Q1 2020: Global Commercial Property Monitor

Pandemic grips the market

- Significant shift in both current sentiment and expectations indicators
- Weakness visible in both occupier and investment metrics
- Office turnaround most significant but retail sector still the weakest

The results of the Q1 2020 RICS Global Commercial Property Monitor (GCPM) tell a predictable tale reflecting the damage to both the global economy and the real estate sector from the spread of COVID-19 around the world. The scale of the impact on confidence is demonstrated most emphatically in charts 1 and 2 which track the Occupier (OSI) and Investor (ISI) Sentiment Indices at a country level.

They show a worsening picture in pretty much all markets and negative readings nearly everywhere. On average, the former (OSI) dropped by 28 points between the two quarters across the universe of countries covered by the survey with the latter (ISI) falling by 24 points. Even if the focus is narrowed to just the larger markets, the decline is of a similar magnitude amounting to 25 and 23 points respectively.

Shift in sentiment in offices most marked

Significantly, while the results at a sector level continue to show feedback around retail as being most depressed, the deterioration in sentiment between the two quarters has actually been most marked in offices. This is the case both for the OSI which fell by 35 points and the ISI which dropped 29 points. For industrials, the readings did slip into negative territory on both parts of the market but only moderately so.

Anecdotal comments from survey respondents bear out the sector patterns with a number highlighting the scope for agile working to become more commonplace in the aftermath of the virus lowering the demand for office space in particular. Predictably, the acceleration in the structural trend towards e-commerce is also noted with increasing interest in prime logistics space viewed as a likely outcome.

Expectations more negative than current readings

Interestingly, the negative shift in the forward looking survey metrics appears to be even more pronounced. Looking at the headline net balance readings for twelve months expectations, in the case of both capital and rental values, the turnaround is in excess of 50 points. Once again, it is offices where the deterioration is particularly marked but retail with the weakest projections. Although we only capture insight from a limited number of markets for the multifamily sector at this point, alongside logistics, this is an area where the feedback remains relatively resilient.

Predictably there is a noticeable divergence in expectations between prime and secondary properties. Taking the entire range of countries included in the survey, capital values in the secondary retail sector are seen declining around 8% over the coming year against roughly half that amount in prime space. Broadly similar gaps exist for both the office and industrial parts of the market.

Previously most upbeat markets see biggest knock

Turning to individual countries, the biggest turnaround in capital value projections (in net balance terms) between the two quarters were in Portugal (-90), Greece (-89) and Hungary (-88). In each case, expectations had been running particularly strongly towards the back end of last year which helps to explain the scale of the adjustment. By way of contrast, the Hong Kong real estate market which had been under some pressure from the political unrest over the past year saw only a 13 point deterioration in the readings for capital value projections (although the results are still pointing to a near double-digit decline over the next twelve months).

In terms of some of the other large investment markets, the US recorded a significant shift in prospects for capital values according to respondents (net balance moving by -72 points) as did Japan (-67), Singapore (-65), France (-58) and Germany (-56). More modest changes were visible in the Netherlands (-38), the UAE (-31), the UK (-30) and Switzerland (-27). The turnaround in India (-60) reflects in part the optimism that was still evident in Q4 with the headline net balance for Q1 actually relatively resilient at -4. For China, the equivalent figures are -39 and (the latest reading of) -33. It is worth bearing in mind that the divergent pattern partly reflect the spread of the virus around the globe and the way in which lockdowns have been applied.

International capital turns more defensive for now

In a separate question put specifically to members of AFIRE** (the association for real estate investors focused on commercial property in the United States), the US is seen as likely to benefit from the strongest growth in cross-border capital flows over the next twelve months. Feedback for both Asia and Europe in relative terms is less positive compared to Q4 with, in particular, the allure of the UK diminishing after the bounce associated with the decisive General Election back in December.

Meanwhile all survey participants were asked to assess how risky they viewed the current environment for real estate investment on a scale of 1 (no risk) to 6 (very high risk). In the previous iteration, the average reading was between 3 and 4 and it has since shifted, unsurprisingly, to between 4 and 5. Moreover, there has also been a modest increase in the number of respondents viewing the current environment as very high risk.

