Market Report
Germany Offices

February 2017

Summary

Office availability to remain scarce in 2017 – excess demand to persist

■ The above-average performance of Germany's office markets continued in 2016. This resulted in the highest take-up since 2007, rising rents and diminishing availability.

■ In central locations in particular, demand is significantly greater than the supply. Consequently, many occupiers are shifting to the next best locations or further out into the periphery, causing an increasing supply shortage and rising rents in these submarkets.

■ While it remains to be seen how new office concepts will impact occupation of office space, demand is not expected to decline for the time being. Growth in new-build office space remains below average.

■ As a result, there will be no meaningful improvement in the supply shortage over the coming years. Occupiers should, therefore, take a proactive approach by extending existing leases prematurely or becoming owner-occupiers.

"The record take-up is incredible in view of the growing supply shortage, which is increasingly challenging occupiers to lease the optimal space for their company."

Marcus Mornhart, Head of Agency Germany

Key office market figures at multi-year highs or lows

Key figures for the six largest German office lettings markets are at multi-year highs or lows. The current high demand for office space was reflected in the highest take-up since 2007 last year (3.46 million sq m). Availability is so scarce that vacancy rates in these cities are at their lowest levels for many years. Vacancies are currently particularly low in Berlin (2.7%), Munich (4.0%) and Hamburg (5.1%). Consequently, even offices of lesser fit-out quality or those in poorer locations are currently finding tenants. This confluence of factors has driven rents to multi-year highs. The average prime rent across the top six cities rose by 3.2% last year to €29.28 per sq m/month while the average rent increased by 3.4% to €15.82 per sq m/month (see Table 1).

Landlords might be generally satisfied with the current overall situation. They can often select a preferred tenant from a number of interested parties, they have practically no need to offer incentives any longer and they can demand high rents while holding fully-let properties. From a tenant's perspective, however, the current market situation is problematic. Competition for the little available space is intense. In some market segments, landlords are even demanding rental bids from interested parties.

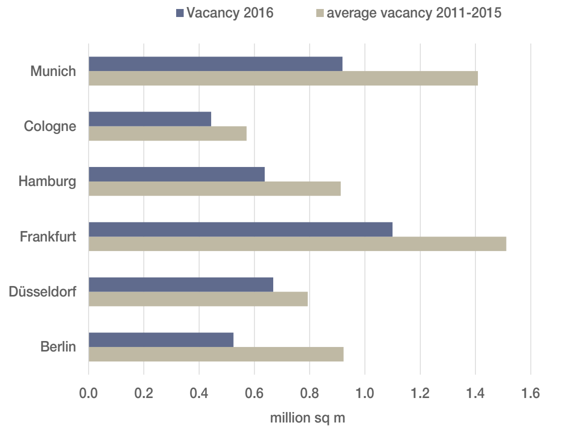
Office space is scarce – particularly in central locations

Available space is relatively rare in all six of the largest German office markets at present. Vacancy rates in these top six markets range between 2.7% (Berlin) and 8.8% (Düsseldorf) of the current office stock. In terms of floor space, vacancies range from 440,000 sq m in Cologne to 1.1 million sq m in Frankfurt. Vacancies are materially below their five-year averages at present. In Munich, for example, there is currently almost 500,000 sq m less vacant office space compared with the period between 2011 and 2015 (see Graph 1). Vacancies across the top six markets total almost 4.3 million sq m. Dividing the current vacancy by the average office take-up over the last three years produces a ratio of 1.4 (see Graph 2). Hence, there is currently only marginally more vacant space than is absorbed in an average year. This comparison illustrates how acute the shortage of office space is at present. The ratio of 1.4 is the lowest for more than 15 years and the ratio of vacancies to take-up is at multi-year lows across all markets. Berlin currently has the lowest ratio of 0.6 followed by Hamburg with 1.2 and Munich with 1.3. In Frankfurt, the ratio of 2.6 is the highest across the top six markets.

