Q4 2019: Global Commercial Property Monitor

Sentiment improves helped by more supportive credit conditions

- Share of respondents viewing their market to be in an 'upturn' phase increases
- Feedback on European real estate remains most positive in general
- Prime offices set to continue outperforming with secondary retail lagging

The Q4 RICS Global Commercial Property Monitor (GCPM) shows a slightly firmer tone to key indicators when compared with the results from the previous three month period. Although the picture is not consistent in all markets, the trend is generally visible in the readings for both the headline Occupier Sentiment Index (OSI) and the Investment Sentiment Index (ISI)*. It is also evident in the feedback regarding perceptions as to where markets are in the real estate cycle. So, for example, just over a quarter of respondents are suggesting (on an unweighted basis) the market they are operating in is in a 'downturn' phase at present compared with a third in Q3. Meanwhile, the share of contributors identifying their market to be in an 'upturn' or 'peak' phase has climbed from 55 to 60% (chart 5).

Without wanting to overplay the shift in the macro mindset at the back end of 2019 and the early weeks of this year (in driving this improvement), it is probable the thawing in trade tensions between the US and China allied to the more extended period of easing in monetary policy is being interpreted as lessening the risk of a global recession in 2020. For the time being, consensus growth estimates for the next twelve months remain relatively subdued but key activity and sentiment metrics are pointing towards a firmer tone in the second half of the year.

Regional trends broadly unchanged

Within the context of a modest strengthening in tone to the latest set of GCPM results, the picture at a more disaggregated level suggests that the regional divergences highlighted previously by contributors to the survey show little sign of closing. This is evident whether viewing the country level (charts 1 and 2) or city level (charts 3 and 4) indicators. European markets, with a few notable exceptions generally remain in positive territory with negative readings continuing to be picked up in some, but by no means all, APAC, African and Middle Eastern markets. Meanwhile the numbers for the Americas remain generally firm. Significantly, the forward looking indicators are, on balance, stronger than the metrics regarding the current environment which, arguably, reflects the potential for improvement in macro conditions.

This is also apparent in the responses to the question regarding credit conditions as it effects the real estate sector with around two-fifth of all respondents indicating they have seen an improvement over the past three months with a similar proportion signalling no change. Notable exceptions to this trend include Hong Kong, Thailand and Oman where more than half of the contributors suggested that credit conditions had deteriorated over the period.

Offices to continue outperforming

At an aggregate level, the key forward looking gauges show offices to be the strongest segment of the market (compared with industrials and retail) and within that area, prime space likely to deliver the highest returns (amongst a core group of markets). Over the next twelve months, capital values (on an unweighted basis) are projected to rise by 3.7% on average for prime offices compared with just under 3.5% in the Q3 survey. Meanwhile the increase in secondary offices values is seen as being just one percent. The projection for prime industrial returns has also risen over the period from 2.5 to 3.2% while the comparable figures for prime retail are 0.9% and 1.3%.

It is however noteworthy that while virtually no markets are expected to see a fall in prime office values (Hong Kong and Oman are notable exceptions), around one-quarter are projected to see a drop in the value of prime retail assets, to a greater or lesser extent. Moreover, when it comes to secondary retail real estate, the structural changes impacting household consumption patterns are rather more evident with around two-thirds of markets envisaging the pricing of those assets being, on average, lower one year out. This is also reflected in the occupier market with rental values for secondary retail projected to fall by a little over 2% but this relatively modest drop masks more material declines in some markets including the UK (-8%) and Hong Kong (-12%). Although only assessing the temperature for multi-family assets in a few markets at this point, the feedback in this area is unsurprisingly robust with expectations for healthy returns.

International capital flows favour UK and Japan

In a separate set of questions put specifically to members of AFIRE** (the association for international real estate investors focused on commercial property in the United States) who have supported the broader GCPM questionnaire as well, Asia continues to be viewed positively as a destination for the deployment of international capital with Japan identified as a particular beneficiary. The ongoing attractions of Europe are also noted with, interestingly, the UK highlighted by a significant number of contributors. This quite conceivably reflects a shift in mood amongst international investors in the wake of the decisive general election that took place in the middle of December easing political risk.

