Q2 2020: Global Commercial Property Monitor

Cyclical and structural pressures depress sentiment amongst real estate professionals

- Both occupier and investor sentiment indicators remain firmly in negative territory in Q2
- Europe sees sharpest deterioration in key metrics after a relatively resilient Q1
- Twelve month expectations still downbeat albeit slightly less so in APAC

The results of the Q2 2020 RICS Global Commercial Property Monitor (GCPM) reflect the ongoing impact of Covid-19 on the macro economy and the way in which this is playing out in the real estate sector. Key measures of sentiment are unsurprisingly firmly entrenched in negative territory, albeit that the aggregate readings still remain above the lows recorded in the wake of the Global Financial Crisis (chart 1).

Downbeat economic outlook casts shadow over sector

Most forecasts for the global economy are understandably being heavily caveated at this stage with many assessments incorporating a range of different scenarios designed to capture calibrations around health and macro policy outcomes. The IMF's latest attempt at interpreting the outlook (updated in June) suggested as a central case that the global economy would grow by 5.4% next year following a contraction of 4.9% this year. However, this sharp turnaround is very much being driven by 'Emerging and Developing Asia'. The picture for the 'Advanced Economies' is viewed as rather more downbeat with only just over half of this years loss of output forecast to be recaptured in 2021.

This chimes with the headline RICS global sentiment indicator (capturing feedback regarding both the occupier and investor markets) dipping from -28 to -37 in the latest three month period according to respondents from the universe of countries covered in the survey (weighted average). Reviewing the numbers at a regional level show Europe seeing the most marked deterioration compared with Q1 with the aggregated sentiment metric slipping from -14 to -36. This follows a period during which the readings for this region have been relatively firm. For APAC, the key sentiment indicator fell from -31 to -38 in Q2, for the Americas from -37 to -38 and in the Middle East and Africa from -26 to -39.

But increase in proportion viewing markets as fair value

As chart 2 highlights, around two-thirds of global respondents to the survey now view the commercial property market as being in the downturn phase of the cycle; a further 9% perceive the market to be in the bottom phase. Interestingly, this proportion is roughly the same across the regional blocs. But alongside this, over forty percent of contributors contend that the asset class is in fair value territory perhaps partly because of the significant adjustments that have been made to monetary policies in the wake of the pandemic. Once again, the responses do not diverge significantly across regions although APAC has a slightly lower proportion of respondents in this category (and a slightly higher share indicating they perceive markets to now be relatively cheap).

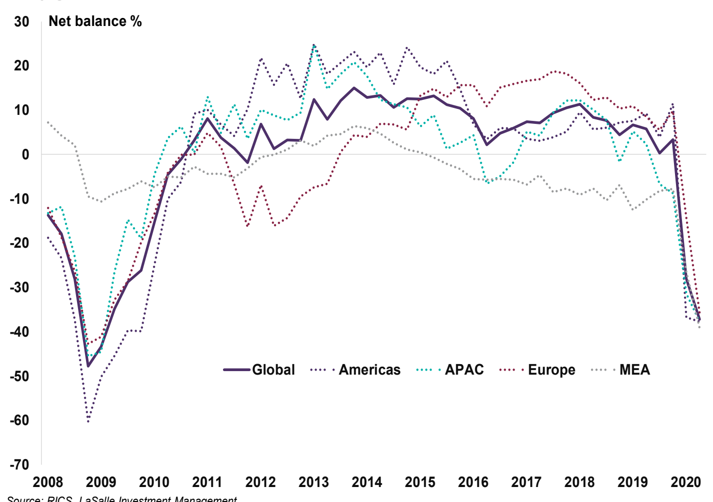
Consistent with this message is the indication that respondents to the survey have not shifted materially since the first quarter in their view regarding the risk to returns from commercial property; the largest group of contributors continue to put the risk at level 4 within a range of 1 to 6.

