

Is office development meeting expectations in demand?

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Executive Summary

- In EMEA, office leasing activity accelerated in Q4 2021, reflecting a robust pick-up in demand. As the economic recovery strengthens, we expect further increases in 2022.
- At the same time, occupiers are showing a preference for amenity-rich modern space, the choice of which is limited in many markets.
- Most major office markets saw a steady increase in the overall level of completions in 2021, which is a trend we expect to continue in 2022 and 2023, particularly in markets such as London, Berlin and Moscow.
- As well as scale, the next development cycle will need to provide space that is aligned with occupiers' rapidly evolving needs for quality and amenity. There is emerging evidence of this in the upcoming development of new sustainable office buildings in some markets including Amsterdam and Barcelona, and we expect this to become more widespread.

As 2021 drew to a close, we saw a continuation in the upward trend of office leasing which had been apparent for much of the year. Office leasing in 2021 was over 20% up on the previous year, and we expect a further rise in 2022.

Introduction

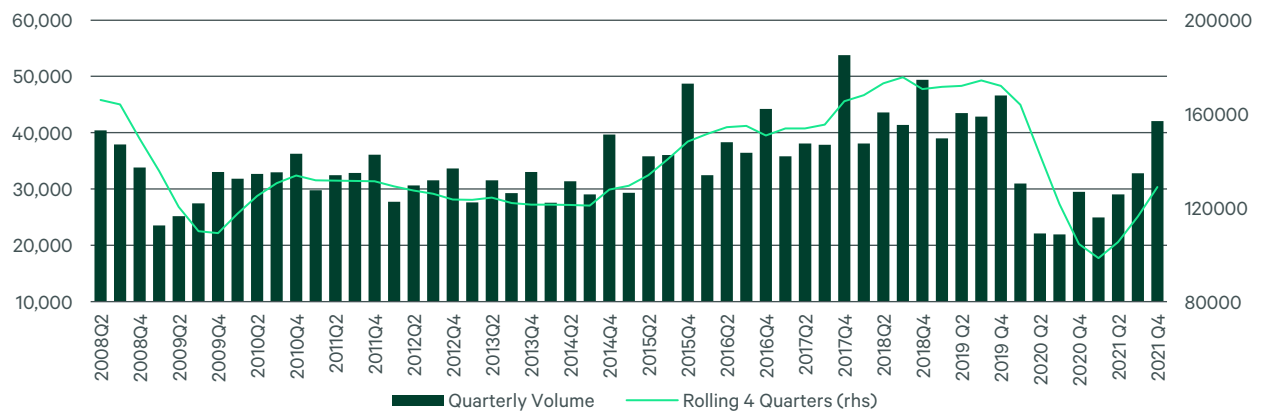
As the recovery cycle progresses and the scale and character of occupiers' space demands become clearer, how is office development responding? As 2021 drew to a close, and as we witness a gradual return to office-based working, office development will be one gauge of whether occupiers can exercise their evolving preferences for scale and type of space. This brief explores the extent to which the development pipeline is meeting expected demand, not only in scale but also the type of demand too.

Strong leasing recovery at end of 2021

As 2021 drew to a close, we saw a continuation in the upward trend of office leasing which had been apparent for much of the year. In isolation, Q4 take-up across EMEA was almost 43% higher than in the same quarter in 2020, and over the year as a whole leasing was 23% higher than in 2020. We expect a further increase in leasing levels in 2022, bringing them closer to pre-pandemic levels (see source 1b).

CBRE’s 2021 EMEA Office Occupier Sentiment Survey found that large companies are looking for certain key amenities, including flexible open space and sustainable building designs.

