Q2 2016: Global Commercial Property Monitor

Momentum now easing in a number of key markets

- Brexit hits UK sentiment while market impetus fades in the US and Japan
- Trends remain robust in Germany, New Zealand and Hungary
- Feedback still downbeat across many emerging markets although the outlook in India improves

The Q2 2016 RICS Global Commercial Property Monitor shows momentum, although still broadly positive, is easing across a number of developed markets. Meanwhile, conditions in emerging economies remain generally downbeat, with renewed weakness in China underlining the challenges.

The instant impact of the Brexit vote has been to dampen sentiment significantly across the UK, with the decline most pronounced in London. Indeed, the Investment Sentiment Index (a composite measure encompassing a number of investment market variables) for London fell from +13 to -23 over the quarter. Other parts of the country have fared a little better but uncertainty is set to remain heightened for a prolonged period according to forward looking indicators.

Following three years of strong activity growth, feedback in the US and Japan has turned a little less favourable over the past two quarters. In Japan, the RICS investment enquiries gauge shows buyer demand failed to rise during Q2 for the first time since 2011. Nevertheless, a lack of supply is supporting prices for the time being. However, around 70% of respondents are now of the opinion the Japanese market has hit its peak, while 8% feel the sector has already started to turn down. What's more, over 80% of contributors now believe commercial real estate is overpriced relative to fundamentals. In the US, demand from both occupiers and investors grew at the slowest pace since 2010. Alongside this, respondents trimmed their capital value and rental growth forecasts for the year ahead in each area of the market. Although projections at the headline level remain in modestly positive territory, rents and capital values are expected to come under downward pressure in some secondary markets.

Defying the generally softer tone to sentiment globally, the German market continues to display robust underlying momentum. Indeed, the ISI now stands at +51 - the highest reading across all 34 countries covered. New Zealand also recorded another strong ISI reading, as these two nations continue to lead the global pack. In both instances, buyer demand is rising firmly while the supply of property for sale contracts, squeezing capital values higher in the process. Moreover, capital value projections point to strong growth across prime and secondary markets over the year ahead. Nevertheless, although investor appetite continues unabated for now, 50% of respondents in both markets feel conditions are close to the peak of the current cycle. This suggests there may be limited scope for such strong growth beyond the short term.

