Q2 2018: Brazil Commercial Property Monitor

Near term sentiment still cautious although twelve-month expectations improve

The Q2 2018 Brazil Commercial Property Monitor results highlight some caution as far as the near term outlook is concerned, which is not entirely surprising given the disruption caused by the truck divers' strike. Indeed, with the country brought to a halt for eleven days, economic activity is estimated to have plunged -3.3% in May. Given this, sentiment in the commercial real estate market held up reasonably well, despite the recent recovery in investor and occupier demand pausing. Nevertheless, further out, rental growth expectations for the year ahead actually strengthened, with projections across the prime office sector in Sao Paulo now stronger than for some time.

Occupier Market

- The Occupier Sentiment Index (a composite measure of occupier market indicators shown on chart 1 overleaf) dipped a little during Q2, coming in at -6 following +2 in Q1. That said, the latest figure is consistent with only a marginal deterioration in overall sentiment.
- Following a relatively stable trend last quarter, occupier demand reportedly edged lower in Q2, although this was mainly driven by a decline in the industrial sector. The office sector meanwhile saw little change in tenant demand.
- Availability continued to decline, marking the sixth quarter in succession in which the amount of leasable space available has contracted. Likewise, the use of landlord incentive packages to entice tenants fell again, representing the fourth straight quarterly decline.
- Although the near term view remains cautious on rents, respondents upgraded their projections over the next twelve months across all sub sectors (relative to Q1), Prime retail and industrial space is now anticipated to see the strongest rental growth, while the rental outlook in secondary locations also turned more positive (chart 6).
- In Sao Paulo, expectations for rental growth exceed those at the national level comfortably, with the prime office sector exhibiting the firmest twelve month rental projections. Respondents are now anticipating a near 6% rise, compared with forecasts of closer to 3% in Q1. Furthermore, all market categories covered by the survey (both prime and secondary) are now seen posting some level of rental increases.

Investment Market

- The Investment Sentiment Index (a combined gauge of investment market indicators also shown on chart 1) eased to -2 from +9 last quarter. Even so, this is signalling a broadly stable backdrop across the investment market overall.
- Having increased in each of the last two quarters, investment enquiries were more or less flat across both the office and industrial sectors. By way of contrast, investor demand slipped in the retail sector, albeit only marginally. In terms of foreign demand, this declined slightly across each area of the market.
- The supply of property on the market for sale was more or less unchanged for the second quarter running, although respondents noted a marginal increase in industrial properties available for investment purposes.
- Capital value projections for the year ahead were left largely unaltered at the headline level compared with the previous results. When broken down, respondents did raise their expectations for prime industrial values as well as those for prime offices. Both are now seen posting gains of close to 4% (chart 5).
- When disaggregated, Sao Paulo displays stronger expectations for capital value growth than Brazil as a whole. Growth in prime industrial prices is now expected to lead the way, followed by prime offices. Secondary retail values exhibit the most subdued outlook on a sectoral comparison, but this is still positive nonetheless.
- 72% of respondents sense commercial real estate to be either at or below fair value nationally, down slightly on 78% in Q1. Meanwhile, a majority of contributors continue to sense the market is in the early stages of an upturn.

