

# Market report Germany Offices

February 2016



## Summary

### Top six office markets at a glance

■ The six largest office letting markets in Germany are enjoying an uptrend characterised by growing demand, rising rents and declining vacancy rates.

■ On the supply side, there is a markedly below-average completion volume of 0.9 million sq m scheduled for 2016 (unchanged on 2015), two thirds of which is already pre-let. The vacancy rate may, therefore, decline even further in 2016.

■ Owing to the sustained supply shortage, which may conceivably worsen, rental growth is likely to continue over the coming years. In (good) B locations, the rental growth may well even accelerate.

■ Against this background, companies seeking suitable office space will have to adjust to facing even fewer leasing options going forward, which will also be more expensive. For landlords, the market continues to improve.

„The motto for 2016 is again: It is becoming more narrow in German offices – companies will have to adjust to facing even fewer leasing options, which will also be more expensive.” Marcus Mornhart, Head of Office Agency Germany

### Favourable market conditions are providing positive growth in the office sector

The six largest office letting markets in Germany, namely Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne and Munich, are currently enjoying an uptrend. This market phase is characterised by rising take-up, increasing prime and average rents and declining vacancy rates (see table 1). The growth is being driven by favourable socio-economic conditions. Three particular trends are of decisive importance for this office demand.

1. Population growth has been relatively strong in all cities. Across the top six markets as a whole, the population increased by 1.4% year on year in 2014, which was significantly higher than the ten-year average growth (+0.5%). Data for 2015 is not yet available. However, it is safe to assume that the population growth continued last year.

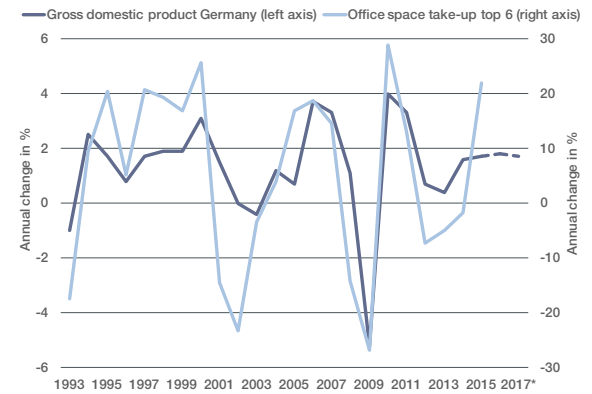
2. The number of office employees has also grown. The total across the top six cities rose by almost 360,000 in 2014 compared with the previous year, an increase of 2.6%. The ten-year average growth for this figure stands at 1.4% (see also box "Office employment"). The strongest growth was recorded in Berlin, where the number of office employees rose by 3.5% in 2014. Consequently, activity in the Berlin office market is also particularly

buoyant. The growth is also likely to have continued in 2015.

3. Finally, the German economy is in good health. Following growth of 1.6% in 2014, the gross domestic product rose by 1.7% in 2015. There is fundamentally a close correlation between gross domestic product (GDP) growth and office take-up growth (see graph 1). While the growth ran almost in parallel between 2006 and 2011, take-up growth between 2012 and 2014 was below average compared with GDP trends. In 2015, this relationship reversed.

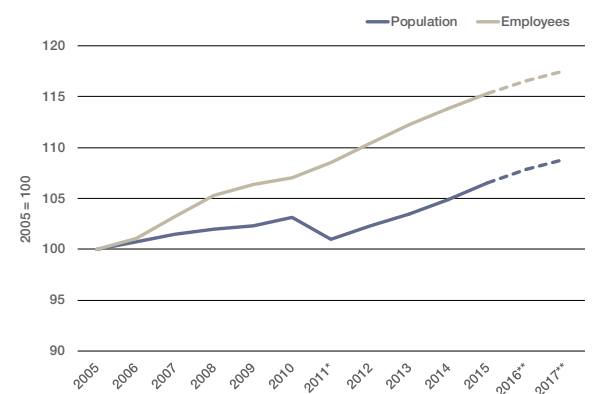
A glance at the projections for these three indicators of population, employee and GDP growth also promises high levels of activity on the demand side in the office markets over the coming years. Population projections for the top six markets to 2017 assume average annual growth of 1.2%. Projections for the number of employees are also correspondingly positive. Over the same period, the number of employees in the top six markets is expected to grow by 1.1% per year (see graph 2). Consequently, the number of office employees is also expected to rise. GDP is projected to grow by 1.8% and 1.7% respectively in 2016 and 2017.

