GVA

RESEARCH

Central London office analysis

Q1 | 2018

OCCUPIER MARKET

Central London take-up for Q1 2018 totalled 2.5 million sq ft, 21% up on the corresponding quarter in 2017.

INVESTMENT MARKET

During Q1 2018, central London investment totalled £3.1 billion across 52 deals, 25% down on the five-year quarterly average and 39% down on the corresponding quarter in 2017.

Cover photo : GVA have advised in fully letting 80-100 Victoria Street for LandSec.

Occupier market – in brief

Welcome to GVA's central London office analysis;
our detailed view of the market in Q1 2018.

Need for speed

Q1 was very much steady as she goes for the central London office market, with no big stories either way. Whilst there are nuances in submarkets, demand remains relatively robust, and supply in check.

Nevertheless, a noticeable theme is the hesitation amongst landlords and occupiers to let or acquire space with negotiations taking as long as nine months in extreme scenarios. While this is understandable in the current climate, it is in sharp contrast to the serviced office market where providers such as WeWork and TOG have been very aggressive in letting space to both corporate and smaller occupiers. Indeed, large occupiers taking space within serviced offices have completed certain transactions in a matter of days.

Supply affecting demand

Take-up is currently dominated by larger deals and pre-lets. However, higher levels of take-up are currently prevented by dwindling supply, especially for larger units and good quality stock. Indeed, in the City core, demand for units over 100,000 sq ft is high, but the supply is not necessarily there. The demand exists solely for the right supply. In Mayfair and St James's, higher supply levels are mirrored in last quarter's significant levels of completions, with a further amount also currently under offer.

Dominoes

Over the last two years, headline rents in the City and East London submarkets have been relatively stable, with incentives increasing over the majority of the time. The same cannot be said for the West End however which has seen rents fall significantly in some submarkets.

The last two quarters specifically has seen dynamics in the markets change slightly. With availability decreasing in the West End, rental growth has returned following two years of stability. In the City however, after a similar two years of stability, we have started to see glimpses of prime rents falling. With availability low and demand for new space strong, we expect current pressures on headline rents to diminish.

With supply remaining low therefore, pressure on tenants is expected to continue. Indeed, with high demand, we have seen cases where tenants have missed out on their first choice of building, and in order to not repeat the same mistake, have become more flexible on rents. It only takes one deal to spark a run on a certain type of space.

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> Higher levels of take-up are currently prevented by dwindling supply

Central London

Take-up
Central London take-up for Q1 2018 totalled 2.5 million sq ft, 11% down on the previous quarter, and 5% down on the five-year quarterly average of 2.6 million sq ft.

The City core saw take-up 33% in excess of its five-year quarterly average, with East London fringe also seeing a very strong quarter, up 10%.

The largest deal of the quarter was in the City where Sumitomo Mitsui agreed to pre-let 160,000 sq ft of British Land's 100 Liverpool Street (EC2). In the West End, Google took an assignment of 123,000 sq ft at New Look's office on Handyside Street (NW1), whilst in East London, the largest deal was Thomson Reuters' acquisition of a 38,400 sq ft floor at 5 Canada Square (E14).

