RESEARCH

Central London office analysis

Q3 | 2017

OCCUPIER MARKET

Central London take-up for Q3 2017 totalled 2.4 million sq ft across 119 deals, 10% up on the previous quarter.

INVESTMENT MARKET

During Q3 2017, central London investment totalled £4.1 billion across 32 deals, 6% up on the previous quarter and double the corresponding quarter in 2016.

Cover photo : GVA have been appointed by Swiss RE to advise on the refurbishment , marketing and disposal of 85,000 sq ft of Grade A office accommodation at 30 St Mary Axe (EC3)

Occupier market – in brief

Welcome to GVA's central London office analysis; our detailed view of the market in Q3 2017.

Patches and the right matches

In the last quarter, we have seen large deals done by Deutsche Bank, Cancer Research, British Council, Boston Consulting Group and Spotify. These significant deals have ensured that take-up for the year remains robust. This is likely to continue into the final quarter, with ICAP, Lloyds, Mimecast and Nike just a handful of the names that are rumoured to be under offer.

Despite this, there is a feeling that underneath these large deals there is patchiness in demand and there are more examples of requirements being temporarily shelved or businesses erring towards the lower end of their size requirements.

On the majority of smaller buildings, we are seeing relatively thin demand with just one or two interested parties. In cases where there is significant competition, bidding between parties is helping keep headline rents at their current levels, illustrating that in certain markets there are still significant supply shortages.

However, these cases are few and far between, with the volume of deals done at the 'prime' end of the market, quite thin. In fact it seems that despite the differing rental tones of the central London markets, a large proportion of deals are being done at around £65 - £80 per sq ft.

Despite the thin level of demand, we have not seen headline rents fall in most submarkets, but rent free periods have been increasing significantly not just over the last quarter, but over the last year. On a net effective basis, occupiers are getting a substantially better deal than they were this time last year, with net effective rents on average around 13% cheaper than they were in Q3 2016.

Refurb vs prefurb

One very interesting trend of the last few quarters has been the slight erosion of the proposed development pipeline. Buildings such as One Mark Square, 51 Eastcheap and 125 Shaftesbury Avenue, rather than being refurbished/redeveloped in the usual manner, have instead been let to WeWork, who have refurbished themselves.

These buildings, rather than being taken out of the market for two-three years have been turned around quickly and offered to the market. This perhaps highlights the variance in what occupiers need, in terms of a Cat A refurb, and it will be interesting to see if other serviced office providers, or even occupiers follow suit.

Well, well, well....

The last few weeks have been busy at the GVA offices. One of the more interesting events was a Health and Wellbeing breakfast seminar, hosted by Jon Gibson and Anna Scally.

The seminar focussed on the trend of encouraging health and wellbeing into office space and how this is influencing the market. Landsec are an early adopter and recently obtained the WELL Building Standard on their HQ at 80-100 Victoria Street. Elsewhere EQT Partners are applying the standard in their new office at 30 Broadwick Street.

A key message that emerged was that this is being driven by occupiers who are trying to work out how to keep their employees happy and productive, leading to engagement with landlord and project teams, with the aim of improving the environment in which we work.

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> "On a net effective basis, occupiers are getting a substantially better deal than they were this time last year"

Central London

Take-up

Central London take-up for Q3 2017 totalled 2.4 million sq ft, 10% up on the previous quarter, but 4% down on the five-year quarterly average of 2.6 million sq ft. This brings take-up for the first three quarters of the year to 6.7 million sq ft, which is 6% up on the corresponding period last year, where a lot of activity happened in the final quarter of the year.

The City core saw take-up 8% in excess of its five-year quarterly average, with East London fringe also seeing a strong quarter.

The largest deal of the quarter was in the City where Deutsche Bank agreed to take 469,000 sq ft at Land Securities' 21 Moorfields (EC2) on a 25 year lease. In the West End, Boston Consulting Group took 124,000 sq ft on a pre-let at Derwent London's 80 Charlotte Street (W1) and Cancer Research took 130,000 sq ft on a pre-let at S9 in the International Quarter in Stratford (E20).

Second-hand grade A space accounted for the largest proportion of take-up during the quarter, totalling 710,300 (29%). Pre-letting remained relatively robust with pre-construction letting making up 469,000 sq ft (19%), albeit across one deal whilst letting of space under construction made up 569,000 sq ft (23%).

Take-up of new space accounted for 442,100 sq ft (18%). Second-hand grade B space accounted for just 11% of take-up (258,400 sq ft).

