Colliers
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EMEA

City Offices

August 2021

Executive summary

Economy

The *EEA30's GDP grew by +4.8% (y/y) by mid-year 2021, which confirms economic recovery is underway and ahead of (Oxford Economics) forecasts made at year-end 2020 (+3.8% (y/y) in 2021). Progress is attributable to the success of vaccination roll-out programmes, with most European countries making progress towards double-dosing populations. This has enabled easing restrictions, helping consumer-facing sectors get back on their feet, all while stabilising unemployment levels.

Employment

By year-end 2020, the EEA30's workforce saw early signs of labour market momentum. This momentum has not only continued but accelerated, expanding by an estimated +0.2% (y/y) by end-H1 2021, on the -1.5% at year-end. Equally, the fears that the unwinding of government employment packages would increase unemployment rates in 2021 appear to have been abated. As of end – H1 2021, the EEA30's unemployment rate is 7.3% and forecast to fall to 6.9% in 2022. This is a marked improvement on year-end 2020 forecasts which expected unemployment to reach 8.1% in 2021, before recovering in 2022, dropping to 7.3%. However, cautious optimism is still in play as the Delta variant's threat casts a shadow on Europe's current recovery, and short-to-mid term prospects could yet be impacted by the winding down of government stimulus packages.

Take-up & pre-letting

Year-end momentum continued to gain traction in Q1 and Q2 as occupiers continue to revisit occupational plans. Large markets, like London–Southbank (+87%), London–West End (+26%) and Frankfurt (+13%) all saw positive (q/q) growth, reflecting growing confidence in the market. This is reflected in higher levels of pre-letting activity, given the lack of existing grade-A stock that meet occupiers' requirements. That said, regearing and extensions continue to dominate the bulk of take-up activity as occupiers continue to assess the long-term impact of COVID-19 on future occupational plans, meaning take-up volumes remain below (pre-pandemic) trend and are prone to fluctuation.

Supply

Despite the rise in pre-letting activity, development pipelines are being closely controlled, particularly in markets close to 10% vacancy or above. We expect developers will become more cautious to ensure new developments coming to market have a base level of pre-leasing secured before practical completion (PC). We also expect new developments filtering through will follow more of a build-to-suit (BTS) model, ensuring building specifications meet evolving industry standards and occupier requirements.

Vacancy & sub-letting

Vacancy has begun to plateau, and in some markets, there has been inward movement in vacancy rates. Madrid's vacancy rate moved in -340 bps (q/q), matching its rolling take-up improvement of +11% (q/q). Riga's (q/q) 12-month rolling take-up grew +35%, mirroring vacancy which moved -169 bps (q/q) inwards. Vacancy should continue to stabilise over the next 12 months, with only 57% of markets surveyed expecting further outward movement in rates, down from 75% at Q1-end. In core CBD locations, where grade-A stock is in short supply, vacancy is expected to contract. Sub-let levels are also plateauing, aiding overall vacancy, with drop-offs between 5-20% (q/q) registered. However, against a backdrop of rising vacancy, rental incentives are generally on the rise, so market conditions continue to favour tenants.

Occupier conditions

Market conditions have sizeably shifted in tenants' favour, now 52% of markets, up from 44% recorded in Q1. There are little signs of this slowing as our 12-month indicator forecasts tenant-friendly conditions to grow to 56% of markets by end Q2 2022, at which point landlord-favourable markets would represent a mere 6%.

Rental performance

Prime headline rents continue to hold firm, though propped up by rising levels of incentives. This resulted in prime rental growth in 10% of markets we survey, including St Petersburg (+3%), Helsinki (+3%) and Paris – CBD (+2%). However, not all markets have fared so well, and some 16% of markets expect further downward pressure (in prime spaces) in the next 12 months including Warsaw, Madrid & Frankfurt.

*EEA30 = EU27, UK, Norway & Switzerland

Quarter 2 | EMEA
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Key Metrics In Major EMEA Cities: Q2 2021

CITY	Take-up 12M rolling [sq m]	Take-up 12M change [%]	Vacancy Current [%]	Vacancy 6M change [bps]	Vacancy 12M outlook	Prime rent Current [€/sq m/mth]	Prime rent 6M change [%]	Prime rent 12M outlook
Abu Dhabi	n/a	n/a	35.0	-1,000	↓	22.5	2.3	↑
Amsterdam	204.8	-30.6	7.9	192	↑	38.8	0.0	↔
Berlin	729.0	-24.8	2.4	66	↑	41.9	-0.2	↔
Birmingham	34.7	-43.9	9.4	79	↑	36.1	0.0	↔
Bucharest	201.7	-33.0	15.8	200	↑	18.0	0.0	↔
Budapest	338.2	-39.7	9.8	70	↑	23.0	0.0	↔
Copenhagen	n/a	n/a	9.7	50	↔	23.5	0.0	↑
Dubai	n/a	n/a	30.0	-1,000	↔	33.7	-1.7	↑
Dublin	74.0	-70.3	10.6	60	↔	55.8	0.0	↔
Frankfurt	384.6	-5.3	7.5	40	↑	45.0	0.0	↓
Helsinki	n/a	n/a	17.0	450	↑	40.0	5.3	↓
Istanbul	116.4	10.1	29.1	6	↑	27.8	0.0	↓
London - City	250.3	-48.1	9.0	136	↑	75.8	0.0	↔
London - West End	200.7	-37.6	6.8	27	↔	125.5	0.0	↔
Madrid	302.0	-29.4	10.7	150	↑	34.0	-2.9	↓
Milan	302.3	-23.2	9.5	62	↑	49.2	0.0	↔
Moscow	1,422.0	-2.5	8.1	-60	↓	63.1	0.0	↑
Munich	462.7	-30.3	4.4	85	↑	40.0	-1.2	↔
Paris	1,261.6	-25.5	8.3	90	↑	76.7	2.2	↔
Prague	362.6	-4.9	7.8	82	↔	22.5	0.0	↔
Stockholm	n/a	n/a	6.0	-25	↔	61.8	-1.3	↔
Vienna	190.2	40.5	4.1	-10	↑	28.0	0.0	↓
Warsaw	522.9	-35.3	12.5	256	↑	24.5	0.0	↓

