UK Commercial – September 2021

SPOTLIGHT

Savills Research

Central London Office Development

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Development activity • Office Demand • Sustainability • Pre-lets

Development completions are set to hit a three year high by the end of the year

Development completions are set to hit a peak this year whilst new starts show little sign of a significant fall

5.5m sq ft of speculative space is scheduled for delivery this year

of the pipeline for the next 5 years (2021- 2025) has already been pre-let

of developments starts for this year are extensive refurbishments

So far this year we have continued to see high levels of pent up demand as many occupiers have continued to adopt a 'wait and see' approach with their future office requirements. As a result active Central London requirements currently stand at 10m sq ft, up 41% on the same period last year.

Almost half of the overall quantum of this space is made up of occupiers with lease events into 2023 and beyond, giving strong indication we will continue to see occupiers considering pipeline options.

The continuation of strong demand for newly developed or extensively refurbished space, has resulted in pre-lets accounting for 22% of space acquired since the first lockdown in March 2020.

The increased polarization between best in class space and Grade B space is further illustrated by the fact that 88% of leasing activity over this period has been of Grade A standard.

Whilst there is still much debate about the longer term impact that hybrid models of working may have on office demand, almost half of the pre-lets that have exchanged this year are at least 2 years ahead of their scheduled completion, illustrating the continued importance occupiers attach to the office.

This strong appetite for newly developed product has led to high levels of developer confidence in recent years and we are expecting development completions for this year to hit a 3 year high, with 5.5m sq ft scheduled for delivery by the end of this year. Most notably, development completions in the West End are set to reach their highest level on record with 3.4m sq ft currently forecasted.

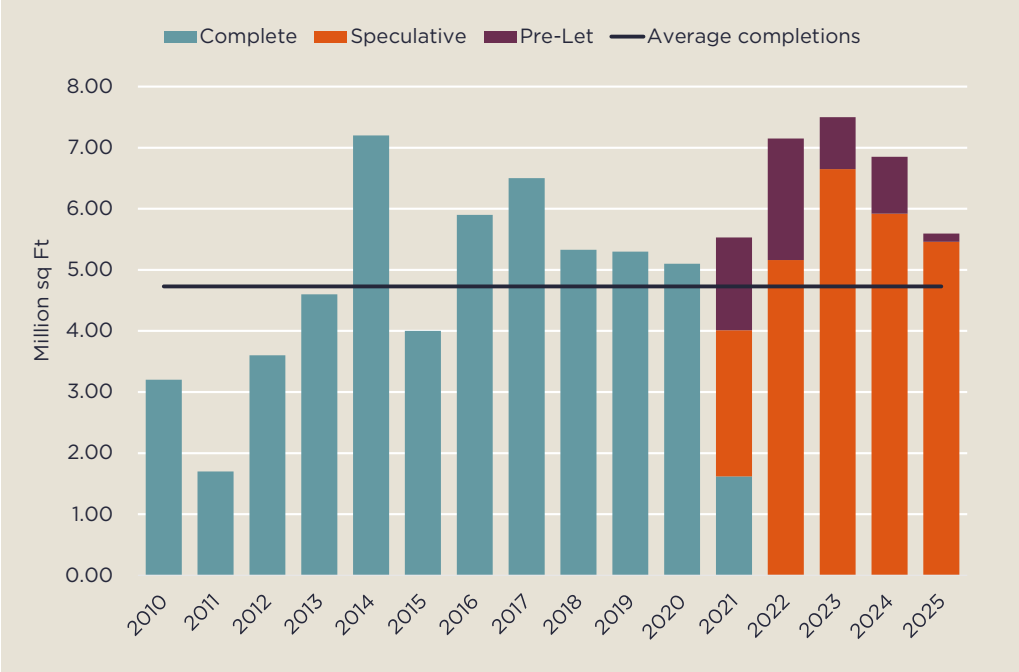
Due to the prevalence of pre-letting activity, 42% of this year's deliveries have been let prior to completion. Notable completions this year include Battersea Power Station, SW8 (550,000 sq ft), 1 Portsoken Street, E1 (233,000 sq ft) and 2 Gresham Street EC2, (180,459 sq ft).

