Lisbon Office Market Outlook

2nd
Quarter
2016

www.prea.pt

Lisbon Office Market Outlook

Research & Market Analysis Report

2nd Quarter 2016

Overview 2016 1S

The global perspectives for economic performance are now slightly optimistic than in recent past. Major drivers should be private consumption and some retake in investment. Nevertheless, GDP growth should continue weak and fall short of 1.5%.

Although peak of recession seems now to be surpassed some austerity measures shall continue to be imposed by EU, namely some increase in indirect taxes.

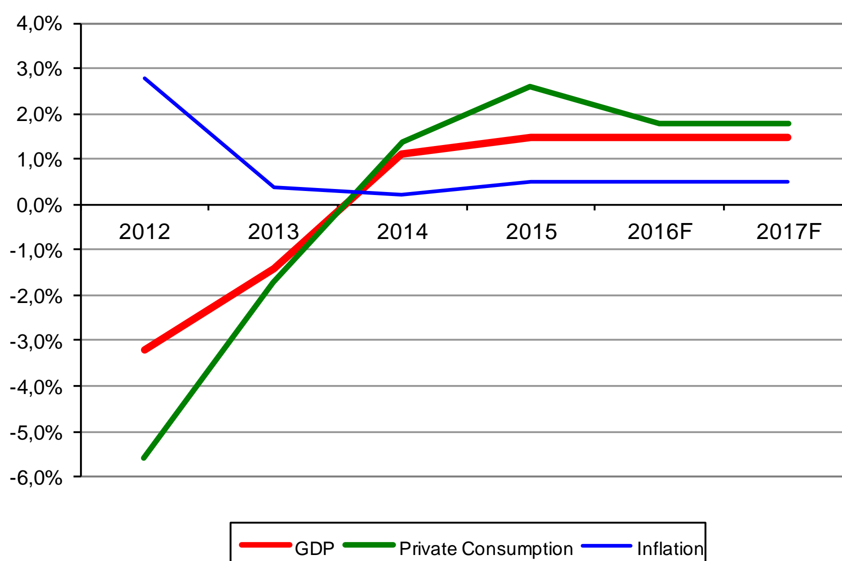
Major Portuguese banks continue to endorse severe restructuring measures towards increasing solvability ratios, cutting costs and dealing with increasing bad debt ratios. Mortgage and consumer's credit are now increasing although with more cautious patterns than in the past.

Major concerns about public debt and public deficit figures, which has to be strictly below 3% by EU rules are in public and private players' agenda. For the time being major sanctions by EU have been avoided. Most analysts point to public deficit forecasts for 2016 in the range between 2.5% and 3.2%.

Another concern is the slowdown in export growth due to impact of recent crisis in Brazil and mainly Angola. Nevertheless exports continue to perform rather well with growth above 2% although far from recent around 5% increase.

In the follow up of economic adjustment demand gross take-up is now increasing after record lows of 2011 to 2013. In the first semester of current year figures seem optimistic as 75000 sq m of gross take up is already observed. Figures close to 2015 (145.000 sq m) or even slightly higher are feasible at this point.

Economy – Main Indicators



Summary:

Outlook 1
The Economy 2
Take-Up Demand 3
Rental Levels 4
Supply 5
Vacancy Rates 6
Investment 7

"In 2016 major drivers are private consumption and slight increase in private investment and credit"

"GDP growth is expected to continue very moderate and slightly below euro zone average"

"Economic indicators are now more positive although still fragile"

"Gross Take-Up levels are now recovering from record lows in recent years"

"Regain of confidence and investment will be very slow and progressive"

"Decrease of interest rates in long term government bonds may set the context for slight additional compression of yields"

