Smart decisions. Lasting value.

Space Exploration

Rethinking real estate in the UK

Audit / Tax / Advisory / Risk

Contents

Click on a section to quickly view it

3 Foreword

8 At a glance findings

9 The overall picture

12 Investment flows: A flight to value

14 Rethink or think again: Barriers to repurposing

17 Space management: The active landlord

19 Sustainability in focus

21 Asset classes in focus: Retail

24 Asset classes in focus: Hotels

27 Asset classes in focus: Offices

29 Government support

31 Space exploration continues

33 Methodology

Foreword

As the lyric goes,

“You better start swimmin’ or you’ll sink like a stone, for the times they are a-changin’.”

Smart decision-makers know that adapting is the name of the game. Forces beyond their control require prudent response and reaction. In periods of significant change, such reactions are what set the truly successful apart.

Real estate is no different. The property world is all about lifecycles. It takes time to plan, commission, finance and construct a building of any description. Staying on top of trends that influence supply and demand is therefore paramount for the safeguarding of real estate assets and mitigation of investment risk.

It is for this reason that we have undertaken a forensic review of the changing ways space is being used – and what this means for everyone involved in the property lifecycle.

While most accept the mantra that change is the only constant, it is the sheer pace of change that has been most pronounced in recent years. No sector has been immune to this space revolution. The spaces used for commercial offices today are far different from those of yesteryear, as the factory floor rows-of-desks model for working life gave way to cubicles and open plan designs which in turn have been supplanted by flexible workspaces, hot-desking and collaboration zones.

1 In retail, residential, hotels and leisure spaces, similar stories continue to be told.

2 Retail spaces are no longer simple point-of-sale locations with stock lining shelves and 'pay here' signs directing customers to cashiers. Attracting footfall relies on providing an experience and establishing a connection between brand and consumer.

3 Housing requirements continue to shift, as the demand for home-working space and access to the great outdoors (either through bigger gardens, or more rural locations) increase, while other classes of social need housing emerge including senior living, co-living and multi-generational units.

4 Leisure, too, continues to evolve as the value of socialising and experiences outside of the home become more valuable in the wake of societal lockdowns.

5 Hotels suffered greatly during the international travel hiatus, but now perform as strongly as ever, enticing visitors with a renewed focus on value from the basic right through to the premium luxury end of the market.

6 Across the real estate industry, as ever space is king. And as the use of space is being reassessed – to ensure and improve efficiency and protect margins, as well as to respond to changing economic conditions and occupier desires – a repurposing revolution has begun.

Sustainability and net zero considerations are a key part of the zeitgeist and real estate retains a central role in meeting that challenge, in light of UN statistics that **40% of carbon emissions arise from the building and construction industry**, and international targets such as the European Commission seeking to reduce carbon emissions from buildings by 60% by 2030. With around a third of organisations starting to plan their Net Zero journey and a quarter having no plan in place, a lot is going to have to change in a short space of time over the next six years.

In response to all of the above, spaces within existing asset classes are being changed and improved, while movement is being seen between and among asset classes as owners and investors realise that, in light of the changes outlined, certain spaces must be utilised in different ways.

> To better understand the twists and turns of this revolution, Crowe gauged the opinions of key industry players, surveying owners, investors, brokers, managers, landlords and tenants from across the UK.

Alongside this insight, we spoke directly, and in detail, with a range of expert voices to garner insights into how key trends in space utilisation are playing out on the ground and, crucially, what the next frontier in space exploration looks like. Clear patterns emerge, as overall confidence in real estate assets continues to strengthen following a period of uncertainty.

Hospitality, Tourism and Leisure

Having proved remarkably resilient and adaptable through COVID-19, the hotel sector is increasingly favoured by UK real estate investors (as reflected in Crowe research set out in this report). With growth in demand expected to outstrip new supply in the coming years, the sector's fundamentals appear likely to remain strong.

Average UK Hotel Revenue per available room (RevPAR) rose 15% in 2023 and should increase further in 2024 supported by a healthy mix of growth in international arrivals and strengthening domestic leisure and corporate demand. We therefore anticipate a strong showing in the coming year despite concerns around the ongoing 'cost-of-living' crisis.

Supply growth is likely to continue (to the tune of some 24,000 rooms, or 3.5% of existing inventory, as of the start of 2024), albeit at a slower pace than the last two years given inflation in construction costs and interest rate levels. The relatively limited availability of new-build hotels means many investors will have their eye keenly trained on added value and change-of-use or conversion opportunities. As we will come to explore, popular conversions will include office-to-hotel and retail-to-hotel and alternatives (e.g. serviced apartments).

Transaction volumes picked up at the end of 2023 and in the initial weeks of 2024 - including the sale in London of two Hoxton Hotels to Archer Capital and 10 Radisson Edwardian hotels to Starwood Capital.

While we expect high deal levels through the full year, this is likely to remain well below typical pre-COVID-19 volumes.

In the meantime, brand groups continue to expand and upgrade their portfolios, prioritising revenue and space maximisation with a focus on controlling operational efficiency (around labour and energy), satisfying evolving consumer expectations and ESG requirements.

One trend to watch is the rapid growth in demand for accommodation around events and experiences, which have the potential to help underwrite new hotel developments across all sectors from economy to luxury.

While the overall picture is positive for UK hospitality, tourism and leisure, the sector is not immune to the broader challenges explored in this report. Investors must plan carefully to ensure their assets can remain profitable and retain value despite rising costs and a tightening regulatory landscape.

Malcolm Kerr →
Managing Director
Horwath HTL UK

Retail

The uncertainty facing the retail sector is news to nobody, at this stage, and we must be frank in acknowledging that there is more pain to come. As with any economic cycle, there will be those that are unable to pull through, as retail spend remains constricted.

The festive season did not provide much respite, as the cost-of-living crisis, energy bills, and mortgage hikes conspired to dampen consumer appetite. January 2024 footfall data shows no sign of a consumer rebound, with tough conditions lingering for the time being.

Added to this, global supply chain issues and geopolitical unrest have worsened the oil crisis, with container rates fluctuating wildly. Retailers of all shapes and sizes are grappling with the consequences. Further product inflation is still to come and price increases are reinforcing cost-conscious consumer habits.

And yet despite the gloom, clear trends have emerged throughout this period of uncertainty, with implications for 2024 and beyond. In the face of consumer appetite trends, creative solutions continue to be required for retailers to survive – and thrive. This is being seen in strategic changes to store portfolios in terms of number, size and layout, while some retail spaces are inevitably being targeted for repurposing, as the figures in this report indicate.

Investment in ecommerce platforms and digital strategies continue apace, but the success of many in luring footfall via in-store experience is a strong argument for continued commitment to the physical store – even if its purpose is evolving. Tied to this, owners and investors are keen to hear how tenants plan to harness the power of technology and innovation in integrating physical and digital spaces. At the same time, retailers must wrap their head around the inherent tension created by measures to counter rising theft, which detract from their shopper experience goals.

But as choppy waters remain ahead, investors will remain alive to portfolio diversification opportunities, as retail site locations and layouts lend themselves to repurposing to serve more buoyant sectors such as hospitality. This conversion will be an attractive proposition for some owners of retail space, as recent M&A activity shows.

If we are outlining a wishlist for the coming months, a key aspiration is for flexibility around leases and a greater ability to move in and out of premises. This would give the sector some much-needed breathing room but, pragmatically speaking, is a tough ask for landlords considering the need to focus on asset value. A healthy mix of realism, creativity and adaptability is required across the sector this year.

Jeremy Cooper →
Head of Retail
Crowe UK

Real Estate

Different asset classes face different challenges and outlooks, as we outline. But some truths are universally acknowledged and regulatory red tape hampering the ability of asset owners to execute strategic plans in timely fashion is a persistent complaint.

Another ‘persistent’ is inflation which, along with high interest rates and market volatility, has contributed to a negative economic backdrop and a knock-on impact for asset values. But hope springs eternal and inflation has begun to be brought under control, falling significantly at the back end of 2023 after reaching record highs in the preceding months. We expect this to fall further, eventually bringing calmer conditions for all.

