IPF Research Programme 2011–2015

EUROPEAN CONSENSUS FORECASTS REPORT

Survey of Independent Forecasts of European Prime Office Rents

This research was commissioned by the IPF Research Programme 2011–2015

NOVEMBER 2014

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This Programme supports the IPF's wider goals of enhancing the understanding and efficiency of property as an investment. The initiative provides the UK property investment market with the ability to deliver substantial, objective and high-quality analysis on a structured basis. It encourages the whole industry to engage with other financial markets, the wider business community and government on a range of complementary issues.

The Programme is funded by a cross-section of businesses, representing key market participants. The IPF gratefully acknowledges the support of these contributing organisations:

Survey of Independent Forecasts of European Prime Office Rents November 2014

Economic Background

In the six months since the last IPF survey of prime office rents, the eurozone economy has continued to suffer from a combination of weak growth and low inflation. The European Commission now predicts the eurozone may grow by just 0.8% this year, compared to the 1.2% estimate it made in spring. The Commission also cut its growth forecast for 2015 to 1.1% from 1.7%. With the eurozone economy contracting as a whole in the second quarter of 2014, analysts believe this presages a third recession since the global financial crisis of 2007/2008.

Concurrent with this, news that inflation has remained well below the European Central Bank (ECB) target of just under 2% - in the year to September prices rose by 0.4% - reinforces the gloomy short-term outlook with the International Monetary Fund predicting a 40% chance of the eurozone falling into outright deflation by the end of the first half of 2015.

Despite cutting its benchmark interest rate to 0.05% in September, the ECB has recently announced its intention to restore the size of the currency bloc's balance sheet to its March 2012 position in an attempt to boost growth. This will require the injection of nearly €1 trillion (c. £760 billion) of liquidity, which observers consider is likely to be achieved only through a programme of quantitative easing that would require the purchase of sovereign bonds.

At the individual country level, in mid-October, Germany's government downgraded its forecast for economic growth for this year, from 1.8% to 1.2%, raising fears that Europe's manufacturing centre is about to falter. Credit rating agency Standard and Poor's cut France's credit outlook to 'negative', due to concerns about the country's struggling economy, stating that a recovery " ... could prove elusive." Official figures from the Bank of France show that the French economy failed to grow at all in the second quarter, whilst, for the third quarter, it is forecasting growth of 0.2%. Meanwhile, Italy, Europe's third largest economy, will see growth of only "around zero" this year according to Prime Minister Renzi, who was quoted earlier in the autumn.

On the upside, however, Spain's economic recovery appears to be gathering momentum, with initial estimates suggesting the economy grew by 0.5% between July and September, its fifth consecutive quarter of growth, whilst the UK's performance remains in relatively stark contrast to the rest of Europe. The latest data for the UK economy show a sixth quarter of positive GDP growth (of 0.5% or better) and the employment rate has also risen and is now approaching a pre-recession peak. Nonetheless, net government debt as a percentage of GDP is still growing and further austerity measures may impact the improvement in consumer confidence witnessed in recent months.

Key Points

Current year

- The range of forecasts for **2014** across the 29 locations recorded (too few data points for Athens, again, means this centre cannot be reported) indicates mixed performance expectations, with some extreme positive and negative projections reflected in the figures presented for the Dublin and Moscow markets.
- Twenty of the 29 average forecasts have strengthened since the last survey (11 by 1.0% or more), including five of the nine centres that are still expected to show negative growth in the current year. Of those markets where sentiment has weakened, six are in locations previously expected to provide sub-zero growth.

Key Points

- With May 2014 positions shown in brackets, in terms of leading centres, once again, Dublin is expected to show the highest rental growth with the **2014** average projected growth rate rising to an astounding **25.4%** (11.7%). Growth predictions for London's West End and City markets have firmed to 8.7% (previously 7.7%) and 8.9% (7.3%) respectively.
- Of the 11 (12) markets that are forecast to weaken in 2014, eight (nine) could fall by more than 1% in this period. Moscow has continued its downward trajectory, to -11.3% (-7.0%) although Paris La Défense has improved to -3.3% (-5.5%).

2015 and beyond

- In **2015**, 24 (26) centres are expected to show positive growth, with up to 10.5% forecast for Dublin. Of these, prospects for three (four) markets have strengthened by more than 1.0% over the previous forecast (Dublin, London City and Hamburg), although both Dublin and London are expected to fall back from a peak in 2014.
- In **2016**, all centres reported are forecast to deliver positive growth, as was the case in May. Again, 27 locations are predicted to grow by more than 1.0%, with 20 (15) potentially exceeding 2.0% growth. Forecasts for 16 centres have improved since the last survey.
- The average outlook over **three years** continues to be led by Dublin, at 13.5% per annum (8.2% in May). The next best performing locations are again London City and West End at 6.8% (5.5%) and 6.2% (6.0%) annualised. A further 20 (22) centres are forecast to deliver average positive annual growth over the period 2014-2016, whilst of the six markets likely to return negative growth, the weakest performer may be Moscow, at -5.0%.
- The **five year** averages indicate all but Moscow (at -2.0%) will deliver positive growth, with 16 centres possibly averaging 2.0% or better. The mean forecast for Dublin is 9.0% (5.8%) per annum, ahead of Madrid at 5.0% (4.5%).

