March 2018

Insights

Real Estate

SwissLife
Asset Managers

Office or hotel? –
Conversion as an optimisation strategy

Coworking spaces –
A growing niche market

“Grand Paris” –
Urban development: project of the century

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Editorial

Dear readers

The economic recovery in Europe has long since extended to commercial real estate. Demand for high-quality properties to let and for sale is currently higher than it's been in a long time. This is causing an upturn in construction in many markets, as evidenced by the development area of the colossal project known as "Grand Paris".

"Office or hotel?" Properties in less attractive locations, on the other hand, are not necessarily benefiting from the market upturn, so owners and providers are starting to think more about a constructive conversion strategy.

At the same time, we also note demand from new user groups for open-space solutions and individually designed spaces conducive to innovation.
The working world is changing and the workplace is changing with it. Even companies are starting to focus increasingly on a more flexible working environment and demand from coworking providers is growing.

I wish you an enjoyable read and new insights into the current theme of "office markets".

Stefan Mächler
Group Chief Investment Officer

Whilst the economy gains momentum, the way we work is evolving

Economies in Europe continue to exceed forecasts. Labour markets are healing and certain countries are nearing full employment. Meanwhile, the nature of work is undergoing radical change.

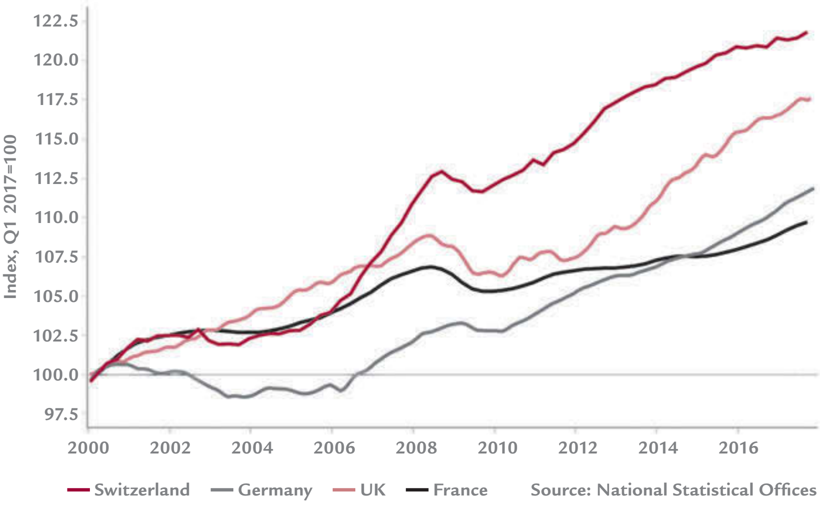
Sylvia Walter, Senior Economist, Swiss Life Asset Managers
Francesca Boucard, Economist Real Estate, Swiss Life Asset Managers

European economies are in the midst of a global cyclical upturn. Even laggards such as Greece, Switzerland and Italy are picking up speed. The UK economy has fared better than many expected, despite the Brexit uncertainties, but softening growth dynamics seem likely going forward. Fears that the currency union might break up have subsided since the election of Emmanuel Macron as French president last spring. Entrepreneurs increasingly believe in the sustainability of the recovery. Consumer confidence in the Eurozone has reached its highest level since the turn of the millennium.

Consumer confidence in the Eurozone has reached its highest level since 2000.

In line with strengthening economic momentum, labour markets throughout Europe are recovering, albeit at different speeds and with varying magnitude. Germany is almost at full employment, the Swiss unemployment rate (which was comparatively low anyway) started to decline a year ago, French unemployment (which has been more stable than elsewhere throughout the crises) is declining and the UK's jobless rate has hit a 42-year low against all odds.

Growth of total employment since the start of the millennium, indexed



Source: National Statistical Offices

The employment picture (see above) looks equally rosy. However, even though the number of people at work is reaching record levels in many places, economies are less successful at delivering pay rises. Most of the job creation is occurring in the service sector, where work has become ever more flexible, mobile and virtual. Temporary employment contracts, a rising share of low-skilled workers and migration flows are impacting the labour market. The knowledge-based economy and global change require swift adjustments. This environment presents new challenges and demands. The resulting changes to physical workplaces also oblige real estate managers and investors to adapt to these trends. ■

Knowledge-based economy and global change require swift adjustments.

