GVA

RESEARCH

Central London office analysis

Q2 | 2018

OCCUPIER MARKET

Central London take-up totalled 3.5 million sq ft in Q2 2018, a 41% increase on Q1 2018 and a 55% rise on the same period last year.

INVESTMENT MARKET

Q2 2018 investment volumes totalled £5.8 billion across 51 deals, a 41% rise on the 5-year average largely the result of several significant deals over £200 million.

Cover photo : GVA successfully advised Rathbone Brothers on the 44,781 sq ft disposal of their office at 1 Curzon Street W1

Occupier market – in brief

Welcome to GVA's central London office analysis; our detailed view of the market in Q2 2018.

Tech on top

The good news for the quarter is that take-up is up on previous quarters and the 5 and 10-year averages. Although supply in most markets is on an upwards trend, we see significant levels of space under offer that may alter future dynamics.

A number of the deals were found in Core markets during the quarter that have previously shown signs of struggling under the weight of Brexit. Mayfair & St James's for example recorded its highest level of take-up ever, largely due to three deals over 30,000 sq ft, for which GVA acted on the disposal of two.

Also of note was the dominance of technology companies within each of the submarkets in the City and West End, with Financial Services companies taking more of a back seat for Q2. What is particularly interesting is that the TMT & Creative take-up was not driven by one key deal in particular, but rather a spread of deals over 5,000 sq ft.

Behind the take-up

While the take-up figure is clearly good news for the market, we cannot ignore the fact that a significant proportion of this take-up was accounted for by a single deal, and a further 18% was taken by serviced office operators that continue to increase their levels of supply in Central London.

Indeed, the rising supply trend is an important consideration, and occupational deals are also taking longer to complete, falling through in some cases after several months of having been under offer. Furthermore, we have seen several examples of tenants finding it is 'easier to stay than go', instead opting to renew or regear the lease on their existing space.

It remains to be seen whether we will see take-up continue to rise followingthe expected completion of under offer space in Q3, or whether deals will continue to stall causing a trickle of take-up and rising supply.

Negotiating position

Traditionally a landlord's position on re-negotiating a new lease with a tenant who has a lease outside the act has been a strong one. Tenants have always had to make sure that they try and agree terms long before the lease expiry due to the threat of running out of time and not being able to move.

We believe that the position on this has changed and now, due to the size of units available through providers like We Work and TOG, tenants have a real option of being able to move to alternative space within a matter of weeks.

Patrick O'Keeffe

Patrick O'Keeffe

Head of London Agency and Investment

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> "Accompanied by high take-up, there is rising supply and occupational deals are taking longer to complete"

Central London

Take-up

Take-up for Central London totalled 3.5 million sq ft in Q2 2018, a 41% increase on Q1 2018 and a significant 55% rise on the same period last year. The excellent level of take-up for the quarter shows the market remains resilient in face of wider economic uncertainties.

The largest deal of the quarter was at Royal Mint Court, EC3, where the Chinese Embassy purchased the entire 589,417 sq ft proposed scheme for its own occupation. Deals of this size are rarely seen in the market, the single deal accounts for 17% of Q2 take-up alone. Two further deals completed over 100,000 sq ft during the quarter at BBC Media Village, W12, where Publicis took 211,998 sq ft; and at Governors House, EC4, where BCLP took 127,317 sq ft.

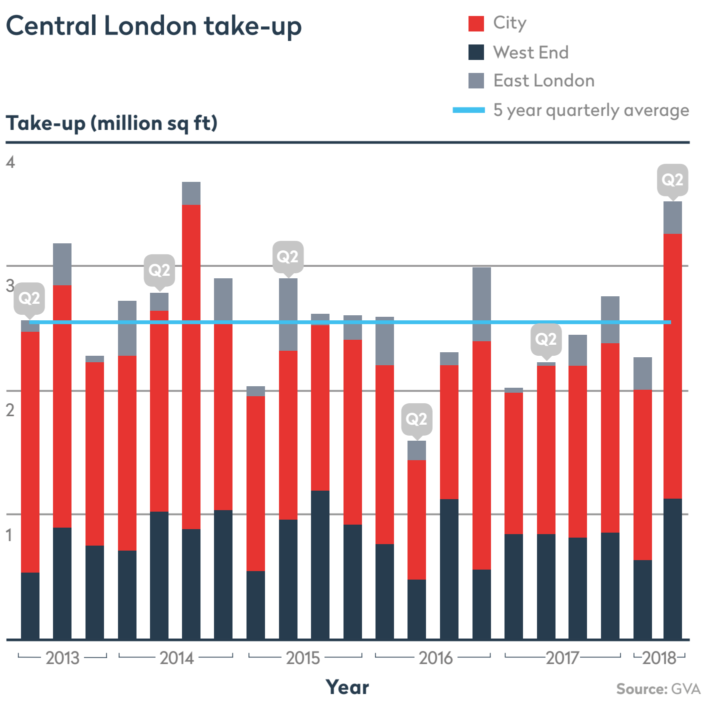
Central London take-up in Q2 was dominated by the TMT & Creative sector which alone accounted for 28% of all take-up. The proportion of take-up was not dominated by one deal in particular but rather a range of smaller occupiers taking space throughout the quarter.