Source: Colliers

Macro-economic overview

EEA30

With restrictions easing, the EEA30's recovery is firmly underway as Q2's preliminary data indicates GDP (q/q) growth of +2.6%, which is a +4.9% (y/y) improvement on this point last year. GDP is expected to expand a further +4.5% by mid-2022. Moreover, industrial indicators (like PMI, Purchasing Managers Index) continue to improve, but show mixed results in some countries, like Germany, which has been negatively impacted by production setbacks in the automotive sector. Overall, successful vaccination progress is helping push European economies towards a broad-based reopening, but there is much uncertainty surrounding Europe's rebound, primarily as the threat posed by the Delta variant continues to cast a shadow on Europe's outlook, as any future restrictions or marked changes in government response and stimulus/support could dampen the recovery.

UK

The Office for National Statistics (ONS) data shows GDP increased +2.3% (m/m) in April, building on the +2.1% (m/m) increase recorded in March, with consumer-facing sectors primarily driving growth. However, construction and manufacturing output fell, diverging from very upbeat PMI results. Nevertheless, the economy is now only 4% below its pre-pandemic level. As the economy recovers, the Bank of England (BoE) is likely to tolerate a temporary rise in inflation above its 2% target. Positively, policymakers seem confident inflation will not run above this target in the long run so interest rates look set to remain at their current levels, for now.

France

After a sharp economic decline in 2020, activity stabilised in Q1 and picked up in Q2. As a result, GDP is estimated to have grown by +5.8% (y/y) by mid-year 2021, above the Eurozone's +4.6%. The business climate index also reached its highest level since mid-2007 in June, reaching 113, driven by improved prospects in the service sector, which has significantly benefitted from government employment protection measures, helping unemployment remain stable (8.1%).

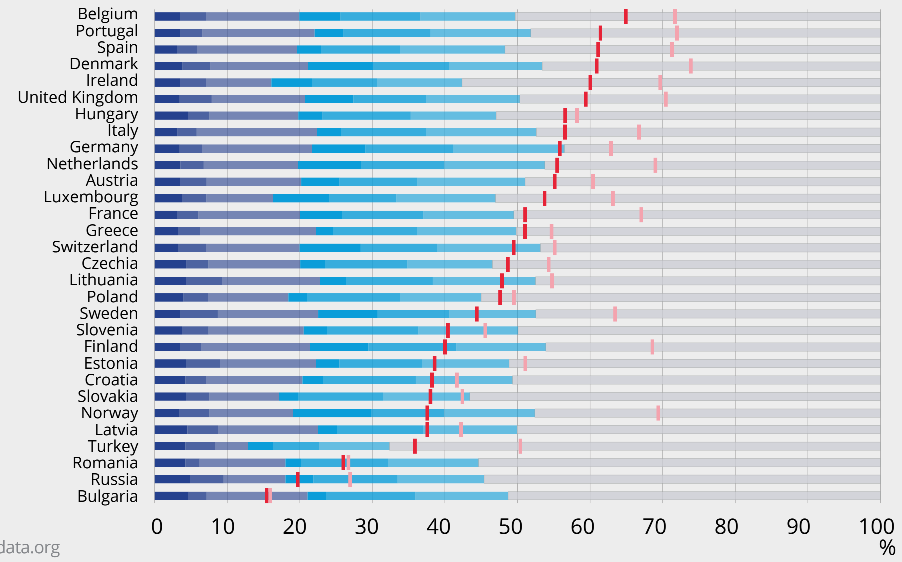
Germany

Q2 saw tighter measures to fight the third wave of COVID-19 which weighed in on consumer spending, while international supply-chain disruptions truncated industrial activity. Yet falling infections and rising vaccination rates since May, have seen restrictions ease triggering a quick rebound in mobility, leading to a faster-than-expected rise in consumer spending during the back end of Q2. However, industrial production remains obstructed by bottlenecks in the supply of semiconductors, critical to Germany's industrial sector, particularly the automotive sector. That said, Germany's GDP could return to the pre-crisis levels earlier than expected - by end Q3 2021 - with further growth projected at +4.4% for 2022.

Italy

The (Improving) monthly business confidence indicators have helped raise GDP estimates for Q2 to around +2%. As a result, Oxford Economics' GDP growth forecast is +5.5% for 2021 (y/y), and +4.8% in 2022. This would mean a return to pre-pandemic output by early-2022. In addition, labour market hiring intentions and monthly employment numbers are rising, though they are expected to be gradual.
While Italy should see a robust economic recovery, this is finely counterbalanced by the potential reimposition of some restrictions in light of the Delta variant.