The rise, and rise, of London's flexible office market

London is a flexible workspace pioneer where new concepts and models are often tested before being applied elsewhere. Understanding the type of space on offer, its impact on broader occupational demand and the landlord response therefore has lessons for all European markets.

Tom Duncan, Senior Analyst, Mayfair Capital

Flexible workspaces – variously called coworking, serviced or shared offices – are a major feature of London's office market. In 2017 they accounted for 20% of take-up compared to less than 1% in 2008. Some 4% of office space in London is now occupied by flexible workspaces, the highest proportion globally.

London has become a test-bed for flexible models which are then adapted and applied to other markets. What happens in London today, therefore, is a bellwether for what could happen in major European office markets tomorrow.

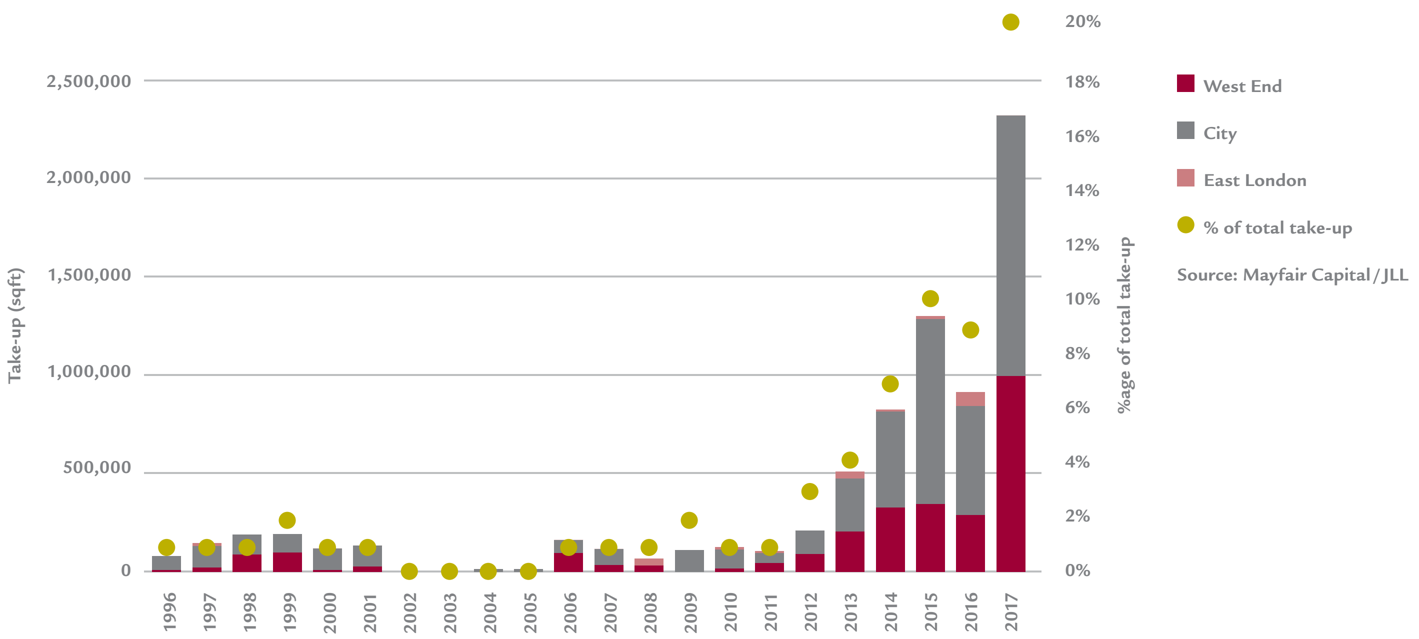
A varied offering

WeWork has been leading the charge in London, committing to or occupying 232,300 sq. m. (2.5 million sq ft) ranging from single floors to entire buildings. WeWork aspires to double its footprint in 2018 and is now London's largest private office occupier. The sector is diverse, though, with a range of providers focusing on different niches – be it workspace-themed around certain sectors or modelled on a service-oriented hotel.

