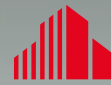


RETHINKING

WE MAKE IT PROGRESSIVE



CUSHMAN &
WAKEFIELD



RETHINKING THE OFFICE SECTOR

Identifying obsolescence risks.

Implementing repositioning and
repurposing strategies.

OBSOLESCENCE

CONTENTS

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BY NOW AT THE LATEST, WHEN HYBRID
WORK HAS BECOME THE STANDARD
FOR MOST COMPANIES, OWNERS MUST
ACTIVELY INVEST IN THE QUALITY OF
THEIR PROPERTY.

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HEIKO HIMME
Head of Berlin
Rethinking Representative Germany

LIFE IS WHAT WE MAKE IT

**CUSHMAN &
WAKEFIELD**

FOREWORD

How can the traditional office continue to survive in the face of changing user needs, increasing implementation of desk sharing and the resulting reduced demand for office space, as well as economic challenges and increased ESG requirements?

The office market is undergoing a transformation that poses major challenges for owners of office properties. The property itself is not immune to these changes. The demands that potential occupiers place on their future space are too great and too varied.

The modern business world has been transformed in many ways, creating both opportunities and challenges. Office users strive for the highest quality at all levels - the "flight to quality". Properties that do not provide this will no longer be marketable in the future, in other words: obsolete. Landlords of such properties must therefore invest more in sustainability, fit-out and the well-being of employees in order to continue to ensure good and reliable office performance.

This is exactly where our study "Rethinking the Office Sector" comes in. It examines the factors that increase the risk of obsolescence. And it provides suggestions as to which market conditions and requirements determine the orientation of office properties currently and in the future. While the discourse on the possible end of the traditional office and the potential redundancy of certain properties continues, this study offers not only a comprehensive analysis of the causes, but above all a solution-oriented perspective. Our focus is on "rethinking" and is intended to encourage owners to respond to changing market demands and realise the full potential of their properties. This not only includes strategic repositioning, which can make properties fit for the future again, but also repurposing, opening up entirely new uses in keeping with the times.

Findings from our global reports (USA, EMEA, APAC) have flowed into this German publication and illuminate national developments in a global context.

We hope you enjoy reading.



Heiko Himme
Head of Berlin &
Rethinking Representative
Germany



Helge Zahrnt MRICS
Head of Research &
Insight Germany

01

AT A GLANCE

OFFICE PROPERTY STOCK MUST ADAPT TO CHANGES IN
WORK CULTURE, ESG TRENDS AND THE ECONOMY. NOW.

In the dynamically changing landscape of the office market, three key factors - new workplace, ESG and economic slowdown - are proving to be significant drivers that have the potential to force certain existing properties out of the market in the future and thus render them obsolete.

The risk of office building obsolescence and the need to reposition the properties endangered by it are therefore gaining importance worldwide. Forecasts indicate that by the end of the current decade, about 76% of the stock in Europe and 61% in the USA could be affected. This issue is also manifesting itself in the APAC markets, especially as half of the office stock there is only of "secondary grade" quality.

"Secondary grade" refers to the fit-out quality of the office property. In the APAC region, two categories are common in this context: Prime Grade and Secondary Grade.

62%
of stock does not fulfil
modern standards

38%
increase in construction
costs in the last three
years

The situation in Germany's Top-5 office
markets illustrates the imminent change:

- By 2030, more than 60% of the office space stock will be over 30 years old.
- Currently, only 13% of the office space stock has a sustainability certificate. In contrast, in current development projects, this proportion is a high 70%.
- Refurbishments account for only 20% of total completions in the last five years.
- Rising construction costs and inflation are making construction projects more expensive, which in turn translates into higher rents and operating costs.

On the demand side, major changes are
already evident:

- The trend towards space reduction is clear: users who have reduced their space per office worker compared to their previous location have done so by an average of around 30%.
- This development results from the increased emergence of hybrid workplace models and desk sharing - further accelerated by the pandemic.
- The trend towards "flight to quality" is evident in the growing proportion of take-up in the CBD (Central Business District) and in adjacent city centre locations (60%), as well as in rising prime rents.



RETHINKING: REIMAGINING
OBSOLESCENT OFFICE PROPERTIES

The office as an institution, the office building and the way we work need to be rethought. And we need to do it now, so that there is still enough time to carry out the resulting measures decided on before the risk of obsolescence becomes too great. The rethinking consequently leads to two options, each of which must be examined individually:

- » **Repositioning** of the property to improve sustainability, quality of fit-out and building fabric
- » **Repurposing** of all or part of the space for other purposes, such as residential space or another type of use

Repositioning often requires lower investment costs, while repurposing entails considerable intervention in the building substance. The following always applies: Each building is unique depending on its age, its basic structure and its building substance.

» The case studies on pages 56 to 60 show how Rethinking succeeds.

02

WHAT LEADS TO OBSOLESCENCE



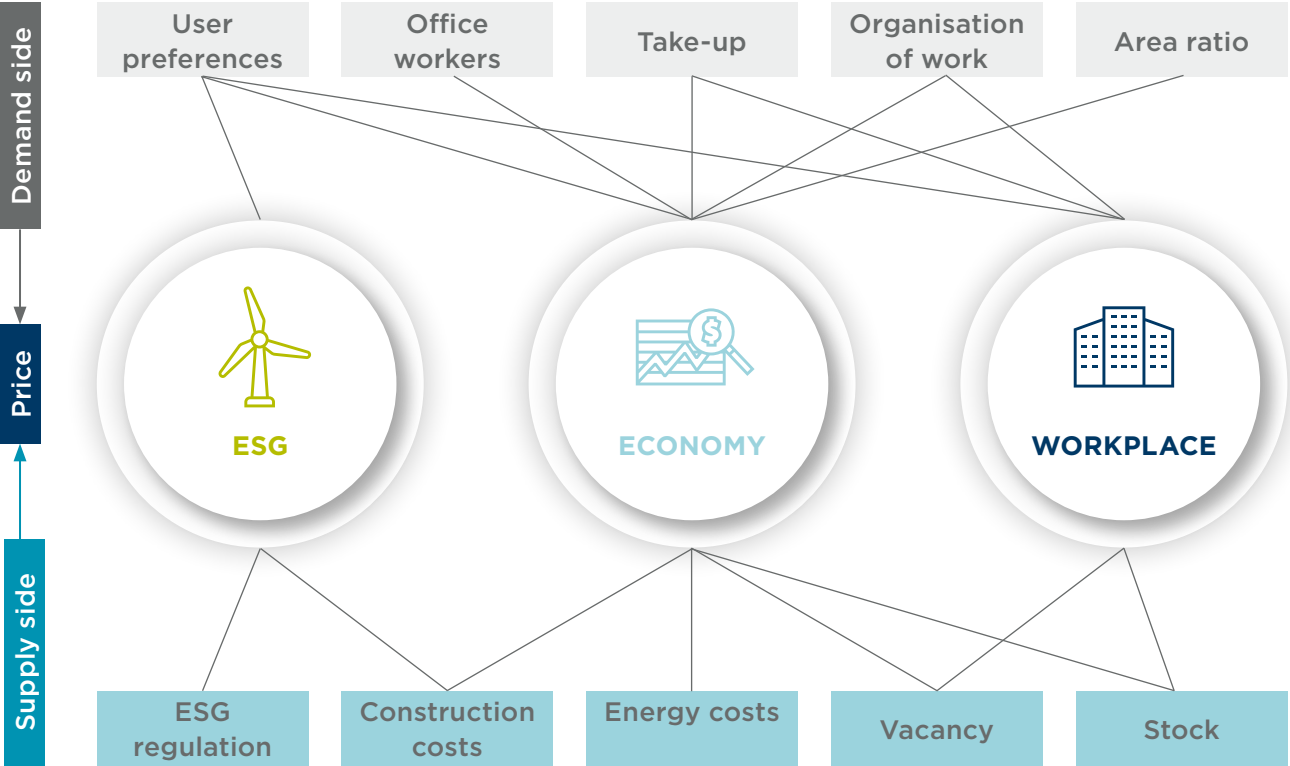
ESG, ECONOMY AND WORKPLACE - THE TRIO THAT DETERMINES THE FUTURE VIABILITY OF OFFICE PROPERTIES

The combination of new workplace strategies, a changed and lower demand for office space from occupiers, increasing legal regulations regarding minimum standards for sustainability and an uncertain economic environment increases the risk of obsolescent office properties. This means that certain office properties in their current form and positioning will no longer be marketable in the future.

The issue of sustainability in particular, both in terms of legislation and user expectations, is a driving factor whose influence will become even stronger in the future. In addition, new workplace strategies, especially with the experiences of the Covid pandemic regarding hybrid and

remote working, play a significant role. And last but not least, the current economic downturn is influencing the supply and demand sides of the market.

These three main drivers, ESG, economic and workplace-related, are in turn modified by numerous influences on the demand and supply sides, or are interrelated with them. These must all be considered together in order to identify the respective causes and possible solutions to obsolescence. If demand and supply do not come together, price formation is impaired or fails completely.



**AVOIDING OBSOLESCENCE:
OFFICE PROPERTIES MUST BE REIMAGINED**

The office sector is at a crucial turning point, forcing owners to adapt, develop or possibly even completely realign their property portfolio. Occupiers are determining the market and are increasingly focusing on the best office properties.

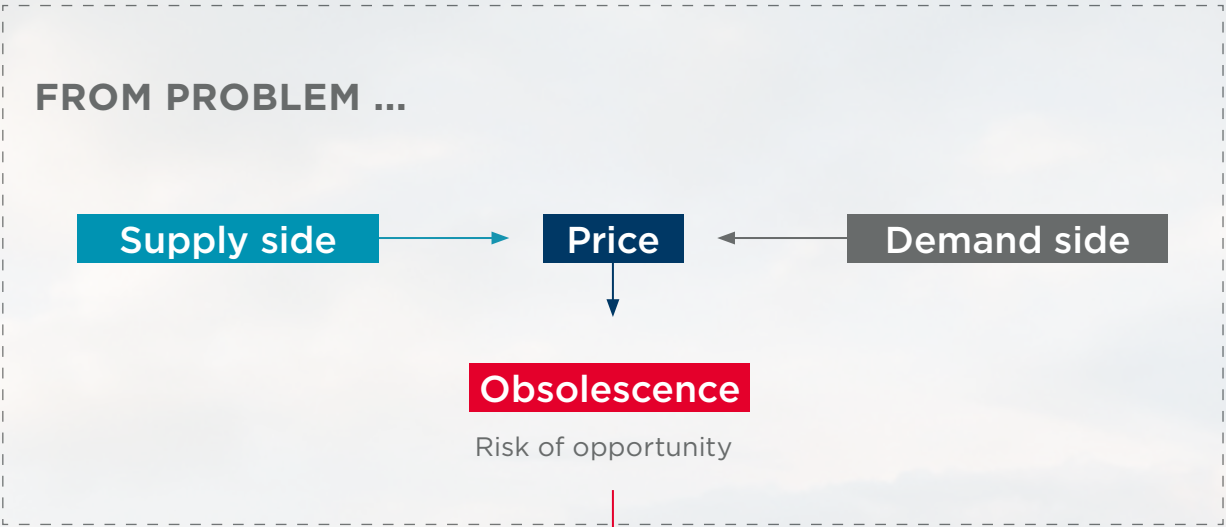
For owners of older, qualitatively weaker properties, doing nothing is not an option. Only those who invest in sustainability, fit-out, quality of stay and the integration of their properties into the local environment will be able to avoid diminishing returns and secure the marketability of their property. This problem can have several solutions.

