Central London Office Market Report

Highest level of under offers in a decade

Q1 2018

Central London overview

Base rates likely to remain unchanged after disappointing Q1 GDP figures

The first estimate of UK GDP growth for Q1 2018 stood at just 0.1%, reflecting the impact of the 'Beast from the East', the very cold weather seen in February and March, particularly on the construction sector. Nevertheless, business sentiment remains robust and employment continues to rise strongly – although the retail sector continues to face strong headwinds. However, the deterioration in some economic indicators over the past month suggests that the Bank of England will now delay the timing of a rate rise beyond the Monetary Policy Committee meeting in May.

Some progress has been made in the Brexit process with the UK and EU agreeing terms on a transition deal which will keep existing trading arrangements in place until the end of 2020. In her latest Brexit speech, the Prime Minister acknowledged that there will be trade-offs in areas such as trade barriers, particularly in relation to the UK's choice to be outside of the single market and not form custom unions. There remains little detail on the end state of the ongoing negotiations.

Pre-leasing driving take-up

Take-up reached 2.4 million sq ft in Q1, lower than the quarterly average but ahead of both the equivalent period in 2017 and the 10 year average for the first quarter, which is typically slower. The West End was the strongest performing market, with take-up reaching 932,000 sq ft, the strongest Q1 for three years. City leasing volumes were robust at 1.3 million sq ft, marginally ahead of the equivalent period in 2017. East London recorded below average take-up, owing to the absence of any large transactions and reached only 215,000 sq ft.

Pre-leasing was a major feature of the market, accounting for nearly a third of quarterly take-up. This will remain a feature of the market throughout the year with 45% of the 3.5 million sq ft currently under offer representing interest in pre-let stock.

Jon Neale
Head of UK Research

Vacancy falls in both City and West End

Supply across London fell by 4% ending the quarter at 11.2 million sq ft, compared to 11.7 million sq ft at the end of 2017. As a result, the Central London vacancy rate fell by 20 basis points to 4.8% and remains lower than the 10 year average of 5.5%. The West End accounted for a major share of this fall, with supply declining 8% across the quarter, pushing the vacancy rate down from 4.4% to 4.0%. The City saw a modest 2% fall in supply, ending the quarter at 5.4 million sq ft, equivalent to a vacancy rate of 4.7%.

Development completions have continued to be quickly absorbed, with 70% of quarterly completions pre-leased or let shortly after completion. The low levels of speculative supply being brought to market has kept the new build vacancy rate severely limited at just 0.4% of total stock, less than a third of the 10 year average of 1.3%. This has been a major factor in keeping prime rents unchanged in Q1 at £110 per sq ft in the West End, and £70 per sq ft in the City.

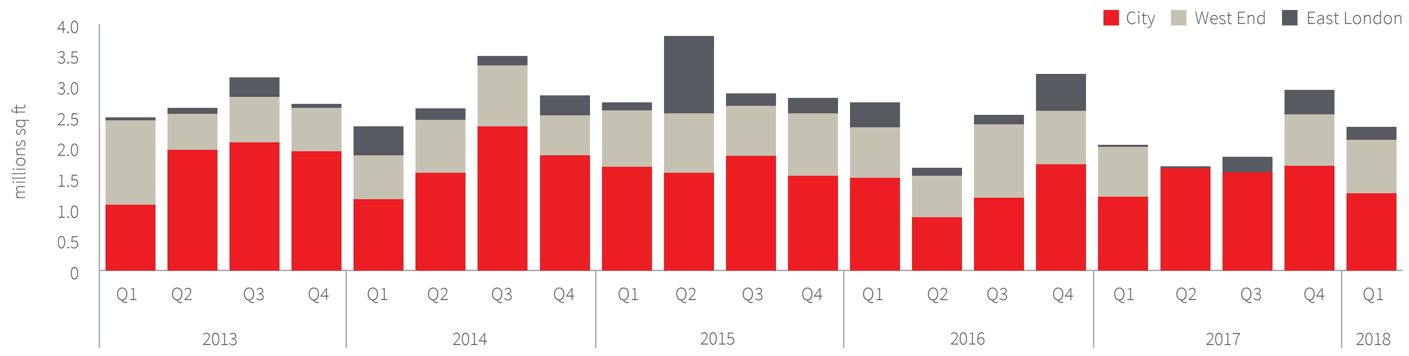
Subdued investment turnover

Central London investment volumes slowed in Q1, reaching £2.4 billion. This figure is half that of the strong Q4 2017 when turnover topped £4.7 billion, and 30% lower than the 10 year quarterly average of £3.4 billion. Both the City and West End recorded below average quarters, and there were no investment transactions in East London.

The market continues to be dominated by strong cross border capital inflows, with 78% of the quarter's transactions involving overseas buyers, and the UK share only inflated by two major owner occupier sales. The buyer profile was diverse in Q1 with the largest transaction – the £360 million sale of Riverbank House – involving a private South African buyer. Hong Kong and mainland Chinese buyers remain prominent, accounting for 23% of turnover, and there were a number of new entrants to the market from Japan and Korea.