In the meantime, our research and interviews point to premium assets being the best protected across all asset classes, with key hallmarks being quality and sustainability. Green credentials will continue to become more deeply embedded in the year ahead and will soon shift from a point of difference to a necessity. Assets with strong energy efficiency ratings will remain popular and repurposing and renovations will focus on improving these aspects with a view to bolstering asset value.

Looking ahead, major political and fiscal events including the UK election will be watched closely, particularly if pre-election discussions around removing or (more realistically) reducing red tape come to fruition.

What we really need in the coming months is for the talking to end and action to match rhetoric. Planning constraints being eased, or local authorities fast-tracking processes, is a major case in point.

Caroline Fleet →
Head of Real Estate
Crowe UK

At a glance findings

Figure 1:

85% Seeking to improve the quality of assets within an existing class.

31% Divesting away from retail.

82% Enhancing assets via renovation and upgrade.

45% Seeking sustainability improvements.

77% Say planning and regulation is the biggest barrier to repurposing.

85% Want planning restrictions reduced.

65% Transforming portfolios due to operating costs and taxation.

32% Say funding is the biggest challenge for net zero improvements.

The overall picture

Recent years have seen seismic economic shocks to the UK economy, which have not only temporarily altered the spending habits of individuals and organisations, but also precipitated permanent shifts in societal attitudes. In the wake of these system shocks, the real estate industry is actively reassessing the role of space and place in the new world order.

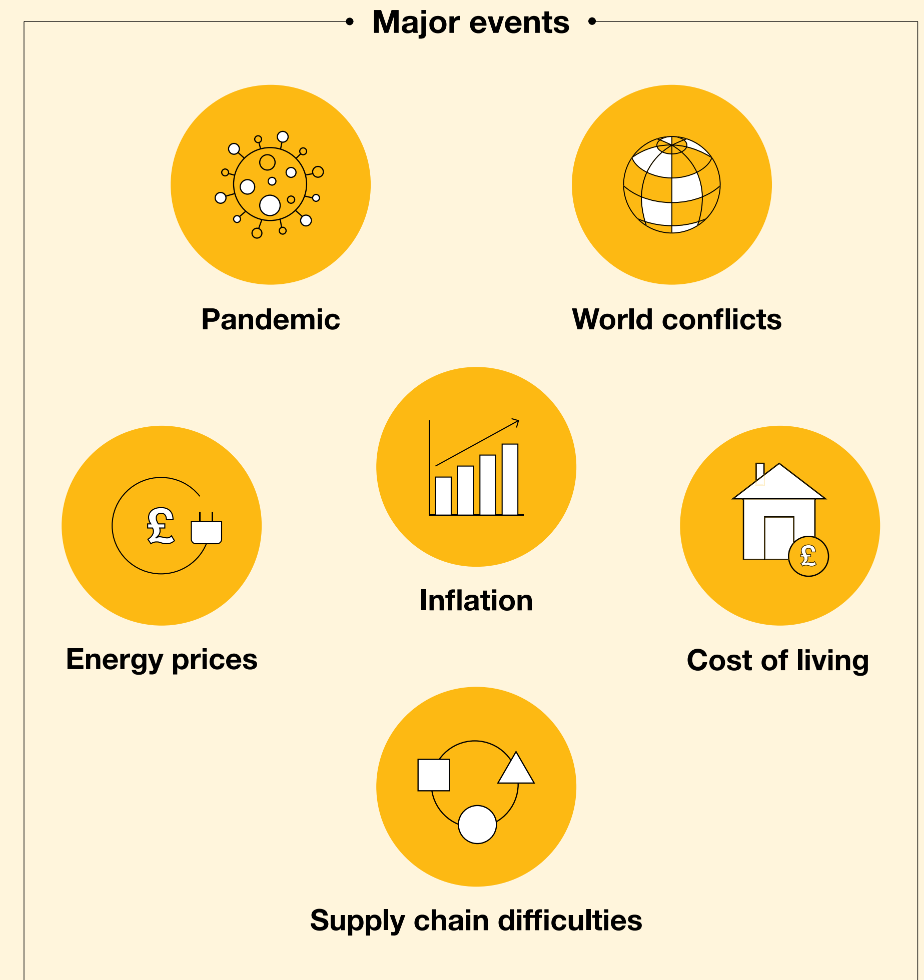
Any major event (let alone the combination of a global pandemic, conflict in Ukraine, a national cost-of-living crisis, energy price volatility, supply chain difficulties and record inflation) has repercussions which cause investors and asset owners to pause for thought and consider their reaction.

But real estate has shown its resilience and the stabilising of commercial, retail, hospitality and leisure assets in the wake of these shocks has been surprisingly smooth and swift.

"Many asset classes are benefiting from a strong rebound – but the recovery for hotels with a leisure component was a lot stronger than expected," says Luc Boschmans, Managing Director at Tristan Capital.

> Despite this optimism, the space race is in full flow across all asset classes. Space and place are constantly evolving. As society changes, the way people interact with the spaces they live, work and socialise in must adapt accordingly.

For property owners, investors, managers and landlords, this creates a continuous cycle of challenge and opportunity. These groups must assess and adapt their use of space to maintain their value to tenants and users with ever-changing needs and demands.

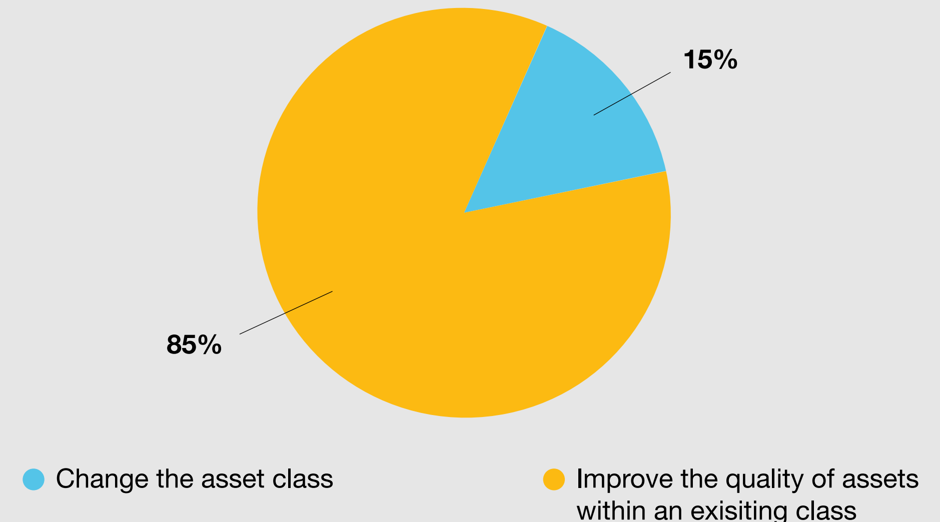


"We live in the most competitive environment there has ever been. There is a competition of space. If you don't maximise your price per square metre, you will be squeezed out or repurposed," says Philipp Rohweder, Director Real Estate at NUMA Group, Europe's leading operator of a fully digitalised hospitality platform.

Some strategy changes are more drastic than others, with a small portion of owners and investors seeking to change asset class completely, while a majority (85%) are seeking to improve the quality of their assets (within an asset class they already operate in).

> "There is a competition of space. If you don't maximise your price per square metre, you will be squeezed out or repurposed."
>
> – Philipp Rohweder, Director Real Estate at NUMA Group

Figure 2: **Rethinking real estate**



This rethinking of portfolios is driven by a number of asset enhancement strategies, from making renovations and upgrades (listed by 82% of respondents), to acquiring new assets entirely (listed by 50%) and making sustainability improvements (a driving force for 45%).

Many of these drivers are related to the changing wants and needs of tenants. More than a third of investors, owners and landlords (38%) cite changing tenant demands as a driver for portfolio transformation, though this is outweighed by rising costs and taxation (65%) and the broader economic climate (81%) as the key reasons prompting a rethink.

