

# Real Estate: Challenging convention

LGIM Real Assets, August 2020

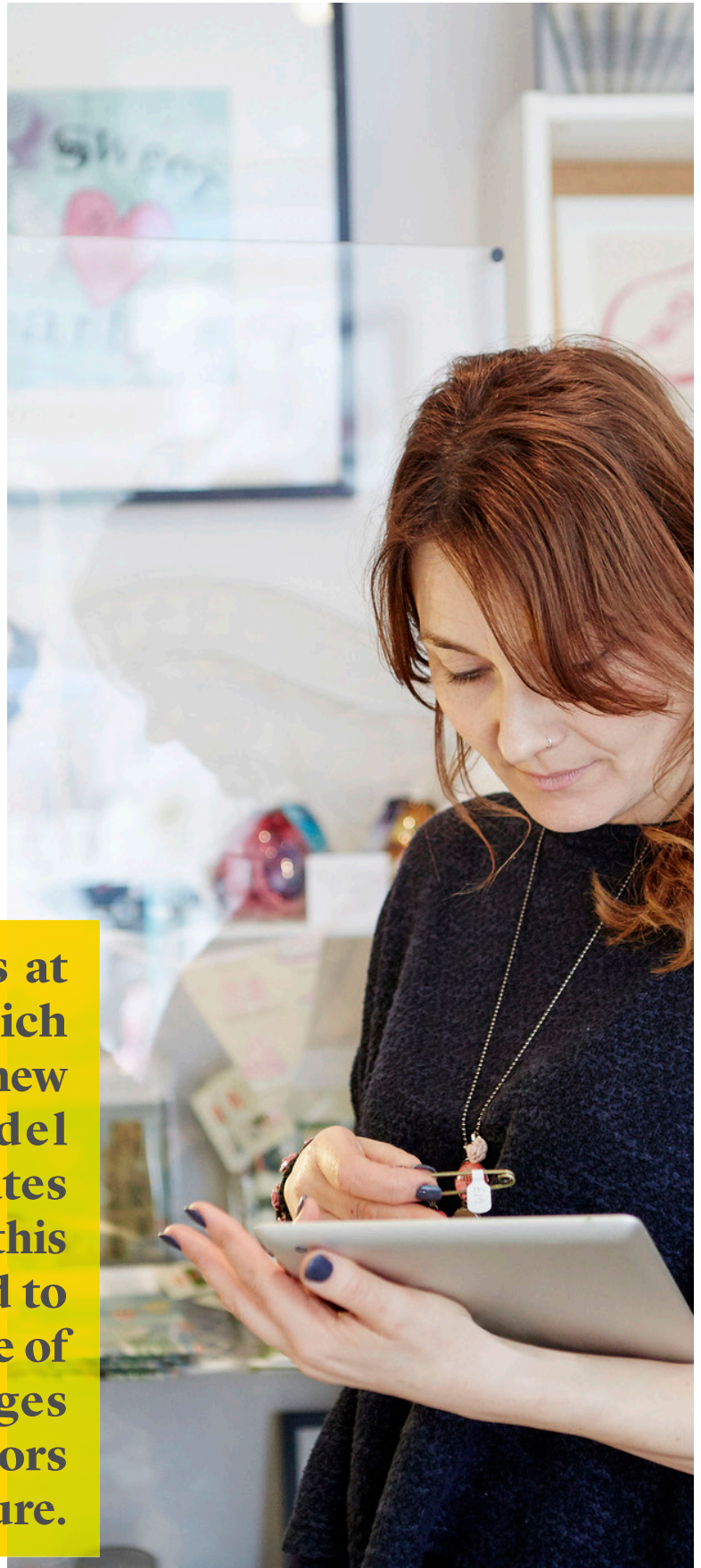


**Bill Page**

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Bill has responsibility for the formation of house views and inputs into fund strategy. He has 19 years' industry experience. Bill is a voting member of the real estate Investment Committee and actively contributes to the platform's Office and Industrial strategy.

**This report looks at the context in which LGIM Real Assets' new operating model "Mercury" operates and discusses how this has been designed to help navigate some of the key challenges Real Estate investors may face in the future.**



## Snapshot

For too long, many real estate owners have relied on inflexible, long-term contracts to be the central feature of their relationship with occupiers. We believe what is needed now is a richer relationship based on collaboration and an alignment of interests. Health and wellbeing is one area where asset owners can work with occupiers to help them achieve their goals.

