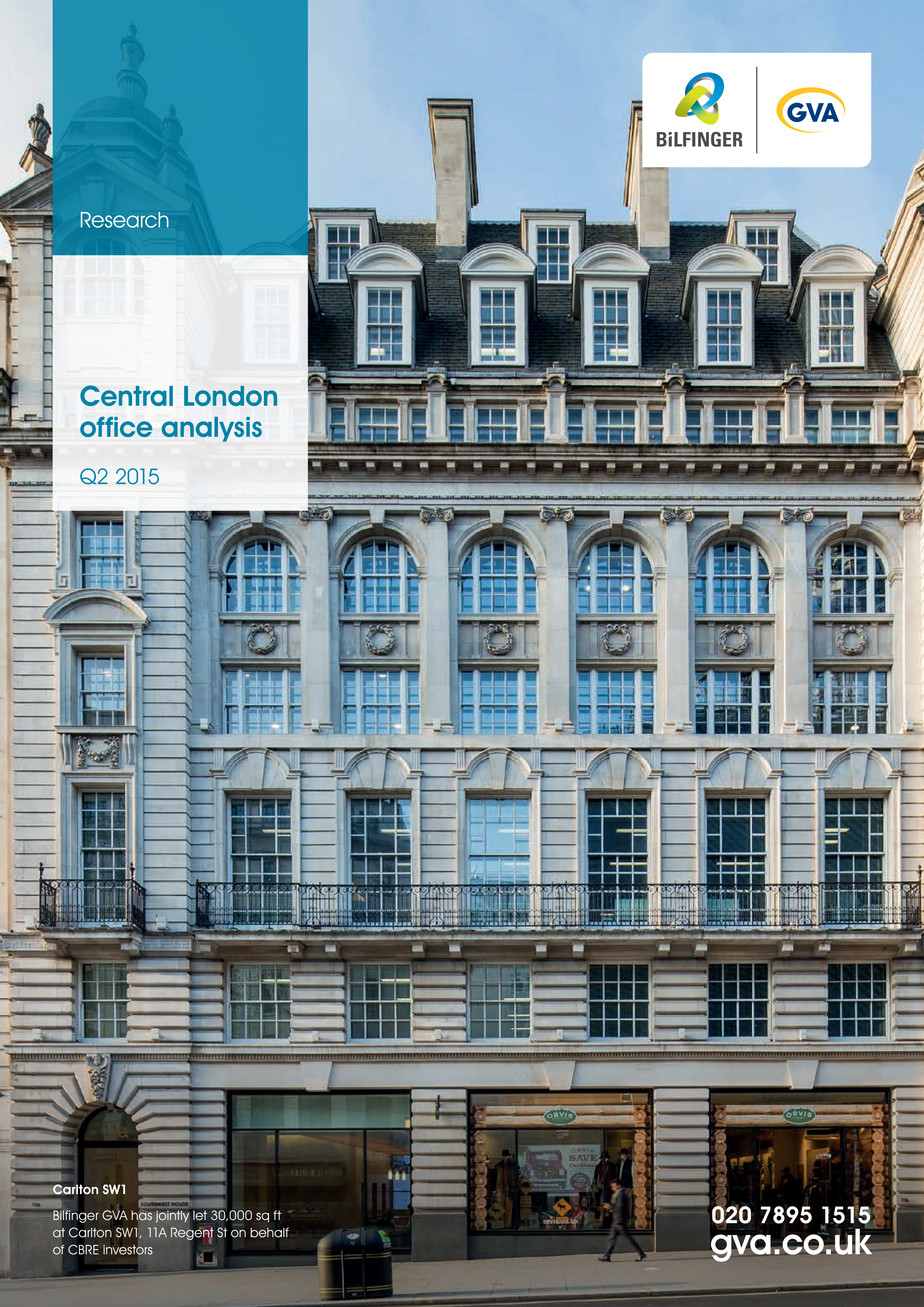
Research

Central London office analysis

Q2 2015



Carlton SW1

Bilfinger GVA has jointly let 30,000 sq ft at Carlton SW1, 11A Regent St on behalf of CBRE investors

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Central London
Market comment

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Welcome to Bilfinger GVA's central London office analysis; a detailed account of our view of the market in Q2 2015.

Changing rents

The rental profiles across central London are changing substantially. We are continuing to see high watermarks of rents achieved. In the core West End markets, there are more deals being done at £150 per sq ft, with Cale Street Partners rumoured to have paid that at 28/29 Savile Row. In the City, we have seen rents achieved on tower floors in excess of £90 per sq ft at The Leadenhall Building. This is despite the fact that these core markets saw relatively little movement on 'normal' prime rents. In some localised cases we are even seeing some landlords becoming more pragmatic, aware that there is not the depth of demand of tenants willing to pay top rents.

