CB RICHARD ELLIS | **BRIEFING PAPER**

Financial Services and European Office Markets

AUGUST 2008

"The global credit squeeze poses particular risks for those European office markets most heavily exposed to financial services, including London, Paris, Madrid, Zurich, Brussels, Amsterdam and Dublin."

KEY FINDINGS

- In terms of contribution to national economic activity and employment, financial services are most highly concentrated in Switzerland, Ireland and the UK.
- The largest city-level stocks of financial sector employment are in London, Paris, Madrid and Zurich, but high concentrations are evident in Geneva, Brussels, Amsterdam and Dublin.
- On the evidence so far, the credit squeeze has had very mixed impacts on leasing activity in financial centres. However, employment growth prospects for the sector have clearly weakened in recent months, particularly for the UK and Spain.

INTRODUCTION

The global credit squeeze has a variety of potential impacts on commercial property markets, one of which is reduced demand for space from financial services. Notably the global investment banks have been severely affected, and many are reporting weaker revenues and in some cases reducing their workforce. Global banks have reported combined losses of over $380bn since the beginning of 2007 and the IMF predicts that aggregate losses arising form the credit squeeze may top $1 trillion. This poses risks for property from both occupational and investment perspectives and, importantly, the impacts are likely to be unevenly spread across markets. We have therefore examined the distribution of financial services across Europe to assess which European office markets are most heavily exposed to financial services, and the extent to which the situation is reflected in measures of property market activity.

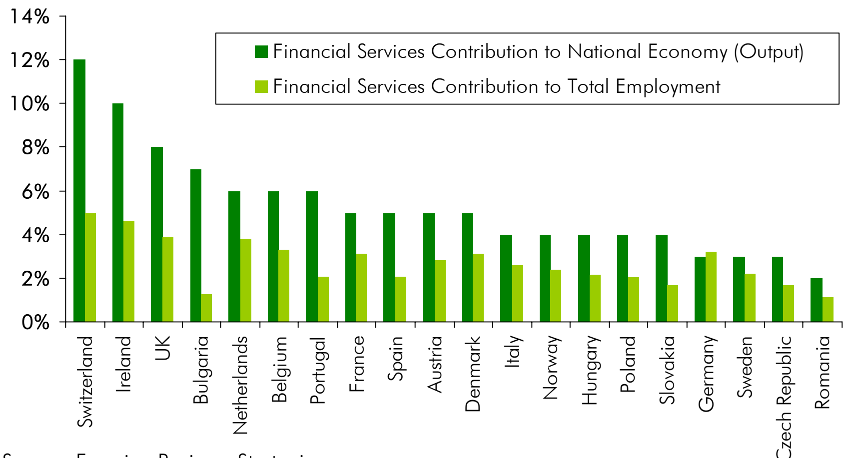
KEY FINDINGS

In terms of employment, financial services account for about 5% of the entire workforce in the major European markets. At national level, the economies of Switzerland, Ireland and the UK have the highest dependence on financial services in both output and employment terms, while the sector also contributes substantially to national output in Bulgaria, the Netherlands, Belgium and Portugal. Germany is near the bottom of the list, reflecting a more diverse economic structure.

At city level, the reversal in sentiment towards the financial sector is clearly more of an issue in those office markets whose economies are highly exposed to the sector. In terms of absolute scale, London is in a league of its own ahead of Paris and Madrid, but there are several smaller markets in which financial services represent a high proportion of local economic activity, or that represent the dominant national cluster in the sector. These include Zurich, Brussels, Amsterdam and Dublin.

So far, evidence of adverse market impacts in the main financial centres, in terms of reduced leasing activity or value movements, is mixed. However, the medium-term employment growth outlook for financial services has weakened, pointing towards slower office demand in the main financial hubs.

Financial Services Contribution to Economy & Employment, 2007



Source: Experian Business Strategies

CBRE CB RICHARD ELLIS

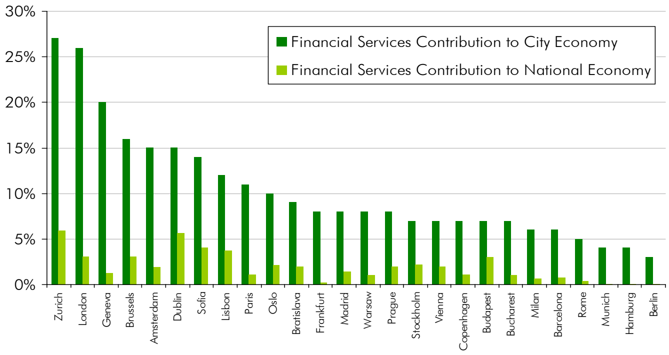
Financial Services across Europe

Financial services in Europe have grown in importance over recent years. Over the five years 2003-07, the EU financial services sector saw output growth of around 4.2% per year compared with 2.3% per year for the economy as a whole. Around half of European investment banking activity is conducted through London, and most investment banks are either headquartered or have a major office there.

