

## Corporate Real Estate: Quarters for Mid-Market Players

### FOR STARTERS

The idea behind the new analytic series called BEOS Survey is to help enhance the transparency of the German real estate market, and to report on the corporate real estate sector in a compact format aimed at decision makers on a quarterly basis. Corporate real estate is a market segment relatively recent to Germany.

In 2010, BulwienGesa AG published, in collaboration with investors and asset managers, a survey of commercial and industrial real estate that touched upon the issue of corporate real estate in Germany for the first time.<sup>1</sup> Against the background of deteriorating yields and accelerating cycles of traditional real estate asset classes, it is gaining increasing significance as alternative investment.

This first issue of the survey elaborates the basics underlying corporate real estate. It showcases the product along with its typical occupier structures.

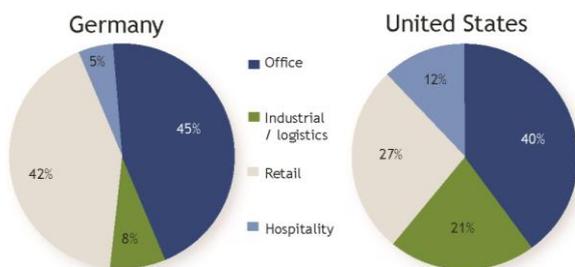
### A NEW ASSET CLASS EVOLVING?

In the Anglo-Saxon countries, corporate real estate established itself as an asset class in its own right a long time ago under the name “light industrial.” Unlike in Germany, it is held in much higher esteem among institutional investors in the US, accounting for 21% of all new investments, and is an integral component of portfolio allocations.<sup>2,3</sup>

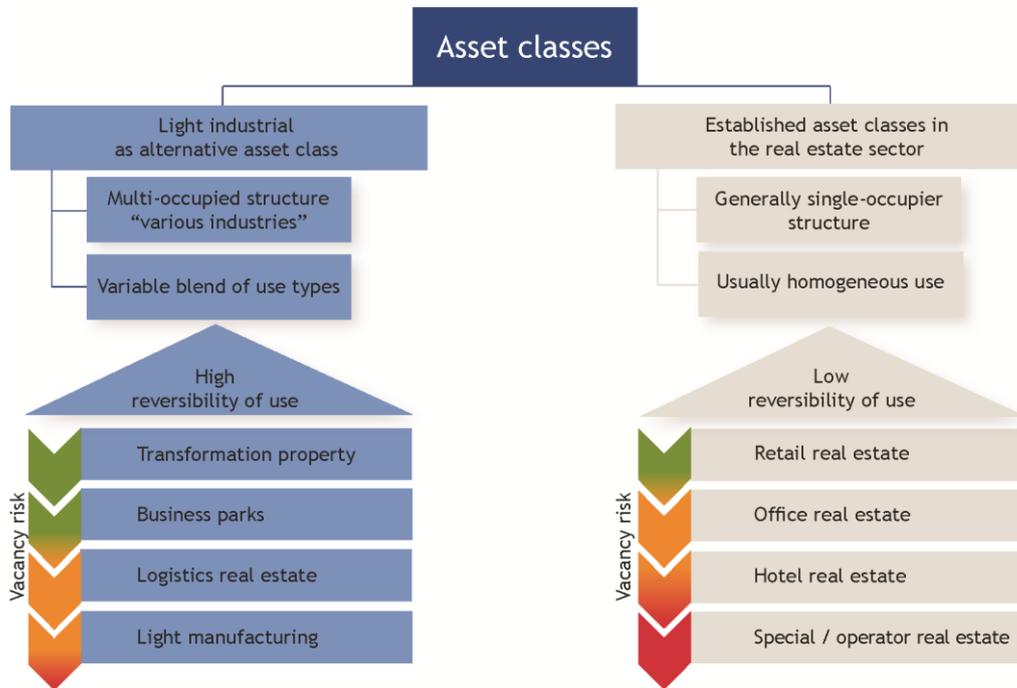
In Germany, by contrast, investments in commercial-use real estate are dominated by the segments office and retail. The upshot of many recent investor polls is that office real estate is now seen as having too high a weighting, and of having become a liability. Nonetheless, office schemes accounted for 45% of the new investments in commercial real estate investments in Germany as recently as 2011. The industrial / logistics sector, by contrast, represented no more than 8%, and this after having experienced a substantial surge.