*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

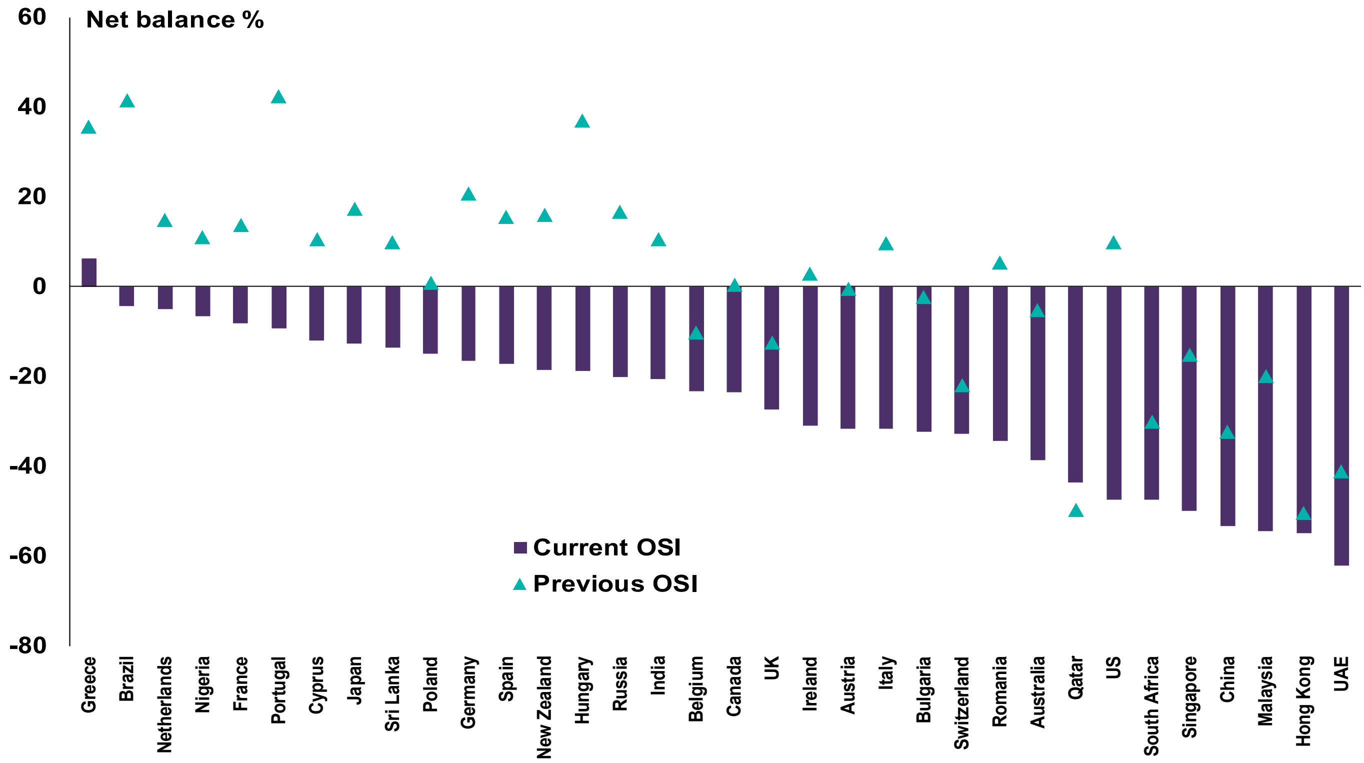


Chart 2 Investment Sentiment Indicator

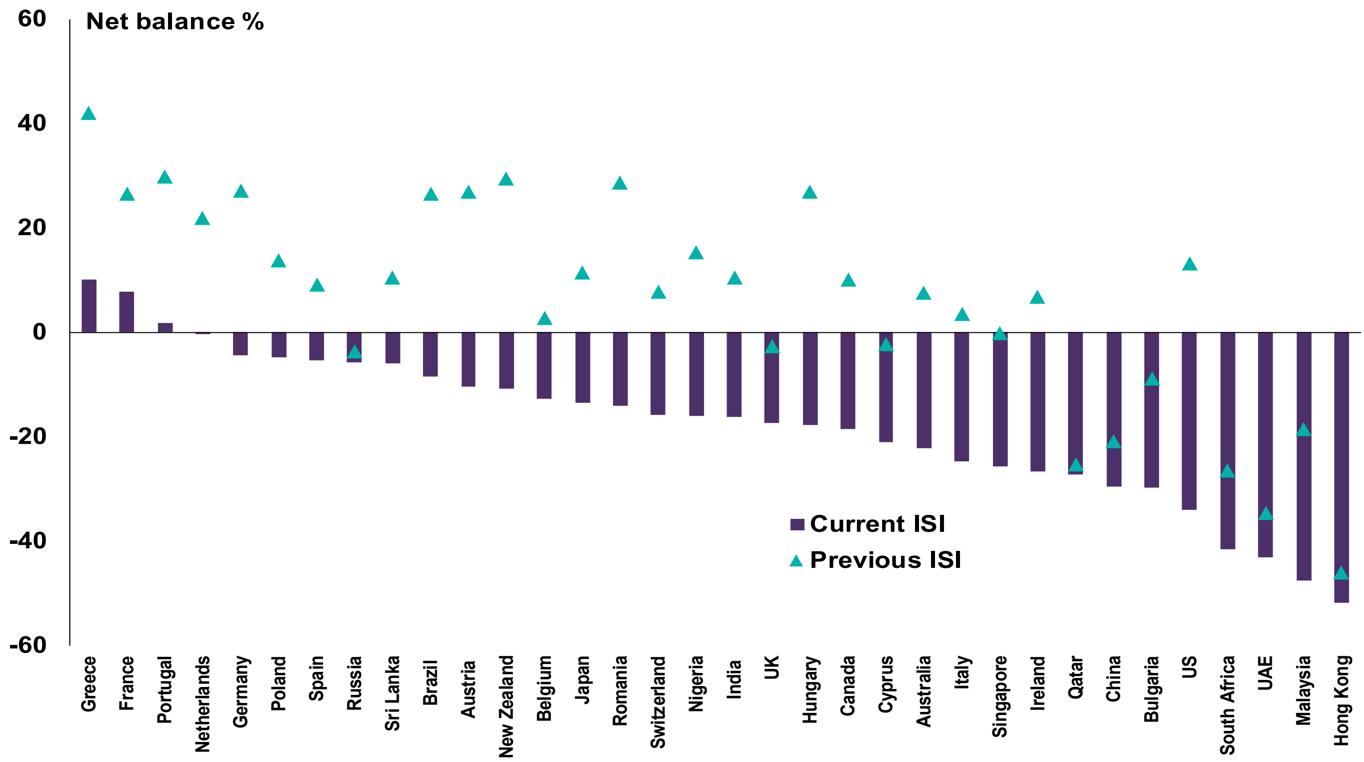


Chart 3 Occupier and Investor Sentiment Indices- All sectors (net balance%)

