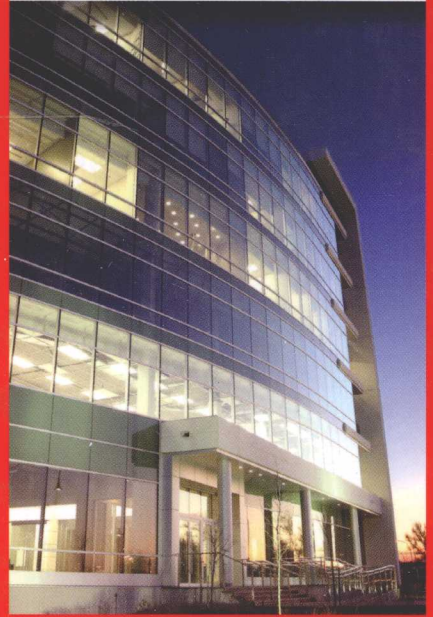


REAL ESTATE ISSUES



Office Markets & Public Policy

Colin Jones

 WILEY-BLACKWELL

 **RICS**
Research

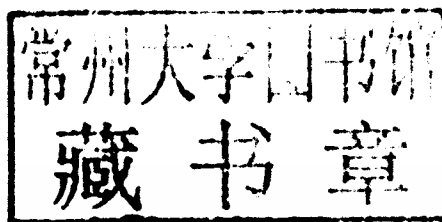
Office Markets & Public Policy

Colin Jones

Professor of Estate Management

Institute for Housing, Urban and Real Estate Research

Heriot-Watt University



 **WILEY-BLACKWELL**

A John Wiley & Sons, Ltd., Publication

This edition first published 2013
© 2013 Colin Jones.

Wiley-Blackwell is an imprint of John Wiley & Sons, formed by the merger of Wiley's global Scientific, Technical and Medical business with Blackwell Publishing.

Registered Office

John Wiley & Sons, Ltd, The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, UK

Editorial Offices

9600 Garsington Road, Oxford, OX4 2DQ, UK

The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, UK

2121 State Avenue, Ames, Iowa 50014-8300, USA

For details of our global editorial offices, for customer services and for information about how to apply for permission to reuse the copyright material in this book please see our website at www.wiley.com/wiley-blackwell.

The right of the author to be identified as the author of this work has been asserted in accordance with the UK Copyright, Designs and Patents Act 1988.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, except as permitted by the UK Copyright, Designs and Patents Act 1988, without the prior permission of the publisher.

Designations used by companies to distinguish their products are often claimed as trademarks. All brand names and product names used in this book are trade names, service marks, trademarks or registered trademarks of their respective owners. The publisher is not associated with any product or vendor mentioned in this book. This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold on the understanding that the publisher is not engaged in rendering professional services. If professional advice or other expert assistance is required, the services of a competent professional should be sought.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with the respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. It is sold on the understanding that the publisher is not engaged in rendering professional services and neither the publisher nor the author shall be liable for damages arising herefrom. If professional advice or other expert assistance is required, the services of a competent professional should be sought.

Library of Congress Cataloging-in-Publication Data

Jones, Colin, 1949 Jan. 13–

Office markets & public policy / Colin Jones.

pages cm

Includes bibliographical references and index.

ISBN 978-1-4051-9976-6 (cloth)

1. Office buildings. 2. Central business districts. 3. City planning. 4. Land use, Urban.

I. Title. II. Title: Office markets and public policy.

HD1393.55.J66 2013

333.33'87–dc23

2012045884

A catalogue record for this book is available from the British Library.

ISBN 978-1-405-19976-6

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books.

Cover design by Garth Stewart.

Cover image courtesy of iStockphoto.

