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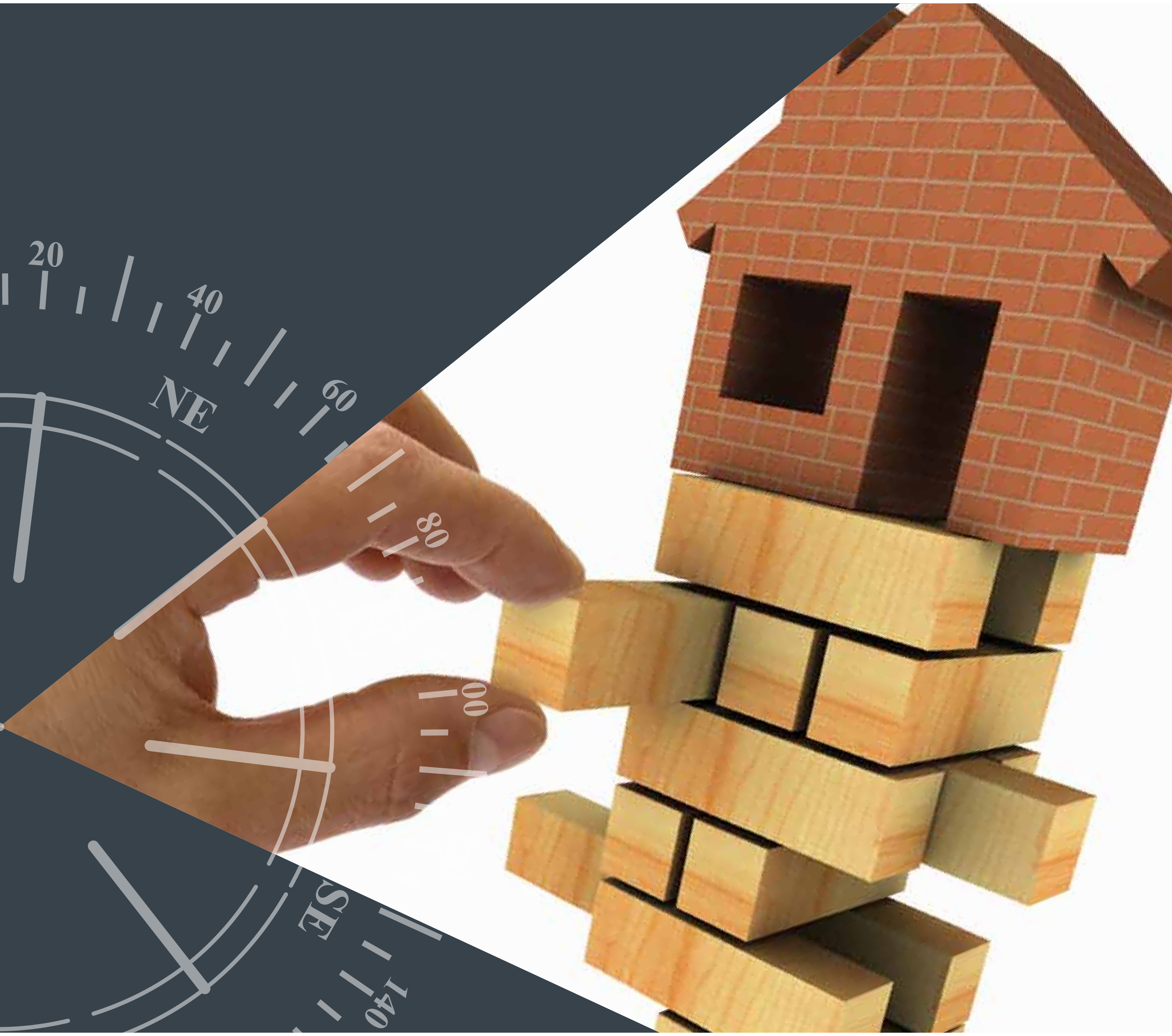
# **RICS** RESEARCH

## RICS IPD Valuation and Sale Price Report European Summary 2011

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# RICS IPD Valuation and Sale Price Report European Summary 2011

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A report for Royal Institution of Chartered Surveyors

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On the pulse of the property world IPD



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# 1.0 Foreword

The Royal Institution of Chartered Surveyors (RICS) and Investment Property Databank (IPD) are proud to present the RICS IPD Valuation and Sale Price Report 2011, which studies data from the IPD Annual Index of France, Germany, the Netherlands and the UK and compares this against the sale prices of commercial properties in those countries.