Changes between May and November 2014 averages in each forecast period are noted in the table in Appendix 1.

2014 forecasts indicate fine balance between growth and easing across most markets

With May 2014 positions shown in brackets, a balance of 18 (17) markets are predicted to show positive rental growth, of which 16 (12) are expected to grow by more than 1.0%. Of these, eight (two) locations may deliver growth of between 1.0% and 2.0%, with the remainder likely to exceed 2.0% annual growth. Growth projections for 2014 have weakened over the last six months in only nine (21) locations, three (five) falling by more than 1.0% in the half year. The most extreme shift recorded is once again for Moscow, where contributors continue to demonstrate a wide range of opinion, resulting in an average forecast of -11.3% (-7.0%). The outstanding improvement over the last six months in average growth prospects was the increase of 13.7% by Dublin – to reach a remarkable 25.4% year-on-year projected rate of rental growth. However, to put this in an historic context, the mean prime rent reported by this survey for Dublin for year-end 2007 was €645 psm.

In terms of the spread of average growth rates across all centres, the range has increased again, to 36.7% (18.7% in May). The extremes in forecasts extend from -11.3% for Moscow to 25.4% for Dublin. In the former case, the range between individual forecasters is a considerable 34.6%, as the influences cited in the

2014 forecasts indicate fine balance between growth and easing across most markets

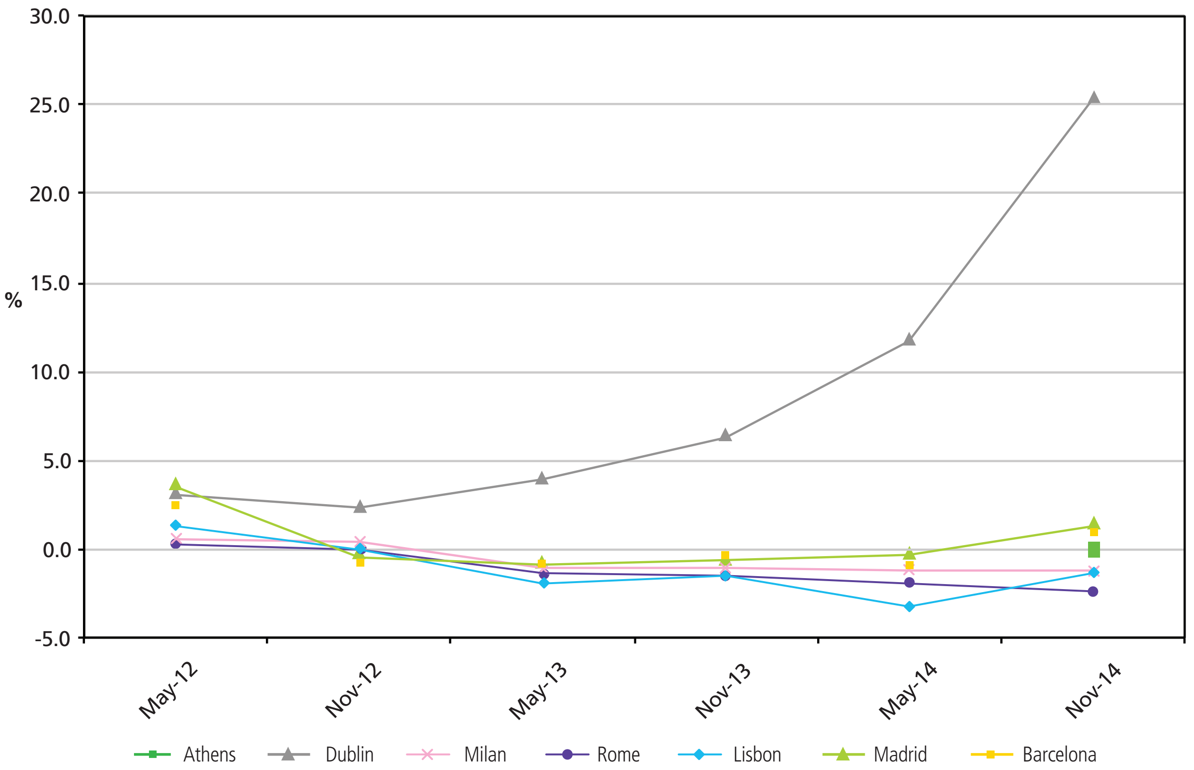
last survey report, together with increasing geopolitical concerns continue to impact on sentiment for this market. For Dublin, the spread is 28.6%.

