

SLAUGHTER AND MAY

Slaughter and May Podcast

The future of the London office market: In conversation with Derwent London and Knight Frank

Jane Edwarde	<p>Hello and welcome to our podcast today I'm Jane Edwarde, I'm delighted to be joined by Paul Williams CEO of Derwent London and Phil Hobley, a Partner and Co-Chair of London offices with Knight Frank.</p> <p>Today we are going to be looking forward post-Covid-19 to a new world and asking ourselves how will the London office market change and in what ways, and I think we might start, if we can, by looking at how we think occupational demand will change post-Covid. Will corporates, will employers still want an HQ? How much office space will they want? How much flexibility will they want?</p> <p>Paul, how have you seen the changes during Covid and what do you foresee?</p>
Paul Williams	<p>I think firstly, I think this is an acceleration of things we were seeing already on a flexible working, agile working was started quite a few years ago and I think people have worked out that they can work from home, but have also worked out that working from home is very hard work. So for our portfolio we are seeing a lot of our occupiers wanting to get back. I think in the way they occupy I think there will be lots more social distancing, I think desk spaces will get bigger but it's interesting if you look at utilisation rates they are not particularly high. If you look at density levels they are also not very high I mean, you know, we design our buildings to 1 to 8 square meters, they are occupied really by 1 to 12 and if you look at utilisation it's sort of 58-60% so I think you're going to see more amenity space, you're going to see more bigger desks but actually I think demand is here to stay for a well-designed office, but I think you'll see the inventions of a two tier market post-Covid, a fight for quality and a fight for good space particularly space that has got wellness and also that is green.</p>
Jane Edwarde	<p>And Phil what would you contribute in terms of what your clients are asking for?</p>
Phil Hobley	<p>Well do you know what, I think the acceleration of things that Paul mentioned at the beginning is key but I'd just like to start actually with the word change, you know, what's going to change. It's often used in a really negative way but you know I've been in the industry now for 25 years and, you know, change has often come off the back of an uncomfortable market, but has usually resulted in really positive progress whether that's in product, in the way occupiers use space or amenity or the development of place that wasn't really around before so, you know, I would sort of almost like to pitch it as there will be a positive that comes out of this. Probably as Paul says in the way that the space is utilised so getting more value from the office space that you have and I agree I think that there was a shift already in train away from really dense occupation to much more intelligent, much more flexible use of the office space, so that you are giving people the sort of environments that is useful for them to work within for different roles during either their job or different roles</p>

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	<p>during a working day. And I think it's about balance as well. You know, the old regime of 5 days a week commuting into the office and long days at the desk, that's not balance as we all know and there was a move away from that. As we've all found five days at home enforced is also not a work life balance, quite the opposite. My family were over the moon to see me return to work and I was waved off from the front drive and I think we will see a better balance come into people's lives, business, in every sense which again is probably no bad thing.</p>
Paul Williams	<p>I call it living at work that's what I say if you're at home doing 10 hours of zoom calls, you're living at work you're not, you haven't got a work life balance but I think things are changing and they are always due to change.</p>
Jane Edwarde	<p>And when as a developer Paul, you're planning, you know the ideals of immunity spaces etc. for your tenants, what are the key top things which tenants are looking for, which they value in their office space of the future?</p>
Paul Williams	<p>I think, we've been talking about, we did White Collar Factory back I think, 3 or 4 years ago we've got a project next door which Phil's helping us with and if it's about adaptability and we held this thing called a tenant forum, I invited some people in for lunch and actually a landlord talking to their customers and asking what they wanted was quite an interesting concept and it was all about adaptability and people get fed up with the dilapidations and obsolescence and things like that, so we looked at, we coined this phrase long life loose fit. We never thought Covid was coming along but it's been really useful for us because it's meant the space that we've got across our portfolio is easy to change. So it's that adaptability and being able to space out, the amenity space so we've looked at our portfolio going forward and thinking what changes do we need to make and actually when we did an independent survey of what we need to do very little needed to be changed and its built into that long life loose fit adaptability and I think that's what occupiers want whether its adaptability or lease lengths where its core and flex or where it's that sort of the type of space they want, and I think the old days of landlords knowing best and this is what you must have and maybe too reliant on the agents, no offence Phil. I think you need to be a bit more nuanced about what your customer really needs.</p>
Jane Edwarde	<p>And post-Covid do you think occupiers will ask for more from the landlords in terms of safety in their own health and safety and ventilation etc. Do you think there's going to be naturally more focus on those areas?</p>
Paul Williams	<p>I think that's a very good point definitely. I think the age of sort of a sealed building without the ability to have mixed mode, opening the windows, you know, hopefully London is getting cleaner so I think the ability to run the air conditioning without actually re-circulating dirty air, more amenity space, more roof terraces, more break out areas and health and safety we looked at the way we run our portfolio, what changes we've made for Covid; whether its screens, whether it's the lifts and things like that. I think as a responsible landlord you need to do it and I think, you know, I think people will be looking</p>

