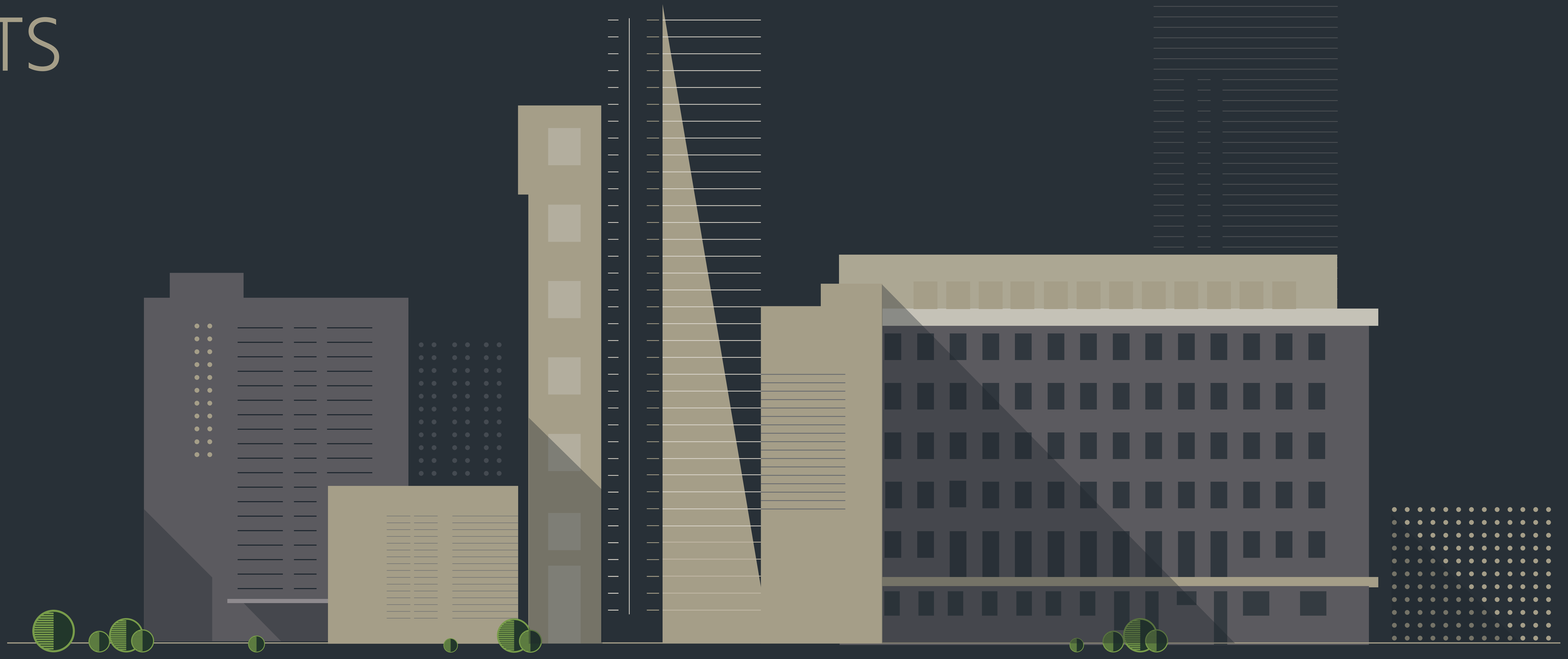
LONDON MARKETS

London office property performance and key themes

November 2021



Read more

LONDON OFFICE MARKET SUMMARY Q3 2021

Occupier take-up increased 30% to 2.8m sq ft in Q3, driven by a small number of large commitments by key London occupiers and on space currently in the development pipeline. It was the highest level of occupier activity since before the pandemic and only 7% below the 5-year quarterly average.

Occupiers have a better understanding of the real estate implications of hybrid working policies and many are now beginning to implement their strategies. As such, the recovery in leasing activity over 2021 has been stronger than anticipated, particularly for higher quality space.

Overall central London availability increased from 9.4% to 9.6% in Q3. This small overall increase masks quite wide variances across individual sub-markets. Strong occupier activity in Q3 in sub-markets such as Mayfair and St James's, Fitzrovia and Southbank has driven down availability. Other submarkets, such as Farringdon & Clerkenwell and Canary Wharf remain at historic peaks.

Prime rents fell 4% in Shoreditch and 5% in Canary Wharf in Q3 following weak demand and persistently high availability. Evidence in Fitzrovia however points to an increase in Grade A rent to £89.50 sq ft in Q3. The London office rental market is polarised, with intensifying occupier demand for best-in-class space and a general softening of demand for secondary space. Particularly so for assets with weak environmental credentials and limited amenity provision.

Construction costs are rising well ahead of previous expectations on the back of the continued global supply chain disruption and consequent cost-push inflation as well as labour market shortages. General build costs are estimated to be up by 10.3% in the year to October, which is 3.2%-pts higher than envisaged only a quarter ago. This will put further cost pressure on landlords undertaking refurbishment or redevelopment activities.

Investment activity rose again to £3.2bn in Q3, up from £2.8bn in Q2. This was dominated by overseas investment with a clear preference for best-in-class assets, long leases and diversified tenants. Increased global competition for the finite pool of prime London assets points to some yield compression in Q4.

2.8 m sq ft ▲ Take-up, Q3 2021	9.6% ▲ Availability rate, Q3 2021
10% ▲ Annual build cost growth, Oct 2021	£3.3bn ▲ Investment volume, Q3 2021

THE LONDON ECONOMY

GROSS VALUE ADDED (GVA)

	2020	2021	2022
London	-9.3%	6.5%	7.1%
UK excl. London	-10.1%	7.5%	6.6%

ILO UNEMPLOYMENT RATE

	2020	2021	2022
London	5.7%	6.0%	5.7%

LONDON WORKPLACE-BASED EMPLOYMENT GROWTH

	2020	2021	2022
Office	-1.4%	0.1%	2.4%
Non-office	-1.9%	-0.2%	2.7%

Source: Oxford Economics

LONDON FLASH INDICATORS PMI SEPTEMBER 2021

55.9 ▼
Business Activity Index
Down fractionally from 56.0 in August.

