Research

Central London office analysis

Q3 2015

10 Upper Bank Street, E14

Bilfinger GVA let 388,000 sq ft to Deutsche Bank

Winner of the Docklands Deal of the Year 2015 - CoStar Agency Awards

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Central London

Market comment

Welcome to Bilfinger GVA's central London office analysis; a detailed account of our view of the market in Q3 2015.

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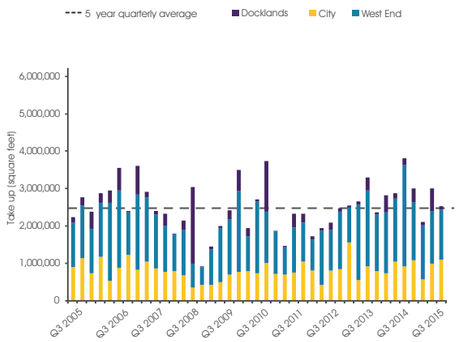
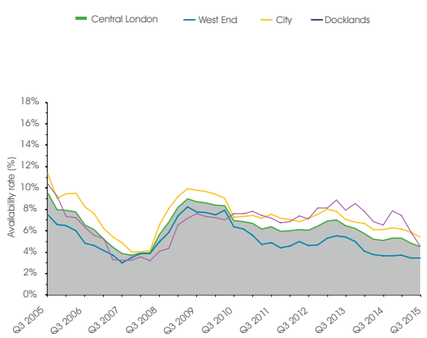
Central London take-up

Source: Bilfinger GVA,EGI



Central London office availability rates

Source: Bilfinger GVA, CoStar



Are you being serviced?

We are in line to see record activity from serviced office providers this year with activity just 9% down on last year's total, despite there being a quarter left of the year. Of the four largest deals in the City this quarter, two were to serviced office providers. The most notable operator being WeWork who have already acquired in excess of 500,000 sq ft in the last 12 months across London.

This increased demand is not only having an effect on take-up but having an upward pressure on prime rents with Executive Offices responsible for setting record rents in the City where they took the entirety of the Sugar Building at a reported rent of £83 per sq ft overall.

Heard it through the pipeline

As of the end of Q3, there was 1.5 million sq ft more space under construction than there had been at the end of Q2 2015. The Insurance sector saw a flurry of activity, with construction starting at 10 Fenchurch Avenue, whilst demolition work is underway on the 'Can of Ham' and 80 Fenchurch Street. There is now 13.4 million sq ft under construction, the highest amount of space in development since the peak of the last cycle, although with a third of this space already let, available space under construction stands at a more palatable 8.9 million sq ft.

However, whilst the development pipeline is healthy, 2015's supply of new buildings has been and gone. Of the 4.1 million sq ft that we expect to have been delivered to the market by the end of the year, only a quarter of that is currently available, with that expected to decrease even further during the final quarter of the year.

The area that has seen the most change in the recent past is King's Cross where, of the 3 million sq ft of office development planned, just 800,000 sq ft remains, due to come forward over the next few years. Pancras Square, the first stage of the office development is now fully let, following Universal's pre-let deal this quarter.

A strong end to the year?

Activity in the last quarter of the year should be healthy, with plenty of high profile deals still yet to complete. The largest of these is in the Docklands where Thomson Reuters are under offer on 330,000 sq ft at 5 Canada Square.

In the City, Royal Bank of Canada remain under offer on 250,000 sq ft at Brookfield's 100 Bishopsgate, with Bouygues in the same position on 150,000 sq ft at Becket House on the Southbank whilst Aecom are rumoured to be taking 130,000 sq ft at the Whitechapel Building.

In Victoria, the remaining 80,000 sq ft at 62 Buckingham Gate is now under offer to a host of tenants. With Pret A Manger and Oaktree at Verde and Deutsche Asset and Wealth Management at the Zigzag building, we are likely see a further 180,000 sq ft of lettings in the area. Deutsche's move is part of a consolidation process across central London.

Patrick O'Keeffe

Central London

Occupier market

Take-up

Central London take-up for Q3 2015 totalled 2.6 million sq ft, 10% down on the previous quarter, but 6% above the five-year quarterly average of 2.5 million sq ft. With some key deals still under offer, we expect the final quarter of the year to see plenty of activity.

Take-up for the first three quarters of 2015 totalled 7.6 million sq ft which, whilst 18% down on the corresponding period in 2014, is just marginally down on the annual figures recorded in 2011 and 2012, with a quarter left to go.

