School of Real Estate and Planning
University of Reading

Henley Business School
UNIVERSITY OF READING

Flexible Real Estate
Perception Vs. Reality

(Summarised version)

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MWB BusinessExchange

Contents

Introduction

This document presents a summary of the key findings of academic research carried out by Dr Ashley Dabson and Professor Pat McAllister, from the School of Real Estate and Planning at the University of Reading. MWB Business Exchange PLC commissioned Dr Dabson and Professor McAllister to research the following:

- The extent to which the serviced office and meeting venue sectors are aligned to the corporate real estate supply chain.
- How corporate occupiers and real estate portfolios have evolved.
- An overview of the cost of over expansion in relation to corporate real estate.
- An overview of the cost effectiveness of serviced offices vs. conventional leasing in today's occupier market.

At the end of 2011 and during early 2012, 21 UK based large corporate occupiers were interviewed to discuss their company's real estate and property procurement strategy. Also discussed was how their current property portfolio meets their business requirements. The individuals involved came from key decision-making roles in either real estate, facilities or procurement.

Key findings

1. A decade of research avoidance

Compared to other real estate sectors, there is an extremely limited body of knowledge that is focused on the serviced office sector. Indeed, one of MWB's main motives for commissioning the report was the real estate research community's lack of engagement with the serviced office sector over the last decade. In an industry worth £2bn in the UK, both MWB and University of Reading felt that it was time that this was addressed.

2. Meeting and training venues – it's real estate

This is the first research to evaluate the 'meeting and training venues' product as an integral component of the corporate real estate portfolio.

In the past decade, the purchasing of space within corporate businesses for off-site meetings, training and events has been increasingly managed centrally on behalf of the business through procurement and learning & development departments. This has enabled corporates to get a clear understanding of their spend in these areas, which has previously been difficult to track. This information has also allowed them to consolidate their purchasing to make savings, and introduce policies to manage risk within the business, from both contractual and health & safety perspectives.

However, in the past three to four years the challenging economic environment has seen many corporate businesses beginning to look at how their own internal meeting room inventory can be effectively managed. This is to ensure that the unnecessary expenditure of going off-site is not incurred when there are meeting rooms sitting empty within their existing portfolio.

These interviews have, in most cases, seen areas of the business coming together that would not have previously done so. Procurement, learning & development, facilities management and corporate real estate are involved in this process. This review has begun to see the net widen to include all off-site space including meeting, training, events, hot-desking and project space.

True business hospitality – the market demands it

The research shows that serviced office operators need to ensure that their venues match the increasing expectations of space and hospitality from corporate users. It is vital that serviced office operators improve upon the hotel experience.

Many corporates' own internal space is of a very high standard, with dedicated and experienced employees providing a personalised service and high quality, restaurant-standard food and beverage.

The current economic climate makes it prohibitive for many corporates to use 5* hotels, and they have begun looking at serviced office providers' venues as a solution for off-site meetings. However, they do not want to compromise on the quality of standards and service they have been used to, both internally and in hotels.

The market is driving a demand for non-residential off-site meeting space of a very high quality standard, and currently there is work to do in the venues sector to match the increasing expectations of business hospitality.

3. Real estate portfolio management

With serviced work space remaining the core product line, the serviced office sector has developed a complementary product, currently referred to as 'managed offices'. These truly outsourced property products have the potential to provide solutions to corporate real estate procurement problems from both an acquisition and disposal perspective.

Real estate portfolios – How do they look in 2012?

The research introduces a new conceptual framework for analysing the corporate real estate portfolio. In particular, five categories of space are identified:

- **Core** – The core portfolio is defined as those assets - owned or leased - that are critical to the occupier. This may be for reasons of location, scale, image or capital investment.

- **Peripheral** – The peripheral portfolio comprises all non-core space that is occupied by the business. The tenure is largely irrelevant; it can be freehold, leasehold, or held on a licence. The facilities management can be in-house or outsourced. The form can be traditional office space or a managed or serviced office.