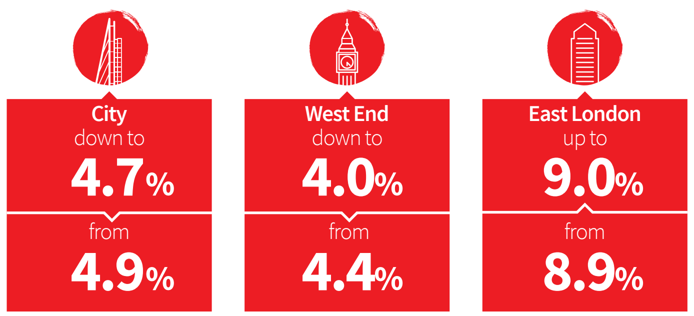
Prime yields remained stable at 3.5% in the West End and 4.25% in the City. Secondary yields are softening with increasing divergence between prime and secondary expected in 2018.

Historic take-up by quarter

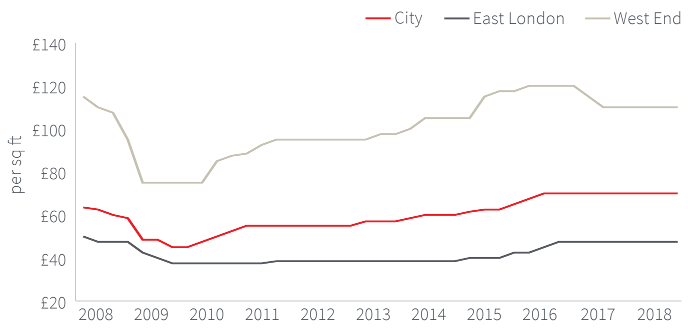


Speculative development under construction

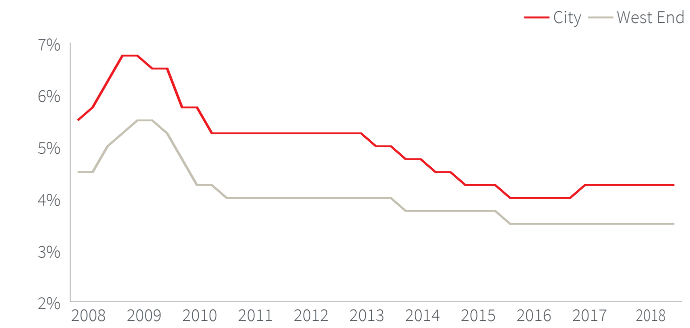
Vacancy rates



Prime rents



Prime yields



Invester nationality

Investment volumes

Key transactions

Verde, SW1

Tenant: Carwow / Girls' Day School Trust

Size: 14,750 sq ft / 13,560 sq ft

Chris Valentine
Director
Office Agency

Completion of leases to Carwow Ltd and the Girls' Day School Trust in Q1 2018 has taken Verde to 100% occupancy within 14 months of practical completion. The strong leasing momentum and attractive terms achieved from a wide range of sectors are testament to the quality of the building delivered and the continued strength of the West End office market.

Regent Quarter, N1

Price: c. £300 million

Purchaser: Nan Fung Group

James Buckey
Director
Capital Markets

We advised our client on the purchase of this unique 3.5 acre estate in the most pre-let submarket in central London; King's Cross. Our client secured the transaction as part of a competitive bids process and the deal marks the expansion of our client's London portfolio. The estate has a diverse tenant mix with reversionary rents and offers the opportunity for significant income growth

70 St Mary Axe, EC3

Tenant: Sidley Austin LLP

Size: 100,694 sq ft

Dan Burn
Director
Office Agency

We advised TH Real Estate on a major pre-let to Sidley Austin LLP, which will see them move its London operations to 70 St Mary Axe, EC3. The international law firm is to acquire 100,000 sq ft on a long-term lease in the upper section of the building, with options on approximately 34,000 sq ft of additional space. The development, comprising a total of approximately 300,000 sq ft, is due to complete in Q4 this year, and will form an integral part of London's instantly recognisable skyline.

The Corn Exchange, 55 Mark Lane, EC3

Price: £128 million

Purchaser: Hao Tian Development Group Limited

Jonathan Sharpe
Director
Capital Markets

Acting on behalf of The Reignwood Group, a private Chinese conglomerate, we advised on the sale of 55 Mark Lane, EC3 to Hao Tian Development Group Limited, a Hong Kong listed construction company. Originally developed in 1996, the building has been recently refurbished and is fully let on a multi tenanted basis. The low passing rent of c. £42 per sq ft provides asset management potential to enhance value. The sale price reflects a net initial yield of 5.1% on the basis of the SPV acquisition and provides our client with an attractive return since their acquisition in 2014.

Issue to watch

Shortage of new supply

Despite uncertain market conditions Central London take-up volumes surpassed long term averages in both 2016 and 2017, easing fears that the EU referendum result would cause the market to slow. Indeed, there is now evidence to show that supply conditions are tightening, particularly for new supply which is quickly being absorbed through pre-leasing. The take-up figures for 2018 so far suggest that this momentum does not appear to be abating. As a result, the development pipeline will continue to be eroded as this year progresses.

