

Real Estate House View

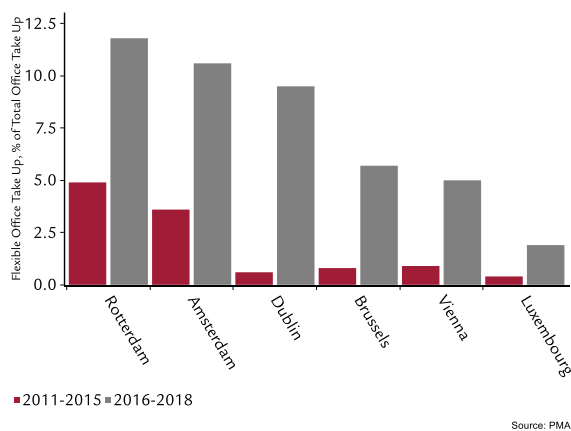
Benelux, Austria, Ireland

First half-year 2019

Key takeaways

- The Luxembourg market continues to attract occupiers and investors. It is expected to experience both rental growth and further yield compression over the medium term. The development pipeline is sizeable but market fundamentals remain solid given the growth prospects of the country.
- The Brussels office market shows signs of a mature market cycle, with limited rental growth expected and stagnating or potentially softening yields in the medium term.
- Investor demand for property in Dublin has been strong. The office sector has dominated investment activity this year but the Private Rental Sector (PRS) is attracting a growing share of capital.
- Occupational markets in Ireland are strong. The office market in Dublin is seeing sustained demand from a range of businesses. High retailer confidence and new international entrants are aiding retail demand.
- Vienna continues to justify its reputation as a stable market. In the office sector, rental growth is expected to remain subdued due to a high number of completions as opposed to a lack of occupational demand. Investor demand persists so yields remain low.
- The upswing in the Amsterdam office market is continuing. It is expected to slow in the medium term as a result of rising construction activity.

Chart in focus



London and Berlin are often mentioned as hotspots for flexible offices. However, besides these markets there is growing demand in other Western European cities. The Dutch markets have seen large increases in demand. Flexible space operators accounted for 11.8% and 10.6% of take up in Rotterdam and Amsterdam, respectively, in 2016-18, significantly up on 2011-15. Brussels and Vienna also both saw take-up of over 5%. Luxembourg is lagging behind the other markets considered here with 2016-2018 flexible office take-up of less than 2%. Trends from other Western European markets suggest this could rise sharply in the short term.

Economic dynamics in this group of booming Eurozone member states have continued to moderate. Yet, purchasing managers indices (PMI) for the manufacturing sectors suggest that the slowdown is more gradual than elsewhere. PMIs are holding up well above the 50-points expansion threshold in Austria, the Netherlands and Ireland. In Austria, the PMI recovered in November suggesting continued growth above the long-term potential rate. We observe firm wage growth across these markets. Unemployment is declining in all countries, with the Dutch unemployment rate having fallen to 3.7% – the lowest rate since January 2009. Inflation started to rise in the second half of the year, albeit mostly due to the temporary rise in energy prices. Nevertheless, we expect rising core inflation pressure and think that the ECB's monetary policy is too accommodative for all countries in this group. All four economies are strongly integrated into global trade chains and thus disproportionately vulnerable to an escalation of the US-China trade dispute.

Strong demand, lack of stock

The investment market remains very active. Total transaction volumes in these markets remained high or increased in the first half of 2018. Belgium recorded relatively stable investment volumes in 2018 totalling EUR 1.5 billion, similar to 2017. Investors still have a strong appetite but little is on the market, limiting investment volumes. In Luxembourg, investment volumes are rising with EUR 725 million invested in H1 2018, 50% more than in 2017. For the Dutch market PMA reports stable commercial transaction volumes of about EUR 6.5 billion in H1 2018 whereas residential rose strongly to more than EUR 3 billion due to portfolio deals, according to JLL. Irish real estate attracted EUR 665 million in Q3 2018 which represented a 25% increase on the same period last year. This took year-to-date volumes to EUR 2.6 billion. PRS is attracting a rising investment share. The Austrian market is the outlier with a slight decline in activity (across all sectors) to EUR 3.2 billion in H1 2018 according to CBRE. Investment activities nevertheless remain at historically high levels.