It is important to deal with the issue at an early stage, because decisions and processes in the real estate sector usually take a long time. Rethinking must take

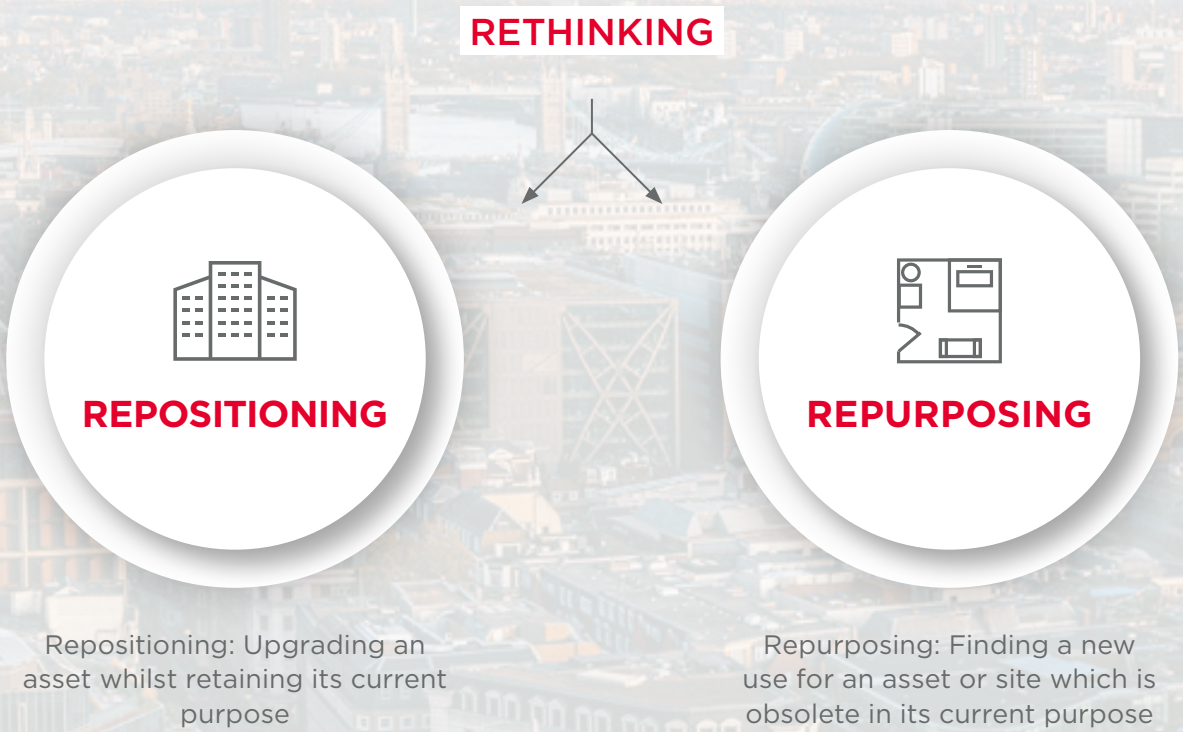
place. The office concept, the office property and the way we work must be rethought. This includes:

- » **Repositioning** Improving the quality of fit-out, amenities and sustainability
- » **Repurposing** all or part of the space for other purposes, such as residential, logistics and industry, Life sciences or healthcare, if the previous office use is no longer marketable in the future.

If no subsequent use is possible in terms of market and price perspectives, or due to structural or planning law requirements, the life cycle of a property ends. The value then amounts to the value of the site minus demolition costs.



... TO SOLUTION



//////////
**IN ORDER TO AVOID THE RISK OF OBSOLESCENCE,
OWNERS NEED TO RETHINK AND CONSIDER
REPOSITIONING AND REPURPOSING.**
//////////

HELGE ZAHRT MRICS
Head of Research & Insight Germany

03

OBSOLESCENCE RISKS IN THE GERMAN OFFICE MARKET



MODERN OFFICES ARE SOUGHT AFTER. BUT DO THEY EXIST?

HYBRID WORK WILL REMAIN WITH US: HOW THE OFFICE NEEDS TO RAISE ITS STANDARDS NOW TO STAY IN THE RACE.

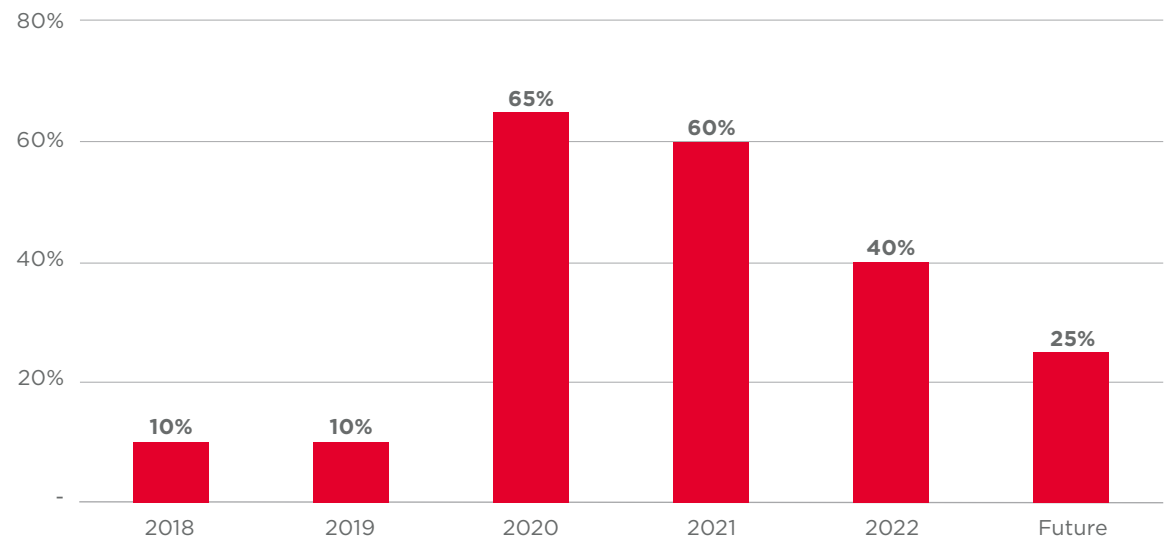
Before the advent of the Covid pandemic, the remote working rate among office users was around 10%. During the pandemic, this level increased sharply. Although office occupancy has since increased again, it is not expected to return to pre-pandemic levels. The majority of employees prefer a mix of office work and working from home, in short: hybrid work. Although clear differences are visible, depending on the sector, the trend is nevertheless clearly discernible.

According to a recent study by the Technical University of Darmstadt, respondents rate working from home as beneficial for their well-being, while they feel more productive in the office.

The clear recommendation for owners and landlords is therefore to significantly strengthen the attractiveness of their office properties - with a view to well-being, productivity and efficiency.

Share of remote working

Share of remote working in Germany (based on a 5-day week)



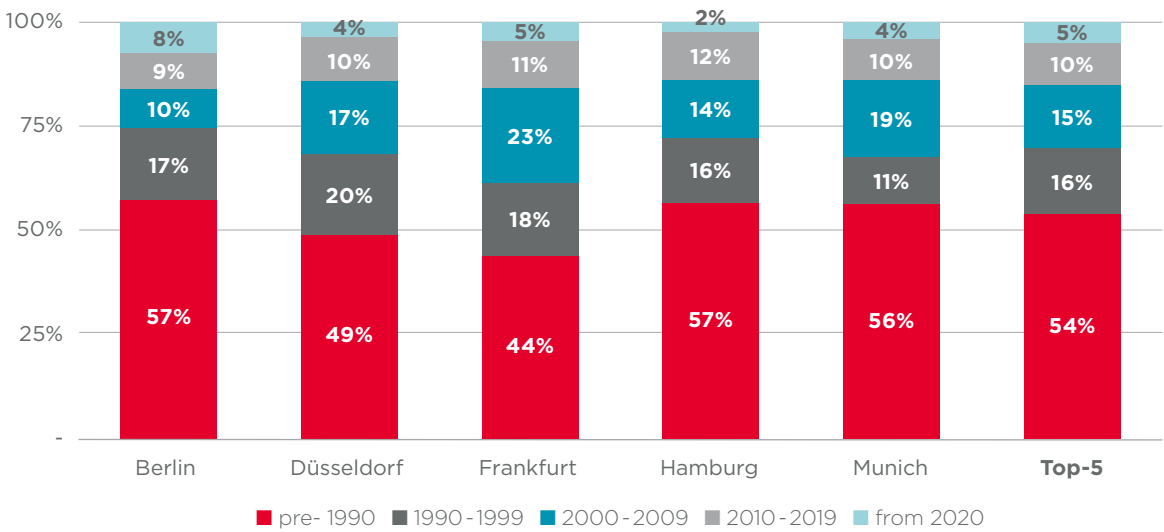
Source: Own assessment based on data from PWC, ifo Institute, Destatis and TU Darmstadt

¹ Source: Pfnür, A.; Höcker, M. C (2023): Office buildings in employees' conflict of interests

62%

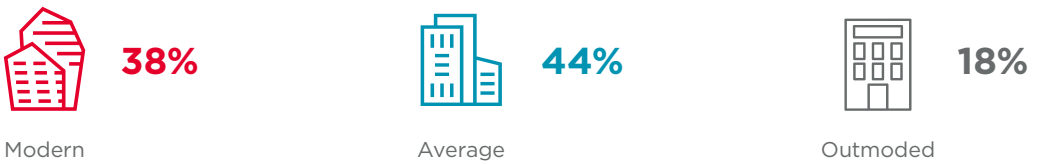
of office stock is no longer compliant with modern standards.

Office stock by building age (end of 2022)



Source: Riwis

Office stock in the Top-5 by fit-out quality (Q2 2023)



By 2030 over 60% of office stock in the Top-5 will be more than 30 years old

The proportion of space in office stock built before 1990 is 54% on average for the Top-5 markets. Berlin has the highest proportion in the "from 2020" category (8%) due to the high level of construction activity in recent years. As property ages, modernisation and, if necessary, creative (re-)use concepts must be considered.

38% of the office space stock in the Top-5 meets modern standards, while 18% of the office space stock is outmoded. There is already a considerable letting risk here and investment in modernisation is necessary. 44% of office stock is of average quality, with a medium letting risk.

MORE THAN HALF OF EUROPE’S OFFICE STOCK COULD BECOME OBSOLETE IN THE COMING YEARS.

