EMEA

CITY OFFICES

QUARTER 2 | 2019

EXECUTIVE SUMMARY

- **ECONOMY:** Increasing divergence between robust activity in services and a struggling manufacturing sector is starting to make its mark on European growth. Despite solid GDP growth in Q1 2019 (EU28: 0.5%), Q2 is expected to be much lower. The forecast for full-year 2019 is down to 1.3%. Domestic demand is the key driver of the economy, with net trade makinga zero contribution to growth. If weakness in the industrial sector persists and external threats continue (generating economic shocks), there is an increasing likelihood that domestic resilience and sentiment will falter, dragging down growth.
- **EMPLOYMENT:** The labour market remains resilient. Employment growth of around 0.9% is forecast for 2019 across the EU28, and the unemployment rate had fallen to a new low of 7.5% in June. However, employment growth is slowing and will continue to decelerate in line with the slowdown in the overall economy. Moreover, structural change in the form of declining working populations are starting to distort unemployment rates. The total pool of employed labour is beginning to diminish in some locations.
- **TAKE-UP:** Despite the positive influence of co-working and broader corporate expansion, the 12-month rolling take-up average for EMEA dropped by -2.8% (y/y) at end Q2 2019. This represents a big change from a year ago when the same measure indicated growth of 10.8% (y/y). Tight labour markets and weakening economic sentiment are clearly a factor in this trend shift, as expected in our 2018 H1 review, but they are not the only causes. Supply-side factors are also having an impact, whereby the lack of quality, available space is acting as a drag on take-up volumes. above total pre-letting activity for full-year 2018.
- **PRE-LEASING:** In the majority of major city markets, a shortage of availability is curtailing leasing activity, pushing occupiers into taking pre-lets.

  Pre-leasing activity has been absorbing much new development coming to market over the next 24 months. In Germany, 60% of the pipeline has been pre-let in Berlin, and 70% in Hamburg, for example. In Barcelona, pre-leasing activity is already 28% above the total for full year 2018. In CEE markets, Sofia and Bucharest witnessed very high pre-leasing activity and the largest leasing transactions in Warsaw this H1 were all pre-let contracts. Conversely, developer caution is maintaining tight vacancy and availability.
- **VACANCY:** The EMEA weighted vacancy average reached 6.4% in Q2, compared to 8% just two years ago, indicating that availability remains very tight, with vacancy at record lows. The lowest vacancy rates tend to be concentrated in Western Europe, especially Germany. Yet , but a range of cities are reporting vacancy rates of sub-5% including Berlin, Munich, Stuttgart, Cologne, Hamburg, Vienna, London West-End, Stockholm, Barcelona, Prague and Belgrade. Many other markets are below the 8% vacancy threshold.
- **RENTAL GROWTH:** The rental growth trend remains positive, with average growth of +2.8% for all the EMEA markets surveyed, on an annual rolling basis. A number of markets continue to perform strongly on a 12-month rolling annual basis, such as Cologne, Oslo, Barcelona and Porto, and further afield in Cairo - all of which posted rental growth of over 10%. On a quarterly basis, Berlin (9%) Cairo (6%) Aarhus (4%) Amsterdam and Krakow (both 3%) were the fastest-growing of all EMEA markets surveyed in 2Q19 vs 1Q19. The slowest-growing (or declining markets) included Dubai (-6%) Brussels (-5%) Rotterdam (-1%). London West End, London City, Paris and Dublin remained stable. Other major markets witnessed subdued growth q/q, including, such as Stockholm (+1.8%) and Munich.

KEY METRICS IN MAJOR EMEA CITIES: H1 2019

	PRIME HEADLINE RENT			VACANCY			TAKE-UP	
CITY	€/SQ M/ MONTH Q2 2019	6MONTH RENTAL GROWTH	12M OUTLOOK	% Q2 2019	6M CHANGE, BPS	12M OUTLOOK	SQ M H1 2019	ANNUAL CHANGE
Abu Dhabi	27.24	-8.8%	▬	32.00	200	▼	n/a	n/a
Amsterdam	37.92	3.4%	▲	6.90	110	▬	59	-62.1%
Berlin	38.50	9.7%	▲	1.40	-10	▼	391	3.7%
Birmingham	34.02	3.0%	▲	7.85	33	▼	48	61.6%
Bucharest	18.00	0.0%	▬	10.00	50	▲	188	26.0%
Budapest	21.00	5.0%	▲	7.30	0	▬	242	-4.2%
Copenhagen	22.89	2.5%	▲	8.00	80	▬	n/a	n/a
Dubai	42.18	-12.7%	▬	25.00	0	▬	n/a	n/a
Dublin	55.83	0.0%	▬	6.50	-90	▬	32	-80.6%
Frankfurt	43.00	2.4%	▲	7.20	40	▼	256	0.7%
Istanbul	30.89	-7.5%	▼	33.65	-234	▬	67	5.3%
London - City	68.53	0.0%	▲	5.26	-24	▬	255	-22.6%
London - West End	120.06	0.0%	▲	4.43	9	▬	196	-1.2%
Madrid	35.50	2.9%	▲	8.90	-120	▲	380	64.6%
Milan	48.33	5.5%	▬	11.86	-14	▬	225	21.4%
Moscow	65.91	0.0%	▲	7.43	-130	▼	805	8.3%
Munich	41.00	0.0%	▲	1.70	-10	▬	424	-10.5%
Paris	70.00	0.0%	▬	5.20	-20	▼	996	-16.5%
Prague	22.50	2.3%	▲	4.56	-56	▬	211	-10.3%
Stockholm	59.96	1.3%	▲	4.75	-25	▬	n/a	n/a
Vienna	28.00	0.0%	▬	4.30	-140	▼	38	-55.2%
Warsaw	22.00	0.0%	▲	8.50	-20	▼	406	-4.4%

