From offices to oligarchs: a new role for Mayfair?

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Introduction

If property values are an indicator of success, Mayfair is one of the most successful business locations not only in London, but globally. The area is bounded by Piccadilly in the south and Oxford Street in the north; and by Park Lane in the west and Regent Street in the east. Stretching back in time this area has gone through many transformations, but most recently it has been re-inventing itself as the home of the hedge fund industry and high net worth individuals from around the globe.

But behind the apparent success lies a more complex story. This involves a number of factors that could together lead to a long-term shift in its character, particularly its traditional role as a vibrant home for corporate business. Whether this shift is a “good” or a “bad” thing is for others to consider. Our purpose here is to highlight what is happening with evidence of recent trends and causative factors.

The exodus

One of the most visible features of Mayfair’s recent change has been a continuing loss of large employers, accompanied by an almost complete lack of new inward investment. One of the early movers was insurer Royal & Sun Alliance which left Mayfair in 2003 when office rents passed £70/sq ft. A rent review at its 30 Berkeley Square HQ indicated a hike from £54/sq ft to around £71/sq ft, an increase in costs it considered untenable.

Property advisors themselves have voted with their feet, leading the Mayfair exodus for a number of years. CBRE, Cluttons and Cushman & Wakefield all moved out of the heart of Mayfair to the north of Oxford Street. Donaldsons, King Sturge and Lambert Smith Hampton soon followed. A more recent flurry of moves has seen Drivers Jonas and DTZ move most of their staff to the City, while Knight Frank has left for Baker Street. In December 2011, Savills announced plans to vacate its two offices around Berkeley Square for the Great Portland Estates development at 33 Margaret Street, north of Oxford Street.

But the trickle has become a gush, and those fleeing Mayfair and neighbouring high-cost locations such as St James’s have become more high profile. Cadbury Schweppes decided to quit 25 Berkeley Square and head to cheaper Uxbridge as part of a cost-cutting drive. The property was re-let on a floor-by-floor basis in 2009 and 2010 at rents ranging from £67.50/sq ft to £75/sq ft. Mining specialist Rio Tinto moved out of St James’s Square in 2007 into Derwent London’s Telstar building in Paddington. Its former offices have lain vacant since, with permission for a major office and residential redevelopment and refurbishment. Demolition works commenced only in November 2011. Meanwhile property developer British Land moved to one of its own schemes near Edgware Road.

Statoil, the Norwegian oil group, moved from 11a Regent Street to Paddington in June 2009, where it paid £52.50/sq ft for brand new offices, while its former offices remain vacant at the end of 2011. And ICI’s Dutch owner, Akzo Nobel, moved its 20 Manchester Square HQ to Amsterdam, its space assigned to management consultant Boston Consulting Group.

In addition, the likes of global asset management firm Alliance Bernstein and private investment firm Bain Capital, all based in Devonshire House on Mayfair Place, are thought to have considered escaping Mayfair’s rents; while HSBC has been considering its presence at 74 St James’s Street for some while.

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The occupiers that moved into Land Securities' Cardinal Place in Victoria prove that occupiers in Mayfair and St James's can be lured to neighbouring districts by good-quality space at a very significant rent discount. More than 150,000 sq ft at Cardinal Place was leased to former Mayfair and St James's occupiers, including data manager Experian, Canadian investment dealer Canaccord and asset manager Wellington Management International.[1] And 180,000 sq ft was leased to former occupiers on the fringe of Mayfair, north of Oxford Street, including investment fund manager Ruffer, IPG and Cambridge Associates.

More recently, AstraZeneca is to join the exodus from Mayfair in favour of Paddington; while GE has announced its departure for a building that it already owns in Hammersmith. And there are signs that other leading companies are looking to get out of the heart of the metropolis: the Economist Group is thought to be planning a move, while ad agency Ogilvy & Mather is thought to be considering relocation from Berkeley Square to King's Cross.

The scale of this exodus would be ameliorated if other businesses were moving in to replace the leavers. However, this appears not to be the case, as indicated in Figure One. This shows the ten largest lettings in Mayfair in 2011 with scant evidence of larger firms moving into Mayfair.

