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Press Release

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Office space constrained across global markets as co-working and knowledge economy continue to expand

Avison Young releases its Mid-Year 2019 Global Office Market Report

Toronto, Canada — Against a global backdrop of diminishing business confidence and a weaker outlook for economic growth, a robust labour market in the world's largest economies continues to underpin demand for office space with high employment levels prevalent across a number of major markets. Demand continues to be driven by the knowledge economy, with the co-working boom continuing to broaden its reach across major markets, forcing traditional landlords to adapt their offering in order to best accommodate existing and potential occupiers.

These are some of the key trends noted in **Avison Young's *Mid-Year 2019 Global Office Market Report***, released today.

The report covers 79 office markets in eight countries across the globe: **Canada**, the **United States**, **Mexico**, the **United Kingdom**, **Germany**, **Poland**, **Romania** and **South Korea**.

"Despite increasing headwinds and political uncertainty, the relative health of the economy and labour markets continues to provide a positive foundation for office space demand across major global markets," comments **Mark E. Rose**, Chair and CEO of Avison Young. "We continue to see significant development in urban areas of major metropolitan markets across all countries in which we operate. The impact can be seen on city skylines, which are changing rapidly, and in the delivery of new forms of workspace driven by organizations that are constantly adapting to their changing workforces and new technologies."

Rose continues: "The large development pipeline is being more than offset by robust demand. This situation is particularly true for good-quality class A space with preleasing levels at historic highs."

According to the report, of the 79 office markets surveyed by Avison Young in North America, Europe and Asia, which comprised 7.5 billion square feet (bsf), market-wide vacancy rates declined or remained flat in almost two-thirds of the markets as more than 126 million square feet (msf) was absorbed on an annualized basis – up 12% compared with the prior 12-month period.

The report goes on to say that construction cranes remained prominent fixtures across many skylines as nearly 84 msf of office space was completed during the 12-month period, while another 253 msf was under construction at mid-year 2019 (40% preleased) – up 16% year-over-year.

For the most part, sound leasing fundamentals continue to attract investor capital to the office sector. Investment sales volumes for the 12 months ending at mid-year 2019 were up at least marginally year-over-year in all of the countries covered in the report, with the exception of the U.K.

“The most significant story now is the proliferation of co-working space,” says Rose. “The ever-increasing demand for flexibility from occupiers, as well as the evolution of technology, has resulted in a co-working boom across the globe. This growth has led to new markets being opened for providers of shared workspace.”

He adds: “Office market fundamentals continue to be sound across both the U.S. and Canada, with robust demand continuing to drive down vacancy levels in most major markets. In the U.K., the looming Brexit deadline has done little to stymie demand, while in Germany, leasing activity continues to be above average.”

CANADA

Canada’s office market posted positive absorption of 9 msf in the 12 months ending June 30, 2019 – significantly more than the nearly 6 msf absorbed in the prior 12-month period. Demand was strongest in Toronto, Montreal and Vancouver, while Calgary finished in positive territory. Consequently, Canada’s overall office vacancy trended lower, falling 120 basis points (bps) year-over-year to end first-half 2019 at 10.3%. Urban intensification and surging demand from tech and co-working companies in major markets are driving absorption in downtown office markets, with 12-month absorption almost doubling year-over-year to 4 msf – more than half of that absorbed in Toronto. Meanwhile, Vancouver (1.9%) surpassed Toronto (2.1%) to register the lowest downtown office vacancy in Canada – and North America.

“The labour market remains the major catalyst for Canada’s economic expansion and thriving commercial real estate sector,” says **Mark Fieder**, Avison Young Principal and President, Canada. “Urban intensification boosted by immigration, a growing knowledge-based economy and the rising co-working industry have powered Canada’s office market. A global phenomenon, co-working is taking Canada by storm and prompting landlords and tenants to adapt. Meanwhile, the growing technology sector is taking a bigger slice of the leasing pie – especially in Vancouver, Toronto, Montreal and Ottawa – and, in many cases, driving innovation within traditional businesses.”

Developers are doing their best to keep pace with the robust demand, as more than 21 msf was under construction at mid-year 2019 – an increase of 40% year-over-year. Downtown construction outstripped the suburbs by more than twofold. Toronto had the most overall (11.4 msf) and downtown (9.7 msf) office space under construction in Canada, trailing only New York (14.6 msf) among North American markets.

