AVISON YOUNG

Avoid a void

How landlords are responding to the serviced offices boom

Glossary

Cat A

A traditional landlord finished product including: raised floors, suspended ceilings (unless offering exposed services), lighting, fire detection services, heating, ventilation and air conditioning to the standardised building planning grid and occupancy density.

Cat B

A usually tenant-commissioned fit-out of office space, to meet the occupier's requirements, including: kitchen and amenity space, meeting rooms, fixed furniture, small power and internet connectivity. Often involves extensive changes to the landlord's Cat A fit-out in order to accommodate the tenant's requirements.

SMEs

Small and Medium sized Enterprises, businesses with fewer than 250 employees.

Serviced offices

An alternative to the traditional office lease, with desks/office space offered by the operator on licences for terms typically from 3 months to 3+ years. There are various models available and they are sometimes also known as flexi-space or co-working and generally include a range of office services either included as standard and / or as an optional menu.

GFC

The Global Financial Crisis of 2007-2008

IFRS 16

IASB standards with an effective date from 1 January 2019. This requires all leases to be registered on a company's balance sheet.

SDLT

Stamp Duty Land Tax is payable on the lease purchase price and on the value of annual rent.

FF&E

Loose furniture, fittings and equipment. Excludes fixed office furniture included in Cat B costs and IT, audio visual (AV) and telecoms equipment.

FRI Lease

A lease where the tenant is fully responsible for repairing and insuring its demised premises.

Headline Rent (per sq ft)

The rental payment paid under the terms of the lease following expiry of the rent free period.

Net Effective Rent (per sq ft)

The average annual rental payment over the term of the lease adjusted for the rent free period.

Wayleave

A legal agreement that gives a utility service provider the right to install, maintain and recover infrastructure in a landlord's property (typically basements, risers and roofs) for use by tenants. Typically needed for a tenant's internet and telecom services.

Contents

1.0 Executive summary

Less than ten years ago, serviced offices in their current form were a significant but small part of the market. As a consequence of wider market trends as well as the changes to serviced offices themselves, the provision of such space is now so significant that it is impossible to ignore. Flexibility has become essential to businesses of all sizes, as has the provision of greater user experience in all commercial sectors. Landlords are consequently finding it harder than ever to let space that comes into direct competition with serviced offices.

Despite the improvement in customer experience and added flexibility, growing businesses are not inherently loyal to serviced offices. Issues of privacy, density and corporate image can outweigh the advantages at any point during a businesses growth cycle.

Whilst there has been a move to the mainstream in terms of the perception of serviced office providers, some landlords and investors continue to be relatively cautious with regards to leasing space to serviced office providers. This is especially true in cases where the lease has not been underwritten by a parent company, and has recently been brought under closer scrutiny as a result of WeWork's attempted IPO.

As a result of the increased provision, some landlords have launched their own serviced office offering. In addition, there has been an increase in the range of fit-out options being offered to potential tenants. Such provisions have proved extremely successful in minimising void periods, rent free periods and also achieving higher rents. Despite the initial requirement for additional capital expenditure from the outset, landlords are increasingly able to achieve better net income returns above those expected for a typical Cat A product in the current market.

Image: Derwent London

Less than ten years ago, serviced offices in their current form were a significant but small part of the market. As a consequence of wider market trends as well as the changes to serviced offices themselves, the provision of such space is now so significant that it is impossible to ignore.

2.0
The growth of serviced offices

Serviced offices are not a new concept, having been present in the market since the 1970s. However, over time, the focus has evolved from a budget-friendly offer with basic amenities to a customer focused, often technology based lifestyle offering. This has been underpinned by increasing demand for flexibility from businesses, as well as a change in working practices and employment post-GFC. This has manifested itself most clearly in the growth of self-employment and micro-businesses who are more reliant on flexibility for their growth plans. More recently, serviced offices have enabled the provision of more productive workspaces which embrace the changing occupier sentiment towards using space as a service and the increasingly important retention and recruitment of the best talent.

These factors helped drive a 400% growth in demand from serviced office providers between 2010 and 2014 as take-up reached almost 1.1 million sq ft. From 2015 to 2018 the serviced office sector grew by a further 96%, peaking in Q4 2017, when central London saw take-up of just under 900,000 sq ft. Recent strong growth in the regional office markets saw Q2 2019 activity surpass central London for the first time, with 580,000 sq ft transacted. Such rapid growth has seen the emergence of major players in the market including WeWork, The Office Group, IWG (Spaces), The Argyll Club and most recently Knotel. Each has their own USP, but they share a common purpose of providing flexibility, customer service and first class amenities.

This is likely to continue, despite WeWork's recent announcement of a hold on new leases. The growth in flexible working practices has clear implications for the traditional office market in both the short and long term. Slowing economic growth and an uncertain political climate is likely to exacerbate the conditions, driving a long-term trend towards shorter leases and greater flexibility.

