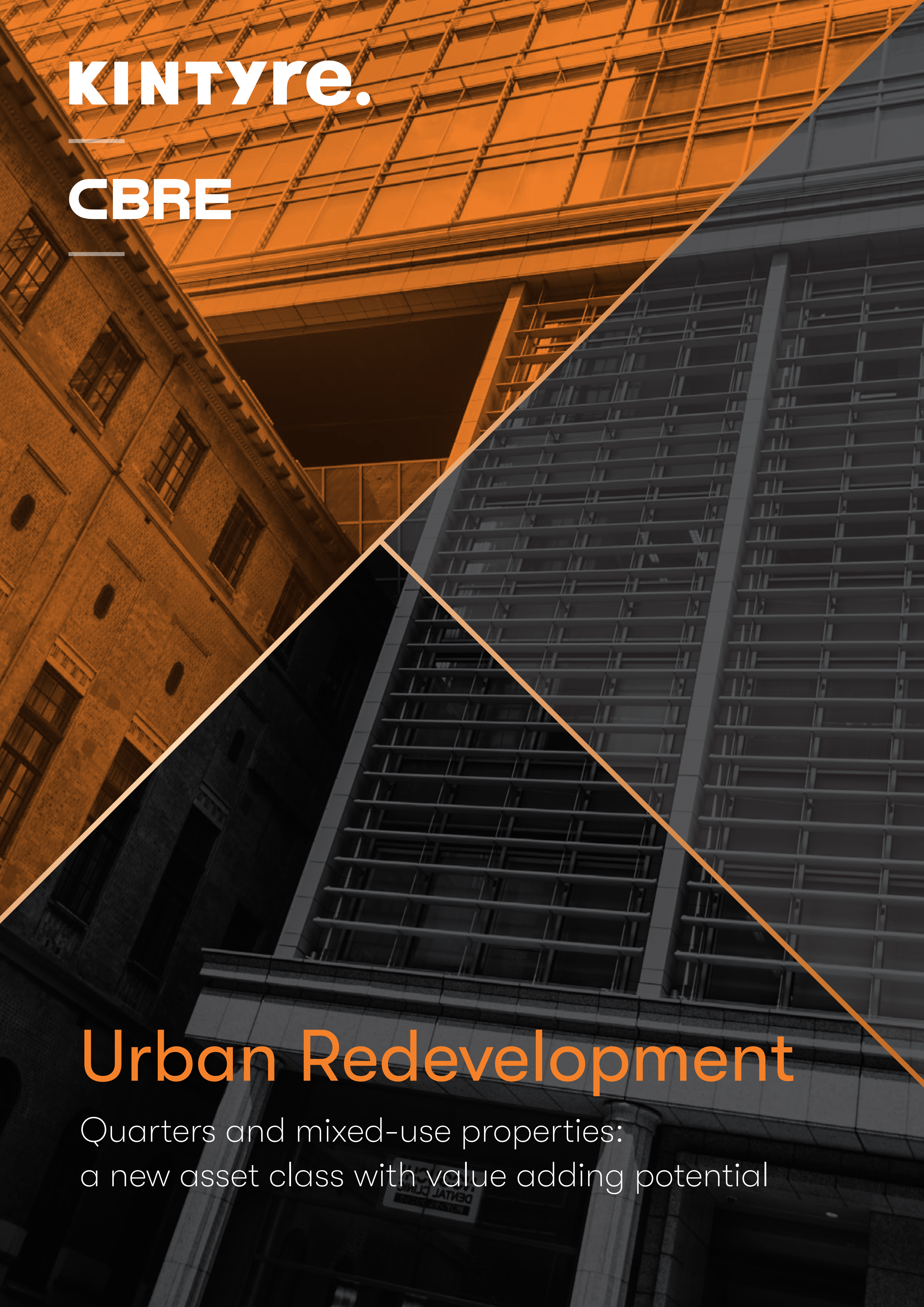


KINTYRE.

CBRE

Urban Redevelopment

Quarters and mixed-use properties: a new asset class with value adding potential

Contents

Foreword

Dear readers,

Kintyre is currently one of the largest owner-managed developers, investors and managers of urban quarters in Germany. The focus of our work is on the further development of monofunctional, outdated and underutilized urban spaces into mixed-use properties and urban quarters. We are driven by the firm conviction that by activating and revitalizing existing spaces, we make a positive contribution to society and generate social, ecological and economic benefits.

The term quarter is currently omnipresent in the real estate industry and since 2020, definitions, criteria or location clusters have also already been analysed in various publications, some of which are ground-breaking. In addition, together with CBRE, we have investigated in recent months how quarters have developed as a market product and now believe that urban quarters will be treated as an asset class in their own right in the not too distant future.

We look forward to sharing our findings with you and wish you an inspiring read.

Sebastian Müller
Head of Advisory Services

> “We are driven by the firm conviction that by activating and revitalizing existing spaces, we make a positive contribution to society and generate social, ecological and economic benefits.”

