GERALDEVE

LONDON MARKETS

London office property performance and key themes

May 2022

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LONDON OFFICE MARKET SUMMARY Q1 2022

London office demand was stable in Q1 and occupier take-up reached just over 3.1m sq ft. This quarter marked the highest number of lettings since before the pandemic and activity was focused in the smaller size bands. Lettings between 10,000 – 20,000 sq ft made up a significant portion of demand with 713,000 sq ft (or 23%) of all activity.

Tenants are now voting with their feet for best-in-class space, with ESG, namely sustainability, at the forefront of decision making. Increasingly, what occupiers demand from an office is influenced more by subjective business-linked or staff retention requirements than overall cost.

Two consecutive quarters of above-average demand contributed to another quarterly fall in availability in London, as the rate declined by 0.6%-pts, reaching 8.1% in Q1. Tenant-controlled space remains a residual part of post-Covid availability in London, with a total of 5.6m sq ft still available, accounting for 26% of all availability.

Grade A rents were stable quarter-to-quarter, with no movement across any tracked submarkets. On the back of improved demand and sentiment, the generous incentives offered through the pandemic are under increased scrutiny though, with landlords likely to tighten terms over the coming months.

7.3m sq ft of office space is expected to complete in the remainder of 2022, a third of which is currently pre-let. However, headwinds to construction activity remain as construction costs over 2022 are anticipated to be 5% above the expected level at the end of last year, coupled with the ongoing material and labour shortages.

Investment amounted to just under £3.5bn in Q1, an increase of 13% on Q4 and 18% above the 5-year quarterly average. Overseas investment returned with a bang, shaking off the travel disruptions prevalent in the early stages of the year. There was over £3bn of cross border acquisitions over nine transactions.

3.1 m sq ft ▼
Take-up, Q1 2022

8.1% ▼
Availability rate, Q1 2022

£3.5bn ▲
Investment volume, Q1 2022

11% ▲
Construction cost, Dec 20 vs Dec 22

THE LONDON ECONOMY

LONDON AND THE REST OF UK GVA

	2021	2022	2023
London	6.2%	4.7%	3.1%
UK excl. London	7.5%	4.5%	2.7%

ILO UNEMPLOYMENT RATE

	2021	2022	2023
London	6.0%	5.1%	4.6%

WORKPLACE-BASED EMPLOYMENT GROWTH

	2021	2022	2023
Office	-0.9%	0.6%	1.6%

Source: Oxford Economics

LONDON FLASH INDICATORS PMI MARCH 2022

63.5 ▲
Business Activity Index
Up from 63.0 in February, boosted by a strong recovery in sales.

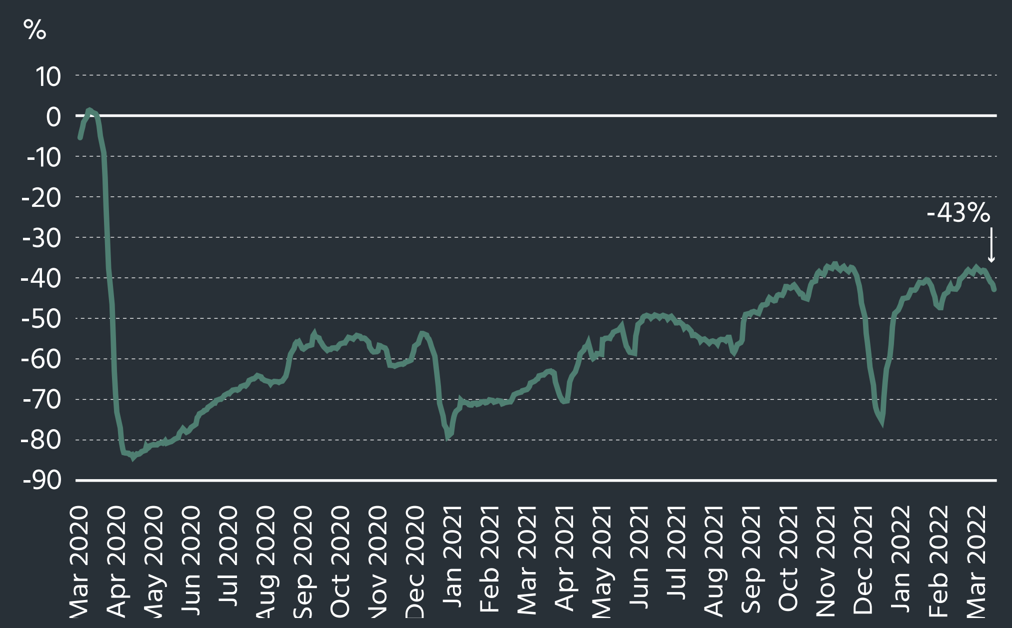
62.7 ▼
New Business Index
Monthly deceleration as firms report concerns over rising costs and inflation.

73.8 ▼
Future Activity Index
Confidence drops to lowest since October 2020 following the Ukraine crisis and rising inflation.