Lisbon Office Market Outlook

Research & Market Analysis Report

prea
Portuguese Real Estate Advisors

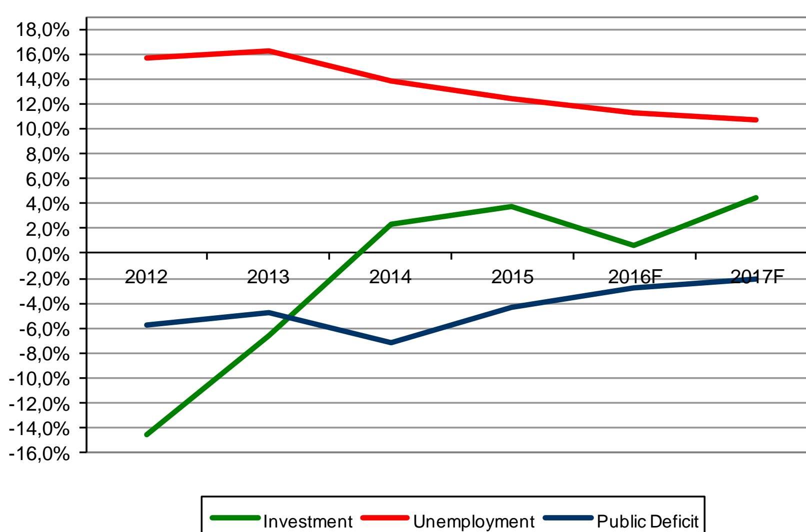
2nd Quarter 2016

The Economy

Last two years have been observing a continuous and very progressive improvement in primary economic indicators: GDP is now growing at around 1.5%; Public Deficit seems more controlled, Investment is slowly recovering, Unemployment figures continue to fall moderately and private consumption is regaining momentum.

New left wing government supported by moderate and far left informal coalition has been progressively cancelling previous cuts in public wages. Being so, throughout 2016 gross wages of public employees should be reset to pre troika levels.

Economy – Selected Indicators



On the other hand direct taxes on families are now extremely higher (after EU bail out) and major increases on indirect taxes (petrol, tobacco, alcohol, stamp tax, etc,) have been set on 1Q2016. That trend is likely to continue with significant increases on indirect taxes on families. VAT rate continues at 23% but some increase can be set at any time if other austerity measures aren't sufficient to restrain public deficit.

Consumers' confidence and private consumption are slowly improving from record lows, exports continue to grow above 2%, and investment is forecasted to regain momentum mostly in 2017.

Major targets are now regain of private consumption, retake of private investment and decrease in employment along with keeping up with major EU rules (public deficit below 3%).

Sustainable medium term improvement of economic performance is still uncertain as main indicators are still fragile. In the short term economic indicators should be favourable although with some risks and uncertainty always present.

GDP Growth:
2013: -1.4%
2014: 1.1%
2015: 1.5%
2016F: 1.5%
2017F: 1.5%

YE Public Deficit (%GDP)
2013: -4.8%
2014: -7.2%
2015: - 4.4%
2016F: 2.8%-3%

Inflation:
2013: 0.4%
2014: 0.5%
2015: 0.5%
2016F: 0.5%
2017F: 0.5%

Investment:
2013: -6.6%
2014: 2.3%
2015: 3.7%
2016F: 0.7%
2017F: 4.5%

Unemployment:
Avg 2013: 16.3%
Avg 2014: 13.9%
Avg 2015: 12.4%
Avg 2016F: 11.3%
Avg 2017F: 10.7%

Private Consumption:
2013: -1.7%
2014: 1.4%
2015: 2.6%
2016F: 1.8%
2017F: 1.8%

Take-Up and Demand

In 2015 a 14% increase was observed in gross take-up. Accumulated figures for 1S 2016 reached 75,000 sq m. Demand figures are considered good when compared to crisis period average data. 2011-2013 average fell under 90,000 sq m/year and 2014-2015 average already reached 135,000 sq m/year representing a major retake in gross take-up figures although far from pre financial crisis indicators.

