries – all ahead of the Tier 1 markets of Germany, the UK and France.

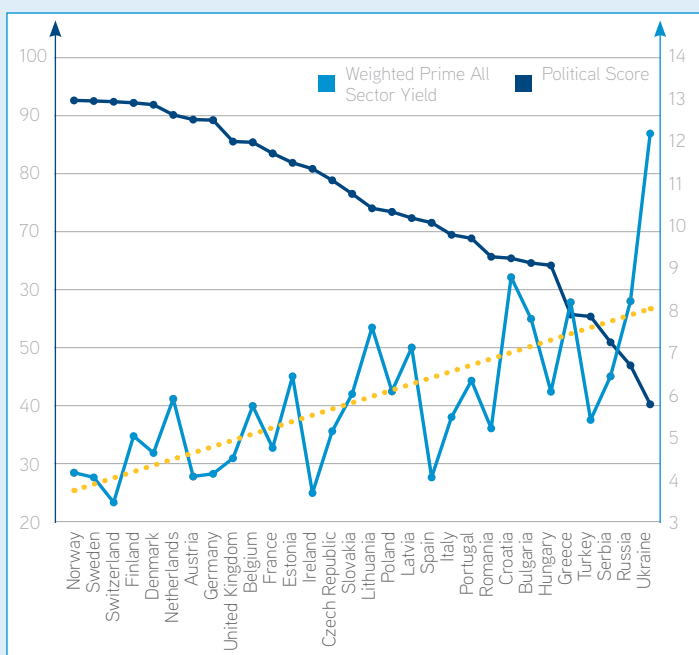
Belgium, Ireland, the Baltics and the core Central Eastern European (CEE) markets of the Czech Republic and Poland hold the middle ground, ahead of the Southern European markets of Spain, Italy and Portugal. It highlights that the latter three markets really do need to push through reforms to improve their trading position. Poland, however, has not been as adversely affected by changes in the constitutional tribunal as first feared.

The 'outer-CEE' markets of Romania, Croatia, Bulgaria and Hungary are positioned at the lower end of the rankings. At the risk end of the spectrum sit the challenging markets of Turkey, Greece, Russia and Ukraine.

Low risk, however, comes at a price. By country there is a clear inverse relationship in real estate pricing, based on a weighted all-sector yield for each country relative to country risk.

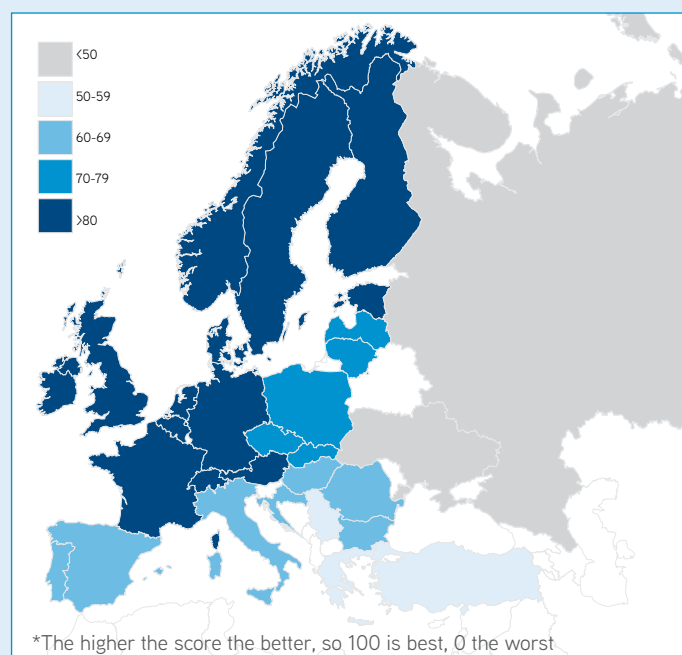
On a weighted, all-sector yield basis, Finland and the Benelux markets of the Netherlands and Belgium look best positioned of all the low-risk countries. Of the middle-risk countries, the Baltics also look appealing, while Ireland, Spain and Italy appear relatively overpriced. Further up the risk curve Croatia also looks like an interesting proposition.

