Q3 2020

UK Research

Central London office market report

Activity remains subdued

Table of contents

01 Central London overview

Challenging economic backdrop

The number of Covid infections has risen sharply over the past few weeks. National social distancing measures will remain largely in place for the next six months, with a four week national lockdown coming into effect on November 5th. Assuming infections have fallen over this period, the country will return to more localised lockdowns via a three-tier system, with Greater London placed in the high alert tier. The government's Coronavirus Job Retention scheme has been extended for the period of national lockdown, but this is unlikely to prevent further job losses once the scheme ends and unemployment is expected to rise.

The economic outlook is dependent upon the trajectory of the virus over the coming months and the measures taken to limit its spread. GDP forecasts were revised downwards for the final quarter and into 2021 against a background of the second wave of Covid and Brexit uncertainty. Oxford Economics' latest forecasts show that the UK's economy could shrink by 9.6% during 2020 but a loosening in restrictions from mid-2021 could trigger a strong rebound of 7.4% for 2021 which is well ahead of the Eurozone average of 5.5%. Built into the forecasts are the new EU-UK trade relationships which will become operational from January 2021 and which, at the time of writing, are still being negotiated, but any impacts from the four week lockdown have not yet been factored in.

Occupier activity pauses

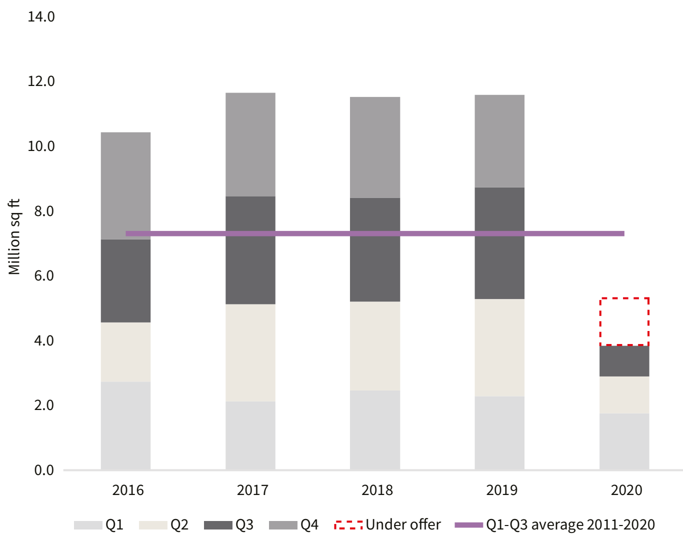
The leasing market remained subdued as the impact of the pandemic continued to influence occupational decision making. Just 941,000 sq ft was let during the quarter, which was down 20% on the previous three months and was the lowest quarterly total since Q1 2009. This brought the year-to-date total to 3.8 million sq ft, which was 60% down on the same period last year and 6% below the previous Q1-Q3 low recorded in 2009.

Volumes were similar to last quarter across both the City and West End, but there was limited activity in East London which dragged aggregate leasing volumes down quarter-on-quarter. The City recorded 440,000 sq ft of take-up, which was the lowest quarterly level of take-up on record, but it was only 53,000 sq ft below Q2 volumes. The West End recorded a marginal uptick to 457,000 sq ft from its low point of 359,000 sq ft in Q2.

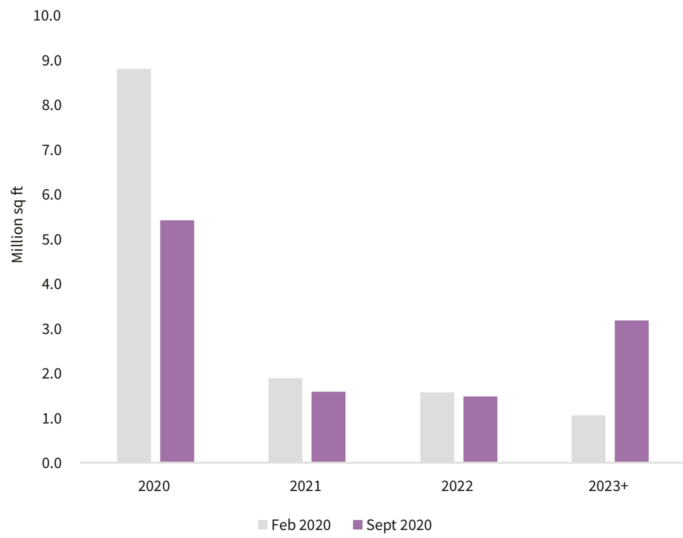
Space under offer decreased over the quarter to 1.6 million sq ft and is now less than half of levels seen in the market pre-lockdown. There is still evidence of occupiers looking to the longer term, with more than half of all space under offer being for pre-let space. Nevertheless, companies continue to place their transactions on hold or downsize as they re-evaluate their real estate strategy. The timing of requirements is being delayed, with demand for space in 2023+ tripling during the pandemic.

Positively, the pace of the contraction in active demand slowed, falling by 2% quarter-on-quarter to stand at 7.8 million sq ft, compared to the 20% decrease seen during Q2. Professional services firms, driven by the legal sector are the main source of active demand accounting for 36% of floorspace, followed by the TMT sector (19%).

Central London take-up



Central London active demand by year required

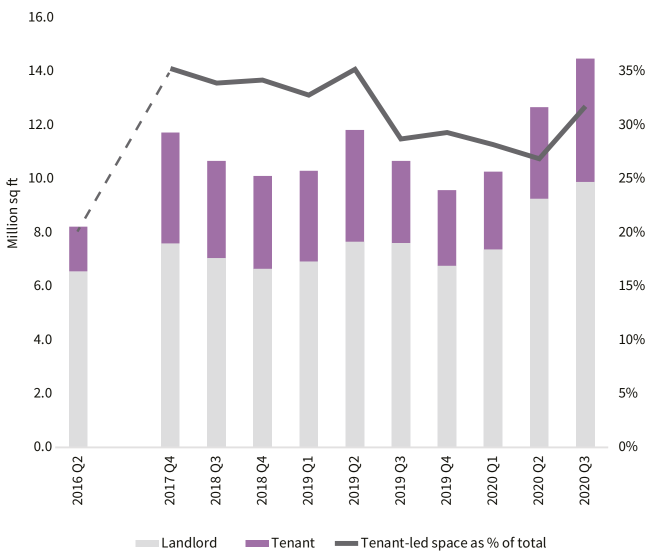


Second-hand space fuels supply increase

At the end of Q3, there was 14.3 million sq ft of space available, which was up from 9.9 million sq ft at the start of the pandemic. The inertia in the leasing market and a continued increase in second-hand space being marketed, up by almost 50% over the last 6 months, led to the increase. The vacancy rate rose to 5.9%, which was an increase of 170 basis points since the start of the pandemic and back to levels last seen in mid-2013. The market is polarised between a continued low vacancy for new space, currently at 0.8%, and a rising second-hand vacancy which reached 5.1% at the end of the quarter.

