

CBRE RESEARCH | EMEA

# REAL ESTATE MARKET OUTLOOK 2020

EMEA





### 04

## ECONOMICS AND POLITICS

Weak global trading conditions continue to weigh on European growth, primarily reflecting a struggling manufacturing sector, but with far greater resilience in services. The main risk to Europe is escalation of US-EU trade tensions, with further falls in demand for European exports. Despite this, labour markets remain robust and wage growth has accelerated in several countries providing further support to consumer demand in Europe.

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## CAPITAL MARKETS

The accommodative policies of central banks are reinforcing our expectation of lower interest rates for longer. Prime yields are nearing their floors, although we still expect compression for the best assets to continue into 2020. Investors are increasingly favouring real estate in multi-asset portfolio allocations, so we expect 2020 volumes to be at least around the 2019 level in continental Europe, with a possible rebound in the UK.



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## SUSTAINABILITY

The construction and operation of buildings contributes to around 40% of worldwide greenhouse gas emissions. Driven by a combination of regulatory and social pressures, we expect companies to devote more attention and rigour to ESG policies that integrate organisational, portfolio and asset level objectives. Investors, developers, occupiers and advisors, as well as asset, property, and facility managers all have a role to play in this transition.

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Positive prospects for growth and continued investment in the rapidly evolving multifamily sector in 2020, although regulation remains a key concern for investors.

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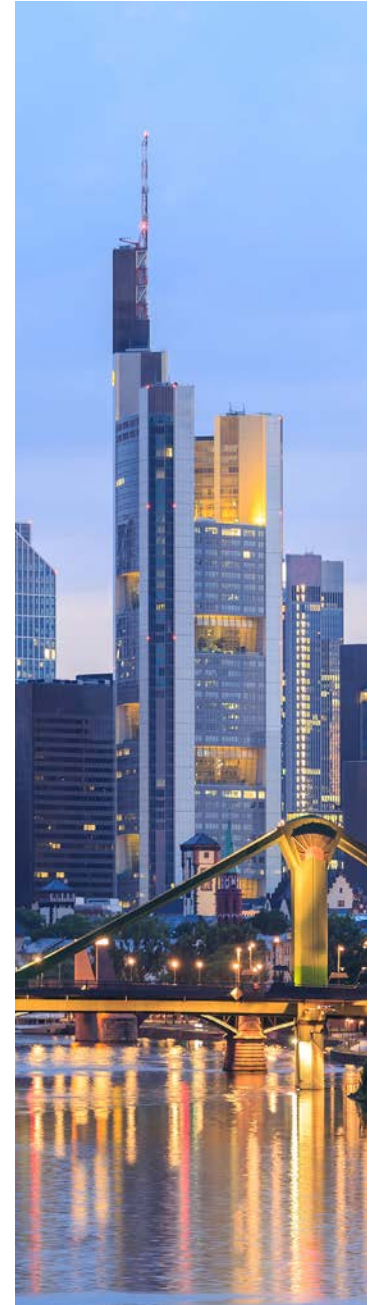
Institutional investors to make more freehold and variable-income hotel acquisitions in 2020.

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Major institutional investors now firmly committed to operational real estate, especially established sectors such as healthcare and student housing.

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Further capacity expansion will continue to attract investment capital.



An abstract graphic featuring four vertical bars of varying heights and colors: a grey textured bar on the left, a tall green bar, a blue-to-purple gradient bar, and a grey gradient bar on the right. A white line graph with four circular nodes connects the tops of the bars, showing a peak at the green bar, a trough at the blue-to-purple bar, and another peak at the grey gradient bar. A horizontal grey gradient bar is positioned behind the vertical bars.

# ECONOMICS AND POLITICS



**Weak global trading conditions continue to weigh on European growth, primarily reflecting a struggling manufacturing sector, but with far greater resilience in services. The main risk to Europe is escalation of US-EU trade tensions, with further falls in demand for European exports. Despite this, labour markets remain robust and wage growth has accelerated in several countries providing further support to consumer demand in Europe.**

## **2019 IN PERSPECTIVE: A TWO-SPEED ECONOMY**

Europe failed to maintain 2018's pace of economic growth, with GDP growth expected to be around 1.3% by the end of 2019, slightly below the long-term average. This can largely be explained by slowing international trade and Brexit-related uncertainty which is weighing on export-demand and industrial output in Europe. Consumer demand, by contrast has been quite strong.

As a result, Europe has become a two-speed economy, with service sector output remaining buoyant as industrial output continues to weaken. Unemployment fell in several countries, with EU-28 unemployment below 7%, the lowest since 2000. Aggregate measures do hide intra-country differences, however. The UK, Germany and large parts of central Europe have unemployment rates below 5%; while Italy, Spain and Greece, continue to see double-digit unemployment rates.

Despite tight labour markets, Euro area inflation has been persistently weak, prompting the European Central Bank (ECB) to lower the deposit rate further into negative territory and reinstate its net asset purchase programme at a monthly pace of €20bn. Again, aggregate inflation hides local disparities, with countries in central Europe seeing persistently higher inflation.

## **2020 AND BEYOND IN EUROPE: WEAKER BUT STILL POSITIVE**

There is still some way to go before international trading arrangements normalise and Brexit-related uncertainties subside, and as such we expect Euro area GDP growth to remain slightly

weaker than in recent years, but still modestly positive. We are forecasting Euro area GDP growth of 1% per annum through 2020 and 2021.

While we expect the western economies to show slightly weaker growth for 2020 as a whole, we expect Q4-on-Q4 growth rates to be much the same as 2019. Central Europe is forecast to slow compared with 2019, as the bottoming out of the German industrial sector starts to spill over into those countries that depend on Germany as a source of external demand.

Despite the struggles in Europe's industrial sector, service sector output has been relatively robust, and we expect this to continue into 2020. Employment growth will slow in response to weaker GDP growth, which will have some dampening effect on consumer demand, but this will mostly be reversed as we move into 2021 and the growth outlook starts to improve.

Looking at the five-year outlook, we are expecting a gradual improvement in growth in the UK and European economies as Brexit uncertainty eases and trade starts to pick up. In addition, the acceleration of the US and APAC economies will provide some much-needed support for European exports.

## **INFLATION AND INTEREST RATES: LOW AND LOWER**

The near-term outlook for inflation is being influenced by two opposing forces. On the one hand, tight labour markets should help to push up wages and prices. Conversely, moderating commodity prices have acted to pull down inflation. In eastern Europe, the tight labour market is passing through into price



inflation and we expect this to continue for the next few years. In western Europe the pass-through from higher wages to prices is much less pronounced.

Overall, we expect the stabilisation of commodity prices to raise core inflation moderately, but not enough to push inflation above the target in the eurozone for the next few years. With monetary policy in the eurozone remaining accommodative and continued low interest rates globally, policy normalisation is likely a long way off. As such, we do not expect any increases in short-term interest rates in 2020 and 2021. Indeed, the effectiveness of monetary policy may be nearing its end, which would make the European economy increasingly reliant on fiscal policy in the unlikely event of a downturn.

Long-term interest rates in Europe, and elsewhere, are likely to drift upwards, but this is largely because of developments in US interest rates, rather than an expectation of higher short rates in Europe. Our view that long rates will drift up is a cyclical

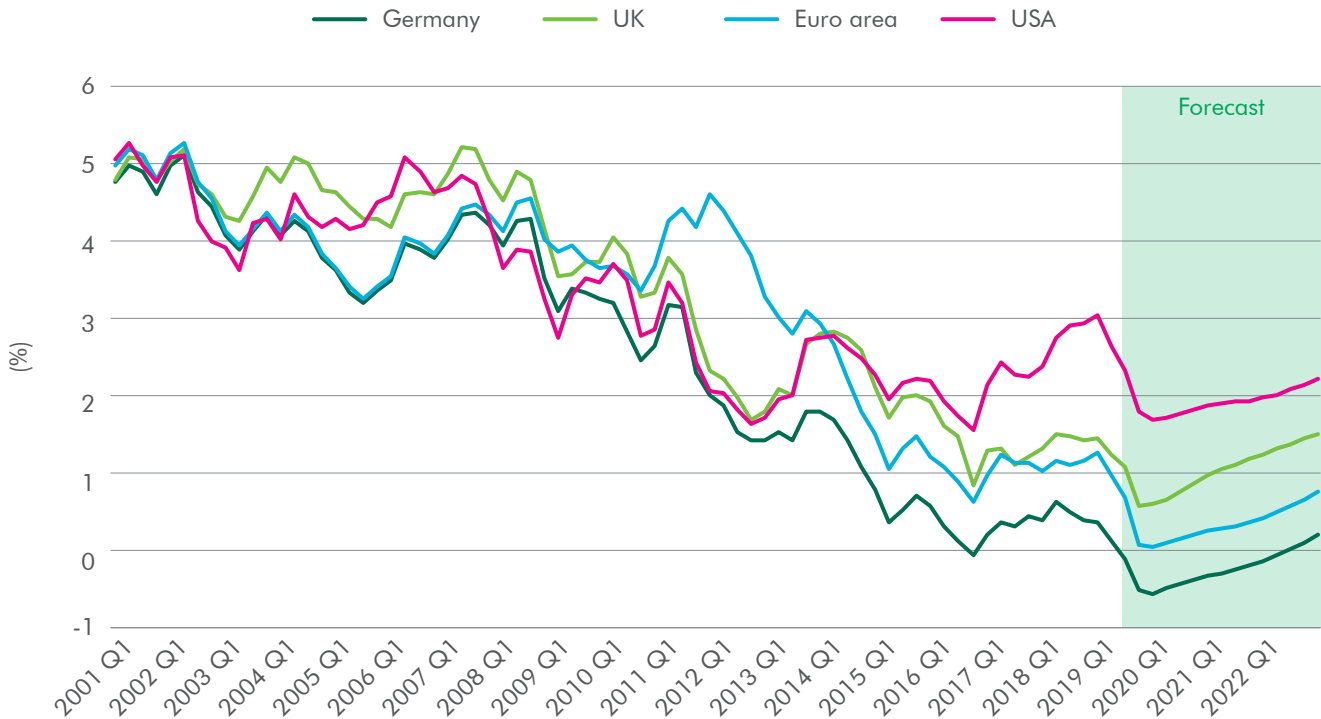
phenomenon, and not a structural adjustment back to pre-Global Financial Crisis (GFC) levels. Long-term interest rates are still expected to remain at historically low levels for at least another three years, and particularly through 2020.

**POLITICS IN EUROPE: BREXIT AND ITALY**

Political risks in Europe will continue to centre mainly on country-specific issues in the UK and Italy, and the continued geopolitical tensions among the US, China and the EU.

Business confidence and investment, particularly in the UK, have been eroded by the Brexit process. With the withdrawal stage of Brexit negotiations expected to complete soon, the UK will move into the ‘implementation period’ during which the UK and EU will enter discussions on their long-term future relationship. This is unlikely to be straightforward and may end up being extended beyond the one year currently provided for. In any event the UK will not have as good access to EU markets as it has now.

