Real Estate House View

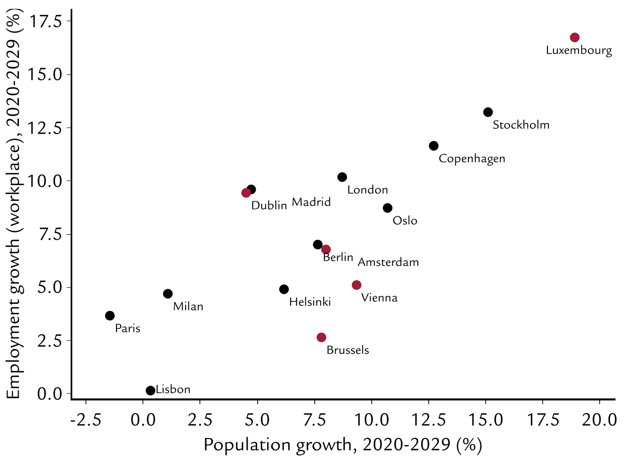
Benelux, Austria, Ireland

Second half-year 2020

Key takeaways

- **Robust investment markets:** transaction volumes in most markets decreased in H1 2020 compared to the same period last year. This was despite a very strong first quarter in most countries. We expect some yield softening over the remainder of the year due to broader economic conditions.
- **Office market transition:** weaker office take-up was evident in H1 due to COVID-19. However, with the exception of Dublin, vacancies remained stable. We do not expect rental growth for the remainder of 2020.
- **Industrial & logistics performance is not all positive:** the logistics sector is experiencing strong occupational demand and a lack of suitable stock, constraining take-up activity. Industrial locations near airports and seaports are likely to suffer from a fall in international trade and the potential relocation of industrial activities.
- **Structural change in retail is accelerating:** the retail sector has been severely impacted by the pandemic. Occupier failures are likely with knock-on implications for rent and availability.
- **Living maintains its strong position:** the residential sector has been resilient in the first half of the year. Strong market drivers should support ongoing investor and occupier demand. An increasing EU workforce supports the case for growing demand for residential units in Brussels.

Chart in focus:



Source: Oxford Economics

Europe's major cities are absorbing rising numbers of residents and jobs in their city centres and the hinterlands, although different spatial development patterns create different growth patterns. For example, Luxembourg has the strongest population growth rate at 19% over the next 10 years, in part because the city centre and the surrounding area form a single administrative unit. In contrast, city centre population growth in Dublin is the weakest at 4.5%, compared to a 13% rise in its hinterland.

The COVID-19 pandemic triggered the deepest recession in decades in all five countries, but the local healthcare systems were not at risk of being overwhelmed at any point in time. Thus, we do not expect a potential second wave to cause renewed national lockdowns. In the short-term, Luxembourg appears most exposed to the risk of a fast acceleration in the number of cases of infections. The debate as to whether working from home becomes a "new normal" is of importance to Luxembourg, as many people working in the region commute from abroad. Austria has managed the pandemic well and its domestic economy has recovered since the reduction in lockdown measures. The manufacturing sector in Austria is closely aligned to the German car industry and highly dependent on global trade. We expect industrial activity to remain below pre-crisis levels for the time being.

Investment remains robust

The investment markets held up better than expected but remained mixed across the region. Investment volumes in Brussels and Luxemburg rose as other markets saw large declines. Overall, investor demand remained buoyant, fuelled by low interest rates, and sound fundamentals in the rental market. Prime yields remained stable across most sectors in H1 2020, but signs of pressure are evident in the retail sector. We expect prime office and logistics yields to stay at current levels for the rest of the year in Vienna and Amsterdam, but to soften in Dublin reflecting economic conditions.

