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2019

THE RACE FOR SPACE

PRE-LETTING'S IMPACT ON THE UK OFFICE MARKET

A CUSHMAN & WAKEFIELD RESEARCH & INSIGHT PUBLICATION

CUSHMAN & WAKEFIELD

CONTENTS

DEFINITIONS

For the purposes of the report, we will be analysing both off-plan pre-lets and pre-lets under construction.

Unless otherwise stated, all analysis in the report includes transactions above 5,000 sq ft.

UNDER CONSTRUCTION

An agreement between the tenant and landlord to lease a building where construction or refurbishment is underway and is prior to practical completion.

OFF-PLAN

An agreement between the tenant and landlord to lease a building where construction has yet to start.

EXECUTIVE SUMMARY

Pre-letting has become a vital component of the UK office market for both occupiers and landlords. Against the backdrop of prolonged uncertainty in the run-up to Brexit, the factors involved in occupier decision-making are evolving.

This report explores the trends in UK pre-letting and looks ahead to how pre-letting might impact the UK office market in the future.

OUR KEY FINDINGS FROM THIS REPORT WERE:

1. **Pre-letting looks set to continue across the UK, especially in Central London.** Supply levels are set to trend downward and occupiers will be forced to look even further ahead to secure quality space. For large transactions this could be as far as 4-5 years ahead of a lease event.

2. **Occupiers have not been dissuaded from committing to large-scale office moves in Central London in the wake of the EU referendum result,** although we are now approaching unchartered territory and there is potential for a downturn in occupier sentiment.

3. **Flexibility has become the main focus for most pre-let occupiers.** They require the ability to commit to a core space but with options to expand or reduce their footprint over time.

SETTING **THE SCENE**

The UK commercial property market has undergone significant systemic changes since the global financial crisis (GFC).

One of the most noticeable of these is the paucity and cost of debt available to investors and developers.

Estimates suggest that development debt fell from 27% of total lending to real estate in 2009 to less than 3% in 2017. This has led to a decline in the delivery of new space to the market, which has prompted tenants to consider their real estate options further in advance of a potential move than would previously have been the case.

Fears that Brexit uncertainty would delay decision-making and see occupier requirements placed on hold have proved largely unfounded. Occupier demand has remained surprisingly robust since the EU referendum, and many businesses have focused on securing the best solution to their long-term real estate needs beyond Brexit.

This has led to a growing appetite for pre-letting, across a widening spectrum of business sectors, geographies and size bands. The trend is particularly pronounced in Central London where the near-term pipeline of space speculatively under construction is quickly being eroded.

This report provides a deep-dive analysis of the causes and the nature of the increase in pre-letting in the UK and explores the consequences for both landlords and tenants.

The pre-let market will play an increasingly important role in UK commercial real estate over the next five years; it will be essential to understand the dynamics behind the headlines.

KEY CENTRAL LONDON PRE-LETTING HIGHLIGHTS 2009-2018

- **267** Number of pre-lets
- **24.4m** Volume of pre-lets (sq ft)
- **27%** Proportion of 2018 annual take-up volumes accounted for by pre-lets
- **Media & Tech** Source of 6 out of 10 largest pre-lets
- **27** Average number of pre-lets per annum
- **91,676** Average size of all pre-lets (sq ft)
- **13** Average months between exchange and completion of scheme
- **69** Number of all pre-lets in excess of 100,000 sq ft over the last 10 years

WHAT THIS REPORT AIMS TO ACHIEVE…

- **Assess the historical trends in pre-letting and how they might change in the future.**
- **Explore what impact pre-letting has for both occupier and landlord decision making.**
- **Examine the barriers and enablers for pre-letting in the UK office market.**
- **Provide insight into the future needs of occupiers seeking pre-lets.**

PRE-LETS **BY BUSINESS SECTOR** (2009-2018)

- **32%** Media & technology
- **31%** Banking & Financial
- **13%** Professional services (inc Legal)
- **5%** Retail & Leisure

KEY PRE-LET TRANSACTIONS (2018)

Facebook
11-21 Canal Reach & P2, King's Cross, N1C
611,000 sq ft, off-plan

SMBC
100 Liverpool Street, EC2
161,000 sq ft, under construction

Sony Pictures
Brunel Building, 55 North Wharf Road, W2
77,000 sq ft, under construction

LiveNation
Farmiloe Building, 34 St John Street, EC1
63,000 sq ft, under construction

HISTORIC **TRENDS**

Pre-letting has historically been an important part of the Central London office market, accounting for 23% of total transactions over 5,000 sq ft between 2009 and 2018.

Overview

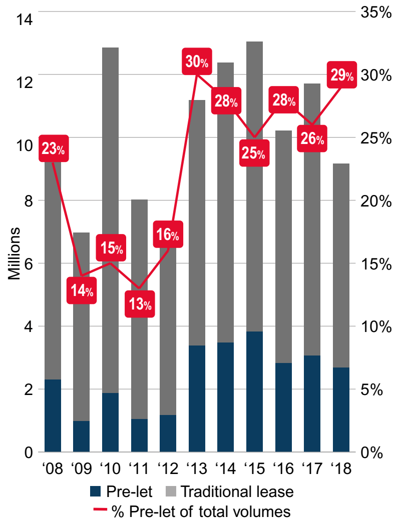
A total of 24.4 million sq ft across 267 pre-let transactions completed during this period. On average, there were 27 pre-lets each year over this period, with the peak being 2013 and 2014 when 42 pre-lets were completed. Pre-letting was more prevalent in the City and East London than in the West End, with 148 pre-lets and 119 pre-lets, respectively.

A combination of limited supply, and a lack of available debt for speculative development is resulting in Central London occupiers launching searches further in advance of their planned relocations than ever before. This has resulted in a surge in pre-letting activity across London over the past five years. With supply expected to remain constrained and take-up volumes set to remain above average, the trend towards pre-letting is expected to continue into 2019 and beyond, as occupiers face an increasingly limited choice of space.

Figure 1

Central London pre-lets as a proportion of total leasing volumes

(2009-2018)



Source: Cushman & Wakefield

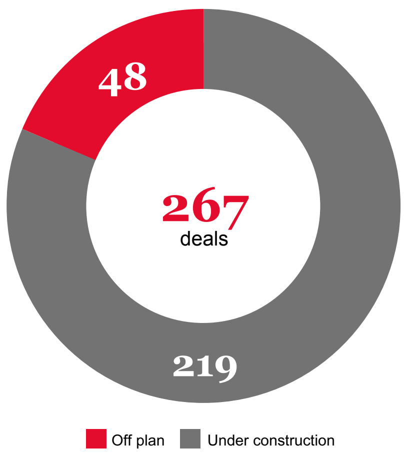
Location

Since 2009, the City has accounted for 57% of all pre-let deals across Central London by sq ft floorspace, compared with 34% in the West End and Emerging West. In East London, pre-lets were a key source of Docklands activity in the early 2000's, as investment banks moved to Canary Wharf mainly to accommodate large trading floorplates. However, there have been minimal pre-letting transactions in Docklands over the past three years as activity has focused around regeneration schemes in Stratford, with a total of five pre-let transactions signing since 2015. Over the period of analysis, East London has accounted for 9% of floorspace pre-let.