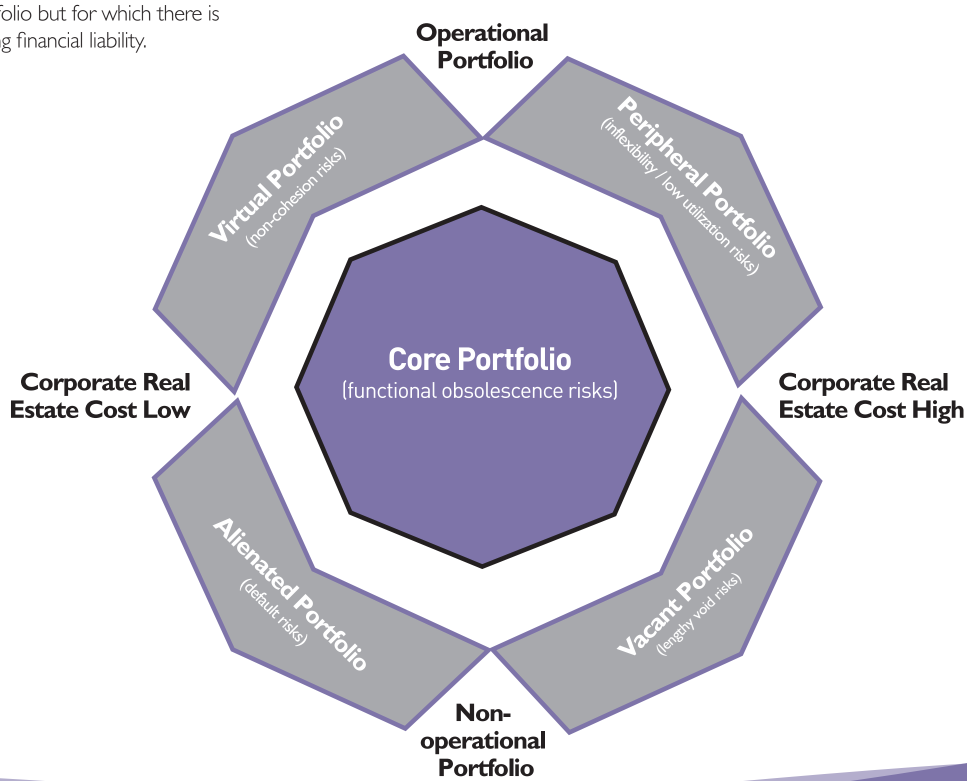
- **Alienated** – The alienated portfolio comprises all space that is occupied by third parties by reason of assignment, lease, sublease or licence. It is space that does not form part of the operational portfolio but for which there is some legal obligation and often an accompanying financial liability.

- **Vacant** – The vacant portfolio comprises all of the space that is unused. This divides into six categories, all of which represent a forward cost exposure. This cost risk is particularly pronounced in cases where the period to invocation is likely to be long or the void is likely to be protracted.

- **Virtual** – The virtual portfolio exists where the emphasis is on the service rather than the space. It is space normally used to support short-term, highly serviced, specific business activities. The venues product falls into this category.

Driven by the growth of mobile technology, the virtual real estate portfolio has become an increasingly important part of the corporate real estate portfolio. This consists of a diverse range of informal and formal spaces such as purpose-built training venues, coffee bars, off-site meeting rooms and conference venues.

The corporate occupier situation has changed over the last ten years, and dramatically so during the last five. There have been three major changes: commercial lease lengths have reduced; the virtual portfolio (where space is used but not held) has emerged; and non-operational real estate has become a significant distraction and cash drain. The five portfolios model encapsulates these changes into a simple descriptive tool that will assist corporate real estate managers in planning.



