

London Occupier Focus: TMT

Spring 2012

The TMT sector has outperformed in a tough economic climate; we expect the sector to continue to grow in importance to the Central London office market.



- The TMT sector accounted for 20% of Central London take-up 2011. The last time the sector accounted for a similar proportion was just before the dotcom crash of 2000.
- The stronger financial position of TMT companies and more restrained valuations, suggest the market is sustainable.
- Computer technology is entering a “third platform” of mobile devices and applications, cloud computing and big data.
- London’s TMT strengths reflect established experience in finance and advertising, but social media and gaming are also increasingly important.
- New submarkets in peripheral locations such as Shoreditch and Paddington are increasingly attractive to occupiers establishing a presence in London.
- Staff attraction and retention is the main driver of locational decisions in this sector.

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Recent developments

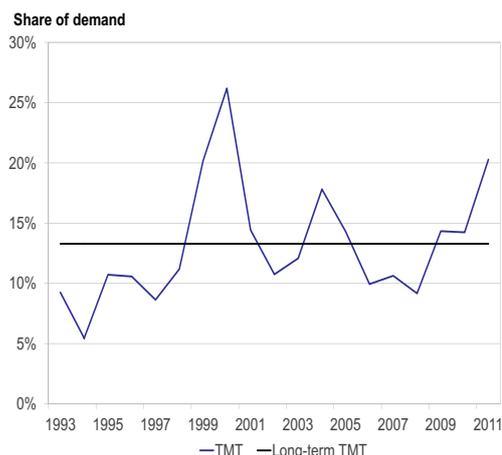
Introduction

In 2011 occupier demand from the technology and creative sectors accounted for 20% of total take-up in central London, a level only exceeded in 2000, the year the dotcom bubble burst. This trend begs the question of whether demand is sustainable. If it is, what types of firm will drive future TMT demand? And what drives their location decisions?

Recent developments in the sector

Over the last 10 years, the TMT sector (Technology, Media, and Telecommunications) accounted for 13% of Central London take-up, in 2011 the sector accounted for 20%. This demand was spread across 126 deals, a figure only exceeded in 2000 and 2001, and amounting to 1.5 million sq ft of space.

The importance of TMT demand is growing



The strength of TMT demand in 2011 not only reflected the resilience of the sector but also the weakness of the traditional source of large-scale demand, banking and finance. The lack of major deals done by Banking and Finance in 2011 both inflates TMT's share of demand but also left opportunities for others to acquire high-quality space on favourable terms.

The two largest deals in 2011 were both at Central Saint Giles, in the Covent Garden submarket. NBC Universal took 105,909 sq ft in Q1 and Google took 165,000 sq ft in Q2 in what was the second largest deal of the year by any sector. Although Google was only founded in 1998, its emergence from the dotcom crash with few rivals has allowed the firm to become a dominant internet player.

Despite a few large deals, the average size of a deal by the TMT sector (12,100 sq ft) over the last ten years is almost 20% below the average market deal size.

Is there a risk of the dotcom crash repeating itself?

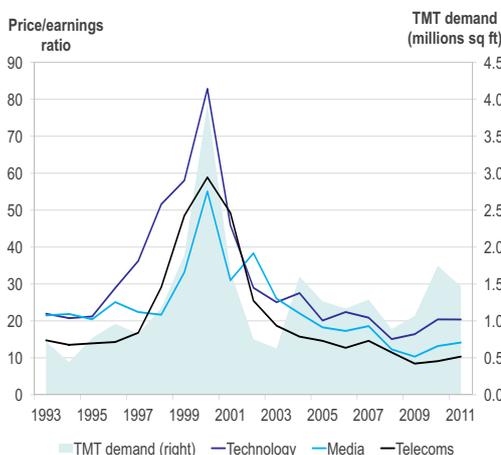
The internet started to catch on commercially in 1995 and as usage rose it revealed a huge untapped international market.

However, investors wanted big ideas more than solid revenue streams and valuations soared. In 1999 there were 457 tech and internet IPOs, of those 117 doubled in price on the first day of trading. The euphoria surrounding these IPOs began to wane as investors realised that revenue streams remained weak and the valuations were flawed. By 2001, the bubble had burst and most dotcom start-ups ceased trading once their venture capital was gone, most never having made a net profit. In 2001 there were 76 IPOs, of which none doubled in price on their first day of trading.