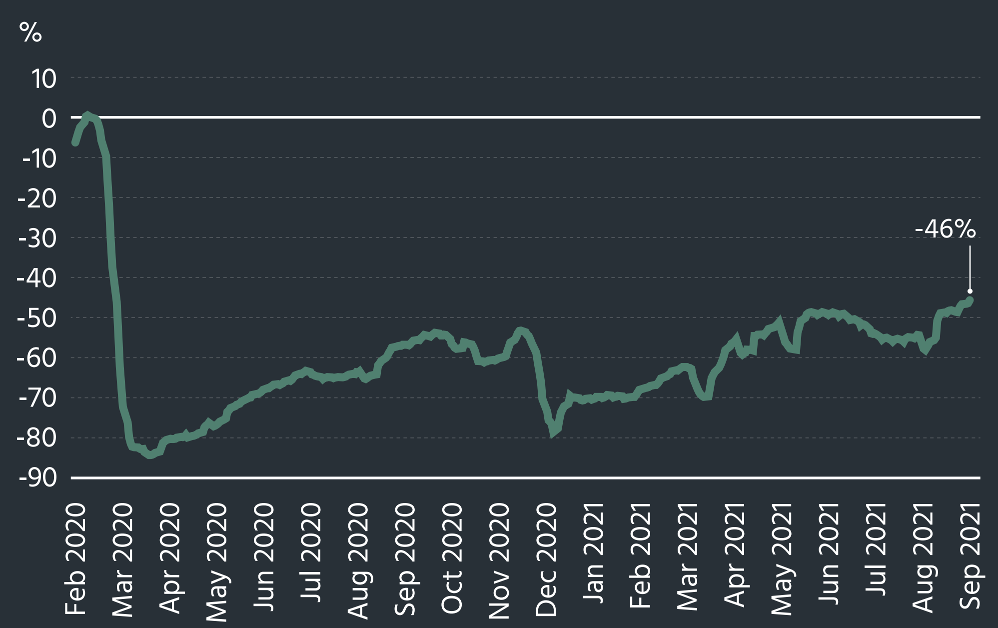
54.9 ▼
New Business Index
An uplift in new business, but labour shortages and supply issues are a drag.

78.7 ▲
Future Activity Index
A second monthly increase. Around two-thirds of businesses expect increased new orders.

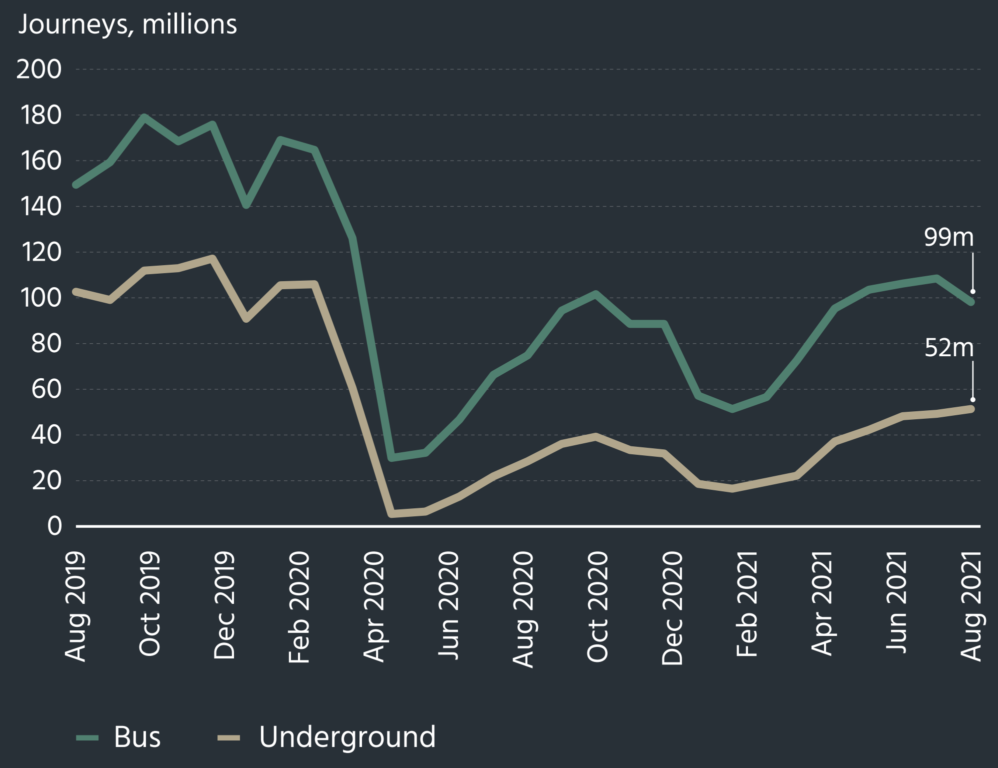
60.6 ▲
Employment Index
Firms continue to hire more staff as confidence and workloads increase post-Covid. However, many are citing difficulties in securing the right candidates amid recent labour shortages.

Source: IHS Markit (figures below 50 signify contraction)

Central London, visits to workplace, difference from pre-pandemic baseline
Sources: Google Mobility Data, Gerald Eve