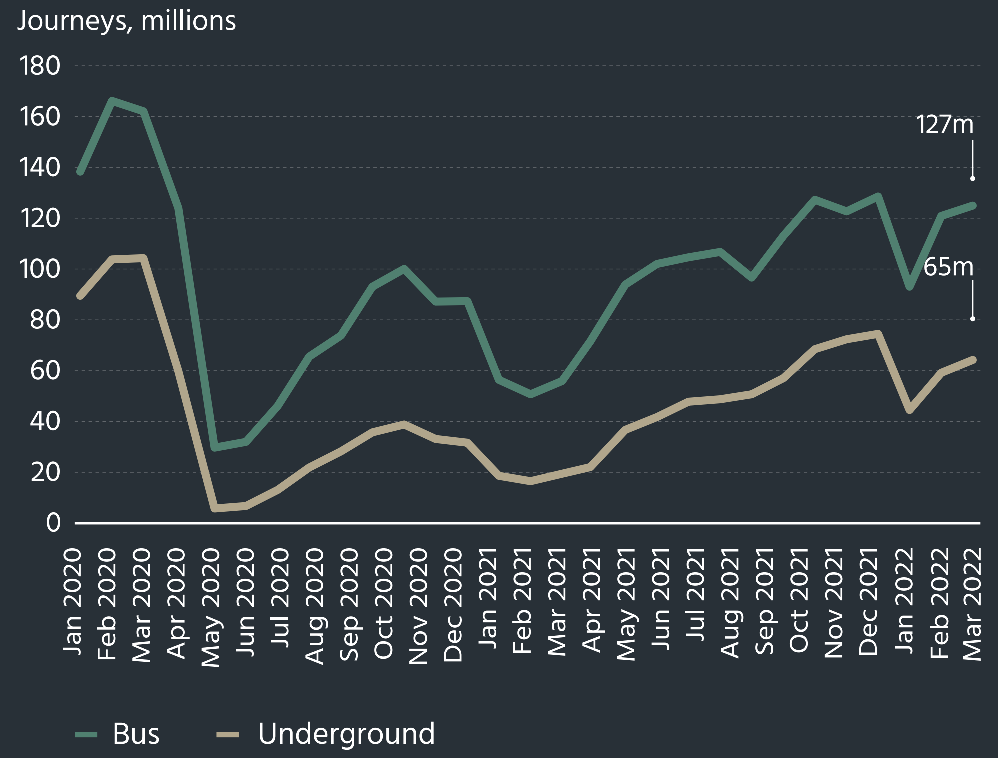
60.8 ▲
Employment Index
Employment levels rose at quickest pace since August 2021, with London leading the country in employment growth in March.

