FOREVER YOUNG?
Analysis of mature offices in Warsaw, Budapest and Prague
March 2016
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INTRODUCTION

The story of modern office markets in Warsaw, Budapest and Prague dates back to the early 90s. Although steel and concrete remain the backbone of any office building, much has changed in the landscape of these capitals in terms of the skyline, volume, technical specifications, as well as specific occupier requirements. Undoubtedly, the pace of development has been remarkable and each of these cities have undergone two or three property cycles since then.

Given the office market (r)evolution over the last 25 years in the three capitals, BNP Paribas Real Estate has taken a closer look at the office buildings developed over the roaring 90s when the first boom occurred.

The office accommodation completed over that period accounts between 25-30% of the overall stock in the city. This in turn was a reason to pose the following questions:

- How to unlock mature office potential so that they can successfully compete with newer buildings and pipeline supply?
- What are the tricks of trade to apply in mature offices enabling them to meet the current and future occupier requirements?
- Are mature offices the right investment?
- What is the future of this asset class?

By analyzing the key indicators of mature offices including the stock, tenancy structure, rents, vacancies as well as the investment market, we hope to have found some answers to these fundamental questions and the results are presented in our report Forever Young? Analysis of mature offices in Warsaw, Budapest and Prague.

The study shows there are different ways to tackle aging of an office building and landlords can mitigate the risk of tenant rotation and decline in occupancy rate. Putting a few cases aside where no retrofit action can be taken, the majority of landlords understand the need of being proactive when it comes to asset management. Some of them decide to do some ‘face lifting’, some go ahead with ‘plastic surgery’ and others decide to replace the old with new. All approaches aim at one ultimate goal – to maintain or upgrade property value as doing nothing leads in the opposite direction. The report presents different policies that can be applied to mature offices, very often located within city centre, which can’t be matched by new schemes given scarcity of development land especially in case of Prague and Budapest. The study also points to crucial elements to be considered regarding technical specification as well as letting strategy.

Anna Staniszewska
Head of Research & Consultancy CEE
BNP Paribas Real Estate

KEY INDICATORS FOR CEE MATURE OFFICES

STOCK

WARSAW 1.19 m²
BUDAPEST 1.01 m²
PRAGUE 0.89 m²

WARSAW 18.6% 15.4% 17.1%
BUDAPEST 17.00-19.00
PRAGUE 18.00-20.00

Source: BNP Paribas Real Estate
The life cycle of an office building has its milestones. The very important ones are the points in time when it is necessary to conduct minor or major refurbishments to rejuvenate the interior and/or exterior. The timing of this depends greatly on the quality of design and materials initially used in construction.

The primary goal of today’s owners of office properties is to retain existing tenants while devising strategies to attract new occupiers. By applying different types of measures, these assets cannot only maintain but also improve their value. Through increased space efficiency and reduction of operating costs, the old can compete with the new modern offices.

Buildings completed over the 90s very often need modernisation of technical installations (plant & machinery and lift); office interiors and amenities; lobbies; new landscaping and given environmental requirements, implementation of energy efficiency solutions. Energy efficiency is becoming immensely important to older buildings. By applying low energy lighting, thermal modernization and renewable energy solutions, the refurbishment not only lowers operating costs but also improves quality of working environments thus positively influencing wellness and health of employees.

Choosing the appropriate treatment for an office building is critical and there are differences in the types of projects undertaken. The selection of treatment depends on two areas. First the quality of design and materials used in original construction plus the building’s current condition. Second, the intended use of the building and the landlord’s strategy with expected returns. Ultimately of course the available budget determines what can be done.
The basic types of refurbishment include:

**RESTORATION**

Office restoration is nothing more than reinstatement of an asset to its original condition. In the majority of cases, such fixings and minor repairs are general maintenance. They follow regular technical inspection of a building structure and its installations, which are usually planned in the capex budget. Obviously, if there are some unexpected damages or leakages, restoration is done immediately.

**REFURBISHMENT**

In case of limited capex budget, some landlords decide to undertake ‘face lifting’ actions, which can improve building’s image relatively quickly, without straining the budget too extensively. Such light refurbishment can take the form of repainting of walls, refurbishment of toilets, rearrangement of lobbies, adding a bike rack or putting new landscaping around the building. In some cases, it also involves replacement of lighting systems, introduction of low-cost ecofriendly solutions.