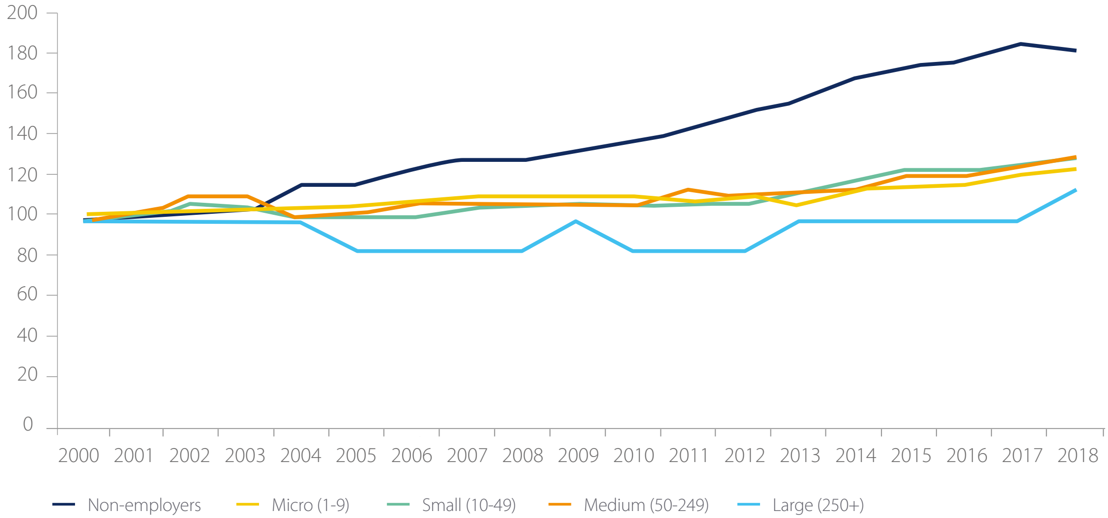
Landlords have responded in part by shortening lease terms for smaller office space, providing more break options and greater amenity provision and consequently are changing their perception towards occupiers as customers who require user-enabled workspaces. Regardless, the continued growth in the serviced office sector suggests traditional landlords still have some way to go.

wework	IWG International Workplace Group	TOG THE OFFICE GROUP	THE ARGYLL CLUB	KNOTEL
4.6 million sq ft	3.4 million sq ft	1.6 million sq ft	750,000 sq ft	260,000 sq ft

Source: Avison Young Q2 2019

Estimated growth in number of UK private sector businesses (thousands)

(100 = 2000)

