COVID-19:
UK REAL ESTATE PERSPECTIVES

PART 5

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CUSHMAN & WAKEFIELD

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This is Part 5 COVID-19 UK Real Estate Perspectives. Our experts share their insight on how the pandemic is already effecting change within their sectors.

Many in the UK will be returning to the workplace in the coming weeks. **Tony Comber, of Building Engineering Services**, in The Safe Office – Pivoting Building Ventilation Strategies, outlines how ventilation systems in office buildings should be adjusted to create a COVID-19 safe environment for employees.

Tim Crighton, Logistics & Retail EMEA, takes us on the journey of a humble T shirt destined for sale in What do you do with 1,000,000 T Shirts Stuck on an Airfield in Suffolk. Fashion retailers are resorting to some unconventional solutions within their supply chains to tackle the restrictions imposed during COVID-19 pandemic. Solutions which may accelerate supply chain changes within the sector.

While lockdown for millions worldwide has brought positive environmental effects, **Andrew Baker, Head of Energy Infrastructure & Environment**, reminds us that the potentially catastrophic impacts of climate change remain. In his article The Urgency to Mitigate Climate Change Increases he looks at 4 key actions the real estate industry must take to accelerate its commitment to action on climate change, as it finds its way out of the COVID-19 crisis.

Continuing the theme, **Richard Pickering, Chief Strategy Officer, UK** sees that The Property Industry Needs to Change. He reviews the factors that have shaped the sector and looks 2 years ahead to identify key areas where change will hap pen, including: business consolidation, property ownership, worker location and a change in the value chain of assets, skills and capital, and the relationships between those that provide each.

Please do get in touch; we stand ready to help you navigate through these uncertain times.

Tony Comber
Partner and UK Skill Head Building Engineering Services

THE SAFE OFFICE - PIVOTING BUILDING VENTILATION STRATEGIES

The start of 2020 saw our team of engineers focused on the imminent introduction of new minimum energy efficiency standards and the UK Government's drive to net zero carbon by 2050.

The last few months have been anything other than business as usual. We have pivoted to looking at how safe our office buildings are for occupiers upon a return to work. There are a number of key factors that have to be addressed as part of this process:

Considering the effects of the COVID-19 pandemic on ventilation and air conditioning systems.

It is recognised through Public Health England guidance that the transmission of the virus occurs mainly through two main routes; respiratory droplets generated by coughing and sneezing and through contact with contaminated surfaces. The predominant mode of transmission is assumed to be by droplets that generally fall out of the airstream within a short distance hence the guidance to remain 2 metres apart and observe social distancing. There is evidence to suggest that it can be spread through the air, particularly in poorly ventilated indoor spaces.

A third transmission route is via faecal-oral contamination within WC's. It is recommended that toilet lids are closed when flushing and to check that drains in sanitary devices do not dry-out.

The primary prevention mechanisms against COVID-19 remain regular personal and office environment hygiene, strictly adhering to social distancing requirements and staying at home.

Are building ventilation systems safe during a pandemic? Return to work will be gradual and social distancing guidance will remain in force where practicable. Initially this is likely to reduce the typical office occupancy density from a standard of between 1 person per 8 or 10m^2 to at least 1 person per 12.5m^2 or more dependent on the site.

Current guidance from CIBSE (the Chartered Institute of Building Services Engineers) recommends running mechanical ventilation systems for longer periods to ensure that the air is purged to reduce any risk of potential airborne viral transmission by reducing exposure time to any airborne viral aerosols. For non-ventilated buildings the increased use of operable windows is highly recommended. Combined with reduced occupancy densities, ventilation systems should provide a safe environment.

There are a few important things to look out for: Reducing any potential for cross contamination from exhaust to incoming fresh air is vital. Any recirculation paths should be identified and removed. This is particularly important between office and WC extract systems where maintaining positive and negative pressures in both respectively is key.

Some forms of ventilation heat recovery systems can cause cross contamination and should be decommissioned.

In the UK most buildings either have not been fitted with or have disconnected the humidification plant. In winter low humidity levels make the human body more susceptible to infection and could aid the transmission of the virus. It is recommended that a humidification plant is fitted.

Fan coils, VAV terminal units, passive and active chilled beams recirculate air and these systems should be frequently cleaned.

Can existing building ventilation systems be more effective? It seems obvious that fitting improved filtration to building ventilation systems will reduce the risk of respiratory droplets being transmitted throughout the building. HEPA (High Efficiency Particulate Air) and MERV (Minimum Efficiency Reporting Value) filters can be used where the installed systems manufacturer recommends them. However most building ventilation systems have not been designed for this level of filtration and would not work effectively, inadvertently reducing the required ventilation rates required for effective air purging.

