RESEARCH

EUROPEAN QUARTERLY

COMMERCIAL PROPERTY OUTLOOK

Q3 2018

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

EUROPEAN OUTLOOK

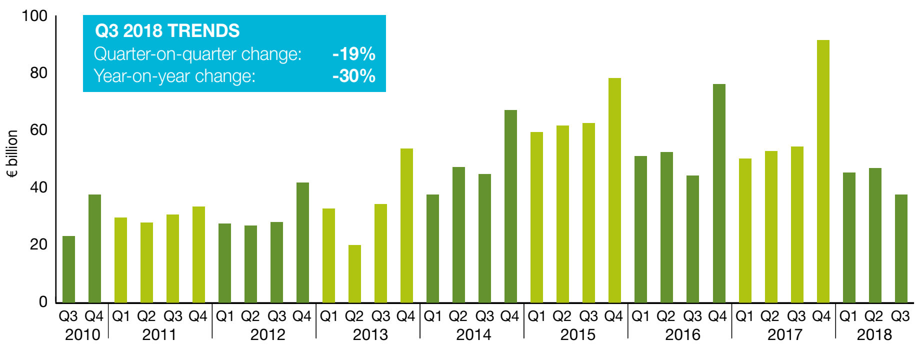
Despite a slowdown in the investment market, the occupier market is still buoyant

A total of €38.3bn was invested in European commercial property in Q3 2018. While this is down from €47.4bn invested in Q2 2018 pockets of strong growth were seen in Belgium (+46% yoy), Ireland (+36%) and Poland (+26%). What's more, we believe that investment volumes could bounce back significantly during the fourth quarter. There remains a very significant weight of capital targeting European assets, half of it coming from cross-border sources. Momentum seems assured as a myriad of new funds are raised to gain exposure to European property, either through direct purchases or debt provision.

The result of this demand is evident in pricing. European prime office yields came under further downward pressure in Q3 falling 17 basis points annually to 4.2%, with the most significant falls being recorded in Frankfurt (-50bps) and Munich (-35bps). However, the number of cities experiencing double-digit falls has slowed and, on a quarterly basis, very few markets have seen any yield movement at all. The average European yield is at least 50 bps lower than the long-term average. Further yield hardening is unlikely in the upcoming months, and we expect yields to remain stable across the majority of markets in the first half of 2019.

FIGURE 1

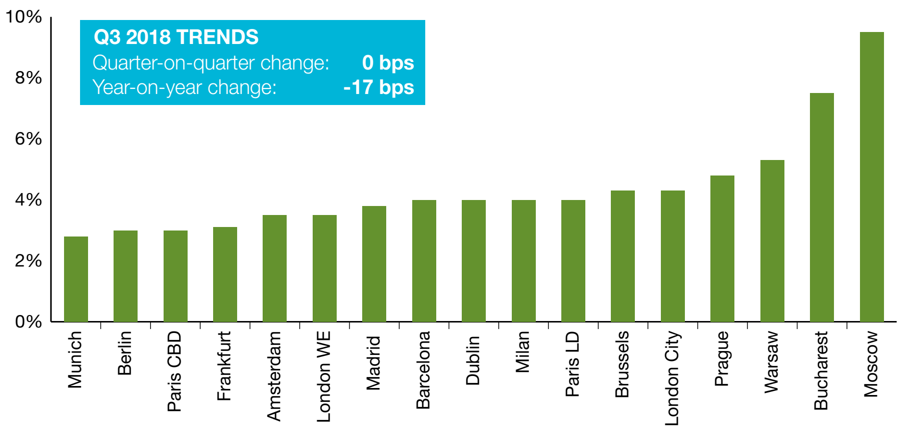
European commercial property investment volumes



Source: Real Capital Analytics / Knight Frank

FIGURE 2

European prime office yields Q3 2018



Source: Knight Frank Research

With yields remaining at multi-year lows, the challenge, for investors, will be in finding opportunities that can deliver the required returns. As a consequence we expect ongoing interest in assets further up the risk curve, with next tier cities and a wider range of property types increasingly coming into focus.

Part of the current allure of continental property is the fact that for many markets the economic recovery is at an earlier stage than in the US, or the UK. Reflecting this, leasing activity continues to hold up well, buoyed by continued business expansion and falling unemployment. In Vienna for example, take-up increased 166% thanks to an increase in the number of lettings over 1,000 sq m compared to the previous year. Milan has seen occupier take-up rise 82% year-on-year. Overall, take-up across our survey area increased 22% year-on-year and we predict that a continuation of this strong demand will be reflected in Q4 2018 data.

