



## A NEW OFFICE DEVELOPMENT CYCLE ? NOT YET

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### OVERVIEW

Some recent indicators have suggested a measure of improvement in the European office markets: rents have stabilised, vacancy rates are peaking at lower levels than in some previous cycles and leasing volumes have risen from their mid-2009 lows. This raises the question as to whether these are the early precursors of the next development cycle. Evidence from the development pipelines in the major European markets shows that the absence of new starts will cause a sharp drop in completions next year and that, by 2012, completions will be running at less than half their 2008 peak. Sentiment towards the reactivation of schemes that were mothballed in the early stages of the credit crunch is harder to assess but, other than in London, there is little sign of a shift in developers' attitudes. There are some isolated examples of renewed interest in development in European markets, but these reflect specific circumstances rather than a broader shift in momentum. Generally, the combination of an uncertain rental outlook and constrained access to development finance mean that the start of the next development cycle is still some way off.

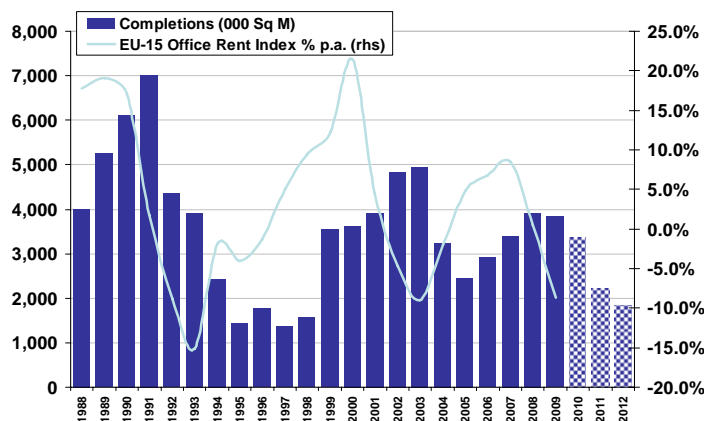
### INTRODUCTION

The downturn in the major European office markets and the limited availability of development finance caused a sharp fall in the scale of development activity and particularly in new construction starts. With prime rents now showing some signs of stabilising (indeed rising in some markets) and economic growth beginning to improve in most markets, are the conditions taking shape for the start of the next office development cycle in Europe ?

The overall shape of the development cycle across the main Western European office markets indicates that deliveries of new space peaked in 2008-09 and are set to slow progressively over each of the next three years. The dip in 2011 is likely to be particularly sharp as developers in many markets remain cautious and/or capital-constrained in the short term.

Aggregate completions<sup>1</sup> over the four years 2007-10 are expected to amount to around 14.5 million sq m, which compares with over 17 million sq m in the 2000-03 period and over 22 million sq m between 1989-92. Relatively weak rent signals (certainly by comparison with the late 1980s), followed by a sharp dip in both leasing activity and debt availability, have combined to produce a subdued office development cycle across Europe.

### Office development completions, Western Europe, 1988-2012



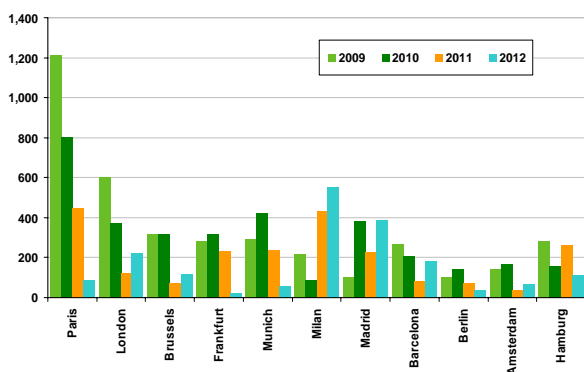
Source: CB Richard Ellis

1. Based on figures for London, Paris, Brussels, Frankfurt, Madrid, Berlin, Hamburg, Munich, Milan, Amsterdam and Barcelona

## LITTLE ACTIVITY IN 2011

The forward development pipelines for the period to end-2012 are mainly comprised of schemes already in progress, and the gradual contraction expected in most markets therefore reflects the impact of recent low levels of starts. Nearly all markets see a dip in 2011 and while some, such as London, Brussels and Madrid are expected to see higher completion levels in 2012 than 2011, in most cases the absolute level of completions in 2012 remains lower than that recorded in 2009.