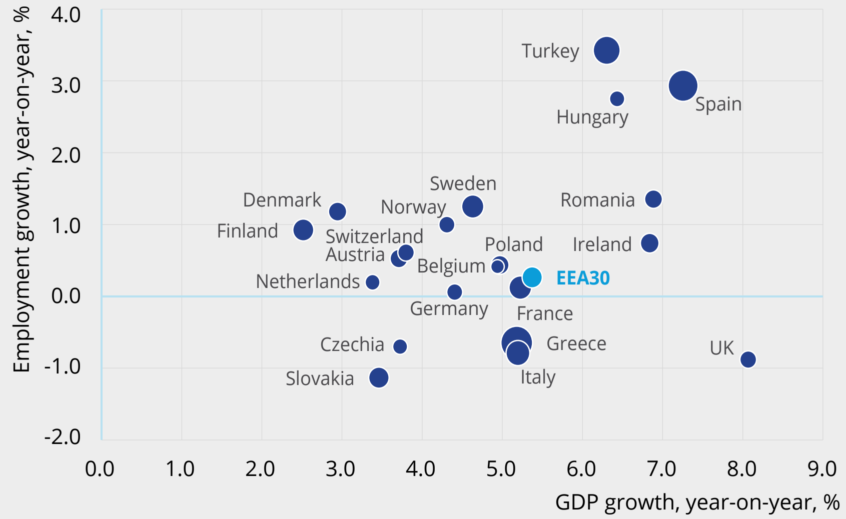
Figure 1: Administered COVID-19 vaccines, % of population, August 10th 2021.



Sources: Colliers, Oxford Economics, ourworldindata.org

Figure 2: Country GDP & employment forecast 2021, as at June 2021

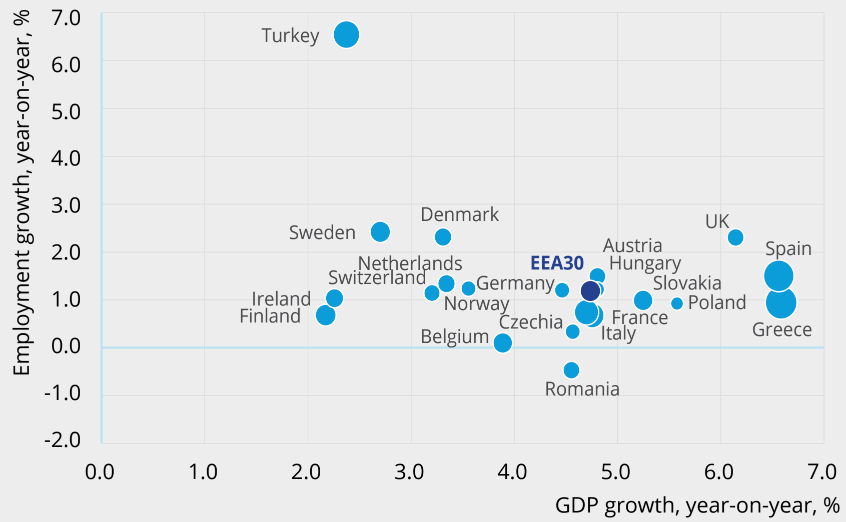
Bubble size represents unemployment rate (*ILO Unemployment rate definition).



Sources: Colliers, Oxford Economics

Figure 3: Country GDP & employment forecast 2022, as at June 2021

Bubble size represents unemployment rate (*ILO Unemployment rate definition).



Sources: Colliers, Oxford Economics

Market overview: Demand

Take-up

While 2020 was characterised by suspended and limited corporate activity, momentum that started at the end of the year – bolstered by several large deals completing in December – has continued, resulting in higher levels of take-up in both Q1 and Q2 2021. As a result, Q2 (12-month rolling) volumes have grown +5.3% (q/q) with major markets like London – South Bank (+87%), Riga (+35%), London – West End (+26%) and Frankfurt (+13%) positing positive Q2 (q/q) growth.

However, despite an uptick in activity which is helping push markets' take-up volumes in the right direction, many remain below their pre-pandemic levels. Hamburg remains 14% & 10% below their five & ten-year averages, respectively, despite a positive +22% (y/y) uplift in H1. In Paris – CBD, H1 2021 remains below trend despite growth of +14% (y/y), helped by a more active Q2. London's levels are also expected to remain 25% below trend over the coming 12 months, even after 2mn sq ft was let in Q2.

Helping spur market volumes is the noticeable level of activity from a clear group of occupiers. The TMT (Tech, Media & Telecoms), Finance & Public Sectors have become the engine room of demand throughout H2 2020 / H1 2021. In Berlin, H1 take-up was marginally below last years' result as several large deals (>10,000 sqm) from the public sector accounted for almost half of Q2's take-up (116,000 sqm). Cologne similarly saw 44% of Q2 take-up (33,000 sqm) leased by TMT occupiers.

The oscillation in take-up rates is being fuelled by corporate occupiers adjusting their office footprints, as they take time to assess the full impact of agile working. This is primarily a feature of larger corporates that drive the market overall. For example, in London, Barclays Bank is contemplating condensing their Canary Wharf operations into (a revamped) One Churchill Place, possibly meaning vacating 5 North Colonnade, putting 635,000 sq ft back to market. SME type businesses are acting quicker when making decisions given the comparative size of their footprints.