Where there are concerns over air quality it is recommended that portable air purifiers are installed. These can be installed at desk and office locations requiring no connection to the main building ventilation systems.

Indoor air quality sensors are also good indicators of the effectiveness of ventilation systems. These can be quite easily fitted but ideally would be linked to a responsive building management system so that the building ventilation systems respond to occupancy and conditions.

Will future building ventilation systems be pandemic proof? The basics of building ventilation systems are unlikely to significantly change although much more consideration will be given to occupant wellbeing and future building and energy use than previously.
Future office design will require greater flexibility in terms of use, the ventilation systems will need to be responsive and adaptable. Use of smart technology should aid the responsiveness and drive the energy efficiencies necessary for buildings to achieve net zero carbon aspirations.

Adopting ventilation strategies that incorporate the principles of the WELL Building Standard in terms of enhancing indoor air quality and raising the awareness of the internal conditions to the occupants should all be considered. While there will be no guarantee of being pandemic “proof” adopting these standards will drive improved occupant wellbeing and, through the monitoring process, provide instant reporting on internal conditions.

You can download our Safe Six: Workplace Readiness Essentials here to find out how real estate owners can most effectively prepare for the return of building occupants. And how employers can make sure they are prepared to receive their workforce—and ensure employees are also prepared.

Tony Comber heads up the UK Building Engineering Services team within Cushman & Wakefield. The team will be able to assist clients in assessing the current condition of their building ventilation systems and advising on next steps to improve them.

Tim Crighton
Partner, Logistics & Retail EMEA

WHAT DO YOU DO WITH 1,000,000 T SHIRTS STUCK ON AN AIRFIELD IN SUFFOLK?

It might seem an odd question – indeed at any other time it would be an odd question but it's exactly the sort of challenge facing some of our major retailers as a result of the COVID-19 pandemic.

Over the past half century, we've become increasingly dependent on global supply chains. Retailers and manufacturers have chased CPR (Cost Price Reduction) to maintain margins and compete on pricing for a consumer looking at value as one of their primary decision factors. More recently global digital platforms and the internet have opened new channels for manufacturers to sell products internationally and often direct to customers meaning more choice and more competition.

This globalisation has accelerated rapidly since 2000. In 1999 China was the UK's 15th largest source of imports accounting for around 1%. By 2019 China was the 4th largest imports source for the UK rising to around 7% of all imported product* (House of Commons Briefing Paper on the Geographical Pattern of UK Trade). Our reliance on Asian sourced products has therefore markedly increased with manufacturers and sourcing teams being attracted by a combination of speed of production and labour arbitrage compared to domestic production. We've also seen the rising influence of LATAM, especially for Food & Beverage production and the US remains the UK's biggest trading partner with exports from the UK to the US worth $121Bn in 2018 and imports of $77Bn (11% of all imports, placing it second behind Germany as our biggest import market).

The result of all of the above? Longer, more complex supply chains are needed to support the movement of goods.

Most retailers have some seasonality to their business, particularly in Fashion, Apparel and Home Improvement sectors. It's much easier to sell a BBQ in the May than it is in November and radiators sell better in Autumn than they do in Spring.

If we take a typical fashion retailer as an example, they will have 3 core seasons, Spring, Summer and Autumn/Winter and usually these have sub seasons to them with some of the fast fashion retailers re-merchandising as frequently as every 4-6 weeks.

When Boris Johnson announced the enforced closure of retail outlets in the UK on the 23 March most were full of Spring fashion. We would usually see retailers discounting through Spring sales in April to clear stock as they re-merchandise with Summer lines. Summer lines usually give way to the Autumn/Winter range through August. With stores closed the usual cycle and flow of products isn't occurring and now in mid-May they remain full of Spring fashion.

One of the compromises sourcing teams make when selecting products is the balance between cost and lead time. As a result of globalised sourcing we've seen longer lead times for many products. If you look at the traditional garment sourcing markets in Asia of Bangladesh, Vietnam and China these typically need lead times of: 4 weeks for design, 4-6 weeks in production and around 8 weeks in shipping, meaning many retailers are committing to orders around 4 months ahead of landing products onto the shop floor. For significant volumes this can be extended even further. That means that for many retailers their Summer stock is either already in the UK or on ships due to arrive into the UK over the next month.

