

Deloitte.



Office

Our real estate investment perspective

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Our point of view

Our view of the current situation

COVID-19 has created near-term economic uncertainty, which also impacts office investments as an asset class for investors

CURRENT SITUATION ON THE OFFICE MARKET

Due to the strong correlation between the overall economic strength and the real estate market, effects of the COVID-19 pandemic are clearly noticeable also on commercial real estate. Although office real estate is typically characterized by high income and value stability (long running lease contracts), a clear decline in office space turnover was notable (approx. -1/3 compared to the first half of 2019).

After COVID-19 and the economic uncertainties, companies were significantly more cautious in the first half of the 2020. Decisions to rent new office space are put on hold or shifted significantly into the future to get a better picture on how the pandemic progresses and assess the effects on the economy in the second half of the year.

However, the risk of corporate insolvencies has not yet been completely eliminated, even in sectors relevant to the office market, such as transport, tourism or event management. A calculation of the foreseeable average scenarios for vacancy development for the A-cities shows how strong the effects can be: with a zero growth of office employment in the seven A-cities by 2024 a vacancy rate of approx. 4.9% is expected, which is approximately the same level as in 2016. With slight declines in employment the vacancy rate rises until 2024 to about 6.7% in the top office locations, which would have a much more sustainable effect on office rents.

Source: ZIA Herbstgutachten des Rates der Immobilienweisen; Deloitte Research
Deloitte 2020

DEMAND DRIVERS FOR OFFICE SPACE DEMAND

The demand for office space primarily depends on the number of office employees. Through extensive fiscal measures, the economic impact of the pandemic on the working population and companies have been well mitigated in recent months. Also short-time work has proven to be an effective instrument against job losses. A fundamental slump in demand due to declining employment is therefore currently not expected in the office sector.

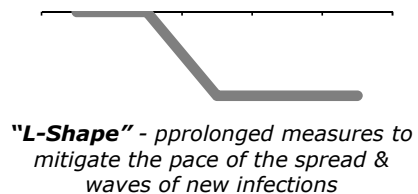
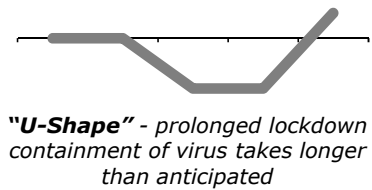
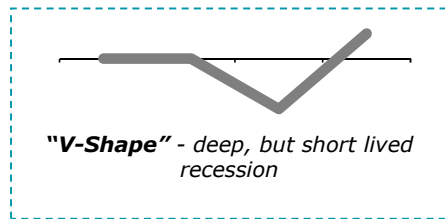
Besides the number of office employees, also the office space per employee is relevant for the future office space demand. In this regard there are two opposed developments: on the one hand, home office became more relevant during the pandemic which basically leads to a compression in office space demand. On the other hand, new workplace concepts are required in order to allow more distance between employees and achieve respective hygienic standards.

If this can be implemented in existing office spaces in the short term, for example by revising and adapting open-space concepts, operators of flexible workspaces could benefit from this. It can be assumed, however, that a relevant share of this additional demand will be absorbed by expanding home office regulations.

Our view of the current situation

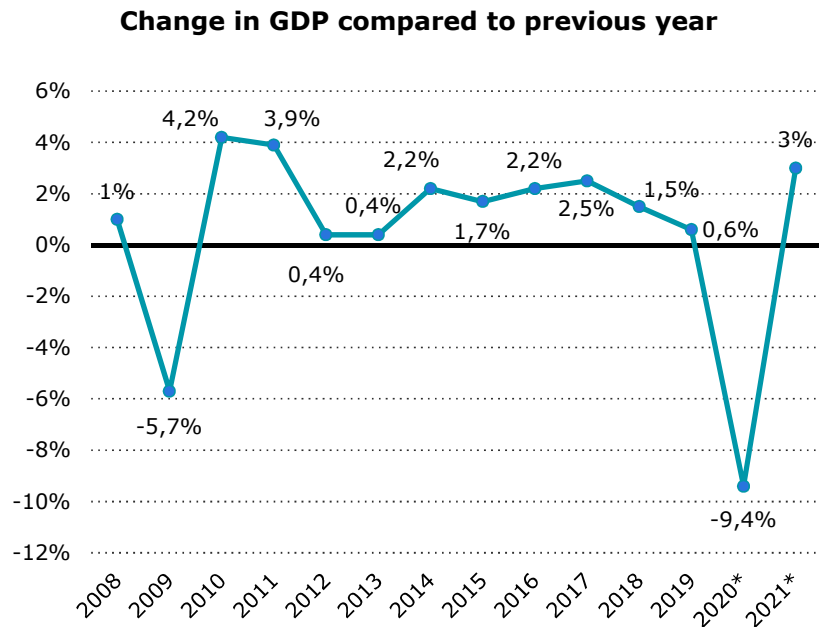
In the beginning of the crisis in March 2020 three scenarios were drawn – today it looks as the development is likely to be quite close to the V-shape scenario

