

# M25 & South East Markets Report

*A Spotlight on Offices and Life Sciences*

EXECUTIVE SUMMARY

In 2023, organisations and real estate alike must adapt to a rapidly changing landscape, with some challenges inherently disruptive and requiring difficult transitions. As part of our annual review of the M25 and South East markets, we have identified and investigated the leading topics that will shape the market in 2023.

### Obsolescence or Opportunity?

Changing work patterns, tightening regulation, and a more significant corporate focus on ESG means that functional and physical obsolescence is entering the narrative with more vigour. The rapid onset of hybrid working during and after the Covid pandemic has shifted the employer and employee mindset. This has meant that organisations increasingly realise that existing space could be functionally obsolete – a product of a different era of work. Occupiers seek high-quality, amenity-rich offices providing a first-class workplace environment and experience, and this mantra is narrowing the market and shaping new requirements.

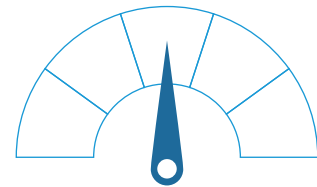
The Minimum Energy Efficiency Standards (MEES) requirements will further reduce office stock in the South East. Around 6% of office space in the South East did not comply with the minimum regulation of April 2023. Moreover, analysis indicates that 54% of office space in the South East falls short of the 2027 MEES requirement of an EPC rating of C or above. When considered against the 2030 requirement of an EPC rating of B or better, 80% of office space in the South East does not comply.

### Pressure on the purse strings?

In 2023, a confluence of factors, including higher occupational costs, higher build costs, volatile debt markets, and the realisation of structural change, is dictating market activity. For the occupier, cost pressure has mounted. Prime rent in the South East has risen by 3% on average, whilst the rating revaluation increased 26% for South East offices in the region. For the landlord or developer considering refurbishment or development, the BCIS General Building Cost Index shows an increase of 7.1% compared to the same juncture in 2022, while materials costs are up 8.1% over the same period. For the investor, interest rates have hiked at an unprecedented pace, resulting in the cheapest debt available at a minimum all-in rate of circa 6%, with senior lenders insisting on lower loan-to-value levels in the high-rates environment to bring debt service coverage ratios back to acceptable levels. Whatever the perspective, 'Cost' is leading the narrative in 2023.

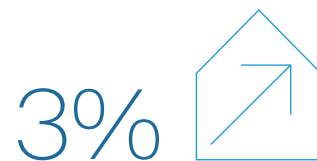
### Offices – A new sense of purpose

Many agree that the death of the office has been greatly exaggerated. Indicators show that office occupancy rates are slowly rising, but the pre-pandemic workplace strategy no longer has relevance in the workplace culture of 2023. The orthodoxies of pre-pandemic life are undergoing a fundamental re-evaluation, whether it is the structure of the working week or day, the balance between work and personal life, the effect of our working lives on our mental and physical health, the sustainability of commuting, or the office as the central place of work. Businesses are now prioritising experience in the workplace alongside an agenda inclusive of an employees' social, physical and psychological well-being. This shift is influencing the quantum and qualities of workspace required by occupiers. The office's role is now attuned to creating a healthy, collaborative and productive environment that offers tangible benefits to those working there.



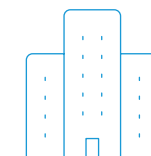
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## The Growth Sector of the Moment – Life Science


Life Science clusters form around talent and knowledge, usually from an anchor such as a university or research institute. In this respect, the South East is rich with globally renowned institutions at Oxford and Cambridge and a growing representation at the Universities of Reading, Sussex and Surrey. This platform has meant that space demand in the South East has multiplied from the Life Science community. Cambridge, for example, has over 1.2m sq ft of named lab requirements. Supply is short, however, with 24,000 sq ft of available lab space and just over 306,000 sq ft of additional space set to come online in the short term. This type of market imbalance is replicated across the region, a position that is spurring investor interest. Life sciences investment volumes in Oxfordshire and Cambridgeshire alone totalled £1.1bn in 2022.

## Finding opportunities in uncertain times

A flight to quality is underway, but the South East has few fully let and stabilised 'Prime' offices that will match high-end occupier and core ESG investor requirements. Assets that fit these criteria prove particularly liquid and, following the capital markets turmoil of late 2022, are demonstrating a 15-20% discount compared to last year. Pricing is beginning to stabilise where these assets exist. So what of the rest? Core-plus strategies are harder to define, with investors targeting traditional value-add returns whilst factoring in the increased risk and capital expenditure. Where spending exceeds potential return, exit is the strategy, albeit the rebased price is often tracking well below today's book value. Therefore, polarisation in the marketplace is developing, creating a 'best and the rest' offices landscape.

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