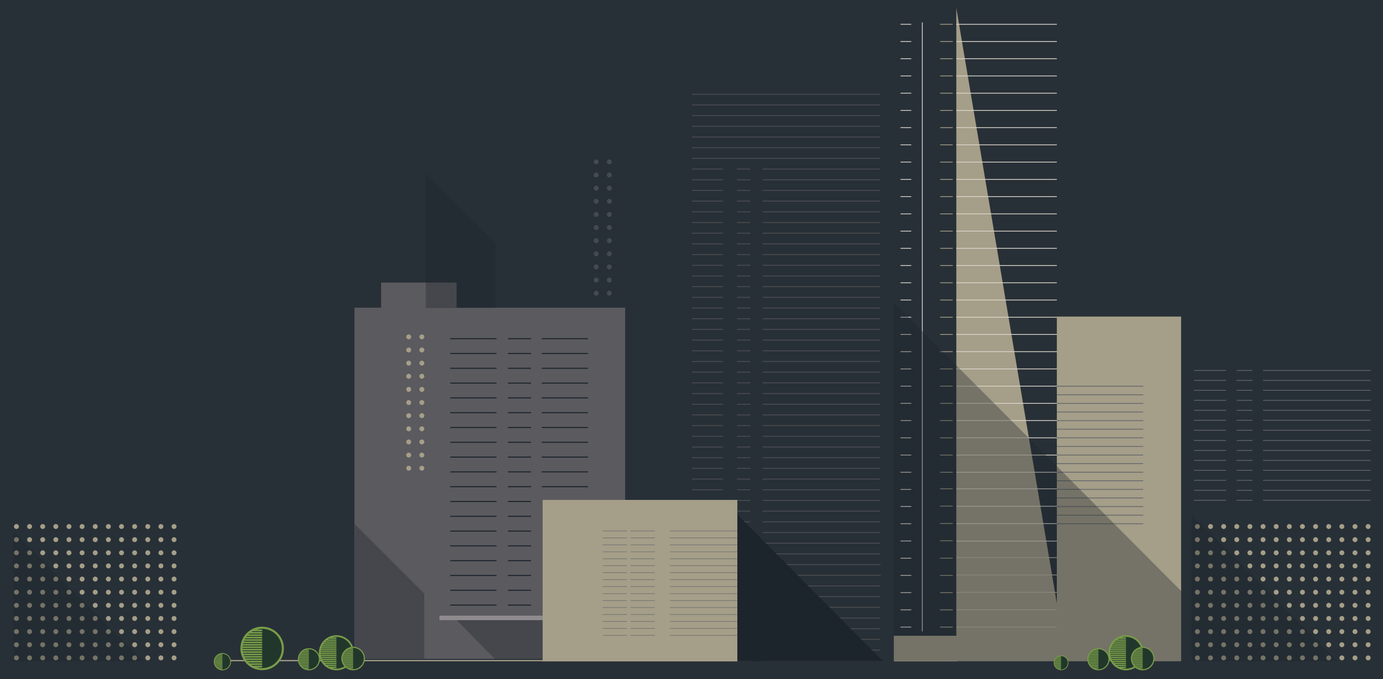
GERALDEVE

# LONDON MARKETS

## London office property performance and key themes

September 2021

Read more



geraldeve.com

# LONDON OFFICE MARKET SUMMARY Q2 2021

Green shoots of improved leasing activity were evident in Q2 and take-up reached 1.9m sq ft. This was an uplift of 36% on Q1 and almost double the recent trough in Q4 2020.

Central London availability continued to rise and hit 9.4% in Q2, but there has been a clear deceleration in the rate of space being brought to market.

We expect the rate of development activity will cool in the short run given the uncertainty in the occupier market and following a sharp increase in building costs. Annual growth of material costs reached 7% in July 2021, exacerbated by labour shortages in the construction sector.

Rents have softened in Soho and Midtown. It is expected there will be further decline in rents over the next six months, particularly in poor quality stock that is not fit for hybrid work models.