GRAPH 1 GDP and office space take-up Take-up increase above average to GDP in 2015



Source: Statistisches Bundesamt, Focus Economics, Savills / \* Forecast

GRAPH 2 Population- and employment-development top 6 Positive trend



Source: BBSR, Oxford Economics / \* Census data revision / \*\* Forecast

TABLE 1 Key office market figures

	Take-up (sq m)			Vacancy rate (%)		Prime rent (€ per sq m/month)		Average rent (€ per sq m/month)	
	Q1-Q4 2015	against Q1-Q4 2014	against Q4 2014 - Q3 2015	Q3 2015	q-o-q change	Q3 2015	q-o-q change	Q3 2015	q-o-q change
Berlin	940,800	+20.3%	+7.1%	3.6	+/-0bps	24.30	+1.3%	14.80	+0.7%
Düsseldorf	414,600	+74.7%	+19.7%	9.9	-30bps	26.00	+/-0.0%	14.20	+1.4%
Frankfurt	392,266	+6.0%	-7.3%	10.2	-110bps	39.00	+1.3%	19.00	+2.7%
Hamburg	526,952	+3.1%	+2.1%	5.5	-40bps	25.00	+/-0.0%	14.50	+/-0.0%
Cologne	291,624	+29.6%	+9.5%	6.5	-10bps	22.00	+3.5%	13.15	+2.7%
Munich	750,516	+26.6%	+9.3%	4.7	-10bps	34.00	+/-0.0%	16.10	+1.3%
Top 6	3,316,758	+21.9%	+6.4%	6.8	-30bps	28.38	+0.9%	15.29	+1.5%

Source: Savills

### Office supply is (too) low

The situation on the supply side is in stark contrast with the dynamic activity in terms of demand. Just less than 0.9 million sq m of office space was completed in the top six markets in 2015, which is approximately in line with the 10-year average. The average completion volume over the last 20 years stands at more than 1.1 million sq m (see graph 3). While the completion volume is expected to rise moderately in 2016 to almost 1 million sq m, there will still be less space completed this year than is required to maintain current levels of office stock. Assuming an economic life of 50 years for an office building, this would require a completion volume of almost 1.7 million sq m. Such a volume was last achieved at the start of the millennium, when more than 1.7 million sq m was completed in three successive years. One explanation for the lower completion volumes today is that the banks are now more restrictive than previously in terms of lending and currently stipulate pre-letting of 30-40%. A few years ago, 50% pre-letting was even required in some instances. The few speculative developments are mostly attributable to market participants that can manage without debt capital from the banks.

### Vacancy rates fall to the lowest in 15 years

As a result of the high demand for office space last year and the relatively low completion volume, the vacancy rate fell further to reach its lowest level for 15 years (see graph 3). At the end of 2015, the vacancy rate across the top six markets averaged 6.8%, which was 100 basis points lower than a year earlier. In contrast with the previous boom in 2006 and 2007, the current uptrend is additionally characterised by reductions in office stock as a result of demolitions and particularly the significant number of conversions. The most frequent conversion is to (freehold) apartments. Such conversions are attractive to developers for two reasons. Firstly, in the sustained low interest rate environment, both private and institutional investors are seeking alternative investments and purchasing apartments is regarded as one of the few alternatives by many investors. Secondly, there is also high demand

for housing in the rental apartment market. The average vacancy rate across the top six cities is extremely low at less than 1%. In 2007, the equivalent figure was 2.3%.

