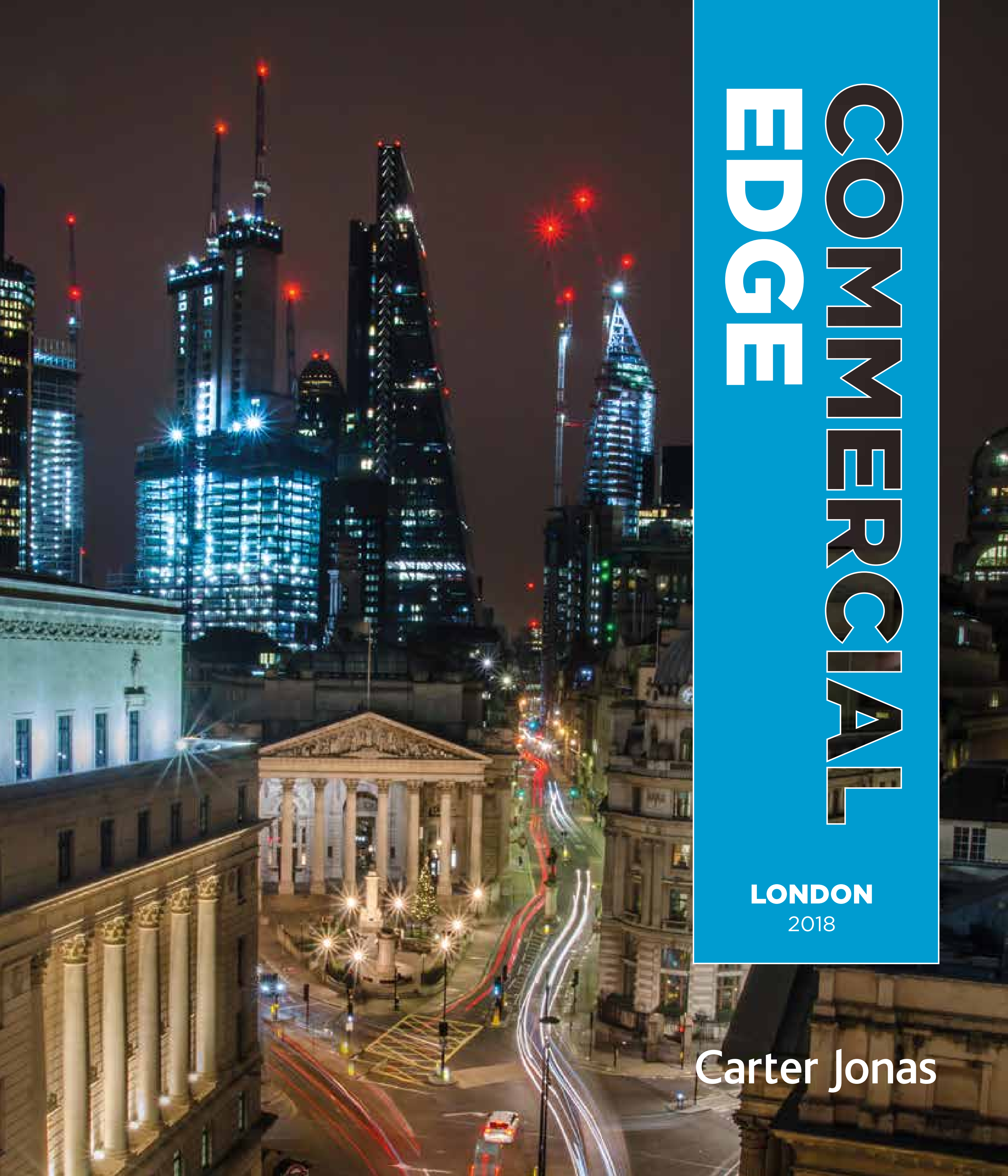


COMMERCIAL EDGE

LONDON
2018

Carter Jonas

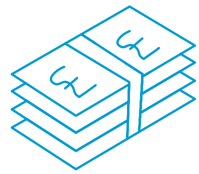
POLITICAL TURMOIL WAS WITHOUT DOUBT THE LOW OF 2017. CABINET CHANGES AND IN-FIGHTING ASIDE, THE UPS AND DOWNS OF THE BREXIT NEGOTIATIONS HAVE HAD AN IMPACT ON THE LONDON MARKET.

