PRIMONIAL REIM

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THE POST-COVID OFFICE IN EUROPE: DISRUPTION OR ACCELERATION?

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The longer the Covid-19 pandemic lasts, the more it transforms our lives, and, in particular, the way we work. Companies have scaled up partial or total remote-working practises and, in reaction, employers have taken another look at their real-estate policies, and employees at their lifestyles. What should we expect going forward, from the investor's and asset manager's viewpoint? How do we distinguish already existing long-term, and now accelerating, office trends from novelties brought on by the pandemic? Will changes be uniform or vary from country to country and sector to sector?

I. A revolution in building uses, including remote-working

For the past several years now, the emerging age of access. The transformation in real estate use is part of a broader economic and social evolution. In Jeremy Rifkin's words, we are collectively shifting from the age of ownership to the age of access[1]. Real estate had already travelled a little down this path with companies' increasing preference for leasing their offices, rather than owning them. Technological innovations and demand from generations Y and Z are now accelerating this trend. Landlords are moving from merely making a property infrastructure available to managing this infrastructure for their tenants.

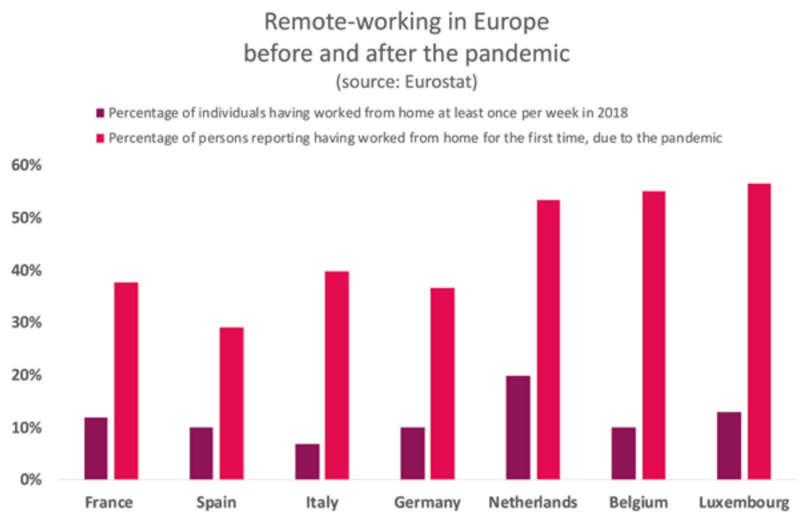
Age of ownership	Age of access
Selling/leasing a property	Giving access to a service/an experience
landlord/tenant	Service provider/User
Real-estate market	Real-estate services network
Paying rent	Monetising a service
Tenant	Member
"Where can I find well-located 5,000 m^2?"	"What can your building do?"

During the age of access, a new real-estate actor emerges: **the operator, i.e., the organiser of the user experience in the building.** Whereas in a traditional organisation the landlord made a building available to the tenant in exchange for rent, in the emerging world, one (or more) operator(s) provide the user with an experience via services (concierge, fitness, catering, etc.). The tenant/user pays both the landlord for making the premises available and the operator for the services. Monetising services can take several possible forms, including pay-per-use, monetising of intangible resources, or monetising user data.

It is through this prism, which had been taking shape long before the pandemic, that the increase in remote-working should be analysed.

The remote-working trade-off. Prior to the pandemic, Europe was already trending slowly towards remote-working, with an increase in the percentage of occasional remote-workers from 5.8% on average in 2008 to 9.7% in 2019. Remote-working is most common in countries with a high proportion of executives, such as in Northern Europe (the Netherlands, Denmark, etc.). During the first lockdown, the percentage rose three- to five-fold, to about 40% in France, Germany, and Italy and to 30% in Spain[2].

[1] *Jeremy Rifkin, 2000, The Age of Access, or Dror Poleg, 2020, Rethinking Real Estate.*
[2] *Eurostat, 2020, How usual is it to work from home?*



Keep in mind that this percentage is close to its technical maximum, as an estimated 37% of jobs could be done remotely on a permanent basis[3]. The percentage is far greater, of course, in sectors such as finance, IT, communication and advisory. And these sectors are heavily represented among the large users on rental markets. So remote-working does indeed have lots of potential.

