City of London Corporation

Future of Office Use

Summary Report

June 2023

© Joshua Ng via Unsplash

Job number 294482-00

Ove Arup & Partners Ltd
8 Fitzroy Street
London
W1T 4BJ
United Kingdom
arup.com

Contents

This report has been prepared specifically for and under the instructions and requirements of the City of London Corporation, under an appointment dated 7 February 2023.

This report is prepared for use and reliance by our client only. No third party is entitled to rely on this report unless and until they and we sign a reliance letter in the form attached to our appointment. We do not in any circumstances accept any duty, responsibility or liability to any third party whatsoever (including property investors whether by bond issue or otherwise) who has relied on this report in circumstances where they and we have not signed a reliance letter in the form attached to our appointment. Accordingly, we disclaim all liability of whatever nature (including in negligence) to any third party other than to our client, or to any third party with who we have agreed a reliance letter (and such liability is subject always to the terms of our agreement with the client and the reliance letter with the third party). In preparing this report we have relied on information provided by others and we do not accept responsibility for the content, including the accuracy and completeness, of such information. In no circumstances do we accept liability in relation to information used by us which has been provided by others. We emphasise that the forward-looking projections, forecasts, or estimates are illustrative only and scenario based. They are based upon interpretations or assessments of available information at the time of writing. The realisation of the prospective financial information is dependent upon the continued validity of the assumptions on which it is based. Actual events frequently do not occur as expected, and the differences may be material. For this reason, we accept no responsibility for the realisation of any projection, forecast, opinion or estimate. Findings are time-sensitive and relevant only to current conditions at the time of writing.

We will not be under any obligation to update the report to address changes in facts or circumstances that occur after the data of our report that might materially affect the contents of the report of any of the conclusions set forth therein. No person other than our client and any party to who reliance has been expressly permitted by us pursuant to a reliance letter may copy (in whole or in part), use or rely on the contents in this report without prior written permission. Any copying or use of this report (in whole or in part) by any party whatsoever shall be accompanied by or incorporate this notice at all times. We accept no responsibility for, and have not authorised, the contents of any report, prospectus, supplementary prospectus, listing particulars, supplementary listing particulars, presentation or other document or communication in respect of the sale, acquisition, offering or transfer of any shares or securities or interest in them, whether on the primary or secondary market or otherwise, which uses, includes or incorporates any report, deliverable or information, or any element thereof, prepared by us under or in connection with this agreement.

Glossary

Term	Definition
Best in Class (Grade A+)	New or refurbished space that is Grade A+ in the BCO Office Specification. Additional services added to enhance the tenant offering. Typical building ratings including BREAAM Outstanding, EPC A, Well Platinum, Cycling Score Platinum, NABER 5*+.
City of London office sub-markets	Office sub-markets located in the central area of London, defined by Knight Frank. Composed of: City Core, Aldgate/Whitechapel, Midtown and Clerkenwell/Farringdon.
Grade A	New or refurbished space that meets the criteria of the British Council for Offices (BCO) Office Specification. Typical building ratings include EPC B, Wired Scored Platinum, and BREEAM Excellent.
Grade B or Second-Hand	Previously occupied office space, that either does not meet the Grade A specification, or it does, but wear and tear has triggered a need for substantial refurbishment.
Institutional grade	A building with over c. 5,000 sq ft (NIA) which accommodates blue chip (nationally recognised, well-established and highly capitalised) occupiers and can be traded by institutions such as pension funds, banks, hedge funds or insurance companies.
Net Internal Area (NIA)	Net Internal Area (NIA) is the usable area within a building measured to the internal face of the perimeter walls at each floor level. NIA covers all areas which are used for a specific purpose.
Office attendance	The proportion of employees in the office as a share of the total workforce based there.
Office-based jobs	Emerging and traditional office-based jobs as defined by the SIC 2 code categories in the Appendix.
Office-based jobs - traditional	Office jobs that belong to more traditionally office-based sectors such as financial services, insurance, legal and accounting activities.
Office-based jobs - emerging	Office jobs that belong to emerging or growing business markets such as digital activities, information and communication and professional, scientific and technical activities.
Office occupancy	The proportion of desks occupied for any given time of the day, relative to the total number of desks in an office.
Prime	Best in Class and Grade A buildings greater than 10,000 sq ft (NIA) and in the best quality locations.
Prime rents	The rent for 10,000 sq ft (NIA) office floor in an extensively refurbished or new building, with a lease term of 10 years.

