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OUT OF OFFICE

ADAPTING TO NEW WAYS OF WORKING

Covid-19 changed office-based working almost overnight. Technology stepped up to keep us connected while working from home. How are offices now evolving to meet the generational and geographical demands of the workforce?

The working habits formed over the past three years may prove longer-lasting than many initially anticipated. In the US, 56 per cent of full-time employees – that's 70 million people – say their jobs can be done remotely. In Germany, 51 per cent of people work remotely at least one day a week. In the UK, it's 42 per cent.[1]

As a result, many firms are downsizing or "right-sizing" their office spaces; others are still taking the equivalent amount of floorspace but upgrading in terms of quality or layout to give workers a better experience.

The picture, however, is far from uniform worldwide, as the Savills Future Office Availability Index reveals. It certainly doesn't spell the end of the office either.

We have created an index of the top-tier office markets globally to understand how current office environments – in terms of cost and availability, pipelines and hybrid working trends, as well as future office needs – could all come together to result in an increase in office availability in some markets.

Time for a rethink

Our analysis suggests we need to rethink the number and nature of the offices we are building – and reposition existing offices to suit new ways of working. By identifying the factors leading to rising availability levels in different cities, we can pinpoint the key drivers for office market resilience in each location.

Factors include existing vacancy rates, quality of stock, ESG considerations, and the prevalence of hybrid working. Booming finance and business services sectors in certain cities – notably Mumbai, Delhi and Ho Chi Minh City – are also driving demand. Each of these cities is forecast to see the Gross Value Add from their finance and business services sectors increase by 50 per cent or more in the next five years, and employment in the sector is also forecast to increase by more than 10 per cent over the same period.

Demographics are also crucial in this conversation; growing populations, especially increasing numbers of younger people in some locations, are likely to help support office usage in the near to mid-term. Over the next five years, the populations of Mumbai, Shenzhen, and Ho Chi Minh City are forecast to increase by 8 per cent or more.

Office allure

Office life may help the younger demographic feel more involved in company culture. It also provides an alternative to working from their homes, which are likely smaller and without dedicated office space compared to older colleagues.

This is not only driving demand for offices; it's also shifting the nature of those offices to more flexible and collaborative environments than in pre-Covid times.

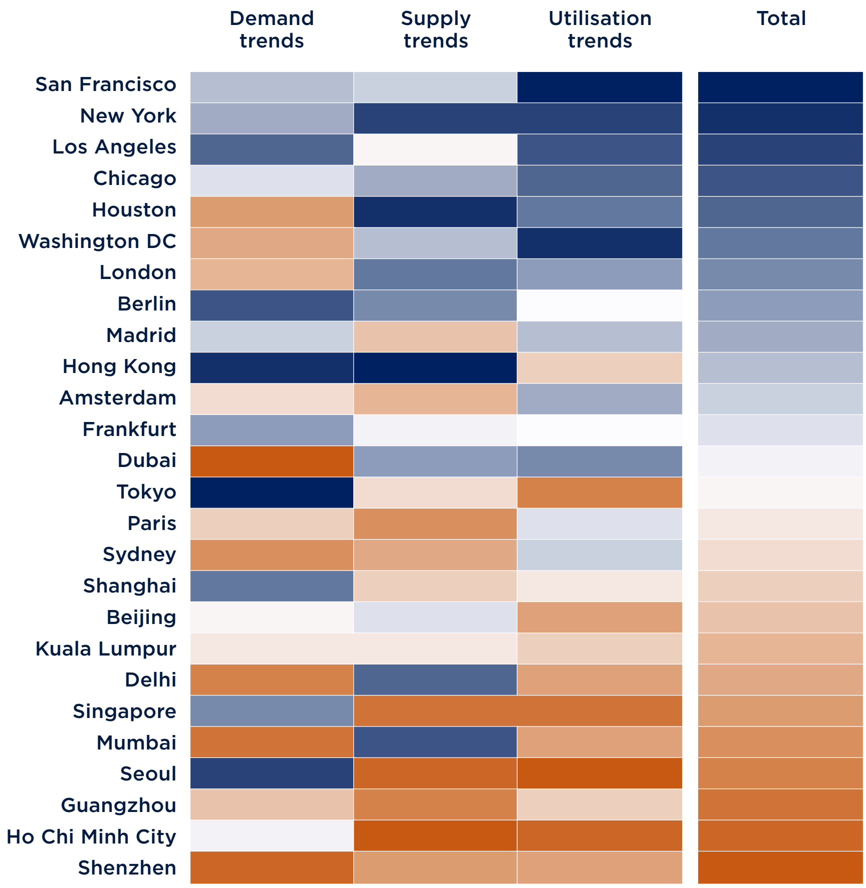
Cultural factors can also drive our attitudes to office life and hybrid working. Businesses in Tokyo and Paris tend to encourage cultures of mentorship in the office. They prize the informal training opportunities that face-to-face interaction with experienced colleagues brings and this is reflected in their higher utilisation rates – 80 per cent in Tokyo and 66 per cent in Paris as of March 2023.