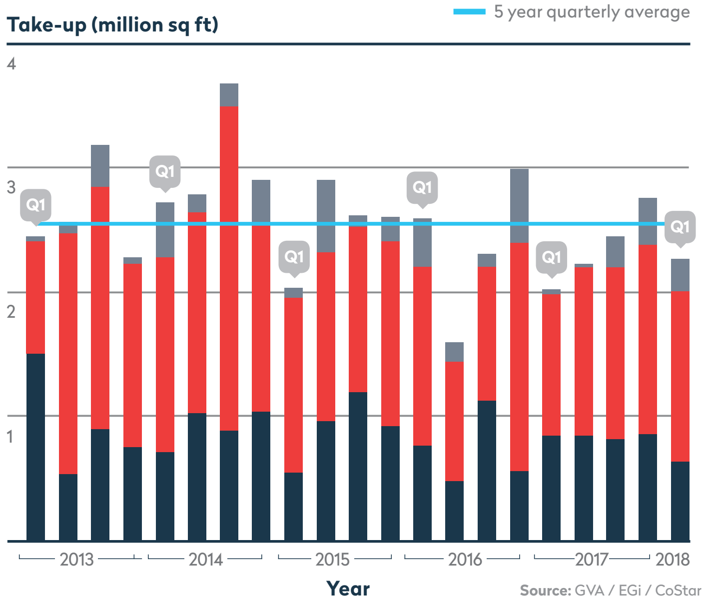
Second-hand grade A space accounted for the largest proportion of take-up during the quarter, totalling 892,500 (36%). Pre-letting remained relatively robust, with space under construction making up 724,300 sq ft (29%). Take-up of new space accounted for 520,300 sq ft (21%). Whereas, second-hand grade B space accounted for just 13% of take-up (322,300 sq ft).

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

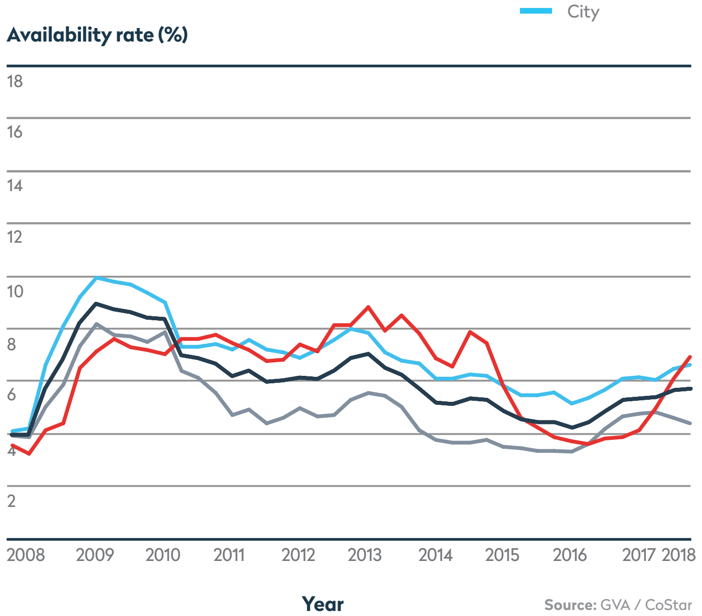
Availability
There is currently 11 million sq ft available across central London, increasing from 10.9 million sq ft as at the end of Q4 2017. Since Q1 2017, the amount of available space has increased by 9% with 866,000 sq ft.

The addition of vacancy rate has increased slightly to 5.7%, the highest it has been since Q1 2014, although it remains low compared to previous cycles.

Central London take-up



Central London office availability rates



Development
During the quarter, seven buildings totalling 1 million sq ft completed, including four buildings over 100,000 sq ft. Of the total space delivered, just 353,400 sq ft is actually available, meaning that 50% of space was let either pre- or immediately post completion.

The largest building to complete in the City was M&G's development of 10 Fenchurch Avenue (EC3). Elsewhere, construction also completed at the 130,000 sq ft 8 Devonshire Square (EC2), L&G's refurbishment of Senator House (EC4) as well as One Poultry (EC2). Outside of the City, Derwent London's rolling refurbishment of 25 Savile Row (W1) was the only notable completion.