There was some resumption of speculative development during the quarter, with an estimated 208,000 sq ft of space starting on site, albeit schemes were generally small-scale with the average size of new schemes being just 42,000 sq ft and most, by number, were refurbishments. Speculative development rose marginally to 7.8 million sq ft, of which 1.3 million sq ft is due for completion during the rest of 2020. This will filter through to a higher new build vacancy rate in Q4, but two schemes are expected to deliver two-thirds of this speculative space - 22 Bishopsgate, EC2 and 60 London Wall, EC2.

Central London supply

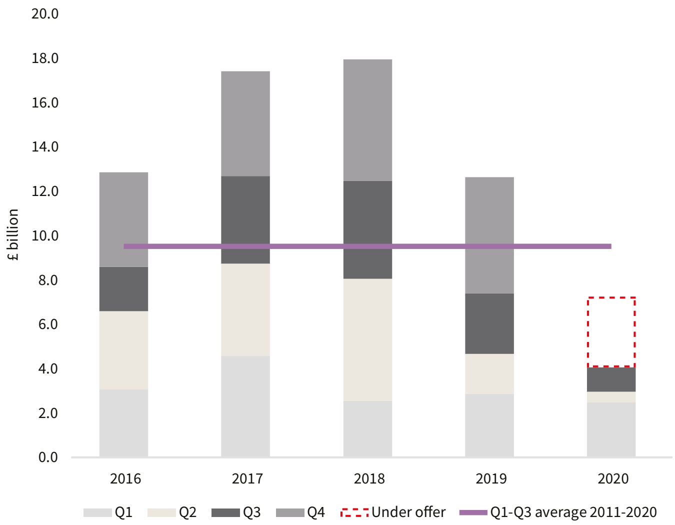


Investment activity rallies

The investment market saw a resurgence in activity during Q3, although this was from the record low seen in Q2. Over £1.0 billion of transactions were completed in Q3, which takes the annual volume traded to £4.1 billion. This compares to £7.4 billion in the same period in 2019. Full year volumes are expected to be boosted by a strong fourth quarter with some sizeable deals having already exchanged and circa £3.0 billion worth of stock currently under offer.

Overseas investors accounted for 76% of volumes this quarter, and over the year-to-date have also been dominant at 69% of activity. This trend is expected to continue in the final quarter, with 89% of stock under offer being bought by overseas purchasers. The largest transaction of the quarter was the sale of 25 Cabot Square, E14 which traded for £380 million and was sold to Link REIT, from Hong Kong. The trend for UK buyers to be more acquisitive of smaller lot sizes continued, with an average transaction size of £51 million during Q3, compared to £91 million for overseas purchasers.

Central London investment volumes



02

Key transactions

14-15 Stanhope Gate, W1

Tenant: Evercore Partners International LLP

Size: 40,600 sq ft

Rent: Confidential

Description: JLL advised AstraZeneca UK Limited on the head lease assignment of the 40,000 sq ft property to US company Evercore Partners International LLP. Consent to the assignment was obtained from the owner, Audley. 15 Stanhope Gate is an attractive building constructed behind façade in 1991, providing open plan modern office accommodation.

Nick Smith
Director, Head of West End Lease Advisory

7 Soho Square, W1

Price: £78.00 million

Purchaser: Hines Pan-European Core Fund

Description: Soho Square is an iconic landmark and positioned directly opposite the new Tottenham Court Road Elizabeth Line station entrance and is one of the West End's most sought after destinations. JLL were delighted to have advised Hines Pan-European Core Fund on the purchase of 7 Soho Square, the most significant commercial property transaction to be openly marketed and exchanged in the West End of London following the Covid lockdown period.

The property presents a rare opportunity over time for Hines to leverage their value enhancement approach and create workspace that caters to a new generation of office occupiers in the post-Covid environment.

James Bramble
Director, Central London Capital Markets

70 St Mary Axe, EC3

Tenant: Vattenfall Aktiebolag & Cubico

Size: 16,517 sq ft & 9,102 sq ft

Rent: Confidential

Description: JLL advised Nuveen Real Estate on two lettings to Vattenfall (5th floor) and Cubico (part 11th floor) at the 21-storey 70 St Mary Axe, EC3. Despite challenging market conditions, these signings in July 2020 demonstrate the strong appeal of the tower with its unique elliptical design providing extremely efficient and progressive workspace. They join occupiers including Sidley Austin, HP, Samsung and Adaptive.

Richard Carson
Director, Office Agency

23 Alie Street, E1

Price: £11.50 million

Purchaser: Confidential

Description: JLL were delighted to have advised Travelers Insurance on the disposal of their former headquarters at 23 Alie Street. The asset is situated in the heart of Aldgate, which is recognised as one of London's most vibrant and diverse submarkets. The immediate location has seen substantial development recently and this is expected to continue. The sale was conducted throughout the initial lockdown period in the UK where virtual viewing technology was utilised, resulting in a competitive bidding process and pricing exceeding the guiding level.