During Q3, activity was mainly in the City and West End fringes, accounting for 817,800 sq ft and 720,700 sq ft respectively. These areas were the only submarkets to see above average take-up, with City fringe 19% up on its five-year quarterly average, and West End fringe the star performer, 60% above its quarterly average.

The largest deal of the quarter was done by Ashurst who took the entire 275,000 sq ft at M&G Real Estate's Fruit & Wool Exchange (E1), due to complete in 2018. At 1 Rathbone Square (W1), Great Portland Estates secured a 220,000 sq ft pre-let from Facebook who have in the recent past also completed deals of 50,000 sq ft at 338 Euston Road (NW1) and, earlier on in the year, 60,000 sq ft at 1-2 Stephen Street (W1) (serviced offices).

The majority of take-up during the quarter was on new and future stock. Pre-letting accounted for 896,000 sq ft (35%) of lettings during the quarter, with deals on newly completed space an extra 805,600 sq ft (31%). We have now seen 1.7 million sq ft of pre-letting activity so far in 2015, 42% down on the corresponding period in 2014 when 3 million sq ft had been let by this time last year.

During the quarter, six deals completed over 50,000 sq ft, three of which were over 100,000 sq ft.

Availability

During Q3 2015, availability across central London decreased from 9.3 million sq ft to 8.7 million sq ft.

The vacancy rate therefore reduces to 4.5%, its lowest since Q2 2008 when the vacancy rate was down at 3.9%.

Availability is 12% down on the corresponding period last year when the vacancy rate was 5.1%, representing a reduction of 1.2 million sq ft in available space.

Development

During the quarter, 11 buildings totalling 881,241 sq ft of development completed. Of this only 264,439 sq ft (30%) is still available.

Four buildings over 100,000 sq ft completed during the quarter including Resolution Property's 218,000 sq ft Alphabeta Building (EC2), which was then sold to Sinarmas Land and Land Securities' 191,000 sq ft ZigZag Building, where the Wealth Management arm of Deutsche Bank went under offer on 90,000 sq ft during the quarter.

1.9 million sq ft of development started during the quarter, following on from 2 million sq ft in the previous quarter. Three of the four largest starts were in EC3 where Generali started on the 420,000 sq ft 10 Fenchurch Avenue (EC3). TIAA-Henderson began work on its 326,000 sq ft 'Can of Ham' (EC3) and Partners Group with Marick Real Estate began work on 80 Fenchurch Street (EC3). In the West End, work is now underway at Derwent London's 80 Charlotte Street (W1).

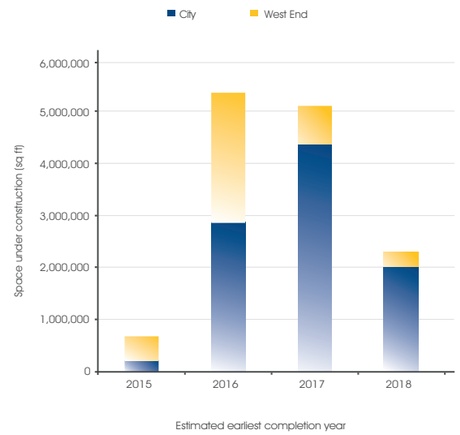
There is currently 13.4 million sq ft under construction across central London, with 599,926 sq ft (4%) due for completion before the end of 2015 and 5.4 million sq ft (40%) due before the end of 2016. Of the space currently under construction, 4.5 million sq ft (34%) has already been let, leaving 8.9 million sq ft of available space currently under construction.

Rental growth

Central London prime rents grew by 1.6% during the quarter. The City and the West End grew by 2.3% and 1.3% respectively, while Docklands remained stable. Prime rents across all central London increased by 7.1% compared to Q3 2014. The Bilfinger GVA Central London index is now 16% above its previous Q4 2007 peak.