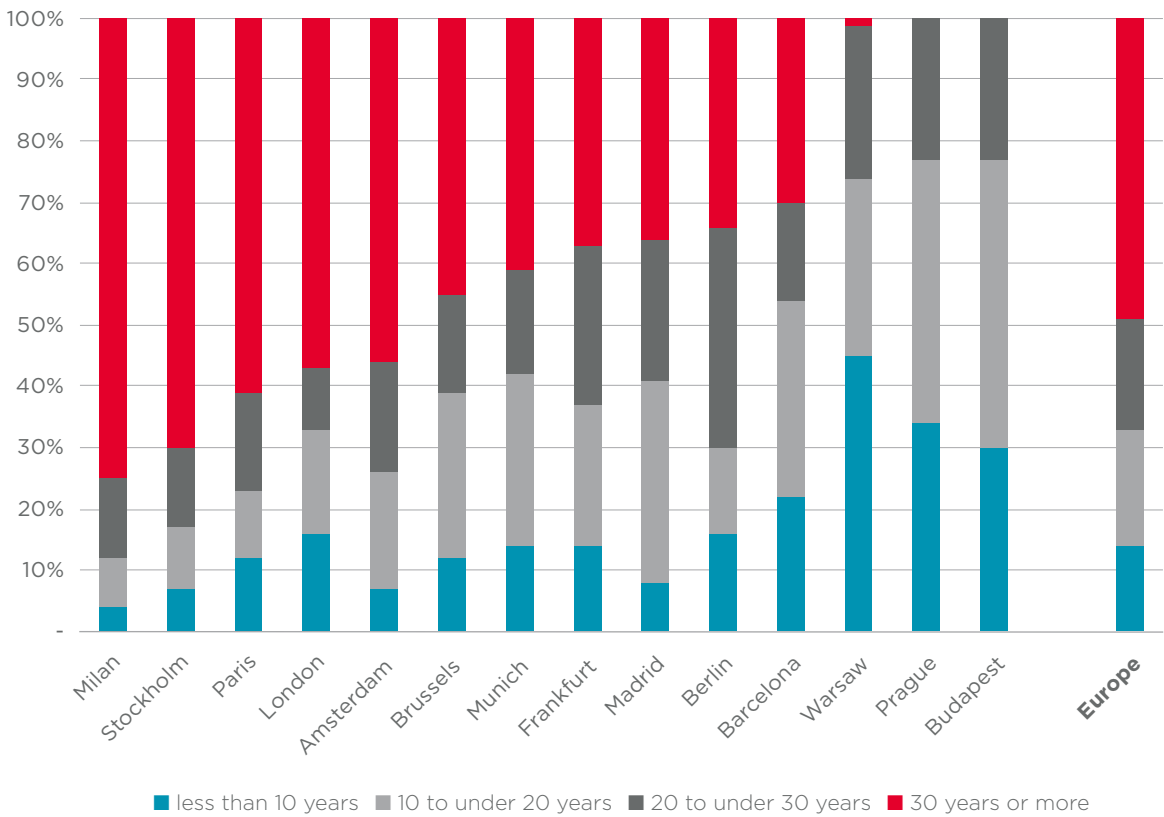
The high proportion of office properties that are no longer modern is by no means limited to the German market. Our most recent survey of office space in 14 markets and eleven European countries covers a total of 218 million square metres of office space. One of its findings is that, in the major European markets, only 14% of office space was newly built or has undergone core refurbishment in the last ten years.

Interestingly, the data shows that the Eastern European markets in particular

have the newest office stock due to the high level construction activity following the fall of the Iron Curtain.

Although the year of construction does not necessarily reflect a property’s quality, due to refurbishment possibly having been carried out in the interim, there is some correlation. Around a quarter of the analysed stock has modern fit-out quality, while around 14% of the space is of basic quality. In between, there is a large proportion of average space at over 62%.

Office stock by age (end of 2022)



MORE EFFICIENCY VIA LESS SPACE

STRUCTURAL SHIFT IN DEMAND: IN NEW LEASES, THE AREA PER EMPLOYEE IS GENERALLY ABOUT 30% LOWER THAN IT WAS A FEW YEARS AGO.

The office area per employee in stock has been declining slightly for years (-10% since 2012) and at the end of 2022 was arithmetically around 24 sq m in the Top-5. The analysis of selected leases brokered by Cushman & Wakefield in the past 1.5 years shows a wide range of leased space per employee. Overall, a trend towards space reduction is visible despite widely varying quantitative space requirements.

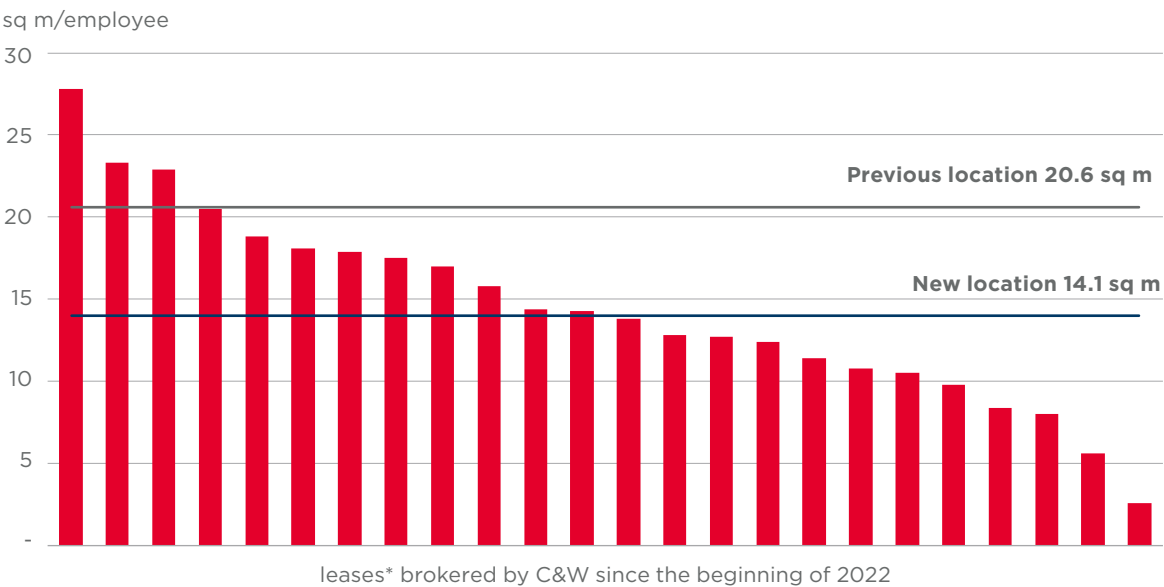
Excluding small-scale lettings of less than 1,000 sq m, office users are renting an average of 22% less space at their new location. Users who have reduced their space per office employee compared to the previous location rent an average of

14.1 sq m per employee. For these, the reduction in space per employee is on average around 30%.

The reasons for this include a structural change in demand due to hybrid working and desk sharing, which saves space and costs. This effect exists despite an expected growth in the number of office employees. However, the demand for space is not decreasing in the same proportion as office occupancy, because in many companies the proportion of communication space is growing. Here, an individual view of the building as well as the work organisation of the specific sector and company are important.

¹ Source: Riwis

Area per office worker



* Leases where occupiers have reduced their space per office worker compared to their previous location

MANY WORKPLACES REMAIN VACANT DUE TO WORKING FROM HOME AND ABSENCES. COMPANIES ARE INCREASINGLY RESPONDING BY INTRODUCING DESK SHARING.

HEIKO HIMME

Head of Berlin | Rethinking Representative Germany

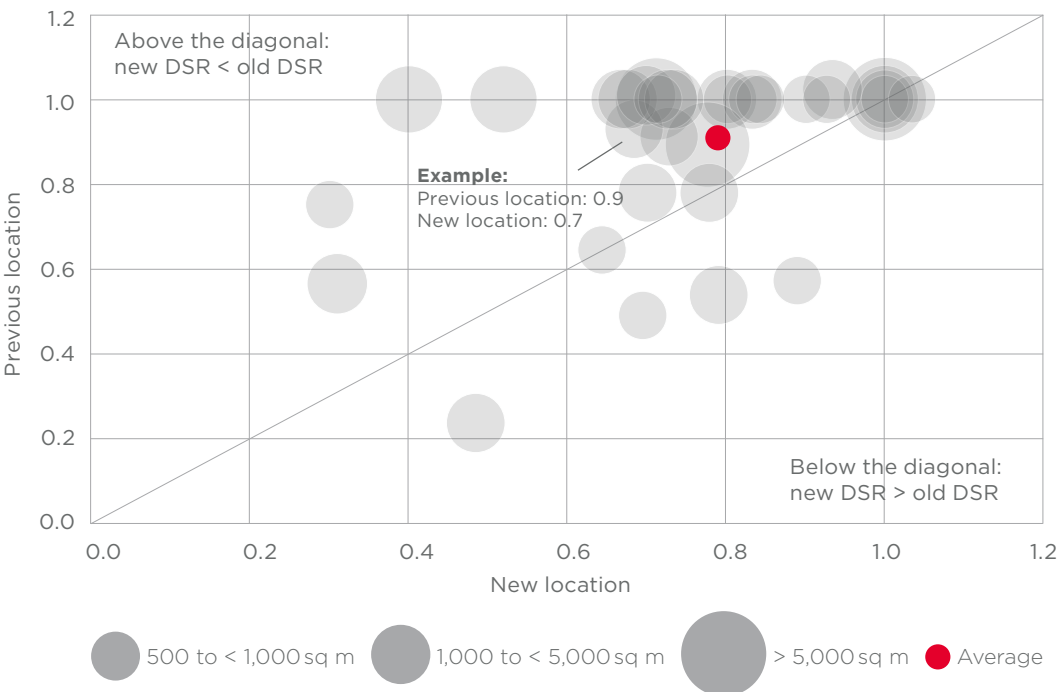
The Desk Share Ratio is a major lever for space optimisation

Up to now, the majority of office users allocated one workstation for each of their employees (Desk Share Ratio 1.0). In current new lettings, a lower ratio is often registered. For example, almost three quarters of the deals brokered by Cushman & Wakefield rely on desk sharing in the new space. The range of the Desk Share Ratio is between 0.3 and 1.0, which is very large. On average, it is around 0.8.

The tendency here is that the larger the company, the lower the Desk Share Ratio. However, this is highly dependent on:

- Occupier sector
- Respective hybrid work policy
- Whether a works council exists
- Building layout

Desk Share Ratio* (DSR) of selected leases



* Ratio of number of workstations to employees

** Selected office leases brokered by C&W since the beginning of 2022



THE IMPORTANT THING IS TO RECOGNISE YOUR **OPPORTUNITIES** AT THE RIGHT TIME

INTERVIEW WITH HEIKO HIMME

What is the purpose of the office today and do the majority of office spaces fulfil this purpose?

Offices are still highly important to companies. However, their purpose is changing. While concentrated work increasingly tends to take place at home, the office now increasingly serves communication, creative interaction and training. Companies who want to implement this trend often need office properties with the greater building depths most often found in new buildings. Conventional office layouts often have disadvantages here. After the pandemic, many spaces no longer fulfil the changed requirements. The trend is clearly towards desk sharing and larger communication spaces. Companies offer fewer fixed workstations, which reduces inefficient absences.

What consequences do owners have to deal with regarding the changing requirements of their tenants?

Change the changeables! While some aspects can be changed, such as interior fit-out, basic structural aspects such as ceiling height, building depth and location remain unchangeable. Investment in interior fit-out is important in order to meet the new user requirements. ESG guidelines must be complied with. The creation of additional building amenities such as central lounge areas, coffee bars, co-working areas, conference rooms, fitness and wellness facilities must

be considered. Infrastructural measures such as e-charging stations for vehicles and bicycles as well as bicycle parking garages are also necessary.

In principle, re-orientation of real estate has always been around. What's different now?

The change consists in the increased demands on real estate. Sustainability is no longer optional. Competition between office properties has increased due to lower demand for space and will continue to intensify. What's new is that the traditional office is now having to compete with the home office. Many companies struggle to bring employees back into the office. Employers need to consider how the company office can surpass the home office in attractiveness. Comfortable ergonomics, peace and quiet and services are important. Owners who respond quickly to these demands and adapt their properties will emerge as winners from these developments.

The spring 2023 Cushman & Wakefield EMEA report is called "Obsolescence Equals Opportunity": What are the opportunities for owners?

The title emphasises repurposing as a concept that is often more cost-effective and sustainable than new construction. Vacant office space can, for example, be converted into housing for the needy, for social use, serviced apartments, hotels or for city logistics. If owners recognise this opportunity in time, they can prevent their buildings from becoming obsolete.

“

Employers need to consider how the office can surpass working from home in attractiveness – and how owners can react quickly.

