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EUROPEAN CONSENSUS FORECASTS

REPORT

Survey of Independent Forecasts of European Prime Office Rents

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MAY 2014

European Consensus Forecasts

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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.

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Survey of European Office Market Rental Forecasts May 2014

Since the last IPF survey, in November 2013, the economic condition of the eurozone has shown some modest recovery, with an average 0.2% growth in the final quarter of the year. However, the European Union's Statistics Office estimates that the economy of the 18 countries sharing the euro expanded only 0.2% on the preceding quarter in the first three months of the current year, rather than the 0.4% growth expected, reflecting a disappointing loss of momentum as overall growth remains static.

Despite a strengthening German economy, growing by 0.8% between January and March, and Spain maintaining its upward path (0.4% from 0.2% in the previous quarter), this has not been enough to offset disappointing news from France and Italy. The former's economy is flat, whilst Italy's GDP turned negative, by 0.1%, having only just emerged from recession last year. In addition, both the Netherlands and Portugal recorded contracting GDPs (-1.4% and -0.7% respectively).

Combined with stubbornly high unemployment in many countries (Italian and French rates are in double figures, whilst one in four of the workforce in Greece and Spain are jobless), these figures are widely expected to put pressure on the European Central Bank to act next month. In order to maintain growth, as well as counter deflationary pressures - annual inflation in the eurozone area was 0.7% in April - many commentators anticipate the ECB will loosen monetary policy further to weaken the euro, the main eurozone interest rate being 0.25% currently. All in all, this suggests the eurozone is something of a curate's egg, being good and bad in parts.

Key Points

Current year

- The first survey of **2014** suggests mixed fortunes for a number markets, with some divergent views being demonstrated amongst forecasters for several locations. Compared to 2013, when 12 of the 29 markets reported were projected to deliver positive growth over that year, the balance for 2014 is that 17 markets should deliver increased rents, of which 12 are expected to grow by more than 1.0%. Of these 17 locations however, only two centres may produce growth rate improvements of more than 1.0% above their November 2013 forecasts, whilst the growth potential in nine markets has weakened by over 1.0% in the same period.
- As reported previously, the location expected to show the highest rental growth remains **Dublin**. The 2014 average predicted growth rate is 11.7%, against a November 2013 forecast of 5.4%; and up on the forecast annual increase of 9.8% for 2013. The next best prospective growth rates, from London's West End and City markets (7.7% and 7.3% respectively), appear relatively modest by comparison. Beyond these markets, however, growth prospects decline substantially, with a group of only nine centres, led by Oslo at 2.6%, expected to record average growth of over 1.0% in the current year.
- Conversely, 12 markets may decline in 2014, as average forecasts indicate nine may experience falls in excess of 1.0% in this period, including Moscow (-7.0%) and Paris La Défense (-5.5%). Some of the weaker (PIIGS) locations continue to struggle: Lisbon, at -3.2%, is the next worst prospective performer, whilst Rome, Milan and Barcelona also feature. The Warsaw, Zurich and Prague markets comprise the remaining negative growth locations for the current year.

Key Points

2015 and beyond

- Average forecasts for **2015** are an improvement over 2014, as 26 centres are expected to show positive growth of between 0.4% and 8.5%. Of these, prospects for four markets have strengthened by more than 1.0% over the previous forecast (Dublin, Luxembourg, Madrid and London West End). Although both Dublin and London are expected to fall back from a peak in the current year, Luxembourg and Madrid may improve further on their 2014 expected growth rates.
- For the first of the **2016** forecasts, all 29 centres are anticipated to deliver positive growth on average, from a weak 0.6% for Rome to a highly respectable 5.1% for Madrid. Indeed, 27 locations are predicted to grow by more than 1.0% in that year, with 15 potentially achieving more than 2.0%, including Milan (2.3%) and Barcelona (3.3%).
- The average outlook over **three years** confirms Dublin's strong performance prospects (at 8.2% per annum) against London West End and City (6.0% and 5.5% annualised respectively). A further 22 centres are forecast to deliver average positive annual growth over the period 2014-2016, ranging from a meagre 0.2% for Zurich to 2.9% per annum for Madrid. The weakest markets comprise, in ascending order, Paris La Défense, Moscow, Lisbon and Rome, with forecasts averaging from -2.0% to -0.5%, clearly reflecting the impact of the current year's negative growth forecasts.
- In the longer-term, the expectation over **five years** is for all markets to produce positive growth, although both Moscow and Paris La Défense lie very close to delivering a flat performance (at 0.1% per annum), whilst the consensus view is that Rome and Zurich are not likely to breach 1.0%. Dublin maintains its premier position over this time frame, with a predicted average of 5.8% per annum, ahead of London's West End and **Madrid** (4.6% and 4.5% per annum respectively).