Offices dynamics vary by market

The pandemic led to many office leasing transactions being delayed or cancelled. Leasing volumes decreased in H1 2020 compared to H1 2019 in all markets to varying degrees. Vienna and Brussels recorded declines of roughly 50% whilst take-up in Amsterdam almost matched levels seen in previous year. The slowdown was most severe in Q2, especially in Dublin. Take-up slumped -90% compared to Q1. In contrast, take-up in Brussels picked up significantly led by public sector demand as the local EU public workforce grew. Vacancy rates in Amsterdam, Luxembourg and Vienna remained stable in Q2. In Dublin, weaker demand led to a rise in vacancy rates across the market. In our view, prime office rents in Dublin will see a notable fall this year. Overall, far more incentives than seen in previous years are likely to be included in rental contracts across all markets.

Industrial demand is nuanced

Occupational activity slowed moderately in the major markets in H1 2020. For the logistics sector this had been evident prior to COVID-19 due to a shortage of good quality, modern stock and insufficient levels of new construction. Demand in the manufacturing sector fell over the period whilst demand by online retailers rose. The Dublin market is a good example of a shortage of stock limiting activity. This will be exacerbated by construction delays from COVID-19 impacts, resulting in a marked decrease in take-up compared to the same period last year. There was more resilience in markets in the Netherlands and Belgium, although we expect a fall in international trade to weaken local industrial demand near seaports. Prime rents have remained stable so far but may decline in the year ahead, especially in Dublin.

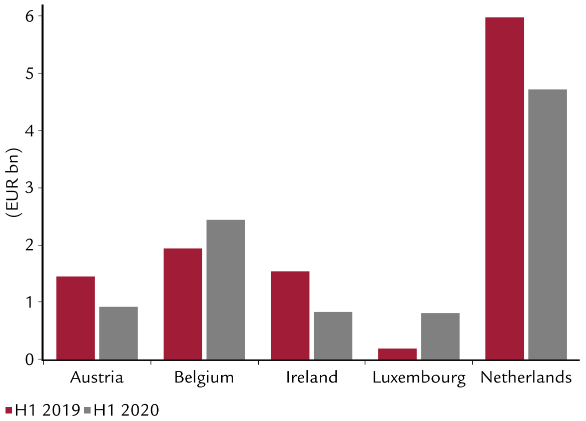
Stronger pressure in retail

Retail has been strongly impacted by the pandemic due to enforced business closures and country-wide shutdowns. This has compounded broader structural changes, impacting physical retail. It is expected that many retailers, restaurants, and pubs will not reopen or become insolvent and vacancy rates will rise. Retailers in large tourist destinations, such as Vienna and Amsterdam, have suffered from a decline in turnover, reducing their ability to pay rents. We predict pressure on rents to remain for at least the rest of the year.

Residential demand endures

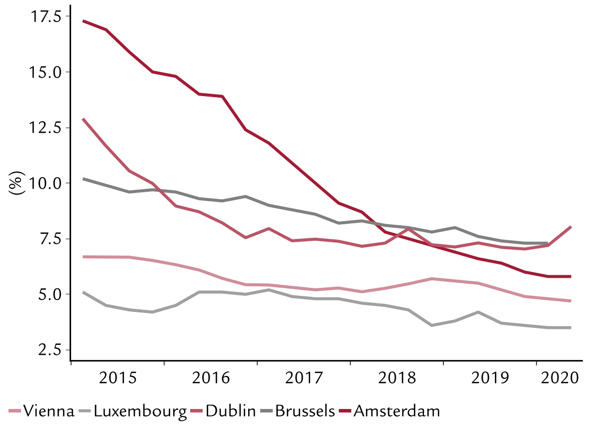
The residential sector has remained resilient over H1 2020. Most landlords have managed to collect due rents. In the Netherlands, for example, just 2% of tenants contacted their landlord to report payment problems. As a result, rents have remained stable and residential sales prices continued to rise. Ongoing lack of stock will support long-term sector prospects in the major cities. In Brussels, rising numbers of EU public workforce are expected which will increase the demand for residential rental units.

Chart 1: Commercial real estate investment volumes



Source: RCA

Chart 2: Office vacancy



Source: PMA

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