INSIGHT

The age of unreal estate

October 2020

THE AGE OF UNREAL ESTATE

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Acknowledgments

Author

Dr Robert Harris

Professional group lead

Paul Bagust (Global Property Standards Director)

Project manager

Helvi Cranfield

Editor

Sam Birch

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Preface

This paper was commissioned from Ramidus Consulting by RICS. The purpose of the commission was to ask some fundamental questions about the role of real estate in the 21st century, given the rapid and fundamental changes that have been reshaping our industry. This insight paper traces the origins and drivers of recent economic, technological, social and environmental turbulence in real estate.

The relationship between occupiers and commercial buildings is changing rapidly – and fundamentally – but a number of issues relating to established perspectives and practices have slowed the industry's response to change. This paper addresses how these will have to change in order for the industry to remain relevant, and suggests an agenda for change, including a customer-centric, people-centric and responsible approach that recognises the rapidly evolving role of real estate in the economy and society.

The aim is not to provide prescriptive answers to all the questions posed, but to promote an industry-wide debate to inform how we adapt.

Dr Robert Harris

Principal, Ramidus Consulting Limited

5 June 2020

1 Something happened!

Until recently, commercial real estate was quite a straightforward affair. There were three simple categories: office, retail and industrial. Limited supply ensured that, over time, values would rise. Funders managed the development risk, and leases underwrote capital value and provided security of income. Managing agents administered the service charge and collected the rent. Occupiers generally sought to minimise costs by managing efficiency. They were relatively undemanding; their needs were predictable and fit-outs were quite generic. Obviously this is a rather simplified representation of the process, but not overly so.

Then, something happened.

In the 1990s, a revolution got underway, slowly at first, before gathering momentum. A recession forced corporate occupiers to rethink their approaches to real estate, with efficiency and cost saving becoming overriding mantras. Office technology morphed into the all-consuming activity that it is today, first with email and the internet, and later with personal devices, social media and agile working.

The global financial crisis of 2007–2008 gave another major jolt to the economy but had little impact on the speed of the technological revolution. Add to this the growing awareness of sustainability – leading recently to the declaration of a climate emergency – and rapidly evolving attitudes to health and wellbeing as part of a wider set of social changes, and the overall impact on real estate has been profound.

Patterns of work have changed greatly, and so too have demands on real estate. Fundamental changes to business, the economy, society and the environment mean that the relationship between real estate and occupiers is shifting – quickly and radically. Perhaps most telling in the long term is that, today, more and more occupiers can choose to turn real estate on and off, rather like other corporate resources in their businesses (capital, human and equipment).

Suddenly, for occupiers real estate is not so real. How has this happened? And if real estate is less real, then what is it? A product? A commodity? A service? A profession? With such fundamental questions hanging in the air, we also have to ask how real estate, and the industry that designs, delivers and manages it, will remain a relevant and socially positive force.

Before we seek the answers to these questions, we must step back and understand why the relationship between the occupiers of real estate and the real estate itself (and its supply chain) is changing so radically.

2 Real estate revolution

History is marked by periods of intense change, sometimes referred to as revolutions. The latter part of the 19th century was one such period: the scale of invention, industrialisation and globalisation was unprecedented. These highly dynamic periods are often separated by longer periods of relative stasis. While society and the economy evolve during these quieter times, it is the revolutions that fundamentally change accepted norms, customs and behaviours.

We are in the midst of a dynamic period of change today. This revolution has seen the emergence of the knowledge economy (also called the digital economy, weightless economy or new economy). This economy, and the social and political structures that support it, is fundamentally different to the one that predominated for most of the 20th century. The knock-on for real estate is profound.

Figure 1 demonstrates the links between the economic, business, technological, social and environmental drivers of change in this revolution and their implications for real estate. It is by making these links between what is happening in our customers' worlds (the drivers) and the implications for real estate that we can ensure we remain relevant.

