LONDON OFFICES: WHERE WILL GROWTH COME FROM?

Introduction

The London office market continues its adjustment to the post-Covid, hybrid working pattern of occupation. There has been no collapse in demand, but there is clear evidence of occupiers adjusting their real estate footprints to reflect the new reality of reduced occupancy. Office vacancy has not escalated sharply, but there are notable exceptions such as in Canary Wharf. Certainly, we are not seeing anything like the 20-25% vacancy rates in some US cities. And while the development pipeline was scaled back during the uncertainty of Covid, there are signs now of developers responding not only to adjusted demand levels, but also to the key occupier agendas around quality, sustainability and experience.

There is now a widespread acceptance in the market that hybrid working is a permanent feature of the office work landscape. There are major differences between sectors, and between large and small occupiers; but reduced attendance in the office is the new norm. What has yet to be resolved is the Tuesday-Thursday issue, whereby the office is virtually empty on the four days either side. This is unsustainable in environmental, cost and operational terms.

London Global City

London has recovered well since the Pandemic. It surpassed pre-pandemic levels of output by Q4 2021, and continued to grow into 2023. By Q1 2023 London's GVA was 4.5% above its pre-pandemic level.

The capital has once again topped Resonance's World's Best Cities annual survey of the top 100 global cities. The survey highlighted the fact that London ranked third, globally (and first in Europe), for tourism with the biggest international traveller spend ($16.07bn in 2022), behind Dubai and Doha.

The latest Zyen Global Financial Centres Index has again placed London second, behind New York, and ahead of Singapore and Hong Kong. Other Eurozone centres feature in the top 20 include Paris (14th), Amsterdam (16th) and Frankfurt (17th).

Of course, the post-Covid work environment is seeing a major re-adjustment in working patterns, with occupancy levels in buildings remaining low, particularly on Mondays and Fridays. Economic uncertainty, with worrying signals from both the USA and China, compound uncertainty in the market.

Foreign direct investment Foreign Direct investment (FDI) continues to pour into London. Data published earlier this year by the City of London Corporation show that in 2022 the UK attracted 263 financial and professional services (FPS) projects valued at £2bn, the highest amount of investment in four years and more than any other country in Europe. The data also revealed that London held the top spot in attracting FDI in FPS for five consecutive years: with 779 projects – well clear of Dubai (592 projects), Singapore (586), New York (424) and Paris (332).

Between 2018 and 2022, the UK attracted investment from 65 countries over the world – the highest among all financial centres. The US was the largest investor into the UK's FPS followed by Switzerland and Germany. In 2022, although North America remained the UK's largest source of FPS investment there was a strong rebound of investment from Europe which increased by 54% from the previous year.

On 7th June 2023 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 FT it planned to 'invest billions' in the UK, "*including on projects linked to the country's green industrial revolution*". In a similar move, Australia's **Aware Super**, which manages A$150bn (£78.2bn), has chosen London as its first international office. It will house around 40 staff at the Crown Estate's Charles House on Regent Street.

Occupier activity

Reading across a range of agent reports, take-up of new leases obviously slumped in 2020 and 2021, but rebounded to above the ten year average in 2022. The current year is, more-or-less, on track at the halfway point. In short, there has been no major slump in demand as a result of Covid and changed working patterns, yet.

Meta grabbed the real estate headlines in September 2023 when it announced that it had agreed to cough up £149m to extricate itself from a 310,000 sq ft lease on one of its buildings at Regent's Place. For some it was taken as a sign of the parlous state of the office market; although too much should not be read into the size of the payment, which is small change for the tech giant. More importantly, 'big tech' is going through one of its characteristic adjustments to over-optimistic growth phases.

More surprising is that the business signed a 20 year lease with no breaks at the back end of 2021, when the impact of Covid on working patterns was becoming clear. It then announced that it would not occupy the building in December 2022, leading to this month's settlement with British Land. The firm will now operate from its other Regent's Place building, on Brock Street, and from its 620,000 sq ft building at King's Cross.

Social media company **X** (previously Twitter) is reported to be planning to sublease most, and perhaps all, of its 84,000 sq ft head office at Air Street in the West End. X has recently settled a dispute with landlord the Crown Estate over unpaid rent. It is not clear what longer term plans might be for a relocation.