The Business Services sector took the second largest proportion of take-up with 20%, of which 90% was from serviced office operators. The level is in line with the high levels of serviced office take-up in previous quarters, with additions this quarter from landlord brands including Storey (British Land) and Uncommon (Carlyle Group). Financial services, historically a front runner in take-up figures, made up only 9%.

Availability

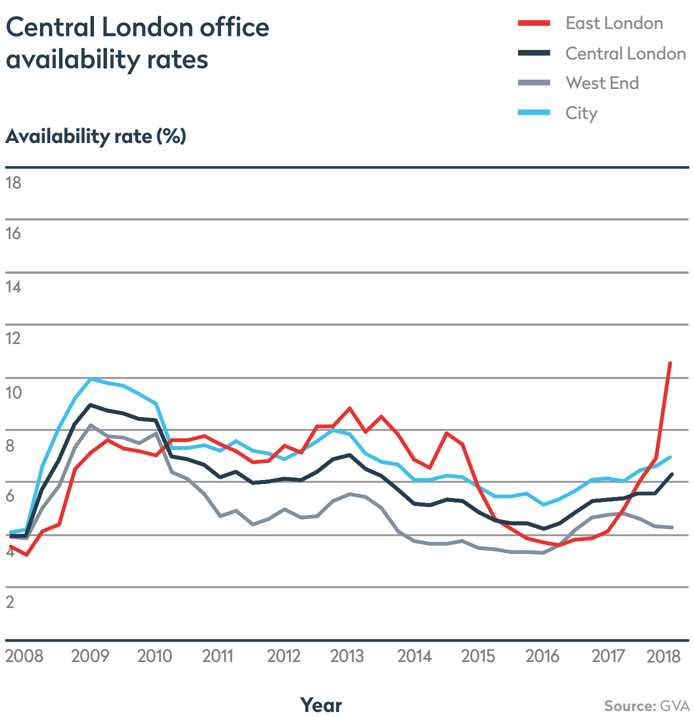
Despite the rising take-up figures, availability rose considerably from Q1 to Q2 2018 reflecting a full development pipeline and the continuing addition of grey space to the market. Grey space currently makes up 19% of all availability. Availability rose 12% from Q1 to Q2 2018 to a total of 12.4 million sq ft reflecting a vacancy rate of 6.4%, up from 5.7% in Q1 and 5.3% in Q2 last year.

Central London take-up



Source: GVA

Central London office availability rates



Source: GVA

Development

The Central London development pipeline currently totals 17 million sq ft, of which 37% is due to be delivered in the next six months comprising 2.3 million sq ft of availability. We continue to see good pre-letting activity however, with prelets comprising 30% of all take-up in Q2 2018, in 10 deals.

Key prelets over the quarter included the entirety of Royal Mint Court EC3 comprising 589,417 sq ft, the prelet of 86,983 sq ft at One Embassy Gardens SW8 by DK Publishing and the first letting at Derwent's Brunel Building W2 by Sony who took 77,200 sq ft.

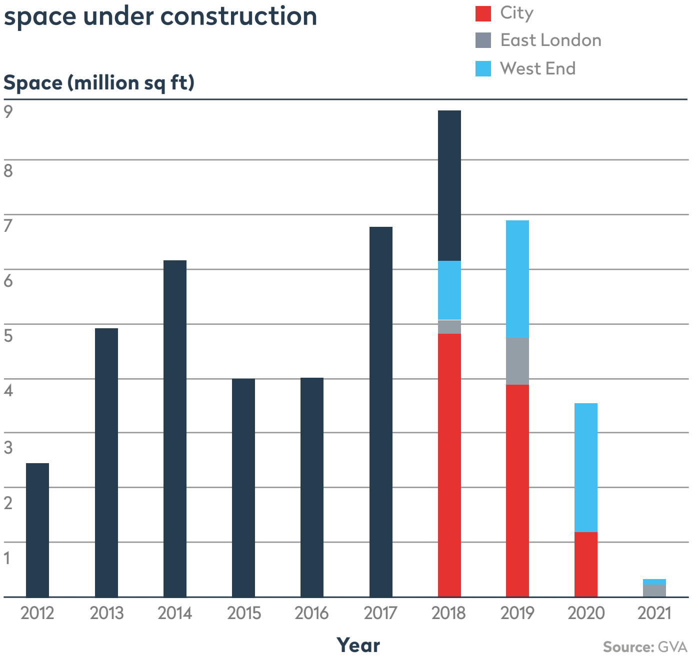
Post 2018, we will see 10.7 million sq ft of space delivered with 2019 reaching a peak across Central London. Although the planning pipeline is currently significant, we have seen increased hesitance by landlords to go ahead with larger schemes, until a prelet is secured.

