LONDON BOUNCES BACK

Normality returns to the market following the EU referendum vote and a shock snap General Election

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Data reporter

With the Cheesegrater, EC3, sold in the City's second biggest investment deal, Brexit negotiations becoming a normal fact of life and the snap election safely behind us, London has resuscitated its leasing market and kick-started its activity.

Take-up rebounded to just above 3m sq ft, up by 50% on Q2 last year and up by 20% on Q1 this year. Although the bar was set low, considering the sluggish lead up to the EU referendum last year, take-up in Q2 was within 2% of the five-year average, according to EG's London Office Market Analysis.

A semblance of normality has returned.

There were only three major deals of more than 100,000 sq ft – just as there were in Q1 – as the market continued to rely on the sheer volume of smaller deals.

However, availability rates continued to rise on average, from 6.97% to 7.17%, with average rents falling as a result.

In Mayfair/St James, rents were down by 7.9% year-on-year, to £113 per sq ft, and in Victoria there was a 4.9% fall to £76 per sq ft.

If parts of London are slowing despite rising activity, who is spurring on the market – and why are occupiers choosing to stay in the capital?

TMT continues to grow

Co-working behemoth WeWork was responsible for the two biggest deals of the quarter, taking a combined 423,000 sq ft at 125 Shaftesbury Avenue, WC2, and 2 Southbank Place, SE1.

Patrick Nelson, executive vice president of real estate at WeWork said: "We're committed to London. It has been a centre for commerce for centuries and always will be.

"We are comfortably above 90% occupied in all mature locations across the market and demand is increasing so we are growing fast. Uncertainty in the market favours our flexible model and we have seen this reflected in increasing demand across all business types."

While WeWork dominated the market in major deals, it did not dent the continuing growth of TMT.

The sector once again tightened its grip on the capital, with close to 800,000 sq ft of lettings, pushing its market share from 29.6% last quarter to 31.6% in Q2 – more than double that of the financial services sector.

Like the London market as a whole, the sector thrived thanks to the volume of smaller deals. The five biggest leases accounted for just over a third of let space, compared with 58% in Q1.

Occupiers in the sector targeted space across the whole capital, which meant that most submarkets benefited from its activity. Although Midtown saw 36% of the sector's take-up, 25% went to the West End and 21% to City fringe. A further 13% was leased in the City core – the historic home for finance.

Finance falling behind?

The financial services sector, meanwhile, continued its pattern of low activity with 380,000 sq ft of take-up – only 15% of the market share.

For Philip Pearce, executive director of central London at Savills, these trends are largely a reflection of financial companies as mature, rather than declining, mainstays of the London market.

Pearce said: "They all carry significant footprints in terms of occupancy. They've got the ability to absorb quite a lot of expansion without having to go back out in the market to acquire more space, whereas if you're a three-year-old tech company and you double in size, you've got no option but to go and acquire space."

The financial services sector still occupies 41m sq ft in central London – a third more than the 31m sq ft that TMT occupies. The gap has closed in recent years – it was 57% in 2006 – but finance remains a London stalwart.

The question now is at what point does the TMT sector mature in the same way financial services has? When will it have an established presence in the capital that does not demand continued expansion?

"Every day I think the wave has got to break, but every quarter it just seems to roll," Pearce said.

He argued that since tech companies are innovative and "disruptive" businesses, they will continue to etch away at other sectors. As long as fintech keeps evolving, for example, it will take space from traditional finance players.

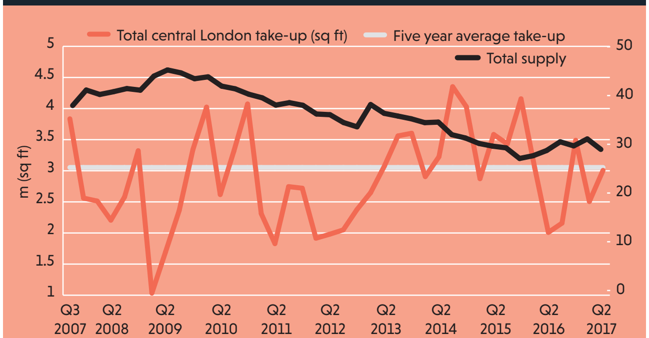
The waning City core

While the overall picture was robust, recovery evaded certain parts of London, including in the City core, where take-up was 749,000 sq ft.