Things have come a long way in ten years. In 2000, there were comparatively few people online, high-speed internet was rare and start-ups had grand plans but very low revenues. Today there are two billion internet users, broadband access is ubiquitous and today's start-ups such as Groupon and Zynga make respectable profits. It is also worth noting that the 1990s bubble only expanded after numerous internet firms floated as tech-hungry investors pumped up the price of their shares. Presently the NASDAQ, although rising, remains 40% below its March 2000 peak.

The chart below illustrates how in the late 1990s a surge in demand for office space was accompanied by growth in company valuations. Today, although TMT demand has risen, occupiers are far more conservative in their future office projections than in 1999/2000. Likewise, public valuations are considerably more measured than before.

TMT take-up and PE ratios

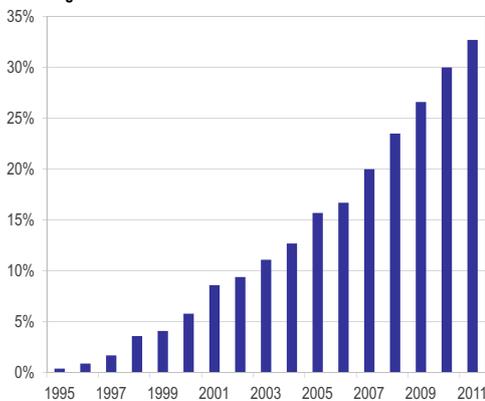


London's TMT submarkets

In essence the failure of the previous cycle reflects the disconnect between technology and ideas. The technology of the times hinted towards a new way of shopping and interacting with friends and colleagues, but the reality was cumbersome and frustrating. It took five years for products to catch up with the potential of 3G. Technology today plays a far greater role in the daily lives of people. Companies that were able to adapt and survive emerged unopposed, and are now established online names.

Global internet users

Percentage of world online



internetworldstats.com

London's TMT submarkets

Although many cities are benefiting from the growth of the TMT sector, London has characteristics that make it particularly strong. London benefits from the confluence of a young, well educated workforce with the city's established creative heritage. London also has the advantage of the English language and familiarity for major international (US) firms looking to establish a European HQ. So London is seen as a key location for expanding international companies as well as a good place for entrepreneurs starting their own businesses.

The traditional home of the TMT sector is the West End submarkets of Soho, Noho, and Covent Garden. Indeed the largest deals of 2011 - by Google and NBC - were both in Central Saint Giles, Covent Garden. However, insufficient space and rising rents are attracting occupiers (large and small) to other areas. This is particularly so for companies with no existing London presence. The area surrounding Old Street roundabout in particular (Silicon Roundabout) has become a hotbed of start-up activity. The area started to attract tech start-ups in the late-1990s with the introduction of six fibre-optic nodes in Brick Lane providing the necessary bandwidth for early internet companies.

Central Saint Giles



Since 2008 the number of start-ups in TechCity has soared whilst the cost of starting up has fallen. The cloud negates the need to invest in expensive computing hardware and the arrival of incubator facilities like TechHub, Trampery and Google's "Campus" (opening in March 2012) allows fledgling companies very flexible leases. Moreover, the area has developed an entrepreneurial spirit akin to that of Silicon Valley. Budding e-entrepreneurs hold regular networking events whilst a mentoring programme provides advice on how to make the next step.

Beyond Shoreditch, there are a number of other areas attracting TMT occupier attention. Larger companies looking for quality space are increasingly likely to take space in areas like Paddington, Victoria, and Kings Cross. Such locations have strong transport links, a better supply of large Grade A space, and rents below what would be paid in core submarkets.

Meanwhile, rents for Grade A space in City fringe areas are in the region of £35 per sq ft, compared with nearer £60 per sq ft in Soho. So cost-conscious companies with smaller space requirements are more likely to locate in Clerkenwell, Farringdon or Shoreditch.

Beyond London, the computing giants of the M4 such as Microsoft and Cisco although increasingly establishing a presence in London, remain firmly rooted where they are. Beyond the South East, the cities of Bristol and Manchester also have strong TMT sectors. Bristol has an international reputation in microchip engineering, whilst with the BBC moving to Salford, Manchester is seeing strong growth in the media sector.

