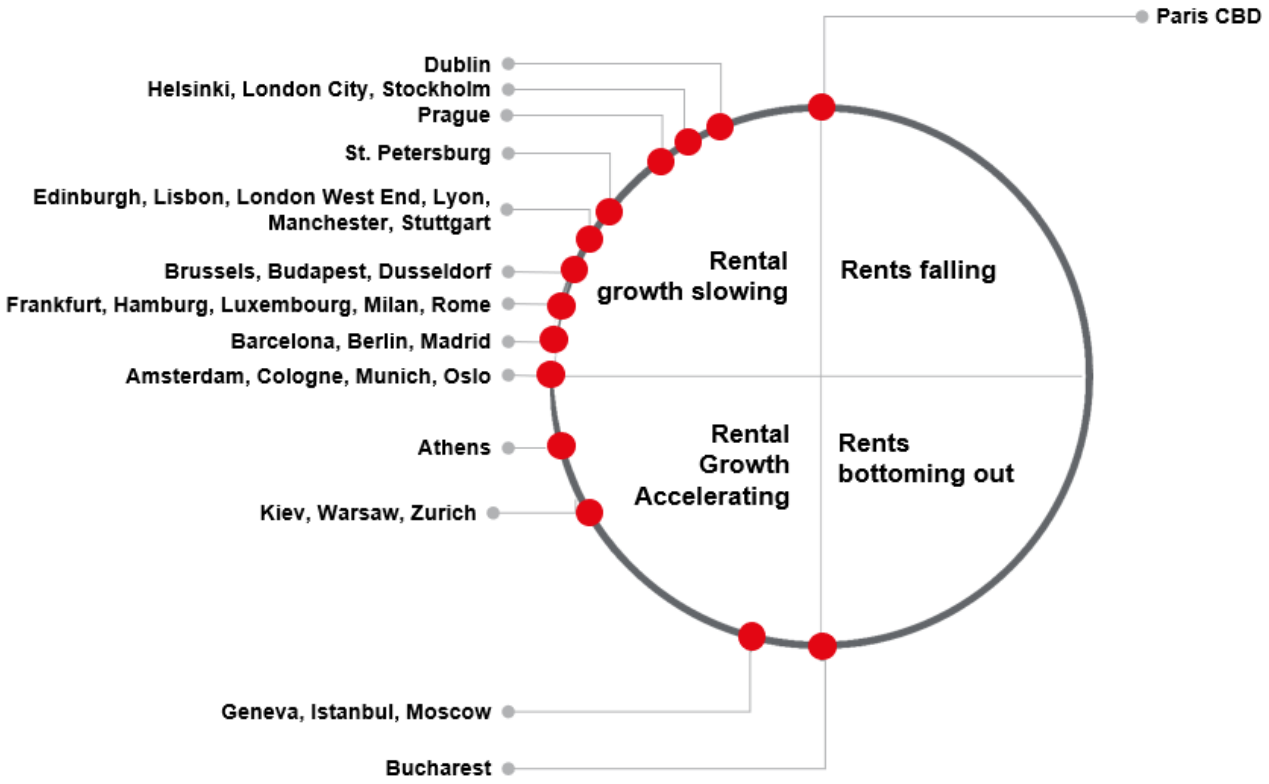
JLL Office Property Clock Q3 2019

EMEA Office Research

Strong occupier demand pushes European take-up to record Q3

- European office take-up amounted to circa 3.5 million sq m in Q3 2019, representing a 5% y-o-y increase.
- European office vacancy decreased by 20 bps to 5.7% in Q3 2019 - the lowest level since 2002.
- The European Office Rental Index rose by 0.5% q-o-q and 4.2% y-o-y.



Source: JLL, October 2019

The clock diagram illustrates where JLL estimates each prime office market is within its individual rental cycle as at the end of September 2019. Markets can move around the clock at different speeds and directions. The diagram is a convenient method of comparing the relative position of markets in their rental cycle. Their position is not necessarily representative of investment or development market prospects. Their position refers to prime face rental values. Markets with a "step pattern" of rental growth do not tend to follow conventional cycles and are likely to move between the "hours" of 9 and 12 o'clock only, with 9 o'clock representing a jump in rental levels following a period of stability.