**FIGURE 1: 10 YEAR GOVERNMENT BOND YIELD BENCHMARKS**



Source: CBRE Research, Macrobond, 2019

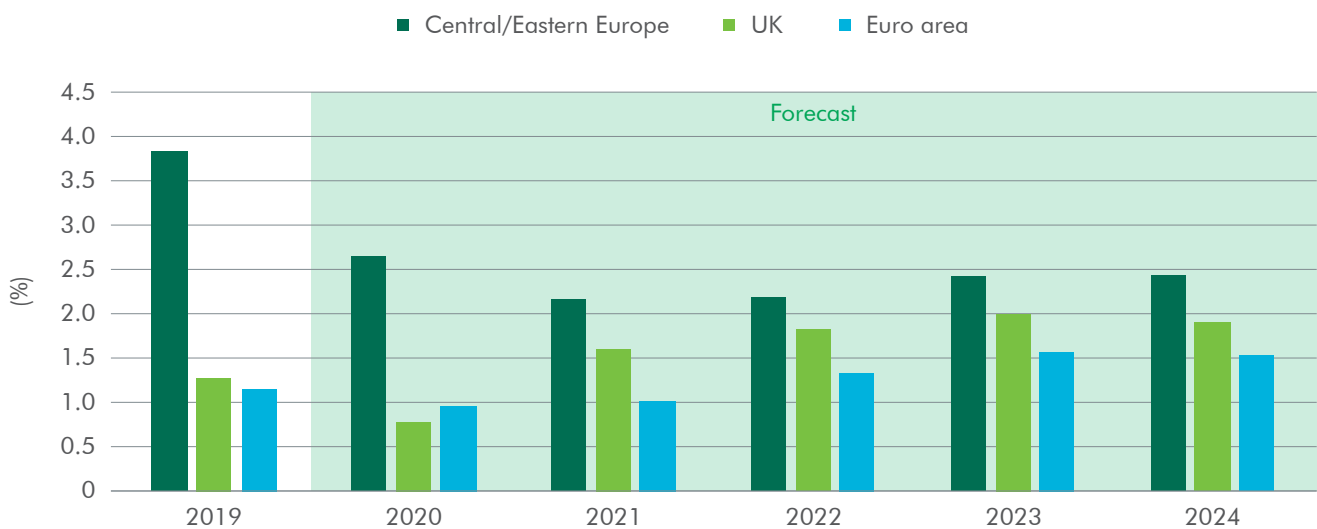


In Italy, the new Government has put forward modest fiscal projections that have calmed markets and brought the spread on Italian debt down to much more reasonable levels.

The appointment of Christine Lagarde as President of the European Commission, replacing Mario Draghi, will see a

continuation of the disagreement between the Bundesbank and the ECB on the need for coordinated fiscal policy to maintain demand in the eurozone. Any further escalation of trade protectionism is likely to weigh heavily on the industrial sectors of Europe, and is a key downside risk to the outlook.

**FIGURE 2: GDP GROWTH**



Source: CBRE Research, Oxford Economics, 2019

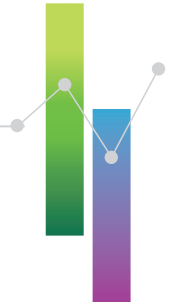
## KEY INFLUENCES

- Weak global trading conditions continue to weigh on European growth.
- Two-speed European economy continuing in 2020, with weak manufacturing but stronger services sector and resilient consumer demand.
- Central Europe out-pacing western Europe.
- Modest but increasing emphasis on fiscal policy to drive growth.
- Long-term interest rates to remain low for at least another three years.
- Geopolitical risks remain the key downside to the outlook.

# CAPITAL MARKETS







**The accommodative policies of central banks are reinforcing our expectation of lower interest rates for longer. Prime yields are nearing their floors, although we still expect some compression for the very best assets to continue into 2020. Investors are increasingly favouring real estate in multi-asset portfolio allocations, so we expect 2020 volumes at least around the 2019 level in continental Europe, with a possible rebound in the UK.**

## **CENTRAL BANKS NO LONGER LEANING AGAINST THE WIND. 'LOWER FOR LONGER' NOW THE CONSENSUS**

2019 was marked by a U-turn in the policy position of central banks, prominently the Fed and the ECB. Up to that point, they had conducted a tighter monetary policy approach against the background of a more healthy macroeconomic environment, but have again reverted to a more accommodative approach. For the ECB this includes the resumption of Quantitative Easing (QE), while the Fed has lowered key rates.

While this shift does reflect some weakening in economic indicators, the change of stance also reflects increased aversion to crises by central banks since the GFC.

Given current Fed and ECB attitudes, we expect the accommodative policies of central banks to continue. While their real and long-term impact on the economy can be questioned – Mario Draghi has stated that governments with fiscal space should act to support economic activity – it is clearly reinforcing our scenario of lower interest rates for longer.

Ten-year government bond yields in several countries, including Germany, France, The Netherlands and Denmark have all turned negative in recent months.

## **HOW GOOD IS IT FOR REAL ESTATE?**

The 'lower for longer' scenario is a favourable one as it supports a comfortable real estate premium over government bonds. Having said that, we see two concerning side effects for real estate:

- Lower yields mean investors must reduce their return

requirements, starting with value-add strategies, and/or consider higher risks

- Yields are converging, narrowing risk premia within property as an asset class

Bond yields may have gone negative in parts of Europe but prime property yields appear to be nearing their floors, except for our expectation of some further yield compression for the very best assets in Europe. This is likely to be accompanied by a widening spread between London and other European cities, as long as Brexit uncertainty persists. Some specific markets or asset classes (datacentres, senior/student housing etc.) should also experience yield compression as a result of investors widening their criteria beyond mainstream asset types in search of enhanced returns. In the medium term, we do not expect yields will return to the levels that preceded the GFC, as the equilibrium level of interest rates, for various reasons, is now significantly lower.

## **'FORCED' ELEMENT TO INVESTORS APPETITE FOR REAL ESTATE IN 2020**

2019 will have seen property investment levels in continental Europe slightly lower than the record year of 2018, down by a mid-single digit percentage, due to supply shortages in certain markets, including Germany. The decline, however, will be more pronounced in the UK, given the continuing uncertainty regarding the timing and impact of Brexit.

Looking forward, in the context of strong liquidity maintained by central banks, investors are increasingly favouring real estate in their multi-asset allocations, attracted by its yield compared to other asset classes and the safe haven offered in the face of monetary erosion. One study notes an increase in target allocations to real estate (to 10.6%) for a sixth straight year<sup>1</sup>.

<sup>1</sup> Source: Cornell University Baker's Program in Real Estate – Hodes Weill & Associates



So despite decelerating churn, we expect 2020 levels to come in at around the 2019 level in continental Europe, with a possible rebound in the UK, depending on the progress of Brexit negotiations. With investors faced with entry values that are already cyclically-high, the market’s attraction derives partly from property’s favourable return spread over bonds: in other words, institutional investors (insurance companies, pension funds, etc.) will continue to display an almost ‘forced appetite’ for real estate.

**BEYOND 2020: MEGA TRENDS AND STRUCTURAL SHIFTS IMPACTING REAL ESTATE INVESTMENT**

The investment outlook for 2020 contains elements of longer-term shifts in the structure of property investment activity. We are seeing a bifurcation of real estate investment comprising two main elements:

- On the one hand, a strong search for capital protection with large flows into core assets in highly liquid markets, often at a very low yield
- On the other hand, a search for growth by identifying mega-trends and structural shifts, with the aim of formulating strategies to deploy capital on these themes

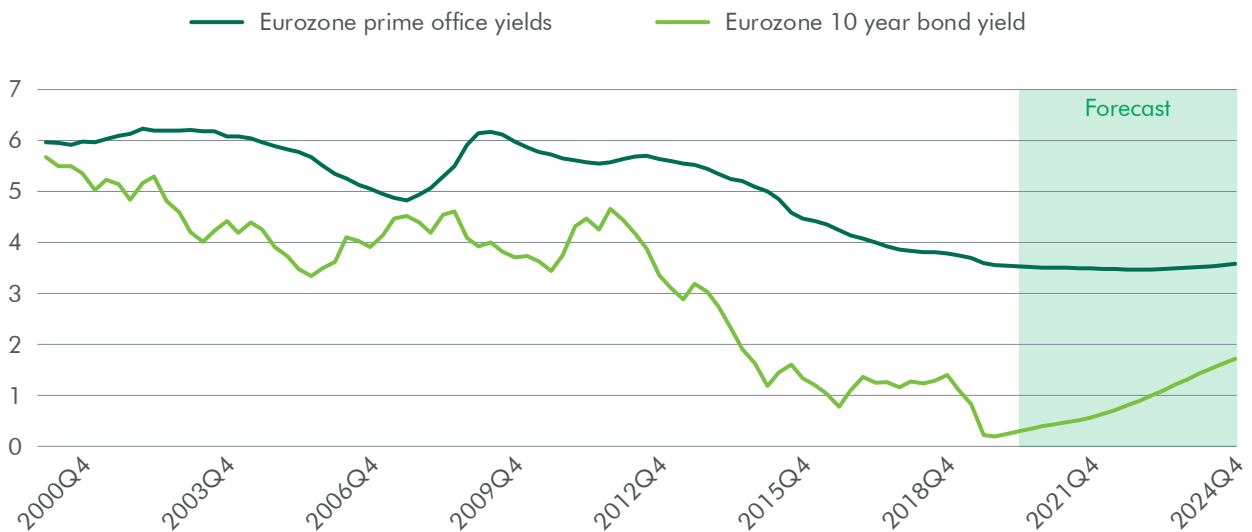
Among the mega trends that already guide real estate investment choices, ecommerce, urbanisation and the ageing population are among the best identified trends. Others include the shift from home ownership to renting or privatisation of social housing or healthcare. ‘Hotelification’ of real estate is a major structural shift in the industry, impacting income streams and investors’ business models.

In the years to come, two other secular trends will need to be embraced by investors, even though timing and impact may still be quite uncertain:

- Energy transition and sustainability: now a major societal issue and one where changes imposed by occupiers and their labour force could be imposed on real estate investors earlier than expected;
- Technological innovation, including the possible impact of artificial intelligence on labour requirements and thus the quantity and location of real estate expected in the medium term

The effects of these shifts could come to impact pricing, strength of occupier demand for specific assets, value gradients and the emergence of new types of asset, all of which investors will need to consider as part of a balanced portfolio strategy.