2011 is the eighth year that RICS has commissioned this study, which is an important barometer for the investment valuation community and makes a very welcome contribution to the transparency and integrity of our market place.

Valuations are key to performance measurement and pricing within the property industry. This report provides vital analysis of the performance of the valuation profession in some of the largest European property markets, by tracking the difference between valuations of real estate against actual sales.

The first study in this format was published in 2003 and since then the commercial real estate market has presented some dramatic highs and lows. 2004-2007 was characterised by unparallel growth in capital value, followed by falls from the summer of 2007 as a result of the credit crunch, which gathered speed after Lehman Brothers in September 2008. The time that has followed since has presented a real test to the skills of property valuers worldwide, particularly relating to the speed that they have been able to reflect market conditions.

## What is Market Value ?

The definition of “Market Value” follows the International Valuation Standards (IVS) definition, which is available in the RICS Valuation Standards. It is described as:

*“The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.”*

The words “willing seller” and “willing buyer” comprise a small section of the whole definition but understanding how this should be interpreted is fundamental to the correct application of the basis of value. The supporting explanatory text in the Standards makes it clear that a “willing seller” in the context of the definition is:

*“…neither an over eager nor a forced seller prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the property at market terms for the best price attainable in the market after proper marketing, whatever that price may be.”*

In other words, it is of no consequence that the actual owner of the property is not prepared, or un-willing to sell in a particular market. The preferences of the actual owner are irrelevant to the process of establishing market value. The seller in the market value definition is one who is actively in the market and looking to sell at the best price that can be achieved on the date of valuation and suggestions that there are no willing sellers in a falling market are sometimes made by commentators who have either little understanding of how markets operate, or have their own motives to change this definition. It is no more correct than saying that there are no willing buyers in a rising market.

It is the nature of markets that values rise and fall with the passage of time. The real estate market is not isolated from this cycle and, in fact, due to the drivers of supply and demand, the rise and fall of real estate is often more pronounced than it is in other markets. Certainly this has been the case in the property market over the past 10 years.

Those who question either rapidly rising or falling valuations must remember that it is the valuers’ role to track the market as they see it, not how they would like it to be. Market Value requires that the valuer marks to market, which does not make an allowance for a longer term sustainable value or “worth”. The consequence of this is potentially large peaks and troughs in value, rather than a smooth transition which longer term value would allow for.

# The way we were…
# …the economic outlook in 2010

With the global economic outlook changing on a weekly basis in 2011, it feels difficult to speak of it as it was a year previously. However, that we must for the purpose of this commentary and looking at much of the information that was available in 2010, the written text from economists and property professionals alike forecasted a rather prettier picture than what we see now.

## France

Following the downturn of 2008 and 2009, the French economy went through a period of convalescence in 2010 with GDP growing by 1.5%. Even though the number of businesses going bankrupt fell, the resumption of growth did not reflect improvement in the job market, with employment actually falling by 0.3% to stand at an average of 9.2%.

Take up of office stock across the 15 main regions with the exception of Ile de France stood at 1.32 million sq m in 2010, which was a rise of 22% year on year. This compares well with the boom years of 2006 and 2007 when office take-up in the same regions was 1.37 million sq m and 1.43 million sq m respectively. By contrast the level of both immediate and future supply fell from the year previously forcing average market rents for prime space up from €250/sq m per annum to €280/sq m per annum.

As in previous years the public sector and semi-public organisations were the driving force for transactions in these markets accounting for 13 of the 27 letting transactions that were over 5,000 sq m in these locations. The general revision of public policy was seen to aid this endeavour as public and semi-public bodies recentralised their services requiring fewer sites that offer better facilities.