Expectations are however still modest

At a global level, respective net balances of -36% and -37% of respondents see rents and capital values declining (on mainstream assets classes) over the next twelve months. Disaggregating by region shows slightly less negative projections for APAC, slightly more downbeat numbers for the Americas and roughly similar expectations for Europe. Within APAC, China performs relatively strongly on the forward looking metrics albeit that values are still anticipated slipping over the period in question. In contrast, respondents remain more cautious about the outlook for Hong Kong partly because of ongoing political issues and India; in the former, rents are expected to fall by more than 7%.

In terms of Europe, the expectations numbers are weighed down by the UK, which currently displays the weakest projections for both capital and rental values across the continent. Switzerland is at the other end of the spectrum with more modest declines anticipated over the course of the next

Chart 1: Global Commercial Property Sentiment Index*



Source: RICS, LaSalle Investment Management

*The Global Commercial Property Sentiment Index is a weighted composite measure capturing overall market momentum, encompassing variables on supply, demand, and expectations

Survey responses were supported by AFIRE, APREA, RISM, SCSI and Iberian Property

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twelve months. In the Americas, the US is driving the weaker numbers while in Middle East and Africa, feedback from the UAE remains particularly downbeat with rents expected to decline by a further 9%.

Sector performance becoming more divergent

Past surveys have highlighted a worsening trend in the retail sector in many but not all parts of the world in response to the rise of ecommerce. The latest results suggest that this pattern has been exacerbated by the lockdown imposed in a large number of countries in response to the spread of the coronavirus. Demand for retail space at a global level fell sharply in Q2 (net balance of -81%) with the reading in the US reaching -98% (implying almost all respondents saw retail tenants reducing demand for space over the period). Alongside this, there was a sharp reduction in appetite to take up office space with a much more modest decline in the industrials/logistics sector.

Looking forward, the twelve month rent expectation indicator suggest a combination of cyclical weakness and structural change will continue to weigh particularly heavily on the retail sector as well as increasingly on offices. By way of contrast, the reading for industrials/logistics has returned to positive territory at a global level but this masks significant differences at a country level with the US and Germany likely to be amongst the stronger performers.

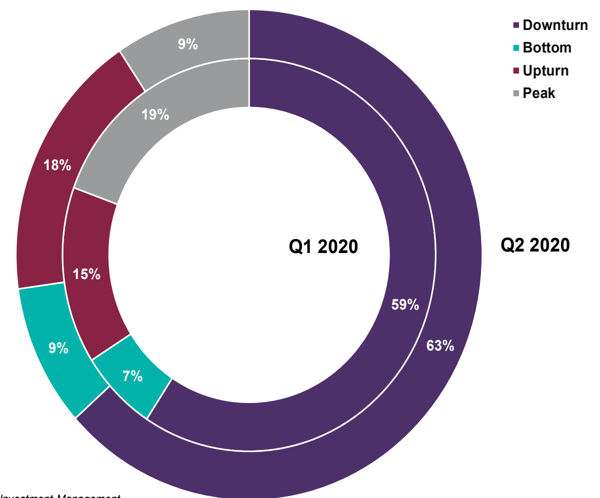
Survey respondents were asked to what extent they envisaged the footprint of the office estate being scaled back over the next two year. At a global level, over 50% indicated that it would be by up to 10% with around one-third suggesting that it would be greater than this; only 14% judged there would be no change. For the Americas, just 10% indicated the office foot print would be left unchanged. Alongside this, respondents also indicated they envisaged a shift in office space from urban to suburban locations as another aspect of the fallout from Covid. The global results show 10% viewing this as a strong trend, 50% saying it will happen to some extent with 40% pushing back on the notion.

Meanwhile, in a new question designed to capture expectations for capital and rental value for a range of alternative asset alongside mainstream sectors, data centres consistently receive the most positive feedback with little change anticipated over the next year. Meanwhile, hotels in contrast are projected to remain under considerable pressure.

Higher demand for health and wellbeing

One other aspect of the post-Covid world is that greater emphasis will be placed on health and wellbeing in the workplace. 89% of respondents agreed this was likely. However at a global level only around one-third of respondents felt that tenants would be willing/able to shoulder the cost of paying for the required enhancements. Significantly, more respondents from the Americas answered in the affirmative to both questions. It is also noteworthy that AFIRE contributors had a stronger belief that tenants would be willing to shoulder more of the cost burden which may reflect in part the premium nature of the properties owned by many of their members.

