MASTER

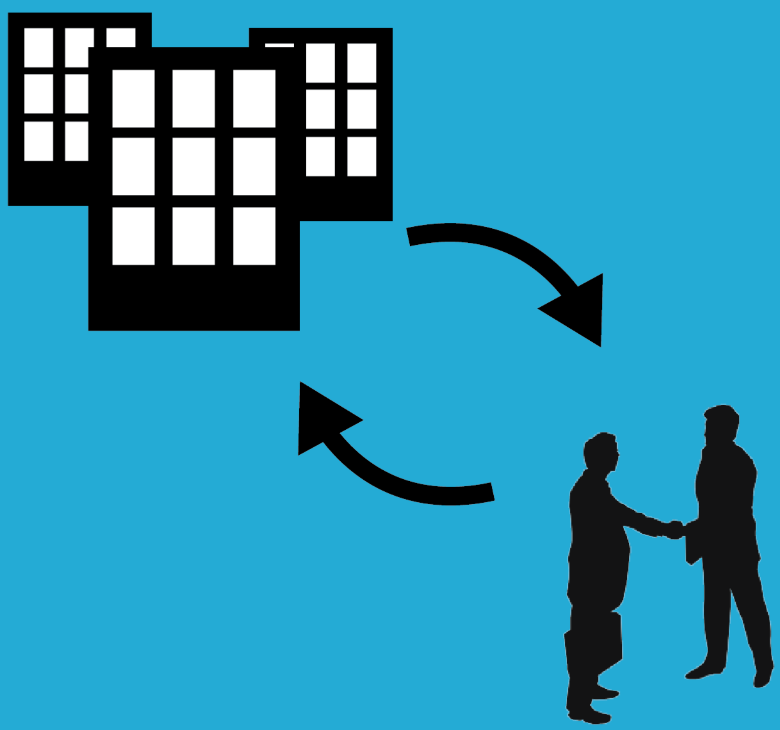
The office market in transition
the dichotomy between real estate management and the tenant

Janssen, M.G.J.

Award date:
2013

THE OFFICE MARKET IN TRANSITION:

The dichotomy between Real Estate Management and the Tenant



Michiel Janssen
Master's Thesis
Real Estate Management & Development

TU/e Technische Universiteit **Eindhoven** University of Technology

May 2013

Colophon

The Office Market in Transition: The Dichotomy between Real Estate Management and the Tenant
27 May 2013

Master's thesis by

Michiel (M.G.J.) Janssen - 0567819
Eindhoven, The Netherlands
michiel.g.j.janssen@gmail.com

Graduation committee

Academic supervisors

Ir. H.A.J.A Appel-Meulenbroek
Department of Real Estate Management & Development
Faculty of Architecture Building and Planning
Eindhoven University of Technology

Dr. W.J.M. Heijs
Department of Real Estate Management & Development
Faculty of Architecture Building and Planning
Eindhoven University of Technology

External supervisors

Ir. B. van Egmond
Owner
VEG Interior Building Systems BV

Preface

About a year ago I started putting the first pieces of this thesis on paper, and now these words are the last of many. This research concludes my Master's program Real Estate Management & Development, but it also lies as the start of my professional career in the real estate industry. The topic of vacancy on the office market I chose is one that has reached the Dutch news continuously since I started my research, ranging from warnings for an investment bubble to the prime cause of the failing of a Dutch bank early in 2013.

A part of this thesis I wrote from a vacant, 7.400 sq.m. office building in Amsterdam Southeast, the largest office park in the Netherlands. Spending the evenings after an internship on these vast, empty floors, I came to realise the magnitude of the subject I had chosen to investigate. The author of one of the books I had taken with me to spend the evenings, wrote the following:

"when you look long into an abyss, the abyss also looks into you."

Well, spending your nights in an empty office building of that size feels exactly like that. It provided me with a sense of the implications that the rising vacancy level on the Dutch office market has brought forth. And it sparked the interest that stayed with me until the very end.

But I could not have done this without the support from the people around me. First, I would like to thank my graduation committee; Wim Heijs and Rianne Appel-Meulenbroek from the Eindhoven University of Technology, and my external supervisor Berend van Egmond (VEG office). Their constructive criticism and fresh perspectives have guided me in writing this thesis. I would also like to thank Diederik Bakker and the rest of the team at UBS Global Asset Management for their valuable input during my internship, especially in the early stages of this research.

Then, I would like to thank my parents for providing me with a safe harbour and their unconditional care. I would also like to thank my brother Thomas for the Skype sessions from across the globe, and my sister for all the weekends in Brussels, providing me with both moral support and most welcome advice. I am also grateful to all of my friends, providing me with the necessary, enjoyable distractions.

Finally, this work would not have been possible without Kristen. Despite the distance between us, you stuck by me and never complained upon hearing the words office market and vacancy. I am immensely grateful for your love and support. Thank you and see you soon.

Michiel Janssen
Eindhoven, May 2013

Summary

Motivation
April 2012 - Dutch newspapers are filled with debate about a new bubble threatening economic growth: the office market in The Netherlands is over-valued and permeated with high and structural vacancy. High levels of vacancy are regarded as a societal problem of social and economic decay. The implications of this high vacancy market are widespread: abandoned office parks, graffiti, break-ins, radical depreciation of real estate assets and bankruptcy of construction companies to name a few.

Problem definition
This thesis focuses on recent developments on the Dutch office market that affect organisational and financial decisions regarding the lease of office space. From both the perspective of supply and demand, it assesses how these developments contribute to a growing, qualitative mismatch between the intentions of the Real Estate Management Organisations (REMOs) that manage the supply of office real estate and tenants seeking to lease office space.

Research questions
To answer the problem as stated above, this research revolves around answering the following central research question:

What current organisational and financial developments contribute to a qualitative mismatch between supply and demand on the Dutch office market and what improvements can be made by Real Estate Management Organisations to better meet the changing demands of the tenant?

In order to answer this central research question, the following subquestions are addressed:
1. *What are the historic characteristics of supply and demand that have shaped the current situation on the office market in the Netherlands?*
2. *What developments are expected in the next 5-10 years on both the supply and demand side that will affect the current situation on the office market?*
3. *What business models are employed by the Real Estate Management Organizations and how do they currently meet changes in the tenant's demand?*
4. *What reasons do businesses have to lease office space and how are these affected by recent developments?*
5. *How does this mismatch manifest itself in practice and what improvements can be made by the REMO to address the current mismatch on the office market?*

Research Methods
This research conducts applied scientific research in order to examine the nature of the mismatch between the lessors and tenants of office buildings in The Netherlands. By means of a literature study, it first provides a contextual framework of data describing the key factors at play in the Dutch vacancy debate. Secondly, it assesses whether the assumptions made in the literature study correctly represent the situation on the current office market by means of conducting interviews with stakeholders of both the supply and demand on the Dutch office market.

The Dutch office market

The office market in The Netherlands has steadily grown over the past 60 years under the influence of a shift towards a services-oriented economy, an expanding labour force, increased female participation on the labour force and an increase of space usage per office employee. The cyclical behaviour as described through the DiPasquale-Wheaton 4-quadrant model (1992) reveals itself through fluctuating vacancy levels. At the same time it seems that foreign office markets show comparable fluctuations in the level of vacancy. As such, an increased vacancy level is not necessarily a need to worry. However, the supply no longer seems as strongly interlinked with the changes in demand.

While the Dutch office market has seen a long period of growth, the major growth drivers of demand for office space in The Netherlands are currently stagnating:

- jobs in the Dutch services sector are expected to grow only 0.7% per year between 2014-2017.
- the labour force in The Netherlands will decrease from 10,1 million in 2011 to 9,3 million in 2040.
- the increase in participation of women in the labour force seems to have slowed down.
- the average amount of space per employee has been dwindling.

The tenants themselves face a number of developments that affect their real estate decisions:

- global economy is currently in a recession and companies focus on cutting costs.
- the new Basel III banking regulation poses stricter rules for borrowing capital.
- new IFRS criteria make shorter real estate leases financially favourable to longer ones.

But apart from a difference in absolute supply and demand, recent developments also seem to shape a growing discrepancy between the intrinsic characteristics of supply and demand. While the supply offers office space from a 'traditional' view of providing space for companies to execute their work, companies on the demand side begin to discover the advantages of adapting to new office concepts such as the New Ways of Working. This changes the nature of the expectations tenants have for leasing office space on the space market, feeding a mismatch between supply and demand.

The office market from the perspective of the REMO

The core business model of the REMO remains to safeguard the pros and negate the cons of investing in real estate: retaining a stable asset value, maximising rent from the leased office space, safeguard its protection from inflation and minimise the cost of management. With the professionalisation of the REMOs the number of activities have grown, and day-to-day property management has often been outsourced to external REMOs to make use of their scale advantages. A consequence is that the tenant relations are often also outsourced, distancing the owner from the tenant.

To cope with the increasing competition in a high vacancy market, the owner of the office building has two different types of approaches to meet the tenant's demand:

- Core business responses: meeting the tenant usually comes down to providing financial incentives in the lease contract. These can be periods of rent free lease, cash contributions to fit-out or moving costs, or omitting the tenant's reinstatement obligation at the end of the lease. The REMO prefers to retain long leases and high gross lease prices to positively affect the capital value of the real estate asset.
- Non-core business responses: regarding the real estate from the perspective of the tenant. Helping to reduce the tenant's service charges by increasing the sustainability of the building can increase the competitive factor of the building and persuade the tenant to continue/extend its lease. Another

factor is helping the tenant shift its work to the New Ways of Working. This implies investing in the building (internal staircases, meeting areas, improve flexibility of layout and improve the facade) and providing for additional amenities in order to facilitate their different need of work environment.

With increasing vacancy levels, the tenants have gained power on the bargaining table. While rent levels are declining, REMOs might be reluctant to invest on lower margins due to diminishing returns and remain passive, waiting for the market to stabilize. However, with a declining and changing demand, shorter leases and increasing competition this might prove to be a long wait.

The office market from the perspective of the tenant

The Dutch tenant in 2013 faces economic decline, tightening regulations and a shrinking pool of talented employees. Real estate can contribute to the core business of the firm by pursuit of wealth maximisation for the shareholders. There are two types of considerations involved in pursuit of using the real estate to create added value for the business: numerator considerations and denominator considerations. Denominator considerations strive to reduce the operational cost of the real estate, therefore increasing the profitability of the business. These considerations are tangible and can usually be measured by the degree to which they reduce the cost of the real estate. Numerator considerations, on the other hand, strive to use the real estate to create additional revenue for the company by means of e.g. increasing productivity, employee satisfaction, or creating opportunities to increase communication. These considerations are often intangible and are hard to translate directly to added value for the company.

The literature study revealed three types of denominator considerations that have a direct relation with the REMO on the supply side. These are the reduction of the length of the lease, the reduction of the height of the lease cost per square meter and finally the minimisations of service costs. These focus solely on reducing costs.

Next, there are three types of numerator considerations that the literature study revealed that have a relation with the considerations of the REMO. These are the improvement of the sustainability of the real estate, the adaptation to new office concepts such as the New Way of Working and the provision of additional supportive amenities. These considerations focus on a wide array of improvements that are not necessarily tangible in their contribution to creating additional revenue for the business. Examples are: to attract new talent, to improve productivity, to increase the efficiency of the use office space and to increase employee satisfaction. It should be noted that considerations under the New Way of Working can add both numerator value as denominator value. This would explain its popularity in the current market.

Lastly, the literature study reveals that tenants prefer a more direct communication with the lessor in order to express concerns or complaints. Direct communication is also appreciated in discussing the business' considerations pertaining to the real estate. Insufficient communication might contribute to a mismatch, lowering the satisfaction of the tenant with its current real estate position.

Empirical data collection

By means of interviews, the findings from the literature study on both the perspective of the REMO and the tenant have been tested in practice. Five REMO respondents and five tenant respondents have given their view on the topics of a possible mismatch, but were also free to contribute new views so better reflect the nature of the qualitative mismatch. The results of compared topics can be found in Figure A.

Recommendations for REMOs in increasing the match with tenants

Findings from practice

Recommendations

Length of the lease agreement	❌	Tenants primarily seek flexibility of office space to accommodate growth or shrinkage of the business. Lease contracts inadequately address this need right now, therefore it would be prudent for REMOs to increase their focus on this topic.
Gross lease price & incentives	🟢	While the height of the lease price is key in the negotiation process, tenants do not seem to value net lease prices over gross lease prices and incentives. There seems no need for the REMO to focus on net lease prices to reach the tenant.
Indexation of the lease price	🟠	Currently, the indexation of the lease price is often regarded as a given part of the lease contract. However, if the level of inflation threathens to increase, tenants will want to share the risks involved. The REMO should anticipate this development.
General Provisions in ROZ Lease Contract	🟢	There is a disagreement between the REMOs and the tenants about the partiality of the standard ROZ contract. While it does not weigh heaviliy in the tenant's considerations, the REMO could benefit from a more customer friendly approach.
Sustainability	🟢	While the considerations of the tenant regarding the sustainability of the office space seem to increase in relevance, the weight of these do not seem to play a great role in the tenant's decision process. A low degree of attention is however advised.
Service Costs	🟠	The importance of addressing the height of the service costs is regarded as highly important in the relationship with the tenant. It would be beneficial to the match with the tenant to keep addressing this topic with a high degree of attention.
New Way of Working	🟠	Tenants expect the REMO to be flexible in accommodating their aspirations in adapting new work concepts. While the interviews did not provide grounds to suspect a mismatch, proactive participation of the REMO seems required.
Additional Amenities	🟠	Tenants appreciate the provision of additional amenities, if the associated costs are transparent and participation is not compulsory. These amenities can greatly contribute to the pros of an office building, which can increase the match.
Tenant relations	❌	The need for direct communication with the REMO is regarded as very important by tenants, and is often not adequately met. Therefore this contributes to a mismatch, which should be addressed by the REMO to better meet the tenant's demands.
Diversification of the services provided by the REMO	🟢	While the provision of additional services might be appreciated by the tenant, there seems to be no indication this plays an important role in the decision process concerning the real estate.

❌ Mismatch, requires immediate attention

🟠 No mismatch, requires high degree of attention

🟢 No mismatch, requires low degree of attention

Figure A: Grounds for a potential (mis)match between supply and demand, based on the findings from the interviews with REMOs and tenants

The two topics on which the interviews found grounds to suspect a mismatch are the length of the lease contract and the degree of communication between the REMO and the tenant. The first lays bare an insufficient response of the REMO in addressing the need for flexibility in the tenant's business. The REMO employs financial incentives to negotiate longer leases. The tenant also wishes to negotiate a lower lease price, but often finds long leases to be lacking the flexibility to accommodate growth or shrinkage of the real estate needs. The second mismatch is related to the first. An important wish of the tenant is to communicate any real estate needs directly with the owner (in this case the REMO). Where the literature indicates that communication for a majority of the REMOs happens through a third party, the external REMO, this erects a barrier between the REMO and the tenant.

Then there are four topics (orange dot) on which the REMO can expect a mismatch to occur if neglected: the indexation of the lease price, service costs, the NewWoW, and the provision of additional amenities. Based on the opinions expressed in the interviews, it is advisable for REMOs to spend a high degree of attention on these in order to better meet the tenant's needs concerning their real estate.

The last four topics (green dot) are not inconsequential to the match between the REMO and the tenant, but the findings from the interviews do not suggest that these play a crucial role in the tenant's decision process. It is advised for REMOs to excel in these areas in order to distinguish their office space from the competition.

Conclusions & recommendations

The REMO and the tenants have very different perspectives on office space. The former think mostly from a perspective of maximising its financial returns, while the latter considers not only a minimisation of real estate costs but also the way the real estate can contribute to its core business. These different perspectives provide the grounds for a qualitative mismatch, which, as the results show, primarily manifest itself in the degree of communication between the two groups and the flexibility the REMO offers. Knowing that the majority of the office space on the Dutch space market is in the hands of REMOs, there is a large area of improvement to better adjust the match between the REMO and the tenant.

Based on the results of both the literature study and the interviews, there are several recommendations for REMOs that might contribute to the creating a better match with the tenant:

1. Make sure there is clear communication with the tenant in which it can express its considerations concerning their real estate position. The primary complaint heard during the interviews was that tenants often only see the owners a year before the end of the lease. Secondly, the tenant appreciates direct contact with the owner. When the tenant has a good relation with the REMO, it is less likely to consider terminating its lease at the end of the contract.
2. Focus on the want of the tenant for flexibility. This flexibility can for example be found in the length of the lease contract, or in offering the possibility for growing or shrinking the amount of leased space in the middle of the contract.
3. Innovate and think from the perspective of the tenant. If the tenant is convinced that the lessor is involved in their well-being, it will be less prone to move. A good example is the focus on reducing the service costs. This is not per se directly the core business of the REMO, but it can increase its office building's competitive edge by lowering the total real estate expense of the tenant. Innovation is key in addressing the intangible contributions the real estate can pose for the tenant to contribute to its business.

One recommendation for further research would be to investigate the distinction in REMOs working for institutional investors, for private equity investors or for private investors. These have different financial goals and risk profiles, causing the REMOs working for them to also have different views on the approach of the demands of the tenant.

Another recommendation for further research is to investigate how the economic crises since 2008 and the rising vacancy levels have affected the outsourcing of a part of the REMO's management activities to an external party. Broker firms are increasingly offering services that include management tasks on the tactical level, but also facility management to the tenant. It would be interesting to investigate the opportunities, as well as potential conflicts of interest that might arise when both the tenant and the REMO are represented by the same company.

The research performed in this thesis has shown that the size of the demand is expected to shrink short to mid-term, which means that the quantitative mismatch between supply and demand will not easily correct itself. It has also shown that there are a number of factors at play in shaping a qualitative mismatch. Its contribution to solving the current vacancy debate has come in the form of a list of topics that describe where a Real Estate Management Organisation can improve themself to better meet the tenant's demand. This hopes to reduce the need for new office space that does meet the tenant's demand, which would further impair the vacancy issue.

Table of contents

Chapter 1: Introduction

Background

April 2012 - Dutch newspapers are filled with debate about a new bubble threatening economic growth: the office market in The Netherlands is over-valued and permeated with high and structural vacancy. Headlines such as *"Dutch Central Bank sees bubble on the office market"* (De Waard, February 4th 2012 in Volkskrant) and *"If offices will ever start yielding results again, it is beyond our lifetime"* (Kooijman, April 26th 2012 in Financieel Dagblad) indicate a sentiment that does not believe in a short term recovery. Remoy (2010) describes the structural vacancy as a societal problem of social and economic decay. The implications of this high vacancy market are widespread: abandoned office parks, graffiti, break-ins, radical depreciation of real estate assets and bankruptcy of construction companies to name a few. Most recently, in February 2013, the Dutch government had to save the Dutch bank SNS for 3.7 billion Euros due to its underperforming real estate portfolio (Rijksoverheid, 2013).

Since it can take years to go from a plan to a constructed building, real estate is a rather illiquid market and it takes time for the supply to adapt to the demand. Therefore, it is an inherent property of commercial office markets to reveal this mismatch through some level of vacancy, usually in between 3-8% of the total supply of office space (Wheaton 1999; Tse and Webb 2003). However, vacancy levels have been gradually increasing in the last decade, which implies a broader mismatch between supply and demand. The national average vacancy rate in Dutch offices is currently 15,4% of the total office stock, or 7.6 million square meters (Bak, August 2012).

The prime causes and characteristics of this mismatch and the idiosyncrasies of the Dutch office market have been well documented over the years, in both scientific as commercial literature. A number of strong growth drivers have provided for decades of growth in the demand for office space. But after years of overdevelopment and a diminuendo of these major growth drivers, this long period of growth has come to an end. At the same time, owners of office buildings face a changing breed of tenants that want shorter leases, have more specific demands and gain power on the bargaining table due to the increasing competition of available excess of supply. While the office property market faces the challenge of adapting to these changes, the European office market faces rapid change under the influence of recent economic decline and stricter pan-European financial regulations. These developments lead to a reduction of risk-taking, while the office market asks for more risk taking, innovation and new office concepts.

As an answer to this problem of high vacancy, an increasing amount of research explores solutions for the vacant office buildings that enter the market. Some of these explorations focus on the removal of the buildings from the office market into another market, therefore effectively reducing vacancy, e.g. by transformation or demolition (e.g. Remoy, 2010; Gelink & van Zeeland, 2010). This addresses the problem of a growing oversupply (or quantitative mismatch), but not the current qualitative mismatch between supply and demand on the office market. This research will focus on this qualitative mismatch, which has only been marginally approached in the light of the current Dutch vacancy debate.

In order to analyse this mismatch, one needs to know what parties represent the supply and demand, as schematically presented in figure 1.1. The demand is represented by the businesses seeking to lease new office space, also referred to as the tenant. While the supply consists of the owners of office buildings that offer their office space for hire, a majority of the Dutch office supply is in hands of investors and managed internally or externally by real estate managers. This thesis focuses on the entirety of the real estate management organizations (REMOs) that take care of the management and exploitation of commercial office real estate on behalf of one or more (institutional) investors.

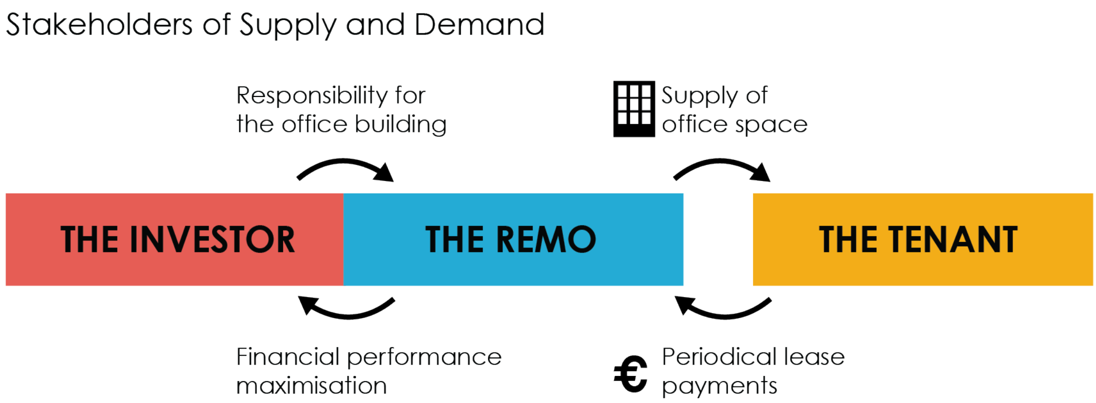


Figure 1.1 Stakeholders on the office market

Real Estate Management Organization

A REMO acts on behalf of its (institutional) investors to manage and exploit its real estate. Their main target is the optimal lease of the office space to ensure returns. The REMO can be a part of the investor's organisation or a financial firm representing the investor, but can also (partly) be an external services firm where these tasks are outsourced. To assess their impact, both the size of their presence and the nature of their business is briefly addressed.

Since there are no official, uniform statistics that register the amount and nature of the Dutch office space due to a lack of transparency in the market, it is difficult to estimate the size of the presence and type of investors on the Dutch office real estate market. Vermeulen and Wieman (2010) state that about 45% of the total office stock was offered for rent in 2010, or 19,8 million square meters (figure 1.2).

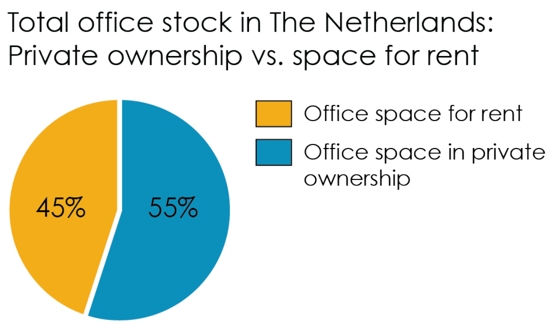


Figure 1.2 Based on Vermeulen, M., Wieman, M. (2010); Bak, R. (2006) and Dataland (2010)

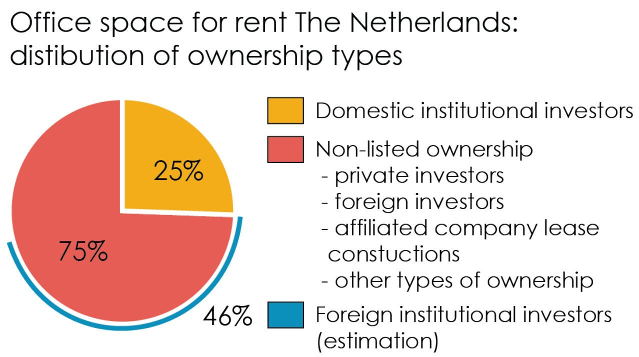


Figure 1.3 Based on Vermeulen, M., Wieman, M. (2010); Dataland (2010) and Vastgoedmarkt (2011)

The amount of which is owned by (institutional) investors is comprised of both domestic and foreign ownership. According to data provided by the organization of Dutch instutional investors IVBN (2008), about 5,1 million square meters of lettable office space (or 25% of the rental market) is in hands of Dutch institutional investors, totalling an investment volume of about 10 billion Euros. Numbers about foreign investments on the Dutch office market are not readily available and therefore more difficult to obtain. The real estate magazine Vastgoedmarkt (2011) states that foreign investment in Dutch rental office space totalled an approximate 17,7 billion Euros. By comparing the ratio of investment to office space as seen in Dutch investments, this investment would represent roughly 9 million square meters of office space (or 46% of the rental market). So on a total amount of lettable floor space of 19,8 million square meters in The Netherlands, a rough estimation would suggest that up to 25+46=71% belongs to institutional investors (see figure 1.3). This implies that the Dutch office market is largely dominated by large, institutional, foreign investors. The Dutch economical institute for the built environment EIB (2010) estimates that up to 90% of the rentable space on the office market is in the hands of investors. Although these remain rough approximations, it is safe to assume that the REMOs representing (institutional) investors operate on a significant portion of the market for Dutch office space.

The core tasks in which the REMO facilitates the investor in the exploitation of their real estate can be generally described by means of the real estate management pyramid (Janssen, 2008). As shown in figure 1.4, these tasks are divided into three management levels: strategic, tactical and operational management. The shape of the pyramid indicates that the strategic level of the REMO is smaller in size than the tactical level and subsequently the operational level. The strategic management translates the (usually financial) goals of the investor into a plan for the entire real estate portfolio. By means of this portfolio plan it describes broadly the needed changes in the portfolio (acquisition and disposition) and the nature of the exploitation in order meet the underlying goals. Subsequently, the tactical management translates the portfolio plan into a more concrete strategy for the real estate objects (assets). It assesses the consequence of the changes in the market on the rentability of the assets and the development of the asset value. The premier goal will usually remain the financial performance, but on the longer term secondary goals like a user-oriented approach can add to the aforementioned. By means of a performance analysis the tactical management will assess if the assets fulfil the criteria as described in the portfolio plan. Finally the operational management executes the asset strategy and takes care of the day-to-day management of the real estate object (e.g. maintenance, tenant relations). Since the tactical level -the

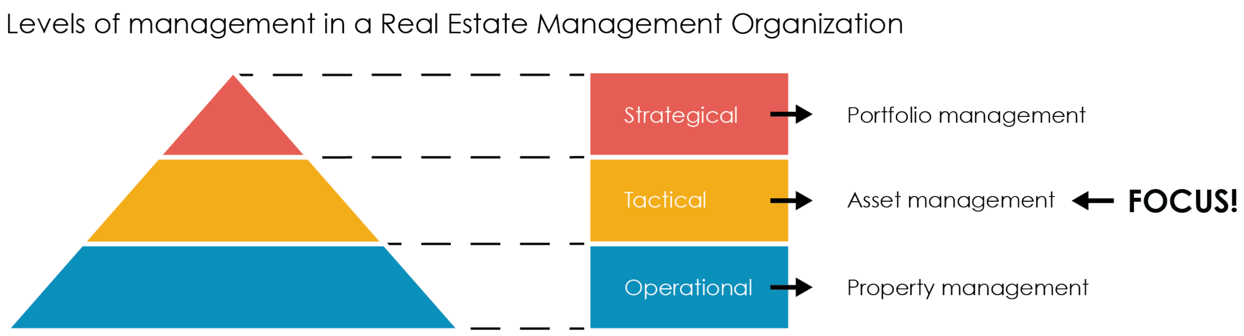


Figure 1.4 The real estate management pyramid with accompanied areas of expertise. Adapted from Dutch from Janssen, I. (2008)

asset management- links the portfolio goals to the market conditions and therefore the tenants, it will be primarily this level of the REMO this thesis focuses on. During this thesis, the REMO will be used interchangeably with 'supply side' and 'lessor'.

Problem definition

This research focuses on recent developments on the Dutch office market that affect organisational and financial decisions regarding the lease of office space. From both the perspective of supply and demand, it assesses how these developments contribute to a growing, qualitative mismatch between the REMOs that manage the supply of office real estate and tenants seeking to lease office space.

Where the focus of real estate management once lay primarily on the upkeep of a building, current developments seem to suggest that its range of services is expanding and the level of performance is intensifying (Janssen, 2008). In the mean time the role office space plays in the business of the tenant is changing under the influence of changing ways of working, pressure for financial performance in time of economic decline and external regulations. With the REMO's services aimed primarily at the performance of the real estate and the targets of the investor, a qualitative mismatch is formed between supply and demand, further pressuring the existing vacancy level on the Dutch office market.

Goal

The goal of this thesis is to offer a better understanding of the specific characteristics that shape an expected growing discrepancy between the organisational and financial developments of the supply side (longer leases, lower risk) and the demand (shorter leases, demand for more risk taking by owners) on the Dutch office market. By providing this understanding and exploring improvements that can be made for this discrepancy in the market, it aims to offer insights for Real Estate Management Organizations in order to build new bridges between their office space and the tenants seeking new office space. By doing so, this thesis aims to contribute to the contemporary vacancy debate.

Scope

The extent of this research thesis focuses itself on the qualitative mismatch between the organisations representing the supply (the REMO) and demand on the Dutch office market. This qualitative mismatch is approached from an organisational/financial perspective, placing current developments on the office market into perspective in regard to the decisions being made about leasing office space. While for example building characteristics and changing work processes play a crucial role in the qualitative match between supply and demand, these factors will play a secondary role. It refrains entirely from scrutinizing solutions for vacancy by removal from the office market (a quantitative solution) and instead focuses on improving the understanding of the match between the owners and the tenants of office space.

Research questions

To answer the problem as stated above, this research will revolve around answering the following central research question:

What current organisational and financial developments contribute to a qualitative mismatch between supply and demand on the Dutch office market and what improvements can be made by Real Estate Management Organisations to better meet the changing demands of the tenant?

In order to answer this central research question, the following sub-questions will be addressed:

1. *What are the historic characteristics of supply and demand that have shaped the current situation on the office market in the Netherlands?*
2. *What developments are expected in the next 5-10 years on both the supply and demand side that will affect the current situation on the office market?*
3. *What business models are employed by the Real Estate Management Organizations and how do they currently meet changes in the tenant's demand?*
4. *What reasons do businesses have to lease office space and how are these affected by recent developments?*
5. *How does this mismatch manifest itself in practice and what improvements can be made by the REMO to address the current mismatch on the office market?*

Scientific relevance

The rapid development of technology in the last few decades continuously changes the way people work, changing the characteristics of the demand for office space. Meanwhile, the supply side of office space is firmly linked to investment of credit and carries a separate set of behavioural characteristics. To better understand the growing incongruence between these two separate but intertwined markets, this thesis aims to explore the decision framework of the two by means of scientific and corporate literature and then testing it in practice. By offering a better understanding of this qualitative mismatch, it adds knowledge to existing literature how Real Estate Management Organisations can bridge this mismatch.

Societal relevance

The recent developments of continued additions to the office supply in The Netherlands with a decreasing demand and an unfortunately timed economic crisis left The Netherlands with high vacancy rates on the office markets. This leaves the public domain with an increasing amount of empty, abandoned buildings and illegal squatting to the point where a whole documentary series aired on public television to raise awareness, called "The battle for The Netherlands" (Slag om Nederland). Apart from the societal problems, this vacancy also represents an investment bubble in Dutch real estate, which could trigger a new credit crunch. Therefore, it is imperative to understand the mechanics that have lead to these high vacancy levels and discuss potential solutions.

Research Design

This research conducts applied scientific research in order to examine the nature of the mismatch between the REMOs and tenants of office buildings in The Netherlands. By means of a literature study, it first provides a contextual framework of data describing the key factors at play in the Dutch vacancy debate. Secondly, it assesses whether the assumptions made in the literature study correctly represent the situation on the current office market by means of interviews with stakeholders of both the supply and demand on the Dutch office market. Following the research questions formulated under the problem definition, each chapter in this thesis answers one of the sub-questions. The following model will act as a guide throughout the chapters (figure 1.5).

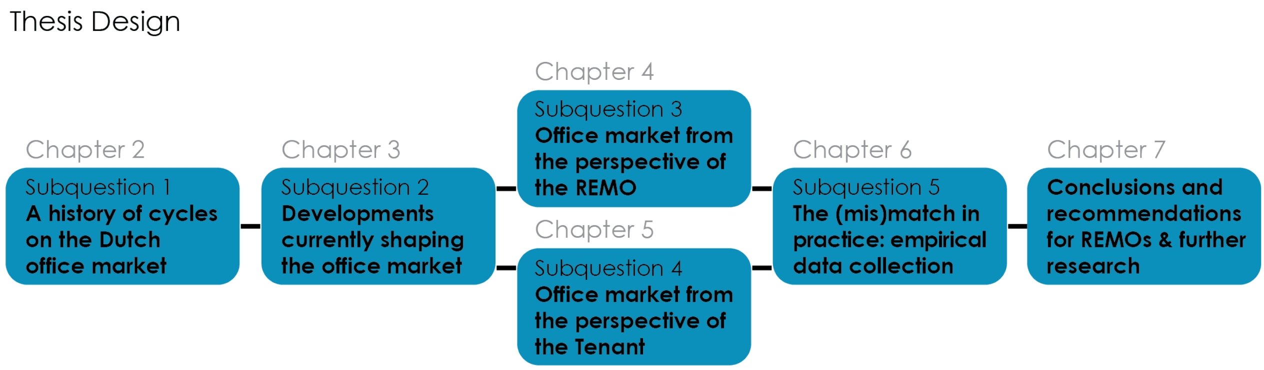


Figure 1.5 The research design

The thesis starts by examining the landscape of the Dutch office market. Chapter 2 summarizes the history and idiosyncrasies of the Dutch office market, describing the actors, facts and figures that have lead to the state of the market presently available. Through this, it becomes apparent how supply and demand react to each other and how this affects the (mis)match between them. Following these historic developments, chapter 3 describes the developments that currently help shape the market as well as their expected effects in the next decade.