Rental growth

Central London prime rental levels increased by 1% from Q1 to Q2 2018, the third consecutive quarter of rental growth. On a more detailed level, it is mainly the fringe markets that have seen the rental growth with rents in core markets such as City Core and Mayfair & St James's remaining stable.

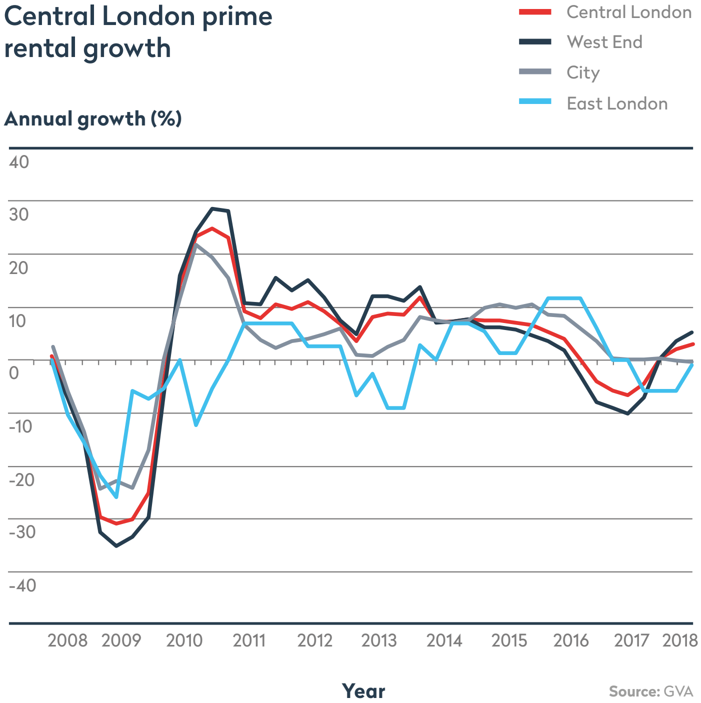
Rent free periods remained stable across the board in Q2 2018 at a Central London average of 24 months. Similarly, divergence in length of rent free periods was mainly in the fringe markets.

Central London completions vs space under construction



Source: GVA

Central London prime rental growth



Source: GVA

West End

Take-up
West End take-up totalled 1.1 million sq ft in Q2 2018, a 30% increase on Q1 2018 and a 29% rise on the same period last year. The largest deal of the quarter was to Publicis at White City, W12, the only West End deal over 100,000 sq ft for the quarter.

Notably, the Mayfair & St James's submarket recorded its highest ever take-up figure of 208,247 sq ft, a 99% rise on Q1 2018 and a 91% rise on the 5 year average. The rise in take-up was primarily due to deals at 18-19 Hanover Square, 1 Curzon Street and Park House W1 all three of which were over 30,000 sq ft. Indeed, almost every key West End submarket saw take-up rise from Q1 to Q2; the only exception was in the Victoria submarket where take-up dropped 232% in the same period; recent deals at Nova and Verde SW1 have left little good supply left in the submarket.

TMT & Creative tenants made up almost half of all West End take-up for the quarter at 45% suggesting the market is remaining resilient in face of economic uncertainties. The majority of West End TMT & Creative deals however were found in the West End fringe submarkets including White City, Battersea and Covent Garden. More traditional financial services companies, making up 15% of the quarter's take-up, still continue to dominate the core West End submarkets.

Availability
Availability from Q1 to Q2 2018 stayed stable at 3.56 million sq ft, reflecting a vacancy rate of 4.35%. There is however currently 600,000 sq ft of space under offer with almost 150,000 sq ft under offer in Mayfair alone.

Development
There is currently 5.8 million sq ft under construction in the West End of which 48% is prelet, leaving 3.million sq ft available. Preletting activity in the West End is generally limited but Q2 alone saw 244,000 sq ft transact in 5 deals, up from only 51,200 sq ft in Q1.

Over the course of Q2 2018, 406,445 sq ft completed of which 218,327 sq ft was in key buildings including 21 St James's Square, 20 St James's Street and 120 Pall Mall SW1.