A number of businesses have faced difficulty in forward planning and making decisions about their future, prompting moves in the financial sector to other European locations and halting expansion plans against a backdrop of consolidation. At the same time London is set to also see the loss of the European Medicines Agency to Amsterdam and the European Banking Authority to Paris. While these announcements represent a series of blows to the capital, the scale of demand lost within the occupier market appears, at present, to be relatively minimal.

The City remains a global powerhouse and an attractive market for doing business. It continues to draw highly skilled individuals to its universities, which creates a pool of prized talent and a rising population, which is a major incentive for a range of industries. This continues to be reflected in occupier and investor demand, which outperformed expectations in 2017. A number of major corporates including Deutsche Bank and Amazon have shown commitment to the UK as a result, the former representing one of the largest leasing transactions of 2017.

During the on-going period of negotiations to leave the EU, other European locations will continue to benefit from further movements of staff overseas. London, however, will continue to remain highly competitive as a market, benefiting from its readily available supply of talent, cultural environment, infrastructure and quality of real estate that is currently lacking in many competing locations.

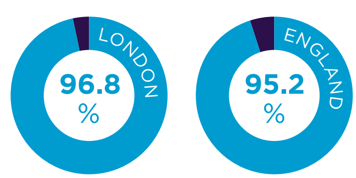
FOCUS ON INVESTMENT



£82,430
GROSS VALUE ADDED (GVA) PER WORKER
(UK £61,444)

17TH
FASTEST GROWTH CITY RANKING
(UK 2018)

96.8%
SUPERFAST BROADBAND COVERAGE
(England 95.2%)



41.7%
BUSINESS SURVIVAL RATES
(% after 5 years)
(England 44%)

Investment turnover in Central London totalled just under £20 billion during 2017, up by 25% on 2016 and 21% above the 10-year annual average. Whilst Brexit negotiations may have led to some deals being subject to delay rather than significant re-pricing, trophy asset sales to overseas investors such as the Leadenhall Building in the City, which transacted for £1.15 billion, helped support overall investment volumes. Deals in the office sector accounted for 75% of all transactions with City based offices being particularly attractive and accounting for 37% of all investments.

The weaker value of Sterling continued to generate heightened demand from overseas capital. A total of 20 deals in excess of £200 million were transacted in 2017, taking the overseas investment market share to 60%. Confidence in UK institutions improved with a total of £1.4 billion invested during 2017, 59% up on 2016, although heightened competition and some underlying caution continues to keep volumes below the longer term average.

In terms of pricing, prime office yields in the West End and City tightened, in the region of 3.50% and 4.25% respectively, with little movement anticipated during 2018. Retail yields have remained stable at 2.25% in prime Bond Street and Oxford Street locations.

> **THE WEAKER VALUE OF STERLING CONTINUED TO GENERATE HEIGHTENED DEMAND FROM OVERSEAS CAPITAL.**

Figure 1 London business sector employment and forecast (% total employment)

