UK Commercial – Summer 2023

SPOTLIGHT
Savills Research

Spotlight: UK Flexible Offices

savills

Runway East, Aldgate East

Expansion ● Management Agreements ● Outlook

20,557 sq ft
Average deal size since 2020-2023

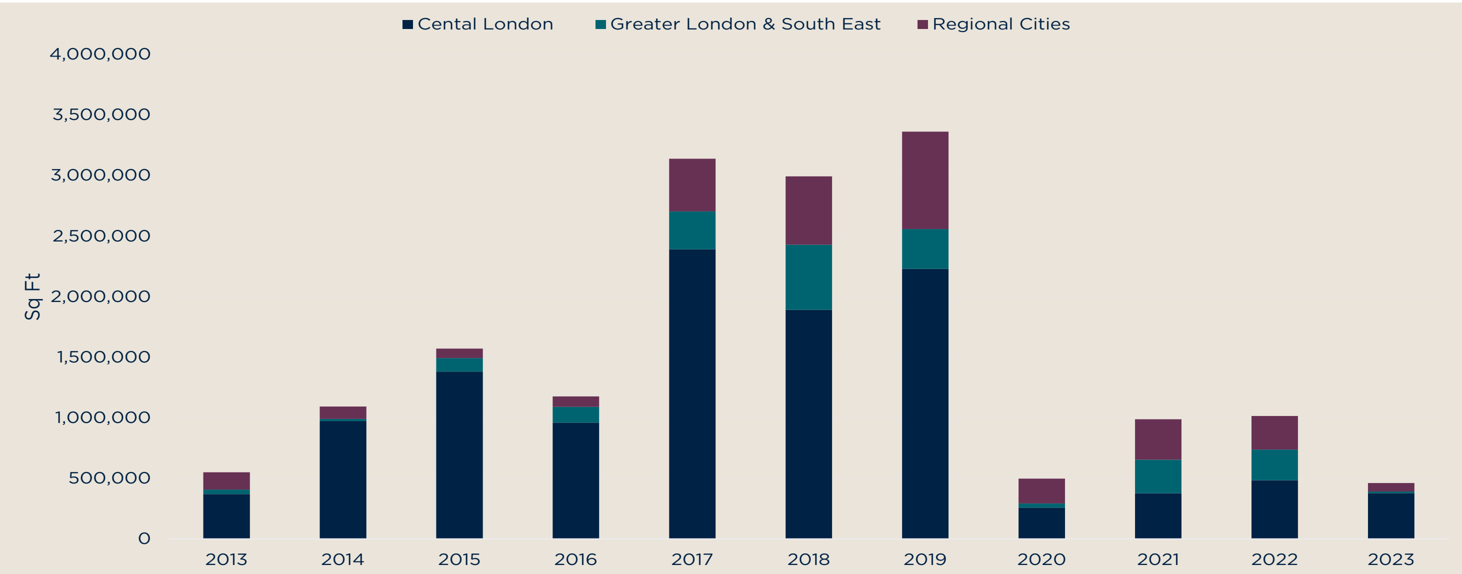
Most active operators 2020-2023
The Office Group, Orega and Spacemade

14
Live Requirements
There are 14 operators who requirements for new sites over 20,000 sq ft

Market take-up
Central London has accounted for 82% of operator take-up in H1 2023

Flexible office operator take-up 2013-Present

H1 2023 serviced office take-up reached 461,000 sq ft



Source Savills Research

Operators are seeking to expand across the market amidst a rise in demand for flexible office space

Introduction

WeWork's troubles are not reflective of wider operator sentiment. In contrast to the wider office occupational markets, flex operators are benefiting from strong occupancy and desk rate growth on the back of the exceptional rise in demand. The average price per private office desk in the UK H1 2023 was up 15% on the first half of last year, and surpasses the desk price pre-Covid by 30%. UK enquiries are up 12% Y-o-Y, which is an increase of 173% on pre covid levels and providers have reported that this year occupancy levels in London are at 88% while the rest of the UKs contract occupancy was at 86%.

The increase in demand for flexible office space has resulted in an uptick in requirements for new sites from operators. There are currently 14 flexible operators looking for space greater than 20,000 sq ft across the UK, with 93% of these seeking a management agreement structure. The demand is predominantly focused in London or the Big Six regional cities.

