Jones Lang LaSalle

Real value in a changing world

/pulse/

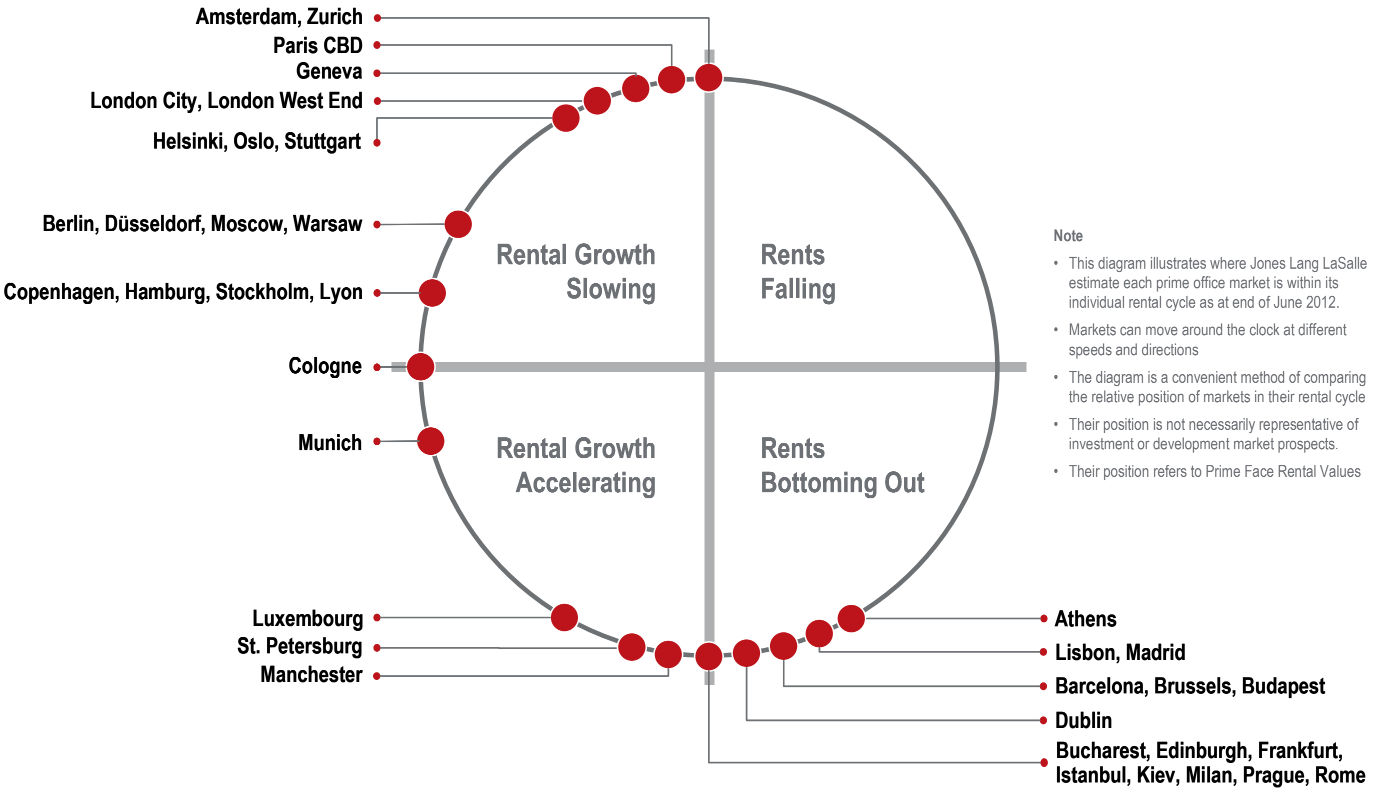
The Jones Lang LaSalle Office Property Clock - Q2 2012

European office rental struggle amidst subdued demand

The European rental index records a second successive modest fall (-0.2%)

The European vacancy rate remained unchanged at 9.8%

The Capital Value Index increases as yield compression in core markets compensates for weak rental conditions



Note
- This diagram illustrates where Jones Lang LaSalle estimate each prime office market is within its individual rental cycle as at end of June 2012.
- Markets can move around the clock at different speeds and directions
- The diagram is a convenient method of comparing the relative position of markets in their rental cycle
- Their position is not necessarily representative of investment or development market prospects.
- Their position refers to Prime Face Rental Values

Source: Jones Lang LaSalle IP, July 2012

The clock diagram illustrates where Jones Lang LaSalle estimates each prime office market is within its individual rental cycle as at end of June 2012. Markets can move around the clock at different speeds and directions. The diagram is a convenient method of comparing the relative position of markets in their rental cycle. Their position is not necessarily representative of investment or development market prospects. Their position refers to prime face rental values. Markets with a "step pattern" of rental growth do not tend to follow conventional cycles and are likely to move between the "hours" of 9 and 12 o'clock only, with 9 o'clock representing a jump in rental levels following a period of stability.

