

## Spotlight | 2017

## London's future homes and workplaces – the next five years



**Summary** To remain a successful and competitive city, and to meet the demand from its growing economy and workforce, London needs both more affordably priced homes and workspace

■ **London has been resilient to the aftershocks of the EU referendum.**

Venture capital is still being actively targeted into the city at a far more aggressive rate than competitor cities.

■ **There is great potential for more office space in outer London.**

This will accommodate mid-range rents that cater for the expanding range of occupiers.

■ **London needs more affordably priced homes.** Failure to deliver these poses a major risk to the capital's economic competitiveness at both a domestic and international level.

■ **Policy intervention is required in order to reach the level of homes needed and shift the focus to the lower-value markets.**

Our analysis shows that current development models have let the market reach capacity, with net completions in 2017 expected to peak at 46,500.

■ **New market-delivery models are needed.** More Build to Rent and affordable housing is required, but London requires fundamental changes to the ways in which land is brought forward.

# Looking out for future office growth

With central London office rents at a record high, focus is turning on the city’s outer boroughs to provide more flexible and cost-effective workspace solutions to meet London’s dynamic growth

WORDS STEVEN LANG

The vote to leave the EU has thrown London’s businesses into a sustained period of uncertainty. However, business decisions will still need to be made during the next two years and we believe that London will face a shortage of workspace that matches the changing needs of London’s businesses. This heightened degree of uncertainty will lead businesses to demand more cost-effective and flexible real estate solutions and this trend could present a huge opportunity for the outer London boroughs.

A review of employment forecasts across the 33 London boroughs for the next five-year period shows that the demand for workspace will continue to increase. However, the most active drivers and locations of this demand are going to change. For example, the arts and entertainment sector is forecast to show 11% employment growth in the next five years in Tower Hamlets, but only 6% in Hammersmith and Fulham. This demonstrates the varying fortunes, geographically, across the capital.

**Increasing demand for workspace**

Employment in inner London is expected to rise by around 72,000 across the three key business sectors of arts and entertainment, financial and business services and information/communications (see table below), compared to 20,000 in outer London. Using an average employment density, this equates to a gross additional need for 5.8 million sq ft of office space over the next five years for inner London. For outer London, the total is 1.6 million sq ft.

So, is there enough additional office space planned across London for this growth? In inner London,

excluding City and West End, there is 3.2 million sq ft of new office space planned during the next five years. In outer London, there is only 707,000 sq ft. This points to a dramatic shortfall between the supply of and demand for office space in outer London.

While some of this shortfall is down to developers focusing on the central locations where the highest rents are achievable, another factor has been the conversion of office space to residential under the Permitted Development Rights. We estimate that across London, at least 3 million sq ft of office space has been lost to change of use in the last three years.

**Meeting local needs**

This lack of supply in some outer London areas has been good news for some landlords and developers as it has resulted in substantial rental growth in markets such as Croydon, Wimbledon and Ealing. Indeed, grade A rents have increased by up to 40% in certain markets. Many of these occupiers have been out-migrators from central London. For them, the rents still look comparatively cheap. However, it is worse news for local occupiers and start-ups in these suburban locations. In order to accommodate London’s future growth, we believe that landlords, developers and planners need to ensure that a full range of quality, price points and tenure of workspace is on offer.