**RENOVATION**

Following a thorough building analysis, renovation results in an essentially new building within the framework of an old one. In order to avoid disrupting tenants and maintain cash-flow, floor-by-floor renovation is more frequently applied.

Renovation is a highly structurally focused exercise. For the interior it usually includes replacement of lifts, HVAC, plumbing, fire protection and electrical systems, as well as revamping of exits, fire separations and other structural systems. For the exterior, roof and facade replacement and repair or replacement of exterior enclosure elements such as walls, windows and doors are also frequently part of the process. In a total renovation, all of the above is done and new features can be added like building entrances and lobby locations that improve functional efficiency and marketability. What links all these processes today is special regard to eco-friendly solutions reducing carbon emissions through low energy consumption.

In addition to the above features characteristic for renovation of the building itself, landlords also take care of revamping entry plazas and landscaping. Changing occupier requirements mean that special emphasis is put on providing additional amenities for tenants.

**RECONSTRUCTION**

It is the lengthiest and the most capital intensive type of office makeover. However, in the long-run due to substantial increase of space and energy efficiency as well as improvement of occupier working comfort, it provides the most savings and returns.

There are also cases when an office building needs to be demolished with a view to be reconstructed.

It may happen due to the fact that some older schemes no longer meet local building codes and ordinances, regarding health, safety and fire protection; it is either too expensive to do renovation or the building cannot be practically altered. At this point rebuilding it to modern standard becomes a necessity. The other reason for reconstruction occurs when there is a change in zoning. If the new master plan for the city increases the development density allowing for larger Gross Leasing Area (GLA) and/or change in use, it creates new opportunities. For economic reasons, it may be more profitable to bulldoze an old scheme and build a new one to take advantage of the better efficiency parameters.
KEY INDICATORS OF MATURE OFFICES

Warsaw  POLAND

- **Vacancy rate in mature offices**: 18.6% vs. 12.5% overall
- **Stock of mature offices**: 1,195,200 m² vs. 4,676,000 m² in total
- **Selected major occupiers**: Asseco, DELL, Metlife, Warta, AXA, HP, Michelin, Intrum Justitia, Henkel, PGNiG, IBM, Xerox, Alstom, Gleeds
- **Major institutional landlords**: Adgar, CA Immo, Griffin Real Estate, Immofinanz, Kulczyk Silverstein, Peakside, UBS

- **Prime rental range in mature offices**: €17.00-19.00 per m²/mth vs. €20.00-22.00 per m²/mth in prime modern offices
- **Average rental range in mature office buildings**: €11.50-15.00 per m²/mth vs. €13.00-16.00 per m²/mth in other modern buildings

- **137 mature offices vs. 428 in total**
Mature office buildings can be excellent assets if managed in the right way. It requires a specific kind of know-how, experience and market intelligence as it is far more challenging than constructing a new building.

An existing scheme is like a patient, where despite the X-rays and CT scans, we only know what is going on inside when the surgeon begins the operation. Not everything you dream up can always be realized exactly the way you intended it, many unexpected surprises only come to light as the modernization work progresses, and these surprises mean adjustments to the plans, and so to the budget.

We purchased an already functioning, partly leased building in a very attractive location for a good price. We completely re-imagined its function and form, and revitalized it, giving it a whole new character and a new lease of life.

We adopted the strategy of providing a unique offering of facilities for the building’s users and neighbourhood residents with active lifestyles, creating the unique AdgarFit sports zone concept. We have built a community of active sports lovers around a collection of facilities such as Gravitan health and sport club, equipped not only with gym, pool, and computerized cycling stations, but also kids gym and kindergarten, dancing school, specialist sports shops, a sports medicine facility and cafes and restaurants offering healthy food. We also added a glow-in-the-dark running track, which does not freeze over and circles the entire complex. There are bikes for tenant use as well as showers and a bike room for people who cycle to work. This is how we stand out from the competition. The building has also been dramatically transformed: we added a whole new front façade with a modern glass atrium, which has completely changed the look and feel of the building. As Adgar Park West used to house one of the main mobile telephony operators, it was already technologically advanced when we purchased it, but is now a completely different building from the one we bought. We have given it a new life.