Investment activity ticked up to £2.2bn in Q2 after a slow start to the year of only £1.9bn in Q1. There are now numerous available investment assets in the market and we expect investment volumes will pick up markedly in the second half of the year.

| 1.9 m sq ft ▲ | 9.3% ▲ | 14.2 m sq ft ▲ | £2.2bn ▲ |
|---|---|---|---|
| Take-up Q2 2021 | Availability rate Q2 2021 | Under construction Q2 2021 | Investment volume Q2 2021 |

# THE LONDON ECONOMY

## GROSS VALUE ADDED (GVA)

| | 2020 | 2021 | 2022 |
|---|---|---|---|
| London | -9.3% | 7.2% | 6.4% |
| UK excl. London | -9.9% | 7.3% | 5.7% |

## ILO UNEMPLOYMENT RATE

| | 2020 | 2021 | 2022 |
|---|---|---|---|
| London | 5.6% | 6.3% | 6.0% |

## LONDON WORKPLACE-BASED EMPLOYMENT GROWTH

| | 2020 | 2021 | 2022 |
|---|---|---|---|
| Office | -1.4% | -1.1% | 2.6% |
| Non-office | -2.2% | -1.9% | 3.3% |

Source: Oxford Economics

## LONDON FLASH INDICATORS – PMI JULY 2021

60.5 ▼

### Business Activity Index

Business activity slipped from 61.9 in June, following increased input costs and supply chain disruption. Material costs and labour expenses also contributed to the deceleration.

55.1 ▼

### New Business Index

Business activity growth trended upwards for six months but softened in July. Many companies saw increased sales from higher demand as restrictions ease.

74.2 ▼

### Future Activity Index

Optimism edged downwards but firms are confident of a business recovery, with improved hiring intentions and increased client demand.

58.0 ▼

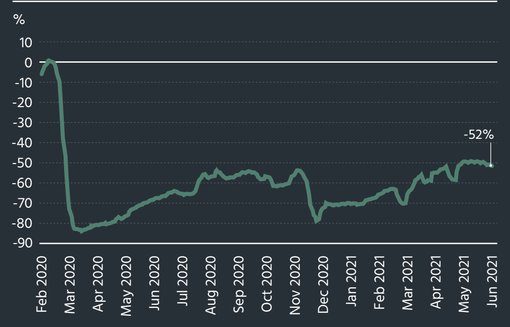
### Employment Index

London firms reported a slight easing in the rate of job creation. However, latest data points to a strong rise in employment, and the second-quickest across the UK.

Source: IHS Markit (figures below 50 signify contraction)

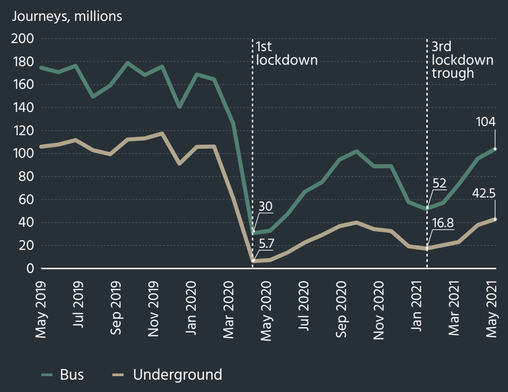
## Central London, visits to workplace, difference from pre-pandemic baseline

Sources: Google Mobility Data, Gerald Eve




## TfL Journeys by type of transport

Source: Transport for London




Google mobility data show a clear uplift in visits to workplace following the lifting of lockdown measures on 12th April. In Zone 1, there has been an increase of 18%-pts since 12th April - visits to workplace at the end of July was 52% below the baseline, the highest level since the beginning of the pandemic. We expect this to continue an upward trend from September.

Journey data by mode of transport from TfL also show a marked improvement in travel throughout London. Bus and underground journeys in May reached the highest level since the beginning of the pandemic. There were 104m unique bus journeys and 42.5m unique underground journeys.

# OFFICE OCCUPIER DEMAND

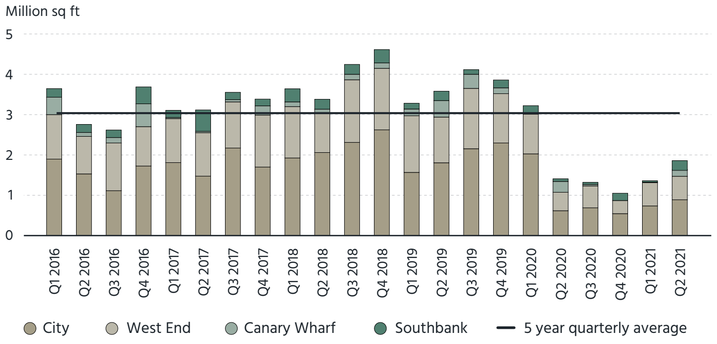
## THE BEGINNING OF THE RECOVERY?

Green shoots of occupier demand for London offices were evident in Q2. Take-up of 1.9m sq ft was a 36% improvement on Q1 and the strongest quarter since the beginning of the pandemic. Letting activity was nevertheless 40% below the 5-year quarterly average. However, this still represents a marked improvement on the trough in Q4 2020.