There are various ways of looking at the pattern of financial services activity, one of which is the the sector's contribution to overall city or national output. London's dominance is reflected in the fact that financial services make up over 25% of the Inner London economy - only Zurich has a comparable reliance on the sector. Other centres where the sector contributes over 15% to the city economy include Geneva, Brussels, Amsterdam and Dublin.

There are also several cities whose financial services sectors make relatively large contributions to their national economies. These include Sofia, Lisbon and Budapest, in each of which the local financial services sector accounts for at least 3% of national GDP. This highlights the fact that in a number of smaller economies, financial services are often heavily concentrated in a single city.

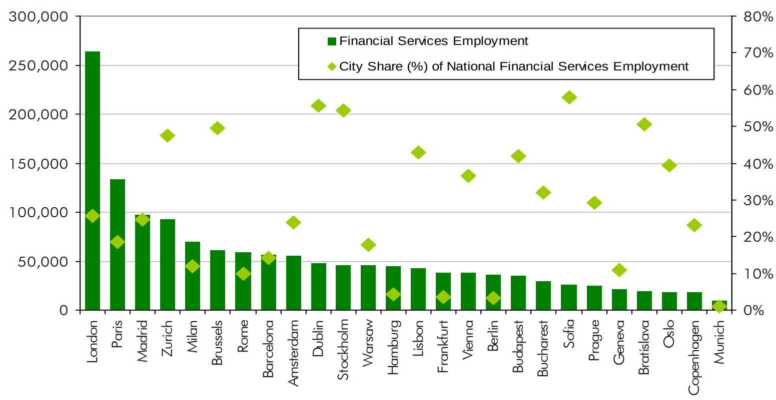
Financial Services Contribution to Economy, 2007



Source: Experian Business Strategies

This is even clearer when looking at employment levels. In absolute terms London is by far the largest centre followed by Paris, Madrid and Zurich. The financial services workforce of 264,000 in Inner London accounts for a quarter of total UK financial services employment, with Paris and Madrid accounting for similar proportions of their national totals. Elsewhere, the financial services sector of many smaller economies is much more highly concentrated in the capital city. Some cities – such as Dublin, Stockholm and Sofia – contain over 50% of their country's financial services employment, suggesting that any general downturn in the sector would have highly localised impacts in some countries. Others, particularly Germany, have a much more dispersed pattern. Frankfurt, for instance, often cited as a "financial hub" has more of its workforce engaged in business services than in the financial sector and a relatively small share of national sector employment.

Financial Services Employment Concentration, 2007



Source: Experian Business Strategies

Market Impacts

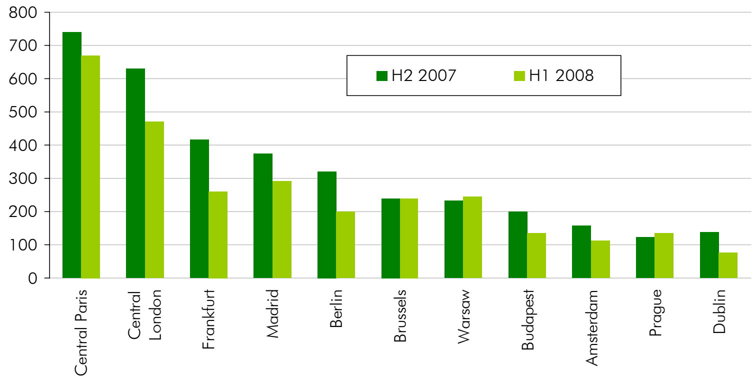
Although demand across European office markets was generally robust in 2007, there are some indications that the uncertainty connected with the credit squeeze has started to bite in the first half of this year, and that some of the major European office markets are seeing a slowdown in office leasing activity. Against this general background, though, the contribution of financial services has mostly been surprisingly robust.

London responded relatively quickly to the slowing demand from financial services, with take-up in the banking and finance sector in the City of London falling from nearly 35% of total take-up in H1 2007 to under 25% in H1 2008. Brussels followed a similar pattern, seeing a slowdown in financial services demand from nearly 13% of total take-up at the end of 2007 to around 7.5% in the first half of this year. Dublin witnessed a general weakening in occupier demand and a sharp drop in the number of outstanding new requirements from financial services. Even in these markets, however, the contribution of financial services to total take-up has not fallen far below recent norms.

Other major office centres such as Paris and Madrid have seen generally reduced office activity in the last six months, but with the contribution of financial services holding firm. In Paris, for example, demand from financial services in the first half of 2008 averaged over 25%, well above the typical 2007 level. Other markets have seen little or no adverse impact with the German cities for instance seeing the contribution of financial services to overall take-up rising in the first half of this year, quite markedly so in Frankfurt. Similarly in the CEE region, in both Warsaw and Prague financial services have accounted for increased proportions of take-up so far this year.

