RESEARCH

EUROPEAN QUARTERLY

COMMERCIAL PROPERTY OUTLOOK

Q4 2014

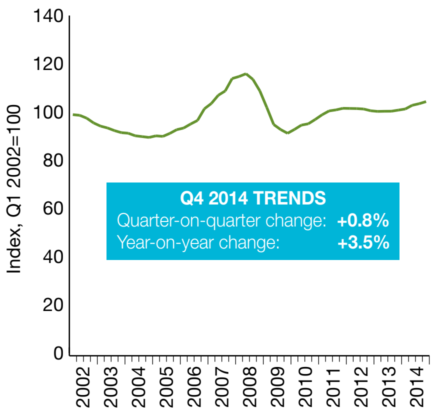
OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET INDICATORS

EUROPEAN OUTLOOK

The buoyant European investment market remained disconnected from wider economic uncertainties in Q4 2014.

FIGURE 1

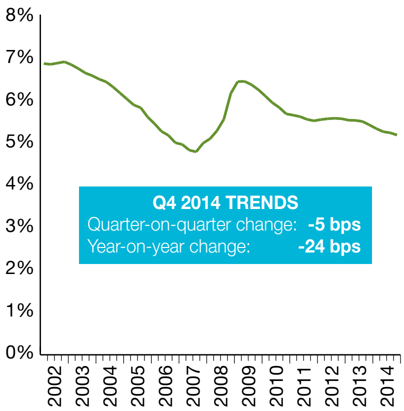
European prime office rental index



Source: Knight Frank Research

FIGURE 2

European weighted average prime office yield



Source: Knight Frank Research

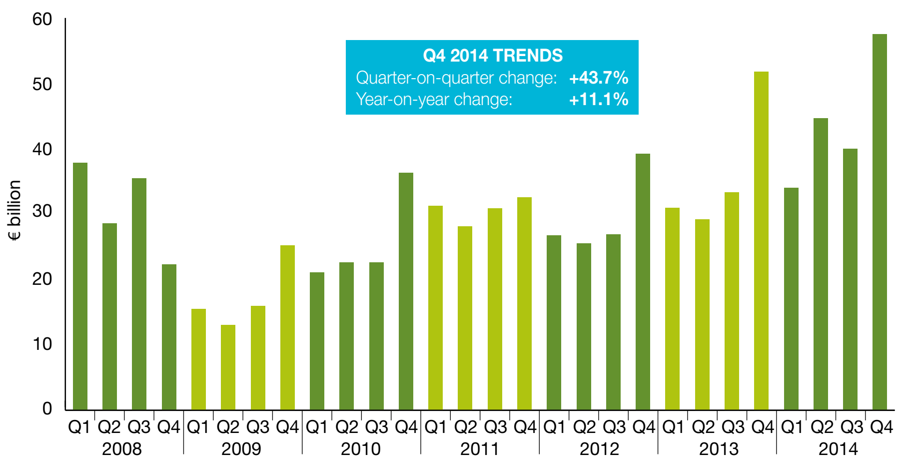
A total of €57.9 billion was invested in European commercial property in Q4 2014, making this the strongest quarter since Q2 2007. Investment volumes for the whole year came to €177.6 billion, 21% up on 2013.

Investment activity in Q4 was boosted by several large transactions in core markets, including the Qatar Investment Authority's acquisition of 8 Canada Square in London for c.€1.5 billion, and Deutsche AWM and ECE's purchase of the PalaisQuartier in Frankfurt for €800 billion. However, investors' increased risk appetite remained a major theme of the market, and a wide range of non-core locations and sectors continued to attract heightened interest in Q4.

The Spanish retail sector has been heavily targeted by investors in recent months, with several large shopping centres being transacted. Investment volumes in Ireland, the Netherlands and the UK regions increased strongly throughout 2014, while the Portuguese investment market finally revived in Q4, having been one of the last of the peripheral markets to show signs of recovery.

FIGURE 3

European commercial property investment volumes



Source: Knight Frank Research / Real Capital Analytics

The strength of recent investment activity has come in spite of the slow progress of Europe's economic recovery, with Eurozone GDP growing by 0.3% in Q4 2014, and by 0.9% for the whole year. Growth is expected to accelerate in 2015, although a range of threats and uncertainties linger over the European economic outlook. These include the risk of deflation, the collapse in oil prices, the renewed possibility of Greece leaving the Eurozone and the strong likelihood of a recession in Russia.