TfL Journeys by type of transport
Source: Transport for London

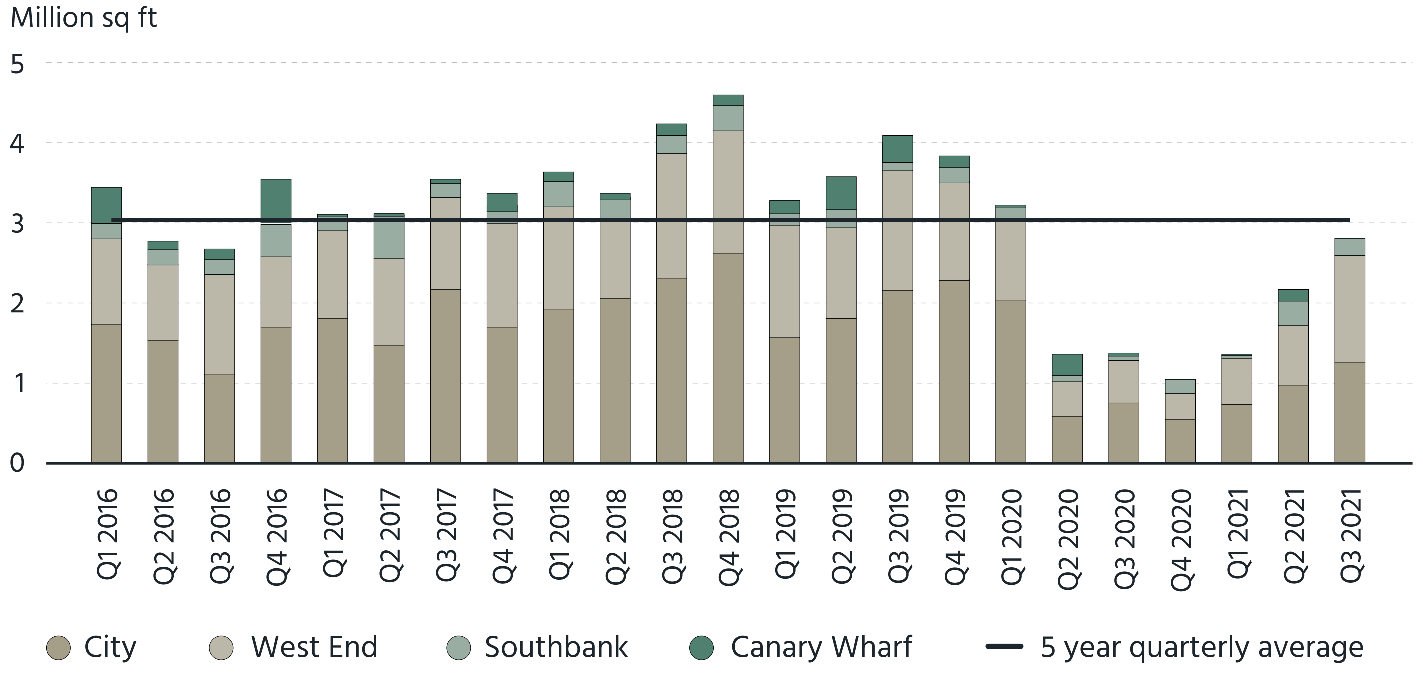


Google mobility data show an ongoing increase of visits to the workplace. Many firms used September as a soft deadline for employees to return to the office. As at 30th September, visits were 46% below the pre-pandemic baseline, the highest level since the beginning of 2020.

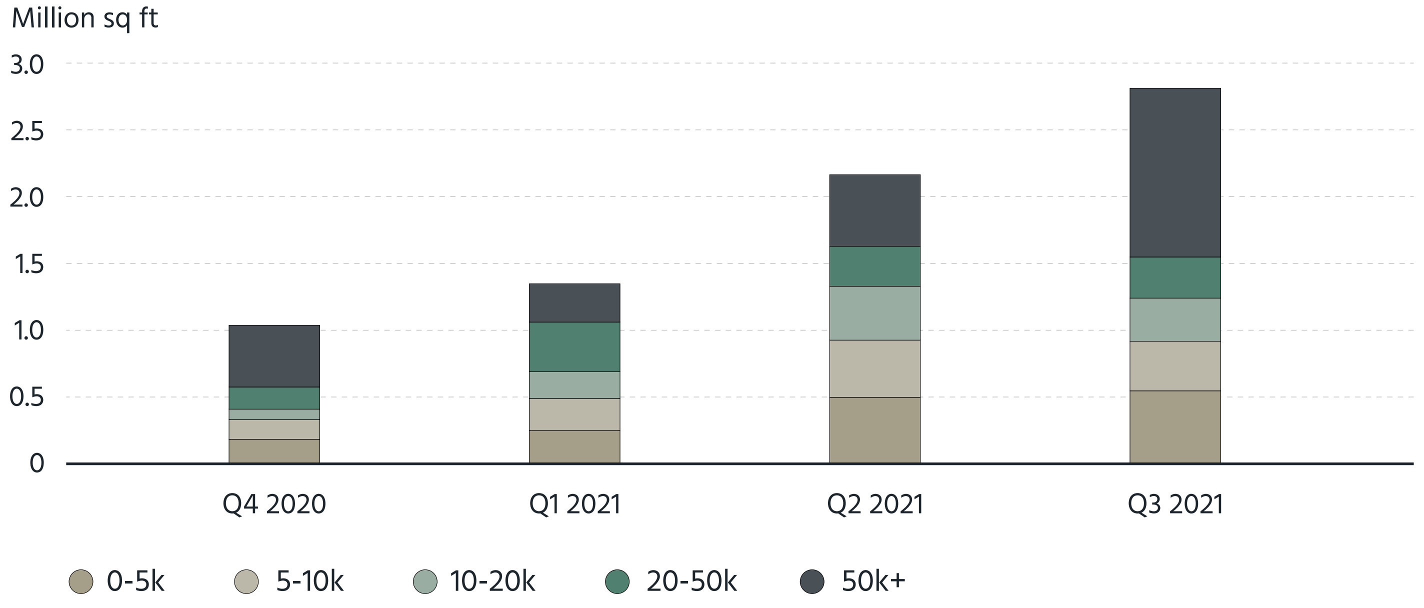
TfL data show the use of underground public transport continued to trend upwards in Q3. Around 52m journeys were made in August, more than double the amount during the third lockdown. Bus journeys reached a new peak of 109m in July but fell marginally in August. However, historically there is usually a short seasonal fall for bus journeys in August given the summer holiday period.

DEMAND

London office quarterly take-up by broad market
Source: Gerald Eve



Take-up by size band, last 4-quarters
Source: Gerald Eve



Occupier take-up was 2.8m sq ft in Q3 and mainly comprised of a small number of large commitments by key London occupiers. It was the highest level of occupier activity since before the pandemic and only 7% below the 5-year quarterly average. The recovery in leasing activity over 2021 has been stronger than anticipated, particularly for higher quality space. The West End and the City were the most active submarkets in Q3, with 1.3m sq ft and 1.2m sq ft of take-up, respectively.

