Adaptive Spaces

European flex office market update H2 2024

REPORT

CBRE RESEARCH
NOVEMBER 2024

Positive signs as operator take-up increases

Introduction

Our latest European Office Occupier Sentiment Survey results have reinforced the positive sentiment towards Flex (defined by CBRE as a less than three-year commitment, typically turnkey fit-out, and managed by a third party). This increased interest has led to heightened operator activity in 2024, with a focus on more mature markets. While growth in Flex take-up has outstripped conventional office take-up, there remains a significant gap between occupier demand and the available supply.

CBRE has previously explored management agreements as a possible means to bridge the gap between landlords and operators, thereby improving the availability of Flex space. With the same aim in mind, insights into demand and supply dynamics and micro location intelligence can help identify areas where additional space is needed, presenting opportunities for landlords, investors, and operators.

Operator sentiment H1 2024 update

Leasing patterns

The broader economic landscape improved slightly in H1 2024, as declining inflation led to more positive expectations around the future path of interest rates and debt costs, raising confidence in business investment and consumer spending.

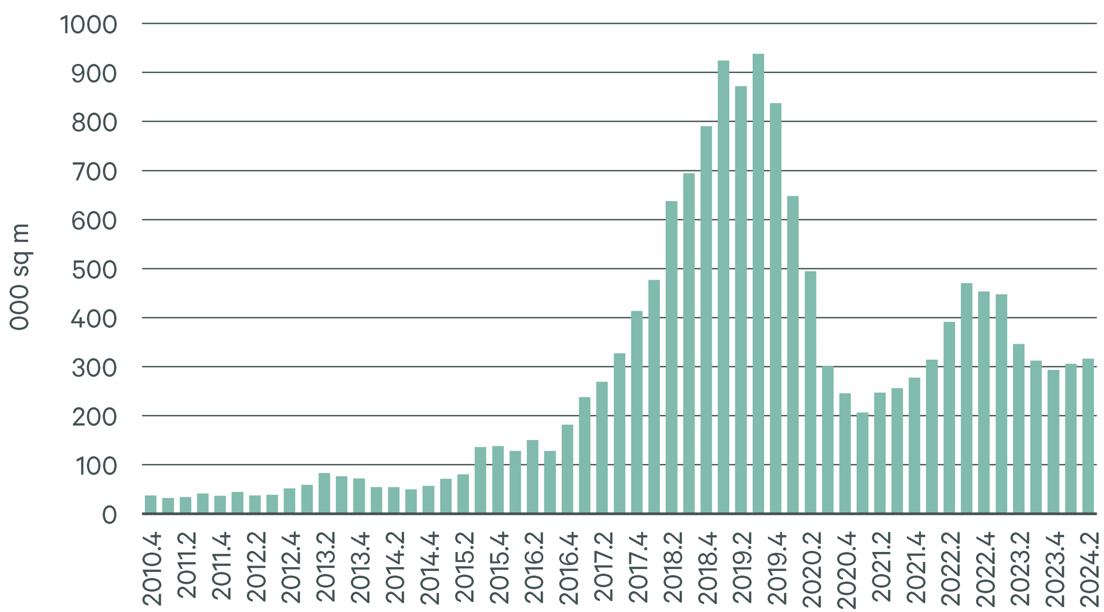
This has been reflected in recent operator take-up in H1 2024, which was up 17.5% against H1 2023. Demand was concentrated in four of the 32 main markets, with London, Paris, Madrid, and Barcelona collectively accounting for 45% of take-up across the key European markets in H1 2024.

Market penetration rates leave occupier demand untapped

Despite an increase in take-up in H1, overall growth in Flex stock has reduced year-on-year, registering 3.1% growth to the year ending Q2 2024, down from 6.1% year-on-year growth to the end of Q2 2023. It remains to be seen whether a strong performance in H2 will boost the long-term growth rate, as indicated by take-up levels in H1. Nevertheless, the Flex market has continued to grow more rapidly than the traditional office market, which saw 0.9% year-on-year growth of total stock to Q2 2024. This has driven the European Flex penetration rate (flex stock as a percentage of total office stock) up to 2.45% in aggregate.