Chart 2: Perceptions of phase of cycle



Source: RICS, LaSalle Investment Management

Chart 3: Commercial property sentiment by country Q2 2020

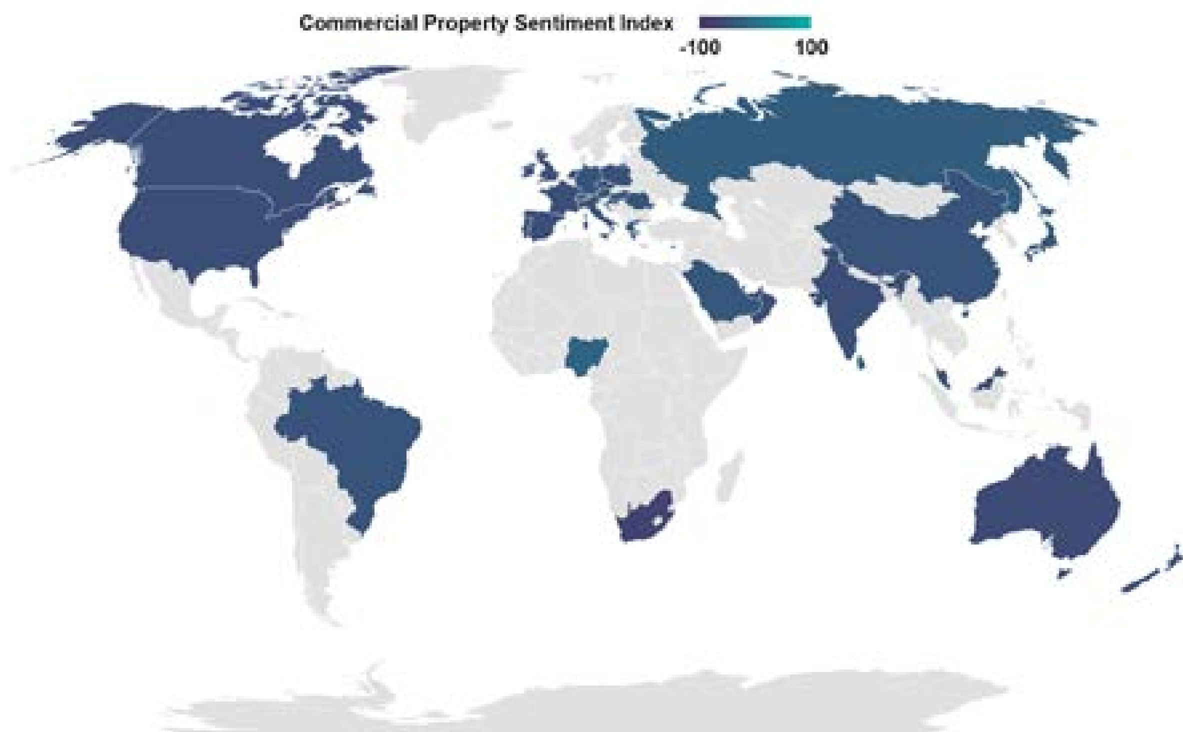


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Chart 4: GCPM Twelve Month Expectations

