European Commercial - June 2022

SPOTLIGHT
Savills Research

European Office Occupier Outlook

● Economy ● Occupier ● Rents

European Office Take Up

Increased demand for flexible office space.

Eurozone inflation is forecast by Focus Economics to average 6.6% in 2022, before declining to 2.8% in 2023 as GDP growth is expected to slow to 2.6% in 2022 and 2.1% in 2023. Coupled with supply chain disruption and rising fit-out costs, a key question emerging from Q1 2022 is where rents will go to offset inflation. Unemployment rates across Europe continued to fall throughout Q1 2022, including in Germany, Italy and the Netherlands. Moreover, the Eurozone Services PMI remains strong at 56.3 indicating growth amongst the services sector.

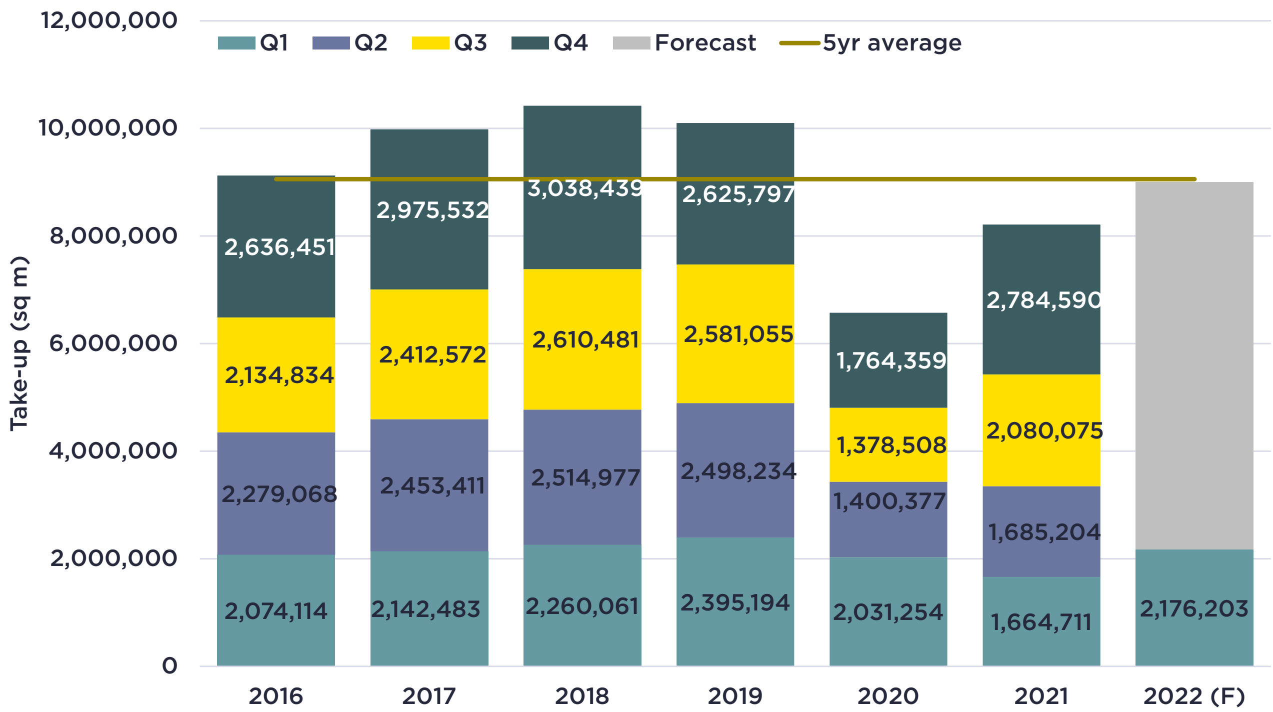
European office take up reached 8.2m sq m during 2021, with office demand recovering strongly at 4% above the five-year Q1 average. Occupier decision making and leasing activity has resumed with Q1 2022 recording the strongest first quarter leasing volume since Q1 2019, driven by pent up occupier demand. La Defense (13.7%), Warsaw (12.2%) and Bucharest (11%) now have the highest European vacancy rates, yet all observed decreases over the past six months.

