

# European Office Market

Q4 2020

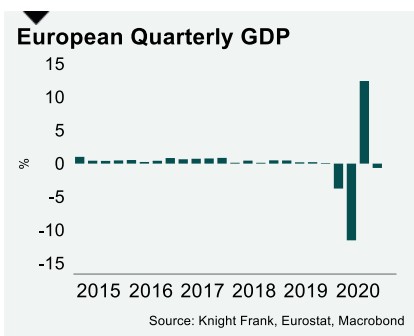
## ECONOMIC OVERVIEW

### Final quarter growth moderated as COVID-19 pressures ensued

Following a +12.5% increase in quarterly GDP over Q3 2020, the Eurozone faced a challenging fourth quarter, moderating to -0.6% quarterly growth, better than expectations of a -1.0% decline.

Eurozone GDP growth for 2020 declined -6.8%, with Spain, Italy and France all seeing record annual falls. Germany's GDP contraction last year was less severe than at the start of the GFC (-5.3% 2020, vs -5.6% 2009).

Oxford Economics forecast Eurozone GDP growth to be -1.7% in Q1 2021, +12.7% in Q2, +2.3% in Q3 and +4.4% in Q4, leading to an overall growth of +4.2% in 2021.



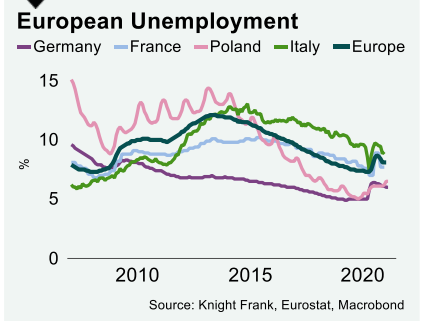
### ...while employment is -2% lower than pre pandemic levels

In Q4 2020 employment increased +0.3% q-q, in line with expectations. Increases were recorded in Spain (+0.7%), France (+0.3%), Italy (+0.2%) and Germany (+0.1%).

Latest data available suggests that 5% of the total labour force in both Germany and Italy are participating in a furlough scheme, with 4% participating in Spain and 7% in France. While this is down considerably from peaks of 28% in France, 17% in Italy, 16% in Spain and 12% in Germany, it continues to mitigate the effects of the pandemic on unemployment.

Going into the pandemic, the Eurozone was at its lowest level of unemployment on record in February 2020 at 7.3%. Unemployment has since increased to 8.1% in January 2021, remaining below the long term average of 9.5%, due in part to these national furlough schemes in place.

Oxford Economics forecast unemployment to peak at 8.8% in 2021, before paring back to 8.5% in 2022 and 8.0% in 2023.



Workplace mobility in Europe has largely improved from lows seen through the pandemic, according to Google's Mobility Index.

At its peak in April 2020, over three quarters of people in Spain were working away from their usual place of work, reducing to circa one fifth by March 2021.

Sweden and France's workplace mobility is at similar levels, with circa one fifth of workers away from their usual place of work, from lows of -57% and -67% respectively.

Germany has seen faster return to the workplace with levels only 17% lower than prior to the pandemic, from a peak of 63% working away from their normal place of work. It is expected these numbers will improve over the year.

## INVESTMENT HEADLINES

Prime office yields remained stable both over the quarter to Q4 2020 and when compared to Q4 2019, with an average prime office yield of 4.04%.

European office investment volumes increased +73% over the final quarter of 2020 to €31.4 billion. However, compared to Q4 2019, volumes remain muted, down -44%. Over Q4, multiple markets recorded further recovery in office investment, including Poland (+473%), Norway (+160%) and the Netherlands (+129%).

