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Q4 2015: Global Cities Commercial Monitor

Investment surge in Europe

- Investment conditions strongest in Madrid, Amsterdam and a number of German cities
- Twelve month rental and capital value projections remain strongest in Dublin
- Markets approaching peak of the cycle in Munich, Toronto and Auckland

The Q4 2015 RICS Global Cities Commercial Property Monitor shows sentiment improving markedly across several cities within the euro area, producing an increasingly upbeat outlook for sector performance over 2016. Meanwhile, feedback remains more cautious for a number of cities in emerging markets, where concerns over the health of the Chinese economy, currency weakness and sharp falls in commodity and oil prices are all weighing on commercial real estate confidence.

According to the RICS Investment Sentiment Index (ISI) – a composite indicator capturing overall changes in investment market conditions – Madrid, Amsterdam and Berlin posted the sharpest improvement in investment market dynamics (relative to all other cities covered) during Q4. In fact, three of the top five ISI readings were returned in German cities, with Munich and Frankfurt also seeing a notable improvement in investment activity. In each of these markets, demand from both domestic and foreign buyers rose considerably against a backdrop of falling or stable supply.

Meanwhile, the RICS Occupier Sentiment Index (OSI) suggests Dublin, Madrid and Budapest experienced the most significant upturn in occupier market conditions over the quarter. Indeed, demand for leasable space increased rapidly across all sectors, driven by strong job creation and healthy GDP growth. In total, 19 of the 32 cities covered in this report display positive values for both OSI and ISI gauges, confirming somewhat divergent trends across the globe.

Moscow, Dubai and Hong Kong all posted firmly negative readings for both ISI and OSI measures while occupier sentiment was especially weak in Singapore, Zurich and Jakarta. In the case of Moscow and Dubai, the collapse in oil prices have slashed revenue and is reflected in a relatively bleak assessment of the real estate sector's near term prospects.

Meanwhile, different parts of India are seeing varied conditions, with near term sentiment fairly neutral in the National Capital Region (NCR) and only marginally better in Mumbai. Bangalore, on the other hand, is reportedly seeing demand growth outstrip that of supply on both the investment and occupier sides of the market.

Nevertheless, the twelve month outlook is positive across each market with capital values and rents projected to rise, although expectations are particularly strong in Bangalore.

On a global comparison, respondents are most confident of seeing rental growth in Dublin, London and Madrid during the next twelve months. In each case, demand from tenants continues to rise firmly while available space falls. Rental projections are especially buoyant in Budapest, Bangalore and New York, with a net balance of +60% or more respondents expecting rents to rise (rather than fall) over the coming year. Overall, 22 of the 32 cities covered by the RICS monitor display positive twelve month rental twelve projections. Cities in which respondents anticipate rents to decline most notably over 2016 include Singapore, Zurich, Moscow, Warsaw and Paris, with an excess of supply over demand a feature of each market.

With respect to all-sector twelve month capital value expectations, the most elevated projections were in Dublin, Auckland and Frankfurt, driven by surging investment demand. Berlin, London, Bangalore and Madrid all registered a net balance of close to +70% more respondents anticipating prices to increase. In total, only 6 of the 32 cities exhibit negative capital value expectations at the headline level, which would include Dubai, Singapore, Zurich, Moscow and Toronto.

Finally, half of all cities included in the monitor had a majority of respondents perceiving their local market as being overpriced in Q4, unchanged from Q3. However, whereas less than one in six cities had 70% taking this view last time, the proportion has jumped to one in four in the latest results. Although the number of markets deemed overpriced held steady, those markets already considered to be above fair value are seeing prices become increasingly stretched relative to fundamentals.