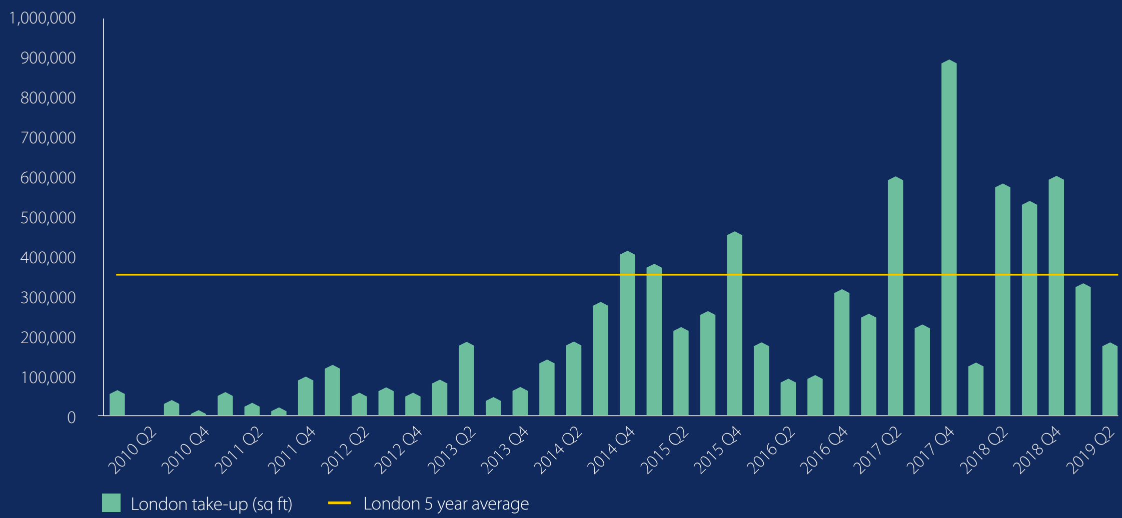


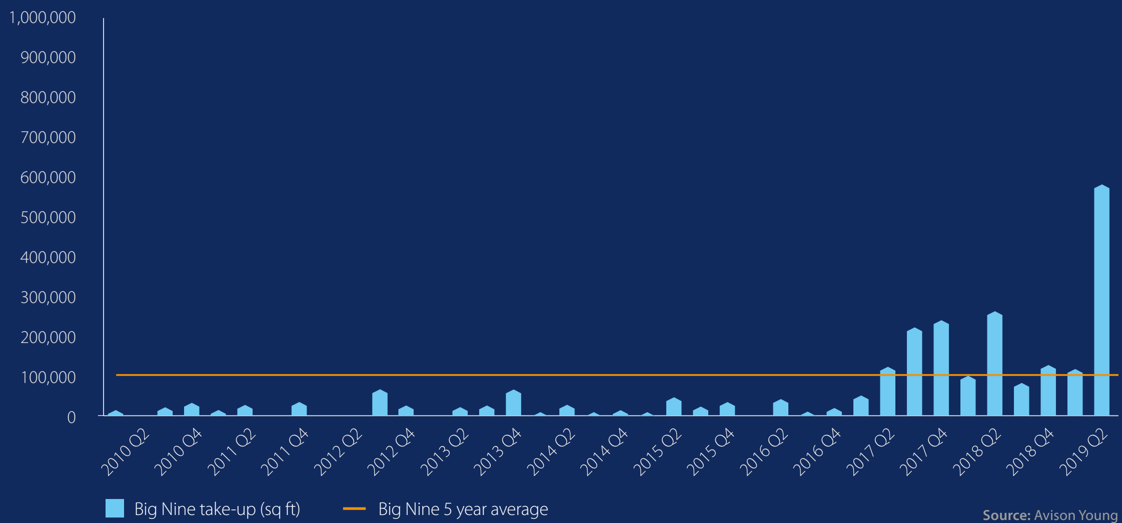
Estimated number of UK private sector businesses 2018 vs 10-year average (thousands)

Size (employees)	2018	10-year average
Non Employers	4,278	3,790
Micro (1-9)	1,137	1,050
Small (10-49)	210	191
Medium (50-249)	35	32
Large (250+)	8	7

Source: ONS

Serviced office provider take-up





Source: Avison Young

3.0 Serviced offices: a real estate (r)evolution?

Serviced offices are able to provide for a variety of workspace types including standalone private offices and flexible 'co-working' space within a larger workspace location, which has tended to appeal more to start-ups and SMEs.

Corporate occupiers are also committing rising proportions of their portfolio to serviced offices and developing core-flex strategies. Also called 'Enterprise' tenants, these occupiers make up a rising proportion of serviced office provider revenue as businesses embrace the flexibility.

As a result, deals on entire floors, or a large proportion of sizeable floor plates, which are offered on a flexible basis with fully fitted furnishings and managed by the provider, are becoming increasingly common.

A significant aspect of the appeal stems from the flexibility, offering a solution that allows occupiers to take office accommodation in central locations, but on unrestrictive terms allowing tenants to expand and contract with greater ease than a conventional lease provides.

Moreover, serviced offices also provide greatly improved speed of entry as less time is spent on lease negotiations, fit-out planning, licences to alter and obtaining wayleaves, which previously carried significant time and costs to tenants. Tenants are prepared to pay above market rents for these advantages.

A new generation of providers have put service at the forefront of their offer with a focus on retaining customers and this continues to be a key draw to tenants who appreciate the focus on customer care. This is enabled through collaboration and networking zones, on-trend interior fit-outs and access to amenities.

Furthermore, according to IFRS 16 legislation, there are exemptions for lease accounting on a company's balance sheet. Short term leases less than one year in length can sit outside the balance sheet and be treated as operating expenses. In addition, where an agreement is a licence this is also likely to sit outside IFRS 16 although this will be dependent on the final wording in the contract.

Small occupation (start-ups)	Mid-sized occupation (satellite offices)	Large occupation (HQs)
<1 year term	1-2 year term	2-5 year term
Shared workspace or private office	Private office with shared amenity space	Private office/floor with own branding
Plug and play	Plug and play	Tenant instructed fit-out

ADVANTAGES OF SERVICED OFFICES

Flexibility
This affords companies the possibility of implementing versatile space solutions

Enables collaboration and networking
Serviced offices enable collaboration and networking with staff from other businesses and industries

One cost covers all
Simpler process prior to and during occupation

Amenity provision
E.g. office equipment, food & drink, parcel delivery, lockers and meeting rooms

Speed of entry
An occupier can move in within days, versus months for a conventional lease

DISADVANTAGES OF SERVICED OFFICES

Corporate image
Personal or corporate branding is more difficult to implement

Restrictions on renovation
Extent of renovation allowed to each member is very limited, and in some cases, not possible

Reduced data security
Collection of personal data creates issues around privacy

Occupation density
Higher desk densities meaning less space per employee

Privacy
Working in close proximity to other firms risks breach of confidentiality and potential distraction

Despite the benefits, serviced offices are more likely to be viewed as 'inspirational rather than aspirational' to tenants that have full exposure to co-working and therefore turnover rates within serviced offices are considerably higher than on traditional leases.

A key downside of serviced offices is their inability to offer the same level of personal or corporate branding to their occupiers, with the brand of the operator taking precedence. This is something some serviced office providers are now trying to address with brands such as WeWork HQ and Knotel.

Furthermore, although communal elements such as kitchens or meeting rooms may offer cost savings, this may affect a company's image and certain spaces may not be available when required. Other concerns include issues around data privacy, opportunity for businesses to 'poach' other employees through use of the communal areas and poor responsiveness to building management issues.

