MORTONS MARKET MONITOR 2022

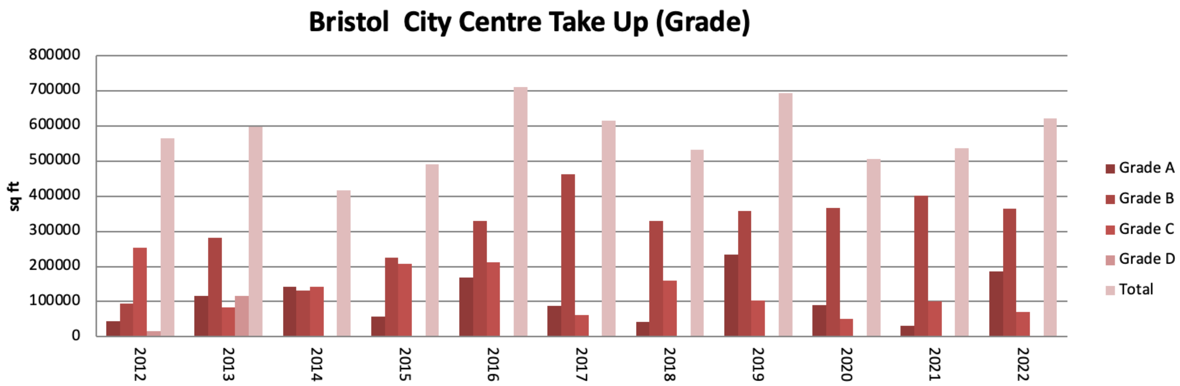
Bristol rides out the economic uncertainties

While the economic turbulence we saw from mid-2022 onwards has put pressure on the development and investment sides of commercial property, the Bristol office letting side has proved resilient – buoyed by a strong local economy.

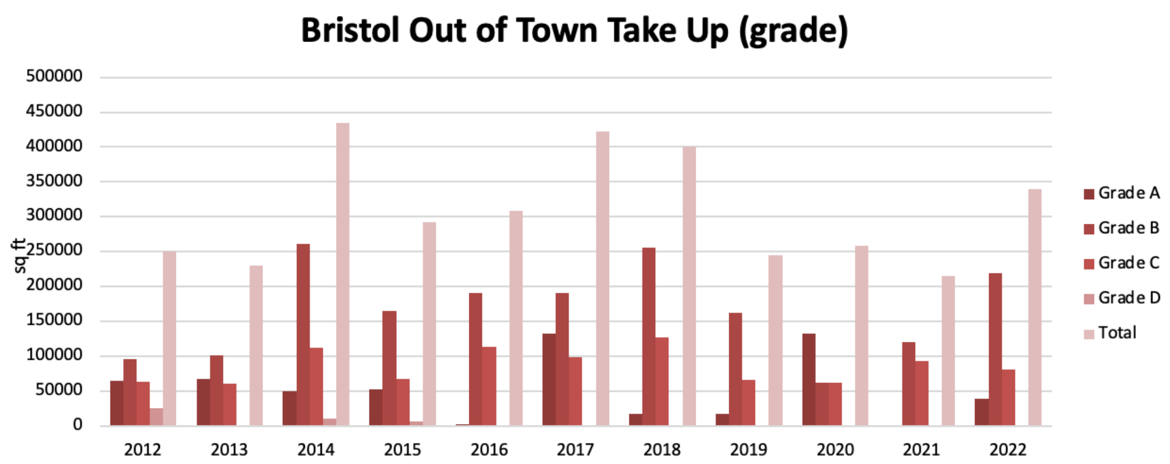
Over the year, demand across the city was actually at its highest level since 2017, boosted by strong out of town figures.

First, the stats…

If we drill down, some very encouraging figures emerge: city centre take up for 2022 totalled 620,211 sq ft – 8% higher than the five-year average – although H2 was distinctly quieter than H1.