Next, the business objectives of the REMOs and the tenants are examined regarding the lease of office space in order to help shape the understanding how a qualitative mismatch may occur. Chapter 4 looks into the stakes and goals involved in the world of the REMO that is active on the asset market, in this context of this thesis interchangeably referred to as the supply side or the lessor. These are often driven for a large part by financial investment and returns, which significantly shapes their business goals. Chapter 5 scrutinizes the stakes and goals of the tenant, also referred to as the demand side, which is active on the space market.

Since a lot of the changes this thesis wishes to explore are fairly recent, it is difficult to acquire up-to-date information in scientific literature about the effects of these developments on the Dutch office market. Therefore, chapter 6 discusses the findings of interviews with stakeholders on both the supply and demand side, in which additional information is gathered about the effects of these recent developments on the demand for office space and its qualitative (mis)match with the current supply. The following parties were approached to supply this information:

Real Estate Management Organisations
The REMOs represent the owners of office space and therefore the supply side of the Dutch office market. Their premier business objective remains securing financial returns from the real estate object for the investor/owner. In what way do their strategies regarding the management of the real estate object take into account the rapidly changing demands of the tenant? Can a shift from passive management towards a more proactive attitude be perceived? How does the REMO change its strategies in a market of high vacancy and fierce competition?

Tenants of office buildings
The tenants themselves are a premier source of information. The difficulty of approaching tenants lies in the variety of types of work they exercise. This thesis does not pretend to be able to index the wide variety of types of work and their inherent different requirements of office space. Instead, it would be informative to learn how the Corporate Real Estate Management (CREM) responds to economic decline and ample competition on the office market, and what role current developments in work processes and changing regulation plays.

Finally chapter 7 answers the main research question, reflects on the research, and provides recommendations for both the REMOs managing commercial office real estate as well as suggestions for further research.

With the above, this thesis hopes to aid the real estate owner to adapt to changing conditions and external influences in order to build new bridges between supply and demand. Ultimately, it hopes to provide a constructive contribution to the current vacancy debate on the commercial real estate market in The Netherlands.

Chapter 2: A history of cycles on the Dutch office market

This chapter is the first of two chapters that outline the context of this thesis: the Dutch office market (see figure 2.1). It defines what the office market exactly is, how it works, provides a concise history and explains which forces helped shape it over the course of the larger part of the last century, while the next chapter will go into the more recent developments and expected developments in the next five to ten years. This chapter will focus itself on answering the first subquestion of this thesis:

Subquestion 1
What are the historic characteristics of supply and demand that have shaped the current situation on the office market in The Netherlands?

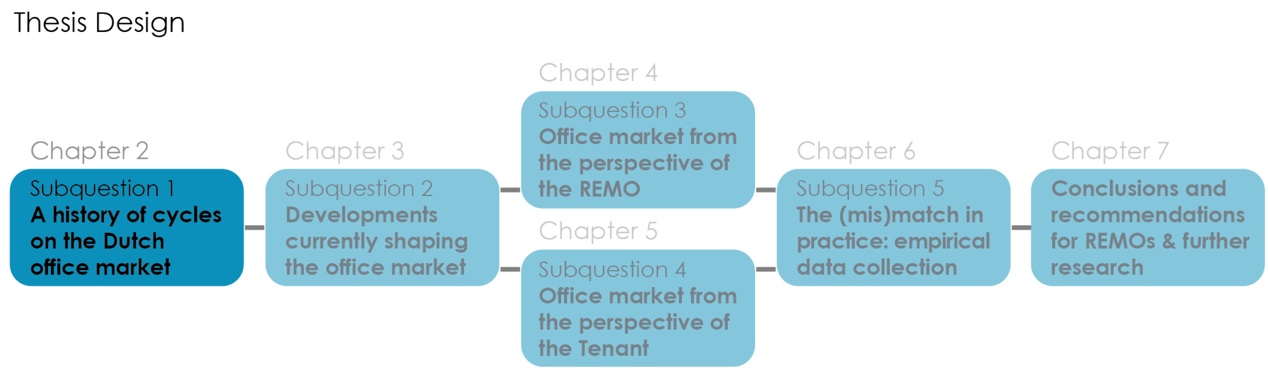


Figure 2.1 The thesis design

Definition of the office market

In order to discuss the office market, it is imperative to provide a clear and concise definition of the office market. Commercial office markets can best be described as markets where office space is traded, characterised by the supply and demand of office space (Remoy, 2010).

Taking a closer look, the office market can be divided into two closely interwoven markets. On the one hand there is the space market (usage market, rental market) and on the other hand the asset market (property market). When generally speaking about the commercial office market one usually refers to the space market, where office space is in demand for consumption or production purposes and in supply by the real estate owners who rent space to tenants. While this market is of fundamental relevance to the real estate business, equally important is the asset market. The asset market is the market of trade of these real estate assets, where the physical buildings and the land they are built on is traded. These physical assets represent a certain worth, as well as the cash flows derived from the lease of the space in or on it. As such, these real estate assets are part of the capital market, which can be traded just like stocks and bonds. (Geltner & Miller, 2001) This distinction will prove to be important in the assessment of the current (mis)match between supply and demand on the Dutch office market.

Mechanics of the office market

Since real estate markets rely on a complex set of variables, a number of attempts have been made over the course of the last few decades to simplify them in order to predict their behaviour. DiPasquale and Wheaton (1992) developed such a model to quickly assess the effects of changes in the foremost variables. The model, called the four-quadrant model, includes a number of variables in each quadrant. This 'last' quadrant affects in turn the first quadrant, creating an endless cycle by which changes in the model reiterate towards a new equilibrium. (figure 2.2)

The DiPasquale-Wheaton 4-Quadrant model

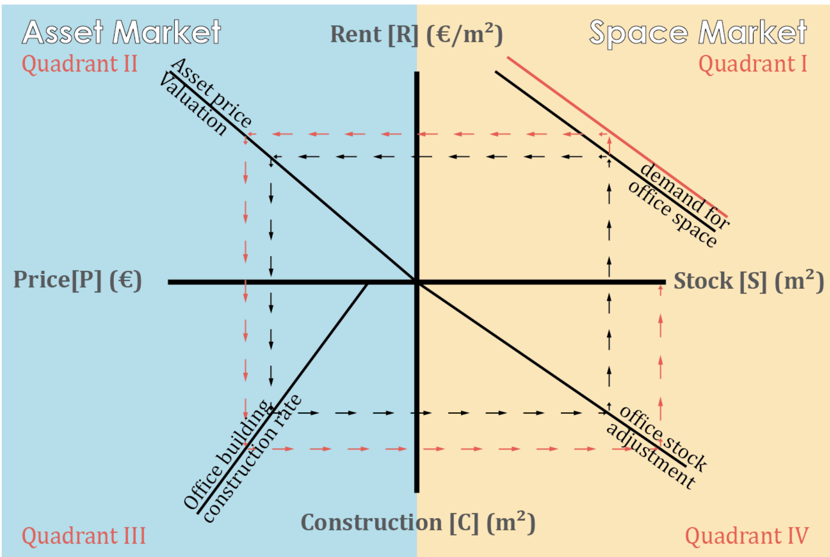


Figure 2.2 DiPasquale and Wheaton's 4-Quadrant model. Adapted from DiPasquale and Wheaton (1992)

The simplified model - in this case specifically adapted to the office market - links the asset market with the space market. It includes variables such as office stock, demand, rent levels, cap rates on investment, construction cost and the rate at which buildings are removed from the stock. Any changes in these variables will send the market equilibrium (the black square) spiralling out of control. For example, figure 2.2 shows the effect of a rise in demand (the red line). The increased demand (quadrant I) will raise the rent levels, which in turn raises the valuation of the office buildings for investors (quadrant II). With more investments on the market, new office buildings will be developed (quadrant III), raising the total office stock (quadrant IV). Further continuing the path of the red line - representing the new market state - will quickly send it out of control. The sudden (theoretical) surge in office stock will lower rent levels, leading the market in the opposite direction. Adjustment of other variables is required to bring the spiral back to its equilibrium state. The new equilibrium will finally find its way between the current one and the red line. It should be noted that in practice there will never be any equilibrium, but an ongoing adjustment of variables reaction on changes in other variables. These ongoing adjustments translate into a cyclical behaviour of the office market, as the description of the history of the office market will reveal later in this chapter.

Before this model is used as an aid to explain the coming of age of the Dutch office market, the four quadrants are first explained in a bit more detail. The way in which these variables affect the equilibrium is illustrated in figure 2.3.

Quadrant I: Rent determination on the space market
The demand for space on the space market is firmly linked to both the height of the rent and the current economical context, which in turn is linked to the stock of available space. Generally this connection can be described by a straight line: a high stock leads to lower prices and a greater demand, a low stock leads to higher prices and a lower demand. (see figure 2.3)

Quadrant II: Valuation by investors on the asset market
The goal of investors on the asset market is fairly straightforward: generating returns on their investment. The height of their investment is determined by the annual rent income divided by their interest (cap) rate target. So the height of the rent rate in the previous quadrant determines the height of the investment available for new developments. The lower the interest rate, the steeper the line is.

Quadrant III: Construction on the asset market
The investments portrayed in the previous quadrant can be used by developers to construct buildings (replacement). Once again, the simplified relation between the amount of construction and the amount of available investment is a straight line. Since there is always a fixed cost involved in construction this line does not start in the origin of the model.

Quadrant IV: Stock adjustment
The final quadrant links the amount of new construction on the asset market to the available space that is used in the first quadrant to determine the rent level. The addition to the amount of stock can be described as the amount of new construction divided by the depreciation rate of the existing stock.

The DiPasquale-Wheaton 4-Quadrant model (adjustment of variables)

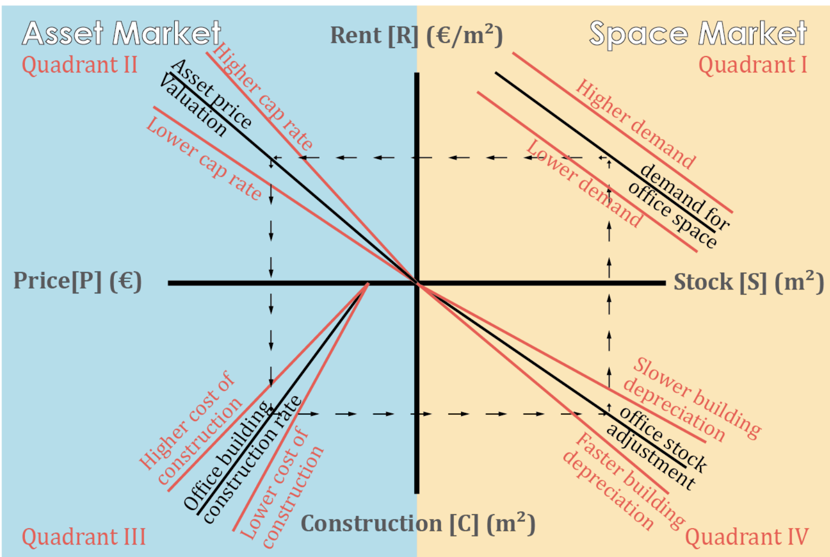


Figure 2.3 DiPasquale and Wheaton's 4-Quadrant model - adjustment of the variables.

The model remains a simplified version of reality and does not take other external factors into account (such as employment rates or the condition of the economy). Nevertheless, it is a useful tool to predict the effect of change in the used variables.

Another fairly predictable mechanic of the office market is commonly called the Hog-cycle or Cobweb, as commented on by Brunes (2007). Because of the relatively long time it takes to construct an office building and the lack of transparency of the market, stakeholders must commit to the project before it is known at what price the building will sell or be leased, if at all. Short-sighted expectations and unfounded optimism can lead to the classical mistake to extrapolate current rents towards the future, based on the belief that the 'good times will continue forever'. As an effect, new developments in the pipeline will enter the market years after it becomes apparent that there is no sufficient demand for further additions to the supply.

The current state of the office market

As a point of reference before describing the history of the Dutch office market, the following facts and figures give a concise description of its current state. By using this as a starting point, it aids in assessing whether its current state is on par with the expected behaviour as described previously.

The Netherlands currently has a total office space supply of about 49,5 million square meters, of which about 7,62 million sq.m. (15,4%) is currently vacant (Bak, August 2012). This figure is based on office buildings offering at least 500 square meters for lease. Due to a lack of transparency of the market these figures remain approximations, gathered by the Dutch association of real estate brokers NVM. Unfortunately, there are no consistent numbers available predating 1990. As shown in figure 2.4, one can perceive a steady and gradual growth in office supply between 1990-2010 (top line) and a demand with a considerably slower growth since 2001 (bottom line). The difference between these two lines reveals the resulting amount of vacancy on the Dutch office market. Figure 2.5 shows this increase of vacant office space as a percentage of the total office stock. So apart from the rising vacancy levels, one can see the sharp increase in the relative amount of vacancy as well, from about 3% in 2000 to its current level of 15,4%. However, to understand what significance these number have, it is necessary to put this into the context of market mechanics and the history of the Dutch office market.

Office supply and office space in use

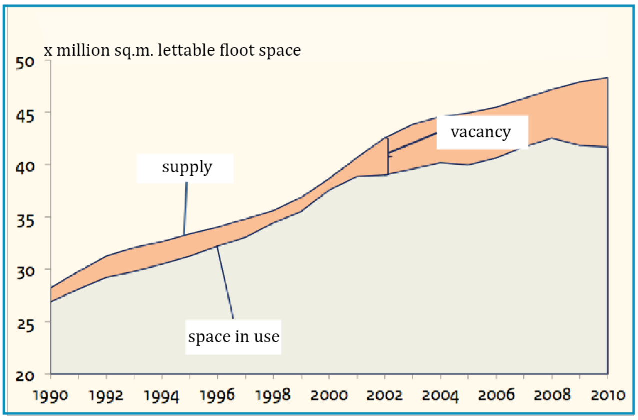


Figure 2.4 The absolute amounts of supply, use and vacancy of office space in The Netherlands. Adapted from Dutch from: Bak (2012), CPB (2012)

Vacancy as % of the total office supply

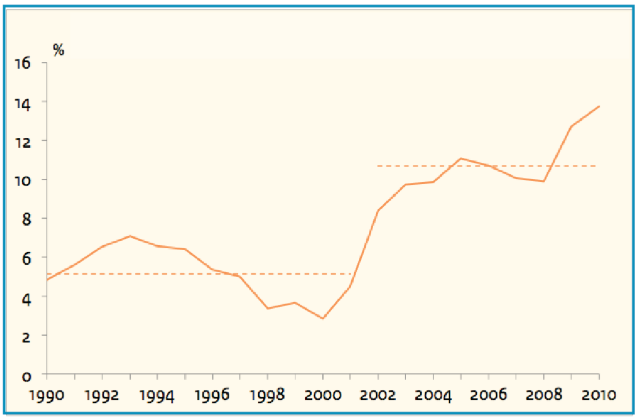


Figure 2.5 The amount of vacant office space in relation to the total office supply in The Netherlands. Adapted from Dutch from: Bak (2012), CPB (2012)

Emergence of the Dutch office market

The Dutch commercial real estate market is relatively young compared to for example the housing market. To acquire an understanding which forces have taken part in shaping it, how general parallels can be made with foreign office markets but also to see what makes the Dutch office market unique, it is imperative to describe a short history from it's 'birth' to its current condition.

The demand for office space is primarily driven by the services sector, which in the Netherlands finds its roots in the first half of the twentieth century. The gradual emergence of these markets has gone paired with the transition from an agricultural and industrial based economy to an economy of services. Krumm (2001) explains that initial corporations were family or state run and predominantly required real estate for its production, sales and engineering departments. With a limited size and scale of their business activities the organisations were characterised by a flat, centralised structure. As business grew in the first few decades of the 20th century so did the need for real estate accommodation, which resulted in the foundation of staff departments responsible for corporate real estate management (CREM).

In the aftermath of the Second World War building materials were scarce, investments in (commercial) real estate were inconsequential, and commercial and consumer spending was still largely frozen. The first signs of economic recovery were in the early fifties when the social housing market boomed under the influence of a rapidly increasing demand for housing and cheap government funded social housing projects. With this, large pension funds, insurance companies as well as private investors slowly started getting involved in new construction of new real estate. (Van Gool et al, 2007)

With the expansion of corporations came a growing need for accommodation. Towards the early 1960s businesses became increasingly aware that the more capital was locked up in real estate, the less was available for use in the core activities of the business. This is where the first shift is perceived from in-house development of real estate towards the lease of flexible office space on the office market that could grow with the needs and requirements of the company. (Krumm, 2001)

Key growth drivers

A number of large driving forces propelled a long period of growth on the Dutch office market. Firstly, as previously described, the transition from an agricultural and industrial economy towards one of services provided for a growing demand for office space. Secondly, the post World War II baby boom generation delivered an expanding working class, from 3,5 million in 1950 to 7.1 million in 2010 (figure 2.6). Thirdly, as figure 2.6 also shows, female participation on the labour market increased significantly since the sixties, significantly propelling the growth in the labour force. According to CBS (2004), the percentage of women on the labour market increased from 30% in 1985 to 55% in 2004. The last growth driver is the gradual increase of office space per employee. This is amongst others caused by an increase in workplace norms (ARBO-normen in Dutch), a rise in function level and a increase in rented office space which allows for easier expansion of office space (Ham, van den, 1996).

With these growth drivers thrusting the demand for office space, the Dutch office market experienced a long period of growth between the 1960s and the start of the 21st century. The following paragraph provides a detailed description of this growth in combination with the cyclical behaviour described earlier, using the DiPasquale-Wheaton 4-Quadrant model to illustrate the effect of changes in variables on the market equilibrium.

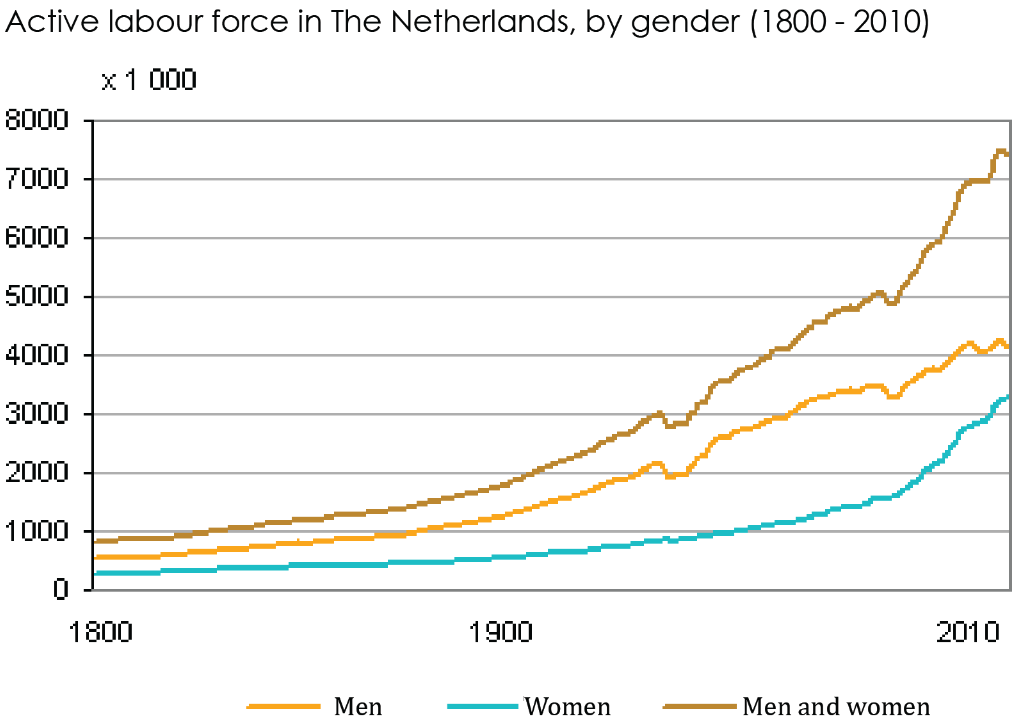


Figure 2.6 the total active labour force in the Netherlands, divided by gender. Source: CBS (2012)

Growth in cycles

In the sixties the Dutch economy expanded rapidly. Businesses grew and increasingly made investments, leading to an explosive demand for commercial office space. Along with the growth of these companies came an increasing demand for flexibility in use of their investments. Leasing office space was preferred over the commitment of the purchase or self-development of a building, therefore boosting demand in the commercial office space market. (Krumm, 2001) At the same time large institutional investors like pension funds and insurance companies were looking for good investment opportunities for large amounts of equity, fed by a growing working class. The widespread availability of investors coupled with the rapidly increasing demand for office space led to a new impulse on the development market of commercial office space. Fuelled by an additional influx of British developers and investors in the early seventies, the market for commercial office space was suddenly filled with ambitious new developments of high quality office buildings (Van Gool et al, 2007; Hart, 1987). Using these variables as input in the 4-Quadrant model, one can see this leads to a disturbance of the equilibrium that steers towards an increase of the office stock (figure 2.7, left hand side).

In the mean time, the economy cooled down again. The development of the economy of scale and centralisation no longer prompted an increase of productivity, but instead lead to a decrease of jobs. Paired with rising inflation due to the 1973 oil crisis, wages and prices plummeted and interest rates rose. The decades of Dutch economic growth had come to an end, decreasing the demand for commercial office space. Decreasing returns on real estate brought investors to look abroad for better investment opportunities (Van Gool et al, 2007). The decreasing demand and returns both steer towards a 'shrinking' equilibrium (figure 2.7, right hand side).

Growth (1960s - 1973) Decline (1973 - late 1970s)

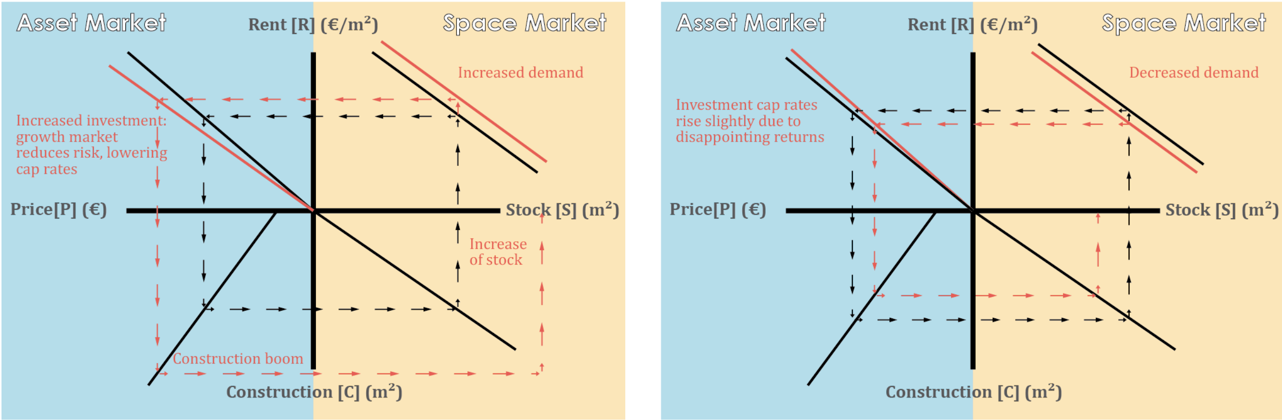


Figure 2.7 The first cycle on the Dutch office market (1960 - late 1970s)

Following an increase in absorption of office space in the late 1970s, the construction of new office buildings reached a modest peak of 1,5 mln square meters in 1980 (Van Gool et al, 2007), as seen in figure 2.8 on the left. But falling demand for real estate due to deteriorating economic conditions created a recession in the construction industry, which downsized the construction of new office space with 25% in the following 3-4 years (Romijn, 2000). This period of decline mitigated the growth of office stock during these years (figure 2.8, right).

Growth (late 1970s - 1980) Decline (1980 - 1984)

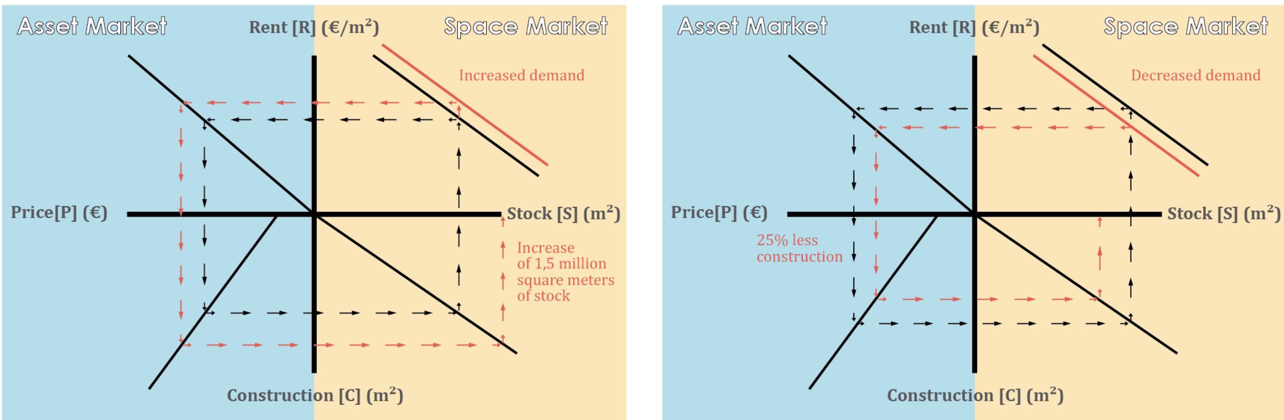


Figure 2.8 The second cycle on the Dutch office market (late 1970s - 1984)

In the mid-eighties the Dutch economy started to recuperate again. The increasing demand in office space and rising prices reinvigorated interest in the real estate investment market. Lessons learned from the risks of investing in a single market led to a rising interest in international, diversified funds. As capital became widely available development commenced again, increasing the additional constructed office stock with 2 mln square meters in 1990 (Van Gool et al, 2007), as seen in figure 2.9 on the left. Real

Growth (1984 - 1990) Decline (1990 - 1994)

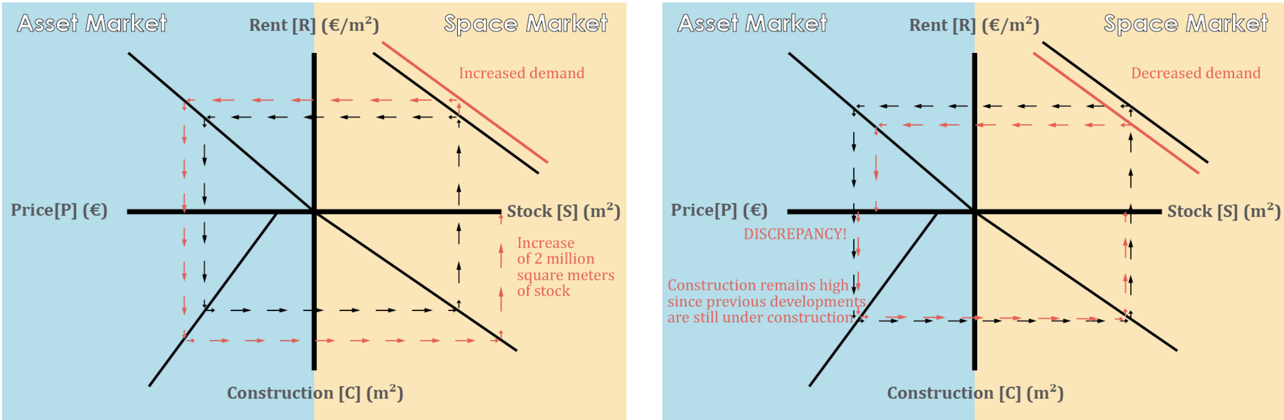


Figure 2.9 The third cycle on the Dutch office market (1984 - 1994)

estate proved to be a good investment vehicle and asset prices rose fast, unjustified by the actual rental income from the properties. This lead to a valuation bubble on the office property market (Krumm, 2001)

In 1990 the expansion came to an end by a crisis on the real estate market that had blown over from the United States of America. With their economy faltering, the Dutch economy was affected as well and demand for office space once again declined. Meanwhile, all the developments from the eighties were still under construction. So while demand was declining the supply of new office space continued to grow. This can be seen in the 4-Quadrant model as a disconnect in the change of the equilibrium, the jump in the red line as can been in figure 2.9 on the right. The oversupply caused an increase in vacancy which caused the bubble on the Dutch office market to burst, devaluating office buildings by as much as 50% between 1986-1993 (Louargand and Lambert, 1996; van Gool et al, 2007). Some cities - amongst which Amsterdam - introduced ordinances for developers, requiring preleases for new developments in order to reduce what was referred to as 'building for vacancy'.

Krumm (2001) described the implications of these developments to the way corporations looked at their real estate. Facing rising competition, a high rate of innovation and pressure from shareholders, the importance of optimising company efficiency was key to retain a competitive edge. After the cost of employees, real estate often proved to be the second largest financial factor businesses could change without directly affecting its core business. Its value could be as high as 20-25% of the total corporate assets and expenses associated with accommodation averaged between 5-8% of the total revenue (Veale, 1989 in: Krumm, 2001). Mergers, crises and reorganisations forced a new attitude towards real estate. The pressure to increase profitability increased the need to reduce costs and focus on the core business. Outsourcing real estate activities was possible due to the availability of professional service providers. The absence of these external service organisations prior to the 1980s was the main argument to keep these activities in-house. As mentioned before, freeing up the capital locked up in fixed assets offered the potential of solving financial problems. A fully matured office space market offered solutions for companies to refocus on their core activities, increasing the want to lease.

Increased demand, but delayed growth (1994 - 2000)

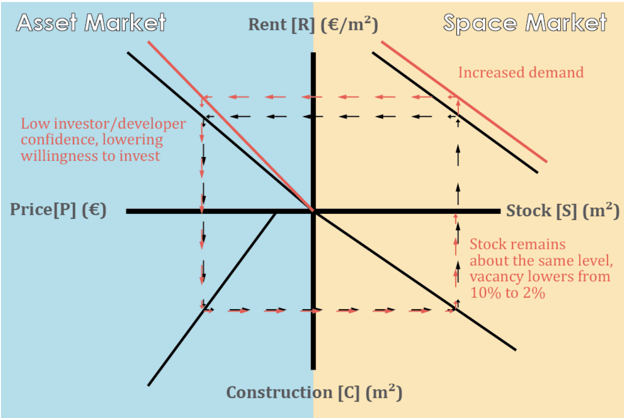


Figure 2.10 The start of the fourth cycle on the Dutch office market (1994 - 2000)

In 1994 the economy started to recover, increasing demand for office space and consequently decreasing the vacancy that had been built up. To illustrate, under influence of the growing popularity of the internet the number of people employed in the Dutch IT sector increased sharply from 76.000 in 1997 to 125.000 in 2001 (Jennen & Moll, 2009). This increase in jobs resulted in an increased demand for office real estate, as can be seen in figure 2.10. However, the confidence of developers and investors had been scathed by the disappointing and unreliable returns and new developments remained low in a promising market. As a result, the outward change in the equilibrium on the office market did not result in a growing office stock (as can be seen in figure 2.10). The vacancy rate dropped from over 10% in 1993 to 2% in 2000 (van Gool et al., 2007), driving prices up which solicited a new influx of office space. To meet this demand many municipalities urged developers to start developments again and the ordinances requiring preleases were mostly abolished. A tangible effect on the demand was that tenants became more flexible in picking offices, lowering average lease contracts from 10 years to 5 years in order to keep the option open of changing to a better fitting accommodation (EIB, 2010). An influx of new developments started slowly after 1996.

A change of the game

Up to the end of the 20th century, most shifts in the balance of the office market behaved largely according to the basic rules of supply and demand and the earlier described market mechanics. If the demand increased, more capital was invested which in turn triggered new developments. This increased the office stock, which satisfied the rising demand. In times of a decreased demand new developments would be minimal until the demand increased again. However, at the start of the 21st century a break can be observed in the predictability of this market mechanism.