The next generation of technology

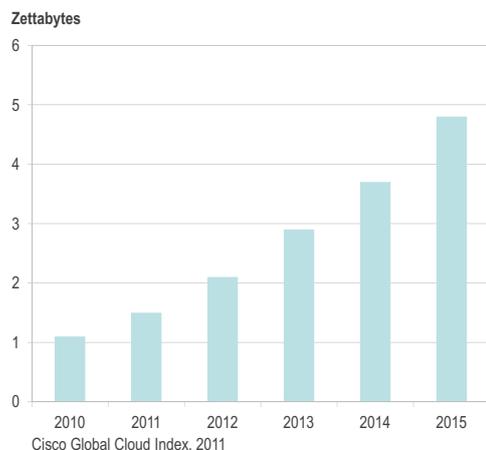
The next generation of technology

A report by technology consultancy IDC highlights the emergence of a “third platform” of computing. The “first platform” of mainframe computers gave way to the “second platform” in the mid-1980s as PCs brought computing into the home. The third platform is based on mobile devices and applications, the cloud, and big data. In the last quarter of 2011 global mobile, app-capable devices outsold PCs for the first time.

Cloud computing, often mentioned but rarely fully understood is simply the use of computing as a service rather than a product. It is not a new phenomenon; Hotmail and Google are both cloud based services. What is new is the outsourcing of servers to a specialist company. This shift is being fuelled by a combination of a weak economy, high-speed internet and improved security. This growth is reflected in forecasts by Gartner who say spending on cloud services grew 20% to \$90 billion in 2011 and is projected to be \$175 billion by 2015.

The expansion of mobile devices, and cloud based applications has given rise to an explosion of data and the need for tools capable of coping with it; here lies a major opportunity. In 2010 the amount of information created globally passed the zettabyte barrier. In 2011 1.8 zettabytes was created, nine times the level of five years earlier. This data is being used in many ways to understand what consumers and businesses want, for example big data analysis is being used to suggest the next film you watch on online services like Netflix.

Growth in global data centre traffic



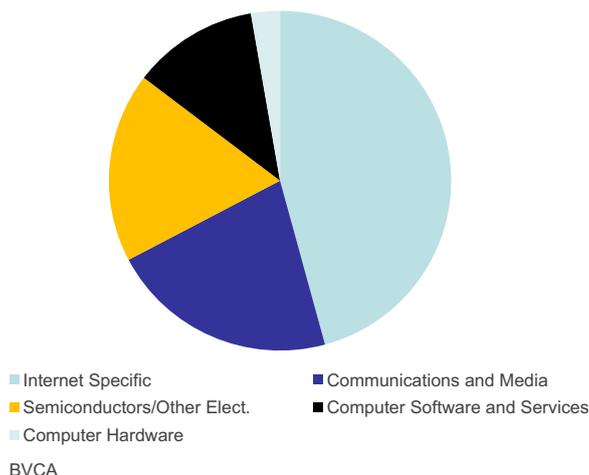
The need to embrace the third platform is reflected by Nokia’s recent Smartphone drive and Microsoft’s next version of Windows (Windows 8) being designed specifically to work on tablet computers.

Although the majority of the larger TMT companies are

American based, many of the capital’s fastest growing TMT companies combine technology with London’s established strengths in the professional and financial services. For example, Fixnetix is a West End based company which provides ultra low latency technologies that allow hedge funds and banks to trade very quickly. According to the Deloitte 500, it was the second fastest growing TMT firm over the last five years in the EMEA region.

In 2011 £792 million of venture capital was invested into UK TMT companies. Although this is down slightly on the five year average (£800 million), the internet specific subsector has shown strong growth and accounted for 46% of all equity invested in 2011; against an average 33%. The Communications and Media sector also registered above average investment in 2011. Both of these sectors have a strong presence in the start-up area of East London.

Venture capital investment in 2011



A growing source of financing for small companies is corporate venture capital; parent companies investing in small innovative outfits in order to access emergent technologies. For example Twitter paid £25 million for Tweetdeck in May 2011, a Shoreditch start-up, in order to have the software that had attracted 20 million users.

The late 1990s saw a proliferation in start-ups raising capital through IPOs, this is no longer so common beyond the headline grabbing IPOs in the USA of companies such like Zynga, Groupon and LinkedIn. However, through conversations with equity analysts companies providing data storage are attracting significant attention as the amount of data being generated continues to expand strongly.

