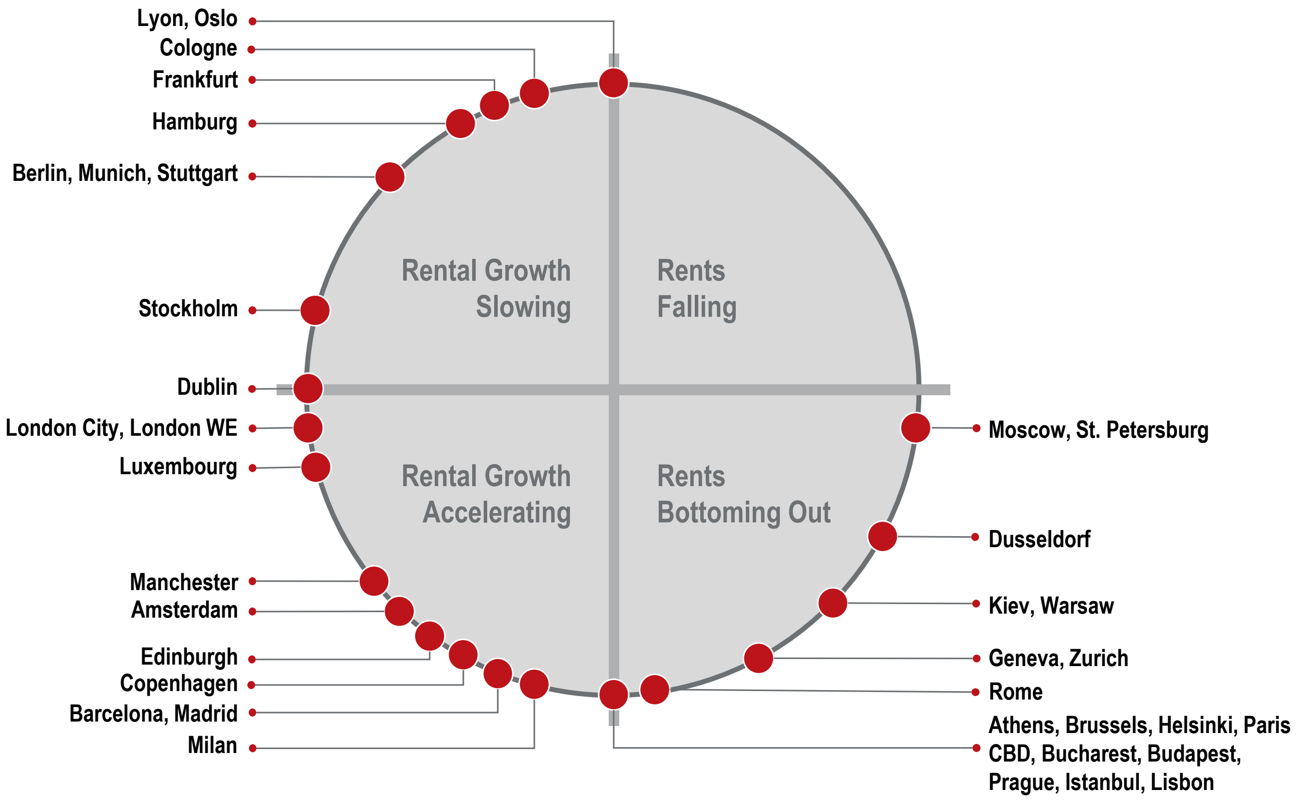
JLL Office Property Clock Q2 2015

EMEA Offices Research

European office leasing markets return to growth

- Office leasing activity up 2% y-o-y and the strongest Q2 since 2008.
- Central and Eastern Europe (CEE) performs well, with leasing activity up by 27% q-o-q on Q2 2014.
- Office Rental Index up by 0.5% q-o-q as prime rents increase in seven markets.
- European office vacancy rate declined by 10bps to 9.4%



Source: JLL, July 2015

The clock diagram illustrates where Jones Lang LaSalle estimates each prime office market is within its individual rental cycle as at end of June 2015. 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

Thus far the Greek crisis has had limited effect on the overall momentum in the European office occupier markets. While Europe remains a multi-speed environment with city markets moving in different directions and at very different speeds, the overall sentiment is positive, with out-performers more than making up for more muted activity numbers and rental declines in Q2.