When the dot com bubble burst in 2001, office employment changed rapidly from growth into decline (figure 2.11). At the same time, the 9/11 disaster in New York shocked the world's financial markets, which plummeted stock values and restrained economic growth. These developments left little room for growth in the demand for office space. Like in the early nineties, developments were still under construction while the vacancy increased. At the same time, companies that had leased office space based on growth sub-leased their surplus space on the office markets, further increasing the supply of

% Change in GDP and office employment in The Netherlands

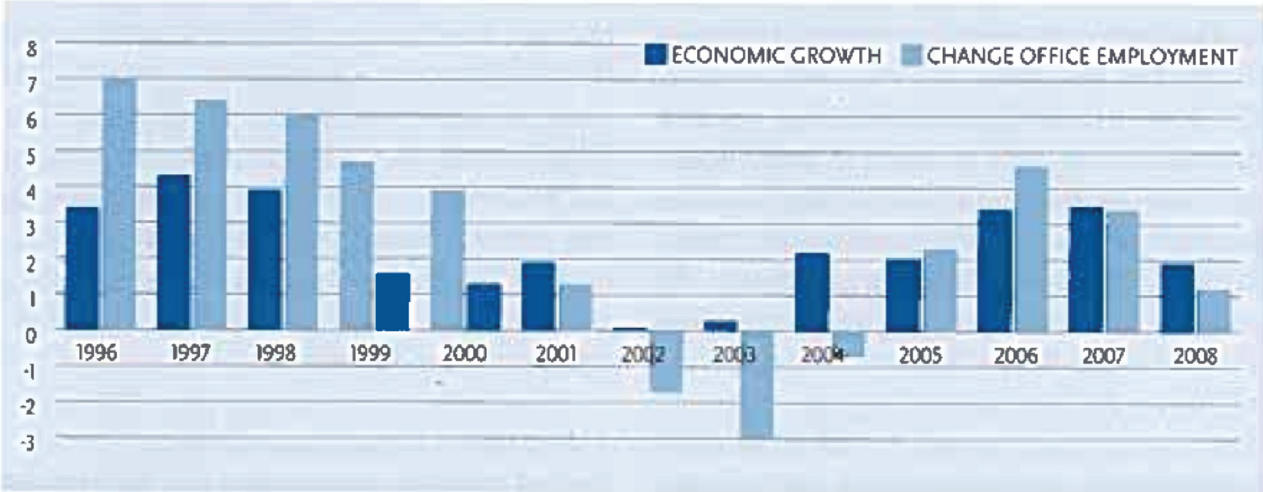


Figure 2.11 Economic growth and office employment in The Netherlands. Source: Jennen, M., Mol, M. (2009), Eurostat (2009)

officespace. But since returns on investment in real estate outperformed other types of investments after the 2001 stock market crash, and with ample investor capital available, developers were encouraged to become even more competitive. While the basic rules of supply and demand would dictate to stop building, developers succeeded to entice sitting tenants with good deals in new developments. Authorities often encouraged this, aiming to attract companies to stimulate the local economy and to acquire additional revenues from selling land to developers. To illustrate this, in 2006 offices were still being developed on the South Axis in Amsterdam in the midst of a vacancy of over 60% (van Gool et al, 2007). The number of office buildings that were being developed with no end user in mind rose up to levels as high as 80% (EIB, 2010). Inevitably, this lead to an explosion in the growth of the supply. According to Bak (2006), between 5,0-5,3 out of 43,3 million square meters of office space lay vacant by the end of 2005, about 11.5 - 12.2%. With the short-term lease contracts of the late nineties ending, the vacancy shifted from the newly developed offices to the older segments.

By 2006, the Dutch economy started to recover again and the demand for real estate investments showed growth again (figure 2.12). Owners of real estate started offering increasing rent-free periods (incentives) to convince tenants to move to their building. The gross absorption of office space increased (EIB, 2010), but this was mostly caused by tenants moving from one building to another. Moving often meant significantly downsizing housing costs for the tenant. However, paired with these moves came an improving efficiency of office space usage, lowering the amount of sq.m. leased in these new leases (this is addressed in chapter 3). Due to strict prelease rules re-imposed by the government, only a small amount was added to the office space supply. So while office employment grew and the gross absorption of office space grew, the vacancy level online lowered slightly, mostly shifting it to lower quality office buildings.

Before the increasing demand would lower the vacancy level, a global economic crisis struck in 2008, paired with the credit crunch. This double hit had a number of implications for the Dutch office market.

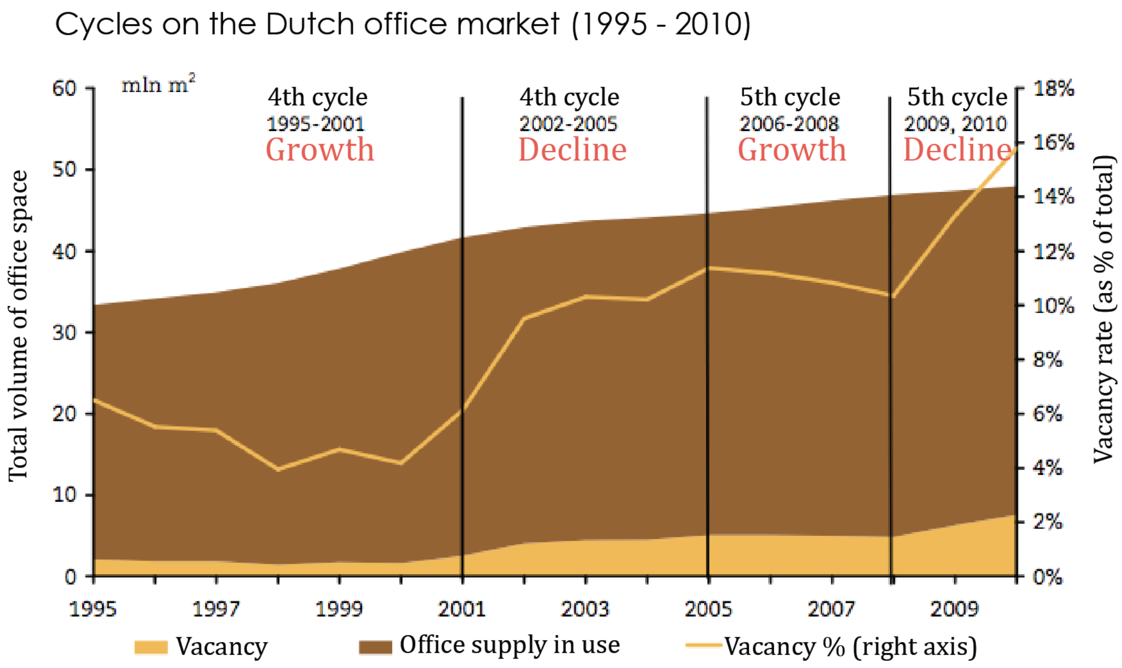


Figure 2.12 Cycles on the Dutch office market 1995 - 2010. Adapted from: EIB (2010), Bak, R.L. (2010)

Firstly, the demand for real estate investments subsided, lowering the value of lease contracts and consequently the value of office buildings. Secondly, companies were not as inclined to move, let alone lease extra space to accommodate future growth. Vacancy kept rising to the current level of 15,4% under influence of marginal new developments and a declining demand due to increasing efficiency in usage of office space and the effect of economic decline on Dutch businesses.

As can be seen in figure 2.12, the total supply of office space has been steadily rising until 2010, as it has since the 1960s. However, since demand significantly fell behind since 2001 it has showed little sign of real growth. The interlinked behaviour of supply reacting on demand seems to have faded, the immediate result of which is an increase in the level of vacancy.

An international comparison

To assess whether this development of the heightened vacancy rate level is exceptional it should be compared with foreign office markets. Without going into details on the reasons behind these vacancy levels of foreign markets, comparing the level and amplitude of the cycles gives an idea whether the current status of the Dutch office market is comparable with a larger group of office markets.

If one looks at vacancy levels of office space in the USA between 1968 and 2008 (figure 2.13), it seems to fluctuate between approximately 4% - 18%. Three cycles can be discerned in this period of time, subsequently measuring roughly 12, 20 and 8 years in length. Comparing these to the first four Dutch cycles that have been described in this chapter (subsequently 20, 14, 10 and 10 years), both the lengths and the amplitude of the vacancy rates seem to be comparable.

Vacancy levels on the US office market

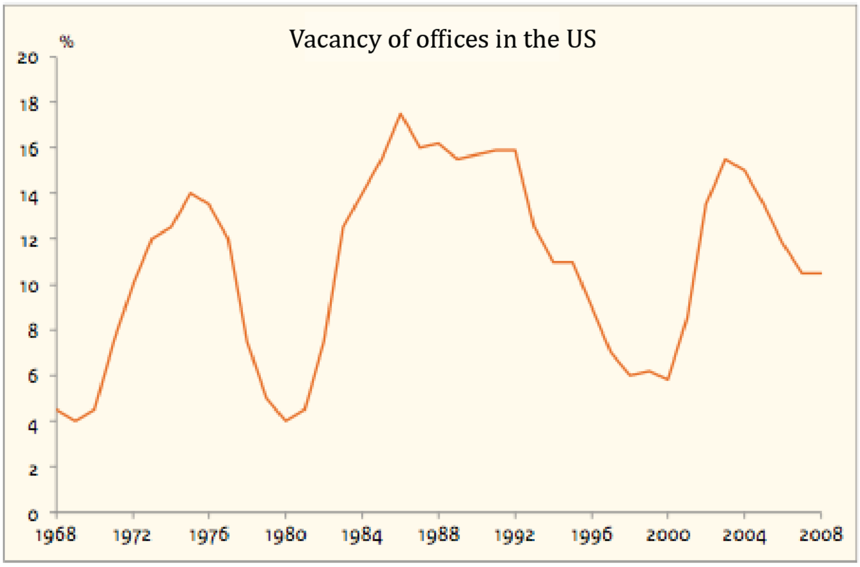


Figure 2.13 vacancy levels as a percentage of the total office stock in the USA. Source: Wheaton and Torto (1988), NCREIF (2009)

Vacancy levels on the Japanese (city) office markets

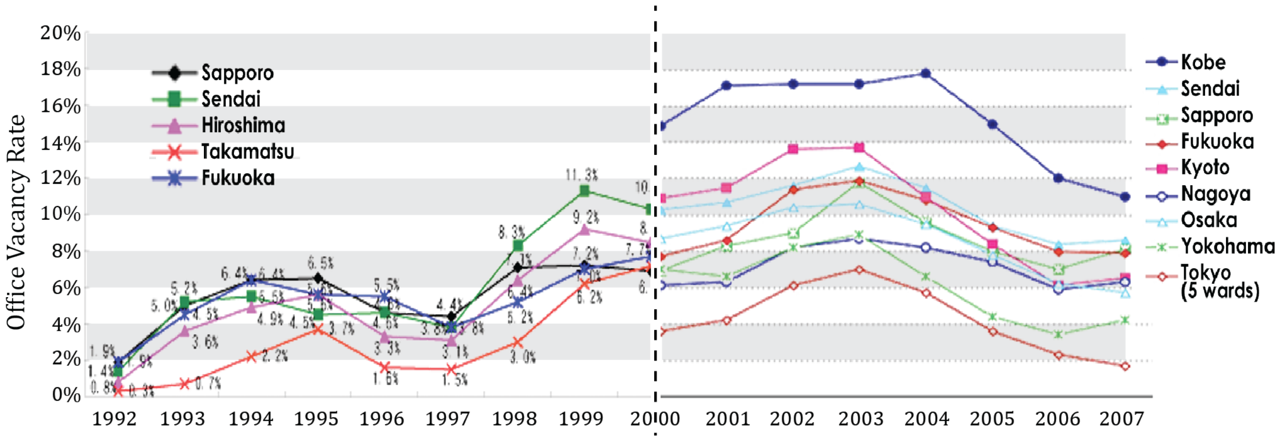


Figure 2.14 vacancy levels as a percentage of the total office stock in various Japanese cities. Sources: 1992-2000: IKOMA/CBRE (2003); 2000-2007: CBRE Research Institute (December 2007)

In comparison, Japanese cities seem to illustrate somewhat lower levels of vacancy (figure 2.14). However, this might be attributable to the fact that these numbers represent solely vacancy levels of cities as opposed to national levels. The cycles seem to be slightly shorter in length as well.

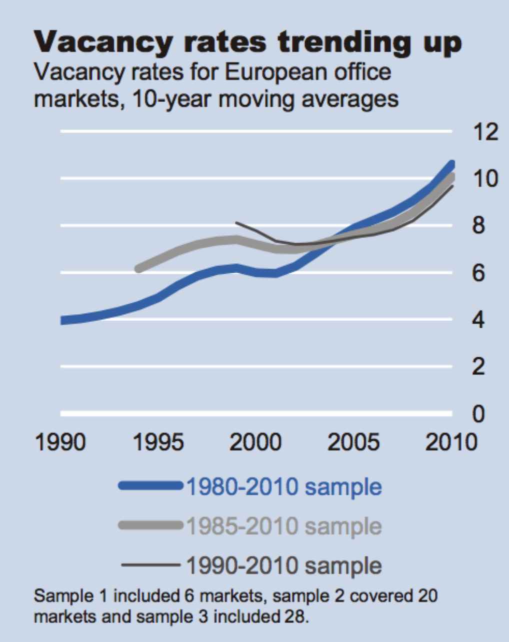


Figure 2.15 Average vacancy levels in Europe. Sources: Deutsche Bank Research, RREEF Research (2011)

When a comparison is made with the entirety of the European office market (figure 2.15), the cycles are not clearly discernable anymore. This can either be attributable to the relative short period that is shown, or to the effects of averaging the multiple nations. But there is a parallel to be made with the slowly rising vacancy levels that have als been perceived on the Dutch office market since the mid 1990s, as was seen in figure 2.12.

In a balanced office market the level of supply will not differ greatly from the level of demand. As a result from a natural mismatch between these two, the levels of vacancy will normally equal an amount between 3% - 8% of the total office supply (Wheaton, 1999; Tse and Webb, 2003). In an economic upswing scarcity may be seen, during a recession a vacancy excessing this 8% (Keeris, 2007). Based on this quick comparison, it seems that the relative height of the vacancy level in The Netherlands (15.4%) is comparable with extremes in foreign office market cycles. However, in the light of the previously described developments, there are good reasons to assume that this current status might nevertheless be a unique situation.

Resume

This chapter has shed some light on how the office market in The Netherlands has steadily grown over the past 60 years under the influence of a shift towards a services-oriented economy, an expanding labour force, increased female participation on the labour force and an increase of space usage per office employee. The cyclical behaviour as described through the DiPasquale-Wheaton 4-quadrant model reveals itself through fluctuating vacancy levels. At the same time it seems that foreign office markets show comparable fluctuations in the level of vacancy. As such, an increased vacancy level is not necessarily a need to worry. However, as can be seen in the description of the developments since 2001, the supply no longer seems as strongly interlinked with the changes in demand. While DiPasquale and

Wheaton's model suggests that the office market will always steer towards equilibrium, it implies at the same time that variables need to adapt in order to reach it.

As the next chapter explains, there is a strong reason to assume the driving forces behind the long period of growth have come to an end. In the mean time, a number of trends significantly negatively affect the demand for office space and will shape the equilibrium of the office market the forthcoming decade. By interpreting these trends and extrapolating their effects it will gradually become clear what challenges the Dutch office market will face in the upcoming years.

Chapter 3: Developments currently shaping the Dutch office market

With the historic events described in the previous chapter as a basis, this chapter continues on the previous chapter by scrutinizing the current state of the described growth drivers and explaining what trends are currently influencing the stock of office space in The Netherlands (see figure 3.1). By understanding the forces that help shape it, it will help form an outline of the future of the office market in the next 5-10 years.

Sub 2. What developments are expected in the next 5-10 years on both the supply and demand side that will affect the current situation on the office market?

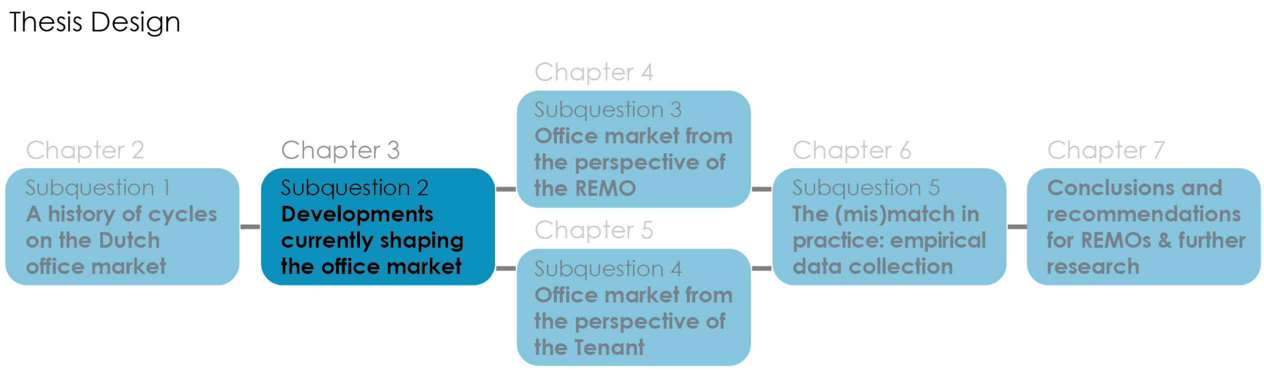


Figure 3.1 The thesis design

Life and death of the growth drivers

On a macro-economic level a continuous growth - in cycles - of office use and supply can be perceived between World War II and 2011. As explained in the previous chapter, this can be largely explained through a number of growth drivers. However, the following data seems to indicate that these growth drivers are past their prime. Most of them are diminishing and some have already fizzled out completely.

Firstly, the transition from an agricultural and industrial economy towards a service economy is a very broad concept, but can be substantiated with the amount of jobs available in each sector. Figure 3.2 shows a firm overall increase in jobs between 1970 and 2010, for the largest part attributable to a flight in the amount of jobs in the services industry. These jobs, in turn, provided a steadily increasing demand for office space. However, current forecasts (UWV, 2012) predict that economic growth until 2017 will be meagre and the total amount of jobs in the Netherlands, which is currently declining, will only grow as much as 0.7% per year between 2014-2017. Additionally, this sparse growth will largely be attributable by an increase in jobs in the care sector, which does not predominantly operate on the office market. Therefore, figures suggest that the macro-economical shift towards a more service-oriented economy will not provide for growth in the demand for office space in the Netherlands.

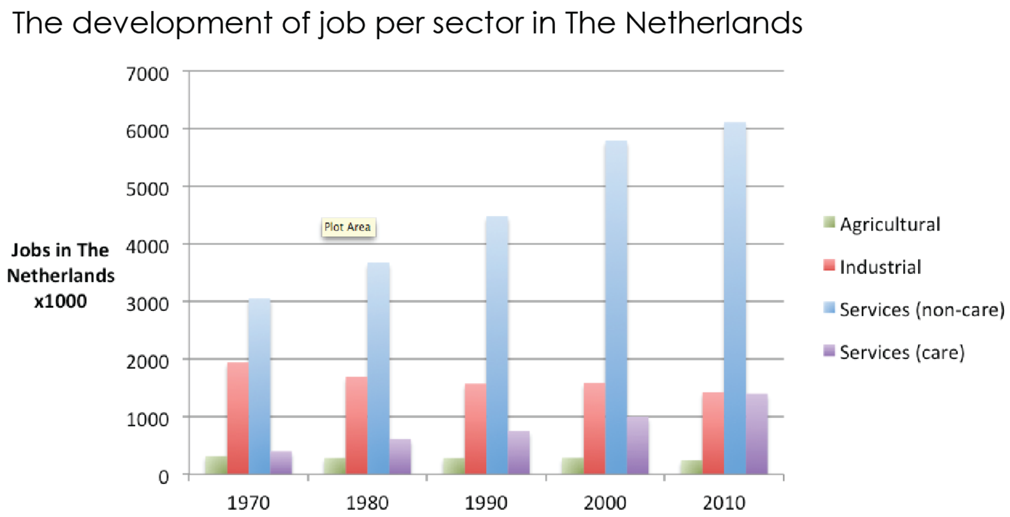


Figure 3.2 Jobs per sector in The Netherlands. Source: CBS (2012)

Secondly, the sheer expansion of the population in The Netherlands, from 10 million in 1950 to 16.7 million in 2012 (CBS, 2012), is expected to approach its end. Forecasts by CBS, the Dutch Central Bureau of Statistics, show that growth will dwindle and the population will reach a high of 17,5 million in 2038, after which the net population will decrease. This trend is largely to be explained by the increasing mortality rate as an effect of the ending baby boom bubble, an average fertility rate of 1,75 children per woman and an expected decrease in immigration numbers (Poelman & van Duin, 2010). The pivot point for the labour force, however, has already been reached. Current forecasts show that the active labour force will decrease from 10,1 million in 2011 to 9,3 million in 2040 (CBS, 2010). A different prognosis (UWV, 2012) predicts a slight but diminishing growth in the labour force on the short term, but also expects a continuing dwindling of available jobs on the market. With the total amount of jobs in The Netherlands dwindling and the relative small growth in the services sector largely attributable to the growth of the care sector, it is safe to assume that the amount of jobs in the rest of the services sector will either remain constant, or slightly dwindle. This would result in a smaller demand for office space.

Thirdly, the participation of women in the labour force has reached its peak. Forecasts about further growth in these numbers are sparse, though it is expected that female participation will level out and only grow slightly due to already significant growth in the past decades (UWV, 2012). Therefore, its contribution to growth of the total labour force is considered to be negligible.

Lastly, under influence of innovations in office usage the average surface per employee has significantly lowered (figure 3.3), decreasing the demand for office space. These innovations will be addressed later in this chapter in the paragraph ‘Innovations in the office environment’.

Space usage per workplace at larger companies and organisations

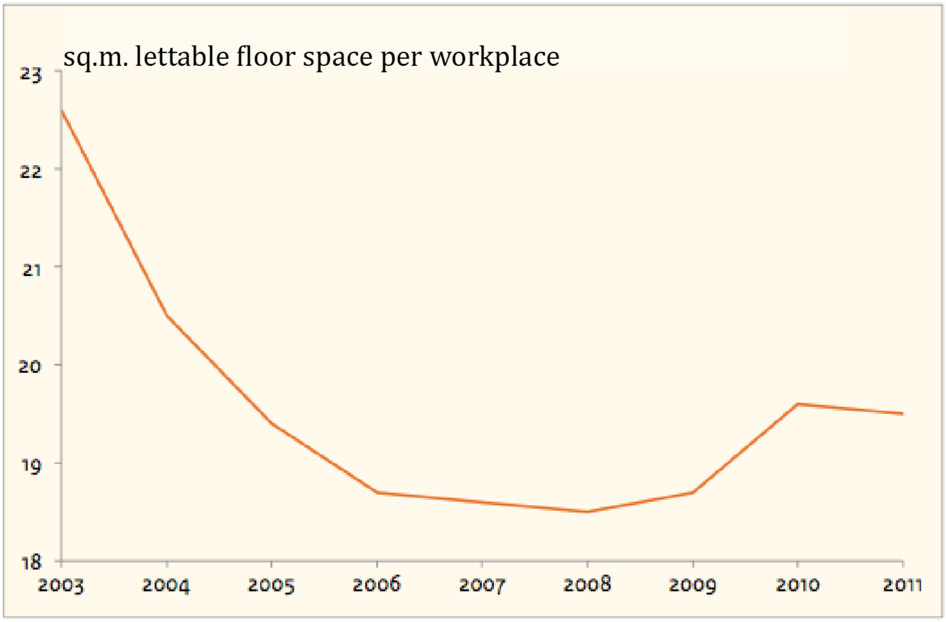


Figure 3.3 Space usage per workplace at larger companies and organisations. Source: NFC Netherlands Facility Cost Index (2012)

Changes in international regulation

There are two major changes in international regulation that will affect the office market in The Netherlands. The first is a new regulatory standard for banks as documented in the Basel III accord (Bank for International Settlements, 2010). As the international banking system had proven not to be able to withstand the stress of a global financial crisis, a new set of regulations was deemed necessary to improve the resilience of the system. In various stages up until 2019, banks are required to strengthen their capital requirements, meet new liquidity standards, reduce risk-taking, make risk more transparent and create various buffers to be able to endure prolonged stress. The major consequence of these new regulations is that there will be less credit available and the cost to borrow for corporates will increase. Therefore, acquiring the large sums of capital needed for investments in the office market will be significantly harder than before the credit crisis. It should be noted that private equity fills a part of this gap. Another effect, albeit indirect, is that a diminished availability of capital slows the recovery of the economy. As history has proven in the previous chapter, growth in the office market is closely connected to growth in the economy.

Another development that will affect the office market is the upcoming update on the international regulations of IFRS Lease Accounting (Schelle & Baltussen, 2013). This new regulation requires corporates to bring the cost of all real estate leases on the balance sheet, including the optional renewal periods that are likely to be exercised. Hitherto, the cost of leasing real estate could remain off-balance and only real estate in possession was required to be factored in on the balance sheet, making it financially favourable to lease. This new proposed standard *"...will have a significant impact on a company's operating results, financial ratios, and potentially their debt covenants"*, according to the professional services firm

PriceWaterhouseCoopers (2010). If a company's operating results are affected and even their debt covenant might be at risk, there will be a very tangible incentive to prefer shorter leases over longer leases. Since buildings are valued predominantly by the expected future cash flow, shorter tenant leases would lead a more uncertain expected future cash flows and thus to a depreciation of the buildings. It can be questioned, however, whether these regulations will be put into effect while the market has to deal with high vacancy levels and low availability of equity. Doing so would potentially further cripple the property markets, which most likely would raise considerable resistance on both the corporate and governmental level.

Innovations in the office environment

As Di Martino and Wirth (1990) and Toffler (1980) point out, already in the sixties and seventies enthusiastic predictions were made about using advancing technological possibilities for innovations in the way people work. Under labels such as Teleworking, Smart Working, E-Office and Flex working, how and where people work and what relation it has to their personal lives has gradually changed. Defining these terms is a rather strenuous undertaking, since they are often used interchangeably and are at the same time undergoing a continuous evolutionary process, redefining the original meaning.

To illustrate this, Di Martino and Wirth (1990) point out that one analysis (Beer & Blanc, 1985) examined 50 definitions of telework alone. It showed that roughly 60% of these definitions are based on at least two of the following concepts: organisation, location and technology. The study pointed out that telework could generally be defined as "...work carried out in a location where, remote from central offices or production facilities, the worker has no personal contact with co-workers there, but is able to communicate with them using new technology".

These innovations are often driven by new technological possibilities, but flourish as they act up as unexpected solutions to sudden problems. Teleworking, for example, proved to be an attractive alternative for working at the office when the petroleum crisis struck in 1973 and companies needed to downsize the cost of travel and overhead, as illustrated in the previous chapter.

However, scrutinizing the various names of workplace innovation is not the aim of this chapter. Conveniently, a new term emerged that has become the umbrella term for innovations in the workplace environment. The developments of when, where and how work is carried out shows a change not only in the way people work, but also in the way real estate is a part of the company. Coined under the term 'New Ways of Working' (NewWoW), these developments have put an increasing focus on the interaction between work and real estate.

Real estate is traditionally viewed as a physical place to facilitate work. Nenonen et al. (2009) stated that *"Work is something what you do, it is not something where you go"*. With an increasing number of technological innovations eliminating the pure necessity of facilitating a place to work by means of real estate, it poses the question to reconsider the need for real estate. Instead of viewing office space as a necessity, a growing number of companies start looking at it as a tool to propel organisational change, change the nature the business reaches its clients and alter the way people combine their private life with their work. In 1993, Duffy and Tanis reviewed this changing role of the workplace:

"We live in an extraordinary period of technological change and of organizational creativity. Client organizations are anxious in the midst of severe turbulence and vicious international competition to

invent better ways of working, more effective forms of organization and more brilliant ways of processing knowledge. Users are coming to expect a world of work in which they have the maximum freedom to use all their talents in the way they think best for their own as well as their employer's continuing benefit."

The essence of their article argues that the physical office environment can, rather than being an impediment, be a means by which aspirations of a company can be achieved. While the term NewWoW is used widely, it lacks a clear definition and often has a context specific meaning. It is widely accepted though that it questions the aforementioned changing relation between work and office space.

Aaltonen et al. (2012) describe this changing relation in a combination of three environments: physical, virtual and social space (figure 3.4). Between these environments they categorize and address a multitude of factors related to work, acknowledging that the complexity of the modern workplace increases because it is no longer seen only as physical space, but also containing social and virtual aspects of work.

It is important to keep in mind that the New Way of Working is not a tangible set of principles, but more so an attitude to adapt the organisation of office work to a rapidly changing cultural and technological environment. However, in order to address what kinds of developments are currently scrutinized in

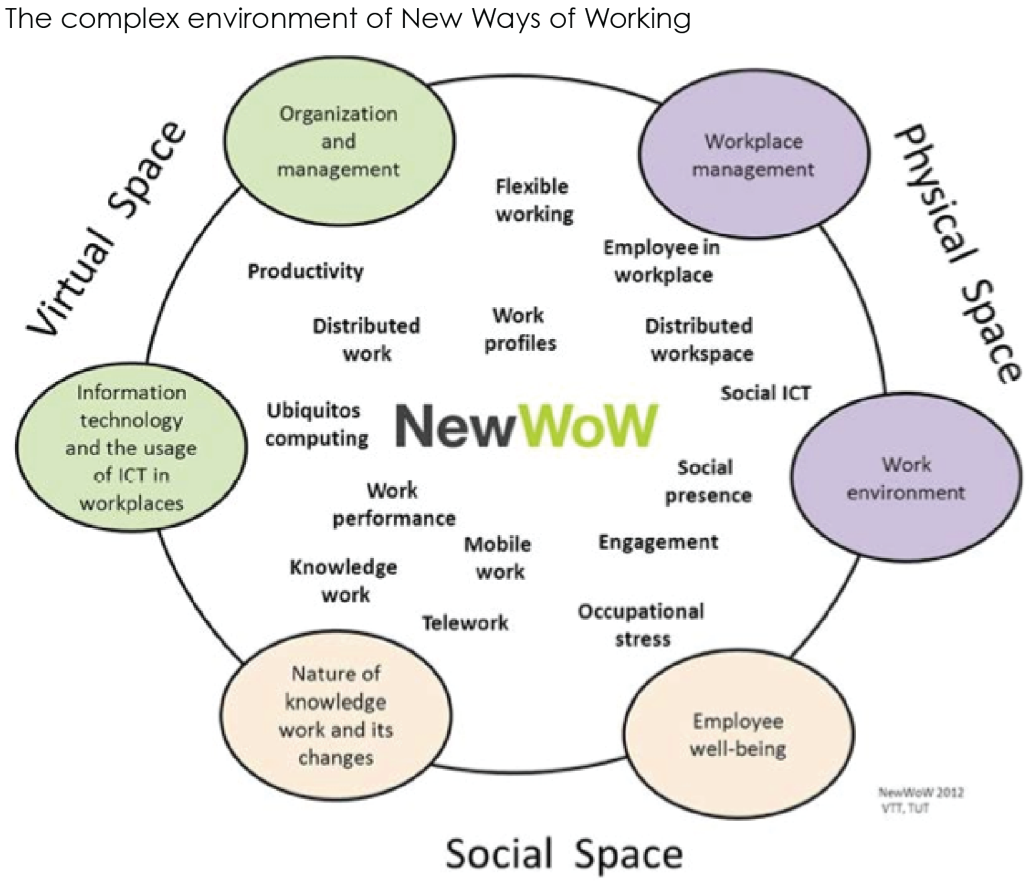


Figure 3.4 The interaction environments of New Ways of Working. Source: Aaltonen et al. (2012)

corporate real estate management it is inevitable to use a more palpable definition. Baane, Houtkamp & Knotter (2011) describe the use of the New Way of Working as an integral utilisation of four basic principles:

- *'any time, anywhere'*: the flexibility for employees to manage the time and location they work
- *'manage your own work'*: employees are judged on results
- *'unlimited access and connectivity'*: free and unlimited access to and use of knowledge, experience and ideas
- *'my size fits me'*: flexibility in the relation and contract between employer and employee

They stress that all of these principles are not inherently new, but that the adaptation of these combined principles will certainly require a transformation of the way work is organised, specially tailored to the characteristics of the business.

There are a number of concrete advantages for companies to adapt to the New Ways of Working. Erik Veldhoen, a Dutch architect, described three major advantages that are considered by companies: lowering real estate costs, increasing productivity and creating 'culture' in order to bind employees to the organisation (Veldhoen, 2005). With the Baby Boom generation starting to leave the active labour force, it is essential to maximise the productivity of the new generation to mitigate the effects of this shrinking labour force. Innovating the way in which a company facilitates its employees is also a means to capture sparsely available talent (Gates, 2005).

Scientific evidence of the effects of New Ways of Working is still scarce. The aforementioned productivity increase for example is often disputed. In an extensive study into the effects of the New Way of Working, Aaltonen et al. (2012) find no clear evidence of increased productivity. However, scrutinizing a study of Batenburg et al. (2008), a multivariate regression analysis showed a significant correlation between the satisfaction of facilities and the worker's estimation of the supporting effect of the work environment on their productivity.

Quantifiable effects of the New Way of Working on the office market remain largely undetermined. However, the culmination of possible downsizing of floor space (and therefore lease cost) and a fierce price competition on the office market provide an incentive for companies to look for new (and less) office space. Bouwfonds REIM (2011) expects demand for office space to shrink with 6% until 2016 due to the effects of The New Way of Working.

Resume

While the Dutch office market has seen a long period of growth, the major growth drivers of demand for office space in The Netherlands are currently stagnating:

- the amount of jobs in the Dutch services sector is expected to grow only 0.7% per year between 2014-2017.
- the size of the labour force in The Netherlands will decrease from 10,1 million in 2011 to 9,3 million in 2040.
- the increase in participation of women in the labour force seems to have slowed down.
- the average amount of space per employee has been dwindling.

The tenants themselves face a number of developments that affect their real estate decisions:

- global economy is currently in a recession and companies focus on cutting costs.
- the new Basel III banking regulation poses stricter rules for borrowing capital.
- new IFRS criteria make shorter real estate leases financially favourable to longer ones.

But apart from a difference in absolute supply and demand, recent developments also seem to shape a growing discrepancy between the intrinsic characteristics of supply and demand. While the supply offers office space from a 'traditional' view of providing space for companies to execute their work, companies on the demand side begin to discover the advantages of adapting to new office concepts such as the New Ways of Working. This changes the nature of the expectations tenants have leasing office space on the space market, feeding a mismatch between supply and demand.

Challenges and opportunities

With the major trends in the use of office space steering towards a shrinking demand market, there is reason to believe that the current vacancy levels on the Dutch office market will not easily return to lower levels. As seen in the previous chapter (figure 2.12) the vacancy rate has been continuously growing since 2000, with a barely noticeable reduction in 2007. To return the office market back into balance, towards the 'equilibrium' as described in the previous chapter, it is clear that change is mandatory. A lot of initiatives such as transformation and demolition of office buildings reduce the absolute level of supply, removing the part of the office stock that is now deemed unlettable. However, this does not change anything about the intrinsic health issue of the market, a growing mismatch between the requirements of the demand and the characteristics of the supply.

In order to clarify the nature of this mismatch chapter 4 will scrutinize the business models of the Real Estate Management Organisations (REMOs) behind the supply of office space, seeking to find how they focus on the needs of the tenant seeking office space. Next, chapter 5 will analyse the motives and needs of companies seeking to lease (new) office space. By comparing the approaches of these two parties it will clarify the nature of the mismatch. This will reveal the opportunities available for the REMO to better meet the tenant's demand.

