

Tight supply is keeping rents on high level

26 September 2014

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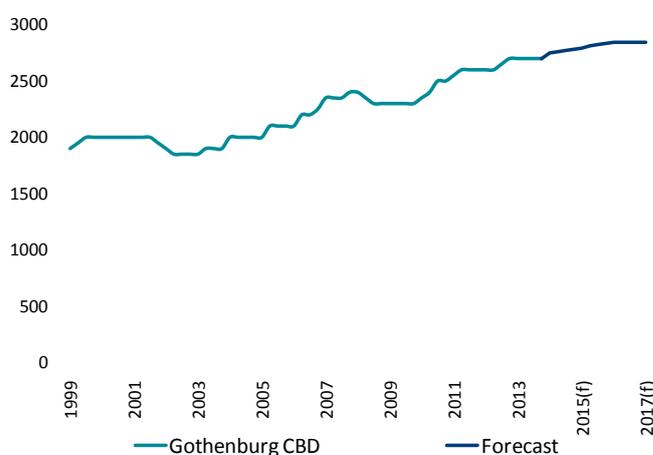
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- Swedish GDP grew weaker than expected in Q2 2014. This slowdown is caused by a subdued international economy, which is hampering Swedish exports. But on the other hand household consumption is keeping up momentum.
- The consensus of economic forecasters expects GDP to grow by 2.6% in 2014 and 3.0% in 2015. Total employment is forecast to expand by just over 1% per year over the next three years.
- Gothenburg has historically been a highly industrialised and export driven region. However today Gothenburg's economy is more diverse and comprises a large number of different business sectors.
- The regional employment market has been relatively strong this year and indicators point at a continuing recovery.
- Construction activity will be balanced over the next 2-3 year with a net new supply in 2014-2016 corresponding to 2.3% of the total existing office. The vacancy rate is relatively low, particularly in attractive locations.
- When economic growth starts to translate into new hiring we believe that office demand should strengthen further and support rental growth.

Figure 1

Prime office rent Gothenburg CBD, SEK/sq m/year



Source: DTZ Research

Gothenburg Offices Q3 2014

Economic Overview

The global economy is once again in a challenging position. The positive signs at the beginning of the year are now being reversed due to geopolitical tensions which are having an impact also on the European economy. After several quarters of expansion, the European economy slowed in Q2, and indicators point at a further slowdown in Q3.

Swedish GDP grew by a weaker than expected 0.2% q-o-q (1.4% y-o-y) in Q2 2014. The slowdown is caused by the weak international economy, which is hampering Swedish exports. But on the other hand household consumption is keeping up momentum.

The consensus of economic forecasters expects GDP to grow by 2.6% in 2014 and 3.0% in 2015 (figure 2). Total employment is forecast to expand by just over 1% per year over the next three years. Gradually improving labour market conditions is expected to lead to the unemployment rate averaging 8.0% this year, and further down to 7.6% in 2015.

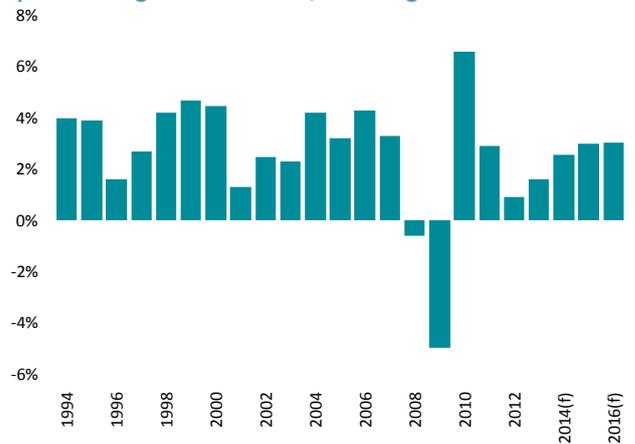
Gothenburg has historically been a highly industrialised and export driven region. In 2009 Swedish exports dropped significantly and the Gothenburg Region suffered particularly badly. Growth returned in 2010-2012 but 2013 saw exports drop below zero. Looking ahead, we forecast a slow recovery in exports given that external demand remains weak. Business Sweden's Export Manager's Index (EMI) came in at 58.1 in August, indicating that exporters expect some growth in the near future. Oxford Economics forecast exports to grow by 2.5% this year and gradually up to 5.1% in 2016, which is in line with the long term average (figure 3).