Multiple factors drive growth

Flexible workspaces have traditionally

Flexible workspace take-up in London 1996 – 2017



Source: Mayfair Capital / JLL

lacked choice, offering a basic and expensive short-term solution. As a result, they were used as satellite offices, overflow space or a temporary option whilst occupiers found a permanent home.

That has changed as costs have reduced and demand for shorter leases has grown. Online platforms have increased the speed and ease of flexible workspace transactions. Strong employment growth in small enterprises has fuelled demand for small tenancies available for an all-inclusive fee without a long contract. This is an area that was previously under-served by landlords.

Societal changes have fuelled the sector too. Talent is increasingly footloose and able to work from anywhere. Modern offices must work hard to attract talent and enable its productivity. Offices need to be user-focused, amenity-rich and engaging places that give employees a choice as to how and where they work. In response, flexible workspaces have developed a strong experience-led environment.

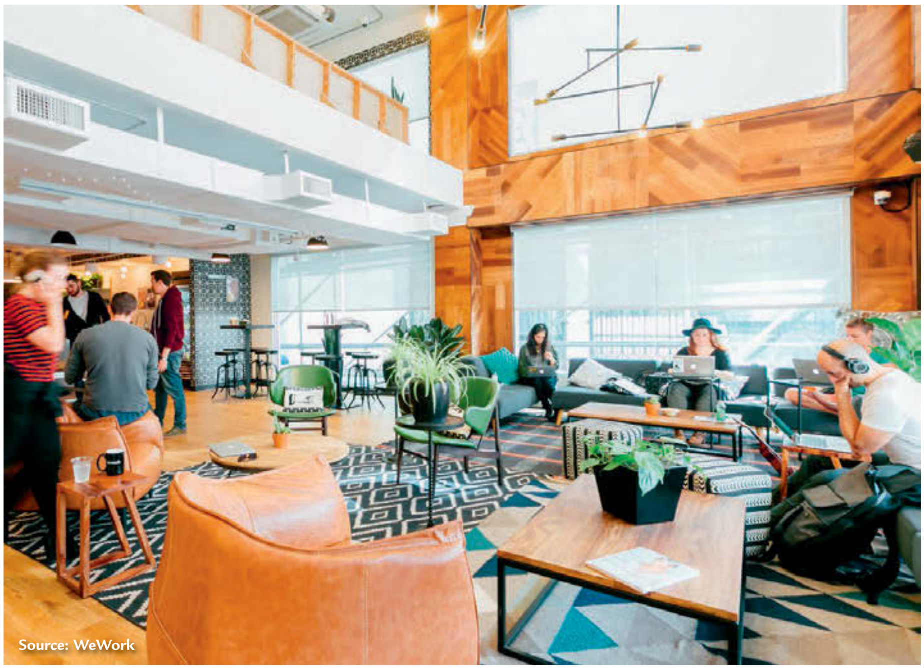
Modern offices must work hard to attract talent and enable productivity.

The future outlook

The extent of occupier demand for more flexible workspace in London is uncertain. Growth will require large corporates to embrace the model. It will also depend on the staying power of their existing occupier base in market downturns, which has not yet been tested. It is unclear whether, in a less tenant-favourable market, landlords would have been as willing to allow an as-yet unproven business model to occupy so much space. Whatever happens though, flexible workspace is here to stay – as is the impact on occupiers' expectations.

London has become a test-bed for flexible models which are then adapted and applied to other markets.