Evidently the impact has so far been fairly limited, and very unevenly distributed across Europe. Since property market indicators often lag economic changes, it may be that it is too early in the process to detect clear patterns of impact. There are also factors other than existing levels of sector concentration that could affect local impacts, including the maturity of the sector at national level. The German banking sector, for instance, is highly fragmented and ripe for consolidation, a process likely to favour Frankfurt over other cities. Nevertheless, since financial services support a range of other business services in most markets, the sector's impact on overall patterns of local office demand is critical.

Office Take-Up Across Europe (000s sq m)



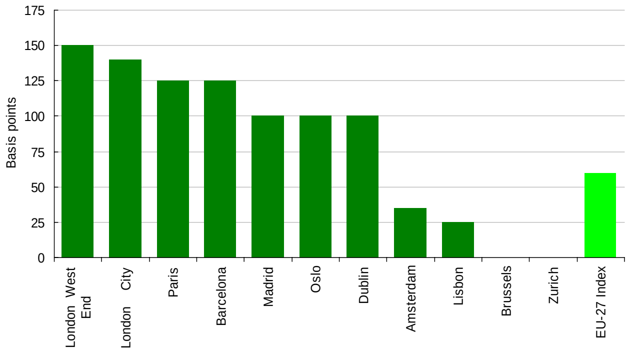
Source: CB Richard Ellis

Evidence that the main financial centres have seen larger value movements than others in recent months is also sparse. Slowdown in the scale of quarterly rental increases has been widespread, with the EU-27 rent index up by around 1.7% per quarter in the past three quarters compared with nearly 3% in the previous two. While some financial centres, notably the City of London, have seen a sharper fall than this, others including Zurich, Dublin and Amsterdam have seen little, if any, deterioration relative to their earlier performance.

CB RICHARD ELLIS

This may help explain the absence of any clear pattern in yield movements. Reduced investment turnover, rising debt costs and bond yields have caused general outward movement in prime office yields in recent quarters. The EU-27 office yield index has risen by 60 basis points since mid-2007. While some financial centres, again notably London, have seen larger yield movements, this is not uniformly the case (Zurich, Geneva and Brussels have seen no change) and other more diverse markets such as Oslo and Barcelona, have also seen increases of at least this magnitude. The yield changes seen in European markets so far can be characterised as a general capital-markets driven change, but if the market enters a further phase in which yield shifts begin to discriminate more precisely among markets, it could be the main financial centres that see some of the biggest changes.

Prime Office Yield Shift, Q2 2007 – Q2 2008

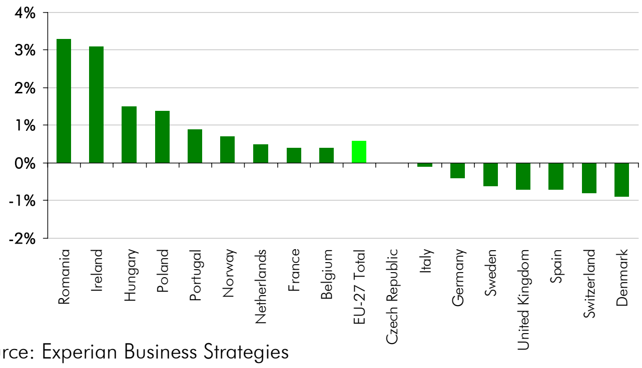


Source: CB Richard Ellis

Summary

With many banks sustaining losses, it is likely that we will begin to see generally weaker office demand, with the contribution of the financial services sector to city and national economies weakening over the course of 2008. Looking further ahead, sector employment is expected to stay broadly static across the EU as a whole over the five years 2008-12, but with downward revisions indicating declines in some key markets including the UK and Spain.

Financial Services Employment Growth, % p.a., 2008-12



Source: Experian Business Strategies

There are particular difficulties at present in forecasting sector employment levels over this sort of timeframe, and it may be that a more rapid recovery in the credit markets underpins a stronger "bounce" in some markets. The reliance of many major European office centres on the financial services sector means that future changes in the sector will need close monitoring as an indicator of office market prospects.

Note : All GDP and employment calculations have been based on data provided by Experian Business Strategies. The classification of Financial Services consists of financial intermediation including banking, insurance, pension funding and activities auxiliary to financial intermediation: security broking & fund management.

For additional information please contact:

Richard Holberton
Director, EMEA Research
richard.holberton@cbre.com
Tel. +44 207 182 3348

Catherine Bushnell
Analyst, EMEA Research
catherine.bushnell@cbre.com
Tel. +44 207 182 3405

CBRE
CB RICHARD ELLIS