RESEARCH & INSIGHT

# European Fair Value Index™ Q2 2017

## Property yields continue to fall, stretching property valuations

August 2017

CUSHMAN & WAKEFIELD

- Cushman & Wakefield's European Fair Value Index™ was 51 in Q2, down from the Q1 figure of 57, indicating a balance between fully and under-priced markets (Figure 1).
- The main reason for the fall in the index over last quarter has been the narrowing spread between fair and forecast returns, driven by a lower forecast return due to property yield compression already experienced during the first half of this year, despite a lower fair return caused by widespread decreases in government bonds;
- Healthy investment activity in Q2 saw European property becoming more fully priced as property yields fell further across all sectors;
- The number of attractive investment opportunities in European commercial property has reduced. Just 30 of the 122 markets included in our index were classified as under-priced for Q2, with logistics continuing to be the most attractive sector (Figure 2).
- We expect European property's attractiveness to continue to diminish as yields fall further and bond yields are expected to rise which will increase the required return.

The all-property Fair Value Index™ score for Europe fell further this quarter, dropping to 51 from 57 in Q1, as prime yields fell again in Q2 making property valuations look more stretched. As such, 4 markets have been downgraded from 'fairly priced' to 'fully priced' with a further 5 markets downgraded from 'underpriced' to 'fairly priced'. Only eight markets were upgraded, resulting in 25% of the index being classified as 'underpriced' (Figure 3).

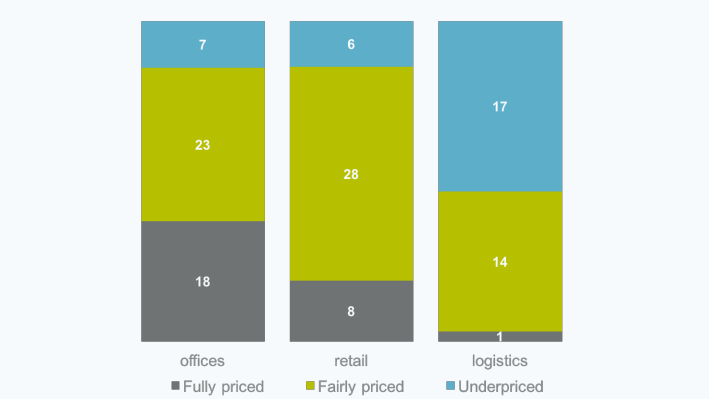
CEE has the highest number of 'underpriced' markets. Germany, Benelux and EZ Periphery have a good balance of 'fairly priced' and 'underpriced' markets, while in contrast, the UK and France have only a few 'underpriced' markets. Logistics remains the most attractive sector, with 53% of the markets classified as 'underpriced', and only one market as 'fully priced'.

The most 'underpriced' European markets in Q2 (Table 1) are Moscow (retail and office), Sofia (office), Dublin (logistics), and Barcelona (logistics) experiencing the highest medium term rental growth forecast and further yield compression expectations in 2017/18. At the other hand of the scale, the top five

**Figure 1: Cushman & Wakefield European Fair Value Index™, Q2 2017**

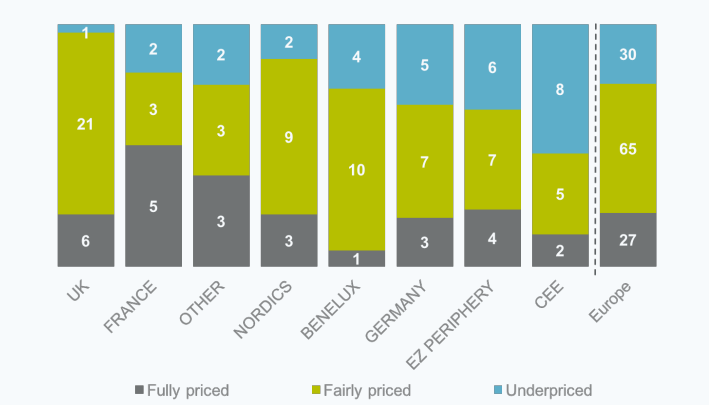

Source: Cushman & Wakefield Research

**Figure 2: Number of markets in each category by sector**




Source: Cushman & Wakefield Research

**Figure 3: Number of markets in each category by region/country**




Source: Cushman & Wakefield Research,
*Other includes markets from Turkey, Russia and Switzerland.