Source: IHS Markit

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

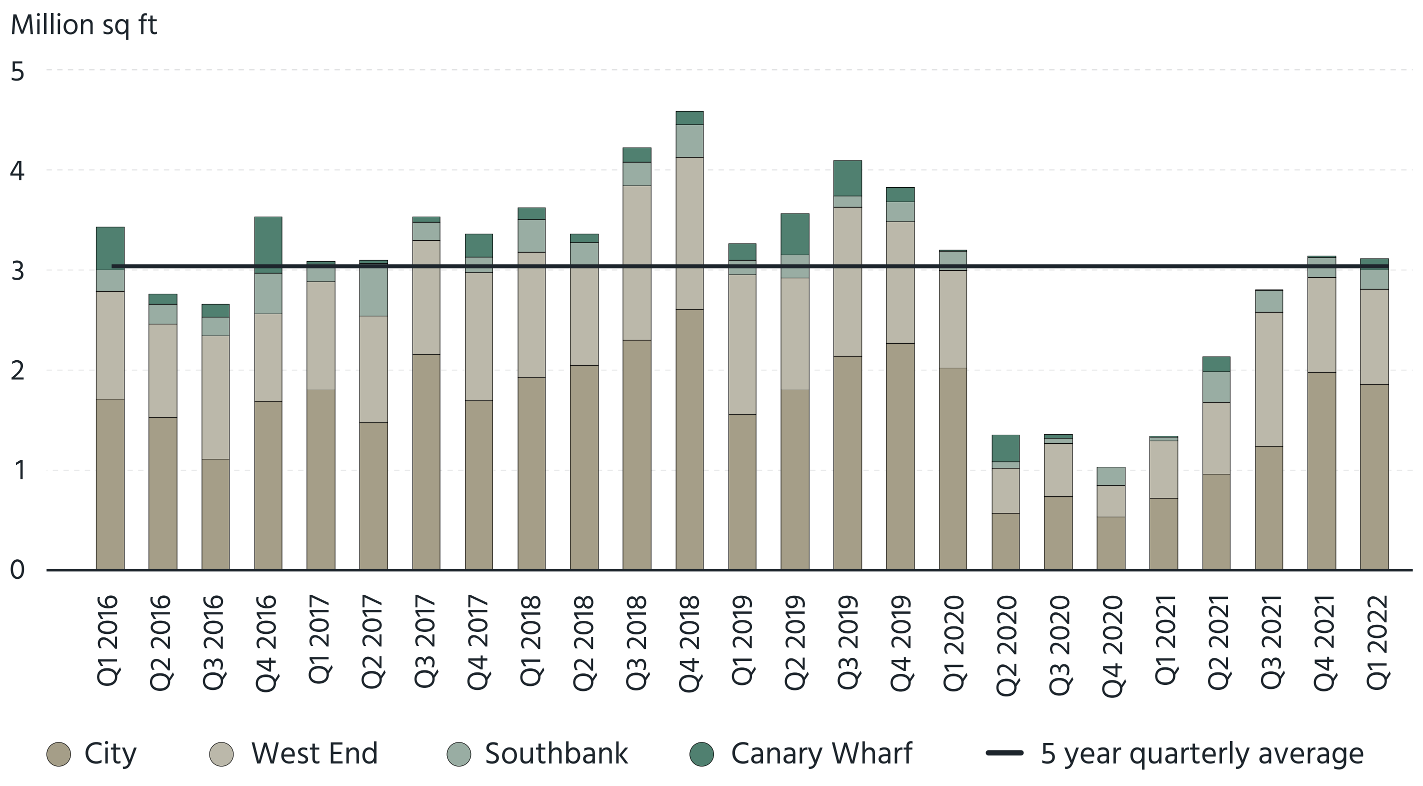


Visits to the workplace have seemingly reached a peak of 40% below the February 2020 baseline, with figures on a slight decline in the early portion of April. With most Covid-related restrictions in the UK now lifted, a ceiling is emerging for office occupancy following the adoption of hybrid working. On average, the common adoption for many occupiers seems to be three-out-of-five days in the office, which would convert to a fall of two-fifths or 40% in occupancy terms.

TfL data show the use of public transport fell in early Q1. The fall in January appears to be seasonal and journeys have nearly recovered to the peak reached in December. Around 127m bus and 65m underground journeys were made in March, with figures 3% and 14% below the December level, respectively.

