

MARKETBEAT EUROPE



Office Q3 2023

| | YoY Chg | 12-Mo. Forecast |
|--|------------|--------------------|
| 8.6% Availability Ratio | ▲ | ▲ |
| 10.2m Annual Take-Up (sqm) | ▼ | ▼ |
| 15.0m Under Construction (sqm) | ▼ | ▼ |
| 5.4% Prime Rent Growth (%pa) | ▼ | ▼ |

Source: Cushman & Wakefield Research

ECONOMIC INDICATORS Q3 2023

| | YoY Chg | 12-Mo. Forecast |
|---|------------|--------------------|
| -0.1% Euro area GDP | ▼ | ▲ |
| 6.5% Euro area Unemployment Rate | ▼ | ▲ |
| 4.00% Deposit rate, Euro area | ▲ | ► |

Source: Moody's; Eurostat; ECB

ECONOMY: Deterioration in outlook, nearing turning point?

The latest flash estimate for the GDP growth across the Euro area showed modest contraction of -0.1% quarter-on-quarter in Q3 2023 compared with just 0.2% in Q2 2023 and 0.0% in Q1. A number of markets turned negative in Q3 including Germany (-0.1%), Czech Republic (-0.3%) and Ireland (-1.8%). The latest Eurozone service sector PMI showed a further deterioration in October falling to 47.8, with a reading below 50 in many major markets indicating contraction. Labour markets remain tight with the unemployment rate broadly stable in the Euro area at 6.5%. In more positive news inflation across the Euro area slipped to an estimated 2.9% in October from a peak of 10.6% a year ago, aided by a drop in energy prices. Inflation is higher in the UK at 4.6%, albeit down from 11.1% a year ago. Interest rates in the Euro area and the UK remain on hold, with the expectation that rates have reached their peak, albeit policy makers will keep rates on hold until inflation reaches target levels.

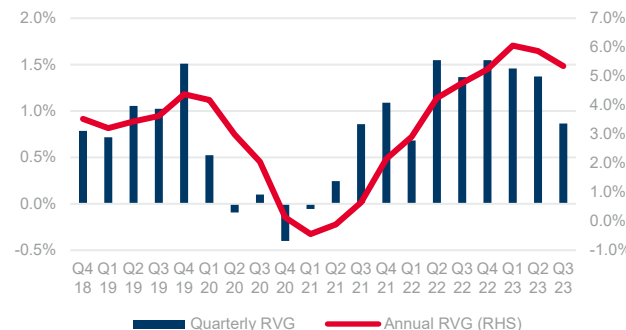
DEMAND: Leasing remains subdued

Demand for office space across Europe remained subdued. Despite a modest 6% increase in leasing activity from 2.3m sqm in Q2-2023 to 2.5m sqm in Q3 2023, overall activity is trending lower. Over Q1-Q3 2023 leasing activity totalled 7.2m sqm, down 21% from 8.9m sqm in the same period for 2022. Activity is below the five, ten and fifteen year average for the Q1-Q3 period, with 23 out of 29 markets reporting a fall in activity in the first nine months of the year. Despite the weakening in demand overall net absorption remains positive. We see a clear bifurcation in activity. Although demand for all grades of asset fell, activity for Grade A was down a more modest 6% as tenants scramble to secure the best in class, sustainable solutions.

RENTS: Prime rents show little sign of weakening

Despite the reduction in demand, rents at the prime end of the market continue to hold up. Rents grew by a further 0.9% in Q3 versus a 1.4% increase in the previous quarter. Annual growth remains strong at 5.4%, albeit down from a recent peak of 6.1% in Q1 2023. The continued growth underscores the strength of demand for the best located sustainable space that offers tenants flexibility to manage headcounts and hybrid working practices.

European Prime Rental Growth



Source: Cushman & Wakefield Research

European Take-Up and Availability Ratio



Source: Cushman & Wakefield Research



Leasing: Quality over quantity as leasing volumes subside

The third quarter provided some respite, with just over half the 29 markets tracked reported an increase in leasing activity quarter on quarter, the overall trend is more negative with leasing activity across Europe slowing. A majority (80%) of markets tracked reported a reduction in activity in Q1-Q3 2023 compared with the same period in 2022. Over Q1-Q3 2023 a total of 7.2m sqm of office space was leased, a 21% reduction on the 8.9m sqm leased in the same period of 2022. Activity sits below the five, ten and fifteen year average of this period. Part of the reduction is down to a weaker business environment, but also companies taking relatively less space. Despite the reduction in activity, net absorption has remained positive at 284,000 sqm. In the shift towards hybrid working, quality over quantity is the mantra, as corporates focus on leasing the best located space and amenity to drive greater collaboration and to attract and retain workers in the war for talent. Grade A leasing now represents over half of leasing volumes, compared to around a third a decade ago, with the volume of take-up over Q1-Q3 2023 only down (-6%) on the same period a year ago compared with a reduction (-17%) for other grades.

