Research

Central London office analysis

Q2 2016

55 Bishopsgate, London, EC2

Our City Agency team has secured the acquisition of 50,105 sq ft on behalf of Charles Stanley Group plc.

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Central London

Market comment

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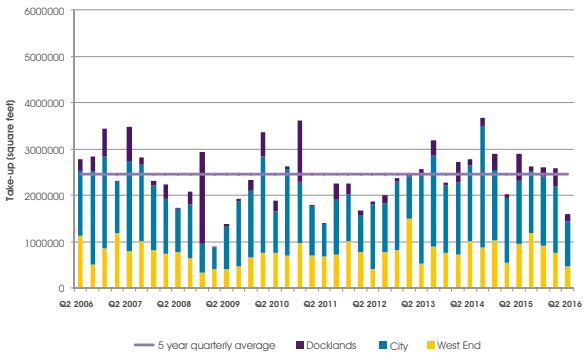
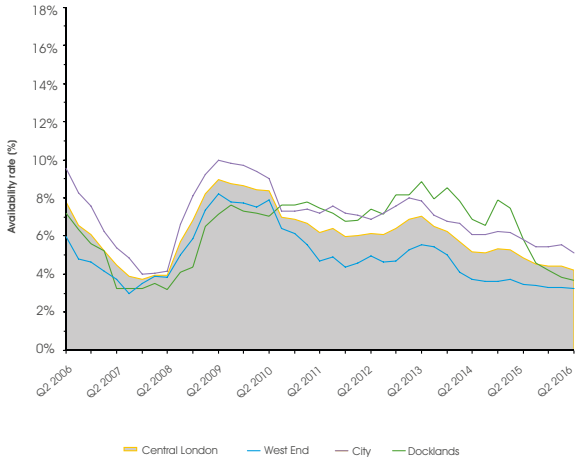
Central London take-up

Source: Bilfinger GVA, EGi, CoStar



Central London office availability rates

Source: Bilfinger GVA, CoStar



Welcome to Bilfinger GVA's central London office analysis; our detailed view of the market in Q2 2016.

The B word

It actually happened! Despite the fact that the EU referendum has cast a shadow over the last year, when the results came through, it seems that nobody actually expected it.

The fallout of the decision to leave the European Union is still to be fully understood but there has clearly been quite a shock wave throughout the whole of the UK and the central London office market.

Deal or no deal

The decision to leave the EU has, if nothing else created uncertainty for many occupiers. In light of this, we believe that there will be very limited expansionary demand and that the majority of requirements will now be 'event driven'. A new cost-effective seam of demand may well appear.

Whilst deals continue to be done and negotiated, the loudest noise seems to be focused on those deals that have been lost such as GAM withdrawing from taking 50,000 sq ft at Nova, and WeWork pulling out of talks to take 45,000 sq ft at 7 Westferry Circus.

In retrospect, we had already seen a few examples of withdrawals and negotiations in the West End prior to Brexit, with the market relatively subdued since Q3 2015. We are likely to see more examples over the next few weeks of deals being renegotiated or suspended. However, having said that, deals completing just after the quarter-end by Wells Fargo at 33 Central, PA Consulting at Verde, and the GPU at 20 Cabot Square show that there are plenty of occupiers for whom Brexit changes very little.

Rental growth… on hold?

Despite the fact that availability remains close to record lows and the short-term development pipeline is muted, a fall in demand is likely to curtail the long period of rental growth we have seen over the last six years.

The rental market had started to slow during the six months prior to the referendum. However, the City saw substantial rental growth over this time period, with prime rents in the core increasing to £70 per sq ft.

A drop off in demand will mean that rents could remain stagnant or fall in the short-term. It is worth noting is that, in the core markets, the types of tenants prepared to pay (and able to afford) top rents are likely to be those most affected by Brexit.

We believe that whilst uncertainty remains, landlords may be willing to offer generous terms to existing tenants rather than take the risk of going to market. In fact, it will be interesting to see who 'breaks first' in terms of landlords changing quoting rents, although we believe there is every chance that tenant disposals will lead the way.