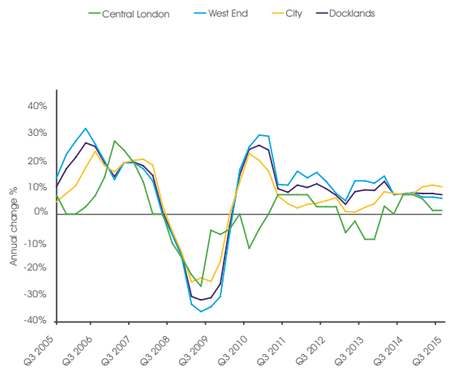
Central London office space under construction

Source: Bilfinger GVA



Central London prime rental growth

Source: Bilfinger GVA



Central London
Investment market

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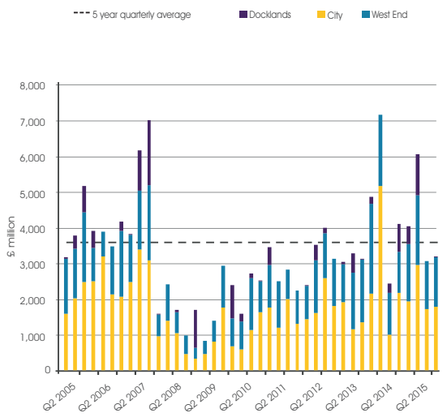
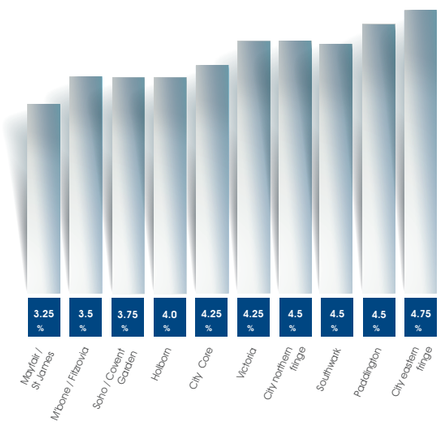
Central London office investment transactions
Source: Bilfinger GVA, PropertyData



Central London office yields
Source: Bilfinger GVA



Overview

For a change our market has plenty of stock! There are assets of all lot sizes and across all categories including dry institutional (60 Great Portland Street), value add institutional (Tower House, Southampton Street), refurbishment/change of use (50 Bedford Street) and prime retail (Standbrook House, Old Bond Street). In the City fringes during the quarter, Starwood Capital put Aldgate Tower up for sale for £350 million, with the proceeds likely to be ploughed into the redevelopment of the nearby Beagle House.

Whilst demand remains robust, pricing is becoming more and more ambitious based on already high rents and prospects for further rental growth. Whether this pricing is sustainable remains to be seen. There is definitely an underlying feeling within the market that with more opportunities to choose from, perhaps investors will resist competing for some assets and we may even see properties unsold before the end of the year. Having said that, quality assets in prime locations will continue to attract strong interest and there still seem to be numerous 'trophy' hunters who still regard London as relatively good value for money and more importantly, as a 'safe haven'.

After such a long period of good news for investors, some are questioning how much rental growth and yield compression we are likely to see. With the likes of Derwent London and GPE selling core assets, this adds fuel to the argument that some are calling the top of the market. Of course others are arguing that this is a sensible ploy by property companies with large development programmes to raise cash by selling developed stock in a hot investment market. We expect institutional buyers to compete only on assets that have true value add prospects and probably not in the core areas where overseas buyers are expected to dominate.

It is early days in the final quarter of 2015 but with plenty of stock and plenty of buyers, it looks to be a pretty active market. A little price correction in some of the 'core plus' assets will attract more opportunists and will not be bad for the market. By the end of the year we will see either a bit of common sense prevail or it will be 'business as usual'.

Transaction volumes

During Q3 2015, central London investment totalled £2.8 billion across 45 deals, marking a 14% decrease on the previous quarter and a 23% decrease on the five-year quarterly average. Activity for the first three quarters of 2015 totalled £9.1 billion, 15% down on the corresponding period in 2014 when £10.7 billion was transacted.

The West End saw £1.1 billion transacted, 29% down on the same period last year. The largest deal was British Land's sale of 39 Victoria Street (SW1) to Singaporean property company Ho Bee Land for a price of £144 million, representing a yield of 3.9%. In the core, a client of Citi Private Bank purchased 20-21 St James's Square (SW1) from Pembroke Real Estate for £120 million.

