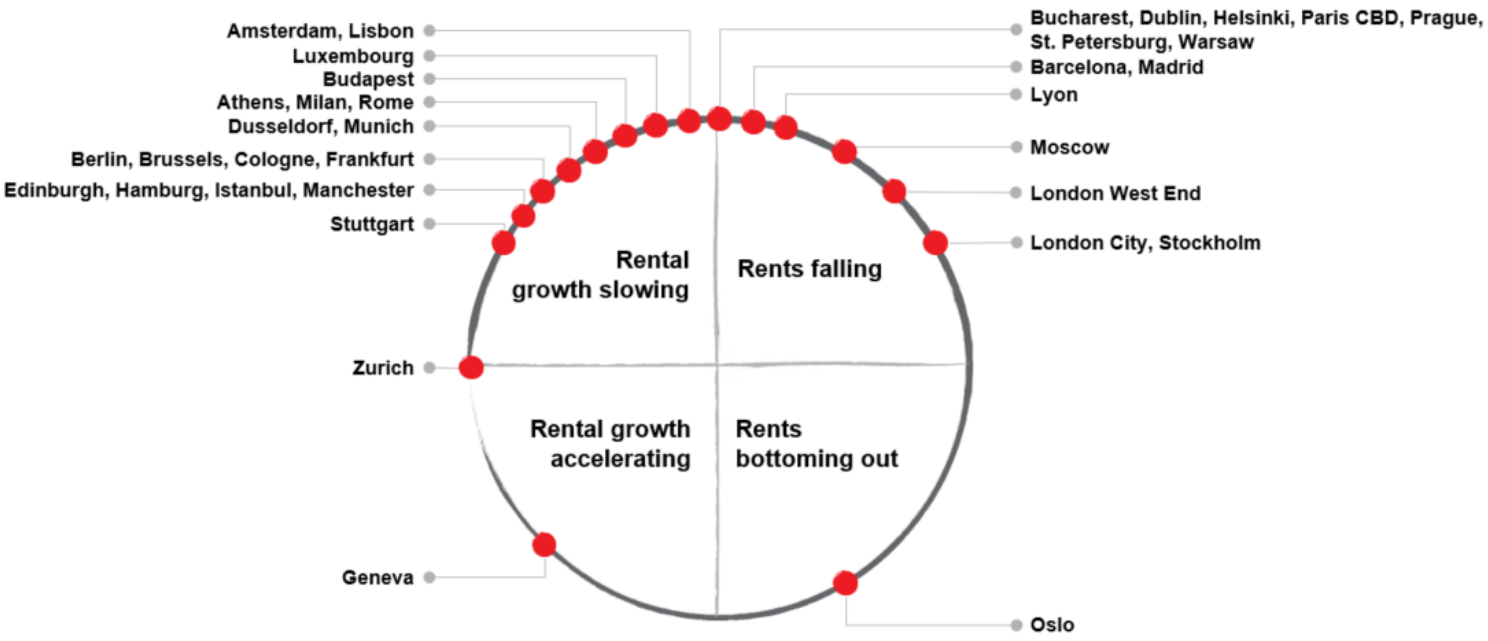
JLL Office Property Clock Q4 2020

EMEA Office Research

2020 European office take-up lowest since 2002 due to COVID-19 pandemic

- The European Office Rental Index increased by 0.5% q-o-q despite challenging market conditions.
- European office take-up totalled approximately 2.4 million sq m in Q4 2020, a 35% decrease y-o-y.
- European office vacancy increased by 40 basis points to 6.7% during Q4 and is set to continue to move up during 2021.



Source: JLL, January 2021

The clock diagram illustrates where JLL estimates each prime office market is within its individual rental cycle as at the end of December 2020. 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 public health response to the Covid-19 pandemic continued to determine the economic and real estate market performance in Q4. With a second wave of outbreak accelerating, many countries across Europe imposed further restrictions or lockdowns on its citizenry in October and November. The effect was to reverse a forecast expansion of GDP in the fourth quarter, leading to a double-dip economic contraction in 2020. Momentum had already been fading before restrictions were tightened, reflecting the unpredictability of the situation and households' and firms' inability to plan. The extension of government support schemes will help to minimise the fallout, or economic scarring, resulting from the toughened restrictions, but will not prevent it entirely meaning losses will accumulate. As we enter a new calendar year, a further tightening of restrictions has been conducted in many countries. The net effect will be to deepen the immediate economic hit and delay and lengthen the recovery. More positively, the rollout of vaccination programmes across the region offer hope for the end of lockdown-reopening cycles, and the prospect for a return to some semblance of normality.

Office Rents

The European Office Rental Index increased by 0.5% q-o-q in Q4 2020. The prime segment remains tight in most cities which is at the root of the resilient performance during this pandemic. Meanwhile, the 1.0% y-o-y European office rental increase is the lowest rate of growth recorded since 2010.