Forecast projections for a number of other individual markets also show a high degree of variation in the short-term, with six sets of forecasts for 2014 exceeding a range of 10%, including all three French office markets, but over half (15 centres) lie within ranges of 2.0% to under 7.0%.

Eurozone offices

Figure 1 shows current forecasts for locations in economies that have been under greatest strain during the eurozone crisis. Disregarding Dublin, these again appear to be around or slightly better than previous forecasts. Lisbon's modest declined in May appears to have been reversed (to -1.3% from -3.2). Once again, there were insufficient forecasts for Athens offices to permit an analysis of this market.

Figure 1: Weighted Rental Growth Forecasts 2014 – Peripheral Eurozone Economies



In eastern Europe, the average outlooks for Warsaw and Prague have worsened slightly (from -2.7% to -3.5% for Warsaw and from -1.3% to -3.9% for Prague), whereas the Budapest market is improving (to 1.0% from -0.6%).

Remaining eurozone locations expected to deliver negative growth in 2014 comprise the three French office markets monitored: Paris la Defense, Paris CBD, -0.2% and Lyon at just under 0.0%, although there is a relatively high degree of volatility around these forecasts, as previously mentioned.

2014 forecasts indicate fine balance between growth and easing across most markets

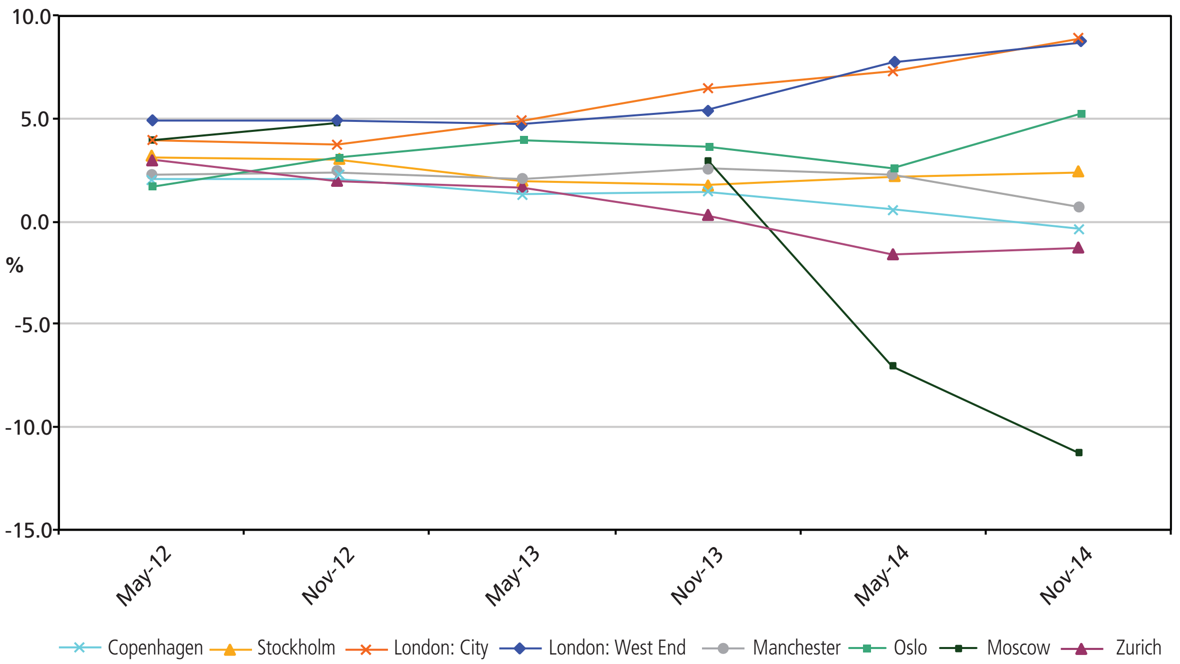
Turning to those centres predicted to deliver positive returns, after Dublin, the strongest growth expectations lie within Germany markets, ranging from 3.6% (2.5%) for Munich to 1.5% (1.1%) for Hamburg. Luxembourg, Amsterdam, Helsinki, Vienna and Brussels make up the remaining locations, with all but Brussels expected to exceed 1.0% growth.

Non-eurozone markets

Outside the eurozone, prospects for growth have continued to weaken in a number of locations, with Moscow expected to show a further significant decline (see Figure 2) as some local agents report lower rents, coupled with high vacancy rates and currency weakness. Manchester's prospects have weakened further to 0.7% (from 2.3% six months ago), whilst the only other centre that has weakened over the last six months is Copenhagen, which has fallen into negative growth (-0.4% from 0.6%). Zurich has firmed slightly, to -1.2% from -1.6% previously.