Another important business aspect of this kind of investment is the building’s public image. Time and effort has to be spent to re-position the building in line with the architectural and conceptual changes, and again this is more ambitious than building the brand of a new asset developed from the ground up. In the current, competitive marketplace you need to find the right positioning of the revitalized building to attract the right tenants. It is no longer enough just to introduce cosmetic changes to a building. Its whole concept needs to be looked at with fresh eyes; it needs to be re-imagined. We take a more long-term approach and combine the roles of developer, investor and manager. We are a one-stop shop for our tenants, which means they build a long-term relationship with just one partner with whom they can discuss all of their office and other related needs. We nurture these relationships with our tenants and support their businesses by, for example, promoting their products and services amongst our other tenants.

Adgar Park West is now an attractive, modern office complex with a unique offering and is now 95% leased. We are also planning to extend the existing site in the future.
Budapest, HUNGARY

**KEY INDICATORS OF MATURE OFFICES**

- 166 mature offices vs. 385 in total
- 1,012,000 m² vs 3,281,000 m² in total
- €18.00-20.00 per m²/mth in mature offices
- €11.00-13.00 per m²/mth in other modern buildings
- €18.00-20.00 per m²/mth vs. €20.00-25.00 per m²/mth in prime modern offices
- €11.00-13.00 per m²/mth vs. €12.00-14.00 per m²/mth in prime modern offices

**SELECTED MAJOR OCCUPIERS**
- Magyar Telekom HQ, Budapest
- Waterworks, Duna TV HQ, K&H, Antenna Hungaria, Generali
- Providencia

**MAJOR INSTITUTIONAL LANDLORDS**
- AEW Europe, MINT Investment, Generali, CPI Group, Immofinanz, Invesco, CIMEX Group

**15.4%**
- Vacancy rate in mature offices vs. 12.1% overall
FOR EVER YOUNG? ANALYSIS OF MATURE OFFICES IN WARSAW, BUDAPEST AND PRAGUE - MARCH 2016

CASE STUDY

RIVER ESTATES

Landlord: S Immo
Developed: 1998
Modernisation: 2015
Size: 21,300 sqm

New life of a building in the heart of Budapest

HEART COMMUNICATIONS, S IMMO Hungary

The office block is in a much-frequented part of district XIII, at the junction of Váci street and Dózsa Győrgy street (about 50 m from the underground station).

River Estates is a modern 9-storey office block, A category, air-conditioning in the office areas, 24 hours security and reception service, entry only with magnetic cards on every storey, vestibules and passages with continuous camera surveillance, flexible partition-walls (according to the tenants request). The building has a modern 3-level underground garage with 300 parking places, protected by security service, not only for parking the tenants cars but for parking for guests – paid by the hour.

The technical and visual renovation of River Estates office building located on Váci út was completed by the end of 2015. In terms of sustainability, the installation of the new HVAC system (heating, ventilation, air conditioning) is the most important part of the project, significantly improving the building’s energy features.

The first step of the project, which began in 2013, was the complete mechanical reconstruction, with an investment of about EUR 2m. The new HVAC system includes modern heat pump devices; the utilization of renewable energy significantly improves the building’s energy efficiency. The owner aims to achieve a BREEAM-certificate for the building.

In H2 2015 the works came to a more spectacular stage with the renovation of reception areas and the façade. Beyond repainting the building and replacing covers, tenants have been provided with new visualization opportunities as well. Inside the building, the works affected primarily the common areas: the reception and the lift lobbies. Besides installing a new reception desk, painting walls and replacing floor tiles, new visual elements – design lighting and an imposing Voronoi-installation – also enrich the interior. In order to maintain the tranquility of tenants and smooth operation of service units in the building, a major part of the works was done outside working hours, gradually building the new image of the facility.