Rental growth
Mayfair & St James's prime rents were stable in Q2 2018 at £112.50 per sq ft, in line with Q1 2018 but an increase from £105.00 per sq ft in Q2 2017. Quarterly rental growth was mainly evident in the fringe West End submarkets. Rent free periods currently average 23 months across the West End with the core markets generally registering rent frees of 24 months, and fringe markets seeing greater variation.

KEY STATS THIS QUARTER

1.1 million
sq ft let. 26% up on the five-year quarterly average

4.4%
vacancy rate

5.8 million
sq ft under construction

£112.50
per sq ft prime rent

5.27%
annual rental growth

Patrick O'Keefe
Head of London Agency and Investment

City

Take-up

City take-up totalled 2.2 million sq ft in Q2 2018, a rise of 63% on Q1 2018 and Q2 2017. Although the rise in take-up is partly explained by the deal to the Chinese Embassy at Royal Mint Court EC3, without that deal, take-up is still up on previous quarters and on the 5-year average by 45%.

The Government and Public Services sector made up the majority of take-up in the quarter at 26%, largely due to the deal at Royal Mint Court EC3. Close behind was the TMT & Creative sector at 22% with Financial Services recording only 7% of the quarter's take-up, a record low for the market, home to the city's historic financial district, with not a single deal recorded for the sector over 20,000 sq ft. There is no evidence that Financial Services occupiers have made significant steps to relocate elsewhere however.

Second hand space comprised 44% of take-up for Q2 2018, equating to 967,000 sq ft. Thiswas an increase on previous levels that saw the proportion of Second hand lettings reach only 38% (565,000 sq ft) in Q1 2018. This perhaps suggests tenants are increasingly concerned about the cost and flexibility of their leases, opting for cheaper space that tends to be associated with more flexible lease terms.

Availability

Availability rose to 6.5 million sq ft in Q2 2018, a significant 6.1% jump from 6.1 million sq ft in Q1 2018 and reflecting a vacancy rate of 7%. This can to some extent be explained by the addition of grey space to the market, with 993,000 sq ft of tenant space currently available.

The City Core submarket currently has the largest supply figure with availability totaling 2.2 million sq ft, followed by EC3 with 1.8 million sq ft. The dominance of City Core and EC3 suggests the rising supply to be predominantly the result of a concentrated development pipeline.

Development

Of the 4.9 million sq ft of construction space projected to complete by year-end, 69% is currently prelet, leaving around 1.5 million sq ft of space available. Post 2018 however, only 18% of under construction space is prelet leaving 4 million sq ft available. Dependent on preletting activity, this has the potential to cause a significant rise in supply.

Preletting activity in the City remains good with levels totalling 781,000 sq ft in Q2 2018, making up 35% of City take-up for the quarter. Q1 2018 preletting levels totalled 617,000 sq ft, 45% of take-up.

Rental growth

Prime rents in the City were £67.50 per sq ft in Q2 2018 remaining stable on Q1 2018 but registering a minor decline on levels in Q2 last year at £70.00 per sq ft. Rent free periods are currently stable at 24 months.

KEY STATS THIS QUARTER

2.2 million
sq ft let 45% up on the five-year quarterly average

7.0%
vacancy rate

9.8 million
sq ft under construction

£67.50
per sq ft prime rent

-0.19%
annual rental growth

Jeremy Prosser
Head of City Agency

East London

Take-up

Take-up for East London totalled 165,696 sq ft in Q2 2018, a 62% fall on Q1 2018 but a significant rise on the same period last year, following a year of record low take-up in the East London market. Canary Wharf in particular saw take-up reach 160,360 sq ft in Q2 2018, good news for the submarket in which take-up reached just 160,000 sq ft in 2017.

All Q2 deals in East London were over 10,000 sq ft, the largest being The Office Group's take-up of 82,977 sq ft at 1 Canada Square E14. We predict a further increase in East London take-up in Q3 2018 following the completion of deals that are currently under offer.

Availability

Availability rose to 2 million sq ft in Q2, a significant rise on Q1 2018 and reflecting a vacancy rate of 10.5%. The availability in the market can largely be explained by tenant space from occupiers such as Morgan Stanley, Citi and Thomson Reuters. Altogether second hand space currently makes up around 70% of the market.

Development

The East London under construction pipeline currently comprises 1.36 million sq ft of which 47% is prelet. The largest development currently under construction is 1 Bank Street E14 where 420,000 sq ft is available due to complete in Q1 2019. One development completed in Q2 2018 at S5 International Quarter E20, around 50,000 sq ft now remains following lettings by the FCA and Unicef at the development.