SCENARIOS



GDP DEVELOPMENT IN GERMANY

The statistics show the development of real gross domestic product (GDP) in Germany in the years from 2008 to 2019 and a forecast by DIW Berlin for the years up to 2021.



DESCRIPTION / IMPACT

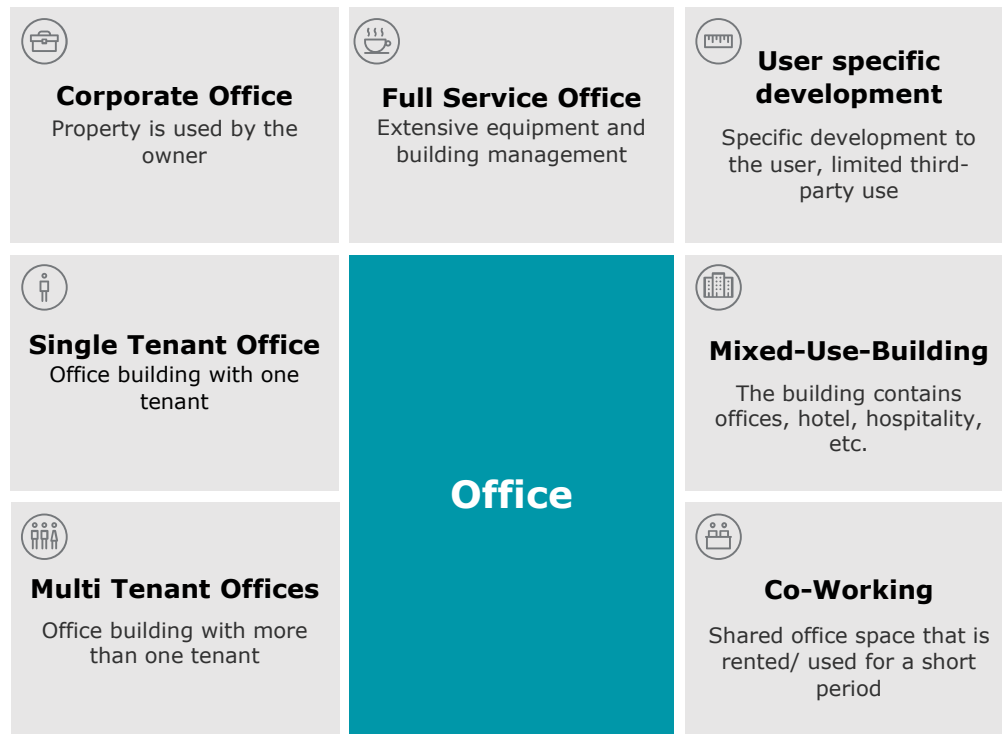
- The development of the German economy is likely to be quite close to V-shape scenario, that was one of the three drawn scenarios in the beginning of the crisis. Uncertainty for further developments is still high.
- In order to limit the spread of the coronavirus in Germany, far-reaching restrictions on economic activities were decided and ordered in March. This economic shutdown due to the corona crisis affected large parts of companies and self-employed persons in Germany. After a decrease in the number of infections, the restrictions were gradually relaxed nationwide. Nevertheless, the consequences are serious for the overall German economy.
- According to the DIW forecast, GDP in Germany will fall by 9.4 percent in 2020 compared to the previous year. For 2021, a GDP decline of 3.0 percent compared to 2020 is forecasted.
- Construction activity is currently slightly restricted and is likely to be somewhat lower in the future. However, there aren't any signs of a massive slump in construction activity to date.