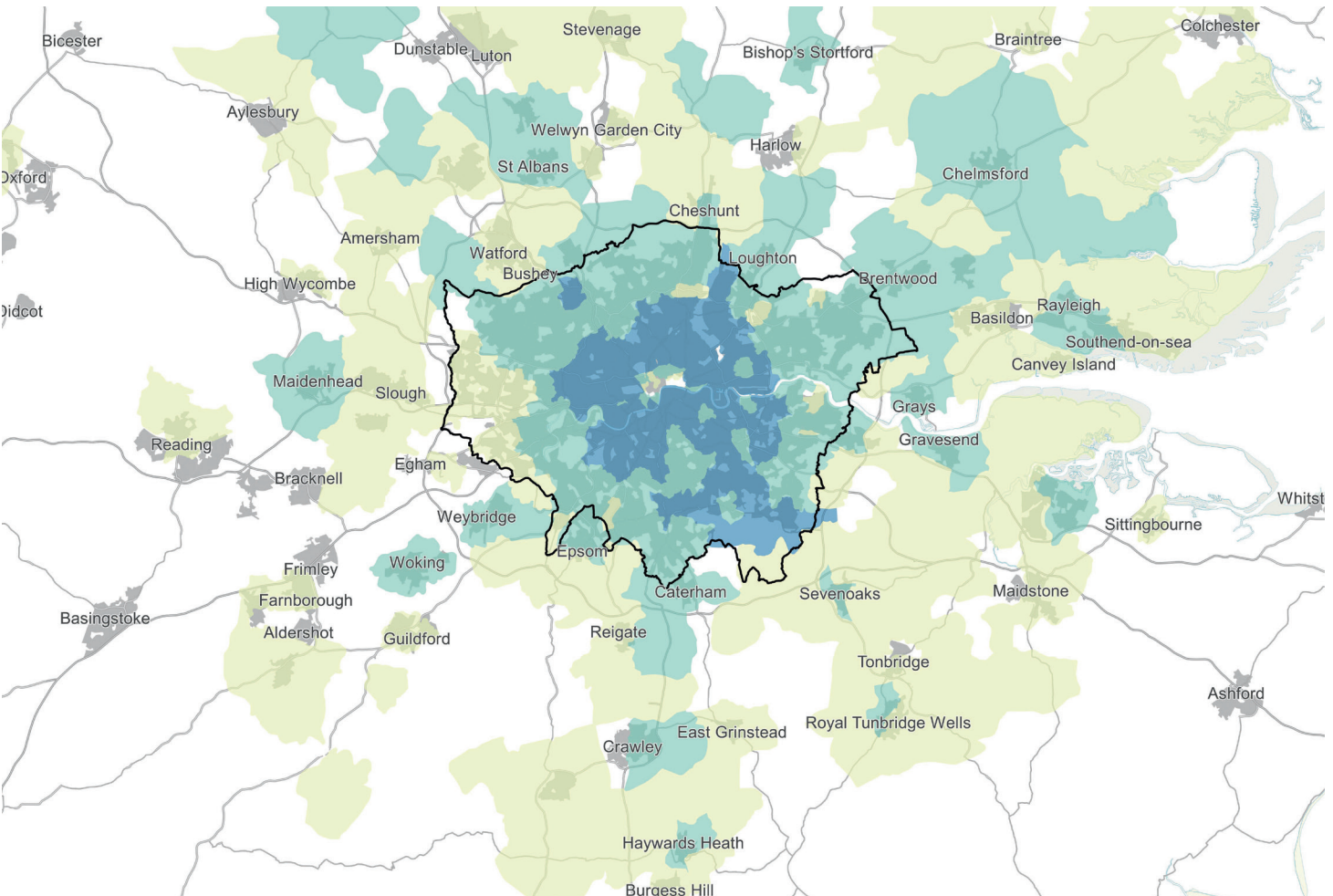
Even if office rents start to fall in central London, it will remain one of the more expensive global office locations, so businesses will continue to relocate outwards, or possibly adopt a hub-and-spoke model. Furthermore, the uncertainty around Brexit will intensify the need for those who run London’s businesses to make clever real-estate decisions. These

**Employment and five-year growth for key sectors** 2021 employment levels and predicted five-year growth (between 2017-2021) for both inner and outer London

	Arts & Entertainment	Financial & Business Services	Information/Communications	Total
2021 employment levels – inner London	91,000	896,500	326,400	1,313,900
2021 employment levels – outer London	59,300	187,500	108,900	355,700
5-year growth – (2017-2021) inner London	6.3%	4.9%	8.2%	5.8% (+72,000)
5-year growth – (2017-2021) outer London	8.7%	4.2%	7.2%	5.9% (+20,000)

Source Oxford Economics

**Destination central London** 1.3 million daily commuters travel in to Zone 1. Savills has ranked, highest to lowest, the UK local authorities that have residents who commute to Zone 1. The blue area represents those local authority areas that account for 50% of the total daily Zone 1 commuters. The green is those local authorities that account for the next 30% of the total and begins to show the commuter belt around London. The yellow is the next 10% of the total. The remaining 10% is spread throughout the UK



will be based not just around the cost of property, but the message that the move and location sends to staff.

### Commuters reaching their limit

Successful locations are not just about workplaces or homes, but the integration of the two. In London, as staff commutes get longer and more expensive, due to the rise of central residential costs, dissatisfaction with commuting has risen.