Sources: Colliers International

FIGURE 1:
EUROZONE: CONTRIBUTIONS TO GDP GROWTH
2011-2020

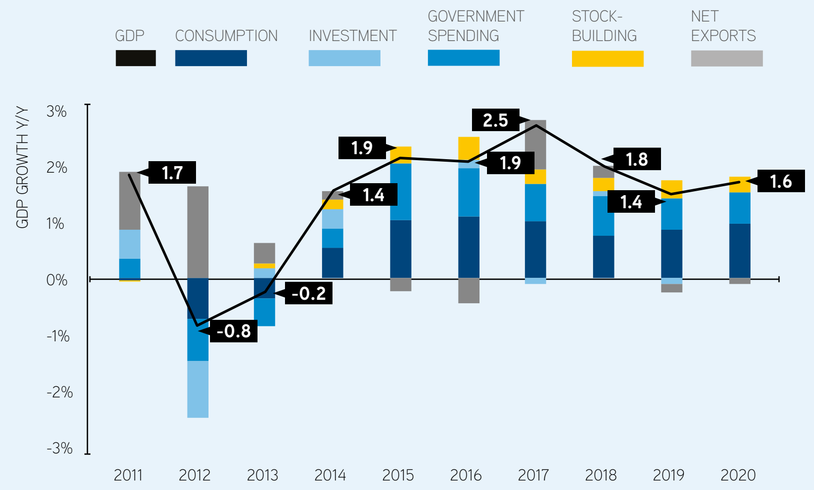


FIGURE 2:
ANNUAL GDP GROWTH RATES:
2018-2020

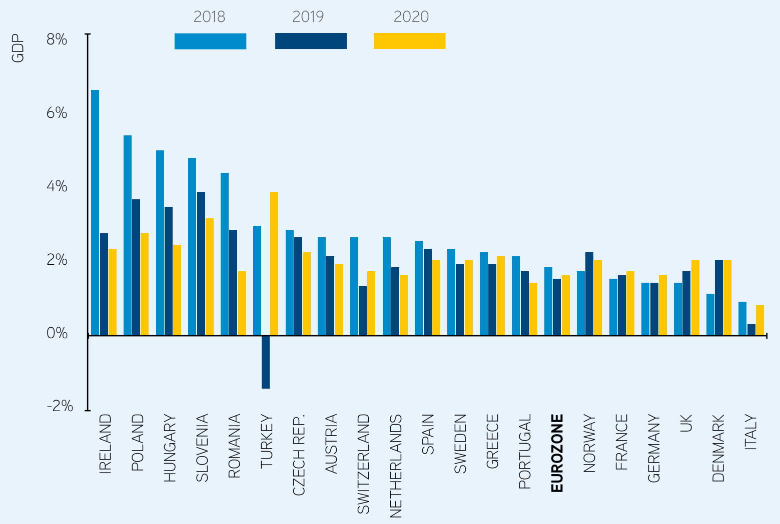
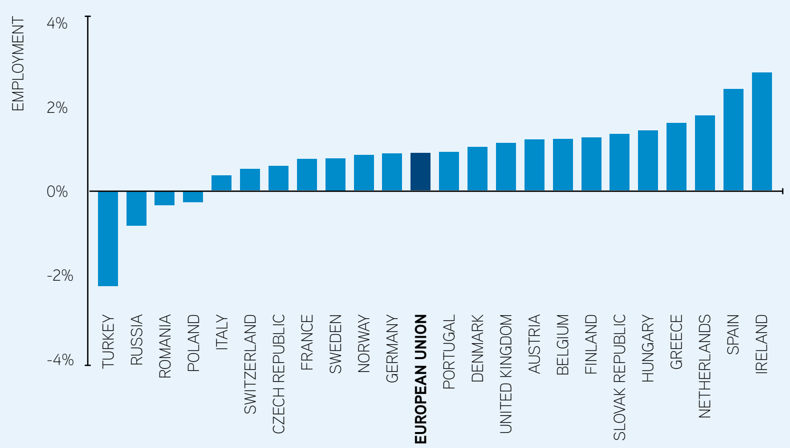


FIGURE 3:
FORECAST EMPLOYMENT GROWTH
2019 (VS 2018)



Sources: Figure 1: Colliers International, Oxford Economics | Figure 2: Colliers International, Oxford Economics | Figure 3: Colliers International, Oxford Economics

MACROECONOMIC OVERVIEW

The first half of 2019 displayed some tentative signs of recovery after the disappointing performance of the EU28 in the second half of 2018, but disappointing PMI numbers for July highlight that the economy remains weak at the start of Q3. The Sentix investor index for the eurozone fell to -5.8 (down from -3.3 in June).

