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ANTONY SLUMBERS

News

Contributor Series #7

letter

PART III: Real Estate as a Service: All Change, All Change.

In Part 1 of this 5 part series we looked at the changing nature of demand within the real estate industry, and in Part 2 we looked at how as an industry we need to become better informed about new technologies, and how the winners of the future will be those who marry Human + Machine skills. In this article we will look at how all of this change will impact on Commercial Office Landlords.

Landlords aren't what they used to be.....

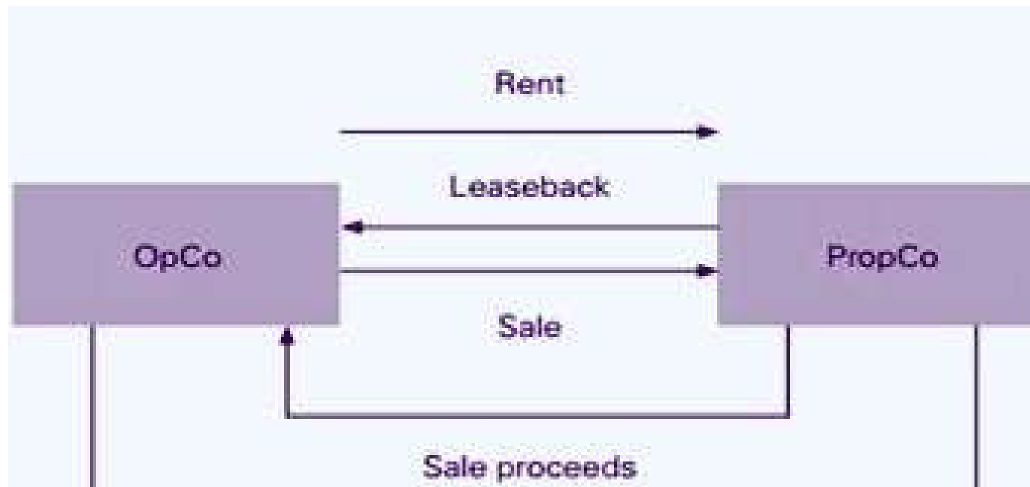
We've seen how it is likely that 'Flexible working will be the defining characteristic of the future workplace' (Google, Workplace 2020). JLL have stated they believe **30% of the market will be flexible by 2030**, but this seems too conservative. According to Hong Kong based research company MingTiandi, by **March last year, 56% of Asia's top 200 occupiers were already using flexible workplaces** in some capacity, and 91% were considering using them. If you look beyond just the workplaces that are procured on a flexible basis (co-working, short term leases and the like) and include all the workplaces that are adopting flexible working practices, irrespective of tenure, then it would not be outlandish to think a large majority of the market, especially the top end, will be effectively #SpaceAsAService space by 2030.

And that means the 'Operators' of all that space will first of all be highly important to the revenue generating capabilities of an asset, but secondly, will represent a significant cost. A well operated building, providing a great user experience, will definitely be generating considerably more revenue than a standard lease would have enabled, but how much of that additional revenue will flow through to net earnings and who will be benefiting from it?
Who will the 'Operator', the creator and curator of that user experience, actually be? Will it be the Landlord, the Facilities or Property Manager (ignore the names - these companies will morph into new entities with new, more appropriate nomenclature), 3rd party companies (WeWork, TOG, Knotel etc), or some combination of all three?

> The answer will determine what the value tree looks like: today the Landlord is very much King or Queen of the Castle, but in this new world they could easily become little more than the providers of commoditised 'dumb space'

The office landlord's biggest strategic question to answer today is 'Am I a Chicken or a Pig?' Referring to the joke about 'What's the difference between the chicken and the pig in a bacon and egg sandwich? - the chicken is involved but the pig is committed!
In the future world of offices the operators are the pigs and none will be a success unless they are fully committed to being the service oriented companies that are essential to creating great spaces for customers. No company actually wants an office, what they want is a productive workforce. In old school real estate we have focussed on the former, but in the #SpaceAsAService world it is the latter that matters. And performance will be judged against new KPI's such as sustainability, wellness and productivity (more on this in Part 4).

But delivering this is complex and hard so whoever manages to repeatedly pull it off will be much in demand, and expensive. The pie is getting bigger but there are more slices.
In an ideal world landlords would smoothly transform themselves from Product to Service companies, hire a wide range of new employees, with a rich diversity of new skills, and see off the challenge of the likes of WeWork. In so doing they would capture all the new value being created. In the real world it is more likely that WeWork and others perform the reverse trick and remove Landlords from the equation entirely by owning buildings themselves.
The argument against that happening is 'they don't do that in the Hotel business - they use an 'OpCo/PropCo' strategy'.



Well yes, but in an advanced #SpaceAsAService world the physical asset is going to be continually modified or adapted to reflect the data driven insights about customer wants, needs and desires. In that sort of environment the operator needs near total control over the property in order to maximise utilisation, and therefore revenue. Being an owner/operator has significant benefits. So the tradeoff is complicated, but the answer is relatively clear. IF you are a major landlord, with a Pig mentality and culture, you should do it all yourself. They are few of these around. Those that do exist will be great investments, as they represent the optimum solution. Mostly though landlords will not be able, or desirous, of changing to this extent, in which case their best move will be to partner, very tightly, with an operator or operators. This partnership though cannot be a standard hierarchical client/supplier type arrangement; this has to be about one coin, with two sides. A Team of Teams, with aligned interests and incentives.
The alternative solution is for landlords to 'stick to their knitting' and simply sign long leases with a 3rd party operator, knowing it will be leaving money on the table. Being a rent collector not a service provider is no crime. For certain types of companies it will be absolutely the right thing to do. But be in no doubt, this is no way to generate large returns. Low risk, low reward is the game here.
There is a big question left though, and that is about who owns the Brand associated with any #SpaceAsAService operation.