Letting activity was highest in the City with 483,000 sq ft of take-up in Q2. The key deal of the quarter was JLL's 134,000 sq ft letting at 1 Broadgate in April accounting for over 25% of the total volume. Notably, 131,100 sq ft of City take-up involved buildings available on a sub-let, with five of the six largest lettings in the submarket by way of assignments. A similar pattern occurred in the West End, with six of the top lettings by size completed on assignments, totalling 170,000 sq ft.

Absorption of tenant-space, on both sub-lets and assignments, has been particularly high, hitting 808,000 sq ft in Q2. This was 43% of all take-up, one of the highest proportions on record, driven by a group of large lettings of good quality tenant space. This is likely to continue while some occupiers revise the amount of space they need post-lockdown. Quality is key, with those marketing high spec sub-let space the most likely to attract prospective tenants. In the current market, such tenants will also seek improved terms via rent discounts or incentives along with their quality and/or location upgrade.

**London office quarterly take-up by broad market**
Source: Gerald Eve

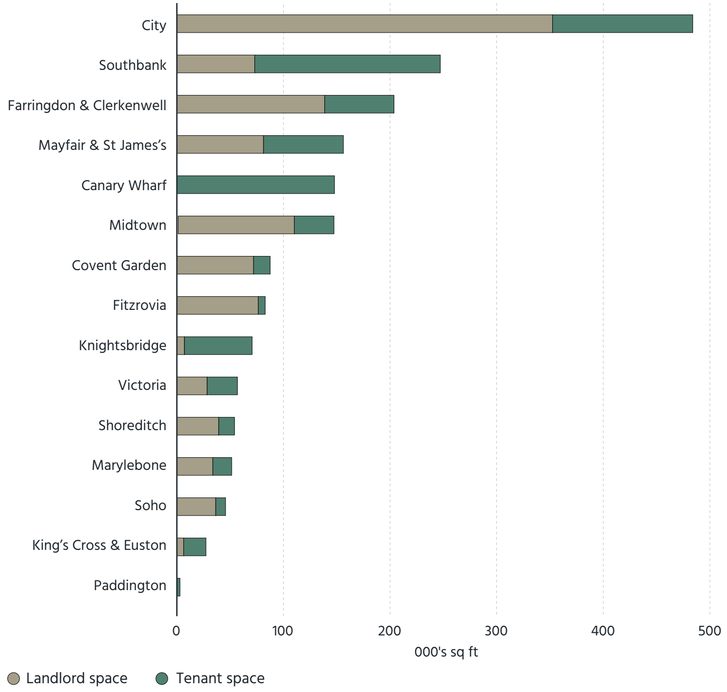



Employers appear to have the bit between their teeth in terms of the return to the office with most staff now fully vaccinated. Younger staff appear to have the largest appetite for returning.

Growing momentum will see a considerable uptick in market activity from September as companies stop kicking the can down the road and finally agree the shape of their existing or new offices. However, poor quality offices across central London are unlikely to benefit from this increased activity and landlords will have to grasp the need to bring offices up to the rising standards that companies want, both in terms of building quality and environmental credentials.

**Patrick Ryan, Partner**

**Take-up by submarket and lease type, Q2 2021**
Source: Gerald Eve, Property Data




Continue reading

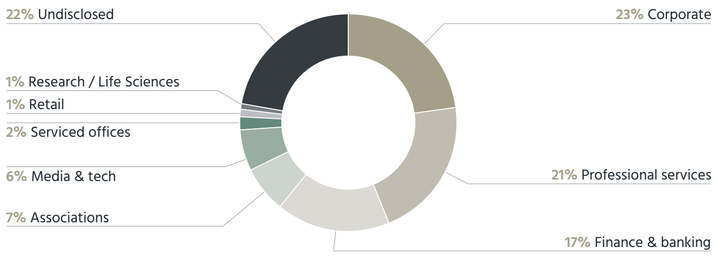
# OFFICE OCCUPIER DEMAND

Corporates were the most active occupier sector in Q2, with total take-up of 424,000 sq ft, constituting 23% of all market activity. Professional services were similarly active and accounted for 21% of total demand. Within the sector, law firms have continued to dominate, taking advantage of current property market conditions. Over the last six months, lettings to law firms total 424,000 sq ft - alone this accounts for 13% of totalled take-up in H1 2021. Law firms are characteristically active during downturns but this time the case is even stronger, given concerns over the potential operational security implications of long-term home and hybrid working.

