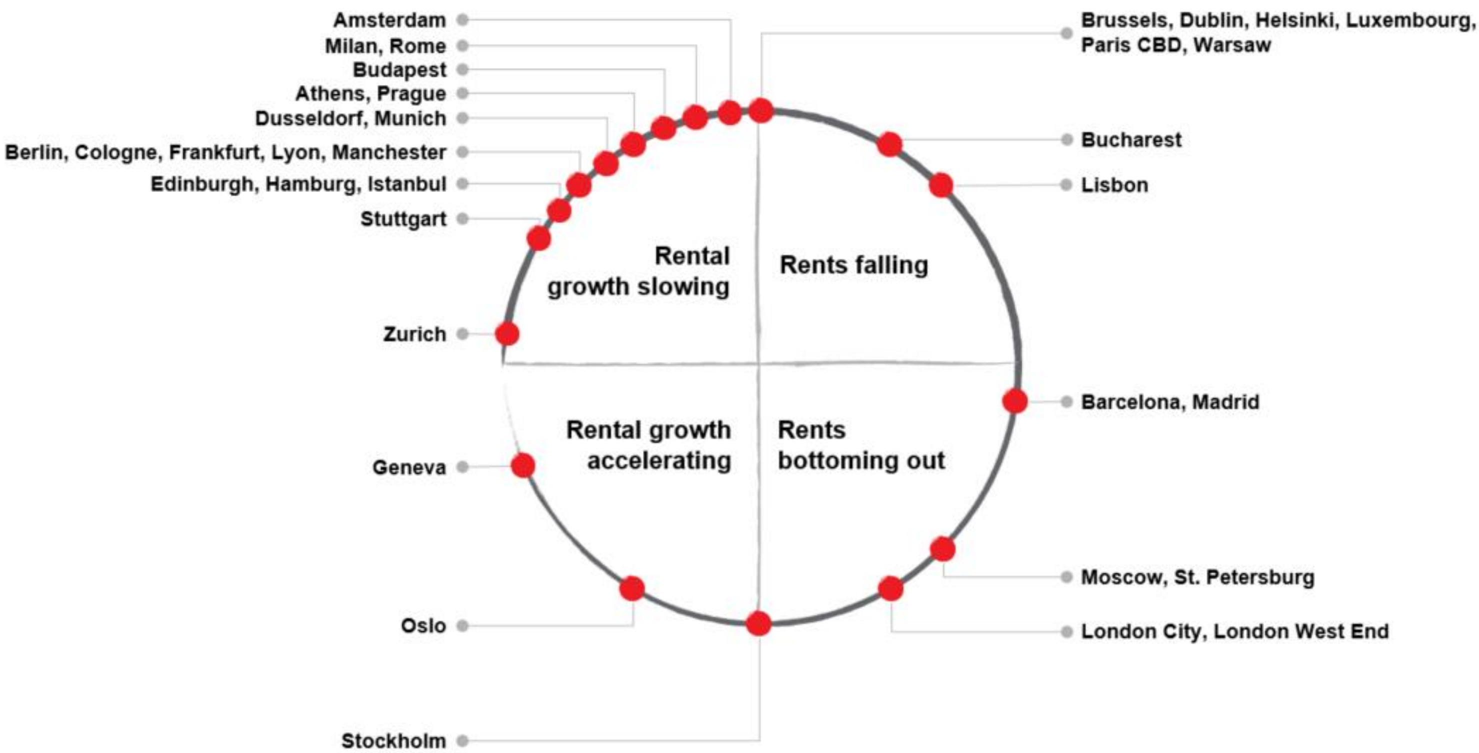
JLL Office Property Clock Q2 2021

EMEA Office Research

European office take-up records recovery in H1 2021 as sentiment improves

- The European Office Rental Index remained stable during Q2 2021.
- European office take-up totalled approximately 2.3 million sq m in Q2 2021, up by +26% y-o-y.
- European office vacancy increased by 30 basis points to 7.5% during Q2 and is set to continue to move up during 2021.



Source: JLL, July 2021

The clock diagram illustrates where JLL estimates each prime office market is within its individual rental cycle as at the end of June 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 second quarter looks likely to mark a turning point with mass vaccination programmes achieving critical mass, and pandemic restrictions starting to be eased once more. The renewed outbreak and economic contraction in Q1 gave way to declining case numbers and renewed activity, movement and spending in Q2, despite the continued application of many restrictions. Consumer confidence rebounded – achieving its pre-pandemic level by quarter-end - and fear of catching the virus eased in line with rising inoculation. Whilst the manufacturing sector had seen buoyant activity since the middle of last year, the harder-hit services sector executed the first stages of a strong rebound over the last few months. Support from loose monetary conditions and government spending programmes largely remained in place. Combined with the strengthening recovery, there is optimism that further economic scarring – such as delayed unemployment and business insolvency – will be avoided. Many European countries are forecast to recover their pre-pandemic GDP level before the end of this year. One chink in the recovery story is inflation concerns, exasperated by global supply shortages and bottleneck, commodity price speculation, and labour market shortages. Inflation will rise, exceeding central banks targets in many countries (albeit not excessively), and unless there is greater scarring than anticipated, the rise will be short-lived, and inflation will come back to normal levels within the upcoming year.