Following its take-over of Credit Suisse, **UBS** cancelled a deal to sub-let 105,000 sq ft at 5 Broadgate to Grant Thornton. UBS will instead relocate Credit Suisse staff from Canary Wharf into its City building.

Since our previous London Offices Update there have been a number of notable occupier deals.

- **ICE Futures Europe** leased 127,000 at Mitsui and Greycoat's scheme, Sancroft, near St Paul's Cathedral. Earlier this year, lawyer Goodwin Procter took almost 90,000 sq ft at the same building.

- Other active lawyers include **Latham & Watkins** who pre-let a further 77,000 sq ft at One Leadenhall (taking its total commitment to 280,000 sq ft); **Dentons,** who pre-let 67,500 sq ft at One Liverpool Street, and Proskauer who signed for 60,000 sq ft at Stanhope and Mitsubishi Estate London's 8 Bishopsgate.

- Fintech business **Acrisure** pre-leased almost 51,000 sq ft at 40 Leadenhall. The building, to be completed in 2024, offers a fitness studio, a wellness suite, 30-seat cinema and two restaurants. Acrisure will join Chubb Services (77,000 sq ft) and lawyer Kirkland & Ellis (219,000 sq ft).

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

- 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 to host European operations to develop AI software solutions. The company already employs more than 800 people in the UK.

A number of other significant moves currently being planned merit highlighting.

- **NBC Universal** is searching for around 150,000 sq ft in the West End. The media and entertainment group is based at Google's Central St Giles building in Covent Garden. Other large requirements are reported to include: **Evercore** (120,000 sq ft); **Janus Henderson** (150,000 sq ft); **Legal & General** (150,000 sq ft); **Mayer Brown** (130,000 sq ft) and **Visa** (up to 200,000 sq ft).

A recent Estates Gazette article reported Cushman & Wakefield research that a number of large occupiers were expanding their pre-let deals. The research claimed that 15 of the 42 office pre-lets signed i London since 2020 included the option for the occupier to take on more space, and that over half of those options have already been taken. Nine of the 13 deals identified involved the occupier taking similar or more space compared to the premises they will be leaving.

Vacancy

The latest Knight Frank data show that vacancy rates have risen steadily over the past year from 8.2% to 10.1% (compared to a ten year quarterly average of 6.8%). The overall average is pushed up by the escalating vacancy in Docklands, where the Knight Frank data show it to be 16.5%, compared to 11.1% in the City and 7.1% in the West End.

The rising vacancy rate in **Canary Wharf** is of particular concern. Departures by Citigroup, Clifford Chance, Credit Suisse and HSBC (totalling something like 2m sq ft); subletting by Barclays (c500,000 sq ft) and vacant buildings at 20 Canada Square (c530,000 sq ft), 17 Columbus Courtyard (c190,000 sq ft) and YY London, previously Reuters' building (c410,000 sq ft), add up to a major leasing challenge!

Given the uncertain economic situation over the past twelve months, together with the continuing fallout from Covid, a central London vacancy of 10% is not a particularly stressful situation (6% is an accepted structural vacancy rate). 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%.

But the fact remains that there is a significant risk that the situation will worsen significantly.

New development

A number of large schemes continue to come forward. Supply dynamics will become an increasingly important market indicator in the medium-term because Energy Performance Certificates are, in effect, bringing many buildings into premature obsolescence; and largely explain the 'flight to quality' that is constantly being referred to in the market place. The supply pipeline will need to at least match the pace of obsolescence by refurbishing and rebuilding properties while responding to latent demand levels.

Singapore developer Perennial Group and development manager Stanhope are reported to be reviving plans to build the City's tallest tower, **1 Undershaft.** This will be built on the site of the St Helen's building, aka, the Aviva Tower. It will comprise 73 storeys and total 1.4m sq ft. The building will eclipse the neighbouring 22 Bishopsgate.

Hines has submitted £1bn plans for two skyscrapers on London's on **Blackfriars Road**. Foster+Partners have designed three towers, of 45, 40 and 22 storeys. The tallest of the buildings, to be used for offices, is a shade under 200m high. In addition to the 825,000 sq ft of office space, including 20,000 sq ft of affordable workspace, the scheme will include more than 400 homes.