New build supply becoming scarce

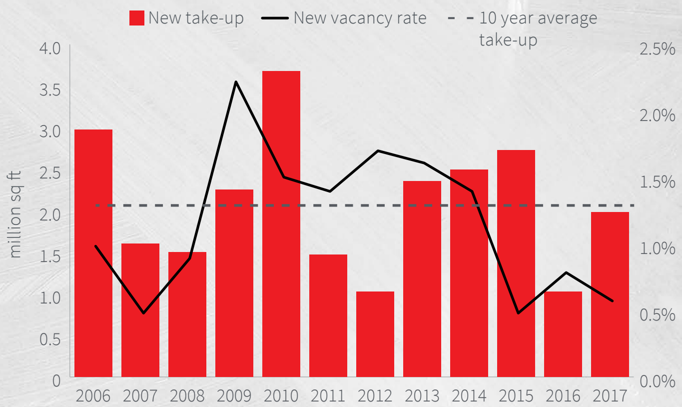
The new build vacancy rate in Central London has been declining since 2012. Except in 2016, when the uncertainties of the Brexit vote led to more caution, take-up over this period has been above or in line with the long-term average. This trend is especially evident in the West End where take-up of new stock in 2017 amounted to 1.1 million sq ft, well above the 10 year average of 700,000 sq ft.

The high level of take-up has resulted in the new build vacancy rate across Central London falling to 0.4% in the first quarter of 2018, well below the long term average of 1.3%. Occupiers increasingly see workplace design and selection as central to corporate strategy. Newly built offices are more likely to offer the flexibility, amenities and design principles that benefit their businesses, and are in high demand. However very little of this stock makes it into newly available supply at present as much of it is pre-leased before the building reaches practical completion.

Pre-leasing erodes future pipeline

The level of pre-leasing in Central London has been above the 10 year average of 2.3 million sq ft every year for the past five years, consistently comprising around 30% of total take-up. Pre-leasing momentum is likely to be sustained in both the City and West End this year as 45% of all stock which is currently under offer in Central London is either under construction or off-plan.

Central London take-up of new build stock, 2006 - 2017



Potential shortage of future new build stock

The level of new build stock currently under construction across Central London and deliverable in 2018 stands at 1.4 million sq ft. This is 0.4 million sq ft below the 10 year average of new speculative completions. Newly built stock is expected to become more of a feature in 2019 when 2.7 million sq ft of speculative space is likely to be delivered, although around 10% of this space is under offer already.

The shortage of new supply is more evident in the West End where the amount of new stock expected to be delivered is below the 10 year average in both 2018 and 2019. There is a healthier development pipeline in the City but it is being delivered in just a few large schemes. This means that not only will occupiers face a limited choice of buildings and locations but also some submarkets will become undersupplied.

The evidence suggests that we could potentially face a shortage of new build stock over the next two years as take-up of this kind has been particularly high over the past few years. Continued pre-leasing activity is likely to exacerbate this shortage unless further construction is started on new schemes.

West End overview

First quarter take-up levels slightly above average

Take-up in the West End was above average during the first quarter of 2018, reaching 932,000 sq ft across 63 transactions. Take-up levels were slightly higher than those reached in the first quarters of both 2016 and 2017 suggesting that leasing momentum remains relatively robust.

The TMT and services sectors had the largest share of quarterly take-up with 33% and 25% respectively. Within the services sector, the majority of take-up (63%) involved flexible office providers indicating that this sector is continuing to expand.

Pre-completion leasing was limited during the first quarter and accounted for just 8% of overall take-up compared to 27% in the equivalent period last year. However it is likely that pre-leasing momentum will pick up as the year progresses given that new supply is very scarce and a significant portion of the future pipeline is already under offer.

The volume of space under offer increased significantly in Q1 and stands at 1.6 million sq ft, well above the long term average of 578,000 sq ft. Buildings under offer during the quarter include the Brunel Building, W2 where a single occupier is interested in taking nearly half of the building and Westminster City Hall, SW1 where 96,000 sq ft is under offer to a flexible office provider. Both of these buildings are currently under construction.

Overall demand is broadly unchanged from last quarter and stands at 4.9 million sq ft although it remains marginally below the long term average of 5.0 million sq ft. However, at 4.1 million sq ft, active demand is above average, suggesting that leasing momentum will be sustained in the coming quarters. Key active requirements in Q1 included Capital International Group (90,000-100,000 sq ft), Premier League (30,000-40,000 sq ft) and Lansdowne Partners LLP (20,000-30,000 sq ft).

Overall vacancy falls below average

Overall supply fell during the quarter to 3.8 million sq ft down from 4.1 million sq ft at the end of Q4. The fall was mainly due to take-up of new stock which was not replenished by development completions during the quarter. The level of second hand and refurbished stock was broadly unchanged. The fall in supply resulted in a decrease in the overall vacancy rate to 4.0%, below the 10 year average of 4.4%.

The new build vacancy rate also fell and stands at 0.4%, well below the long term average of 0.9%. Grade A vacancy decreased from 3.8% to 3.6% but remains above the long term average of 2.9%.

Supply is expected to remain tight over the next two years as half of the 2018 pipeline has already been pre-let. Given the lack of new supply in the West End, it is likely that more of the future pipeline will be eroded, putting increasing pressure on vacancy rates.

Prime rents unchanged

Prime rents in the core were unchanged at £110 per sq ft in Q1, where they have remained since the final quarter of 2016. They are expected to remain stable throughout 2018 although supply pressures are likely to cause them to increase to £112.50 per sq ft in 2019.

