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RETAIL INVESTMENT COMPASS EUROPE

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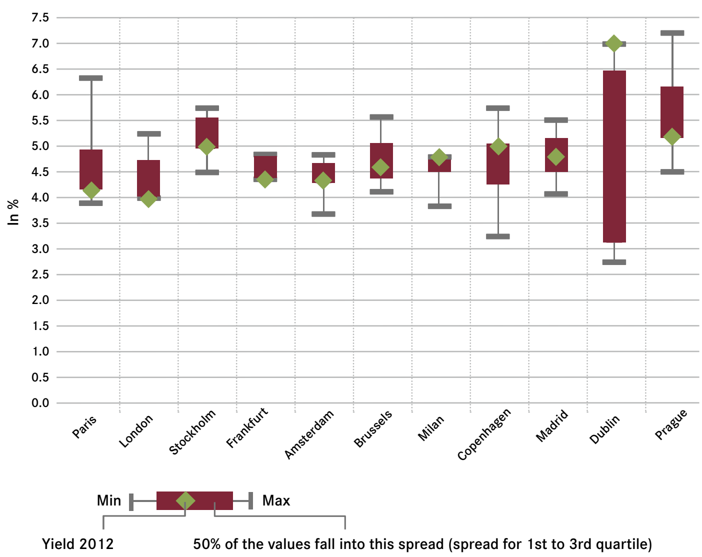
Consumer Climate and Prime Rents – Sentiment Profiles Provide Few Clues that could Facilitate Investment Decisions in the Top Segment

The price rally on the European retail market appears to be running out of steam as the year draws to a close. At least this is what the regressive share in the overall transaction volume, a dip in turnover by nearly 20 percent compared to 2011, and the relatively stable price levels suggest. That said, the latter fact also implies something else: Retail properties continue to sell at peak prices in many markets. Indeed, demand for German properties is so high as to outpace supply in some locations. Even the initial net yields appear to have bottomed out in most markets – excepting Southern Europe and Budapest. The background to the minimal yield rates should be seen in the cautious approach taken by investors, who are focusing exclusively on core real estate, and commit themselves almost solely in markets that are deemed safe.

Accordingly, many have shelved their planned investments for the time being. Against the background of postponed decisions, it is safe to say inversely that the pressure to invest keeps mounting while the economic prospects remain rather bleak. Thus, the question presents itself whether and how investor preferences can be brought into congruence with the economic outlook. After all, many investors explain their commitment in the retail market with reference to the sound consumer climate in a robust economic environment.

