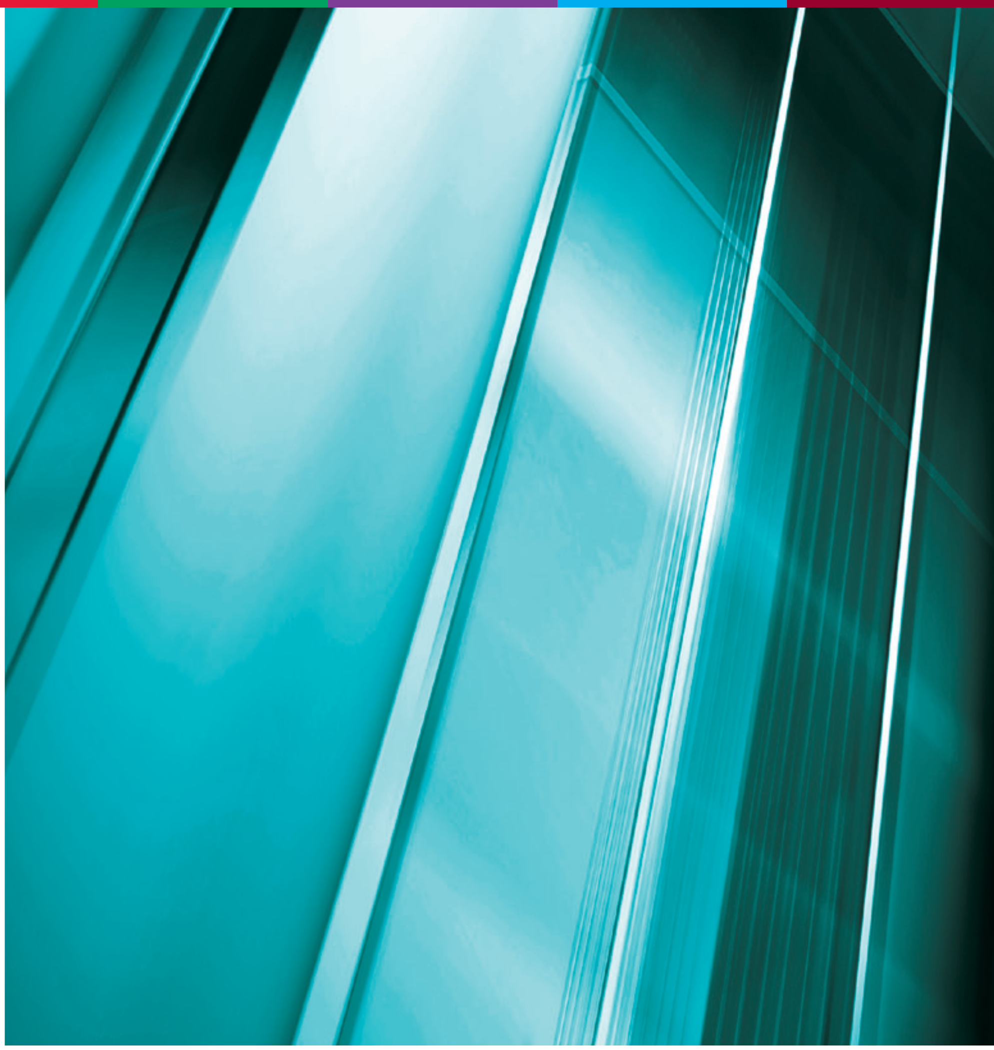
IPF Research

Investment Property Forum European Consensus Forecasts of Prime Office Rents

NOVEMBER 2015



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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 European Office Market Rental Forecasts November 2015

Economic Background

According to a recent European Commission press release[1], the economic recovery in the euro area and the European Union as a whole is now in its third year, with the economy of the 28-nation EU set to grow by 1.9% this year (and the 19-nation Eurozone by 1.6%). Its autumn 2015 economic forecast is for this moderate recovery to continue despite more challenging conditions in the global economy.

Growth is being supported by factors such as the fall in energy prices caused by the collapse in the oil price, which has boosted consumer spending, and a weaker euro exchange rate – a result of the attempts to stimulate the Eurozone economy through its bond-buying programme (quantitative easing) being conducted by the European Central Bank (ECB) since March. In some countries, the positive impact of structural reforms will also contribute to further growth.

This recovery is still fragile, however, and, as the impact of these positive factors fade, new challenges are appearing with the continent facing a downturn in global growth, provoked by the slowdown in China and emerging economies, which account for a quarter of Eurozone overseas trade. This will hurt exporting companies, with Germany, in particular, likely to be affected since the Chinese market has been a lucrative one for its exports of investment goods and luxury cars. Already, German industrial orders have fallen whilst industrial production declined in the third quarter. The EU also notes that the recent Volkswagen emissions scandal could affect business: "Possible spillovers from Volkswagen's manipulation of diesel engine emission tests to other sectors via production chains or confidence effects could create downside risks to corporate investment," it said.

The labour market is picking up modestly and employment growth should slowly recover in 2015 (+0.8%) in the Eurozone. Germany, Spain and the UK show good prospects in job creation for 2015-2016. In Italy and France, the recovery in the job market should gain impetus over the same period, though at a softer pace. However, unemployment is expected to continue to decline only gradually, with substantial disparities between Member States. In the euro area, the forecast is for a fall in unemployment to 10.6% next year and 10.3% in 2017 from 11.0% this year, while in the EU as a whole, the forecast shows a fall from 9.5% this year to 9.2% and 8.9% in 2016 and 2017 respectively.