Executive summary

Arup and Knight Frank were commissioned to undertake an assessment of the City of London's office market, covering the current and anticipated office-use behaviours, the qualitative and quantitative demand for net additional office floor space and an assessment of the extent of risk of stranded assets.

The research suggests that:

- City-based office jobs, and office attendance, are expected to grow in the future.
- Long term growth prospects appear good in our scenarios, with the City requiring 6 – 20 million sq ft of additional office space by 2042. Much of this will be high quality office space for smaller employers.
- Demand for best in class is higher now than pre-pandemic, but growth may soften in the next few years as existing occupiers look to right-size their real estate footprint for hybrid working as leases expire.
- Greater home working could allow for more office jobs to be sustained from the same City real estate footprint.
- But, a proportion of the City's existing office stock, may require investment to meet new energy regulation and market demands.
- As such, our projections for higher overall demand for office space do not account for the challenges faced by some existing lower grade stock in the City. We suggest that intervention is needed to allow for fewer obstacles for older stock to be updated to meet office market needs, or to convert to other uses.

City-based office jobs, and office attendance, are expected to grow in the future.

Traditional-office jobs are the dominant sector in the Square Mile, representing 59% (346,000) of all jobs in 2021. However, emerging office-based firms are faster-growing with 41,600 new jobs (+80% from 51,700 to 93,300) between 2015 and 2021 compared to a 25% increase over the same period for traditional office-based jobs. Emerging office-based firms (information and communication and professional, scientific and technical activities) are tending to value different typologies of office spaces including more agile working environments with lower workplace densities and higher-amenity offices[1], implying a forthcoming shift for the market in terms of demand for best in class office spaces.

Emerging office-based jobs grew by **80%** between 2015 and 2021

Concentration of attendance between **Tuesday to Thursday**

Tube ridership in the City shows levels returned to 69% of pre-pandemic levels by the last week of April 2023, and were busiest in the middle of the week (Tuesday-Thursday) at around 75% of 2019 levels[2]. An increased focus on corporate culture and business performance pressure indicates that office attendance may move upwards in the future.

[1] British Council for Offices, 2022. Guide to Specification – 2022 Update.

[2] TfL, 2023. Demand by Station Type (City stations).

Moving forward, office jobs in the City are projected to continue growing, with the GLA forecasting an additional 85,000 jobs (or +13%) in the City by 2042[3].

Additional **+85,000 jobs** in the City by 2042

Demand for best in class is higher now than pre-pandemic, but growth may soften in the next few years as existing occupiers look to right-size their real estate footprint for hybrid working as leases expire. Long term growth prospects appear good, in our scenarios.

Increased focus on **"Flight to Quality"**

Employers are placing greater value on high-quality sustainability credentials, quiet spaces for phone calls or working, abundance of meeting spaces and places for collaboration, good access to public transport and food and beverage amenities as well as design which communicates the company's brand and values[4]. Tenants are seeking a step-change in the quality of space, and the quality of offer outside the 'office door' to entice people back to in-person work, to differentiate themselves in a competitive labour market, and to drive up utilisation. This is often referred to as the 'flight to quality'.

A new standard of office space has emerged that exceeds the standards of those previously classified as Grade A, termed 'best in class'. Since 2017, rental price growth for best in class buildings has been twice the rate of secondary/average quality buildings[5].

Rental price growth for best in class buildings are **2 times higher** than average quality buildings

Demand for best-in-class (i.e. new and refurbished buildings) is higher now than pre-pandemic, with these buildings representing the majority (70%) of all lettings in the City in Q1 2023 (see **Figure 1** below), which is over 20% above the average of the five years before the pandemic. Demand for Grade B space has slowed post-pandemic. However, demand for the highest grade stock may soften in the next few years as existing occupiers look to right-size their real estate footprint for hybrid working as leases expire.

[3] GLA, 2023. London Long Term Labour Market Productivity Trend-based Projections by Borough.

[4] Arup, 2022. The future of the office in Central London.

[5] Knight Frank, 2023. Knight Frank Research and MSCI.

