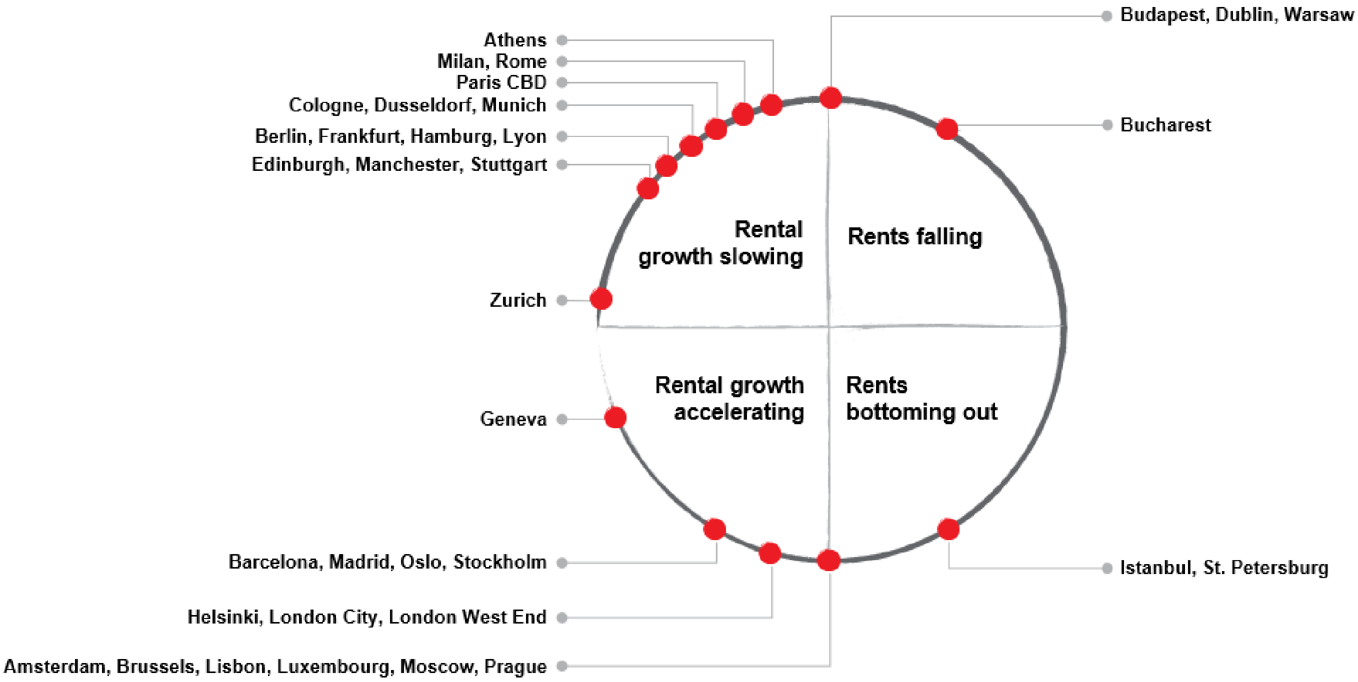
JLL Achieve Ambitions

JLL Office Property Clock Q3 2021

EMEA Office Research

European resurgence in corporate sentiment drives solid recovery in leasing activity

- The European Office Rental Index improved marginally during Q3 2021, growing by 0.8% q-o-q and +1.3% y-o-y.
- European office take-up totalled circa 2.5 million sq m in Q3 2021, up +2% on Q2, though 20% below the 5-year quarterly average.
- European office vacancy increased by 10 basis points to 7.6% during Q3 and is set to continue to rise.
- Clock resets recorded across major markets as demand resurgence bolsters pricing fundamentals.



