

LOMA: London
office market
analysis **Q1 2021**



London offices Q1: Stabilisers on

A third nationwide lockdown meant continued suppression of activity across London's office market in Q1 2021 – but emerging signs of stability may give grounds for cheer as the nation plots its path to recovery.

The flurry of investment activity towards the end of last year failed to continue into 2021 as figures from EG Radius indicate a 67% drop against Q4 2020 with £1.2bn spent.

Meanwhile, occupiers took 1.3m sq ft in new lettings – a healthy increase of 43.3% against last quarter, but still less than half the five-year average for quarterly take-up.

While those headline figures are far from spectacular, there are other indicators which improve the mood music.

A total of 163 individual leasing deals got over the line in Q1 – a third consecutive uptick in transactional volumes as post-pandemic workplace strategies begin to take shape. Planning activity suggests persistent confidence in the prospects of new-build space and the slump in Grade-A rental tone seen throughout last year's quarterly reports has been arrested. Domestic economic forecasts are also improving.

EY Item Club's UK growth estimate for 2021 improved from 5% to 6.8% last month – leading to a recalibrated prediction that we will return to the pre-pandemic peak in the middle of next year. Concurrently, data from Metrikus has indicated that office occupancy hit 45% of the pre-pandemic norm in mid-April as workers flocked back to their headquarters after a winter of enforced remote working.



So, there can be a modicum of optimism offered even off the back of relatively low levels of market activity – but naturally, this must come with a measure of caution.

The first three months of this year has seen a glut of high-profile companies announcing plans to 'right-size' their office footprint, affirming that there will be a persistence in distributed patterns of working. Research from Grant Thornton has showed that 39% of medium-sized firms are also expecting to reduce their office footprint going forward.

In addition, analysis published in March by AEW indicated that London ranks as one of the least resilient office markets in Europe – citing relatively expensive occupational costs per employee and a predicted high retention of home working over the next four years (influenced by traffic congestion) as the main reasons for its low position.

Within the same analysis, however, AEW concluded that London ranks best for demand inelasticity as a measure of resilience – meaning that decreases in office-based employment have, historically, impacted the capital less severely than other European markets. Therefore, the city does have some innate ability to steel itself against unforeseen swings in demand, but in order to capitalise on that, there is a need for proactive adaptation to constantly shifting circumstances.

On that front, the City Corporation's ten-year plan to reduce its historic reliance on incoming commuters by converting redundant office space into homes is an encouraging indication that key stakeholders in London's future are pushing those adaptations which can help ensure that the capital is as best placed as it can be to withstand the incoming winds of change.



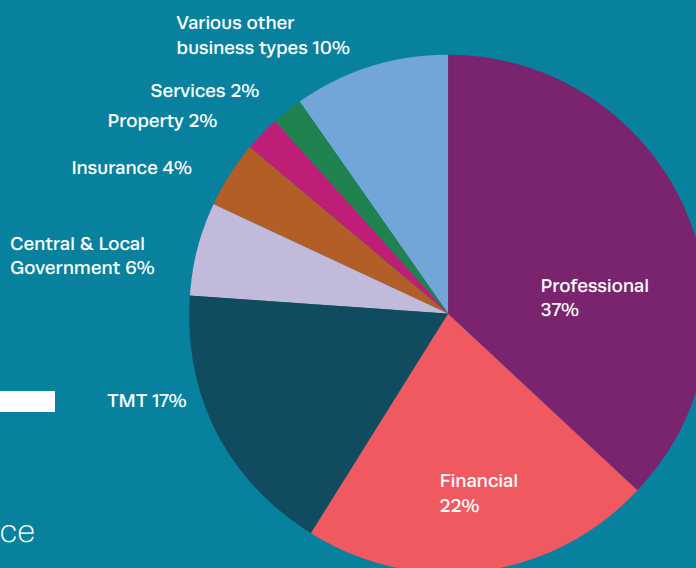
In our Q1 2020 report, we discussed the fact that the weight of requirements from law firms could be pivotal to the future shape of London's office market – and while many of those businesses are still evaluating their future workplace strategy, the opening quarter of 2021 has seen significant influence from the legal sector in driving leasing activity.

Latham & Watkins' 246,000 sq ft deal at 1 Leadenhall, EC3, comprised 19.4% of the total take-up during Q1 – the largest proportion of quarterly activity for a single transaction since Google's 860,000 sq ft deal at King's Cross, N1, in Q1 2013.

This headline letting was supplemented by nine further deals for legal firms, including Leigh Day at Panagram, EC1; Kirkland & Ellis' expansion at 30 St Mary Axe, EC3; and Cripps Pemberton Greenish at 80 Victoria Street, SW1, to propel the professional occupier sector to the top of the pile for new business take-up with 37% of activity.