Alongside this. AFIRE members were asked to assess how risky they viewed the current environment for commercial real estate investment (chart 6). On a 1 (no risk) to 6 (very high risk) scale, the overwhelming majority of respondents opted for 3 and 4 (almost three-quarters) which is consistent with a fairly balanced outlook for the sector.

*The Occupier and Investment Sentiment Indices are both composite measures capturing overall market momentum, encompassing variables on supply, demand, and expectations

** To learn more about AFIRE and its membership, visit www.afire.org

Chart 1 Occupier Sentiment Indicator

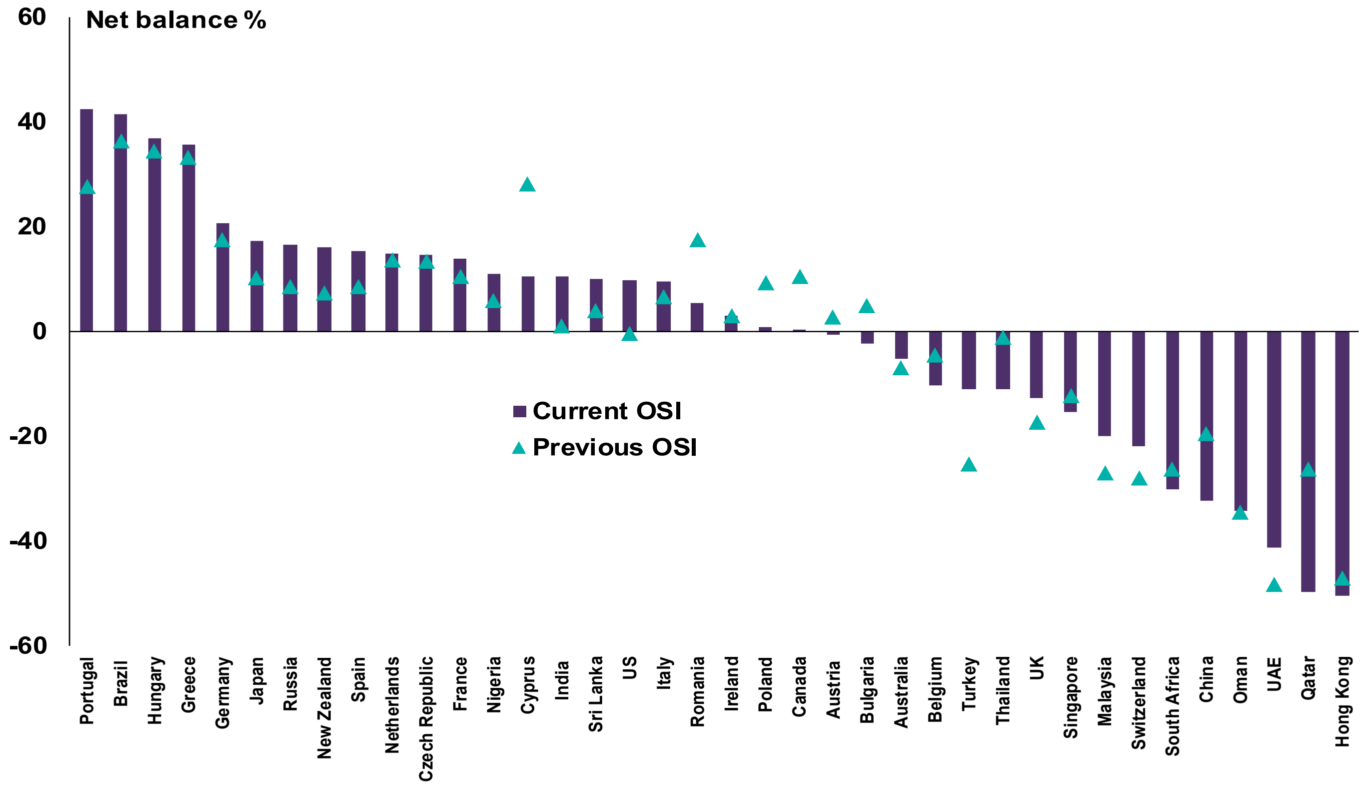


Chart 2 Investment Sentiment Indicator

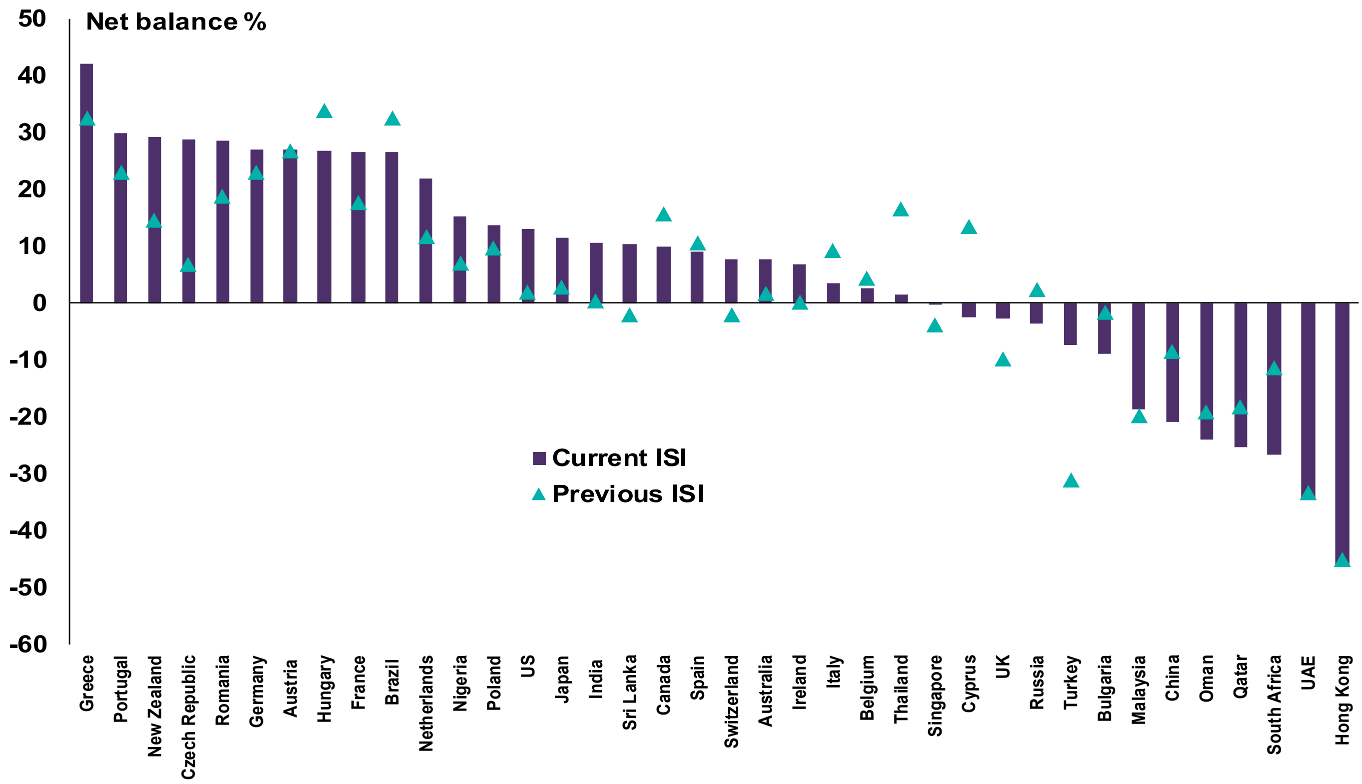


Chart 3 Occupier and Investor Sentiment Indices- All sectors (net balance%)

