New Normal – the future of the real estate industry

WebCast 28. Oktober 2020 10:00 – 11:00 am

Corporate Real Estate Management, Digitalisation & Developments in the hotel sector

- Transformation of working environment – new requirements for CREM?
- Digitalisation – Update PropTech Map & Trends in the PropTech Market
- Hotel industry – slow recovery or collapse of the industry?
- Update Legal – legal implications of changing working procedures

Registration via LINK: www.pwc-events.com/Real-Estate-WebCast
Updates and Informationen here: https://blogs.pwc.de/real-estate/
Which usage concept provides the best opportunities?

Intensified trends through Covid-19

- **Capital flows** to real estate as an alternative investment class **increased**
- PwC Investor Survey confirms **lower yield expectations** for real estate (e.g. Top7 Office Core approx. -50bps)
- Uncertainty about **sustainable use concepts**
  - What purpose does the property serve?
  - What does the user expect?
- **PropTech-Trends:** Covid as a catalyst for market shakeout **Ecosystems** of owners, users and PropTechs will change the industry dramatically
- **Future of Office & Hotel** Industry in Focus
- **Rent Attack & Best Practice** in the rental market
Many companies are already planning to reduce floor space and increase home office.

**Current mood of selected companies**

**Siemens**
"140,000 employees are to be given the standard option of mobile working two to three days a week."

**Vodafone DE**
"Employees should be up to work up to 90% ‘mobile’."

**Bayer**
"However, we expect that after the positive experiences during the pandemic, more employees will use this form of work in the future (...)."

**BMW**
"At least two days a week, employees should no longer have to appear in the office."

**Allianz**
"Management believes that office space in the Group could be reduced by a third in the longer term."

**Lufthansa**
"In Germany, administrative space will be reduced by 30%."

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Our current study focuses on the "office of the future"

1st part of the study: Survey

- **Period:** August and September 2020
- **Respondents:** 100 employers and 500 employees of German companies with at least 50 office workplaces
- **Industries:** Service, industry and trade (excluding public services)
- **Regions:** all federal states with focus on central and southern Germany

2nd part of the study: calculation model

- Calculation of possible **saving potentials** with space reduction from the user’s point of view
- **Basis for the quantitative model:** Results of the survey and market-driven assumptions for rental and ownership scenarios
The survey shows a clear vote for home office and mobile working

Results of the survey

• **Productivity**: Employers and employees evaluate previous experiences with home office as successful and observe an unchanged or higher productivity.

• **Number of home office days**: 71% of employees want more home office in the future. Employers expect an increase in weekly home office days from 2.0 to 3.3 days on average.

• **Reduction of space**: 60% of employers expect a reduction in the amount of space required within the next three years - on average 20% of the space is to be reduced.

• **Costs**: An average of €220 per m² is calculated for renovations to existing office space (additional meeting rooms, digital infrastructure at the workplace, flexible desk sharing) and an average of €950 per employee for technical equipment.

- 3,3 days per week employees will work in the home office in the future
- 20% of office space should be reduced on average
- 220 € per m² on average for the modification of the office space
- 950 € per employee for technical equipment for the home office
We have calculated potential savings for rental and ownership scenarios

Overview of the scenarios

• **Scenario 1 - Rental scenario:**
  The user is the tenant of the office space. In case of a change in the space, the rental space is reduced.

• **Scenario 2 - Ownership with leasing to third parties:**
  The user is the owner of the office space. In the event of a reduction in space, space that is no longer used is rented to third parties. The real estate remains the property of the user.

• **Scenario 3 - Ownership with sale and leaseback:**
  The user is the owner of the office space. The property is sold. The required office space is then rented.

Model assumptions

• Number of employees: 500
• Office space: 7,500 m²
• Net monthly rent: 20 € per m² with 2% indexation p.a.
• Discounting interest rate: 10%.
For tenants, a reduction in space of 8% can already pay off

Results – rent scenario with 20% reduction of space

In the rental scenario, the profitability of a reduction in floor space is significantly influenced by two factors:

1. Costs for modification measures
   With a 20% reduction in floor space, the costs for conversion measures should therefore not exceed 630 € per m².

2. Remaining term of the lease agreement („breakage fees“).
   With a remaining term of more than 9 years, the costs exceed all cost savings of a 20% reduction in area.
In the ownership scenario, the costs for conversion measures can amount to a maximum of 700 € per m², so that a reduction in area of 20% is economically viable. The rent to be achieved by subletting is also decisive. 