If commuting is not satisfactory, then what will the location of future office space look like? Of course, the City and West End markets will remain important. The question is whether we'll see an office network on an intra-regional scale, ie Greater London rather than nationally. Could companies take smaller offices in various locations throughout Greater London? According to the Savills/BCO What Workers Want survey, 50% of workers in London commute for 46-90 minutes (each-way) compared to just 22% nationally. Furthermore, 29% of London office workers would most like to change their 'length

of commute' compared to 21% nationally. A work location that minimises commute times would be more attractive to employees. This can be achieved in outer London as transport infrastructure improves.

### Adopting a new style of working

These real-estate decisions need not just be about traditional ways of working. Co-working and other types of managed workspace already enable businesses to have greater flexibility on location and tenure. In the future, we expect that this sector will go beyond the physical space and will become much more community driven. Could this be co-located with residential? Yes. Indeed, one of the attractions of outer London to employers is the more mixed-environment.

Outer London is already facing a shortage of suitable workspace. This needs addressing for the health of local businesses, residents and in-migrators. The supply-side answer is not to adopt a one-size-fits-all approach, but to ensure that a truly mixed offer is delivered in terms of quality of space, price point and flexibility of tenure.

# LONDON NEEDS MORE AFFORDABLY PRICED HOMES

The shortage is London mayor Sadiq Khan's number one priority. A failure to deliver them poses a major risk to the capital's economic competitiveness

WORDS KATY WARRICK & EDWARD GREEN

**B**ased on the current market-delivery model, our analysis shows that London's residential development market has reached capacity. To meet strong demand from London's growing economy and workforce, more affordably priced homes are needed. To achieve that, there needs to be change.

More Build to Rent and a strengthened Affordable Housing programme are part of the answer. But in order to increase delivery in the sectors of the market where it is needed most, further changes are needed to the way in which land is brought forward. It requires much greater public-sector land release. It points to a review of the green belt. It also means exploring ways of effectively capturing the uplift in the value of development land to fund infrastructure and affordable housing delivery, without killing the market.

## **Delivery not matching demand**

When appointed London mayor, Sadiq Khan made the city's shortage of homes his number one priority. He will be encouraged by the housing delivery figures for

2016. Leading indicators suggest 41,000 homes were completed. This is the highest number of new homes built since the 1930s and close to the London Plan minimum target of 42,000 per year.

But there's no room for complacency. These numbers are a long way short of the 64,000 new homes per year required to support forecast employment growth.

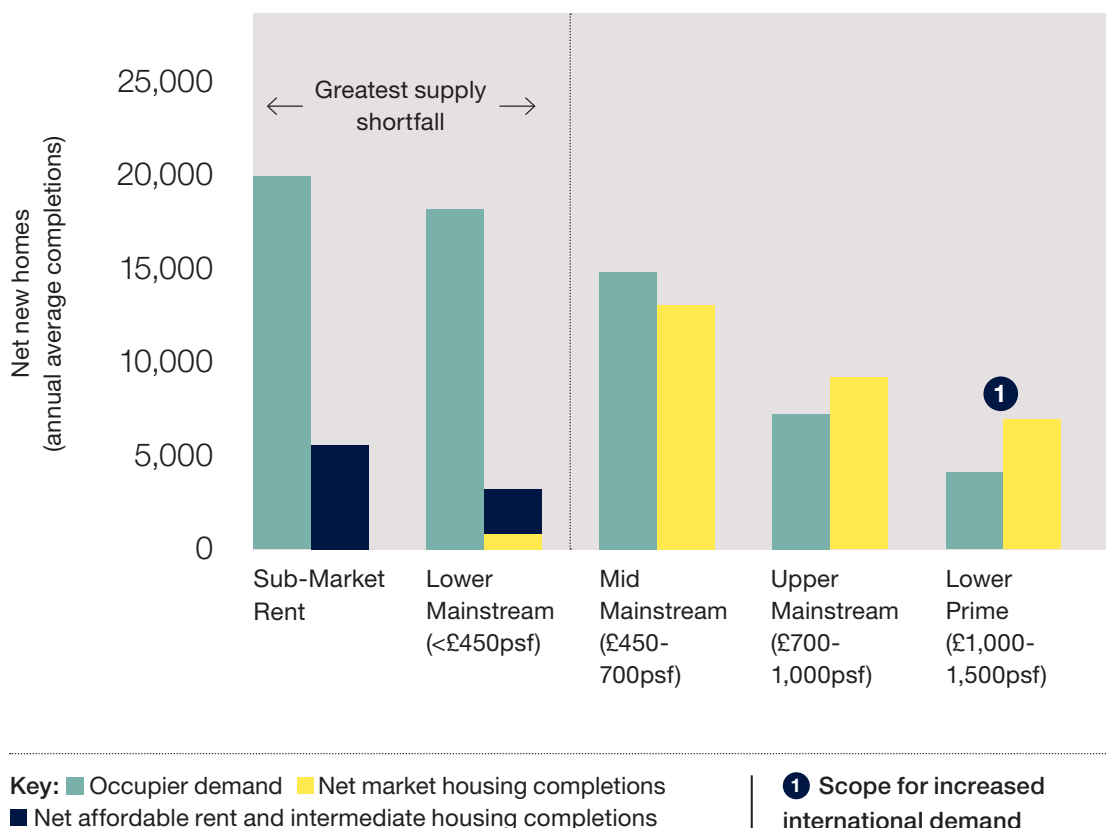
Current delivery does not match the shape of demand, given a failure to meet targets in lower-priced markets. We estimate that 58% of demand is for homes costing less than £450psf, whereas only 15% of the five-year demand forecast is met by future supply.

