The M25 and South East Office Market Report

M25

Navigating the property lifecycle

2022

Foreword

If we were to roll back the clock six months, consensus opinion probably would have cited 2022 as the year in which the imbalances wrought by the pandemic would begin to resolve.

Instead, geopolitical instability has reared and quickly replaced Covid-19 as the biggest risk to business confidence and global growth. In addition, UK inflation has risen to 7% – the highest it has been for 30 years. Seemingly, the stable foundation that businesses were hoping for in 2022 has been deferred for a little longer.

So, what of south east offices?

To understand the implications for the market, we have reconnected with the fundamental principles on which the real estate market is formulated. There is, of course, nothing more fundamental than the lifecycle of property. From concept and first occupant. Operational to end of life and reinvention. Identifying the factors that influence each stage can help us understand where the market is heading – and identify opportunities.

Foremost, the subject of viability has entered the market narrative with much greater vigour. The construction industry is feeling the impact of Covid, through supply chain disruption and price inflation. Climate responsibility is compounding the pressure on build costs prompting a reassessment of the future development pipeline.

This challenge to supply comes at a time when there is a greater onus on the quality of workplace. Office stock in many of the south east centres is now showing signs of obsolescence caused by age, future conformity and changing occupier preference. Vacancy rates for best quality are at critical lows in some centres meaning there is a case for selective new development.

But the requirement for "best" space is just part of the workspace evolution.

The pandemic has been a catalyst for people and companies to reassess working practices. In effect, it has been the biggest workplace experiment this century. Freedom to choose the optimum place where tasks can be performed is now integral to the employee/employer relationship. Consequently, understanding the quantum and type of office space required is now first order for organisations, however, "rightsizing" might not necessarily mean "resizing".

And this is particularly true of the innovation-led sectors. Life sciences and technology businesses are growing rapidly and represent the dominant sources of new space requirements so far in 2022. This shifting demand profile is changing the dynamic of the marketplace, the requirements placed on product and the basis on which that product is occupied. Landlords take note.

While the uncertainty generated from externalities is having the biggest impact on the market presently, the impact of technology, the demands placed on the office workplace and the changing face of the occupier are factors with longevity. Clearly, each will play out in different ways across different markets. In an office market as diverse as the south east it is vital to have a detailed and granular understanding of current market conditions and future dynamics. We are delighted to help.

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1

THE M25 AND SOUTH EAST OFFICE MARKET REPORT

Concept: Balancing responsibility and viability

With the cost of construction materials in the UK continuing to escalate and additional expenditure increasingly required in response to a tightening sustainability agenda, what impact will these pricing pressures have on office development in the south east?

Balancing responsibility and viability

AUTHORS: PAUL PRIOR AND CHARLES INGRAM EVANS

The current construction and real estate landscape presents significant challenges – but also great opportunities. The recovery across the south east office market is gaining traction, with headline metrics on demand moving further into positive territory with each passing week. With supply still tight in many locations, this is fuelling anticipation of rental growth and an uptick in development activity.

Uncertain times

Brexit, Covid-19 and the Ukraine conflict have heightened uncertainty, however. Manufacturing and supply chains have been disrupted, whilst shortages of labour, products, and inflated energy prices are making vital components more expensive. The impact is being felt most acutely in construction: the BCIS All Work Material Price Index rose 21.5% in 2021, the highest annual increase on record.

Price fluctuation clauses now form part of contractual negotiations for many larger projects, leading to reduced cost certainty on projects that may be reaching their viability point anyway. With forecasts indicating further annual increases of between 4% and 5%, the viability question is here to stay, at least for the short term.

Environmental legislation on the rise

It's not just geopolitics and the legacy of Covid fuelling cost pressure. Major tenants are seeking commercial buildings with strong sustainability

credentials, and legislation continues to ratchet up. By 2023 all existing tenancies will need to achieve at least EPC E, and landlords must prepare for a minimum EPC B rating from 2030. Prospective tenants must now seriously consider the implications of future EPC upgrades.

Furthermore, as part of the UK's drive to achieve net zero carbon, from April 2022 large investors must now report publicly on their carbon emissions. This in turn will require everyone in the property value chain to provide accurate carbon data. Research found that 40% of green claims currently made by businesses could be misleading, with the Competition and Markets Authority publishing its Green Claims Code in November 2021. Now, by law, all claims must be backed up by robust, credible and up-to-date evidence.

This puts a greater onus on certification of real estate. An interesting and very timely addition to the UK's current certifications list is NABERS, which seeks to close the energy performance gap between design intent and real-life operation. Accreditations in the UK, though, are plentiful, and assessment varies widely. Inevitably, all come at an additional cost.

"Nice to have" is the new norm

The past five years have seen a growing trend for the provision of amenities within office buildings of scale. Best practice now extends beyond end-of-trip facilities such as showers and changing rooms to include smart technologies, healthcare and spaces that support mental wellbeing.

Post-Covid, expect to see new forms of amenity emerge that reflect changing business agendas and the new contract between employee and employer, for example, sanctuary and learning spaces, to support up-skilling and re-skilling. These will be particularly important in a future workplace which puts the emphasis on collaborative over personal space, as employees' relationship with the office becomes more fluid and flexible.

What does this all mean in practice?

To fully understand the impact of these pressures, Knight Frank's Building Consultancy team compiled a case study comparing costs of a hypothetical office refurbishment project in 2017 vs 2022.

The subject building spans ground, first and second floors, measuring 50,000 sq ft net (62,500 sq ft gross). It features a brickwork façade, three lifts, and a four-pipe fan coil heating/cooling system and mechanical ventilation. The building has an EPC rating of D with no current environmental accreditations.

In 2017, the cost of refurbishing to modern standards equated to £104 psf. But by 2022, this cost has risen +66% to £175 psf.

This is because in addition to the +16% increase in tender prices, an additional £3.4m of costs were identified to achieve newer 2022 standards. These included:

- £1 million of improvements enhancing the EPC rating from D to B. Key upgrades include transitioning boilers from gas to electric, and installing VRF heating and cooling systems.
- £650,000 worth of ESG enhancements, including replacement of the building management system to better monitor energy consumption, and development of a smart app to enable interaction with building amenities.
- £1 million for development of quality amenity space in line with current occupier demand, including provision of outdoor and wellbeing space.
- £700,000 in consequential fees due to extended scope of works.

In 2017	**£104 per sq ft**
Tender price (2017-2022)	+16%
EPC conformity	£1.1m
ESG upgrades	£650,000
New amenity	£1m
Fees and other costs	£700,000
In 2022	**£175 per sq ft**

Assessment against capital values in the key markets of the south east indicates that only a third of the key markets have registered capital value growth higher than the 16% rise in tender price.

Conclusion

While our example is theoretical, the incorporation of enhancements to specifications and the use of new suppliers is undoubtedly increasing costs.

Design teams will be under pressure to deliver more for less, particularly post novation when contractors look to value engineer schemes to drive cost savings. Increasingly, the allocation of risk will move away from the contractor and on to the employer, with shorter acceptance periods for bids. The need to create a narrative to market schemes will require more studies, data collection and reporting throughout the design and construction process in order to show how ESG requirements have been met.

Price certainty and economic viability are coming under increasing scrutiny from investors and lenders who want greater due diligence and transparency on procurement and supply chains. From a development perspective, land prices remain high, construction costs continue to increase and occupier and lender demands around ESG are growing. It will be interesting to see what gives first.

2

Market Positioning: Aligning to future demand

As the markets begin to "stabilise", the need to acclimatise to an unfamiliar occupational and investment landscape is setting new challenges for landlords. What will be the origins of new demand?