Paris's central business district (CBD) has one of the lowest vacancy rates in Europe, at 2.3 per cent. Tokyo has one of the lowest vacancy rates in Asia Pacific, with approximately 4 per cent of stock available for rent; only Seoul and Ho Chi Minh City have lower vacancies at 3 per cent.

ILLUSTRATION: JAKE READ

FUTURE OFFICE AVAILABILITY INDEX

Note: Index is colour ranked from markets most likely to see an increase in office availability (dark blue), to those least likely (burnt orange). Each category is individually colour-scaled. Utilisation trends is given a half weighting. Demand trends and supply trends are equally weighted.



Source: Savills Research using Oxford Economics, Kastle Systems, and local sources

Commutability is another key part of the office/hybrid working equation. American cities with significant urban sprawl are more likely to have greater numbers of workers commuting by car, which carries time, cost and environmental implications. Their more compact European equivalents are better placed to embrace the "15-minute city" concept of mixed-use neighbourhoods designed for living, working and playing.

Future of offices: newbuilds and refurbs

Also topping priority lists is the green factor: the need to build or retrofit office space that fulfils companies' ESG responsibilities, in turn providing the calibre of sustainable stock that occupiers seek.

We are seeing a growing chasm between the best and the rest, with best-in-class, sustainable, people-focused office space in highest demand and achieving the highest prices. In Europe, for example, the average rent for prime office stock is 142 per cent higher than

[1] Practices and representations associated with teleworking in Europe – Fondation Jean-Jaurès (jean-jaures.org)

the average rental price for secondary stock. Even if the pandemic hadn't disrupted work practices, much of the older stock was overdue for modernisation.

In most cities studied for the Savills Future Office Availability Index, the majority of stock (an average of 69 per cent) was built before 2010 – meaning there was already an oversupply of non-green office stock. This stock does not meet the growing demand and preference for sustainable office spaces, as large numbers of occupiers seek out spaces that support their ESG commitments.

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East meets West

By piecing it all together, we have drawn a new map of the office environment based on hybrid working. Broadly it shows an East-West divide – between countries that have largely returned to pre-Covid-19 office practices and those in which hybrid working is much more normalised. This is reflected in office utilisation rates – the share of workers going to the office on a daily basis. Across Asia Pacific markets, the average office utilisation stands at 86 per cent, as at March 2023. This stands in contrast to the averages across EMEA and Americas markets, which average 61 per cent and 48 per cent respectively.

US markets – particularly key cities such as San Francisco, New York and Los Angeles – have higher potential to see increased office availability in the future. Of examples, San Francisco is among the strongest. Pre-Covid-19, it had one of the lowest office availability rates in the US, at 9.5 per cent. In the current climate, 30 per cent of its office space is vacant or due to return to the market in the next year, representing a 30-year high in availability rate.

San Francisco's status as a tech hub cannot be overlooked in this either; post-pandemic, many tech companies and workers alike have reassessed their needs for in-person working. In the current economic climate, too, we are seeing some tech firms examine their space and staffing needs, with reports of tech redundancies also characterising this shift.

Asia-Pacific markets – including Chinese cities, Singapore, Seoul and Mumbai – are likely to have a lower surplus of space over the next decade. Their expanding economies are drivers for office demand and hybrid working trends have not taken root in the same way as in the West. Europe sits somewhere in the middle. The average vacancy rate is 13.7 per cent, which while lower than the availability rates in the US markets (which accounts for vacancy as well as space listed as available for lease in the next 12 months), has increased in recent months with the rise in hybrid working and the changing office environment. Berlin, London and Madrid are in the middle of the table where demand for high-quality offices is expected to persist, meaning that availability will likely be concentrated in older office stock.