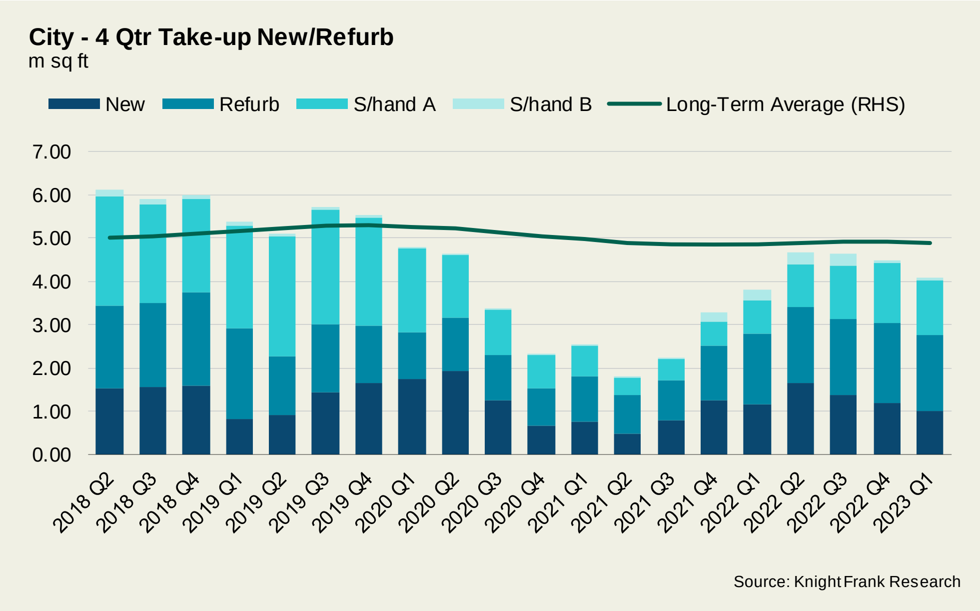

Figure 1: Take up by Quality - Knight Frank Research, 2023

Employment is projected to grow

The employment trends by sector are highlighted in **Figure 2** based on GLA Economics London Long Term Labour Market Projections[6]. Results show that the number of traditional office-based jobs and public sector office-based jobs across London are projected to decline, mainly due to job losses in Finance and Public Administration. On the other hand, information and communication jobs (+67,600) as well as professional, real estate, scientific and technical activities (+335,000) - all part of emerging office-based jobs - are projected to drive growth in London. The GLA projects employment in the City to grow by an additional 85,000 jobs (+13%) by 2041[7] with consistent growth until 2035 which then stabilises until 2041.