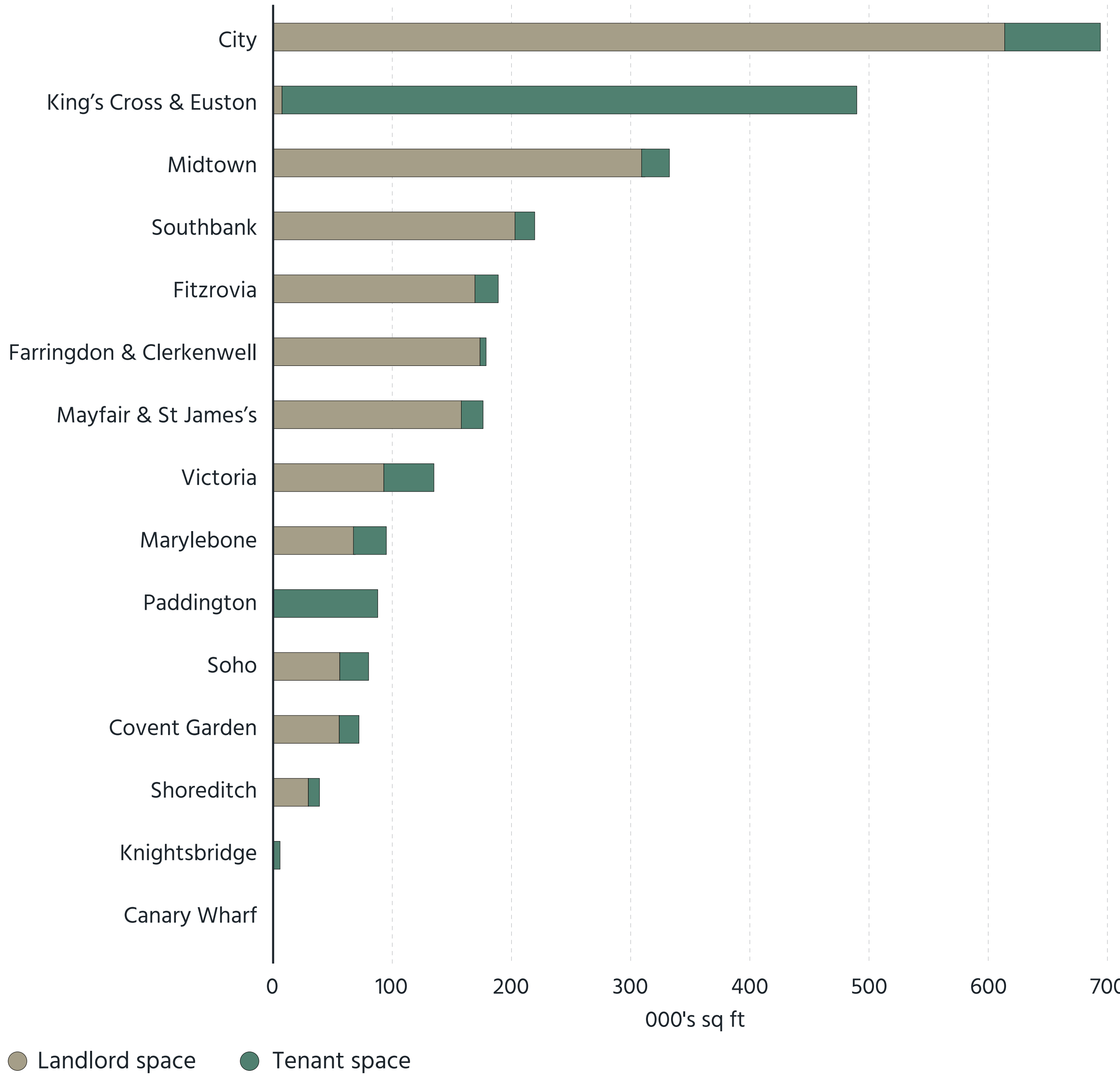
Leasing data in Q3 show that large occupiers are now enacting business plans to secure space for post-Covid working practices. This quarter, there were 10 lettings over 50,000 sq ft in size totalling around 1.3m sq ft – 45% of all activity and one of the highest proportions on record. The top five lettings were for space currently under construction or refurbishment, within a 15-min walk of two mainline train stations and close to leisure amenities.