Adapt and evolve

The question now is how to retrofit and repurpose excess and vacant office stock to suit today's needs.

Where there is the potential for higher availability levels, there are opportunities for repurposing. In central locations, there is often both the demand and potential for converting offices into residential property. The boom in on-demand delivery culture in some locations is driving the need for last-mile logistics, which may lead to some spaces in suburbs and more fringe urban locations being turned into delivery depots, fulfilment centres or retail outlets.

Regardless of the end-use of the repurposed office, cities becoming more mixed-use will provide opportunities for new uses and revitalisation. New locations for residential, education, health, retail, and culture will increase the social and environmental sustainability of cities, supporting the livability, walkability, and diversity of the social fabric across these areas.

Given the sheer amount of embodied carbon in buildings, interest in finding new uses for existing properties is only increasing, and we expect to see this trend towards thoughtful repurposing continue. ■

San Francisco

MICHAEL McCANDLESS
CORPORATE MANAGING DIRECTOR, SAVILLS SAN FRANCISCO

Markets across North America could see increased availability over the coming years, with San Francisco leading in terms of both rising availability and opportunities. Even before the pandemic, the market was beginning to embrace remote work. As a result, the city is still trending below 45% office utilisation, according to Kastle Systems, giving the city the lowest utilisation rate of all the Tier One markets in the US.

The situation is less than optimal for landlords. Availability rates are nearing 30%, which is an all-time high for San Francisco, above even the highs that followed the 2001 dotcom crash and the 2008 financial crisis. Couple the high availability and low daily utilisation rates and most office buildings are running at sub 30% capacity.

On top of this, most San Francisco renewals have reductions in floorspace of anywhere from 20 per cent to 50 per cent. We are also seeing very little growth or even stability in new square footage leased from existing companies that did not put space on the sublease market. Occupiers, notably tech tenants, have begun implementing "return to office" mandates in 2023, so a greater share of employees returning to the office would likely help office demand increase over time and begin to chip away at the oversupply of space.

Looking ahead, there are opportunities to be found for tenants in San Francisco and beyond. Increased interest rates, reduced building valuations, and growing vacancy have resulted in a strong tenant's market.

Prospective tenants will have a lot of options, and aggressive landlords are offering big concession packages to lure tenants into relocating or staying in their buildings. San Francisco also remains a hub for innovation, with a highly educated workforce. This will help it recover from current market volatility over time.

Paris

SERGE VAYER, HEAD OF OCCUPIER SERVICES, SAVILLS FRANCE

The French capital is Europe's outlier when it comes to office vacancy levels. The vacancy rate – currently 2.3 per cent in the CBD – has fallen drastically over the past decade. The supply pipeline is limited and swamped by demand for Grade A spaces.

Demand is partly driven by a culture of working in the office and in-person interaction. Some managers still believe work can only be done in the office. It is both cultural and generational, and that is changing slowly with younger generations and the tech industry. But most managers still like to have their team around them in the office.

Most companies prioritise having a central Paris address over a more modern office, such as in La Défense business district on the outskirts, where vacancy is at 16 per cent.

A city-centre location is a way to attract new talent, attract people back to the office and offer a good office experience compared to working from home.

Although companies are keen to occupy Grade A, ESG-certified office space in the centre, most of the CBD stock is Grade B and there is little land available for new-build, as the Town Hall favours residential over offices.

China

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The majority of Chinese workers are now back in the office, after nationwide lockdowns, marking a return to company culture which prizes in-person working.

While employees had to work remotely during these lockdowns, generally speaking, remote work has not really caught on that much. When travel giant Trip.com implemented its policy of two days working from home a week in February 2022, it was the first large tech company in China to give employees a hybrid working option.

Chinese cities' efficient and inexpensive public transport is one incentive for workers to go into the office along with the desire to escape typically cramped, multi-generational home environments.

However, the threat of oversupply is constant. There is a concept of constructing an office building to attract a company and grow your economy and tax base. But even leading cities such as Shanghai are seeing multi-year high vacancy rates.

It's the result of overbuilding and weak demand – because of slower economic growth, especially in 2022 – and business uncertainties, especially surrounding zero-Covid-19 policies. ■