



# High-Rise Office Buildings in Berlin

Analysis of Potential 2016, Update

 bulwiengesa

## Introduction

“Yes, but...”, is the short conclusion of the Analysis of Potential for High-rise Office Buildings in Berlin, which appeared in 2015 under the title “Berlin im Wandel – kreativ, innovativ und hoch?” (“Berlin in Transition – creative, innovative and high?”) and was greeted with a resounding response. Players from both the real estate industry and politicians and authorities have noted the results of the study with interest and have been able to utilise these strategically in their daily work. The “Yes, but...” conclusion was based on the one hand on clearly recognisable and increasing existing potential and on the other hand a number of obstacles. These referred to particular target groups and above all the market rental levels in the Berlin office property market.

In the twelve months since the results of the first analysis were published, the Syrian and Turkish crises and the Brexit referendum have resulted in political shifts across Europe, which in fact continue to work in favour of both Berlin and Germany. This analysis update has also been driven by the change in the overall situation.

As before, the interest shown by German and international players in investing in Germany is on the increase. At the same time there is no end in sight for the office boom in Berlin: demand for office space is extraordinarily robust, driven by the continued strong growth in office employment levels, not least due to Berlin’s position as the principal start-up city with an increasing number of high growth companies in the digital sector. The supply of new office space lags well behind the level of demand. The result: extremely low vacancy rates and rising market rents.

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*Has the time come for a commercial real estate market in Berlin, in which there is a resounding “Yes” to the construction of high-rise office buildings on a sustainable basis?*

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In addition to the market parameters, which will be summarised on the following pages, there are also urban planning, historic and social aspects to take into account when it comes to such a fundamental decision as the approval and planning of high-rise office buildings as a matter of course. It is not without good reason that the Senate’s Building Director Regula Lüscher points out that a sustainable and robust regional economy could represent the basis for high-rise development in a city such as Berlin, in which development has generally been limited to a height of under 30 m to date.

Also important objectives such as the attempted carbon neutrality in Berlin by the year 2050 must be weighed against the requirements of the economy and the real estate market. Aspects relating to energy conservation mean that there is a current tendency towards compact new-build structures as opposed to slim stand-alone buildings. The enormous energy costs of, for example, the Burj Khalifa in Dubai are in this respect a warning to the European city of the future. At the same time high-rise development is also an agenda to preserve the open spaces and parks which characterise Berlin. Growth without high-rise development means that land will be



lost and overbuilt in the open spaces and peripheral locations around the metropolitan regions.

There is also the fundamental question of urban transport networks. The previous year’s report already made mention of the specific “modal split”, in other words the division of transport services across the various means of transport and the high quality of the (rail-based) public transport network, which is so important for the future of Berlin. The close correlation between dense development and (extremely expensive) urban transport infrastructure will have to be examined in more detail in relation to the future workplaces and office districts, in order to bring private and public sector investments closer together in a politically meaningful symbiosis.

One thing is clear: the new Berlin Senate will not be able to achieve the three central aims of BerlinStrategie 2.0

- ▶ **work**
- ▶ **living**
- ▶ **open society**

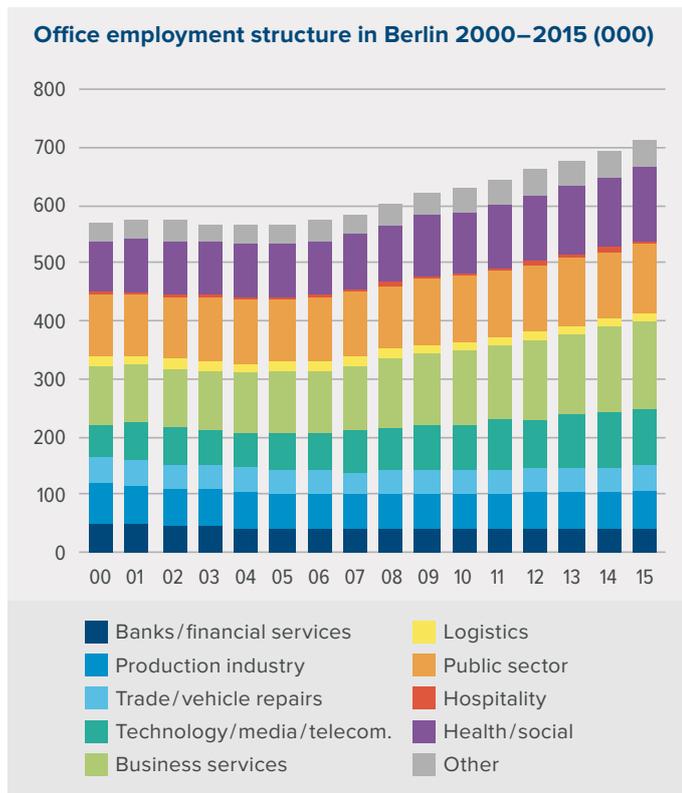
without an increase in the density of urban development and high-rise construction. This update of the Analysis of Potential is intended to assist in defining the overall principles for high-rise office development within such an important context.