Positive sentiment for the two central London markets is maintained, with both expected to deliver increased growth of up to 8.9% (7.3%) in the City and 8.7% (7.7%) in the West End. The predicted growth rate in Oslo has risen to 5.2% (2.6%), whilst for Stockholm has risen to 2.4% (2.2% in May).

Figure 2: Weighted Average Rental Growth Forecasts 2014 – Non-eurozone Centres

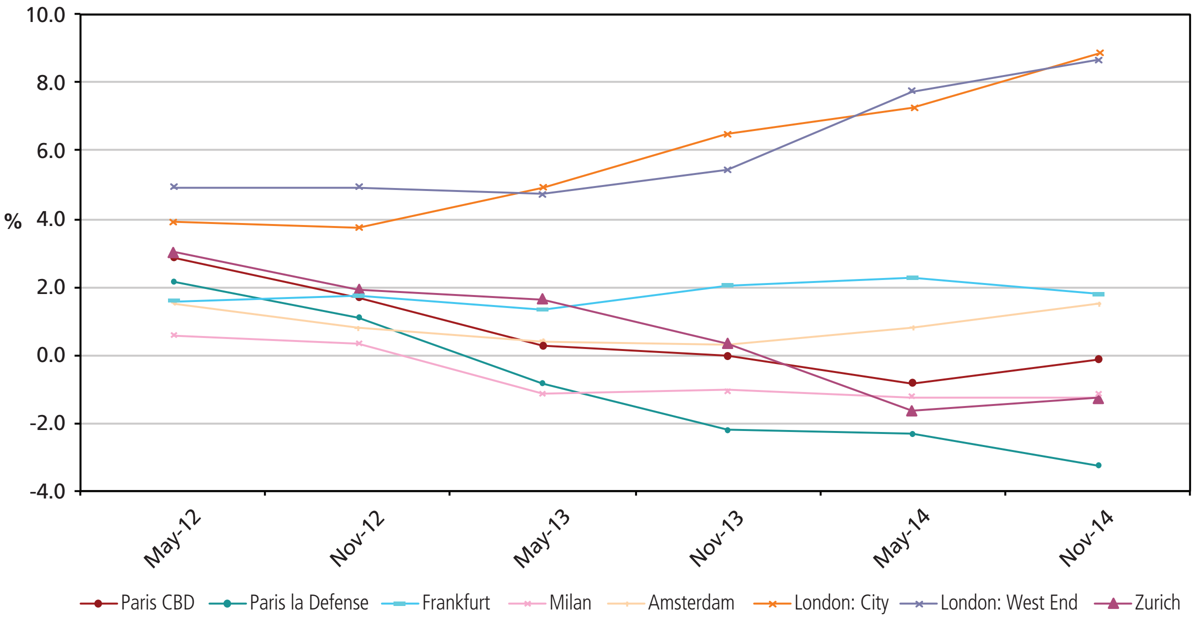


2014 forecasts indicate fine balance between growth and easing across most markets

Financial markets

Within the loose grouping of financial centres, London, Frankfurt and Amsterdam are projected to achieve growth in excess of 1.0%, the latter being projected at 1.5% (see Figure 3).