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	<p>for more. We've done a huge amount of work across our portfolio, spoken to every single tenant in the portfolio asking what they needed and it is the sort of stuff you'd expect, you know, touchless lifts and automatic doors and automatic faucets and things like that so you need to decide the building that's health and safety but also green.</p>
<p>Jane Edwarde</p>	<p>And what is that sort of increased focus on the green agenda, what does that do to cost?</p>
<p>Paul Williams</p>	<p>It's a marginable increase, I mean White Collar actually cost a little bit less but that's just the way we caught it at the time. You know, obviously, opening window or having a window that opens is a little bit more expensive than having a sealed façade but I concur, I think the reality of life is if a bit more construction cost is pretty de minimus when you think about the extra rent you might get or the shorter period time it might let. I've got a view that actually greener buildings will be worth more than a brown buildings so they should be a greater rent for green buildings in future and may be a lower yield so actually it's a good investment decision apart from being the right moral decision. We have committed to a less zero carbon by 2030 and it's something our occupiers are very excited about but also our investors so I think its good business.</p>
<p>Jane Edwarde</p>	<p>And Phil, any input from you on that side?</p>
<p>Phil Hobley</p>	<p>Yes I've always found that shifts tend to happen when there is more than one force applied to it, so you've now got the twin forces of legislation on carbon and obviously investor pressure and in fact you've even got a growing pressure from staff, from the people who occupy this space on their employer, on a landlord and so I think with those factors, you know, with every company now having to have a stated target, you know, on carbon, yes I think that that grounds well of change is undoubtedly coming.</p> <p>A premium for green buildings, I think it is going to become, you know, the entry level and you're going to get obsolesce pretty quickly if you're not at the races but I think that in tandem with other elements of, you know key elements of design, amenity, good location you know part of a wider public realm then yeah I think it will be the space of choice for the, you know, the informed, the intelligent, the forward looking occupier and we are starting to see that across London. You know, occupiers are being drawn to the most sustainable, the greenest buildings in the market because it matches their own vision and values or it matches the push from their investors that they need to meet.</p>
<p>Jane Edwarde</p>	<p>Yep and Covid has perhaps accelerated then that desire for greener buildings because occupiers are perhaps looking for safer space at the same time?</p>

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Phil Hobley	<p>Yeah I think when you look at it in the wider perspective than just sustainable so come back to wellness, you know, as Paul said, it's all about safety first so you know, that's the key near term goal, that's all about making staff comfortable and feeling safe about returning to the office and then once that return, you know, the return to work starts to get into full flow, schools are back, we're in September now, our offices, you know, we've got the busiest day today at our headquarters we've had through the last, what is it now, it's nearly 6 months isn't it. It's about making it a place that staff want to go. So now coming back to Paul's point, you want to commute into the office for the experience, for the collaboration, for the time, you know, with your colleagues. You know, its collaboration, it's also learning, it's the social side of business and life that we're all in in it for. So it's all part of that wider mix but it's certainly the future of the office. You know, there was a focus on that in any event and come back to I think the first point that Paul made on the call was that, you know, we're seeing an acceleration of the trends that were already in place because of Covid, you know, its super charging them.</p>
Paul Williams	<p>I've just added to that point, Jane I think the two words go together, health and safety and for too long landlords have not thought about the health of their occupiers and so I think the wellness of that. Yes you've got to keep people safe but I think the health and how a building will help and collaborate with those sorts of things is really important and that's the sorts of things that we are looking at in our portfolio you know, having our buildings certified for wellness and I think people's health is incredibly important.</p>
Phil Hobley	<p>I think the other thing, Jane if I may, the point that, it was nice to hear Paul say about the sort of, the town halls that he has been having with his customers and talking to them about what you're doing and what they are looking for and I think that that, I think occupiers are going to be more demanding of the service from the client, they are going to be held more to account as a landlord and therefore the transparency in that, I think is going to be really important as we move forward not just because of Covid but looking at things like the efficient use of the building, controls of lighting, of your fresh air quality, security and safety, all of these things, you know, I think that the transparency around all of that is going to be really key moving forward and technology can really help with that. You know, here we are on our call, I think I'd only done one zoom call before lockdown started and now I think I've only done one without it and so I think the enabler that technology can bring when used productively can be really part of that solution to connect landlord and tenant not just through tech but tech enabling the transparency to come to the fore.</p>
Paul Williams	<p>Well maybe I think we should ban the word landlord and tenant, it's a pretty historic term. Why don't we just call it customers or clients or just actually have a proper relationship because actually our experience of Covid, actually the more we have collaborated with our occupiers, the more they have collaborated with us. And actually having a connection and having a customer focus is really important and I think it's an acceleration of what we've been</p>