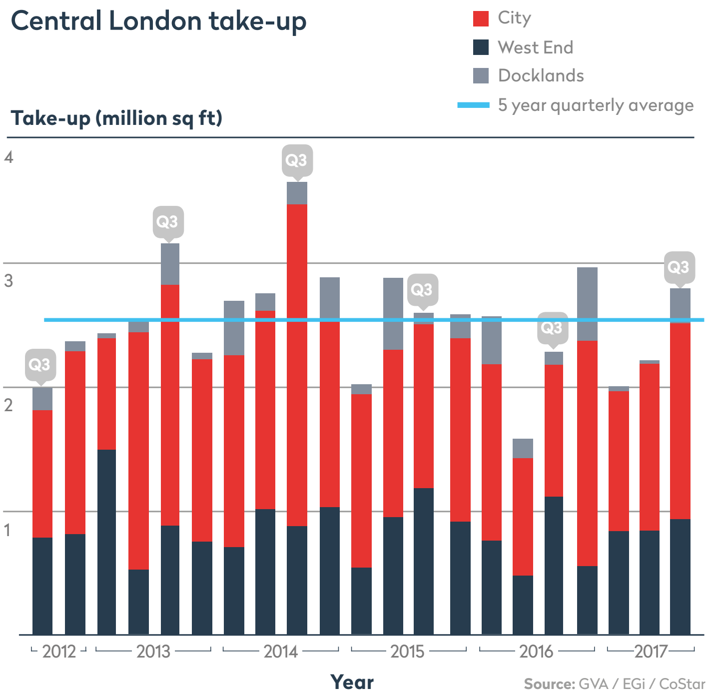
During the quarter, seven deals completed over 50,000 sq ft, with four of these in excess of 100,000 sq ft.

Availability

There is currently 10.4 million sq ft available across central London, increasing from 10.3 million sq ft as of the end of Q2 2017. Since this time last year, the amount of available space has increased by 22% with 1.9 million sq ft more on the market.

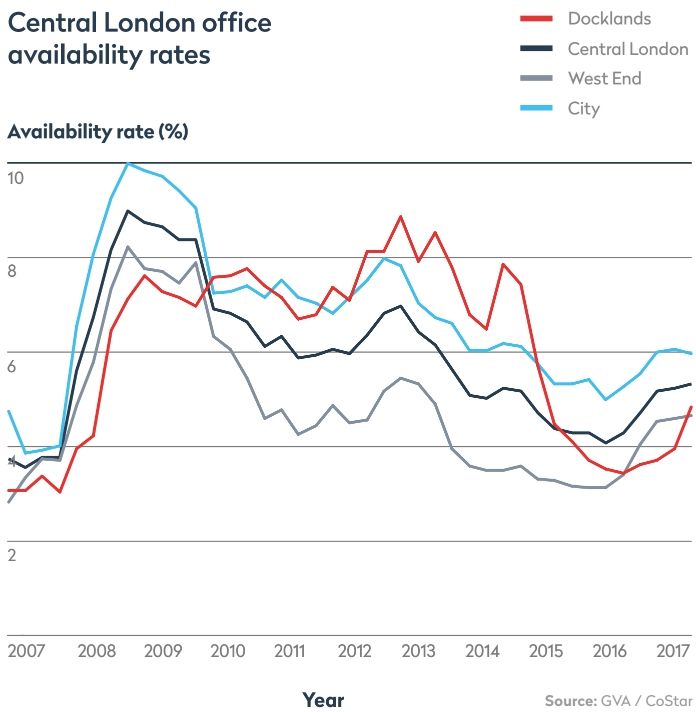
The vacancy rate has increased slightly to 5.4%, the highest it has been since Q1 2014, although it is still not high compared to previous cycles.

Central London take-up



Source: GVA / EGi / CoStar

Central London office availability rates



Source: GVA / CoStar

Development

During the quarter, 18 buildings totalling 2.6 million sq ft completed, including six buildings over 100,000 sq ft. All of these were in the City. Of the total space delivered, just 676,400 sq ft is actually available, meaning that 74% of space was let either pre or immediately after completion.

The largest building to complete was Brookfield's 620,000 sq ft new Amazon headquarters at Principal Place (EC2). Elsewhere, construction also completed at Brookfield and Oxford Properties' 1&2 London Wall Place (EC2), Bloomberg and Stanhope's 1&2 Bloomberg Place and Blackstone's 20 Old Bailey (EC4). In the West End, work completed at AXA's 80,000 sq ft 25 Wilton Road (SW1).

The first three quarters of 2017 have seen 5.1 million sq ft of new space complete, 28% more than in the whole of 2016.

11 buildings totalling 1 million sq ft of development started during the quarter including LaSalle IM and CalSTRS' 323,000 sq ft 60 London Wall (EC2) and the refurbishment of Blackstone's 135 Bishopsgate (EC2). The largest start in the West End was Almacantar's 106,000 sq ft Marble Arch Tower (W1).