Source: www.m3c.co.uk

Continue reading

OFFICE OCCUPIER DEMAND

Take-up by submarket and lease type, Q3 2021
Source: Gerald Eve

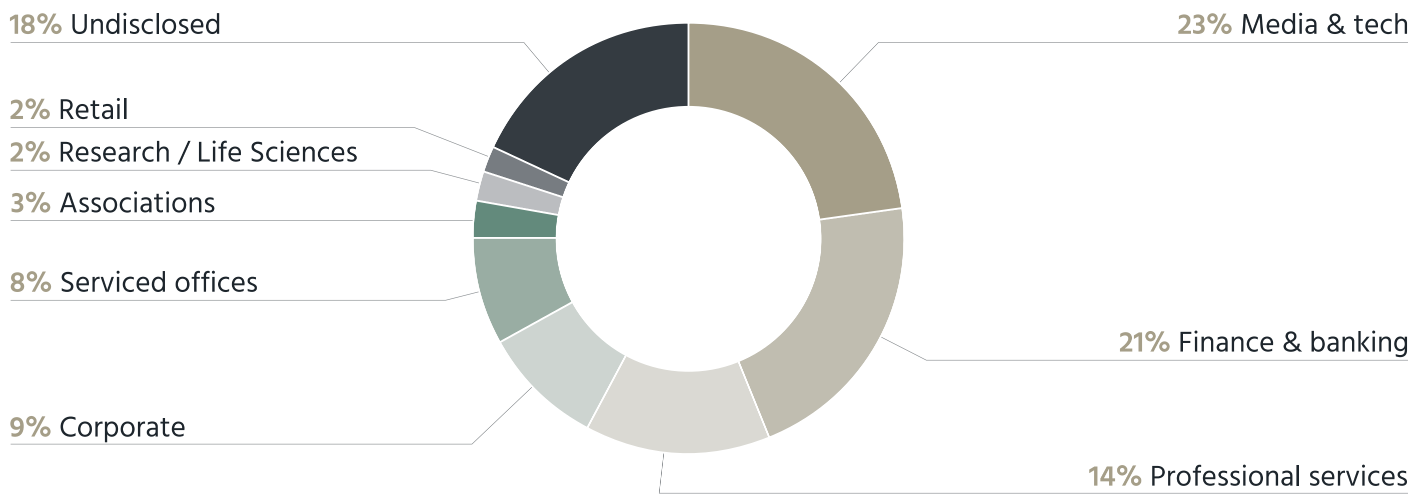


The take-up of tenant-controlled space (including sub-lets and assignments) has been a feature of 2021 and this segment accounted for 31% of all activity in Q3. This is more than twice the 15% 5-year quarterly average. This was particularly evident on new stock in King's Cross & Euston in Q3, as nearly 0.5m sq ft of tenant-controlled space was taken-up across two lettings. Facebook took an assignment of a pre-let at 1 Triton Square, as did The Office Group at King's Cross Central development.

Such activity is linked to the evolution of post-pandemic occupier strategies. More tenant space has been released back to the market as occupiers reassessed office space requirements, and, so far, the best quality tenant-controlled space has attracted occupiers.

The media and tech sector made up almost a quarter of all occupier activity in Q3. The total volume taken by the sector amounted to 622,000 sq ft, driven by 380,000 sq ft of lettings in the West End. Southbank was an attractive market for the sector too, with almost 130,000 sq ft taken overall. Subsectors such as studio, film production and design accounted for a fifth of activity within the sector. Professional services and finance and banking occupiers were most active in the City, with 319,000 sq ft and 312,000 sq ft of lettings respectively.

Take-up by business sector, Q3 2021
Source: Gerald Eve

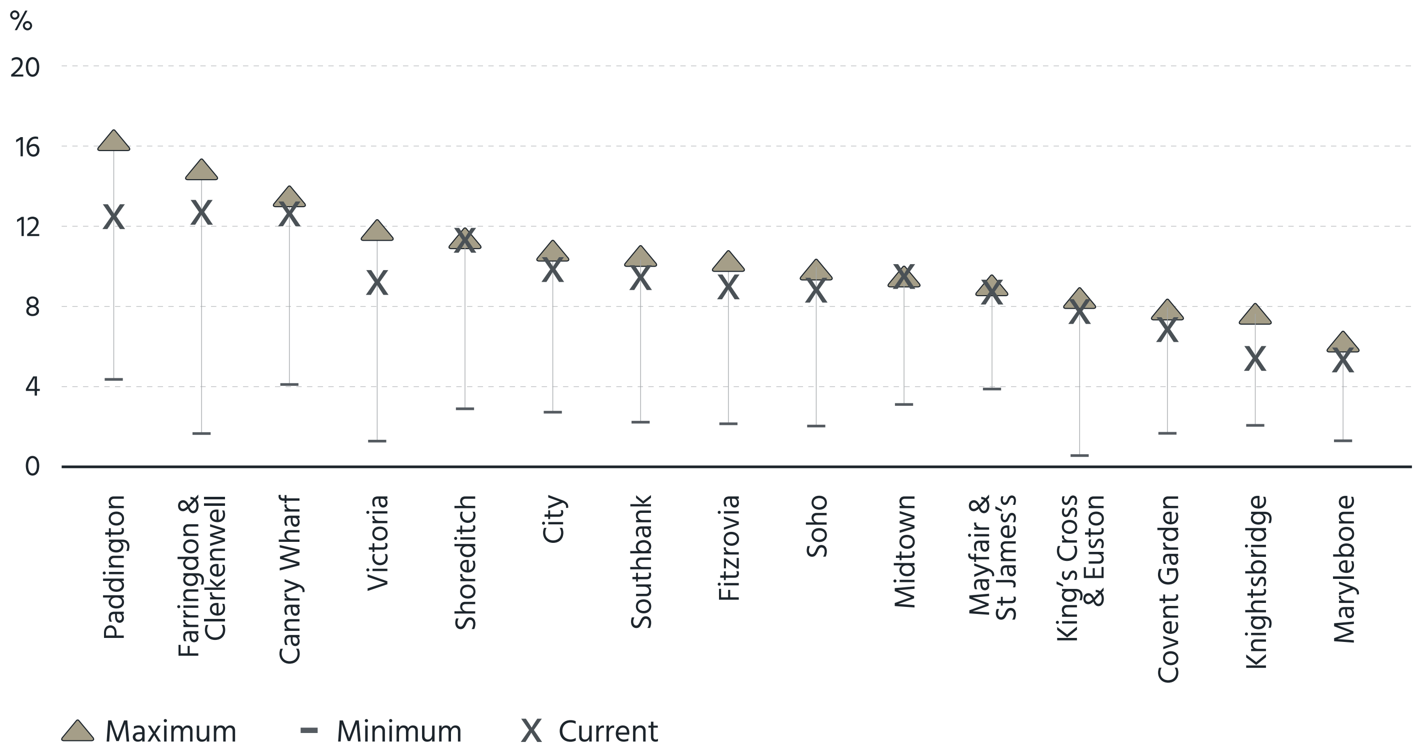


By the end of September, visits to the workplace had risen to their highest point since before the pandemic following 'back to school' initiatives from many employers. As businesses and staff find a new working rhythm, and competition for the best talent intensifies, the office has an important role to play, with our data suggesting that companies are acting decisively to secure high-quality space that fits with their business strategies.

