Q4 2016: Global Cities Commercial Monitor

German cities continue to attract strongest investment growth

- Confidence remains most upbeat in European cities with those in Germany again outperforming
- Respondents view property values to be most stretched in Tokyo, Toronto and New York
- Demonetisation hits near term sentiment in Bangalore, NCR and Mumbai

The results of the Q4 2016 RICS Global Cities Commercial Property Monitor again point to key centres across Europe retaining the strongest momentum on a global comparison. Ongoing monetary policy stimulus from the ECB, coupled with a recent firming in the macro newsflow, both appear to be supporting this relative outperformance on the continent.

The headline Investment Sentiment Index (a combined measure incorporating variables on demand and supply, as well as capital value expectations) sits most firmly in positive territory in Munich, Frankfurt, Berlin, Barcelona, Amsterdam and Budapest. In fact, Sydney was the only city outside of Europe to make it into the top eight ISI rankings. In each of these markets, a net balance of more than 50% of respondents reported higher investment enquiries during Q4 (relative to the previous quarter). Likewise, foreign investor demand was also reported to have increased firmly. An excess of demand over supply is exerting upwards pressure on capital values, leading respondents across each of the aforementioned areas to project significant price growth over the next twelve months. Prime assets continue to display stronger expectations than secondary counterparts, with the office sector generally seen to have the strongest outlook.

At the other end of the spectrum, feedback to this quarter's Monitor suggests momentum remains less positive in Dubai, Singapore and Zurich. Falling demand from both investors and occupiers is being met by rising supply, weighing on rental and capital value expectations which are still negative at the headline level. The results from Dubai have become progressively worse in recent reports, with 57% of contributors now viewing conditions to be consistent with the middle stages of a downturn (up from 43% previously). In Perth, trends on the occupier side of the market are particularly weak, with anecdotal evidence highlighting the weakness in commodity prices (notwithstanding the recent pick-up) as the key factor. Nonetheless, 80% of respondents from Perth now sense the market has reached a floor and the medium term outlook for capital values is positive.

Interestingly, both OSI and ISI readings turned negative in NCR and Mumbai following the announcement that India's 500 and 1000-rupee notes would be demonetised in November. And, while these two indicators stayed modestly positive in Bangalore, respondents were prompted to pare back their expectations for capital value and rental growth significantly over the next twelve months. That said, both are still expected to increase in all three areas in the year ahead, but the pace of expected gains has moderated. When asked if they felt demonetisation would cause capital values to decline, 45% of respondents across India as a whole felt the policy would lead to some softness in prices. On the other hand, a majority (51%) did not feel this would be the case, while the remaining 4% did not have a view at this stage.

Meanwhile, concerns over valuation persist in a number of markets, with some seeing a rise in the proportion of respondents who feel values have become stretched relative to fundamentals during Q4. Tokyo (95%), Toronto (92%) and New York (91%) all exhibit the highest share of respondents viewing commercial real estate to be overpriced to some extent. In keeping with this, the largest proportion of contributors in Tokyo and Toronto now sense conditions have peaked in the current cycle. In New York, 50% of contributors feel the market has started to turn down. For the time being, capital values are expected to hold steady although rents are anticipated to slip slightly over the year ahead.

By way of contrast, 61% of respondents in Sao Paulo feel the market has now reached a floor following three years of volatility. Although OSI and ISI readings remained modestly negative in the latest results, twelve month capital value expectations turned positive across the city for the first time since this series was introduced in 2013. This improved sentiment is being driven by growth in investment enquiries from both domestic and foreign investors, while credit conditions are now reported to be stabilising.

In an attempt to capture the initial response to the outcome of the EU referendum in the UK, respondents across Europe were asked if they had seen any evidence of British based firms looking to move. Most significantly, 50% of contributors in both Dublin and Warsaw now claim to have seen evidence of businesses at least scoping out contingency plans to relocate. In Amsterdam 42% reported having seen such enquiries with the figure around 30% in Berlin, Frankfurt, and Madrid. This question was also posed to respondents in New York, with a smaller (but not insignificant) 18% of respondents seeing evidence of firms looking to move. This could perhaps give an early indication as to which markets are being viewed as more appropriate alternatives to London if firms are left unsatisfied with the trading relationship put in place after negotiations conclude.