There is currently 14.9 million sq ft under construction across central London, with 2 million sq ft (14%) due for completion before the end of 2017 and a further 8 million sq ft (54%) due before the end of 2018. Of the space currently under construction, 4.8 million sq ft (32%) has already been let, leaving 10.1 million sq ft of available space currently being built.

Rental growth

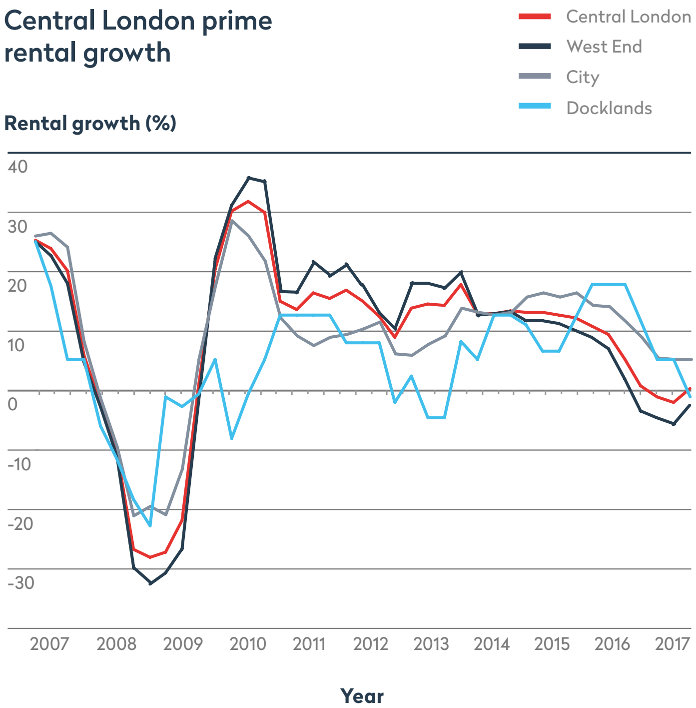
Central London prime rents remained stable during the quarter, after four successive quarters of rental falls. Prime rents were down 4.6% on the year and are now down to the levels seen at the end of 2014.

By and large, prime rents were stable during the quarter, with incentives increasing across almost all submarkets. Canary Wharf prime rents were the most significant faller, decreasing by 5.9%.

Annual development completions

Source: GVA

Central London prime rental growth



Source: GVA

West End

Take-up

Take-up during the quarter reached 826,300 sq ft. This was just 1.7% down on the previous quarter and 4.4% down on the five-year quarterly average of 864,400 sq ft. Take-up for the first three quarters of the year has been very consistent, totalling 2.5 million sq ft, 6% up on the corresponding period last year.

In the West End, Boston Consulting Group took 124,000 sq ft on a pre-let at Derwent London's 80 Charlotte Street (W1). At the Adelphi (WC2), Spotify took 102,000 sq ft across five floors, whilst the largest deal in the core markets of Mayfair & St James's was HSBC pre-letting the entire 37,000 sq ft at 7 Cork Street (W1).

Pre-letting was robust during the quarter, totalling 182,200 sq ft, 22% of activity for the quarter, with take-up of new space an additional 182,000 sq ft. Take-up for second-hand grade A space accounted for 40% of take-up, with grade B space an extra 16%.

Availability

Availability remained stable at 3.9 million sq ft during the quarter, although the vacancy rate jumped up slightly to 4.8%, its highest since Q4 2013. Availability is 34% higher than this time last year, equating to 1 million sq ft more space.

Development

During the third quarter of the year, 283,200 sq ft was delivered across six buildings.

The largest of these was AXA REIM's 25 Wilton Road (SW1). In Mayfair, owner-occupier Aelton's 71,000 sq ft 7 Hanover Square (W1) completed. So far this year, 1.7 million sq ft has been completed.

There were seven starts during the quarter, totalling 220,000 sq ft, the largest of which was Almacantar's 106,000 sq ft Marble Arch Tower (W1).

There is currently 3 million sq ft of development activity in the West End.

Rental growth

The third quarter of the year saw rents remain stable across the West End, and 7.1% down on the same time last year. The West End has now not seen positive rental growth since Q4 2015.

In Mayfair and St James's, prime rents were stable at £105 per sq ft with rent free periods increasing from 22 to 24 months. Net effective rents are now £84 per sq ft, the lowest since Q1 2013 and 14% cheaper than the corresponding period last year. Super-prime headline rents are £125 per sq ft, with rent free periods stable at 18 months.