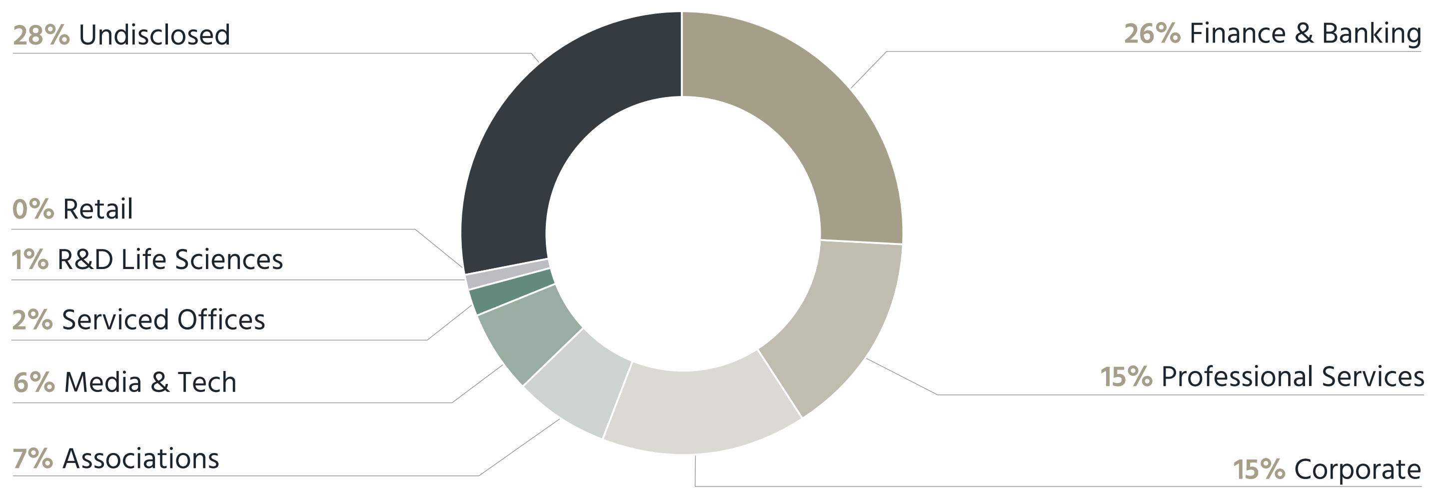
OFFICE OCCUPIER DEMAND

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



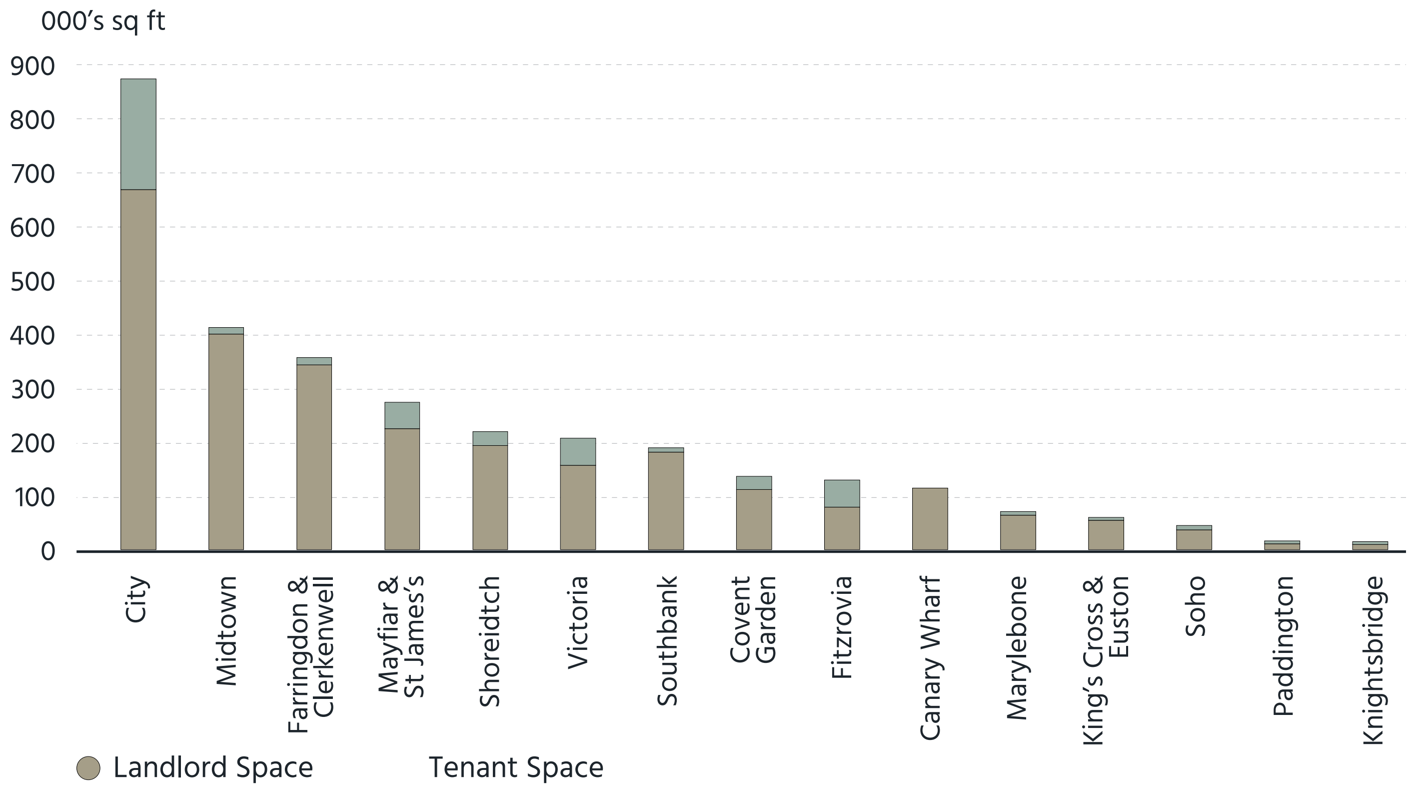
London office demand remained stable in Q1 2022 and occupier take-up reached just over 3.1m sq ft. This was a decrease of only 1% when compared with Q4 but 4% above the 5-year quarterly average of just over 3m sq ft. By broad market, the wider City had the largest volume of occupier activity with almost 1.9m sq ft of take-up. In the West End and Southbank, occupier activity was largely comparable to Q4 2021 with lettings totalling just under 1m sq ft and 190,000 sq ft, respectively. Canary Wharf take-up reached 115,000 sq ft, driven by Citibank's temporary move to 40 Bank Street where they will occupy around 90,000 sq ft.

Take-up by business sector, Q1 2022
Source: Gerald Eve



Finance and banking was the most active sector, taking just under 800,000 sq ft and accounting for over a quarter of total demand. By subsector, insurance, wealth management, and private equity firms were particularly active. Occupier preference within this sector was geared towards Grade A space, with an average lease length of 9.3 years. Professional services were the second most active with 470,000 sq ft of activity, and as a subsector, law firms drove activity with 12 lettings totalling 431,000 sq ft.

Take-up by submarket and lease type, Q1 2022
Source: Gerald Eve



By submarket, the City recorded the highest level of activity. Take-up amounted to just under 880,000 sq ft with a number of large commitments from the finance and banking sector. The largest letting of the quarter though was Hogan Lovells' 266,000 sq ft pre-let at the Holborn Viaduct development, which contributed to a 414,000 sq ft outturn for Midtown. Tenant-controlled space has been a feature of the market throughout Covid, and better-quality space has continued to attract attention. Total activity in this space amounted to 478,000 sq ft, 15% of all occupier activity this quarter.

THE NEW SHAPE OF OFFICE DEMAND

With the pandemic seemingly in the rear-view mirror, London office activity has rebounded with two consecutive quarters of above-average demand. Occupier sentiment is less defensive and many now view taking office space in London as a great opportunity to get a foothold in the market. Business decisions made over the last 12-18 months will begin to materialise in 2022, either driven by lease expiries or an attitude change to how much space is needed and how it is utilised, which in turn will set the tone for demand over the near and medium term.

Tenants are now voting with their feet for best-in-class space, with ESG, namely sustainability, at the forefront of decision making. The recovery in leasing activity has been characterised by these commitments and this will continue, especially for large HQ-style buildings. Increasingly, what occupiers demand from an office is influenced more by subjective characteristics than the overall costs. Offsetting increased cost of capital expenditure for refurbishment or higher rents in better quality offices is being achieved through trimming the overall volume of space, or maintaining space despite headcount expansion plans. Cost analysis is shifting on the spectrum towards the relative rather than the absolute.