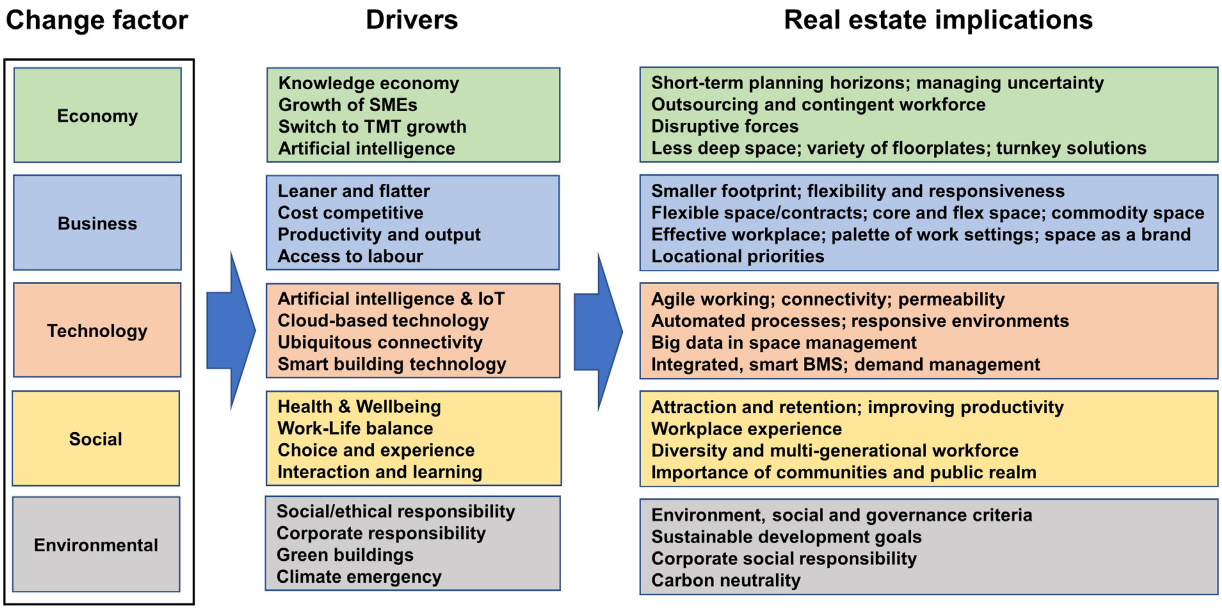

Figure 1: Drivers of change and real estate implications (source: Ramidus Consulting)

These drivers impact all commercial property sectors, including offices, the high street, logistics, factories and higher education. All are awaiting the onslaught of artificial intelligence, while the climate emergency will bring enormous change in environments and behaviours. There are multiple drivers all working in concert to exert radical change, and nowhere more so than in the office workplace.

The knowledge economy

Many of the changes referred to previously reflect the transition from a manufacturing economy to a service-based economy. A hugely important component of the service economy is the growth of knowledge-based roles – the knowledge economy – most obviously exemplified in office jobs.

Previously, offices were primarily process-based environments, with serried rows of sedentary people managing paper along the lines of a factory production line. There was a 'nine-to-five' regime; people were largely sedentary; work was routinised; 'command and control' management ensured a regimented style of behaviour. Workers mainly received security, benefits and a regular salary 'for life', while employers in return received a stable workforce in which they could invest. Large, relatively unchanging and predictable 'corporate islands' could plan ahead with a comparatively high degree of certainty.

This old model is now being redefined; Figure 2 summarises the main features of the new model.

