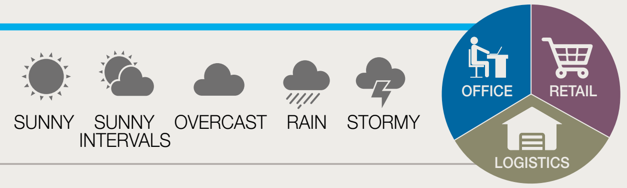
RESEARCH

EUROPEAN
COMMERCIAL PROPERTY OUTLOOK **2016**

MIPIM SPECIAL: A VIEW FROM LA CROISETTE

KEY

The weather symbols represent our view of investment sentiment for commercial property in 2016.



EUROPEAN OUTLOOK

The European investment market entered 2016 on the back of a very strong 2015, in which annual commercial property transaction volumes rose by 25% year-on-year to €238.5 billion.

The main drivers of this increased activity – the stabilising Eurozone economy, low borrowing costs and wide yield spreads to other asset types – continue to attract large volumes of capital to the property sector at the outset of 2016.

Although the investment case for European property remains strong, there are headwinds which may cause the investment market to lose a little of its recent momentum in 2016. These include the prospect of global interest rate rises, concerns over pricing and a possible slowdown in capital flows from Asia and the Middle East into Europe. Knight Frank's expectation is that overall European transaction volumes for this year will be similar to 2015 levels, ending a run of three consecutive years in which volumes have risen by more than 20% annually.

Global interest rate rises are currently at the forefront of investors' minds. The US Federal Reserve raised interest rates in December 2015 and the Bank of England may follow suit in 2016. In the wake of global interest rate rises, bond yields could rise and the margins between property yields and bond yields may be gradually eroded, although they should remain attractive to investors. The European Central Bank is the least likely of the "big three" central banks to raise interest rates in 2016, and yield margins can be expected to stay wider for longer in the Eurozone than in the US and UK.

Investors should be buoyed by continued improvements in European occupier market activity in 2016. Increased take-up was recorded in the majority of key office markets in 2015, and Knight Frank forecasts that aggregate European office take-up will increase by around a further 10% in 2016. Although improved occupier demand has, to date, resulted only in moderate office rental growth outside of hotspots such as Dublin and London, rental increases should become more widespread in 2016, supported by the diminishing availability of prime office space in European CBDs.