European Office Occupational Markets

The gradual recovery of the European office market has stalled somewhat as progress towards a sustained solution of the Eurozone debt crisis remains turgid. The supportive Greek election result and some encouraging steps taken at the EU leaders' summit in June have so far failed to impress markets. 2012 GDP forecasts for the Eurozone show a weak picture and unemployment has reached the highest level since the Eurozone was formed. The picture remains mixed, with markets like Greece, Portugal, Spain and Italy continuing to struggle. Markets such as Germany and the Nordics, which showed sustained and solid performance over 2011 and are still expected outperform Eurozone averages, are however also expected to experience a slowdown. As a convincing solution to the economic challenges seems unlikely in the near term, office demand will remain weak with any upturn delayed.

Prime office rents witnessed a marginal reduction for the second successive quarter. Again, changes in individual markets nearly cancelled each other out, with the European Office Index showing a negative quarter movement (-0.2%) following last quarters decrease (-0.1). Rental changes were only recorded in Western Europe, with rents in the CEE region remaining unchanged. Over the quarter, prime rents increased in Düsseldorf (+4.2%) and Berlin (+2.3%), whereas decreases were recorded in Dublin (-6.5%), Madrid (-2.0%), Barcelona (-1.4%) and Paris (-1.2%). For the first time since Q1 2010, European prime rents stand slightly lower in an annual comparison, albeit by only -0.1%. The Jones Lang LaSalle office clock illustrates the increased polarisation of European markets, with markets that saw conditions recover in early 2010 now increasingly moving towards 12 o'clock, whereas markets that have experienced continual headwinds since 2008 remaining around the 6 o'clock position. Key inner-city locations with good accessibility remain highly sought-after and should support prime rents. However, until demand picks up markedly, prime rental growth will remain a function of supply.

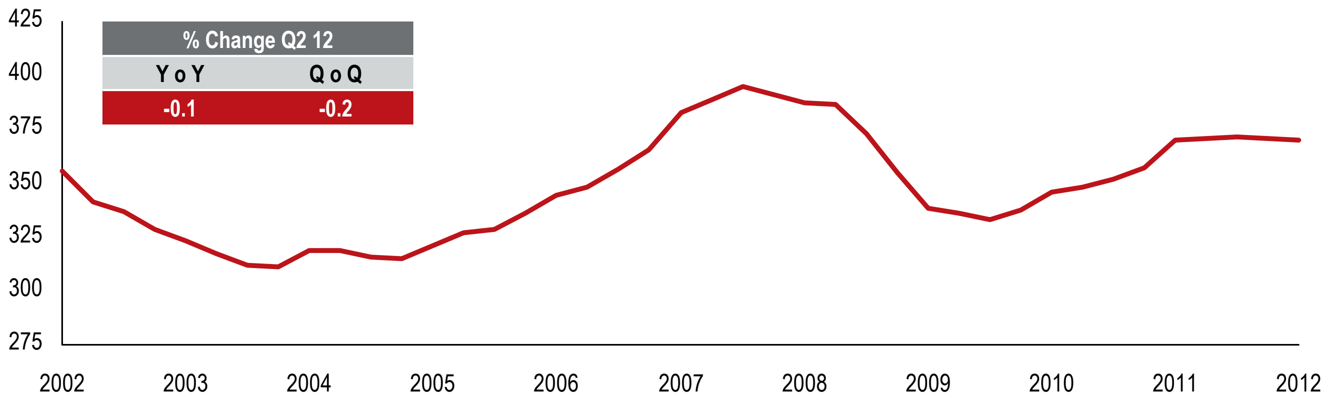
Leasing activity actually increased by 5% quarter on quarter, totalling 2.4 million sq m. However this was 14% below the level of the second quarter of 2011 and 12% below the five year average. The CEE markets showed more dynamism, seeing levels rising 15% as all four CEE index markets recorded quarterly improvements. In Western Europe, take-up was up a mere 2% as Paris saw a weak quarter and volumes in London remained almost unchanged. However, Q2 results were strong in Brussels and, while Frankfurt and Düsseldorf saw slightly lower momentum, all other German markets continued to see take-up increase. Expectations for 2012 for Europe as a whole are for slightly lower volumes than in 2011, but remain inline with long term averages.