Figure 3:

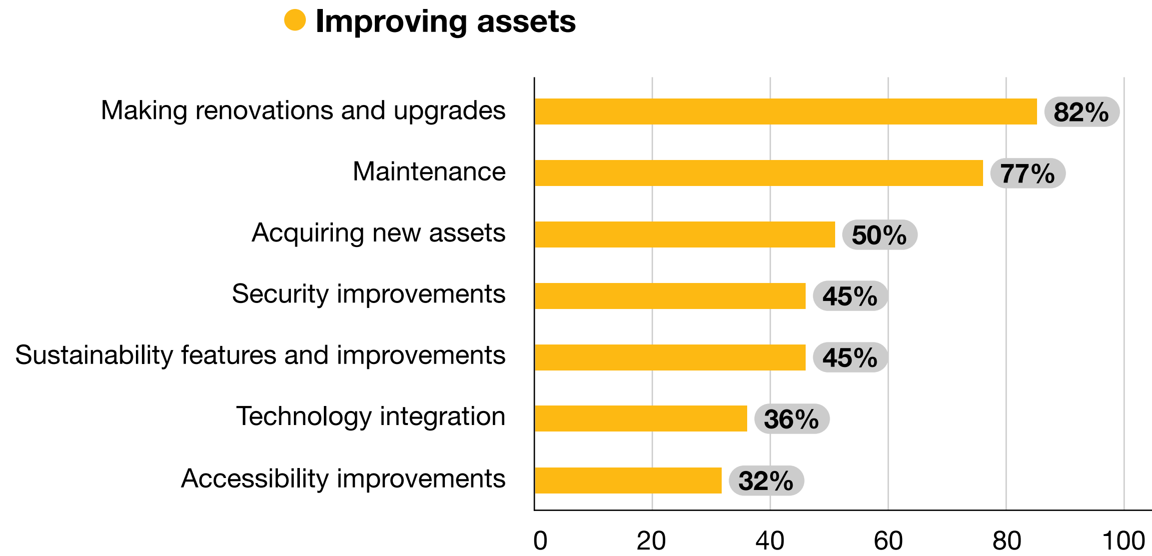
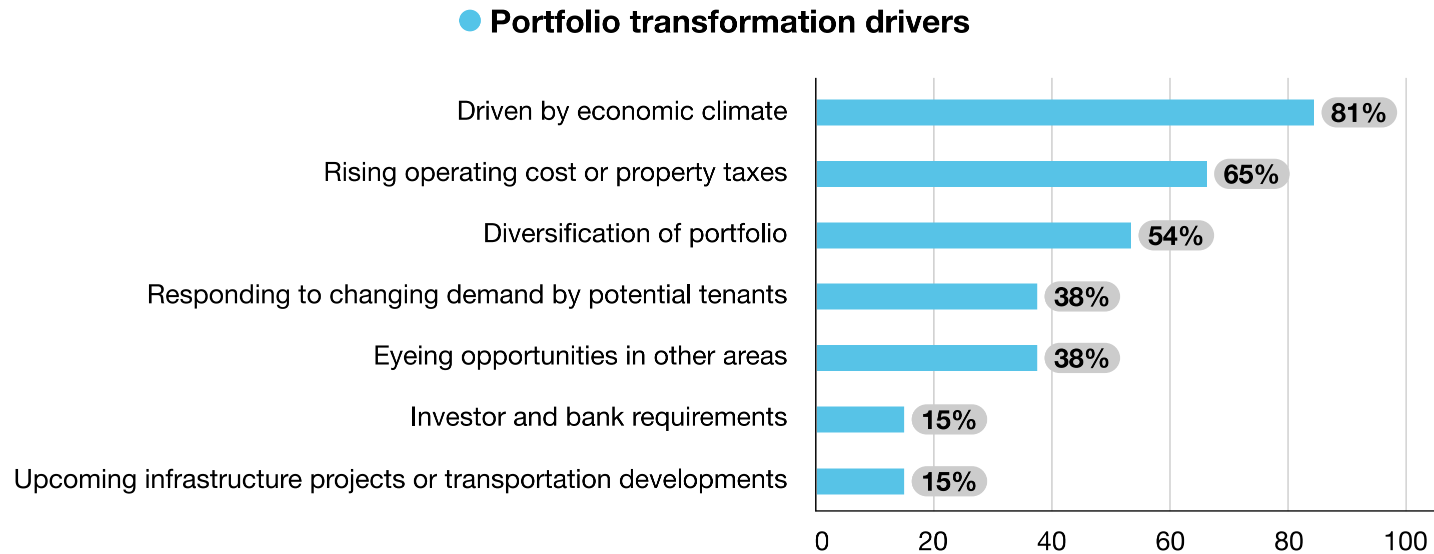


Figure 4:



Investment flows: A flight to value

When it comes to portfolio reassessment, it is interesting to see where the money flows look to be heading. Given ongoing High Street struggles, it is unsurprising that Retail is the main asset class being divested away from (62% of respondents identify it among the top three in this regard) and the asset class with the fewest number of real estate owners considering pivoting towards.

Over the past five years, 6,000 retail outlets have closed, according to the British Retail Consortium and Local Data Company, who cite COVID-19 and the crippling business rates regime as the two main drivers of store closures.

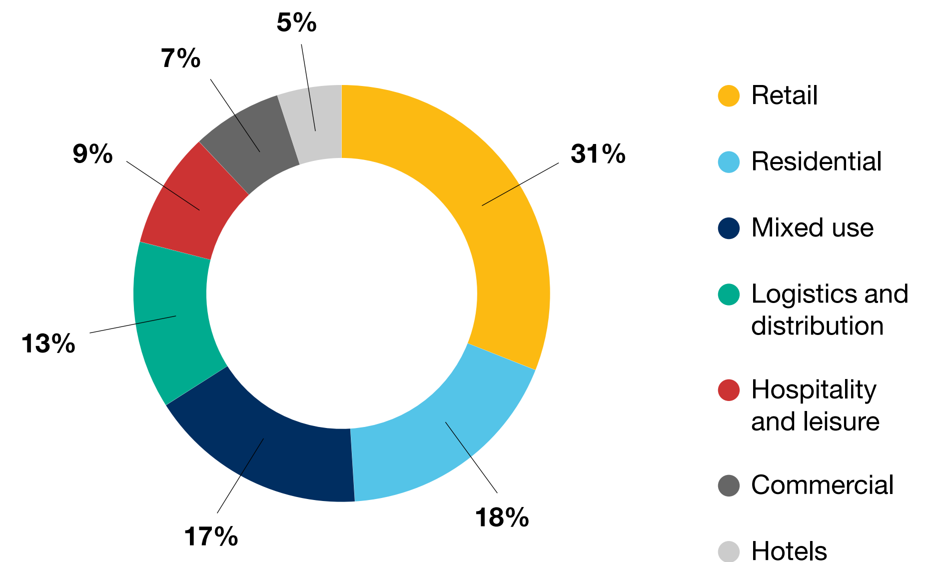
Conversely, responses were relatively evenly split in identifying the most popular asset classes that are attracting additional investment, reinforcing both the appetite for balanced portfolio diversification and the overall resilience of real estate assets across the board.

As far as investors are concerned, choppy economic waters typically prompt a flight to quality. Or, more accurately, a flight to value. This is clearly the case in real estate, where value is the keyword for investors, tenants and users feeling a squeeze on their pockets and for investors (debt and equity) needing to make a strong case for deploying capital.

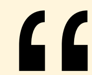
"The world is being divided into Ryanair and Emirates. You provide the very best product, service or experience – or you provide the best value proposition." says Rohweder.

In this pursuit of value maximisation, one thing is clear: the focus on rethinking space has never been sharper.

Figure 5: **Asset classes falling out of favour**



Respondents were asked which asset classes are primarily being divested from.



The world is being divided into Ryanair and Emirates. You provide the very best product, service or experience – or you provide the best value proposition.

– Philipp Rohweder, Director Real Estate at NUMA Group

Rethink or think again: Barriers to repurposing

Turning repurposing plans into reality is not always straightforward, of course. Some challenges – like planning permission – are perennial problems. Others – such as the need to satisfy ESG standards (both regulatory and tenant-driven) – are more recent phenomena but must be afforded significant weight in decision-making nonetheless.