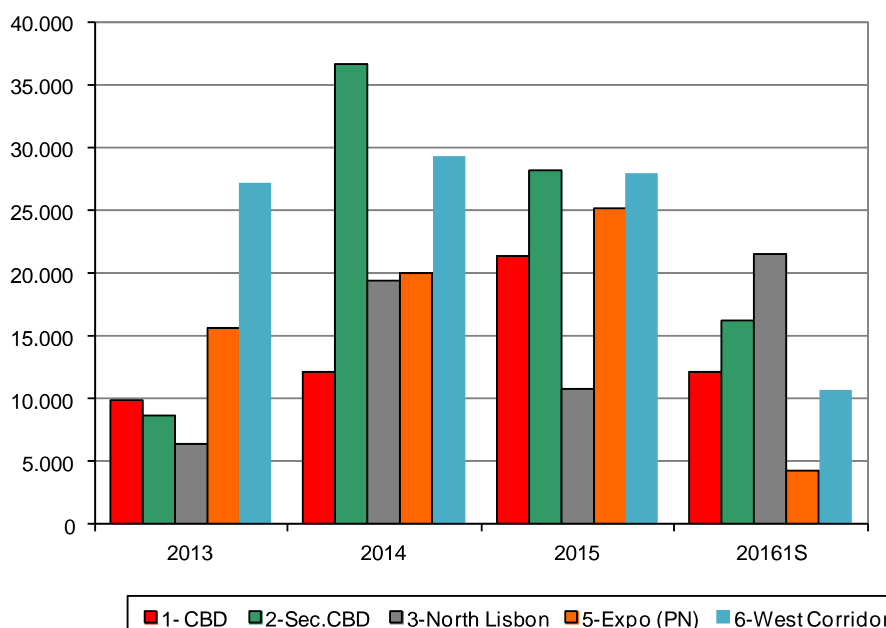
Recovering of demand has been accompanying the regain of private consumption and consumers' confidence index. Cost cutting and shorter lease contracts in the context of a more flexible lease market also explain constant renegotiation of rental costs and rental spaces.

Some scarcity of large spaces can now be felt in most zones (with exception of western corridor) as some companies tend to move to new locations as a result of internal restructuring that most local companies have to endure.

Excess of supply is now mainly felt in western corridor and other out of town areas. Parque das Nações has managed to reduce drastically its vacant area and central areas like CBD remain attractive as a prestigious and central location for most companies.

Lease market is absolutely dominant and represented 98% of area transacted as sales were almost absent. Number of transactions reached almost a hundred in 1S 2016 (which is considered quite good by most players) and average area transacted increased very significantly to 830 sq m.

A new trend of increased average space transacted seems to have emerged but will difficultly be sustainable in the long term. 50% of transactions are still below 300 sq m. Also used space represented approximately 97% of total area leased illustrating substitution demand dominance.



Gross Take-Up sq m:
2011: 88,000
2012: 102,000
2013: 78,000
2014: 127,000
2015: 145,000
20161S: 75,000

"New companies and expansion of area deals are now more noticeable although cost cutting continues to be a main driver "

"Average area transacted increased significantly to around 830 sq m per operation"

"Leases below 300 sq m are about 50% of total lease operations"

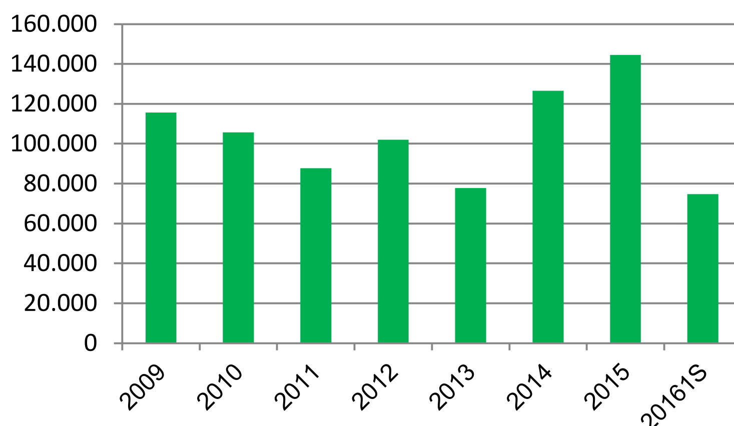
"With some exceptions, lease operations of larger spaces might be a short term trend to be observed"