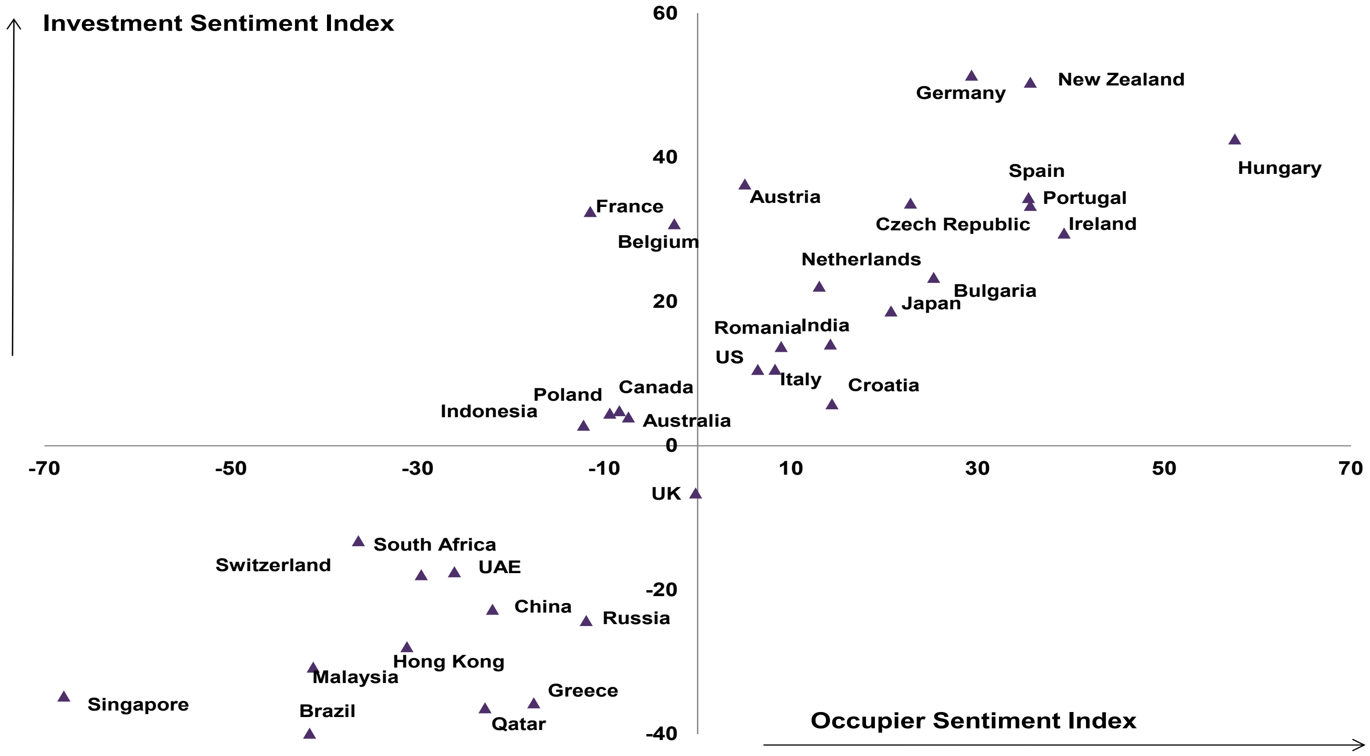
Hungary now appears to be the real standout performer in terms of occupier market momentum, with the Occupier Sentiment Index (an amalgamated indicator of demand, supply and expectations) posting a figure of +58. Employment has increased by 3% over the past twelve months, making the annual rate of job creation in Hungary amongst the fastest across the EU. Firmly rising occupier demand, created by businesses looking to expand, is quickly reducing the availability of leasable space. This is despite the fact commercial construction activity has grown strongly in recent years. Dynamics therefore continue to exert upward pressure on rents, with expectations buoyant both at the twelve month and three year time horizons. Elsewhere in Europe, near term momentum remains solid in Ireland, Spain and Portugal, but has moderated somewhat over the past six months. Indeed, in each instance, both OSI and ISI readings are noticeably softer compared to the end of 2015; While respondents still expect rents and capital values to rise firmly, activity does appear to be losing steam slightly.

Overall sentiment in China turned negative again. Demand fell while availability rose sharply on both the occupier and investment sides of the market. At the headline level, rents are expected to decline over the year ahead while capital values are anticpated to remain flat. On closer inspection, though, weakness is largely concentrated in secondary markets while prime segments may prove more resilient. Meanwhile, the outlook is still downbeat in many parts of Asia. Rents and capital values are expected to fall across the board in Malaysia, Hong Kong and Singapore during the year to come. On a brighter note, Q2 results signal a more stable backdrop in Indonesia compared with the previous quarter, although oversupply in the office rental market remains an issue.

