Q2 2016: Global Cities Commercial Monitor

Brexit vote dampens London sentiment significantly

- Brexit vote hits London sentiment while investment in German cities remains robust
- Capital value and rental expectations buoyant in Budapest and Auckland
- Stretched valuations weighing on markets in New York and Tokyo

The Q2 2016 RICS Global Cities Commercial Property Monitor continues to show increasingly contrasting trends in current sentiment towards investment and occupier markets across key cities around the globe.

The most noteworthy development visible in the Q2 results comes in London, where the Brexit vote has had a noticeably adverse effect on market sentiment. Capital value and rental expectations both lurched into negative territory in the aftermath of the decision. Investment enquiries contracted sharply as political and economic uncertainty ushered in a heightened sense of caution. Whether or not the initial fall is a knee-jerk reaction that will unwind as the result is digested, or the start of a more prolonged downturn, remains to be seen (54% of respondents now feel the market is in an early downturn phase).

Interestingly, key cities across Germany (often put forward as potential beneficiaries to activity relocating from London) continue to attract strong interest from domestic and foreign investors alike. Indeed, Frankfurt, Berlin, Munich and Hamburg all recorded another significant rise in investment enquiries during Q2. Consequently, twelve month capital value projections point to smart gains across both prime and secondary assets in each city. Nevertheless, a majority of respondents consider valuations to be somewhat stretched relative to fundamentals in each location. Consistent with this, capital value growth is expected to decelerate over the medium term. Hamburg is an exception however, where respondents anticipate growth to gather pace.

Elsewhere, the Q2 results signal particularly firm momentum in Auckland and Budapest. In both cases, strong confidence in the investment market outlook is being underpinned by upbeat rental growth projections. Indeed, Auckland and Budapest exhibit well-rounded readings for both the RICS Investment Sentiment and Occupier Sentiment Indices (composite indicators combining demand, supply and forward looking variables).

Commercial real estate in Dublin, Lisbon and Madrid also continues to display solid trends having outperformed the recovery in Europe over much of the past 18 months. Nevertheless, current momentum does appear to be fading slightly, with OSI and ISI gauges noticeably softer than six months ago in each case. For now though, there remains widespread confidence amongst contributors that capital values and rents will continue to rise firmly over the year ahead (notwithstanding the fact respondents in Lisbon and Dublin have begun trimming the pace of expected gains slightly).

Meanwhile, recent results across New York and Tokyo show a clear moderation in momentum. Following strong gains over the past three years, concerns over valuation appear to be taking their toll on these two markets. Indeed, over 85% of respondents across both Tokyo and New York sense commercial real estate is now overpriced to some extent. The Investment Enquiries gauge in Tokyo has slipped sharply in recent quarters, falling from a net balance of +62 just twelve months ago, to sluggish reading of +3 in the current quarter. However, the stock of investable property continues to dwindle and this remains a key feature of the market. Given these dynamics, capital values are expected to remain broadly stable over the next twelve months. Even so, 70% of respondents feel the market has now peaked and three year capital value projections are in fact negative at the headline level. Meanwhile, the largest share of New York respondents already sense the market has started to turn down. As such, capital values are expected to come under downward pressure over the year ahead, although the weakness is largely concentrated in retail and secondary office markets.

Feedback remains particularly downbeat in Singapore, Perth and Sao Paolo, with both ISI and OSI readings steeped in negative territory. A challenging macroeconomic climate continues to weigh on market sentiment while weak commodity prices (notwithstanding the recent rebound) are badly impacting activity in Perth. The twelve month outlook also remains firmly negative in several other cities. These include Geneva, Zurich, Hong Kong, Doha and Athens. A number of factors are creating difficulties for the sector, ranging from an overvalued exchange rate in Switzerland, to the financial strain of low oil prices in Qatar. Even though these markets have generally performed poorly in recent quarters, over half of all respondents in each location still express concerns over high valuations. Athens is an exception, where a large share of contributors sense the market offers good value for investors. Nevertheless, political and economic instability seems to be deterring investment for the time being, although 69% of contributors sense the market is close to finding a floor.

India continues to be an outperformer across emerging markets and the medium term outlook suggests this is likely to persist. Over the year ahead, capital values and rents are expected to rise at a solid pace in Bangalore, Mumbai and NCR. Moreover, the three year outlook is exceptionally strong. In fact, over the longer time frame, each of these markets is ranked in the top 5 (out of 41 cities covered) with regards to capital value and rental projections.