most 'fully priced' markets in Europe are Istanbul (office), Geneva (office), Vienna (office), Rome (retail) and Milan (retail). Very high bond yields in Turkey pushed fair returns for property to almost double our forecast returns for them. While Rome and Milan markets have very low prime property yields, both at 2.75%, making them look unattractive on a relative pricing basis.

Government bond yields were well supported for most of the quarter with widespread decreases, as expectations for European economic growth strengthened. However, a sell-off in the final week reversed earlier gains for several markets, like the UK and Germany (Figure 4), driven by comments from central banks leaders, which were interpreted as signalling the end of ultra-loose monetary policy. Overall our fair total return ended lower for the majority of the markets, however not enough to counteract the decrease in the forecast total return driven by the combination of yield compression already experienced during the first half of the year, meaning that our five year return estimation starts from a lower yield. As a result European property's attractiveness has diminished in a wide range of markets and sectors.

Healthy investor appetite for property continued this quarter with 55.3 billion EUR invested, 15.6% lower than Q2 2016, but still higher than its 10 year average (Figure 5). European property become more fully priced, with 27% of markets recording yield compression, by an average of 22 bps, driven by a weight of money and a lack of available product for core opportunities. Lower for longer interest rate environment will maintain downward pressure on prime yields and lead to extended market cycle. The UK regained its top position as the most active European market, followed by Germany and the Netherlands. However, a growing quantity of capital continued to flow into other markets like Spain, Italy, and France.

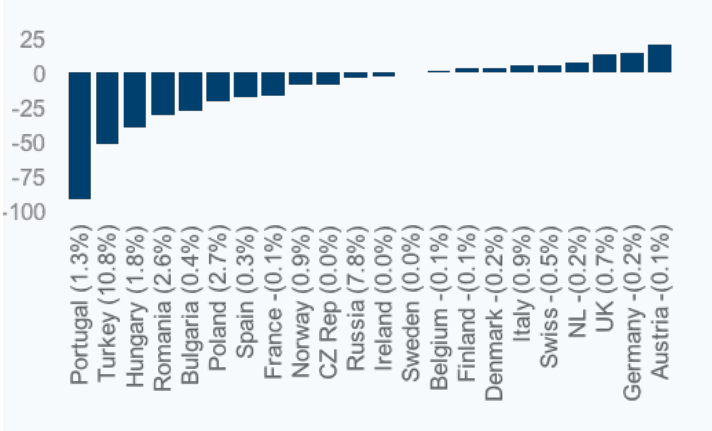
In July-17, comments by Mario Draghi suggested that further tapering of asset purchases could be announced earlier than previously anticipated. In any case, the ECB is still likely to maintain low interest rate environment until 2020 when first rate hike is expected. As such, our property yields move out in 2020 to reflect broader asset re-pricing, albeit the magnitude of movement is modest to account for the positive yield spread to bonds.