Figure One The ten largest lettings in Mayfair in 2011

Occupier	Sector	Address	Size (sq ft)	Reported rent (£/sq ft)
Rathbone Brothers	Investment management	1 Curzon Street	41,000	75.00
Apple Computer	Technology	1 Hanover Street	26,000	72.50
Evercore Partners Ltd	Financial services	14-15 Stanhope Gate	24,000	n.a.
Montagu Evans	Property advisor	Redwolf House, 5-10 Bolton Street	19,700	50.00
Zodiac Maritime Agencies Ltd	Shipping	1 Hanover Street	17,500	73.50
Manchester United Football Club	Sport Operator	Stratton House, 5 Stratton Street	11,600	82.00
African Minerals Ltd	Mining	Stratton House, 5 Stratton Street	11,600	n.a.
GSA Capital Partners	Investment management	Stratton House, 5 Stratton Street	11,200	n.a.
BTG Pactual Europe LLP	Financial services	Berkeley Square House, Berkeley Square	10,500	65.00
Pegasus Resourcing Ltd	Recruitment consultant	3 Grafton Street	9,800	n.a.

Source: EGi London Offices Database

[1] At an average occupancy density of 140 sq ft per person, this equates to nearly 1,100 people.

The largest letting in Mayfair in 2011 was to venerable UK investment management firm Rathbone Brothers who leased 41,000 sq ft at 1 Curzon Street, W1, at a reported rent of £75/sq ft. This space was formerly occupied by Swiss bank UBS.

Although this is only a snapshot of ten deals in 2011, it illustrates some of the trends in Mayfair. Investment management, asset management and other financial services aimed at high net worth individuals remain the most important sector of demand, accounting for four of the top six transactions. Only one transaction relates to Mayfair's long-standing association with the UK property sector. Some of the occupiers already have a link with Mayfair, the lettings reflecting business expansion, sometimes within an existing building, as in the case of Apple.

The arrival of hedge funds, wealth managers other financial businesses in Mayfair is well documented, but such firms individually take small amounts of space, typically around 5,000-7,000 sq ft and rarely over 10,000 sq ft. A good example is York Capital Management which took 7,800 sq ft at the new development of 23 Savile Row in April 2011 at a headline rent of £97.50/sq ft, prompting the developer to seek £100/sq ft for the remaining 25,000 sq ft in the building. It takes a large number of lettings of this size to make up for the exodus of one 70,000-80,000 sq ft occupier.

Why are businesses leaving?

There are a number of reasons why businesses are leaving Mayfair. Cost is clearly a key driver, but by no means the only one.

Rising occupancy costs For most of the 1980s the West End had lower rents than the City (Figure Two). However, over the long-term, rents in the West End (of which Mayfair and St James's are the most expensive sub-markets), have increased in real terms such that they are now roughly twice rents in the City: mid-£90s/sq ft versus low-£40s/sq ft. At the peak of the property boom in 2007, prime office rents in Mayfair soared to £140/sq ft.