Figure 1. Occupier and Investor Sentiment Indices (capturing current momentum) - All sectors (net balance %)

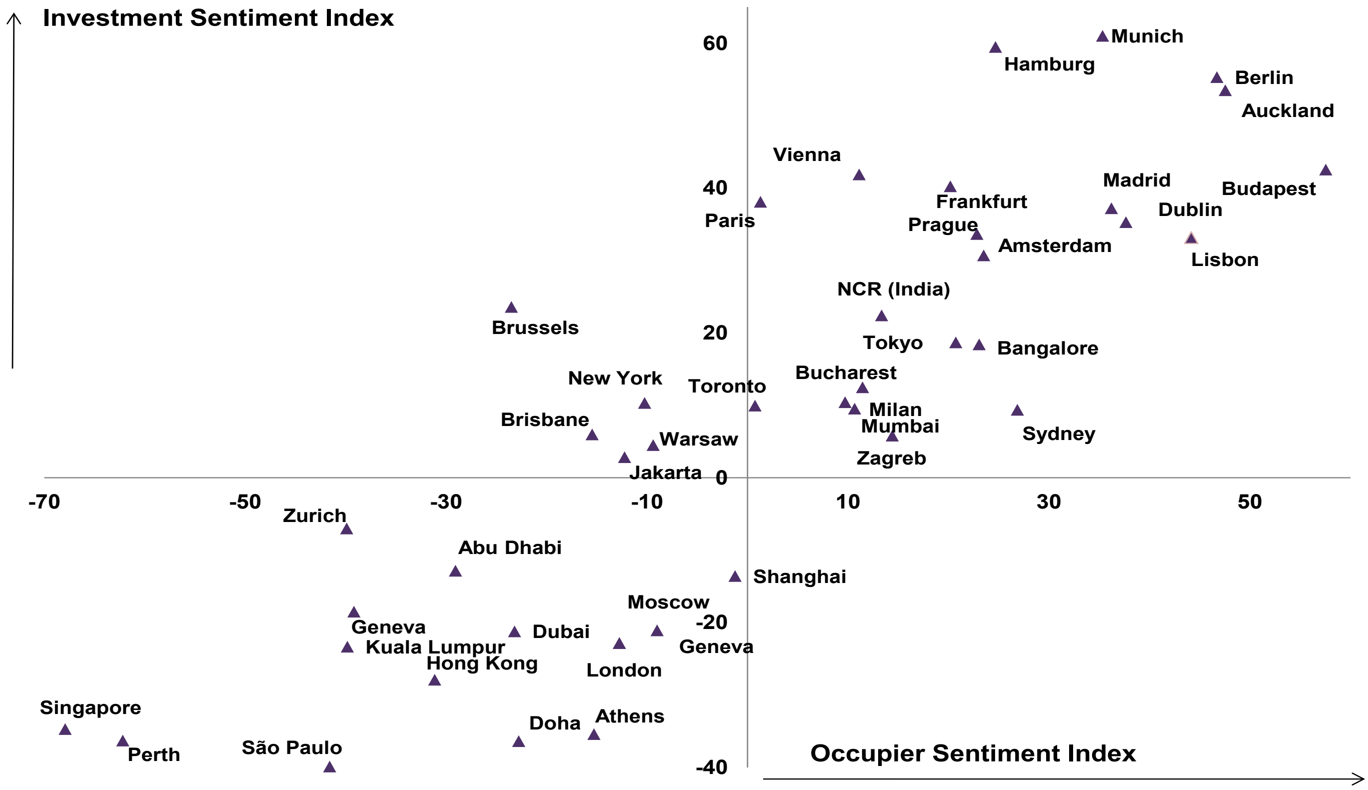


Figure 2. 12 Month Rent and Capital Value Expectations - All sectors (net balance %)

