trowers & hamlins

Thinking Real Estate

Issue 14

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Introduction

Welcome to issue 14 of Thinking Real Estate, where we share thoughts on ideas from across the real estate industry. In this issue we explore the following topics:

People and plant: Looking at strategies for a just transition to net-zero and ensuring the delivery of this is done in an inclusive way.

Balancing city centre living with a night-time economy: With our towns and cities veering towards greater resident and visitor tension, what are the solutions?

Understanding life sciences: What are the opportunities for real estate?

The flight to sustainability for airport operators: How can operators hit their sustainability targets and make the most of their real estate?

We hope you're enjoying Thinking Real Estate. If you would like to continue the conversation about any of these topics please get in touch with us at thinkingrealestate@trowers.com and continue the debate with us on LinkedIn and on Twitter @Trowers.

#14

People and planet
Delivering net-zero inclusively

Do you have a strategy for a just transition to net-zero?

We all know that reducing environmental impact is hugely important, but the Impact Investing Institute has advocated that the move towards a more sustainable way of living and doing business is carried out in a fair way so that no one gets left behind.

The built environment has a huge role to play in reducing carbon emissions.

Legislation and regulations are increasing the pressure on real estate to be more sustainable. Examples include the transition to more energy efficient buildings through changing rules around EPC certificates and the new Environment Act, which requires a 10% biodiversity net gain (calculated by reference to a biodiversity metric) on any new development.

Businesses will also need to think about whether they need to make climate-related financial disclosures. A change in the Companies Act (which came into force on 6th April 2022), makes it mandatory for all publicly traded companies and all businesses and LLPs over a certain size (more than 500 employees and a turnover of more than £500 million) to disclose the climate risks and opportunities of their investments and mitigation strategy.

Scrutiny of business activity

Businesses advocating strong ESG credentials are being scrutinised to ensure they deliver on their values, and that extends beyond what the company is doing internally.

There have been cases where ethical brands have been called out where one element of their supply chain didn't match the standards they promoted. Several banks recently made headlines for how much money they were lending to oil and gas companies. For property businesses, this focus on ensuring that every element of your business maintains the same ESG values means that businesses need to carefully scrutinise all the companies they do business with and lease space to.

"If you're building with timber frames, you want to make sure the timber is coming from sustainable forests," says Katharine Lewis, Partner at Trowers & Hamlins. "Or, as a landlord, your ability to comply with the ESG requirements your investors want from you, is only as good as what you can pass on to your tenants."

But pursuing a just transition to net-zero isn't as simple as cutting ties with those businesses that don't meet certain environmental standards. The danger is that businesses struggling to become more sustainable will get squeezed out when it comes to opportunities or future financing resulting in those businesses failing with the associated job losses that would bring.

Similarly, certain skills risk becoming obsolete as we move towards renewable energy and more efficient ways of building.

The oil and gas sector is a good illustration of this challenge. Earlier in the year, there was a debate about whether the Government should invest in the oil industry in Scotland. On the one hand, supporting an industry we need to rely less on feels counterintuitive. However, divesting from oil also means divesting from the jobs and communities that industry supports; unless there is a strategy in place to reskill employees and replace lost jobs.

Levelling up, not leaving behind

There are plenty of examples of communities across the UK that, decades on, have yet to fully recover from the closure of key industries like coal and steel, something which could be replicated if the transition to net-zero isn't properly planned. With levelling up high on the Government's agenda, there is a political imperative to ensure a just transition.

The pragmatic approach is for businesses to transition in a way that includes their supply chain and tenants, so they aren't left behind. For a landlord, this could mean having green clauses in a lease.

Eileen Duncan, Partner at Trowers & Hamlins comments: "Green clauses can include collaborating with tenants on energy efficiency or green energy. A landlord might require that all tenants sign up to using renewable energy, and in return, the landlord can bulk buy to get tenants a better rate."

Larger companies are also in a better position to help small businesses by redistributing the cost of transition.