With retail closures the usual supply chain flow of pushing product into stores has been interrupted. This means inventory in warehouses has been rising as retailers are unable to turn off the supply of goods quickly enough to respond to the pandemic. UK warehouses are therefore under considerable pressure as stock levels are rising and consequentially, we've seen enquiries for demurrage related storage. This isn't exclusively a retailer challenge either as manufacturers have also had their supply chains impacted in a similar manner with closures of manufacturing sites due to social distancing requirements.

When a shipping container arrives into the UK it is usual for the port to allow storage of the container for between 5 and 7 days free of charge before collection. After that it attracts a demurrage charge - a rental cost for keeping it on site. With distribution centres full and product still arriving logistics and supply chain teams are being forced to look at alternative storage options. This could be additional warehousing; it might be reoccupying previously vacated warehousing as we've seen in several cases. Alternatively it could be keeping the product in its shipping container and storing the containers away from the ports in low cost locations. We've seen rising container volumes not just in ports but also in inland rail freight terminals and even short-term container storage being secured at old airfields and redundant industrial sites.

The next challenge, beyond finding low cost storage for this additional stock will be managing the return and clearance of stock which is now in stores and is out of season. The numbers here can be significant with Primark taking a £284m write-down on its excess stock in April (ft.com). Range clearance will be a key issue for retailers in the coming months. The debate about whether you discount these in store or look to back haul them into the distribution centre and restock and pack them will be central here. This adds cost but may mean less discounting. It will be fascinating to see how retailers resolve this challenge.

Even pre-pandemic the complexity and increasing length of global supply chains were becoming a point of contention in the industry. We had seen Inditex move production back from Asia to Morocco (which together with Turkey offers the core sourcing markets for garment manufacture in EMEA). This was predominately to reduce the timeline from design board to shop floor which played to Zara's strengths as a fashion leader, allowing greater turnover of lines through the seasons and more responsiveness in supply. Shortening supply chains should allow lower inventory and therefore working capital in the supply chain, but it will need to be balanced against potentially increased production costs. The political lens for this has shifted since the outbreak of COVID-19 and we've seen increasingly protectionist rhetoric from many governments. This could influence changes to the supply networks further, particularly in the U.S. But that is a debate for another time.

Tim Crighton provides specialist logistics and retail supply chain advice to clients across EMEA.

Andrew Baker
Partner – Head of Energy, Infrastructure & Sustainability

THE URGENCY TO MITIGATE CLIMATE CHANGE INCREASES

As we entered this new decade **Climate Change was topping** polls across the globe **as the public's #1 concern**. The past few months have seen COVID-19 claim all the headlines and be the singular focus of people and governments alike.

The 2020 United Nations Climate Change Conference (COP26) would have been hosted in the UK. It was to be the most important gathering of up to 200 world leaders on climate change in history and the largest summit the UK has ever hosted. The aim to produce a set of commitments to transition to a low carbon global economy. Instead, COP26 has been postponed to 2021 and we are in the depths of a human and economic crisis the likes of which we have not seen in our lifetimes.

Yet, we are assured the impacts of COVID-19, while catastrophic, will be relatively short term and the economic bounce back will be strong.

Will climate change then reassert its #1 position on people's agendas or will we see a lost decade of climate action similar to the period post Global Financial Crisis? There is only one answer that is even vaguely acceptable. Climate change has to be addressed and to be seen as part of the solution to the global economic travails we face.

Prior to the COVID-19 crisis, there was widespread consensus among the majority of global leaders, policy makers and senior financiers that climate change was an existential threat to our current way of life. Urgent transition to a zero-carbon economy was required.

If the climate models are correct the estimated number of human casualties and the threat to the global economy are in a different stratosphere to COVID-19 if we continue on our current path.

Even if all nations go beyond the global carbon targets agreed in the Paris Climate Agreement the modelling suggests we are still on course to see mass extinctions, unprecedented flooding of coastal communities, collapse of some ecosystems and fishery catches decreasing by up to 3 million tonnes over the next few decades.

The real estate industry has a fundamental role in mitigating the impact of climate change and helping the regrowth in the global economy.

1. **Transitioning to a zero-carbon future**, this means factoring in full lifecycle carbon analysis into construction and refurbishment projects.
2. **Accounting for carbon impacts** in our site selection criteria. on and refurbishment projects.
3. **Greater awareness of what a "green" asset is** and be able to provide this insight to the broader industry.
4. **Sustained and systemic change in the commercial real estate industry** and in the wider economy.

The highly influential Taskforce on Climate Related Disclosure – established in the wake of the Global Financial Crisis to ensure long term economic stability – has set out in detail the level of in-depth information required from business to allow investors, lenders and insurers to adequately understand and factor in their exposure to climate risk.

