

APRIL 2018



A MAGENTA REPORT

The demise of the commercial property lease

The demise of the commercial property lease

Is the conventional office lease dead? For a whole host of reasons, this is a question growing more legitimate every day. Work and commerce are no longer contingent on a physical base of operations, as new internet and mobile technologies equip people with tools that enable them to trade, work and communicate whenever and from wherever is convenient. The change is huge. Data from online market research portal Statista shows that global e-commerce sales totalled \$2.3 trillion in 2017, while this figure is expected to climb to \$4.5 trillion by 2021.^[1]

As the dependence on bricks and mortar has diminished, commercial organisations have begun to view office space as another cost that can be reduced and managed. The emergence of a more mobile workforce has encouraged these businesses to reconstitute the policies that govern their employees' working hours and locations. But this new trend, commonly known as 'flexible working', is incompatible with most traditional workspaces. A switch to flexible working often leaves large swathes of existing office space unoccupied, which results in unnecessary property, maintenance and lease costs.

So, the increasing adoption of flexible working practices is forcing businesses to find property, lease and workplace models that fit this new way of working. One of the biggest trends to emerge from these changing circumstances is 'co-working'. Made famous by the rapid rise of global co-working provider WeWork, the term is used to describe the use of the same workspace, equipment and amenities by separate groups and individuals. Co-working is growing in popularity

because it offers businesses shorter leases and plug-and-play workspaces, as well as ergonomic furniture and high-quality amenities and services. Much has been made of WeWork's decision to offer its tenants free food, coffee and beer on a daily basis.^[2]

But while these attributes have ensured that WeWork and other shared workspace providers belong to a new generation of trendy and progressive businesses, co-working's ascendancy would not have been possible without a series of deeper socio-economic changes. Research by financial services firm PwC projects that an extra 2 billion people will inhabit the world's major cities by 2050.^[3] This mass urbanisation is already putting pressure on metropolises like London, with councils and developers struggling to meet increasing property demand.

A report by property consultancy Knight Frank found that 4.1 million sq ft of London office space was acquired in 2017, a figure 31% higher than average. This boom was largely driven by businesses in the technology, media and telecoms

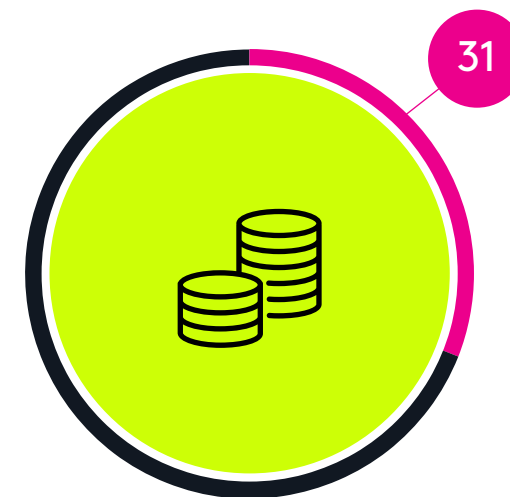
industry (TMT) that are seeking higher volumes of space in the sub-5,000 sq ft category, which is an expectation that co-working environments can meet. Yet the report also found that of the 72 properties in the UK capital offering commercial space, only two thirds are available to lease, with many of them already pre-let to office tenants.^[4]

Such rapid growth and change is part of a wider pattern of increasing volatility. A confluence of factors, including advances in technology, soaring commercial property rates and greater economic uncertainty, has left businesses less inclined to gamble on long-term financial decisions such as leases, favouring speed and flexibility instead. Brexit, for example, has been blamed for a 10-year low in office leases in the City of London.^[5]

- ¹ <https://www.shopify.com/enterprise/global-ecommerce-statistics>
- ² <https://www.theguardian.com/global/2016/jan/11/wework-transforming-office-life-and-home-life-car-ole-cadwalladr>
- ³ <https://www.pwc.co.uk/issues/megatrends/rapid-urbanisation.html>
- ⁴ <http://www.knightfrank.co.uk/blog/2018/02/09/central-london-office-market-reaches-peak-due-to-unprecedented-demand-post-brexit>
- ⁵ <https://www.independent.co.uk/news/business/news/brexit-latest-news-city-of-london-office-leasing-ten-year-low-leave-eu-financial-services-a8035381.html>

The Magenta Roundtable

In April 2018, Magenta Associates invited a group of highly respected corporate real estate and facilities management professionals to participate in a roundtable dinner to debate the topic 'Is the office lease dead?' The chair Neil Usher, author of The Elemental Workplace, proposed a series of ways commercial leases could change in the coming years. Though the responses in this report are anonymous, the event created a lively and, at times, contentious debate. This white paper reviews that roundtable, examines the fate of the office lease, and its influence on property and workplace trends.