Lewis adds: "I think we'll see a lot more pressure on bigger businesses to support the smaller businesses in their supply chain to take steps towards transitioning to net-zero rather than just walking away completely."

Landlords may, however, choose to walk away from undesirable tenants. Businesses with bad sustainability credentials may end up on 'red lists' and find it harder to secure business space. This might be an additional incentive for businesses to move towards more sustainable operations, but it also risks damaging businesses in a way that impacts jobs.

Accessibility and fair price

Some landlords may not be in a position to choose who they rent to, and there is a balancing act in ensuring that greener products and services are accessible and affordable. Part of a just transition is also about ensuring that businesses pay a fair price for goods and services and a fair wage to their staff.

Community engagement, particularly around large-scale projects, has long been important, but it is even more so when it comes to the transition to net-zero. Those affected by changes can't be marginalised or excluded.

Duncan says: "It's not just about job opportunities but also health and well-being and ensuring development projects, particularly larger ones, are inclusive and that people feel they have agency over what is happening."

But this means asking the right questions and delivering what is appropriate for a particular community. For example, a developer may offer apprenticeships as part of a reskilling strategy, but it's a redundant exercise if there aren't enough people to fill those apprenticeships.

Lewis comments: "It's not just about providing one solution, say job creation, it's about providing the right solution for a particular community, and that could be jobs, but it could also be promoting well-being or social benefits."

While there is pressure on businesses to follow ESG principles, particularly

from investors, strategies will still need to consider returns. Duncan says: "Social value and sustainability are important, but so is the commercial viability of a project for it to go ahead. Businesses still need to make money."

Considering natural capital

The inclusion of biodiversity net gain in the Environment Act highlights the importance of considering natural capital. The act requires a 10% net gain in biodiversity on new developments or, to put it another way, developers need to leave a site in a better natural state than it was to start with.

In parallel to the move towards financial disclosures on climate change, a new British accounting standard in relation to natural capital accounting has been introduced. The Taskforce on Nature Related Financial Disclosures (TNFD) is looking to bring in a set of standards businesses will need to adhere to and report against in relation to their impact on the natural world.

Natural capital treats the resources we rely on, such as clean air and water, as finite goods and services.

The Natural Capital Financial Alliance has developed a tool to guide understanding of how businesses depend on natural resources and impact them. The tool is called ENCORE (Exploring Natural Capital Opportunities, Risks and Exposure) and it helps businesses identify and understand the business risks associated with dependence on natural resources.

Lewis comments: "ENCORE allows banks and lenders to assess the impact on natural capital of the businesses they are investing in."

BALANCING CITY CENTRE LIVING WITH A NIGHT-TIME ECONOMY

"It isn't about drinking and music venues versus nine o'clock bedtimes, it's actually about what kind of society are we moving towards and what are our towns and cities actually for?" This is how Trowers & Hamlins Partner, Christopher Plumley sums up the debate about the future of the night economy.

Our towns and cities are veering towards greater resident and visitor tension. The story is all too common: The area around an established pub or club gets redeveloped to residential, the residents move in and then complain about the noise. So the pub or club gets closed down.

And it will only get worse as local authorities and developers look to satisfy the demand for more residential. While, at the same time, looking for ways to attract more visitors and workers back to towns and cities centres and boost local economies.

So, what is the solution?

The last two years have been devasting for the night-time economy, with some 86,000 jobs lost, according to the Night Time Industry Association (NTIA). Pre-pandemic, the sector contributed £46 billion to GDP.

There is some rebuilding to do, and if night-time uses are going to sit comfortably alongside residential, it needs to start with perception. Mention night-time economy, and immediate thoughts are of loud music and drinking.

However, the night-time economy is much broader than this, encompassing everything from music venues and clubs to theatres, cinemas, restaurants and a whole raft of new experiential leisure offerings.

And they all play an important role in the attractiveness and vibrancy of a place. Older venues, particularly independents, can be part of the cultural fabric and history of a town or city centre. They have historical significance and are a destination.

