European Commercial - February 2024

SPOTLIGHT
Savills Research

European Office Outlook

• Demand • Availability • Occupiers

Vacancy rate begins to stabilise

European office take up in 2023 fell by 17% against pre pandemic average

Economic overview
The Eurozone narrowly avoided a recession during Q4 2023, with Southern Europe continuing to support economic growth, as Germany recovers at a slower pace. The Eurozone is expected to remain close to recession in the first half of the year as the effects of higher rates continue to weigh on business and consumer confidence.

Latest data also indicated a further fall in Eurozone inflation during January 2024, from 2.9% to 2.8%, although the ECB continues to report caution on interest rate cuts until wage inflation falls further. Despite higher inflation, the Eurozone Employment Expectations indicator remains stable at 102.5, indicating employers are seeking to increase, rather than reduce, staff headcount.

Leasing activity
European office take up reached 7.7m sq m in 2023, a 17% fall against the pre pandemic average, reflecting a similar fall YoY.

Oslo (+35%), Milan (+29%) and Lisbon (+23%) marked the largest increases against pre-pandemic averages. However, German cities and those European cities with a higher exposure to the tech sector, including Dublin, Amsterdam and Barcelona reported relatively weaker take up volumes against pre-pandemic averages. In Germany, the fall in take up can largely be attributed to the increase in lease renewals, as occupiers extend their current leases by three to five years. Offices which offer an element of flexible/grow-on space are therefore particularly popular among occupiers.

On a brighter note, Q4 2023 marked Europe's strongest quarter of office leasing activity since Q4 2022. Despite weaker economic sentiment, we expect an average 1% increase in take up in 2024.

Vacancy rate and rental outlook
European average office vacancy rates rose by 60 bps YoY to 8.4% during Q4 2023, although this is beginning to stabilise on a quarterly basis. With core European office vacancy rates between 2-5%, prime rents rose by an average of 4.3% in 2023, and we expect further growth in 2024. Despite weaker German economic growth, the depth of demand for higher quality office space across Cologne and Dusseldorf lifted the European average rental growth. Given this broader demand for the very best office space in prime locations, the relationship between prime rental growth and vacancy rates has weakened since 2020.

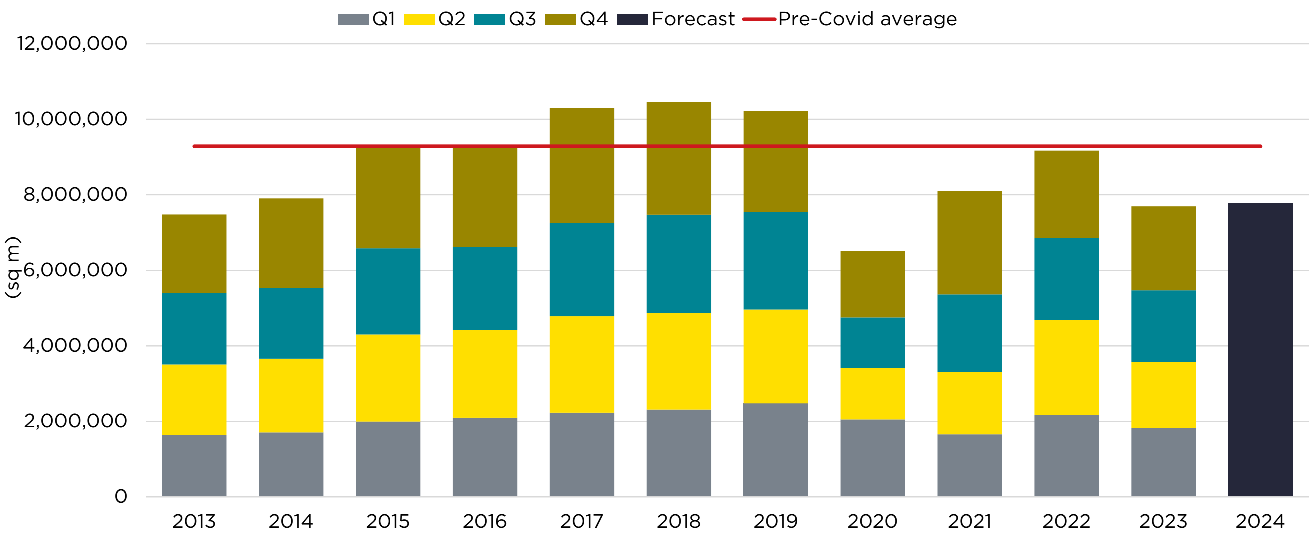
At current average vacancy rates, this has historically indicated annual prime rental growth of 2.3%. With a limited speculative development pipeline and increased project timescales, we expect rental growth for prime stock to average circa 3% in 2024.

Occupiers and post-pandemic leasing demand
Landlord contributions to fit-out costs are increasing in order to retain existing tenants amid rising vacancy rates in periphery locations.

As is well documented, office demand falls during an economic downturn. Analysing the pre-pandemic relationship between economic growth and take up, against an average year of +0.5% GDP growth (as recorded in 2023), we would have expected core office take up in the region of 4.3m sq m. In fact, core office take up actually reached 3.7m sq m in 2023, indicating the 'remote working impact' on demand was -15%. This was, however, against a backdrop of record Eurozone inflation, significantly impacting German office markets, business confidence and extending decision-making timeframes.

