RESEARCH

EUROPEAN QUARTERLY

COMMERCIAL PROPERTY OUTLOOK

Q3 2014

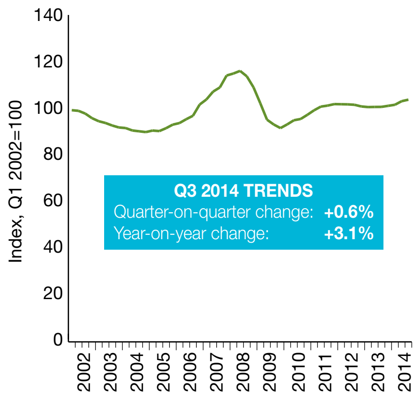
OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET INDICATORS

EUROPEAN OUTLOOK

Recent concerns over the Eurozone economy have failed to derail investment market activity, but occupier market sentiment is more subdued.

FIGURE 1

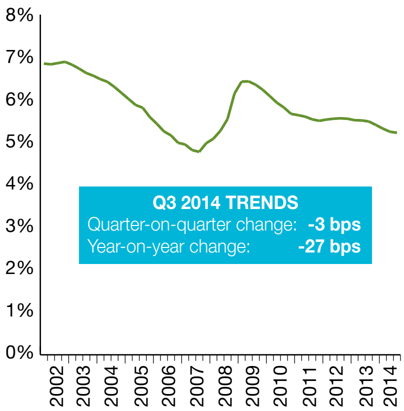
European prime office rental index



Source: Knight Frank Research

FIGURE 2

European weighted average prime office yield



Source: Knight Frank Research

The Eurozone economy has performed below expectations in 2014, with GDP growth of 0.3% in Q1 and 0.1% in Q2. Annual growth of around 0.8% is generally forecast for 2014, rising to about 1.3% in 2015.

Compounding the weakening growth outlook, concerns over the threat of deflation have intensified, with Eurozone inflation standing at 0.4% in October, and negative inflation recorded in several European countries, including Italy, Greece and Poland. While a period of low inflation in Europe remains more likely than outright deflation, this could still depress economic and property market activity, and would have particular implications for European property owners and occupiers with index-linked leases.

Despite the wider economic uncertainty, European investment market activity remained healthy in Q3 2014, with commercial property investment volumes reaching €37.0 billion. Although this was a slowdown from the exceptionally strong performance of Q2, it was a 10.3% increase compared with Q3 2013. Investment volumes for the first nine months of the year amounted to €114.9 billion, a 22.3% increase on the same period of 2013.

The core markets of the UK, Germany and France have continued to post healthy year-on-year increases in investment. However, the strongest improvements have been in recovering non-core markets, as countries such as Spain, Ireland and the Netherlands have benefited from investors' increased willingness to move up the risk curve and invest across a broad range of geographies and property types.

With Q4 investment volumes likely to be boosted by investors seeking to close deals by the year-end, it is forecast that European commercial investment for 2014 will break the €160 billion barrier. Investment activity is expected to remain strong into 2015, as there is a large wall of capital continuing to target the sector. European property yields will retain attractive margins over other asset classes, particularly as it seems increasingly unlikely that the European Central Bank will raise interest rates before 2017.

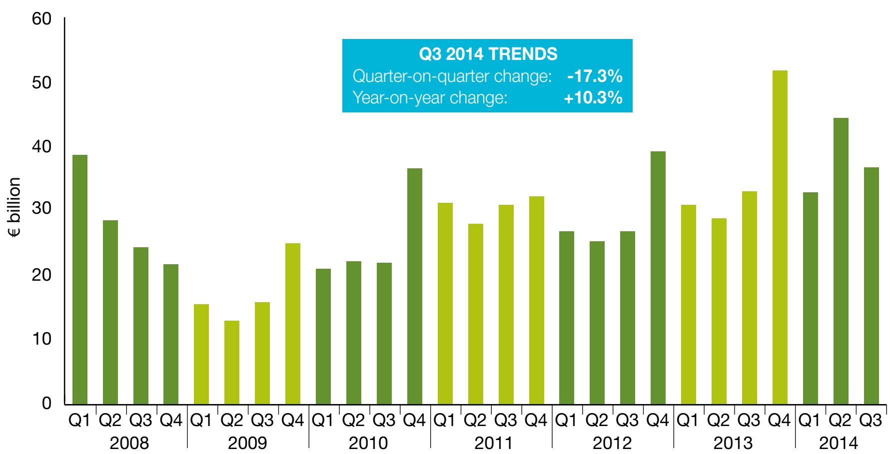
European occupier market trends remain varied, and there was a marked contrast between the performances of the continent's two biggest markets in Q3. The central London office market recorded its highest quarterly take-up for seven years, but leasing activity in Paris was at its lowest level since Q3 2009.