…But London is London

Despite all this, it is important to emphasis the positives. The central London office market has just experienced the longest period of rental growth on record, due to a prolonged period of high activity, with record take-up levels during the cycle. In a cyclical market such as ours, it should be of no surprise that we experience a slowdown.

Whatever the short-term fears about the market it is likely that many of these will be over exaggerated. We should take comfort from the fact that the central London office market remains robust. It will continue to benefit from its excellent infrastructure, talent pool and position in the world markets. For both occupiers and investors alike, our market continues to be as desirable as it ever was.

Patrick O'Keeffe
Head of London Markets

Central London

Occupier market

Take-up

Central London take-up for Q2 2016 totalled just 1.4 million sq ft, 45% down on the previous quarter, and 42% down on the five-year quarterly average of 2.5 million sq ft.

During Q2, activity was focused on the City and West End fringes, accounting for 542,000 sq ft and 422,900 sq ft respectively. All our submarkets were down on their five-year quarterly averages, with Fringe Docklands the best performer, just 3% down.

The largest deal in the City was Amazon agreeing to take 80,000 sq ft of the space it had optioned at Brookfield's Principal Place (EC2). The largest deal in the West End was at 64-66 Wigmore Street (W1) where Schön Klinik took the entire 54,400 sq ft.

Take-up of newly completed space made up 305,200 sq ft (19%) of take-up for the quarter, with pre-letting making up an additional 244,000 sq ft (15%). Second-hand grade A take-up made up 49% of the quarterly total and 776,000 sq ft, with second-hand grade B space a further 19%.

During the quarter, three deals over 50,000 sq ft completed.

Availability

There is currently 8.1 million sq ft available across central London, decreasing from 8.5 million sq ft as of the end of Q1 2016. The vacancy rate is now down to 4.1%, its lowest in the current cycle and as low as it has been since Q2 2008 when the vacancy rate was down at 3.9%.

Availability is 13% down on the corresponding period last year when the vacancy rate was 4.8%, representing a reduction of 1.2 million sq ft in available space over the last 12 months.

Development

During the quarter, 15 buildings totalling 1.7 million sq ft completed. Of these, 6 were refurbishments.

The largest building to complete in the City was Mitsubishi and Stanhope's 160,000 sq ft 8 Finsbury Circus (EC2). In the West End, work completed at Havas' new HQ at 3 Pancras Square (NW1). In Stratford, the 585,000 sq ft Broadcast Centre @ Here East (E20) is now finished.

Five buildings totalling 1.1 million sq ft started during the quarter, following on from 1.1 million sq ft in the previous quarter. The largest start was in the West End where Brockton Capital started work on the 306,000 sq ft Post Building (W1).

There is currently 15.2 million sq ft under construction across central London, with 3.7 million sq ft sq ft (24%) due for completion before the end of 2016 and a further 6.8 million sq ft (44%) due before the end of 2017. Of the space currently under construction, 5 million sq ft (33%) has already been let, leaving 10.5 million sq ft of available space currently under way.

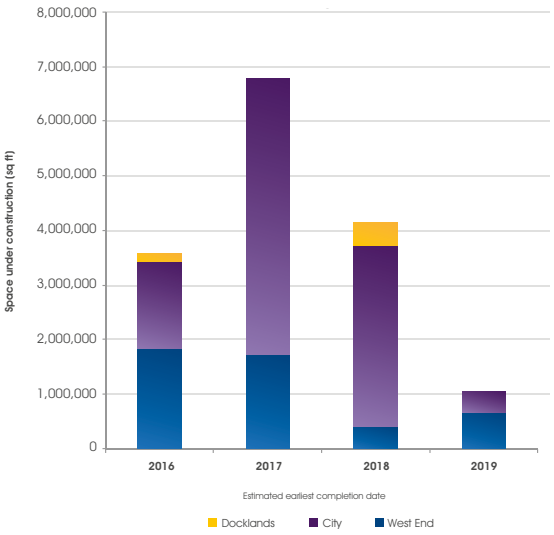
Rental growth

Central London prime rents grew by just 0.1% during the quarter. Q1 2016 saw Docklands and West End rents remain stable whilst our City rental index grew by 0.3%

Prime rents across all central London increased by 4% compared to Q1 2015, the lowest annual growth since Q1 2013. The Bilfinger GVA central London index is now 19% above its previous Q4 2007 peak.

