CLUTTONS

West End office update

December 2011

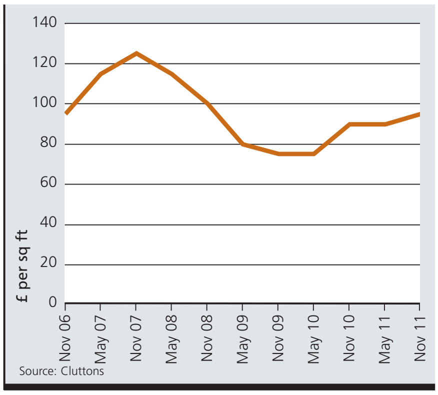
Uncertainty taking its toll

The economic uncertainty plaguing the Eurozone, combined with slowing growth in the US and emerging economies, is starting to take its toll on London's output.

The latest Markit Lloyds TSB London PMI survey signals a stalling in private sector economic activity, with growth rising at the slowest rate in 14 months, following a period of relatively strong expansion. Given events over recent months, growing business and investor caution appears inevitable; the current economic slowdown is likely to herald a challenging and uncertain period. The West End office market is not immune to these influences, with a slowdown in occupier activity occurring during the third quarter. Following a 29% increase in Q2, take-up fell by 39% last quarter with close to 47,600 sq m (512,366 sq ft) of office space let. The pace of the turnaround is stark, falling 16% below the ten year average, although still remains ahead of the 2008 market trough. It is also worth noting that the strong Q2 figure was distorted in part by the satisfaction of two significant requirements, including Google.

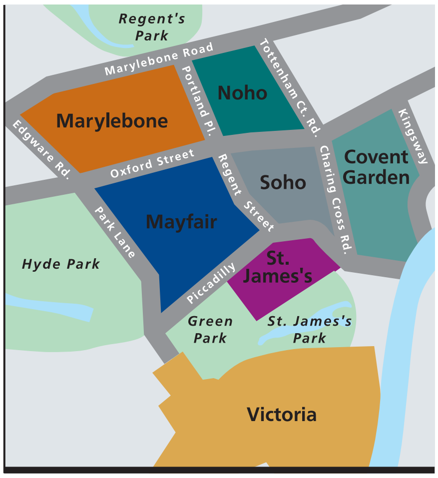
Again, the largest letting during the quarter was generated by the TMT sector; Facebook took 3,400 sq m (36,440 sq ft) of space at Seven Dials Warehouse in Covent Garden, expanding from a considerably smaller space nearby. This was facilitated by Expedia's move to less expensive space in Islington, at Derwent London's 'Angel' Scheme. Away from this headline letting, current economic events have driven caution amongst occupiers and property decisions are being deferred where possible. Activity that is occurring in the market continues to be driven by lease events. The new space requirements are dominated by the service industry, with the technology sector maintaining a strong presence, although we anticipate many may prove slow to translate into deals as decision makers take an increasingly 'wait and see' approach.

Prime rents remain static



Source: Cluttons

West End office submarkets



Supply constraints underpinning vacancy rate

Despite the slip in take-up over the quarter, available space remained stable, increasing by just 3.3% to 284,000 sq m (3.06 million sq ft). Occupiers with larger space requirement face limited options particularly in central locations, with little new stock coming to the market. Three quarters of current available space is in units of 4,000 sq m (43,100 sq ft), or less. 1a Page Street, owned by Derwent London, offers the largest single block, with 10,800 sq m (116,250 sq ft) of refurbished space coming available in the building.

The slowdown in take-up activity has resulted in a marginal increase in the overall West End vacancy rate to 4.9% from 4.8%. However, there remains considerable variation between submarkets, with the rates in Mayfair and Noho/Fitzrovia falling to their lowest levels since February 2008 at 3.6% and 3.0% respectively. In contrast, Soho, which has seen vacancy levels of sub 3% since January this year, has seen the rate rise to nearly 6% in large part due to the addition of the refurbished 25 Soho Square and new space at 25 Great Pulteney Street. The latter scheme adds a total of 7,700 sq m (82,900 sq ft) to the market, with the top floor is reported to be under offer at a rent of £90 per sq ft (£969 per sq m).

