Serviced Offices and Agile Occupiers in the City of London

SPECIAL INTEREST PAPER CITY OF LONDON CORPORATION

DOMINE DIRIGE NOS
CITY OF LONDON

RAMIDUS

Serviced Offices and Agile Occupiers in the City of London is published by the City of London Corporation. The author of this report is Ramidus Consulting Limited.

October 2014

PO Box 270
Guildhall
London EC2P 2EJ

www.cityoflondon.gov.uk/economicresearch

Contents

Foreword

The City of London is home to a diverse and complex business population, ranging in size from multi-national corporations with thousands of employees, to the small and medium sized businesses (SMEs) who account for over 98% of the businesses in the City. Striking the right balance in providing the right mix of space to accommodate businesses' varied needs is an ongoing challenge, and key to the City's continued success.

Serviced offices – providing centrally-managed fully fitted and furnished flexible space – are of growing importance in the provision of business space, and an area of expansion in the City; our previous research into firm migration into and out of the City showed between 2003 and 2012, the number of firms in serviced offices in the City had grown from 365 to 1,600. Yet, until now, little had been known about the range of provision offered to businesses, or the characteristics of the enterprises that choose to utilise them; this new research was commissioned to fill the gap.

This report explores the rapidly evolving serviced office market within the City of London. The number of serviced offices has more than tripled over the last two decades from 25 in 1995 to the current 85, comprising of nearly two million sq ft of office space. The sectoral representation reflects a similar breakdown to the rest of the City, with a preponderance of financial and professional services firms. Around 70% of the City's serviced office space is occupied by SMEs, with the remainder providing representative offices or flexible space for larger corporates.

A widely acknowledged benefit of serviced offices is the flexibility they provide, hence a perhaps unexpected finding here has been the stability and maturity of many serviced office occupiers in the City, with an average length of stay of 18 to 24 months, in some cases ranging up to a period of three to five years. In fact, around half of serviced office space is occupied by stable SMEs. For many such businesses, this reflects the ease of use that such facilities offer, with the provision of fully equipped and furnished space without the need for individual facilities management.

This work contributes to the wider body of evidence we have published looking at business population trends and office stock in the City. Serviced offices are likely to continue to form a key part of the City's property offer in the future, and we also expect other approaches that provide flexible space, for example, co-working spaces, to develop a stronger presence.

The continued attractiveness of the City will be in ensuring that there are opportunities for businesses of all sizes to thrive, with space that can attract new firms to the City, as well as providing flexibility and choice for those already located here.

Mark Boleat
Chairman of Policy and Resources
City of London
October 2014

Executive summary

Purpose of the report

In June 2014, Ramidus Consulting Limited was commissioned by the City of London Corporation to undertake a detailed study into the role of the serviced office market in the City of London. This report investigates the size of the market, the characteristics which define serviced office providers and users, and the trends which will define the future of serviced offices in the City. This was informed by reviewing existing data and literature on the subject alongside interviews with key serviced office operators and other stakeholders in the City.

Key research findings

The market is young, though fast-maturing and expected to grow

- There are around 85 serviced offices (or centres) in the City of London, with a combined area of two million square feet (sq ft), representing 3% of the City's total office stock space. They house an estimated 2,250 businesses and 18,000 workers.

- The serviced office market itself is relatively new, dating back to the late1980s. Between 1995 and 2014 the serviced office market in the City has grown from 25 centre sites to 85, and the square footage has quadrupled. Total occupied space doubled from 1995 to 2000 and doubled again between 2000 and 2014. About 60% of the centres have opened since 2008, despite the global financial crisis.

- We estimate that there are 10,437 small occupiers (occupying space of less than 1,000 sq ft) in the City, of which 8,173 (78%) occupy conventional leased space, and 2,264 (22%) occupy serviced office space.

- If the number of small occupiers in the City was to grow by 10% over the next decade, and the proportion of small occupiers accommodated in serviced offices rose from its current 22% of the total to 35%, then the market for serviced offices would grow by 77% by 2025.

- This is in addition to potential demand from the growth of core and periphery business models from corporates; new business formation and in-movers and representative offices. For this reason, we consider it a cautious prediction to expect the market for serviced offices to double in size within the next decade.

- The distribution of centres is expected to evolve. There is a notable gap in provision of serviced offices in the West and North West of the City Fringe[1]. We expect centres to open in these areas especially given the arrival of Crossrail at Farringdon by 2018.

[1] In the context of this report the 'City Fringe' refers to the surrounding administrative boroughs of the City, namely Camden, Islington, Hackney, Lambeth, Southwark, Tower Hamlets and Westminster.

The scale and maturity of occupiers is surprisingly diverse

- The serviced office community is a microcosm of the business cluster within which it sits. We found no evidence that SMEs in serviced offices are materially different from those in conventional space. We estimate that around 40% of occupiers operate within Business Services and Professional Services (accounting, consulting, legal, real estate, recruitment, etc.); around 20% are Financial and Insurance companies, with a similar proportion in ICT, and the remainder in 'Other' sectors.

- Around 70% of serviced office space is occupied by SMEs. Two-thirds are steady state businesses, with the remainder consisting of start-up/growth companies. Of the remaining 30% corporate space we estimate that perhaps one-third is representative offices, and two-thirds flexible space. Thus around half of serviced office space is occupied by stable SMEs. While serviced offices are generally thought of as 'a first step' on the commercial property ladder, in fact they often provide a second (and semi-permanent) step on the ladder.

- A key finding of our research has been the stability and maturity of many serviced office occupiers. We found the average length of stay to be between 18 and 24 months, while some occupiers remain *in situ* considerably longer, with three to five years being not uncommon. The implication is that the largest untapped source of growth for the serviced office market might be small occupiers in conventional leases.

Operators position themselves by quality and style and offer flexible all-in charges for their services

- The operator market is segmented in terms of quality, style and price. While this is not explicit and verified (like hotel star ratings), it is clearly understood among occupiers, landlords and the operators themselves. The differentiating features tend to revolve around management, quality of the working environment and level of service.

- Operators generally offer fully-equipped and furnished space. The key attractor is occupational flexibility: they offer 'easy in, easy out' terms, they bundle and fix occupancy costs; and they relieve businesses of the capital costs of establishing a new office and the responsibility for office services.

- High quality ICT provision is an essential part of the serviced office offer, its critical aspects being consistency, resilience and support. For small unit occupiers there is the tangible benefit of being part of a bigger ICT infrastructure.

- The most common offer is a 12-month licence, with a fixed desk rate, payable monthly in advance, with one month's deposit. Most operators offer an all-in unitary charge per desk, although some make a core charge for base services and a 'pay-as-you-go' top-up for additional services such as print and copying, secretarial support and meeting rooms. Pricing responds rapidly to market conditions and desk rates for new licenses can vary from week to week.

- Pricing has reduced in recent years in response to competitive pressures. The differential between the cost of serviced office space and short leases has narrowed considerably comparing base property costs alone (although it is difficult to compare like with like).

- A typical desk cost in the City (at the time of writing) is £550-£700 per month, including VAT, although premium products can be twice that rate. The range of prices clearly reflects the quality of the offer and its position in the market.

- While it is difficult to compare like with like, we estimate that the headline cost of a serviced office attracts a price premium (over the base property costs in the leasing market) of between 40% and 80%. The inclusion of management costs within the headline cost makes them competitive with conventional leases.

Future trends

Demand is expected to grow with a broader range of offers to emerge

- Potential for growth exists, based on three principal sources of demand. First, there is strong and sustained growth in the number of small, often technology-enabled, knowledge-based, businesses in London. Secondly, corporate occupiers are becoming accustomed to supporting their core property need with flexible 'on-demand' space. Thirdly, small businesses that are occupying secondary properties in conventional leases will likely opt for a different approach, spurred by a diminishing supply of small and short-term office space in the conventional leasing market.

- In the future, a broader range of offers will emerge. It is likely that serviced office providers will continue to differentiate their offerings in terms of quality and style, with a strongly tiered market emerging. Furthermore, we expect to see a broader 'flexible space' market emerging, with more managed space and co-working space. Incubators and accelerators are less likely to enter the City, instead remaining in the City Fringe areas.

Supply constraints and a changing leasing market could inhibit market expansion…
There are strong grounds to forecast robust and rising demand for serviced offices, but we also identified constraints on operators' ability to create new supply.

- Operators are less likely to be able or willing to acquire office space in the City market during a strong phase in the market cycle because of their exposure to rising office rents, which are then passed on to customers. If demand for serviced offices falls, desk rates will adjust accordingly but operators' base costs are fixed. A secondary, albeit less influential factor, is that the investment market views operator covenants[2] as comparatively weak, resulting in discounted valuations of buildings in which they are present.

[2] 'Covenant strength' is a term used in assessing the security of rental income, when valuing properties for investment purposes. It describes the ability of a lessee to honour their commitment ('covenant') to pay the rent for the period of the lease. A lessee with a strong covenant is unlikely to default on the rent, whereas one with a weaker covenant is perceived to be a riskier prospect in the same terms. As serviced office operators are often lessees, then their operator covenant is assessed in the same way.

- Irrespective of underlying demand, serviced offices are exposed to the vagaries of the rental market. Much of the growth that has taken place in recent years has been against the backdrop of a weak leasing market in the City, making it easier for operators to do deals. Upward pressure on base rents raises the question of how elastic prices can be.

- Given the current strength of the letting market in the City, the decline in availability and associated rise in rents, opportunities to acquire space in the core City market are likely to be more limited in the foreseeable future. The same is true in the City Fringe, particularly in the Shoreditch and Clerkenwell markets, where there is enormous competition for space from within and outside the office market.

- We expect the provision of serviced office space in the City to move into a period of slower growth, as it consolidates and absorbs its recent period of rapid expansion. Once rental growth settles, there is every reason to expect a further phase of expansion based on untapped demand. This might encourage the emergence of alternative business models in the sector.

Thus, the wider property market represents a significant potential brake on the growth of the serviced office market in the short-term, but long-term prospects are strong as the market adapts and evolves.

…but more landlords will embrace serviced offices

- Traditional property valuation practices militate against short-term income and favour strong covenants. Yet our research has demonstrated the notable stability of many serviced office occupiers, not to mention the 30% or so of space that is occupied by corporate occupiers. The question therefore is whether landlords will adopt different approaches. We believe that more landlords will embrace the serviced office market.

- The joint venture model of serviced offices seems to offer a number of advantages. It moderates the risk to the operator of falling rental markets, or any decline in demand and it gives a mechanism to share the rewards of a rising market with the property owner, making it a more attractive proposition and allowing the property owner to become involved in a market that seems to be expanding.

1 Introduction

In June 2014, the City of London Corporation commissioned Ramidus Consulting Limited to undertake a detailed study into the role of the serviced office market in the City of London ('the City'). This report summarises the main findings of the investigation, setting out how the serviced office market has evolved, the size of the market within the City, the characteristics of serviced office providers and the businesses that occupy them, and the trends in the market that will help define its future characteristics within the City.

1.1 Background

The underlying purpose of the research was to investigate the scale and nature of businesses that have a trading presence in the City, but do not occupy space within conventional leases. In so doing, the work focused on the important and expanding role of the serviced office market in accommodating this element of the City's business ecosystem. We term these businesses 'agile occupiers'.

Rather like 'agile workers', agile occupiers can be defined by their tendency towards knowledge working and use of technology to support a style of work that can be undertaken in a variety of settings. While they might have a fixed presence in the serviced office, many agile occupiers are likely to work in more than one location. Importantly, while most are small businesses, the unit of occupation in a serviced office may be an agile part of a larger, corporate organisation.

The presence of agile occupiers in the City was first identified in *Taking Stock: the Relationship between Businesses and the Provision of Office Stock in the City*, published by the City of London Corporation in March 2013. The research focused on businesses occupying offices of 1,000 square feet (sq ft) or more, and identified 3,627 occupational records – considerably fewer than the 2013 Office of National Statistics (ONS) estimate of 14,385 businesses in the City.

This discrepancy partly arises as many businesses occupy less than 1,000 sq ft of office space. While some do so on conventional leases, the *Taking Stock* report highlighted the role of the serviced office market in meeting the demands of agile occupiers. The level of commitment made by businesses occupying serviced offices can vary from as little as one month to in excess of one year.

One additional explanation for the discrepancy between the two estimates is that there are a large number of 'brass plaque' companies in the City – those with a registered address but no physical presence.

In 2014 the City of London Corporation published a research report, *The Impact of Firm Migration on the City of London*, which included a section on the serviced office market. The research found that, between 2003 and 2012, the number of firms in serviced offices in the City had grown from 365 to 1,600. The research suggested that serviced offices form an increasingly important part of the City's property offer, but that further work was needed to understand the dynamics of the market.

Given the relatively recent emergence of agile occupiers, we know little about the way they use office space and the options currently available to them. Small occupiers by their very nature (small users of floorspace and small contributors to rental income individually) have not been a high priority for the property industry. It is not surprising therefore, that they have not been given a particular focus by the property research industry in the past. For this reason, the body of published literature and data on small occupiers is limited.

Discussions with serviced office operators as part of this research also revealed that most do not keep comprehensive records of the number and type of businesses that pass through their centres. Consequently, relatively little is known about the users of this market, making it difficult to evaluate its impact on the City, and consider how this is changing. We have therefore had to rely on qualitative data and estimates in some areas, including sector breakdown and business size of occupiers, for this research.

1.2 Research questions

The research carried out for this report is centred around eight key research questions and sub-questions, which are set out below:

- How many serviced offices are there in the City?
- How many businesses are serviced office occupiers?
- How large is the potential market for serviced office operators?
- What role do serviced offices play in building a business ecosystem?
- What facilities and terms are offered by different types of serviced office?
    - What are the characteristics of the companies using them?
- What types of businesses occupy serviced offices?
- How long do businesses stay in serviced offices?
    - Where do they come from and where do they move on to?
- How is the serviced office market changing?

The questions are addressed through a number of strands of research (see Section 1.3), and are considered from different perspectives (operators/occupiers etc.) through the report.

1.3 Methodology

In order to quantify and describe the scale and nature of agile occupiers and the role of the serviced office market as accurately as possible, we drew upon the available published literature and data, and used this in conjunction with company and enterprise data. We also relied on intelligence gleaned from serviced office operators and other stakeholders through interviews. The stages in the research methodology are outlined below.

1.3.1 Review of existing evidence

A review of existing evidence relating to the serviced office market was undertaken to understand its origin and evolution. This involved a literature review to collate published evidence on the market in the context of the UK, London and the City, as well as synthesising our expert knowledge and experience of the market, using a number of data sources to quantify the market.

As part of this work we drew on the City of London Corporation's database of serviced offices, verifying and updating the data. We accessed operator websites to identify their centres, and then used property market data to quantify sizes and determine opening dates.

This evidence informs Chapter 2 which defines the serviced office and looks at the wider market context, and Chapter 3 which quantifies the number of serviced offices in the City and how this is changing over time. It also uses this to estimate the number of workers and businesses resident in serviced offices in the City.

1.3.2 Data analysis

The majority of serviced office occupiers in the City are SMEs and most of them are micro-businesses (businesses with fewer than ten workers). Therefore in order to estimate the size of the potential serviced office market, we set out to establish an accurate estimate of the total number of small occupiers in the City and compared this with the number already accommodated in serviced offices. To do this we undertook an analysis of a number of data sources and cross-checked these with capacity in the built stock.

The results of this analysis can be found in Chapter 4 which aims to establish an accurate estimate of the total number of small occupiers in the City, as well as how many of these are accommodated in serviced offices currently, and what future growth may look like. Additional detail on the sources used can be found in the Appendix in Section 8.1.

1.3.3 Interviews

The primary source of evidence for this report is a series of face-to-face interviews, carried out with serviced office centre operators and other stakeholders with a significant presence in the City.

The interview sample comprised of ten operators who, we estimate, account for 80% of the serviced office floorspace in the City. Operators were selected for inclusion on the basis that they have (1) more than one centre in the City; or (2) an innovative product, or (3) a high profile in other locations even though their presence in the City is relatively small.