U.S.

In first-half 2019, the U.S. continued to experience an ongoing flight to quality, asset repositioning and adaptive reuse of obsolete office buildings in the country’s 5.3-bsf office market. The ever-increasing co-working space model is forcing other landlords to offer flexible workspaces and lease terms, as well as plug-and-play tenant fit-outs. Overall vacancy continued its downward trajectory, and the market reported an 11.5% vacancy rate at mid-year 2019, improving 50 bps year-over-year, while class A rents ticked further upward.

New development of office product increased and 116.3 msf was under construction as of June 30, compared with 98.9 msf underway one year earlier. And most U.S. markets reported positive net absorption and significant take-up amounts. In spite of elevated construction, further improvement in office market indicators is expected based on preleasing levels.

“It seems clear that transit-oriented developments rich in amenities or new, first-class spaces will win the leasing race, and tenants have displayed a willingness to pay higher rents on a per-square-foot basis while looking for efficiency through design and technology. Look for that trend to continue into 2020,” says **Earl Webb**, Avison Young’s President, U.S. Operations. “Sales volume increased year-over-year even while cap rates remained flat. The highest 12-month volumes were reported in New York, Washington, DC and the tech-heavy markets of Boston and San Jose/Silicon Valley.”

Mexico

The Mexico office market’s overall average monthly asking rents ranged from US$13.66 per square metre (sq. m) to US$22.06 per sq. m, depending on the city, across the country. Nationally, the inventory continued to expand by 6.3% year-over-year, and the overall office vacancy rate decreased 9.6% compared to second-quarter 2018. Net absorption remained positive during the 12 months ending at mid-year 2019, reaching a total of 1.4 msf across the country. Of this figure, Mexico City accounted for 80% and Monterrey 9.8%.

The amount of office space under construction has increased 3.1% across the country compared with one year earlier. Construction activity will add 25.7 msf of new office space in the next four years, representing 19% of the current inventory.

“The office market in Mexico continues to show strength in spite of a slowdown in the Mexican economy due to the economic policies being implemented by the new government,” says **Guillermo Sepulveda**,” Avison Young Principal and Managing Director of the company’s Mexico City office. “Additionally, developers have put many of the new projects already in the pipeline on hold until urban development policies and future behaviour by the authorities governing new development become clear. Thus, for the remainder of 2019, we can expect growth in office inventory to suffer a significant slowdown and, should absorption continue at present levels, for the vacancy rate to end up at 12% or 13% by year-end.”

United Kingdom

Despite economic uncertainty, demand for U.K. office space continues to be robust. Over the last 12 months, the market has witnessed some of the strongest activity on record across major cities.

“Demand is particularly strong for grade A space, with preletting accounting for a large proportion of activity,” comments **Charlie Toogood**, Avison Young Principal and Managing Director, Offices, U.K. “Conversely, smaller second-hand space is becoming increasingly difficult to let, a situation which is partly attributable to the growth of the co-working sector. The two largest deals outside of London during second-quarter 2019 were completed by co-working firms as 120,000 sf was let to Spaces at 125 Deansgate in Manchester and 92,000 sf was taken up by WeWork in

Birmingham. We believe this activity is a prelude to a greater expansion of co-working's presence in the country's key regional cities."

Toogood adds: "Strong demand and low grade A supply are creating rental-rate growth and putting downward pressure on incentives, particularly in the regions that continue to offer a considerable rent discount to London. This situation is unlikely to change in the short term due to constrained development pipelines in almost all markets."

Germany

Germany's office leasing and investment markets continue to thrive in 2019. Although several risk factors were prevalent through first-half 2019, thus putting pressure on the German export-driven economy, demand has remained noticeably above average. Growth factors include a solid national economy with a fast-growing business-services sector, favourable financing conditions and the gap between real estate prime yields and government bonds.