Winchester House on London Wall will be vacated by Deutsche Bank when it moves to Lend Lease's 21 Moorfields scheme. Castleforge and Gamuda Group bought the building in March 2022 for £257m in have recently unveiled plans for a £1bn refurbishment, including enlarging the building from 320,000 sq ft into a 400,000 sq ft building by 2027.

Nearly one year after completing the Forge at Bankside in Southwark, Landsec has pressed the button on a nearby 380,000 sq ft speculative scheme. **Timber Square** is due for completion in 2025.

Canadian pension fund Oxford Properties and life science specialist Pioneer Group have released plans to convert **Victoria House** in Bloomsbury Square into a life sciences hub. The 1920s, Grade II-Listed building will deliver 220,000 sq ft lab and life science space and will be home to trade association the BioIndustry Association. There will also be 80,000 sq ft of office, amenity, meeting, retail and lounge space

PineBridge Benson Elliot has secured consent for its scheme on **Mark Lane** in the City. The new 230,000 sq ft scheme will comprise for four linked buildings designed by Danish architect 3XN. The eleven storey building will include around 14,000 sq ft of restaurant and retail space.

The 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. There is growing evidence that flex space is going mainstream, with the range of offerings expanding, with varying elements of flexible contract and service provision. Importantly, the main growth dynamic is in *managed space* for larger companies, rather than in co-working space for individuals and micro businesses. 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. Orega will offer c550 workstations on the first and fifth floors of the 175,000 sq ft building. It has also taken a further 37,000 sq ft at 70 Gracechurch Street, in addition to the 50,000 sq ft already operated by the serviced office provider.

- **Huckletree** took 35,000 sq ft at 199 Broadgate.

- In a similar deal, **Fora** (now part of TOG) 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.

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

- **Convene** 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. The facility will offer meeting spaces, including one space capable of accommodating 900 people.

One forecast from CBRE suggested that up to 1m sq ft of flexible space take-up during 2023.

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

Landsec has unveiled plans to open three new Myo sites 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; 46,000 sq ft at One New Change and 48,000 sq ft at The Forge, Bankside. 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. 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.

At his Conference speech in Manchester, the Prime Minister cancelled the northern extension of HS2, from Birmingham to Manchester. At the same time he confirmed that the line's London terminus would be at Euston, and that the Euston site would transfer from HS2 management to the government in the form of a new development zone. It is not clear at this stage what the decision means for **Lend Lease's** plans for 3m sq ft of offices.

Sources of growth

According to the most recent GLA Forecasts the number of jobs in London will rise from today's 6.12m to 6.56m in 2030 and to 6.75m in 2035. If today's distribution between sectors holds firm over this period, there will, in round terms, be a further 250,000 to 300,000 office jobs in London by 2035.

In 'old money' this would have represented something like 35m sq ft of additional demand at the top end. Even with a full agile working agenda, it might have equated to around 27m sq ft of net new demand. But in a hybrid world?

Corporate downsizing in the face of post-Covid hybrid work patterns has dominated headlines; and some have predicted a major downward adjustment in demand levels. There is no hard evidence for this yet, but highly uncertain times lie ahead. So where might we look for growth?

We highlight three possible areas here that might drive growth and positive change in the London office market in the short-term: life sciences, creative industries and Energy Performance Certificates.

(a) Life Sciences

Our July 2022 London Office Update featured the growth of Life Sciences in the capital, identifying six clusters of activity. The market is continuing to mature and expand. Recent major announcements include the following.

- Pharma giant **Eli Lilly** has shortlisted three buildings in its search for a new UK HQ. The 65,000 sq ft requirement. The three buildings are in central London.

- 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 West London to Royal London UK Real Estate Fund's The Earnshaw on the corner of New Oxford Street and Earnshaw Street. The 155,000 sq ft scheme will house around 3,000 people; with easy access to the company's Artificial Intelligence and Machine Learning Hub in King's Cross.

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

- **UCL Neuroscience** is overseeing the construction of a new centre of excellence in Grays Inn Road 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. The plans promise a 172,000 sq ft lab facility.

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

Investor Aviva has signed up to partner developer Socius on the 1.1m sq ft cancer research and treatment hub being planned in **Sutton, south London**. Along with the Royal Marsden NHS Foundation Trust, Epsom and St Helier University Hospitals NHS Trust and the Institute of Cancer Research, the team will create a campus supporting up to 13,000 high-skilled jobs in cancer research and development, diagnostics and treatment.