The industrial sector is at the centre of the slump, with German manufacturers suffering the brunt of the impact. While the service sector remains robust, there are increasing signs of negative spill-over effects slowly filtering through from the weak manufacturing sector. Meanwhile the increasing probability of a 'no-deal Brexit' is further clouding the outlook.

As the engine of the eurozone, the faltering German performance is having a considerable impact on the outlook. Despite the global weakness, q/q GDP growth in Germany in 1Q19 came in at a healthy 0.4%. Employment growth is slowing in part due to the tightness of the labour supply, but it remains solid. The unemployment rate was at 5% in June and wage growth seems to be stabilising at around 3% y/y. But survey indicators point at a slowdown to q/q GDP growth of 0.2% in Q2.

In the UK, although there was a rebound in economic growth in May, there's still a high possibility that the economy contracted in Q2. After higher-than-expected GDP growth of 0.5%, a possible result of stockpiling and other Brexit-related economic distortions, Oxford Economics estimates Q2 growth could have declined by 0.2% q/q. With the prospects of a 'no-deal Brexit' and a General Election uncertainty is not showing signs of abating any time soon.

France is bucking the trend and business and consumer confidence have recovered sharply, after Macron's fiscal policy to placate the Yellow Vest protests lent an added boost to the economy. However, lukewarm q/q GDP growth of 0.2% in Q2 (after 0.3% q/q in Q1) means the pace of growth is moderating. The unemployment rate shrank to 8.7%, and is forecast to fall to 8.3% by year-end.

In Southern Europe, Spain is set for yet another year of growth above the eurozone: after q/q growth of 0.7% in Q1, a similar rate is expected in Q2. The stubbornly high unemployment rate of 13% implies a heightened vulnerability to the deteriorating global environment. Meanwhile, Italy has become the eurozone's weakest link: although GDP was slightly up (0.2%) q/q in Q1 2019, the economy is expected to contract again in Q2, marking the third quarterly drop in a year.The current political instability is priming downside risks in the medium term.

The Nordic economies continue to expand. With low unemployment rates of 6.3% (Sweden), 6.8% (Finland) and the extremely tight labour markets in Denmark and Norway hovering below the 4% mark, domestic demand remains robust. Moreover, labour shortages have eased since the start of 2019.

Growth peaked last year in Central and Eastern Europe (CEE) but the GDP data for Q1 suggests the region weathered the slowdown in the eurozone relatively well. Pressing labour shortages are particularly acute however, with unemployment rates among the lowest in Europe, particularly in Czechia (3%) Hungary (3.5%) and Poland (5.6%).