Pre-leasing

Pre-letting activity is beginning to return with real vigour. In the London-City market, 132,000 sq ft was pre-let at British Land's 1 Broadgate scheme. There are three pre-let deals (all >100,000 sq ft) currently being negotiated on pipeline space by Travers Smith, Snapchat, and Inmarsat totalling close to 500,000 sq ft. Further afield, in Budapest, IBM pre-let 14,450 sqm in the Corvin Innovation Campus, signalling their commitment to the market.

The primary driver behind strong pre-letting activity now seen is the chronic lack of grade-A stock that meets prospective occupiers' requirements. As a result, active searches are commencing 3-4 years in advance of occupation, with 1.3mn sq ft already pre-let in London for space coming to market from 2023 onwards. This is creating a two-tier market and bifurcating rental values in prime and second-hand stock.

Leasing deal types & sizes

Over the last 18 months, regears and renewals have dominated take-up activity. In Budapest, only 7% of Q2 take-up was proportioned to new leases, while renewals accounted for the majority of activity (40%) - the largest being Magyar Posta's 13,780 sq m at the Gateway Office Building. In Warsaw & Bucharest, their two largest Q2 transactions were renegotiations: Orlen's lease in the Senator for 20,000 sq m (Warsaw) and Rompetrol Group in City Gate for 9,400 sqm (Bucharest).

With the preference to regear, and most expansionary plans ending up being scaled back by 15% on average (but up to 25% in some cases), this has meant deal sizes/cohorts are shrinking, negatively impacting on both take-up and vacancy. Average deals size fell from 12,600 sq ft (Q1) to just 5,833 sq ft in London-City in Q2. In Helsinki, typical requirements are now <250 sqm: now much lower than the average office floor print of 350-700 sqm.

Flight to quality

Small can be beautiful, and so while deal sizes are reducing, there is a clear preference for 'quality' over 'quantity'. In fact, of the ten largest deals (totalling 295,000 sq ft) completing in the City of London market in Q2, 80% of the space taken were in new or existing Grade-A space. Concurrently, there is also a growing appetite for refurbished space in London, growing substantially throughout 2020 which saw over 600,000 sq ft of space pre-let in refurbished schemes. By comparison, between 2018-2020, this was only 44% of all pre-let deals. It highlights that product embracing the newest smart tech, better-enabling space efficiency and wellness analysis, is high on prospective occupiers' ESG & wellness shortlists.

Sub-letting

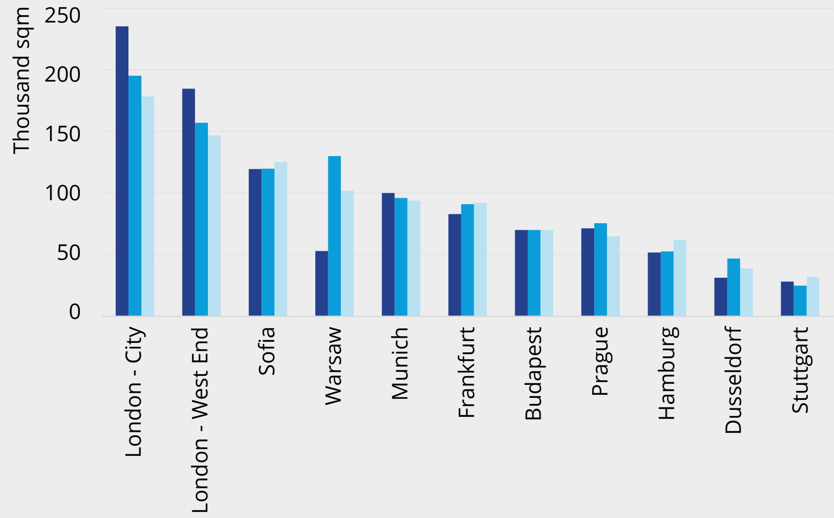
Although the volume of sub-let/grey space emerging across Europe during the second half of 2020 raised a few eyebrows, by end Q2 2021, levels are fading. This being is being aided by the gradual absorption of existing sub-leased space, with any further upward pressure mitigated by exceptional shortages of speculative and Grade-A supply. Landlords have also now begun retracting initial offers to reduce cannibalisation of their existing and forthcoming stock. Figure 5 reflects this with 5-20% (q/q) reductions in the volume of sub-let space being offered to market. Dusseldorf's and Warsaw's offering dropped by -17%. In London, Q2 saw significant space absorbed, including ITV take 120,000 sq ft of sub-lease space at the BBC Broadcast Centre and IBM's 132,000 sq ft at 1 Southbank Place, SE1; helping both the City & West End register drop-offs of -9% & -7%, respectively.

Figure 4: 12 month rolling take-up changes, by market

<-20%	<-10%	<0%	0%<	10%<	20%<
	Warsaw	Bucharest	Wroclaw	Poznan	Paris - La Defense
	Berlin	Munich	Barcelona	Paris	Birmingham
	Vilnius	Krakow	London - City	Rome	Riga
	Stuttgart	Cologne	Istanbul	Gdansk	Leeds
		Vienna	St Petersburg	Dublin	Sofia
		Rotterdam	Bratislava	Frankfurt	London - West End
			Budapest	Moscow	Milan
			Prague	Bristol	Manchester
			Amsterdam	Madrid	
			Dusseldorf		
			Hamburg		