KEY STATS THIS QUARTER

826,300 sq ft let

4.4% down on 5-year quarterly average

4.8% vacancy rate

3 m sq ft under construction

£105 per sq ft prime rent

-7.1% annual rental growth

City

Take-up

Take-up during Q1 2017 totalled 1.4 million sq ft, which was 1.3% up on the previous quarter, but 7.5% down on the five-year quarterly average. Take-up for the first three quarters of 2017 was 3.9 million sq ft, which was 12% up on the same time last year. As a point of interest, the final quarter of 2016 saw a lot of activity, with 1.8 million sq ft transacted.

The largest deal of the quarter was in the City where Deutsche Bank agreed to take 469,000 sq ft at Land Securities' 21 Moorfields (EC2) on a 25 year lease. On the Southbank, Mitie Group took 30,000 sq ft across the 12th floor of the Shard (SE1), , which is now fully let, whilst at CPIB's Aldgate House (E1), the 1st and 2nd floors were let to Transperfect Translations and Taboola Europe who took 28,000 sq ft and 26,000 sq ft respectively.

Pre-letting for the quarter accounted for 53% of activity and totalled 613,400 sq ft, the largest quarterly volume since Q3 2014. New space made up an additional 260,000 sq ft of take-up (19%), with take-up of second-hand space accounting for 36% of activity for the quarter (505,100 sq ft).

Availability

Availability in the City decreased slightly from 5.7 million sq ft to 5.6 million sq ft, with the vacancy rate coming down from 6.1% to 6%. Availability is 13% up on the corresponding period in 2016, equating to just over 630,000 sq ft of additional space. Interestingly, over the same time period, the City has seen 3.9 million sq ft of new space complete.

Development

During the quarter 2.3 million sq ft completed across 12 buildings, with the largest being Amazon's new HQ at Principal Place (EC2). Elsewhere, 630,000 sq ft completed across the two buildings at Bloomberg Place (EC4), with 490,000 sq ft also completing across Brookfield and Oxford Properties' 1&2 London Wall Place (EC2). Other notable buildings to complete during the quarter include 85,000 sq ft at Morgan Capital Partners' 45 Cannon Street (EC4) and 70,000 sq ft at Beltane's 24 King William Street (EC4).

Construction started on 780,000 sq ft across four buildings during the quarter. All of these were refurbishments, including British Land's 330,000 sq ft 135 Bishopsgate (EC2), where TP ICAP are under offer on 120,000 sq ft and elsewhere work started at LaSalle IM and CalSTRS' 323,000 sq ft 60 London Wall (EC2).

There is now 10.6 million sq ft under construction, of which just 6.6 million sq ft is available (62%).

Rental growth

Prime rents in the City remained stable for a fifth successive quarter, with rental levels therefore in line with this time last year.

Prime rents remained stable across almost all submarkets during the quarter, with Shoreditch and West City the only submarkets to see the froth come off. Whilst headline rents held up, incentives increased across all submarkets, with 24 months now expected on a ten year lease. On a net effective basis, prime rents are now cheaper than they were this time last year in all submarkets, with Shoreditch and Clerkenwell seeing the largest decrease.

Prime headline rents in the City core remain at £70 per sq ft, where they have been since Q1 2016, with rent free periods now at 24 months. Net effective rents in the City core are now at £56.00 per sq ft, their lowest since Q3 2015.

KEY STATS THIS QUARTER

1.4 m sq ft let

7.5% down on 5-year quarterly average

6% vacancy rate

10.6 m sq ft under construction

£70 per sq ft prime rent

0% annual rental growth

East London

Take-up

There was virtually no activity in Canary Wharf during the quarter, with all of the activity in East London occurring off the Wharf.

Take-up totalled 244,100 sq ft, with the majority occurring in Stratford where Cancer Research took 127,000 sq ft at S9, International Quarter (E20) and the British Council took 85,000 sq ft in the same building. At Here East, Ladbrokes Coral saw a 'safe bet' and acquired 26,000 sq ft, whilst the only other deal in the market was at Republic where Threepipe Communications took 5,746 sq ft.

All take-up was of newly completed space.

Availability

Available space during the quarter increased from 795,000 sq ft to 958,000 sq ft, equating to a jump in vacancy rate from 4.1% to 4.9%. The majority of space is still available on a sublet basis, and there seems to be a large supply of 'grey' space, with tenants quite flexible on how much space they have readily available.

Available space is 38% higher than this time last year and at its highest since Q4 2015.

Development

In Canary Wharf, there is 695,000 sq ft under construction at 1 Bank Street (E14), due to complete in 2019, whilst at The Cabot (E14), Hines are currently refurbishing 455,000 sq ft.

At Canary Wharf's new district, the first two office developments (D1 and B3) are due to complete in 2018, delivering a combined total of 192,000 sq ft.