Chapter 4: The office market from the REMO's pespective

One cannot begin to understand the supply of real estate without taking into account the broader economic environment of real estate asset markets. As described in chapter 1 of this thesis, the distinction between the space market and the asset market is one of two fundamentally different interests. In the case of the space market the core business is the leasing of office space, in the asset market it is generating returns on investment. To better understand how these two markets interact and how they mould the Dutch office market, it is necessary to explore the mechanics of both. In this chapter the supply side is explored that operates on the asset market, represented by the Real Estate Management Organization (REMO) that manages the real estate (see figure 4.1). It is explained what the REMO is, the nature of the asset market behind it, what generic business models the REMO employs, and finally how these are currently affected by the current situation on the Dutch office market. By examining this it strives to clarify its interaction with the space market as well as the Dutch real estate landscape as a whole. It does so by means of using the following research question as a guideline:

Sub 3 What business models are employed by the Real Estate Management Organizations and how do they currently meet changes in the tenant's demand?

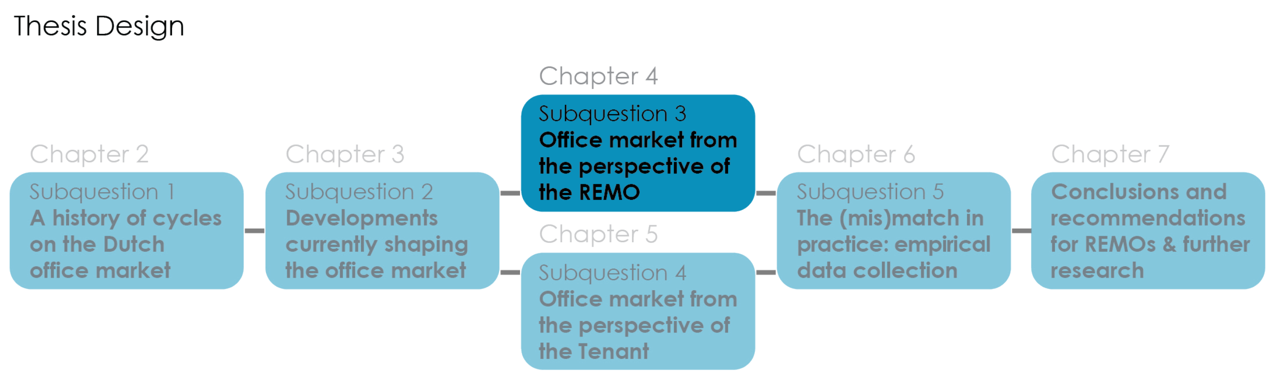


Figure 4.1 The thesis design

The emergence of the REMO

With the ownership of an office building comes the responsibility of basic building management. Janssen (2008) describes that before the emergence of the commercial office space market in the 1960s this included not much more than basic technical building maintenance and administrative management (e.g. collecting rent). With the great increase in demand for office space in the 1980s, the focus of investors lay on acquisition and development of new office buildings. In 1994, at the end of the third cycle on the Dutch office market (as seen in figure 2.9), the market suffered from oversupply and an awareness grew amongst investors that commercial management was required to reach and satisfy their tenants. With new emerging tasks such as relationship management, periodical performance analyses and strategic portfolio management, the role of real estate management became more important and the need for a more professional management increased. Van Gool et al (2007) suggest that with active real estate management both returns and asset value can be increased. Gradually, institutional investors with large portfolios began to set up special departments to take care of these activities (Janssen, 2008).

With the increasing amount and complexity of tasks, as shown in figure 4.2, the responsibilities of the real estate management had spread to all levels of management: the strategic level, the tactical level and the operational level. The organization responsible for (a part of) these three management levels is referred to as the REMO. Janssen (2008) explains that in practise these activities are not always executed by the same organisation, and that it is a common occurrence amongst real estate investors to outsource a part of these activities, often those at the operational level. Therefore, this chapter will make a distinction between the inhouse REMO and the external REMO.

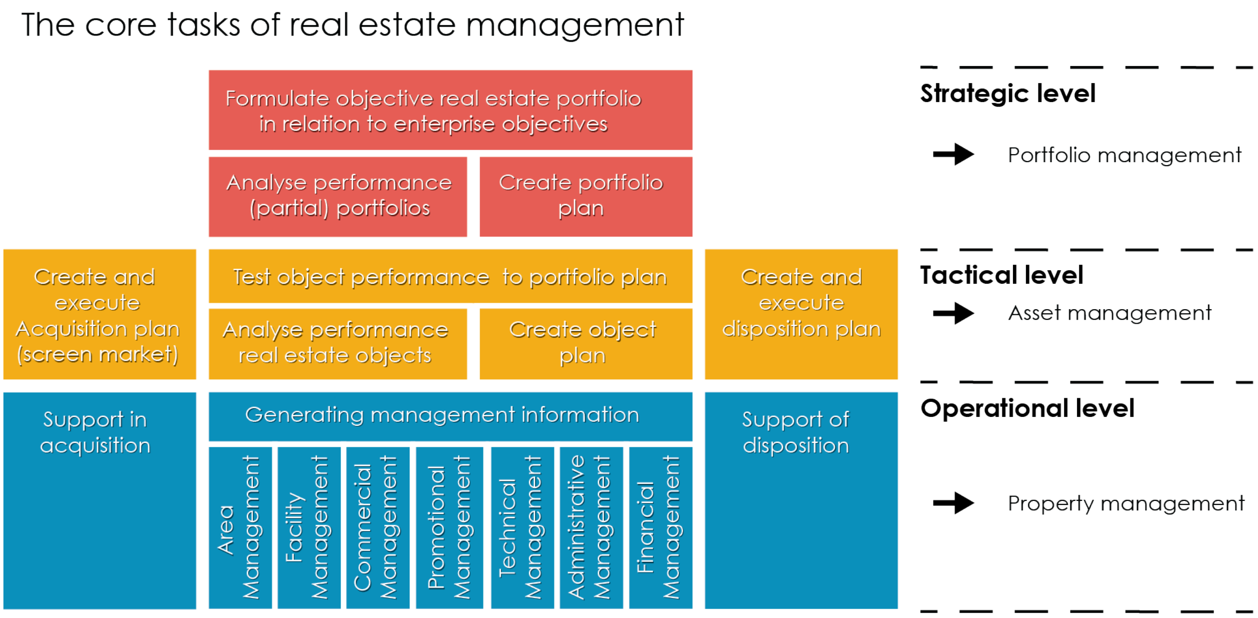


Figure 4.2 The core tasks of real estate management on strategic, asset and operational level (translated and adapted from: Janssen, 2008)

The asset market in a nutshell

Before further addressing the REMO, it is required to examine the nature and goals of the clients they represent: the real estate investor. The core business of these investors on the asset market - also referred to as the property market - is generating return on investments. These assets usually consist of the property itself and the land parcel it is built on. In order to clarify their motivation to invest in real estate as a financial asset, it is necessary to explain what kind of characteristics set real estate apart from other forms of capital assets such as stocks and bonds. Then one can see real estate investments as a part of the larger capital market.

To put these real estate investments into perspective on the landscape of the capital market, Geltner (2001) divides capital investments along two axes (figure 4.3). The first differentiation is the one between public markets and private markets. Public markets are generally characterized by a high degree of liquidity and transparency, meaning it is possible for everyone to buy and sell assets relatively quickly and that the worth of an asset responds quickly to news that affects it. To lower the threshold of dealing in these assets and make them available to a larger group of investors, these assets are usually a small part of a larger asset. Assets on the private market, on the other hand, are traded between individual buyers and sellers that find each other, often through a mediating party such as a broker. The size of the private assets tends to be considerably larger than on the public market, dealing with whole assets (such as a company, building, or a mortgage) instead of a part. Due to the size of these assets it is harder to find buyers or sellers, leading to less liquid markets and higher transaction costs. At the same time these assets are often unique, which makes it harder to compare it to other transactions in order to assert its worth.

Major types of Capital Asset Markets and Investment Product

	Public Markets	Private Markets
Equity Assets	Stocks REITs Mutual funds	Real property Private equity Hedge funds
Debt Assets	Bonds MBS Money instruments	Bank loans Whole mortgages Venture debt & LBOs

Figure 4.3 Major types of capital asset markets and investment products (source: Geltner, 2001)

The second differentiation is the one between debt assets and equity assets. Debt assets represent money that is owed, like a household that has to pay back its mortgage to the bank. Even if the indebted party defaults, the worth of the underlying asset (in this example the house) ensures that the investor is still guaranteed to see its investment returned, making debt assets relatively low risk. Debt assets are usually finite and end after the lifetime of the asset, which gives insight into the expected future cash flows. Equity assets investments are based on the residual claim of cash flows of an underlying asset. This means that the revenues are based on what remains of the cash flow after deduction of senior claims such as paying off loans or maintenance cost. A good example is the ownership of an office building. Assuming the value of the office building stays more or less the same (for the sake of the simplicity of the argument), the investor receives a steady cashflow from the leased office space, after deduction of the expenses required to operate and maintain the building. The equity asset is typically infinite or open-ended, which means that the present asset value is based on the expected cash flows in the near future, where usually the biggest uncertainties lie. This makes the investment riskier and more volatile than debt assets. In return, owners of equity assets have more control over their assets and can benefit a lot from growth.

As can be seen in figure 4.3, direct investments in real estate objects (real property) are found on the equity side. While real estate is traded both publicly (Real Estate Investment Trusts) and privately, this thesis focuses primarily on these private market investments, where investors deal with whole properties and can exert a certain amount of control over their investment. Van Gool et al. (2007) describe the pros and cons of these direct investments in real estate, as summarised in figure 4.4. A noteworthy discrepancy with the Geltner's model is that Van Gool et al. describe real estate investments as having limited risk, instead of the high risk characteristics of private market equity assets Geltner describes. This discrepancy can be explained by the hidden risk of the illiquid nature of real estate investment. It is not possible (within reason) to move the building to a more preferable location, and trading the building requires intensive management and high transaction costs. The long period of growth as described in chapter 2 has kept the risk relatively low. This is an essential premise when looking at the nature of the real estate asset market. These pros and cons form the basis for the business models of the REMOs managing the real estate for the investor.

Pros and cons of direct investments in real estate

Pros	Cons
+ High returns, and a limited risk.	— Time intensive and high cost transactions
+ Relatively stable flow of direct income	— Very opaque markets, subject to lag between supply and demand
+ No direct relation with other capital markets such as stocks and bonds	— Highly inflexible nature, especially on the short term
+ Indexation of the rent protects the rental cashflow from inflation	— Goverment influences can have potentially a large impact.
+ Returns can be positively influenced by active management	— Requires very intensive management
+ Inefficient real estate markets create unique investment opportunities	— The valuation of the real estate assets is complicated and subjective
+ Fiscal advantages due to an often tax deductable nature	— High entry investments, starting around €500 million.

Figure 4.4 The pros and cons of direct investment in real estate . (Source: Van Gool et al., 2007)

Business models of REMOs

A Real Estate Management Organisation's premier task is to relieve its client, the investor, from any or all responsibilities regarding the management of these real estate objects (Vermeulen & Wieman, 2010). The core business of the REMO, then, is to focus on exploiting the pros and trying to negate the cons listed in figure 4.4, where possible.

The variables that the REMO can influence/safeguard on the pro side are most importantly the length of the lease, the height of the lease price, the protection of the indexation, and the activity level of the management. Longer leases ensure future cashflows, and therefore reduce the risk of the investment and also increase the value of the underlying asset. Higher lease prices also positively affect the value of the asset, and also increase the returns. Van Gool (2007) states that the indexation of the lease price is a key attribute of real estate investments, therefore it paramount for REMOs to safeguard it.

There seems to be an internal conflict of interest when it comes to negating some of the cons of managing the real estate. The lack of transparency on the market, for example, increases the risks of the investment due to the subjectivity of the valuation of the asset. But on the other hand, it is exactly this lack of transparency that creates unique investment opportunities with high returns. A similar parallel can be observed in the intensity of the management of the REMO. The REMO would like to lower the cost associated with the intensive management, but at the same time a more intensive management can increase both the asset value and the returns (Van Gool et al., 2007).

These described considerations concerning the level of management can be substantiated by the trend of outsourcing of a part of the management activities at the REMO. While the real estate management activities on strategic and tactical level are often still executed at the in-house REMO, scale advantages of larger, external REMOs often make the outsourcing attractive (Janssen, 2008; Grunt, 2001). In most cases this concerns (a part of) the tasks at the operational level. These external REMOs add to the level of service, professionalisation and innovation: three fields that become increasingly essential in a market of growing competition (Janssen, 2008). These external REMO services are often provided by large broker firms. What sets Dutch external REMOs apart from e.g. ones in the USA or England, is that the knowledge and responsibility of strategic and tactic management has been kept within the in-house REMO for a long time. Most inhouse REMOs servicing the institutional investors outsource solely the operational (property) management to external service companies (Uittenbogaard & Kohnstamm, 1996; Goesten, 2007). As a result, Dutch external REMOs have not been able to build decades of expertise in the fields of strategy and asset management, while their foreign counterparts have.

Growth strategies of external REMOs

With vacancy rates as well as the pressure from competitors increasing, in-house REMOs see the need to increase the level of service. As a result, the external REMOs in The Netherlands are continuously expanding their range of services, and increasing the level of professionalisation and specialisation (Vermeulen & Wieman, 2010). But as the in-house REMO demands for more quality, the profit margins for external REMOs remain small. Therefore, the development of innovative new services goes paired with considerable risk. Vermeulen & Wieman describe four growth strategies for REMOs, based on Ansoff's Growth Model (Kotler, 1988) to improve the market position of an organisation (figure 4.5). These growth strategies at the external service providers indicate in what way the total range of real estate management activities is subject to change, in order to better meet the tenant's demand.

Market Penetration - Increase the coverage of core activities on the market. The total size of the Dutch real estate investment portfolio is not expected to increase, but the players are expected to change. Ownership is expected to shift from institutional investors to private investors and publicly traded real estate funds, but also from domestic investors to foreign ones. These new players have different objectives and therefore might require a different approach with a different set of services. With the external REMOs focusing on these new players, it would be interesting to compare the difference in approach between the in-house REMOs at the institutional and the private investor.

Development of New Services - Hitherto Dutch external REMOs have not built extensive experience in providing for strategic and asset management. However, these external REMOs are increasingly expected to benchmark their operational management performance to the objectives on the strategic and tactical level. While the investor may want to keep a large part of the responsibilities of the strategic decisions in-house, the REMO can expand their range of services to include core tasks on the asset and strategic level, profiling their commitment to increased performance and the benefits of outsourcing these tasks.

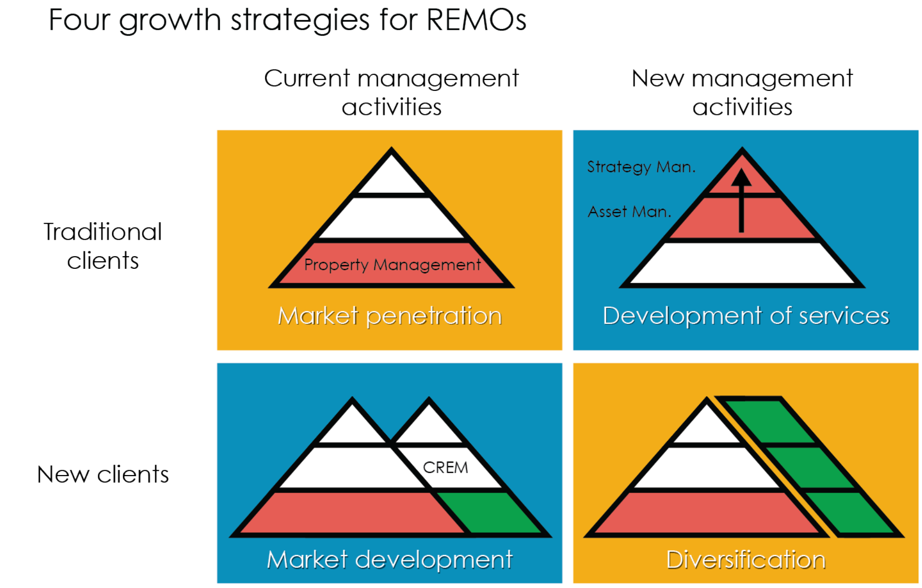


Figure 4.5 The four growth strategies for REMOs, based on Ansoff's Growth Model (adapted from: Vermeulen & Wieman, 2010)

Market Development - There are significant opportunities for REMOs to offer services for different types of real estate for different parties (e.g. housing corporations, care facilities). However, since this is not the topic of this research thesis, this strategy is excluded.

Diversification - Besides offering services in the field of real estate management, there are opportunities to expand the range of services to related activities that may not be directly related to the real estate object itself. Examples are facility management (i.e. security, catering, interior design, data communication) and parking management. Apart from the added service and the scale advantage, including a broad range of services under the control of the external REMO might provide for a higher quality of service towards the tenant. Since the tenant has a growing number of demands and increasing power on the bargaining table, this might be an invaluable service to offer the in-house REMO.

The key areas in which the business models of REMOs are developing all focus on increasing the coverage and spread of services towards their clients, the investors, while margins are low and with high risk attached to new innovations (Vermeulen & Wieman, 2010). Although (Dutch) in-house REMOs are still reluctant to outsource more of their activities, they face an increasing demand in quality and quantity of services from the tenant. Moving towards a greater overlap between operational (property) and tactical (asset) management may align the focus of the entire REMO with that of the tenant.

It should be noted that the primary business objective of the strategic/asset management is generating returns and increasing asset value for the investor (Van Gool, 2007; Waals-Vos, 2011), while it is creating added value for the end user (the tenant) at the operational level (Beukering, 2008). A study by Goesten (2007) suggests that up to 85% of the Dutch in-house REMOs outsource their property management, and just 14% outsource their asset management. Separating these two targets between the investor REMO and an external REMO, effectively putting an additional party between the owner and the tenant, creates a disconnect between the tenant and the owner of the building. A survey amongst tenants by Waals-Vos (2011) finds that tenants put a lot of value in speaking directly with the owner of the office building. While property management is quick and effective, it misses the decision power when it comes to urgent, more important matters. A further expansion of the services of the external REMO towards tactical (asset) management could potentially improve tenant relations.

The influence of market conditions

These business models of the REMOs are subject to the conditions on the office market. As described in chapters 2 and 3, there is a vast oversupply of office space and the demand will likely cease to grow or even start to decline. On top of this, the characteristics of the demand seem to be changing. This provides a basis for increased competition between REMOs, low margins and potentially the threat of an increasing level of vacancy.

While forced sales of commercial real estate funds dump office buildings on the market, competition increases from the corner of private equity. Vermeulen & Wieman (2010) predict that the volume of office real estate investment until 2020 will not expand, but instead shift from institutional investors towards private investors. Early 2012, institutional investor Uni-Invest sold a commercial real estate portfolio 40% under the latest valuation to a private investor (Financieel Dagblad, May 4th 2012). This enables the buyer to generate the same returns on investment as current investors, while offering considerably lower lease prices. Opposed to the institutional investors, private equity investments usually accept higher risks for potentially higher returns, increasing the competition between owners of office real estate. This means that in order to remain competitive, the institutional investor shall have to drop the lease price (directly, or by means of financial incentives) or face vacancy, which means that margins of profit will drop.

There are several alternatives how owners of office buildings can deal with vacancy (Priem, 2005; Houtveen, 2002). Two of them - maintaining the asset in current condition, and disposition - are seen as passive alternatives. The four remaining alternatives require active investments pertaining to the physical condition of the asset: upgrading (small investment, same use), renovating (large investment, same use), transforming (large investment, different use) and demolishing & redeveloping. Transforming offices for new uses gained considerable popularity in The Netherlands, but is still for the larger part dependent on the economic feasibility and willingness of the investor. Since this study focuses on reducing the mismatch on the office market and not removing office space from the office market altogether, the two options considered here are upgrading and renovating. Taking into account the low margins in which the REMO operates in the current market conditions, solutions for a mismatch between the owner's office space and the tenant will have to be sought in enhancements that require small to medium investments.

In addressing these market changes, this research makes the distinction between core business responses and non-core business responses. Core business repsonses pertain to the primary goals of the REMO as described in the paragraph '*Business models of REMOs'*, primarily focused on exploiting the pros of real estate investments. Non-core business responses are outreaches to the tenant in order to increase the satisfaction of the tenant, and therefore increase the competitiveness of the office space on the market.

Core business responses to obsolescence

Brown & Teernstra (2008) suggest in a preliminary study of investors making decisions on the obsolescence of structurally vacant office stock that their expertise is subject to certain behavioural, cognitive limitations. Although the study is not conclusive, it shows that investors understand the economic obsolescence of their assets the best, then external (physical) obsolescence and least of all functional obsolescence. This is understandable, since their primary goal is to meet certain economic return targets. Tweaking the existing variables that have always played a role in setting up a lease with a tenant with little to no upfront investments are regarded here as passive responses to changing market conditions.

Since the worth of the asset represents the investor's invested capital, it is natural that it is preferred to retain this worth on the balance sheet. The premier methods to value the asset are by means of Gross/Net Initial Yield (Dutch: BAR/NAR), x-times-the-rent or the Discounted Cash Flow (DCF) method (Van Gool et al., 2007). In these methods the most important variable is the gross rent per year, defined by the rent per square meter times the amount of square meters. The duration of the lease, which provides security of income, is usually also an important variable. Relying on the buoyance previously seen on the commercial real estate markets, REMOs stay optimistic, hoping that the net rental values representing the worth of their assets will veer back. According to Royal Institution of Chartered Surveyors (RICS), the valuations of 35% of office buildings in The Netherlands differed more than 10% from the final sale value (Nederlandse Beroepsorganisatie Accountants, 2011). This indicates that this trust in the buoyancy of the market currently lead to a valuation bubble on the market for investments on the office market.

So instead of lowering the lease price, the REMO provides financial incentives (EIB, 2012). This keeps the rent levels - and therefore the worth of the asset - artificially high instead of reflecting the balance between supply and demand on the market. Muijsson (2010) describes various types of incentives that are prevalent, usually written down in the terms of the lease contract:

- The most widespread form of incentive is rent-free periods. During this period the tenant does not have to pay rent. Most of the times this rent-free period starts with the start of the lease, sometimes it is strategically placed in later years of the lease contract or at the start of a lease extension, making it financially favourable for the tenant to continue the lease in the current office space.
- A fit-out contribution. Usually office space is offered in its skeletal state, without any form of interior present. Since a new tenant would have to make a considerable investment placing walls, furniture etc. the owner can contribute a cash incentive to be used solely for this fit-out investment.
- A move incentive translates into a similar cash contribution as the fit-out contribution, aiding the tenant financially in his move to the new office space. But this type of incentive does not limit itself to the physical aspects of moving, but can for example also be used to finance a marketing campaign to get the news of the new location of the tenant in the market.
- The standard ROZ office lease agreement states that the tenant is obliged to remove any fit-out at the end of the lease. Costs associated with this removal are around €80,- per net square meter leased. The owner can annul this obligation, saving the tenant these costs. The bonus for the owner is that the fit-out can be donated to a new tenant as a 'free' incentive, with a risk of having to finance the fit-out removal himself.

The other variable in retaining the asset value is the length of the lease contract, which represents future cashflows as used in the DCF valuation method (Van Gool et al., 2007). As described in chapter 3, there are several reasons why shorter leases are becoming more preferable for tenants. By means of providing financial incentives, the REMO can make lease extensions financially attractive. It differs widely per REMO what lease length threshold is handled in making the decision whether a short lease is favourable to a potential chance on a longer lease with a different tenant.

Another core goal of the REMO is to protect the yearly indexation of the lease price. With the entire Euro region in economic difficulties, this protection of the real estate investment from inflation gains considerable importance. RentReview (2012) states that while the Central Banks assure that the interest rates will stay low, unforeseen events might change this fairly quickly. They argue that a fair number of economists believe that Europe's debt can only be financed monetarily. This means by printing extra money, consequently leading to an increased inflation. In anticipation of shielding the investment from this risk, REMOs will try to guard this essential premise of real estate investment.

The last core business response is the outsourcing of (a part of the) management activities to an external REMO. While figures from 2007 earlier in this chapter indicate that the majority of the in-house REMOs outsourced a part of the operational management, it is difficult to ascertain whether this number has increased or decreased since the financial crisis in 2008. For now, it is assumed that REMOs still prefer to outsource these activities.

Non-core business responses to obsolescence

As opposed to passive responses to changing market conditions, active responses target specific changes in demands of prospective tenants that would normally not fall under the REMO's core activities. REMOs are increasingly aware that in order to retain a competitive edge in a high vacancy market, it is essential to pay heed to topics that view the office space from the perspective of the tenant. After all, the core interest of the owner is to safeguard the future cashflows (in the form of the lease contract) and therefore the tenant's satisfaction increasingly gains importance.

The first points of interest are sustainability and service costs. Although the rent of the office space is the only source of income for the owner, this comprises only around 55% of the costs of housing for the tenant. About 20-25% is on average taken up by service costs, which represents charges for e.g. electricity, water, security, telecom (Jones Lang Lasalle, 2012). While the REMO does not directly benefit from helping the tenant to downsize the total housing cost, it does increase their competitive edge towards other suppliers of office space and a satisfied tenant is likelier to continue its lease (Uittenbogaard & Kohnstamm, 1996; Verkerk, 2012). One way of reducing service cost is downsizing the energy consumption of the building, represented for a large part by its energy label. The investment the owner needs to make to upgrade the building's energy label - effectively reducing service costs - could for example be compensated by a temporary increased lease price until the break-even point is reached. The REMO and the tenant can secure mutual performance agreements in a Greenlease, documenting how each side is willing to invest towards a more sustainable solution. Apart from tangible costs, sustainability is often also part of corporate branding for running a sustainable business. While the awareness on the field of sustainability seems omnipresent on the real estate market, a study by Jones Lang LaSalle (2012) amongst 272 office buildings found that only 28% had an energy label. However, a previous study by Jones Lang LaSalle (2010) amongst Dutch institutional real estate investors showed that 85% of the investors had clear targets on Corporate Social Responsibility, including sustainability.

A second point of interest is the New Way of Working (NewWoW). A lot of businesses are adapting these new work concepts in some degree, which demands certain characteristics or qualities from the office building. Berlee (2012) lists these characteristics. Those specific characteristics that are fixed to existing buildings and cannot be changed with reasonable investment (such as location and structure factors) have been omitted, leaving the following list:

- The entrance of the building is seen as a logic place for a meeting area. It should look presentable and facilitate places to meet.
- The facade of the building should be as transparent as possible, as an increased visual connection with the outside world might positively affect productivity.
- Visual connections in the building (atria, voids, staircases) make it possible for knowledge workers to find, meet and communicate with each other.
- A flexible layout leaves room for various kinds of work and meeting places to mix.

Almost all professional services in real estate, such as large brokers and consultancy firms, offer some kind of services aimed at advising owners as well as tenants on the possibilities of the NewWoW.

Resume

The ownership on the Dutch office market is for a large part represented by (institutional) investors seeking to generate returns on investments. Until 2001, these high return investments had their high risks mitigated by a long period of growth. With the oversupply of office space, the accompanied competition and the diminishing demand, these investors saw the risk and vacancy levels increase and the return diminish. This chapter aimed to answer the following research question *[sub3]: What business models are employed by the Real Estate Management Organizations and how do they meet changes in the tenant's demand?* From the available literature the following approaches seem to be prevailing (figure 4.5).

The core business model of the REMO remains to safeguard the pros and negate the cons of investing in real estate: retaining a stable asset value, maximising rent from the leased office space, safeguard its protection from inflation and minimise the cost of management. With the professionalisation of the REMOs the number of activities have grown, and day-to-day property management has often been outsourced to external REMOs. The advantages of scale, professionalisation and efficiency that these REMOs offer can reduce the total management costs. A consequence of outsourcing property management is that the tenant relations are often also outsourced, distancing the owner from the tenant.

To cope with the increasing competition in a high vacancy market, the owner of the office building has two different types of approaches to meet the tenant's demand, which applies to both existing tenants and potential new tenants:

- Core business responses: meeting the tenant usually comes down to providing financial incentives in the lease contract. These can be periods of rent free lease, cash contributions to fit-out or moving costs, or omitting the tenant's reinstatement obligation at the end of the lease. Decreased returns still outweigh the prospect of vacant office space and having to find a new tenant. The REMO prefers to retain long leases and high gross lease prices, since these positively affect the capital value of the real estate asset.
- Non-core business responses: meeting the tenant moves the perspective of the owner into that of the tenant. Helping to reduce the tenant's service charges by increasing the sustainability of the building can increase the competitive factor of the building and persuade the tenant to continue/ extend its lease. Another factor is helping the tenant shift its work to the New Ways of Working. This implies investing in the building (internal staircases, meeting areas, improve flexibility of layout and improve the facade) and providing for additional amenities in order to facilitate their different need of work environment. Growth strategies for external REMOs suggest that offering additional services to the tenant might be another way to bridge a potential mismatch.

REMO perspective on the lease with the tenant

Findings from the literature study

	CORE RESPONSES
Length of lease agreement	Prefers a long lease to ensure the future cash flow, reducing the risk of investment and increasing the asset value.
Lease price & incentives	Prefers a high gross lease price per square meter to ensure high returns and a high asset value. Financial incentives are used to approach the market value.
Indexation of the lease price	Wishes to retain this essential premise of real estate investments in order to safeguard it from inflation.
Tenant relations	Prefers to outsource property management (including tenant relationship management) to increase effectivity and reduce cost.
	NON-CORE RESPONSES
Sustainability	In order to increase competitiveness of the image of the building, the REMO can invest in a more sustainable building.
Service Costs	In order to ncrease the financial competitiveness of the office space, the REMO can reduce the tenant's total real estate cost by reducing service costs.
New Way of Working	In order to facilitate the changing use of office space, the REMO can proactively meet the tenant's demand in adapting to new office concepts.
Additional Amenities	In order to compensate for lack of amenities on the location of the office building, the REMO can provide these in the office building.
Diversification of the services provided by the REMO	In order to differentiate the building in the level of services offered, the REMO can offer new services: e.g. security, catering, telecom.

Figure 4.6 Summary of the findings from literature about how the REMO approaches the organisational and financial mismatch with the tenants

With increasing vacancy levels, the tenants have gained power on the bargaining table. While rent levels are declining, REMOs might be reluctant to invest on lower margins due to diminishing returns and remain passive, waiting for the market to stabilize. However, with a declining and changing demand, shorter leases (see chapter 3) and increasing competition this might prove to be a long wait.

This seems to increase the mismatch between the business models employed by the owners of office real estate and the tenants, between the asset market and the space market. Where the investor used to be in direct contact with the tenant, the services that build a relationship between them have been outsourced to external REMOs, while the importance of a good relationship and active responses to demands of the tenant is growing. Two decades ago this might not so much have been a problem, but the demands of the tenant are undergoing rapid developments while the task of closing this gap lies with the REMO. Whether these findings from the literature accurately represent the reality will become clear in chapter 6 where REMOs are asked to respond on these findings.

Opportunities in Real Estate Management

It seems that while the attitude of many investors has been one of wait-and-see, a realisation has emerged amongst REMOs that they need to proactively meet the demands of the tenant. The REMO, seeking to expand its services, might start to play a crucial role in reducing the mismatch between the investor's real estate object and the evolving wishes of the tenant. Solutions for aging stock in unfavourable locations remain uncertain, but the urgency of a more proactive approach from REMOs seems to grow rapidly. By proactively meeting the tenant's demands the REMO can help the owner of the real estate object close the gap.

The next chapter explores what goes on in the decision process of a tenant seeking (new) office space. By linking the conclusion of this chapter with the next, this exploration of existing literature seeks to provide a base for a concise view on the organisational/financial mismatch between supply and demand.

Chapter 5: The office market from the tenant's perspective

With the essentials of the business models of real estate management organizations discussed in the previous chapter, this chapter focuses on their primary target group: the tenant that seeks to lease office space (see figure 5.1). It first explains the market on which these tenants are active - the space market - by explaining the reasons and options to lease office space. Then it focuses on the development of the department within businesses that manage the real estate, a profession referred to as Corporate Real Estate Management (CREM). It continues by summarising the contemporary focus areas of CREM in the light of external influences such as the current market conditions and new regulation. Finally, it explains two distinct ways in which the real estate can provide a positive contribution to the performance of the company. By exploring the decision process of the tenant in its search for real estate, this chapter aims to lay bare the premises for a potential mismatch between supply and demand from the perspective of the tenant.

The following research question will guide this chapter:

Sub 4 What reasons do businesses have to lease office space and how are these affected by recent developments?

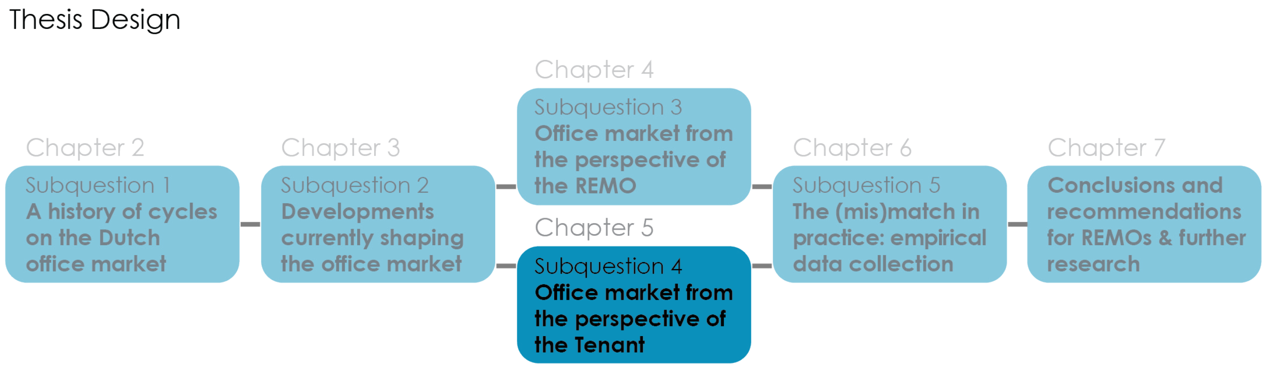


Figure 5.1 The thesis design

The space market in a nutshell

The space market (usage market, rental market) is the market of the usage - or right to use - of real property, which applies to both the leased space and the land it is built on (Geltner, 2001). More specifically, it consist of businesses seeking to lease a type of real estate to facilitate their type of business.