An encouraging number of occupiers are now fast-adopting ESG into their working practices. Factors like triple bottom line accounting, which gauges corporate commitments to social responsibility and environment, and the power of the brand from a governance perspective are becoming increasingly important in decision-making. How individuals use branded space includes the choice of bespoke fitouts to exemplify company values, with the added benefit of incentivising employees back to the office. This will spur refurbishment activity in offices, and many occupiers, such as Google, Omnicom, and Citibank, are underway with these strategies and more large occupiers are expected to follow suit.

The war for talent is ramping up and a company's attitude toward post-pandemic work practices is a make-or-break factor for an individual's decision to take a role. The advent of hybrid working means employees are seeking companies where working practices are conducive to both work and home life. The office environment needs to appeal to a wide range of roles and many occupiers are seeking to provide dynamic space for a diverse range of talent with accommodating office designs. How an individual uses the office will become a prominent factor in job selection, and corporates will need to adapt space accordingly to get ahead in securing the best talent.

CHARACTERISTICS OF NEW DEMAND

- Sustainability credentials of building
- Governance and company values
- Company branding
- Local and in-building amenities
- Competition for talent
- Quality and utilisation of space
- Accommodating neurodiversity

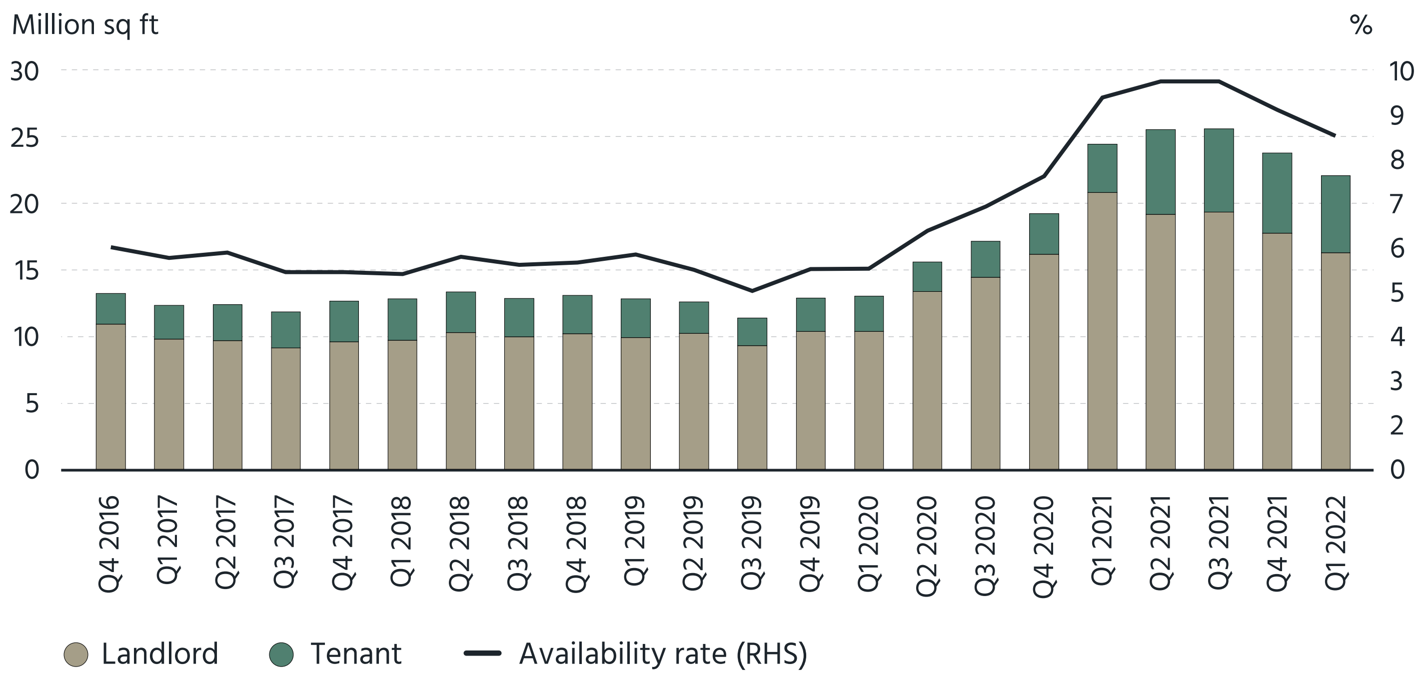
SEEKING COST OFFSETS

- Reduce floorplate and seek increased quality
- Maintain floorplate size but improve quality despite expansion plans