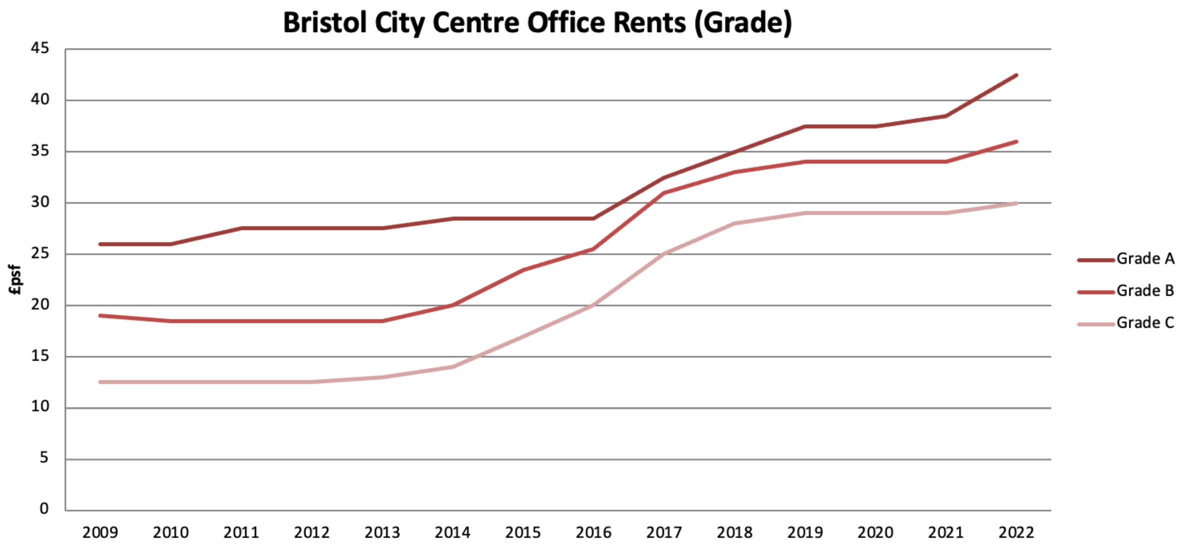


The Bristol out of town market saw its strongest take up since 2018 with a Q4 figure of 109,191sq ft. The annual total was 340,158 sq ft, also the highest since 2018.



Bearing in mind the overarching trend towards occupiers taking smaller (but smarter) offices, that's testament to the strength of the local market, built on the back of the city's rich mix of sectors.

Headline rents in Bristol city centre rose during the year for Grade A space and are now the highest of the Big Six regional cities at £42.50psf – achieved in the EQ building. Several other transactions came in just under this benchmark. Incentives edged slightly higher but are still historically low: a reflection of the fine balance of supply and demand in the market, together with the preparedness of tenants to pay for quality workspace that will help them recruit and retain skilled personnel as well as meet their brand values around ESG. Grade B+ space is commanding around £37psf – a relatively small discount to Grade A.



Out of town rents lag well behind, but there will always be occupiers keen to operate close to the motorway network and to take advantage of the lower rents. With industrial rents soaring, we have already seen two buildings taken out of the equation at Aztec West for industrial use, and others may follow.

Supply pipeline

On the supply side, just 65,000 sq ft of new Grade A is currently available in the centre, predominantly at The Distillery and 10 Victoria Street, with some 712,000 sq ft under construction/refurbishment.

The big new build schemes are EQ, Assembly B & C and Welcome Building, while refurbishments on site include V7's One Hundred Victoria Street and L&G's North Quay House.


EQ


Assembly C


The Welcome Bldg


One HUNDRED


North Quay House

That should take us comfortably through to 2024/25. However, a number of other new and refurbishment schemes which have consent, and which would deliver a further year or two of new supply, may well be delayed because of borrowing and/or construction costs and residual concerns about the economy. That could cause a constriction in supply several years from now – and may act as a spur to developers with consents and funding in place to take advantage of the gap in supply. It's difficult to see rents dropping off by then because supply will be lower and a large number of occupiers will be facing lease events in buildings coming up for refurbishment or repurposing.

Market sentiment

The quiet confidence in the local market is in part due to the very low levels of unemployment locally: vacancies still outnumber candidates; and, until that situation reverses, sentiment will continue to be largely positive.

Bristol has always been very good at generating a balanced supply, making it a very stable market compared to some regional counterparts: that's why investors like the city. This situation is likely to continue for the foreseeable future because, while there are a few individual sites offering the potential for development, there is no significant land release in the offing – and any sites that do come along will find keen competition from other uses.

Because of the new EPC ratings being introduced, explained in more detail below, landlords are contemplating a choice of either upgrading or repurposing many buildings over the next few years. Those offices being upgraded will be out of action in the lead up to and during refurbishment; and, unquestionably, some will be lost to the occupational market entirely, further constraining supply.