In addition to the operators, we consulted four large landlords, three intermediaries, serviced office market trade body the Business Centre Association (BCA), and a firm of chartered accountants. These additional interviews provided a broader range of perspectives to deepen the understanding of the market provided by the operators.

The interviews with operators were semi-structured and wide ranging but always covered a core set of topics relating to the serviced office market. These are summarised in the list below:

About the operators
Business background
Extent of activities
Activity in the City of London
About the occupiers
Type of business: size, sector, age, employee profile
Occupier variation between centres
Length of license and length of stay
Origin of occupiers and destination on leaving
Sources of growth
About the offer
Terms and facilities offered
What types of firms take up which offers
How demand is changing
Broadband and ICT infrastructure
The City of London market
The size of the potential market for serviced office operators
The role of serviced offices in the business ecosystem
How the market is changing: emerging offers

The findings from the interviews can be found in Chapter 5 which focuses on the perspective of the operators and building owners, and Chapter 6 which looks at the main characteristics emerging on the occupiers of serviced officers.

Chapter 7 summarises the main findings of the report in relation to the research questions and considers the implications for the future of the City's serviced office market.

The research focuses on serviced office provision within the administrative borough of the City of London. However, we recognise that the functional City property market extends beyond the City of London boundary, with serviced offices just beyond the City's border supporting the market within. Therefore, where relevant, this report will consider the impact of these fringe areas for the City's serviced office market ('City Fringe').

1.4 Acknowledgements

We would like to acknowledge the help that we received during this research from a number of individuals listed below. Their generosity with time and market insight was invaluable.

Company	Contact
Anton Page	Stephen Page
Avanta	Alan Pepper
Argent	Nick Searle
Bathtub to Boardroom	Paddy Willis
British Land	Paul Burgess
Business Centre Association	Jennifer Brooke
Canary Wharf Group	Richard Archer, Katie Oliphant & Tarun Mathur
Crowe Clark Whitehill	Alan Dawson
Co-Work	Tom Kuhn
Green Kinnear	Douglas Green & Will Kinnear
Hubworking	Jane Foreman
I2 Offices	Mark Grant
Instant Offices	Lucy Watts
Landmark	David Todd
Land Securities	Kaela Fenn-Smith
Lenta	Robert Levy
London Executive Offices	Tim Giles
Orega	Paul Finch
Regus	Ben Munn
Servcorp	Krystle Sulway & Leonie Ruegg
The Office Group	Olly Olsen
Workspace	Chris Pieroni

2 The serviced office market context

To understand the role of the serviced office market in the City, it is important to consider what defines a 'serviced office', as well as the wider market context. This chapter provides a brief introduction to serviced offices, where they fit within the flexible office space market, how and why the market has grown and the size of the market in the UK.

- Serviced offices provide occupational flexibility for businesses, with 'easy in, easy out' terms.
- Serviced offices bundle and fix costs, and relieve businesses of the capital costs associated with establishing a new office.
- There are around 6,000 serviced offices worldwide, of which the UK accounts for around 2,000.
- In the UK the sector serves some 80,000 customers, employing close to 500,000 people and occupying around 70 million sq ft.

2.1 Definition and features

The distinctive features of serviced office space are that operators generally offer fully fitted and furnished space, in segregated office units in a relatively conventional office environment, with additional facilities management services. Occupancy costs (business rates, service charge, management and facilities) are bundled into a unitary charge, fixed for the duration of the license. Whether the customer is a start-up business making its first commitment to commercial space, or a large corporate business seeking project or overflow space, the ability to outsource property responsibilities, based on a single cost, is a key driver of this market.

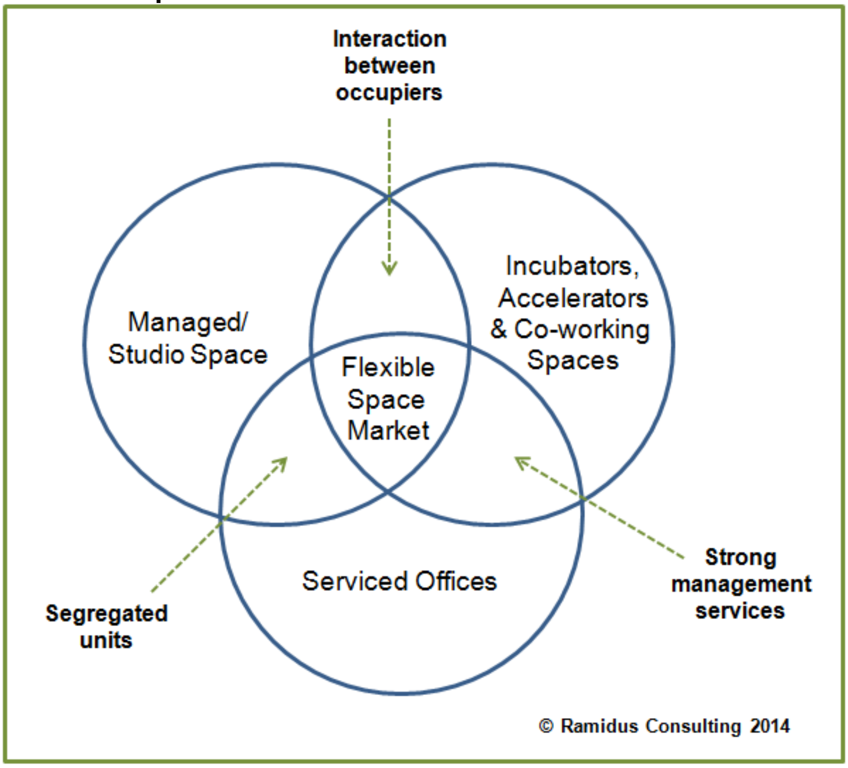
The defining feature of the serviced office market is that it provides occupational flexibility for businesses. Flexibility is crucial to occupiers because it allows them to respond to their changing market conditions efficiently and effectively. In contrast to conventional leases, serviced offices provide for 'easy in, easy out' terms, and they relieve businesses of the capital costs associated with establishing a new office, such as fit-out and furniture.

Serviced offices are part of a rapidly evolving section of the office property market which is widely referred to as the 'flexible space market'. This term embraces serviced offices, managed offices, co-working spaces, incubators and any other flexible space offering. The fact is that most such flexible spaces in the City currently comprise of 'pure' serviced offices, but it is important to understand the wider context, not least because the market is continuing to evolve.

- **Managed space** is similar to serviced offices in terms of flexibility of occupation, but typically involves licenses for space in larger units to single occupiers over longer periods of time.
- **Incubators and accelerators** are spaces which involve the additional provision of mentoring and advice, and occupiers are encouraged to adopt growth programmes.
- **Co-working spaces** are becoming more common and offer small businesses a working environment that encourages collaboration in an informal and contemporary style.

Figure 2.1 shows the various sub-sectors that make up the flexible space market - serviced office space, managed/studio space, and incubators, accelerators and co-working spaces. The graphic illustrates how all three formats can potentially suit the needs of agile occupiers.

Figure 2.1: The flexible space market



Source: Ramidus Consulting

There are fundamental differences between the flexible space office market and the market based on conventional leases. Customers (as distinct from tenants) in flexible space do not have to demonstrate their 'covenant strength'[3], they are able to occupy space more quickly and with fewer commitments, and they are able to exit with minimal fuss. Flexible spaces are also available to start-ups and micro-businesses that are not catered for in the conventional leasing market.

Although conventional leases have been reducing in length over recent years, they remain a significant commitment for a start-up business, or for a larger corporate business looking for overflow or project space. Similarly, even the much-shortened conventional lease requires professional advice, and is accompanied by the complications involved in the fit-out process, as well as the time involved. By contrast, a flexible space can be occupied very quickly and, once in occupation, space can be up-sized, down-sized and reconfigured with relative ease.

[3] 'Covenant strength' is a term used in assessing the security of rental income, when valuing properties for investment purposes. It describes the ability of a lessee to honour their commitment ('covenant') to pay the rent for the period of the lease. A lessee with a strong covenant is unlikely to default on the rent, whereas one with a weaker covenant is perceived to be a riskier prospect in the same terms. As serviced office operators are often lessees, then their operator covenant is assessed in the same way.

2.2 An emerging market

The serviced office market has matured in recent years. As the BCA notes, while it is:

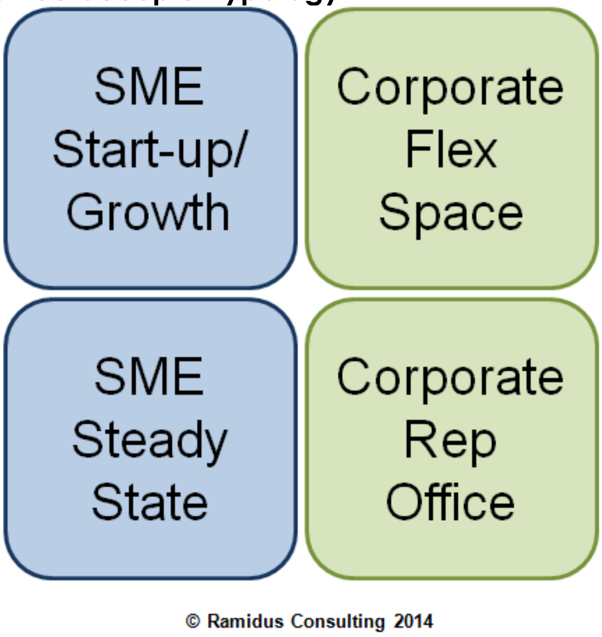
> "a *commonly held assumption that, during recession, more people start businesses and the demand for smaller and flexible office space grows*", in reality "*the sector has proved itself to be much more than a stepping stone to career or business progression.*"

The BCA suggests that the sector:

> "*has been rigorously 'stress-tested' through two recessions [and] has shown its ability not only to survive but to adapt to changing markets*".[4]

Serviced offices appeal to agile occupiers, be they small to medium sized enterprises (SMEs), which include micro and single person companies, or teams within corporate occupiers.[5] In Figure 2.2 we provide a typology of occupiers based upon the scale of the operation from small to large and functional requirements from stable to volatile.

Figure 2.2: Serviced office occupier typology



Source: Ramidus Consulting

[4] Business Centre Association *Per Comm* 26th August 2014

[5] 'Corporate occupier' is an informal term, but one widely used in the property market, to refer to larger occupiers who occupy property in multiple markets (nationally and locally), and who typically plan their occupation in a centralised manner with specialist property professionals. In these ways they contrast with agile occupiers. However, agile occupiers are not necessarily small firms – they might be large international firms occupying a foothold or representative office.

Agile occupiers are not necessarily growing SMEs, although some are. Neither are they necessarily start-ups (SME Start-up/Growth). They might be long established businesses that remain small and stable (SME Steady State) and choose serviced offices in preference to the conventional leasing market. Equally they might be small teams from within large corporates (Corporate Flex Space) or a representative office of a corporate headquartered elsewhere (Corporate Rep Office).

Serviced offices are a relatively new addition to the UK property market – emerging in the late 1980s. Following the property crash of 1990, unprecedented amounts of office space became surplus to requirements. On one hand the wave of new development arrived just as the demand tide receded rapidly, while on the other, many occupiers sought to off-load space as they rationalised their operations. Up to this point, the UK's property market had discouraged approaches to flexible occupation through long leases and obligations on occupiers. However, such was the scale of surplus space that landlords turned to the serviced office market as a means of bringing income to otherwise surplus buildings.

While serviced offices might have been 'born of necessity' in the UK, their evolution over the past two decades has been associated with a number of positive structural changes in the economy. At least four key drivers of these changes can be identified:

- **The rise of the SME:** The UK has witnessed a major growth in the number of SMEs[6], creating a demand for space (and flexibility) that cannot be satisfied in the conventional leasing market.
- **Technology:** The information, communications and technology (ICT) revolution has transformed ways of working, leading to greater mobility and decreasing reliance on centralised real estate solutions.
- **Flexibility:** Business planning horizons have shortened, often to as little as one year, corporate structures are changing, and working practices are changing radically. Serviced offices allow business flexibility.
- **Corporate real estate management:** Cost competition has led to corporate occupiers becoming more discerning in their procurement of space. Many now rely on flexible space to supplement their core estates.

The first two drivers identified, the rise in SMEs and the impact of technology, merit further explanation.

A report from Oxford Economics underlines the impact of the digital economy on small businesses[7]. The report argued that the rise of the digital economy:

> "*has set in motion a third wave of capitalism that will transform many aspects of the global marketplace – from consumer behaviour to new business models. Mobility, cloud computing, business intelligence and social media underpin this shift*."

---

[6] BIS (2012) *Business Population Estimates*
[7] Oxford Economics (2011) *The New Digital Economy*

The digital economy is transforming business structures, particularly among SMEs: it has enabled small businesses to compete for business directly with large corporates, as the barriers of entry to business become redefined by knowledge work. This in turn is associated with a significant increase in the number of SMEs, and one of the defining features of recent economic change.

The BCA similarly underlines the importance of the serviced office sector market to the digital economy, arguing:

> "*customer profiles have changed over the past two decades, and the need for a fixed office base in a specific location is increasingly being replaced by a need for flexible contracts, opportunities for linked touchdown bases and an approach which removes the need to expend energy on organising utilities, internet and telecoms by presenting a variety of inclusive packages*".[8]

Recent data from the Office for National Statistics (ONS) has revealed that 4.5 million UK workers are now self-employed – a rise of 18% since 2008. Many of these businesses are 'footloose', working from home, working on clients' premises and working in 'third places'. With its provision of flexible space, touchdown space, hot desks and support services, the flexible space market is meeting a growing demand from such workers. The BCA also highlights that serviced offices:

> "*provide a launch pad for the entrepreneurs and new and growing companies … The structure of the sector as a whole enables it to be 'fleet of foot'; and able to respond to changing work patterns, reacting and adapting to demand*".[9]

2.3 The size of the UK and global market

The worldwide serviced office market is estimated to comprise of around 6,000 centres, of which the UK accounts for 36% (around 2,000 centres).[10] The US accounts for a further 1,500 centres, suggesting that the UK and US offer together makes up almost two-thirds of the global serviced office market. In this sense, it can be seen that the UK serviced office market is comparatively mature.

The importance of the sector in the UK is illustrated by the BCA, which suggests that the serviced office sector currently serves:

> "*80,000 customers, employing close to 500,000 people and occupying around 70 million sq ft. In all, the sector generates around £2 billion of income per annum for UK Plc*".[11]

According to serviced office broker Instant, since 2005:

> "*All of the UK's top markets have more than doubled their total number of available centres with the exception of London (which has grown by 43%) and Edinburgh (which has grown by 50%)*."

---

[8] Business Centre Association *Per Comm* 26th August 2014
[9] Business Centre Association *Per Comm* 26th August 2014
[10] Instant (2011) *Global Serviced Office Review*
[11] Business Centre Association *Per Comm* 26th August 2014

London's slower growth is a relative phenomenon: it was already a mature market and has, therefore, grown more slowly than to other, less mature markets.

The following chapter looks to establish the size of the serviced office market within the City itself, and to illustrate the speed with which the sector has grown in recent times in the City.

3 Serviced offices in the City of London

This chapter quantifies the scale of the serviced office market within the City and describes the trends in its growth over recent years.

- There are 85 serviced office centres in the City, comprising of nearly two million sq ft of office space, or 3% of total stock.
- We estimate the City's stock of serviced offices houses 2,250 occupiers and 18,000 workers (6 to 7% of total office employment in the City).
- The number of serviced offices has more than tripled over the last two decades from 25 in 1995 to the current 85.
- 60% (51) of the serviced offices in the City have opened since 2008, indicating the recent expansion of the market.
- There is a strong concentration of serviced office centres in the City in the triangle between Liverpool Street, Bank and Moorgate stations.

3.1 The size of the market

Our research has revealed there are a total of 85 centres within the confines of the City of London boundary. These centres have a combined area of 1,967,816 sq ft net internal area (NIA), with an average size of 23,151 sq ft NIA per centre. Serviced offices therefore represent almost 3% of the City's total stock of office space.

Within the wider definition of 'the City', also including fringe areas, we estimate that this increases to around100 serviced office centres housing around 22,000 workers.