Nonetheless, the property investment market has been boosted by the European Central Bank's announcement in January 2015 of a €1.1 trillion programme of quantitative easing (QE), which promises to stimulate economic growth and keep borrowing costs down. The announcement led to falls in already-low government bond yields, and further widened the spreads between property and bond yields. The QE programme should help to preserve the attractiveness of property as an asset class in 2015 and beyond, and boost investment activity.

The fortunes of European occupier markets varied in 2014, with annual take-up rising in markets such as London, Paris and Berlin, but falling in Frankfurt, Vienna and Moscow. A combination of political and economic uncertainties, weak demand, high completion levels and rising vacancy rates have coalesced to create particularly challenging office market conditions in the Russian capital.

There was limited prime office rental growth across Europe in Q4, with the only major markets to record prime rent increases being London, Dublin and Lisbon. As a result, the Knight Frank European Prime Office Rental Index rose by just 0.8% over the quarter. Prime rental growth is likely to remain modest in 2015, although further increases are anticipated in established growth markets such as London and Dublin. More widespread rental increases will depend on the Eurozone economic recovery becoming more entrenched and supporting improved occupier demand.

MARKET HIGHLIGHTS

AMSTERDAM (1)
Work began in Q4 on the conversion of The Dam office building in Sloterdijk into a hotel. This was formerly Amsterdam's largest office building with c.42,000 sq m of space and its conversion continues the trend of vacant offices in Amsterdam being repurposed for other uses.

BRUSSELS (2)
Investment volumes in Q4 were boosted by the sale of the Covent Garden office complex for c.€270 million, to a joint venture between Hannover Leasing and Gingko Tree Investment.

DUBLIN (3)
Dublin office rents continue to be pushed upwards by strong demand and a lack of new supply. Prime rents ended 2014 at €47.50 per sq ft (€511 per sq m) per annum, 48% higher than a year earlier.

FRANKFURT (4)
The Frankfurt investment market ended the year very strongly, as the €800 million sale of the mixed-use PalaisQuartier took 2014 commercial investment volumes to more than €5.6 billion; the highest total amongst the major German cities.

LONDON (5)
Prime office rents increased in both the West End and City submarkets during Q4. With vacancy rates at their lowest levels since 2007, further rental growth is forecast in 2015, which would take prime rents above their pre-credit crunch highs.

MADRID (6)
Around €3.2 billion was invested in commercial property in Madrid during 2014, and there has been a strong start to 2015, with Pontegadea, the investment vehicle of billionaire Amancio Ortega, acquiring Gran Vía 32 in Madrid for c.€400 million.

MILAN (7)
Occupier activity was dominated by lease renegotiations in Q4, but demand for prime space is steadily increasing. There is a limited availability of prime offices and a restricted development pipeline, which may result in upward pressure on rents in 2015.

MOSCOW (8)
In 2014, Moscow office completions reached their highest level since 2008. With occupier demand softening, the office vacancy rate rose to 18.3%.

PARIS (9)
Île de France office take-up reached 2.1 million sq m in 2014, about 15% up on 2013 but still below the ten-year average. There was a notable rebound in La Défense, where take-up of 245,500 sq m was well over double that of the previous year.

WARSAW (10)
In one of the largest deals of the year in Poland, the mixed-use Plac Unii asset in Warsaw was acquired for €226 million by Invesco Real Estate, acting on behalf of two German pension funds.