Set in 10/13pt Trump Mediaeval by SPi Publisher Services, Pondicherry, India

Printed and bound in Singapore by Markono Print Media Pte Ltd

Office Markets & Public Policy



The Royal Institution of Chartered Surveyors is the mark of property professionalism worldwide, promoting best practice, regulation and consumer protection for business and the community. It is the home of property related knowledge and is an impartial advisor to governments and global organisations. It is committed to the promotion of research in support of the efficient and effective operation of land and property markets worldwide.

Real Estate Issues

Series Managing Editors

<i>Clare Eriksson</i>	Head of Research, Royal Institution of Chartered Surveyors
<i>John Henneberry</i>	Department of Town & Regional Planning, University of Sheffield
<i>K.W. Chau</i>	Chair Professor, Department of Real Estate and Construction, The University of Hong Kong
<i>Elaine Worzala</i>	Director of the Carter Real Estate Center, Department of Economics and Finance, School of Business and Economics, College of Charleston

Real Estate Issues is an international book series presenting the latest thinking into how real estate markets operate. The books have a strong theoretical basis – providing the underpinning for the development of new ideas.

The books are inclusive in nature, drawing both upon established techniques for real estate market analysis and on those from other academic disciplines as appropriate. The series embraces a comparative approach, allowing theory and practice to be put forward and tested for their applicability and relevance to the understanding of new situations. It does not seek to impose solutions, but rather provides a more effective means by which solutions can be found. It will not make any presumptions as to the importance of real estate markets but will uncover and present, through the clarity of the thinking, the real significance of the operation of real estate markets.

Further information on the Real Estate Issues series can be found at <http://eu.wiley.com/WileyCDA/Section/id-380013.html>

Books in the series

Greenfields, Brownfields & Housing

Development

Adams & Watkins

9780632063871

Planning, Public Policy & Property Markets

Adams, Watkins & White

9781405124300

Housing & Welfare in Southern Europe

Allen, Barlow, Léal, Maloutas & Padovani

9781405103077

Markets & Institutions in Real

Estate & Construction

Ball

9781405110990

Building Cycles: Growth & Instability

Barras

9781405130011

Neighbourhood Renewal & Housing

Markets: Community Engagement in
the US and UK

Beider

9781405134101

Mortgage Markets Worldwide

Ben-Shahar, Leung & Ong

9781405132107

The Cost of Land Use Decisions: Applying

Transaction Cost Economics to
Planning & Development

Buitelaar

9781405151238

Urban Regeneration & Social

Sustainability: Best Practice
from European Cities

Colantonio & Dixon

9781405194198

Urban Regeneration in Europe

Couch, Fraser & Percy

9780632058419

Urban Sprawl in Europe: Landscapes,

Land-Use Change & Policy

Couch, Leontidou & Petschel-Held

9781405139175

Transforming Private Landlords

Crook & Kemp

9781405184151

Real Estate & the New Economy:

The Impact of Information and
Communications Technology

Dixon, McAllister, Marston & Snow

9781405117784

Economics & Land Use Planning

Evans

9781405118613

Economics, Real Estate &
the Supply of Land

Evans

9781405118620

Management of Privatised Housing:

International Policies & Practice

Gruis, Tsenkova & Nieboer

9781405181884

Development & Developers: Perspectives
on Property

Guy & Henneberry

9780632058426

The Right to Buy: Analysis & Evaluation
of a Housing Policy

Jones & Murie

9781405131971

Housing Markets & Planning Policy

Jones & Watkins

9781405175203

Office Markets & Public Policy

Jones

9781405199766

Challenges of the Housing Economy:
An International Perspective

Jones, White & Dunse

978047062334

Mass Appraisal Methods: An International
Perspective for Property Valuers

Kauko & d'Amato

9781405180979

Economics of the Mortgage Market:
Perspectives on Household Decision Making

Leece

9781405114615

Towers of Capital: Office Markets &
International Financial Services

Lizieri

9781405156721

Making Housing More Affordable: The Role
of Intermediate Tenures

Monk & Whitehead

9781405147149

Global Trends in Real Estate Finance

Newell & Sieracki

9781405151283

Housing Economics & Public Policy

O'Sullivan & Gibb

9780632064618

International Real Estate:
An Institutional Approach

Seabrooke, Kent & How

9781405103084

Urban Design in the Real Estate
Development Process: Policy Tools & Property
Decisions