European Office Occupier Markets

The pace of economic activity has slowed across the board in Europe. Declining global trade volumes, in part the result of escalating protectionist measures, in part due to a softening in global demand, has led industrial output in Germany into recession and this threatens to drag the services sector down with it. Political risks continue to top the agenda, especially in the UK with the impending Brexit deadline, though they have temporarily dissipated in Italy. Policymakers are responding to mitigate the slowdown, with the ECB cutting rates and restarting its asset purchase programme, while fiscal authorities are weighing up additional spending and tax cuts should a deterioration in conditions really take hold. For now, the services sector is holding up, employment remains high and recruitment continues. This should support rental levels in most key office markets.

Office Rents

The European Office Rental Index increased by 0.5% q-o-q in Q3 2019, with 8 of the 24 Index markets recording growth over the quarter (compared with 11 in Q2 2019). At 4.2%, annual European rental growth continues to outperform the 10-year average of 2.8%.

The Hague (+5.0% q-o-q) led the way in terms of rental growth in Q3, benefitting from strong occupier demand. Elsewhere in The Netherlands, Rotterdam (+2.2% q-o-q) saw an increase in prime rents as well, while Amsterdam and Utrecht remained stable during Q3 following years of consecutive rental increases. However, we do expect further movement in rental growth across most Dutch markets in the coming years.

In London, prime rents were unchanged in Q3 2019, highlighting the robust occupier market, despite some uncertainties in the macro environment. Elsewhere in the UK, prime office rents remained stable.

We continue to see stellar prime rental growth across the Spanish office market, with both Barcelona (+0.9% q-o-q) and Madrid (+0.7% q-o-q) registering healthy rental increases in Q3.

On the back of strong leasing activity in Germany, prime rents increased in Berlin (+1.4% q-o-q) and Munich (+1.3% q-o-q), but were unchanged in Hamburg, Dusseldorf and Frankfurt.

Other notable Q3 performances include Luxembourg (+4.0% q-o-q) and Lyon (+3.1% q-o-q). Elsewhere in Europe, prime rents held stable.

Looking ahead, with strong demand and a tight supply side, we forecast annual European office rental growth to remain in positive territory at around 3.6% and 2.2% in 2019 and 2020 respectively.

Office Demand

Following a strong H1 2019, strong occupier demand pushed European office take-up to circa 3.5 million sq m in Q3, representing a 5% y-o-y increase and the strongest Q3 on record. In line with Q2, Central and Eastern Europe (+20% y-o-y) outperformed Western Europe (+1% y-o-y).

In London, Brexit headwinds have so far not had a significant impact on leasing activity. Demand fell by just 7% y-o-y after a strong 2018, and we forecast healthy activity in the last three months of 2019. In Paris, take-up increased by 8% y-o-y and we still expect a total of 2.2 million sq m to be transacted in FY 2019.

In Germany, following a strong Q2, leasing activity continued apace in Q3. However, take-up is slightly down on 2018 levels. In the Big 5 office markets, take-up reached 872,000 sq m, down 4% on the same quarter last year. This robust leasing activity was mainly due to solid occupier demand in Berlin (+46% y-o-y) and Dusseldorf (+46% y-o-y). Elsewhere, Frankfurt (-45% y-o-y), Hamburg (-34% y-o-y) and Munich (-14% y-o-y) all recorded decreases compared to last year.

In Amsterdam, Q3 take-up was down 56% on Q3 2018 as tight vacancy held back activity. Occupiers are finding it increasingly difficult to secure space in the key office districts and are instead looking to other Randstad cities. Both The Hague (+815% y-o-y) and Utrecht (+15% y-o-y) recorded strong occupier demand during Q3.