Figure 3. Valuation Perceptions

% of respondents viewing their local market as cheap, fair value or expensive

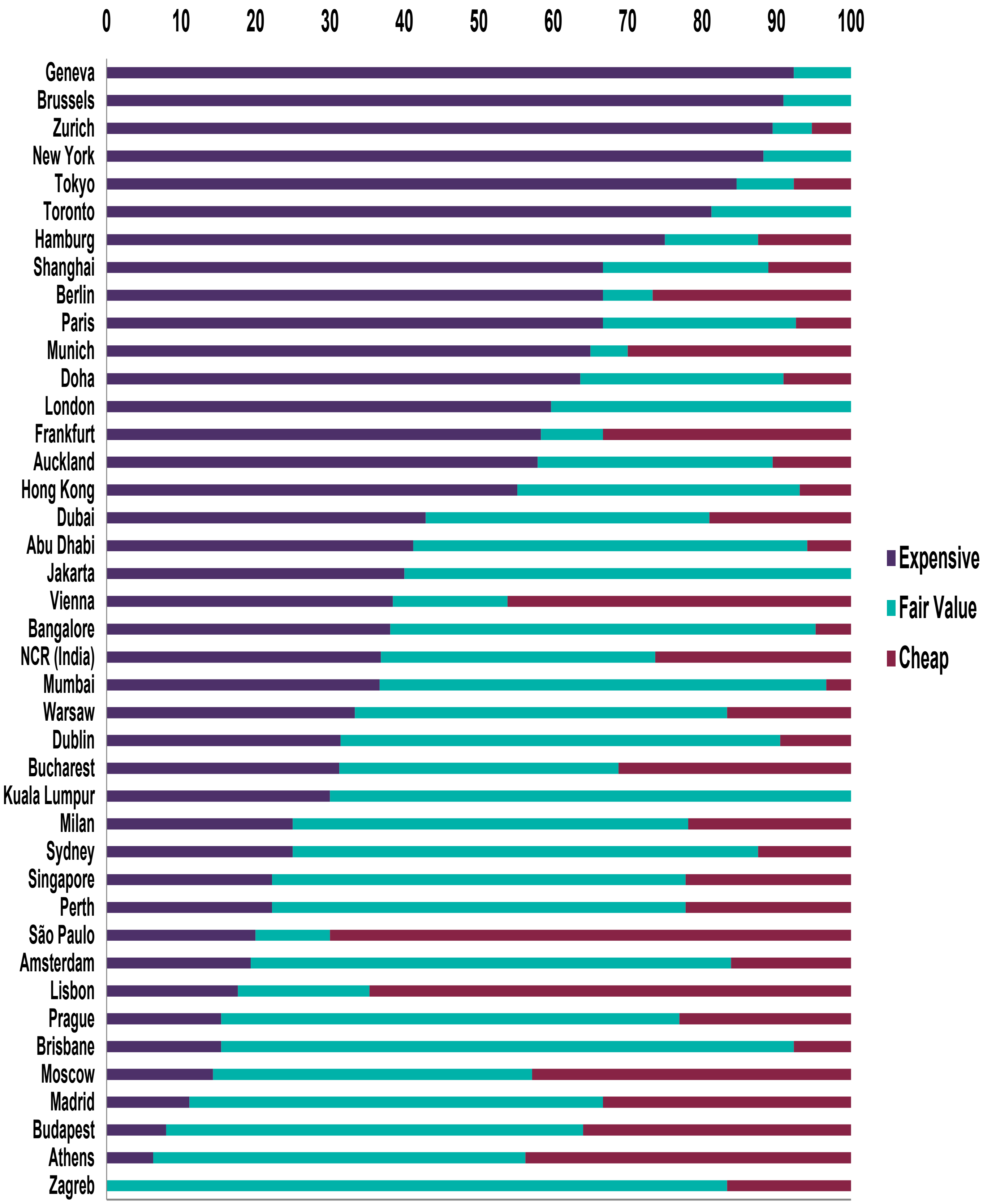
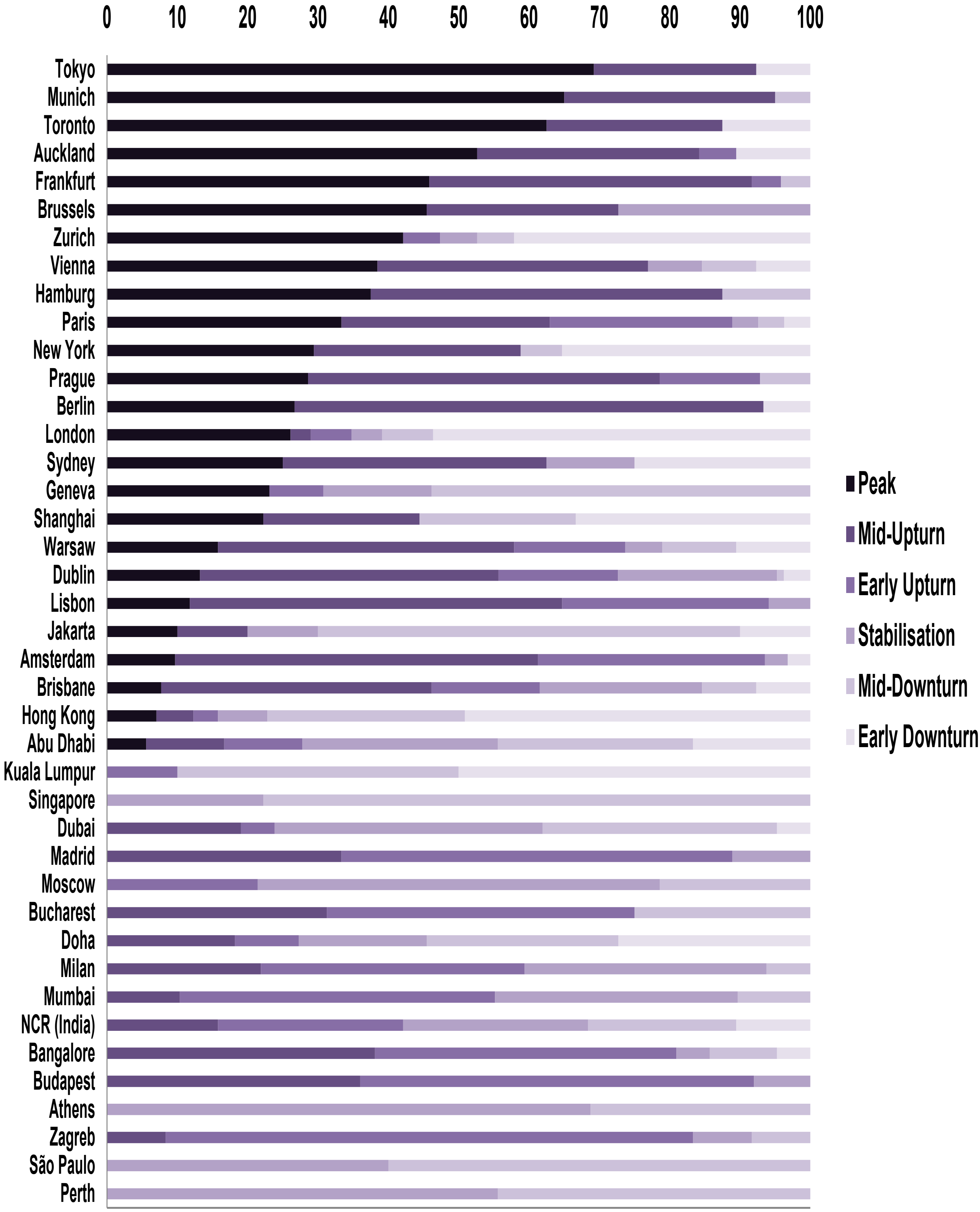