On a positive note, the financial crisis and the downturn in exports brought with it an awareness of the need for increased diversification in the local economy in order to become less vulnerable. Today Gothenburg's economy is made up by a large number of different business sectors and the city has got three science parks, all with different profile.

According to Region Västra Götaland the regional employment market has been relatively strong this year and only few business sectors have experienced a decline in the number of staff. As can be seen in figure 4, employment in office intensive sectors in Västra Götaland picked up in the final quarter last year and has remained solid ever since. However, although the recovery may well continue the quarterly growth figures may come down towards the end of the year as the comparative numbers gets higher.

Figure 2

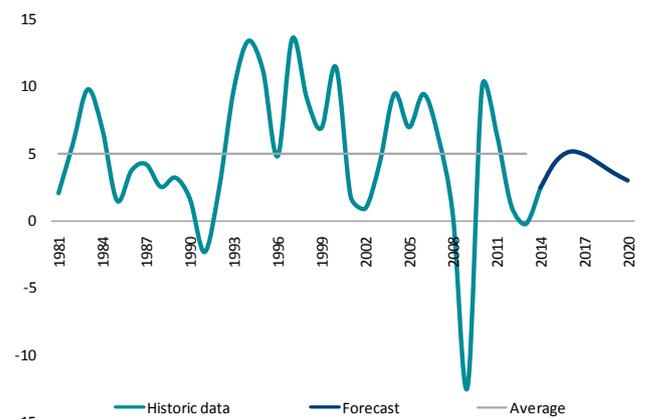
Exports GDP growth Sweden, annual growth



Source: Statistics Sweden, Consensus Forecast

Figure 3

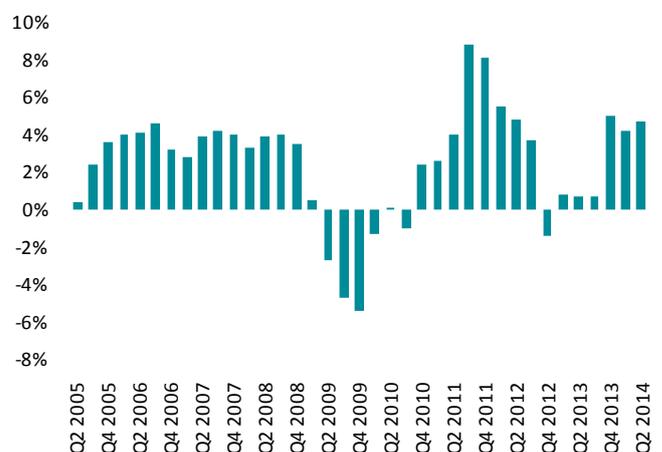
Exports, goods & services, real, % change y/y, Sweden



Source: Oxford Economics

Figure 4

OIS Employment Västra Götaland, annual growth



Source: Statistics Sweden, DTZ Research

Gothenburg Offices Q3 2014

Demand

The recovering OIS jobs statistics suggests that office demand should continue to strengthen. This view is being reflected in DTZ's Property Investor Confidence Index for Q3 2014 where the share of respondents with a positive view of office demand going forward has remained on a high level. This group now represent 42% of the respondents (figure 5). The remaining 58% expect demand to remain unchanged in Q3 2014. No one expect demand to slow in the short term. The index has come down only a little bit from 48 last quarter to 42 today.

Among occupiers there is a strong polarisation in favour of modern office space in attractive locations over more secondary space. The occupiers favour either inner city locations or, if they require larger offices or head quarter type buildings, certain suburban areas with prime office stock. Thanks to stable demand for prime offices and low availability of such space, prime office rents have remained stable at SEK 2,700 per sq m per year (figure 6).

Examples of recent leases include a five year lease signed between Alten Sverige AB and BNP Paribas REIM GmbH for 4,700 sq m of offices in the property Front Lindholmen in Gothenburg. On behalf of Platzer, Skanska has let approximately 420 sq m of offices to DNV GL and Conscriptor in the rebuilt and extended property Kv Tennet. In the same building Superoffice has taken 550 sq m of office space. Furthermore, the Tax Authority has extended their 22,900 sq m lease in Vallgraven 37:20-21, a property owned by Alecta. In Lilla Bommen Aberdeen has let 2,000 sq m to Manpower in the property Gullbergsvass 1:2, owned by SEB Trygg Liv.