The vacancy rate has fallen for the eighth consecutive year and now stands at an average of 6.3% across our survey area, 174bps below the five-year average. Companies are riding the economic wave and moving their offices to modern, conveniently located spaces and willing to absorb the higher rents.

As attention turns to 2019, what can we can expect for the year ahead? Consensus forecasts suggest that economic fundamentals should remain supportive of healthy occupational demand on the continent, with the agreement of a smooth Brexit transition a potential catalyst for renewed demand in the UK. From an investment perspective we foresee no let-up in the weight of global capital targeting continental assets in particular, but with yields unlikely to move meaningfully in either direction, we expect that investors will continue to push into new markets, explore different property types, and take a more flexible approach to stock selection.

MARKET HIGHLIGHTS

VIENNA

Many tenants are unwilling to absorb the higher rents after a long period of stable rents and few incentives.

WARSAW

There has been a further decrease in the vacancy rate despite the high volumes of office space currently under construction.

PRAGUE

Approximately 38,200 sq m of modern office space was delivered to the Prague market in the third quarter of 2018, bringing the total modern office stock to 3.45 million sq m. New completions include four properties over three developments: Palmovka Open Park in Prague 8 with two buildings totalling 23,000 sq m, AFI Vokovice in Prague 6 with 12,200 sq m and the new Eurovia headquarters in Prague 4 with 3,000 sq m.

MUNICH

Office rents are still growing and total take-up in the Munich market is up 16% year-on-year; a historic high. Strong demand and low vacancy rates are leading to increasing rents.

MILAN

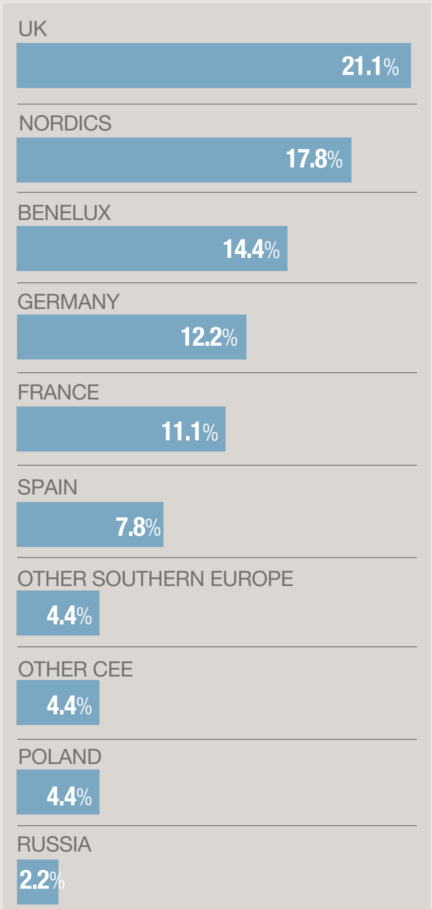
Though Milan is still proving to be the most attractive destination for investments in Italy, the general italian economic weakness might affect investor demand in the coming quarters.

MOSCOW

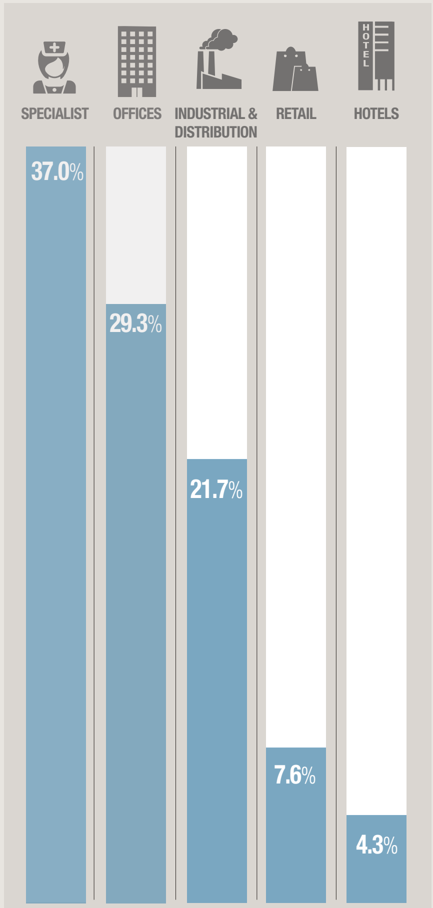
There is a shortage of good quality office stock in the most sought-after areas where the vacancy rate is below 6%. Occupiers are finding it increasingly difficult to find space larger than 20,000 sq m.

ASSUMING A 3-5 YEAR HOLD FROM TODAY WHICH OF THESE IS YOUR PREFERRED INVESTMENT IN 2019?