John Woodger
Director, City Capital Markets

03

Issue to watch

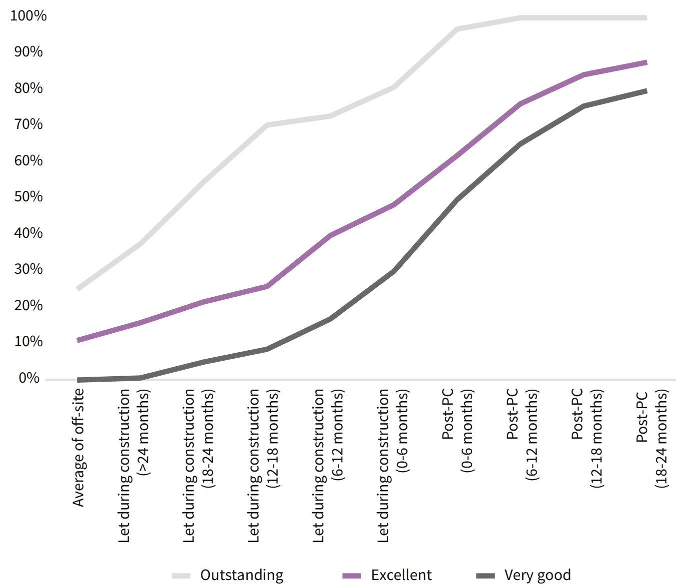
The impact of sustainability on value

The property industry is now at the heart of the UK's drive to reduce carbon emissions to net zero by 2050 - some of this action has come from the government's commitment to net zero and the rest has come from within, as the industry recognises that it has no excuse not to act now. Since 2019 there has been real momentum in the industry, and we are increasingly seeing business leadership and collective action on sustainability - a trend that is likely to accelerate as a result of the pandemic.

It is often argued that sustainable buildings are associated with higher rents, lower tenant incentives and re-leasing costs, but there is limited hard evidence available to support this especially for Central London offices. To understand how this is impacting corporate real estate, JLL examined the trends in the performance of sustainable buildings in Central London in terms of rental values and leasing velocity.

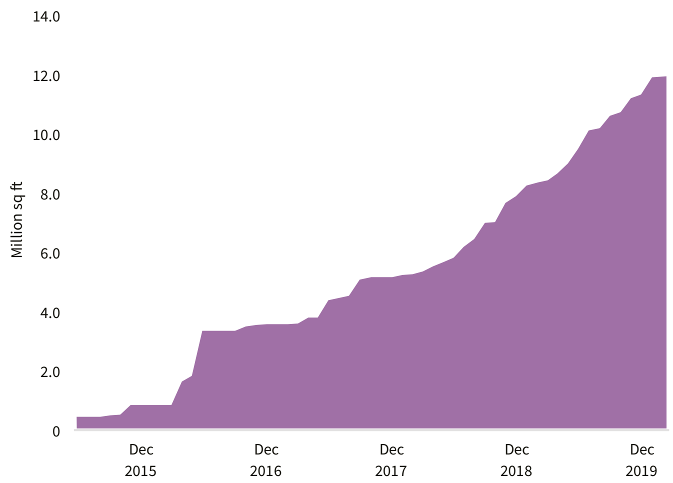
JLL's analysis of Central London BREEAM rated buildings showed that higher rated buildings perform better than the average in terms of both rental value and leasing velocity. Over the last three years, the average rental premium of Outstanding/ Excellent rated buildings above non-rated was around 10%. Performance is also about reducing void periods on initial lettings. Our analysis suggests that the payback for investors who target higher ratings is through shorter void periods through the cycle.

Leasing velocity - schemes completed 2013-2017



Pressure on the real estate industry to act is being driven by action from organisations on their own sustainability journeys. We interviewed a number of corporate occupiers which shows that they are becoming more demanding and are ready and waiting for the delivery of net zero carbon buildings in Central London to meet their own science-based target (SBT) commitments. Even though most of the evidence is derived from large corporates, numerous surveys show that workers – particularly young people - increasingly value sustainability so regardless of company size, it is important for all companies to illustrate their ambitions in this area, a lot of which can be achieved through their office space.

Growth in Central London SBT committed companies by occupied floorspace



Around 130 businesses in London, including some of the capital's largest occupiers, have signed up to science-based targets for carbon reduction – approximately double the number at the end of 2018. Most companies have committed to achieve their targets by 2030 - which is effectively only one real estate cycle. In fact, around 100 of these firms have lease events coming up by 2030 and more than three quarters of these lease events will take place in an office that does not currently have a BREEAM rating. Even those firms that are in a BREEAM-rated space will find that their offices were generally rated according to an older qualification, which may not be sufficient to meet the now higher requirements of these sustainability-minded firms.

As occupier awareness of sustainability increases, it will play a greater role in the decision making for new developments and building refurbishments. Occupiers, developers and investors now have a clear opportunity to showcase their sustainability credentials via their real estate footprint. In the short to medium-term however, there is likely to be competition for space in highly sustainable buildings and those developers that act early will reap the financial and performance benefits.

More details can be found in "*The impact of sustainability on value in Central London*" report, which was published earlier this year.

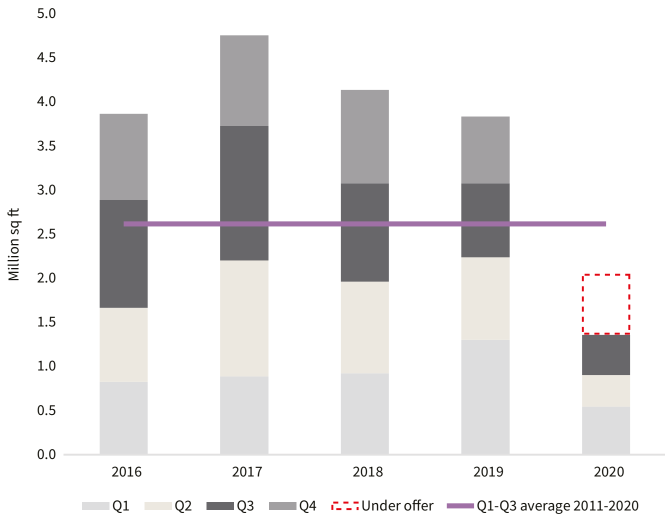
04

West End overview

Take-up volumes remain subdued

Take-up volumes were subdued in the third quarter although they did surpass last quarter's total. Volumes reached 457,000 sq ft in 31 deals compared with 359,000 sq ft in 25 deals in Q2. The Q3 total was 48% below the 10-year quarterly average of 884,000 sq ft. Year-to-date take-up stood at 1.4 million sq ft, 61% below the 10-year annual average of 3.6 million sq ft.