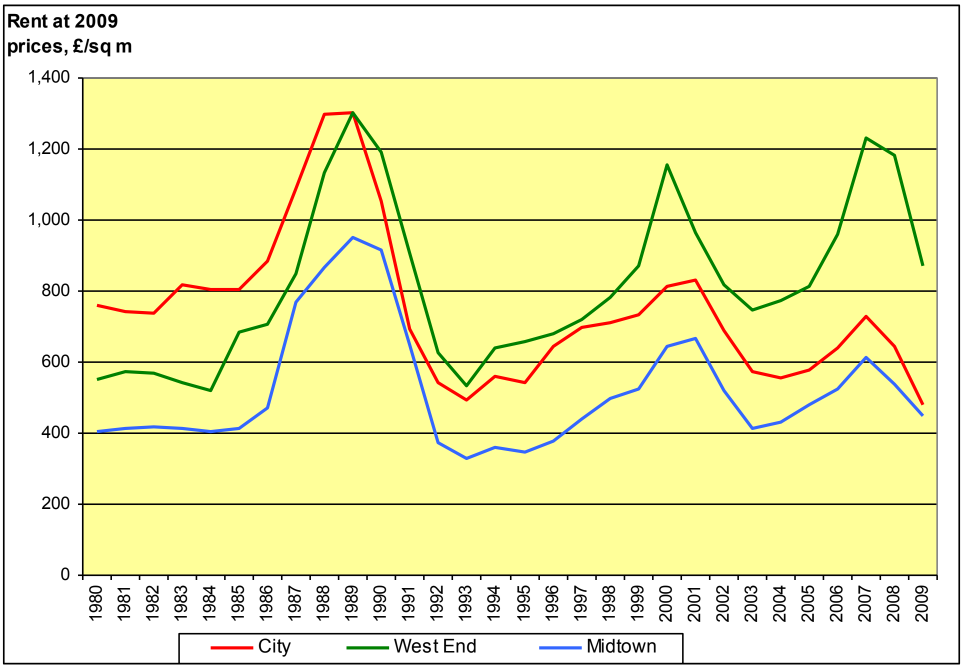
One of the contributing factors to the large hikes in rent, certainly during the years leading up to the credit crunch, was the increased interest shown in the area by the financial businesses, referred to above, which paid unprecedented rents for prestigious accommodation.

In occupancy terms, for many businesses these levels of rent are unsustainable, leading inevitably to many companies reconsidering their need to be in Mayfair.

Of course rent is not the only cost of occupying commercial property: there is also the small matter of business rates. The recently-published Valuation Office Agency's 2010 Rateable Value assessments reveal wide variation, with a particular impact on the West End's offices.

The largest increases are for offices in the West End of London with many assessments doubling. The Government's own properties are not spared with the Houses of Parliament's RV up 72%, the Treasury's Westminster up 76.4%, and the MoD's Whitehall offices jumping 88%. These are topped by the 108% increase for the American Embassy in Grosvenor Square.

Figure Two Central London office rents, 1980 to 2009



Source: GLA London Office Policy Review 2009 (Ramidus Consulting, data from DTZ Research)

The new assessments are based on rental values at 1st April 2008, since when rents have fallen in most locations and sectors. Those sectors and regions where 2008 values were significantly greater than at the last revaluation five years ago will see the biggest increases in bills.

By far the largest increase across any local authority is Westminster, where the total rateable value will increase by 60%, although this mostly reflects the large jump in office values. And the revaluation will also be good news for some businesses in the City and Docklands. The Bank of England's assessment in Threadneedle Street goes up by 13.5% whereas HSBC's Docklands HQ increases only 6.7%.

Although occupiers in locations such as Mayfair will be able to avail of transitional relief, by 2015 they could be paying as much as £50/sq ft in rates compared to £25/sq ft now. Even if rateable values fall at the next revaluation in 2015, transitional arrangements are such that rates in Mayfair would come down only gradually. Rates will contribute to high occupation costs in Mayfair for the next decade.

The UK tax regime The UK tax system has been criticised in recent times for its potential to encourage businesses to relocate from London to lower tax countries. A recent story in the Daily Telegraph illustrated the issue.[2] British workers, disillusioned at the imminent 50p tax rate, have been crowding into seminars held by Savills, the London estate agent, to be briefed on the advantages of leaving Mayfair and the City for Geneva and the Swiss Alps.

[2] Daily Telegraph *High-taxed City workers consider Swiss move* 21st November 2009

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Swiss personal tax rates are as low as 20% and there have been reports of UK-based executives being offered a 10% tax rate as the government steps up its drive to entice high earners.

As well as personal tax, approaches to corporate tax are having a similar effect. Companies from McDonald's (fast-food) to Informa (publishing) to Regus (serviced offices), are moving their headquarters to Switzerland because of what they regard as onerous UK corporate tax rates.

Despite the interest, some experts say talk of an exodus from the City to Switzerland is overdone. Housing supply is limited and rules denoting who is able to buy a property are rigorous. In Geneva, foreigners must gain residency before they buy, which generally requires a contract of employment or proof of sufficient wealth. And of course the real estate market is quite small. But growing dissatisfaction could reduce the attractiveness of London in the long-term.