## THE VIEW ON RENTS

Greater transactional activity provided evidence that rents declined in Soho and Midtown in Q2. Both submarkets recorded a quarter-on-quarter fall in Grade A rents, from £92.50 to £90.00 and £72.50 to £70.00, respectively. However, across most submarkets, landlords have maintained headline rents at pre-pandemic levels for Grade A offices, instead offering early access for leases and fit-out improvements. Incentives have cemented at the top of the range that was being offered 3-6 months ago. Rent-free incentives in Mayfair & St. James's were between 21-24 months, but recent evidence suggests that this has now moved out to 24 months and beyond, with similar, movements in Midtown, Soho, and Victoria.

**Take-up by business sector, Q2 2021**
Source: Gerald Eve




## OFFICE REDEVELOPMENT FOR LIFE SCIENCES

In July 2021, Camden Council approved the plans for the comprehensive redevelopment of 330 Grays Inn Road, creating a truly mixed-use development in a central, well-connected location, providing homes and jobs as well as new publicly accessible space and new access routes through the site.

Designed with sustainability at the forefront, through retention and re-use of the existing building as far as is possible, the lab-enabled, high-specification floorspace will cater for organisations that will strengthen the Knowledge Quarter's reputation as a centre for innovation and excellence.

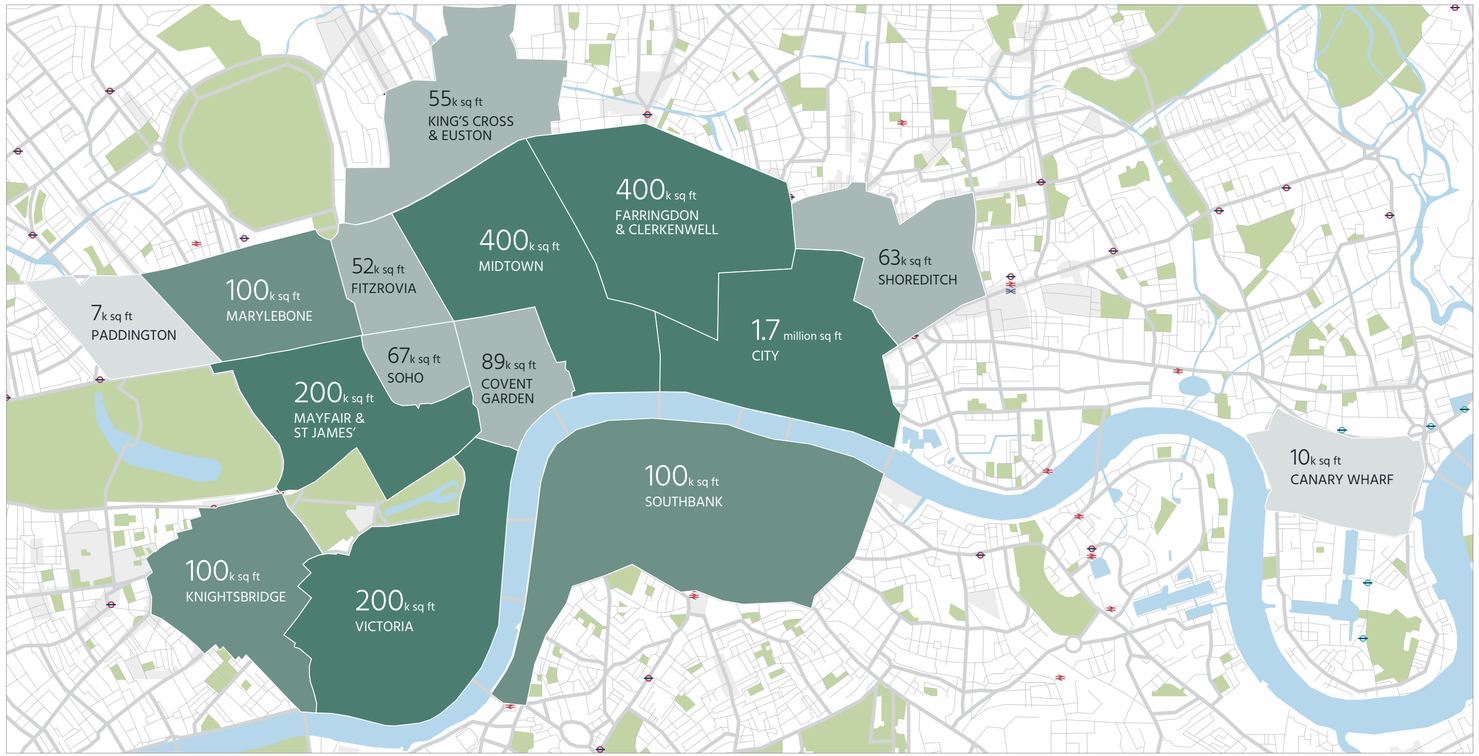
**Lisa Webb, Partner**

330 Grays Inn Road proposes over 14,000 sqm of new innovative office space, including lab-enabled floors, alongside a 182-bed hotel, a gym, café, and restaurant. Click **here** for further insight.