"Slowness of deals, price sensitivity and volatility characterize the market"

Rental levels

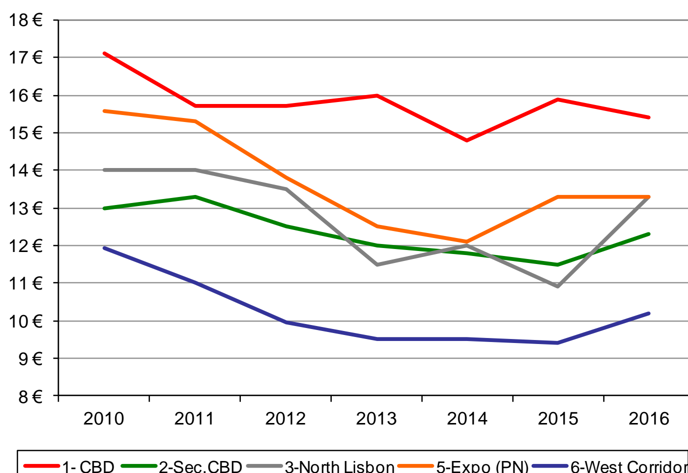
Average rents are now rising significantly as demand is more active and quality and flexible/large spaces seem to be scarce in some zones.

Prime rents have managed to sustain higher levels and avoid sharper declines during 2011-2013 period due to specific location and better quality or more differentiation on buildings/spaces. Also commercial incentives like rental free periods and space fit outs financial contributions were (are) common in order to sustain rental levels for investment funds and institutional investors.



Consolidation/Stability of prime rents is now likely in most zones along with some increase in average rents for new deals as demand figures are now more attractive.

Average Rents estimative (rounded figures) Eur/Sq m/month



Prime rents now stand at around Eur 18 sq m/ month in CBD and at around Eur 12 to 12.5 on Western Corridor for prime buildings. Zone 5- Parque das Nações now presents prime rents at around 15 Eur/sq m/month.

Prime Rents CBD Estimative Eur/Sq m/Month
2013: 18.5
2014: 19
2015: 18.5
20161S: 18

Prime Rents Expo – Parque Nações Eur/Sq m/Month
2013: 15
2014: 14
2015: 15
20161S: 15

Prime Rents Western Corridor Eur/Sq m/Month
2013: 11
2014: 12
2015: 12.5
20161S: 12.5

Average Rents: "Strong pressure on average rents and major commercial incentives"

Average Rents on CBD – zone 1: "Sustained resilience"

Prime Rents: "Slight downward pressure."

Lisbon Office Market Outlook

Research & Market Analysis Report

2nd Quarter 2016

Supply

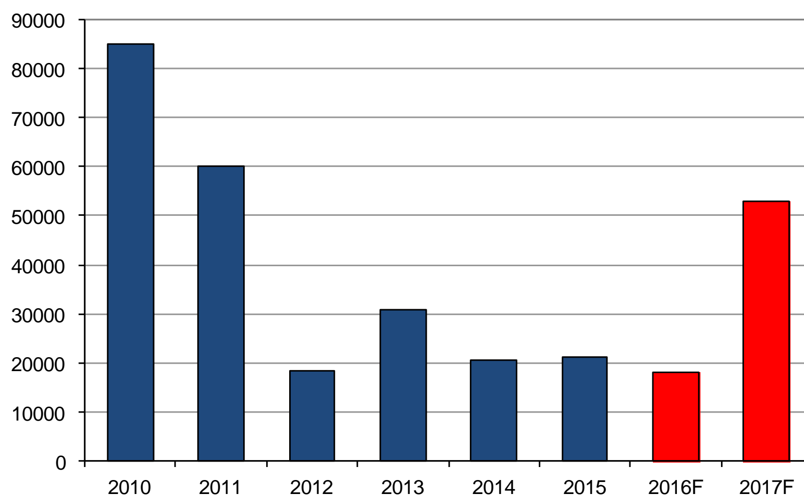
Globally market is still considered in relative excess of supply with overweight of used space. With some exceptions (in CBD for instance) available space is abundant mostly in zones 6 Western Corridor (215,000 sq m) and 2 secondary CBD (95,000 sq m).

