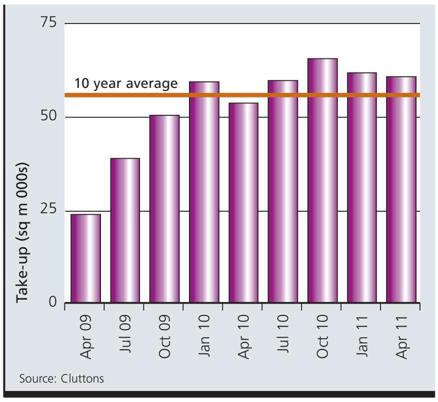
CLUTTONS

West End office update

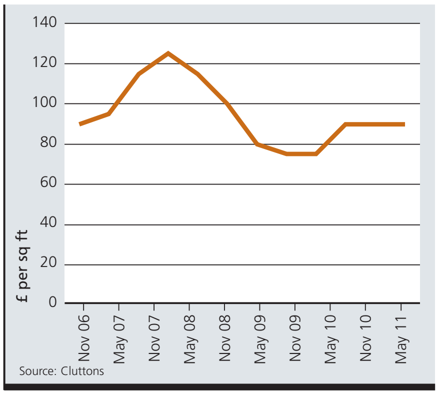
June 2011

Take-up activity remains healthy



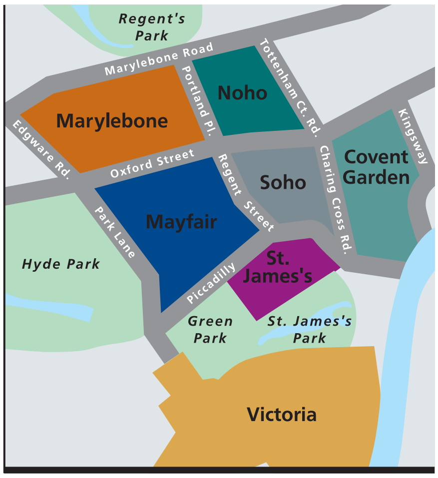
Source: Cluttons

Prime rents remain static



Source: Cluttons

West End office submarkets



In summary

The West End office market has maintained its momentum over the last quarter, but activity is being stifled by the lack of available stock in both investment and occupier markets. This has dampened take-up and investment turnover, but not sentiment, which remains buoyant despite continued business caution. With London leading the way in the economic recovery, the strength of the West End will be maintained, although it is likely activity will extend further beyond the prime core.

London the forerunner of economic growth

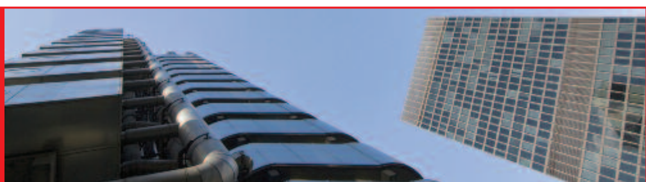
Estimates for economic growth in Greater London show that the capital is significantly outperforming the UK average. The London Markit Lloyds TSB Purchasing Managers' Index points to continued growth in private sector economic activity for the eighth consecutive month, with employment in the capital continuing to rise at a steady pace, ahead of the long run average. This out-performance reflects, in large part, a strong rebound in activity in the service sector, a key driver of the Central London economy, accounting for more than half of all jobs. The Reed Job Index reports that while the number of new job opportunities in London was slightly down in May, it remained nearly 10% up on the start of 2011, and over 24% higher year on year.

The steady improvement in the capital's economic circumstances is translating into greater confidence in the occupier market. Demand remained steady over the last quarter; however, take-up was virtually flat compared to January, albeit close to 9% ahead of the long run average. Considerable caution remains in the corporate community; however it is the scarcity of good quality office space in the West End which is dampening potential take-up activity. Three-quarters of floorspace let was good quality offices, demonstrating the bias in demand for large Grade A space. Central Saint Giles, in the Covent Garden sub-market, was one of the few offerings in the market and attracted the largest deal over the last quarter with NBC Universal taking 10,400 sq m (111,900 sq ft). Google has also agreed terms on a further 14,900 sq m (160,000 sq ft) of space in this development. This letting occurred subsequently to the quarter end, however it does highlight the draw of good quality space when it becomes available. These lettings, which reflect a net increase in space occupied in London by both occupiers, are not typical in the market at present with most take-up remaining lease event driven.

The imbalance between supply and demand over recent quarters has gradually depleted the supply of space, with overall availability across the West End slipping to just under 300,000 sq m (3.23 million sq ft), resulting in a further decline in the average vacancy rate to 5.2% from 5.4%. However, many of the submarkets are experiencing a more acute space shortage. At the quarter end, Soho recorded a vacancy rate of only 2.6%, while a number of other markets including Noho, Fitzrovia, Marylebone and St James's experienced a sharp fall in their respective rates.

Vacancy rates – how low can they go?