In the central submarkets of all top six cities, vacant office space is not only scarce, it is practically non-existent. In sought-after locations, interested parties often either find that there

GRAPH 1

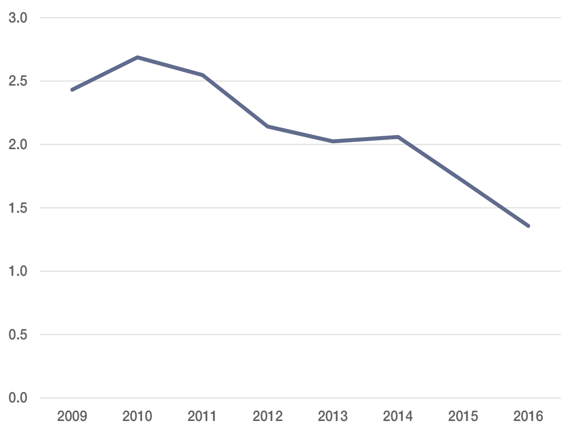
Vacant floor space Lowest office vacancy in Cologne



Source: Savills

GRAPH 2

Ratio of vacancies to take-up* Lowest figure since 2001



Source: Savills / * vacancy/average office take-up over the last three years

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 16	against Q1-Q4 15	against Q4 15 - Q3 16	Q4 16	against Q3 16	Q4 16	against Q3 16	Q4 16	against Q3 16
Berlin	929,500	-2.1%	-6.0%	2.7	-20bps	28.30	+5.2%	16.00	+0.6%
Düsseldorf	325,400	-21.5%	-13.7%	8.8	-40bps	26.00	+/-0%	14.90	+/-0%
Frankfurt	527,300	+34.4%	+19.8%	8.6	-20bps	39.00	+/-0%	18.70	+/-0%
Hamburg	529,400	+0.5%	-4.3%	5.1	-20bps	25.50	+2.0%	14.60	+/-0%
Cologne	413,900	+41.9%	+5.9%	5.8	-20bps	21.90	+/-0%	14.20	+1.8%
Munich	732,000	-2.5%	-2.6%	4.0	-10bps	35.00	+/-0%	16.50	+0.6%
Top 6	3,457,500	+4.0%	-1.3%	5.8	-20bps	29.28	+1.1%	15.82	+0.5%

Source: Savills

is no available space of sufficient size or they lose out to a competitor. Vacancy rates in these locations are significantly below the average figures for the respective overall markets. In the central submarket of Munich, for example, the vacancy rate is significantly below 2%, while the corresponding figure for Berlin is close to 1%.

Companies are shifting to peripheral locations resulting in increasing rents and supply shortages

One way in which companies are responding to the supply shortage is to shift to the next best locations or even to significantly more peripheral submarkets. Submarkets that have recently been upgraded have particularly benefited from this behaviour. This is confirmed by take-up figures from last year (see Graph 3). Take-up in the Grafenberger Allee submarket in Düsseldorf, for example, stood at 23,000 sq m, which is almost double the five-year average. A material reason for this was the completion of the “Wehrhahnlinie”, the suburban rail link between the district and the city centre. A similar picture emerges in Frankfurt. The former Bürostadt Niederrad district has been transformed into a mixed-use quarter comprising offices, apartments, local amenities and childcare facilities. In Niederrad, too, take-up last year was significantly higher than the five-year average. In Cologne, the Deutz and Kalk/Mülheim submarkets are noteworthy. While the above-average take-up in Deutz is primarily attributable to the Zurich Versicherung letting, the area still has available development sites and is therefore likely to remain in focus going forward. Kalk/Mülheim is attractive as a hip location owing to its socio-economic mix and benefits from good links to the city centre and relatively favourable rents. However, potential space in the area was exhausted in the first half of 2016. The greatest shift to the periphery across all top six markets can be seen in Munich. From the city centre to the main ring road (Mittlerer Ring), available space is a rare commodity. Consequently, more than a quarter of take-up, the highest proportion in the last five years, was attributable to peripheral locations such as Obersendling and locations outside of the city boundary such as Unterschleißheim and Haar.