For investors, this means that the ability of offices to attract and retain occupiers in the future will be more closely related to amenity and user experience. An element of flexible workspace within buildings could be viewed as an advantage for securing occupier diversity and providing choice rather than as a covenant risk. If landlords elect to operate these workspaces themselves, opportunities for income creation will arise. ■



Source: WeWork

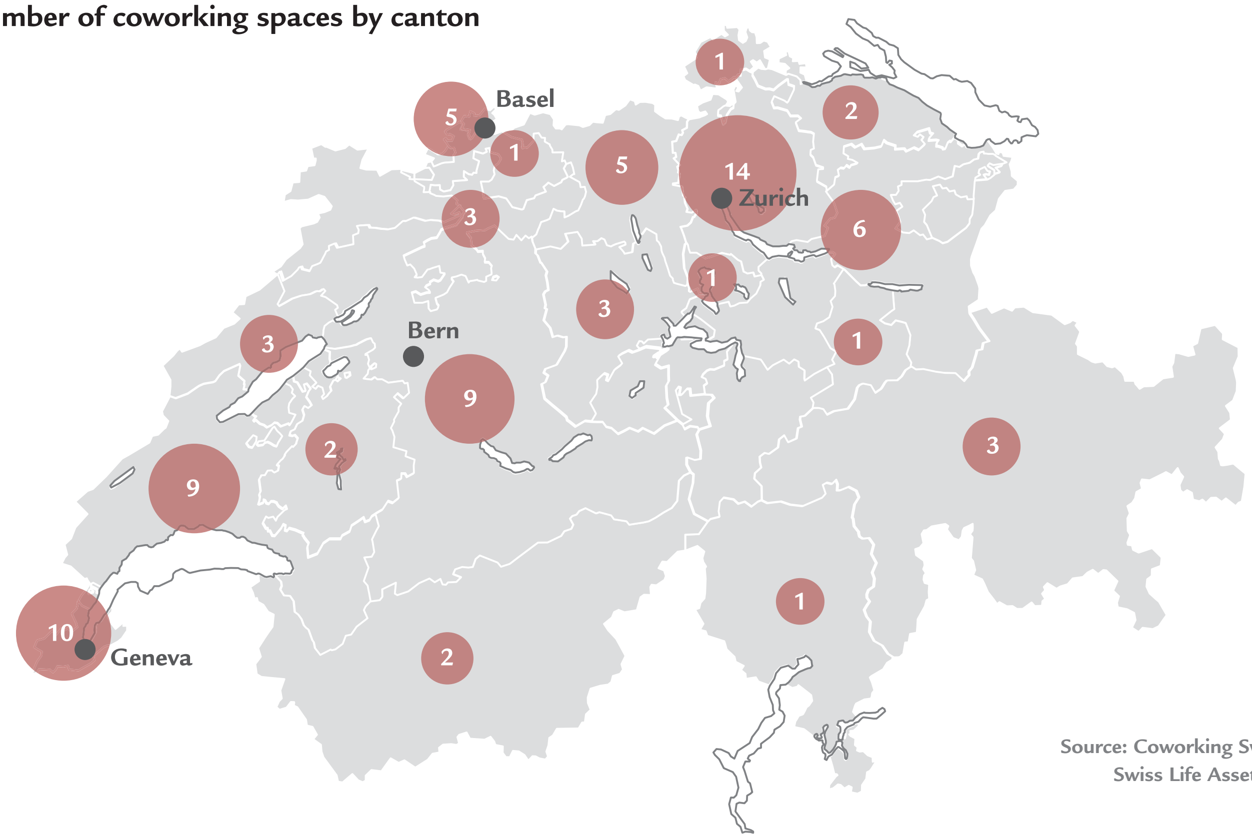
Flexible workspaces provide amenity-rich and engaging spaces.

Coworking spaces: an attractive niche segment

Coworking spaces are the next big thing in Switzerland. The trend is mainly being driven by the growing importance of the service sector and digitalisation. Although the traditional office is not likely to be replaced in the near future, coworking spaces constitute a dynamic niche segment of interest to real estate investors.

Alfonso Tedeschi, Real Estate Product & Service Manager, Swiss Life Asset Managers

Number of coworking spaces by canton



Source: Coworking Switzerland/ Swiss Life Asset Managers

Coworking spaces have emerged in recent years as an alternative to the conventional office. They are popular not only among freelancers, creative types and start-ups, but also – because of their great flexibility and potential for cost savings – among smaller and medium-sized companies.

