European Commercial - August 2024

SPOTLIGHT
Savills Research

European Office Outlook Q2 2024

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● Demand ● Business Sector ● Lease Incentives

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European office demand showing signs of improvement

GDP in the eurozone rose by 0.2% quarter-on-quarter in Q2, a slower pace of growth than the 0.3% recorded in Q1. Annually, GDP is expected to grow by 0.7% in 2024, and 1.2% in 2025. The European Central Bank (ECB) left the deposit rate at 3.75% in July, with the inflation rate currently at 2.6%. While Capital Economics forecasts a 25 bps cut in September as weak activity continues to suppress price pressures in the economy, there is a chance the ECB will hold rates.

In July 2024, the Economic Sentiment Indicator (ESI) remained broadly stable in the eurozone (-0.1 points to 95.8). The Employment Expectations Indicator (EEI) declined more significantly (-1.8 points to 97.8), falling below its long-term average for the first time since April 2021.

Office Demand

European office take-up reached 1.6 million sq m in Q2 2024, a 9% increase on the same period last year. This takes the H1 2024 figure to 3.7 million sq m, a 5% increase on H1 2023. Though despite positive signs that European office occupiers are resuming leasing activity as the economic landscape begins to settle, take-up across Europe is still down compared to the previous five-year average. The Q2 2024 figure is down 3%, while the H1 2024 figure is down 7%.

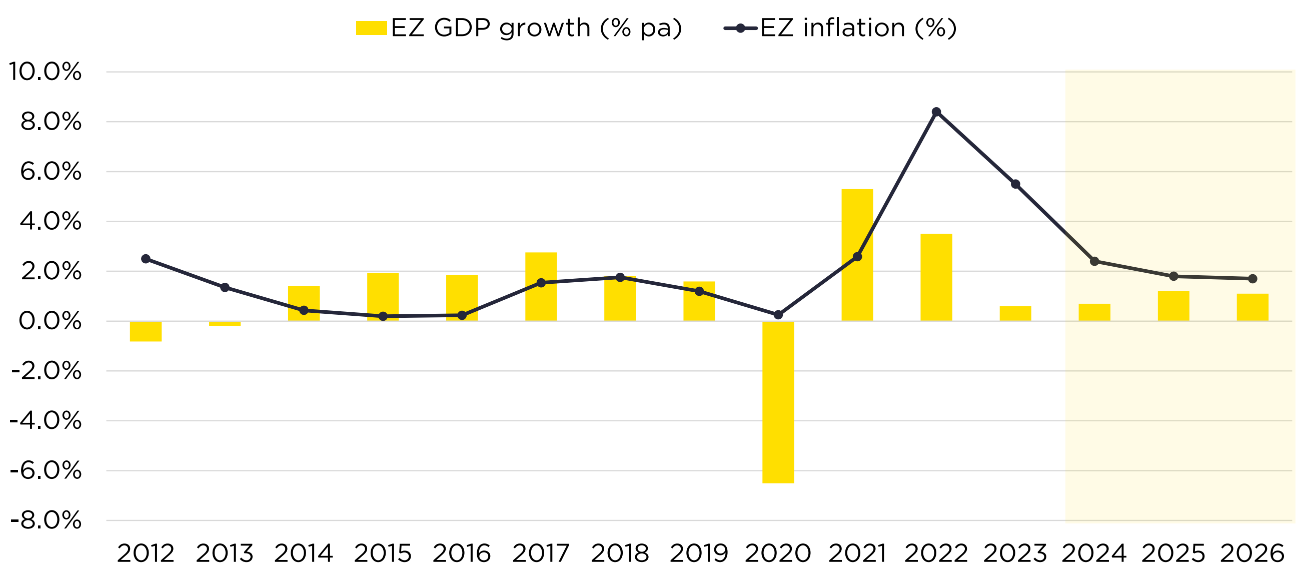
Corporate cost control, coupled with the adaption to hybrid working, has meant that some firms will be reducing their office footprint in the interim, and some more permanently in order to align with new requirements.

Southern Europe continues to outperform from a leasing perspective. Lisbon, Barcelona and Madrid all reported positive increases in H1 2024 on the previous five-year H1 average at 40%, 11% and 9%, respectively.

In Prague, Česká spořitelna's new 75,000 sq m HQ has resulted in a 45% H1 2024 increase on the previous five-year average, while the 40% growth in Lisbon is following a weaker base.