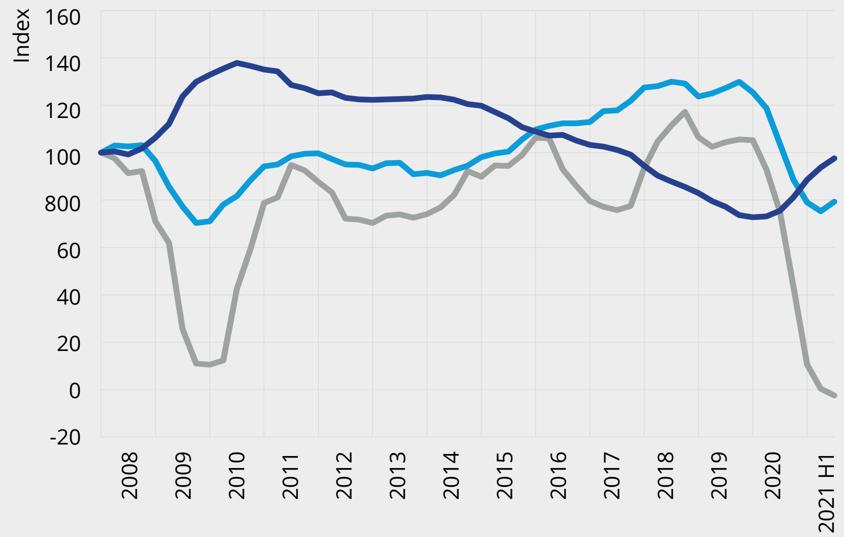
Source: Colliers

Figure 5: Sub-letting offer



Source: Colliers

Figure 6: Market indices, 2007 =100



Source: Colliers

Market overview: Supply

Vacancy

Vacancy bar some over-supplied locations, has remained within our <10% predictions and positively below GFC-levels. By Q2-end, many markets have plateaued or even recorded inward movements, mirroring the improvement in take-up and corporate activity and drop-offs in 'grey-space'. Of those markets still recording outward movement in vacancy rates, the pace is at least slowing. Some notable mentions were Riga, where vacancy fell -169 bps (q/q), as take-up expanded by +35%. Madrid also saw a contractionary movement of -340 bps (q/q), matching its rolling take-up improvement of +11% (q/q).