Tom Wainwright, Senior Associate at Trowers & Hamlins, points to the Cavern Club in Liverpool where The Beatles played: "Events happen in these places that get talked about for decades. They can also be safe spaces for marginalised communities."

But these venues, which have been around for 20-30 years or more, have either been closed or are under threat because of complaints from new residents.

In Manchester, there was a case where a resident moved into an area near a famous music venue while it was closed during the pandemic. When restrictions lifted and it reopened, the resident complained about the noise.

"The irony is most of what attracts people to city centres in the first place is the idea of being close to the action, the shops, bars, clubs, restaurants but they are less keen when living next door to such venues," says Wainwright.

In London, the 88-year-old Curzon Mayfair cinema was threatened with closure when a noise complaint was made by developers converting the offices above into residential. The cost of installing soundproofing was expected to be picked up by the cinema operator and risked putting them out of business. However, a petition by supporters and intervention from London Mayor Sadiq Khan saved the venue.

There are some protections under Agents of Change. For example, a residential development near an established music venue would have to include provisions against the noise.

At the time of the Curzon case in 2017, Khan promised that Agents of Change rules would be tightened up in the London Plan. And it was also something addressed in NPPF2 in 2018, but it still leaves a gap.

Could something similar to an 'Asset of Community Value' help? ACVs give a local community certain rights when a change of use is proposed. Wainwright suggests a 'Cultural Asset of Community Value' could be an equivalent.

But such an idea isn't without problems. How do you decide which venues are worthy? And what happens if they go out of business, move or the venue gets re-leased as something different?

"The question is how far can you go to protect an individual venue?" asks Julien Allen, Partner at Trowers & Hamlins. "The counterargument you're going to get with something like that is why are you trying to preserve things in aspic?"

It is a conundrum for those involved with regeneration. He says: "Successful real estate is about placemaking. We've seen too many examples of investment and development in places which all look snazzy and then become wastelands."

So it's a balancing act between preservation and new, which is particularly important when looking at how we revive our town and city centres post-pandemic.

"We have to keep asking ourselves what town and city centres are for, particularly when they are less about retail and more and more about cultural affirmations and cultural heritage," says Plumley.

This means cultural space will be increasingly important, but he says you can't look at night-time venues in isolation.

"It's about having a holistic town centre strategy, looking at planning, different uses, economic drivers and how they relate to each other and influence social factors like crime rates," says Plumley. "And once you build that, you've got a more cogent argument for protecting certain venues."

Allen points out that planning should protect venues, planning authorities get to decide what to allow, and it can form part of an overall planning strategy.

The problem is there is something missing: "There is no real framework, structure or no clear legislation you can point to other than planning strategy planning decisions made on a case-by-case basis with conditions attached," he says.

An answer could be to empower local authorities with specific rights to grant protections through licensing and planning.

Some areas have become cultural clusters, for example, the LGBTQ+ community-focused venues around Canal Street in Manchester and Vauxhall in London. And local authorities can help protect these areas.

By the same token, landlords with estates or clusters of assets can set terms in their leases to control certain behaviour and activities and protect their assets. But in the main, towns and cities have a mixture of ownerships and a more homogenous mix of uses rather than clusters.

This comes back to careful planning and taking a holistic view. Through the 80s, 90s and early 2000s, the focus was primarily on retail in towns and city centres. Then leisure was added to increase dwell, but it hasn't always been blended to provide continual activity.

