LONDON OFFICES: A TRIUMPH OF HOPE OVER EXPERIENCE?

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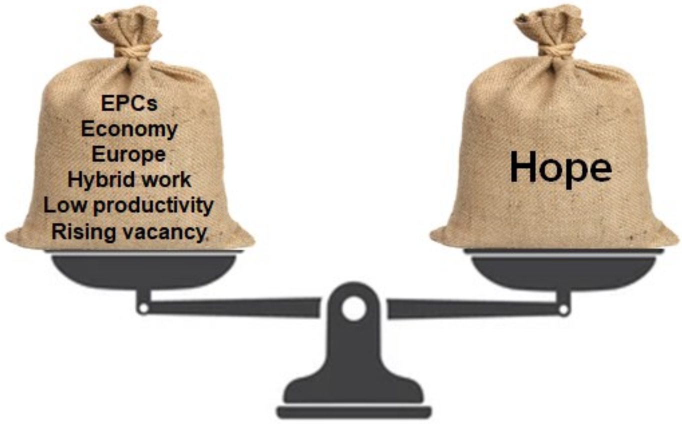
So, here we are, over three years on from the first lock downs and the closure of offices across the country. What is the state of the London office market today?

In short, the apocalyptic warnings appear to be on the wane, but there remain plenty of potentially damaging headwinds to help maintain a general atmosphere of uncertainty and a degree of gloom.

Hybrid working will likely have the greatest long-term impact on the office market, but the introduction of Energy Performance Certificates, the abject performance of the economy and the EU's approach to the City of London, among others, all add up to a weight of uncertainty.



But despite these threats, market confidence remains strong. Why so? Is it just down to the property sector's famous optimism? Or something else? We begin our latest sideways look at the market by asking: *where are all the passengers going?*

The journey-to-work paradox

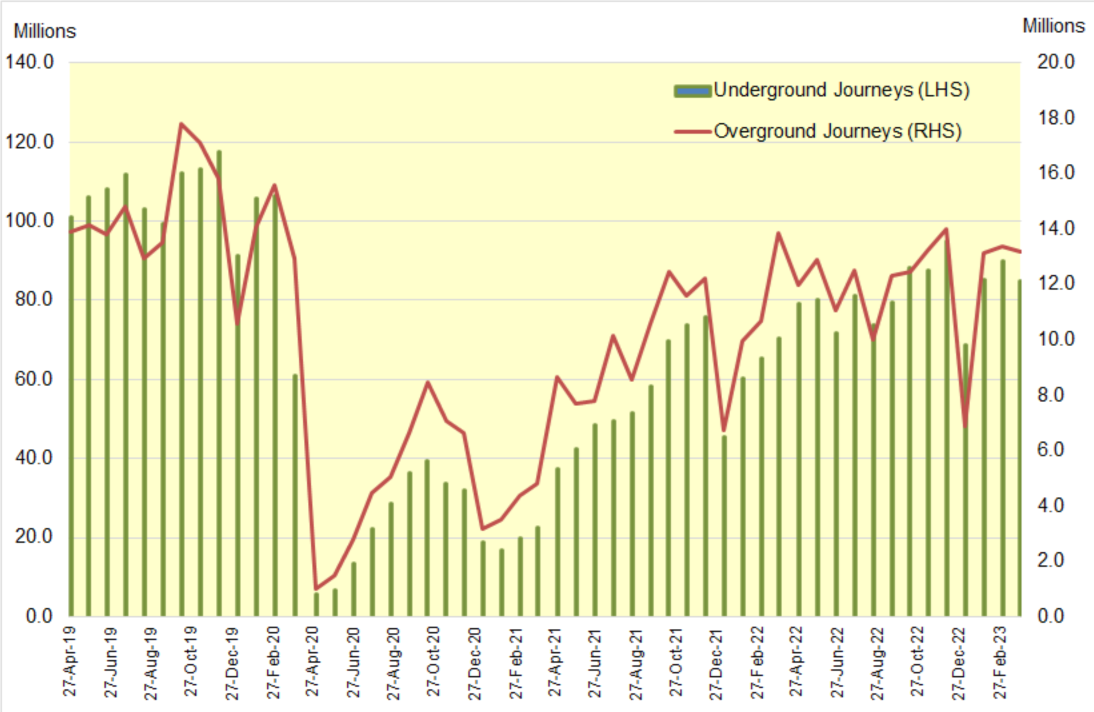
There appears to be something of a mismatch between return-to-office data and travel-to-work data. Remit Consulting's monthly *ReTurn Report* of 29th March 2023 (based on a sample of 75 buildings) suggested that occupancy rates in London are peaking at around 50% in the West End and Docklands, and running at less than 30% in the City, Midtown and 'Other'. By contrast, journeys on the transport system suggest a rather different picture. [1]