In Savills recent European Remote Working Impact Analysis, we estimate the potential impact of remote working will reduce office demand by 10%, with the most resilient markets located in Western and Northern Europe.

Since end 2021, we have observed a relatively low proportion of demand in the 500-1000 sq m size band, with a number of mid-sized occupiers opting to sign for flex space during the short/medium term as they deal with a return to the workplace. There are a number of factors at play here: primarily uncertainty around the return to work, talent attraction, employee retention and also capital expenditure in uncertain times. Workthere's latest data indicates UK enquiries for flexible office space are up 82% on pre-pandemic levels, and 20% of demand in 2021 has come from companies previously working from home looking for flexible space.

Savills Research forecast in the region of 9m sq m of take up for the full year 2022 as occupiers shift to more prime locations and seek to densify their floorspace, although much of this will depend on the level of quality available space.

Chart 1: European office take up (sq m)



Source: Savills

Stabilising Vacancy Rates

Rental growth across Europe as a shortage of grade A space adds upwards pressure on prime rents.

European office vacancy rates have remained at 7.2% between Q3 2021 and Q1 2022. This was partly due to a shortage of new deliveries of space and tenants withdrawing stock which was previously openly marketed.

Core Western European markets remain at vacancy rates of 2-5%, whilst London WE and London City have stabilised after leasing activity picked up in H2 2021.

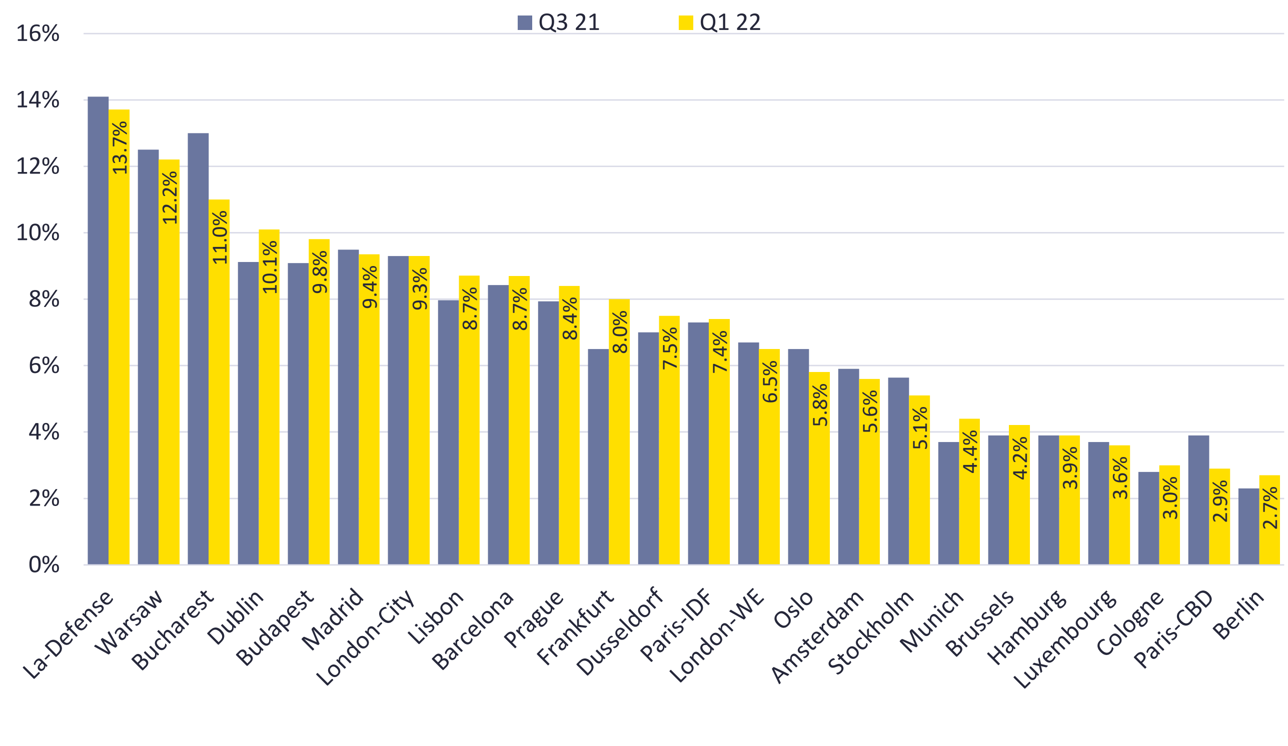
A shortage of prime stock has increased prime rents by an average of 2.2% over the past 12 months. Munich (+18.4%), Oslo (+12.2%) and Amsterdam (+11.1%) reported the largest annual increases, whilst Frankfurt (-7.2%), Cologne (-4.5%) and Barcelona (-1.8%) observed falls.