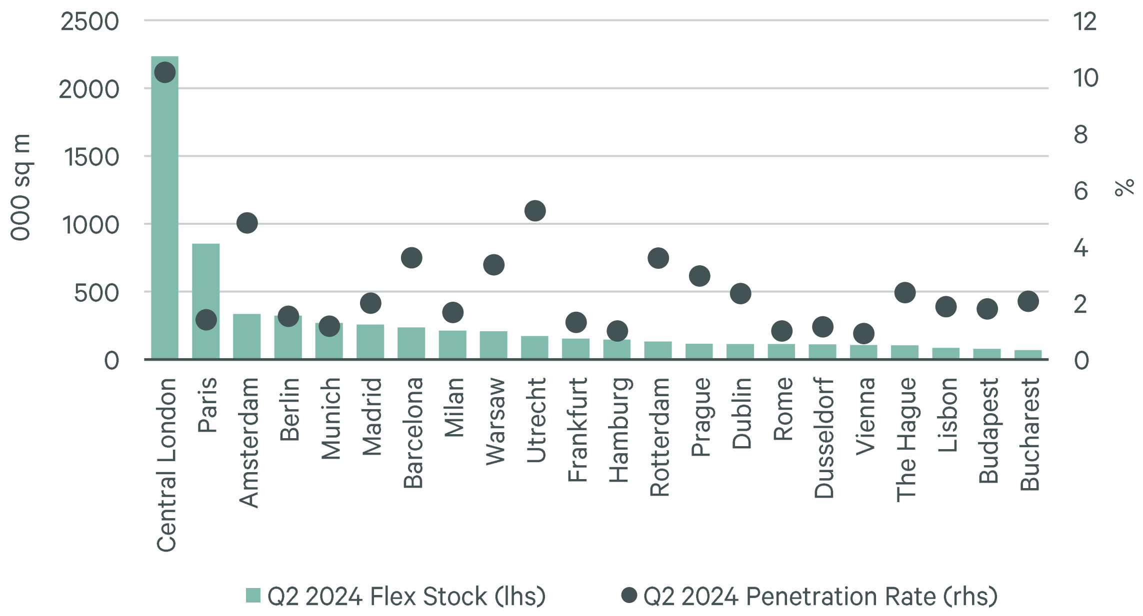
However, in many major European cities, Flex penetration rates still hover around 2%, and the growth in Flex stock is being outpaced by the demand for Flex space, leading to supply pressure in certain markets.

FIGURE 1: Operator take-up of space, Europe, 2010-2024 (Rolling 4Q aggregates)