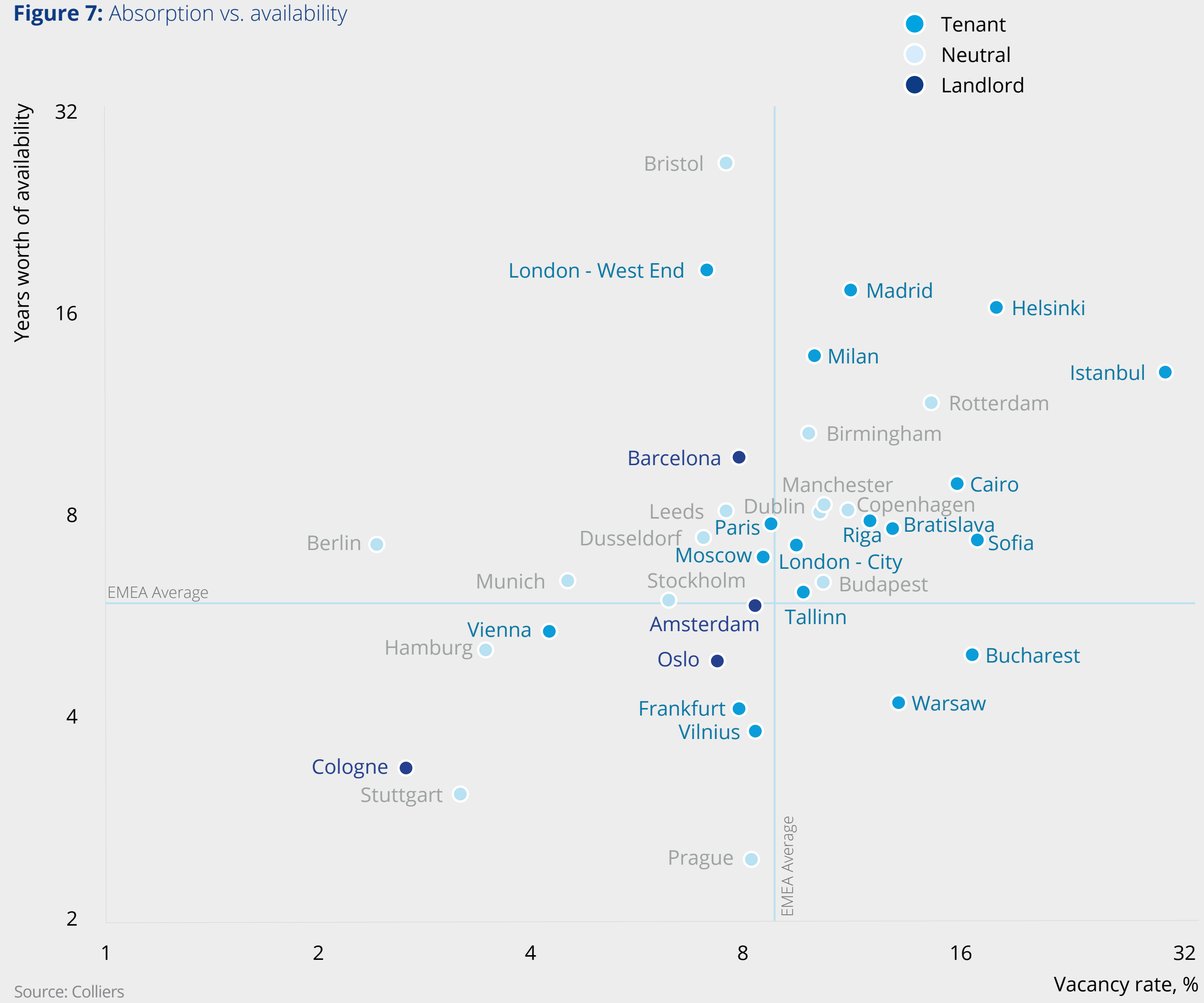
Pipeline

To combat over-supplying markets close to or above 10% vacancy, developers have made limited additions (or even reductions) to active pipelines. In London –West End, 2021 has seen only 933,000 sq ft complete, with the three largest projects being refurbishments and only one new-build over 50,000 sq ft delivered (Ilona Rose House) in Soho. Elsewhere, Prague's active supply for 2021 is now half of the 10-year average (which is primarily pre-let), with a significant portion expected to be ready for deployment in 2023/2024. However, given current conditions, some of these plans are at risk of being (downwardly) revised or delayed, if not mothballed entirely.

As industry bodies and legislation push towards higher sustainability and energy performance standards, there are major questions marks over the suitability of existing stock to meet these evolving requirements. In the UK, some 10% of existing office stock has an EPC rating of 'F' or 'G', which will not meet the new MEES regulations when they come into effect in 2023. This means that this sub-standard EPC space cannot be legally leased/occupied when the legislation comes into effect. This places a greater onus on developers to ensure that refurbished and new developments meet evolving ESG, sustainability and financial reporting standards and legislation while meeting occupiers' specific occupational requirements. This could well result in a shift towards build-to-suit delivery models, and a much tighter supply demand equilibrium going forwards.

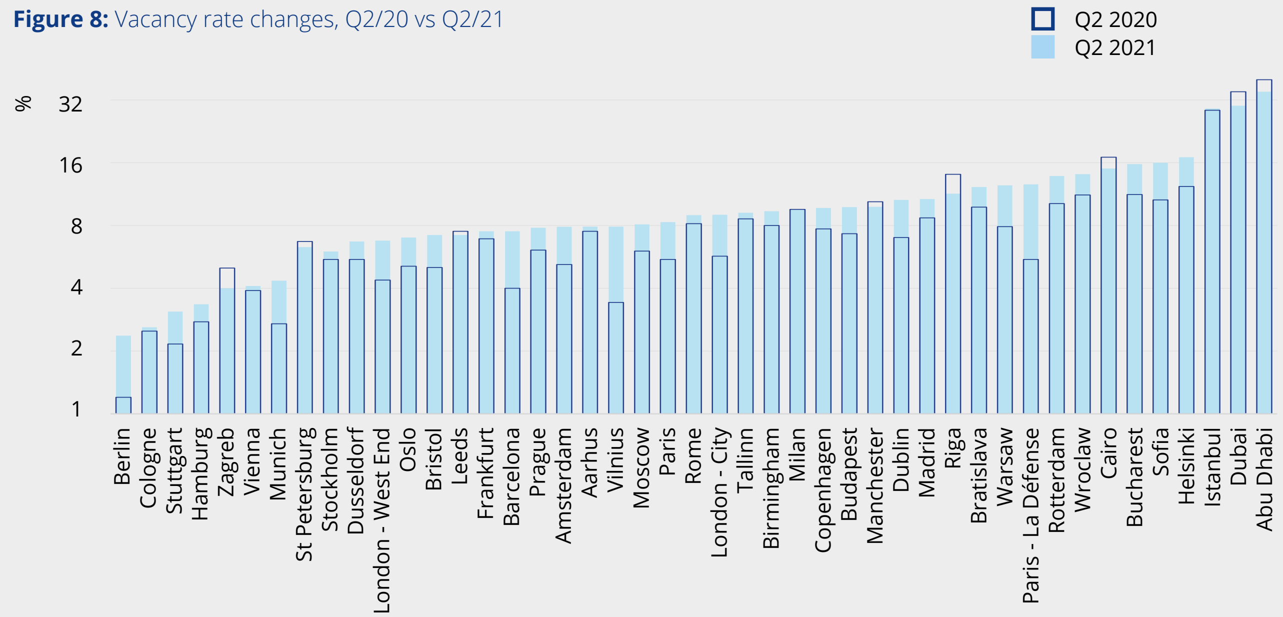
"Development pipelines in markets close to 10% vacancy or above are closely controlled, with limited additions or even (downward) revisions made."

Figure 7: Absorption vs. availability



Source: Colliers

Figure 8: Vacancy rate changes, Q2/20 vs Q2/21



Source: Colliers

Market overview: Costs & occupier conditions

Pricing

Despite turbulent market conditions, prime headline rents continue to hold firm in 84% of markets across EMEA. In secondary spaces, stable conditions are also recorded, representing 78% of markets - no change on Q1. However, availability in prime locations remains incredibly tight, translating into some prime rental growth in 10% of markets we survey: which include St Petersburg (+3%), Helsinki (+3%) and Paris – CBD (+2%) whom all saw q/q growth. Paris saw an uplift of +2% (y/y) in rents for new and refurbished space, widening the gap between prime and second-hand stock. Landlords are aware of this trend, and many have begun to refurbish and retrofit existing spaces.

