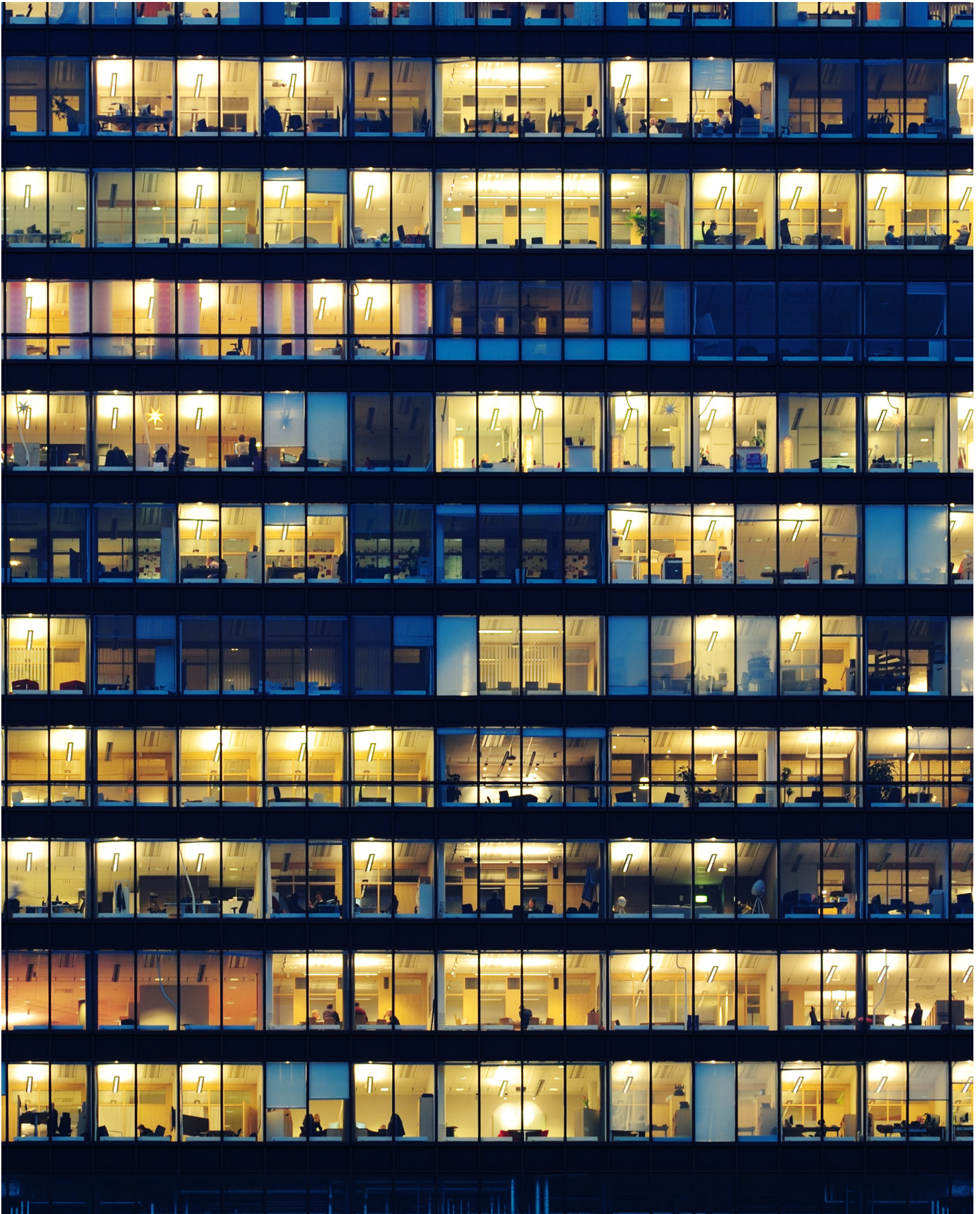


The hybrid working world and its consequences for office markets



“Hybrid working is the new normal and, in our view, there is more to be said for the further expansion of this working arrangement than for its retreat.”

Comparison of working arrangements: hybrid arrangement most advantageous

Essentially, companies today have the **choice between three different spatial working arrangements**. Firstly, they can choose **not to have their own company office** and have their employees work entirely from home or in other locations such as coworking spaces (Fully Remote). Secondly, they can opt for a **full presence** in the company office (Fully Onsite) and thirdly, they can choose the hybrid middle way, where employees can work **both in the company office and in other locations** (Hybrid Arrangement).