Source: CBRE Research

FIGURE 2: Flex stock and penetration rates



Source: CBRE Research

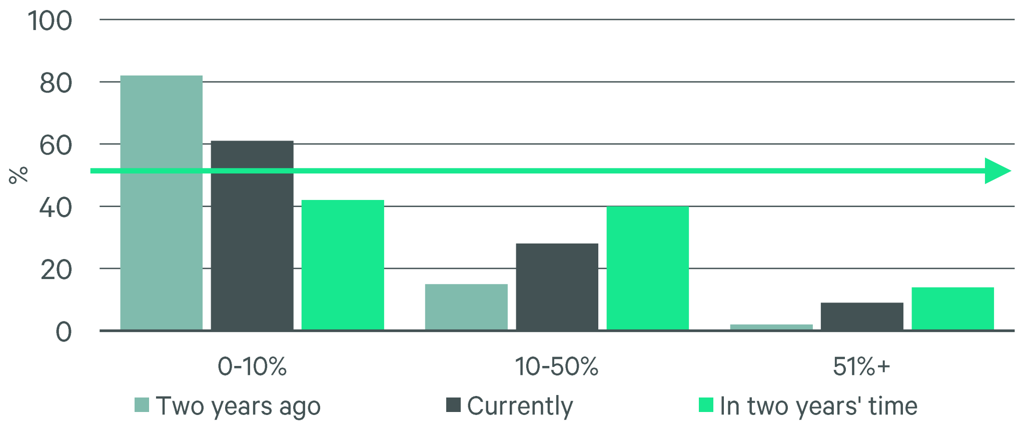
Occupier review

Occupier sentiment towards the use of Flex as part of an accommodation strategy remains strong. CBRE's European Office Occupier Sentiment Survey 2024 indicated that just over 60% of corporate occupiers have no, or only a very small amount (0-10%), of Flex space in their portfolio, a decrease from 82% just two years ago. This proportion is expected to decline further, with only 42% expecting to have 0-10% Flex space within two years.

Correspondingly, the proportion that have between 10-50% of their portfolio in Flex, considered a moderate amount of flexibility, is now 28% (up from 15% two years ago), and 40% expect to be in this band within two years. Currently, 9% of companies have a high amount of flexibility in their portfolio (>50%), up from 2% two years ago.

These clear indications of future demand for Flex suggest the conditions may be right for a meaningful expansion of Flex stock. However, as previously indicated, many markets are currently well below the level that would allow companies to have these levels of flex space in their portfolios.

FIGURE 3: What percentage of your portfolio is made up of flexible office space?



Source: CBRE Research, European Office Occupier Sentiment Survey 2024

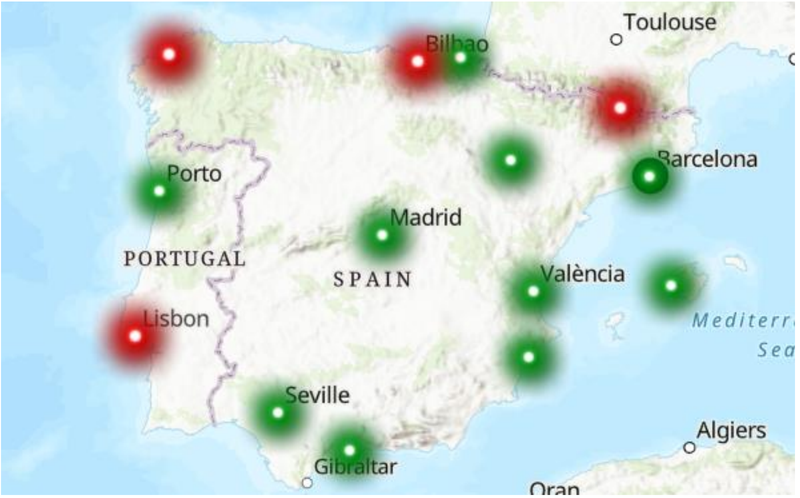
Making sense of the misalignment of demand and supply

To assist landlord and operator clients, CBRE is leveraging its market-leading position to utilise data and insights that provide clarity in the decision-making process of whether, when, and where to open a new Flex office.

CBRE's new Finder of Market Opportunities (FOMO) tool allows the analysis of deep data sets of market fundamentals, highlighting where it makes most sense to deliver new Flex space. The tool uses key market drivers such as known demand (registered requirements from occupiers), Flex supply (including pricing), traditional office dynamics, locations of current occupiers, existing amenity, travel infrastructure, and other relevant data sets.

At a broad level, the tool can show hot and cooling markets (Figure 4). A green market represents more deal activity in the current year compared to the previous year, while a red market signifies a decline in activity compared to the previous year.

FIGURE 4: Desk transaction momentum heatmap, Spain & Portugal 2024 vs. 2023



Source: CBRE FOMO, ArcGIS

FOMO: an example in Barcelona

FOMO in action

FOMO can also be used for more detailed analysis. Suppose an operator wants to open a new Flex office and has identified Barcelona as a possible market. The operator's model targets tech companies seeking a premium offering. FOMO can help provide the justification and the evidence to support the business case.

