Briefing Note
The battle for brainpower

Oct 2017

Location strategies are key to the battle for brainpower

■ With business sentiment rising and unemployment falling across Europe, attracting and maintaining talent has become a challenge for employers. The EU28 unemployment rate was 7.7% in July 2017, stable compared to June 2017 and down from 8.5% in July 2016. This remains the lowest rate recorded in the EU28 since December 2008.

■ In order to remain competitive companies must focus on where and how candidates want to work. Work space is an extension of a company's culture, which can engage employees and improve productivity.

■ The desire to attract skilled workers puts pressure on firms to place their offices in urban hotspots of talent. In order to attract talent companies need to chose buildings close to amenities and public transport. In most cases these criteria are met by the CBD areas and in some cases by some developing locations of the European capitals.

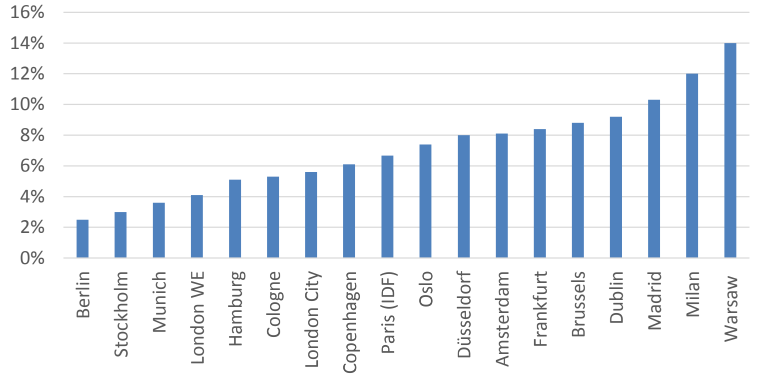
To attract talent you need to be in the CBD…but there is no space left

■ Office vacancies are falling in all European capital city markets. Offices also face competition by conversions into other more profitable uses, such as residential where urbanization trends are strong (Madrid, Copenhagen, Stockholm) or hotels where tourist activity is high (Paris).

■ Q2 2017 recorded the sharpest drop in vacancy rates following the financial crisis. It averaged 7.4% across our survey area which is 67 basis points below the level reached last year at the same period. The vacancy rate in Barcelona and Dusseldorf fell by more than 100 bps yoy, whilst Amsterdam witnessed the biggest drop, falling 420 bps yoy, thanks to a 67% increase in office demand compared to H1 2016. The tightest markets in terms of available space are Berlin (2.5%), Paris CBD (3%), Stockholm and Munich (3.6%) registering the lowest vacancy rates.

GRAPH 1

Vacancy rates in the European capital virtually no space available in some cities



Graph source: Savills

Tenants are facing rising costs

■ Employers need to invest in the design, layout and fit out of their offices to keep up with the latest trends. In addition employers are facing rising costs due to the scarcity of stock and the upward pressure this puts on rents.

■ In Q2 2017, Prime CBD rents increased by 5.2% yoy on average. It increased in nearly all cities, apart from La Defense and Cologne. Unsurprisingly, rental growth was particularly strong in cities where vacancy is the lowest or where it has decreased the fastest, namely Berlin, (33.2%), Stockholm (16.7%) and Amsterdam (15%).

■ At the same time in non-CBD locations prime rents increased by 3.9% yoy on average. These locations are in many cases a secondary option for occupiers, but the only one.

Tenants have limited options

■ Total take up in our survey area reached 4.9m sq m during the first half of the year, a 1% increase on the same period last year. Business expansion continues to drive office demand throughout Europe, often driven by the tech sector and also by M&A activity in the pharmaceutical sector. The lack of good-quality space remains an issue across prime locations leading to situations where companies are put off making relocation decisions. In the face of scarce new and modern supply, tenants have the following options:

• To pre-let offices under construction. The level of pre-letting transactions are growing in all capital cities. At least 38% of space in the pipeline for 2018-2019 is pre-let, while this share can be over 60% in some German cities, Paris and Copenhagen.

• Whilst CBD's remain, by far, the preferred locations, some companies have no other choice than to move to suburban areas with more choice. In urban talent hot-spots, such as Paris, London, Amsterdam and across Germany some companies choose to limit their CBD requirements only for their core operations and move support stuff in non-CBD locations where they can find larger, cheaper space.

• Another option for some companies is to consider owner occupation through purpose built office development. However, this remains rare as land availability in central locations is very tight, the development process is long and can be complex and finally prices are very high.

• Refurbishing a building is another alternative for locations with a tight supply of land. In Milan for example international developers have started significant refurbishment projects in the historic centre with completions due in the next 18/24 months, which are already pre-let. In Madrid refurbishments will account for approximately 60% of new supply this year and over 40% next year.

Supply will not rise substantially before end 2018

■ Due to lack of supply rents are becoming too high for occupiers and the pressure on the local authorities to allow more development is on. Although pipeline is slowly increasing, it is not sufficient enough to face the growing demand. Take-up may drop in some locations for this reason, we are seeing this start to happen in Paris. Completions in the major 15 European capitals in 2017 are expected to be no more than one third of last year's take-up. This ratio is predicted to reach 40% by 2019, when we may start seeing a rebalance of supply in the favour of tenants. The cities that are expected to see the most significant rises in annual new supply in 2018-19 compared to 2016-17 are Dusseldorf, Cologne, Berlin, London City and Paris.

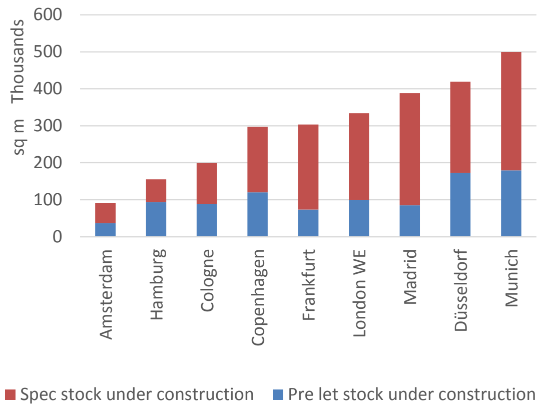
Outlook

■ The combination of lack of financing following the GFC and limited availability of land in central locations have caused tight supply and rising occupier costs. This will remain an issue another one or two years as the development cycle picks up and starts gradually decompressing from 2018-2019 onwards.

■ Prime CBD rents are projected to increase on average by another 2% untill the end of 2018. By that time an office in London WE will cost 27% more than 10 years ago, in Oslo 40%, in Stockholm 50% and in Berlin 60%. Winning the battle for brainpower comes at a significant cost.

GRAPH 2

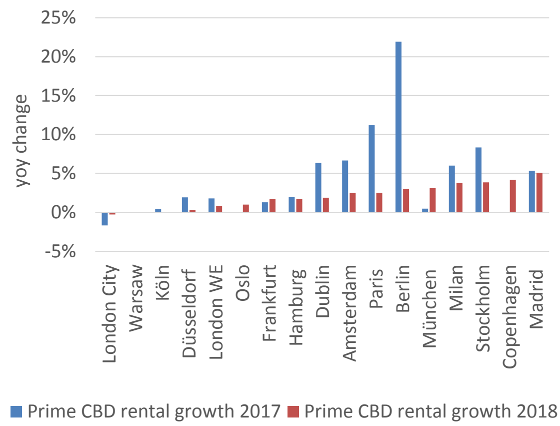
Development pipeline at least 38% of next two year completions pre-let



Graph source: Savills

GRAPH 3

Prime CBD office rents will become more expensive



Graph source: Savills

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