The hybrid arrangement is multifaceted, and companies shape its concrete form primarily on the basis of **two parameters: the degree of decision-making centrality and the degree of flexibility**. With maximum decision-making centrality, the regulations on mobile working apply company-wide; with maximum decentralization, an individual agreement is made with each employee. In between are, for example, departmental or team-specific regulations. Full flexibility is given when all employees can decide for themselves at any time where they do their work. The structured hybrid arrangement differs from this so-called unstructured hybrid arrangement by setting limits to employees' flexibility by specifying how often or when they should work in the company office. The frequent “return to office” headlines that have dominated the media in recent months (e.g. on Zoom) do not refer to a switch from remote to hybrid working, and certainly not to a return to full office attendance, but mostly to the switch from an unstructured to a structured hybrid arrangement.

If the hybrid arrangement is compared with the other two arrangements based on scientific and empirical findings with regard to the three factors that are critical to

companies' success - 'productivity', 'costs' and 'talent pool' - **it can be concluded that it is the best choice for most companies** (Table 1). Some companies will prefer fully remote working because of its significant cost benefits and potentially unlimited recruitment reach, even if it has significant productivity disadvantages compared to the other two arrangements. On the other hand, there is little to be argued in favor of working fully onsite, as it is inferior to the hybrid arrangement in all three aspects (see end of page: detailed explanation of the three models).

In view of these results, we believe it is likely that more companies will switch from working fully onsite to the hybrid arrangement in the future. Already today, practically all large (service) companies, including all DAX companies, are opting for hybrid working. According to a survey by ifo and Randstad, 94% of companies with more than 500 employees offer the option of working from home and are therefore presumably pursuing a hybrid model. Overall, this applies to around half of all companies with a presence in Germany. An estimated 40% are (once again) required to be fully onsite. However, in the long term, few of these companies will be able to afford to accept the obvious disadvantages in terms of productivity, costs and talent pool, and many are also likely to switch to hybrid working. Although this change is likely to take place at a much slower pace than in the past and may include temporary counter-movements, **overall hybrid working is the new normal and, in our view, there is more to be said for the further expansion of this working arrangement than for its decline.**

No more office monopoly, but coexistence of different work locations

If this were to happen, the working from home rate could also receive a further boost. According to an analysis by the

ifo Institute, more than half of all jobs in Germany are at least partially compatible with working from home. However, the fact that this potential is still far from being fully exploited is probably not only due to personal preferences and company regulations that do not allow people to work from home, but also to a lack of technical equipment and other barriers that prevent people from working from home. **At least some of these barriers are likely to be removed over time and contribute to the further expansion of working from home.**

Not only is working from home likely to become more widespread, **its intensity could also increase further.** Office workers in Germany currently work from home on average around one and a half to two days a week. Surveys show that this is largely in line with companies' expectations and that most want to maintain their current working from home regulations. Employees, on the other hand, would like to work from home for one more day a week on average. It remains to be seen to what extent employers will accommodate them here. However, the difference shows that the negotiation process is not yet complete.

But regardless of whether mobile working continues to expand or not, one thing can be stated with certainty: **The corporate office has lost its monopoly as a place for desk work and will have to compete with other workplaces in the future - especially with working from home.** However, even a hybrid arrangement, which will probably be standard for most companies in the future, will not work without a company office. **The individual office will therefore remain irreplaceable** as one place of work among several. For the office markets as a whole, however, the shift to a hybrid working environment is likely to have noticeable consequences that are only just beginning to emerge.

Table 1: Comparison of working arrangements

	FULLY REMOTE	HYBRID ARRANGEMENT	FULLY ONSITE
DISTRIBUTION	<10 %	-50 %	-40 %
PRODUCTIVITY			
COSTS	€	€ €	€ € €
TALENTPOOL			

Source Savills



Occupancy rate at around 40 % to 50%

The offices are currently only occupied at around 40 % to 50 % on average. The current level represents a drop of around a third compared to before the pandemic.