As addressed in chapter 2, it is only since the 1960s that a first shift can be perceived from in-house development of real estate towards the lease of flexible office space on the office market that could grow with the needs and requirements of the company (Krumm, 2001). This is where the role of the asset market plays its essential role. Businesses seeking office space have a number of options to finance their real estate needs if they do not have or wish to use their own resources (Stickney et al., 2009; Schelle & Baltussen, 2013):

- Borrow capital from financial institutions such as banks, insurance companies, and investment firms
- Issue bonds on the capital market (if the company is listed publicly)
- Lease the asset from a third party

So leasing the office space on the space market is essentially an alternative of financing the business' real estate needs with debt, using the investors on the asset market as external investors. Another advantage, as Krumm stated, is that leasing offers a solution for the inflexible, static nature of the building's size and location. It allows the tenant to change its lease to a more preferable building or location, better suiting the needs of its business.

Schelle & Baltussen (2013) and Stickney et al (2009) describe the distinction between two types of leases: the finance lease and the operating lease. In both cases the business leases the right of use of the office space from an external party, the lessor. The distinction between the two types of leases lies in which party bears both the risks and the rewards of ownership (figure 5.2). The finance lease transfers all risks and rewards associated with ownership to the tenant (e.g. vacancy, unforeseen operational expenses). Usually this kind of lease is used as a means of acquiring external investment or loan to purchase the building after the end of the lease. In the operating lease, all the risks and rewards of ownership lie with the lessor, and the tenant merely acquires the right of use of the asset. This last one is the type of lease this chapter focuses on, since the lessor is an active party in the exploitation of the asset and a stakeholder in the (mis)match between supply and demand.

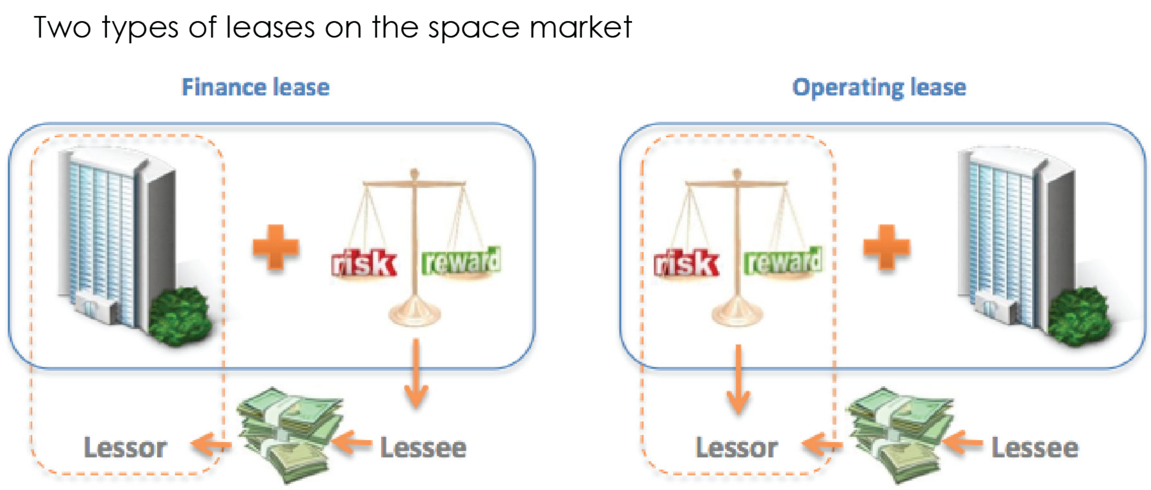


Figure 5.2 The finance lease and the operating lease. Source: Schelle & Baltussen (2013)

The supportive role of CREM

The role real estate has played for businesses has evolved considerably over the course of the 20th century. With the changing role of the real estate, the extent and characteristics of the associated management have also changed. This management as a distinct discipline is referred to as corporate real estate management (CREM). Changes in the role real estate plays for the business illustrate the perspective tenants of office real estate have on leasing on the space market.

Initially, the role real estate had was one of strictly utilitarian use as the accommodation of the business, as seen in the early 20th century. It was not part of the core activities and therefore regarded as mere side activity (Krumm, 2001). The following quote of Henry Ford illustrates this viewpoint:

> *"We will not put up elaborate buildings as monuments to our success. The interest on the investment and the cost of their upkeep only serve to add uselessly to the costs of what is produced; so these monuments of success are apt to end as tombs. We would prefer to be advertised by our product than by where we make our product." - Henry Ford*
> (found in Krumm, 2001)

However, with the gradual emergence of the office market in The Netherlands around the 1960s and 1970s, businesses realised that the rising cost of accommodation and doing business, coupled with increasing competition had put the role of real estate in a different perspective. Business started recognising the financial added value of real estate, resulting in a expansion of centralised CREM activities. Real estate provided a contribution to the business in the form of increasing rental incomes and the increasing capital value of their real estate assets.

Around the 1980s businesses experienced an increasing pressure from shareholders to increase profitability and reduce costs, which forced businesses to rethink their real estate strategies. In order to cut costs, businesses refocused on their core activities and started to decentralise a large part of their CREM activities (Krumm, 2001). The emergence of professional service providers eliminated the necessity for businesses to own and control their own real estate, allowing them to outsource the non-core activities. Leasing instead of ownership also freed up capital which could be invested in the continuity of the core business.

Unifying models describing how CREM can provide added value to the business have for a long time been scarce or not recognised, and often focus on cost minimisation and short-term results rather than investing in long-term strategies. CREM decisions are often based primarily on the functions and requirements in relation to the real estate asset and not so much the businesses performed in them. Joroff et al. (1993) explain that this prohibits CREM to evolve from a role as a task manager to one of a business strategist. Lindholm et al. (2006) created such a model, based on interviews with 26 corporate real estate managers (see figure 5.3). They profess that the supporting role CREM plays should be defined by aiding the business' goal of maximising the wealth of the shareholders, which can be seen on the left side of the figure. It can do this by developing strategies that are aimed at enhancing the value of real estate assets and facility-related services to the core business. In this, they make a distinction between real estate strategies aimed at increasing revenues and strategies aimed at increasing the profitability. It should be noted that the findings of this study are based on the opinions of these 26 corporate real estate managers, and do not per se reflect the opinions of the entire population of real estate managers.

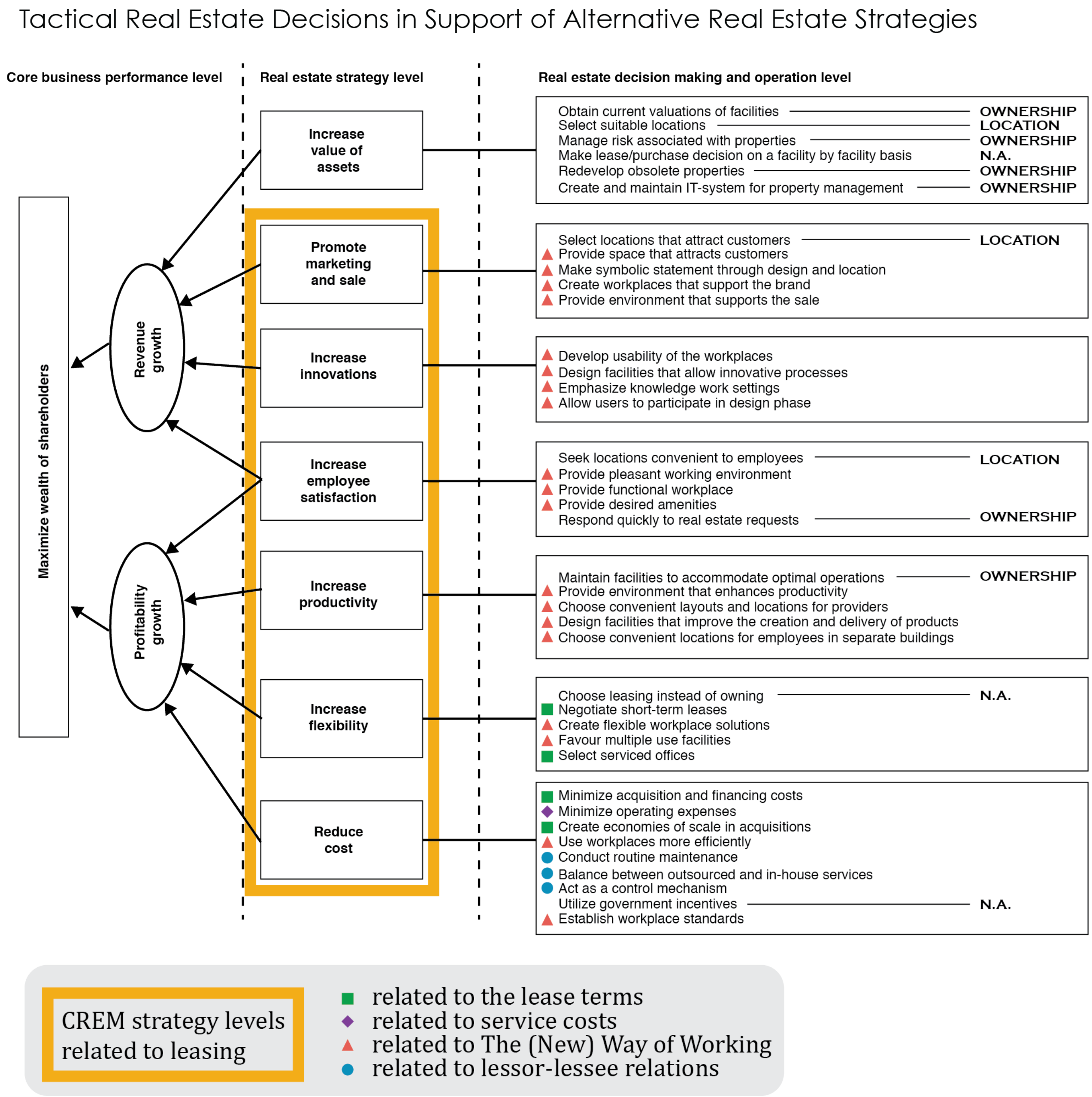


Figure 5.3 The supportive role of CREM towards maximising wealth. Adapted to the mismatch between lessor and tenant, based on: Lindholm et al (2006)

Since Lindholm et al.'s model focuses on the complete range of CREM activities and this thesis focused merely on CREM considerations that pertain to leasing, a number of findings are not of interest. For example, the top strategy field (the one excluded in the orange rectangle) and a number of decisions on the right side (the ones without a coloured symbol) are not relevant for this thesis because they either pertain to office ownership, office location, or simply are not applicable in establishing whether there is a mismatch between the tenant and the REMO.

In order to be able to compare these considerations with the perspective of the REMO as addressed in the chapter 4, the real estate decisions on the right side have been categorised in four different categories: the lease terms as documented in the lease contract, the reduction of service costs, considerations regarding the (new) way of working, and finally the relation between the REMO and the tenant. A key realisation in this supporting role of the real estate to the core business, is that it exists in the tangible, as well as in softer, intangible contributions. Tangible contributions are usually apparent in the visible reduction of costs, or as Lindholm et al. call it: increase in profitability. Intangible contributions cannot always be directly translated towards a perceivable effect of the financial performance, but have the possibility to contribute to revenue growth. These are elements such as productivity, usability, employee satisfaction and support to the core business.

Lindholm et al.'s conclusions are that a majority of corporate real estate managers still believe that the added value of CREM lies mostly in the minization of the costs, while a minority recognises the opportunity of focusing on less tangible solutions. What is interesting about this model is that three of these decision categories used to compare the tenant's considerations to those of the REMO fall entirely under the tangible cost reduction side. And a majority of considerations, both tangible and intangible, fall under the category of the (new) ways of working. While the definition of this category is very broad, this would for a part explain the popularity of the New Ways of Working amongst corporate real estate managers seeking to increase the added value of their real estate.

The future of CREM, according to Krumm (2001), lies in discovering how real estate can contribute to the business' internal resources and capabilities beyond the level of sheer optimisation of operational efficiency. The key, he states, is to find a balance between reducing costs and increasing returns on investment - and the value real estate can add to the core business processes.

Current focus areas of CREM

Take into consideration both the described internal developments in CREM and Lindholm et al.'s findings (2006) of the ways CREM can contribute to a business' wealth maximisation, there are a number of recent developments that affect the perspective of a business on its real estate. This changes the expectations the business has when negotiating a lease on the space market. A number of these issues have been discussed in the third chapter, such as:

- A vast oversupply of office space and increased vacancy increases the power of the tenant.
- The global economic recession following the 2008 credit crisis diminished consumer spending, reducing general growth in the business sector, which increased competition. This in turn increased pressure from shareholders and/or stakeholders to improve business results.
- A European crisis in the banking sector, combined with stricter Basel III regulations led to a reduced availability of capital and a raise in the cost of borrowing.
- Upcoming update on the IFRS Lease Accounting regulation demands that the entire lease it put on the financial balance, which might heavily affect a compay's credit rating. This steers the tenant towards shorter leases and lower gross lease prices.
- The possibility of adapting The New Way of Working (NewWoW), which can increase the efficiency of the used office space and increase teleworking, effectively reducing the needed amount of net office space. It could also be a way to meet the demands of a new generation of employees, and possibly increase the productivity of employees.

The growing oversupply on the office market in The Netherlands has provided an ideal opportunity for companies seeking to improve performance. The increased competition has gradually dropped the average prices for office space, if not in a reduction of the lease price then by means of financial incentives such as rent-free months. These tenants wish to vocalise their expectations and value direct contact with the REMO. However, the absence of information or feedback is often prevalent or communication takes place through a third party, which is a source of annoyance for tenants (Waals-Vos, 2012).

Two ways of improving business results

$$\textbf{GROWTH} = \frac{\textbf{NUMERATOR}\ \text{(increase revenues)}}{\textbf{DENOMINATOR}\ \text{(reduce cost)}}$$

Figure 5.4 Two ways of improving business results. Source: Hamel & Prahalad (1994)

The oversupply has increased the negotiating power of the tenant on the space market, whilst the CREM of the business aims to maxmise contribution of the real estate to the core business and minimise the expenses involved, so either by saving on expenses or by increasing output. Hamel & Prahalad (1994) have provided an apt analogy for this situation. They consider the company as a mathematical fraction with a numerator and a denominator (figure 5.4). The numerator stands for the net income of the company, and the denominator for costs such as (capital) investments and headcount. The total fraction can represent return on investment or return on net assets, or simply function as a measure how good the company performs.

Their analogy helps in making a distinction between two distinctive ways of improvement. The first is by increasing the numerator, so to increase the productivity, output or the revenues of a company (like 'Revenue Growth' in Lindhom et al.'s model). This can be done by seeking out new opportunities, anticipating on changing consumer needs or by expanding the competencies of the company. By increasing the numerator the company facilitates (future) growth, but this tends to go paired with risk and investment and usually does not have an immediate effect. According to Lindholm et al.'s study (2006), 16 out of the 26 respondents believed that CREM can increase the productivity (and thus revenues) of a business. The other way of increasing the performance of the company is by decreasing the denominator, in other words by cutting in the costs (like 'Increasing Profitability' in Lindholm et al.'s model). This can for example be done by increasing the efficiency of the company, by downsizing, uncluttering or returning to the 'core business'. The pros are that the effects are usually immediate and require not too much risk taking, the con is that it it does not provide a contribution to future growth. Reducing the costs proved to be the foremost conviction of CREM to make a contribution to the wealth maximisation (Lindholm et al. 2006). Both increasing the numerator and decreasing the denominator are valid ways to increase the performance of the company, each with its own set of pros and cons. Changes in CREM can facilitate both significant numerator and denominator enhancements, therefore making it an ideal instrument in the improvement of business performance.

Numerator improvements

One central improvement above the line of Prahalad's equation is investing in the employee of tomorrow. With the Baby Boomer soon leaving the Dutch labour force, there is a need for new influx of talent (Baane, Houtkamp & Knotter, 2010). The numbers of highly educated young professionals are scarcely adequate to replace the ones that exit the labour force. Therefore, it is important to secure the continuation of the company's work force by attracting young talent. The generation that is about to enter the labour force is often called Generation Y. Born roughly between 1980 and 1990, this generation has grown up in the digital age with rapid changes and innovations, and is fully trained in the possibilities of new technologies. They have high expectations of personal growth and the line between work and home does not really exist for them (Trunk, 2007). Since Generation Y is in great demand, employers are forced to think more creatively about work-life balance. It is noteworthy that the number of part-timers in the Netherlands is one third of the work force, compared to an average quarter in the rest of the EU (Ministerie van Sociale Zaken & Werkgelegenheid, 2012). The percentage of people that works from home in 2010 averaged on 27%, spiking up to 48% amongst people with a high level of education (CBS, 2012). The threshold used here is working a minimum of 1 hour per week from home. For comparison, the percentage of people working from home in the USA is estimated between 13-19,5% (Global Workplace Analytics, 2010; US Bureau of Labour Statistics, 2012). A comparison with the EU is difficult, since research on the numbers teleworker there is defined as people who work over a quarter of their time from home (Welz, C., Wolf, F., 2010). However, it is valuable to note that at an average of 7% EU-wide, The Netherlands is in the top 5 with 12%, together with The Czech Republic, Denmark, Belgium and Latvia (figure 5.5).

The incidence of telework in the EU27: the top 5 (%)

	% involved in telework at least 'a quarter of the time' or more	% involved in telework 'almost all of the time'
Czech Republic (CZ)	15.2	9.0
Denmark (DK)	14.4	2.6
Belgium (BE)	13.0	2.2
Latvia (LV)	12.2	1.8
Netherlands (NL)	12.0	1.9
EU27	**7.0**	**1.7**

Figure 5.5 The incidence of telework in the EU. Adapted from: Welz, C., Wolf, F. (2010)

Another improvement is increasing the effectiveness of the space usage of office real estate. In adapting more flexible ways of working for employees, office space can be used more optimally for core activities and employees can adjust their work/life balance to their own liking. With the possibilities of modern technology, providing for a workplace is no longer the premier task of real estate. Instead, focus of space usage can be shifted to meeting places, knowledge sharing and corporate identity (Rietmeijer et al, 2011). This requires the availability of a multifunctional, dynamic environment supported by amenities and a certain office layout to stimulate interactivity, communication and knowledge sharing. One can think of a cafe, restaurant, meeting places/rooms, nursery, dry cleaner and a supermarket (Berlee, 2012). These can be provided either in or in proximity of the office building.

The possibilities aggregated under the name 'New Ways of Working' as described in chapter 3 seem to join seamlessly with these goals just described. The combination of personal freedom and innovative office concepts addresses the expectations of Generation Y. Whilst not directly focused on the NewWoW, a study amongst 2000 respondents by Batenburg et al. (2008) observed a positive correlation between the satisfaction of the employee with the workplace, and the perceived productivity. Although this correlation is disputed, the New Way of Working is still widely advocated to contribute to an improved cooperation between employees and an increased productivity. Indirect improvements to the performance of the company can be found in an improved corporate image (flexible, trendy), increased customer satisfaction (employees can do work outside of office hours) and sustainability (a decrease of pollution due a reduced commute), as described by Baane, Houtkamp & Knotter (2010).

Another consideration in a tenant's perspective on real estate is the relation with the lessor. For example, in physically adapting the office space for the New Way of Working, a part of the improvements to the office may be done by the tenant itself, such as redesigning the interior. Some changes might require working together with the lessor of the office space, such as building internal staircases. Not all improvements required from the office space can be applied on existing buildings, though. For example, closed floor plans that are part of the structure of the building will not allow the modifications that facilitate the organisational change as described in the NewWoW (Berlee, 2012).

Next, Kuipers (2012) states that investing resources in improving the sustainability of the real estate might provide a number of indirect advantages for the core business. Firstly, certain customers of the of the business might be attracted to a superior reputation on involvement with environmental matters (Auger et al., 2003). Secondly, reputation effects of a sustainable corporate branding can lead to positive exposure in the media (Fombrun et al. 1990). And lastly, an empirical study by Bassen et al. (2006) revealed that businesses with a high level of responsibility concerning environmental and social issues can notice a positive effect on their credit ratings.

The lack of objective, independent data regarding to the effect of numerator changes to improve the labour productivity urges corporate real estate managers to translate the investments in cost per unit. Since numerator improvements require up front investments and returns often show in the future, these improvements are often paired with denominator improvements (cost reduction). The combination of investing in the future with immediate cost reduction makes it easier for corporate real estate managers to sell these changes to the management of the organisation. But since the leverage effect between the initial investment and the desired productivity level gains is estimated to be around a factor 9, it proves to be an important argument to invest in a productivity increasing work environment (Groenen et al., 2011).

Denominator improvements

Firstly, a cost reduction can also be interpreted as the aversion of negative financial consequences of real estate. As described earlier in this chapter and in chapter 3, new IFRS lease accounting regulations will demand that businesses put the entire cashflow of their lease on the financial balance per 2015. This will likely have a negative impact on their operating results, financial ratios, and potentially their debt covenants (PWC, 2010; Schelle & Baltussen, 2013). From this point of view, it would be favourable for businesses to engage in shorter leases and put the net lease price on the balance instead of leasing for a longer period and a higher gross lease price compensated with incentives.

Secondly, the reduction of operating expenses of real estate can be achieved by minimising service costs. Service costs are the expenses of services made by the lessor, which are in turn redistributed to the tenant according to the ratio of the leased space to the total office space. This includes amongst others gas, electricity, water, telecom and property management. Tenants wish for these costs to be made transparent by the lessor, but in search of reducing these costs also seek sustainable building solutions such as more efficient lightning, or better building insulation (Verkerk, 2012; Lindholm et al., 2006).

Thirdly, a reduction of costs can be achieved as well with the adaptation of the New Way of Working. The direct results make this a popular way of increasing the business result on the short term. First of all, by encouraging employees to work from home and allowing flexible desk usage at the office, a company can decrease the need for office space. A decreased occupancy rate in turn can be a reason to downsize the amount of leased office space, significantly saving on office accommodation costs. According to CBRE, who offers advice on office accommodation to both tenants and owners, the highest occupation peak in traditional office concepts is 70%, and even lower if temporary desk vacancy is taken into account, as seen in figure 5.6 (Rietmeijer et al, 2011). This assumes the company does not employ flexible desk

Workplace occupancy per day, including temporary desk vacancy

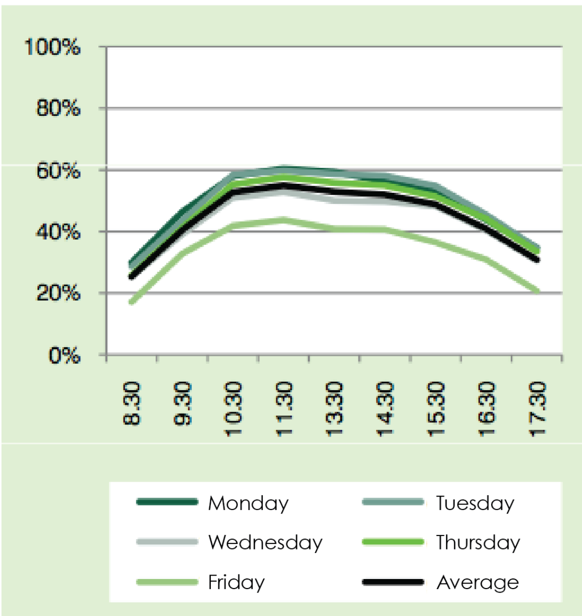


Figure 5.6 Desk occupation of a company with a traditional office. Source: Rietmeyer et al. (2011)

use, and the traditional office means closed rooms and assigned desks. The potential space usage would improve from 20-25 square meters per employee to 9-18 square meters. For a company looking to reduce housing costs, this offers a considerable reduction. It should be noted that this potential reduction is highly dependable on the type of business performed. Another way of saving on real estate costs is to merge various offices into one big office. In doing this the company can profit from scale advantages. (Baane, Houtkamp & Knotter, 2010).

Resume

The Dutch tenant in 2013 faces economic decline, tightening regulations and a shrinking pool of talented employees. Real estate can contribute to the core business of the firm by pursuit of wealth maximisation for the shareholders. This chapter discussed what factors are in play for the tenant reconsidering their position on real estate, answering the research question *[sub4]* posed in the beginning of this chapter: *What factors are involved in the decision process of the tenant with regard to the search for office space?*

As illustrated in figure 5.7, there are two types of considerations involved in pursuit of using the real estate to create added value for the business: numerator considerations and denominator considerations.

Tenant's perspective on the lease of real estate

Findings from the literature study

	DENOMINATOR CONSIDERATIONS
Length of lease agreement	Prefers a short lease to increase the flexibility of real estate expenses and to prevent having to put it on the financial balance due to the IFRS regulation.
Lease price & incentives	Prefers a lease price that reflects the market value of the asset, since this is the price that has to be put on the financial balance due to the IFRS regulation.
Service Costs	Strives to reduce the operational costs of real estate, and therefore seeks to reduce the service costs.
	NUMERATOR CONSIDERATIONS
Sustainability	Potential to contribute to corporate branding and adhere to Corporate Social Responsibility.
New Way of Working	Potential to improve productivity, attract new talent, increase the efficiency of the use of office space by means of implementing The New Way of Working.
Additional Amenities	Potential to improve interaction on the office floor and support a balanced relation between work and life. This requires the presence of additional amenities.
	OTHER CONSIDERATIONS
Tenant relations	Values direct communications with the lessor in order to express concerns or complaints, but also to discuss possibilities concerning the real estate.

Figure 5.7 Summary of the findings from literature about how the tenant approaches the organisational and financial mismatch with the REMO

Denominator considerations strive to reduce the operational cost of the real estate, therefore increasing the profitability of the business. These considerations are tangible and can usually be measured by the degree to which they reduce the cost of the real estate. Numerator considerations, on the other hand, strive to use the real estate to create additional revenue for the company by means of e.g. increasing productivity, employee satisfaction, or creating opportunities to increase communication. These considerations are often intangible and are hard to translate directly to added value for the company.

The literature study revealed three types of denominator considerations that have a direct relation with the REMO on the supply side. These are the reduction of the length of the lease, the reduction of the height of the lease cost per square meter and finally the minimisations of service costs. These focus solely on reducing costs.

Next, there are three types of numerator considerations that the literature study revealed that have a relation with the considerations of the REMO. These are the improvement of the sustainability of the real estate, the adaptation to new office concepts such as the New Way of Working and the provision of additional supportive amenities. These considerations focus on a wide array of improvements that are not necessarily tangible in their contribution to creating additional revenue for the business. Examples are: to attract new talent, to improve productivity, to increase the efficiency of the use office space and to increase employee satisfaction. It should be noted that considerations under the New Way of Working can add both numerator value as denominator value. This would explain its popularity in current market.

Lastly, the literature study reveals that tenants prefer a more direct communication with the lessor in order to express concerns or complaints. Direct communication is also appreciated in discussing the business' considerations pertaining to the real estate. Insufficient communication might contribute to a mismatch, lowering the satisfaction of the tenant with its current real estate position.

The future brings a more demanding tenant

Up until the beginning of the 21st century, the Dutch office market was largely driven by financial investments and new developments. During this period the influence of the tenant was limited. However, in the light of an increasing vacancy level and decreasing prices, the tables seem to have turned. When the predicted decrease of the demand for office space as examined in chapter 3 is taken into account, it seems that this tenant-dominated market is likely to continue for at least a couple of years. This further strengthens the position of the tenant in the negotiations for office space.

Apart from focusing on the reduction of the operational cost of the real estate, corporate real estate managers are staring to see the advantages of less tangible contributions of the real estate to the value of the business. Therefor, it is essential for the owner of real estate (and the REMO managing it) to look beyond the core services they have been used to provide.

The next chapter will combine the findings of this chapter with that of the previous, verifying its assumptions with findings of interviews with both REMOs and tenants, thus shaping a more complete outline of the (mis)match between the tenant and the real estate management organization.

Chapter 6: Empirical data collection

The literature study in the previous chapters has addressed a number of reasons for the current qualitative mismatch on the Dutch office market. First by examining the characteristics of the office market in The Netherlands in chapter 2, the developments that currently help shape the market in chapter 3, and the different perspectives inherent to the supply and demand of office space in chapters 4 and 5 (see figure 6.1). The differences in organisational and financial perspectives on office space suggest that there might be grounds for a disconnect due to the changing role real estate plays for businesses and a lag in the reaction and professionalisation from the suppliers of office real estate. To assess whether these findings correctly represent the current situation on the Dutch office market and lay bare the essential characteristics of this mismatch, these findings have been tested in practise by means of qualitative, explorative research in the form of interviews.

First, the findings from the literature study are addressed, as described in the last two chapters. The comparison of the viewpoints of the REMO and the tenant on office space are used to create a theoretical basis of grounds for a potential mismatch. The chapter then describes how this theoretical basis is used to conduct an empirical study which has tested these initial findings in practice. Subsequently it addresses the type of respondents and the way in which the interview has been operationalised. Finally, it discusses the results of the interview and compare it to the initial findings from the literature study.

This chapter is guided by the following research question:
How does the theory of this mismatch manifest itself in practice and what improvements can be made by the REMO to address the current mismatch on the office market?

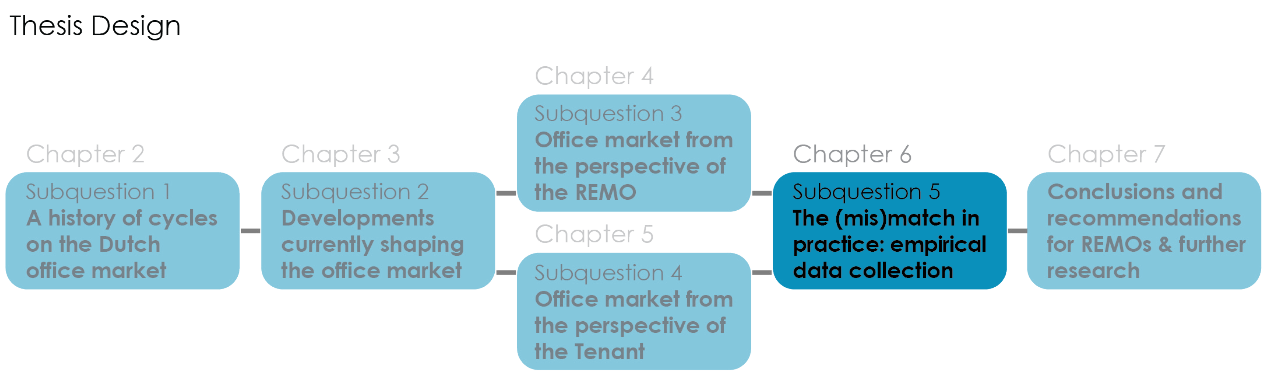


Figure 6.1 The thesis design

Findings from the literature study

The literature study aimed to find common grounds between the REMO and the tenant on which the interests are, or might be, opposed. Since both the fields of the asset market and the space market are continuously evolving, it was only possible to reason from their respective business goals concerning the real estate. The result is nine topics (as seen in figure 6.2) on which there is either a suspected mismatch, or plausible grounds for a mismatch.

Grounds for a (mis)match between the REMO and the Tenant

Findings from the literature study

	The REMO		The Tenant
Length of the lease agreement	Prefers a long lease to ensure the future cash flow, reducing the risk of investment and increasing the asset value.	X	Prefers a short lease to increase the flexibility of real estate expenses and to prevent having to put it on the financial balance due to the IFRS regulation.
Gross lease price & incentives	Prefers a high gross lease price per square meter to ensure high returns and a high asset value. Financial incentives are used to approach the market value.	X	Prefers a lease price that reflects the market value of the asset, since this is the price that has to be put on the financial balance due to the IFRS regulation.
Indexation of the lease price	Wishes to retain this essential premise of real estate investments in order to safeguard it from inflation.	?	No information available from the literature.
Sustainability	In order to increase competitiveness of the image of the building, the REMO can invest in a more sustainable building.	?	Potential to contribute to corporate branding and adhere to Corporate Social Responsibility.
Service Costs	In order to ncrease the financial competitiveness of the office space, the REMO can reduce the tenant's total real estate cost by reducing service costs.	?	Strives to reduce the operational costs of real estate, and therefore seeks to reduce the service costs.
New Way of Working	In order to facilitate the changing use of office space, the REMO can proactively meet the tenant's demand in adapting to new office concepts.	?	Potential to improve productivity, attract new talent, increase the efficiency of the use of office space by means of implementing The New Way of Working.
Additional Amenities	In order to compensate for lack of amenities on the location of the office building, the REMO can provide these in the office building.	?	Potential to improve interaction on the office floor and support a balanced relation between work and life. This requires the presence of additional amenities.
Tenant relations	Prefers to outsource property management (including tenant relationship management) to increase effectivity and reduce cost.	X	Values direct communications with the lessor in order to express concerns or complaints, but also to discuss possibilities concerning the real estate.
Diversification of the services provided by the REMO	In order to differentiate the building in the level of services offered, the REMO can offer new services: e.g. security, catering, telecom.	?	No information available from the literature.

X Suspected Mismatch

? Match Unknown

Figure 6.2 Grounds for a potential (mis)match between supply and demand, based on the literature study, as conducted in chapter 4 and 5.

The length of the lease agreement seems to be under pressure. Ideally, the REMO prefers to sign long lease contracts with its tenants. This guarantees future cashflow for the investor (therefore reducing the risk of the investment), and plays and important role in the valuation of the building. The tenant, on the other hand, faces rapid changes in its business in the aftermath of the 2008 economic crisis. With pressure from stakeholders to increase revenues and an increase in competition, it prefers the flexibility of shorter leases to be able to adapt their lease to their real estate needs. On top of this, new IFRS Lease Accounting regulation makes it favourable to put shorter leases on the financial balance sheet. These opposing interests are reason to suspect a mismatch.