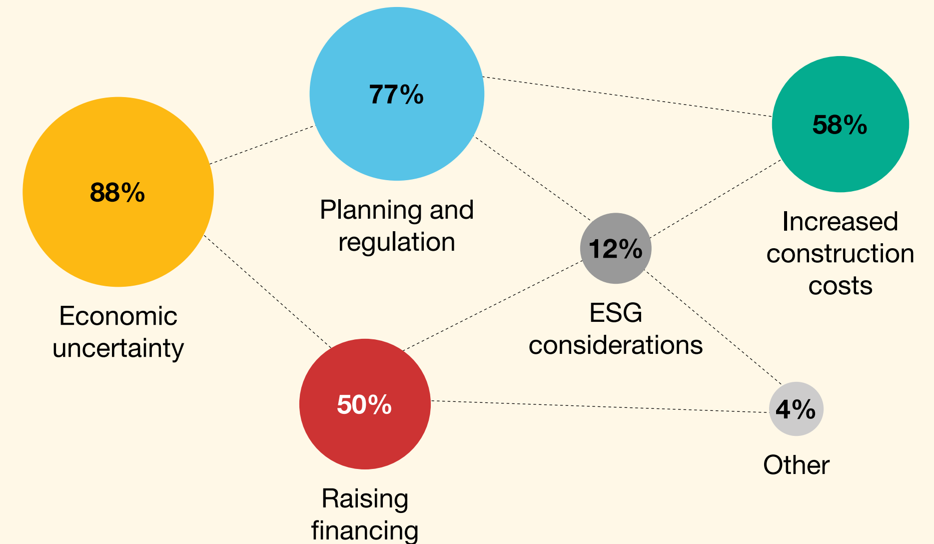
When asked to identify the major barriers to repurposing, responses unequivocally identified two major issues. More than three quarters (77%) listed planning and regulation, while an even bigger majority (88%) pointed to economic uncertainty.

> Uncertainty is the enemy of sound planning, as decision-makers grapple with fluid foundations on which they must try to build structures for success. A cocktail of economic woe is therefore the primary concern for those looking to repurpose, though planning ranks not far behind and is more tangible in terms of the challenge it presents.

"In reimagining spaces, planning is a major obstacle," says Rachel Keighley, Director at Cheltine, a fifth generation family-run estate office.

Always a hurdle to be cleared, even greater bounding skills have become necessary since the pandemic, our data shows.

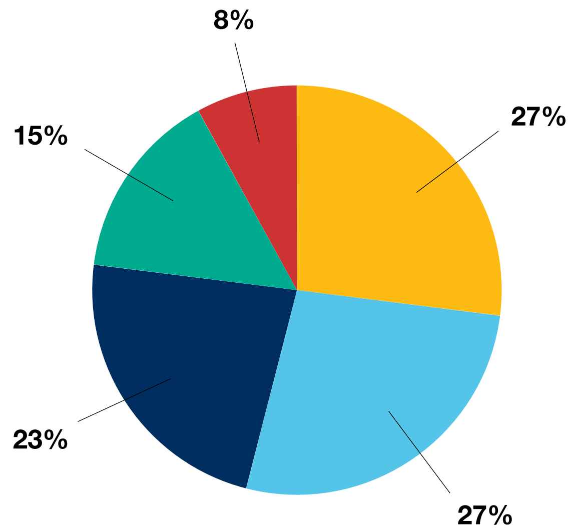
Figure 7: **Barriers and challenges to repurposing**



Two-thirds (65%) believe planning permission post COVID-19 is taking longer, particularly for larger schemes, with less than half that figure saying it takes the same time as before.

"The hurdles of planning are difficult and cumbersome, with delays very common. Lots of our buildings are listed which makes it even more difficult. The process is totally hamstrung by the conservation and planning piece. It can take years," says Keighley.

Figure 8: **Has COVID-19 impacted planning permission?**



- Yes, unless the scheme relates to a retrofitting of an existing building
- About the same time
- Yes, longer for all schemes by at least 6 months
- Yes, but only longer for larger schemes by at least 6 months
- No, taking less time and getting quicker

Breaking down those that believe it takes longer, just under half say it is longer for schemes of all sizes, unless the scheme is retrofitting an existing building. So, while it remains an ever-present challenge, adding to existing spaces, rather than tearing down buildings and starting from scratch, may provide a less burdensome route through planning administration.

Knowing how to approach and interact with relevant authorities, gauging the appetite for zoning changes and finding compelling reasons for conversion are all vital.

“Local authorities may or may not be open to convert, depending on the area and situation. But if you have an empty office building in a good location, there is a clearer case for a hotel operator to occupy it. For example, implementing food and beverage units on the ground floor will often benefit the community. It’s about making the pieces of the jigsaw fit together,” says Boschmans.

Aligning development or repurposing plans with community-building objectives is a shortcut to success. Local authority goals cannot be ignored. “Local authorities have a heavy influence and have a mandate to prioritise social value,” says Andrew Dixon, Founder at Rosemarch, financial management and turnaround specialists.

Planning aside, the other barrier, heavily linked to the economic context within which we currently operate, is soaring costs. Supply chain difficulties and energy price rises have been brought on or exacerbated by conflict in Ukraine, and the knock-on impact for schemes has been drastic.

“The past year or two, cost inflation has been so high that many projects were not viable because they wouldn’t be worth as much as they cost to build,” says Sutanu Samanta, Director at Moxa Hospitality & Leisure, providing financial management services to owners and investors.

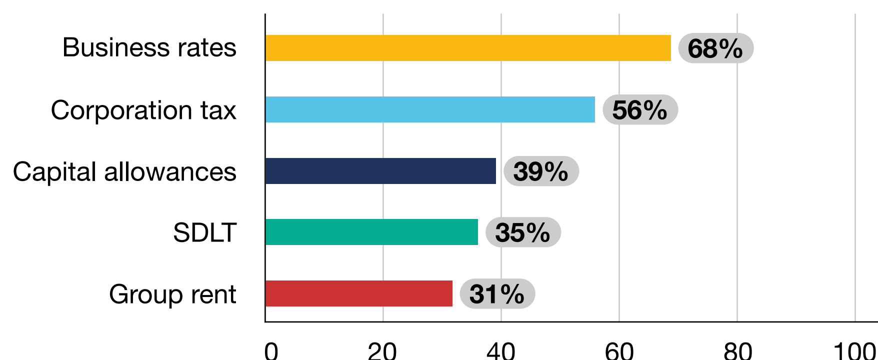
Increased construction costs were referenced by 58% of respondents as a barrier to executing repurposing plans, with interest rates further complicating the picture.

"Interest rates are problematic for developers because the cost of borrowing to develop sites has changed massively. Build costs have also doubled. Commercial viability may be prohibitive, even if you have the idea, the community demand and get through planning in reasonable time," says Keighley.

Turning to tax and financing considerations, business rates remain a topic of contention. When making decisions around the use of space, 68% identify rates as a primary issue, followed by 56% pointing to corporation tax, 39% to capital allowances, 35% to Stamp Duty Land Tax (SDLT) and 31% ground rent.

There is clearly an ongoing need for business rates reform, considering how ratings currently operate out of sync with the property lifecycle.

Figure 9: **Tax and financing considerations**



> The hurdles of planning are difficult and cumbersome, with delays very common.
>
> Rachel Keighley, Director, Cheltine

While business rates apply for most non-domestic properties, there is a particularly tangible link between business rates policy and the health of the high street.

At a time of retail struggling more than most asset classes, the situation is compounded by the risk for landlords that they find themselves with empty properties but with rates still needing to be paid.

This has prompted a number of retailers to call for relief from the coming tax multiplier rate rise which according to Colliers could see £400 million added to retailers' cost base. Freezing the rise is a much-needed short-term step, while broader reform – perhaps rebasing the multiplier – must be the long-term goal.

Space management: The active landlord

Unpacking the dynamic between landlords and tenants serves as an insightful window into the broader state of the real estate market. Our research into lease negotiations, changing tenant demands and expectations all point to the increasingly active role that landlords are having to play, across all asset classes.