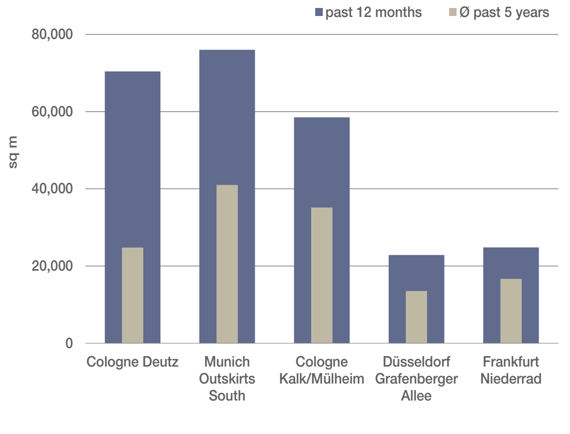
Owing to the increased market activity, availability in these alternative destinations has also declined. Office space is becoming increasingly scarce in these submarkets, which is also reflected in rental growth. The average rent in Munich’s submarket outskirts north (Stadtrand Nord) increased by 5.5% last year to €14.35 per sq m/month. This represented significantly higher growth than in the Munich market as a whole, where the average rent rose by 2.5% in the same period. The above-average rental growth outside of the centres is also set to continue in 2017. We expect average rents across the top six markets to rise by 2.1% and prime rents to gain 1.7% by the end of 2017.

Employment growth to continue

On the one hand, the limited supply of suitable offices is affecting individual companies seeking new or additional space. On the other hand, however, it is also impacting the future growth prospects of cities. More and more people are moving into cities and their surrounding areas. The average population growth across the top six cities over the last ten years stands at 5.7% (see Graph 4). Over the next ten years, the population of the top six markets is projected to grow by a further 5%. All of these people will require (affordable) housing, a subject that has already spent much time on the political agenda, resulting in measures such as the rental cap (Mietpreisbremse) and the principle that the client pays the agent’s fees (Bestellerprinzip). However, companies also require room for growth in cities, and in large volume. The number of office employees has risen by 20% over the last ten years (see Graph 4). Going forward, however, employee growth in the six largest German office markets will weaken significantly according to projections from Oxford Economics. While the number of employees has risen by almost 13% over the last ten years, this figure is only expected to grow by a further 4% by 2025. Consequently, growth in the number of office employees will also be less pronounced over the coming years. Nevertheless, cities must still

GRAPH 3

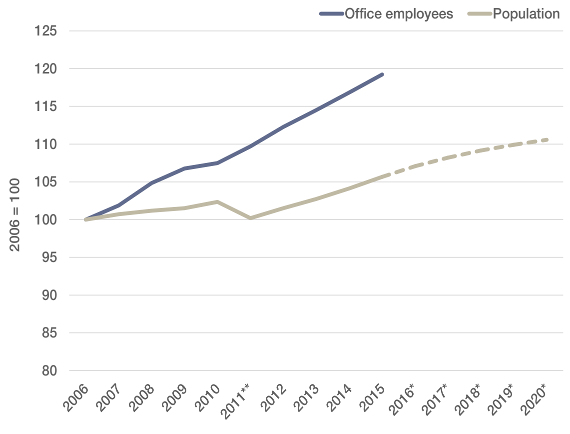
Take-up in selected submarkets
Outskirts with surplus take-up



Source: Savills

GRAPH 4

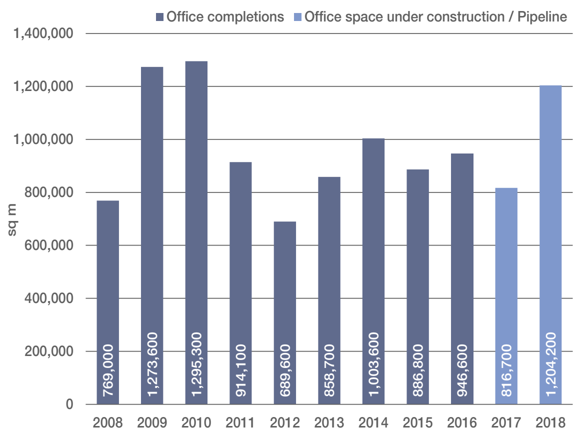
Population and employee development top 6 Further increase



Source: Bulwiengesa, Savills / * forecast ** Revision of population due to census

GRAPH 5

Development pipeline top 6 Gain of 800,000 sq m in 2017



Source: Savills

> ”Office occupiers must adapt to a more sustained or even an increasing supply shortage over the coming years. However, companies have a number of options for dealing with and responding to this market situation, all of which require a proactive approach and more lead time.”
> Matthias Pink, Head of Research Germany

find a solution to balance living and working in the future.