4. Reluctant landlords – an expensive distraction

Given the core offer of flexibility and outsourcing, the serviced office sector seems to be well placed in a business environment characterised by increasingly flexible working practices and a more contingent workforce. In addition, the serviced office sector is developing the capacity to provide solutions to corporate organisations who, due to the inflexibility of owning or leasing real estate, can become 'reluctant' landlords.

According to CBRE (Q4 2011 Central London Property Market Review) the total availability of space across Central London is now at 15.6 million sq ft, and forecasted to rise during 2013.

Of this available space, Savills (Savills Research, Market Watch) reported in January 2012, that 23.5% of the currently available stock in the market was confirmed as tenant led, (the remainder being landlord-led or unknown) which means that an absolute minimum 3.67 million sq ft of the current stock in Central London is being brought to the market by companies whose core business is not real estate.

When we look at the current costs of rents, accepting that tenant led space is likely to be at the lowest end of the rental profiles, it is safe to assume that an average rent applicable to tenant led available space in Central London would be circa £30.00 per sq ft.

Location	Average Rental Ranges*
City	£25.00 to £55.00
Mid-town	£30.00 to £55.00
West End	£35.00 to £95.00

* Source JLL UK Corporate Occupier Conditions March 2012

In this case, 'reluctant' landlords are currently presenting to the market space with an annual rental liability of £1.1bn over 3.67 million sq ft, which is comparable to Land Securities entire Central London portfolio.

Simply put, occupiers that bring to market their own space, for whatever reason, do not possess the required levels of flexibility in their real estate portfolio to accommodate business change. This is a hugely expensive distraction.

The core benefits provided by serviced work space providers remain:

- The ability to rapidly enter and exit high quality work space with access to additional services and facilities. Delays to commencing trading comes with a high cost, with implications for launching products, recruiting staff and marketing your brand.
- The conversion of fixed, inflexible real estate costs associated with conventional leasing into variable, flexible real estate costs and associated reductions in real estate inventory risks.
- The reduction in search costs generated by bundling space, office infrastructure and hard and soft FM services.

Value

Service vs. Conventional Leasing

The Investment Property Databank (IPD) are world leaders in performance analysis for the owners, investors, managers and occupiers of real estate. They continuously measure the cost of building performance through their well established product, the IPD Cost Code, the award winning framework for understanding and collating property cost information.

In the creation of this cost code, a rich variety of occupiers and industry organisations have contributed extensively to providing the following information in this report.

The Central London Total Occupancy Cost splits London into the traditional three geographical areas and examines both actual rental costs and occupancy costs to drive to a workstation cost across each locale in 2011.

