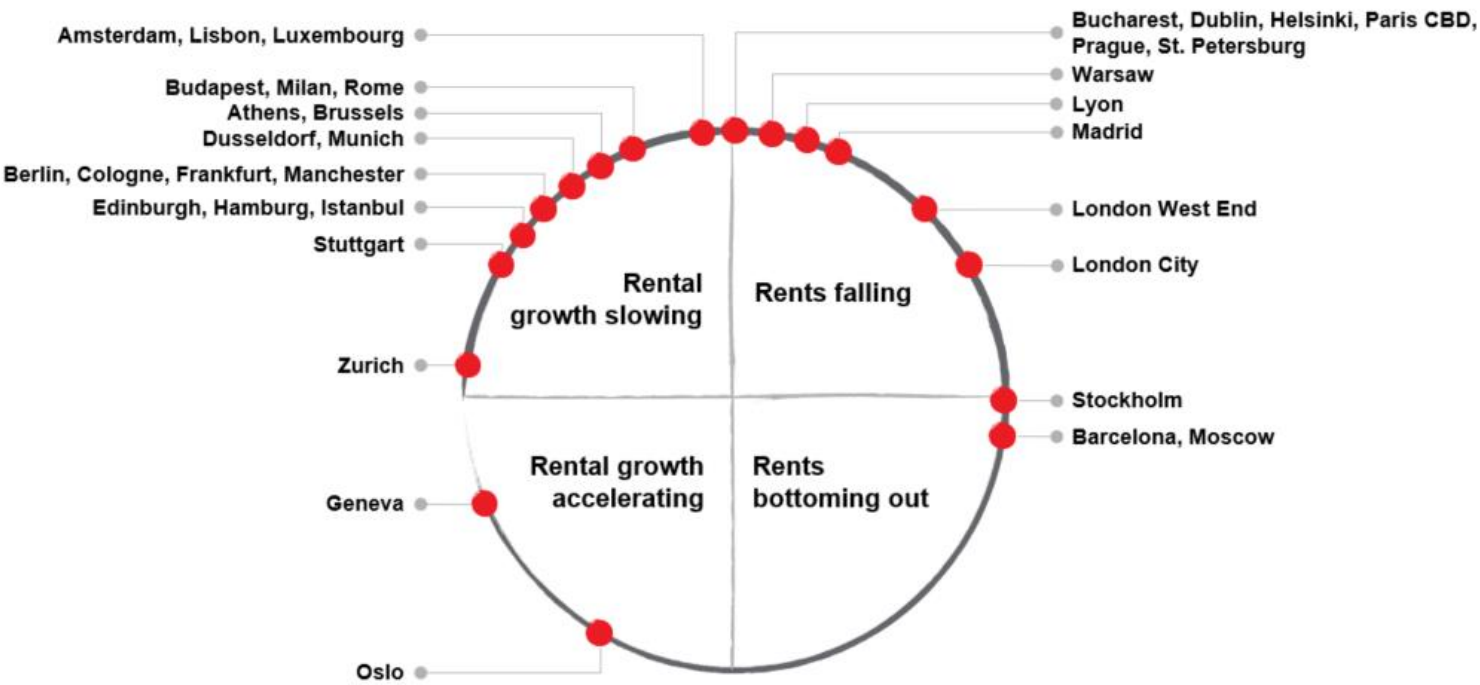
JLL Office Property Clock Q1 2021

EMEA Office Research

European office take-up weak, but occupier sentiment is starting to improve

- The European Office Rental Index increased by 0.2% q-o-q as prime office rents remain resilient despite market headwinds.
- European office take-up totalled approximately 2.1 million sq m in Q1 2021, a 11% decrease y-o-y.
- European office vacancy increased by 40 basis points to 7.1% during Q1 and is set to continue to move up during 2021.



Source: JLL, April 2021

The clock diagram illustrates where JLL estimates each prime office market is within its individual rental cycle as at the end of March 2021. 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 course of the pandemic remained the primary determinant of economic and real estate market performance in Q1 2021. A second/third wave caused the re-introduction of movement and operating restrictions in countries across Europe, leading to further contractions in GDP in Q1 and the postponement of the expected start of the recovery phase. The rollout of mass vaccination programmes begin in earnest in Q1, though multiple hurdles – from supply shortfalls, to inadequate preparation, to unexpected side effects - retarded many immunisation campaigns. A renewed wave of infections across much of the continent late in the quarter forced the imposition of stringent restrictions, highlighting the extreme uncertainty of the operating environment as well as the disparate profiles of recovery across economies. Fiscal support packages largely remained in place, alongside continued monetary policy support, preventing deeper economic scarring emerging. Although sentiment varies widely, broadly there is hope that warmer weather will coincide with accelerated vaccinations and the lifting of restrictions, heralding a much better second half of the year.