In 2015 S IMMO’s team signed lease agreements for approximately 4,500 sqm office space in River Estates, raising the occupancy rate of the 21,000 sqm 10-storey building to over 96%. Several tenants operate their headquarters here since more than 10 years as an unquestionable proof of their satisfaction. They gave positive feedback on the technical and visual renewal of the facility, and River Estates became a worthy competitor to newly built modern office buildings in Budapest. Based on the current figures, the repositioning of the building was an undoubted success, and River Estates was nominated to the „Office Building of the Year 2015 Tenants’ Award.”
KEY INDICATORS OF MATURE OFFICES

Prague  CZECH REPUBLIC

178 mature offices vs. 428 in total

42%

891,000 m²

Stock of mature offices vs 3,222,400 m² in total

28%

€18.50-19.50 per m²/mth

Prime rental range in mature offices vs. €18.50-19.50 per m²/mth in prime modern offices

€11.50-15.00 per m²/mth

Average rental range in mature office buildings vs. €13.00-16.00 per m²/mth in other modern buildings

17.1%

Vacancy rate in mature offices vs. 14.6% overall

SELECTED MAJOR OCCUPIERS
Česká Pojišťovna, GE Money, Plzeňský Prazdroj, MSD, Raiffeisen Stavební Spořitelna, SFŽP, ČEPRO, Czech National Bank, Synlab, Abbott Laboratories, Ricardo

MAJOR INSTITUTIONAL LANDLORDS
AEW Europe, CPI Group, Cimex Invest, Immofinanz, Heitman, PSN, Tristan Capital Partners, MOF
Myslbek

Landlord: AEW Europe
Developed: 1996
Modernisation: 2013-2014
Size: 17,000 sqm (office), 10,000 sqm (retail)

Prime mature property in the historical heart of Prague

LENKA ŠINDELÁŘOVÁ, Head of Consultancy, Associate Director

Myslbek is an example of a prime mature office building in the heart of Prague, positioned on the top of the prime high street Na Příkopě, which due to its standard and location, is competing head to head with newer office schemes.

The 6-storey scheme, developed in 1996, offers 17,000 sqm of office space and 10,000 sqm of retail gallery. The building has a very good parking ratio with 2 underground levels providing 324 parking spaces.

In 2013 the owner, AEW Europe launched a substantial refurbishment programme and redesigned Myslbek, with the aim to modernise the property, improve its effectiveness and enhance its appeal to the current as well as prospective tenants.

The refurbishment project included a modernization of the entrance hall with the reception areas. A redesign of common areas within the upper floors followed by revamping of toilets, lift lobbies and hallways. Subsequently the property also achieved a BREEAM In Use Very Good rating.

The scheme enjoys currently 88% occupancy and constitutes the Czech headquarters of renowned tenants of companies such as Plzeňský Prazdroj, Kinstellar, BNP Paribas, Jones Lang Lasalle, American Express and many others.

It should be noted that Myslbek achieves one of the highest rents in the city centre in line with the prime headline rent €18.50-19.50/sqm/mth.
The mature assets are popular among institutional investors as well as private equity players who are looking for returns, which are on average currently 2-3 p.p. higher than in case of core office buildings, reaching on between 7.50-9.00%. This price spread reflects the cost of risk of owning and managing an older asset, plus the possible value enhancement that can be achieved through active management. A fully refurbished mature office scheme that is performing economically, with muted future capex requirements, would be priced similarly to a newer office development. Prague is an example of this kind, with the best schemes recording the levels of around 5.75%, comparable to those quoted for the most modern assets in the capital.

BNP Paribas RE is witnessing increasing volumes of value-add to core plus office investment volumes across the CEE region. Smaller lot sizes of many mature offices are primarily attractive for local buyers with local market knowledge, while larger lot sizes of properties in prime locations attracted international asset managers and funds such as Immofinanz, Lone Star, Tristan Capital Partners and VIG Fund.

In terms of tenancy structure, across all of the analysed capitals, a lot of public sector occupiers tend to have a seat in mature offices, which provides for a strong covenant in terms of value.

The majority of investors aim to increase property values by intensive asset management activities encompassing revamping of space, and sometimes involving major structural improvements, along with implementation of a marketing strategy for repositioning of an asset.