Occupiers remain cautious and sentiment remains negative. However, across Europe, annual net absorption totalled 3.4 million sq m, a 2% increase over the first quarter. Stronger demand in Moscow and the CEE region overall (+24%) fuelled the European figures, while annual absorption in Western Europe fell 4% over the quarter, driven by negative absorption in Milan and the Spanish markets. Going forward, net absorption for the region as a whole in 2012 and 2013 is expected to remain positive although below long-term average.

The gradual decline in vacancy which started in early 2011 took a pause in the second quarter with the European vacancy rate remaining unchanged at 9.8%. In Western Europe, upward and downward moves cancelled each other out with vacancy unchanged at 9.4%. In CEE, the aggregated vacancy rate decreased (-30 bps to 14.1%). For the rest of the year, vacancy on aggregate is expected to stagnate at the current level. Beyond 2012, declines in vacancy are expected to resume, although only at slow pace until there is a meaningful improvement in jobs growth and office demand.

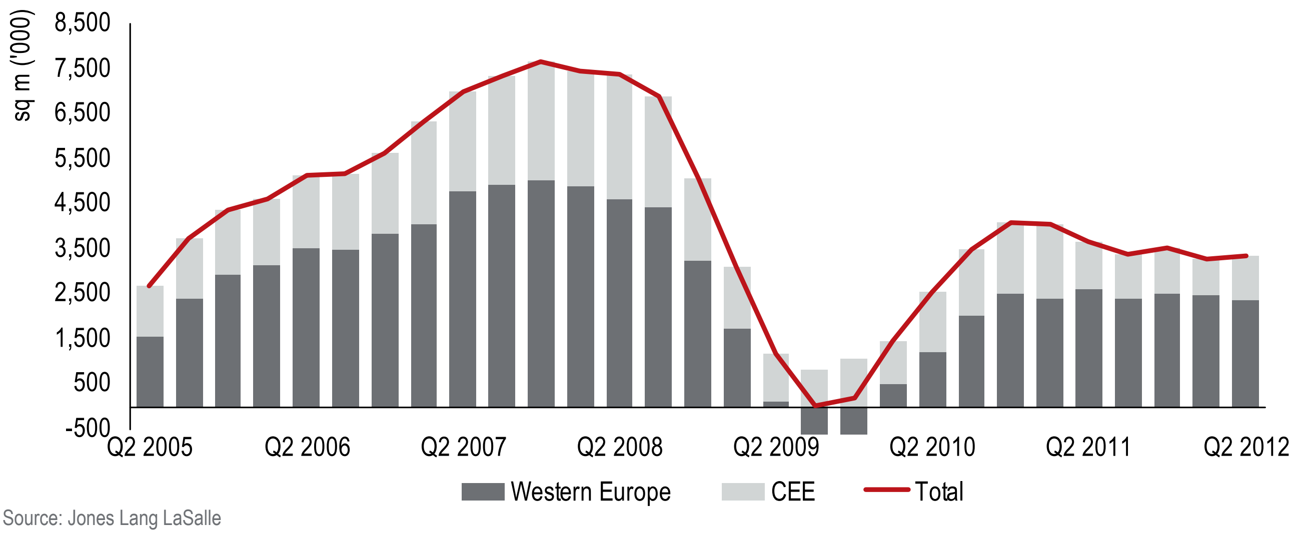
The decline in vacancy rates has been supported by the sluggish development response. Completions increased by 44% over the quarter to 0.9 Mio sq m. However, this is still 35% below the 10 year average. Going forward, completion levels are expected to improve, however with debt constrained, development activity is expected to remain below long term averages in 2012 and 2013.