Less office space required due to mobile working

Even if it is not possible to say exactly how much the offices in Germany are occupied on average due to a lack of reliable data, one thing is certain: **they are far from being fully occupied and are also significantly less frequented than before the pandemic.** Several surveys indicate an average occupancy rate of between 40% and 50%, with occupancy rates appearing to fall as office sizes increase. Before the pandemic, occupancy rates were probably typically between 60% and 80%. **The current level therefore represents a drop of around a third.**

It is true that the lower occupancy rate of offices does not translate one-to-one into a lower demand for office space, as demand must also be based on peak occupancy rates. **Nevertheless, there are signs that mobile working is leading to lower office space demand.** Some companies have already reduced their per capita office space consumption, and many others will continue to do so. In a survey conducted by the ifo Institute, 9.1% of the companies surveyed stated that they still wanted to reduce their office space due to increased working from home. At first glance, this appears to be a relatively small minority, but this appearance is misleading. On the one hand, all companies were surveyed, including those that do not use office space at all or only to a very limited extent (e.g. retailers, restaurants,

accommodation providers, manufacturing companies). A look at the individual sectors shows that the proportion of typical office users is consistently above average, reaching up to 40%. **On the other hand, the proportion of those willing to downsize increases with the size of the company.** For large companies (at least 250 employees or more than 50 million euros in annual turnover), it is 16.5%. This fits with the finding that most of these companies pursue a hybrid arrangement and is relevant because these large companies account for almost half of all employees. They therefore also take up a disproportionately large amount of office space. **It is not possible to determine the actual proportion of office users who have a lower office space demand due to mobile working** on the basis of the ifo data, nor is there any other reliable data available to date. **Individual surveys and our own observations suggest that it is in the mid double-digit range in the space segment from around 1,000 sq m.**

In order to estimate the overall effect of mobile working on the demand for office space, it is not only relevant to know how many companies are reducing their office space, but also to what extent they are doing so. The data situation here is even worse and is unlikely to improve significantly in the foreseeable future, so we have to rely on estimates. **The extent of the reduction in area varies much**, although it tends to

increase with increasing company size. **In the 1,000 sq m and above segment, it appears to be between 20% and 30%.**

“As the companies’ space savings do not materialize at once, but are spread over many years, they do not threaten to destabilize the office markets.”

Scenario analysis: How much office space could become obsolete due to mobile working?

Based on these observations, it is now possible to roughly calculate how much office space is at risk of becoming structurally obsolete or has already become obsolete in the next few years as a result of mobile working in different scenarios (the latter is presumably the much smaller part). We want to concentrate here on the so-called “A-cities” and, in view of the initial situation outlined above, restrict ourselves initially to the space segment from 1,000 sq m. Assuming a per capita space consumption of 20 sq m, this corresponds to all companies with 50 or more office employees. They account for around two thirds of all office employees in these cities and therefore presumably also occupy around two thirds of the office space stock there.

In what we consider to be a conservative scenario, it can now be assumed that 20% of these companies will reduce their office space by an average of 15% (including those companies that have already done so). This would result in a 2% reduction in office space demand for the market as a whole. Based on the stock currently in use, this corresponds to a reduction in demand of almost 2 million sq m. **In what we consider to be a more likely scenario, a third of all companies with 50 or more employees would reduce their office space consumption by 25%. This would amount to an overall effect of around 5% or around 5 million sq m.** If 75% of all office users in the 1,000 sq m and above segment were to reduce their office space consumption by a third, this would result in around 16% or almost 15 million sq m less office space being required in the top seven markets. **These simple back-**

of-the-envelope calculations ignore many aspects, three of which seem particularly important to us:

- **Firstly, they assume that companies that currently use less than 1,000 sq m of office space will not change their space consumption.** Even if the proportion of space reducers in this size segment is likely to be smaller, it is not zero. Here, too, we are seeing space reductions and some of these smaller companies or businesses are even giving up their offices altogether and using coworking space instead, for example. Nevertheless, not only is the proportion of space reducers smaller, but the savings potential in this space segment is also lower (for example, due to the higher proportion of communication space still required in the overall space). As this segment also only accounts for around a third of the market, we believe that the expected overall effect is in any case in the low single-digit percentage range.
- **Secondly, the calculations ignore the skewness of distribution, i.e. the fact that larger companies or businesses tend to reduce their office space much more than smaller ones.** However, it is not possible to determine how large this effect is due to a lack of data. It is likely to be larger than the first effect, but also in the single-digit percentage range.
- **In a hybrid working world in which people no longer have to go to the office every day, the geographical recruitment reach of not only individual companies but also entire cities may increase.** People who previously lived outside the commuter catchment area of a city may now be within reach. This increases the

demand for office space in a city (at the expense of the surrounding area or smaller neighboring cities). It is not possible to determine how large this effect is because it is not yet clear how much people’s willingness to commute has changed.