Office – understand the investment

Understand the investment – office

Office properties characterize the cityscape and offer space for economic activities

OBJECT CATEGORIES



WORKPLACE CONCEPT

Category	Type	Description
rigid	Conventional office space	The office space is owned by a single organization or is rented on a long-term basis. The space can be used for various office concepts and as such represents the most common office type.
	Shared Office	A third party rents a vacant space from a regular office space. Usually, there is no cooperation between the user and the owner.
flexible	Co-Working Space	Different groups of people have the opportunity to use this office space. The space is provided by a service provider and is usually used for a short period of time.
	Incubator Space	Co-Working spaces, whose providers offer additional services such as mentoring programs or similar. Programs especially well suited for start ups with integrated "hub" thinking.
	Accelerator Space	Incubator spaces owned by a single investor who provides temporary workspace to companies from his portfolio. Development programs for Start Ups.
individual	Home Office/ Virtual Office	Working without being tied to place and time is made possible by technical progress. This type of office works through relative independence from physical space.



Source: Deloitte, Office Snapshot (Q3 2018).
Deloitte 2020

Understand the investment – office

The following key figures represent the main criteria for an office property from an investor's perspective

IMPORTANT CRITERIA FOR OFFICE PROPERTIES

	Location	<ul style="list-style-type: none"> The location of the office property is one of the most important criteria Most offices are located in the CBD of a city, especially high-end properties Besides accessibility, prestige also plays a key role 	<p style="text-align: center;">Location</p>
	Flexibility	<ul style="list-style-type: none"> Due to digitalization and the development of new office concepts, flexibility is becoming increasingly important Individually adaptable areas and flexible working hours are increasingly demanded by employees 	<p style="text-align: center;">Flexibility</p>
	Fit-out standard	<ul style="list-style-type: none"> High quality and modern building equipment Technical equipment for workstations and conference rooms 	<p style="text-align: center;">Fit-out standard</p>
	Accessibility/transport	<ul style="list-style-type: none"> Good accessibility by public transport Parking facilities for cars General very good infrastructural connection and surroundings 	<p style="text-align: center;">Accessibility/transport</p>
	Building quality	<ul style="list-style-type: none"> Energy Efficiency Use of the Smart Building concept High quality materials 	<p style="text-align: center;">Building quality</p>
	Sustainability criteria (ESG)	<ul style="list-style-type: none"> "E" for environment stands for e.g. environmental pollution or hazards, emissions or energy efficiency issues (environment) "S" for social includes aspects such as occupational health and safety, diversity and social commitment "G" for governance stands for sustainable corporate management, risk and reputation management 	<p style="text-align: center;">Sustainability Criteria</p>

Source: Deloitte
Deloitte 2020

Office market – current situation and future outlook

Office market – market drivers

The fundamental changes in the world of work, digitalization and digital connectivity, as well as the effects of the COVID-19 pandemic are key market drivers

Future Workplace

- Connectivity, flexible workplace models and new technologies have a significant influence on the way work is done
- New workplace concepts are becoming increasingly important, e.g. moving away from permanently assigned workstations to activity based working
- Rising relevance of home office and flexible working hours, accelerated through COVID-19
- Office for social interactions

Digitization & Connectivity

- Using digital tools and analytics to revolutionize tenant experience
- The concept of smart buildings and smart cities foster connectivity. The technical equipment of an office building will have a strong impact on the attractiveness of the asset



Cost Awareness

- The COVID 19 pandemic leads to measures of active cost reduction in strongly affected companies. The reduction of real estate related costs offers considerable optimization potentials.
- E.g. modular/ short term leasing of rental space and its layout and design

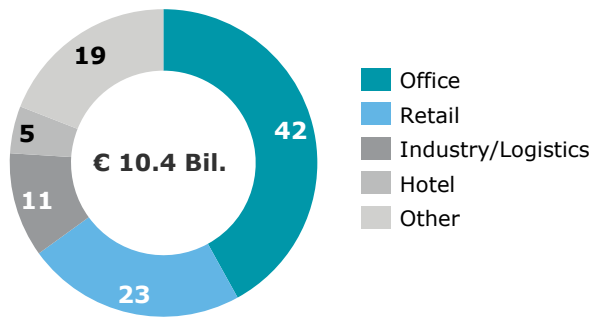
Energy Efficiency and Sustainability

- The office market consists mainly of existing buildings. 64% of the buildings were built before 1977 and do not comply with the newly introduced thermal insulation regulations
- Office buildings have a high share on the total energy consumption which needs to be lowered to meet the European climate targets and comply with ESG* sustainability criteria