Rental increases were witnessed in 4 of the 24 Index markets, including Hamburg (+3.3% q-o-q), Paris (+3.3% q-o-q), Berlin (+2.7% q-o-q) and Edinburgh (1.4% q-o-q). The small increases in the prime segment reaffirms that not all markets have turned tenant favourable yet as result of the pandemic. In Paris, headline rents rose for a second consecutive quarter to € 930/ sqm/ year as grade A availability remains at an all-time low. At the same time, 5 index markets recorded a decrease in prime rents in Q4. Lyon recorded a 4.5% decrease q-o-q, while London (-2.1% q-o-q), Stockholm (-2.0% q-o-q), Barcelona (-1.8% q-o-q) and Madrid (-1.4% q-o-q) also saw a marginal drop.

In Q4, the net effective prime rental index decreased by -0.5% y-o-y. 2020 is the first year since 2013 an annual rental decline has been recorded in Europe. Uncertainty in the market has pushed dynamics to more tenant favourable conditions in some cities. One third of all European markets saw a decrease in net effective prime rents including Prague (-12% y-o-y), Amsterdam (-6% y-o-y), Madrid (-6% y-o-y) and Barcelona (-6% y-o-y). Incentives have started drifting up quickly across Europe. On average these increased by 150 bps to 10% in 2020. In 2021 a notable uptick in incentives is likely as landlords look to secure income, especially on pipeline projects for 2021-2023.

Generally, across Europe a divergence between prime and secondary office rents has been recorded with the latter experiencing a decrease across most of Europe at the end of 2020. Looking ahead, European prime rents are unlikely to see a sharp correction in 2021 with low single digit decrease in 2021 likely across some cities, before picking up again from 2022 onwards.

Office Demand

Market sentiment, which had gradually improved since the summer, was dealt a significant blow at the end of the year as a new wave of Covid-19 infections triggered lockdown restrictions across most of Europe. Weakening sentiment impacted on leasing volumes with many lease transactions, scheduled for completion before the end of the year, postponed into 2021.

Despite constrained market conditions on the back of stringent lockdowns across Europe, leasing volumes did pick up in Q4 2020 (+41 q-o-q). While Q4 represent the highest quarterly take-up level in 2020, the 2.4 million sq m transacted still represent a 35% y-o-y decrease and the weakest Q4 since 2002. At 8.2 million sq m 2020 take-up is down by 41% on 2019. For 2021 leasing volumes are likely to remain weak in Q1 before picking up in H2 2021. FY 2021 take-up is expected to see a 15-20% increase on depressed 2020 volumes, but to remain below the 10-year annual average.

Both Western Europe (-41% on 2019) and Central & Eastern Europe (-39% on 2019) office take up was down significantly reflecting the broad-based impact of the pandemic across geographies. At 25% y-o-y growth, Luxembourg was the one market posting an increase in office take-up compared to 2019. This was on the back of a handful of large one-off transactions. Despite difficult market conditions European net absorption (change in occupied stock) remained positive in 2020, although it dropped to the lowest level recorded since the Global Financial Crisis.

In Germany, take-up across the Big 5 office markets continues to record relatively resilient numbers. Q4 take-up amounted to circa 656,000 sq m, down 22% y-o-y. At 111,000 sq m Hamburg (+16% y-o-y) posted an increase in Q4 occupier activity. On an annual basis, take-up in the German Big 5 totalled approximately 2.3 million sq m (-32% y-o-y). Berlin and Munich outperformed with FY leasing down 'just' 25% on 2019.

In the UK, London registered a decline in leasing activity during Q4, with total demand reaching 60,000 sq m (-77% y-o-y). In 2020, London office take-up reached 411,000 sqm, the lowest full-year result on record. In addition to the pandemic the UK experienced significant headwinds on the back of Brexit related uncertainty. With a hard Brexit avoided, business confidence is expected to strengthen in 2021. In France, Paris saw a strong close to the year with Q4 take-up close to the combined Q2-Q3 volume at 409,000 sqm. However, this still represents a 40% decrease on Q4 2019.

In 2020, 8 of the 24 European index markets saw take-up decrease by at least 50%. Aside from London, Utrecht (-67% y-o-y), Barcelona (-64% y-o-y), Dublin (-55% y-o-y), Lyon (-54% y-o-y), Budapest (-53% y-o-y), The Hague (-51% y-o-y) and Stockholm (-50% y-o-y) all saw take-up decrease by half or more compared to 2019.