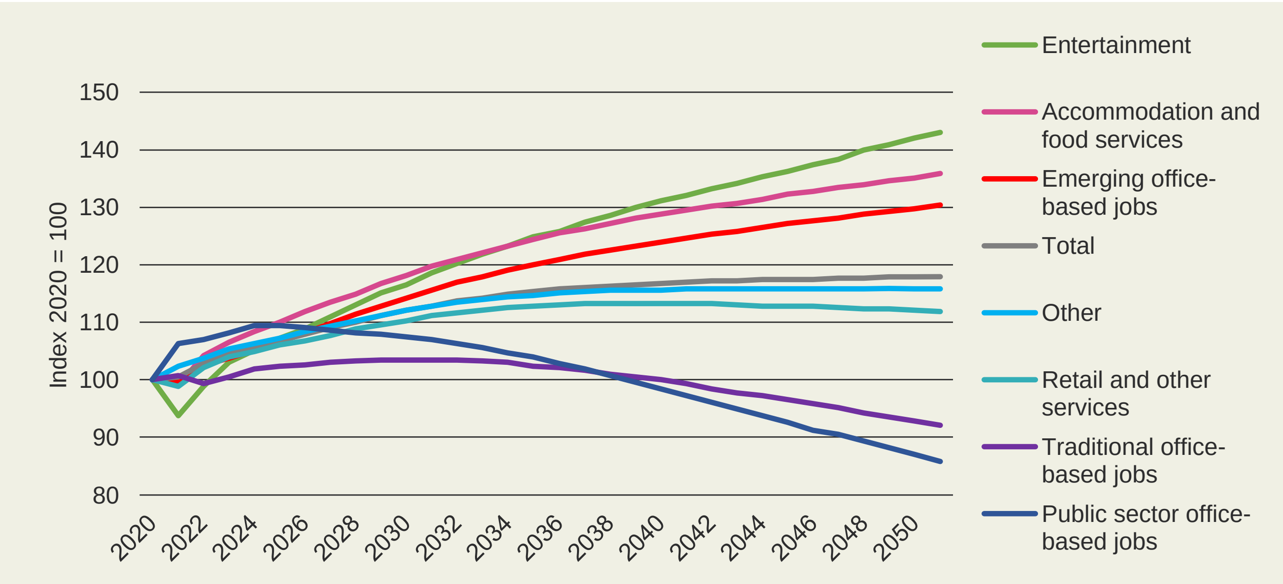

Figure 2: London-wide Long Term Labour Market Projections – Sector projections - GLA Economics, 2022

[6] GLA, 2022. London Long Term Labour Market Sector Projections; Arup analysis 2023

[7] GLA, 2023. London Long Term Labour Market Productivity Trend-Based Borough Projections; Arup analysis.

Long term growth prospects appear good in our scenarios, with the City requiring 6 – 20 million sq ft of additional office space by 2042. Much of this will be high quality office space for smaller employers.

We modelled future demand for *overall* office floor space in the City using three scenarios (*Return of In-Person*, *Hybrid Peak* and *New Diverse City*). All three scenarios suggest a slowdown (i.e. if employers *immediately* right-size for their needs) overall in office floor space demand during the next few years, with *Hybrid Peak* and *New Diverse City* suggesting lower implied overall demand for much of the rest of the 2020s (**Figure 3**). The inertia caused by long leases means that, in reality, this is likely to manifest as a soft landing. Within the overall picture of demand, there is a more upbeat market for best in class space, and a weaker one for lower grade space.

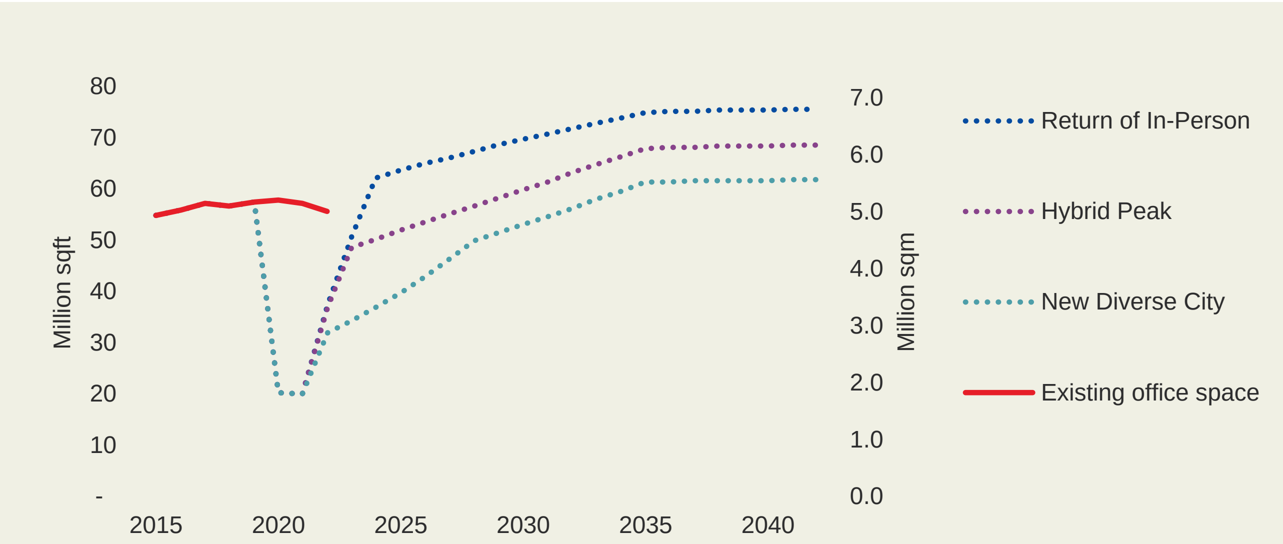

Figure 3: Underlying demand for office space in the City of London by scenario – Arup analysis, 2023