Future demand: *Who's occupying?*

AUTHORS: EMMA GOODFORD, JACK RILEY, JENNIFER TOWNSEND AND DARREN MANSFIELD

While the south east is home to a broad base of organisations from all industries, the region has long since demonstrated a strong relationship with innovation-led sectors. The rapid growth of the telecommunications, media and technology (TMT) sector in the late 1990s for example, served as a catalyst for the development of the leading business parks in the region. Many of these sites today are recognised as major UK technology hubs housing both global technology behemoths and the major names of tomorrow. Most recently, life sciences has gained recognition. The south east now has 39% of the UK's life sciences jobs. With the technology and life sciences sectors combined attracting 87% of committed venture capital funding in 2021, and double digit employment growth forecast, getting a full understanding of each is required to capture the next wave of demand growth.

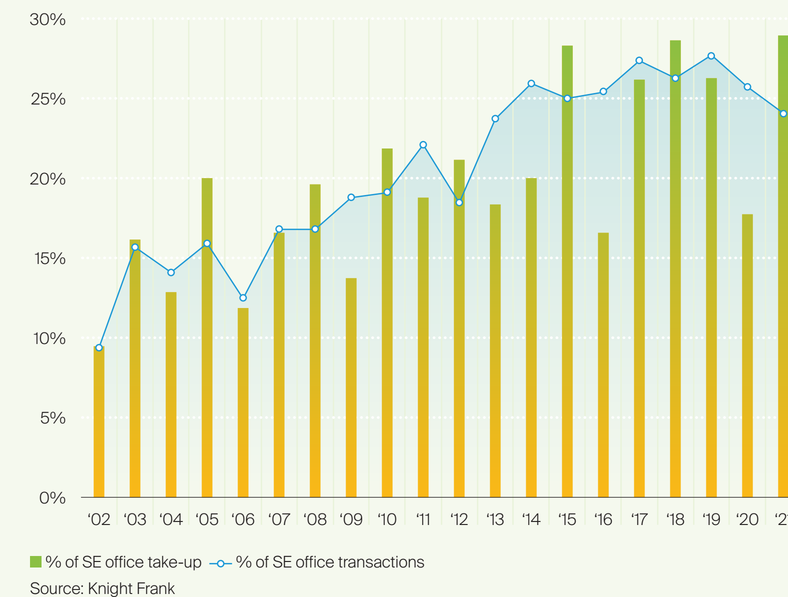
First, the bigger picture

The UK tech industry is booming. According to the analysis for UK Digital Economy Council, the UK accounted for a third of the total £89.5 billion that flowed into the European tech ecosystem in 2021, with capital investment into UK start-ups and scale-ups reaching £29.4 billion. This total represents a year-on-year increase of more than 100% and is double the amount raised in the second largest market, Germany. But what does this rapid rate of growth mean for the south east office market?

Understanding the south east cluster

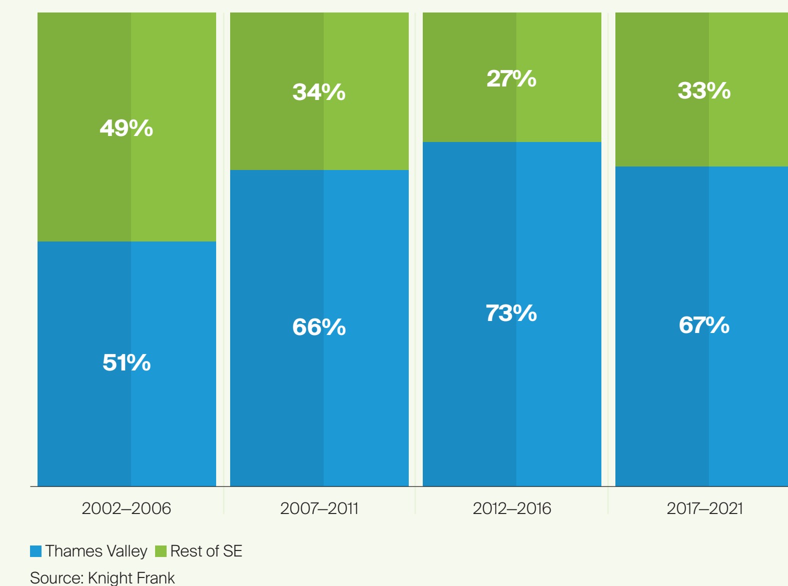
The technology sector in all its guises has maintained a prominent place in the fortunes and development of office markets in the south east. The region is home to companies delivering everything from innovative research and development to high tech software and hardware. Indeed, analysis of office take-up in the south east between 2002 and 2021 shows that some 900 occupier leasing transactions derived from the TMT sector. These deals account for nearly 15 million sq ft of office space, more than any other business sector over this period.

THE GROWING INFLUENCE OF THE TECHNOLOGY SECTOR



Source: Knight Frank

% OF TECH TAKE-UP IN THE THAMES VALLEY



Source: Knight Frank

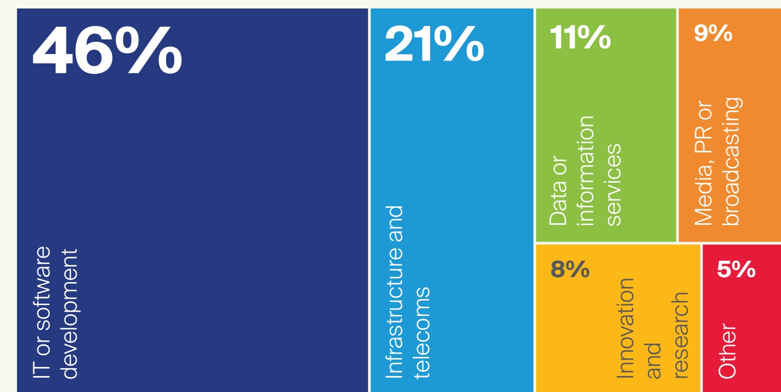
Thames Valley accounts for 65% of office take-up in the south east over the past 20 years

Of the major south east office market areas, the Thames Valley has been the principal target location. Today considered a top 10 UK technology hub, resident firms include Microsoft, Oracle, Vodafone, Télefonica, Symantec and McAfee. These companies exert a considerable draw to the area, attracting skills, infrastructure investment, and nurturing an innovative culture. From an office space perspective, take-up in the Thames Valley over the same 20-year period (2002–2021) shows that the technology sector transacted 9.6 million sq ft of office space. This represents 65% of total technology sector activity recorded across the wider south east.

But is a more granular view of tech needed to understand the market?

Segmentation of office take-up over the past 20 years identifies the main sources of demand. Close to 6.2 million sq ft or 46% of office space acquired over this time derives from IT or software development companies. The south east is also a

SOUTH EAST OFFICE TECH TAKE-UP 2002–2021



Source: Knight Frank

significant location for telecoms and infrastructure companies, responsible for 2.8 million sq ft or 21% of take-up since 2002. The most active period for this sub-sector, though, was pre-2011, driven by the rapid growth of mobile and fibre-derived applications.

Focusing on the technology hotspots

The south east is home to a range of innovative tech clusters which are highly regarded both nationally and globally. Several of these centre around Oxford and Cambridge (health and computing); Thames Valley (global IT infrastructure firms); and Brighton (gaming and immersive tech).

According to Tech Nation, 49,000 digital tech firms are located in the south east, employing more than 320,000 people. Digital turnover in 2021 was £91billion, approximately 12% of the UK total. The current number of seven unicorn companies looks set to expand, with 11 "futurecorns" in the pipeline.

New businesses are heavily supported. The ScaleUp Institute identifies the south east as the most successful for scale-up companies alongside London. Meanwhile Data City's Top UK Tech Cities list includes three south east hubs (Milton Keynes, Brighton, Reading) in its national top 10 for digital teams seeking emerging technology clusters. This is unsurprising given the mix of local and global, new and more established businesses that create a diverse, vibrant environment.