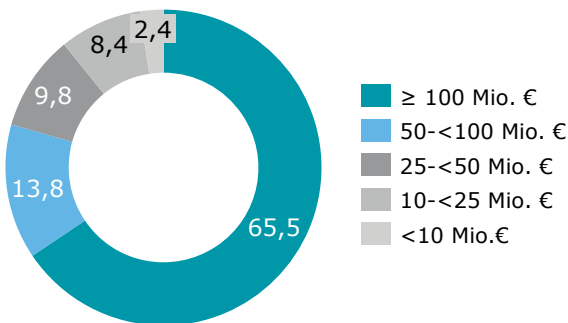
Office market – transactions and investments (1/2)

Although the market situation has deteriorated noticeably due to the COVID-19 crisis, there are many indications that a comparatively good result is quite possible in 2020

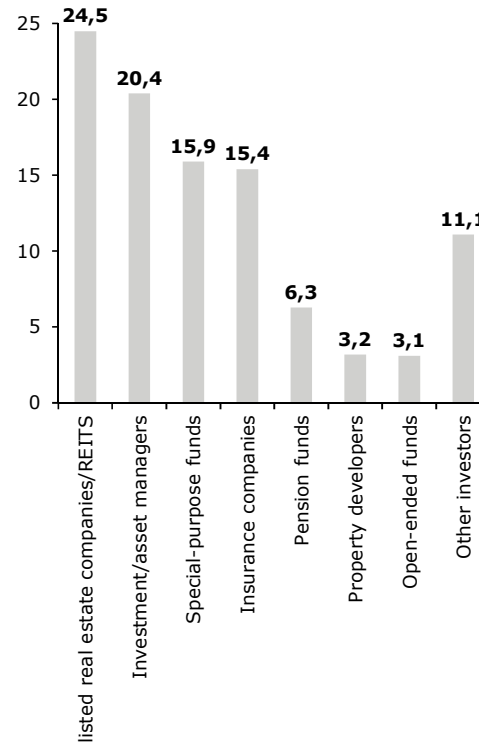
Transaction volume H1 2020
by asset type, in %



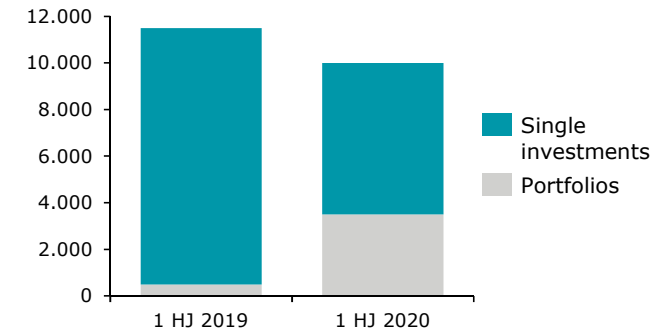
Office investments Q2 2020
by size, in %