”



Heiko Himme

Cushman & Wakefield
Head of Berlin &
Rethinking Representative Germany

OFFICE TAKE-UP REACTS

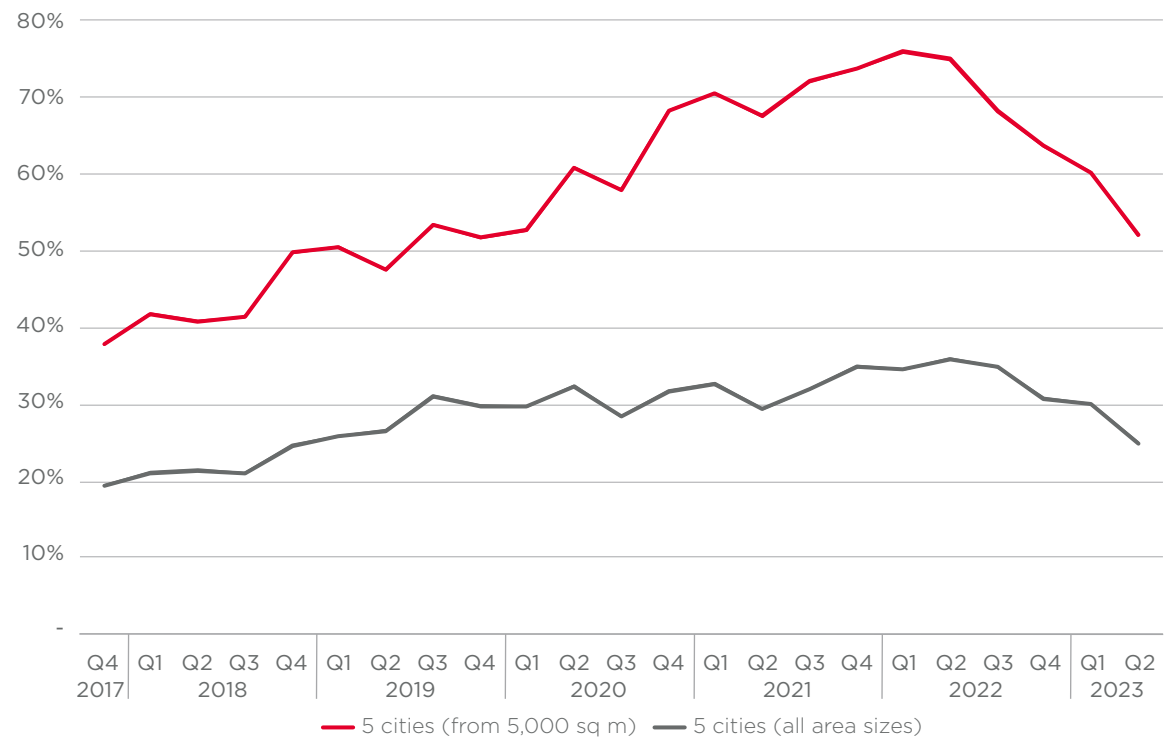
There is a high correlation between office space take-up and economic development - with a significant delay. With the declining economic sentiment indicators since spring 2023 and a slight recession expected for 2023 (Consensus forecast from August 2023: -0.3%), a rather restrained office take-up is to be expected in the coming months. However, take-up is not only declining due to the weak economy, but also due to the lower amount of space per employee leased.

Uncertainty is currently particularly pervasive among large users, with regard to their future space requirements. Many companies are therefore opting to remain in existing space.

The lack of large lettings in particular is currently contributing to a lower take-up, while the small-space segment of up to 1,000 sq m is recording more stable demand.

Large occupiers with space of 5,000 sq m or more have recently been leasing space in development projects more frequently (2021: 74% of take-up in this size category). Since Q3 2022, this figure has been falling again due to lower demand.

Proportion of take-up in development projects (Top-5 markets)





CURRENTLY, **AROUND 30% LESS** OFFICE SPACE IS REQUIRED

3 QUESTIONS FOR **CHRISTIAN LANFER**

How has the space requirements of office users changed in recent years?

In recent years, the demand for space has stagnated at a low level. As our analyses show, an average of 30% less office space is currently required per head.

The number of office workers is increasing in Germany – how do you manage the balancing act between more employees and shrinking space?

In general this can be regulated very well with strategies such as desk sharing and hybrid work. It becomes problematic when the majority of employees follow the classic "DiMiDo" (Tuesday to Thursday) rhythm. Because then the lack of space quickly becomes noticeable again, while the office remains largely empty on Mondays and Fridays. This must be equalised accordingly.

At the beginning of the pandemic, three years ago, companies tended to move to smaller, more expensive spaces in more central locations. At the moment, many people are simply waiting – on the one hand to see how the market and future work trends develop, and on the other hand because many do not feel able to make a meaningful decision. In my view, the journey is the reward. A company with several offices could, for example, try out which setting works best for its employees in various test runs and align its space planning based on this.

Users prefer development projects in top locations above all, can the supply satisfy this "flight to quality" demand?

First of all, about half of the demand is concentrated in less central locations. The rest is concentrated in prime locations close to the city centre, where rents will definitely continue to rise. In order to keep up with this trend, we are increasingly seeing property developments of first-class buildings and recommend that tenants look into leasing them years in advance to secure a high-quality, state-of-the-art space. Clients should not wait for their existing leases to expire, but should take care to acquire space in new developments at an early stage and consider long-term pre-letting agreements.

“

The trend is towards the development of first-class office buildings in prime locations – owners and occupiers alike should focus above-all on pre-leasing and pre-letting.

”

Christian Lanfer

Cushman & Wakefield
Head of Office Agency Germany

AS THE VACANCY
RATE INCREASES,
COMPETITION
FOR TENANTS
INCREASES

Since 2020, the vacancy rate for office space has been rising steadily - especially for outdated space with a lower quality of fit-out.

In the super cycle since the end of the financial crisis, the vacancy rate fell significantly. The lowest vacancy rate in the Top-5 markets was reached at the end of 2019 at only 3.7%. With the onset of the pandemic, the vacancy rate began to rise again, to 6.4% by the end of Q2 2023.

A further increase is expected over the next few years. This trend is driven by the economic slowdown as well as hybrid working and the resulting lower demand for office space.

At the same time, supply is increasing due to completions and subletting space.

Longer vacancy periods are to be expected, especially for spaces with a basic standard that no longer fulfil occupiers' requirements.

Currently, outmoded C-quality space accounts for about 15% of total vacancy. This office space is likely to be particularly exposed to the risk of becoming obsolete and thus no longer marketable.

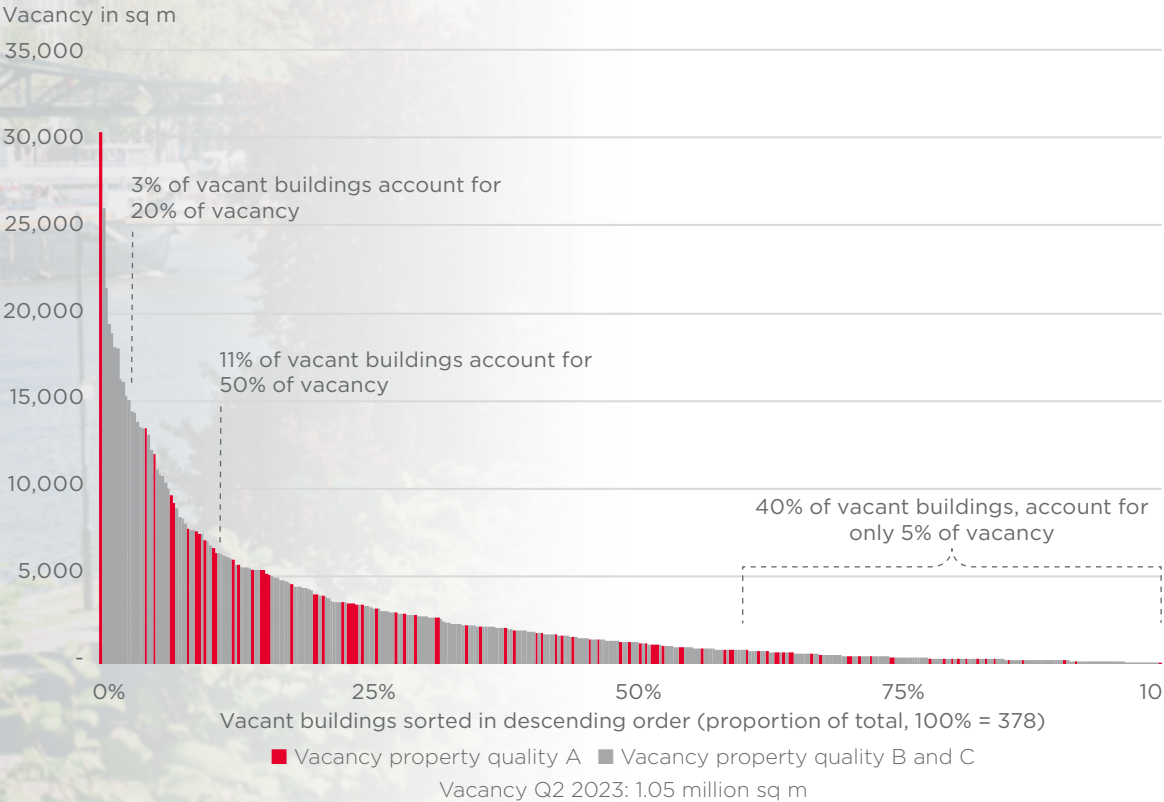
Example Frankfurt: Vacancy in the banking metropolis is concentrated in a few large - and older - buildings.

The vacancy rate for office space in Frankfurt has also increased and stood at 1.05 million square metres at the end of Q2 2023. But an examination at property level shows: The vacancy is concentrated in only a few large properties.

Older office stock is particularly affected. The ten largest vacancies are, with one exception, properties of property quality B or C. Overall, 76% of the vacancy in Frankfurt is in buildings of medium or basic quality.

Only 11 properties account for 20% of the vacancy or around 215,000 sq m. This corresponds to 3% of the buildings with office space available for immediate occupancy in Frankfurt. None of these are in the central CBD locations.

Office vacancy in Frankfurt
by vacant buildings (Q2 2023)





THE AMOUNT OF SUBLETTING SPACE ON OFFER WILL INCREASE FURTHER

3 QUESTIONS FOR HELGE ZAHRNT

Why does it make sense to sublet space that is surplus to requirements?

If tenants who want to reduce their space are lucky enough to have their lease expire in the foreseeable future anyway, they naturally have the option of handing back space, such as one floor for example. However, if the lease runs for another eight years, subletting can be a sensible solution. Even if this is often associated with additional costs and effort.

Is that so easy?

Only to a limited extent – because if the subtenant does not take over the space exactly as offered to him, this can be expensive for both parties. All users who have surplus space will usually try to bring it to market – whether you actually come together here in the end depends on the specific conditions and flexible possibilities on site as well as on individual agreements, compromises and concessions.

Will the supply and demand for subletting space rise still further?

Yes, it can be assumed that the supply will continue to increase. How well the space can be let depends primarily on the remaining term and the conditions.