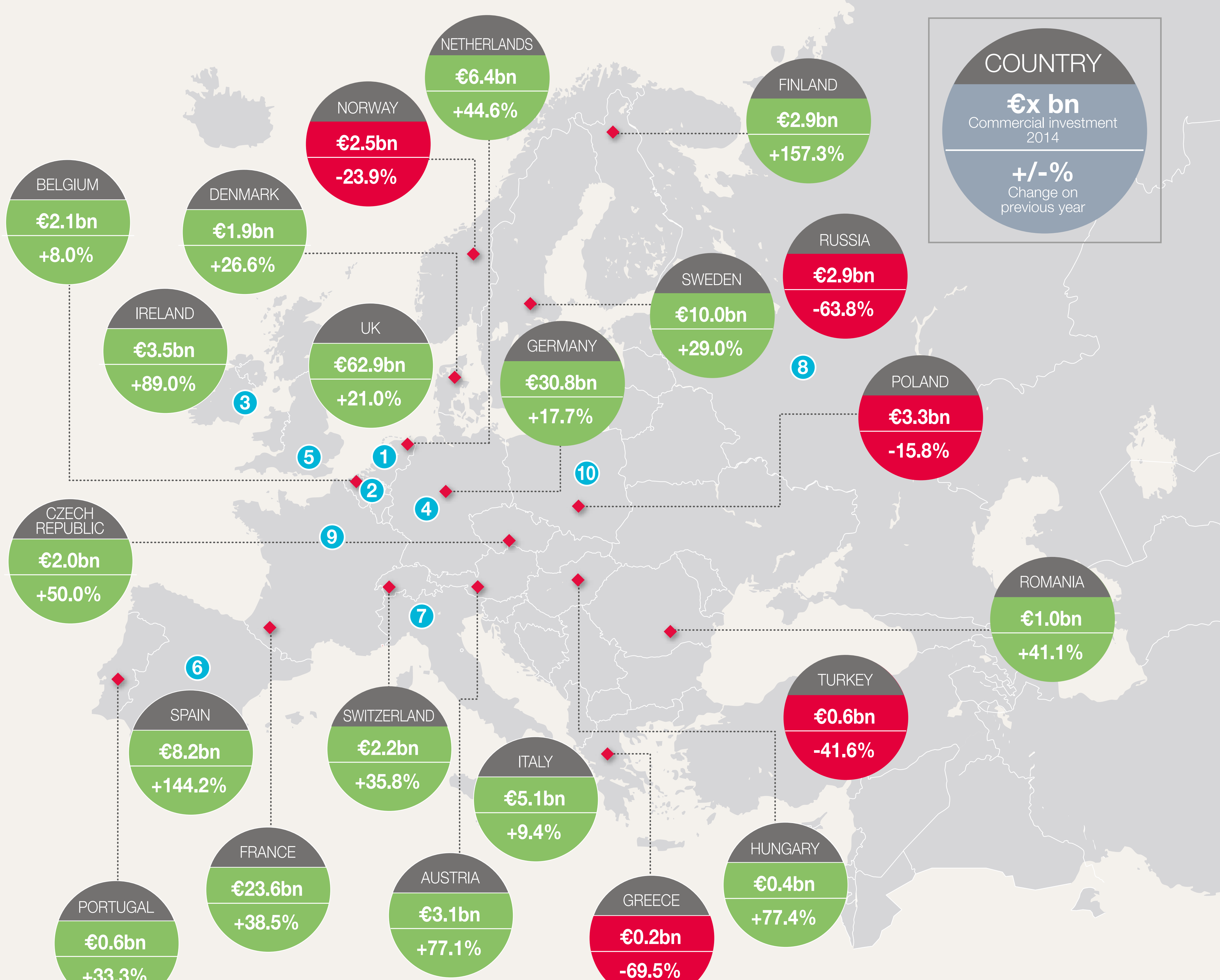
FIGURE 4 **How much prime office space does €100 million buy? (sq m)**

LONDON (WEST END)	2,532
LONDON (CITY)	4,936
ZURICH	5,132
PARIS	5,333
STOCKHOLM	8,781
OSLO	8,945
DUBLIN	9,785
FRANKFURT	10,307
MUNICH	10,628
MILAN	11,053
MOSCOW	12,987
HELSINKI	13,441
MADRID	14,881
VIENNA	15,833
BERLIN	16,844
AMSTERDAM	16,912
BRUSSELS	20,000
COPENHAGEN	20,213
WARSAW	20,408
PRAGUE	26,316
LISBON	28,509
BUDAPEST	30,208
BUCHAREST	37,037

Source: Knight Frank Research

The above figures are derived from hypothetical prime capital values, based on current prime rents and yields in each of the cities listed.