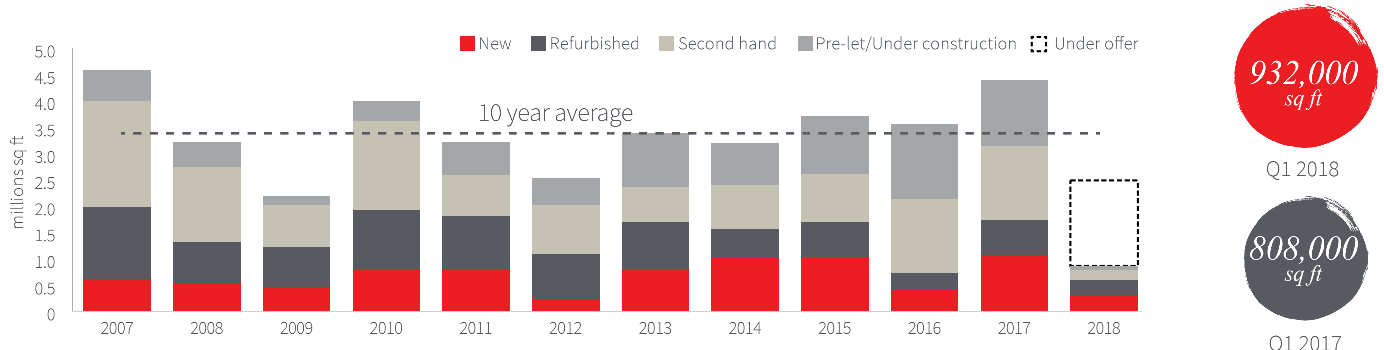
UK-based investors take largest share

Investment volumes reached £1.0 billion across 16 transactions in Q1 which was below both the Q4 figure of £1.1 billion and the 10 year average of £1.3 billion. There were three transactions during the quarter which achieved a price of over £100 million and these accounted for 60% of the total. UK investors had the largest share of purchases in the first quarter, spending around £470 million and taking a 47% market share across six deals. The second largest source of capital, at 30%, was Hong Kong, although this represents just a single deal.

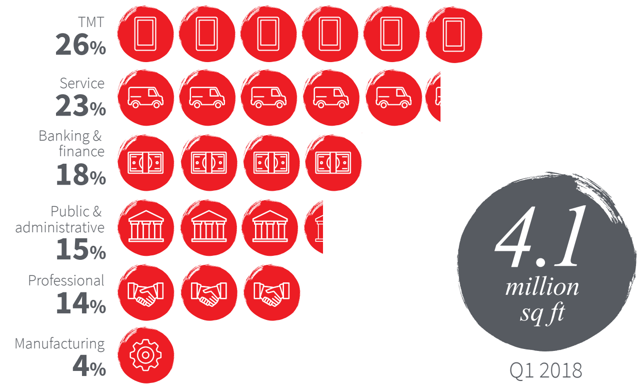
There continues to be a shortage of stock in the West End although demand from private overseas investors in particular remains strong. The lack of opportunity may mean that some buyers turn their focus to the City.

Key deals during the quarter include: the acquisition of Regent Quarter, N1 by Nan Fung Group for circa £300 million, a net initial yield of 4.34% and a capital value of £1,161 per sq ft; The Empress State Building, SW6 which was acquired by The Mayor's Office for Policing and Crime from Capital & Counties Properties for £248.50 million, a net initial yield of 6.56% and a capital value of £550 per sq ft and Blocks 3, 4 and 5 of the Centro Buildings, NW1 which were purchased by Workspace Group for £109 million, a net initial yield of 4.20% and a capital value of £832 per sq ft.

Take-up



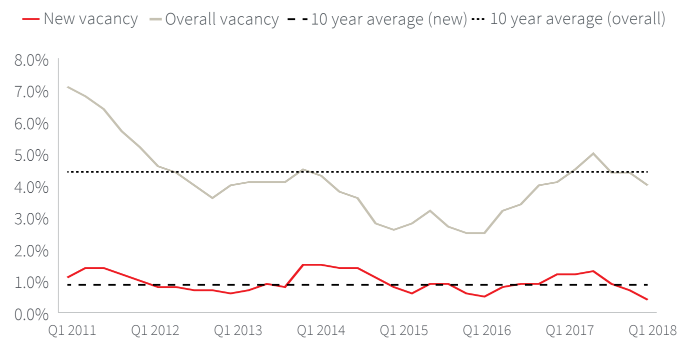
Active demand



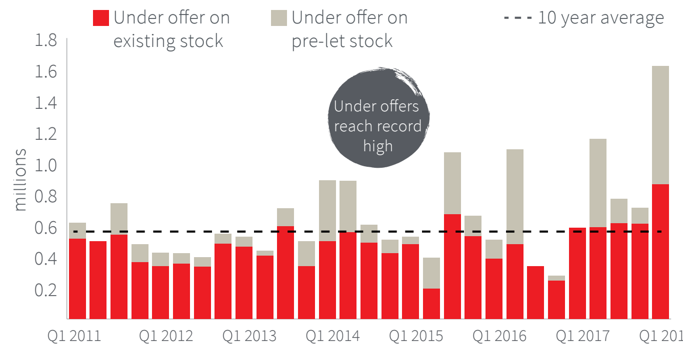
Key deals

Google	SoftBank	Regus
123,000 sq ft	6,000 sq ft	32,000 sq ft
£77.50 per sq ft	£120.00 per sq ft	c. £60.00 per sq ft
R7 Handyside Street, N1C	77 Grosvenor Street, W1	60-61 St Martin's Lane, WC2