**FIGURE 3: PRIME OFFICE YIELDS AND 10-YEAR GOVERNMENT BOND YIELDS, EURO AREA, 2000-2024**



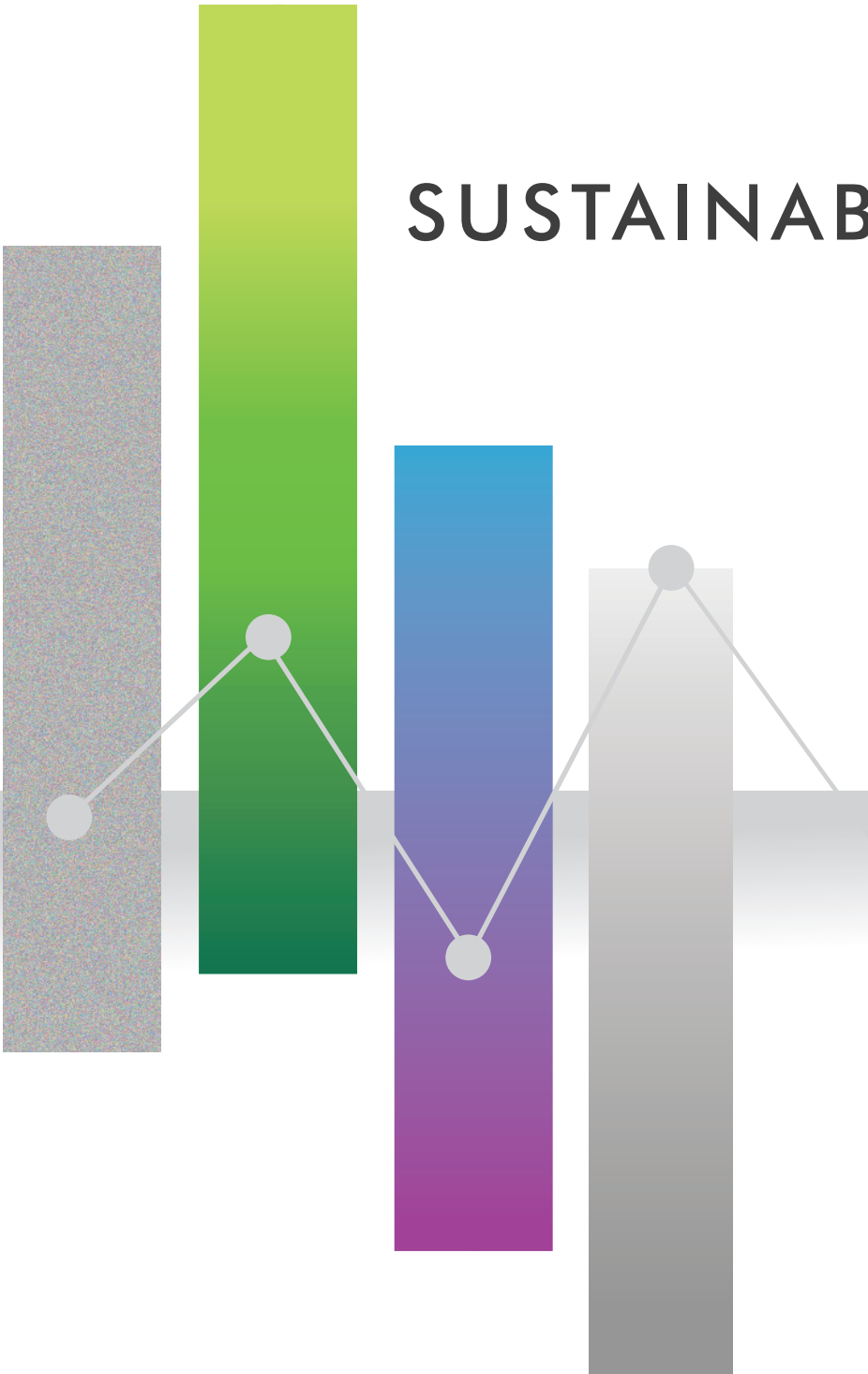
Source: CBRE Research

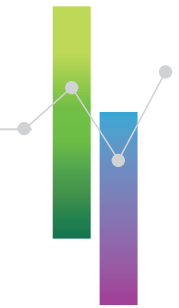


## KEY INFLUENCES

- 'Lower for longer' scenario now the consensus, but spread over bonds supporting high levels of real estate investment.
- Still some yield compression for the very best assets in Europe.
- 2020 volumes to be at least around the 2019 level in continental Europe, with a possible rebound in the UK.
- With growth in leasing activity likely to ease, investors will need to be increasingly selective, picking markets with the strongest rental growth expectations.
- Beyond 2020, investors will be increasingly influenced by mega trends and structural shifts such as 'hotelification' and technology innovation.

# SUSTAINABILITY





The construction and operation of buildings contributes to around 40% of worldwide greenhouse gas emissions. Driven by a combination of regulatory and social pressures, we expect companies to devote more attention and rigour to ESG policies that integrate organisational, portfolio and asset level objectives. Investors, developers, occupiers and advisors, as well as asset, property, and facility managers all have a role to play in this transition.

## SUSTAINABILITY AGENDA GAINING RENEWED PROMINENCE

At the Paris climate conference (COP21) in December 2015, 195 countries adopted the first ever universal, legally-binding global climate deal. The agreement sets out a global action plan aimed at avoiding dangerous climate change by limiting global warming this century to below 2°C above pre-industrial levels and pursuing efforts to limit it to 1.5°C.

The response of the real estate and construction sector to this deal has been slow and uneven, but more recently momentum has picked up. This is partly a reflection of the requirements of the agreement itself, but also a growing acknowledgment of the need to respond to the demands of their workforce, particularly younger workers. For instance, ethical business practices and environmental credentials both play a significant part in the role selection of millennial workers, and the issue has gained renewed prominence through the actions of the Extinction Rebellion movement in London and elsewhere.

For investors, occupiers, and developers, the common aims of optimising the performance of real estate, people and environment mean that sustainability forms an increasingly integral part of decision-making. Evidence of this can be seen in the fact that 93% of investors include Environmental, Social and Governance (ESG) criteria in investment decisions<sup>1</sup>, and that 72% of occupiers express some degree of preference for WELL-certified buildings<sup>2</sup>.

The precise consequences of this heightened focus will vary as businesses plan their strategies for 2020 and beyond, but we expect to see a growing occupier preference for sustainable buildings, and rising incidence of impact investing.

<sup>1</sup> Source: Global ESG Real Estate Investment Survey Results, March 2019

<sup>2</sup> Source: CBRE, EMEA Occupier Survey Report 2017

<sup>3</sup> Source: UN Environment: Global Status Report 2017 – Towards a zero-emission, efficient, and resilient buildings and construction sector

## WHY THE REAL ESTATE SECTOR NEEDS TO DECARBONIZE

The construction and operation of buildings contributes to 39%<sup>3</sup> of worldwide greenhouse gas emissions: 28% from operational emissions and the remaining 11% emitted during the manufacture, transport and construction of building materials, together with end of life emissions. Embodied carbon has typically been overlooked in the past, but as operational carbon emissions are reduced, embodied carbon will grow in importance as a proportion of total emissions.

## A HIERARCHICAL APPROACH

Investors and occupiers alike are increasingly keen to improve the ESG credentials of their organisations. We see this operating at various levels and increasingly expect a hierarchical approach to be adopted for tackling the issue. Three interlinked levels can be identified:

- **Organisational-level** – The number of organisations that have ESG-related policies incorporated in their corporate strategy has been steadily increasing. These typically include short and long-term targets around reduction in energy, water and CO<sub>2</sub>, as well as targeted improvements in health & wellbeing and biodiversity. Many of these strategies are enshrined in existing frameworks, most importantly the UN Sustainable Development Goals and Science Based Targets – a method to assess whether carbon reduction targets are aligned with the Paris Climate Agreement – and reporting methods such as GRI or GRESB.
- **Fund/portfolio level** – Organisation-level policies are typically translated into fund level initiatives to manage ESG compliance through the adaptation of a portfolio level action



# SUSTAINABILITY

plan over a period of 3-5 years. Portfolio owners recognise that they are not always in full control of the fulfilment of their targets, but depend on the attitudes and behaviours of their occupiers, investors and other stakeholders. To accommodate this disparity, we expect a growing focus on stakeholder engagement and reporting transparency. Benchmarking with peers and disclosure of performance, for instance via GRESB, has seen a steep increase in recent years.

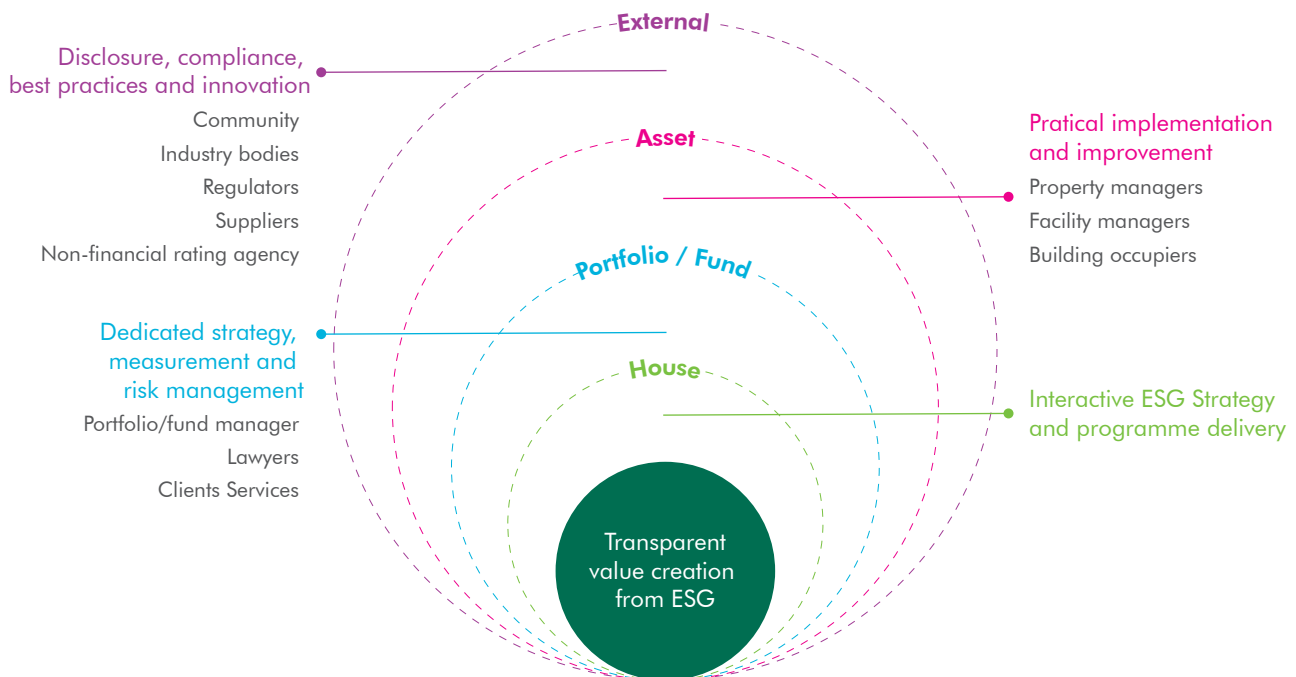
- **Asset level** – Where the strategic approach to ESG is set and anchored at the organisational and fund level, these policies are made concrete at the asset level. Strategies that are site-specific can be incorporated in predictive maintenance plans and aligned with expected natural moments in the occupiers’ lease structure. Asset-level action plans can be very wide-ranging, including upgrades to building installations or envelope, smart meters and monitoring systems to drive operational reductions, targets to improve EPC ratings or Green Building certification scores; or alterations to hard and soft services, such as waste recycling, green cleaning programs or healthy catering concepts.

## GROWING LEVEL OF CO-ORDINATION AMONG STAKEHOLDERS

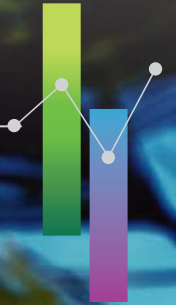
As well as operating at a variety of levels, coherent policy approaches to ESG, carbon reduction or enhanced wellbeing conditions will also require increased co-ordination among the various parties involved in delivering, owning, managing and occupying buildings.

ESG strategy could be built according to this three-tier architecture and should be simple, accessible and understandable for each stakeholder (see figure 4 below). This level of coherence will require a collective understanding of the aims and constraints of each of the parties involved, and the trade-offs that may be needed in order to move towards a co-ordinated approach. In short investors, developers, occupiers, advisors, as well as asset, property, and facility managers all have a role to play to improve ESG performance of an organisation.

