

SLAUGHTER AND MAY

Slaughter and May Podcast Office Occupation trends – post Covid

Graham Rounce	<p>Hello and welcome to the Slaughter and May podcast. I am Graham Rounce and I am joined by two of our real estate partners, Jane Edwarde and John Nevin. We are going to talk about what we are already seeing in the office letting market and consider both the human and legal post lockdown trends.</p> <p>Jane, starting from the human perspective, what do owners want from their premises and how has this changed?</p>
Jane Edwarde	<p>Thanks Graham. I think in the short term owners want a safe and secure office to return to. I think there is a desire to return to the office but to make sure that office is the right size, the right shape and crucially the right cost.</p>
John Nevin	<p>Yes I think that's right, Jane, and adding to that I think building owners are now being far more innovative in terms of what they are looking to provide to their potential tenants. So we are seeing facilities such as gyms, we are seeing doctors rooms, dentists rooms, sleep pods, prayer rooms, cycling facilities are absolutely key at the moment. There is a big focus on terraces where the building design allows for that. Certainly professional services firms are looking for auditoriums where the building can accommodate it, and in addition building owners in terms of their mix of tenants are looking at bringing on board shared space. So a co-working floor so if you have a tower of say 30 floors they are looking to ensure that one of those floors is occupied by a co-working provider.</p>
Jane Edwarde	<p>I have also heard it said from various clients that they are under severe pressure to reduce costs in terms of looking at their space going forward and clearly covid-19 has caused huge economic pressure globally and so I think directors, facilities directors and operations directors at various big employers are under a lot of pressure to reduce their occupational costs, reduce all costs but particularly their occupational costs and they are really looking to see how they might achieve that going forward.</p>
Graham Rounce	<p>Thank you, so Jane how is the pandemic affecting clients who are planning or beginning to plan for their HQ office premises requirements?</p>
Jane Edwarde	<p>I think they are really thinking about how much space they need and how they want to occupy it. Clearly most big businesses have managed to work from home pretty successfully and the technology has generally worked, and so clients and occupiers are asking what do we actually need? What space do we want to pay for at top whack in city centres and how much can we afford to pay for? And they are asking questions about how they want to occupy that space, do they want cellular offices or do</p>

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	they want to share that space? And what is going to be a safe and secure and affordable environment going forward?
Graham Rounce	You mentioned technology, you are right we have seen incredible advances in technology in a very period space of time, so do we think that the way we work and how we use offices has changed forever?
Jane Edwarde	I think we will always remember this time and I think it will definitely have a short and medium term impact, and I think probably also a long term impact. It's kind of turbo boosted if you like, our flexible agile inclinations and made everybody work flexibly, rather than just those who chose to previously. I think that is a good thing, so long as colleagues can still get together and still have the social aspect of working which we have all missed I think, and that is evident.
Graham Rounce	Thank you. Just linked into the co-working model which we have heard so much about in recent years and its expedient rise, do you think this is the end of the co-working model or rethink in terms of how it operates?
Jane Edwarde	I think that's a really interesting question and it's one I discussed with other advisers in the industry, for example architects and environmental consultants and views differ. I think there's a sort of myth that co-working units and sharing a whole load of equipment, and that people wouldn't want to touch hard surfaces and share equipment going forward. But actually the reality of co-working often ends with locker space and you have your own equipment and you just plug yourself into shared space, so we will see what happens. I think co-working if it can bring costs efficiencies will therefore remain in demand, but I think there will be some return to short term demand for cellular space because people will feel safer in their own cubby holes in offices and having their own phone, their own things around them, their own environment. They will just feel a bit safer from a pandemic infection perspective.
Graham Rounce	Thank you. John, turning a little bit more to the legal side of things Jane has already mentioned cellular offices and the need to balance between the costs efficiencies of high density open plan occupation and the health and safety wellbeing of employees. Do you think we are going to go back to the cellular office model?
John Nevin	I agree with Jane, Graham, in the sense that we will see both models exist in the future. I think the first point I would make on the cellular office verses the open plan model is that the cost savings involved in moving to the open plan design are not actually that great when you balance it in the great scheme of a HQ move and the ongoing costs of the building. Yes you can potentially fit more people in but the cost savings are not that significant. And I think it splits between the types of occupiers, I think if you look at corporates they will almost certainly stick with the more open plan environment, and they will look to make use of the working from home model, flexible desk and flexible working. I think for professional