4.1m sq ft

of London office space was acquired in 2017, a figure 31% higher than average



An extra **2bn** people will inhabit the world's major cities by 2050



A brief history of commercial office space

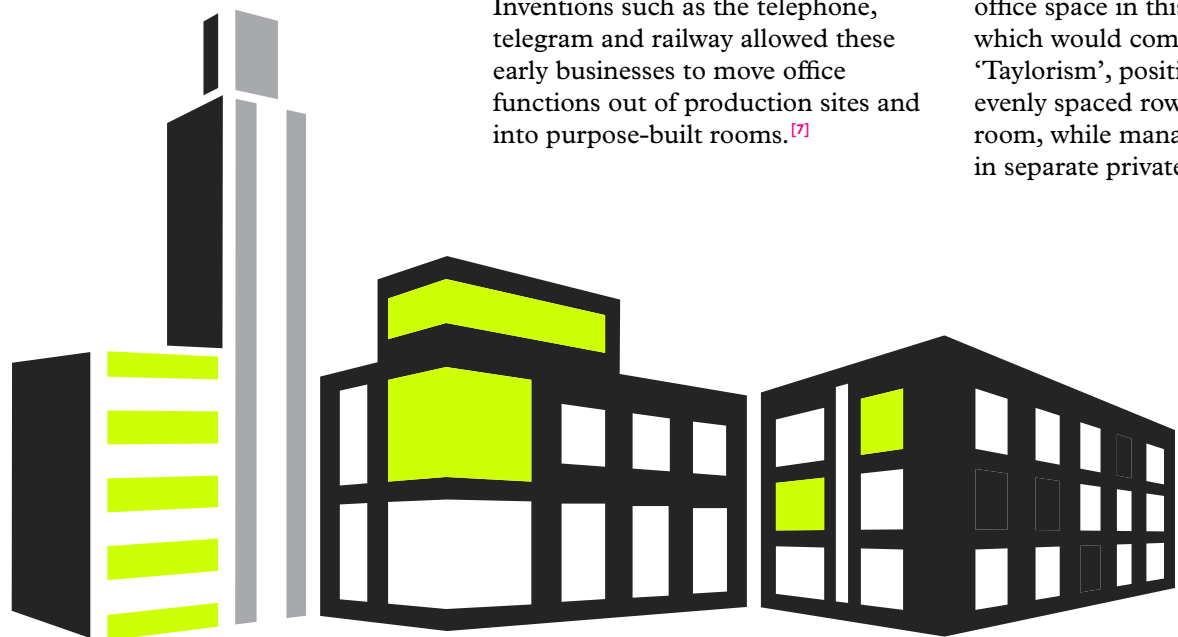
It is impossible to determine the fate of the office lease without first considering the evolution of office space. The history of work is bookmarked by changes to working environments brought to bear by technological advances, rapid economic growth and learnings about the nature of human beings.

Office work, as it may be understood today, can be traced back to the formalisation of administrative tasks in Ancient Rome. The modern word 'office' comes from the Roman Latin term 'officium', which loosely means 'bureau'.^[6]

But it was the Industrial Revolution in the latter decades of the 18th century that moved the workers from the farm to factories and offices. Inventions such as the telephone, telegram and railway allowed these early businesses to move office functions out of production sites and into purpose-built rooms.^[7]

► Taylorism

Once businesses were given the tools to work in these offices at the turn of the 20th century, including typewriters and calculation machines that enabled unprecedented amounts of information to be processed, efforts turned to designing and refining office space. American engineer Frederick Taylor is customarily credited as being one of the first people to design office space in this period. His system, which would come to be known as 'Taylorism', positioned workers in evenly spaced rows within one large room, while managers were situated in separate private offices.^[8]



► Open plan

Taylor's system was pioneering in its efficiency, but it accentuated the disparity between lower-rung workers and management staff. So, in the progressive post-war years, attention turned to democratising the office space through the creation of open-plan environments. Two German brothers with the surname Schnelle developed the 'Burolandschaft', a system that aimed to remove office hierarchies and improve communication by knocking down walls and partitions. Early adopters of this approach discovered that the flow of information not only improved between managers and administrative staff but also different departments.^[9]