Continue reading

# OFFICE OCCUPIER DEMAND

## UPCOMING LEASE EVENTS BY SUBMARKET (SQ FT)




## LEASE EVENTS SET TO DICTATE PACE OF OFFICE DEMAND

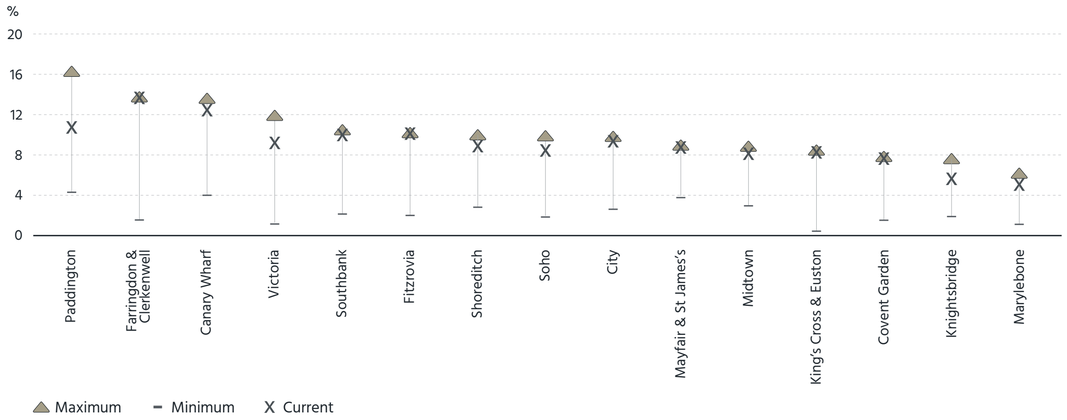
Occupiers are looking to lease events to implement new, post-covid office requirements. An estimated 3.7m sq ft of leases are set to expire in central London in H2 2021, which will likely boost the overall number of leases signed in the second half of this year. However, a contraction in the overall volume of space is a possibility as occupiers adapt to a hybrid working model and put more emphasis on building quality.

Large scale occupiers with upcoming lease events have already signed deals, such as Linklaters and Latham & Watkins. Linklaters is set to vacate 1 Silk Street in favour of 20 Ropemaker in 2023, with a reduced footprint of 130,000 sq ft to 330,000 sq ft. Meanwhile Latham & Watkins will move out of 99 Bishopsgate and into 1 Leadenhall at a net reduction of 100,000 sq ft from current occupancy of 344,000 sq ft in late 2020.

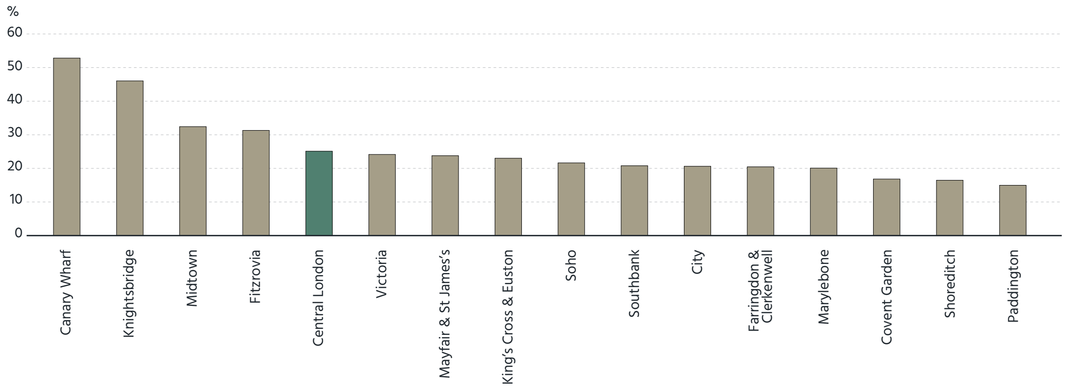
It is still too early to tell if these deals are a sign of how the wider market will act and what the impact will be on office availability in the medium to long term. But if smaller occupiers similarly look to downsize their occupied space it will at least drive increased take-up activity, since subletting floors or part of a floor is not an option for these tenants.