Foreword

Dear readers,

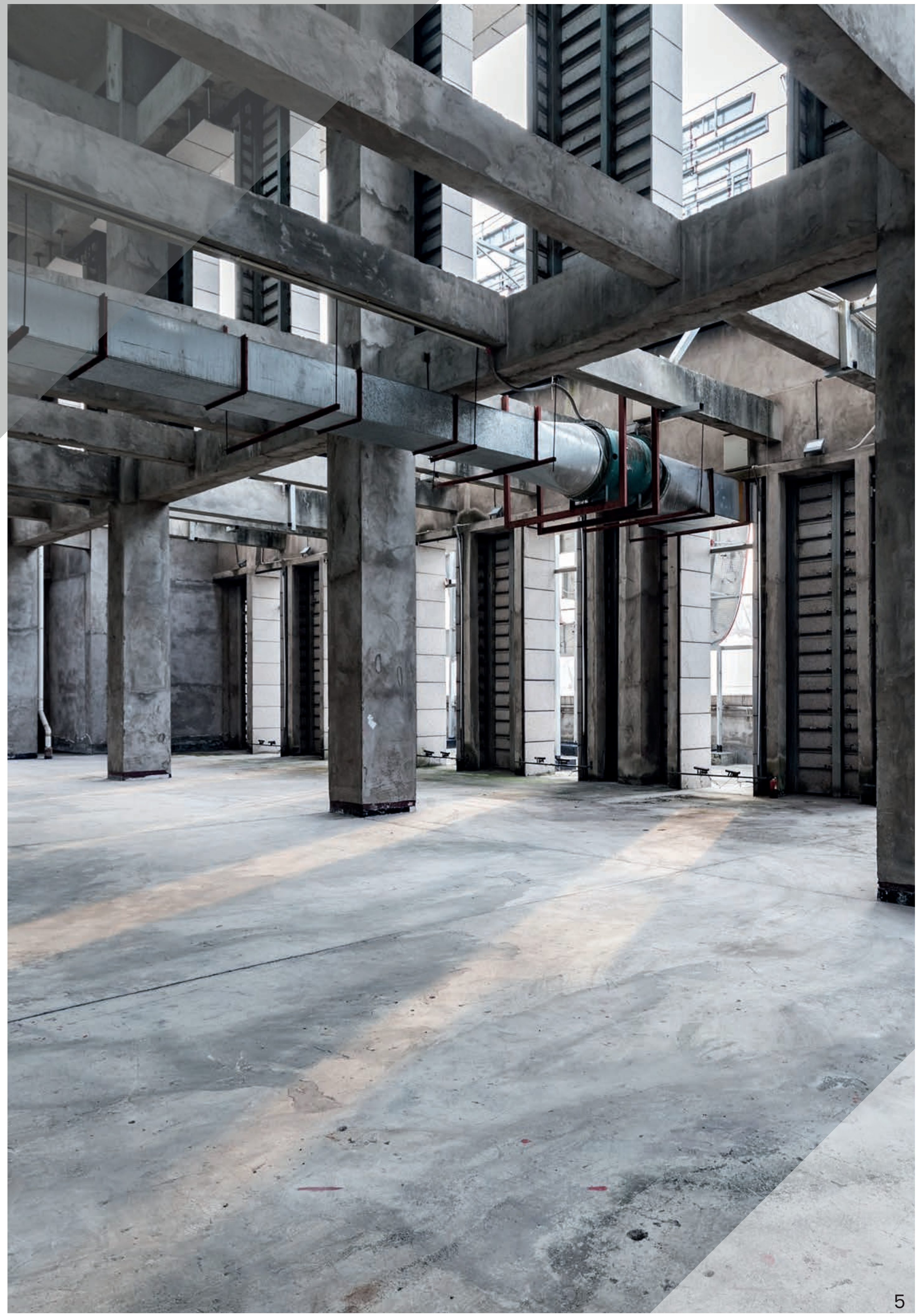
The urban development of tomorrow will be based on mixed-use, liveable, socially and digitally networked quarters. On the one hand, they provide the answer to current social megatrends such as increasing urbanization, demographic changes, mobility and digitalization. On the other hand, they offer long-term investors in particular the opportunity for broader risk diversification in their real estate investments.

As our analyses show, urban quarters hold promise when they succeed in embedding a broad mix of uses - living, working, and amenities - like a missing piece of the puzzle in the existing built environment to complement urban functions and expand existing infrastructures. If the people involved, with their diverse needs, are consistently the focus of all efforts, then quarters will establish themselves as a sustainable asset class in their own right.

We wish you exciting and informative reading and look forward to a lively discussion.

Prof. Dr.-Ing. Alexander v. Erdély | FRICS
CEO | CBRE GmbH

“If the people involved, with their diverse needs, are consistently the focus of all efforts, then quarters will establish themselves as a sustainable asset class in their own right.”



Introduction

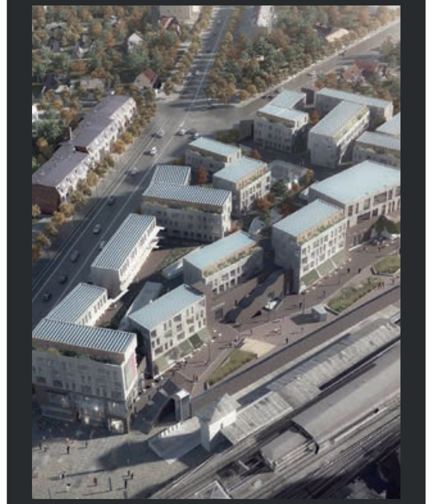
For some time now, urban quarters have enjoyed a significant increase in popularity among investors, tenants and project developers. The mix of different uses combining retail, food service, office, hotel and residential, but also public and medical facilities or city logistics in one property or a cohesive complex offers various advantages and contributes to the attractiveness of this property type, the district and ultimately the entire city.

In the past, mixed-use properties have tended to be viewed critically from an investment perspective, as these properties place higher demands on the assessment of the opportunity-risk profile and management than monofunctional properties in one of the large, established asset classes. Moreover, the tax treatment of different tenants is not always unproblematic. In the meantime, however, a noticeable mindset change has set in. The background to this is, on the one hand, constantly falling yields in the main asset classes, which is why possible alternative investments are coming into focus. On the other hand, many investors want their real estate portfolios to be stable and crisis-proof in the long term. Here, mixed-use quarters offer advantages over monofunctionally used properties, which are subject to the risks of use-specific market cycles to a greater extent. Mixed-use can spread individual risks of individual uses and possible negative effects on property performance. At the same time, there are opportunities for positive synergies and coupling effects that are likely to increase the value of the properties.