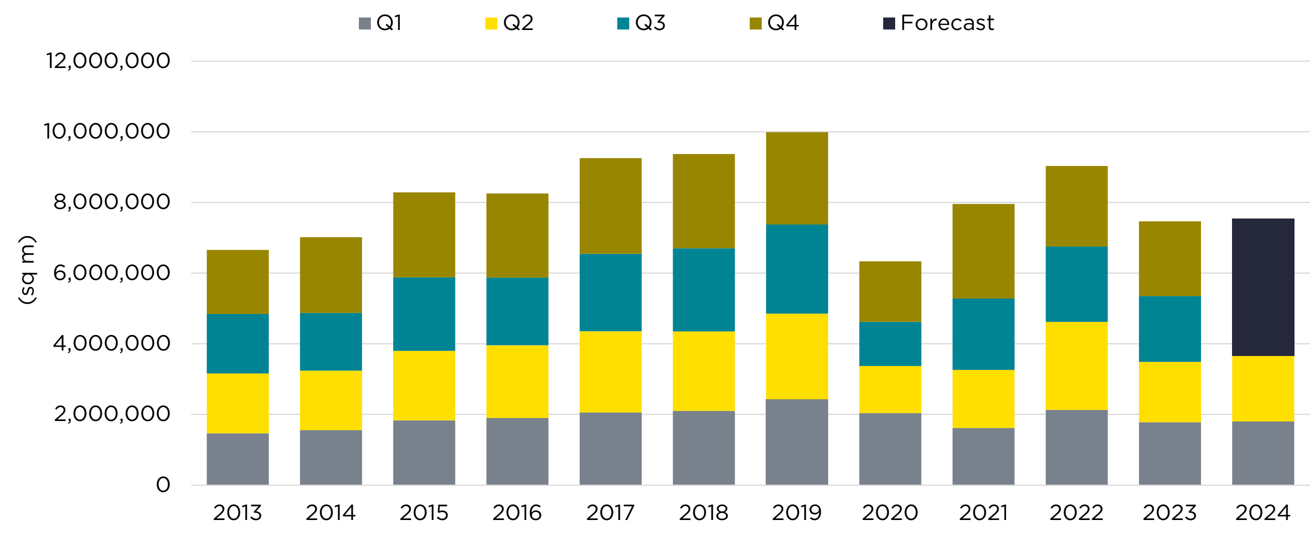
London City office take-up rose 24% compared against the previous five-year H1 average, while take-up in London WE recorded -24% growth. The West End has seen weaker demand from the tech sector and larger occupiers staying in their premises due to limited availability of large office space.