► Walls

The next notable change in office design emerged in the late 1970s with the financialisation of the economy. The ideological shift to capital creation and individualism was epitomised by the cubicle farm office. Heavy on focussed work and light on employee wellbeing, this design typically featured grey, felt-covered walls that shut each worker away from sunlight and other colleagues.^[10]

► Open plan 2.0

While lots of contemporary workplaces still make many of the same mistakes when it comes to office design – spaces that are too cramped, too open, too dark and too chaotic – designers and businesses have been able to apply and develop many of history's best ideas. The open-plan office is back but this time with a new focus on ergonomic design, collaborative work and modern ideas around building community and culture.^[11]

► Remote working

The proliferation of smartphones, laptops and web-based technologies has given birth to remote working. Today's office does not have to be fixed; it can just as easily be the home, a coffee shop, or even on the move on a train.

► Agile working

With an increasing number of employees performing tasks outside of the office, businesses are redesigning workplaces to accommodate these flexible working patterns. Most agile workspaces feature a hot-desking system where no one has a designated workstation including senior management. Like the Burolandschaft, it is an approach that is aimed at flattening organisational structure, encouraging collaboration and deriving as much productivity out of the physical space as possible.

A key component of agile workspaces is the inclusion of different areas to encourage specific types of working, such as individual tasks, teamwork, creative work and informal meetings. When an organisation develops a system that incorporates agile working, flexible working and multi-purpose office spaces in accordance with wider cultural or strategic objectives, this is often labelled 'activity-based working'.^[12]

► Dream factories

Arguably, the most ambitious stage in office design can be found today among the innovative and immensely wealthy technology giants of California's Silicon Valley. The likes of Apple, Facebook and Google are designing workspaces that shape every single interaction an employee has with their working environment to microscopic detail, which has led to the creation of offices that provide workers with everything from nature and home comforts to recreational activities, places to exercise and areas for meditation.^[13] In an effort to take this approach to its logical conclusion, Facebook has even revealed plans to build housing, retail shops and a hotel in its corporate headquarters.^[14]

The logic behind providing such sophisticated workplaces is simple: the company expects its employees to dedicate their lives to their work, and in return the company will make those lives as easy, enjoyable and stress-free as possible. In this way, though it doesn't appear so on the surface, these new offices are similar to the Taylorist and open-plan spaces of yesteryear – each is designed to extract value from the worker.

So how does this all relate to the possible demise of the traditional office lease? Co-working, the latest office model, represents the culmination of all these styles, trends and designs. While the technology companies were the first to design spaces aimed specifically at improving employee comfort and wellbeing, co-working spaces now provide many of these features – though in a flexible manner and at a competitive price. Given these new expectations, there are huge question marks around whether traditional leases can deliver.

6 <https://www.morganlovell.co.uk/articles/the-evolution-of-office-design/>
 7 <http://www.deskmag.com/en/a-brief-history-of-the-workspace-coworking-Chicago-Architecture>
 8 <http://www.runtech.co/blog/evolution-office-design>
 9 https://issuu.com/stevenlin0/docs/evolution_of_office_design_in_and_b
 10 <https://labs.com/blog/the-transformation-of-office-design/>
 11 <https://labs.com/blog/the-transformation-of-office-design/>
 12 <https://www.veldhoencompany.com/en/activity-based-working/>
 13 <https://www.theguardian.com/artanddesign/2017/jul/23/inside-billion-dollar-palaces-of-tech-giants-facebook-apple-google-london-california-wealth-power>
 14 <http://uk.businessinsider.com/facebook-building-employee-housing-silicon-valley-headquarters-2017-7>

Is the commercial lease dead?