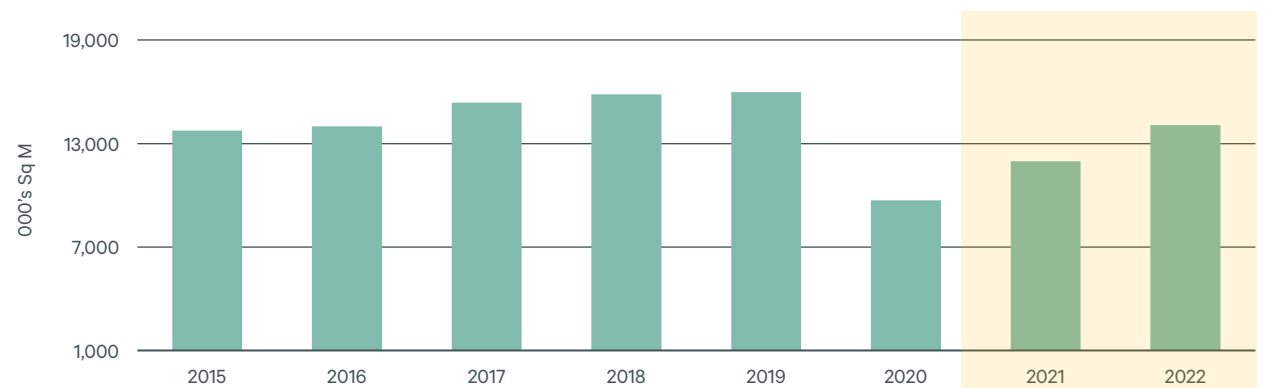
European Office Gross Absorption (Millions Sq. Ft.)



Source: CBRE Research, EMEA Leasing Outlook, Q4 2021

Source 1a

Office Leasing, Europe, Sum of Main Markets



Source: CBRE Research, Q1 2022

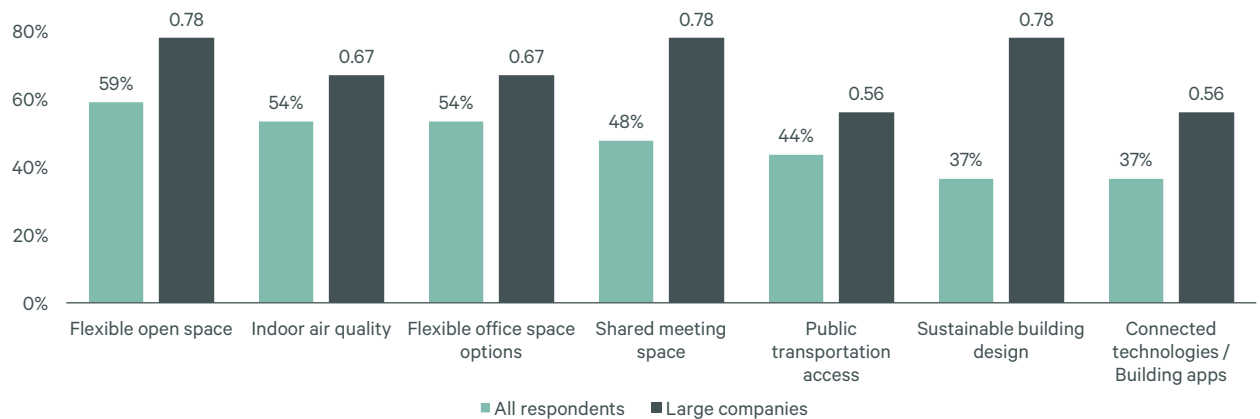
Source 1b

Demand remains focused on premium space

As well as a cyclical pick-up we are also seeing a strong ‘flight-to-quality’ trend among occupiers, accelerated by the widespread adoption of hybrid working in the wake of the Covid-19 pandemic. As a result, any new supply should be absorbed quickly, whilst higher availability of secondary space looks likely to persist in several major markets. Where occupiers do look to rationalise their portfolios, this is likely to focus disproportionately on secondary assets.

CBRE’s 2021 EMEA Office Occupier Sentiment Survey found that large companies are looking for certain key amenities, including flexible open space sustainable building features and enhanced technology. The persistent demand for, and limited availability of such space creates an opportunity for new development – but is this happening?