However, the ECB is poised to loosen monetary policy still further when its governing council meets in December. With an expectation of up to three million migrants arriving in Europe by 2017, fleeing war and poverty in Syria and other conflict zones, spending on refugees will provide a modest fiscal stimulus and an additional positive impact on growth is expected in the medium term from the increase in labour supply, provided the right policies are in place to facilitate access to the labour market. For the EU as a whole, the growth impact is small, but it is likely to be more sizeable in some Member States, especially Germany.

Greece, which is receiving up to €86bn in a three-year bailout, is expected to see its economy shrink by 1.4% this year and by 1.3% in 2016, but is forecast to grow by 2.7% in 2017.

Real GDP growth forecasts for the EU as a whole are 2.0% in 2016 and 2.1% the year after, whilst the Eurozone is expected to grow by 1.8% next year, rising to 1.9% in 2017.

Headline inflation in the euro area and the EU fell below zero in September, driven by the steep fall in oil and other commodity prices. However, wage growth, strengthening private consumption and the narrowing of the output gap are beginning to add increasing pressure to prices. Annual inflation is expected to rise from 0.1% in the euro area and 0% in the EU this year, to 1.0% and 1.1% respectively next year, and to 1.6% in both areas in 2017.

[1] European Commission press release, Brussels, 5 November 2015: Forecasts up to 22 October 2015, based on external assumptions regarding exchange rates, interest rates and commodity prices. The Commission is due to update its economic forecast in February 2016.

Key Points

- For the second Consensus report of 2015, 14 contributors provided their forecasts for the 30 office markets surveyed. As fewer than five forecasts were received for Athens, rental growth projections for 29 locations are provided on this occasion.

Current Year

- Average rental growth expectations for the current year continue to range widely, from Dublin at 15.8% (from 13.5% in May) to Moscow at -9.3%, albeit an improvement of more than 400 basis points over the last six months. The mean rental growth projection across all locations, however, has remained at 2.2%.
- Negative forecast averages now extend to eight centres, compared to five in May (excluding Athens), to take in Oslo, Paris CBD and Brussels.
- Fifteen markets posted weaker growth prospects than six months ago, led by Budapest and Brussels, falling by 2.6% and 2.5% to 0.2% and -0.1% respectively. Of the remainder, however, the decline had been less than 1.0% in seven locations. Of the 14 improved forecasts, five have firmed by 1.0% or more, led by Moscow at +4.1%.
- Leading growth centres, in addition to Dublin, are London's City and West End at forecasts of 10.0% and 9.0% respectively, followed by Barcelona and Madrid at 7.3% and 7.0% (2.3% and 0.2% higher than their May averages).

2016

- Next year, four markets are projected to deliver negative growth, as Warsaw (-3.6%) is joined by Moscow, Zurich and Oslo, although all three may average better than -1.0%.
- Of the remaining 25 centres, the range of growth rates extends from 1.0% for Paris La Defense, Helsinki and Prague to 10.6% for Dublin (overtaking Madrid despite the latter's average rising to 9.2% from 6.8% in May).
- Compared to 2015, rental growth is expected to slow in nine locations, led by Dublin, (down 5.2%) and the two London markets (each potentially weakening by more than 3.0%, to 6.7% in the case of the City and to 5.6% in the West End). Another major fall may occur in Helsinki, where the average could decline by 3.6%.
- The most improved forecast in 2016 is for Moscow, although the considerable 8.6% increase reported over the 2015 projection would still result in a sub-zero growth rate. Otherwise, only Rome, Paris CBD, Lisbon and Milan are predicted to exceed their 2015 forecasts by 2.0% or more.

2017

- In the last individual year of the survey, average forecasts for all centres are positive, ranging from just under 0.4% for Warsaw to 7.2% for Madrid. Other than Oslo (0.8%) all remaining office markets are predicted to grow by more than 1.0%, with 20 potentially exceeding 2.0%.
- The top three growth centres in 2017 are anticipated to be Madrid (7.2%), Barcelona (5.6%) and Moscow (4.4%).

Three- and five-year averages

- Averages over the next three years (2015-2017) range between -2.7% per annum for Warsaw (previously -1.2%) and 9.6% for Dublin (from 7.1% in May).
- In addition to Warsaw, three other locations are likely to average sub-zero growth, being Moscow (-2.1%), Zurich (-0.4%) and Oslo (-0.1%).
- Twenty-two of the remaining 25 centres projected to show positive growth may deliver more than 1% per annum over the period 2015-2017.
- Ten markets could outperform the mean for all locations of 2.4% per annum, including both Spanish centres and London (all averaging over 5.0%), followed by Manchester, Stockholm, Munich, Berlin and Helsinki.
- Whilst the May survey indicated only Moscow as performing negatively over the five years to 2019, the Russian capital has been replaced by Warsaw, at -0.6% (previously 0.3%), presumably driven by weaker forecasts in 2015 and 2016 (now -4.7% and -3.6% respectively, from -3.3% and -1.3% previously).
- Against a 2.2% five-year mean forecast for all locations, 11 may exceed this mark, including most notably Madrid and Barcelona, at 7.0% and 5.1% respectively, with Dublin at 4.6%, followed by both London markets at 3.7%.

Changes in average forecasts between May and November 2015 are detailed in the table in Appendix 1.

