

The tipping point – a new reality for offices?

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The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

As offices around the world were shut down in response to government containment measures, in an instant, the working day was shoehorned into our kitchens, bedrooms and living areas. The immediate impact on our lives was one of necessity. CEOs congratulated their teams over the speed of this transition. But, before long, the natural question arose: “Will this lead to a more permanent shift?”

The short-term answer to this is heavily anchored to personal circumstance. While home working policies have been adopted en masse, individual experience has been far from consistent.

How has my experience differed from others?



Do I have a private workspace to use as a home office?



Do I live in a shared flat or have access to private outdoor space?



Am I responsible for looking after small children?



Can I mentally switch off from work, when work is now my home?



Do I have the right equipment to work efficiently and healthily?



Do I miss the social aspect of working; the spontaneous chats with colleagues?

The psychological impact of lockdown is also pivotal to employees’ appetite for a return to the office. Whilst the current threat to health is temporary, as long as distancing measures are in place, many will be reluctant to jump back onto overcrowded transport systems. That said, history has taught us that memories can be short. Following the 9/11 terror attack in New York, commentators were quick to prophesise the end of the skyscraper. Evidently this has not been the case. Similarly, social distancing rules will dictate our return to the office, but once a vaccine is found it is likely that we will see an initial rush of ‘revenge’ office time: workers beleaguered by isolation fatigue and seeking wider human interaction.

Therefore, we need to frame the debate beyond the next 12-24 months. In our judgement, the proverb ‘people tend to overestimate the short term, and underestimate the long term’ feels realistic. We firmly believe in the place of the office building. The real question is what the modern office of the 2020s actually represents, and whether this space is still fitting in a post-virus world.

Agile working means having the option

The shift towards flexible working has been underway for several years. Rather than resisting this trend, senior decision makers have been embracing it. It is now widely accepted that employees don’t need to be in the office 9 till 5, five days a week. There is no singular method of working. Are you a morning person or an evening one? Are you an introvert or an extrovert? Arguably, fewer meetings or ‘urgent’ desk drop-ins can improve productivity. It makes sense, then, that agile working becomes more ingrained

in our weekly lives. But flexibility means having the option to work in an office. Often that choice – be it three days in the office or five – is based on weekly circumstance.

It is also important to make the distinction between different cultures and sectors. Whilst social attitudes and labour laws have been more progressive in countries like the Netherlands and Sweden, for example, Japan has yet to shake its ‘salaryman’ stereotype. Flexible working has also more naturally evolved in particular industries. A survey by CIPD¹ indicates that IT workers are already split between permanent office-based and fully flexible roles. By the same token, technical roles with less client engagement are more predisposed to home working. There are other nuances to consider, such as variations between departments or the stage of a person’s career. Younger employees aged under 35 are much less likely to want to work from home than those aged over 50. All of this points to different levels of requirement for flexibility and space.

The office building is here to stay, with a focus on quality over quantity

The typical modern office environment now reflects something more engaging than rows of identical cubicles. Its purpose had already started to evolve prior to COVID-19. Office space can help companies to innovate and create. It allows for collaboration – at a level beyond the continuously interrupted and awkwardly apologetic virtual meeting. Increasing flexibility levels may ultimately create an even bigger headache for managers. How do you coordinate collaboration if the team is split across multiple locations?

¹ Mega Trends; Working from home: what’s driving the rise in remote working?, CIPD, April 2020.

The office also forms a part of an organisation's values, helping to define its culture. In the battle for talent, this is crucial. First time entrants to the workplace now largely identify with 'Generation Z', often with already entrenched ideas around social interaction, wellbeing and work ethic. It is arguably this demographic that firms need to cater for most.

To accommodate this new format, the direction of travel has been quality over quantity. Office optimisation has been underway for more than a decade. Obsolete desk space has been replaced with break-out coffee spots, innovation hubs and wellbeing facilities. So while space per worker has been falling, fit-out costs and service charges have been trending upwards. For occupiers, this has helped to level out their overall costs. For landlords, the rental premium attached to the 'right' space is of even greater value. COVID-19 will surely accelerate this trend.

A two-tier market will open up – with a major saving grace

The loser in this instance is the space that falls below modern office standards: the back office locations; those in out of town business parks; or third tier towns. Call centres or industries where the technology has long-existed to enable a transition of the role to the home. All it needed was a catalyst. Inevitably the old, the compromised and the too-costly-to-retrofit space will suffer.

Polarisation. Where have we heard that before? Like retail, the office sector is likely to face a two-tier market. A key mitigant is that office-based corporations tend to think in multiples of years rather than weeks, which means the underlying real estate is less connected to seasonal profits. Moreover, tertiary office space can more easily be reinvented than retail. The structure of office buildings lends itself well to residential conversions – a saving grace for many global markets. A new wave could well be coming.

Office Investible Universe



Stars

High performers: income and growth

Where: CBDs; emerging sub-markets; transport hubs

What: Energy efficient; wellbeing and amenities focus

Who: Client-facing; collaboration and creative intensive



Question marks

What next?

Where: Fringe locations

What: Medium capex risk

Who: SMEs; high density flexible offices



Cash cows

Stable and resilient

Where: Central sub-markets; gateway cities

What: Corporate HQs; large sustainable floorplates

Who: Professional services; core finance and banking



Laggards

Potential loss makers

Where: Back-office business parks; tertiary cities

What: High capex risk; non-compliant ESG

Who: Non-client functions; finance; admin and tech

Best quality central office hubs reflect the likely winners

If 'quality' is the direction of travel, this surely reinforces demand for a centralised office hub. The occupier shift to centrally located front offices has played out for many reasons; better connectivity, agglomeration economies, talent retention, a lower carbon footprint. In the long run, we expect these factors to outweigh the near-term complications of social distancing on the commute.

As with any heterogenous asset class though, for every generalisation there are four times as many caveats. Central hub offices must reflect occupier needs of the 2020s. The motto 'if we build it, they will come' must change to 'if we build it, they should come', providing we think very carefully about the design, incorporate the right ESG characteristics and get the location bang on. ESG targets need to be thinking 10 years ahead. The design emphasis must revolve around flexibility, amenities, staff wellbeing and the human aspect of working. The best quality space will always command a higher security of income. But landlords of older buildings or those in off-pitch locations may need to get used to weaker cashflows.

How investors adapt will determine their success

Like all major crises, we can expect a period of reflection to follow. Inevitably, corporates will look to claw back lost revenue through restructuring and cost savings. The traditional office floorplan will likely be at the heart of this. But the modern office building has, arguably, already moved on. How investors adapt to the speed of future change will likely determine their success ten years from now. The fact that real estate is a slow moving asset class, defined by the legalities of lease terms, may provide a temporary buffer from behavioural change. But in the long term, it will be the occupier that increasingly shapes global office space.

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