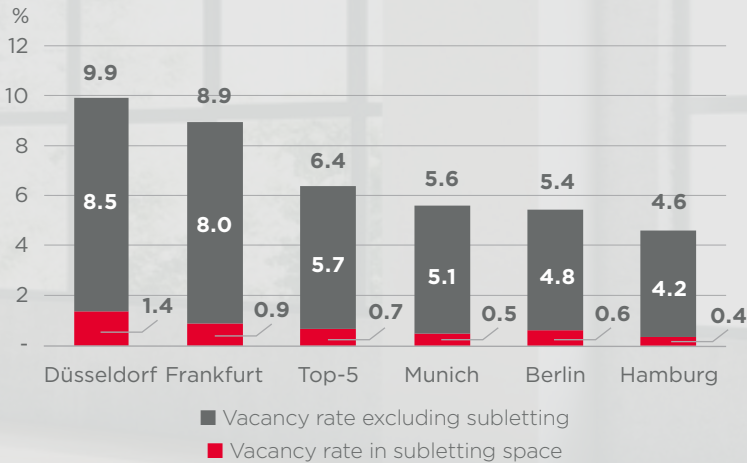


Helge Zahrnt MRICS

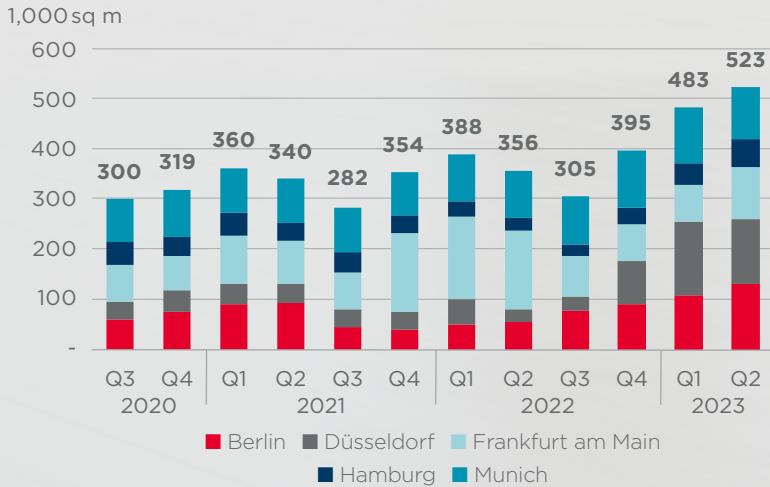
Cushman & Wakefield
Head of Research & Insight Germany

VACANT SPACES RECONSIDERED

Vacancy rate (Q2 2023)



Subletting space for immediate occupancy



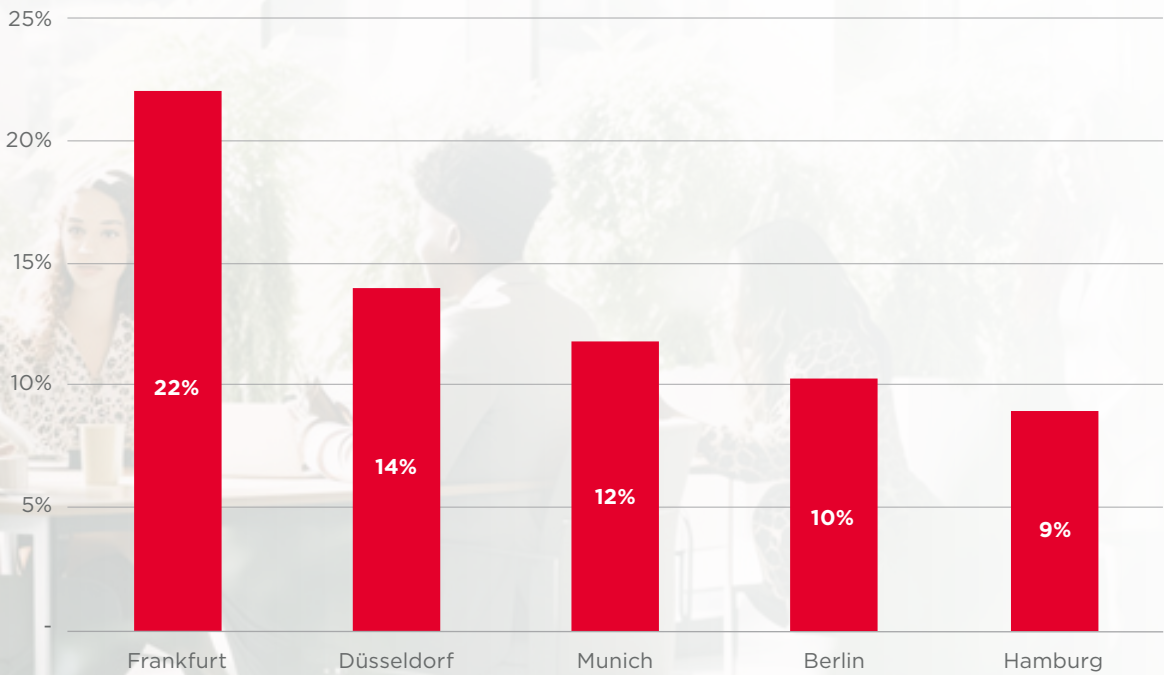
GREEN BUILDINGS ARE BECOMING A "MUST"

SUSTAINABILITY CERTIFICATES ARE NOW STANDARD FOR DEVELOPMENT PROJECTS – BUT STAKEHOLDERS STILL HAVE DIFFERING UNDERSTANDINGS OF ESG CONFORMITY.

Sustainability certification clearly offers improved marketing opportunities. Global players and large companies in particular now make this one of the basic requirements in their location decisions. However, it cannot make any definitive statement about the real consumption of a property. Among the Top-5 markets, Frankfurt has by far the highest proportion of certified office space in its total office stock. The reasons for this are the highly international nature of the market as well as the high-rise density with many certified properties overall.

Nevertheless, the upward trend is noticeable everywhere and can also be clearly seen in the figures: Of the new buildings constructed between 2018 and 2022 in the Top-5, around 45% have certification. For developments for completion between 2023 and 2027, the figure is already 70%.

Proportion of office stock with sustainability certificates* (end 2022)



* LEED, BREEAM, DGNB

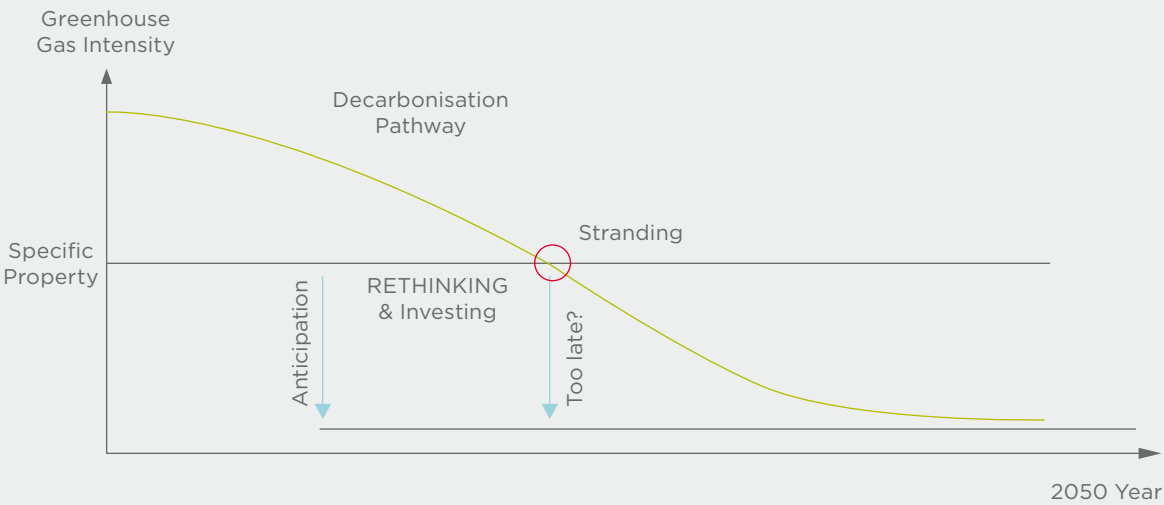
THE CLOCK IS TICKING: BUILDINGS IN THE EU ARE TO BE CO₂-NEUTRAL BY 2050 – IN GERMANY EVEN BY 2045.

AXEL FUNKE

Head of ESG / Sustainability & Sales

Real estate is responsible for about 35% of CO₂ emissions in Germany and 40% of energy consumption. The topic of energy saving is on the political agenda in both the EU and Germany, so increasing regulation is to be expected.

In the real estate sector, however, there is a very different - and partly also low - understanding among the participants regarding what exactly ESG compliance comprises. The fact that ESG is often only reduced to the "E" further underlines the educational and transformational task that the real estate sector must face up to.



CRREM – Carbon Risk Real Estate Monitor

The Carbon Risk Real Estate Monitor (CRREM) was developed to comply with ESG criteria and to classify a property. It can identify "stranded assets" and show when there is a need to modernise a property in terms of energy efficiency.

The Decarbonisation Pathway (green line) shows the permissible average CO₂ emissions for a property. From the intersection of the green line and the emissions of the respective property, a property is considered stranded.



WHOEVER ACTS IN GOOD TIME, REMAINS COMPETITIVE

INTERVIEW WITH AXEL FUNKE

How do I make ageing existing properties fit for certification?

In order to make existing properties fit for certification and increase energy efficiency, the technical building systems (**B**uilding **S**ervices **E**ngineering) – i.e. heating, ventilation and sanitation systems – should be optimised. There are various approaches to this; in principle, everything is possible, but it depends strongly on budget and goal. Redevelopment is primarily aimed at technical measures such as core removal or facade renovation in order to make certification possible. However, it is also important to go beyond purely technical aspects in order to achieve holistic ESG compliance.

Why is ESG so important? And do all owners acknowledge this importance?

ESG is becoming ever more important due to both political requirements and client requirements, we are currently observing a clear shift from a seller's to a buyer's market. However, despite the need to consider and implement these measures, there is still a great need for education. Not all owners are fully aware of the importance of ESG. Timely recognition of the importance and active engagement with the issue are necessary to ensure that a property remains competitive.

How do owners achieve ESG compliance for their properties – and not just with an emphasis on the "E"?

ESG compliance goes far beyond the environmental ("E") issue and also includes social ("S") and governance ("G") aspects. Technology is only one part of it.

A holistic view is required here. In addition to technical measures, social responsibility, transparent documentation and equality are important. For example, owners can promote the ESG compliance of their office property by ensuring that certain standards are achieved in their supply chain, such as guaranteed overtime payment for all participants. While the emphasis on the "E" is necessary, the focus should be on the bigger picture. The first step is usually an analysis of the current situation. Where do we stand?

And – more importantly – where do we want to go? Based on these considerations, we can then create a "climate roadmap" together with the client.

Could there be bans in Germany on selling or letting office properties above certain energy consumption threshold?

I think this is problematic due to the current significant reduction in new construction projects, coupled with an acute housing shortage. However, given the political focus on sustainability and energy efficiency, such bans would be within the realm of possibility in Germany; in the Netherlands, for example, something like this has already been introduced. At the EU level, it has already been decided that all residential buildings must at least comply with energy class E by 2030, so the current trend is clearly in the direction of de facto forcing owners of such properties to renovate.

Education is still needed here to prepare the industry for the changes. The timely adaptation of properties is also crucial here, and focused activity in the direction of ESG compliance is unavoidable.

“

Despite the necessity of ESG, there is still a great need for education. Not all owners are fully aware of the importance.

”



Axel Funke

Cushman & Wakefield
Head of ESG / Sustainability & Sales



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HIGH ENERGY COSTS REPRESENT AN OPERATIONAL RISK FOR OBSOLES- CENT PROPERTIES

//////////

Price rises	Y-o-Y	3Yr
Consumer price index	6%	18%
Food & beverages	9%	31%
Transport	7%	26%
Electricity, gas and other fuels	11%	58%
Electricity	17%	37%
Gas	18%	98%
Heating oil	-15%	88%
Solid fuel	-6%	76%
District heating	1%	41%

Source: German Federal Office of Statistics, status August 2023

Particularly since the beginning of the war in Ukraine, consumer prices have risen significantly. Food and beverages as well as energy costs have seen particularly strong growth. The price of gas rose by almost 100% in the past three years.

Rising energy costs have significantly increased the ancillary costs of office properties and represent an operating risk, especially for outdated existing buildings that have not been energy-optimised. High ancillary costs also place an additional burden on tenants and play an important role in leasing decisions.