Prime European Office Rental Index



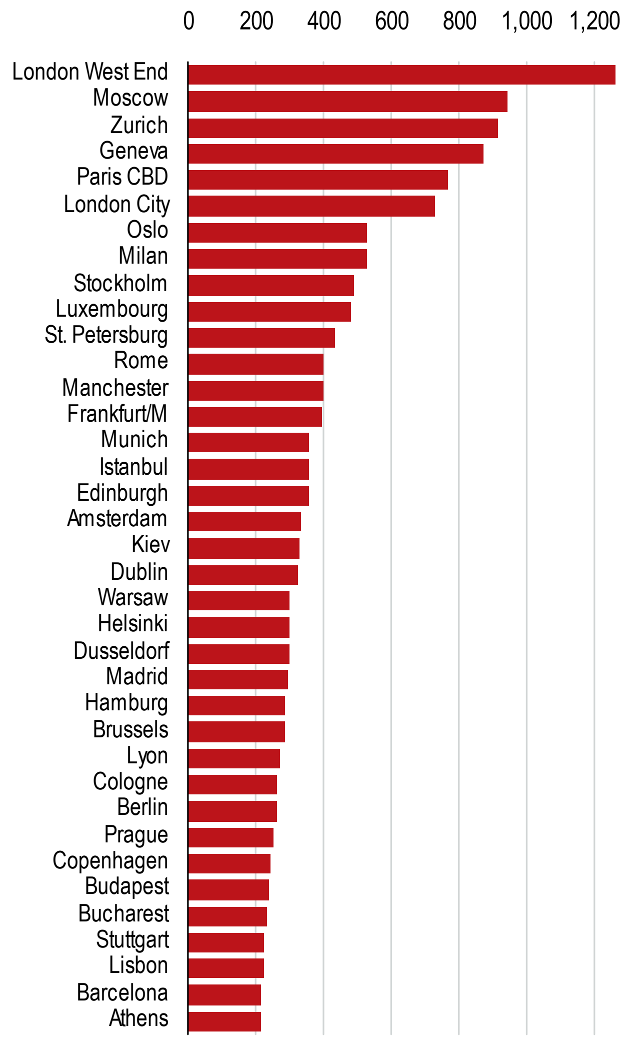
Weighted Nominal Rental Trend, 1980 = 100
Source: Jones Lang LaSalle

Annual Office Net-Absorption



Source: Jones Lang LaSalle

Prime Office Rents Q2 2012 (EUR / sq m pa)



Source: Jones Lang LaSalle

Prime Office Rents and Rental Change Q2 2012

	EUR / sqm pa	% Q-o-Q		% Y-o-Y	
Europe		-0.2	▼	-0.1	▼
Amsterdam	335	0.0	▶	0.0	▶
Athens	214	-8.5	▼	-20.7	▼
Barcelona	216	-1.4	▼	-4.0	▼
Berlin	264	2.3	▲	4.8	▲
Brussels	285	0.0	▶	-8.1	▼
Bucharest	234	0.0	▶	2.6	▲
Budapest	240	0.0	▶	0.0	▶
Cologne	264	2.3	▲	2.3	▲
Copenhagen	242	0.0	▶	0.0	▶
Dublin	323	-6.3	▼	-9.1	▼
Düsseldorf	300	4.2	▲	6.4	▲
Edinburgh	359	0.0	▶	-1.8	▼
Frankfurt/M	396	0.0	▶	0.0	▶
Geneva	874	0.0	▶	0.0	▶
Hamburg	288	0.0	▶	4.3	▲
Helsinki	300	0.0	▶	2.0	▲
Istanbul	360	0.0	▶	0.0	▶
Kiev	331	0.0	▶	0.0	▶
Lisbon	222	0.0	▶	-2.6	▼
London City	732	0.0	▶	0.0	▶
London West End	1,264	0.0	▶	0.0	▶
Luxembourg	480	0.0	▶	5.3	▲
Lyon	270	0.0	▶	0.0	▶
Madrid	297	-2.0	▼	-6.6	▼
Manchester	399	0.0	▶	5.3	▲
Milan	530	0.0	▶	1.9	▲
Moscow	946	0.0	▶	0.0	▶
Munich	360	0.0	▶	0.0	▶
Oslo	530	2.6	▲	11.1	▲
Paris CBD	770	0.0	▶	6.2	▲
Prague	252	0.0	▶	0.0	▶
Rome	400	-4.8	▼	-4.8	▼
St. Petersburg	433	0.0	▶	0.0	▶
Stockholm	491	0.0	▶	4.9	▲
Stuttgart	222	0.0	▶	2.8	▲
Warsaw	300	0.0	▶	0.0	▶
Zurich	916	0.0	▶	0.0	▶