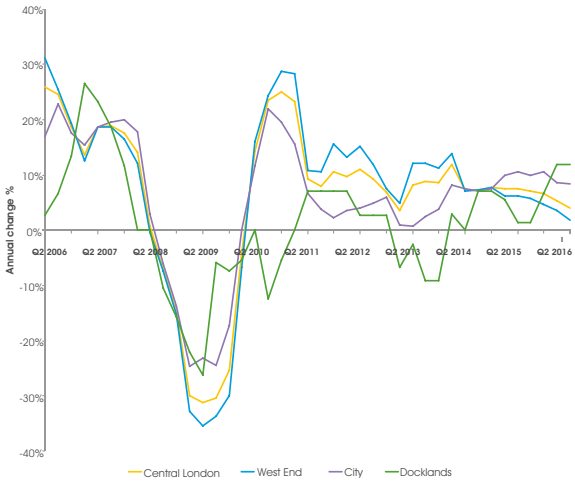
Central London office space under construction

Source: Bilfinger GVA



Central London prime rental growth

Source: Bilfinger GVA



Central London
Investment market

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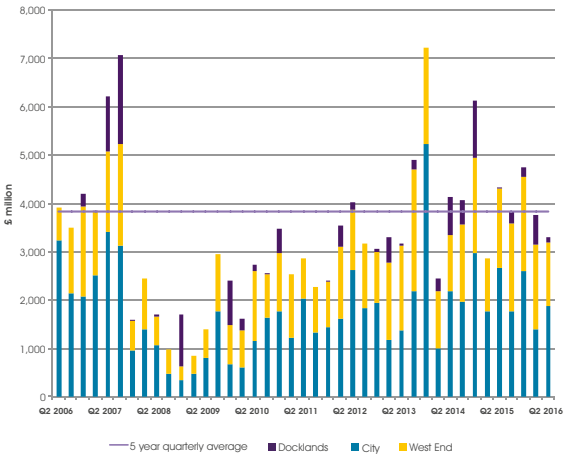
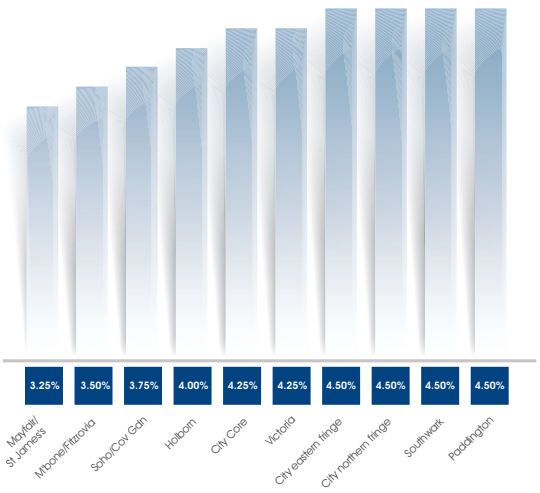
Central London office investment transactions
Source: Bilfinger GVA, PropertyData



Central London office yields
Source: Bilfinger GVA



Overview

Even before Brexit, the London investment market had been slowing due to a perception of the market being overpriced in an environment of slowing rental growth. The 'Leave' vote has since some more positive sentiment. Retail funds, with their 'open' tradeable real estate investments were the first to take the brunt after the more liquid listed real estate stocks. Funds closed and have since reduced their asking prices by up to 17%. We are now in the process of selling assets for those who to wish to redeem.

For anything that is not totally rock solid we expect to see price reductions. In Hammersmith, Aberdeen are selling Hammersmith Grove for what appears to be a discounted £90 million to Brockton Capital, representing a yield of 6%. Speed of execution is increasingly important and we understand Brockton were able to undertake this in 48 hours. At 440 Strand (Coutts HQ) THRE are selling this long income investment for £220 million / 3.75% which will be a barometer of where trophy prime asset prices are.