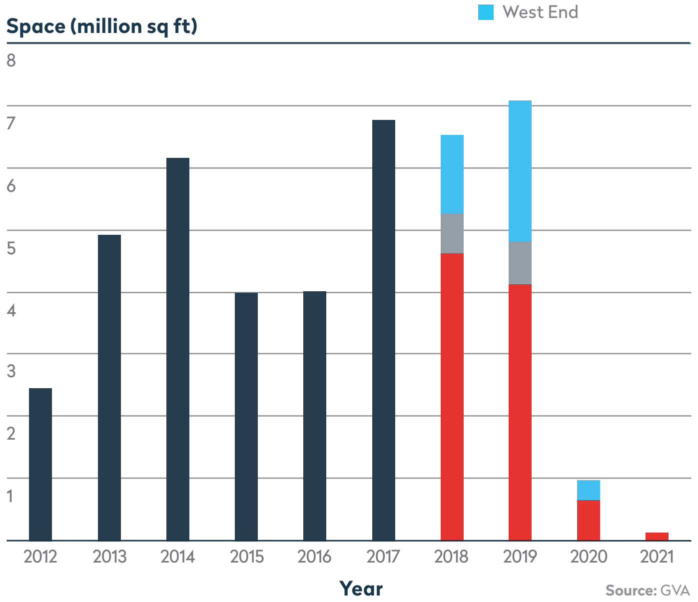
2.5 million sq ft of development started during the quarter, with the largest schemes being British Land's 1 Triton Square (NW1) which was pre-let during the final quarter of 2017, Aldgate Developments' 280,000 sq ft 1 Braham Street (E1) and Exemplar and Partners Group's 240,000 sq ft 80 Fenchurch Street (EC3).

There is currently 14.8 million sq ft under construction across central London, with 6.5 million sq ft due for completion before the end of 2018 and a further 7.1 million sq ft due before the end of 2019. Of the space currently under construction 5.2 million sq ft (35%) has already been let, leaving 9.6 million sq ft available.

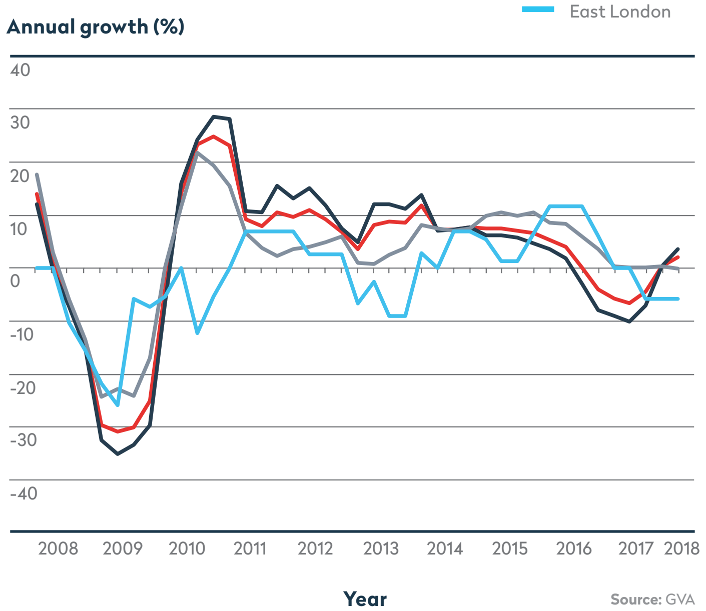
Rental growth
Central London prime rents increased by 1.2% during the quarter. This was the second quarter of rental increase after five successive quarters of negative or no growth. Prime rents are now 2.1% up on the same time last year.

Despite modest growth in the central London index, there was a divergence with some submarkets seeing significant rental increases, whilst others saw rents fall. The first quarter of the year saw incentives by and large remain stable.

Central London completions vs space under construction



Central London prime rental growth



West End

Take-up
Take-up during the quarter reached 834,000 sq ft. This was 2.2% down on the previous quarter and in line with the five-year quarterly average.

The largest deal of the quarter was Google's acquisition of 123,000 sq ft on an assignment from New Look at Handyside Street, Kings Cross Central. Elsewhere, SNC Lavalin took 66,000 sq ft at Nova (SW1), whilst 38,000 sq ft was let to Intuit at 80 Victoria Street (SW1), with GVA advising Landsec. The largest deal in the core was Varde Partners taking 20,000 sq ft St James's Market (SW1)

Pre-letting was slow during the quarter, making up just 51,200 sq ft and 6% of activity. Take-up of new space made up 240,200 sq ft and 24% of activity. Second-hand grade A space accounted for the majority of take-up, with 433,200 sq ft and 52% of take-up, with grade B space accounting for an additional 109,800 sq ft (13%).