Office Rents

The European Office Rental Index remained stable during Q2 2021 (+0% q-o-q). Mainly due to the lack of available Grade A supply, which remains at the root of the resilient performance of the office sector during the pandemic. In addition to recent stability, the 0.2% y-o-y European office rental increase is the lowest rate of growth recorded since 2015.

Rental increases were witnessed in 2 of the 24 Index markets, including Lyon (+6.3% q-o-q) and Stockholm (+1.3% q-o-q). These new prime rents are mainly achieved within new office developments situated in the CBD as occupiers continue to seek the best space. Meanwhile, prime rents in Paris decreased by 1.1% during Q2 2021. Prime rents across all the other Index markets remained flat in Q2.

The net effective prime rental index decreased by -0.1% during Q2 2021. Meanwhile, net effectives are down by 2.3% on Q2 2020. 15 Index markets posted a decrease on the corresponding period in 2020. Markets including Prague (-14.1% y-o-y), Barcelona (-8.2% y-o-y), Madrid (-7.9% y-o-y), Moscow (-6.7% y-o-y) and Utrecht (-6.6%) are pushing market dynamics to more tenant favourable conditions while cities such as Hamburg (+3.3 y-o-y) and Edinburgh (+2.8% y-o-y) remain 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.

We forecast low single digit decrease in 2021 across a handful of European cities, while prime rents are expected to remain stable across most parts of Europe, with the European index expected to decrease by 0.1% throughout 2021. Moving forward, rents are expected to bounce back across most of Europe in 2022. However, supply heavy markets such as Paris and Dublin are likely to see continued pressure within the prime segment. Even with a small bounce back in late-2022, the European rental forecast is likely to remain down by -2.9% on the 5-year average.

Office Demand

Following an initial recovery in Q1, office leasing activity showed continued signs of improved traction in Q2 2021. European Q2 2021 office take-up reached 2.3 million sq m, up 9% on Q1 2021 and up 28% on Q2 2020. Sentiment on the European office market remains cautiously positive with continued demand for the best-in-class office space, especially buildings that meet occupier ESG agenda's and offer high quality amenities and wellness credentials are the most sought after. Encouragingly, we are seeing the level of leasing under offers rise, which is hopefully an indicator of a strong rebound during H2 2021. Most of the activity over the last quarter has been for small to medium sized deals, with a notable increase from companies active within the technology and law industries. However, a number of deals for larger spaces (>5,000 sq m) were closed across London and Paris.

As deal activity picked up some evidence of changing requirements is being witnessed. 2021 saw a number of deals directly quoting the pandemic as a determining factor to take less space compared to pre-pandemic expectations.

Increased activity was particularly notable in southern Europe with Milan (+79% y-o-y), Madrid (+70% y-o-y) and Barcelona (+20% y-o-y) recording a notable y-o-y increase. London recorded the strongest quarter since the start of the pandemic with Q2 office take up reaching 150,000 sq m, up 42% y-o-y. This was underpinned by IBM's lease of 14,600 sq m and JLL taking 12,200 sq m for its new HQ's. In Germany, the Big-5 markets saw take-up reach 504,000 sq m in Q2 2021, in line with the result in Q2 2020. Frankfurt (+87% y-o-y) and Hamburg (+25% y-o-y) recorded strong performances in Q2, whereas activity in Munich (-13% y-o-y), Berlin (-11% y-o-y) and Dusseldorf (-10% y-o-y) was more subdued. In Europe's largest office market, Paris, leasing activity reached 423,000 sq m (+ 107% y-o-y). In particular, the life science, education, public administration, legal and finance sectors have been very active across the French capital. They come with strong budgets often looking at creating a best-in-class environment to their people.

Other notable Q2 results were witnessed in Luxembourg (+106% y-o-y), Budapest (+88% y-o-y), Lyon (+57% y-o-y) and Moscow (+35% y-o-y), while demand was significant lower in Warsaw (-38% y-o-y), Brussels (-34% y-o-y) and Amsterdam (-26% y-o-y) compared to the same period last year.

Moving forward, recovery in demand is expected throughout H2 2021 as sentiment is likely to recover further, which will result in stronger leasing volumes. At approximately 9.2 million sq m, FY 2021 take-up is expected to see a 15% increase on the reserved volumes of 2020, but is likely to remain below the 10-year annual average of 11.6 million sq m.

