Real Estate House View

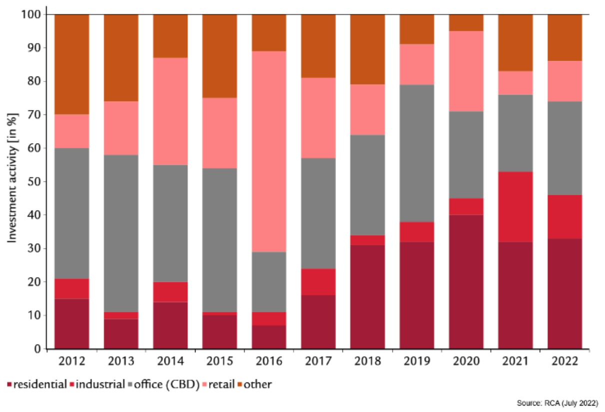
Benelux, Austria, Ireland

Second half-year 2022

Key takeaways

- **Office markets with good start to the year and robust prospects:** Take-up for office space is resilient, particularly in the central locations, and underlines the need for additional modern space, for which there is room for additional rental growth.
- **Prospects on the logistics rental market remain favourable:** Demand continues to exceed supply and is expected to push rents up further, assisted by rising construction costs.
- **Retail may suffer the inflation shock:** The past downward adjustment of rental values signals prospects to seize opportunities across the board. However, in an inflationary context, households are set to tighten their belts which could pressure rental growth potential.
- **The residential sector has a new challenge:** Apart from lower rental growth prospects in both Vienna and Amsterdam due to past steady completions, market fundamentals in Dublin and Brussels remain strong. The key challenges over the short term the rising level of financing and construction costs.

Chart in focus



In recent years, the residential sector has significantly increased its market share of investment activity in Ireland, consistently accounting for over a third of total volume since 2019. Although there are several factors that underpin this demand, one significant market fundamental present across Ireland, Benelux and Vienna derives from the affordability of home ownership. As inflation rises, more strain is put on household budgets, negatively impacting the ability to save for a mortgage deposit. Furthermore, the ECB has begun to tighten mortgage-lending standards making it more challenging to access finance in some markets. As a result, we anticipate occupier demand to increase further, underpinning the continued attractiveness of this sector to investors.

These countries have been affected to varying degrees by the war in Ukraine. Belgium and the Netherlands are playing a key role in making Europe independent of Russian natural gas supplies. The increased production of natural gas or the provision of infrastructure for the import of liquefied natural gas are supporting growth in the respective sectors of the two countries. In Ireland, the Purchasing Managers' Index (PMI) for construction indicates that this sector is already being affected by increased financing costs. Austria, on the other hand, is in a difficult position in securing an energy supply over the coming months and the industry is already facing a slump in incoming orders.

Offices started well in 2022

The office market entered 2022 in good shape. In Dublin, space requirements and job growth announcements in Q1 suggested positive momentum for the year whilst supply is forecast to increase only modestly as delayed projects continue to edge closer to completion. Rental growth forecasts should be robust for the remainder of the year. In Vienna, modern space remains scarce due to restrained construction activity, so prime rents are likely to rise slightly this year. Take-up in Brussels has been steady in Q1, especially in key locations such as the European districts. Overall, the vacancy rates decreased below their 10-year average at 7.8% (PMA), but vacancy remains high in the periphery driven by new completions. Rents are stable, hiding rent-free periods. In Luxembourg, rents stabilised at a historic high; the market has suffered a lot during the pandemic, but the slowdown in completions has prevented the vacancy rates from bouncing back. High-quality office space in central locations is at the core of demand in Amsterdam, e.g. from the (fin)tech industry. Construction activity is high, and vacancies are rising slightly, but modern space is needed and some upward movement in prime rents can be expected.