Forecast sentiment mixed between and within markets

For the current year, 12 office markets are predicted to show rental growth in excess of the 2.2% average for all 29 locations. However, 15 of the 2015 forecasts have weakened since May, including eight that have dropped by over 1.0% (and four of these fell by over 2.0%). Conversely, forecasts improved by 1.0% or more in five of the remaining 14 markets.

The array of average growth rates across all centres for 2015 has fallen slightly to 25.5% (from 15.8% for Dublin to -9.3% for Moscow) compared to 26.9% in the last survey. The range of forecast averages reduces to 14.2% next year (Dublin at 10.6% compared to Warsaw at -3.6%) and to 6.9% in 2017 (Madrid at 7.2% and Warsaw at 0.4%).

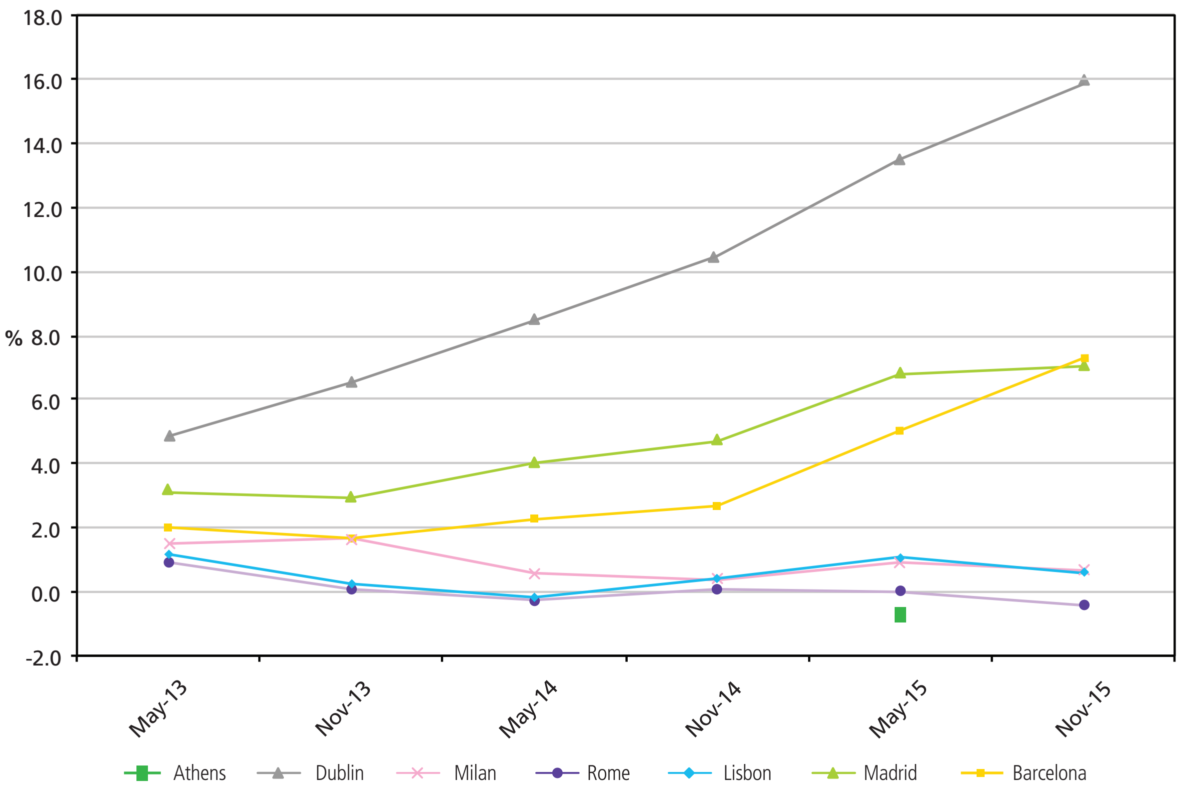
Within individual sets of forecasts, the highest and lowest growth markets attracted the widest ranges of projections (with Dublin at 15.6% and Moscow at 11.9%, albeit down from 14.4% in May). In 2015, the closest alignment of forecaster opinion recorded is for Rome (1.4%), against an average of 7.2% across all locations.

Peripheral Markets

Current forecasts for the so-called 'PIIGS' locations, illustrated in Figure 1, demonstrate further improvement in Irish and Spanish prospects. In the latter case, where the office market was already showing signs of recovery in 2014, the higher volume of take-up in 2015 (overall 6 million square metres in the year to date) has confirmed this reversal in the trend with the tentative upswing in the economy now starting to be reflected in the rental market, with an increase in the number of tenants looking to extend their premises or to relocate. The 2015 forecast for Dublin now stands at 15.8% with Barcelona at 7.3% (5.0% in May) and Madrid at 7.0% (previously 6.8%).

Lisbon and Milan continue to show weak positive performance prospects of 0.6%, whilst Rome prime rents are expected to fall by 0.4% over the year.