## **Building unsold homes**

For the majority of the last five years, new-build sales and starts have outpaced completions in London due to a very strong off-plan sales market. However, in 2016 new-build sales slowed – much in line with the secondhand London market.

In the mainstream markets below £1,000psf, transaction levels have been affected by the continued

**High demand, low completions** London completions five-year forecast for 2017-2021.  
Lower-priced housing in huge shortfall. Upper end ready for increased international demand



Source Savills Research, Molior, Oxford Economics

affordability squeeze and a fall in domestic buy-to-let purchasers following a range of tax changes. Help to Buy (H2B), which has supported new-build sales across the rest of the UK, has been far less popular in London, where it is capped at £600,000. There have been just 5,700 sales since the scheme was launched in 2013 which means H2B has supported less than 10% of market sales. There was a distinct increase when the 40% equity loan was introduced.

Although uncertainty around Brexit and high stamp duty have had an impact above £1,000psf, total sales volumes have stayed fairly level due to international

58% of demand is for homes costing less than £450psf, whereas only 15% of the five-year demand forecast is met by future supply

demand. Of more concern is the ratio of starts to sales – in this £1,000psf+ market, there have been 1.6 starts for every sale during 2015 and 2016.

Together this has meant that 25,000 of the 60,000 market homes under construction in 2016 have not been sold. This represents the highest number of unsold homes that are under construction since Molior began recording new home supply data in 2009.