Source: JLL, October 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 third quarter saw two occurrences of decoupling accelerate. Firstly, thanks to the success of mass vaccination programmes, the emergence and spread of the Delta-variant resulted in a significant rise in case numbers. Still, commensurate increases did not match these in hospitalisations and deaths. This allowed policymakers to break the cycle of tightening restrictions and imposing lockdowns with each new wave of the pandemic. Secondly, confidence in the coronavirus situation – which deteriorated with the spread of the delta-variant – no longer determined consumer and business confidence more broadly, both of which exceeded and stabilised at above pre-pandemic levels. Deeds followed words, and consumer and business behaviour made considerable strides back to normality: travel, commuting, and the return to offices continued to recover, and recruitment activity mushroomed. However, the pace of normalisation was not uniform, neither across countries, across different urban conurbations, nor across sectors. Close-contact services, such as hotels, hospitality, and air travel, saw activity remain subdued, still subject to a patchwork of international rules on quarantine and travel. As economic activity resumed in earnest, supply chain and capacity constraints began to bite from still-disrupted production activity. Commodity prices continued to climb, shortages emerged, and inflation spiked. Most upward inflation pressure is expected to dissipate as short-term disruption is resolved but remains uncertain, especially as policy stimulus fades and pandemic support unwinds.

Office Rents

The recent recovery in demand and resilient performance of best-in-class offices during the pandemic was reflected in Q3 2021 prime rental growth. The European Office Rental Index increased during Q3 2021 (+0.8% q-o-q), the highest since the start of the pandemic. At 1.3%, annual European office rentals remain well below the 5-year average of 3.4%. Rental increases were witnessed in 8 of the 24 Index markets, including Edinburgh (+2.8% q-o-q), Frankfurt (+2.4% q-o-q), Munich (+2.4% q-o-q), London (+2.2% q-o-q), Barcelona (+1.9% q-o-q), Madrid (+1.4% q-o-q), Berlin (+1.3% q-o-q) and Stockholm (+0.7% q-o-q). Across all other European index markets, prime rents remained stable.

Net effective rents are up by 0.6% from Q2 2021, although incentives remain elevated for tenants willing to commit to pipeline projects in particular. Utrecht (+3.0% q-o-q), Munich (+2.4% q-o-q) and Frankfurt (+2.4%) showcased the greatest Q3 improvements, whilst markets such as Warsaw (-7.8% q-o-q) experienced a notable decline.

We forecast minor decreases in 2021 across a handful of European cities, while prime rents are expected to remain stable across most parts of Europe. The European index is expected to see further upward pressure in the next 18 months before seeing some stronger growth in 2023. Accordingly, various markets have experienced a rental clock reset, with the likes of Amsterdam, Brussels and Prague anticipating steady prime rental growth over the coming years.

Office Demand

Q3 2021 leasing sentiment continued to show improvement, with demand resurgence recorded across many European markets. 2.5 million sq m of take-up was recorded in Q3, representing a slight increase of 2% from Q2. A divergence in take-up trend is evident at a regional level, with demand softening slightly across Central and Eastern Europe (-5% q-o-q). Western Europe fared better, with take-up volumes firming by +5% (q-o-q). At a European level, however, take-up remains 20% below the 5-year quarterly average. Leasing activity recorded in Q3 predominantly comprised of medium-sized deals (+/-3,000 sq m), driven by operators in the tech, professional service, life science and public sectors. Subsequently, year-to-date take-up stands at circa 7.2 million sq m, compared to the 5-year average of 8.8 million sq m taken up during quarters 1-3.

Leasing sentiment across major markets continues to improve, with demand rebounding seemingly as quickly as it faded during the height of the pandemic. In London, active demand and space under offer are now both well above the 10-year average as well as pre-covid levels. Quarterly take-up reached 233,000 sq m (up +167% y-o-y), the highest levels recorded since Q4 2019. Q3 activity was underpinned by major transactions by tech firms such as Facebook (28,800 sq m), and flex operator The Office Group (15,000 sq m).

In Paris, Europe's largest office market, occupier sentiment continues to showcase a robust recovery. Q3 take-up reached 406,000 sq m (+66% y-o-y), bringing year-to-date leasing volumes to circa 1.2 million sq m. Operators in the tech, legal, and life science sectors continue to play a central role in take-up resurgence, evidenced by the likes of SANOFI acquiring more than 9,000 sq m in the CBD.

Average new leasing requirements across the Germany Big-5 markets picked up considerably over the latter part of Q3. Subsequently, quarterly take-up amounted to 719,000 sq m (+39% y-o-y), the largest contributors including Munich (209,000 sq m) and Berlin (182,000 sq m). Hamburg (130,500 sq m), Frankfort (105,500 sq m) and Dusseldorf (91,000 sq m) similarly showed strong recoveries. This year-to-date, a total of 1.8 million sq m of space has been taken up across the Germany Big-5 markets.