**Fig. 2: Political & Operational Country Score vs Weighted All Sector Yield**



Source: Colliers International/ Oxford Economics

**Fig. 3: Map Political & Operational Country Score**



Source: Colliers International



# STABILITY & GROWTH-LED INVESTORS

Of course, political and operational risk are not the only considerations. For those more interested in looking to future drivers of demand for real estate, we need to factor in key macroeconomic and demographic trends and forecasts. By adding in the outlook for short and long-term interest rates, GDP and employment growth factors we see a big shift in the overall ranking of which markets look most attractive. Add in forecast demographic change, notably urban population size and forecast change to 2030, and some real changes in country profile emerge.

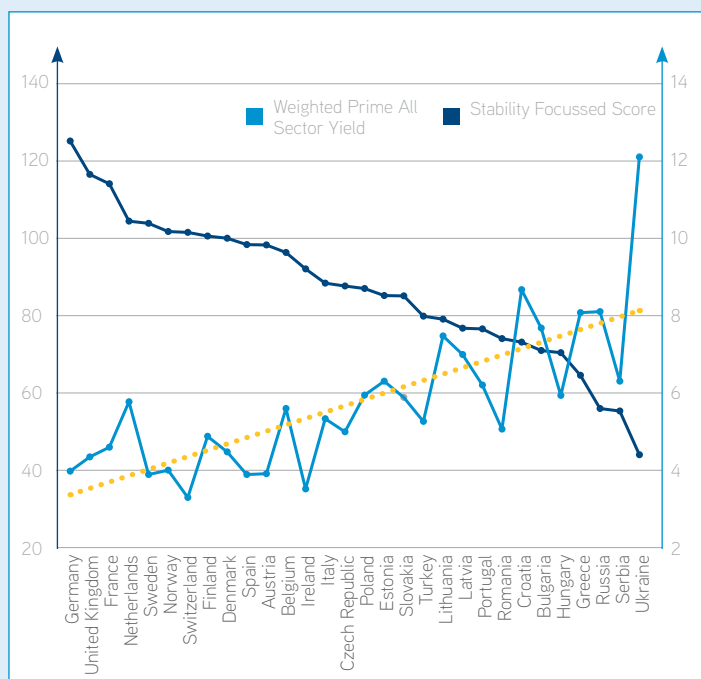
Firstly, the Tier 1 countries rise back to the top of the pile, led by Germany, driven by their economic size. Although forecast economic growth may not be at the rates of key Tier 2 countries such as Spain, Sweden, Ireland or Poland – the overall impact on the value of GDP to be generated is more significant than percentage growth terms may imply.

The Netherlands again fares well, coming in fourth position, and on a risk-adjusted pricing basis looks very attractive relative to those countries putting in similar scores. The Nordics are next up, but we also see Spain and Italy rise further up the rankings – driven by strong economic growth forecasts for Spain (yet weak demographic growth), and a reminder of just how large Italy's economy is, supported by strong forecast urban demographic change.

The CEE markets of the Czech Republic, Poland and Slovakia and the Baltic markets stay firmly in mid-table. Yet we also see Turkey move much higher up the rankings courtesy of its huge demographic growth potential. If markets were driven by positive demographic change alone, Turkey would be way out on top, as per Figure 5.

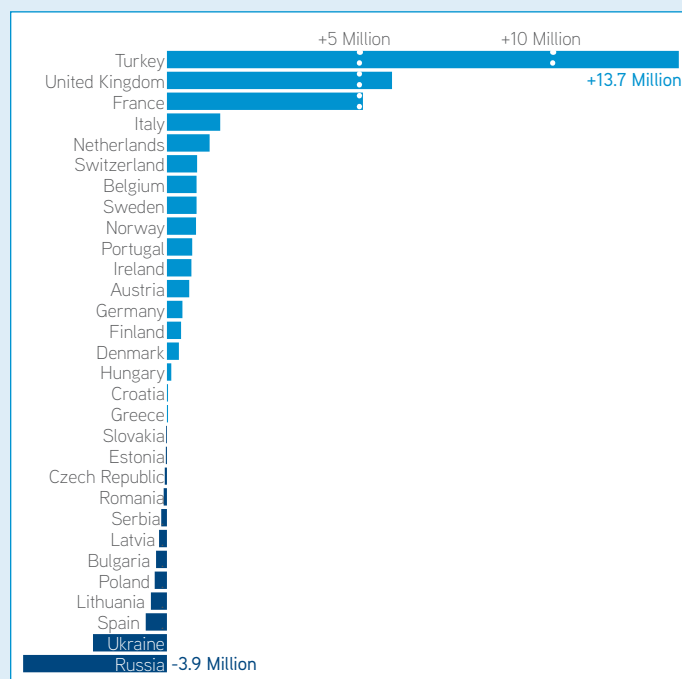
The outer-CEE markets feature toward the lower end of the rankings, as their scores are diminished by weak demographic forecasts – Croatia and Hungary aside – despite showing positive economic growth forecasts.