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

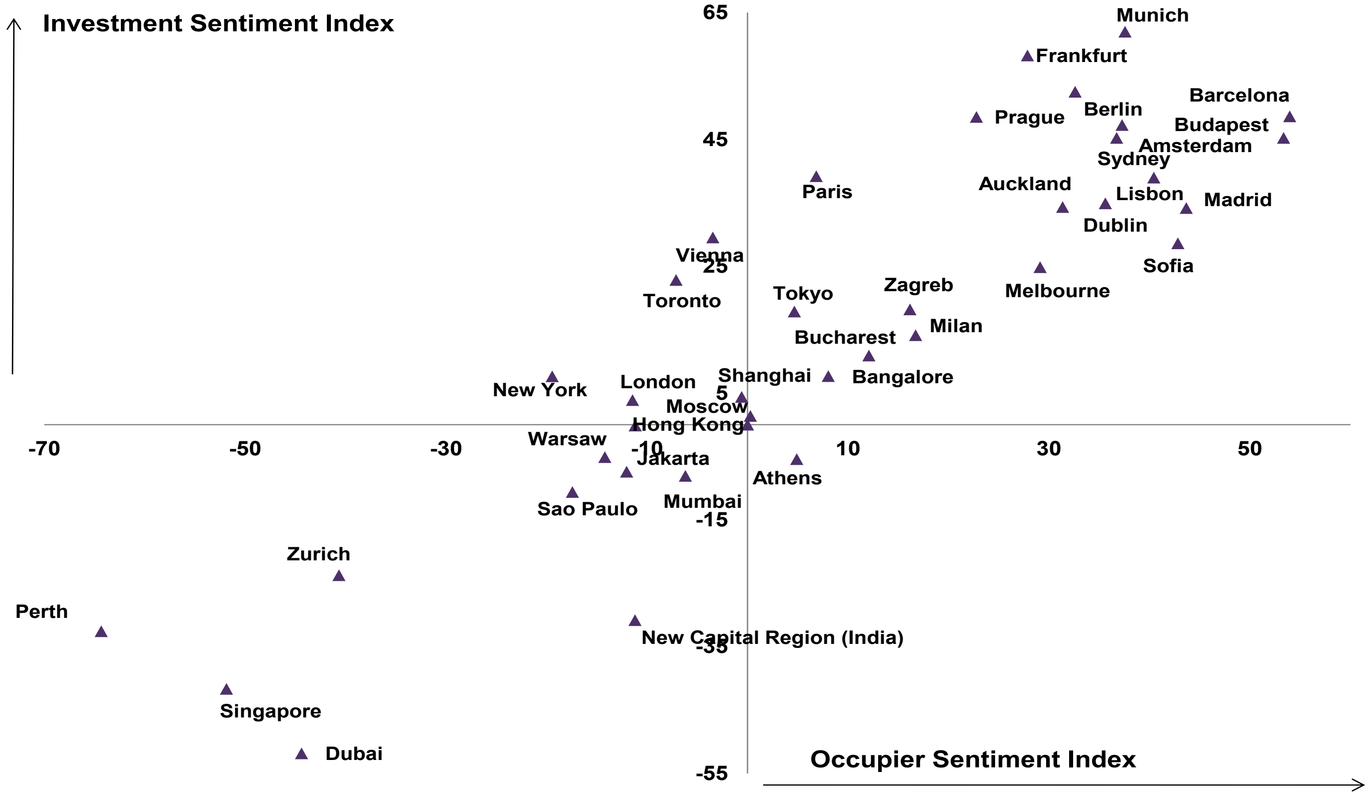


Figure 2. 12 Month Rent and Capital Value Expectations - All sectors (net balance %)