Sale and Leaseback

The ownership scenario with sale and leaseback is particularly interesting for users with liquidity needs. However, the profitability of the sale and leaseback is particularly dependent on the achievable sales proceeds and the terms of the lease agreement.

A reduction in space is only worthwhile from a 30% reduction in space.
Decision-relevant questions must first be clarified – the focus is on a holistic solution

Decision relevant questions (e.g.)

• How much willingness is there to initially accept costs for the reduction of space?

• How long do the current leases run and what penalties are payable?

• What is the quality of the office space and what modification measures are necessary?

• Is the space suitable for subletting?

• Is there a willingness to give up ownership of the property and at the same time enter into a (long-term) lease agreement?

What should the individual "Office of the Future" look like for the company?

With a holistic strategy for the "Office of the Future", companies have advantages in the competition for talent and can reduce their costs at the same time.
The PropTech investor paradox

**Caution and confidence among investors**

- Investor confidence has reached a **4-year low** due to Covid-19, yet a majority of CEOs (89%) believe that Covid-19 will positively impact PropTech development.

- **Financing rounds** continue to be delayed or are taking place at a significant **discount** of up to 20%.

- 33% of investors still intend to **invest more in PropTechs** in 2020 than in previous years.

- Start-ups are experiencing stronger competition: We expect **market consolidation** in the coming months and expect up to 30% less PropTechs in the medium term.

- **Networking of PropTechs** becomes an important **success factor** – both with other PropTechs and with corporates (increase during the crisis)
Hotels: Slow recovery or on the verge of collapse? The recovery phase in summer appears to have come to a halt in September 2020

A comparable trend is evident in all regions.

In China, capacity utilization figures recovered to around 70% in August. This corresponds to a pre-crisis level.

The greatest impact of the crisis continues to be felt in Europe, with the lowest occupancy rates.

All major cities in Europe are affected.

The second wave began in many German states during the autumn vacations.

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Sources: PwC Research, STR
How is the situation on the side of the operators?

**Challenges**

- **Business travelers** are still staying away and have not returned after the summer vacations as hoped.
- **Major events and trade fairs** have been cancelled or are only taking place digitally.
- Due to **risk areas, accommodation bans and forced closures**, many hotel rooms remain empty.
- Added to this is the **uncertainty** about the further development of the tourism market.
- **Continuation of short-time working** possible after extension until the end of 2021.

**Many risks and isolated opportunities in the crisis**

- **Corona-Krise**: Frankfurter Luxushotel macht dicht – 63 Mitarbeiter arbeitslos
  22. Oktober 2020, 18:08 Uhr | dpa

- **Nach Insolvenz: Deutsche Hotelgruppe sucht Käufer**
  13.10.2020, 10:39 Uhr | mak, I-online

- **Sofitel Berlin: Insolvenzverfahren eröffnet**
  04. Oktober 2020 11:59 Uhr | Hotelerie

- **Louvre Hotels übernimmt zehn Hotels in Deutschland, Österreich und Italien von Plateno**
  21. Oktober 2020 | 07:00 Uhr

- **Die Deutsche Hospitality strebt nach Großen**
  22. Oktober 2020 | 19:11 Uhr

- **Dorint übernimmt Sofitel-Hotel am Berliner Kurfürstendamm**
  22. Oktober 2020 | 19:31 Uhr | Hotelerie
City hotels have been hit hard by the crisis and had hardly any recovery in summer

### Top-6 locations in comparison

<table>
<thead>
<tr>
<th>Location</th>
<th>March 2020</th>
<th>August 2020</th>
<th>September 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Berlin</td>
<td>-60%</td>
<td>-55%</td>
<td>-73%</td>
</tr>
<tr>
<td>Düsseldorf</td>
<td>-66%</td>
<td>-52%</td>
<td>-65%</td>
</tr>
<tr>
<td>Frankfurt</td>
<td>-69%</td>
<td>-57%</td>
<td>-73%</td>
</tr>
<tr>
<td>Hamburg</td>
<td>-60%</td>
<td>-45%</td>
<td>-54%</td>
</tr>
<tr>
<td>Cologne/Bonn</td>
<td>-70%</td>
<td>-57%</td>
<td>-62%</td>
</tr>
<tr>
<td>Munich</td>
<td>-60%</td>
<td>-64%</td>
<td>-77%</td>
</tr>
</tbody>
</table>

### Boom in vacation hotels

- Strong **domestic tourism in summer** due to increased demand.
- Hotels on the **North and Baltic Seas** are **above budget** in summer 2020.
- On the islands of Sylt, Usedom and Rügen the average rate was **18% higher** than in the previous year.