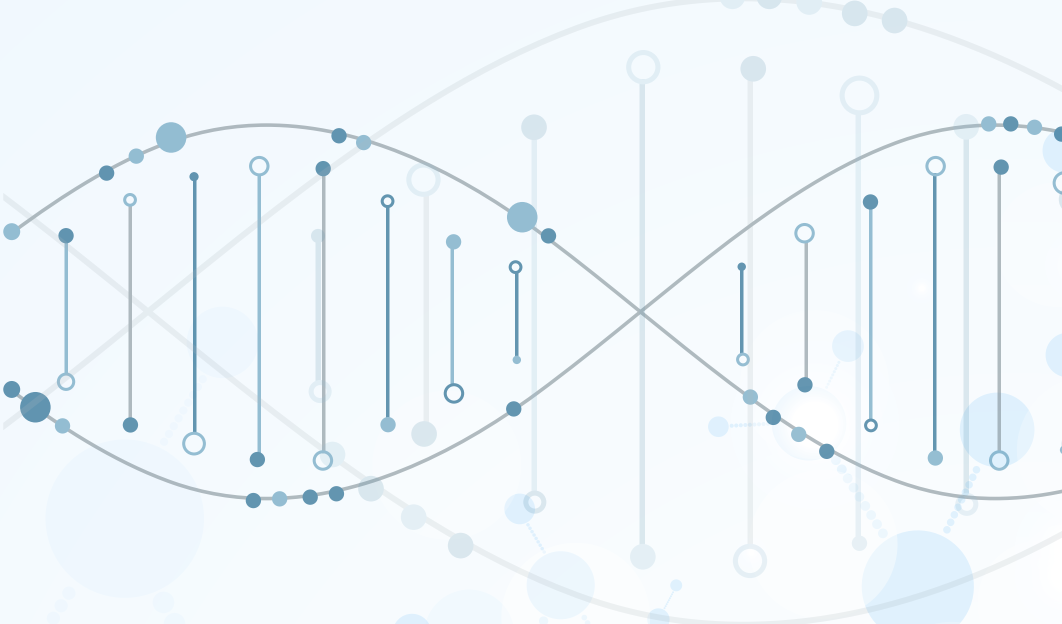
More recent examples show how a blend can work; Southwater in Telford is an example. It mixes community and business uses such as a library and convention centre with leisure such as ice skating, bowling and cinema, restaurants, bars and a music venue.

It is not dependent on just one type of use, there are different reasons to visit and dwell, and the different uses can feed off each other.

Night-time economy needs to play an important role in the future economy of our towns, but, as Plumley states, it's a piece of bigger placemaking jigsaw.

Understanding life science:

The opportunity for real estate



The life science sector has been thrust into the spotlight during the pandemic as scientists worked to develop Covid vaccines. Coupled with a Government focus on life sciences as a growth sector, it is attracting increasing amounts of investment.

By the end of Q1 last year, the amount of investment pouring into the sector was already half 2020's total.

This is fuelling demand for space, and the life science sector has become a hot ticket for real estate. When the Life Science REIT launched in November, its target of raising £300 million was exceeded by £50 million.

Last year Blackstone spent £850 million on two sites in Cambridge where it plans to develop 800,000 sq ft of lab and office space, Derwent London spent £200 million on properties in London's Knowledge Quarter around King's Cross and Euston, and the Ellison Institute for Transformative Medicine, marked its first acquisition in the UK property market with the purchase of a prime life science property in Oxford.

Life science businesses present an opportunity; however, it is a niche sector with niche requirements.

Fit-out costs and commitment

Fit-out can be complex, and the costs are usually high, but this can mean a commitment to a longer lease. Lab work means staff on-site rather than working from home. All of which is a plus for landlords and investors looking for certainty in a market where flexible and short leases are a growing trend.

But targeting space to attract the life science sector isn't straightforward.

"Fitting out life science space is obviously not as straightforward as a normal office fit-out process. It's usually incredibly bespoke as to what a particular organisation is going to do: How much wet lab space, how much dry lab space, how much office and break out space are factors that will have to be considered when it comes to configuring space, as well as in relation to permitted use, licensing requirements and possible planning restrictions" says Tom Calnan, Partner at Towers & Hamlins.

As such, no investment into this sector can be discussed without factoring in planning uses and consents required to do that sort of work. The planning and the pre-development process is key and highly technical.

Bespoke or speculative?

