

RESEARCH



EUROPEAN QUARTERLY

COMMERCIAL PROPERTY OUTLOOK
Q2 2018



OCCUPIER TRENDS

INVESTMENT TRENDS

MARKET OUTLOOK

EUROPEAN OUTLOOK

Prime yields across Europe are contracting with the average yield now 50 basis points lower than the five-year average.

The H1 18 investment market fell 16% to €87.2bn compared to €104.0bn for the same period last year and is 32% down on the 2015 peak investment volume. It is important to note that it is not one location or one asset class that is causing the fall in investment volumes. Out of the core markets, Germany, previously the favoured destination for US capital, has seen the greatest fall in investment with volumes down 27% as the ongoing trade disputes between China and the US is leading to increasing caution from investors. On a positive note, the investment volume in France increased 38% year-on-year after a sluggish first half of the year for

commercial property in 2017. There is growing interest among investors for core+ and value-add assets due to the lack of core products available on the market.

Investment into capital cities versus regional cities appears unchanged from previous years with over 50% of investment being directed to the capital cities. Only the Netherlands, Poland and Spain are seeing investment spreading out of the capital to the regions where there is more availability of product and more attractive yields.

After an incredible year in 2017, the industrial sector has seen one of the

sharpest falls reaching €11.4bn in H1 2018 compared to €14.14.3bn in H1 2017. With approximately €1.8bn of industrial properties under offer, it is unlikely volumes will reach previous quarters. Office investment volumes in H1 2018 reached €46.8bn which, while down against 2016 and 2017 volumes, is in line with the long-term average.

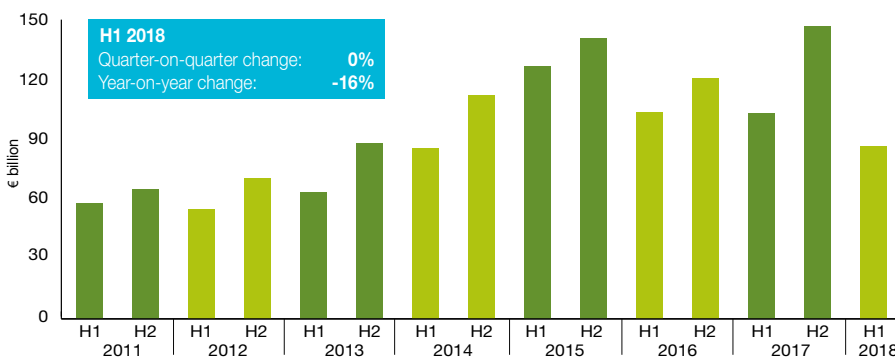
In the first half of the year, few markets recorded year-on-year yield compression with only Frankfurt, Dublin, Brussels and Amsterdam recording noticeable yield contraction. Over half the markets in our survey area are already recording yields well below their five-year average with little room to compress further. We expect yields to remain stable throughout the rest of the year and into H1 2019.

The average European prime office rent fell by over 6% year-on-year, the steepest fall in ten years. The 30% rental increase in Berlin could not offset falls in Zurich, Geneva and Paris La Defense, where the current prime rent is below the 5-year average. The fall in rents can also be explained by a lack of transactions of prime new-redeveloped properties.

Only Berlin experienced double-digit rental growth (+30%) as a critical shortage of space in the CBD continues to put pressure on occupiers who must absorb the higher rents, move to less desirable locations or move to short-term flexible office spaces. Markets that were previously behind the rental cycle such as Madrid and Prague are experiencing rental increases well above the five-year average and will likely see further rental increases in the upcoming months before stabilising towards the end of next year.

