Strongest Q2 European office take-up on record

- European office take-up increased to 3.4 million sq m in Q2 2018, representing a 5% y-o-y increase
- European office vacancy decreased by 30bp to 6.7% in Q2 2018 - the lowest level since 2002
- The European Office Rental Index rose by 0.7% q-o-q
- At 3.4%, 2018 European office rental growth is forecast to outpace the 5-year average (2.1%)

Source: JLL, July 2018

The clock diagram illustrates where JLL estimates each prime office market is within its individual rental cycle as at the end of June 2018. 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

A year ago, economic growth in Europe was outstripping expectations, but H1 2018 saw a slight deceleration. Germany and France are expected to record a step down in growth this year and next, although forecasts remain healthy in the context of the recent past. In the UK, ongoing political uncertainty is likely to continue to impact confidence, though recent economic data has been more upbeat than expected. Nevertheless, the European office market shows little sign of slowing, with current economic and employment growth providing enough traction for solid take-up levels. We expect demand for offices to remain strong and rental growth to continue to outperform the long-term average.

Office Rents

The European Office Rental Index rose by 0.7% q-o-q in Q2 2018, with 10 of the 24 Index markets seeing rental growth over the quarter (compared with 11 in Q1 2018). At 4.1%, annual European rental growth continues to exceed the 10-year average of 0.3%.

The Q2 2018 Office Clock underlines our view of an extended cycle with occupier markets continuing to perform well. As at Q2 2018, just one city (Istanbul) is located in the ‘negative rental growth’ section of the Office Clock. At the same time, most markets have now moved into the ‘rental growth slowing’ phase. This does not mean rental growth is a thing of the past, highlighted by the performance of most German office markets in recent years. For example, Munich, which has been located between 9 and 12 o’clock for 24 consecutive quarters, recorded 23% prime rental growth in the same period.

In London, prime rents remained unchanged in Q2 2018, highlighting the continued robustness of the occupier market despite some uncertainties in the macro environment. Elsewhere in the UK, prime rents continue to see healthy growth, with Edinburgh recording a 3% increase on Q1 2018.

Q2 rental growth was strongest across the Netherlands, led by Utrecht (+6.0%) and Amsterdam (+2.5%). This positive result came on the back of tightening Grade A supply and robust demand for prime space. Rental growth across Southern Europe continued, with Barcelona (+1.0%), Madrid (+3.1%) and Milan (+1.7%) the standout performers.

We continue to see stellar prime rental growth in Stockholm (+1.4%), as the market remains exceptionally tight due to limited development. In Germany, prime rents increased in Munich (+1.4%), Berlin (+1.6%) and Frankfurt (1.3%), but held stable in Hamburg and Düsseldorf. Elsewhere, prime rents remained unchanged. Looking ahead, solid occupier activity and limited development will continue to restrict the availability of high quality space, driving up rents as a result. European prime office rental growth is expected to total around 3.4% in 2018, followed by 1.9% in 2019.

Office Supply

European office vacancy decreased by 30bp to 6.7% in Q2, the lowest level since 2002. Robust leasing activity offset stronger development completions in most cities. Across Europe, 19 of 24 Index markets recorded a decline in vacancy in Q2. In four markets, vacancy remained stable and one saw an increase (Dublin +140bp to 8.5%). The largest falls were recorded in Moscow (-110 bps to 12.0%), Prague (-100 bps to 6.2%) and Utrecht (-90 bps to 6.9%).

As expected, the development cycle continues to pick up in Europe with total Q2 office completions reaching 1.1 million sq m. While this is up 77% from a quiet Q1, it still represents a 9% decline on the 10-year Q2 average. As usual, Paris and London accounted for a large share of new space. We expect development completions to increase towards the end of 2018, but this is primarily focused in a handful of cities. In total, Paris, London and Munich account for 40% of the total H2 2018 pipeline.

Looking ahead, we expect vacancy to stabilise as development picks up in H2 2018. Nevertheless, the pipeline does not look exaggerated, particularly when taking into account the limited speculative component and the record low vacancy rates across the continent. Completions in 2018-2019 are unlikely to address the supply shortages in many European office markets.
Prime European Office Rental Index (EUR / sq m pa) % Change Q2 2018

Weighted Nominal Rental Trend, 1980 = 100
Source: JLL, July 2018

Source: JLL, July 2018
**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 sq m of lettable floor space, 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.

**Vacancy Rate**
The Vacancy Rate represents immediately vacant office floor space, 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 floor space 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 floor space 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 Q2 2018 for Q3 to Q4 2018). 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.

**Take up**
Take-up represents floor space 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 floor space leased and sold for occupation, and the pre-lettings of floor space 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. floor space held vacant and not being offered for letting, usually pending redevelopment or refurbishment, is excluded.

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