Nevertheless, in markets previously considered fringe, rental growth continues to be very strong. In Chelsea, prime rents have increased by over 30% in the last year with Marshal Wace rumoured to have paid £110 per sq ft at the Cadogan Estate's 130 Sloane Street, a new rental record for the Knightsbridge/Chelsea market and in line with the prime rents seen in Mayfair and St James's at the top of the last cycle. Rental growth has been of similar levels in Shoreditch and Clerkenwell where prime rents are now £60 per sq ft.

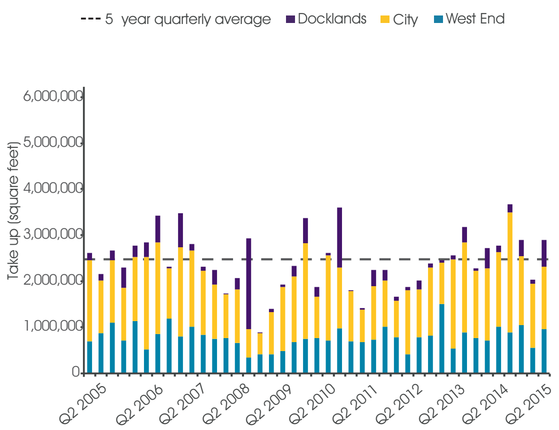
Pre-let it be

One of the big stories of recent times has been the success of pre-letting. Indeed, of the almost 23 million sq ft transacted during the very active years of 2013 and 2014, almost a third of this space was pre-let. In total, almost 7 million sq ft of deals were completed on buildings either before or during construction. However, during the first half of 2015 we saw just 830,000 sq ft let on a pre-let basis, representing just 17% of total take-up, not far removed from the levels we saw in 2012.

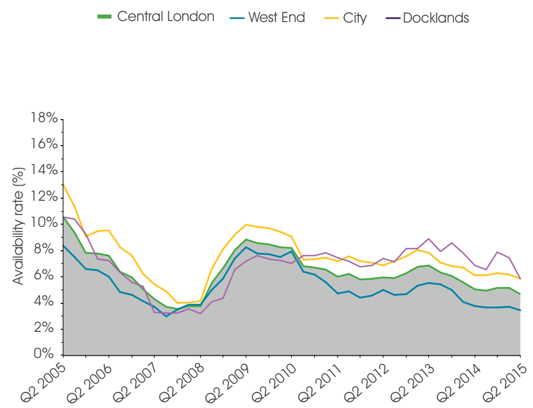
As availability continues to decrease sharply, and with further rental growth expected, we expect pre-letting to be a necessity for many large occupiers. In fact, the news that Royal Bank of Canada is under offer at 100 Bishopsgate is very positive for the market and, of course, Brookfield. Nevertheless, the fact that this trend has dropped off in the last two quarters is noteworthy, and it will be interesting to see if we return to the same levels we saw in 2013 and 2014.

Patrick O'Keeffe

Central London take-up
Source: Bilfinger GVA/EGI



Central London office availability rates
Source: Bilfinger GVA, CoStar



Central London
Occupier market

Take-up

Central London take-up for Q2 2015 totalled 2.9 million sq ft, 43% up on the previous quarter, and 18% up on the five-year quarterly average of 2.5 million sq ft. Take-up was in line with the last quarter of 2014.

The strong quarter means at take-up for H1 2015 totalled 4.9 million sq ft, which whilst 10% down on H1 2014, is just 2% down on the corresponding period in 2013.

During Q2, activity was mainly in the City core and West End fringe, both accounting for just over 850,000 sq ft each, circa 30% of take-up across central London. Canary Wharf was the star performer, with Q2 take-up 152% up on its five-year quarterly average. The City core and West End fringe also saw strong performance, up 41% and 21% respectively on their five-year quarterly averages.

The largest deal of the quarter was in Canary Wharf where Bilfinger GVA disposed of 390,000 sq ft at 10 Upper Bank Street (E14). At King's Cross Central, Google took 182,500 sq ft at S2, Handyside Street (N1) on a 15 year lease at a rent of £55 per sq ft. In total, Google has leases on 545,000 sq ft of space across the development, in addition to its ongoing plans for a European headquarters, likely to be in excess of 750,000 sq ft. The largest deal in the City was Brit Insurance taking 66,400 sq ft at The Leadenhall Building (EC3).