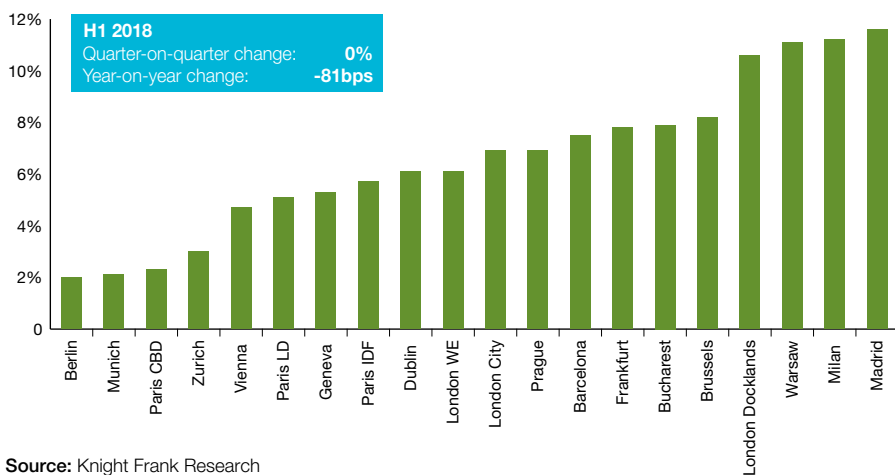
Vacancy rates continue to fall, albeit at a slower pace than previous years. The average vacancy rate across our survey area fell 81 bps to 6.5% with the steepest falls being recorded in Paris La Defense (-290) Warsaw (-280bps), Prague (-170bps) and Dublin (-170bps).