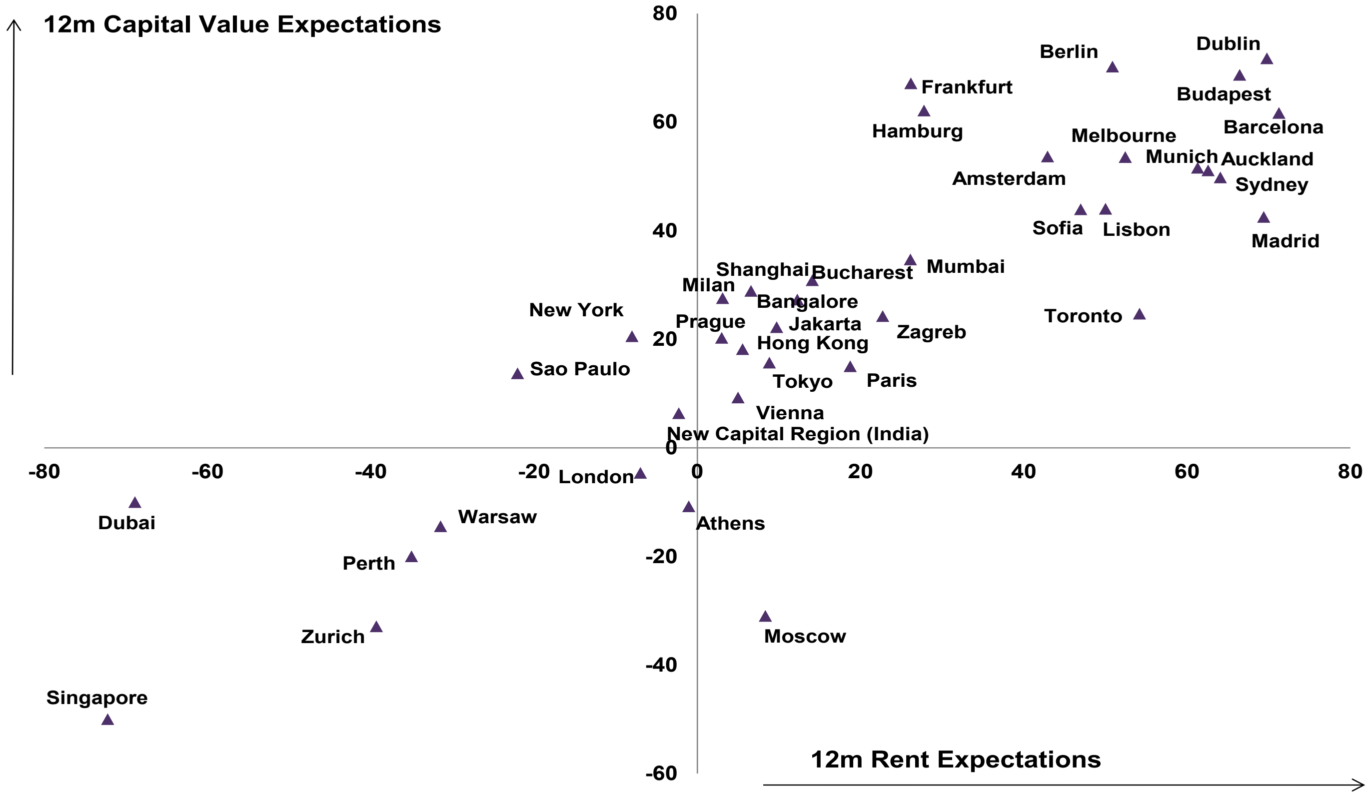


Figure 3. Valuation Perceptions

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

