CBRE

Evolution and growth: Looking to the year ahead in European flex office markets

CBRE's 2022 Flex Report highlighted the sector's progress towards recovery. New supply of flexible office space was on the rise and, with increased occupier appetite, take-up across major markets was returning towards its pre-pandemic levels. There have been a lot of changes since then, including a fluctuating short-term economic picture, high inflation and rising interest rates. Against this background, how have European flex markets performed and where are they positioned now?

- Transaction volumes and occupier enquiries continued to accelerate through 2022. Uncertainty in the wider office market is a short-term positive; and flex options are increasingly featuring earlier and more integrally in portfolio decisions
- Operator take-up of flex space was over a third higher in 2022 than the previous year, and stock was up 10%. We expect to see a broadening in the range and type of operators in the market in 2023, and activity continuing to permeate into smaller markets
- Major landlords are evaluating and testing flex concepts and we expect to see delivery of landlord-managed space broadening from its core markets of the UK and Spain. Landlords may also become more amenable to management agreements
- Other areas to watch are the growth of aggregators that allow on-demand space booking across multiple platforms; expansion in the range of demands occupiers make of flex space and, consequently, a more varied and responsive landlord offer

Occupier sector

In our 2022 Occupier Survey, our clients indicated a strong intent to increase the percentage of flex space in their portfolios, with the majority expecting flex space to account for at least 10% of their portfolio within two years. While structural barriers such as existing lease obligations and operational considerations (technology, security, etc.) may constrain this, there is a significant gap between corporate appetite for flex space and current availability as evidenced by the amount of flex space in the main markets. The key question through the second half of 2022 was how the changing economic climate would impact occupier sentiment.

Strong second half with tech demand prominent

– **Continued demand growth in H2** – The second half of 2022 showed no signs of a decline in occupier demand, with volumes in both enquiries and completed transactions increasing across the region. In total, CBRE recorded a 37% increase in completed transactions in Europe compared with 2021

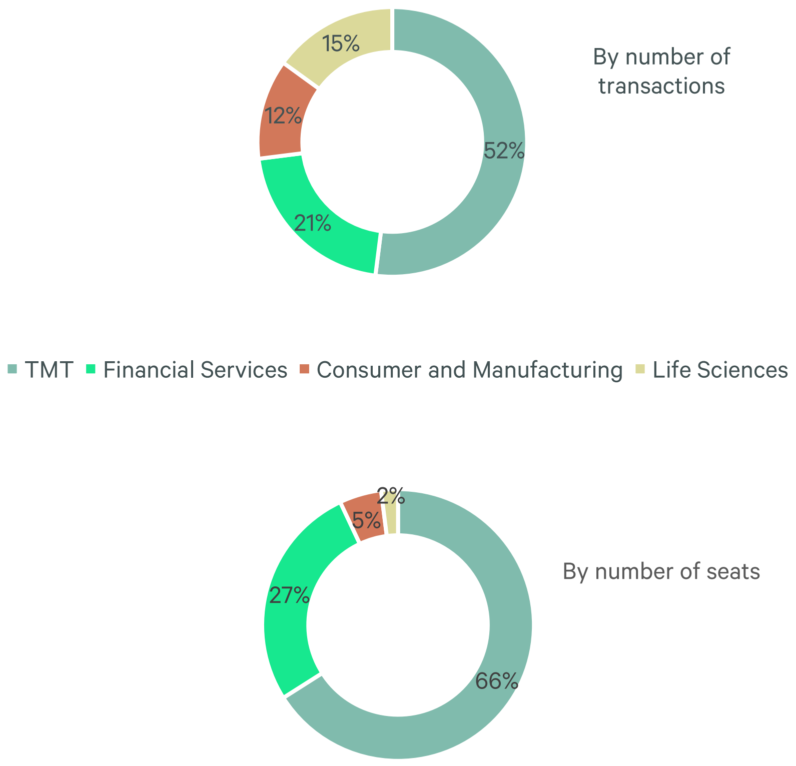
– **Technology, Media and Telecoms (TMT) continue to dominate activity** – While we observed flex transactions across a broad range of sectors, the TMT sector contributed 52% of transactions by number of deals, and 66% by number of seats acquired. Financial and Professional Services (FPS), who were particularly active in 2018/9 contributed a further 27% of seats, with lower levels of activity in the Consumer and Life Sciences sectors (both less than 10%). Despite lower levels of activity in Life Sciences, a number of our clients in this sector have been, or are, going through business divestment programs which have incorporated a significant component of flex space as part of their broader real estate strategies