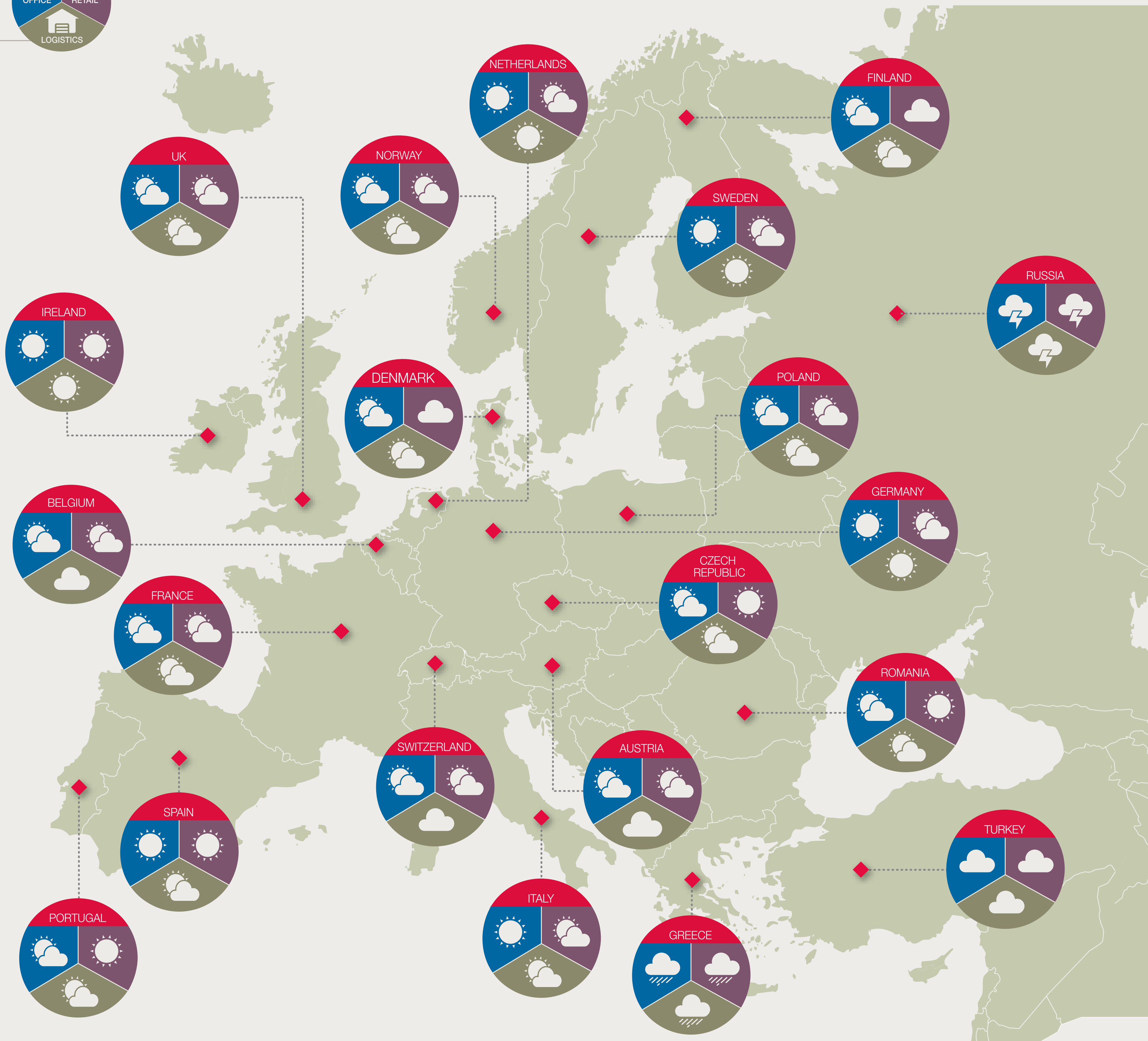
OPPORTUNITIES FOR 2016

Investment

- **Rental growth hotspots:** Prime office rents are still close to the bottom of the cycle, and below long-term averages, in markets such as Spain and France. A combination of improving occupier demand and falling vacancy rates should support rental growth in a growing number of European markets, and this will increasingly drive investment decisions.
- **Specialist sectors:** Sectors such as healthcare, automotive and student property are still emerging in many European markets, but they offer higher yielding opportunities than traditional commercial property sectors and a route to portfolio diversification.

Development

- **CBD office development:** The lack of new development since the global financial crisis has led to shortages of prime CBD space, and occupiers seeking large centrally-located offices have very limited choices in many European cities. The pent-up demand for such office space should mean that well-located new developments are able to command rental premiums.
- **Redevelopment of secondary stock:** The polarisation of European office demand has resulted in low vacancy rates for prime central offices, but continued high vacancy levels in Grade B offices and secondary locations. There are opportunities to gain value by redeveloping secondary assets, and through change of use to residential, hotel or student accommodation.



Source: Knight Frank Research

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Lee Elliott
Partner, Head of Commercial Research
+44 20 7629 8171
lee.elliott@knightfrank.com

Matthew Colbourne
Associate, International Research
+44 20 7629 8171
matthew.colbourne@knightfrank.com

Heena Kerai
Analyst, International Research
+44 20 7629 8171
heena.kerai@knightfrank.com

EUROPE

Chris Bell
Managing Director, Europe
+44 20 7629 8171
chris.bell@knightfrank.com

Andrew Sim
Head of European Capital Markets
+44 20 7629 8171
andrew.sim@knightfrank.com

Nick Powlesland
Head of European Valuations
+44 20 7629 8171
nick.powlesland@knightfrank.com

Emma Goodford
Head of EMEA Tenant Representation
+44 20 7629 8171
emma.goodford@knightfrank.com

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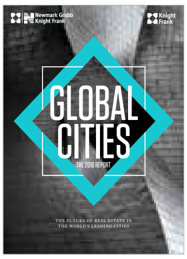

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Knight Frank Research Reports are available at **KnightFrank.com/Research**

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