Availability
Availability decreased from 3.8 million sq ft to 3.6 million sq ft during the quarter, with the vacancy rate coming down to 4.4%. Availability is 6% lower than this time last year, equating to 235,000 sq ft less space.

Development
During the quarter, Derwent London's refurbishment of 25 Savile Row (W1) was the only notable completion. However, there were 13 new starts, including British Land's 310,000 sq ft Triton Square (NW1), BL Develoment's 135,000 sq ft 10 Broadway (SW1) and Tishman Speyer's 27 St James's Street (SW1).

There is currently 3.8 million sq ft of development activity in the West End.

Rental growth
The first quarter of the year saw prime headline rents increase by 3.5% across the West End, the second quarter of positive growth after two years of negative to no growth. Prime rents are now 3.5% above where they were this time last year, their highest levels since Q3 2016.

In Mayfair and St James's, prime rents increased to £112.50 per sq ft with rent free periods stable at 24 months. Net effective rents are now up to £90 per sq ft, their highest since Q3 2016 but still 15% down on the top of the market. Super-prime headline rents are at £170 per sq ft with the top end of the market continuing to see activity.

KEY STATS THIS QUARTER

834,300
sq ft let. 0.2% up on 5-year quarterly average

4.4%
vacancy rate

3.8 million
sq ft under construction

£112.50
per sq ft prime rent

3.5%
annual rental growth

Patrick O'Keefe
Head of London Agency and Investment

City

Take-up
Take-up during Q1 2018 totalled 1.4 million sq ft, 20% up on the first quarter of 2017, but 11.2% down on the previous quarter, and 10% down on the five-year quarterly average.

The largest deal of the quarter was Sumitomo Mitsui taking 162,000 sq ft at 100 Liverpool Street (EC2), Sidley Austin took a pre-let of 101,000 sq ft at 70 St Mary Axe and Mimecast agreed also to take 79,000 sq ft at 1 Finsbury Avenue (EC2).

Pre-letting for the quarter accounted for 43% of activity and totalled 583,000 sq ft, with take-up of new space also accounting for 21% of take-up – 280,000 sq ft. Take-up of second-hand grade A space accounted for 26% of activity (358,000 sq ft), whilst second-hand grade B accounted for just 10% of take-up and 142,700 sq ft.

Availability
Availability in the City increased during the quarter from 6 million sq ft to 6.1 million sq ft, with the vacancy rate increasing from 6.4% to 6.6%. Availability is 9% up on the corresponding period in 2017, equating to just over 500,000 sq ft of additional space.

Development
During the quarter just under 1 million sq ft completed across seven buildings, with the largest being M&G's development of 10 Fenchurch Avenue (EC3). Elsewhere, construction also completed at the 130,000 sq ft 8 Devonshire Square (EC2), L&G's refurbishment of Senator House (EC4) as well as One Poultry (EC2).

Construction started on 1 million sq ft across five buildings during the quarter, with the largest being Aldgate Developments' 288,000 sq ft 1 Braham Street (E1), with 80 Fenchurch Street and Crown Place also in excess of 200,000 sq ft each.

There is now 9.6 million sq ft under construction in the City. Of this, 4.6 million sq ft is due to complete in 2018, with 4.1 million sq ft earmarked for 2019. Of the space under construction, 4.3 million sq ft is already let (45%), leaving just 5.3 million sq ft of available space in the pipeline.

Rental growth
Prime rents in the City decreased slightly by 0.6% during the quarter, the first decrease since Q1 2013. This slight decrease means that prime rents are marginally down on the same period last year.

Prime rents remained stable across most submarkets during the quarter, with the only movement being in the City core where rents decreased by 3.6% and EC3 where rents increased by 2.3%.

Rent free periods saw very little movement this quarter, with rent free periods of 24 months available in almost all submarkets.