Taking all three aspects into account, the overall effect in the three scenarios outlined above would presumably be higher, although we can only speculate as to the extent. **As the space savings made by companies, however large they may be in the end, do not materialize all at once but extend over many years, they do not threaten to destabilize the office markets.** Even a 20% reduction in total space demand loses its fright if it unfolds over a period of ten years. This is because **the supply side can presumably adjust well to a (foreseeable) reduction in demand of 2% per year,** as landlords and project developers will have time to take suitable measures (e.g. repositioning or reallocation of properties and redesign of projects). However, the time lag also means that demand for office space will be dampened for a correspondingly long time. **In addition, the space requirements of many companies have not only decreased, but their requirements for the space they still need have also changed.** This in turn means that the volume effect will not be evenly distributed across the market, but that certain locations and property or space qualities will be disproportionately affected.

Table 2: Comparison of working arrangements

	SCENARIO 1	SCENARIO 2	SCENARIO 3
OCCUPIED OFFICE SPACE (MILLION SQ M)		91	
OF WHICH: SHARE OF OFFICES OF 1,000 SQ M OR MORE		66%	
PROPORTION OF SPACE REDUCERS	20%	33%	75%
EXTENT OF THE AVERAGE SPACE REDUCTION	15%	25%	33%
DECLINE IN DEMAND FOR OFFICE SPACE (%-POINTS)	2.0%	5.4%	16.3%
DECLINE IN DEMAND FOR OFFICE SPACE (SQ M)	1.8	5.0	14.9

Source Savills



1,000 sq m

Today, the average rented space is around 1,000 sq m and this figure is likely to be lower in the future. We expect the large space segment to be disproportionately affected by the decline in demand due to mobile working.

Office users' preferences in the mobile working world

Overall, there is still a lack of insights and data on how exactly the preferences of office users have changed as a result of mobile working. The following comments are therefore based on individual data points, indications and general considerations. We want to outline what we believe are likely developments that can serve as initial anchor points for office landlords and other stakeholders to adequately adapt their strategies to the quantitatively lower and qualitatively changed demand for office space.

We are quite certain that the large office space segment will be disproportionately affected by the decline in demand due to mobile working. As described above, there is a positive correlation between the potential to save space and office size, meaning that the largest offices to date are likely to shrink the most. This phenomenon may already be reflected in the space take-up statistics: While on average between 2013 and 2022, a fifth of take-up in the top 6 markets was accounted for by lettings or owner-occupier transactions for space of 10,000 sq m or more, this figure was only 9% in the first three quarters of 2023. The fact that their share has fallen so much is probably also due to the economic and uncertain environment. However, it seems very unlikely to us that this is the only reason, as even in other years with

weak growth, such large deals contributed significantly more to take-up than recently.

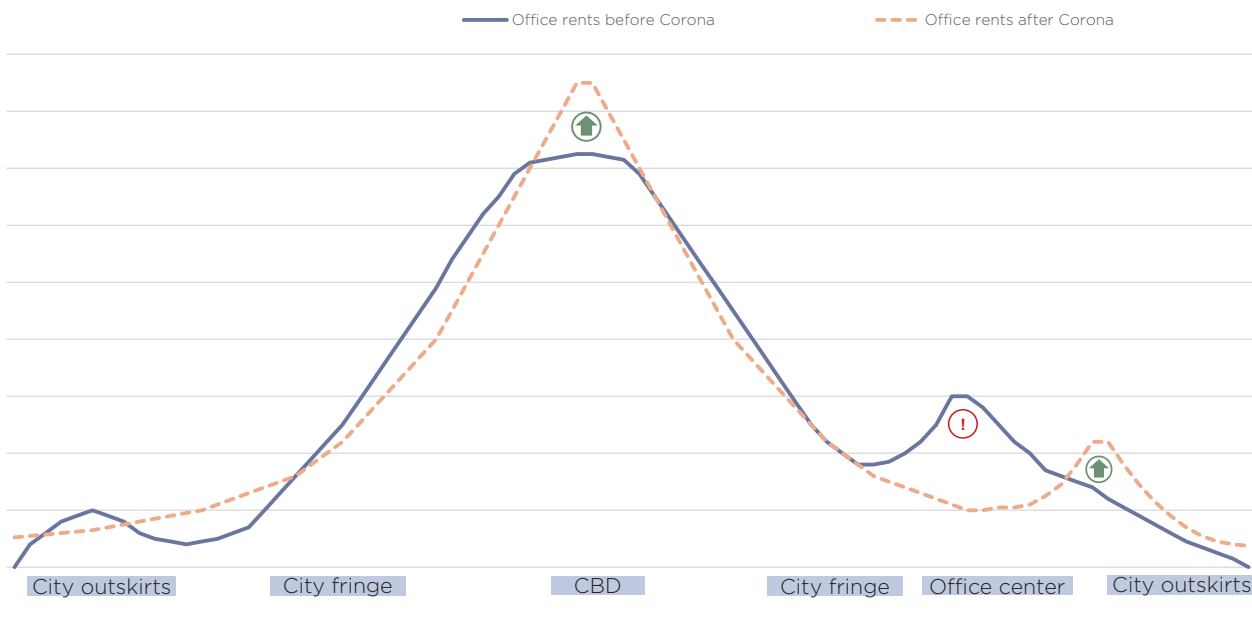
Simply put, when large spaces shrink, they become medium-sized spaces. And since medium-sized spaces are also shrinking, but not as much, there will be an area in this medium-sized space segment where demand will be higher than before. It is not possible to predict exactly which size range this will be. What can be said is that today, **the average size of a leased space is around 1,000 sq m and this figure is likely to be lower in the future.**