# Current trends in the Berlin office property market

## Office employment numbers continue to rise

Parallel to the dynamic growth in population, economic conditions in Berlin have steadily improved over the last few years.

This is reflected particularly by the continued significant increase in office employment. There has been an increase in the numbers employed in offices of around 150,000 over the last ten years, which equates to a growth rate of 2.4% p. a. which is the same level as central London. bulwiengesa estimates that the office employment numbers will increase by a further 19,000 and 18,000 in 2015 and 2016 respectively.



Source: bulwiengesa based on Federal Employment Agency

## Sector changes in office employment

During the course of this growth, office employment structures have changed – in some cases significantly; this is particularly due to the structural changes brought about by the tourist industry over the last few years and the increasing digitalisation of our lives and working environments.

The principal drivers of the continued growth have been the business services providers and the TMT sector (technology, media, telecommunications). The increasing importance of Berlin as a start-up hub is also particularly noticeable in these sectors. Since 2008, every eighth new job has been created in start-ups and in companies in the digital sector. These have not been created solely in companies in the TMT

1 Statistical data are often only available after a significant delay

sector but also in other segments such as business services providers and “other”.

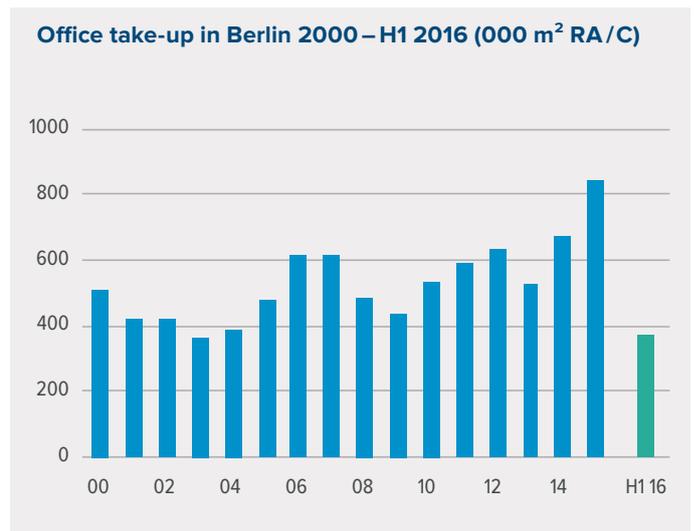
There has been a clear transition not just in terms of volume but also in terms of quality. This is at the expense of traditional economic sectors such as production industry and banks, but gives room for a very widely diversified sector mix, which in some cases (for example under “other”) cannot be defined in detail.

