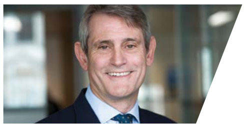
Trends in office leases

Wider social changes, including changes in working patterns and new forms of business, are impacting on office leases, with a drive towards shorter terms and greater flexibility for tenants.



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Malcolm joined the team in 2018. He helps clients in connection with their real estate requirements, whether acquiring, developing, leaving, managing, disposing of or financing. He is experienced in all aspects of commercial real estate and focuses on advising corporate occupiers and investors, supporting corporate transactions and representing banks on real estate financing matters.

Malcolm Headley expands on the evolution of the office leasing market and outlines the key trends for the future

The office leasing market is constantly evolving. The 1980s saw 25-year leases without breaks, which were very landlord friendly. Since then, things have changed – shorter leases, more break clauses and more flexibility, particularly in relation to alienation and alterations.

The changes over the past few years have been pronounced. The market balance between landlords and tenants was adjusted after the banking crisis of 2009, so that we now see a more collaborative relationship, with landlords being more consumer focused; while the publication of the Lease and Service Charge Codes and the Model Commercial Lease have led to more balanced documents. With uncertainty now the norm – from geo-political and macro-economic uncertainties to the disruptions caused by technological advances – long-term forward planning has become difficult. At the same time, working practices have changed. We now have a much more mobile workforce – impacting on occupational demand – and the rise in co-working has also driven changes in the way we occupy. Finally, the workplace environment has also become a boardroom priority. See our special wellness-focused Summer 2018 update: https://www.bwbllp.com/knowledge/2018/07/13/real-estate-update-summer/.

The demand for co-working has been driven both by high-growth companies demanding flexibility to keep down long-term liabilities, and by millennials who exemplify the trend towards ‘non-ownership’ and the ‘gig’ economy, but at the same time seek the advantages of a ‘corporate workplace’ with a community that fosters collaboration.

SMEs think in a much shorter timeframe and therefore want to minimise the cost of acquiring, fitting out and occupying their property, while at the same time maximising flexibility. Larger corporates, on the other hand, are able to take a longer-term view and are able to accept more traditional, ‘investment grade’ leases. However, some of the influences from the non-traditional leasing market are finding their way into traditional leases.

Tenants are seeking efficiency and flexibility in better working environments in the right locations and all of these things are underpinned by the need to contain cost and demonstrate value.

How are these influences and demands manifesting themselves? Leases are becoming shorter (both the term of the lease and also the document itself). Occupiers are seeking to minimise their financial exposure. As well as the payments under the lease itself, the cost of business rates and taxes have meant that occupation costs have increased significantly in recent years. New lease accounting standards that require all leases to come onto company balance sheets will continue to drive the trend for shorter leases.

The requirement for flexible, adaptive design has seen less restrictive alteration provisions. Occupiers are demanding the right to do much more without the burdensome process of landlord approvals and consents. This leads into less onerous reinstatement obligations and a more user-friendly dilapidations protocol.

Tenants are also demanding more flexible alienation provisions – from enhanced sharing provisions that allow sharing with non-group companies to the use of core and flex space with options to expand and extend.

We see more relaxed user provisions that provide a more realistic business platform and a demand for buildings that provide the apparatus, connectivity and resilience that businesses now require. The need to use buildings 24 hours a day means that the provision of 24-hour canteens (and the right to service them) and social areas (entertainment spaces, gyms and yoga studios) are becoming more common in larger offices. A lot of businesses want to be able to share space with other businesses that they work with and to provide hubs for start-ups or perhaps charities with which the occupier may be involved.

Transparency in the delivery of and charging regimes for services has been driven by the Service Charge Codes. We are also seeing the demand for more innovative solutions to the provision of services and charging structures, with all-inclusive rent, service charge and insurance deals becoming more prevalent.

Offices have become more than just a place of work. The workplace is an embodiment of an organisation's brand and values, but also feeds into its culture. We are designing spaces that promote not only agility and collaboration but also wellness. Numerous studies have shown the impact of light, air quality and acoustics on happiness and productivity, with people working in green offices showing a higher cognitive function than those working in a conventional office by as much as 50%. If you are not considering light, air and acoustics and also the design, layout, look and feel in your space design then attracting staff and retaining them will be an issue.

In addition, the sustainability and environmental impact of our offices has become a priority and most organisations will now demand that their assets meet low or zero-carbon standards. Added to this, the impact of MEES (the minimum energy efficiency standard) has led to significant changes in lease drafting.

Changes are not limited to increased flexibility and improved working environments. Location continues to be an important consideration. The cost of central London rents, the availability of talent and building stock, the infrastructure to support work places both in terms of technology and transport are leading to micro-ecologies in different neighbourhoods – particularly tech and creative hubs.

And what do the next few years have in store? Technology will continue to disrupt business. We are likely to continue to work more collaboratively so we will need to design space (and draft documents) to assist that. Health and wellbeing and the occupiers' experience (around social and retail offer) will become more important and companies will continue to look closely at costs and strive to make their property work for them to increase productivity.