In total, 19% of the 32.6 m sq ft of the extensive refurbishments and new developments scheduled for completion over the next 5 years, have so far been pre-let.

Peak levels of annual completions are expected over the next 3 years with a record level of 7.5m sq ft currently scheduled for delivery in 2023. Although there are pricing headwinds ahead particularly with rising building costs as a result of increased pricing on raw materials, and lower productivity levels. This will likely temper overall development completions over the next few years.

The BCIS is currently forecasting building cost across the board will rise on average by 2.7% per annum between 2021 and 2025. This along with the typical planning and construction delays will further reduce any potential risks of oversupply despite the peak levels of activity anticipated.

Chart 1: Central London development pipeline



Source; Savills Research

Pre-letting analysis

We have analysed our leasing data over the past five years looking at occupiers who have pre-let more than 10,000 sq ft (excluding transactions to Serviced Office Providers).

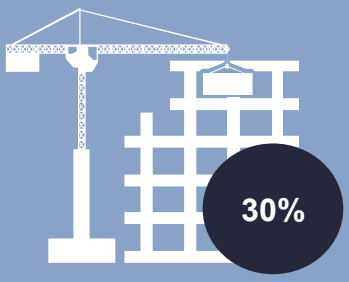
Since 2017, **37%** of Central London occupiers who pre-let 10,000 sq ft or more were occupiers who were relocating but taking at least an additional 10,000 sq ft of space. Over a third of these occupiers took an additional 10-20,000 sq ft. 25% of these occupiers took an additional 50,000 sq ft or more. The average length of time for occupiers taking additional space,at their previous address, was 11 years.

30% of the occupiers that have pre-let space over the past 5 years were acquiring additional space to their existing space or were new entrants to Central London.

22% of occupiers who pre-let space over this period were relocating to similar sized space (10,000 sq ft more or less).

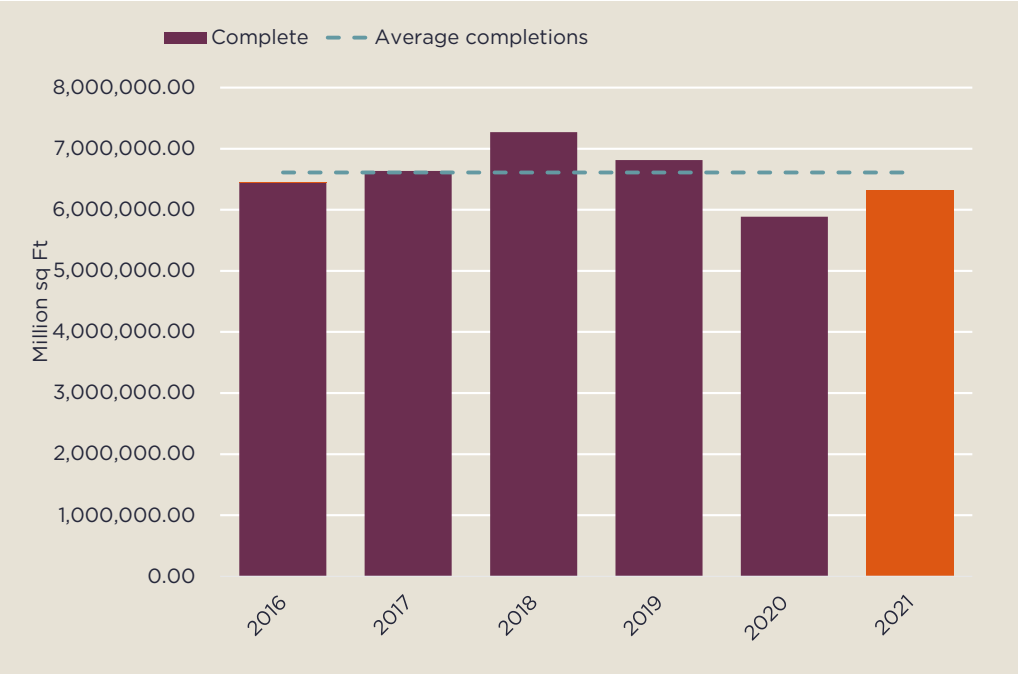
Only **8%** of pre-lets over the past 5 years have consisted of occupiers who were downsizing.

