Real Estate. Disrupted

The changing use of space in 2020 and beyond

MemeryCrystal

What's inside

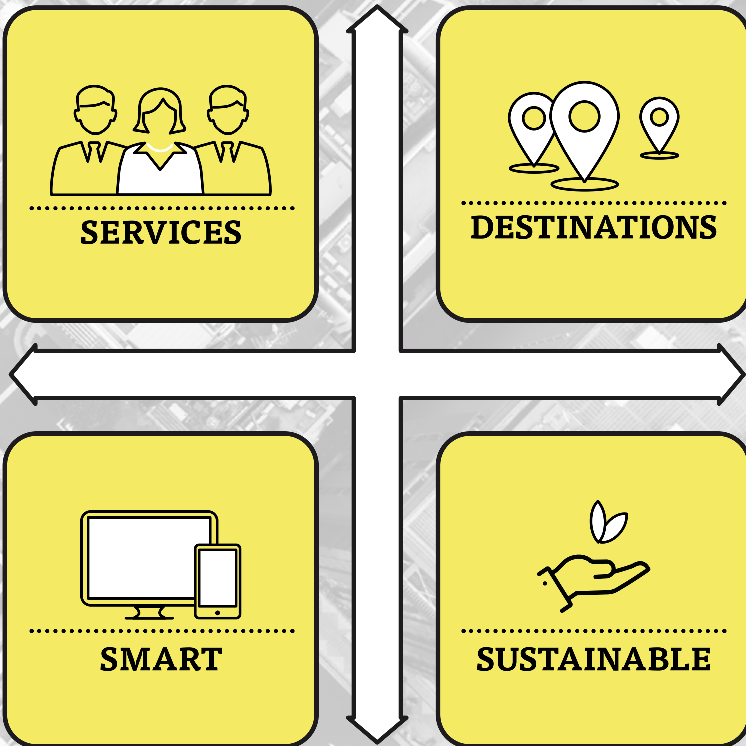
Introduction

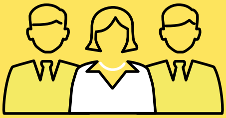
Real estate has historically been a deceptively simple asset; it is bought or sold, whether as a leasehold or freehold interest. The UK property market is however undergoing significant changes in demands.

Both macro-economic and socio-cultural factors are significantly changing just what it is that people require from property. The proliferation of technology, demographic shifts, environmental awareness and a rising demand for flexibility are making both residential and commercial occupiers a far more discerning class of consumer with a new and evolving set of expectations and priorities. The traditional real estate industry is responding to this dynamic, but it needs to accelerate the pace of change if it is to meet these demands and keep up with competitors who are already reacting.

While the world is currently experiencing severe difficulties and disruption, systemic change was already underway in the market and in this context, we have identified four key drivers of change in the industry which will shape the decision-making of owners, developers and occupiers in 2020 and beyond.

The future is...





The future is services

As occupier demands evolve, the property industry will continue its transformation into a services-led business. Landlords will seek to improve occupier 'stickiness' by continuing to complement their built assets with an enhanced focus on user experience and flexible usage. This will impact on valuations and investment decisions.

Services have disrupted the software world, heralding the rise of so-called Software as a Service (SaaS) - estimated to soon be a $100bn[1] industry, if it isn't already. But services have also disrupted more tangible industries - look no further than the Uber effect on the taxi market. This includes real estate, and is particularly noticeable in the increasing attention being paid to flexible workspaces, where space is now subscribed to in the same way a consumer subscribes to a music or TV streaming service.

Flexible workspaces as a product are nothing new, but their marked growth in recent years has tracked the wider economic requirement from businesses for both services and agility. In 2015, a report by Google[2] stated that flexible working will be the defining characteristic of the future workplace and, in the years since, the amount of available flexible office space has increased exponentially. In the UK, according to JLL, the flex space footprint grew by 25% in 2018 – a similar rate to 2017 – and there is now a corresponding effort to reimagine how this kind of space is more effectively valued (RICS)[3].

[1] https://www.srgresearch.com/articles/saas-spending-hits-100-billion-annual-run-rate-microsoft-extends-its-leadership
[2] https://gsuite.google.com/learn-more/workplace-2020.html
[3] https://www.rics.org/globalassets/rics-website/media/knowledge/research/insights/valuation-of-flexible-workspace.pdf

Part of this is being driven by evolving workspace trends, not least the growth of the so-called ‘gig economy’ and the march of automation. Nearly 50% of companies expect that automation will lead to a reduction in their full-time workforce by 2022 (World Economic Forum)[4], and this will have a tangible impact on property requirements. But it also goes much deeper. There is an increasing realisation that, while property is a discernible cost, people and productivity have a far greater impact on business success. Therefore, occupiers are increasingly seeking ways to more carefully tailor their real estate strategies based on their specific people needs – and this includes the services that those people have access to while they are in the building, even when they are not in the building.