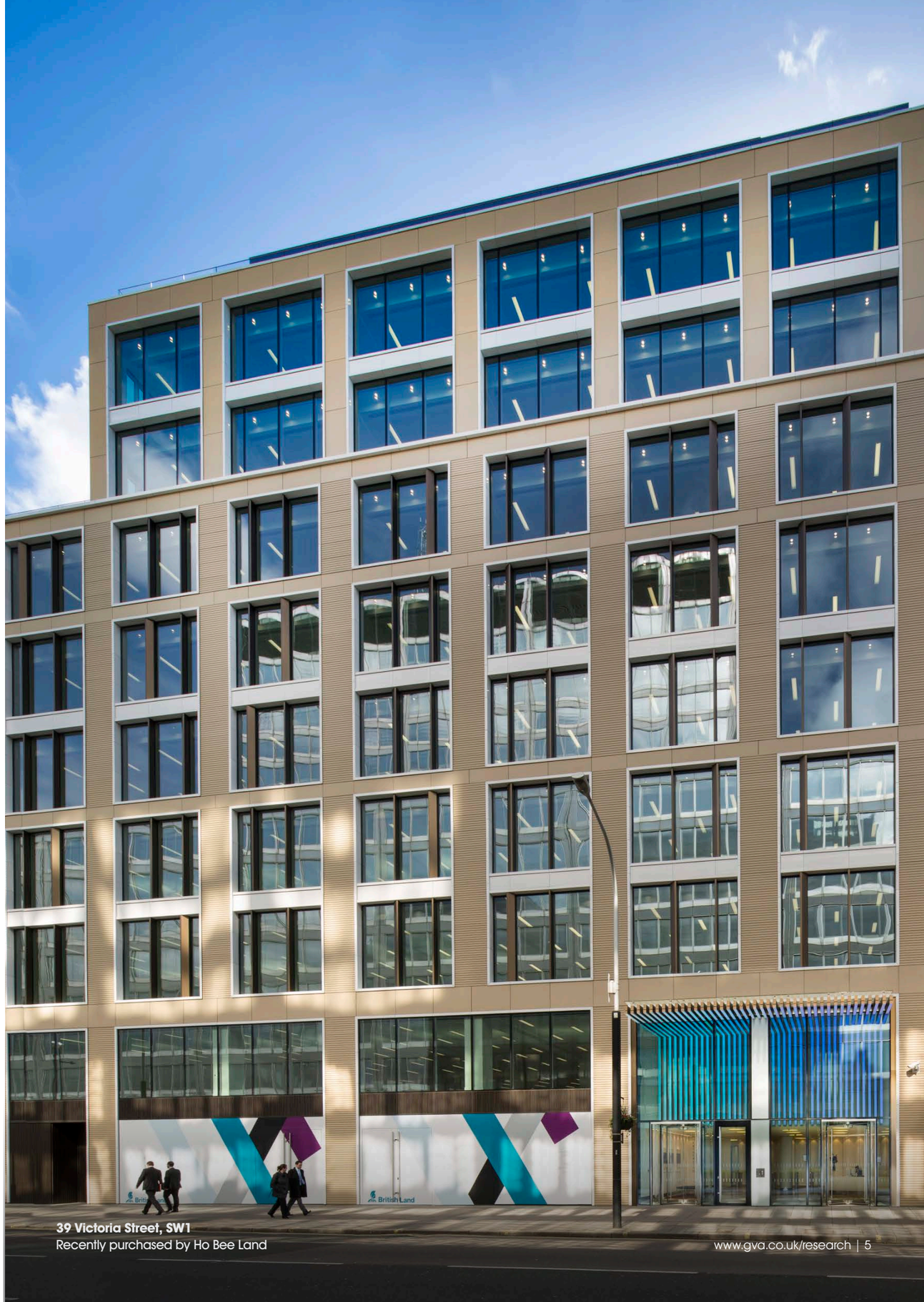
In the City £1.6 billion was transacted across 22 deals, an 18% decrease in value compared to the same time last year. The largest deal of the quarter was Sinarmas Land's acquisition of the Alphabeta building, Finsbury Square (EC2) from Resolution Property for £280 million, representing a yield of 4%. Blackstone completed their £268 million purchase of Times Square (EC4) from Land Securities during the quarter, whilst Derwent London purchased the freehold of Aldgate Union (E1) for £132 million from RBS.

Overseas investors were once again the most active this quarter, accounting for 64% (£1.8 billion) of purchases but only 27% of sales (£741 million) across central London. Far Eastern and North American investors made up 20% of the market each with the Middle East accounting for an additional 13%. UK property companies and UK institutional investors each made up 16% of the market.

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

Yields

After seven quarters of yield compression, Q3 2015 signifies the first quarter that we have seen no yield movement in any of our subareas since Q3 2013. This is not a great surprise as yields came in by between 50 and 100 basis points in all subareas during the previous year, with prime yields in Mayfair and St James's now at 3.25% and at 4.25% in the City core. Having said that, we believe that there continues to be downward pressure on yields and there could be further movement in Q4.