Given the very low levels of availability in most submarkets, small movements are having a marked impact on the vacancy rate. However, looking beyond these headline levels, it is apparent that while occupier sentiment is understandably

cautious, the West End market remains characterised by a depleted supply environment.

Rents stable

This dynamic continues to support rents across the West End, which remained stable during the quarter. In Mayfair and St James's, average Grade A rents are £95 per sq ft (£1,022 per sq m), while the top prime rent also remains firm at £105 per sq ft (1,147per sq m). While there is little 'penthouse' space available, the demand for such offices is also weak with a growing caution amongst higher paying segments of the market, in particular the hedge funds. Overall, annualised rental growth for West End offices stands at 5.2%, down from 16.6% at this point last year.

Development pipeline slips back

With expectations that the cautious occupier environment will persist well into 2012, the key risk to West End office rents is a marked increase in supply; however this looks very unlikely. Development finance from traditional banking sources remains severely constrained and while private mezzanine and equity finance has become more prevalent in the market, many planned schemes have been placed on hold in the wake of recent events in the Eurozone, illustrated by the decision by Great Portland Estates to defer their start on 51 Jermyn Street. The West End development pipeline slipped back sharply over the quarter with a 57% decrease in floorspace at the planning application stage. This tight balance between supply and demand is expected to maintain rents during 2012, although there is an obvious downside risk to this forecast given the Eurozone crisis.

Investors active but cautious

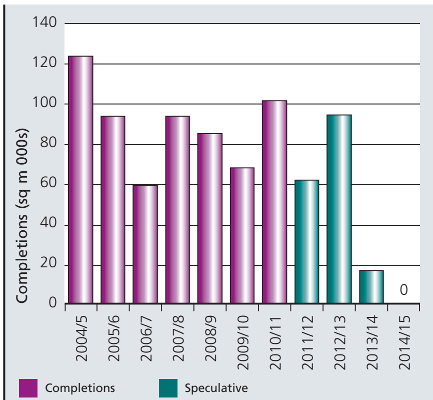
Despite the economic uncertainty, investors remain positive towards the West End office market, with volumes up by over a third on 2010, totalling £990 million, well ahead of the long run average. The largest transaction was Tishman Speyer's purchase of the government let Sanctuary Building, Great Smith Street, for £172 million, reflecting a yield of 6.00%.

Overall, the market continues to see a wide range of investor interest; however, there is undoubtedly more caution, with overseas investors a little more tentative. In particular, Middle Eastern and Far East investors have proved more guarded in their requirements and the prices they are willing to pay. This said, the dearth of West End stock persists and quality assets continue to receive multiple bids, albeit slightly down on the numbers received earlier in the year. Particularly strong competition persists for properties with residential or repositioning angles. One of the most noteworthy examples is at 1 Berkeley Street, where the 17,200 sq m (185,000 sq ft) building is reported to be under offer to Joint Treasure and Crosstree Real Estate Partners, backed by Ernesto Bertarelli, the Swiss-Italian pharmaceuticals billionaire. The building has a guide price of £130 million and the purchasers will be looking to take advantage of long term repositioning, given the lease expiries in 2019. Greater caution has favoured the West End relative to the City, which is seeing weakness in both the occupier and investment markets as uncertainty in the banking sector persists.

