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SPOTLIGHT
Savills Research

European Office Green Rental Premiums

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● Prime ● Secondary ● Regulation

Green premiums widening

A green rental premium is emerging across European CBDs.

Key takeaways

• Prime CBD rents have risen by an average of 7.4% since the Covid outbreak, above the secondary CBD average of 1.1% as the relationship between prime and secondary rents has diverged.

• London West End and Amsterdam have observed the strongest divergence in prime and secondary CBD rental growth since Q1 2020.

• Savills expect prime CBD rental growth to outperform secondary CBD rental growth for mainland European markets once stricter EPC regulations are inevitably introduced.

Introduction

In Savills latest European office research note, we have analysed the rental trends between prime and secondary central business district (CBD) office rents to indicate the rental premium for newbuild, energy-efficient office stock in a comparable location to older, less energy-efficient office stock, with a focus on how this has changed leading up to and in the aftermath of the pandemic. All rents refer to newly signed leases, and do not reflect index-linked rents.

What was the pre-pandemic prime/ secondary CBD rental trend?

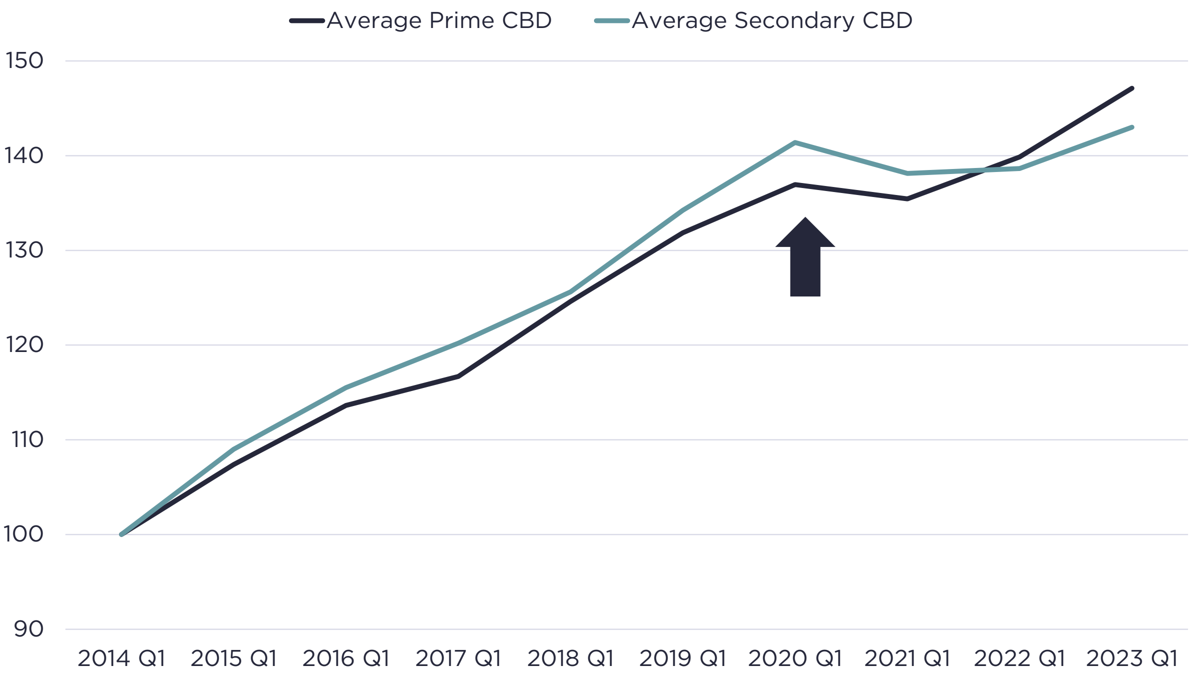
Between 2014 and 2020, prime and secondary CBD office rents tracked a fairly similar path. Average office vacancy rates fell in the aftermath of the Eurozone crisis to only 5.5% by Q1 2020, firmly in a landlord's market. As such, many occupiers seeking office space in CBD locations were forced to settle for older, more inefficient office space, lifting annual secondary CBD rental growth above that of prime CBD.

What has happened to prime and secondary CBD rents since Q1 2020? And why?

The pandemic has disrupted the relationship between prime and secondary rental growth. Average vacancy rates have since risen to 7.6% and average prime CBD rents have grown by an average of 7.4% since Q1 2020, above the secondary CBD average of only 1.1% over the same period.

Clearly, there are push and pull factors

Chart 1: European prime/ secondary CBD rental growth index (2014=100)



Source: Savills, Markets include; Amsterdam, Berlin, Copenhagen, Dublin, La Defense, London City, London West End, Madrid, Oslo, Paris CBD, Prague, Stockholm, Warsaw. Data reflects market equilibrium rents, no indexation.

influencing the shift to greener office space. On one hand, occupiers are opting for greener office space, both to attract and retain talent against industry competitors amid record low unemployment rates. More recently, though, larger, listed companies are opting for greener stock in order to reduce Scope 3 emissions for company reporting.

Perhaps the more dominant factor is the impact of EPC regulations (Energy Performance Certificates) which have been introduced in the UK and the Netherlands. Interestingly, the cities where we have seen the largest divergence between prime and secondary rents are in the countries where EPC regulations have been introduced- London West End and Amsterdam, suggesting the EPC regulation is the key driver differentiating prime and secondary CBD rental growth, rather than changing occupier requirements. In London West End, occupiers in search of prime space have very limited options, supporting newbuild rents, whilst in the City, there is a higher availability of prime buildings for occupiers. In Amsterdam, secondary CBD office rents have not grown since 2019, reflecting the challenges with leasing older stock.