Chart 1: Eurozone GDP growth and inflation rate



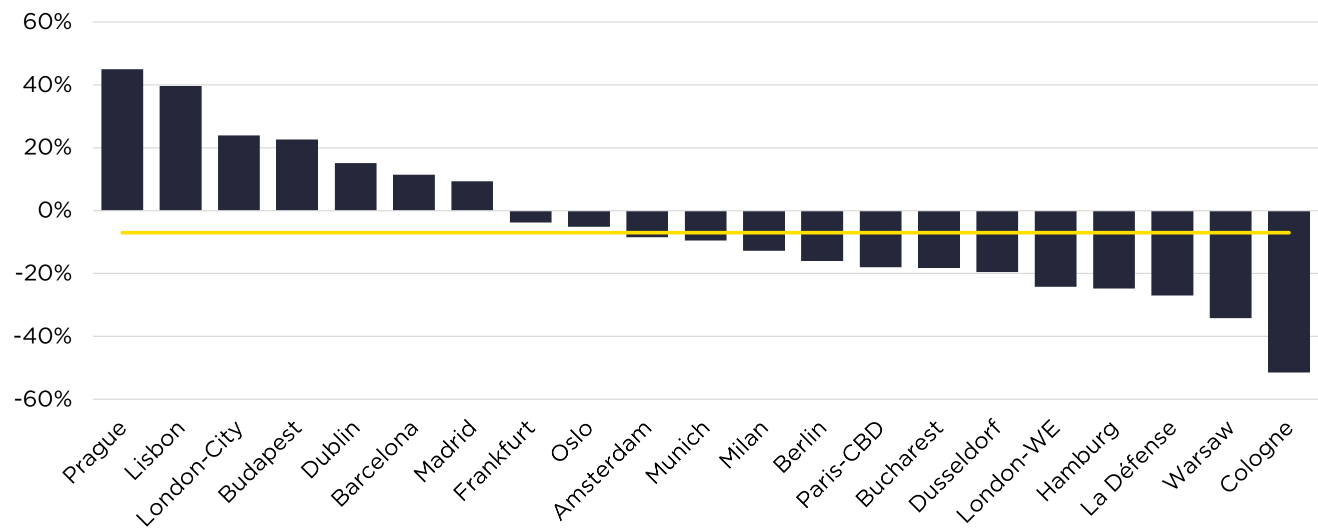
Source Oxford Economics

Chart 2: European office take-up



Source Savills

Chart 3: European office take-up by city



Source Savills

Core markets recording lowest vacancy and highest rental growth

European Office Vacancy Rates

European office vacancy rates rose marginally from 8.6% to 8.8% during Q2 2024. Core markets continue to record the lowest vacancy rates, with Paris CBD and major German cities remaining under 6%. Rising vacancy rates can be partly attributed to the return of secondary stock to the market, in which occupiers are prioritising higher-quality space in well-connected locations with established amenities and good sustainability credentials.

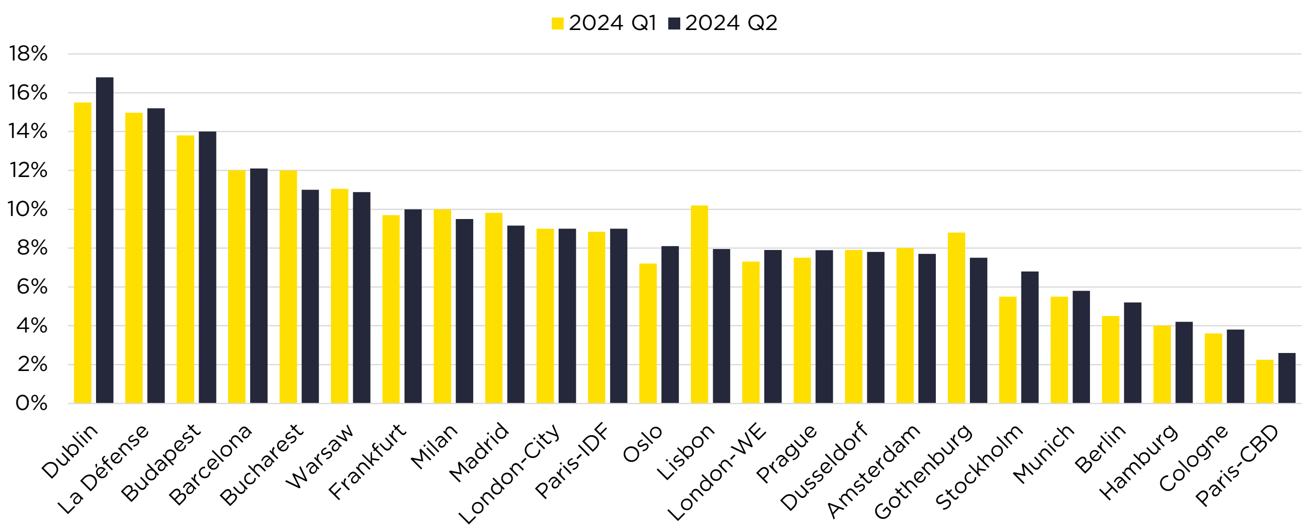
European Office Prime Rents

Average European prime office rents have increased by 2.4% over the past twelve months. In markets where there is a limited supply of prime office space, such as in London WE, negative or flat rental growth can be attributed to a lack of availability of appropriate office stock, which is prohibiting occupiers from leasing space. The decline in rental growth in La Défense is reflective of the occupiers' desire to move closer to the CBD, which has translated into strong rental growth for Paris-CBD. German cities Dusseldorf, Munich and Hamburg recorded strong rental growth, in part, because landlords try to offset higher construction costs by raising rents.