Indicative of momentum over the previous quarter

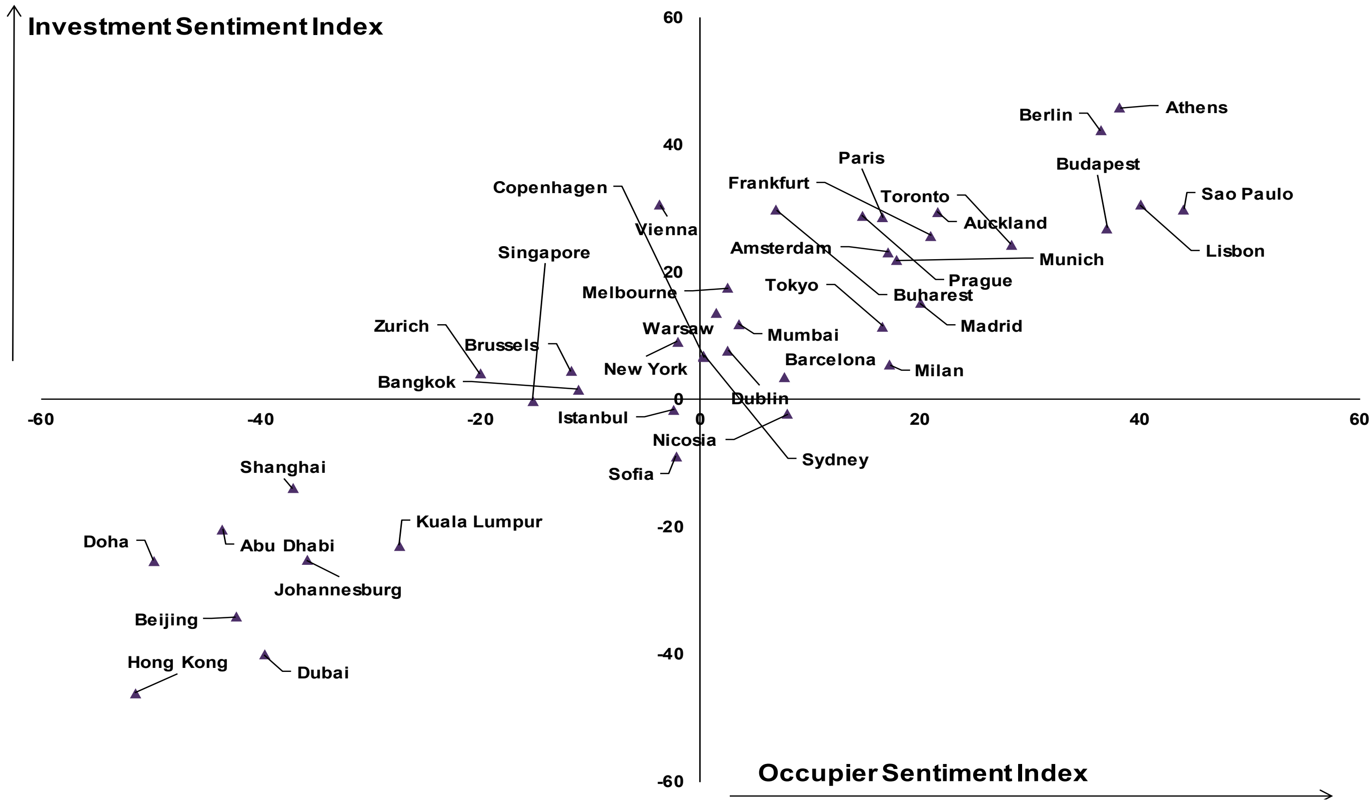


Chart 4 Twelve Month Rental and Capital Value Expectations - All sectors (net balance %)