Flex becoming core part of decision processes

– **Fundamental drivers for flex remain** – Ongoing uncertainty around business demand remains a key driver for flex activity, particularly in the TMT sector, in conjunction with speed to occupy and limited CapEx budgets. We do not anticipate these changing in 2023, although the slowdown in demand from the financial sector can be partly attributed to focusing on return-to-office strategies for core buildings

– **Deeper and more strategic engagement with flex market** – Our teams advising occupiers at a more strategic and portfolio wide level for flex have seen a marked increase in 2022. Typical projects include structured regional and global flex roll-out programmes, negotiation of global operator framework agreements, core and flex strategies for larger locations and broader engagement with on-demand solutions. We expect this to continue in 2023, along with a continued blending of traditional and flex demands

FIGURE 1: Sector composition of CBRE flex activity, 2022



Source: CBRE Flex Team

Operator sentiment

Q4 2022 represented another strong quarter of flexible office leasing across the main European markets, as operators revive strategic expansion plans. Take-up was above that of the corresponding quarter in 2021 and on a full-year comparison, leasing of space by flexible office operators in 2022 was 35% above 2021 levels. This has contributed to net growth in overall flexible office stock of around 10% compared with the end of 2021, reaching 4.7 million sq m across the key markets.

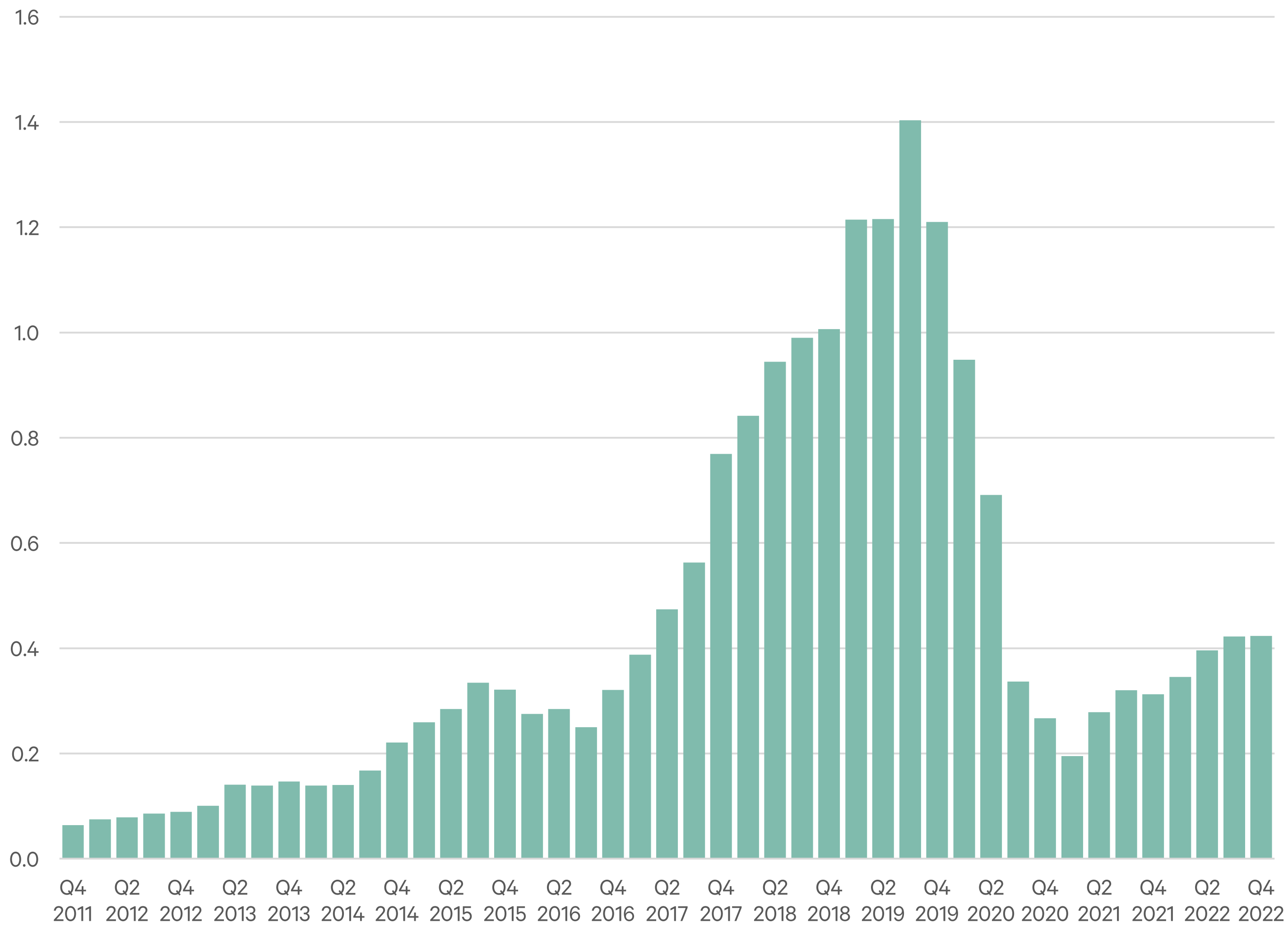
Key operator activity trends