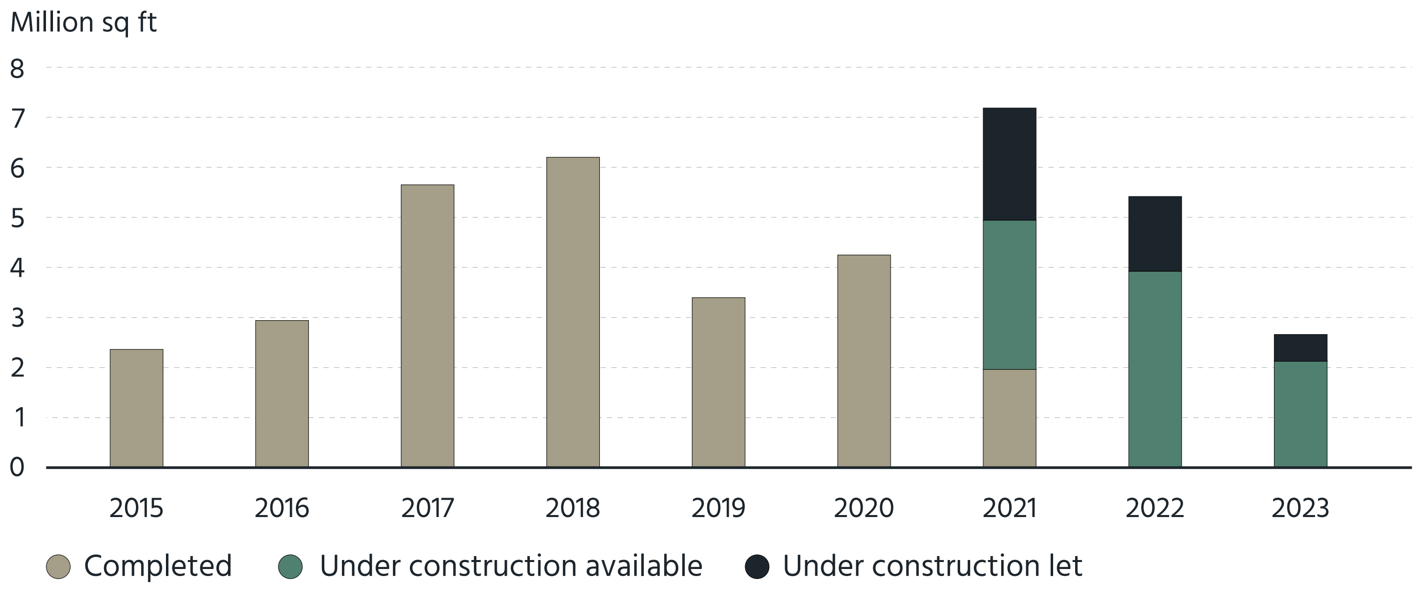
Rhodri Phillips, Partner

AVAILABILITY & SUPPLY

Availability ranges by submarket, Q1 2013 – Q3 2021
Source: Gerald Eve



London office development pipeline
Source: Gerald Eve



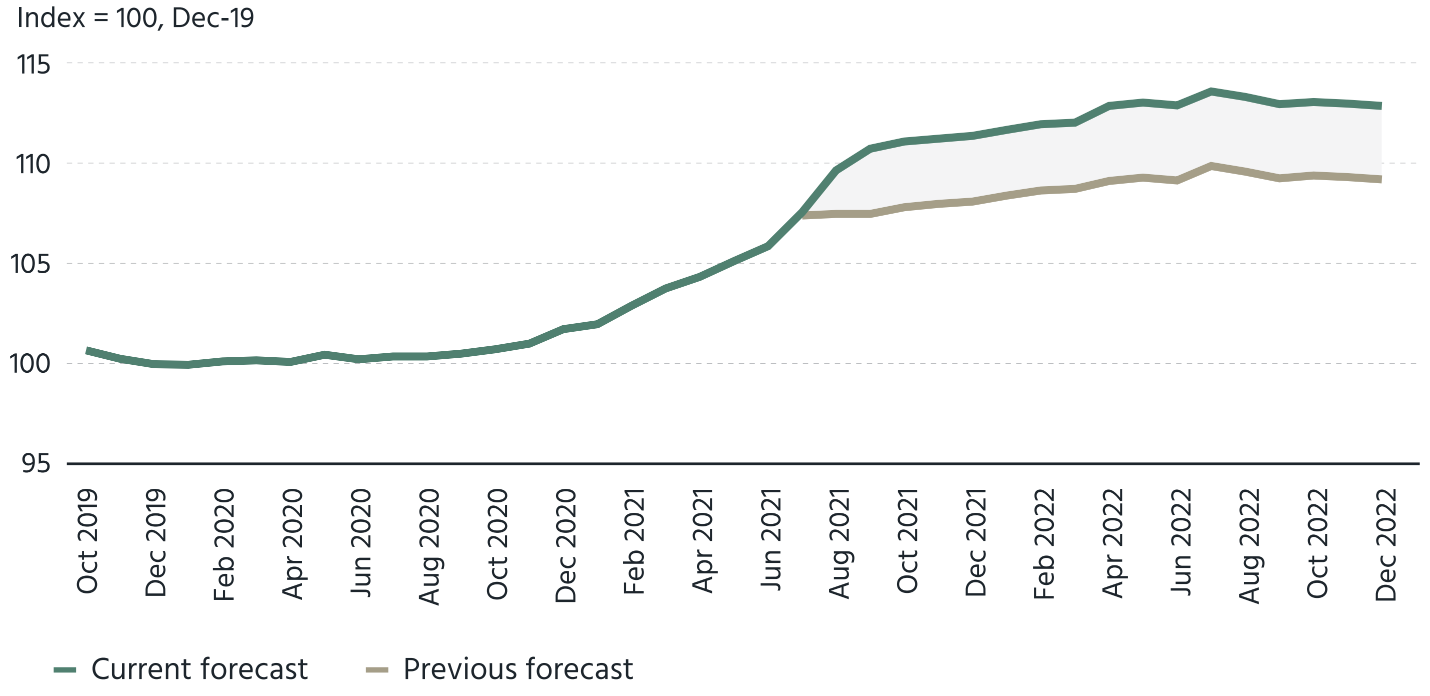
The overall availability rate in London marginally increased by 0.2%-pts to 9.6% in Q3. However, this small overall increase masks quite wide variances across individual sub-markets. Strong occupier activity in Q3 in sub-markets such as Mayfair and St James's, Fitzrovia and Southbank has driven down availability. Other submarkets, such as Farringdon & Clerkenwell and Canary Wharf remain at historic peaks. Tenant-controlled space remains a significant part of the market, although the proportion of sub-let space fell to 23% of all availability, down from 25% in Q2.

