What we suspected has been confirmed!

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During the first half of 2021, we began to glimpse the first signs of a revival of the European office real estate market. In Q2, the economy of the eurozone rebounded as sanitary measures progressively lifted. Investment and rental markets logically bounced back, and recent activity may be indicative of the start of a new cycle against the backdrop of new ESG-related (environmental, social and governance) regulations and changing investor and user behavior.

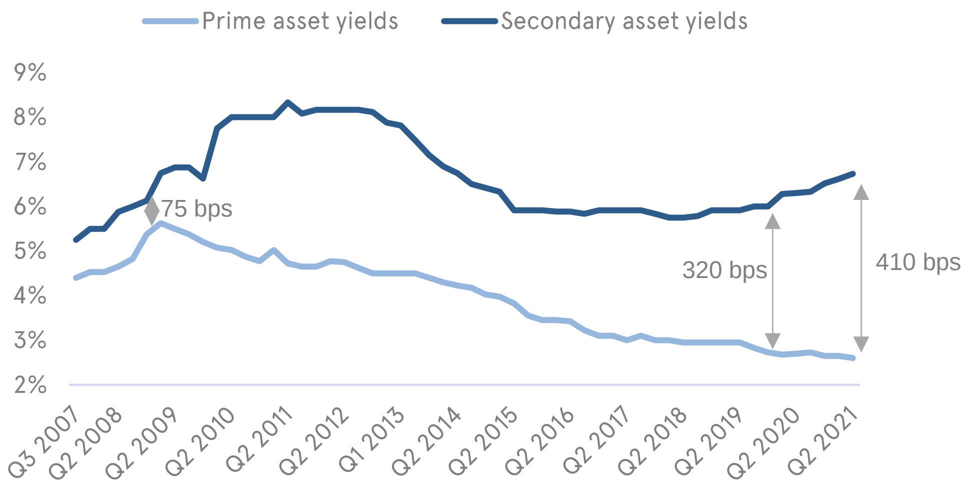
Promising investment volume figures

The figures are promising. After four quarters of uninterrupted decline (2020), the volume of office real estate investments continued to rise over the first two quarters of 2021, due in large part to accommodative financing conditions and favorable valuation perspectives. Across the board and with the United Kingdom in lead position, all European countries, apart from France, registered an increase in investment volumes. A rebound in France is expected in Q3 2021. Naturally, demand was focused on prime assets, with strong ESG performance. However, investors continued to shy away from dated assets given the capital expenditures necessary for renovation.

Diverging yields of Primary and Secondary assets

Prime office assets in Europe, particularly resilient, continued to offer attractive yields, especially in the low-for-long interest rate environment. However, investors are now demanding a risk premium, subject to local market conditions, on secondary assets.

Prime and secondary yields in Europe



Source: CBRE, LF REM Research

The perceived risk on centrally located assets remained weak in markets with low vacancy rates or on assets with promising value-added perspectives in light of new user behavior. The context was however quite different for peripheral location assets!

During S1 2021 and across most European markets, prime asset yields registered a slight decrease. Alternatively, in certain markets, such as Madrid and Amsterdam, with high vacancy rates (over-supply), yields increased. Prime assets located in Paris and the primary German cities offered yields below 3%.

Rebound in take-up

The second quarter of 2021 was marked by a general rebound in take-up across European real estate markets. Some projects, liberating space, were even cancelled. Total take-up over twelve months ending Q2 2021 was slightly higher than year-end 2020. However, the rebound was not homogeneous across all markets. On average, the vacancy rate of European office real estate assets increased by 140 bps over the twelve-month period, ending Q2 2021. No surprise that obsolete second-hand assets made up the bulk of supply. Conversely, vacancy remained low for centrally located assets that satisfy new user work habits. For example, the level of supply at the end of Q2 2021 amounted to only five months of take-up (based on average take-up over the past five years) in the central business districts of Berlin and Munich and nine months in Paris central business district. Supply remained weak in the main German cities and Luxembourg; vacancy rates were below 4%.

Supporting factors for prime asset rental values

The heavy demand for prime office assets in Q2 2021 should continue to support prime rental values. Alternatively, assets located in the suburbs of large cities such as Madrid or Milan or in sub-markets with excessive supply could suffer a correction in rental values. Across all of Europe, significant lease incentives have continued to widen the gap between headline and economic rental values. In the long-term, increasing construction costs and ESG performance booster measures could put upward pressure on rents.

Sources: CBRE, BNP Paribas Real Estate, La Française REM Research

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