2014 forecasts softening but a better year in prospect than 2013

Whilst the current year is expected to be an improvement on 2013 in most markets, growth projections for 2014 have weakened over the last six months in 21 locations, nine of them falling back by more than 1.0% in absolute terms. The most extreme reversal is recorded for Moscow, where a considerable divergence of opinion between contributors has resulted in an average forecast of -7.0% (down from 3.0% positive growth in November). In only two centres have growth prospects increased by more than 1.0% during this period – Dublin and London West End, at 11.7% and 7.7% respectively. Changes in each year's forecast averages from November 2013 to May 2014 are noted in the table at Appendix 1.

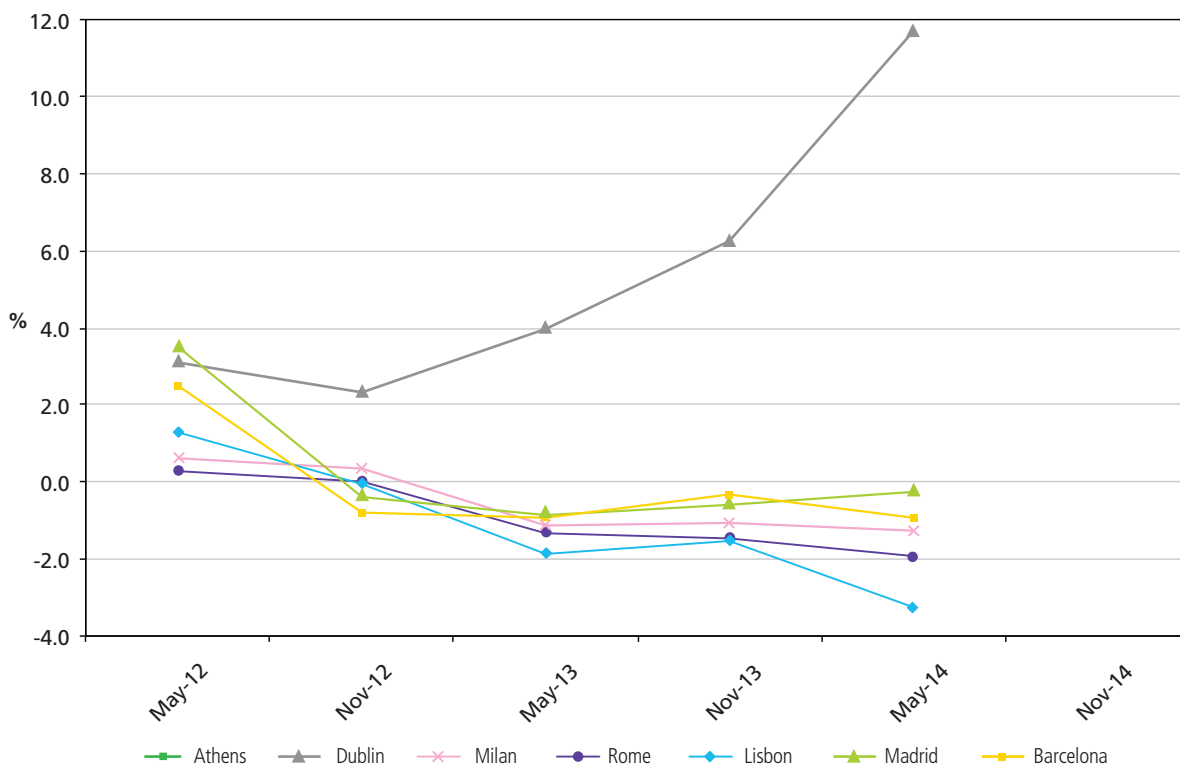
In terms of the spread of average growth rates across all centres, the range has increased yet again, to 18.7% from 16.2% in November. The extremes extend from -7.0% for Moscow to 11.7% for Dublin. In the former case, the disparity between individual forecasters is a substantial 26.1%.

Forecast projections for other individual markets also show wide variations in the short-term, albeit fewer (six) sets of forecasts for 2014 extend beyond 10% than in the last survey (nine). The sizeable disparity displayed by forecasts for Paris La Défense in November (18.0%) has reduced to 6.8%, although the ongoing weakness of the French economy continues to suppress growth in both central Paris markets.