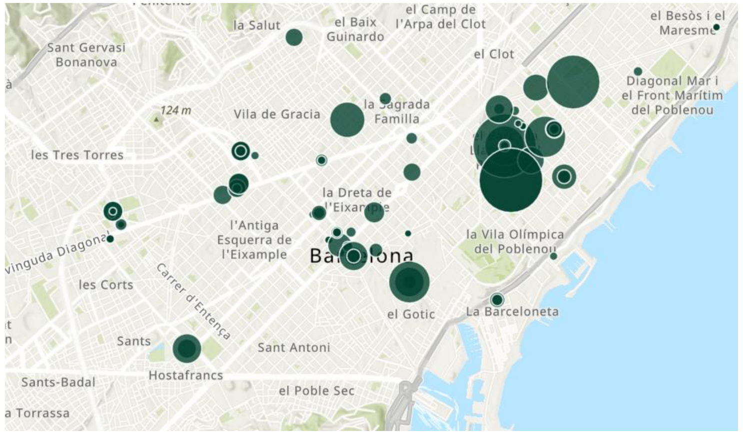
Firstly, how much demand is there for Flex office space in Barcelona? The green dots show the location and size (no. of desks) of each requirement. This can be filtered by size, sector, and sub-sector to determine optimum design and build-out.

Supporting the underwriting model

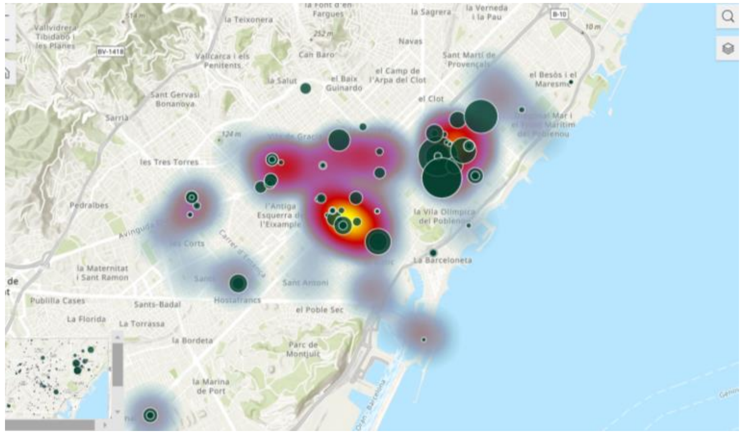
By overlaying the desk pricing heatmap, CBRE can identify which locations within the city can support the level of investment required. In this case, given the operator is planning to provide a premium experience, the search can be focused on the two areas with yellow centres.

Other pools of demand

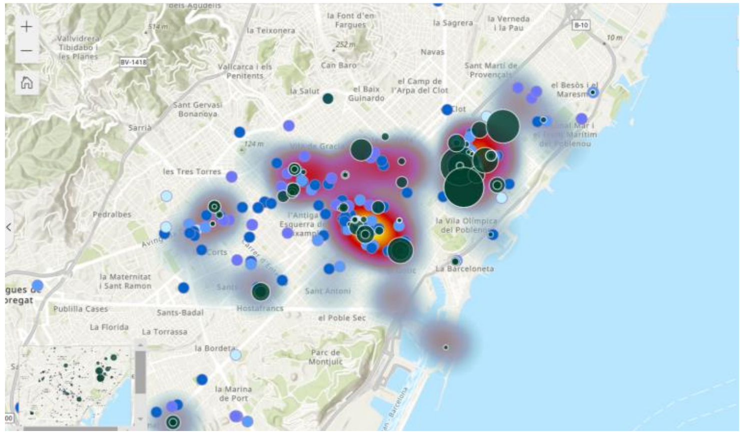
Some demand categorised as traditional office demand might be absorbed by Flex space and can be considered potential demand. By overlaying this traditional office demand (the blue dots, shaded by building size), it can be seen that high Flex desk pricing corresponds with strong demand for traditional office space. This alignment provides additional confidence in focusing a search in these areas.