Those who choose not to embrace this shift could be left behind. Those who challenge convention, embrace technology and change their mindsets to a service-oriented model will likely deliver better outcomes for owners and occupiers alike.

## Introduction: changing the way we manage Real Estate

It is more important than ever that we remain close to our occupiers. Real estate is an industry where the asset owner can be invisible to the ultimate customer, the occupier, masked by a series of intermediaries. This prevents principal to principal dialogue and has frequently caused friction, exacerbating the feudal "landlord and tenant" relationship.

We think it is remarkable that the real estate sector has retained its arm's length approach while good customer service is a prerequisite in so many other industries. Not only is this poor stewardship, it is also bad business: Property income has comprised 70% of total return over the last 39 years, according to MSCI. Retaining, nurturing and growing this income should be a key priority for all asset owners.

Research indicates that enlightened owners are embracing good occupier engagement and creating a reputational – and performance gap – from those who do not. PHD research quoted by RealService Ltd suggested that good customer service resulted in enhanced total returns of 1.9% p.a. over 10 years. Meanwhile, the impact of a strong service offer provided by many flexible office operators has had a demonstrable impact on markets: in London, for instance, the proportion of leasing volumes derived from small units

on the traditional 'arms-length' model halved as flexible office operators took market share, according to data from CBRE.

Meanwhile, MSCI data shows how contractual income security has been falling as lease lengths have reduced, owing to occupiers requiring greater flexibility across their portfolios. The same data shows that void periods have also become more regular; whilst 50% of office income experienced a void at lease expiry in 1998, this had risen to 77% in 2018.

We believe owners have to provide an asset that works for occupiers physically via the specification but also commercially; the process required to acquire and occupy space needs to be simplified, it should provide demonstrable value to its occupiers in terms of health, wellbeing and productivity, and it should increase the likelihood of retention at the end of a lease. And, if the occupier outgrows the asset, we are of the view that there should be a clear case for an occupier to remain within the same owner's portfolio.

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## An introduction to “Mercury”: managing our assets to provide the best outcome for occupiers and owners

Last year LGIM Real Assets announced that it had established a new innovative operating model, Mercury, for managing our relationship with occupiers. We believe it will improve the financial, environmental and social performance of the investments we are responsible for by developing stronger relationships with occupiers and the local community.

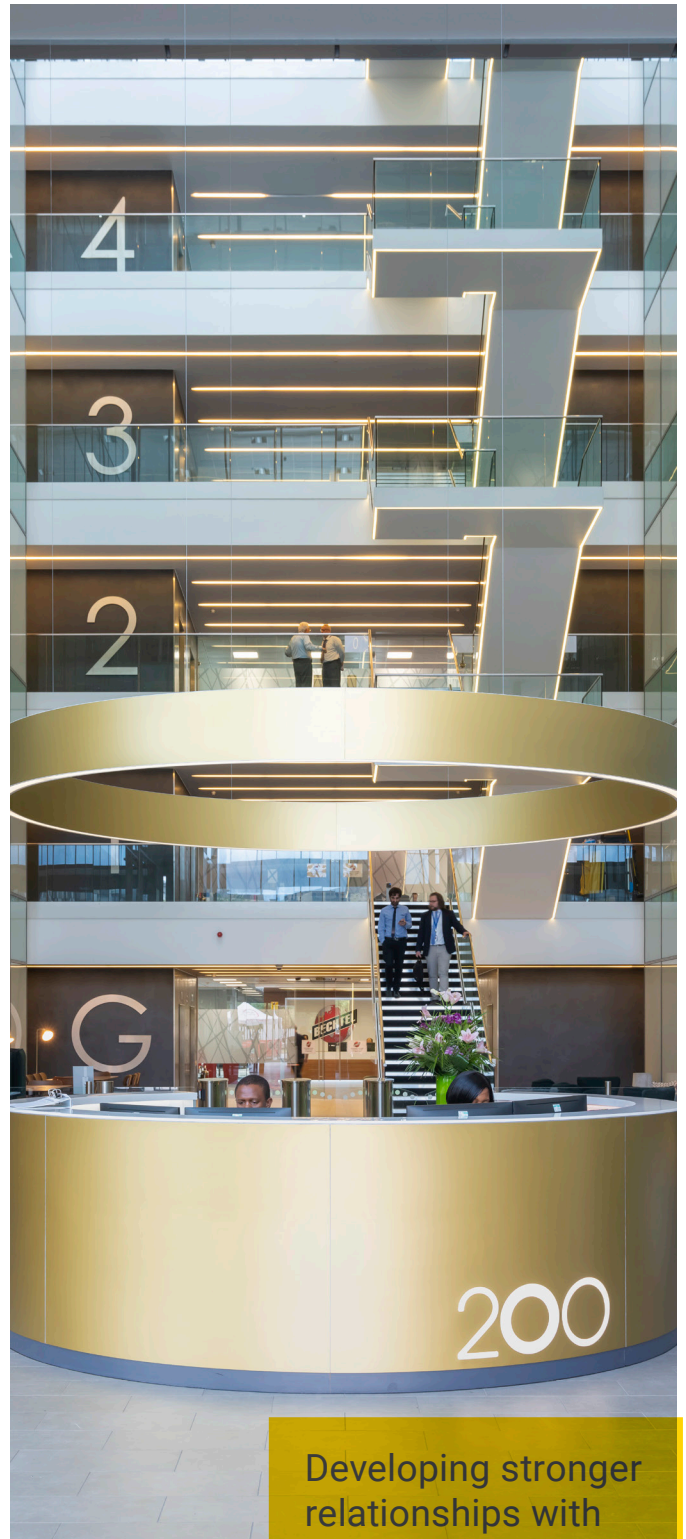
The model is built on the following principles:

