Q3 2018: Global Commercial Property Monitor

Real estate sentiment remains firm despite increasing macro risks

- Q3 results show real estate markets across much of the globe remain firm
- European markets continue to lead the way
- Occupier indicators in Asia flatlining in the face of heightened trade fears

Although the global economy has continued to perform relatively strongly during the third quarter of the year, some of the risks that we have previously drawn attention to have begun to materialise. In particular, rising trade tensions, as protectionist rhetoric has progressed into an outright use of tariffs, a reversal of capital flows to emerging markets, and heightened political risks all threaten to contribute towards a marked slowing in growth momentum as 2019 approaches. Alongside this, policymakers in a number of countries have either given consideration, or actually taken further steps along the path, towards unwinding the still highly accommodating monetary stance in place across much of the globe.

Despite this, the broad-based feedback provided to the Q3 RICS Global Commercial Property Monitor (GCPM) suggests that sentiment in the real estate world, in general, remains fairly solid. This chimes with much other anecdotal evidence which is pointing towards actual transactional volumes at least as strong as last year and possibly a little bit firmer. The underlying tone to the RICS results is most visibly reflected in charts 1 and 2 showing the Occupier Sentiment Index and Investment Sentiment Index at a country level. Significantly, overall occupier momentum is only negative in around twenty percent of the countries included in the survey (compared with just over a quarter in Q2). Meanwhile, investment sentiment is negative in just under twenty percent of the national markets (some eight percent lower than in the previous survey).

Unsurprisingly, the city level data in the GCPM tells a pretty similar story. This is most clearly highlighted in charts 3 and 4 which track both occupier and investment sentiment as well as the feedback regarding twelve month expectations for rental and capital values (captured in net balance terms). European cities continue to show the most positive trends on the basis of current indicators but the picture is a little more nuanced when it comes to the forward looking measures; these series also display firm readings from a number of cities in the Asia-Pacific region.

Inevitably, the extended nature of the current real estate cycle leaves some markets more vulnerable to both macro surprises and/or industry specific shocks. However, the key series in the GCPM designed to capture risk - perceptions around valuation and the phase of the cycle - have changed little over the past quarter; the latest readings for both are shown in charts 5 and 6. And a similar interpretation can be inferred from not just the near term expectations indicators but also in projections for rent and capital values over the medium term. Whether this generally resilient tone can shrug off an intensification of hostilities on the trade front remains to be seen.

As noted earlier, European markets continue to show strongest momentum at the current time helped by the ongoing stance of the ECB. German cities such as Berlin, Frankfurt and Munich are still recording upbeat feedback on both occupier and investor segments of the market as is the Netherlands, Portugal and some CEE markets. However, it is worth noting the imminent ending of the quantitative easing programme at the same time as some key macro indicators appear to be flagging. Significantly, the London readings remain fairly flat although investor enquiries appear to holding up for now despite ongoing concerns surrounding the issue of Brexit. The additional questions included in the survey show a growing proportion of respondents expecting to see some business relocate from the UK to other centres in Europe over the next couple of years, although this clearly remains a very fluid situation.

The feedback for the Asia-Pacific region remains generally solid although the forward looking indicators, as highlighted previously, are typically stronger than the current ones. This is particularly the case in India where the real estate market was able to ignore the recent modest interest rate hike amidst generally encouraging macro fundamentals. Meanwhile, Australian cities appear to be holding up for now although there are some signs that a tightening in credit conditions is beginning to take on toll on investor behaviour. The introduction of tariffs on Chinese products by the US appears to be having some impact on the mood music with the Occupier Sentiment Index only just remaining in positive territory. The results for Hong Kong tell a broadly similar story while in Singapore, they are slightly more downbeat which, in part, reflects its particular vulnerability to a further escalation in trade tensions.