FIGURE 1
European commercial property investment volumes



Source: Real Capital Analytics / Knight Frank

FIGURE 2
Vacancy Q2 2018

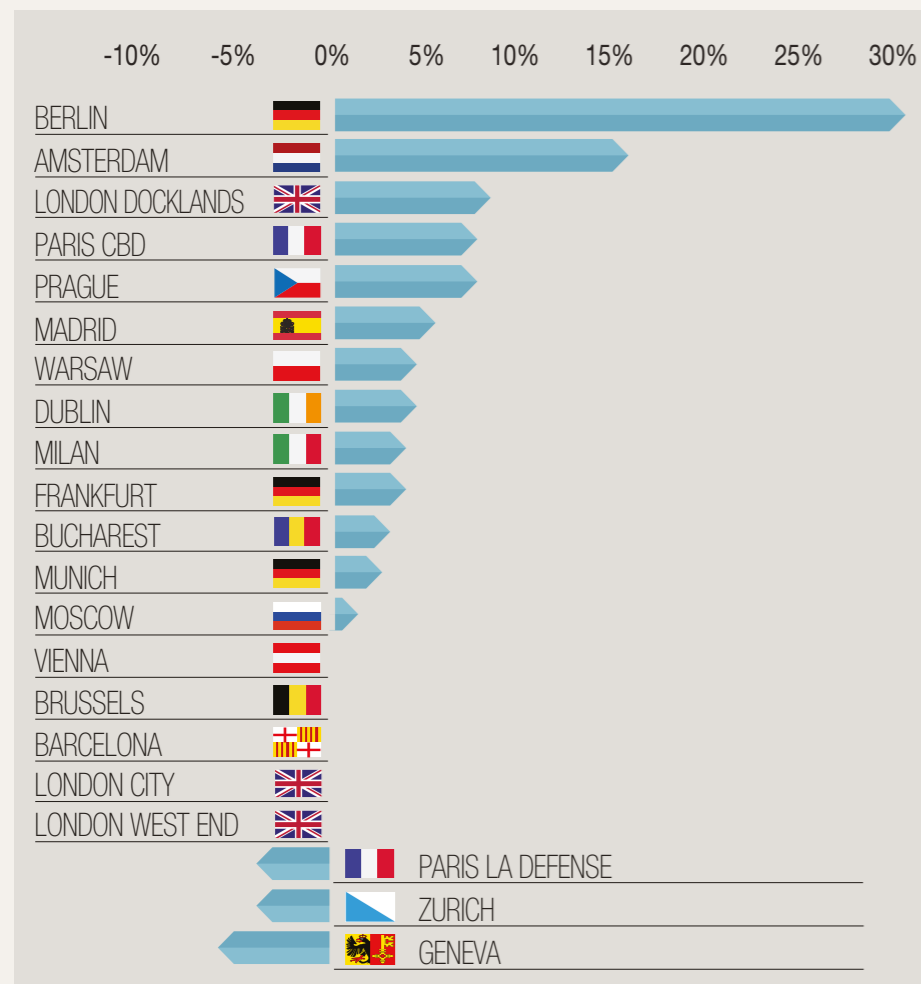


Source: Knight Frank Research

MARKET HIGHLIGHTS

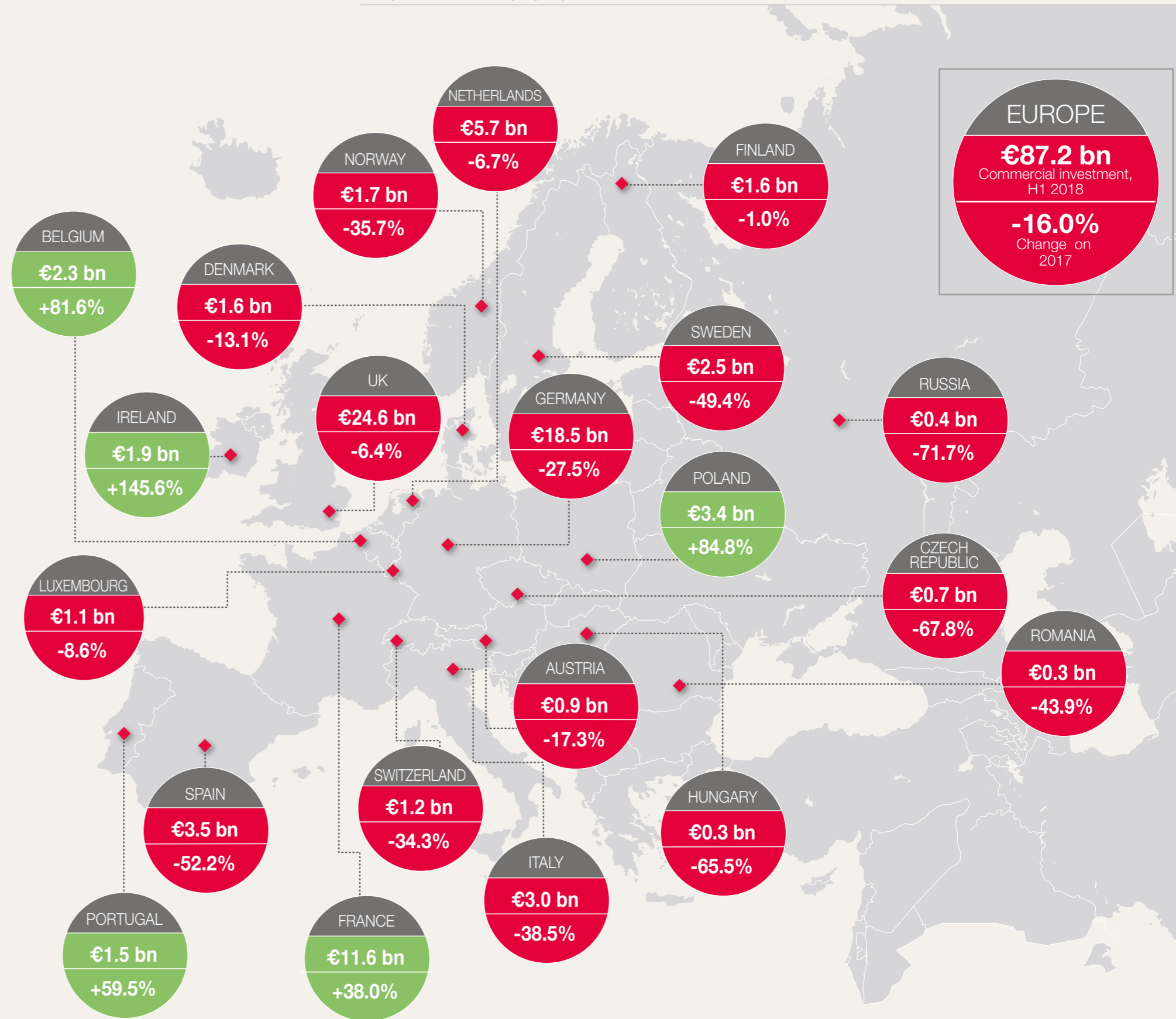
BERLIN 30% prime rental growth in 24 months. 6 years of exceptional growth in investment volume and 65% of all transactions in the office sector.	MOSCOW The lowest delivery of new office space for last 10 years where take-up fell 10% year-on-year.
BUCHAREST The Bucharest office market saw a number of deliveries totaling 33,000 sqm comprised of two buildings. However, H2 will bring 160,000 sqm, a surface almost five times larger than that of the previous first half.	MUNICH Low vacancy rates cause further leases of newbuild projects leading to high pre-lease rates. Rents are still growing in all space segments, even in case of large-scale lettings of over 10,000 sq m prime rents were achieved.
FRANKFURT The Frankfurt investment market ended 2017 strongly, boosted by Deka Immobilien's purchase of Tower 185 for €775 million, in the city's largest single-asset deal of the year.	PRAGUE There is currently ca. 334,200 sq m of office space under construction in Prague with scheduled completion between 2018 and 2019. In Q1 2018, five projects commenced construction, including these buildings: VN47 (14,100 sq m) in Prague 1, Rustonka R3 (11,300 sq m), Rustonka R4 (13,200 sq m), Praga Studios (10,600 sq m) and Praga Office&Garden (2,100 sq m), all in Prague 8.
MILAN The Milan market keeps on proving to be very attractive for investors, though the market is still suffering from a lack of quality product.	WARSAW Continued strong developer activity. The Warsaw market is experiencing a stable vacancy rate despite a high volume of new supply. H1 saw historically high six-month take-up volumes.

