A quarterly report providing a concise overview of European Office market trends

Knight Frank

European office outlook

Winter 2019

knightfrank.com/research

EUROPEAN OUTLOOK

Europe saw moderate stabilisation in Q3 2019, with Germany avoiding recession and the overall Eurozone economy recording a 0.2% GDP growth rate over the quarter, in line with expectations.

Dovish monetary environment is expected to support the overall European economic environment, despite continued global geopolitical headwinds. For example, in November the ECB resumed net purchases at a monthly pace of €20bn, while interest rates remain unchanged for now.

European Office investment volumes increased by 9% q-q to €29bn in Q3 2019. Cross border investment volumes totalled just under half of this number, at €14bn.

A significant contributor to cross border capital investment across Europe have been South Korean investors. In the year to Q3 2019, the South Korean market share of cross border investment into European Offices increased by 10% to 16%, compared to the year prior. Excluding the UK from the European figures, the South Korean market share grows from 5% to 19% over the same period.

Looking ahead to 2020, we expect demand for European commercial real estate to strengthen. In the current lower for longer interest environment, over half of Eurozone government bonds are negative yielding, an amount of circa €4.6 trillion. In this context, the positive yield and income feature of commercial real estate could look relatively attractive. This is particularly relevant for liability matching investors, notwithstanding regulatory considerations.

Specifically, according to Capital Economics, over €40 billion of German government bonds with a coupon of 3% or higher are due to mature in 2020. These bond-holders are either going to have to realign their income expectations or look to other asset classes such as commercial real estate, to find similar expected returns.

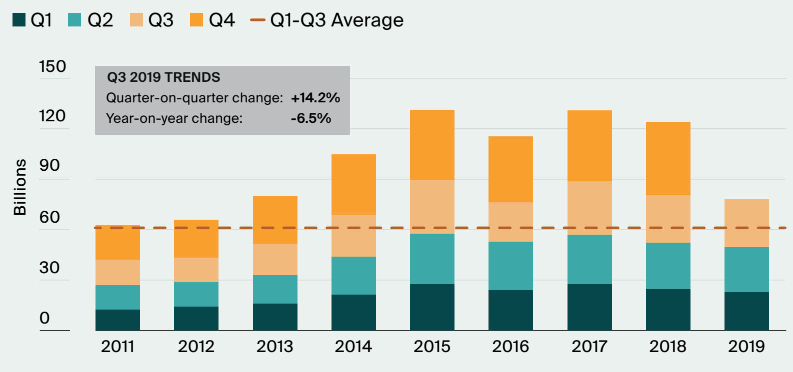
Compared to such a low yielding bond environment, the average prime office yield across our European survey area is 4.08%.

However, there is evidence from across the risk spectrum of demand for real estate. At the more risk seeking end, Preqin estimates that in Q3 2019 alone, $14 billion of dry power targeting European real estate was raised by Private Equity.

Alongside continued investment prospects in 2020, we also anticipate further growth in the occupier markets in Europe. Across the survey area, prime Office rents grew by 1.9% q-q and 4.3% over the year, with Berlin and Amsterdam experiencing close to 17% and 16% rental growth year-on-year, respectively. 32% of the survey area, including Bucharest, Madrid, Barcelona, and Warsaw still have room to grow compared to previous cycle rents. This is reaffirmed by low vacancy rates across the survey area, which have continued to drop both over the quarter (-0.1%) and year-on-year (-0.8%) to just 6.4%. The combination of growing rents and falling vacancy rates is indicative of the occupier appetite in European Prime Offices, and we expect this to continue into 2020.

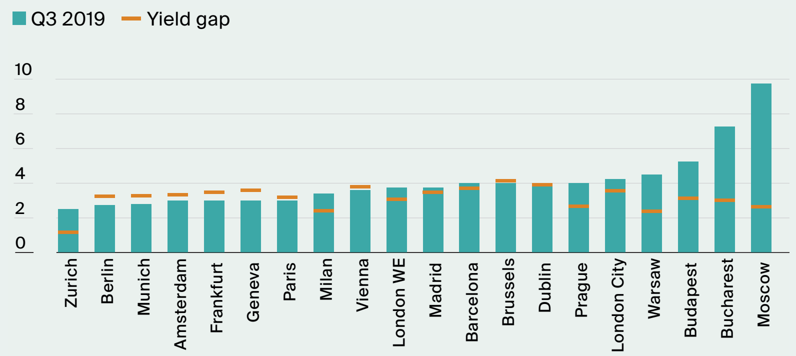
Take-up also supports this view, as the survey area experienced growth in take-up by 14% over the quarter and 11% year-on-year. Cities including Berlin, Brussels, Budapest and Moscow contributed significantly to this. We expect this positive momentum to continue in the occupier market over the coming quarters.