Indicative of momentum over the previous quarter

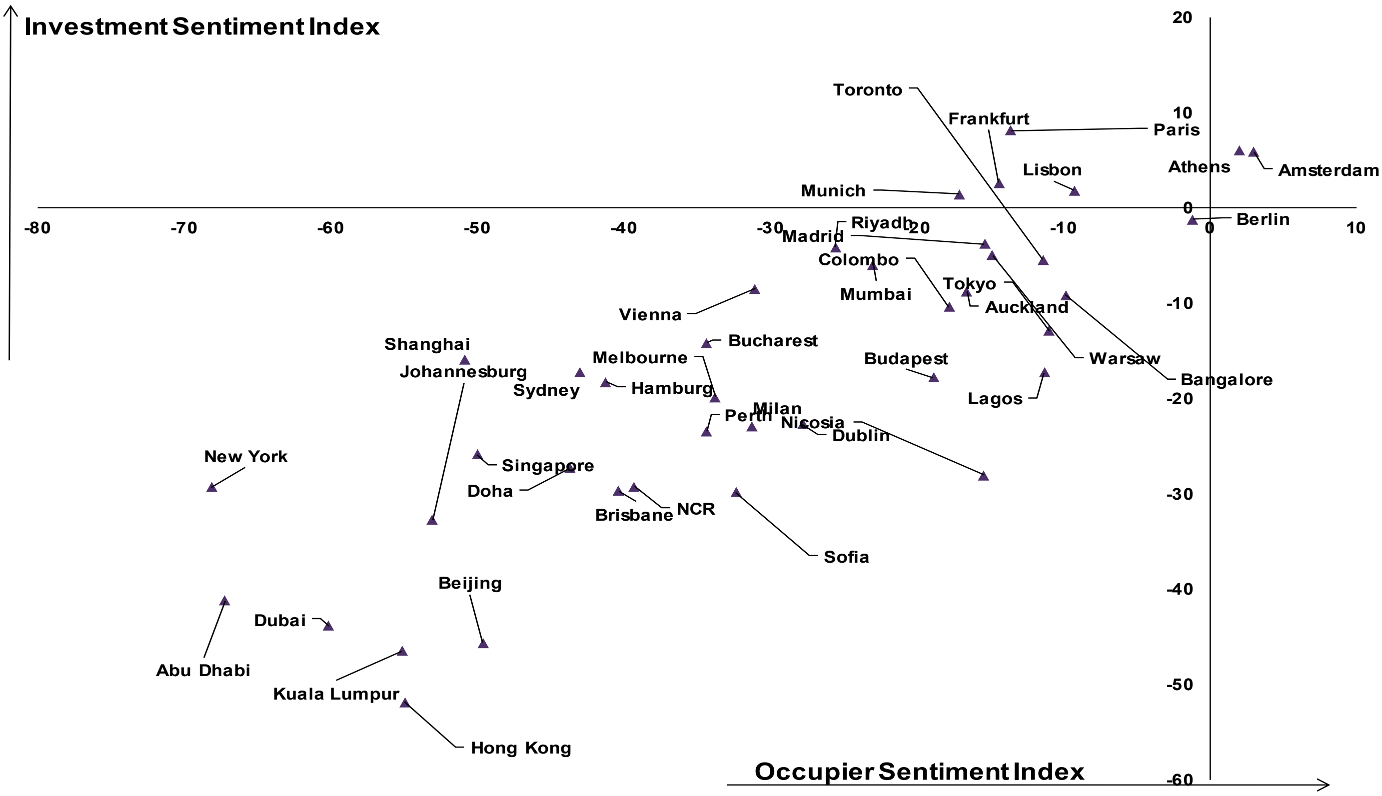


Chart 4 Twelve Month Rental and Capital Value Expectations - All sectors (net balance %)