The supply of new office space fell as the lack of finance in the development chain started to take effect. By contrast, the supply of second hand space rose by 10%, particularly in badly located tertiary sites now considered unsuitable by occupiers. There are two factors that are likely to have made an impact on this including higher taxes having a larger proportional effect on buildings with lower rental values and also the obligations for owners to bring their buildings up to standard or convert them as a result of Grenelle II environmental laws.

Following a difficult time in 2009 when the impact of the financial markets was evident in all areas, investment in standard commercial real estate rose in 2010 signifying a move towards pre-crisis levels. The Q4 was particularly active as it benefited from the usual pressure to close deals before the end of the calendar year, although this pressure was weaker in the regions than in Ile-de-France.

The improvement in the market during 2010 can best be put down to the investors renewed interest in commercial real estate as an investment asset. Even when the sovereign debt crisis began to take hold, real estate was considered to be a very tangible asset and a safe haven from the upheaval in the financial markets. Buyers focused on secure assets let on long leases to strong covenants and most of the purchasers in the market consisted of equity players alongside institutional investors at the front line. Where obtaining credit was necessary, there were a few more financing options than previously with slightly reduced equity contributions and decent conditions due to low short-term interest rates. Saying this, credit was only possible where the asset was secure, which is often more prevalent in larger transactions to big corporations, resulting in a decline in smaller transactions on the previous year.

## Germany

Exports have historically underpinned German economic activity and an increase in export demand saw strong expansion in the German economy in first half of 2010. GDP grew to 3.6% from -4.7% the previous year and registered the fastest enlargement in 19 years. Most of the expansion took place in the first half of the year which then slowed down, however the economy certainly proved itself to be the European engine, driving activity in the euro zone. The unemployment rate also fell to 7.7% in that year compared with 8.2% a year previously.

€18.815 billion of transactions were registered in the German commercial investment market, with the largest proportion of €6.015 billion traded in the fourth quarter. Large-volume transactions drove this huge increase on 2009, such as the sale of the Sony Centre in Berlin to the Korean Pension Fund NPS for €570 million in Q2 and Opernturm in Frankfurt for €580 million in Q4. In fact more than 30 transactions of over €100 million took place in 2010 compared with just 13 the previous year. Over a 12- month period, initial yields on prime office and retail premises moved in by approximately 0.25 bps as investors focused on properties with safe income streams and limited supply. Foreign investors took particular interest in large volume transactions, especially where they were well-let prime properties with strong covenants. In 2010, this rose to roughly 37% of market share from just 13% in 2009 and whilst they played a large factor in driving the market, they did not dominate it like in 2007-2008 where their market share was more than 60%.

The volume of transactions between offices and retail property was fairly evenly spread throughout the year at €7.355 billion and €7.33 billion, with the residue of invested funds being in logistics, hotels, social and leisure uses as well as mixed use property.

### The Netherlands

International trade is the largest engine of the Dutch economy. In 2010, exports increased by 17% and imports by 15% compared with the previous year. GDP grew by 1.75% from -3.9% in 2009, however the national budget deficit of 6.6% remained a concern.

Investment volumes in the Netherlands showed signs of recovery in the second half of 2010. Although the share of investment captured by the Netherlands fell as investors began expanding their horizons, absolute investment volumes increased by 13% from €4.14 billion in 2009 to €4.66 billion in 2010. Demand was derived predominately from domestic investors who accounted for 72% of all transactions. The drive was assisted by the sale of two shopping centres by Unibail-Rodamco in separate transactions but with a combined value of €363 million.

### UK

The first half of 2010 saw some recovery in the commercial market with good returns in some sectors. Of the properties analysed by IPD during the whole year, capital growth improved by 8.3% across all sectors, with the majority of this in the first half of the year. This compares with negative growth of -3.6% in the previous year

Activity was particularly prevalent in the prime end of the market where long leases in good locations let to strong covenants were available. The market saw an increase in available money at that time, particularly from overseas investors, which in turn drove up prices. This is reflected in the capital value rise reported in 2010 as a result of limited stock available. However, only long let investments in the UK and a few prime locations demonstrated lower investment yields and higher capital values and the ongoing divergence of prime yields and much higher investment yields in other parts of the UK continued as has been the case since the market downturn.

