Spotlight
The future for serviced offices in Europe

July 2017

Serviced offices sweeping into Europe

■ The growth of serviced office space is disrupting the conventional commercial real estate market. The demand for serviced offices is rising significantly in a number of European markets fuelled by the trend towards more flexible working. There are reasons to believe that this strong growth in demand will persist in select locations in the long run.

■ The UK and US are the most mature serviced office markets. Central London is the leading city globally with 1,100+ serviced office locations. Serviced office providers in London accounted for 10% of total take-up in 2015 and 9% in 2016. The question is whether serviced offices are expected to grow to the same extent in other European cities.

■ Other European cities lagged significantly behind London in terms of serviced office take-up share in 2015 and 2016. This share was sub 3% in most markets including all the main German cities, Paris, Madrid, Barcelona, Dublin, Warsaw, Birmingham and Manchester. The exception is Amsterdam where serviced offices accounted for 7% (40,000 sq m) of total take up in 2016.

■ During Q1 2017 serviced office providers increased their share of total take-up in a number of European locations. The standout cities include Birmingham where serviced offices accounted for 25% of total take-up compared to 2016 when no transactions were recorded. Frankfurt's share increased from 0.5% in 2016 to 7.5% in Q1 2017. Similarly, Dublin's share rose from 1.7% in 2016 to nearly 7% in Q1. This could be an early sign of the growth that is yet to emerge in many European markets.

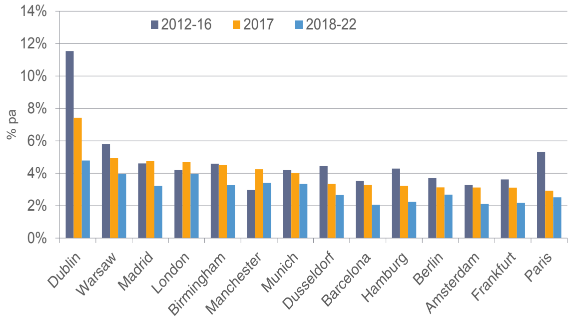
Growth of Tech has been one of the key drivers

■ There are a number of key drivers behind the rise of serviced office space. The expansion of the Tech sector, particularly of small enterprises and start-ups, has been one of the key factors. These firms require flexibility which in most cases conventional offices do not offer. Indeed, 17 out of the 20 cities covered in our analysis mentioned the growth of Tech sector as one of the key drivers.

■ Unsurprisingly, the UK leads the rankings in terms of new start-ups; around 14% of all active enterprises are newly born enterprises (Eurostat, Graph 4). Poland follows in second place with 12.5%. The estimate shows that there were around 2,700 start-ups in Poland last year, which is expected to lead to a strong future demand for flexible office space. In contrast, new start-ups as a % of all active enterprises were at 10% or lower in all other European countries.

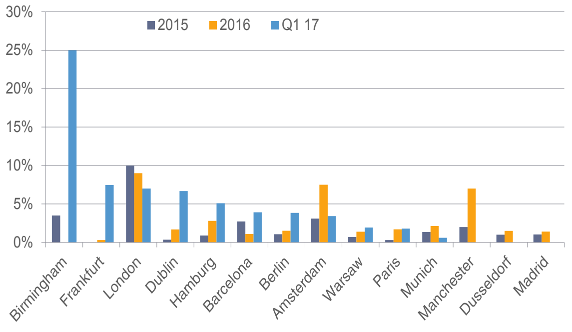
■ Other key drivers of the demand for serviced offices include inflexible lease terms and lack of conventional office space. With continued political and economic instability in Europe, some occupiers do not want to get tied into long-term leases. Firms want to be agile and expand or downsize as required. Meanwhile, the vacancy rates for grade A office space in the majority of the CBD markets are currently below 5%. In particular there is a shortage of modern small sized offices suitable for start ups and small enterprises, which is leading occupiers to consider moving to serviced offices.

GRAPH 1
Tech output growth



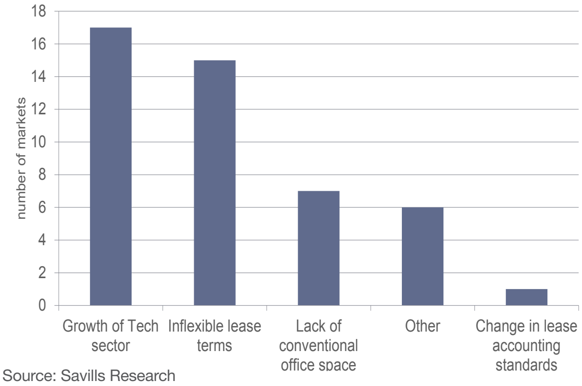
Source: Oxford Economics

GRAPH 2
Serviced offices as % of total take-up



Source: Savills Research

GRAPH 3
Reasons for growth of serviced offices



Source: Savills Research

■ With new lease accounting standards coming into force in 2019, occupiers will need to review their active portfolios and start analysing the impact of the accounting measures. All leases of one year or more will need to appear on the balance sheet both as an asset and a liability, incurring an annual interest charge. Leases under 12 months will be excluded from new regulations as well as leases that are serviced agreements (where another entity has control over the right of use). Therefore, there may be a favourable business case for occupiers to switch from conventional office leases to serviced office agreements.