West End take-up

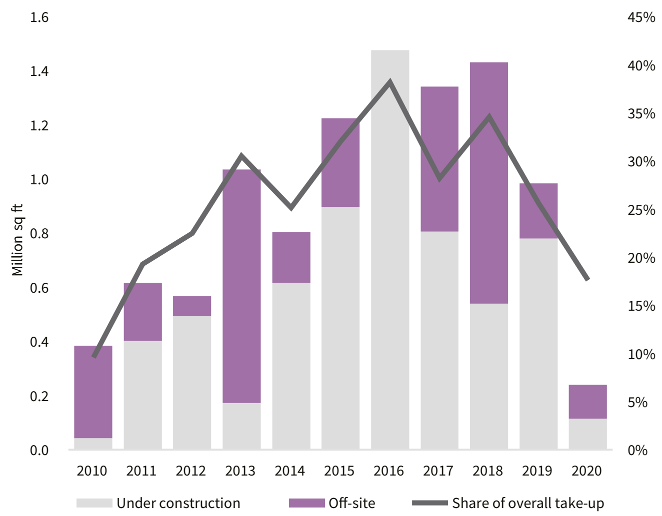


The TMT sector leased the most space in Q3 and accounted for 32% of take-up. This was followed by the banking & finance sector at 19% and the flexible offices sector with a share of 14%. This is the first time the flex sector has been active in the West End since January.

There were three pre-let deals during the quarter amounting to 81,000 sq ft or 18% of take-up and all three deals signed after construction had started. The largest pre-let was at 210 Euston Road, NW1 where The Office Group acquired 64,000 sq ft.

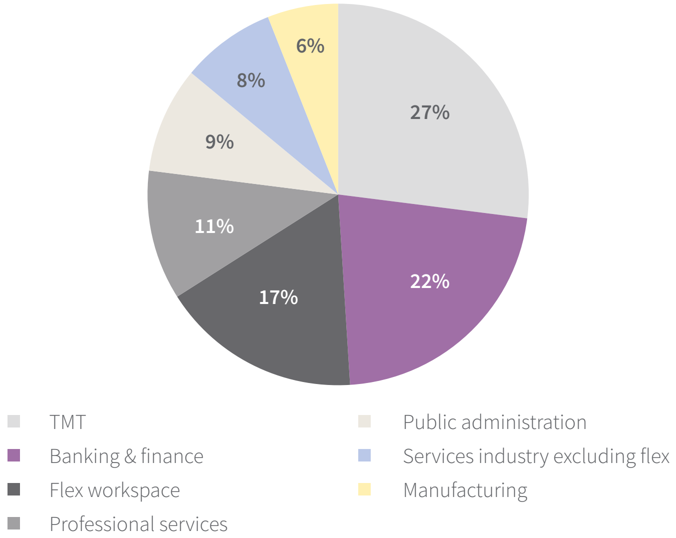
The level of under offers fell by 8% during the quarter and stood at 693,000 sq ft, which is broadly in line with the 10-year average. These transactions may take longer to conclude than normal and there has been some evidence of under offers being withdrawn.

West End pre-leasing



Active demand increased marginally and reached 3.5 million sq ft, above the 10-year average of 3.3 million sq ft. The TMT sector was the most active, accounting for 27% of floorspace required. This was followed by the banking & finance sector at 22%.

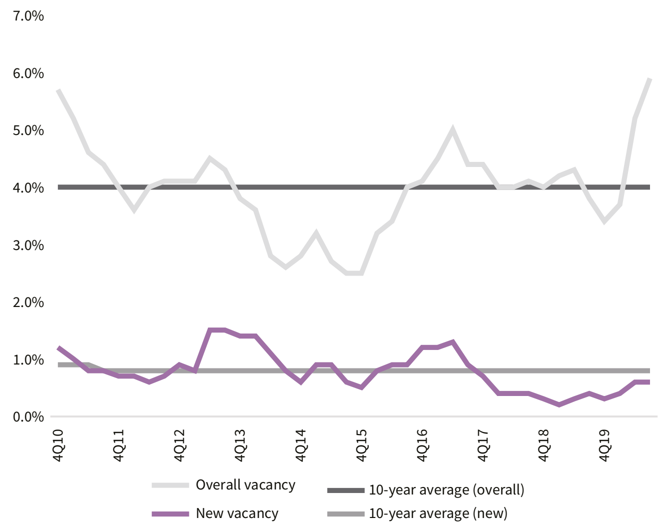
Active demand by business sector (Q3 2020)



Overall vacancy increases further

Supply increased by 13% to 5.8 million sq ft, due to a rise in second-hand space brought to market. The overall vacancy rate rose from 5.2% to 5.9% and is above the 10-year average of 4.0%, and the highest since Q3 2010. New supply remained stable and the new build vacancy rate was unchanged at 0.6%, below the 10-year average of 0.8%. Tenant-controlled space amounted to 1.9 million sq ft, a 58% increase compared to Q2 2020.

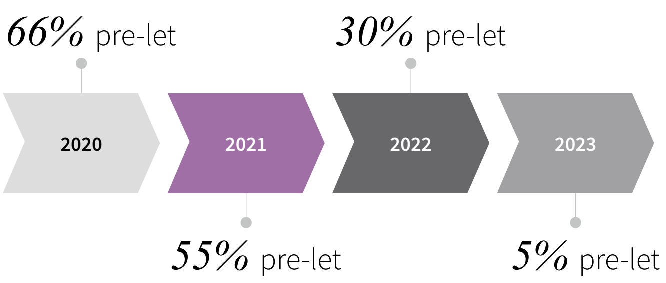
West End vacancy rates



Speculative development completions totalled 102,000 sq ft across five schemes with the largest scheme being 1 Medici Courtyard, W1, amounting to 33,000 sq ft.

Development completions for the remainder of the year are expected to total 137,000 sq ft and 51% of this space has been pre-let. Beyond 2020, the future pipeline remains quite limited with 55% of the 2021 pipeline and 30% of the 2022 pipeline already pre-let.