These figures are reinforced by other recent estimates. For example, a 2013 report from Office Broker.com suggested that central London contains 267 serviced office centres, and that the EC postal districts account for 99 of these.[12] Similarly, a market overview from Instant suggests that central London contains 285 centres, of which 118 are in the City (EC postal districts) and Docklands.[13]

If we assume an occupation density of 110 sq ft NIA per worker (reflecting good practice in modern offices)[14], then we can deduce that the City's stock of serviced offices potentially houses around 18,000 workers (a figure that represents around 6 to 7% of total office employment in the City).[15] This figure corresponds well with previous research published by the City of London Corporation, which estimated total employment in serviced offices in the City and 'City Fringe' at just over 22,000.[16]

3.2 Growth of the market

The serviced office market in the City has undergone significant growth in recent years in terms of the number of centres and the total space available, as well as the number of firms and employees based in them.

---

[12] Office Broker.com (2013) *Serviced Office Review Central London Q4 2013*
[13] Instant (2013) *UK Serviced Office Review 2012*
[14] The British Council for Offices' *Occupier Density Study* (2013) provides a benchmark occupancy density for London of 11.3 sq m (121 sq ft).
[15] We recognise that serviced offices operate typically at 80-85% occupancy, and so this calculation might be slightly inflated. We also recognise that operators do not calculate capacity on NIA.
[16] City of London Corporation (2014) *The Impact of Firm Migration on the City of London*. In the context of this report the 'City Fringe' refers to to the surrounding administrative boroughs of the City, namely Camden, Islington, Hackney, Lambeth, Southwark, Tower Hamlets and Westminster.

Table 3.1 illustrates how the market has grown from less than half a million sq ft in 1995, to almost two million sq ft today using data from the EGi London Offices Database. Similarly, during the same time period, our research shows the number of centres has grown from 25 to 85. The figures suggest that centres have begun to increase in average size in recent times, although more time-series data will be required before this can be verified. Section 3.5 looks at centre size in more detail.

Table 3.1: The growth of serviced offices in the City

Year	Total provision of serviced offices sq ft	No. of centres	% change sq ft	% change in no. of centres	Mean size of centre
1995	492,000	25	-	-	19,680
2000	1,056,471	53	115	112	19,933
2005	1,227,364	63	16	19	19,482
2010	1,354,141	72	10	14	18,808
2014	1,967,816	85	45	18	23,151

Source: EGi London Offices Database/Ramidus Consulting

The City of London Corporation *Firm Migration* report[17] referred to in the previous section includes an analysis of the growth of the serviced office market in the City and City Fringe, based on a sample of over 110 serviced office premises.[18] This data revealed the extent of recent growth of the market in terms of firms and employees (Table 3.2). Clearly, there has been substantial growth, with a tripling of firms in serviced offices between 2003 and 2012, and 154% growth in employees.

Table 3.2: Firms and employees in serviced offices, City and City Fringe, 2003-12

Year	Firms	Employees
2003	670	8,760
2008	1,535	16,620
2012	2,355	22,260

Source: *The Impact of Firm Migration on the City of London*

The report notes that, for the area of the City alone (i.e. excluding the City Fringe) the number of firms rose over the period 2003 to 2012 from 365 to 1,600.

It should be emphasised that the data sources for Tables 3.1 and 3.2 are different and it is therefore not possible to read directly across the output.

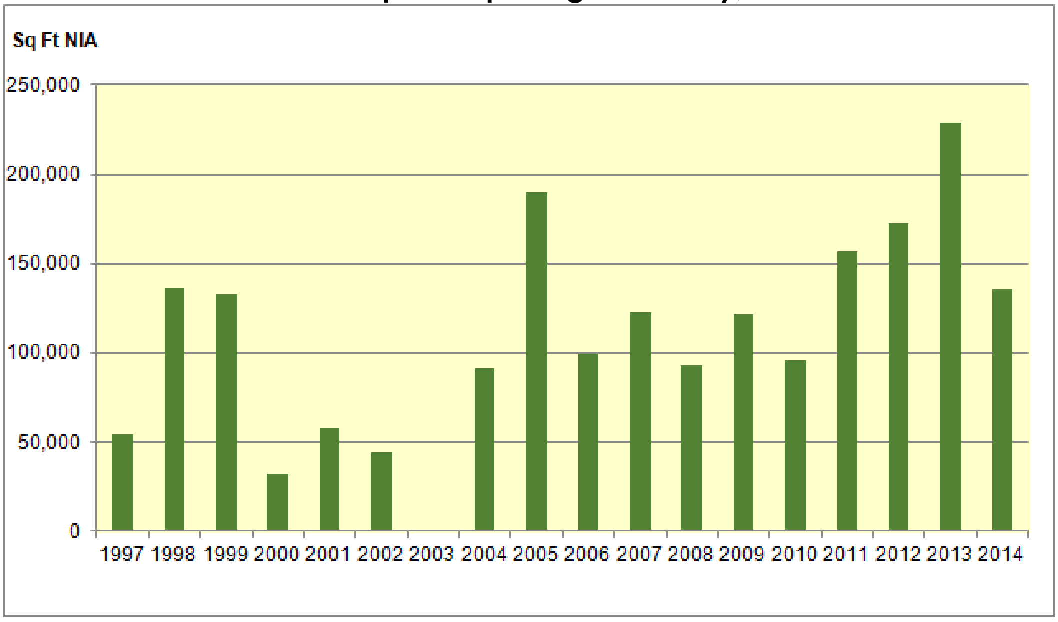
Figure 3.1 shows the combined floorspace of centre openings between 1997 and 2014, for the 85 serviced office centres that were identified in the City in this research. The data shows a healthy market in 1998 and 1999, followed by a steep decline in newly available space around the Dotcom crash in 2000, particularly 2003 – unsurprising given the link between the digital economy and increase in small businesses, discussed above.

[17] City of London Corporation (2014) *The Impact of Firm Migration on the City of London*

[18] The sample of was cross referenced with business data from TBR's Trends Central Resource (TCR) database to identify businesses listed as operating from one of the serviced office addresses.

The amount of newly available space rose sharply from 2004, albeit a smaller increase in 2008 and 2010. A total of 51 centres out of the 85 in the sample (60%), have opened since the financial crisis in 2008, indicating the recent expansion of the market.

Figure 3.1: New serviced office space opening in the City, 1997 to 2014



Source: EGi London Offices Database/Ramidus Consulting

Figure 3.1 does not include centres that have opened and subsequently closed over the period shown, simply the opening dates of those that operate today.

There are a number of factors that might contribute to the pattern of opening dates, although there is no commonly agreed explanation. One theory is that openings reflect the state of the wider economy, as operators open centres more rapidly when they anticipate growth in demand, and more slowly in economically strained times.

However, an alternative explanation is that, although operators may wish to respond to strong economic performance by opening centres, their ability to do so is dictated by the prevailing supply/demand balance in the conventional leasing market. This is because demand (and rents) in the mainstream market also rise in strong economic circumstances. This could mean that landlords are less inclined to lease space to serviced office operators, and/or the operator's profit margin will be reduced by having to pay a higher base rent.

If, as has been the case in the City until very recently, there is a high rate of availability in the office market, then operators remain able to secure space even as demand recovers. This has probably contributed to the high rate of openings in 2013, and so far in 2014, shown in Figure 3.1, enabling operators to respond to raised levels of demand for serviced office space as the UK's economy recovers.

This is supported by a number of our operator interviewees who said that the City has one of the highest levels of available space in serviced office centres in central London, and the most competitive workstation rates, despite healthy levels of demand for their product.

While time series data for the cost of occupying serviced office space is not available, two important observations arise from our research. The first is that workstation rates have been lower in the City than in most other parts of central London. The second is that rates have been more stable than in other parts of central London. Both of these characteristics reflect the underlying supply of office space in the market. The City has been less supply-constrained than other parts of central London for most of the period since the emergence of serviced offices, particularly in comparison to the West End.

However, data available from The Instant Group[19], for the period from 2012 to 2014, shows that prices remained broadly unchanged in 2012 and 2013. Prices have risen in 2014 for small units of less than five workstations, and larger units with more than ten workstations. The mid-size range (six to ten desks) remains at the same price level, suggesting that there is some pressure on supply now and that demand for the mid-size units is squeezing options for smaller (and to a lesser extent, larger) occupiers.

The most significant price change has been in EC1, which had the lowest rates of the four City postcodes in 2013, at around £450 per desk, but by mid-2014 had risen to the highest rates, with an average of over £700 per desk. Rates in EC2 also grew, although by a smaller amount, from around £600 in 2013 to over £700 in mid-2014. In the other two post codes there were only modest increases, from around £600 to £625 or £675 per desk.

It seems likely that strong demand from tech and media businesses for small units of flexible office space have driven the price rises. There is plenty of anecdotal evidence to support this assertion.

3.3 Spatial patterns

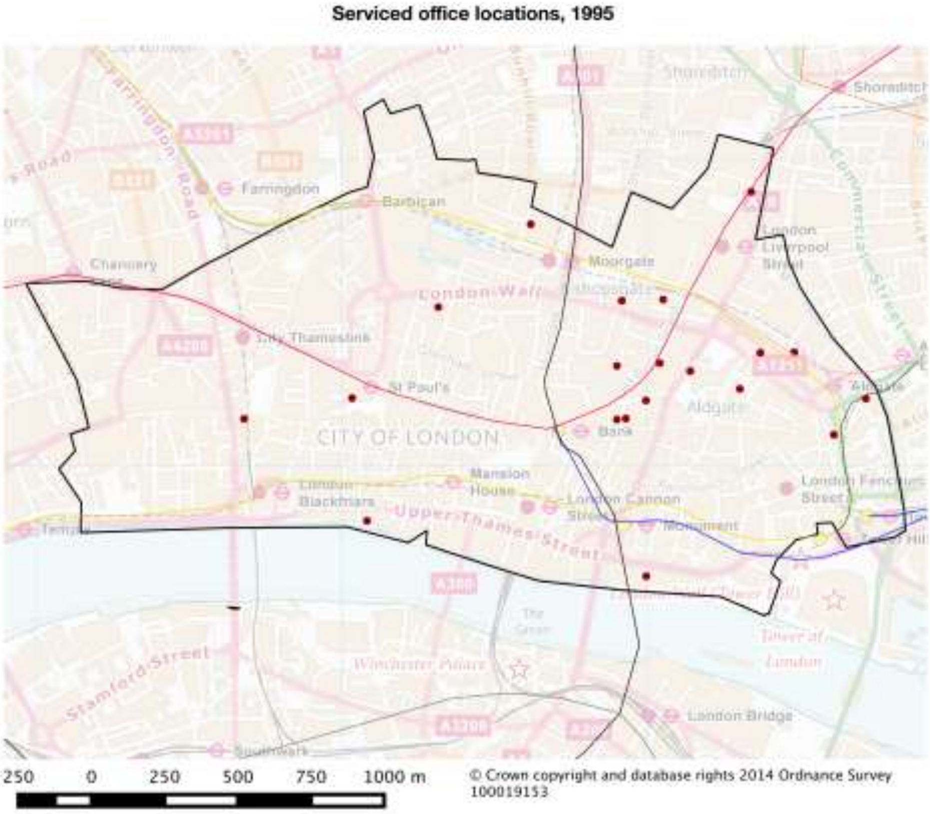
In order to identify spatial patterns and trends in the location of serviced offices in the City we have mapped the evolution of the serviced office market between 1995 and 2014 in Figures 3.2 to 3.4. Each dot on the maps represents an individual serviced office.

The maps show a strong concentration of serviced office centres in the City in a triangle between Liverpool Street, Bank and Moorgate, or close to one of these nodes. This pattern was evident in 1995 (Figure 3.2) and has remained distinctive since.

This triangle is one of the best connected areas on London's public transport network, giving access to the following lines: Central, Circle, District, Metropolitan, Northern, Hammersmith and City, Waterloo and City, and the DLR, as well as mainline rail from Moorgate and Liverpool Street and, by 2018, Crossrail.

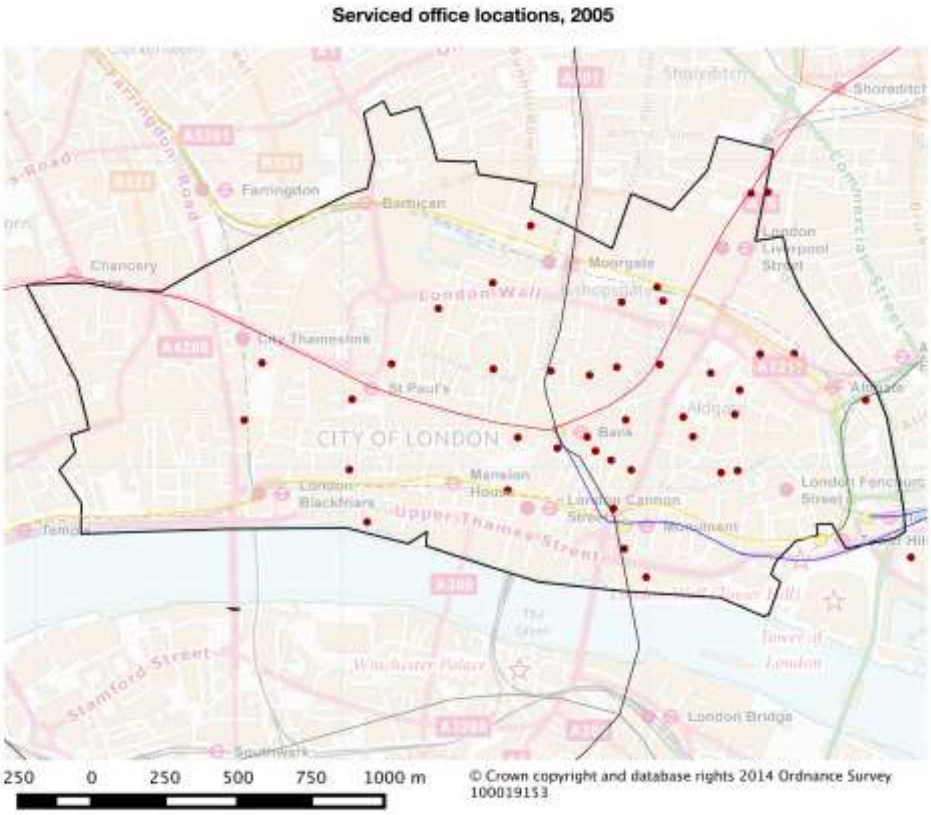
[19] Covering postcodes EC1-4. It is important to note that the data from the Instant Group included in this report covers the whole of the EC postcode area, and therefore includes parts of EC1 and EC2 that lie outside the City boundary.