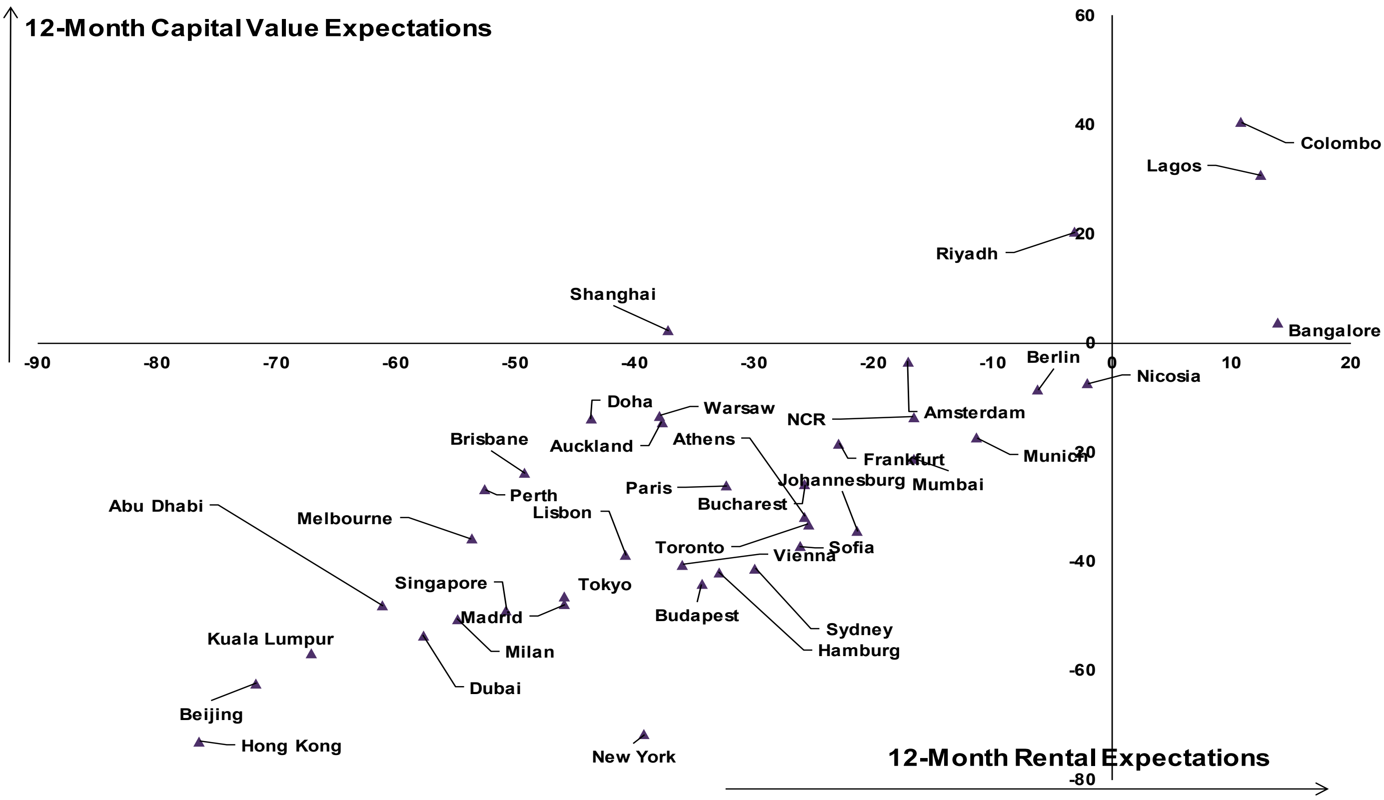


Chart 5 Valuation Perceptions