Second-hand grade A space accounted for the majority of take-up during the quarter, totalling 1.3 million sq ft across central London and making up 45% of activity. Recently completed space accounted for 24% of take-up (0.7 million sq ft). Pre-letting was similar to that measured in the previous two quarters, accounting for 16% of activity, although this is substantially down on the 43% measured in Q3 2014. Take-up of second-hand Grade B space totalled 16% of take-up.

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

Availability

During Q2 2015, availability across central London decreased from 10.2 million sq ft to 9.3 million sq ft. The vacancy rate reduces to 4.8%, its lowest since Q2 2008 when the vacancy rate was down at 3.9%.

Availability is 7% down on the corresponding period last year when the vacancy rate was 5.2%, representing 0.7 million sq ft less available space.

Development

During the quarter, 18 buildings totalling 1.5 million sq ft of development completed. Of this only 543,000 sq ft (37%) is still available.

The largest buildings to complete, the only two schemes over 100,000 sq ft, were British Land and GIC's 5 Broadgate (EC2), which was pre-let to UBS before construction started, and Blackstone's refurbishment of 250,000 sq ft at The Adelphi (WC2), where 64,600 sq ft has been let.

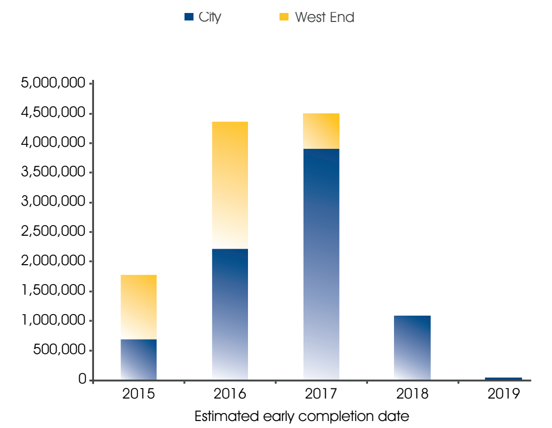
2.0 million sq ft of development started during the quarter, the largest two schemes being Brookfield's 866,000 sq ft 100 Bishopsgate (EC2) and Goldman Sachs and Tishman Speyer's 844,000 sq ft Plumtree Court (EC4).

There is currently 11.9 million sq ft under construction across central London, with 1.8 million sq ft (15%) due for completion before the end of 2015 and 4.4 million sq ft (37%) due before the end of 2016. Of the space currently under construction, 4.1 million sq ft (35%) has already been let, leaving just 7.8 million sq ft of available space currently under construction.