New supply and pipeline are now considerably lower. Developers are now extremely cautious. Some pipeline and new built is already pre-let and most of operations in centre of the city are refurbishments and rehabilitation of buildings.

For 2016 a total amount of 18,000 sq m is in pipeline and 53,000 sq m for 2017, although some delays are feasible.

No new developments are forecasted for zone 5 Parque das Nações. In zone 1- CBD only one or two refurbishments are underway leading to future compressed supply in those specific zones.

New Built Supply and Pipeline – Estimative in Sq m



Most actives zones in terms of new supply will be zones 1- CBD (mostly refurbishments) and zones 4 and 3 (new or expansion of headquarters for existing companies) at this point.

New Supply sq m:
2011: 60,000
2012: 18,000
2013: 31,000
2014: 21,000
2015: 21,000
2016F: 18,000
2017F: 53,000

"The pipeline for out-of town is zero. Only one building was completed in 2016 in zone 6 where vacant area is very significant"

"CBD pipeline is very scarce and registered pipeline for Parque das Nações is zero at this point"

"Most active zones in terms of pipeline are zones 3 and 4 (mostly new headquarters for existing companies)"

" Some (few) refurbishments on CBD are also underway"

Vacancy Rates

For greater Lisbon market 10.3% is now the global official vacancy rate for 1S 1016.

Vacancy rates decreased moderately in recent quarters as a result of increase in demand for existing supply.

Moreover, new companies and new installments were more active leading to a more dynamic market.

CBD – Central Business District vacancy has been decreasing significantly to around 6.9%.

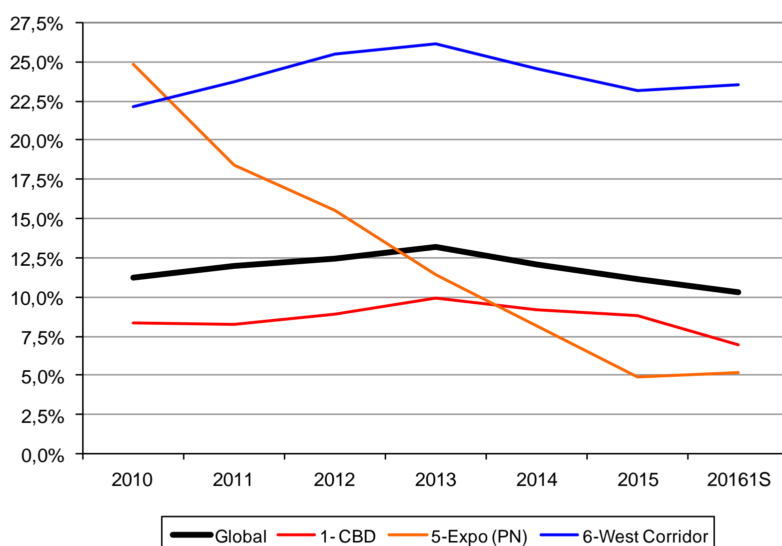
Zone 5 – Parque das Nações with its small dimension and huge sensitivity managed to reduce its vacancy rate down to about 5% due to reduction of new built and specific/occasional large dimension lease deals.

Zones 1 and 5 have met the conditions to consolidated vacancy rates at low levels in coming trimesters/years.

Due to its large dimension zone 2 – Secondary CBD registers low figures (currently around 8.5%) but available space is considerable high (close to 95K sq m).

Major vacancy rates are structurally observed in zone 6 - Western Corridor (24%) where available (new and mainly used) space is still very abundant.

Vacancy Rates Estimative (%)



On the very short term vacancy rates are expected to decrease. On the medium term vacancy rates are expected to stabilize as new built is compressed and take-up will be driven by better forecasted economic performance.