**Fig. 4: Stability & Growth Country Score vs Weighted All Sector Yield**



Source: Colliers International/ Oxford Economics

**Fig. 5: Urban Population Change to 2030 (Million)**



Source: Colliers International/ Oxford Economics



# YIELD-HUNGRY INVESTORS

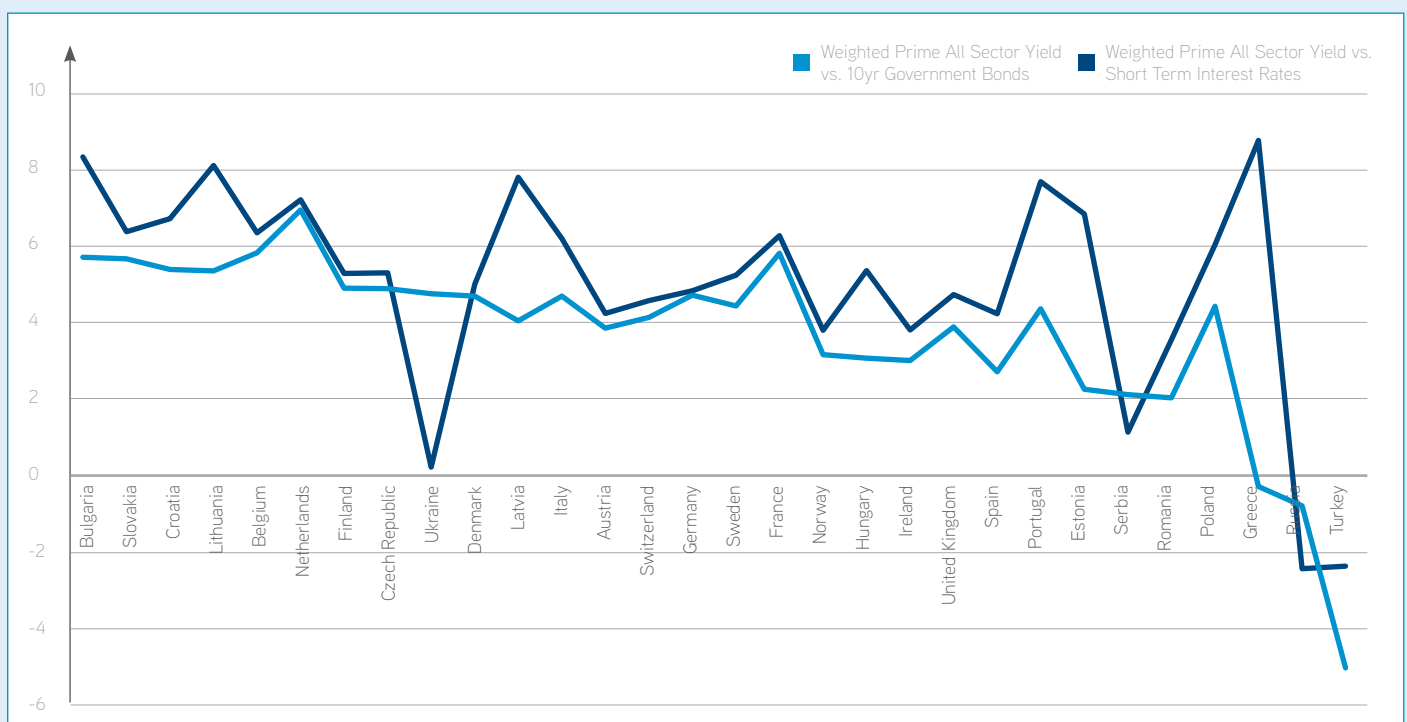
For those with a bigger appetite for risk, where liquidity may be lower but yields are higher, it is understandable why some investors are moving deeper into key Tier 2 markets and driving a resurgence in activity in CEE markets, both core and outer.