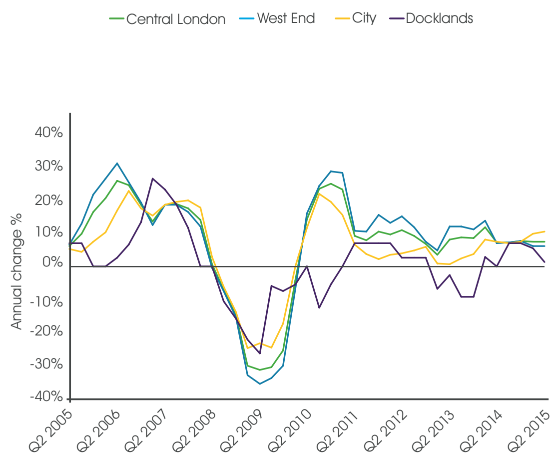
Rental growth

Central London prime rents grew by 1.4% during the quarter. The City and the West End grew by 0.6% and 1.9% respectively, while Docklands remained stable. Prime rents across all central London increased by 7.6% compared to Q2 2014. The Bilfinger GVA Central London index is now 14% 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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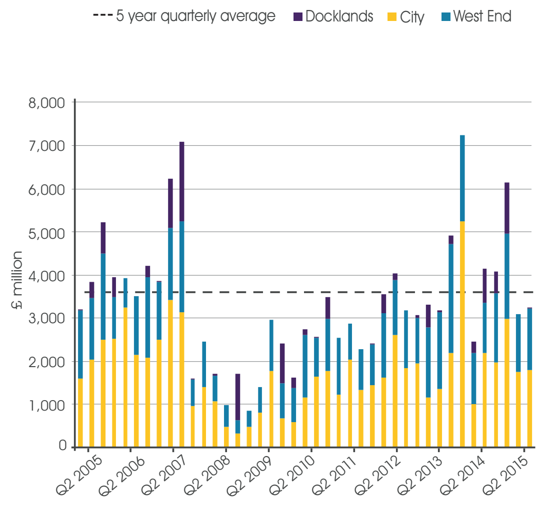
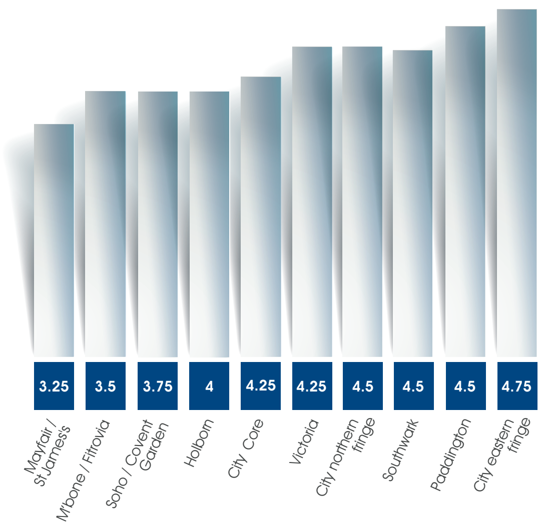
Central London office investment transactions
Source: Bilfinger GVA, PropertyData



Central London office yields
Source: Bilfinger GVA



Overview

During the last quarter, a number of large lot sizes have come to the market increasing the levels of stock significantly from a relatively 'lean' first quarter. These are almost exclusively from UK based vendors. From the REITs, British Land have two sales at 39 Victoria Street (SW1) and Ebury Gate (SW1) with Land Securities actively marketing Haymarket House (SW1). The UK institutions are also selling assets with Orchard Street placing their West One Shopping Centre (£240 million) on the market and WELPUT recently placing their 16/17 Connaught Place (W1) building under offer.

In the West End, residential developers are increasingly facing competition from commercial developers with office values having risen so much that they are 'neck and neck' with residential values.

Even with an increase in supply, there is no shortage of purchasers with interest from the UK as well as from overseas. Well located, quality buildings are continuing to attract significant interest and record low yields are being achieved almost on a monthly basis in both the City and West End.

Transaction volumes

During Q2 2015, central London investment totalled £3.2 billion across 449 deals, marking a 4% increase on the previous quarter but 10% down on the five-year quarterly average. Activity for the first half of 2015 totalled £6.3 billion, 4% down on the corresponding period in 2014 when £6.6 billion was transacted.

The West End saw £1.4 billion transacted, 23% up on the same period last year. The largest deal was UBS' £222.4 million purchase of 95 Wigmore Street (W1) representing a yield of 3.4%. In Paddington, British Land paid £210 million for the 200,000 sq ft 1 Sheldon Square (W1). The largest deal in the core was at Bond Street House where Thor Equities and Meyer Bergman paid £113 million.

In the City £1.8 billion was transacted across 21 deals, an 18% decrease in value compared to the same time last year. Cathay Life were responsible for the largest deal of the quarter, buying The Walbrook from Delancey and Ares Management for a headline price of £575 million, which represents a yield of 4%. The second largest deal of the quarter was on the South Bank where Carlyle Group sold Sampson House (SE1) and Ludgate House (SE1) for £308 million to a consortium made up of Native Land, Temasek, Hotel Properties and Amcorp. The site will be developed to house a 1.4 million sq ft mixed-use scheme including 288,000 sq ft of offices.

Overseas investors were once again the most active this quarter, accounting for 67% (£2.2 billion) of purchases but only 37% of sales across central London. Far East investors alone made up 42% of the market. UK property companies were the second most active purchaser in the market, accounting for 17% of investment during the quarter, but 36% of sales.

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

Yields

Prime yields came in 25 basis points in seven out of the ten central London subareas during the quarter. Furthermore, in the past year we have seen yields come in by 75 basis points or more in five of our subareas, with Marylebone / Fitzrovia yields coming in from 4.5% to 3.5% during this time.

Prime yields in Mayfair and St James's are now at 3.25%, 50 basis points lower than the top of the market in 2007. In the City core, yields remain at 4.25%.