Note: Q-o-Q and Y-o-Y rental change is based on the local currency.
Source: Jones Lang LaSalle

European Office Capital Values

After a slow first quarter with the markets taking a breath after a very active Q4, overall investment volumes totalled EUR 27 bn, an increase of 17% and 4% above the same quarter a year ago. Over the quarter, volumes in the UK market increased by 43% driven primarily by the London office market, in addition to several large portfolio transactions. On the continent, equity is targeting core markets such as France with Paris being the specific target, as well as Germany and the Nordics. In contrast, more peripheral markets are struggling, with Southern Europe seeing only limited transactions. Overall, the market continues to be heavily skewed towards the prime segment and primarily income driven with a long term investment horizon.

Office transactions accounted for around EUR 15bn, an increase of 11% over the quarter and 10% compared to Q2 2011. As for the overall market, investor interested remains focused on highly liquid core markets with the UK, Germany and France accounting for more than 70% of the office investment volume. Activity was particularly strong in France, where volumes more than doubled. However, Germany saw activity slightly fall, caused to an extent by a lack of prime stock as opposed to a lack of demand.

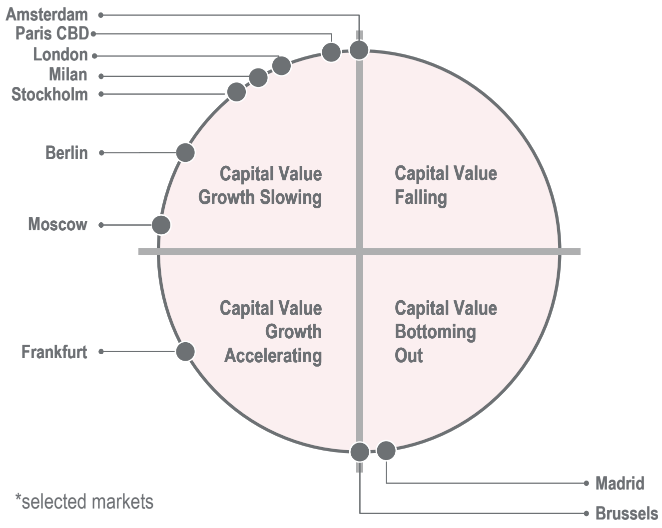
The weighted European office yield compressed by a mere 2bps over the quarter to stand at 5.25%. The strong interest in prime product led to further prime yield compression in a few German markets (-25 bps in Düsseldorf and Munich, -10bps in Hamburg) as well as in Stockholm (-25bps). In contrast, yields moved out in Edinburgh (+25bps) and Lyon (+10bps) as investors favoured the more liquid centres. Yields also moved out in the Spanish markets (+25 bps) as investor concerns over the economic outlook grew. Yields in the CEE markets were unchanged.

Despite the slight rental decline on aggregate, the yield performance led to a modest quarterly increase in capital values of 0.4%. Of the 24 index markets, six saw capital values increasing, while they dropped in five markets. The drivers vary: Capital value changes in Berlin, Dublin and Paris were based on the rental performance, whereas movements in Edinburgh, Lyon, Hamburg, Munich and Stockholm were based entirely on yield shift. And while Düsseldorf benefited from both rental growth and yield compression, the opposite was true in the Spanish markets with both rental and yield numbers worsening.

Looking ahead, there is a potential for increased investor activity as very low government bond yields increase the attractiveness of real estate and overseas capital continues to flow towards perceived safe havens. However, with banks exiting the commercial lending business, and new entrants only able to provide a fraction of the shortfall, private equity, institutional and high net worth purchasers will continue to dominate purchasing activity.