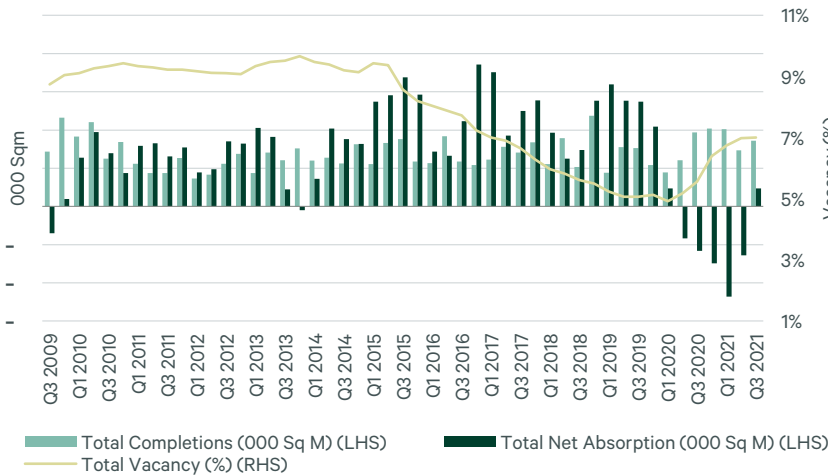
What will be the most in-demand building amenities in the future?



Source: CBRE Research, Global Office Occupier Survey, 2021

Source 2

European* Office Net Absorption, Completions and Vacancy:



Strong leasing activity is occurring in Paris, Berlin, Moscow and Barcelona, whilst Dublin, Amsterdam and Warsaw remain weaker.

Source: CBRE Research, EMEA Slide Library, Q3 2021

Source 3

*Vienna, Brussels, Prague, Copenhagen, Paris, London, Berlin, Frankfurt, Munich, Dublin, Amsterdam, Warsaw, Barcelona, Munich, London City, London West End

Is development adequate to meet demand in scale and type?

As stated earlier, we have seen a steady increase in development, but more importantly is to determine whether this development is meeting the requirements of expected demand.

Signs of increasing development

We saw positive leasing figures across several EMEA markets in 2021, and in 2022 we expect further leasing growth of 15-20% in aggregate. Strong activity is occurring in Paris, Berlin, Moscow and Barcelona, whilst Dublin, Amsterdam and Warsaw remain weaker.

Development seems to be responding to this pick-up in demand. By Q3 2021, completions had almost doubled to 860,000 sq. m. — up by 93% from the start of the pandemic in Q1 2020 (see source 3). This upward trend in EMEA development activity is expected to continue in 2022 and increase by a further 2% in 2023 (see source 4).

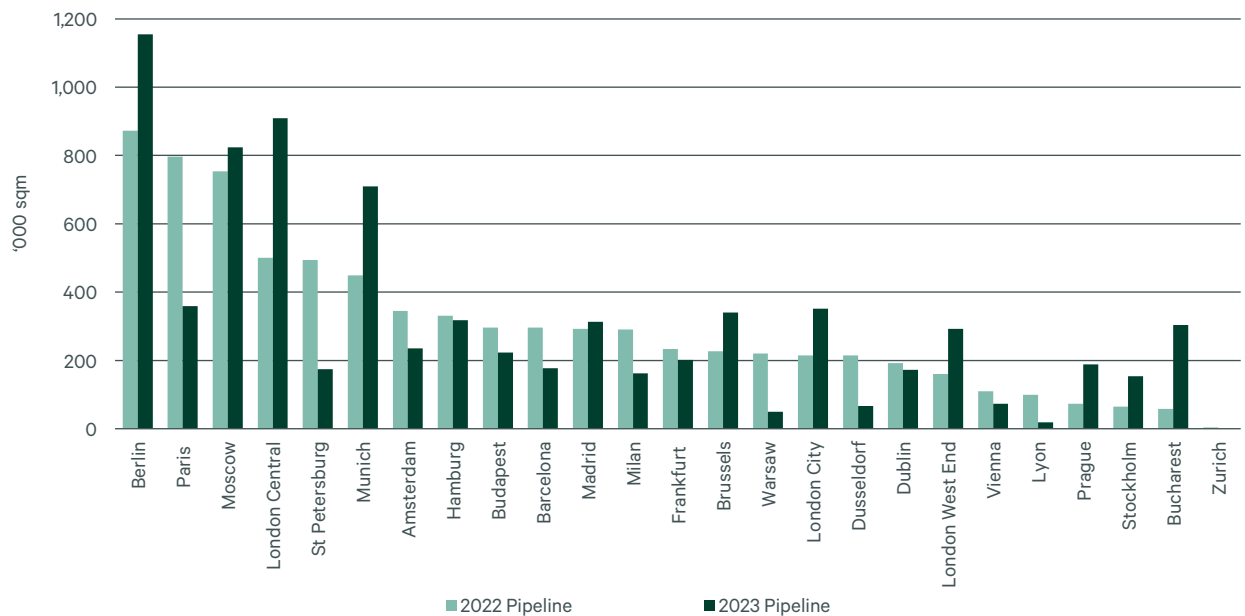
The balance between demand and development varies widely by city. For example, Amsterdam’s forecast stock and take-up are positively correlated for 2023-2025 (expected change in stock accounts for net additions partly in the form of new development). Nevertheless, Amsterdam’s take-up is expected to increase at a faster rate of around 80% between 2023-25, whereas stock is expected to increase at a slower rate of 9%. This indicates that most new space will be absorbed and that there is potential for further grow in the development pipeline (see source 5). Conversely in Dusseldorf during the same period, stock is forecast to remain flat during 2023-2025, whilst take-up is expected to steadily decline. This demonstrates some of the nuances between some major EMEA markets in this respect.