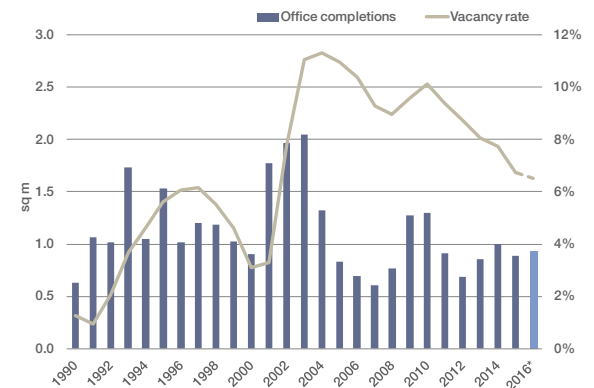
As a result of these conditions, namely the low completion volume, high demand for office space and reductions in office stock owing to conversions, the reduction in vacancy rates will continue and companies seeking suitable office space will face an even greater challenge, particularly since around two thirds of the projected completion volume for 2016 is already pre-let. In some markets, such as Hamburg and Munich, it has long been apparent that tenants are extending leases in view of the lack of alternatives, unless they have a necessity to move. In certain cities, such as Cologne, companies with plans to expand are faced with a lack of alternatives and are sometimes forced to accept space of a lesser quality. Where there are still alternatives of equal quality, these are more expensive.

However, the higher the surplus demand for (modern) office space, the more probable it is that development activity will also increase again. The growing surplus demand and resulting higher rents will also generate greater interest in new-build projects, thus achieving the higher pre-letting rates required to facilitate access to debt finance. Furthermore, in recent years, the banks' margins on portfolio financing have fallen significantly and some institutions are, therefore, keen to become more involved in development financing. Consequently, it is likely that more development projects will soon be able to commence, which will contribute to an increase in the completion volume over the coming years.

### Scarce supply is resulting in significant rental growth

The increasing supply shortage has also been reflected in rental growth in recent years. The prime rent across all six markets rose by an average of 2.6% in 2015 to €28.38 per sq m/month. The average rent rose even more sharply, increasing

GRAPH 3 **Completions and vacancy top 6**  
Scarcity of space increases



Source: Bulwiengesa, Savills / \* Forecast

## Office employment

### Plus of 360,000 office jobs since 2005

The number of office employees subject to social security contributions in the top six cities has risen by 21% over the last 10 years (2005 to 2014) to almost 2.1 million. The largest proportion of office employees work in technology, media and telecommunications (14.3%), finance, banking and insurance (12.2%) and public administration (11.9%). While the technology, media and telecommunications sectors and public administration have registered significant growth in office employees, the number of employees in finance, banking and insurance has risen by just 1.4%.

The largest relative and absolute growth over the last ten years is attributable to the 'Other higher-level business-related services' sector, which has witnessed 55% growth in the number of employees to 227,000. As a result, the sector accounted for 11% of all employees subject to social security contributions in 2014 compared with 8% in 2005, which was higher relative growth than in any other sector. In absolute terms, the sector has created around 80,000 office jobs across the top six markets during the last ten years. The total growth in the number of office jobs across all top six cities stands at almost 359,000.

by 9.5% to €15.29 per sq m/month. This represents the continuation of a sustained phase of rental growth that commenced in 2010 (see graph 5). The prime rent has increased by 10.6% during this period while the average rent has risen by 8.2%. Furthermore, rents are currently at their highest level since the start of the millennium. In view of the scarce supply and high rents in central locations, many companies with requirements are forced to shift their attention to peripheral locations. This outward movement is also boosting rental levels in B and C locations. The trend also explains the significantly higher growth in the average rent compared with the prime rent over the last year.