Figure 1 All Sector: Occupier Sentiment Index and Investment Sentiment Index – compared to previous quarter (net balance %)

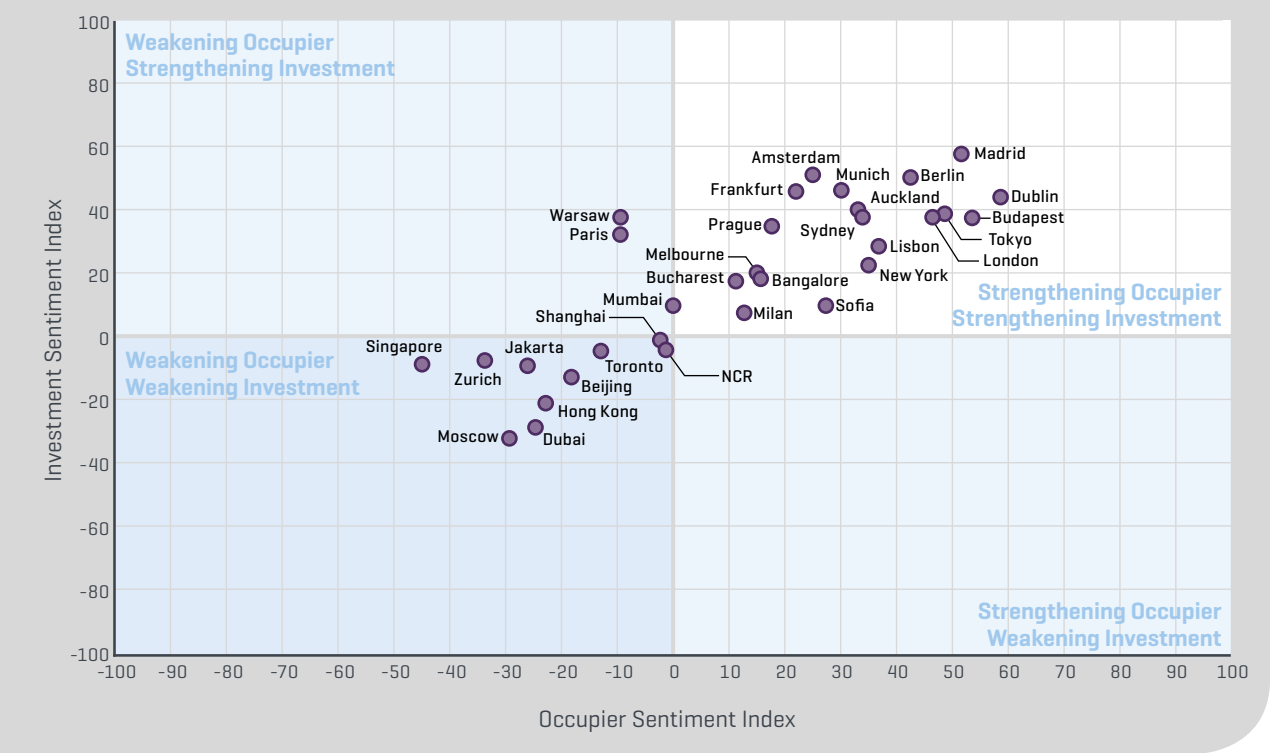


Figure 2 All sector: Twelve Month Rent and Capital Value Expectations (net balance %)