As the home of many of the world’s largest internet and technology companies, the USA leads the rest of the world. According to Cresa, Savills’ American partner, demand for space in the San Francisco Bay

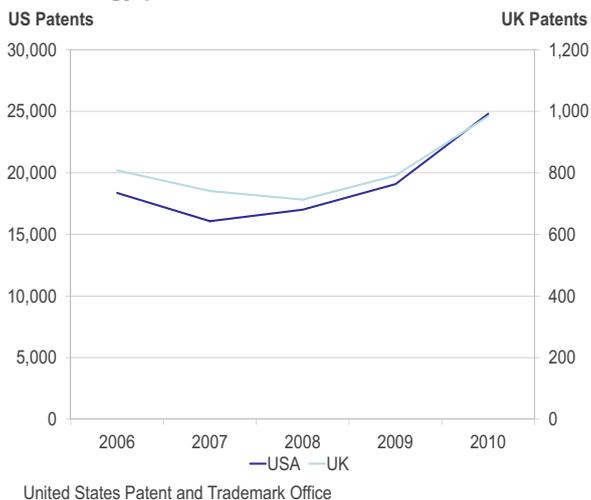
What does this mean for offices?

area is coming from social media, cloud computing, and gaming companies. Apple, Google, and Facebook have all recently taken large units of space. However, the hottest area in Silicon Valley is the area near 4th Street Train Station where gaming companies and start-ups are flocking.

This growth in gaming has been mirrored in London with an increasingly blurred division with social media. Companies like Moshi Monsters, with over 100 million global users reflect the growth of this subsector. It is also clear that downloadable games onto mobile devices dominate the gaming world. Games meant for physical distribution now only accounts for 30% of the market. The business model being implemented by these games is based on advertising. The game is often free to download but, owing to the improved means of data analysis, brands are being highly focussed on who they advertise to. For the first time, online advertising can monitor the value of each advert.

In both the USA and the UK the number of technology patents filed with the U.S patent office has risen over recent years, suggesting there will be a growth in the delivery of products in the future. In 2010, there were 24,787 technology patents filed with the US Patent and Trademark Office agency, a level 54% higher than in 2007. Apple alone accounted for 566 of these. In the UK there were 984 technology patents filed in 2010, 33% higher than the level in 2008.

Technology patents filed in the US and UK



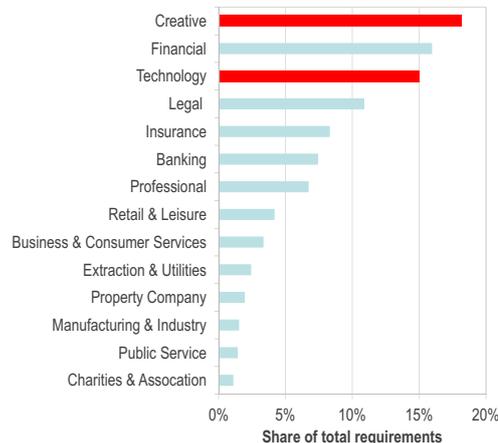
Therefore, we expect demand in the near term to continue to come from established, often American companies. The emergence and establishment of the “third platform” has created an environment for the proliferation of start-up companies and although they currently account for small deals, their expansion will lead to larger deals.

What does this mean for offices?

33% of Central London’s 2.2 million sq ft of active space requirements is by TMT companies, and this includes four companies looking for more than 100,000 sq ft.

The average size of these requirements is 48,000 sq ft, significantly above the market average (33,000 sq ft). This is in contrast to the average deal size over the last 10 years where TMT deals were consistently below the average size. This likely shift to larger deals reflects not only the relative strength of the TMT sector, but also their improved negotiation position in the absence of other business sectors.

TMT office requirements



Case Studies

In order to better understand what drives office location we spoke to a number of companies. The two highlighted below represent a typical SME and a major global corporate.

ustwo

Founded in 2004, ustwo is a digital design studio that provides user interface design, app development and digital entertainment to clients ranging from H&M to major City banks. In Q1 2011, ustwo chose to locate their rapidly expanding staff base in the area where they started, taking 8,616 sq ft of Derwent’s Tea Building at a rent of £26.50 per sq ft on a five-year lease.

The building provides refurbished warehouse space with obligatory exposed walls for their 100 staff. A large cafe style kitchen greets you as you walk in, and small clusters of stylish sofas are dotted about for informal discussions. In their view providing this kind

Characteristics of office demand

of working environment, pioneered by the likes of Google, blurs the boundaries between work and home life. The comfortable environment is designed to encourage the free flow of ideas between individuals which will improve the quality of the output and generate new avenues of growth.