“There is a dearth of Grade A office space being delivered at the moment and, along with high occupancy rates, this means there’s a real fight on for new space coming to market. If you want to get the best tenants you’ve got to have an edge.”

Daniel Abrahams, Co-Head of Real Estate, Memery Crystal

There is potentially a huge growth opportunity for those real estate businesses which extend their zone of influence beyond the core ‘product’ of property, further into the services that complement occupiers’ use of that property. We have already started to see this, with LandSec’s Myo brand and British Land’s Storey Club both launching in 2019.

If real estate does not adapt, then there are new competitive threats waiting in the wings. Consider, for instance, the push that Amazon has made into property, firstly with its home IoT (Internet of Things) solutions, based on Alexa and its Ring platform; as well as its recent investments into keyless entry start-up SmartRent and agency disruptor Realogy. It is not a huge leap to imagine Amazon developing its own real estate product, powered by its suite of integrated services.

[4] http://www3.weforum.org/docs/WEF_Future_of_Jobs_2018.pdf

But this is not just true of the commercial office market. The same effects are impacting on residential, where the Build to Rent (BTR) market increased by almost 40% in 2018 (BPF)[5].

"One of the problems being faced by operators in the BTR market, and this is where there may be some learnings from the offices and even alternative residential sectors like student and retirement living, is a lack of skills. You now need data scientists and concierge staff as much as traditional asset managers. Developers are having to think long-term and with property management and curation front of mind. This is a real shift for many."

Joanne Kelly, Head of Construction, Memery Crystal

[5] https://www.bpf.org.uk/media-listing/press-releases/building-boom-uk-build-rent-housing

The BTR market is still relatively immature in the UK, yet the suggestion that residents are willing to pay an 11% premium (JLL)[6] for the kinds of amenities that schemes have become famous for – from swimming pools and Yoga classes, to co-working spaces and concierge – indicates that services are very much here to stay, transforming how space is used.

“Property can create a sense of community within the home space as well as the working environment. There has been a huge growth in co-living and we have seen the provision of affordable rooms and so-called neighbourhoods within buildings. People are living differently and are looking for both convenience and cost reductions.”

Victoria Lowe, Partner, Memery Crystal

[6] https://residential.jll.co.uk/insights/opinions/will-tenants-pay-more-rent-for-amenities

The future is destinations

People will be put at the centre of real estate strategies. The property industry is increasingly acknowledging the impact of generational change and consumer psychology, adapting the built environment to play a new role in delivering economic value. This includes an added emphasis on property and placemaking as a tool for attracting and retaining talent, and creating experiential environments to increase dwell-time and discretionary spend.

By 2025 an estimated 75% of the global workforce will be millennials (EY)[6], with the so-called Gen Z hot on their heels. While many of the assumptions made about this demographic are rapidly proving to be a myth, there is no doubt that the next generation have a different set of expectations and behaviours which are disrupting existing notions of live, work and play.

This is perhaps playing out most noticeably, for now, in the retail sector. The shifting fortunes of the high street are well documented, with many retailers struggling to keep up with the pace of consumer change and landlords correspondingly having to reassess their portfolios. The easy explanation is that online is killing bricks and mortar, but the truth is far more complex than that and the watchword is experience.

Research from Barclaycard[7], for instance, has found that more than half of consumers would now rather spend money on events and entertainment rather than on material items, and experience and brand is now cited as of almost equal importance to price when making purchase decisions.

[6] https://www.ey.com/Publication/vwLUAssets/ey-the-future-of-work-is-changing-will-your-workforce-be-ready/$FILE/ey-the-future-of-work-is-changing-will-your-workforce-be-ready.pdf
[7] https://www.home.barclaycard/media-centre/press-releases/Experience-economy-grows-as-consumers-seek-out-memories-in-favour-of-material-possessions.html

“The way people spend their time has radically shifted, with leisure time – and disposable income – now much more likely to be spent online or in front of a screen. This changes the game for retail as the competitor set is now much more diverse and ever more integrated with consumer’s personal lifestyles. There is huge competition for social spend and it’s no longer just about setting up shop in a convenient location – to compete you need to offer something else to attract people in and keep them engaged.”

