

European Fair Value Index Q1 2018



Tightening European prime property investment opportunities

The all-sector C&W Fair Value Index score for Europe was 42 in Q1 2018, the same as the figure published last quarter, and approximately the same level recorded in Q1 2006, reflecting the advanced stage of the current property cycle and fewer attractive prime opportunities (Figure 1).

As such, seven markets have been downgraded from 'fairly priced' to 'fully priced' with a further five markets downgraded from 'underpriced' to 'fairly priced'. On the other hand, 12 markets were upgraded, resulting in just 19% of the index being classified as 'underpriced'.

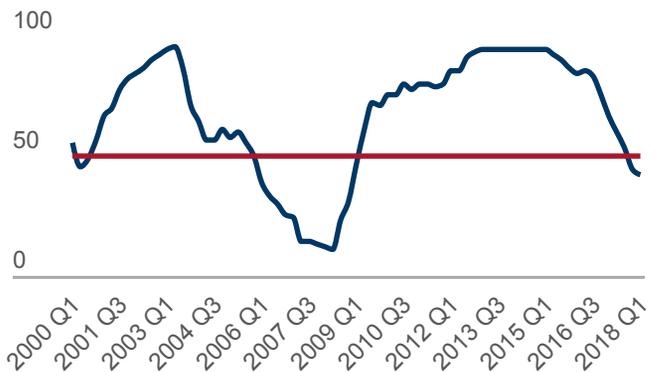
CEE and Semi-Core regions continue to show a good balance of 'fairly' and 'underpriced' markets, while in contrast Germany, Benelux and the Nordics have only a few 'underpriced' markets (Figure 2).

Logistics remains the most attractive sector, with 46% of the markets classified as 'underpriced', and only one market as 'fully priced' (Figure 3).

Overall, our fair total return ended lower for most of the markets, as our illiquidity and risk premium component decreased. This premium in part resulted from the spread between corporate and 5-year bond yields, used as a proxy for tenant risk, which narrowed during the last three months.

On the other hand, the forecast total return increased, as our rental growth forecast has been revised upwards this quarter. Reasonable growth in most European economies is forecast to filter through to modest rent increases. For all the European markets covered in our Fair Value analysis, we expect rents to rise by 1.3% p.a. over the next five years. The best rental growth performers continue to be Semi-Core economies of Ireland, Spain and Portugal, still benefitting from a cyclical upswing after being impacted the most during the GFC and Eurozone crisis.

Figure 1: C&W European Fair Value Index, Q1 2018



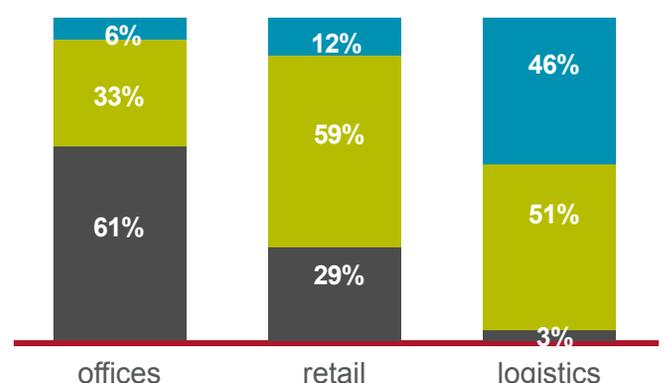
Source: Cushman & Wakefield Research & Insight

Figure 2: Number of markets in each category by region



Source: Cushman & Wakefield Research & Insight

Figure 3: Share of markets in each category by sector



Source: Cushman & Wakefield Research & Insight

The most 'underpriced' European markets in Q1 are Moscow (retail and office), Dublin (logistics), Budapest (retail) and Lisbon (logistics), experiencing the highest medium-term rental growth forecast and further yield compression expectations in 2018 (Table 1).

Conversely, the top five most 'fully priced' markets in Europe are Istanbul (office and retail), Vienna (office), Paris CBD (office) and London City (office). High bond yields in Turkey pushed fair returns for property to almost double our forecast returns .