Development pipeline



Prime rents unchanged but incentives move out

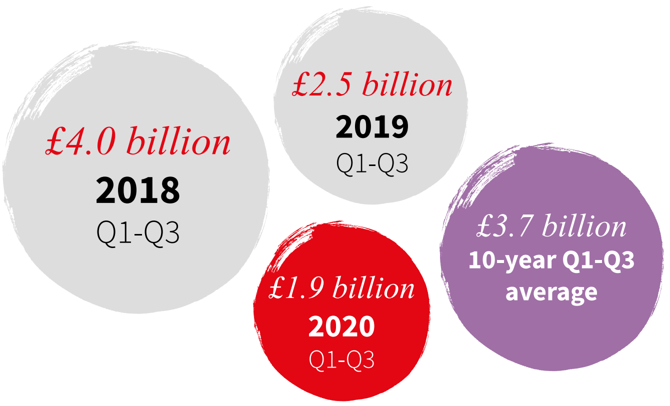
Prime rents in the Core were held stable at £117.50 per sq ft and rent-free periods were moved out from 21 months to 24 months (assuming a 10,000 sq ft floor plate and a 10-year term). The decision to keep rents on hold is based on hypothetically achievable deal terms in the absence of sufficient prime evidence.

Investment volumes remain subdued

Investment volumes reached £452.0 million across seven transactions in Q3, below the 10-year quarterly average of £1.4 billion but above the Q2 total of £195.0 million. Year-to-date investment volumes stood at £1.9 billion, significantly below the 10-year average of £5.6 billion and 25% below the equivalent period last year.

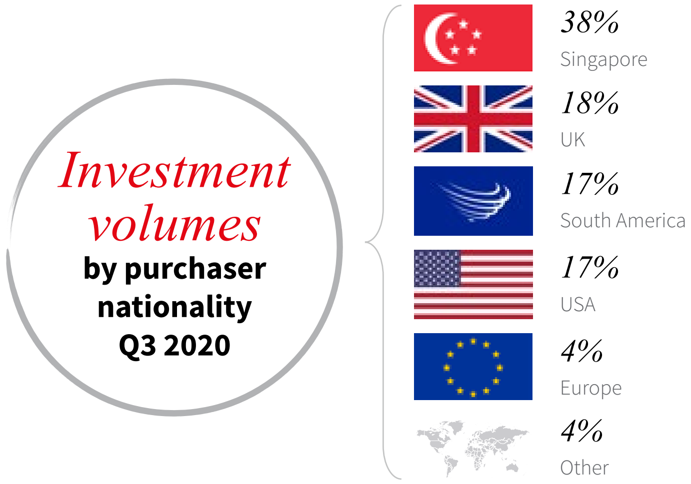
Full year volumes are expected to be boosted by a strong fourth quarter with some sizeable deals having already exchanged and a significant amount of stock currently under offer.

Investment volumes



Singaporean investors were the largest source of capital in Q3, accounting for 38% of volumes albeit in just one deal. This was also the largest deal of the quarter and involved the purchase of 1 New Oxford Street, WC1 by Sun Ventures for £173 million, reflecting a net initial yield of 4.19% and a capital value of £1,583 per sq ft.

Investment volumes by purchaser nationality



Prime yields were unchanged during the quarter and stood at 3.75% for lot sizes below £40 million and for lot sizes between £40 million and £125 million. Prime yields were 4.00% for lot sizes above £125 million. We are however witnessing a stricter definition of prime emerging. Assets qualifying under the strictest definition are achieving pricing well in excess of the yields just mentioned and evidence of this will be confirmed on exchange of several headline deals currently under offer.

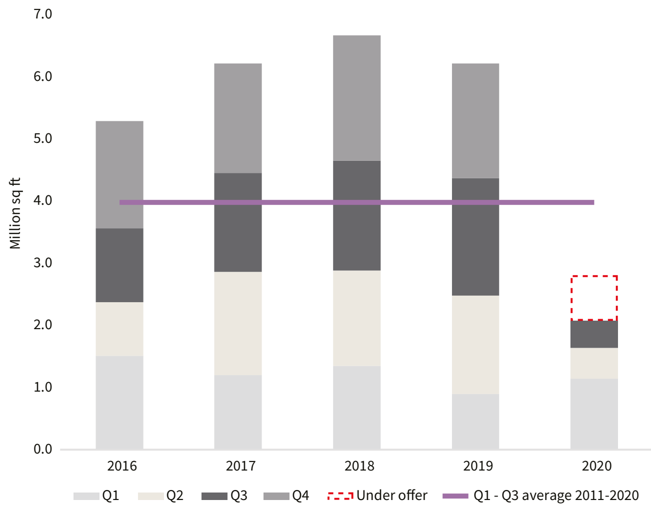
05 City overview

Take-up heading for record annual low

The slowdown in leasing activity continued in Q3 with take-up reaching 440,000 sq ft, slightly down on the Q2 total, and 69% below the 10-year quarterly average. Baker & McKenzie's commitment to lease 155,000 sq ft at DUO, 280 Bishopsgate, EC2, ahead of completion in Q3 2021, was the largest transaction of the quarter. This deal, together with four further transactions, meant that the professional services sector was most active, with a 53% share of quarterly take-up. This continued the recent trend, underpinned by law firms which have accounted for the three largest transactions of the year.

Leasing transaction volumes are unlikely to recover in the final quarter due to the low level of under offers, which have fallen 37% during the quarter to 735,000 sq ft and are now at the lowest level since Q1 2011, when just 544,000 sq ft was under offer.

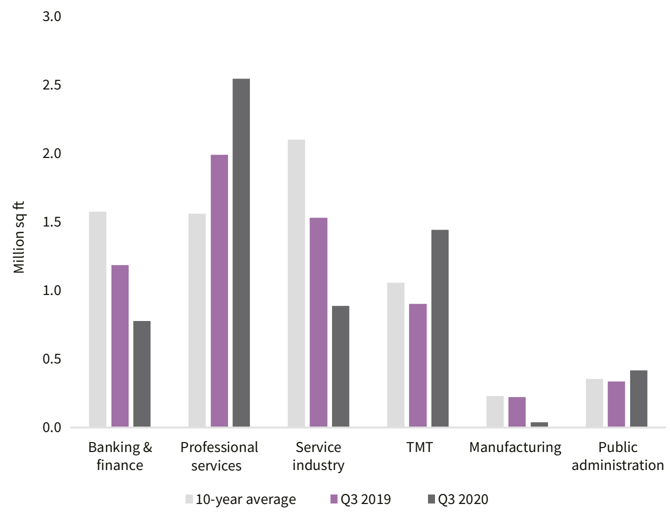
City take-up



Legal sector drives demand

Active demand rose 3% to 6.1 million sq ft, marginally lower than the 10-year average of 6.2 million sq ft. Professional services accounted for the largest share of active requirements at 42%, driven largely by law firms with 1.9 million sq ft of space requirements across 19 enquiries, followed by the TMT sector, with a 24% share. Despite a number of TMT requirements being put on hold during lockdown, it is worth noting that active demand from the TMT sector is now at its highest level since Q4 2016, with over 1.4 million sq ft of requirements from the sector. Conversely, active demand from banking & financial services has fallen to its lowest level since late 2012.