The boom of serviced office providers

■ To cater for increasing demand for flexible workspaces, there has been a boom in the number of serviced office providers over the last few years as well as the amount of centres they have opened. This has been evident in the UK, particularly in London. However, strong growth is increasingly starting to spread to other European cities.

■ While Regus has been the main "established" serviced office provider globally for over two decades, "new" providers have emerged which are growing rapidly. For instance, the American giant WeWork is taking the world by storm and is currently present in over 190 office locations. Other international providers include The Office Group, i2 Office, Business Link, TechHub, Mindspace etc. Besides these main operators, there are smaller local players in each of the cities providing a more boutique offering. For instance, in Berlin there are more than 100 serviced office spaces serving a vibrant start-up community, the majority of which are operated by local providers.

■ Each operator's brand identity is shaped depending on who their target audience is. WeWork is branded around creativity and community of businesses. London based Huckletree is focussed on Tech and innovation led businesses, and sustainability. Mindspace, with locations in Germany, Israel and Warsaw, shaped its brand based on collaboration and community appeal.

■ Serviced office operators, particularly larger providers, tend to take modern grade A offices in the CBD or near the city centre to attract the top tenants. This was confirmed in 19 out of the 20 markets in our analysis. In contrast, some smaller providers tend to favour high quality secondary offices in trendy suburbs.

■ To capitalise on the significant growth potential of the serviced office market, landlords and property developers are also getting directly involved. For instance, Skanska has partnered with Business Link to create the largest network of serviced office space in the CEE. British Land has launched its new flexible workspace - Storey, which is targeted at companies employing between 20 to 70 people. The new brand will initially offer flexible workspace around its current developments in London such as Broadgate, Paddington and Regent's Place campuses. 8,000 sq m of flexible space is currently being fitted out with a further 8,000 sq m earmarked for development as the year progresses. It is expected that other landlords and developers will follow this trend.

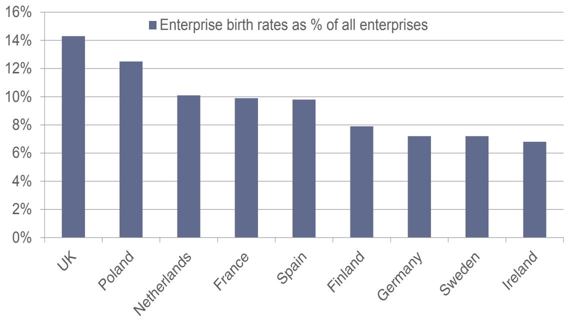
Full spectrum of services on offer

■ New "popular" ways of working such as co-working and desk-sharing are challenging the traditional working practices driven mainly by cost advantages. To cater for this change in employees' working styles, serviced office providers not only offer private office space but also areas for co-working, desk-sharing, meeting rooms and communal areas. Globally, around 30% of flexible office spaces are dedicated to co-working while in London this number stands at around 20%. However, the set-up of the serviced office space depends on the locational attributes such as the economic and demographic profile of the area. Serviced office operators located in financial centres provide a significantly higher share of private offices compared to those located in "creative" quarters which offer more spaces designated for co-working.

■ Initially, many "new" serviced office operators targeted small enterprises, start-ups and freelancers, offering month-to-month flexible agreements. However, they are now gearing up to cater for more corporate needs. Larger enterprises, including finance firms and banks (particularly their innovation and Tech departments), are showing interest in serviced offices and are willing to sign longer term contracts. This way, banks are attracting the best talent whilst also encouraging their staff to collaborate. Most operators are adapting to these changes and now offer customised solutions for businesses of any size. ■

GRAPH 4

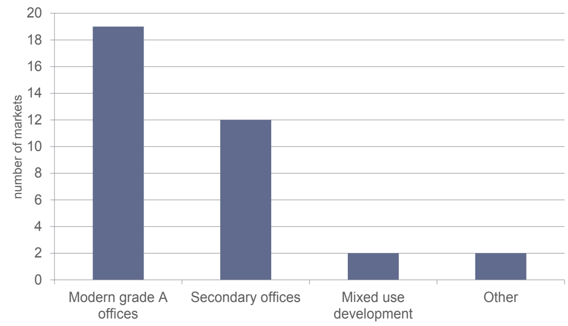
New start-ups



Source: Eurostat data

GRAPH 5

Type of space taken by serviced office providers



Source: Savills Research

Demand drivers

Flexibility of work & workers to drive future demand

■ Technology has revolutionised where and how we work, and has therefore been one of the main catalysts of the growth of serviced offices. For example, cloud technology enables occupiers to be more agile and cost effective when it comes to workplace solutions.