But not all markets have fared so well, as rising availability - particularly in CEE markets where vacancy has surfaced above 15% - has forced rents down. Sofia, Budapest & Warsaw all saw (y/y) rental declines of -5% to -13% during H1 2021. With the quality gap widening, our 12-month forecasts predict some 10% of markets will see a further uplift in prime headline rents, though the majority (74%) are expecting stable conditions. The remaining 16% of markets expect further downward pressure on rents in prime spaces.

Incentives

Most downward pressure on rents has been mitigated by rental incentives, which, even now, are still growing in some markets. Frankfurt's & Munich's levels have risen again, now 5.5 & 4 months (per 5-year term), respectively and their deployment, especially in sub-prime spaces/second-hand stock, will be critical to maintaining occupancy. Particularly where vacancy surpasses that of the central CBD areas. For example, in Paris' periphery markets, incentive discounts worth 23% of the headline rent have been recorded.

Some markets have witnessed rental incentives plateau, or even decline. In London–West End & London–City markets, incentives remain at 28 months per (10-year) term, Copenhagen remains flat on Q1, with Madrid's moving in from 1.5 to 1 month (per year of term). Berlin's incentives have now stayed at pre-pandemic levels for two consecutive quarters, after initially rising to 3 months (per 5-year term) in Q4 2020.

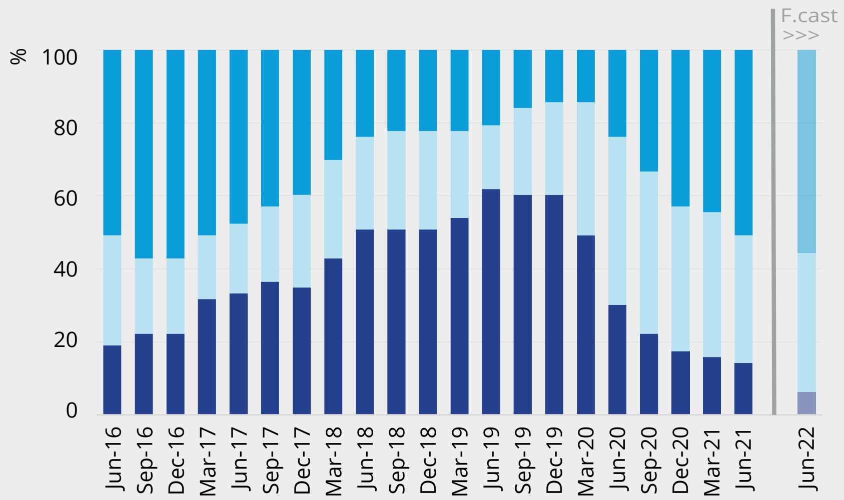
Occupier conditions

Rent-free periods aside, occupiers are looking for further flexibility while pushing back on commitments to traditional, long-term leases or are at least looking at shorter break options. For example, Babylon Healthcare is actively looking to build lease flexibility and take shorter-term sublets in their London-based operations. In fact, they had recently signed a shorter-term lease extension at their Sloane Avenue HQ but have now taken 65,000 sq ft at 1 Knightsbridge, albeit on a sublease until 2024, underlining their current need for flexibility as they continue to assess their long-term occupational strategy.

In addition, many occupiers have adopted, or are transitioning towards, agile working. When combined with current supply and demand dynamics, market conditions keep shifting in tenants' favour. Some 52% of markets Colliers surveys are now classed as tenant-favourable, moving up from the 44% recorded in Q1. There are no signs of this slowing, with our 12-month forecast indicating tenant favourable conditions will be in place across 56% of markets by end H1 2022. Landlord-favourable conditions are expected to hold sway in just 6% of markets: their lowest ever level in our index. While occupiers have an opportunity to act upon, market conditions can change quickly.