Six trends to watch

We recently conducted research with around 100 businesses in the region to track key occupier trends, and this was published in Business Insider towards the end of 2022. Here are some of the findings along with several other emerging trends.

1. **Companies shift from remote and remote-hybrid first to hybrid**

Hybrid working is now the new normal for 77 per cent of businesses. Just 5 per cent defined themselves as “fully remote” and 8 per cent as ‘fully office-bound’.

Significantly, the shift towards more remote and hybrid working is not leading to an overall reduction in demand for office space, as the take up figures demonstrate. Drill down into those numbers and you start to see what’s going on beneath the hood. Top grade space take-up has risen significantly – up over 40% – while demand for the lowest grade has plummeted by two thirds.

Businesses are investing in quality space which ticks all of the ESG boxes and offers the flexibility to accommodate the new templates for working, with a mix of collaborative and individual work areas.

2. **Tenants are rethinking how they use their existing space**

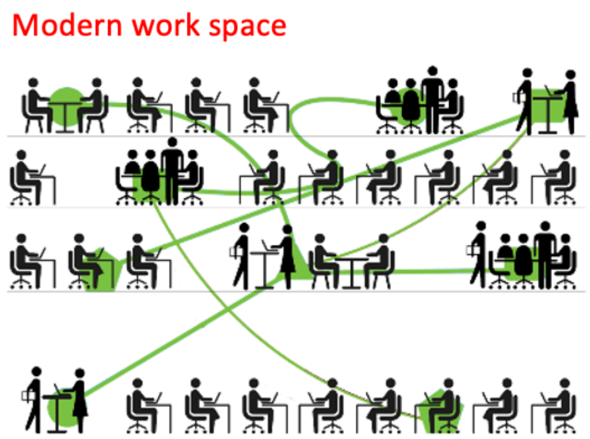
The pandemic served to encourage more businesses to adopt flexible working; and, for most of them, that’s here to stay. Almost half of respondents are “constantly re-evaluating” their space requirements. Workspace was traditionally an item that came up on board or partners’ agendas once a year perhaps, or just when a lease event was looming. Now it’s being discussed monthly.

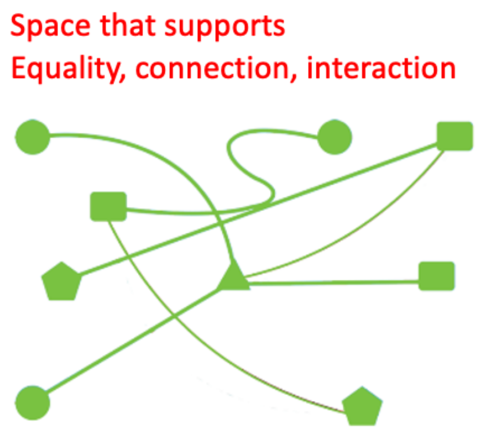
The office is seen as a dynamic feature of business planning: no longer a dead weight cost on a company’s finances but an investment in making a business more efficient as well as a better place to work. Fortunately, many landlords recognise this as an opportunity rather than a threat, and are prepared to offer shorter leases with break clauses because tenants are prepared to pay a premium: the higher rent achieved adds up to the same capital value.

3. The office is still a vital tool for companies to foster creativity, innovation, culture and careers

Not that many years ago, we'd design a building or floor for a specific sector – the way desks and working spaces were laid out for a legal practice for example, would look very different from a call centre or tech company. Now a typical hybrid floor space is 50% agile/collaborative space, 50% desks… and that can apply across sectors.

Top-down hierarchies have been largely replaced by flatter management structures, team and project working… and that's playing out in today's office lay-outs: more collaborative space, formal/informal meeting areas – coffee bars, high seat bars, quiet areas for people to think as well as the desks where people can get on working alone when they need to.