Prime rental growth was fairly modest in Q3, with the Knight Frank European Prime Office Rental Index rising by 0.6%. This was on the back of continued strong growth in Dublin, and more modest increases in markets such as London (West End), Barcelona and Vienna. Rising supply levels continue to restrict rental growth prospects in a number of Eastern and Central European markets including Moscow, Warsaw and Prague.

Prime office rental growth is expected to be modest over the coming quarters, and largely restricted to strong core cities with limited supply and the recovering peripheral markets.

FIGURE 3

European commercial property investment volumes



Source: Knight Frank Research / Real Capital Analytics

MARKET HIGHLIGHTS

1 AMSTERDAM

Demand from TMT occupiers has boosted office take-up in Amsterdam. Two of the largest deals of the year have been lettings to Booking.com, for 5,000 sq m at Prins en Keizer and 5,300 sq m at Rembrandtplein 29-45.

2 BRUSSELS

Office leasing activity slowed during Q3, after take-up in H1 was boosted by several large public sector transactions. The Flemish Government's 50,000 sq m pre-lease at the Meander project in Q2 remains the year's largest deal.

3 DUBLIN

Continuing an exceptionally active year for the Dublin investment market, Green REIT confirmed in October that it had completed the €375 million acquisition of the Sapphire Portfolio, which comprises office and retail assets.

4 FRANKFURT

The strength of international investor demand for Frankfurt office towers was underlined in Q3 by Blackstone's acquisitions of the MesseTurm for c.€250 million and the Pollux tower for c.€100 million, the latter being purchased with co-investor Finch Properties.

5 LONDON

With office take-up of 427,000 sq m in Q3 2014, the central London market enjoyed its strongest quarter since Q3 2007, driven primarily by strong activity in the City submarket. The largest deal of the quarter was Amazon's pre-lease of c.40,000 sq m in Brookfield's Principal Place development.

6 MADRID

International investor demand for Spanish commercial property remains heightened. In October, TIAA Henderson Real Estate reportedly bought the Islazul shopping centre for c.€230 million.

7 MILAN

Milan prime office rents have stabilised at €475 per sq m per annum but, with occupier sentiment remaining cautious, rental growth is not anticipated in the short term.

8 MOSCOW

Office completions in Moscow during 2014 are expected to reach the highest annual total since 2008. With occupier demand remaining subdued, rents are subject to downward pressure and vacancy rates are rising.