In terms of location preferences, there are indications that **the office locations that are traditionally most in demand have now become even more popular with companies** (CBD and city center), while **the less attractive locations have been disproportionately affected by the decline in demand.** This is indicated, among other things, by the slight increase in the share of CBD locations in take-up since the start of the pandemic, as well as the persistently low vacancy rates and the continued rise in rents in these locations. The opposite can be observed in the C-locations. However, we also expect to see much more differentiation within the central locations. In terms of rents, this would mean, metaphorically speaking, that the rental peak is higher than before, but the mountain faces are steeper and the foot of this mountain is

correspondingly narrower (Graph 2).

Elsewhere, too, the rental landscape is likely to change considerably. **On the losing side, we primarily see the classic back office locations.** There are two main reasons for this, which are mutually reinforcing. Firstly, these locations are often not very attractive for the people who work there because they offer hardly any urban amenities. Secondly, the activities that are often in the foreground in the offices in these locations are characterized by little collaboration and are therefore particularly predestined for working from home. The resulting space-saving potential in these locations is therefore likely to be particularly high and demand is likely to fall much accordingly.

Graph 2: Hybrid working changes location preferences



Source Savills

“Flight to quality does not mean that only modern office space is now in demand. Rather, the focus of demand is shifting towards higher-quality space and only the lowest-quality space will no longer find an occupier in future.”

Conversely, there are likely to be other locations in addition to the CBD and city centers where mobile working will lead to an **increase in demand**. This is to be expected, for example, in **densely populated residential areas**, especially in the middle class. There are probably a lot of people there who would like to work from home (more often) but are unable to do so because they don't have the space, for example. Coworking options close to home could close this gap in demand.

How the **preferences** of occupiers have changed in terms of **space quality and criteria** seems **the least clear**. The fact that prime rents are still growing despite rising vacancy rates is an indication that occupiers' space requirements have increased overall. **However, this much-cited “flight to quality” does not mean that only modern office space is now in demand. Rather, the focus of demand is shifting towards higher-quality space and only the lowest-quality space will no longer find an occupier in future.** For landlords, this means that not every space, not even those of below-average quality, will have to be modernized into prime space. In many cases, this will even be uneconomical, for example because it will not be possible to achieve sufficiently high rents in the relevant submarket to cover the modernization costs. In any case, in our opinion, **there is still no**

reliable evidence as to whether and how the criteria that make an office space a top space have changed in the course of mobile working. It is possible that the same criteria that were important to the actual users of an office space - namely the people who work there - were important before (see, for example, our [“Spotlight: The perfect office. What employees want”](#)) and which are now taken more seriously than before by their employers in their efforts to attract their employees to the office as often as possible. In this case, landlords would already have a reliable compass at hand as to what an office space that can also exist in a hybrid working environment should look like. Otherwise, it might make more sense to wait until there is more clarity about whether and how user preferences will change as a result of mobile working.