Other mentionable improvements in quarterly take-up were recorded in Dublin (+98% q-o-q), Brussels (+42% q-o-q) and Barcelona (+27% q-o-q). At a CEE level, stand out Q3 improvements emerged out of Warsaw (+18% q-o-q), whilst Moscow continues to showcase the most impressive recovery at an annual level (+140% y-o-y). Although up over a 12-month period, markets showcasing slightly more subdued Q3 take-up activity include Stockholm (-48% q-o-q), Milan (-27% q-o-q), and Prague (-12% q-o-q).

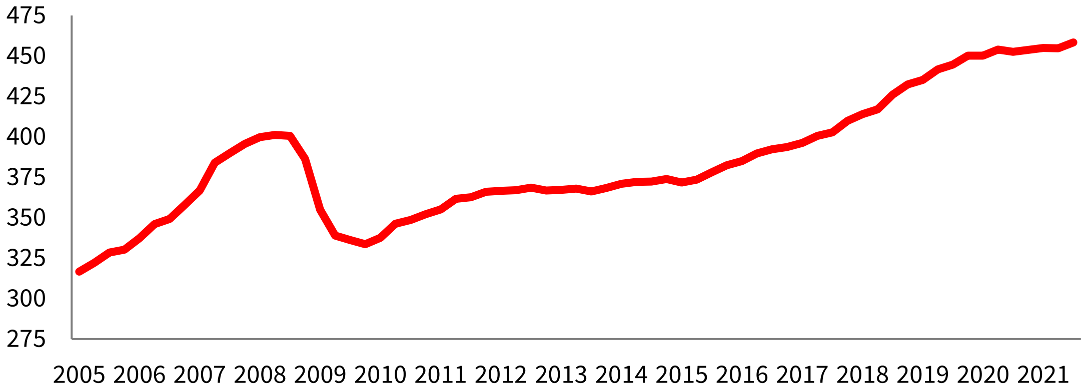
Across Europe, positive sentiment is further reflected in the quantum of sub-lease space available, as many corporates opt to withdraw and reoccupy space under offer. Additional signs of the improved demand outlook have been evidenced by the growing frequency of lease clauses ensuring first preference on new space options. Corporate demand remains focused on premium quality, characterised by strong sustainability credentials, high levels of accessibility and amenity proximity. Consequently, this best-in-class transition may cause medium to long-term obsolescence risks among outdated B and C-grade stock. Moving into the latter part of the year, demand for prime office space is anticipated to continue improving. The resurgence in leasing activity is set to carry through its momentum into 2022.

Office Supply

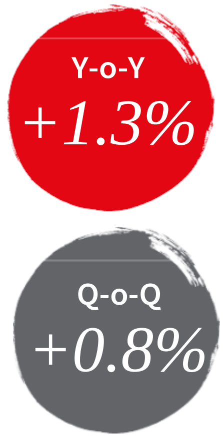
European office vacancy rose by 10 bps to 7.6% during Q3. This was the slowest rate of increase since the start of the pandemic, despite 1.4 million sq m of new space being added to the market. This clearly indicates the positive impact of demand revival across Europe. Pipeline space was particularly popular providing occupiers with best-in-class space for their talent as well as decent incentives as landlords looking to de-risk. As always, the supply-demand balance does differ greatly across Europe. 7 of the 24 index markets recorded a decline in vacancy during Q3 2021, including Moscow (-100 bps to 11.8%), Stockholm (-80 bps to 10.2%) and Madrid (-30 bps to 9.3%). 11 markets experienced an increase in available supply, with the greatest quarterly movements recorded in Barcelona (+170 bps to 8.4%) and The Hague (+150 bps to 5.6%). Vacancy remained stable in Amsterdam, Edinburgh, Paris, Prague and Warsaw.