FIGURE 4: OVERVIEW OF KEY STAKEHOLDERS FOR ESG STRATEGY



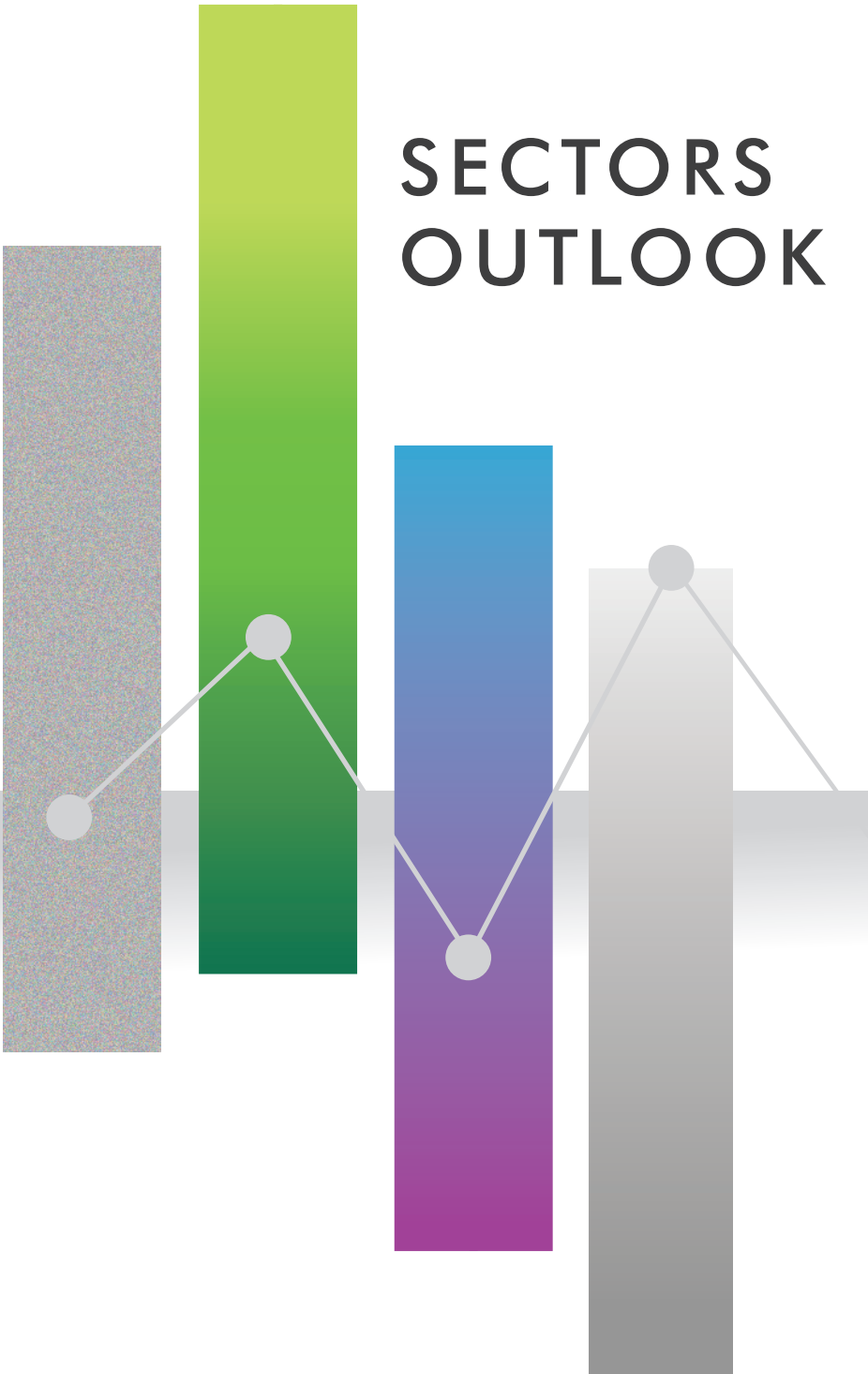
Source: CBRE Research



## KEY INFLUENCES

- Growing rigour in the formulation and execution of occupiers' and investors' sustainability policies.
- While there is evidence of both investors and occupiers including sustainability factors in their building-selection decisions, adoption has so far been uneven.
- With the existing focus on reducing emissions from existing operational buildings, attention will start to shift towards emissions associated with the construction process.
- We see the industry starting to adopt a hierarchical approach to ESG strategy spanning three linked elements: organisational, fund-level and individual-level.

# SECTORS OUTLOOK







## 18 OFFICES

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Office-based employment growth will slow in 2020, with leasing activity starting to turn down and a more balanced, less tech-dependent demand profile emerging. Supply conditions will begin to loosen, with vacancy levels likely to plateau or rise as new development completions accelerate. City-level variations in these trends will, if anything, widen. Look for occupiers to take a more activist approach to their portfolios, with a growing focus on retain-reposition-dispose decisions.

## 21 RETAIL AND LOGISTICS

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The retail and logistics sectors will continue to be supported by slowing but steady economic growth. Retail sector performance will be country-specific, reflecting the current level and speed of growth of internet sales in each market. The logistics sector will continue to benefit from demand from expanding online retailers.

## 24 MULTIFAMILY

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The rise in the scale of capital deploying into Europe's multifamily sector in the last few years has been substantial and is set to increase in 2020 and beyond. This reflects urbanisation and demographic trends, with up to two thirds of the global population expected to live in cities by 2050 according to the UN. Currently uneven, the sector is evolving rapidly, and those looking to deploy need to take their cue from markets where the sector is already more mature.

## 27 HOTELS

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Europe is outperforming other global regions in terms of hotel operating performance. Strong trading is encouraging more development activity, but the key European cities look well positioned to absorb this new supply. Institutional investors will increase their hotel exposure, acquiring freeholds and other variable income structures, and partner with sector-specialist operating partners.

## 29 OPERATIONAL REAL ESTATE

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Operational real estate will remain a key focus for major institutional investors. Shortage of net-leased stock in regulated sectors will drive cross-border and sector diversification, and in turn harmonisation of pricing and structuring. Technological and cultural change are enabling investors to engage in operations directly, with substantial implications for the market.

## 31 DATA CENTRES

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Fuelled by growth in the capacity needs of cloud service providers, the European data centre market will continue to grow in 2020. The increased scale of individual end-user deployments will be a key theme in the year ahead and will need to overcome the significant constraints around land and power availability that exist in some of the most popular data centre hubs. Expect further land price inflation, and some displacement, as a result.

## OFFICES

### SLOWER OFFICE-BASED EMPLOYMENT GROWTH CONSTRAINS TAKE-UP

All the major western European economies experienced a slowdown in economic growth in 2018 and 2019, and all are expected to post still lower levels of growth in 2020. Central European economies, which had been stronger, are now also experiencing a slowdown. In line with this view, office-based employment in the major cities, a key driver of user demand for office space, will also see slower growth: we expect an increase of around 1.2% compared with an estimated 1.6% in 2019 and an average of 1.7% per year in the previous three years.

This is already beginning to affect leasing activity. Through three quarters of 2019, office take-up across the main European markets was 2.1% ahead of the same period in 2018, but the rolling 12-month comparison is -1.4%. We expect aggregate take-up for the calendar year 2019 to be down around 1%, with a slightly larger decline of perhaps 2.5% in 2020, with supply shortages in some markets also contributing to this outcome.

Behind this overall picture, expect significant variations in the outlook for individual sectors and cities. For much of the recovery period since 2014 leasing markets have relied heavily on the technology sector as a source of demand. Recent data indicates a shift towards a more balanced demand profile. So far in 2019 technology's share of take-up in the largest markets is down slightly relative to 2018, with financial and business services rising. Sector level employment forecasts suggest that this rebalancing will persist through 2020, and asset leasing strategies will need to take account of this shift.

Geographic variations are also marked, but do not always fall into simple regional groupings. So far in 2019, Central and Eastern Europe (CEE) markets as a group have posted stronger take-up numbers; moving into 2020 this will become more nuanced with Prague, Warsaw and Budapest looking stronger than Moscow and Bucharest. The late-cycle recovery that has boosted take-up levels in Spain and Italy in 2019 seems set to abate. Germany looks likely to be a mixed bag next year, with Frankfurt leading. Paris and Amsterdam look set for moderately strong demand growth next year.

### SUPPLY SIDE TURNING AS DEVELOPMENT PICKS UP

As well as reflecting national economic cycles, city-level variations in leasing prospects are also a function of supply shortages. Occupier choice in some markets is highly constrained by low levels of availability, particularly for large, modern centrally-located buildings. Vacancy has continued to decline across virtually all major European office markets through 2019, and looks likely to end the year at least 0.5 percentage points lower on aggregate. 2020 will be different with the supply side of the market starting to turn and, on our expectations, vacancy levels flat to slightly up over the course of the year, albeit remaining levels under 6% in a number of the larger markets.

Alongside weaker demand pressures, this is also partly a product of higher development levels – new completions in 2020 will be some way higher than in either of the past two years, with a similar amount scheduled for 2021. While nearly half of this is already pre-let by occupiers faced with limited built-space alternatives, it is still sufficient to mark a turning point in the supply side.

Again, there is quite a wide spectrum of outcomes – higher availability in London, Paris, Dublin and most of CEE contrasting with continued tightening in Spain, Italy and the Netherlands.

On balance this is, good news for occupiers as locational choice starts to expand. Owners will need to start to assess supply conditions and income growth prospects more closely. In this environment we expect growth in prime rents across the region to slow from around 4.0% in 2019 to nearer 2.0% in 2020. In real terms, rental growth remains strongly positive in some cities through 2020 (Berlin, Amsterdam, Barcelona and Brussels), while turning negative in the UK and much of CEE.

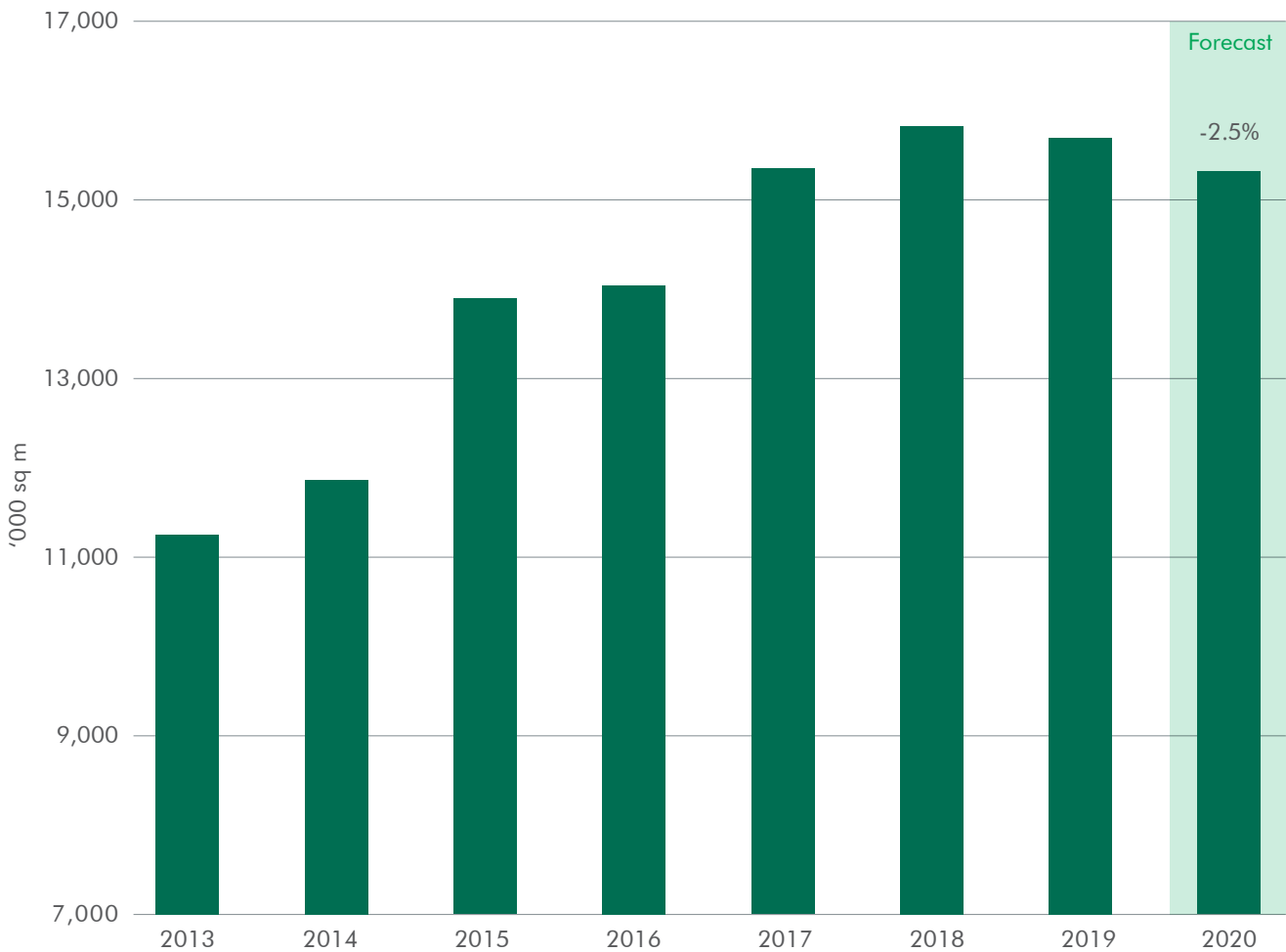


**INCREASING OCCUPIER RIGOUR**

As well as change arising from the cycle, we also expect occupiers to take a far more activist approach from towards their real estate portfolios in 2020 and beyond. This reflects the convergence of several trends and trade-offs around space utilisation, talent attraction and management, user experience, digital and technology strategies and portfolio agility and flexibility. Look out for some of the following in 2020:

