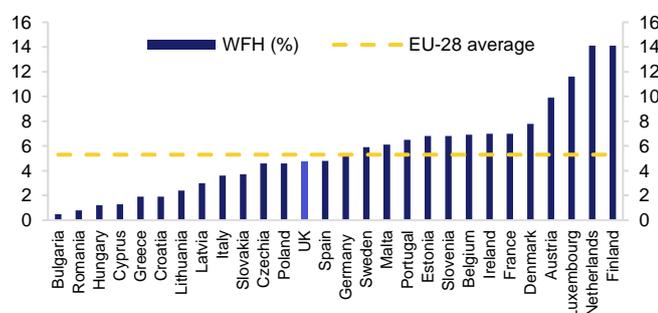


Is the future of work at home or in the office?

- Since the start of the COVID-19 lockdown, some commentators and mainstream media have been quick to predict the death of the office. The reality is likely to be more tempered.
 - Face-to-face office collaboration facilitates knowledge spillovers, learning and mentoring; improves creativity; and enhances productivity. The office is also a hub for social interaction.
 - In particular, central business district (CBD) locations with good transport links are here to stay. Those buildings that are efficient, accessible and offer strong amenities are likely to perform better relative to others.
 - We would strongly advocate that investors keep an eye out for pricing opportunities. We do not see the death of the CBD office. In fact, buying opportunities with some discount in entry pricing would be a good reason to invest in the sector.
-
- In the UK and the EU, around 5% of the labour force mostly worked from home in 2019, according to Eurostat data (figure 1). These numbers are quite small, and a big movement to home working would require a radical change in approach.

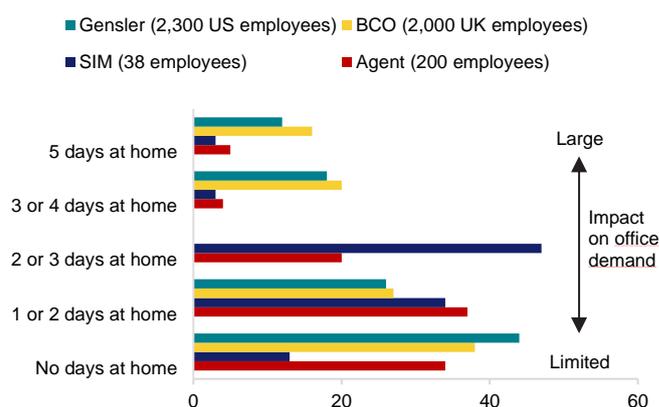
Figure 1: Employed persons usually working from home (WFH) as a percentage of the total employment (2019, %)



Sources: Eurostat, Savills IM

- The COVID-19 pandemic has demonstrated that home working is feasible for more professions and companies than previously assumed. Twitter, for example, recently announced that all staff would have the option to work from home permanently.
- However, many people still prefer office-based work. **Just 20% of UK workers plan to work mostly from home when normality returns**, research commissioned by the British Council of Offices finds. Similarly, **a Gensler survey of US office workers finds that only 12% want to work from home full time (figure 2).**

Figure 2: Employee location preference post-COVID-19, work from home versus office (%)



Sources: Savills IM, Gensler, British Council of Offices

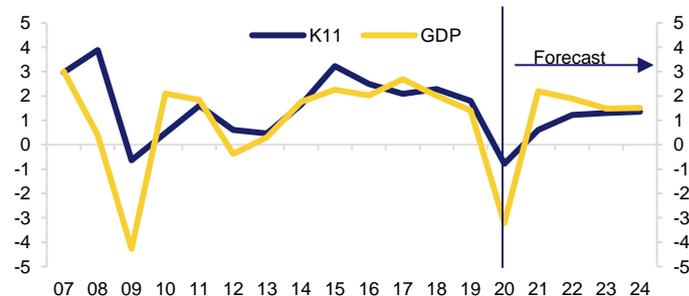
- After three months of lockdown, **the downsides of working from home are becoming apparent.** Some of the obvious drawbacks are **unsuitable working spaces, lack of privacy, and noise levels.**
- Not every worker is at the stage of his or her career to **afford a home with a separate office, while others may find it challenging to balance work and childcare responsibilities in the same environment. Loneliness, isolation and blurred work-life boundaries** are just a few of the more intangible issues that come with long-term home working.

- Moreover, the global work-from-home experiment is untested around **productivity and creativity, aspects that are important to economic recovery.** In-person meetings and face-to-face interactions boost innovation and foster new ideas. They facilitate knowledge spillovers, on-the-job learning and fuel skill development, all of which contribute to a firm's productivity.

Employees will be drawn back to offices

- Getting workers safely back to the office will require a gradual approach using a rota or quota system in line with social distancing rules. Companies are likely to change their office space layouts, as desks need to be spread out to allow more space between colleagues – **i.e., increasing the floor space per person in the short term. Could this be a trend to stay, and that reverses the per person occupancy per workplace that we have observed over the last 10–12 years?**
- If the threat of the pandemic does not disappear, we could see occupiers having to reconsider their office layouts and space per workplace to meet social distancing guidelines. It may not be two metres apart, but reducing space per person may no longer be an option. It could even lead to rising trends in space per person.
- For many, there are clear benefits to working from home, such as more time with family and no daily commute. Workers may want to work from home more frequently in the future, suggesting a new 'mixed-working' approach. **We do not believe the trend towards agile working or the need for greater flexibility is going to change,** nor should this significantly alter the trend towards CBD office locations.
- **Job losses due to COVID-19 and weak employment conditions will weigh more on demand over the next few years,** PMA and Capital Economics expect (figure 3). This is a delayed effect and something most economies have yet to experience, but it is coming. You cannot have a major disruption to business activity without a consequential fallout in employment levels.
- The degree of this pandemic has been severe. The initial government support in terms of job-saving initiatives will create a temporary delay and maybe also go some way to reduce the overall fallout in job losses, but it is inevitable that most business will look to rationalise and save costs. Staff costs are where businesses make the biggest cost reduction impact to their P&Ls.