Inside the eurozone

Figure 1 shows current projections for those locations in economies that have been under greatest strain during the eurozone crisis. These appear generally to maintain previous forecasts, although Lisbon has declined further since November (to -3.2% from -1.5%). Dublin's stellar trajectory has been sustained and expectations are approaching a 12.0% uplift in rents in the current year. Once again, there were insufficient forecasts for Athens offices to permit any analysis of this market.

Figure 1: Weighted Rental Growth Forecasts 2014 – Peripheral (PIIGS) Economies



2014 forecasts softening but a better year in prospect than 2013

The dynamics affecting the Dublin office market remain broadly unchanged to that described in November – commentators report a continued tightening of supply as strong tenant market has driven down vacancy rates without a construction pipeline sufficiently advanced to meet occupational demand, although some speculative development has commenced¹.

In eastern Europe, the outlook for the Warsaw, Prague and Budapest markets is improving; although none is expected to return to positive growth in the current year, rents are bottoming out (from -2.7% for Warsaw and -1.3% for Prague to -0.6% for Budapest). In the Polish capital, despite high take-up in 2013, net absorption has been low, with a significant development pipeline likely to maintain vacancy rates above 10%².

Turning to those centres within the eurozone predicted to deliver positive returns, following Dublin, the highest expectations lie with Germany markets, ranging from 2.5% for Munich to 1.1% for Hamburg, where economic factors are beginning to have a positive impact on real estate markets. Lyon, Helsinki, Amsterdam, Vienna, Brussels and Luxembourg make up the remaining locations, with only Lyon and Helsinki expected to exceed 1.0% growth.

Outside the eurozone

Outside the eurozone, prospects for growth have continued to weaken in most locations, with Moscow, as previously mentioned, expected to show a dramatic decline (see Figure 2). The two central London markets continue to move ahead, with both expected to deliver increased growth of up to 7.3% in the City and 7.7% in the West End. By comparison, in Stockholm (the only other location where projections are rising) rents may achieve up to 2.2% average growth, whereas Oslo and Manchester, which have both suffered a weakening in their prospects over the last six months, are still predicted to grow by 2.6% and 2.3% respectively.

Moscow's considerable decline in prospects may be explained by a number of factors: in the final quarter of last year, the Moscow market experienced strong take up but a similar level of development completions, resulting in a headline vacancy rate exceeding 18% by the end of 2013³. Combined with a sharp fall in the rouble, this situation has led to considerable downward pressure on office rentals.

The remaining location expected to deliver negative growth in 2014 is Zurich, at -1.6%, although, again, the consensus is that this market is beginning to recover (from -2.2% in 2013). However, vacancy rates are increasing, with an additional 420,000 sq. m of new supply being delivered over the next three years, of which only around 40% is pre-let. Combined with insufficient employment growth to absorb this space, prime rents will remain under pressure, leaving Zurich's office market "occupier-favourable" in the near-to medium-term⁴.

¹ Jones Lang LaSalle Dublin Office Market Profile - Q4 2013

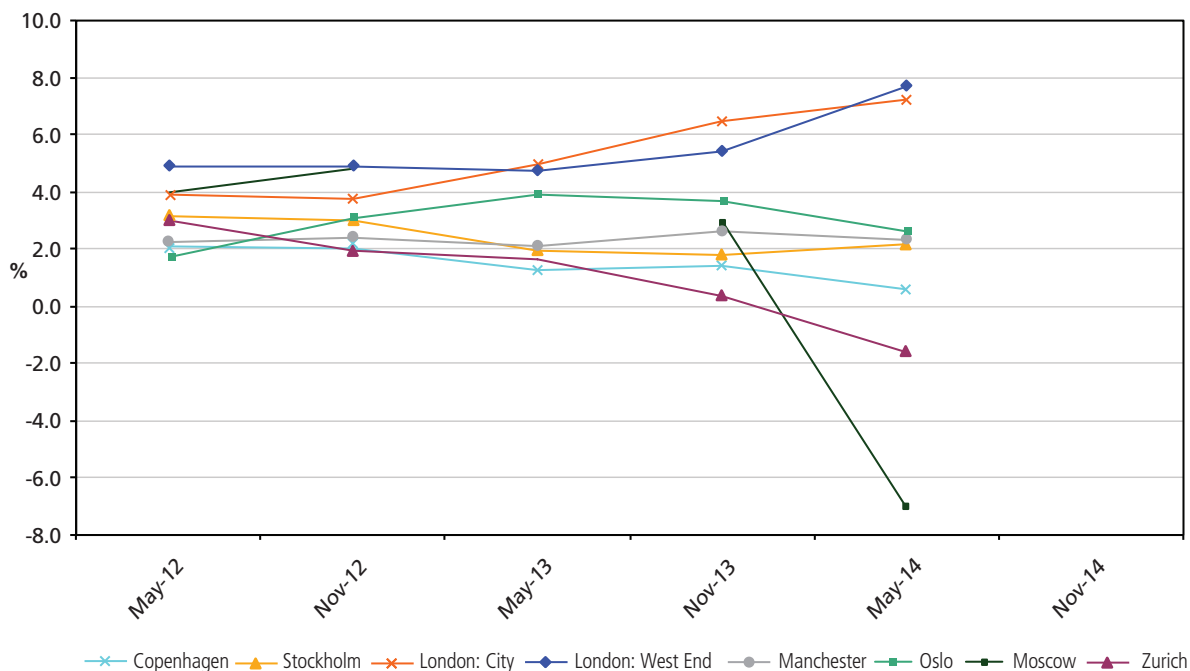
² Savills Warsaw office market February 2014