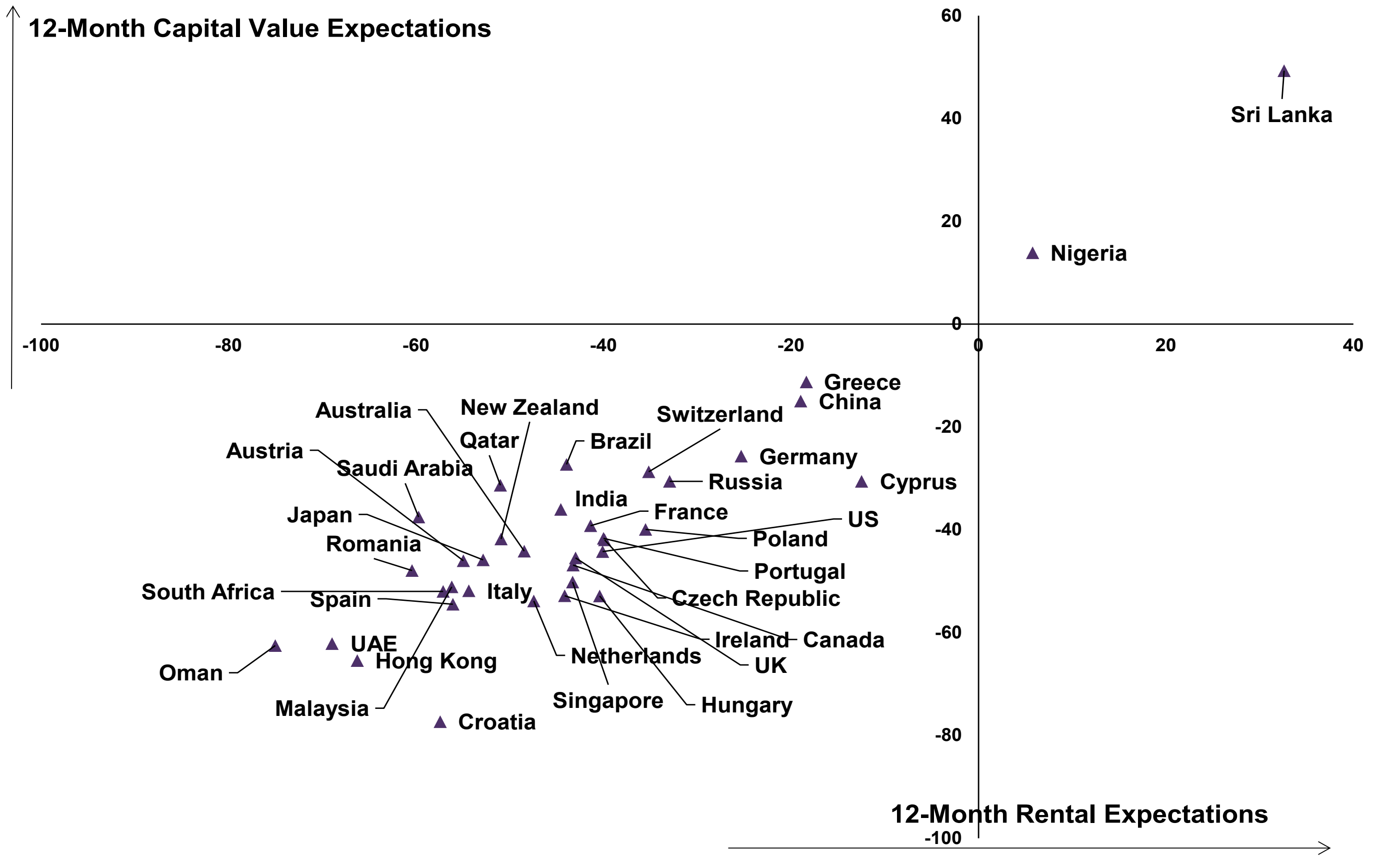
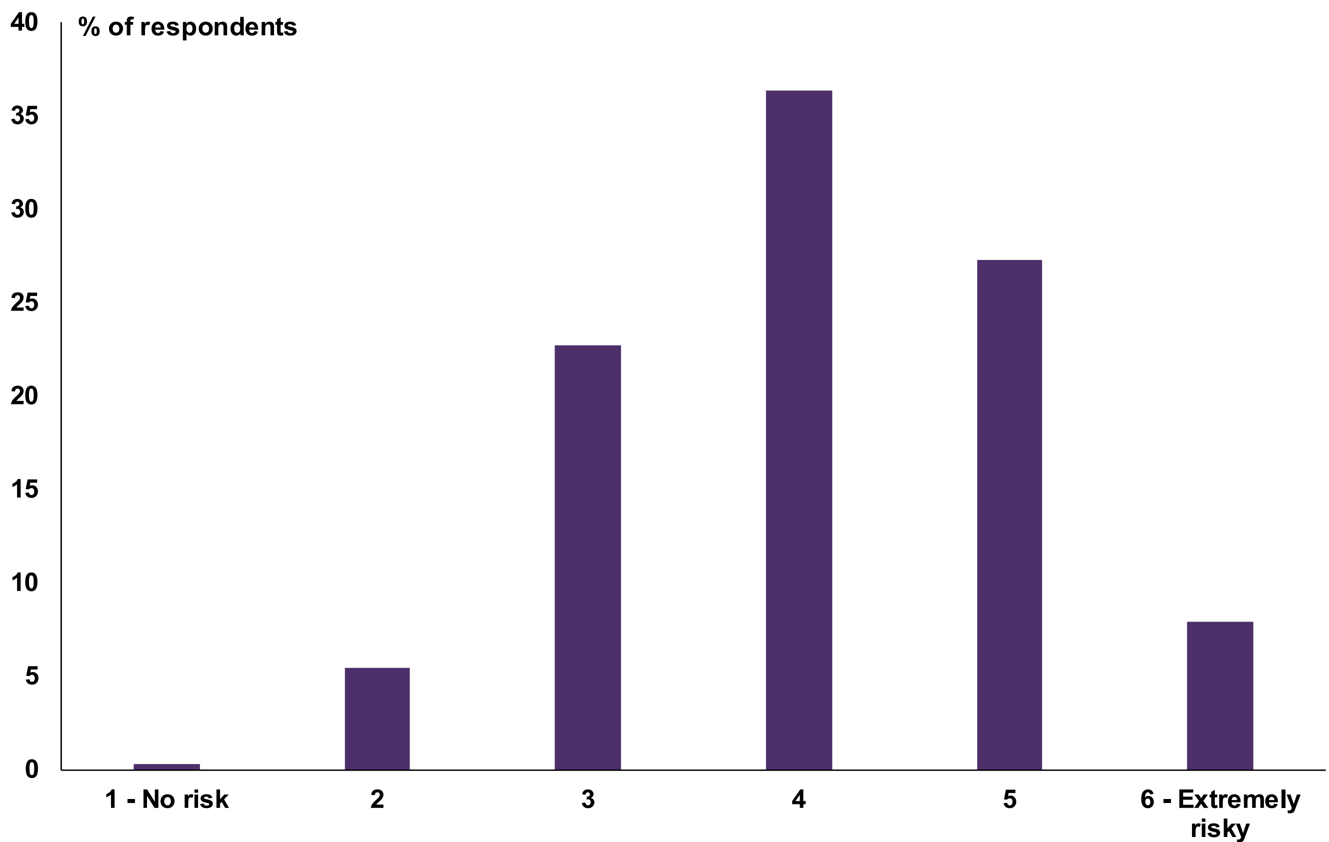