Figure 1: Weighted Rental Growth Forecasts 2015 – Peripheral Eurozone Economies



Remainder of Eurozone

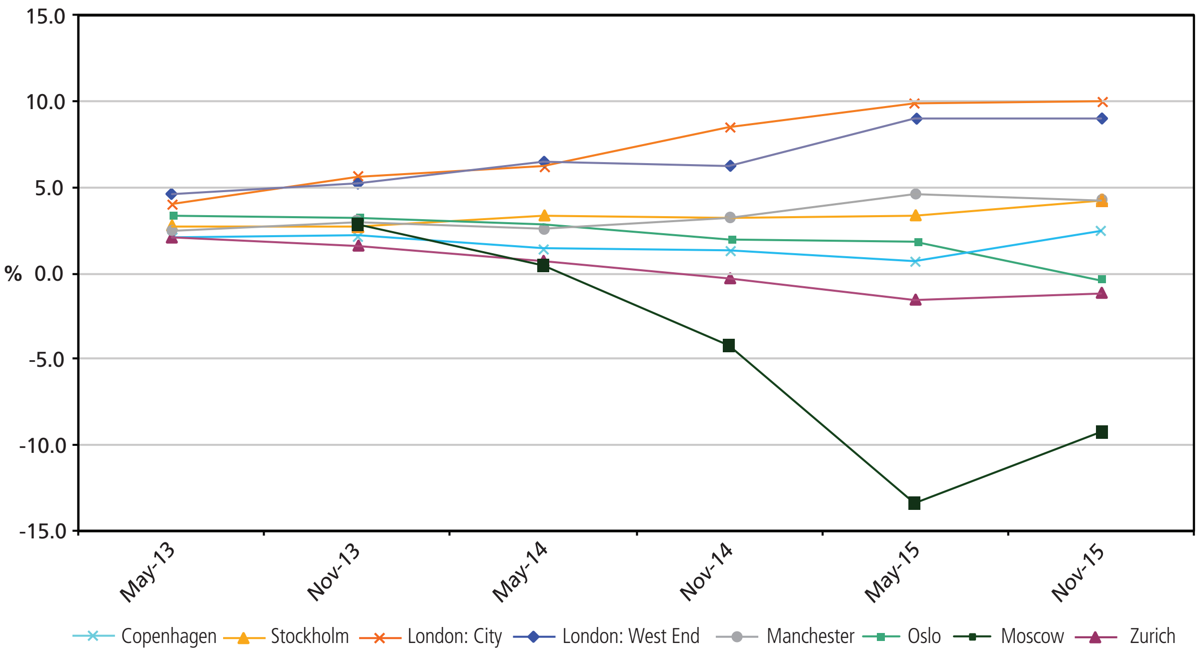
Probably the most liquid CEE market, Warsaw continues to experience downward pressure on rents with the construction of new offices set for double-digit growth in the near future. The current year's average forecast has fallen to -4.7% from -3.3% in May. Elsewhere in central and eastern Europe, despite the country's improving economic fundamentals, the outlook for Prague has worsened slightly (from -1.5% to -1.6%), due in part to a strong development pipeline that has resulted in overall supply significantly exceeding tenant demand. Budapest's recent improvement (from 1.0% a year ago to 2.8% in May) has reversed with a likely outturn for 2015 of around 0.2%, based on current forecasts received. Vienna is the only centre expected to deliver better than 1.0% growth, although the current projection has fallen over the last six months by 0.7% to 1.4%.

Across the wider Eurozone markets, those expected to provide the best growth in 2015 in addition to Dublin, Barcelona and Madrid are Helsinki (4.6%), Berlin (3.4%) and Munich (3.0%). The remaining seven locations are all expected to exceed 1.0% growth.

Outside the Eurozone

Prospects for growth in five of these eight locations are positive for 2015 and six forecast averages have improved over the period since the May survey. The most significant change, however, has been the decline in sentiment for Oslo, the forecast for which has dropped by 2.2% to -0.4% in the current as the Norwegian economy has been adversely affected by the fall in global oil prices and weaker business forecasts, resulting in a downward revision to GDP forecasts. The office market has been further impacted by high levels of construction activity with a number of schemes completing.

Figure 2: Weighted Average Rental Growth Forecasts 2015 – Non-eurozone Centres



[2] BNP Paribas Real Estate Research October 2015

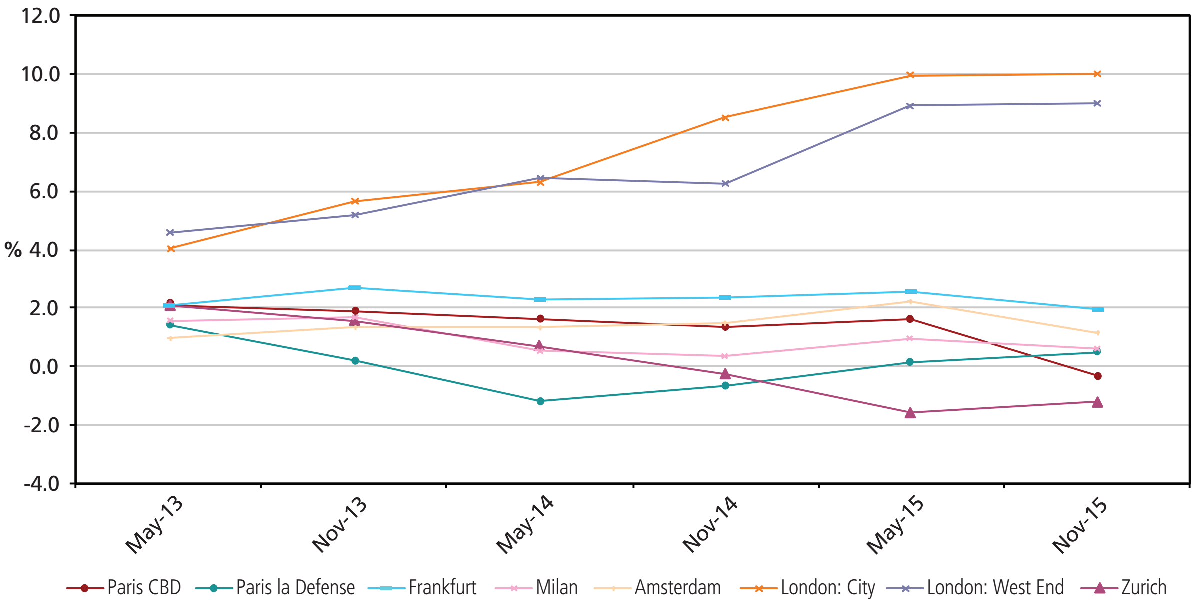
The two remaining markets where rents continue to contract are Moscow (at -9.3% for 2015) and Zurich (-1.2%). With the Russian economy subject to contend with sanctions and contracting growth, demand for office space has declined considerably with the vacancy rate increased to over 18% by the middle of the year. However, with overall construction activity falling and schemes being withdrawn until stronger fundamentals are seen in the occupational market, the downward trajectory of rents appears to have been reversed.