Despite playing host to that large deal for Latham & Watkins, the City Core could not subvert the leasing pattern which enveloped all of London's submarkets this quarter, as volumes across the board came in much lower than the equivalent period last year – and were even more subdued when compared to long-term quarterly averages.

Take-up by sector Q1 2021



“ London ranks best for demand inelasticity as a measure of resilience

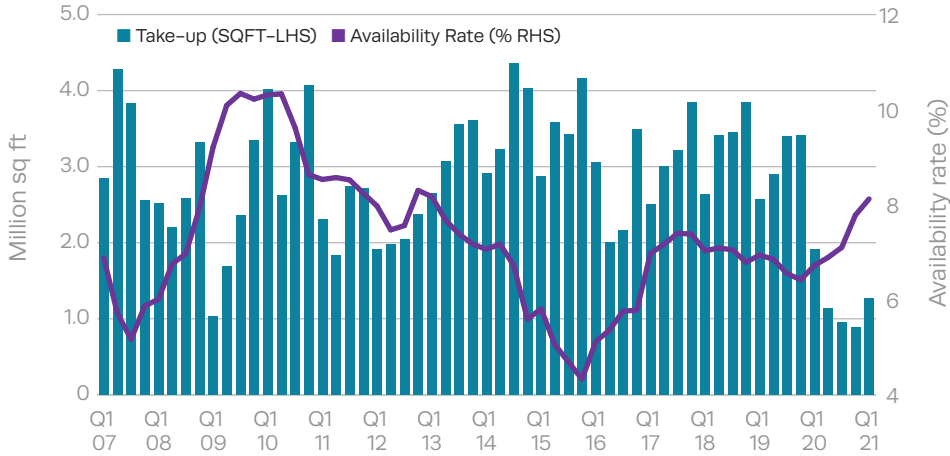


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With take-up figures remaining steadfastly shallow, the in-situ availability rate for London as a whole drifted outwards for the fifth quarter in a row – and now stands at over 8% for the first time since 2013.

In this context, we can probably expect to see further moves over the medium term to accelerate the repurposing of second-hand office stock throughout the capital, conducted either by authoritative bodies in a similar guise to City Corporation’s ten-year plan, or simply through individual landlord activity.

Landlord development activity has been in evidence already this year, albeit on the side of providing new space rather than conversions – with volumes of new office proposals and consents dwarfing the amount of new take-up.

To a casual observer, that might seem counter-intuitive given the outwardly-drifting availability rate and associated risk of structural oversupply.

However, for those closely watching the London office market in recent quarters, the bifurcation in demand levels and return potential of top-grade space against lower quality stock has been a common feature – with new-build space continuing to transact relatively well even in such a subdued overall market.

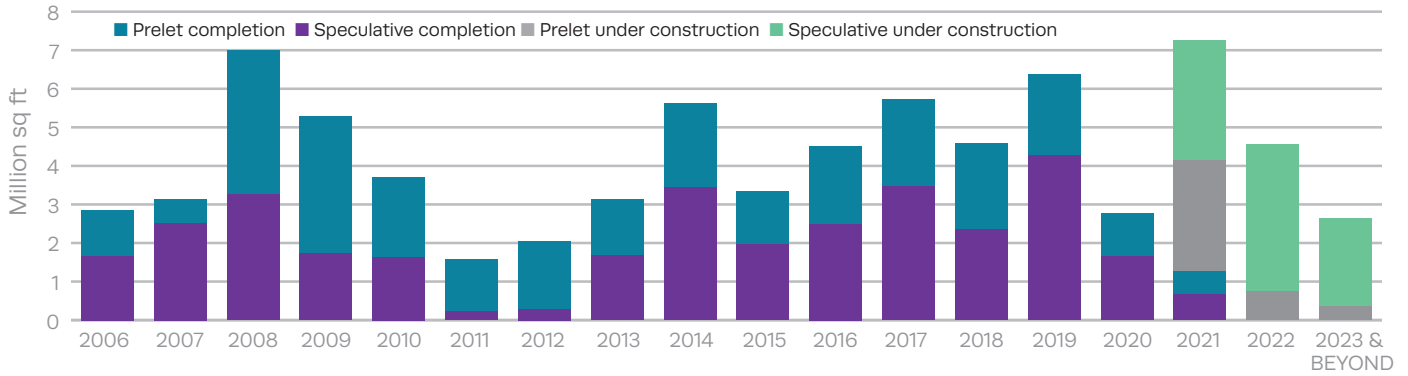
This year’s completions pipeline, for example, is already 49% pre-let by square footage. Such a strong volume of newly proposed developments would suggest a residual belief that those dynamics are set to continue over the short-to-medium term – and in an environment where major occupiers are seeking to consolidate space,

London Office Take-up Q1 2021 Submarket Comparison

	City Core	City Fringe	Docklands	Midtown	Southbank	West End	Total
Take-up Q1 2021	657,169	144,245	15,440	145,369	8,684	300,068	1,270,975
VS Q1 2020	-26.2%	-29.8%	-58.4%	-19.7%	-91.9%	-39.5%	-33.7%
VS 5 YR AVG	-27.0%	-60.0%	-91.9%	-61.8%	-95.0%	-53.1%	-52.8%
VS 10YR AVG	-30.0%	-60.9%	-92.1%	-66.8%	-95.4%	-55.6%	-55.1%



London's office pipeline Q1 2021



a new-build product with appropriate timing of completion may even be able to tempt those big names into relocating as part of that new workplace strategy.