Tiesdell & Adams

9781405192194

British Housebuilders: History & Analysis

Wellings

9781405149181

Acknowledgements

The genesis for this book is research on property markets undertaken with a small number of colleagues stretching back almost twenty years. Chapter 3 on submarkets had its inception with the PhD of Neil Dunse from which joint papers were originally published in the *Journal of Property Investment and Finance* and the *Journal of Property Research* in 1998 and 2002 respectively. Elements of Chapter 5 derive from research undertaken with Neil Dunse and Michael White on short-term office market dynamics, partly published in the *Journal of Property Research* and the *Journal of European Real Estate Research* in 2007 and 2010. Similarly, Chapter 6 draws on joint papers with Allison Orr and Craig Watkins published in *Urban Studies* (1996, 1999 and 2004). My interest in sustainability, developed in Chapter 7, stems from research undertaken as part of the Cityform research consortium of five universities on sustainable urban forms funded by the EPSRC and published in the book, *Dimensions of the Sustainable City* (Springer, 2010), edited by Mike Jenks and myself.

Preface

This book is primarily about the use of offices and how office markets work, and also about the role and influence of public policy in these processes. The book is designed to relate to the dynamics of office markets and public policy across the world. It therefore presents case studies from different continents and draws on the widest possible range of published international evidence. Nevertheless, it inevitably focuses on the UK and, to lesser extent the USA, simply because of the weight of published research in these countries.

It is a book about the economies of cities and written very much from an urban economics perspective. Unlike most economics books, there are deliberately no equations and the arguments are all expressed in words. This is to ensure the greatest access to the arguments presented.

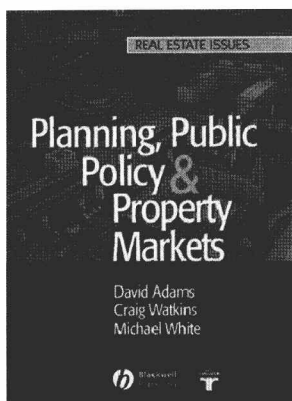
The book takes a long-term perspective on office markets so the analysis considers how office markets have developed over almost two centuries. Change is a key theme of the book and it begins by looking back and ends by looking forward.



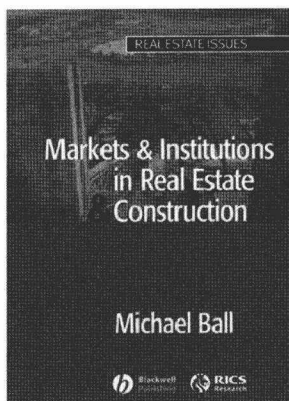
WILEY-BLACKWELL



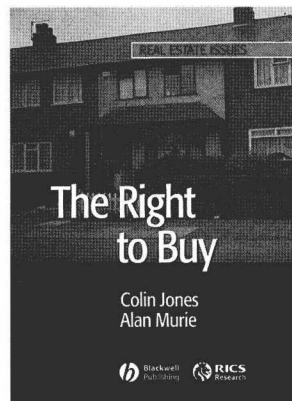
Other *Real Estate Issues* Series Books Available from Wiley-Blackwell



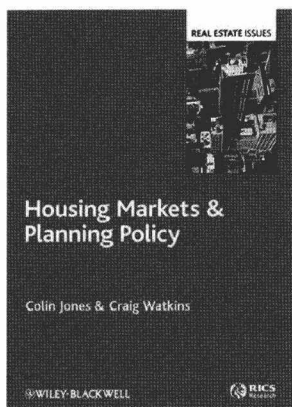
Planning, Public Policy & Property Markets
Adams, Watkins & White
978-1-405-12430-0



