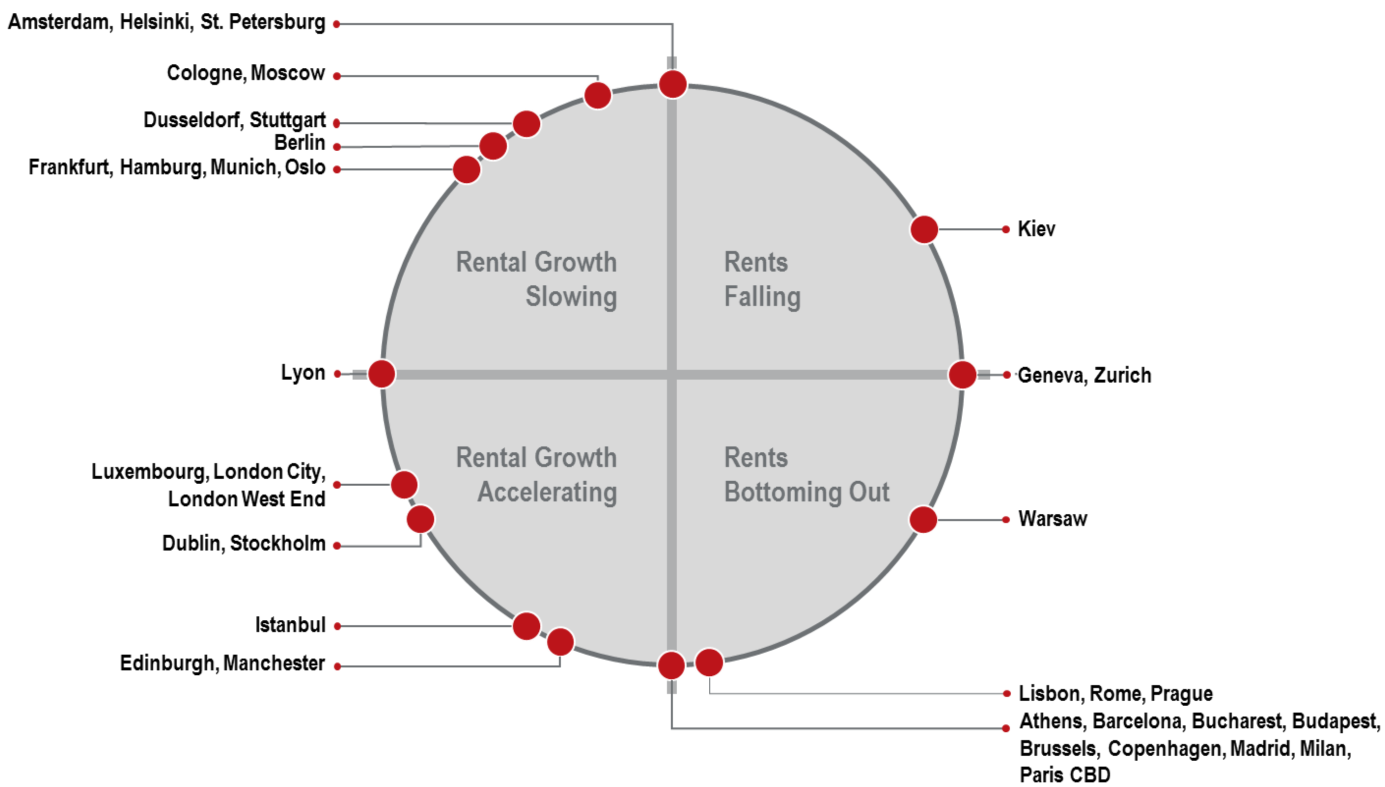
JLL Office Property Clock Q2 2014

EMEA Offices Research

Occupier market momentum increases in Q2

- Rental Index increases by 0.4% q-o-q
- Leasing volumes the highest since Q4’12 at 2.8m sq m
- Vacancy remains static on aggregate – completions notably up



Source: JLL, July 2014

The clock diagram illustrates where Jones Lang LaSalle estimates each prime office market is within its individual rental cycle as at end of June 2014. 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

The momentum seen in European occupier markets at the beginning of the year continued into Q2. Conditions continue to vary across the region, however, and while Q2 stats were encouraging, the recovery is only just starting in some markets. The disconnect between the strong performance of capital markets and occupier markets also remains.