Although energy prices will fall again - as can already be seen in some cases - the need to save energy for cost reasons as well as climate protection aspects will continue.

EVEN MORE FOCUS ON REFURBISHMENT

MANY INVESTORS CONTINUE TO FOCUS ON NEW DEVELOPMENT PROJECTS. AT THE SAME TIME, THE POTENTIAL OF RENOVATIONS COULD BE EXPLOITED EVEN MORE – ALSO WITH A VIEW TO SUSTAINABILITY AND LOWER EMISSIONS.

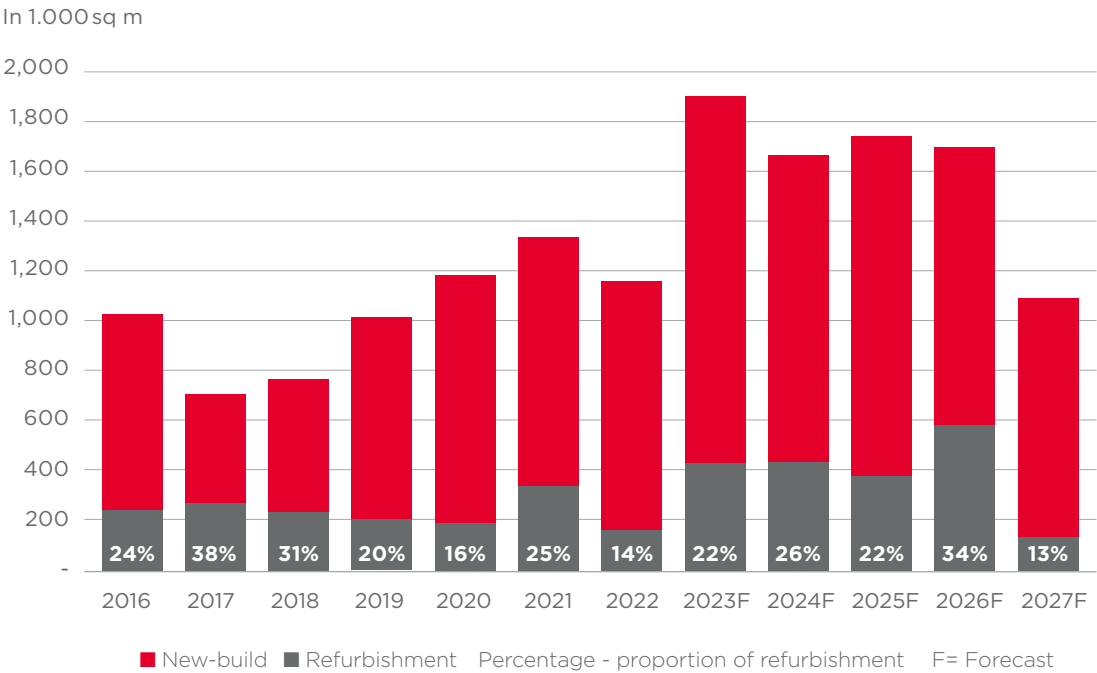
Completion volumes have been rising significantly since 2019. The drivers are the demand for modern space (“flight to quality”) and pre-letting from previous years. In 2023 as a whole, just under 2.0 million square metres of newly-built or core refurbished office space are expected. The pre-letting rate for 2023 is 68%.

In the current market environment, however, it is likely that some projects with an expected completion date of 2025 onwards, will be realised later or not at all. The changed financing environment and lack of pre-lettings play an important role here.

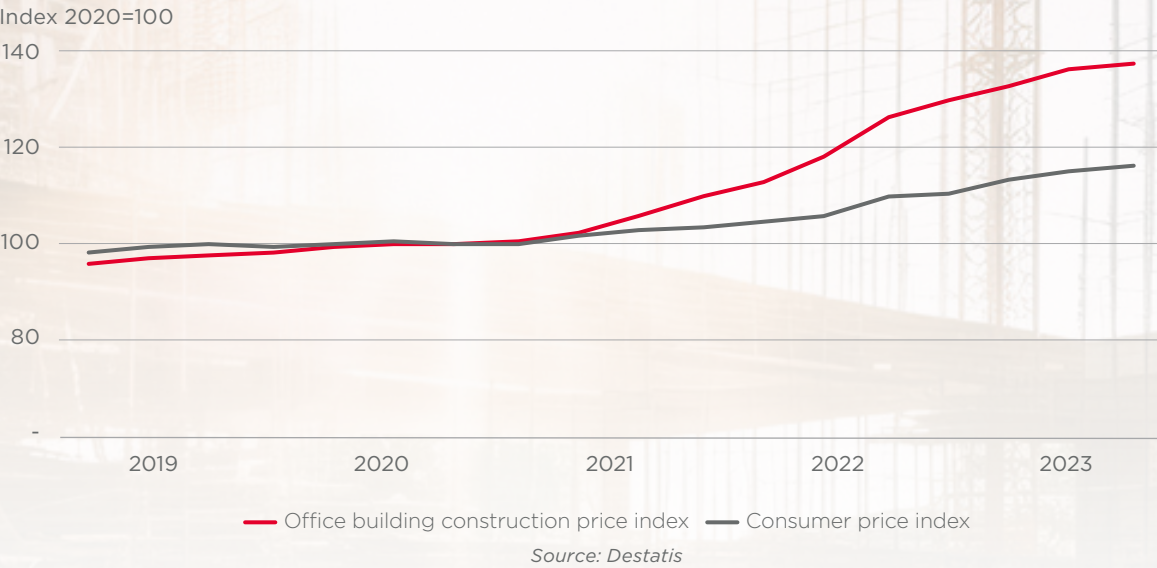
On the other hand, the proportion contributed by refurbishments to total completions has remained largely stable at around 25% over the last few years. Only now is there an increase – in the years 2023 to 2026 refurbishments will reach peak levels: As things stand, a good 1.8 million square metres of refurbished office space will come onto the market in the Top-5 markets during this period, which corresponds to 35% of the total.

Overall, however, most developers continue to focus on new buildings. The potential of refurbishments could – and should – be exploited to a much greater extent.

Completions (Top-5 markets)



Price indices development



Increased construction costs are limiting construction and refurbishment activity and raising rental prices

Construction prices have risen sharply in recent years (more than the CPI) and are reflected in higher rents. Especially in locations outside the city centre, there is a risk that the rental price level necessary for new buildings or refurbishments will be above that of the submarket.

The increase in construction costs will probably decelerate due to price reductions in individual building trades, but a significant decline seems unlikely for the time being.

CONTINUED HIGH RENTS FOR FIRST CLASS PROPERTIES

RENTS HAVE CONTINUED TO RISE FOR FIRST CLASS PROPERTIES IN FIRST CLASS LOCATIONS – AND RENTAL INCENTIVES ARE ALSO RISING.

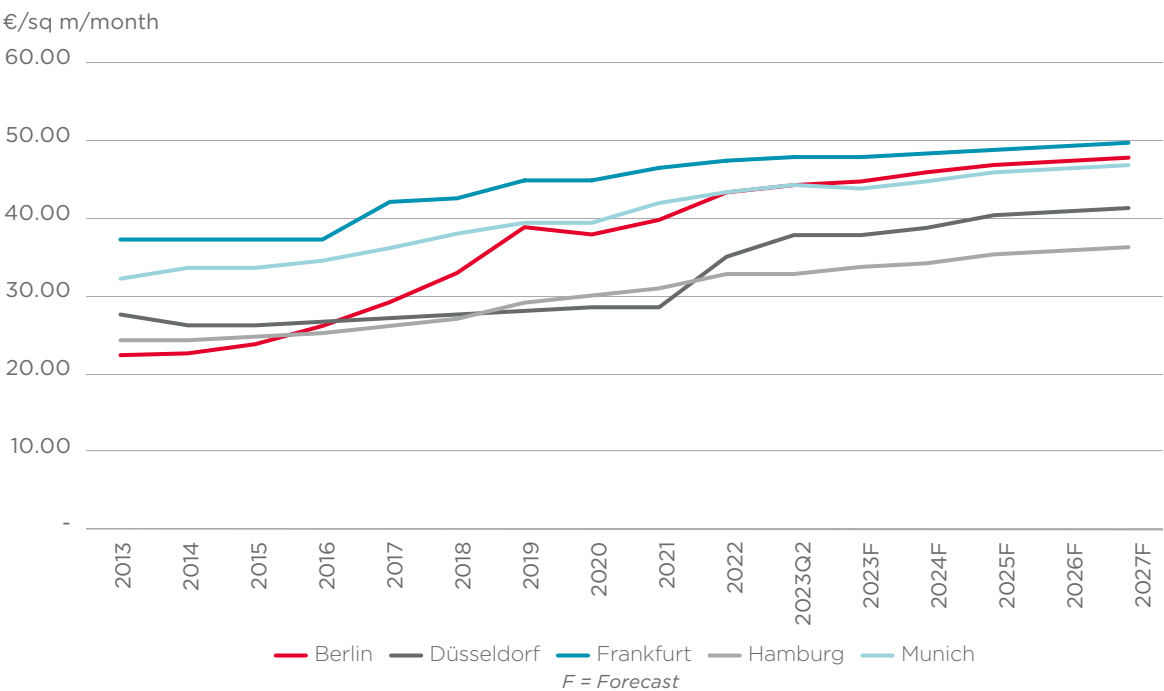
Prime rents have risen sharply in the Top-5 markets in recent years, especially in Berlin (+ 35% since 2018). In terms of average rents, a differentiation is discernible depending on the location category. Currently (Q2 2023), a weighted average monthly rent of around €24.80/sq m is registered in the Top-5. This corresponds to an increase of 28% compared to 2018.

Both supply and demand-side factors continue to speak for rising rents, although lower take-up is expected.

On the supply side, rental growth is driven by the scarcity of prime quality space in prime locations as well as high construction costs. On the demand side, the user focus on space with very good location and fit-out quality is currently compensating for the quantitative decline and is also leading to rent increases.

The high development volume and the current financing conditions will put increasing pressure on developers and portfolio holders. Rising rental incentives are therefore to be expected.

Prime rents (Top-5 markets)



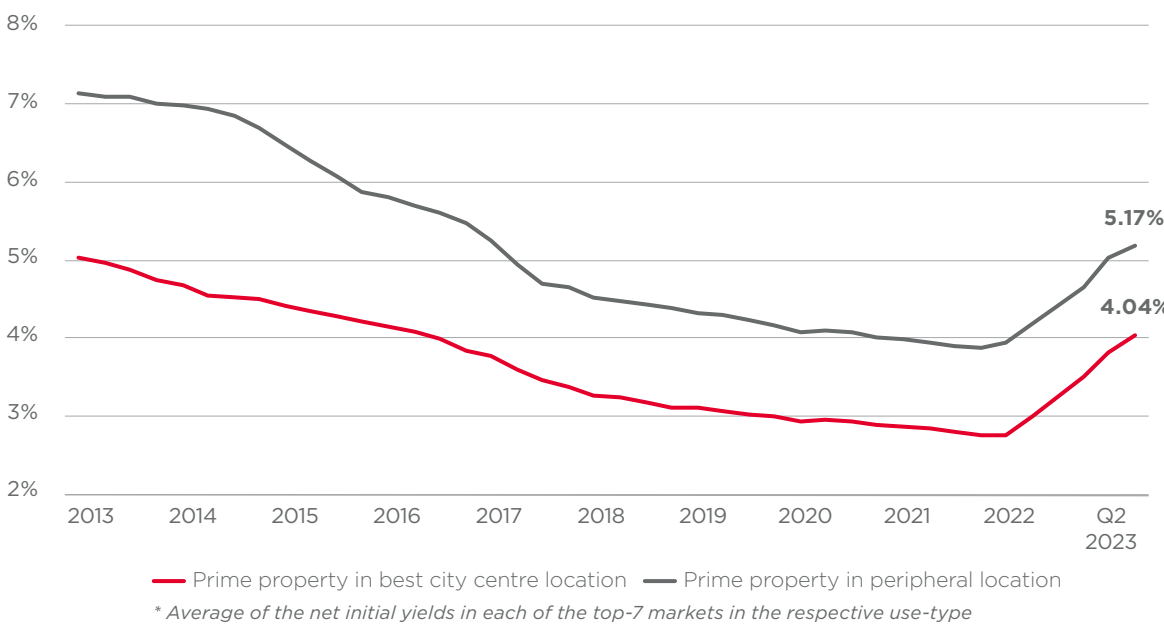
LOW LEVEL OF MARKET ACTIVITY SINCE BEGINNING OF INTEREST RATE TURNAROUND

Investor demand for office properties is currently very subdued, as the current financing situation is characterised by higher interest rates and stricter financing conditions. For outdated buildings that are no longer marketable, longer vacancy periods and falling rents will lead to necessary investment. Repositioning and repurposing, however, requires capital, which has become correspondingly more expensive.