All three scenarios return to higher levels of implied overall demand for office space in the City in the long term. The key findings from the model compared to 2022 levels[8] include:

Return of In-Person

+ 20 million square feet of net office-space needed by 2042

+ 60,000 office-based FTE jobs accommodated in the City by 2042*

* using GLA forecasts

Hybrid Peak

+ 13 million square feet of net office-space needed by 2042

+ 60,000 office-based FTE jobs accommodated in the City by 2042*

* using GLA forecasts

New Diverse City

+ 6 million square feet of net office-space needed by 2042

+ 147,000 office-based FTE jobs accommodated in the City by 2042*

* using Arup's forecast based on historic BRES employment figures (2015-2020) to account for more efficient use of office space in a new hybrid era. This figure is compared to Return of In-Person and Hybrid Peak scenarios.

2 out of 3 scenarios (Return of In-Person and Hybrid peak) are broadly aligned with the draft City Plan 2036 target in terms of net office space development needed.

The *Return of In-Person* scenario projects additional need for 20 million sq ft of net office space by 2042 (in addition to the net 8.7 million sq ft delivered between 2016-2023) which is higher than the draft City Plan 2036 target. This scenario implies that the supply of high-quality office stock may

[8] Based on 2022 Valuation Office Agency data (NIA) for office floorspace in the City of London.

struggle to meet demand in the short term if the flight to quality continues, due to sustained high demand and low turnover in office spaces not allowing for the refurbishment and upgrade that may be required for existing office space in the City.

The *Hybrid Peak* scenario projects a more progressive increase in demand for additional office space in the City while still being aligned with longer term targets of delivery of around 21 million sq ft of office space from the draft City Plan (based on the net 8.7 million sq ft delivered between 2016-2023 and the additional net 13 million sq ft required in the scenario). In addition to new developed space, this scenario also implies that potential stranded assets are being quickly refurbished for supply to keep up with demand for more qualitative spaces. However, a window of opportunity to take action exists in the short term, with levels of underlying demand being lower than pre-pandemic levels until 2029, mainly due to medium attendance of workers and progressive employment growth allowing for higher churn and opportunity to refurb space in the short term.

Greater home working could allow for more office jobs to be sustained from the same City real estate footprint.

The *New Diverse City* scenario, which includes the highest rates of home working, has the ability to service a greater number of jobs through the same real estate footprint through less frequent office attendance. The results suggest that the Square Mile could service around an additional 147,000 office jobs by 2042 (compared with the other scenarios, and an increase of 48% on today). This scenario does imply a deeper trough of office demand in the 2020s, but in the medium to long term, as the economy grows, new organisations would be expected to take the place of those that were there previously, provided that suitable office space were (still) available. The organisations filling the space would be more likely to be smaller, emerging office-based firms. A holistic approach to curating sustainable business districts attracts a diverse occupier base particularly from innovation-led growth sectors such as life sciences and education.

Implicit in the *New Diverse City* scenario is that whilst future footfall may be slightly lower than in other scenarios, a higher number of individuals would access the Square Mile for work. This may result in higher net levels of local spend, given that hybrid workers are likely to 'splurge' on their days in the office[9].

But, a proportion of the City's existing office stock, may require investment to meet new energy regulation and market demands.

Based on EPC data, refurbishment and investment may be required by owners and occupiers to bring buildings in line with standards for businesses in the City. A proportion of institutional grade leases (approximately 32m sq ft[10]) may not currently comply with EPC regulation, with a rating below C (as illustrated by **Figure 4)**. It is anticipated many businesses will implement changes required to adhere to EPC changes. Conversion of Grade B stock to Grade A, or to best in class is possible in some cases, however this can be challenging. Many assets in the City are historic, including over 600 listed buildings and 26 conservation areas. Heritage assets can impose additional constraints on development, and the financial case for retrofit can be difficult to make, particularly in terms of additional costs and limitations on the potential to deliver modern office requirements, whilst at the same time conserving or enhancing the significance of the heritage asset[11]. In some limited circumstances, where Grade B offices are obsolete, cannot be viably refurbished and there are wider sustainability and planning benefits, there may be a case for demolition.

