RESEARCH

Knight Frank

EUROPEAN QUARTERLY

COMMERCIAL PROPERTY OUTLOOK

Q1 2017

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

EUROPEAN OUTLOOK

In Q1 2017, Germany consolidated its position as the most active investment market in Europe.

Following a strong end to 2016, European commercial property investment volumes eased to €44.2 billion in Q1 2017, an 8.3% decrease compared with the corresponding quarter of 2016 (Figure 1). However, contrasting trends were observed in the continent's largest markets.

On a year-on-year basis, Q1 investment activity was down in both France (-33.2%) and the UK (-22.1%). The slowdown in France reflected investor caution in the run-up to the presidential election, while UK investment activity continued to be influenced by uncertainty following last year's Brexit vote. However, the overall decrease in UK volumes belied an upturn in the London office sector, driven by overseas buyers from Hong Kong, China and Germany.

The German investment market maintained the strong momentum which has seen it overtake the UK as Europe's most active market in recent quarters. Q1 investment volumes increased by 27.3% year-on-year, and were boosted by Blackstone's completion of its acquisition of the €3 billion OfficeFirst portfolio.

A strong start to the year was also observed in Spain, where an improving economy and rental growth prospects fuelled international investor demand. Unusually, Madrid overtook Paris to be the second most active European city investment market in Q1, behind only London.

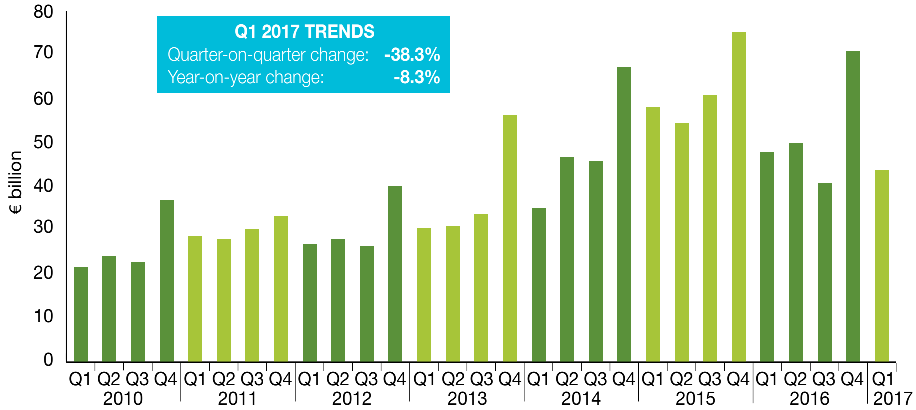
Regardless of the decrease in overall European investment volumes in Q1, investor demand for European real estate remains strong and it continues to drive yield compression. The Knight Frank Weighted Average Prime Office Yield hardened by four basis points in Q1 (Figure 2), on the back of inward yield movements in markets such as Amsterdam, Budapest, Prague and Stockholm.

Recent economic and political developments will have buoyed investor sentiment. The Eurozone recorded robust GDP growth of 0.5% in Q1, while election results in the Netherlands and France have calmed fears that the series of major European elections in 2017 would result in a lurch towards politicians with disruptive populist agendas.

Occupational activity remained robust across a range of European markets in Q1, with Paris, Milan, Munich and Warsaw being among the cities to make a strong start to the year. Aggregate office take-up in the markets monitored by Knight Frank was up by 8% year-on-year.

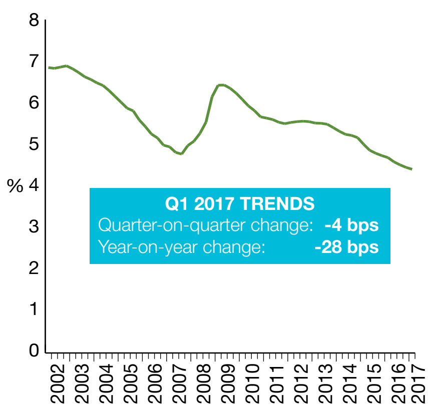
Despite the strong level of occupier activity in Q1, only modest prime rental growth was recorded across Europe during the quarter. This is reflected in the Knight Frank Prime Office Rental Index which increased by just 0.2% (Figure 3). However, there is the potential for rental growth over the rest of the year, as the diminishing availability of prime space in European CBDs is creating increasingly landlord-favourable markets. Prime rental growth prospects are strongest in key cities in France, Germany, Ireland, Spain and Sweden.