Lease indexation is contributing to upward rental pressure, whilst rising construction costs are helping to support rental levels for standing stock as occupiers demand higher quality space.

As a result of stabilising vacancy CBD rates, we have seen lease incentives move back in, from 11.1% of average total contracted rent in Q4 2020 to 10.5% of contracted rent in Q1 2022. For example, in Warsaw rent free periods have contracted by 10 basis points due to resilient office demand, however, space is tight in Berlin and Paris-CBD with vacancy rates of 2.7% and 2.9% respectively.

Although the Eurozone Services PMI decreased to 56.3 in May 2022 from 57.7 in April 2022, business confidence within the services sector remains high when looking at a ten year average.

Chart 2: European office vacancy rates (%)



Source: Savills

Occupier Insights

As employers navigate the office landscape post-pandemic, demand for talent is still high on the agenda. Deloitte's latest UK CFO Survey indicates that although the disruption caused by recruitment difficulties and labour shortages had fallen by around 10% in H1 2022, such issues are expected to remain in a year's time with one in four CFOs still anticipating disruption.

Data from the Office for National Statistics Opinions and Lifestyle Survey (OPN) shows that although the number of those exclusively home working had fallen in Spring 2022, the proportion of people who plan to work from home more often than their usual place of work has risen from 30% to 40%. As a result, employers are more aware they need to offer choice and flexibility to their employees.

However, many global occupiers remain committed to the office and remain in search of high quality office space in prime locations with the best amenities. This year, we have already seen Google recently acquire both The Warsaw Hub complex from Ghelamco and the St John's Terminal building in New York in a move indicating a commitment to office based working post-pandemic.

Moreover, we are observing a rising demand from occupiers in search of more flexible lease terms who are increasingly opting for flexible office space. In particular, financial and professional services companies have increased their flex office footprint in order to attract talent back to the workplace and consolidate their existing office portfolio. Occupiers are demanding greater convenience, looking to move into plug and play offices, either through a flexible operator or through landlord fitted space. However, the biggest change post-pandemic has been businesses adapting to how their employees now want to work, including the return to the office.

Sustainability is another key theme surrounding office demand in 2022. Occupier demand has now intensified to find the best-in-class space and this includes having high environmental credentials as a result of both corporate statements and employee demand. However, given the rising construction costs in order to futureproof office stock, this will create upward pressure on overall rental levels. Although it was observed that there was no real change in build costs during Q1 2022, a result of supply chain disruption and labour cost inflation is likely to create an upward pressure on rents and raises the question as to who will absorb the increase in cost.

We are now observing human resources teams begin to offer more flexibility to workers with regard to remote working policies. Having this choice is attractive to employees and a way for employers to retain staff. Collaboration is one of the key reasons many have a need to go into the office and so adapting the space to include more meeting rooms and break-out areas will only encourage employees back and maintain the necessity of the office.

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Savills Commercial Research
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Offices

Matthew Fitzgerald
Cross Border Tenant Advisory – EMEA
+44 (0) 207 299 3082
mfitzgerald@savills.com

Research

Mike Barnes
European Commercial Research
+44 (0) 207 075 2864
mike.barnes@savills.com

Georgia Ferris
European Commercial Research
+44 (0) 798 973 3368
georgia.ferris@savills.com