FIGURE 4:
UNEMPLOYMENT RATE, MAIN EMEA CITIES,
2018-2020

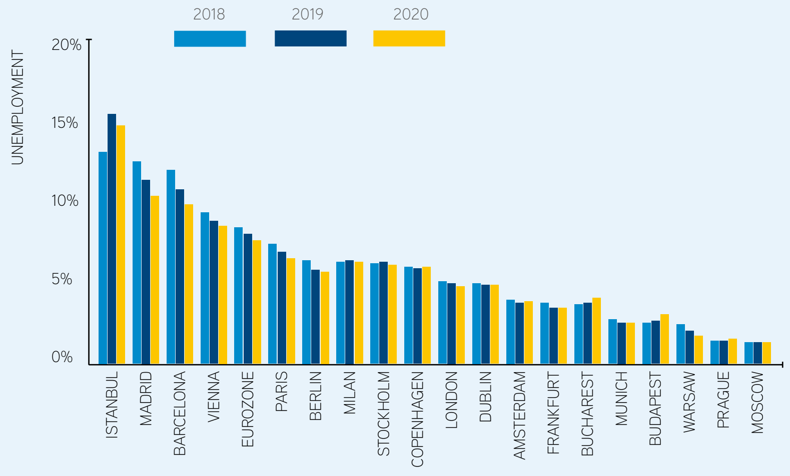


FIGURE 5:
CHANGE IN 12 MONTH ROLLING TAKE-UP

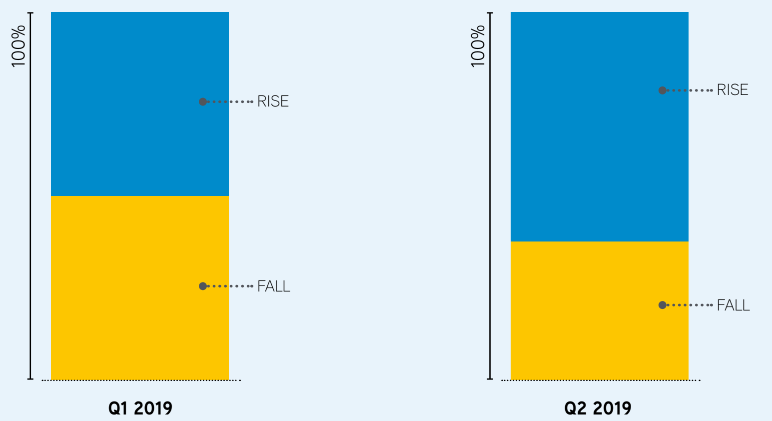
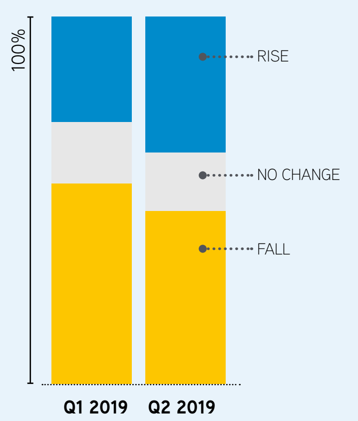
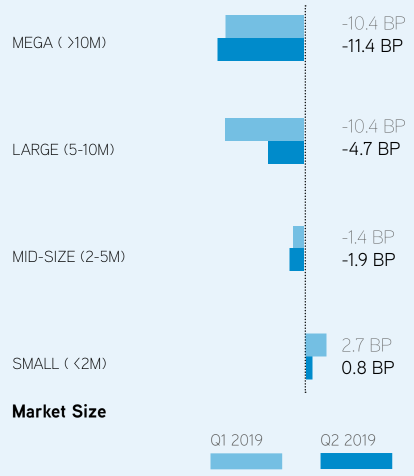


FIGURE 6:
VACANCY RATE CHANGES *| left*

AVERAGE SHIFT IN VACANCY RATES *| right*
BASIS:
QUARTER-ON-QUARTER





Sources: Figure 4: Colliers International | Figure 5: Colliers International | Figure 6: Colliers International

MARKET OVERVIEW: DEMAND

Employment remains strong, but is expected to slow down

The unemployment rates of European cities remained very low in 1H 2019, and some cities are now running at close to full capacity. The unemployment rate in Prague is currently as low as 1.5%, with Warsaw at only 2.5%. In Germany, unemployment rates are also very low, with Munich at 2.7% and Frankfurt at 3.7%.

The labour market remains resilient, with forecast employment growth of 0.9% for the EU region in 2019. There is a wide variation in employment growth across the continent with late cycle economies such as Spain and Finland experiencing above average growth. Moreover, wage growth continues to hover around the highest level in a decade. Furthermore, gains in wages are widespread across countries and sectors, with more than 90% of sectors in 17 eurozone economies surveyed experiencing annual increases in wages, with 70% seeing annual wage gains of 2% or more.

Take-up figures across the market point to mixed, but robust, activity across the region. The 12 month rolling take-up figure to Q2 2019 for selected European markets shows a minor decrease in activity (-3% y/y). Yet the number of markets recording a rise in their 12 month rolling take-up increased to 59% (of markets surveyed), up from 51% in the previous quarter (Q1). While this may seem contradictory, the disconnect is driven by a slowdown in activity in the larger markets, while many mid-sized and smaller locations continued to see expansionary demand-based activity.

Take-up declines were most apparent in the bigger markets of Amsterdam (-51%), Frankfurt (-14%) Stuttgart (-13%), Munich (-11%) and Dublin (-8%), amongst others.

The best-performing markets in terms of y/y take-up growth were Istanbul (37%), Barcelona (24%), Milan (23%), Lisbon (19%), Madrid (18%), Hamburg (17%) and Rome (11%).

Availability shortages have been cited as a key factor behind markets suffering from take-up declines. This was certainly the case in Amsterdam which is significantly impacted by availability bottleneck, although H1 2019 has seen a significant supply-side response. Meanwhile, Paris-City has long suffered from supply shortages, but this is being compensated by activity rippling outwards towards the suburbs.

In Stuttgart and Munich, availability constraints have been driving a decrease in absorption. Although, as we note in the 'Supply' section, Munich is now taking firm steps towards increasing supply through new development activity.

Further tightening vacancy conditions in Western Europe

Colliers analysis (Fig. 6) indicates that vacancy rates are showing clearer signs of 'bottoming-out'. Of the markets surveyed in this report, only 41% witnessed falls in vacancy in Q2, compared to 55% in the previous quarter. Concurrently, 31% of markets witnessed a rise in vacancy in June vs 29% the previous quarter, while many more markets reported no change (27%) in Q2 than in the previous quarter (16%).