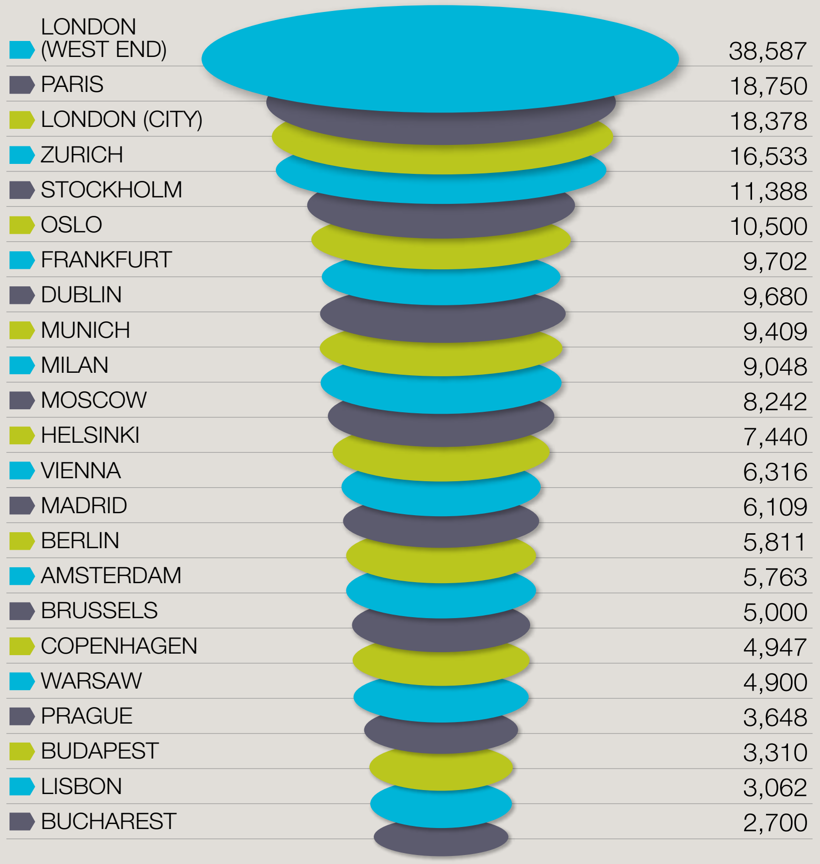
9 PARIS

Although Q3 was a weak quarter, Île de France office take-up over the first nine months of 2014 amounted to 1.53 million sq m, putting the market on course to overtake the 1.87 million sq m leased in 2013. The overall vacancy rate has remained relatively low and stable, at 7.2%, as a result of limited development activity.

10 WARSAW

A growing range of international investors are seeking opportunities in Poland. The US investor Starwood Capital made its first Polish office acquisitions in Q3, acquiring a portfolio comprising two office parks in Warsaw and one in Katowice for c.€192 million.

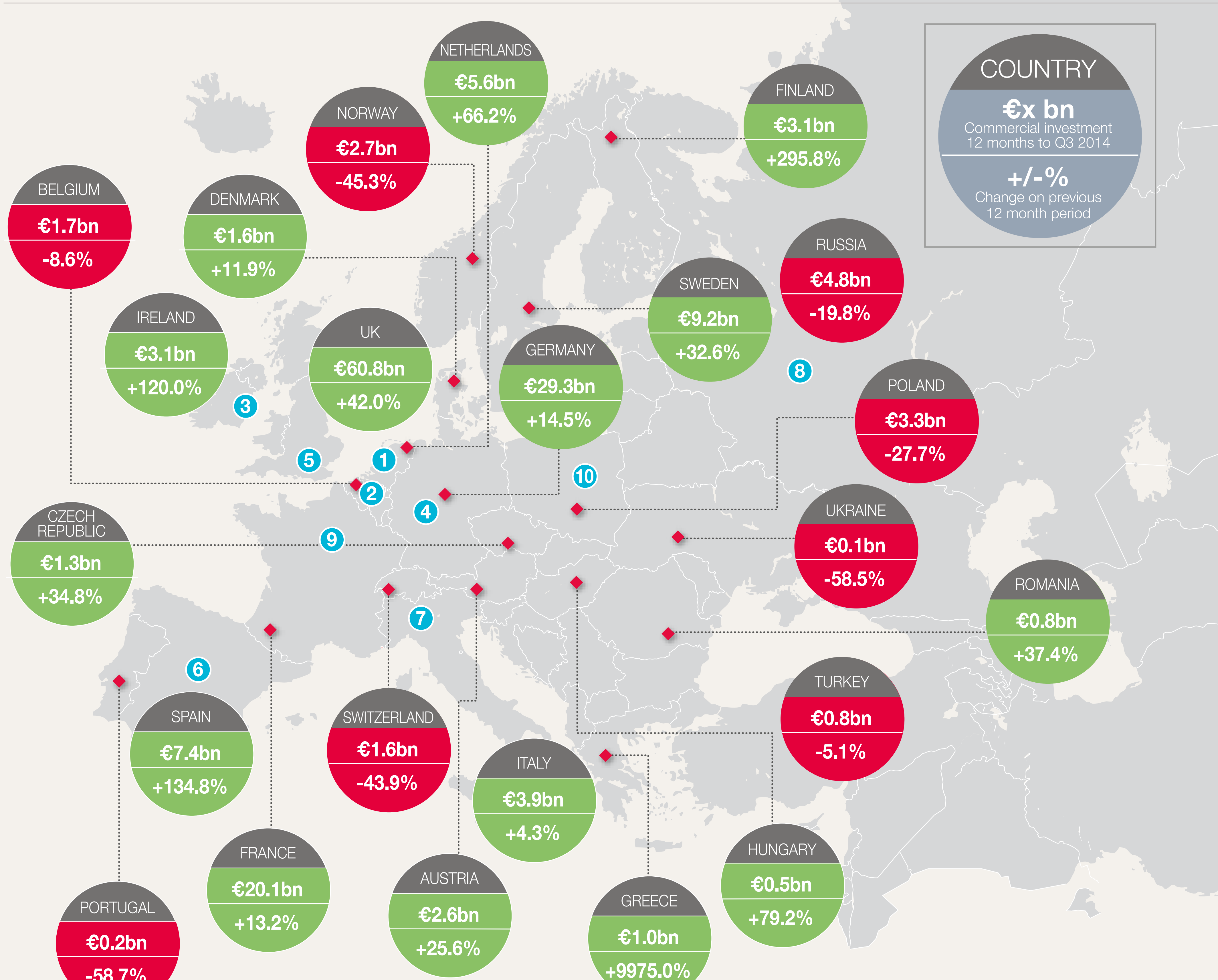
FIGURE 4 **European prime office capital values (€ per sq m)**