Julian Ehrhardt, a Director of ustwo, explained that although low rents were important in attracting them when they were a start-up, other fringe areas of London were cheaper. More important was attracting the right staff; young, creative, IT literate people of whom a critical mass was clustering in the cheaper residential parts of East London (Hackney, Dalston, and Clapton). Bike stands full of fixed wheel bikes attest to the desire for staff to be able to get to work without enduring the drudgery and creativity sapping experience of London's public transport.

There was also a desire to tap into Shoreditch's creative heritage. The edgy environment, the result of decades of decay and underinvestment, unknowingly created the desired combination of affordability and character for artists. Given the cross over between technology and creativity in the relatively new industry of social media, Shoreditch has benefitted. This emphasis on artistic creativity is a large part of what sets Silicon Roundabout apart from Silicon Valley.

Nokia

Employing 130,000 people in 120 countries, Nokia is typical of a global technology company. In Q4 2011, Nokia signed a 15-year lease for 60,540 sq ft at 2 Kingdom Street paying a rent of £57.50. Nokia join a growing number of traditionally M4 based IT companies who have taken the step of opening an office in London.

2 Kingdom Street, Paddington



Paddington was chosen primarily for its location in West London which provides the company with the

central London presence whilst limiting the disruption of staff based to the west of London. Added to this, a significant number of employees make regular trips to Finland and so the convenience of Paddington with its fast links to Heathrow airport was another consideration.

In terms of the space wanted, the internal space has an emphasis on hot-desking and there are large areas for interacting with fellow employees.

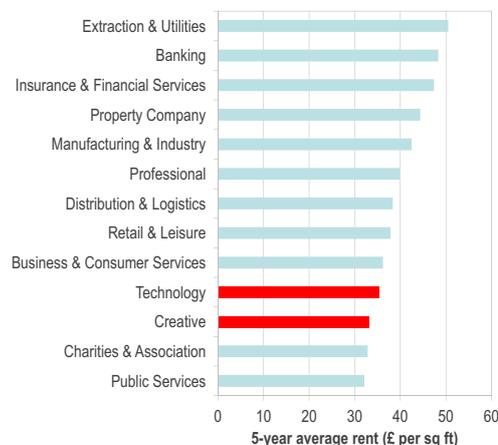
Joining other TMT companies such as Vodafone, Orange, and Huawei was not considered important in choosing the area. These companies all have their offices west of London. Whilst clustering is attractive to the SME's of East London who benefit from the exchange of ideas and a sense of collective strength the same is not the case for larger organisations. Mark Squires, Director of Communications and Media Relations at Nokia, said that if anything clustering would have a negative impact because it would dilute corporate identity.

The current dearth of high quality stock of over 50,000 sq ft means there are a limited number of places where they could move and given the development activity in Paddington, it lends itself to attracting companies like Nokia.

Characteristics of TMT office demand

A major unifier of TMT firms is their level of cost consciousness. Between 2007 and 2011 the average rent paid in the creative and technology sectors were £33.20, and £34.40 respectively, both well below the market average of £40.65 per sq ft.

Recent average rents paid in central London



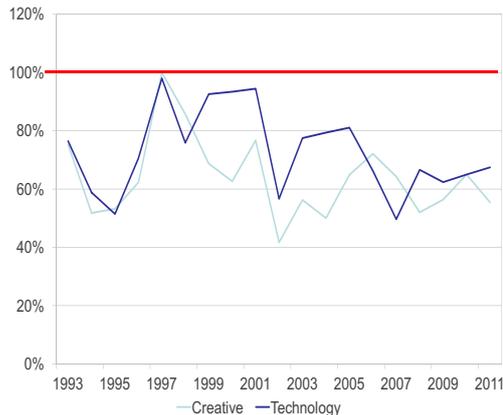
Furthermore, over the same period the highest rent paid by a creative company was 64% of the top rent paid across all sectors in Central London, for technology companies this figure was 73%. So as

Outlook

rents have risen in core locations, pressure has risen on occupiers to move out.

Top rents in the TMT sector can approach the top rents paid in the market

Top TMT rent vs market



Averaging 7.7 years over the last 10 years, the TMT sector has the shortest leases in central London. This reflects the shift in sentiment of young companies since the late 1990s dotcom bubble. Back then, space projections were overblown and most space was released back to the market soon after the crash. Today, young companies prefer short leases which allow the flexibility to expand.