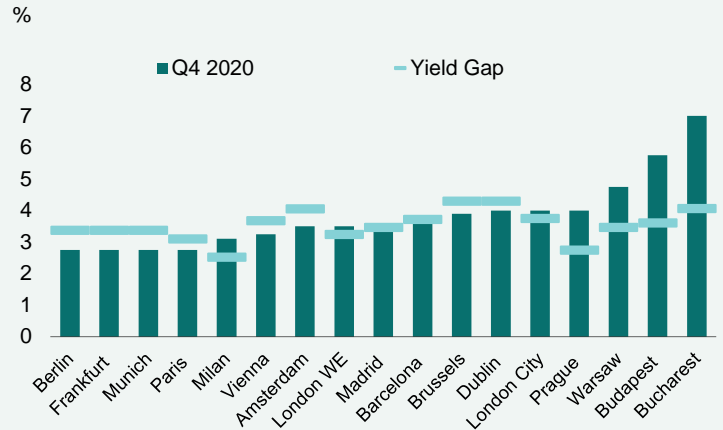
Annual investment totalled €99.7 billion in 2020, down -31% over the year, reflecting the pressures of the pandemic on the sector. While this was the lowest investment activity since 2013, the overall reduction in office investment is a smaller proportional decline than the global average fall of -34%. Germany was the largest recipient of European office investment over the year, with a quarter of total investment, at €24.9 billion. However, this was down -29% from 2019's record investment. France (20%) and the UK (16%) also received a substantial share of investment in 2020.

Cross border investment into European offices improved in the final three months of 2020, up +56% q-q to €13.9 billion. However, over 2020, cross border investment declined -39% to €44.7 billion, albeit a marginally smaller decline than the global average reduction in overseas investment of -41%.

Domestic investors were supportive of European offices investment in 2020, increasing their share of total office investment from 48% in 2019 to 54%. This is slightly above the long term domestic average of 53%.

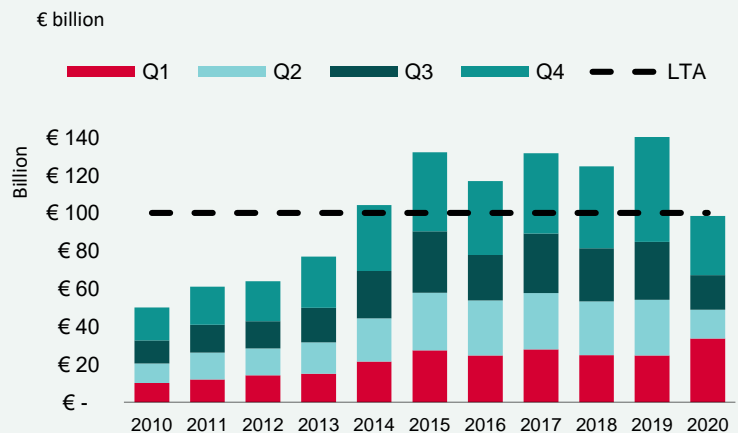
In particular, domestic investors in Denmark (+56%), Finland (+42%), Norway (+35%) and Belgium (+5%) increased their investment in office assets in 2020 compared to 2019.

### Prime European Office Yields



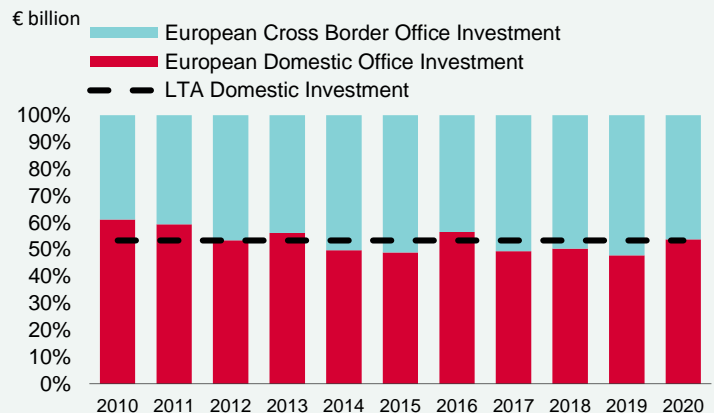
Source: Knight Frank

### European Office Investment Volumes



Source: Knight Frank, Real Capital Analytics

### Share of Domestic and Cross Border European Office Investment



Source: Knight Frank, Real Capital Analytics

## LEASING HEADLINES

Over 2020, average office take-up totalled 326,110 sq m, down -43% on the year prior. However, average office take up for the Q4 2020 did see some recovery, with a double digit increase in activity of +17% over the quarter, signalling improvement. However, despite this, take-up for the final quarter remained -47% lower than was seen in Q4 2019.

At a city level, take up performance over the quarter saw significant variation. Vienna was the only market to record an increase in take up in Q4 2020 compared to Q4 2019, up +34%. However, Milan (+159%), Paris (+67%), Berlin (+64%) and Warsaw (+54%) all saw take-up recover significantly q-q.