– **Short-term pause in demand followed by steady growth into 2023** – A brief pause in operator leasing activity in the second half of 2022 reflected the level of economic uncertainty, but given continued occupier demand, we expect growth to return, albeit likely at a more moderate rate in 2023

– **Growth not just focused in major traditional flex markets** – While there is an inevitable focus in operator growth in the core European markets, we have seen a rising demand and associated market penetration in other smaller markets such as Budapest, Prague, Krakow and Porto

– **Market participants continue to diversify** – We continue to see a broader range of operators across Europe, including local operators and, increasingly, cross-border expansion. These operators are continuing to put pressure on the larger players, both in terms of quality and pricing. At the same time, we are seeing an increased appetite to consider M&A, with smaller, local operators being taken over by larger, more acquisitive groups. Closed deals in 2022 were limited but examples included TOG/FORA and Industrious' acquisition of Welkin & Meraki. We expect selective growth in 2023

FIGURE 2: Operator take-up of space, Europe, 2011-2022 (Millions Sq M; Rolling 4-quarters aggregates)



Source: CBRE Research

TABLE 1: Recent CBRE-advised portfolio transactions

Client	Number of sites	Time taken (months)	Driver
Organon	80 globally	12-15	Spin off of new company
Global consumer goods company	31 globally	9-12	Spin off
Global pharmaceutical company	20-25 globally	3-6	Spin off
Leading tech imaging company	15 globally	18-24	Business transformation
Leading tech company	35+Europe	18-24	Market expansion