Figure 3: Office employment under the recession scenario forecast to remain below pre-COVID-19 levels (K11 centres average, %)



Sources: PMA (Spring 2020, recession scenario), Savills IM

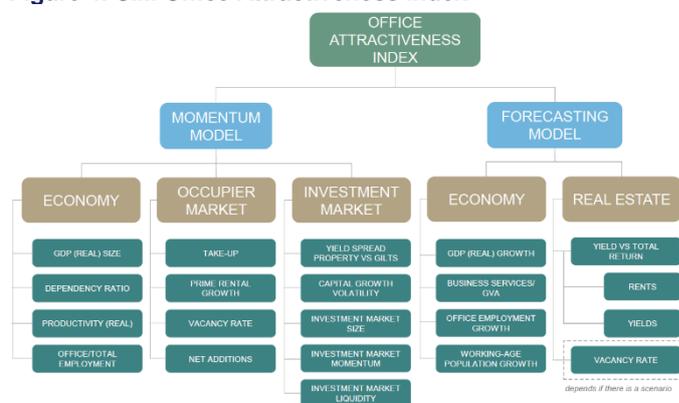
- Another trend that may continue to gain momentum is the need for occupier flexibility. We do see this as an ongoing characteristic feature of the real estate market. **Shorter lease lengths or earlier break options are likely to become more prevalent.** Depending on where the balance of negotiation power sits, the resulting impact will come down to rental-level pricing. In immediate terms, the pressure on rental levels will be downwards, but the trade-off for increased occupier flexibility might limit the fallout we expect to see in property pricing.
- Although the cost of borrowing has increased, the short-term deflationary effects of this pandemic will result in a much-lower-for-longer interest rate environment. As more debt providers come back into the market, we could see greater competition and those debt-pricing margins reducing further. This will cushion the anticipated extent of those pricing discounts.
- From an **environmental perspective, home working has reduced pollution. But the price of economic loss, as all economies are suffering major falls in GDP, is not a fair trade-off,** and not one that can last indefinitely. All countries need levels of activity to create sustainable economies. There will be a desire for 'back to normality,' no doubt with subtle changes to working practices.
- Not just governments but also businesses want people back to spending, travelling, socialising and interacting. It is what sustains and grows economies. This does not take away the ongoing need to deal with pollution and aim for a net zero carbon target. **A growing number of cities – most prominently the C40 Cities (C40 Cities Climate Leadership Group) – are actively addressing climate change and air pollution, and COVID-19 has only accelerated this trend.**

Conclusions

- **Office-based collaboration has many advantages over home working.** We expect this form of working to be the norm, and the current situation of total home working to reverse. This does not take away the increasing desire for flexibility and agile working, but the office location is here to stay.
- Occupiers tend to take office space in locations that offer good transport links, entrepreneurial spirit and universities producing a well-educated workforce, as highlighted in our **Dynamic Cities Index**, reinforcing the advantages of central locations. Also, if people work fewer days a week in the office, they might prefer city centre locations that offer a wider range of services and amenities.
- The crisis will likely result in more employer emphasis and spending on workplace health and wellbeing, and a greater focus on corporate responsibility. Employers will start to place greater importance on the quality of the office environment, including more desk space per employee beyond the post COVID-19 period and more breakout facilities. Building technology will also play a greater role, with touch-free technology and biometric verification being more widely rolled out across offices.
- In our opinion, core CBD offices are still a good investment, after a certain degree of pricing discount. Most office workers will want to return to their desks, be it for a few days per week. While slower or even negative employment growth could weigh on rental growth prospects in the short term, we feel there are also counterbalancing forces to limit the pricing falls.
- **Our advice would be to take advantage of any 5-10% negotiated price falls in the market. We do not expect to see major falls, for the reasons highlighted previously.** This is further supported by the weight of money still trying to get into real estate. **Consequently, we would advise clients to be active in the market in the next three to six months as pricing evolves.**

- To help our clients identify the European office markets with the strongest fundamentals and best prospects, **we have created the Savills IM Office Attractiveness Index (OAI), which covers an assessment of 34 office markets.** In brief, the model is supported by a methodology that allows us to rank markets from the most to the least attractive, according to a combination of specific economic and property indicators, thus creating an allocation policy.
- The OAI score is a combination of the results of two independent models. First, the **Momentum Model**, or which markets currently have the best fundamentals and strongest momentum; and second, the **Forecasting Model, or which** markets have the best prospects over the next five years.
- A schematic below represents the approach (figure 4). For a given risk profile or return target, modelled portfolios can be viewed, allowing clients to target their appropriate investment strategies. **CBD offices are the future, and one subsector we believe should be a mainstay of any real estate diversified portfolio.**
- We will publish an extended office paper in the coming months where the results of the OAI are discussed in detail.

Figure 4: SIM Office Attractiveness Index



Source: Savills IM

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