Despite that figure being 34% up on Q2 2016, the submarket fell short of its five-year average by 26%.

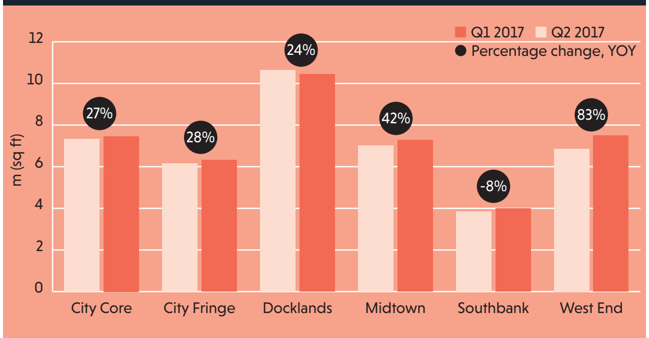
The problem, according to Shaun Simons, director of City fringe at Colliers International, is that other submarkets have

CENTRAL LONDON OFFICE TAKE-UP AND SUPPLY, 2007-2017



Source: EG Research

CENTRAL LONDON AVAILABILITY RATES



Source: EG Research

THE BIGGEST DEALS OF Q2 2017

Business	Sector	Address	Submarket	Space let (sq ft)	% of total quarter take-up
WeWork	Property	Two Southbank Place, SE1	Southern fringe	283,450	9.40%
WeWork	Property	125 Shaftesbury Avenue, WC2	Midtown	140,000	4.70%
Nex Group	Financial	39 Brushfield Street, E1	City fringe	115,680	3.80%
Framestore	TMT	28 Chancery Lane, WC2	Midtown	93,882	3.10%
Hearst Magazines UK London	TMT	30 Panton Street, WC2	West End	71,701	2.40%

benefited from the City core's "identity crisis".

The submarket is highly dependent on finance take-up and has failed to attract significant activity from sectors like tech, which is now one of the city's most important economic drivers.

"It lacks all the culture and amenities that the City fringe provides," he said, adding that the fringe has been able to attract activity from occupiers shunning traditional stock available in the financial heart of the capital.

Even financial services had 11% more take-up in the City fringe than the City core. Property and TMT, both of which accounted for more than 15% of the core's take-up, also favoured other submarkets.

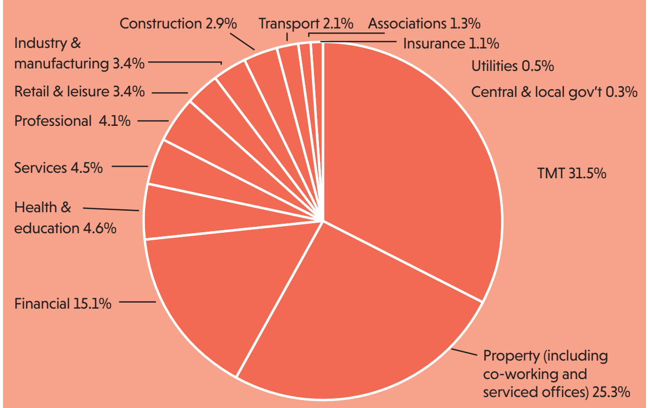
The City core effectively relied on sectors that viewed it as a secondary option.

Long-term returns

When CC Land bought the Cheesegrater, EC3, from British Land and Oxford Properties for £1.15bn in one of the biggest deals in London's history, the industry breathed a collective sigh of relief. It was proof of London's resilience in a time the city needed a firm vote of confidence.