# AVAILABILITY

**Availability ranges by submarket, Q1 2013 – Q2 2021**
Source: Gerald Eve




**Sub-let availability, % of total**
Source: Gerald Eve




The availability rate in London continued to rise in Q2 and reached 9.3%. However, there are signs that the kinds of large jumps that occurred over 2020 are receding. Around 11m sq ft of additional office space has become available across London since Q2 2020, an average of 2.8m sq ft per quarter. In Q2 the increase was 'only' 1.1m sq ft. The worst for the market is likely in the past, as the growth in secondhand space decelerates and gets increasingly absorbed.

Almost half of the tracked submarkets have recorded slight falls in availability. The strongest relative decline was in Knightsbridge, following the subletting of 1 Knightsbridge Green. This was the largest available building in the submarket, shifting the availability rate from 7.5% to 5.1%. In the City, availability fell by 0.4%-pts to 9.3% in Q2.

Tenant-controlled grey space still makes up a large proportion of total availability across many submarkets. Especially, in submarkets where occupier activity has been particularly weak during the pandemic. The highest proportion is in Canary Wharf, where 53% of all available space is tenant-controlled. Here many large financial institutions and banks have released space on the back of anticipated shifts to hybrid working and in gradual structural shifts to European offices following Brexit.

# DEVELOPMENT

Just over 1m sq ft completed in the first half of 2021 across 10 different schemes. The City accounted 40% of all deliveries, the highest of any individual submarket. We expect developer activity to pick up significantly in H2 with a further 6m sq ft to complete across central London. Of the remaining 2021 projects, 32% of space is pre-let, a total of 2.6m sq ft. The expected increase in occupier activity in Q2 could prompt a round of new pre-lets on space under construction as tenants seek out more modern stock that is better suited for hybrid working or with strong ESG credentials.

Temporary inflationary pressures have been working their way through all sectors of the economy since Q1 2021. Build costs have been driven upward by global shortages of materials coupled with supply chain disruptions in the UK and globally. Data from BCIS show that the materials costs index increased by 13% in the year to July. Wages in construction are also up 12% following worker shortages, with the ONS citing there are currently 38,000 unfilled vacancies in the sector. Further sharp price rises in the sector are expected to continue until late 2021.

This is likely to have a dampening effect on new development starts in the near term. Firms that are well capitalised and with high liquidity may be able to take advantage of this, and take on development opportunities that others are unwilling to execute, though this pool is relatively small. Putting a spade-in-the-ground while taking on increased development and cost risk, will seem an unattractive option for many developers over the next 18 months. This could have a knock-on effect on completions volumes post-2023 and the next 6-12 months of new starts will show indicate whether this will be a factor.

Refurbishments or full fitouts instead of completely new developments will be more cost effective for developers and landlords attempting to secure tenants in a post-pandemic environment. In Q2, 130 planning applications were submitted in our tracked submarkets, of which 103 are for full refurbishments of office space. Of the 40 planning permissions that were given, 37 of those are for refurbishments. Consequently, most development activity will likely be on existing stock over the medium term.

**7% ▲**
Annual general build costs growth, July 2021

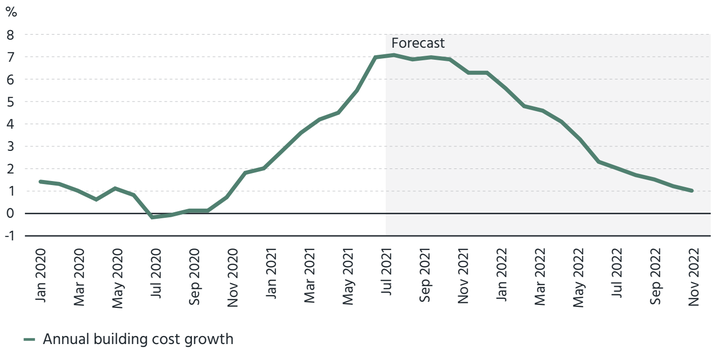
**130**
Total planning applications submitted