## Berlin office take-up at record level

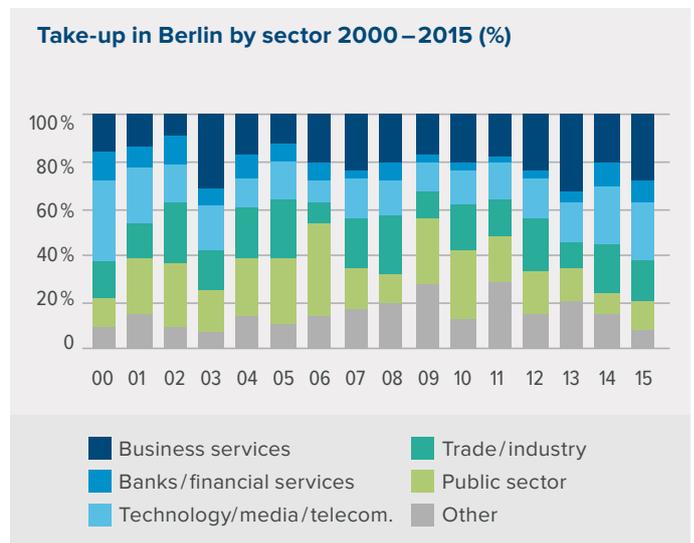
The development and structural changes in office employment are also reflected in the demand for office space. After the record letting year in 2014, this was significantly exceeded in 2015 with lettings of almost 850,000 m<sup>2</sup> RA/C.

Also the first half of the current year 2016 has been very active with lettings of 380,000 m<sup>2</sup> RA/C, which means that a total full-year take-up of at least the previous year’s level, or even higher, appears realistic.

Demand is focussed on the submarkets Mitte, Mitte 1a and Kreuzberg and also Potsdamer Platz.



Source: bulwiengesa, RIWIS and broker information



Source: bulwiengesa, RIWIS and broker information



### Start-ups are growing and the public sector is gaining in importance

The demand for space is structured similarly to the growth in office employment with a high proportion of business services providers and steady growth in the TMT sector.

The TMT sector has meanwhile established itself as an important contributor to sustainable demand, also on account of the growth in the proportion of start-ups. It is noticeable that in addition to the many small letting deals in this sector, the Berlin market has also been characterised by an increase in large-scale lettings, e.g. to Rocket Internet, GIGA Digital and Beko.

Furthermore after a downwards trend in lettings to the public sector over a number of years, there has been a noticeably higher volume let to this sector in 2016. The growth is due to the high level of demand from institutions relating to the administration of refugees and other government departments.

### High demand results in a fall in vacancy rate to 3.5%

The huge demand for space on the Berlin office property market has meant a continual fall in vacancy rate. This was already below the 4% mark in 2015, which is a level not seen since the 1990s.

The continued high demand in combination with an insufficient level of new-build activity has resulted in a further fall in vacancy rate in 2016. There is currently only around 3.5% of the 18.9 million m<sup>2</sup> RA/C total office stock in Berlin available in the market. There are no changes in overall conditions expected in the short to medium-term, which means that the scarcity of supply will continue to increase.

### Highest rental increase for many years

As a result of the continued excess demand in Berlin, market office rents have risen continually over the last few years. Whilst there was rather a moderate increase up to 2015, rental

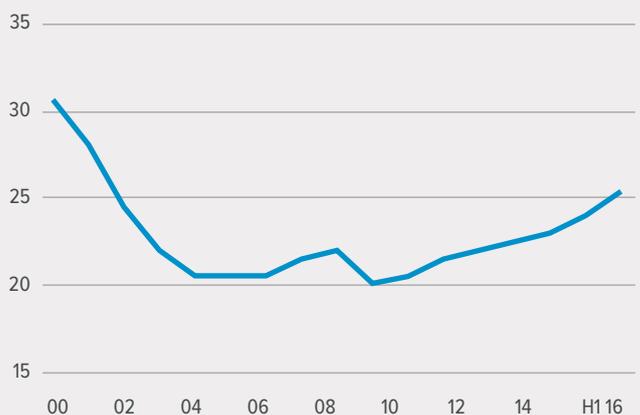
price growth in the last few months has become significantly more dynamic – which is a further reason why this update has been necessary.