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	<p>services firms, we are hearing a lot of anecdotal evidence that it is not working as well. We are hearing that breakout rooms are being utilised by some of the more senior people within those organisations. We are certainly hearing within law firms for example, something that we probably know a bit more about, that the trainee experience is not as good within the open plan environment. And I think as Jane has rightly pointed out, that the whole issue will turn upon whether the pandemic is something that will return again and again and if it does, I think Jane is right that buildings are going to need future proof against that, and a return to a cellular model will allow for that.</p>
Graham Rounce	<p>Even before the pandemic, we were seeing greater collaboration between landlords and tenants. Do you predict an even more flexible model going forward and if so, what do you think the main changes will be?</p>
John Nevin	<p>Well I would say Graham that starting off at the start of my career looking at the whole landlord and tenant relationship, it used to be very much one of master and servant. Very much the landlord being the dominant party dictating terms to the tenants, where tenants felt themselves lucky to be allowed into the landlords building. That has changed over the past 5-10 years that is not the relationship that we recognise today. The relationship is now much more one of partnership, much more one of the landlord providing as much a service as much as a building for its tenants. So how does that translate into terms? We are seeing the agreement for lease stage, we are seeing that tenants have options in expanding into a building and contracting, so tenants are being allowed right up to very close indeed to pc, they are being allowed to make a decision about whether they will hand back or take more floors. We are also seeing that where you have a large occupation by corporate or a professional services firm, whereas historically that tenant would take a core lease, so it could be a core lease of 10 or 15 floors. Tenants are no longer doing that, they are doing what is now termed a multi-tiered leasing structure, so what that means is that they might have a core lease of 5 or 6 floors but the remaining 4 floors are normally taken on individual leases, and what that enables the tenant to have is much more flexibility. It enables them to exist any floor by way of assignment, it enables them to have break rights to hand back floors every 5 years normally by way of a cycle. Tenants now have far greater underletting rights with much less interference by their landlords and there is also much greater latitude given by landlords on sharing. So historically tenants were not allowed to let third parties into their space, now as long as tenants effectively regulate how that works. Tenants are allowed as long as those entities have a sort of bona fide a commercial relationship with a tenant, they are allowed to let these third parties into their building to occupy.</p>
Jane Edwarde	<p>And I think I would also add that we saw before the pandemic over the last 10 years or so leases are getting distinctively shorter. And so the days of the 25 year lease are absolutely gone. And I think leases are getting much shorter and I think the pandemic will accelerate that, so</p>