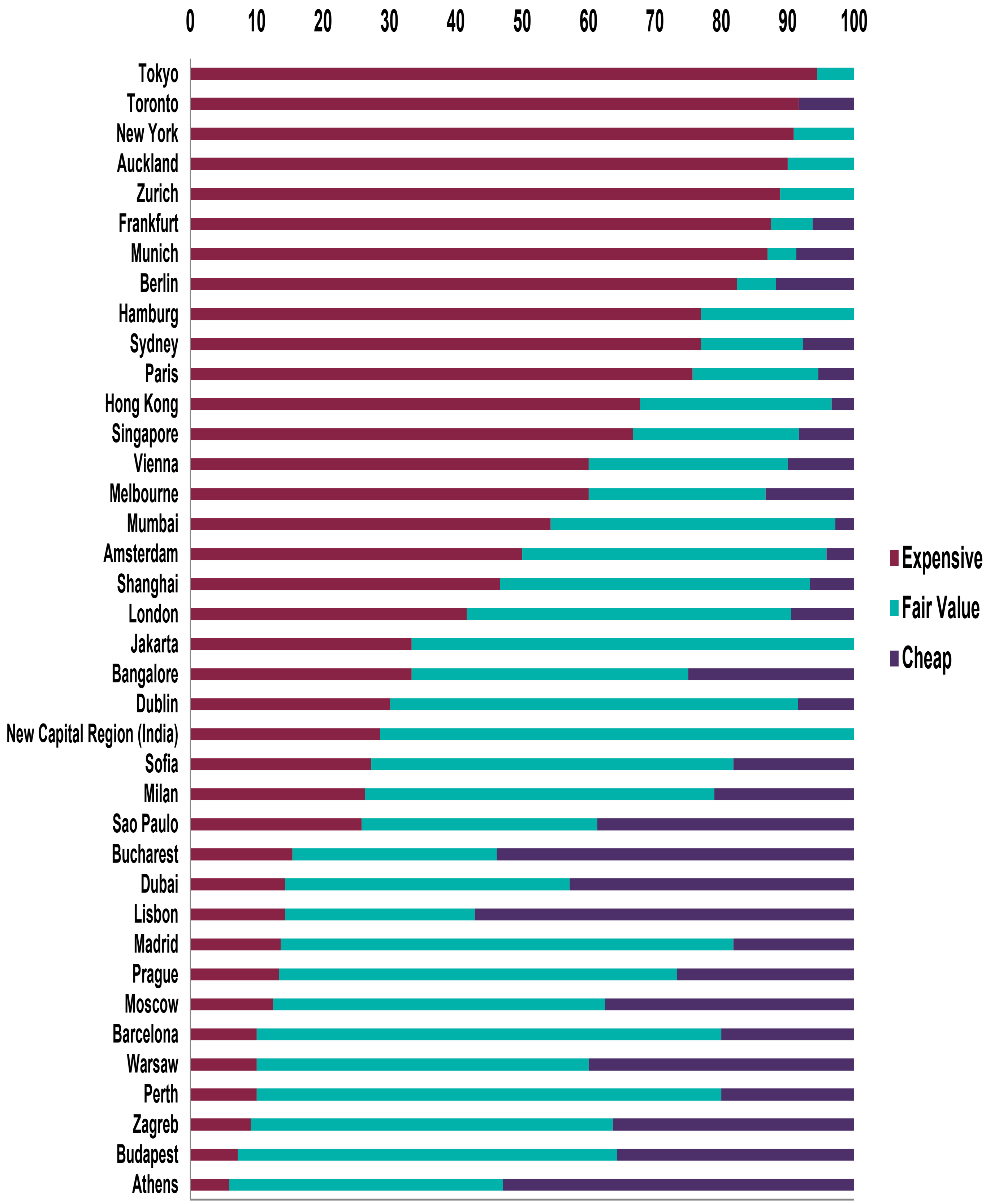
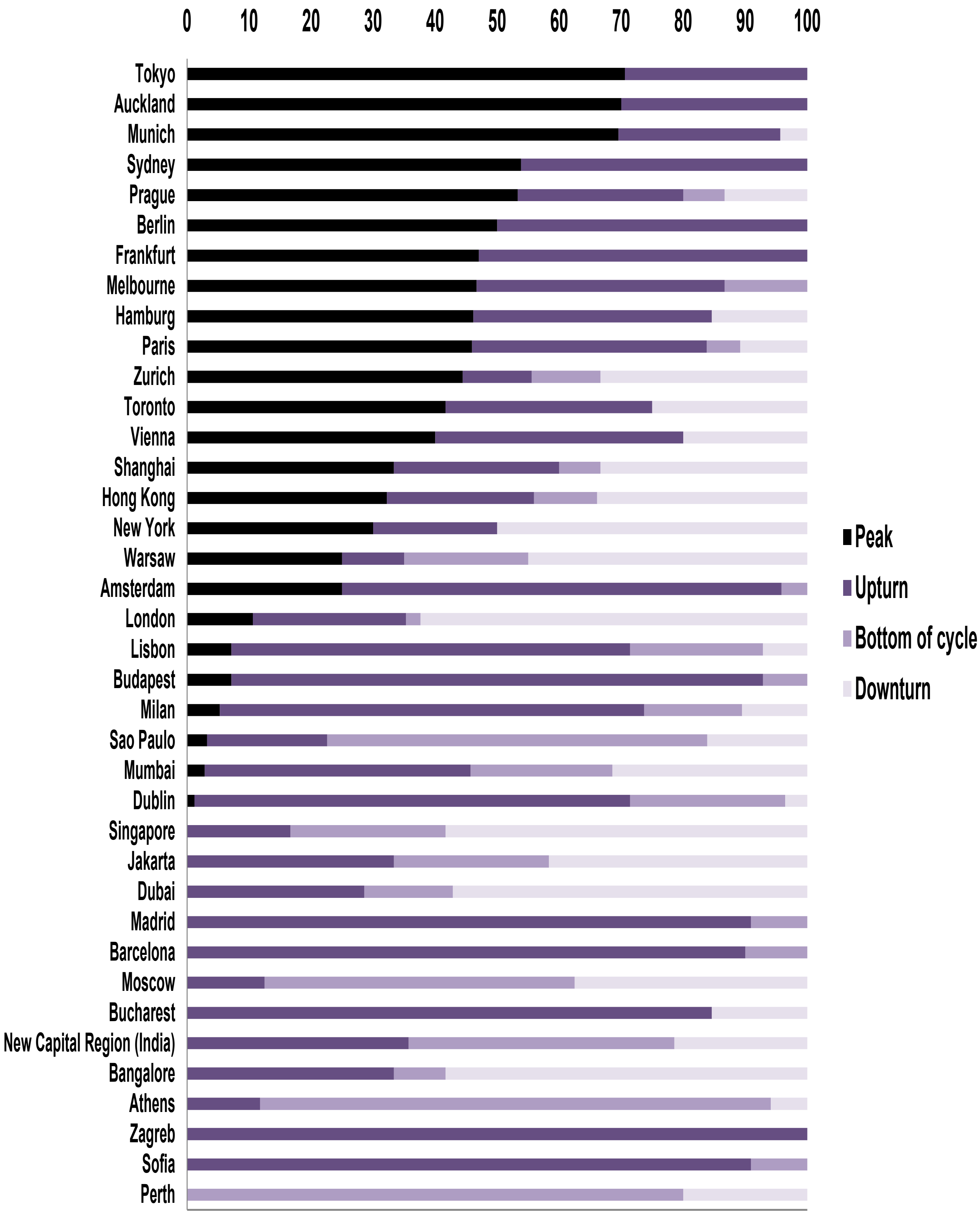