Office rents

After a temporary dip in Q1 (-0.7%), the European Office Index returned to growth in Q2. Despite a decline in prime rents in Paris and Warsaw, the weighted European Office Index increased by 0.5% q-o-q, indicating positive momentum across the rest of Europe. Of the 24 index markets, seven saw prime office rental increases q-o-q (compared with just three in Q1 2015). At 0.7% growth over the quarter, Eurozone markets performed strongly, with just Q2 2014 higher at 1.9% over the last four years. The robust recovery in Spain translated into further prime rental growth with Barcelona (5.7%) outperforming Madrid (1.0%) in Q2. In Germany, the rise in office-related employment continued to feed rental growth. While rents were stable in Hamburg and Dusseldorf, q-o-q increases were seen in Frankfurt (1.4%) and Munich (1.5%). Berlin significantly outperformed with 4.5% rental growth in Q2. Outside the Eurozone, London prime rents remained unchanged. However, a 5- 6% uplift in prime rents is likely in H2 2015 as the London office market tightens even further, moving prime rents well ahead of the previous peak.

In Paris, prime CBD rents dropped marginally (-1.4%), a second consecutive quarter of rental decline as many corporates continue to be very cost cautious. While there is a risk of further minor corrections in Paris in the short term, prime rents have recently fluctuated between quarters without a strong uptrend. The most significant correction in prime rents was recorded in Warsaw, where prime rents declined by -2.1% q-o-q to stand at € 282/ sq m. On a positive note, with Moscow and St Petersburg moving between 3 o'clock and 6 o'clock, signalling that rents have started bottoming out, there are now no markets positioned in the 'rental values falling' quadrant. H2 2015 should see more markets move towards 9 o'clock. The intensifying supply squeeze in markets such as London and Dublin will add to this momentum. On the other side of the spectrum, oversupplied markets such as Warsaw, Rome and The Hague might see some further downward corrections. In general, the outlook for European offices is upbeat, although at 2.1% pa on average, rental growth in Europe will remain modest over the mid-term.

Office demand

European office take-up totalled just over 2.8 million sq m, up 2% y-o-y and the strongest Q2 since 2008. In contrast to the overall positive momentum, two of the largest office markets (Paris and Moscow) underperformed in H1 compared with their long term averages. Excluding Paris and Moscow, overall take-up for Europe was up 15% on the strong Q2 2014 numbers.

While the overall momentum is positive, 11 out of the 24 European office Index markets saw a decline in take-up compared with Q2 2014. In Paris, demand for office space improved substantially from the subdued levels in Q1, but remains 15% below the 10-year Q2 average. While the economic outlook has improved, the impact of the relatively weak performance over recent years still hampers growth in the occupier markets. Other European office markets which saw a y-o-y decline in take-up included Lyon (-39%), Brussels (-39%), Milan (-33%) and Madrid (-21%).

Out-performers more than make up for more muted activity numbers in Q2, with for example German offices going from strength to strength. Here, the five largest office markets recorded a y-o-y increase in take-up of 12%. Berlin and Hamburg put in a particularly strong performance as the willingness of occupiers to expand has increased substantially in recent quarters, as signified by a jump in occupied stock and y-o-y increases in take-up of 22% and 15% respectively in H1 2015. Meanwhile the London office market shows no signs of weakening, with take-up increasing by 17% y-o-y in Q2, representing the strongest quarter in almost 10 years. In Spain, Barcelona experienced a strong quarter, with leasing volumes up by 87% y-o-y. In Madrid occupier activity was more moderate with take-up down by 21% on Q2 2014. However, transaction volumes in Madrid are increasingly held back by the lack of good quality supply in central locations, rather than a decrease in demand.