Tenants are resoundingly seeking greater protections (cited by 81% of respondents), which reflects a trend that regardless of lease length, what is crucial is greater flexibility – such as break clauses or, for retailers, performance-linked measures – to acknowledge the potential for economic and market undulations.

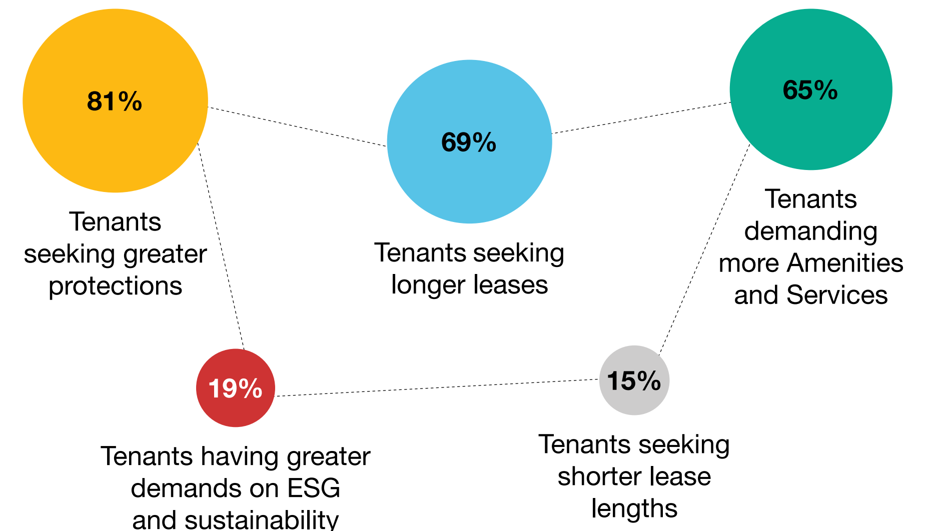
Support for tenants

Rent-free initiatives are among the measures that could be taken to assist tenants battling through difficult periods. Rent waiver schemes have been mooted for Oxford Street, following successful use in Poole, Dorset where Legal & General Investment Management implemented a two-year rent holiday (and zero business rates) to revive Kingland Crescent. A public-private partnership between Westminster City Council and the New West End Company seeks to replicate this for London's flagship shopping street and could be a useful tool in attracting businesses and preventing vacant units. Its progress will be keenly watched, particularly as 45% of our respondents listed rent-free periods as a top three factor that tenants assign greatest weight to.

A recent high-profile example of why lease negotiations may be changing along such lines includes Meta, which has paid British Land £149 million to break its lease on 1 Triton Square, having let the space in 2021 for an 18-year term.

Specific tenant demands vary but include straightforward financials such as headline rent and service charges, alongside contributions to fit-out costs, flexible terms and the inclusion of break clauses (with some also seeking capital contribution towards fitout costs).

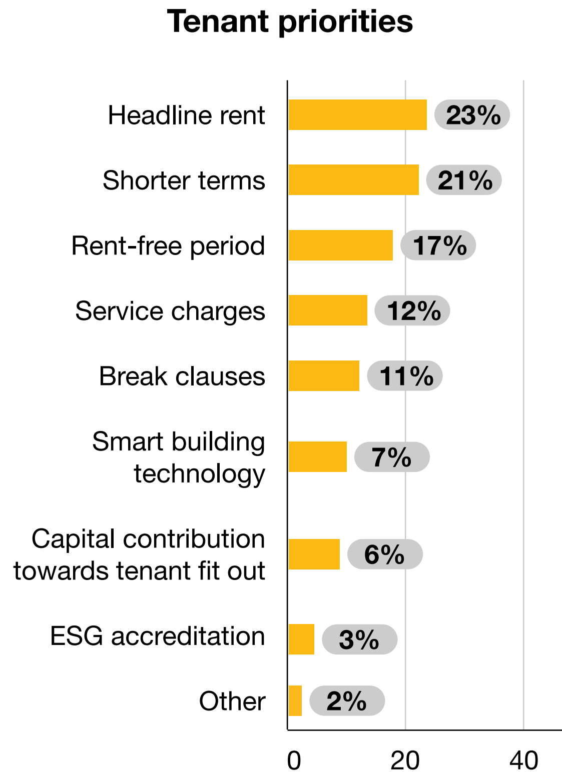
Figure 10: **Lease trends - tenant demands**



In response to changing demands, 73% of industry participants observe landlords offering incentives (such as the flexible leases alluded to, geared rents or alternative financial outlay support) to attract or retain tenants.

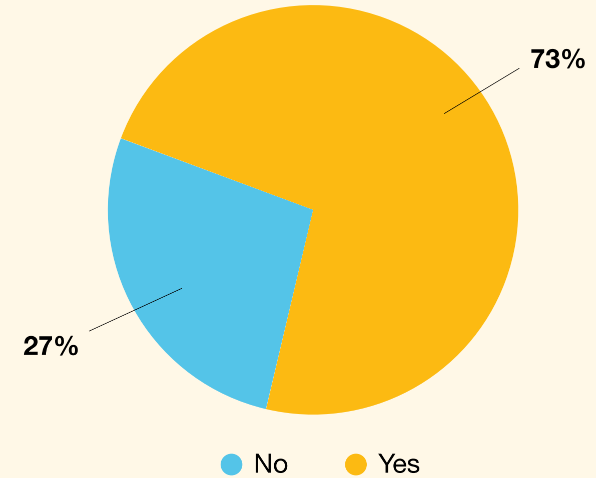
“We are now starting to receive more offers for capital incentives for shop fits than we have seen for a while,” says Christian Cook, Global Treasurer at Build-a-Bear.

Figure 11: **Tenant priorities**



Respondents were asked which factors tenants consider most when choosing properties.

Figure 12: **Landlords attracting tenants via new incentives**



“Some shopping centres or high streets have high vacancy levels so are prepared to offer better incentives – rent-free, capital contribution, turnover rent leases, shorter terms, break options – whereas other locations are refusing to vary terms too much,” he adds.

When it comes to lease discussion changes, it is again clear that landlords are doing what they can to meet tenant expectations. Alongside greater incentives and flexibility around lease length and payment terms, 86% say landlords are expected to provide better property maintenance, and 59% say landlords are expected to provide more amenities or better services.

Sustainability continues to come into focus

ESG accreditations feature lower down the list of tenant priorities but are still rising in prominence, with 19% saying tenants are increasing ESG and sustainability demands. However, it remains a nice-to-have rather than must-have, with only 10% listing it as a top three factor they assign greatest weight to when entering into negotiations with prospective landlords. Anecdotally, the topic is having an impact on tenant relocation decisions, and this mirrors prevailing views around the most sought-after commercial spaces, where green buildings are driving demand.