Chart 5: RICS-AFIRE Perceptions of risk on CRE returns



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Regional Comments from Survey Participants in the Americas

Canada

The Calgary Alberta market has been impacted by the COVID-19 pandemic, but underlying economic conditions were not favourable previously and will be doubly impacted by the ongoing energy sector volatility, which will impact office tenant demand and the overall stability in the Calgary economy.

Prior to the COVID-19 pandemic small town Alberta was already beginning to struggle as a result of the oil industry taking a hit. While we have had very few cases here most people are being very cautious and retail businesses are not doing well. The exception is one of our grocery stores which has provided service above & beyond expectations during the past 3.5 months and is busier than before!

The jury is out but in a 1% vacancy market and significant institutional ownership, a downside scenario is significantly moderated in it's effect in the short term.

Industrial is still the "darling" of the real estate industry in Toronto. Occupancy is at overall 97% to 98% and demand is equal to or greater than supply. Rents for industrial in the GTA (Greater Toronto Area) are still likely to increase by 12% to 15% annually for the next several years. Office is strong, with several new towers getting ready to come on stream. Many new ones were around 65% to 80% pre-leased. The pandemic will have a small impact evidenced mostly by a delay to take up space.

United States

Capital market shifts take a while to be reflected in general market sentiment. So while there is significant negative sentiment around rents and values, actual rents and sales prices may still be contractually fixed and we won't see COVID-related outcomes until the next half of the year.