Figure 2

Number of pre-lets – central London

(2009-2018)



Source: Cushman & Wakefield

Timing of pre-lets

The average duration between exchange and practcal completion was 13 months with an average size of approximately 91,676 sq ft. The average duration between exchange and completion for those schemes which were pre-let off-plan was 30 months, with an average size of 225,140 sq ft. Considering pre-lets for buildings which were under construction, the average duration between exchange and completion was 9 months, with an average size of 62,423 sq ft.

Off-plan pre-lets

It is clear that pre-lets off-plan tend to involve large-scale occupiers. This trend was traditionally driven by the financial services sector taking large pre-lets in the City Core and Canary Wharf. Over the last ten years, there were 33 pre-lets off-plan for over 100,000 sq ft . The most active sector for pre-lets off-plan above 100,000 sq ft was the media & technology sector (12 deals) , followed by banking & financial companies (9 deals) and public & government sector (7 transactions). From a geographical perspective, 21 out of the 33 off-plan pre-lets were in the City and East London submarkets.

8%

Average rental discount for pre-lets over 100,000 sq ft 2009-2018

BARGAIN HUNTERS?

It has long been held as true that an occupier signing a pre-let will secure a rental discount over built stock, with the landlord willing to concede net effective rent for de-risking a scheme.

Our analysis of 100,000 sq ft+ pre-lets over the last ten years shows that an average discount of 8% against prime built space was granted to occupiers. However, it is crucial to note that any potential discount is closely linked to the movement of the Central London market cycle, as well as the individual elements of the deal including location, competition for space or covenant of the incoming tenant.

After the Global Financial Crisis in 2009, when the market cycle was perceived to be at its low point, occupiers actually paid a premium for pre-lets. Our research suggests developers will seek a premium at the bottom of the cycle due to the increased level of risk involved in kick-starting a scheme in a weak market.

As the market cycle progresses, the level of risk falls as developers become more optimistic about the potential for letting space on the open market if necessary. Consequently, developers are able to offer pre-let space at a discount to occupiers often to provide early-stage financing.

As we approach the very end of the cycle, developers are likely to once again price risk into their rental aspirations for pre-lets, which will ultimately reduce the discount available to occupiers.

PRE-LET **SIZE ANALYSIS**

The average size of all pre-lets across Central London since 2009 is 91,676 sq ft.

- For schemes **under construction**, the average size for the same time period was **62,423 sq ft.**
- For **off-plan pre-lets**, the average transaction size was **225,140 sq ft.**
- The **average** size of Central London pre-lets **under construction** has fallen by **20%** since last year, although this remains in line with the 10-year average.
- The **average size** for Central London **off-plan** pre-lets **increased by 178%** in the last twelve months, which is **51%** ahead of the 10-year average.

SO WHAT?

There has been a decline in the average size of pre-lets under construction while off-plan pre-lets are increasing in size.

Smaller pre-let transactions can help achieve a more balanced tenant profile which could drive the formation of a community, whilst increasing asset management opportunities.

This presents a potential conundrum for developers – designing a scheme for large occupiers seeking off-plan pre-lets may compromise the attractiveness to tenants looking to acquire smaller units post-completion.

Figure 3
Central London pre-lets by size band
(2009-2018)

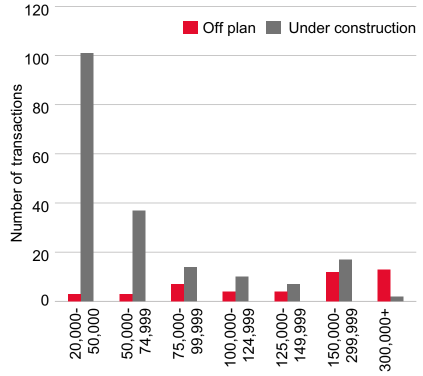


Figure 4
West End pre-lets by size band
(2009-2018)

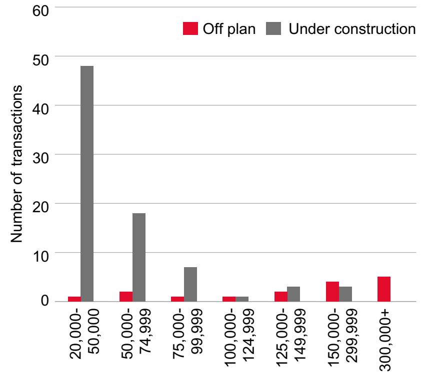
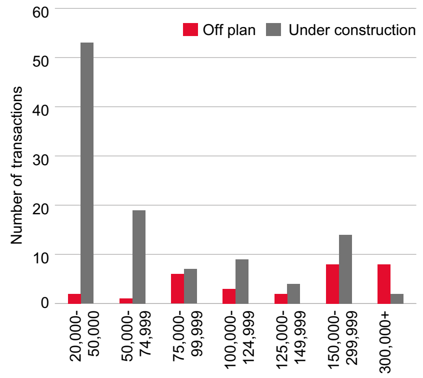


Figure 5
City and East London pre-lets by size band (2009-2018)



Source: Cushman & Wakefield

OCCUPIER **SECTOR ANALYSIS**

London's position as a global centre for creative industries is reflected in tenant demand for new, quality space; media & tech occupiers have accounted for 32% of total space pre-let in the last 10 years

Large transactions from several 'unicorn' companies have buoyed pre-let volumes in recent years including Apple's acquisition at Battersea Power Station (475,000 sq ft), Dentsu Aegis Network's 312,000 sq ft deal at 1 Triton Square and Facebook's recent commitment at King's Cross (600,000 sq ft).

Banking & financial occupiers were the next most active sector, accounting for 31% of total pre-let volumes over the last ten years. significant recent transactions include Deutsche Bank's future consolidation into 21 Moorfields (469,000 sq ft), SMBC's acquisition at 100 Liverpool Street (161,000 sq ft) and TP ICAP's acquisition of 135 Bishopsgate (122,000 sq ft).

Public sector and government occupiers have remained a vital component of the pre-let market in Central London, with volumes driven by large-scale consolidations from HMRC, FCA and TfL, as well as the Chinese Embassy's owner-occupier transaction at Royal Mint Court.

Interestingly, no professional services firms have committed to an off-plan pre-let over the last ten years. This sector has been involved in 27 pre-lets during construction in that time period, with an average transaction size of 67,150 sq ft, and an average lead-in time of just over 11 months.

Despite their high profile, flexible workplace providers have accounted for a small proportion of pre-lets since 2009, representing just over 6% of pre-let volumes (see fig. 9). The majority of these transactions have taken place during construction, with an average lead-in time of 14 months.

When analysing the largest pre-lets (300,000 sq ft and above), there are just three sectors represented over the last ten years; Banking and financial, media and tech, and public and government.