While the retail funds are keen to sell, there is little evidence that the overseas institutional investors are under the same pressure. Indeed, with the reduction in the value of the pound against the Dollar, the UK may appear more attractive to some buyers. Furthermore, investment fundamentals remain strong. 10 year UK gilts are now yielding 0.75%, compared to 1.25% pre-Brexit and 2.1% at the same time last year. This means that the risk premium against prime London yields are now at their highest since Q2 2012, with prime central London property historically good value.

Overall, sentiment is fragile and it will require some transactional activity from 'seasoned' investors to rebuild confidence. We believe the best transactions will be undertaken by those with existing cash resources and the ability to move very quickly. This window of opportunity is likely to be short-lived. There remains a substantial quantum of high quality investment stock but in general vendors' mood is to extend the marketing to seek buyers at current pricing rather than sell into this current window of uncertainty.

Transaction volumes

During Q2 2016, central London investment totalled £3.3 billion across 48 deals, marking a 12% decrease on the previous quarter, where £3.8 billion was transacted, and a 14% decrease on the five-year quarterly average. Investment was down 23% on the corresponding quarter in 2015.

The West End saw £1.3 billion transacted, 21% down on the corresponding period last year, and 15% down down on the five-year quarterly average. The largest deals of the quarter included Shaftesbury purchasing 20 Grosvenor Street (W1) for £96 million, representing a yield of 3.8% and Sports Direct buying 161 Oxford Street (W1) for £108 million to convert into a flagship Flannels store. Outside the core, Mitsubishi Estates purchased 245 Hammersmith Road (W6) from L&G for £137.5 million.

In the City £1.9 billion was transacted across 24 deals, 35% up on the previous quarter but 8% down on the five-year quarterly average. The largest deal of the quarter was at the new Amazon HQ at Principal Place (EC2) where EPNAM purchased a 50% stake in the development for £382 million. This represents a yield of 4%. The beginning of the quarter saw China Life Insurance and Brookfield acquire the £346 million Aldgate Tower (E1) from Aldgate Tower Investments, backed by Starwood Capital, representing a yield of 4.75%.

This quarter overseas money dominated even more than usual, accounting for £2.7 billion (80% of total investment). UK property companies accounted for £313 million of investment for Q2 2016 (9%), whilst UK institutions were responsible for just 1% of total investment.

During the quarter, there were eight purchases of over £100 million, with five of those in excess of £200 million.

Yields

Q2 2016 saw no yield movement whatsoever. Prime yields in Mayfair and St James's remain at 3.25%, with City core at 4.25%. With the market potentially readjusting post-Brexit, we expect that yields may move out a quarter of a point during Q3, though there is no evidence to support this yet.

Finsgate, 5-7 Cranwood Street, London, EC1

Bilfinger GVA are advising on the sale of this mixed use development opportunity at Old Street roundabout

West End Occupier market

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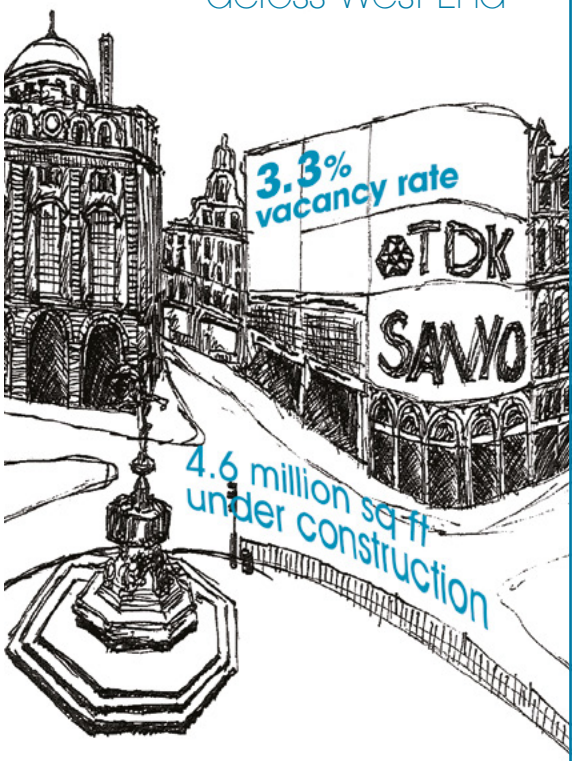
483,800 sq ft let
43% down on 5 year
quarterly average

1.8%
Annual rental growth
across West End



£120 per sq ft
prime rent

Take-up

Take-up during the quarter reached 483,800 sq ft. This was 37% down on the previous quarter and 43% below the five-year quarterly average, and in fact the lowest quarterly take-up since Q2 2012.