Depending on the specific use or spatial concept, mixed-use urban quarters have a stronger economic resilience. This characteristic has once again noticeably increased interest in this investment product, due in part to the impact of the Covid 19 pandemic on real estate markets worldwide.

ADVANTAGES OF MIXED-USE QUARTERS:

- Minimization of individual risks of specific tenants and sectors
- Reduction of negative effects on property performance & cash flow
- Value enhancement through positive synergies and coupling effects



> “There are opportunities for positive synergies and coupling effects that are likely to increase the value of the properties.”

> The integrated approach of a city of short distances strikes a chord with the times, as it offers the prerequisites for efficiency and sustainability.

www.kintyre.de

Quarters definition

Quarters are extremely multifaceted in their character. They come in a wide variety of shapes, sizes, locations, user target groups and stakeholders. They can arise on conversion or development sites, as a planned project or as a redevelopment of an existing property, and consist of individual buildings (single assets) or several functionally linked buildings (multi-assets). These diverse characteristics make it difficult to find a generally valid definition and leave some leeway when analysing these properties.

In order to establish an appropriate definition of a quarter, its most distinctive elements can be considered:

- The most characteristic feature is a diverse mix of uses including office, retail, logistics and residential, linked with social components and public facilities for leisure, education and culture.
- The properties are fundamentally characterized by multidimensionality: location, scale, and uses are not merely juxtaposed, but are interconnected and coordinated with each other as well as with the surrounding area, resulting in interactions and positive synergies.

The mix of uses of different basic functions within one property or area is thus the small-scale counter-design to the Athens Charter, whose paradigm of separation of uses was formative for European urban development for decades. The integrated approach of a city of short distances strikes a chord with the times, as it offers the prerequisites for efficiency and sustainability and thus represents a promising alternative in the increasingly growing and further densifying urban spaces of the metropolises.

IN FOCUS:

75%

OF INVESTOR GROUPS:

- Open-ended real estate & special funds
- Asset & fund managers
- Insurance companies & pension funds

Success factors

The right and well-coordinated mix of uses is important for a functioning and thus successful quarter. It is essential to determine the existing requirements and to combine the different uses in a suitable way. In particular, uses that generate emissions, such as logistics, industry or the food service sector, must be integrated into the overall concept in such a way that other user groups are not disturbed. There is no such thing as an ideal concept, but each property must be tailored to the individual conditions of its surroundings. Moreover, these conceptions - just like the surrounding urban space - are subject to evolution, which is why mixed-use properties must be continuously adapted to the changing conditions over time.

The establishment of a quarter management office is particularly advantageous in the case of large-scale urban quarters which comprise numerous buildings. A uniform guiding strategy assists in the marketing of the quarter and the development of its own image. Both management and marketing must contribute to the idea of "space-as-a-service" progressing from concept to reality. This involves taking into account financial KPIs as well as the needs of everyone who lives and works in the quarter, and requires a high level of communication skills. If this succeeds, user satisfaction increases and, as a result, the attractiveness and value of the investment increases as well.

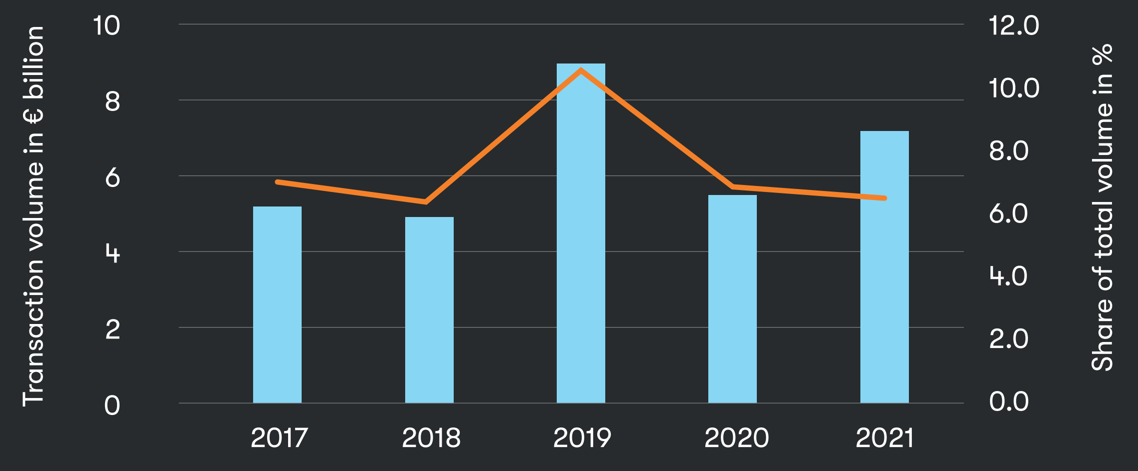
Furthermore, the topic of ESG has rightly gained in importance in the real estate market in recent years. Even though ESG pursues a holistic approach in the areas of environmental, social and governance and does not focus solely on the property, green building certificates for real estate are an important component of a comprehensive sustainability strategy. The DGNB reacted early to the increasing importance of quarters in the real estate market and already started with the certification of such properties in 2012. In 2020, the DGNB's certification system was reviewed and updated. The new, international version was adapted to the global Sustainable Development Goals of the United Nations and is intended to promote certification and support the development of quarters that generate the lowest possible emissions over their life cycle. The DGNB currently has a total of 54 certified quarters, 36 of which are pre-certified, with a wide range of quarter types including commercial areas, industrial sites, resorts, vertical cities, event areas, office and commercial quarters, business quarters and urban quarters.