³ Jones Lang LaSalle Moscow Office Market Profile - Q4 2013

⁴ Jones Lang LaSalle Zurich Office Market Profile - Q4 2013

2014 forecasts softening but a better year in prospect than 2013

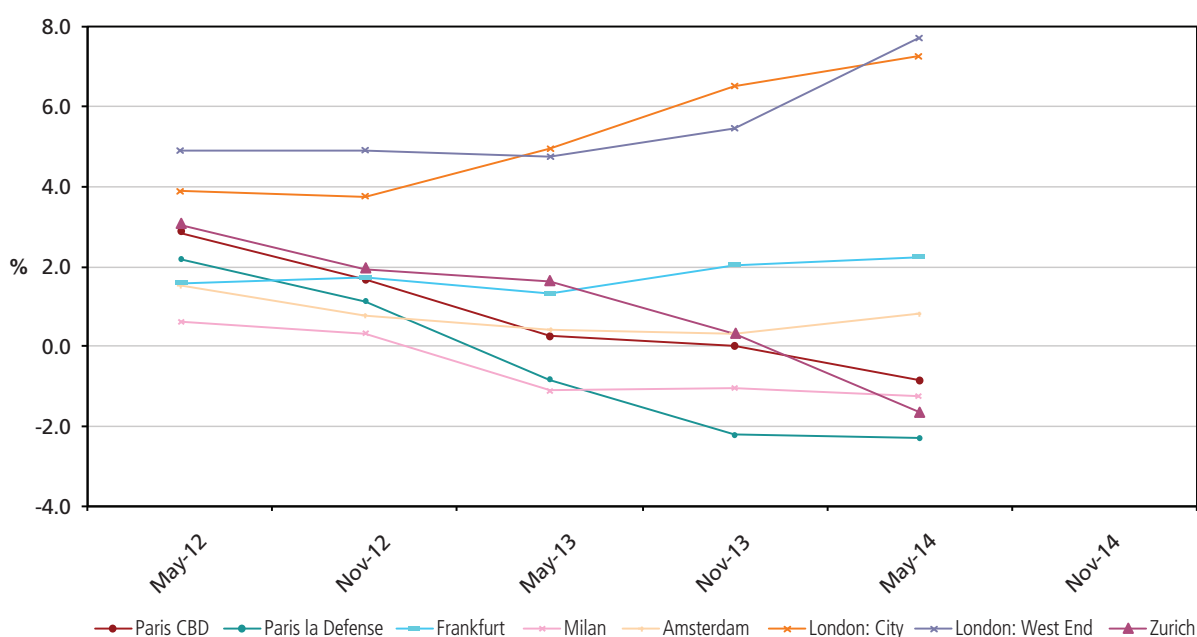
Figure 2: Weighted Average Rental Growth Forecasts 2014 – Non-eurozone Centres



Financial centres

Within the major financial centres, in a broad continuation of 2013, London and Frankfurt are the only markets expected to achieve growth in excess of 1.0%, the latter being projected at 2.2%, albeit lower than the forecast for 2013, of 3.7%. Figure 3 clearly illustrates the difference in expectations between locations, with a clear split visible between eurozone and non-eurozone centres, the exception being Zurich, as previously described.