Haymarket House, SW1

Currently on the market from Land Securities

West End Occupier market

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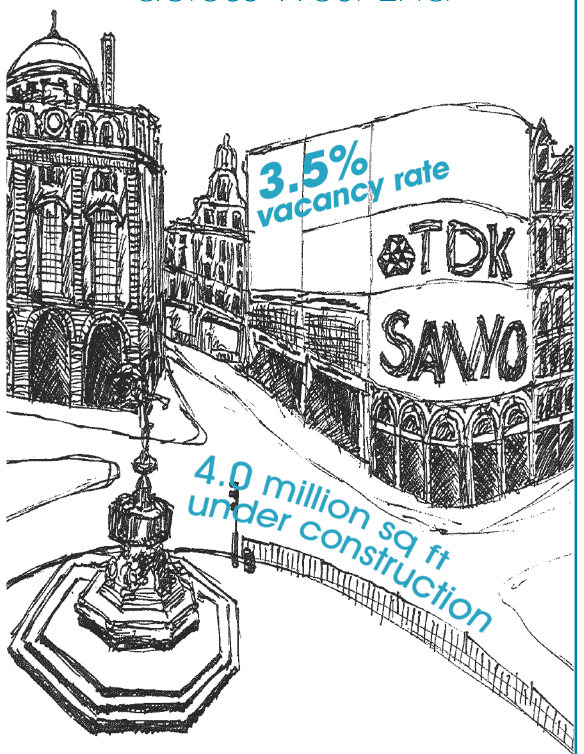
968,600 sq ft let
75% up on Q1 2015

£150 per sq ft
"super-prime" rent

6.1%
Annual rental growth
across West End



Take-up

During Q2 2015, take-up across the West End totalled 968,600 sq ft, a 75% increase on Q1 2015 and 17% above the five year quarterly average. Despite the strong quarter, take-up for the first half of the year stands at 1.5 million sq ft, 13% down on the corresponding period in 2014.

The largest deal of the quarter was at King's Cross Central, where Google took 182,500 sq ft at S2, Handyside Street (N1) on a 15 year lease at a rent of £55 per sq ft. At 130 Sloane Street (SW1), Marshall Wace took a pre-let on the entire 43,000 sq ft building at a rumoured rent of £110 per sq ft, a new rental record for the market. Just after the quarter-end, Facebook signed on 65,000 sq ft at 338 Euston Road (NW1) and have taken short-term serviced offices at 2 Stephen Street (W1).

TMT and financial and business services were the most active sectors in the West End, accounting for 27% and 26% of take-up respectively during the quarter. Professional services made up 9%.

During Q2 2015 deals on pre-let space accounted for 314,600 sq ft and 32% of take-up across the West End. Deals on recently completed space made up a further 145,700 sq ft, and 15% of take-up for the quarter.

In total, lettings of new space made up 48% of take-up.

Availability

Availability decreased significantly during the quarter from 3.1 million sq ft to 2.8 million sq ft. The vacancy rate is now at 3.5%, its lowest since Q2 2007, when it was 3.0%. There is 14% more available space now than during 2007.

Development

597,200 sq ft completed across the West End during Q2 2015. The largest building to complete was the refurbishment of 250,000 sq ft at Blackstone's The Adelphi (WC2). At Resolution's Ampersand (W1) on Wardour Street, construction completed on 65,000 sq ft.

Only 129,000 sq ft went under construction during the quarter across two buildings. There is 79,000 sq ft now under construction at Bedford Estates and Exemplar's 1 Bedford Avenue (W1), with 50,000 sq ft under construction at GE Real Estates and O&H Properties' 8-10 Grafton Street (W1). As of the end of Q2 2015, there is 4 million sq ft of development activity in the West End.

Rental growth

During the quarter, prime rents across the West End increased slightly by 1.9%. This means that prime rents across the market are up 6.1% on the same period last year.

In Mayfair and St James's, prime rents increased slightly to £120 per sq ft with rent free periods stable 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 Cale Street Partners understood to have taken the top floor of 28/29 Savile Row (W1) at these levels.

The big movers during the quarter were outside of the core markets, in west London. Belgravia/ Knightsbridge, Chelsea and Fulham all saw rental growth of 6% during the quarter. Prime rents in Chelsea have increased by over 30% in the last year.

City Occupier market

Take-up

Take-up in the City during Q2 totalled 1.3 million sq ft, 3.5% down on the 1.4 million sq ft measured in the first quarter of the year, and 4.2% down on the five-year quarterly average. This means that take-up for H1 2015 totalled 2.7 million sq ft. Whilst this is a 13% decrease on that measured in H1 2014, it is just 4% down on the corresponding period in 2013.

During the quarter there were four deals of over 50,000 sq ft, compared to just two in Q1 2015. The largest deal of the quarter was Brit Insurance's letting of 66,400 sq ft at The Leadenhall Building (EC3) on a 15 year lease. At Aldgate Tower (E1), WeWork took 60,500 sq ft over three floors. At 67 Lombard Street (EC3), Arthur J Gallagher took 53,300 sq ft. The largest pre-let of the quarter was at 2 London Wall Place where Cleary Gottlieb Steen & Hamilton took 60,000 sq ft across the top five floors of the building.