Despite more employers requesting employees to be in the office a minimum

Chart 1: European office take up (sq m)



Source: Savills

number of days per week, employers are generally refraining from assigning which days their employees should attend the office. Given peak weekly occupancy rates across Europe are only 10% below the pre-pandemic weekly peak, occupiers are unable to downsize to any significant extent, all things being equal. Particularly with occupiers' preference for an increased provision of breakout areas and meeting space, demand remains fairly resilient. In fact, Savills Central London analysis of current occupier requirements indicates that more than twice as many occupiers are seeking to expand, than contract.

As economic growth recovers over the next 12-18 months, we maintain our view that by 2026, overall office demand will have fallen by 10% against the pre pandemic average.

Chart 2: European office take up 2023 (% change vs pre-Covid average)

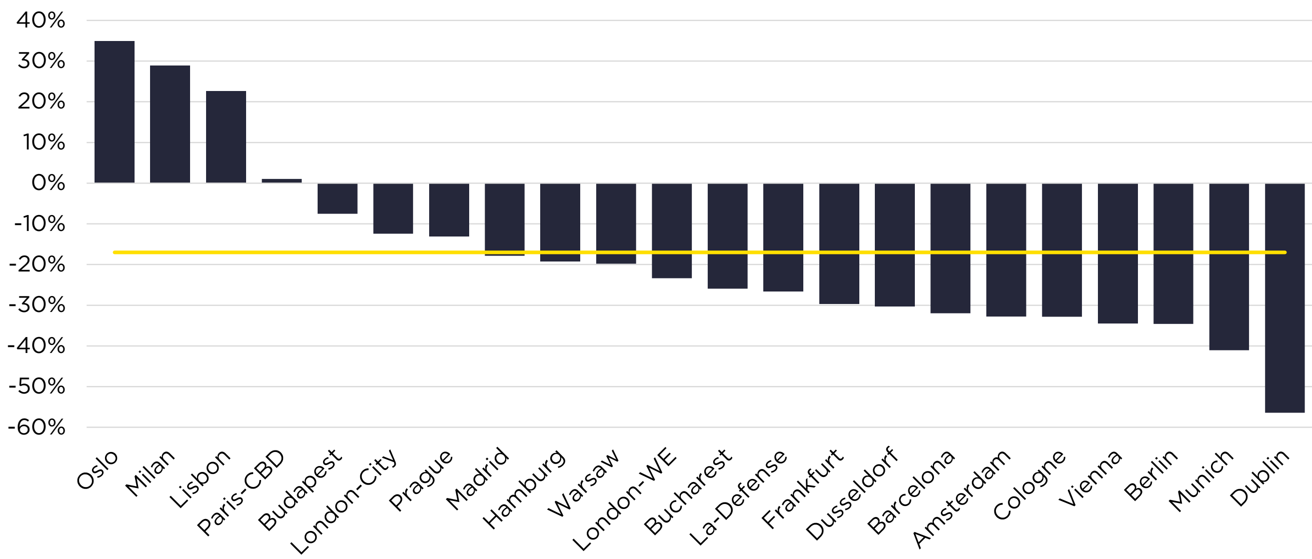
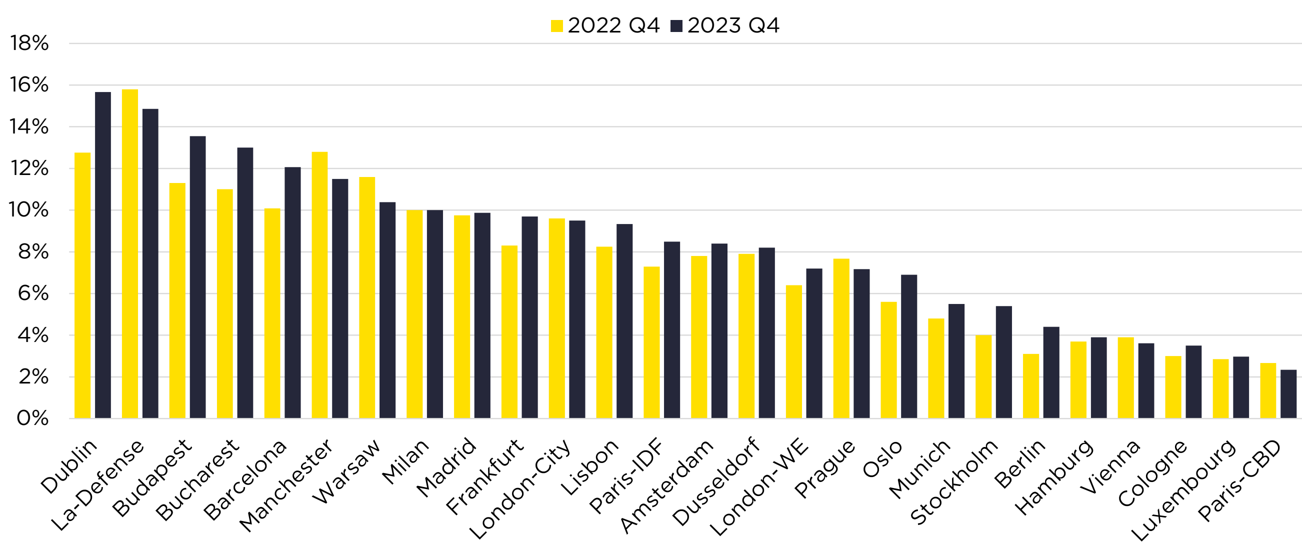


Chart 3: European office vacancy rates (%)



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Savills Commercial Research
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

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