### SELECTED INVESTMENT TRANSACTIONS OF MATURE OFFICE BUILDINGS, 2014-2015

<table>
<thead>
<tr>
<th>BUILDING</th>
<th>GLA (SQM)</th>
<th>VOLUME (€ MILLION)</th>
<th>PURCHASER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Empark (50% shares)</td>
<td>115,000</td>
<td>90.0</td>
<td>Immofinanz</td>
</tr>
<tr>
<td>Europlex</td>
<td>25,300</td>
<td>60.0</td>
<td>Lone Star</td>
</tr>
<tr>
<td>Bliski Office Center</td>
<td>4,880</td>
<td>10.9</td>
<td>Griffin RE</td>
</tr>
<tr>
<td>Jerzolimskie BP</td>
<td>16,900</td>
<td>28.5</td>
<td>Ares</td>
</tr>
<tr>
<td>Kaskada City (shares)</td>
<td>4,850</td>
<td>8.0</td>
<td>PHN</td>
</tr>
<tr>
<td>BBC1</td>
<td>15,200</td>
<td>7.0</td>
<td>Magyar Posta Takarék Ingatlan Befektetési Alap</td>
</tr>
<tr>
<td>Duna Office Center</td>
<td>12,700</td>
<td>n/a</td>
<td>Europa Capital / Convergence</td>
</tr>
<tr>
<td>Westend Business Center</td>
<td>30,000</td>
<td>n/a</td>
<td>Wing &amp; Morgan Stanley &amp;CC Real</td>
</tr>
<tr>
<td>M3 Business Center</td>
<td>15,600</td>
<td>n/a</td>
<td>Public company</td>
</tr>
<tr>
<td>EAST-WEST Business Centre</td>
<td>33,000</td>
<td>n/a</td>
<td>Erste Property Fund</td>
</tr>
<tr>
<td>Praha City Centre</td>
<td>20,000</td>
<td>51.0</td>
<td>Tristan Capital Partners</td>
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<td>Hadovka</td>
<td>23,300</td>
<td>43.0</td>
<td>Europa Capital / Resolution Capital Management</td>
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<tr>
<td>Burzovni Palác</td>
<td>9,700</td>
<td>27.0</td>
<td>VIG Fund</td>
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<tr>
<td>ČSOB Leasing headquarters</td>
<td>9,410</td>
<td>20.0</td>
<td>Cimex Invest</td>
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<td>Arbes</td>
<td>3,565</td>
<td>11.5</td>
<td>Rimo</td>
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</table>

n/a - not available

Source: BNP Paribas Real Estate
The CEE capitals are currently at different stages of the market cycles. Yet, considering the market data collected for the report and bearing in mind landlords’ current approaches.

**BNP PARIBAS REAL ESTATE FORESEES** **THE FOLLOWING, THERE ARE A COUPLE OF TRENDS FORECAST FOR THIS PARTICULAR MARKET NICHE:**

- Extensive renovation works are expected in relation to 30% of mature office space in the capitals of CEE. This trend is primarily visible among landlords, who are both investors and asset managers. They have started or are planning to conduct wide-ranging revamping of their portfolios.

- Increase of energy efficiency along with improvement of workplace solutions aimed at enhanced employee comfort as well as space efficiency, are likely to be the key themes of mature office renovation.

- From the occupiers’ perspective, a properly renovated mature office building can turn to be the optimum option. Not only offering competitive rental rates, with strong incentive packages, but very often also attractive operational costs. Office space in older schemes can compete with newly completed ones, achieving equally strong scoring in the selection process matrix. Additionally, very often the offices developed over 15 years ago are well located, providing convenient access as well as good visibility. For these reasons, the tenancy structure should continue to be dominated by business service sector, occupying mainly mid-size units with requirements between 500 to 1,000 sqm. Small tenants will also form an important component of demand for mature office space, especially for tower-type schemes.

- Considering the volume and quality of mature office stock in CEE cities along with overall economic performance and general market conditions, investors shall continue pursuing investment opportunities in this market niche. The appetite to acquire older generation offices derives from the fact that value-add offices offer much more attractive yields when compared with prime buildings. The improvement of key office indicators in Prague and Budapest is coinciding with sharp prime yield compression; more opportunistic players will be looking to place money in such schemes. In Warsaw, entering a downward cycle due to record high pipeline, there are also opportunities to purchase attractive mature offices, especially in central and fringe of centre areas, which should increase in value in mid- to long-term.