FIGURE 4
European prime office year-on-year rental growth H1 2018



Source: Knight Frank Research
Changes calculated in local currencies

FIGURE 5
European commercial property investment volumes, H1 2018



EUROPEAN MARKET INDICATORS

Berlin is still recording office rental growth well above the European average. The vacancy rate is the lowest in Europe at 2.0% putting upward pressure on rents.

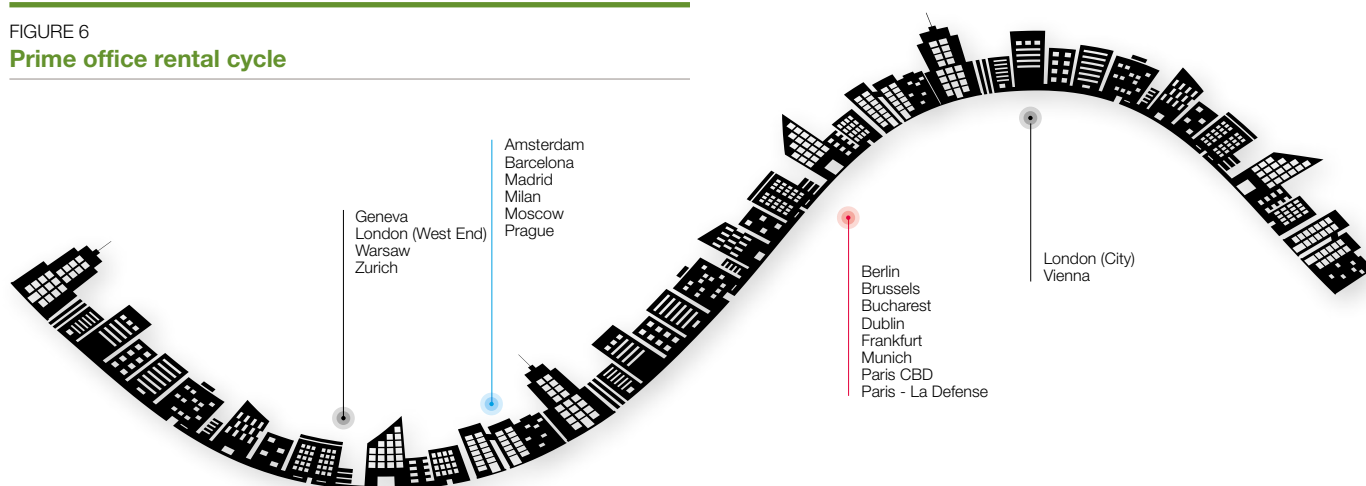
Commercial property prime rents and yields