Yields stable but downside risks

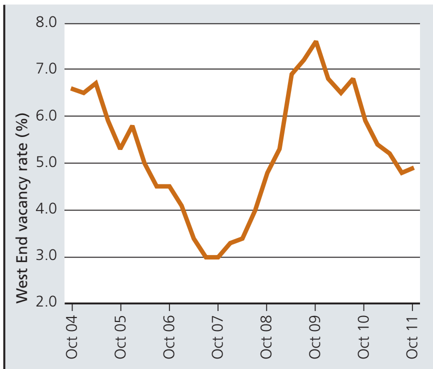
A shortage of investment stock continues to underpin prime West End yields which have remained stable for the last 12 months at 4.00%. Price stability is evident across all submarkets, although with a slightly reduced pool of buyers, investor perceptions of worth are resulting in some assets languishing on the market. While we maintain our forecast for stable yields over the next quarter, there is, as in the occupier market, a downside risk. Outward yield movements may occur if the economic climate deteriorates further and investors take a step back until the rental growth story becomes a little clearer. This scenario is however likely to be short-lived given both the positive long term expectations for economic growth in the capital and the constrained supply pipeline in the West End.

Development pipeline set to stall



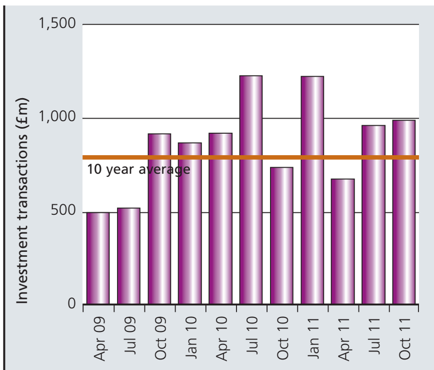
Source: Cluttons

Vacancy rate stabilising



Source: Cluttons

Investment activity recovering



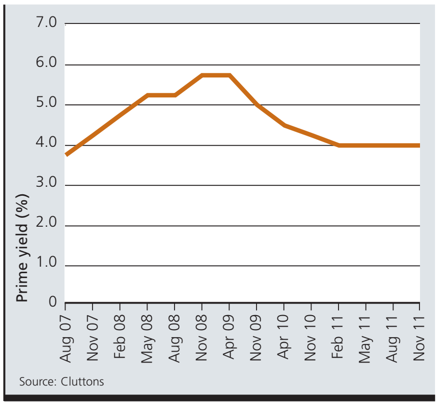
Source: Cluttons

West End Market Statistics

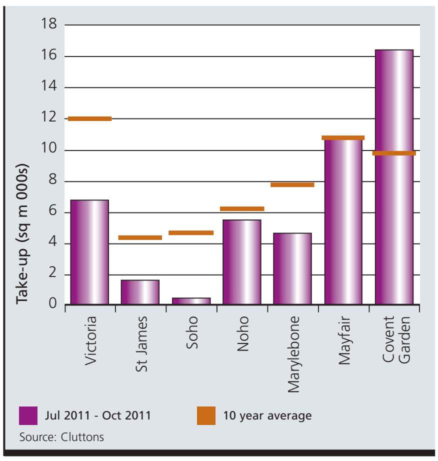
Rental values and take-up

- Take-up fell by 39% on the previous quarter, with 47,600 sq m (512,366 sq ft) let.
- The largest deal was at Seven Dials Warehouse, Earlham Street, Covent Garden, where Facebook took 3,400 sq m (36,440 sq ft) of office space over five floors at £52.50 per sq ft (£565 per sq m).
- Prime rents in the West End remained at £95 per sq ft (£1,022 per sq m), while the top prime rent remained at £105 per sq ft (£1,130 per sq m) with the fifth floor at 3-5 Burlington Gardens achieving this figure during the quarter.