This quarter, pre-letting made up 137,100 sq ft, just 10% of all activity, compared to 27% in the previous quarter. In total, pre-letting for H1 2015 totalled 517,500 sq ft, 19% of all take-up. This is markedly down on the 1.1 million sq ft of pre-letting we saw in H1 2014, which made up 36% of take-up for the first two quarters of 2014. Similarly, H1 2013 saw 871,700 sq ft of pre-letting, 31% of activity for that period. This would indicate a drop-off in the strong appetite for pre-letting we have seen over the last two years, although the news that Royal Bank of Canada are in negotiations to take 250,000 sq ft across five floors Brookfield's 100 Bishopsgate (EC2) is a boost to the market.

During the quarter, the majority of take-up was on newly completed space, making up 38% of take-up and 512,200 sq ft. Second-hand grade A space totalled 474,700 sq ft, 35% of take-up, with second-hand grade B space responsible for 17% (225,000 sq ft) of activity.

Professional services was the most active sector accounting for 37% of take-up, with the finance and banking sector and TMT making up 17% and 12% of take-up respectively.

Availability

Availability in the City decreased from 5.7 million sq ft to 5.4 million sq ft, with the vacancy rate now at 5.8%. Availability is 5% down on the corresponding period in 2014 and at its lowest since Q2 2008.

Development

At the end of the quarter, there was 8.0 million sq ft under construction, with just 700,000 sq ft of this due to complete in 2015. Of this, 470,000 sq ft (67%) is already let.

During the quarter 867,000 sq ft completed, with the largest being UBS' new home at 5 Broadgate (EC2). Construction also completed at four other buildings including Asia House, Lime Street (EC3) and Block C – Old Truman Brewery (E1).

As well as the large construction starts at 100 Bishopsgate (EC2) and Plumtree Court (EC4), other significant starts were on City Road where 120,000 sq ft went under construction at 250 City Road (EC1) and Epworth House (EC1).

Rental growth

Prime rents across the City increased marginally by 0.6%, with prime rents up 10.6% on the corresponding period in 2014.

Shoreditch saw the biggest change during the quarter, increasing 9% to £60 per sq ft. Prime rents in the area are now 33% up on the same time last year. Core City rents remain stable at £63.50 per sq ft, their joint highest since Q1 2008. Rent free periods remain the same at 21 months. Net effective rents are still 10% down on the 2007 peak.

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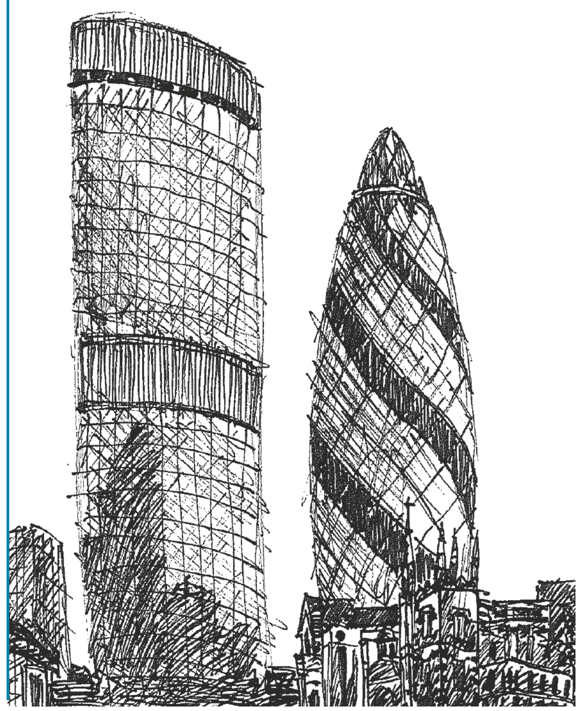
1.3 million sq ft take-up
4.2% down on the five-year
quarterly average