German investors continue to see corporate real estate as a negligible alternative to the traditional office / retail allocation. They have yet to abandon the idea that light industrial is associated with air pollution, short-lived lightweight construction, and greenfield locations. The operational value-add generated in corporate real estate today has long ceased to be associable with classic industrial manufacturing. Today's industrial is clean, synchronised with demand, and technologically sophisticated. Administration, research, services, and production, which used to be organised in separate locations, are now clustered in one central location, preferably inside urban agglomerations.

The qualities this lends to corporate properties makes them into potentially stabilising anchors in economically challenging environments. An uncertain market is likely to make so-called “core” properties particularly susceptible to distress, being characterised by a single type of use and by a single blue-chip tenant as often as not. Corporate real estate, by contrast, responds to adverse developments with relative resilience because it offers great options to diversify and to minimise risks. Its distinguishing features include alternative use potential and flexibility, either of which are attributable to its structural qualities. Corporate real estate can accommodate several occupiers of the most diverse sectors, while also featuring various types of use and accommodation.



Breakdown of commercial real estate investments by segment, 2011 (source: RCA 2012).



Corporate real estate compared to other real estate assets (source: BulwienGesa AG 2012)

## REVERSIBLE FLOOR PLANS AS STABILISING ANCHOR

Alternative use potential in the conventional sense is understood to refer to the re-letting or re-utilisation potential of a given property, whereas corporate real estate is generally defined by its reversibility, meaning that existing floor areas may be customised to serve other purposes. This means that manufacturing space may be converted into warehouse space, or research areas into offices. The reversibility of uses lowers the risk of a permanent loss of rent or of structural vacancy.

Share of the manufacturing industry	Germany	US	UK
GDP	28,6%	19,2%	21,5%
Workforce	24,6%	20,3%	18,2%

Comparing GDP and employment share of the manufacturing industry (source: OECD, 2012)

With its broad basis of small and medium-sized enterprises (SME), and its relatively high share in internationally competitive production and manufacturing plants, the German economy presents plenty

of occupier potential for light industrial real estate. So far, more than 80% of Germany's corporate real estate has been owner-occupied, according to experts. Yet in the context of their CREM strategies, companies are taking a harder look at ways to turn their mainly or partially business-critical property stock into liquidity.

The fact that companies belonging in the manufacturing industry, which is highly important for Germany, are virtually absent as tenants from the portfolios of institutional investors is amazing.

## THE FOUR TYPES OF CORPORATE REAL ESTATE

Corporate real estate may be defined as mixed-use commercial property, typically having an SME tenant structure. A corporate property will normally represent a blend of offices, warehouse, manufacturing plants, research facilities, service space and / or wholesale space as well as open areas. The increased overhead compared to less diversified properties is compensated by a secure rental income and a lower default risk. Corporate real estate divides essentially into four distinct types:



*Exemplary breakdown of a transformation property by use type (source: Gewerbe- und Industrieimmobilien in Deutschland 2010)*

### Transformation Property

Properties of this type often represent former manufacturing sites with a building structure that evolved historically in line with changing business needs. Some of them have campus character, are found in comparatively central locations in urban areas, and are managed on a higher level. During the transformation process, the existing rental income will facilitate conversion, supplementary and redevelopment measures aimed at turning a single-occupier property of homogeneous use into a multi-occupied property marked by a mix of use types. The historic nature of period buildings in particular add charm to the premises to be marketed. Especially young service providers identify with the “Made in Germany” image of industrial brownfield sites.



*Exemplary breakdown of a logistics property by use type (source: Gewerbe- und Industrieimmobilien in Deutschland 2010)*

### Logistics Real Estate

Against the background of the supply chain management, modern logistics properties serve purposes beyond the business of storing, transshipping and order-picking goods and commodities. Existing infrastructure and technology (for instance, annexed offices and social areas, warehouses, conveyor technology, IT, service areas, shops, etc.) facilitate the quick adjustment to new requirements.

As early as the project planning stage, project developers see to it these days that the buildings they raise comply with the latest market requirements, lend themselves to mixed use by several occupiers, and have a modular structure. Logistics properties raised after the year 2000 generally manifest these qualities. They tend to be operated by logistics companies on the basis of service agreements (contract logistics), and are often located near transportation hubs.<sup>4</sup> Due to their principal architectonic structures, dated legacy properties are rarely suitable for multi-occupied use because they were often custom-developed for their former primary user. This means they qualify for the light industrial real estate market segment only to a degree.