Underground journeys were running at around 100m per day immediately before the pandemic, plummeting to a low of 1.2mn in 2020 (Figure 1). A slow recovery followed, but daily journeys in 2023 are now exceeding 85mn. The overall pattern on overground journeys has been a mirror image, but at much lower volumes. Pre-pandemic daily journeys topped 14mn, and in 2023 they have more or less recovered.

In short, there is a paradox insofar as travelling appears to have made a much stronger recovery than days spent in the office. Where are all the people going?

Given that Remit's sample of 75 buildings accommodate an average of c1,700 people per building, is this further evidence that large, corporate offices are under-occupied compared to the SME sector where the bulk of jobs are?

Figure 1 Underground and overground journeys, London, Apr 2019 - Mar 2023



Source: GLA (2023)

Whilst discussing the journey-to-work, it is worth highlighting that data from the US and data from Europe should be treated very differently. The pattern of commuting in the two is entirely different, with the American tradition of daily long-distance travel by car, compared to the European tradition of rail travel and shorter distances. Vacancy rates across key European centres (Berlin, Frankfurt, London, Paris) are averaging between 4% and 9%, which is mirrored in Tokyo and Sydney; while US vacancy rates (Chicago, Los Angeles, New York, Washington) range between 15% and 25%.

London's competitiveness

How is London faring compared to other cities? On most measures it seems to be holding its own.

For example, since March 2007, Z/Yen has published the twice-yearly Global Financial Centres Index. The survey provides one of the most comprehensive and accurate assessments of global city competitiveness. Issue 33, March 23, offers a ranking of 120 cities.[2] Throughout the life of the Index, London has vied with New York for the No1 spot, having settled into a close second since 2018. This year, London again ranks second behind New York, followed by Singapore, Hong Kong, San Francisco and Los Angeles. London's highest ranked European competitor is Paris, lying a distant 14th, with Amsterdam and Frankfurt ranking 16th and 17th, respectively.

A key barometer of confidence in any economy is the level of foreign direct investment (FDI). Again, on this measure, the UK and London are out-performing other European countries. Figure 2 shows the UK total FDI compared to its largest four rivals for inward investment.

Figure 2 Foreign Direct Investment, largest Euro countries, 2021-2022

Country	Projects	New jobs
United Kingdom	1,589	84,759
Germany	100	7,399
France	84	4,628
Netherlands	74	4,316
Italy	72	1,283

Department for International Trade (2022) Inward Investment Results 2021-2022

In the FDI sub-sector of financial services, the UK continues to be Europe's most attractive location, according to EY's latest UK Attractiveness Survey. In attracting 63 projects in 2021 (up from 56 from 2020), the UK outpaced France (60 projects). (11 more than in 2020).

While the UK and France saw an increase in the number of financial services investment projects secured, Europe as a whole experienced a fall – the third annual decline in succession. Germany, which for much of the past decade was the second largest recipient of financial services projects, also reported a third consecutive annual decline, with project numbers falling from 81 in 2018 to 29 projects, and is now ranked fourth behind Spain. [3]

Specifically in London, the Corporation of London recently released more data to underline the strength of the City. [4]

- Over the past five years, London has attracted $166bn of Fintech investment (New York = $407bn; Paris = $19bn).
- In 2022 UK tech companies raised £24bn in tech investment (France = £11.8bn; Germany = £9.1bn).
- London has 132 unicorns, Paris has 36.
- London is the world's largest centre for the issuance and trading of international bonds at $1.110bn (Frankfurt = $558bn; Paris = $453bn; New York = $371bn).