On the pulse of
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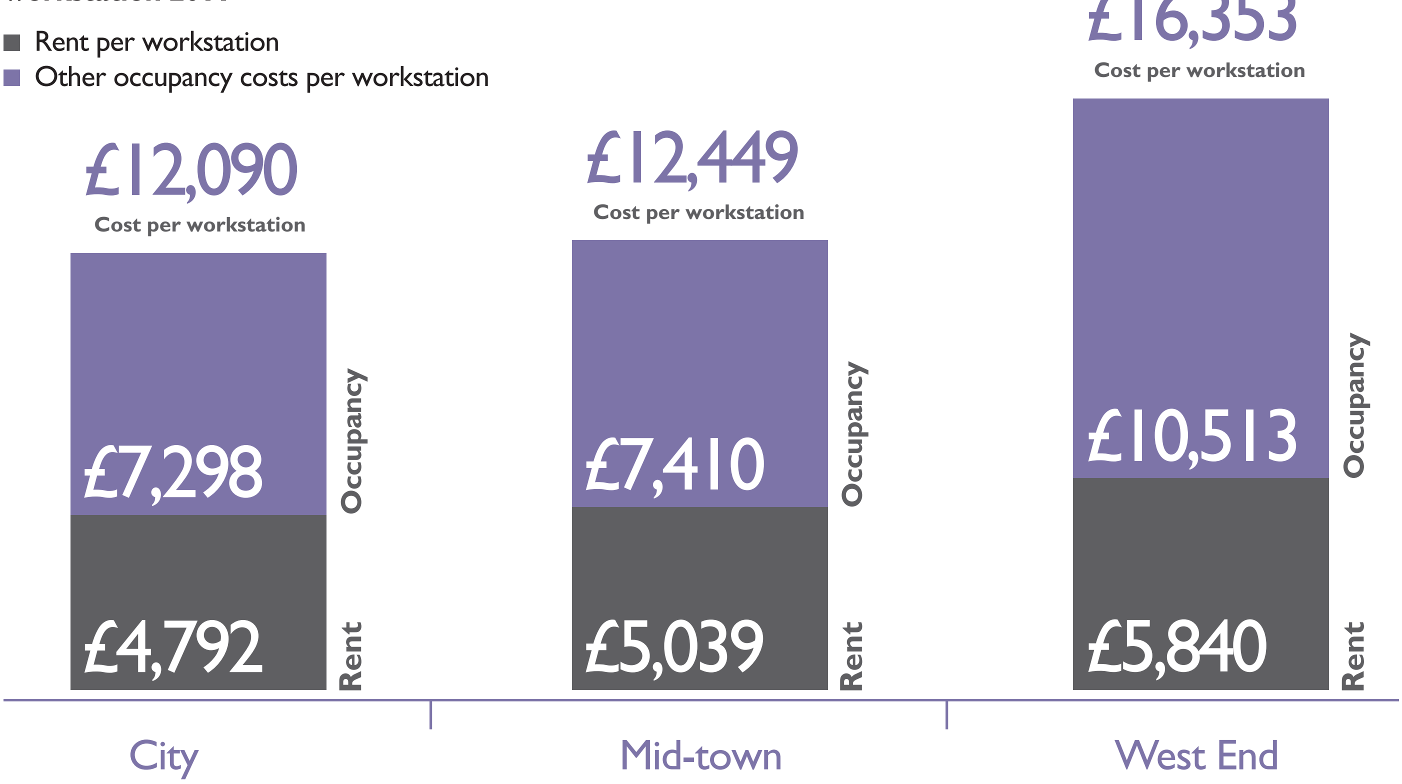
IPD

Central London Total Occupancy Costs per workstation 2011



All the IPD data is derived from the 'IPD Occupiers All Office Benchmark for 2011', which contains a sample of more than 2,600 UK offices, including Deloitte, HSBC, PwC, KPMG and GlaxoSmithKline. The benchmark is composed of actual costs for the 2010/11 financial year from a wide variety of occupiers across multiple sectors.