New office concepts make future demand for office space uncertain

Another decisive factor in demand for office space is the question of whether every office employee will actually need an office workstation going forward. Already, there are recurring examples of companies, normally larger ones, experimenting with desk-sharing concepts rather than providing a workstation for every employee. This is happening against a background of the megatrends of digitisation and connectivity, which make it possible to work from home, a coffee shop or anywhere at all. To what extent this possibility will become a reality remains to be seen. In Google's Hamburg office that opened in 2012, for example, each employee has a fixed workstation. The recently opened Microsoft office in Munich, on the other hand, exclusively uses desk-sharing. However, such concepts do not inevitably mean smaller office requirements since their sensible implementation often requires more communal space for teamwork and creative tasks as well as smaller meeting rooms for confidential discussions and telephone calls. Hence, the question of whether and to what extent digitisation will result in lower demand for office space cannot yet be answered.

Increasingly popular co-working concepts could also contribute to a decline in demand for office space since they allow companies to efficiently satisfy short-term space requirements. This segment is (currently) small compared with the traditional office market but is growing rapidly. Berlin is also the capital city of co-working in Germany. There are around 100 providers of such spaces in the city, including many smaller operators, making Berlin's co-working segment the second largest in Europe behind London. Co-working providers accounted for more than 10% of take-up in the centre of London in 2015, which was more than in the years from 2009 to 2013 combined. In Berlin, lettings from co-working providers represented around 3% of overall take-up last year.
However, another factor could impact future demand for office space even more than co-working, namely more efficient use of vacant commercial space owing to intermediation by aggregators (see box “Reduced office demand due to aggregators?”).

New-build offices remain rare commodities

Despite the current, and likely future, excess demand, the development pipeline is below average and is unlikely to relieve the strain in the market in 2017. The 800,000 sq m of new office space that will come to the market in 2017, of which more than half is already pre-let, is below both the five-year (877,000 sq m) and ten-year (924,000 sq m) averages (see Graph 5). This does not even represent one per cent of the current office stock and is significantly too low to satisfy current demand. The pipeline for 2018 currently comprises around 1.2 million sq m.

Consequently, office occupiers must adapt to a more prolonged or even an increasing supply shortage. However, companies have a number of options for dealing with and responding to this market situation, all of which require a proactive approach.

Option 1: Become an owner-occupier

Particularly for occupiers of larger offices who have difficulty in finding suitable space owing to the market situation described, the answer might be to become an owner-occupier. This would mean they could build offices that fulfil their precise expectations and requirements. However, this is a protracted process and requires the longest lead time of all options discussed here. The process from the initial decision to build an office to planning, searching for a site and finally building a property takes several years. An alternative with a less prolonged lead time is to acquire an existing (partial) property. One occupier in Berlin that could not satisfy its requirement for space in the rental market recently opted to purchase more than 1,000 sq m of a building.

Option 2: Extend the lease and improve efficiency of space

If the owner-occupier route is not an option, it may be advisable for companies to extend their existing lease prematurely to secure their current space for the long term. It may also be useful to check whether the lease should be extended for longer than the typical three or five years. Where companies have increased space requirements owing to employment growth, this can be satisfied by improving the efficiency of their existing space. However, efficiency improvements such as desk-sharing or working from home should be used prudently and with the involvement of employees. Where companies have a temporary or cyclical requirement for additional office space, this can also be satisfied by leasing co-working space.

Option 3: New letting in an existing property or development

When a company decides upon a new letting, they should act as swiftly as possible in view of the current, and likely future, supply shortage.

Then, they must choose between two options: to lease offices in an existing property or a development. Again, a pre-let in a development requires the occupier to allow a longer lead time. In either case, they should also check whether it is sensible to take a longer lease than the typical five years. Fast-growing companies should also investigate leasing larger space of which they can sublet part until such time as they require it themselves. In Berlin, tech companies and start-ups are particularly active in the subletting market, both offering and occupying space in this way.