*Exemplary breakdown of a business park by use type (source: Gewerbe- und Industrieimmobilien in Deutschland 2010)*

### Business Parks

By their very nature, business parks are intended for mixed use. Office, service, storage and open spaces is let complete are put on the rental market as combination complete with professional management. Distinguishing features of modern properties include central locations and smaller dimensions, whereas older business parks are often located in suburban

sites marked by convenient transportation access. Principally speaking, business park divide into several generations: The first generations were defined by a low share of office accommodation. Over time, office spaces became increasingly dominant, in some cases accounting for a share of up to 80%. More recently, the trend has shifted again in favour of other types of floor space.

### Light Manufacturing Properties

Light manufacturing properties represent buildings used for light non- nuisance manufacturing purposes. Accordingly, this does not include industrially used areas marked by high levels of pollution. Present-day light manufacturing properties tend to be found in location clusters with great access to their constituent cities. The frequently combine several floor area types, such as manufacturing, logistics, and warehouse space, along with a modest office share.



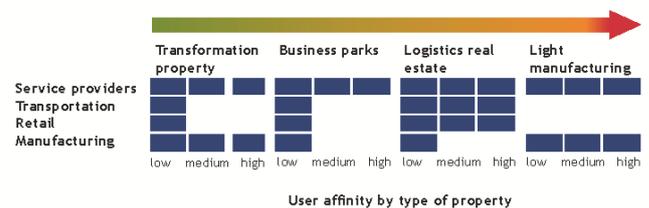
Exemplary breakdown of a light manufacturing property by use type (source: Gewerbe- und Industrieimmobilien in Deutschland 2010)

### MID-MARKET COMPANIES AS PRIMARY TARGET GROUP

Main demand groups of mixed-use commercial units include, in addition to light manufacturing businesses, mainly companies in the sectors services, logistics, and retail. Especially the high number of potential users offers a concomitant broad-based risk diversification. Sometimes, the aforesaid criteria can make it hard to classify corporate properties, because distinctions get blurry. Nonetheless, types may be used to identify specific use profiles:

Transformation property has a broad-based user structure that can embrace anything from service providers to smallish transportation and retail com-

panies, and all the way to companies in need of light manufacturing and general purpose accommodation. They provide particularly convenient options for reversing uses and re-letting, though this applies only to integrated urban locations. By their very nature, business parks are structured to accommodate a wide variety of occupiers and use types. That said, they may be designed mainly for specific types of use, depending on the concept. Younger business parks of the third and fourth generation can create problems when re-letting because of their frequently high office share.



Re-Letting Potential by Occupier Group (source: BulwienGesa AG 2012)

Logistics properties are usually occupied by service providers handling transportation and order-picking jobs, whereas light manufacturing properties are mainly used by companies engaged in actual production. However, either property type lends itself to other purposes, and may generally be used by more than one occupier, an aspect that in turn boosts their re-letting potential.

### OUTLOOK

BEOS Survey No. 2 will look into the subject of economic key ratios of corporate real estate. It will be published in March 2013.

- 1) BulwienGesa AG et al., 2010, Gewerbe- und Industrieimmobilien in Deutschland, [www.beos.net/sites/beos.net/html/media/pdfs/downloads/BulwienGesa\\_Gewerbe-Industrieimmobilien\\_2010-06-08.pdf](http://www.beos.net/sites/beos.net/html/media/pdfs/downloads/BulwienGesa_Gewerbe-Industrieimmobilien_2010-06-08.pdf)
- 2) CBRE, 2012: The Logic of Logistics: Supporting a Bigger Role in Institutional Portfolios, [http://www.cbre.eu/emea\\_en/services/industrial\\_logistics\\_home/research](http://www.cbre.eu/emea_en/services/industrial_logistics_home/research)
- 3) Prologis, 2012, Opportunities in the European Industrial Market, <http://www.prologis.com/docs/whyindustrialeurope.pdf>
- 4) Fraunhofer-Arbeitsgruppe für Supply Chain Services SCS et al., 2011, Logistikimmobilien - Markt und Standorte 2011: Deutschland, Österreich, Schweiz

#### CREDITS

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