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

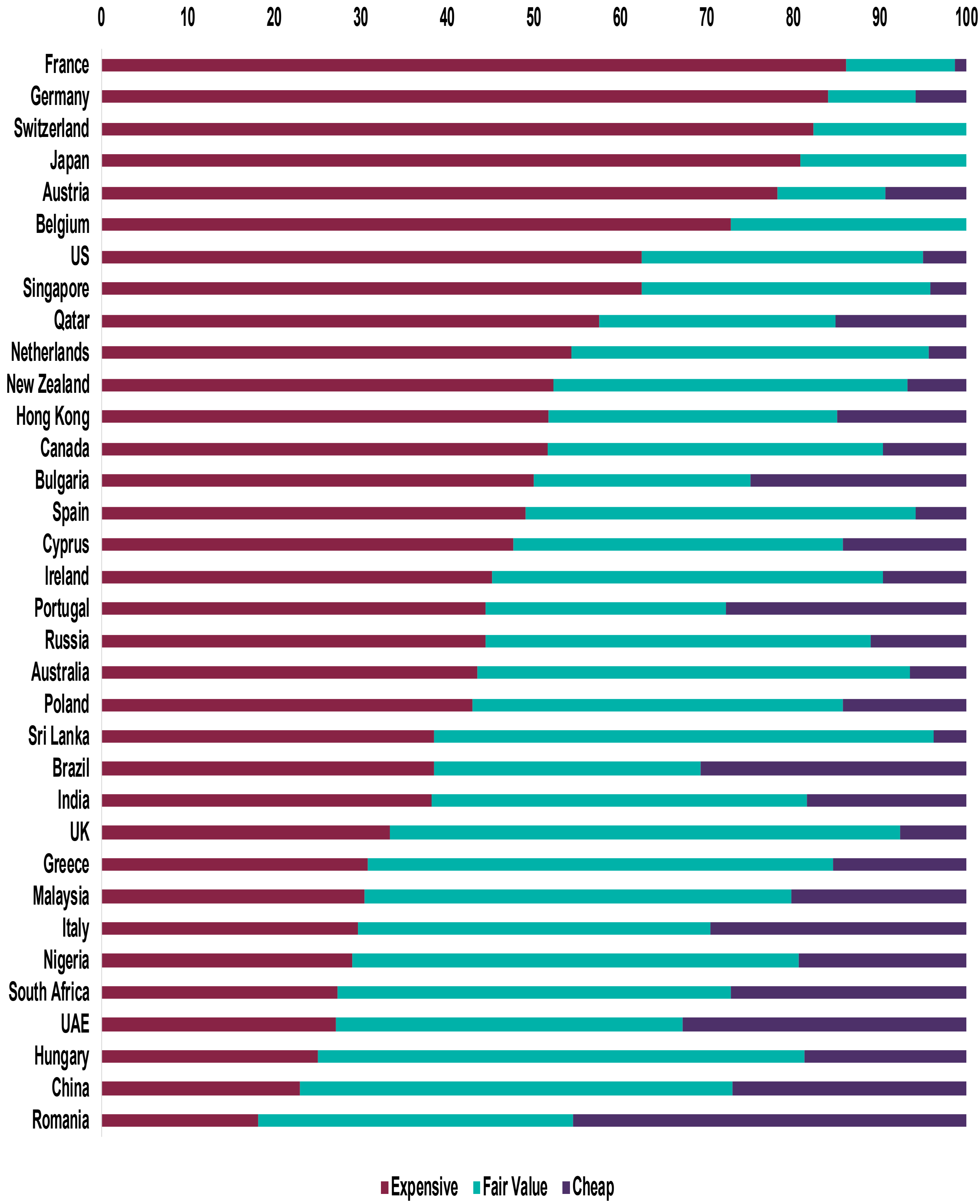