The numbers for the US continue to show a divergence between the picture in New York and the rest of the country. Investment sentiment for the latter remains in positive territory although the occupier indicator was, once again, little changed. Significantly, something in the region of half of all responses from New York see the market in the downturn phase of the cycle although the expectation is that this is likely to be accompanied by only a modest retracement in rents and capital values. For the wider market, the majority of respondents see the market in the upturn/peak phase of the cycle.

For the time being, despite the rise in oil prices, feedback from the Middle East remained cautious at best. Occupier and investor sentiment in the UAE was little changed from Q2 with forward looking indicators also still negative.

*The Occupier and Investment Sentiment Indices are both composite measures capturing overall market momentum, encompassing variables on supply, demand, and expectations

Chart 1 Occupier Sentiment Index (change v previous qtr) - Net balance %

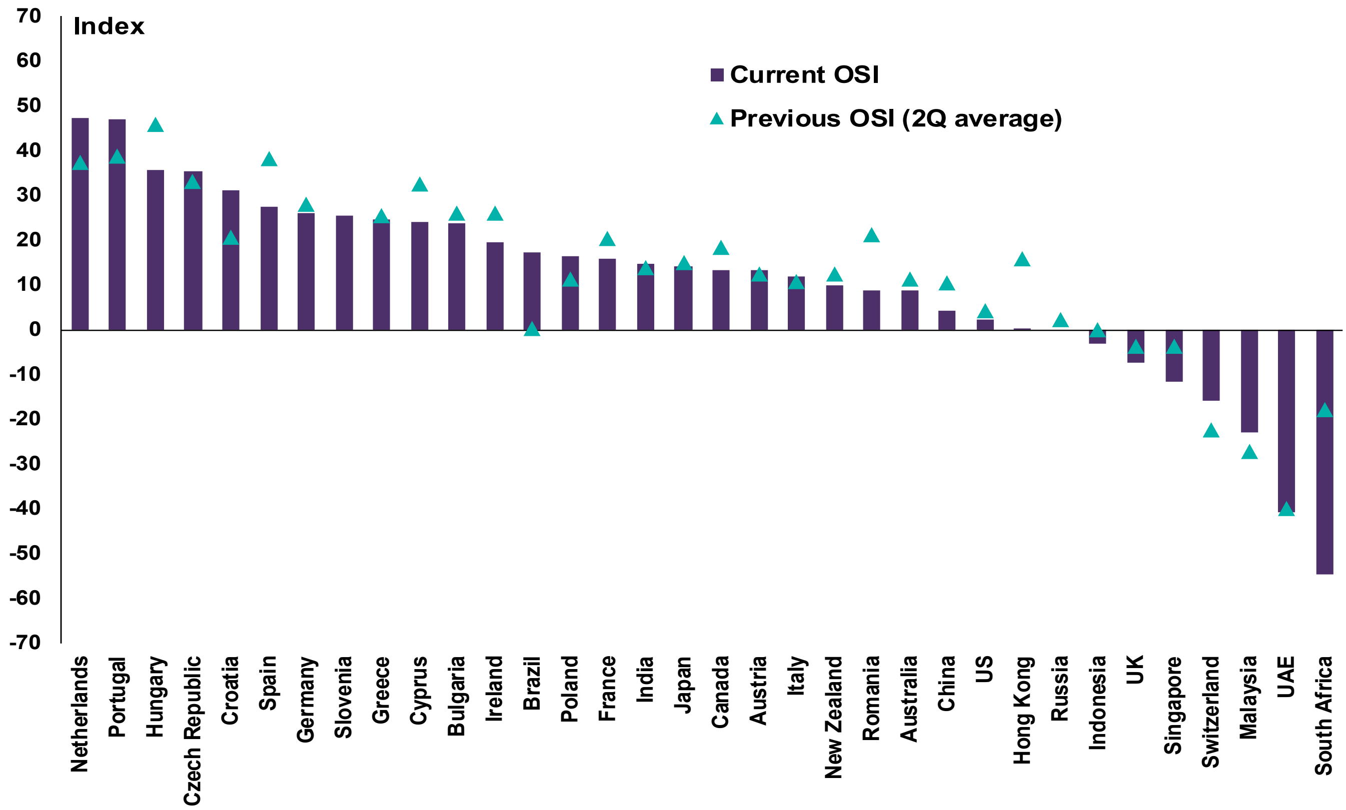


Chart 2 Investment Sentiment Index (change v previous qtr) - Net balance %

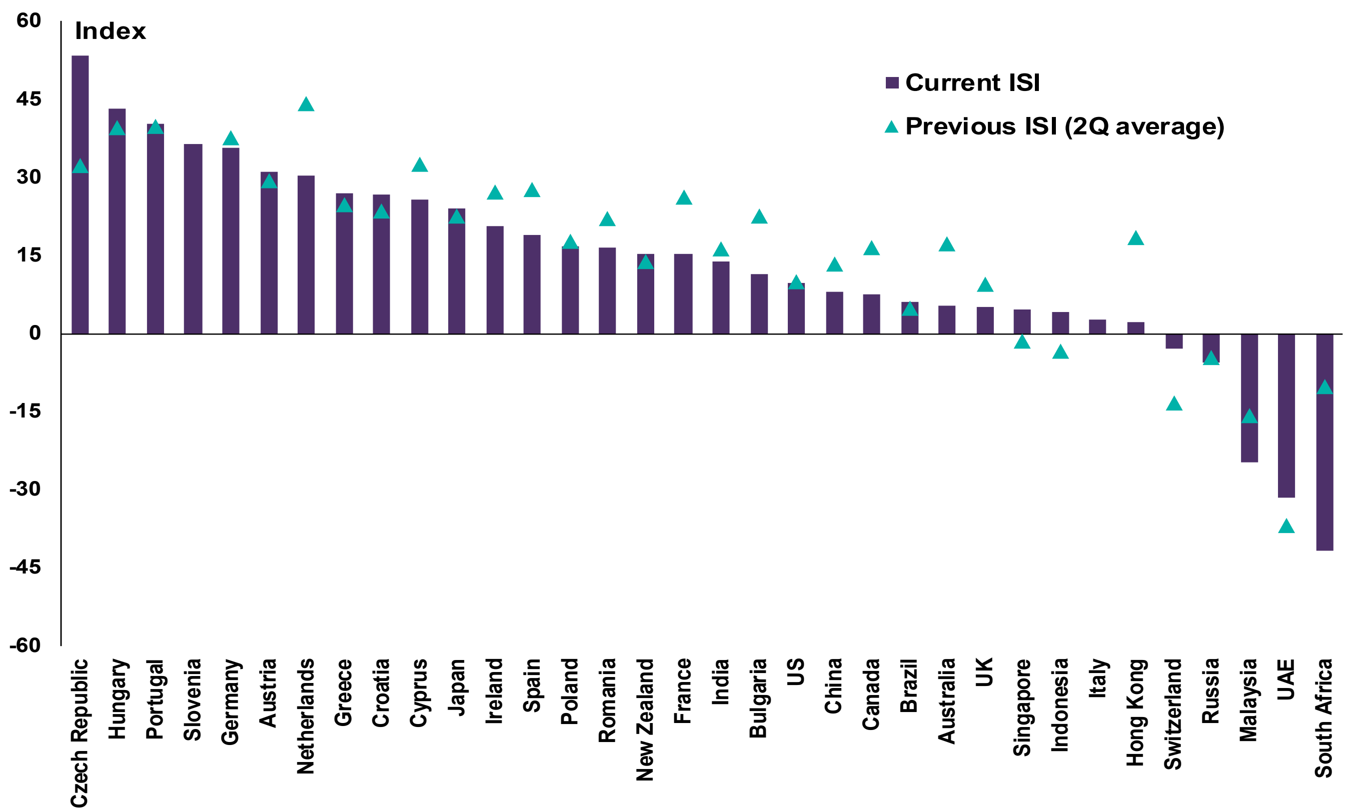


Chart 3 City Level Occupier and Investor Sentiment Indices- All sectors (net balance %)