Source: CBRE FOMO, ArcGIS



Source: CBRE FOMO, ArcGIS

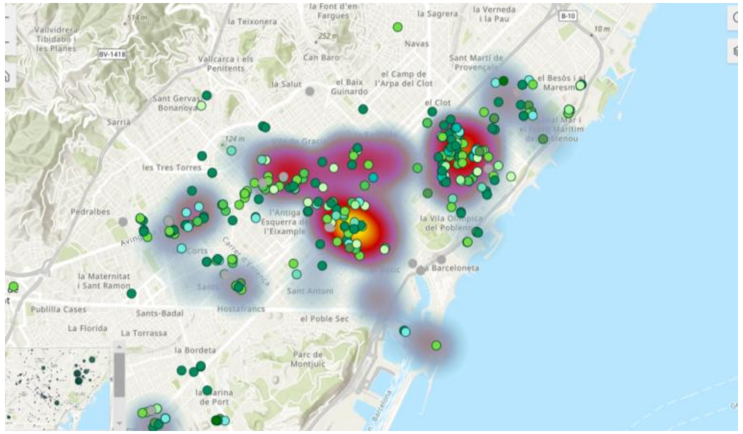


Source: CBRE FOMO, ArcGIS

FOMO: an example in Barcelona

Sector clustering

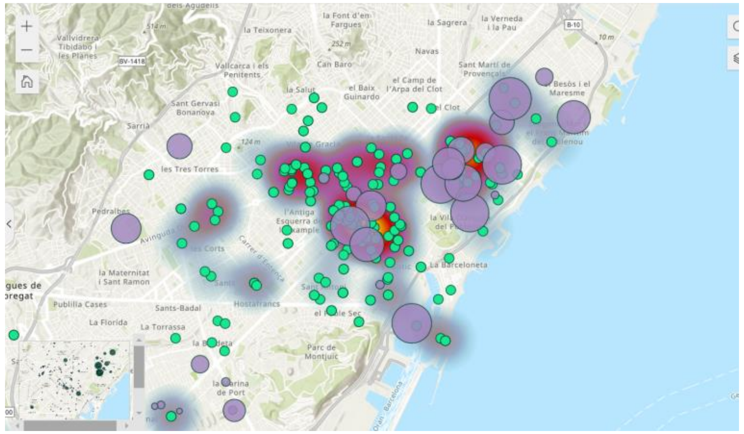
The operator’s model is designed to attract tech companies. By overlaying the locations of current tech company, CBRE can identify clusters and further refine the data based on their current office size and sub-sector.



Source: CBRE FOMO, ArcGIS

Monitoring supply

With a better understanding of the target area(s), the next step is to identify if there are suitable buildings available in those locations. Purple dots indicate available options, while green dots indicate where competitors are located. By clicking on each dot, it is possible to obtain detailed information about the competitors and their offerings in that location.

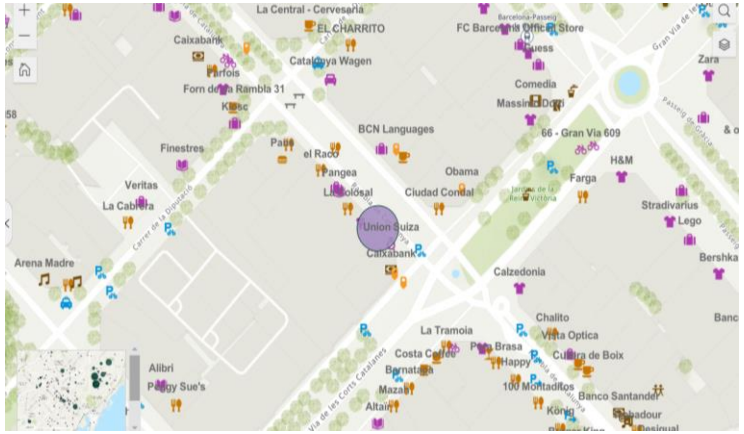


Source: CBRE FOMO, ArcGIS

Good neighbours?

