European Commercial - Summer 2023

SPOTLIGHT
Savills Research

European Flex Offices

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● Market dynamics ● Contract occupancy ● Flex expansion

Contract occupancy increases

Operators increase occupancy rates before further expansion expected in 2024.

Key takeaways

- **Flex offices accounted for 4% of European office take-up in H1 2023. We expect operator expansion to gather pace in 2024 as operators focus on increasing occupancy rates to retain profit margins.**
- **Management agreements are becoming more popular in regional cities with higher vacancy rates.**
- **Desk prices are expected to increase over the next 12 months as occupancy rates rises.**

Market context

European flex office take-up accounted for 4% of total office take-up in H1 2023, down from the 8% peak recorded during 2019 and from the 7% level recorded in H1 2022. London City remains the most active market at 13% of take-up, followed by Prague (8%) and Amsterdam (6%). A similar trend is visible across the US major cities, as flex office take-up fell from 7% in 2019 to 1.5% in 2023 as globally, we are observing smaller operators enter the market and increase their presence outside the major cities.

Contract occupancy resilient

Operator demand remains stable but the availability of good quality space remains limited. Many large operators have reported increases in contract occupancy rates to around the 80% level in European markets, above the 70-75% mark which usually separates profit from loss.

What's more, Savills workplace office occupancy data indicates that peak-to-trough occupancy over the course of a week has increased, reflecting employee remote working preferences. As a result, the 'timeshare' theme of two companies sharing the same flex space has not played out across the majority of the European markets and is not a trend we expect to pick up in the office sector.

As a result of stable demand and higher occupancy, both London and Amsterdam have reported 10% growth in desk prices YoY. So why have flex offices only accounted for 4% of take-up in Europe during H1 2023?

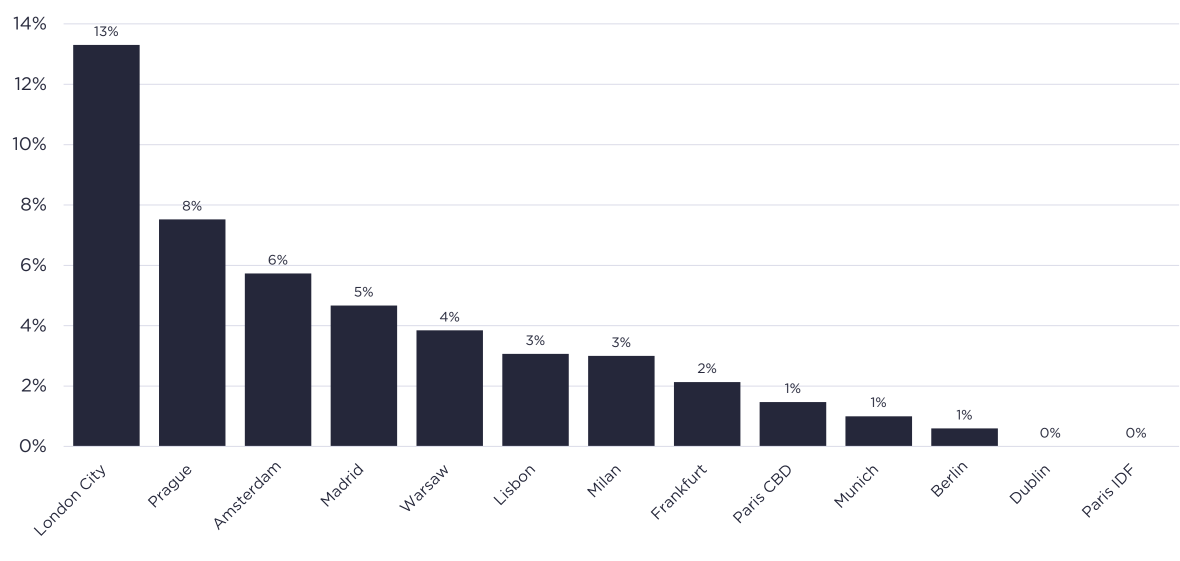
Cost pressure

Given rising operational costs, flex operators are seeking to reduce fixed overheads by forming management agreements through a profit-share arrangement with landlords. Landlords are naturally drawn to conventional leases due to the income security, and operators are finding it difficult to agree a rent low enough with the landlord to make a sufficient profit. As occupancy rates rise, landlords can achieve a higher income stream, alongside a lower initial fixed rental income, although many landlords are cautious at internalising the risk.

The difficulty comes for operators with expanding in secondary cities, where management agreements are becoming more popular. Operators are concerned with the availability of good quality stock and are reluctant to sign for older stock, particularly with increasing fitout costs, ESG considerations and higher energy costs, making it more difficult to create a profit. As landlords become more familiar with management agreements, we expect this model to gather pace in Europe outside the core locations.

However, any operators looking to reduce costs on fitout or amenity provision will be disappointed, with an increasing demand from customers for concierges, catering services, and some bespoke operators even offering spa access. We have also observed a slight

Chart 1: European flex take-up as a percentage of total, H1 2023 (%)



Source: Savills

increase in the number of private phone booths in flex office fitouts as operators adjust to the demands of agile working. We expect operators will seek to increase occupancy rates to circa 85% before expanding into new centres, more likely in 2024.

Several UK landlords have opted to launch a fitted, plug-and-play offering for clients on standard lease length, providing a fitout directly for the occupier. Landlords have more control over their scheme, but face increased operational costs, requiring expertise.

Country trends and outlook
Data from Workthere indicates that in the UK, technology firms remain the largest single occupier type who have signed for flex space (38% of total). However, we have observed a trend of professional services increasing from 6% to 13% of flex deals, supported by legal and accounting services opting for private, fully serviced space. Now, many UK tenants will refuse to sign for conventional office space unless the building has an element of grow-on space to satisfy future needs.

In **Germany**, many of the flex operators have been working on a profitable business model and have grown at a sustainable pace. However, given low market vacancy rates, operators are forced to pay headline rents on long leases. Small and medium sized enterprises (SMEs) support the majority of demand, due to the expansion requirements.

Amsterdam remains among the more mature mainland European markets, where HOFF signed for 7,250 sq m at Tower Ten during the first quarter of the year. Some operators are providing high-end boutique flex space, which is beginning to create a two-tier market. We have also seen niche operators convert some retail and conventional office units into flex offices to reduce voids.

In **Madrid**, smaller office deals are accounting for a lower proportion of the conventional market than previously, as occupiers opt for flexible terms that facilitate a more hybrid model.

Operators are reporting occupancy rates >80% in **Paris CBD**, where operators and landlords tend to agree terms at headline rents on traditional leases due to the low vacancy rates. Desk costs are generally stable but tend to range between €800 to €1000 per month for prime space, in some locations. Outside the city centre, management agreements are becoming more popular.

In **Warsaw**, four flex deals were signed, reflecting 6,200 sq m of space, although occupancy rates remain high. In regional cities, six deals were recorded, but one case reflected an operator having to surrender a lease, with one assignment to a new operator. Rents have increased by >10% YoY in several locations.

Overall, we believe flex office operator expansion will increase in 2024 to circa 5-8% of take-up, once contract occupancy approaches the 85% mark. Given employer hiring sentiment has shown signs of weakening over the last 3-6 months, flex contract occupancy growth will be supported by companies looking for flexible terms to ensure they optimise the right level of workspace during this period, at the same time as providing an enhanced amenity offering.

Savills Commercial Research
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