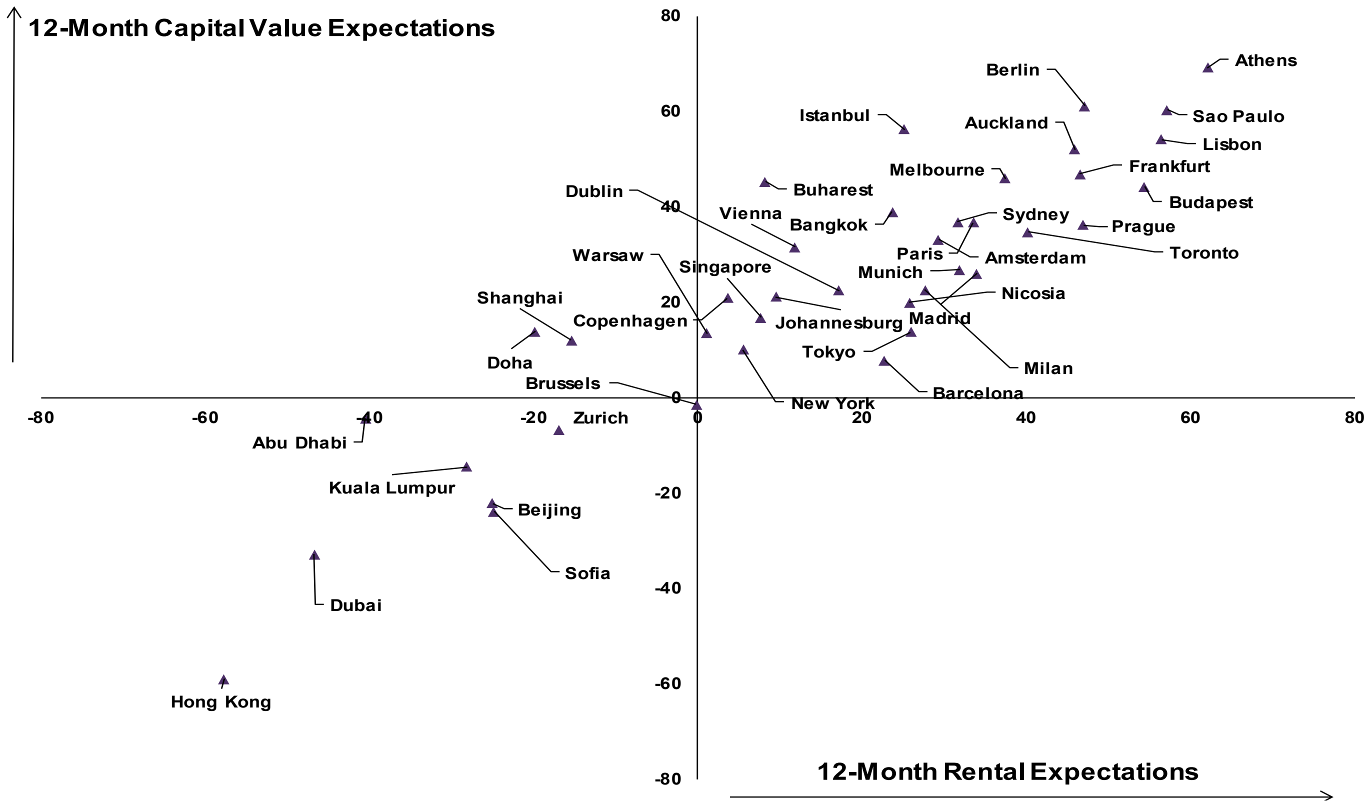


Chart 5 Property Cycle

% of respondents perceiving market conditions to be at various stages of the cycle