Operator take-up has been concentrated in Central London

Demand from flexible office operators has been resilient as we have emerged from the Covid-19 pandemic. Take-up at the end of H1 2023 reached 461,000 sq ft. The recovery in demand has been notable in Central London with take-up rising incrementally each year since the Covid-19 pandemic which is set to continue by the end of 2023. Additionally, take-up has grown across the five-year period of 2018-2022, in comparison to 2013-2017 in both the regional cities and the Greater London and South East region, with a growth of 159% and 130%, respectively.

The majority of take-up has been in Central London, accounting for 82% of take-up in 2023, with 15% of take-up occurring in the regional cities and 3% in the Greater London and South East office market. In terms of overall market take-up, this represents 10% of Central London's overall take-up for H1 2023, which has grown from the previous 4% proportion in 2022. Notable deals in H1 2023 in Central London include Convene pre-letting 45,000 sq ft at Christchurch Court and The Office Group leasing 43,000 sq ft at the Blue Fin Building.

There has historically been an undersupply of prime flexible office space across the regional markets, which has resulted in certain operators targeting these markets for expansion. This has been evident in Birmingham in 2023 where Spacemade have launched 10X at 10 Brindleyplace and Cubo have expanded their presence at 2 Chamberlain Square, both of which are considered Prime buildings within the market.

Some flexible operators are expanding their portfolios

The profile of which operators have been most active in terms of take-up pre-and post-pandemic has changed. The Office Group, Orega and Spacemade have been most active since 2021 whereas WeWork and IWG Group were previously the most active from 2013-2019.

Orega plan to nearly double their UK portfolio size in the next two years to reach one million sq ft, in particular seeking new space in Edinburgh, Newcastle, Aberdeen and Cardiff, whilst also increasing their presence in London, Birmingham and Manchester. Spacemade is also rapidly increasing their market portfolio with a goal of opening 50 locations across the UK by 2024. Other examples of flexible operators who are expanding include x+why, Cubo and Venture X, amongst others.

The lack of prime regional supply has however hampered the ability of some flexible office operators to execute their expansion programmes. The flight to quality from conventional office occupiers has also been evident from operators with 74% of take-up, across the UK since the start of 2021 being grade A standard.

> "Management agreements have accounted for 43% of deals recorded in H1 2023."

Tenants are seeking greater flexibility

A trend which has accelerated post Covid-19 is the greater desire for flexibility from office occupiers. This was evident from Savills 2022 Landlord Flexible Office Survey where 72% of landlords expect tenants to require more flexible lease terms.

Demand for flexible office space has varied from small companies to large corporate occupiers seeking project space. Notably the number of enquiries from occupiers seeking over 100 desks has increased by 50% year-on-year, compared to pre-pandemic levels. Flexible office space solutions have proved attractive whilst companies evaluate their optimal spatial requirements. Occupiers are also attracted to these spaces due to the savings they can make by utilising hot-desking and minimising the risk of unused office space.

The importance of providing flexible office space in prime buildings will heighten with an increasing number of corporate occupiers only considering buildings which provide this offering when relocating.

There has been a growing preference towards management agreements

Alongside the shift in the most acquisitive flexible office operators, comes the growth in the preference towards management agreements over conventional leases. In 2019, management agreements only accounted for 9% of deals recorded, however at the end of H1 2023 it stood at 43%.

A management agreement is essentially a profit share model between the landlord and the operator, typically gaining popularity in more challenging markets. This is because they are seen as more cost effective and can reduce the risk for the operator. It also benefits the landlord by granting them greater control levels of how the space is delivered, alongside transparency around the providers performance. The greater amount of management agreements seen regionally and across the South East can be explained by the markets carrying more risk for operators than in Central London.

There has been a rise in 'hotelification' within flexible workspace. This trend sees landlords and operators transforming the ground floor unit to incorporate a café, lounge, co-working and meeting spaces. The idea of providing spaces as hospitality amenities creates a more cohesive customer experience within the building, whilst also driving higher revenues for landlords. A price premium has emerged, in terms of desk rates, for the best quality space as there is a lack of new space being delivered, driving greater polarisation in the flexible office market.

A rise in demand for fitted space

There is increasing appetite from occupiers for both flexible and landlord fitted office space, following rising fit out and finance costs, combined with delayed development completion dates, making these options more appealing as they help mitigate these risks and can increase flexibility and convenience for the occupier.