Commercial Property Market

Chart 1: Occupier, Investment Sentiment Indices

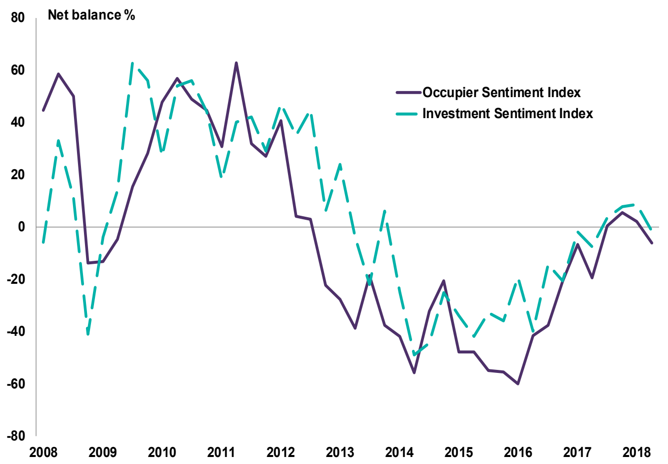


Chart 2: 3-month Rents, Capital Values

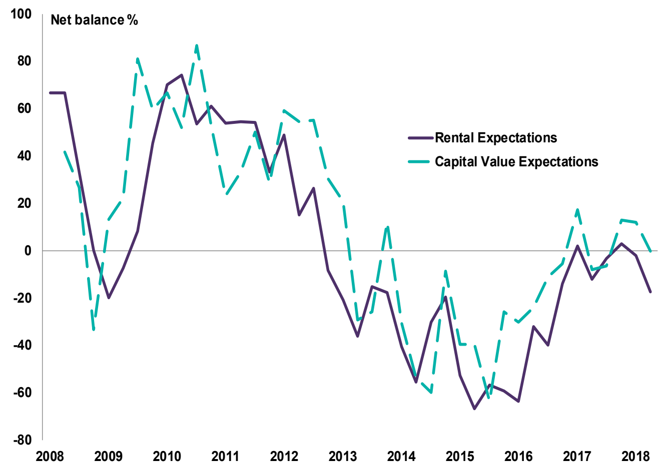


Chart 3: Credit Conditions

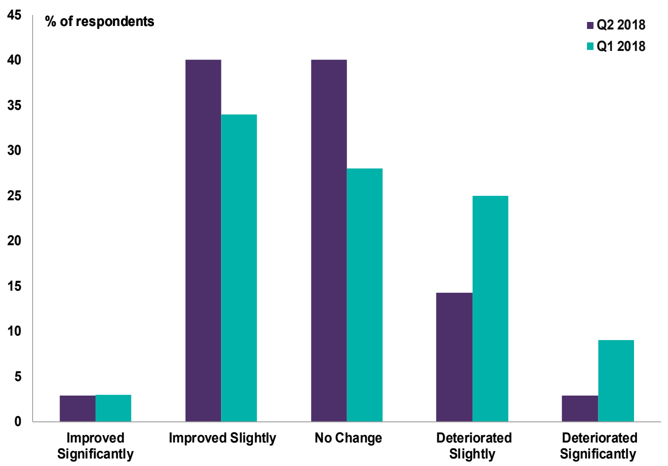


Chart 4: Valuations

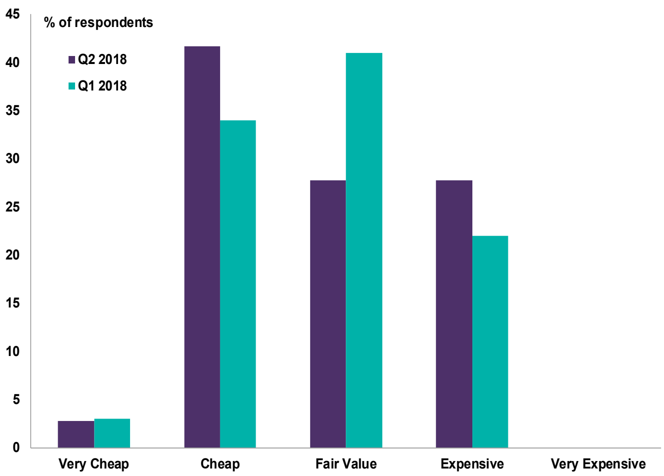


Chart 5: 12-month Capital Values Forecast

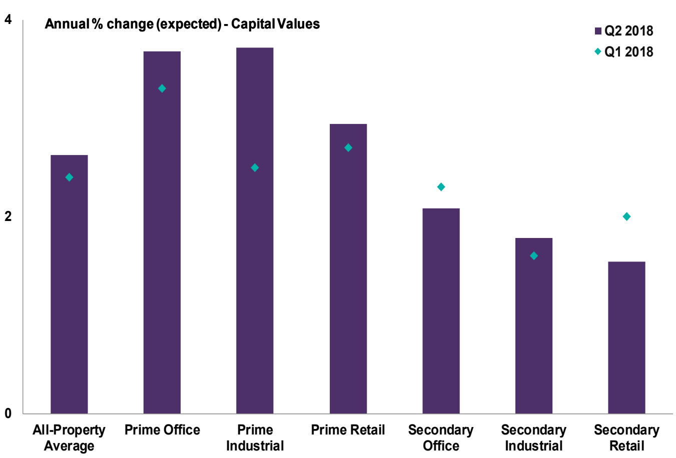
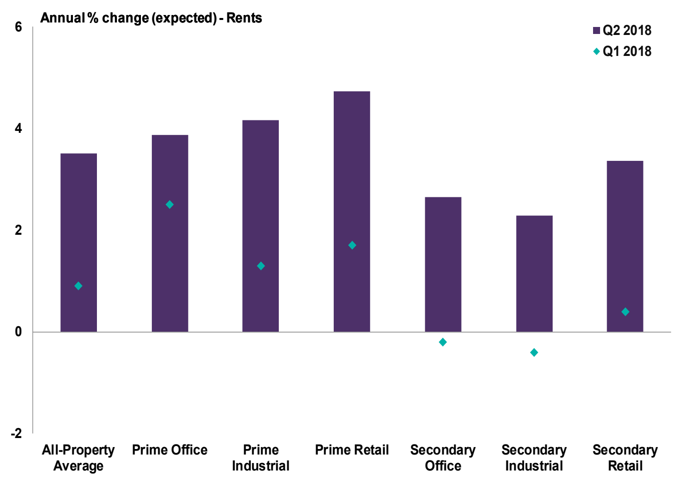


Chart 6: 12-month Rent Forecast



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 13 June 2018 with responses received until 8 July 2018. 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 1965 company responses were received, with 371 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.

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