In some cases, there are questions over the comfort of high density offices. Operators such as WeWork regularly target densities of around 65 sq ft per person/desk, as opposed to conventional offices operating at around 100 sq ft per person (assuming an equally divided communal provision such as front of house, meeting rooms and break-out areas). This creates a competition on cost between serviced and traditional office space.

Despite lower regular costs associated with a traditional lease to occupy the same size of premises, traditional leases contain a number of additional costs such as: fit-out costs (including design and project management fees), dilapidations costs to return the premises to its original condition at the end of a lease, SDLT and any agency and legal fees to agree the lease in the first instance.

Assuming such additional costs are required at the start of a lease agreement, there are large costs associated with a traditional lease. The rent free period normally runs during the Cat B fit-out so tenants do not have to pay rent and fit-out costs at the same time. This being said, the cost of a serviced office usually only covers a very basic level of provision; and serviced office providers can charge additional fees for the use of meetings rooms, (generally in the region of £10 per hour) internet and staff passes. Serviced office providers are increasingly investigating alternative income streams such as HR and healthcare provisions on top of a regular customer payment.

Indicative City Core* rental cost comparison

	Serviced office (per sq ft)	Traditional Lease (per sq ft)**
Rent	£150.00 - £200.00	£56.00***
Rates	n/a	£25.75
Service Charge	n/a	£10.25
Density	1:65	1:80 to 1:100 (subject to building)
Overall cost per employee	**£9,750 - £13,000**	**£7,360 - £9,200**

Indicative City Core* additional cost comparison

	Serviced office (per sq ft)	Traditional Lease (per sq ft)*
Tenant-instructed fit-out (Average - including professional fees, FF&E, security systems and AV)	n/a	£170.00
Dilapidations	n/a	£20.00
Agency and legal fees	n/a	£7.00
SDLT	n/a	£3.00
Density	1:65	1:80 to 1:100 (subject to building)
Overall cost per employee	**n/a**	**£16,000 to £20,000**

* City Core is the UK's largest serviced office market | ** Assumed 5,000 sq ft floor on a 10-year lease | ***Net effective rent, existing building

4.0 Landlords respond to serviced offices

With serviced offices making up an increasing proportion of the smaller (sub 5,000 sq ft) and larger enterprise tenant market, landlords are having to differentiate and expand their offering in order to meet an increasingly varied set of requirements. The following options have been adopted by many landlords to date:

1) Leasing space directly to a serviced office provider carries risk, but can be an added amenity to existing tenants within the building.

2) Cat A+ or Plug and Play space that offers ready-to-occupy, fully fitted space on flexible lease terms.

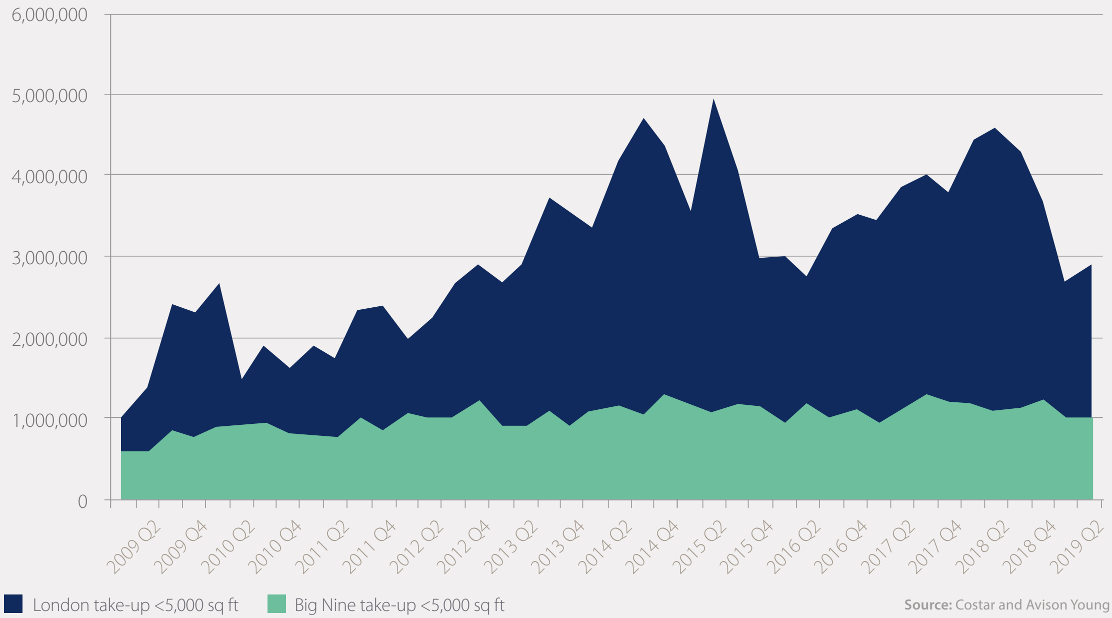
3) A landlord-brand serviced office provision that offers space of an equivalent level to a mainstream serviced office provider.

Attracting and retaining occupiers is of the up-most importance as tenants reduce their overall occupation in order to adopt flexible working strategies. With a range of offerings, landlords can retain occupiers throughout their growth journey without losing out to serviced offices when occupiers decide they need greater flexibility.