Switzerland's first coworking space opened in 2007 and today there are over 80 such spaces in the "Coworking Switzerland" network. According to a study by Wüest Partner, there are currently about 6700 coworking workplaces on offer in Switzerland with a total surface area of around 70,000 sq. m. They still only account for a modest proportion of Switzerland's total office space (just over 0.1%) but a glance at more developed coworking markets points to the dormant potential of this niche segment. JLL expects coworking to account for 2% of total office floorspace in the US

Source: Fotowerder

Tessinerplatz in Zurich city centre offers good connections to public transport.

by 2020. Transferred to the Swiss context, this would equate to all the office space available in greater Zug.

Real estate investors can gain exposure to a niche segment with rapid growth prospects by investing in coworking spaces, where the returns are comparable to those generated by traditional office space. Moreover, inclusion of this up-and-coming rental segment can help to increase occupancy at portfolio level. The know-how acquired can also be used for the planning of conventional offices. Market entry may initially take the form of cooperating with providers of coworking spaces, with investors subsequently becoming operators of coworking spaces themselves and thus extending their value chains.

Coworking lounge on Tessinerplatz

A coworking space of some 500 sq. m. is being created at Tessinerplatz 7 in Zurich as part of a cooperation between Swiss Life and Village Office. The innovative pilot project consists of four main modules:

- **Coworking spaces**
- **Workshop rooms with cutting-edge technology**
- **Café/bar**
- **Event location**

The project is currently in the community development phase. It is expected to open in the autumn of 2018. ■

Short interview with Giorgio Engeli, Head of Real Estate Portfolio Management PAM

What sort of areas make good coworking spaces?

Central locations are particularly suitable and not necessarily in cities, smaller centres are also an option. Easily accessible ground-floor areas with high visibility and integrated catering facilities make ideal coworking spaces.

What are the key success factors?

A well-connected community corresponding to the location and spirit of the coworking space, to add life and stand out from a conventional business centre. The right mix of additional services is also important.

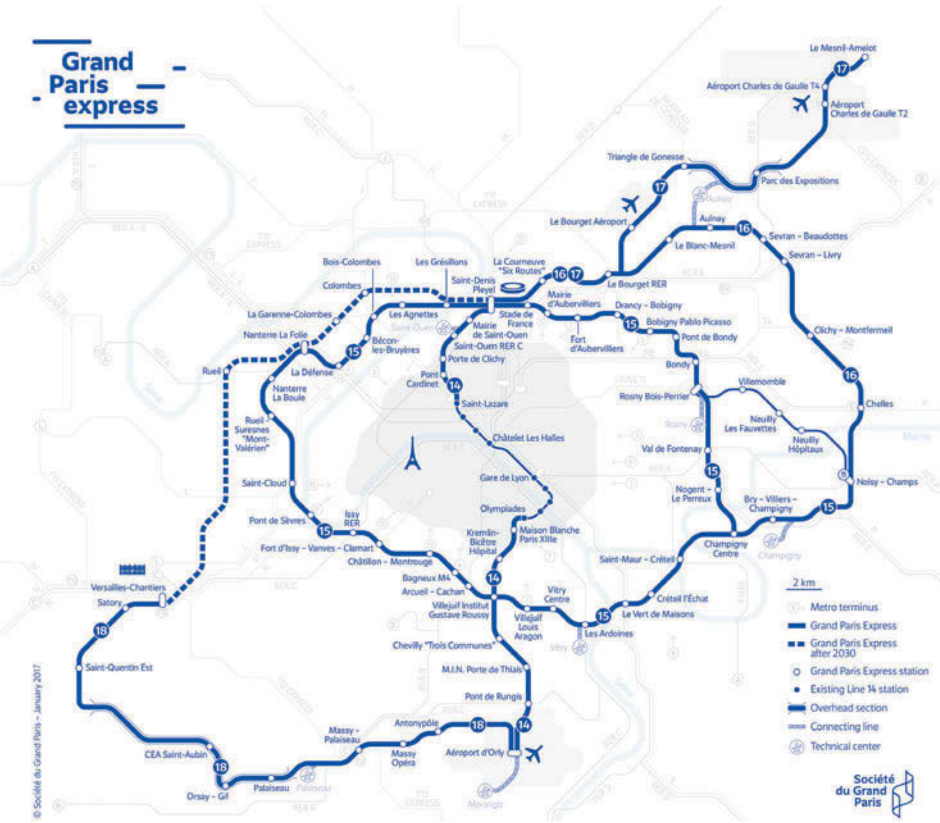
Why should Swiss Life Asset Managers invest in coworking spaces?