Indicative of momentum over the previous quarter

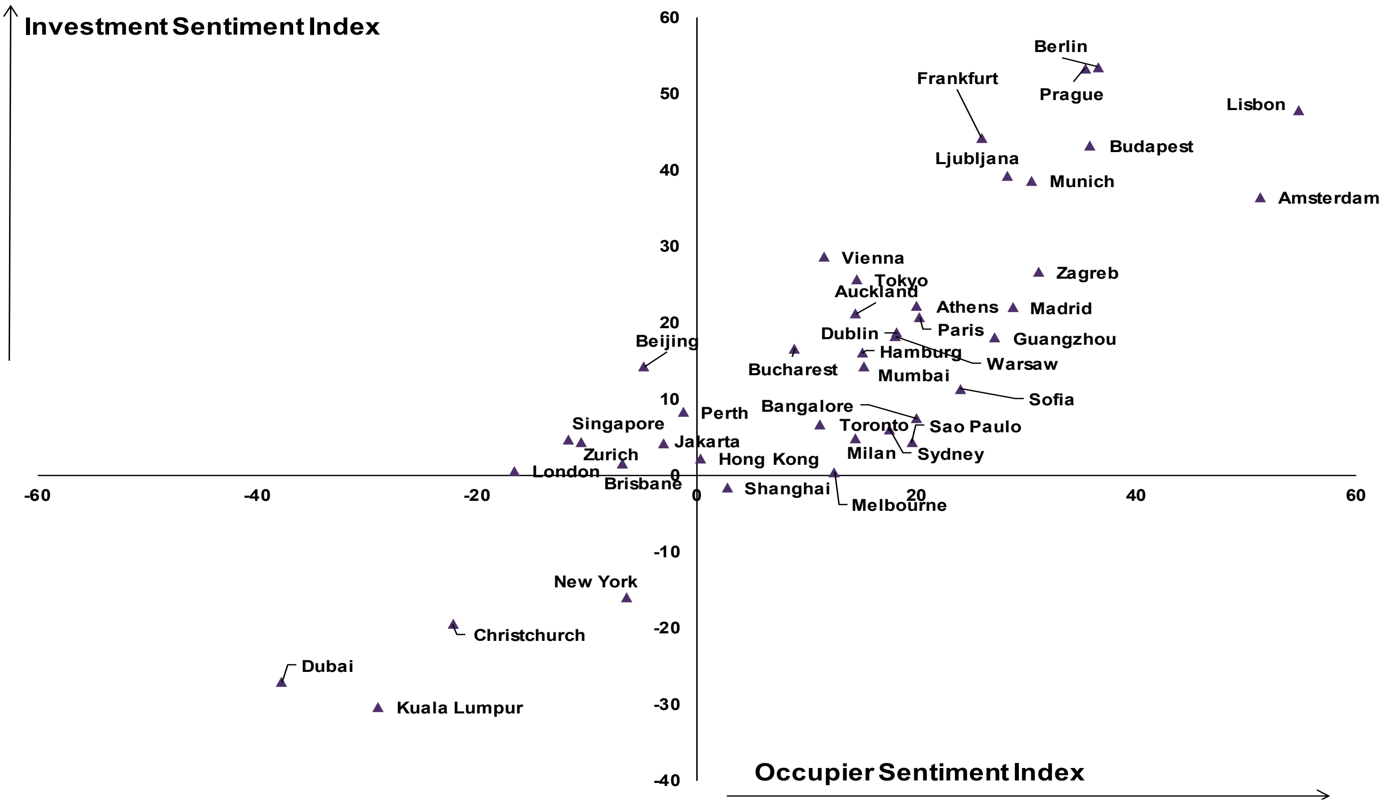


Chart 4 City Level Twelve Month Rental and Capital Value Expectations All sectors (net balance %)