Type

New office development is also increasingly integrating advancements in sustainability and technology to meet demands for premium space. Examples include Vivaldi III in the South Axis in Amsterdam, which will be one of the world’s tallest wooden office buildings and aims to achieve the highest sustainability certificate BREEAM-NL rating, and the One Parc Central office development in Barcelona, which particularly focuses on energy efficiency, is on track to obtain the highest quality LEED GOLD certification.

This indicates that there are some developments in train which closely align with occupiers’ evolving preferences around space quality and amenity. This is further supported by the relationship between rolling 4-quarter completions as a percentage of stock and the vacancy rate (see source 6). Several European cities, including Warsaw and Madrid, are seeing increases in rolling-four-quarter completion totals despite an also rising office vacancy rate. One reason for this is because vacancy is rising in secondary stock, which in many cases fails to meet the demands of today’s occupiers, leading to new completions in an attempt to satisfy requirements for premium office space.

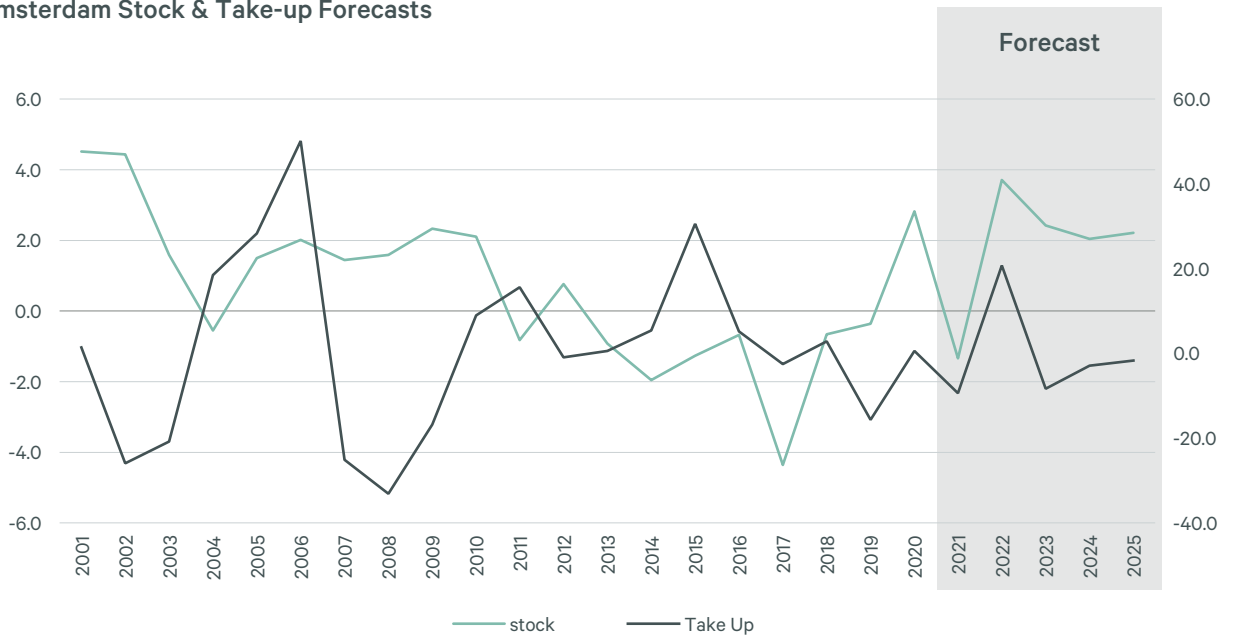
Development Pipeline