A surge in occupier demand, coupled with limited stock as few schemes are coming to completion, has caused central London vacancy rates to drop to a 15-year low in the third quarter (to around 4.7%[2]),as take up for the year reached almost 10.8 million square feet in the last three months, representing 18% above the long-term trend.

Financial centres

Aside from London, with the exception of Zurich, all the financial office markets surveyed have experienced a softening in forecaster sentiment over the last six months. An expectation of modest growth in 2015 is illustrated by Frankfurt, projected to achieve around 2.0%, with Amsterdam, Milan and Paris La Defense all weakly positive at between1.1% and 0.5%, whilst the Paris CBD forecast has fallen to -0.3% (representing a 1.9% drop from May's average). Conversely, Zurich has improved slightly (to -1.2% from -1.6% six months ago).

Figure 3: Weighted Average Rental Growth Forecasts 2015 – Financial Centres



Nordics

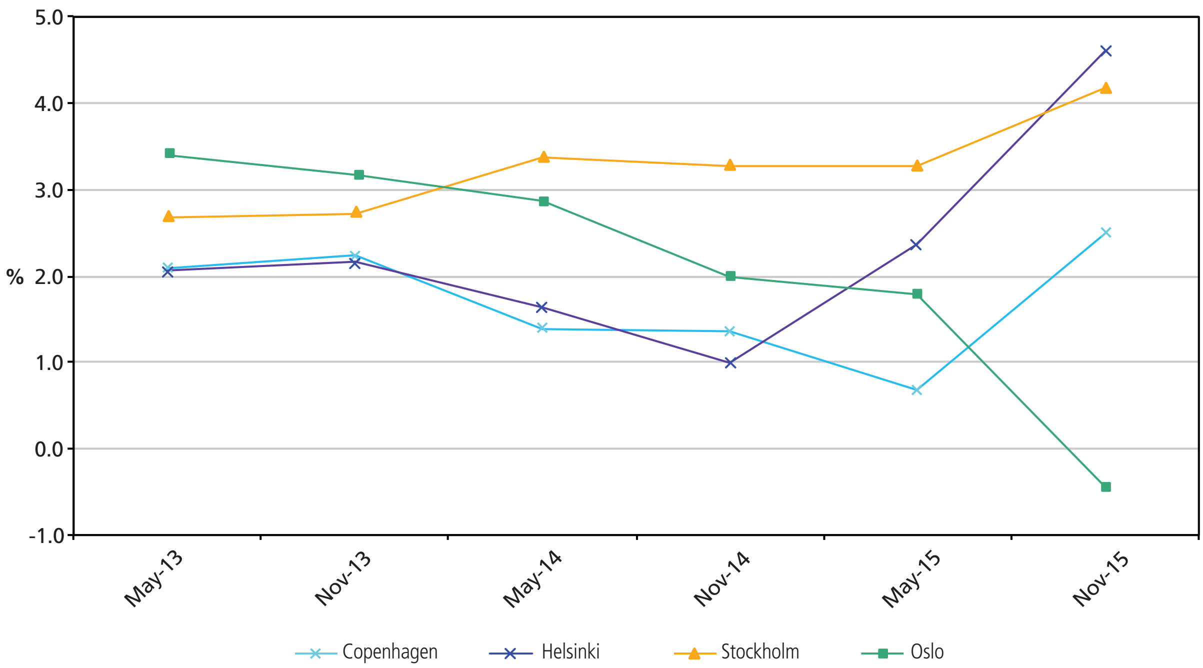
Three of the four locations are showing a strengthening in growth rates, with the central area of Stockholm starting to see a fall in vacancies for quality stock, which has underpinned improved rental growth, rising from 3.3% in May to 4.2% currently.

Elsewhere in the Nordic region, despite a slow recovery in the Finnish economy (suffering from declines in its traditionally strong electronics and timber industries), projections for the Helsinki office have continued to rise with average expectations now at 4.6%, from 2.4% six months ago. This appears to be in response to a trend in occupiers moving to superior locations or better specified accommodation, resulting in a significant amount of older vacant stock no longer meeting tenant requirements.