39 Victoria Street, SW1
Recently purchased by Ho Bee Land

West End Occupier market

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1.2 million sq ft let
41% up on 5-year
quarterly average

£150 per sq ft
"super-prime" rent

5.8%
Annual rental growth
across West End

Take-up

Q3 2015 was the busiest quarter since Q1 2013, as take-up across the West End totalled 1.2 million sq ft, a 24% increase on Q2 2015 and 41% above the five year quarterly average. Take-up for the first three quarters of 2015 totalled 2.7 million sq ft, 3% up on the corresponding period in 2014.

At 1 Rathbone Square (W1), Great Portland Estates secured the largest deal of the quarter with Facebook agreeing to take 220,000 sq ft on a pre-let. Facebook also completed a deal of 50,000 sq ft at 338 Euston Square (NW1) and 60,000 sq ft at 1-2 Stephen Street (W1) earlier in the year. At King's Cross, Universal Music has pre-let the entire 177,000 sq ft 4 Pancras Square (N1), due for completion in mid-2017.

Victoria is seeing plenty of activity with the Wealth Management arm of Deutsche Bank going under offer on 90,000 sq ft at Land Securities' ZigZag. At TS's Verde (SW1) a further 90,000 sq ft is under offer to Oaktree (60,000 sq ft) and Pret A Manger (30,000 sq ft). In the core, the super-prime end of the market continues to see activity with Point 72 Asset Management taking the 7,000 sq ft first floor at 8 St James's Square (SW1) at a rent of £147.50 per sq ft.

TMT and financial was the most active sector in the West End, accounting for 46% of take-up during the quarter. Professional services and Financial and Business services made up 13% and 12% respectively.

During Q3 2015 deals on pre-let space accounted for 411,700 sq ft and 35% of take-up across the West End. Deals on recently completed space made up a further 358,300 sq ft, and 30% of take-up for the quarter.

In total, lettings of new space made up 65% of take-up, with second-hand deals accounting for 35% of space let.

Availability

Availability remained relatively static during the quarter at 2.8 million sq ft, with the vacancy rate coming down slightly from 3.5% to 3.4%. Vacancy is now at its lowest since Q2 2007, when it was at 3.0%. There is 13% more available space now than during 2007.

Development

264,439 sq ft completed across the West End during Q3 2015. The largest building to complete was the refurbishment of 120,000 sq ft at Rowen Asset Management and GI Partners' Aldwych House (WC2). Work on the Royal College of Practitioners' new 108,000 sq ft HQ at Euston XChange (NW1) also finished during the quarter.

358,500 sq ft went under construction during the quarter across two buildings, with 321,000 sq ft of this being accounted for by Derwent London's 80 Charlotte Street (W1). In the core, work began on The Pollen Estate's Clarebell House (W1). As of the end of Q3 2015, there is 3.9 million sq ft of development activity in the West End, with the busiest submarket being Victoria.

Rental growth

During the quarter, prime rents across the West End increased slightly by 1.6%. This means that prime rents across the market are up 5.8% on the same period last year. 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, with evidence of these levels continuing to be seen at 8 St James's Square (SW1).

The big mover during the quarter was Soho where prime rents increased by 5.6% to £95 per sq ft. Belgravia/Knightsbridge, Chelsea, Camden and Vauxhall all saw rental growth of c.5% during the quarter. Camden, Bloomsbury and Chelsea have seen the most rental growth in the last 12 months.

Docklands Occupier market

Take-up

Eight deals completed in Docklands during Q3 2015 totalling 97,200 sq ft, 84% down on the previous quarter and 59% down on the five-year quarterly average. This means that take-up for the first three quarters of the year totalled 768,500 sq ft, in line with the same period last year when 759,000 sq ft was transacted.

Despite the relatively quiet quarter, activity in the final quarter should see a marked increase with Thomson Reuters under offer on 330,000 sq ft at 5 Canada Square. Ofcom are rumoured to be taking 90,000 sq ft and Citigroup are still in the process of sub-letting some of their space at 25 Canada Square.

The busiest sector in the Docklands was public services which made up 58% of activity during the quarter, with Financial and Business Services responsible for 36%.

Activity in the last quarter of the year should be healthy, with a number of large occupiers rumoured to be looking at Canary Wharf.