In Stratford, the recently completed S6 (E20) is fully let to TfL, with the next major completion due in Q2 2018, at S5 (E20) which is partly let to the FCA.

Rental growth

In Canary Wharf, prime rents decreased from £42.50 per sq ft to £40 per sq ft with rent free periods increasing from 22 to 24 months.

Outside the Wharf, prime rents remain at £32.50 per sq ft with rent free periods at 24 months, whilst in Stratford prime rents are now at £45.00 per sq ft, with 24 months rent free.

KEY STATS THIS QUARTER

244,100 sq ft let

15% up on 5-year quarterly average

4.9% vacancy rate

1.3 m sq ft under construction

£45 per sq ft prime rent

Midtown

Take-up

Take-up in Midtown during Q3 2017 was robust, totalling 395,900 sq ft which was 65% up on the previous quarter and 9% up on the five-year quarterly average. Despite a relatively weak Q2, the first three quarters of 2017 have totalled 1.2 million sq ft – 55% up on the same period last year.

The largest deal of the quarter was at 20 Old Bailey (EC4) where Metero Bank took 65,000 sq ft. Elsewhere, UCL signed for 45,000 sq ft at 90 High Holborn (WC1) on a sublease from Olswang.

Pre-letting was strong during the quarter, accounting for 144,400 sq ft of take-up, and 36% of activity for the quarter. Take-up of new space accounted for an additional 35,100 sq ft (9%). Second-hand grade A space totalled 163,500 sq ft(41% of all take-up), with grade B space 13% (53,000 sq ft).

Availability

During the quarter, availability in Midtown decreased slightly to 1.6 million sq ft, with the vacancy rate also coming in to 4%.

Development

During the quarter, the only building to complete was Blackstone's 235,000 sq ft 20 Old Bailey (EC4).

The only new start during Q3 was South Yorkshire Pension Fund's 42,000 sq ft refurbishment of 262 High Holborn (WC1), which is due to complete during the middle of 2018.

There is currently 2.1 million sq ft under construction across Midtown.

Rental growth

Prime rents across Midtown submarkets generally remained stable during the quarter, although West City saw a slight fall in prime rents from £70 per sq ft to £67.50 per sq ft. This change means that Midtown prime rents are 1% down on the same time last year. Prime rents in Bloomsbury remain at £75 per sq ft.

KEY STATS THIS QUARTER

395,900 sq ft let

9% up on 5-year quarterly average

4% vacancy rate

2.1 m sq ft under construction

£75 per sq ft prime rent

GVA have advised on the sale of both 41 & 43 Chalton Street (NW1) on behalf of a private investor.

Investment market – in brief

The central London investment market has continued relatively 'unchecked' through the first three quarters of 2017, albeit the headline statistics are supported by fewer and much larger transactions. This is particularly the case in the West End where multiple £100 million plus transactions have taken place, including most recently the £152 million sale of 10 Grosvenor Street.

This activity and appetite for 'income' continues, despite a 'softer' occupational market and continuing uncertainty surrounding the UK's exit from the EU and various political 'wobbles'.

The real difference going into the final quarter of the year is that much more stock is either being 'prepped' or is already openly on the market. Estimates of City investment stock on the market vary between £6 billion and £10 billion and include landmark buildings such as Ashby's £320 million 200 Aldersgate sale, 25 Gresham Street (£142m) and reportedly The Gherkin (£700m).

The West End is a different story in that lot sizes are much smaller, with many buildings being offered with vacant possession, hoping to attract the cash rich owner-occupier market. There are however a few key investment opportunities in the market such as 28 St George Street, which is anticipated to sell at or around its 2.5% asking price and larger development opportunities such as the Triangle site in Paddington, TfL's Kingsbourne House above Holborn Underground station and Blackrock's 5 Strand that are expected to attract serious interest, albeit with a degree of caution.

Generally there is a feeling that pricing in central London does not truly reflect the current economic climate and the issues surrounding Brexit, and that investments 'higher up the risk curve' are going to need an adjustment in pricing in order to attract 'value add' buyers. It remains to be seen how much of today's stock remains unsold towards year-end and whether or not vendors are prepared to reduce pricing in order to secure a sale.

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> The real difference is that much more stock is either being 'prepped' or is already openly on the market.

Investment commentary

Transaction volumes

During Q3 2017, central London investment totalled £4.1 billion across 32 deals, 6% up on the previous quarter, 3% up on the five-year quarterly average and double the corresponding quarter in 2016, which of course had been affected by the result of the EU referendum.

Nevertheless, investment volumes for 2017 so far are just 10% down on those registered during the whole of 2016. This, despite there being 45% less deals.