Office space will be reconfigured for social distancing and remote work & hotel schedules will keep space about the same. Apartment rents & occupancy will decline moderately..

The post COVID recover is likely to be uneven across markets and property types. Expect a slow growth and low yield environment for a long time to come.

Markets are impacted by performance related issues   In certain sectors, cap rates may decline in the near term- impacted by rental relief and collection issues.

Orlando is rather unique with over nearly 100 million visitors annually from around the world that will not be coming back at the same levels for the foreseeable future, which has disrupted the lodging, retail, convention and air travel business significantly, with expectations of a slow recovery on the horizon - Orlando will be one of the last communities in the US to recover.

Secondary market, US State Capital region location. Retail has experienced the vast majority of the economic fall out of the pandemic and the ripples are broad. The office market is in pause but occupiers are not in panic. The industrial market remains steady and the brief pause has expired.

We are currently in the heavy financial intervention stage of a market that has no real insight as to what the economy will look like post July. The key factors are how long will loan forebearance be permitted by the bank/insurance regulators and what the ultimate drag on the economy from slow recovery portions (travel, hospitality, entertainment, leisure) will be on GDP, employment, spending and loan payments. I believe there is more pain to come and therefore, CF projections are at risk.

Scary, especially for retail.

Trindad and Tobago

The impact of CovID19 has had a debilitating effect on the economy, and is expected to continue to dampen the level of demand in the real estate market across all sectors going forward.

I expect that the Trinidad & Tobago, as well as the broader Caribbean markets, would more or less remain flat. Already sales within the residential market are down as the economy continues to struggle. The oil and gas sectors have been fragile, and there is no sign of a quick recovery. We do not anticipate any real growth in the housing market for the remaining half of 2020. The retail and industrial sectors are expected to remain dormant for the remainder of 2020 and perhaps 2021.

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Regional Comments from Survey Participants in Asia Pacific

India

The Bangalore market appears to be reviving on the housing demand, with a sharp reduction in retail loan lending rates. The affordable and mid-end houses are the major benefactors of this move. Organized retail, hospitality and leisure will see a subdued demand over the next 2-3 quarters.

The vacancy rate of office space may increase for a period of 12 to 15 months due to Covid-19, however, no business can be fully functional without an office space. So, there is no need to panic. Demand will rise gradually once situations will come to normalcy. There is a market for every property at particular pricing. The right buyer/lessee profile needs to be targeted. Eg: The client who is currently using 5000 sqft Office may be a prospective client for a 2000 sqft office space.

The real estate market is slow on account of the pandemic and prevailing uncertainty. The time is ripe for investors with good risk appetite with probable higher returns when market recovers over next 2-3 years. The drop in real estate demand should be seen as only a temporary phenomenon during this time of uncertainty and the prices will bounce back once the pandemic is over. The time for recovery is fully dependent on the time taken for invention of a vaccine or suitable cure for Covid-19.

Demand for office space may enter a challenging period over the next 12 months

Hong Kong

The next few months should indicate to what extent the effect of COVID-19 on the real estate market has already been priced in. I expect that H1 2020 will see the biggest market movements in Hong Kong, with H2 seeing a more gradual decline as the situation starts to stabilise.

The usage of A.I. especially now under the Covid-19 stands to reshape the mode of working and living globally

Singapore

Markets are hit badly due to the global epidemic COVID-19 which has caused many sectors and re-think, re-strategize, re-structure their capital, re-position to survive and to compete in the current market. Recovery is expected to happen in times to come after the market correction.

The market is going through a state of uncertainty and disruption making it very difficult to forecast future investment and demand. However, the trend that is emerging is a reduction in office and retail, but an increase in industrial.

Malaysia

The Malaysia property market has been softened since 2017 due to overhang property. The soft sentiment will be further affected by the pandemic and global geographical tensions and instability.

Many retail businesses rely on tourists. After international travel was banned, despite landlords provide discount in rental during lockdown period for covid 19, a lot of tenants especially those in retail sector terminated the tenancy immediately after the lockdown was lifted. We anticipate the retail sector will remain soft for the next year.

China

There is huge supply coming on stream amid uncertain global economic conditions. Shanghai will do better than other places as it is the financial hub of China.