Source: CBRE Research, EMEA Slide Library, Q3 2021

Source 4

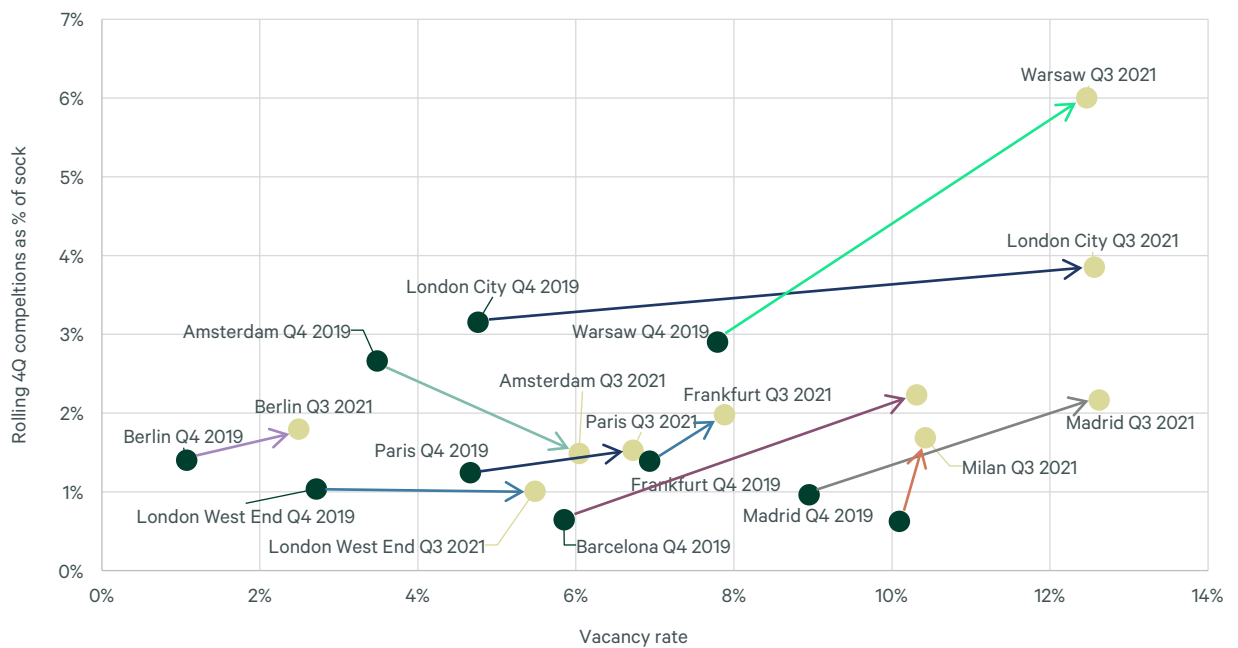
Amsterdam Stock & Take-up Forecasts



Source: CBRE Research, Q3 2021

Source 5

Vacancy Rate and Rolling 4Q Completions as % of Stock



Source: CBRE Research, Q3 2021

Source 6

Conclusion

- Emerging evidence, particularly from the final quarter of 2021, indicates a cyclical turning point in the office market, with demand recovery running up against reduced choice of good quality space in many markets.
- This provides a stimulus for development and we expect completions to increase in several markets in 2022 and again in 2023 including Berlin, London and Munich, to meet expected demand needs.
- In this context, occupiers need to assess their future space requirements – both strategically and at micro-market level – along-side existing availability and identifiable development. Quality will be as important as quantum.
- Since the shift in occupier needs is qualitative as well as cyclical, developers will also need to pay close attention to the changing profile of occupier needs, as well as their scale. This will need to include analysis of the cost base and expected rent profile of new schemes.

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