Figure 3: Weighted Average Rental Growth Forecasts 2014 – Financial Centres

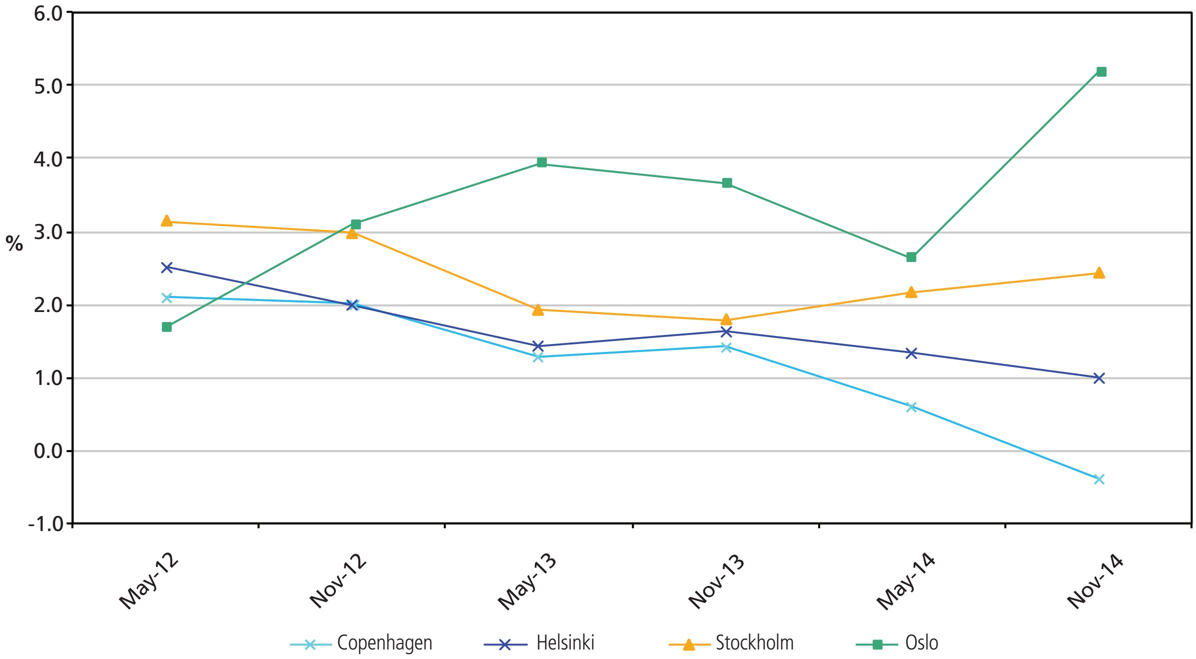


2014 forecasts indicate fine balance between growth and easing across most markets

Nordics

In the Nordic region, individual growth projections for Oslo have resulted in a notable rise in average forecasts, although expectations of a weakening of the Copenhagen market have continued to drive the average forecast down.

Figure 4: Weighted Average Rental Growth Forecasts 2014 – Scandinavian Centres



2015 and 2016 outlook

Whilst 24 of the 29 centres are projected to deliver growth in **2015**, forecasts have softened for almost half of these centres (14) over the last six months, with Moscow down by 4.6%, to -4.2%, and Warsaw falling by 2.8% to -1.7%. Of the remainder, Prague and Zurich may be weakly negative, whilst the Paris la Defense forecast, the only other market expected to show negative growth next year, at -0.7%, has firmed since May (-1.2%).

Whilst contributors believe the spectacular growth of the current year will not be repeated, Dublin, at 10.5%, and London City (8.5%) are likely to be the leading centres in 2015, followed by London's West End and Madrid (6.2% and 4.7% respectively). A further eight centres are expected to deliver better than 2.0% annual growth in the next 12 months.

By **2016**, whilst all centres are anticipated to deliver positive rental growth, the spread of growth rates is expected to tighten (from 0.3% in Warsaw to 5.6% in Dublin).

Three and five-year average forecasts show markets in recovery

The rolling average growth rates point to a recovery to positive growth in most markets in the near term, although six of the **three-year** average forecasts indicate negative rates, compared to four in May. Moscow and Warsaw may prove to be the weakest of these, at average annualised rates of -5.0% and -1.6%

Mixed outlook in the short- to medium-term

respectively. In the six month period since May, eight forecasts have improved by more than 1.0%, including Madrid and Barcelona (rising by 4.7% and 3.6% to potential annualised growth rates of 3.3% and 2.1% in these markets).

In absolute terms, of the 23 markets averaging positive projections, only three (Lisbon, Milan and Lyon) may produced sub-1.0% growth, with a further eight expected to grow by between 1.0% and 2.0% annually over the three years. Of the remaining 12 locations, annualised rates of between 2.1% (Manchester) and 13.5% (Dublin) are predicted. See table at Appendix 1 for individual market consensus forecasts.

With the exception of Moscow (at -2.0%), the five-year forecasts are positive for all centres. Average growth rates in 17 markets have strengthened since May, eight by more than 1.0%, led by Dublin at 3.6% per annum. Of the 16 locations where average forecasts exceed 2.0% per annum, Madrid (averaging 5.0%) and Barcelona (3.7%) maintain their presence towards the upper end of the range in this group, together with Zurich (which, at 3.0%, indicates a recovery in the later years of the forecast period) and the two central London markets (3.3% West End and 4.0% City), although the latter are anticipated to deliver slower growth in the later years of the decade. Dublin continues to be the premier market with an average expected growth rate of 9.0% per annum.

Conclusions

Dublin and the two London markets continue to offer the best growth prospects in the current year, with the Irish capital expected to deliver strong growth throughout the entire period of the survey. Whilst current projections indicate a remarkable 9.0% per annum average over five years, based on a 2013 year-end prime rental average of €361 psm, this only translates into a figure of €555 psm by the end of 2018.

The majority of markets continue to group within a relatively narrow range of predicted growth rates, as illustrated in the charts of three- and five-year rolling averages in Appendix 2. Whilst expectations for growth are broadly improving, the medium-term outlook still appears relatively weak for a number of centres and the recent poor economic news within the eurozone may not have been reflected in a number of contributors' forecasts, several of which date from August 2014.