Office vacancy rate in Berlin 2000 – H1 2016 (%)



Source: bulwiengesa, RIWIS and broker information

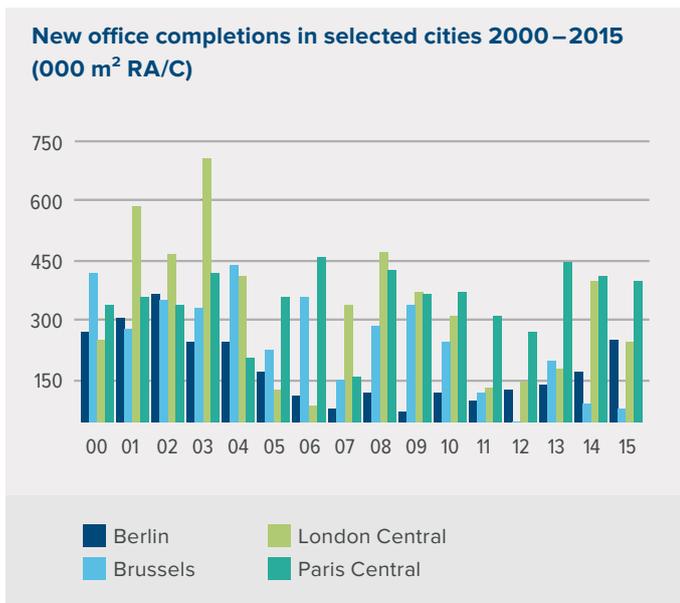
Prime office rent in Berlin 2000 – H1 2016 (€/m<sup>2</sup> RA/C/month)



Source: bulwiengesa, RIWIS and broker information

Since the end of 2015, prime rents have risen by more than one euro from €24.00/m<sup>2</sup> RA/C /month to €25.50/m<sup>2</sup> RA/C/month. This is the strongest growth in Berlin for many years. This rise has been driven by the large-scale deals in central locations such as Mitte 1a and Potsdamer Platz. Lettings in individual iconic buildings have achieved rents in excess of €30.00/m<sup>2</sup> RA/C/month.

A look at the history of Berlin shows that there is still a wide gap between this and the highest rents dating from the 1990s. Rents back then had been up to almost €50.00/m<sup>2</sup> RA/C/month.



Source: bulwiengesa, PMA

### New-build volume in Berlin is still too low

After years of extremely low new-build activity on the Berlin office property market, completion volumes have risen again noticeably in the recent past. In 2015, the completion volume of around 250,000 m<sup>2</sup> RA/C was the highest level since 2002; however it should be noted that 110,000 m<sup>2</sup> RA/C were attributable to the new-build for the BND German Intelligence Services.

There are an increasing number of new-build completions expected for the coming years. However, the speculative proportion continues to be at a relatively low level, which means that the supply and demand situation is unlikely to be relieved significantly over the medium-term.