### Office development completions by market, 2009-12



Source: CB Richard Ellis

As a proportion of existing stock, the three-year pipeline ranges from over 10% in Milan, Barcelona and Madrid to under 4% in Paris, London and Berlin.

### Office development completions 2010-12 as % of end-2009 stock

	%
Berlin	1.5
Paris	2.5
London	3.5
Amsterdam	3.8
Munich	3.9
Brussels	3.9
Hamburg	4.1
Frankfurt	5.0
Madrid	8.5
Barcelona	8.7
Milan	10.9

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## AND BEYOND....?

As regards any revival of interest in reactivating delayed schemes for delivery beyond 2012, **London** is currently the only major market where there is any substantial evidence of this. There are indications of increasing developer interest in bringing forward some of the key sites in the City of London market, although actual development starts remain extremely subdued.

The shift is predicated in part on the currently-limited availability of large, high quality units, and on demand arising from concentrations of lease expiries after 2012. Among the schemes that could be revived are British Land's "Cheesegrater" scheme on Leadenhall Street, Land Securities/Canary Wharf's "Walkie Talkie" at Fenchurch Street and Legal & General's Walbrook Square scheme. Even in some of these cases, at least partial pre-lets may be required to stimulate development.

Elsewhere in Europe, there are isolated examples of renewed interest in development but, where instances do exist, they mostly reflect building-specific circumstances rather than a general confidence in market momentum among developers.

In **Madrid**, for example, refinancing terms have been agreed on Rey al Urbis' semi-built scheme on the Castellana and the project is now expected to be taken to completion.

In **Vienna**, the DC Tower 1 (part of a two-building scheme that had been postponed) will be restarted for development over a three-year period.

In **Paris**, developers continue to adopt a cautious stance. There have been very few speculative starts lately, and none more recent than 2009. Most of these were launched as part of multi-use or regeneration schemes where the office element was integral to the larger project. Examples include Le Millénaire in Aubervilliers, linked with a shopping centre and other office buildings; Landy in St Denis which is part of the "Les Studios du Landy" programme; and Le Garance where a bus terminal is under construction under the office building.

Without the context of the larger scheme, it is doubtful whether all these developments would have proceeded. More generally, interest is confined to redevelopments backed by large equity-rich investors in strong locations in the Paris core. Even these cases remain rare, and debt finance is scarce.

In **Milan**, four major projects were shelved due to a combination of financial and authorisation problems. Two of them, Santa Giulia and Rubattino, have seen no change in status and remain on hold. The others, Porta Vittoria and ex Falck, have been the subject of fresh discussions. The first of these could be delivered in 2013 subject to an extension of government financing. The second may be sold to a joint venture developer although financing details remain unclear.

In **Warsaw**, the sponsors of several stalled projects have been trying to redesign their schemes or change the use mix in order to improve viability. However, only two schemes have shown any signs of starting. Mokotow Nova (43,000 sq m) is still seeking a pre-let but on-site works are in progress. The developer of Platinum Business Park IV & V, having secured a tenant for the whole 4th building, has started construction and will look to build the 5th one at the same time. Financing is a combination of equity and bank debt.

There are markets where even this level of interest is absent. In the **Netherlands** for instance, high levels of vacancy continue to restrain development except in instances where developers can respond to specific corporate "build-to-suit" requirements which arise to meet sustainability/CSR targets. These are relatively few and far between so the market impact is small. Similarly in **Germany** development pressure remains weak.

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## CONCLUSION

Across most of Europe, construction starts and expressions of interest in reactivating mothballed schemes, remain low. Anecdotal evidence of renewed interest in development is beginning to accumulate in London, although not yet accompanied by actual construction starts.

Elsewhere, other than in isolated cases, the general picture is one where a combination of an uncertain rental outlook and constrained development finance mean that the start of the next development cycle is still some way off. Indeed, the recent Euro crisis has the potential to cause further banking losses and hence further restrict the appetite of banks to lend on property developments.

What would need to happen for this to change? Clearly an accelerated economic recovery would help, but current forecasts emphasise downside risks and suggest that employment in financial and business services across Europe will not regain its previous (2008) peak until 2012-13. With demand-side pressures on rents remaining subdued, therefore, it could take a considerable time in some markets for speculative development to resume on any scale, even if the availability of development finance improves.

If developers do remain cautious and look to secure pre-lets before initiating schemes, this could have significant consequences for occupiers. Increasingly they would need to forward-plan large new requirements rather than assuming that a choice of suitable buildings will be available when needed.

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