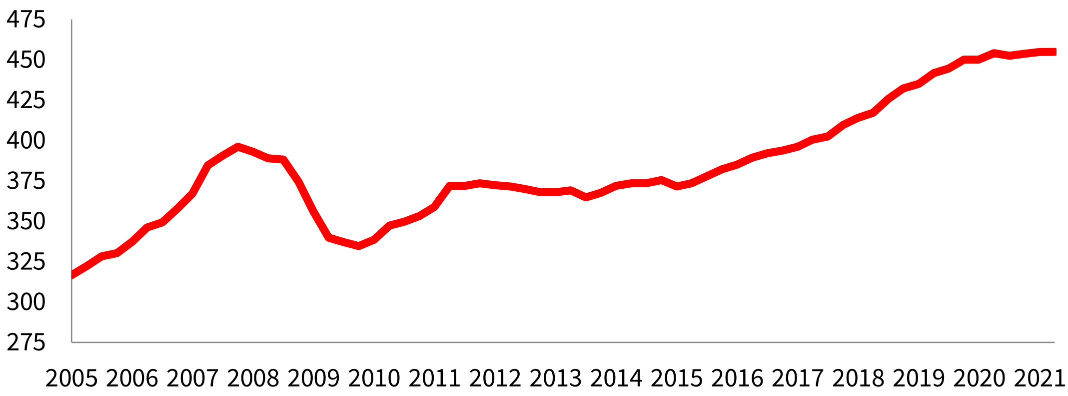
Office Supply

The European office vacancy increased for a sixth consecutive quarter to 7.5% - up by 30 bps q-o-q and the highest since 2017. Across Europe, 4 of the 24 index markets recorded a decline in vacancy during Q2 2021 including Amsterdam (-30 bps to 4.1%), Budapest (-20 bps to 8.7%), Barcelona (-10 bps to 4.0%) and Lyon (-10 bps to 6.7%). In 16 markets available supply increased with Dublin (+100 bps to 12.7%), Berlin (+50 bps to 3.9%), Warsaw (+50 bps to 11.9%), Stockholm (+50 bps to 11.0%) and Paris (+40 bps to 7.3%) seeing the most significant rise compared to last quarter. Vacancy remained stable in Brussels, Milan, Edinburgh and Madrid. Meanwhile, Grade A levels remain at historical low standards.

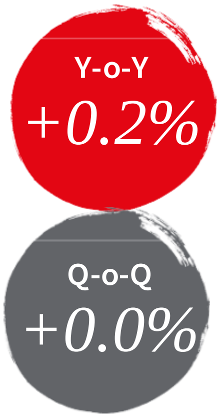
We expect European office vacancy to move out further towards 7.7% throughout 2021, as many markets will see a significant influx of new developments. Sublease space has stabilised now, and we expect it to start decreasing in line with trends seen in the US. There have been a number of subleases taken back in London as occupier strategies evolve as return to office sentiment improves.

The development pipeline is accelerating across Europe, approximately 1.2 million sq m was completed during Q2 2021, 14% above the 5-year average. Paris (227,000 sq m), London (217,000 sq m) and Moscow (137,000 sq m) accounted for the lion's share of new delivered space during this quarter. Looking ahead, we expect another 4 million sq m to be delivered throughout H2 2021, which will push 2021 office completions towards 6.9 million sq m, 55% above the 2020 figure.

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

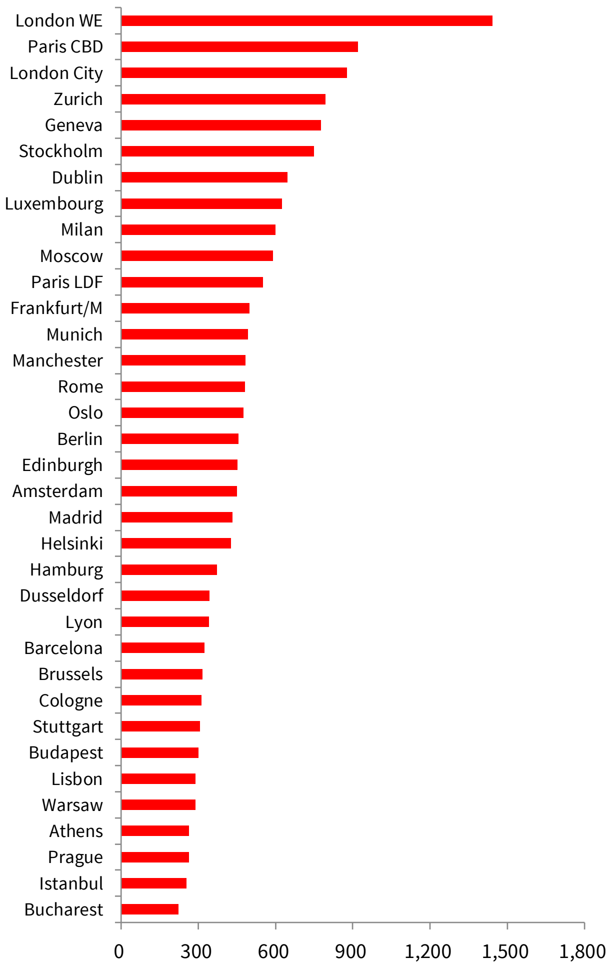


% Change Q2 2021



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

Prime Office Rents Q2 2021 (EUR / sq m pa)



Prime Office Rental Change Q2 2021 (% Q-o-Q)

Source: JLL, July 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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