FIGURE 7:
CHANGE IN SPACE UNDER CONSTRUCTION
BASIS: QUARTER-ON-QUARTER

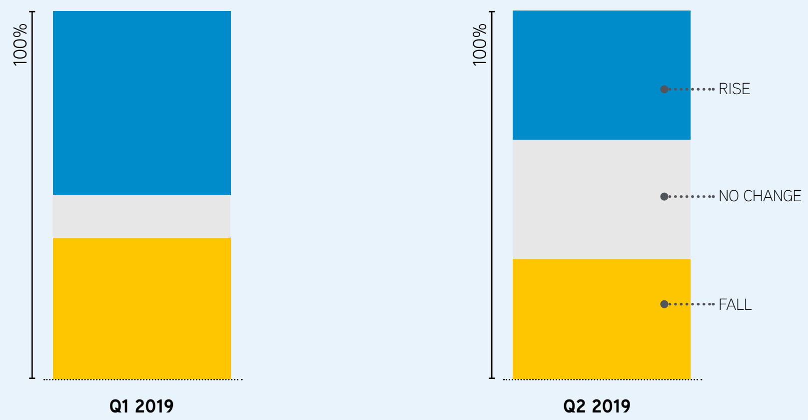
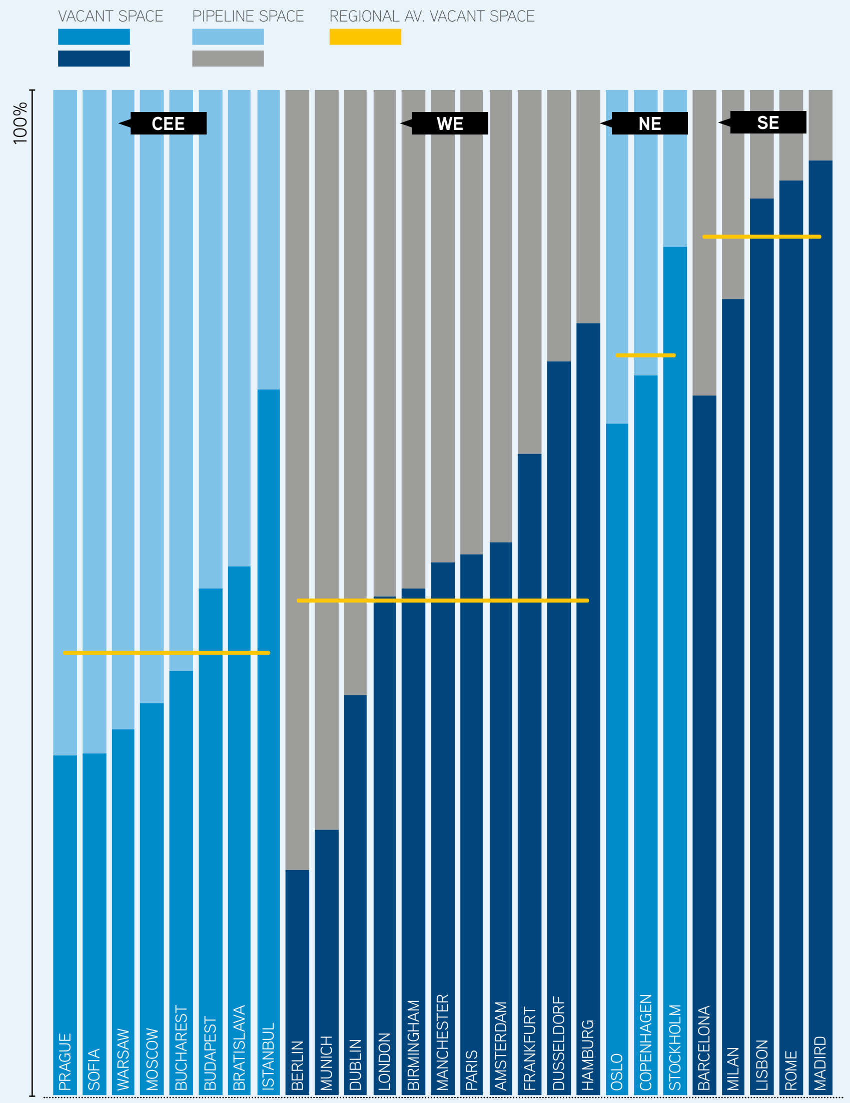


FIGURE 8:
EXISTING VACANT SPACE VS. PIPELINE SUPPLY



Sources: Figure 7: Colliers International | Figure 8: Colliers International

MARKET OVERVIEW: SUPPLY

Supply beginning to loosen up in places

Although vacancy is showing signs of bottoming-out, some markets continue to generate a supply-side response to the lack of availability of modern stock and latent occupier demand. Although there are some signs that supply is beginning to loosen up via pockets of development activity due to come to market in 2020-21, only 35% of markets reported a rise in their development pipeline in Q2 2019. This is some way down on 50% the previous quarter.

Figure 7 indicates that 27% of markets reported a fall in the development pipeline in Q2 2019 compared to 37% the previous quarter. A further 25% of markets reported no change.

With new supply limited to less than a third of markets, there appears to be limited pressure on vacancy to rise in 2020, even if the macro economic environment deteriorates, reducing new demand. As figure 8 shows, the likes of Munich and Berlin which are demonstrating a supply-side response are at limited risk of any rapid change in the supply-demand imbalance given current conditions. If vacancy does move north in either location, it still has some way to go to reach what would be deemed 'regular/normal' levels of vacancy.

German markets respond to demand by boosting development

Figure 8 indicates that Western European cities are catching up with strong development activity observed in the CEE region over the last few years. Within CEE, Poland leads the way, where office pipelines rose 13% in H1 2019, to 833,000 sqm.

In Germany, several city markets have responded to record low vacancy rates with an increase in speculative development activity. Munich reported 39% growth in the amount of space under construction in H1 2019 (vs. H1 2018), topping 1 million sq m of new space. Frankfurt registered an increase of 35% y/y, with 476,000 sq m of space coming to market.