Prime headline rents, having remained stable at £70.00 per q ft since 2016, decreased during Q1 to £67.50 per sq ft. Net effective rents in the City core are now at £54.00 per sq ft, their lowest since Q2 2015.

KEY STATS THIS QUARTER

1.4 million
sq ft take up. 20% up on Q1 2017

6.6%
vacancy rate

9.6 million
sq ft under construction

£67.50
per sq ft prime rent

-0.2%
annual rental growth

Jeremy Prosser
Senior Director

East London

Take-up
Take-up during the first quarter of the year totalled 261,300 sq ft, 29% down on the previous quarter but 10% up on the five-year quarterly average.

Take-up for 2017 totaled 680,100 sq ft, this was down 45% on 2016 but was 37% up on the 5-year average.

The largest deal in Canary Wharf was at 25 Canada Square (E14) where Boston Consulting Group took the 29,200 sq ft 30th floor. Elsewhere, 22,300 sq ft was let at 20 Churchill Place (E14) and 23,900 sq ft at the Columbus Building (E14).

In Stratford, all the deals done during the quarter were at Here East (E20), with BDW Trading taking 18,000 sq ft, Matches Fashion taking 25,000 sq ft and an undisclosed occupier taking a further 25,000 sq ft.

Availability
Available space during the quarter increased from 1.2 million sq ft to 1.3 million sq ft, equating to a jump in vacancy rate from 6.1% to 6.9%. The majority of space is still available on a sublet basis, and there is a large supply of 'grey' space, with tenants quite flexible on how much space they have readily available.

Available space is 80% higher than this time last year and is at its highest since Q1 2014.

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 is due in Q2 2018, at S5 (E20), which is partly let to the FCA.

Rental growth
In Canary Wharf, prime rents remained stable at £40 per sq ft with rent free periods steady at 24 months.

Outside the Wharf, prime rents have decreased to £30 per sq ft with rent free periods at 24 months, whilst in Stratford prime rents are at £45.00 per sq ft. Rent free periods are at 24 months.

KEY STATS THIS QUARTER

261,300
sq ft let. 29% down on 5-year quarterly average

6.9%
vacancy rate

1.3 million
sq ft under construction

£45
per sq ft prime rent

Alasdair Gurry
Director

Midtown

Take-up
Take-up in Midtown during Q1 2018 totalled just 128,956 sq ft which was 33% down on the previous quarter and 25% down on the five-year quarterly average. Take-up was 78% down on Q1 2017.

The largest deal of the quarter was to Ennismore Ltd who took 20,000 sq ft at Old Sessions House (EC1), whilst Beaumont Business Centres acquired the entire 17,500 sq ft Southampton Buildings (WC2).

Second-hand grade A space accounted for 51% of activity and 65,600 sq ft, whilst second-hand grade B space contributed just 4%. Pre-letting was relatively robust, with 20,000 sq ft let, 15% of the total, and new space made up an additional 37% of take-up, 29% of the market.

Availability
During the quarter, availability in Midtown increased slightly to 1.8 million sq ft, with the vacancy rate increasing to 4.3%.

Development
The only building to complete during the quarter was HB Reavis' 43,000 sq ft 20 Farringdon Street.

There were two new starts during the quarter, namely M&G's refurbishment of the 173,000 sq ft 17 Charterhouse Street (EC1) and Mayfair Capital's 40,000 sq ft 20 Red Lion Street (WC1).

There is currently 1.8 million sq ft under construction across Midtown.

Rental growth
Prime rents in Bloomsbury increased from £75 per sq ft to £80 per sq ft. Prime rents across all other Midtown submarkets remained stable during the quarter. Midtown prime rents are 1% up on this time last year.

KEY STATS THIS QUARTER

128,956
sq ft let. 25% down on 5-year quarterly average

4.3%
vacancy rate

1.5 million
sq ft under construction

£80
per sq ft prime rent

Maxim Vane Percy
Senior Director

GVA are advising on the sale of
85 Buckingham Gate for Saga plc

Investment market – in brief

Off Market
The start of 2018 has been characterised by a shortage of new sales. Transaction volume has been supported by deals carrying over from the end of 2017 with a number of large transactions agreed in Q4 closing in January and February. This has been borne out in the investment volumes, with the quarterly total reaching the lowest level since the aftermath of the EU referendum result.