Analysis for the UK Digital Economy Council placed Cambridge as the leading regional tech city in the UK thanks to its combination of high levels of VC funding, VC rounds, advertised tech salaries, number of high-growth

tech companies and future high-growth companies. Other major tech hubs, according to level of venture capital investment received, include Oxford (£344 million), Milton Keynes (£49 million), Brighton (£17 million) and Guildford (£15 million).

In terms of office market activity, granular analysis of office take-up over the past five years confirms the market dominance of Reading as a tech hub, with the city accounting for 16% of tech take-up during the period. Closer inspection shows that Reading is particularly attractive to infrastructure and telecoms firms, with HQ deals by Virgin Media and Three UK underpinning its position.

What next?

Digital technologies have advanced more rapidly than any innovation in history, reaching around 50% of the developing world's population in just two decades and transforming societies. Most recently, the Covid-19 pandemic has triggered a quantum leap in digital adoption at personal, organisational and industry levels. Technology is now so integral to businesses in all sectors and to the workings of everyday life that it is becoming increasingly difficult to distinguish between pure technology companies and those underpinned or transformed by technology.

With technology-derived employment in the region forecast to grow 11% by 2030, well ahead of the national average, the south east is set to be central to the next wave of technological progress, further extending its global influence and reputation as a tech centre.

Life sciences – expanding and evolving

The south east, and the Golden Triangle area (Oxford/Cambridge/London) in particular, is proving an attractive destination for life sciences companies due to its concentration of human, financial and knowledge capital. Home to three of the world's top 100 universities for life sciences, more than 200 hospitals and innovative companies including Lonza, CMR Surgical, Exscientia and Oxford Nanopore, it also offers a successful innovation ecosystem and world-leading facilities.

Occupational demand from life sciences companies is rapidly accelerating. Take-up across the main markets reached 583,375 sq ft in 2021, or 18% of the total.

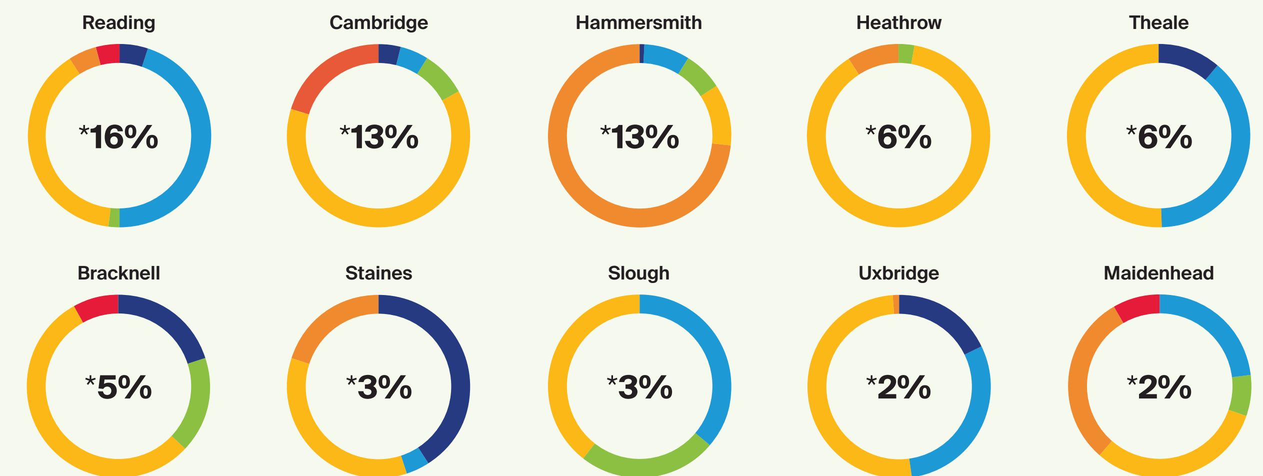
Where is demand coming from?

Future demand will derive from life sciences companies which have thrived during the pandemic, alongside several key drivers, each with a clear real estate dynamic:

The convergence of technology and life sciences

Convergence is driving rapid business restructuring and process re-engineering amongst incumbents, alongside an urgent need for tech talent. New fast-growth occupiers are emerging, alongside a trend for greater collaboration between tech

TECHNOLOGY TAKEUP BY SUB-SECTOR (2017–2021) * % OF TECH TAKE-UP IN THE SOUTH EAST



■ Data or information services ■ Infrastructure and telecoms ■ Innovation and research ■ IT or software development ■ Media, PR or broadcasting ■ Other

Source: Knight Frank

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and life sciences companies. Real estate will be an essential component in facilitating business transformation and attracting, retaining or reskilling talent. Exscientia and CMR Surgical are exemplars of this new breed of tech-enabled life sciences occupier, with both companies acquiring space in the south east in 2021.

Winning the battle for talent
UK vacancies in life sciences roles rose to 127,000 in the period December to February 2022, 91% up on the previous year. According to recruiters Cpl Life Sciences and data analysts Vacancysoft, the south east dominated the hiring landscape for life scientists in 2021, with laboratory roles most in demand. At the heart of the talent conversation lies real estate.

The rising ESG agenda
There is growing bottom-up and top-down pressure for life sciences companies to act in relation to ESG, particularly as life sciences real estate can use up to 10 times the energy of a traditional office. Occupiers in the south east setting bold targets include AstraZeneca which is aiming for zero carbon emissions from its global operations by 2025.

Organisational restructuring and rethinking supply chains
A recent EY survey of 250 life sciences CEOs revealed that 78% either have adjusted or are planning to adjust their global operations or supply chains to increase resilience.

The trend for collaboration is driving the expansion of life sciences clusters, which plays to the region's strengths. Incumbents are also restructuring via mergers, divestitures and acquisition. UK life sciences M&A reached £10.5 billion in 2021, with deals involving companies based in the south east including the acquisition of Kymab by Sanofi, and GW Pharmaceuticals by Jazz Pharmaceuticals. As M&A activity increases, a real estate dimension invariably emerges.

An appetite for expansion
We also forecast significant expansion-led demand fuelled by booming public and private investment and sectoral growth deriving from factors including: the ageing population; huge unmet needs; NHS reform; a shift from treatment to prevention; technological and scientific advancements; continued demand for vaccines and diagnostics related to Covid-19; and consumers taking greater control over their health and wellbeing.

At national level, the UK government has committed to record levels of R&D spending, set to increase by £5 billion to reach £20 billion per annum by 2024–25. At regional level, one of the cornerstones of public investment is the Oxford-Cambridge Arc, which aims to further grow the economies of both cities as well as the towns in between, and to strengthen links between industry and academia. The universities are also playing their part: Oxford University Innovation created 31 new companies in 2021 bringing the total number through its doors to 270. A previous start-up, Oxford Nanopore, now employs more than 600 people. Cambridge University has also spun out 137 companies since 2011, including Gyroscope Therapeutics and CellCentric.