Figure 5

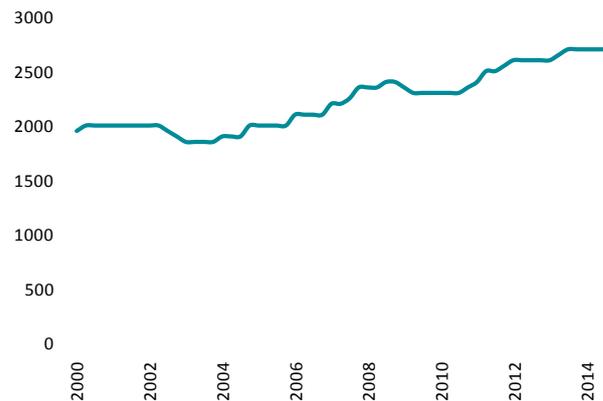
Investor Survey, Demand for office space



Source: DTZ Property Investor Confidence Index Q2 2014

Figure 6

Prime office rent Gothenburg CBD, SEK/sq m/year



Source: DTZ Research

Gothenburg Offices Q3 2014

Supply

Gothenburg have got large scale expansion plans. By 2030 central Gothenburg should have another 45,000 inhabitants and 60,000 new work places.

After low levels of construction in 2012, activity picked up in 2013 with 48,500 sq m of offices being added to the market. This year another 25,000 sq m of office space is to enter the market and in 2015 another 52,000 sq m is due for completion. Since 1995 an average of nearly 30,000 sq m of office space has been produced every year (figure 7). The total supply pipeline for the period 2014-2016 corresponds to 2.3% of the total existing office stock in Greater Gothenburg.

Outside the CBD, the new development area between Gothenburg and Mölndal around Göteborgsvägen; starting at Skanska's ÅF building and the Mektagonen and going all the way to Husvärden's projects Göteborgsvägen 95; stands out as an increasingly attractive office location. Another developing area is Gårda which benefits from the exploitation of Heden, connecting Gårda with the CBD. Lindholmen is still disadvantaged by the river acting as a barrier.

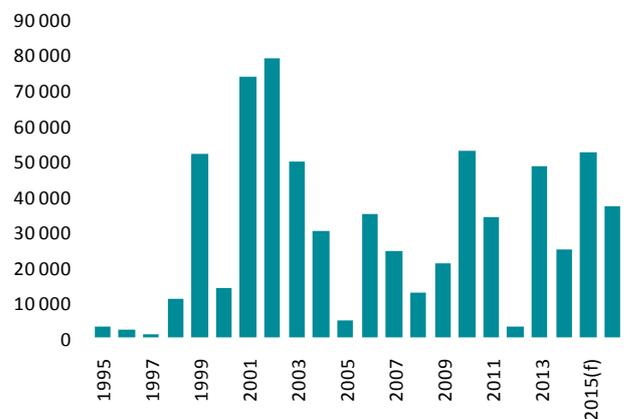
Examples of new construction projects due for completion in the next three years include Skanska's Ullevi Terrasser, comprising 8,500 sq m of office space, the first phase of PEAB's Lyckholms Fabriker comprising 19,000 sq m of office space, NCC's Ullevi Park 4 totalling 19,500 sq m of offices and Semcon's new 8,800 sq m HQ (Lundbyvassen 8:1) that is being built by Ekländia. In addition Göteborgs Energi's office building is being refurbished and extended with another 7,000 sq m. Speculative construction projects exist, but they are not many. To date, nearly 60% of the supply pipeline for 2014 has been pre-let.

The vacancy rate in Greater Gothenburg reached 11% in Q4 2010, before levelling down to the present level at around 10%. Most of the vacant space is found in older buildings in less attractive locations.

In the CBD, the vacancy rate is limited approximately 5% (figure 8). There is a shortage of larger premises available to let in this particular area. The average size of the vacant premises in the CBD is 300 sq m and only a very small number of available offices are larger than 400 sq m. The average market rent estimated for the vacant premises is lower than SEK 2,000 per sq m per year, indicating that these offices are not of prime standard. This shortage of available prime space of some size helps to explain why prime rents are now at record high levels (figure 6).