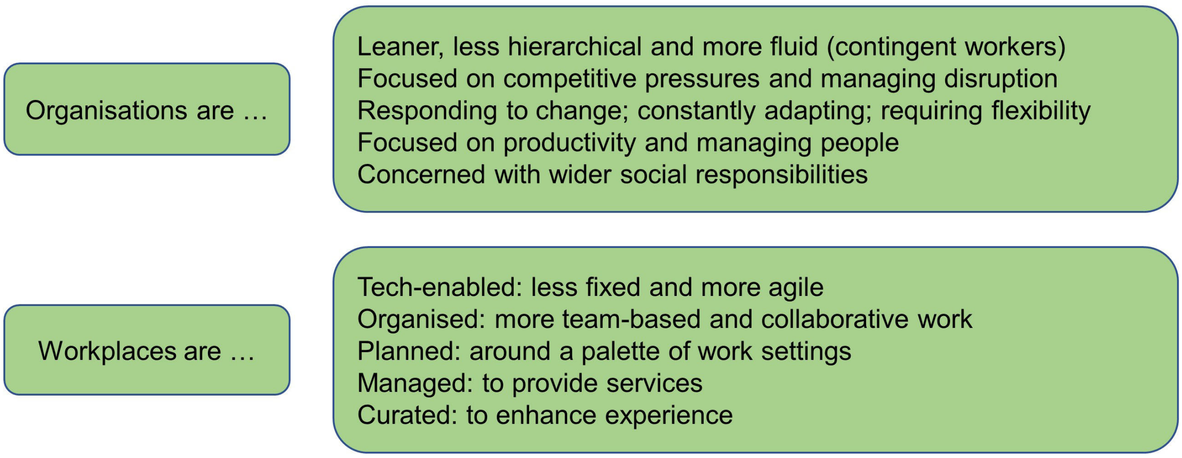

Figure 2: Changing organisations, changing workplaces

Changing corporate structures, the need for flexibility and the need to attract and retain skilled people will all alter the nature of demand for space. The modern office is a hive of activity: people moving around, meeting, collaborating and interacting. The primary driver? Technology. It is to be expected that organisational change is directly related to the nature of work and skills required. This is developed in Figure 3, which describes four key aspects of the emerging corporate landscape.

Connectivity and access to knowledge is a defining feature of modern business and society; it will continue to redefine how and where work is accomplished. Connectivity will help change how businesses interact with each other, and the power of networks will be profound.

Knowledge workers are far more independent of 'place' than the traditional office workforce. They are also less driven by status, hierarchy and traditional rewards. More people spend less time working on the same set of tasks, in one place, simultaneously with the same set of colleagues.

Corporate structures will alter as the traditional employer-employee relationship evolves. Flatter, more agile organisations staffed by knowledge workers will expand; workers will have greater control over their work; and work will dovetail with home, leisure, health and educational needs.

Relationships between organisations will take precedence over the 'corporate island'. More commoditised and non-core activities will be undertaken collaboratively to create value and returns. More work will be undertaken by small companies.

Figure 3: The evolving corporate landscape (source: Ramidus Consulting)

One consequence of the increasing adaptability and flexibility of organisations is the growth of a 'contingent' workforce. In many corporate organisations an increasing proportion of the workforce is not directly employed; they are consultants, interims, contractors, part-timers and supply chain partners. How these staff are housed and managed raises important questions for demand planning within buildings.

Instead, occupiers today operate within short-term planning horizons, responding to an ever-changing economic landscape and seeking to maximise their flexibility to adapt. The power of networks, involving collaborative production and multidisciplinary skills, is coming to be realised. More commoditised and non-core activities are being undertaken by specialists, more work is being undertaken collaboratively and more work is being undertaken by small companies.

The past couple of decades have witnessed a maelstrom of change in all real estate sectors, largely driven by the technological revolution. Given that the pace of change seems to be being maintained, we have some way to go yet. The economy and society are changing rapidly; new forms of business are being created; our engagement with work is changing and the physical structures – real estate – in which those activities take place are changing also. The 20th century model relationship between property and occupier is in the process of being overhauled.

Real estate must respond so it is important to ask how it will remain relevant to its customers, and therefore how all of those engaged in its design, supply and management will also ensure that they remain relevant.

3 Remaining relevant

Acknowledgement of the scope of change leads to the conclusion that we need new, innovative approaches to the design, delivery, occupation and management of real estate. The built environment profession itself must evolve, and this applies to all buildings, whether for working, living, shopping, enriching, relaxing, learning or healing. Clinging to 'the way we have always done things' is not tenable. The built environment professions must learn and adapt – quickly – to remain relevant: to customers, to politicians, to society. Critical to this is the ability to use data as the central thread that will enable us to measure performance across a wide range of indicators.

