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A long-term view on the (German) office market

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The historical trend towards more office workers and offices could peak in a couple of years. Three mega trends the climate crisis, demographics and digitalization will have a striking and lasting impact.

Today, discussions about the future of the office market are often focused on remote working, coworking spaces or reduced working time. Already at the beginning of the pandemic, we pointed out that for Germany remote working will be no game changer for the office demand. We still stick to this view. Likewise, coworking spaces and the debate to reduce the number of working days per week may partially change the office market, but, in our view, not fundamentally. Keep in mind that the demand for office space is mainly driven by the number of office workers and the peak occupation of offices in the middle of the week. As employment has reached a new all-time high in 2023, we assume that the number of office jobs has increased, too. This additional demand for office spaces is clearly helping to cushion the downturn. We are quite optimistic that the current price adjustment, which is necessary to account for much higher refinancing costs, will level off in the coming quarters. Subsequently, prices should start to rise with inflation.

But in the longer term we foresee three potential stumbling blocks for the German office market. All three should also be relevant for office markets in many other countries as they are related to current megatrends demographics, climate change and digitalization.

First, we think that the number of office workers will likely continue to increase over the decade. For Germany our population projection implies that we will have almost 86 million inhabitants in 2030, a plus from roughly 1.5 million people from the current level. This additional influx should also help to grow the number of office workers in the coming years. But in the long-term the rising number of elderly people will be a game changer for the labor market. Population projections imply that an annual net migration of 500k persons would be necessary to avoid a decline in population. This is clearly above the slightly above 300k pre and post pandemic and our own assumptions for the coming years. As a consequence, peak employment may be reached at the end of this decade or the next decade and the demand for office space may then start to structurally decline.

Secondly, rising global temperatures and the threat of more severe natural disasters are likely to lead to more political actions. We think, it is reasonable to expect that there will be more incentives to reduce office space. This could bring about several benefits. First, the construction of offices emits a lot of CO₂, in particular for cement and steel, and the necessary heating and



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cooling is also quite energy and CO₂-intensive. Moreover, less office work implies less commuting, another positive for the climate. This will even hold if electric vehicles dominate the streets. Finally, for decades, and, we think, it holds for all countries, the share of persons living in cities is on the rise. Urbanization might be the unbreakable trend. As a result of ever rising metropolitan areas, a structural supply shortage of affordable housing has emerged. Hence, policies setting incentives to reduce the demand for offices could pave the way for converting offices into condominiums. Scarce building areas will probably be used for housing projects rather than commercial buildings. It seems likely that sooner or later societies and politicians embrace these arguments when they can kill three birds with one stone.

Thirdly, in the future technological breakthroughs may have a much larger impact on our daily work than in the past. Artificial intelligence is the current buzzword which may have an important impact on the job market and office demand. While many jobs may become obsolete, it is fairly unclear whether the net effect is negative too. So far, history tells us that digitalization was a job engine. However, we would like to point to another development. Over the last decades, we have increasingly exchanged paper and pencil against monitors and keyboards. But now with the rapid progress of glasses which provide us with virtual and augmented reality, the question arises is are both paper and pencil as well as monitors and keyboards a thing of the past? Eyes which move the mouse pointer, touching fingers which replace the mouse button and the two monitors of glasses which give us a cinema experience might be just the beginning. We seem close to a world in which finger and hand movements steer IT devices. Moreover, the IT history tells us that new generations of glasses will be lighter, smaller and the computing power will continue to rise. Then, many new applications might simplify our office jobs and the daily life as well. Clearly, new digital technologies can bring about new downsides, health issues, less socializing, among others. From today's perspective the positive factors clearly dominate potential downsides. If virtual and augmented glasses are in high demand the office demand will shrink substantially. Eventually, we may meet our colleagues in the metaverse and now and then in the old reality, i.e. in the regional headquarter, in a hotel or at a social or cultural event.

This comment does not provide full-fledged answers but clearly gives a heads up that in a few years the office market could peak. All three arguments, demographics, the goal to reduce emissions of greenhouse gases and further technological advances point to a fundamental change of hitherto unprecedented magnitude. This could be a historic moment as throughout the history of mankind from the first civil services in ancient societies to today, the number of offices has structurally increased. Now the peak of office demand may be close and then we could enter a new phase in which office demand begins to decline, at least in the real world.

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