Similar to the length of the lease contract, the height of the lease price is an important factor in the valuation of the office building. A higher lease price also implicates a higher cashflow. This is important for the REMO to safeguard the value of the investment and the yearly returns. But in the light of an oversupply of office space and a rising vacancy level, market mechanics of supply and demand lower the price of the office space. To meet the market value REMOs do not decrease the lease price, but instead offer financial incentives to the tenant. This keeps the lease price high, which is beneficial to the valuation of the asset and the yearly indexation of the lease price. For tenants this implicates a more opaque market, where the worth of the office space is not entirely clear anymore. While the incentives might offer flexibility in the allocation of company resources, it also means a seemingly higher commitment on the balance sheet, which is unfavourable in the light of the new IFRS Lease Accounting regulation. These opposing interests are reason to suspect a mismatch.

The yearly indexation of the lease price corrects the lease price for the devaluation of money due to inflation. Since this ‘protection from inflation’ is a core quality of investment in real estate, REMOs will prefer to protect this clause in the lease contract. Especially in view of the current macro-economic situation in Europe, which might lead to an increase in inflation in the next few years. While existing literature did not reveal any information how this affects the real estate decisions of the tenant, it is not strange to think that the tenant might, for similar reasons, not want to carry the risk of a rapidly increasing lease price. It is still uncertain whether this might be grounds for a mismatch.

The sustainability of an office building can be a powerful marketing tool for the REMO. For the tenant, it can be relevant for company branding or play a role in achieving certain targets of its Corporate Social Responsibility program. Aside from the tangible benefits associated with a reduced energy consumption, there can be many reasons for a tenant to prefer a sustainable building. It is not known whether this plays an important role in the tenant’s decision process regarding its real estate considerations and is therefore still uncertain whether this might be grounds for a mismatch.

Next to the costs associated with the lease of office space, a considerable part of the tenant’s real estate expenses are comprised of the service costs. In distinguishing itself (financially) from its competition, the REMO can invest in the efficiency or sustainability of the office building in order to reduce the service costs for the tenant. The degree in which the tenant expects the REMO to involve itself in lowering the service costs and the willingness of the REMO to do so can possibly conflict, but it is still uncertain whether this might be grounds for a mismatch.

With the concept of the New Way of Working gaining popularity, professional services firms offer a wide range of advice for both suppliers and tenants of office space. For REMOs this is a chance to approach the tenant in its considerations regarding the office space, and distinguish the potential of its real estate from the rest. For tenants this innovation in use of the office space offers the potential of contributing in various ways, both tangible and intangible, to the wealth maximisation of the company. It is still uncertain whether this might be grounds for a mismatch.

In order to distinguish its office space from the competition, the REMO can provide additional amenities in its office building which are not provided by the immediate surroundings of the building. This can increase the satisfaction of the tenant, and potentially aid in its adaption of new work concepts. The degree in which the REMO is willing to invest in additional amenities might affect a possible (mis)match with the expectations of the tenant, but it is still uncertain whether this might be grounds for a mismatch.

Recent available literature suggests that a majority of the REMOs outsource (a part of) the operational activities to an external REMO. Scale advantages reduce the costs involved, and allows the REMO to better focus on it's core business on the tactical and strategical level. This puts a third party between the REMO and the tenant, while the literature also indicates that tenants favour direct contact with the owner of the real estate. This provides the grounds to suspect that there is a mismatch.

One growth strategy for external REMOs suggests the diversification of the services it offers to the tenants to increase its spread its activities. These new services are not part of the core business of the REMO, but might help increase the satisfaction of the tenant with its REMO. Since there is no information available about the want for the increase or diversification of the services of the REMO by the tenant, it is still uncertain whether this might be grounds for a mismatch.

These findings from the literature study do not necessarily reflect the reality of the contemporary office market, and will therefore be tested in practice. This is done by means of interviews with respondents representing either the REMO or the tenant.

Explorative interviews

In order to assess if and in what way the organisational/financial mismatch between the REMO and the tenant manifests itself, additional data is gathered from practice by conducting interviews on both sides. Firstly, it is established whether the findings from the literature study are representative for the current situation on the office market. Secondly, it probes whether these potential grounds for a mismatch are complete and if there might be other factors that need to be included. The goal of the research is to acquire a better understanding of how owners approach the demand for office space in a highly competitive market with rising vacancy levels, but also to acquire an understanding in the way their approach answers the changing demands of the tenant seeking to lease (its current, or new) office space. The research compares the results from the interviews to those of the literature findings and offers a first overview of the premier mismatches between the tenant and the REMO. This overview can be used by REMOs to assess what areas might need attention in order to better reach out to the tenant.

The reason why interviews were chosen to gather additional data is because the potential mismatch between the REMO and the tenant is for a large part based on attitude and emotion. While the interview is based on concrete topics, the importance and weight of them are often partly subjective. Since these factors cannot be perceived by observation and are difficult to attain by means of a survey, the chosen form of data accumulation is the interview. Face-to-face interviews allow the respondent to ask for clarification and is preferred when soliciting information that can be sensitive. In order to encourage the respondents to speak their mind without having to think about the sensitivity of the information, all interviews have been anonymised.

The method of data collection is semi-structured. While the literature study provided a number of topics on which the potential mismatch can manifest itself, it is not yet clear whether these offer a complete overview. To prevent the exclusion of topics that have not been uncovered, the interview is conducted in an open-ended manner which leaves room for new information, but is structured enough to allow for comparisons to be made between the two groups. The respondents are first asked about their view on the mismatch, and encouraged to tell their own story. When their story touches one of the topics from the literature study, the interviewer will respond with some targeted, in-depth questions. The interview guide is attached as Appendix A.

Respondents

To analyse the mismatch between supply and demand on the office space market, two groups of respondents have been interviewed. The first type are the REMOs managing the office building. These respondents represent the supply of office real estate and view the relation between their office space and the demand for it from the financial perspective of the asset markets. The second type are the businesses that already rent or seek to rent office space, the (potential) tenants of office buildings. These respondents represent the demand for office real estate and view the relation between their real estate needs and the available supply of office space from the user perspective on the space market. Commercial office brokers have been included in this last group of respondents, since these represent large groups of tenants in their search for office space. This allows them not only to convey the perspective of a larger group of tenants, but their expertise also allows them to relate these perspectives to that of the REMO.

Due to the limited resources available for this research, most respondents were contacted by making use of the researcher's personal network and referrals through these initial respondents. In selecting these referrals, the researcher used the knowledge of the respondents to find new respondents with a distinct, unique or firm opinion to diversify the results.

A total of ten respondents have been interviewed, five on the side of the REMOs and five on the side of the tenants. The requirement for the REMO respondents was that they were responsible on the tactical level or higher. The requirement for the tenant respondents was that they were either responsible or involved with the decisions concerning the lease of office space on both an organisational as well as the financial level, or an advising party that is informed on these levels representing the tenant. The

Professional titles of the respondents

The REMO	The Tenant
Asset Manager	Commercial Real Estate Broker
Asset Manager	Commercial Real Estate Broker
Asset Manager	Commercial Real Estate Broker
Asset Manager	Corporate Real Estate Manager
Chief Operational Officer	Corporate Real Estate Manager

Figure 6.3 The professional titles of the respondents interviewed for this research

professional job titles of the parties that have been interviewed are listed in figure 6.3.

Operationalisation

The interviews were structured in three parts. At the start of the interview, the interviewer started with an introduction of the subject and asked the respondent about his job function and responsibilities. Following the introduction, the respondent was asked to express his opinion/view on the mismatch between the REMO and the tenant. The third part of the interview addressed the topics that resulted from the literature study. These nine topics (as seen in figure 6.2) were phrased as nine targeted questions. The nature and amount of questions were susceptible to a slight degree of change, learning from the opinions expressed in the interviews. This allowed for topics that had not been uncovered in the literature study to be taken up in the rest of the interviews. With one new topic uncovered in the second interview, there were a total of 10 targeted questions (see Appendix A). This new topic is the 4th targeted question: The changing role of the general provisions of the lease contract. It was attempted to interweave these questions in the flow of the conversation as much as possible.

Interview outline:
- **I** General questions (job description, responsibilities) & introduction of the subject
- **II** Explorative questions gauging the opinion/view of the respondent
- **III** Targeted questions on the topics from the literature study

After the interview, a summary was sent to the respondent to verify whether the statements recorded by the interviewer correctly represented their opinion. These summaries have been included, anonymised, in Appendix B.

Interview results

This section contains the analysis of the results from the interviews. The responses from both interview groups on the 10 targeted questions are summarised per topic, reflecting the total range of opinions acquired in the interviews. Every topic contains three paragraphs. First, the responses of both the REMOs and the tenants are summarised separately. In the last paragraph these are compared to both each other as the initial assumptions from the literature study. Here is is also determined whether there is, based on the available information, reason to believe that there is a match or mismatch on these topics between the REMO and the tenant. With this information, the comparison made from the literature study (figure 6.2) is updated to more correctly represent current situation on the Dutch office market and provide suggestions for a preferred course of action for the REMO.

[1] Length of the lease contract

From the perspective of the REMO managing the office building there seems to be consensus that the majority of the tenants still wish to engage in long leases, with a minimum of 5 years. These long leases allow for the negotiation of better deals (higher discounts), and provide the tenant with the security of a location to conduct their business. Also, the impact of moving to a new location is quite disruptive for the business processes, posing a barrier for the tenant in the consideration to move. The REMOs generally attribute the shift towards shorter leases to a want for flexibility and the limitation of financial obligations. This is a consequence of operational insecurities in businesses since the economical recession in 2008, as well as the high degree of competition of price and quality of office space on the market due to the current oversupply. This want for shorter leases applies mostly to small to medium sized businesses, as well as to satellite offices of larger businesses. The stance of the REMO in regard to the office lease is for the largest part dependable on the type of investor behind it; institutional investors focus on asset value (which requires long leases), while private investors focus on cash flow (which requires a steady lease income, but not long leases). The tools the REMO uses to negotiate longer leases are financial incentives and flexibility in the lease by means of break options, allowing the tenant to terminate the contract at a fixed date, possibly against a break penalty.

Amongst tenants and their representatives there seems to be a greater variety in opinions about the nature of the shift towards shorter lease lengths. A majority seems to still believe in the financial benefits of longer leases, and prefer renegotiation of the current lease due to an aversion to the implications to moving to a new location. The exception is when the building can no longer sufficiently accommodate the business or when the service level of the REMO is not satisfactory. One respondent mentions he sees a trend amongst tenants that the flexibility of a shorter lease outweighs the lower lease price a longer lease can negotiate. Two of the respondents interviewed state that the length of the commitment is not so much the issue, but the flexibility that is allowed to grow, shrink or end (a part of) the lease. One recurring factor is that foreign businesses tend to lease for a much shorter period of time, usually under five years.

The assumption made in the literature study that tenants want shorter leases seems to be more nuanced in practice. It seems that most of all flexibility of the lease contract is key in finding a match, where the business can either grow or shrink in the size of the leased office space. Tenants state that this flexibility is still inadequately addressed by REMOs, therefore there is a mismatch between the two parties. Interesting to note is that neither side is either aware, nor sees any visible indication of any implications of the new IFRS Lease Accounting regulations.

[2] Height of the gross lease price and the use of financial incentives

High gross lease prices are favourable to REMOs for two major reasons. Firstly, the valuation of the asset value is for a large part determined on the height of the gross lease price. While financial incentives can be seen taken into account in current valuations, a lack of transparency in the supplied incentives can still have a large effect on valuations. Secondly, the yearly indexation of the lease price is determined on the gross lease price, resulting into a large difference in successive yearly rental increases between gross and net lease prices, making the use of incentives favourable as higher gross lease prices lead to a more rapidly increasing rental income. REMOs perceive that a large group of tenants favour the use of financial incentives for two reasons: firstly to use the financial flexibility to cover expenses involved in moving or making modifications to the fit-out of the office space. Secondly, the financial incentives have become a tool in the negotiation process in which a tenant can measure how good the negotiated deal is. A high lease price with a high incentive (effectively a discount) seems like a better deal than the same net lease price without the use of incentives. While there seems consensus that the use of incentives and the associated lack of transparency will have to drop to some degree, the role of incentives is larger than merely retaining a higher ‘artificial’ lease price level. As was also the case with the length of the lease, private investors are more quickly inclined to drop towards a net rent level since their prime concern, as opposed to the institutional investor, is primarily cash flow. All note that the value of incentives varies greatly per tenant.

All tenants and tenant representing brokers indicate that they prefer the transparency of a net lease price, and that the decisive factor is the net financial obligations of the lease. While the financial incentives are useful for financial flexibility in investments and spread of payments concerning the real estate, this mostly is only a decisive factor for smaller to medium sized businesses. Interesting to note is that the brokers see that incentives have a degree of emotional value in the negotiations, while the tenants do not see that this applies to them. Also, the fee of the brokers is often a prenegotiated percentage of the yearly rent, which means they have a steak in upholding the use of incentives and retaining high gross lease prices.

The assumption from the literature study that tenants demand a more transparent, net lease price seems not true. While transparency is preferred by both groups, the final lease obligations are most important to the tenant. The use of incentives seems actually preferred by small to medium sized businesses to create flexibility in allocating its financial resources. The use of incentives is an intrinsic characteristic of negotiations on the Dutch space market, and while not necessarily preferred, poses no mismatch between the REMO and the tenant. Once again, the upcoming change in IFRS Lease Accounting regulations does not play any role in the consideration of lease contracts right now.

3. Yearly indexation of the rent

The REMOs are unanimous in agreeing that the indexation of the rent and the coupled protection against inflation is the essence of what makes investments in real estate interesting, its “premier Unique Selling Point” to quote one REMO. They are adamant in protecting this part of the lease contract as best as possible. While not every REMO experiences the capping of the indexation as a trend amongst its tenants, some experience that for an increasing group of tenants this point is a dealbreaker in the negotiation of the contract.

The interviews with the tenants and brokers revealed similar findings as with the REMOs. There is no unanimous stance about the weight of the yearly indexation of the rent. Most tenants focus on the length of the lease contract and the height of the negotiated financial incentives, and take this clause for granted. It is usually the external advisors (such as brokers) that point out this fact to the tenant.

The yearly indexation does not seem to be of large consequence in the current lease negotiation process between the REMO and the tenant. But with the risk of higher inflation levels, it does increasingly beget more awareness amongst tenants and their advisors. On these grounds it can be concluded that this topic does not currently pose a mismatch between the REMO and the tenant, but has a risk of becoming one when the level of inflation increases.

4. The changing role of the general provisions of the lease contract (“Algemene bepalingen”)

There is a mixed attitude found amongst REMOs about the standard 2003 ROZ Lease Contract. Some acknowledge it is written in favour of the lessor, others think of it as fairly neutral but shielding the lessor from certain risks. All of the respondents see an increase in exceptions demanded by the tenant in the negotiation of the lease contract. While all respondents in this group acknowledge that an increasing amount of time is spent discussing these provisions, none of the respondents regard these discussions as a barrier in negotiating a deal.

All tenants and brokers are unanimous that the standard 2003 ROZ Lease Contract is predominantly lessor oriented. It is regarded as old, outdated and not very customer (tenant) oriented. The interviewed parties indicate it is not so much a barrier in the negotiation process, but more so an example of an old attitude of the lessors towards their tenants. The increasing amount of exceptions in the general provisions can be perceived as a shift of power towards the tenants in the negotiation process, as an effect of a demand-driven market.

While there seems to be a disagreement between the two groups about the partiality of the standard 2003 ROZ Lease Contract in favour of the lessor, it does not weigh heavily in the negotiation process. More so, it has become a negotiation tool where concessions are made on both sides in finding a balanced agreement. While it does not prove to be grounds for an important mismatch between the two groups, it does require attention of the REMO in order to provide a more customer friendly approach toward its (potential) tenant.

5. Sustainability
All REMOs perceive that there is an increased relevance amongst tenants regarding to the non-cost related aspects of sustainability. However, none of the respondents have the experience that a tenant is willing to pay extra for a more sustainable building and that sustainability remains a cost issue, except when sustainability is linked to the tenant's core business. One REMOs survey amongst its tenants concluded that sustainability is usually part of the company policy and that it is likely to influence the tenant's choices (in real estate) in the future, but not in the next five years. All REMOs state they are willing to invest in a more sustainable building, but usually in combination with the negotiation of a lease extension.

The tenants and brokers state that sustainability does play a role in the search to lease office space, but is usually for a large part subordinate to the financial cost reduction it implies. The level of expectation about the sustainability has increased in the last couple of years and buildings have to meet higher standards than 10 years ago. The tenants interviewed regard the sustainability of the building in a wider sense than merely energy related and state that sustainable solution should in the long run never be more expensive than an unsustainable solution. Tenants expect an open dialogue with the REMO to discuss any expectations regarding sustainability.

While expectations of the sustainability of the building seems to be of increasing relevance for the tenant, few are willing to pay more for it. The minimum requirements the tenant expects of the building seem to slowly rise, but it is of no major consequence in negotiating a lease contract. REMOs are expected to focus on this area, but it does not prove to be a ground for a mismatch between the two parties.

6. Service costs
The respondents from the REMOs state that the reduction of service costs is predominantly a cost issue for tenants, that has increased in popularity in the last few years. The bare minimum the REMOs are expected to provide is a transparent break-down of these costs, but a majority of the respondents admit that is often not enough anymore. There seems to be a great diversity in opinions, however, in how to further meet the demands of the tenant. Some state that service cost reducing investments have to be made and that tenants are willing to accept a higher lease price. Others contest this and state that tenants believe this is for a large part a financial burden for the lessor. Two of the REMOs state that sharing the responsibility of keeping the service costs low by capping the height of it is a good way to approach the tenant. There seems to be willingness to approach the tenant on this topic, but the difficulty in finding a good way to finance it and the fear of losses can prevent the REMOs from executing their intentions.

Tenants and brokers find the willingness itself to tackle service costs is rarely an issue, both on the side of the lessor as the tenant. The issue is always the cost associated with it. The respondents state that transparency of these additional charges is essential in order to see if they are fair and if cost reductions can be made. All the brokers expect major changes to take place on this issue: more detailed and demanding Service Level Agreements, capped service costs and the lessor sharing the risk of the costs associated with these.

The importance of addressing the height of the service costs is regarded as highly important in the relation between the REMO and the tenant. Since it seems that most REMOs already spend time and resources in increasing their competitiveness on this front, it does require increasing attention but does not pose immediate grounds to suspect a mismatch.

7. The role of the New Way of Working
The REMOs state that there is a strong need to play a more active and more personal role in meeting the wishes of the tenant in order to remain competitive; providing visualisations is a great way to show new tenants the potential of the office buildings. But one of the larger issues in adapting the NewWoW in existing buildings is the capacity of the existing environmental control systems. When you increase the occupancy of your workspace, the output of the machines also needs to go up. When maximum capacity is not enough, the lessor cannot meet the tenant's demands on that area. One respondent states to a lesser extent important to inform the tenants of the possibilities of new work concepts, but it is most important to accommodate their adaptation(s) in order to make sure they are satisfied with their current lease.

Between the brokers and the corporate real estate managers, there seems to be a discrepancy in convictions about the role of the NewWoW. The brokers state that tenants are usually convinced this concept promotes interaction between employees, increases productivity and provides a more open structure in the business which allows employees to work more flexibly. But primarily, the driving force always seems to be a financial one of short-term cost reduction, the respondents state. Most tenants that currently seek to lease office space already have fewer employees than at the start of their previous lease, and adapt this new office concept to further reduce the amount of needed office space. After implementation, the brokers seem to agree, a large amount of companies see some downsides of the implementation. The interviewed corporate real estate managers, however, were very positive about the increased interaction, the higher quality of amenities and the efficiency of space usage. Both brokers and tenant agree that is expected of the lessor to be open for discussion about changes to the real estate to accommodate the NewWoW.

Based on the interviews with both groups, it can be concluded that REMOs are expected to be flexible in accommodating the tenant in adapting to the New Way of Working. It requires attention, but it does not provide grounds to believe that there is a mismatch between the two groups.

8. Additional amenities
The respondents of the REMOs agree that there is more emphasis on facilitating additional amenities in the building, especially if the location of the office building does not already accommodate these. It is stressed that there is no one-size-fits-all approach in providing additional amenities. Usually these types of amenities (e.g. a restaurant) are quite costly to build and maintain, so there usually are also costs involved for the tenant. The accommodation of central conference rooms is usually a little different since it enables the tenant to exclude this space from his leased office space, allowing it to be used for

different purposes. A lot of these investments are only possible in large buildings to keep the costs per square meter low. In order to make the office building more appealing REMOs see the need to invest in the appearance of the entrance and the reception area. These investments have to be justified in some way, so are usually not executed without the reasonable expectation to acquire a new lease or extend a sitting tenant.

The tenants and brokers state that additional amenities are in most cases a plus. External mutual amenities are assets for a tenant, because they can be used from a cost reduction perspective. If a tenant has a shareholders meeting twice a year, but otherwise does not use a big conference room, it doesn't want to allocate office space for this. Lessors can therefore increase the competitive edge of the office space by providing these. The type of amenities are very dependant on the type of business, but should in any way contribute more than merely from a utilitarian point of view. A restaurant should offer a positive experience that leaves employees with a good feeling. Although lessors have shown an increasing amount of initiative on this front, the investments associated with adding these amenities usually don't fit in the lessor's budget. While the lessor will not always be able to meet the wishes of the tenants, it is important that they show an active interest in their well-being. Also, the costs associated with these amenities should be entirely transparent.

Based on the input from both groups, there seems to be no ground for an immediate mismatch. Tenants appreciate it if the REMO is proactive in offering additional amenities, but the costs associated should be transparent and the participation should not be obligatory. The danger in providing these amenities lies in the cost efficiency of the investment. The tenants expect these amenities to make a positive contribution to the experience of the office building, instead of the pure utilitarian function of the amenity.

9. Relationship between lessor-lease (and the Property Manager in between)
REMOs have come to the realisation that a more proactive role of the asset manager is imperative to reach new tenants in a competitive market. Direct, personal contact with the tenants and having detailed knowledge of the market (instead of through middle-man parties such as the property manager or broker) is essential. One of the most important factors in the satisfaction of the tenant is the processing of complaints. Three out of the five respondents state that this is the reason to have taken property management in-house after having it outsourced for a long time. Also, the cost of external property management is not always cheaper than to do it in-house, at least for larger portfolios. Another important reason to keep property management in the same company as the asset management is that internal communication can lead to innovative initiatives. One REMO respondent states that while the relationship management with the tenant gets increased attention from the Asset Management level, there are still certain benefits to outsourcing the Property Management. For example, it allows to separate the lessor from association with complaints on an property management level.

Both the tenants and brokers state that tenants appreciate short communication lines with their lessor, and quick and concise responses. The distinction between Asset Management (lessor) and Property Management (operational management) is usually blurry and can be confusing for the tenant, since it is not always clear which party can respond the best to a certain issue. Respondents state that most tenants would rather stay than move to a different location. Moving is expensive and disrupts company processes, while sometimes it is inevitable. Tenants ask of their lessor for more communication than the obligations as recorded in the lease contract. This is a key area for improvement for the lessor. Usually the tenant is only approached by the lessor at the end of the lease contract to negotiate an extension.

One tenant states that it would not accept an additional (external) property manager between it and the lessor. The additional barrier it raises slows down the decision process and further weakens the relationship with the tenant. With already sparse contact concerning the real estate, the tenant states, this approach seems highly impersonal and not befitting of a good lessor-tenant relationship.

While the three out of five REMOs state that they value a more personal interaction with the tenant and keep active contact with their tenants, all of the respondents on the side of the tenants respond that the perceived communication with their lessor is either inadequate or barely existent. The tenants wish to actively discuss their thoughts and concerns pertaining to their real estate needs with the REMO. This provides the grounds to believe that there is a mismatch between the two groups.

10. Diversification of the services provided by the lessor
There is a broad range of views amongst the REMOs on providing additional services to the tenant. Since work is increasingly seen as interwoven with personal life, one REMO states that the office building should accommodate a sense of place and belonging: Engaging building entrances, styling of interior, catering, security and meeting places are examples of these 'services'. The new generation of tenants would rather have these demands met over a stripped-down lease package with the lowest possible lease price. Another REMO respondent believes that tenants appreciate any services that relieve the tenant of responsibilities (e.g. security). Another REMO respondent claims that no additional services are offered to the tenant, but that it is willing to consider offering them if approached by the tenant.

There is a also a broad range of views amongst the tenants on this topic. One broker states that in his experience most tenants expect a well maintained building with a preferably stripped down level of services; maximum quality for a minimum price. Two brokers acknowledge that extra services by the lessor would be an asset for the tenant, however mostly for small to medium sized tenants. One tenant states it would be greatly appreciated if the lessor would proactively offer services that would benefit the company. These services should be optional and transparent in cost.

While the provision of additional services is received positively amongst tenants, it does not seem to play an important role in their real estate decisions. There is no reason to suspect a mismatch between the two groups based on the information gathered from the interviews.

Resume
With the findings from the literature study tested in practice, the initial assumptions can be updated to more accurately reflect whether there are any organisational/financial mismatches between the REMO and the tenant. This chapter aimed to answer the last sub-question of this research: [5] *How does this mismatch manifest itself in practice and what improvements can be made by the REMO to address the current mismatch on the office market?*

Instead of listing the interests of both groups, as was done in figure 6.2, the findings from the interviews are summarised in a way that offers a clear classification of the importance of the topics for the match between the two groups (see figure 6.4). Firstly, there are topics where the most important mismatches occur. Next, it also shows which topics do not provide grounds for a mismatch but do require the continuing attention of the REMO in approaching the real estate requirements of the tenant. Lastly, it classifies the topics in which no mismatch is found in the interviews and which do not seem to weigh heavily in the tenant's real estate decisions.

Recommendations for REMOs in increasing the match with tenants

Findings from practice

		Recommendations
Length of the lease agreement	✗	Tenants primarily seek flexibility of office space to accommodate growth or shrinkage of the business. Lease contracts inadequately address this need right now, therefore it would be prudent for REMOs to increase their focus on this topic.
Gross lease price & incentives	🟢	While the height of the lease price is key in the negotiation process, tenants do not seem to value net lease prices over gross lease prices and incentives. There seems no need for the REMO to focus on net lease prices to reach the tenant.
Indexation of the lease price	🟠	Currently, the indexation of the lease price is often regarded as a given part of the lease contract. However, if the level of inflation threathens to increase, tenants will want to share the risks involved. The REMO should anticipate this development.
General Provisions in ROZ Lease Contract	🟢	There is a disagreement between the REMOs and the tenants about the partiality of the standard ROZ contract. While it does not weigh heaviliy in the tenant's considerations, the REMO could benefit from a more customer friendly approach.
Sustainability	🟢	While the considerations of the tenant regarding the sustainability of the office space seem to increase in relevance, the weight of these do not seem to play a great role in the tenant's decision process. A low degree of attention is however advised.
Service Costs	🟠	The importance of addressing the height of the service costs is regarded as highly important in the relationship with the tenant. It would be beneficial to the match with the tenant to keep addressing this topic with a high degree of attention.
New Way of Working	🟠	Tenants expect the REMO to be flexible in accommodating their aspirations in adapting new work concepts. While the interviews did not provide grounds to suspect a mismatch, proactive participation of the REMO seems required.
Additional Amenities	🟠	Tenants appreciate the provision of additional amenities, if the associated costs are transparent and participation is not compulsory. These amenities can greatly contribute to the pros of an office building, which can increase the match.
Tenant relations	✗	The need for direct communication with the REMO is regarded as very important by tenants, and is often not adequately met. Therefore this contributes to a mismatch, which should be addressed by the REMO to better meet the tenant's demands.
Diversification of the services provided by the REMO	🟢	While the provision of additional services might be appreciated by the tenant, there seems to be no indication this plays an important role in the decision process concerning the real estate.

✗ Mismatch, requires immediate attention

🟠 No mismatch, requires high degree of attention

🟢 No mismatch, requires low degree of attention

Figure 6.4 Grounds for a potential (mis)match between supply and demand, based on the findings from the interviews with REMOs and tenants.

The two topics on which the interviews found grounds to suspect a mismatch are the length of the lease contract and the degree of communication between the REMO and the tenant. The first lays bare an insufficient response of the REMO in addressing the need for flexibility in the tenant's business. The REMO employs financial incentives to negotiate longer leases. The tenant also wishes to negotiate a lower lease price, but often finds long leases to be lacking the flexibility to accommodate growth or shrinkage of the real estate needs. The second mismatch is related to the first. An important wish of the tenant is to communicate any real estate needs directly with the owner (in this case the REMO). Where the literature indicates that communication for a majority of the REMOs happens through a third party, the external REMO, this creates a barrier between it and the tenant.

Then there are four topics on which the REMO can expect a mismatch to occur if neglected: the indexation of the lease price, service costs, the NewWoW, and the provision of additional amenities. Based on the opinions expressed in the interviews, it is advisable for REMOs to spend a high degree of attention on these in order to better meet the tenant's needs concerning their real estate.

The last four topics - the gross/net lease price, the general provisions, the focus on sustainability and the provision of additional services by the REMO - are not inconsequential to the match between the REMO and the tenant, but the findings from the interviews do not suggest that these play a crucial role in the tenant's decision process. While the literature study findings suspected a mismatch to occur on the heigh of the lease price, this revealed not to be an issue yet. It is suspected that the anticipated impact of the new IFRS Lease Accounting regulation has not found its way to the market yet. It is advised for REMOs to excel in these four areas in order to distinguish their office space from the competition.

With both the data gathered from the literature and the data gathered from practice, it is now possible to answer the main research question. The next chapter elaborates on answering all five research questions in order to provide this answer, evaluate the research and provide recommendations for further research.

Discussion

The REMOs seem to be slowly adapting to the changing demands of the tenant. They are moving out of their core business towards focus areas that are directed to increase the the competitiveness of the buildings as well as the satisfaction of the tenant. But there is one curious finding from the interviews that should be noted. While the literature study pointed towards a mismatch between the artificially high, opaque lease prices of the supply and a wish of the tenant for transparency on the market, the interviews did not indicate that there was a mismatch. The use of financial incentives seems so ingrained in the way lease contract are negotiated that while everyone agrees that the office market would benefit from more transperency, no-one really sees the need to reduce usage of these incentives. The REMOs use the artificially high lease prices to beget higher valuations, the tenants employ the incentives to bargain for a better deal and to create financial flexibility in resource allocation, and the brokers usually have their fees based on the artificially high gross lease prices. All parties involved benefit from these incentives, but at the same time the respondents unanimously agree that the market would benefit from an increase in transparency. Investigating this stalemate would contribute in creating a healthier market.

Chapter 7: Conclusions & Recommendations

The status quo on the Dutch office market is one of oversupply and increasing vacancy levels. In order to pave a path towards a new equilibrium, this research had the goal to contribute by investigating an assumed qualitative mismatch between supply and demand. Both findings from theory and practice have been used to explain why mismatches occur in the first place, how recent developments shape the current qualitative mismatch, and how the different perspectives from supply and demand contribute to this mismatch. As seen in the conceptual model used to guide this thesis (figure 7.1), the previous chapters have covered these areas and its conclusions will be addressed in this chapter. These conclusions will pave the way to answer the following central research question:

What current organisational and financial developments contribute to a qualitative mismatch between supply and demand on the Dutch office market and what improvements can be made by Real Estate Management Organisations to better meet the changing demands of the tenant?

After the research question has been answered, both the accomplishments and the shortcomings of the research are addressed. Then, a number of recommendations for stakeholders are proposed, and finally recommendations for further research are made.

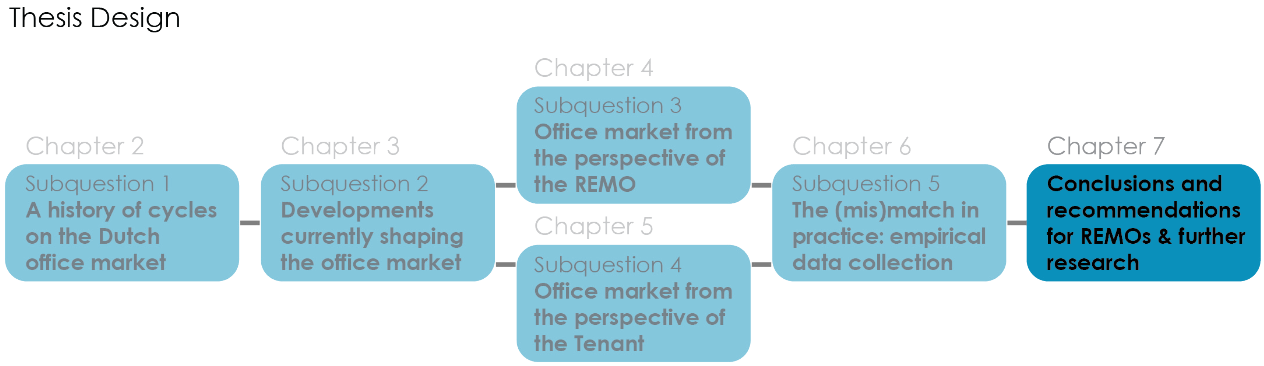


Figure 7.1 The thesis design

Conclusions

The office market in The Netherlands has steadily grown over the past 60 years. This long period of growth can be attributed to an increase in demand under influence of a number of strong growth drivers. The presence of vacancy on itself seems no reason to worry, since it was found that it is a natural characteristic of office markets to show a cyclical behaviour of rising and declining vacancy levels. This quantitative mismatch exists due to a lag between supply and demand, caused by the long time that is required between the start of a development and the time the office space enters the market. The height of the current office vacancy (15.4%) does not indicate a healthy market, but at the same time does not appear to be unprecedented. As such, an increased vacancy level is not necessarily a need to worry. While natural behaviour of supply and demand usually steers the vacancy levels back towards an equilibrium, the status quo on the market does not show any signs of this corrective behaviour. In the last two cycles on the office market, vacancy levels have been persistently increasing. New office buildings are still being developed in an already vacancy riddled market. So besides a quantitative mismatch, there also a qualitative mismatch present on the Dutch office market.