We know that over half of all employees will no longer have a fixed workplace for at least two days a week by 2025. Companies can use shared offices to optimise their space and the associated costs. Coworking spaces will arise and cater increasingly to corporate requirements.

Keeping the city on the move: the Grand Paris project

France's largest infrastructure project of the 21st century is set to strengthen the Greater Paris region's position as one of the most attractive international cities. The emergence of new business districts is expected to generate superior rental growth and investment opportunities.

Elie Medina, Analyst, Swiss Life REIM (France)



The Grand Paris Express network will open in phases.

A colossal investment in transportation and urban renovation should accommodate the growth momentum and ambitions of Paris as a major capital.

With 200 kilometres of additional automated tracks and 68 new metro stations, the Grand Paris Express (GPE) is the West's most ambitious transportation project of the decade. The GPE consists of a ring route around Paris, three lines connecting developing neighbourhoods and the extension of an existing line, which altogether will double the size of the existing metro network. Construction of the new lines began in June 2015 and is being carried out in phases up to 2030. The new network is expected to impact the metropolis. Due not least to Brexit and the 2024 Olympic Games, the Paris office market seems ideally positioned to sustain superior rental growth in the medium term.

The GPE includes a broader urban renovation project to create new neigh-

Saint-Denis Pleyel station (architect: Kengo Kuma) will see more than 250,000 passengers per day.

bourhoods around the future metro stations and to regenerate urban centres. The "Inventons la Metropole du Grand Paris" development consultation launched by the metropolitan authority will result in 2.1 million square metres of land being developed via public-private partnerships at a total cost of EUR 7.2 billion. 41% of the land will be dedicated to commercial development, potentially attracting new businesses and investors to emerging business districts.

Anticipating where transformations will result in value creation

The most promising areas in terms of investment opportunities will combine improved accessibility via new metro stations and ambitious urban projects. The network's largest train station, "Saint-Denis Pleyel", will connect two districts currently separated by an extensive area of railway tracks. The 45,000 sq. m. station, which also includes a business centre, is expected to stimulate the local office market.

Real estate opportunities in Villejuif – a suburb in the south of Paris – are expected to arise from the creation of the "Villejuif-Institut Gustave Roussy" metro station. This will enable commuters to reach central Paris in 20 minutes compared with 35 minutes today. These developments will increase the attractiveness of the area for innovative businesses as the zone already features a cluster of universities and offers low rents.

Further opportunities will arise in Peri-Défense – the neighbourhoods surrounding the La Défense business district. The "Nanterre La Boule" metro station will open up the area and shift the current mix of uses towards business activity and retail. The "Place de la Boule" project in front of the future metro station reflects this evolution: an apartment block will be replaced by an office building and retail space.

Opportunities related to the GPE are primarily of interest to long-term investors as delivery of most of the projects is expected in the mid-2020s. Yet the level of transformation expected from this infrastructure project is set to deeply influence the dynamics of the Paris real estate market. ■

Construction site of the Porte de Clichy metro station.

Office revitalisation is a challenge for asset management

Despite the boom in demand, many offices no longer fulfill occupier requirements. Investors are exploring possible alternative future uses, some of which offer attractive returns.

Andri Eglitis, Head of Research, Corpus Sireo

The occupational office markets in Germany are characterised by strong demand for space, an increasingly limited supply and rising rents. However, not all submarkets and properties are benefiting because some buildings no longer meet occupier requirements. Owners, or their asset managers, are being forced to evaluate an office refurbishment as well as alternative usage options based on the market, competition or property conditions. The most profitable of these can then be implemented.