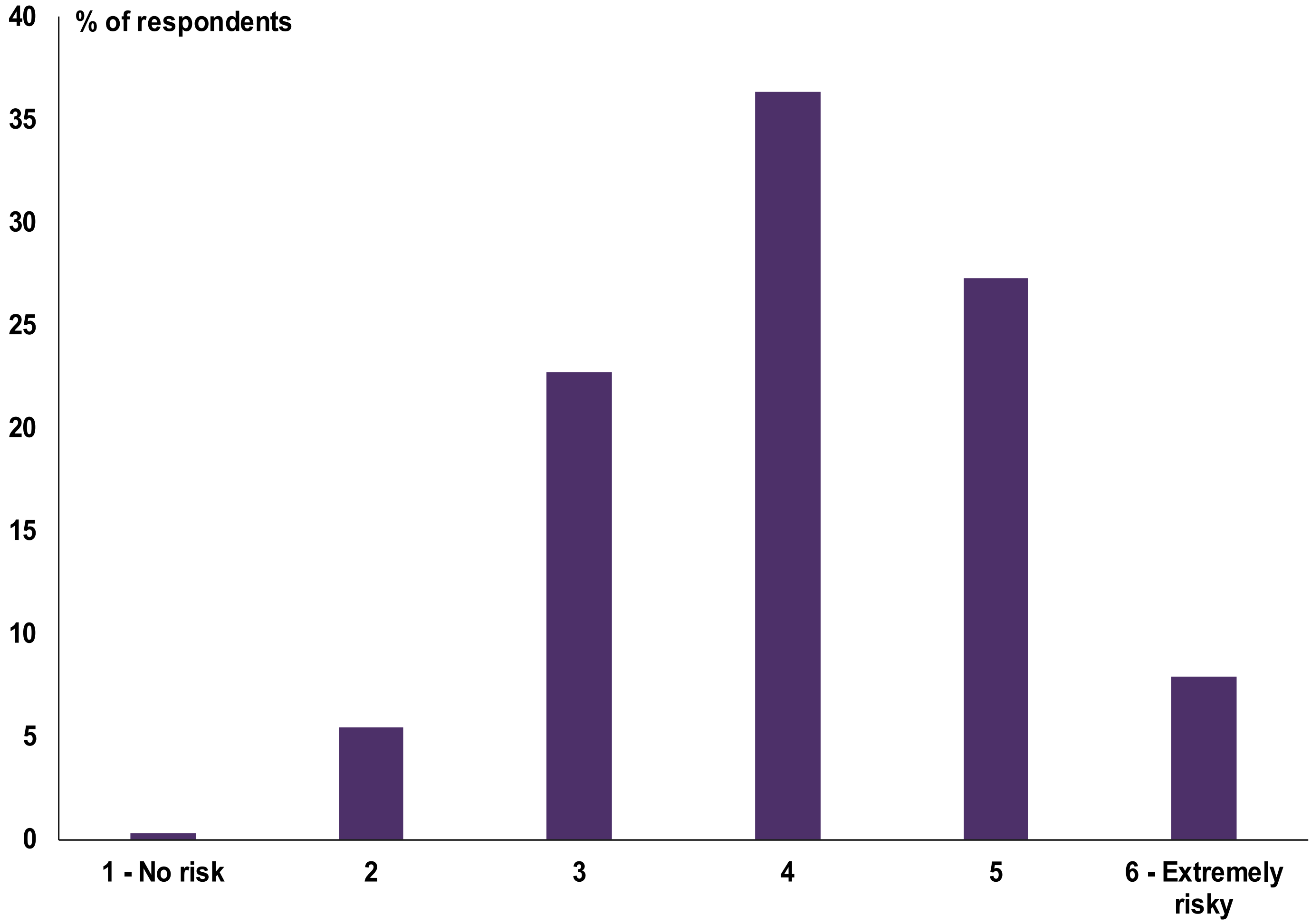
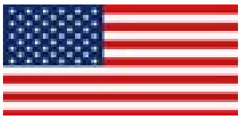