By comparing the size of the gap between the prime real estate all-sector yield and both short and long-term interest rates, Bulgaria leads the charge across Central and Eastern European countries, closely followed by Slovakia, Croatia and the Baltic markets.

Ukraine also features at the top end of the rankings, as country government bonds yields have started to compress since mid-2016 relative to double-digit property yields. The financial yield gap between real estate and short-term interest rates also needs to factor in the all-in-cost of debt, of course, which would render some CEE markets less attractive, notably Ukraine.

Offering a healthy combination of both yield and market depth are Belgium, the Netherlands, Czech Republic, Finland and Denmark. Markets where investment finance is quite widely available.

**Fig. 6: All-sector Weighted Yields vs. Short-term Interest Rates & 10-yr Government Bonds**



Source: Colliers International/ Oxford Economics

# Concluding Comments

While geopolitical disruption is nothing new, the scale and timing of changes that the European investment market faces at the business end of 2016, and will continue to face heading into 2017, are unprecedented. The UK referendum sits squarely at the head of the uncertainty table, yet is only one of many major events and factors disrupting the market, and making investors reconsider where best to invest.

Colliers' own view is that the outcome of the UK vote to leave the EU (see Colliers' recent [UK Brexit report](#)), could be defined as early as January 2017. Whether there is a hard or soft exit remains to be seen. The majority of Europe's big economies also face a combination of elections and referendums over the coming 12 months - France, Germany, Italy, Spain and the Netherlands are all in the mix - and it's easy to understand the current 'pause for cause' which has led to a 27% year-on-year fall in investment volumes across Europe in the first half of 2016.

The upcoming US election adds another significant destabilising factor, which will impact global and European property markets - potentially both occupier and investor-led. The election run-in is a tightly fought, divisive affair, and the policy-economic-investment outcome for 2017 remains highly opaque.

Add to this the fact that Europe is heading into the eighth year of its current investment cycle (the historical average, although this does differ greatly by market) it begs the question 'what will investors do next?' It's challenging enough to have a clear understanding of Brexit's implications for markets, let alone adding in all the other factors.

Investors can't sit on hands for too long. Finding well-priced product may have become increasingly difficult toward the end of the current cycle, but the current political upheaval impacts all investment types. Commercial real estate investment remains a very attractive option in a macro environment of 'lower for longer': be it interest rates or GDP growth.

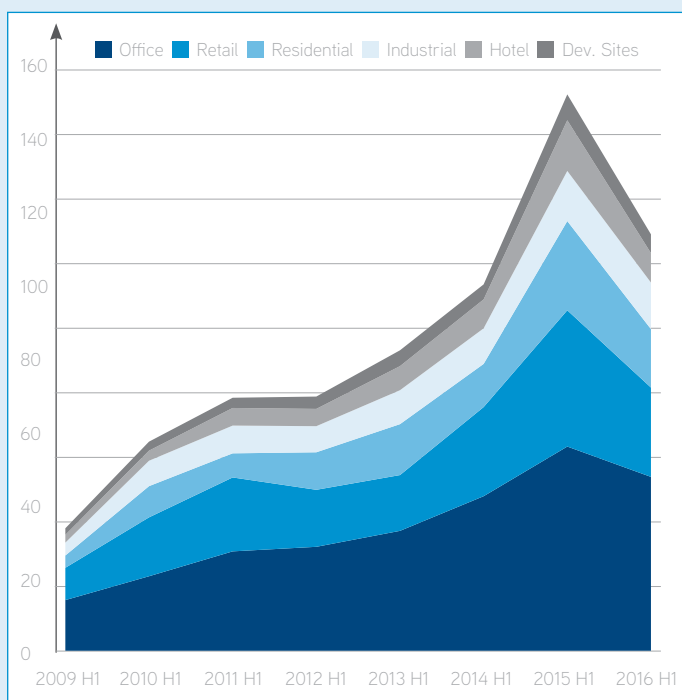
Which is why more and more capital continues to find its way into global real estate, with allocations continuously on the rise. Preqin research on the 'global alternative assets universe' reports that allocations continued to grow up to end H1 2016, with fund managers now managing an all-time record US\$7.4tn, up \$500bn from this time a year ago. Around two thirds of this (66%) has been allocated to real estate - ca. US\$4.9 trillion, which is way ahead of the 10% allocation estimate of funds under management at end 2015 (equivalent to US\$3.4 trillion).