Despite these positive indicators, that fact is that the London economy flatlined at slightly below pre-pandemic levels of output through the whole of 2022. Part of the decline in activity is due to the number of days lost to strikes. The ONS estimates that this was 843,000 days in December across the UK. This is the highest figure since the strikes of November 2011. The ONS reports that there was anecdotal evidence that rail strikes had negatively affected some businesses, particularly restaurants, caterers, hotels and bars.

Another area of concern is the number of companies floating in New York and elsewhere rather than in London. Recent examples of companies shunning the LSE in favour of New York's Nasdaq include Cambridge-based software company ARM; Irish-based building materials company CRH; plumbing and heating products distributor Ferguson, and Paddy Power and Betfair owner Wolseley. The number of companies listed in London has fallen rapidly over the past decade, as have the capital's share of global IPOs.

The Financial Conduct Authority has lately responded with a series of measures to make London more attractive. Time will tell whether it can reverse a worrying trend.

Notable occupier activity

Since our last London Offices Update in December 2022 there have been a number of notable occupier deals.

- **Standard Chartered** has resolved its long-standing requirement by agreeing a long-term reversionary lease on its 200,000 sq ft office at 1 Basinghall Avenue, EC2. Landlord Zeno Capital will refurbish the building, completing in 2026.

- International lawyer, **Taylor Wessing**, has renewed its lease on 175,000 sq ft Landsec's 5 New Street Square, EC4, from 2025. The new deal entails an expansion of 22,000 sq ft, and an extensive refurbishment of the building.

- UK insurer **Charles Taylor** has signed for a new 66,000 sq ft London headquarters at the Minster Building, EC3. The firm will consolidate its three London offices into the recently refurbished 275,000 sq ft building.

- Investment manager **Pimco** has taken 106,000 sq ft at Derwent London's 300,000 sq ft 25 Baker Street, W1U. The firm has taken floors five to nine on a fifteen year lease with no breaks. The building will be complete in 2025.

- In Paddington Central, media firm **Virgin Media O2** has taken 83,000 sq ft for a new headquarters in 3 Sheldon Square, W2 currently being refurbished by British Land.

- Luxury brand **Chanel** is doubling its London footprint with a move to 38 Berkeley Square, W1. Chanel has signed a 20-year lease across 86,000 sq ft.

Three other significant moves currently being planned merit highlighting.

- Following the merger of law firms Eversheds and Sutherland Asbill & Brennan in 2017, **Eversheds Sutherland** is reportedly looking for c100,000 sq ft.

- On the 7th June the Financial Times carried a story regarding plans by one of Canada's largest asset managers to "*more than double its headcount in London and invest billions in the UK, hailing the city as more of a gateway to the world than New York*". The **Alberta Investment Management Company** (AIMCo), which manages $120bn on behalf of Alberta's wealth fund and pension funds, told the Financial Times it planned to 'invest billions' in the UK, "*including on projects linked to the country's green industrial revolution*" policy. The FT noted that AIMCo's move followed similar moves by other large global investors, including the $102bn Australian superannuation fund Super Aware, which is opening its first London office later this year. [5]

- US tech firm **Palantir** has selected London for its new European HQ for AI development. The company's CEO was quoted as saying that London is a magnet for the best software engineering talent in the world and was, therefore the natural choice as the hub of European operations to develop the most effective artificial intelligence software solutions.

Our July 2022 paper on Life Science in London examined the rapid growth of both demand and supply of new space for this rapidly expanding sector. The trend has continued.

- Pharma giant **Eli Lilly** has shortlisted three buildings in its search for a new UK HQ. The 65,000 sq ft requirement is focused on Endurance Land's Regent Quarter; the Tribeca scheme, north of King's Cross, promoted by Reef, GIC and BlackRock Alternative and Oxford Properties and Pioneer Group's Victoria House in Bloomsbury Square WC1.