Office rents

Prime office rents continued to increase over the quarter on aggregate, though the pace was slightly slower than at the beginning of the year - the European office index increased by 0.4%, compared with 1.1% in Q1 14. Of the 24 Index markets, three saw prime office rental increases q-o-q (compared with 8 in Q1), with Dublin again leading (+7.1%) driven by the rebound in demand and a severe lack of quality supply. Munich rents (+3.2%) rose to their highest levels since the early 1990s. Positive news also came from Spain, where Madrid saw the first increase (+1.0%) since Q3 08. With occupier sentiment and economic activity improving, rental decreases have become the exception, but there was a 2.5% decline in Prague due to high volumes of new supply. Prime rents elsewhere including London, Paris and Moscow remained unchanged.

The slightly slower pace in growth is also mirrored in JLL's office clock, where the majority of markets saw positions unchanged or only slightly changed. The exception was Kiev, which moved back into the "rents falling" quadrant, given the ongoing political tensions. With markets appearing across all four quadrants, the clock continues to show a high degree of variation across the region.

For the rest of the year, prime rents are forecast to increase further, given the low levels of quality space available. From 2015, expansionary demand should also support rental growth. Conditions will continue to vary across markets, with strong growth in London, Southern Europe and Dublin. In Central and Eastern Europe (CEE) there will be further downward pressure in Warsaw, while Budapest and Prague are expected to have reached the bottom and Moscow is likely to see stability following the downward correction in Q1. Regardless of economic factors, it is expected that a region-wide preference for quality space in good locations will widen the performance gap between quality space in well-connected areas and the rest.

Office demand

European office leasing activity also showed encouraging signs. Leasing volumes totalled 2.8 million sq m in Q2, an increase of 19% on Q1 14 and 11% stronger than in Q2 last year. Though activity has typically strengthened throughout the year, Q2 14 was the strongest outcome since Q4 12 and 3% above the Q2 average of the last 10 years. In total, H1 14 volumes were 5% higher than in H1 13. Over the quarter, activity increased in both Western Europe and CEE. Performance in Western Europe was boosted by a 25% increase in take-up over the quarter in Paris, which saw its best Q2 since 2007. London was able to maintain its strong momentum with gross take-up up 11% over the quarter. Activity in Germany remained healthy, but slightly lower than expected with Frankfurt and Munich slightly subdued. With circa 200,000 sq m let, Stockholm had a record quarter and activity also increased in Brussels, Milan and Lyon. Quarterly performance in the CEE was driven by high activity in Budapest and Warsaw, while volumes in Moscow and Prague remained subdued.

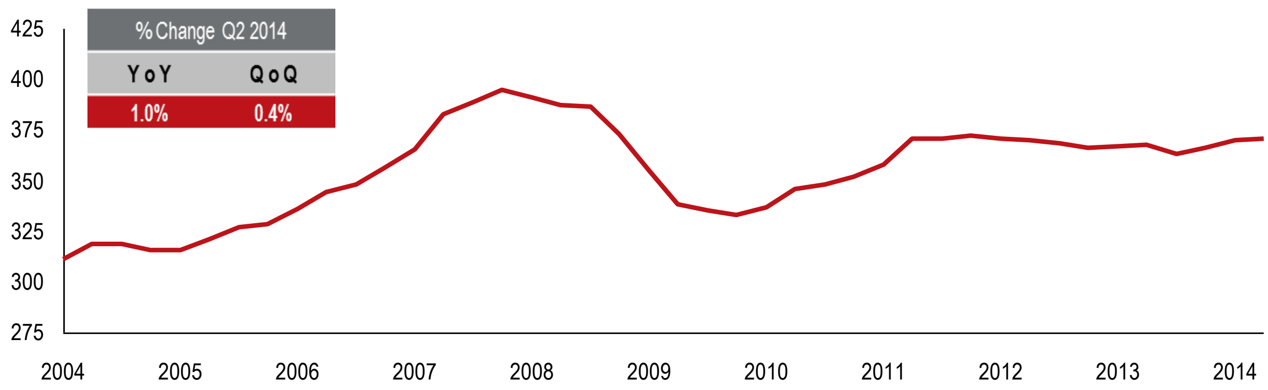
Going forward, stronger economic activity and employment growth will fuel expansionary demand. In the short term, however, unemployment remains high and occupiers are expected to remain cost-conscious. The preference for modern space to drive productivity and efficiency remains and a lack of such space in some markets has resulted in limited activity. The high volumes of pre-letting for space completing this year and next year demonstrates the willingness of occupiers to commit to modern space. In total, European office take-up is forecast to increase by 6% in 2014 and by another 5% in 2015. Following a good start to the year, annual net-absorption increased by 25% in Q2 to 2.2 million sq m.