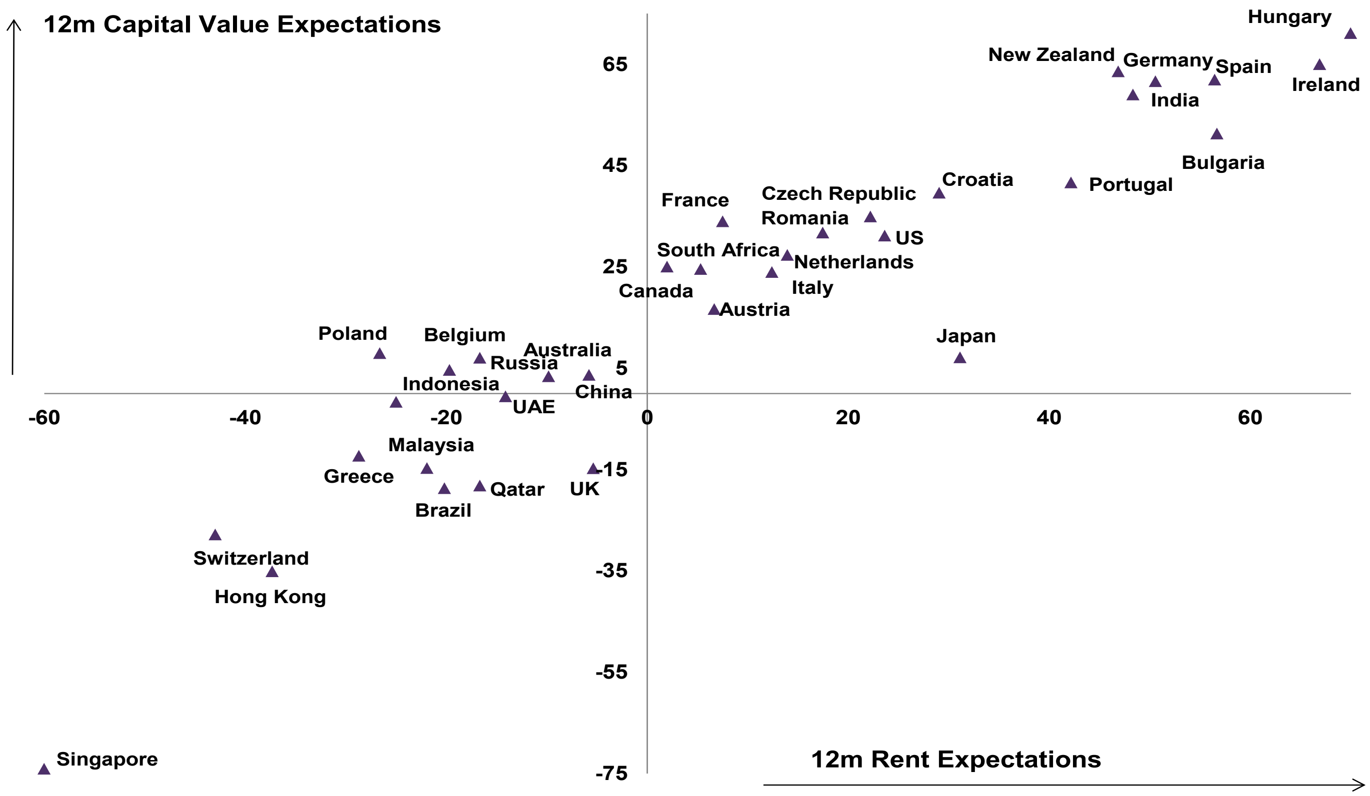
Confidence towards the outlook for Indian commercial real estate is however on the up, bucking the general trend across emerging markets. In fact, both Investment and Occupier Sentiment Indices recorded their highest readings since 2011. Even so, the overall tone to sentiment remains consistent with gradually improving impetus, rather than a sharp acceleration.

Finally, feedback in Brazil and Russia remains negative, albeit to a lesser extent than previously. Both economies have shrunk since 2014, with GDP down 7% and 3% in Brazil and Russia respectively. But, having suffered steep falls over the past two years, respondents now feel real estate offers good value for investors. As such, Brazil exhibits the greatest proportion of contributors (70%) viewing current valuations as 'cheap' on a global comparison. Likewise, in Russia, 85% of respondents sense commercial property prices are either at or below fair value.