A new approach to value

Traditionally, 'value' in real estate has been defined solely in financial terms. Increasingly however, this is changing both for investors and those who occupy and use space. Organisations expect more from their buildings, and decisions are being driven by factors other than cost such as talent retention, wellbeing, environmental performance and social value.

The new approach set out in this paper demonstrates that while compliance, cost and function remain critical, they must now be considered alongside other factors of equal importance to organisational objectives such as environmental performance, stimulation and the experience that they provide.

We need to reimagine our whole attitude to operating buildings and what data we collect to demonstrate performance, in order to adopt a more human-centric approach.

A useful starting point is shown in Figure 4. Here, we show on the left Maslow's original hierarchy of needs, a theory that states humans have certain needs that must be fulfilled in a hierarchical order, beginning with the most basic before moving on to the more advanced. On the right, we see how this might be reimagined for real estate.

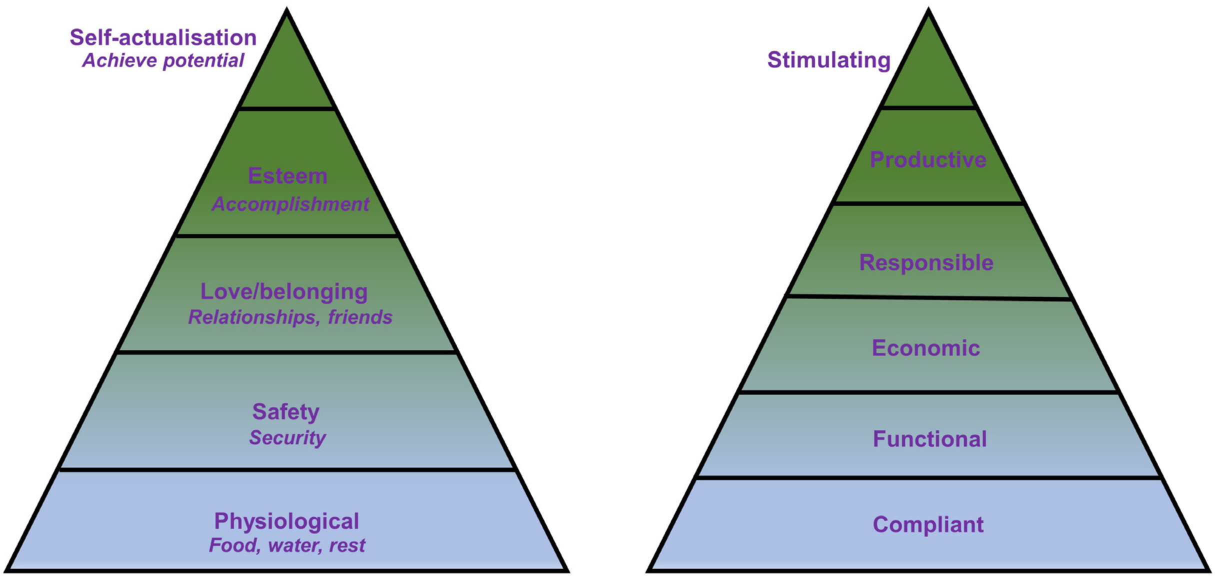

Figure 4: Maslow reimagined for real estate

- At the most basic level, buildings must be healthy, safe and secure (**Compliant**).
- They should then be designed and managed to enable occupiers to operate in their space (**Functional**).
- Next, buildings should enable efficient occupation within cost and value parameters that are affordable (**Economic**).
- Moving up the pyramid, **Responsible** buildings respond to social (health and wellbeing) and environmental (climate emergency) pressure.
- **Productive** buildings provide spaces that enhance wellbeing, provide systems and connectivity and support work processes.
- Finally, those that are **Stimulating** provide environments that enable people to interact with each other and their space in a manner that contributes to their sense of worth.

This model can help to create a relevance agenda for real estate. However, in Figure 5 we invert the pyramid to show the value equation in real estate. The fundamental point about this model is that it implies a radical reversal in the current priorities of the industry. Instead of expending most of our energies, as we currently do, focusing on compliance and functionality (which we ought to be able to take as givens), real estate should be focusing on those areas where it can add or create greater value.