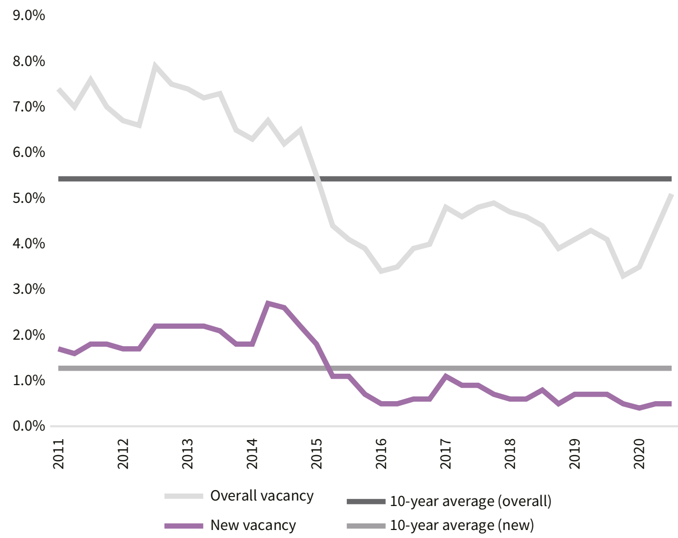
Active demand by business sector



Second-hand supply underpins rising vacancy

Supply rose for the third consecutive quarter, increasing 18% in Q3 to 6.0 million sq ft and reaching its highest level since Q4 2015. This resulted in a 0.8% uptick in the overall vacancy rate, which ended the quarter at 5.1%, although it still remains below the 10-year quarterly average of 5.4%. The increase in supply was underpinned by a rise in tenant-controlled sub-lease space, which rose 36% to 2.0 million sq ft, and accounted for a third of overall supply. Immediately available new build supply remained restricted, despite a marginal increase in Q3 to 584,000 sq ft - the new build vacancy rate of 0.5% is less than half the 10-year average of 1.3%.

City vacancy rates

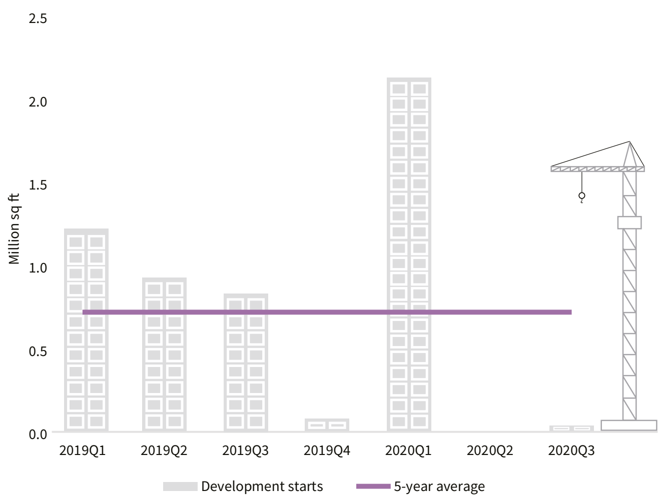


Low levels of development starts

Development starts were limited to a single refurbishment at Holborn Central, 88 Kingsway, WC2, which totals 25,000 sq ft and is scheduled to complete in Q1 2021. Despite delays to many developments, three schemes totalling 346,000 sq ft reached practical completion. The largest building completed was 80 Fenchurch Street, which totals 233,000 sq ft of which Convene pre-let 72,000 sq ft.

Speculative development currently under construction totals 5.0 million sq ft, including 1.2 million sq ft scheduled to complete before the end of 2020, although we expect some of this to be delayed into 2021 due to ongoing Covid-19 related construction delays.

Development starts



Prime rents fall

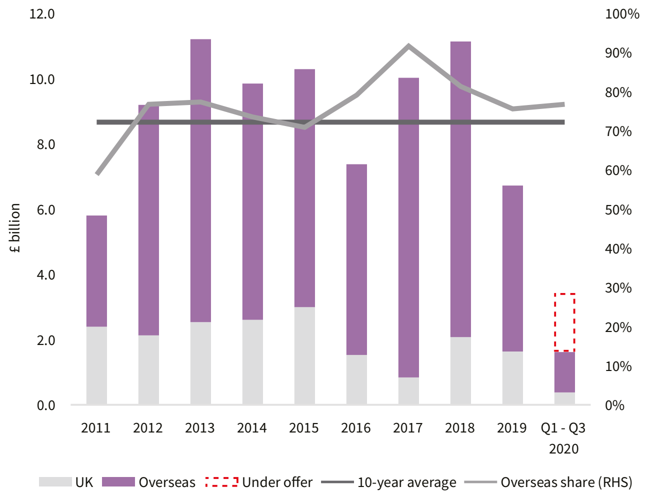
Prime rents fell for the second consecutive quarter to stand at £72.50 per sq ft, down from £73.50 per sq ft in Q2 and £75.00 per sq ft at the start of the year. Typical rent-free periods moved out one month to 27 months, based on a 10-year lease term. This adjustment is largely sentiment driven and based on hypothetically achievable deal terms, in the absence of sufficient prime evidence.