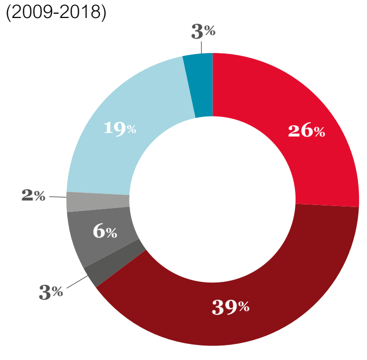
WHAT WILL THE FUTURE TRENDS BE?

Oxford Economics forecasts a fall in banking sector jobs over the next five years with Brexit dampening demand from banking and financial occupiers.

Both the professional and media & tech sectors are forecast to grow over next five years.

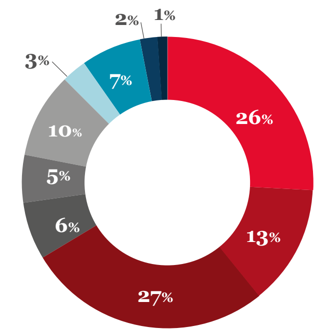
Landlords cannot rely on flexible workplace providers to buoy pre-construction letting volumes in the same way they can with post-completion lettings, not least due to covenant.

Figure 6
Central London off-plan pre-lets
(2009-2018)



Source: Cushman & Wakefield

Figure 7
Central London under construction pre-lets (2009-2018)

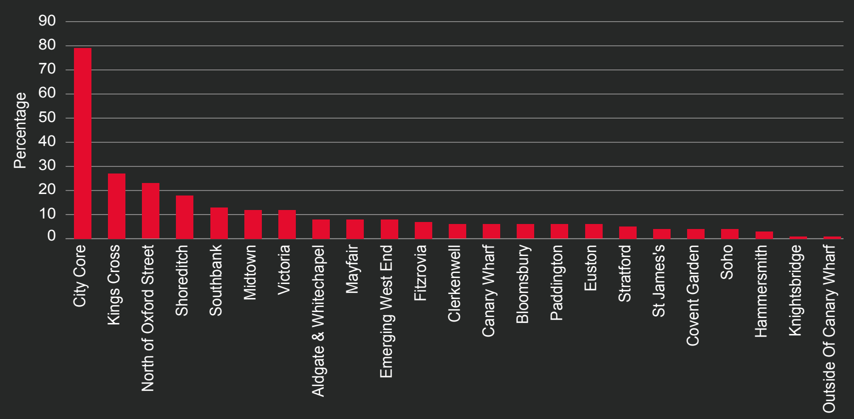


Source: Cushman & Wakefield

PRE-LET **LOCATION ANALYSIS**

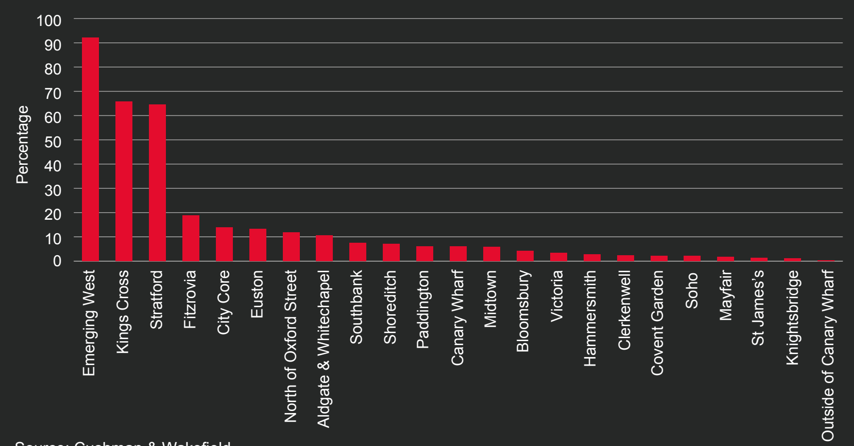
The City Core takes the crown for both the largest volume and the highest total number of pre-let transactions over the last ten years, largely due to the size of the office market relative to the other Central London submarkets.

Figure 8
Number of pre-lets by submarket (2009-2018)



Source: Cushman & Wakefield

Figure 9
Pre-let take-up by submarket as percentage of stock



Source: Cushman & Wakefield

Also unsurprisingly, King's Cross features towards the top of the list, having seen virtually all the new office stock secure pre-lets in recent years.

Perhaps more popular with occupiers in recent years are submarkets such as Shoreditch and Southbank, which provide a more varied retail offering, combined with a more creative 'vibe.'

When comparing pre-let take-up, but weighted by submarket stock levels, a different pattern emerges.

Over the last ten years, the emerging West End submarkets such as White City, Battersea and Nine Elms have attracted pre-lets totalling more than 75% of their total stock levels.

King's Cross is second on the list in terms of performance, underlining the submarket's appeal to occupiers in need of quality office space.

Stratford is another more peripheral submarket that features highly on this ranking, buoyed by early success at the International Quarter as well as a number of transactions that took place at Here East; more than 60% of office stock in this market was pre-let.

At the other end of the scale, core submarkets such as Mayfair, St James's and Soho have struggled to attract pre-let tenants at the same quantum as the emerging locations.

This is partly due to a lack of supply in the core West End but is also likely to have been influenced by the relative cost saving attached with relocating to a fringe location.

SO WHAT?

Occupiers are looking beyond the traditional core office markets. This is an opportunity for businesses to better reflect their brand.

Established submarkets continue to attract high number of pre-let tenants.

Emerging locations have a significant pipeline of space, which should see the trend of occupiers looking outwards continue.

Large occupiers endorsing new locations will drive demand in emerging markets, especially where a major pre-let has kick-started the development.

CO-WORKING
IS THERE AN IMPACT ON PRE-LETTING?

Against a backdrop of continued demand for flexibility from occupiers in both lease terms and occupation, there is a potential threat emerging that could disrupt the frequency and scale of off-plan pre-lets.

“WE BELIEVE CO-WORKING PROVIDERS SHOULD NOT BE THE DOMINANT TENANT IN A SCHEME, IT’S ABOUT BALANCE.”

A Central London Landlord

“CO-WORKING IS VERY IMPORTANT FOR LARGE-SCALE SCHEMES. YOU NEED TO HAVE THE CRITICAL MASS OF YOUNG, SMALL, GROWING COMPANIES THAT HAVE THE OPPORTUNITY TO GROW WITHIN THE PORTFOLIO.”

A Central London Landlord

Does co-working pose a threat to off-plan pre-lets?

We know that occupiers are increasingly looking as far as four to five years ahead of a potential move in order to secure the right space for their business, but there is now another option which allows occupiers to wait for the right building to come along. By taking shorter term flexible space as an interim solution, occupiers are now in a position where they can relocate temporarily in a flexible option, giving them more leverage in what has been a supply-driven market in recent years.