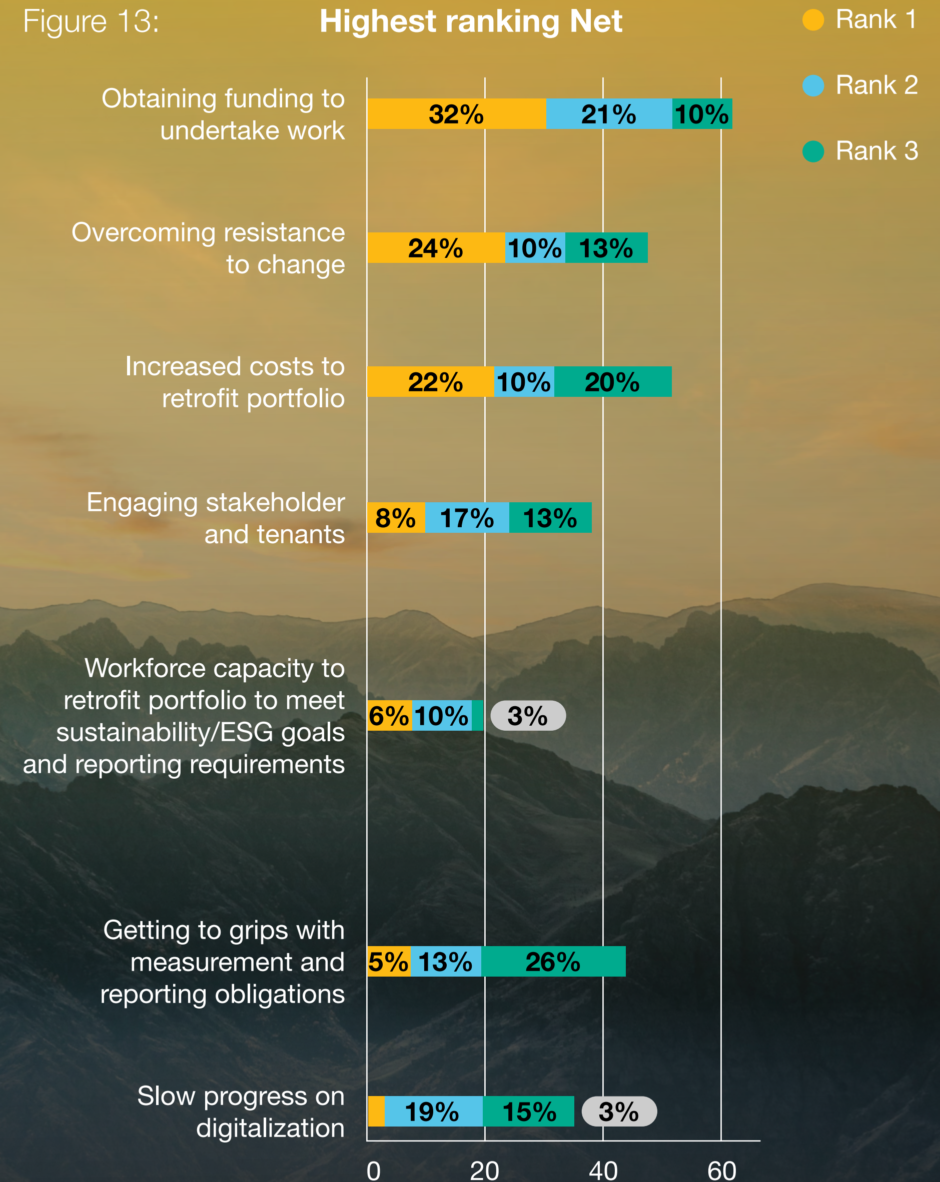
“Many tenants seeking to relocate list sustainability as a key factor for moving,” says Keighley. But the ESG conversation is two-way, with landlord requirements also rising, according to 29% of our respondents.

“Landlords have begun raising it as part of lease discussions in the last 12 months,” says Cook.

“There are more and more pandemic clauses included in leases as well as HMAs, along with ‘green/ESG’ clauses – for example around what the tenant has to do for the owner to measure (and reduce) energy consumption,” adds Boschmans.

> The interplay between rethinking space and ESG cannot be overlooked. Carbon concerns and Net Zero targets are likely to drive a wave of potential redevelopments around the country, particularly in towns and cities whose buildings largely date back to the Victorian era.

Figure 13: **Highest ranking Net**



Respondents were asked to rank the top three challenges for landlords & building owners when meeting Net Zero goals.

In this continued drive to meet Net Zero goals, there are a mix of challenges to be overcome. Culture and administrative reasoning feature, though not as dominantly as financial concerns. Overcoming resistance to change was identified as a top three challenge by 47%, with getting to grips with measurement and reporting obligations a top three concern for 44%. Ranking above these were bottom-line considerations – 63% cited obtaining funding to undertake work as a top three barrier for landlords and property owners, with the increased costs of sustainable retrofitting highlighted by 52%.

Despite barriers, environmental concerns relating to real estate are not going away. Certain government commitments have been watered down or suffered from political back-pedalling, but formalisation of rules and regulations will nevertheless continue in the UK and internationally. At the same time, tax incentives such as R&D credits should not be overlooked by those unsure how to progress their Net Zero plans.

"The E of ESG is on everyone's agenda, driven by regulation, debt markets, and demand-side. From the development side, the investor and financing side, and from the consumer side, the pressures are obvious," says Rohweder.

For consumers – tenants, hospitality and leisure site users – transparency on these issues is slowly improving. Booking.com and others have introduced green ratings so consumers can make more informed decisions.

"It can be tricky to assess if a building is more sustainable or less sustainable," says Rohweder, who argues a top-down approach is the most impactful, led by institutional investors and lenders.

"When supermarkets gave free plastic bags, consumers acted via convenience. Once the government mandated paying for bags, behaviours changed."

> "Many tenants seeking moves to relocate list sustainability as a key factor for moving."

Rachel Keighley, Director, Cheltine

Asset classes in focus: Retail

Stark statistics around the health of UK retail cannot be ignored. The retail sector has accounted for 16% of UK administrations in 2023, according to law firm Shakespeare Martineau, while Nexus Planning reports that more than half of the UK's department stores have closed since 2015. Previously, the department store had been a focal point for town centres but the closure of names like Debenhams across the country was a clear sign of the model's demise.

Such sites, however, provide ample opportunity for redevelopment or repurposing – both between asset classes and within retail.

In the retail sector, the process of adapting is by no means a new phenomenon. Various trends come and go – think out-of-town retail parks, or the continuing shift to cater to the explosion of ecommerce since the internet became a mainstream tool for consumers. But while the press has long foretold (somewhat prematurely, despite various high-profile insolvencies) the 'death of the high street', recent years in particular have presented an existential requirement for change.

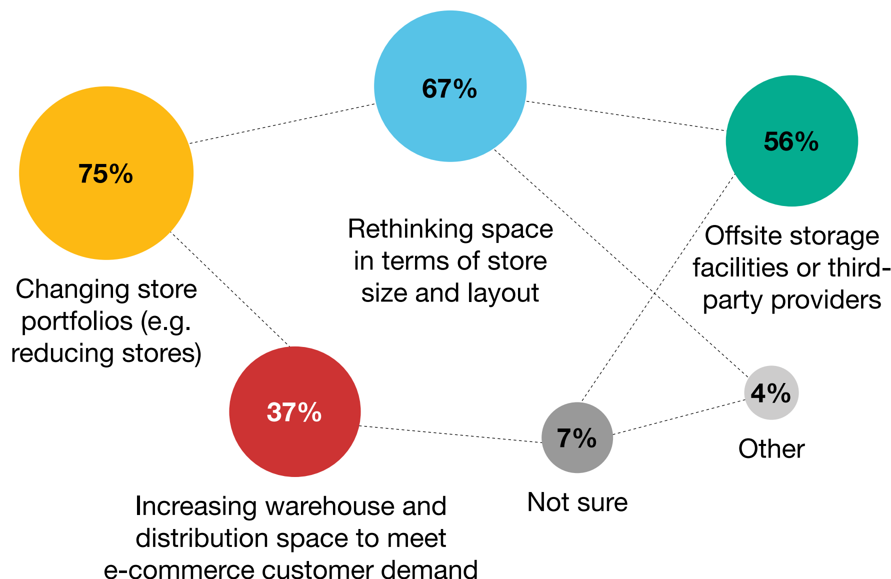
"COVID-19 came along and compressed five years of change into five months, accelerating the path retail was already on," says Keighley.

The reaction of retailers has been varied. Some are doubling down on their existing proposition while others have fervently explored new avenues. All options should be on the table.

"Retail owners need to be open and creative about what to do with their sites and space," says Keighley, who gives the example of transitioning from retail being the lead on a site to placing greater emphasis on previously unused spaces, such as converting floors above a shopfront for residential use.

Our data reinforces the fact that retail square footage is not being used in the same way as it was previously.

Figure 14: **How retailers are adapting**



Three quarters (75%) see retailers changing their store portfolios (reducing their number of stores) while a similar proportion (67%) observe a rethinking of store size and layout.

With retailers looking to reduce store space and adjust layouts for optimal efficiency, bigger sites in particular are being reconfigured, either by fitting more tenants into the same space, or catering to new leisure trends.