Attracting and retaining occupiers is of the up-most importance as tenants reduce their overall occupation in order to adopt flexible working strategies

With the growth in the serviced office sector, there has been a clear fall in traditional demand for suites below 5,000 sq ft across Central London. Sub 5,000 sq ft Central London take-up fell 60% from Q2 2018 to Q2 2019, conversely regional take-up stayed relatively stable.

Take-up below 5,000 sq ft



Source: Costar and Avison Young


Image: The Office Group

4.1

Mind the yield gap

Investors who lease space to a serviced office provider take on their covenant risk. Not all landlords are comfortable with this and serviced office providers can face resistance from some institutional landlords. Landlords are particularly exposed where a serviced office provider receives large rent free periods or financial contributions up front that often incentivise operators to take leases and fund fit-out.

Serviced office providers normally take a lease via a separate Special Purpose Vehicle (SPV) although some have offered limited parent company guarantees, limited rental deposits or bank guarantees. This structure enables them to close individual locations if they are not performing without affecting the parent company business. A Regus centre at Legal & General's 43 Temple Row in Birmingham recently went into administration after the SPV, MWB Business Exchange (since acquired by Regus), which originally took the lease in 2006 on a 15-year term, appointed liquidators.

There are further examples of Regus dissolving SPVs at 1 Berry Street, Aberdeen and at Stockley Park, Heathrow. Although this presents significant risk to institutional investors, the quality of the underlying office building will determine whether or not the landlord can a) re-let it or b) run the centre themselves if they lose the service operator and "inherit" the space.

Many investors believe insolvency continues to be a real possibility. WeWork's recent press shows the operator is exposed to $47.2 billion of total rental payments. WeWork's projected valuation was recently cut from $47 billion to $10 billion and then its IPO was formally cancelled following concerns from investors over the ability of the lossmaking company to generate a profit.

Serviced offices make it harder for investors to raise affordable debt, and over-exposure affects the overall investment value of the building. Our research has indicated that serviced office leased investment deals were on average 46 bps above the prime yield for their respective submarkets, increasing to 50 bps for buildings located in the City Core submarket which contains the majority of serviced office leased investment deals. Interestingly, the figures show that some Asian investors have been particularly active in this sub-sector in London, with the attraction of the weakened pound and long let assets exceeding any tenant-related uncertainty.

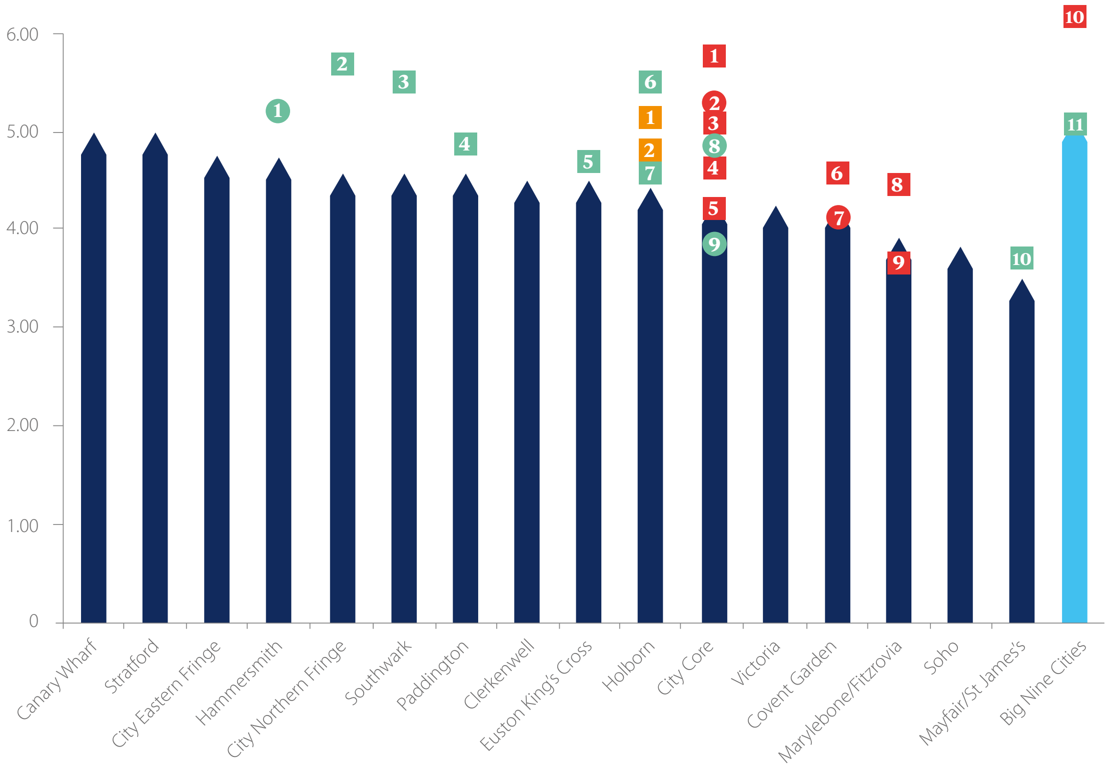
There are examples where concerns over the value have impacted decisions to lease space fully to a serviced office provider. For example, at Deansgate in Manchester, an 116,000 sq ft deal to WeWork fell through in January 2019 after Worthington Group decided against the letting due to concerns over covenant strength.