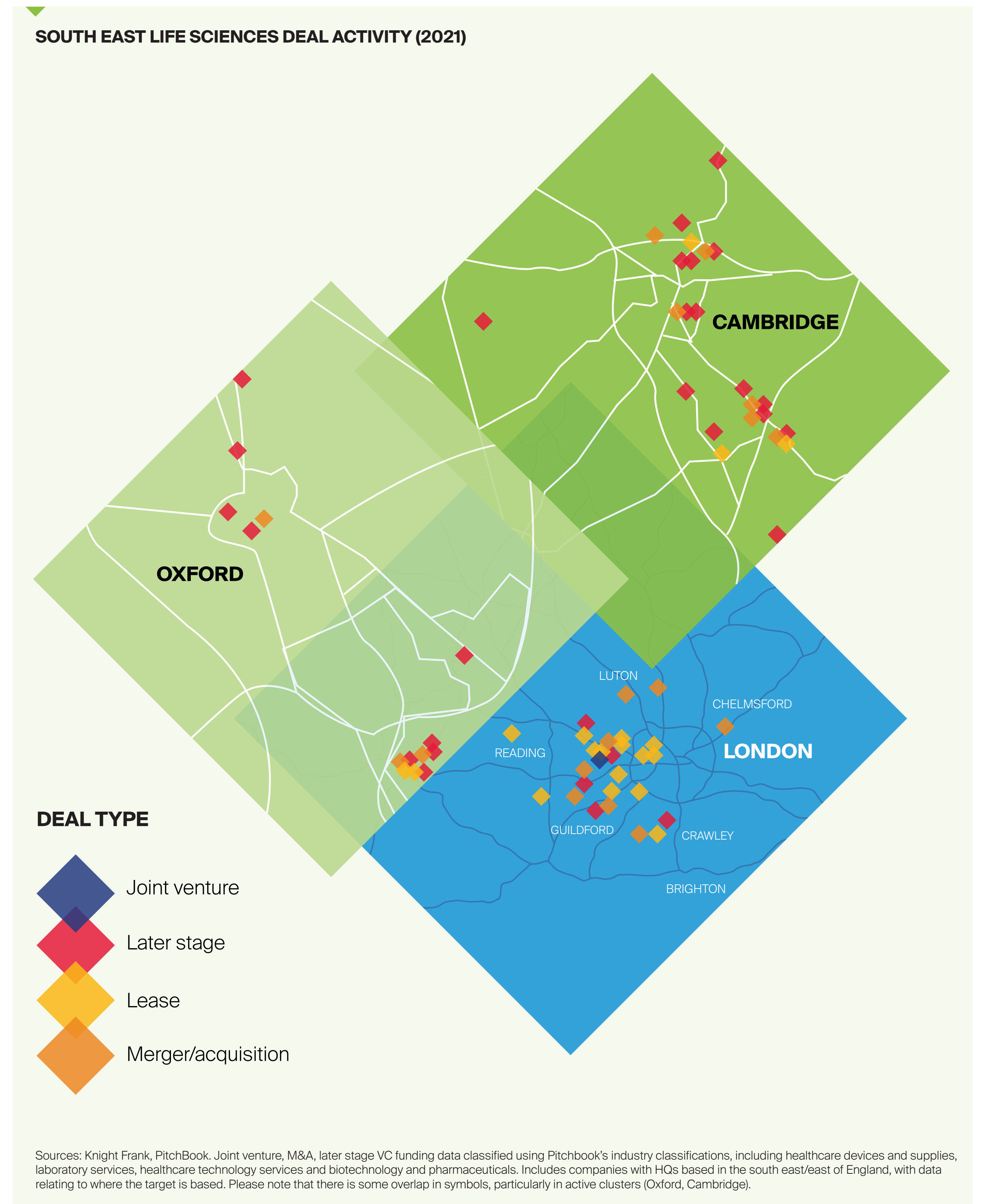
Over the past five years, more than £4 billion has been raised at a later stage, usually the point at which life sciences companies move into larger, more bespoke space. This is a 242% increase compared with the previous five years (2012–2016). Top sub-sectors by volume and value of deals were drug discovery, healthcare technology systems, therapeutic and surgical devices and diagnostics.

Examples of expansion-led real estate activity include:

- Altos Labs signed a 10-year lease on 51,000 sq ft of space in the Portaway Building, Granta Park, Cambridge. The company raised US$3 billion from investors in January 2022, having previously raised $270 million of Series A venture funding from investors including Jeff Bezos, putting its pre-money valuation at US$1.1 billion.
- Vaccitech, the company responsible for the technology behind the Oxford/AstraZeneca vaccine, took 31,000 sq ft in the Zeus development at Harwell Business Park. The company raised US$110.5 million in its initial public offering in 2021.

Demand from the life sciences sector shows no signs of abating. Capturing this demand , whether disruption-led or expansionary, will require an understanding of the sector trends along with proactive prospecting through tracking occupier activity.

Providing real estate for this expansion will drive speculative development in core life sciences markets. The focus for this supply must be lab enabled or lab ready to meet the greater percentage of occupier demand in these sub-markets. Our predictions are that Oxford and Cambridge together could see 5 million sq ft of development over next five years - with existing demand to satisfy this pipeline.



Sources: Knight Frank, PitchBook. Joint venture, M&A, later stage VC funding data classified using Pitchbook's industry classifications, including healthcare devices and supplies, laboratory services, healthcare technology services and biotechnology and pharmaceuticals. Includes companies with HQs based in the south east/east of England, with data relating to where the target is based. Please note that there is some overlap in symbols, particularly in active clusters (Oxford, Cambridge).

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Future Demand: *Who's buying?*

AUTHORS: VICTORIA ORMOND, HENRY WYLD AND ANTONIA HARALAMBOUS

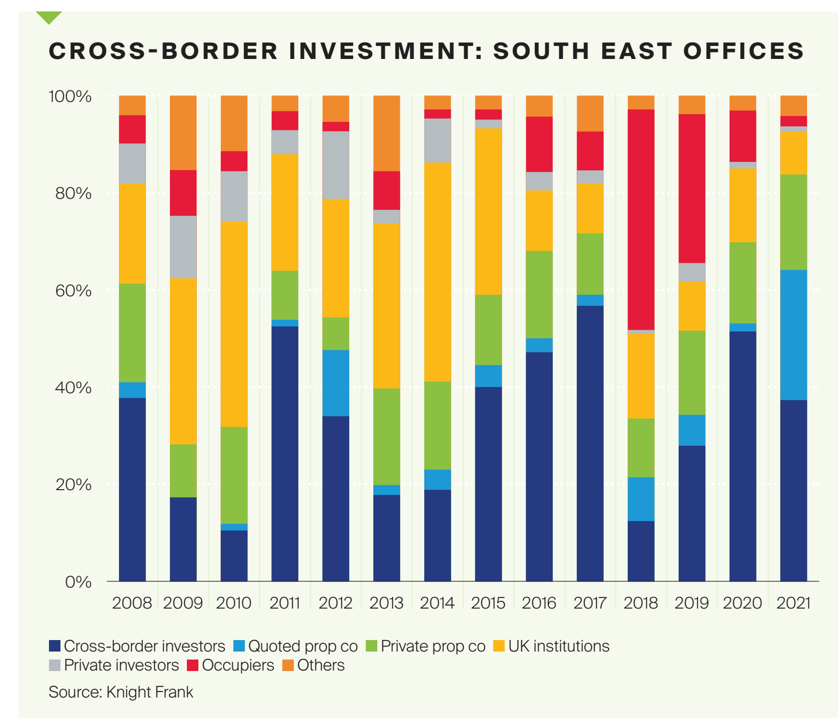
The investor landscape in the south east has realigned in recent years, consistent with the experiences of the wider UK. Pre-pandemic, institutional investors accounted for an average 32% of domestic UK office investment; in 2021, this share of domestic investment had fallen to 20%. This pattern is mirrored in the south east, with institutional investors' proportion of the market falling from 28% pre-pandemic to 14% in 2021.

Institutional activity, however, will remain a strong influence on the market. Institutional investors are expected to focus on a strategic downsizing of their office exposure, with a renewed focus on prime opportunities in the south east.

As institutional investors scale back, who's taking over?

Cross-border private equity buyers and investment managers have emerged as frontrunners for office assets across the UK and in the south east. Using a capital gravity model from our *Active Capital* research, we have forecast where we expect cross-border capital to allocate money in the year ahead. A record year for UK offices is anticipated, with the sector set to be the most invested asset class globally in 2022.