Take-up was especially strong in Luxembourg in Q3, reaching 116,000 sq m, which is by far the highest volume on record. This was underpinned by a 40,000 sq m deal involving the European Union in the Court of Justice in the Kirchberg district.

Central and Eastern Europe saw the strongest Q3 on record, led by significant increases in activity in Budapest (+43% y-o-y), Warsaw (+40% y-o-y) and Moscow (+25% y-o-y).

Other notable Q3 results were witnessed in Madrid (+15% y-o-y), Brussels (+12% y-o-y), Milan (+7% y-o-y) and Lyon (+2% y-o-y).

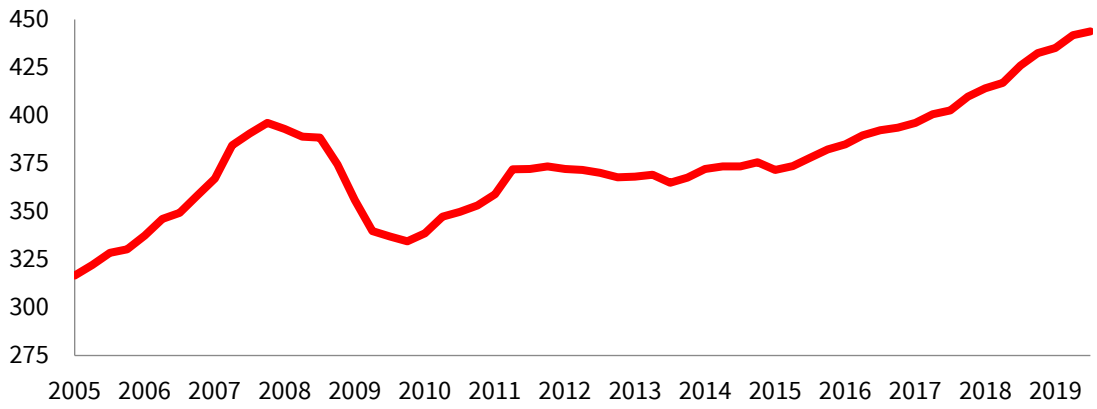
Office Supply

Robust office take-up continues to apply pressure on available space, with the European office vacancy rate tightening by 20 bps q-o-q to 5.7% - the lowest level since Q3 2002. Across Europe, 17 of 24 Index markets recorded a decline in vacancy in Q3. The largest falls were recorded in The Hague (-210 bps to 4.0%), Warsaw (-140 bps to 7.2%), Madrid (-60 bps to 8.7%) and Lyon (-60 bps to 4.1%).

The development pipeline continues to pick up across Europe, with total Q3 office completions amounting to circa 1.3 million sq m. This is up 42% on the corresponding period of 2018 and 21% above the 10-year Q3 average. Paris and London combined for 35% of new space delivered in Europe.

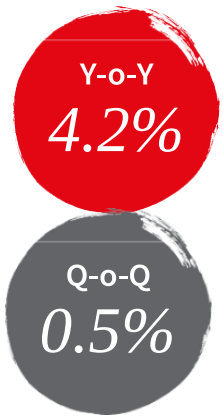
Looking ahead, we expect full-year completions to reach approximately 5.1 million sq m in 2019. Completions of around 6.8 million sq m and 8.4 million sq m in 2020 and 2021 respectively are unlikely to address the supply shortages in many office markets, given already tight vacancy and low speculative development activity across Europe.

Prime European Office Rental Index (EUR / sq m pa)