Figure 3: Weighted Average Rental Growth Forecasts 2014 – Financial Centres

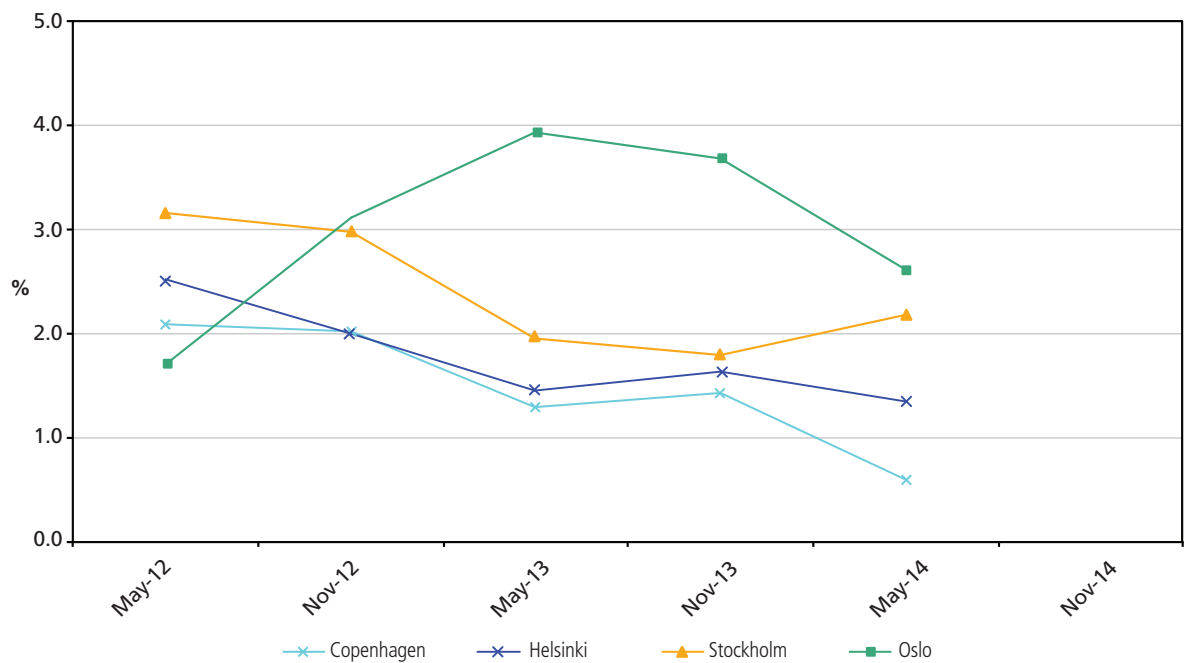


Market expectations weaken for 2014

Nordics

Within the Nordic region, three of the four markets have weakened since the November survey, although growth rates remain positive for all. The previously relatively strong performance of the Oslo market is expected to moderate further, despite reportedly strong letting activity in the final quarter of 2013 leaving the overall vacancy rate well below 10%.

Figure 4: Weighted Average Rental Growth Forecasts 2014 – Scandinavian Centres



Favourable outlook generally for 2015 and 2016

The rolling average growth rates point to a recovery to positive growth in most markets in the shorter term, although four of the three-year average forecasts remain negative, with Paris and Moscow greater than -1.0% per annum. However, since the last report in November 2013, 10 forecasts have improved by more than 1.0% in this six month period, including both sets of Italian and Spanish office locations, which have risen by more than 2.0% on average (Madrid reverting to positive growth via a 3.1% rise, the greatest improvement in any market). This is a significant reversal of previous consensus views on the weakest centres, which had been dominated by southern peripheral eurozone locations. Of these, only Lisbon is expected to deliver negative growth over three years (-0.5% per annum on average).

In absolute terms, of the 25 markets averaging positive growth, only four (Zurich, Prague, Warsaw and Milan) may produced minimal (sub-1.0%) average growth, with a further 11 expected to grow between 1.0% and 2.0% annually over the three years. This leaves 10 locations where annual rates of between 2.3% (Frankfurt) and 8.2% (Dublin) are predicted. See table at Appendix 1 for individual market consensus forecasts and a comparison with November 2013 average forecasts.

Five-year average forecasts point to continued recovery in most markets

Looking out as far as 2018, the five-year average forecasts are positive for all 29 centres covered by the survey. Average growth rates in eight markets have strengthened by more than 1.0% since November, led by Rome at 3.8%, reversing a five-year average forecast in decline, from -3.2% to 0.6% per annum. Of the 13 locations where average forecasts exceed 2.0% per annum, Madrid (4.5%) and Barcelona (2.9%) are also present in this group, attracting increased confidence through an anticipated turn round in their economic prospects. Unsurprisingly, given strong growth expectations in individually forecast years, Dublin and central London occupy the remaining three of the four leading positions (at 5.8%, 4.6% and 4.0% per annum respectively), followed by Barcelona.