Investment market

The fact that quarters are gaining in importance as an investment product is shown both by the increasing use of terms such as quarter, plaza, palais, courtyard, park or district in investment properties and by the actual trading of large-area buildings (complexes) that encompass several uses.

As a recent study[1] published by CBRE shows, an increasing number of real estate transactions have featured the label "quarter" or "district" in recent years. The share of the total transaction volume rose from just over 5% in 2016 to just under 11% in 2019, when transactions worth around €9 billion were made that can be grouped under the term quarters. Although the pandemic year 2020 led to a drop in investment volume to around €5.5 billion, the number of transactions was still almost on a par with those of the previous year (93 to 94). In 2021, a well above-average result was again achieved. A total of 84 quarter transactions with a volume of €7.2 billion were recorded. This corresponds to a share of 6.5% of the total transaction volume.

Figure 1: Transactions of properties with the label "Quarter" 2017-2021

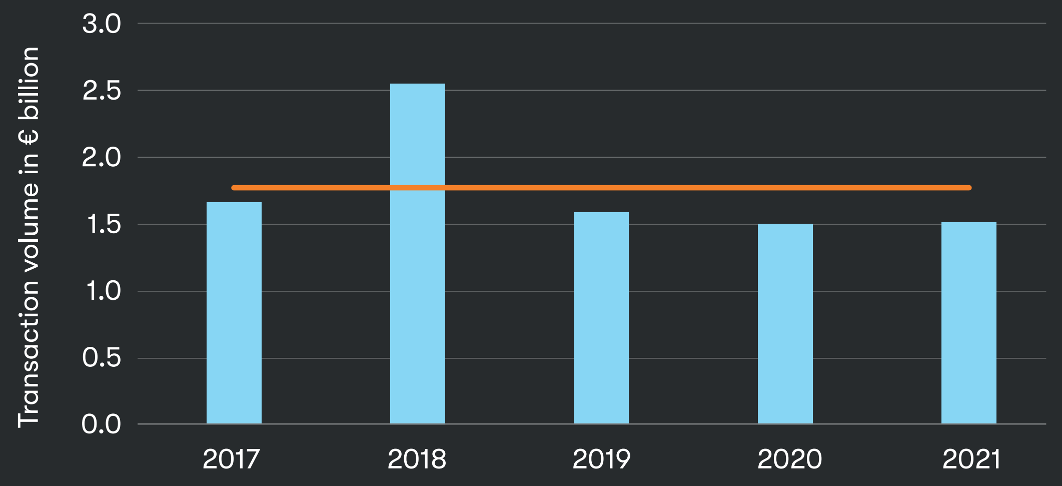


Transaction volume quarters ■ Share of total transaction volume ■

Source: CBRE Research, 2022.

[1] *vgl. CBRE (Hrsg.) 2021: Wie werden QUARTIERE zu einer neuen Erfolgsstory in Deutschland?*

Figure 2: Transactions of mixed-use properties with a minimum size of 10,000 m²



Transaction volume mixed-use real estate ■ 5-year average ■

Source: CBRE Research, 2022.

However, a detailed analysis of the underlying transactions shows that the term quarter is understood very differently by market participants. It is often used irrespective of the size of a property or the use or uses accommodated in the area. Purely residential quarters or commercially used quarters are equated with mixed-use quarters. In this respect, the term quarter is often used for marketing purposes to emphasize the special quality of an asset and does not serve as a fundamental description of an independent asset class.

In order to provide a more in-depth analysis of the transaction activity in recent years, two characteristic features of a quarter are assumed hereinafter: A size of at least 10,000 m² and a mix of uses that includes at least three different types of spaces. Since these properties represent only a part of the wide range of possible quarter characteristics, they will be referred to in the following as mixed-use properties.

Using these criteria, the average annual transaction volume over the past 5 years amounts to around €1.8 billion. A total of 81 properties changed hands during this period, i.e. an average of around 16 properties per year. This results in an average deal size of around €110 million per transaction. Despite a defined minimum size of 10,000 m², two thirds of the transactions (67%) were below the €100 million threshold. The above-average transaction volume in 2018 results from a large number of transactions above this benchmark in that year. A total of 10 transactions with a purchase price of over €100 million contributed to the high overall volume.

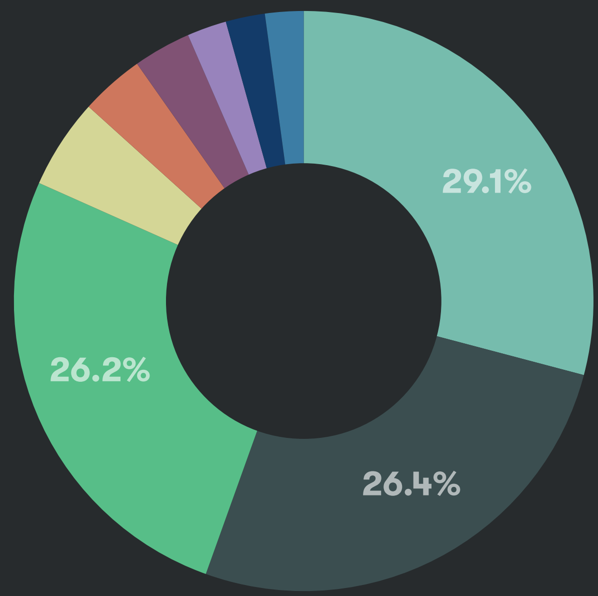
An evaluation of investment activity since 2017 by purchaser type shows that three groups of institutional investor types in particular have purchased mixed-use properties. Open-ended real estate and special funds, at 29%, are just ahead of asset and fund managers as well as insurance companies and pension funds, each accounting for 26%. The fact that particularly this rather risk-averse and equity-strong group of investors has purchased mixed-use properties may give an indication of the stability of this investment product. It can also be assumed that many insurance companies and pension funds have indirect investments in real estate, i.e. in various fund vehicles which are represented by the first two buyer groups. The remaining transaction volume of around 18% of the properties purchased since 2017 is divided up on a smaller scale among other investor types.