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	<p>doing and I think going forward that's what occupiers will want and what they need and what they deserve.</p>
Phil Hobley	<p>Very good point, I'll take that.</p>
Jane Edwarde	<p>And do you see Paul, Phil, do you see lease lengths coming down or more breaks? How do you see the sort of structure of the lease changing?</p>
Paul Williams	<p>Well again I think leases have been coming down quite a lot anyway. I think when I started the business a lot earlier than poor old Phil but you know 25 was the norm right you know for our new buildings we get a 15 year lease so that's fine. We do a lot more of what we call core and flex, where people may take a substantial amount of space on say a 15 year lease and have a break and I'll say you'll have more flexibility from within. The flexible providers are here to stay, there will be less of them and there's probably too many of them at the moment, you know, but tenants want light break rules but rarely trigger them, and I see a bit of flexibility but just for us in our portfolio, you know, tenants say they want a 10 year lease say actually can I have a 5 year break and they said fine and they reduced their rent for it so actually you've just got to offer a whole menu of different lease lengths. For some tenants they will want a nice long lease, for others they will want a short lease and for some tenants or customers they will want a combination of both and I suspect that is really the future.</p>
Jane Edwarde	<p>And if as you say, you know, going forward there is likely to be a menu of you know, flexible products out there for customers I should say rather than tenants to select from. How, Phil, does the investment market sort of respond to valuing that breadth of product, how do you think London will fare as a global product with so many sort of varieties around the theme?</p>
Phil Hobley	<p>Yeah well it's interesting, you know, does London lose a bit of USP if it loses the long lease which is quite unique to the UK market. You know, I think it's a change that has been happening in the market anyway and if you look at the yield profile across London, mid-three's on the West End, mid-fours in the City it actually already looks like good value compared to continental Europe. Continental Europe, particularly France, you know, they're working on a 369 lease term model anyway on keener yields so I don't think, no, I don't think it does, is it a change – yes, does London lose its USP and its appeal for global investors – absolutely not.</p> <p>You know, I think that if you look at it on a global perspective, you're looking at a number of things reaching out across our global network and looking at our teams across the globe in our gateway cities, you realise London actually, from a product perspective, has, you know, globally leading products that is delivered by the developers like Derwent so its product which is next generation, it's a product which is appealing to occupiers which you know we've got incredibly low voids so half that are in the pipeline have already been pre-leased so no I don't think it impacts London's global appeal for investors</p>

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	<p>you know its fundamentals of, for investment as a safe haven is still there to stay.</p>
Jane Edwarde	<p>And maybe that word “safe haven” is key, you know, it could be even safer in a world seeking safety.</p>
Paul Williams	<p>I think the establish, of the rule of law, the language, the time of day that safe haven is interesting to see there’s still international money wanting to come into London. You know, I saw an investment sold recently at 4%, apparently it was bought by Singapore money, they hadn’t even seen it yet, they bought it online, they spent X million quid on line you know, it’s maybe the way of doing things for the future so I think London is a safe haven and going back to your point about yields, reality is a multi-let building to have some leases short term and have the ability to have some co-working within the building office to have a bit of breathing space with the occupiers therein I don’t think yields are going to shift. If you have a single let building to a poor covenant with short leases then clearly that would affect the value.</p>
Jane Edwarde	<p>Yep and looking forward then, what would your top predictions be for the future, what are we going to see and what do we need to look out for in the next 12/18 months post-Covid and beyond, hopefully?</p>
Paul Williams	<p>I think climate change will become really hard on the agenda, I think there will be big demands to make sure people commit to net zero carbon. I think wellness from an office point of view will go up the agenda dramatically. I think going back to my point I made earlier I think health will be a critical issue and tenants and occupiers and customers will be looking at the buildings, does that building fit for my staff? It’s interesting to say that decisions for new space is still made by HR not by CFO not even by CEO’s it’s made by, you know, people who are actually going to occupy the space. So we are going to, as Phil said earlier change happens, there are always triggers, you know, and I think it’s difficult to make predictions apart from things will change but London will remain a global city, a great city and people will be attracted to it.</p>
Jane Edwarde	<p>And Phil?</p>
Phil Hopley	<p>Yeah, I completely agree with that sentiment, you know, while I think that it will bring through positive change into the market. I think that the focus on wellbeing was key anyway but will absolutely be fundamental and you’re right Paul to say you know, its HR Executives that we are spending a lot of time with on tours, in discussions on acquiring new space and their focus is on staff you know, it goes further than just wellbeing it’s also I think, migrating towards that sort of lifelong learning and so bringing education into the workplace so that people have more, you know, enriched personal development experiences and enriched career development, you know, within that working environment. So I think that, you know, the office absolutely has a future that the death of the office articles that the Press have been keen to write for years I think has completely overplayed. Will it bring change – yes, is that a bad thing – no. I</p>

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	<p>don't think so at all and I think to Paul's point quite rightly made earlier you're going to see an increase in the collaboration and partnering, you know, between customer and developer so that you're getting product that works for the business and the needs of that business relative to, you know, their culture, their brand and the staff that they are looking to host and keep safe and keep productive within that envelope.</p>
Jane Edwarde	<p>Well thank you. A challenging future no doubt but an exciting one as well as the market responds in terms of product and becomes, as you say Paul, even more necessarily customer focused. So thank you both very much for your views today, very welcome and thanks again.</p>