Figure 3.2: Serviced offices in the City 1995



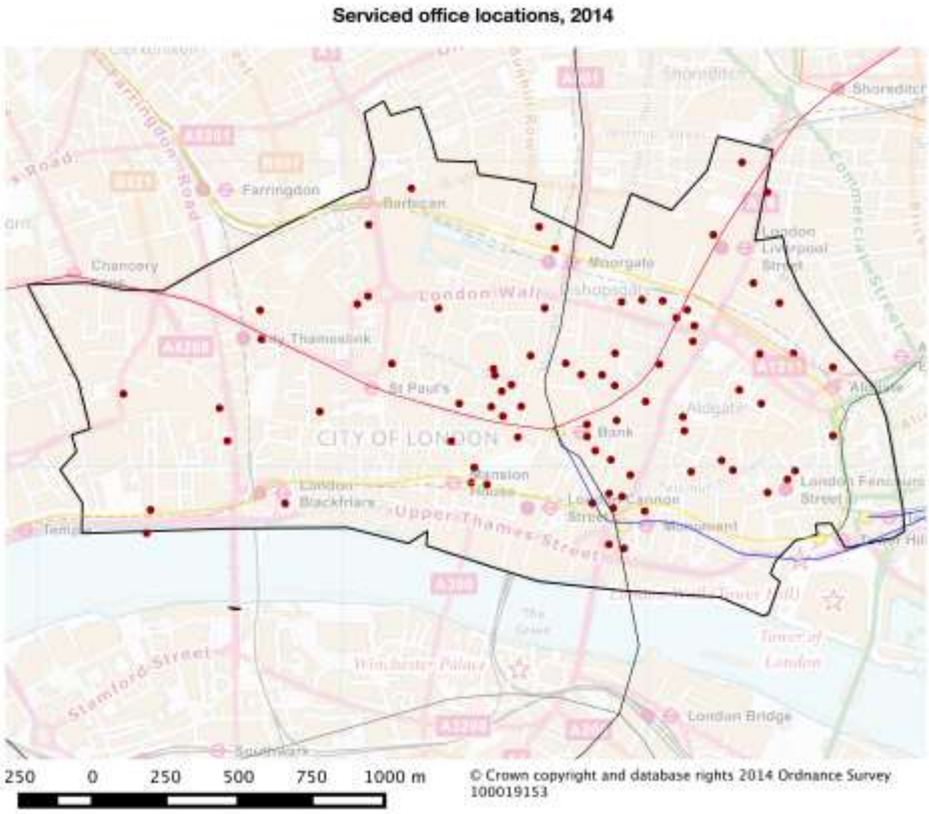
Source: Ramidus Consulting

Figure 3.3: Serviced offices in the City 2005



Source: Ramidus Consulting

Figure 3.4: Serviced offices in the City 2014



Source: Ramidus Consulting

In the 2014 map (Figure 3.4) it is evident that centres are beginning to populate the westerly reaches of the City but the overall density of centres in the west of the City remains comparatively low. There is also a lower density of centres than might be expected in the lower cost areas on the edge of the City and within the City of London boundary adjacent to the tech and media clusters in the east. This suggests a gap in the market and a possible opportunity. The most marked additional cluster to emerge is just to the west of Bank station, and there is also a spur running east through EC3.

3.4 The buildings

Some serviced office operators operate from freehold buildings, although this is rare in the City. In most cases, operators lease parts of multi-let buildings and take leases at market rents for periods of 10 to15 years, as in the wider leasing market.

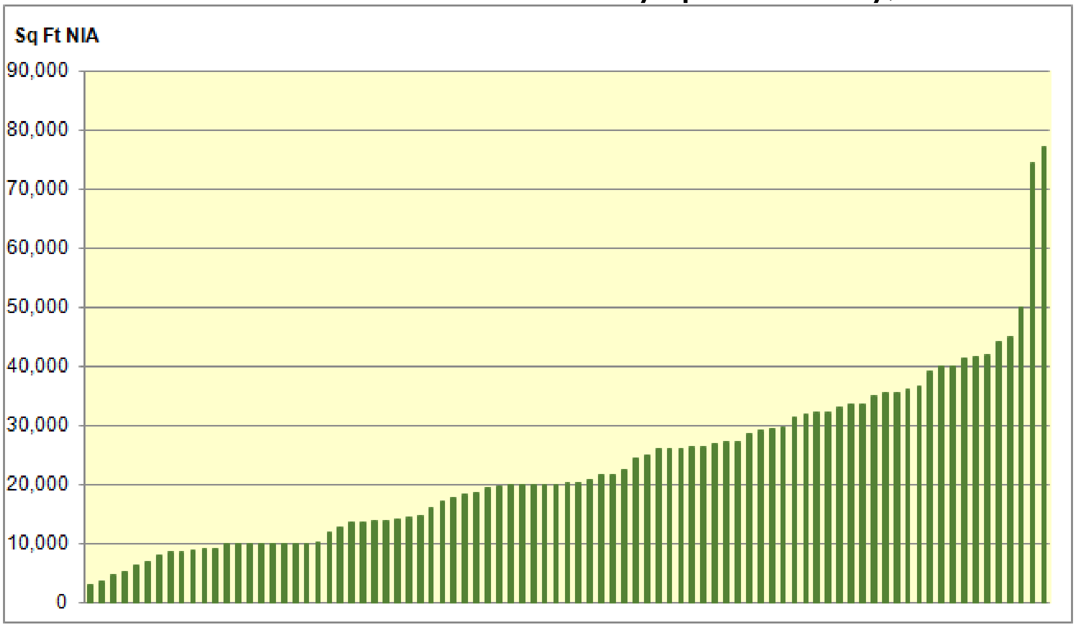
The serviced office market offers a range of building qualities for customers. In the City, prime offers tend to be concentrated in newer, Grade A buildings, and therefore benefit from higher specification and efficient space planning. Typically, these buildings are multi-let, and the serviced office normally comprises a single floor.

However, not all serviced office centres are in modern, Grade A buildings. One operator explained that the optimum building for a viable serviced office centre is a good (but not necessarily top) quality building in a prime location, with strong visibility and proximity to a transport hub. The floorplate should be capable of division into small units, suggesting that buildings of shallow depth are important. Many period buildings fall within this description, and the serviced office market can be supported by a wide variety of building types and ages.

3.5 Centre size

Our database of 85 serviced office centres in the City yields an average size of 23,151 sq ft NIA. In the City, this average has risen significantly in recent years, from less than 20,000 sq ft throughout the period from 1995 to 2010. Figure 3.5 shows the sizes in sq ft of each of the serviced of centres open today. One-third (35%) are less than 15,000 sq ft; one-fifth (22%) are 15,000-25,000 sq ft, and almost half (43%) are in excess of 25,000 sq ft.

Figure 3.5: Sizes of serviced office centres currently open in the City, 2014



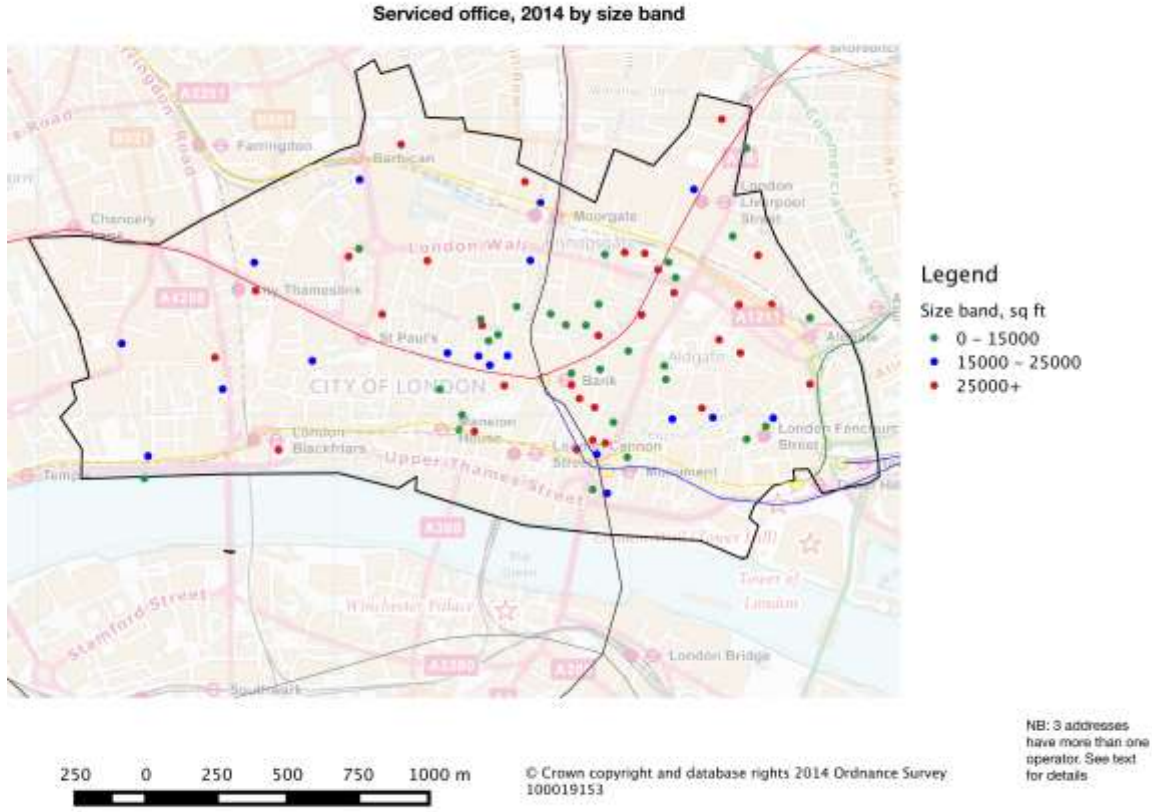
Source: EGi London Offices Database/Ramidus Consulting

In 2010, only 31% of centres were larger than 25,000 sq ft, reinforcing the fact that the average size has increased in recent years. Two of the centres are in excess of 70,000 sq ft although, as Figure 3.5 suggests, these are atypical; the next largest being 50,000 sq ft. The two centres in excess of 70,000 sq ft were opened in 2004 and 2005, and so do not account for the most recent growth in average size.

While there is no prescribed optimum size for a serviced office centre, it should be noted that there are factors that influence viability from the perspective of the operator at different size levels. For example, staffing costs will affect viability because the same number of staff might be required in, say, a 15,000 sq ft centre as in a 25,000 sq ft centre. However the equation might change in the 35,000 sq ft centre where more staff are required to manage the centre effectively.

Figure 3.6 shows the distribution of serviced offices within the City by size band. There are two notable features in this map. First, the largest centres (25,000+ sq ft) are clustered in the EC2 and EC3 postcodes. Secondly, there is some significant clustering around transport nodes (Cannon Street, Bank and Liverpool Street).

Figure 3.6: Distribution of serviced offices by size band, 2014



Source: Ramidus Consulting

4 Estimating the size of the potential market

One of the key tasks for this study was to estimate the size of the potential market for service offices in the City. As outlined in Chapter 2, serviced offices are a relatively new product in the property market and their role is still evolving. Thus it is wise to assume that the potential market may be significantly bigger than the current number of businesses accommodated in serviced office space. To ensure our estimates are as accurate and robust as possible, we review a number of data sources in this chapter.

- There are 14,385 enterprises and 17,345 workplaces in the City.
- Of a sample of 11,571 companies from FAME with registered addresses in the EC3 postcode district, only 6,438 had a physical presence in the City.
- There were an estimated 10,285 office workplaces with fewer than ten employees in the City in 2013, of a total 14,760, according to ONS figures.
- Estimates based on the capacity of built stock in the City indicate there are 10,437 small occupiers in the City, of which 8,173 occupy conventional leased space and 2,264 occupy serviced office space.

4.1 Context

Our research has found that the vast majority of occupational units in serviced office space are for between five and ten people. Most commonly these are micro-businesses (businesses with fewer than ten employees) but a significant number are small teams from within large corporates, or a representative office of a corporate headquartered elsewhere.

Therefore, in order to estimate the size of the potential market for serviced office space, we need to first consider the following:

1. The total number of businesses in the City.
2. The total number of workplaces in the City.
3. An estimate of the number of small occupiers in City workplaces.
4. An estimate of how many small occupiers are already accommodated in serviced office space.

We looked at Inter-Departmental Business Register (IDBR) data on the number of enterprises in the City and compared it with the number of businesses registered at Companies House, using the FAME interface (see Section 8.1 for further detail on the IDBR and FAME).

We then used the breakdown of ONS/IDBR workplace data by size to estimate how many small occupiers there are in the City. For a comparative estimate of the number of small occupiers in the City, based on occupational units, we looked to EGi's London Offices Database (see Section 8.1 for further detail on EGi's London Offices Database). This is then broken down into an estimate of those that occupy conventional leased space and those that occupy serviced office space.

4.2 The number of businesses and workplaces in the City

According to the ONS/IDBR there were 14,385 enterprises present in the City in 2013 and 17,345 workplaces (local units).[20] For the purpose of this study, we are most interested in workplaces, since these are equivalent to occupational units (for example, large businesses may have several separate physical presences in the City).

A year earlier, in 2012, there were 15,940 workplaces – indicating a substantial 9% increase in just 12 months. This suggests a period of rapid business formation, business growth, or business fragmentation (expansion into overflow space). This pace of change suggests robust demand for flexible workspace.

We tested the most recent total number of workplaces (2013) against the number of businesses with a physical presence (i.e. those with a primary trading address and/or a trading address) registered in the City at Companies House, using the FAME interface. Using EC3 as a sample postcode district for illustrative purposes we identified 6,438 companies with a physical presence in this area. We believe this number is consistent with the total of 17,345 workplaces for the whole City, as derived from the IDBR, and therefore it is the office workplaces estimates based on IDBR that we take forward into our estimate of potential market size.

Not all of the 17,345 workplaces counted in 2013 are offices. The data includes all types of workplace although, in the City, the only significant other categories are Retail and Hospitality (hotels and restaurants). Once the non-office sectors have been subtracted, we estimate that there were 14,760 office workplaces in the City in 2013.

The total number of businesses registered in the City at Companies House, however, far exceeds the number in the IDBR counts. There are several possible explanations for this discrepancy which are set out and explored further in Section 8.2.2.

4.3 The number of small occupiers in City workplaces

Using a breakdown of the IDBR data by business size, we are able to estimate how many small occupiers there are in the City. We further estimate that there were 10,285 office workplaces with fewer than ten employees in the City in 2013, up from 9,435 in 2012 (Table 4.1).

Table 4.1: Office workplaces in the City, by business size, 2012 and 2013 (est.) [21]

Office-based workplaces	Employees			
	0-9	10-249	>250	Total
2012	9,435	2,660	1,450	13,540
2013	10,285	2,900	1,580	14,760

Source: ONS/IDBR/Ramidus Consulting

In the next section we test these numbers against the capacity of the built stock.

[20] For clarity, we point out that 14,385 is the number of enterprises in the City, where each enterprise is counted only once, no matter how many workplaces it might have in the City. It is not to be confused with our later estimate of the number of office-based workplaces, which turns out to be a similar number (14,760).

[21] The 2013 business size data breakdown is based on pro rata estimates from the 2012 figures.

4.4 Small occupiers and capacity of the built stock

An alternative way to arrive at an estimate of the number of small occupiers (below 1,000 sq ft) is to calculate the capacity of the City's building stock to accommodate them. In *Taking Stock*, we analysed a comprehensive data set of businesses that occupy office space of more than 1,000 sq ft on conventional leases in the City using the EGi London Offices Database. In 2010 these amounted to some 3,645 occupancies and between them they occupied 48 million sq ft of office space.[22]

Using this base data we can derive a figure for the capacity of the stock to accommodate smaller occupations that occupy space in the conventional leasing market. We estimate that 9.68 million sq ft is occupied by small occupiers on conventional leases in units of less than 1,000 sq ft. The calculation is set out in Table 8.6 in Chapter 8.

By assuming an office density ratio of 150 sq ft per worker[23] for businesses in conventional leased space, we can calculate how many employees might be accommodated. We then apply an average business size of eight employees which produces an estimate of 8,173 small occupiers in conventional leases[24]. The calculation is set out in Table 8.7 in Chapter 8.

We know that many small businesses are accommodated in the serviced offices sector. We therefore undertook a similar calculation for capacity of the serviced office stock to arrive at an estimate of 2,264 businesses in the serviced office space in the City (this is in line with our estimate of 2,250 occupiers in Section 6.4, based on the mean occupier size of serviced offices and the number of workers accommodated in them calculated in Section 3.1).

By adding together 8,173 small occupiers in the conventional leasing market and 2,264 in serviced offices, we produce an estimate of 10,437 small occupiers in the City, derived from what we know about capacity of the built stock (shown in Table 8.7)[25].

4.5 Small serviced office occupiers and growth potential

In our interview survey, one respondent quipped, "*Those that know us use us, those that don't, don't (yet)*". In other words, operators like this one assume that there is a large untapped potential demand from businesses that have not yet discovered the merits of flexible occupation.

The intention of this analysis was to quantify the share of the small business occupiers in the City that are already using serviced offices and to estimate the potential market size if that proportion were to increase.

---

[22] Data extracted from *Taking Stock*, hence dating from 2010.

[23] This occupancy density is lower than the 110 sq ft referred to in Chapter 3.1 because we believe that space is used more efficiently in modern serviced offices than in typical, often older stock on conventional leases in the City.

[24] This business size corresponds with the estimated average size of businesses in serviced offices as set out in Chapter 6.4.