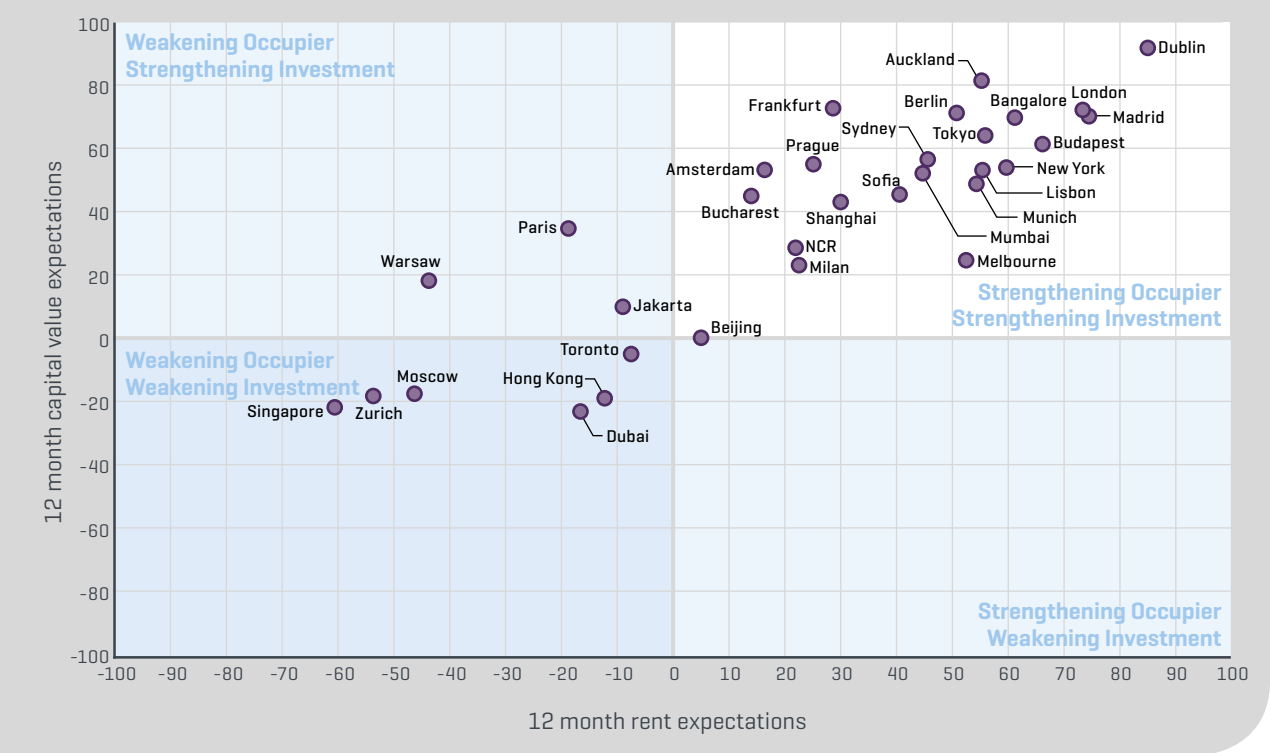
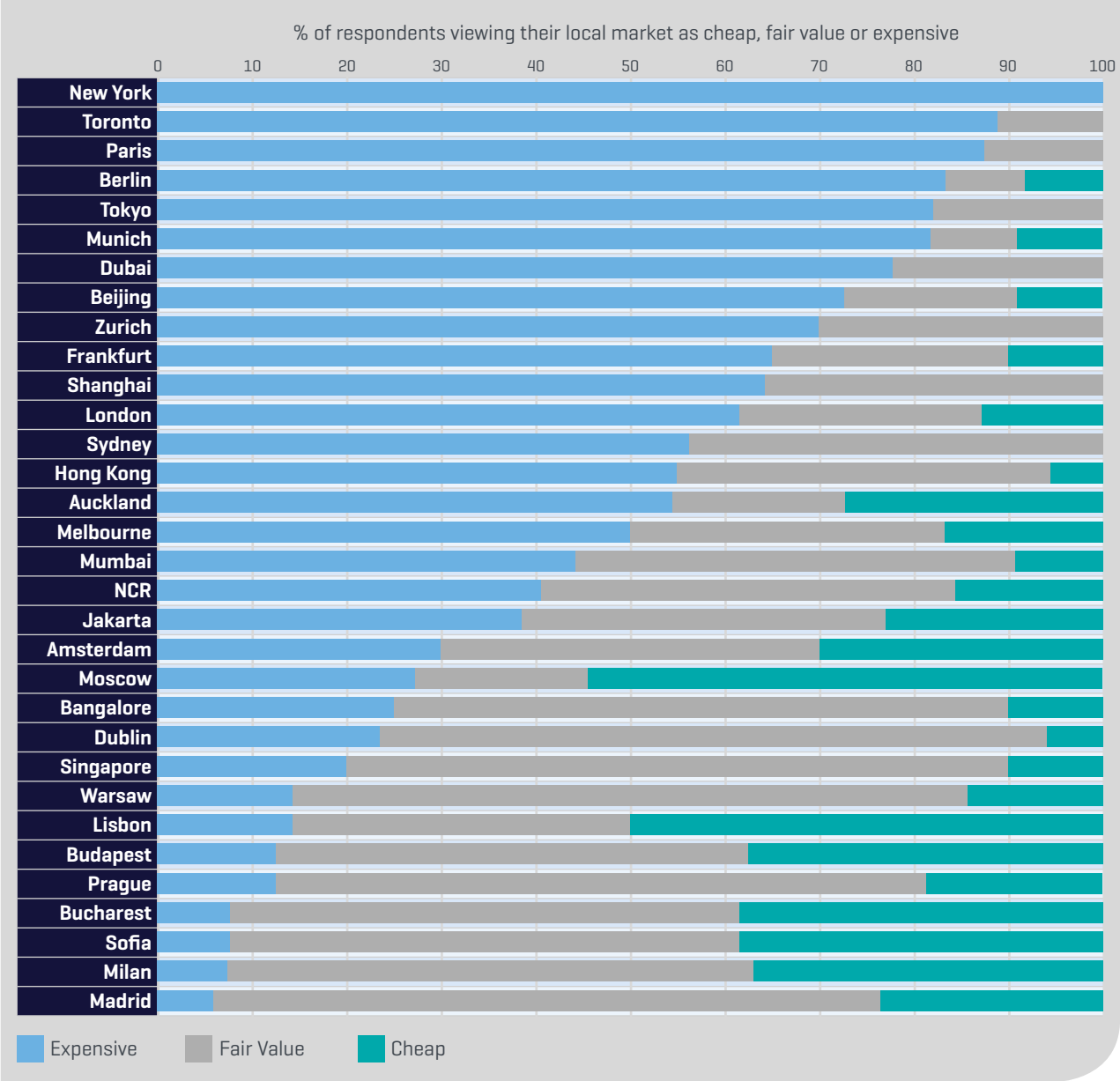