A total of 570,000 sq ft of office space completed development in Q3 across four schemes, bringing total completions to just under 2m sq ft in 2021. Of the space under construction due to complete this year, 2.2m sq ft (43%) has already been pre-let and 3.0m sq ft is available. However, there are acute labour and materials shortages in the construction sector. This is likely to increase overall build costs and prolong construction timelines, pushing some 2021 deliveries into early-to-mid 2022. The phasing of the pipeline and the potential impact this will have on prime rents next year will be one to watch.

Inflationary pressures have continued to build in the UK economy over the last few months, particularly so in the construction industry. The development market is facing notable price increases in materials, driven by two main factors. Improving demand as the economy opens after the pandemic, and fragmented global supply chains. Materials shortages are made worse by competing demand from large scale infrastructure projects such as Crossrail and HS2 as well.

Economically speaking, there is both demand-pull and cost-push inflation at play. This has caused an upward revision in the general build cost index compared with July. On average, costs are expected to be 3.2% above the original estimation in Q2 over the next year, with annual growth of 10% expected in November. This will put further cost pressure on those landlords who plan to undertake refurbishment or redevelopment activities to cater for elevated demand for the best quality space.

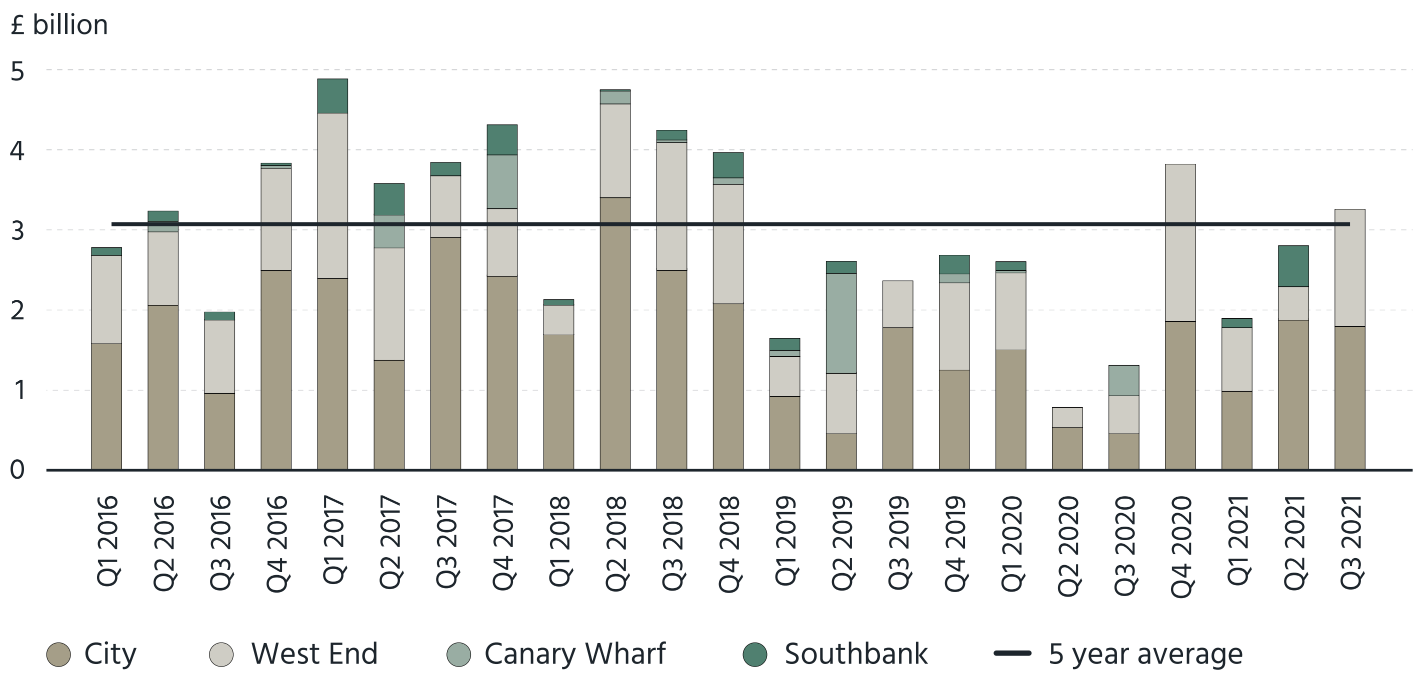
BCIS general building cost index
Source: BCIS



LONDON OFFICE RENT MAP

INVESTMENT

Quarterly investment volume by market
Sources: Gerald Eve, Property Data



The volume of investment in Q3 was almost £3.3bn, up by 16% on Q2 and the second consecutive quarter of improvement. Most of the activity was focused on the City, with £1.8bn of acquisitions across 17 properties. This was followed closely by the £1.5bn transacted in the West End across 24 properties. Investments in Q3 reflected the lowest weighted average transacted yield (3.8%) recorded over the last three years. This is due both to improving investor sentiment and a clear preference for best-in-class stock with long leases and diversified tenants. Derwent's acquisition of the UCLH HQ at 250 Euston Road for a 2.5% yield, with nearly 20 years of income is a case in point.

Overseas investors were the most active buyer group in Q3, making £2.4bn of acquisitions, compared with £1.9bn of sales. These volumes accounted for 72% and 58% of the overall buy/sell market respectively. By domicile, North American investors were again the largest overseas group, accounting for £734.5m of acquisitions, driven by four £100m+ purchases of large HQ-style offices in the City.

European investors were also active with £649m of acquisitions – just over a quarter of all activity. Assicurazioni Generali's purchase of 160 Queen Victoria Street in the City for £450m drove the overall volume, bolstered by smaller lot size purchases in the West End. Uncharacteristically, Far Eastern investors were net sellers in Q3, disposing of £767m, with five out of six transactions on lot sizes over £50m.