## IPD Data

Even given what appeared to be strong market recoveries in some of the European countries, this did not appear to manifest itself in capital growth throughout 2010. In both Germany and the Netherlands, both countries whereby the GDP swung from negative to positive returns, saw a decline in capital growth on real estate of -0.9% and -0.8% respectively. However, this decline was much less profound than the previous year where it stood at -2.6% in Germany and -5.3% in the Netherlands. France and the UK performed much better than their counterparts with 4.0% capital growth in France and 8.3% in the UK. Both countries had shown negative capital growth the previous year.

The UK and French markets both saw large increases in their assets being sold above the previous market valuation which is often what happens when the market in reality is mirrored by an increase in capital growth. What is interesting however is that this isn't the case in the Netherlands, even though a large proportion of their assets were sold above the previous valuation.

## …..so where are we now ?

Everyone appreciates that the European economy has shifted significantly since this data was provided to IPD. Economic sentiment was cautiously optimistic at the time of the data, which has been taken over by a dramatic retreat in confidence as a result of the sovereign debt crisis picking up pace, perhaps as much through fear as fundamentals.

Fear of the debt crisis began as early as 2009 when concern amongst investors that rising government debt levels across the globe and particularly in certain parts of Europe were becoming unsustainable. Concerns intensified in 2010, making it difficult or impossible for Greece, Ireland and Portugal to re-finance their debt. In May 2010 an approved rescue package of €750 billion was granted to ensure financial stability across Europe by measures designed to prevent the collapse of member economies.

The sovereign debt crisis has been created by a combination of complex factors such as the globalisation of finance, easy credit conditions during the boom period that encouraged high risk lending and borrowing practices, international trade imbalances, real estate bubbles that have burst, slow growth economic conditions since 2008 and fiscal policy choices and approaches used by nations to bail out banking industries and private bond holders.

Whilst sovereign debt increases have only been pronounced in a few countries, due to the shared currency they are perceived to be a big problem for all of the member states sharing that currency and also to the EU member states as a whole. The interconnection of the global financial system has essentially led to financial contagion: for example, should Italy be unable to finance itself then the French banking system and economy could come under significant pressure due to the amount that the Italian borrowers owe French banks. This will then in turn affect France's creditors and so on….


There have been numerous meetings in recent weeks to reach an agreed bail out plan for the Euro zone but there is concern about the possibilities of policy makers to contain the crisis at the speed that is required. Countries that use the Euro as their currency have fewer monetary policy choices as they are unable to print money in their own national currencies and the European Central Bank has thus far refused to provide quantative easing as a way out, instead insisting that the countries resolve the issue amongst themselves. Some believe that it is as much a political problem as an economic one as the euro zone is not supported by mutual bonds of a single state. The crisis of confidence has widened bond yield spreads and risk insurance on credit default swaps. The European economies of 2011 and 2012 will make interesting reading as each next stage in the crisis unfolds.

## Challenging times ahead

There are many challenges ahead for valuers and the turbulent markets across Europe mean we are likely to endure a relatively unstable year ahead.

If future market predictions of gloom in 2012 turn out to be correct then it may prove a very difficult environment for valuers to operate in 2012. It will be more important than ever for them to understand the economic market drivers in which they work and put themselves in the mindset of those that are buying and selling. It is the valuers' role to emulate this thought process in their valuation model and a judgement based on market understanding is usually more reliable than one based on historical transactions where all of the information is not necessarily always available.

Generally, market valuation is essentially seen as a proxy for price and prices in the real world are based not on what has gone on before but by what direction the market is heading. The author emphasises the importance of this long-running RICS Research and IPD analysis on European sales and valuation markets and as a tool to aid European valuers weighing up their valuation appraisals in challenging times.