There is an argument to suggest that leasing part of a new development to a serviced office provider can be beneficial due to the "buzz" they bring to a scheme. Diversification is increasingly important in an uncertain economic climate and there is a belief that serviced offices should now be an asset class in their own right. Furthermore, serviced offices can provide an additional amenity to existing tenants through over flow or 'pressure valve' space and it is generally believed that 20-40% of an asset can be dedicated to flexible offices without impacting the valuation. As overflow space can attract and retain conventional tenants, there is also potential for it to increase investment value in the long-run.

A potential solution to landlords is to enter a management agreement with the serviced office provider which reduces the long term lease liability from the mainstream providers. This allows landlords to take advantage of the expertise and resources within the operator company, whilst participating in the financial upside of the location. Companies such as Industrious and Convene operate on this basis; Convene for example will occupy 100,000 sq ft at 22 Bishopsgate, EC2 under a management agreement with the landlord.

There is a view to suggest it makes sense to lease part of a new development to a serviced office provider due to the "buzz" they bring to a scheme.

Flexible office based investment transactions vs prime yield



Source: Avison Young

Freehold   Long Leasehold

<50% let

1 12 Hammersmith Grove
2 One Commercial Street
3 Southbank Place
4 One Kingdom Street
5 Euston House
6 322 High Holborn
7 Aldwych House
8 200 Aldersgate
9 London Wall Buildings
10 8 St James's Square
11 2 Cornwall Street

50-75% let

1 Fox Court
2 The Cursitor Building

>75% let

1 Dawson House
2 23-26 Austin Friars
3 Cannon Green
4 One Poultry
5 30-34 Moorgate
6 125 Shaftesbury Avenue
7 Golden Cross House
8 North West House
9 48 Charlotte Street
10 53 Fountain Street

4.2
Cat A+: Avoid a void

Cat A and Cat B fit-outs are well defined and traditionally landlords have marketed space in Cat A condition followed by a Cat B fit-out which is commissioned and paid for by the tenant. In response to the serviced office market offering immediately available accommodation and simple licence agreements, the market is increasingly seeing the emergence of fully fitted, plug and play landlord offered space, often referred to as Cat A+.

A Cat A+ fit-out provides tenants with varying degrees of ready-to-occupy space placing it between Cat A and Cat B in terms of the level of provision. This has numerous benefits including enabling tenants to visualise the space and speeding up the moving-in process for the occupier. Furthermore, the space has the benefit of appealing to tenants who appreciate the flexibility of serviced office provision, but who want their own private space without the association to a provider.

On its simplest level, Cat A+ is a show room with basic furniture and finishes. The most comprehensive approach to Cat A+ provides a fully fitted solution to tenants with generic (rather than bespoke) furniture, partitions and prior installation of internet connectivity. Alternative connectivity options can be via fibre or roof top microwave dishes with shorter installation times and which easily connect the building wirelessly to the network.

A Cat A+ fit-out has numerous benefits including enabling tenants to visualise the space and speeding up the moving-in process for the occupier.

Cat A

A traditional landlord finished product including: raised floors, suspended ceilings (unless offering exposed services), lighting, fire detection services, heating, ventilation and air conditioning to the standardised building planning grid and occupancy density.

Cat B

A usually tenant-commissioned fit-out of office space, to meet the occupier's requirements, including: kitchen and amenity space, meeting rooms, fixed furniture, small power and internet connectivity. Often involves extensive changes to the landlord's Cat A fit-out in order to accommodate the tenant's requirements.

Cat A+

Aesthetic Cat A+
Minimal provision to allow tenants to more easily visualise the space with furniture and finishes

Functional Cat A+
Likely to include some aspects of a full Cat B fit out such as a tea point, meeting rooms, minimal furniture and telecoms

Plug and Play Cat A+
Cost intensive and fully fitted with reception, meeting rooms, desks and fully installed telecoms

Our research suggests that void periods can fall to between one and three months with a Cat A+ provision, which is below the six to twelve months often recorded with conventional leases that are; increasingly reaching 24 months in extreme cases. Furthermore, there are a number of success stories where landlords have leased Cat A+ units with no marketing void, following a lengthy void period in standard Cat A condition.

There is also evidence to suggest rental premiums have been achieved with Cat A+ provisions, generally a 10% uplift on previously compromised space, which is in addition to a reduced rent free period of around three to six months, compared to over nine months on a traditional lease.

Landlords are offering shorter lease terms ranging from two to three years for Cat A+ units. Although in comparison, five year leases are more common for Cat A units, third year break clauses are increasingly common and there is a risk the tenant could leave. As lease lengths are generally on the decline, this may have less of an effect on building values than it has in the past.