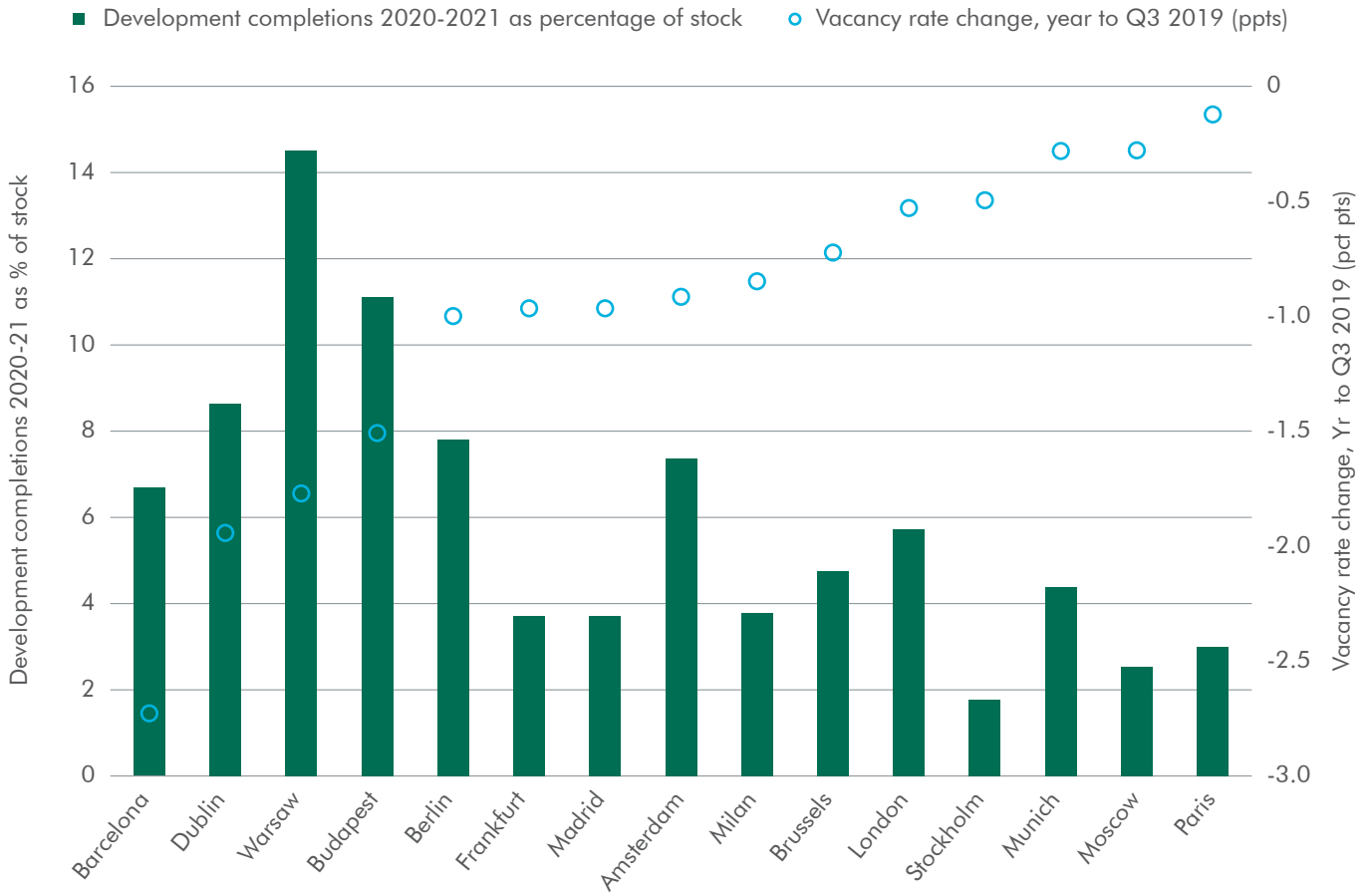
- Attempts by occupiers to dispose of non-core property commitments and consolidate portfolios into fewer high-quality assets
- Greater use of flexible space for strategic reasons, rather than temporary or reactive ones
- Focus on the utilisation and efficiency characteristics of all buildings in a portfolio, with more rigorous focus on retain-reposition-dispose decisions
- Greater focus on the recentralisation-decentralisation tension as occupiers assess the trade-offs between skills, amenity, accessibility and cost across different corporate functions

**FIGURE 5: OFFICE TAKE-UP, SUM OF MAJOR CITIES, 2014–2020**



Source: CBRE Research

FIGURE 6: VACANCY AND DEVELOPMENT SUMMARY, MAJOR CITIES



Source: CBRE Research

### KEY INFLUENCES

- Occupier choice starting to expand as market begins to turn.
- Slower growth in office-based employment will check growth in leasing activity in 2020.
- Market demand becoming more balanced, with reduced tech sector dominance.
- Currently tight supply conditions will ease as new development additions rise above the levels seen over the past two years. Rental costs expected to rise more slowly.
- With space choice expanding, occupiers respond to trend convergence around skills, digital strategy and user experience by taking a more activist approach to their portfolios.



## RETAIL AND LOGISTICS

### PERFORMANCE DRIVERS: ECONOMIC FUNDAMENTALS AND ECOMMERCE GROWTH

In 2020, the performance of both the retail and logistics sectors will be driven by economic fundamentals and the growth of ecommerce across Europe. In northern and western Europe, cultural factors such as high credit card usage and a digitally-literate consumer base will foster further internet spend. So the UK will remain Europe's most mature online market through 2020, followed by the Netherlands. In most southern and central European countries, internet sales will remain at low levels during 2020, but they are catching up.

### EUROPEAN RETAIL OUTLOOK: CONTINENTAL EUROPE MORE POSITIVE

Retail will remain a thoroughly examined and heavily discussed sector in the coming year. Negative retail news, mainly from the UK, will make headlines. UK retail will continue to weather a 'perfect storm' driven by a combination of structural (ecommerce), cyclical (GDP growth slowdown) and temporary factors (Brexit, the 2017 business rates revaluation).

The outlook for continental Europe is not as negative. This is driven by lower levels of online shopping, stronger expectations of economic growth in certain countries, absence or lower levels of property taxes, and different lease structures. With rents in some markets linked to turnover, continental European landlords have better visibility on how retail businesses are performing. Annual CPI-indexed rents, provide landlords with an increasing source of income which is also linked to the performance of the economy. So, while prime high street rental values in most cities will either decline or see subdued growth over the year, we expect to see pockets of higher rental value growth in selected markets. These include cities such as Rome, Madrid, Warsaw, Budapest and Stockholm, driven by tourism, lower levels of internet sales, and/or positive GDP growth expectations.

For shopping centres, prime rental growth prospects are muted in most cities with some exceptions including Paris, Rome, Warsaw and Copenhagen. These cities will experience growth because of

tourism, lower levels of online shopping and/or more favourable prospects for economic growth. The Netherlands will see the biggest decline in rental values due to higher levels of ecommerce penetration and subdued economic growth.

Retail investment in continental Europe is declining, and in the third quarter of 2019, it moved below the 10-year average. Negative sentiment from the UK, and the underlying level of uncertainty in the sector, are reducing the number of buyers in the market, mainly in France and Germany. Investors will be more selective in their choice of asset, preferring those that have an experiential, leisure or convenience element to them. Retail yields are expected to either stay flat, or rise slightly, in most European cities.

### EUROPEAN LOGISTICS OUTLOOK: INTERNET RETAILING AND LABOUR AVAILABILITY KEY AREAS TO WATCH

European logistics will benefit from steady, but slowing, economic growth across the continent and the structural shift towards internet retailing.

Occupier demand will remain strong during 2020 as ecommerce penetration continues to increase in all European countries. The supply side has been responsive to this trend, although speculative developments are significantly lower than 2009 levels and the average vacancy rate remains below 5%.

In 2020, rental value growth will be highest in supply constrained locations such as London, Dublin and Barcelona.

We expect to see more moderate growth in German and Dutch markets due to lower economic growth expectations and weaker manufacturing output. Supply in the Netherlands is currently limited, but land availability and planning regulations are favourable for development.

A key factor driving location preferences among occupiers is the availability of labour to fill vacancies in distribution centres. Even with the increasing implementation of robotics, we are still a long way from seeing warehouses without a human presence. Low unemployment rates across Europe have increased the importance of this factor. As a result, new and secondary locations, such as the north-east of England and the south of Italy,

## SECTORS: RETAIL AND LOGISTICS



are becoming more attractive for developers and occupiers, especially in the ecommerce sector.

We expect greater collaboration between city authorities and logistics operators to tackle urban logistics and the last leg of supply chains. Cooperative hubs for environmentally-friendly delivery vehicles will be encouraged by local authorities.