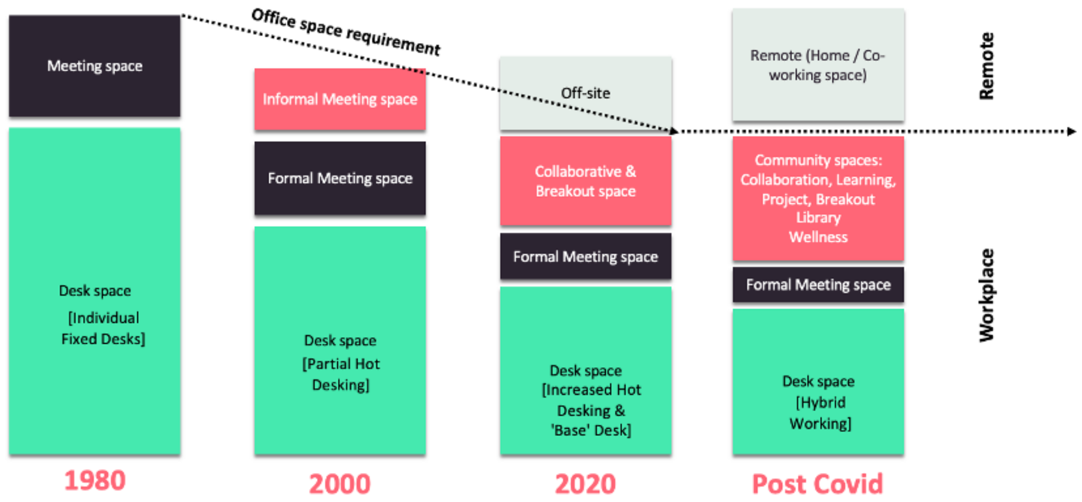




Moreover, the critical need for an office for maintaining company culture, morale and wellbeing came across loud and clear as the pandemic wore on… and younger employees in particular found it increasingly problematic to work remotely for large chunks of time without interaction with colleagues and the all-important mentorship that goes on within an organisation.

Just 27 per cent of our survey sample said remote working had had a positive impact on company culture, while 62 per cent were unsure or felt it had a negative impact. Some 47 per cent felt offices were "extremely important" for reflecting company culture and boosting staff morale. Further, 69 per cent of respondents said it was important to them that their workplace existed in an environment that promoted collaboration and knowledge-sharing across businesses.

The Changing Workplace



No business has an identical profile in terms of the demographic of its workforce and how best to meet the needs of its client/customer base, making it important for employers to examine closely what works best for them.

2 The rise and rise of ESG

In the survey, 54% of businesses said they had a defined ESG strategy: many potential occupiers are now actually asking for the “ESG policy” of buildings… which doesn't actually exist, as it is made up of so many different components.

ENVIRONMENTAL – impact on the planet

- Climate change
- Carbon footprint
- Resource depletion
- Water usage
- Waste & pollution

SOCIAL – contribution to communities

- Impact on local communities
- Employee relationships and diversity
- Wellbeing and mental health
- Working conditions including modern slavery and child labour

GOVERNANCE – corporate conduct

- Corporate Transparency
- Executive pay
- Bribery and corruption
- Board diversity and corporate structure
- Lobbying and donations
- Diversity and inclusion

Of course, we shouldn't forget that factors such as a building’s energy efficiency also impact a tenant’s bottom line... Energy Performance Certificate (EPC) ratings now are really key: some clients won’t view properties with less than an EPC B.

Over this decade, EPC ratings will be rising progressively: landlords will not be able to let a building with anything less than an EPC C by 1 April 2027 leading up to EPC B by 1 April 2030. Replacing the Air Conditioning, for instance, is a major undertaking: not only expensive but also noisy and disruptive for any occupiers remaining in that building.

5 Stepping up to safety… and convenience

The hybrid working model has also thrown up other issues around safe escape and the configuration of toilets in multi-storey, multi-let buildings.

Historically, buildings were let to accommodate a density of 1 person per 100 sq ft, with a margin (1 per 80 sq ft) allowed for the means of escape. Many occupiers are now taking advantage of hybrid working to reduce the space they take; but if more people than they allow for come into work on a given day, it could potentially overload the fire escape measures and the toilet provision – especially if the other tenants in the building operate to full occupancy levels.

6 Certification

As mentioned earlier, ESG continues to grow in importance for occupiers, and so the growing number of building environment certifications now available can help tick that box. Alongside EPC and BREEAM, certifications such as AirScore, NABERS, CycleScore, WiredScore, EUI (kWh/m2/yr) and so on demonstrate a commitment to various strands of ESG. They require an investment from the landlord, but they can make the decision-making process for an occupier that much easier.

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