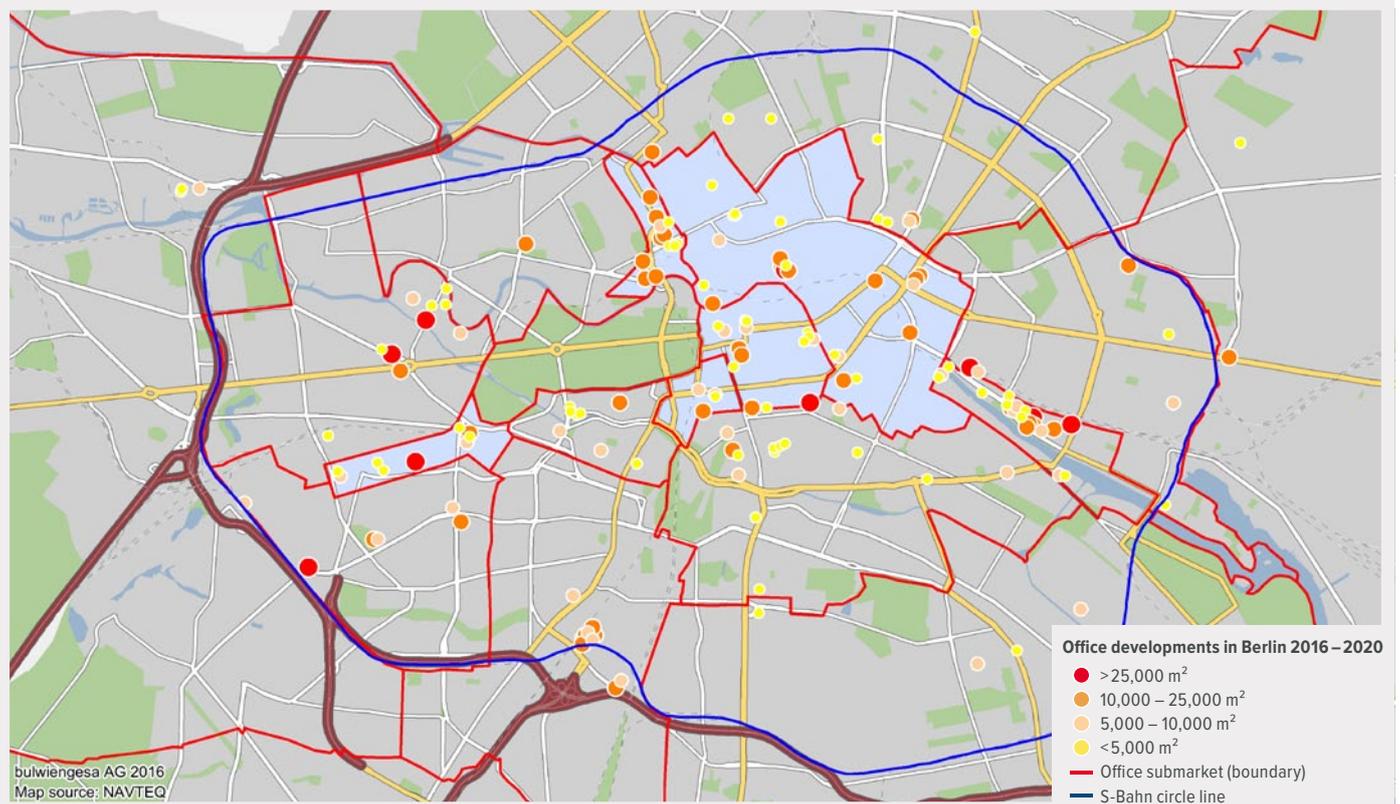
### The city centre is the place to be...

The focus of new-build activity was and is distinctly on the city centre and fringe core locations around the city. Around 81% of all new office space built over the last five years was located within the S-Bahn urban railway circle line. In the future, the majority of all new-build volume will be concentrated in Berlin's so-called "dog's head". 79% of all planned new-build office space due to be completed by 2020 is in the city centre.

Above all, market activity is strongly determined by the two development zones Mediaspree and Europacity. The planning of further schemes and their development potential mean that these will be the focus of new development in future, but there are also further locations such as the Gleisdreieck, Südkreuz, Alexanderplatz and City West which are developing noticeably.

2 pure office space

### Focus on the city centre – 80% of all new office space in Berlin is constructed within the S-Bahn urban railway circle line



# Current pre-requisites for high-rise office buildings in Berlin

## Rise in rental prices and urban development objectives support high-rise office buildings

The development of the Berlin office property market over the last few months gives increasing support for the development of high-rise office buildings. The obstacles in Berlin such as a relatively moderate rental price level and too few office occupiers familiar with high-rise office buildings, mentioned as braking effects in our Analysis of Potential in 2015, are increasingly dwindling.

This is particularly noticeable in the development of prime rents in the market. This has grown by €1.50/m<sup>2</sup>/month in the last six months to €25.50/m<sup>2</sup>/month.

Furthermore, in addition to the “classic”, less price sensitive, high-rise office buildings occupiers, there are new occupier groups from the TMT sector and also from the co-working space sector which have established themselves as potential tenants. Over the course of this year, some of these have leased large areas of space at rents of up to €30.00/m<sup>2</sup>/month.



Between 2009 and 2014 around 20% of all take-up in Berlin's top submarkets was achieved at rents of in excess of €20.00/m<sup>2</sup>/month. In the first half of 2016 this proportion had already grown to more than 26%. In fact 5% of all take-up was achieved at rents in excess of €25.00/m<sup>2</sup>/month.

Also a look at the individual submarkets shows that the market rental price level has risen. Lettings at rents of over €25.00/m<sup>2</sup>/month are currently only achievable in the Mitte 1a and particularly in the Potsdamer Platz submarkets. However, it is expected that there will soon be lettings at this rental price level in the City West submarket in the Upper West high-rise development.

