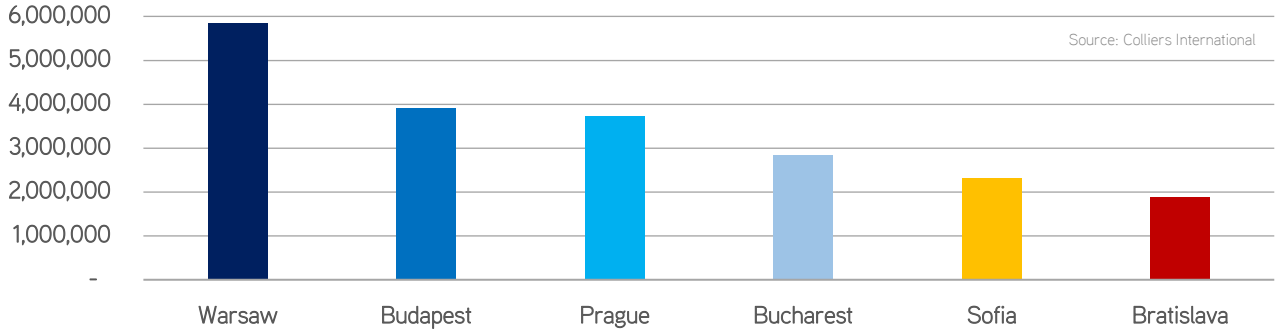
The CEE Office Scene
2020-2022

In this regional comparative report, we look at the CEE capital city office markets to compare the key indictors from 2020, assess how they have been impacted and furthermore, what trends we see are emerging as a result.

It has been approximately 9 months since the majority of office buildings were 'temporarily' vacated across the CEE region due to COVID-19. Life ever since has been challenging, but certainly not dull, as many of us have worked intensively trying to make sense of something so new, so disruptive, and so unpredictable. The recent second wave of rising case numbers in many countries also indicate that it is far from over, despite positive news from the pharmaceutical industry that some vaccines are very close, with potential deployments in Q1 2021. Risk of lockdown fatigue was mentioned early in the pandemic and this seems to have been fully realized with many people desperately craving a change of scenery and to travel abroad for holidays for example. More importantly, many of us are eager to regain some level of normality so that we can reopen our businesses and sources of income effectively, particularly those which cannot be run from our living rooms or kitchen tables. This is especially important for the CEE office markets featured in this report, as the ca. 21 million m^2 is looking forward to welcoming back its occupants, as will certainly all of the countless restaurants, cafe's and other amenities that service and complete these destinations.

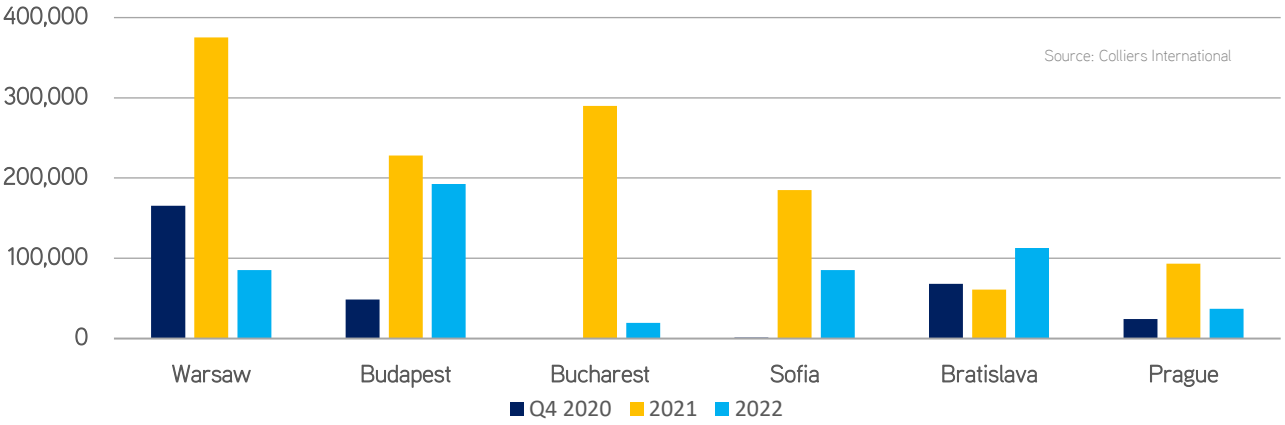
CEE CAPITAL CITY OFFICE STOCK AS OF Q3 2020 (M^2)