Office supply

Of the 24 Index markets, 12 showed decreasing and 4 stable levels of vacancy. Over the quarter, strong reductions were recorded in Edinburgh and Budapest (-90 bps each) as well as in Amsterdam and Dublin (-80 bps each). But the aggregate office vacancy remained stable for the 6th consecutive quarter at 9.7%, as a 90bps increase in Moscow and a rise of 20bps in London cancelled the reductions out. Going forward, vacancy is expected to reduce only slowly, as expansionary demand only recovers slowly and occupiers continue to release second-hand space back into the markets. The drive to increase efficiency has also reduced overall requirements of occupiers and resulted in significantly lower vacancy rates for higher quality space.

Office completions continue to notably rebound and increased over the quarter, with a total of 1.3 million sq m added on aggregate in Q2. This is an increase of 33% over the quarter and, while Q2 completions are seasonally higher than at the start of a year, these volumes reflect an increase of 76% on Q2 13. As a result, H1 14 volumes are now almost double H1 13 levels, while Q2 almost matched the 10Y Q2 average. Completion volumes were notably strong in Moscow and London, delivering over 500,000 sq m combined this quarter, while in Paris volumes remained moderate. Warsaw also continued to see high volumes of supply. Elsewhere, completions were still moderate to low. Going forward, supply is expected to increase across a wider range of markets to reach 5 million sq m by the end of the year, an increase of 20% compared with 2013 and in line with the 10Y average.

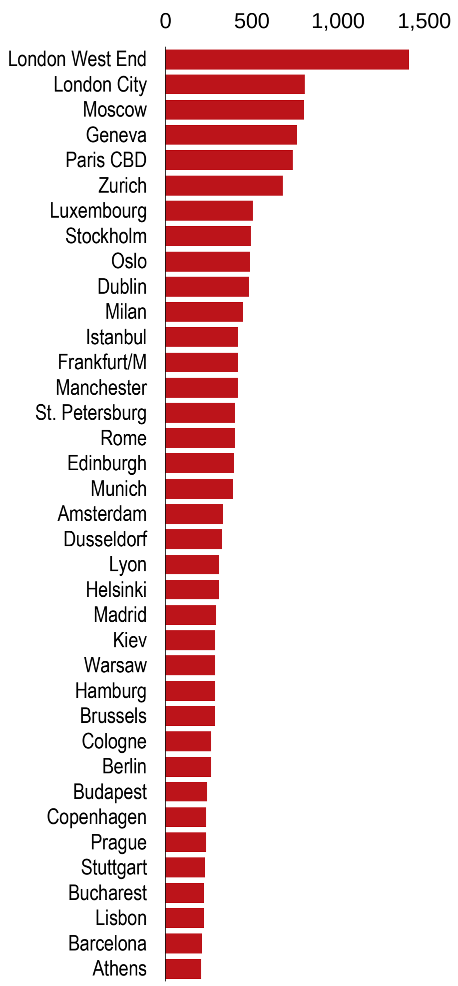
Prime European Office Rental Index



Weighted Nominal Rental Trend, 1980 = 100

Source: JLL, July 2014

Prime Office Rents Q2 2014 (EUR / sqm pa)



Source: JLL, July 2014

Prime Office Rental Change Q2 2014 (% Q-o-Q)

Note: Q-o-Q rental change is based on the local currency.
Source: JLL, July 2014

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 2014