COSTAR INTERVIEW

Welput's Gilchrist on the Year That Was for London Office Market

The Managing Director Talks New Deals in The Pipeline, Operating Through Lockdown and What Occupiers Really Want

Ker Gilchrist, managing director at Welput.

By Sharon Smyth
CoStar News
December 23, 2021 | 12:00 P.M.

Welput is the largest specialist central London office fund, with a £800 million portfolio. Managing director Ker Gilchrist catches up with CoStar News to discuss how the sector is navigating the effects of the pandemic as the market shrugs off another year of COVID-19 limbo and lockdowns.

How has the pandemic affected the office sector and how you do business?

What is changing in reaction to the pandemic is a definite polarisation of the office sector between "green" and "brown" buildings. Our focus now is very much on moving towards only owning assets that meet the agenda of occupiers in the post-pandemic world.

When we look back on COVID, the positive we will take from it is that sustainability and social contribution has moved up the list of occupational criteria. These have gone from something that some landlords were considering and occupiers were thinking it was nice to have, to everyone truly believing it is absolutely essential.

How hard has it been to operate throughout lockdowns?

Throughout the pandemic, one thing the UK and particularly England has done well is keep construction sites going. At our refurbishment of 78 St James Street when the pandemic hit we only had one week off site, which was really for the construction teams to work out how they could work safely. We have had genuine continuity of project – more recently there have been some staffing challenges, but show me an industry or a sector where there hasn't been! Build cost inflation has become a very real challenge, with the availability of materials and workforce but we had long foreseen this so had made provisions and we were covered.

Savills is predicting a 10% reduction in London office space by 2026 in response to the pandemic and work from home but best in class and ESG-compliant offices will thrive given lack of supply. What kind of messages are you hearing from occupiers?

105 Victoria Street is a meaningful 400,000-square-feet project but we are keen to see it move to the construction phase, which will start in July next year. What is driving that is straightforward supply and demand. There is currently no meaningful grade A supply in core central London, let alone in the West End, and 105 Victoria Street will provide that, with large, flexible floor plates and proximity to significant transport entry points in London. Plus, because of its scale and the Village Square, it will give occupiers a chance to make a real London statement.

It is very early for conversations with tenants to take place as we're not yet in the construction phase, but we have had a number of approaches from potential occupiers who are looking much further forward than they used to. We have been really encouraged by how those conversations have started.

We've seen this with other sites too. For example, the 78 St James Street project didn't reach practical completion until just before Christmas, but we've already preleased a couple of the floors. Again, it's a high-quality space in a market where that is in pretty short supply, and that is even more acute in St James.

The uniform feedback we got from both those occupiers was that in a post-pandemic world they wanted to be sure they could tell their current and prospective employees they were going to be working in the best space in the core West End.

What is your outlook for office rents and prices?

We are very confident with our view that if we get the design and location right from a sustainability and well-being perspective, this will translate to better and quicker leasing and that in turn should translate into stronger pricing at the end of the project.

The only thing that might hold that back is that in all the major global cities, and London will be one of them, there will be an oversupply of brown space that will not be popular among occupiers and the rents for those buildings will come under pressure. If there is too much pressure, that might limit the outperformance we can see of some of the green buildings. At the moment though, the market seems deep enough for the second-hand space too.

The early-stage feedback we are getting from our 110,000-square-foot project at Regents Wharf in Kings Cross is giving me comfort, as we've had a strong level of enquiries from occupiers. The space there is much more tangible and they can see a clearer delivery time, and we're seeing occupiers coming to us and saying they just want to be in the best space, which underpins our faith that if we get it right we will see some real outperformance.

We will see some blips along the way. The outbreak of this new variant isn't the last one we are going to see, no doubt, but the recurring theme we are hearing from occupiers is that while their businesses can function in a hybrid model between the home and the office, they cannot thrive and evolve in the same way and at the same pace as if you have your teams in the office. Every employer will have a different approach, but the selection of the place of the work is going to be way more forensically explored now than before.

What factors do you take into account when deciding to refurbish or redevelop?

We are very focused on the commitments we have from a carbon perspective. There has been a lot of noise of late about redevelopment versus refurbishment and there is a very relevant conversation to have there, but the focus we have in everything we do is all about the circular whole life carbon investigation. So, with Victoria Street we are saying to ourselves that we shouldn't be building something that will last 60 years, we should be building something that will has a much more ambitious life cycle. You have to look at the whole-life carbon benefit of a new building and the savings as a consequence of that new building set against the embodied carbon challenges of a redevelopment.

We have made that decision with Victoria Street but with one of our other projects, the Farringdon Estate, we have made the decision that the most appropriate plan is a refurbishment to avoid the embodied carbon challenges of a ground-up development. It really comes down to trying to make sure we do come up with green-focused offices that meet our ESG policies and our ambition is to be net-zero carbon within the next two years.

We will start on our Farringdon project in the final quarter of next year. This was probably the asset where we saw the biggest distress during the pandemic. Ultimately, we love the location but the space just isn't good enough. Here, we are not creating tons more space but we are making it way better and reminding ourselves that Crossrail is coming – finally – next year, and as we are right opposite the station we should capture some of the undoubted upside we will see by having an office right in front of it.

What are the plans for Bury Street given the recent decision by planners?

We were disappointed with the decision on Bury Street but we had some really positive feedback from stakeholders and from the City planners. We have been doing this for over twenty years and know that London planning is never straightforward. With Bury Street we have some really good options ahead of us and we will decide early in the new year what the next steps are. We took a lot of positives from the feedback we got and the great thing is that current leases on Bury Street run until 2025 so we have time. The [Bevis Marks] synagogue and our other neighbours have been very good neighbours and have always been very open and clear with us. We have always listened to them and will continue to do so, and I am confident we can find a solution.

This year Welput sold Stirling Square and is expected to close soon on the sale of 20 St James Street, where are you deploying the proceeds?

At 20 St James Street, we leased five floors during lockdown because of the quality of the space we created – again this is an example of what we do: refurb, make good, modern office space then sell on and recycle that capital back into projects like Victoria Street. We are looking for London value-add and have three buildings under offer at the moment. Welput was traditionally West End-focused but that changed in 2014 as a result of tenants changing their attitudes to where they want to be. So what we are buying right now is all across London – we can consider anything from Hammersmith to City Fringe, though our focus remains very much on core markets. For example, we sold Stirling Square earlier this year so we would like to bring more core back into the portfolio, where we see some embedded value.

The assets we are looking at have to be accretive to the portfolio – we have a limited number of buildings that are in different stages of refurbishment or redevelopment or income cycle – so when we look at buying things we consider them relative to the holdings that we already have. We don't want to be redeveloping everything we have in the portfolio at the same time, so we are buying a few assets that knit in with what is already there. I am not sure they will happen prior to Christmas, but they are all in pretty good shape. Our investors want to see us redeploy the capital from sales back into Welput. It is always a pretty active process, so there’s never a chance to sit back and say let’s pause for breath for a while - there is always something going on.

Welput is the largest specialist Central London office fund and is managed by BentallGreenOak. Its portfolio of eight assets spans 800,000 square feet of best in class sustainable properties and the Welput team has managed a total of 6.6 million square feet of space throughout central London.

Gilchrist joined Welput in 2014 having led Knight Frank’s West End investment and development team. He serves as a Board Member of the Westminster Property Association, is a Member of the Royal Institution of Chartered Surveyors and a member of the Investment Property Forum.