Vacancy

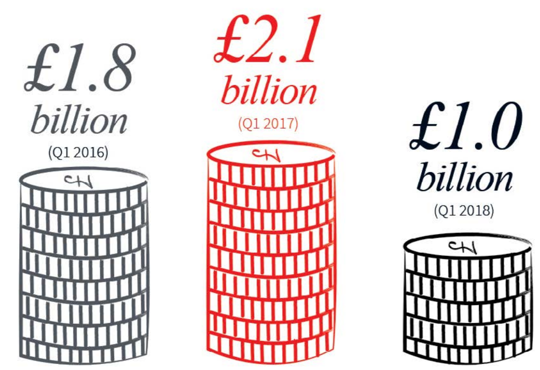


Under offers



Purchaser origin

Investment volumes



City overview

Strong pre-leasing driving market

In line with the usual seasonal trend, take-up volumes were slower in Q1, reaching 1.3 million sq ft. This was 29% below the strong take-up recorded in the final quarter of 2017, but marginally ahead of the equivalent period last year. Pre-lets underpinned quarterly leasing activity, accounting for a 46% share of quarterly take-up, including seven of the 10 largest transactions.

The banking and finance sector was most active with a 28% share of take-up, buoyed by the largest transaction of the quarter, Sumitomo Mitsui Banking Corporation Europe's pre-let of 161,000 sq ft at 100 Liverpool Street, EC2. The service industries and professional services sectors were also prominent, accounting for 27% and 25% of quarterly take-up respectively, including major transactions to Sidley Austin LLP, Charles Taylor and Prudential.

The completion of a number of major transactions led to a 24% decrease in the volume of space under offer, which ended the quarter at 1.1 million sq ft, marginally lower than the 10 year average of 1.2 million sq ft. However, active demand recovered (largely driven by lease events) from a recent low point, rising 19% to 6.8 million sq ft, which should sustain strong leasing momentum in the remainder of 2018. Many active requirements are seeking space for the future, meaning that pre-leasing will remain a major feature of the market throughout the year.

New supply being quickly absorbed

Overall supply fell 3% to 5.5 million sq ft, compared to 5.6 million sq ft at the end of 2017. This led to a 20 basis point fall in the vacancy rate to 4.7%, well below the 10 year average of 6.4%. Q1 development completions totalled 678,000 sq ft although this space is being quickly absorbed, with 48% let prior to completion, and a further 125,000 sq ft leased or placed under offer shortly after completion.

As a result, the supply of newly built space remains limited with a vacancy rate of just 0.6%, significantly lower than the 10 year average of 1.6%. Strong pre-leasing has continued to erode the development pipeline with 41% of space under construction already committed, leaving a balance of 4.8 million sq ft of speculative supply due to be delivered between 2018 and 2020.

Prime rents stable but rental tone softening

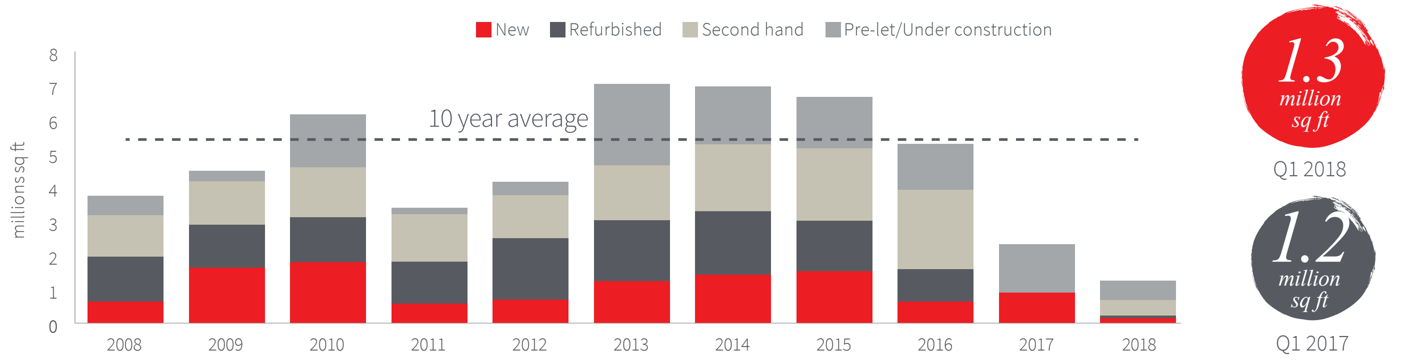
City prime rents and incentives were stable in Q1 at £70 per sq ft and 24 months' rent free on an assumed 10 year term. Prime rents have now remained unchanged for 2 years, although the tone of the market had shifted during this period. The basket of prime rental evidence has shrunk and average grade A rents have fallen back slightly.