UK property companies were active sellers in Q3, disposing of £778m of assets, but were also active on the buy-side, especially in the core West End. Derwent made two direct purchases totalling £215m from Lazari Investments as the two companies committed to a joint venture. The JV involves commitment to purchase three assets in Marylebone.
The redevelopment of 38 Baker Street is the first of these commitments as Derwent purchased a 50% stake. With Derwent committed to extending their development pipeline and pursuing life sciences opportunities, the focus will be on the medium term provision of best-in-class sustainable offices in core locations.

CENTRAL LONDON OFFICE CAPITAL FLOWS, Q3 2021
Source: Gerald Eve, Property Data

INVESTMENT VOLUME BY INVESTOR SUB-DOMICILE

£734.5m	£649.1m	£431.0m	£390.0m	£209.1m
NORTH AMERICAN	EUROPEAN	MIDDLE EAST	GERMAN	FAR EAST
30% OF OVERSEAS INVESTMENT	27% OF OVERSEAS INVESTMENT	18% OF OVERSEAS INVESTMENT	16% OF OVERSEAS INVESTMENT	9% OF OVERSEAS INVESTMENT

OUTLOOK

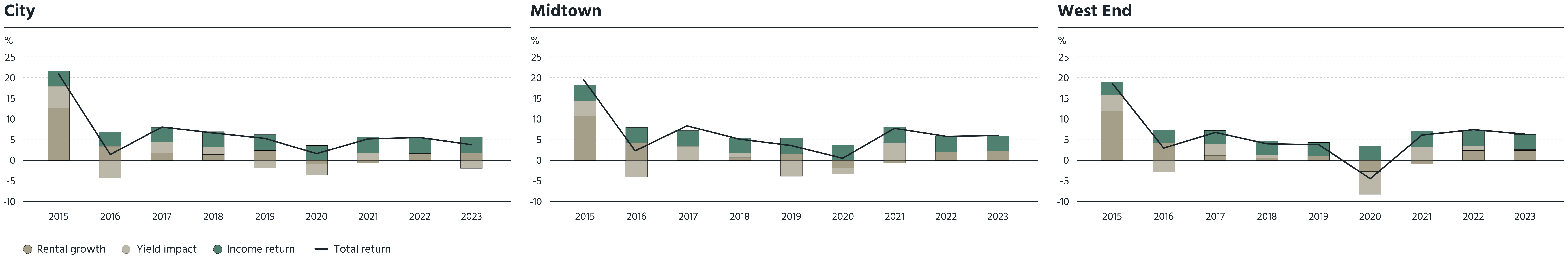
London office rents are expected to stabilise in Q4 after slipping back earlier in 2021 with the influx of tenant-controlled space. The fall in headline rents has by and large been isolated to Grade B space, where demand is in decline, although these falls have not been as severe as previously envisaged at the start of the year. We expect the polarisation of the best-in-class vs. poorer quality space to intensify in 2022 as hybrid working policies are implemented and demand is channelled into the best quality most sustainable office space.

Prime yields have tightened over 2021 and are expected to compress further in the last three months of the year, driven by investor demand and brighter rental growth prospects. Total return across London will be boosted by an average of 3% positive yield impact this year. Landlords and developers are reportedly marketing buildings which will deliver in the next 6-12 months above current market rents as they know competition for new space will be high.

Growing footfall in city centres and a recognition that an accessible and central base in the capital remains a priority for many London businesses mean investor confidence has returned. With travel opening up, we have seen some pent-up demand from overseas investors, who led the significant growth in volumes seen in Q3, with a clear preference for best-in-class assets, long leases and diversified tenants. Increased global competition for the finite pool of prime London assets points to some yield compression in Q4.

Lloyd Davies, Partner

Total returns and components
Sources: Gerald Eve, MSCI



LONDON OFFICE CONTACTS

Agency & Investment

Lloyd Davies
Partner
Tel. +44 (0)20 7333 6242
Mobile +44 (0)7767 311254
ldavies@geraldeve.com

Fergus Jagger
Partner
Tel. +44 (0)20 7653 6831
Mobile +44 (0)7787 558756
fjagger@geraldeve.com

Rhodri Phillips
Partner
Tel. +44 (0)20 3486 3451
Mobile +44 (0)7768 615296
rphillips@geraldeve.com

Patrick Ryan
Partner
Tel. +44 (0)20 7333 6368
Mobile +44 (0)7792 078397
pryan@geraldeve.com

Lease Consultancy

Tony Guthrie
Partner
Tel. +44 (0)20 3486 3456
Mobile +44 (0)7717 225 600
tguthrie@geraldeve.com

Graham Foster
Consultant
Tel. +44 (0)20 7653 6832
Mobile +44 (0)7774 823663
gfoster@geraldeve.com

Malcolm Hull
Partner
Tel. +44 (0)20 3486 3458
Mobile +44 (0)7768 154324
mhull@geraldeve.com

Jenny Rodericks
Partner
Tel. +44 (0)20 7653 6857
Mobile +44 (0)7775 697645
jrodericks@geraldeve.com

Planning & Development

Lisa Webb
Partner
Tel. +44 (0)20 7333 6225
Mobile +44 (0)7747 607309
lwebb@geraldeve.com

Research

Steve Sharman
Partner
Tel. +44(0)20 7333 6271
Mobile +44 (0)7508 008118
ssharman@geraldeve.com

Ben Clarke
Partner
Tel. +44(0)20 7333 6288
bclarke@geraldeve.com

Oli Al-Rehani
Senior Research Analyst
Tel. +44(0)20 7518 7255
Mobile +44 (0)7584 112501
oal-rehani@geraldeve.com

FURTHER INSIGHT

- How can we change our buildings to meet changing requirements?
- What are occupiers and employees looking for in their buildings?
- Legislation changes threaten the value of large older office buildings
- The end of the office? Don’t count on it
- Grays Inn Road Redevelopment
- Life Sciences - Planning for the Future
- InBrief for October 2021

View our full-service offer
Find out how we can help