In Copenhagen, the declining rate recorded over the last four surveys has been reversed with the 2015 forecast now averaging 2.5% from 0.7% in May, as tenant demand has increasingly focused on modern, efficient premises and the supply of prime offices in the central business district remains limited.

The predicted 2015 growth rate for Oslo has continued to decline, from 1.8% in May to -0.4% currently. This weakening, as mentioned previously, has been driven by a combination of falling oil prices, resulting in lower economic growth forecasts, and an excess supply of stock in the Norwegian capital, as tenants have tended to postpone or reconsider relocating to new or larger premises.

Figure 4: Weighted Average Rental Growth Forecasts 2015 – Nordic Centres



2016 and Beyond

The **2016** forecasts now suggest four of the 29 centres surveyed are projected to deliver positive growth, compared to only Warsaw six months ago. Forecasts have softened in 15 markets since May and in only two instances have predictions improved by more than 1.0%, these being for both of the Spanish markets. In total, 13 markets are expected to grow by 2.0% or more over the next 12 months, led by Dublin at 10.6% and Madrid at 9.2%. Confirming May's expectation, the greatest improvement is likely to be seen in the Moscow market, where the average projection of -0.9% represents an 8.4% increase on the 2015 average, although the range of individual forecasts lies at 11.4%.

The forecasts for 2017 average 2.2% across all centres, ranging from 7.2% for Madrid to 0.4% for Warsaw. Twenty of the market forecasts have improved over the last six months, with 16 locations equal to or better than the average. No geographic pattern appears to explain the spread of expected performance.

In absolute terms, the figures show declines in the growth rates of 13 centres between 2016 and 2017. As reported in May, the biggest potential fall may be experienced in the Dublin market from 10.6% to 2.8%, albeit both projections are an improvement on those previous reported (6.7% in 2016 to 1.5% in 2017). In seven of the remaining weakened predictions, forecasts lie less than 1.0% lower than their respective 2016 figures.

Three and five-year average forecasts show markets broadly in recovery

The **three-year** average forecasts point to Warsaw, Moscow, Oslo and Zurich, delivering sub-zero growth on an annualised basis, albeit the latter two are only marginally negative, at -0.4% and -0.1% per annum respectively. Since May, 19 forecasts have improved, eight by more than 1.0%, including four by more than 2.0%.

Of those markets projected to deliver positive growth, only three (Prague, Brussels and Rome) average less than 1.0%, with nine are expected to deliver between 1.0% and 2.0% per annum over the three years. In the remaining 13 locations, rates lie between 2.1% (Hamburg) and 9.6% (Dublin) are predicted.

With the exception of Warsaw (at -0.6% replacing Moscow, previously -2.0%), all **five-year** average forecasts are positive. Growth rates in 18 markets have strengthened since November, although only Madrid, Barcelona and Moscow have improved by more than 1.0%, rising to 7.0%, 5.1% and 0.4% per annum respectively. Eleven locations exceed the 2.2% per annum average across all locations, led by the two Spanish markets, Dublin (4.6%) and London (both at 3.7%).

The table at Appendix 1 details individual market consensus forecasts for both the current survey and for six months ago.

Conclusion

Contributors continue to demonstrate widely varying views on growth prospects both within individual markets and between the centres surveyed. In the main, growth in EU and, more particularly, Eurozone countries (with the notable exceptions of Ireland and Spain) is still constrained by challenging economic conditions and structural issues. A trend is for year-on-year increases in growth rates is visible in a number of markets with declining prospects primarily confined to those markets currently expected to perform well in excess of the average.

Current-year forecasts for Dublin and the two London markets sustain their rankings as leading growth markets but the prospects for both Madrid and Barcelona continue to strengthen and, whilst expected to peak in 2016, they are likely to be the best centres of growth in 2017 as well as over the five-year forecast horizon.