COUNTRIES

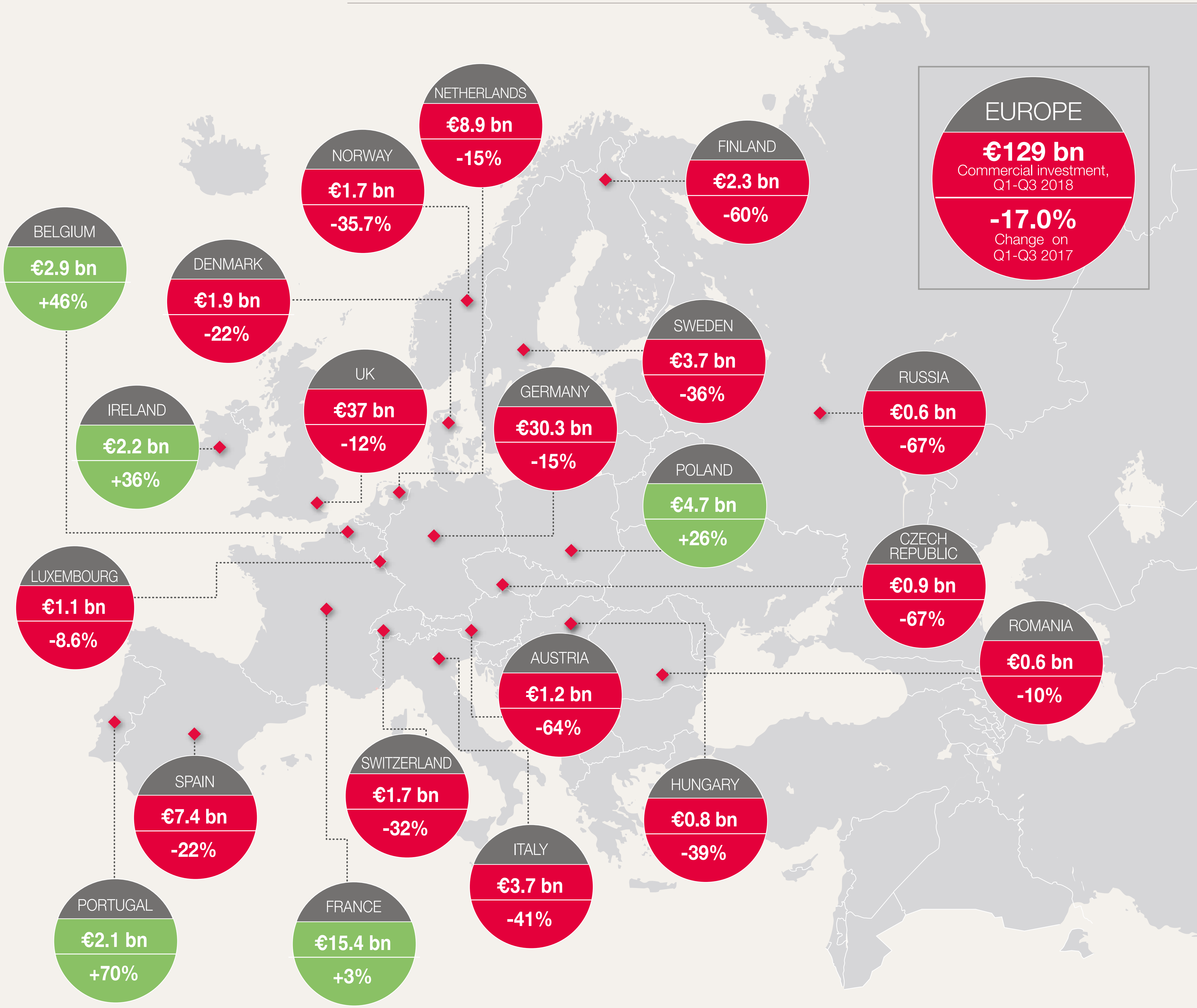


SECTOR



Source: Knight Frank Research
Changes calculated in local currencies

FIGURE 5
European commercial property investment volumes, Q1-Q3 2018



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

EUROPEAN MARKET INDICATORS

The average European office yield is at least 50 bps lower than the long-term average. The majority of yields are expected to remain stable into the first half of 2019.