**Table 1: Five most under/fully priced markets in Europe**

| Most Underpriced Markets | Most Fully Priced Markets |
|---|---|
| 1. Moscow retail | 118. Rome retail |
| 2. Moscow offices | 119. Milan retail |
| 3. Sofia offices | 120. Vienna offices |
| 4. Dublin logistics | 121. Geneva offices |
| 5. Barcelona logistics | 122. Istanbul offices |

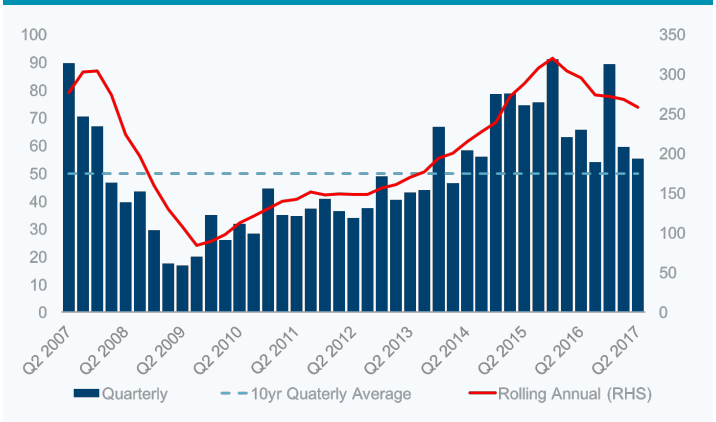
Source: Cushman & Wakefield Research

**Figure 4: 5-yr Government bond yields bps change, Q2 vs Q1 2017**




Source: Cushman & Wakefield Research

**Figure 5: European Investment Activity, EUR bn**



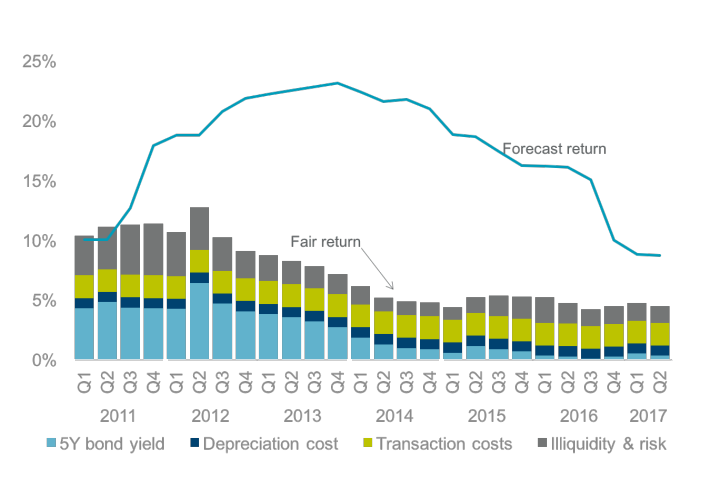

Source: Cushman & Wakefield Research

# MARKET IN FOCUS

## BARCELONA LOGISTICS

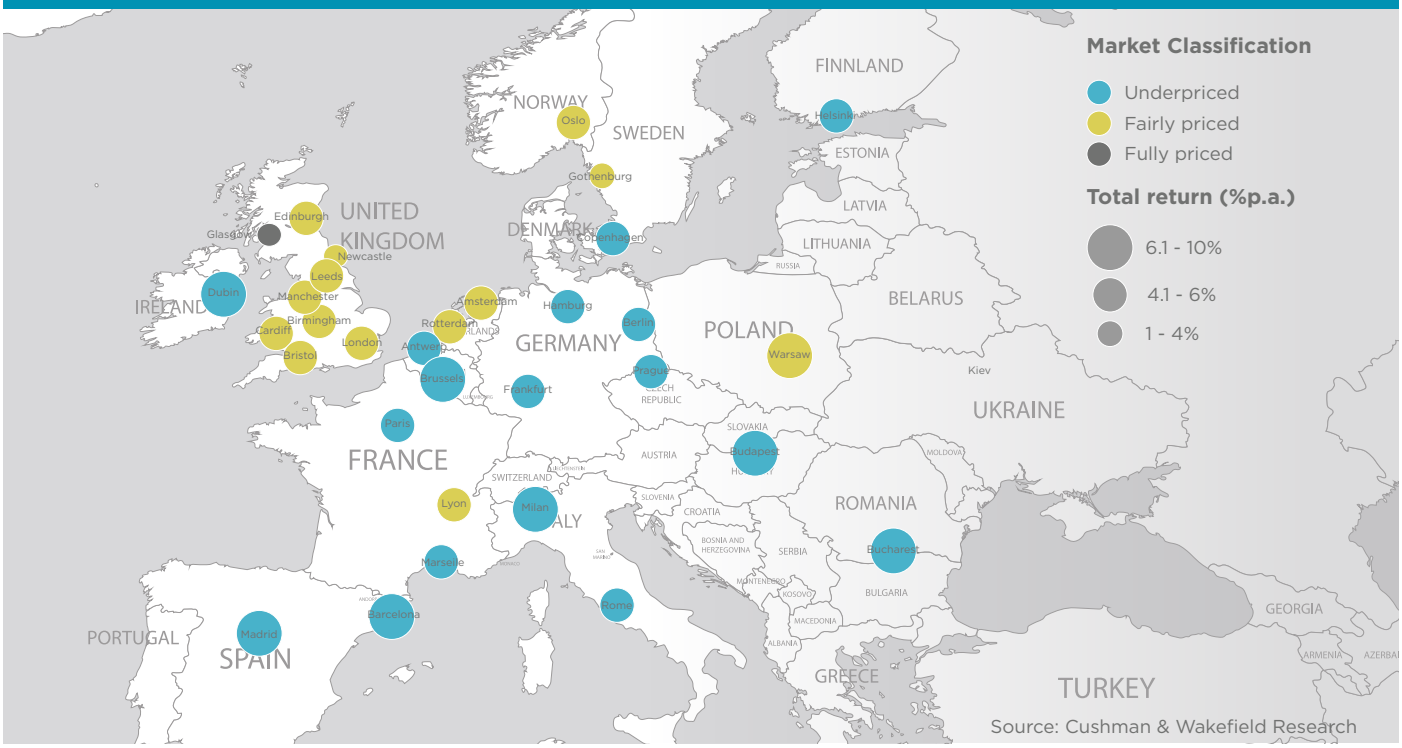
- Ranked 5th overall in our Fair Value Index™ in Q2, Barcelona logistics shows as underpriced by 15.3% according to our Fair Value analysis.
- The Spanish economy is expected to grow by 3.2% in 2017 and to average growth of 2.3% p.a. over the next five years. The outlook for imports and exports remains positive, with exports expected to grow by 7.6%, while imports are forecast to rise by 6.5%, according to Oxford Economics.
- Fair total return component decreased to 4.5% driven by an 18bps bond yield decrease in Q2. Expectations for further yield compression this year, supported by healthy investment volume in Q2, and stronger occupier demand lead us to forecast prime total returns of around 8.7% p.a. over the next five years (Figure 6).

**Figure 6: Barcelona Logistics fair and forecast returns**




Source: Cushman & Wakefield Research

**Figure 7: European logistics market Fair Value™ classifications, Q2 2017**




## Cushman & Wakefield Forecast Methodology

The Cushman & Wakefield Fair Value Index™ was launched in August 2010 and covers 122 markets across Europe.

Fair value is the value at which an investor is indifferent between a risk free return and the forecast return from holding property, taking into account the extra risk of investing in the property asset class.

When a property price is at fair value, an investor is being adequately compensated for the risk taken in choosing to purchase real estate; similarly, when the property price is below the fair value price, an investor is being more than compensated for the risk taken in choosing to purchase real estate.

When buying at or below fair value, an investor does not necessarily buy at the bottom of the market. Our Fair Value analysis focuses on prime assets and a five-year investment horizon, and hold for the market overall; individual transactions may provide opportunities and risks beyond the average market view.

In the report we compare results for the current quarter with the previous quarter which may differ from those published in the previous quarter's report, this is due to the forward-looking methodology. As such, when our forecasts change so too does the Fair Value Index.

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