RENTAL YIELD SPREAD ON EUROPEAN RETAIL MARKETS, 2003 - 2012



Source: PMA, PATRIZIA

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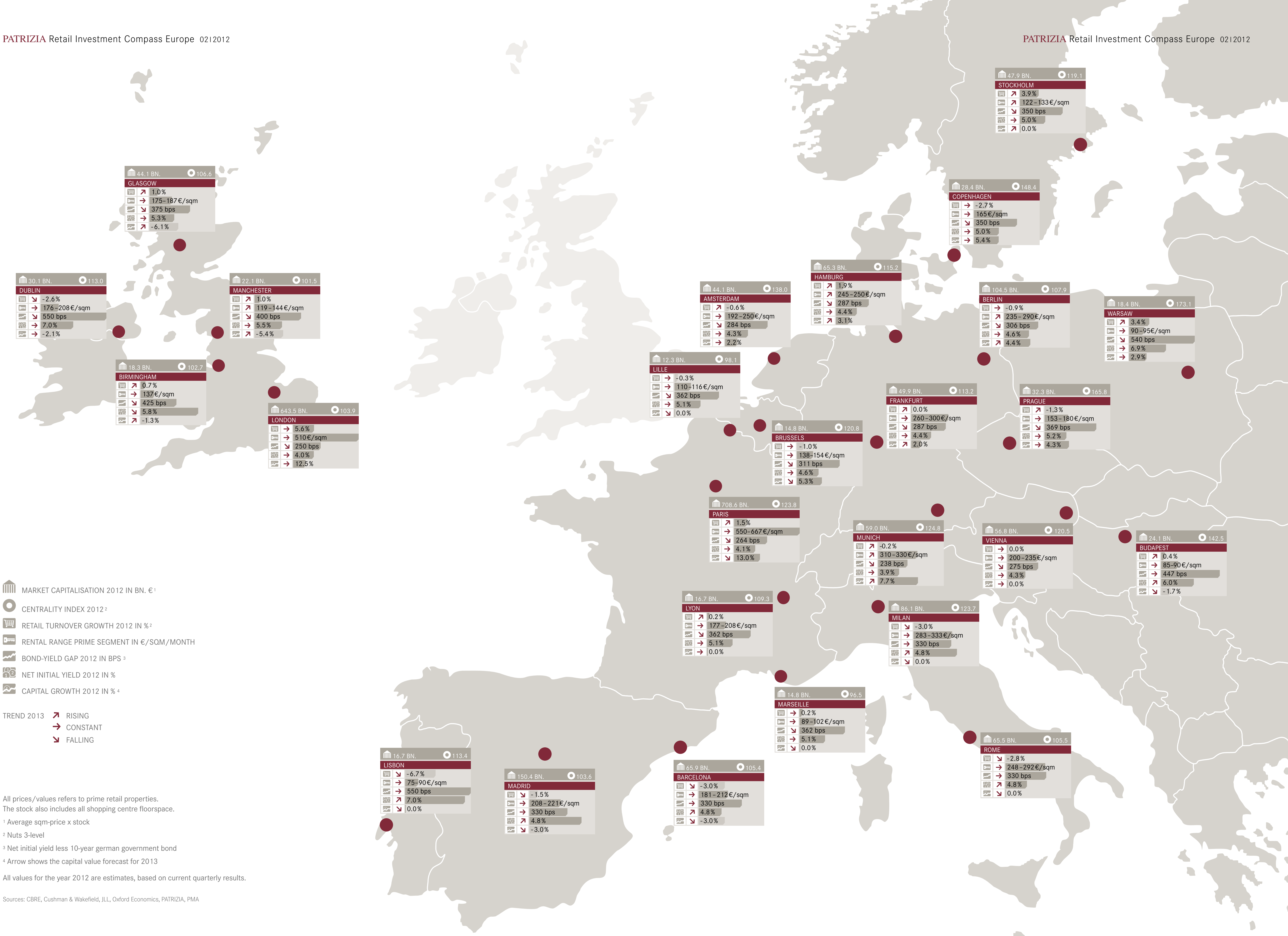