The West End saw £1.7 billion transacted, 2% down on the previous quarter and in line with the five-year quarterly average, despite being 31% up on the corresponding period last year. During the quarter, Angela Leong bought Aldwych House (WC2) for £250 million, representing a yield of 4.5%. The largest deal in the core was AFIAA Investments' £58.25 million purchase of Schomberg House (SW1). Elsewhere, R&F Properties and CC Land paid St Modwen and Vinci £470 million for the Nine Elms Square (SW8) mixed use development site, which had previously been under offer to Dalian Wanda.

In the City, £2.4 billion was transacted across 11 deals during the quarter, 32% up on the previous quarter. Investment for Q3 was 17% up on the five-year quarterly average but 222% up on the corresponding quarter last year.

Half of the investment for the quarter was accounted for by one deal when Infinitus Property Investment paid Landsec and Canary Wharf Group £1.285 billion for 20 Fenchurch Street (EC3), representing a yield of 3.4%. The second largest deal was at Lacon House, where a private Middle Eastern Investor paid Blackstone £470 million for the recently completed development, representing a yield of 4.5%.

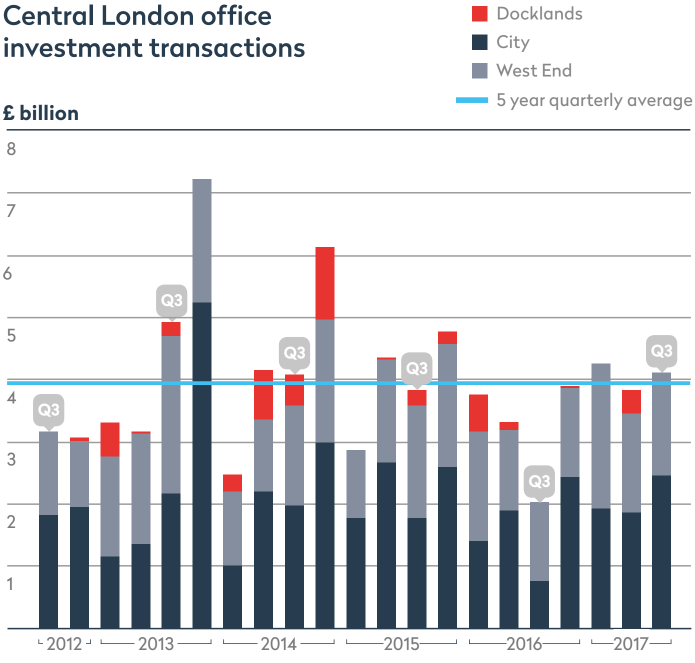
This quarter overseas money accounted for £3.5 billion (86% of total investment). UK property companies accounted for £396 million of investment for Q3 2017 (10%), whilst UK institutional investors were responsible for just 2% of total investment for the quarter (£72 million).

During the quarter, there were ten purchases of over £100 million, with five of these in excess of £200 million, and one being the largest single asset deal ever to transact in the UK at £.1285 billion.

Yields

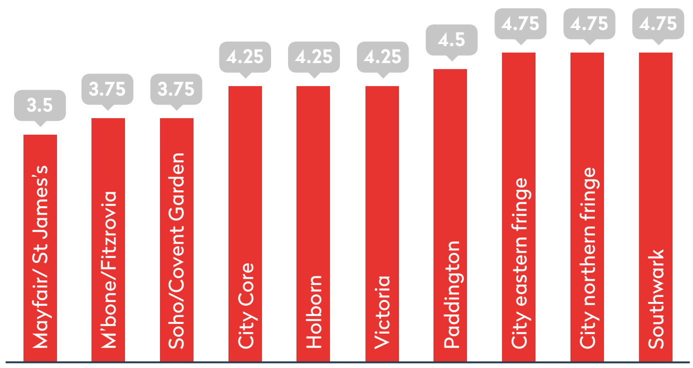
Q3 2017 saw yields remain stable in all our submarkets. Prime yields in Mayfair and St James's remain at 3.5%, with City core at 4.25%.

