Office stock shrinks hugely as Covid drives a flight to quality

Some 18m sq ft of space taken out of use as amenities and ESG become top priorities for office occupiers

Adam Branson

Those who thought the impact of Covid-19 on the office market would be a flash in the pan should think again.

Last week, research from law firm Boodle Hatfield revealed that in the year to the end of March 2021, a total of 18.2m sq ft of office space had been lost in England and Wales – the equivalent of 239 football pitches.

That is not space in want of a tenant. It is space thought to have been permanently dispensed with – a trend not likely to be reversed once the pandemic is over. Indeed, many commentators agree that the trend is set to continue, Covid-19 or no Covid-19.

So, what exactly does the future hold for the commercial office market as we now enter a third year under the shadow of a pandemic?

As was to be expected, the Boodle Hatfield research showed that the volume of office space being taken out of use accelerated substantially between 2019-20 and 2020-21, increasing by 70% from 10.7m sq ft.

Perhaps more surprisingly, given that many commentators speculated that the pandemic would result in more people taking flexible space closer to home, it also found that the worst-hit areas were generally smaller cities and outer London areas. The areas with the highest proportion of office space lost include Derby (20%), Brent (19%), Brentwood and Southampton (18% each) and Ealing (14%).

Barry Jessup
Socius

"The loss of this mostly tertiary space should come as no surprise

"Coronavirus has shaken up the commercial property landscape, resulting in substantial quantities of office space being put out of use," says David Rawlence, associate at Boodle Hatfield. "This has been particularly evident in smaller cities and outer London suburbs."

The reason is actually fairly obvious. With vast swathes of the workforce having proved over the past two years that they can do their jobs at least as well from home, employers that do believe in the benefits of an office environment – and there are many that do – have found they need to offer ever more attractive workplaces to tempt their staff back.

Such buildings do not tend to be found in smaller cities or the London suburbs.

"Businesses are increasingly looking for high-spec office space with all the mod cons in order to tempt workers back into the office," says Rawlence.

"Spaces that facilitate collaboration between colleagues, with amenities that promote mental wellbeing such as gyms and relaxation rooms, will be the most attractive to prospective commercial tenants."

Office obsolescence

Barry Jessup, managing director of developer Socius, which separated from First Base in December to concentrate on its £1bn pipeline of urban regeneration schemes in locations such as Brighton, Bristol, Cambridge and Milton Keynes, agrees.

"The loss of this mostly tertiary office space should come as no surprise," he says. "A lack of investment in regional offices over the past couple of decades means that a lot of them are now obsolete. A lot will be converted to residential, but two wrongs don't make a right. Creating poor-quality housing and losing crucial employment space is rarely a win for any town centre."

Jessup adds: "There has to be a good reason to come into the office in the post-Covid world and »

«

Best in class: up and down the country, businesses are homing in on the best new stock available in a bid to attract workers back to the office

CANADASTOCK/ALICE-PHOTO/SHUTTERSTOCK

few of the historic office buildings currently provide the flexibility, amenity, air quality and brand value that will resonate with the occupier market."

Nigel Mapp, chief executive of MAPP, which manages around £13.2bn of commercial space for a variety of leading UK funds, REITs and real estate investors, makes a similar point.

"In 2021, we saw how investors are no longer just looking at location and the tenant line-up, but are increasingly also looking at amenities, the quality and occupational readiness of space and the services that they can offer to occupiers," he says.

"This is largely driven by occupier demand for optimum workspaces that are maximised from a design, wellness and environmental perspective, not just from the point of rental and building value but also to inspire people to return to the office."

According to industry experts, it is a trend occurring up and down the country. Greg Davison, partner at Cushman & Wakefield's Newcastle office, observes that businesses in the North East are increasingly homing in on the best new stock available.

"There is certainly palpable evidence of a flight to quality as occupiers wrestle staff back to the office and look to create a workplace environment that encourages staff engagement and collaborative working," he says.

"I dare say we will see more secondary buildings struggle to retain tenants, but that will be impacted by two things: first, a willingness from landlords to invest in improving those buildings and lift them out of their secondary ranking, thereby helping to retain tenants; and second, how much new grade-A stock will actually be available."

It is not just amenity and attractiveness that matter, however. Companies are also increasingly looking for best-in-class buildings from an environmental standpoint, too, driven by both their employees and investors.

Greg Davison
Cushman & Wakefield

> **"There is certainly palpable evidence of a flight to quality**

While no doubt accelerated by the pandemic, the trend was already evident and is likely to continue post pandemic.

Sustainable stock

"In addition to the Covid-19 effect, the rising importance of zero carbon corporate pledges mean that a number of these buildings are also not occupiable from a sustainability perspective," says Jessup. "The answer, of course, is wholesale refurbishment, but ideally retaining as much of the existing buildings as possible to ensure maximum carbon retention."

The drive for ever greener buildings is also set to be given a regulatory boost. The latest iteration of the government's Minimum Energy Efficiency Standard (MEES) legislation is currently being passed through parliament and will make it illegal to lease an office with an Energy Performance Certificate (EPC) with a lower than 'B' rating by 2030.