City	Market capitalisation 2012	Centrality index 2012	Retail turnover growth 2012	Rental range prime segment	Bond-yield gap 2012	Net initial yield 2012	Capital growth 2012
GLASGOW	44.1 BN.	106.6	↗ 1.0 %	→ 175–187 €/sqm	↘ 375 bps	→ 5.3 %	↗ -6.1 %
DUBLIN	30.1 BN.	113.0	↘ -2.6 %	→ 176–208 €/sqm	↘ 550 bps	→ 7.0 %	→ -2.1 %
MANCHESTER	22.1 BN.	101.5	↗ 1.0 %	↗ 119–144 €/sqm	↘ 400 bps	→ 5.5 %	↗ -5.4 %
BIRMINGHAM	18.3 BN.	102.7	↗ 0.7 %	→ 137 €/sqm	↘ 425 bps	↘ 5.8 %	↗ -1.3 %
LONDON	643.5 BN.	103.9	→ 5.6 %	→ 510 €/sqm	↘ 250 bps	→ 4.0 %	→ 12.5 %
STOCKHOLM	47.9 BN.	119.1	↗ 3.9 %	↗ 122–133 €/sqm	↘ 350 bps	→ 5.0 %	↗ 0.0 %
COPENHAGEN	28.4 BN.	148.4	→ -2.7 %	→ 165 €/sqm	↘ 350 bps	→ 5.0 %	→ 5.4 %
HAMBURG	65.3 BN.	115.2	↗ 1.9 %	↗ 245–250 €/sqm	↘ 287 bps	→ 4.4 %	↗ 3.1 %
AMSTERDAM	44.1 BN.	138.0	↗ -0.6 %	→ 192–250 €/sqm	↘ 284 bps	→ 4.3 %	→ 2.2 %
BERLIN	104.5 BN.	107.9	→ -0.9 %	↗ 235–290 €/sqm	↘ 306 bps	→ 4.6 %	↗ 4.4 %
WARSAW	18.4 BN.	173.1	↗ 3.4 %	→ 90–95 €/sqm	↘ 540 bps	→ 6.9 %	→ 2.9 %
LILLE	12.3 BN.	98.1	→ -0.3 %	→ 110–116 €/sqm	↘ 362 bps	→ 5.1 %	↘ 0.0 %
FRANKFURT	49.9 BN.	113.2	↗ 0.0 %	→ 260–300 €/sqm	↘ 287 bps	→ 4.4 %	↗ 2.0 %
PRAGUE	32.3 BN.	165.8	↗ -1.3 %	→ 153–180 €/sqm	↘ 369 bps	→ 5.2 %	→ 4.3 %
BRUSSELS	14.8 BN.	120.8	→ -1.0 %	→ 138–154 €/sqm	↘ 311 bps	→ 4.6 %	↘ 5.3 %
PARIS	708.6 BN.	123.8	↗ 1.5 %	→ 550–667 €/sqm	↘ 264 bps	→ 4.1 %	↘ 13.0 %
MUNICH	59.0 BN.	124.8	↗ -0.2 %	↗ 310–330 €/sqm	↘ 238 bps	→ 3.9 %	↗ 7.7 %
VIENNA	56.8 BN.	120.5	→ 0.0 %	→ 200–235 €/sqm	↘ 275 bps	→ 4.3 %	→ 0.0 %
BUDAPEST	24.1 BN.	142.5	↗ 0.4 %	→ 85–90 €/sqm	→ 447 bps	↗ 6.0 %	↘ -1.7 %
LYON	16.7 BN.	109.3	↗ 0.2 %	→ 177–208 €/sqm	↘ 362 bps	→ 5.1 %	→ 0.0 %
MILAN	86.1 BN.	123.7	↘ -3.0 %	→ 283–333 €/sqm	→ 330 bps	↗ 4.8 %	↘ 0.0 %
MARSEILLE	14.8 BN.	96.5	→ 0.2 %	→ 89–102 €/sqm	↘ 362 bps	→ 5.1 %	↘ 0.0 %
ROME	65.5 BN.	105.5	↘ -2.8 %	→ 248–292 €/sqm	→ 330 bps	↗ 4.8 %	↘ 0.0 %
LISBON	16.7 BN.	113.4	↘ -6.7 %	→ 75–90 €/sqm	→ 550 bps	↗ 7.0 %	↘ 0.0 %
MADRID	150.4 BN.	103.6	↘ -1.5 %	→ 208–221 €/sqm	→ 330 bps	↗ 4.8 %	↘ -3.0 %
BARCELONA	65.9 BN.	105.4	↘ -3.0 %	→ 181–212 €/sqm	→ 330 bps	↗ 4.8 %	↘ -3.0 %

MARKET CAPITALISATION 2012 IN BN. € [1]

CENTRALITY INDEX 2012 [2]

RETAIL TURNOVER GROWTH 2012 IN % [2]

RENTAL RANGE PRIME SEGMENT IN €/SQM/MONTH

BOND-YIELD GAP 2012 IN BPS [3]

NET INITIAL YIELD 2012 IN %

CAPITAL GROWTH 2012 IN % [4]

TREND 2013
↗ RISING
→ CONSTANT
↘ FALLING

All prices/values refers to prime retail properties.
The stock also includes all shopping centre floorspace.

[1] Average sqm-price x stock

[2] Nuts 3-level

[3] Net initial yield less 10-year german government bond

[4] Arrow shows the capital value forecast for 2013

All values for the year 2012 are estimates, based on current quarterly results.

Sources: CBRE, Cushman & Wakefield, JLL, Oxford Economics, PATRIZIA, PMA

In this context, however, the GfK consumer research society observed in October 2012 that consumer confidence is slipping everywhere in Europe: Few countries in Europe show signs of improving economic parameters. By contrast, sentiment among German consumers continues to be buoyed by positive income expectations, and is therefore higher than in most other European countries. As a result, the situation in Germany is characterised by a pronounced propensity to buy or willingness to spend despite concerns that the country might be dragged into the maelstrom of recessions elsewhere in the European Union. In other countries in Europe, e.g. in France, the fear of a radical structural shift in conjunction with income cuts has caused the shopping mood to sour.