- Global pharma company **GSK** has announced that its new global headquarters will be in central London. The company will move in 2024 from its current site in Brentford, West London to Royal London UK Real Estate Fund's The Earnshaw on the corner of New Oxford Street and Earnshaw Street, WC2H. The 155,000 sq ft scheme will house around 3,000 people using a hybrid working model, and it offers easy access to GSK's global R&D hub in Stevenage, as well as proximity to the company's Artificial Intelligence and Machine Learning Hub in King's Cross. [6]

- **Omega Pharma** has taken 21,000 sq ft at Kennedy Wilson's One Embassy Gardens in Nine Elms, SW8. Marie Curie already occupies 14,000 sq ft.

- **UCL Neuroscience** is overseeing the construction of a new centre of excellence in Grays Inn Road, WC1X that will bring together UCL Queen Square Institute of Neurology, the UK Dementia Research Institute, the UCLH National Hospital for Neurology and Neurosurgery.

- Developer **Lateral** has announced plans for its key site next to the Royal London Hospital, Whitechapel, E1. The plans promise a 172,000 sq ft lab facility.

- **GIC and Oaktree** have bought 17 Columbus Courtyard, Canary Wharf, E14, and plan to create a 200,000 sq ft life sciences facility.

In our July 2022 paper, we also raised the possibility of a 'life science bubble', with developers and investors piling in. This remains a concern, with a growing pipeline of life science schemes.

Flexible space market

The flexible space market seems to be making a strong post-Covid recovery. Occupancy levels have reportedly recovered to early-2020 levels. Recent operator announcements include the following.

- **Orega** completed a management agreement with Thames Estates to create a 33,000 sq ft centre at Holborn Gate, 330 High Holborn, WC2A. Orega will offer c550 workstations on the first and fifth floors of the 175,000 sq ft building.

- **Huckletree** has taken 35,000 sq ft at 199 Broadgate, EC2.

- In a similar deal, **Fora** (now part of TOG) has entered into a management agreement with Oxford Properties to open a 43,300 sq ft centre within the 500,000 sq ft Blue Fin building in Southwark Street, SE1.

- **x+why** has joined forces with Grosvenor and the Westminster Foundation to launch a flexible workspace facility at 8-10 Grosvenor Gardens, SW1W. The space, called Fivefields, is designed for charities and social impact organisations.

- **Convene** has signed for a 45,000 sq ft meeting and events venue at Greycoat and Mitsui Fudosan's Sancroft St Paul's redevelopment in Paternoster Square, EC4M. The facility will offer meeting spaces, including one space capable of accommodating 900 people.

In a demonstration of the attractiveness of flexible space to large corporates, Amazon, which already has major facilities at 60 Holborn Viaduct, EC1A and at Principal Place, EC2A in Shoreditch, has taken 70,000 sq ft of expansion space at WeWork's Moore Place, EC2Y.

Landsec has unveiled plans to open three new Myo sites across London by the end of the year, tripling the size of its flexible office brand to more than 210,000 sq ft. The centres include 45,000 sq ft at New Street Square, EC4A; 46,000 sq ft at One New Change, EC4M and 48,000 sq ft at The Forge, Cornhill, EC3V. Landsec said it was also exploring opening an additional 23,000 sq ft site at its Lucent office scheme in Piccadilly.

Looking ahead, British Land is taking its interest in the flexible space market to a new level, with proposals for a 158,000 sq ft of facility called The Grand Press at the iconic Printworks site in Canada Water, SE16. Together with JV partner Australian Super, and architect Hawkins\Brown, the plans will reposition Harmsworth Quays, which was once Europe's largest printing facility, into an office-led, mixed-use scheme and cultural venue, with a wide range of retail and F&B outlets on the ground floor.

Market performance

According to the latest Deloitte London Office Crane Survey, up to ten million square feet of new office space will be delivered in 2023, with around 2.85m sq ft of this being pre-let. Despite this apparently high number, the pipeline shrinks dramatically: around three million square feet is due in 2024 (with one-third already pre-let) followed by, so far, small upturns in 2025 and 2026.

Given the level of economic uncertainty, wrapped together with the anticipated shrinkage in demand brought about by post-Covid hybrid working, it is reassuring that we do not have a huge wave of construction activity coming to the market in the short-term.

Knight Frank data suggest vacancy ranged between 20m and 21m sq ft throughout 2022, with around half being accounted for by the City and South Bank. The overall vacancy rate is around 9%, - slightly below the long-term average. The vacancy rate was held in check by a healthy level of take-up – somewhere in the region of 11-12m sq ft, slightly over the long-term pattern. [7]

A number of new development schemes have been announced this year.