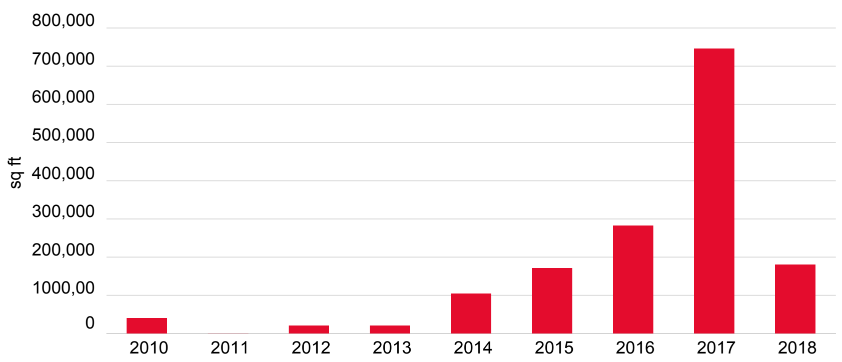
Whilst flexible space is certainly now a more realistic interim option for many occupiers, especially given the rapid growth of WeWork, The Office Group and Spaces’ respective portfolios, there may yet be an opportunity for landlords to capitalise on this increased demand for flexibility, as well as achieving their pre-let ambitions.

If traditional landlords could facilitate a short-term flexible move within their portfolio, they could allow prospective pre-let tenants to expand or contract whilst preparing for a future wholesale relocation.

This will, therefore, only be possible for landlords that either have their own flexible space platform, or indeed those who have partnered with a third-party provider. With flexible providers acquiring large-scale schemes with hundreds of desks available, they have quickly become a significant competitor for all types of relocation or expansion.

Figure 10

Central London flexible workplace pre-let take-up (2010-2018)



Source: Cushman & Wakefield

FLEXIBLE WORKING

- **Flexible workplace providers have had a significant impact on the Central London office market, especially over the last three to four years. Despite accounting for 21% of all take-up in 2017, flexible providers account for just 6% of total pre-let volumes over the last ten years.**
- **There has been a total of 1.56 million sq ft of pre-let take-up from flexible workplace providers over the last ten years, of which just 243,000 sq ft was let off-plan.**
- **This preference for schemes under construction is evidenced by an average lead-in time of 14 months.**

Flexible Workplace Providers who have pre-let space in Central London

TOWER ANALYSIS

Pre-letting is historically a City-centric phenomenon in Central London, and towers form a significant part of the City market.

There is a perception that towers are built with pre-letting as the main focus, however this is often not the case. Whilst some tower developments require an off-plan pre-let to kickstart the scheme, our analysis shows that generally this is not the case. In fact, some landlords that we interviewed suggested that in order to 're-create' an area, they would prefer to deliver space speculatively.

Tower pre-let analysis

Size of lettings

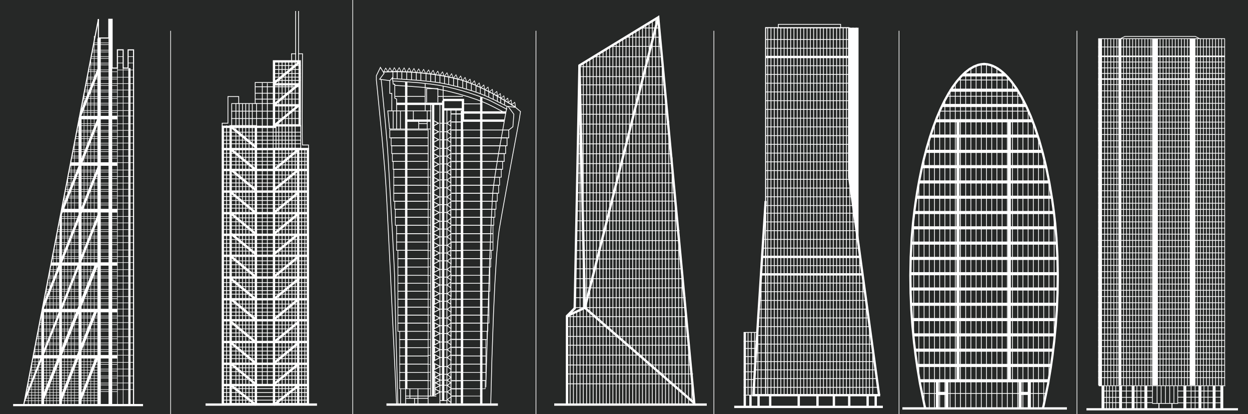
Larger floorplates are more likely to be pre-let in tower buildings. Of all tower pre-lets signed between 2009 and 2018, 65% had an average floorplate size greater than 17,500 sq ft. These floorplates tend to be situated on the lower parts of the building as landlords look to lease the larger floors first.

Diversity of occupier profile

Banking & financial occupiers took the largest share of tower pre-lets over the last 10 years with 32% of total volumes, mirrored by insurance companies (32%).

Amenity profile

Important to manage/segregate public accessed space.



THE LEADENHALL BUILDING, EC3	110 BISHOPSGATE, EC2	20 FENCHURCH STREET, EC3	THE SCAPEL, 52 LIME STREET, EC3	100 BISHOPSGATE, EC2	70 ST MARY AXE, EC3	22 BISHOPSGATE, EC2
Completed 2014	Completed 2011	Completed 2014	Completed 2018	Completing in 2019	Completing in 2019	Completing in 2019
31% Pre-let off-plan	0% Pre-let off-plan	0% Pre-let off-plan	21% Pre-let off-plan	30% Pre-let off-plan	0% Pre-let off-plan	0% Pre-let off-plan
18% Pre-let during construction	13% Pre-let during construction	80% Pre-let during construction	14% Pre-let during construction	49% Pre-let during construction	30% Pre-let during construction	14% Pre-let during construction
49% PRE-LET TOTAL	13% PRE-LET TOTAL	80% PRE-LET TOTAL	35% PRE-LET TOTAL	79% PRE-LET TOTAL	30% PRE-LET TOTAL	14% PRE-LET TOTAL

Source: Cushman & Wakefield

SO WHAT?

Towers don't generally achieve an off-plan pre-let. Most towers are let during construction or post completion.

Of the towers analysed, 17% of lettings were pre-let off-plan and 29% let during the construction process, compared to 54% let post completion.

The diversity of the amenity offer is becoming increasingly important to occupiers.

Also of importance is to manage or segregate public accessed space within the building.

The leasing velocity is enhanced the larger the floorplate.

53% of all tower pre-lets by number since 2009 have had floorplates larger than 20,000 sq ft, the majority of which are located on lower floors.

Figure 11
Tower pre-lets by type (by number)
2009-2018

Source: Cushman & Wakefield

WHAT ABOUT **THE REGIONS?**

Leasing activity across the UK regions has experienced a significant boost in the last five years as the market recovered from the effects of the global financial crisis.

As shown in Figure 12, the regional cities appear to have shrugged off Brexit concerns, with two-year rolling take-up registering a record level of performance in Q3 2018. This is particularly important given that this data point is largely unaffected by pre-referendum deals.

Although office take-up has been driven, in part, by large requirements generated by the rationalisation of the government's property portfolio, corporate activity has also played a significant role. Much has been made of the 'north shoring' of back-office functions from London, but it should be noted that regional take-up has grown alongside London take-up and not at its expense.

In Glasgow, Barclays committed to one of the largest leasing transactions ever recorded outside Central London, pre-letting 470,000 sq ft at Buchanan Wharf. The new building will house existing Glasgow staff along with new positions created in technology and operations functions.

