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Commercial property market analysis: an ECB perspective

“This presentation should not be reported as representing the views of the European Central Bank (ECB) or the European System of Central Banks (ESCB). The views expressed are those of the author and do not necessarily reflect those of the ECB. Thanks is given to the members of the ECBs Working Group on General Economic Statistics without whom much of the work and ideas presented would have not been possible.”
Overview

1. Framework and relevance of commercial property
2. Background and data requirements
3. Sources and caveats
4. Results and outlook
## Overview

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Framework and relevance of commercial property

Financial Stability

Commercial real estate market (lending for commercial property investment tend to be more volatile)

Indirect effect through the real economy

Adjustments in commercial property prices can have negative implications for real estate developers and construction companies

Direct effect

A significant proportion of banks assets comprised of commercial property loans

Large direct and indirect investments

Banks

Declining prices can lead to deterioration of asset quality and together with declining debt-servicing capability it can lead to credit losses and deterioration of profitability

Institutional investors

Financial stability

Source: ECB: Commercial property markets, December 2008
Framework and relevance of commercial property

CRE Cycles

Tightening financial conditions

- high LTV ratios
- high property prices
- high volume of transactions
- increasing expected yields
- decreasing rents
- increasing vacancy rates

Boom
- Credit boom
- Property boom
- Falling credit availability
- decelerating capital values (property prices)

Recovery
- Rising credit availability
- accelerating capital values (property prices)

Downturn
- Credit crunch
- Property crash

Bust
- low LTV ratios
- low property prices
- low volume of transactions

Easing financial conditions

Leverage rising

Leverage falling
# Overview

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Background and data requirements

Background

• 20 data gaps identified in 2010 IMF and Financial Stability Board paper “The financial crisis and Information gaps” (see http://www.imf.org/external/np/g20/pdf/102909.pdf)

• Recommendation 19 deals with real estate data
  “The Inter-Secretariat Working Group on Price Statistics to complete the planned handbook on real estate price indices. The BIS and member central banks to investigate dissemination on the BIS website of publicly available data on real estate prices. The Inter Agency Group to consider including real estate prices (residential and commercial) in the Principal Global Indicators (PGI) website.”

• ESCB taken lead on topic in Europe

• Work undertaken by the ESCB’s Working Group on General Economic Statistics
Data Requirements and Issues

- ECB requirement = Euro area / EU quarterly index, 60-90 days timeliness, ideally broken down by:
  - Member State;
  - urban/non-urban;
  - main property types

- Experimental hybrid indicators (using if possible national available and otherwise commercially provided data), GDP-weighted

- If possible: Transaction based by national source (DK, DE, IT), if not: Valuation based, quarterly rather than interpolated (GR development work about to come on stream)
Data Requirements and Issues

• Commercial Data: IPD (Investment Property Databank)
  - Directly held commercial real estate assets
  - Valuation based or transaction-linked compilation method
  - Issues: market illiquidity → control for transaction numbers
    volume changes → keep sample constant
    not quarterly, but annually interpolated data
    only prime segment market
    no buildings in construction/development → crucial to financial
    stability analysis

Comparability in compilation methods or assumptions not
data (e.g. ECB data vs JLL data)
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## Sources and caveats

- Data collectable at various stages by various entities → quality and comparability affected

### Commercial Property Prices

#### Transaction Based:
- Ideal, representing current market

**Problems:**
- CP = Highly heterogeneous and infrequently traded
- Property markets = highly illiquid during financial/ economic stress

#### Valuation Based:
- Majority of CPP data
- Sources = private organisations → rather designed for performance measurement

**Problems:**
- Valuation errors, smoothing issues, varying coverage, short time span

#### Other Expert Judgement
- Market professionals judge fictitious property (e.g. Jones Lang Lassalle)
- Very timely data

#### Financial Market Data
- Real Estate Trusts containing CPs as assets
- Inferring of CPPs, available in real time

**Problem:**
- Movements in assets not only due to CPPs, assets do not represent whole market
Sources and caveats

Breakdowns

- Not always large enough and representative property sample / sufficient coverage of geographical areas
- Hard to control for changes in quality of properties and in sample composition
- Individual results for EU countries – transaction numbers!
- Problems distinguishing between urban and non-urban
- Same issues for separate indices for different property types

Methodology

- Index compilation can be problematic due to shifts in composition of real estate properties (monthly indices only feasible with high turnover markets), RPP = quarterly, CPP = sometimes only annually
- Potential overlap of RPP and CPP (Non-owner occupied RP = income generating = CPP)
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Results

- ESCB data published as “experimental statistics” in February 2014
- (See http://www.ecb.europa.eu/pub/pdf/mobu/mobu/mo201402en.pdf pages 54-58) -> Good feedback thus far
- Major issues in comparability and harmonisation → elaborate metadata needed
Outlook

• Currently: drafting of international handbook on CPP (under the auspices of the Inter-secretariat Working Group on Price Statistics)

• Main Research objectives:
  - Alternative data sources, examination of robustness
  - Indicators for property type breakdown
  - Integrating property still under development
  - Weighting schemes representative of market structure
  - Review of interpolation methods
  - Exploitation of geographical information
  - Quality adjustment

• Further joint work of ECB and NCBs
Thanks for your attention!

Questions?