[25] The IDBR/ONS count finds 9,435 workplaces in the City occupied by businesses with fewer than ten employees in 2012. That figure broadly corresponds with our estimates derived from capacity calculations. The most likely explanation for the difference between the two figures is that larger organisations using small units in the conventional leasing market are not included in the IDBR/ONS figure for workplaces occupied by small businesses.

Based on our estimates, 22% of small occupiers are currently accommodated in the serviced office sector and 78% in leased space. We tested the impact of growth in the number of small occupiers in the City (for the reasons outlined above), combined with a shift from leased to serviced office space under a number of scenarios (Table 4.2).

If the number of small occupiers in the City were to grow by 10% and the proportion of small occupiers accommodated in serviced offices rose from its current 22% of the total to 35% over the next decade, then that would produce an additional 1,749 small occupiers for the serviced office market – growth of 77%.

Table 4.2: Current position and potential growth of small occupiers in serviced offices, 2014 to 2025
Table 1

Measure	2014 actual numbers	5% growth in total	10% growth in total	5% growth in total	10% growth in total
Small business occupiers in serviced offices	2,264	3,283	3,440	3,830	4,013
% of total	22%	30%	30%	35%	35%
Small business occupiers in leased space	8,173	7,661	8,026	7,114	7,452
% of total	78%	70%	70%	65%	65%
Total number of small occupiers	**10,437**	**10,944**	**11,465**	**10,944**	**11,465**

Source: Ramidus Consulting

In our view, these small occupiers of conventional leased space represent a large pool of potential occupiers for serviced office space that remains largely untapped. This is in addition to potential demand from the growth of core and periphery business models; new business formation and in-movers and representative offices. For this reason, we consider it a cautious prediction to expect the market for serviced offices to double in size within the next decade.

5 Operators and building owners

The findings from the serviced office operator interviews are set out over the next two chapters of this report.

This chapter first explains what we learned from serviced office operators about the economic and business drivers of their operations; the range of services offered, including technology and market positioning; and other related flexible office products that are emerging alongside serviced offices in the City. Our discussions with landlords are then summarised in terms of commercial considerations, the value of serviced offices as part of a wider occupier ecology, and practical matters when deciding whether to offer serviced offices.

- Operators have fewer opportunities to open new centres in a strong leasing market, when rents are rising.
- Operators can be vulnerable to dips in the market cycle because base costs (rent, rates and service charge) are fixed, while desk rates fluctuate with supply and demand.
- Occupancy levels in serviced offices average around 80-85% in the City.
- A typical desk cost in a serviced office in the City (at the time of writing) is £550-£700 per month, including VAT. The price differential between serviced office space and conventional leasing has narrowed.
- The use of license rather than a lease is key to flexibility and ensures neither side is bound by Landlord and Tenant legislation.
- High speed, consistent and secure ICT is an essential component of the serviced office offer, but it is generally no longer charged as an add-on.

5.1 Viability and business models – the operator perspective

Operators said that the UK has the most mature serviced office market anywhere in the world, and that central London has the critical mass to make serviced offices a viable and attractive business proposition. They maintained that demand for flexible offices did not decline during the recession, although prices did. This equation between base rent and workstation rate (the price charged for serviced office space) is central to the viability of the business model.

Operators spoke openly about issues with covenant strength and exposure to fluctuations in property and economic cycles. Difficulties suffered by a number of operators in the past decade with exposure to market cycles, have caused parts of the landlord community to be wary of the serviced office sector. There have, during the recession, been examples of operators needing to withdraw from a lease commitment, or request a rent reduction. However, as the market has matured, operators have responded to these perceived weaknesses with a wider range of operating models.

5.1.1 Constraints on supply

Even if there is proven demand for a flexible product, the operators must be able to meet the demand at a price level that supports a profitable business. While demand for serviced offices is currently high and rising there are, nevertheless, some significant constraints on being able to create supply:

- The base cost of providing the building or space is critical and exposure to rising market rents has an enormous impact on viability.
- Operator covenants are generally considered weak by landlords and are discounted in investment valuations.
- An operator exposed to the open market on the base rent, has to be able to pass on cost increases to the customer, thus there needs to be price elasticity.

We understand that for a centre to be truly secure, it should break even with occupancy rates running at between 50% and 60%.

5.1.2 Occupancy levels

Serviced offices are attractive to SMEs and large corporates alike because they offer flexibility, responding to short-term changes in customers' demands on space. An inherent aspect of this flexibility is that centres are rarely 100% occupied. Occupancy levels tend to average around 80-85% (in order to allow for churn and for the operators to respond to changing demand), and this was confirmed by our survey.

5.1.3 Demand drivers

The operators we interviewed suggested a number of drivers of demand for serviced offices in the City, which are currently running at high levels:

- Structural change in the economy with a growing number of small businesses.
- A limited supply of small units available on short lease terms.
- Inherent unpredictability associated with immature small businesses, dictating a need to flex up and down.
- Larger corporates now adopting 'core and periphery' real estate models, with serviced offices satisfying part of the 'periphery' element.

The important issue here will be the difference between drivers resulting in short-term cyclical demand, and drivers resulting in a structural shift in the levels of demand for serviced offices. The latter will be critical.

The property market, in terms of the rental cycle, thus represents a very significant factor potentially influencing the future growth of the serviced office market. As one operator put it:

> *"There are still operators with big expansion plans in London but rents are becoming prohibitive for some. They need very high prices to make it work."*

One of the cyclical effects (albeit evidence is anecdotal), is that there are fewer opportunities to open new centres. One intermediary said: *"We are seeing more centres in secondary space."*

Operators have responded in a variety of ways to supply constraints. Chief among these are the following:

- Taking freehold buildings.
- Taking leases on buildings at the end of life, before redevelopment.
- Signing leases during a tenant's market on favourable terms.
- Entering a joint venture with a property owner.
- Improving margins on the management component (or other add-on services).

Some operators also seek to protect themselves from the vagaries of the rental cycle by signing RPI (Retail Prices Index)-linked deals. While evidence is scarce, and opportunities are likely to be fewer in a strong demand market, this represents one strategy for ensuring longer-term viability.

5.1.4 Current market conditions

Some operators reported rising prices for serviced office space, and that demand is strong, although the City market is the most competitive of all the central London markets and has the highest levels of supply. One pointed out that their rates per workstation were lower in the City than in Clerkenwell, Shoreditch or the West End.

This fact does not preclude operators from seeking more opportunities to open centres in the City. Indeed the very stability of base rents may be attractive to operators, although it is not necessarily a permanent state of affairs. One operator, who described the market as 'saturated' in the City, is seeking to expand its presence in the City, relying on quality as a critical differentiator for its business.

Some, who had expanded aggressively during the recession, said that they expected to find it more difficult to find viable opportunities in the next few years.

Pricing has reduced in recent years in response to competitive pressures. Several operators stated that the differential between the cost of serviced office space and short leases has narrowed considerably. Hard evidence to verify this statement is difficult to uncover since it is very difficult to compare like with like when operators tend to price per workstation, or even per room, while conventional property is valued per sq ft. Prices also vary from week to week in the serviced office sector, in response to supply and demand.

5.1.5 Marketing

Most operators rely heavily on brokers to connect them with new customers although, once in, renewal rates are high. At either end of the quality spectrum there is some variation – at the premium end, a small number of operators like to build relationships with agents who "*care more about finding the right space for the occupier*". While at the lower cost end of the spectrum, operators put more emphasis on the use of their website.

The UK market is unusual in having brokers dealing specifically with serviced office space and this reflects the scale and maturity of the market.

5.2 The offer

The serviced office market is becoming increasingly segmented and operators recognise a hierarchy in the market, according to the quality of space and service that they offer. We found a broad consensus on where the main operators fit into this hierarchy. It is also the case that occupiers of City serviced offices are relatively homogenous compared with the wider flexible space market. Newer operators are developing centres where brand has more to do with image and culture than traditional property market measures of quality (such as specification).

5.2.1 Occupancy services

Operators generally offer fully-equipped and furnished space. In most cases, occupancy costs (for example, business rates, service charge and office facilities) are bundled and fixed, together with a full management service. In this sense, the City serviced office market is no different to any other property market. Whether the customer is a large corporate looking for project or overflow space, or a start-up business making its first commitment to commercial property, serviced offices allow businesses to outsource the hassle of property acquisition and management.

Table 5.1 shows a menu of occupancy costs that can be wrapped into a unitary serviced office charge. It can be seen that the customer is relieved of the capital costs of establishing a new office (for example, fit-out and furniture), as well as the costs of managing the space during occupation (for example, business rates and maintenance). Staff facilities, such as refreshments, meeting rooms and WiFi, are normally included. The customer is also relieved of dilapidation costs and professional fees associated with conventional leases.

Table 5.1: Occupancy costs included within serviced office offers

Occupancy life cycle stage	Costs and services
Acquisition	Fit-out Furniture Professional fees
Management	Business rates Maintenance Reception + security ICT Utilities
Facilities	Breakout space Gym/shower Kitchen and refreshments Meeting rooms Print and copy Secretarial Videoconference WiFi
Disposal	Dilapidations Professional fees

Source: Ramidus Consulting

The operators that we interviewed in the City offer a typical range of services. As well as enabling flexibility with simple acquisition and disposal terms, they mostly offer basic office services, including meeting rooms, print/copy and reception. Given that most serviced offices are within multi-let buildings, the provision of reception services will sometimes depend upon the quality/nature of reception space in the landlord's demesne.

In addition to meeting rooms, some operators also offer café/refreshments, hot desking and break out spaces. The introduction of such facilities requires more intensive facilities management (and cost), so such facilities are available in fewer centres than say, the more ubiquitous meeting rooms.

The importance of information and communications technology (ICT) infrastructure to businesses is such that its provision has become almost uniform in serviced offices in the City. This is discussed further in Section 5.2.6.

Most of the operators that we interviewed offer a virtual office service (whereby they manage mail and/or calls for customers). For reasons explained elsewhere (see Section 5.3.2), this is becoming increasingly problematic in terms of security and compliance.

The provision of health and welfare facilities (such as gym/exercise space, showers, bicycle parking, etc.) is far more limited than the services outlined above, potentially as they are considered part of a 'premium' rather than essential workplace service.

5.2.2 Serviced office charges

The extent to which all of these services are bundled into a single unitary charge varies somewhat. For example, some operators in our sample offer unlimited and free access to meeting rooms, for which other operators have a booking system, against which usage is monitored and charged. Similarly, in higher quality centres, fees normally include unlimited access to refreshments.

The majority of operators offer an all-in unitary charge per desk that bundles together a selection of the services identified in Table 5.1. This means that customers have certainty of outgoings. Some other operators offer a core charge for base services (rent, utilities, reception, etc.) and then charge on a 'pay-as-you-go' basis for additional services such as print and copying, secretarial support and meeting rooms, and these charges are added to monthly bills.

Costs vary in the City both between operators and also as the level of demand changes. Operators are adept at responding to market signals and adjusting their charges accordingly. Variability between operators is chiefly accounted for by the market position of the operator in terms of the 'quality offering'.

Most operators levy a charge on a desk basis, so that customers are charged according to how many desks they occupy (as distinct from £/sq ft in the conventional leasing market). A typical desk cost in the City (at the time of writing) is £550-£700 per month, including VAT. The range of prices clearly reflects the variation in the quality of the offer and its position in the market.

Data compiled by The Instant Group shows that a price premium emerged for small units in 2014 that had not been evident in the two preceding years. Average desk rates rose to £800 per desk for units with five desks or less, compared with £600 for between six and ten desks. There was also a premium for large units with more than 11 desks. This tiered pricing is new and in 2012 and 2013 there was virtually no differential.

Some operators consider ICT to be a revenue generation stream but most offer it as part of an all-in occupancy rate. Some were accidental beneficiaries – because clients request more than required and pay for the surplus capacity.

5.2.3 Licenses versus leases

A fundamental difference between conventional office space and serviced office space is that in the latter, a licence replaces a lease. Licences are more flexible allowing customers' greater freedom to come and go. The length of a typical license varies quite widely, even within the City; for example with the following staple models:

- A 12-month licence, rolling renewable, paid monthly in advance, often with a two month deposit; and
- A monthly licence, rolling renewable, also paid in advance, normally through a direct debit system.

5.2.4 Quality

Rather like the hospitality sector, there are clear 'levels' of quality in the serviced office market. These are not explicit and objectively verified (like hotel star ratings), but they are clearly understood among occupiers, landlords and the operators themselves. For example some operators refer to themselves as offering a five (or even six) star service, and the differentiating features tend to revolve around the level and quality of centre management, quality of fit out and level of service – reflected in the price.

The market is thus highly segmented in terms of quality and the style of space offered. Operators also adapt their offer to suit the target market. For example, some operators target international businesses looking for a 'presence' in the City, and who are less price sensitive than, say, smaller SMEs. While operators in the City suggested that there is strong demand for a more premium-end product, they also expressed a view that there is potential for a new target market within the City. One described this market in terms of catering for more creative and technology-related businesses. Such firms require more cost effective, lower specification space than the type of international businesses referred to above.

5.2.5 Centre branding

Some operators brand their centres prominently with their own corporate identity. Others in our survey emphasised the importance of creating a particular style or type of working environment but without making their own identity or signage prominent. Some operators are consciously neutral. Those seeking to create an exclusive, 'club-style' ambiance refrain from using branding, often not even on the exterior of the building.

5.2.6 Technology infrastructure

While high quality ICT provision is an essential part of the serviced office offer, it is not a key differentiator between brands. It was taken as standard that all operators are able to offer a high standard of speed and capacity at short notice to all their customers.

They do however present ICT service provision as a differentiator with the conventional market for small unit short leases. For SMEs in particular, there are benefits to being part of a bigger ICT infrastructure – it is more secure, it is more resilient, there is high quality support and greater consistency than might be achievable by a small business, in a small unit, on a short lease.

Some operators explained that, by having a preferred supplier, they can offer better pricing and faster problem solving for businesses. Having a preferred supplier enables an operator to offer 'whatever the customer requires'. One said that they have spent more time negotiating contracts with ICT providers than leases. "*It's the 4th utility*".

There seems to be some consensus that the minimum speed requirement is 20MB or so, though most can offer considerably more - up to 100MB. One said that, in reality, few businesses need more than 2MB and that they had monitored usage to support this statement. The critical aspect is not speed but a range of other factors:

- Consistency and continuity of service;
- Dedicated lines (for satellite offices);
- Smaller companies generally satisfied with contended lines (shared);
- Resilience, in terms of security and back up; and
- Speed of response time to set up and fix any problems.

Several operators expressed frustration that prospective clients compare prices with home broadband services, without appreciating that commercial supply is more expensive.

While operators consider their technology a critical part of their offer, we did not get any strong sense that businesses take space purely for the broadband quality. We were told that expectations have changed and occupiers now expect "*all inclusive, all-you-can-eat*" data as standard in any serviced office centre.

5.3 Variations on serviced offices

This report focuses on pure serviced offices as they are the predominant flexible space offering in the City. However, variations on this theme are beginning to emerge - we acknowledge these in this section and look at their presence in the City.

5.3.1 Co-working or shared space

This can be a standalone business model or offered as part of a serviced office facility. Standalone co-working space has two main business models:

- Club membership which might give access to drop-in space at one or a number of centres and is charged annually; and
- Price per workstation per hour/day/month.

As part of a serviced office centre, it might be referred to as shared workspace or break out space and again, there are two broad approaches:

- Operators assign perhaps 5% of the total space to shared space. It is often in the least lettable space – a basement or windowless area; and
- A more formal offer in lettable space on a rate per desk per month. A maximum of 15% of the space is allocated as a greater proportion would impede the centre's ability to meet demand conventional serviced offices.

Prices for co-working space tend to be lower than for serviced offices, at around £300 per person per month, including VAT. This lower rate reflects the fact that there is, in most cases, no workstation allocated to an individual and so it relies on hot-desking. Co-working space also tends to be open plan, allowing higher densities to be achieved. Desks are often laid out in continuous bench formats, for example.

Co-working spaces are in their infancy in the City, and are generally only offered as part of a serviced office centre. However some new products have emerged to suit a City audience and it is likely to grow in the future. For instance, one operator has created a co-working environment that combines the quality and corporate styling of a conventional City serviced office fit out, with the collaborative atmosphere and sociability of a co-working space.