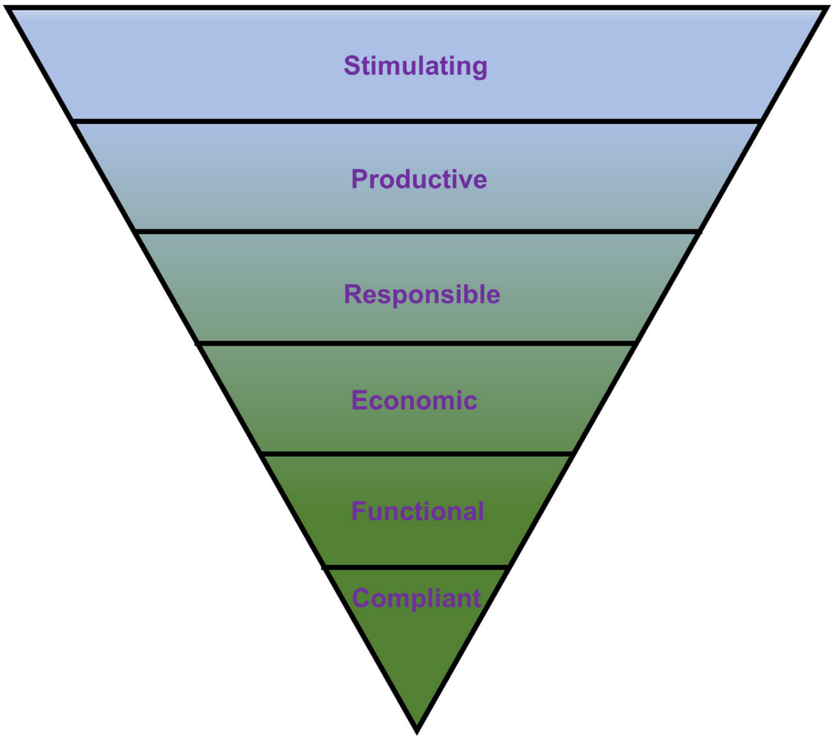

Figure 5: The value equation in real estate

For example, the industry should be more concerned with matters pertaining to socio-environmental responsibility, productivity and experience. Not only are the latter issues relevant to the time, but they also add greatest 'value'.

There is an emphasis here on responding to the changing requirements of our customers. While this is quite correct, we must also address issues relating to what it means to be a responsible business.

There are important political ramifications to the role of real estate within society and the economy that should not be ignored. These are made clear in the UN Sustainable Development Goals. For example, real estate has a role to play in reducing inequality, enhancing opportunity, improving living and working conditions, making cities work and improving the built environment for all.

The real estate industry must address the relevance debate quickly. Economic obsolescence, business change, digital disruption, changing social values and environmental responsibility are all immediate threats to traditional approaches. Investors, occupiers, surveyors, facility managers, asset managers, designers and owners – everyone involved in the real estate process – will be affected by the changes. There is a common interest in ensuring that, together, the industry remains relevant.

Achieving this reversal of industry priorities will require cultural changes, new skills and competencies, new measures and indices, and fresh approaches. It will also require a focus on non-real estate issues, including service, experience, environment, social justice, business performance and customer satisfaction.

4 What must change?

Rather a lot actually.

We can begin by recognising some uncomfortable truths. Unless this happens, the industry cannot prepare itself for the wholesale change that will be required.

The customer position

The real estate industry exists in a kind of pre-Copernican world in which its customer does not sit at the centre of the process. This is because the occupier has had to share the customer role with the investor.

Commercial property has, at least since the middle of the 20th century, served two masters. On the one hand, there are its direct consumers: firms occupying shops, offices, factories and all manner of workplaces. For these customers, real estate provides an operational platform; it is *where they get their work done* in a clean, safe, hygienic and supportive environment. On the other hand, real estate is an investment medium – a very important and valuable one. The investment community is a fundamental part of the built environment profession, providing the capital to fund development projects that are often complex and hugely capital-intensive.