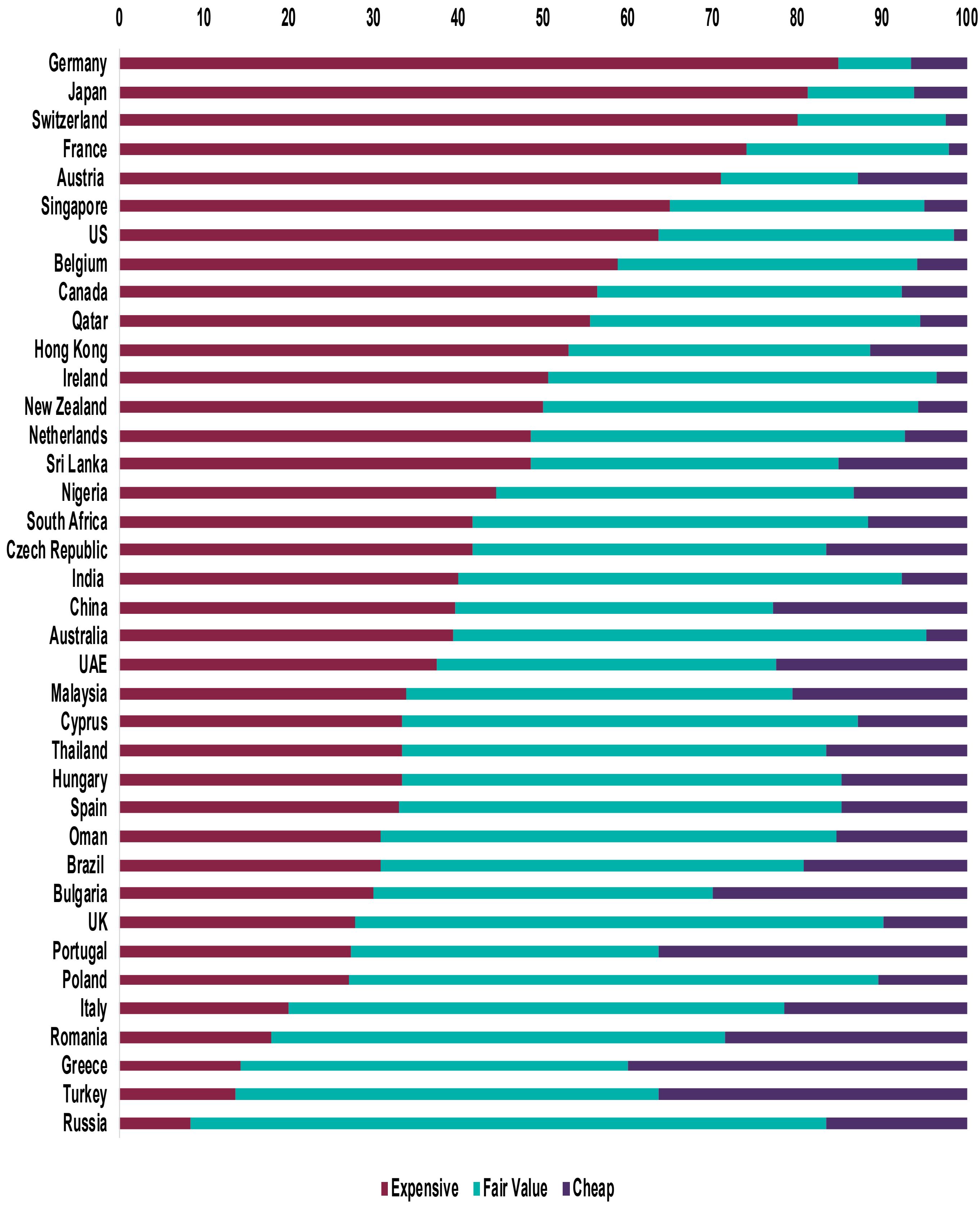
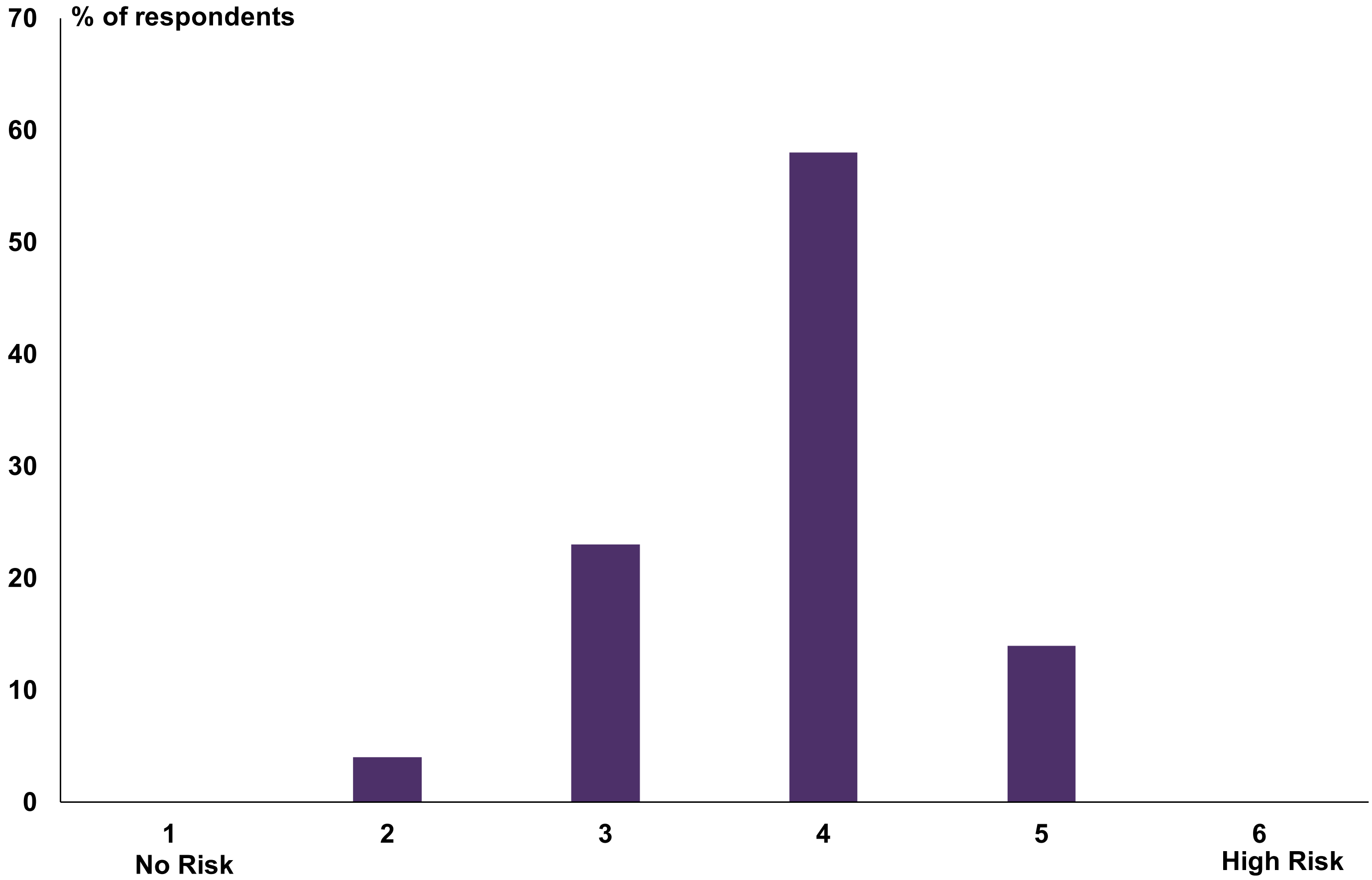
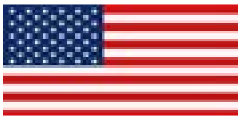