Just beyond London's border, UBS Asset Management and Reef Group have received planning consent to proceed with their plans for a £900m life science campus in **Stevenage**. Adjacent to GSK's global R&D facility, the 15-building scheme will be known as Elevate Quarter. It will provide 1.6m sq ft of R&D space, offices manufacturing and lab spaces; as well as training, innovation and collaboration spaces.

In our July paper we 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. New schemes to come forward since July include **Kadans Science Partner's** plans for a purpose-built R&D facility in King's Cross. The 55,000 sq ft building, at 4 Brandon Road, neighbours Kadans' 115,000 sq ft space at 5-10 Brandon Road. The new proposal will provide five storeys of flexible space. Also, **British Land** have announced plans to transform Euston Tower into a 500,000 sq ft 'life sciences and innovation hub'.

(b) Creative London

London's specialism in Financial & Professional Services is very well known and understood. Real Estate and Information & Communications are also key sectors.

What is less well understood is the role of the creative sector. A recent report from GLA Economics provides some very useful insights.

Creative industries comprise nine sub-sectors: advertising and marketing; architecture; crafts; design and designer fashion; film, television, video and radio; IT software and computer services; publishing; museums, galleries and libraries, and music, performing and visual arts. Together, they account for c650,000 jobs, or nearly 11% of all London jobs (and 36% of GB creative industry jobs). Between 2010 and 2019 London's economy grew at 3.0% a year, and Britain's at 2.1%. The creative industries in London grew at 5.2% a year, and across Britain by 4.1%.

They produce 12.6% of London's total economic output, behind only Financial Services (17.4%) and Real Estate (14.3%); and higher than Professional Services (12.1%) and Information & Communication (10.8%). In terms of the index of specialisation (where GB is 1.0), the creative industries in London score 2.7 (finance is similar, with professional services on 1.7). Within the creative sector, Advertising & Marketing score 5.3 and Film, TV & Radio score 3.6.

A previous London Office Position Paper highlighted the growth in studio space in and around London, with 14 projects promising 25-30,000 new jobs. In September, Warner Bros confirmed it will go ahead with a major expansion of Leavesden film studios. The project will see ten new sound stages and 400,000 sq ft of production and support space.

(c) Energy Performance Certificates

There is one non-demand factor that might drive growth, or at least activity: Energy Performance Certificates (EPCs). From April 2023 it became unlawful to lease or sell office premises with an energy efficiency rating of E or below. This minimum requirement will be lifted to C by 2027 and to B by 2030.

Given that buildings falling outside the minimum requirements can be neither leased nor sold, the overall impact is a huge rise in obsolescence in the built stock. Owners will have to radically refurbish their buildings or knock down and re-build (increasingly contentious). Analysis by EGI suggests that, across the City of London, some 57% of office stock has an EPC of D or below.

As the EPC legislation makes great swathes of office space redundant when it becomes vacant, there is an opportunity to re-purpose as well as replace the office stock. It is thus just possible that EPC legislation could underpin a resurgence of activity in the supply process as landlords scramble to prepare their buildings for continued commercial use.

Prospects

The London office market is at a strange juncture. In many ways, the market is functioning perfectly 'normally': take-up, demand, new development and vacancy are all working at medium-term averages. But of course, we know that offices are under-occupied as workers continue to work from home most of the week. The evidence from post-Covid leasing deals is mixed as some occupiers downsize to reflect hybrid working, while others expand their footprints.

What is patently clear is that operating buildings to max capacity mid-week, while leaving them largely empty Friday to Monday is not sustainable in environmental, cost or operational terms. The resolution of this quandary will have the greatest impact on the long-term state of the office market. In the shorter term, economic malaise is a complicating factor adding a further layer of uncertainty to corporate decision making and in the real estate industry.

Despite the uncertainties, investors continue to invest unabated in the capital, and the forecasts suggest continued growth in London office jobs. While mathematically speaking it is possible that the projected growth in headcount will not transfer to net growth in demand for real estate due to hybrid working, there remain prospects for growth in emerging sectors and renewal of stock to help meet net zero targets.

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