Looking ahead, the pandemic appears to have flattened the peak of the current development cycle with many planned office schemes delayed or cancelled on the back of uncertain demand. Therefore, 2022 is likely to be the peak of the current development cycle (and vacancy rise) with around 7.4 million sq m due for completion. The more modest 6.8 million sq m currently planned for 2023 is likely to erode further as most projects which haven't broken ground will be delayed as they await significant pre-lets. The slowdown in development and expected pick up in demand should support more rental growth for high quality space post 2022.

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

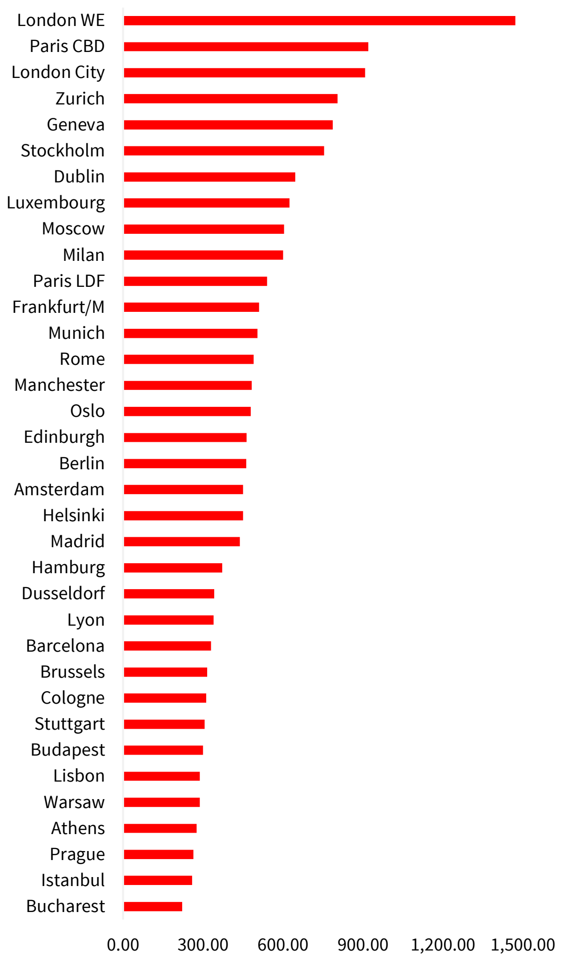


% Change Q3 2021

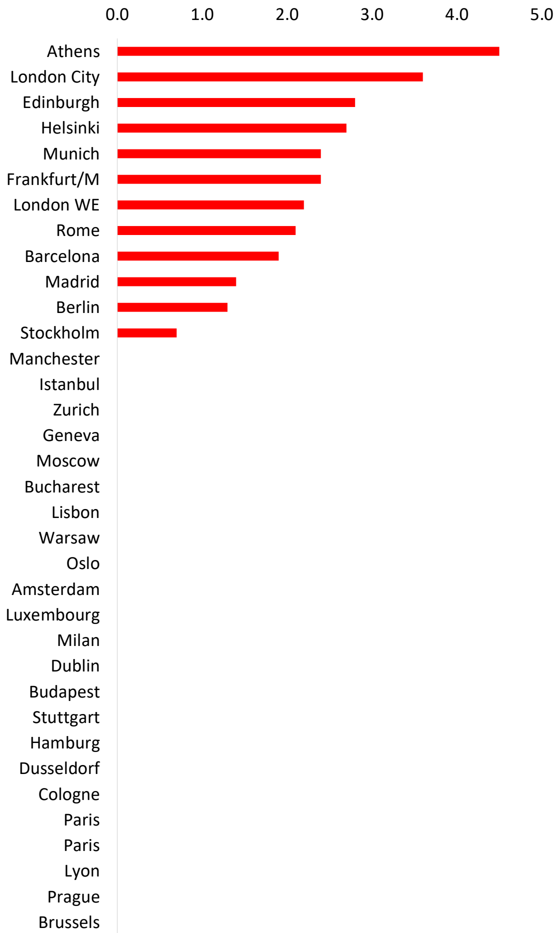


Weighted Nominal Rental Trend, 1980 = 100
Source: JLL, October 2021

Prime Office Rents Q3 2021 (EUR / sq m pa)



Prime Office Rental Change Q3 2021 (% Q-o-Q)



Source: JLL, October 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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