CROSS-BORDER INVESTMENT: SOUTH EAST OFFICES



Source: Knight Frank

Investment managers and private equity are expected to be the driving force behind this investment, with a 30% and 23% share of cross-border investment respectively. Private equity investors from the US, Greater China and Switzerland are expected to be particularly active.

Private equity a key player

French and US private equity firms such as Corum and Kennedy Wilson, alongside investment managers including Longmead and Trinova, are expected to be particularly interested in the south east "core plus" office market in the year ahead. The south east offers larger lot sizes and a relative 'day one' yield discount compared with prime UK cities and alternative sectors, including the industrial sector where yields have reached record low levels. As pricing in this category stabilises, global equity firms could pay even greater attention to the market.

Equity is also expected to target refurbishment opportunities in markets where the supply/demand balance is strong and rental growth projection supports the level of capital expenditure required. This is where we may record the widest range of investor type. UK funds will remain active in prime markets, along with property companies and development managers who require a three- to five-year project. Although an exciting proposition for some, this could be a cause for concern in markets where rents have stagnated and/or are not at a level to support these rising costs. Pressure on rents, coupled with the ESG journey some of these assets may need to embark on, underscores the delicate balance between opportunity and challenge.

Turning challenge into opportunity

As a result of the pandemic, some office markets in the south east face a challenging future. This has created opportunities to explore alternative uses, with industrial buyers able to underwrite land values in excess of the historic office use. For example, British Land and London Metric have been able to sit on short- to medium-term income in order to unlock alternative use potential.

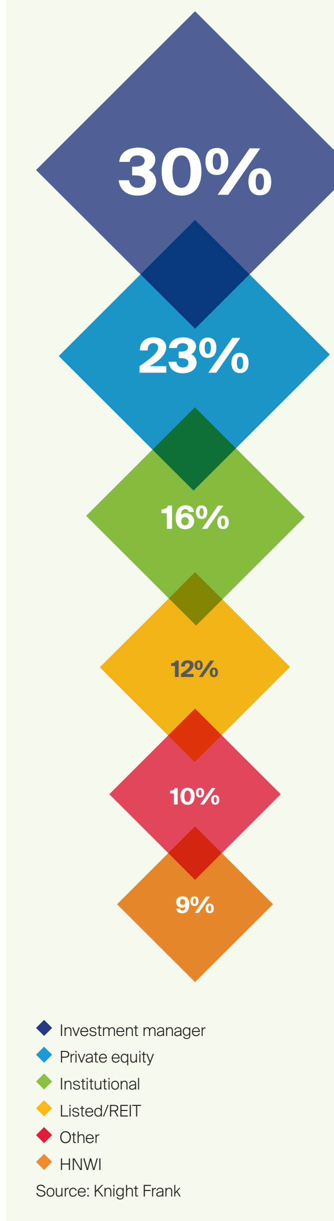
Life sciences

The life science sector remains an important part of the south east office market, with a queue of investors seeking exposure. There is genuine depth to the market, with investors such as Blackstone/BioMed, Oxford Properties, Kadans and Tishman Speyer seeking space in the core Golden Triangle of Oxford/Cambridge/London, while investors such as Mission Street, British Land and UBS have been more focused on some less established centres.

Data centres

Data centres have quickly become an asset class of interest in markets such as Slough, Hayes and other areas of the M4 corridor. In locations with appropriate site size and where power supply is sufficient, vendors have been considering the planning options open to them. Where vendors choose to exit, more opportunistic investors have been prepared to take on the planning risk, seeking higher return potential. A recent example includes Segro's £435 million acquisition of 950,000 sq ft of office stock on the Bath Road in Slough, with a view to converting to data centres.

FORECAST SHARE OF CROSS-BORDER INVESTMENT TO SOUTH EAST OFFICES (2022)



Source: Knight Frank

What next?

The diversification of investor demand places the south east office market in good stead for the next phase of the current cycle. Stock selection will continue to be critical. As occupiers move back into their offices, established markets look set to perform well. Having been so active over recent years on the acquisition side, councils are now under increasing pressure to reduce debt and selectively exit assets. This could create an interesting investment environment for buyers over the next year.

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3

In Operation: Understanding the workplace in a post-Covid era

The return to office is well under way but the workplace experiment is far from over. How are organisations creating balance and embracing a post-Covid world of work?

From FLUX to FLEX

AUTHOR: DR LEE ELLIOT

The onset of the Covid-19 pandemic ushered in a great – if unsettling – global workplace experiment, challenging traditional notions of workstyle and workplace. This was evident both in a first phase of enforced lockdown (where working from home was the only option) and then in a second phase which saw the splitting of working time between the office and other settings, including home.

As the UK dealt with spikes and variants, we oscillated between these two phases, leading to inertia in occupational markets. Occupiers found themselves in a state of flux, with sentiment and strategy clouded by uncertainty. Horizons moved to the near term with a focus on operational resilience and survival, and market activity postponed unless necessitated by lease events.

Yet as Covid-19 restrictions lifted in the early months of 2022, evaluations of the pandemic experience (both good and bad) are bringing greater clarity to the future needs of both employees and employers. This is actively shaping the south east's real estate markets as we enter a progressive third phase of the experiment, whereby workstyles and workplaces are being reimagined for the post-pandemic future.

The factors shaping future occupier decision-making

As occupiers begin to draw upon lessons learned, we will see greater momentum in active requirements and leasing volumes across the south east. This will serve to counter some of the more sensational suggestions made in respect of future space needs. Indeed, there has to date been somewhat of a phoney war on space. Whether the attack has been deferred or will in fact never materialise is difficult to determine at this stage.

The real dynamic will become apparent as lease breaks and expiries come into view and force occupiers into action. This will play out over the next three to six years rather than months. As market momentum builds, we see three distinct but interconnected "flights" shaping occupier decision-making.

1. A flight to hybrid workstyles

The pandemic experience has brought hybrid working – work that takes place across a combination of formal office space and external third spaces or employees' homes – into common currency. A recent survey of global business leaders by KPMG found that more than three quarters were expecting to implement hybrid workstyles within their organisation. This clearly has the potential to impact on the quantum of office space occupiers will require over the longer term. It is also a clear response to labour market conditions, in which an acute shortage of skilled labour has put employees in a position of some power.

It is worth noting, however, that only around one third of the KPMG respondents had actually implemented hybrid working strategies. The devil may well be in the implementation and there are risks to corporate culture and connection (with colleagues and clients) if an appropriate balance is not struck. The adoption of a flexible but "office first" stance from occupiers may well be the outcome.