There is strong evidence to suggest that traditional office lease terms are at least under threat. According to data compiled by Estates Gazette (EG) Insight, average lease lengths in five of the six big UK cities fell in 2017 compared with the previous year. The EG Data report found that lease lengths in Birmingham and Manchester, for example, had dipped below seven years, with tech start-ups pushing “landlords and developers to experiment with new and risky approaches”.^[15]

But while new property models represent a step into the unknown for landlords and developers, flexible alternatives to traditional leases have become attractive to record numbers of start-up companies (approximately 660,000 were established in 2017).^[16] With little in the way of employees, assets and starting capital, start-ups are by nature nimble, flexible and less reliant on physical space. A conventional lease requires an expensive deposit, a costly fit-out post-move, a long-term lease that might not accommodate future growth, and a long legal process that involves many lawyers.^[17]

Changing the way we work

Co-working spaces and serviced offices are booming in major cities like London because they remove many of the risks associated with conventional commercial leases. The market for flexible workspace in central

London has grown by 67% in 10 years, now taking up more than 5 million sq ft of real estate. Current estimates suggest that the UK flexible workspace market may be worth as much as £62 billion by 2025, while co-working environments could account for 30% of all office space in the UK by 2030.^[18]

It is important to note that this trend is not being shaped solely by SMEs and start-up businesses. In its 2018 EMEA Occupier Survey, CBRE found that a majority of companies now see flexible office space as a key element of their corporate portfolios. The “proportion of organisations making no use of flexible space is expected to decline from 35% to 21% over the next three years”.^[19]

Though there are a number of co-working spaces capitalising on this trend in the UK, including The Office Group, Spaces and The Clubhouse, it is WeWork that best encapsulates the huge growth of co-working providers. In 2017, it rented more office space in London than any other company since 2012, making it the largest occupier of offices in the capital after the UK government.^[20]

The rise of the knowledge worker

When WeWork formed seven years ago it targeted young, city-dwelling creatives – initially offering these customers memberships rather than

leases. This was a response to huge socio-geographic shifts in migration and job market trends. A transfer of economic power to big cities like London has seen growing numbers of skilled graduates and young creatives move into urban areas to find work and the co-working spaces are satisfying the new demand.

Many of these knowledge workers are freelance or part-time staff, too, which means they need a base that is both flexible and close to their homes in city locations. The most recent study on the size and impact of the UK’s freelance economy, carried out in 2017, revealed that approximately 2 million freelance workers contribute £119 billion to the country’s economy.^[21] Meanwhile, the high cost of residential properties in cities like London means these workers cannot use a home as a base that is in close proximity to centrally located clients.^[22]

In a competitive job market, employers may also use these flexible spaces as a means to recruit and retain talent. A wide range of sectors now find themselves competing for the same pool of web developers and data analysts, as they move more of their processes online and attempt to build sophisticated predictive models.^[23] Providing high-quality workspaces, amenities and services in cool cultural hubs to attract these ‘techies’ allows all kinds of businesses to compete with more established sectors.

15 https://www.egi.co.uk/news/tech-sector-shrinking-office-lease-lengths/?eg_tr_fm_cmpt=true#

16 <https://www.ft.com/content/cb56d86c-88d6-11e7-afd2-74b8ecd34d3b>

17 <https://theurbandevolver.com/articles/is-the-conventional-office-leasing-model-dead->

18 <https://www.bdgsp.co.uk/insight/lease-dead-long-live-lease>

19 <https://www.propertyweek.com/news/flexible-space-to-account-for-half-of-office-occupation-by-2021/5095572.article>