	Potential advantages	Potential drawbacks
Employers	- Saving on rent and overheads - Reducing staff turnover and attracting young talent - Eliminating costs of adjusting to staff numbers	- IT expenses - Reimbursement of employee-borne costs (Internet charges, office equipment, etc.) - Risk to data confidentiality - Loss of productivity/control
Employees	- Savings in transport costs and time - Flexibility/autonomy - Less stress	- Difficulties in signing out - Feelings of isolation - Loss of data

That being said, remote-working is not an inevitable choice, either for companies or for employees. The most obvious advantage for companies in switching to total or partial remote-working is savings on rent. In France, for example, rent is equivalent to about 8 to 9% of companies' added value and is trending upward (it was below 7% before 2008)[4]. The most obvious risk is lost employee productivity, caused by a rupture in the link with the employer brand, including less a sense of belonging, less circulation of information, greater management obstacles, etc. The trap for companies is obvious – short-term savings in exchange for a long-term decline in productivity[5]. There have been several examples of this (Yahoo, IBM, etc.), even some involving technology companies.

The most recent surveys confirm that companies and their employees are quite aware of this trap[6]. A survey was conducted in late 2020 of a panel of employees and managers on post-pandemic remote-working. 61% of the panel replied "three days or more each week" "as long as the public health risk lasts". Post-pandemic, this proportion falls to… 2%, with 49% replying "at least twice a week". These replies show clearly that while the all-remote-working model is felt to be a temporary alternative during a pandemic, what people really want is a hybrid model.

[3] *European DataLab, based on Dingel and Neiman (2020).*
[4] *Antoine Bergeaud, Simon Ray, September-October 2020, "Macroéconomie du télétravail", Bulletin de la Banque de France.*
[5] *See Battiston, Blanes, Vidal and Kirchmaier (2017), "Is Distance Dead? Face-to-Face Communication and Productivity in Teams." CEPR Discussion Paper No. 11924.*
[6] *JLL, December 2020, Reimagining offices of the future. CSA survey of 88 companies and 2033 employees worldwide.*

On top of this difficult trade-off there is a major unknown implicit in the aforementioned survey: what distancing standards will remain after the pandemic? Will the public health threat become endemic, forcing us to reorganise our social behaviour and, hence, how we use real estate?

If so, it is entirely possible that the pandemic will trigger demand for more square metres of office space! But only time will tell how likely this is.

II. The post-Covid office uses, spaces, leases

Just as the 2008 financial crisis triggered a new phase of streamlining of companies' real-estate strategies, heightened demand for flexibility is now likely. This could occur on three levels: flexibility of uses, spaces and leases.

Flexibility of uses: serviced offices and hybridisation. With increasing qualified staff, more women employees, the rise of individualism, shorter work times, and so on, demand has emerged in the areas of structuring of living time and reconciling the work-life balance. This is especially the case with knowledge workers[7] in cities with long commuting times. Hence, the development of personal services (dry-cleaning, massages, etc.) that can be consumed without taking away from work time.

Assuming that a building is designed as a network of services, there is nothing, apart from technical legal constraints, to keep it from offering multi-purpose services – i.e., a hybridisation of functions. An office, for example, could have a restaurant this is open to the public. Working space in the offices could be interchangeable. The same office might have a co-working space to host a community of entrepreneurs or freelancers. Modern offices can actually be designed as modulable activity centres, and even as spaces operating by day as offices and in the evening or on weekend for other activities.

With this in mind, corporate headquarters now plays a key role in maintaining cohesion, creativity and internal and external identity. The corporate campus shapes the feeling of belonging to an organisation and helps promote corporate values with clients and attract new talent.

Workstation flexibility: fewer m² or more flexible m²? Workstation flexibility comes down to the issue of employee mobility, i.e., the path between office, home-office and third places. Proper management of this "employee path" can achieve objectives of space optimisation, team-building, and well-being at work better than an all-remote-working model.

Based on trends in practises over the past 10 years and the general rethinking brought on by the pandemic, it is safe to assume that greater efforts will be made to optimise use of office space as part of an effort to control employee flows. This is not the time to be thinking of long-term solutions, as it is not yet known how long social distancing measures will last. This is why the rental market is moving so slowly now. But going forward, two "ideal" models emerge.

- **A move towards reducing space (fewer m²):** the company develops remote-working, reduces its square meterage per workstation (but not necessarily its total square meterage), and reconfigures the office as a space for maintaining a certain amount of togetherness.
- **A move towards office work (more flexible m²):** the company keeps its existing space while redistributing it smartly: this is the flex-office adjusted for new health and technological innovation protocols.