FIGURE 1
European commercial property investment volumes



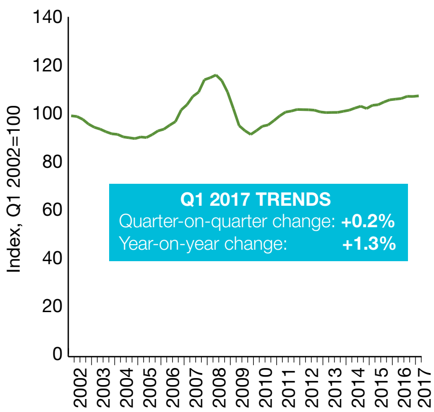
Source: Real Capital Analytics / Knight Frank Research

FIGURE 2
European weighted average prime office yield



Source: Knight Frank Research

FIGURE 3
European prime office rental index



Source: Knight Frank Research

MARKET HIGHLIGHTS

1 BERLIN

The German capital continues to record heightened levels of occupier activity, with Q1 seeing large-scale transactions involving the Institute for Federal Real Estate (BIMA) (47,000 sq m) and Zalando (34,000 sq m).

2 DUBLIN

The TMT sector remains a key driver of occupational market activity in Dublin, and notable recent deals have included Facebook's lease of around 100,000 sq ft (c. 9,300 sq m) at the Beckett Building in Dublin 3.

3 LONDON

Demonstrating the current dominance of Far Eastern investors in the London market, Hong Kong's CC Land has agreed to buy the Leadenhall Building skyscraper for UK£1.15 billion (c. €1.3 billion).

4 MADRID

UK-based Intu Properties acquired the Xanadú shopping centre in Madrid for €530 million in Q1. This is Intu's third shopping centre acquisition in Spain.

5 MILAN

US investors remain very active in the Milan investment market, with Hines and Blackstone both making sizeable office acquisitions in Q1.

6 MUNICH

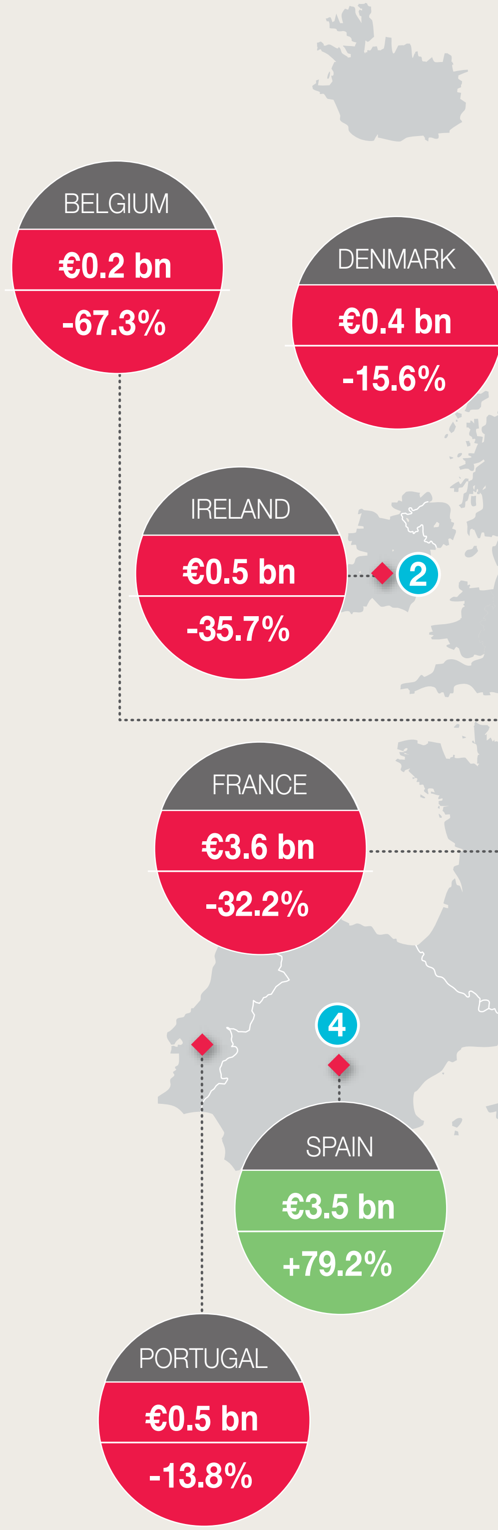
The largest leasing transaction of an extremely active Q1 saw Deutsche Pfandbriefbank pre-lease approximately 14,000 sq m in a building to be constructed at the Business Campus München in Garching.