What can we expect to happen to CBD rents next?

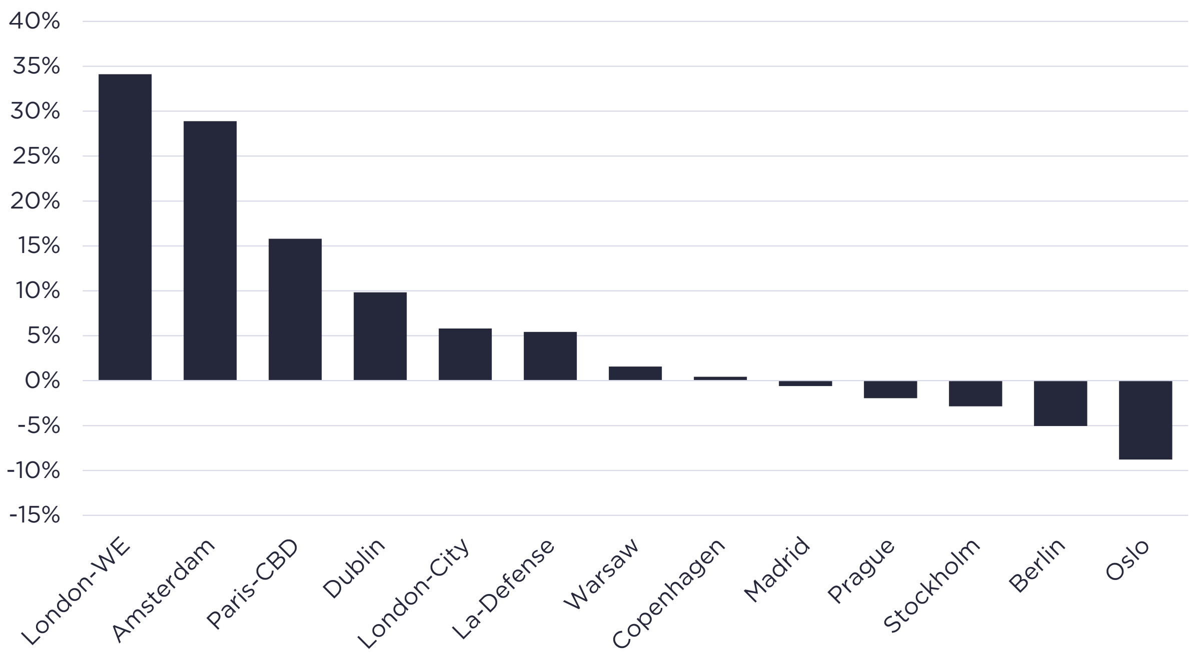
Given the relationship between tightening EPC regulation and a widening divergence between prime and secondary CBD rental growth, we expect mainland European markets will observe a similar rental diversion once stricter EPC regulations are inevitably introduced.

Should further regulation be introduced across other European markets, some landlords will review opportunities to convert to alternative uses. In Madrid, for example, developers have converted 130,000 sq m of secondary office stock over the last five years (66% of which is for residential), which has supported overall office rents.

However, occupiers have become more sensitive to location over the past three years, with demand intensifying for CBD locations in proximity to transport nodes. Indeed, our latest analysis from the City of London indicates that companies have signed leases an average of three minutes' walk from a tube station, as occupier demand shifts from non-CBD, towards CBD.

We expect landlords who are willing to undertake asset management of older CBD office stock in cities with low vacancy rates to be rewarded with rental uplift. Occupiers in search of prime CBD offices with upcoming lease expiries in 2025/26 should seek to secure their premises early, before rents rise further.

Chart 2: Prime/ secondary CBD rental growth spread (since Q1 2020)



Source: Savills , data indicates rental growth differential between prime and secondary CBD rents between Q1 2020 and Q1 2023

A view from Copenhagen

David Hauge, Head of Research, Denmark, explores the office trends impacting occupiers.

In the Copenhagen office market we have observed a trend towards higher rental levels for ESG-certified properties. Properties with the best sustainability certifications typically have lower energy consumption and thus reduce operating costs for the tenants. On the landlord side, this provides an incentive to invest more in the buildings and charge a higher rent that reflects the value of sustainable and energy efficient facilities.

The increasing awareness of properties' sustainability and environmental footprint will not only influence landlords and investors, but also drive a wider transformation within the construction and property industry. The expectation of more sustainable and energy efficient buildings will lead to further innovation, development of green technologies and new standards for construction and property management in the future.

In terms of rental development, we have not seen a decline in either the primary nor secondary office markets. One of the reasons why could be due to a relatively low vacancy combined with a large spread between prime and secondary. The number of prime offerings is relatively low, which can put an upward pressure on the secondary locations.

In light of changed working patterns, companies are reconsidering their space needs as well as new requirements for office design and technology. The increasing trend towards hybrid and home working increases the demand for flexible and serviced office solutions.

More and more office workplaces are implementing shared workplaces and free seating to reduce the number of fixed desk spaces. Several major foreign companies show increased interest in new premises needs as well as serviced, energy-efficient office solutions, which accelerates the development among landlords who actively use office furnishings, design and ESG as strategic tools in their letting practices.

Savills Commercial Research
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