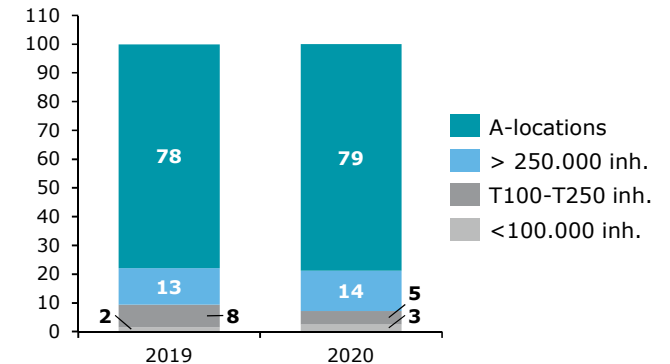
Office investments by buyer group
in %



Office investments H1 2020
by type of deal, in Mio. €



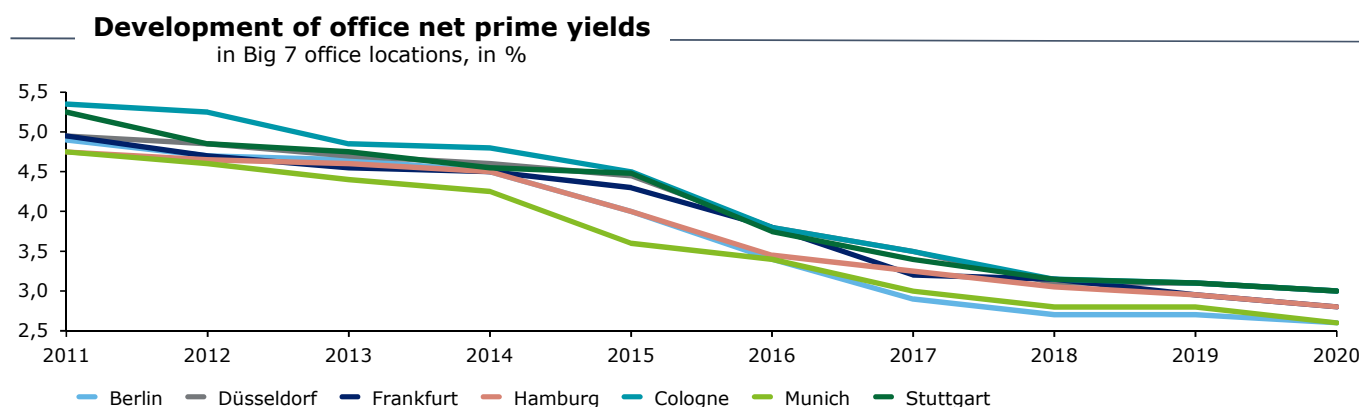
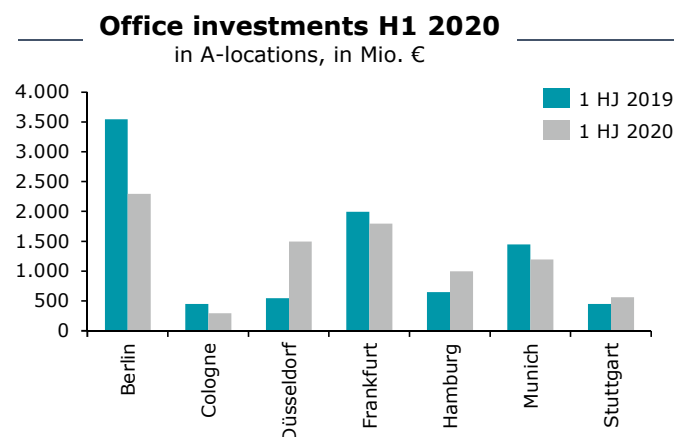
Office investments H1 2020
by city size, in %



Source: BNP Paribas Real Estate, Colliers. Deloitte 2020

Office market – transactions and investments (2/2)

On a long-term average, portfolio deals account for about half of the transaction volume. Net prime yields are still in a continuous downward trend



Quarter	Seller	Buyer	Object	Units	Price
Q3 2019	Dream Global	Blackstone	Dream Global REIT (office, logistics)*	109	€ 4.200 Mio.
Q3 2019	Generali/Viridium	Commerz Real	Millennium-Portfolio (mixed-use)	49	€ 2.500 Mio.
Q4 2019	Hypo Vereinsbank AG	Commerz Real	Tucherpark (mixed-use), Munich	10	€1.100 Mio.
Q4 2019	Blackstone	AGC	The Squaire (office, hotel), Frankfurt	1	€ 950 Mio.
Q4 2019	Hypo Vereinsbank AG	Imfarr	Omega-Portfolio (office, logistics)	35	€ 800 Mio.
Q2 2019	AXA/Norges Bank Investment Management	Invesco	Die Welle (office), Frankfurt	1	€ 620 Mio.
Q4 2019	Accumulata/Art-Invest	Bayerische Versorgungskammer	Die Macherei (office, hotel), Munich	-	€ 600 Mio.

Office real estate market – future space demand

Recent transformation processes have major implications on the current and future space demand and strengthen the need for an adjusted demand analysis process

THE PRESSURE TO CHANGE




The working environment is in a **fundamental change**. New and innovative (work) technologies and the widespread introduction of flexible working models are leading to major **changes in how, where and when we work**. As one of the result of these major changes, even before COVID-19, around **40%** of the available working space **remained unused** by the workforce. ^[1]

