MARKET TRACKER NOVEMBER 2015

Paradigm shift in the market for office space – less room, more innovation.

Over the past 15 years, changes in the 14 cities that top the table for office space in Europe have pointed in one direction only: up. Availability, demand and the number of people working in offices all saw constant growth – as did levels of unoccupied floorspace. However, what are the reasons behind this turnaround, and what are its implications for today's market?

Vacancy levels will increase and new strategies will become more attractive

Even during periods of dynamic growth, such as 2000–2001, 2005–2007 and 2012–2014, it was virtually impossible to change the fate of unoccupied office space and repurpose it for third-party usage. In short this means that the lifespan of office space is growing ever shorter, in both economic and technological terms. Securing long-term tenants for purpose-built offices is becoming increasingly difficult, regardless of how much demand there is on the market. And there certainly is demand: following the relative decline in construction rates over recent years, businesses are currently having trouble locating modern facilities in their immediate surroundings, as the properties on offer no longer meet the companies' changing requirements.

At Catella Research, we believe that structurally induced vacancy rates in major towns and cities will continue to climb as the number of outdated office complexes that are no longer marketable increases space. Structural changes will also affect demand for office space, with principle reasons including cost-cutting pressures, temporary uses, and the transition to modern forms of working at companies.

These developments will trigger the following changes.

- Empty office blocks will be repurposed as residential units: the latent shortage of homes in Europe's cities will contribute to this process.
- Creation of new plans for office space, such as mixed usage and "work landscapes": proposals aiming to reflect the future nature of work, i.e. central locations, mixed-use character, temporary occupation of workspaces ("land-scapes") in the form of shared and coworking spaces, will become increasingly attractive.
- Growing investor interest: investors will strive for greater participation in repurposing projects as well as new builds.

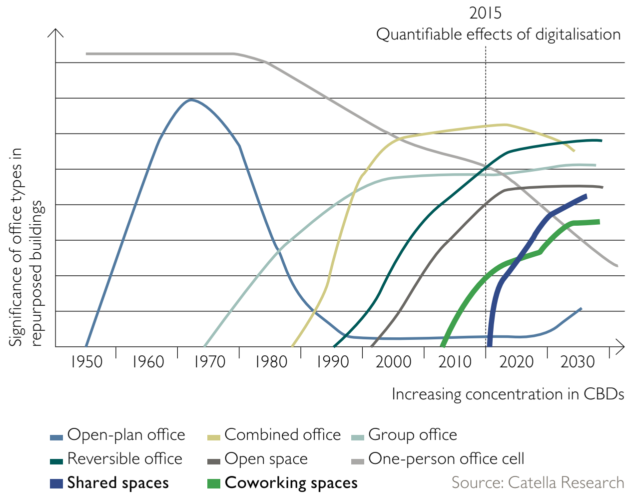
TABLE I: VACANCY RATES AND OFFICE SPACE USAGE IN MAJOR EUROPEAN CITIES

	Vacancy rate in %			Office space usage* in 1000 m² (net)		
Locations	2000	2014	Δ ppt	2000	2014	Δ %
Stockholm	6.2	10.0	+3.8	9,087	10,121	+11.4
Copenhagen	2.4	10.3	+7.9	7,686	8,032	+4.5
Helsinki	3.0	11.0	+8.0	6,723	7,561	+12.5
Berlin	9.8	7.4	-2.4	11,911	13,798	+15.8
Frankfurt	2.0	12.6	+10.6	8,045	9,038	+12.3
Düsseldorf	3.8	10.7	+6.9	5,929	6,727	+13.5
Munich	0.4	5.9	+5.5	11,305	12,853	+13.7
Hamburg	3.1	7.4	+4.3	9,152	10,658	+16.5
Madrid	1.4	12.2	+10.8	5,377	7,339	+36.5
Barcelona	2.2	15.5	+13.3	2,893	3,502	+21.1
Paris (Central)	0.8	9.6	+8.8	15,126	15,642	+3.4
Lyon	2.9	6.0	+3.1	3,665	4,498	+22.7
London (Central)	2.6	6.5	+3.9	12,055	12,891	+6.9
Luxembourg	0.8	5.5	+4.7	1,658	2,646	+59.6
Average	**3.0**	**9.3**	+6.3	**7,901**	**8,950**	+17.9

* Office space usage = office facilities – vacant premises

Source: Catella Research

CHANGING OFFICE TYPES



Source: Catella Research

Catella is a leading financial advisor across Europe and asset manager for the areas of property, fixed-income and equity. We occupy a leading position in the real estate sector, with a strong local presence in Europe with around 500 employees across 12 countries.

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Over the past 15 years, **vacancy levels** have seen a substantial increase in towns and cities across Europe. The sole city to buck this trend is Berlin. The reason is, we believe, as follows: the German capital exhibits high demand for office space due to a combination of positive predictions regarding its economic future, low prices, and the prevalence of start-ups basing their operations there. On average, vacancy rates in the European cities under investigation rose by 6.3 %.

Office space usage (office building stock minus vacant properties) saw strong, parallel growth of 17.9 % on average. Luxembourg and Madrid saw the highest levels of growth, while Copenhagen, Paris and London returned the lowest. The reason for this is more efficient usage in London and Paris, coupled with the general absence of available, unused space. Prices and vacancy rates are very high when compared with other European cities.