8.0 million sq ft
under construction

231,000 sq ft
of available space left
to complete during 2015

Vacancy rate 5.8%

Prime rents
£63.50
per sq ft



Docklands Occupier market

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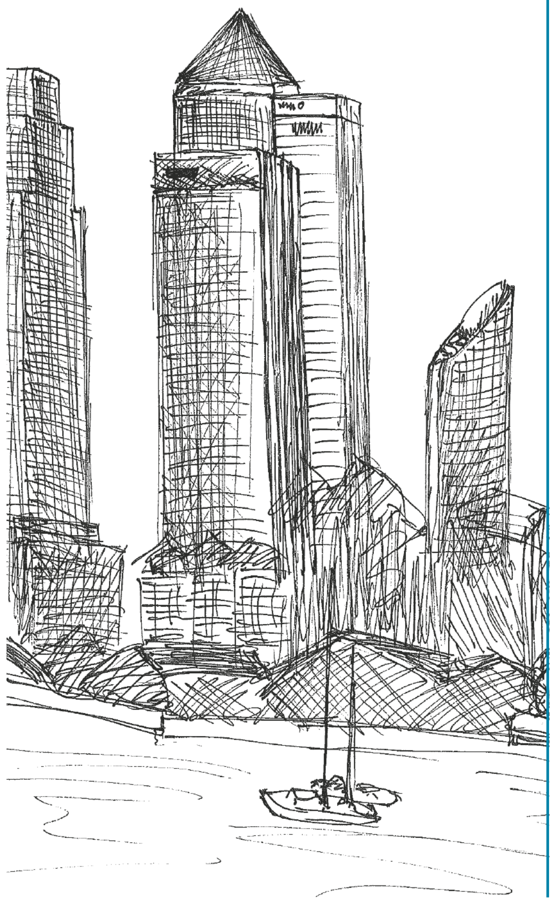
588,172 sq ft let
150% up on five-year quarterly average

Prime rents
£38.00 per sq ft

5.8%
vacancy rate

10
deals completed during Q2

78%
of activity by financial and business services companies



Take-up

Ten deals completed in Docklands during Q2 2015 totalling 588,172 sq ft of take-up, the busiest quarter since Q4 2010 and 150% up on the five-year quarterly average. This means that H1 take-up totalled 671,300 sq ft, 15% up on the corresponding period in 2014.

66% of take-up was accounted for by one deal, with Deutsche Bank agreeing to let 388,000 sq ft at 10 Upper Bank Street (E14). The second largest deal was at 1 Canada Square (E14) where Level 39 took 40,300 sq ft of accelerator space across two floors, having taken its first floor back in late 2012. 25 Canada Square (E14) saw 109,000 sq ft of take-up across five deals, including lettings to HSBC and NYK Line.

The busiest sector in the Docklands was finance and banking which made up 78% of activity during the quarter.

Availability

There is 1.1 million sq ft of available space across Docklands. The vacancy rate decreased from 7.5% to 5.8% during the quarter.