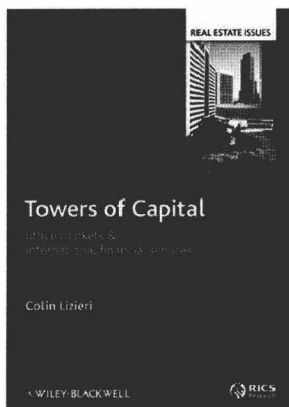
Markets & Institutions in Real Estate & Construction
Ball
978-1-405-11099-0



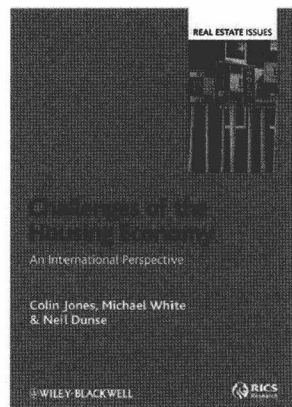
The Right to Buy: Analysis & Evaluation of a Housing Policy
Jones & Murie
978-1-405-13197-1



Housing Markets & Planning Policy
Jones & Watkins
978-1-405-17520-3



Towers of Capital: office markets & international financial services
Lizieri
978-1-405-15672-1



Challenges of the Housing Economy: An International Perspective
Jones, White & Dunse
978-0-470-67233-4

Further information on the *Real Estate Issues* series can be found at:
<http://eu.wiley.com/WileyCDA/Section/id-380013.html>

www.wiley.com/go/construction

Keep up with critical fields

Would you like to receive up-to-date information on our books, journals and databases in the areas that interest you, direct to your mailbox?

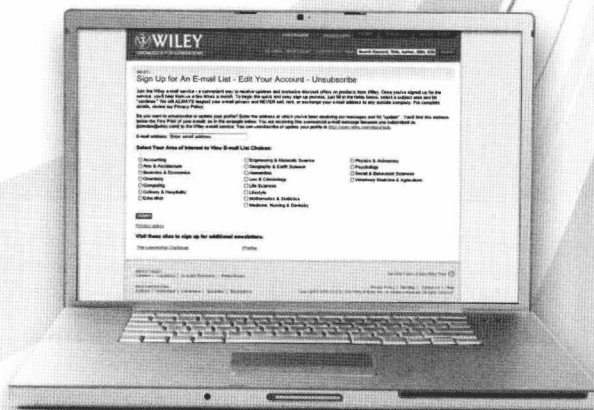
Join the **Wiley e-mail service** - a convenient way to receive updates and exclusive discount offers on products from us.

Simply visit **www.wiley.com/email** and register online

We won't bombard you with emails and we'll only email you with information that's relevant to you. We will ALWAYS respect your e-mail privacy and NEVER sell, rent, or exchange your e-mail address to any outside company. Full details on our privacy policy can be found online.



www.wiley.com/email



Contents

<i>Acknowledgements</i>	ix
<i>Preface</i>	xi
1 Introduction	1
History of offices	2
City office markets	6
Overview of office market trends	19
Book structure	20
2 Market Fundamentals	25
Growth of services	26
New technology, new work and new offices	28
New specialist office forms	31
The office stock	31
Constraining influences on the office property market	33
Office market cycles	37
Repeating the 'mistakes'	42
Conclusions	44
3 Submarkets and the Changing Nature of the Traditional Central Business District	47
Economics of cities and office location	48
The Central Business District and intra-urban rent structures	50
Office submarkets	55
Identifying submarkets	59
Changing submarkets and a polycentric office market	67
Summary	69
4 Decentralisation and Edge City Office Centres	73
The information age	74
The motor age and urban forms	75
Deconstructing agglomeration economies	78
Decentralisation processes	82
Suburban offices and edge cities	84
Spatial structure of urban office markets	87
Spatial pattern of rents	90
Congestion, decentralisation and public policy	92
Conclusions	95