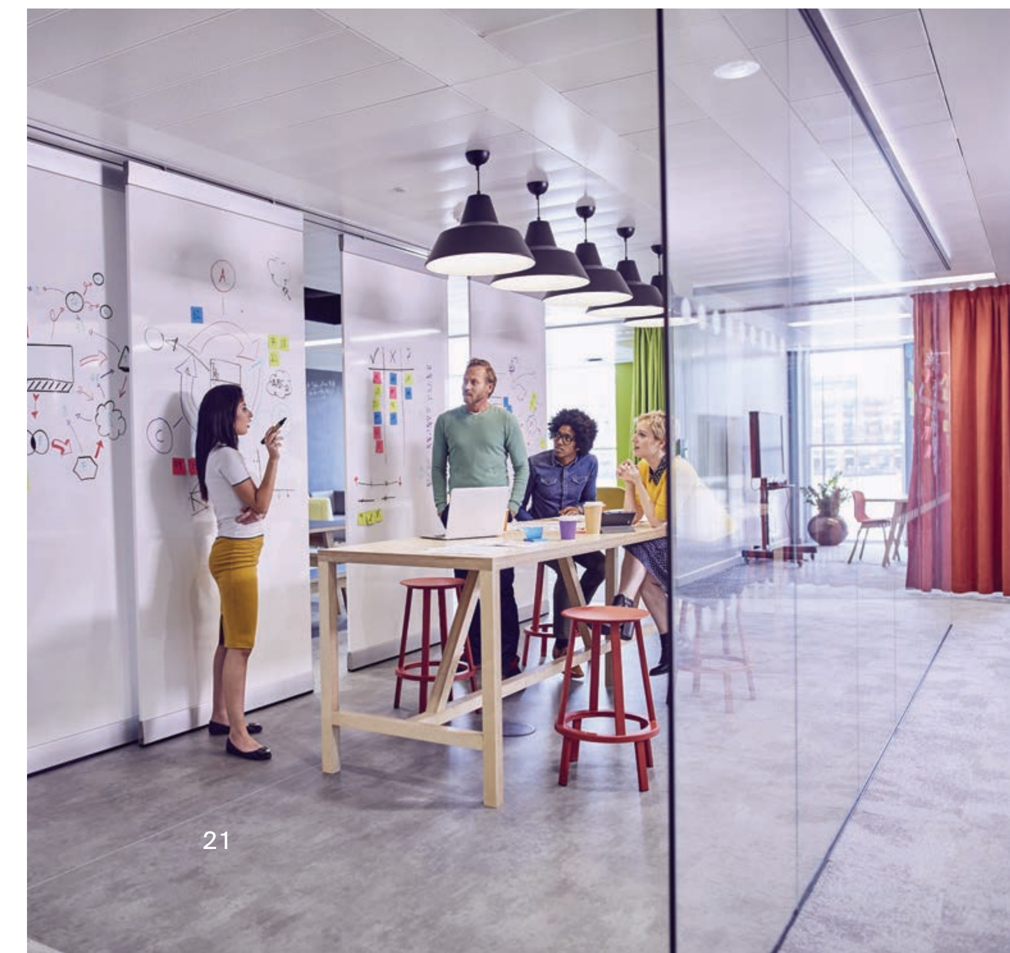
2. A flight to quality workplaces

Hybrid working does not negate the need for office space. Rather, it amplifies the need for better quality space that can attract staff who now have greater agency over where, when and how they work. Occupiers around the world are increasingly seeking high-quality, amenity-rich space that offers an alluring alternative to home or third space settings while fostering connections and strengthening corporate culture. Central to this are amenities that support personal wellbeing and, increasingly, access to in-person training and development opportunities. This flight to quality is leading to intense competition for best-in-class office space by occupiers keen to make the required step change in the quality of their offer.

3. A flight to flexibility

Occupiers are also taking flight to more flexible real estate solutions – that is, office space that is underpinned by flexible lease structures and also allows for flexible configuration so occupiers can "rightsize" in sync with the business cycle. Until recently this has been the purview of serviced office and co-working operators but increasingly we are seeing conventional landlords presenting more flexible product either directly through self-operation or through informal partnership with operators. This partnership arrangement also supports the flight to quality, as many operators have been at the forefront of the delivery of high-quality, high-service office space.

The flight to flexibility also has a significant role to play in supporting hybrid workstyles as shown by the recent announcement by electrical retailer Currys, for example, which is closing its permanent HQ and switching to WeWork space throughout the UK. This supports a more dispersed workforce and enables a shift towards a hub and spoke model of occupancy that has been trumpeted as a likely legacy of the pandemic.



A future space strategy: Just enough. Just in case.

AUTHORS: RODDY ABRAM AND DARREN MANSFIELD

The turmoil brought about by Covid-19 has been all-consuming, with leasing activity hitting a "hard brake" almost overnight. Understandably, occupiers have bought time by engaging with regearing and renewal as the focus shifted to dealing with the operational challenges brought about by the virus. Most managed to avoid knee-jerk strategic responses and now, as we enter the third – and hopefully less tumultuous – year of the pandemic, the implications for south east offices are beginning to become clearer.

The impact of post-Covid working practices on office demand

Our bespoke analysis of Knight Frank market data shows 4.8 million sq ft of active occupier demand over 10,000 sq ft remains unfulfilled as of March 2022. This figure has gradually risen from a low of 3.5 million sq ft at the depths of the pandemic, and provides a clear sign that, even though the appetite of businesses to enact space moves is still below pre-pandemic levels of greater than 5 million sq ft, confidence is solidifying and engagement with the market is increasing as a result.

Are active organisations requiring the same quantum of space?

Analysis of active named demand over 20,000 sq ft concludes that 39% of occupiers active in the market are requiring less space. The scale of this reduction ranges from 5% to as high as 50%, although the results are skewed by the inclusion of several larger corporates all with current accommodation over 100,000 sq ft. A number of these companies had already embarked on significant downsizing plans pre-Covid, but these were accelerated by the pandemic as well as, in some cases, by a lease event.

Indeed, a wider review of historic patterns indicates that space utilisation was changing ahead of Covid-19. The average deal size in the south east between 2000 and 2010 was 19,000 sq ft. By the following decade (2011–2020), this had decreased by 18% to 15,600 sq ft, with a low of 12,500 sq ft recorded in 2017. Cushioning the impact of this though was a rise in deal numbers, which increased on average by 5% between these two timeframes.

What happens next?

The remaining 61% of future space requirements analysed in our study were either space neutral or upsizing, although "rightsizing" will clearly be a consideration for the market moving forward. One possible product of a strategy focused on the acquisition of "just enough" space might be the need to secure "just in case" space. This could mean that as business operating models increasingly accommodate a flexible option to avoid holding dead space, preference is given to locations where third-party flexible space providers are strongly represented.

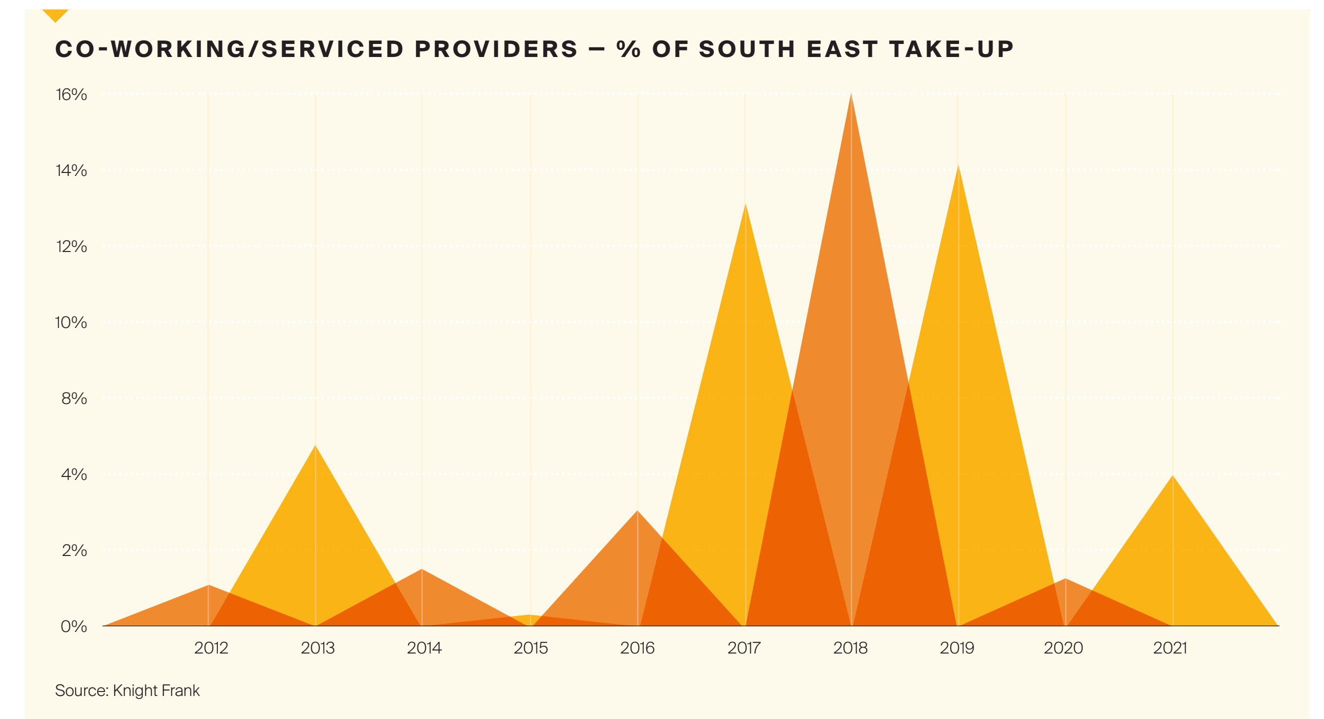
How well serviced are the south east markets?