A comparison of the three working arrangements

Fully Remote

In the fully remote arrangement, employees work completely outside the office, either from home and/or at third-party locations. In terms of costs, this model offers the greatest advantages in the comparison. Firstly, the space costs are the lowest, as little or no office space is required. Secondly, there is great potential for savings on wages, as companies can potentially recruit employees regardless of location and therefore benefit from wage differences. Companies that recruit internationally can achieve high cost savings. Being location-independent also means that the greatest recruitment reach can be achieved. Although only 10% to 30% of people prefer working fully remotely, depending on the source, it offers access to the largest talent pool in the comparison. Ideally, people from all over the world can theoretically be recruited. However, there can be barriers in terms of language and bureaucracy. There are disadvantages in terms of productivity: compared to the in-person models, the less informal and rigid communication and restrictions on mentoring in particular lead to a 10 to 20% loss in productivity.

Hybrid arrangement

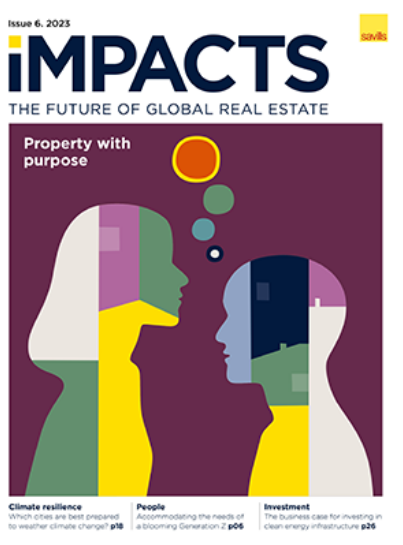
In the hybrid working arrangement, employees work both outside and inside the company office. This can take place either in an unstructured hybrid arrangement, where employees have the freedom to decide where to work, or in a structured hybrid arrangement, where the company specifies when and how often employees should visit the office. The hybrid arrangement can take many different forms, which is why the following points may vary depending on the arrangement. Whether productivity is higher in the hybrid approach than in the onsite approach is still controversial among scientists. However, recent studies point to slightly higher productivity, although there is naturally still a lack of evidence as to whether this also applies in the long term. In any case, employees can benefit from a quieter working

environment and fewer distractions on working from home days and from (informal) communication and knowledge sharing on office days. Costs can also be saved with a hybrid approach, as less space is usually required than with a full presence. Furthermore, wage costs can be reduced due to the increased recruitment reach, as employees commute further. This means that employees from areas with lower wage expectations can be recruited. The greater recruitment reach also means that the talent pool expands compared to the onsite approach, although employees must live within reach of the company, unlike in the fully remote approach. The hybrid arrangement is also the most popular - around 50 to 60% prefer it. Overall, the hybrid arrangement has advantages over the fully onsite approach in all three dimensions. Compared to the fully remote approach, there may be disadvantages in terms of costs and the talent pool, especially if recruitment is possible regardless of location.

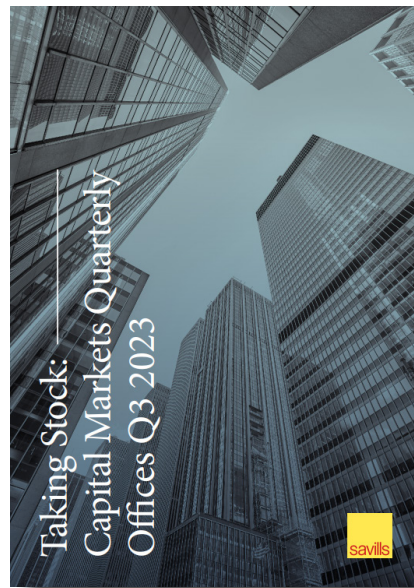
Fully Onsite

In the onsite approach, employees work entirely in the office. Productivity is higher than in the fully remote approach and, depending on the study, similarly high or slightly lower than in the hybrid arrangement. Productivity benefits in the office arise primarily from personal interactions, which can have a positive impact on communication, knowledge sharing and mentoring. The space and wage costs for companies with a full office presence are typically the highest, as there is no potential to save space. On the other hand, the available workforce usually lives in the vicinity of the office, i.e. generally in urban areas, and can therefore have higher wage expectations. This also has an impact on the talent pool, which is the smallest in the comparison, as the recruitment range is the shortest due to the acceptable commuting distance. In addition, only up to a quarter of the workforce prefer working fully onsite. Overall, the model is inferior to the hybrid arrangement in all respects. Compared to the fully remote approach, it only scores better in terms of productivity.

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