Figure 9: Evolution of occupier conditions, by % of markets

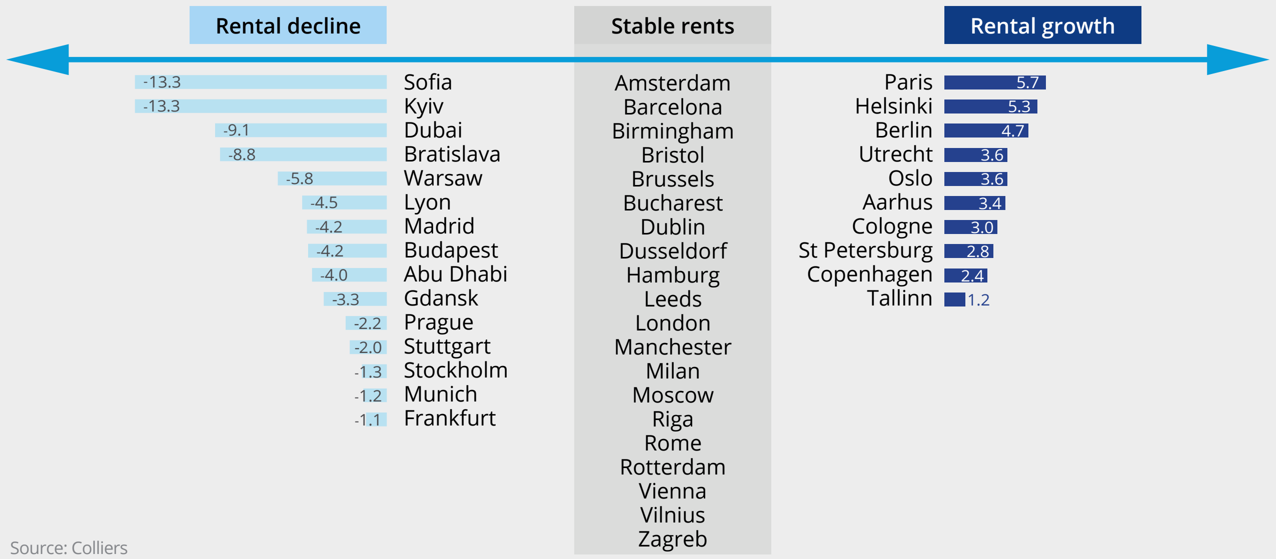
Tenant
Neutral
Landlord



Click here for our latest Office Occupier Conditions Map

Source: Colliers

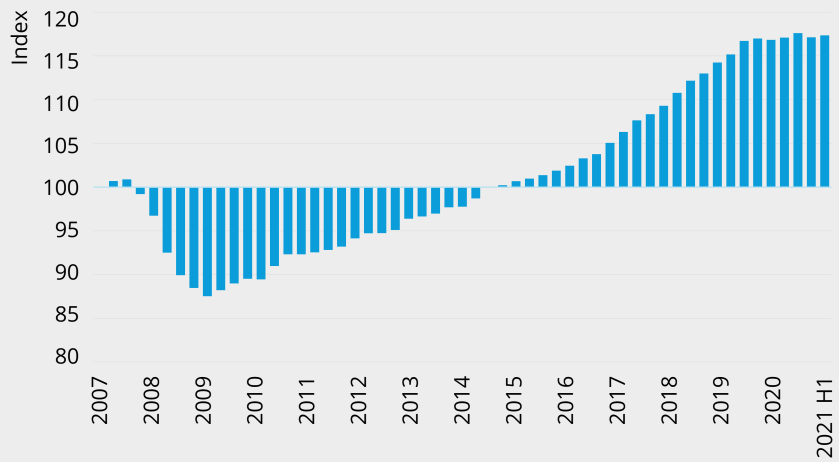
Figure 10: Prime CBD office rental growth, year-on-year, %



Source: Colliers

Figure 11: Prime CBD office rent index, 2007 = 100

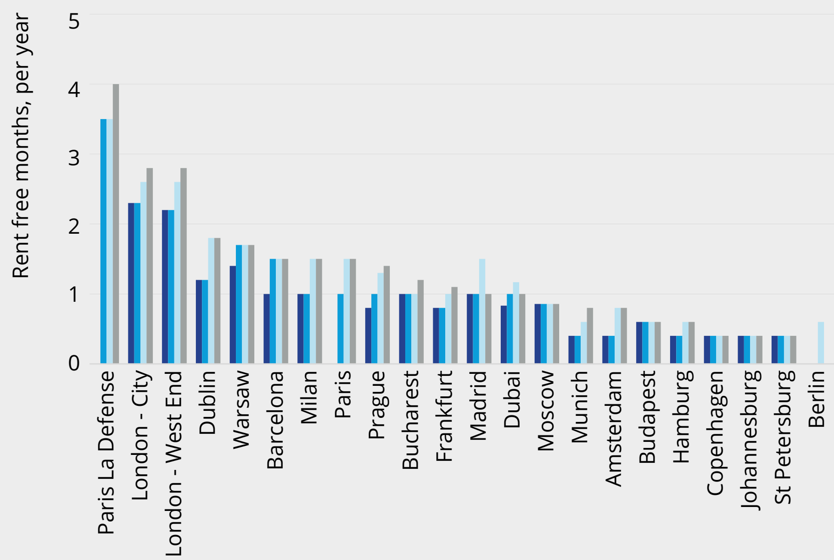
Click here for our latest Office Pricing Map



Source: Colliers

Figure 12: Occupier incentives

Q4 2019
Q2 2020
Q4 2020
Q2 2021



Source: Colliers

Outlook

The collective EEA30's GDP forecast looks positive at +4.5% for 2022, bolstered by easing restrictions and mass vaccination roll-out programmes that are helping to push the continent towards a broad-based recovery and expansion. Despite concerns over the real impact of furlough packages on unemployment, by mid-year 2021, employment growth performed better than expected, up +0.2%. This is in line with the uptick in occupier activity and general business activity, reflecting improved hiring intentions as occupiers return to pre-pandemic business plans. This has helped support household income and consumer spending However, while there has been a noticeable uptick, many markets are well behind their pre-pandemic averages: on average, between 10%-20%.

However, country by country, the rebound rates are mixed, and the threat posed by the Delta variant continues to cast a shadow on Europe's outlook. Moreover, any future restrictions in response to the rising number of infections could dampen the recovery, resulting in a lower 2022 output than presently forecast. Even if take-up remains flat, latent demand will be activated in future limiting any further outward movement in vacancy, with retractions/drop-offs in sub-let offerings, and a return of pre-letting activity. While the uncertainty looming over Europe means occupier conditions are likely to shift further in tenants' favour in the next 12 months, the picture differs when considering the bifurcation of fortunes for prime and second-hand stock's availability/pricing – prime space being increasingly difficult to come by.

Occupiers may look to find alternative arrangements, supporting further growth in demand for flex-working space, but occupiers must find the balance between the need or quality core and flexible-space. Landlords & flex operators will look to cash in on this demand, but this will require a considered investment to retrofit existing stock or repurpose tired, outdated stock to match modern, ESG-compliant requirements.

For more information

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