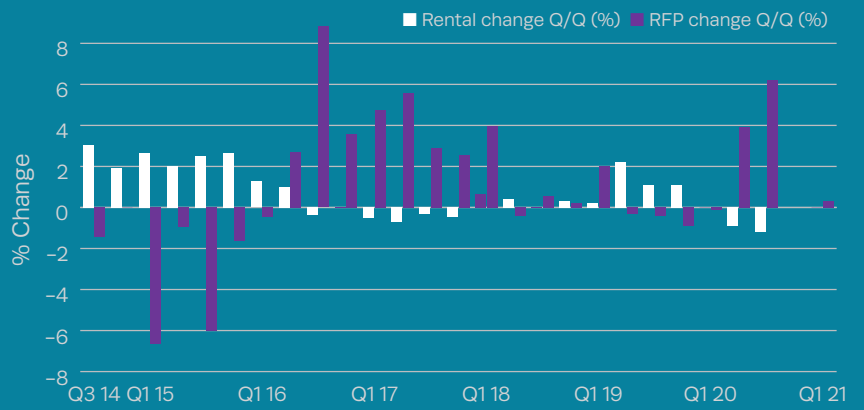
London's office market may well be incredibly transient over the medium-term as a result, with an accelerated need to reimagine older spaces and a clear desire from landlords and developers to provide fresh offering happening concurrently. Within such transience, rental predictions become a little foggier, and can lead to a wait-and-see approach from investors to attempt to glean more information on the future shape of the market as activity gradually picks back up to more 'normal' levels.

For Q1, our consensus panel of agents have returned rental figures which indicate that after three consecutive quarterly periods of downward movement on rental tone and increased incentivisation, lease mechanics on Grade-A space have started to settle.

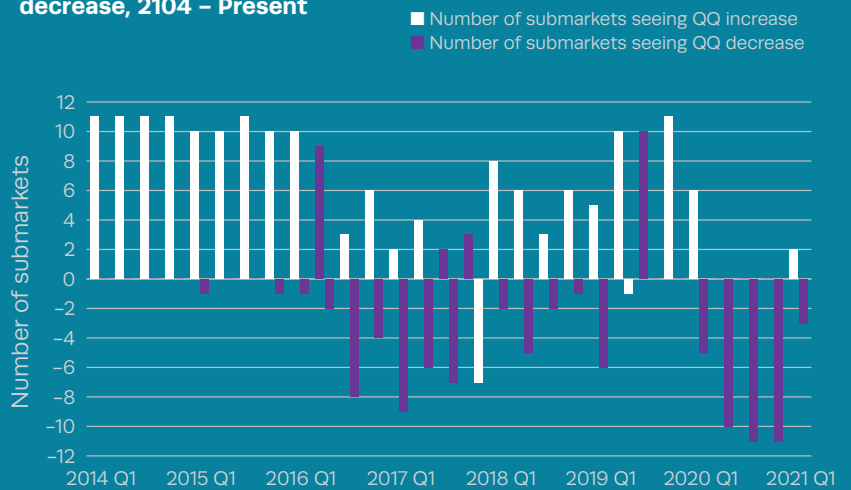
From the aggregated figures, only a marginal uptick in rent-free periods was registered as Grade-A rents across London as a whole saw no movement against last quarter.

Within individual submarkets; Victoria and Mayfair saw an increase against Q4 2020, while only three areas came back with a lower figure than the end of last year – in stark contrast to what we saw during the second half of 2020 when all eleven enclaves suffered quarter-on-quarter downturns.