There are other solutions that fall between these two models. Ultimately, it is companies' specific needs that will decide. A small company, for example, may prefer a packaged real-estate solution for its flexibility.

We can also see that each of these models opens the door to the use of third places. Third places can be dedicated co-working spaces or vacant space on campuses.

In any case, **it is too early to say whether this enhanced flexibility in space will increase or decrease take-up.** Regardless of the impact of the economic recession and social distancing, it is not yet clear whether the alternatives of "fewer workstations but more services" or "fewer workstations at the office but more third places" will result in weaker overall demand for m².

[7] Workers whose raw material is information. Terme introduced by Peter Drucker in 1959.

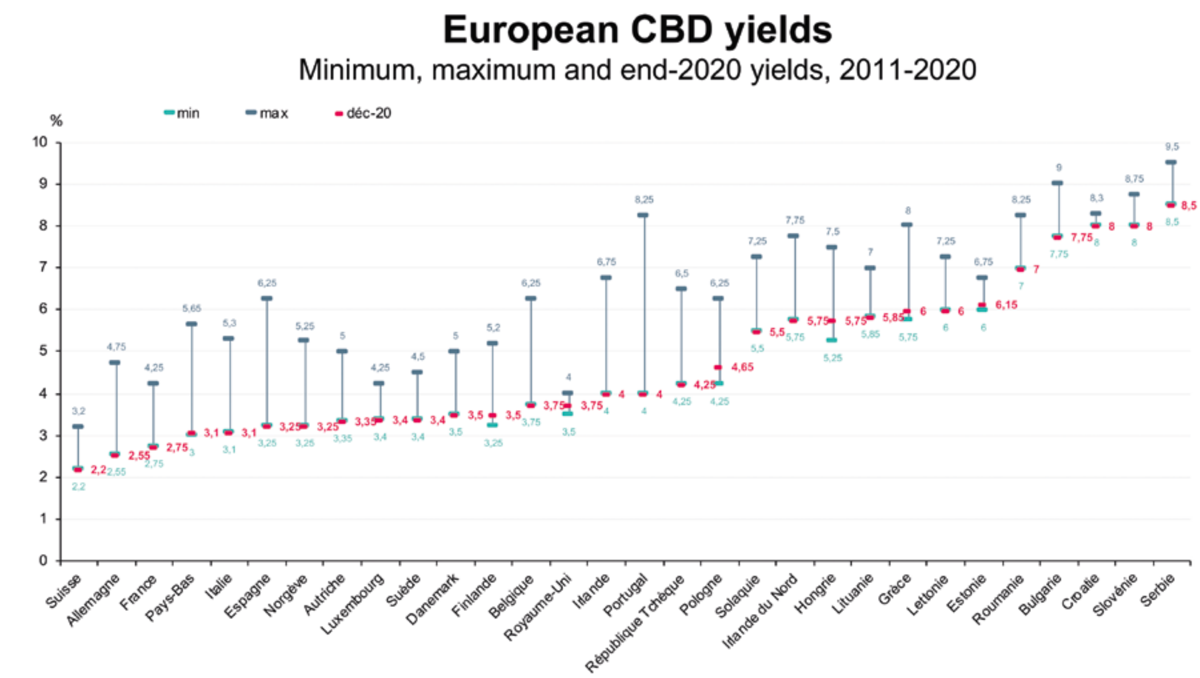
Flexibility of leases. The traditional commercial lease is now predominant. The current crisis has not kept users from signing long-term leases. On the contrary, they are open to incentives in the form of rent holidays, which increase as the lease gets longer.

However, the market will probably trend towards a larger share of variable rents, particularly though subletting of collective spaces, or acquisition of co-working spaces. The issue of monetising indoor building services and data compiled from users could arise in the medium-long term. Co-working companies are still struggling to build a profitable business model. The rest of the pandemic will show whether the "5 m² per workstation" model will remain valid for co-working companies.

Shift, Primonial REIM acquisition in January 2021. 47,000 m², including 4,000 m² in services. Capacity ratio of 1/10. Double "HQE Exceptionnel" and "BREEAM Excellent" certifications.