There is a strong argument that the User Experience = Brand & Brand = Value. Whoever 'owns' the customer relationship is in the best position to embrace new revenue generating opportunities.

As one builds a large network of customers, the potential to develop an ecosystem of mutually supporting companies who co-create new products and services specifically designed for the particularities of those customers is great. In the tech world one talks about the 'TAM' (total addressable market) and 'Adjacent markets' (complimentary offerings to one's core business - think Uber and Uber Eats). If one goes back to the idea of 'the real estate business is no longer about real estate' then these adjacent markets, that expand the total addressable market, become very interesting. WeWork of course is the poster child for this; already they are tapping the adjacent markets of co-living and education with WeLive, WeGrow and the Flatiron School. And they have a large and growing ecosystem of partners addressing the needs of their 'members'. You cannot do this unless you own the relationship.
Does owning the relationship matter? I think it does. The recent history of the US based Events/FlexSpace operator Convene is instructive. They typically work closely with landlords of Prime offices to install a 'Convene' as an amenity to people in the building. They started by providing great Event spaces, with quality catering and other services but have now expanded their offering to include flexible workspaces, meeting rooms and quiet zones. They then started offering all of this as a 'White labelled' service that a landlord could Brand as their own, which seemed a neat way to expand their distribution and service more customers. Recently though they have pulled back from this so that if you want a Convene type service in your building then you have to have a 'Convene' space. They are continuing servicing their existing white labelled spaces but are no longer offering it as a service.

What I think this demonstrates is that the power, and value, of Brand is growing fast in real estate. And becoming a key differentiator.

We're back to the value tree; who's going up, and who down? In the past, one 'Prime' office was pretty much the same as another. Beyond the marketing brochure it was all the same. High quality, but just the same. Today, two identical buildings are likely to become differentiated by the services on offer, and by who is offering them. The total user experience will define them, and represent how customers think about them. For the likes of Convene being the Brand that makes that difference really matters.

Where that leaves an 'un-Branded' landlord is hard to say. It will all depend on what sort of scale 'Operators' end up achieving. Who needs who more is a function of size. If landlords find that their customers demand X or Y operator be in their building as an amenity then they'll lose a lot of power. If enough other customers exist that aren't so bothered then landlords can breathe easily. Either way we are moving beyond the primacy of 'location, location, location'. The power of Place is giving way to the power of Service. This is a critical juncture; it is likely that several very powerful Brands, with particular user experiences, designed with great insight into customer needs, will develop over the next five years, and these will sit solidly at the top of the value tree. If I was a major landlord I would be developing my own Brand or Brands (not necessarily to be self-operated, more likely in a partnership of sorts) but also buying stakes in all the key operators. Remaining a straight, no frills, real estate landlord feels somewhere between a dead end and very risky.
All of the above is an open door for PropTech companies, as any successful strategy will necessitate an understanding of end users (customers) that currently does not exist. Where to buy or build, what to buy or build, will increasingly be informed by a prior understanding of who a landlords customers are, or who they wish their customers to be. A users' needs & expectations will be particular to their type of customer; they are building, designing for them, not to a standard, generic specification. Whether they are doing it themselves, or in partnership with an operator, they, as the landlord, need to define what their Brand stands for, what differentiates it, and why people should pay them more than they hoped they would have to, to occupy their space.

What is it about the user experience of their space that is compelling?

That does not sound very 'techie' does it? But actually it is, very. Because the best tools you can enlist to help you work this out are sensors, data and analytics. There are three things we need to know about a space, be it a City, a neighbourhood, a building, or a meeting room, in order to personalise, optimise and localise the experience of that space.

#1 we need to understand how the physical space is functioning, in terms of light, noise, temperature and air quality? That tells us if the infrastructure is performing as it should and whether or not this is a pleasant place to be.

#2 we need to understand how the space is being used, if people are loitering in certain areas, avoiding others, by how many and when are spaces being used, and what are they doing there?

#3 we need to understand who is using any given space. what are they doing, what do they need, and why?

Putting all of these data points together is a prerequisite for creating great spaces that deliver a great user experience. Using artificial intelligence to then seek out correlations and causations between how a space is functioning, how it is being used and by whom is the power tool that will take placemaking and workplace design to a new level. This is where PropTech will go as it gets more serious. This is where the next generation of real estate winners will go. Deep understanding leading to a better built environment.
Much of the above was unthinkable 10 years ago; in 10 years time it will be old hat. In the meantime it leaves landlords in a difficult, potentially dangerous position. Changing technology is changing demand and exactly what is required, and the value of the new, is not yet clear. But standing still isn't an option. If this trend is as strong as I am suggesting, there is much to lose. But also much to gain.
My advice? Be a Pig!

ABOUT THE AUTHOR

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HAS BEEN A SOFTWARE DEVELOPMENT AND TECHNOLOGY STRATEGIST IN COMMERCIAL REAL ESTATE SINCE 1995. NOW, HE CONSULTS AND WORKS WITH REAL ESTATE BOARDS ON TRANSFORMATION, TECHNOLOGY AND INNOVATION. A WELL-KNOWN SPEAKER IN PROPERTY, HE IS A GLOBALLY RECOGNISED EXPERT ON PROPTECH, AND #SPACEASASERVICE. FOR MORE GO TO ANTONYSLUMBERS.COM OR TALK TO HIM ON TWITTER @ANTONYSLUMBERS