Mixed use policy Local planners are able to influence the mix of uses within development projects. The City of Westminster pioneered site specific mixed use policies requiring the introduction of residential use into developments where there is an increase in office size. The result is to the overall deterrent of office development, including refurbishment/extension projects. There is also a longer-term impact on the size of the Mayfair stock, helping to promote scarcity and higher rents. The following is taken from the London Office Policy Review 2009.

Within CAZ there have been two different approaches which have led to different outcomes in terms of office development. The so-called “50:50” mixed-use policy which is utilised by Westminster and Camden requires any increase in office floorspace to be matched by an equal increase in residential floorspace. In Westminster the threshold for increase is set at a very low 200 sq m – enough space to accommodate around a dozen office workers at an average density or provide for two two-bedroom flats.

The need for developers to take account of mixed use policy and to provide housing can require complex resolution. If an increase in office floorspace leads to an amount of residential development over either Westminster’s or Camden’s affordable housing thresholds, it will trigger the need for affordable as well as market housing.

There is a sequential preference for housing, including affordable housing, to be provided on-site, then off-site, or through a commuted payment. For housing to be provided off-site or through a commuted payment must be justifiable in terms of the development – that on-site housing is not either physically or economically viable. Quite often, especially in Westminster and also in Camden, off-site provision is provided through the change of use of office buildings in the vicinity, tending to neutralise the increase in the office stock.

If residential use is to be provided within the primary site, there are implications for the design and layout of the development in terms of separate access and servicing. There are also implications for the value of sites and their ability to be redeveloped in the future.

Generally developers prefer to separate the housing use “horizontally” to occupy a discrete building or part of a site, simplifying servicing and access arrangements (as distinct from “vertical” separation where different floors within a single building are used for different purposes). This also enhances the values of the office and other commercial uses on the site which can be traded without the encumbrance of residential use.

On large-scale sites, the application of the 50:50 approach appears to work reasonably well (e.g. the Central St Giles scheme off New Oxford Street) But sites like this are relatively rare in Mayfair, which is characterised by smaller plot sizes. Developers seeking to redevelop office buildings or to refurbish them incorporating additional floorspace may in some cases be deterred due to the requirements of the mixed use policy. Office development continues to occur in Westminster and Camden, but probably at a lower quantum than would be the case without mixed use policy.

Supply shortage Apart from the main driver of cost, a subsidiary factor driving companies out of Mayfair is the lack of good-quality, modern, flexible office space, and good alternatives elsewhere. The success of schemes such as Cardinal Place (see above) in fringe West End locations like Victoria is just as much about the quality of the building as it is about rent, because office supply in Mayfair and St James’s is so low.

Mayfair has seen a dearth of large new buildings in recent years. The largest office building completed in the last five years was 23 Savile Row, 91,500 sq ft and with a typical floorplate of 16,500 sq ft. In total, only three office completions over the period 2007-2011 in Mayfair exceeded 50,000 sq ft, with developments more typically 20,000-40,000 sq ft with floorplates in the order of 4,000-6,000 sq ft.

At the end of 2011 there was only one office building under construction in Mayfair over 50,000 sq ft at Park House, 116 Park Street. Due for completion in late 2012 this building offers 163,000 sq ft offices, 88,000 sq ft retail and 58,000 sq ft residential.

More recently, a few larger schemes have begun to emerge. Looking ahead there are only four permissions offering in excess of 50,000 sq ft. Two of these form part of The Crown Estate’s long-term renewal of its Regent Street estate, with permissions for 150,000 sq ft at 169-173 Regent Street and 120,000 sq ft at neighbouring 153-167 Regent Street. On Piccadilly there is permission for 100,000 sq ft in the proposed redevelopment of the Clarges Estate at 82-84 Piccadilly which also includes 24 private apartments. In the heart of Mayfair, there is permission for 68,000 sq ft at 8 Grafton Street.

Competing locations Traditionally, the core London office market was tightly defined by the Square Mile; Mayfair and St James’s and Victoria. During the 1980s, the Square Mile spread northwards and eastwards; while London Bridge City and Canary Wharf provided “off centre” alternatives.