Source: CBRE Flex Team

Case Study

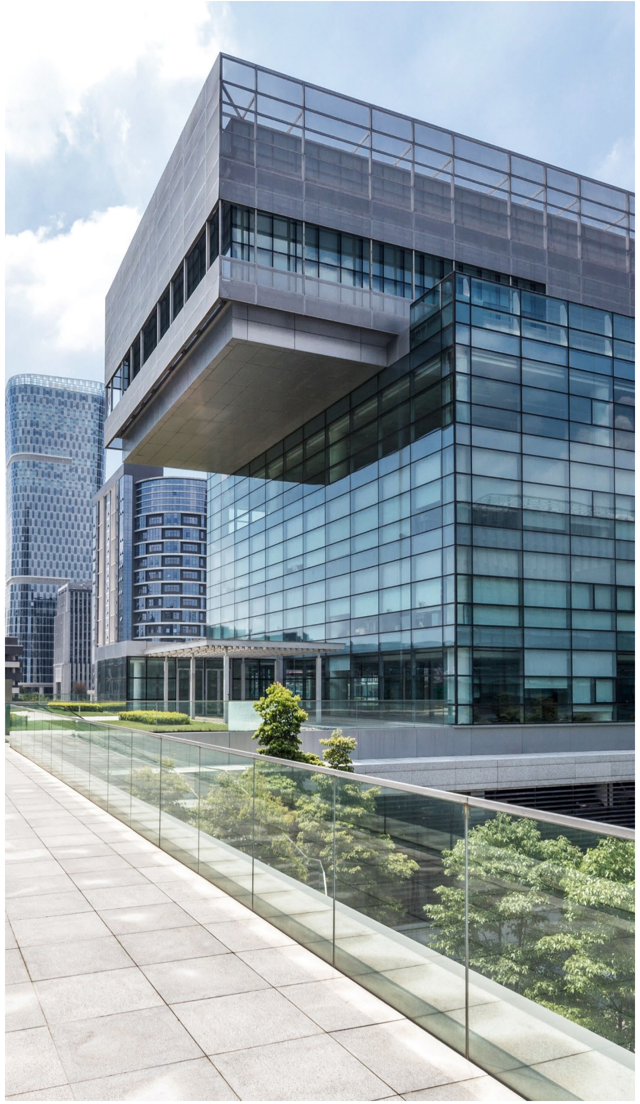
Flex Portfolio Transactions

Responding to demand for innovate flex transactions from our occupier clients, we are leading the way in advising clients on portfolio deals where multiple flex offices are acquired in one deal or a programme of deals.

These are often linked to a global framework or master service agreement (MSA) negotiated between one or more operators and an occupier to enable these transactions.