Availability

Available space decreased from 1.1 million sq ft to 0.9 million sq ft during the quarter, with 60% of this space available from occupiers. The vacancy rate decreased to 4.6% during the quarter, its lowest since Q4 2008.

Development

Whilst construction is yet to start in Docklands, there is plenty of preparation work being done at Wood Wharf (E14), as well as the earmarked 1 Bank Street (E14), which is yet to start as work continues on land reclamation around the site. Similarly at 1 Park Place (E14), work is yet to start, although the site remains cleared.

During the quarter, JP Morgan shelved plans to sell its Riverside South development site, which was down to a shortlist of three interested parties and expected to fetch close to £400 million. The area had originally been earmarked for a 1.9 million sq ft European HQ for the bank.

Rental growth

In Canary Wharf, prime rents remained stable during the quarter at £38 per sq ft, with rent free periods coming in from 24 months to 21 months. There continues to be a wide disparity in asking rents between landlord space and space available on a sub-let from occupiers, and we believe that once the remaining occupier space lets, prime rents will increase sharply. Outside the Wharf, rents stayed stable at £31 per sq ft with rent free periods decreasing from 24 months to 21 months.

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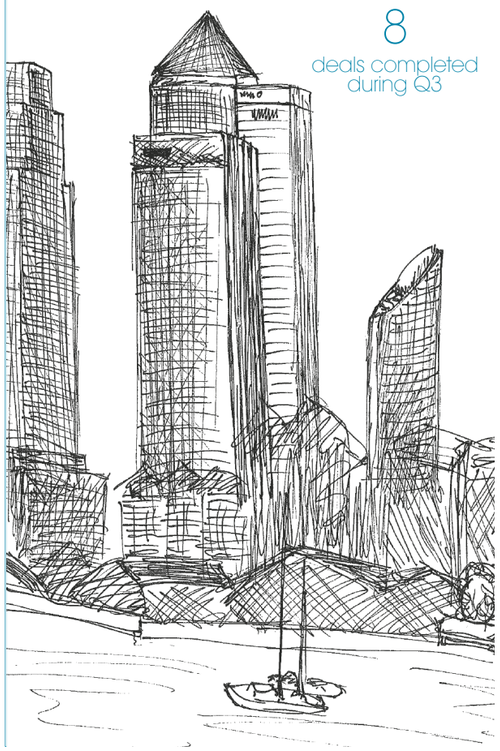
768,500 sq ft let
so far this year

58%
of activity by
public services

4.6%
vacancy rate

Prime rents
£38.00 per sq ft

8
deals completed
during Q3



City Occupier market

Take-up

Activity in the City so far this year has been very consistent. Take-up for the first three quarters of the year reads Q1 – 1.4 million sq ft; Q2 – 1.3 million sq ft and; Q3 – 1.3 million sq ft. Take-up for Q3 was 4% down on the five-year quarterly average.

So far this year, we have seen 4.1 million transact, 30% down on the corresponding period in 2014, but already 3% higher than the annual take-up for 2011, with a quarter of the year still left to play out.

The largest deal of the quarter was by Ashurst who took the entire 275,000 sq ft at M&G Real Estate's Fruit & Wool Exchange (E1), due to complete in 2018. Of the four largest deals completed during the quarter, two were to serviced office providers. The Office Group paid £57.50 per sq ft for 41,300 sq ft at White Collar Factory (E1) on a 20 year lease. London Executive Offices took 40,126 sq ft at 5 Cheapside (EC2) on a 15 year lease at a rent of £83 per sq ft. Elsewhere, NESTA bought the 46,500 sq ft 58 Victoria Embankment (EC4) from FORE and Kier for its own occupation.

This quarter, pre-letting made up 484,300 sq ft, 36% of total activity, a marked increase on the quarter before where pre-letting accounted for just 137,100 sq ft and 10% of take-up. So far this year, we have seen 1 million sq ft of pre-letting, accounting for 25% of take-up. In comparison, by this point last year, we had seen 2.1 million sq ft of pre-letting.

During the quarter take-up of newly completed space totalled 447,200 sq ft, making up 34% of activity. Second-hand grade A space totalled 301,200 sq ft, 23% of take-up, with second-hand grade B space responsible for just 7% (94,500 sq ft) of activity.

Professional services was the most active sector accounting for 43% of take-up, with the Finance and Banking sector and TMT making up 10% of take-up each.