"Big anchor tenant stores can be broken into smaller units. Conversion to leisure boxes is popular, thanksto the rise of competitive socialising – think axe-throwing, darts, trampolining, golf sites," says Dixon.

As with other asset classes, not all sites are born equal and some are more resistant to the winds of change than others. Even these sites, however, are having to change their offering.

High profile brands are still occupying premium retail sites, but many are more like marketing fronts than point-of-sale locations.

Considering the drop in disposable income that has dampened retail results thanks to inflation and interest rate rises, resulting in cost-of-living pressures and higher mortgage costs, brand resonance is an increasingly important force of attraction. Getting people through the door repeatedly requires a stronger sense of connection between buyer and seller, consumer and producer.

"The most successful retail streets in the world have become marketing suites. Look at the difference between Oxford Street and Regent Street. Value creation has less to do with

> COVID-19 came along and compressed five years of change into five months, accelerating the path retail was already on.

Rachel Keighley, Director, Cheltine

what's being sold; it's about the experience and representing what the company stands for," says Rohweder

Other adaptations include seeking offsite storage facilities (56%) and increasing existing warehouse and distribution space (37%) to cater to ecommerce customer demand.

"As demand for retail space fell off a cliff [in COVID-19], we looked at logistics, food distribution, because footfall and tenant demand were waning," says Keighley.

That being said, there are reasons to be bullish despite the challenges faced.

> Many organisations are looking at repurposing space, but the physical store remains an important piece of the retail jigsaw.

Businesses like Build-a-Bear are committed to bricks-and-mortar as a key part of their growth plans, enabling enhanced customer experience through a more interactive and engaging on-site offering.

"We still see physical stores as essential to our future," says Cook.

There is also a societal challenge for retailers centred on security, which must not continue to go unchecked. Shoplifting and organised crime present a very real threat to retail and its impact on financial wellbeing, staff wellbeing and national attitudes towards retail as a cultural past-time is having repercussions. If stock is being stolen, employees do not feel safe to come to work, and shoppers are deterred from visiting stores, more and more will close down.

Vacant units serve no social or economic purpose and, more broadly, traditional shops and stores must retain their role in community-building and placemaking in urban environments.

"High streets are the heartbeat of the town. It's important for society, for community and for the wider economy that these buildings are used," says Keighley.

Asset classes in focus: Hotels

Hotels, tourism and leisure are showing investors enormous upside. Greater control of variable, rather than fixed, income is proving a valuable tool in owners and landlords remaining responsive to changing economic trends.

This is borne out in our data, where hospitality and leisure score lowest among asset classes being divested away from (5%) and high as an asset class seeing growing investor interest.

Tristan Capital is a case in point. The investment manager was previously focused on traditional asset classes but has since diversified its focus to include living sectors and operational assets.

It now has an active Europe-wide strategy to invest funds in other asset classes such as hotels and has executed three hotel transactions with a combined value of over €700 million in the past two years. It has also raised a new value add fund with €2 billion in equity including a considerable amount that will be invested in hotels.

"Hotels and leisure are doing well. Occupancy rates are almost at 2019 levels, while average room rates are quite a bit higher. The advantage hotels hold is that room rates – 'rent' for other asset classes – can be changed on a daily basis, resulting in a solid inflation hedge. Adaptable pricing allows for careful management of the bottom line," says Boschmans.

Indeed, hotels and hospitality can be a more challenging asset class, given the number of moving parts, but bring additional flexibility both in terms of room rates and use of space within an overall unit.

"For commercial, it can be quite simplistic. You have a box, find an occupier and charge rent. With hotels, there is more scope to change or add facilities, upscale or downscale," says Samanta.

Recent financial figures from leading groups show numbers backing up the anecdotal evidence of a strong rebound for hotels. InterContinental Hotels Group posted $459 million profit for H1 2023, up 112.5% from the prior year period, with total revenue growing 24.1% year-on-year.

London's high-end hotel scene is particularly buoyant when it comes to investor attention and appetite. Raffles at the OWO, The Peninsula and The Emory (both in Hyde Park), The Mandarin Oriental in Mayfair, Six Senses and a Rosewood (conversion of the former US Embassy in Grosvenor Square) all recently launched or are well underway, many of them billion pound-plus schemes.

This wave of super-luxury hospitality in big cities reinforces the polarising of the hotels market. The mantra is very much 'low-cost or lavish'.

"In our investment model, we would rather not be in the middle – we prefer to look at hotels with a lean business model or upscale hotels," says Boschmans.

IHG's interim results also revealed that it is set to launch a new brand (Garner) targeting midscale conversion, which it labelled "a major growth opportunity" – highlighting how established brands are seeking to take a fresh look at the mid-market given the potential challenges foreseen there.

> "Hotels were historically guilty of wasting space, with huge reception areas generating no income. Now wising up to this with a greater focus on yield and yield management," says Samanta.

At the innovative end of the scale, new solutions to operational challenges are finding traction. NUMA Group offers a model that straddles hotel and short-term rentals and has just raised $59 million in Series C funding to expand across Europe.

> "Across all classes, hospitality is special because value is driven by operators creating it on-site."

Rachel Keighley, Director, Cheltine

"At NUMA, we embarked on a mission to provide an institutionalised product between traditional hotels and AirBnB." explains Rohweder.

Elsewhere, new product types are beginning to emerge.

"There is huge opportunity between the top end of the hostel market and the bottom end of the hotels market. Capsule rooms are a solution and open-plan offices are a good conversion model," says Samanta.

Along all points of the hospitality spectrum, the keyword is 'value'. Under inflationary and other pressures, hospitality providers must make a strong case that their offer answers the visitor's question of 'am I receiving the right value and experience for money?' while simultaneously ensuring a satisfactory profit margin is maintained. That could mean providing a competitive price point with 'no frills' or pushing the boundaries of extravagance to major on service or experience provision.

Leisure-related travel is a big part of the hotels rebound, but corporate travel – another area which dramatically reduced during the pandemic – is also part of the equation. While hybrid working means that corporate travellers may not be travelling quite so frequently, we are seeing a move towards 'bleisure' visits, which see workers travelling for longer stays that incorporate both business and personal time.

"That is definitely something we see. If you build a hotel these days, you need to have these travellers in mind. A co-working space is essential, sometimes going beyond that with flexible spaces that can be used for meetings, private events, or even as offices-for-a-day," says Boschmans.

Even before COVID-19 restricted both business and leisure visitors, corporate travel was changing thanks to organisations giving greater scrutiny to their carbon footprints. Changing working patterns are now also firmly in play, with online calls largely replacing physical meetings, but the increase in bleisure travel goes some way to offsetting the reduction in corporate travellers and space for hosting business gatherings or private events remains a viable stream of income for hotel owners and managers.

Asset classes in focus: Offices

Commercial office space is another increasingly polarised market, where – at one end – the flight to quality (and sustainability) is clear to see in soaring demand for super prime spaces and upward pressure on prime rents.

Tenants continue to require less space, but are still working with previous budgets, so are increasingly looking at providing a more premium experience for their employees, to address the constant fight for human capital.

“This will wear off over time, though, as readjustments are made,” warns Rohweder.

In the meantime, there is a healthy demand for premium sites.

“High quality is not an issue, but secondary office space is set for a difficult time as the gulf in stock continues to widen,” says Dixon.

This difficult time is of course underpinned by the permanent shift to remote or hybrid working for a majority of employers.

CBRE research indicates that approximately 2.2 million sq ft of secondary office space in central London has traded or is under offer for alternative uses since January 2022, equating to £2 billion in investment. CBRE cites examples of offices being repurposed for life sciences laboratories, hotels and serviced apartments, and student accommodation.

But the death knell is far from ringing.

"With offices used less extensively, we need to rethink what the function of office space is. There is still a bright and clear future for offices but it looks different," says Bas Wilberts, Director at Savills.

This future is one that depends on location, layout and, increasingly, sustainability – a critical point as compliance with ESG standards hovers over many buildings like the Sword of Damocles.

"The door is not completely shut on offices. There is a market for well-located offices with the right ESG rating," says Boschmans.