The fastest-growing markets were Oslo and Amsterdam. Oslo was up 108% y/y with 250,000 sq m under construction; Stockholm, where there was no change in the pipeline, hosts around 200,000 sqm of space under active construction. Amsterdam's office construction was up 77% in H1 2019, with an additional 328,000 sq m of new space in the pipeline.

London West End was not far off, with an additional 411,000 sqm of space under construction lifting the pipeline by 73% y/y. With London City generating 563,000 sqm of new supply, this takes the London total to around 1.1 million sqm. Paris, despite a slight decrease in new construction activity (-2%) boasts a healthy pipeline of 1.6 million sq m.

FIGURE 9:
ABSORPTION VS. AVAILABILITY SUMMARY

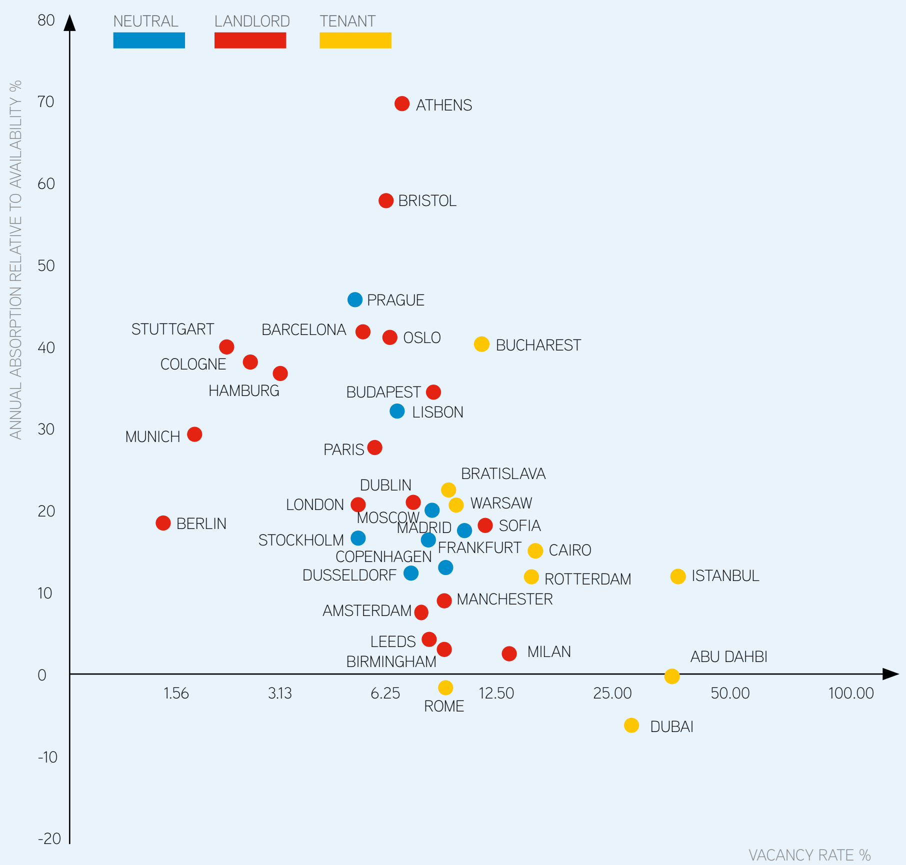
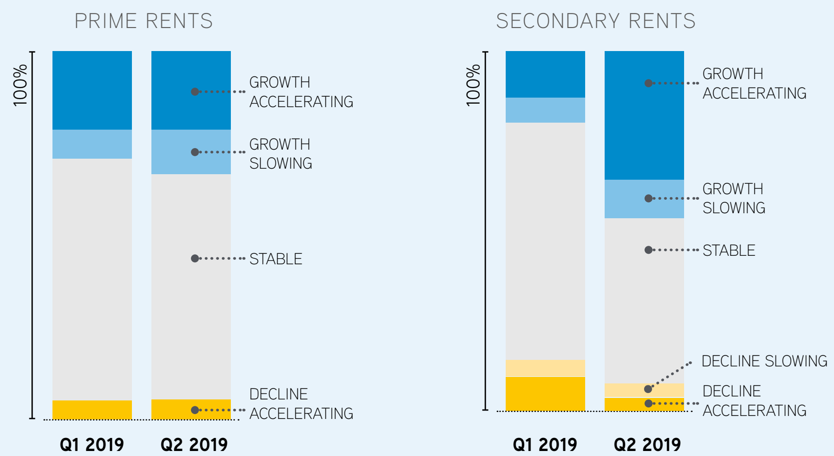


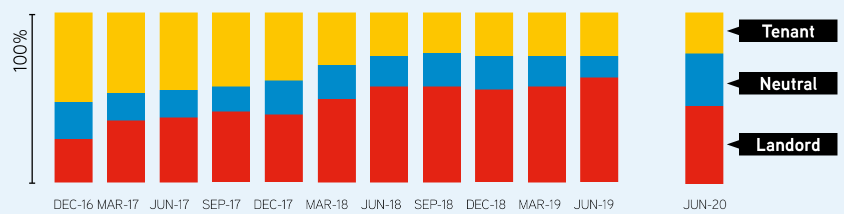
FIGURE 10:
RENTAL GROWTH PRIME RENTS | *left*