**40**
Total planning permissions granted

**103**
Applications for office refurbishment

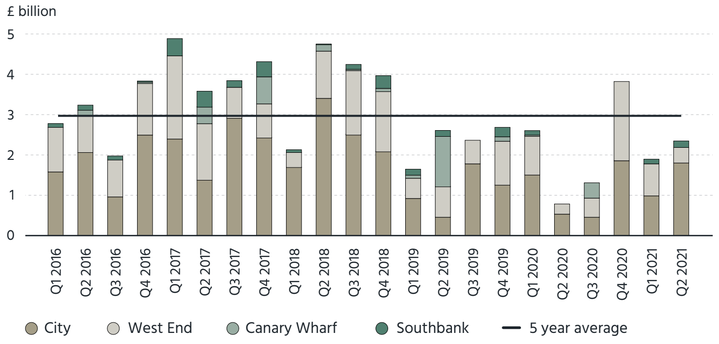
**London office new supply and development pipeline**
Source: Gerald Eve


**BCIS general building costs**
Source: BCIS



# INVESTMENT

**Quarterly investment volume by market**
Sources: Gerald Eve, Property Data

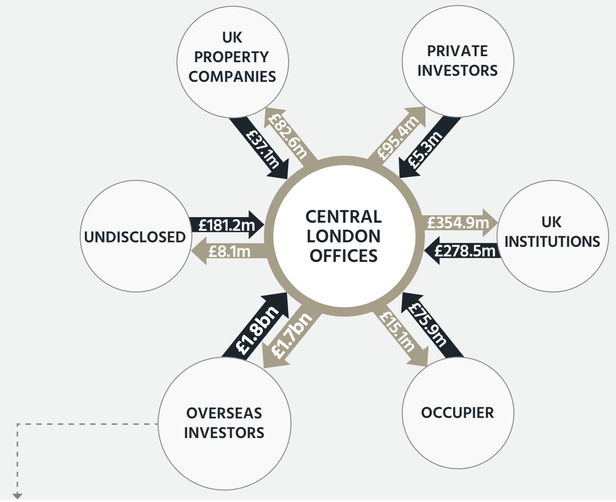



Quarterly investment increased in Q2 to just under £2.4bn, up by a quarter on Q1. There is continued evidence of the flight to quality, with prime assets in the City dominating activity. The top three investments by value in Q2 were all located in the Square Mile, with £1.5bn of overseas capital allocated to buildings with long-dated income and strong covenants. Large investments have shown clear favour towards long and secure income, with all transactions over £100m on offices sold with at least 10 years of income.

Overseas investors continue to account for the bulk of activity in London offices. In Q2, cross border investors made £1.8bn of acquisitions, while disposing of £1.7bn, accounting for 75% of both the total volume bought and sold. By investor domicile, North American investors were the most acquisitive, making £695m of purchases. However, this figure is made up of only two transactions, the largest of which was Brookfield Property's acquisition of 30 Fenchurch Street for £635m. German investors were the second most active buyer group, taking the opportunity to act while other international investor competition has been relatively low. They acquired £594m of offices located exclusively in the City.

Over the last 12 months, a large proportion of investors have allocated to beds and sheds because of their outperformance during the pandemic. This has led to strong yield compression, particularly in industrials. However, capital values in prime London offices have not fallen as hard as originally expected. Pricing is still relatively strong and the outward shift in yields ended in Q2, with equivalent yields actually tightening somewhat across all London office segments. Prime London offices now look attractive to other international cities in relative value terms at this point in the current cycle, and there is still clear investor interest.

**CENTRAL LONDON OFFICE CAPITAL FLOWS, Q2 2021**
Source: Gerald Eve, Property Data




INVESTMENT VOLUME BY INVESTOR SUB-DOMICILE

| £695m | £593.9m | £378.7m | £101.1m |
|---|---|---|---|
| NORTH AMERICAN | GERMAN | FAR EAST | EUROPEAN |
| 39.3% OF OVERSEAS INVESTMENT | 33.6% OF OVERSEAS INVESTMENT | 21.4% OF OVERSEAS INVESTMENT | 5.7% OF OVERSEAS INVESTMENT |