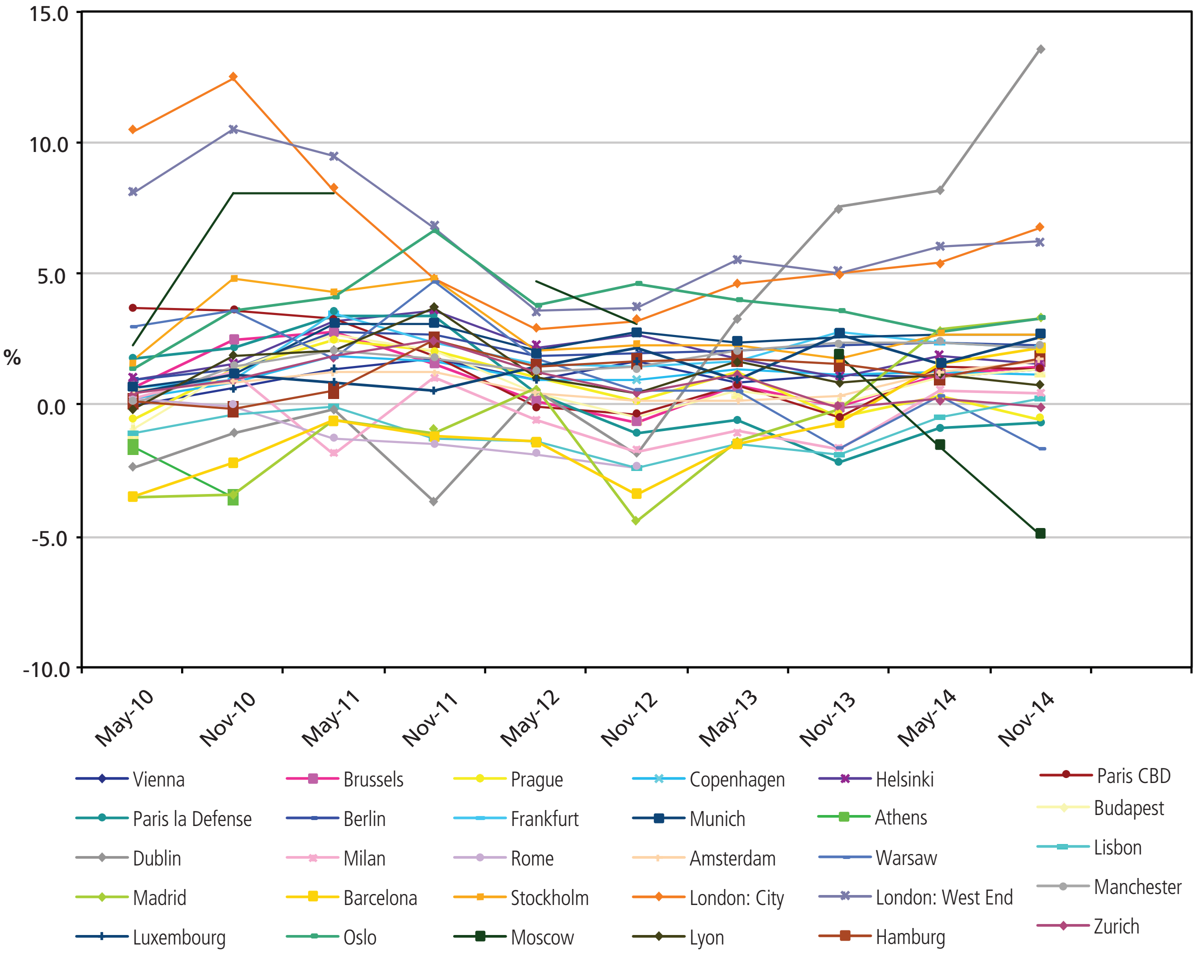
Appendix 1

Table 1: Mean weighted rental value growth forecasts - November 2014

	Year weighted average rental growth forecast						Rolling 3-year average (2014 - 2016)		Rolling 5-year average (2014 - 2018)	
	2014		2015		2016					
Vienna	1.0	(0.7)	1.4	(1.4)	1.6	(1.3)	1.3	(1.1)	1.4	(1.3)
Brussels	0.9	(0.6)	1.4	(1.2)	2.1	(1.6)	1.4	(1.1)	1.8	(1.6)
Prague	-2.9	(-1.3)	-0.5	(0.8)	1.8	(1.5)	-0.6	(0.3)	0.8	(1.1)
Copenhagen	-0.4	(0.6)	1.4	(1.4)	2.5	(1.9)	1.1	(1.3)	1.8	(1.8)
Helsinki	1.0	(1.3)	1.0	(1.6)	2.7	(2.6)	1.6	(1.8)	2.0	(2.1)
Lyon	0.0	(1.6)	0.7	(0.4)	1.7	(1.4)	0.8	(1.1)	1.3	(1.4)
Paris CBD	-0.2	(-0.8)	1.4	(1.6)	3.0	(3.7)	1.4	(1.5)	1.8	(2.3)
Paris la Défense	-3.3	(-5.5)	-0.7	(-1.2)	2.0	(0.8)	-0.7	(-2.0)	0.8	(0.1)
Berlin	2.2	(1.5)	2.1	(2.6)	2.6	(3.1)	2.3	(2.4)	2.3	(2.3)
Frankfurt	1.8	(2.2)	2.4	(2.3)	2.4	(2.5)	2.2	(2.3)	2.0	(2.2)
Hamburg	1.5	(1.1)	2.0	(1.0)	1.7	(1.3)	1.7	(1.1)	1.8	(1.2)
Munich	3.6	(2.5)	2.4	(2.9)	2.2	(2.8)	2.7	(2.7)	2.4	(2.4)
Athens	na	(na)	na	(na)	na	(na)	na	(na)	na	(na)