The average length of time for all relocating occupiers opting for pre-lets had been in occupation at their previous location



The Tech & Media sector accounts for 30% of the pre-lets that have completed over the past 5 years

Chart 2: Central London development starts



Source; Savills Research

Continued developer confidence in the Central London office market is further illustrated by the lack of a significant slump to development starts for this year in contrast with previous downturns. New starts are expected to be down by just 9% on the average annual level of starts we have seen over the past 5 years.

We are currently anticipating around 6.3m sq ft of new developments and extensive refurbishments will start by the end of this year. This is up 5% on 2020, where development starts were down 17% on 2019.

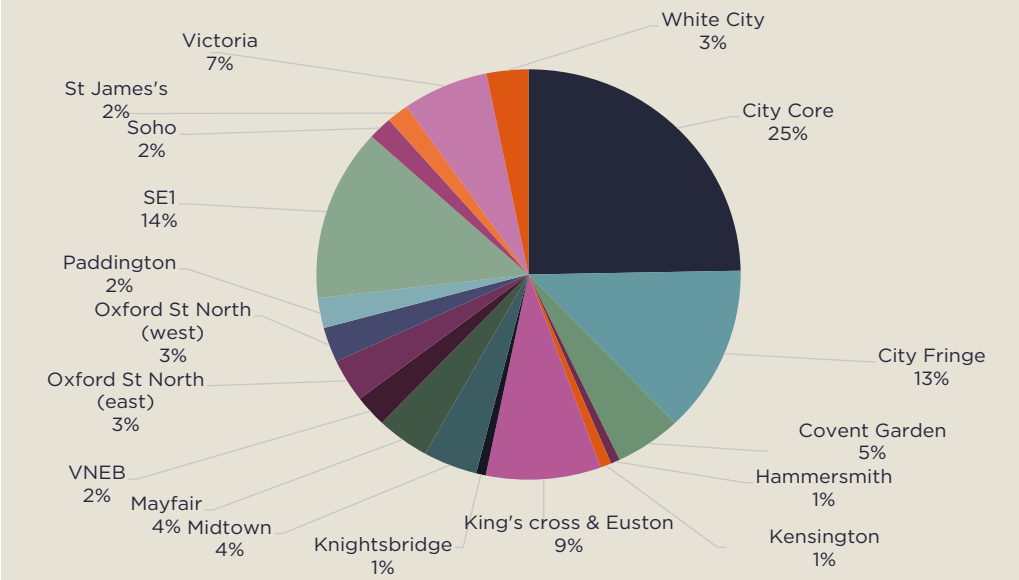
Almost two thirds (65%) of schemes starting this year are extensive refurbishments, the majority of which are set to complete by the end of 2022.

The City Fringe sub-market accounts for 29% of this year's new starts, followed by the City Core with 24%, and then by SE1 with 11%.

Over the past decade, prior to Covid-19, average annual Grade A take-up was typically around 8.4m sq ft. Accounting for a 15% reduction as a result of the fall in the demand for office space we could potentially see, if we were to see similar levels of demand for this type of product return, this would equate to just over 7m sq ft of annual demand for Grade A space.

At this rate of take-up the entire speculative pipeline for the next 5 years equates to around 43 months of supply indicating that if similar levels of demand were to return the potential risk of oversupply of this type of product would be limited.