European Office Lease Incentives

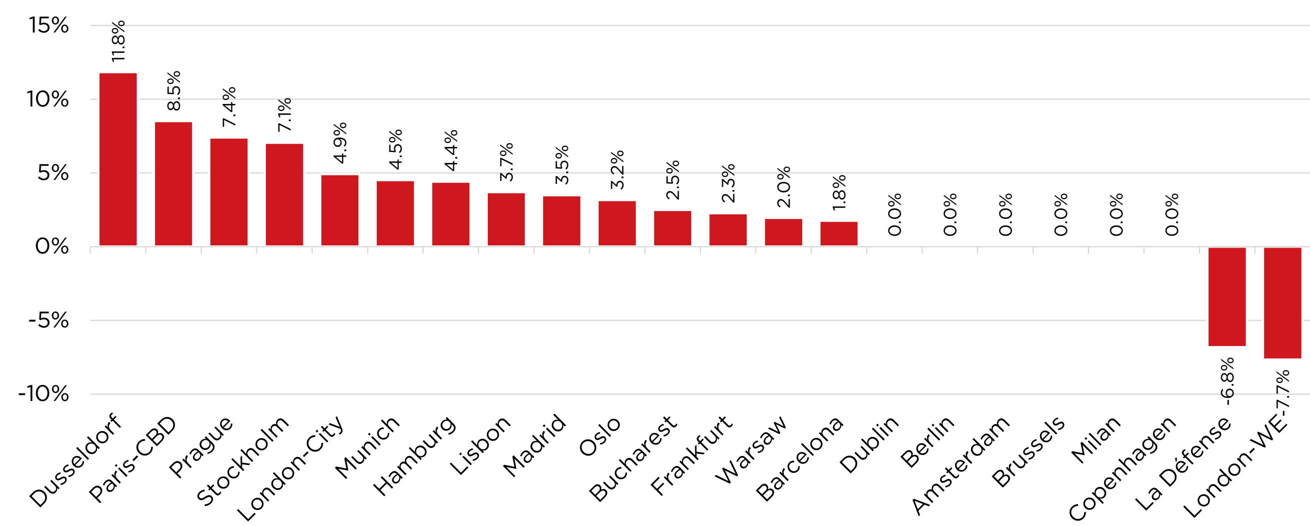
Savills recent lease incentive analysis shows that incentives for prime office stock have risen from an average of 11% to 13% of lease value over the past 18 months. German cities Munich and Berlin have recorded the largest proportional increases, whilst Amsterdam and La Défense have also risen. Rising vacancy rates have caused landlords to offer attractive incentives in a bid to support leasing activity. Average prime European lease lengths have also increased from 71 to 74 months during the same period. Lease lengths increased most significantly in Amsterdam, as occupiers who are able to secure prime space are choosing to commit for a longer term.

Chart 4: European office vacancy rates



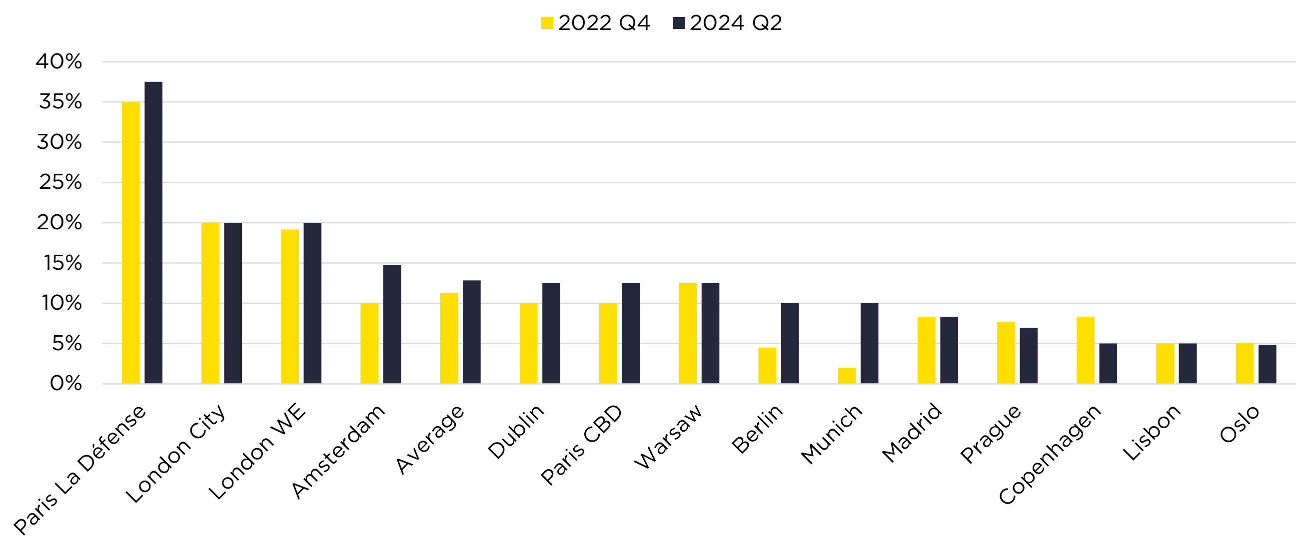
Source Savills

Chart 5: European prime office rental growth, YoY, Q2 2024



Source Savills

Chart 6: European office rent-free period as a percentage of total lease value



Source Savills

Feature: take up by business sector

In H1 2024, the banking, insurance and finance sector took the highest share of leasing activity at 25%, up from 17% in H1 2023. Some of the largest banking, insurance and finance deals in H1 2024 include ING in Amsterdam signing for 31,500 sq m, CGD in Lisbon for 26,700 sq m, and a renegotiation for Bank Gospodarstwa Krajowego in Warsaw for 13,600 sq m.