> Open-ended real estate and special funds, at 29%, are just ahead of asset and fund managers as well as insurance companies and pension funds, each accounting for 26%.

An analysis of the multipliers - i.e. the gross multipliers - in connection with the transaction volume once again shows the large share of investments in mixed-use properties below the €100 million threshold. The multiplier ranges from a factor of 10 for a property just under 30 years old with a high proportion of storage and logistics space, to a factor of 66 for a historic building in a prime location in Hamburg with a balanced floor area ratio between office, retail and storage, in which, however, only just over half of the space is let and which represents an outlier in the present evaluation. Accordingly, the yield spread ranges from 10% to around 1.5%. In addition, another outlier was omitted from the following chart for reasons of clarity: The transaction of a mixed-use property with a combination of office space, residential space, retail space and a cinema for around €1.1 billion is not included in the chart.

An analysis of transactions over the past five years shows that the gross return on a property tends to fall as the investment volume increases. For investments below €100 million, the average gross return is around 5.4%. For properties above this threshold, the average return is around 3.7%. However, it is not just the purchase price that determines the value of the return. The determination coefficient - i.e. the extent to which the dispersion of the dependent variable is explained by the independent variables - is around 18% across all the transactions surveyed. If only transactions with a volume of up to €100 million are considered, the value rises to 42%. Here, the correlation between purchase price and return is therefore more pronounced.

Figure 3: Buyer types of mixed-use properties with a minimum size of 10,000 m² (time period 2017-2021)



Investor type

- Open-end real estate funds/special funds
- Asset/fund managers
- Insurance/pension funds
- Other
- Private investors
- Closed-end real estate funds
- Project developers
- Real estate companies
- Real estate stock companies/REITs

Source: CBRE Research, 2022.

MIXED-USE REAL ESTATE:

3.7%

gross yield

MONOFUNCTIONAL PROPERTIES:

4.4%

gross yield

A comparison of gross yields shows that mixed-use properties predominantly rank below the yield level of monofunctional properties. Starting from a gross yield of 4.6% in 2017, the figure for mixed-use properties has fallen to 3.7% to date. For monofunctional properties, starting from around 5.2% in 2017, 4.4% has been achieved to date. Mixed-use properties are thus following the years-long trend of yield compression to an even greater extent.

Although mixed-use properties place higher demands on investors than monofunctional properties, for example in terms of management, the yield level is below that of investment properties in the established asset classes. Apparently, the security promised by mixed-use real estate is priced into these investments.

Differences in gross returns for mixed-use properties are dependent on the dominant use type, and are related to their relative proportion of space within the property.

> Although mixed-use properties place higher demands on investors than monofunctional properties, the yield level is below that of investment properties in the established asset classes.

Figure 4: Mixed-use property transactions 2017-2021 by gross initial yield and transaction volume

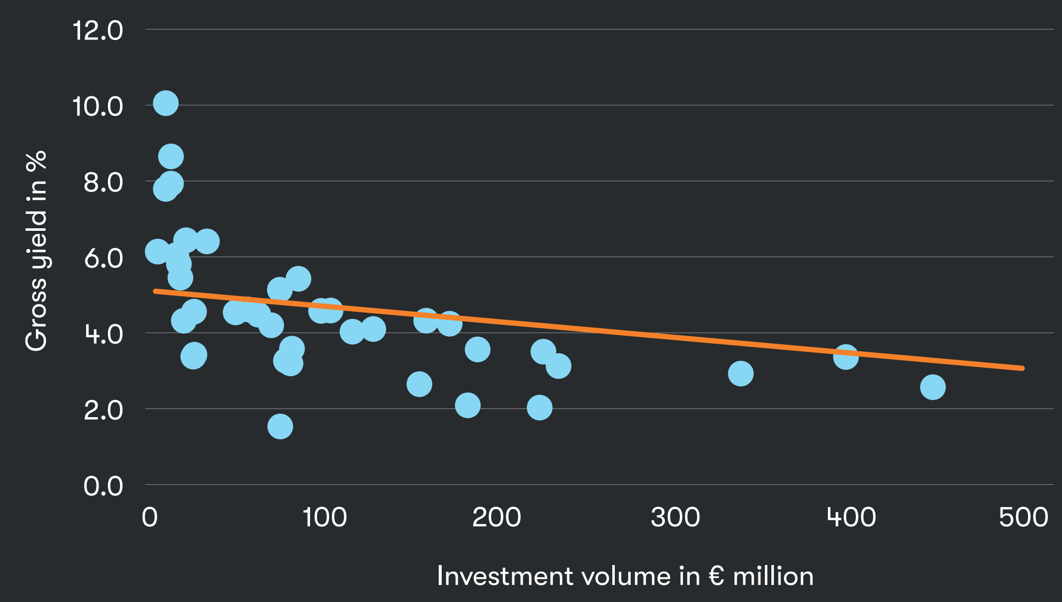
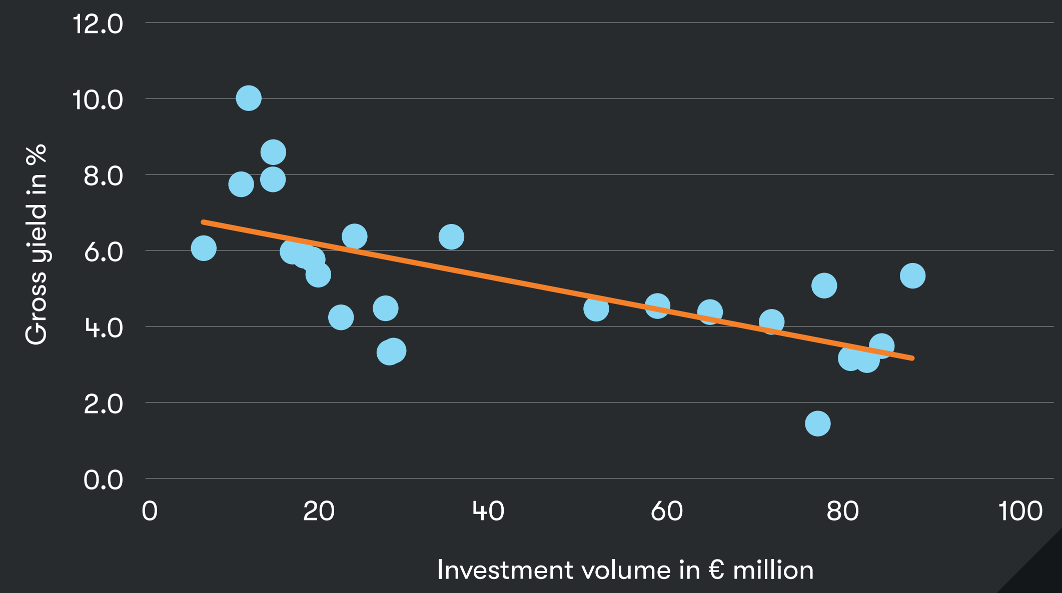