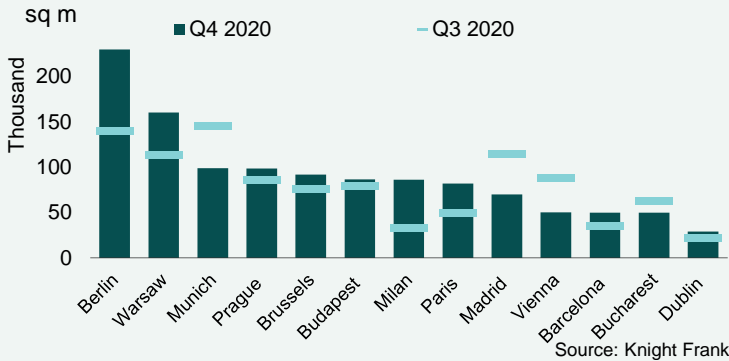
Despite the pandemic, Munich (+11%), Paris (+9%), Madrid and Berlin (both +5%) recorded prime office rental growth in Q4 2020 compared to Q4 2019. The majority of the remaining markets were stable, over the year to Q4. Only Dublin, Madrid and Warsaw prime office rents are below their previous cycle peak.

Vacancy for Q4 2020 was 7.4%, remaining -0.6% below the long term Q4 average of 8.0%. This is despite the vacancy rate increasing by +0.4% over the quarter and 1.5% over the year as a whole.

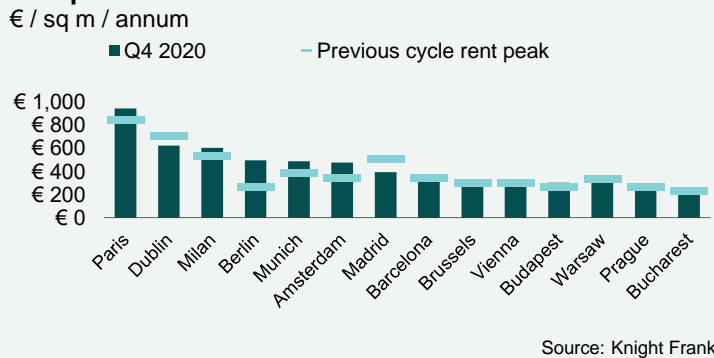
Vacancy in markets except for Bucharest, Dublin and Paris are either on par or below their local Q4 average vacancy, further suggesting demand for office space has not declined significantly due to the pandemic.

Compared to the GFC, most markets in Europe currently have a considerably lower vacancy rate, indicating less distress in the market compared to the previous economic dislocation of comparable scale. Markets including Warsaw, Milan and Madrid are the only ones with higher vacancy than in Q4 2009.

### European Office Take-Up



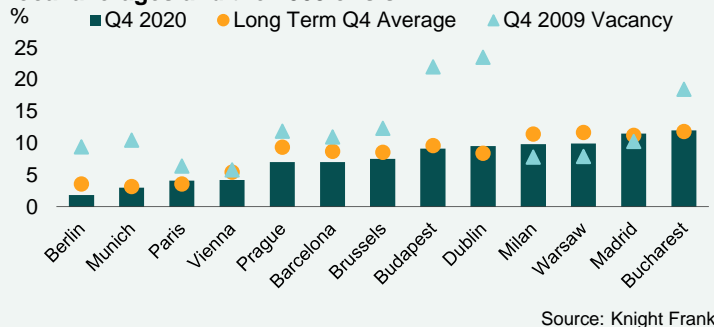
### European Office Market Rents



### Vacancy



### European vacancy remains favourable compared to local averages and the 2009 crisis



## Capital flows into and within Europe to remain resilient

Europe remained as the largest recipient of cross border capital in 2020. With €108 billion worth of inbound investment, the region increased its market share last year, to 62% of global cross-border capital. While we did see a 19% decline in European cross-border activity, this is much less than the average global decline of 28%.

All sector, cross border activity was actually somewhat more resilient than domestic through 2020, leading to an overall investment volume decline for Europe of 23% over the year to €227 billion dollars. This remains a softer fall in volumes than the global average of a 28% drop in transactions however.