Off-market deals have accounted for a significant proportion including Oxygen Asset Management's purchase of Riverbank House on Swan Lane which, at £400 million, which was the largest deal of the quarter. Other notable off market deals include the Mayor's Office for Policing and Crime buying the Empress State Building, where it was already an occupier, from CapCo for around £250 million.

On demand
Where properties have been widely marketed they have generally commanded strong interest. Nan Fung purchased the Regent's Quarter estate in King's Cross from ADIA for c. £302 million. Over 50 parties undertook inspections with around 15 first round bids representing over £4 billion of demand. More recently Blackrock's sale of 5 Strand, a 2019 development site, received around 22 first round bids with very strong interest from the hotel development market in particular. Investor demand for long dated hotel income is helping developers to support significantly higher appraisals.

International demand for London remains strong across all lot sizes. In the City strong demand from Korean investors has been particularly notable with Mirae rumoured to be under offer to purchase 20 Old Bailey from Blackstone for around £340 million. At smaller lot sizes, the demand from private overseas investors remains strong with significant South African capital looking for opportunities along with more typical Middle and Far Eastern investors.

In the West End there has been a shortage of supply, particularly in the mid ticket bracket between £20 and £80 million. The only transaction of this size in W1 this quarter was the sale of North West House, Marylebone Road, by WELPUT to a private Middle Eastern investor for around £60 million, reflecting a net initial yield of 4.35%. The property is single let to WeWork for 20 years with a fixed uplift at the first review. Investor appetite for serviced office and co-working income has improved, a result of greater understanding of the sector and a shortage of other opportunities.

The strongest demand remains for long dated secure income but there have been very few of these opportunities in the market. One of the few that traded in the quarter was the long leasehold of 12 Hammersmith Grove, sold by Aberdeen Standard to Spelthorne Borough Council for £170 million. The block is multi-let with a WAULT of around 13 years. The price reflected a net initial yield of around 5.25% and a capital value of around £1,000 per sq ft, a strong price for a leasehold interest in that location.

Back to the future
Moving into Q2, activity seems to be improving with more sales rumoured to be launching in the coming weeks. If there is a weaker area in the market it is probably for office buildings with upcoming or immediate vacancy, where a margin has opened between vendor's and purchaser's pricing of risk, and for shorter geared long leasehold interests. On the whole though the market remains strong, backed by improved sentiment in the occupational markets, and we expect transaction volumes to remain buoyant over the next two quarters particularly with a number of large ticket sales coming to market.

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> "The strongest demand remains for long dated secure income but there have been very few of these opportunities in the market."

Investment commentary

Transaction volumes
During Q1 2018, central London investment totalled £3.1 billion across 52 deals, 32% down on the previous quarter, 25% down on the five-year quarterly average and 39% down on the corresponding quarter in 2017.

The West End saw £1.4 billion transact, 45% up on the previous quarter but 15% down on the five-year quarterly average. During the quarter, Nan Fung purchased Regent Quarter (W1) for £303 million, representing a yield of 4.4%. The largest deal in the core was Motcomb Estates' purchase of 69-70 Pall Mall (SW1) for £34.25 million.

In the City, £1.7 billion was transacted across 26 deals, 40% down on the previous quarter and 23% down on the five-year quarterly average.