Prior to 2017, the principal market for flexible office operators was largely limited to central London, with providers typically only representing 1%–2% of leasing activity in the wider south east markets. From 2017 to 2019 though, operators acquired some 1.4 million sq ft of flexible space, more than in the previous 10 years combined. All leases taken during this period were to support business growth as opposed to satisfying an end user pre-commitment, with only the onset of Covid-19 stemming onward ambitions. Analysis of current space leased or managed by third-party providers shows that serviced or flexible office stock in the south east and greater London markets was 3.8 million sq ft.

One possible product of a strategy focused on the acquisition of 'just enough' space might be the need to secure 'just in case' space

Of this, 73.7%, or 2.8 million sq ft is located in our identified 18 key south east markets. For context, this is similar to the amount of space operated by WeWork in central London. Unsurprisingly, the highest concentration is found in west London, with 35% (1 million sq ft) identified as operational. Interestingly, west London also has the highest ratio of serviced space to total stock of the major markets at 7%.

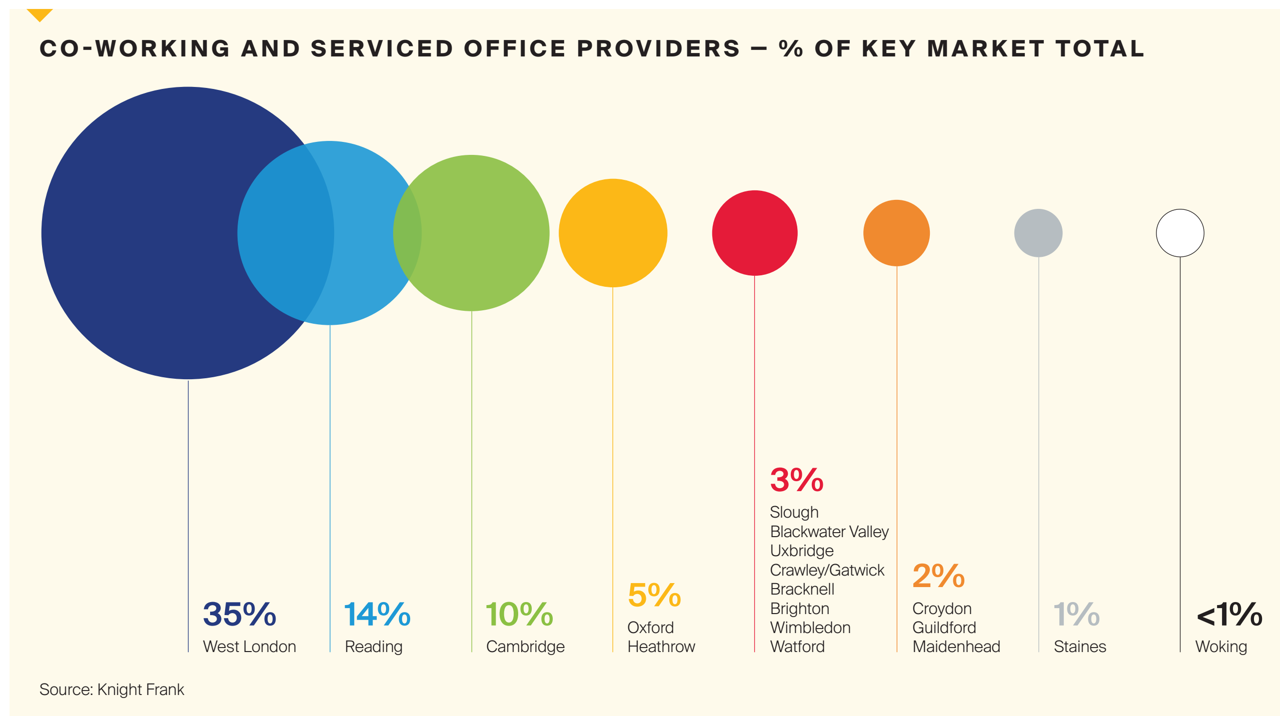
CO-WORKING/SERVICED PROVIDERS – % OF SOUTH EAST TAKE-UP



Source: Knight Frank

A hybrid approach will mean a combination of core, flex and home

CO-WORKING AND SERVICED OFFICE PROVIDERS – % OF KEY MARKET TOTAL



Source: Knight Frank

A flexible future

With the constitution of the occupier changing, not surprisingly the demands placed on offices is undergoing transformation. Integrating an element of flexible space is sure to gain traction in real estate strategy moving forward. Technology, creative and digital firms are good examples where businesses need to be nimble to respond to the changing demands of the marketplace. Demand for flexibility is by no means limited to these sectors though. Indeed, firms across all sectors are increasingly exploring the merits of incorporating an option for flexible space in their occupational strategies.

Fundamentally, the Covid pandemic has raised awareness of different ways of working, prompting businesses to evaluate what their property brings to the company. A hybrid approach that delivers on-demand, customisable and scalable access to space, amenities and services is gaining favour. The physical office must accommodate this change in a forward-thinking, creative way. Increasingly, the "workplace" is becoming more adaptable, elastic and responsive to what individuals and teams are doing. This will mean a combination of core, flex and home, with the office integral to bridging the gap between "in person" and digital experiences.

THE M25 AND SOUTH EAST OFFICE MARKET REPORT

THE M25 AND SOUTH EAST OFFICE MARKET REPORT

4

Recycle, Reinvent, Reposition: Quality over quantity

Is the current supply landscape presenting a development opportunity? And if so, where are the potential gaps in the market?

Development opportunity: *Identifying gaps in market supply*

AUTHORS: RODDY ABRAM, DARREN MANSFIELD AND EMMA BARNSTABLE

Although availability has marginally increased in recent months, the vacancy rate for the south east has remained below long-term trends. As a result, the question of a supply crunch continues to be raised, with the answer increasingly less clear given the changing focus of the occupier and inflationary cost pressure on future build projects. At the time of writing, any conclusion has been deferred by a demand side that continues to be impacted by both geopolitics and Covid-19. But given the changing dynamics of the market, some key south east locations are presenting as an opportunity to respond to a lack of best quality space.

Fundamentally, businesses will be drawn to wherever quality space is available. Analysis of take-up over the past 10 years reveals that the instances of Grade B space being transacted has lessened over time, with new or Grade A deals accounting for 88% of take-up in 2021.

But not all Grade A space is created equal. Occupiers are increasingly digging deeper into the attributes of the building and the surrounding location to fulfil business objectives such as sustainability and, importantly, employee expectations. It is unsurprising therefore that occupiers are willing to consider moving from their existing locations in search of the right space.