In addition, Booking.com has pre-let 222,000 sq ft at St John's, Manchester as the new global headquarters for its ground transportation division, which will consolidate from four offices around the city.

Does this increase in pre-letting from corporates represent the start of a trend, or is it merely an anomaly?

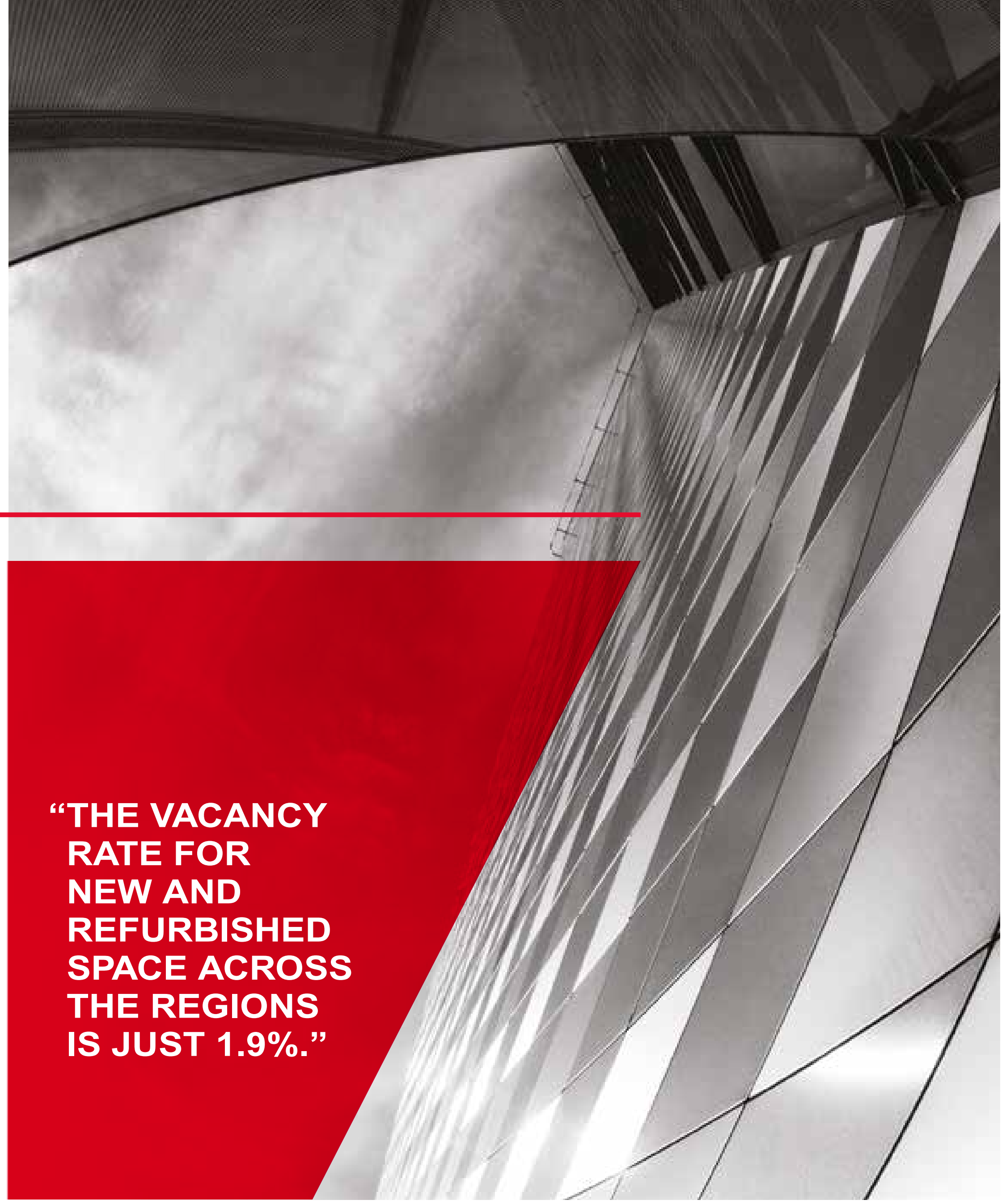
Pre-letting in London normally occurs at the extremes of a cycle; at a time when supply levels are bottoming out and demand has peaked. In the regions, the relationship between the market cycles and pre-letting has been less clear as requirements tend to be smaller and can often be absorbed by existing speculative stock. As a result, true pre-lets (commitment pre-construction) have tended to be the domain of the regional mega-deals.

This is changing. As take-up continues to increase, there has been a corresponding fall in the availability of quality space in the majority of markets.

The vacancy rate for new and refurbished space across the regions is just 1.9%, falling to just 0.8% in Bristol.

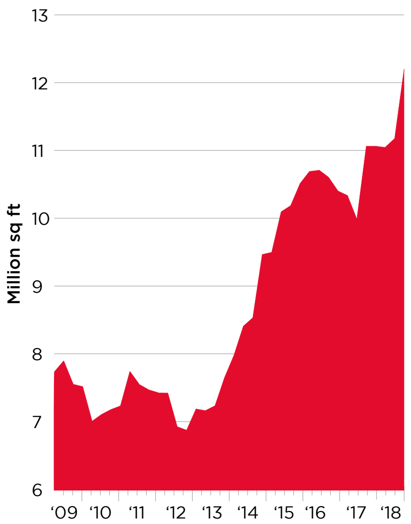
This has led occupiers to focus on stock in the pipeline to satisfy their requirements. As shown in Figure 13, as the total amount of space under construction has fallen, the proportion that is committed has risen.

As this space continues to be absorbed, occupiers will look further ahead to ensure their requirements are satisfied. In London, lead-in times for requirements have already increased significantly; we will see a similar trend in the regions.



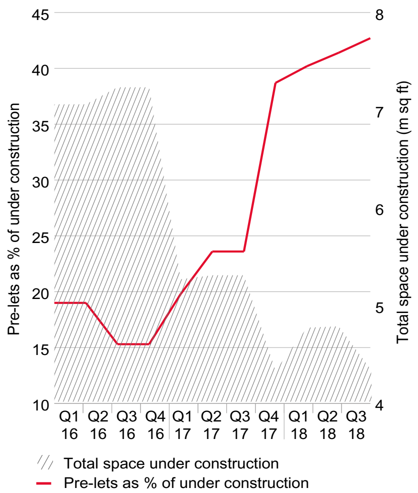
"THE VACANCY RATE FOR NEW AND REFURBISHED SPACE ACROSS THE REGIONS IS JUST 1.9%."

Figure 12
2-year rolling take-up in the regions



Source: Cushman & Wakefield

Figure 13
Pre-lets as percentage of total space under construction, big eight cities



Source: Cushman & Wakefield

Where in the past, an occupier might activate a requirement 18 months in advance of expiry, confident of securing quality options, requirements will become live far sooner as the choices become fewer.

What does the future hold for pre-lets in the regional markets?