Space for the life science sector doesn't necessarily have to be design and build for a specific occupier, but speculative development is harder to get right. One type of space might be suitable for one branch of life science business but not another, which narrows the pool of potential tenants and makes future-proofing trickier.

If an asset manager has elements of a property portfolio, such as retail space, which is struggling, is change of use feasible?

Lizzie Pillinger, Partner at Trowers & Hamlins, believes it can be: "You could look at partnering with occupiers and if you've got the right location, and the right building you could realise huge values."

The right building means high ceilings and large floor plates to accommodate and fit equipment and ventilation systems.

Tech take-over of life sciences

But not all life science businesses are 'lab coats and test tubes'. In the last decade, the boundary between tech and life sciences has blurred.

Pillinger says: "There are companies that operate within the life science sector that solely deal with data collection and analysis. They operate out of a relatively standard set of offices."

Tech companies have expanded into the health sector, buying life science businesses or forming collaborations. For example, in 2014, Google bought the AI company DeepMind and the number-crunching technology is being used to develop new drugs.

During the pandemic, an app was developed for scientists to gather and analyse data from volunteers to better understand the range of symptoms presented by the Covid virus.

And late last year, the Ellison Institute for Transformative Medicine, bought a 5.9-acre site on Oxford Innovation Park with plans to develop space for vaccine research and scientific data collection.

Location, location, location

And while the type of space and spec is important for certain life science businesses, what is key for all is location. Planning designation is important; some out of town parks are specifically designated for life sciences, for example.

But whether in town or out of town, proximity to universities and teaching hospitals is crucial.

Oxford, Cambridge and London form a golden triangle for the life science sector because of the academic and medical talent and expertise located in the area. Universities collaborate with the private sector; the Oxford AstraZeneca Covid vaccine being a notable example.

As well as famous universities and teaching hospitals, proximity to research institutions can be a draw. The Francis Crick Institute at King's Cross, for example, is home to 1,000 scientists and the largest biomedical lab in Europe and sits at the heart of London's Knowledge Quarter.

Outside of London, examples of life science clusters include Newcastle, where the University has been leading on dementia research.

The magnetic pull of prime academic and medical institutions means competition for sites in or around life science clusters is stiff.

Calnan says: "It's an incredibly competitive sector, as has been shown by the recent bidding wars on key sites. The sector is highly in demand at the moment, which means that existing assets and development opportunities in the space are being bid on aggressively by some very high profile private equity funds and UHNW investors. As such it has become an expensive sector to be involved in in terms of up-front investment – however it is also a sector that has demonstrated considerable value for developers and investors."

The buzz around life sciences shows no signs of abating any time soon, but Calnan cautions:

"It remains a highly technical and specialised sector. There is significant forward engineering and forward planning that comes with these sorts of opportunities."

The flight to sustainability **for airport operators**

Airports, by their nature, hold a lot of land and buildings; they also attract a lot of vehicle traffic. How can they hit sustainability targets and make the most of their real estate?

There are around 20 airports in the UK that are household names, airports that we commonly use to fly on holiday. There are also about another 50 airfields with a variety of operations, from handling small amounts of holiday traffic, business aviation and private charter to flying clubs or air ambulances. All of these airports will have some of a mixture of offices, industrial, retail and hotels, hardstanding in the form of aprons, runways, taxiways and carparks, and open land depending on their size. And all need to be sustainable to reach net-zero targets, but that isn't the only sustainability challenge.

The aviation industry is awaiting the Department for Transport Jet Zero guidance document, which had its consultation last year. Aside from the obvious target of making aircraft sustainable, there were questions around how to help consumers make greener choices, which puts airport infrastructure in the spotlight.

Making airports greener will require a number of different approaches. And while it will be a challenging process, it also presents an opportunity for airport operators.

Taking existing property first, Sam Folley Partner at Trowers & Hamlins, says the rules around carbon emissions are tightening and will only get stricter.

"Airport operators are going to need to think about retrofitting properties to make them more environmentally sound," he says.