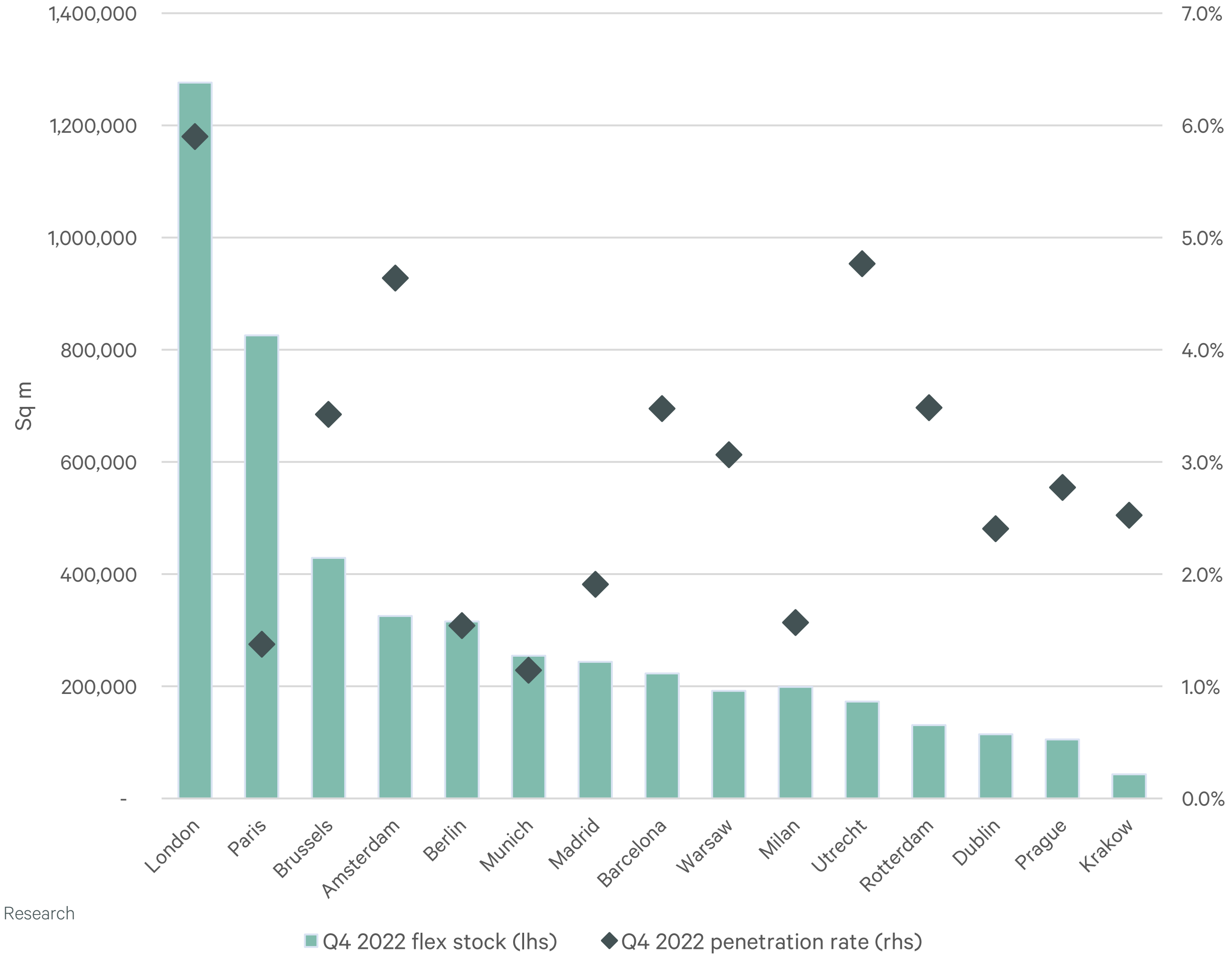
The business drivers for these deals include change in operating model, corporate restructuring (M&A/divestment etc), cost saving or growth. These deals are attractive to companies seeking to acquire space quickly in multiple markets with a standardised approach and workplace outcome, often involving little or no capital and without the need to hire multiple contractors or consultants to achieve.

These deals also provide inherent flexibility in the outcome i.e. shorter term contracts which can be particularly valuable in times of uncertainty as experienced through the pandemic period, or for new embryonic initiatives when headcount is liable to fluctuate. These advantages can also outweigh the price premium often attached to flex space by avoiding overreaching in terms of space and length of commitment, and therefore overheads.



Occupier sector

FIGURE 3: Flex stock and penetration rates, top 15 markets



Source: CBRE Research

Note: Penetration rate represents flex stock as a percentage of total office stock

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Market penetration rates still point to significant room to grow – Despite operator expansion, the flex sector still only represents just over 2% of total regional office stock. Among the major markets, only London and Amsterdam have serviced space representing more than 5% of total stock. With consensus estimates across the region for anywhere between 10%-20% within 3-5 years, expectations are for continued growth for the foreseeable future

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Operators still seeking management or revenue share agreements – There remains a discrepancy between landlords and operators around deal structures. Operators remain reluctant to sign traditional leases and mostly want to minimise capital outlay, while for landlords, in many markets a lease is the only acceptable arrangement. Much of this divergence is due to evolving views on market maturity and the long-term potential of flex, as well as to trust between the parties around mutual value creation. We believe that this will remain the case through 2023, which will be a constraint to sector growth

Landlord sector

While landlords have been more cautious about delivering their own flex space, we continue to see major landlords reviewing and testing flex concepts in key markets. During 2022, we have observed the following trends:

– **Cautious engagement in the flex sector by major landlords** – Many major office investors are exploring how to engage in the flex market i.e., self-delivery or partnering with an operator. However, there is no strong emerging trend one way or the other. Active delivery of landlord managed flex space is by far the most prevalent in the UK and Spain, and we expect to see this slowly broadening to other major European markets through 2023