Alexander Kropf
Cushman & Wakefield
Head of Capital Markets

Average prime yield* for prime office properties by location quality (Top-7 markets)



04

RETHINKING





In a historic period of office market change, owners face significant challenges. And two critical ones in particular:

First, the ever-increasing ESG requirements and guidelines and the associated investment required to reduce or avert obsolescence risk for office properties.

Secondly, the declining demand for office space due to remote working trends and increasing desk sharing, which will lead to further vacancy growth in the coming years. For the first time, the classic office is competing with remote working.

Rethinking is our keyword here: on the one hand, owners must actively consider a new orientation via repositioning. On the other hand, for properties that are no longer marketable for office use, repurposing should be considered.

As is so often the case, turbulent times also bring many opportunities - let's take advantage of them.

Heiko Himme

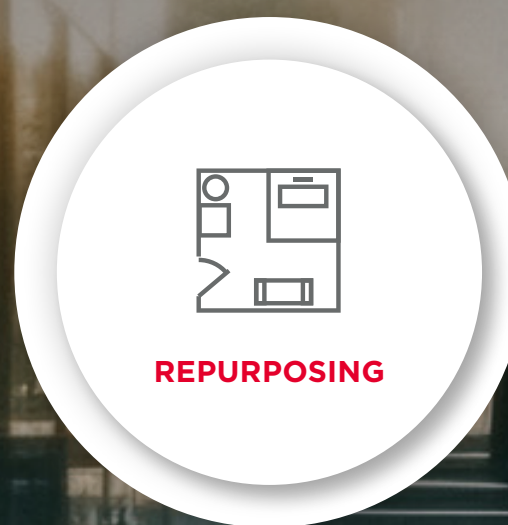
Cushman & Wakefield
Rethinking Representative Germany

RETHINKING

YOUR PROPERTY

Rethinking goes far beyond mere re-imagination. Above all, it is about making properties competitive again, increasing performance and sustaining it in the long term.

RETHINKING



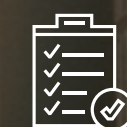
Reorientation and upgrading an asset whilst retaining its current purpose

Developing a conversion for a property that is no longer marketable for its previous use

PROCESS

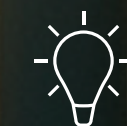
HOW WE SUPPORT YOU

We offer multidisciplinary solutions for properties that are no longer marketable due to economic, ecological or user-side changes.



Analysis

Together with you, we take a close look at your building or even your entire portfolio and work out - as a basis for all further steps - the current market drivers and their impact on your property.



Strategy

With a view to the current and future requirements of the market, your market requirements, your goals and your budget, we develop a comprehensive strategy for repositioning and/or repurposing your property. We show you various options and make recommendations for optimisation.



Implementation

We support you with an individually tailored combination of our services and global and local expertise - from the modernisation of the building fabric, sustainability and ESG to the realisation of an improved and high-quality user experience.

WE
CREATE
YOUR
TOMORROW
TODAY



A CONVERSION IS OFTEN ALSO A WORST-CASE SCENARIO

INTERVIEW WITH RAMIN RABEIAN

MONTANO
REAL ESTATE



How do you evaluate the risk of office property obsolescence?

We look at obsolescence risk holistically in the context of environmental, social and governance (ESG) criteria. The "E" (environment) in particular plays the decisive role here. Using the Stranding Asset Analysis, we assess whether a building is still marketable or at what point this will no longer be the case. ESG compliance is a decisive factor here for the assessment of obsolescence risks. Added to this is the quality of the location, as this has a significant influence on future use.

How do you reduce the obsolescence risk of your portfolio?

We proactively analyse user behaviour in detail and are now focusing more on central locations and certain sectors. For example, we have launched an Article 8 fund that invests in properties with public sector users. We use a scoring model approved by BaFin and set a minimum score that must be achieved for our assets. Overall, we always keep a close eye on the target group and their changing needs in order to be able to flexibly adapt the buildings, as well as our strategy. In terms of ESG criteria and trends, we look particularly closely at London, as new developments often appear there first and come to Germany later.

Repurposing or demolition – what are the arguments in favour of each?

The decision between repurposing or demolishing office buildings depends on various factors, including not only the building itself but also the location and the remaining useful life. Another important aspect is business tax. This is especially true for municipalities that are reluctant to forego business tax revenues and are therefore more hesitant to redesignate in favour of other uses. If this redesignation does take place, it is often through demolition and new construction. The grey energy and emissions - emissions that result from the construction and demolition of a building - should be taken into account in this decision, as it is usually more sustainable to maintain the existing building substance. Nevertheless, converting an office building into, for example, an efficient residential building is extremely difficult and is often a worst-case scenario financially for the owner. Modular construction and standardisation could be a sensible solution here.

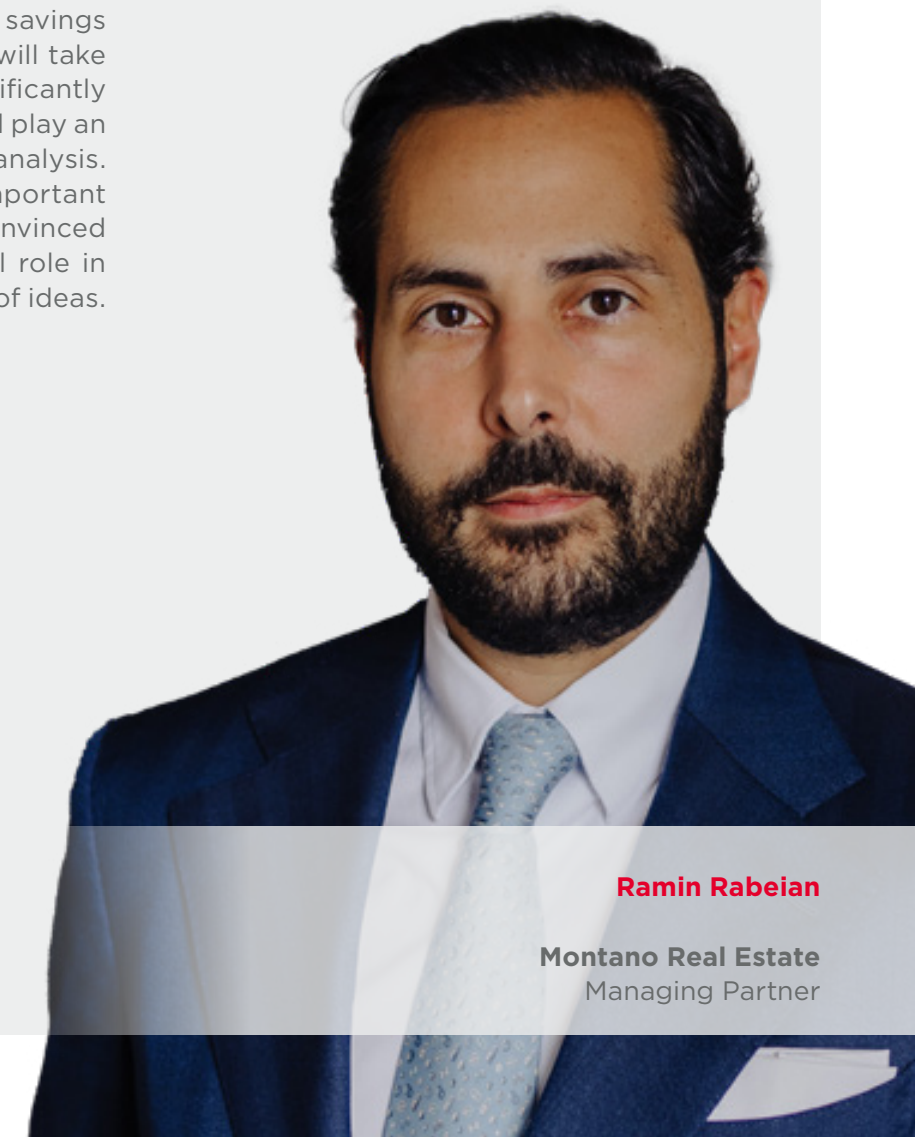
How do you think the market will develop over the next ten years?

We expect rents to continue to rise, although occupiers will tend to downsize in the medium term. This is because companies are increasingly investing in high-quality, well-located office space to attract and retain talent. This "flight to quality" is putting pressure on the letting markets. Meanwhile, there will be potential for space savings in the back-office sector. This downsizing will take place over the next few years and will significantly change everyday office life. ESG criteria will play an increasingly important role in the overall analysis. Legislators will also have to play an important role here. Overall, however, we are convinced that offices will continue to play a central role in personal interaction and the development of ideas.

“

In some cases, a conversion of an office property does not make economic sense and it has to be completely rethought in the direction of demolition and new construction.

”



Ramin Rabeian

Montano Real Estate
Managing Partner



A CLEARLY DEFINED ESG ROADMAP IS ESSENTIAL

INTERVIEW WITH INGO SCHIERHORN

ALSTRIA
OFFICE REIT-AG



How do you see the risk of obsolescence in alstria's office portfolio?

We are convinced that our buildings and office space will remain relevant and continue to experience correspondingly good demand from users. However, we closely monitor the changing requirements of our tenants and analyse our buildings to ensure that they meet current market demands.

What are you doing with ESG in mind?

A clearly defined "ESG roadmap" that sets the direction in which the property is to be developed is essential. This planning becomes all the more relevant the larger the rental area. We place great emphasis on actively involving tenants in this process so that they can use their property in the most energy-efficient way possible. Our approach starts by asking fundamental questions: What is the current status of the property and specifically its technical systems? Where are the "low hanging fruit", i.e. those starting points with the greatest return in terms of ESG? Our initial focus is on the technical data and consumption. Our own property management is very helpful here, as it gives us direct access to relevant data. Thanks to this data, we can, for example, optimise energy consumption in our buildings and implement sustainable strategies.

What's your strategy regarding ESG?

Even before the pandemic, we were receiving more enquiries about ESG issues. However, at that time the emphasis was more on the ESG label than on energy efficiency. These enquiries came mainly from international companies, which had been requesting certifications since the early 2010s. This trend continued in the following years and shows the steadily growing focus on sustainability in the real estate industry. Our strategic measures are strongly focused on actively shaping this change and meeting the needs of our users in line with ESG criteria.

From a strategic perspective, we focus in particular on those properties that fall below a certain CRREM (Carbon Risk Real Estate Monitor) path. This requires an individual approach and a comprehensive consideration of what can be done. This can mean that a building is directly re-let if everything fits, or that more intensive measures are required. Here we are not only thinking about the replacement of technical components, but also beyond that.

Repurposing or demolition – what are the arguments in favour of each?