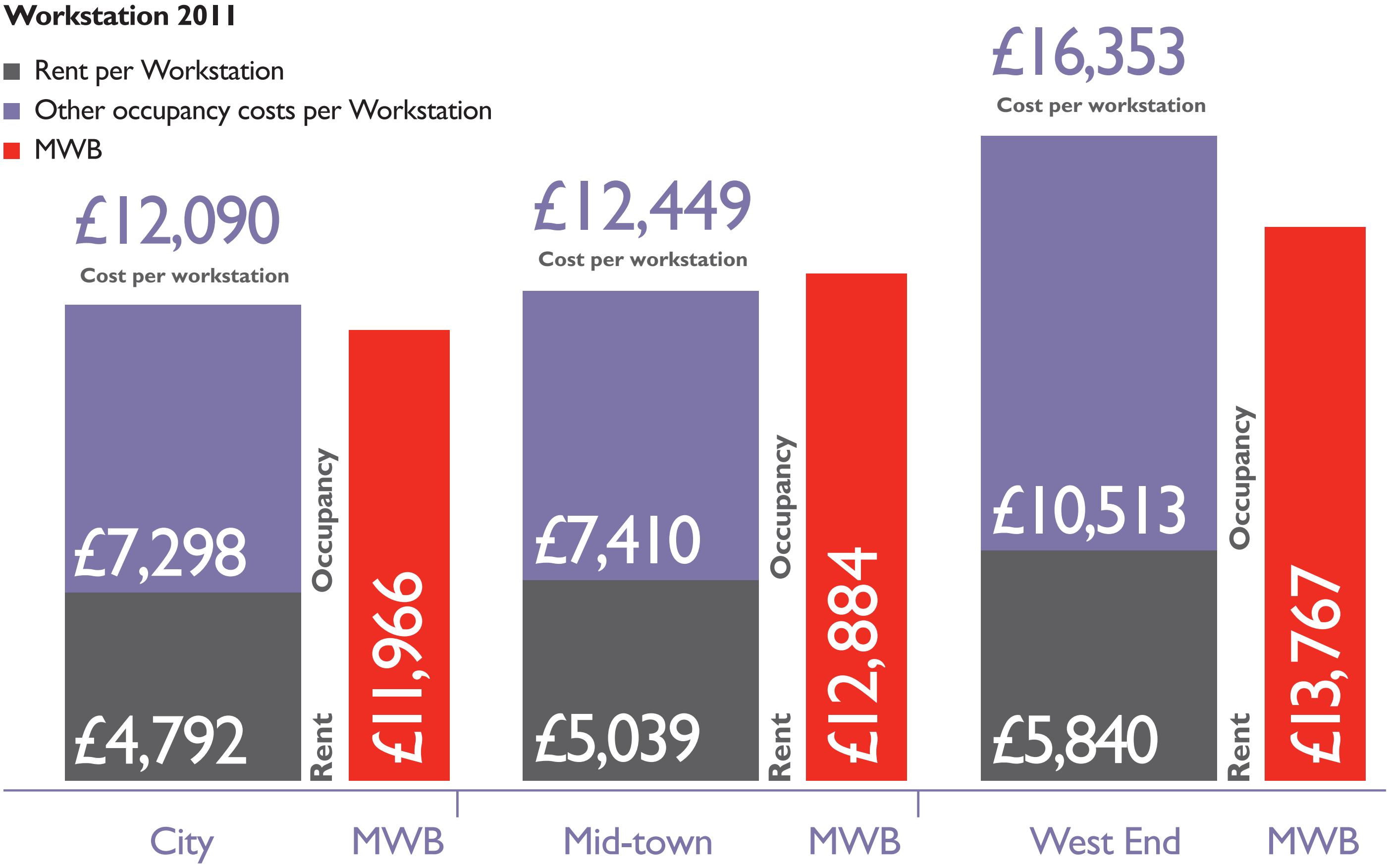
To ensure accuracy in comparison to the costs associated with occupying serviced office space, "other occupancy costs" need to be compared on a like-for-like basis. Each figure takes into account a cost for rent per workstation and other occupancy costs. These include:

- Local property taxes (rates)
- Net service charges
- Fit out & improvement
- Furniture & equipment
- Total insurance
- Internal repair & maintenance
- M&E repair & maintenance
- External repair & maintenance
- Minor improvement
- Reinstatement
- Internal moves
- Security
- Cleaning
- Waste disposal
- Internal plants & flowers
- Grounds maintenance
- Water & sewerage
- Total energy
- Catering & vending
- Reception
- External distribution
- Internal distribution
- Real estate management
- Facilities management
- Capital project management
- Acquisition, disposal & removal

Frequently the serviced office industry competes with conventional leasing with a perception held by occupiers of being more expensive. The lack of ease with which these costs can be compared and the lack of independent cost comparison research contributes to this view.

So in direct comparison, we examine the average list price from MWB Business Exchange PLC's Grade A Central London portfolio in 2011 to compare with the IPD's cost code.

Central London Total Occupancy Costs per Workstation 2011



Conclusion

Over the last ten years, there has been a lack of research into the serviced office market. Considering its size of over £2bn in the UK alone, this is surprising. We hope that this report will lead to a better understanding of the true advantages and disadvantages of the sector.