Development

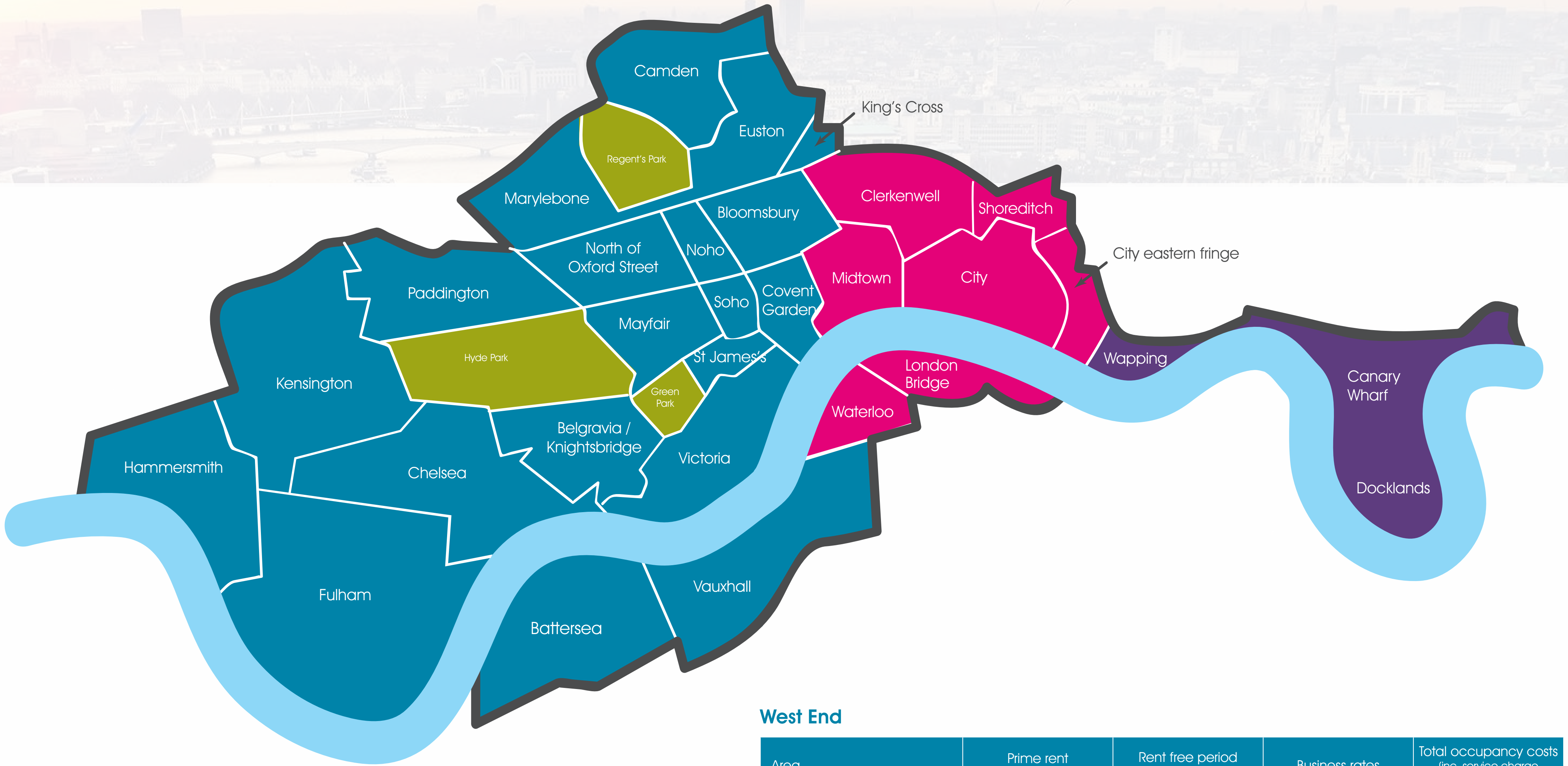
There are no office developments currently under construction, although enabling works continue at 1 Bank Street (E14), where Societe Generale have already agreed a pre-let for 280,000 sq ft in the 700,000 sq ft scheme. Work on Wood Wharf is expected to start next quarter, where there is potential for 2 million sq ft of offices, which will be phased to 2023.

Rental growth

In Canary Wharf, prime rents remained stable during the quarter at £38 per sq ft, with rent free periods at 24 months. There continues to be a wide disparity in asking rents between landlord space and space available on a sub-let from occupiers, although we expect rental growth during the rest of the year. Outside the Wharf, rents increased slightly from £30 per sq ft to £31 per sq ft with rent free periods decreasing from 27 months to 24 months.

10 Upper Bank Street, E14

Bilfinger GVA let 388,000 sq ft to Deutsche Bank



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	£63.50	21	£21.52	£95.27
Chancery Lane	£62.50	15	£25.14	£97.89
City Eastern fringe	£50.00	22	£17.24	£77.49
Clerkenwell	£60.00	15	£14.28	£84.53
Insurance Sector	£60.00	21	£22.29	£92.54
London Bridge	£57.50	18	£19.02	£86.77
Northern City	£63.50	22	£17.44	£91.19
Shoreditch	£60.00	18	£11.88	£82.13
Waterloo	£57.50	18	£19.02	£86.77
West City	£65.00	21	£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	24	£16.17	£64.42
Other Docklands	£31.00	24	£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	£95.00	17	£45.39	£150.64
Bloomsbury	£70.00	17	£25.50	£105.75
Camden	£52.50	18	£17.34	£80.09
Chelsea	£95.00	17	£33.15	£138.40
Covent Garden	£83.00	18	£28.56	£121.81
Euston	£72.50	18	£28.56	£111.31
Fitzrovia	£82.50	18	£26.01	£118.76
Fulham	£42.50	18	£16.32	£69.07
Hammersmith	£50.00	18	£18.87	£79.12
Kensington	£60.00	18	£23.46	£93.71
King's Cross	£77.50	18	£23.46	£111.21
Mayfair	£120.00	15	£46.92	£177.17
Mayfair "super-prime"	£150.00	15	£52.02	£212.27
North of Oxford St	£95.00	16	£40.80	£146.05
Paddington	£62.50	18	£26.15	£98.90
Soho	£90.00	17	£33.15	£133.40
St James's	£120.00	15	£46.92	£177.17
Vauxhall	£47.50	22	£15.10	£72.85
Victoria	£82.50	17	£30.09	£122.84

London
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