- Developer Hertshten Properties has committed to redevelop 85 Gracechurch Street, EC3 and deliver a 32-storey, 377,000 sq ft tower.

- Winchester House on London Wall is due to be vacated when Deutsche Bank moves to 21 Moorfields, EC2 later in 2023.Owners Castleforge and Gamuda Group (Malaysia) have bought the building and will transform the eight-storey, 320,000 sq ft building into an eleven-storey, 500,000 sq ft building.

- Salisbury Square, will be transformed into a 525,000 sq ft space housing 18 courtrooms, which will serve as a headquarters for the City of London Police. And the former Goldman Sachs HQ at Peterborough Court, 133 Fleet Street will be redeveloped.

There are grand plans for the Fleet Street quarter of the City of London. Plans were revealed earlier this year in which the former home of the newspaper industry could see £5bn of investment in around 34 projects, including 3mn sq ft of offices. [8]

Wider occupier market: Film & TV Studios

It is always good to report on an emerging trend or a growth sector within London’s ecosystem of occupiers, and while these papers have a focus on offices and London, we also like to draw attention to other news that contributes to the wider business community of the capital. Film and TV is one such rapidly growing sector and the UK appears to be building, literally, a leading European position.

According to one source, there are currently 13 major film studios in London and its immediate hinterland, providing a total of 1,629,000 sq ft of studio space and 110 sound stages, 54 of which are larger than 10,000 sq. ft. But looking to the future, a total of 16 new studio developments currently being planned or built, totalling some 3.8m sq ft of space. [9]

If all the planned studios get delivered, London and its environs will be home to c5.5m sq ft of film and TV studios spread across 300 stages – one of the densest production clusters in the world. Since the data quoted here were compiled, two further major schemes have come forward.

- Developer VERB and film studio operator Quartermaster have revealed plans for a film and television studio campus near Stewartby in Bedfordshire. The Home of Production Studio scheme, designed by architect Scott Brownrigg, involves redeveloping a 143 acre site to provide more than 1.75m sq ft flexible studios, accommodation and amenities.

- Pinewood Studios in Buckinghamshire has announced plans for a 1.4m sq ft expansion – to give it 'world's largest' status. The plans involve 21 new studios, filming space, education and training facilities, creating 8,000 new jobs.

This enormous growth will have knock-on effects for the wider London economy, including the office economy.

Prospects

London's economic performance remains sluggish, but no more so in round terms than other European capitals. The fundamentals are strong, but productivity doggedly refuses to make a real improvement. On most indicators London remains in the very top flight of global cities, although this long-standing position will be challenged in the coming years – not by Paris or Frankfurt, but by Chinese cities. London's continuing global role is seen in the level of foreign direct investment it attracts – the largest in Europe – and in the quality of the office occupiers that continue to move and expand here.

The office real estate market faces strong headwinds – EPCs and hybrid working will combine to ensure more secondary space becomes available, placing pressure on vacancy rates. The mixed use nature of London's central area has thus far helped to avoid the rocketing vacancy rates being witnessed in the US.

EPCs could make great swathes of space redundant, while hybrid working could lead great swathes being extra to need. There is though a third scenario.

It is just possible that as EPCs underpin the so-called 'flight to quality', so this will release secondary space for conversion to non-office uses. Taken alongside a few years of modest growth in the office economy, and it might just be that one cancels out the impact of the other.

But such a scenario will need growth. Where will this come from?

We know that London has maintained its global financial centre ranking during the pandemic; but in recent times it has, once again, been quietly adapting and diversifying to become a world-leading centre for digital, life science and creative industries. Take for example, artificial intelligence. London is home to almost 1,300 AI companies, more than New York and double the combined number in Paris and Berlin. In 2021, more than £3.4bn was invested in London AI businesses, up 36% on 2020. UK GDP will be up to 10.3% higher in 2030 as a result of AI – an additional £232bn. [10]

Such new industries will drive growth in London. And with their younger demographic profile of workers who live closer to the centre, they might just help ensure that central London evolves as a vibrant, mixed use economy.

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