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Why UK offices aren't following the US route

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Trends usually drift across the Atlantic but this time it might be different

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Earlier this month seasoned US shorter Bruce Richards turned his attention from retail malls to offices as the next big market risk. There are significant differences between the US and UK office sectors, but it is food for thought.

There are some who think working from home, ESG, increased construction costs and money shift to other asset classes means the London office market has lost its allure.

There are certainly structural challenges and a high risk of obsolescence across the sector, but I would say it is oversimplistic to say the global office market will crash. Rather, this is a chance to bring the right space to market for a changing occupier base with new, modern demands.

Meta has been seeking to shed space at British Land's 1 Triton Square in Regent's Place

While obsolescence in the office sector is a global challenge, this brings an opportunity for investors and lenders willing to take the time to unpick how the sector is changing. We, both as a lender and a responsible participant in the development of the built environment, want to support this.

Traditionally, the US leads the UK in cycles and gazing across the Atlantic can give us some idea of what's to come.

The US numbers are striking. Vacancy rates are over 20% in Manhattan and Los Angeles and 27% in San Francisco, according to CBRE. Cushman & Wakefield say around a quarter of US office space is considered undesirable and another 60% at risk of obsolescence in the future. A growing number of high-profile assets in the US have defaulted and five to 10 office towers a month join a list of at-risk assets, according to Trepp.

> *"The UK market does not operate with the same financial mechanisms for large-scale shorting of office stock as the US. Nor do I believe this strategy would be valuable even if there were"*

This is justifiably feeding scepticism in the UK but there are several reasons why London exhibits different dynamics. Aside from the fact there is more supply in the US, there is also a much bigger suburban office market, different leasing structures and a heavier reliance on tech occupiers whose demand has now dried up.

In London there are lower vacancy rates and lower development starts. There remains demand from occupiers for the right quality space which helps to attract and retain employees and to meet their ESG requirements.

There will be an adjustment – look at Meta's decision to sublet its 310,000 sq ft office at Triton Square – but fundamentally it's a market that serves an important need: offices are part of the social fabric of how we operate as businesses and communities. People are returning to the office – only 17% of workers in the UK are never in the office, compared to 43% in the US – and we all want to increase productivity through collaboration. Now is the time to repurpose space to appeal to that zeitgeist.

Retail read across

It is not difficult to draw parallels between the office market and the structural shifts that undercut the retail sector 15 years ago.

Covid and working-from-home practices have changed the market forever. We will need different space going forward as hybrid working has become a permanent part of working life. There is a change in demand patterns from historic space ill-suited to future needs to that which maximises the benefits of co-located colleagues.

Obsolete space will create a polarised market in the office sector and there will be further flight to quality from occupiers and investors. Indeed, rent premiums for the best buildings are already evident.

Shopping centres have endured structural change and values have plummeted

To remain relevant, space needs to be reconsidered and repurposed. Some offices could be demolished, some reconfigured and some changed to residential or other alternative uses. This brings financial challenges and opportunities, but these are not just restricted to the physical aspects of assets. The availability of capital will also be dependent on how projects address the climatic, social and economic futures we face.

Sustainability and environmental concerns are genuinely influencing the sector and complicating redevelopment and repurposing plans. The row around the redevelopment of M&S on Oxford Street and its embodied carbon took many by surprise, but if we see buildings as stores of materials and energy, we realise that there is more at stake in the decision to refurbish or redevelop than how much energy is used to heat and light.

With impending legislation around biodiversity requirements, renting energy-inefficient buildings and plans to broaden climate reporting across most UK companies by 2025, there's a richer and more complex landscape over here. The US has been a slower adopter of ESG requirements in buildings, and this may be one area where the UK (driven by Europe) can lead.

Permanent change

The UK market does not operate with the same financial mechanisms for large-scale shorting of office stock as the US. Nor do I believe this strategy would be valuable even if there were.

A permanent change has been made to working patterns and office usage and there is increasing focus on environmental aspects and employee well-being. Office investors and landlords will need to be on the right side of what will become a polarised market to attract occupiers and stay relevant.

But, despite the difficulties, a well-considered approach to reposition offices in core locations to meet changing occupier and investor requirements can outperform the market.