OFFICE SUPPLY & PIPELINE

New office supply across the region has been relatively unaffected, with the pipeline of projects that were under construction either being completed or continuing as planned and with limited delays. Some shortages of labour and materials were initially feared but seemed to have had minimal impact. New supply levels, meaning space that is actively under construction, and planned for delivery in Q4 2020 and into 2021 and 2022 do vary quite considerably across the region for city specific reasons. Fairly strong supply pipelines are expected in Bucharest, Budapest, Sofia and Warsaw in 2021. Depending on how the situation with the pandemic evolves over the next 6 to 12 months, including the impact on net absorption levels of existing and newly delivered space, we might expect to see some delays to projects that have not yet commenced construction. Office projects that require a certain level of pre-lease in order to secure development financing could also potentially expect some delays. From the ca. 2.1 million m^2 under active construction across the region, and due for delivery until 2022, an average of 40% of space is already pre-let.

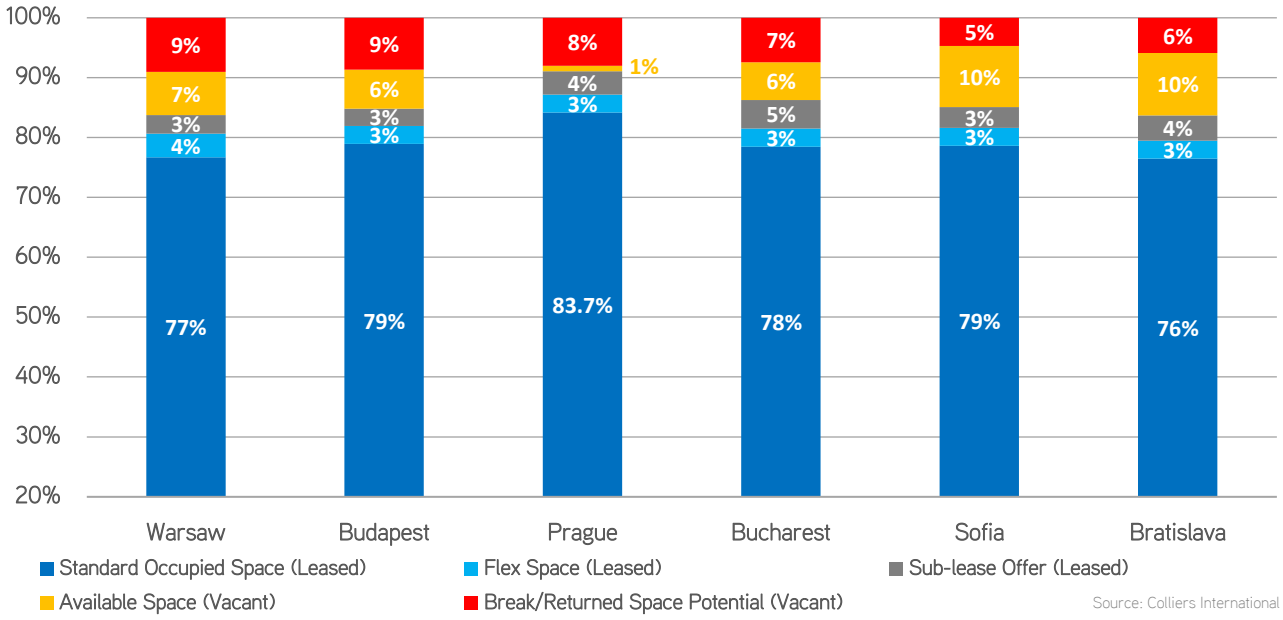
CEE CAPITAL CITY OFFICE SUPPLY PIPELINE (UNDER CONSTRUCTION) Q4 2020 - 2022



SUPPLY OUTLOOK SCENARIO

The uncertainty arising from the pandemic makes predicting the future very challenging and, if they were available, we are sure that crystal balls would be a number #1 best seller this Christmas. We all have our views, and there is no comfortable answer here however, we wanted to try and visualise a scenario based on historical data and some trends that could develop. To create such a scenario, we have used certain assumptions to show how the composition of the stock might look by the end of 2022. The assumptions in this scenario, and also reflected in the vacancy rates below, include a 1 percentage point increase in the office stock occupied by Flex operators, a perhaps conservative doubling of the Q3 2020 volumes of space offered for sub-lease, a 30% reduction in net absorption for the period Q4 2020 - 2022 (based on recent averages) and a proportion of space returned (calculated as 30% of recent gross take-up volumes), due to potential space reductions or exercised lease events. The latter volume is the most challenging to predict and only time will reveal all. Finally, the scenario takes into consideration the delivery of pipeline of projects that are currently under active construction and due for completion by the end of 2022, less any pre-leased space. Again, just to clarify, this is not a prediction, it is simply a visual scenario based on the above assumptions.

CEE CAPITAL CITY OFFICE STOCK OCCUPANCY COMPOSITION SCENARIO TO 2022

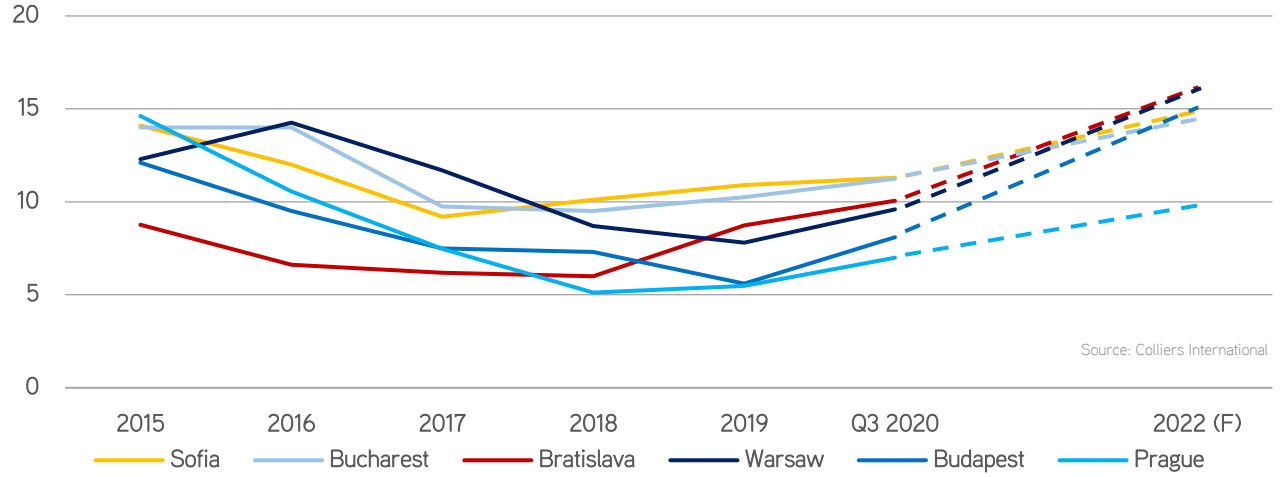


Source: Colliers International

VACANCY

Vacancy rates in most markets coming into the pandemic were in relatively shape, and we expect that these levels will help to weather some of the current uncertain market conditions. Some of the higher vacancy levels can often be attributed to specific sub-markets, locations and/or properties that are nowadays perhaps considered less desirable. There is much speculation about vacancy rates in the office property sector as a whole rising to record levels, based on upcoming supply levels and reduced demand. Based on the above scenario and assumptions, this is one view of how vacancy could look by the end of 2022. As mentioned, it is possible to create a variety of scenarios by playing with demand and returned space data points, however market evidence remains inconclusive, but cannot be ruled out.

CEE CAPITAL CITY OFFICE VACANCY SCENARIO (%) 2015 – 2022



Source: Colliers International

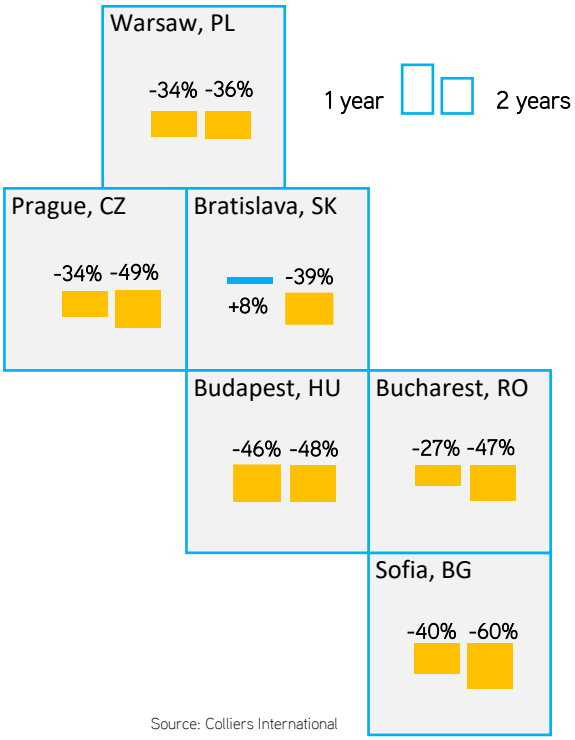
This is just one scenario of many and, can be argued that it is leaning towards a more pessimistic view, but maybe it is better to be prepared for the worst and be pleasantly surprised if (hopefully) it turns out to be less drastic. One thing you hear people saying often is that they do not expect things to go back to the way they were pre-pandemic, meaning that our physical places of work will, and have, already become more fluid and flexible. For some companies, this means that they will further evaluate their physical office spaces and working practices over the coming months and years and adapt them accordingly. As we are talking about thousands of individual companies, we cannot speak on behalf of them all but, the options open to them regarding their office/working practices essentially include the following: 1) Make no changes and carry on, 2) increase space to provide more distance between returning employees, 3) increase the number of office locations within a city (or other city), 4) reconfigure the current space based on new working practices, 5) reduce space through a sub-lease, 6) dispose of some, or all space at the next contractual opportunity (or earlier and pay a penalty) and finally, in addition or separately to one of these options, 7) take some flexible space in multiple locations to be more convenient for your employees based on where they live. Next, we will look at what has been happening with demand so far in 2020.

OFFICE DEMAND

Net take-up across most office markets for the first 3 quarters of 2020 has declined between 27% and 46% as occupiers take a wait-and-see approach. This is particularly the case if they are not under any real pressure to do so. To add a little comfort, these figures are on also the high side as most markets saw record levels of take-up in the last couple of years.

As mentioned previously, case numbers are rising under a second wave, and many experts expect there to be further growth to come. The truth is that no one knows for sure and having been through this now once before, we do all have a little more experience than we did back in March and April. That said, there is no single solution that fits all, as some tenants will be guided by global/regional corporate policies and others will be made by local decision makers. Tenants are however looking at their options and looking at ways to cater primarily for their people as their most important assets. This involves working with, or around, the health and safety guidelines they have, in how to effectively use or adapt their core office space, how flexible office solutions might be used and what makes most sense in terms of having employees work from home longer term. In future, we may see stronger occupier trends forming based on sectors or types of work being carried out but, for now, there are still too many unknown variables to make any bold claims.

NET TAKE-UP CHANGE YOY
(Q1-Q3 2020 vs. Q1-Q3 2019 & Q1-Q3 2018)



Source: Colliers International

SUB-LEASING

Over the Q2 and Q3 periods of 2020, there was an increase in the amount of space that occupiers have offered up for sub-lease and although technically still leased, it does raise the amount of available space on the market. In most markets this figure is, on average, now equivalent to an additional 1.5 percentage points of vacancy or 'Grey Space" at the end of Q3 2020, up from around 1 pps at the end of Q2. While we do expect this trend to continue at some level, it is important to comment that sub-leasing space does come with some challenges and, to a large extent, does not necessarily pose a great threat to 'regular' vacant space. It means that the company wanting to sub-let the space needs to divide up part of their current leased space for another company to move in and, at the end of the day, this simply might not work out as originally hoped or companies may realise a few months down the road that they actually need that space back. In addition, many companies may see this as an opportunity to cut some costs but, in reality, those taking on sub-leases are unlikely to pay full market price for that space, which also raises some issues.

Of course some potential occupiers may see this space as an opportunity to occupy some 'ready to move-in' space at discounted rates that were perhaps previously unattainable. Flex space operators might see this as a threat to their flexible offerings, but might also see this as an opportunity to expand their footprint and communities for good commercial terms, limited upfront investment and short-term commitments.

FLEXIBLE SPACE

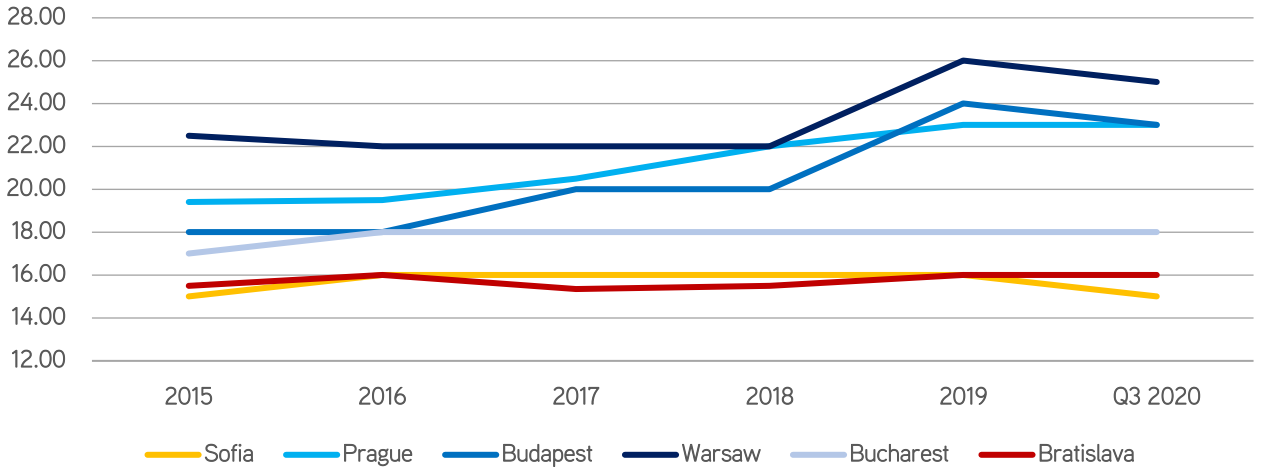
In addition to serviced offices, flexible space and coworking operations have grown gradually over the last few years, and altogether, occupy between 2 and 3% of office space in CEE capital city markets on average. These levels are still somewhat lower than in many Western European markets. It can be said that this particular sub-sector of the market has not really experienced a crisis before COVID and has started to see some challenges and casualties appear, particularly during lockdowns when very few people went to their offices at all, and particularly those that are often shared with 'strangers'. For those operators that can find their way through these tough times, we do expect to see good potential upside, particularly from companies that would like more flexibility to their leases and to have a proportion of their business that can grow and contract more freely, when required. In addition, many companies are considering making flexible offices available to a percentage of staff members in convenient locations around various cities. Office and meeting spaces on-demand are evolving and at Colliers we have recognised the need to make using this type of space even easier and more accessible - see the later section on Colliers Mobility Pass.

RENTS & INCENTIVES

The rental costs of office accommodation for most medium to large sized companies are typically less than 10% of turnover and are therefore not the biggest operational cost by far, which does of course belong to people at ca. 80-90%. Office spaces drive a lot of value to an organisation, which we will not get into now, but the question is, will saving 10% of costs by terminating your office lease really support the needs of your employees and your business goals longer term? From a landlords perspective, the cost of building properties over the last few years has risen by as much as 25% or more, largely due to rising, land, planning, labour and material costs, but we have certainly not seen this translate into equivalent increases in rent. At the same time, particularly for newer, modern spaces, we do not expect headline rental levels to dramatically decline. Rents are under some pressure due to the market uncertainty, but are expected to remain stable over the short term with even some potential to grow in locations with limited availability. Older properties, in poorer locations with perhaps longer-term vacancies, may see more of an impact. Overall, we would expect most pressure to be eased, where appropriate, by the provision of tenant incentives such as rent-free periods and fit-out contributions offered by landlords. As of Q3 2020, prime headline office rents range between €15.00 per m^2 / month in Sofia up to €25.00 per m^2 / month in Warsaw.

The level of incentives and rents provided are of course individually determined by the fundamentals of the market, the property, the location and other parameters. It is also important to say that fit-out costs have also increased in-line with rising costs and this also having an impact on what is offered by landlords as standard, and what the cost will be for tenants to create their desired office space. Once the incentives are all added up, this means that net effective rents across the region can typically range anywhere between 10 and 20% below headline rents. In some cases we have even seen levels of over 20%, but again this often due to specific circumstances in respect of the tenant and/or the property.

PRIME HEADLINE RENTAL LEVELS (€ / M^2 / MONTH) - Q3 2020



Source: Colliers International

OFFICE TRENDS ACCELERATION – PROPTECH

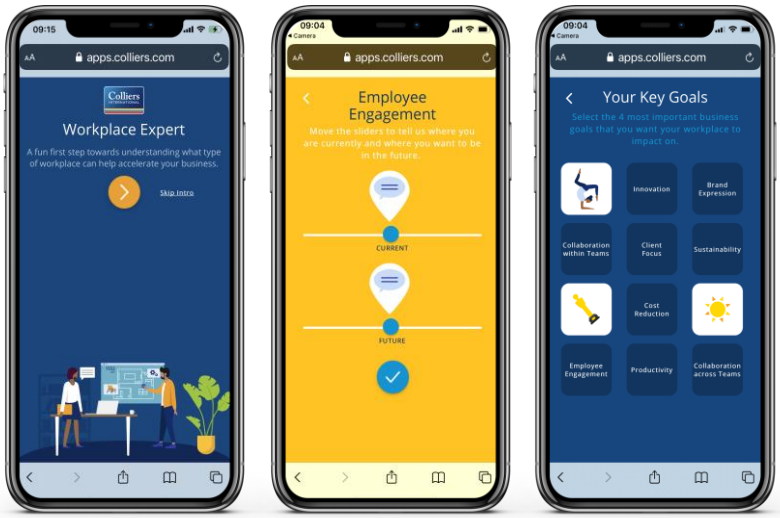
If you didn't know what MS Teams, Zoom, WebEx or similar tools were before March, you certainly do now! We have been using these and other technologies before of course, but perhaps not in such large doses. In fact, it is reported that in December 2019 around 10 million people were participating daily on Zoom conferences and since the Covid-19 outbreak, this number has reached over 300 million! Technologies and solutions, which of course include the web, wi-fi, cloud services, video conferencing and a multitude of other apps and software almost magically appeared to the masses overnight. These tools have proven that we can work in other ways very nicely and are a great addition when more common working practices and travel are not possible. However, after 9 months at your kitchen or coffee table at home, we are sure that many of you are also quite tired of some of these by now and crave a face-to-face meeting with an actual person or a random exchange with a colleague.

Tech isn't exclusive to working tools and the real estate sector is still someway behind other industries in adopting innovative technologies. The COVID pandemic is to some extent fast-tracking some solutions, and particularly those that make our lives a little easier or more comfortable when things around us are perhaps worrying or off-limits. Plus, nowadays we are spoiled by 'on-demand' access to entertainment, banking, food, and all kinds of other services. As users, we are now starting to expect the on-demand approach in all industries. We at Colliers have been tracking the developments in various technologies that touch the property sector for some time now through our proptech accelerator programme, powered by Tech Stars, along with some great initiatives led by our colleagues. Here are just a few examples that can be applied in the office sector:

COLLIERS WORKPLACE EXPERT

Now more than ever it is being acknowledged that the office is more than a pure cost asset and has a vital role in connecting and empowering an organisation's people to operate at their best. Creating the right core work environment is crucial to attract and retain talent, build culture and enable employees to perform and collaborate. Workplace Expert is a quick, easy and understandable way to find out more about the type of work environment which can help a specific business to succeed.

This engaging, intuitive, free online tool translates business goals and characteristics into high level insights in future workplace characteristics. So , how does it work?



1. Introduction

Workplace Expert starts with a brief introduction explaining the tool and the added value.

2. Input questions

After the introduction, Workplace Expert asks questions about business goals, working patterns, work location and organisational brand and identity. Completing the questions only takes a couple of minutes.

3. Real time insights

After answering the questions, the tool provides real time insights into what work environment could best suit an organisation. This includes required sqm breakdown of different areas, balance of open and closed space and more.

4. Download and contact

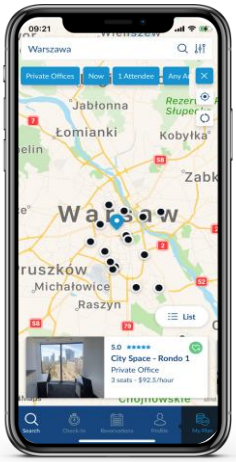
Finally there are two closing screens recommending next steps. On the final page people can leave their contact details to receive a PDF report or ask to be contacted to discuss next steps.

Give your business the Colliers Workplace Expert treatment: **https://apps.colliers.com/WorkPlaceExpert/**

COLLIERS MOBILITY PASS

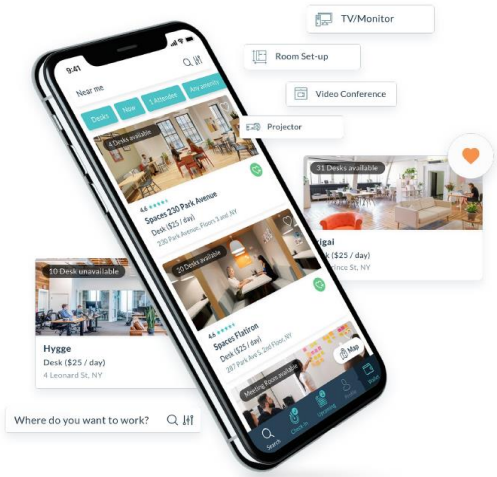
Colliers has partnered with Upflex, a platform that provides access to a wide network of flexible offices spaces. The platform does not own or lease any actual space itself, but aggregates flex spaces from all over the world and creates a central booking platform for occupiers.

Currently the platform offers over 5,000 flex spaces globally. Afterall, no operator is able to cover every workspace employees need, which is why Colliers Mobility Pass aggregates workspaces so that companies can access multiple vendors without the hassle of managing bookings, cancellations, billing, reconciliation, reporting and so much more.



Download on the App Store

GET IT ON Google Play



Get flexible by installing the Colliers Mobility Pass app or, contact thomas.jodan@colliers.com for more info.

OFFICE APP

We believe that an office is more than just a space in itself. That is why we look at the workplace from the perspective of its users experiences. Through the implementation of new technologies, we strive to simplify office life, support space flexibility, all while enhancing the experience of its users. To deliver on these promises, we approached the team at Office App who have become our strategic proptech partner. Whether you are a landlord or tenant, thanks to this unique set of knowledge and experience, we are well positioned to support you in creating a smart office building or workplace strategy, designed specifically to your needs. Office App is one of the most advanced and complex tenant engagement platforms in the world. It provides both a mobile app for daily users and a web platform for administrators.

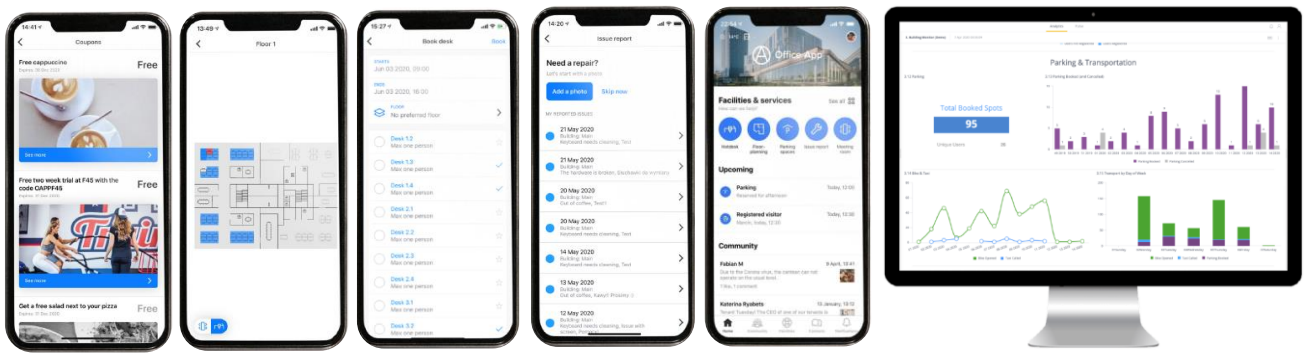
Mobile App

For daily users the mobile app offers a really wide range of modular functionalities that engage with office workers on three main levels:

- Community and Services: including - office info, library, community board, events, coupons, lunch menu, services
- Building: including - visitor registration, smart parking, parking space booking, maintenance reporting, surveys
- Workplace: including – interactive office map, desk and room booking, workplace and occupancy analytics

Administration Platform

The administration platform allows management of the workplace in real time by providing control of assets and analysing office data to increase the efficiency of your space.



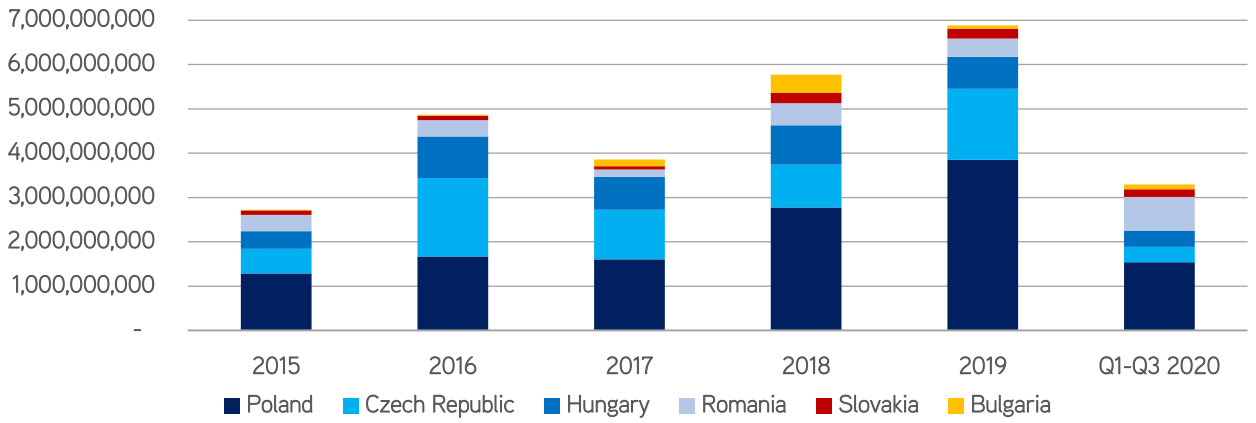
Open your building or office space up to a new world of possibilities. For more info contact maciej.plichta@colliers.com

CEE OFFICE INVESTMENT MARKETS

The COVID pandemic has had quite an impact on this years office investment volumes for various reasons, one of which being the limited or challenging travel conditions for international investors to get out there and view product. This has meant that CEE domestic investors have been responsible for 47% of all acquisitions so far in 2020, followed by European capital with 35%. Many investors, sellers and buyers, have adopted a wait and see approach on both the sales and acquisitions processes due to the uncertainty in the office markets and where they will settle. Unsurprisingly, this has also created some level of mismatch between seller and buyer expectations.

Overall, this has led to a 37.5% decrease in overall office volumes for the first 3 quarters of 2020, compared to the same period of 2019. The number of transactions has also dropped significantly, by 45%, although the average ticket size has risen by well over 25%. With positive news of vaccines due for deployment in early in the new year, we would expect offices volumes to rebound in 2021.

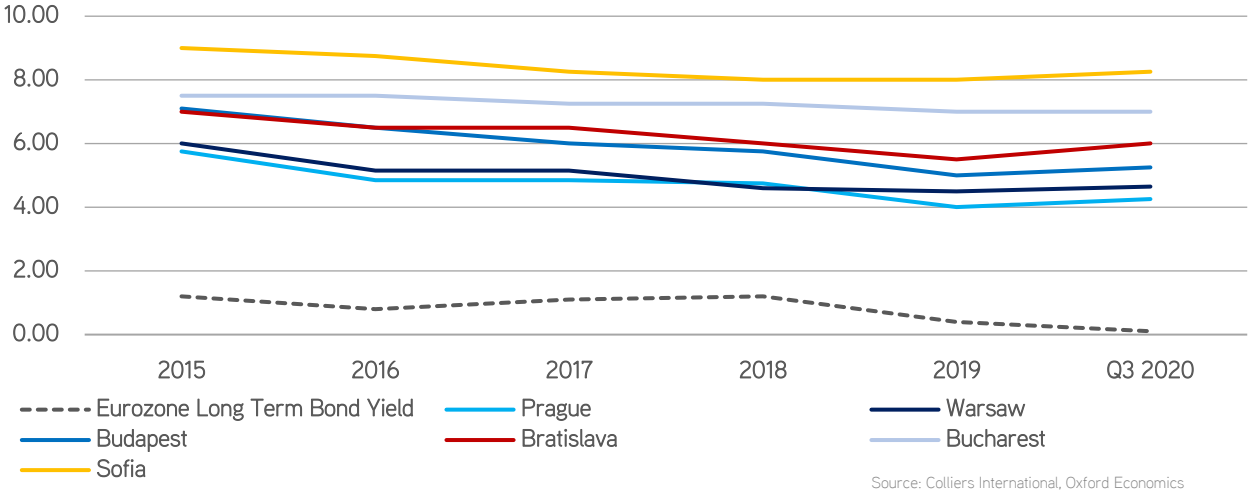
CEE OFFICE INVESTMENT VOLUMES (€) 2015 - Q3 2020



Source: Colliers International

Since the outset of the pandemic, we have recorded limited movement in prime yields, partially due to the lack of transactional evidence to support further shifts. Our view remains that while some shifts are inevitable, core, well performing office assets should hold up well, with more pressure on secondary product. When benchmarked against other investment vehicles, such as 10-year Euro bonds, real estate still maintains a compelling story.

CEE PRIME OFFICE YIELDS (%) 2015 - Q3 2020



Source: Colliers International, Oxford Economics

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