Compared to the past, there are significantly greater proportions of lettings in the rental price category between €20.00/m<sup>2</sup>/month and €25.00/m<sup>2</sup>/month in almost all submarkets.

## Lack of large areas of contiguous space

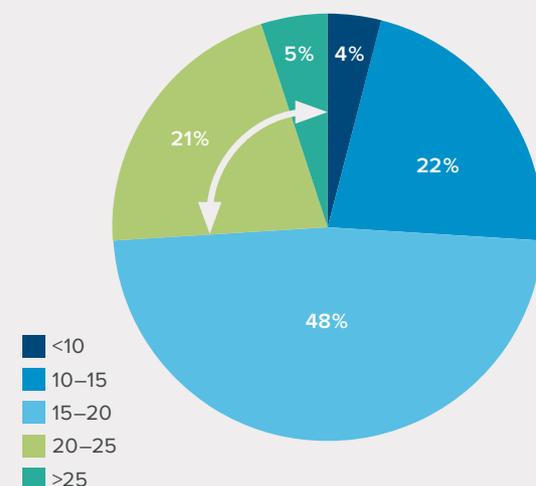
However, it is not only the achievable rental price level which is relevant for the development of high-rise office buildings. The size of the lettable areas also plays an important role.

Office take-up by rental price category in Berlin's top submarkets\* (in m<sup>2</sup> RA/C)

Rent €/m <sup>2</sup> RA/C/month	Take-up 2009–2014 (p.a.)	Take-Up H1 2016
<10	15,059	8,194
10–15	72,473	43,553
15–20	101,886	95,307
20–25	43,766	41,039
>25	2,118	10,836
<b>Total</b>	<b>235,302</b>	<b>198,929</b>

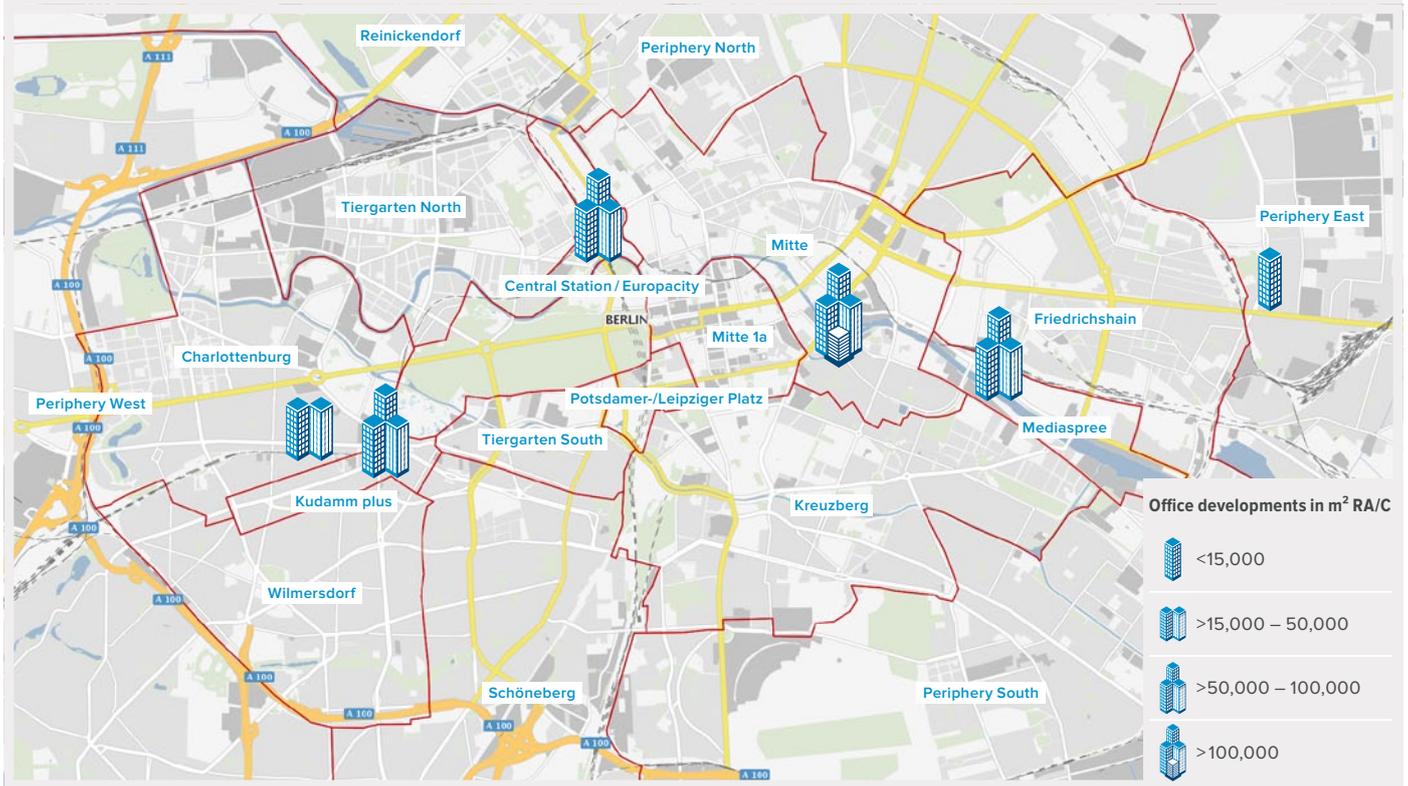
\* Berlin's top submarkets include Mitte, Mitte 1a, Potsdamer Platz, City West and Europacity