The pre-let market over the last three years outside Central London has largely been driven by consolidation requirements from the government and, in particular, HMRC.

The department has consolidated its occupation from 170 offices to just 13 – the final transaction for a regional centre in Nottingham was signed recently.

In many ways, the government is the ideal tenant for an off-plan pre-let. Headcount is less affected by market movement, meaning future requirements can be more accurately forecast, mitigating the risk of committing to accommodation years in advance of a move. In addition, as a tenant the government offers a triple A covenant, which should facilitate debt availability.

We expect to see more large scale government moves out of London with the implementation of the Government Estate Strategy 2018, which aims to relocate 'thousands' of civil service posts around the country by 2030.

Conversely, the combination of uncertainty surrounding the outcome of Brexit and the limited availability of development debt has caused a fall in the amount of space being built speculatively.

We anticipate demand for pre-lets will strengthen in the UK regions given the low volume of new space being developed speculatively. The ongoing relocation of the government estate out of London will place further pressure on the development pipeline and cause corporate tenants to look even further into the future to secure their real estate options.

KEY REGIONAL PRE-LET TRANSACTIONS (2018)

Barclays
Buchanan Wharf, Glasgow
470,000 sq ft, off-plan pre-purchase

Booking.com
Goods Yard, St John's Quarter, Manchester
222,000 sq ft, off-plan pre-let

PIPELINE
HOW MUCH IS BEING BUILT?

*The total potential size of the development pipeline between 2018 and 2023 is **35 million** sq ft.*

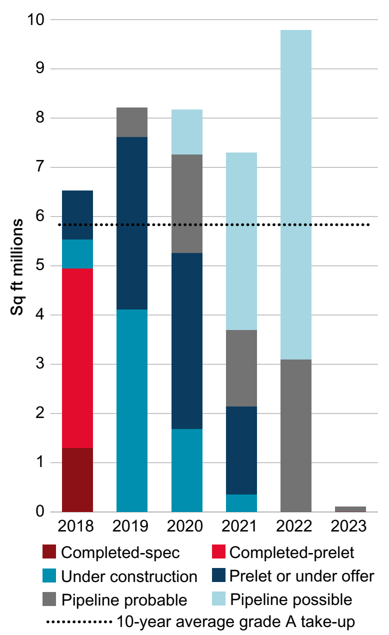
- **9.9 million sq ft** is pre-let or under offer (29%).
- There is just **6.72 million sq ft** of office space currently under construction for **speculative** delivery between 2018 and 2023 (19% of pipeline).
- The constrained pipeline sits against a backdrop of increased demand for new Grade A take-up. The volume of new or refurbished grade A space declined for the fifth consecutive quarter in Q3 2018.
- The 10-year average annual volume of new Grade A take-up is **5.79 million sq ft.**

Submarkets: oversupply or undersupply?

The map on figure 16 shows the potential impact of the development pipeline on a submarket level. Kensington has an extremely limited development pipeline and as such is the submarket most at risk of continued undersupply in the next five years. On the other end of the spectrum are the emerging submarkets of Stratford, White City and Vauxhall, Nine Elms and Battersea.

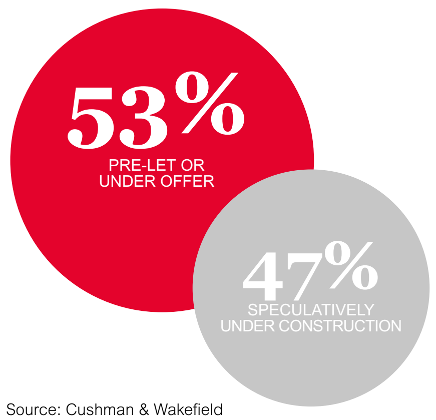
Whilst these areas do indeed have relatively high levels of anticipated development completions in the coming years, their comparatively low stock levels distort the analysis. Non-core locations where landlords are prepared to build will continue to benefit from footloose occupiers who want quality buildings with good transport links. Looking at the more established submarkets, it is evident that the West End leans further towards potential undersupply than the City. The core West End submarkets are amongst the most acutely affected by a diminished development pipeline over the next five years. The City and surrounding submarkets are more likely to remain stable in terms of future supply coming online, however there are pockets that are exposed to oversupply if take-up volumes decline.

Figure 14
Central London development pipeline (excluding committed space)