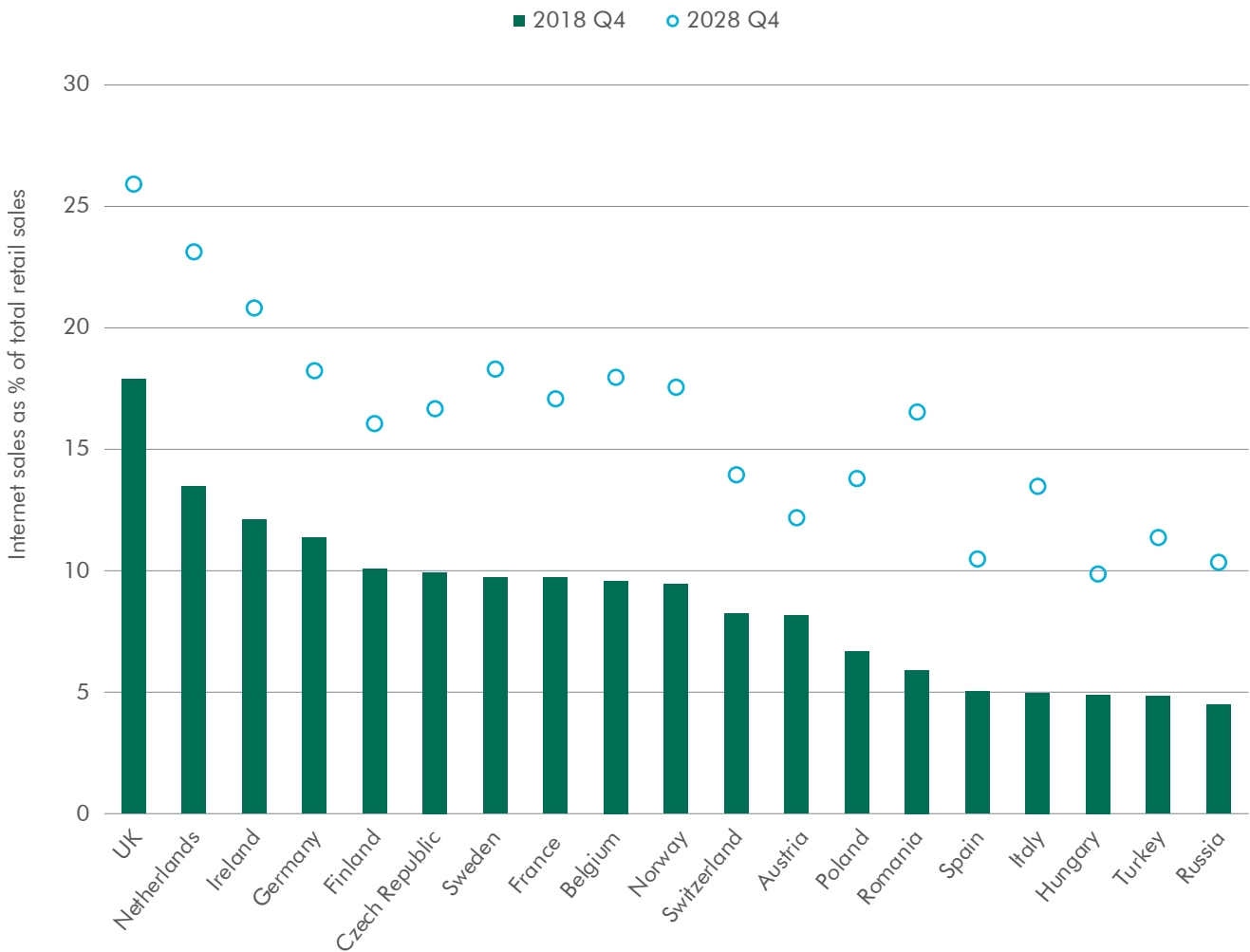
Challenges regarding cold storage space will emerge across Europe, as demand confronts old stock not fit to support the expansion of online groceries.

Investment in European logistics has been strong during the last seven years. We expect this positive sentiment to continue in

2020, as investors will continue to be attracted by the sector's yield premium versus other traditional property sectors and government bonds. According to CBRE's 2019 Global Investor Intentions Survey, investors continue to favour industrial and logistics over other commercial property sectors.

We expect logistics yields to stay broadly flat in most major European markets but with continuing downward pressure in some, including Dublin and the main German markets. Instances of yield increase are expected to be scarce and small, limited to markets such as Prague and Bucharest.

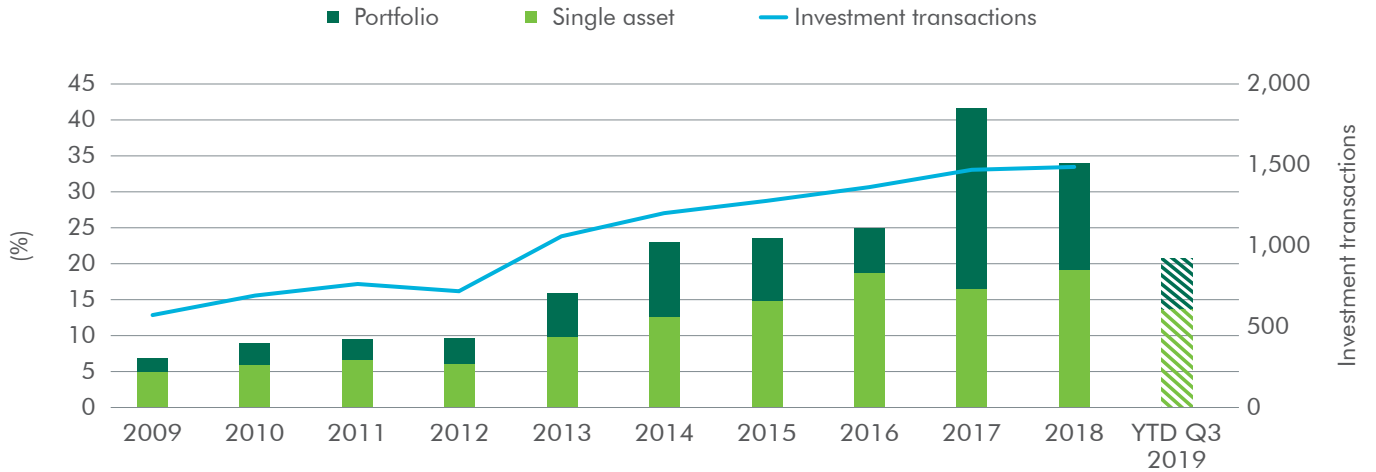
**FIGURE 7: CURRENT ECOMMERCE PENETRATION (2018) AND 2028 FORECAST**



Source: CBRE Research



FIGURE 8: EUROPEAN LOGISTICS INVESTMENT VOLUMES (LH) AND NUMBER OF INVESTMENT TRANSACTIONS (RH)



Source: CBRE Research

### KEY INFLUENCES

- The growth of ecommerce, combined with economic fundamentals, will be the major driver of performance for the retail and logistics sectors.
- Retail will be a heavily-discussed sector in the coming year with some negative retail news, mainly from the UK, making headlines.
- The retail outlook for continental Europe is not as negative due to lower levels of online shopping, stronger expectations of economic growth, lower levels of property taxes, and different lease structures.
- Innovative retail schemes, close to transport hubs, that introduce experiential, convenience and mixed-use elements will appeal to both consumers and investors.
- Redevelopment and repositioning of excess retail space to create new and innovative mixed-use schemes will become a key trend.
- Availability of labour will continue to drive general location preferences among logistics occupiers.
- Micro-depots and shared urban hubs to tackle the lack of logistics land in urban locations.
- Logistics innovations will continue to flourish in order to increase efficiencies and meet final consumer convenience.

### MULTIFAMILY

#### POSITIVE MOMENTUM FOR THE SECTOR TO CONTINUE EVOLVING

The multifamily sector continued to gather pace throughout Europe over the past year and is set to continue to evolve and increase in popularity in 2020. This momentum is being driven by two related factors:

- A fundamental shift in the number of people opting to rent rather than buy residential accommodation in many countries. One fifth of households in Europe already currently rent and the proportions are higher in cities and certain countries, such as Germany where renting accounts for more than 50% of total occupation
- A growing pool of both domestic and international institutional capital looking to deploy into this sector with investment in this sector in Europe expected to exceed €64bn by 2021, an increase of over 18% on the 2018 level

What was deemed alternative only a few years ago is now increasingly considered mainstream, with many investors attracted by the favourable return profile from a sector that is generally less susceptible to cyclical movements over the medium to long term – a trait that is particularly attractive at this late point in the property cycle. Over the past decade, multifamily has outperformed the retail and office sectors in a number of European markets including Germany, Norway, Netherlands, Sweden and the UK. In Germany for instance, residential returns have averaged 7.4% per year over the past decade, compared with 5.9% for retail and 3.8% for offices (MSCI).

We expect to see this momentum continuing in 2020 with a considerable weight of capital and many new entrants looking for opportunities to deploy at scale into the multifamily sector across Europe. The capital base is becoming increasingly diverse with US private equity investors bidding alongside REIT-type vehicles from Canada as well as European institutional investors and fund managers. Investors are targeting both mature markets where residential investment has been established for some time, including the Nordics and Germany; and also emergent markets such as Spain, the UK and Ireland where new purpose-built stock is now starting to emerge with a strong emphasis on design, amenity and customer experience.

#### EXPANDING RANGE OF INVESTMENT STRUCTURES AND TARGET LOCATIONS

With limited standing stock available in many European markets, structures such as forward-funding and forward-commits will become increasingly popular as investors get involved at an earlier stage of the development process in order to secure opportunities in their core target cities.

We also expect that in 2020 many investors will start to expand into regional cities, in search of diversification opportunities and potentially more attractive returns, rather than focussing solely on core capital cities.

As the year progresses, we expect to see increased focus on design and amenity as multifamily developers increasingly incorporate best practice from successful schemes in other jurisdictions. Equally, from an operational perspective, we expect to see greater efficiencies coming to the fore as developers and operators alike build up expertise in this sector and as technological solutions continue to evolve.

#### REGULATION FOREMOST AMONG THE INVESTMENT CHALLENGES

While investors will be encouraged by the volume of end-user appetite for high-quality rental offering, a number of challenges threaten deliverability in some markets. These include:

- The availability of land
- Planning issues
- Rising build cost inflation

However, the single biggest concern among investors around the region is regulation in the form of measures such as rent controls that some governments have implemented or potentially will implement, in an effort to address affordability concerns. Investors are clearly concerned about this in cities including Berlin, Barcelona, Amsterdam and London as, depending on the severity of the measures, this can have significant implications from a pricing and return perspective. This issue will become increasingly topical during 2020.





**POLICY NEEDS TO EMBRACE NEW LIVING FORMATS**

The multifamily sector can make a significant contribution to housing delivery in many markets across Europe and should be part of an overall housing policy solution, particularly considering that a large cohort of the millennial generation are transient and, in any event, either have little aspiration towards home ownership or are unable to afford it.

However, the sector still suffers from inadequate policy frameworks, and so needs promotion and explanation by sponsors. This will continue to be the case as the sector evolves to include new forms of living such as co-living, micro-living, serviced

apartments and later living and becomes increasingly topical in the context of mixed-use development, urbanisation and placemaking.

Another issue that is likely to become increasingly topical in 2020 is sustainability as occupiers and investors alike increasingly focus attention on environmental and sustainable attributes. As it applies to this sector, in an effort to speed up the delivery of multifamily stock, we are likely to see increased focus on modular construction over the course of the next year.