Figure 5: Transactions of mixed-use properties 2017-2021 by gross initial yield and volume up to max. €100 million



Source: CBRE Research, 2022.

Figure 6: Development of returns on investment transactions of mixed-use vs. single-use properties as of 2017

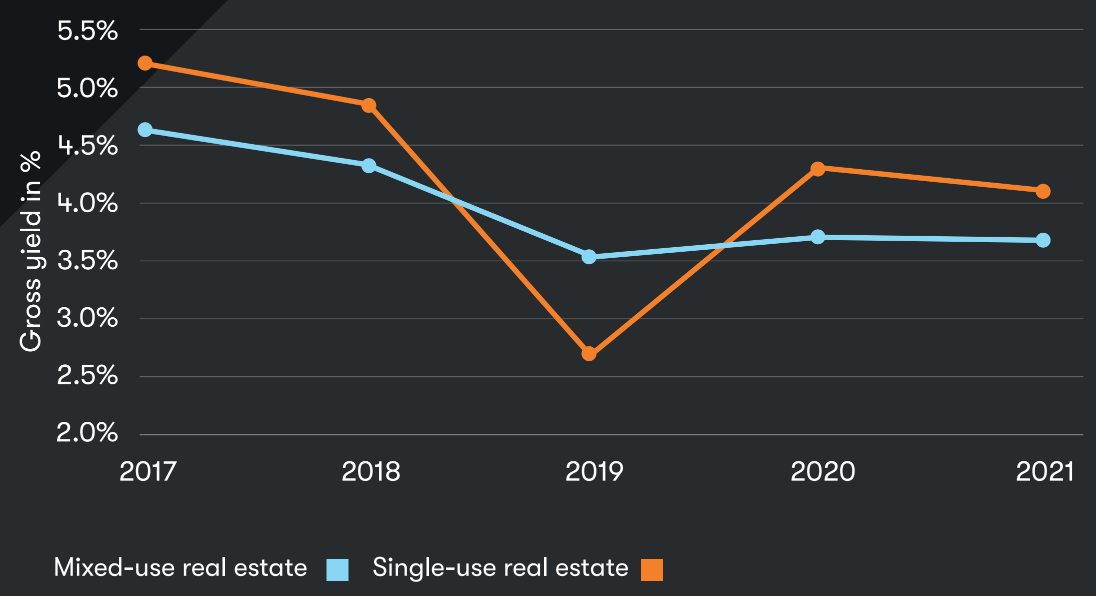
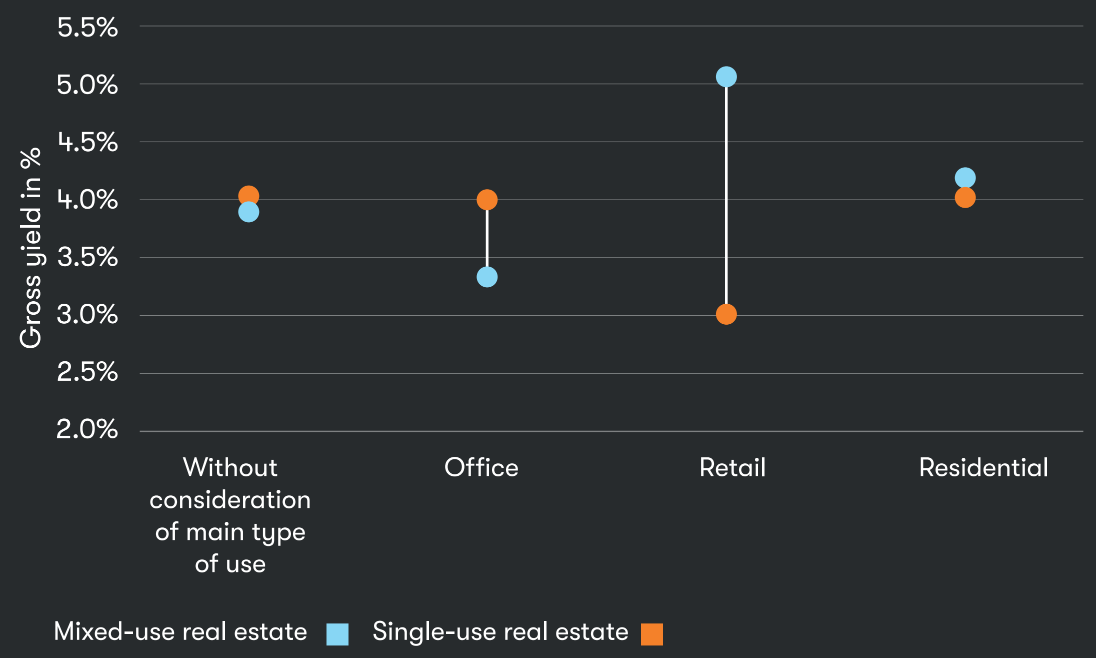