FIGURE 5
European commercial property investment volumes, 2014



Source: Knight Frank Research / Real Capital Analytics
Investment volumes comprise office, retail, industrial and hotel transactions

EUROPEAN MARKET INDICATORS

In Q4, the largest increases in prime office rents were in Dublin (+5.6%) and London City (+4.2%).

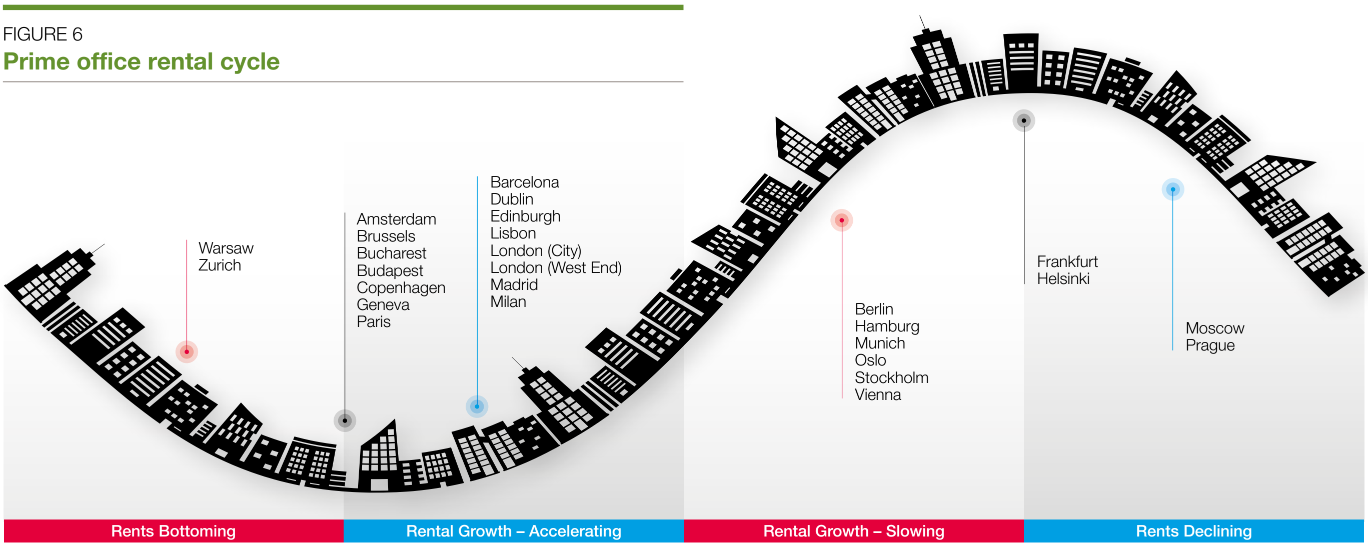
Commercial property prime rents and yields