Fig 1. European commercial property investment volumes



Source: Real Capital Analytics/Knight Frank

Fig 2. European prime office yields vs 10 year government bond rate
Q3 2019



Source: Knight Frank Research, Eurostat, Macrobond, Swiss National Bank

If just 1% of the negative yielding government bonds were re-allocated to real-estate, this would equate close to €46bn of additional capital, which is 20% more than the total commercial investment for France in 2018.

MIKE BOWDEN
PARTNER, CAPITAL MARKETS

THE ASCENT OF SINGLE ASSET MEGA-DEALS

EXCEPTIONAL EUROPEAN FUNDRAISING DRIVING DEMAND

2019 has been an exceptional year for European fund raising, further highlighting the attractiveness of real estate as an asset class. In H1 2019, €19.5bn was raised between the top 10 funds, with €10bn raised by Blackstone alone. Whilst sizeable portfolio deals have remained extremely attractive, a lack of product and scalable opportunity has kept volumes at a similar trading level to last year. But what is clear is the increase in large single asset transactions. In the 12-months to Q3 2019, excluding the UK, €200m+ single asset transactions rose by 14%, to 50 transactions worth €18.4bn.

PARIS TOP FOR LARGE SINGLE ASSET TRANSACTIONS

Of the 10 largest single asset Office transactions across Europe over the last 12 months, 70% were in Paris. The largest single asset transaction was the Lumiere Building in Paris's 12th Arronndissement, a 150,000 sq m property, which traded for €1.2bn to a consortium of Korean investors in a joint venture with Primonial. Germany has also witnessed a similar phenomenon with Korean capital. Trianon, a 45-storey tower building spanning 69,000 sq m located in Frankfurt CBD was sold for €670m to a consortium of Korean investors.

CROSS-BORDER CAPITAL DRIVING DEMAND

The main drivers behind this growth are cross border investors. In the year to Q3 2019, overseas investors accounted for 62% of European Office single asset transactions above €200m, which is 10% up from the year prior. The largest cross-border investor group purchasing these large assets are the South Koreans, who account for 35% of all cross-border investment into €200m+ single assets in the year to Q3 2019. The number of these transactions by South Korean investors has increased by 175% to 11 transactions, worth €5.4bn year-on-year in Q3 2019.

Source: Knight Frank Research, RCA

EUROPEAN MARKET INDICATORS

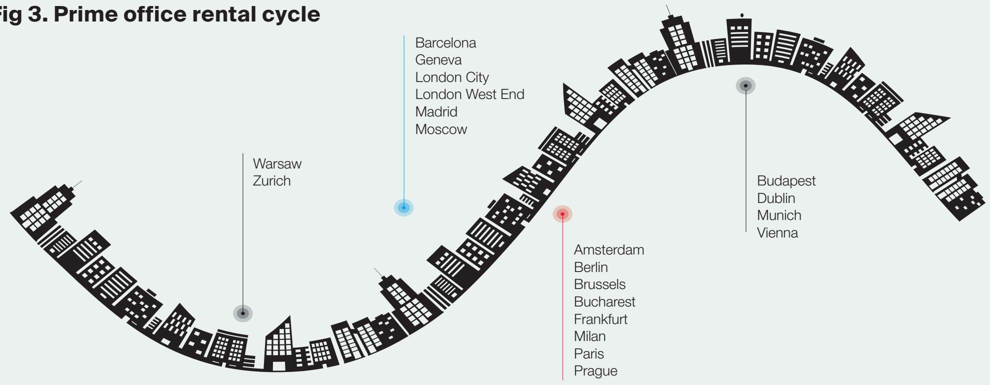
The average European Office yield fell 18bps year-on-year in Q3 2019. Just over a quarter of prime Office yields are expected to experience yield compression into 2020.

