According Cushman & Wakefield investment volumes jumped 53% in third quarter of 2009.

Green shoots of recovery are at last starting to appear in the European property market, with investment volumes jumping 53% in the third quarter, yields stabilizing and even the occupational market managing to show some more encouraging signs, at least of approaching stability, according to Cushman & Wakefield's latest European commercial property investment update.

As in the second quarter, increased activity has been driven by cross-border investment, which more than doubled on the previous quarter and stood at its highest for over a year. International investors increased their share of activity to 44% versus 31% in the opening 6 months. Whilst more cautious, domestic investors were also increasingly active, with €10.9 bln. in investment, 29% up on the second quarter, and making a particularly significant contribution to the resurgence in activity seen in markets such as Germany and France.

"There are still plenty of problems for the market to deal with but with two quarters of growth in activity and much improved sentiment, it's clear we've turned an important corner," commented David Hutchings, head of the European Research Group at Cushman & Wakefield. "With yields stabilising at levels which are clearly attractive for long-term equity buyers, a growing number believe that now is the time to act even if the occupier market has not yet hit bottom. Their problem is finding enough stock, with banks still generally supportive of their loans and some vendors holding back hoping that pricing will improve. Hence while we're looking forward to a busy final quarter, with trading volumes for the year around €65bn, the jury's out on what 2010 may hold."

Average prime yields across Europe now stand at 7.51% and over the third quarter they were stable in 21 of the 32 countries analysed. Overall they actually fell 1bp on the quarter, albeit solely due to the UK, where yields dropped 24bp to 6.73%. This is still marginally higher than the Western Europe (ex UK) average (6.68%), which rose 3bp, the smallest quarterly increase since late 2007. Elsewhere, Central and Eastern European averages were largely stable, but performance is increasingly diverse, with yields holding firm in Poland and the Czech Republic, and indeed in Russia, but moving out further in Bulgaria, Romania and Hungary amongst others.

"Investors are clearly still very focused on prime, secure income producing assets with limited interest for anything else" said Michael Rhydderch, head of the European Cross Border Capital Market Group at Cushman & Wakefield, "The bigger, more liquid Western markets are leading, with the UK very busy but France also enjoying better international demand and Germany seeing good interest from local buyers. Elsewhere investors are looking for distress and hence markets which have fallen a long way are being re-examined. Spain had a good quarter, as did core markets such as Belgium and the Netherlands. In other areas the picture is more mixed, with an increasingly polarized market in terms of activity and performance."

With yields stabilising, the trend in capital growth improved again, with values across Europe shedding just 0.8% on the quarter, compared with falls of 7.4% and 2.8% respectively in quarters 1 and 2. For Europe as a whole, values are now 22% down on their peak, with the UK down 40%, the rest of Western Europe averaging a fall of 17%, Central Europe 26% and Eastern Europe 45%.

The yield differential between east and west now stands at 618 bp, its highest since early 2006. This is starting to stir some interest, although largely from domestic investors, who have generated a pick up in activity in Turkey and Russia for example. Foreign buyers are still more cautious and where they are looking, they are focussing on the more developed Central European countries, albeit with only Hungary seeing a pick up in activity to date.

Offices have remained the most active market segment, with volumes rising 87% on the quarter to stand at €10.6bn. Industrial activity also rose strongly whilst retail was more stable, largely due to the lack of availability of quality product and the still difficult financing market for larger lots such as shopping centres.

Demand is driven by equity players, be they high net worth individuals or the increasing number of institutional funds back in the market. German institutions and open-ended funds remain the most significant international group in many markets but some opportunity funds are now starting to invest directly as well as in debt and a number of European REITs may soon return to the market after the recapitalisations seen over the past year.

Occupier Markets

Across Europe, prime rents fell by 7.9%, led by Eastern markets, down by over 29% on average, and by offices and shopping centres more than shops, parks or industrial space. Most notably for offices however, the pace at which rents fell saw an improvement. "With an annualised drop of 3.6% in the third quarter, it seems clear that the rental market saw its weakest moments in the opening quarter – when rents dropped by an annualised 14.1%, reflecting of course the very severe dip seen in the economy at that time. " said Hutchings. "Better sentiment towards the economy is now clearly being factored into occupier and investor views but the common perception of a 6-12 month lag between an economic recovery and a pick up in the occupational market may be overly simplistic. The Credit Crunch forced companies to cut back and re-organise and hence the adjustment process was already well underway before recession actually hit. As with the property market, some businesses are still being supported by their banks and may fail as soon as the recovery picks up and banks look to recover their loans – but for the corporate sector overall, many businesses are in a stronger position than usual at this stage in the cycle."

As a result, while rental growth may not return for some time, activity should pick up more rapidly from the typically depressed levels seen earlier this year. "As soon as the dust starts to settle on the economic collapse, some occupiers will decide the time is right to take advantage of their market strength to secure better accommodation. That is what we are starting to see now" continued Hutchings. "Of course even if take-up picks up, net absorption will remain low and with availability still rising, tenants will have the upper hand for some time. Nonetheless, the availability of grade A space is typically more restricted and will be taken-up first, meaning that the best financial terms on the best properties may not be around for long."

The Outlook

Commenting on the outlook Rhydderch said, "With more buyers and fewer sellers, its clearly going to be a frustrating market for some and for the best assets, prices can only be expected to harden in the months ahead. In some areas a fall in yields will bring additional stock onto the market and support the rebound in trading volumes. What is not in doubt is property's appeal in terms of income and its perception as a valid inflation hedge."

The steady improvement in finance availability is another positive for the outlook meanwhile, with more banks competing to lend at what they see as attractive margins. Their willingness to lend individually or in consortiums for larger lots is also improving. Terms however will remain relatively restrictive and availability limited to better quality property and borrowers.

"Refinancing needs will pose a greater problem for the market than new debt, but this is also set to be a key area of opportunity which will slowly open up as we move through 2010 and more banks decide to release stock. We do not anticipate a flood of property, however, and hence investors may have little option but to adjust their return expectations or take on more risk to generate higher returns," concluded Rhydderch.

Source: Cushman & Wakefield

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