5.3.2 Virtual offices

Virtual offices (VOs) provide small businesses with the ability to have a business address (and implied presence) in a particular area. Services in VOs include phone answering/transfer and mail forwarding. The majority of the operators that we interviewed offered a VO service.

VOs are proving increasingly difficult to 'police' as regulation is tightened around money laundering and other fraudulent activity. There is now extensive guidance around 'Know your customer' procedures to verify the identity of clients. Some operators expressed that they are considering ceasing to offer VO services.

5.3.3 Managed workspace

This is, in effect, an outsourcing model. The business model is more understood and accepted by the property industry because it offers some certainty of income and greater commitment. It is less management intensive but gives economies of scale. Managed space is well established in the City.

5.4 The building owners' perspective

As part of our research we interviewed a number of building owners who lease space to serviced office operators in the City. While the main thrust of the research was focused on serviced office operators, their offerings and customer base, the perspectives of owners are also important, because the great majority of serviced offices (estimated to be as many as 80% or more) operate from leased space in multi-let buildings.

5.4.1 Commercial considerations

The serviced office market has evolved since the late-1980s from a fringe activity – in property market terms – into an integral part of the property market offering. While this is recognised by London landlords, many remain equivocal over the 'value' that serviced offices bring to the market, and they have a range of approaches to the market.

Serviced office operators are not able to offer the same covenant strength as corporate occupiers. Their business model is generally considered to be susceptible to short-term economic swings, and a downturn in the economy undermines demand for serviced offices at the very time that demand in the conventional market is least robust. Owners also perceive that many centres rely heavily on the custom of start-ups, which are more vulnerable to failure than established businesses. These characteristics mean that serviced office operators are perceived to have 'weak covenants'. The investment value of a building is directly related to the security of its rental income and serviced office operators are not perceived to produce the same security of income as corporate occupiers.

A landlord's resistance to a serviced office covenant depends, in part, on the time horizon of the investor – how long they intend to hold the investment - and also on the proportion of the total investment income represented by the serviced office. Several operators suggested that the business model was not "*well understood*" by the property industry and that there are several "*fallacies*", particularly the perception that serviced offices rely on volatile customer businesses such as start-ups.

If the serviced office forms part of a whole estate, the landlord is more likely to see the serviced office as an integral part of good estate management – providing the full range of property options in building a business ecosystem. If, on the other hand, maximising short-term investment value is critical, then landlords are more likely to be wary of serviced office operations because of the covenant impact on value. A landlord with a longer time horizon and a 'place making' agenda is more likely to absorb the risk in return for the benefits to the ecosystem.

The desirability of having a serviced office within a building is partly influenced by the scale of ownership. For example, the 'risk profile' of a 20,000 sq ft serviced office within a 500,000 sq ft ownership is easier to contemplate than the same serviced office in, say, a 80,000 sq ft building. Thus, if it is less than, say, 5% of the total income, it is unlikely to have a significant impact on the investment yield applied. In large estates, serviced offices are seen to help ensure a diverse offer.

There remain concerns among owners that serviced offices are vulnerable to the vagaries of the wider property market. Specifically they suggest that when operators take space during weak property market conditions, they will then be subject to rental increases as the market improves. This is perceived to affect the sustainability of their business models.

Owners appear to be more comfortable with managed office space. Distinct from pure serviced offices, managed space is delivered mainly for single occupiers, in larger units and for longer-term commitments. The rental income from a managed space provider is therefore considered more secure and reliable than other forms of serviced office provider, as they are seen to be more akin to the conventional leasing market.

5.4.2 Value brought by serviced offices

There is a perception that the serviced office market generally helps support a broader ecology of occupiers in the City – both in terms of their sector activities and price sensitivity. It is seen particularly to create opportunities for small or less mature occupiers to occupy space in high quality office buildings or locations.

Owners confirmed that, as the main occupier base within a larger estate, they see value in having serviced offices close by, as it provides the option of taking space for short-term needs (for example, for projects and overflow). There is also perceived benefit in having a serviced office facility in close proximity – which might be in a neighbouring building.

It might be that serviced offices present an opportunity to attract smaller occupiers that grow and in time, become occupiers of conventional leases. The owners that we interviewed had little direct experience of this but acknowledged that it is a plausible outcome.

5.4.3 Practical matters

We have noted elsewhere that serviced office operators are a far from homogenous group. There is a wide range of offers in terms of quality, style and pricing. The market positioning of an operator is often important to an owner, in terms of the impact it has on the kind of working environment they are seeking to create or nurture. For example, a serviced office operator that prides itself on being 'quirky, creative and innovative' might be more attractive to a landlord seeking to create a place that attracts creative industries or even the tech sector. Other landlords are sensitive to more traditional perceptions of quality and will prefer a premium provider. Thus operators with a distinctive brand can be more attractive than a more generic offering.

We asked owners whether they would consider directly offering serviced offices within their own portfolios. The unanimous view was that they would not. Several reasons were advanced for this:

- First, it is not regarded as part of "*core business*" activities.
- Second, it is perceived as management and resource intensive, and therefore not desirable.
- Third, there is a need to have related marketing functions.

5.4.4 Summary

Overall, owners appear to accept that serviced offices have become an integral part of the property market offer today. Building owners recognise that structural changes in the economy – the rise of small businesses as well as core and periphery property solutions - mean that they should consider making provision within their buildings and portfolios for flexible space. We also heard that some landlords feel a sense of responsibility for accommodating the rise of small businesses, especially in helping to build a sustainable business ecosystem. At least one owner raised the question of threats to 'affordable offices' in London. The concern here is that the central London economy might be in the process of 'pricing out' smaller occupiers.

However, when discussing how flexible space might be incorporated into portfolios or buildings and whether it can be aligned with investment returns or the core skills of a property investment company, there are many unresolved issues and landlords remain equivocal. Certainly we picked up a genuine willingness to look for solutions and to consider a range of options. Operators with new business models might find that there is mutual benefit.

6 Occupiers

We asked serviced office operators to describe their customers to find out more about the businesses that occupy serviced offices in the City. In this chapter we summarise the main themes in terms of these businesses origins and destinations and their motivations for taking serviced office space, as well as their typical size and business activities.

- Serviced offices provide accommodation for small and stable businesses. Relatively few are start-ups.
- Flexibility is perhaps the most significant attractor, along with the all-in fixed charge which adds certainty to business costs.
- Serviced offices provide access to a quality of space that would not normally be offered by the market on short leases or in small units.
- Occupiers include stand-alone SMEs (start-up/growth, and 'steady state'), thought to represent 70% of occupiers, and larger corporate organisations (corporate flex space and rep offices) though to account for the remaining 30%.
- Among larger corporate firms, serviced offices are attractive for providing additional space for (time limited) projects, or space for confidential work.
- The average length of stay is 18 to 24 months, but a period of three to five years is not uncommon.
- The sector profile of occupiers mirrors the wider City market, but occupier type is less important in understanding the dynamics of the sector than occupation type.

6.1 Origin and destination of occupiers

Most operators emphasised that the majority of their clients are established businesses, with relatively few start-up businesses. One of the underlying messages here is that contrary to perceptions, operators are not over-exposed to very weak covenants or fragile, unstable businesses, but in fact cater the majority of the time for established and stable businesses.

The City is a unique business cluster in terms of its scale and complexity, and its gravitational pull on businesses is strong. There is no hard evidence to suggest that serviced office occupiers are any different in terms of origin than other businesses operating in the City.

However, a number of themes on this topic did emerge from our discussions with operators:

- While the perception is widely held that serviced offices provide a first step on the property ladder, in fact they often provide a second (and semi-permanent) step on the ladder. This refers to companies that have been created in, for example, secondary locations/buildings, in conventional leases, and which then look for a physical presence within their main market.
- Many SME occupiers of serviced offices comprise of individuals who have formed a new company after leaving a larger one. Such a move keeps their profile in the market and maintains their business relationships. As such, these firms will have moved, typically, from within the City.
- Overseas companies looking for a 'presence' or a representative office in the City often take serviced space. The space is perceived to portray quality and 'market position'. Such companies might also take serviced space simply for the convenience of visiting executives.
- There is anecdotal evidence, that some occupiers move from the City Fringe (for example, Camden, Hackney and Islington) in order to reinforce their corporate brand and image. However, robust evidence on this is lacking.

Operators interviewed for this study confirmed (but could not quantify) that some occupiers move from secondary, leased space into serviced offices. In doing so, they suggested that such moves allow SMEs to professionalise the 'image' that they convey (for example to customers and clients) while avoiding the commitments of conventional lease structures.

The 'semi-permanent' point made in the first bullet point above is worth emphasising. There is an unwritten assumption in common discourse that small businesses are 'large businesses waiting for growth'. However, as suggested in Chapter 2, the structure of today's economy is far more sympathetic to small businesses, and many do not seek growth in the way that, for example, technology start-up businesses might. Serviced offices offer such businesses the opportunity to take flexible space, without necessarily having a plan to vacate within a set time.

The result is that serviced offices provide accommodation for small and stable businesses. Operators confirmed that it is not uncommon for businesses to remain in occupation for three, four or five years (see Section 6.5 for more on length of stay).

The BCA emphasises the stability of occupiers in the serviced office sector. It states that businesses:

> "*are choosing to permanently locate within serviced or managed centres, benefitting from the networking, peer-to-peer support and inter-trading which is a natural part of the sector. In some centres, trade between customers accounts for as much as 20% of sales*".

The BCA goes on to note that:

> "*the sector is no longer promoted as the 'affordable' alternative to other options. Rents achieved across serviced, managed and co-working spaces are frequently comparable to more conventional leases. Businesses and individuals choose to locate in such premises because of the wide range of benefits accrued, not because it is the cheap choice.*"[26]

In terms of where occupiers go once they leave service offices, the operators that we interviewed lacked any hard evidence. Moving to another serviced office is one identified destination. Such a switch in provider might be motivated by securing "*a better deal*". Operators' offers change subtly over time, and occupiers occasionally find something new. Another possible destination is the conventional leasing market. However, to date there is no tangible evidence to support this.

6.2 Motivations of occupiers

Operators described a range of motivations for businesses to occupy serviced office space, including the following:

- Flexibility is perhaps the most significant attractor: the ability to get in and out of property quickly, together with the ability to grow or contract at short notice. This attractor is important even to those businesses that expect to remain in a serviced office for a relatively long period.
- The all-in, fixed charge is a key driver because it adds certainty to business costs (albeit for relatively brief periods).
- The ability to outsource office services and facilities is important, particularly among SMEs that do not want such responsibility.
- It provides access to a quality of space that would not normally be offered by the market on short leases or in small units.
- The ease of entry, particularly for start-ups needing the flexibility to upsize or downsize, that do not have a strong covenant to take a lease, or that do not want to commit to a lease.
- Among larger corporate firms, serviced offices are attractive for providing additional space for (time limited) projects, or space for confidential work, such as compliance work, as well as giving flexibility to grow without committing to a new lease for expansion space.

There is no particular evidence to suggest that any of these motivations are more prevalent in the City, or parts of the City, than in the serviced office market generally. Certainly across central London, these motivations appear to be fairly uniform.

One motivation for occupation of serviced offices that might be anticipated, but we did not find to be the case, is 'mixing' with other occupiers. Section 5.4 referred to co-working spaces, which are becoming more common in London, although not yet in the City. These seem to have a greater emphasis on interchange and commerce between businesses. However, most space in serviced offices is sub-divided into discrete units, and we found very little evidence of inter-firm activity.

[26] Business Centre Association *Per Comm* 26th August 2014

Large organisations are accustomed to outsourcing aspects of their businesses such as transactional activities, property management, and so on. Serviced offices essentially provide an outsourcing service to SMEs; they allow smaller organisations to shift the responsibility for property (potentially a complex and time-absorbing issue) to an outsourced provider. Operators obviously benefit from economies of scale (for example, in terms of purchasing) and they are able to provide services (such as photocopying, secretarial support, call answering, reception and security) when they are needed rather than on a permanent basis.

6.3 Occupier typology

All the operators that we interviewed in the City emphasised that their centres are home to a wide range of business sectors. Accounting, construction, consulting, design, finance, insurance, legal, recruitment and software are all common sectors represented in serviced offices. In fact, it is no real surprise to find the serviced office community, to a large extent, is a microcosm of the business cluster within which it sits.

6.3.1 Sector

Our interviews uncovered very little quantitative data on the sector breakdown of serviced office occupiers: it appears that most operators do not keep such data. However, our discussions yielded some evidence which suggested that around 40% of occupiers operate within Business Services and Professional Services (for example, accounting, consulting, legal, recruitment); around 20% are Financial and Insurance companies; perhaps 20% are in ICT and the remainder comprise 'Other' activities such as construction, design and engineering. This anecdotal evidence also suggests that technology companies have become more common in recent years (even in premium products).

Table 8.2 in Chapter 8 shows the sector profile of businesses in the City according to the IDBR. The distribution appears to closely mirror the data supplied by operators. The IDBR data classifies 18% of firms in Financial and Insurance activities; 47% in Professional, Scientific and Technical (PST) and 8% in Information and Communications Technology (ICT). The lower percentage in ICT (and higher in PST) can be explained by the broader definition of PST to include Scientific and Technical activities, which covers some ICT businesses as classified by the operators.

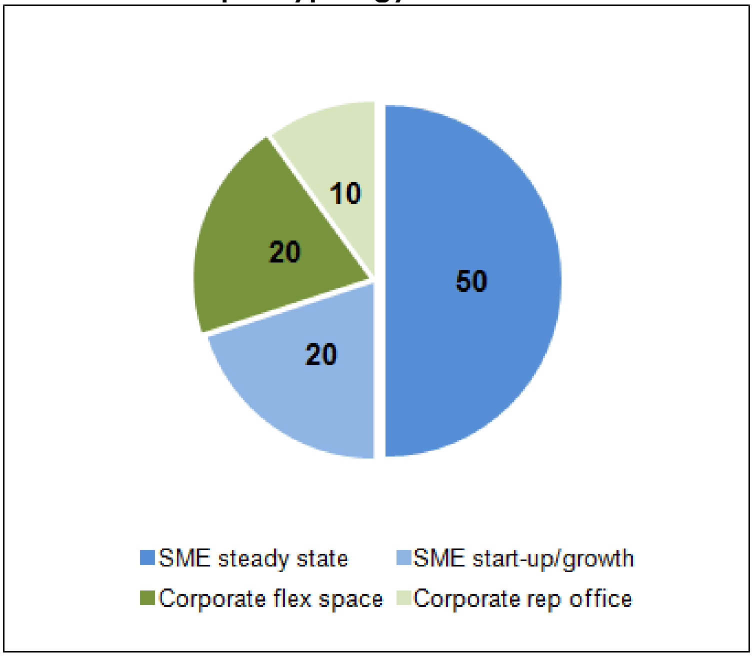
6.3.2 Scale

As serviced office occupiers so closely match the wider City occupational market, a sectoral breakdown is not particularly helpful in understanding demand dynamics. As one operator put it: "*It is not occupier-type that matters but occupation-type*". Perhaps what is more helpful is an understanding of the type of company in terms of its scale and functional requirement. To this end, we presented the occupier typology in Chapter 2, Figure 2.2.

This typology identified two 'scale' categories: stand-alone SMEs (including micro-businesses) and larger corporate organisations. The former then breaks down into start-up/growth companies, and 'steady state' SMEs, while the latter break down into corporates looking for flexible space, and international companies looking for 'a presence' in the form of a representative office. Our discussions with operators confirmed that this typology held true for the City.

It is not possible to accurately state the proportion of space occupied by each of these occupier types. However anecdotal evidence and discussions with operators, suggest that SME space might make up 70% of the occupied space, with perhaps at least two-thirds of this being steady state occupiers, and the remainder being start-up/growth companies (Figure 6.1). Of the remaining 30% corporate space, perhaps two-thirds is flexible space and one-third representative offices.