■ While by 2020 millennials will form 50% of the global workforce, one of the most pressing concerns for employers is that of an ageing population. Companies will need to respond to both generations' needs and aspirations in order to attract and retain the best talent. Neither generation is driven primarily by the financial rewards. Quality of life and flexible working/careers are the key elements which will drive the future demand for office space.

■ Millennials prefer to live in urban centres or "hip" suburbs and are unwilling to travel far to get to work. Serviced office spaces located in the CBDs/city centres, are therefore a preferred choice by firms in attracting the right talent.

Outlook

■ London has been the top city globally in terms of the serviced office market share. While serviced office operators accounted for a mere 1% of total take-up in London in 2010, this share gradually climbed to 10% in 2015. The share stood at 9% in 2016 and 7% in Q1 2017. Impressively, serviced office operators accounted for nearly a quarter of all leasing transactions in Central London in Q2 2017. This was boosted by the two largest transactions of the quarter by WeWork. We expect occupier demand for serviced offices to remain strong, driven by the economic and political uncertainties including Brexit, pushing companies to shorter and more flexible leases.

■ Are other markets going to experience the same level of growth of serviced offices as London? In the UK, growth is spreading to other regional cities such as Birmingham and Manchester. For instance, WeWork has just announced the opening of the office in Manchester, its first UK office outside of London. A number of other European markets such as Amsterdam, Berlin, Dublin, Frankfurt, Paris and Warsaw started to witness an increased level of take-up by serviced office operators in 2016 and Q1 2017. It is expected that this growth will accelerate on the back of growth in the Tech sector and employment, supportive start-up environment and declining vacancy rates for modern small sized offices. As a result, Savills forecast that take-up by serviced office operators could climb up to around 5% of total take-up in 2017 with a significant growth potential going forward.

■ Demand for serviced offices is also growing in other "peripheral" cities. Examples include Lisbon and Barcelona with a strong culture of co-working, and Belfast where serviced office operators accounted for 9% of total take-up in 2016 with take-up expected to grow by 10-15% pa over the next five years. Eastern European Tech hubs have a strong growth potential driven by a vibrant start-up and entrepreneurial culture. Some CEE cities tend to specialise in specific sectors. For instance, Krakow is a hub for beacon technology while Prague for cybersecurity. It is expected that other cities will follow this trend.

■ One of the key challenges for operators is what happens if tenants start to resist paying higher costs associated with serviced office space. Also, as serviced office market continues to expand, the competition amongst operators will intensify.

■ One of the questions is whether we will start to see a consolidation amongst the operators and whether larger operators will start buying smaller local ones. In addition, some larger providers such as Regus and WeWork are starting to buy their own properties. All providers might also face further competition from traditional landlords as they start to enter the serviced office market directly. ■

Markets to watch

■ **Amsterdam**: Serviced office operators accounted for 7% of the total take-up in 2016. There are 22 digital incubators across the city contributing to growth of the Tech start-ups. Take-up is expected to grow between 20-30% pa over the next five years.

■ **Berlin:** There are more than 100 serviced offices in the city and Tech start-ups could generate as many as 100,000 jobs by 2020, according to McKinsey.

■ **Dublin:** Take-up by serviced office operators is on the rise. Growth in Tech GVA is expected at 5.5% pa during 2017-21, according to Oxford Economics - the strongest growth amongst the main European cities.

■ **London:** The underlying fundamentals of demand for serviced offices remain strong. London will keep its crown in the serviced office market share and a choice it offers to end users.

■ **Barcelona and Madrid:** The volume invested in start-ups has increased significantly over the last few years. Barcelona has a strong culture of co-working while Madrid is enjoying a strong growth in Tech GVA - forecast at 4.8% this year.

■ **Paris:** Demand from Tech firms is expected to rise over the coming years as the government promotes Paris as the new Tech start-up capital of Europe. Start-ups will be drawn to the world's largest digital incubator - Station F campus due to open this year.

■ **Stockholm:** It is one of the leaders in innovation and the second most prolific Tech hub in the world on a per capita basis, only behind Silicon Valley.

■ **Warsaw:** Google opened Tech campus for start-ups in 2017 - the first of its kind in the CEE. Tech GVA is forecast to grow by 4.1% pa during 2017-21. A number of international serviced office providers are expected to enter the market in 2017.

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