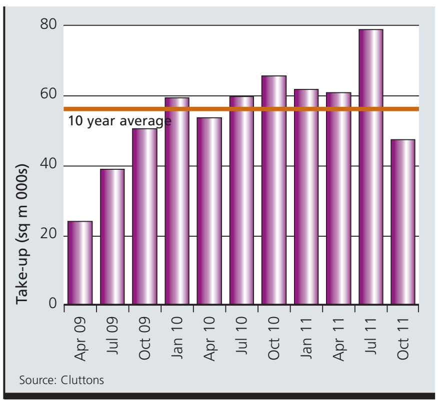
Prime yields remain flat



Contrast in take-up performance between sub-markets



Take-up activity falls back



Availability and vacancy rates

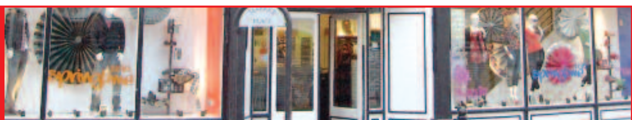
- Availability remained relatively stable this quarter, increasing by 3.3% to 284,000 sq m (3.06 million sq ft). 75% of the office space available in the West End is in blocks less than 4,000 sq m (43,100 sq ft) in size, with very few options remaining for occupiers with larger requirements.
- The largest block of available space is at 1a Page Street, owned by Derwent London, where 10,800 sq m (116,250 sq ft) of refurbished space is available throughout the building.
- The slowing of take-up activity led to the West End vacancy rate widening slightly to 4.9% from 4.8% in the previous quarter.

Development

- Three schemes completed in the West End this quarter, totalling 19,400 sq m (208,800 sq ft) of office space.
- Space at application fell by 57% this quarter, with 32,800 sq m (353,100 sq ft) of office space awaiting permission in the West End. This fall comes despite four new application submissions this quarter.
- Office space with consent remained relatively flat this quarter, increasing by 1.1% to 286,600 sq m (3.08 million sq ft), with four new applications gaining permission. The largest outstanding scheme remains Land Securities' Victoria Circle site which is scheduled to provide 65,700 sq m (707,200 sq ft) of new build office space.
- Construction activity also remained stable this quarter, with three new developments getting underway, leaving the total at 180,000 sq m (1.94 million sq ft), a drop of just 1.9%.

Investment transactions and yields

- Investment volumes in the West End remained relatively strong this quarter, increasing by 2.9% to £990 million, up 34% on the same period last year and 27% above the long term average.
- The largest deal of the period was Tishman Speyer's purchase of the Sanctuary Buildings, Great Smith Street for £172 million, reflecting a yield of 6.00%.
- The prime yield in the West End remained at 4.00%.



CLUTTONS

London commercial property services

Cluttons has a team of market specialists who are able to provide a full range of commercial property services to landlords, occupiers and developers.

Our services range from commercial and investment agency through to negotiating rent reviews and providing planning advice.

Our dedicated specialists, using their local market knowledge and experience, ensure they deliver the right results for clients.

Head office

Cluttons LLP
Portman House
2 Portman Street
London
W1H 6DU

020 7408 1010

UK offices

Brighton
Chichester
Maidstone
Oxford

Overseas offices

Bahrain
Italy
Oman
South Africa
UAE – Abu Dhabi
UAE – Dubai
UAE – Sharjah

Services & contacts

email: first.lastname@cluttons.com

Asset management
Jamie Eastaugh
020 7647 7098

Asset recovery services
Michael Dix
020 7647 7220

Cluttons Capital Partners
Ross Owen
020 7647 7117

Commercial
John Wood
020 7647 7232

Commercial agency
Ralph Pearson
020 7647 7037

Commercial valuation consultancy
John Barrett
020 7647 7218

Development agency
Malcolm Chumbley
020 7647 7143

Investment and fund management
Ross Owen
020 7647 7117

Lease advisory
Bob Maxted Jones
020 7647 7129

Planning and regeneration
Diane Rider
020 7647 7029

Project and building consultancy
James Gray
020 7647 7204

Rating and compensation
Peter Chapman
020 7647 7042

Rating and compensation
Geoff Hubble
020 7647 7229

Research
Sue Foxley
020 7647 7023

Structured finance
Ed Stollery
020 7647 7210

Telecommunications
John Wood
020 7647 7232

r research