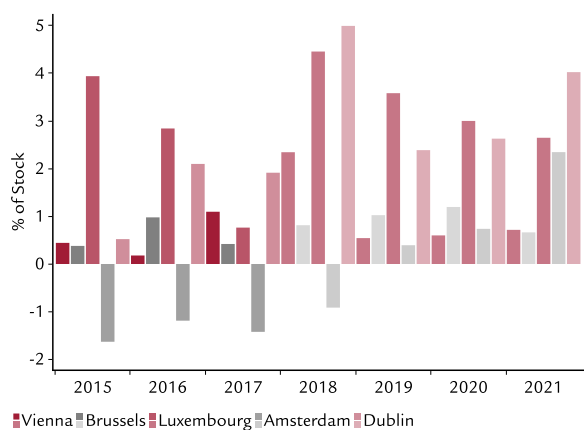
Yields look set to remain low

Strong investment demand is reflected in prices and returns. We do not predict any changes in the overall picture in the foreseeable future. Vienna recorded some yield compression (20 bps) in the prime retail and office segments at the beginning of 2018 but these stabilised in the subsequent quarters. There is a very similar picture for yields in Belgium, where most real estate sectors stabilised over the past six months. No further compression is expected in a context where bond yields are under pressure and limited rental growth is projected. In Luxembourg, office yields compressed further as investors doubled-down on a market where the vacancy rate is low and rents still have room to grow. It is considered that yields could compress further, albeit modestly, in the medium term. The strong momentum of the Amsterdam office market is reflected by a yield shift to 3.5% by mid-2018. According to PMA analysis, yields in the Dublin market have stabilised since the end of 2017, with the exception of the logistics sector. In Ireland, ongoing demand for real estate maintained low levels of office and logistics yields in Q3 2018 according to agency reports. Structural change promoted some retail yield softening.

Ongoing office demand

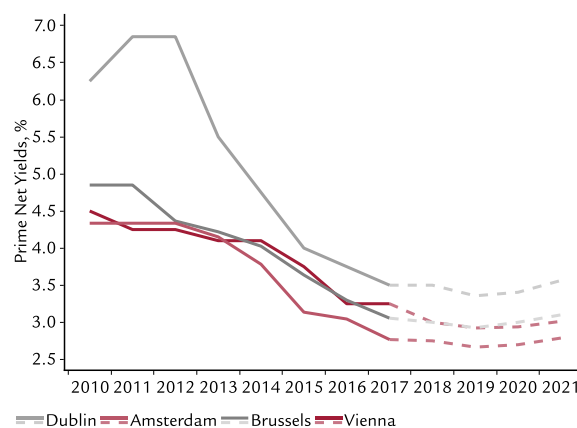
The office markets continue to benefit from the supportive macroeconomic environment, although different local trends play out in each market. Luxembourg rents have been flat over the past few months after significant increases in both 2016 and 2017. Rental growth could pause temporarily, given new supply coming to the market in the short term. Market fundamentals are sound and further rental growth is expected in the medium term. Dublin office occupational demand has been sustained. There is approximately 399,500 sqm under construction, of which around half is prelet. Occupier preference for high-quality products means that the remainder is expected to be absorbed and oversupply is not anticipated. Take-up in Vienna gained momentum in 2018 but the bulk of new supply, about 280,000 sqm this year, will have an impact on vacancies and result in limited pressure on rents. This trend is likely to continue over the next few quarters. In contrast is Amsterdam, where construction activity is rising but significant net addition is not expected until after 2020. This means that there is still considerable rental growth potential.

Chart 1: Office net additions



Source: PMA

Chart 2: Retail yields bottoming out



Source: PMA, SLAM (Forecast)

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