City	Offices		Logistics		Shopping centres		Retail warehousing	
	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	450 ▲	3.35 ▼	85 ▶	5.00 ▼	1,000 ▶	4.75 ▼	N/A	N/A
Barcelona	270 ▶	4.00 ▶	82 ▶	5.50 ▼	600 ▶	4.25 ▶	129 ▶	5.50 ▶
Berlin	468 ▲	3.00 ▼	84 ▲	4.30 ▼	1,380 ▶	3.75 ▶	150 ▶	5.00 ▼
Brussels	300 ▲	4.25 ▼	55 ▶	5.50 ▶	1,800 ▶	4.25 ▶	185 ▶	5.50 ▶
Bucharest	222 ▶	7.50 ▶	48 ▶	8.25 ▶	720 ▶	7.25 ▶	120 ▲	9.50 ▼
Dublin	673 ▲	4.00 ▼	100 ▲	5.25 ▶	3 500* ▶	4.50 ▶	290 ▲	5.25 ▶
Frankfurt	492 ▲	3.25 ▼	80 ▶	4.25 ▲	1,560 ▶	4.00 ▶	170 ▶	5.00 ▼
Geneva	647 ▶	3.00 ▶	176 ▶	5.50 ▶	1,140 ▶	4.00 ▶	180 ▶	5.00 ▶
London 1,217 (WE) ▶ 852 (City) ▶ 3.50 (WE) ▶ 4.25 (City) ▶			17 ▲	4.00 ▼	445 ▶	4.50 ▲	570 ▶	4.00 ▼
Madrid	366 ▲	3.75 ▼	63 ▲	5.25 ▼	600 ▶	4.25 ▶	156 ▶	5.25 ▶
Milan	540 ▶	4.00 ▼	55 ▲	6.50 ▶	900 ▲	5.00 ▶	300 ▶	6.00 ▶
Moscow	693 ▶	9.75 ▶	65 ▲	11.00 ▶	3,500 ▶	10.25 ▶	N/A	N/A
Munich	443 ▲	2.90 ▼	82 ▼	4.50 ▼	1,900 ▶	3.75 ▶	N/A	N/A
Paris 830 (CBD) ▶ 500 (LD) ▶ 3.00 (CBD) ▶ 4.00 (LD) ▶			58 ▶	4.75 ▼	2,500 ▶	4.25 ▲	180 ▶	5.00 ▶
Prague	258 ▲	4.80 ▲	54 ▲	6.00 ▶	1,050 ▶	5.00 ▼	126 ▲	6.50 ▶
Vienna	309 ▶	3.75 ▼	72 ▶	5.50 ▼	1,320 ▶	4.00 ▼	168 ▶	5.85 ▶
Warsaw	288 ▶	5.25 ▶	60 ▶	6.75 ▶	1,800 ▶	5.50 ▶	132 ▶	7.50 ▶
Zurich	647 ▶	3.00 ▶	188 ▼	5.25 ▶	1,322 ▶	4.00 ▶	171 ▶	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 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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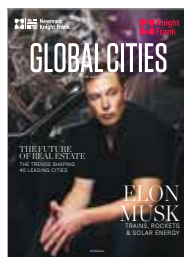
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