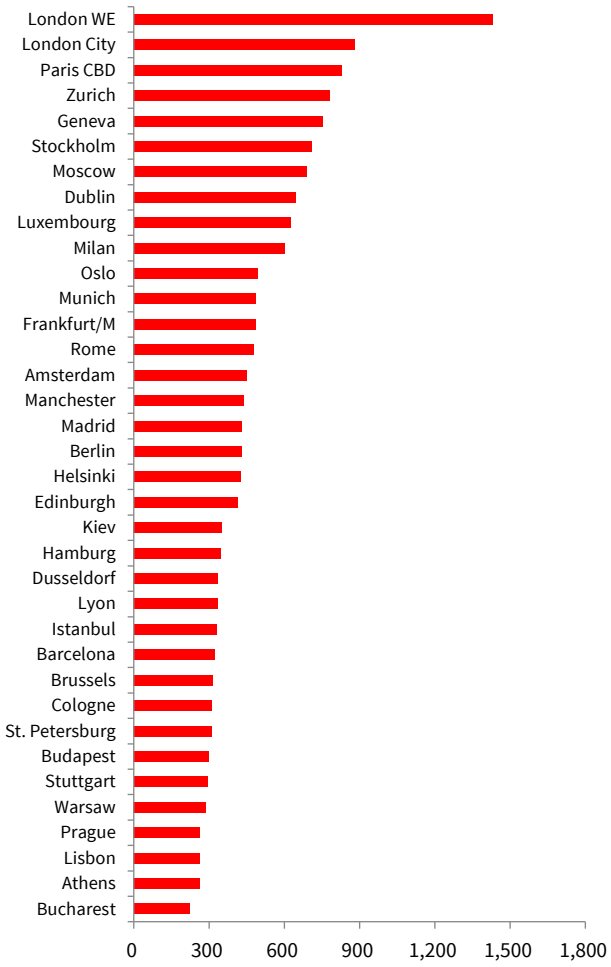


Weighted Nominal Rental Trend, 1980 = 100
Source: JLL, October 2019

% Change Q3 2019



Prime Office Rents Q3 2019 (EUR / sq m pa)



Prime Office Rental Change Q3 2019 (% Q-o-Q)

Source: JLL, October 2019

Definitions

Prime Rent

Represents the top open-market rent that could be expected for a notional office unit of the highest quality and specification in the best location in a market, as at the survey date. The rent quoted normally reflects prime units of over 500 sq m of lettable floor space, which excludes rents that represent a premium level paid for a small quantity of space. The Prime Rent reflects an occupational lease that is standard for the local market. It is a face rent that does not reflect the financial impact of tenant incentives and excludes service charges and local taxes. The Prime Rent represents Jones Lang LaSalle's market view and is based on an analysis / review of actual transactions for prime office space, excluding any unrepresentative deals. Where an insufficient number of deals have been made for prime office space, an assessment of rental value is provided by reference to transactions generally in that market adjusted accordingly to equate to prime.

Take up

Take-up represents floor space acquired within a market for occupation during the survey period (normally three-monthly). A unit is registered as taken-up when a legally-binding agreement to acquire the unit has been completed. Take-up includes floor space leased and sold for occupation, and the pre-lettings of floor space in course of development or prior to the start of construction.

Annual Net-Absorption

Represents the change in the occupied stock within a market during one year. Net Absorption is calculated on the basis of "top-down" estimates of occupied stock derived by subtracting vacant office stock from the total office stock of that market. Mothballed stock, i.e. floor space held vacant and not being offered for letting, usually pending redevelopment or refurbishment, is excluded.

Vacancy Rate

The Vacancy Rate represents immediately vacant office floor space, inclusive sub-lettings, in all completed buildings within a market as at the survey date (normally at the end of each quarter period), expressed as a percentage of the total stock

Completions

Completions represent floor space completed during the survey period (normally annually and projected forward by three years) within a market. Completions include both new development and refurbished accommodation that has been substantially modernised. An office is regarded as complete when the developer will undertake no further work until a tenant / occupier is secured. In the majority of instances this means that all main services are completed, and suspended ceilings and light fittings are installed. Some developments are considered to be completed when they reach "shell-and-core" condition where the accommodation is to be marketed in that state.

Future Completions

Represents the total floor space of new and refurbished developments, either pre-planned, planned or under construction, that are expected to complete in a given year or the remainder of a current year (e.g. at Q3 2019 for Q4 2019). The total volume contains developments of high completion probability which are usually already under construction, have obtained building permits / authorisation, or are considered for other reasons highly likely to be completed.

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