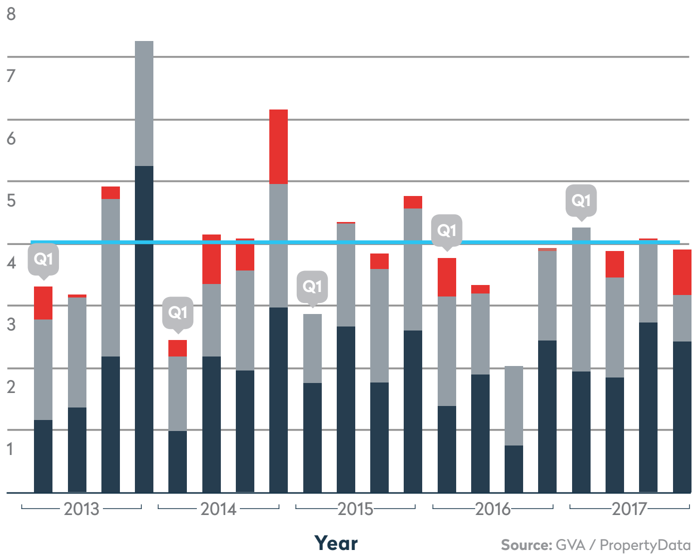
The largest deal to complete was Zeno Capital's purchase of Riverbank House (EC4) from Evans Randall for £400 million, representing a yield of 3.9%. Elsewhere, FG Asset Management bought The River Building for (EC4) for £248 million, representing a yield of 5.2%.

This quarter overseas money accounted for £1.7 billion (54% of total investment). UK property companies accounted for £623 million of investment (20%), whilst UK institutional investors were responsible for a further 15% of total investment (£471 million).

There were nine transactions of over £100 million, with five of these selling for £200 million and above.

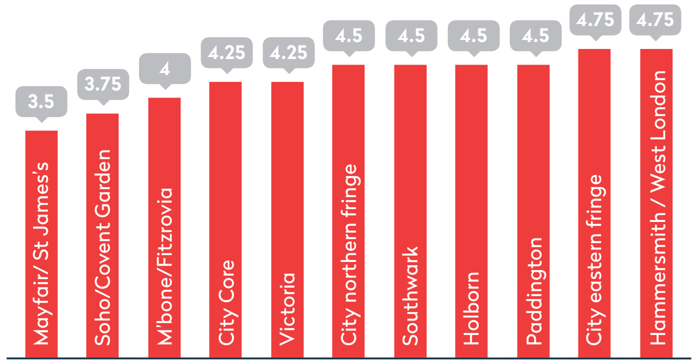
Yields
Q1 2018 saw yields push out 25 basis points in Marylebone and Fitzrovia, whilst other submarkets saw stability. Prime yields in Mayfair and St James's remain at 3.5%, with City core at 4.25%.