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	tenants are not willing to commit for that length of time. It is impossible to predict the size and shape and success or otherwise of your business for that long, so tenants are looking for 10 or a max of 15 year leases with breaks as John has described.
John Nevin	Yes I think that is right Jane, and I think the other thing that landlords are now willing to do Graham is, they are often, particularly in a tower environment willing to give tenants a right of first offer. So if a floor becomes available during the term of a major tenant's lease, they are willing to effectively give that preferred tenant the major tenants a right of first offer on acquiring a further floor in the building. And I think finally and sometimes this is forgotten when people are taking a new lease, they often forget about what happens at the end of a lease, and we are seeing movements there from landlords. So reinstatement obligations, where a tenant would normally have to hand back the premises in the conditions that it was given to them at the start, those obligations are now more often than not replaced by a fixed sum that it paid on the expiry of the term. So landlord and tenant agree at the outset of the lease, a sum of money that is paid at the expiry, and it obviates the need to get into any discussions or arguments about a dilapidation settlement.
Graham Rounce	Thank you both. Bringing us bang up to date, are we starting to see Covid drafting, Covid specific drafting in lease documentation?
John Nevin	Yes Graham we are, we are certainly seeing it in building contracts that governs tenants works, and we are seeing it in the agreements for lease where Landlords is obliged to deliver the building by a certain time for a tenant. We are certainly seeing pandemic extensions wordings being agreed in those documents. I think we are starting to see a discussion around the whole pandemic issue in leases, I think it is too early to say that there is any market norm yet far too early for that, but we are certainly seeing it being discussed by lawyers, we are seeing it being discussed by the agents. And you know, from a personal perspective, I see this very much as an uninsured risk. You know historically, landlords regarded uninsured risk as a tenant problem, and over the passage of the past 5, 10, 15 years it is now very much a convention in the market that uninsured risk are a landlord issue. And I think the pandemic may very much go the same way, save that I suspect that the landlord and tenant may well agree to share the pain of a pandemic going forward, so you could for example, agree something like capped at 6 months that landlords are willing to grant a rent free period for up to 6 months, if a pandemic arises during the currency of the tenants lease. But I think we are very much on a journey here.
Jane Edwarde	I think it will occur first in a retail and restaurant setting, where obviously the tenants have absolutely no revenue coming in, save for online sales and if a store is forced to be closed, and I think it is going to happen first year before offices, where clearly, office workers can work from home and can progress matters from home much more easily. But I do think that

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	once retail and leisure introduce the concept, it won't be long before offices follow behind.
Graham Rounce	You mentioned insurance and uninsured risks and thinking by analogy with the risk of say later defects on a new build. Do you think that there is a possibility that we will end up with an insurance product to deal with the risk of a similar pandemic?
John Nevin	I don't think so Graham, the early signs from the insurers are that they are very much running a mile from any kind of pandemic cover, so there's no appetite certainly in these early days from the insurers to look to provide any such cover. And I think it would be very difficult for them to do so, because statistically if a pandemic were to occur, it would affect the entire market. It's not like a usual insure risk like fire or flooding that occurs to a minority of the insured customers. If a pandemic occurs, it affects every business in the country and therefore I think it would be very difficult to see the insurance industry respond. The only caveat I would make to that is obviously, we saw the Pool Re scheme back in the 80's and 90's, when terrorism was unavailable by the commercial insurers and the government effectively provided a back-up scheme, so I would not rule out the government effectively providing a scheme analogist for the Pool Re scheme, where they are the insurers last resort.
Jane Edwarde	But we have seen obviously this time in this pandemic the government preferring to legislate, to tinker around the edges really in terms of enforcements and other breaks, so to step in and provide a very expensive comprehensive government backed policy seems unlikely. It would be a much bigger set certainly than the government has chosen to take so far.
Graham Rounce	Thank you. And to finish and apologies for putting you both on the spot, but if you had to pick one, what is the main trend you see going forward?
John Nevin	I think what we are seeing increasingly viewed by tenants as of critical importance, both in how the building is designed, how it's delivered, and how it is occupied is the whole sustainability agenda. And I think that is a real trend that is gathering pace and we are now seeing far more extensive drafting both within agreements for lease and within leases, as to how that is dealt with. And tenants, corporate occupiers who have responsible business obligations, they are looking to ensure that not only in how they conduct their own business, but in the buildings they occupy are sustainable.
Jane Edwarde	And for me I think flexibility, flexibility and more flexibility for tenants in terms of being pretty demanding from their landlords and what is built for them and provided for them, and the flexibility they have over the term. And I also think there will be an increasing trend for big corporate occupiers to look at other options for their people that is not necessarily working from home. That could be for example, investing in an online

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	<p>platform, allowing their employees to work from other locations near to their homes, but where the coffee and the IT and the socialising and the community is provided in a convenient way to them. And I foresee that will become an employee benefit going forward in the same way as a gym membership, and I do think that is an important development for the industry in terms of employers being able to offer that choice to their people.</p>
Graham Rounce	<p>Thank you. Thank you both and thank you all for listening. If you have any questions then please get in touch with us or your usual Slaughter and May contact.</p>