While prime offices in Vienna, Paris CBD and London City have reached their lowest historical yield, with no expectation of further yield compression and modest, if any, rental growth expectations making them look unattractive on a relative pricing basis.

Bond yields were mixed during the first quarter, with some markets rising slightly and others falling (Figure 4). However, yields for all markets but Turkey remain well below their historical average.

Given that the ECB is scaling back from stimulus measures at a gradual pace, investors' hunt for yield remained in place, making Semi-Core government bonds relatively attractive. Indeed, bonds in Ireland, Portugal, Spain and Italy have compressed by an average of 18 bps. Meanwhile, core markets such as the UK and Germany moved out by an average of 24 bps

Investor activity in 2017 was surprisingly positive in Europe, with a record quarterly investment volume of €112bn in Q4. However, prime product is becoming increasingly scarce as the economic cycle matures, resulting in the slowest quarter since 2014 with €49bn invested in Q1 2018, 25% lower than Q1 2017 (Figure 5).

We expect yields to trend downward for selected markets in 2018, as a weight of capital helps sustain competition for quality assets. But, from late 2018 onward, higher government bond yields will mean that on a relative basis property will look less appealing.

From January 2018, the ECB reduced the QE programme from €60bn of bond purchases per month to €30bn. Purchases will continue until September 2018 but

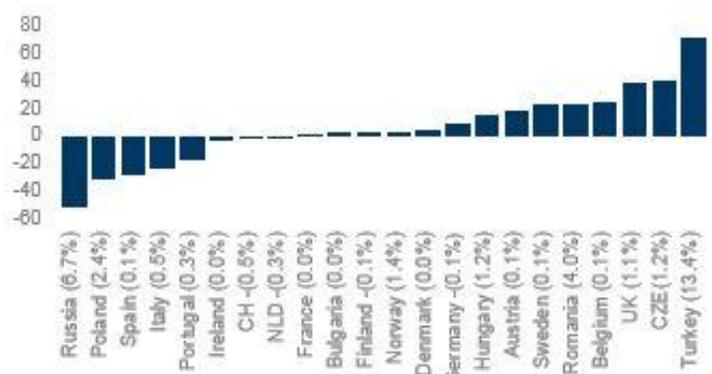
as yet no decision has been made about ending or extending QE. The reduction in bond purchases is already putting upward pressure on bond yields. The ECB is still likely to maintain low interest rates until 2019-20 when tightening is expected to commence. As such, our property yields move out in 2020 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	119. London(City) offices
2. Moscow offices	120. Paris(CBD) offices
3. Dublin logistics	121. Vienna offices
4. Budapest retail	122. Istanbul retail
5. Lisbon logistics	123. Istanbul offices

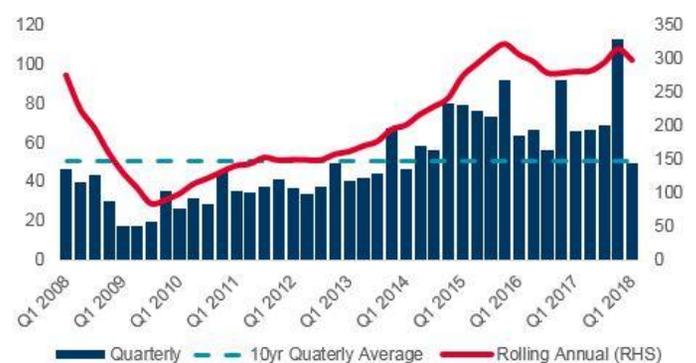
Source: Cushman & Wakefield Research & Insight