Office Rents

The European Office Rental Index increased by 0.2% q-o-q in Q1 2021. The lack of available Grade A supply is at the root of the resilient performance in the exceptional market conditions during this pandemic. Meanwhile, the 1.0% y-o-y European office rental increase is the lowest rate of growth recorded since 2014.

Rental increases were witnessed in 2 of the 24 Index markets, including Luxembourg (+2.0% q-o-q) and Paris (+1.2% q-o-q). In Paris, prime rents rose for a fourth consecutive quarter and currently stand at €930 / sq m/ year. Mainly finance and advisory companies are signing deals around this quoted rent, with prime and grade A availability remaining at an all-time low. Meanwhile, no single market recorded a decrease in prime rents. In some European cities, we have seen tenants taking office space on sublease agreement locking in rental level well below the market rent. While this is putting further pressure on average rents, prime (development) product has so far not been severely impacted.

At the same time, the net effective prime rental index remained flat during Q1 2021. Net effectives are down by 0.9% for a second consecutive quarter y-o-y. 14 Index markets are showing a decrease on Q1 2020 in net effectives including Prague (-12.2% y-o-y), Utrecht (-11.6% y-o-y), Barcelona (-8.2% y-o-y), Madrid (-7.9% y-o-y) and Stockholm (-6.8%) pushing market dynamics to more tenant favourable conditions while both Paris (+8.1 y-o-y) and Hamburg (+6.9% y-o-y) remain heavily landlord favourable. 2021 is expected to see a notable uptick in incentives as landlords look to secure income, especially on pipeline projects for 2021-2023. In previous downturns incentives increased by +20% in the first year of the recession.

Looking ahead, we forecast low single digit decrease in 2021 across a handful of European cities, while prime rents are expected to remain stable across most part of Europe, we do forecast rental increases across some UK regional and German cities. Secondary rents are likely to see a more pronounced decrease as the flight to quality persists.

Office Demand

After a slow start to the year in January, European office markets started to see signs of increased activity emerging in February and March. This was particularly notable in London and Germany, where there was a notable uptick in viewing activity, negotiations and deals signed towards the end of Q1. More corporates have now kicked-off projects that will determine when and how staff will re-enter the office. As many employees will put their key focusses on health, wellness, employee experience and accessibility, demand is strongest for the best quality space. Improved occupier sentiment is reflected in Q1 office take-up, which reached 2.1 million sq m, down 'just' 11% on Q1 2020. Q1 leasing activity is clearly still weighed down by uncertainty of a wider market recovery and structural implications on demand for offices. However, Q1 was down -20% on the 10-year average, a notable improvement on the 9 months to December 2020, where leasing volumes were down 40% on the 10-year average.

As deal activity picked up some evidence of changed requirements is coming through. Q1 2021 saw a number of deals directly quoting the pandemic as a determining factor to take less space compared to pre-pandemic expectations. At the same time, these deals also included an increased investment in terms of the quality of the asset and fit-out.

London recorded the strongest quarter since the start of the pandemic with Q1 office take up reaching 120,000 sq m. A number of larger deals were signed in Q1 with the Legal and Finance sector particularly active. In Germany, the Big-5 markets saw take-up reach 593,000 sq m in Q1 2021, down just 9% on a strong Q1 2020. Hamburg (+31% y-o-y) Frankfurt (+22% y-o-y) and Berlin (+20% y-o-y) recorded the strongest performance in Q1. Throughout the crisis, the largest German markets saw relatively low volatility compared to most of Europe. This is also reflected in the number of examples of large (publicly stated) corporate space/ requirement reductions. In Paris leasing volumes remained more subdued. At 327,000 sq m leasing volumes were down -30% y-o-y.

Other notable Q1 results were witnessed in Barcelona (+101% y-o-y), Luxembourg (+92% y-o-y), Brussels (+50% y-o-y) and Prague (+50% y-o-y), while demand was significant lower in Dublin (-96% y-o-y), Amsterdam (-65% y-o-y), Edinburgh (-44% y-o-y) and Madrid (-30% y-o-y) compared to the same period last year.

Looking ahead, sentiment, office requirements and take-up are likely to recover further towards the end of the year, with potentially stronger H2 2021 leasing volumes. At approximately 9.5 million sq m, 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.