20 <https://www.ft.com/content/40a87044-ff97-11e7-9650-9c0ad2d7c5b5>

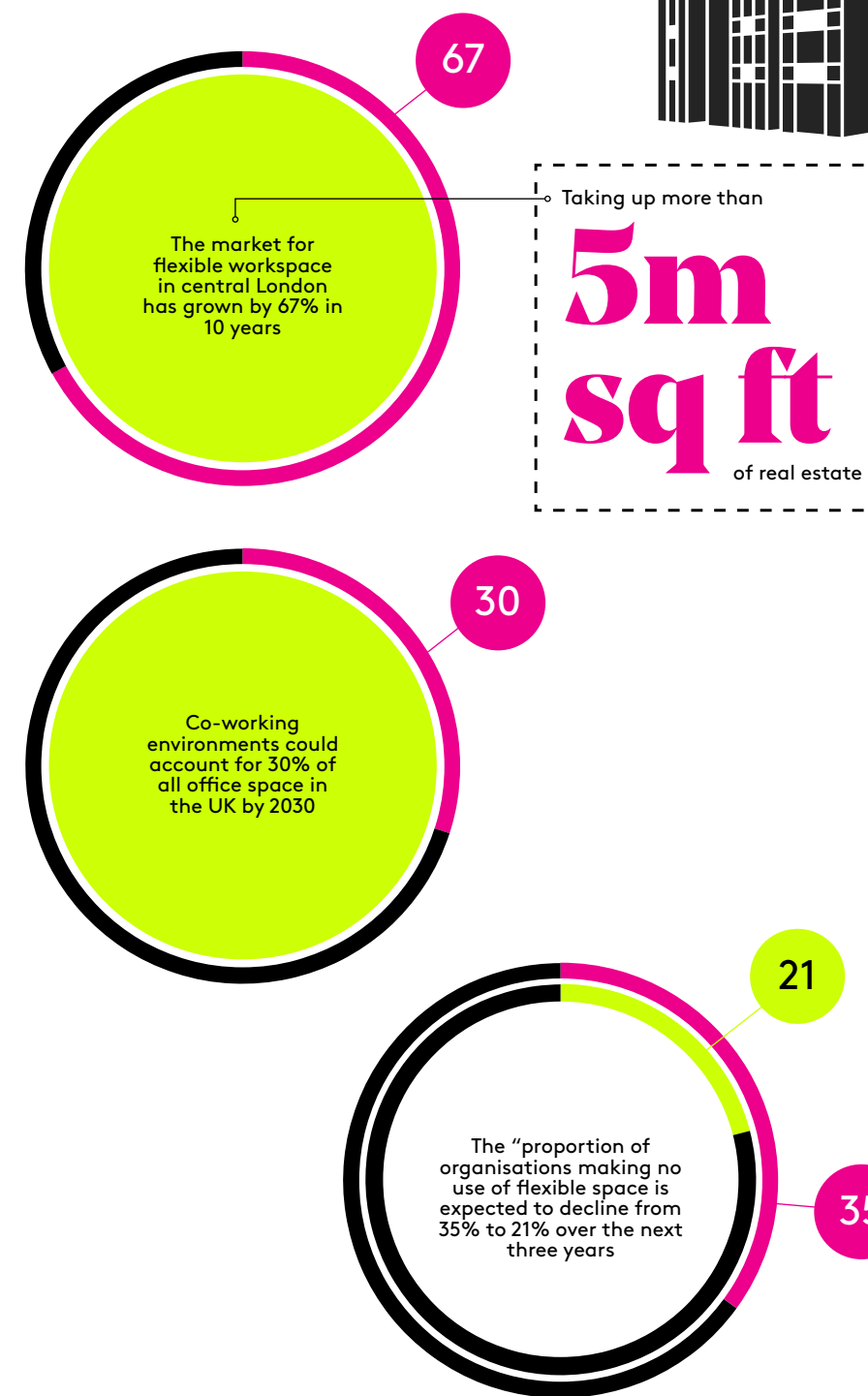
21 <https://www.ipse.co.uk/uploads/assets/uploaded/de84dfb7-283a-4c26-ba446f95f5547c1f.pdf>

22 <https://www.i-fm.net/news/can-fm-be-disrupted>

23 <https://www.cnn.com/2017/08/10/every-company-is-a-tech-company-including-blue-apron.html>

24 <http://knowledge.wharton.upenn.edu/article/future-jobs-world-ai-robotics/>

25 <https://www.gensler.com/design-forecast-2015-the-future-of-workplace>



Current estimates suggest that by 2050 the UK flexible workspace market may be worth as much as

£62bn

Approximately 2 million freelance workers contribute

£119bn

to the country’s economy.

Finally, as automation shifts the job market from process-oriented tasks to more creative work^[24], these trends will continue apace. The demand for co-working space will be driven by a constant influx of flexible freelancers.

Place-making

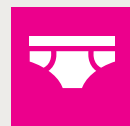
While options that offer flexibility and speed are growing in popularity, a look at certain parts of the economy reveals that there is still plenty of life left in the traditional commercial leases. In 2017, Apple and Facebook signed long-term leases in London – with the former moving into a 500,000 sq ft development in Battersea Power Station, and the latter taking a lease for a 400,000 sq ft space in the redevelopment at Kings Cross. This highlights an appetite and readiness from organisations of a certain type and size to make long-term investments in physical space. It is a form of place-making in which the office is treated as a tool of competitive advantage. In this environment, long-term leases are essential to fulfilling that goal.

As already discussed, both businesses have well known internal cultures that emphasise the design of working environments in the service of employee wellbeing as well as fostering a strong corporate culture. Architectural firm Gensler has referred to this approach as building a “corporate campus...reflecting the importance of ‘everyone under one roof’ to boost productivity”.^[25]

Five scenarios for the future of the office lease

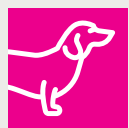
The deafening buzz surrounding co-working makes it easy to forget that other property model alternatives exist. A rise in co-working will not usher in the end of the commercial lease but change its structure. The model that co-working providers use is to lease space, make improvements to the environment, and then sublet that space for a small profit.