Conclusions

Only the two London and Dublin markets consistently offer the best prospects of growth over each yearly period of the survey but there is a growing confidence in the recovery of several other locations in the medium term, particularly within the major southern European economies of Spain and Italy. Growth in the nearer term will prove challenging, however, for so long as individual economies struggle to expand and such recovery remains very fragile as the mixed Q1 GDP figures show.

The majority of markets seem to be grouping within a narrower range of predicted growth rates, as illustrated in the three- and five-year rolling averages charts in Appendix 2. Whilst expectations for growth are improving, the medium-term outlook still appears relatively weak for a number of centres. By way of comparison, the first IPF European Consensus Forecast, dated November 2006, reported nearly three-quarters (17) of its 24 three-year average forecasts to be in excess of 2.0% (as against 10 of 29 locations in the current survey). Eight of the 14 five-year average growth rates forecast in 2006 were predicted to achieve 4.0% or more, compared with four out of 29 in 2014.

Appendix 1

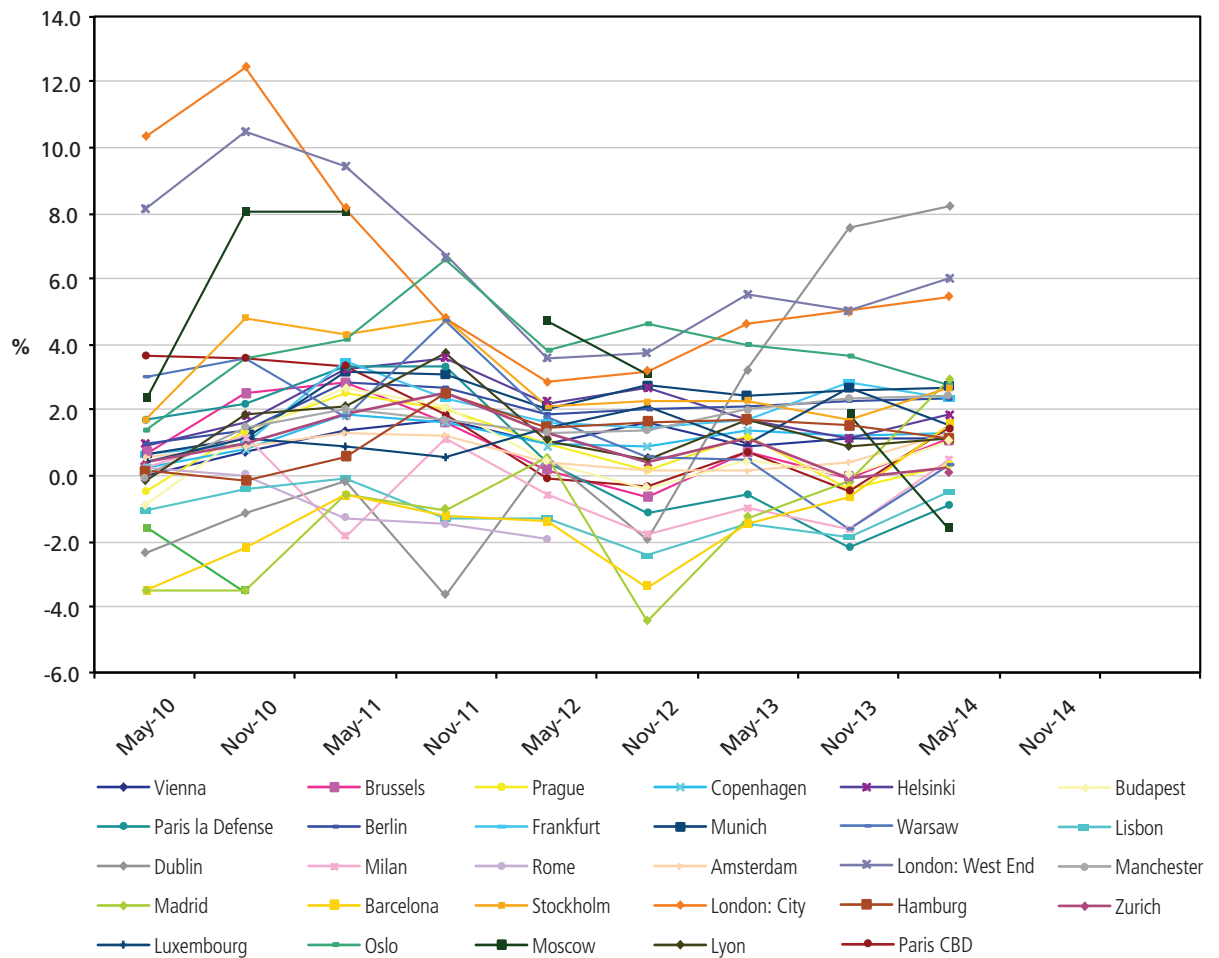
Table 1: Mean weighted rental value growth forecasts - May 2014