Chart 6 RICS-AFIRE How risky do you perceive the current macro environment for returns on commercial real estate investment

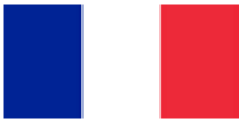


Regional Comments from Survey Participants

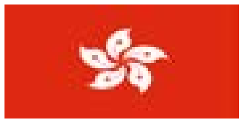


"The Covid 19 virus spread provides changes in the marketplace that we have no history in which to compare. While the results may be similar to the 2008 financial recession, the effects will create drastic long term changes in the office and retail markets"

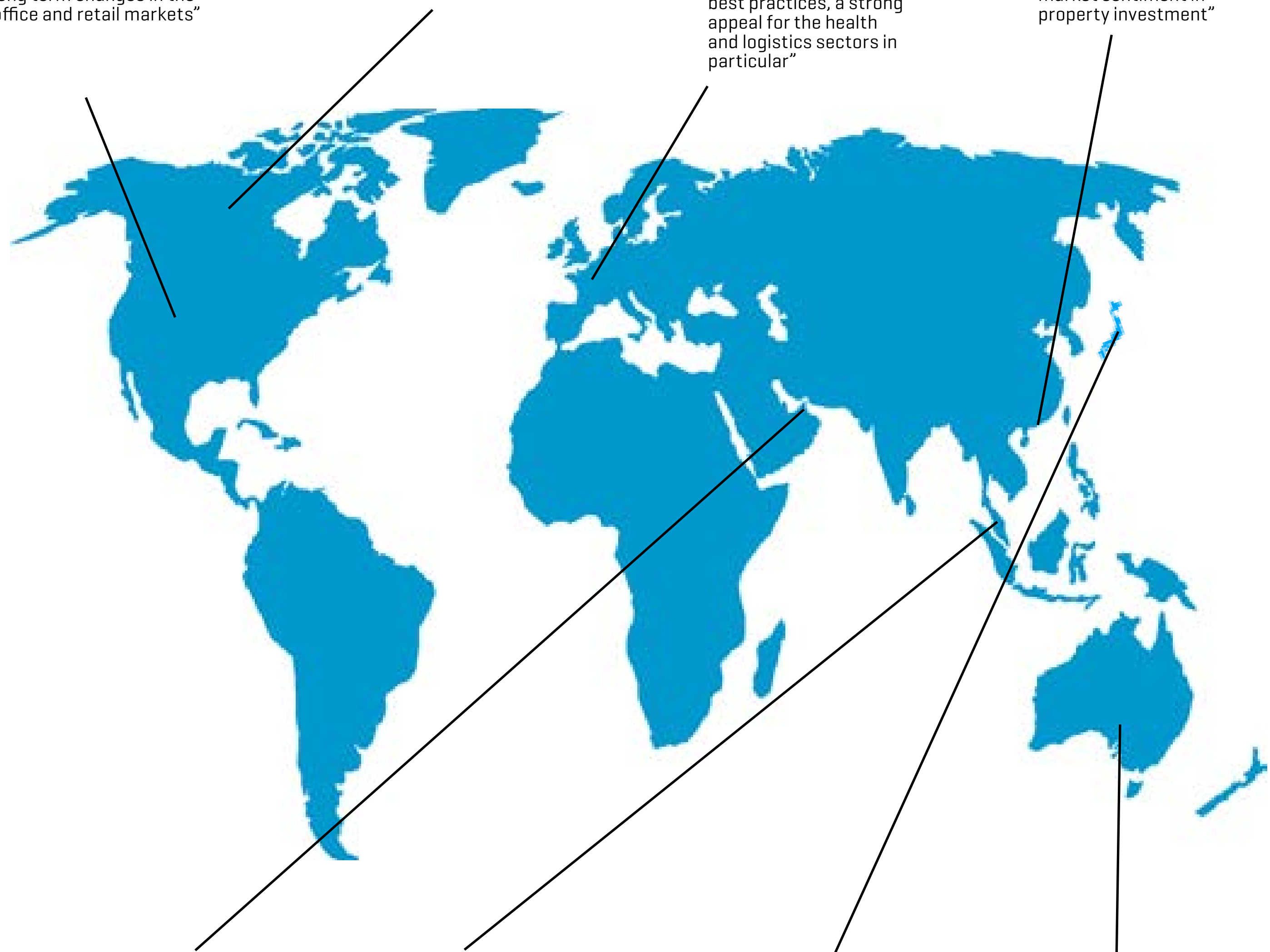
"Office and Industrial continue to do very well with high demand for space and low availability. Retail, as in many markets, is struggling with increasing bankruptcies and rising vacancies. The current pandemic is drastically changing everything we know"