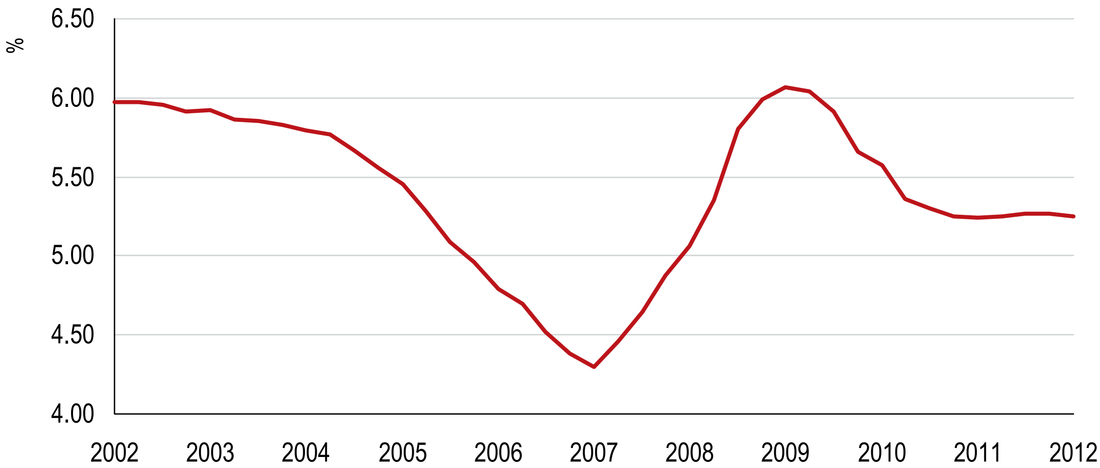
Further yield compression is not expected. Hence, further capital value growth will depend highly on rental growth. For secondary products and non-core m arkets, yields are likely to remain under upward pressure.

Prime European Office Capital Value Clock Q2 2012*



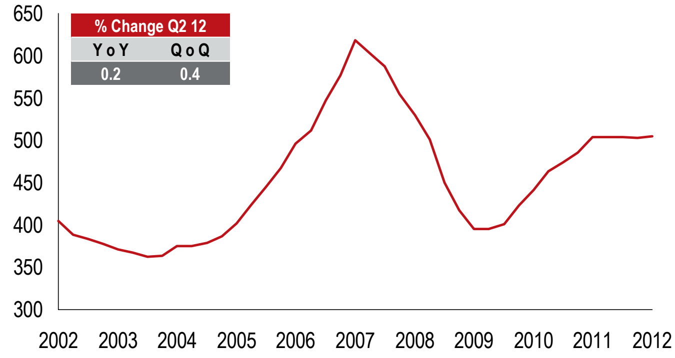
*selected markets

Weighted European Prime Office Yield



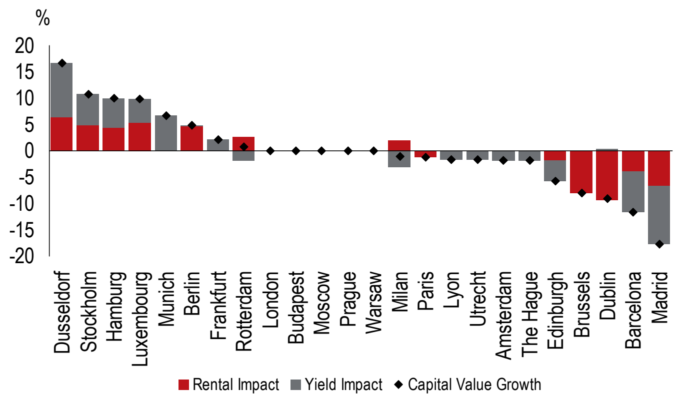
Source: Jones Lang LaSalle

Prime European Office Capital Values Index Q2 2012



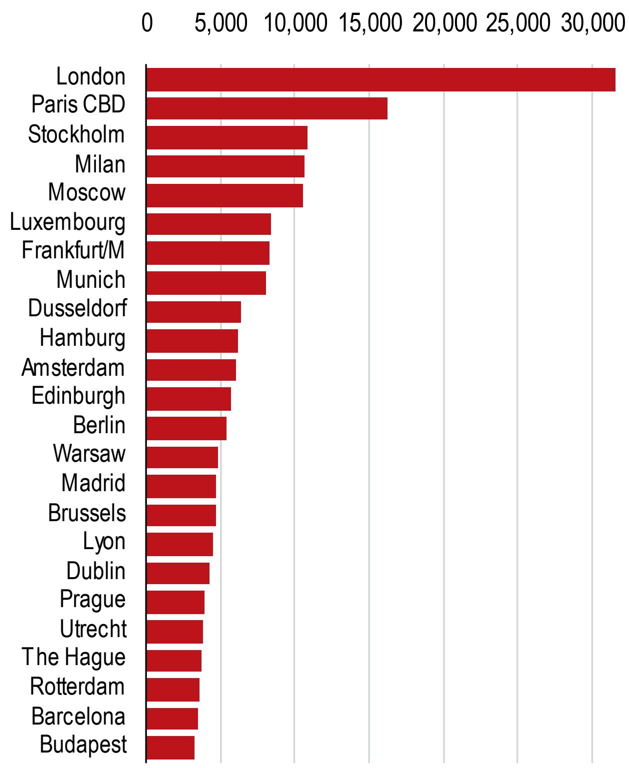
Weighted Nominal Capital Value Trend, 1980=100
Source: Jones Lang LaSalle