AVAILABILITY & SUPPLY

Availability by type of listing and rate

Source: Gerald Eve

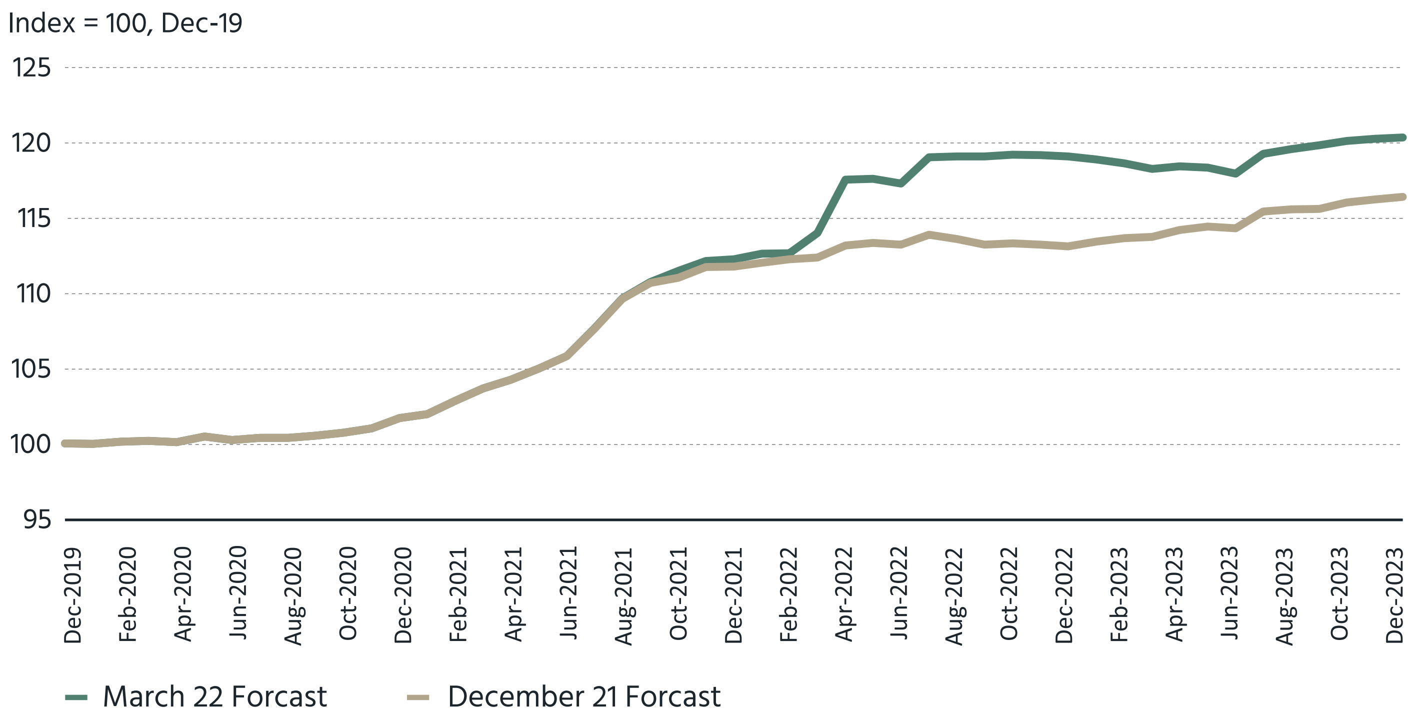


London office development pipeline

Source: Gerald Eve

BCIS general build cost index

Source: BCIS



Two consecutive quarters of improved demand contributed to another quarterly fall in availability in London, as the rate declined by 0.6%-pts, reaching 8.1% in Q1. The new wave of demand post-pandemic suggests that availability peaked at 9.4% in Q2 2021. Occupiers are now enacting business strategies, which in turn is fuelling absorption of office space that suits new requirements. However, tenant-controlled space remains a large part of post-Covid availability in London, with a total of 5.6m sq ft still available, or 26% of all space currently on the market.