1. Transparency, agility and collaboration
2. Occupier focussed culture
3. Responsive service delivery platform with flexible local supply chains
4. Direct visibility of asset operational performance
5. Direct influence of sustainability performance

Mercury removes the layers between us as the asset manager, our occupiers and those responsible for the building operations. It does this by introducing a Facilities Management Integrator (FMI) partner. This enables us to provide a more data-led, agile service and build independent local building identities.

Already, the level of engagement we are having with our occupiers has become much more positive. We believe that Mercury has also bolstered the continued flow of rent and service charge payments following the onset of the Covid-crisis.

The use of advanced technology has been key to capturing data on occupier experience and building performance. Our newly created Building Performance Team combines technical and data science expertise to deliver balanced scorecards and building models which measures each individual asset against its unique business plan.



Developing stronger  
relationships with  
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## Case study: using data to drive change and increase occupier satisfaction

A key part of our strategy is to provide transparency on building performance from a variety of perspectives; asset strategy, operational efficiency, occupier experience, and environmental and social sustainability. Our asset managers are able to identify issues early and, through open discussion with our property management teams, make a positive and timely impact. Crucially, it also provides a benchmark against which we can judge our performance over time.

This transparency allows us to create asset-specific strategies to drive higher occupier satisfaction, better occupier retention and, ultimately, higher income. This will be further enhanced with a flexible and locally based supply chain to maximise the positive impact on surrounding communities.

To drive an occupier focus throughout our supply chain and asset management team we looked to measure ourselves in a way a hospitality business would. To do this we introduced a Net Promoter Score for our strategic occupiers which hinges on the key question 'would you recommend our property as a place to work'. We do this via interaction with high level decision-makers within our occupier businesses but also seek to collate real-time feedback from the individuals using our buildings. Occupiers and users of the building are incentivised to scan a QR code on a poster and respond to a short survey.

# HAVE YOUR SAY

Your opinion matters. Tell us how we can improve 76-88 Wardour Street and we will donate £1 per response to LandAid – a charity focused on ending youth homelessness in the UK.

Scan the QR with your camera or visit the URL below to complete the survey.

<https://bright.eu/crf7s>



**SEVENTYSIX WARDOUR**  
SOHO / LONDON

AN INVESTMENT BY



## Case study: Mercury in focus - Health & Wellbeing

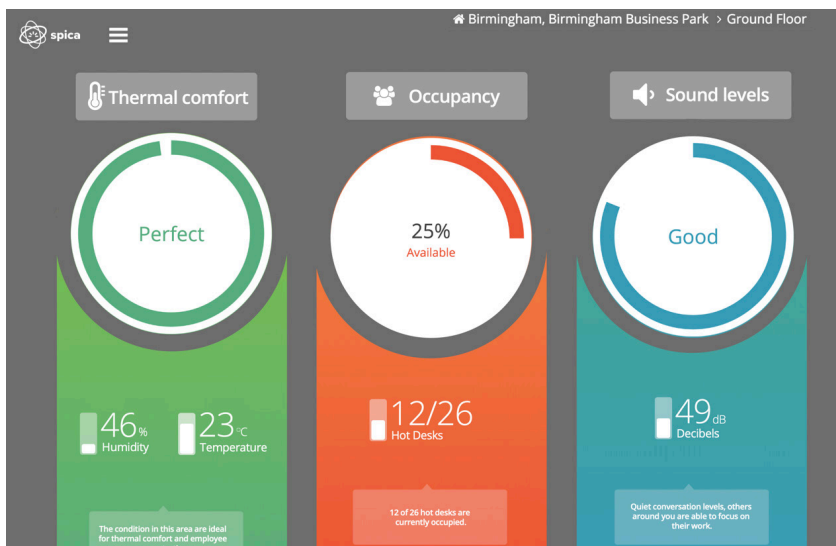
The debate about how the working environment affects the productivity of individuals is not new. However, what has changed recently is the industry's ability to measure scientifically the impact physical real estate has. The Health and Wellbeing of occupants (H&WB) is a crucial part of this drive for productivity, and the Indoor Environmental Quality (IEQ) provided by buildings is a key driver of H&WB.