Figure 4. Property Cycle

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 07 December 2016 with responses received until 6 January 2017. 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 1695 company responses were received, with 496 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.

Contact details

This publication has been produced by RICS. For all economic enquiries, including participation in the monitor please contact: **economics@rics.org**

Disclaimer

Economics Team

Janet Guilfoyle

Market Surveys Administrator

+44(0)20 7334 3890

jguilfoyle@rics.org

Simon Rubinsohn

Chief Economist

+44(0)20 7334 3774

srubinsohn@rics.org

Jeffrey Matsu

Senior Economist

+44(0)20 7695 1644

jmatsu@rics.org

Sean Ellison

Senior Economist

+65 68128179

sellison@rics.org

Tarrant Parsons

Economist

+44(0)20 7695 1585

tparsons@rics.org

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United Kingdom RICS HQ
Parliament Square, London
SW1P 3AD United Kingdom
t +44 (0)24 7686 8555
f +44 (0)20 7334 3811
contactrics@rics.org

Media enquiries
pressoffice@rics.org

Ireland
38 Merrion Square, Dublin 2,
Ireland
t +353 1 644 5500
f +353 1 661 1797
ricsireland@rics.org

Europe
(excluding UK and Ireland)
Rue Ducale 67,
1000 Brussels,
Belgium
t +32 2 733 10 19
f +32 2 742 97 48
ricseurope@rics.org

Middle East
Office G14, Block 3,
Knowledge Village,
Dubai, United Arab Emirates
t +971 4 446 2808
f +971 4 427 2498
ricsmenea@rics.org

Africa
PO Box 3400,
Witkoppen 2068,
South Africa
t +27 11 467 2857
f +27 86 514 0655
ricsafrica@rics.org

Americas
One Grand Central Place,
60 East 42nd Street, Suite 2810,
New York 10165 – 2811, USA
t +1 212 847 7400
f +1 212 847 7401
ricsamericas@rics.org

South America
Rua Maranhão, 584 – cj 104,
São Paulo – SP, Brasil
t +55 11 2925 0068
ricsbrasil@rics.org

Oceania
Suite 1, Level 9,
1 Castlereagh Street,
Sydney NSW 2000. Australia
t +61 2 9216 2333
f +61 2 9232 5591
info@rics.org

North Asia
3707 Hopewell Centre,
183 Queen's Road East
Wanchai, Hong Kong
t +852 2537 7117
f +852 2537 2756
ricsasia@rics.org

ASEAN
10 Anson Road,
#06-22 International Plaza,
Singapore 079903
t +65 6635 4242
f +65 6635 4244
ricssingapore@rics.org

Japan
Level 14 Hibiya Central Building,
1-2-9 Nishi Shimbashi Minato-Ku,
Tokyo 105-0003, Japan
t +81 3 5532 8813
f +81 3 5532 8814
ricsjapan@rics.org

South Asia
48 & 49 Centrum Plaza,
Sector Road, Sector 53,
Gurgaon – 122002, India
t +91 124 459 5400
f +91 124 459 5402
ricsindia@rics.org