London-wide Q/Q changes in Grade-A rents & rent-free periods, Q3 2014 – Q1 2021



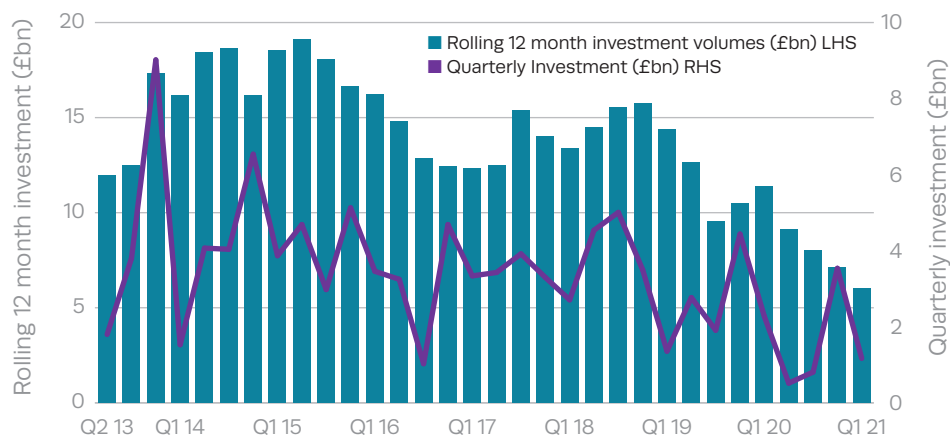
Consensus Grade A rents – no of markets seeing Q/Q increase and decrease, 2104 – Present



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London office Quarterly & rolling 12 month investment



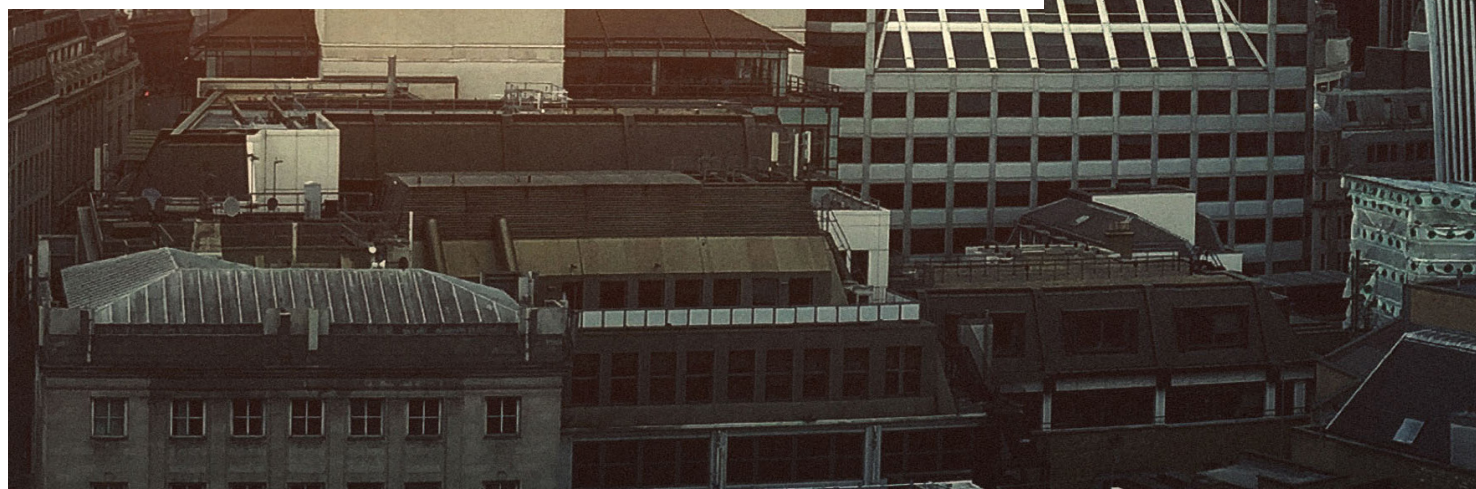
Given the unique nature of the last twelve months, the most likely driving force behind this pattern of Q1 rents is that we are entering a settling phase pending further information on market activity.

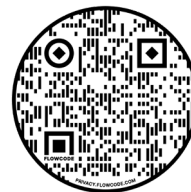
We can't say definitively whether this is a 'bottoming out' of a rental curve prior to uplifts throughout the remainder of the year – merely that the initial rental correction off the back of a unique set of circumstances has taken place, and we wait to assess how occupational demand manifests itself after restrictions on movement have eased, and leasing deals are easier to get in motion.

Those types of considerations may be partially feeding into the investment picture as well – with activity during the first three months of the year 67% below the levels we saw at the end of 2020.

A total of £1.17bn was recorded as completed by EG Radius – which is not too far behind similar opening quarters seen most recently in 2019 and 2014. It is worth mentioning that the opening quarter of the year is traditionally quiet for investment even in 'normal' times. Over the last seven years, the typical average drop-off in Q1 from the antecedent quarter is 45% as transactional pipelines build up again after the end-of-year rush.

Ultimately, the process of building up that pipeline of transactions on both the leasing and investment side remains inordinately difficult under travel and movement restrictions. As such, we should anticipate that Q2 will deliver another relatively subdued set of quarterly figures for market activity – with critical indicators for the second half of the year likely to come from movement (if any) on Grade-A rents; and the extent to which a returning workforce helps to propel a replenishment of occupier requirements. ■





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