Figure 4: 5 year Government bond yields bps change, Q1 2018 vs Q4 2017



Source: Bloomberg

Figure 5: European Investment Activity, EUR bn



Source: RCA

MARKETS IN FOCUS

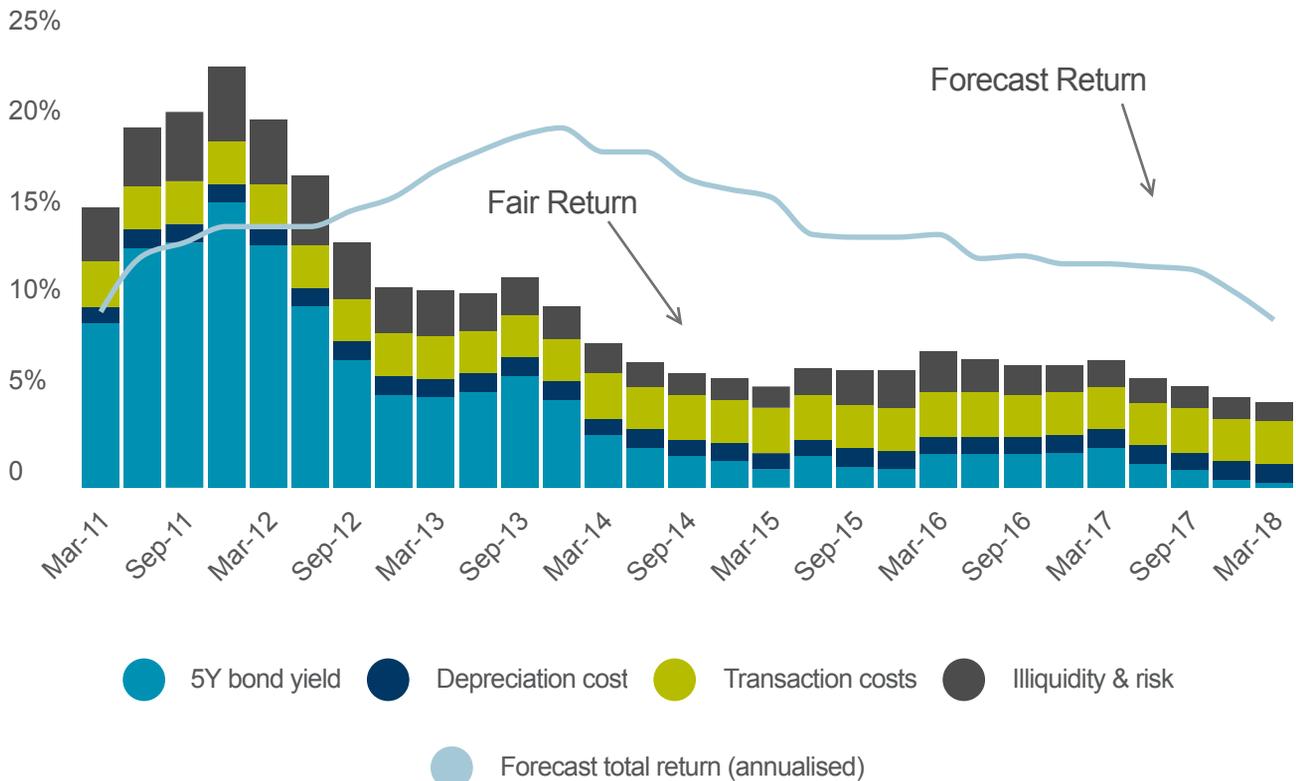
Lisbon Logistics

Ranked 5th overall in our Fair Value Index in Q1, Lisbon Logistics shows as underpriced by 16.2% according to our Fair Value analysis.

The Portuguese economy is enjoying solid momentum, with a balanced mix of consumption, investment and export. After a record growth of 7.4% in 2017, the highest of the decade, export volumes in the first two months of the year indicate a similar trend, with a year-on-year growth of 10% in January and 6.2% in February