Figure 6.1: Serviced office occupier typology and market share



Source: Ramidus Consulting

The occupier typology raises an interesting issue. The predominant occupier type – steady state SMEs – might be considered the least likely to require the defining benefit of serviced offices – flexibility. They are not growing and do not require temporary space, but rather seek a semi-permanent solution. Though their motivations are different, serviced office space still meets their needs as they are looking to outsource property overheads and secure a higher quality of space in a small unit than most traditional landlords are prepared to offer. The implication of this finding is that the greatest untapped source of growth for the serviced office market might be small occupiers in conventional leases.

6.4 Occupier size

In 2013, over 95% of private sector businesses in the UK could be classified as micro-businesses with nine or fewer workers.[27] Our work in the City suggests that the typical occupier requirement in serviced office space is at the upper end of this micro-firm range, at between five and nine workers, with an average of eight.

[27] BIS (2012) *Business Population Estimates*

There are at least three, possibly overlapping, explanations for the City having a larger average size of small business than the national picture:

- First, it could be partly explained by a greater preponderance of corporate occupiers taking up flexible space and setting up representative offices in the City, and these tend to take larger units.
- Second, there could be a greater willingness of small firms in London to exit conventional leases and move into serviced offices, as they grow and mature.
- Third, it could be due to a prevalence of stable established SMEs in City serviced offices, which have reached a certain size and stayed at that level, as opposed to the start-up culture of other markets.

Data compiled by The Instant Group for the wider City area, covering the whole of EC1 to EC4, finds an average enquiry size of 6.25 desks in 2014. This had risen from an average of four in 2012. The average for the whole EC1 to EC4 area is lower than our figures for the area within the City boundary, which suggests that the average size of occupational unit is smaller on the City Fringe and in the parts of EC1 and EC2 that lie beyond the City boundary.

Most centres in the City can accommodate up to 40 desks for a customer, and occasionally more. Requirements for more than ten desks are likely to be from corporates looking for project space or overspill space rather than from small businesses. Evidence from some operators suggests that 15% of their space is occupied by businesses with more than ten employees; while another said that less than 5% of its space was occupied by businesses with over 50 desks. For a number of operators, their preference is that no single customer should occupy more the 10% of the space in a centre (to manage risk).

Operators can accommodate large requirements more easily early in a centre's life, but it gets more difficult as the space becomes more sub-divided.

Assuming that our mean occupier size of eight is representative, then the 18,000 workers we estimate are accommodated in serviced offices, referred to in Section 4.1, represent almost 2,250 occupiers (a mix of stand-alone SMEs and corporate space).

6.5 Length of stay

The average length of stay in centres run by the operators that we interviewed is between 18 and 24 months, but some occupiers remain *in situ* considerably longer, with three to five years being not uncommon. One operator reported an average stay of 38 months, which they understood to be twice the industry average. Although the typical license is for a 12-month period, renewal and retention rates well in excess of this are common in the City. Serviced offices are, in fact, remarkably stable environments in terms of occupier turnover.

In fact, one of the key points to emerge from our research has been the stability and continuity in most serviced offices. As discussed in Section 6.1, it is widely perceived that the small businesses that typify serviced offices are unstable start-ups, among which a small number will survive and grow. However the reality is quite different. Many SMEs are 'steady state', with no particular growth trajectory, and most are long-established businesses.

At one level, this runs counter to the point made in Section 5.1.2: that serviced offices are attractive because they offer flexibility, responding to short-term changes in customers' demands on space. However, the contradiction is explained by the fact that while many occupiers remain *in situ* for relatively long periods, they have the ability to change their situation quickly if they so choose, with minimum cost.

6.6 Affordability

We understand that the premium for serviced office space has narrowed substantially as the market has matured. Where this is the case occupying a serviced office space becomes a viable option for a much broader range of businesses and business situations, with all that that implies for market size and its potential to expand.

In order to test this assertion, we compared the base property costs of occupying space in the conventional market with an equivalent rate per sq ft for serviced office space and estimated the ratio between the two. The size of the additional cost in serviced office space is the margin available to provide fit out, utilities, ICT and all the facilities management services associated with serviced offices, including reception, cleaning and so on. For an occupier, it is the margin they pay for those services and, in addition, it reflects the benefits of flexibility, the fact that they are paying only for desk space (and not for circulation space, meeting rooms and so on), and avoid liability for dilapidations at the end of a lease.

Table 6.1 shows the open market rental values for conventional leased space alongside rates and service charges. The sum of these is the 'base property cost' of renting space in the open market.

Table 6.1: Base property costs for a conventional lease in the City, 2014

Cost component	Grade A	Grade B	Grade C
Rent	£58.00	£40.00	£20.00
Rates	£18.00	£12.00	£7.00
Service charge	£9.00	£6.00	£3.00
Cost per sq ft	£85.00	£58.00	£30.00

Source: Ramidus Consulting

In order to convert a serviced office workstation rate into an approximation of cost per sq ft, we applied a range of floorspace assumptions between 80 sq ft NIA per workstation and 110 sq ft NIA.[28] We have provided this range simply to allow different scenarios to be built.

[28] We have used NIA calculations here, although we recognise that operators are more concerned with the net usable area, or the area on which customers pay fees. We have adopted NIA in order to allow comparability with the conventional market.

Table 6.2 calculates the relationship between leased property costs and serviced property costs as a ratio and shows a number of scenarios. For instance, a workstation rate of £550 per month, assuming 80 sq ft per workstation, equates to 142% of the base cost of Grade B office space in the City. This seems to be a reasonable premium to cover all the additional services and benefits of a serviced office. On the other hand, compared with the cost of leasing Grade C space, serviced office rates look high, as would be expected.

Table 6.2: Comparing prices for standard serviced office space with base property costs

Cost and Grade of building	Scenario					
	High density		Medium density		Low density	
	1 Low rate	2 High rate	3 Low rate	4 High rate	5 Low rate	6 High rate
Cost/workstation/month	£550.00	£700.00	£550.00	£700.00	£550.00	£700.00
Sq ft/workstation	80	80	90	90	110	110
Annual equivalent per sq ft	£82.50	£105.00	£73.33	£93.33	£60.00	£76.36
Ratio to Grade A	97%	124%	86%	110%	71%	90%
Ratio to Grade B	142%	181%	126%	161%	103%	132%
Ratio to Grade C	275%	350%	244%	311%	200%	255%

Source: Ramidus Consulting

The reason that serviced offices look highly favourable in comparison with Grade A space in Table 6.2 is that these typical workstation rates are for a standard serviced office product, and rates in the premium centres might be significantly higher. Office Broker recently quoted a range of £400 to £1,200 for workstation rates in the City. Taking the highest rate of £1,200 per workstation, and assuming 90 sq ft per workstation, the ratio to Grade A conventional leased space is 188%. At 80 sq ft per workstation, it is 212%.

If we assume that typical serviced office space in the City is in good quality, well located, Grade B space, with occupancy densities of 80 sq ft NIA per workstation, then the premium for serviced office space is between 42% and 81% and, since these calculations are based on estimates and assumptions, say 40% to 80% for a standard product and 88% to 112% for a premium offer.

It is difficult to make accurate comparisons between workstation rates and conventional lease costs because of the bundled services and different ways of calculating prices. However, our calculations were supported by the opinion of one operator who suggested that the desk rate should be about twice the base property costs in a robust business model. These ratios support the view that serviced office space could be an economically viable option for a wider range of occupiers than is generally perceived or are currently in occupation.

7 Findings and implications

The serviced office market has matured in recent years. The novelty with which it was once viewed has largely disappeared and with it, some of the scepticism over the role of the sector. Serviced offices are becoming, in effect, the multi let buildings for smaller occupiers. In this chapter we set out the main findings of our research and their implications. The key research questions on which this work was based are highlighted in bold.

7.1 The serviced office market in the City

How many serviced offices are there in the City?
There are around 85 serviced offices in the City, including some managed workspace. Their combined area is almost two million sq ft, representing nearly 3% of the City's total office stock. We estimate that they house around 18,000 workers. The wider City and City Fringe areas account for around 100 centres and over 22,000 workers.

The stock of serviced offices in the City has grown rapidly recently. Between 2010 and 2014 square footage expanded by 45% and, of the 85 centres that we identified, 51 (or 60%) have opened since the financial crisis in 2008.

How many businesses are serviced office occupiers?
The average serviced office occupier comprises of eight workers. Applying this figure to the 18,000 workers estimated above, we can infer that the City's serviced offices accommodate around 2,250 occupiers.

The number of serviced office occupiers has grown rapidly over a relatively short period of time. Data suggests that between 2003 and 2012 there has been a tripling in the number of firms, and 154% growth in workers in the City and City Fringe areas.

What role do serviced offices play in building a business ecosystem?
The growth of serviced offices has enriched the property offer in the City, enabling small occupiers to secure property on terms that have historically been unavailable to them.

Given the pressures on the supply of office space across central London today, it seems likely that options will diminish for occupiers of small units and short leases. In this context, serviced offices seem set to be an increasingly important element of retaining a diverse occupier base. Serviced offices also enrich the business ecosystem by nurturing companies that will grow into conventional leased space.

7.2 Estimating the size of the potential market

Drivers of demand include a growing number of small businesses and a comparatively limited supply of small units available on short lease terms. The growing tendency among corporates to adopt 'core and periphery' real estate models, with serviced offices satisfying part of the 'periphery' element, is another factor, as it is the tendency for overseas businesses seeking a presence in London to favour serviced offices as a base for a representative office.

How large is the potential market for serviced office operators?
There is a large untapped market of small occupiers that lease small units of space, often on relatively short leases, in the conventional leasing market. There are some 10,437 small occupiers in the City and we estimate only 22% of them currently use serviced offices.

We believe the proportion using serviced offices will rise in the future. A 10% increase in the number of small occupiers in the City, combined with a shift to 35% using serviced offices (from 22% currently), would result in a 77% growth in the size of the market.

If account is taken of small occupiers on conventional leases, growth in demand from corporates, new business formation and in-movers and representative offices, then the market for serviced offices could double in size within the next decade.

7.3 Property market constraints

A number of supply issues could potentially restrict growth and we highlight two here. First, as tenants in open market buildings, operators are themselves exposed to rising market rents. Any increase in base rents ultimately has to be passed on to customers, and so price elasticity is critical. Second, despite the large number of openings in recent years, the investment market continues to view operator covenants as comparatively weak, resulting in discounted valuations of buildings in which they are present.

Operators have responded in a variety of ways to supply constraints by limiting their exposure to rising rental markets. Chief among these are: taking freehold buildings, taking leases on secondary buildings prior to their redevelopment, signing leases during a tenant's market on favourable terms, entering joint ventures with property owners to share both upside and downside risks, and signing RPI-linked deals.

7.4 Operators and offers

What facilities and terms are offered by different types of serviced offices? What are the characteristics of the companies using them?
The market is segmented in terms of quality, style and price. At the higher end of the quality spectrum, target occupiers include large corporates looking for additional space, international firms looking for representative offices and high margin advisory businesses, all of which are less price sensitive than small businesses generally. Premium operators are a core part of the City market for serviced offices and probably make up a larger proportion of the operator market than in other locations.

Operators generally offer fully-equipped and furnished space, with all occupancy costs bundled and fixed, together with a full management service. In this sense, the City serviced office market is no different to any other. This gives customers certainty over outgoings for the period of their licence (although they are exposed to price increases at licence renewal if the rental market has risen). Some other operators offer a core charge for base services (rent, utilities, reception, etc.) and then charge on a 'pay-as-you-go' basis for additional services such as print and copying, secretarial support and meeting rooms. These charges are added to monthly bills.

High quality ICT provision is essential. For small occupiers in particular, there are benefits to being part of a bigger ICT infrastructure, and the critical aspects are not speed but a range of other factors, including consistency, resilience and support.

Most operators levy a charge per desk basis, as distinct from a square foot basis. A typical desk cost in the City (at the time of writing) is £550-£700 per month, including VAT, although premium offers can be nearly twice that level. Our estimates suggest that, based on current workstation rates, pricing is competitive with conventional space with typical premiums ranging between 40% and 80% over base property costs to cover all the services and benefits.

7.5 Occupiers

What types of businesses occupy serviced offices?
The serviced office community, to a large extent, is a microcosm of the larger business cluster within which it sits. Our interviews yielded anecdotal evidence suggesting that around 40% of occupiers operate within Business Services and Professional Services(for example, accounting, consulting, legal, real estate and recruitment); around 20% are Financial and Insurance companies, with a similar proportion in ICT and the remainder in 'Other' sectors.

The technology and creative community outside the City boundary (in Camden, Islington and Hackney) is only a small component of demand in the City core market. However, there is some evidence of demand seeping from these areas into the City.

To understand demand for serviced offices, the scale and function of occupiers is more helpful than sector type. We found that occupiers fall into two broad 'scale' categories: stand-alone SMEs (including micro-businesses) and larger corporate organisations. SMEs then break down into 'steady state' SMEs and 'start-up/growth' companies; while corporates break down broadly into those looking for 'project/swing/flex space', and international companies looking for a representative office.

We estimate that around 70% of serviced offices are occupied by SMEs, of which two-thirds are steady state, and the remainder start-up/growth companies. Of the 30% of services office space occupied by corporates, we estimate that two-thirds is flexible space and one-third representative offices.

Flexibility is the most significant attractor, even to businesses that expect to remain *in situ* for a relatively long period. The all-in, fixed charge is also a key driver, adding certainty to business costs, and the ability to access a quality of space that would not normally be offered by the market on short leases or in small units.

How long do businesses stay in serviced offices? Where do they come from and where do they move on to?
The average length of stay in centres run by the operators that we interviewed is between 18 and 24 months, but some occupiers remain considerably longer, with three to five years being not uncommon. Although the typical license is for a 12-month period, renewal and retention rates well in excess of this are common in the City. Serviced offices are, in fact, highly stable environments in terms of occupier turnover.

While serviced offices are generally thought of as providing a first step on the commercial property ladder, in fact they often provide a second (and semi-permanent) step on the ladder.

Demand from within the City includes: new companies created by individuals leaving larger businesses, existing small occupiers moving from conventional leases, and corporates looking for flexible space. Demand from outside the City includes overseas companies looking for a 'presence' or a representative office and companies moving in from the City Fringe.

We found very little evidence of businesses arriving from within the City that were not already part of the City's business culture. Similarly, we found little evidence of a start-up culture in serviced offices. Rather there is a strong emphasis on stable and well established micro-businesses or corporates.

We were unable to identify any reliable evidence on the destinations of businesses leaving serviced offices. However, most operators assumed that moves out of serviced offices are most likely to be into the conventional leasing market.

7.6 Implications

The serviced office market has been very strong in recent years, and our interviews revealed operators who were planning significant growth in the short to medium-term. But how is the market likely to evolve in the medium to long-term and what are the implications of our findings?

How is the serviced office market changing?
There are a number of ways in which the serviced office market is changing. It continues to grow rapidly, with new openings being sustained through the recession and recent recovery. The historic premium paid in serviced offices appears to be eroding as margins on 'add-ons' decrease. Serviced offices are coming to be more accepted by larger landlords; and there is the prospect of diversifying offers (for example, co-working space).

However, given the current strength of the letting market in the City, the decline in availability and associated rise in rents, opportunities to acquire space in the core City market are likely to be more limited in the foreseeable future. The same is true on the City Fringe, particularly in the Shoreditch and Clerkenwell markets where there is severe upward pressure on rents and competition for space from within and outside the office market.

For these reasons, we expect the provision of serviced office space in the City to move into a period of slower growth, allowing it to consolidate and absorb its recent period of rapid expansion. Once rental growth settles, there is every reason to expect a further phase of expansion based on untapped demand. This may well also encourage the emergence of alternative business models in the sector.

This interpretation is echoed by the BCA which argues that, in the post-recession environment, a key challenge in the City market will be the availability of space, because:

> "*Competition for floorspace is high and developers of new build tend to focus on securing large corporate pre-lets rather than looking at the adaptability of the model. To compete in this market, the sector needs to further convince those analysts and commentators that it is a sound financial investment.*"[29]

7.6.1 Will growth in demand be sustained?

There are three principal sources of potential demand growth. First, there are small businesses occupying secondary properties in conventional leases that may opt for a different approach. This will be given added impetus by a diminishing supply of office property in the conventional market. Second, the London economy is nurturing new businesses at unprecedented rates. This growth will generate demand for serviced office space in the City. Third, corporate occupiers are becoming accustomed to supporting their core property requirement with a more flexible 'on-demand' approach. Again, this will underpin growth in demand for serviced offices.