With that in mind, guests at the Magenta Roundtable were presented with five possible future property lease models and then asked to debate their merits, as well as any thoughts they had on the future of the office lease. Neil Usher's five scenarios included:



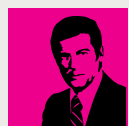
1 / The pants-free model

This scenario is named after *The Year Without Pants*, a book by author Scott Berkun that tells the story of his time at WordPress.com, a business where everyone worked from home and nobody used emails but nevertheless became a phenomenal success. In this scenario, office space is no longer necessary because everyone works where and how they choose. Technology such as holograms could make collaborative work possible. Commercial businesses could be converted for residential use, or knocked down to create green space.



2 / Bring a dachshund model

In this scenario, space still exists but is no longer leased. Instead, it is funded by short-term service agreements where occupants use what they want for the time they want it. This is a flexible pay-as-you-go model in which great care is taken to design healthy and productive workspaces. It is a logical endpoint for the co-working model. The dachshund invokes the trendy, gentrified neighbourhoods in which the co-working trend is finding a great deal of success.



3 / Roger Moore model

According to this model, office space will be occupied in similar terms to today, but all agreements will be made on the basis of trust only – perhaps a simple handshake – following the realisation that the only people who have made money from the conventional leasing model are lawyers. It takes its name from the *James Bond* actor's autobiography – *My Word is My Bond*. In time, the handshake could be replaced by the slight raising of one's eyebrow.



4 / Simply Red model

In this scenario, office space will once again be occupied in similar terms, but on the basis of a profit share. The model would work much like the pre-internet record industry, where less than 10% of artists repaid their initial investment, but the ones that did repaid many times over. Tenants would fish for deals and attempt to entice landlords, while no one would pay rent or service charges. This scenario is named after Simply Red, a band whose sales saved their UK record company.



5 / The FFS model

The fifth and final model would cut out legal verbiage by reducing a lease down to a one-page agreement. This would feature no capital contributions, no dilapidations, no rent reviews, no gratuitous requirements like re-painting the underside of the carpet every five years, and the addition of reasonable term breaks. This scenario stands not for the popular street refrain but 'Fair, Frank and Simple'.

The debate



The first guest to speak provided a reality check to proceedings, asking how the market could be incentivised to change. "We have a particular set of circumstances in the UK linked to the investment market that encourage landlords to want a long lease because that has a bearing on the value of the asset they hold," he said. "Unless there is a real market drive to shift the equation, nothing will change."

Evolve or die

The conversation soon turned to the steps that property companies and workspace providers must take in order to embrace this brave new world. One guest claimed that some serviced office providers had not adapted to the added value piece offered by co-working companies quickly enough. This is reminiscent of the fate of Kodak and Blockbuster, examples of companies that did not see the potential for change, ultimately allowing smaller start-ups to exploit gaps and eventually monopolise.

Another guest pointed out that FM service providers now face a similar threat: "Some of the serviced office providers are now acting as FM providers, not to lease space but to provide the services within the space, because they are more in tune to service provision and the experience of the occupant than the traditional FM providers."

"FM companies have missed the point of their role," said another guest. "So, there is an opportunity to deliver a very different kind of service that puts people at the heart and delivers it in a frictionless way. Most of the existing players are not doing that."

What are we trying to achieve?

More than once, the conversation steered back to a key question: what are we trying to achieve with office space? Only when organisations understand the purpose of their workplace can they work out how it should look and operate. A guest had an answer: "What we are trying to achieve is happy people creating successful businesses."

While there were some dissenting voices in the room, there was broad agreement on the necessity to build successful teams, culture and purpose through the physical environment. Multiple guests said businesses that want an identity need their own space.

The office as a recruitment tool

Another attendee explained how his organisation was focussed on developing a culture and DNA through its workplace that would ultimately allow it to recruit, retain and grow people.

The majority of guests agreed that young graduates, on the whole, wanted to be social and situated in exciting central locations. One attendee, however, claimed that 'socialness' can be nurtured from other sources.

When the host asked if organisations still need their name above the door, one guest said that it was a proud day when she was able to do just that at her office.