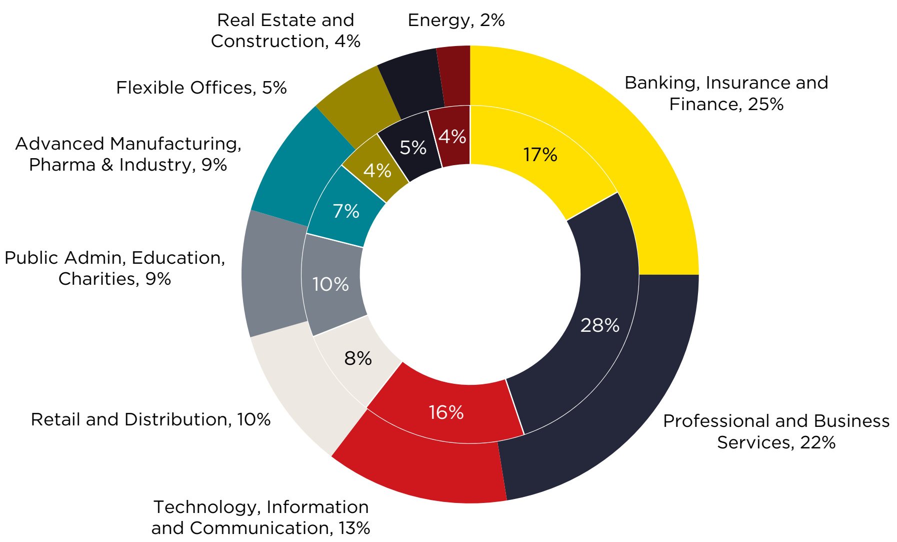
Financial centres have seen some of the largest share growth, with leasing activity increasing in both London City and Frankfurt. In London City, banking, insurance and finance was the most active sector in H1 2024, with the largest deal being Citadel, signing for 23,000 sq m. Banking firm Wise signed for 8,000 sq m, and insurance firm Sompo signed for 7,000 sq m. Banking, insurance and finance occupiers in London City have more active requirements this year, largely as a result of lease expiries. One of the main contributors to the high level of take-up in Frankfurt's financial sector was the lease of 34,800 sq m by the ECB in the first quarter of 2024. Other leases in Frankfurt in the financial sector include Frankfurter Sparkasse, with 7,100 sq m, and KT Bank AG with 2,000 sq m.

The professional and business services sector takes the second highest share of leasing activity this year with a share of 22%, previously 28% in H1 2023. The reduction in activity from the sector can be attributed to requirements being largely satisfied in 2023, rather than a shift in occupier sentiment and a reduced drive for office space. We therefore expect professional and business services to continue to maintain a high share of office leasing activity in 2025-26. Some of the largest deals in this sector include Deloitte in Amsterdam signing for 35,000 sq m, Grant Thornton in London City for 9,000 sq m, and a renegotiation for Mercer in Warsaw for 7,300 sq m.

The tech sector took the third highest share of leasing activity in H1 2024 at 13%, but reported a reduction from 16% in H1 2023. Take-up from the tech sector has been declining since 2022, where we recorded a 20% share of leasing activity. This downward trend is emblematic of a shift we have seen in the sector over recent years, where higher interest rates have impacted corporate fundraising, resulting in some redundancies and weaker office demand. We are seeing the biggest reduction in demand in markets with typically a high exposure to the tech sector. In Dublin, the share of tech occupiers reduced from 30% to 14% in 2024, and in Lisbon the share reduced from 32% to 16%. Though with an expected pick up in the economic landscape next year, and we can expect to see the sector become more active in the future.

The advanced manufacturing and pharma industry sector has been gaining traction for office demand, with the share of leasing activity rising to 9% in 2024 from 7% in 2023. The increase has been largely driven by life science occupiers as the sector expands its commercial real estate footprint.

Chart 7: European office take-up by business sector
H1 2023 inner ring, H1 2024 outer ring



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Savills Commercial Research
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