According to a recent workplace survey by Leesman, almost 40% of office workers stated that their office did not help them to work productively. This matters; at a high level, the productivity of the UK economy is way behind where it should be, relative to both its own history and the rest of the G7. The UK is also more dependent on the output that comes from people who work in offices than ever before. Better offices are unlikely to close this productivity gap in entirety but there is an increasing body of evidence that it can make a meaningful difference. Even a small nudge to office productivity would equate to significant additional output for UK plc. Studies from Harvard and Oxford Brookes universities, as summarised by Cundall, indicate that superior management of environmental factors such as CO<sub>2</sub> concentrations, thermal, visual, and acoustic comfort can have a 20% positive impact on productivity for those working in offices.

There are now internationally recognised accreditation schemes to measure the H&WB attributes of indoor environments, such as the WELL standard. These are mostly focussed on office buildings. Although such accreditation schemes have their place, we seek to monitor the drivers of H&WB on an ongoing basis and communicate it to our occupiers.

H&WB offers a great opportunity to partner with occupiers to ensure they make the most of their space while satisfying a commercial motivation for income retention. The risks of not doing this have also grown: measurement of air quality is more readily available, and we expect that the scrutiny of IEQ by employees will increase. COVID-19 is likely to drive this further; maintaining humidity between 40 – 60%, for instance, decreases the probability of virus transmission indoors. As more people are aware of the demonstrable health outcomes generated from the real estate they occupy, the scrutiny on the providers of their space will grow.

We have embarked on a program to grow our ability to measure and communicate the IEQ in our buildings. We have deployed IEQ sensors to collect this information and display it on small screens in the common or reception areas of our multi-let properties and within our Capsule flexible space offering. This allows occupiers to understand how the space is performing against these parameters (as seen below) and find out more via a QR code. We are rolling this out across a minimum of eight Capsule spaces across the UK in Q3 in addition to First Central 200 and 390 Strand where this is already live.



We are confident that with the Mercury model we can deliver the proactive service required to keep these variables within the best practice ranges.

## Final thought

For too long, many real estate owners have relied on inflexible, long-term contracts to be the central feature of their relationship with occupiers. We believe what is needed now is a richer relationship based on collaboration and an alignment of interests. Health and wellbeing is one area where asset owners can work with occupiers to help them achieve their goals.

Those who choose not to embrace this shift could be left behind. Those who challenge convention, embrace technology and change their mindsets to a service-oriented model will likely deliver better outcomes for owners and occupiers alike.

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"My name is Alina and I work for life Residential which is based on the 5th floor in FC200 building. We started our journey here about a year and half ago and it has been an amazing experience so far. All building's staff members from the concierge to building management team, have been nothing but great - providing excellent services and always going the extra mile when needed. Our staff members are so happy to hve the office based in this beautiful and innovative building that is always changing and is always exceeding our expectations"

[liferesidential.co.uk](http://liferesidential.co.uk)

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Maintaining humidity between 40 – 60% decreases the probability of virus transmission indoors and is also optimal for human comfort.

## Ranges recommended for optimal IEQ

IEQ Parameter	Considered Good/Excellent
Temperature	22-25°C
Relative Humidity	40-60%
CO <sub>2</sub>	<800 ppm (1000 ppm; acceptable)
Sound	<60 dB over 8 hr
TVOCs	<500 µg m <sup>3</sup> per 8 hr

Source: Cundall, LGIM Real Assets





## Contact us

For further information about LGIM Real Assets, please visit [www.lgim.com/realassets](http://www.lgim.com/realassets) or email [contactrealassets@lgim.com](mailto:contactrealassets@lgim.com)

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