To understand where development opportunity exists, we have created a heat map indicative of these competing forces. Our research team have analysed current and future market factors, including occupiers' preferred building attributes, market growth potential and future supply to identify where gaps may arise in the short and medium term.

The methodology

Our bespoke M25 Development Opportunities map pinpoints hotspots where there is potential to develop office space based on:

- Quality of current supply, such as amenity provision within the building envelope and the wider location.
- The strength and potential delivery timings of development pipeline, inclusive of schemes under construction and those with the potential to start within the next 12 months.
- Rental growth prospects.

To gauge strength of current amenity, we focused on 20 unique datasets, collating more than 600 data points across our 18 key markets. This included assessing quality of available building stock (building age, time since last renovation, BREEAM), amenity provision (roof terraces, shower facilities, education spaces, car charging points), as well as connectivity (walkability, digital connectivity). Oxford, Brighton, Croydon, Wimbledon and Cambridge are predicted to be the most active development markets in the short term due to the strength of demand, supply profile and rental growth prospects. Meanwhile, Woking, Heathrow and Slough are considered balanced markets, meaning the supply profile meets expected future demand. Guildford, Watford and Reading are examples of "ones to watch".

By understanding the granular aspects of supply and balancing these with occupational preference, investors and developers can gain a rounded view of potential opportunities in the south east marketplace.

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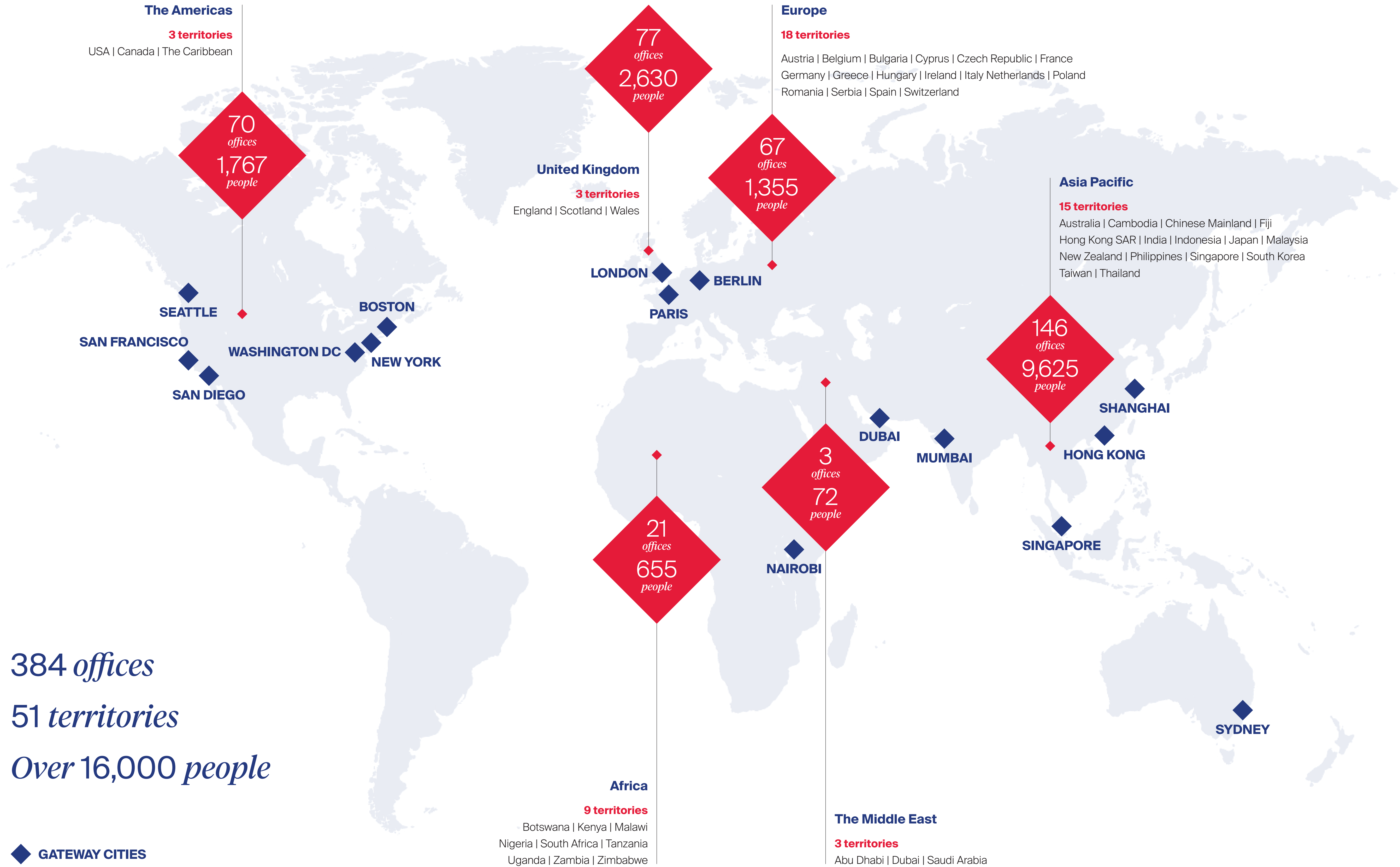

The Americas
3 territories
USA | Canada | The Caribbean
70 offices
1,767 people
77 offices
2,630 people
United Kingdom
3 territories
England | Scotland | Wales
Europe
18 territories
Austria | Belgium | Bulgaria | Cyprus | Czech Republic | France
Germany | Greece | Hungary | Ireland | Italy Netherlands | Poland
Romania | Serbia | Spain | Switzerland
67 offices
1,355 people
Asia Pacific
15 territories
Australia | Cambodia | Chinese Mainland | Fiji
Hong Kong SAR | India | Indonesia | Japan | Malaysia
New Zealand | Philippines | Singapore | South Korea
Taiwan | Thailand
146 offices
9,625 people
LONDON
BERLIN
PARIS
SEATTLE
BOSTON
SAN FRANCISCO
WASHINGTON DC
NEW YORK
SAN DIEGO
SHANGHAI
DUBAI
MUMBAI
HONG KONG
3 offices
72 people
21 offices
655 people
SINGAPORE
NAIROBI
SYDNEY
384 offices
51 territories
Over 16,000 people
Africa
9 territories
Botswana | Kenya | Malawi
Nigeria | South Africa | Tanzania
Uganda | Zambia | Zimbabwe
The Middle East
3 territories
Abu Dhabi | Dubai | Saudi Arabia
GATEWAY CITIES

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TECHNICAL NOTE

- The figures in this report relate to the availability of built, up-and-ready office/B1 accommodation within the M25 market. Vacant premises and leased space which is being actively marketed are included.
- All floorspace figures are given on a net internal area basis (as defined by the RICS).
- A minimum 10,000 sq ft (net) cut-off has been employed throughout. Major and minor refurbishment have been treated as new and secondhand respectively. Data is presented on a centre and quadrant basis. Classification by centre relates to the locational details contained within the marketing material for available properties. Classification in this manner is clearly somewhat arbitrary.
- The development pipeline is a combined total of speculative schemes that are either under construction, proposed and expected to start within the next 24 months, and those with potential to start within five years.
- Secondhand floorspace has been sub-divided into A and B grade accommodation, reflecting high and low quality respectively. Whilst subjective, this categorisation is based on an assessment of each property's age, specification, location and overall attractiveness.
- Pre-let = the letting of proposed schemes not yet under construction and those let during the construction process.
- Headline rent assumes a new building let on a 10-year lease.
- Headline rent assumes a transaction over 10,000 sq ft new office space.
- Rents are stated per sq ft per annum NIA.
- All data presented is correct as at May 2022.

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