	Year weighted average rental growth forecast						Rolling 3-year average		Rolling 5-year average	
	2014		2015		2016					
Vienna	0.7	(1.3)	1.4	(1.5)	1.3	(na)	1.1	(1.2)	1.3	(1.2)
Brussels	0.6	(0.9)	1.2	(1.0)	1.6	(na)	1.1	(-0.1)	1.6	(1.0)
Prague	-1.3	(-0.3)	0.8	(1.1)	1.5	(na)	0.3	(-0.4)	1.1	(0.7)
Copenhagen	0.6	(1.4)	1.4	(2.2)	1.9	(na)	1.3	(1.2)	1.8	(1.8)
Helsinki	1.3	(1.6)	1.6	(2.2)	2.6	(na)	1.8	(1.1)	2.1	(2.0)
Lyon	1.6	(1.2)	0.4	(1.8)	1.4	(na)	1.1	(0.9)	1.4	(1.5)
Paris CBD	-0.8	(0.0)	1.6	(1.9)	3.7	(na)	1.5	(-0.5)	2.3	(1.2)
Paris la Défense	-5.5	(-2.2)	-1.2	(0.2)	0.8	(na)	-2.0	(-2.2)	0.1	(0.1)
Berlin	1.5	(2.6)	2.6	(3.0)	3.1	(na)	2.4	(2.2)	2.3	(2.1)
Frankfurt	2.2	(2.0)	2.3	(2.7)	2.5	(na)	2.3	(2.8)	2.2	(2.3)
Hamburg	1.1	(1.9)	1.0	(2.0)	1.3	(na)	1.1	(1.6)	1.2	(1.2)
Munich	2.5	(2.9)	2.9	(2.8)	2.8	(na)	2.7	(2.6)	2.4	(2.2)
Athens	na	(na)	na	(na)	na	(na)	na	(na)	na	(na)
Budapest	-0.6	(0.6)	2.1	(1.8)	1.8	(na)	1.1	(0.0)	1.6	(0.8)
Dublin	11.7	(6.3)	8.5	(6.5)	4.5	(na)	8.2	(7.5)	5.8	(5.5)
Milan	-1.3	(-1.0)	0.6	(1.7)	2.3	(na)	0.5	(-1.7)	1.7	(0.6)
Rome	-1.9	(-1.4)	-0.3	(0.1)	0.7	(na)	-0.5	(-2.6)	0.6	(-3.2)
Luxembourg	0.5	(1.9)	2.4	(1.2)	1.8	(na)	1.6	(2.7)	1.6	(1.9)
Amsterdam	0.8	(0.3)	1.4	(1.4)	1.7	(na)	1.3	(0.4)	1.8	(1.2)
Oslo	2.6	(3.7)	2.9	(3.2)	2.8	(na)	2.8	(3.6)	2.4	(2.4)
Warsaw	-2.7	(-1.9)	1.1	(1.1)	2.6	(na)	0.3	(-1.7)	1.5	(0.4)
Lisbon	-3.2	(-1.5)	-0.2	(0.2)	2.0	(na)	-0.5	(-1.9)	1.3	(0.1)
Moscow	-7.0	(3.0)	0.4	(2.9)	1.9	(na)	-1.6	(1.9)	0.1	(2.9)
Madrid	-0.3	(-0.6)	4.0	(2.9)	5.1	(na)	2.9	(-0.2)	4.5	(2.4)
Barcelona	-1.0	(-0.3)	2.3	(1.6)	3.3	(na)	1.5	(-0.7)	2.9	(1.4)
Stockholm	2.2	(1.8)	3.4	(2.7)	2.4	(na)	2.7	(1.7)	2.3	(2.0)
Zurich	-1.6	(0.3)	0.7	(1.5)	1.7	(na)	0.2	(-0.1)	0.8	(1.0)
London: City	7.3	(6.5)	6.3	(5.7)	2.9	(na)	5.5	(5.1)	4.0	(3.1)
London: West End	7.7	(5.4)	6.5	(5.2)	4.0	(na)	6.0	(5.0)	4.6	(3.5)
Manchester	2.3	(2.6)	2.6	(3.0)	2.3	(na)	2.4	(2.4)	2.4	(1.9)