A half-year record of 1.6 million sq.m was let in Germany's top five markets (Berlin, Duesseldorf, Frankfurt, Hamburg and Munich) during first-half 2019. Munich was a stellar performer with 421,000 sq. m let, followed by Berlin (411,000 sq. m). With the exception of Munich, where the record half-year result from 2017 could not be sustained due to lack of supply, all markets recorded stable or rising take-up levels. Year-over-year, office vacancy further decreased in all of the top markets. Collectively, vacancy decreased 16% in the 12 months ending at mid-year 2019. Berlin (1.4%), Munich (2.4%) and Hamburg (3.5%) will remain landlords' markets in the medium term. Rents have continued to rise. Across the top-five markets, prime rents rose 6% year-over-year with Berlin recording the strongest growth at 11%.

"Although we have seen a remarkable rise in construction activity in all of the top markets, the shortage of supply will remain a major challenge for tenants in the medium term," states **Nicolai Baumann**, Avison Young Principal and Managing Director of the company's Berlin office. "Especially in Berlin, Munich and Hamburg, the lack of vacant space is a severe obstacle for companies on a growth path. Vacancy rates around and below 3% are certainly a threat for further economic growth. However, given the confidence that investors and developers have in the German market, we anticipate further sustainable growth in supply and a return to more moderate-rent developments."

Poland

The Warsaw office market expanded by 100,000 sq. m new space between mid-year 2018 and mid-year 2019. Currently, the office space under construction totals 780,000 sq. m, and new developments are expected to be delivered in the coming months. The high demand for office space perfectly corresponds with decreasing vacancy, which as of second-quarter 2019 averaged 8.6%.

"Although market prices have remained relatively stable over the past year, we have recently noticed an increase in asking rents due to the relatively low level of new space delivered and the high demand for office space, especially in the central business district," notes **Michał Ćwikliński**, Avison Young Principal and Managing Director of the company's Poland region. "At the same time, construction material and labour costs, as well as prices of investment plots, remain at high levels, putting more upward pressure on office rents."

He adds: "During the period under review, active tenants included companies providing business-to-business services and firms offering flexible office space. These two tenant groups drove the high demand for new office space in the past year. This trend is being observed not only in Warsaw, but also in the major regional cities of Kraków, Tricity, Wrocław and Poznań."

Romania

All facets of Romania's office market show signs of maturity. On the supply side, the market is witnessing a strong commitment from international institutional developers to grow their portfolios, as well as high standards and competition among local developers who made landmark deals in the last 12 months. Bucharest achieved a milestone in first-half 2019 as its modern office stock surpassed 3 million sq. m, providing a positive outlook on the forthcoming pipeline in cities outside of the capital.

Demand is being fuelled by the IT and outsourcing sectors, which represent almost 50% of the take-up – a trend that has been consistent since the beginning of this economic cycle. As headline rents are stable and there is steady demand, landlords are likely to decrease new-tenant incentive packages while pushing for longer lease terms. The co-working trend is receiving more and more attention with the advent of WeWork, which recently preleased 8,000 sq. m in the new Matei Millo Office Building being developed by Forte Partners in downtown Bucharest.

'We had a solid take-up of 390,000 sq. m leased in the 12 months leading up to the end of second-quarter 2019," says **David Canta**, Avison Young's Principal of Bucharest Operations and Managing Director of Avison Young's Bucharest office. "Also, the development pipeline is at an all-time high with more than 500,000 sq. m to be delivered by year-end 2020. These results are indicative of a market where all stakeholders are raising the bar to meet the increasing demands of a maturing market."

Korea

The Seoul office vacancy rate dropped 150 bps year-over-year to 8.7% at mid-year 2019, the lowest rate recorded in two years. The suburban vacancy rate (9%) was slightly higher than the downtown level (8.7%) but fell 370 bps from one year earlier, far exceeding the downtown vacancy-rate decline (70 bps). In particular, the vacancy rate for new suburban office product has fallen sharply in the last two years.

Seoul office investment volume totalled ₩13.3 trillion in the 12 months ending June 2019, up 44% compared with the prior 12-month period. During the same period, the average investment sale price rose 4.1% to ₩6.5 million per sq. m, while the average office cap rate fell 20 bps to 4.7%.

"The recent growth of co-working space in the Seoul office market has been expanding in the suburban office area as co-working operators extend their reach beyond the downtown market," states **Injoon Choi**, Principal of Seoul Operations and Managing Director of Avison Young's Seoul office. "Following its best-ever result in 2018, the Seoul office investment market remained strong in the first half of 2019. With liquidity high and commercial mortgage rates relatively low at 3%, office sale prices continue to rise."

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