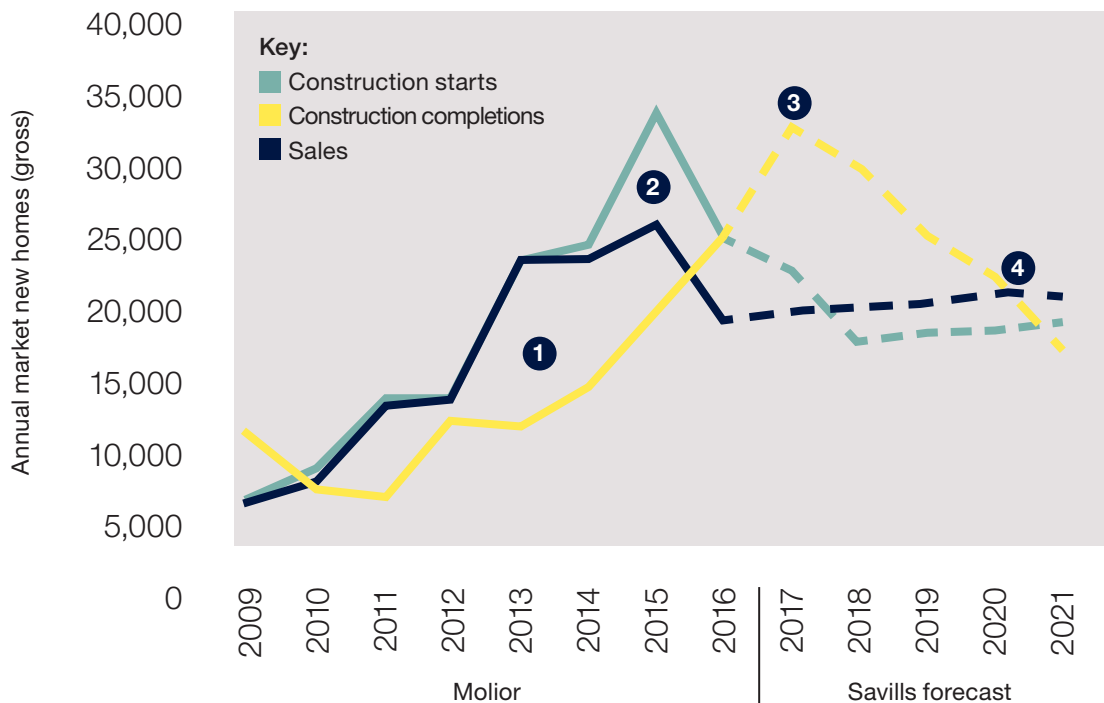
#### Affordability is stretched

As we look forward, we expect sales volumes across all price points to remain largely unchanged over the next five years.

Given stretched affordability and the constraints of mortgage regulation, purchases by owner occupiers are unlikely to increase unless more affordably priced housing becomes available.

Among investors, falling numbers of mortgaged buy-to-let buyers will be offset by increasing appetite for larger private rented-sector (PRS) deals, which have accounted for 21% of private sales in the last

**Homes for the future** Projected figures for construction starts, construction completions and sales in Greater London show recent trends will not continue



- ❶ Majority of homes selling off-plan
- ❷ This gap between construction starts and sales is responsible for the expected increase in future unsold completed stock
- ❸ Homes sold off-plan between 2013 and 2016 finally complete construction
- ❹ Construction completions slow as a result of falling starts in 2016

**Source** Savills Research, Molior (all sites under construction above 20 private homes including large scale PRS)

three years, an increase in overseas investment that is assisted by the weak pound (assuming the mayor does not meddle in this market) and steady volumes of domestic cash investment.

Transaction levels are down in London. High SDLT at upper price bands means fewer chains form to release smaller more affordably priced homes. Buy-To-Let purchases have reduced, and any additional restrictions on buyer types will further depress the capacity of the market delivery model.

### Completions to peak this year

Reduced sale rates will slow income flows for developers. That means they will take longer to pay back debt, leading to slower completion programmes and reduced starts on new projects. We have already seen some evidence of this with construction starts falling by 25% in 2016.

While we expect 2017 construction completions to peak at 46,500, we predict that they are likely to slow from this point onwards unless further significant

stimulus is provided. Savills Research analysis suggests this will fall away to 35,000, but this could be boosted. The chart above shows how construction starts and completions are expected to play out until 2021.

Policy intervention is required in order to reach the level of development needed as well as shift the focus to the lower-value markets. This must be a policy framework which encourages developers to maintain a London presence, at a time when other regional markets have begun to look comparatively more attractive, with more policy carrots than sticks, to ensure it is commercially viable.

As well as policy, continued momentum in the delivery of Build to Rent is crucial, given the needs of younger private renters. More private and public-sector partnerships are needed to deliver more intermediate tenure, and ensuring land supply to allow this to evolve.

The mayor must make best use of his forthcoming devolved powers to bring together housing, transport and infrastructure to provide the homes and workspaces for London to flourish.



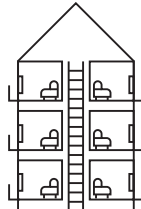
# How we live and work in new ways: 5 key trends

The habits of Londoners are changing; and what they expect from their workplaces, homes and neighbourhoods is in a constant state of change

WORDS STEVEN LANG & KATY WARRICK

Following years of failure to build sufficient new homes, living in London is increasingly expensive. Singles in their twenties are sharing with friends in rented houses. Couples in their thirties are still living (or moving back) with parents to save for a deposit, and renting has become the new norm. Now, those renters want more choice.