Logistics still on the up

Demand outweighs supply in all markets, keeping vacancy rates low at roughly 1% and pushing rents up, as Q1 2022 indicates. Completions are substantial, particularly in Dublin, with 200 00sqm of stock delivered in 2022 and 220 000sqm. in 2023. In the Netherlands, a shortage of land is driving demand and construction activity outside logistics hotspots such as Rotterdam and Amsterdam. In 2022, the majority of developments will be located outside of these hotspots, helping rental growth in peripheral markets. Moreover, build cost increases, for example in +5.2% Belgium in Q1 2022 compared to the previous quarter, may cause rental inflation as developers protect their margins. An economic slowdown may weaken rental markets in the medium term.

Retail on the edge

The downward adjustment in rental value levels in double digits could have been a driver to revive demand in Amsterdam, Vienna, Brussels and Dublin. In Vienna, new concepts and retailers have flourished and are ebbing the vacancy rates. However, letting activity across all submarkets, from high street to shopping centres may face new headwinds triggered by the high level of inflation across the board. In the shopping centre spectrum, more specifically in Belgium and the Netherlands, the effort ratio has increased again, meaning that landlords and tenants will have to find a “win-win” solution in the short term. Conversely, out-of-town retail parks with flagship hard discounters are set to remain in better shape. On high streets, the bounce-back of tourism in H1 2022 is set to be short-lived as households are likely to tighten their belts. The current vacancy rates in double digits might not ebb quickly. Finally, the rising financing costs are preventing any opportunistic strategies. The rallying shout for investors will be a ‘wait-and-see’ stance given potential new moves on cap rates.

Residential new challenge

Rental growth prospects may moderate compared to previous expectations. In Vienna, the forthcoming supply, in line with steady past developments, will act as a brake while in Amsterdam, high inflation is pressuring the affordability ratio in the short term. In Brussels and Antwerp, the build-to-rent (BTR) sector has been key in boosting the supply and in Dublin this has accounted for one third of the supply over the past five years. In Dublin, demand outstrips supply and forward funded projects achieve 25-50 bps yield spread against income-producing assets. However overall, a key challenge remains as to how developers handle the rising cost of both construction and financing. This could turn into an opportunity for cash-rich investors.

Chart 1: Office vacancies

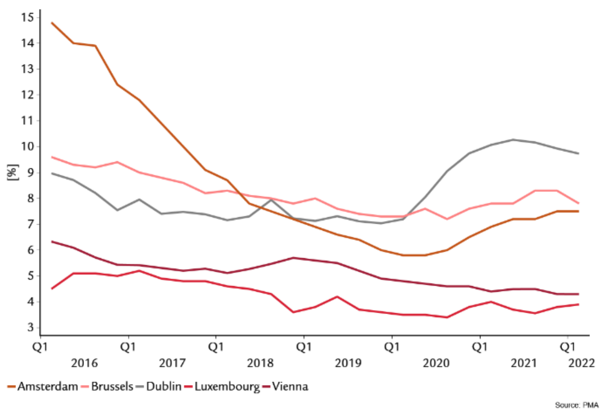
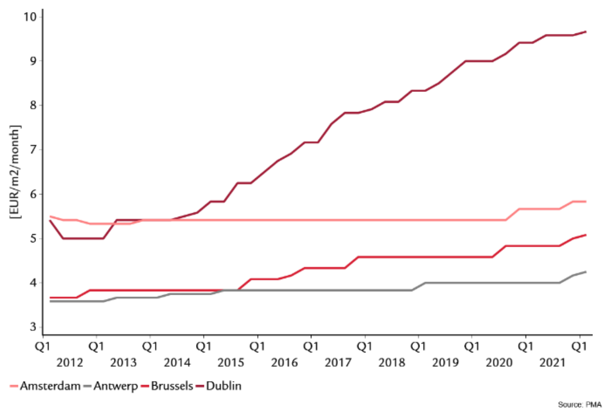


Chart 2: Logistics prime rents on upward path



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