Zooming in on local details and layering on shops and amenities provides a glimpse into the local live-work-play ecosystem. Further layers can include transport, employment rates, household income, consumer spending and footfall, offering a detailed view of the micro-location revealed by this process.

FOMO is now available to help operators and owners in making data-driven decisions when seeking to underwrite the business case for flex. Please get in contact if you would like to learn more.



Source: CBRE FOMO, ArcGIS

Case Study: Management Agreement Innovation Barcelona

Once the most relevant operating model and the right micro-location have been decided upon, the last hurdle to be cleared is striking a deal that works for all parties.

The owner-occupier of 390 Carrer Diputacion, an office building in Barcelona, decided to end their own occupation of the building and lease it. The owner had no experience of the Flex market and planned to market on a traditional lease basis, post-refurbishment.

CBRE was appointed to advise on the marketing and advocated for Flex as a higher-returning model for the landlord; providing research and data that gave an objective view of the opportunity.

CBRE approached a number of operators as part of the marketing strategy. Aticco, one of Spain's leading Flex operators, expressed interest in operating the asset under a management agreement that aligned with their expansion strategy.

CBRE negotiated on behalf of the landlord, resulting in a management agreement that protects the interests of the landlord while enabling the operator to expand its portfolio. Under this agreement, the landlord was to receive a preferential share of the operating margin and staged repayment of an element of the refurbishment CapEx that they funded. These terms are anticipated to yield medium-to-long-term returns for the operator, encouraging a stronger partnership. The operator found these conditions agreeable, given their positive outlook on the Barcelona Flex market.

By signing this management agreement, the landlord secured an occupier for on attractive terms (with the agreement's value being 25% higher than their target rental rate under a traditional lease). At the same time, the operator expanded its portfolio without initial capital investment.

> Working alongside CBRE in this transaction has been an incredibly positive experience. Through their continuous support throughout the process; their attention to detail and their professionalism, they structured an innovative and secure deal; helping us achieving an important objective for our company.

Gabriel Espin
Co-Founder & CEO, Aticco

> This transaction shows how operator and landlord interest can align - the landlord can ride the wave of occupier demand for flex, while relying on the professional management of a dedicated operator. The operator can expand at pace, without too much financial exposure, resulting in the desired result for both.

Salvador Aguilar
Head of Flexible Office Solutions, CBRE Spain

Source: Aticco

Key takeaways

01

Operator take-up was up 17.5% in H1 2024 vs. H1 2023, an improvement on the equivalent H2 23 vs. H2 22 comparison, which was 24% down.

02

Take-up is heavily concentrated in key markets of London, Paris, Madrid and Barcelona, which captured 45% of European demand collectively.

03

The year-on-year growth rate of Flex stock has slowed to 3.1% in the year to the end of Q2 2024, compared to 6.1% in the year to end of Q2 2023.

04

The European Flex penetration rate increased to 2.45% of the total office market.

05

CBRE's occupier survey shows that the **proportion of companies with small amounts of Flex space in their portfolios is declining, while those with a greater amount of Flex are rising.** This trend is anticipated to continue over the next two years.

06

CBRE's new FOMO Tool will be launched to facilitate data-driven location analysis, and operators will be able to make faster decisions with increased certainty.

07

FOMO leverages proprietary CBRE data and insights to provide a clear view of micro-location demand and supply within a market.

08

Management agreement innovation continues at pace and is becoming main structure for operator growth in some markets.

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