Uptick in investments under offer

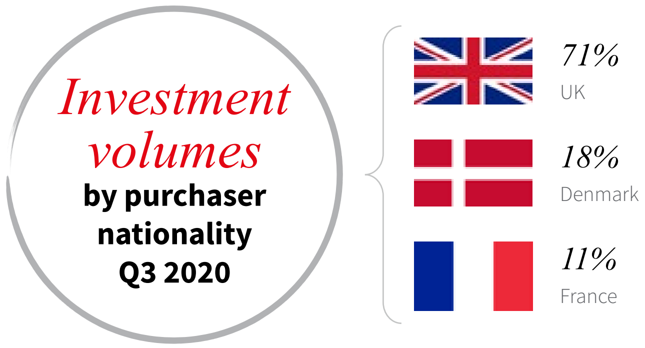
Investment volumes totalled £245.0 million across six transactions, a 21% fall on the Q2 total, itself a subdued quarter, and broadly in line with the low levels of activity observed during the global financial crisis. The largest transaction of the quarter was M&G's purchase of Fleet Place House, EC3 for £111.7 million, reflecting a net initial yield of 4.86% and capital value of £1,212 per sq ft. A partial recovery in investment volumes is anticipated before the end of the year, with a strong start to Q4 and an uptick in under offers, buoyed by a number of larger transactions.

Prime yields remained unchanged at 4.00% across all lot sizes and whilst there was limited evidence to support these levels in Q3, there are a number of large transactions that have already exchanged in Q4 or are currently under offer that should provide further yield evidence.

Investment turnover



Investment volumes by purchaser nationality

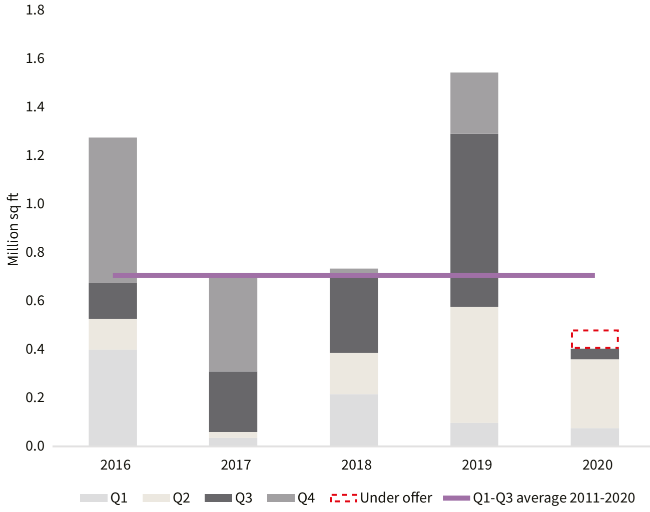


06 East London overview

Take-up volumes subdued in Q3

Take-up volumes were subdued in the third quarter, with just two deals totalling 44,000 sq ft signed compared with 284,000 sq ft in four deals in Q2. This takes the year-to-date total to 403,000 sq ft, which is 69% below the same point in 2019. The largest transaction of the quarter was Coventry University's acquisition of 32,000 sq ft at 6 Mitre Passage, SE10.

East London take-up



Demand drops due to uncertainty

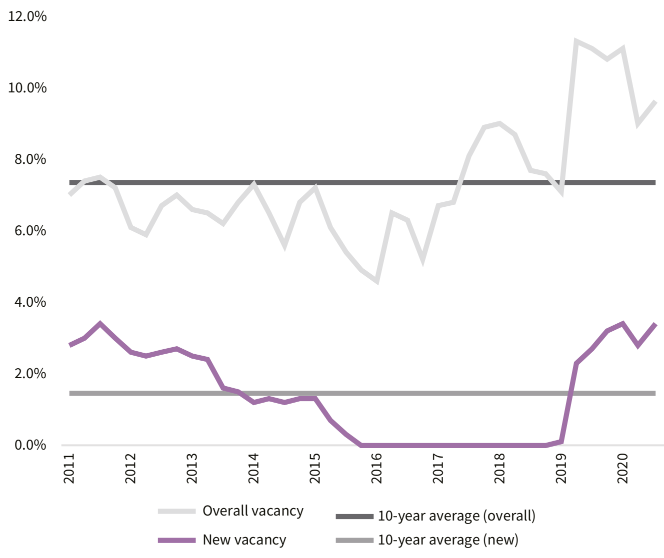
Active demand stood at 1.5 million sq ft, a 13% decrease on Q2 and 32% below the 10-year quarterly average of 2.2 million sq ft. The professional services sector accounted for just over half of active demand, while the TMT and banking & finance sectors accounted for shares of 19% and 11% respectively.

Supply increases and remains ahead of average

Supply increased by 8% to 2.5 million sq ft during the quarter, reflecting a vacancy rate of 9.7%. This is significantly higher than the 10-year average of 7.3%, as well as the current levels recorded in the City (5.1%) and West End (5.9%) markets.

There were no development starts or completions during the quarter. There are two major schemes currently under construction speculatively, comprising 20 Water Street, E14 (215,000 sq ft) and Cargo, North Colonnade, E14 (of which 346,000 sq ft is speculative and 226,000 sq ft has been pre-let to BP) which are both due to complete in the first half of 2021.