David O’Dwyer, Partner, Memery Crystal

The crux of the issue is that real estate needs to be much savvier and more responsive to the demands of consumers in order to stay relevant, generate footfall and capture share of mind and spend. real estate assets must become destinations.

The importance of experience is not confined solely to the retail industry. Indeed, the future is almost certain to be characterised not by siloed sectors – such as retail – but by the growth of mixed-use and holistic places which deliver on a broad spectrum of needs. This will be a critical factor for broader economic success in our cities, which are facing the very real prospect of a growing talent exodus. Statistics suggest that almost 60% of millennials are happy to move out of cities within the next ten years (Youthful Cities)[8], whilst in London, we have already seen a growth in migration out of the city – particularly among 30 to 40 year olds. This is likely to continue driven by factors ranging from a desire for healthier lifestyles to more affordable housing (ONS/Knight Frank)[9].

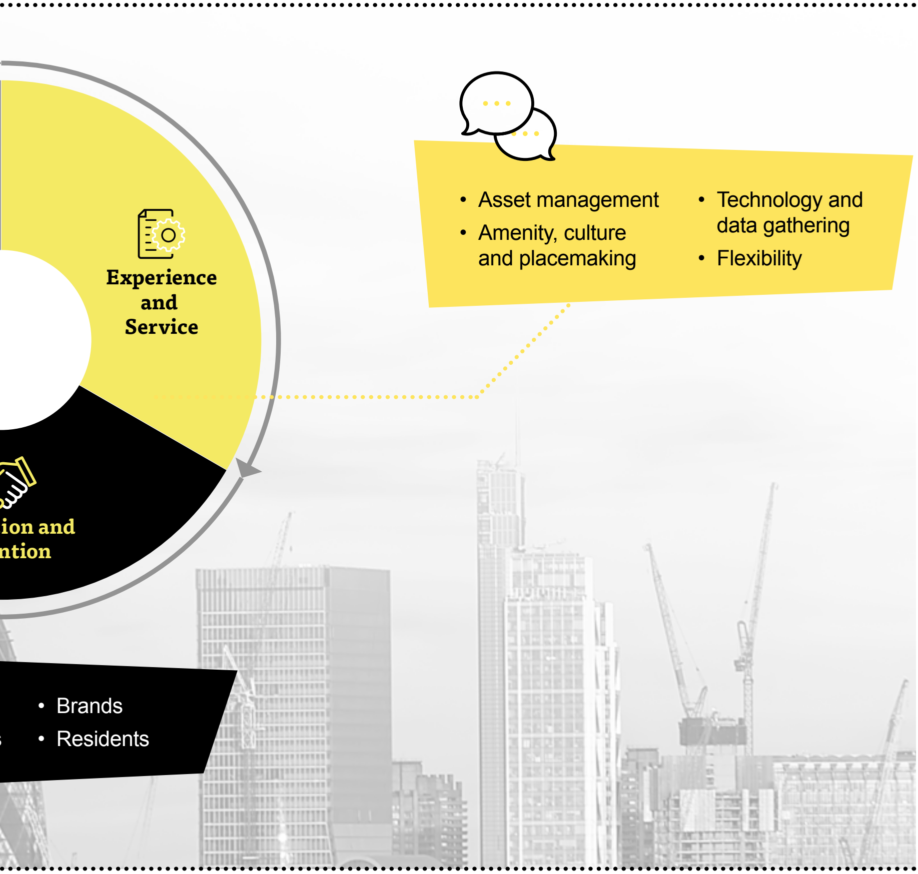
[8] https://www.youthfulcities.com/urban-millennial-survey
[9] https://www.knightfrank.co.uk/research/article/2019-06-26-london-leavers-reach-new-high

Businesses are therefore seeking new ways to attract and retain talent, with their working environment central to their propositions and enlightened landlords are adapting likewise. This is not just about fit-out and amenity, it is about the wider environment, access to infrastructure and the mix of cultural and leisure assets which are within the workplace vicinity. Consumers of space – be that a retail shopper or an office worker – are demanding more, and so occupiers are demanding more from developers.

"There is an appreciation that the consumer wants something that changes and wants something that's different. The generic offerings have had to adapt and so landlords and developers are having to adapt to those requirements. The pop up cinema trend is a great example – just a couple of years ago landlords would have laughed at the prospect of an occupier raking in a high spending set of consumers for a night spent in a car park or on a roof watching a film they've seen a numerous times in fancy dress! In many cases, these concepts are still a proving ground that changes how real estate is valued; there needs to be a blend between what's of the moment and driving footfall, and what is going to generate investment returns."