Furthermore, as Cat A+ is a more generic fit-out suitable to a wide range of occupiers, and with provisions in the lease to return the premises to its refurbished original state, landlords are potentially able to re-lease the space post expiry. Therefore the landlord receives income over a longer period without significant additional expenditure, whilst also opening up potential to increase the rent.

As a potential solution to minimise Cat A+ fit-out costs, landlords may initially carry out a full plug and play fit-out on a single floor to enable tenants to visualise the space before acquiring space elsewhere in the building either as Cat A or Cat A+. In this example, the cost of the fit-out is more evenly spread over the building's entire income stream. Furthermore, Cat A+ fit-outs may allow the landlord to assess the need for capital expenditure on areas such as the reception and WCs.

Cat A vs Cat A+ lease term comparison

Conventional Cat A

	Term (years)	Rent free (months)	Void (months)
Sub 5,000 sq ft	5 break at 3	7	6-12
Over 5,000 sq ft	5	12	6-12

Plug and Play Cat A +

	Term (years)	Rent free (months)	Void (months)
Sub 5,000 sq ft	2	3	1-3
Over 5,000 sq ft	3	6	1-3

Source: Avison Young

Image: The Office Group

Scenarios

Initial assumptions:

- A 5,000 sq ft floorplate in the City of London.
- On lease expiry, the tenant vacates and the landlord has to undertake works to make the space marketable.
- The landlord has the option either to return the space to new Cat A or refurbish the space to Cat A+.

Scenario 1: Cat A

- The floorplate requires a new Cat A fit-out costing the landlord in the region of £75.00 per sq ft. The refurbishment takes three months to complete.
- Following the refurbishment, the space is vacant for nine months and the landlord spends circa £36.00 per sq ft in rates and service charge with no tenant in place.
- The space is let on a five year term (third year break) at £57.50 per sq ft with 12 months' rent free. The tenant does not exercise the break.
- The landlord receives £1.15 million in rental payments over the course of the lease. The total return on investment is £595,000.

Scenario 1: Cat A - 5,000 sq ft*	
Rent (£57.50 psf)	£1,150,000
Rates & S/c void costs (£36.00 psf)	-£180,000
Cap Ex (£75.00 psf)	-£375,000
Total	**£595,000**

*Assumptions in Appendix A & B

Scenario 2: Cat A+

- The floorplate is refurbished to Cat A+ costing the landlord in the region of £120.00 per sq ft. The refurbishment takes three months to complete.
- Following the refurbishment, the space is vacant for three months and the landlord spends circa £36.00 per sq ft in rates and service charge with no tenant in place.
- The space is let on a three year term at a rent of £65.00 per sq ft with six months' rent free.
- Upon expiry of the three year lease, the space is vacant for three months and is let on a two year term at £65.00 per sq ft with a further three months' rent free.
- The landlord receives £1.4 million in rental payments over the course of the leases. The total return on investment is £646,250. Despite additional capital expenditure, the rental premium, reduced rent free and reduced void mean that Cat A+ is more cost effective in the short to medium term.

Scenario 2: Cat A+ - 5,000 sq ft*	
Rent (£65.00 psf)	£1,381,250
Rates & S/c void costs (£36.00 psf)	-£135,000
Cap Ex (£120.00 psf)	-£600,000
TOTAL	**£646,250**

*Assumptions in Appendix A & B

Results:

- By spending an additional £225,000 to take the space to a Cat A+ finish, the landlord creates an additional value of £1.1 million, capitalised at 4.5% NIY.

Cat A vs Cat A+ comparison	
Capitalisation (4.5%)	£1,138,889

There is currently relatively little evidence of Cat A+ provision in the regional office markets, although we expect this to change as the provision grows in key regional markets, with some landlords already looking to differentiate from the competition with landlord-offered space. This could have significant cost implications. A plug and play Cat A+ fit out will have similar costs in both regional markets and central London, however, the same rental levels cannot be expected.

In what is becoming an increasingly competitive market for attracting occupiers, serviced office providers are themselves responding to the landlord products. Operators such as Knotel and 'WeWork HQ' offer serviced space on flexible terms but with a bespoke fit-out and customer branding opportunities. Where previously tenants struggled with establishing an identity separate from the serviced office provider, new offerings accommodate this requirement with unique fit-outs and signage available.

4.3

The Landlords entering the flexi game

As an alternative to Cat A+, some landlords are competing directly with the serviced office brands by creating their own brands or partnering separate businesses that operate on a similar basis to mainstream serviced office providers. Landlord provisions are often marketed as 'scale-up' space for fast growing businesses that have out grown serviced office space.

Although such brands are not unique to this cycle, some of the largest landlord serviced office brands include: British Land's Storey, Landsec with Myo, Brockton Capital with Fora, HB Reavis with HubHub and The Crown Estate's new flexible workspace at One Heddon Street. In the regional office markets, Castleforge Partners manages Clockwise, operating centres in Liverpool, Glasgow and Belfast. There are relatively low barriers to entry in the serviced office market and therefore it is a relatively easy, yet profitable, solution for landlords. For example, British Land was reported to be earning a 48% net rent premium on its Storey space a year after opening.