RENTAL GROWTH SECONDARY RENTS | *right*
BASIS:
QUARTER-ON-QUARTER



Click here for our
Office rent & occupier conditions map

FIGURE 11:
EVOLUTION OF OCCUPIER CONDITIONS



Sources: Figure 9: Colliers International | Figure 10: Colliers International | Figure 11: Colliers International

MARKET OVERVIEW: RENTS & OCCUPIER CONDITIONS

Net absorption rates remain positive but are slowing down

Although the overall EMEA absorption rate (relative to availability) declined slightly in Q2 2019 on an annual basis to around 18% in Q2 2019, from 20% a year earlier.

On a market-by-market basis, Figure 9 offers a graphic display of the divergence in local supply and demand conditions. This chart highlights the interaction between absorption and availability on the vertical axis, and the traditional vacancy rate on the horizontal axis.

Firstly, despite the marginal decline in absorption vs availability overall only two markets saw absorption vs availability drop into marginal negative territory: Rome (-2%) and Dubai (-6%), with Abu Dhabi at zero. Dubai, Abu Dhabi and Istanbul represent the biggest outlier markets in terms of high vacancy, which are very much tenant favourable.

At the other end of the scale are Athens and Bristol, where recent levels of take-up have absorbed large chunks of availability space, vastly improving market conditions to be landlord favourable. The absorption ratio is now greatest in Athens (70%) where the improvement of the economy is driving demand for Grade A space in the CBD and the Northern suburbs, resulting in very tight availability. Bristol comes on the back of new stock released to market recently being absorbed by a high degree of pent up demand.

The vast majority of markets remain landlord friendly, notably those with a 20% absorption/availability ratio (less than five years worth of existing availability). More markets are shifting to a neutral position, notably those under the 20% ratio. Tenant friendly markets only feature at vacancy rates of above 10%, and tend to be in smaller or evolving city markets.

When it comes to rental growth, there was very little change in prime rents across the markets surveyed in Q2 2019. Figure 10 illustrates that there was no change in the percentage of markets where prime rental growth accelerated, although there are very early signs that the prime market is cooling down with growth slowing in 11% of markets surveyed in Q2- compared to only 7% in the previous quarter. The vast majority of markets saw prime rents remain stable.

In the secondary rental market, growth accelerated in 35% of markets in Q2 2019, compared to only 13% of markets in Q1. Also, the share of markets where declines were accelerating decreased to only 4%, from 9% the previous quarter. This is most likely a response to the lack of available supply in markets, driving up secondary rents in select locations most under pressure.

Occupier conditions changed only marginally in Q2 2019. The number of Landlord favourable markets only increased by 1%, from 53% to 54%, while tenant friendly markets increased from 20% in Q1 2019 to 22% in Q2 2019.

While the mid-2019 market signifies limited changes in the EMEA office sector, the outlook to mid 2020 paints a different story. Neutral markets are expected to account for a much greater proportion of locations, primarily at the expense of landlords.

AROUND THE MARKETS

LONDON *While London office take-up edged back up above the 10-year average in Q2 2019, the see-sawing of activity between City and West End markets continued. City transaction levels rose above average after a poor Q1, but West End volumes fell to a 30-month low. Stable levels of take-up, coupled with sluggish delivery of new supply, meant that London-wide vacancy dipped below 5% for the first time in over two years. Since 2000, average annual speculative completions across London have totalled 2.9 mn sq ft. Currently, totals for 2019-2020, even combined, will still undershoot that figure.*

PARIS *Co-working operators signed 8 leases in Paris - City during 1H 2019, accounting for 50% of all transactions – 5 of these leases were signed by WeWork, which set up its first operation in Paris in 2016. Lack of supply in Paris City is driving occupiers to the Inner Suburbs: in H1 2019, demand in the suburbs came from bank Société Générale (31,000 sqm), Edvance (22,250 sqm), and law firm Société du Grand Paris (26,500 sqm) which will move to Saint Denis, where its new HQs will be located, in 2021.*

PORTO *Demand from larger occupiers is propping the market with Critical Techworks (a partnership between BMW and Critical Software), the Global Media Group and online retailer Farfetch expanding or relocating their offices in Porto. Over 50,000 sqm of new office space is expected to enter the market by year end, with over 100,000 sqm of supply forecast to enter the market in the next 2 or 3 years.*

BRUSSELS *2019 is shaping up as a record year with several large transactions. Demand from government contracts represented almost a third of total take-up of 345,000 sqm in H1 2019. Outside the CBD, the largest transaction was a lease by PwC taking 23,000 sqm in a new development in Diegem. New developments due to come to market in 2021 are now under construction.*

FRANKFURT *Take-up in H2 reached 256,400 sqm, the strongest half-year result of the last ten years. Demand was driven by a strong uptick in activity in surfaces above 5,000 sqm, and DekaBank signed the most significant lease in the last six months, for 46,000 sqm of office space. Vacancy grew 60 bps in Q2, compared to the previous quarter, marking the first vacancy rise since 2015 – however, several major requests are now in the negotiating stages, and this is expected to contribute to a renewed reduction in vacancy.*