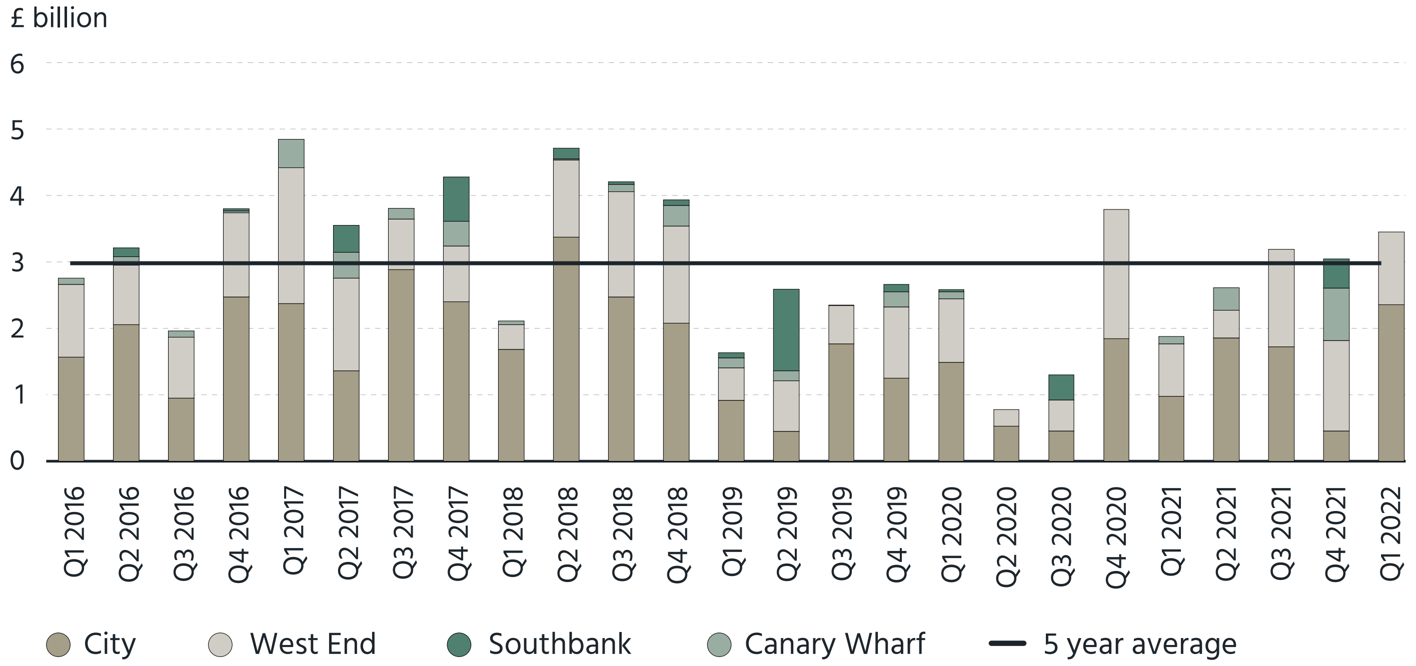
Development completions have been hampered by supply chain issues in the construction sector as well as labour shortages. This has contributed to lower-than-expected completions, with just over 350,000 sq ft of office space completing in Q1 across two schemes. The remaining expected completion volume for 2022 stands at 7.3m sq ft, a third of which is currently pre-let. The shift in occupier preference towards best-in-class, sustainability-geared space should result in healthy absorption of 2022 deliveries, particularly those which are touted to achieve positive sustainability scores.

For developers, build cost inflation has been a strong headwind to construction activity over the last year. General build costs are now 11% higher than in December 2020 and over 2022, construction costs are anticipated to be 5% above the level expected at the end of last year. As cost inflation ramps up, there is a case that cost-pull inflation contributes to an uplift in rents, especially for newly delivered prime stock. Developers and landlords will look to recoup costs over the development cycle of the property, setting rents higher than they otherwise would have been in a low inflation environment to achieve targeted exit yields.

INVESTMENT

Quarterly investment volume by broad market

Sources: Gerald Eve, Property Data



Total investment was just under £3.5bn in Q1, an increase of 13% on Q4 and 18% above the 5-year quarterly average. The majority of activity was in the City with £2.2bn transacted, more than half of which was accounted for by the National Pension Service of Korea's acquisition of 5 Broadgate for £1.2bn. In the West End, the total volume reached £1.1bn, driven by Google's £762m purchase of Central Saint Giles in Covent Garden. Bespoke and tailored office space is becoming a core requirement for occupiers post-pandemic, as it enables them to curate their space to their model of work and brand. For larger corporates like Google, making purchases and conducting refurbishments is expected to become a more common theme over 2022 and beyond.