Berlin is a particular example of this. Take-up in central office locations as a proportion of overall take-up in the German capital fell by eight percentage points compared with the previous year to 27%. The prime rent rose by 8.0% year on year to €24.30 per sq m/month, reaching its highest level since 2002. However, the average rent rose by 12.1% compared with the previous year to €14.80 per sq m/month (see graph 6). In certain submarkets, this growth was even more pronounced. The prime rent in Kreuzberg increased by more than 13% during the year, ending 2015 at €17.20 per sq m/month. Over the last five years, the prime rent has risen by almost 20%. During the same period, the average rent has risen by more than 50% to €14.10 per sq m/month (+2.2% compared with 2014).

### Start-ups in Berlin demand alternative space concepts

A principal driver of this rental growth in Kreuzberg is the development of Berlin as a vibrant European metropolis for start-ups, particularly in the fields of information and communications technology. However, fintechs – start-ups in financial technology – are also abundant in Berlin and are significantly higher in number than in Germany's established financial centre of Frankfurt, for instance. Consequently, Berlin is the only German city to feature in Savills' published Tech Cities Index (<http://sav.li/4hp>), occupying ninth place among the world's 12 largest technology cities. A nucleus of this

sector is found in Kreuzberg. However, the importance of this sector for the office market is also apparent beyond Kreuzberg. The communications sector accounted for more than 36% of overall office take-up in Berlin in 2015 compared with 16% in 2013.

However, some of these start-ups have quite different requirements in terms of office space than tenants from established sectors. The standard fit-out can include integrated cafe, lounge and fitness areas as well as flexible workspace and meeting concepts or co-working spaces. A number of properties have been developed in Berlin in recent times with precisely such a concept to fulfil these requirements. The new concepts also offer leasing models that accommodate the commercial reality for start-ups. The spectrum ranges from short-term leases for small start-ups in their initial phase to leases with variable structures and short to medium-length terms.

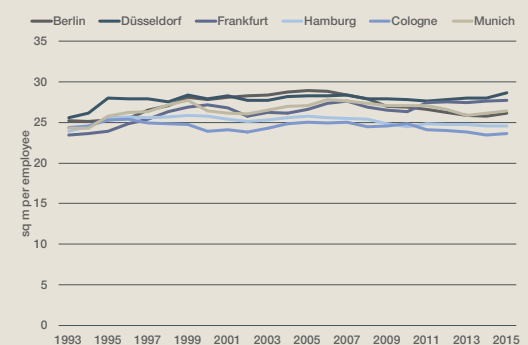
Supply is becoming increasingly scarce and expensive for tenants. Whether start-ups or not, companies in the top six cities will be increasingly confronted with rising rents over the coming year, particularly since demand will remain high while take-up is expected to remain in line with 2015 levels. Prospective occupiers will have to adjust to facing even fewer leasing options, which will also be more expensive. This is particularly true of central locations, where there is scarcely any high-quality space available. Larger companies seeking high-quality space upwards of around 5,000 sq m will be practically limited to pre-lets in developments. Consequently, vacancy rates will fall further, causing rental growth to continue in the prime segment and even to probably accelerate in (good) B locations. In view of the expected rental increase, tenants agreeing a new lease or lease extension should consider the longest terms available.

## How much office space will be required in future?

### Does the growth in office employment require a proportional increase in the office stock?

Trends such as shared-desk policies and time spent working from home are now increasingly used in practice. This prompts the conclusion that less office space will be required overall. Furthermore, the proportion of part-time employment has also increased since the start of the new millennium and currently stands at around 26%. These trends mean (in theory) that office space per employees will decrease. However, actual office space per capita has remained unchanged for years at 26 sq m (see graph 4). While some larger international companies may be increasing their efficiency of space via shared-desk concepts, this phenomenon has not (yet) filtered down into the statistics. Whether such concepts will establish themselves across the entire market remains to be seen. In view of demographic trends and the associated reduction in the potential workforce, as well as the increasing competition for highly-skilled workers, employers must be prepared to make concessions to their personnel. Against this background, more efficient use of office space must be given lower priority in some instances.