A reasonable amount of airport property will be leased out, which, in the absence of in-house expertise, makes partnering with an established property investor a good option.

Folley explains: "Property companies will have the sustainable building expertise and deals can be structured around a share in rental income. Such partnerships could bring additional benefits for airport operators around asset management and new development opportunities."

Where there is excess land that falls outside the public safety zones in which development is restricted or prohibited, airports have some advantages for certain commercial uses. The Civil Aviation Authority has recently changed its policy regarding PSZ's, reducing the areas of land at the ends of runways which are sterilised from development. Airports tend to be easily accessible and close to good road infrastructure. They are also generally located away from residential areas. This makes them prime spots for logistics and last-mile distribution.

Not having residential neighbours who may object to increased lorry and van traffic also means securing planning for light industrial and logistics is likely to be easier. What will need careful consideration is integrating access with regular airport traffic. "HGVs relying on quick deliveries aren't going to want to be held up by miles of EasyJet customers," adds Folley.

A lot of the functions of an airport – security, baggage handling, aircraft catering and cleaning, for example, are subcontracted out. But this means demand for offices. While business parks adjacent to airports may have lost some of their appeal, development within the boundary of the airport is of particular value to these businesses. And as a result, they are often prepared to pay a premium.

New airside buildings can be developed to meet high sustainability targets, but there is also an opportunity to use existing or underused space to help reach net zero. Car parks, hangars and main airport buildings are ripe for roof-mounted solar panels. Open land around an airport which is otherwise unsuitable for buildings, is also a great location for solar panels. It is something being pursued by Edinburgh and Glasgow airports.

With solar power, there is the potential to create an extra revenue stream if excess energy generated can be sold back to the grid. Battery storage can be an issue for urban areas, but airports are more likely to have the space, particularly in areas where other development is prohibited by PSZ's.

For solar panels, consideration will need to be given to existing structures and how much weight they can support. And there will need to be a risk assessment to check the panels don't interfere with radar or cause glare for pilots. But Folley says in reality, "it's rarely an issue".

Solar power generation could also help with an additional sustainability conundrum: Green transport choices.

Most people drive to the airport and use short or long-stay car parking, making them the perfect place for mass EV charging points.

"I think airports are a bit behind the curve on this one," says Folley. "You have an audience: A quick charge if you are dropping off or collecting and only parked up for an hour. And, for long-stay parking, the comfort of knowing you are coming back to a fully charged car has got to be a good sell."

Solar power and battery storage could also help overcome the capacity problem that some commercial landlords or business owners have run into when installing EV charging points for tenants or customers which draw power from the grid.

While you would expect a high energy user like an airport to have sufficient power, probably in the form of a substation, EV charging, particularly at scale, needs to be factored into the overall requirements.

You have to make sure the power supply for EV charging is economical, commercially viable and sustainable. There is no point in people charging electric vehicles with power generated from unsustainable means.

Given the nature of airports and the assets they have, there are economies of scale that can come into play. With the right approach and expertise, the route to sustainability is clear for take-off.

Don't forget the 'S' in ESG

With the scale of the challenge of reaching net-zero, it is easy to forget the social value part of the ESG equation. But aside from being the right thing to do, there are additional benefits.

Generally, airports aren't going to be the most popular thing amongst the local community," she says. "But one way to overcome that would be to really push social value as well as the sustainability agenda.

One area airports are fairly good at is promoting is apprenticeships and employment for young people. If that could be pushed to a local level, that's got to be a good thing.

However, while airport operators may have a social value strategy, the vast majority of people working on-site will be subcontractors and not direct employees. Ensuring social value principles are reflected more broadly through all airport functions, subcontracted or otherwise, is a key challenge.

Often big contracts such as baggage handling are embedded in international law, so it's not just a case of adding a clause.

Folley believes specific provisions in the leases to airport-based businesses could be used as a driver not only for helping reach net-zero but social value. For example, adding a requirement for tenants to buy energy from a renewable provider or stipulating that a proportion of staff should be recruited locally.