# 2.0 Introduction

The IPD Valuation and Sale Price research study has been running for over 20 years and was first undertaken as a collaborative study with the RICS in 2003, in response to the Carsberg report recommendations. This advised that the relationship between achieved sale prices and previous valuations should be monitored on an annual basis.

The analysis in the European Summary covers the markets of France, Germany, the Netherlands and the UK at the all property level and addresses several key questions:

1. How much do sale prices differ from previous valuations?
2. Are differences random or were sale prices consistently above or below the latest valuation?
3. How much did the results differ across the four European markets?

Addressing these questions has involved market adjusting nearly 1,540 market valuations delivered across 2009/10 for average movement between valuation and sale dates and then applying a rigorous set of tests against the corresponding achieved open market transaction prices.

A summary of the main measures referred to in this report:

- **Preceding Market Adjusted Valuation**
  - The most recent valuation in the IPD database which must have been recorded a minimum of three months prior to the sale date. This is then adjusted for market movements in values by applying capital growth rates up to the third month before the sale. Finally, capital expenditure between the last actual uninfluenced valuation month and the updated valuation month is added to the updated valuation.
- **Average Price-Valuation Differences**
  - Average Absolute Difference – the average difference between an asset's sale price and its preceding Market Adjusted Valuation regardless of whether the adjusted valuation is above or below the sale price.
  - Average Direction Difference – the simple difference between an asset's sale price and its preceding Market Adjusted Valuation.
  - Differences are analysed on both an un-weighted and value-weighted basis with the latter assigning greater importance to more valuable assets.

# 3.0 Analysis and Findings

**Table 1** **Valuation Price Differences, % 2010**

| | France | Germany | Netherlands | UK |
|---|---|---|---|---|
| **Capital Growth** | 4.0 | -0.9 | -0.8 | 8.3 |
| **Un-weighted Average Absolute Difference** | 11.7 | 15.9 | 12.7 | 12.6 |
| **Weighted Average Absolute Difference** | 8.8 | 14.2 | 11.8 | 12.5 |
| **Un-weighted Average Direction Difference** | 3.4 | -0.1 | 0.5 | 4.4 |
| **Weighted Average Direction Difference** | 2.8 | 0.4 | 5.0 | 8.3 |

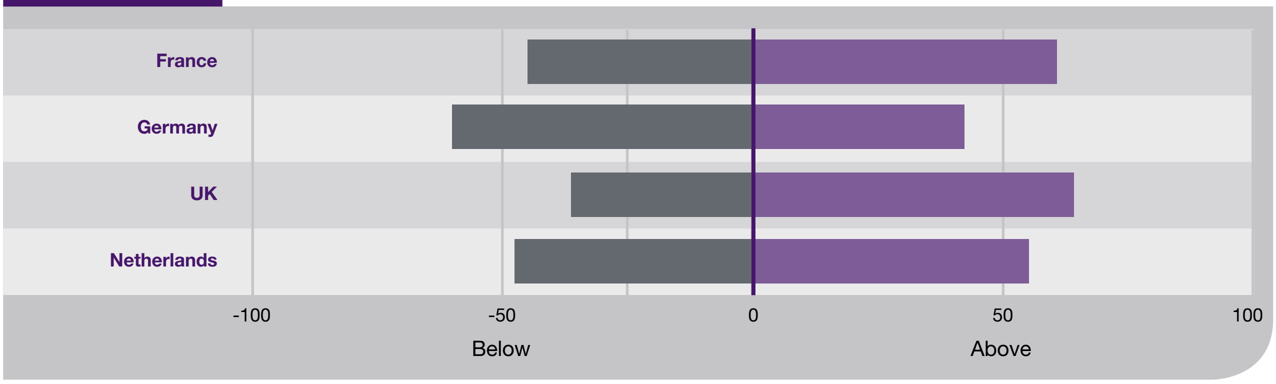
**Source:** RICS/IPD

The headline 2011 findings across the four major markets were as follows:

- In 2010, the value weighted average absolute differences between sale prices and preceding Market Adjusted Valuations ranged from 8.8% in France to 14.2% in Germany. Treating all valuations equally – regardless of capital value – Germany reported the widest spread, at 15.9%.
- In the past, there has been evidence to suggest that current market trends are related to the difference between the sale price of an asset and its preceding Market Adjusted Valuation. On an average weighted absolute difference, current market trends tend to follow the previous years' performance and influence subsequent sales differences. This was the case for all markets, with the exception of the German market where in 2010 there was a sharp increase in average weighted absolute difference compared to previous years' trend.
- Average weighted direction differences, which measure whether values were under or over stated, were positive in all four markets.