Continue reading

# INVESTMENT

## NEW SALE CAMPAIGNS LIKELY TO PRECEDE UPTICK IN H2 2021 INVESTMENTS

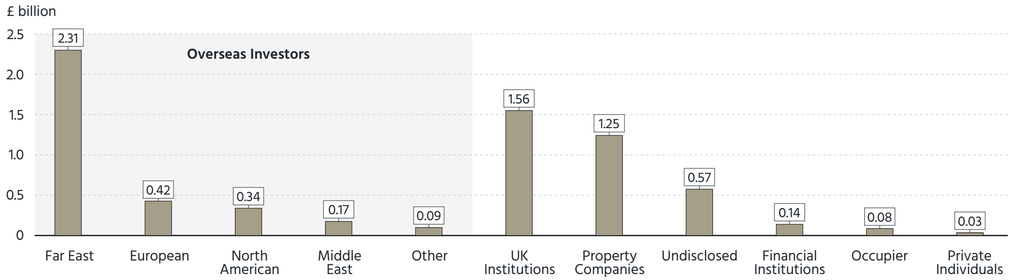
There is in excess of £40bn of private capital targeting London offices and many major European institutions have been open about increasing capital allocations to this segment. This coupled with the turning point in the occupational market is likely to precede an uptick in investment volumes as investor confidence recovers, increasing the prospective size of the diminished buyer pool due to the pandemic. Increased confidence on the buy-side coupled with a range of purchase opportunities will mean that the second half of 2021 will see an improved level of liquidity and activity.

There is around £6.9bn of office stock listed for sale at present in London, with £4.2bn put on the market in H1 2021. By submarket, the City has the largest stock available (£2.3bn), followed by the West End (£1.2bn). Overseas investors could be the largest divestor this year, listing a total of £2.2bn in H1 2021, accounting for almost a third of total volume by value. By investor sub-domicile, Far East investors are the most active on the sell-side. Current Far East listings total £1.7bn of prime assets in the City and all are expected to trade at under 4.5% net initial yield.

UK-based investors are also expected to be active on the sell side. UK institutions and UK property companies have £1.6bn and £1.2bn on the market respectively, totalling £2.8bn. UK based investors are more active in selling smaller lot sizes than their overseas counterparts. In the under £25m bracket, property companies have listed 15 assets, while institutions have sale campaigns online for 12 buildings.

Travel restrictions have been important limiting factors for investment activity over the last 18 months. While transactions have completed with buildings unseen, this has been usually reserved for quality assets in well known locations. As travel corridors begin to open this should allow more physical visits to assets and potentially drive more investment in value-add or development opportunities. This is particularly the case for investors from Asia, as on-site due diligence can now be conducted.

**Available investment stock by sell-side investor type, Q2 2021**
Source: Gerald Eve




**£6.9bn**
Offices available for purchase

**£4.2bn**
Offices listed for sale, Q2 2021

**£3.3bn**
Volume of listings from overseas investors

**£41bn**
Capital targeting London offices

# LONDON OFFICE CONTACTS


## Agency & Investment

**Lloyd Davies**
**Partner**
Tel. +44 (0)20 7333 6242
Mobile +44 (0)7767 311254
ldavies@geraldeve.com

**Fergus Jagger**
**Partner**
Tel. +44 (0)20 7653 6831
Mobile +44 (0)7787 558756
fjagger@geraldeve.com

**Rhodri Phillips**
**Partner**
Tel. +44 (0)20 3486 3451
Mobile +44 (0)7768 615296
rphillips@geraldeve.com

**Patrick Ryan**
**Partner**
Tel. +44 (0)20 7333 6368
Mobile +44 (0)7792 078397
pryan@geraldeve.com

## Lease Consultancy

**Tony Guthrie**
**Partner**
Tel. +44 (0)20 3486 3456
Mobile +44 (0)7717 225 600
tguthrie@geraldeve.com

**Graham Foster**
**Consultant**
Tel. +44 (0)20 7653 6832
Mobile +44 (0)7774 823663
gfoster@geraldeve.com

**Malcolm Hull**
**Partner**
Tel. +44 (0)20 3486 3458
Mobile +44 (0)7768 154324
mhull@geraldeve.com

**Jenny Rodericks**
**Partner**
Tel. +44 (0)20 7653 6857
Mobile +44 (0)7775 697645
jrodericks@geraldeve.com

## Planning & Development

**Lisa Webb**
**Partner**
Tel. +44 (0)20 7333 6225
Mobile +44 (0)7747 607309
lwebb@geraldeve.com

## Research

**Steve Sharman**
**Partner**
Tel. +44(0)20 7333 6271
Mobile +44 (0)7508 008118
ssharman@geraldeve.com

**Ben Clarke**
**Partner**
Tel. +44(0)20 7333 6288
bclarke@geraldeve.com

**Oli Al-Rehani**
**Senior Research Analyst**
Tel. +44(0)20 7518 7255
Mobile +44 (0)7584 112501
oal-rehani@geraldeve.com


## FURTHER INSIGHT

- Planning update – Class E to residential permitted development right
- Legislation changes threaten the value of large older office buildings
- The end of the office? Don't count on it
- Grays Inn Road Redevelopment
- Life Sciences - Planning for the Future
- InBrief for August 2021

**View our full-service offer**

Find out how we can help