We have not had any specific experience with repurposing of our buildings so far. Our main focus is on optimising our existing office space to ensure that it meets current requirements.

What will happen in office real estate in the next ten years?

The office is not dead, but will continue to play an important role as personal interaction remains indispensable. The importance of ESG criteria will continue to increase and close cooperation between owners and tenants will be crucial to jointly master future challenges. In terms of preferred locations, little will change as central locations continue to offer the best accessibility. Neighbourhood locations that are more suitable for residential purposes will also be (re)used for this purpose. However, we believe that the neighbourhood and campus idea will continue to gain in importance.



Ingo Schierhorn FRICS

alstria office REIT-AG
Head of Real Estate Operations

04

CASE STUDIES - RETHINKING PROJECTS



RETHINKING CASE STUDIES



DAS CENTER AM POTSDAMER PLATZ



Berlin



120,000 sq m



Oxford Properties |
Norges

CHALLENGE

- Landmark building from 2000 with various uses spread over eight buildings, including Deutsche Bahn headquarters
- One of the tasks was to find a suitable use for the cinema space, to refurbish the office space and to upgrade the outdoor areas

SOLUTION

- Former cinema becomes fitness and immersive entertainment space, former lmax becomes food hall, redesign of public areas
- Rebranding during and after the conversion phase
- Implementation of comprehensive ESG measures (e.g. certification, e-charging points, bicycle stands, reduction of energy consumption, etc.)



AUGUSTANLAGE



Mannheim



28,880 sq m



Landmarken

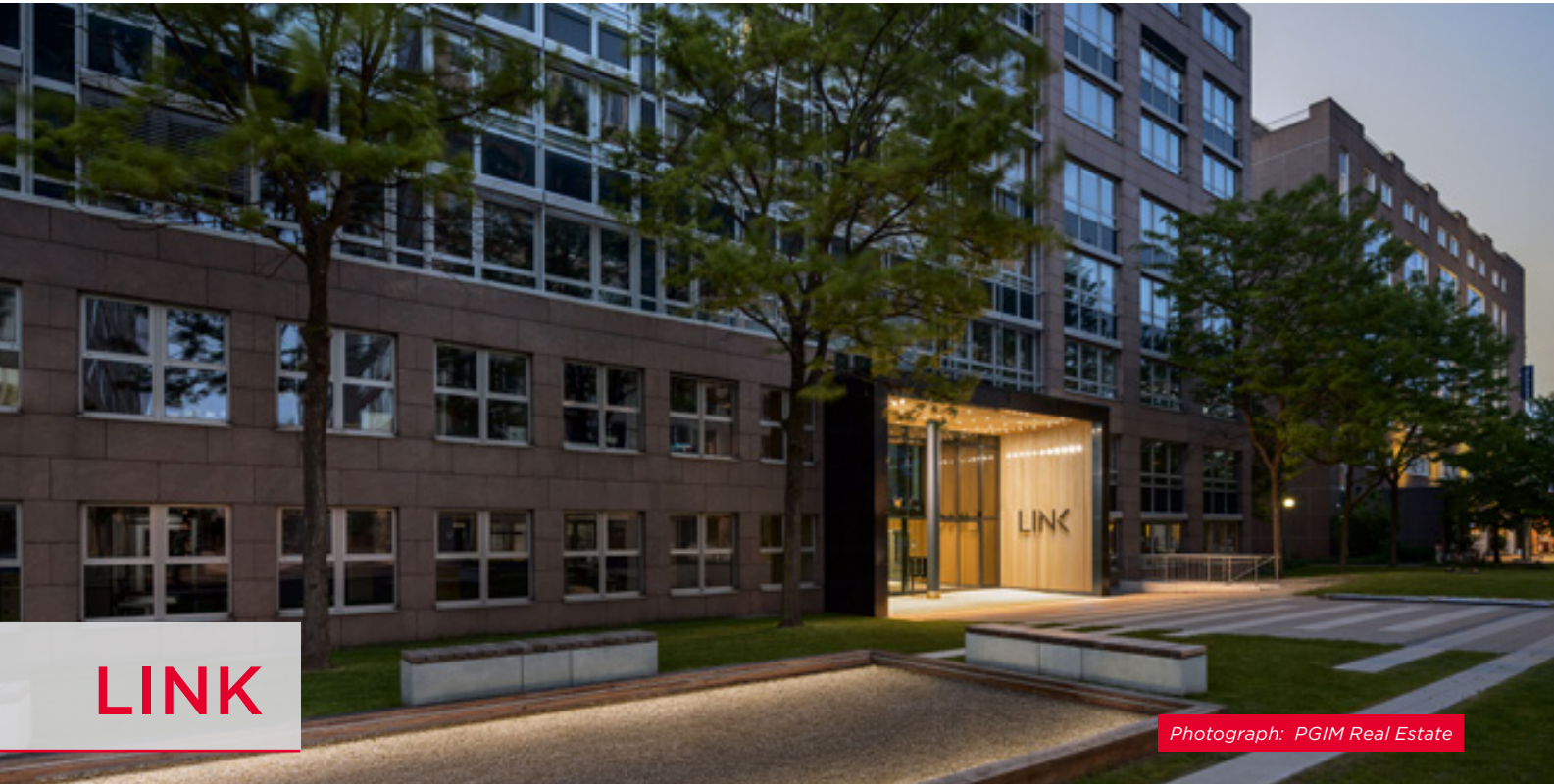
CHALLENGE

- Listed building ensemble
- Part of the office space has a remaining term of more than ten years, 20,000 sq m are about to become vacant - accordingly, different investor target groups had to be addressed
- High re-letting risk (location outside the Top-7)

SOLUTION

- C&W carried out various scenario analyses as well as a strategy review of the current letting situation and the potential of the building.
- The building was structured as a sale & lease-back and a post-letting strategy was developed.
- The buyer plans to implement a manage-to-ESG strategy for the historic building stock.

RETHINKING CASE STUDIES



LINK

Photograph: PGIM Real Estate



PLATZ DER IDEEN 1-3

Photograph: Holger Peters



Frankfurt



9,900 sq m



PGIM



Düsseldorf



11,800 sq m



Patrizia

CHALLENGE

- The previous main tenant moved out of the building in 2020.
- The office space (built in 1996) no longer met current requirements; above-average competition in the submarket (City-West).

SOLUTION

- Technical upgrading by PGIM Real Estate representing the owner
- Special attention to ESG criteria: e.g. BREEAM & WiredScore certification, reduction of CO2 footprint, smart metering, green leases, new design of outdoor areas (courtyard, bowling alley, roof terraces) and lobby, beehives on roof
- Redesign of office space from individual offices to a modern open-space concept
- The process resulted in a very successful repositioning as a multi-tenant property with numerous renowned occupiers

CHALLENGE

- Creation of new working environments in a listed former barracks building.
- In view of the monument protection requirements, corridors and barrack wall positions had to be retained, which entailed a high level of inefficiency in this volume of space.

SOLUTION

- Establishment of a creative and diversified mix of uses
- Increase attractiveness through ESG, creation of new meeting zones in the entrance area and landscaped redesign of the outdoor space
- Through new positioning on the market, existing leases could be extended. The vacant space is nearing successful conclusion of letting to a major user

RETHINKING CASE STUDIES



WILHELMSTRASSE



Braunschweig



8,850 sq m



Hans Oeding
GmbH & Co. KG

CHALLENGE

- The site was developed with a 6-storey post-war building, which was extended several times and used as a printing and publishing building.
- Low flexibility of the existing space.

SOLUTION

- C&W was mandated with the development project as well as the planning for a repurposing and repositioning of the building.
- The building was extensively converted for office use and as student accommodation.
- Commercial space was created on the ground floor.

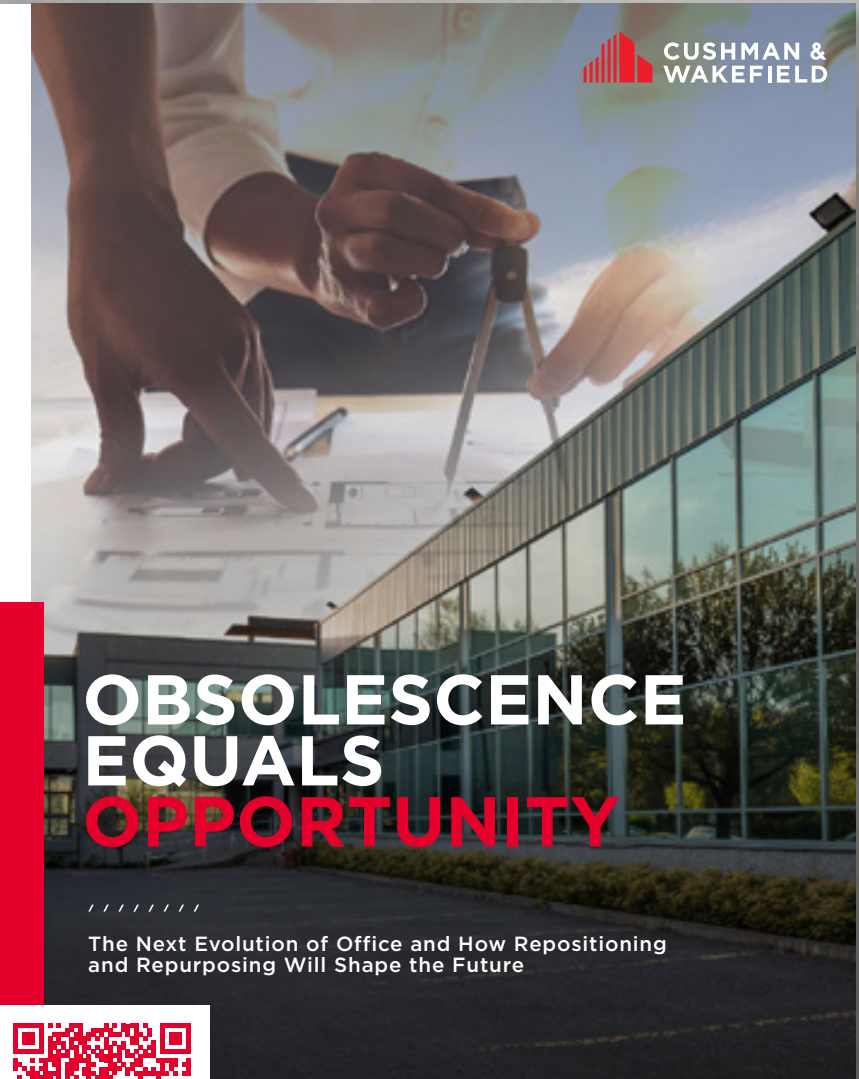
////“////
THERE ARE FEW BUILDINGS
THAT CANNOT BE LED INTO
THE FUTURE.

////”////
INGO SCHIERHORN FRICS
Head of Real Estate Operations
alstria office REIT-AG

PREVENTING OBSOLESCENCE VIA RETHINKING

GLOBALY RESEARCHED: OUR INTERNATIONAL REPORTS ON THE
TOPIC OF OBSOLESCENCE

USA-Report (February 2023)



- Weak growth in office employment
- Vacancy as a relevant issue
- Shift to flexible working - densification and reduction of space
- Flight to quality
- » **61% of the stock obsolete by 2030**

EMEA-Report (March 2023)



- Vacancy rate lower than in the US - Demand robust and exceeds new supply
- Flight to Quality
- ESG regulation
- » **76% of stock obsolete by 2030**

APAC-Report (June 2023)



- Very diverse markets in terms of maturity
- Strong growth in office employment in China, India and the Philippines
- Increased pressure: vacancies, changing user needs, introduction of ESG regulation
- » **50% of the stock has only average fit-out quality**







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KEEP IN TOUCH



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