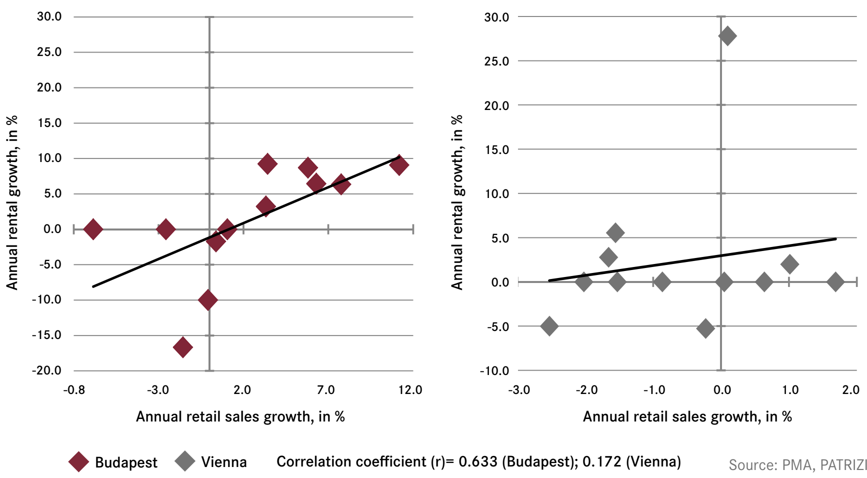
CONNECTION BETWEEN SHOPPING MOOD AND RENT RATES REMAINS AMBIGUOUS

In many places, sentiment among European consumers is therefore defined by uncertainty, and the fact is reflected in the meagre cash receipts of retailers, especially in the crisis-ridden countries. Yet the question presents itself: Does the shopping mood of consumers – no matter whether it is good or bad – principally represent a suitable benchmark for decision to invest or disinvest?

While there is no doubt that rent rates and real estate values move in sync, the connection between consumption and rents is hard to gauge. A long-term survey we conducted in 26 European metropolises pairs the retail sales of a given region with the corresponding rent performance in the prime segment.

Surprisingly, only in a few cities did rising retail sales coincide with prime-rent hikes or, conversely, were declining sales matched by a drop in prime rents, and these findings applied even when allowing for a two-year lag. Some markets did show an analogous growth of sales and rents, especially the emerging markets of the past decade, including Warsaw, Budapest and Prague. Rental growth in other markets, such as Vienna, London and Germany's "Big Seven," remained more or less oblivious to retail sales fluctuations.

CONNECTION BETWEEN PRIME RENT AND LOCAL RETAIL SALES (2001-2012)



Source: PMA, PATRIZIA

This makes it safe to conclude that prime locations and prime properties – these being the assets that tend to command the highest rents – are largely resilient against turnover fluctuations on the overall market. Their space utilisation remains consistently high, enabling rent rates to maintain their level even during times of crisis. Vacancies in the prime sections of European high street locations have increased but marginally, rising from 1.3 percent in 2007 to 2.2 percent today. By contrast, the vacancy rates registered in Class B locations and second-rate properties ranged from two percent (Nordics) to nine percent (Eastern Europe). On average, they climbed from 4.5 percent in 2007 to six percent today.

Specifically in the shopping centre segment, size seems to constitute the decisive competitive advantage. Vacancies in the major malls of more than 40,000 sqm in sales area are down to around four percent, whereas smaller malls with less than 15,000 sqm report vacancy rates of more than twelve percent.

This means: Retail properties in unique metropolitan locations and the major malls present a robust picture even during slow consumption cycles. These markets are governed by international retail chains for whom having a presence in established and mature markets in Central and Western Europe is mandatory. This is a migration pattern that has survived the years of slow economics intact.

EXPECTATIONS FOR 2013

The sales forecast for 2013 breaks down into three categories across all European locations: Six out of 26 European locations will experience declining retail sales, while another seven locations will remain stable, and 13 cities are likely to see growing sales. Compared to the figures identified this past spring, the outlook has remained virtually unchanged across cities. Predictions remain particularly bleak for recession-ridden countries such as Spain and Italy. Inversely, the signs for German cities continue to point toward sales increases.

In all of the 26 locations we analysed, prime rents maintained at least the level of 2011, or actually gained in some markets, cases in point being Paris (+6.7 percent), Berlin, Hamburg, Munich (+4 to +5 percent) and London (+12.5 percent). The prospects for 2013 are quite similar: Overall, rental growth is predicted for five of the 26 markets, while rents in the other cities will at least remain stable – and this goes even for cities with a currently negative sales performance outlook.

Notwithstanding the glum sentiment among many European consumers, it is therefore safe to sound the all-clear signal for the top retail segment. Then as now, investors will be on the safe side with prime assets in this segment, and this in relative autonomy from the macro-economic situation in a given country. Investors planning to shift their focus to non-core properties / locations are well advised to pay more attention to consumers' propensity to buy and purchasing power when making their investment decision.

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