

EUROPEAN COMMERCIAL PROPERTY UPDATE

24th Nov. 2011

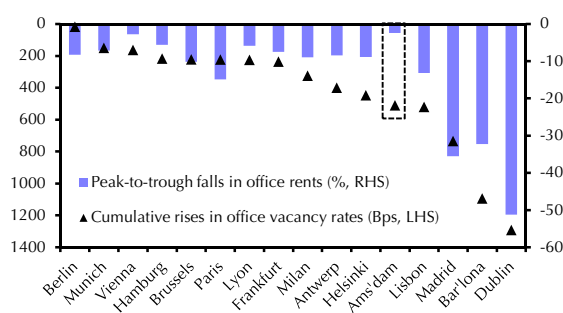


Amsterdam retail rental outperformance won't last

- Retail rental value growth in Amsterdam over the past year has been strong relative to other euro-zone markets and also relative to the office sector. In our view, there is little justification for the retail market's outperformance and, in fact, we think that rising unemployment together with falling consumer confidence and retail sales will rapidly bring the trend to a halt.
- In Amsterdam, over the past year, prime retail rental values have increased by about 8.5%, but prime office rents have barely risen at all. This means that Amsterdam is among the leading euro-zone property markets for retail rental value growth, but among the laggards for office rental value growth. This raises the question of why there is such a wide divergence between these sectors.
- We think the fact that Amsterdam office rents have barely risen is unsurprising. **After all, during the recession, despite the office vacancy rate increasing from 11.7% to 16.8%, the total decline in office rents, at about 2.5%, was the smallest in the euro-zone.** (See Chart 1.) At the time, we argued that weak rental growth in the years leading up to the recession and fairly resilient underlying occupier demand helped to explain why Amsterdam office rents held up so well.
- However, another key factor behind the resilience was the widespread use of rental incentives. **This means that even if the health of the office occupier market improves markedly, the incentives are likely to have to be unwound (thereby raising effective rents) before headline rents begin to increase.** But based on data for the first 9 months of the year, take-up in 2011 looks unlikely to match 2010's level and, at below 200,000sqm, will be only about half of the 2000 to 2008 average.
- For the retail sector, the resilience of rents throughout the downturn was at least partly justified by the resilience of the Dutch labour market. Yet more recently, strong growth in retail rents has coincided with rising unemployment and falling household spending. **Indeed, the unemployment rate has risen from 4.1% in June, to 4.8% in October, its highest level since February 2006. Meanwhile, recent national accounts data show spending fell by 0.2% q/q in Q3, the third consecutive quarterly decline.**
- What's more, the Dutch consumer confidence index has plummeted by more than 27-pts since February, with particularly sharp falls coming through in the last three months. **This has left the index more than 20-pts below its long-run average and consistent with continued annual falls in retail sales volumes.** (See Chart 2.) And a renewed tightening of consumer credit will only worsen the situation.
- Thus, we see little prospect for the strong performance of Amsterdam retail rents to be sustained. **Indeed, our central view is that retail rents will stagnate for the next two years. But with rising unemployment and deteriorating consumer confidence, the risks to our forecasts are to the downside.**
- For offices, despite there being nothing in the development pipeline, we think weak occupier market activity will keep the vacancy rate relatively high for the foreseeable future. Hence, it may be some time before incentives are unwound and net effective rents catch up with headline rents. Moreover, if we are right that occupier demand will soften, falls in headline office rents in 2013 look likely.

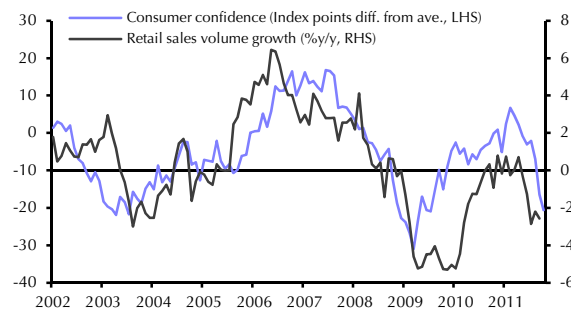
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Chart 1: Prime Office Rent Falls vs. Vacancy Rate Rises



Sources: Various Agents, Capital Economics

Chart 2: Dutch Retail Sales and Consumer Confidence



Source: Thomson Datastream