- Germany was the only market where the majority of assets were sold at prices below their preceding Market Adjusted Valuations (Figure 1). When compared to 2009, the French and German markets saw a fall in the proportion of assets sold at prices above the preceding Market Adjusted Valuation.
- UK market experienced the largest increase in its assets' sale prices being sold above their preceding Market Adjusted Valuations (Figure 1), which is mirrored by an increase in capital value growth, which was significant when compared to the capital value losses observed in 2009.

**Figure 1** Proportion of sales sold above/below their preceding Market Adjusted Valuation, % 2010




**Source:** RICS/IPD

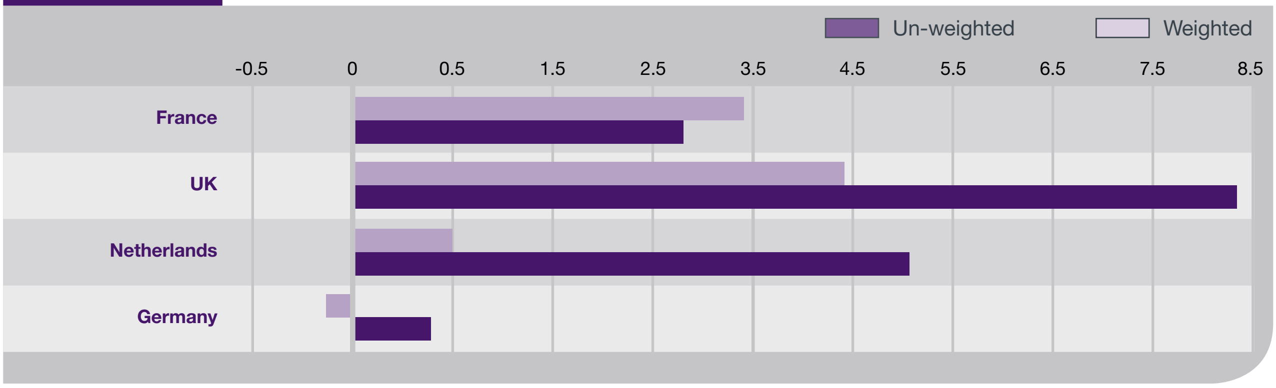
- In 2010, all markets experienced an increase in the weighted average absolute differences compared to 2009. Germany and the Netherlands saw the largest increase in these differences – therefore, on average, sale prices differed from their preceding Market Adjusted Valuations by a greater margin to what was observed in 2009, for both markets. (Figure 2).
- Traditionally across all four markets, the trend was for more valuable assets to be sold at prices closer to their preceding Market Adjusted Valuations, as indicated by a lower weighted average absolute average difference than un-weighted. 2010 saw a continuation of this trend in all markets apart from Germany, where smaller assets were sold for prices more in line with their preceding valuations.