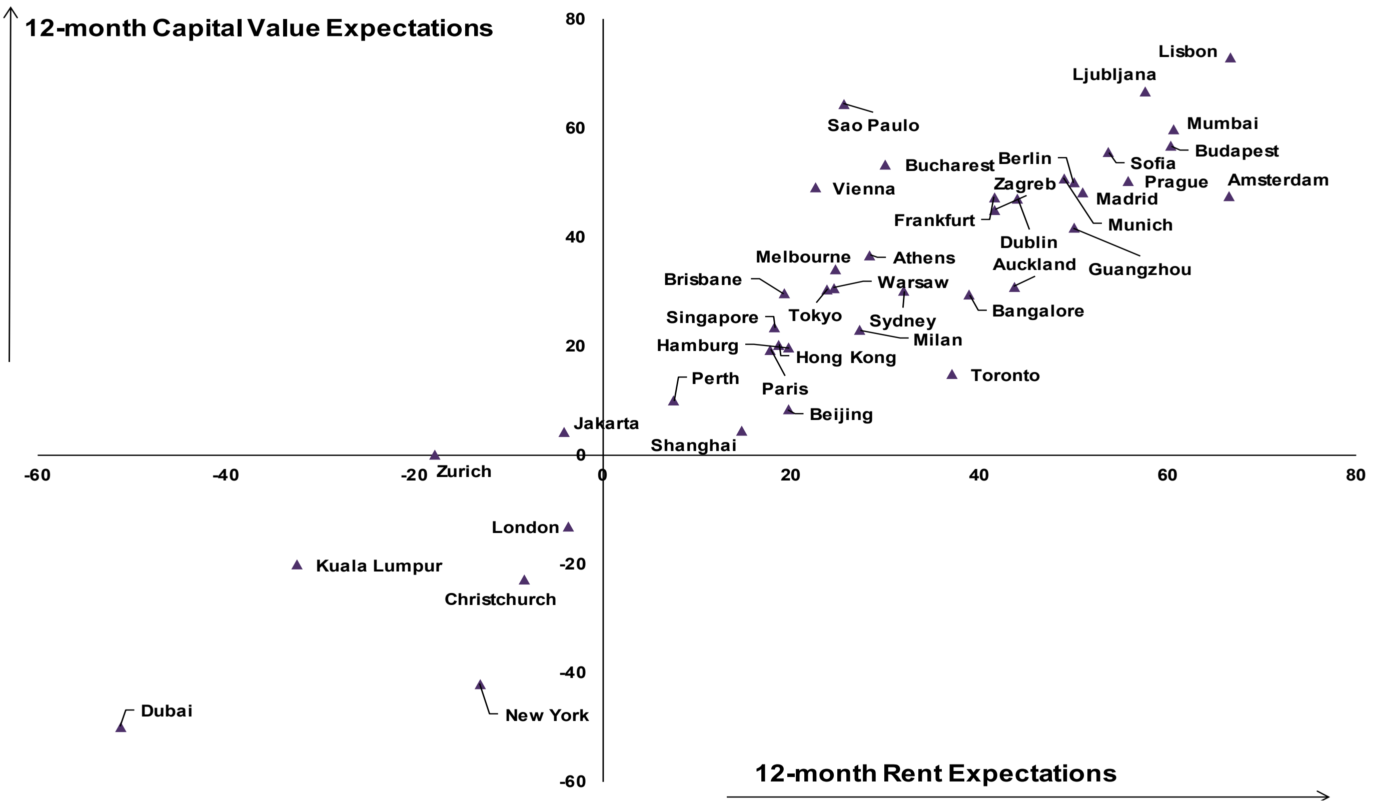


Chart 5 Valuations Perceptions

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

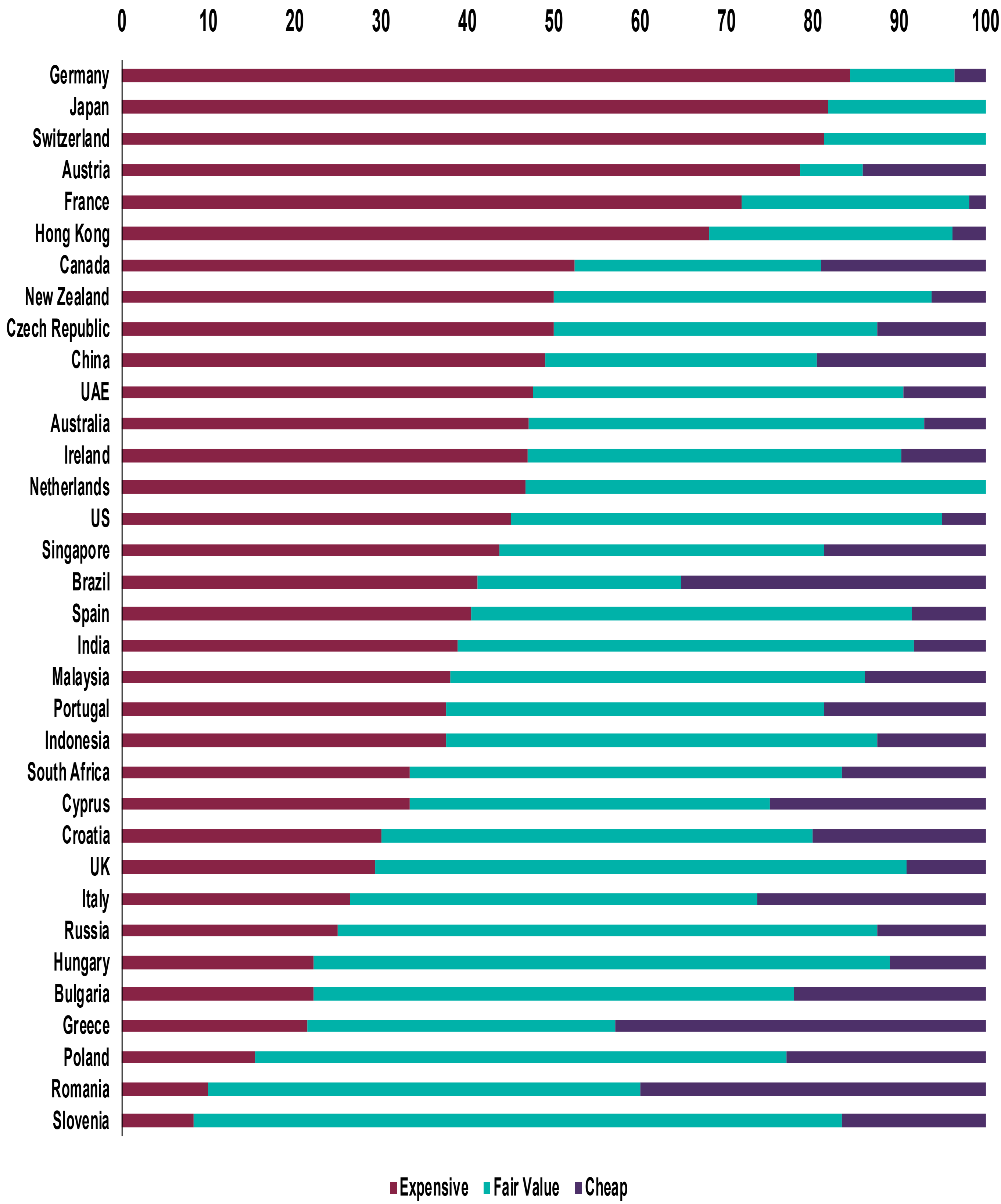
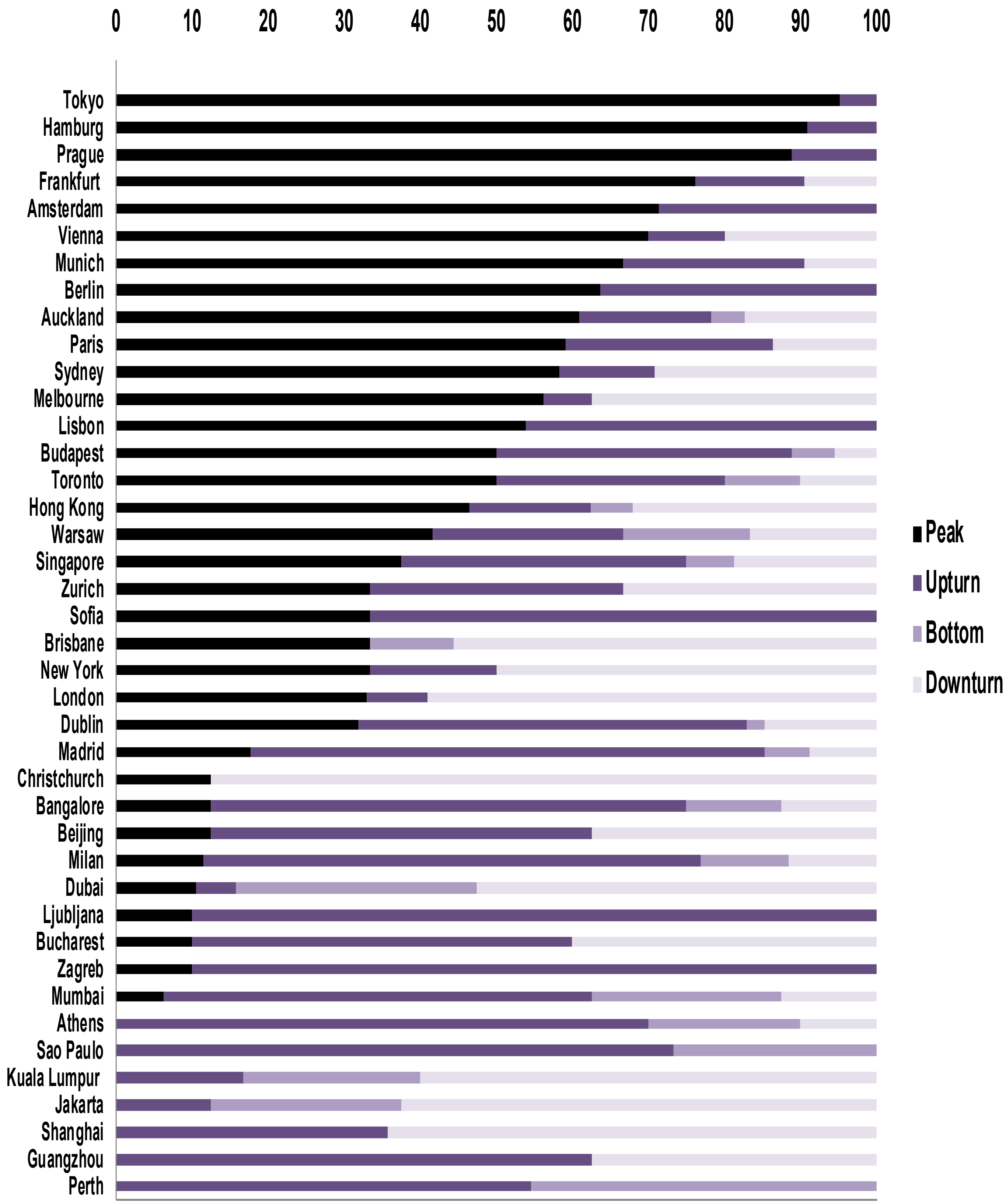


Chart 6 Property Cycle

% of respondents perceiving market conditions to be in various stages of the cycle



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 September 2018 with responses received until 14 October 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 1791 company responses were received, with 341 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 for Malaysia were collated in conjunction with Royal Institution of Surveyors Malaysia.

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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