David O'Dwyer, Partner, Memery Crystal

The lifecycle of space in the service economy


Experience and Service
ion and
ntion
Asset management
Amenity, culture and placemaking
Technology and data gathering
Flexibility
Brands
Residents

The future is smart

Technology will be increasingly incorporated into the built environment, providing new sources of intelligence for landlords and occupiers as well as potential new revenue streams. This will unlock a new relationship paradigm, driving better decision-making regarding space utilisation and the impact of buildings on the environment, communities and the individual. But it will also pose challenges in terms of privacy and cyber security.

Technology has had, and is having, a transformative effect across the global economy and within all sectors. It is disrupting traditional ways of doing thigs, and providing huge opportunities to connect disparate groups, gather intelligence and make better commercial decisions.

Real estate has, until now, been slow moving when it comes to innovation and the adoption of new technologies. According to a recent industry survey, 97% of global property professionals think that digital will impact their business, but 66% did not have a clear digital and technological innovation strategy (KPMG)[10]. This is a gap that must be closed if the industry is going to thrive in the future and not be muscled out of the market by new competitive threats.

The direction of travel is clear. By 2030, 500 billion devices are expected to be connected to the internet (CISCO)[11] and this will radically alter how people engage with each other and with their environments. This is entwined with a need for cyber-security and enhancements around automation, including robotics and AI.

[10] https://assets.kpmg/content/dam/kpmg/fr/pdf/2018/11/fr-KPMG-Global-PropTech-Survey-2018.pdf
[11] https://www.cisco.com/c/dam/en/us/products/collateral/se/internet-of-things/at-a-glance-c45-731471.pdf

"Property has largely been an undynamic community because of its structural norms - it's worked the same way for hundreds of years and there's a real risk of stasis and a reticence to change. But now change is being forced on the industry via external factors and innovation, and the race is on to catch up."

Alastair Moss, Co-Head of Real Estate, Memery Crystal

Although the growth of connected devices has the potential to open up real opportunities for real estate. In the retail industry, for example, eCommerce should no longer be seen as a standalone competitor to traditional stores. Rather, it provides brands whole new opportunities to engage with their consumers both in store and online, joining up the overall purchase process into a connected retail experience. From facial recognition to smart beacons, this will involve the use of technology to track preferences and requirements, monitor brand engagement, provide personalised services and marketing, and join the dots between in-store activity and purchasing.

Bricks and mortar in this landscape has a wholly new function. It is no longer the place at which transactions necessarily happen. Instead, it is a brand touchpoint more akin to marketing or a piece of media, designed with the intention of generating footfall, brand exposure, dwell time and engagement.

1.3 BILLION

According to Deloitte, the number of sensors deployed across the commercial real estate sector could hit 1.3 billion in 2020.

Intelligent buildings will become the norm, rather than the exception.

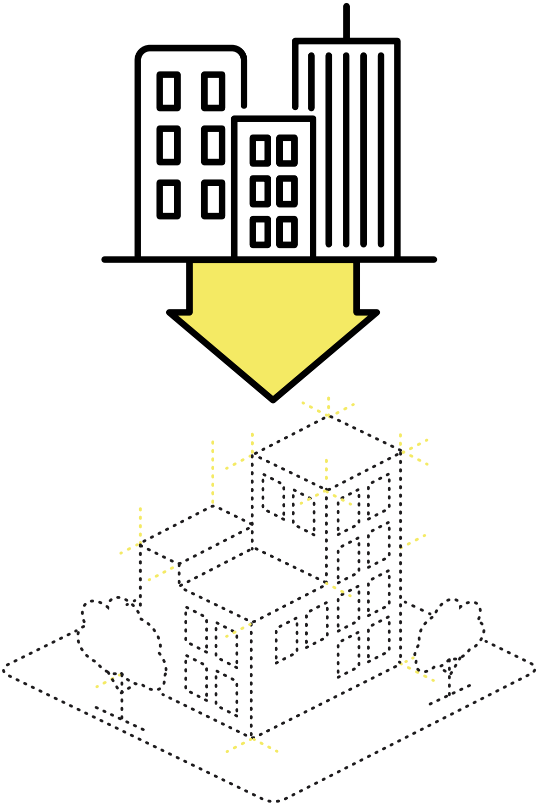
At the same time, there are additional factors which are necessitating a more robust effort to incorporate better technology into buildings and broader built environment strategies – notably people and productivity. As more agile ways of working become the norm, businesses have the ability to more proactively monitor their space requirements and are demanding the flexibility to be able to grow or shrink based on need. They are also increasingly mindful of the impact of the workplace on employee health and wellbeing. An estimated £77.5bn is lost to UK economy in lost productivity due to physical and mental health issues (Mercer/Vitality)[12] and employers are already looking to technology to help monitor and address these issues in the office. All of this means occupiers, and landlords, are sitting on vast tracts of data which are potentially incredibly valuable and will lead to a new relationship paradigm between landlord and tenant.