Source: Knight Frank Research

FIGURE 5

European commercial property investment volumes, 12 months to Q3 2014



Source: Knight Frank Research / Real Capital Analytics

Investment volumes comprise office, retail, industrial and hotel transactions

EUROPEAN MARKET INDICATORS

European prime office rental growth slowed in Q3, but quarterly growth of 12.5% in Dublin was the stand-out performance.

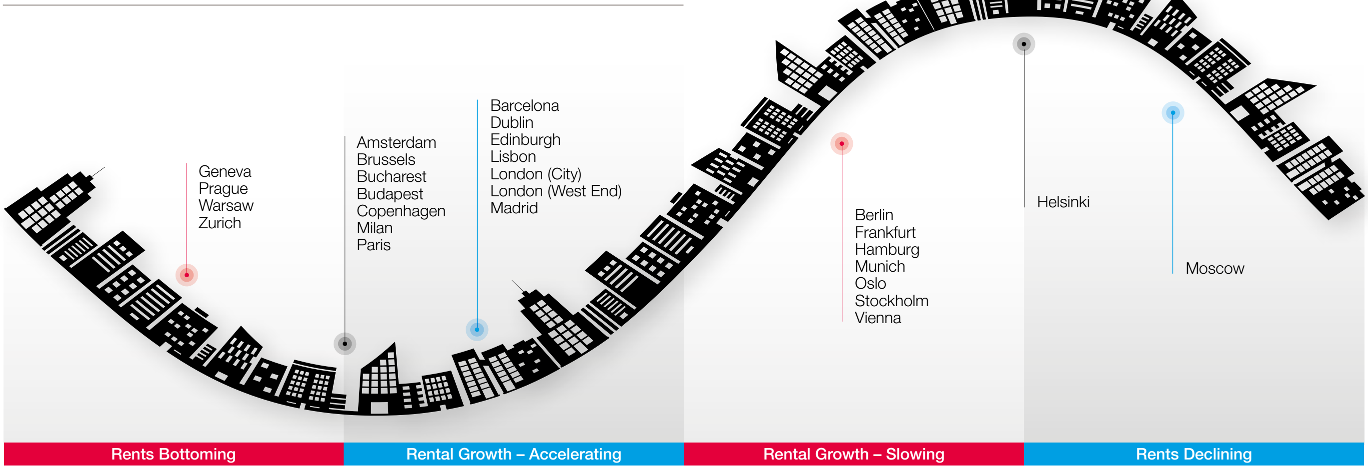
Commercial property prime rents and yields