As further development space is added to supply, and with increasing levels of tenant and second hand space, we expect the under construction development pipeline to remain low for the time being. Indeed, although the planning pipeline is full, we do not expect landlords to commence with certain schemes unless a prelet is secured.

Rental growth

Prime rental levels in Canary Wharf are relatively stable on previous quarters at £42.50 per sq ft with rent free periods also stable at 24 months. With the arrival of Crossrail by year end, we may see more occupiers considering the submarket given its relative rental discount to other markets and its large supply. Separately, Stratford rents are currently stable at £45.00 per sq ft, as are rent free periods at 24 months.

KEY STATS THIS QUARTER

160,000
sq ft let. 50% down on the five-year quarterly average

10.5%
vacancy rate

1.4 million
sq ft under construction

£42.50
per sq ft prime rent

Alasdair Gurry
Director

Midtown

Take-up
Midtown take-up totalled 360,000 sq ft in Q2 2018, a 180% rise on Q1 2018 but only an 11% rise on the 5-year average. The largest deal of the quarter was at 90 High Holborn WC1 where Labtech took 75,298 sq ft. The Trade Desk also took 54,455 sq ft at One Bartholomew Close, EC1 in the sixth largest prelet of the quarter. By grade, take-up was primarily for second hand stock in Q2 with only 28% of take-up from new or refurbished stock, with the rest comprising second hand lettings.

The TMT & Creative sector made up a significant majority of take-up in the quarter at 66%. Indeed, from the top five largest deals of the quarter, four were TMT & Creative deals; the only exception was a serviced office deal at 16 Upper Woburn Place WC1.

Availability
Availability totalled 1.1 million sq ft in Q2 2018, a drop on previous quarters and reflecting a vacancy rate of 2.6%. A 61% majority of availability comprises new and under construction supply.

Nevertheless, 281,000 sq ft of space is currently under offer, of which 68% is new space. This is likely to boost take-up and reduce supply for such space in the future.

Development
The development pipeline in Midtown currently totals 1.5 million sq ft of which 60% is currently prelet, largely due to the letting of the Fleet Building to Goldman Sachs.

Farringdon specifically is likely to see increased levels of development activity with the arrival of Crossrail in late 2018. Two proposed oversite developments, for example, will see the addition of 236,000 sq ft by 2020, likely to meet future levels of interest for space in the Farringdon submarket.

Rental growth
Prime rents in the Holborn submarket stayed stable at £65.00 per sq ft in Q2 2018, in line with Q1 2018 and Q1 2017. Bloomsbury rents are at £80.00 per sq ft for the quarter.

KEY STATS THIS QUARTER

360,000
sq ft let. 11% up on the five-year quarterly average

2.6%
vacancy rate

1.5 million
sq ft under construction

£65.00
per sq ft prime rent

Maxim Vane Percy
Senior Director


GVA advised on the sale of 15 Abchurch Lane, EC2 on behalf of a private investor.

Investment market – in brief

Asian investment dominates
Asian investors are continuing to dominate the market, accounting for 48% of turnover in Q2 2018. Although the variety of geographies is becoming more apparent with increased activity for investors from Singapore, South Korea and Japan, this is challenging Hong Kong's recent dominance in this market. Whilst the two most talked about transactions of the quarter were from China & Hong Kong in Li Ka-shing's acquisition of 5 Broadgate EC2 for £1bn and the Chinese Embassy's acquisition of Royal Mint Court EC3, other significant transactions included Ho Bee Land's acquisition of Ropemaker Place for £650m (Singapore), Mirae Asset's acquisition of 20 Old Bailey EC4 for £341m (South Korea) and Korean Investment Securities' acquisitions of 70 Mark Lane EC3 for £200m.

Buyer or Seller
It is rare to find buyers and sellers from the same region active in the market, but this year it seems to be a reoccurring theme, sometimes with the same investor in the same submarket, as illustrated by South Korean investor Samsung's recent acquisition of 200 Aldersgate EC1 for £320m in Q1 2018 and the launch of a sale of 30 Gresham Street EC2 for £425m in Q2 2018. Korean KFCC are selling £238m Waterside House W2 in Paddington whilst NPS, Mirae and KIS are all buyers in the City. Meanwhile whilst we have seen repeat buyers from Hong Kong this year in Nan Fung and Lion Fund, we are also seeing significant sellers, to include Minsheng, Gingko Tree and HNA. Even UK investors, who continue to be net sellers, are beginning to re-emerge as buyers with M&G, L&G, RDI REIT and Workspace all making significant acquisitions in H1 2018.