7 PARIS

Île de France office take-up reached 638,800 sq m in Q1, making it the strongest opening quarter since 2007. There was one exceptionally large deal, which saw Natixis Bank pre-lease 88,500 sq m at the Tours Duo skyscraper project, which is scheduled for completion in 2021.

8 WARSAW

Gross take-up reached 194,000 sq m in Q1, a 40% year-on-year increase. The largest deal of the quarter saw AstraZeneca renew a lease of 7,000 sq m, and take an additional 6,200 sq m, at Postepu 14.



ELECTION WATCH

Europe is in the midst of a series of major elections. What impact will these have on real estate markets?

NETHERLANDS General election, March 2017

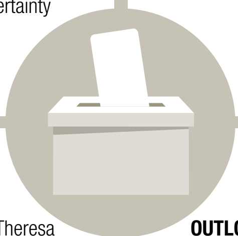
RESULT Prime Minister Mark Rutte's VVD Party was returned as the largest party, beating the far-right PVV into second place. It is likely to be some months before a government is formed, as initial negotiations aimed at creating a four-party coalition collapsed in May.

IMPACT The election had little impact on the buoyant Dutch real estate market, and the failure of the far-right to make significant gains will have reassured many investors. However, uncertainty remains with the composition of the coalition to be confirmed.

FRANCE Presidential election, April/May 2017

RESULT The pro-EU centrist Emmanuel Macron beat the far-right candidate Marine Le Pen by a 66% to 34% margin in an election run-off.

IMPACT Investment activity slowed significantly in the run-up to the election, and clauses to be enacted in the event of a Le Pen victory were placed into some real estate contracts. The decisive result has eased investor uncertainties, and a post-election surge in activity is now anticipated.



UK General election, June 2017

OUTLOOK Conservative Prime Minister Theresa May has called a surprise snap election for 8th June. Opinion polls suggest that it is highly likely that the Conservative party will be returned to power with an increased majority.

IMPACT With a Conservative victory widely seen as an inevitability, the election is unlikely to provide many surprises for investors. Sentiment towards the UK market will be more greatly influenced by the progress of ongoing Brexit negotiations.