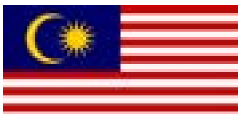
"Coming out of a cycle high, Prime market values should fall and then recover quickly, unlike non-prime values, which should fall structurally. The current crisis should show the emergence of a new world, new fundamentals, new best practices, a strong appeal for the health and logistics sectors in particular"



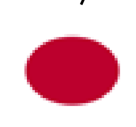
"The actual impact of coronavirus in the market is yet to be seen, notwithstanding that consumption in travelling and durable goods have weakened. Stock market fluctuation is also affecting market sentiment in property investment"



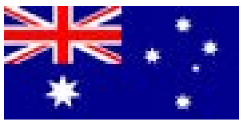
Some recent encouraging stats on residential transaction numbers. However, coronavirus is yet another obstacle in general commercial activity and business sentiment. Retail, transport, hospitality & service sectors already feeling pain.



"These are extremely uncertain times made worse by covid 19 and irrational political behaviour. The property market is therefore very much affected by these events. The market can only stabilise in the medium to long term"



"The retail and hotel markets have been quickly decimated by COVID-19. Factors include the difficulty in international and domestic travel, the reluctance of people to entertain at night in crowded places for work or pleasure and the continuing decline of workers/ commuters in center city office buildings that support the retail and restaurant infrastructure nearby"



"A lot of uncertainty around with the COVID-19 crisis. Property investment may currently be difficult with isolation restrictions and work-from-home arrangements, however low interest rates have been dropped further to 0.25% in an attempt to increase buyer confidence within the economy"

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 11 March 2020 with responses received until 13 April 2020. 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 2604 company responses were received, with 592 from the UK. Responses for Ireland were collated in conjunction with the Society of Chartered Surveyors Ireland. Responses for Spain and Portugal were collated in conjunction with Iberian Property. Responses for New Zealand were collated in conjunction with Property Council New Zealand.

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

This publication has been produced by RICS. For all economic enquiries, including participation in the monitor please contact: **economics@rics.org**

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Economics Team

Tarrant Parsons

Economist

+44(0)20 7695 1585

tparsons@rics.org

Sean Ellison

Senior Economist

+65 68128179

sellison@rics.org

Simon Rubinsohn

Chief Economist

+44(0)20 7334 3774

srubinsohn@rics.org

Kisa Zehra

Economist

+44(0) 7695 1675

kzehra@rics.org

Janet Guilfoyle

Market Surveys Administrator

+44(0)20 7334 3890

jguilfoyle@rics.org

Responses were gathered in conjunction with the following organisations:

AFIRE APREA SOCIETY OF CHARTERED SURVEYORS IRELAND IBERIAN.PROPERTY

Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the valuation, development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to markets and effecting positive change in the built and natural environments.

Americas

Latin America
ricsamericalatina@rics.org

North America
ricsamericas@rics.org

Asia Pacific

ASEAN
ricsasean@rics.org

Greater China (Hong Kong)
ricshk@rics.org

Greater China (Shanghai)
ricschina@rics.org

Japan
ricsjapan@rics.org

Oceania
oceania@rics.org

South Asia
ricsindia@rics.org

EMEA

Africa
ricsafrica@rics.org

Europe
ricseurope@rics.org

Ireland
ricsireland@rics.org

Middle East
ricsmiddleeast@rics.org

United Kingdom RICS HQ
contactrics@rics.org