During the 1990s further peripheral developments began to challenge traditional boundaries: Paddington, More London and Bankside, and British Land’s investment at Regent’s Place and Euston are all good examples. At various stages of development, there are also proposals for Battersea/Vauxhall, Greenwich Peninsula, King's Cross and Waterloo.

These "off centre" urban campuses will continue to pull large occupiers away from the expensive and tightly constrained core area of Mayfair, and elsewhere, with the offer of brand new space, large floorplates, integrated environments and headline rents in the region of £40/sq ft.

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It is clear that there are a number of reasons why firms are leaving Mayfair. It is equally clear that the vacuum they are leaving is being filled immediately by developers hungry for sites to convert to luxury residential.

High net worth individuals from around the globe have long held London at the top of their buying lists, and they have driven prime residential values in London upwards, when other places have fallen or become stagnant. With buyers from Russia, China and India fuelling the high value residential market, their continuing love for London has become critical to sustaining values, and fuelling the pressure to change from commercial to residential use in prime areas such as Mayfair.

Knight Frank measures changes in the value of prime residential property in cities across the globe. Its research has shown that in 2009, London was 9th in the list of top ten best performers and one of only two cities in the western developed economies that appeared in the top ten – the other was Washington.[3] According to the Knight Frank research: "*it is those locations that offer a genuine lifestyle attraction to the world's wealthy, rather than just an investment opportunity, that will prove most sustainable*".

The super-prime market is dominated by foreign buyers. Press reports last year heralded the arrival of the Chinese super-rich into the high value London residential market. If China is the source of the next wave, it follows the Middle East and Russia and it comes in tandem with India and Singapore.

CBRE[4] observed that the international appeal of central London property is buoyed by the popularity of its universities: "*Many wealthy parents look to combine an apartment for their off-spring with a good long-term asset*". Furthermore, "*the attitude towards property ownership in the Far East also adds to the appeal of a Central London Property. For example, in Hong Kong, it is not so much about owning a second home, as it is about owning a collection*".

The impact of the prime residential character of Mayfair is also seen in its prime retail spots of Bond Street, St James's and the area around Mount Street. All are thriving, and attracting new, prestigious brands. Needless to say, such demand is reflected in investor demand. Two transactions in the summer of 2011 exemplify the trend. The Prada flagship store at 16 Old Bond Street was sold for £32m, a yield of 3.1%; while the Cartier store at 40-41 Old Bond Street was sold for £16.5m at a yield of 3.1%. There are plentiful other examples.

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[3] Knight Frank (2010) *Wealth Report*
[4] CBRE (2010) *UK Residential Viewpoint*

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The future of London's high value residential market depends not so much on its ability to spawn new wealth at home, as on its ability to attract potential purchasers from overseas. Research from Savills[5] suggests that

> *International demand is expected to continue to underpin growth in prices across prime London, particularly in core central locations. This demand will be underpinned by a growing world economy (forecast to grow by 12% by the end of 2012) and particularly strong growth in some parts of the world (notably India and China), creating new demand for prime London residential property.*

London is not immune to competition and as competitor cities mature, their relative attractiveness is likely to increase. But London is a hard act to follow, and it is probably more daunting to envisage catching up in the popularity ratings than to hold on to a position of power and influence. And particularly during recent economic turbulence around the globe, London is seen as a safe haven for personal wealth.

Conclusion

Mayfair is clearly undergoing significant change. Corporate businesses are moving out and high net worth individuals are moving in – along with their bankers and luxury shops. How far this trend will go, we do not know. Neither, as was stated at the beginning, are we judging it to be a good or bad thing. But the evidence is seems to be convincing.

One of London's enduring characteristics over hundreds of years has been its ability to change and adapt to new circumstances. This helps to explain its role on the global financial stage; its role in the creative and technology sectors, and its continuing attraction to overseas investors. What is happening in Mayfair today is perhaps another symptom of this adaptability.

[5] Savills (2010) *Market in Minutes: Prime London Residential Markets*