- Generally, after proper renovation is done the result is increase in space efficiency, decrease in operational costs and improving occupier comfort. Along with a professionally implemented repositioning strategy, the mature asset can successfully compete with modern schemes and turn into high yielding property. This has been confirmed by a number of examples across the CEE capitals.
The latter element is currently being analyzed by office tenants with increasing diligence as over the last couple of lease agreement cycles, occupiers have become fully aware of how much service charges contribute to their operational costs.

It therefore follows that those tenants that are attracted to competitive rent levels and consider mature offices as alternative locations, should nevertheless investigate in detail aspects that contribute to operational costs.

These include planned refurbishments aimed at decreasing the building’s maintenance costs and price negotiations with service providers historical reconciliations to understand their future service charge cost.

Moreover, during the lease negotiation process we advise our occupier clients to strengthen their position by introducing caps related to service charge increases on a year-to-year basis. Alternatively to define as much as possible the service charge inclusions to mitigate any risks of covering unjustified expenses within the budgets such as building investment CAPEX.

However, it should be stated that nowadays the majority of landlords, whose buildings are professionally maintained, present a clear approach towards service charge reconciliation and are willing to grant tenants the right to perform an audit of the costs. The tenant should have the right to appoint an external auditor for this purpose and raise any issues flagged to the landlord prior to settlement.

The above trend is resulting from the need for transparency: an increasing awareness of transaction mechanisms by tenants and a better understanding of each party’s constraints rather than which side has the upper hand, which in the current market cycle is in favour of the tenant.
A major refurbishment will involve the replacement of the lighting, HVAC installations and the controls. These systems have a major impact on the quality of the office environment and can create healthier and more efficient office buildings. When refurbishing on office building it is important to consider the following technical aspects:

**AIR QUALITY AND THERMAL COMFORT**
A healthy office should have high levels of ventilation and in many buildings there could be the opportunity to implement a mixed mode type system that combines natural ventilation with a mechanical one. Such systems give occupiers more control of their environment and help to create healthier working conditions. Modern controls and technology can also be incorporated into the design to allow the amount of heating, cooling and even levels of ventilation to be closely matched to the current demand – resulting in minimised draughts, overheating and noise issues and at the same time reducing the energy consumption.

**LIGHTING AND DAYLIGHT**
Natural and artificial lighting are both critical in the creating of comfortable and healthy offices. A modern lighting system can provide high levels of flexibility in an office space to ensure the lighting levels are matched to the variable needs of occupants, and they work in harmony with natural daylighting and presence detection to minimise the energy consumption. With the latest design of LED lamps there is the possibility to control each lamp individually and the brightness and even colour of the light can be changed at the touch of a button – giving the occupiers full control.

**ACOUSTICS**
A comfortable office is neither too quiet nor too noisy. Acoustic treatment can be provided by ceilings, floors and wall panels and there are many items of office furniture that have been designed to act as sound absorbers or insulators. Good acoustics can create a calmer environment in which employees are less stressed and more productive. Isolation from external noise and noise transferred between meeting rooms or noisy areas with quiet ones can all be resolved by design.

**OTHER**
It’s beneficial for health and well-being to ensure views out to the outside world. The key is the access to amenities so that occupiers feel connected to their vicinity around the office. Also materials used for decoration should be low in volatile organic compounds (VOCs). Moreover it’s worth ensuring zoning: loud, social sections and quiet rooms facilitating

Engineer Perspective

Many of the mature buildings, which are coming to the end of their first life cycle, are in need for refurbishment. They have lots of potential that can be unlocked during the refurbishment process through clever design and the implementation of smart technologies.

IAN BOOTH
Partner
BuroHappold Engineering

BuroHappold Engineering is an international engineering practice that over the last 40 years has become synonymous with the delivery of creative, value led building and city solutions for an ever changing world. Having worked on every continent, our clients include more than 90% of the world’s leading architectural practices.

The office in Poland was established in Warsaw in 1997 and currently employs over 120 engineers. As pioneers of user-centred design we are able to elevate tired spaces and implement new technologies that enhance space utilization, process efficiency and visitor experience. Working in diverse environments where space is often a premium and occupant comfort, wellbeing and safety a priority, we link design to operational performance with clear and measurable results for clients whilst ultimately increasing reliability, performance and value of their buildings.

BuroHappold Engineering
www.burohappold.com