Multiple parameters determine the future use of properties

In terms of the market, certain submarkets may be less in demand as office locations. Alternatives may be feasible in the form of different usage types, e.g. due to strong demand for accommodation and sharply rising rents, or a need for more hotel capacity. Today, offices both in central and less central locations are facing competitive pressure. At micro-locations, for example, quality and local demand need to be taken into account, but planning regulations may rule out changes in use.

Ultimately, the structure and condition of a property can provide a variety of usage options, but can also be limiting, leading to demolition and reconstruction. Considerations range from structural measures, e.g. for a flexible office concept, to modern building technology and legal requirements (energy, fire safety). The costs for conversion and refurbishment of the property play a vital role in decision making.

Steigenberger Hotel Munich.

Source: Steigenberger Hotels AG

Refurbishments require individual solutions depending on the market, the location and the building fabric.

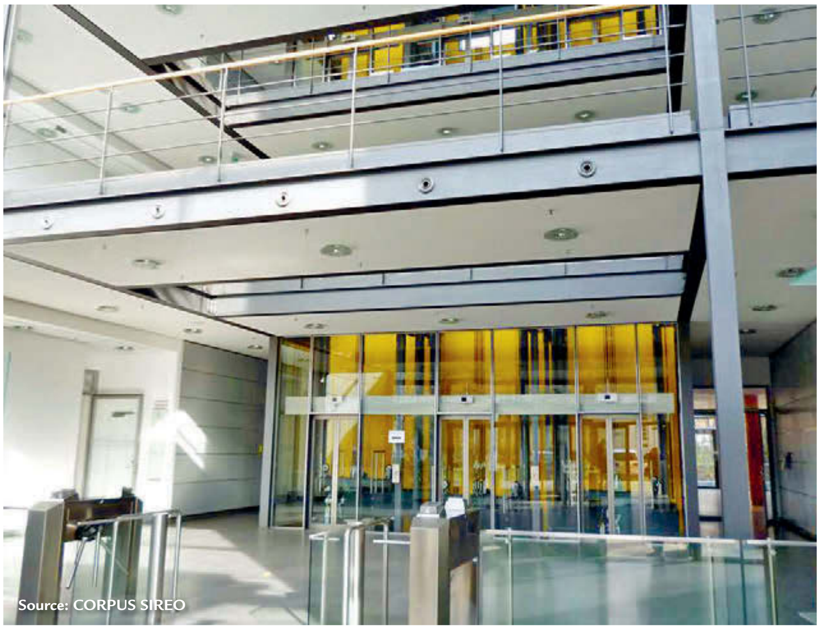
From office to hotel

One example of refurbishment and repurposing is the former head office of Swiss Life Germany in Munich, for which CORPUS SIREO acted as project manager. The feasibility study showed repurposing as a hotel to be more profitable than retaining the property's function as an office. As an attractive travel destination, Munich is benefiting from an increasing number of overnight stays. At the same time, the hotel market is exhibiting healthy business performance, which has led to an expansion of hotel capacity. The Schwabing area has established itself as a hotel district.

Furthermore, the fabric of the building provided ideal conditions – a foyer, lifts and spaces for restaurants could be largely left as they were. The same applied to the façade which meant that only a limited amount of investment in the building was needed. The challenges lay in actually converting the property into a hotel, including catering technology, conference facilities and fitness areas as well as the construction of rooms and, in particular, bathrooms. The hotel (part of the Steigenberger chain) opened in autumn 2017 as scheduled.

This is just one example of existing office properties that challenge their owners to find a profitable usage during their life cycles. Implementing such a project requires an experienced asset manager with profound knowledge of the real estate markets as well as project management skills. ■

The old foyer before the conversion.



Source: CORPUS SIREO

Breakfast room.