These requirements stand unimpacted and independent of COVID-19 and will continue to revolutionize our sector in the years to come as increasing numbers of investors and occupiers respond to pressure to report on and address their exposure to strategic climate risks.

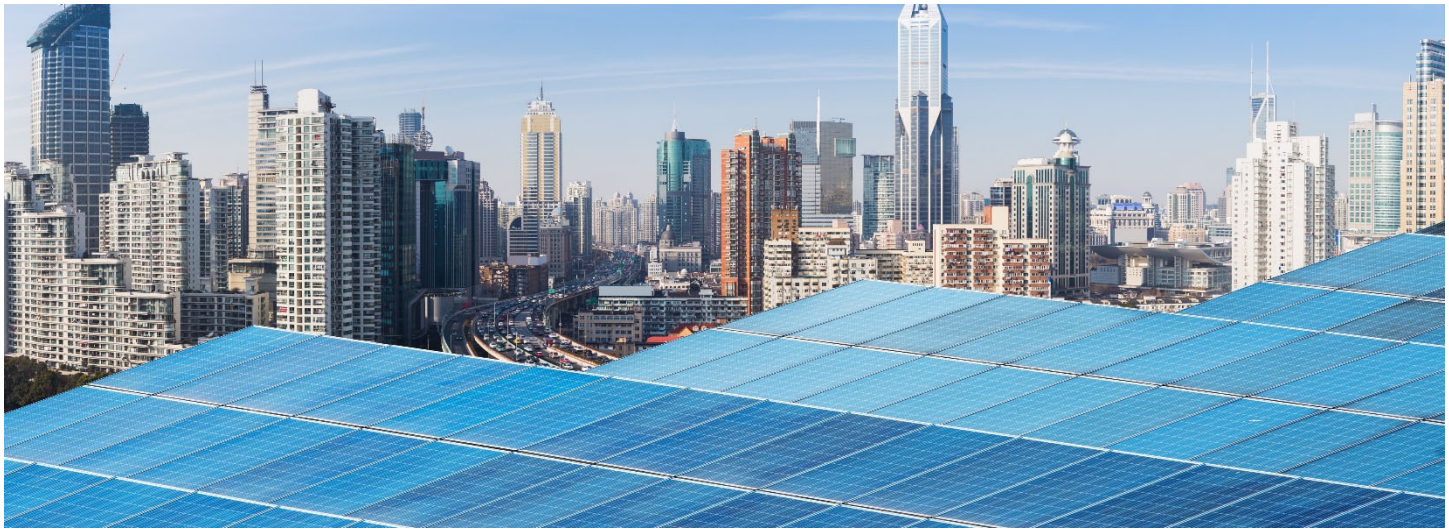
I recently wrote about the potentially long lasting impacts of COVID-19 on real estate sustainability performance buoyed by the radical change in business travel patterns and the shift to technology solutions, changes to commutes and positive attitudes to remote working, as well as the focus on the health and wellbeing of building occupants.

It has to be recognised that these short-term positive impacts cannot replace the fundamental and urgent need to decarbonise all aspects of the real estate industry.

Time again, we've seen that failure to take decisive global action can have catastrophic results. We must achieve collective global agreement and action against strategic global threats like climate change. If we do not, we will be contributing to yet more human and economic hardship in the future.

The built environment is a critical driver of the global economy. It is now essential that we recognise the role it plays as part of the solution to negating the worst potential impacts of climate change.

Andrew leads the Energy Infrastructure & Environment team. The team advises on environmental impact reduction, making buildings healthier and more productive places and enhancing social impacts.



Richard Pickering
Chief Strategy Officer, UK

THE PROPERTY INDUSTRY NEEDS TO CHANGE

When I joined the industry 15 years ago, much of the sell was that ***'this is a people business'***. More critically, I was told that surveying is what you end up doing if can't get into banking. I don't think that's fair. As a reformed lawyer, I have found those in real estate to be quick minded, commercial and entrepreneurial. However, the same cannot be said of the industry as a whole, which fairly earns its attribution as sleepy and backward looking.

Perhaps because the industry has historically offered a quality of life above many other careers, whilst combined with decent earnings potential, there has been little incentive for people to change. Similarly, for businesses, whether on the advisory or principal side, positions have been cosseted.

For investors, there is limited genuine competition on product. Most make their money on timing things well and spotting under-pricing; the word 'customer' is a relatively new concept. For occupiers, a group with more liberty to innovate, an overwhelming focus on cost has crowded out the discussion on the value of space. And in this context, advisory practices have had limited cause to adapt. Success in real estate advisory relies at it always has, on personal relationships, experience and tenacity.