**Figure 2** Weighted Average Absolute Differences, %. 1998-2010


**Source:** RICS/IPD

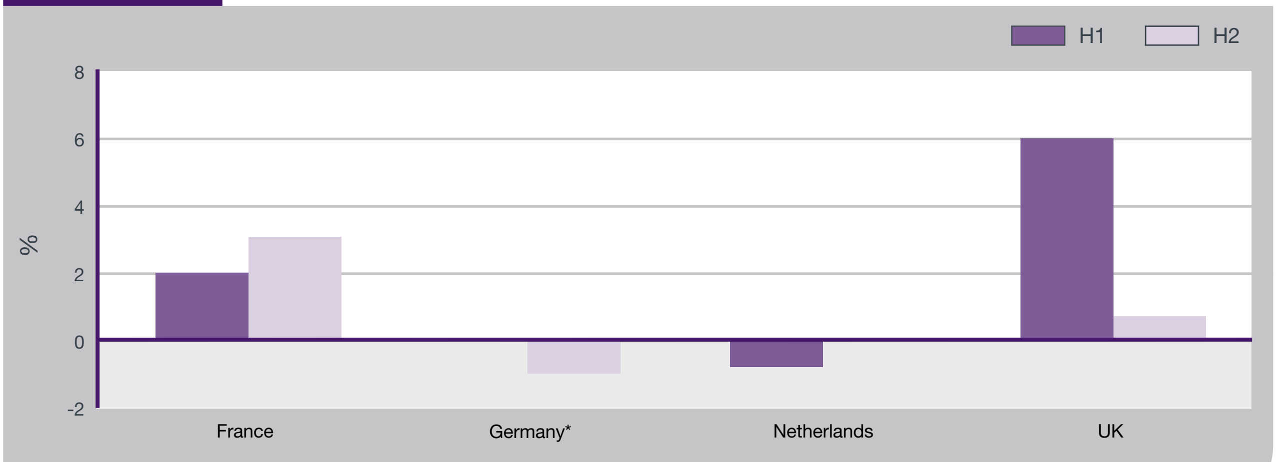
- On an average un-weighted basis, assets in Germany were sold at a discount to preceding Market Adjusted Valuation.
- On an average weighted basis, all markets saw larger and more valuable assets sold at greater premiums to their preceding valuations than smaller, less valuable assets (Figure 3). In comparison with other markets, the UK saw the greatest weighted premium.
- The average discount to preceding valuations for sales in Germany may be evidence of lagged valuations in a falling market. (Figure 4).
- 2010 saw a market turnaround in France and the UK, with the UK reporting higher capital growth in the first half of 2010. Both of these markets' capital growth improved in 2010, compared to previous years. The return of capital growth in the UK and France may also be evidence of the reciprocal relationship to that seen in Germany.

**Figure 3** **Average Direction Differences 2010, %**




**Source:** RICS/IPD

**Figure 4** **Capital Growth, H1 and H2 % 2010**




*Germany only has an annual capital growth percentage, which is allocated to H2 for the purpose of the chart

**Source:** RICS/IPD

- The spread of sale prices about preceding valuations was wider in all markets, apart from the UK, in 2010 with a noticeably lower proportion of transactions sold for within +/-10% and +/-15% of the preceding Market Adjusted Valuations in France and in the Netherlands, respectively, than in 2009. (Table 2).
- The UK displayed the tightest of all the markets' spreads in 2010, with 82% of properties sold for within +/-20% of the preceding Market Adjusted Valuation, a similar spread seen in 2009 within the same band.

**Table 2** Distribution of Transactions by Average Un-weighted Direction Difference Bands, % 2010 (2009)

| | +/- 10% | +/- 15% | +/- 20% |
|---|---|---|---|
| France | 40 (63) | 48 (78) | 52 (86) |
| Germany | 50 (53) | 65 (59) | 75 (69) |
| Netherlands | 64 (65) | 75 (82) | 80 (88) |
| UK | 57 (55) | 72 (71) | 82 (82) |

**Source:** RICS/IPD

**Table 3** Sample Sizes, 2010

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| France | 27 | 97 | 123 | 262 | 366 | 355 | 370 | 402 | 485 | 527 | 519 | 505 | 557 |
| Germany | 30 | 77 | 85 | 142 | 313 | 247 | 300 | 257 | 617 | 483 | 190 | 64 | 107 |
| Netherlands | 148 | 228 | 210 | 369 | 487 | 418 | 286 | 361 | 296 | 318 | 197 | 197 | 222 |
| UK | 1274 | 1648 | 1114 | 1318 | 1340 | 1216 | 984 | 1006 | 1020 | 903 | 1233 | 1042 | 652 |

**Source:** RICS/IPD

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