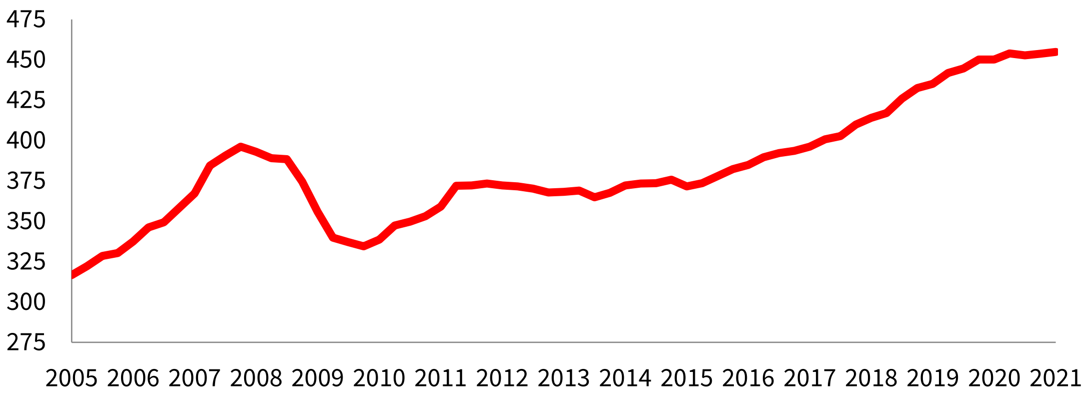
Office Supply

European office vacancy increased by 40 bps to 7.1% in Q1 2021 – the highest rate recorded over the last three years. Across Europe, 3 of the 24 index markets recorded a decline in vacancy in Q1 2021 including Budapest (-20 bps to 8.9%), Hamburg (-10 bps to 2.9%) and Luxembourg (-10 bps to 4.0%) posted decrease on Q4 2020. In 19 markets, vacancy increased with London (+100 bps to 7.8%), Utrecht (+90 bps to 6.0%), The Hague (+80 bps to 4.8%), Rotterdam (+80 bps to 8.7%) and Stockholm (+70 bps to 8.0%) seeing the most significant rise compared to last quarter. Available supply remained stable in Dublin and Edinburgh. Meanwhile, Grade A levels remain at historical low standards.

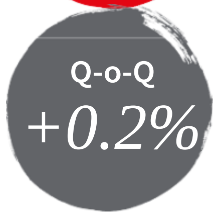
We expect European office vacancy to increase towards 7.7% later this year, as result of large shares of new office space delivered to the market and due to the increasingly large share of sublease space available as corporates look to improve liquidity through subleasing space. In London alone, the share of subletting space grew by 156% compared to pre-pandemic level.

The development pipeline is accelerating across Europe, approximately 1.5 million sq m was completed during Q1 2021, the highest Q1 since 2008. Moscow (309,000 sq m), Paris (293,000 sq m) and Warsaw (156,000 sq m) accounted for the lion's share of new delivered space during Q1 2021. Looking ahead, the development pipeline is set for a significant uptick in 2021, with another 6.4 million sq m of office space expected to be delivered. This would push 2021 completions to circa 7.8 million sq m, almost double the amount of supply compared to 2020.

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

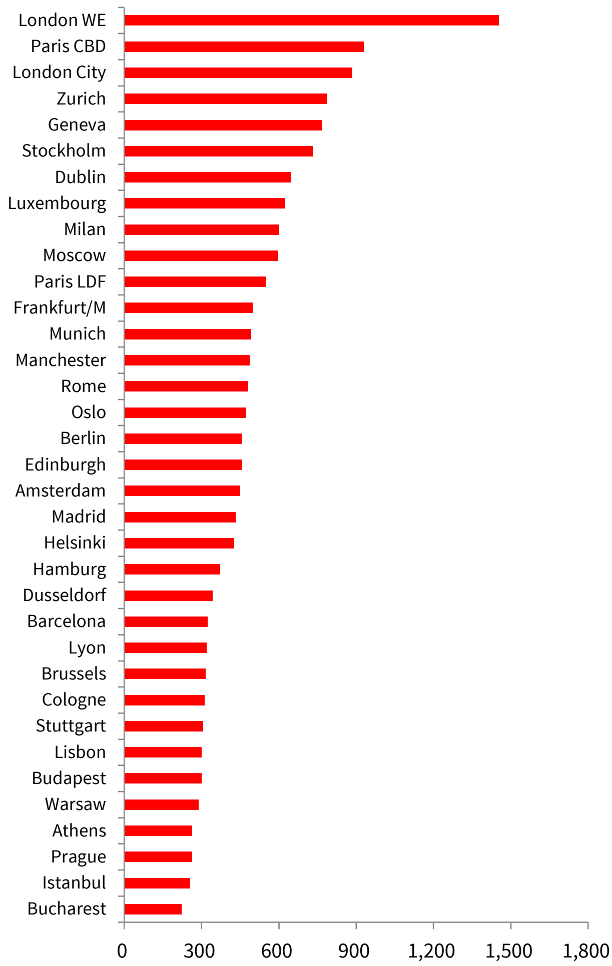


% Change Q1 2021



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

Prime Office Rents Q1 2021 (EUR / sq m pa)



Prime Office Rental Change Q1 2021 (% Q-o-Q)

Source: JLL, April 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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