The barriers around our industry have also restricted the gene pool. We are well behind other industries in gender, ethnicity and socio-demographic diversity. Equally troubling, we have limited our diversity of skills to those needed to do jobs that we largely designed 30 years ago. All of this inhibits innovation and gives rise to the spectre of disruption.

And so, in spite of radical change in other sectors, one might be forgiven in mistaking the real estate industry of today for that of 10 years. Nevertheless, an undercurrent for change has been building momentum for some time.

This has typically arisen from one of three sources.

Firstly, big personalities. Over my career, I have worked with several personality driven organisations that are willing to shake up the status quo. Founder owned business can innovate in a way that public businesses and institutions, weighed down by governance and reporting, find more challenging. However, increasingly, these are few and far between. Consolidation in all areas of the industry has led to fewer, bigger businesses, and typically it is these large cost-efficient businesses that are dominating the industry.

Secondly, exogenous influences. In recent years, several businesses have peered into our industry and found something lacking. Particularly the tech sector and those with platform models, have tried to export these principles to real estate with varying success. For commercial real estate generally, Proptech has failed to deliver on its promise. Office 365 has had a much bigger impact on our industry than any faddish app or one of the now ubiquitous *'the Uber for…'* aggregators. The most significant innovators like AirBnB and WeWork, haven't really been about tech, but rather reframing an offer to better suit the needs of the end user.

The final source of innovation is distress. It is no surprise that retail is where the most interesting things have been happening over the past 5 years. The threat of failure is a powerful incentive to change. That same threat now presents itself on a much wider basis.

However, the ability to change is not equal.

The paradox for most successful businesses is that their success is often measured by their ability to return value to shareholders in the short term, whereas their future potential is reliant on investments made now that might limit their capacity to do so. A good story on growth and reinvestment is often traded off against annual dividend payments.

The economic environment in which we now all operate constrains resource and creates cashflow challenges. The inevitable response is to preserve stability by turning off discretionary expenditure. When the wolf is at the door this makes perfect sense. However, this implicitly stores up a challenge for the future. If investments in change are not made in the short term, then self-evidently change will not materialise in the medium term. This provides an opportunity for those businesses with significant cash reserves to steal competitive advantage. Evidence shows that those businesses that invest during a downturn perform better over the cycle; however, this is a luxury of the cash rich, and those that have earned some slack from their shareholders.

One could as easily apply this principle to counter-cyclical investment, occupier investment in workplace, or investment in technology that will create longer term business efficiencies. Those that will come out on top over the next 5 years, are right now looking at growth and opportunity in these areas.

So, what are we likely to see happen in the next 2 years?

Firstly, we will almost certainly see some distress. Experience tells us that those that arrived at the party late and geared up thinking the cycle had more steam will be the worst hit. In the Proptech sphere, many start-ups that operate hand-to-mouth at the best of times, will likely go to the wall. Some sectors, through no fault of their own, will suffer extreme operating impacts in the short term and potentially longer-term structural shifts, which will diminish their relevance. Across all areas of our industry, those that aren't able to adapt will struggle. Some of these will fail, but I suspect that more will be eaten up by the financially stronger competition as PE ratios reset. Watch out for further industry consolidation.

Secondly, whilst few would actively seek out such, a pricing rebase has the potential to catalyse change. The evidence on pricing tends to follow the fact, and large emerging discounts to NAV point to the future. A number of assets across the country, stagnating under the millstone of their book values, will be unburdened, unlocking the potential for redevelopment and renewal. Some existing owners holding for income will be replaced by banks, capital appreciation vultures and perhaps the public sector. Watch out for shifts in the ownership of real estate.

Thirdly, in a world where remote working is given more emphasis, businesses can and will become more globally integrated – talent pools can be drawn from further away. Workers at Twitter, which announced last week that employees need never go back to the office, can trade their expensive Bay Area flats for an estate in southern Italy and still keep their jobs. Watch out for shifts in who works in our industry and where they work.

Finally, businesses will take a long look at themselves, and perhaps see this as the time to give up old dogmas that are no longer relevant. External shock creates a focus on necessary internal change that might have been bubbling for a while. For the industry this might mean finally letting go of the past. The value chain of assets, skills and capital will be unsettled, as will the relationships between those that provide each. New importance must now be placed on:

(a) a new proposition to the end users of real estate that gives them something beyond a place to keep dry,

(b) data and analytical skills – a professionalisation of real estate expertise,

(c) new commercial structures between investors, occupiers and advisors, and

(d) a genuine approach to ethical and sustainable propositions that goes beyond lip-service.

You can read more from Richard Pickering on his blog The Cut.

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