Institutions Disrupting the Office Market

WeWork became the biggest individual corporate occupier of office space in central London – second only to the UK government. We explore how serviced office growth has been driven by many things.

In 2018, WeWork became the biggest individual corporate occupier of office space in central London – second only to the UK government. The growth from this and other operators has been driven by many things.

There are 1.5 million more self-employed people than in 2001, there is an ever growing number of tech-start ups, which increased a further 14% last year alone, and occupiers of all scales are demanding better flexibility and service from their real estate.

The trend towards flexibility and demand for service has been seen more widely than just the commercial property sector. The rise of Build to Rent over the last five years has demonstrated people are changing the way they live and work across the board. For the office sector, this is a continuation of a long trend – but one which has been accelerated aggressively by the emergence of new operators.

Traditional players getting left behind

The effect has been particularly stark over recent years, with evidence of rising voids for smaller traditional space, something previously beloved as the bedrock of the institutional market, whatever the economic environment.

Against this backdrop, it is therefore less surprising that institutions have been keen to get a slice of the 'flexible office' pie. However, the diverse and disparate portfolios they have built up over many years have not lent themselves to today's working environment. Institutions hold portfolios with building sizes, locations, configuration and ground floor uses which were designed to satisfy a market which had very different expectations than today.

This is compounded by inadequate levels of direct occupier contact and traditional valuation methods which overly discount short term income.

WeWork may be dominating but institutions like LGIM are fighting back

A different level of service

Developers and serviced companies acquiring space today, meanwhile, can seek out trendy buildings capable of high density occupation and attract staff from the hospitality industry to run them with high levels of service. These offerings are not without compromise.

The downsides being poor company visibility, cramped offices, shared facilities, privacy and poor environmental conditions (CO2, air quality, temperature etc.). Providers may also have licenses allowing them to move occupiers to alternative premises at short notice.

The serviced market will undoubtedly continue to grow over the coming years. However, it will perhaps not just be in the flexible manor some are predicting. There is growing demand from occupiers in serviced space who want their own private traditional fitted offices, promoting business stability and company branding.

There is further demand from those in traditional space who want a better personalised service. Well serviced and fitted traditional space has the potential, therefore, to be the next area of significant growth.

A gap in the market

Whilst companies such as WeWork and Knotel have recognised this, the serviced industry doesn't have the availability of stock or the reputation of providing premium quality space. This leaves a gap in the market for institutions willing to reinvent themselves as occupier facing providers of service..

There are different ways institutions are approaching this market; UBS, for example, commissioned WeWork to redesign their New Jersey office to test its effects on productivity and employee wellbeing.

At Legal & General, we launched 'Capsule' in 2018 to offer flexible, high quality, ready to occupy fitted offices throughout the UK. Our focus is on turning the traditional occupier relationship on its head, providing a more direct and personal service and improving user experience by offering managed space. This allows occupiers to focus directly on their business, rather than cleaning, internet connections, general maintenance or even putting milk in the fridge.

Maximising returns

Capsule is already seeing results. For example, we recently leased a premium quality 3,000 sq ft office on The Strand for a five-year term certain, with four months rent free, at around £90 per sq ft (inclusive of outgoings other than rates).

Bringing Capsule into 55 Strand has maximised LGIM's returns

Our experience has been that leasing an office of this size under Capsule can generate an additional 20% return for our investors through lower voids and rent free periods. We are also benefiting from some occupiers keen to secure Capsule space for longer terms.

Given this success, Legal & General are now marketing 60 Capsule offices across the UK plus 83 turn-key (on request) opportunities, through agents, internet search engines and on our Capsule website.

As more institutions look at alternative, flexible and service-led solutions, the office market is set to be a much more competitive place going forward. As with many changing industries, the winners will be those who can best adapt to what today's occupiers – the consumer of the service – want.

The serviced market may have forced modernisation into the traditional office market but if user experience can be addressed, institutions are well placed to disrupt the disrupters.

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