5	Investment, Risk Premiums and Office Market Dynamics	97
	Obsolescence of offices and depreciation	98
	Institutional office investment trends in the UK since the 1980s	101
	Investment in offices	102
	Establishment of office parks as an investment class	104
	Mixed-use development	108
	Institutional investment and office cycles	113
	Credit crunch, cycles and bubbles	118
	Conclusions	121
6	Public Policy and Competitiveness	125
	Offices, competitiveness and the urban economy	127
	Overview of public policy	130
	Competitiveness and property market constraints	132
	Public policy and office location constraints	134
	Logic of property-led local economic development policies	140
	Sustainable markets	145
	Case studies of public policy initiatives	148
	Concluding comments	157
7	Green Offices, Office Markets and Sustainability	161
	A sustainable city?	163
	Offices and the environmental dimension	165
	Tall office towers and the economic dimension	168
	Greening the office stock	171
	Arguments for paying higher rents for green offices	173
	Green refurbishment of existing offices	177
	Current and changing occupier attitudes	178
	Towards a green office rental market	179
	Green investment	188
	Conclusions	189
8	Market Changes and Challenges	193
	Evolving offices	194
	Evolving office markets	196
	Office market cycles, bubbles and globalisation	199
	Toward greener offices?	201
	The future of offices as an investment	208
	Public policy issues	211
	Future challenges for the market	217
	<i>References</i>	219
	<i>Index</i>	233

1

Introduction

Throughout history, the image of a city has been identified with the cathedral, the palace, the market place and the factory chimney, but today the office is arguably the prime symbol of a modern city's development (Cowan et al, 1969). Offices now dominate the centre of the cities we live in, and whereas once a cathedral was the focal point of a city's skyline this has now quite likely been replaced by tall, plate-glass office citadels. Very often a city can be recognised by the skyline of tall office buildings and structures. One historic example is 'The Three Graces' of the Liverpool waterfront: the Royal Liver Building (1911), the Cunard Building (1916) and the former offices of the Mersey Docks and Harbour Board (1907) that is now a UNESCO World Heritage site. In Shanghai, there was a deliberate plan to create a memorable skyline in the new financial district, Lujiazui. Many offices, even if they are not high-rise, are landmark buildings at major street junctions or squares. With the city centre normally the central business district, as the predominant built form offices represent a major element of the signature of a city.

Offices are increasingly the principal locus of economic activity. The amount of office space in England and Wales has more than doubled since 1980 (Mayor of London, 2009). The shift to a service economy from a manufacturing economy in developed countries, especially in cities, during the latter half of the last century is reflected in the rise of office-based employment. A high proportion of workers in service industries – accountants,

lawyers, surveyors, bankers, insurance brokers, etc and managers through to specialist service and clerical staff – spend their working day in an office. The history of office development is bound up with the evolving economy of cities and new technologies.

The cluttering of city skylines by offices also emphasises the capital sums invested in this real estate. A large office block in London could be worth more than £20m and financial institutions in the UK invested £66bn in offices in 2006 (Investment Property Databank, IPD, 2007). Office areas, especially financial centres, are the most expensive areas of real estate in the world. Foreign real estate investment often targets ‘trophy’ offices. With real estate investment increasingly part of the globalisation of capital markets, major offices can be an integral part of an international real estate investment labyrinth involving vast sums of money. In December 2009, for example, Dubai World sent shudders through global financial markets after requesting a six month ‘hold’ on interest payments to a range of international banks in order to restructure its \$26bn debt, part of it invested in offices around the world.

The aim of this chapter is to provide the context for the book. It begins by reviewing the history of offices, noting the interaction between their changing built form, technological progress and commercial activity. The next section considers the development of office markets through the prism of a series of city profiles that offer a historical perspective on their current roles and built form. The chapter then takes a wider view of the trends in office markets, drawing on the evidence in the first two sections. The final part of the chapter briefly sets out the logic of the subsequent chapters and how they link together.