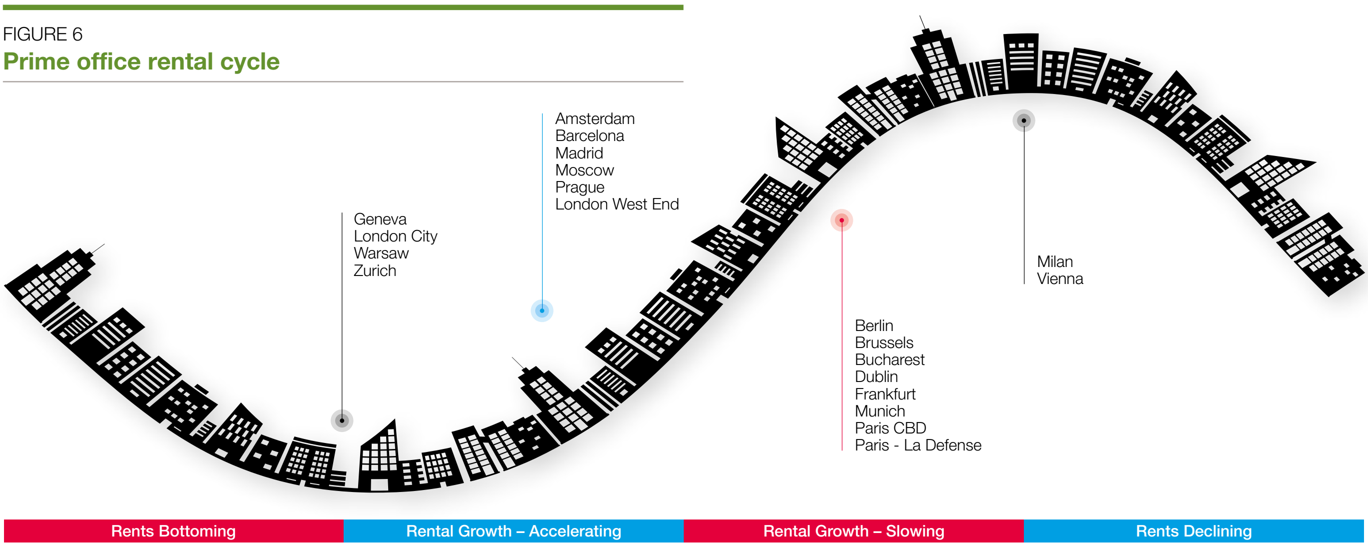
Commercial property prime rents and yields

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	410 ▲	3.50 ▼	85 ►	5.00 ▼	1,000 ►	4.75 ►	N/A	N/A
Barcelona	270 ►	4.00 ►	82 ►	5.25 ▼	600 ►	4.25 ►	129 ►	5.50 ►
Berlin	396 ▲	3.00 ▼	84 ▲	4.30 ▼	1,380 ►	3.75 ►	150 ►	5.00 ▼
Brussels	320 ▲	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 ►	105 ▲	5.25 ►	3,500* ►	4.50 ►	290 ▲	5.25 ►
Edinburgh	420 ▲	5.00 ►	102 ▲	N/A	3,143* ▲	5.50 ▲	364 ►	5.75 ►
Frankfurt	492 ▲	3.10 ►	80 ►	4.25 ▲	1,560 ►	4.00 ►	170 ►	5.00 ▼
Geneva	661 ►	3.00 ►	200 ▲	5.50 ►	1,140 ►	4.00 ►	180 ►	5.00 ►
London	1,217 (WE) ► 852 (City) ►	3.50 (WE) ► 4.25 (City) ►	205 ▲	4.00 ▼	5,984* ▲	4.75 ▲	N/A	N/A
Madrid	366 ►	3.75 ►	63 ►	5.25 ▼	600 ►	4.25 ►	156 ►	5.25 ►
Milan	570 ►	4.00 ►	55 ▲	6.50 ►	900 ▲	5.00 ►	300 ►	6.00 ►
Moscow	693 ►	9.50 ►	74 ▲	11.00 ►	3,500 ►	10.25 ►	N/A	N/A
Munich	443 ▲	2.80 ▼	82 ▼	4.50 ▼	1,900 ►	3.75 ►	N/A	N/A
Paris	840 (CBD) ▲ 500 (LD) ►	3.00 (CBD) ▼ 4.00 (LD) ▼	120 ►	4.75 ▼	2,000 ▼	4.25 ►	180 ►	5.00 ►
Prague	246 ►	4.80 ▼	54 ▲	6.00 ►	1,560 ►	4.75 ►	126 ▲	6.50 ►
Vienna	309 ▼	3.75 ▼	72 ►	5.50 ▼	1,320 ►	4.00 ▼	168 ►	5.85 ►
Warsaw	288 ►	5.25 ►	60 ►	6.75 ►	1,200 ▼	5.50 ►	132 ►	7.50 ►
Zurich	705 ►	3.00 ►	250 ▲	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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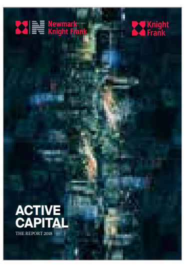

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