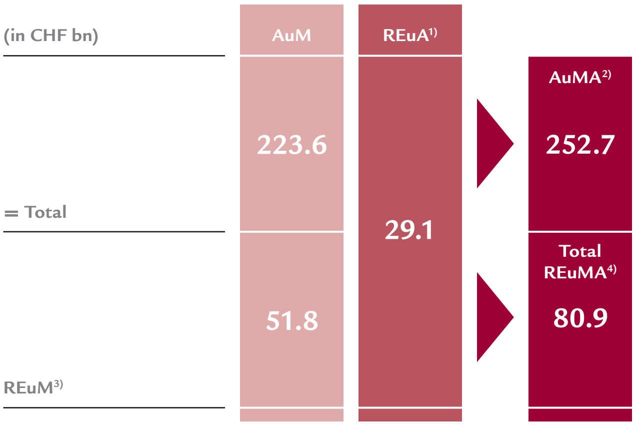
Source: CORPUS SIREO

An attractive new foyer welcomes the hotel guests after the conversion.

Source: CORPUS SIREO

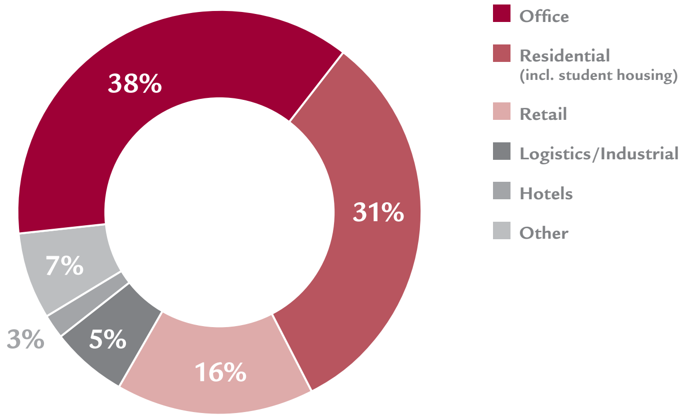
Real estate – facts and figures

Assets under Management and Administration



¹⁾Real Estate under Administration (not included in Swiss Life AuM definition)
²⁾Assets under Management and Administration ³⁾Real Estate under Management
⁴⁾ Real Estate under Management and Administration

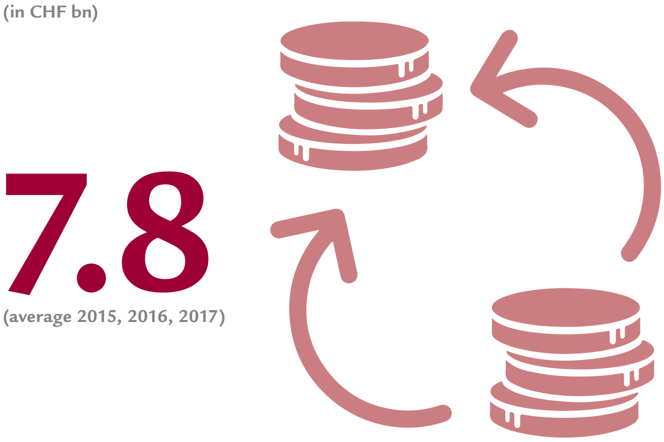
Breakdown by real estate sector



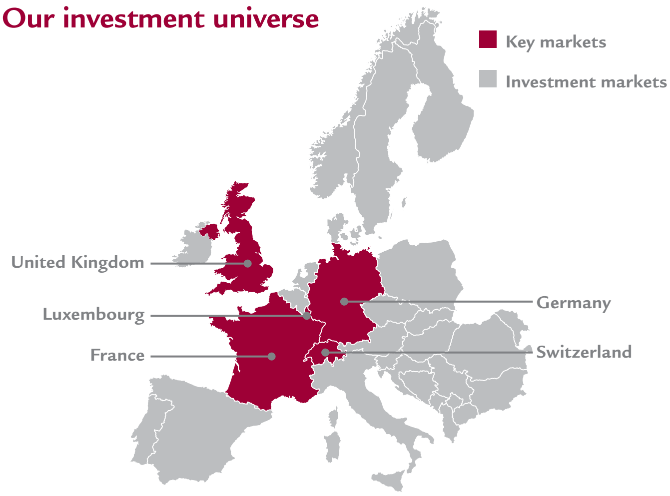
REuM CHF 51.8 bn

Transaction volume real estate

(in CHF bn)



Our investment universe



All figures as of 31 December 2017, unless stated otherwise

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