<u>European Real Estate Market Outlook for 2017</u>

The BNP Paribas Real Estate Confidence Index (RECI) quantifies how the different combination of challenges facing real estate in the present environment are impacting on investor sentiment, tracking the proportion that think that investment conditions will improve, worsen or stay the same over the next 12 months.

Key findings

- No change in business conditions in 2017 is the majority opinion of real estate investors (70%) across the European markets in Q3.
- This position was subject to a dip in Q2, driven by UK investors who reacted negatively to the Brexit vote only to bounce back in Q3. Investors in France and Germany were largely unmoved by that event.
- The path of the RECI with its Q3 net balance figure of -11% shows that majority opinion may be to anticipate a slower market.
- With total returns, net balance of investor opinion is moving away from anticipating decline over the next year towards growth. Investors are still cautious, possibly a reflection of worries about how income growth will be affected by a slowing economy.
- Around 44% of investors take the position of holding assets across all sectors. The net balance change suggests that majority opinion of hold is moving towards favouring buying property.
- Most investors think the lending situation in Europe will not be any different next year. The net balance across the year of the survey has remained slightly negative (favouring tightening) for lending conditions in 2017. All of this suggests investors believe that central bank action is only having a limited effect on the commercial real estate market.

Despite weaker expected economic activity in Europe this year, there are reasons to be optimistic. Inflation in the Eurozone is projected to stay extremely low in line with oil prices; hence we anticipate that the European Central Bank will increase its quantitative easing policy. As a result, the Euro is expected to stay low against the major currencies; this will support purchasing power across Europe. In Germany and the UK unemployment rates remain at historical lows, albeit with limited impact on wages but consumption is rising on the back of weak inflation and increasing consumer confidence. At the same time countries such as Spain, Cyprus, the Netherlands and Ireland are showing solid GDP growth.

More than ever real estate looks attractive compared to bond and equity markets. Indeed the bond market is less and less rewarding while the equity market is more and more volatile.
On the back of this analysis, we expect that the fundamentals in most European Real Estate markets will be resilient in 2017. With our expectations of further yield compression, as well as pick-up in rental growth, European real estate looks to be an attractive investment.

There has been considerable press attention on the potential impact of the Brexit decision on European occupier markets, with cities such as Frankfurt, Paris and Dublin touted as possible beneficiaries should companies decide to relocate staff from London. However, for the time being, most occupiers appear to be in "wait and see" mode as they monitor how the UK's withdrawal from the EU plays out. There is no evidence, as yet, of any significant exodus of occupiers from London, but the UK's exit from the EU will be factored into occupiers' decision- making over the medium term.

“Europe looks well set,” conclude some global investors. There is an improving macro-economic picture, unemployment is improving, supply has been minimal for many years, and banks and investors are becoming active in terms of cleaning up their balance sheets and selling assets. That is creating a lot of interest. There is a continuing appetite for real estate, and that demand is coming from a pretty broad spectrum of investor types – pension funds, retail investors, wealth management, sovereign wealth and the larger insurance companies.

If the real estate sector has and is to play an increasingly prominent role in financial market activity, then it is equally important to understand its relative past and how that might inform decision-making for a more stable and secure future. Unlike other asset classes such as equities, bonds or even commodities, real estate has both a functional and financial dimension that complicates its understanding as a cyclical investment. Long-term rental contracts do not align well with the short-term planning horizon of many tenants, and capital valuations of properties depend on large variations in investor discount and borrowing rates.

Whereas debt and equity investment was once sourced locally, globalisation has expanded the investor base thereby accentuating volatile swings in capital availability and occupier demand. Geopolitical and socioeconomic risks, have the potential to shift the market prioritisation and business planning of multinationals in unexpected ways. Sudden market illiquidity or value cyclicality could produce sizeable asset price distortions that, if left unattended, could result in a market crash.

In a highly interconnected global economy driven by rapid technological change, the current sense of anxiety is notable. Geography no longer binds the mobility of capital or labour, each in pursuit of higher returns. Such fluidity of resources creates extraordinary opportunities as well as risks. Ultimately, sustainable growth in the real estate industry and overall economy can be better achieved in 2017 through enhanced market transparency and greater levels of confidence and trust enabled by the professional players including advisors, investors and politicians.

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