Following the final lettings in Central Saint Giles there remains only one large block of space available at 1 Kingsway where 9,700 sq m (104,400 sq ft) will be completed in July. There are other small blocks of space which are lingering on the market, such as 23 Savile Row, which emphasises the fact that active demand is predominately for



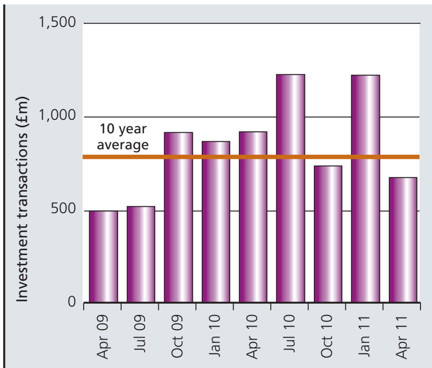
Development pipeline set to stall

Source: Cluttons

Vacancy rate continues to fall

Source: Cluttons

Investment activity weakens



Source: Cluttons

larger floorplate offices at economical prices rather than boutique-style space. The constraints on both supply and demand have, on average, left the market broadly in balance. As a result the top Grade A rent in the West End remained stable over the quarter at £90 per sq ft (£969 per sq m) in Mayfair and St James's. However, the compression in the supply of vacant space in many of the more affordable sub-markets, such as the Southbank, Noho and Marylebone, has driven rental growth of between £2.50 and £5.00 per sq ft. The upturn in rents in some of the submarkets has also resulted in a hardening in the rent incentives.

Given the restrictive supply environment, a small number of developers and funds are finally feeling confident enough, with the benefit of funding, to get speculative schemes underway. However developments such as Selborne House and Ashdown House are focused largely in the Victoria area, with no schemes under construction in the sought after St James's area. With a lead time of 12 to 24 months, this new space will do little to ease the supply constrained market. The options available to occupiers will be challenged further over the next year or two as more office space is decommissioned for conversion to residential use. In some locations the site value for conversion is double the equivalent office value. Rents will, as a result, continue to show steady growth, particularly in the highly sought core. Peripheral areas will also experience further increases as occupiers opt for such locations either to contain costs, or simply as a result of the limited options available in the prime core of Mayfair and St James's. We expect average Grade A rents to grow by an average of 5.8% per annum over the next four years, but we expect the very best accommodation to be achieving significantly stronger rental growth.

Stalemate in the investment market

As in the occupier market, investors are also continuing to feel the pinch in the supply of assets. Investment volumes in the West End fell back by 45% over the quarter, standing 12% below the long run average. The dearth of activity reflects investor perceptions of the market. Current pricing, the relative value of property against the other asset classes and a general flight to real assets amongst some investor groups provides little incentive to sell West End office assets. This stalemate is placing pressure on prices, but with little market evidence pricing remains at 4.00% yield for prime investments. The profile of West End investors remains diverse, encompassing funds, overseas buyers and listed and unlisted property companies. The few investments that have come to the market over the last quarter have generally attracted large numbers of bidders. For example, 91 New Cavendish Street saw 15 bids and 80 inspections, signifying the weight of money in the market. The lack of stock, combined with improved confidence in the outlook, has driven many investors to take more risk and look outside the core. This is particularly the case for the funds, but they have also been joined by overseas investors, particularly Middle East based, who are proving more willing to look at assets with angles. This enhanced appetite for risk amongst many investor groups is exemplified by the more recent purchase of the vacant 60 St Martins Lane, by Threadneedle, for £26 million. Such purchases have not been seen in the market since the 2008 downturn and demonstrate improving investor sentiment in the outlook, despite a relatively subdued occupier environment, pinned under by the structural supply constraints.

Looking ahead, despite the fact that there are few prospects for further capital growth over the coming quarters, there is little evidence there will be an increase in investment stock due to profit-taking, especially as overseas investors, in particular, continue to show a strong preference for real assets. Banks are likely to step up their release of stock which will satisfy some frustrated demand, but this is unlikely to have a significant impact, given the steady loss of secondary assets to residential conversion. The recent narrowing in the yield gap between prime West End assets and those with repositioning potential has already narrowed and while further compression is likely, this will depend in large part on the perceptions of the trajectory of residential values. Current pricing, for example at New Cavendish Street, suggests a firm belief in a strong upturn in residential values over the coming years.

West End Market Statistics

Rental values and take-up

- Although take-up slipped back by 1.5% this quarter to 60,900 sq m (655,500 sq ft), this remains 8.8% above the long term average for lettings.
- Grade A space made up over 75% of the total take-up, whereas less than 25% of the lettings were of Grade B stock.
- The largest deal was at Central Saint Giles, where NBC Universal took 10,800 sq m (116,250 sq ft) on a 15-year lease on confidential terms.
- Prime rents in the West End remained flat at £90 per sq ft (£969 per sq m), while the top prime rent reached £105 per sq ft, (£1,130 per sq m), up from £100 per sq ft last quarter. Increases were seen in all sub-markets except the prime Mayfair and St James's core.