According to data published by Cushman & Wakefield, only 4% of buildings in London have at least an EPC 'B' rating. For its part, the government estimates that the proportion of rented commercial property covered by MEES will increase from around 10% to around 85% – approximately one million buildings across England and Wales.

"We'll see some buildings offloaded on to the market and bought by those who are prepared to invest to deliver a sustainable building that is relevant and in demand by occupiers," says Mapp. "Some will be converted to residential, but obsolesence will become an increasing problem."

So, the emergence of Covid-19 and the work-from-home mandate may have led to a jump in the volume of office space being turned over for alternative uses, but the trend is also being driven by slower-moving but more powerful forces.

As Jessup notes, there is actually no shortage of demand for high-end stock in more marginal locations; the issue is that supply has yet to catch up with demand. ■

Steven Charlton

BARRY JESSUP

Managing director, Socius Development

It was fantastic to track the increased importance of environmental sustainability in the decision-making of office occupiers (and consequently investors) in 2021. I expect that 2022 will see a rise in the prominence of the 'E' and the 'G' parts of ESG, as occupiers align themselves with their target employees. Developers will need to respond accordingly.

I also expect that BTR investors will follow their office counterparts and demand more sustainable products as they anticipate their future residents' requirements.

I hope 2022 will also see the continued rejuvenation of our high streets as we replace outdated big-box retail and oversized car parks with a more interesting mix of uses and experiences, and encourage broader human and business interaction by reintroducing homes and flexible workspace into town centres.

DARREN GARDNER

Chief operating officer, Nido Student

This year, we predict the PBSA sector will continue performing as a strong asset class. Throughout the pandemic, it has shown incredible resilience and, due to significant investment across Europe specifically, has become a consistent news topic. The importance of safety and security is now paramount and has allowed PBSA operators to demonstrate their capabilities in providing a place of support.

Operationally, we expect to see the consumer experience taken to the next level. Residents will have hotel-style management alongside technology offerings and pastoral provision, meaning our communities will be more looked after than ever before.

As PBSA continues to be the desired choice of accommodation for many students, there lies an opportunity for investors and operators to capitalise on user feedback, as this will be the key to the economic success of a residence.

ROBERT COTTERELL

Head of investment Europe and head of UK, Cromwell Property Group

The next 12 months will be really interesting in the UK. There are huge variances across a market where you can buy logistics at 2% yields and retail at 15%. It is unlike anything we have experienced. The sleepy property sector of a few years ago is practically unrecognisable.

The trio of the pandemic, increased focus on ESG and lingering Brexit after-effects are having a big impact, putting pressure on investment managers' decision-making. Property is a long-term game and asset management is a bit like steering a ship, as small movements can have massive implications further down the road.

As investment managers, we must remain flexible. What's happened to retail real estate is unlikely to be a once-in-a-generation event. Investable assets that hold their value over the long term will be easily adapted to a variety of uses and there will be more focus on development capability as a core skill set.

JOHNATHAN CRAWLEY

UK managing director, MiddleCap

Last year proved the office and London are far from dead, despite doom-mongering predictions to the contrary. The combined effects of Brexit and the pandemic have not lessened the appetite of investors or occupiers – as we have seen with the market bouncing back strongly, particularly in the last quarter – and I expect it to continue to thrive in 2022.

The industry's fixation on ESG will rightly continue and those who dismiss it as a passing trend will do so at their peril. Investors and developers are already making changes to their businesses and portfolios and we'll see progress with occupiers being more demanding about the environmental credentials of their spaces in particular. However, greater collaboration between development, design and construction teams, as well as the wider real estate industry, will be required to meet such targets and optimise building performance (in all aspects of the word) if we are to truly make progress.

STEVEN CHARLTON

Managing director, Perkins&Will London

Contrary to earlier predictions, the flexible working model is here to stay, with office spaces that blur the lines between home, work and leisure reigning triumphant.

Wellbeing will emerge as a central tenet of office design, with incorporation of biophilia in aesthetics and drawing inspiration from the hospitality sector for operations. As evidenced by AstraZeneca's unveiling of its Cambridge site, and with pharmaceutical companies now household names, the pandemic has also been pivotal in giving the UK's life sciences sector the boost it needs to emerge as a global leader.

From the architect's point of view, the sector's rapid evolution will mean placing adaptability at the heart of life sciences design. This will ensure that new technologies and research priorities can be slotted into laboratories, continually adapting to society's changing healthcare needs.

GABRIELA HERSHAM

Co-founder and chief executive, Huckletree

In today's climate, business employees, from entry-level right the way through to C-suite, place significant emphasis on the experience their workplace offers. While data is proving that most employees now want to return to the office at least 50% of the time, developers must still take a 360-degree perspective of what buildings provide for their tenants from the outset.

Whether it is a hotel-inspired front-of-house service or a forward-thinking wellness offering, great amenities are essential to attracting and adding value to companies, especially when it comes to retaining talent.

Developers will be investing increasingly in third-party hospitality operators, recognising that a high-quality, thought-through hospitality strategy is what will drive yields. Buildings positioned to capture a younger, more demanding audience through avant-garde, differentiated offerings will be even more celebrated in 2022.

RUSSELL PEDLEY

Co-founder and director, Assael Architecture

As the built environment continues to be revolutionised by digital processes such

»