Previous survey figures in brackets

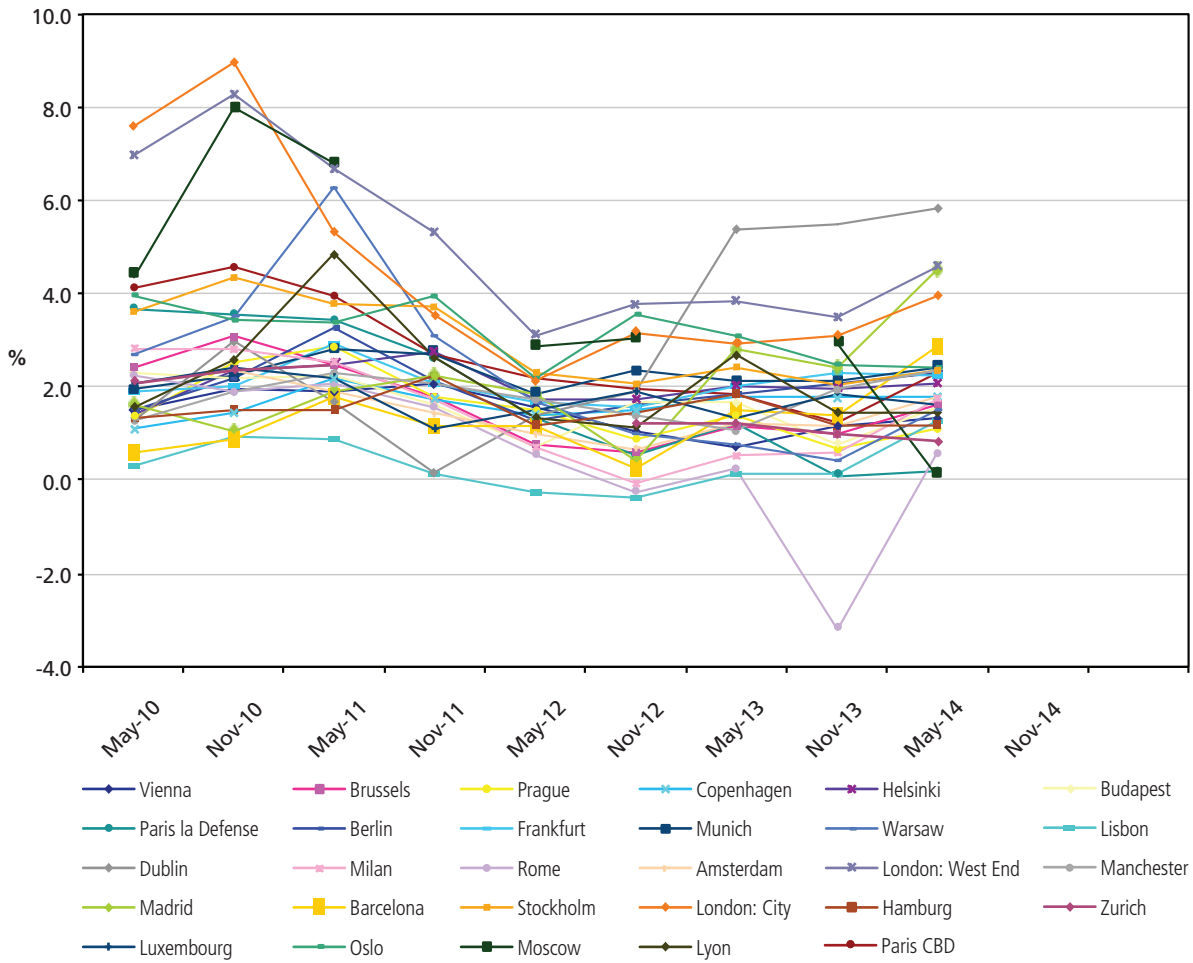
Appendix 2

Figure 5: Rolling three-year % weighted rental growth forecasts



Appendix 2

Figure 6: Rolling five-year % weighted rental growth forecasts



Acknowledgements

Forecast Contributors

IPF thanks all participants in the survey for contributing rental data to the May 2014 European Consensus Forecasts, including the following organisations:

Aberdeen Asset Management, Aviva Investors, AXA Real Estate, CBRE, CBRE Global Investors, CoStar Portfolio Strategy, Cushman & Wakefield, Danish Property Federation, DTZ, Grosvenor, Invesco, JLL, LaSalle Investment Management, Paul Mitchell Real Estate Consultancy Limited, Standard Life Investments and TIAA Henderson Real Estate.

Notes

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

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 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.

Contributors receive a more detailed set of statistical outputs than those shown in the table above – for each office centre the sample size, median and range of rental values are also provided.

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