Europe was also home to eight out of the top ten global cities for real estate investment last year. These ranged from the safe haven locations of London, Paris and Berlin, to cities such as Madrid in the south, which has benefitted over the last few years from a continued later recovery from the Eurozone crisis earlier last decade.

Looking forward, we expect two themes to drive European capital flows over the coming year. This first is the continued draw of capital to liquid, transparent, globally understood, safe havens while the second is a continuation of more local, intra-European investing between 'near-neighbour' countries.

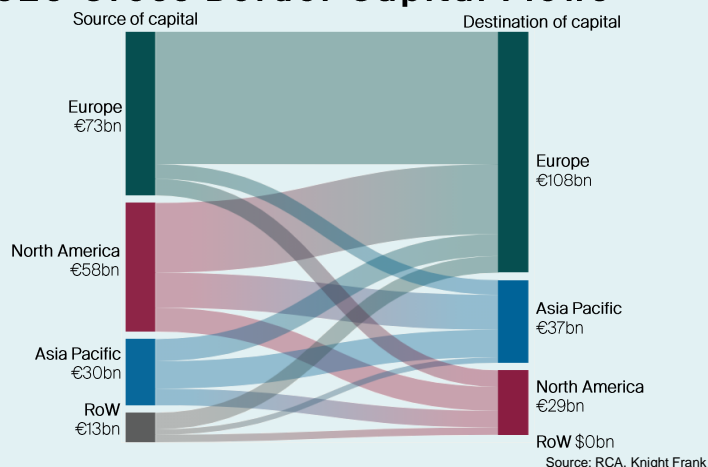
Intra-regional, near neighbour investing within Europe, takes advantage of local expertise and mitigates the issues of travel disruption. Safe havens, those large, relatively liquid, transparent locations are likely to also be destinations for capital, regardless of travel disruption. Indeed, there has already been evidence of motivated investors from Asia buying best in class buildings in London via virtual inspection.

This forecast is borne out of our flagship Active Capital research, where we have used a capital gravity model, to predict where we think capital will flow over the coming year. Using a variety of economic, geographic and real estate inputs, as well as a shock factor to try and capture the lagged effects of the pandemic, we predict top destinations for capital in Europe to include the UK, Germany, France and the Netherlands.

Our model predicts that Germany should benefit from robust within-Europe, near-neighbour investment, particularly from France, the Netherlands and the Nordics, as well an increase in interest from further afield such as the United Arab Emirates. We also expect France to particularly see an increase in investment from the United States.

Currency hedging benefits for dollar denominated investors investing into Europe on a five year basis,

### 2020 Cross Border Capital Flows



have also been seeing some improvement recently, as they also have for Korean capital. This could energise investment from these locations, into Europe, over the coming year.

In terms of investor type, we see a broad spectrum targeting European real estate, from private equity looking for opportunities, particularly those more non-traditional asset classes, to institutional investors looking for quality income.

Overlaying all of this, is an increase in demand for sustainable led assets.

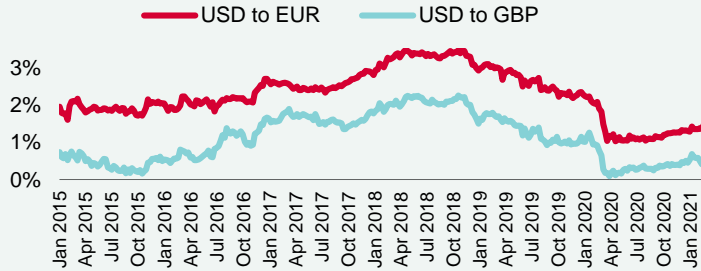
**By Victoria Ormond, CFA**

“In terms of offices, the most aggressive capital and demand remains in the core space, focussed on modern, well-let properties both in terms of income sustainability and term certain, with appropriate environmental accreditation becoming extremely important. ESG is fast becoming a key value driver in this sector. ESG credentials are so important that assets that do not or can not conform post a refurbishment, will see exponential value deterioration.”

**Mike Bowden, Partner, Co-Head of European Capital Markets**

## Hedging Benefits for US dollar denominated investors are improving

### Hedging benefit p.a for US denominated investors, investing into Europe and the UK



Source: Knight Frank, Reuters

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