The real world

Much of the discussion centred around the need to design workplaces that help people be productive, even giving people the choice to be their most productive selves. A contrarian voice, however, reminded attendees that at a meeting of minds in the property and facilities management space, they were in a bubble. "Go outside," he said. "What you are talking about is idealistic and a small percentage of the reality. There is a whole world out there to evangelise."

One guest who was less convinced about the necessity of permanent spaces went further. "The acid test is, if you were to start your business all over again, what resources would you decide you really need? In the UK, we have hugely expensive rates that forces us to think more innovatively about how we do stuff. One thing holding companies back is this huge

lead weight they are carrying called property and cost. Buildings are a grudge purchase, so if you are going to have them, make them work.”

Another attendee predicted a future in which work was carried out on a more local scale. In this vision, as technology makes the world smaller, the business of the future might not be a monolith with corporate headquarters but a collection of smaller SMEs in regional offices.

One guest questioned whether the co-working trend could apply to larger organisations in industries where privacy is paramount and there are legislative requirements around Chinese walls. Law and finance firms, for example, are particularly sensitive about their data.

Facebook – utopian dream or dystopian nightmare?

When the debate turned to the organisations that are designing offices as campuses, the reaction was mixed. “Are we benevolent providers of wellbeing because it is the right thing to do, or are we looking to squeeze every last bit of the person in the space?” asked one guest.

“We seem to be intent on making all of our people like robots and all of our robots like people,” said another. “Are we in danger of making our people inhuman if we monitor everything?”

Do what’s right for you

If the Magenta Roundtable approached a conclusion, it was that conventional office leases, flexible working and other workplace models are all about choice. Guests agreed that it was impossible to group every organisation in together because some industries thrive in ways that others don’t.

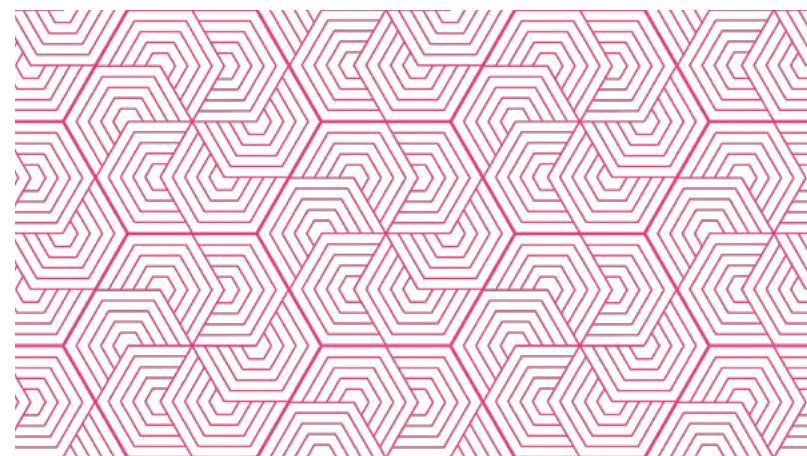


Conclusion

The office lease might not die but it will be irrevocably changed by far-reaching social, economic and political trends. Increasing volatility is spurring businesses to adopt flexible approaches that allow them to stay responsive and manage uncertainty. New technologies have freed people from their desks. Mass urbanisation is creating greater demand for office space as well as a new type of worker that expects it to be flexible and exciting in nature. The concern is that conventional commercial leases and the workplaces that often accompany them are not equipped to meet the myriad of challenges and threats.

However, while there is clear evidence of a growing market for shorter leases and more flexible working arrangements, it is impossible to ignore the huge potential for workplaces to make a genuine difference to employee effectiveness, company culture and the wider strategic business goals. The traditional office lease will be under threat from more flexible alternatives until there is a wholesale shift in how workplaces are viewed, from cost centres to enablers.

As with most things in life, this debate is about culture and choice. Businesses must determine what it is they need from their workplaces and whether their current property strategy is meeting those objectives. Perhaps then right question isn’t ‘Is the commercial lease dead?’ but ‘Does this commercial lease fit my needs?’



‘The office lease might not die but it will be irrevocably changed by far-reaching social, economic and political trends’

Magenta Associates
Office 3, Design Quarter,
129-130 Edward Street,
Brighton BN2 0JL

www.magentaassociates.co.uk
info@magentaassociates.co.uk
Call +44 (0)1273 934295



© 2018 MAGENTA ASSOCIATES LTD