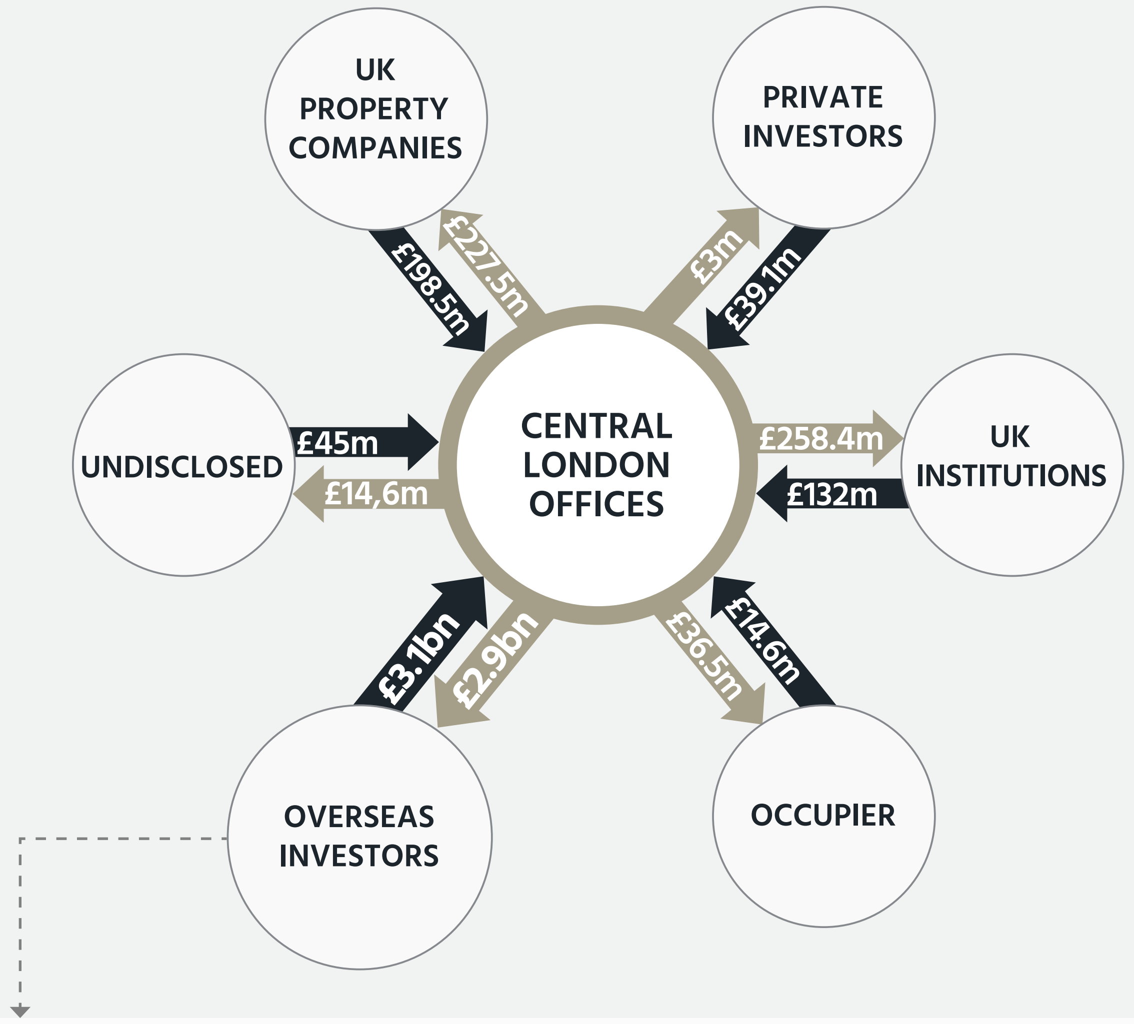
Investment this quarter was characterised by large transactions with half of the purchases made on lot sizes over £100m, with £3bn attributed to this segment. Joint ventures also featured as Allianz took a 25% stake from Aviva in 101 Moorgate, the oversite Crossrail development in the City. Obayashi Corporation increased their overall holding in 20 Gracechurch Street to 75% through the purchase of a further 50%. Obayashi cited the proximity to major tube stations as a key reason why the building is an attractive redevelopment prospect over the coming years.

Overseas investment returned with a bang, shaking off the travel disruption seen in the first few months of the year. Cross-border investors made just over £3bn of acquisitions over nine transactions in Q1. By sub-domicile, Far Eastern investors were the most active, accounting for 52% of overall overseas investment, making four acquisitions. Singaporean-based Sun Venture made their third acquisition in London since 2020, bringing the total allocation to £874m over the period. The investor has acquired buildings over 100,000 sq ft with diverse tenant bases, purchasing at yields between 4-4.5%, which provides a stronger income spread over domestic markets.

UK based investors made acquisitions of £330m, with UK property companies and UK institutions accounting for £198m and £132m, respectively. This segment was largely driven by value-add strategies with the weighted average transacted yield at 5.7%. Great Portland Estates acquired 7-15 Gresse Street, where the Fashion Retail Academy are in current occupation. The investor will seek to redevelop and reposition the asset to sustainable and modern managed flex space, pursuing net zero carbon commitments across the portfolio.

CENTRAL LONDON OFFICE CAPITAL FLOWS, Q1 2022

Source: Gerald Eve, Property Data



INVESTMENT VOLUME BY INVESTOR SUB-DOMICILE

£1.6bn	£951m	£420m	£115m
FAR EAST	NORTH AMERICAN	OTHER	GERMAN
51.9% OF OVERSEAS INVESTMENT	30.7% OF OVERSEAS INVESTMENT	13.5% OF OVERSEAS INVESTMENT	3.7% OF OVERSEAS INVESTMENT

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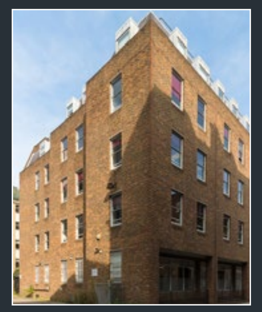
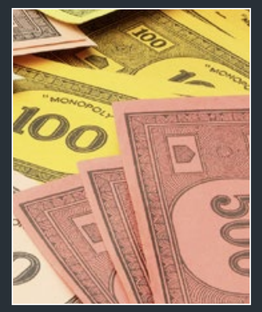
GERALD EVE IN THE MARKET



2-10 Princeton Street, WC1

The London Office Agency team have advised University of London on the successful sale of their long leasehold interest, achieving a sale price of £14 million. The building totals 18,000 sq ft of teaching space with four residential flats on the top floor in London's Midtown district.

For any further information please contact Fergus Jagger, Ben Nichols Amy Bryant.



A Life Sciences Lease of Life: Adaptive Repurposing

UK Life Sciences had a barnstorming 2021 with investment volumes of £2.5bn. A closer look at these figures shows that a sizeable proportion of the, already dwindling, up and built stock has now been traded. This leaves the limited stock opportunities firmly centred around development or repurposing. Is repurposing a swifter, more sustainable, way to satisfy the life sciences demand problem?

View our full-service offer

Find out how we can help