Budapest	1.0	(-0.6)	1.0	(2.1)	2.3	(1.8)	1.4	(1.1)	2.0	(1.6)
Dublin	25.4	(11.7)	10.5	(8.5)	5.6	(4.5)	13.5	(8.2)	9.0	(5.8)
Milan	-1.2	(-1.3)	0.4	(0.6)	2.4	(2.3)	0.5	(0.5)	1.7	(1.7)
Rome	-2.4	(-1.9)	0.1	(-0.3)	1.6	(0.7)	-0.3	(-0.5)	0.9	(0.6)
Luxembourg	2.6	(0.5)	2.8	(2.4)	2.3	(1.8)	2.6	(1.6)	2.0	(1.6)
Amsterdam	1.5	(0.8)	1.5	(1.4)	2.0	(1.7)	1.7	(1.3)	2.0	(1.8)
Oslo	5.2	(2.6)	2.0	(2.9)	2.8	(2.8)	3.3	(2.8)	2.8	(2.4)
Warsaw	-3.5	(-2.7)	-1.7	(1.1)	0.3	(2.6)	-1.6	(0.3)	0.5	(1.5)
Lisbon	-1.3	(-3.2)	0.4	(-0.2)	1.6	(2.0)	0.2	(-0.5)	1.6	(1.3)
Moscow	-11.3	(-7.0)	-4.2	(0.4)	0.9	(1.9)	-5.0	(-1.6)	-2.0	(0.1)
Madrid	1.2	(-0.3)	4.7	(4.0)	4.0	(5.1)	3.3	(2.9)	5.0	(4.5)
Barcelona	0.9	(-1.0)	2.7	(2.3)	2.9	(3.3)	2.1	(1.5)	3.7	(2.9)
Stockholm	2.4	(2.2)	3.3	(3.4)	2.3	(2.4)	2.7	(2.7)	2.2	(2.3)
Zurich	-1.2	(-1.6)	-0.3	(0.7)	1.3	(1.7)	-0.1	(0.2)	3.0	(0.8)
London: City	8.9	(7.3)	8.5	(6.3)	3.0	(2.9)	6.8	(5.5)	4.0	(4.0)
London: West End	8.7	(7.7)	6.2	(6.5)	3.8	(4.0)	6.2	(6.0)	3.3	(4.6)
Manchester	0.7	(2.3)	3.2	(2.6)	2.4	(2.3)	2.1	(2.4)	2.2	(2.4)