We note that lower EPC-rated offices may face a 'perfect storm' from the market's aversion to lower quality, less sustainable, less accessible amenity-rich spaces. Although we note that in the wider London and UK context, these locations perform well in terms of amenities, they are perhaps at greatest risk of becoming stranded assets. It should be noted that whilst EPC ratings provide a measure for understanding potential stranded assets, it should also be complemented on a site-by-site basis with specific NABER rating data for individual premises, to accurately understand a building's real energy performance across energy, water, waste and indoor environment.

---

[9] Arup, 2022. The future of the office in Central London.

[10] Estimated as the share of premises below EPC C office floorspace (GIA) on total office floorspace (GIA) from the Department for Levelling Up, Housing and Communities EPC rating data, applied to 2022 total office floorspace stock (NIA) from the Valuation Office Agency.

[11] City of London, 2015. Office Use – Supplementary Planning Document.

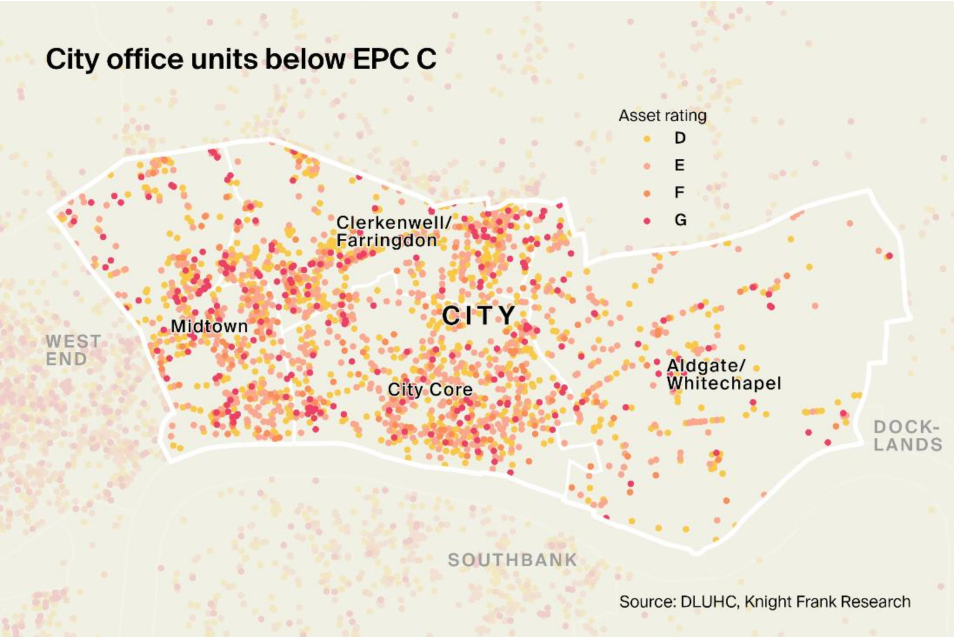

Figure 4: City Office units below EPC Rating C in the City – Knight Frank Research, 2023

As such, our projections for higher overall demand for office space do not account for the challenges faced by some existing lower grade stock in the City. We suggest that intervention is needed to allow for fewer obstacles for older stock to be updated to meet office market needs, or to convert to other uses:

***Planning Policy Recommendations** – for consideration when updating the City Plan:*

1. *Increase the supply of the best-in-class spaces*

- **Review the existing portfolio of office assets in the City**: review the portfolio of office assets in the City and identify potential sites that can be developed to increase the total supply of high quality, sustainable spaces. Consider providing direct support in the form of supporting advice for individual sites.
- **Consider area additions under certain circumstances:** consider area additions more positively when linked to broader outcomes, such as sustainable upgrades.

2. *Encourage conversion of existing Grade B stock to high quality office spaces*

- **Promote good practice refurbishment**: alongside existing SPDs, the City should consider building on the retrofit case studies work, to promote and share good practice of refurbishment that has led to upgraded office stock. The City could share these case studies with the broader construction industry.
- **Support policies that encourage retrofit**: City planning policy should encourage and promote retrofit and refurbishment to improve EPC ratings.