But the problem with having two masters is that one is likely to be more dominant than the other. In the case of real estate, this has been the investment community. The practical outcome of this relationship is that buildings have been constructed, first and foremost, to meet investment objectives, and only secondarily for operational objectives. As we address the relevance agenda, this balance must shift to a more collaborative approach.

We must ask why we are constructing a building and for whom; how it will be constructed; how it will be managed; and what its contribution to wider social, environmental and political objectives will be. Once industry discourse refers to 'owners and occupiers' rather than 'landlords and tenants', progress will have been made because it will signify a conceptual shift from a feudal mindset of lord and subject to a customer-centric model.

The investor comfort blanket

Because much of the real estate industry is not exposed directly to end users, this has led to an industry culture that is more resistant to change than might otherwise be the case. The role of the investor client has encouraged the persistence of a one-size-fits-all approach, most obviously in specification and leases. Such an approach works against competition, against innovation and against the interests of the customer.

It is easy to forget that this 'old' model is not in fact very old. It is, in essence, a post-World War Two model. It fitted the time; austerity and rebuilding required such thinking. The arrangement did have some positive points: as well as giving the owner security, it also provided occupiers with security in the form of a tenure during which they could not be exploited. When the real estate industry's core customer base consisted of large, steady-state, lumbering corporates who were themselves taking a long-term perspective, the model worked.

However, this is no longer the case. The economy is evolving rapidly, and the investor comfort blanket is wearing very thin. The rise of white-collar work and the knowledge economy has exposed the real estate industry to the fact that it is providing space for people, not faceless corporations, and peoples' expectations of their workplace today are a world away from those of even 20 years ago. Real estate practitioners can no longer hide behind the investor comfort blanket.

Real estate as an end in itself

Throughout much of the 20th century, real estate was seen as 'bricks and mortar', an inert backdrop to the activities that took place within the buildings. In turn, buildings were:

- architectural masterpieces
- corporate statements of power
- capital investments and
- income earners.

They were rarely considered in terms of how they influence and affect those who work, play, learn, enjoy or heal within them. The continuing separation of property management and facilities management speaks volumes about the cultural as much as functional separation within the supply industry. Property management, focused on service charge administration and rent collection, was never integrated with customer-facing, service-providing facilities management – at least not until the arrival of the serviced office model.

Real estate is a by-product of economic activity, not an end in itself – a fact laid bare by the knowledge economy.

Process fragmentation

For many decades, real estate markets have been riven by fragmentation in supply structures (Figure 6). At least three generic groups can be identified: design, delivery and management. Within each of these, there are labyrinthine silos of activity, each with their own practices and arcane lexicon.

Figure 6: An industry of industries

The point is that the real estate supply process is focused on the highly fragmented delivery of technical skills, rather than offering a customer-facing management function. The weakness here is that many 'technical' skills are being automated, commoditised or otherwise made marginal – or even obsolete.

Some of the issues with this approach are the following:

- Separate design, construction, property and facilities management silos prevent the presentation of a coherent discipline to customers.
- Duplication in activities and a lack of joined-up planning creates inefficiencies and costs, as well as inconsistency in methods, approaches and standards.
- There is a dominant transactional/procurement culture rather than one based on genuine business relationships.
- Property is seen as an end in itself, rather than as an aspect of the customer's corporate resource planning.
- The separate silos result in hierarchies and turf wars, not to mention reinforcement of cultural differences, none of which are in the interests of the industry's customers.

None of this is to argue against specialism, but it highlights one of the key issues for this paper: the nature of the customer-supplier interface. For a customer of the real estate supply industry (which here means the occupier), the array of skills required over the life cycle of occupation is baffling and labyrinthine, not to mention inefficient and costly.

The response must be to work towards greater collaboration. This will benefit the customer in terms of simplifying the procurement of services. It will benefit the quality of advice in terms of encouraging integrated thinking. And it will benefit careers with a wider perspective.

5 What must happen

It is clear that the industry must adapt to a fast-changing market context, and the previous section identifies some of the issues that will need to be addressed. But can we prescribe what needs to happen? This is difficult to do with a high level of specificity, but six themes for the necessary changes can be identified.