Chart 3: Speculative completions 2021-2025 by sub-market



Source; Savills Research

Sustainable office development

The importance of sustainbility is set to remain high-up on the agenda

67% of pipeline schemes targeting a rating of Excellent or above are new developments

82%

of the 805,000 sq ft of this year's new starts that have already been pre-let are targeting a BREEAM rating of Excellent or Outstanding

10%

of schemes schedules for delivery over the next 5 years are currently targeting BREEAM rating out Outstanding

There has been an increasing focus on the need to reduce the environmental footprint of commercial developments over recent years which has been intensified by Covid-19. This focus on sustainability credentials has been driven by planning policies and changing expectations across the board from investors and occupiers.

Around 44% of this year's new starts are known to be aiming to achieve a BREEAM rating of Very Good or above.

Whilst the vast majority of schemes starting this year are speculative, when you look at the space that has already been pre-let a stronger preference for space in buildings with good sustainability credentials is reflected by the fact that 82% of new starts (that have already been pre-let) are targeting a BREEAM rating of Very Good or above.

At present only 10% of schemes scheduled for delivery over the next 5 years are currently targeting a BREEAM rating of Outstanding, a further 26% are targeting Excellent and 3% are targeting Very Good.

Over half of the schemes that will be delivered over this period that are targeting a rating of Outstanding or Excellent are in either the City Core or City Fringe, 17% are in SE1, and collectively, West End sub-markets account for 30% of this total.

Around 67% of schemes targeting a rating of Excellent or above are new developments, (as opposed to extensive refurbishments). This reflects the balancing act being struck between sustainability considerations(for example, retaining the embodied carbon) and maximising the scheme/site coverage.

As more and more businesses (including investors and occupiers) set their own net zero carbon targets and consider their wider sustainability objectives, there is increasing incentives for occupiers to consider how these objectives can be achieved through their real estate decisions for example by targeting office schemes with measures that can reduce/eliminate emissions.

Around 45% (14.3m sq ft) of take-up since 2018 has been in space with a BREEAM rating of Excellent or above. At present just 11m sq ft of speculatively available schemes in the pipeline are targeting a rating of Excellent or Outstanding, which equates to 44% of all speculative deliveries. This gives an indication that future supply of this type of product will most likely be outpaced by demand.

> "Investors and occupiers are increasingly looking to refurbished properties over new build, amid growing awareness of the embodied carbon impact of construction. New development remains necessary but, to compete, these must demonstrate that the improved efficiency they bring delivers a whole-life carbon benefit, when compared to keeping an existing building in-use."
>
> *Chris Cummings, Director*
> *Engineering & Design Consultancy*

Chart 4: 2021-2025 Pipeline BREEAM targeting

***TBC** represents schemes that are yet to announce what rating they are targeting

Source; Savills Research

Commercial development investment

Investors generally want the best of the best developments featuring strong connectivity, occupier resilience, with the potential for the highest ESG, amenity and well-being credentials.