The largest deal in the West End was at 64-66 Wigmore Street (W1) where Schön Klinik took the entire 54,400 sq ft, paying £77 per sq ft. At 20 Triton Street, Regent's Place (W1) Dentsu Aegis Network acquired 32,000 sq ft across two floors.

During Q2 2016 deals on pre-let space accounted for 106,600 sq ft and 22% of take-up across the West End. Deals on recently completed space totalled just 135,400 sq ft, and 28% of take-up for the quarter.

Take-up of second-hand grade A space made up 176,400 sq ft of take-up and 36% of activity for the quarter.

Availability

Availability remained at 2.7 million sq ft, with the vacancy rate still at 3.3%. Availability is 12% lower than this time last year, equating to 350,000 sq ft less space.

Vacancy is still at its lowest since Q2 2007, when the rate was 3.0%. There is 9% more available space now than during 2007.

Development

463,000 sq ft completed across the West End during Q2 2016. The largest building to complete was the 160,000 sq ft 3 Pancras Square (NW1) at King's Cross Central. In the core, 1 & 2 St James's Market (W1) have now completed, making up 144,000 sq ft and 67,000 sq ft respectively.

487,000 sq ft went under construction during the quarter, with the largest being Brockton Capital's 306,000 sq ft Post Building (W1). Work also started at the 180,000 sq ft S2 Handyside Street (NW1). As of the end of Q1 2016, there is 4.6 million sq ft of development activity in the West End.

At Tishman Speyer's Verde (SW1), which is due to complete in Q3 2016, PA Consulting are under offer on 58,000 sq ft, meaning that the building is now almost 50% let or under offer.

Rental growth

After 26 quarters of consecutive growth, we have now seen prime rents stable across the West End for the second successive quarter. Prime rents are up 1.8% on the year, which whilst robust, is the weakest annual growth since Q1 2010.

In Mayfair and St James's, prime rents remained stable at £120 per sq ft with rent free periods at 15 months. Net effective rents are now £105 per sq ft, 4% above the peak of the last cycle in 2007. Super-prime rents remain at £150 per sq ft.

None of our submarkets saw growth during the quarter, with the market very much 'waiting to see' on how Brexit affects rental growth in the short-medium term.

The Point, Paddington W2

GVA are jointly instructed to let 47,000 sq ft on behalf of Tishman Speyer.

City Occupier market

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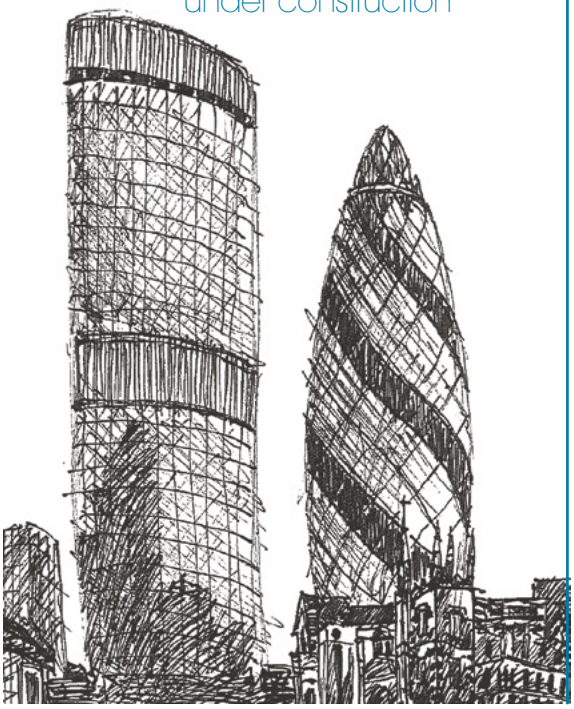
5.1%
vacancy rate

952,000 sq ft
take-up 33% down on the 5-year quarterly average

28% of take-up on new and pre-let space

£70.00
per sq ft prime rents

10.6 million sq ft
under construction



Take-up

Take-up during Q2 2016 was affected by the anticipation of the EU referendum vote and totalled 952,000 sq ft. This was 33% down on the five-year quarterly average and the total measured in Q1 2016.