New buyers from Korea and Japan

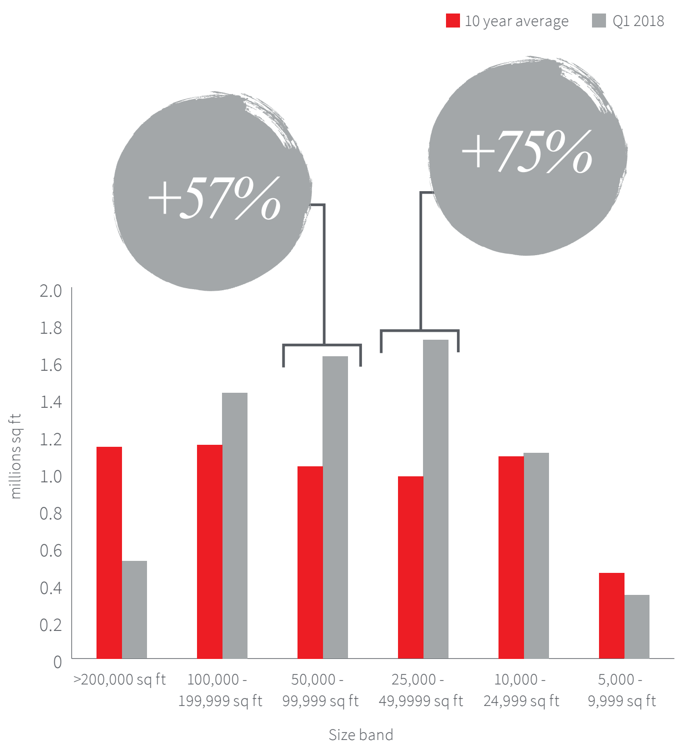
Investment volumes slowed in Q1, reaching £1.4 billion in 18 transactions, a 51% fall on the strong turnover recorded in the final quarter of 2017. The largest transaction of the quarter was the off-market sale of Riverbank House, EC4 to a private South African client of Oxygen Asset Management for £360 million, reflecting a net initial yield of 4.50% and capital value of £1,108 per sq ft. Continuing the recent trend, a significant share of purchasers were from Asia and the Middle East. They accounted for eight transactions totalling £934 million with new entrants from Korea and a debut Japanese investor.

Prime yields remained unchanged in Q1 at 4.25% across all lot sizes. However there is evidence that Private Equity and UK REIT money are beginning to focus on more value add opportunities. As the majority of the overseas money is chasing prime freehold trophy assets, secondary yields are softening as investors become more discerning on tenure and lease length. This divergence between prime and secondary is expected to grow in 2018.

Take-up



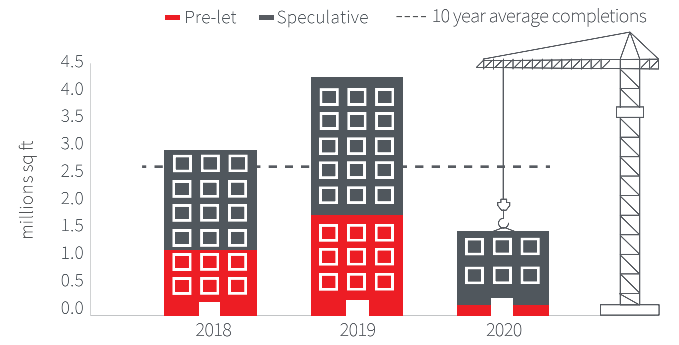
Active demand



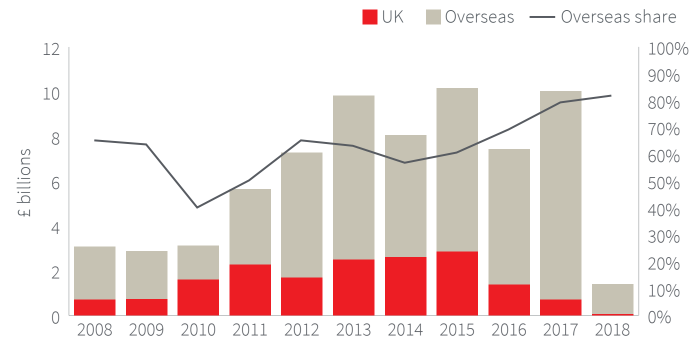
Key deals

SMBC Europe	Sidley Austin LLP	Charles Taylor
161,000 sq ft	101,000 sq ft	61,000 sq ft
100 Liverpool Street, EC2	70 St Mary Axe, EC3	The Minster Building, EC3
Confidential rent	Confidential rent	£57.50 per sq ft
Under construction	Under construction	Under refurbishment

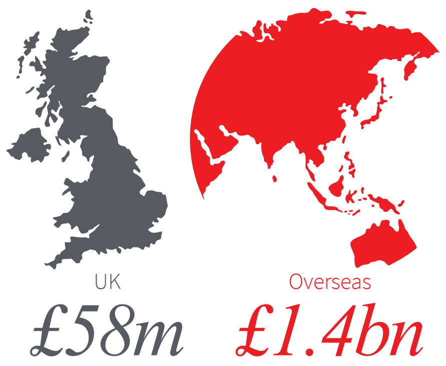
Development pipeline - under construction



Investment volumes



Purchaser origin



- South Africa: £360m
- South Korea: £248m
- Israel: £200m
- Hong Kong: £157m
- Japan: £154m
- Singapore: £76m
- China: £71m
- Saudi Arabia: £29m
- USA: £15m
- Other: £43m

East London overview

Under offers double 10 year average

Take-up reached 215,000 sq ft across 12 transactions, a 46% fall on the strong final quarter in 2017. The slower leasing volumes in Q1 are a result of the absence of larger transactions, with the largest deal totalling 31,000 sq ft. The number of transactions completed is double the 10 year quarterly average.