Figure 4. Property Cycle

Percentage of respondents viewing their local market in the various stages of the property cycle



Information

Global Commercial Property Monitor

RICS' Global Commercial Property Monitor is a quarterly guide to the trends in the commercial property investment and occupier markets. The report is available from the RICS website www.rics.org/economics along with other surveys covering the housing market, residential lettings, commercial property, construction activity and the rural land market.

Methodology

Survey questionnaires were sent out on 10 June 2016 with responses received until 4 July 2016. Respondents were asked to compare conditions over the latest three months with the previous three months as well as their views as to the outlook. A total of 1728 company responses were received, with 392 from the UK. Responses for Ireland were collated in conjunction with the Society of Chartered Surveyors Ireland.

Responses have been amalgamated across the three real estate sub-sectors (offices, retail and industrial) at a country level, to form a net balance reading for the market as a whole.

Net balance = Proportion of respondents reporting a rise in a variable (e.g. occupier demand) minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%). Net balance data can range from -100 to +100.

A positive net balance reading indicates an overall increase while a negative reading indicates an overall decline. The RICS Occupier Sentiment Index (OSI) is constructed by taking an unweighted average of readings for three series relating to the occupier market measured on a net balance basis; occupier demand, the level of inducements and rent expectations. The RICS Investment Sentiment Index (ISI) is constructed by taking an unweighted average of readings for three series relating to the investment market measured on a net balance basis; investment enquiries, capital value expectations and the supply of properties for sale.

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