Availability and vacancy rates

- Availability fell for the third consecutive quarter, dropping 7.2% to 298,800 sq m (3.22 million sq ft).
- Available Grade A space dropped by 3.6% to 220,400 sq m (2.37 million sq ft), while vacant Grade B office space stood at 78,400 sq m (843,900 sq ft), contracting by 6.5%.
- The largest block of available space is at 1 Kingsway, where 9,700 sq m (104,400 sq ft) of new build space is available. The space is currently under construction and due for completion in July.
- The West End vacancy rate fell to 5.2% from 5.4%. This compares to 7.6% at the peak of the market downturn in October 2009.
- The lowest vacancy rate was in Soho where it fell from 2.9% to 2.6%. Covent Garden has the highest vacancy rate, although this is primarily due to 1 Kingsway coming to the market. Victoria, which has consistently recorded one of the higher vacancy rates in the West End, has seen it fall to 4.9% from 5.4% with lettings such 123 Buckingham Palace Road, where Google took a further 3,500 sq m (37,700 sq ft).

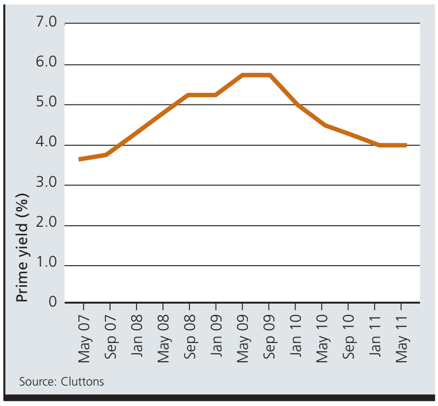
Development

- Only two schemes completed this quarter, adding a total of just 1,600 sq m (17,200 sq ft) of new stock. This included a completion in St James's at 98-100 Jermyn Street, contributing 1,100 sq m (11,800 sq ft) of new space to the sub-market. This building has been purchased off market by CREMS.
- There was a 12% increase in space under construction this quarter, totalling 179,500 sq m (1.93 million sq ft). Victoria continues to dominate the construction total, while there is no new space underway in the sought after St James's.
- Space with planning consent edged up again this quarter by 4.7%, with 240,800 sq m (2.59 million sq ft) currently in the pipeline. The largest scheme yet to get underway remains Land Securities' Victoria Interchange site, with consent for a total of almost 65,900 sq m (709,300 sq ft) of office space.
- New office space awaiting permission fell by almost 40%, with just 36,100 sq m (388,600 sq ft) at application. The absence of any new applications submitted this quarter, coupled with the three applications that gained consent, contributed to this decline.

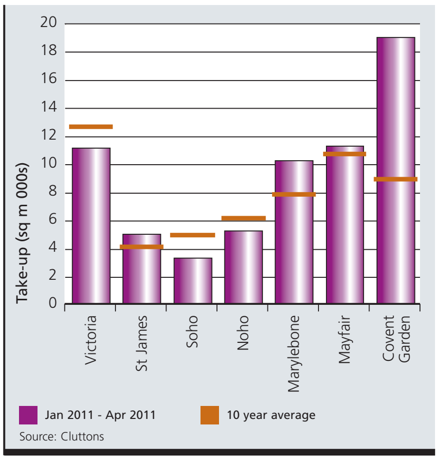
Investment transactions and yields

- Investment volumes in the West End fell back by 45%, with £679 million of transactions. This is a 26% decline on the same quarter last year and 12% down on the 10-year average.
- The largest recorded deal was the sale of Centre Point, New Oxford Street for £120 million to Almacantar, at a yield of 6.5%.
- The prime yield in the West End remained at 4.00%. There have not been any transactions at this level during the quarter, a reflection of the tightness in the supply of prime investment stock, but it would be achieved if a suitable property came to the market.

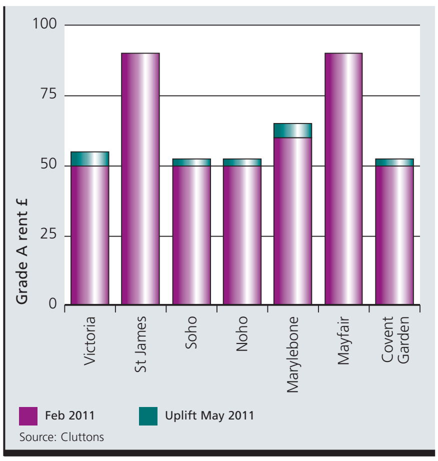
Prime yields stabilise

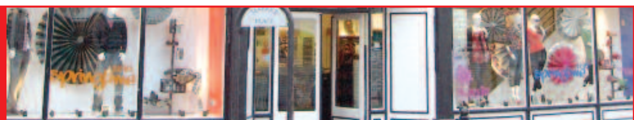


Contrast in take-up performance between the sub-markets



Rental growth outside prime core





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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
Saudi Arabia
Oman
UAE – Abu Dhabi
UAE – Dubai
UAE – Sharjah
Spain – Marbella

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

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