Figure 7

Office development, sq m



Source: DTZ Research

Figure 8

Gothenburg CBD vacancy rate



Source: DTZ Research

Gothenburg Offices Q3 2014

Outlook

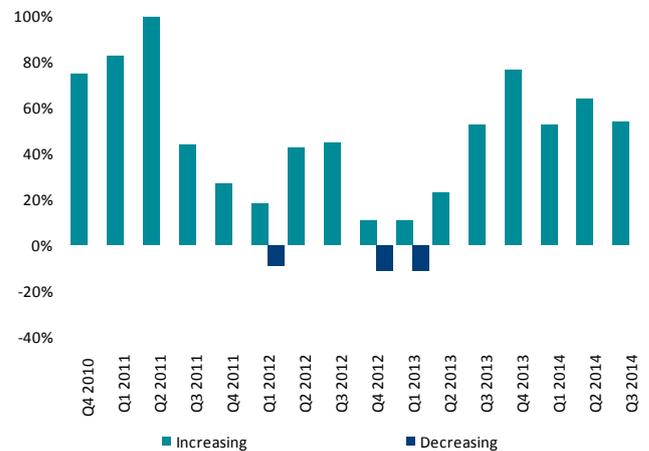
Construction activity will be balanced over the next 2-3 year with a net new supply in 2014-2016 corresponding to 2.3% of the total existing office. The vacancy rate is fairly low, at least in attractive locations. The consensus of economic forecasters expects GDP to grow robustly from 2014 onwards, and the labour market is expected to continue to improve. This should result in a stable demand for offices in the years to come. When economic growth starts to translate into new hiring we believe that office demand should strengthen further and support rental growth.

A similar view is seen in the latest consensus forecast from SEPREF, the Swedish Property Research Forum. According to this survey, prime office rents in Gothenburg are expected to remain stable in the very short term. Looking one year ahead 54% of the respondents expect prime rents to rise, and the remaining 46% expect rents to remain stable (figure 9).

Occupiers are increasingly selective about their relocation site, both in terms of location and quality of office space. We expect the polarisation between prime and secondary space to continue to intensify. Therefore, in order to capture occupier demand it will be crucial for property owners to actively manage and upgrade the quality of their buildings.

Figure 9

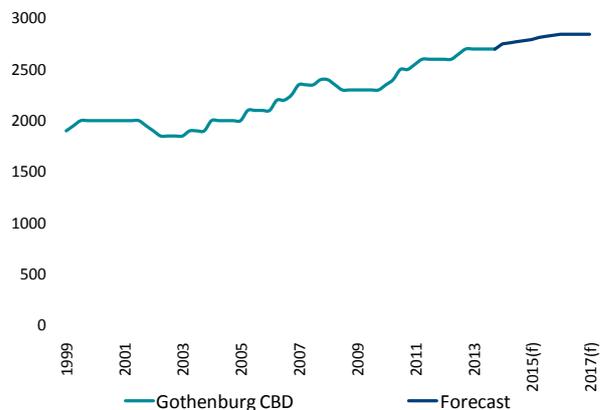
One year prime rent view, share of respondents



Source: SEPREF, the Swedish Property Research Forum

Figure 10

Prime office rent Gothenburg CBD, SEK/sq m/year



Source: DTZ Research

Gothenburg Offices Q3 2014

Definitions

Stock

The office property stock is the sum of office properties which are in use and office properties standing empty at the time of analysis. The office property stock is not a static amount. Due to new-build or totally refurbished operations it increases (new supply). It decreases due to demolition, change of use or even larger refurbishments that make the space not usable for a significant amount of time.

Our stock figures include both prime space and secondary space. However, we don't include office space in properties that are primarily for residential use.

New supply

New supply represents the total amount of floor space that has reached practical completion (including major refurbishments) as known on the last day of the quarter. This is regardless of whether or not the space is occupied or still available on the market. Common areas and service areas are not included.

Prime rent

Prime office rent represents the top market rent that could be expected for a notional office unit of the highest quality and specification in the best location in a market. The rent quoted normally reflects prime units of over 500 sq m of lettable floor space, which excludes rents that represent a premium level paid for a small quantity of space. The Prime Rent reflects an occupational lease that is standard for the local market and would exclude service charges and property tax. Note that the rent figures in this report include heating.

It should be an effective rent that factors in any rent free-periods spread over the life of the lease. It should not be a face rent that does not reflect the financial impact of any other tenant incentives like fit-out contributions, rental payments under existing leases or any other benefit provided to tenants.

It represents the average mean value of all rents achieved on leasing transactions completed during the survey period, but excludes any unrepresentative deals. If there are no prime transactions during the survey period a hypothetical rent should be quoted, based on expert opinion of market conditions.

The rent should not include any additional rent for non VAT registered tenants. The rent should be quoted per sq m and annum.

Vacancy

Vacancy represents the total floor space in existing properties, which are physically vacant, ready for occupation and being actively marketed as known on the last day of the quarter. The vacancy rate represents the total vacant floor space divided by the total stock at the survey date.

Gothenburg Offices Q3 2014

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