Appendix 1

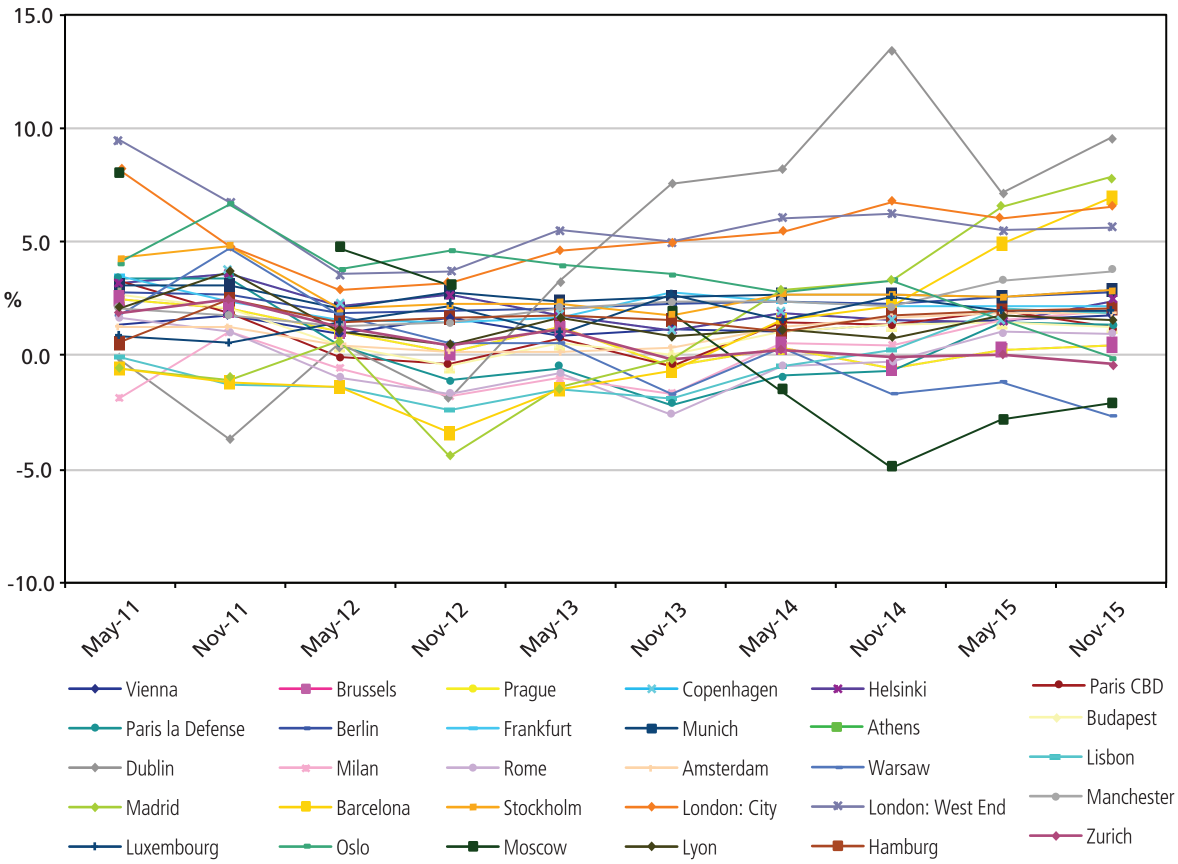
Table 1: Weighted Rental Growth Forecasts - November 2015

	Year weighted average rental growth forecast						Rolling 3-year average (2015-2017)		Rolling 5-year average (2015-2019)	
	2015		2016		2017					
	Nov. 2015	May 2015	Nov. 2015	May 2015	Nov. 2015	May 2015	Nov. 2015	May 2015	Nov. 2015	May 2015
Vienna	1.4	(2.1)	1.6	(1.4)	2.2	(1.1)	1.7	(1.5)	1.6	(1.5)
Brussels	-0.1	(2.3)	1.3	(1.5)	1.5	(0.8)	0.9	(1.5)	1.3	(1.7)
Prague	-1.6	(-1.5)	1.0	(0.6)	1.9	(1.8)	0.4	(0.3)	0.8	(0.9)
Copenhagen	2.5	(0.7)	1.7	(1.5)	2.2	(2.1)	2.1	(1.4)	2.2	(1.7)
Helsinki	4.6	(2.4)	1.0	(1.4)	1.6	(0.6)	2.4	(1.5)	2.3	(1.8)
Lyon	1.4	(2.7)	1.4	(1.8)	1.8	(0.8)	1.5	(1.8)	1.7	(1.9)
Paris CBD	-0.3	(1.6)	1.9	(2.2)	2.3	(2.0)	1.3	(1.9)	1.6	(1.9)
Paris la Défense	0.5	(0.2)	1.0	(1.6)	2.5	(2.5)	1.3	(1.4)	1.8	(1.8)
Berlin	3.4	(2.6)	2.5	(2.7)	2.4	(2.4)	2.8	(2.6)	2.4	(2.2)
Frankfurt	2.0	(2.5)	2.7	(2.7)	1.9	(1.2)	2.2	(2.2)	1.6	(1.8)
Hamburg	2.1	(1.6)	2.1	(2.2)	2.1	(2.1)	2.1	(1.9)	1.9	(1.6)
Munich	3.0	(3.0)	3.0	(2.6)	2.6	(2.0)	2.9	(2.5)	2.3	(1.9)
Athens	n/a	(-0.8)	n/a	(1.3)	n/a	(2.2)	n/a	(0.9)	n/a	(1.7)
Budapest	0.2	(2.8)	1.3	(1.5)	2.2	(0.1)	1.2	(1.5)	1.8	(1.6)
Dublin	15.8	(13.5)	10.6	(6.7)	2.8	(1.5)	9.6	(7.1)	4.6	(4.0)
Milan	0.6	(1.0)	2.7	(1.7)	2.6	(2.1)	2.0	(1.6)	2.3	(2.2)
Rome	-0.4	(0.0)	1.8	(1.0)	1.6	(2.3)	1.0	(1.1)	1.1	(1.6)
Luxembourg	2.6	(4.9)	1.2	(1.0)	2.0	(0.1)	1.9	(2.0)	2.1	(2.2)
Amsterdam	1.1	(2.2)	1.9	(2.0)	2.6	(1.4)	1.9	(1.9)	1.7	(1.9)
Oslo	-0.4	(1.8)	-0.6	(1.2)	0.8	(1.7)	-0.1	(1.6)	0.8	(1.6)
Warsaw	-4.7	(-3.3)	-3.6	(-1.3)	0.4	(1.0)	-2.7	(-1.2)	-0.6	(0.3)
Lisbon	0.6	(1.1)	2.8	(2.4)	2.1	(2.8)	1.8	(2.1)	1.9	(2.1)
Moscow	-9.3	(-13.4)	-0.9	(1.2)	4.4	(4.9)	-2.1	(-2.8)	0.4	(-0.2)
Madrid	7.0	(6.8)	9.2	(6.8)	7.2	(6.1)	7.8	(6.6)	7.0	(5.7)
Barcelona	7.3	(5.0)	7.8	(5.5)	5.6	(4.3)	6.9	(4.9)	5.1	(4.5)
Stockholm	4.2	(3.3)	2.5	(2.4)	2.0	(2.1)	2.9	(2.6)	2.2	(2.5)
Zurich	-1.2	(-1.6)	-0.9	(0.4)	1.0	(1.3)	-0.4	(0.0)	0.9	(0.6)
London: City	10.0	(9.9)	6.7	(5.6)	3.0	(2.7)	6.5	(6.0)	3.7	(2.9)
London: West End	9.0	(9.0)	5.6	(5.3)	2.5	(2.5)	5.6	(5.6)	3.7	(2.8)
Manchester	4.2	(4.6)	4.6	(2.8)	2.3	(2.6)	3.7	(3.3)	2.8	(2.3)