City	Offices Prime rents (€/sq m/yr)	Offices Prime yields (%)	Logistics Prime rents (€/sq m/yr)	Logistics Prime yields (%)	Shopping centres Prime rents (€/sq m/yr)	Shopping centres Prime yields (%)	Retail warehousing Prime rents (€/sq m/yr)	Retail warehousing Prime yields (%)
Amsterdam	340 ▶	5.75 ▼	85 ▶	6.75 ▼	1,000 ▶	5.50 ▶	135 ▶	6.75 ▶
Barcelona	204 ▲	5.25 ▼	57 ▶	7.75 ▼	552 ▶	5.50 ▼	120 ▶	6.75 ▼
Berlin	282 ▲	4.75 ▼	66 ▶	6.50 ▼	1,380 ▶	4.75 ▶	150 ▶	6.25 ▶
Brussels	300 ▶	6.00 ▶	45 ▶	7.00 ▶	1,800 ▶	5.35 ▶	170 ▶	6.00 ▶
Bucharest	216 ▶	8.00 ▼	45 ▲	9.50 ▼	504 ▶	8.00 ▼	96 ▶	10.00 ▶
Budapest	240 ▶	7.25 ▶	54 ▶	9.00 ▶	960 ▶	7.00 ▶	90 ▶	8.00 ▶
Copenhagen	235 ▶	4.75 ▼	67 ▶	7.00 ▶	698 ▶	5.75 ▶	158 ▶	6.75 ▶
Dublin	511 ▲	5.00 ▶	65 ▲	7.25 ▼	2,520* ▶	6.50 ▼	200 ▲	7.25 ▼
Edinburgh	386 ▶	5.75 ▶	83 ▶	6.50 ▼	2,761* ▲	5.50 ▶	345 ▶	6.25 ▶
Frankfurt	456 ▶	4.70 ▼	80 ▶	6.25 ▼	1,560 ▶	4.50 ▶	168 ▶	6.00 ▼
Geneva	623 ▶	3.75 ▲	208 ▶	6.00 ▶	1,100 ▶	4.50 ▶	166 ▶	5.50 ▶
Hamburg	300 ▶	4.50 ▼	68 ▶	6.25 ▼	1,620 ▶	4.75 ▶	150 ▶	6.25 ▶
Helsinki	372 ▶	5.00 ▶	120 ▶	7.00 ▶	1,200 ▶	5.25 ▶	145 ▶	6.50 ▶
Lisbon	228 ▲	6.50 ▼	45 ▶	7.75 ▼	1,020 ▶	6.75 ▼	102 ▶	8.75 ▼
London	1,481 (WE) ▲ 861 (C) ▲	3.75 (WE) ▶ 4.25 (C) ▼	190 ▲	4.75 ▼	6,143* ▶	4.25 ▶	649 ▶	4.25 ▶
Madrid	336 ▲	5.00 ▼	57 ▶	7.75 ▼	528 ▲	5.25 ▼	120 ▶	6.75 ▼
Milan	475 ▶	5.25 ▶	50 ▶	8.00 ▶	850 ▶	6.25 ▼	300 ▶	7.50 ▶
Moscow	770 ▼	10.00 ▲	95 ▼	12.00 ▲	3,452 ▼	11.25 ▲	N/A	N/A
Munich	414 ▶	4.40 ▼	82 ▶	6.25 ▼	1,860 ▶	4.50 ▶	172 ▶	6.25 ▼
Oslo	531 ▶	4.75 ▼	127 ▶	6.25 ▶	1,327 ▲	5.25 ▶	150 ▶	6.25 ▶
Paris	750 ▶	4.00 ▼	55 ▶	7.00 ▶	2,000 ▲	4.50 ▶	180 ▶	5.25 ▼
Prague	228 ▶	6.00 ▶	51 ▶	7.50 ▶	840 ▶	5.75 ▶	120 ▶	7.75 ▶
Stockholm	484 ▶	4.25 ▼	111 ▶	6.25 ▼	840 ▶	5.00 ▶	226 ▶	6.00 ▶
Vienna	300 ▶	4.75 ▶	72 ▶	7.25 ▶	1,320 ▶	5.25 ▶	168 ▶	6.00 ▶
Warsaw	294 ▶	6.00 ▼	66 ▶	7.50 ▶	1,200 ▶	6.00 ▶	132 ▶	7.50 ▶
Zurich	682 ▼	3.50 ▲	208 ▶	6.00 ▶	1,247 ▶	4.00 ▶	166 ▶	5.50 ▶

Indicative prime yields, as quoted locally, based upon a hypothetical Grade A unit. Office rents are for prime city area Grade A space, 2,000 sq m. Shopping Centre rents are based on prime covered shopping malls, quoted on best position, 100 sq m units. Retail Warehouse rents are for units of 1-5,000 sq m located in purpose built parks. Typical Retail Warehouse schemes vary between countries. Logistics rents are for prime industrial space of units over 5,000 sq m. The data above is provided for general reference purposes only. Local market conditions will vary. *Zoned/weighted figure. Arrows provide a broad indication of recent movements and the short-term outlook for prime rents and yields. London office data is quoted for the West End (WE) and City (C) submarkets.

FIGURE 6

Prime office rental cycle



The above diagram is intended to provide a comparative guide to the current positions of European prime office markets in their rental cycles. Markets will move through their cycles at different speeds and, sometimes, in different directions. The positions indicated in the diagram do not constitute formal forecasts of future rental trends.

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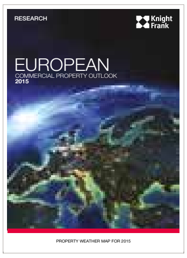

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