> For many organisations, decisions being taken around office leases are part of broader brand positioning. The office is a showpiece, which feeds into and exemplifies company culture and acts as a selling point for talent attraction and retention. This, combined with sustainability considerations, is leading to a trend of relocating over renewing. New supply is focused on these factors more than ever before.

For those tied into longer leases or committed to their existing location, design and configuration changes are common as employers seek to make the office a more rewarding environment for people to engage, connect and collaborate.

"Nowadays you provide an event space, not a traditional workspace. The emphasis is on bringing people together," says Rohweder.

Flexible space and flexible lease terms allow organisations to react to varying numbers of workers in the office at any one time, as well as uncertain business growth, not wanting to be caught out by the potential for hiring – or downsizing – decisions which radically change desk-space requirements.

As the supply and demand balance is thrown out of kilter, repurposing again comes into play.

"Even pre-pandemic, there was a huge amount of new office supply, particularly in London. But what happens to the old office when people move out – is there enough demand to soak up the extra supply?" asks Samanta.

One of the major repurposing trends is from commercial office to hotel. Location and layout are two of the key drivers, here.

> "We need to rethink what the function of office space is."
>
> Bas Wilberts, Director, Savills

Government support

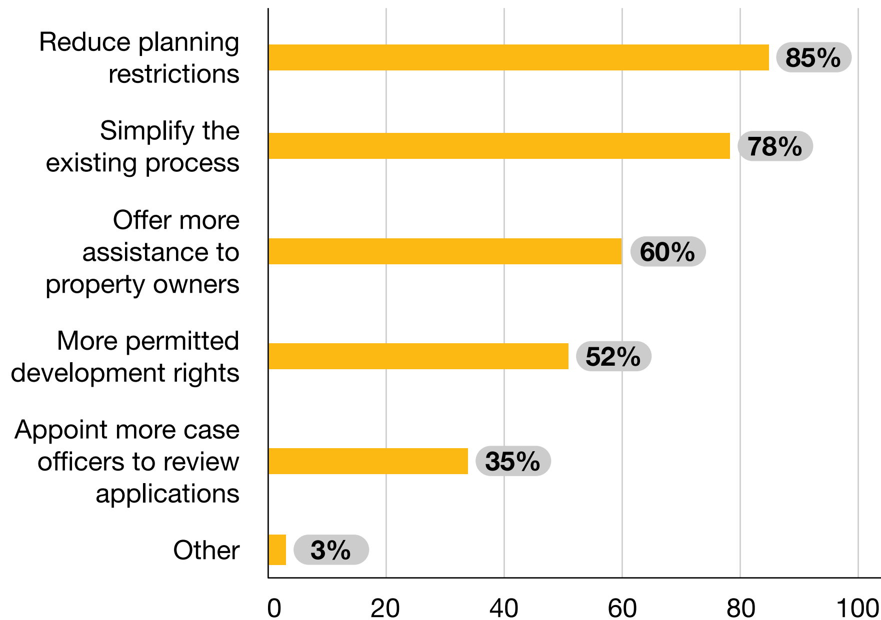
With the thirst for repurposing peaking as opportunities to maximise value through alternate use present themselves, property owners and investors want to see more being done to remove – or at least lower – the barriers to change.

More efficient planning processes are therefore high on the wishlist and a vast majority (85%) say they want government action to reduce planning restrictions to accelerate conversions, while a similarly large proportion (78%) want the existing process simplified. Just over half (52%) also list more permitted development rights to allow changes of use without the need for a full planning application.

More than a third (35%) want to see resource investment to speed up administrative processes, via appointment of more case officers to review applications. This tallies with the real-world experience of building owners who are keen to take a collaborative approach with planning teams but often find those teams are under-resourced.

"Planning has become a system that doesn't function particularly well across the board. Bureaucracy is there, but we are happy to go through those hoops. One thing we find particularly difficult is simply a lack of staff in terms of planning officers. Staff resourcing needs to be sorted, or processes need to be streamlined, otherwise planning pain will persist. At the moment, there is bloated bureaucracy and no staff to manage that," says Keighley.

Figure 15: **How the government can help property owners**



There is a broader policy point around government acknowledging the community nurturing benefits of assisting property owners to cultivate a thriving built environment.

"If owners and property companies can't afford to redevelop sites, what is the government going to do policy-wise to make town centres places people want to be in?" asks Keighley.

"While policy measures stall ahead of a looming election, inaction cannot continue. This government, or the next one, must be a change-driver. We know what the market wants and needs – investors want long leases and landlords want more flexible leases. Now is the time for policy to facilitate.

Top of the reform list are planning and business rates. Proposals in the Autumn Statement to speed up planning applications are desperately needed, but don't go far enough, while the sticking plaster approach to business rates reform was confined to small businesses only. Both systems are broken and crying out for substantial reform, so government must show commitment and appetite here."

> "At the moment there is bloated bureaucracy and no staff to manage that."
>
> Rachel Keighley, Director, Cheltine

Space exploration continues

Having explored the challenges presented over recent years, it is clear that rethinking space is not only profitable, but necessary. Going forward, smart decisions around space must be made based on the balanced needs and desires of investors, landlords, tenants and the wider community.

Filling space is not enough. The costs associated with construction, repurposing or refurbishing mean that careful thought has to go into its intended use today and in the years to come.

“The jigsaw pieces have to fit together to ensure you have something more valuable at the end of a process,” says Samanta.

> From identifying community needs and requirements, satisfying planning and sustainability regulations, weighing commercial viability and ensuring tenants are attracted, everything needs to add up.

“Somebody has to bring discipline to the process and join the dots. You can have something that looks great, but if it’s too expensive to build, it’s no good to anybody,” says Samanta.

In placemaking and the commercialisation of public space, public and private operators each have a role to play.

“This is something which cities and private landlords have undervalued. Landlords and occupiers will be commercialising public space more for the communal benefit in the wake of Covid and commuting changes – cities, councils, landlords and investors need to be alive to this,” says Rohweder.

“Town planning has to assess existing build stock and look at what they want these places to be. It’s difficult because they represent the entire spectrum of community views, but holistic vision is needed,” says Keighley.

Given the focus on placemaking and community, one trend we expect to continue is the popularity of mixed-use schemes, as we see some sectors increasingly blurring into each other, for example residential developments with retail or leisure components such as a gym beneath them, or a mix of student housing and budget hotel, given the similarity in use of space.

> Ultimately, whether through mixed or single-use schemes, our insights show that there is demand across asset classes. Space will always underpin how we go about our daily lives. It must simultaneously respond to, and influence, societal change.

As economic stability returns, we will continue to track the key trends in real estate space utilisation over the coming year.

“In the operator world, everybody is excited, numbers are strong, people are travelling again. The investment market is cautiously optimistic. You need a strong argument for deploying capital today, given the economic and geopolitical backdrop,” says Rohweder.

Rethinking and repurposing will continue in the year ahead, as lack of stock and availability of land leave conversion as a chance to enhance value and breathe new life into assets which may no longer be fit-for-purpose. Although it may have been kicked into the long grass in some quarters, tenant demands for sustainability will not abate, so further adaptations are inevitable as key Net Zero dates grow ever closer.

With this in mind, and with investor optimism for stronger returns, the repurposing revolution is set to continue.

Methodology

We undertook this project to better understand the trends outlined in this report and to seek industry insight around what the future holds for UK real estate.

Quantitative research: In H2 2023, we surveyed 125 respondents comprised of Landlords (building owners, real estate brokers, agencies and consultancies) and Tenants / Leasees (across Offices, Industrial, Retail, Logistics, Distribution, Hotels, Hospitality, Tourism, Leisure, Student Accommodation, Senior Living and Caregiving). The seniority of respondents was Manager and above level executives (job titles included CEO, CFO, MD, Estate Manager, Property Manager, Tax Director, Finance Director etc).

Qualitative research: To supplement the survey findings, we also spoke to industry contacts on a deeper 121 basis, to dig into the details of what they are seeing in the market, how that is impacting their strategy, and what they see as the key challenges when it comes to maximising space and value.

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