Office take-up by rental price category in Berlin's top submarkets (by volume) H1 2016 (%)



Quelle: bulwiengesa

## Relevant foreseeable office high-rise projects up to 2020 by submarket



Source: bulwiengesa

As in 2015, the first half of 2016 saw the conclusion of many large-scale new lettings. Large areas of contiguous space are demanded by office occupiers, but these are hardly available except within new projects (still in planning stage).

Examples of the latest letting successes in the Potsdamer Platz submarket, which had to date been characterised by the availability of large areas of vacant space, show that future new office buildings in Berlin's central submarkets will have to concentrate on offering large volumes of space. This is a risk for both the local economic development office, which is competing with other cities to attract high-profile companies to Berlin, and also to private owners and investors, who expect high income streams from these properties. However, the Berlin office property market is likely to remain cyclical in

future. Locations such as City West and the Alexanderplatz, which function conceptually as Berlin's traditional office locations and according to medium-term planning could again offer large areas of new-build office space, are facing questions relating to optimal, contemporary and sustainable building formats.

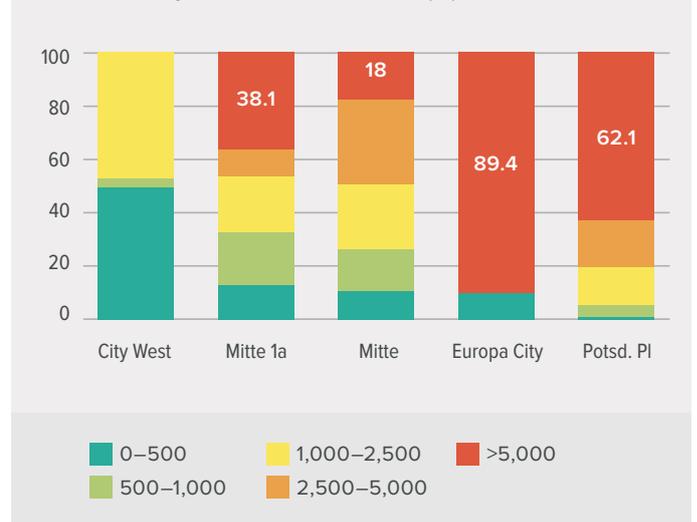
In addition to the ratio of effective usable office space as a proportion of gross external area, the flexible access to the individual building sections and certainly also technological issues such as data transfer, security and energy also play a role. Energy efficiency in high-rise office buildings is definitely an increasingly important issue over the long-term.

