

## PROGNOSIS – Core markets in 2004

In 2004 I expect real estate returns in core markets to continue to benefit from relatively high levels of investment, notwithstanding a probable continued recovery in equity markets. In many markets this will be in spite of a continued failure of market fundamentals.

In the office sector it is difficult to see any sustained recovery in demand for space emerging in 2004.

<b>London</b>	London is the most difficult of the core markets to call. On the positive side there are indications of demand stirring in the undergrowth. On the other hand the supply data, in the City at least, looks pretty grim. On balance I expect City rents to continue to fall to an end 2004 value of €900 per m <sup>2</sup> per annum, whilst West End rents stabilize at their current levels.
<b>Frankfurt</b>	The decline in this market has some way to go. A vacancy rate of some 14% and negligible demand have lead to increasing incentives. I anticipate a further fall in rents of 10-15% with an end 2004 value of €360 per m <sup>2</sup> per annum
<b>Paris</b>	Paris seems to be slightly ahead of Frankfurt in the cycle. The vacancy rate is a far more manageable 6% but again evidence of demand is thin and incentives are increasing. I anticipate a fall of around 10% here with an end 2004 rental value of €595 per m <sup>2</sup> per annum.
<b>Brussels</b>	The European public sector looks set to stimulate the Brussels market into action in 2004. Rents rose by 10% or so in 2003 however I anticipate any rise in 2004 will be more modest. I expect an end 2004 value of €285 per m <sup>2</sup> per annum.
<b>Madrid</b>	Vacancy rates in Madrid are under 7% and rents have fallen back from their peak. Expectations for the Spanish economy are high in 2004 and I anticipate that this will stabilize rents and I expect little change in rental values.

Core retail markets should be approached with caution in 2004. In my view there is a reasonable risk of a marked slowdown in consumer expenditure in the “spending” economies and a likelihood that continued uncertainty will continue to constrain the “saving” economies. None of this is good news for retail demand.

Industrial markets, at least in the Eurozone, look strong candidates for core funds in 2004. Setting aside considerations of income, there appears to be room for yield compression in many of the key distribution nodes. Potential investors should look for high distribution quotients\* and take account of the structural changes affecting the logistics sector.

By comparison, the prospects for the UK distribution market do not look as rosy for 2004. Total returns for UK distribution property have been driven mainly by yield compression over the last decade – rental growth has been disappointing. With yields around 7.25% (lower around Heathrow) and weak rental growth there doesn't seem to be anywhere this market can go.

For income, the multi-let industrial estate should be the investment of choice throughout the EU. As ever, identification and acquisition of stock are problems that we have a pressing need to address.

\* Distribution quotients are explained fully in *Benchmarking Distribution Property in Europe* available early in 2004.

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**PROP**ECONOMY is published quarterly with monthly supplements and is available by subscription only priced at €350/£250/\$450 per annum.

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**PROP**ECONOMY is published by :

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