Figure 7: Spread gross yield on investment transactions between mixed-use properties and single-use properties by main use type 2017-2021



Source: CBRE Research, 2022.

> Mixed-use properties tend to rank at the yield level of shopping centres, whereas the lower yield level of the other retail properties is influenced by the high demand and therefore expensive food markets.

Regardless of the primary use type, the spread between a mixed-use and a single-use property has been quite small over the past five years. For example, mixed-use properties rank nine basis points below a single-use property.

However, if the mixed-use properties include a high proportion of office space, the spread widens compared with pure office properties and stands at 67 basis points. Apparently, the issue of remote work or work-from-home, which has come into even greater focus as a result of the Covid-19 pandemic, is already factored in here. These differences are also reflected in the development of new buildings. There is a clear trend away from the dogma of monofunctionally toward multifunctional office properties.

The ratio is reversed for properties with a focus on retail space. At 206 basis points, mixed-use properties lie significantly above pure retail properties. Mixed-use properties tend to rank at the yield level of shopping centres, whereas the lower yield level of the other retail properties is influenced by the high demand and therefore expensive food markets. This is understandable insofar as mixed-use properties are significantly larger (in our evaluation at least 10,000 m^2) and contain various other uses in addition to retail, compared with, in particular, significantly smaller, monofunctional properties that are typically designed as stand-alones. The significant yield spread makes especially mixed-use properties with a retail focus appear to be an attractive investment when compared with mixed-use properties with a different focus of use - but also when compared with monofunctional properties.

By contrast, there are minor differences between mixed-use properties with a dominant residential use and purely residential properties. The gross yield of a mixed-use property with a dominant residential use is 18 basis points higher than a property characterized entirely by residential use.

Potential for project developments - opportunities for redevelopments

The increased investor interest in quarters and mixed-use properties stands in contrast to the rather limited market offering of such real estate. New developments are only being undertaken to a limited extent, as building land in attractive, central locations in particular is a restrictive factor. For this reason, the restructuring and conversion of large-scale monofunctional existing buildings in central locations with a use concept that is no longer economically viable is becoming increasingly interesting. In particular, large-scale retail properties, mostly located in urban areas, such as department stores or shopping centres, with conceptual problems, are increasingly coming into focus. While the first floor and second floor are usually still unproblematic and function well from a retail perspective, it is especially the middle and upper floors where further retail use is questionable and possible alternative uses are required. In particular, this offers an option for the creation of residential space, which is in short supply, especially in the high-growth regions that have very low vacancy rates in marketable multi-story residential properties. The new federal government plans to build 400,000 new homes annually, 100,000 of which will be publicly subsidized, so that the realization of affordable housing in mixed-use neighbourhoods or districts will also be supported by government incentives.

In addition to the limited availability of suitable brownfield or development sites in attractive, urban locations, another complicating factor is that the obtaining of building permits for mixed-use sites in Germany is very complex, despite the introduction of "urban areas" in 2017 as a new type of development area to enable higher building density and a different mix of uses in urban locations. This is one of the reasons why the focus is increasingly on the subsequent use of existing buildings, which often do not require a complex development planning process.

> “The new federal government plans to build 400,000 new homes annually, 100,000 of which will be publicly subsidized.”

Potential for project developments

The fact that there are a large number of existing buildings that offer potential for redevelopment in combination with a mix of uses is demonstrated by the example of shopping centres. Based on a minimum of 10,000 m² of contiguous retail space and uniform management, the market for shopping centres in Germany currently comprises 373 existing properties with a combined area of 10.2 million m².