### Take-up structure by rental price category (volume in €/m² RA/C/month) in Berlin's top submarkets H1 2016 (%)



Source: bulwiengesa, RIWIS and broker information

### Take-up structure by size category (volume in m² RA/C) in Berlin's top submarkets H1 2016 (%)



Source: bulwiengesa, RIWIS and broker information

## Also politicians see what's necessary

The opinion of politicians with regard to high-rise office buildings in Berlin is changing noticeably in view of the economic and demographic trends. In addition to the Senate's economic administrative offices and Berlin Partner, which are always looking at the (global) competition between locations and which promote Berlin as a business services and economic location with attractive real estate offers, the offices responsible for building and planning are also looking for solutions for the densification and adequate supply of workplaces.

From a real estate perspective, there are three central questions which require a sustainable political framework:

### 1. City centre versus new locations (large new urban development districts)

A high proportion of residential space in combination with cultural attractions and amenities currently makes central locations attractive places. A high concentration of workplaces contributes to this appeal over the working day and together with tourist attractions supports lifestyle, restaurants and 24/7 living. The more difficult it is to protect and stabilise such a mix throughout the various fashions and cycles, the more it is required to do so in order to retain value from an urban planning and investment viewpoint. Across the whole city this means a good balance between the development of the city centre and the creation of new districts. On the one hand this is dependent on the market and on the other hand it is determined by the growth and contraction processes throughout the city and its important submarkets.

### 2. Mixed-use versus single use

The Analysis of Potential in 2015 introduced the "Berlin solution" and mentioned as an example the Zoofenster and Upper West projects located in the City West submarket as valuable projects for subsequent planning, both in terms of urban development and for owners and lenders. The large-scale lettings over the last few months have shown that it is increasingly possible to construct single use office buildings in Berlin, i.e. excluding other uses. Above all it is the economic risks in each individual location which means a tendency towards one type or the other. Given current perspectives, a side-by-side co-existence of both concepts appears sustainable for a market such as Berlin. In terms of the overall attractiveness, the concept and quality of the ground floor areas will play a greater role than in the past in the case of both alternatives.

### 3. Density/height and transport infrastructure

An office building is only as good as its accessibility. Depending on means of transport, motorway locations can be attractive, such as in the Netherlands, and so can locations close to the major public transport hubs as in the European megacities. From a real estate perspective, this symbiosis results in an essential parallel between both investment types (transport is public, building is private). Thus the development of high-

rise office buildings and the densification of new office space in Berlin appears sustainably justifiable, above all in the submarkets Zoo/City West, Hauptbahnhof, Alexanderplatz, Potsdamer Platz and Mediaspree assuming the capacities at rush hours are sufficient in future. The use of Bahnhof Zoo (Zoo station) as a long distance station and also the recent significant (but already incurred) investment costs in the large regional station at Potsdamer Platz are already signals for a stronger densification.

## New high-rise office buildings in Berlin 2016

### Conclusion

**As over the last few years, the Berlin office property market is currently promoting the construction of high-rise office buildings.**

- 1 The **demand** for office space is supported by a very strong **growth in office employment**, which has been at the same rate as central London over the last few years.
- 2 The office take-up and the growth in office employment have been mainly attributable to the **TMT sector** and **business services providers**. This means that Berlin is leaving its old traditional sectors behind and is approaching the future with a new generation of employees, which are strongly characterised by the **digital sector** but in some cases **cannot be defined precisely**.
- 3 The **office vacancy** is extremely low in relative terms, but at the same time the **availability** of new office space is starting to increase only **moderately**.
- 4 For around one year now the high level of demand and the very short supply on the Berlin office property market have resulted in a **very rapid rise in market rents**, which can now be clearly seen in the rise in prime rents. With office rents now in excess of the €25.00/m<sup>2</sup>/month mark, high-rise development in Berlin now appears feasible for investors.

Current structures in local office take-up have been of benefit to the Berlin-Mitte submarket and its "new districts". The Potsdamer Platz submarket is currently experiencing a renaissance and also the City West and Mediaspree submarkets are now positioning themselves as sustainable high-rise locations.

In Berlin, the concept of the "growing city" will have to be well balanced and organised by city planners as part of a high level framework plan. Important **environmental and transport objectives** and also **social considerations** serve to reduce the availability of development land. In order to avoid the reduction and overbuilding of land for reasons of ecology and sustainability, **high-rise development is more than ever on the agenda** as an urban planning instrument.

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