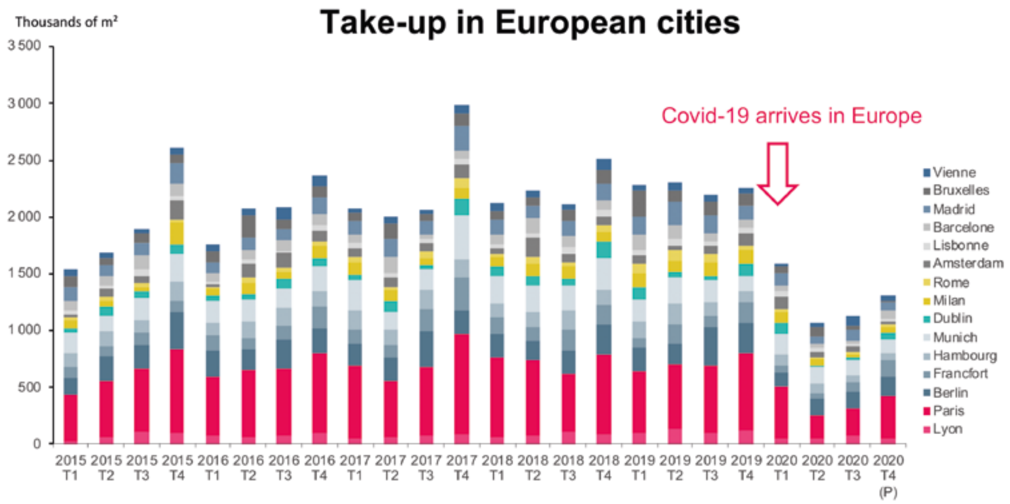
III. Performance: vacancies as a driver of rent adjustments

It will be difficult in the coming months to distinguish between the impact of the economic recession on the office market and the impact of shifting uses, especially as the pandemic came amidst a historic decline in yields. And yet, as of the end of 2020, central business district (CBD) yields have suffered no price declines. **The negative interest-rate environment continues to favour real-estate investment.**



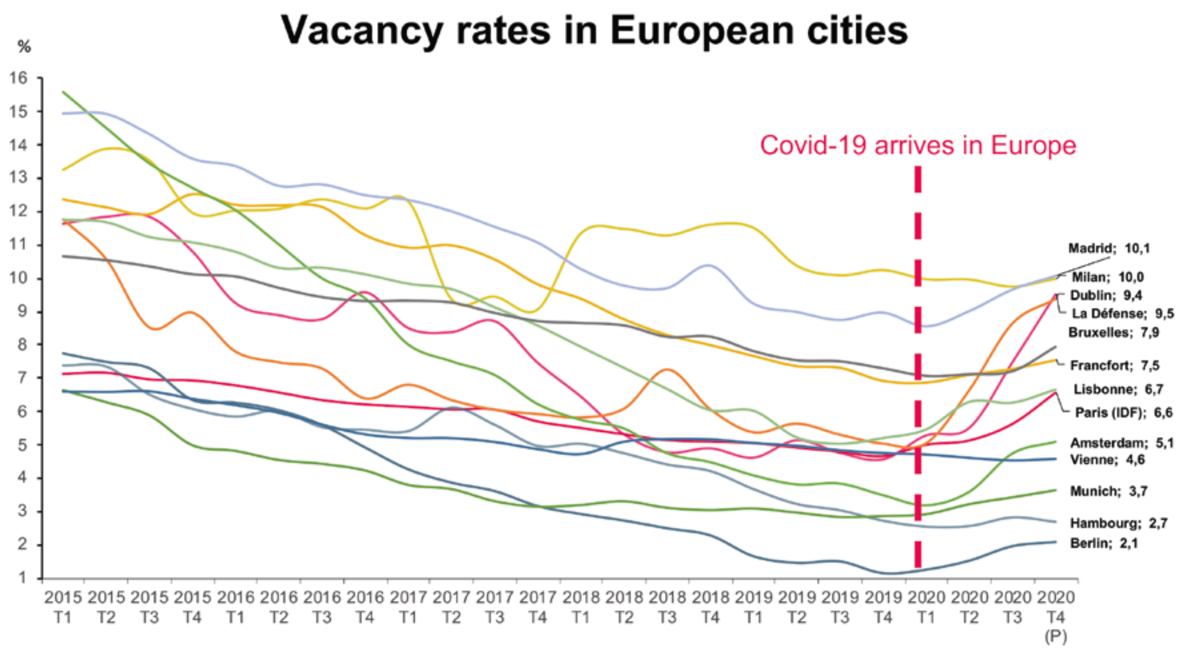
Source(s): Primonial REIM Research & Strategy, based on CBRE figures.