Millennials typically value convenience and experience over material goods – ‘stuff’ is out. Workplaces and homes need to keep up with these changes. With a greater emphasis on sharing and living collectively, along with the need for affordable housing, we welcome these five key trends as part of the solution.



## 1. Micro living. Small becomes big

For more affordable urban living, micro living is increasingly popular. More developers are including smaller homes in their plans. While this won't single-handedly solve London's housing crisis, it does plug a gap and offers choice to people with limited budgets.

Smaller homes for purpose-designed Build to Rent got a welcome acknowledgement in the Housing White Paper, having previously been constrained by the space standards in the Housing Supplementary Planning Guidance. London lags behind New York, Tokyo and Munich in the supply of micro-units, although that may be set to change. Pocket Living provides compact homes at 38 sq m/409 sq ft (above national minimum space standards). Other developers are going smaller, in central boroughs and in Croydon.

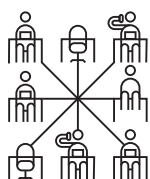
Micro living (and Build to Rent more generally) ticks another box by being well suited for modular construction, which keeps build periods short and quality high – enabling swifter delivery and, over time, greater volumes. Pocket Living has produced more than 100 homes in Lambeth using off-site factory construction methods, and Legal & General is set to accelerate housing delivery as its housing factory in Yorkshire comes online.



## 2. Co-living. The sociable option

Providing exceptional communal living space and amenities, co-living rental spaces offered by providers such as The Collective and Roam entice young professionals with a sociable environment and lifestyle offering (such as access to games rooms, community events, cinema, sauna and spa), all with a hassle-free system of paying just one bill.

For those looking for the 'experience' but who don't want to forego personal space, some Build to Rent schemes are setting new standards for premium rental products, with amenities ranging from resident lounges to private-dining facilities. Tenants want better quality and facilities, and they're willing to pay for it. A quarter of the tenants we surveyed moved out of their last rental due to poor management – an obvious sign of a gap in the market.



### 3. Co-working. A rise in flexibility

Co-working has increased in popularity as companies seek greater flexibility from their operational environment. The obligations associated with a longer-term traditional lease can constrain formative companies seeking to establish their direction as well as grow or mature – clear requirements for both start-up and scale-up companies.

The locations in which co-working environments are provided are key to catering for this increased demand. While we've seen examples of well-located large landlords offering this type of space, questions remain around the appetites of more traditional landlords to provide it.

The growth of co-working space, across all qualities, tenures and price points, has been impressive for London. We expect to see corporates increasingly using their own space to attract start-up and scale-up organisations, particularly seeking to draw in companies within similar business sectors. Real estate that is not formally office space – hotels, libraries or universities – may also be able to provide opportunities for co-working environments.

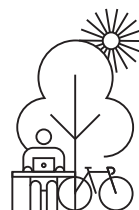


### 4. Affordable workspace. New Mayoral plans

The affordability of workspace is a key issue for small and medium-sized businesses in London. Permitted Development Rights have done much to aid the delivery of new homes, but 'office-to-resi' conversions have constrained the availability of affordable workspace.

In light of this, the Mayor of London, Sadiq Khan, announced the creation of The Workspace Providers Board to advise on securing and creating affordable workspace. Khan has asked local authorities to sign up to a 'workspace pledge', which seeks to limit the conversion of office space to residential space as well as encourage funding and partnerships to create new space for start-ups, small businesses, the creative industries and artists.

Some local authorities have also introduced new policies that ensure a certain level of a new development is affordable workspace, or at capped rents. There's an opportunity for developers to allocate areas as co-working style office space, but these restrictions may limit the marketability of the space, and reduce financial viability.



### 5. Health and wellness. Workers value satisfaction

A company's most valuable asset is its employees. According to a British Council for Offices (BCO) report last year, 15% of businesses' operational costs are real-estate related, while employee costs account for 55%. Much has been written on the role of a building in relation to the wellness of employees, but how employees are impacted by workplace location should be considered, too.

The report showed a quarter of London workers believe that their office environment has a negative impact on their physical and mental health. Just under half of those surveyed are satisfied with their proximity to green spaces. The most important factor was the length of commute to work (ranked higher than office cleanliness).

Workspaces in locations outside central London could solve many of these issues – being closer to relatively affordable housing will reduce commute times. In addition, many outer London locations have good access to high-quality green space that clearly contrasts with the high-density, built-up environments of central London.

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