– **Increasing evidence of valuation benefits** – While the weight of data is still growing, there is directional evidence that having up to 20% of flex space within major office schemes can have a positive impact on value, when compared with 100% traditional space

– **Management agreement vs traditional leases** – This remains a key point of difference between operators and landlords with the former preferring capital light, revenue share style agreements. However, we see a continued but gradual alignment here as the flex sector continues to mature and potentially as traditional demand declines in 2023

– **Flex as a way of increasing building amenity** – Landlords are beginning to see the incremental value of their remaining space by offering some form of flex within their building stack, either to attract tenants in, with the hope they grow into traditional space, or to provide overflow/on-demand meeting spaces to make the overall building offer more attractive

Things to watch in 2023

- **Management agreement acceptance** – If occupier demand for traditional leases soften and vacancy rates increase, will landlords' stance towards management agreements or hybrid lease arrangements become more accommodating, as pressures to fill and activate empty space increases and demand for flex space remains robust?
- **Year of the aggregators** – Upflex and Desana have sought to disrupt the operator model, providing users with the ability to book office space on an as-needed basis across multiple operator networks, via one simplified app. With significant investment in these platforms, they are both vying to become the "killer app" that dominates the market and wins lucrative corporate mandates for on-demand space
- **Landlord flex solutions** – Institutional landlords are becoming aware of the opportunity of including their own flex product in their portfolio, either as a way to secure revenue, to increase returns or to improve letting prospects for other space by providing associated amenity space. While impact on investment values is not conclusive, evidence is growing in support of this. As these initiatives mature and more buildings are traded, we will understand how the investor community views prospects for buildings with a flex offer
- **Occupier driven sophistication** – Occupiers are demanding more from operators, with increasingly complex and structured deals. As flex space replaces or supplements core lease space, operators will need to think creatively to address a range of challenges from strategic (core and flex, hub and spoke, ESG agenda) to tactical (parking, security, desk sharing/occupancy data, printing). Those that can successfully address the challenges that occupiers face and solve for them stand to benefit the most
- **Uplift in desk prices** – Partly driven by tightening vacancy and partly driven by inflationary drivers; in an opaque market, actual fair market value will be difficult for occupiers to determine, particularly on contract renewals

TABLE 2: Pricing levels, selected European markets, Q4 2022

City	Price per desk per month, range
Amsterdam	€450 - €900
Barcelona	€370 - €530
Berlin	€500 - €900
Brussels	€400 - €770
Dublin	€300 - €690
London	€800 - €1,300
Madrid	€400 - €650
Milan	€300 - €850
Munich	€650 - €1,000
Paris	€700 - €1,200
Warsaw	€300 - €550

Source: CBRE Flex Team

Case Study

GPE – Sustainable Business Growth via Flex

Since 2018, GPE have been increasing the amount of flex space within their portfolio, delivering fitted workspaces as well as a full service provision in their fully managed spaces, giving customers their own front door and the ability to brand space as their own. According to GPE's most recent financials, these parts of the portfolio have outperformed the group's traditional office estate.

Today, flex makes up 15% of GPE's office portfolio, and with their projected pipeline, they are targeting 650,000 sq ft (26%) by 2027; with an ambition to grow further through acquisition.

The driver is clear: most customer requirements under 10,000 sq ft in London will likely end up taking a flex solution, and more than 80% of GPE's portfolio is in that size bracket. While highly flexible deals can be structured for those that need it, GPE's average length of contract is around three years. There's also no need for customers to remove a fit out, which sits within with GPE's sustainability agenda.

The benefits of this strategy include higher headline rents; greater speed of leasing; and increasing customer loyalty. The flex occupiers of today could become the larger pre-let HQ customers of the future.

Customers today are buying and occupying their workspace differently, wanting more from the property owner. We're seeing flex becoming mainstream, with increasing demand for our spaces from a broad range of businesses - not only fast growing 'gazelles', but larger corporates as well.

Supply of larger, quality flex spaces in many London markets is, however, struggling to meet this demand. We are well placed to capture this exciting opportunity.

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