The public administration and TMT sectors were most active, each accounting for around a quarter of leasing volumes. The largest transaction of the quarter saw Thomson Reuters lease 31,000 sq ft at 5 Canada Square, E14. There is currently 714,000 sq ft under offer, more than double the 10 year average of 335,000 sq ft, which will support stronger leasing volumes later in the year.

Overall demand increased 8% to 4.2 million sq ft, well ahead of the 10 year average of 2.8 million sq ft. The quarterly increase in overall demand was driven by a 12% rise in the level of active demand to 2.8 million sq ft, up from 2.5 million sq ft at the end of 2017. Potential demand remained broadly unchanged at 1.4 million sq ft.

The relatively high levels of demand can be largely attributed to companies considering options to the east of the City boundary, rather than Canary Wharf and Stratford, where demand remains broadly stable.

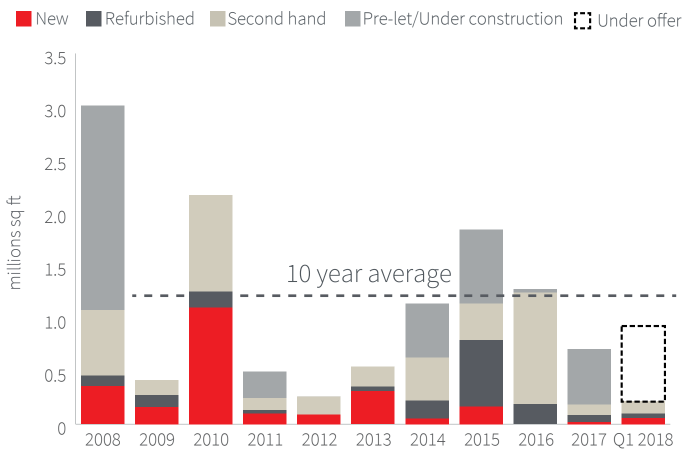
Supply remains stable

Supply remained broadly unchanged at 2.0 million sq ft, well ahead of the 10 year average of 1.3 million sq ft. The overall vacancy rate of 9.0% is significantly higher than the City (4.7%) and West End (4.0%), and the 10 year average of 6.6%. Most supply is second hand, particularly in Canary Wharf where 73% of supply is tenant controlled. The balance of supply will remain in the tenants favour until 2019 when the 420,000 sq ft of speculative supply currently under construction at 1-5 Bank Street, E14 is scheduled to complete.

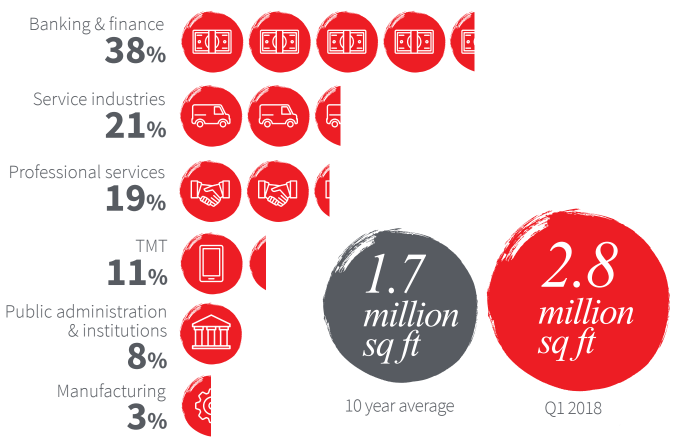
Canary Wharf remains three tiered rental market

Canary Wharf, the benchmark for East London, remains a three tiered rental market. Prime rents are unchanged in Q1 at £47.50 per sq ft, supported by recent evidence at 40 Bank Street, E14. Tenant controlled supply, which accounts for the majority share of Canary Wharf availability, is being marketed at rents from £37.50 per sq ft and continues to restrict rental growth, while pre-let supply is being marketed at rents of £50-£55 per sq ft.