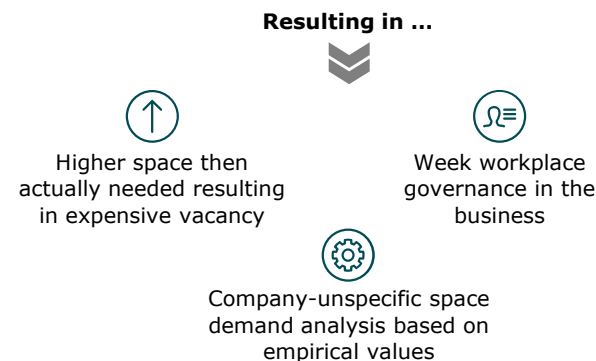
The COVID-19 pandemic in this respect is acting as a **fire accelerant** increasing the development of **empty working spaces even further** and forcing companies to rapidly take up the challenges related to the “**new normal**”. Many companies (e.g. Novartis, Allianz) are changing their working environment towards a **more flexible working environment** to react to the increased flexibility demand by their workforce. Recent studies found out that 75% of the workers polled want to **retain the current flexibility** over their schedule post-pandemic. ^[2]

This development will further drive the development of **unused office space** and increases the importance of a better approach **to forecast the future space demand**.

COMPLICATION IN FORECASTING SPACE DEMAND

Most of the companies are currently determining their **space demand** by the operative business without knowledge in real estate related matters. It is therefore mainly driven by **basic factors**:

-  Amount of employees
- ✖
-  Work desk per employee
- ✖
-  Space needs per employee



FUTURE SPACE DEMAND PROCESS

In order to **better foresee the future demand** (medium- and long term) of office space, companies must take a lot more **different factors** into consideration to be in the position to **reliably forecast the office space needed** by the business and therefore avoid high vacancy rates.

One of these factors is the change in ... :

- Workplace**

 -  Workplace concepts will have to focus much more on **hygienic factors**, the level of cleaning and **distance regulations** in the office
 - Introduction of **flexible working** (location or time)
- Workforce**

 -  Collaboration tools and platforms will support diverse and **dynamic work locations** and asynchronous **collaboration**
 - The possibility of **working regardless of time and place** is now becoming basic requirement for employees
- Work**

 -  Companies will **challenge** the idea that work should be performed **in a specific physical location**
 - The **Automation of work** drives efficiency, humans will focus on **innovation, creativity and problem solving tasks**

^[1] = ZIA, Die Zukunft der Arbeit

^[2] = Adecco, Resetting Normal: Defining the New Era of Work Deloitte 2020

Our consulting approach

Wrap-up

Deloitte provides profound market knowledge for the office real estate segment to support investment decisions

Our service for investments in single properties and portfolios cover, among others:

- Real estate transaction advisory
- Financial/ Commercial due diligence
- Analysis of office market conditions and trends, including forecast of future demand, etc.
- Regional competitive analysis of the relevant office markets
- Operator/ tenant analyses regarding economic key figures of the relevant operating companies/ tenants
- Review of concepts (strategic, operational, fit out and area review)
- Financial modelling & real estate valuation for external/ internal purposes
 - Valuation according to national (BauGB, ImmoWertV) or international standards (Red Book, TEGoVA, IVSC)
 - Independent real estate valuations for accounting purposes, purchase and sales due diligence, taxation, financing/ collateralization as well as for strategic portfolio management
 - Audit-related valuation reviews, 2nd opinions and asset quality reviews (AQR)
 - Implementation of IT-supported risk and planning tools for ongoing monitoring of real estate risks
- Location, site and property analyses, SWOTs, lease reviews, market rental assessment, operating costs benchmarking

Benefit from the experience we gained through previous projects – and from the insider knowledge of a thought leader in the real estate sector!

Our consulting approach

We focus on the parameters critical for success in office real estate and help you to assess every single one of them in order to make solid investment decisions.



Tenure & Tenancy

- Indexation clauses
- Lease term duration and extension options
- WALT
- Occupancy / vacancy rate



Competition

- Competitor analysis for relevant office real estate types and operators



Cash flows

- (Plausibility) check of pay rolls
- Analysis/ support regarding cash flow optimization



Technical infrastructure & building situation

- Support of building condition assessment (coordination of specialized companies)



OPEX/ CAPEX

- (Plausibility) check of OPEX/CAPEX figures and modernization backlog/ renovation works



Non-recoverable costs

- Evaluation of non-recoverable costs taking into consideration relevant contract types (triple-net vs. double net)



Micro/ Macro Location

- Assessment of Micro and Macro location
- SWOT analysis



Government Regulation

- Assessment of regulatory environment affecting investment decisions

Our consulting approach

Our team set up combines experienced transaction advisors and experts from the healthcare real estate sector

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