Customer-centric real estate

One of the most important challenges ahead is to place the customer at the centre of the industry, rather than as a secondary consideration to the investment decision. This means more joined-up thinking and more holistic service provision. An occupier business should not have to become part of the real estate industry in order to manage its occupation. It should not have to become an expert in the labyrinthine world of real estate skills.

Customers need to be able to respond quickly and effectively to changing markets, which means quickly and effectively adjusting their occupancy to meet the new landscape. They should be able to do this, not by employing an in-house team of experts but by reaching out to a customer-facing industry.

A customer-centric industry will involve a major cultural change: recognising that customers include both the organisation that procures the real estate and the people who work in, or otherwise use, the space provided.

People-centric real estate

One of the most important lessons from recent fundamental changes has been that real estate exists to support the activities that take place within it. The greatest value of real estate lies in its ability to enable and enhance the activities and experiences of the people who use it. Today's real estate must be much more than compliant, functional and economic. These have to be taken as givens. Real estate has to go further.

First, it must enhance productivity. Whether an office, a warehouse, a classroom or a shop, real estate must provide appropriate settings, have the right systems and connectivity, provide the right environmental conditions and contribute to health and wellbeing.

Secondly, it must stimulate. Again, whatever the use of the space, occupants must be provided with a positive experience, with appropriate amenities and services, using plants and materials and forms of curation to stimulate activity, thought and social interaction.

Data-centric real estate

We live in an age when data is all-important and is used in all aspects of our lives to predict, manage, anticipate, precipitate, assist and validate. This is no less the case in the real estate industry. Building management systems have made advances and the growth of proptech companies bears witness to the level of expectation regarding the future impact of data harvesting technologies.

One of the great challenges the real estate industry has is the need to use data to demonstrate value, rather than cost. This is a pivotal opportunity for the industry and if it is not seized, real estate will fail to remain relevant.

From building management systems to smart cities, data underpins our ability to measure and standardise. The use of technology to collect data is meaningless unless that data is consistent. This enables it to be analysed and the results used to drive strategic decision making and performance measurement in real estate.

This better use of data and the application of consistent standards will lead to better valuation, better buildings, better climate, better people, better outcomes.

Responsible real estate

Real estate must urgently align with the climate emergency agenda. As an example of how this could be achieved, real estate organisations could adopt environmental, social and governance criteria, which are a set of standards for a company's operations. They consider how a company performs as a steward of the environment; how it manages relationships with employees, suppliers, customers, and the communities in which it operates; and how its leadership oversees executive pay, internal controls and shareholder rights.

Similarly, the Sustainable Development Goals are a collection of 17 global goals designed to be a 'blueprint to achieve a better and more sustainable future for all'. Set in 2015 by the UN General Assembly and intended to be achieved by the year 2030, they are part of UN Resolution 70/1.

The real estate industry must embrace these initiatives, adapt them for specific activities and commit to demanding targets.

Real estate as a resource

Real estate is a factor of production, like labour or capital. The 'old world' language of 'asset management' must change; real estate is not an asset (in the financial sense of the term) for an occupier – unless they are an owner occupier. A common thread running through all of the changes is the need for ever-greater flexibility, with risk transferred to the property sector as occupiers procure real estate as a resource, like other corporate resources. Real estate today, for the customer, is more commodity, to be turned on and off as needed, rather than a long-term, fixed commitment.

Real estate sits alongside capital, people, technology and information as a corporate resource to be managed. The notion of integrated workplace management as a strategic management function follows naturally from such thinking.

The focus on resource management highlights the different but complimentary roles of those who make buildings work (the supply chain) and the 'workplace professionals' (typically in-house) who focus more directly on ensuring that those facilities serve the needs of the business and the workforce. The RICS report **Raising the Bar III: From Operational Excellence to Strategic Impact in FM** argued that both aspects are equally important and strategic, but that they 'are different activities that require different but complementary skillsets', and 'they are both necessary for ultimate success'. The report argued that whether 'facilities are managed in-house or by a contracted service provider, they are a strategic business resource, and must be managed as such'.