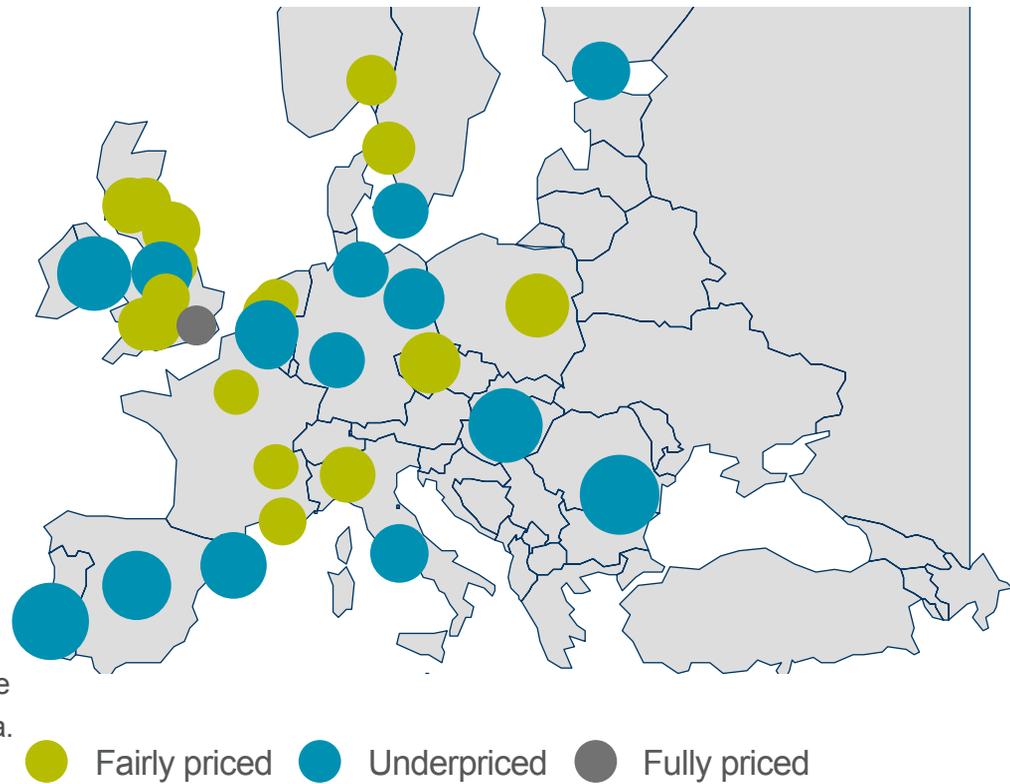
Lower bond yield, illiquidity and risk premium in Q1 decreased our fair total return component to 4.7%. While, expectations for further yield compression over the forecast period, supported by healthy investment volume, and stronger occupier demand lead us to forecast prime total returns of 9.3% p.a. over the next five years (Figure 6).

Figure 6: Lisbon Logistics fair and forecast returns



Source: Cushman & Wakefield Research & Insight

Figure 7: European logistics market Fair Value classifications, Q1 2018



Source: Cushman & Wakefield Research & Insight



Author

Riccardo Pizzuti
 Senior Analyst, EMEA Forecasting
 +44 (0) 20 3296 2409
 riccardo.pizzuti@cushwake.com



Contacts

Mark Unsworth
 Head of EMEA Forecasting
 +44 (0) 20 3296 4221
 mark.unsworth@cushwake.com



Elisabeth Troni
 Head of EMEA Research
 +44 (0) 20 3296 2121
 elisabeth.troni@cushwake.com

Explore more of our Research & Insight at:
www.cushmanwakefield.com and follow us on Twitter
 @CushWake

Cushman & Wakefield Fair Value Methodology

The Cushman & Wakefield Fair Value Index was launched in August 2010 and covers 123 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.

Disclaimer This report has been produced by Cushman & Wakefield for use by those with an interest in commercial property solely for information purposes. It is not intended to be a complete description of the markets or developments to which it refers. The report uses information obtained from public sources which Cushman & Wakefield believe to be reliable, but we have not verified such information and cannot guarantee that it is accurate and complete. No warranty or representation, express or implied, is made as to the accuracy or completeness of any of the information contained herein and Cushman & Wakefield shall not be liable to any reader of this report or any third party in any way whatsoever. All expressions of opinion are subject to change. The data contained in this report is based upon that collected by Cushman & Wakefield. Our prior written consent is required before this report can be reproduced in whole or in part. ©2018 Cushman & Wakefield