History of offices

Offices have probably always existed within large, multifunctional buildings whether they be, for example, palaces, houses, education establishments or factories. Up to at least the 18th century the administration of trading companies and banking was undertaken from houses. This is illustrated with some examples from London, the leading commercial centre of the 18th century. The East India Company, founded in 1600, built a headquarters in London in 1726 while the Bank of England was built in 1732. And while the 18th century saw a take-off in professional services, such as lawyers and financial services, to cope with the increasing complexity of trade and government these were not administered from offices (Clark, 2009).

Lloyd’s of London, now the largest specialist insurance market in the world, started life as an informal group of marine insurance brokers meeting in Edward Lloyd’s coffee house in 1688. Gradually the community became

more formalised and it leased rooms in the Royal Exchange, a centre for commerce, in 1774 (Lloyd's, 2010). Similarly, the London Stock Exchange was initiated at the end of the 17th century in a coffee house where prices of stocks and commodities were listed. In 1773, the first purpose-built building was constructed, comprising a dealing room on the ground floor and a coffee house above (London Stock Exchange, 2010). Over this period, whilst areas of cities were beginning to be created that specialised in particular office functions – for example, the administration of the law – the office as a generic built form did not really exist (Cowan et al, 1969).

The industrial revolution replaced the old cottage industries and brought the establishment of the factory and cities as we know them, with the latter becoming the centre of manufacturing. There were wider implications for the scope of economic activity in cities and the scale of office functions, both of which led ultimately to the establishment of offices as separate entities. The expansion of industrial activity required systems to control and finance these new businesses, and this in turn brought a growth in the number of messages and financial transactions such as bills and agreements. These economic activities, the associated communication and the control of complexity, are essentially offices functions. As these functions expanded with the increasing intricacy of the organisation needed to finance, administer and support the industrial revolution, offices began to exist in their own right (Cowan et al, 1969). Supporting specialist services such as insurance either expanded substantially or developed during this period in line with the growth of manufacturing, and were also based in offices (see examples below).

The office block as a distinct building form in its own right began to evolve in the early 19th century. Initially, residential buildings were converted, and then in the 1840s speculative purpose-built office development began to emerge. Development then accelerated in Western economies during the latter half of the century with a rapid growth of office employment (Scott, 1996). The detachment between administration and production and the promotion of offices was facilitated by the development of the telegraph. Originally invented in 1746, it was only following a method for printing messages devised in 1854 that an extensive cable system was constructed to permit widespread use of the telegraph. Two decades later the detachment process was accelerated by the extensive use of the telephone invented in 1876. Commercial production of the typewriter in the 1870s and the spread of high-speed shorthand (stenography) also contributed to the efficiency of office functions and shaped the design of office buildings (Cowan et al, 1969).

After 1850 came the first generation of large-scale headquarters erected for banks and other institutions. From the beginning, these new offices often sought to adopt distinctive architecture and new construction technologies.

Oriel Chambers, a five-storey office block in Liverpool, was one of the first 100% iron-framed, glass curtain-walled buildings, constructed in 1864 (Oriel Chambers, 2009). The first building that combined both metal frames with the invention of the hydraulic lift (elevator) was the Home Insurance Building, built in 1884 in Chicago, often referred to as the first skyscraper in the world. Originally it was ten storeys and two more were added later. In fact, the building was not a pure steel-framed building and relied upon both metal and masonry to support it. In 1888, a patent was taken out in America for iron skeletal frame buildings and the construction method subsequently gained wide acceptance. It was the beginning of the skyscraper era (Emporis, 2010a).