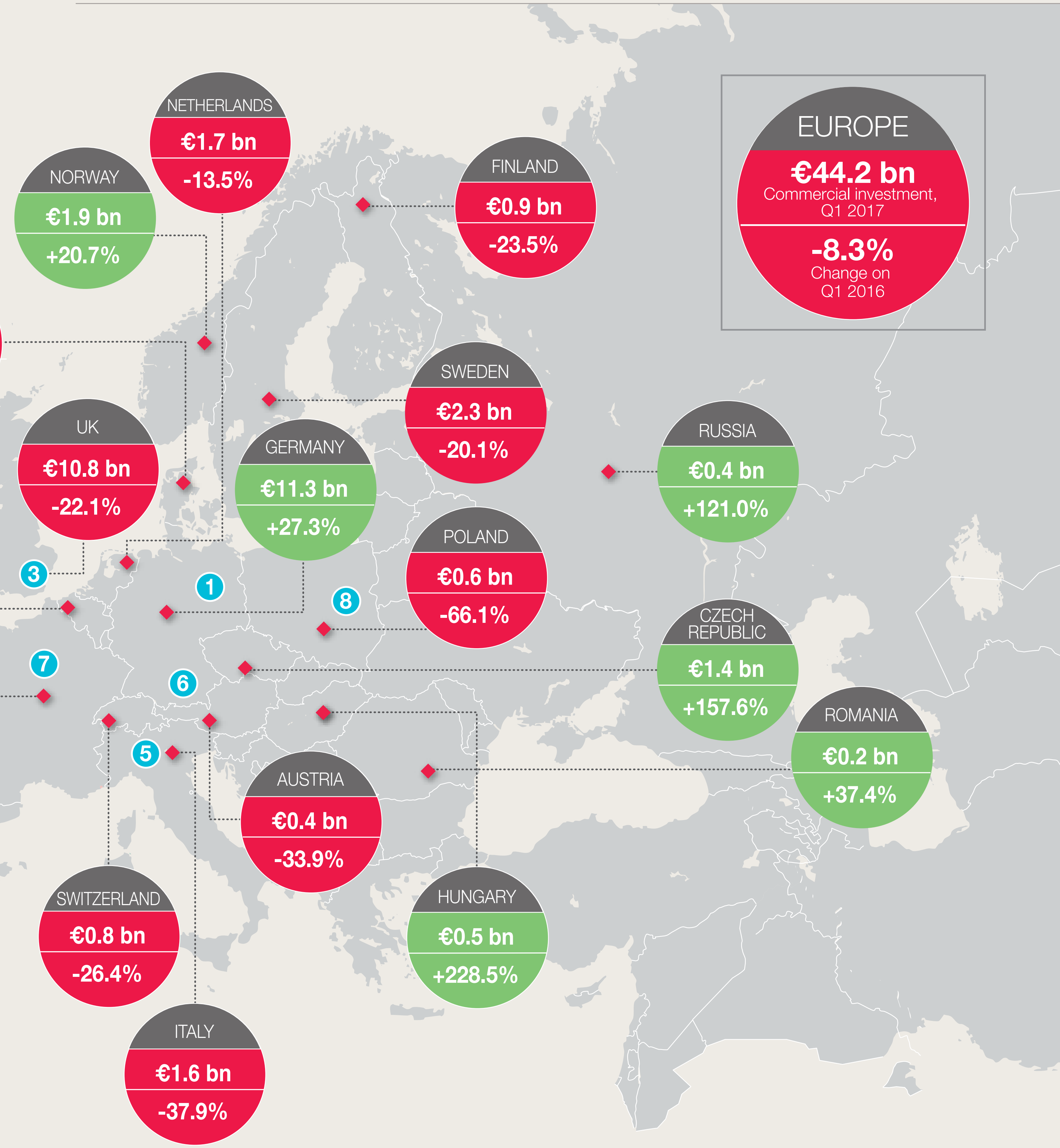
GERMANY Federal election, September 2017

OUTLOOK Chancellor Angela Merkel's centre-right CDU party will face a challenge from the centre-left SPD, with which it currently forms a coalition government. After making gains at regional elections in 2016, support for the anti-immigration AfD party appears to have slumped.

IMPACT With the CDU making a strong showing in 2017 regional elections and support for the AfD receding, it now seems unlikely that the federal election will deliver a seismic shift in the German political landscape. Although investors may show some caution around the time of the election, Germany should retain its current popularity as a safe haven market.

FIGURE 4

European commercial property investment volumes, Q1 2017



Source: Real Capital Analytics / Knight Frank Research
Investment volumes comprise office, retail, industrial and hotel transactions

EUROPEAN MARKET INDICATORS

Although Berlin saw a pause in rental growth in Q1, prime office rents in the German capital are 25% higher than a year ago.