"Businesses are now looking more at the data around them and expecting buildings to be responsive – from automatic wi-fi connectivity to temperature control – to help drive better utilisation of space. Indeed, there are a number of companies now in the property space where, really, the sources of value are almost entirely derived from the data which they harvest. This will lead to a fundamental shift in how occupiers and landlords interact, and what sources of intelligence are deployed to make occupation, investment and development decisions."

Alastair Moss, Co-Head of Real Estate, Memery Crystal

[12] https://www.uk.mercer.com/newsroom/Unhealthy-employees-now-cost-British-firms-six-working-weeks-a-year-in-lost-productivity.html

The growing value of the intangible



Real estate values are no longer just about bricks and mortar. Intangibles are increasingly key to decision making:

- **Big data and smart**
- **Brand and design**
- **Experience and culture**

The future is sustainable

Climate change continues to be one of the most pressing challenges facing the global economy, and real estate has a critical role to play. The industry must take a more long-term approach to the assets it creates and manages. New approaches, including the successful deployment of technological solutions and sustainable construction methods will be key.

Climate change and environmental responsibility have never been higher on the agenda. In the UK, 27% of people cite it as one of the top three issues facing the country, with the figure rising to 45% for young people (YouGov)[13]. This is a global issue, and the real estate industry - which is estimated to be responsible for around 30% of global energy consumption and associated emissions (World Green Building Council)[14] - is becoming ever more conscious of the important role it has to play.

"People don't view property in the same sense anymore and space is more accountable – mainly for environmental reasons. There's more concern about how space is used and utilised and what is acceptable in terms of its impact on people and the environment. Policy and regulation has played a role in this, but it is also now being driven by the demands of occupiers."

Alastair Moss, Co-Head of Real Estate, Memery Crystal

[13] https://yougov.co.uk/topics/politics/articles-reports/2019/06/05/concern-environment-record-highs
[14] https://www.worldgbc.org/news-media/thousands-billions-coordinated-action-towards-100-net-zero-carbon-buildings-2050

First and foremost, this is driving, and will continue to drive, a reimagining of what and how real estate assets are built. According to the most recent statistics, Construction, Demolition and Excavation accounts for more than 60% of the UK's total waste (DEFRA)[15] and occupiers, not to mention the general public, are demanding more and better from the industry.

To some extent this is also being driven by market factors, particularly in the housing sector. The growth of the BTR model, for example, is leading to a fundamental shift in mindset for developers who are no longer focused on building a product and selling it on as swiftly as possible. Developers are now very much stewards of space who, in order to make the required returns on their investment, have to take a curatorial and long-term approach to their assets. This means adopting construction methods which are durable, sustainable and cost-effective, resulting in multi-decade buildings.

"The mode of construction in the recent past has been to build for a specific purpose and then when it reaches the end of its design-life, it's knocked down and you start again. We were perhaps better at this in years gone by and perhaps we are likely to come again to a point at which the preference is to build buildings as envelopes which have the innate flexibility of simplicity, to be fitted out for a number of different uses. In the same way for instance that industrial warehouses have evolved to become residential, workspace or leisure assets."

Daniel Abrahams, Co-Head of Real Estate, Memery Crystal

[15] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/784263/UK_Statistics_on_Waste_statistical_notice_March_2019_rev_FINAL.pdf

Modern Methods of Construction (MMC) and modular is likely to have a key role here, with estimates showing that modular has the potential to deliver 67% reductions in energy consumption during construction, and a 70-90% reduction of on-site waste creation (Housing, Communities and Local Government Committee)[16]. While modular is for the most part a niche endeavour today, there is a significant investor appetite – particularly with regard to the BTR sector – and, as with any innovative solution, as costs come down and accessibility increases, demand and utilisation will become more widespread.