Where Central and Eastern Europe (CEE), excluding Moscow, recorded leasing volumes of around the 10-year quarterly average for the past two years, the region outperformed strongly in Q2. Prague saw a y-o-y increase in take-up of around 84%, while Budapest and Warsaw recorded their best quarter in over 15 years. While leasing volumes in Budapest and Warsaw were boosted by a number of large one-off deals, underlying sentiment has improved notably, which is expected to feed into positive leasing volumes in H2.

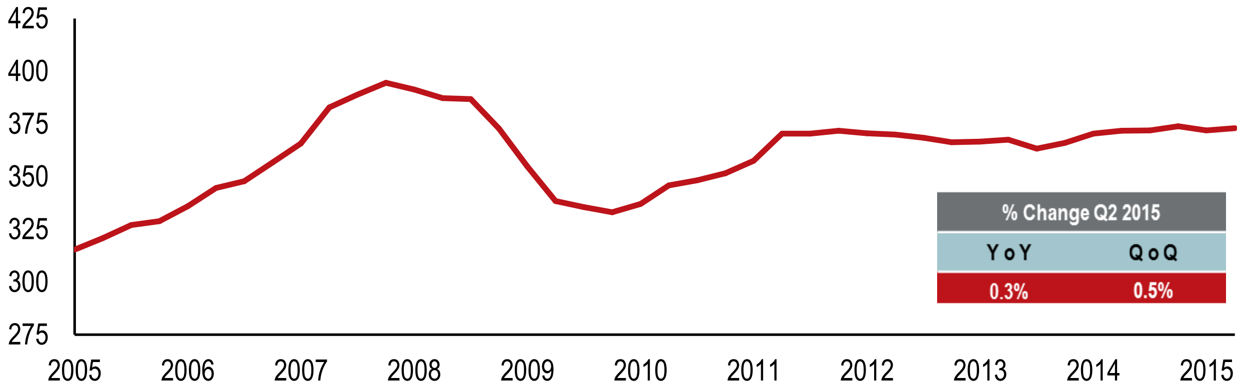
Office supply

Strong leasing activity in Q2 pushed down the overall office vacancy rate in Europe for the second consecutive quarter (to 9.4% from 9.5% in Q1). Q2 saw a decline in vacancy across CEE, the first in over two years, driven by declines in Budapest (-150 bps) and Prague (-90bps). Nevertheless, at 16.1% vacancy in CEE remains well above that of Western Europe (8.6%).

In many markets, the persistent strengthening of the occupier market and a lack of speculative completions has resulted in a sharp fall in office supply. In Dublin, this effect has been most extreme with the vacancy rate dropping from 16.6% to 8.6% over the last 12 months. In London, the vacancy rate dropped to 3.8%,while in Germany, strong occupier demand has pushed vacancy rates to their lowest levels in over 5 years across the five largest markets.

Looking ahead, any decline in the overall European vacancy rate is likely to be limited with around 3 million sq m of office space expected to be added to the market in second half of 2015, more than double the volume in H1.