Vacancy Rates (global) :

2011: 12.0
2012: 12.4%
2013: 13.2%
2014: 12.1%
2015: 11.1%
20161S: 10.3%

"Vacancy rates decreased in recent quarters in most zones "

"Some occasional exceptions to decreasing vacancy rates in zone 6 due to local market specific characteristics and dimension"

Lisbon Office Market Outlook

Research & Market Analysis Report

Portuguese Real Estate Advisors

2nd Quarter 2016

Investment

Investment market has been very active in recent quarters. Investment reached a record high in 2015 with more than 1.6 billion euros in recorded transactions.

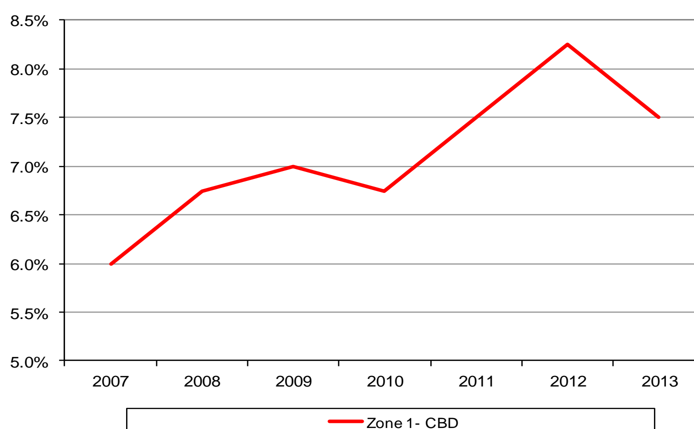
In 2016 perspectives are quite optimistic for most brokers with more than 850 million euros already recorded in investment transactions in the first half of the year.

Major investors are foreign investment funds and family offices. Major targets continue to be prime retail developments, prime office buildings and some specific touristic or pinpoint logistic developments.

As interested rates declined to record lows with Euribor rates being negative for most periods investors seeked alternatives for their investments. Prime Portuguese Market remains with good returns but prime yields already compressed to record lows.

Available data reports that prime gross yields now stands at around 5.25% after peaking at 8,25% (estimative) in 2012 for prime buildings in CBD. In the periphery – out of town - perceived gross prime yields normally imply a premium of 2% to 3% relatively to CBD. Perceived gross yields seem now more sustainable.

Gross Prime Yields – Estimative (%)*



Local property funds continue to restructure following the harsh restructuring process of major local banks. Total assets managed by Portuguese funds dropped 11% in one year according to APFIPP association. Being so most active buyers are foreign players that currently dominate the market.

Nevertheless recent deals have proven confidence on Portuguese prime market on behalf of foreign investors. Some investors and funds with liquidity continue to seek good returns or good opportunities with low risk and assured liquidity. Also, on the medium term some owners may be pressured to sell due to specific financial constraints.

Prime Gross Yields Estimative:

2009: 7.0%
2010: 6.75%
2011: 7.5%
2012: 8.25%
2013 : 7.5%
2014: 6.5%
2015: 5.5%
20161S: 5.25%

"Prime Gross yields managed to decrease in recent quarters in CBD".

" Some major deals brought back confidence and long term perspective"

"On the medium term some opportunity deals may occur"

"Improvement of ratings is likely only on the medium term. Some local banks continue to restructure".

Lisbon Office Market Outlook

Research & Market Analysis Report

2nd Quarter 2016

Appendix I – ZONE DEFINITION

Data Source: PREA based on LPI; INE, Bank of Portugal, and Min.Finance for Economics

Zone 1: CBD Central Business District
Zone 2: Secondary CBD
Zone 3: North Lisbon/Inner Circle
Zone 4: Historical Areas
Zone 5: Parque das Nações (former expo 98)
Zone:6: Western Corridor (out-of town)

Published by PREA's Research & Market Analysis Department on 01.08.2016