3. *Encourage alternative uses for Grade B stock for which conversion is not feasible*

- **Take a flexible approach to planning consents for heritage and stranded assets**: the City contains a large number of historic assets. For some of these specific, protected historic sites and conservation areas in the City, there may be cases where it may not be financially viable to refurbish existing office space to meet regulation. The City could explore the implications of amending policy that requires 'viability assessment' when considering change of use, where this would incentivise the retention and improved environmental performance of existing buildings.

***General recommendations** – for broader City consideration:*

1. *Increase the supply of the high quality, sustainable office spaces*

- **Identify opportunities within the market**: the City should continue to work in partnership with occupiers, developers, landowners to help promote and facilitate opportunities for investment and development opportunities.
- **Continue to promote and invest in amenity, urban and workplace experience in the City to attract employers, office workers and tourists**: continue to invest and improve amenity within the City, for example public transport and active travel accessibility and office-supporting sectors – including food and beverage. Together with a focus on the workplace experience, consider ways to encourage employees back to offices and support high attendance rates. The workplace experience for employees needs to focus not only on the office building, but also wider amenity including improvements in public realm, retail as well as programmatic interventions such as an arts, culture and entertainment programme for example.

2. *Encourage conversion of existing Grade B stock to high quality office spaces*

- **Continue to monitor closely assets at risk of becoming stranded**: following changes in regulation and market demand, relevant refurbishments are anticipated by owners and occupiers to bring buildings in line with standards for businesses in the City. Based on EPC data, a proportion of stock (approximately 32m sq ft) may not currently comply with EPC regulation. Work closely in partnership with developers and land owners to understand future plans and uses for these assets, identifying any potential blockers to convert these (primarily Grade B stock) to best-in-class or Grade A spaces.
- **Form a City Advisory hub to provide expert advice**: the City should form a City Advisory hub to actively connect developers, business owners and other stakeholders with potentially challenging stock to experts, both within the City and externally to support them with upgrading their existing stock. For example, the City could join together with English Heritage to share skills and cost effective methods of retrofit for historic and listed buildings to upskill the broader construction sector.
- **Protect office space during a potential period of softening of demand in the short-term through enabling meanwhile uses**: the 'flight to quality' trend, coupled with EPC regulation is driving demand for higher quality best-in-class and Grade A space. Engage with investors and landowners to understand how low grade stock could become more attractive or could be repurposed for meanwhile uses, with a focus on population-serving sectors such as cafes, bars and restaurants.
- **Support broader construction industry campaign for low cost, carbon retrofit:** the City could work with other stakeholders to address the costs of low carbon retrofit, including matters such as campaigning for VAT relief - particularly for buildings deemed stranded assets.

3. *Encourage alternative uses for Grade B stock for which conversion is not feasible*

- **Support a more efficient use of office stock for long-term vacant sites**: there may be some cases where a change of use may be the best option to optimise the use of space due to other constraints (i.e. a site having compounding factors such that it may be a historic asset and a current grade B space), in which case – the City should work with landowners and developers to ensure that transition is done in a way which is planned. The City should also monitor the amount of properties that are left long-term vacant. If this increases significantly over time, the City should look to identify potential alternative uses, or tax incentives (i.e. business rate relief to businesses that benefit the local community or economy) to bring buildings back into use, increasing provision of affordable spaces for example.

4. *Strengthen the City's role as a premium office market location*

- **Encourage growth in emerging sectors**: the City could consider providing support to encourage emerging sectors. This includes providing marketing, space, skills and incentives to encourage growth, and ensure the City remains a premium office market location that can accommodate emerging-office sectors in particular.

- **Develop targeted marketing campaigns**: develop targeted marketing campaigns to reemphasise the City as a leading global financial hub and office market and attract office market investment. This could include:
  - A) Local marketing campaign – a localised marketing campaign focussed on the City set to become the first zero carbon office market in London. This campaign would aim to differentiate the City from other neighbouring office markets, highlighting the abundance of low carbon, best-in-class offices available.
  - B) Foreign marketing campaign – a targeted campaign focussed on foreign investors to capitalise on the significant investor appetite for high-quality, best-in class space. This campaign would focus on influencing the investment pipeline in the City.
- **Leverage Business Improvement Districts (BIDs)**: leverage BIDs including including Fleet Street Quarter, Cheapside, Eastern City Partnership and Aldgate BID in the City as the convenor for neighbourhoods to develop a programme of activity to strengthen the City's role and function as a premium office market.