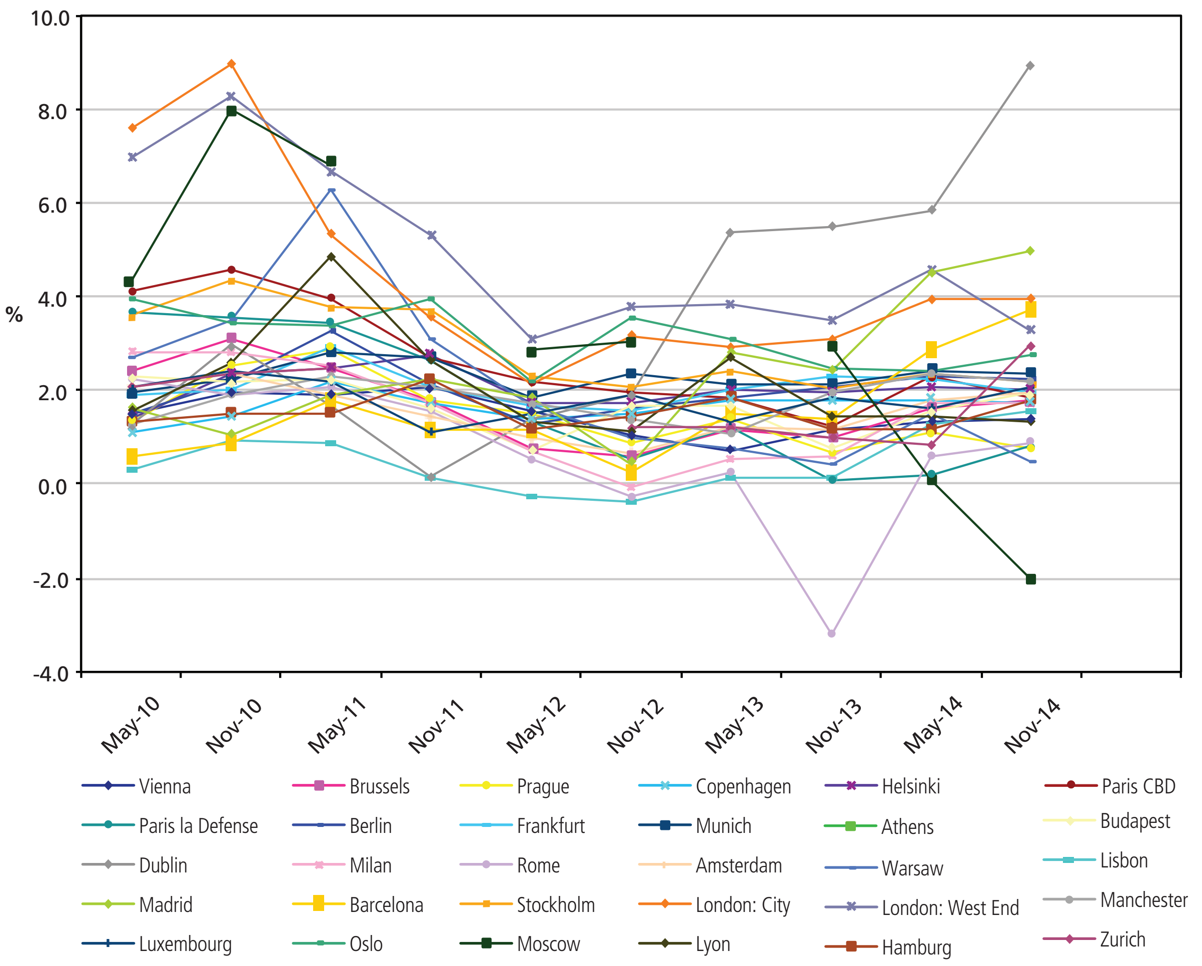
Previous survey figures in brackets

Figure 5: Rolling three-year weighted rental growth forecasts



Appendix 2

Figure 6: Rolling five-year weighted rental growth forecasts



Appendix 2

Forecast Contributors

IPF thanks all participants in the survey for contributing rental data to the November 2014 European Consensus Forecasts, including the following organisations:

Aberdeen Asset Management, AXA Real Estate, CBRE, CBRE Global Investors, CoStar Portfolio Strategy, Cushman & Wakefield, Danish Property Federation, DTZ, Invesco, JLL, LaSalle Investment Management, Paul Mitchell Real Estate Consultancy Limited, Rockspring, Standard Life Investments and TIAA Henderson Real Estate.

Notes

At present the IPF European Consensus Forecasts survey focuses on office rental value growth in major cities. It is not possible currently to assemble sufficient forecasts of all sectors across all European countries to produce a meaningful consensus of views, although our ambition is to extend and improve the scope of the survey.

In addition to the rental value forecasts, we run a consensus survey of forecast IPD European total returns by sector. The samples provided for this survey were once again insufficient to permit publication, as fewer than five forecasts were received for each sector/territory. We aim to produce a full release of this data at a future date, once the number of responses has grown to five or more.

The Data

This latest survey collected prime office rental forecasts for 30 centres for the calendar years 2014, 2015 and 2016. We request a three-year average forecast for 2014-2016 where individual years are not available, as well as a five-year average for 2014-2018. The survey requested both the percentage annual rental growth rates and also the year-end rent levels. The growth forecasts provided by each organisation are analysed to provide weighted average ('consensus') figures for each market. Figures are only aggregated and reported for office markets for which a minimum of five contributions are received.

The definition of market rent used in the survey is "achievable prime rental values for city centre offices, based on buildings of representative size with representative lease terms for modern structures in the best location." Prime in this case does not mean headline rents taken from individual buildings but, rather, rental levels based on market evidence, which can be replicated. All figures included in the survey are required to have been generated by formal forecasting models. This report is based on contributions from 16 different organisations (fund/investment management houses and property advisors).

Consensus forecasts further the objective of the Investment Property Forum to enhance the understanding and efficiency of the property market. The IPF is extremely grateful for the support those organisations that contribute to this publication, which is only possible thanks to the provision of individual forecasts.

The IPF welcomes new contributors for future surveys, so that the coverage of the market can be widened. If your organisation wishes to contribute to future surveys, please contact Pam Craddock, IPF Research Director at pcraddock@ipf.org.uk, tel. +44 (0)20 7194 7925.

Contributors receive a more detailed set of statistical outputs than those shown in Appendix 1 – for each office centre, the sample size, median and range of rental values are also provided.

Acknowledgements

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