Office markets remain landlords' markets for now – waiting is not an option for tenants

The market is likely to remain challenging for tenants over the coming years. Simply waiting and hoping for the situation to improve is, therefore, not advisable for occupiers. Rather, they should act proactively and secure their space requirements at an early stage. Landlords, on the other hand, will continue to operate from a position of strength. In almost all cities, the office markets, or at least the central locations, remain landlords' markets.

Reduced office demand due to aggregators?

Many people consider providers of co-working spaces to be disruptive and believe they pose a challenge to the business models of traditional landlords. However, the real disruptive change for office markets and providers of office space, including co-working space operators, may be imminent.

Everybody is currently talking about co-working space providers, of which Wework and Mindspace are merely the largest or most well-known. Such operators lease "normal" office space or acquire properties and offer fully-equipped workstations within these spaces to individuals or entire teams for a period of time, whether a few days or several months.

However, no sooner have they appeared than they, along with traditional providers of office space, are threatened by new competition in the form of aggregators, i.e. intermediaries that bring together supply and demand without being a provider themselves. Such models are already familiar from other sectors (see Graph 6). Uber brings together available cars and drivers with passengers to the detriment of established taxi firms. Airbnb lets temporarily vacant residential accommodation without owning or operating it. In this case, it is established hotel operators that suffer. Now, the first aggregators are appearing in the commercial property sector. The provider spacious.com, for example, delivers co-working spaces in restaurants and bars that are not used during the day. The service has only been available in New York to date but is due to be rolled out in Los Angeles, San Francisco and London going forward. The provider breather.com delivers unused office space by the hour or day. It is surely only a matter of time before such concepts gain a foothold in Germany. Should they establish themselves, demand for traditional office space and "traditional" co-working spaces would decline. Hence, those providers would be the victims of disruption.

GRAPH 6

Traditional Business vs. Aggregators Are office space providers situated on the 'wrong' side of the equation?

Unused supply	+	Aggregators	=	Sufferer
Unused cars (and drivers)	+	uber	=	Taxi operators
Unused residential space	+	airbnb	=	Hotel operators
Unused commercial space	+	spacious.com breather.com …	=	Provider/Owner of office space

Source: Savills, adapted from Poleg (https://www.linkedin.com/pulse/what-killwework-dror-poleg?trk=hp-feed-article-title-publish)

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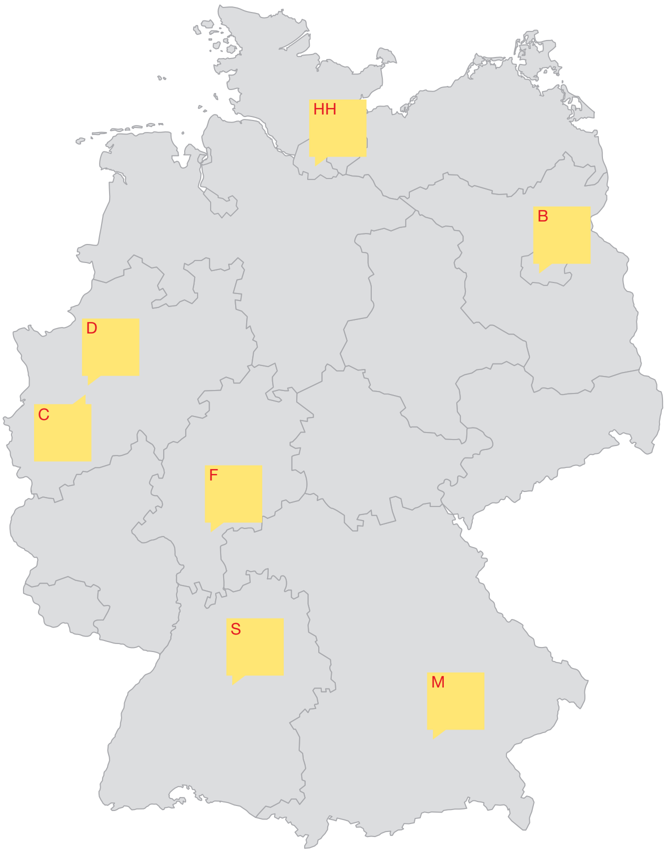

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