GRAPH 4 Office space per employee Stable at 26 sq m per employee



Source: Bulwiengesa

„Until now, there is no significant increase in the completion volume foreseeable. In this respect, the reduction in vacancy will also continue this year – particularly as we assume that demand for office space will remain high.” Matthias Pink, Head of Research Germany

**Tenants in Frankfurt hold some aces**

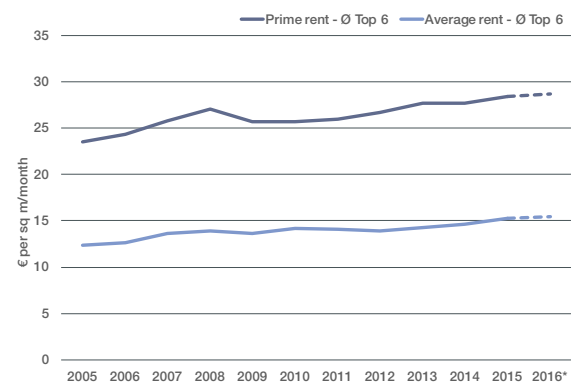
This picture is true of all cities with the exception of Frankfurt. While demand is currently very high across all markets, demand in Frankfurt is somewhat lacking in momentum. One reason is the now largely completed period of consolidation in the financial sector. Prior to 2014, the financial sector consistently generated a large number of requirements and regularly accounted for deals above 10,000 sq m. Last year, however, there was only a single deal for more than 10,000 sq m, which was an owner-occupier transaction by Deutsche Vermögensberatung. Furthermore, the major international companies based in Frankfurt are very efficiently managed and are seeking to reduce their office space requirements via alternative concepts, which is also dampening demand (see the box "How much office space will be required in future?"). Despite the relatively low take-up, the vacancy rate fell by 140 basis points last year to 10.2%, which is the lowest level since 2002 (9.0%). Five years ago, the equivalent figure was 15.0% (see graph 7). This reduction in the vacancy rate is particularly attributable to reductions in office stock via conversion or demolition of office space no longer suitable for the market. Nevertheless, there is more than 200,000 sq m of space available in existing buildings or current developments in Frankfurt's financial district in the triangle formed by Neue Mainzer Straße, Taunusanlage and Jungghofstraße. The majority of this space is suitable for the market and is no more than twelve years old but cannot find tenants owing to the weak demand. Going forward, even more space will be available in planned buildings, with available space on the afore-mentioned streets set to double to some 400,000 sq m by the end of 2017. Some of these projects are being

developed completely speculatively. Consequently, landlords in Frankfurt are likely to face greater difficulty in finding a tenant for their space going forward. For tenants, on the other hand, the prospects are good since competition between landlords for new and existing occupiers is likely to intensify.

**Landlords can expect high rents for years**

In all other markets, it is the tenants that are in competition for attractive space. Owing to the surplus demand and scarcity of available office space, landlords are benefiting from rising rents. Landlords with expiring leases can particularly benefit from this situation. In some instances, it may even be attractive to agree short-term leases in order to benefit from further rental growth in two or three years. In view of the circumstances, rents are likely to remain high for the foreseeable future.