Availability

Availability in the City decreased from 5.4 million sq ft to 5 million sq ft, with the vacancy rate now at 5.4%. Availability is 11% down on the corresponding period in 2014 and at its lowest since Q2 2008.

Development

During the quarter, the amount of space under construction in the City increased by 1.5 million sq ft to 9.5 million sq ft. Of this 9.5 million sq ft, only 121,768 sq ft is due to complete by the end of this year. There is currently 2.4 million sq ft of space under construction, due for completion in 2016.

During the quarter there was 457,904 sq ft of completions across five buildings, with the largest being Resolution Property's development of 218,000 sq ft Alphabeta Building (EC2). Helical Bar saw two of its developments complete, with the 123,000 sq ft The Warehouse (The Bower) (EC1) and 62,000 sq ft C Space (EC1) both completing during the quarter.

In EC3 Generali started construction on the 420,000 sq ft 10 Fenchurch Avenue (EC3) whilst TIAA-Henderson began preparing its 326,000 sq ft 'Can of Ham' (EC3) site and Partners Group began working with Marick Real Estate on the demolition of 80 Fenchurch Street (EC3), due for completion in Q1 2018. EC1 saw work begin on Allied London and Aerium's Herbal House (EC1).

One of the longest running development sagas in the City also saw movement during the quarter, with the City of London being authorised to buy Smithfield Market from AimCo and TH Real Estate for in the region of £35 million, with the view being to house the new Museum of London.

Rental growth

Prime rents in the City increased marginally by 2.3%, with prime rents up 9.8% on the corresponding period in 2014.

The City eastern fringe saw the biggest change during the quarter, increasing 10% to £55 per sq ft. Prime rents in the area are now 22% up on the same time last year. Core City headline rents increased 2.4% to £65 per sq ft, matching the peak of the last cycle. Despite rent free periods coming in slightly during the quarter to 20 months, net effective rents are still 7.4% down on the peak.

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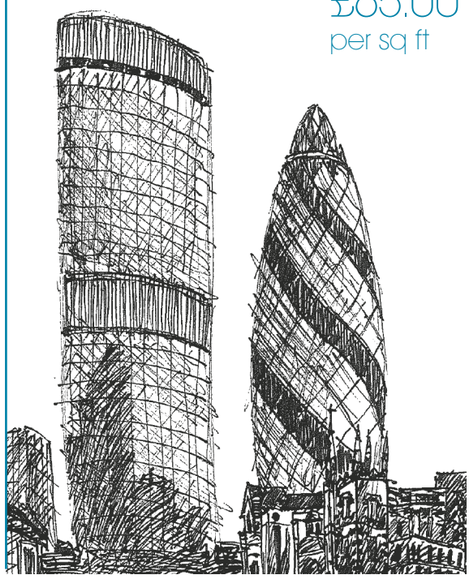
1.3 million sq ft take-up
4% down on the five-year quarterly average