Other major deals, like Deka's £485m acquisition of

TAKE-UP BY SECTOR, Q2 2017



Source: EG Research

Cannon Place, EC4, suggested healthy levels of interest from investors, and expectations were high for the quarter.

But despite the headline grabbers, total investment came to a lacklustre £3.4bn in Q2 – 13% below the three-year quarterly average of £3.9bn, though above Q1's £3.3bn.

For the first time since Q2 2013, the biggest transaction accounted for more than a third of all investment volume.

James Beckham, head of London capital markets at Cushman & Wakefield, which advised on the Cheesegrater deal, says the problem was not a lack of demand but a lack of supply.

"I can't think of a single building that's come onto the market that hasn't sold for want of buyers," he said.

He pointed to one of Cushman & Wakefield's recent deals, 20 Gresham Street, EC2, which sold to China Resources land and NorthStar Realty Europe for £300m – a 4% yield. That deal, Beckham says, had £1.8bn of capital chasing it from six bidders, all from Asia Pacific.

"We're surprised by investors' responses. Our general position is that even in the face of the headwinds of Brexit and the Conservative election and terrorism and so on, the investment market hasn't really blinked. The pricing hasn't changed at all to reflect any of that," he said.

He added that his team managed to sell Starwood Capital's One Braham Street, E1 – an 18-storey, 320,000 sq ft development – to Hong Kong investor Kwong Hing Investment Group for £65m, despite only being in the early stages of construction.

"There are people bidding all across the risk spectrum and you've even got an Asia-Pacific investor buying a spec development site on the east side of the city. I wouldn't call that lacklustre."

Events like the EU referendum and the snap General Election, he said, were seen as transparent democratic processes, which would not have impacted on London's image as a safe gateway city.

Places like Berlin, Paris or Tokyo have yields just above or below 3% in the prime office market, but similar properties in London return 3.5%-5% with long-term income.

While the leasing market slowed in City core, the opposite was true on the investment side. The core attracted £2.1bn of capital – 62% of the central London total – including the quarter's four biggest deals.

It was a reflection of the presence of major trophy assets with long leases, which is what the Asian and German investors that dominate the market look for in London deals.

As long as those assets are out there, the capital will continue to draw in institutions looking for long-term returns.

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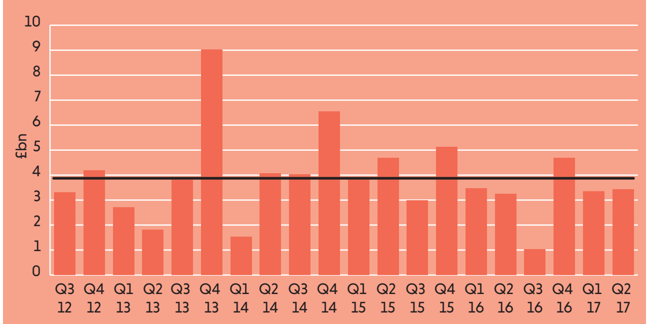
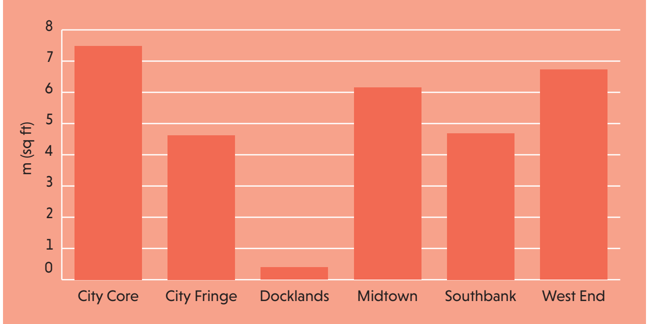
CENTRAL LONDON OFFICE INVESTMENT



Source: EG Research

LONDON OFFICE TAKE-UP BY SUB-MARKET, Q2 2017



Source: EG Research