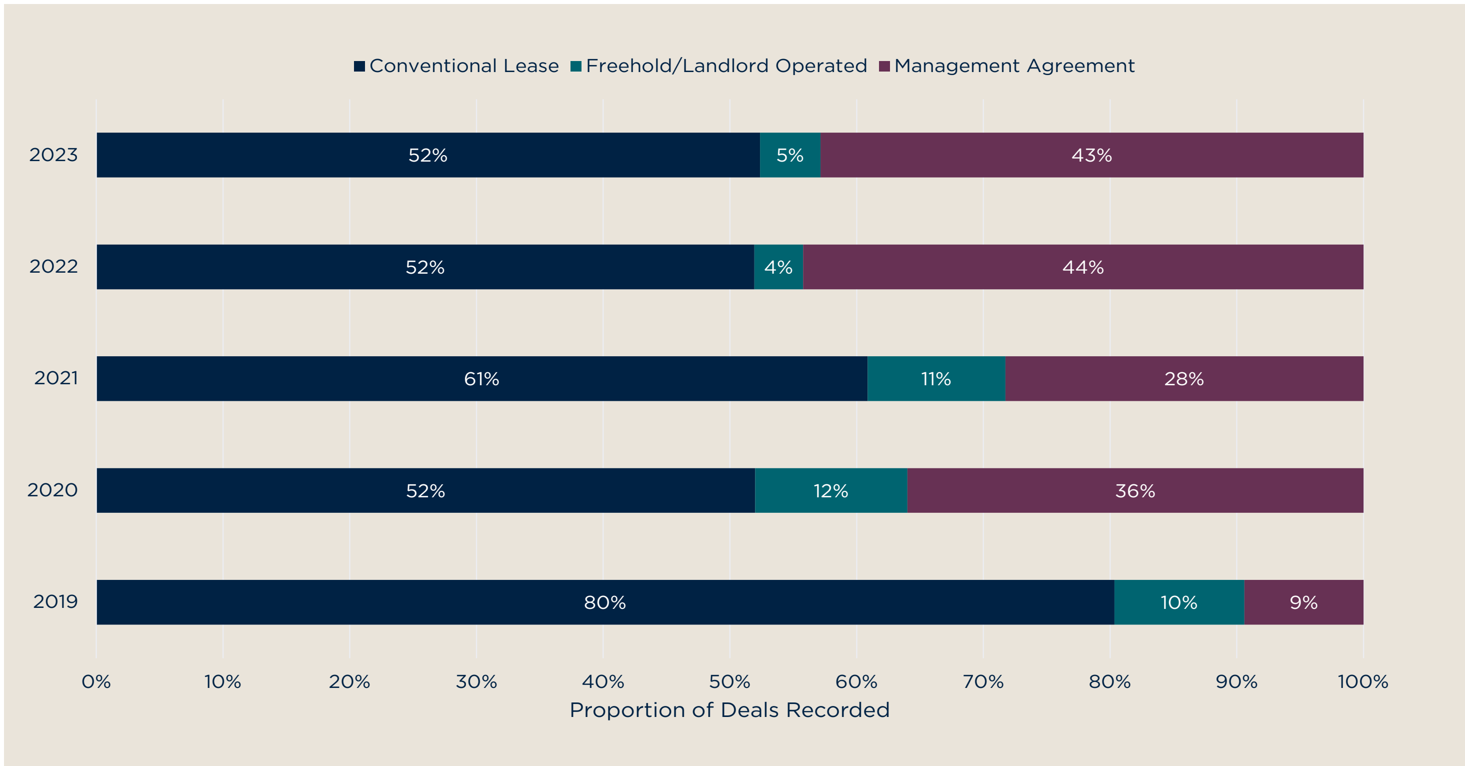
The lack of prime flexible office supply in core locations is also a factor in driving demand for landlord fitted space with occupancy rates rising to full capacity in some centres.

Historically, fitted space has appealed to smaller occupiers with the majority of transactions below 5,000 sq ft. There are though a growing number of fitted office space deals between 5,000 to 10,000 sq ft. This has been evident in the City of London market where in 2022, transaction volumes doubled for landlord fitted space below 10,000 sq ft. Landlord fitted space also accounted for 42% of all office leasing transactions in the City of London in 2022 below 10,000 sq ft, compared to 21% of activity in 2021*. There has also been an increase in demand for fully managed space where landlords also provide soft services. We expect that a preference towards fitted space from smaller tenants will continue, especially with a rise of 'package deals' to include soft services as an offering.

*Savills data accounts for Landlord space only. If you incorporate Tenant controlled space, the percentage of 'fitted space' transactions in the City rises to 61% of all activity.

Flexible office operator transactions by deal type 2019-Present

The proportion of management agreements in the serviced office sector is on an upward trend



Source Savills Research

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