Occupier Sentiment Index and Investment Sentiment Index (capturing current momentum) - Net balance %

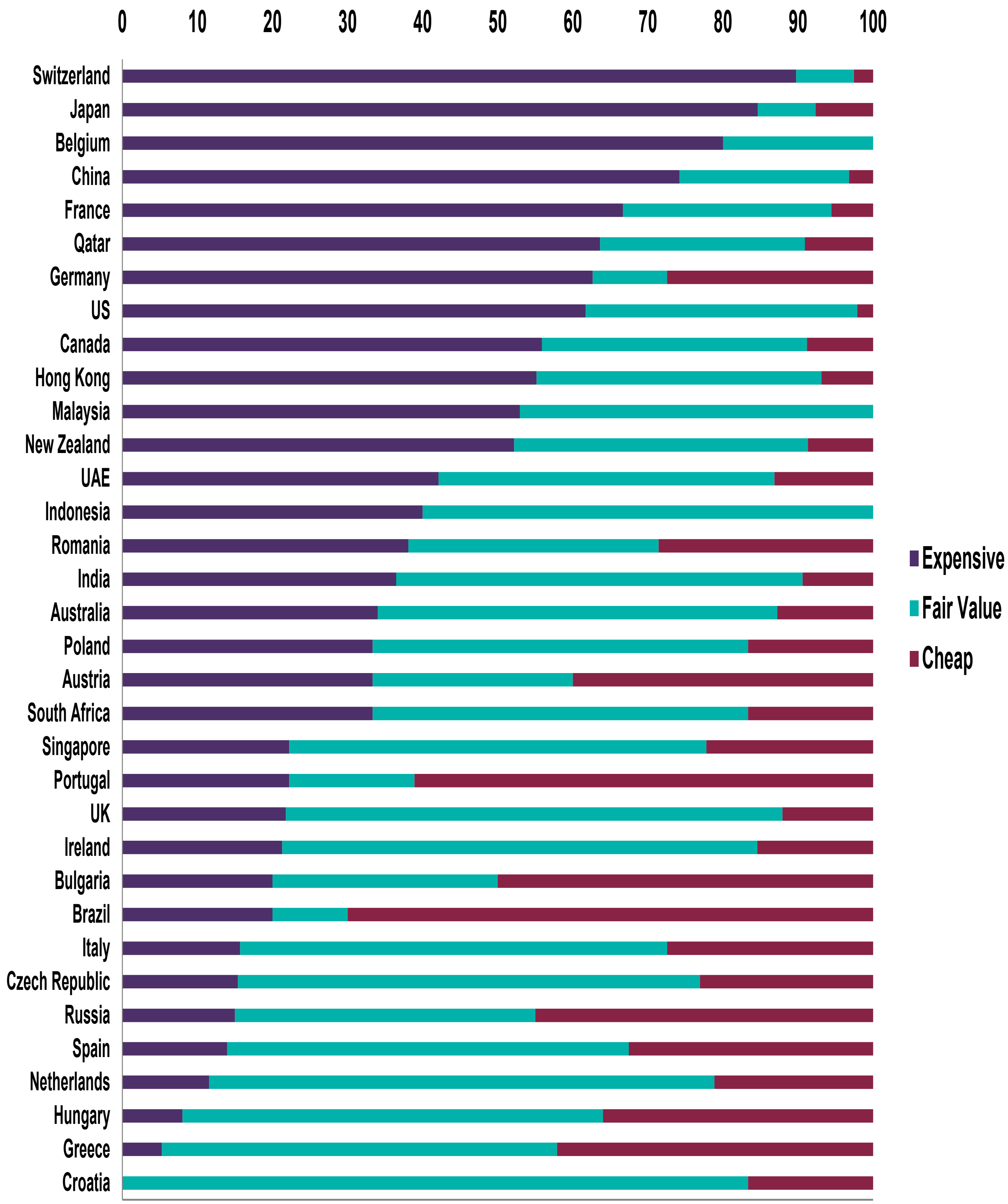


Twelve Month Rent and Capital Value Expectations (net balance %)