GRAPH 5 **Rental development top 6** Increasing trend since 2010



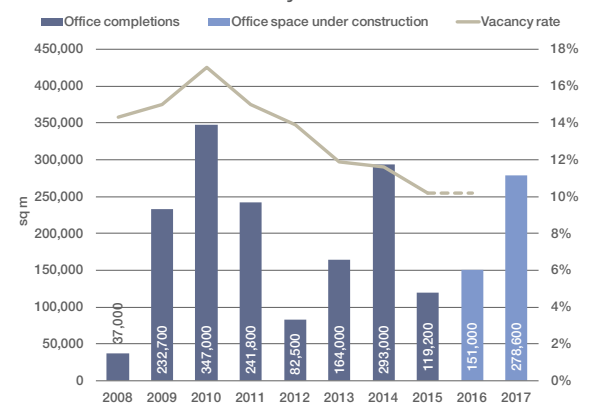
Source: Savills / \* Forecast

GRAPH 6 **Rental development Berlin** highest increase of all top 6 markets



Source: Savills / \* Forecast

GRAPH 7 **Completions and vacancy Frankfurt** Reduction of vacancy comes to an end



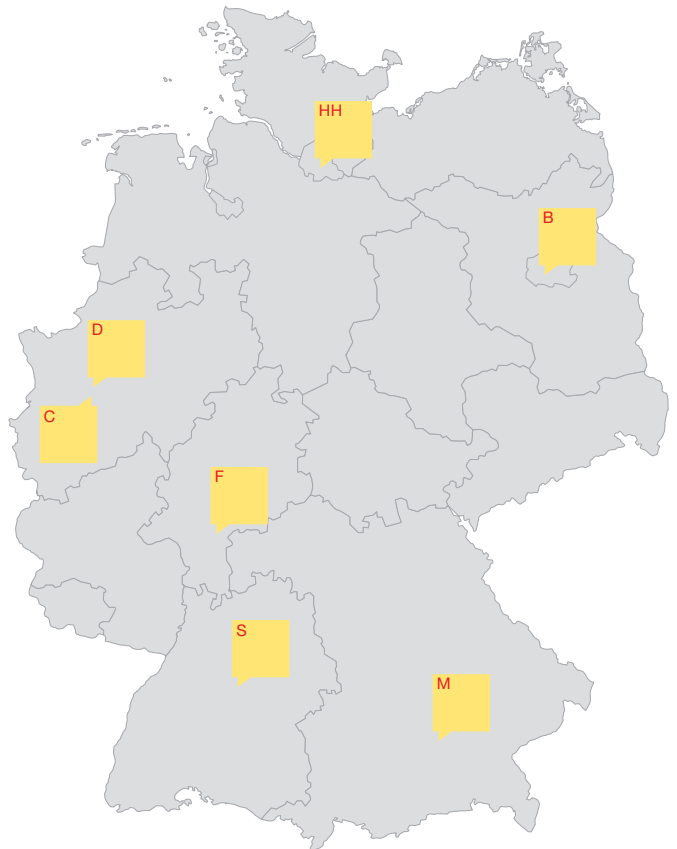
Source: Savills

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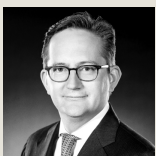
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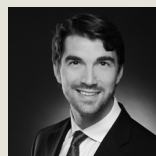
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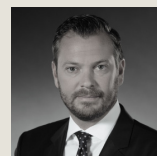
**Marcus Mornhart**  
Office Agency Deutschland  
+49 (0) 69 273 000 70  
mmornhart@savills.de



**Christian Leska**  
Office Agency Berlin  
+49 (0) 30 726 165 186  
cleska@savills.de



**Jan-Niklas Schroers**  
Office Agency Düsseldorf  
+49 (0) 211 22 962 223  
jnschroers@savills.de



**Benjamin Remy**  
Office Agency Frankfurt  
+49 (0) 69 273 000 34  
bremy@savills.de



**Ken Hoppe**  
Office Agency Hamburg  
+49 (0) 40 309 977 132  
khoppe@savills.de



**Simon Löseke**  
Office Agency Köln  
+49 (0) 221 933 313 32  
sloeseke@savills.de



**Nico Jungnickel**  
Office Agency München  
+49 (0) 89 427 292 114  
njungnickel@savills.de



**Matthias Pink**  
Research Deutschland  
+49 (0) 30 726 165 134  
mpink@savills.de

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