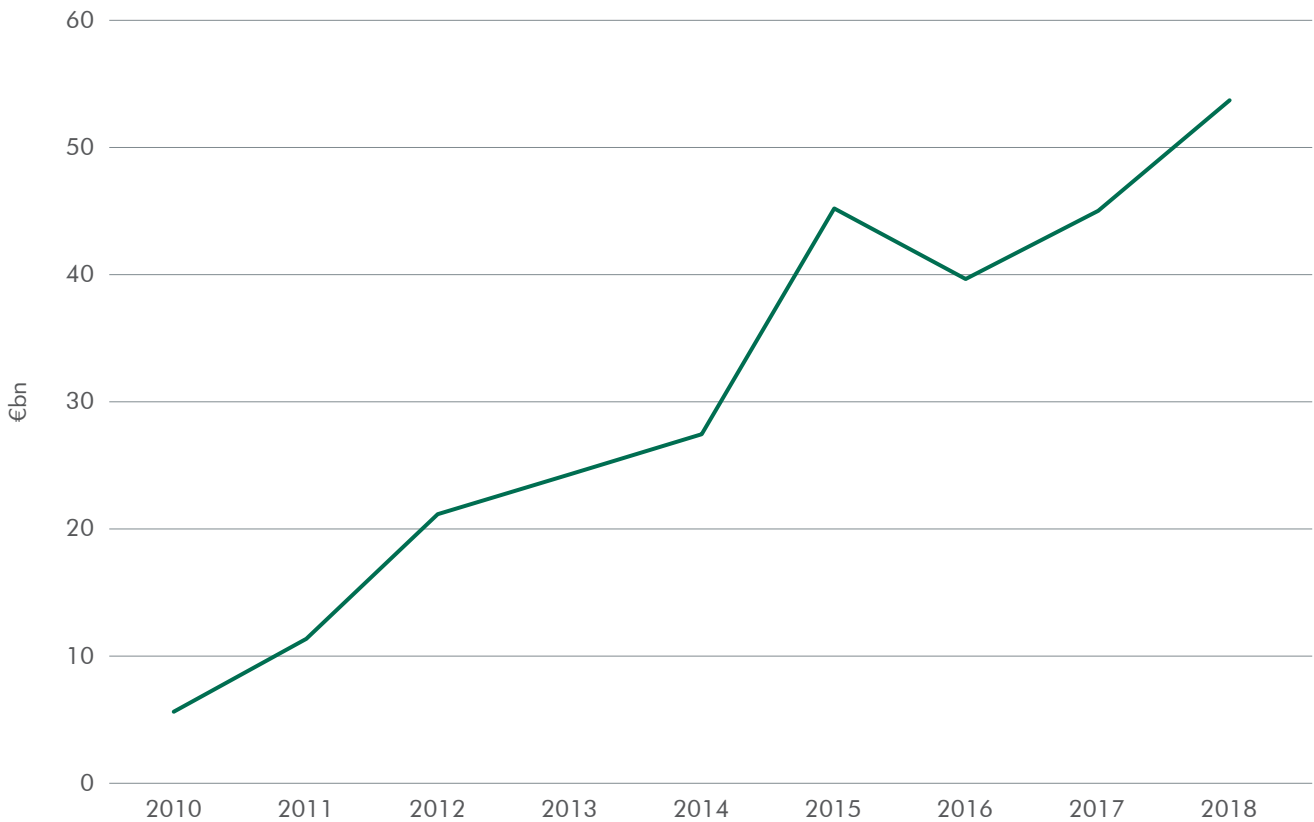
Overall, we remain positive about the prospects for growth and continued investment in the evolving multifamily sector in 2020.

**FIGURE 9: DOMESTIC AND CROSS BORDER INVESTMENT INTO MULTIFAMILY IN EUROPE**



Source: CBRE Research

FIGURE 10: INCREASE IN MULTIFAMILY INVESTMENT IN EUROPE 2010-2018



Source: CBRE Research

### KEY INFLUENCES

- Positive prospects for growth and continued investment in the rapidly evolving multifamily sector in 2020.
- A sector that offers comparatively attractive returns and is becoming increasingly mainstream through its growing appeal to domestic and international institutional investors across EMEA.
- Quality of design, amenities and fit-out are increasingly critical with the 'end user experience' becoming paramount.
- We expect to see new forward-commit and forward-funding structures coming to the fore in 2020 as investors look to deploy in markets where there is limited standing stock available.
- The impact of regulation will continue to be a primary concern for investors.



## HOTELS

### A STRONG STARTING POSITION

The European hotels sector begins the year from a position of strength. Europe significantly outperformed the other key global regions in 2019 in terms of hotel operating performance, according to data from STR.

In the year to October 2019, European occupancy averaged 73.3%, with Northern Europe exceeding this at 76.2%. In comparison, North America recorded an occupancy of 67.6% and Asia Pacific 69.2%. Allowing for seasonal constraints it is apparent that Europe, in general, has a hotel capacity issue.

This is enabling hoteliers to increase the price of hotel rooms. For instance, in the year to October average daily rate (ADR) increased in Southern Europe by 6.1%. This may not be ideal for the guest, but is clearly positive for the property owner particularly in a sector that can reward with nightly rent reviews.

And demand growth is expected to persist. Based on Tourism Economics forecast data, the weighted increase for nights in paid accommodation across European capital and gateway cities in 2020 will be 2.0%.

### SUPPLY RESPONDING BUT NOT EXCESSIVE

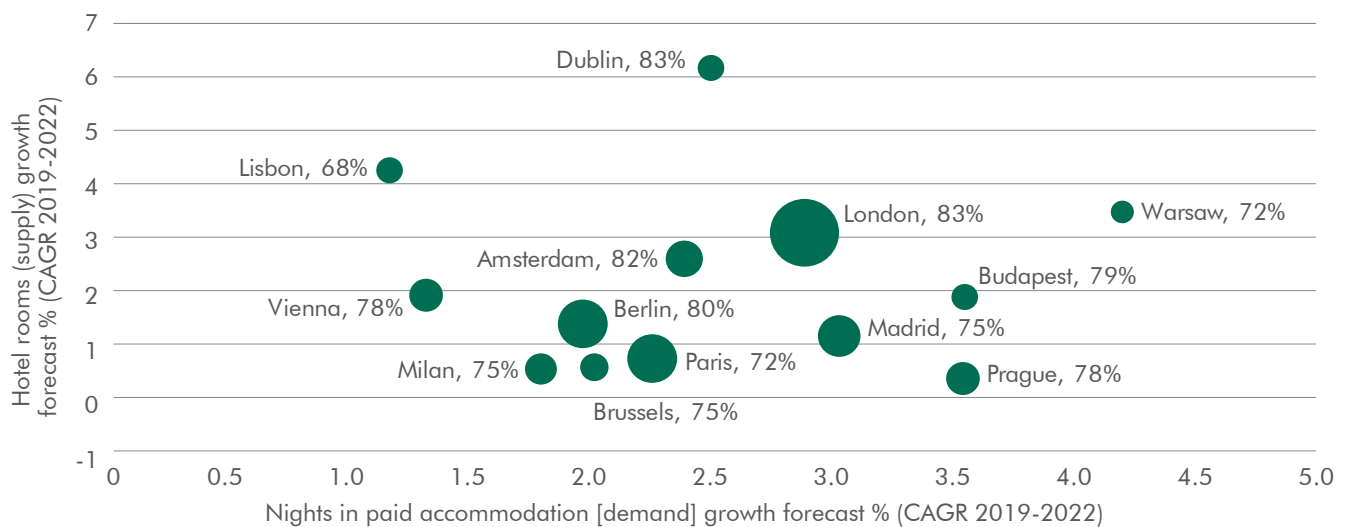
Alongside healthy demand, some cities have also seen considerable supply growth. Development activity has generally been spurred by a sustained improvement in income returns and capital growth in recent years, despite rising build costs. Figure 11 below shows that supply growth is forecast to edge demand growth in a small number of key European cities, notably Dublin and Lisbon, over the next three years.

However, the average levels of occupancy observed over the last 12-months, along with expectations of future demand growth, suggest that most markets are well positioned to effectively absorb new rooms supply without too much difficulty. In markets such as Prague, Budapest and Madrid, limited future supply growth and the anticipated increase in demand for overnight accommodation should create a strong climate for further revenue growth in 2020 and beyond.

### BRANDED CONCEPTS DOMINATE SUPPLY PIPELINE

Of the 1,081 hotels (121,079 bedrooms) earmarked for a 2020 opening in Europe, 67.4% are so-far affiliated with a brand. MOXY by Marriott, Hampton by Hilton, Holiday Inn Express by

**FIGURE 11: FORECAST ACCOMMODATION DEMAND AND HOTEL SUPPLY GROWTH, KEY EUROPEAN CITIES**



Source: CBRE, HotStats, Tourism Economics

Note: Size of bubble represents size of market by number of rooms as of September 2019

Percentages on chart indicate market average occupancy for 12-months to September 2019

InterContinental Hotel Group and ibis by AccorHotels are proving particularly popular with developers.

These limited-service concepts, recognised for their high share of revenue generated through bedroom sales, have established a track record of achieving strong market penetration in a short period of time. They typically have a lean operation, strong profit margin and lower development costs than their full-service counterparts. Most four and five-star projects are limited to gateway cities, outside of which full-service hotel replacement costs often exceed existing asset values. This disparity will continue to be a driver of investor demand for other hotel property types, for example, resorts.

### INVESTORS MANAGING RISK THROUGH ALLIANCES WITH OPERATING PARTNERS

New stock will increase the acquisition opportunities for the growing number of institutional investors considering operational hotel investments. Having invested principally in leased hotel stock in recent years – and therefore not fully benefiting from the improvement in hotel performance – many funds are actively looking to increase their investments in variable hotel income, principally across European cities but also in resort locations. Whilst some institutions have invested indirectly or through debt, and will continue to do so, many are building relationships with operating partners to effectively manage direct investment risk and

overcome fund-related challenges including the employment of staff. Schroders acquisition of European hotel management firm Algonquin is an example of ‘bricks and brain’ coming together. We expect this trend to continue.

Hotel income and capital values are not immune from market events such as recessions or inflation. However, the availability of granular, real time benchmarking data allows owners and operators to identify opportunities and risks at an early stage and act upon them with immediate effect. As operators focus more on the optimisation of real estate to forge alliances with capital sources, expect per square meter to replace the traditional per room measures of reporting and analysis.

### INSTITUTIONAL CAPITAL TO EXCEED 30% OF EUROPEAN HOTEL DEAL VOLUME

Furthermore, operational hotel investments do not have voids, and residual value is protected through ongoing maintenance and capex. The increase in global travel and rising proportion of consumer spending on experiences looks set to endure, and this should offset the period of expected low economic growth which lies ahead. These are key pull factors which appeal to the institutions and we expect them to support hotel investment volumes and yields going forward. In 2020, we expect that institutional capital will account for over 30% of the European hotel deal volume.

### KEY INFLUENCES

- Institutional investors to make more freehold and variable-income hotel acquisitions in 2020.
- Key cities will experience an average 2.0% increase in overnight visits in 2020.
- Most key European cities look well positioned to absorb new supply, which is mostly focused on branded concepts.
- Institutional capital will invest more in variable-income operating structures, alongside sector-specialist operating partners.



## OPERATIONAL REAL ESTATE

### A UNIFIED EUROPEAN INVESTMENT MARKET?

The perception of operational real estate sectors (such as healthcare and student housing, as well as retirement living, education and leisure) as just a niche area for opportunistic investment has changed greatly in recent years. This reflects the emergence of investors with advanced sector knowledge, more sophisticated lease underwriting, in the form of financial reporting requirements and more prudent rent-setting, and a proliferation of specialist advisers. Demand for these assets has increased correspondingly, both from specialist and core funds and private equity.

In 2020, operational real estate will remain central to many investment strategies, with new and existing investors active in all major European jurisdictions that offer available stock. Indeed, as we foreshadowed in our 2019 forecast, there has already been a marked increase in the number of major investors taking a cross-sector, pan-European view in developing their investment

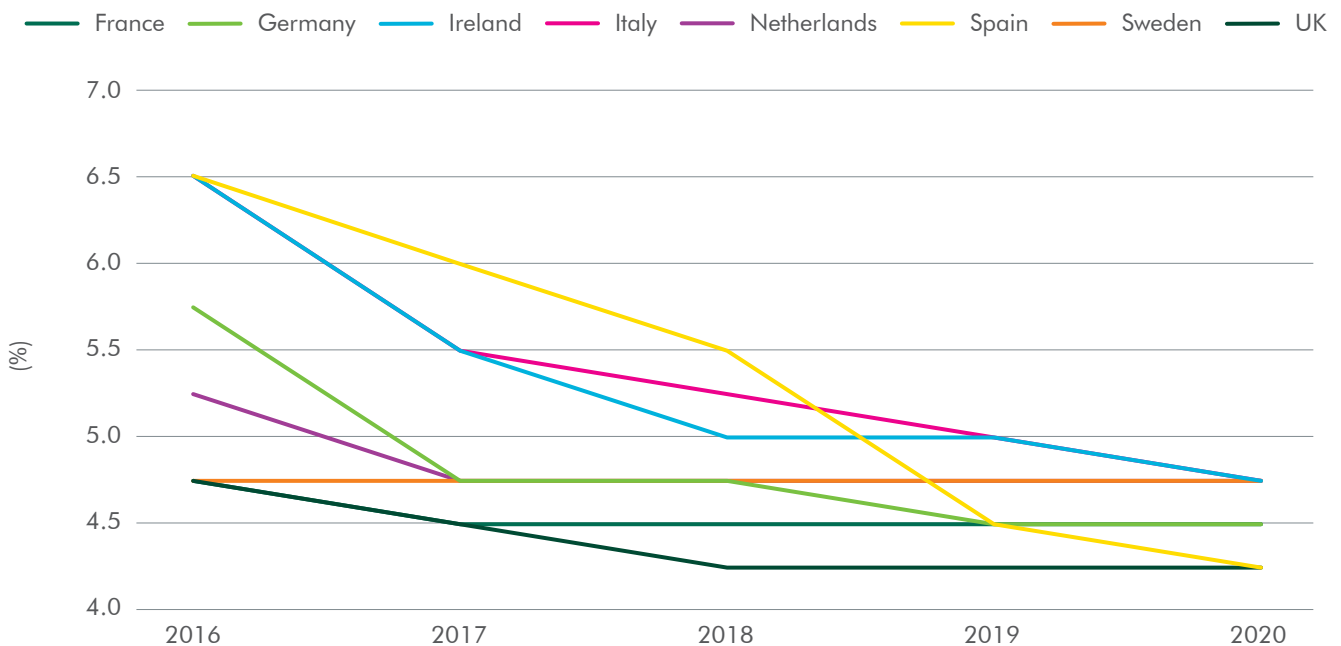
strategies. This will continue into 2020.