One feature of 2020 is **the collapse in rental demand everywhere in Europe.** This is due mainly to uncertainties over public health restrictions, which have made it impossible to assess the number of m² necessary for companies' operations. The "post-pandemic" capacity ratio will trend downward because of the expansion of remote-working and higher social distancing standards, not to mention the sharing of services, some of which (company restaurants, etc.) may also be influenced by health regulations. In this context, cost-optimisation will not necessarily target rent per m² but more likely controlling overall operating costs.



Source(s): Primonial REIM Research & Strategy, based on CBRE figures.

In light of pandemic developments in the first months of 2021, it is reasonable to assume that the level of operations will remain low and that vacancies will rise. **This increase in vacancy rates, seen in almost all European cities, will not be uniform.** For example, the increase in supply in Berlin from 175,000 m² to 479,000 m² in 2020 is likely to make this market more liquid, with a vacancy rate below 3%, whereas other markets (La Défense, Madrid, Milan, etc.) are threatened by excess supply and by numerous speculative projects and could see downward pressure on their rents.



Source(s): Primonial REIM Research & Strategy, based on CBRE figures.

IV. Conclusion: what are the new factors in evaluating office?

Keep in mind that **offices have not been disrupted by the pandemic.** They have actually seen an acceleration in user demand, with landlords being asked to review all opportunities for using this infrastructure to the fullest. Investors' appetite has not shrunk for office property. Rather, they have begun a "flight to quality", which will inevitably result in a relegation of the lowest-quality segment.

Here, in our view, are factors that help an investor assess an office asset:

- **Some factors haven't changed:** location in an established office district, the asset's efficiency, and the tenant's solvency throughout the term of the lease.
- **Some factors are now more prominent:** an optimised capacity ratio (typically 1 to 9 for companies and 1 to 5 for co-working companies) but offering the option of meeting or service space, or even buffer spaces; reversibility and mixed use.
- **Some factors have emerged during the pandemic:** the quality of ventilation (air renewal and conditioning), the building's environmental labelling (including its ability to monitor and control energy consumption).

Large buildings are currently the most resilient, as they are better equipped to address future challenges:

- They are able to deploy services on a sufficient critical scale and thus achieve profitability from these services; this is a guarantee of quality, with the user's option to switch to pay-per-use;
- They are able to address flexibility challenges by implementing co-working and co-meeting solutions within the building;
- They make it possible to deploy the building as a "social network", characterised by the critical mass of staff that it accommodates;
- The better meet the challenges of building streamlining, through the option of centralising a company's staff.

Lastly, smart, **technology**-based buildings will be increasingly essential in understanding, measuring and adapting properties to users' needs. Data has commercial value in and of itself. It promotes interoperability (insertion in a future urban smart grid) and the ability to manage energy consumption. The building's connectivity with the users' digital tools (smartphones) also allows full access to the property, as the level of connectivity expands the range of uses.

Primonial Real Estate Investment Management (Primonial REIM) is a portfolio management company approved by the French financial markets authority (AMF) on 16 December, 2011.

It received AIFM accreditation on 10 June, 2014. Its business consists in creating, structuring and managing long-term real estate investments by individual and institutional investors.

Primonial REIM has a comprehensive range of expertise:

- **multi-products:** SCPI, OPCI, SCI;
- **multi-sectors:** offices, retail, residential, hotels, healthcare and education property;
- **multi-national:** France, Germany, Spain, Italy, Belgium, Ireland and Netherlands.

At 31 december 2020, Primonial REIM had:

- **€ 26,8bn** of assets under management;
- **75 909 associates;**
- **50** independent real estate advisors;
- a portfolio of **4,643,011 m² and 7,000 tenants,** including a high share of large corporate tenants (Samsung, Korian, Crédit Agricole, SNCF, etc.).

www.primonialreim.com

PRIMONIAL REAL ESTATE INVESTMENT MANAGEMENT

A Limited Liability Company with a Board of Directors and Supervisory Board and share capital of €825,100.
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The Research & Strategy Department's role is to formalize Primonial REIM's real estate investment strategies, based on continuous monitoring of the French and European markets. Although collective real estate accounts for a growing share of institutional portfolios and household savings, it is at the crossroads of financial (hierarchy of rates), economic (tenants' business models), demographic (the metropolisation phenomenon) and societal (changes in usage) factors. This is why a cross-cutting analysis is needed, which is also long term and therefore in keeping with the horizon of most real estate investors.

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