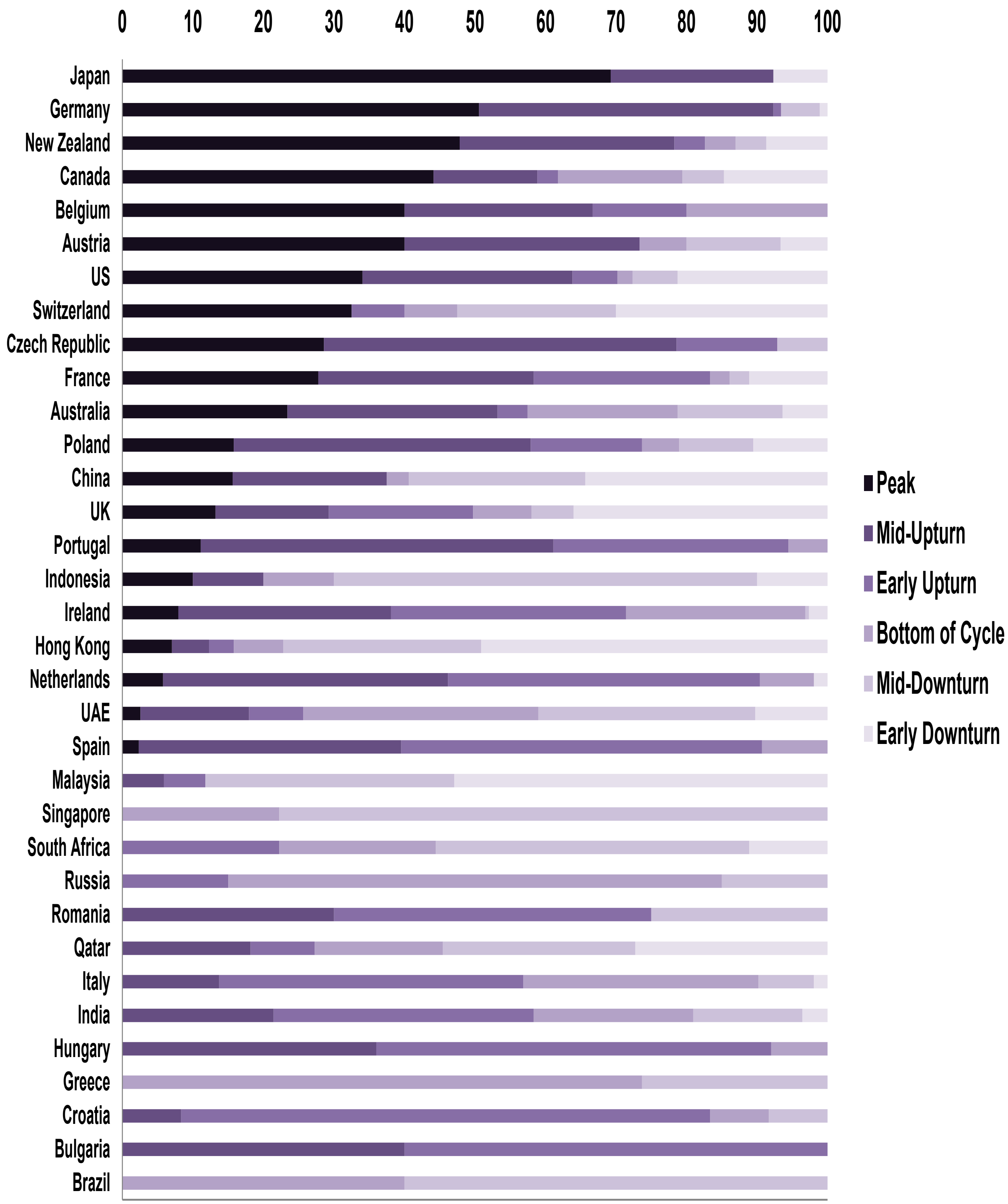
Valuations Perceptions

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



Property Cycle

% of respondents viewing conditions in their local market at 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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