Size matters
The sale of 5 Broadgate EC2 is the fourth building to trade for over £1bn in the City, and the third in the last 18 months. The forthcoming sale of Goldman Sachs new European HQ, now reportedly going under offer is set to be the fifth £1bn+ building. Moreover, large transactions continue to dominate the volumes with seven transactions in excess if £250m in Q2 2018, to add to the four we already saw Q1 2018. Collectively, these deals make up around 55% of the total transaction volume for Q2 2018. This is set to increase as the year goes on, with a significant number of 'large investments' currently on the market including Verde SW1 (£500m), 30 Gresham Street EC2 (£425m), 60 London Wall EC2 (£311m), 125 Shaftesbury Avenue WC2 (£286m) and Waterside House W2 (£238m), making up a sizable amount of the £5bn+ currently available to buy in Central London.

Mind the gap
Whilst pricing for core income remains robust, the pricing of core+ and value add stock appears to be slipping, as concerns surrounding the political turbulence and Brexit kick in. Some investors are being forced to withdraw their assets or to adjust their pricing aspirations to achieve a sale. Whilst the yield gap between submarkets is also becoming more apparent, as illustrated by recent 15-20 year income deals in the City (4.00%), Southwark (4.50%) and Stratford (5.00%). In addition, the gap between freeholds and long leaseholds continues to remain apparent and can be as large as 100 bps in some instances, as illustrated by 30 Moorgate EC2 and 23 Austin Friars EC2, situated 250m apart and providing 14-15 years of IWG (Regus) income, yet respectively priced at 4.00% and 5.00%.

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> "Whilst pricing for core assets remains robust, the pricing of core+ and value add stock appears to be slipping"

Investment commentary

Transaction volumes

Transaction volumes totalled £5.8 billion in Q2 2018, an increase of 40% on the 5-year average and the largest volume transacted in the market since Q4 2014. The increase was largely the result of several key deals in the market with deals over £200 million making up 64% of the total transaction volume.

The West End market saw transaction volumes reach £1.5 billion, a 4% rise on Q1 2018 but a fall on the 5-year average of 7%. The largest deal of the quarter was Burlington Arcade W1 which Motcomb Estates acquired for £296.5 million, the only West End deal over £200 million for the quarter.

By submarket, Mayfair performed the best making up 47% of West End investment volumes for the quarter in a total of seven deals. The Soho market also performed well making up 20% of investment volumes in four deals. The largest Soho deal of the quarter was the acquisition of 20 Soho Square W1 by a Private European investor for £117 million.

Domestic investors are increasing their prominence in the market after several quarters of limited levels. This is particularly true in the West End which saw domestic investors make up the majority of purchasers in Q2 at 52%, equating to £754.2 million of investment.

In the City, investment volumes totalled £3.7 billion for Q2, up on the 5-year average by 59% and the highest level in the market since Q4 2013. The largest deal to complete, making up 27% of the City's investment volumes alone, was the purchase of 5 Broadgate EC2 by CK Asset Holdings for £1 billion, reflecting a NIY of 3.95%.

Within the City market, purchaser types were largely limited to Far Eastern investors who accounted for 69% of the quarter's investment volumes. Indeed, from the top six deals of the quarter, five were purchases from Far Eastern investors with other investor types such as Domestic or European investors limited to smaller lot sizes.

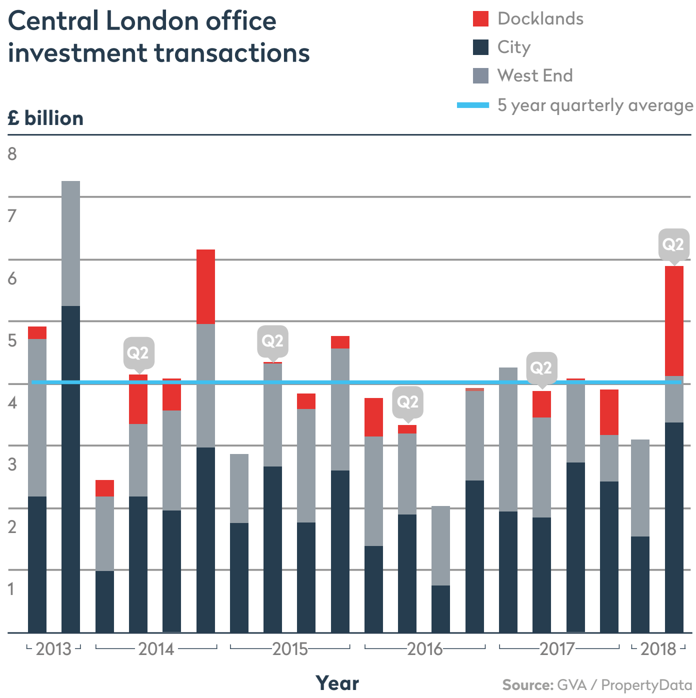
Yields

Yields remained stable across the board in Q2 2018 at 3.50% in the West End and 4.25% in the City.