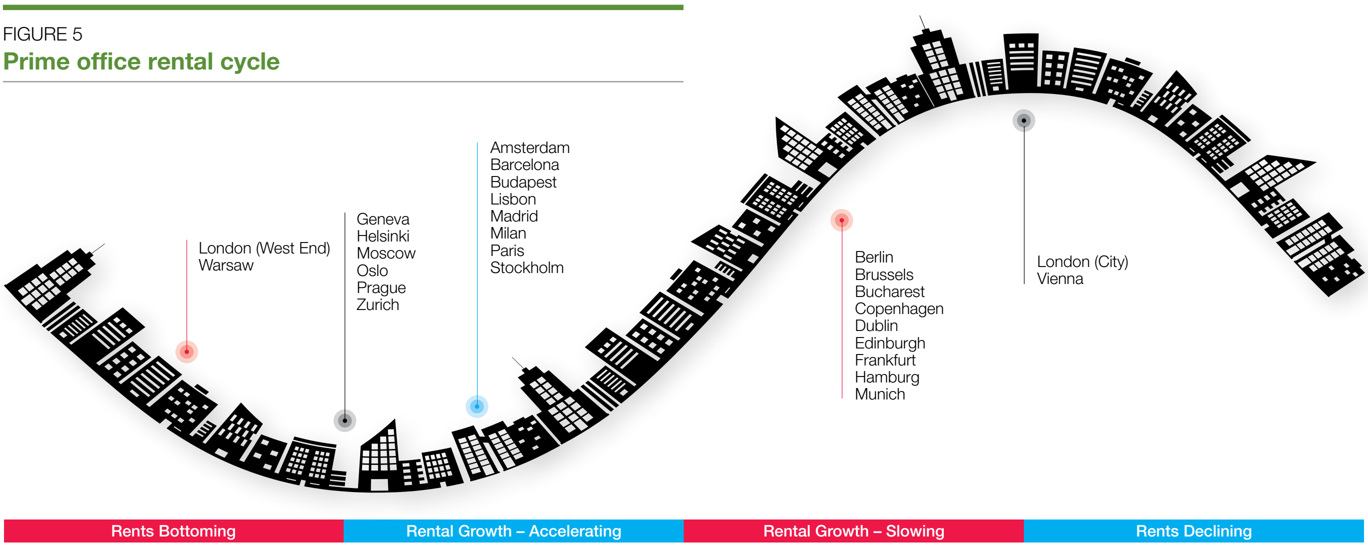
Commercial property prime rents and yields