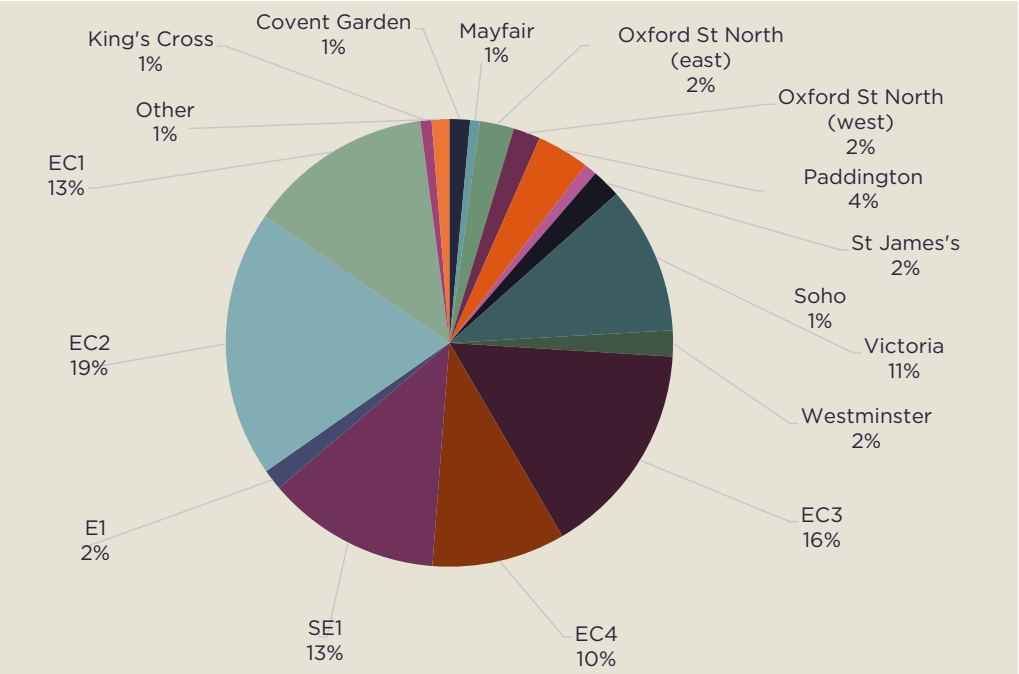
Though, there are some pricing headwinds with construction cost inflation starting to creep in and continued frustrations with London's planning system.

The prospects for the rest of 2021 look promising, as the upward trajectory of occupier confidence continues post lockdown. We are currently tracking approximately £1.25 bn of stock available across central London, with a further £1.8bn or so under offer.

Oliver Fursdon, Director
London Commercial Development

S.P.E.C Indicators Q2 2021 Central London Office	
New Build and refurbishment costs	↑
New Build and refurbishment timescales*	↑
Occupier fit-out costs	↑
Occupier fit-out timescales*	↑

Chart 5:Pipeline BREEAM Schemes targeting Outstanding or Excellent by sub-market (sq ft)



Source; Savills Research

Going beyond ....

Areas with good public realm offerings, strong transport links or that have future infrastructure improvement plans for example Victoria, Farringdon, Clerkenwell, King's Cross and White City have benefited from this in the past and it has helped these areas attract strong levels of demand from increasingly footloose occupiers. They also rank high in terms of retaining their existing tenant base.

Additionally, to this we have seen clear evidence on the post-delivery success of areas that have delivered on creating a place vs those that have not. The integration of ESG considerations will continue to make all aspects of placemaking, an increasingly important compliment for Central London offices.

Areas that have successfully been able to deliver on place have been able to create more vibrant locations which attract occupiers and could act as an incentive to bring workers into the office, as well as helping towards establishing a community feel.

The digital aspects of placemaking like branding and communication also play a crucial role in successful delivery. "Digital place making is particularly crucial for mixed-use schemes for bringing people together across the different uses and also with the wider community, which is a positive for long-term success" Katy Warrick, Residential Research Director.

Prior to Covid-19, our "What Workers Want" survey already revealed London workers were most dissatisfied with the provision of social meeting spaces and outside buildings space (e.g. access to roof terraces, gardens and green spaces). But also easier wins that could be made with improvements to things like air quality and lighting.

Well placed good quality mixed-use developments that are well-balanced have the benefit of being supported by more community related elements, as well as attracting the additional varied footfall from the different complementary uses and have been demonstrated to attract premiums.

The recent change in approach in the office sector to a more user/customer focused approach has increased the importance of having early vision and clear strategy.

Mixed-use developments

"The true innovators and leaders in mixed-use development are already pushing forward. They are challenging, 'how can we do better?', in every sense. How do we go beyond creating not just a great place, but one that is better for the environment, for society, and for every users health and wellbeing? How do we create a place that remains vibrant and fresh, but feels like an authentic part of the City fabric? Value will always be there for the best schemes, but the 'best' will no longer just create a place, they will aim to leave a legacy."

Sophie Rosier, Director
London Residential Development

Savills Commercial
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team

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