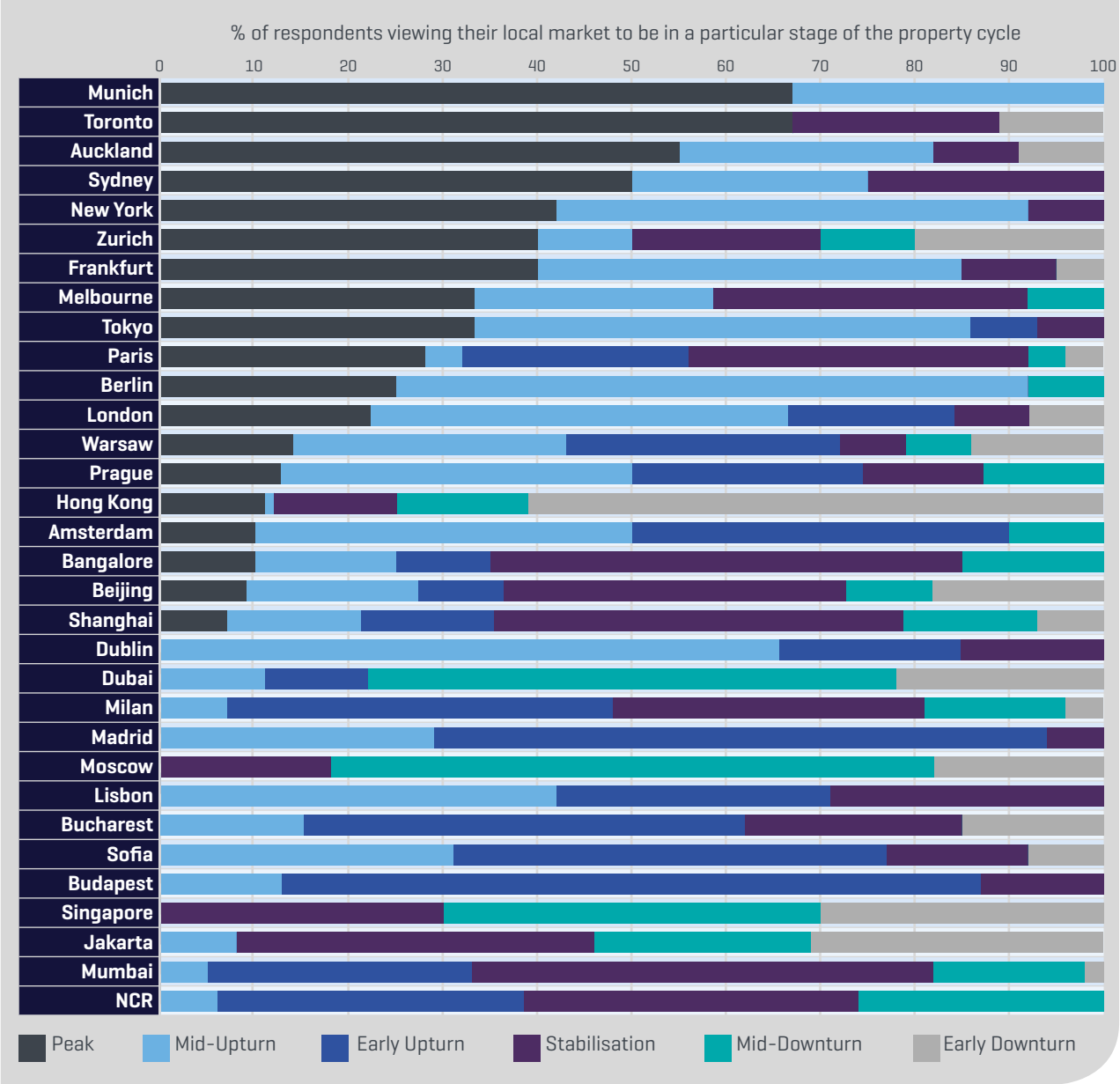