What does this mean for the future? If revenues generated by office space (usage) and vacancy levels both continue their upward trend, the obvious result will be tremendous compression within the continent's business districts. This may even already be underway in certain locations.

The increase in unoccupied offices is the outcome of a fundamental structural transformation.

Our society is changing from one focused on providing services into one based on knowledge and information. New forms of communication are taking shape, and companies are harnessing these for temporary new processes and organisational structures. Offices are losing their traditional divisions between functions and are instead becoming open landscapes consisting of different zones with a temporary character. With regard to planning, this results in a complex situation: the classic office is no longer the central focus, having been replaced by different zones for communication, interaction, cooperation, concentration, isolation, relaxation or contemplation. Increasingly, companies use these new office space strategies to attract and retain employees and promote their corporate culture.

In Europe, we have embarked on a process which will see the professional and personal merge to an ever greater degree, and those leasing and selling office space will have to react to this transformation with flexibility. If we were to describe the typical young company's expectations, it would be this: temporary leases in office facilities that may seem spartan, but which are also positioned in central locations. Leasing prices are still one of the top five conditions in the list of "hard" factors shaping companies' choices, but this cost item is continuously becoming less important. Since 2009, new leases have been falling across Europe, with no sector being so markedly affected as financial services. This is a clear expression of the ongoing structural realignment, and FinTech firms and start-ups have so far not compensated for it.

We will have "less room" for our work in the future

Rising leases and the demands of digitalisation will mean that companies will occupy less floorspace in an effort to keep costs low, so space per employee is likely to fall in Europe's major business centres. This generalisation does not apply to all markets: per-employee floorspace is rising in Frankfurt, Madrid, Barcelona and Lyon. The probable reason is that demand is outpaced by the number of attractive office complexes, so companies can afford to occupy more space. Overall, however, the number of people working in office jobs has grown by an average of 19.3 % across our selected markets in the past 15 years. The related demand for office space is countered by the proportional increase in office facilities.

The concentrated use of this space is the result of unrelenting price pressures: many businesses cut back on their office capacities to save money. At the same time, they are trying to increase productivity per workstation.

Less room for employees – is this the next trend? An analysis of the figures shows a clear: "Yes". Innovations ("new strategies") and behavioural changes ("the human factor") will amplify this development, which will have major structural implications.

TABLE 2: OFFICE WORKERS AND OFFICE FACILITIES IN MAJOR EUROPEAN CITIES

	No. of office workers (in 1000)			Office space[1] in 1000 m²			Office space per employee[2] in m²			No. of office workers[2] per m²		
Locations	2000	2014	Δ %	2000	2014	Δ %	2000	2014	Δ %	2000	2014	Δ %
Stockholm	424	510	**+20,3**	9,686	11,245	**+16.1**	21.4	19.8	**-7.4**	0.0467	0.0504	**+8.0**
Copenhagen	289	320	**+10,7**	7,875	8,955	**+13.7**	26.6	25.1	**-5.6**	0.0376	0.0398	**+6.0**
Helsinki	202	259	**+28,2**	6,931	8,496	**+22.6**	33.3	29.2	**-12.3**	0.0300	0.0343	**+14.0**
Berlin	570	703	**+23,3**	1,3211	14,893	**+12.7**	20.9	19.6	**-6.1**	0.0479	0.0509	**+6.5**
Frankfurt	301	334	**+11,0**	8,210	10,338	**+25.9**	26.7	27.1	**+1.2**	0.0374	0.0370	**-1.2**
Düsseldorf	215	243	**+13,0**	6,164	7,532	**+22.2**	27.6	27.7	**+0.4**	0.0363	0.0361	**-0.4**
Munich	435	503	**+15,6**	11,355	13,653	**+20.2**	26.0	25.6	**-1.7**	0.0385	0.0391	**+1.7**
Hamburg	438	525	**+19,9**	9,442	11,508	**+21.9**	20.9	20.3	**-2.8**	0.0479	0.0493	**+2.9**
Madrid	704	791	**+12,4**	5,454	8,359	**+53.3**	7.6	9.3	**+21.5**	0.1309	0.1078	**-17.7**
Barcelona	472	553	**+17,2**	2,957	4,144	**+40.1**	6.1	6.3	**+3.3**	0.1632	0.1579	**-3.2**
Paris (Central)	782	822	**+5,1**	15,255	17,301	**+13.4**	19.3	19.0	**-1.6**	0.0517	0.0526	**+1.6**
Lyon	245	280	**+14,3**	3,773	4,785	**+26.8**	15.0	16.1	**+7.4**	0.0668	0.0622	**-6.9**
London (Central)	662	776	**+17,2**	12,382	13,780	**+11.3**	18.2	16.6	**-8.8**	0.0549	0.0602	**+9.6**
Luxembourg	128	207	**+61,7**	1,670	2,800	**+67.7**	13.0	12.8	**-1.3**	0.0772	0.0782	**+1.3**
Average	**419**	**488**	+19,3	**8,169**	**9,842**	+26.3	**20.2**	**19.6**	-1.0	**0.0619**	**0.0611**	+1.6

[1] Office facilities (total) = incl. vacant premises

[2] Relative to office usage = office facilities - vacant premises

Source: Catella Research, PMA