Availability: Availability continues to creep up

The amount of available space grew (+1.1%) over the quarter to stand at 24.7m sqm. Compared with the start of the year, availability was up in 22 of the 31 markets tracked. It is largely in Europe's relatively smaller markets, including Brussels, Dublin and Rome where availability has dropped the most, largely on the back of stronger leasing activity earlier in the year. Barcelona (+41%), Berlin (+32%) and Dusseldorf (+20%) all saw significant increases in availability for the year as weaker demand, rising completions and the release of vacant stock added to available space. London also saw a near 9% rise, contrasting with Paris where availability was largely flat.

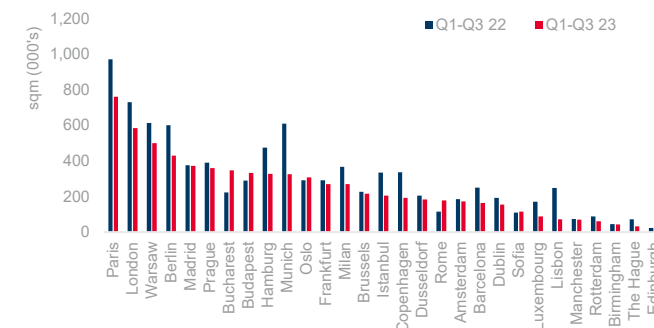
Availability as a proportion of stock continues to drift higher to 8.6% compared to 6.4% just before the onset of the pandemic and is now at its highest level since Q1 2017. The ratio remains below the ten year average and below the high of 10.8% immediately in the wake of the GFC. Some of Europe's leading office markets of Berlin (6.1%), Munich (5.6%) and Paris (5.6%) have ratios well below the European average, whilst Frankfurt (9.3%), London (9.5%), Milan (10.8%) and Amsterdam (11.5%) sit above average.

The rise in availability is partially attributed to more Grade A space coming available to the market as completions remain buoyant relative to demand. Grade A availability as a proportion of stock now stands at 3%, double its level pre-pandemic and contrasts with more modest rise for non-A space. The increase in Grade A reflects the reduction in demand during the pandemic and continued elevated levels of completions combined with a mismatch between demand and supply.

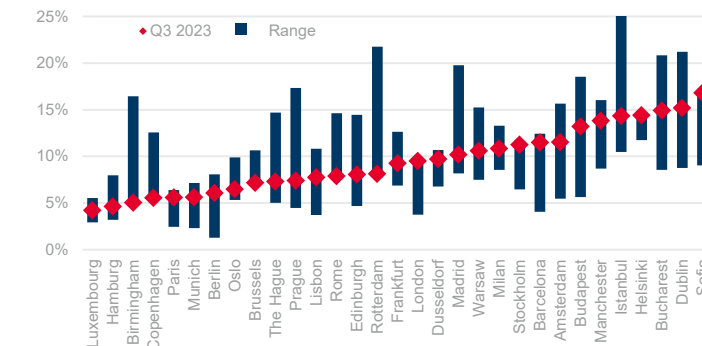
Construction: Construction activity falls with completions set to peak this year

New completions totalled just under 600,000 sqm in Q3, well below recent quarterly averages, although close to 2 million sqm is scheduled for completion over the final quarter. Completions are also set to remain elevated at over 5m sqm for 2024. Next year will mark the turning point in activity as the volume of space under construction continues to abate and now sits below the 15m sqm mark, with close to half (46%) of this space already pre-committed. This should gradually lead to a reduction in the amount of grade A space on the market, with secondary space set to increase as companies downsize from their current premises.

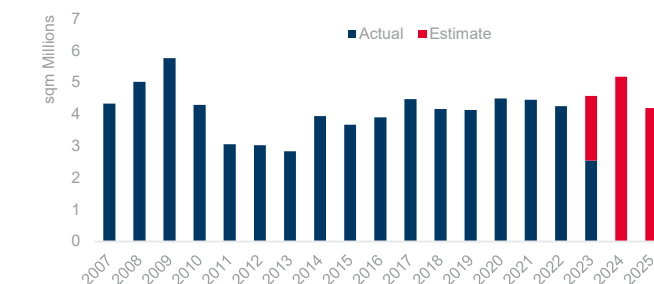
Leasing Activity by Market



Availability Ratio by Market, Q3 2023 and 10y Range



European Office Completions



Yields move out

Prime office yields saw a greater correction in the third quarter moving out by 26bps to 5.11% in Q3 2023 following a more modest 15bps in Q2 2023. The prime European office yield is now 124bps above its recent low, and as much as 178bps in Germany where lower interest rates and strong demand pushed prime yields to below 3% pre-COVID. With Eurozone ten-year bond yields now trading at close to 3% these low rates were not sustainable. The leading core markets of the UK, France, Germany and Benelux have all seen outwards shifts of more than 125bps since their low.