Central London office investment transactions



Source: GVA / PropertyData

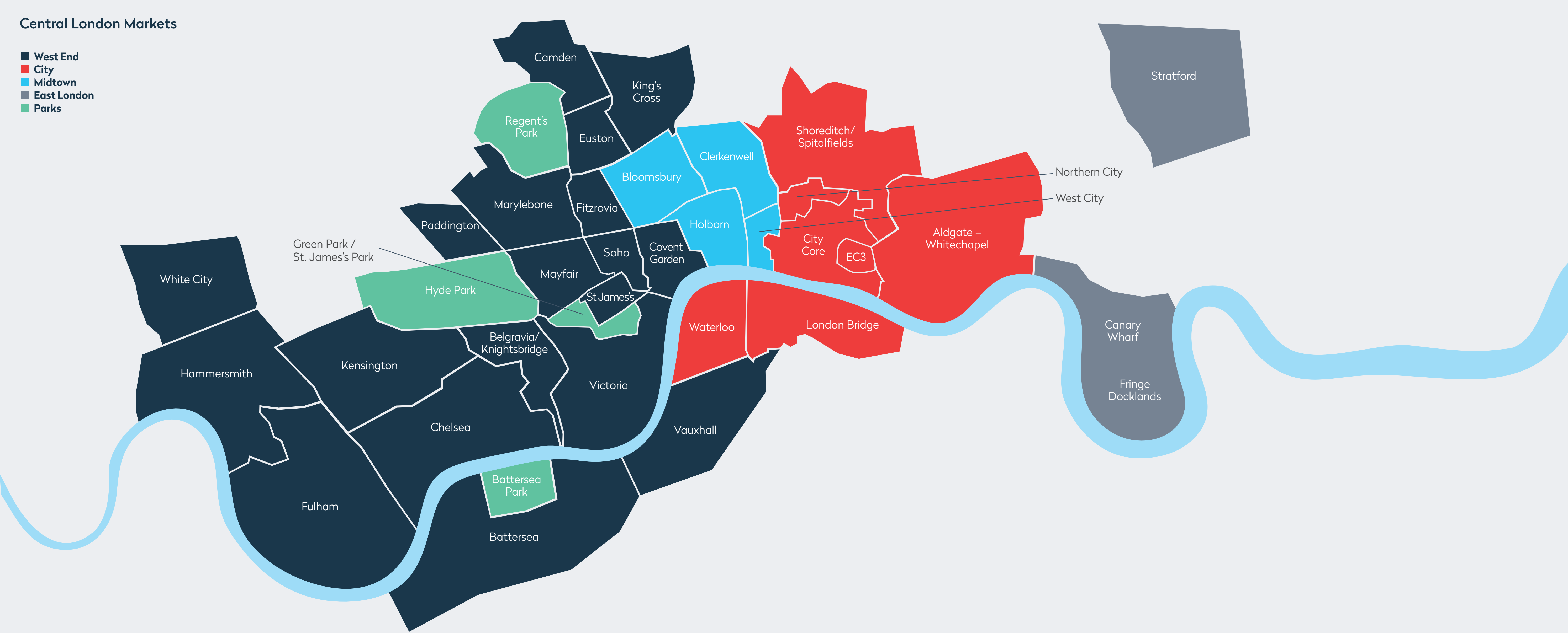
Central London prime office yields



Source: GVA

GVA advised on the acquisition of 64 Essex Road, N1 on behalf of a private investor

Central London Markets



West End	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
Battersea PS	£60.00	24	£15.25	£85.50
Belgravia / Knightsbridge	£90.00	24	£39.50	£139.75
Camden	£57.50	24	£26.75	£94.50
Chelsea	£95.00	20	£37.00	£142.25
Covent Garden	£85.00	24	£30.00	£125.25
Euston	£75.00	24	£27.75	£113.00
Fitzrovia	£80.00	24	£33.75	£124.00
Fulham	£47.50	22	£20.00	£77.75
Hammersmith	£55.00	24	£21.00	£86.25
Kensington	£67.50	20	£44.00	£121.75
King's Cross	£80.00	22	£31.50	£121.75
Mayfair	£112.50	24	£48.75	£171.50
Mayfair/St James's "super-prime"	£170.00	18	£51.00	£231.25
North of Oxford St	£85.00	24	£39.50	£134.75
Paddington	£75.00	24	£26.75	£112.00
Soho	£97.50	24	£41.50	£149.25
St James's	£112.50	24	£46.50	£169.25
Vauxhall	£57.50	24	£15.25	£83.00
Victoria	£77.50	24	£33.50	£121.25
White City	£52.50	24	£8.50	£71.25

City	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
City Core	£67.50	24	£25.75	£103.50
Aldgate/Whitechapel	£57.50	24	£20.00	£87.75
EC3	£67.50	24	£26.50	£104.25
London Bridge	£63.00	24	£26.00	£99.25
Northern City	£65.00	24	£19.75	£95.00
Shoreditch/Spitalfields	£65.00	24	£18.00	£93.25
Waterloo	£67.50	24	£22.75	£100.50

Midtown	Prime headline rent (£ per sq ft)	Rent free period (months)	Business rates (£ per sq ft)	Total occupancy costs (£ per sq ft)
Bloomsbury	£80.00	24	£30.25	£120.50
Clerkenwell	£67.50	24	£23.25	£101.00
Holborn	£65.00	24	£27.75	£103.00
West City	£67.50	24	£25.75	£103.50

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	£63.00
Other Docklands	£30.00	24	£10.00	£50.25
Stratford	£45.00	24	£8.50	£63.75

If you'd like to talk to one of our team to discuss property services or any market leading research, please get in touch.

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