There are a number of recent developments that were found contributing at the root of this vacancy issue. On the quantitative side, the growth drivers that have provided for the long period of growth in the demand for office space are currently in decline. This has caused the demand to stop growing, and is in the short to mid-term future even suspected to dwindle. At the same time, the tenants leasing the office space are facing increasing competition and pressure from shareholders to maximise their returns in the aftermath of the 2008 economic crisis; new banking regulations pose stricter rules for borrowing capital, and new accounting regulations may potentially affect the tenant's real estate decisions. With their negotiation power increased due to the presence of an oversupply of office space, tenants have become more demanding on a qualitative level of the real estate and its owners. The tenants gradually adapt new concepts in the use of office space and the way it contributes to the business, altering their expectations of the real estate. The combination of the tenant's increased expectations of the real estate and its owner, and their drive to optimise their real estate performance, has shaped a change in demand that led to a qualitative mismatch between supply and demand.

A majority of this office space is owned by real estate investors and is managed by Real Estate Management Organisations (REMOs). The literature study provided insights in which business models are employed by these REMOs and how they respond to the increasing vacancy levels and the changing demand. These REMOs' core business is to exploit the pros and negate the cons of investing in real estate, since their clients' goals are primarily financial. For a long time this entailed trying to sign long lease contracts, retaining the protection for inflation and reducing the cost of operation. In the light of the initial vacancy, both the height of the lease price and the length of the lease were adapted to meet the tenant's demand. But in the light of the high vacancy levels and therefore dwindling returns, the REMOs are slowly becoming aware that it is necessary to increase their focus on the satisfaction of the tenant to keep them from moving to the competition. This has created a shift to non-core business responses for the REMO, addressing the needs of the tenants in order to retain their leases or to attract new tenants to the REMO's office building. Examples of these non-core business responses are: an increased focus on sustainability, a reduction of the service costs, the facilitation of new work concepts, the provision of additional amenities and services, and the improvement of tenant relations.

From the available literature it seems that tenants choose to lease office space to reduce the financial burden of ownership and increase the flexibility of their real estate. Next to this, the tenant wants to have the real estate contribute to the core business of the firm. Facing economic decline, tightening regulation, and a shrinking pool of talented employees, real estate proves to be a potent tool in pursuit of wealth maximisation for the shareholders. A distinction is made between two different ways in which the tenant can achieve this: either by increasing the profitability (reducing the cost), or by increasing the revenue of the business. The major difference is that cost reductions are very tangible, while ways of increasing revenue are often not. The costs of the real estate can be reduced by negotiating lower lease prices and reducing the additional operational service costs. At the same time there is an increased need for flexibility of the lease obligations, and a want for shorter leases and a lower (gross) lease price due to the implications of adherence to the upcoming new IFRS Lease Accounting regulations. Less tangible contributions of real estate can be found in improving the sustainability of the building, adapting to New Ways of Working and providing for apt amenities to support its business. A last consideration that needs to be mentioned is the want for close contact with the owner of the real estate, the REMO.

These assumptions from the literature study were tested in practice to see in what way the two perspectives contribute to a potential qualitative mismatch. In the interviews with REMOs and tenants, a broad range of sentiments was observed and amongst the REMOs there was a relatively great variety in opinions how to meet the tenants' demands in the current market. All parties felt the need for a more transparent office market, but at the same time did not see the road that would lead there. A strong sentiment was perceived amongst the tenants towards a want for more communication with the REMO, and more flexibility in the size and length of the lease. These two topics were found to be the two largest mismatches currently existing between the two groups and therefore pose the largest area of improvement for REMOs. Next, there are four topics on which sentiments seem to indicate that these might provide serious grounds for a potential qualitative mismatch. Most tenants expect the REMO to be an active participant in reducing the service costs, and to accommodate both their aspirations regarding New Ways of Working as well as the accommodations to support this. The last of this topic pertains to the yearly indexation of the lease price; while the REMO will want to safeguard this basic premise of the real estate investment, it can expect the tenant to want to limit the risk of higher lease costs due to a rising inflation. The last four topics that have been included in the research do not seem to pose an immediate threat for a mismatch, but do offer possibilities for the REMO to discern itself from the competition. This can be done by increasing the focus on sustainability, offering additional services to the tenant, using more transparent lease prices and increasing the customer-friendliness of the contract. What is particularly interesting amongst these last four is the transparency of the lease price, the high gross lease price + financial incentives versus a low net lease price. While one would expect tenants to favour transparency of lease prices on the market, it seems that the system of incentives has become ingrained in the way deals are negotiated. Tenants can use these incentives also as a way to increase the flexibility of cost allocation in their business. This leads to the current status quo where transparency is said to be preferred, but on the other side the use of artificially high rents and financial incentives is not shunned.

Evaluation of the research

This thesis aimed to contribute to the current vacancy debate by clarifying the nature of a potential qualitative mismatch between supply and demand on an organisational/financial level. This is just a small part of the answer in the grander scheme of solving the vacancy issue. While a large part of the solution will likely have to come from removal of office space from the total office stock, it is important to keep the supply attuned to the demand in order for the natural corrective forces of supply and demand to work. The research performed in this thesis has shown that the size of the demand is expected to shrink short to mid-term, which means that the quantitative mismatch between supply and demand will not easily correct itself. It has also shown that there are a number of factors at play in shaping a qualitative mismatch. Its contribution to solving the current vacancy debate has come in the form of a list of topics that describe where a Real Estate Management Organisation can improve to better meet the tenant's demand. This hopes to reduce the need for new office space that does meet the tenant's demand, which would further impair the vacancy issue.

There are a number of limitations and shortcomings to the research that should be noted. Firstly, since there are many factors in play in the tenant's decision process, but also in the complexity of the management of the REMO. This research does not pretend to have provided a complete and final overview of all the topics on which both parties might have opposing or conflicting interests. These interests tend to be very specific and sometimes unique to for example the building, or the business of the tenant. This list has been largely shaped by the literature the researcher was able to find, refined by the conducted interviews in practice. Secondly, while the list can be used as an indicator for REMOs where areas of potential mismatches can be found, the findings are based on an explorative research amongst a relatively small sample group. With the availability of more time and resources, it might prove to be useful to conduct this interview with a larger sample group, so that the entire populations of REMOs and tenants are better reflected. New topics might be uncovered on which the grounds might be found for a mismatch. With a larger sample size, it would be interesting to discern certain characteristics between the interviewed parties, such as: the size of the business, the type of business of the tenant, the type of investor behind the REMO, etc. This way, a quantitative analysis can be performed to draw more objective conclusions. Lastly, this research can only contribute to awareness and not change the way the real estate is actually managed. The REMO has to justify its performance to the investor, and will therefore always be bound by financial targets. In the face of intangible contributions to returns, it might be hard to justify large investments in the non-core business. This remains an internal debate between the REMO and the investor.

Recommendations for stakeholders

Based on the results of both the literature study and the interviews, there are several recommendations for REMOs that might contribute to achieving a better match with the tenant.

The first recommendation is to make sure there is clear communication with the tenants in which they can express their considerations concerning their real estate position. The primary complaint heard during the interviews was that tenants often only see the owners a year before the end of the lease. If tenants are not entirely satisfied with their current lease, there is a big chance that they are already looking around on the market for a lease that better fits their real estate needs. Perhaps tenants are entirely unaware that they can increase or decrease the amount of space leased in their current contract, or that the owner has another building in ownership that could better meet the tenant's needs. Secondly, the tenant appreciates direct contact with the owner. When there is an external property management company handling the tenant relations, this often raises an additional barrier in communicating the tenant's expectations with the owner. Overall, when tenants have a good relation with the REMO and if clear communication is present, they are less likely to consider terminating their lease at the end of the contract.

The second recommendation is to focus on the want of the tenant for flexibility. This flexibility can for example be found in the length of the lease contract, or in offering the possibility for growing or shrinking the amount of leased space in the middle of the contract. Of course, a smaller lease can be offset with a longer lease commitment. The flexibility can also be found in a commitment to increase the sustainability of the building or the authorisation to build an internal staircase if the tenant requests it. The central theme here is that the contemporary tenant does not want to hear that something is impossible, the REMO is expected to proactively help the tenant in finding solutions to its real estate considerations.

The last recommendation is to innovate and think from the perspective of the tenant. If tenants are convinced that the lessor is involved in their well-being, they will be less prone to move. A good example is the focus on reducing the service costs. This is not per se directly the core business of the REMO, but it can increase their office building's competitive edge by lowering the total real estate expense of the tenant. Innovation is key in addressing the intangible contributions the real estate can pose for the tenant to contribute to its business.

Hopefully, these recommendations can contribute to decreasing the qualitative mismatch that exists between supply and demand. While the issue of the high vacancy cannot be solved by merely reducing this mismatch, it is one of many solutions that together pave the way to tackling the vacancy problem.

Recommendations for further research

This research attempted to lay a basis for the discussion about a qualitative mismatch between the supply and demand on the Dutch office market, from the perspective of organisational differences and financial motives.

One recommendation for further research would be to investigate the distinction in REMOs working for institutional investors, for private equity investors or for private investors. These have different financial goals and risk profiles, causing the REMOs working for them to also have different views on the approach of the demands of the tenant. In the interviews it came to light that the REMO working for a private equity investor focused more on the cashflow instead of the asset value on which the REMO working for the institutional investor focuses. This allows for different degrees of flexibility on for example the length of the lease contract.

Another recommendation for further research is to investigate how the economic crises since 2008 and the rising vacancy levels have affected the outsourcing of a part of the REMO's management activities to an external party. Broker firms are increasingly offering services that include management tasks on the tactical level, but also facility management to the tenant. It would be interesting to investigate the opportunities, as well as potential conflicts of interest that might arise when both the tenant and the REMO are represented by the same company.

Bibliography

Aaltonen, I., Ala-Kotila, P., Järnström, H., Laarni, J., Määttä, H., Nykänen, E., Schembri, I., Lönnqvist, A., Ruostela, J., Laihonen, H., Jääs-keläinen, A., Oyue, J. & Nagy, G. (2012). *New Ways of Working: State-of-the-Art Report on Knowledge Work.* Espoo, (FI): VTT Technical Research Centre of Finland.

Auger, P., Burke, P. Devinney, T.M. & Louviere, J.J. (2003). What will consumers pay for social product features? *Journal of Business Ethics*, *42* (3), 281-304.

Baane, R., Houtkamp P., & Knotter, M. (2010). *Het nieuwe werken ontrafeld: Over Bricks, Bytes & Behavior.* Assen (NL): Koninklijke Van Gorcum.

Baarda, D.M & De Goede, M.P.M. (2006). *Basisboek Methoden en Technieken: Handleiding voor het opzetten en uitvoeren van kwantitatief onderzoek.* Groningen (NL): Wolters-Noordhoff.

Bak, R.L. (2006). *Kantoren in cijfers 2005 : statistiek van de Nederlandse kantorenmarkt* (4th edition). Amsterdam (NL): CB Richard Ellis Amsterdam.

Bak, R.L. (2012). *Stand van zaken Nederlandse Kantorenmarkt.* Nieuwegein (NL): NVM Data & Research.

Basel Committee on Banking Supervision (2010). *Basel III: A global regulatory framework for more resilient banks and banking systems.* Basel (CH): Bank for International Settlements.

Bassen, A., Meyer, K., Schlange, J. (2006). *The Influence of Corporate Responsibility on the Cost of Capital: An Empirical Analysis.* Hamburg (DE): Universität Hamburg.

Batenburg, R.S. & van der Voordt, T.J.M. (2008, June). *Do facilities matter? The influence of facility satisfaction on perceived productivity of office employees.* European Facility Management Conference, Manchester, England.

Beimer, J. (2010). *The Dutch Office Market up to 2015.* Hoevelaken (NL): Bouwfonds REIM Research.

Beukering, C.A.J. van (2008). *Vastgoedmanagement: een integrale en systematische benadering voor effectief en efficient vastgoedmanagement.* Den Haag (NL): SDU uitgevers.

Boelens, A. & van der Valk, J. (2004). *Vrouwen op de arbeidsmarkt.* Den Haag (NL): Centraal Bureau voor de Statistiek.

Brown, M.G., Teernstra, T. (2008). Examining investor perceptions of obsolescence and value through a behavioural economics lens. *Journal of European Real Estate Research*, *1* (3), 267-290.

Brunes, F. (2007). *Overbuilding in office markets: Are behavioural aspects important?* Stockholm (SE): Royal Institute of Technology.

CBS (2010). *Tempo vergrijzing loopt op.* Retreived September 27, 2012 from http://www.cbs.nl/nl-NL/menu/themas/bevolking/publicaties/artikelen/archief/2010/2010-083-pb.htm

CBS (2012). *Kernprognose 2011-2060: iets lagere bevolkingsgroei op korte termijn.* Retreived September 27, 2012 from http://www.cbs.nl/nl-NL/menu/themas/bevolking/publicaties/bevolkingstrends/archief/2012/2012-08-bt-kernprognose-2011-20160.htm

CBS (2012). *The total active labour force in the Netherlands, divided by gender.* Retreived on September 25th, 2012 from: http://www.cbs.nl/nl-NL/menu/themas/dossiers/historische-reeksen/publicaties/artikelen/archief/2011/2011-beroepsbevolking-vanaf-1800-art.htm

CPB (2012). *Kantorenmarkt in historisch en toekomstig perspectief.* Den Haag (NL): Centraal Planbureau.

De Waard, P. (2012, February 4). DNB ziet zeepbel op kantorenmarkt. *De Volkskrant.*

Di Martino, V. & Wirth, L. (1990). Telework: A new way of working and living. *International Labour Review, 129* (5), 529-554.

DiPasquale, D. & Wheaton, W.C. (1992). The Markets for Real Estate Assets and Space: A Conceptual FrameWork. *Real Estate Economics, 20* (1), 181-197.

Driel van, A. (2010). *Strategische inzet van vastgoed: over duurzaam beleid en management.* Nieuwegein (NL): Arko uitgeverij B.V.

Duffy, F. & Tanis, J. (1993). A Vision of the New Workplace. *Site Selection magazine, 162* (2), 1-6.

EIB (2012). *Landelijke samenvatting kantorenmonitor: verkenning van regionale vraag- en aanbodontwikkelingen.* Amsterdam (NL): Economisch Instituut voor de Bouw.

Eurostat (2009). *Economic growth and office employment in The Netherlands.* Retreived September 27th, 2012 from: http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/

Fombrun, C. & Shanley, M. (1990). What's in a name? Reputation building and corporate strategy. *Academy of Management Journal, 33* (2), 233-258.

Gates, B. (2005). *The New World of Work.* Retrieved June 7, 2012 from http://www.microsoft.com/mscorp/execmail/2005/05-19newworldofwork.mspx

Gelink, S. & Zeeland, H.H. van (2010). *TransformatieWijzer : van kantoor naar woonruimte : perspectief, financienen, regelgeving.* Rotterdam (NL): SBR.

Geltner, D.M., Miller, N.M. (2001). *Commercial Real Estate Analysis and Investments.* Mason, Ohio (USA): Thomson Learning.

Goesten, M.F.H. (2007). *Outsourcing van assetmanagement : een theoretisch en empirisch onderzoek naar de voorwaarden voor extern assetmanagement.* (Master's thesis) Amsterdam (NL): Amsterdam School of Real Estate.

Gool, P. van, Brounen, D., Jager, P. & Weisz, R. (2007). *Onroerend goed als belegging* (4th edition). Houten (NL): Noordhoff Uitgevers.

Groenen, P.J.M., Appel-Meulenbroek, H.A.J.A. & Janssen, I.I. (2011). Van delegeren naar leren luisteren. *Real Estate Magazine, 14* (74), 41-45.

Grunt, J.S.G. de (2001). *De Balance Scorecard binnen de vastgoed asset management organisatie: van strategie naar actie.* (Master's thesis) Eindhoven (NL): Technische Universiteit Eindhoven.

Ham, E.R. van den (1996). *Sectorstudie kantoorhoudende dienstverlening.* Petten (NL): Stichting NEEDIS.

Houtveen, H.J. (2002). *Upgraden, renoveren of herontwikkelen van kantoren. Het proces en de organisatiemodellen* (Master's thesis). Amsterdam (NL): Amsterdam University.

Janssen, I.I. (2008). *Kansen voor het vastgoedmanagement.* Nieuwegein (NL): NVM Vastgoedmanagement.

Jennen, M. & Moll, M. (2009). Office market dynamics. *Real Estate Research Quarterly, 8* (1), 26-32.

Jones Lang LaSalle (2010). *Duurzaam Gebruikersonderzoek 2010.* Place of publication unknown: Jones Lang LaSalle

Jones Lang LaSalle (2012, Februari). *Office Service Charge Analysis Report 2012: Nederlandse benchmark boor servicekosten van kantoren.* Place of publication unknown: Jones Lang LaSalle.

Joroff, M., Louargand, M., Lambert, S. & Becker, F. (1993). *Strategic management of the fifth resource: Corporate Real Estate.* Norcross, GA (USA): Industrial Development Research Foundation.

Just, T. & Morawski, J. (2011). *Europe's office markets: Rent cycles weakening.* Frankfurt am Main: Deutsche Bank Research.

Kooijman, J. (2012, April 26). Als de kantoren ooit nog iets opleveren, leven wij al niet meer. *Financieel Dagblad.*

Kooiman, J., Wolzak, M. (2012, May 4). Prijsvechters in vastgoed. *Financieel Dagblad.*

Kotler, P. (1988). *Marketing Management; analyis, planning, implementation and control* (sixth edition). New Jersey (USA): Prentice-Hall.

Krumm, P.J.M.M. (2001). History of real estate management from a corporate perspective. *Facilities*, *19* (4), 276-286.

Kuipers, M.C. (2012). *Een kwalitatief onderzoek naar de adoptie van Groene Gebouwen* (Master's Thesis). Amsterdam, NL: Amsterdam School of Real Estate.

Lindholm, A.-L., Gibler, K.M. & Leväinen, K.I. (2006). Modeling the Value-Adding Attributes of Real Estate to the Wealth Maximization of the Firm. *Journal of Real Estate Research, 28* (4), 445-475.

Muijsson, M.A. (2010). *Incentives op de kantorenmarkt: kan het niet anders?* (Master's thesis). Amsterdam (NL): Amsterdam School of Real Estate

Poelman, B. & van Duin, C. (2010). *Bevolkingsprognose 2009-2060.* Den Haag (NL): Centraal Bureau voor de Statistiek.

PricewaterhouseCoopers (2010). *The overhaul of IFRS lease accounting: Catalyst for change in corporate real estate.* Retreived August 12, 2012 from http://pwc.com

Priem, J.J.C. (2005). *Eens een kantoorobject, altijd een kantoorobject? Operationalisering herbestemmen van structureel leegstaande kantoorobjecten* (Master's thesis). Eindhoven (NL): Eindhoven University of Technology.

Remøy, H.T. (2010). *Out of office: a study of the cause of office vacancy and transformation as a means to cope and prevent.* Amsterdam (NL): IOS Press.

RentReview (2012). *Turbulentie op de Kantorenmarkt: Kansen & Bedreigingen voor Huurders.* Amsterdam (NL): RentReview.

Rietmeijer, B., Dorscheidt, A., Folkers, P. & Wolters, M. (2011). *What users want: De invloed van Het Nieuwe Werken op de kantooromgeving.* Location of publication unknown: CBRE.

Rijksoverheid (2011). *Bouwbesluit 2012.* Staatsbladpublicatie 416.

Rijksoverheid (2013). *Minister Dijsselbloem nationaliseert SNS REAAL.* Retreived at February 6th, 2013 from: http://www.rijksoverheid.nl/documenten-en-publicaties/toespraken/2013/02/01/minister-dijsselbloem-nationaliseert-sns-reaal.html

Romijn, G. (2000). *Economic Dynamics in Dutch construction* (PhD thesis). Rotterdam (NL): Erasmus Universiteit Rotterdam.

Schelle, T. & Baltussen, S. (2013). *IFRS lease accounting impact on Corporate Real Estate Management* (Master's thesis). Eindhoven (NL): Eindhoven University of Technology.

Stickney, C. P., Weil, R. L., Schipper, K., & Ferrier, F. (2009). *Financial accounting: an introduction to concepts, methods and uses* (13th edition). Mason, OH (USA): Cengage Learning.

Toffler, A. (1980). *The third wave.* New York (USA): William Morrow.

Uittenbogaard, L.B. & Kohnstamm, D.A. (1996). *Vastgoedmanagement. De ontwikkeling van de markt voor beheerdersdiensten.* Amsterdam (NL): Stichting voor Beleggings- en Vastgoedkunde.

UWV (2012). *UWV Arbeidsmarktprognose 2012 – 2013: Met een doorkijk naar 2017*. Location of publication unknown: UWV.

Veldhoen, E. (2005). *The Art of Working.* Den Haag (NL): Academic Service .

Vermeulen, M. & Wieman, M. (2010). *Handboek Vastgoedmanagement.* Groningen (NL): Noordhoff Uitgevers.

Waals-Vos, E.A.M. (2011). *De huurder aan het woord: Over verwachtingen en kwaliteit van kantoorgebruik.* (Master's thesis) Amsterdam (NL): Amsterdam School of Real Estate.

Zuidema, M. & Van Elp, M. (2010). *Kantorenleegstand: Probleemanalyse en oplossingsrichtingen.* Amsterdam (NL): Economisch Instituut voor de Bouw.

Appendix A: Interview Guide

Thank you for taking the time to participate in this interview.

Introduction

A. Could you give a brief introduction of yourself and the nature of the function you exercise?

The purpose of this interview is to gain a better understanding of the mismatch between the lessor and the tenant of office space, solely from a organisational / financial perspective. Where the lessor usually aims to satisfy financial returns for the owner of the real estate object, the tenant employs the office space in various ways to accommodate its business. The mismatch resulting from these different perspectives between supply and demand potentially inhibits the recovery of the Dutch office market. The thesis behind this interview aims to clarify this mismatch by listing opposing interests and with this pave the way for improvement of the organisations managing the real estate object.

This interview starts with 2 explorative questions to list any mismatches that might come to mind initially. Next, a number of topics are addressed in which scientific and corporate literature find a organisational / financial mismatch between supply and demand. Afterwards, two last questions allow for reflection on this interview.

Explorative Questions

B. What kind of organisational & financial mismatches do you see or expect between the Real Estate Management Organisation (the lessor) and its premier client, the tenant (tenant)?

C. What kind of improvements do you see for the Real Estate Management Organisation (lessor) to better meet the demands of the tenant?

Targeted Questions

1. What future does your business see for the length of the lease contract and could you describe your concerns or expectations?

2. What future does your business see for the height of the gross lease price (€/m2) and the way incentives are used to approach market value and and could you describe your concerns or expectations?

3. What is your opinion on the future of the yearly indexation of the lease price with regard to rising inflation?

4. What is your experience with the changing role of the additional provisions ('Bijzondere Bepalingen') in the standard lease contract (ROZ, 2003)?

5. What role does sustainability play for your company in relation to the real estate object?

6. What expectations do you have for cooperation between the lessor and the tenant to reduce energy consumption, and therefore the service costs?

7. What role do the New Ways of Working (Het Nieuwe Werken) play in your decisions regarding the office space?

8. What role do additional amenities (such as a central restaurant, meeting rooms) play in your decisions concerning the real estate?

9. What is your opinion on the divide between property management and asset management in the Real Estate Management Organisation (lessor) and the resulting distance between the tenant and the 'owner'?

10. Should the Real Estate Management Organisation (the lessor) increase / diversify the amount of services offered to the tenant?

Final Questions

D. Are there any additional organisational/financial mismatches between lessor and lesse you can think of, or any possibilities improvements you can see on the side of the lessor?

E. Do you have any other questions / comments regarding this interview or the mismatch it focuses on?

Thank you for your time.

Michiel Janssen
Student Real Estate Management & Development
Eindhoven University of Technology (2013)

Type of respondent: *Real Estate Management Organisation (#1)*
Job description: *Asset Manager*

1. Length of the lease contract

Multinationals will keep long lease contracts for their core business, but will search for more flexibility in their satellite offices. The impact of moving - the cost of physically moving, decorating the new location and the disruption of business processes - will be too significant to make a move for a 'good deal' worthwhile. For the value of the real estate asset there is no big difference between a lease of 10 and 15 years, but shorter leases will definitely affect the capital value of the asset. Smaller tenants on the other hand will more likely be affected by the impact of the changing IFRS Lease Accounting regulations, but more importantly they are affected by economic stagnation and shorter leases provide for more (financial) flexibility. After all, if your business shrinks you might not need as much office space in a few years. Lease contract with these parties are already becoming shorter, 5 year leases seem to become more prevalent. Lease contracts under 3 years are presently not desirable for the lessor.

2. Height of the gross lease price and the use of financial incentives

As with the length of the lease, for a large part it is the smaller businesses that are affected most by shifts in price level. For larger businesses it is not as likely that the marginal benefits of a reduction on real estate costs will offset moving to a less favourable location or a lower quality building. If you look at developments like the Uni-Invest portfolio, you see office space being brought into the market at very competitive price levels. But the buildings are outdated, of mediocre quality and not in favourable locations, and one can doubt whether office space of that type is favourable for businesses considering more aspects about their real estate than just cost.

3. Yearly indexation of the rent

[This question was not yet included at the time of this interview]

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")

ROZ contract has been predominantly a lessor contract. But lately changes to the additional provisions ('Bijzondere Bepalingen') have been more frequent, with up to 20 alterations not being rare. The power of the tenant in the negotiations of the contract is becoming more obvious and this reflects in the lease contract leaning more towards the demands of the tenant.

5. Sustainability

This is predominantly a cost issue for tenants that has increased in popularity in the last few years.

6. Service costs

There are several ways in which this can be approached. The shifts most seen are 'all-inclusive lease price' or Service Level Agreements (SLA) between the lessor and the tenant. Investments by the investor in sustainable, service cost reducing solutions seem obvious - the initial investment could be paid back over time by an increased lease price for the tenant, compensated by reduced service costs - but happen rarely on the market. A solution that also happens is that external parties offer various forms energy savings (NUON / Energy Performance Contracts (EPC)) in products structured in financial leases.

7. The role of the New Way of Working

One of the larger issues in adapting the NewWoW in existing buildings is the capacity of the existing environmental control systems. When you increase the occupancy of your workspace, the output of the machines also need to go up. When maximum capacity is not enough, the lessor cannot meet the tenant's demands on that area. Furthermore, a large part of the NewWoW is about capturing talent, so the location of the building is essential. The real estate is becoming a vehicle of investing in a company's future by means of facilitating an attractive place to work for its employees.

8. Additional amenties

In my experience it is mostly multinationals that demand additional amenities. An inhouse restaurant is a costly service and only affordable for office sizes above 7,000 m^2.

9. Relationship between lessor-lease (and the Property Manager in between)

[this question was omitted due to time limitations]

10. Diversification of the services provided by the lessor

[this question was omitted due to time limitations]

X. Useability of New Office Concepts

Spaces/Regus only works in urban areas, close to public transport and various amenities, where there is a buzz. The type of small businesses these office concepts aim at seek this buzz and the flexibility these concepts offer. This is not suitable for quiet suburban areas and office parks and therefore limits the practical use of these concepts.

Type of respondent: *Real Estate Management Organisation (#2)*
Job description: *Asset Manager*

1. Length of the lease contract

The assumption that the tenant always prefers shorter leases is not entirely just. The want for shorter leases is currently driven by operational insecurities due to lower revenues in the economic crises since 2008. The want for shorter leases is lesser an accounting driven decision. Tenants like the flexibility of shorter lease contracts, but when faced with a two-way flexibility (the lessor is authorised to discontinue a lease) they tend to get nervous. Moving means additional costs and a disruption of business activities. A form of contract that finds a middle ground in this is one with a longer lease length, but with additional break options. The tenant only has to put the lease until the first break option on his balance (according to the new IFRS Lease Accounting regulations), which removes the obstacle of accounting for multiple lease years. However, using the break option results in either having to pay a break penalty or not receiving the financial incentive a lease continuation would provide.

2. Height of the gross lease price and the use of financial incentives

This is hard to make a clear statement about. For the lessor, while incentives in the form of a rent free period keep the lease price high, it is counted as vacancy in the property valuation. Incentives are a form of financial flexibility for the tenant, if you don't have to pay rent then you can invest this in your company's core business. It's a form of receiving an alternative investment. An important reason - besides IFRS implications - to choose for lower gross rents is that it is affected to a lesser degree by yearly indexation. While incentives will continue to be used, both the height of the (gross) lease price as the height of the incentives will drop, upholding more or less the same net price level.

3. Yearly indexation of the rent

Another important mismatch on the market is more macro-economical in nature. Real Estate has been a popular investment vehicle that veers with inflations, since the rents are subject to yearly indexation. However, an increasing amount of contracts with new tenants demand that this indexation is capped. To illustrate this with an example: the indexation up to 2.5% is for the tenant, between 2.5%-4% is part for the tenant and part for the owner and the inflation over 4% is entirely for the cost of the owner. The tenant demands this clause to prevent large yearly increases in rent in the face of economic decline. This is understandable, but changes the nature of the investment on the asset market. Arguably, this can decline the popularity of office real estate as investments.

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")

[This question was not yet included at the time of this interview]

5. Sustainability

This is predominantly a cost issue, unless the core business of the tenant is related to e.g. energy or sustainability.

6. Service costs

In theory this would be a good idea, in practice it never happens. In negotiations the tenant will find he is paying for the investment, even though the investor carries the risk initially. Even though the tenant wouldn't have to pay more than his regular service cost payments, since the building upgrade is also a benefit for the investor the tenant will demand a shared investment. This leaves the investor less willing to invest. When the vacancy levels return to lower levels and the bargaining power of the investor increases again, then this might become an option.

7. The role of the New Way of Working

The owner is forced to play a more active and more personal role in meeting the wishes of the tenant in order to remain competitive. Some tenants are familiar with the extent of the possibilities of the NewWoW, some are not. While upfront investments like internal staircases will never be made (but can be considered as incentive), it is imperative to convince the tenant of the possibilities of the office space. The asset manager can make use of external services firms to provide custom made renderings and figures that show improvements for the tenants housing situation.

8. Additional amenties

These kinds of amenities definitely play an essential role in attracting tenants to the office building, but it is highly dependant on the location of the office space. Tenants prefer to have a broad range of amenities at close range to be able to mix personal life with business and to be able to make use of the livelihood the urban surroundings. You will find that these amenities do not play a significant role in dense urban settings with ample amenities, but where these lack it is essential for an office building to provide some basics. A restaurant is usually very desirable, meeting rooms as well but to a lesser extent since those are easily managed in-house in the tenant's office space.

9. Relationship between lessor-lease (and the Property Manager in between)

A more proactive role of the asset manager is imperative to reach new tenants in a competitive market. Direct, personal contact with the tenants and having detailed knowledge of the market (instead through middle-man parties such as the property manager or broker) is essential. You have to proactively show the potential of the building for their company and distinct yourself from your competitors.

10. Diversification of the services provided by the lessor

[this question was omitted due to time limitations]

Type of respondent: *Real Estate Management Organisation (#3)*
Job description: *Chief Operating Officer*

Central to the core business of the lessor of office space is the attitude it holds towards its tenants. The lessor should understand what keeps the tenant occupied and what it wants in regard to the lease of office space. It requires knowing the nature of the business of the tenant and proactively thinking about innovative solutions to its (real estate) issues, and remaining flexible in offering these solutions. Two main factors contribute to the satisfaction of the tenant with its real estate: an attractive building / work environment and a lessor that actively shows an interest in the tenant's satisfaction.

1. Length of the lease contract

There's only a relatively small group of tenants that really want short leases, most likely in the 5-15% range*. The flexibility of your real estate does not have to translate in a short lease, but can be met by the lessor by listening to his tenant and proactively focussing on finding solutions for any real estate issues the tenant might have. The influence of the new IFRS Lease Accounting regulations will have its impact, but is currently only seen with large listed companies.

*note: the company services mostly small to medium sized companies. The range is a gut-feeling estimation.

2. Height of the gross lease price and the use of financial incentives

Gross lease prices that approximate net prices / market value would make the market more transparent and the job of the lessor a lot easier. Since financial incentives are now usually taken into consideration in the valuation of the real estate asset, this will cease to act as barrier for the lessor to decrease the gross lease level. However, the incentives still play a strong emotional role in the negotiation process with the tenant. Having negotiated several months of rent free lease weighs more strongly than having started with a more accurate lease price to begin with.

3. Yearly indexation of the rent

This touches the core nature of real estate investments since it lets the income from the leases grow with inflation. Lessors are usually very adamant to retain this instead of seeing it capped. Although it does plays a role in the negotiations from the side of the tenant, it seems never crucial enough to make or break a deal.

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")

This is hardly a problem in the negotiations between a lessor and the tenant. It is true that in the shift towards a tenant driven space market these clauses get more attention, but they are rarely of consequence in making a deal. It is usually the broker or the legal department that bring these to attention to cover rare risks and mitigate the responsibilities that are placed with the tenant instead of at the lessor.

5. Sustainability

This is very dependant on the personal wishes of the tenant. From a survey amongst our company's tenants, the general consensus seemed that sustainability is usually part of the company policy and that it is indeed likely to influence the company's choices in the next five years. But at the same time it showed that it is usually something of later concern and it will not justify immediate investments in for example real estate.

6. Service costs

This plays an important role in the relations between the lessor and the tenant. Tenants expect nothing less than a transparent specification of the costs of which the service costs consist. Sometimes they are prepared to pay a higher lease price in return for lower service costs, in that case - permit a sufficient length of the tenant's lease - it is worthwhile to make an investment in more sustainable building equipment on behalf of the tenant.

7. The role of the New Way of Working

Most tenants already have a good idea if and how they would like to adapt to a New Way of Working and which aspects would complement their business best. Therefore, as a lessor, it is not so much important to inform the tenants of the possibilities of new work concepts, but it is most important to accommodate their adaptation(s) in order to make sure they are satisfied with their current lease. The lessor should be flexible within reasonable boundaries.

8. Additional amenties

There is no one-size-fits-all approach in providing additional amenities, it is very dependant on the building and the tenant. The key issue here is to understand the tenant and play a role in providing for the needs of the tenant. Providing a (large) conference room is one example of an amenity that would usually cost a tenant to much floor space to keep it in-house. More expensive amenities like a restaurant are only worthwhile in large buildings.