The largest deal in the City was Amazon agreeing to take 80,000 sq ft of the space it had optioned at Brookfield's Principal Place (EC2). The retailer had already commited to 431,000 sq ft of the 607,000 sq ft scheme. Elsewhere, Bilfinger GVA acquired 50,105 sq ft for Charles Stanley Group at 55 Bishopsgate (EC2), and Instant Managed Offices took 47,100 sq ft across two floors at Beaufort House (EC3) on behalf of Amazon.

US bank Wells Fargo completed on the 225,000 sq ft 33 Central (EC4) from HB Reavis for their own occupation just after the quarter end.

Pre-letting for the quarter made up just 137,400 sq ft, 14% of total take-up, with take-up on new space accounting for 129,700 sq ft (14%). Second-hand Grade A space totalled 481,100 sq ft, and 51%, with second-hand grade B space making up 21% of activity (203,500 sq ft).

Availability

Availability in the City decreased markedly from 5.1 million sq ft to 4.7 million sq ft, with the vacancy rate decreasing to 5.1%. Availability is 12% down on the corresponding period in 2015, equating to 670,000 sq ft less space.

Development

During the quarter 621,200 sq ft completed across seven buildings, with the largest being Mitsubishi and Stanhope's 160,000 sq ft 8 Finsbury Circus (EC2).

Construction started on 656,700 sq ft across three buildings during the quarter including the new 280,000 sq ft 1 Southbank Place (SE1) and Ivanhoe Cambridge's 274,000 sq ft The Minster Building (EC3).

There is now 10.6 million sq ft under construction in the City. Of this 1.9 million sq ft is due to complete in 2016, with 5 million sq ft earmarked for 2017. There is currently 3.3 million sq ft under construction due for completion in 2018.

Rental growth

Prime rents in the City increased by 0.3% during the quarter, which whilst only marginal, was the only market to see overall growth in an otherwise stagnant Q2. This modest growth means that prime rents are now up 8.4% on the corresponding period last year.

Four submarkets saw rental growth during the quarter. In Clerkenwell, prime rents increased by 4% from £65 per sq ft to £67.50 per sq ft. Prime rents increased by 2% in the London Bridge, Waterloo and Northern City submarkets. Over the last year, Aldgate/Whitechapel has seen the most prime rental growth at 15%.

Prime headline rents in the City core remain at £70 per sq ft, with limited evidence of rents being achieved in excess of this. Prime rents are therefore 10% up on the year, with rent free periods stable at 18 months. Net effective rents in the City core remain above the peak of the last cycle at £59.50 per sq ft.

Rent free periods reduced, in two of our submarkets. In Shoreditch, rent free periods came in from 16 to 15 months, and from 18 to 16 months in London Bridge.

Docklands Occupier market

Take-up

11 deals completed during Q2 2016, the most active quarter in the Docklands since Q4 2012. However, whilst the level of activity was high, there were no blockbuster deals and therefore take-up only totalled 158,600 sq ft, 59% down on the previous quarter and 23% down on the five-year quarterly average.

The largest deal to complete during the quarter was at 5 Churchill Place (E14) where Gorkana took 40,000 sq ft across two floors at a rent of £42.50 per sq ft.

At 25 Canada Square (E14), AMEC took the entire 33,000 sq ft 12th floor.

Availability

Available space decreased from 746,000 sq ft to 710,000 sq ft during the quarter, with most of this space available on a sublet basis. The vacancy rate decreased from 3.8% to 3.7% during the quarter, its lowest since Q2 2008.

Recently, KPMG have brought 26,000 sq ft of grade A space to the market at 30 North Colonnade (E14).

In the last year, availability in Docklands has decreased by 37%, a reduction of 420,000 sq ft. Despite this substantial fall, availability is still 15% higher than the trough of the last cycle.