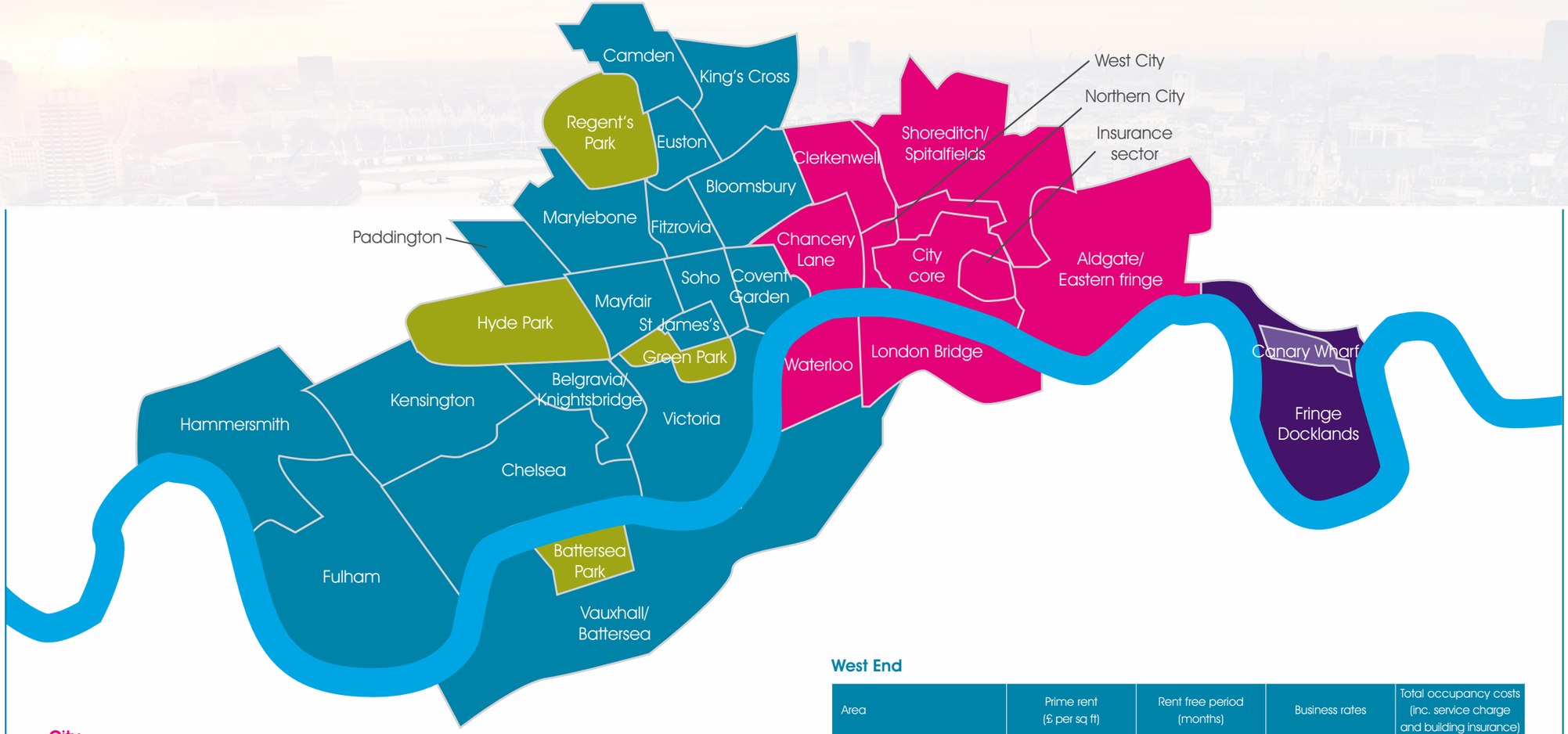
1.5 million sq ft
more under construction, compared to Q2 2015

9.5 million sq ft
under construction

Vacancy rate 5.4%
lowest since Q2 2008

Prime rents
£65.00
per sq ft





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	£65.00	20	£21.52	£96.77
Chancery Lane	£62.50	15	£25.14	£97.89
City Eastern fringe	£55.00	21	£17.24	£82.49
Clerkenwell	£65.00	15	£14.28	£89.53
Insurance Sector	£60.00	22	£22.29	£92.54
London Bridge	£57.50	23	£19.02	£86.77
Northern City	£63.50	22	£17.44	£91.19
Shoreditch	£62.50	18	£11.88	£84.63
Waterloo	£57.50	18	£19.02	£86.77
West City	£65.00	20	£19.18	£94.43

Docklands

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Canary Wharf	£38.00	21	£16.17	£64.42
Docklands fringe	£31.00	21	£11.63	£52.88

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	17	£45.39	£155.64
Bloomsbury	£72.50	17	£25.50	£108.25
Camden	£55.00	18	£17.34	£82.59
Chelsea	£100.00	17	£33.15	£143.40
Covent Garden	£85.00	17	£28.56	£123.81
Euston	£75.00	18	£28.56	£113.81
Fitzrovia	£85.00	18	£26.01	£121.26
Fulham	£42.50	18	£16.32	£69.07
Hammersmith	£51.00	19	£18.87	£80.12
Kensington	£62.50	17	£23.46	£96.21
King's Cross	£80.00	17	£23.46	£113.71
Mayfair	£120.00	15	£46.92	£177.17
Mayfair "super-prime"	£152.00	15	£52.02	£214.27
North of Oxford St	£97.50	16	£40.80	£148.55
Paddington	£65.00	17	£26.15	£101.40
Soho	£95.00	17	£33.15	£138.40
St James's	£120.00	15	£46.92	£177.17
Vauxhall	£50.00	20	£15.10	£75.35
Victoria	£82.50	17	£30.09	£122.84

London
Birmingham
Bristol
Cardiff
Dublin
Edinburgh
Glasgow
Leeds
Liverpool
Manchester
Newcastle

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