Source: GLA Economics

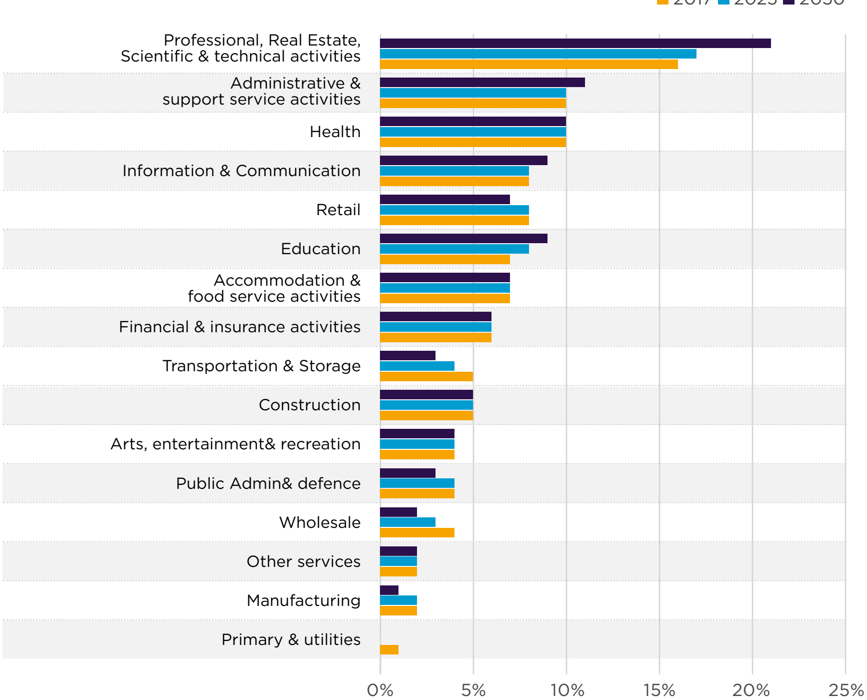
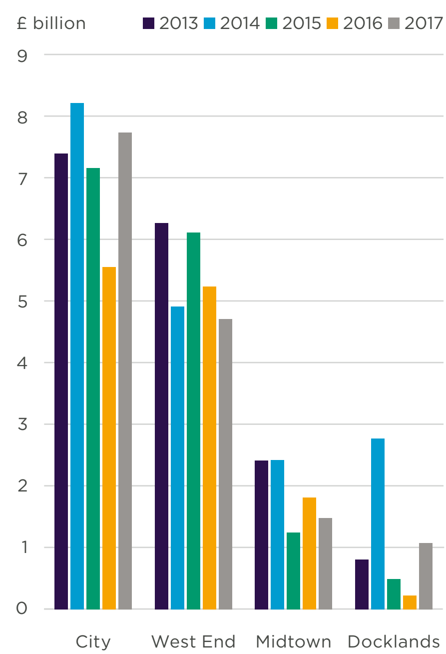


Figure 2
Central London investment by submarket

Source: Carter Jonas/Property Data



BALANCING THE STATS

Three dimensions of a ‘balanced city’ are outlined below. Comparing London’s performance to the national average allows us to consider the affluence of the city.

ECONOMICS

	LONDON	NATIONAL
GVA GROWTH 2017	1.7%	1.7%
EMPLOYMENT GROWTH 2017	1.7%	1.3%
BUSINESS SURVIVAL RATES (% AFTER 5 YEARS)	41.7%	44.0%

PROPERTY

	LONDON	NATIONAL
OFFICE SUPPLY/DEMAND RATIO (YRS SUPPLY)	2.3	5.2
INDUSTRIAL SUPPLY/DEMAND RATIO (YRS SUPPLY)	2.6	13.9
RETAIL SPEND PER SQ FT	£11,221	£10,739

PROSPERITY

	LONDON	NATIONAL
INCOME PER HEAD	£24,062	£18,793
EDUCATION GVA OUTPUT (% ECONOMY)	1.3%	0.6%
HOUSE AFFORDABILITY RATIO	14.0	11.9
5+ A*-C GCSEs ACHIEVED	61.3%	57.8%
LONG-TERM UNEMPLOYED (2016 - %, 1 YEAR+)	4.1%	3.7%
LIFE EXPECTANCY (YEARS)	82.3	81.3

OFFICE MARKET

£110.00
OFFICE RENTS: MAYFAIR (psf) Q4 2017

£65.00
OFFICE RENTS: CITY CORE (psf) Q4 2017

↑
OFFICE TAKE-UP (2017)

+1.7%
EMPLOYMENT GROWTH 2017

+1.7%
ECONOMIC CHANGE 2017

The London office market has demonstrated remarkable resilience throughout 2017, despite Brexit uncertainty. The key drivers of demand have been the business and financial services, technology, creative and media sectors. The co-working and serviced office providers have also been significant contributors to take-up throughout the year. Vacancy levels across all London sub-markets remain at historic lows, which has catalysed pre-letting activity as large space occupiers seek to satisfy their operational requirements against a backdrop of limited choice.