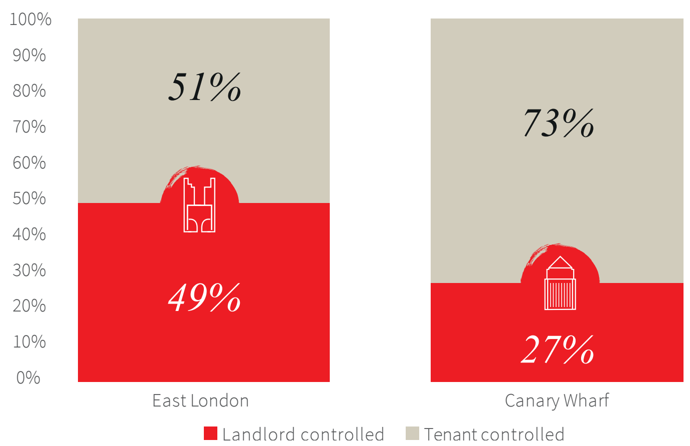
Take-up



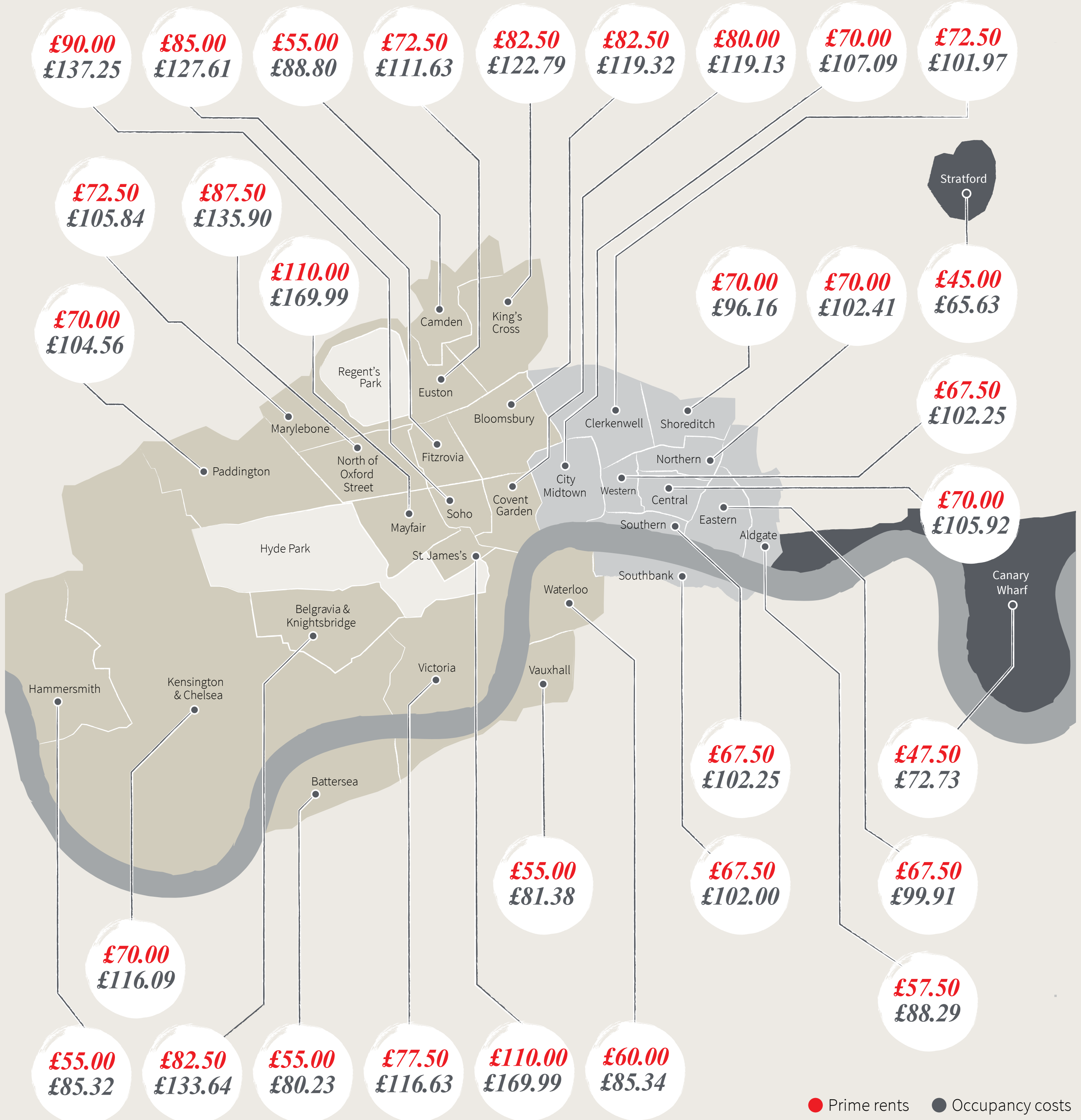
Active demand



Landlord and tenant controlled supply



Rental conditions in Central London



Contacts

Leasing

Neil Prime
Head of Central London Markets
+44 (0)20 7399 5190
neil.prime@eu.jll.com

Dan Burn
Head of City Agency
+44 (0)20 7399 5966
dan.burn@eu.jll.com

Adrian Crooks
Head of West End Agency
+44 (0)20 7399 5135
adrian.crooks@eu.jll.com

Capital Markets

Julian Sandbach
Head of Central London Capital Markets
+44 (0)20 7399 5973
julian.sandbach@eu.jll.com

Patrick Cryer
Director, Capital Markets
+44 (0)20 7399 5639
patrick.cryer@eu.jll.com

Simon Beckett
Head of West End Capital Markets
+44 (0)20 7087 5777
simon.beckett@eu.jll.com

Research

Jon Neale
Head of UK Research
UK Research
+44 (0)20 7087 5508
jon.neale@eu.jll.com

Amy Birdee
Associate Director
UK Research
+44 (0)20 7087 5098
amy.birdee@eu.jll.com

James Norton
Director
UK Research
+44 (0)20 7087 5033
james.norton@eu.jll.com

JLL®

jll.co.uk/london-office-markets