7.6.2 What is the market capacity?

We have established that there is potential growth in demand, but the market's ability to satisfy this demand depends on delivering additional capacity in the sector and this will influenced by a number of factors.

The serviced office market in the City has grown from 25 centres in 1995 to 85 centres in 2014 with a quadrupling of the square footage over that period. This reflects the emergence and maturing of a new market. The total space doubled from 1995 to 2000 and doubled again between 2000 and 2014, interrupted though it was by the global financial crisis.

If space were to double again in the next decade, that would mean total space of four million sq ft by 2024. If the average centre size is 25,000 sq ft, that would result in 160 serviced office centres – in other words close to a doubling of the current number.

7.6.3 How sustainable is the business model?

Irrespective of underlying demand, serviced offices are exposed to the vagaries of the rental market. Much of the growth that has taken place in recent years has been against the backdrop of a weak leasing market in the City. This has meant that operators have found it easier to do deals. There is, however, at least the possibility that a recovering and growing market will place unsustainable upward pressure on base rents. This raises the question of how elastic prices can be. Given the perceived weakness in the covenant of serviced office operators, a highly competitive leasing market also means it will be more difficult to secure space in the open market for new centres.

[29] Business Centre Association *Per Comm* 26th August 2014

For operators that own their buildings, the business model is different: they seek to acquire properties in a downturn and reap the rewards of capital value growth at the same time as margins improve on the serviced office offer. The risk for these operators is that they are exposed to falls in capital values as well as workstation rates, and so the level of borrowing needs to be maintained at a level that can sustain fluctuations in value.

We found that some landlords are keen to find a way to meet demand from small and agile occupiers in a way that is not detrimental to their investment value. Traditional property valuation practices militate against short-term or insecure income. The ability of a tenant to continue honouring their rental commitments throughout an economic downturn has a critical impact on the investment yield. Young and volatile businesses are not expected to provide secure income and yet landlords do recognise the significance of these types of businesses in the new economy, not least because of the stories of rapid and unprecedented rate of growth of technology-based companies such as Google, LinkedIn, Facebook and Amazon, among others.

The joint venture model of serviced office provision seems to offer a number of advantages. It moderates the risk of the operator to falling rents, or any decline in demand, and it gives a mechanism to share the rewards of a rising market between owner and operator. This makes serviced offices a more attractive proposition for owners, allowing them to become involved in an expanding market.

7.6.4 Could rising prices force operators and occupiers out of the City?

If rents in the City rise, is there a point at which serviced offices will leak into the City Fringe, or leap into other central London markets? Functional relationships between serviced office occupiers and other City businesses are very close and there is a strong gravitational pull. However operators looking for opportunities to open new centres may well find it easier to secure premises in other locations.

The role of the City Fringe as a pressure valve for demand in the City is diminishing. It is bracing itself for a major adjustment as established occupiers face rent reviews that will, in some cases, double their property costs. For those occupiers already in the City Fringe, there will be fewer opportunities to find lower rents in the vicinity, so they will need to decide whether to absorb higher costs or relocate further afield. While the market view is that most will weigh up the pros and cons of relocation and stay, it seems inevitable that there will be some displacement to lower cost locations such as, for instance, Stratford or Wood Wharf. These locations are not seen as interchangeable with the City core but at times of stress markets often experience paradigm shifts.

7.6.5 How will offers change?

It is likely that serviced offices will continue to differentiate in terms of quality, with a strongly tiered market emerging. Furthermore, we expect to see a broader ‘flexible space’ market emerging, with more managed space and more co-working space on offer. Incubators and accelerators are less likely to enter the City, instead remaining in City Fringe areas.

The current provision of serviced offices in the City meets a need for good quality, flexible space, with a 'City' culture, and that need is from predominantly stable and mature companies - corporate or SMEs. Given the rising cost of property in the City, a key role for serviced offices in the future might be in providing lower specification and lower cost space in the City Fringe areas. This will be important if the City wishes to attract greater numbers of micro-businesses, start-ups and occupiers looking for co-working space. Such space might also encourage media and technology sector businesses to locate within the City.

Operators are wary of start-ups and keen to reinforce the message that they have stable occupiers and are not exposed to volatile sectors. However, there might be an opportunity for a type of operator, with a lower priced, lower specification product, culturally more suited to the fringes, perhaps offering managed or co-working space. Such a product might draw media and technology sector companies into the City. It might also be most successful in freehold property.

8 Appendix – Methodology

This chapter outlines the key data sources used and additional analyses used in this research to produce the subsequent findings.

8.1 Key data sources

8.1.1 The Inter-Departmental Business Register

The Inter-Departmental Business Register (IDBR) is a list of UK businesses used by the government for statistical analysis of business activity. It covers 2.1 million businesses in the UK and is considered to be the most accurate and comprehensive list available. It includes all businesses except those with no employees, or those with turnover below the tax threshold.

The main sources for this list are: VAT registrations, PAYE records and supplemented with Companies House registrations. These allow government statisticians to identify and count the number of 'Enterprises' – single businesses or organisational units in the UK. The IDBR counts every enterprise in the UK once, i.e. one entry per enterprise, no matter how many locations they operate from, which means there is no double (or multiple) counting of businesses simply because they operate from more than one site.

But to produce 'small area data', i.e. find out how many businesses there are in a specific city or district within the UK, we need to break down these enterprises and count parts of an enterprise in a particular location. To do this, the IDBR is supplemented by the ONS Business Registers Employment Survey (BRES) which is matched to the UK enterprise data, enabling a count of the number of 'local units'.

The ONS de-duplicate within the small area, to avoid double counting enterprises that operate from more than one site in a chosen geography (city, district, etc.) and to exclude addresses with no employees. Thus the local area data can be supplied in two ways:

- Local units: The total number of workplaces within a given geography, counting each operational site of the same business individually.
- Enterprises: The total number of businesses within a given area, counting a business only once, no matter how many operational sites it has in the area.

8.1.2 Financial Analysis Made Easy

Financial Analysis Made Easy (FAME) is a commercial subscriber service based on registered addresses at Companies House. Its key purpose is to enable business customers to access financial information on individual companies and so there is less sensitivity to physical presence in a location. If a company has its registered office at a City address, then it would be listed in a search for that location.

The data records addresses in three categories:

- Registered address: every company listed at Companies House has one.
- Primary address: only some companies have primary addresses.
- Trading address: not all companies have trading addresses. These might be in addition to a primary address, or instead of one. A company might have more than one trading address.

8.1.3 EGi London Office Database

The EGi London Office Database provides an accurate estimate of the number of businesses occupying over 1,000 sq ft of office space but does not record occupations smaller than that. These smaller occupations could be micro businesses or small parts of larger corporates – some, or all, could be agile businesses.

8.2 The number of businesses in the City

8.2.1 City enterprise count based on ONS/IDBR

The ONS produces statistics for counting the number of enterprises and the number of workplaces in a given geographic area. The workplace count is normally higher than the enterprise count by a significant margin. For the City of London the two figures for 2013 are 17,345 workplaces (local units) and 14,385 enterprises.[30] For the purpose of this study however, we are most interested in workplaces, since these are equivalent to occupational units.

According to the ONS, in 2013, there were 17,345 workplaces in the City. A year earlier, in 2012, there were 15,940 – a substantial 9% increase in just 12 months, suggesting a period of rapid business formation, business growth, or business fragmentation (expansion into overflow space). This pace of change suggests robust demand for flexible workspace.

Not all of the 17,345 workplaces counted in 2013 were offices. The data includes all types of workplace although, in the City, the only significant other categories are Retail and Hospitality (hotels and restaurants). We identified the sectors most likely to be based in other types of workspace so that we could subtract these from the total number of workplaces.

The ONS breaks down the data further by business size. The next analysis is based on 2012 business size data with pro rata estimates produced for 2013.

Once the non-office sectors have been subtracted, we are left with 13,540 office workplaces in the City in 2012. In order to make an estimate for 2013, we assumed the same ratio of total workplaces to office workplaces, resulting in an estimate of 14,760 in 2013 (Table 8.1).

Table 8.1: Workplaces (local units) in the City, 2012 and 2013

Measure	2012	2013	Change 2012-13
Total number	15,940	17,345	9%
Number in office sectors	13,540	14,760	9%

Source: ONS/IDBR/Ramidus Consulting

We excluded employment sectors that were unlikely to be office-based, by far the largest of which was 'Accommodation and Food Services Activities', followed by 'Retail'. Together these accounted for 1,615 City workplaces in 2012 (a full breakdown can be found in Table 8.2).

[30] For clarity, we point out that 14,385 is the number of enterprises in the City, where each enterprise is counted only once, no matter how many workplaces it may have in the City. It is not to be confused with our later estimate of the number of office-based workplaces, which turns out to be a similar number (14,760).

Table 8.2: Number of workplaces in City, 2012

Industrial sector	Employees			
	0-9	10-249	>250	Total
Non-office sectors				
Manufacturing	100	30	5	135
Wholesale and motor trades	295	100	50	445
Retail	245	110	260	615
Transportation and storage	110	45	40	195
Accommodation and food service	215	200	585	1,000
Office-based sectors				
Primary and utilities	50	10	5	60
Construction	260	75	50	385
Information and communication	625	315	95	1,035
Financial and insurance activities	1,150	760	400	2,310
Real estate	600	130	60	790
Prof, scientific & technical	5,225	710	180	6,115
Admin & support service activities	915	450	455	1,820
Public administration and defence	0	5	45	50
Education	75	25	20	120
Health and social work activities	130	55	30	215
Arts, entertainment and recreation	125	20	70	215
Other service activities	280	105	40	425
Total all sectors	**10,400**	**3,150**	**2,395**	**15,940**
Total office-based sectors	**9,435**	**2,660**	**1,450**	**13,540**

Source: ONS/IDBR/Ramidus Consulting

Further analysis of the 2012 data shows us that, of the 13,540 office workplaces, 9,435 employ fewer than ten staff. Again, applying the same ratio to the 2013 data, leads us to an estimate of 10,285 office workplaces with fewer than ten employees in the City in 2013 (Table 8.3).

Table 8.3: Workplaces in the City, by business size, 2012 and 2013 (est.)

Office-based workplaces	Employees			
	0-9	10-249	>250	Total
2012	9,435	2,660	1,450	13,540
2013	10,285	2,900	1,580	14,760

Source: ONS/IDBR/Ramidus Consulting

8.2.2 Business registrations at Companies House

The number of businesses registered in the City at Companies House far exceeds the number in the ONS/IDBR counts. There are several possible explanations for this discrepancy:

1. First, it is common for a business to register multiple versions of its name to prevent others taking them and thereby protect corporate brand and identity.
2. Another common explanation is that many businesses register an address in the City for the prestige and status associated with having a City address, even though the business is based elsewhere and has no physical presence in the City. Several serviced office operators provide a 'virtual address' service to clients, which might include mail forwarding or telephone answering.
3. Third, many businesses use their tax or legal advisors for company secretarial support meaning that their company is registered at the address of their advisors rather than at the place from which it trades.

In one example, the company secretarial department of a medium-sized firm of accountants provides a registered office address for over 600 of its clients. The majority of these businesses trade from bases outside the City but their registered address is in the City of London.

To gauge the scale of these activities, we obtained a search of Companies House registrations via the FAME database. Since this exercise was for illustrative purposes rather than to quantify the number, we confined the search to EC3 postal districts to make the numbers more manageable. It found 11,571 companies registered addresses in EC3 alone (Table 8.4).

Of those companies registered in EC3, 6,438 had a primary trading address and/or a trading address in the City; in other words they had a physical presence in the City. The remaining 5,133 did not. There were 3,413 with no trading addresses and 1,720 with trading addresses that were outside EC3. The majority (1,180) were outside of London.

Table 8.4: Businesses registered at Companies House in EC3

Company description	Number
Those with a primary trading address in EC3	3,458
Those with a trading address in EC3 (but not primary)	2,980
Those with no trading address	3,413
Those with a trading address but outside EC3	1,720
Total companies registered in EC3	**11,571**

Source: FAME/Ramidus Consulting

This suggests that 1,720 companies based outside London were using third party services to manage their business affairs in some way, while 3,413 with no trading address at all, are what we would refer to as 'brass plaque companies'.

We identified some of the addresses associated with large numbers of registered companies and analysed the type of companies using these addresses (Table 8.5). 85 Gracechurch St, EC3 had the largest number of companies registered in all of EC3 (1,367) and the vast majority of them had no trading addresses – in other words, no physical presence in the City or elsewhere.

Table 8.5: A sample of EC3 addresses with large numbers of registered offices

Address	No of registered offices	With primary address in EC3	With trading address in EC3 (but not primary)	With no trading address
37 Lombard Street, EC3V 9BQ	730	96	633	1
40 Gracechurch Street, EC3V 0BT	455	34	228	175
5 Lloyds Avenue, EC3N 3AE	192	0	104	0
85 Gracechurch Street, EC3V 0AA	1,367	72	136	1,156
52-54 Gracechurch Street, EC3V 0EH	546	96	143	291
Birchin Ct, 20 Birchin Lane EC3V 9DJ	289	6	58	214
130 Fenchurch Street, EC3M 5DJ	524	242	0	261
35 Great St Helen's, EC3A 6AP	330	36	34	258

Source: FAME/Ramidus Consulting

In contrast to 85 Gracechurch Street, 37 Lombard St, EC3 was associated with a large number of registered offices but most of these also had a physical presence.

Further analysis of this data might shed light on the scale of virtual offices in the City and potential business for serviced office providers but it would require far more detailed investigation to avoid excessive conjecture.

The number of businesses with a physical presence in EC3 (6,438) is consistent with the total of 17,345 for the whole City, as derived from the IDBR, and it is the office workplace estimates based on IDBR that we take forward into our estimate of potential market size; but first we tested the numbers against built stock capacity.

8.3 Estimating the capacity of the stock to accommodate small occupiers

Based on data from EGi London Offices Database used in *Taking Stock*, we know that 48 million sq ft was occupied by businesses with more than 1,000 sq ft (A); and that the total built stock in the City is 69 million sq ft (B). We inflate the occupied space by 3.5% to allow a margin for gaps in the occupation data, assuming that EGi would probably have captured between 96% and 97% of occupations. Table 8.6 sets out the base calculation.

We also know the approximate amount of space that was vacant (V) was 8.9 million sq ft – allowing for 2.1 million sq ft in the development pipeline.

By subtracting A+V from B, we can estimate how much space is occupied by businesses in units of less than 1,000 sq ft (R) as illustrated in Table 8.6.

Table 8.6: Estimating the capacity of built stock to accommodate micro businesses in the City

Current use of stock	Label	Sq ft
Total built stock	B	69,800,000
Stock occupied on leases in units over 1,000 sq ft	A	50,415,000
Amount available or in pipeline	V	8,900,000
Remainder	**R**	**9,685,000**

Source: FAME/Ramidus Consulting

Table 8.7 shows how we arrived at an estimate of the number of small occupiers in the City, derived from what we know about how the built stock is used.

Table 8.7: The capacity of the City stock to accommodate small occupiers

A	City office stock (sq ft)	69,000,000	
B	Space occupied in units over 1,000 sq ft (sq ft)		48,000,000
C	Allowance (3.5%) for non recorded occupations (sq ft)		2,415,000
D	Vacant or in the development pipeline (sq ft)		8,900,000
E	Estimated stock used by small occupiers: E= A-(B:D) (sq ft)	9,685,000	
F	Assume 150 sq ft per worker (sq ft)		150
G	Capacity to accommodate number of workers: G=E/F	64,566.67	
H	Average number of workers per business		8
I	Equivalent number of businesses	8,173	
J	Serviced office stock (sq ft)	1,967,800	
K	Assume 110 sq ft per worker (sq ft)		110
L	Capacity of serviced office space: L=J/K		18,000
M	Average number workers per business		8
N	Estimated number of businesses: (L/M)	2,264	
O	Total number of small occupiers in leased/serviced office space	10,437	

Source: Ramidus Consulting