Development

7 Westferry Circus (E14) is currently under refurbishment, due to complete in Q3 2016. Towards the end of the quarter, WeWork pulled out of taking 40,000 sq ft at the development.

Rental growth

In Canary Wharf, prime rents remained stable at £42 per sq ft, with rent free periods at 20 months.

The disparity between asking rents for landlord space and space available on a sub-let from occupiers has reduced markedly over the last nine months. During this time, occupier space has reduced substantially. Unfortunately, with two large EU agencies based in Canary Wharf, it is likely that we could see another increase in sub-letting.

Outside the Wharf, prime rents are at at £38 per sq ft with rent free periods at 21 months, whilst in Stratford indicative prime rents increased from £37.50 per sq ft to £40 per sq ft, with 21 months rent free.

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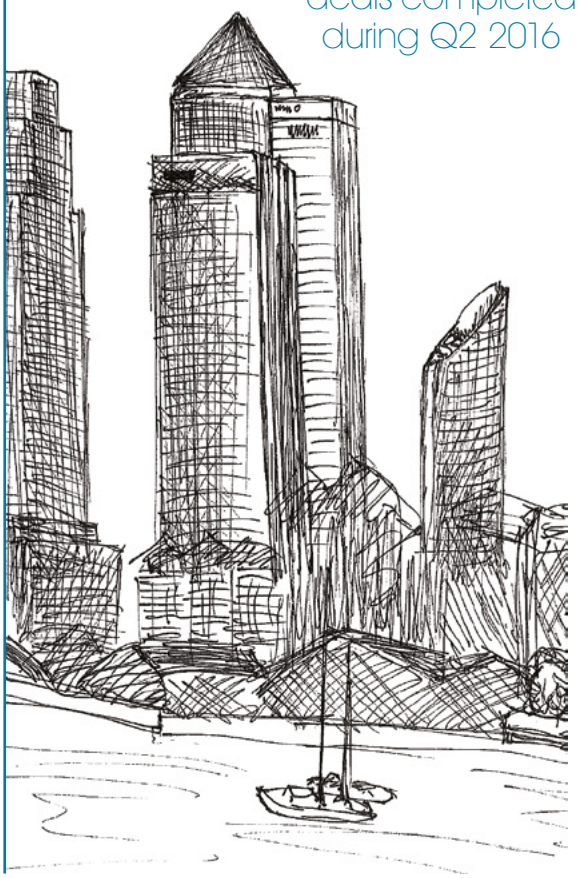
3.7%
vacancy rate

37% decrease in availability
since Q2 2015

158,600 sq ft
take-up in Q2 2016

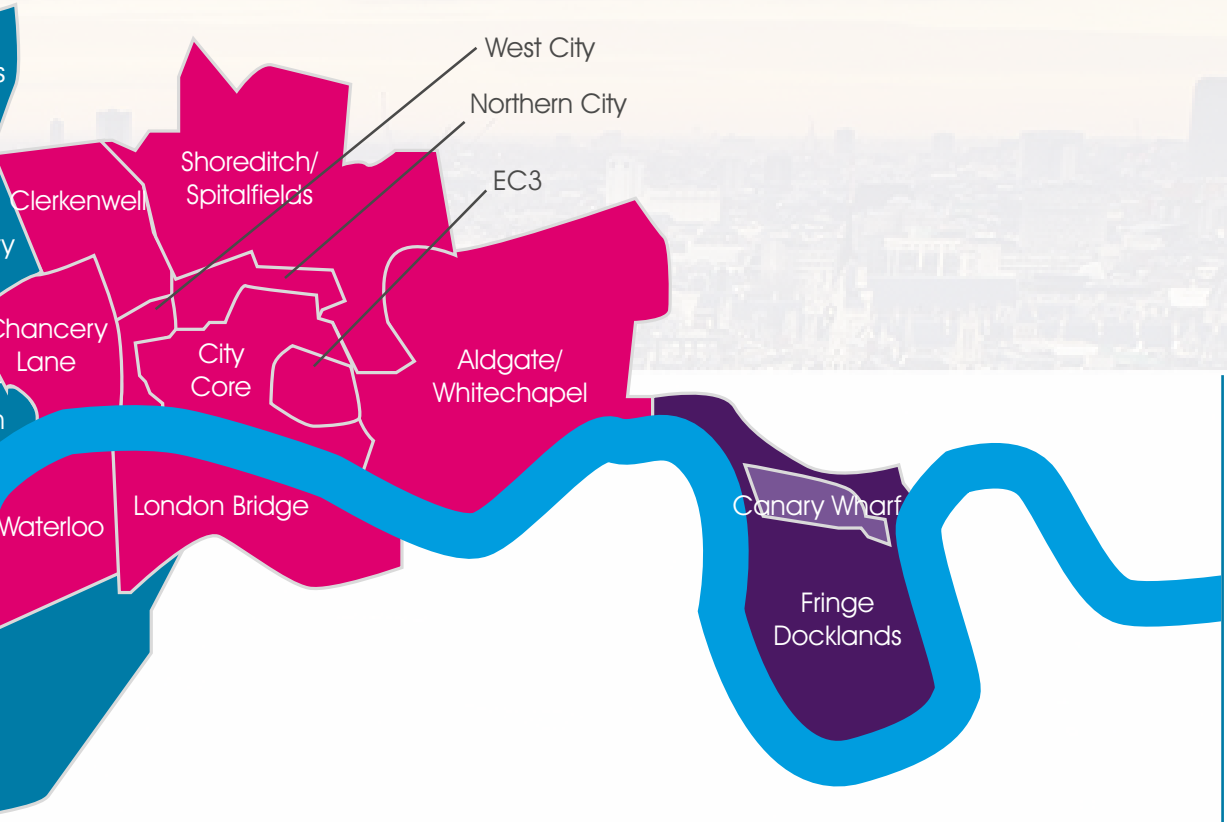
Prime rents
£42 per sq ft

11
deals completed during Q2 2016



West End

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Belgravia / Knightsbridge	£100.00	15	£45.39	£155.64
Bloomsbury	£72.50	17	£25.50	£108.25
Camden	£55.00	18	£17.34	£82.59
Chelsea	£100.00	15	£33.15	£143.40
Covent Garden	£85.00	15	£28.56	£123.81
Euston	£75.00	17	£28.56	£113.81
Fitzrovia	£85.00	16	£26.01	£121.26
Fulham	£45.00	18	£16.32	£71.57
Hammersmith	£56.00	18	£18.87	£85.12
Kensington	£65.00	17	£23.46	£98.71
King's Cross	£82.50	17	£23.46	£116.21
Mayfair	£120.00	15	£46.92	£177.17
Mayfair/St James's "super-prime"	£150.00	15	£52.02	£212.27
North of Oxford St	£97.50	16	£40.80	£148.55
Paddington	£70.00	16	£26.15	£106.40
Soho	£95.00	15	£33.15	£138.40
St James's	£120.00	15	£46.92	£177.17
Vauxhall	£55.00	20	£15.10	£80.35
Victoria	£85.00	17	£30.09	£125.34



City

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Central City Core	£70.00	18	£21.52	£101.77
Chancery Lane / Midtown	£65.00	15	£25.14	£100.39
City Eastern fringe	£57.50	18	£17.24	£84.99
Clerkenwell	£67.50	15	£14.28	£89.53
Insurance Sector	£65.00	18	£22.29	£97.54
London Bridge / More London	£63.50	16	£19.02	£91.77
Northern City	£65.00	18	£17.44	£91.19
Shoreditch	£65.00	15	£11.88	£87.13
Waterloo / Bankside	£63.50	15	£19.02	£91.77
West City	£70.00	18	£19.18	£99.43

Docklands

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Canary Wharf	£42.50	20	£16.17	£68.92
Other Docklands	£38.00	20	£11.63	£56.88
Stratford	£40.00	21	£7.50	£55.25

London
Birmingham
Bristol
Cardiff
Dublin
Edinburgh
Glasgow
Leeds
Liverpool
Manchester
Newcastle

Published by Bilfinger GVA.
65 Gresham Street, London EC2V 7NQ.

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