9. Relationship between lessor-lease (and the Property Manager in between)

One of the most important factors in the satisfaction of the tenant is the processing of complaints. Therefore, it is absolutely essential to keep the property management (or at least relationship management) in-house to ensure there is clear communication possible for the tenant to express their complaints, concerns and expectations. The outsourcing of these activities had increased in the days where tenants were abundant and office space in short supply, but in the current market of oversupply and scarce tenants it can be seen that these activities are once more performed in-house.

10. Diversification of the services provided by the lessor

There is an increasing demand to be perceived amongst tenants for additional 'services' by the lessor. Office buildings are expected to provide for more than merely office space. Since work is increasingly seen as interwoven with personal life, the office building should accommodate a sense of place and belonging. Engaging building entrances, styling of interior, catering, security and meeting places are examples of these 'services'. The new generation of tenants would rather have these demands met over a stripped-down lease package with the lowest possible lease price.

Type of respondent: *Real Estate Management Organisation (#4)*
Job description: *Asset Manager*

A satisfied tenant is a tenant that stays. As a lessor, we make sure to stay in touch with our tenant at least twice a year to gauge their satisfaction. We find that is primarily small things (e.g. a quick response to fixing light fixtures) contribute to the satisfaction level. A crucial factor at the side of the lessor is having the means at your disposal to be able to meet the wishes of the tenant. It can be difficult to meet all the demands, since it remains a business operation and investments have to be justifiable.

1. Length of the lease contract
The length of lease contract can be an issue in the negotiations, depending on the structure of the finances behind the real estate. If the invested capital is leveraged with capital from an external party like a bank, this external stakeholder is likely to pressure to retain longer lease contracts. There will always be tenants that will sign for long leases, which allows the negotiation for higher financial incentives. The lessor, however, has little choice but to accept tenants that wish to lease for shorter periods of time in the current market.

2. Height of the gross lease price and the use of financial incentives
Our experience is that a lot of tenants prefer to receive financial incentives. It provides some flexibility at the start of the lease, which can be used to compensate for expenses made during the move or interrupted company processes. As a lessor it is favourable to give a financial contribution that is directly invested into the building, increasing its quality. Another reason to prefer high gross lease prices and the use of incentives is that a yearly indexation based on a (higher) gross lease price results in higher lease payments.

3. Yearly indexation of the rent
The indexation of the rent is the essence of investments in real estate. Therefore, as a lessor, we try to retain this as much as possible. However, in a high vacancy market with scarcely available tenants it is inevitable to make some concessions. The indexation is more often capped than previously, and for some parties it is a deciding factor in negotiating the lease.

4. The changing role of the general provisions of the lease contract (“Algemene bepalingen”)
The current ROZ 2003 lease contract covers certain risks in the favour of the lessor in order to prevent liability in extreme situations. While some clauses might use some refinement, there is no reason to expect any grave changes. One example of a slight shift towards the tenant is the flexibility the lessor can utilise in the reinstatement obligation (“opleveringsverplichting”), so a tenant can leave the used office space ‘as is’ instead of having to remove its interior.

5. Sustainability
The premier reason for investments in sustainability is to reduce cost. While other factor may be at play, our experience is that the want for a more sustainable building / work environment is usually predominantly cost-driven.

6. Service costs

The lessor is obliged to its tenant to provide a transparent breakdown of the service costs. In order to stay competitive on the market and keep current tenants satisfied, it is also necessary to invest even though the initial investment might not be earned back over time. One type would be a direct investment in the sustainability of the building, reducing the service cost for the tenant but simultaneously upgrading quality of the building. An indirect investment is for the lessor to actively commit itself to reduce the service costs by taking a stake in the risk, for example by capping the height of the service cost. The lessor becomes responsible to keep the costs of maintaining the building low, while risk of an after charge for the tenant is eliminated. This does, however, bring forth a more intensive management.

7. The role of the New Way of Working

The lessor should facilitate the tenant in its real estate ambitions, to a certain extent. Providing visualisations of a the potential of new office concept in a building can prove to be a powerful tool in the negotiation for a deal. The lessor should facilitate, and investment on behalf of the tenant can be made as an incentive in the lease negotiation. The lessor can also raise awareness, for example in pointing out that a higher occupancy rate is often coupled with higher service costs.

8. Additional amenities

Providing additional amenities for tenants can be used to increase the satisfaction of the tenants, but also as a strategic tool to attract new ones. With current tenants we usually approach them near the end of the lease term to see if there are any wishes that can be met in negotiation with the extension of the lease.

9. Relationship between lessor-lease (and the Property Manager in between)

Both Asset Management as well as Property Management is done in-house. While once Property Management had been outsourced in order to reduce cost and focus on core activities, awareness has grown that there can be certain disadvantages to this. The more parties there are between a tenant and the lessor, the longer communication generally takes, which does not enable decisive action. Also, the cost of external property management is not always cheaper than to do it in-house, at least for larger portfolios. Another important reason to keep property management in the same company as the asset management is that internal communication can lead to innovative initiatives.

10. Diversification of the services provided by the lessor

There are no specific additional services we aim to offer as a lessor, it is usually dependant on the tenant. If one tenant for example offers services that our company may use for the portfolio of office buildings, a mutual partnership might lead to a win/win situation.

Type of respondent: *Real Estate Management Organisation (#5)*
Job description: *Asset Manager*

In order to stay competitive in the current market, lessors of office real estate need to spend more energy in approaching the tenant, intensify contact, and ask for feedback. By thinking from the perspective of the tenant the lessor can increase the tenant's satisfaction and therefore the likelihood of a continued lease.

1. Length of the lease contract

Tenants, in the face of economic uncertainty, wish to lease for shorter periods of time or include break-options in the lease contract in order to have the possibility to terminate the lease early. Financial incentives are a means for the lessor to negotiate longer lease terms.

2. Height of the gross lease price and the use of financial incentives

While it can be expected that the gross lease prices will decrease to better approximate the market value of the office space, the role of the financial incentives is larger than retaining an 'artificial' rent level, since it no longer has an effect keeping the valuation of the building artificially high. The financial incentive can be used as a tool for the lessor to negotiate a longer lease, but also plays an emotional role for the tenant in the negotiation process, where the height of the incentive might determine the success of the negotiation. In other words, a higher incentive often gives the tenant the feeling of having negotiated a better deal.

3. Yearly indexation of the rent

The capping of the indexation hardly occurs amongst our tenants. It is often external advising parties that bring up this issue, but it has never been a deal breaker in the negotiation of a lease.

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")

Exceptions and discussions in the general provisions seem to occur more often than a few years ago, and can take up a considerable amount of time in negotiating a lease. The ROZ 2003 lease contract is not so much lessor-oriented, although it does cover certain risks. While the exceptions take up time, it is by no means an obstacle in the lease negotiations.

5. Sustainability

Social responsibility, especially on the subject of sustainability, is a key value of our company and influences the way it operates. This image is not only important to us, but also to our tenants. Investments in a more sustainable building are usually offset by a higher rent or the extension of a lease. What is important is that these investments contribute to the value and competitiveness of the building.

6. Service costs

As a lessor we provide a transparent breakdown of the service costs, but tenants expect more these days. In order to prevent after-charges for the tenant, the service charges are therefore sometimes capped. This means that the lessor becomes an active stakeholder in keeping the service costs down. This shows commitment towards the tenant and increases the competitiveness of the price.

7. The role of the New Way of Working

The active participation in accommodation the New Way of Working usually happens in the process of attracting new tenants. By means of artist impressions the lessor can show the potential of the office space. Investing in these impressions is a bit of a gamble, but has shown that it can be a very potent tool to convince the tenant. Additional participation happens in dialogue with the tenant.

8. Additional amenities

A lot of tenants expect an increasing supportive quality of the office building they're housed in. Examples of this is the want for a more representative entrance, reception and meeting areas. There is also a growth in requests for central meeting rooms that can be booked on demand. While tenants realise that these extra amenities increase the cost of the lease, it also often saves money compared to organising this in-house.

9. Relationship between lessor-lease (and the Property Manager in between)

While the relationship management with the tenant gets increased attention from the Asset Management level, there are still certain benefits to outsourcing the Property Management. For example, it allows to separate the lessor from association with complaints on an property management level. Also, for smaller portfolios it is not very cost-efficient to do the Property Management in-house. On the other hand, the fee of the external property managers is based on the height of the service cost, so there is no drive to reduce these costs for the tenant. This leads to an increasing discussion whether to keep outsourcing it or insource it again. Either way, it is increasingly important for Asset Managers to personally know the tenants and keep in close contact with them to gauge their satisfaction and their real estate considerations.

10. Diversification of the services provided by the lessor

There is an increasing demand from the tenants for extra services, usually aimed to relieve the tenant of responsibilities (e.g. security) or to accommodate extra commodities (e.g. extra power meters, electrical car charger). The lessor should be flexible in accommodating extra services there should be room for investments, although there will often also be costs involved for the tenant.

Type of respondent: *Tenant (#1)*
Job description: *Corporate Real Estate Broker*

1. Length of the lease contract

On the side of the tenant the key decisive criteria for the length of the lease remains finances. Shorter contracts do provide with with a certain flexibility in the lease costs, but also mean a a lesser willingness from the side of the lessor to provide financial incentives. Most tenants are reluctant to move due to the cost of moving and the disruption of company processes. Even though other office lessors might offer attractive lease terms, a renegotiation with the present lessor at the extension of the lease is usually the most prevalent option. On the condition that the current asset still provides a satisfactory basis for the facilitation of company processes, that is. Lease lengths for larger tenants still remain long, ranging between 7-10 years but usually with a break option somewhere in the lease. There is absolutely no visible indication that tenants worry about the implications of IFRS lease accounting. As a side note, it is a curious trait of the Dutch market to consider leases longer than 5 years as a standard since foreign markets characteristically show short lease terms as the standard. In the U.S. market, for example, 5 years would be considered a long lease.
From the perspective of the lessor, there is a difference to be perceived between institutional investors and private investment firms. With the former the capital value of the asset plays a more significant role since they have to report both the returns as the asset value back to the investor, as well as having to constantly consider the exit value of the real estate object. This creates an important incentive to stick to longer leases, where possible. For private investors there is generally less worry about the capital value and a larger focus on the direct cash flow. Shorter leases are therefore not so much an issue.

2. Height of the gross lease price and the use of financial incentives

This is strongly dependant on the situation of the tenant. While some prefer financial cash incentives or rent free months to allow for flexibility in investing in their core business, others will like an overall stable lease cost. The impact of the change in IFRS Lease Accounting regulation has not found a place in this consideration yet. There is always a form of emotion present when the tenant negotiates a deal; they often know, especially in the current market, that there is a lot of flexibility in the price of the lease. The use of incentives keeps the returns of the owner opaque, leaving room for this negotiation. If the height of the price per sq.m. correctly represents the net market value of the office space (so no use of additional incentives), this would simplify things but at the same time limit the space for negotiation. Another effect of this transparency would be that comparison with similar lease objects and other tenants in the same building would become much easier, even though buildings are not always easily comparable and lease prices depend heavily on the state of the market it was negotiated in. Since brokers on the office markets usually work with fees based on the gross lease price, it would initially not be beneficial for them to encourage a shift to net lease prices since this would decrease their fee. If there would be a homogenous shift to net lease prices the fee structure can adapt itself, but this is much complexes in a heterogenous market where change happens very slow and unevenly.

3. Yearly indexation of the rent

The yearly indexation is the basis of value development in real estate. The last few decades (with these last few years as the exception) this compensation for inflation has always risen faster than the lease prices on the market have. As a result, leasing tenants saw their cost of lease increase faster than the net lease prices on the market. Renegotiating the lease price per sq.m. has therefore always been an important issue when renegotiating a lease contract at the end of the lease. From the perspective of a broker, tenants usually accept the terms of indexation as found in a lease contract, since the larger financial effects of the lease are usually found in the lease price and the incentives. The indexation of the lease price as compensation for the yearly inflation are usually processed in a price adjustment of the products or services the tenant offers to its clients. Although the pressure of increasing competition and decreasing revenues might slowly increase awareness on this matter.

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")

The regular ROZ office lease contract, drafted in 2003, is based on old standards and predominantly from the perspective and to the benefit of the lessor. Especially in the terms of accountability (Clause 11 and its subclauses) there a number of strange rules that rule in the favour of the lessor. A lot of clauses are legally in a grey area and relatively poorly defined, aiming to reduce the legal responsibility of the lessor. To name one example, according to the terms as phrased under sub clause 11.6 the tenant waivers any rights to the reduction of the lease price even in the event of an explosion, leaving the office space unusable. There is an increase in the amount of tenants that demand alterations to these general provisions before signing a lease. It is unlikely that the market can expect a tenant-based lease contract, but some small changes to the current contract can be expected.

5. Sustainability

Sustainability does play a role for the tenant seeking to lease office space, but is usually for a large part subordinate to the financial gains it implies. Exceptions are, of course, companies whose core business has some kind of affinity with sustainability.

6. Service costs

The willingness itself to tackle service costs is rarely an issue, both on the side of the lessor as the tenant. The issue is always the cost associated with it. Proactive investment from the side of the lessor, recovered from a period of increased rent; I have not see this happen yet. A large obstacle is usually the difficulty in measuring precisely what benefit can be extracted from such an investment. For example, a multi-tenant building has different tenants that lease different parts of the building, which cannot always be separately measured for energy consumption. If a break-down of service cost per tenant per square meter can be achieved, and if there is a certain reduction that can be guaranteed which would save a guaranteed set amount of money, both parties might be more willing to consider the possibilities.

7. The role of the New Way of Working

Of course, the concept of NewWoW is extremely broad and is applied for a multitude of reasons. Tenants are usually convinced it promotes interaction between employees, increases productivity and provides a more open structure in the business which allows employees to work more flexibly. But primarily, the driving force always seems to be a financial one of short-term cost reduction. From the perspective of the broker this seems like another trend, another like it that currently wins ground for example is 'Healthy Offices'. From the perspective of the tenant, it is important that the lessor proactively puts himself in the perspective of the tenant and offer willingness to cooperate in this endeavour. For the lessor this provides an additional competitive edge against his competition.

8. Additional amenties

In support of changing work concepts like the NewWoW, tenants increasingly appreciate additional amenities such as meeting points, flexible conference rooms and sometimes restaurants. External mutual amenities like these are assets for a tenant, because they can be used from a cost reduction perspective. If a tenant has a shareholders meeting twice a year, but otherwise does not use a big conference room, it doesn't want to allocate office space for this. Lessors can therefore increase the competitive edge of the office space by providing these. What is an important cultural trait of the Netherlands, is that Dutch people are generally speaking used to bring their own lunch to work. Foreign tenants will view the lack of a restaurant or lunch room a negative asset of an office building.

9. Relationship between lessor-lease (and the Property Manager in between?)

Tenants appreciate short communication lines with their lessor, and quick and concise responses. The distinction between Asset Management (lessor) and Property Management (operational management) is usually blurry and can be confusing for the tenant, since it is not always clear which party can respond the best to a certain issue. The key thing to remember is that most tenants would rather stay than move to a different location. Moving is expensive and disrupts company processes, while sometimes it is inevitable. Tenants ask of their lessor for more communication that their obligations as recorded in the lease contract. This is a key area for improvement for the lessor. They should know who their tenant is, if he's happy with the office space and what wishes he has regarding to the lease. If he requires more or less office space, the lessor should be aware of this and offer to help think about a solution. Happy tenants usually mean continued leases. A slow shift can be perceived amongst Asset Managers towards acting for the longer term. These increased tenant relations require more time, therefore it can be expected that Asset Managers will operate on smaller amounts of assets.

10. Diversification of the services provided by the lessor

The key interest of the tenant in leasing office space is a well maintained building with a preferably stripped down level of services; maximum quality for a minimum price. If a tenant would like extra services (reception, catering), the lessor is most likely not the most obvious party to facilitate these.

X. New office concepts

New office concepts such as Regus and Spaces are attractive for smaller tenants, but not so much for lessors that focus mainly on large tenants. Both Regus and Spaces do not hire based on risk, they will only lease office space on a location where they are assured of tenants or already can arrange pre-leases. Concepts like these have a lot of competition from squatting agencies that office large amounts of space for extremely low prices.

Type of respondent: *Tenant (#2)*
Job description: *Commercial Real Estate Broker*

1. Length of the lease contract

A lot of tenants favour the flexibility shorter leases offer, but the lengths of leases are as of yet not influenced in any way by the new IFRS Lease Accounting regulations (one exception might be the multinationals, who are slowly picking up on this). These shorter leases do not always have to translate directly into a shorter lease contract with the lessor; break options are often included in the contract so a tenant can end the lease prematurely at a fixed date, but can be liable to pay a break penalty. This penalty can be a cash payback, or the loss of (a part of) the initial financial incentives that were provided in the contract. Lessors accept these shorter leases, mostly because the market is dominated by the scarcity of tenant due to the amount of oversupply.

2. Height of the gross lease price and the use of financial incentives

Most tenants care primarily about the net financial obligations of the lease. While higher gross lease prices with added financial incentives can have certain benefits, in the end it does not often weigh heavily versus the height of the net lease price. Once again, there are hardly any tenants to be seen yet that include the effects of the changing IFRS Lease Accounting regulations in their decision. From the perspective of the lessor, private investors usually care about cash-flow and institutional investors about the asset value. Therefore, private investors are sooner inclined to drop their gross lease prices than institutional ones. A comparison with the UK might be interesting in this regard; the use of incentives is much less prevalent there. Therefore, gross and net lease prices are much closer to each other (if not the same) and much truer to the value of the office space on the market, veering up and down over the years instead of the more or less constant gross lease prices in The Netherlands.

3. Yearly indexation of the rent

Tenants are normally not aware of the effects of the indexation and how it can quickly increase the rent price with rising inflation. They are usually made aware by external advisors and cap the height of the indexation in the contract, or share the rent increase partially with the lessor. In a tenant driven market, this demand from the tenant is one that the lessor has to accept, even though it means that their real estate investment is not as inflation-proof as it used to be.

4. The changing role of the general provisions of the lease contract (“Algemene bepalingen”)

Even though it is strongly dependant on the wishes of the particular tenant, the amount of changes in the general provisions have been increasing in the last few years. This can be viewed as a symptom of the shift from a lessor oriented market to a tenant oriented market. Whether this might also lead from the lessor oriented (ROZ) lease contract, towards for example a tenant oriented (NVM) lease contract remains to be seen.

5. Sustainability

While sustainability plays an increasingly important role in marketing and/or corporate responsibility for tenants, they rarely wish to pay more for a more sustainable building. Tenants no longer accept buildings that are not adequately sustainable (e.g. energy label D).

6. Service costs

A trend can be seen that more and more tenants ask for a breakdown overview of the service charges in which the various components/costs are specified. They demand transparency of these additional charges in order to see if they are fair and if cost reductions can be made. An effect of this is that the use of Service Level Agreements is quickly growing. These agreements record a common understanding about the services, priorities, responsibilities and guarantees. Therefore, instead of being charged for services performed, the tenant agrees to a transparent, set amount of services performed by the lessor. In 5 years, these SLAs will probably be prevalent in most new leases.

7. The role of the New Way of Working

The decision of a tenant to utilise a form of NewWoW usually starts from a financial motive. It requires a considerable initial investment, but after the adaptation of the new office concept a tenant seems always content and hardly any show discontent with the change. The reduction in required office space, the belief in a higher productivity and the increased communication and openness on the office floor contribute to this satisfaction. The lessor can be expected to accommodate these changes by providing sufficient cooling equipment, extended access to the building and adequate park management outside office hours. Besides accommodating these needs, the lessor is also increasingly expected to proactively approach the tenants to facilitate these needs.

8. Additional amenties

The availability of additional amenities (e.g. central reception, restaurant, meeting rooms) in the office building is in essence always a plus for the tenant, if these are not provided for by the location or the tenant themselves. But the the costs associated with these amenities should be entirely transparent.

9. Relationship between lessor-lease (and the Property Manager in between)

Usually the tenant is only approached by the lessor at the end of the lease contract to negotiate an extension. The tenant, however, would like to have more interaction with the lessor than that to express its wishes, expectations and concerns. When there is an external Property Manager in between the lessor and the tenant, the tenants often regards this party as the lessor. One issue with this is that the business model of these external property management organisations is to minimise the cost of operation, which conflicts with the interest offering the high quality solutions to the tenant's needs. This outsourcing of the property management usually occurs at institutional investors, private investors tend to keep this in-house and outsource only technical management (maintenance). A lot of these external property management organisations can be seen expanding their services towards management tasks on the tactical level (asset management).

10. Diversification of the services provided by the lessor

The expansion of additional services by the lessor certainly has value, on the condition that the costs associated are transparent. From the perspective of a broker it can lately be seen that lessors offer these more. It is very rare that tenants ask for these services themselves.

Type of respondent: *Tenant (#3)*
Job description: *Commercial Real Estate Broker*

The motives in the relation and negotiations between the tenant and the lessor are predominantly driven by cost; the lessor seeks to maximise its return and the tenant wants affordable office space. But a passive approach from the side of the lessor is no longer accepted. The tenant expects more contact with its lessor than merely to renegotiate a lease extension, and therefore it demands proactive relationship management.

1. Length of the lease contract

While there will always be tenants that will sign for long lease contracts, a shift towards shorter lease lengths can be perceived in the last few years. The flexibility of a short commitment outweighs the more favourable price a longer lease can negotiate. Also, international tenants tend to lease for a much shorter time than domestic tenants.Changes in the length of the lease due to new IFRS Lease Accounting regulation are scarcely seen.

The reaction of the lessors depends on the type of investor behind it. Institutional investors have the largest presence on the Dutch office market and focus largely on the asset value of the building, since that represents the worth of the underlying investment. Therefore they will try to maintain longer leases. Private investors tend to focus on cash flow instead of asset value, and are therefore more likely to accept shorter leases.

2. Height of the gross lease price and the use of financial incentives

There is a great variety of preferences amongst tenants in regard to gross versus net lease prices. While the transparency of lease prices (net lease or market value) is greatly appreciated, financial incentives can provide for flexibility, for example in covering the expenses of moving.

The want of incentives in order to retain a high square meter lease price (and therefore a high asset value) has dimmed for lessors, since financial incentives are nowadays taken into account in valuations. However, the indexation of the lease price of high (gross) square meter prices do provide for a larger rent increase than the indexation of lower (net) lease prices, which still provides for an argument to keep using incentives.

3. Yearly indexation of the rent

The indexation of the rent is one of the foremost unique selling points of investments in real estate. While tenants increasingly want to cap this (or share the risk of higher indexations), this is not a prime concern in the negotiations of a lease contract. The biggest stress in negotiations remains at the length of the lease and the height of the lease price.

4. The changing role of the general provisions of the lease contract (“Algemene bepalingen”)

Exception to the general provisions of the lease contract have always been present in the negotiations of a lease contract. With the shift of power to the tenant in this high vacancy market, you can see that these provisions get more attention than they used to. Larger tenants usually work with a legal firm to check the contract, which will highlight the potential risks and liabilities. Since this contract has last been changed in 2003 and focussed on the lessor, one would expect some adaptations in favour of the tenant.

5. Sustainability

Sustainability seems to play an increasing role amongst tenants in the search for office space. Most tenants expect the building to meet at least an energy label of C or better. While sustainability might be an important aspect for the tenant's image, marketing or corporate social responsibility, few tenants are willing to accept considerable additional costs for improved sustainability.

6. Service costs

The costs of services provided besides the real estate itself are increasingly scrutinised by tenants leasing office space. Looking to minimise the total cost of housing, tenants expect full transparency of the service costs from the lessor, and ideally tenants also wish to annul the risk of facing an after charge. From the perspective of the broker, this area is expected to undergo significant developments. In the USA one can already see that service costs are capped in the contract and the lessor shares the risk of costs associated with these services. If a lessor succeeds in reducing the service costs or sharing the risks of these costs, this will certainly contribute to the satisfaction of the tenant and their willingness to stay/ lease.

7. The role of the New Way of Working

This certainly weighs in in the decision to lease. While adapting the business to the NewWoW can benefit the company in terms of increased communication and attracting talented new employees, the largest driver remains the reduction of needed office space and therefore reducing cost. Nine out of ten tenants has less employees than at the start of their previous lease, and further reducing the needed space by optimising its usage seems like a logical combination. In these adaptations, tenants expect the lessor to accommodate these wishes by supplying artistic impressions and/or investing in climate control and the public space.

8. Additional amenties

The want for additional (shared) facilities is very dependant on the tenant. For multi-tenant buildings the addition of a restaurant can for example be a big asset. Although lessors have shown an increasing amount of initiative on this front, the investments associated with adding these amenities usually don't fit in the lessor's budget. While the lessor will not always be able to meet the wishes of the tenants, it is important that they show an active interest in their well-being.

9. Relationship between lessor-lease (and the Property Manager in between)

It is always of utmost importance to a tenant that the lessor is an active participant in the tenant's well-being. The outsourcing of Property Management - and therefore separating the responsibilities from the Asset Management - can cause a delay in the response to the tenant's wishes and complaints, since it is not always clear which party is responsible. Uniting Property Management and Asset Management would therefore have a positive effect, whether these are both done in-house or outsourced. More intensive contact with the tenant is desirable, but also leads to higher management costs. In the end, the relation between the tenant and its lessor is definitely important, but is still subordinate to the cost aspect of the lease.

10. Diversification of the services provided by the lessor

Tenants do not per se expect additional services by the lessor; there is however a distinction to be made between small and large tenants. Small tenants preferably lease pre-equipped office space, with all the usual office amenities and services available in the building. Large tenants would rather not pay for extra services and usually have their own departments to provide for these. Their want for more lessor involvement would perhaps increase they can offer more competitive services than the tenant can. An example could be a turn-key office, although this is not seen a lot on the market.

Type of respondent: *Tenant (#4)*
Job description: *Director Workplace*

There is a total mismatch between lessors of office buildings and their tenants. Firstly, the office buildings are often seen as an investment vehicle from a spreadsheet perspective, while the connection between the lessors and their customers - the tenant - is insufficiently present. This disconnect is strange, since the tenant leasing their product is their one and only customer. One would expect a much more proactive and customer oriented approach. Secondly, the larger part of the office stock is a one-size-fits-all, while every tenant's search for office space is a set of wishes and expectations uniquely tailored to the characteristics of their company.

1. Length of the lease contract

There is a huge variety of lease lengths within the company, which is strictly dependant on the type of activity. There is no singular company strategy that could apply to the variety of activities present. Data centres can have leases up to 25 years while other types of activities might require 5 years. The foremost concern is whether the real estate can sufficiently accommodate the type of activity that takes place in it. If a tenant is satisfied with the the building and the relation with the lessor, longer leases can be financially attractive if business permits. Since the company has its roots in the USA, it is not affected by new IFRS Lease Accounting regulations.

2. Height of the gross lease price and the use of financial incentives

Net lease prices do increase the transparency of the lease, which is always favourable. But in the end it is the net amount of expenses that matters for us as tenant, and the spread of payments (by means of some form of incentives) is usually inconsequential for the lease decision.

3. Yearly indexation of the rent

This certainly plays a role in the negotiation of the lease contract. Especially in large organisations, this poses a considerable financial risk with a rising inflation. Negotiating capping this has therefore been an important aspect in our negotiations for our current lease.

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")

This is a good example of the eschewed relations between the lessor and the tenant. The provisions are all singularly beneficial for the lessor, but are not focussed on providing a service or product to its customer, the tenant. This makes it a somewhat odd tool to document the nature of the relations between a lessor and the tenant. Now that the tenant has gained power on the bargaining table it is a useful negotiation tool.

5. Sustainability

This cannot be seen separately from the decisions regarding real estate. There is certainly an energy related aspect to it (and cost reduction), but also social aspects and future oriented aspects. Unsustainable solutions are usually more expensive on the longer term. A building should not be just fit for one type of activity, but should be flexible to accommodate new uses after its current use. This would, in various ways, benefit the office market as a whole. We have a strong conviction that a more sustainable solution is not more expensive in the long run.

6. Service costs

These should be totally transparent and attuned to the expectations of the tenant. This company handles its own service costs instead of through the lessor. It allows swifter and more independent decision making and eliminates the interference of a lessor who's prime concern lies with financial returns and not (per se) with the growth and functioning of our company.

7. The role of the New Way of Working

The New Way(s) of Working is a trend often focussed merely on cost reduction, rather than on making the office space 'work' for the company. Corporate Real Estate Managers should focus how the building can contribute to creating a nice place to work, where personal life can be combined with business, where new connections can be established and which can convince new talent to work for this company instead of for the competitor. This an essential aspect of creating the right environment where new ideas can be generated that allow your business to stay ahead of the competition.

8. Additional amenities

This is a key aspect in the aforementioned role of the real estate. The type of amenities are very dependant on the type of business, but should in any way contribute more than merely from a utilitarian point of view. A restaurant should offer a positive experience that leaves employees with a good feeling instead; a coffee bar should impress with a barista and good quality coffee instead of cheap coffee. When lessors facilitate amenities, it should add to the experience of working in a stimulating office environment.

9. Relationship between lessor-lease (and the Property Manager in between)

This company would not accept an additional (external) property manager between it and the lessor. The additional barrier it raises slows down the decision process and further weakens the relationship with the tenant. As a tenant you expect more contact with the lessor than merely to negotiate a lease extension. With already sparse contact concerning the real estate, this approach seems highly impersonal and onto befitting of a good lessor-tenant relationship.

10. Diversification of the services provided by the lessor

This is certainly an asset. Any proactive suggestions would be appreciated if it is of benefit to our company and would potentially increase satisfaction with the current lease.

Type of respondent: *Tenant (#5)*
Job title: *Corporate Real Estate Manager*

A key improvement area for lessors/owners of office buildings is to think on the long term instead of the short term. The key focus should be to keep the tenant satisfied, thinking beyond the walls of the office building. A satisfied tenant will stay longer, and if the current space no longer meets the tenant's requirements it will likelier enter a lease with the same lessor, where possible.

1. Length of the lease contract
This depends on the type of the market. In mature markets such as Western Europe we prefer long leases; it provides both security of location and the possibility to negotiate better deals. A crucial factor in long leases is that there is some degree of flexibility towards the size of the space. Over the years, it has to be able to accommodate growth as well as decline. Break options in the contract that facilitate this flexibility play an important role in this. In less mature markets the business may grow or shrink rapidly, therefore we would lease for shorter periods of time.

2. Height of the gross lease price and the use of financial incentives
The use of incentives is the way the game on the space market is currently played. The use of incentives has its benefits, but it prevents the market from becoming more transparent. Financial incentives in the form of a contribution to the fit-out can for example be very beneficial for the tenant. One consequence of a high gross lease price is that the power in the negotiation at the end of the lease is placed at the lessor. This is because the renegotiation price level (the gross lease price) is much higher than the net lease payments that have been paid. Since the lessor is aware of the cost of moving, this will put the tenant at a disadvantage. The use of incentives is maintained by the want to upkeep the asset value and the fee structures of brokers. This whole system can go two ways: either the whole system has to change, or we continue along the current path.

3. Yearly indexation of the rent
This is not a prime concern for us in the negotiation of a deal. Real estate is only a small part of our total expenses (~2%), and therefore the impact of the indexation on the lease price is not of primary concern. We value that this is an important aspect of the deal for the lessor, but it is of subordinate concern compared to other factors in play in the lease negotiation.

4. The changing role of the general provisions of the lease contract ("Algemene bepalingen")
The general provisions reflect the nature of the standard ROZ 2003 Lease Contract. It is focused singularly at the lessor; it documents legal obligations for the tenants, but not does not stress any added value about its relation to the lessor or the real estate. Small businesses often do not have the know-how what the possibilities are and what aspects are open for negotiation, so they either follow the advice of their advisor or accept the contract as-is. Larger businesses like ours often draft their own lease contracts, putting more emphasis on the rights of the tenant and the obligations of the lessor. In this tension area, there is a big role for external advisor such as brokers to devise custom tailored contract instead of the standard ROZ contract that is used currently.

5. Sustainability

There is emphasis on sustainability to an extent that our company expects the building to meet a certain level of quality (for example a minimum requirement of energy label C). This follows partly from the Corporate Social Responsibility of our program, as well as the simple fact that more sustainable buildings usually require less operating costs. This conventional form of sustainability does receive attention, but is not a goal on itself. What is more important is that the way of working is sustainable. For example, with the application of the New Way of Working our employees drive a considerably smaller amount of kilometres, resulting in lower carbon emissions, more efficient space use, and happier employees due to a better life/work balance. Another example would be closing down a part of the office during lower occupancy (summer holidays), shutting down the lighting and turning down the capacity of the cooling installations.

6. Service costs

The most important aspect of the service costs is that the budget is predictable, no tenant will be charmed with high additional charges at the end of the year. While lessors often offer a breakdown of service costs, complete transparency seems very hard to attain in practice. A detailed Service Level Agreement could play a role in better defining improving the transparency of made costs. Capping the service costs would create certainty about the height of the costs (which is preferred), but this also leaves very little room for negotiation in asking for a higher level of service.

7. The role of the New Way of Working

Lessors should be prepared to invest in their tenant. Of course, it is entirely justified they ask for something in return (e.g. a longer lease or a higher lease price), but it is essential that there is a dialogue. A lessor that states that something cannot be done or that he does not wish to cooperate (perhaps because it is time consuming) makes a capital error. Being prepared to co-operate and offering clarity about the possibilities is what we as a tenant expect from them. Our company has very specific wishes in relation to the New Way of Working and therefore did not ask for active involvement of the lessor.

8. Additional amenities

Due to the size of our company we are mostly self-supporting when it comes to amenities such as a restaurant, meeting places, conference rooms, etc. When a lessor provides these types of services, our experience is that they will often be standard solutions that do not add quality to the experience that these amenities can offer.

9. Relationship between lessor-lease (and the Property Manager in between)

The most important things in this relationship are that there should be clarity which party to address for which type of issues and a swift response to queries and/or complaints. In theory there are numerous third party contacts through which the official queries should go, however in practice we have the direct contact information of the people that can solve the problem and they seek approval with the right party. Having the property manager in-house with the lessor would remove these barriers and would therefore be preferred.

10. Diversification of the services provided by the lessor

As with the amenities, our company seeks high quality services that are not the core business of a lessor. Therefore, it is not expected that the lessor actively offers additional services.

Notes: