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Romania

Bucharest Office Market Update

Q3 2022

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Supply

Roughly 100,000 sqm of new modern offices have been delivered in the first three quarters of 2022, with AFI Tech Park (2nd phase, 25,000 sqm) and Hagag Development Europe's refurbishment project H Tudor Arghezi 21 (7,000 sqm) being the newest additions to Bucharest's modern office stock. The second phases of One United's One Cotroceni Park and Skanska's Equilibrium should also be added by the end of the year, bringing together an additional c.50,000 sqm of new modern office stock, which will be taking Bucharest's total supply to almost 3,36 million sqm.

Demand

Following a robust first half of 2022, the pace of recovery cooled off a bit in the third quarter of 2022, indicative of the uneven pace of recovery in highly uncertain times. Total demand looked good enough at 68,800 sqm, rather flat over a year ago and compared to the previous four quarters' average, though new demand printed at only 22,200 sqm, which is down some 39% over a year ago. A similar decline can be observed when compared to the recent average. In short, it is the first softer result following 4 strong quarters. Consequently, when looking at the 4-quarter rolling sum for net take-up, we no longer get a result comparable to the 2019 full yearly result, although it still resides above the historic average, highlighting the robustness of the recovery thus far.

While the year-on-year decline in demand is troubling at first sight, we would argue that there is still quite a lot of underlying strength in the leasing market in Romania, with several large rental contracts in various stages of negotiations; these are likely accompanied by even more small and medium-sized deals. The issue is that uncertain times call for extra caution and we are seeing this in all aspects of the office market.

And while market participants retain a moderately positive approach, this can change in the blink of an eye if economic conditions turn or if, say, the war in Ukraine would take a different twist.

Otherwise, the quarter was largely driven by a handful of deals, with just 3 totaling 30,000 sqm, namely BAT's SSC division relocation to One Cotroceni Park, Infineon Technology's renewal in Novo Park and NXP Semiconductors renewal in Campus 6, with all three transactions roughly equal in size. This further highlights the soft result in Q3, as it was quite heavily reliant on a handful of large deals.

Still, there is a positive aspect which can be illustrated using the previous deals we mentioned: the fact that for some large occupiers, scaling back on their office footprint is not an option, with both Infineon and NXP, for instance, moving in the opposite direction and expanding their office presence. That is not to say that some occupiers (including the very large ones) will not reduce the size of their office in the wake of a new hybrid work model, because we surely have had such examples. But such dynamics underscore the varied approaches undertaken by local companies. And as we have been highlighting quite frequently in the past years, if we take such aspects together with the fact that Romanian office markets are quite undersupplied relative to tertiary sector employment, the future does not look at all band for the local scene even if there may be some difficult times in the short run.

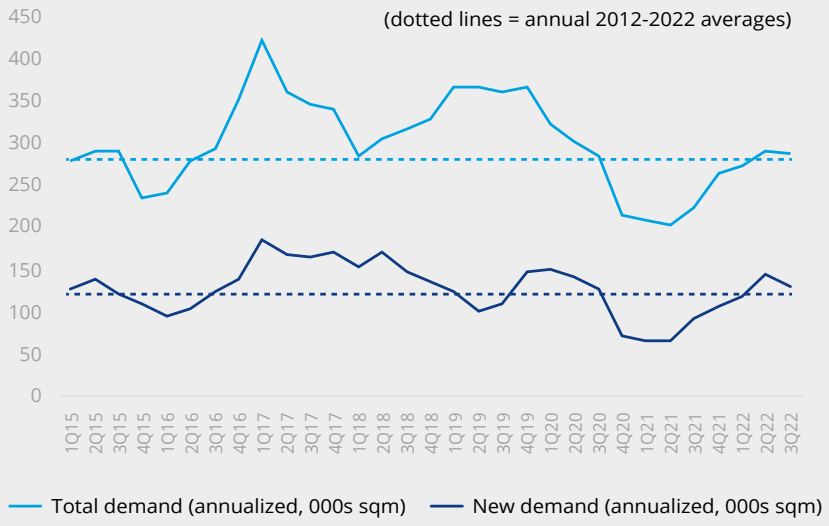
Returning to Q3 numbers, IT&C companies continue to dominate the leasing scene, accounting for c.47% of total demand, followed at a great distance by business and professional services, with 27% of gross take-up. The fact that various high-tech companies are still expanding (and actually just entering the Romanian scene) is quite positive to the longer term outlook of the office scene.

Rents & Vacancy

With quite a few building completions in the recent period, it is possible that vacancy climbed a bit versus our mid-year reading of c.15% (we have bi-annual updates regarding occupancy), but it is important to note that the office scene is quite heterogenous and occupancy in good, well-positioned buildings is already at over 90%, based on our estimations. This means that some tenants actually have a tougher choice ahead of them than they would a few years ago, particularly if they want to be located in a certain part of Bucharest or if they want a certain building. This has the hallmarks of a landlord market in certain parts of the city, which has led to landlords being able to negotiate more favourable terms.

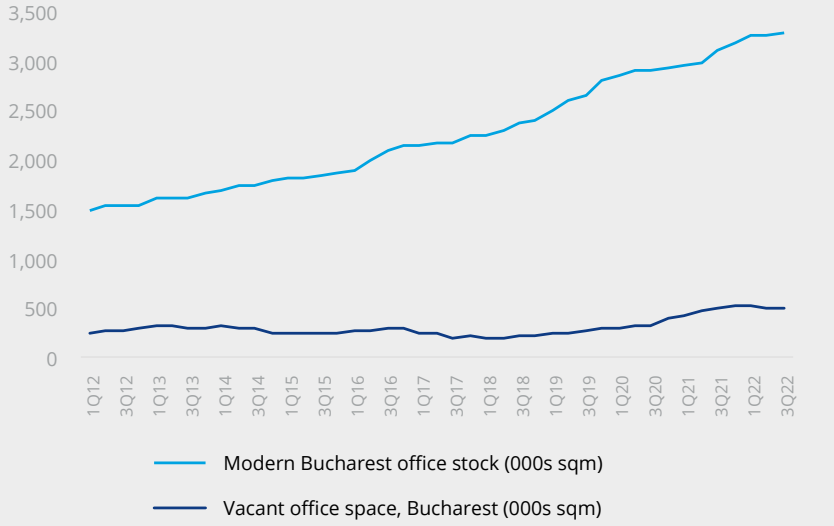
Meanwhile, on the rents front, upside pressures on pre-leases remain in place given the lackluster pipeline calendar for the foreseeable future, alongside greatly increased construction costs compared to the previous years, plus general inflation in general. Also, more recently, landlords for good, well-located buildings have also started asking for higher rents given both the inflation surge as well as the lower vacancy. Still, such pressures on rents are not prevalent throughout the whole market and in quite a lot of cases (particularly for buildings in not ideal locations), maintaining a similar net effective rent to previous years can be seen as a positive aspect.

Figure 1:
Bucharest office market demand versus long term averages



Source: Bucharest Research Forum, Colliers

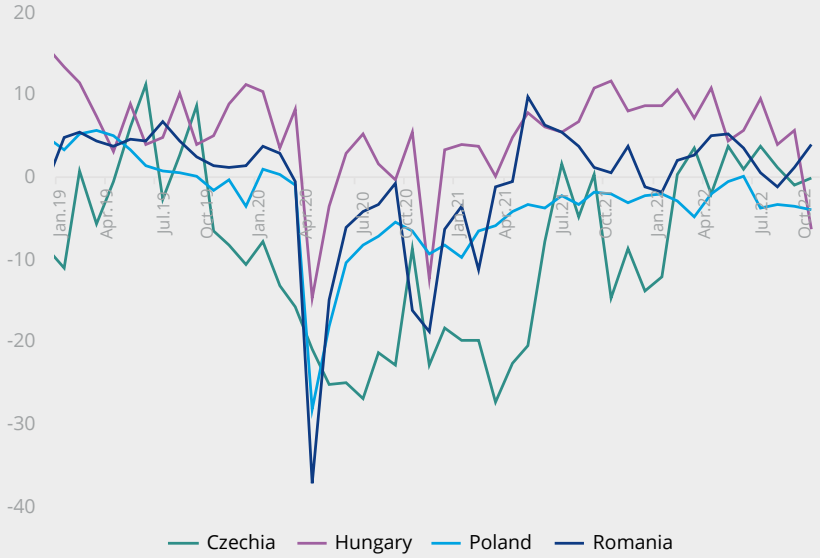
Figure 2:
Vacant space has more than doubled versus pre-pandemic levels



Source: Bucharest Research Forum, Colliers

Figure 3:
Near-term hiring intentions show Romania overperforming versus CEE peers

(near-term hiring intentions index, services, deviation from the historic average)



Source: Eurostat, Colliers

Outlook

For now, the near-term outlook remains mildly favourable and we should see vacancy rates drop even more; in fact, for good class A offices in nice locations, the vacancy rate may decline well into single digits by the end of the year, based on our estimates. This will tilt the balance further in favour of a landlord market, leading to upside pressures on rents, though the trend may be offset partially as some large companies could end up subleasing parts of their office space or scaling back on their office footprint amid hybrid work.

An interesting trend worth monitoring is the office transformation taking place currently, which enjoys significant interest among tenants. This is because of the fact that for many, the work schedule is yet to be fully set in stone and some companies do not have a solution to bring employees back on a constant basis. Furthermore, ESG compliance is becoming ever more relevant, particularly on the energy efficiency side, leading to further complicated discussions between landlords and tenants.

The good news is that near-term hiring intentions for Romanian service companies remain at decent levels, albeit declining from the initial phase of the post-pandemic recovery. The fact that employment expectations remain at or above historic averages in many sectors suggests an expanding labour market, but this alone cannot drive the office market leasing activity higher, it can act as a helpful nudge in the right direction. Furthermore, other factors – the most notable being pessimism about the path of the global economy – act in the opposite direction and we fear that the more these remain in place, the more they will weigh on the outlook for office leasing.

Summing up, the outlook for the Bucharest office market remains plagued by significant uncertainties and we can still see positive arguments for both upside and downside surprises in the following period, with no side clearly on top at the moment. On the positive side, we note a) the still fairly tight labour market (indicative of companies expanding), b) the undersupplied office market here allowing for a better absorption of vacated office spaces and c) (still) decent general economic context. On the negative side, we note that a) hybrid work has still yet to leave its full mark on the occupancy (there are signs that quite a lot of companies have yet to implement any decision on this), b) highly uncertain backdrop which could prompt companies to delay any fresh investments and c) the cooling of developed economies which should be felt in Romania sooner or later. All in all, the old adage “hope for the best, but prepare for the worst” rings quite true in the current context for the economy in general, including for the Bucharest office market. Hybrid work is itself a major unknown and it is not just about companies wanting to bring employees back, in some instances, the question is how well they can manage to do this.

Either way, unless something catastrophic happens, we are probably looking at a soft landing of the Romanian economy and of the office market in turn, where things will look quite different from one type of building to another and from one submarket to another.

For more information

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