Figure 3 **Valuation Perceptions**



- New York appears to be the most overpriced market on a global comparison, with 100% of respondents sensing commercial property prices to be above fair value during Q4. The vast majority of contributors in Toronto (89%), Paris (88%), Berlin (83%), Tokyo (82%), and Munich (82%) also perceive commercial real estate to be above fair value. With capital values expected to continue rising in each market over the next twelve months (with the exception of Toronto), this poses the risk of prices moving further out of line with fundamentals. This is concerning as overpriced markets may be particularly vulnerable if sentiment were to shift.
- By way of contrast, Moscow (55%), Lisbon (50%), Bucharest (38%), Sofia (38%), and Budapest (38%) have the highest proportion of contributors who believe commercial real estate is underpriced to some degree. In Moscow, sharp declines in value have left the market looking attractively priced in the eyes of respondents, although further falls are still expected suggesting the market is not yet undervalued enough to spark a recovery given the uncertain macro climate. In contrast, the Lisbon market has started to see a strong recovery, with the RICS investment enquiries gauge capturing a sharp upswing in buyer demand from 2013 onwards. Going forward, the improving economic backdrop suggests large scope for growth in the sector. Indeed, contributors forecast the upturn in capital values to retain significant momentum over the next three years, with both prime and secondary assets anticipated to post capital value gains.

Figure 4 **Property Cycle**



- Compared with all other cities covered, Munich (67%), Toronto (67%), Auckland (55%), and Sydney (50%) returned the highest proportion of respondents perceiving that market conditions were close to peaking. In each case, this proportion has increased relative to Q3, when only Toronto had more than 50% of respondents taking this view.
- Although all respondents felt the New York market was overpriced, the largest share (50%) still feel the commercial real estate sector is in the middle stage of an upturn as opposed to 42% who feel it is peaking.
- In contrast, Budapest (75%), Madrid (65%), Bucharest (46%), Sofia (46%), Milan (41%) and Amsterdam (40%) all show the largest share of contributors sensing their market is in the early stages of an upturn.
- Hong Kong is the only area in which the greatest share of respondents (61%) feel the market is at the start of a downturn.
- The highest proportion of contributors in Moscow (64%), Dubai (56%) and Singapore (40%) feel their market is in the middle stages of a slump.

Information

Global Commercial Property Monitor

RICS' Global Cities Commercial Property Monitor is a quarterly guide to the trends in the commercial property investment and occupier markets.

The Global Cities Commercial Property Monitor is available from the RICS website **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 1 December 2015 with responses received until 7 January 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 1288 company responses were received, with 291 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

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Disclaimer

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