The London office sub-markets each have very diverse rent and rent-free period characteristics, reflecting the different supply and demand dynamics of each location. The City, for instance, is seeking to re-invent itself to be less reliant on the banking, insurance and financial services sectors. Developers are responding by creating office accommodation that will appeal to the creative, media and technology sectors, which have been an increasingly important source of occupier demand in the City over the last 12-months.

The North City Fringe still retains its attraction for the technology and creative sectors, despite increasing competition from the City. Nevertheless, the area is losing its competitive advantage in property cost terms. The East City Fringe, meanwhile, has not witnessed commercial property regeneration on the same scale as the North City Fringe. However, the start of Elizabeth Line services at the end of 2018 is

likely to increase inward investment in commercial property in the area, witness Aldgate Developments 320,000 sq ft speculative scheme at One Braham, at Aldgate East, E1.

Some areas of the West End, Paddington and Soho in particular, and in neighbouring Midtown district, Bloomsbury, have seen strong interest from occupiers during 2017, which has pushed rents up above 2016 levels in these locations. This is due to a combination of supply side constraints, public realm improvements, the creation of new Grade A space and enhanced accessibility conferred by the Elizabeth Line.

Midtown and the South Bank have particularly low vacancy levels, which has underpinned rents in locations such as King's Cross and London Bridge. Confidence in these locations is such that speculative development is being undertaken, most notably at King's Cross Central.

Stratford and Docklands both provide some of the most competitively priced Grade A office space, which has, as a consequence, attracted several large scale lettings, typically in excess of 100,000 sq ft, to Government agencies.

INDUSTRIAL MARKET

£17.00
INDUSTRIAL RENTS: PARK ROYAL (psf) Q4 2017

INDUSTRIAL TAKE-UP (2017)

INDUSTRIAL SUPPLY (End 2017)

+1.7%
EMPLOYMENT GROWTH 2017

+1.7%
ECONOMIC CHANGE 2017

Demand for industrial space in London and the South East remained strong during 2017 particularly for small-to-mid sized units in London fringe locations. Take-up however, revealed some paucity earlier in the year among occupiers. Annual transaction volumes totalled 3.8 million sq ft with requirements emerging from a shift to online retail and further growth of the UK e-commerce market.

In contrast, take-up of larger units continued to be constrained by a lack of suitable supply. While retail contributed to the majority of demand, requirements from the manufacturing sector noticeably increased. Despite concerns surrounding the uncertainty of the UK's route to leaving the EU, the sector benefitted from a weaker Sterling with a number of manufacturers seeking to raise productivity levels and achieve efficiencies through moves to more modern facilities.

The availability of new stock for larger requirements remained in short supply with only six schemes measuring above 200,000 sq ft available to let. Strong demand and restricted supply delivered rental value growth of 8% during 2017 for prime rents on West London assets, reaching £17.00psf on 10,000 sq ft, well located new units. A lack of land for speculative development continued to force developers to look to longer-term solutions in order to counter supply constraints. Looking forward, options include the potential for multi-storey or below-ground developments and mixed-use schemes due to the high competition for land and requirements for higher value residential development in close proximity to London's periphery.

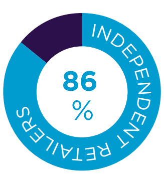
Industrial and logistic investment opportunities were attractive due to stability in capital values and income growth. Yields on logistics assets remained steady at 4.25% with industrial continuing to deliver superior returns to other sectors, a trend anticipated to continue throughout 2018.