All companies are only as good as the staff they employ and this is especially so when the wanted skills are relatively scarce. In order to attract and retain the right staff, location is crucial. For Nokia, Paddington provides the London location whilst minimising the impact on the commute of existing staff. Meanwhile, Shoreditch was appealing to ustwo because it provides employees with the right work-life balance. A previous piece of Savills research, What Workers Want, highlights the importance of the length of commute to employees which showed it to be as relevant to staff as having a comfortable office.

The location of the office in these terms is an expression of its corporate culture. The ability to attract the right staff and to keep them happy when at work is seen as a growing concern to those making space decisions. For example, ustwo are aware that the kinds of people they are looking to hire want to work in warehouse space with plenty of space for social interaction. The same applies to Nokia who chose a new building. Using the space to attract staff may be particularly so in the TMT sector as the average starting salary for the IT sector is below average and is only slightly above average for media jobs.

The provision of social and flexible space is important

across the sector. Although the rent in Paddington will be considerably above that of their previous HQ in Farnborough, hot desking allows space to be used in a more efficient way.

The importance of clustering also depends on the stature of the company. Whilst the need to be part of a specific "scene" as well as the benefits of mixing with likeminded people is beneficial to smaller, innovative technology and media companies, this is not the case for larger companies who prefer to create their own identity.

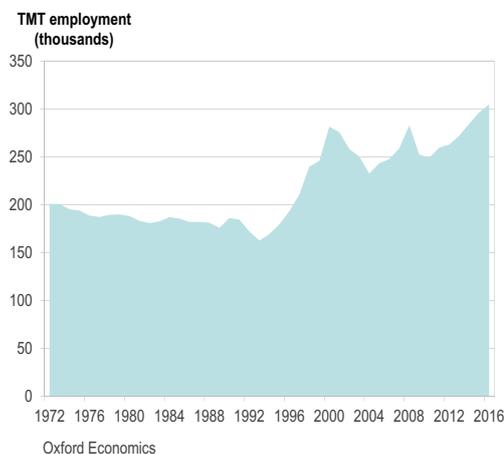
Research by High Fliers, a research company, show that graduate jobs in the IT and technology sector to be slightly below average at £27,000, whilst in the media the starting salary is £32,000. In order to attract the best staff, companies put greater emphasis on creating a working environment that appeals to the type of staff they look to employ.

Outlook

Gartner forecast global spending on IT to grow from \$3.7 trillion in 2011 to \$4.4 trillion by 2015. This is reflected by Oxford Economics who expect London's TMT workforce to grow by 40,000 to top 300,000 by 2016. Based on a simplistic average amount of space per employee of 100 sq ft, this would result in the need for a further 4 million sq ft.

Driving much of the growth in the sector will be the continued rise of the third platform of computing (mobile applications and devices, the cloud and big data). Although much of London's recent strength has been in combining technology with traditional competencies in advertising and financial services, there is also considerable strength in areas such as social media, gaming and apps.

TMT employment in London will continue to grow



Oxford Economics

Outlook

The recent growth in the number of patents being filed point to further technological advancement whilst the growth in venture capital activity aimed at UK internet and communications companies suggest particular growth in these areas. Given continued activity by the likes of Google, Apple, and Facebook in Silicon Valley, major American tech companies will continue to account for significant amounts of demand and this is reflected by existing office requirements.

London's tech entrepreneurs have been quick to adapt to technological developments which has led to the emergence Silicon Roundabout. Although there is little evidence of an exodus of occupiers from traditional areas, newcomers have less attachment to submarkets like Soho, Noho and Covent Garden. For the time being West End submarkets like Paddington, Kings Cross, and Victoria will continue to compete with the traditional areas to attract new entrants into the London office market.

Location decisions will need to take account of the need to retain staff, if relocating, and to attract the right staff if setting up a new office. Clustering is considered more desirable for smaller and more entrepreneurial companies where the discussion of

ideas with similar organisations is beneficial. Large corporates see little benefit in being close to similar companies, preferring instead to stand alone.

Although larger TMT occupiers behave like those from other sectors, the large number of smaller companies in the sector drags rents below average and on shorter leases. This price sensitivity is further highlighted by the average starting wage in the sector being below the market average. The result of this is that companies put greater emphasis on creating an attractive work-life balance by ensuring a comfortable and accessible working environment.

The need to socialise means technological advancement has not reduced the need for offices. However, the way offices are being planned is changing and TMT occupiers of all sizes see value in the provision of social space where ideas can flow easily between individuals. In addition, for increasingly mobile employees, hot desking allows space to be used more cost effectively.

In conclusion we expect the TMT sector to continue to play a significant role in central London's occupier market.

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