"The whole point of modular is to bring a higher density of homes into well developed and desirable locations, potentially providing a real solution to the housing crisis and our rapidly expanding urban populations. At the same time, smart use of components will enable new approaches to building life-spans, with the ability to add or move components to provide different types of space dependent on user need – for example easily converting from a duplex to a bungalow for an older person, or the incorporation of new amenity space in a co-living product. All of this helps with future-proofing the asset whilst having regard to the environment and the longevity of the buildings in society."

Victoria Lowe, Partner, Memery Crystal

A responsible approach to real estate is also being driven by occupier demand, with businesses (and individuals) increasingly conscious of their social and environmental impact. This will continue to shape decision making – impacting on what occupiers expect of a space, and how developers deliver it.

"The property sector has a large part to play in terms of environmental protection, and it gets the attention of tenants because it impacts their pocket if their operating costs are much lower because of energy efficiency gains."

Daniel Abrahams, Co-Head of Real Estate, Memery Crystal

[16] https://publications.parliament.uk/pa/cm201719/cmselect/cmcomloc/1831/1831.pdf

The legal perspective

The real estate industry is evolving. But innovation and disruption will always be impacted, or in some cases limited, by established policy and regulation – which may need to be reformed. As the industry seeks to adapt itself and find new solutions in a changing world, there will be significant legal implications which must be considered.

Flexibility

The traditional lease model is broken; it has not moved with the times, the pace of technological innovation and changing occupier demands driven by how people and businesses need to operate. There is a jarring between the structural norms in the industry and what people who occupy buildings expect, and demand. New models are required and a new paradigm will be created which will see a closer relationship between landlords, occupiers and their wider community. This will drive new sources of value. This might include moving away from traditional rent-based models to subscription models, service charges and licensing of space, as well as the creation of new revenue streams derived from data harvesting. This is already happening, but for the good of the sector needs to be resolved by way of new structures, conventions and norms.

Planning and asset classes

Sectoral siloes are rapidly being eroded, at least partly by technology, and this is transforming, perhaps eradicating, the traditional notion of the asset class. At the same time, there is no real planning policy for shared space, informal space and quasi-public space – and regulation needs to catch up. Changing requirements, including the occupier's need for the flexibility to respond to market demands, means that spaces need to be adaptable for different uses at different times – even within a 24hr period. This will disrupt the established principles of use classes, while the continued development of new and innovative products – such as micro-living products – will require a change in approach from law makers regarding how the planning system can better facilitate the delivery of buildings to suit future needs. This might include adopting dynamic planning policies, which change once a policy objective has been achieved.

Supply chain

As developers rethink their approach to construction, to facilitate faster delivery of more resilient products, there will be a corresponding impact on the supply chain. Construction is characterised by a disparate collection of contractors and other suppliers. MMC, notably modular, may help to streamline the process but will throw up inevitable challenges including the covenant strength of more niche providers and the ability of developers to safeguard the up-front investment made in offsite production. The introduction of technological solutions such as blockchain and smart contracts will also transform how developers interact with and form stronger partnerships with their suppliers, providing the potential for more secure and automated payments, material checks and sign off procedures.

The environment, well-being and building standards

Behavioural change in development is to a large extent driven by downward pressure from policy makers, with stronger or more precise regulations pushing real estate towards the delivery of more environmentally and socially responsible buildings. We have already seen the impact of the likes of BREEAM and with policy makers around the world committing to ambitious climate change targets, the pressure on the private sector to deliver will heighten. This will apply across the lifespan of a building and its construction supply chain. And it will lead to landlords paying closer attention in their lease terms to the environmental credentials of their occupiers (and indeed vice versa). At the same time, new benchmarking systems are emerging such as the WELL Rating which place a new onus on buildings to play a role in the health and wellbeing of their occupants, and these are likely to become if not a requirement in law then at least a requirement in terms of occupier expectation.

Conclusion

Real estate is at a fundamental crossroad. As an industry it has operated in broadly the same way, and according to certain structural norms for centuries and is now seeing the world around it move at a pace of change which it is struggling to keep up with. But transformation is coming. We have seen in the retail industry what happens as a result of inflexibility and a lack of agility, and the lessons need to be learnt for the future. The four drivers of change which we have identified here are not intended to be exhaustive. But they are indicative of the range of issues which the industry must now deal with in order to prepare for, and succeed in, a rapidly evolving economic landscape; characterised by technological disruption, a shift in power towards the consumer/occupier, geo-political uncertainty and significant environmental concerns.

The question now, is how will real estate respond?

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This is not the end.

For any questions, or to talk further,
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