Sources: PwC Research, Fairmas

28. Oktober 2020
The performance of the operators also affects the owners of the hotel properties.

**Cooperation opportunities**
- Lease deferments
- Lease reduction
- Variable components for the lessor
- Extension of rental contracts

**Securing long-term partnerships**
- Lease deferrals and reductions are concluded to secure liquidity or to bridge a reduced business.
- Well positioned hotels will be able to perform again after the crisis.
- Owners do not want to lose operators who were successful before the crisis.
- Avoiding the search for new operators – with the risk of sustainably lower rents and costs when changing operators.
- Despite warnings and restrictions, guests are still interested in travel.
- In return for a concession, operators offer lease extensions or variable fees.
Caution has returned to the transaction market

**Data & Facts**

<table>
<thead>
<tr>
<th></th>
<th>Nr. of assets</th>
<th>2020 (Q1 – Q3)</th>
<th>Changes to previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction volume</td>
<td>48</td>
<td>1,7 Mrd. €</td>
<td>-25%</td>
</tr>
<tr>
<td>Single transactions</td>
<td>41</td>
<td>1,0 Mrd. €</td>
<td>-28%</td>
</tr>
<tr>
<td>Portfolio transactions</td>
<td>7</td>
<td>0,7 Mrd. €</td>
<td>-24%</td>
</tr>
</tbody>
</table>

**Significant decrease**

- The **majority** of the transaction volume for the current year (almost 60%) was generated in the **first three months**

- Most of the transactions concluded since April **originated before the crisis**

- It is expected to be the **weakest year** on the transaction market **since 2013**. At the same time, institutional investors are raising capital for **new funds**

- There are still interested buyers, but **price expectations** are still **far apart**

- In the third quarter, **national investors** dominated the transactions

Sources: PwC Research

PwC Real Estate | WebCast
Forecasts for revenue development in Germany over the coming years

Revenue outlook (in bn. €)

Factors for recovery

- For the year 2020 as a whole, a 42% drop in revenues to €8.6 billion is forecasted

- From 2021 onwards, steady revenue growth is expected. The pre-crisis level is expected to be reached in 2023

- The return of domestic leisure travelers, followed by business travel, is initially expected to be the key revenue driver

- For business trips: what will the volume look like in the future? What losses can there be due to the new working models?

- A recovery is forecasted for international incoming tourism by 2024

Sources: PwC Research, Statista Study (August 2020), DZT
Update Legal

CREM & Legal

Adaptation of types of use / utilization concepts – typical pitfalls
- Public law regulations
- Definition of type of use and structural utilization in rental agreements
- In some cases heritable building rights also restrict the use

Update of safety obligations
- Check: Operator obligations in the context of COVID-19 vary depending on the federal state and mode of operation
- Transfer: Ventilation and heating becomes a challenge
- Clarify: Who has to create the technical prerequisites?
- Avoid: Superspreading events (canteens, company events, etc.) can become a disaster for companies

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Rent Attack – Rent payment obligations in lockdown

Development of jurisdiction

- The moratorium on terminations from April to the end of June 2020 was not extended - there was no legal suspension of the obligation to pay rent
- First instance courts decide on rental claims LG Heidelberg, LG Frankfurt/Main and LG Munich)
- So far no reduction of the rent due to lack or disturbance of the business basis
- Supreme Court clarification still pending

Practical experience

- Smaller landlords let it arrive more often on complaints
- Retailers with large portfolios negotiate package deals
- In the hotel sector rather individual case solutions
- Decreasing number of cases means greater reluctance to reach agreement - second wave gives negotiations new impetus
- Fair agreements continue best practice
- Our recommendation: Use negotiations to anchor ESG in lease agreements
Questions to the PwC experts

- CREM study
- Digitalization & PropTech
- Developments in hotel sector
- Update Legal

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PwC information about the New Normal and its impact on the real estate industry can be found here:

News on the subject of real estate also in the context of New Normal
https://blogs.pwc.de/real-estate/
www.pwc.de/de/real-estate/pwcs-real-estate-institute.html
https://www.pwc.de/de/real-estate.html

Email address for questions to PwC experts on the subject of New Normal
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PwC Plus – Information about real assets with push message function
https://pwcplus.de/

Fortnightly expert session via WebCast on current topics
Wednesday 10:00 to 11:00
The new normal – the future of the real estate industry

Next session 11th of November from 10:00 am – in collaboration with „Urban Land Institute“

„Emerging Trends in Real Estate 2021“

Registration via Link: www.pwc-events.com/Real-Estate-WebCast