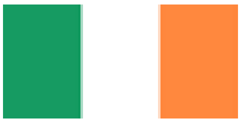
Chart 6 RICS-AFIRE How risky do you perceive the current macro environment for returns on commercial real estate investment



Regional Comments from Survey Participants

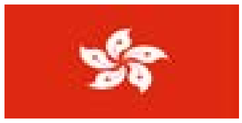


"I view the US market as generally holding steady over the coming year with the exception of Boston office where I expect continued strengthening and retail where I expect continued weakness. Class A multifamily rents are softening and values are flattening in a number of expensive gateway markets"



"The Republic of Ireland's property market, and economy, is very strong especially in the major cities despite concerns over the final shape of Brexit. The recent election of a strong Tory Government is to be welcomed as it will 1) provide clarity and a strong decision making partner and 2) it is likely to lead to a much softer Brexit that will limit the damage to wider Irish economic interests"

"Yields are at an all time low, which is not surprising considering finance is available for, effectively, nothing! However, other than in the logistics sector, occupier demand is, at best static, and probably weakening. This is a precarious situation as sooner or later interest rates must rise and if there is rapid readjustment in values we could find ourselves back in 2008/9!"

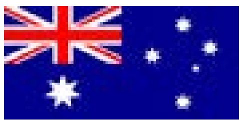


"Political unrest and negative mid term US-China trade confrontation lasts detrimentally in local market"

"The market went through its worst moment and now the trend is for recovery. Low vacancy rates projected over the next 3 years"

"UAE might be heading towards a recession due to a major slowdown in construction and real estate business resulting from over supply"

"Office sector rental growth is starting to slow down, possibly as a result of a slowdown in take-up of space by the co-working operators such as WeWork. We could be reaching the end of the rental growth cycle next year, especially as more new supply is just over the horizon in 2021"



"The commercial market is in a 15-year boom cycle. Real Estate yields still look very good when compared to alternative defensive investments and are therefore attracting funds. Interest rates look likely to fall again in the New year so while the market is fully valued, we don't see a correction looming"

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 9 December 2019 with responses received until 13 January 2019. 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 2956 company responses were received, with 748 from the UK.

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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Responses were gathered in conjunction with the following organisations:

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