City	Offices Prime rents (€/sq m/yr)	Offices Prime yields (%)	Logistics Prime rents (€/sq m/yr)	Logistics Prime yields (%)	Shopping centres Prime rents (€/sq m/yr)	Shopping centres Prime yields (%)	Retail warehousing Prime rents (€/sq m/yr)	Retail warehousing Prime yields (%)
Amsterdam	365 ▲	4.25 ▼	85 ▲	5.25 ▼	1,000 ►	5.25 ►	135 ►	5.75 ►
Barcelona	261 ▲	4.25 ▼	72 ▲	6.00 ▼	600 ▲	4.50 ►	129 ►	5.75 ►
Berlin	360 ▲	3.50 ▼	69 ►	5.25 ▼	1,380 ►	3.90 ▼	150 ►	5.50 ▼
Brussels	300 ►	5.00 ▼	55 ►	6.00 ▼	1,800 ►	4.75 ►	185 ►	5.50 ►
Bucharest	216 ►	7.50 ►	48 ►	8.75 ►	720 ►	7.25 ►	120 ►	9.50 ►
Budapest	264 ▲	6.25 ▼	42 ▲	8.00 ▼	1,140 ▲	6.00 ▼	96 ►	7.50 ►
Copenhagen	249 ▲	4.00 ►	77 ►	5.75 ▼	726 ▲	4.50 ▼	165 ►	6.25 ►
Dublin	646 ►	4.50 ►	80 ►	5.25 ►	3,500* ▲	4.50 ►	290 ►	5.25 ►
Edinburgh	418 ▲	5.25 ►	100 ►	6.50 ►	2,747* ►	5.00 ►	378 ►	6.00 ►
Frankfurt	462 ►	4.00 ▼	80 ►	4.75 ▼	1,560 ►	3.90 ▼	170 ►	5.50 ▼
Geneva	700 ►	3.00 ▼	187 ►	5.50 ▼	1,065 ►	4.00 ►	168 ►	5.00 ►
Hamburg	300 ►	3.50 ▼	72 ►	5.00 ▼	1,650 ►	3.90 ▼	150 ►	5.50 ▼
Helsinki	396 ►	4.00 ▼	120 ►	5.75 ▼	1,200 ►	4.50 ▼	120 ▲	6.00 ►
Lisbon	222 ►	5.00 ►	45 ►	6.50 ►	1,170 ▲	5.00 ►	120 ►	7.00 ►
London	1,311 (WE) ▼ 874 (City) ►	3.50 (WE) ► 4.25 (City) ►	175 ►	4.50 ►	5,556* ►	4.25 ►	587 ►	4.50 ►
Madrid	336 ▲	3.90 ►	66 ▲	6.00 ▼	600 ▲	4.50 ►	156 ►	5.75 ►
Milan	500 ►	4.50 ►	50 ►	7.00 ►	850 ►	5.50 ►	300 ►	7.00 ►
Moscow	726 ►	10.00 ►	75 ▼	11.50 ►	3,260 ►	10.50 ►	N/A	N/A
Munich	432 ►	3.30 ▼	85 ►	4.75 ▼	1,900 ►	3.90 ▼	180 ►	5.00 ▼
Oslo	469 ►	3.75 ►	133 ►	5.50 ▼	1,310 ►	4.25 ►	143 ►	5.75 ►
Paris	770 ▲	3.00 ►	58 ►	5.50 ▼	2,500 ►	3.75 ▼	180 ►	5.00 ▼
Prague	240 ▲	4.75 ▼	48 ►	6.25 ▼	1,380 ►	5.25 ▼	120 ►	7.50 ▼
Stockholm	659 ▲	3.50 ▼	110 ►	5.50 ►	830 ►	4.25 ►	220 ►	5.50 ►
Vienna	309 ►	4.00 ▼	72 ►	6.50 ▼	1,320 ►	4.95 ►	168 ►	5.85 ►
Warsaw	276 ▼	5.25 ►	60 ►	7.00 ►	1,800 ►	5.50 ►	132 ►	7.50 ►
Zurich	747 ►	3.00 ►	233 ►	5.50 ▼	1,401 ►	4.00 ►	187 ►	5.00 ▼

Indicative prime yields, as quoted locally, based upon a hypothetical Grade A unit. Office rents are for prime city area Grade A space, 2,000 sq m. Shopping Centre rents are based on prime covered shopping malls, quoted on best position, 100 sq m units. Retail Warehouse rents are for units of 1-5,000 sq m located in purpose built parks. Typical Retail Warehouse schemes vary between countries. Logistics rents are for prime industrial space of units over 5,000 sq m. The data above is provided for general reference purposes only. Local market conditions will vary. *Zoned/weighted figure. Arrows provide a broad indication of recent movements and the short-term outlook for prime rents and yields. London office data is quoted for the West End (WE) and City (C) submarkets.

Source: Knight Frank Research

FIGURE 5
Prime office rental cycle



The above diagram is intended to provide a comparative guide to the current positions of European prime office markets in their rental cycles. Markets will move through their cycles at different speeds and, sometimes, in different directions. The positions indicated in the diagram do not constitute formal forecasts of future rental trends.

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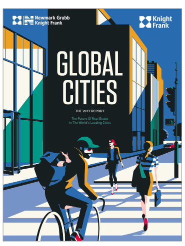

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