Commodity real estate

There has been much talk in the industry in recent times of 'space as a service'. This has reflected the enormous growth in serviced offices, managed space and coworking space, collectively known as flexible space. Typified by simplified tenure terms (e.g. licences rather than leases) and service provision (amenities, etc.), flexible space is more responsive to the new economy.

It provides workspace when required and enables easy disposal when no longer needed. It provides experiential workplaces, curated with activities and amenities, and its customers range from freelancers to global corporates. Moreover, the model is applicable to other market sectors: light industrial, laboratories, studios, shops and warehouses could all be similarly provided.

Traditionally, the development and use of real estate have been long-term processes. Delivering a substantial new building can take three years. Negotiating a lease can take over a year. Making a change to the work environment can be a long and complex process. Yet society now operates on a here-and-now basis. The flexible market has gone some way to resolving this issue, but a similar approach needs to permeate the whole industry.

6 Towards unreal estate: from castle to condominium

> 'The greatest danger in times of turbulence is not the turbulence – it is to act with yesterday's logic' (Peter Drucker, author and management consultant)

Writing this conclusion in September 2020, it is clear the world is a very different place from the one we knew when we began this paper.

COVID-19 has dramatically accelerated many of the conversations on the role and value of buildings that we have been having for several years. As we begin to emerge from the COVID-19 crisis, the scale of the challenge is unprecedented. There will inevitably be major economic consequences, which will impact the demand for and use of property in all sectors.

In addition, the experience and lessons learned as a consequence of COVID-19, and the forced move to remote working, will stimulate a comprehensive review of the role of agile working and the need for traditional offices, home working and 'third spaces'.

However, what has not changed is that we need a fresh way to evaluate, consider and measure what a building does, and that this must be approached from the perspective of the occupier.

To do this, we need to understand the complex relationship between all the 'levers' that need to be adjusted to ensure the building is performing in the best way possible to support organisational objectives.

The recovery after COVID-19 will require tremendous innovation, use of technology and leadership to ensure our buildings – whether they be schools, hospitals, offices or retail – are environments that are, of course, safe and secure, but also perform to a high standard in terms of environmental and social impact. And of course, delivering experience will become more critical.

The changes that are disrupting the real estate industry represent a period of extreme turbulence. Yesterday's truths, assumptions and norms are becoming tomorrow's archaic practices.

Real estate cannot remain immune to the technological, social, economic and environmental changes that are taking places all around us. In fact, real estate has to be an active component of those changes, and this means that old attitudes and perceptions must change. Where once a building was seen as a castle, it must now be seen as a condominium. It exists to meet a short-term need, and everything around its design, delivery and management must be focused on that need.

As the role of buildings becomes part of general media discourse, property professionals will increasingly be expected to demonstrate the breadth of understanding that they possess.

To do this, we need data-led decision making that will clearly demonstrate the role and value of a strategic approach to all real estate in a post-COVID-19 environment.

Therefore, RICS is committed to working with stakeholders from all sectors – occupiers, FM, investors and valuers – to develop a new, global, data-led standard for operating buildings.

This paper sets us on this journey by challenging us all to come together, think flexibly and drive the change we need.

Welcome to the era of unreal estate.

Delivering confidence

We are RICS. Everything we do is designed to effect positive change in the built and natural environments. Through our respected global standards, leading professional progression and our trusted data and insight, we promote and enforce the highest professional standards in the development and management of land, real estate, construction and infrastructure. Our work with others provides a foundation for confident markets, pioneers better places to live and work and is a force for positive social impact.

Americas

Latin America
ricsamericalatina@rics.org

North America
ricsamericas@rics.org

Asia Pacific

Australasia
australasia@rics.org

Greater China (Hong Kong)
ricshk@rics.org

Greater China (Shanghai)
ricschina@rics.org

Japan
ricsjapan@rics.org

South Asia
ricsindia@rics.org

Southeast Asia
sea@rics.org

EMEA

Africa
ricsafrica@rics.org

Europe
ricseurope@rics.org

Ireland
ricsireland@rics.org

Middle East
ricsmiddleeast@rics.org

United Kingdom RICS HQ
contactrics@rics.org

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