This report recognises outsourced meeting and training venues as an important part of a property portfolio. We expect that as occupiers strive for efficiency savings, they will increase reviews of spend between business functions. This will lead to greater consolidation, and will drive value into providers' offerings as they compete for this business.

The new framework in this report explains how changes in technology have led to the emergence of a new real estate portfolio structure. We hope that this model can be used to increase internal awareness, and potentially reduce the huge amount of occupiers' time and cash tied up in becoming a reluctant landlord.

Finally, since it is often presumed that serviced offices are an expensive option, the comparison of occupation costs in serviced and conventional offices is probably the most unexpected finding of the research. There are a number of possible explanations for the finding of price competiveness of serviced relative to conventional office procurement:

- Class A IPD offices are superior to Class A MWB offices.
- MWB may benefit from economies of scale and specialisation in delivery and procurement of FM and office infrastructure.
- Conventional and serviced offices markets are segmented with their respective prices determined by different drivers of supply and demand.
- Serviced office operators maybe able to increase workspace diversity into a given space and therefore profit is generated by an intensity effect.

Whatever the cause, the perception that serviced offices are an expensive option compared to conventional offices seems outdated. Given that serviced offices also offer additional benefits that can considerably reduce the inventory risks associated with conventional leasing, the serviced office offer should be an appealing solution to many real estate procurement problems.

Biography

Pat McAllister is a member of the RICS and is currently Professor of Real Estate Appraisal at the School of Real Estate and Planning. Having previously worked at Heriot-Watt University and Oxford Brookes University, Pat has been teaching real estate students at the University of Reading since 1999. During this period, he has been involved in numerous research projects funded by (or in collaboration with) industry partners. Pat's principal research interests are in appraisal methods and processes, where he has been involved in a number of research projects examining the development viability appraisal, unlisted funds, flexi-leases and serviced offices. Focusing particularly on behavioural issues, he has also published papers on client influence on performance measurement appraisals, valuation accuracy and the production and use of forecasts in commercial property markets. Most recently, he has published extensively on the relationship between real estate prices and environmental performance.

Dr Ashley Dabson began his corporate career after studying at MIT as a Fulbright Scholar in the late 70's. He has extensive experience of corporate property and facility management. He has specific knowledge and experience in the Information Technology and Telecommunications industries.

As a Chartered Surveyor and Town Planner he has spent the last 25 years working in the commercial sector. He has directed both an intelligent building consultancy and headed the UK property and facilities functions in several public companies including Digital Equipment Company and Compaq Computers, (both now part of Hewlett Packard). He was then appointed Director of International Property and Facilities at MCI WorldCom being responsible for the property portfolio and all of the real estate and facilities staff throughout Europe and Asia Pacific. During his career he pioneered the development of flexible working and the intelligent client model.

Since April 2004 he has worked independently specialising in education, research, corporate training, coaching and consultancy in the field of Corporate Real Estate. He has worked in a number of countries for clients in the public, private and charitable sectors.

Reading University is home to the largest school in the UK for teaching and research in Real Estate and Planning.

Established in 1968, with a worldwide reputation for excellence in both teaching and research. They are consistently ranked in the top three positions in all major league tables and the US-based Urban Land Institute ranks them as the leading Real Estate Centre in Europe.

They are now taking a principal role in the development of the Henley Business School at the University of Reading and are the only Real Estate school in the country to have a separate identity within a more general business school.

They aim to maintain the highest standards of undergraduate and postgraduate teaching for the Real Estate and Planning industries and to undertake internationally recognised, leading edge research into real estate, planning and land.

Investment Property Databank are the world leader in performance analysis for the owners, investors, managers and occupiers of real estate.

Today IPD is at the forefront of global real estate performance analysis, providing clients with the accurate and comprehensive information they need to measure real estate market returns, take advantage of emerging trends and to get the most out of their real estate.

MWB Business Exchange PLC delivers a unique blend of commercial property expertise and exceptional business services.

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