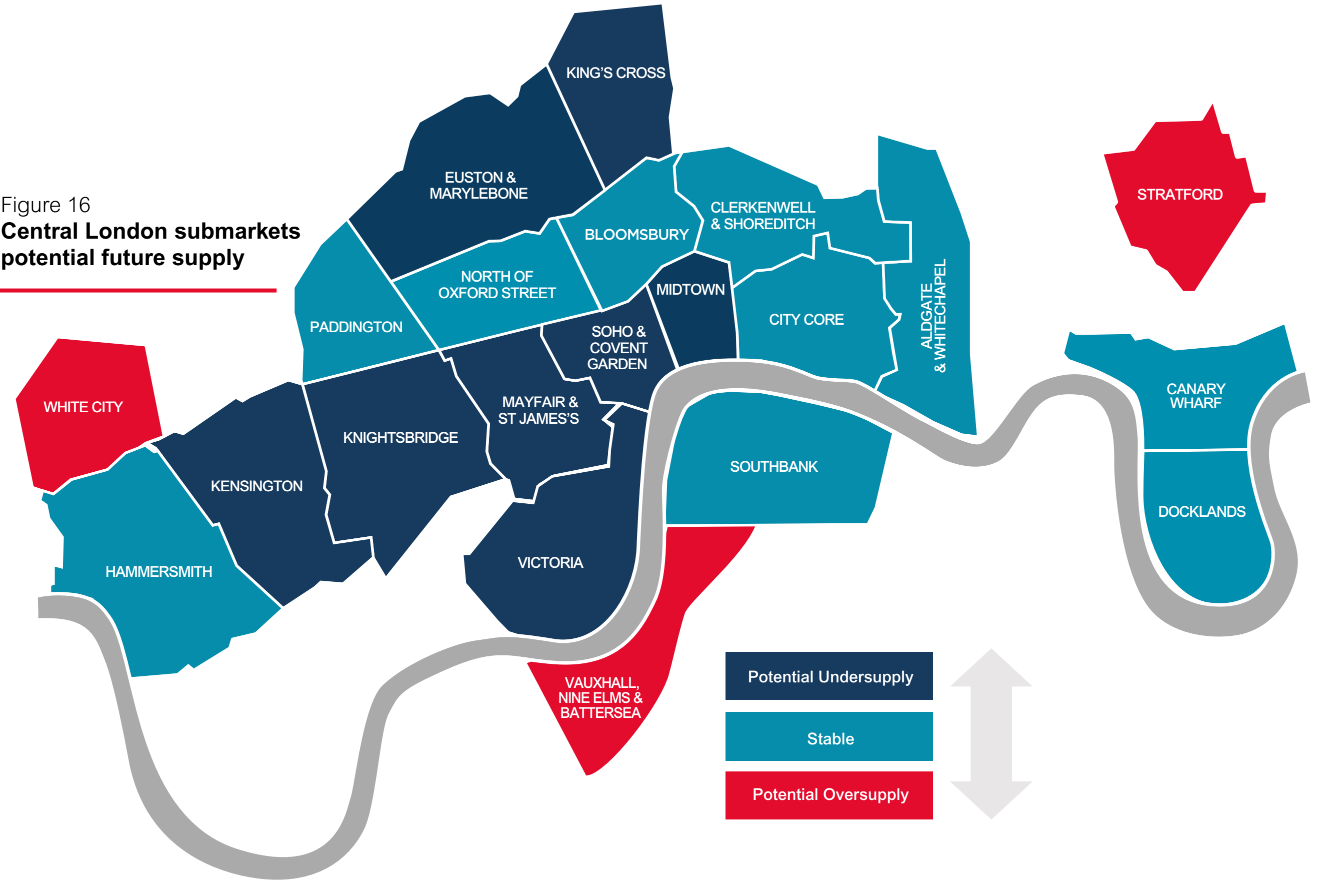
Source: Cushman & Wakefield

Figure 15
Central London development pipeline – speculative vs committed space



Source: Cushman & Wakefield

Figure 16
Central London submarkets potential future supply



Source: Cushman & Wakefield

> **"THE NEXT FEW MONTHS WILL BE IMPORTANT, WITH THE POLITICAL SITUATION. IF ANYTHING, IT'S A GOOD THING THAT THERE'S NOT HUGE AMOUNTS OF SUPPLY CURRENTLY IN THE MARKET."**
>
> A Central London Landlord

The volume of space being pre-let across Central London is reducing the volume of speculative space being delivered to market.

This trend looks set to continue, meaning that occupiers seeking large space-takes in good quality buildings will have to start their searches further and further in advance of their anticipated move date.

With occupiers considering their options 3-4 years ahead of a move, forward-thinking landlords may find more opportunities to pre-let off-plan to existing tenants in their portfolio.

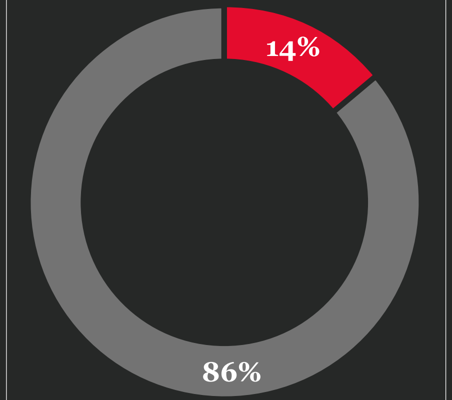
Landlords able and willing to 'push the button' on significant speculative schemes in the core could benefit from a lack of local competition.

LANDLORD SURVEY ANALYSIS

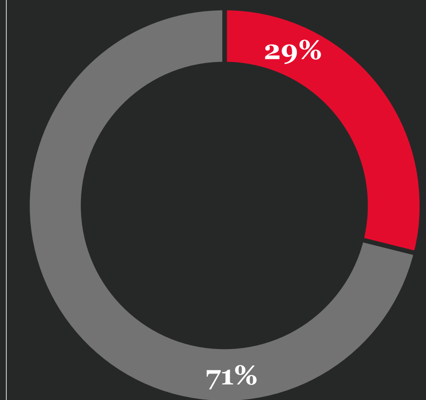
Figure 17

Yes No

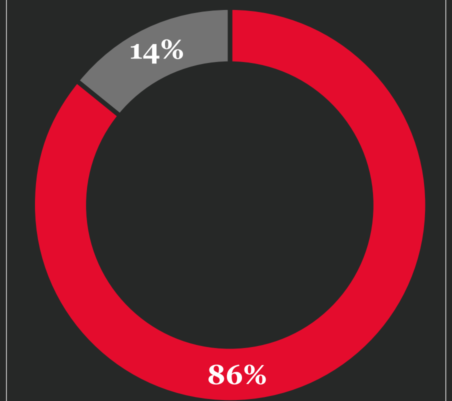
Have you noticed an increase in pre-letting in recent years?



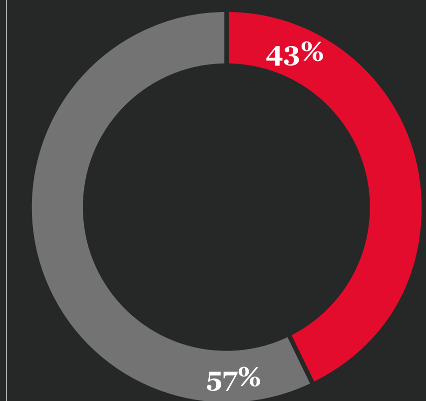
Are you making changes to your portfolio to attract pre-let tenants?



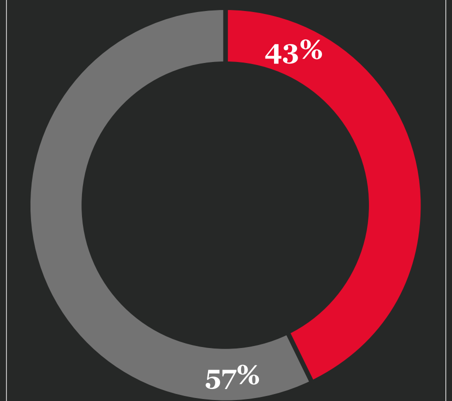
Have you noticed an increased need to incentivise occupiers to commit to pre-lets?



Does pre-letting impact building design?



Would/have you pre-let to a flexible workplace provider?



Do you plan to acquire/develop more space in the next 3-5 years for pre-let delivery?

Source: Cushman & Wakefield

"FOR OCCUPIERS IT'S A CHALLENGE BECAUSE THERE'S NOT A HUGE AMOUNT OF OPTIONS OUT THERE. IT IS A VERY DIFFERENT SCENARIO TO THE GFC."

A Central London Landlord

"OCCUPIERS CAN'T PREDICT WHERE THEIR BUSINESS WILL BE IN 3 YEARS' TIME, LET ALONE 10 OR 15. SO WHEN IT COMES TO THEM MAKING A COMMITMENT, THEY WILL WANT SOME FORM OF FLEXIBILITY."

A Central London Landlord

LANDLORD INTERVIEW ANALYSIS

As can be seen from the landlord responses we collected in figure 17, there are clearly diverging perceptions of the pre-let market, leading to different strategies from the landlords we interviewed.

Whilst most respondents agreed that pre-letting has increased as a trend in recent years, not all landlords we spoke to were making specific changes to their portfolios in order to attract pre-let tenants.

Landlords were also split on whether pre-letting had an impact on building design, although several explained that they felt their buildings didn't need any significant changes in order to accommodate greater volumes of pre-letting deals.

Despite the continued appetite for space from flexible workplace providers, over 40% of respondents said that they would not consider pre-letting to a flexible provider. Whilst some of these responses were linked to the negative perception of some operators' business models, many landlords we spoke to are now operating their own flexible platform, which means they don't need to lease space to a third party. As more landlords continue to explore ways they can facilitate the provision of flexible space within their portfolio, we could see a scenario where third-party operators are excluded entirely from the pre-let market. That said, some landlords may seek to partner with a provider rather than set up their own product. Either way, we anticipate that most pre-let schemes will contain a significant flexible element going forward.