Central London office investment transactions



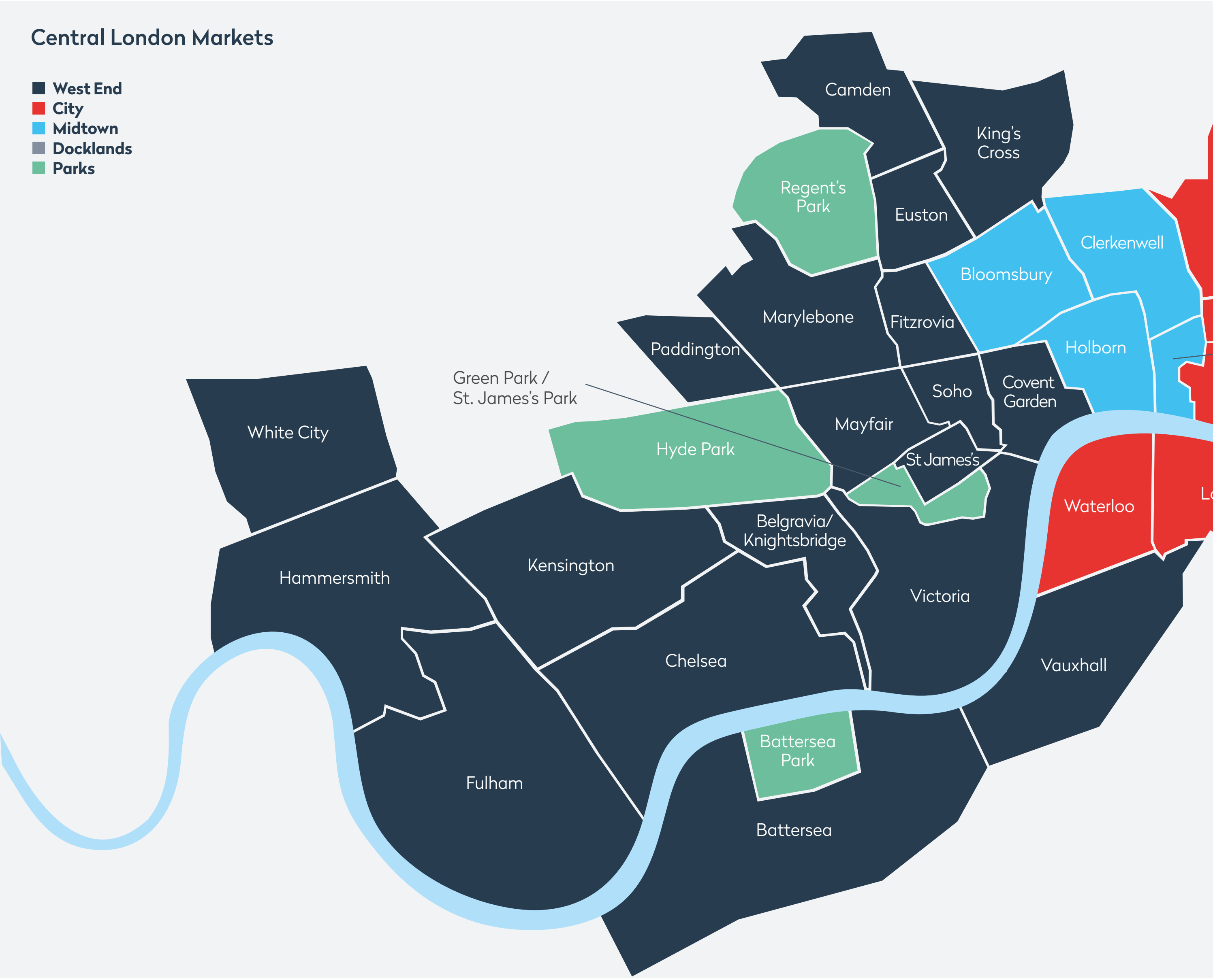
Source: GVA / PropertyData

Central London prime office yields

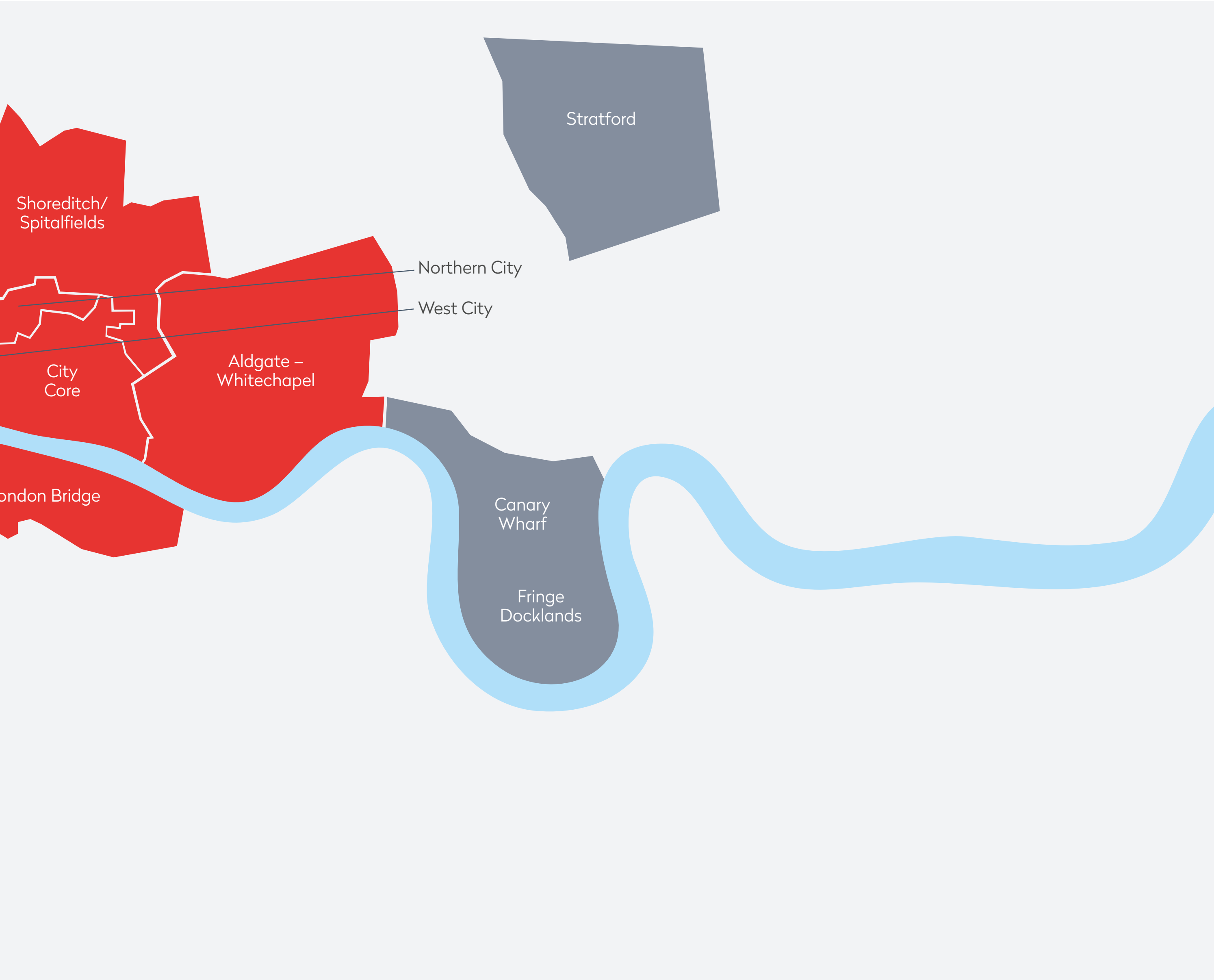


Source: GVA

GVA are disposing of 11,625 sq ft on the 22nd floor of Salesforce Tower (EC2).



West End	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
Battersea	£60.00	24	£15.25	£75.25
Belgravia / Knightsbridge	£90.00	24	£39.50	£129.50
Camden	£55.00	24	£26.75	£81.75
Chelsea	£90.00	20	£37.00	£127.00
Covent Garden	£85.00	24	£30.00	£115.00
Euston	£75.00	24	£27.75	£102.75
Fitzrovia	£77.50	24	£33.75	£111.25
Fulham	£45.00	22	£20.00	£65.00
Hammersmith	£50.00	20	£21.00	£71.00
Kensington	£60.00	20	£44.00	£104.00
King's Cross	£80.00	22	£31.50	£111.50
Mayfair	£105.00	24	£48.75	£153.75
Mayfair/St James's "super-prime"	£125.00	18	£51.00	£176.00
Marylebone	£80.00	24	£39.50	£119.50
Paddington	£70.00	24	£26.75	£96.75
Soho	£90.00	24	£41.50	£131.50
St James's	£105.00	24	£46.50	£151.50
Vauxhall, Nine Elms, Battersea	£57.50	24	£15.25	£72.75
Victoria	£77.50	24	£33.50	£111.00
White City	£52.50	24	£8.50	£61.00



City	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
City Core	£70.00	24	£25.75	£95.75
Aldgate/Whitechapel	£57.50	24	£20.00	£77.50
EC3	£65.00	24	£26.50	£91.50
London Bridge	£62.50	24	£26.00	£88.50
Northern City	£65.00	24	£19.75	£84.75
Shoreditch/Spitalfields	£65.00	24	£18.00	£83.00
Waterloo	£65.00	21	£22.75	£87.75

Midtown	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
Bloomsbury	£75.00	24	£30.25	£105.25
Clerkenwell	£67.50	24	£23.25	£90.75
Holborn	£65.00	24	£27.75	£92.75
West City	£67.50	24	£25.75	£93.25

East London	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
Canary Wharf	£40.00	24	£12.75	£52.75
Other Docklands	£32.50	24	£10.00	£42.50
Stratford	£45.00	24	£8.50	£53.50

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