One notable trend of late is the shift toward lower-risk, income driven strategies with 'ValueAdd' players moving down the risk curve in search of 'CorePlus' deals. The strategy being to accept lower return targets, but with a clearer exit strategy to create core assets for core players later down the line.

Another key trend is the shift to larger lot size, corporate or M&A style deals, where competition from local players tends to be less intense.

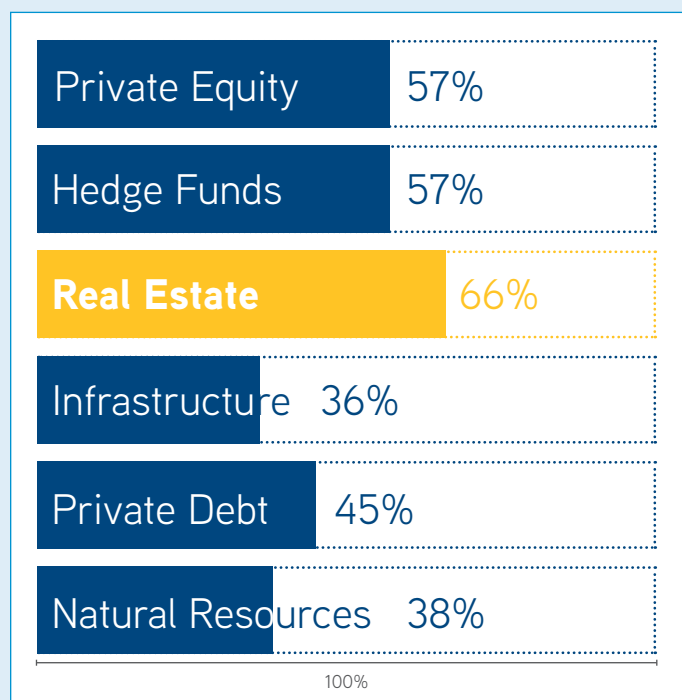
Both of these strategies tend to be focused on the larger, more liquid and dominant markets of Europe. Whether the appetite for such deals can be satisfied is another matter entirely.

**Fig. 7: H1 Investment Volumes: 2009 - 2016 [Billion]**



Source: Colliers International/Real Capital Analytics

**Fig. 8: Proportion of Institutional Investors Allocating to Each Alternative Asset Class**



Source: Preqin, Alternative Asset Investor Outlook, H1 2016/ Colliers International

# Other Factors: Market Depth/Liquidity

If we add in product availability as a key consideration, a simple analysis of annual average investment turnover per capita since 2007, relative to GDP per capita, shows a significant variation in market depth by country.

It's going to be easier for the Tier 1, Nordic, Benelux and Spanish markets to satisfy liquidity requirements irrespective of their outlook. It also suggests that if more markets were to follow the lead of the UK and Sweden in terms of investment turnover, virtually every other European market has the scope to increase the level of real estate investment intensity.

In some respects the strength of the UK and Sweden could be down to transparency. But it is also driven by the diversity of product on offer - from vanilla, core office to student housing, healthcare and infrastructure.

If all markets can shift up the diversity and transparency curve, the European property investment cycle could be extended well into 2017 and beyond. If the price is right.

**Fig. 9: Investment Market Depth**



Source: Colliers International/ Oxford Economics

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# 502 offices in 67 countries on 6 continents

United States: **140**

Canada: **31**

Latin America: **24**

Asia Pacific: **199**

EMEA: **108**

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## \$2.3

billion in  
annual revenue

## 1.7

billion square feet  
under management

## 16,300

professionals  
and staff

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