Market report
Germany offices

2014

Summary

Top six office markets at a glance

- In 2014, take-up in the top six office markets decreased by almost 3% compared to the previous year to reach a level of 2.7m sq m.

- With Hamburg and Berlin only two locations registered a plus in take-up of 20% and 12% respectively. In contrast, Düsseldorf, Cologne and Frankfurt noted double-digit losses.

- Despite decreasing take-up, the vacancy rate decreased on average of the analysed markets by 30 basis points compared to the previous year to a level of 7.7%.

- Both, prime and average rent increased. With a plus of 4.5%, the average rent increased much stronger than the prime rent (+1.1%). This is because many companies looked insubmarkets close to the CBD due to a scarcity of space in central locations.

- Although the take-up is likely to stagnate this year due to a lack of economic impetus, the decline of vacant space will continue in 2015 – and therefore the fifth year in a row. As a consequence, the rental level should also continue to increase.

> ”Despite slightly decreasing take-up figures, rental levels increased last year due to remaining scarcity of central and attractive office space.”
>
> Marcus Mornhart, Head of Office Agency Germany

Real economy and financial environment

German economy remained below expectations in 2014

In December 2013, growth projections for the German economy in 2014 stood at 2%. Actually, the growth rate of the German national economy was at only 1.5%; lower than projected at the end of 2013. There are many reasons for the unexpected low growth, including the sustained weak growth in the eurozone. The positive side is that the single currency area has been able to leave the two-year recession behind and achieve provisional economic growth of almost 1% last year. However, the return to a solid growth trajectory is proving sluggish and continues to suffer with setbacks. The Italian economy, for example, contracted last year for the third year in succession while France, the second largest national economy in the single currency area, effectively stagnated (provisionally +0.4%). The weakness of two such important trading partners alone was a significant burden to the German economy last year. Exports were also negatively impacted by geopolitical crises; notably the conflict in Ukraine. Additional stresses included the floods in the early part of the year and rail strikes in the autumn.

Weak investment, strong consumption

These negative influences caused the German economy to significantly lose its driving force over the course of last year. Investment in particular was once again weak owing to the continued uncertainty of the eurozone crisis, the crisis in Ukraine as well as the increasingly rigid and erratic national and regional economic policy from the federal government. In contrast, consumption was a significant positive growth factor, rising by a provisional 1.1% year on year in 2014. This above-average growth is based not only on real growth in wages and salaries but also on further improvements in the employment market. At the end of December, the (seasonally-adjusted) unemployment rate was just 6.5%; the lowest since German reunification (Graph 1). Both factors have produced an extremely positive consumer climate. The consumer climate index calculated by GfK recently stood at 9 points; the highest level since December 2006 (Graph 2).

Spectre of deflation forces ECB to act

However, for many nations in the eurozone, there are no signs of a healthy employment market or the associated rise in wages and salaries. On average, 11.5% of those capable of work in the eurozone were unemployed at the end of last year. In many countries, as many as one in four or five people is unemployed. This, in turn, is one of the reasons for the consistent decline in the rate of inflation over the course of the year. Inflation stood at 0.3% in November; equal with the lowest level in five years. Consequently, the European Central Bank (ECB) maintained its extremely

TABLE 1

Macro-economic key figures at a glance*
Consumption is driving economic growth

Figure (y-o-y change in %)	2014	2015	2016	2017	Ø 09-13
Gross domestic product	1.5	1.7	1.9	1.7	0.8
Private consumption	1.1	1.3	1.5	1.5	0.9
Industrial production	-0.2	2.3	2.4	2.5	0.2
Consumer prices	1.6	1.6	1.8	2.1	1.7
Exports	0.6	4.6	5.1	4.6	3.1
Imports	1.2	5.0	5.7	5.0	3.2

Source: Statistisches Bundesamt, Focus Economics / * 2013 preliminary figures; 2015-17 forecasts

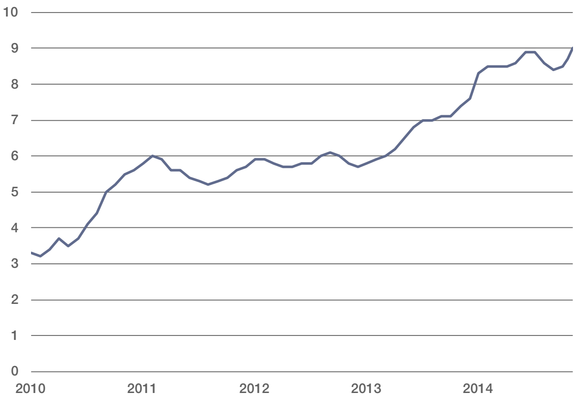
GRAPH 1

Labour market Employment jumps over 30 million mark

Source: Bundesagentur für Arbeit, Focus Economics

GRAPH 2

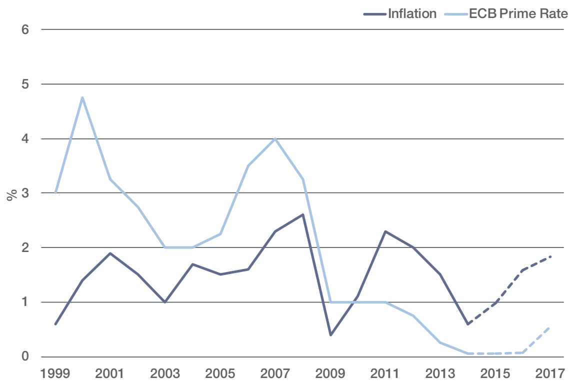
Consumer climate Private households remain generous



Source: GfK

GRAPH 3

ECB prime rate and inflation Inflation decreases despite interest rates of zero



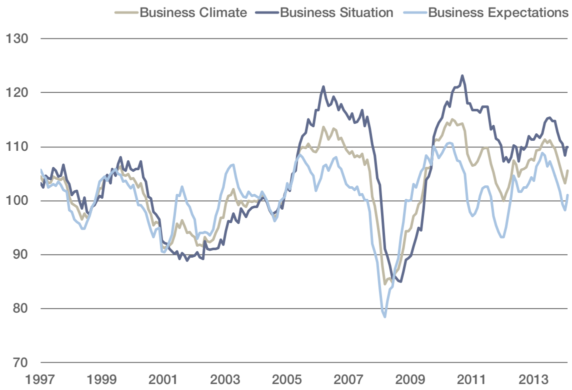
Source: Statistisches Bundesamt, Bundesbank, Focus Economics expansionary monetary policy last year and even loosened the reins further. In two stages, the ECB lowered the main refinancing rate from an already record low of 0.25% to 0.05% (Graph 3). It even lowered the deposit rate to a negative value for the first time in its history. However, despite these measures, the rate of consumer price increases in the eurozone continued to move away from the ECB target (just below 2%), partly due to the recent drop in oil prices and the associated lower energy costs for consumers. As long as the rate of inflation remains in what ECB President Mario Draghi refers to as the "danger zone" of below 1%, the ECB is highly likely to take further measures in monetary policy to dispel the "spectre of deflation". As a start of such a package of measures, although extremely contentious from a legal perspective, they decided in favour of an extensive purchasing of government bonds to increase the ECB's balance sheet.