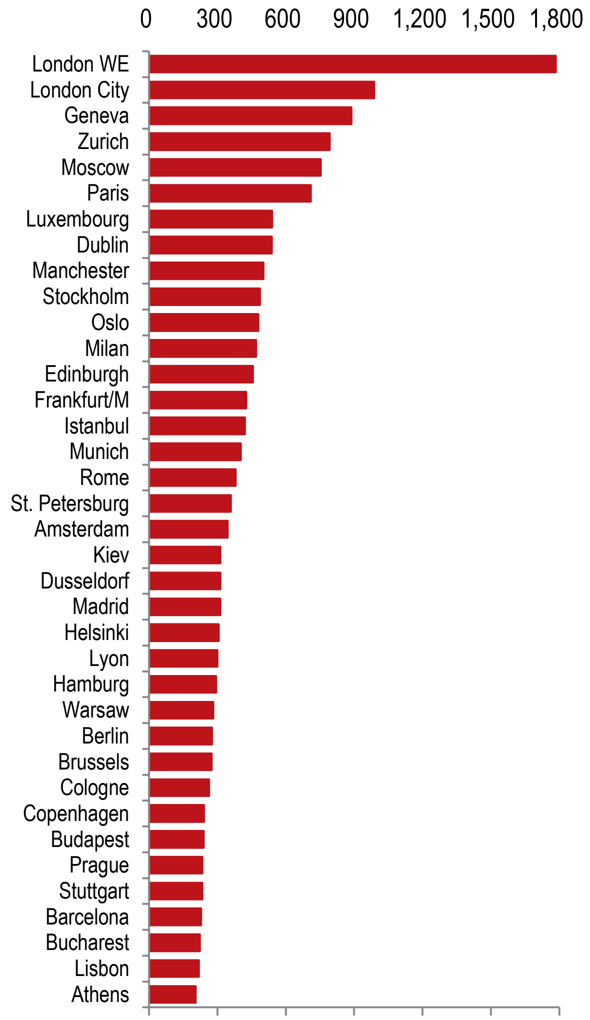
Prime European Office Rental Index



Weighted Nominal Rental Trend, 1980 = 100

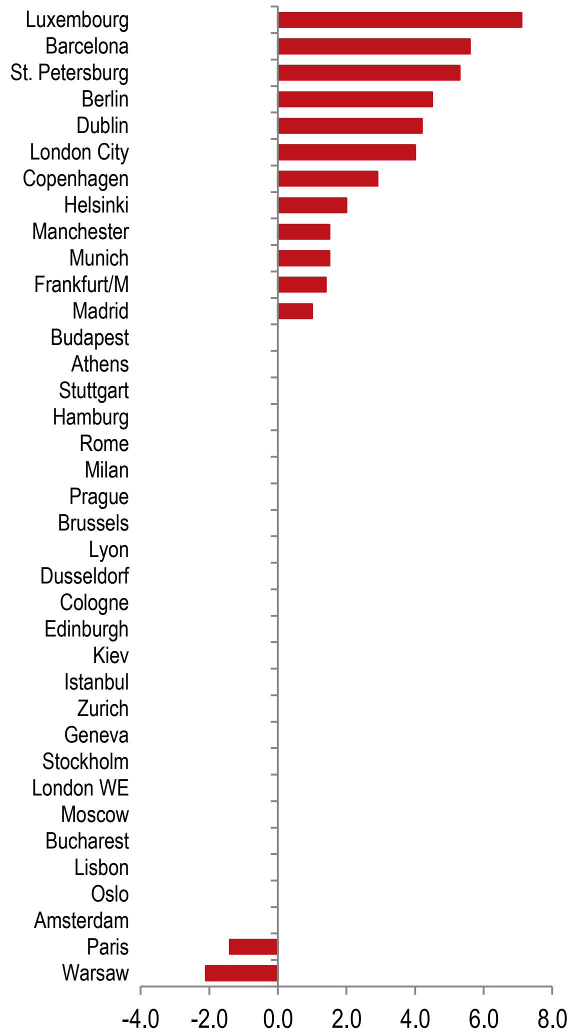
Source: JLL, July 2015

Prime Office Rents Q2 2015 (EUR / sq. m pa)



Source: JLL, July 2015

Prime Office Rental Change Q2 2015 (% Q-o-Q)



Note: Q-o-Q rental change is based on the local currency.
Source: JLL July 2015

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 m² of lettable floorspace, 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 floorspace 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 floorspace leased and sold for occupation, and the pre-lettings of floorspace 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. floorspace held vacant and not being offered for letting, usually pending redevelopment or refurbishment, is excluded

Vacancy Rate

The Vacancy Rate represents immediately vacant office floorspace, 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 floorspace 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 floorspace 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 2012 for Q2+Q3+Q4 2012). 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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The JLL Office Property Clocks – Q2 2015