With rising numbers of serviced office providers in the market, the sector is becoming increasingly price competitive with rents or membership fees declining for serviced office space. Although occupiers continue to seek serviced offices, it is becoming more generic in order to match a widening tenant base; further driving rental levels down.

Landlords launching their own flexible brands have the advantage of owning their buildings. WeWork's recent acquisition of buildings on Eastcheap and Moorgate, The Argyll Club's ownership of several buildings in its portfolio, along with Blackstone's part ownership of The Office Group, suggest the number of buildings owned directly by serviced offices brands may continue to grow.

Serviced office providers incur significant risk where an economic downturn could leave them with low occupancy levels but with significant amounts of space on long and expensive leases. Owning the building outright can help mitigate this problem, subject to the serviced office provider's debt servicing arrangements for the building. Furthermore, increasing numbers of tenants are requesting a flexible working provision elsewhere in a building to allow them to easily expand or contract, as shown by the rising proportion of serviced office deals below 50,000 sq ft. Where landlords own the serviced office brand, this becomes relatively easy to provide without having to take on unnecessary risk.

In addition, having an occupier within its own-brand serviced office provider enables landlords to build a level of customer loyalty that may later create traditional leasing opportunities once an occupier is large enough to take on a traditional lease; in essence, incubating its own future tenants. By following a tenant on its growth journey, a landlord is able to cover all bases and not lose out in an increasingly competitive market.

Whilst the boom in serviced offices has been rapid, the trend towards greater customer care and service, as well as flexibility, puts increasing pressure on landlords to position their assets accordingly in order to mitigate risk.

5.0 Outlook

Serviced offices have become particularly embedded in the UK office market and as a result, landlords are at a crossroads between changing their offering or risk falling behind.

There is increasing evidence of landlords taking on an active role in positioning their space to occupiers who would otherwise be occupying space in a serviced office. Whilst this has implications on capital expenditure, evidence suggests that this has the potential upside of reducing void and achieving a rental premium. Furthermore, in cases where landlords are unable or unwilling to respond to the increasing demands of managing their asset, we are likely to see voids move out further.

Whilst the boom in serviced offices has been rapid, the trend towards greater customer care and service, as well as flexibility, puts increasing pressure on landlords to position their assets accordingly in order to mitigate risk and drive rental and capital returns.


Image: The Office Group

Appendix A
Scenario assumptions

	Upfront Void	Rent	Term	Rent Free Period	Capex
Cat A	3 mos fit-out + 9 mos void	£57.50	5 years (break at 3)	12 months	£75 per sq ft
Cat A+	3 mos fit-out + 3 mos void	£65.00	3 years + 2 years (3 mos intermediary void)	6 mos + 3 mos	£120 per sq ft

Appendix B
Fit-out assumptions

Cat A (City Core) fit-out assumptions

Central plant in good condition and only new 4-port fan coil units but no LTHW and CHW pipework replacement.

- Standard 600*600 metal plan suspended ceiling
- 600 x 600 LED lights but reusing existing lighting control system
- New medium density raised access floor
- No work to WCs or common parts
- Does not include professional fees

Cat A+ (City Core) fit-out assumptions

Central plant in good condition and only new 4-port fan coil units but no LTHW and CHW pipework replacement.

- Standard 600*600 metal plan suspended ceiling
- 600 x 600 LED lights but reusing existing lighting control system
- New medium density raised access floor
- Small power and data
- No work to WCs or common parts
- Does not include professional fees
- Partitioning for two meeting rooms
- Basic furniture provisions
- Excludes AV installation

Should you wish to discuss any details within this update please get in touch.

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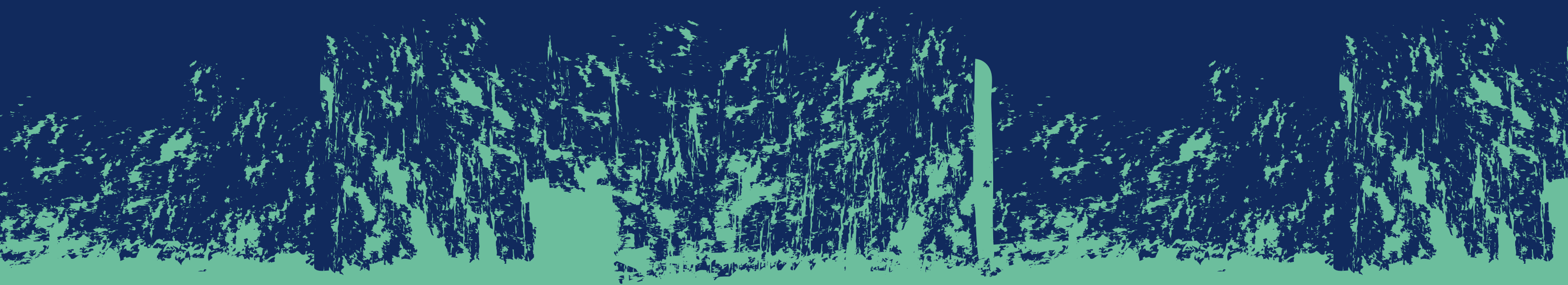

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