Previous survey figures in brackets

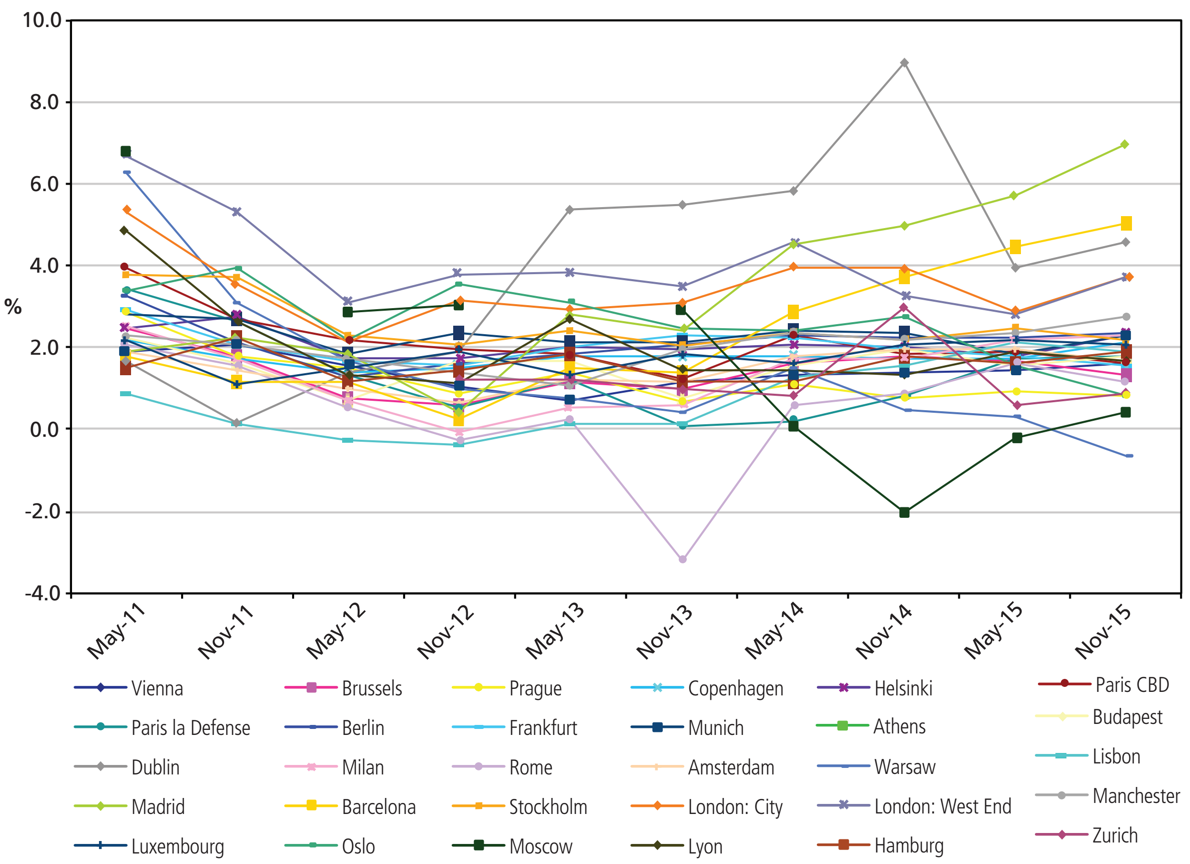
Appendix 2

Figure 5: Three-year Weighted Rental Growth Forecasts



Appendix 2

Figure 6: Five-year Weighted Rental Growth Forecasts



Acknowledgements

Forecast Contributors

IPF thanks all participants in the survey for contributing rental data to the May 2015 European Consensus Forecasts, including the following organisations:

Aberdeen Asset Management, Aviva Investors, AXA IM – Real Assets, BNP Paribas Real Estate, Capital Economics, CBRE, CBRE Global Investors, Cushman & Wakefield, Danish Property Federation, Invesco, JLL, LaSalle Investment Management, Rockspring PIM, Standard Life Investments, TH Real Estate.

Notes

The IPF European Consensus Forecasts survey currently focuses on office rental value growth in major cities. It is not possible 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.

Disclaimer

The IPF Survey of Independent Forecasts for European Prime Office Rents is for information purposes only. The information therein is believed to be correct, but cannot be guaranteed and the opinions expressed in it constitute our judgment as of the date of publication but are subject to change. Reliance should not be placed on the information and opinions set out therein for the purposes of any particular transaction or advice. The IPF cannot accept any liability arising from any use of the publication.

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