"WHILE RETAIL CONTRIBUTED TO THE MAJORITY OF DEMAND, REQUIREMENTS FROM THE MANUFACTURING SECTOR NOTICEABLY INCREASED.

RETAIL MARKET

£2,200
RETAIL RENTS: NEW BOND STREET (£psf ZA) Q4 2017

86%
INDEPENDENT RETAILERS (WEST END)



£11,221
RETAIL SPEND POTENTIAL (£psf)

+2.5%
CONSUMER EXPENDITURE 2017

+1.7%
ECONOMIC CHANGE 2017

The Central London retail market remained resilient during 2017 despite some business failures and rising costs. Leasing volumes earlier in the year were supportive of overall take-up figures, despite some signs of weaker occupier demand in H2, resulting from the implementation of the 2017 business rates revaluation in April. The high street has benefited from the weakened Sterling, which provided an added boost to tourism.

Supply of available units remained restricted on London's most desirable streets and has resulted in Zone A rents holding steady at £2,200psf per annum on New Bond Street.

The sector continues to undergo structural changes due to the growth of online retailing and this will continue to shape the type of real estate retailers are looking to occupy with the overlap between online and physical stores increasing. New types of retail occupiers are being forced to deliver brand experiences and customer engagement to drive footfall in popular spots. Looking forward, population growth and tourism within the Capital will continue to be a driver of pricing, encouraging international brands to relocate, or open flagship stores on London's premium high street locations.

THE TRENDS

		PRIME RENT (END 2017)	CHANGE OVER 2017	FORECAST 2018	YIELD (END 2017)
VALUES	**Office - Mayfair**	£110.00psf	↓	↓	3.50%
	Industrial - Park Royal	£17.00psf	↑	↑	4.25%
	Retail - New Bond Street	£2,200.00psf ZA	↔	↑	2.25%
		2017 TAKE-UP (SQ FT)	CHANGE OVER 2017	CURRENT AVAILABILITY (SQ FT)	CHANGE OVER 2017
BUSINESS SPACE ACTIVITY	**Office (all Central London submarkets)***	12,600,000	↑	28,700,000	↓
	Industrial (within M25)*	3,827,650	↓	9,803,705	↑

**Source: EGi*

FORECASTS

Office rents for most parts of London are likely to decline by £2.00-£3.00psf per annum, over the next 12 months, reflecting economic uncertainty in the run up to the UK's exit from the EU in March 2019. However, areas including Paddington, Marylebone, Fitzrovia, Soho and Bloomsbury are expected to withstand this, with rents to remain static, reflecting both low vacancy levels and the commencement of Crossrail services serving these districts.

Despite a number of headwinds, retail rents are anticipated to remain static during 2018. Some secondary locations of major high streets may become increasingly attractive to private investors coming out of the residential sector, offering good value due to their underlying longer-term defensive characteristics.

Strong rental growth of industrial property in recent years is likely to have be nearing its peak in most London locations. However, there could be a modest uptick in values during 2018 if some developments, focused primarily on smaller unit sizes, come to fruition.

38 OFFICES ACROSS THE COUNTRY, INCLUDING 13 IN CENTRAL LONDON

- Bangor
- Basingstoke
- Bath
- Birmingham
- Boroughbridge
- Cambridge
- Edinburgh
- Harrogate
- Kendal
- Leeds
- Marlborough
- Newbury
- Northampton
- Oxford
- Peterborough
- Shrewsbury
- Suffolk
- Taunton
- Truro
- Winchester
- York

- National HQ One Chapel Place
- Barnes
- Barnes Village
- Fulham Bishop's Park
- Fulham Parsons Green
- Holland Park & Notting Hill
- Hyde Park & Bayswater
- Knightsbridge & Chelsea
- Marylebone & Regent's Park
- Mayfair & St James's
- S. Kensington & Earl's Court
- Wandsworth
- Waterloo

ABOUT CARTER JONAS

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