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	340 ▶	5.90 ▼	85 ▶	6.75 ▼	1,000 ▶	5.50 ▶	135 ▶	6.75 ▶
Barcelona	204 ▲	5.75 ▼	54 ▲	8.25 ▶	552 ▲	5.50 ▼	120 ▲	7.00 ▼
Berlin	276 ▶	4.75 ▼	66 ▶	6.50 ▼	1,380 ▶	4.75 ▼	150 ▶	6.25 ▼
Brussels	300 ▶	6.00 ▶	45 ▶	7.05 ▼	1,800 ▶	5.35 ▶	170 ▶	6.00 ▶
Bucharest	216 ▶	8.00 ▼	45 ▶	10.00 ▼	504 ▶	8.00 ▼	96 ▶	10.00 ▶
Budapest	240 ▶	7.25 ▼	54 ▶	9.00 ▶	960 ▶	7.00 ▶	90 ▶	8.00 ▶
Copenhagen	235 ▶	4.75 ▶	67 ▶	7.00 ▶	697 ▶	5.75 ▶	157 ▶	6.75 ▶
Dublin	484 ▲	5.00 ▼	65 ▶	7.75 ▼	2,520* ▶	6.50 ▼	200 ▲	7.50 ▼
Edinburgh	382 ▶	5.75 ▶	89 ▲	7.00 ▶	2,342* ▶	5.50 ▼	378 ▶	6.25 ▼
Frankfurt	456 ▶	4.70 ▼	80 ▶	6.25 ▶	1,560 ▶	4.75 ▼	168 ▶	6.25 ▼
Geneva	660 ▼	4.00 ▲	166 ▶	6.00 ▶	1,100 ▶	4.50 ▶	200 ▶	5.50 ▶
Hamburg	300 ▶	4.50 ▼	68 ▶	6.25 ▼	1,620 ▶	4.75 ▼	150 ▶	6.25 ▼
Helsinki	372 ▶	5.00 ▶	120 ▶	7.00 ▶	1,200 ▶	5.25 ▶	145 ▶	6.50 ▶
Lisbon	222 ▲	7.25 ▼	48 ▶	9.25 ▶	900 ▶	7.75 ▼	90 ▼	9.50 ▶
London	1,447 (WE) ▲ 827 (C) ▲	3.75 (WE) ▶ 4.50 (C) ▶	172 ▲	5.25 ▼	6,131* ▶	4.25 ▼	524 ▶	4.25 ▼
Madrid	336 ▲	5.50 ▼	57 ▲	8.00 ▶	528 ▲	5.50 ▼	120 ▶	7.00 ▼
Milan	475 ▶	5.25 ▶	50 ▶	8.25 ▶	850 ▶	6.50 ▶	300 ▶	7.50 ▶
Moscow	783 ▼	9.50 ▲	98 ▼	11.25 ▶	3,296 ▼	11.25 ▶	N/A	N/A
Munich	414 ▶	4.40 ▼	82 ▶	6.25 ▼	1,860 ▶	4.50 ▼	172 ▶	6.50 ▼
Oslo	525 ▶	5.00 ▶	140 ▶	6.25 ▶	1,000 ▶	5.25 ▶	150 ▶	6.25 ▶
Paris	750 ▶	4.00 ▼	55 ▶	7.00 ▼	2,000 ▲	4.50 ▶	180 ▶	5.30 ▶
Prague	228 ▼	6.25 ▶	51 ▶	7.75 ▶	840 ▶	6.00 ▶	120 ▶	8.00 ▶
Stockholm	484 ▶	4.25 ▼	113 ▶	6.25 ▼	840 ▶	5.00 ▶	226 ▶	6.00 ▶
Vienna	300 ▲	4.75 ▶	72 ▶	7.25 ▶	1,320 ▶	5.25 ▲	168 ▶	6.00 ▼
Warsaw	294 ▶	6.00 ▶	66 ▶	7.50 ▶	1,200 ▶	6.00 ▶	132 ▶	7.50 ▶
Zurich	620 ▼	3.75 ▲	149 ▶	6.00 ▶	1,200 ▶	4.50 ▶	220 ▶	5.50 ▶

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.

FIGURE 6

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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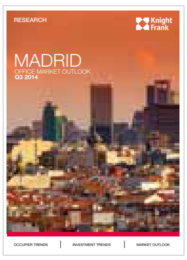

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