If anything, recent signs suggest that in the hunt for investable stock, investors will further expand their activities to new markets, and an ever-widening range of asset types. Specific sectors of interest for investors without existing exposure include retirement living, data centres, cold storage, independent education, roadside services and holiday parks.

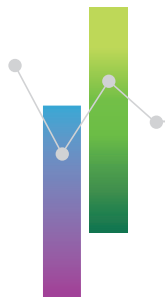
### HARMONISATION IN PRICING

Two consequences flow from this. Firstly, there will be increasing opportunities to drive innovation through new partnership models, underwriting approaches, and real estate structuring. Secondly, we believe it is inevitable that this trend will result in a degree of harmonisation in the pricing of well-let, good quality assets across the more heavily-regulated operational sectors. The rapid harmonisation of prime healthcare yields across all major European markets in recent years, but most noticeably since 2016 (see figure 12), provides a template for how this might appear in practice across the wider European market for net-leased alternative assets.

FIGURE 12: YIELD HARMONISATION – PRIME EUROPEAN HEALTHCARE



Source: CBRE Operational Real Estate



## SECTORS: OPERATIONAL REAL ESTATE

As always in a climate of yield compression, shortage of investable stock and growing exploration of new sectors, caution is vital: proper underwriting of tenants, physical assets, operational setting, and disparate national commercial and regulatory standards will be more important than ever. Identifying opportunities will require ingenuity, a long-term view, and the right strategic partners.

### SHIFTING INFLUENCE – NEW OPPORTUNITIES FOR OWNER-OPERATORS

Elsewhere, in more market-facing operational sectors, an increasingly sophisticated array of social media, mobile connectivity, online booking channels and comparison websites is revolutionising the relationship between consumer and operator. There are signs that this is beginning to erode the established paradigm whereby branding and operational expertise has been separate from capital-intensive real estate and its development. This is a major opportunity for investors in alternative real estate.

Until recently, real estate investors could not readily act as operators, because they had no access to the end-user. This has changed, and investors are no longer reliant on traditional large, branded operators. This is most obviously the case in the hotels sector, where there is increasing recognition that asset ownership

is the best route to income security, but is also becoming a theme at the upper end of the private-pay elderly care and retirement living market.

Property investors are already seeking to align with best-in-class operating partners. In response, operators are focusing on the optimisation of real estate, to attract and forge alliances with real estate capital. We expect operating partners to increasingly take on the role of investment manager, drawing on their specialist operational and real estate skills. L&G and AXA's recent entries into the retirement living market are symptomatic of this trend.

With direct access to the consumer and growing expertise we may also see more investors minimising income leakage by developing their own brands or operating independently. In self-storage and student housing, for example, consumers base their decision principally on convenience and therefore the advantages of a brand may be limited if the end-user can be accessed directly.

These trends will extend into mainstream, unregulated, property sectors – effectively the 'hotelification' of real estate. Lease lengths are falling and service levels increasing. As operational assets start to look more core and as core becomes operational, the opportunities to ride yield shifts as markets realign will be a growing opportunity for investors.

### KEY INFLUENCES

- Major institutional investors now firmly committed to operational real estate, especially established sectors such as healthcare and student housing.
- Cross-sector and regional diversification presents new risks and opportunities – sound advice and underwriting will be more critical than ever before.
- Pricing of prime investments in alternative sectors will continue to harmonise across all jurisdictions where significant stock is available.
- Social media, online booking, and online comparison platforms continue to erode the influence of branded operator tenants. Property owners wishing to operate assets directly will benefit through having access to the end user.



## DATA CENTRES

The data centre sector is measured by megawatts of IT load capacity (MW) developed, and subsequently leased, in the colocation market – that is the third-party outsourcing market. We use activity in the four largest ‘FLAP’ markets – Frankfurt, London, Amsterdam and Paris – as a barometer of the sector in Europe.

### RECORD LEVELS OF DEVELOPMENT

The nature of data centre development in Europe will change in 2020. To keep up with the growing scale of end-user demand, new data centres are being built to much larger capacities than ever before.

We anticipate that 264MW of new capacity will be brought online in the four FLAP markets in 2020, which would be equivalent to a 15% increase in the entire stock of these four markets. The main driver of this increase is not so much the number of new facilities

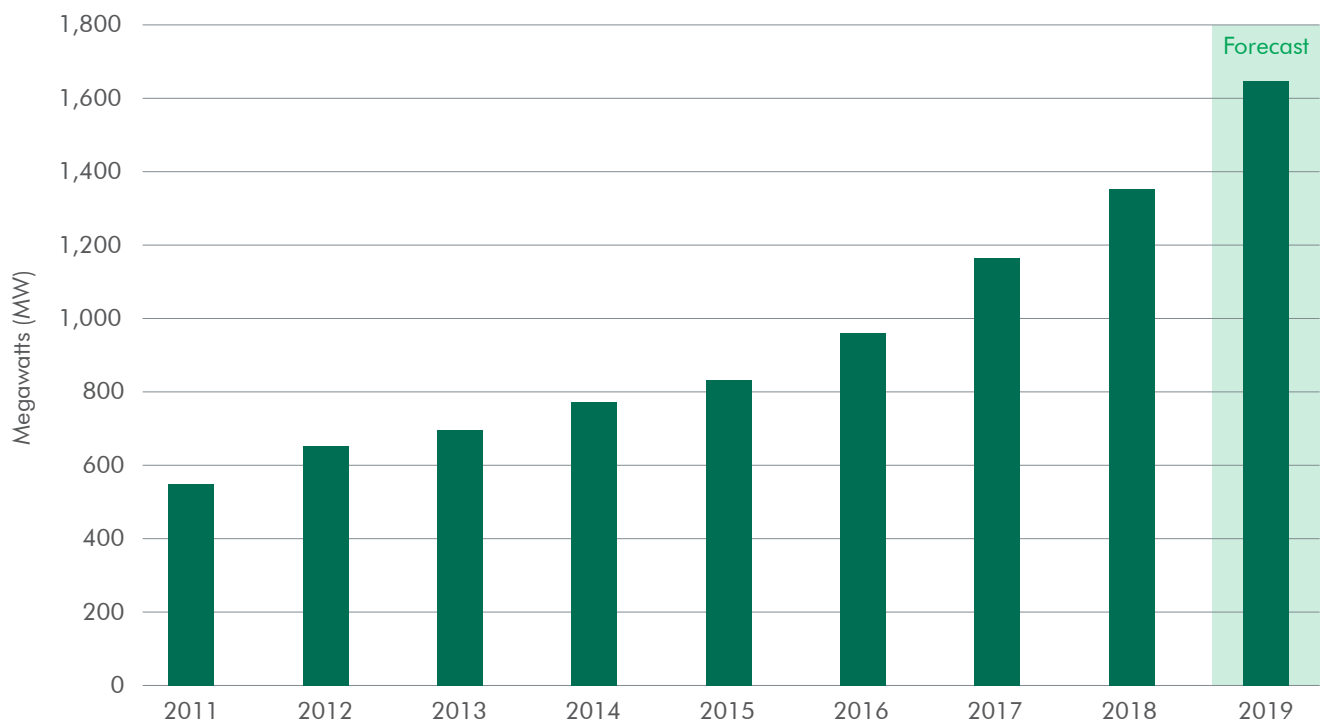
as the size of individual developments. The average size of a data centre in these four major markets today is 10MW, but over the next 12-18 months, developers will be looking for sites that can offer 20MW – 50MW of capacity. These include, for example, schemes in established hubs such as Slough in London and Sossenheim in Frankfurt, as well as new areas such as Dagenham and Hattersheim in those two cities respectively.

Development in 2020 will ultimately be driven by a combination of privately-owned pan-European data centre operators, and large US-REITs. These companies are competing to win large outsourced deployments from the cloud service providers.

### CONSTRAINTS AND BARRIERS TO DEVELOPMENT

Accelerated development in 2020 will have its challenges. The availability of freehold land in popular data centre hubs is highly constrained, such as Slough in the UK and Schiphol in Amsterdam, which offer close proximity to large amounts of high

FIGURE 13: ‘FLAP’ MARKET COMBINED SIZE (MEGAWATTS)



Source: CBRE Research

voltage (HV) power and fibre routes. These factors, along with planning approval and controlling physical risk, are crucial to developing a data centre. However, in established markets, being able to achieve these components will be difficult. In Amsterdam, for example, two municipalities have put a temporary ban on the development of new data centres because of the amount of power required by these facilities in areas where it is already scarce.

The effects of these barriers to entry are that data centre developers are either choosing to locate in new, unproven locations or are competing aggressively on price for land opportunities. We expect both trends to be strong features of the market in 2020. These market conditions have led to one particular site in London, because of its unique attributes, being sold for more than £6m per acre.

### INVESTORS EAGER TO DEPLOY CAPITAL

As forecast last year, M&A played a major role in the consolidation of the European data centre sector during 2019. The year saw the announcement of the largest data centre M&A

deal on record: Digital Realty's \$8.4bn acquisition of Interxion which is expected to close in 2020.

The strong occupational growth story in Europe in 2020 will continue to entice capital from across the globe with infrastructure funds, institutional capital and private money all competing for the same opportunities. However, due to record levels of consolidation through M&A, the pool of viable platforms to purchase will have shrunk considerably, so accessing the sector will become more difficult in 2020.

This will lead to aggressive multiples being sought for the remaining viable opportunities. As a result, data centre companies looking to expand their footprint on the continent through consolidation may miss out to financial investors, which typically have more liquidity and a lower cost of capital to pursue the most attractive opportunities.

### KEY INFLUENCES

- Further capacity expansion will continue to attract investment capital.
- The sector continues to expand through new development, with the stock of the four largest European markets expected to grow by around 15% in 2020.
- Constraints on the availability of land and power in key hubs are a challenge and are leading to an increase in the price of land for provisioned data centre sites, as well as to growing interest in new locations beyond the established core.
- User demand in 2020 will continue to be driven by the major, largely US-based, cloud service providers.
- Investor interest will remain high from a range of sources, but the record level of consolidation through M&A is reducing the pool of viable platforms to purchase.







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This report was prepared by CBRE's EMEA Research Team, which forms part of CBRE Research—a network of pre-eminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe.

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