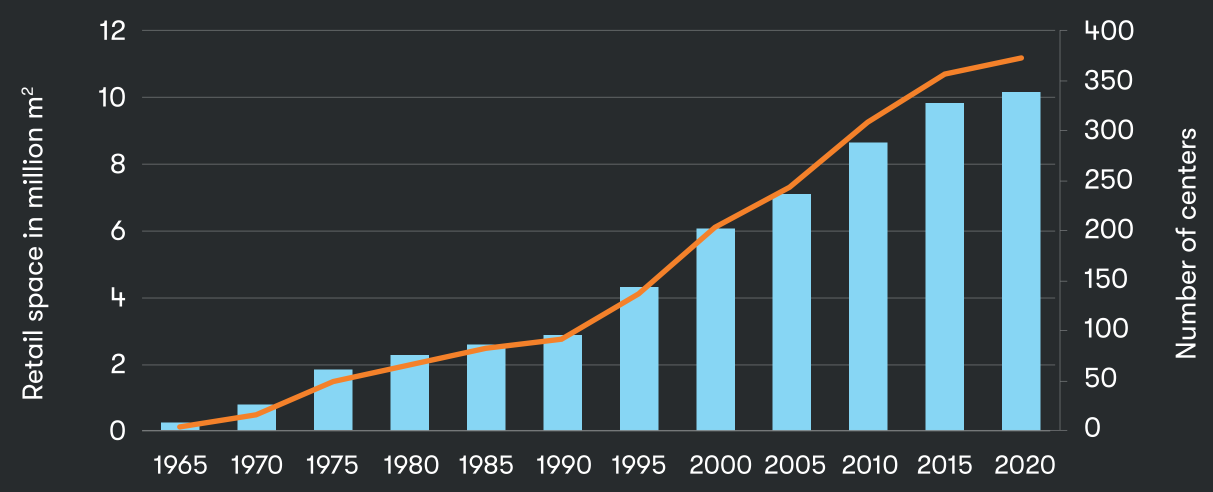
Some centres have already been redeveloped and others are currently in the process of being converted into mixed-use complexes as a result of conceptual errors, such as Haven Höövt in Bremen or MEP in Meppen. Other properties are yet to be redesigned in conjunction with a change of use in order to adapt them to the changes currently facing the retail sector. Shopping centres, for example, traditionally have a high proportion of fashion of around 30-35%, which corresponds to a total area in German shopping centres of around 3.3 million m². Due to the changing shopping habits of consumers, with a steadily increasing shift of clothes shopping to online retailing, it can be assumed that some of this space will be available for redevelopment and will therefore have to be put to a different use than retail. And this particular example is merely indicative of the clothing retail sector.

In addition, a large proportion of the existing shopping centres in Germany are now several decades old. Around 54% of the centres were built before 2000 and 83% before 2010. Even if numerous centres have already been modernized several times, the age of the existing portfolio in combination with changes in usage behaviour indicate that there is considerable potential for revitalization, which will often be associated with changes in usage.

If we assume that at least 25% of centres in Germany are in need of repositioning or revitalization, this corresponds to a good 2.6 million m² of space. With refurbishment costs for an existing property averaging around €2,000/m², this represents an investment potential of around €5.2 billion in the shopping centre segment alone.

In addition, rents for both shopping centres and retail properties in central inner city locations have come under severe pressure as a result of the Covid-19 pandemic and this may present an investment opportunity in suitable properties.

Figure 8: Development of the shopping centre portfolio in Germany



Retail space cumulative

Source: CBRE Research, 2022.

> Various influencing factors suggest that demand for urban quarters and mixed-use properties is likely to increase further in the future.

Outlook

Various influencing factors suggest that demand for urban quarters and mixed-use properties is likely to increase further in the future. A distinction can be made here between exogenous and endogenous factors.

Exogenous influencing factors:

- The unbroken megatrend of continued re-urbanization of major cities and metropolitan areas requires cities to create attractive quality of life and recreation for residents. For the municipalities, mixed-use developments and quarters offer the opportunity for urban densification and, with their lively mix of residential, work, cultural and leisure spaces, are in tune with the zeitgeist of the users.
- Demographic change will lead to a further increase in the age of the population. Areas and properties with a functional mix of uses offer ideal conditions for providing facilities close to home and thus especially suitable for an aging society.
- While the Covid-19 pandemic has contributed to a significant increase in interest in quarter investments in recent months, the ESG issue is likely to additionally boost demand for quarters in the future, as they offer various starting points for implementing or managing different sustainability aspects.
- In addition, it is changes in our mobility behaviour - triggered, for example, by the Covid-19 pandemic or high energy costs - that are making mixed-use, urban quarters increasingly attractive. Essential basic existential needs can be met in one place and do not require a change of location.

IN FOCUS:

Mixed-use properties and quarters offer excellent opportunities to bring social aspects of sustainability into greater focus.

- Tenant satisfaction
- Mixed residential types
- Short distances, time savings
- Interaction
- Social diversity

> In the medium term, quarters and mixed-use properties will successfully establish themselves as an asset class in their own right.

- Driven by climate change, resource scarcity and social segregation, aspects of environmental and social sustainability are becoming increasingly important in construction projects. When it comes to ESG, the focus in the real estate industry has so far been primarily on reducing CO_2 emissions. However, in addition to environmental issues, social issues such as tenant satisfaction, social housing or social diversity are also relevant. Mixed-use properties and quarters in particular offer opportunities to take social criteria into account. The implementation of ESG criteria also makes sense from an economic point of view. In particular, investor interest is increasingly shifting towards sustainable, ESG-compliant investments as a result of ESG regulation. At the same time, there are increasing opportunities if inefficient buildings are refurbished in line with market requirements and optimized in terms of energy efficiency.

Endogenous influencing factors:

- Many investors are looking for alternative investment products due to falling yields and a lack of available properties in the classic asset classes. This is associated with an increasing willingness and conviction to deal with the more complex requirements and special features of mixed-use properties, also in light of the lower level of risk.

- Even before the lessons learned from the Covid-19 pandemic of the past months, the requirements for risk diversification on the part of investors increased. Due to their sector mix, quarters and mixed-use properties are a risk-mitigating defensive asset class compared with cyclically dependent monofunctional properties.

- In the medium term, quarters and mixed-use properties will successfully establish themselves as an asset class in their own right, increasingly taking their place alongside monofunctional properties in the established asset classes and even replacing them in some cases. This will likely manifest itself in rising purchase prices, suggesting that there is currently a clear "window of opportunity".

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