Low external value of the euro and cheap oil are the economic drivers for 2015

The extraordinary measures in monetary policy and economic weakness have caused the euro to significantly lose value against other major currencies, particularly the US dollar. At the start of 2014, one euro would buy 1.35 dollars. At the start of 2015, this had fallen to less than 1.20 dollars. Many experts believe this trend towards currency parity is likely to continue. However, this devaluation combined with the low oil price is likely to provide significant impetus to the economy in the eurozone. The German economy, which is heavily dependent on exports, should particularly benefit. Indeed, some recent indicators have pointed to an increase in economic activity. At the end of the year, the ifo Business Climate Index halted its decline that commenced in the spring, rising slightly in November and December. Both the current business situation and business outlook of companies surveyed showed improvements (Graph 4). German industrial orders also recently resumed an upward trend following a prolonged period of weakness, providing cause for optimism with regard to trends in production activity over the coming months. However, this year too, it is private consumption that is likely to prove the most significant driver of economic growth. Owing to their opposing effects, it remains to be seen what impact legal amendments to pensions and the minimum wage will have in the long term. Indeed, many factors point towards a sustained weakening of the German economy. However, for this year at least, both developments should fundamentally provide further stimulus to the consumer climate. Despite the sustained risks, including the recently resumed talk of a "Grexit" (Greece leaving the eurozone), all of this could bring about a reversal of the situation last year and economic growth may actually exceed the current projections of 1.3%.

GRAPH 4

Business climate Mood amongst enterprises seems to swing up again



Source: cesifo

Spectre of deflation

Effects on property

The inflation rate in Europe has been constantly falling in recent years. Despite massive interventions from the European Central Bank, the downward trend has continued to date. Against a background of continuing weak economic growth, a sustained period of deflation is a quite possible scenario. For real estate markets, such a development would entail some serious consequences, three of which are outlined below:

■ Indexed leases would be highly attractive from a tenant's perspective owing to nominally falling rents. Investors and landlords, on the other hand, would prefer leases without indexing.

■ While nominal interest rates would fall further, the negative inflation rate would result in higher real interest rates than nominal interest rates. Furthermore, since liabilities would increase in real terms, the use of debt capital would make little sense. Consequently, the amount of capital available for property investments would decrease and property prices would fall.

■ Since a deflationary scenario would go hand in hand with a world of stagnating or even contracting economies, real estate investors would once again become much more risk averse and focus more strongly on the core segment than in recent times in order to minimise their risk of tenant default, for example. Property values in the core segment would, therefore, react less strongly than those in the non-core segment.

Top six office markets at a glance

Good year for landlords

From a landlord's perspective, it was a very positive year in the six largest German office lettings markets of Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne and Munich. The year was characterised by solid demand, scarce supply, falling vacancy rates and, thus, moderate rental growth. Together, such factors have strengthened the position of landlords in these cities, or at least in individual submarkets.

Take-up declines slightly further

One of the prevailing themes of last year was the declining take-up, which was relatively low in view of the solid economic growth. Take-up across the six office markets totalled 2.7 million sq m in 2014, representing a decrease of 2.7% on the previous year and the lowest annual take-up since 2009. At the end of 2013, projections for 2014 assumed an increase in take-up, not least owing to higher anticipated growth in the gross domestic product. Indeed, two cities, Hamburg and Berlin, registered significant rises in take-up of 20% and 12% respectively. However, these two cities could not offset some substantial decreases in Düsseldorf (-31%), Cologne (-17%), Frankfurt (-16%) and Munich (-4%), resulting in a modest overall decrease for the year.

In addition to the weaker than expected economic growth, there were three other material reasons for the low take-up, which are partly inter-related:

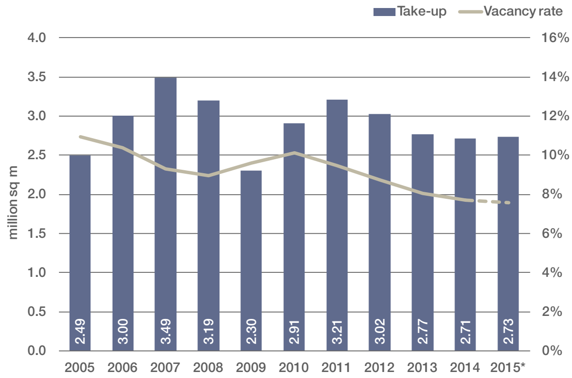
1. Supply shortage in the central submarkets
While there were many requirements in the market last year, some of them substantial, only a few of these culminated in deals owing to a lack of suitable supply. Central locations in particular, which many occupiers favour, suffered from an acute supply shortage. As a result of this trend, at least some markets, such as Berlin, showed a moderate increase in speculative development activity. From a tenant's perspective, however, the activity in this sector is still insufficient. In view of the lead times for such projects, the supply shortage is not expected to be resolved here in the short term.

2. Lease extensions
The lack of available space is one reason why many companies have opted to extend existing leases rather than leasing new premises. Another reason for this trend is that the continued general uncertainty in the economic environment means some companies would rather avoid the costs and risks associated with a move.

3. Increased efficiency of space
In addition, many occupiers are seeking to reduce their office costs. At the same time, however, they have high expectations of fit-out quality. Consequently, office occupiers are seeking to increase their efficiency of space rather than wishing to reduce

GRAPH 5

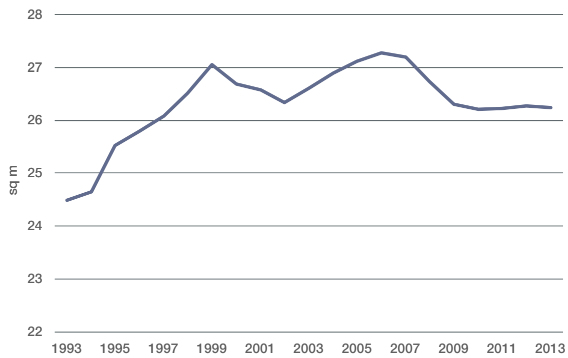
Take-up and vacancy Third decrease in a row



Source: Savills / * forecast

GRAPH 6

Office space consumption per employee Decrease since 2007



Source: Bulwiengesa, from 2012 Savills calculations

TABLE 2

Office market key figures Vacancy rate further down in all markets except Düsseldorf

	Take-up (sq m)		Vacancy rate (%)		Stock (m sq m)		Prime rent (€ per sq m/month)		Average rent (€ per sq m/month)	
	Q4 2014	y-o-y change	Q4 2014	y-o-y change	Q4 2014	y-o-y change	Q4 2014	y-o-y change	Q4 2014	y-o-y change
Berlin	773,800	+11.8%	4.5	-50bps.	19.1	+1.3%	22.50	+2.3%	13.20	+7.3%
Düsseldorf	237,300	-30.7%	10.9	+10bps.	7.7	+0.7%	26.00	-5.5%	14.20	-2.4%
Frankfurt	370,000	-15.7%	11.6	-30bps.	12.0	+0.2%	38.00	+/-0.0%	17.50	+/-0.0%
Hamburg	511,100	+19.7%	6.5	-70bps.	13.4	+2.2%	24.00	+/-0.0%	14.00	+6.4%
Cologne	225,000	-16.7%	6.8	-30bps.	7.8	-0.3%	21.00	-6.7%	12.85	+0.4%
Munich	593,000	-3.7%	6.0	-20bps.	22.8	+2.2%	34.50	+7.8%	15.85	+4.3%
Top six	2,710,200	-2.7%	7.7	-30bps.	82.6	+1.3%	27.67	+1.1%	14.60	+4.5%

Source: Savills

their rent per square metre. This trend of increasing efficiency of space was particularly observed in Frankfurt in the past but is now high on the agenda of occupiers throughout Germany. Companies that require more space owing to increased personnel numbers can achieve this via more efficient space concepts such as a shared-desk policy. This ultimately also impacts take-up. The trend is also reflected in the statistics on office space per capita. The latter has fallen consistently since 2007 and now stands at 26 sq m per employee, the lowest level since the beginning of the 1990s. In international comparison, however, this is still relatively high and approximately 50% higher than in many European countries. Whether these figures will continue to harmonise over the coming years or Germany will retain its special status remains to be seen.

Rental growth concentrated in peripheral CBD locations

Companies seeking new, larger offices last year were often forced to look to the periphery of the central business district (CBD) since appropriate accommodation could not be found on their rental budget in the CBD or there was a fundamental lack of such space. Indeed, these peripheral CBD locations are the winners in the current market environment. This is also reflected in rental growth. While the prime rent across all six markets rose by an average of 1.1% to €27.67 per sq m/month, the average rent gained 4.5% to reach €14.60 per sq m/month. The latter is primarily attributable to rental growth in the peripheral CBD locations.

Further moderate fall in vacancy rates

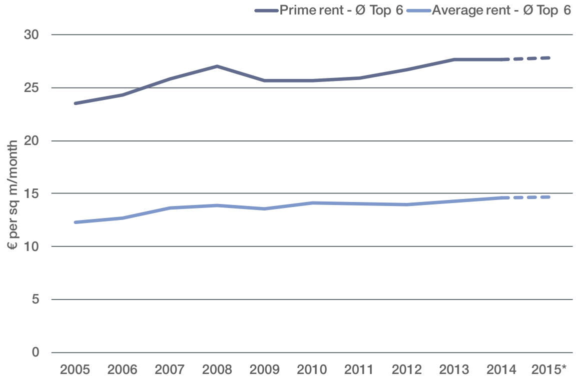
That rents rose despite stagnating demand for space is explained by the further decrease in vacancies. Vacancy rates fell in all cities with the exception of Düsseldorf. Hamburg recorded the largest fall in vacancy rates of 70 basis points compared with the previous year to stand at 6.5%. Berlin still has by far the lowest vacancy rate across all six cities at 4.5%, while the average office vacancy rate is 7.7% (-30 bps year on year). The decline in vacancy rates is attributable to two trends. While the completion volume of some 1 million sq m in 2014 was somewhat higher than in the previous year (2013: 0.9 million sq m), this was only in line with the average of the previous five years. In addition, only a small proportion of this new space in the market is still vacant. On the other hand, the reduction of vacant space which is no longer suitable for the market continued. This is primarily for the purpose of conversion to other uses; mostly residential or similar uses, such as hotels or sheltered accommodation.

Outlook for 2015: stable demand - supply to remain scarce

The decline in vacancies is likely to continue in 2015 for the fifth year in succession. This is all the more remarkable since take-up is likely to stagnate and remain around the previous year's level owing to a lack of positive impetus from the economy. The expected further decline in vacancy rates is attributable to the relatively low completion volumes projected for 2015. Completions are expected to total just below 1 million sq m this year, of which more than 50% is already pre-let. In keeping with last year, attractive space is therefore likely to remain scarce. Consequently, both prime and average rents are more likely to rise than fall in 2015.

GRAPH 7

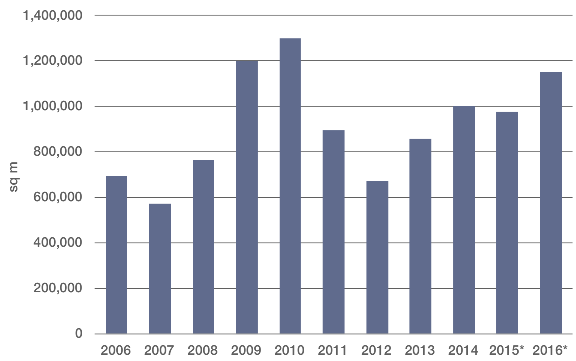
Rental levels Average rent with higher increase than prime rent



Source: Savills / * forecast

GRAPH 8

Development pipeline In 2015 slightly fewer space than in previous year



Source: Savills / * forecast

TABLE 3

Forecast top six markets No major changes

	2015	2014	y-o-y change
Take-up	2.73m sq m	2.71m sq m	+0.7%
Prime rent	€27.79 per sq m/month	€27.67 per sq m/month	+0.5%
Average rent	€14.68 per sq m/month	€14.60 per sq m/month	+0.6%
Vacancy rate	7.6%	7.7%	-10bps

Source: Savills

Office market Berlin

Take-up rises thanks to strong final quarter

A strong finish to the year with deals totalling 217,800 sq m in the fourth quarter ensured good annual take-up for the Berlin office market. The buoyant final quarter lifted take-up for the whole of 2014 to 773,800 sq m, representing an increase of 11.8% compared with the previous year. Berlin and Hamburg (+19.7%) were the only cities among the top six markets to record a rise in take-up figures.

Market activity characterised by large deals...

Overall, activity in the Berlin office market was characterised by solid demand. In addition to the traditionally strong activity from service-related companies, the IT sector made a significant contribution to the high demand in the capital. Online comparison site Idealo leased more than 10,000 sq m in the Ritterhof building in Kreuzberg. However, this was by no means the only large letting of the year. Last year saw 16 deals for at least 5,000 sq m, of which seven lettings were for at least 10,000 sq m. In 2013, there were eight deals for more than 5,000 sq m, of which just one letting was over 10,000 sq m. The return of such large deals was, therefore, a significant factor in the rise in take-up.

...as well as owner-occupier transactions

A further reason for the increased take-up was the buoyant activity among owner-occupiers. The current low interest rate environment means that organisations in particular are tending to seek a property to purchase rather than leasing. Owner-occupiers accounted for almost 9% of overall take-up last year; the same proportion as in 2013. The number of such transactions was also limited by available supply, meaning that many requirements could not be satisfied.

Shortage of attractive space drives rents higher

The buoyant demand and shortage of good, high quality space is also reflected in rental growth. The prime rent rose by 2.3% to €22.50 per sq m/month. The average rent gained even more sharply, rising by 7.3% to €13.20 per sq m/month. This growth is particularly attributable to the fact that good locations within the suburban rail ring are benefiting from the high rents in the central business district (CBD), as price-sensitive occupiers move out to these peripheral CBD locations.

Distribution across the submarkets almost unchanged

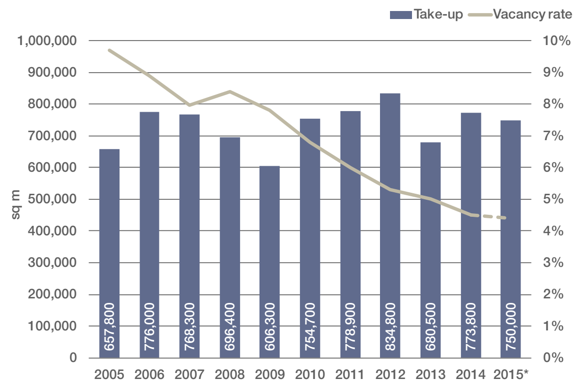
The distribution of overall take-up across the individual submarkets changed only moderately compared with the previous year. In keeping with 2013, the City Periphery submarket accounted for the largest proportion. This was unchanged at 44% in 2014, followed by City East, which accounted for 24% (2013: 23%) of take-up. City West produced 8% of overall take-up; slightly less than in the previous year (2013: 9%). However, demand for space remains very high in this submarket. Higher take-up could not be achieved last year because demand for space was greater than the available supply. In the medium term, however, the 'Upper West' development and a new high-street property on Joachimsthaler Straße will give the submarket fresh impetus, although completion of both projects is around two years away.

Further moderate fall in vacancy rate

The high take-up also ensured that the vacancy rate fell slightly further. This dropped by 10 basis points compared with the previous quarter to 4.5% and is expected to fall further. Rents are also likely to rise further in 2015 as supply in attractive locations remains scarce. For while around 325,000 sq m is expected to come to the market in 2015 (2014: 175,000 sq m), only around 60,000 sq m of this is still available.

GRAPH 9

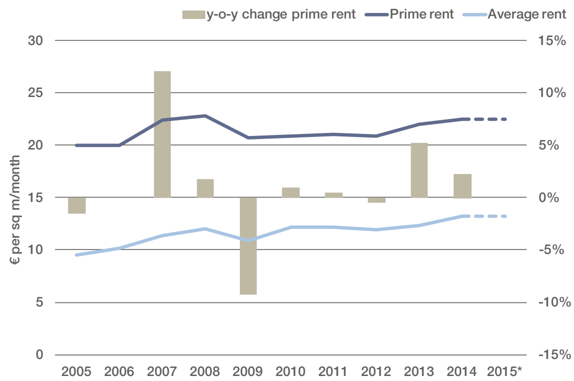
Take-up and vacancy Surplus in take-up of 12%



Source: Savills / * forecast

GRAPH 10

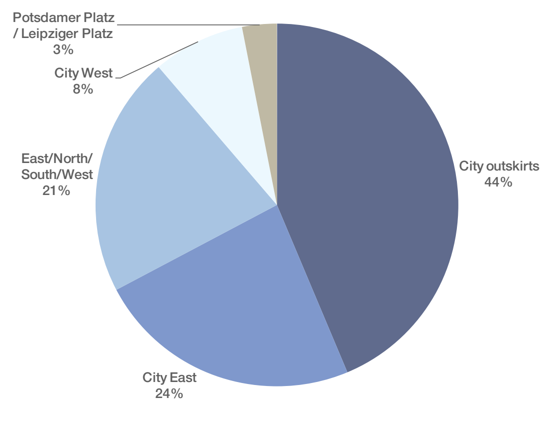
Rental levels Prime rent with continued upward tendency



Source: Savills / * forecast

GRAPH 11

Take-up by submarket Share of submarkets remains nearly unchanged



Source: Savills

Office market Düsseldorf

Lowest take-up for five years

The Düsseldorf office market recorded its lowest take-up figures since 2009. Office deals last year totalled 237,300 sq m, which is 31% lower than in the previous year and 23% below the average figure over the last five years. This was also the largest fall in take-up across the six largest German property markets.

Lack of large deals

A principal reason for this decline in take-up was an absence of large transactions. There were just four transactions above 5,000 sq m in 2014, but not a single deal above 10,000 sq m. In previous years, take-up has been consistently above the 300,000 sq m mark, not least due to such large deals. A significant reason for the shortage or complete absence of transactions in these two size categories is the lack of appropriate space, particularly in central business district (CBD) locations.

Vacancies remain high

The vacancy rate remained at the high level seen in the previous year, ending 2014 at 10.9%. However, there was some variation across the individual submarkets. The vacancy rate of 8.5% in the CBD, for example, was significantly below the figure for the overall market. Since the completion volume of 114,000 sq m projected for the Düsseldorf city area in 2015 is similar to that seen in previous years, the office market will remain a tenant's market this year owing to the surplus supply.

In addition, larger occupiers are able to secure a pre-let at a moderate rent in the peripheral areas of Düsseldorf. This creates the risk that less existing stock will be leased and the relatively high vacancy rate will persist.

Prime and average rents decline

The overall weak demand last year was reflected in rent levels. Lettings in high-value prime properties, such as the Kö-Bogen and Dreischeibenhaus, pushed the prime rent to a record high of €27.50 per sq m/month at the start of 2014. Since these lettings are now outside of the reporting period and such high rents have not been achieved on other properties, or there is a lack of product in this segment, the prime rent has now fallen again. The prime rent at the end of 2014 stood at €26.00 per sq m/month; a decrease of 5.5% year on year. Despite this fall, however, the prime rent remains at a relatively high level. Four years ago, the prime rent was just €23.50 per sq m/month. Over the coming years, a number of developments will offer potential for higher rents to be achieved again. The average rent has also been impacted by the same circumstance, falling by 2.4% to €14.20 per sq m/month.

Submarkets outside the CBD particularly in demand

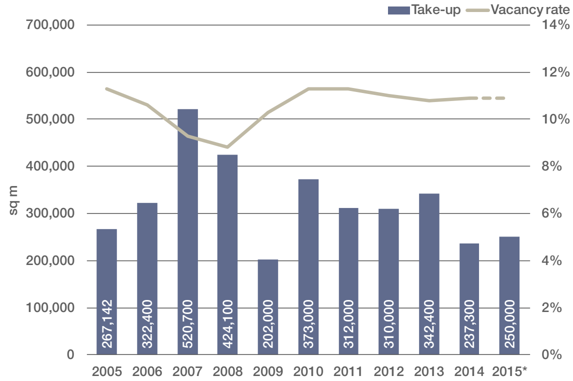
The decrease in the average rent is also a reflection of the fact that letting activity last year was concentrated outside of the CBD and city centre. The financial district and city centre accounted for just 6% and 10% of take-up respectively. The latter was the third strongest submarket in terms of take-up. The highest proportions were recorded by the Kennedydamm (14%) and Düsseldorf North / Airport (13%) submarkets to the north of the city centre. The relatively low take-up in the CBD is largely attributable to a short supply of appropriate space.

Higher take-up in 2015

Since some major lettings expected in 2014 are now likely to be completed this year, take-up in 2015 should be higher than last year's figure. Reaching the 300,000 sq m mark is a possibility if the existing large requirements are satisfied and joined by some other major deals. Both the prime and average rent should remain stable at current levels.

GRAPH 12

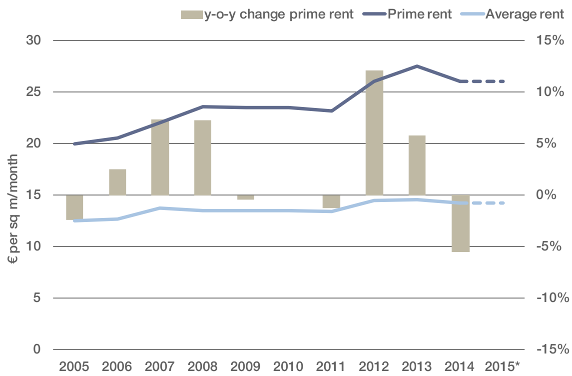
Take-up and vacancy Vacancy rate increases marginally



Source: Savills / * forecast

GRAPH 13

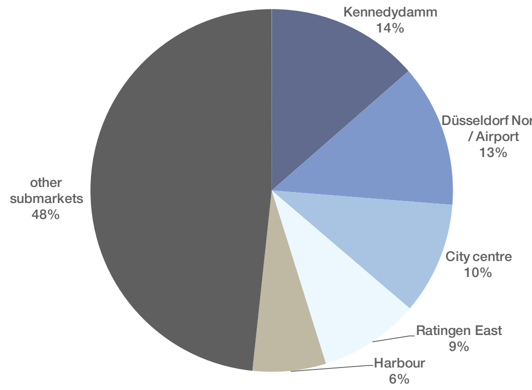
Rental levels Prime rent decreases significantly



Source: Savills / * forecast

GRAPH 14

Take-up by submarket Submarkets outside CBD in demand



Source: Savills

Office market Frankfurt

Take-up falls by 16%

After decreasing in 2013, take-up in the Frankfurt office market recorded a further drop of some 16% in 2014 compared with the previous year, falling below the 400,000 sq m mark. The take-up of 370,000 sq m is the lowest since 2009. The reasons for this decline in take-up are multi-faceted.

Few large deals

Companies in the financial sector showed relatively little demand for space. The large law firms are also not currently seeking new offices. Consequently, there was a lack of demand from two key sectors in Frankfurt. There were also relatively few lettings above 10,000 sq m last year. Besides the letting to Deutsche Bank and the Bundesbank, there was just one other major deal during the remainder of the year. Union Investment leased more than 20,000 sq m in the WinX in the MainTor area. This development helped to somewhat relieve the lack of high-quality space in the CBD.

Shortage of attractive space in the CBD

Nevertheless, in line with the other major office markets, there remains a scarcity of attractive, high-quality space in Frankfurt's CBD. Many tenants currently in high-quality office space are tending to extend leases provided that they can secure an attractive rental offer and that their current space meets their requirements or can be adapted accordingly. This supply shortage in the CBD was also reflected in the proportion of take-up attributable to the financial district. At just over 40%, this was at the lower end of the normal range of 40% to 60%. The submarkets of Eschborn, Frankfurt West and Westend follow in the rankings with 9% each, ahead of Frankfurt South with 8%. While Eschborn is a traditional back-office location, Westend in particular as well as Frankfurt South are attractive alternatives for occupiers whose requirements could not be satisfied in the CBD owing to the supply shortage. Westend is attractive owing to its proximity to the City submarket, while Frankfurt South is of particular interest to companies in the consultancy sector with Airport City in the direct vicinity of the airport.

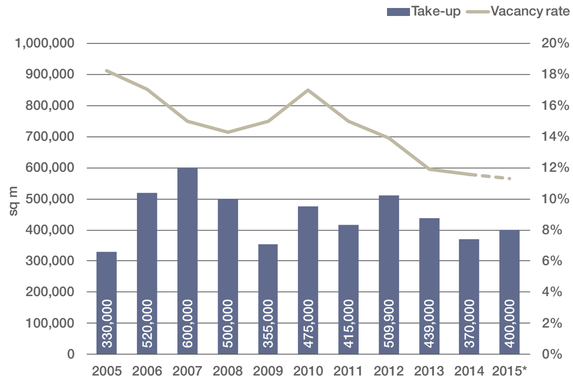
Greater emphasis on efficiency of space

An additional reason for the relatively low take-up is the impact of increasing efficiency of space. In terms of reducing office costs per employee, the Frankfurt market is something of a pioneer among the six major German office markets. Many companies have already introduced appropriate measures, such as a shared desk policy, or are striving to implement similar initiatives. While a number of companies, particularly in the IT and telecommunications sector, strengthened personnel numbers, this did not immediately result in requirements for additional space owing to a reduction in office space per capita.

Vacancies decline - rents remain constant

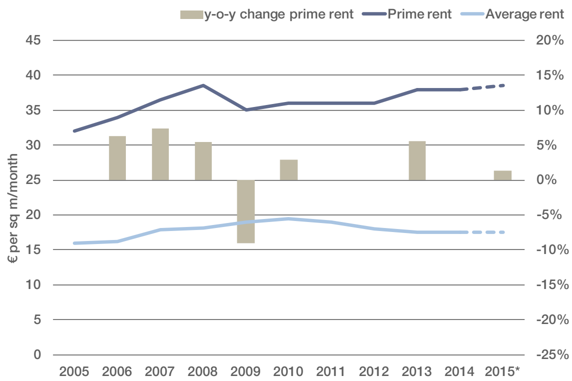
The vacancy rate fell by a further 30 basis points compared with the previous year to 11.6%. The decline in vacancies is largely attributable to the conversion of space no longer suitable for the market to residential or similar use.
Both the prime and average rent remained unchanged year on year. At the end of 2014, the prime rent stood at €38.00 per sq m/month while the average rent was €17.50 per sq m/month. The vacancy rate is likely to fall further this year owing to continued conversions to residential space and the fact that the projected completion volume of 128,000 sq m for 2015 is already mostly pre-let. However, this is only likely to have a slightly positive impact on rents as vacancy levels are still significant in absolute terms.

GRAPH 15
Take-up and vacancy Loss in take-up - few large deals



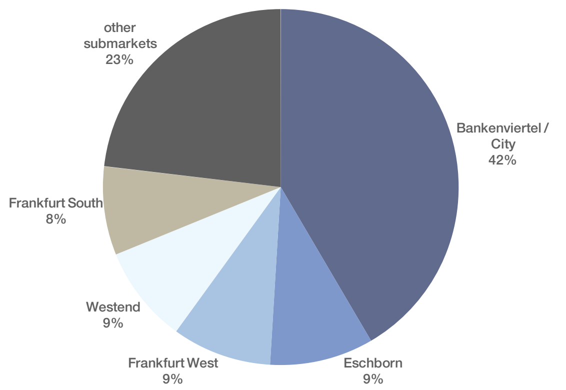
Source: Savills / * forecast

GRAPH 16
Rental levels Rents move sideways once again



Source: Savills / * forecast

GRAPH 17
Take-up by submarket Bankenviertel with share of "only" 42%



Source: Savills

Office market Hamburg

Take-up growth of 20% the highest across all six markets

While many of Germany's major office markets endured mixed fortunes in 2014, the Hamburg office market enjoyed significantly better results. Driven by high demand from all sectors, take-up last year totalled 511,100 sq m; an increase of 20% compared with 2013. Hamburg and Berlin (+12%) were the only markets to record an increase in take-up compared with the previous year. Take-up also exceeded the ten-year average by around 10%.

Large owner-occupier deals drive take-up growth

The take-up growth in Hamburg was bolstered by a number of large transactions. There were more than eight deals above 10,000 sq m in 2014, four of which were owner-occupier transactions. These included the acquisition of some 15,000 sq m of office space by Marquard & Bahls in HafenCity. Medium-sized companies in particular are seeking to use the current capital market situation to purchase their own office space rather than leasing. As a result, owner-occupier deals accounted for more than 15% of overall take-up last year.

Peripheral CBD locations benefit from excess demand in the centre

The City submarket remained the most active in terms of take-up. However, in view of the surplus demand, tenants also shifted their attention to peripheral central business district (CBD) locations. City South, the second most active submarket with 14% of overall take-up, and Altona along with Outer Alsterlage, the third most active submarket with 11%, are evidence of this shift in focus. As a result, the average rent rose by 6.4% to €14.00 per sq m/month, particularly driven by lettings in these peripheral CBD locations, while the prime rent remained unchanged at €24.00 per sq m/month as there was simply a lack of supply in the prime segment. In some segments, therefore, Hamburg has become a landlord's market and owners have already reduced incentives slightly. In addition, the high activity outside the City submarket demonstrates that these office market locations have established themselves as attractive alternatives.

Vacancy rate falls significantly

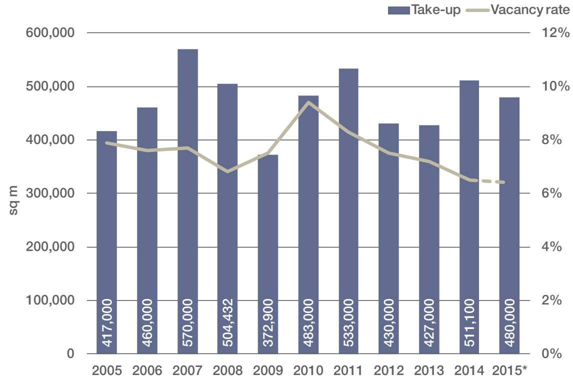
The vacancy rate in the Hamburg office market declined further year on year. At the end of December, this stood at 6.5%; some 70 basis points lower than a year earlier. This was the strongest decrease in vacancy rates across all cities. The principal reasons were high demand combined with the relatively low completion volume last year. Some 156,000 sq m of new office space was completed in 2014; significantly below the average figure over the last five years (2009-2013: 217,000 sq m per year). However, development activity is expected to recover going forward. The completion volume for 2015 is expected to reach approximately 200,000 sq m, while a figure of more than 300,000 sq m is projected for 2016. In line with most other major cities, however, there is little speculative development in Hamburg. Developments often only tend to commence once they are more than 50% pre-let. Consequently, even this relatively high completion volume will only slightly address the supply shortage in the market.

Rental growth and decline in vacancy rates continues

Against a background of greater development activity, the decline in vacancies is likely to continue in 2015, albeit at a slower rate. Take-up in the current year is expected to at least reach the average figure over the last ten years of 460,000 sq m. Since the supply shortage is unlikely to be significantly addressed, rents are expected to rise moderately over the course of the year.

GRAPH 18

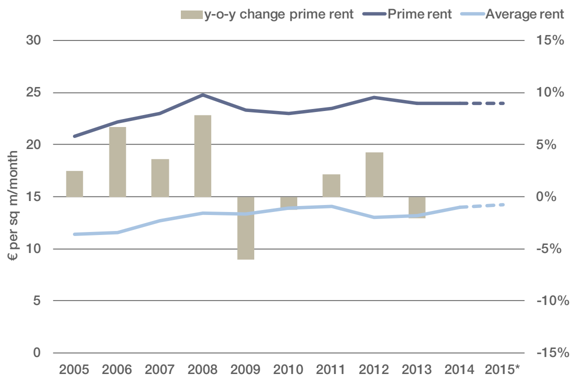
Take-up and vacancy Highest take-up since 2011



Source: Savills / * forecast

GRAPH 19

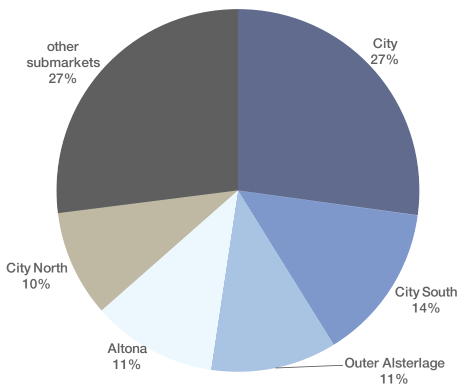
Rental levels Completions in peripheral CBD locations pushed average rents up



Source: Savills / * forecast

GRAPH 20

Take-up by submarket Surplus demand in the City



Source: Savills

Office market Cologne

Lowest take-up since 2003

The Cologne office market recorded its lowest take-up since 2003 last year. Deals totalled 225,000 sq m, representing a decrease of almost 17% compared with the previous year.

Supply shortage prevents higher take-up

Lack of supply in the market prevented a higher take-up from being achieved. There is particular surplus demand for modern space in the mid-price segment and in good locations. Faced with a lack of alternatives, many companies are opting to extend their current leases rather than leasing new space. The supply shortage will not be resolved this year since, in keeping with last year, the projected completion volume of almost 70,000 sq m is relatively low and more than half of this space is already pre-let. Owing to the supply and demand imbalance, Cologne can already be described as a landlord's market in some segments, despite the decline in take-up.

Only one deal larger than 10,000 sq m

A further reason for the fall in take-up was the low number of large transactions. Just five deals for more than 5,000 sq m were completed in 2014. The largest deal was for 12,600 sq m courtesy of the University of Public Administration of North Rhine-Westphalia in Deutzer Feld within the Deutz submarket. This was the only transaction in the size category above 10,000 sq m. In 2013, there were three such deals.

City submarket by far the most popular

Deutz was a sought-after submarket last year, not least due to this large deal. Three other deals in the 1,000 sq m to 5,000 sq m size category lifted Deutz to a 13% share of overall take-up (2013: 8%). In line with previous years, the City submarket was the most popular. The submarket's proportion of overall take-up rose significantly again last year from 40% in 2013 to 49%. In view of the existing demand, the city centre could have provided even greater take-up but not all companies in the market were able to find suitable space. Either such space was not available or the expectations of landlords and potential tenants in terms of rent were so far apart that deals could not be concluded. The median price segment between €14 and €16 saw frequent demand. However, there was almost no supply in the segment, particularly in terms of modern space.

Vacancy rate falls further

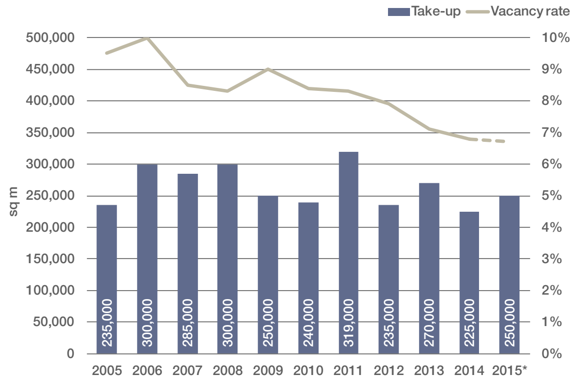
The vacancy rate decreased somewhat further last year. This dropped by 30 basis points compared with the previous year to 6.8%. The fall in vacancies is attributable to a number of factors. Firstly, there was a reduction in office stock owing to demolitions of space no longer suitable for the market and conversions to other uses, such as residential. In addition, there was an influx of various new occupiers into Cologne last year that were not previously represented in the city, as well as a number of new formations, resulting in some vacant offices being occupied. The most common reason for occupiers moving premises was company expansions and consequent requirements for larger office space.

Prime rent falls despite supply shortage

Despite the shortage of space, the prime rent decreased by 6.7% year on year to €21.00 per sq m/month. The reason for this is that a number of high-priced lettings above €22.00 per sq m/month from the previous reporting period have now fallen out of the calculations. No rents of this magnitude were achieved last year as there was simply no space available to let in this segment.

GRAPH 21

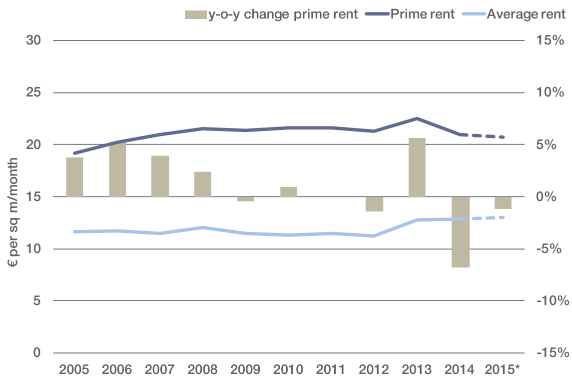
Take-up and vacancy Vacancy rate falls below 7% in 2014



Source: Savills / * forecast

GRAPH 22

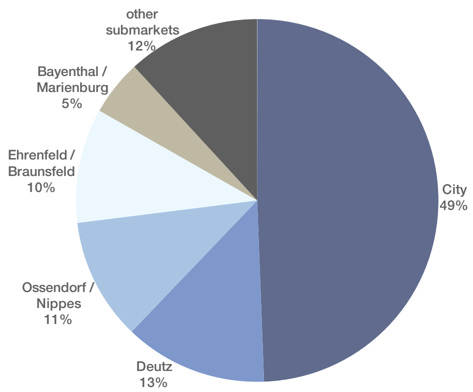
Rental levels Prime rent down on the level of 2012



Source: Savills / * forecast

GRAPH 23

Take-up by submarket Deutz with signficant increase in take-up



Source: Savills

Office market Munich

Take-up marginally down on the previous year

The Munich office market enjoyed a solid year with take-up almost reaching the same level as the previous year's figure. Deals totalled 593,000 sq m over the course of the year, representing a decline of 4%. Letting figures were also curtailed by the fact that a number of large deals were completed shortly before the start of 2014. Consequently, large deals were relatively few in number last year. While seven lettings for more than 10,000 sq m were completed in 2013, there were only four such lettings last year. However, the other size categories registered solid letting figures, boosted by a wide sector mix.

Significant growth in the prime and average rent

Despite the moderate decline in take-up, the prime rent rose by 7.8% year on year to €34.50 per sq m/month. No other major office market recorded higher growth in the prime rent. Rental growth in Munich is also significantly ahead of that in other cities when compared over the last five years. Since 2010, the prime rent in the Bavarian state capital has increased by 19%. The average growth across all top six markets stands at 7.8%, driven by Munich as well as Düsseldorf (+10.6%) and Berlin (+7.7%). The year-end prime rent in Munich is the highest since 2001. Such growth underlines Munich's position as one of the most attractive office locations in Germany. This was also reflected in the average rent, which rose significantly compared with the previous year to €15.85 per sq m/month, equating to growth of 4.3%. This is the highest average figure since 2002. Here too, there has also been significant growth over the last five years. The increase of 9.3% has only been exceeded by Cologne (+13.7%). Across all six markets, the average rent has risen by 3.3% since 2010.

More lettings in the city centre

One reason for the rental growth is the greater number of high-value lettings compared with the previous year. In the centre of Munich in particular, the number of deals rose by more than a third, from fewer than 100 in 2013 to more than 120 last year. There was even stronger growth in the number of completions for more than 1,000 sq m in this submarket, which more than doubled to 22 deals. The corresponding take-up increased by more than 50% to 77,000 sq m. Consequently, the city centre's share of overall take-up rose from 8% to 12%. However, the City West submarket led the rankings with a 14% share (2013: 22%), followed by Stadtrand Nord (outskirts north) with 13%.

Vacancy rate decreases further by 20 basis points

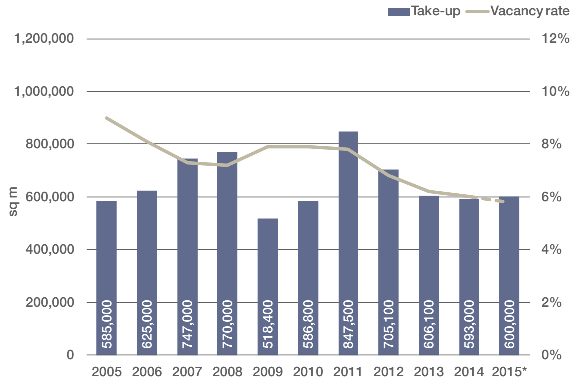
The vacancy rate fell by a further 20 basis points to 6.0% in 2014; the lowest level for 12 years. Towards the centre, available supply is particularly scarce. This situation is also unlikely to be significantly improved by large development completions this year. Against this background, many tenants in Munich are also opting to extend existing leases rather than leasing new space.

Further rental growth expected

Take-up in 2015 should at least equal the level achieved last year. The vacancy rate is expected to fall marginally further to below 6% owing to continuing conversions of space no longer suitable for the market to other uses, such as residential, and the fact that only a small amount of new space will come to the market. Around 130,000 sq m is scheduled for completion; some 18% less than in 2014. Furthermore, almost half of this space is already pre-let. This will have a positive impact on rental growth. Both the prime and average rent are expected to rise further in 2015.

GRAPH 24

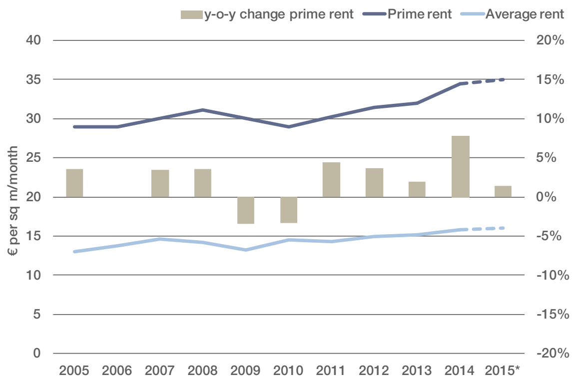
Take-up and vacancy Take-up just below previous year's level



Source: Savills / * forecast

GRAPH 25

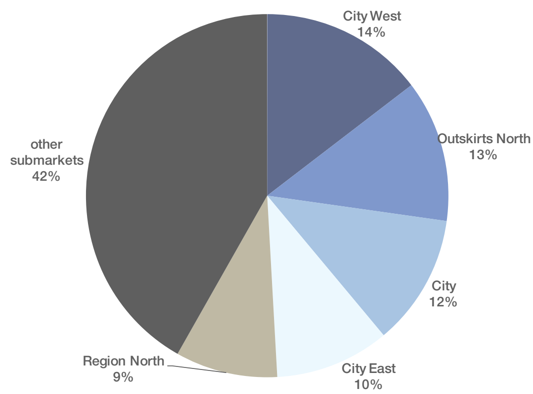
Rental levels Prime rent with significant upward tendency since 2010



Source: Savills / * forecast

GRAPH 26

Take-up by submarket Significant higher activity in City than in previous year



Source: Savills

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