New York in particular embraced the new building engineering techniques, and from 1890 to 1973 the world's tallest building was in the central business district of Manhattan. It began with the New York World Building built for a newspaper, which was one of a number of tall buildings built for this purpose on the same street. It was replaced as the tallest building by the Park Row Building with 29 storeys in 1899 (Emporis, 2010b). The building was originally commissioned by an investor as a speculative office building; it contained 950 offices and accommodated about 4000 workers (Aviewoncities, 2009a). Initial occupiers of the offices included the Associated Press news agency as well as the headquarters of the private operator of the city's underground subway (Emporis, 2010c).

The tallest title was taken by the 41-storey Singer Building, constructed in 1908 as the headquarters of the sewing machine manufacturing company, but it was soon taken over by the Metropolitan Life Insurance Company Tower of 50 storeys in 1909. The mantle of tallest building passed to the Woolworth Building comprising 57 storeys and completed in 1913. It was the corporate headquarters of the retail company and, interestingly, paid for in cash. This building remained the tallest building in the world until 1930 (Skyscraper, 2009).

The late 1920s saw a race to take the Woolworth crown supported by improvements to the speed of lifts. First, the 71-storey headquarters of the Bank of Manhattan at 40 Wall Street was completed in 1930, but its reign was short lived as the Chrysler Building surpassed it within months, only for that to be overtaken by the 102-storey Empire State Building in 1931. It was built by a consortium that included the creator of General Motors (Empire State Building, 2009), and remained the world's tallest building until 1972.

The development of offices in other countries was to a lower number of storeys over this period, often because buildings were subject to height constraints. In the UK during the 19th century, the typical demand for headquarter office buildings was for street-frontage sites with the buildings imposing on their immediate surrounds. In the City of London, examples include offices of the London and Westminster Bank (1838), Sun Insurance

(1843), The Royal Exchange (1844) and Barclays, Bevan & Co (1864). Many substantial government offices were also completed during this period, including the Treasury building in 1846 and the Foreign and Commonwealth building in 1868.

Each provincial city centre in the UK followed in similar fashion, beginning in the 1860s. Over the remaining decades of the century, a series of buildings of up to six storeys were built in a range of distinctive ornate styles inspired by classical buildings in Italy and Greece. They were usually complete with grandiose marble-floored entrance hallways and staircases. In Manchester, for example, 1861 saw building begin on the new premises of the Manchester & Salford Branch of the Bank of England (a private company then) followed by a series of headquarter buildings culminating in buildings such as the Co-operative Wholesale Society Building in 1905 and the Refuge Assurance Building in 1910.

The Three Graces in Liverpool also date from the end of this era. The original of the Three Graces, the Mersey Docks and Harbour Board Building, is a five-storey building, with a dome built using reinforced concrete and faced with Portland stone, opened in 1907. The Royal Liver Building, a purpose-built home for the Royal Liver Friendly Society, was completed in 1911 with 13 floors and was unusually high, but built using the same construction technique. The final element of the Liverpool trinity is the Cunard Building built shortly afterwards in 1916 and which has six storeys (Cunard, 2009).

The story of these developments is not just about buildings but also about the changing economy and growth of modern commerce, stimulated by legislation permitting limited liability companies, and beginning with the establishment of regional banks and insurance companies. This is illustrated by the owners of some of the buildings highlighted above in Manchester and Liverpool. The Refuge Assurance Company was founded in Manchester in 1835 in particular to offer fire insurance to the then ubiquitous cotton mills and warehouses in the surrounding hinterland. The Royal Liver Friendly society was set up in the city in 1850 to provide local people with assistance in the event of losing a wage-earning relative. Their respective headquarter buildings constructed in the first years of the 20th century were demonstrations of their commercial prowess.

The link between the economy and property development is emphasised by New York in the 1920s. The property boom in the city occurred against a backdrop of increasing economic vitality. America recovered relatively quickly from a recession following the First World War, and in 1921 the economy entered a period of prosperity with rising growth, productivity and profits. For the first time, New York became the leading international banking centre in the world as Europe sought to cope with the debts from the war. Domestically too, supported by easy credit, consumers bought more and more household appliances and by the end of the decade most households