Investment activity slumps

Office investment slumped to €8.6bn in Q3 2023, its weakest reading since Q3 2009. The twin impacts of rising interest rates and concerns around the impact hybrid working will have on underlying occupational demand have impacted investment levels. Many investors are assessing their existing holdings and have stopped new investment as they review their strategy towards the sector. With traditional high street banks also pulling away from the sector, financing options for larger lots remain limited, except for the very best in class product. Over the first three quarters of 2023 investment into offices totalled €31.3bn, lower than the €33.8bn in 2010, although above the low of €22.8bn in 2009. Despite the slump in activity, the sector continues to attract the most investment in Europe over the first three quarters of 2023, well ahead of the €21.4bn invested in logistics, €20.9bn in the residential sector and €20.3bn invested in retail.

France, Germany and the UK continue to attract the largest slice of capital accounting for ca 60% of all office investment across Europe in Q3 and for the previous twelve months. Paris and France top the tables for attracting the most capital in the office sector keeping London and the UK off top spot. Germany sits in third spot. Few trophy assets coming to market in the UK has stifled overall investment in the sector, where capital has flowed towards smaller lots. The UK and London has struggled more than other continental European markets in attracting employees back to the office, although the top prime assets, which are not trading, have held their values relative to more secondary assets.

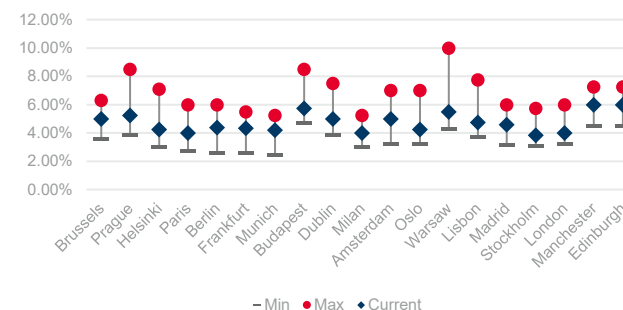
Outlook

Economies across Europe remain fragile with the probability of recession in the region elevated. Against a backdrop of heightened geopolitical uncertainties risks remain on the downside. Although inflation is trending lower, service sector inflation remains high and poses risks. Bar any further shocks, interest rates have peaked in their current cycle, although policy makers are likely to hold rates until there is clear evidence of inflation remaining under control. As such we do not see a cut in rates until later in 2024, with a move in the Eurozone likely ahead of the UK.

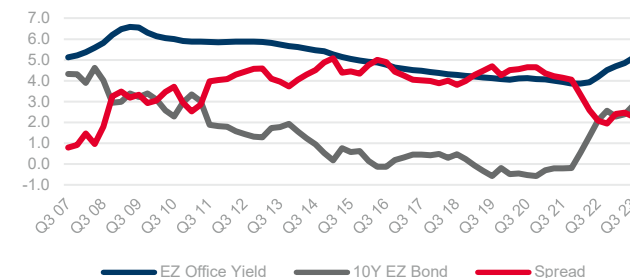
We expect leasing activity to remain subdued over the rest of the year and into 2024 as businesses await more clarity in the outlook. The shift towards hybrid working will also lead to smaller requirements than the market has accepted in the past. This will see sustained demand for best in class space in the most connected locations as companies focus on sustainable solutions that embody their brand and corporate culture. As such we expect positive rental growth to be sustained at the prime end of the market.

The adjustment in yields is expected to continue into the early part of 2024, in part driven by limited transparency. As clarity emerges around pricing, particularly towards the best-in-class sustainable product, we expect to see a pick-up in trading mid way through 2024 and this could precipitate a gradual reduction in prime yields.

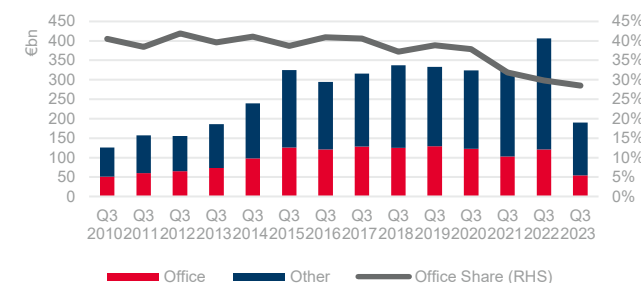
Prime Office Yields and 10Y Range, Key Cities



Eurozone Office Yield v Bond and Spread



European Office Investment (Trailing Annual) and % Total





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