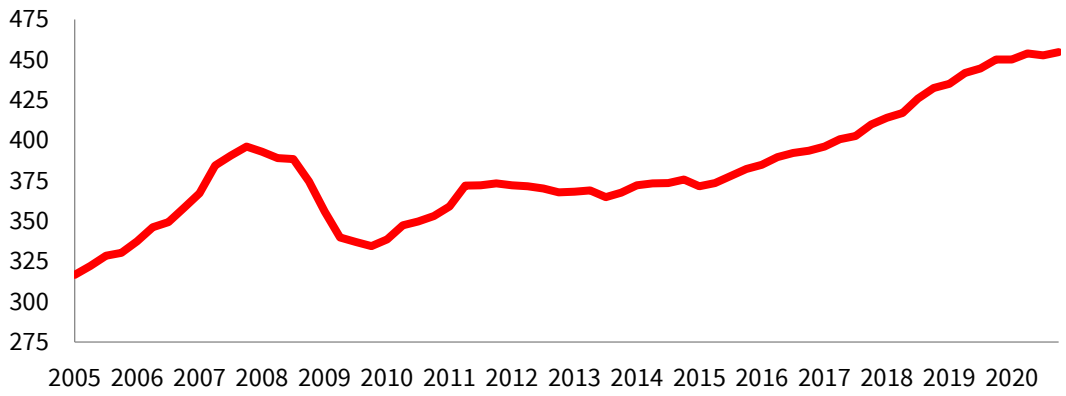
Office Supply

European office vacancy increased for the fourth consecutive quarter to 6.7% in Q4 2020, up 40 basis points q-o-q. Across Europe, 3 of the 24 Index markets recorded a decline in vacancy including Utrecht (-60 bps to 6.4%), Frankfurt (-40 bps to 6.1%) and Milan (-10 bps 11.9%). In 19 of the 24 index markets, vacancy increased with Barcelona (+150 bps to 6.7%), Luxembourg (+120 bps to 4.1%), Dublin (+100 bps to 10.3%), London (+80 bps to 6.6%) and Munich (+70 bps to 3.5%) seeing the most significant rise.

Moving forward, 2021 European office vacancy is forecast to increase steadily to more than 7.5% - the highest level since 2017. Alongside the high levels of completions, this is also partly due to the increase of tenant-controlled space as some corporates are looking to cash in on temporarily obsolete (growth) space, expectations are for this to be more significantly reflected in the numbers from 2021 onwards.

Development activity across Europe reached 4.4 million sq m in 2020, the highest since 2014. Approximately 1.6 million sq m was completed during Q4, the highest quarterly level since Q4 2008. London (281,000 sq m), Berlin (197,000 sq m), Paris (171,000 sq m) and Hamburg (122,000 sq m) accounted for the majority of new delivered space. Looking ahead, the development pipeline looks robust for 2021, with 8.2 million sq m of office space expected to be delivered, the highest ever recorded.

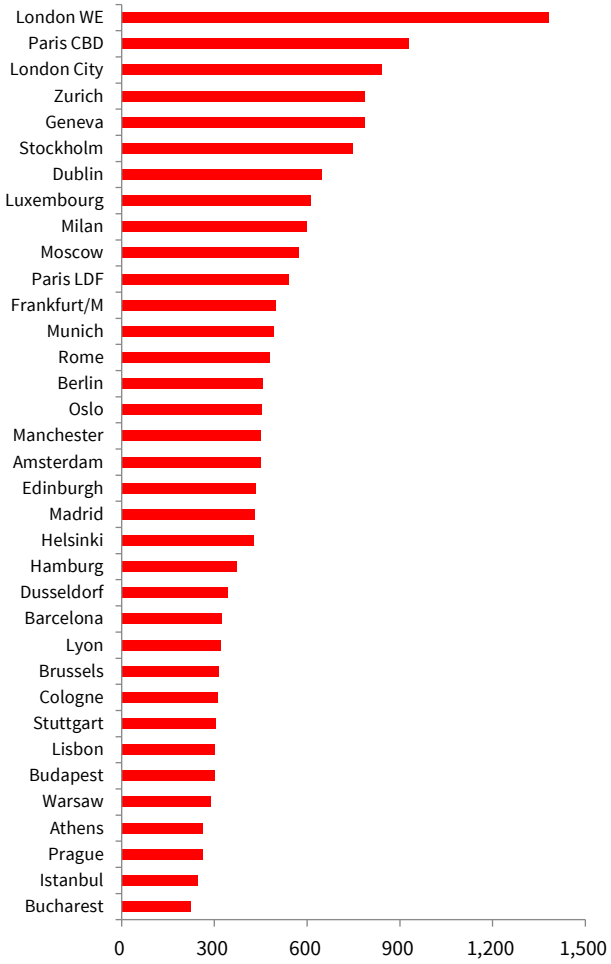
Prime European Office Rental Index (EUR / sq m pa)



Weighted Nominal Rental Trend, 1980 = 100
Source: JLL, January 2021

% Change Q4 2020

Prime Office Rents Q4 2020 (EUR / sq m pa)



Prime Office Rental Change Q4 2020 (% Q-o-Q)

Source: JLL, January 2021

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 Q1 2021 for Q1-Q4 2021). 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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