STOCKHOLM *The Solna/Sundbyberg area remains the main focus of development activity, with around 110,000 sqm due to be completed within three years. Despite this, demand is forecast to continue to exceed supply in the next few years, since Stockholm is poised to be one of the fastest-growing European cities in population terms. Demand from the government sector remains an important market driver and in 1H 2019 the Swedish Tax Agency signed a lease for 42,000 sqm in Sundbyberg.*

MUNICH *Take-up was recorded at 422,900 sqm in H1 2019, exceeding the long-term average but falling short of previous-year H1 results, due to the lower number of large-scale leases signed. Limited supply continues to dominate the Munich market, and vacancy is almost non-existent in many locations. In the Munich municipal area, vacancy now stands at 1%, and inside the city's central ring road (Mittlerer Ring) just 0.2%. The main transactions were driven by two owner-occupiers in the media industry (ProSiebenSat.1 and the Bavarian Broadcasting Company, both for around 25,000 sqm).*

WARSAW *Demand for modern office space in H1 2019 amounted to 405,700 sqm, including particularly high tenant activity in the second quarter of this year - almost 265,600 sqm. The Centrum and Mokotów zones enjoyed the greatest popularity, and the largest transactions in H1 2019 were three pre-let contracts (Getin Noble Bank for 18,500 sqm in The Warsaw HUB, Warta for 17,600 sqm in The Warsaw UNIT, and Bank Gospodarstwa Krajowego for 12,400 sqm in Varso 2).*

BUDAPEST *Total demand in H1 2019 reached 243,371 sqm and new leases accounted for 44% of total leasing activity. Two of the three largest transactions were signed on the Váci Corridor submarke, both of which were pre-letting agreements: BP signed a lease for 22,060 sqm in Agora Budapest. The largest new deal was concluded in the South Buda submarket, while the largest renewal was closed in North Buda's Graphisoft Park for 4,000 sqm.*

DUBAI *Demand is driven by start-ups and ICT companies such as HP, Google, Ericsson, and Intel, as well as fintech small firms. These companies focus on the DIFC (Dubai International Financial Centre) submarket. An additional 370,000 sqm of supply is expected to be delivered to the market this year, with key developments located in the CBD or the DIFC, including ICD Brookfield Place (50% of forthcoming supply) and OneCentral Trade Centre. Rental rates are forecast to continue decreasing driven by oversupply.*

OUTLOOK

Despite global and local macroeconomic challenges, the EMEA office real estate market position remains robust. However, there has been a gentle easing in demand momentum, resulting in a more stable rent regime although supply-demand conditions remain largely in favour of landlords.

Looking forward, there is an anticipation that markets will take a more neutral stance by June 2020. This will represent a move away from the landlord-friendly environment that has dominated for the last three years, and is consistent with a weakening short-term economic sentiment outlook.

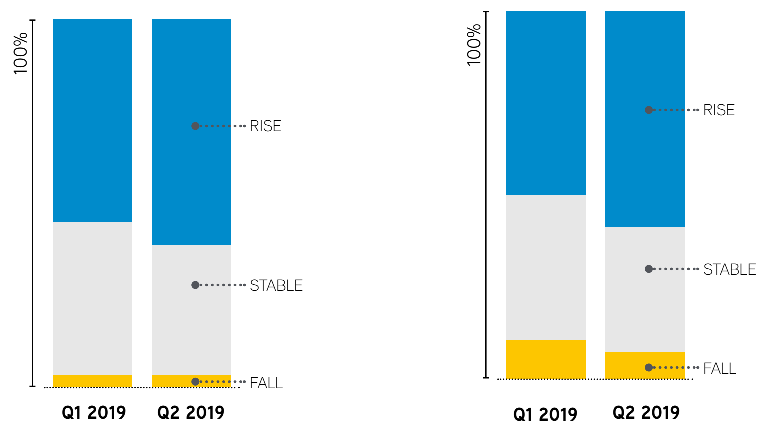
The GDP growth forecast for the eurozone (according to Oxford Economics') is now 0.3% q/q in H2, which is low. Domestic demand is still resilient and easing ECB monetary policy and some fiscal support should help mitigate industrial and external weaknesses and contain recession risks, meaning a recession in the eurozone is unlikely in H2 2019. However, macro headwinds are now stronger than the tailwinds that have helped drive this cycle.

Oxford Economics estimates the impact of an increasingly probable 'No-deal Brexit' would result in GDP growth 0.5 pct lower, per year, than the baseline forecast - the eurozone GDP growth forecast for full year 2019 remains at 1.3%.

That said, no reversal in prime rental rates is anticipated - only 9% of markets forecast falls in secondary rents in 12 months time. The majority of markets expect rents will rise in the year ahead as micro supply-demand economics prevail.

FIGURE 12:
12M OUTLOOK PRIME RENTS *| left*

12M OUTLOOK SECONDARY RENTS *| right*



Sources: Figure 12: Colliers International

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