The impact of the epidemic is very serious with commercial real estate facing substantial rent reductions.

Australia

Covid-19 has had a significant and at times devastating impact on Sydney property markets. Retail has been hardest hit of all. The impact on commercial is yet to be fully appreciated, however, demand for space is likely to fall with a greater trend to employees working off-site either permanently or for several days in the week. Industrial has seen the strongest performance and will likely be seen as a safe haven.

Major/chain retailers driving hard bargains for rent reductions and relief. Industrial seems to have had less impact that office and retail. Specialist property types are dependent on individual demand and potential for property to be multi-functional

New Zealand

QE seems likely to maintain or firm capitalisation rates in at least the short term. Scrutiny will need to be on sustainability of revenue streams - what is it we are capitalising.

Flight to prime. Capital Values for long let assets with strong tenant covenants will continue to rise in this low interest rate environment.

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Regional Comments from Survey Participants in EMEA

Cyprus

Unprecedented conditions whose outcome is difficult to predict. Instinctively, I would expect this Covid-19 downturn to have a short-lasting direct effect (demand, investment etc). I do expect lasting indirect effects, though, as the period has, somewhat, altered attitudes towards the very notion of real estate and its need and purpose.

France

Covid-19 has been a big accelerator of existing trends -specifically for consumer behaviour. Logistics, last mile, single-family housing and data centers emerging as the winners. Low interest rates will continue to support ongoing strong inflows into the real estate asset class - supporting valuations in general.

Greece

The Covid-19 crisis apparently appears to be deeper than initially estimated. In this context real estate is likely to share part of the burden of the economic pain in the short run, but it can be prove more resilient in the long run given its defensive nature.

Germany

Non-food retail sectors and hotels are the sectors primarily affected.

Hungary

Everyone is hesitant, waiting to see if there will be another wave of Covid-19.

Ireland

It is early days to fully assess the fallout from businesses closing since March that are only reopening now. The true picture will emerge in mid/ late Sept this year in terms of their future survival commercial vacancy numbers, demands for office, industrial and retail. The property market is all about confidence and uncertainty is its worst enemy. At present uncertainty is prevailing day by day about the economy , a second wave of Covid-19, unemployment. Many agents have reported busy periods in May and June dealing with the pent up demands and the surge of activity built up over the March /Apr period. However, there are signs this is now petering out somewhat.

Italy

Despite the crisis, real estate sectors saw an acceleration of existing trends, rather then a disruption.

Nigeria

Upon the backdrop of the current global health challenge, the commercial aspect of real estate development and investments such as offices, open plan space, mall etc could see contractions in value due to the trendy adoption of virtual or remote alternative to physical work space arrangements

Poland

Core market has proven resilient to the crisis triggered by the pandemic with the exception of the hotel sector.

Portugal

We will need two years to recover from the Covid-19 impact.

Romania

Bucharest is experiencing aggressive commercial term renegotiations from the tenants' side or a search for "good deals" in the market. This is despite the fact that most tenants are still in the fog in regards with their own business perspectives. The landlords problem is that most office buildings are shaped in a way that makes them easy to lease and/or sell, while almost none of them are designed to in a way that is easily adaptable to fit new requirements following the Covid-19 pandemic.

Spain

Covid-19 has had a devastating impact on commercial values in Spain. E-commerce is now a major threat for retailers.

South Africa

There will be an increase in vacant office CBD space as companies look for office space in less crowded areas dueto Covid-19.

UAE

The market is extremely fragile and investors are looking for cash buys at distress prices. The demand for office space will not drop, but surely the demand for smaller office space with a hybrid work culture will come in place.

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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 12 June 2020 with responses received until 13 July 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 2083 company responses were received, with 496 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 Malaysia were collated in conjunction with the Royal Institution of Surveyors Malaysia. Responses in the Americas were collated in conjuction with the Association of Foreign Real Estate Investors.

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. The Commercial Property Sentimet Index is an unweighted average of the OSI and ISI. Regional indicators are weighted using estimates of the stock of commercial property provided by LaSalle Investment Management, and are adjusted on an annual basis.

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