Largest investment deals of Q2 2018

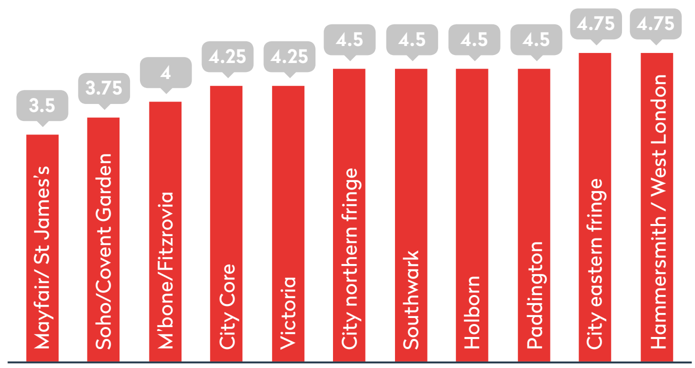
Address	Price (£ million)	Yield (%)	Month	Purchaser
Broadgate, 5	1000	3.95	Jun-18	CK Asset Holdings Ltd
Ropemaker Place	650	4.62	Jun-18	Ho Bee Land Ltd
Old Bailey, 20	341	4.2	May-18	Mirae Asset Daewoo
Charterhouse Street, 17	265	3.94	Jun-18	M&G Secured PIF
Royal Mint Court	255	N/A	May-18	Peoples Republic of China

Central London office investment transactions



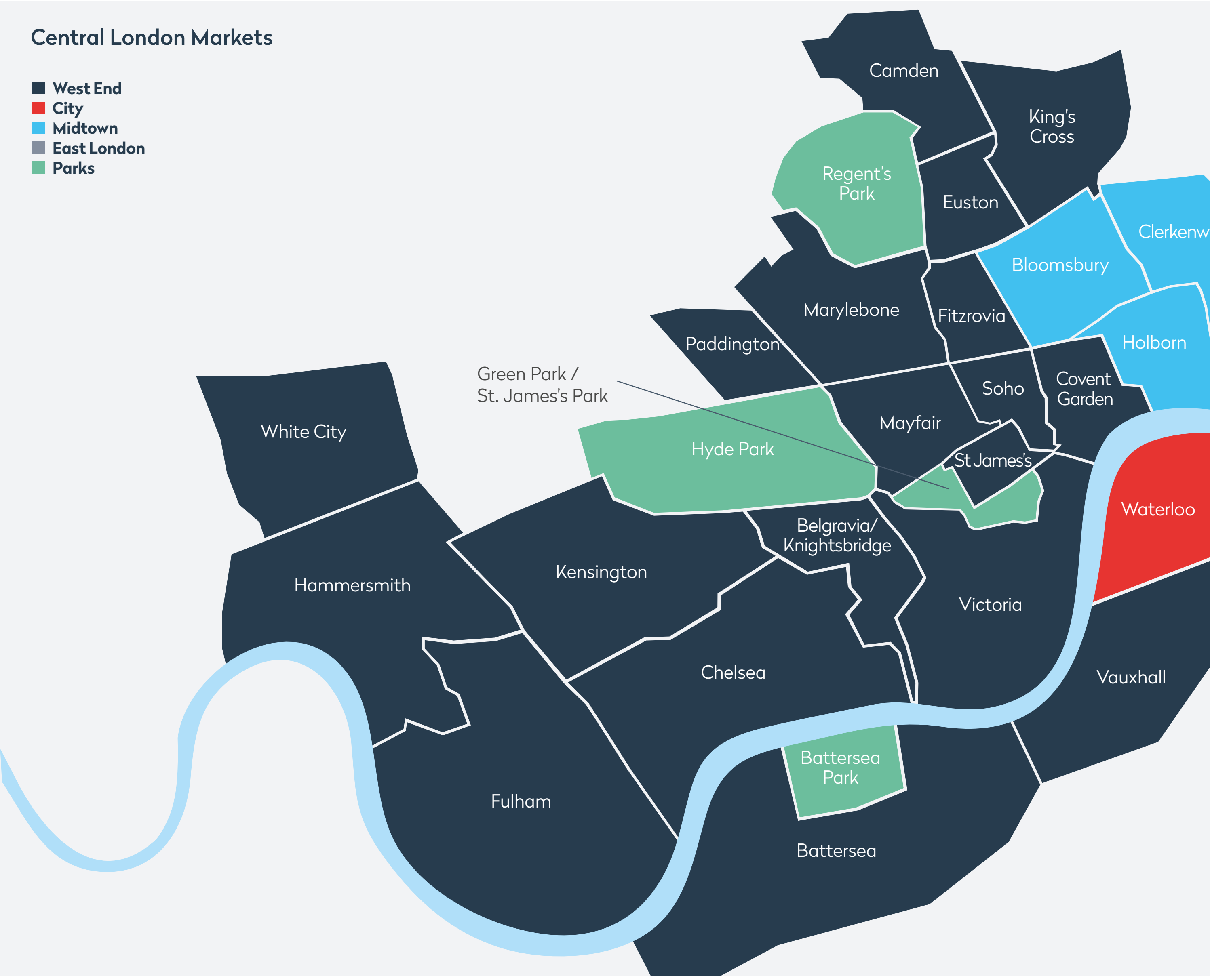
Source: GVA / PropertyData

Central London prime office yields

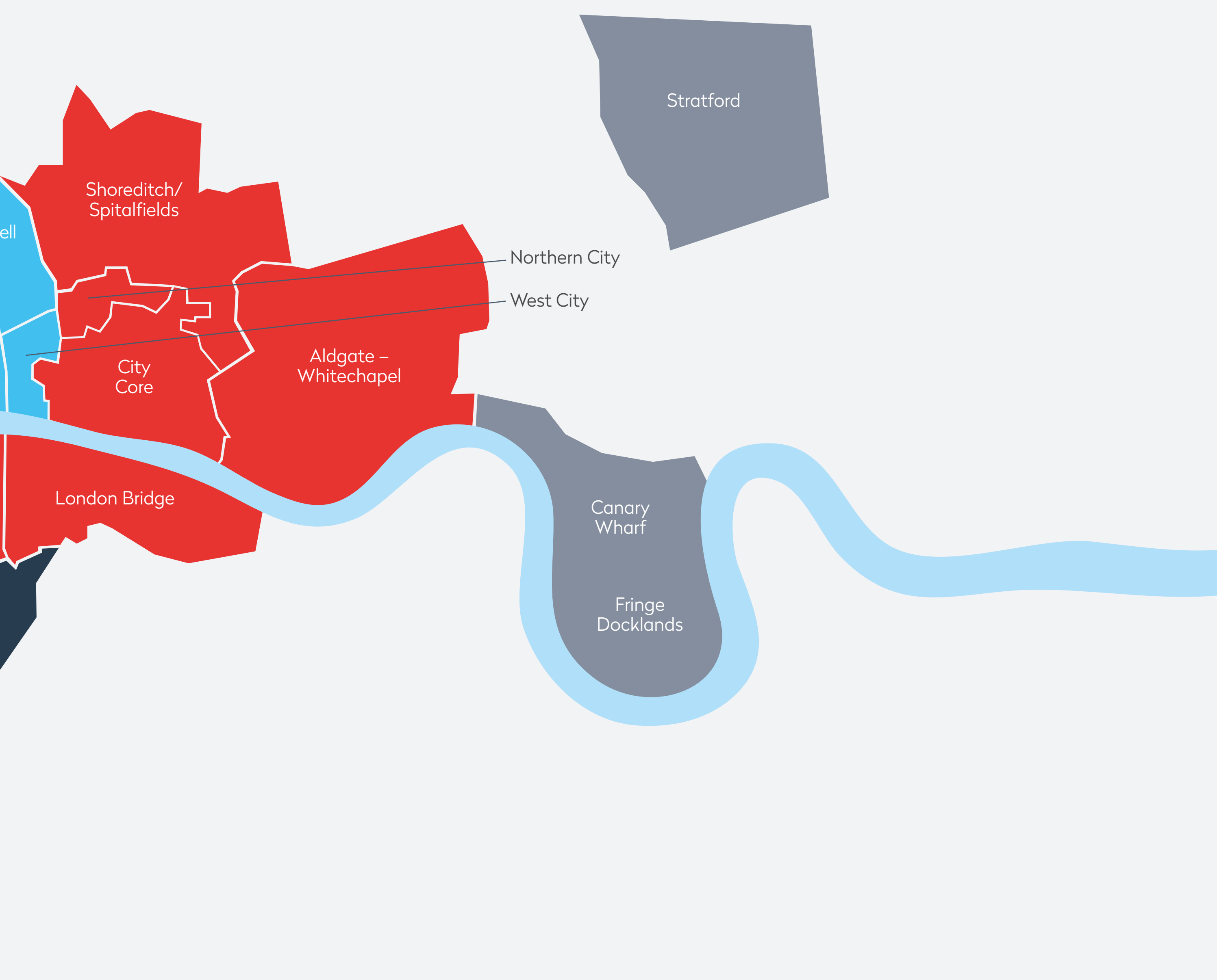


Source: GVA

GVA advised REM on the now fully let Park House W1.



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	£42.50	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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