COMMERCIAL PROPERTY PRIME RENTS, YIELDS AND OUTLOOKS

	OFFICES		LOGISTICS		SHOPPING CENTRES		HIGH STREETS	
CITY	PRIME RENTS (€/SQ M/YR)	PRIME YIELDS (%)	PRIME RENTS (€/SQ M/YR)	PRIME YIELDS (%)	PRIME RENTS (€/SQ M/YR)	PRIME YIELDS (%)	PRIME RENTS (€/SQ M/YR)	PRIME YIELDS (%)
Amsterdam	475 ▲	3.00 ▶	85 ▲	4.25 ▶	N/A	N/A	3,000 ▼	3.50 ▶
Barcelona	276 ▲	4.00 ▶	82 ▶	5.00 ▶	600 ▶	4.50 ▶	3,480 ▶	3.50 ▶
Berlin	450 ▲	2.75 ▼	84 ▶	4.50 ▶	1,380 ▶	3.75 ▶	3,900 ▶	2.50 ▶
Brussels	320 ▶	4.00 ▶	55 ▶	5.25 ▶	1,650 ▶	4.25 ▶	1,800 ▶	3.75 ▶
Bucharest	216 ▶	7.25 ▼	48 ▶	8.25 ▼	N/A	N/A	840 ▶	7.25 ▶
Budapest	300 ▲	5.25 ▼	N/A	N/A	N/A	N/A	N/A	N/A
Dublin	673 ▶	4.00 ▶	105 ▶	5.25 ▶	3,500 ▶	4.50 ▶	7,000 ▶	3.50 ▶
Frankfurt	540 ▲	3.00 ▶	80 ▲	3.90 ▶	N/A	N/A	N/A	N/A
Geneva	644 ▶	3.00 ▶	184 ▶	4.75 ▼	1,049 ▶	4.25 ▲	3,680 ▶	3.75 ▶
London	1,369 (WE) ▲ 882 (City) ▲	3.75 (WE) ▶ 4.25 (City) ▶	195 ▶	4.00 ▶	N/A	N/A	10,949 ▼	2.75 ▶
Madrid	372 ▶	3.75 ▶	66 ▶	5.00 ▶	600 ▶	5.00 ▲	3,600 ▶	3.25 ▲
Milan	580 ▶	3.40 ▶	55 ▶	5.25 ▶	900 ▶	5.00 ▶	11,500 ▶	2.75 ▶
Moscow	722 ▲	9.75 ▶	69 ▲	11.75 ▶	3,181 ▶	10.00 ▶	N/A	N/A
Munich	456 ▶	2.80 ▼	84 ▶	3.90 ▼	N/A	N/A	4,400 ▶	2.90 ▶
Paris	855 ▲	3.00 ▶	58 ▶	4.25 ▼	1,800 ▼	4.25 ▲	20,000 ▶	2.90 ▶
Prague	276 ▲	4.00 ▼	60 ▲	5.00 ▼	N/A	N/A	2,760 ▲	3.50 ▶
Vienna	312 ▶	3.60 ▶	72 ▶	5.15 ▶	1,920 ▶	4.10 ▶	7,200 ▶	3.30 ▶
Warsaw	300 ▶	4.50 ▶	60 ▶	6.00 ▶	1,200 ▶	4.75 ▶	N/A	N/A
Zurich	782 ▶	2.50 ▶	230 ▶	5.25 ▶	1,380 ▼	4.50 ▶	8,279 ▶	2.50 ▶

Source: Knight Frank Research. All yields are in local convention, net yields are in red.

Fig 3. Prime office rental cycle



This 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.

European Research

Victoria Ormond
Partner, Capital Markets Research
+44 20 7861 5009
victoria.ormond@knightfrank.com

Antonia Haralambous
European Research Analyst
+44 20 3866 8033
antonia.haralambous@knightfrank.com

Europe

Richard Laird
Partner, Capital Markets
+44 20 7861 1663
richard.laird@knightfrank.com

Mike Bowden
Partner, Capital Markets
+44 20 7861 1546
mike.bowden@knightfrank.com

Caroline Bathgate
Head of European Valuations
+44 20 7861 1287
caroline.bathgate@knightfrank.com

Colin Fitzgerald
Head of International Occupier Services
+44 20 7629 8171
colin.fitzgerald@knightfrank.com

Knight Frank Research Reports are available at knightfrank.com/research

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.