Prime Office Capital Value Drivers: 12 months to Q2 2012



Source: Jones Lang LaSalle

Prime Office Capital Values Q2 2012 (EUR / sq m)



Source: Jones Lang LaSalle

Prime Office Capital Values and Capital Value Change Q2 2012

	EUR / sqm	% Q-o-Q		% Y-o-Y	
Europe		**0.4**	▲	**0.2**	▲
Amsterdam	6,036	0.0	▶	-1.8	▼
Barcelona	3,456	-5.3	▼	-11.7	▼
Berlin	5,333	2.3	▲	4.8	▲
Brussels	4,750	0.0	▶	-8.1	▼
Budapest	3,200	0.0	▶	0.0	▶
Dublin	4,304	-6.3	▼	-9.1	▼
Düsseldorf	6,383	9.7	▲	16.6	▲
Edinburgh	5,747	-4.0	▼	-5.7	▼
Frankfurt/M	8,250	0.0	▶	2.1	▲
Hamburg	6,194	2.2	▲	10.0	▲
London	31,596	0.0	▶	0.0	▶
Luxembourg	8,348	0.0	▶	9.8	▲
Lyon	4,426	2.1	▲	-1.6	▼
Madrid	4,752	-5.9	▼	-17.8	▼
Milan	10,600	0.0	▶	-1.1	▼
Moscow	10,511	0.0	▶	0.0	▶
Munich	8,000	5.6	▲	6.7	▲
Paris CBD	16,211	0.0	▶	2.7	▲
Prague	3,877	0.0	▶	0.0	▶
Rotterdam	3,540	0.0	▶	0.7	▲
Stockholm	10,909	5.6	▲	10.7	▲
The Hague	3,717	0.0	▶	-1.8	▼
Utrecht	3,793	0.0	▶	-1.7	▼
Warsaw	4,800	0.0	▶	0.0	▶

Q-o-Q and Y-o-Y rental change is based on the local currency.
Source: Jones Lang LaSalle

Definitions

Prime Rent
Represents the top open-market rent that could be expected for a notional office unit of the highest quality and specification in the best location in a market, as at the survey date. The rent quoted normally reflects prime units of over 500 m² of lettable floorspace, which excludes rents that represent a premium level paid for a small quantity of space. The Prime Rent reflects an occupational lease that is standard for the local market. It is a face rent that does not reflect the financial impact of tenant incentives, and excludes service charges and local taxes. The Prime Rent represents Jones Lang LaSalle's market view and is based on an analysis/review of actual transactions for prime office space, excluding any unrepresentative deals. Where an insufficient number of deals have been made for prime office space, an assessment of rental value is provided by reference to transactions generally in that market adjusted accordingly to equate to prime.

Prime Yield
Represents the best (i.e. lowest) "rack-rented" yield estimated to be achievable for a notional office property of the highest quality and specification in the best location in a market, as at the survey date. The property should be let at the prevailing market rent to a first class tenant with an occupational lease that is standard for the local market. The prime initial net yield is quoted, i.e., the initial net income at the date of purchase, expressed as a percentage of the total purchase price, which includes acquisition costs and transfer taxes. The Prime Office Yield represents Jones Lang LaSalle's "market view", based on a combination of market evidence where available and a survey of expert opinion.

Prime Capital Value
Represents the top open-market capital value (per square metre) that could be expected for a notional office property of the highest quality and specification in the best location, as at the survey date. Prime capital values are derived from prime office rents and prime office yields (net initial): Capital Value = (Prime Annual Rent / Prime Yield) * 100. This method will provide notional gross capital values, i.e. purchase price including acquisition costs and transfer taxes.

Annual Net-Absorption
Represents the change in the occupied stock within a market during one year. Net Absorption is calculated on the basis of "top-down" estimates of occupied stock derived by subtracting vacant office stock from the total office stock of that market. Mothballed stock, i.e. floorspace held vacant and not being offered for letting, usually pending redevelopment or refurbishment, is excluded.

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