East London vacancy

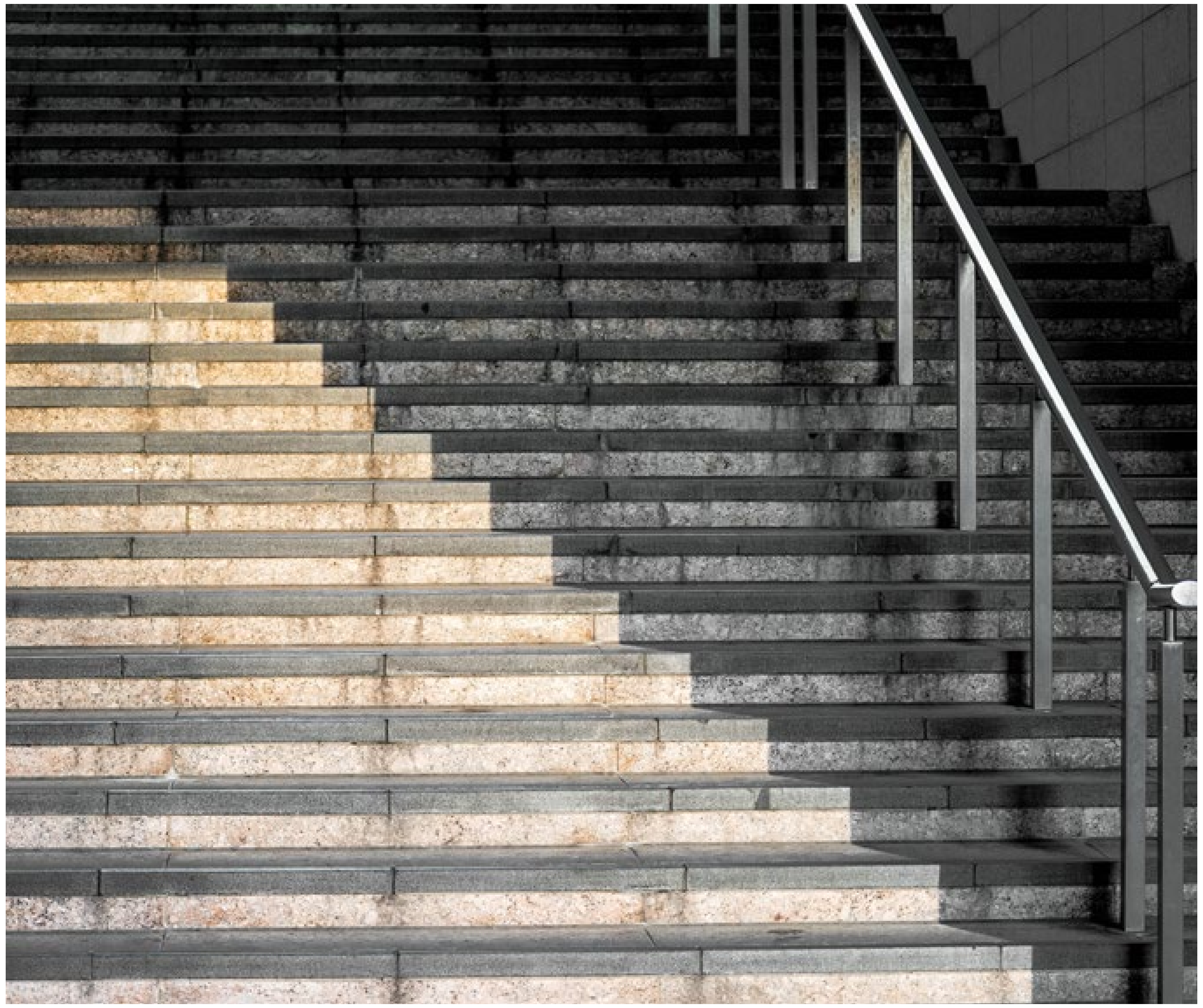


Three-tiered rental market

Canary Wharf, the benchmark for East London, remains a three-tiered rental market. Prime rents were reduced to £50.00 per sq ft from £51.00 per sq ft in Q2. Tenant-controlled supply is being marketed at rents from £42.50 per sq ft and continues to restrict rental growth, while pre-let supply is being marketed at rents of £59.50 per sq ft.

East London rental bands

Despite there being only one investment transaction in Q3, it was the largest transaction across Central London in the three months to September. Link REIT purchased The Cabot, E14 for £380 million from Hines, reflecting a net initial yield of 4.87%. The deal boosted the year to date total to £548 million.



07

Rental conditions in Central London

No.	Area	Prime rents per sq ft	Occupancy costs per sq ft
1	Hammersmith	£55.00	£86.74
2	Kensington & Chelsea	£71.00	£119.54
3	Paddington	£73.50	£108.45
4	Mayfair	£117.50	£180.87
5	Belgravia & Knightsbridge	£77.50	£130.98
6	Battersea	£56.00	£82.30
7	Victoria	£78.00	£122.83
8	Vauxhall	£58.50	£86.03
9	Waterloo	£63.50	£91.28
10	St James's	£117.50	£193.22
11	Soho	£93.00	£142.77
12	Covent Garden	£83.00	£124.13
13	Fitzrovia	£88.00	£132.83
14	North of Oxford Street	£88.00	£139.01
15	Marylebone	£71.00	£105.95
16	Euston	£73.50	£114.63
17	Bloomsbury	£83.00	£121.65
18	Camden	£58.50	£93.94
19	King's Cross	£83.00	£125.36
20	Clerkenwell	£78.50	£112.21
21	City Midtown	£72.50	£111.60
22	Western	£72.50	£109.09
23	Southern	£70.00	£106.59
24	Southbank	£70.00	£106.18
25	Central	£72.50	£110.35
26	Eastern	£72.50	£106.58
27	Aldgate	£62.50	£94.73
28	Northern	£72.50	£106.58
29	Shoreditch	£71.00	£103.48
30	Stratford	£45.00	£69.57
31	Canary Wharf	£50.00	£76.30
32	White City	£57.50	£84.89
33	Nine Elms	£58.50	£87.27
34	Whitechapel	£60.00	£90.01

Prime rents per sq ft ■ Occupancy costs per sq ft

Capital Markets

Julian Sandbach
Head of Central London Markets
+44 (0)20 7399 5973
julian.sandbach@eu.jll.com

Rob Jackson
Head of City Capital Markets
+44 (0)20 7399 5029
robert.jackson@eu.jll.com

Rob Corbett
Head of West End Capital Markets
+44 (0)20 7399 5545
rob.corbett@eu.jll.com

Leasing

Dan Burn
Head of City
Agency
+44 (0)20 7399 5966
dan.burn@eu.jll.com

Chris Valentine
Head of West
End Agency
+44 (0)20 7087 5362
chris.valentine@eu.jll.com

Jeremy Attfield
Lead Director - Central
London Markets
+44 (0)20 7399 5675
jeremy.attfield@eu.jll.com

Research

Jon Neale
Head of UK
Research
+44 (0)20 7087 5508
jon.neale@eu.jll.com

Elaine Rossall
Head of UK
Offices Research
+44 (0)20 3147 1666
elaine.rossall@eu.jll.com

James Norton
Director
UK Research
+44 (0)20 7087 5033
james.norton@eu.jll.com

Amy Birdee
Associate Director
UK Research
+44 (0)20 7087 5098
amy.birdee@eu.jll.com

Lease Advisory

Geoffrey Pentecost
Director - Lease Advisory
+44 (0)20 7399 5390
geoffrey.pentecost@eu.jll.com

Nicholas Smith
Director - Lease Advisory
+44 (0)20 7087 5762
nicholas.smith@eu.jll.com

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