"WE NEED TO APPEAL TO THE BROADEST GROUP OF TENANTS. THE BUILDING NEEDS TO BE FLEXIBLE FOR THE FUTURE IN EVERY SENSE."

A Central London Landlord

The majority of the landlords we interviewed said that they had not needed to increase the incentives they offered prospective tenants in order to attract them to commit to a pre-let. Many of the respondents explained that in most situations there was competition for space, meaning that there was no need to offer a more generous package. Also, some of the pre-let schemes we discussed were in non-core locations, meaning that the relative cost-savings in comparison to more established locations alleviated the need for discounted rents or increased rent-free packages.

The respondents were unanimous in their plans to acquire or develop more space over the next 3-5 years and were adjusting their strategies in order to attract as wide a profile of tenants as possible. All stated that this commitment was happening despite the ongoing uncertainty surround Brexit.

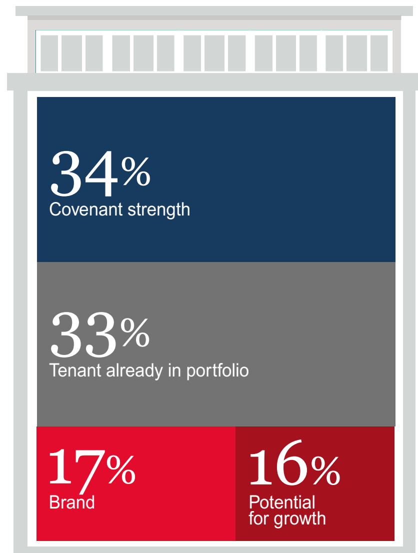
As part of the interview, we asked the respondents to rank their selection criteria for pre-let tenants in terms of importance (see figure 18). This was in a hypothetical situation where there were multiple prospective tenants looking at the same space. The main finding was that a strong covenant is still important for landlords, although interestingly it was only marginally more important than the tenant already being within the portfolio. This was something that our interviewees felt very strongly about, and that they would accommodate an existing tenant wherever possible.

Less important relative to the other two criteria were tenant brand and their potential for growth. Whilst most of our respondents placed some importance on both these factors, they explained that they felt that they would have less of an impact on their decision in a pre-letting scenario.

Looking to the future, now that we are seeing a higher number of smaller pre-lets with shorter leases, particularly whilst schemes are under construction, we might see landlords place a greater emphasis a tenant's potential to grow. This could become fundamental to creating a vibrant occupier ecosystem, especially in emerging locations.

Figure 18

Pre-let tenant selection priorities



Source: Cushman & Wakefield

OCCUPIER
INTERVIEW ANALYSIS

'Flexibility is king'

During our occupier interviews, the term 'flexibility' was the most frequently mentioned. Occupiers want flexibility in terms of the lease length such as the ability to have an earlier break option. This might now comprise a 'core' space-take with break options on certain floors. But the flexibility that occupiers need is changing; they also want options to decrease the amount of space they commit to in the run-up to practical completion. Once the building is completed, they might want options to expand within the building should they need to.

Beyond lease flexibility, occupiers want offices that allow them to adapt their space over time, as their business needs or workplace trends evolve. Although some of this adaptability will be incorporated into the tenant's own fit-out, the building itself needs to lend itself to these changes.

"WE WOULD ALWAYS SAY LOCATION IS TOP OF THE AGENDA. IT'S ALWAYS LOCATION. THERE IS SO MUCH DEMAND TO BE IN THE RIGHT PART OF LONDON."

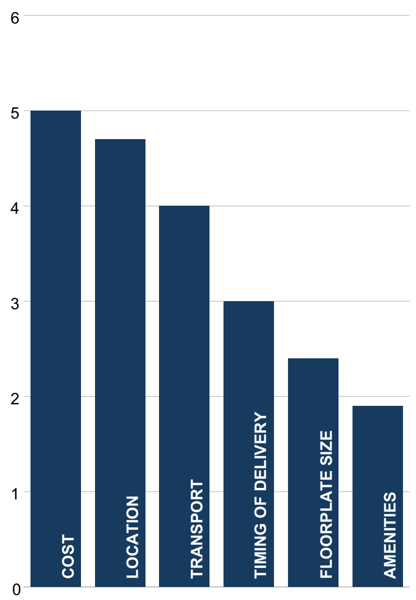
A Central London Occupier

Figure 19
Word Cloud showing Frequency of Key Words During Occupier Interviews

OCCUPIER
SURVEY ANALYSIS

Occupiers put cost as the most important selection criteria when considering a pre-let transaction. This was closely followed by location, which despite being mentioned more frequently in interviews, was consistently seen as secondary to cost.

Figure 20
Importance of factors for occupiers selecting a building



Source: Cushman & Wakefield

Occupiers put cost as the most important selection criteria when considering a pre-let transaction. This was closely followed by location, which despite being mentioned more frequently in interviews, was consistently seen as secondary to cost.

One of the reasons why location was seen as such a vital factor in occupier decision-making was that occupiers are able to change or mitigate many of the other factors through fit-out, but the location is fixed. Some occupiers felt that as long as a building had the fundamentals (good natural light, fresh air provision, workable floor plates) then any shortcomings of the building could be overcome, if the location worked.

Amenities were viewed as the least important in relative terms, although several occupiers mentioned that if they were committing to a pre-let then they would have an expectation that the scheme had a certain level of on-site or nearby amenity.

Specifically, gyms were cited as vital to nearly all of the occupiers we interviewed or surveyed. Some occupiers wanted the gym to be located within the building itself, whereas others were open to walking a short distance to the gym.

Several occupiers mentioned that whilst employee wellbeing was now on the agenda for their decision-making, it was by no means the most important. Occupiers did, however, say that much of their wellbeing agenda could be addressed by their own fit-out.

Some occupiers were accepting of a longer-term commitment, despite the increasing need for flexibility. There was a general perception that a 15-year lease, for instance, was still of value. In fact, they would require a longer term to amortise the costs of their fit-out. Given that a pre-let is often for a HQ or strategically important office, occupiers are often willing to 'put down roots.'

One recurrent theme in our interviews was that of 'connectivity.' Whilst internet connectivity is clearly important, our interviewees were more concerned with physical connectivity. Occupiers want connected spaces within a building, perhaps a central break-out area or vertical connectivity between floors via staircases. This demand was confirmed during out interactions with landlords, who said this had become a more frequent request.

All the occupiers we spoke to said that if they were to look for another pre-let in Central London, they would start their search earlier, often four years prior to lease event or more.

"But what about Brexit?"

One of the most frequently debated topics in the media is how the EU referendum result has impacted occupiers' decisions to commit to London. Whilst there has clearly been greater emphasis placed on due diligence, and perhaps a great sensitivity to costs, major occupiers have continued to commit to the London office market.

This is because the fundamentals of London's attractiveness as a city remain in place; access to an educated talent pool, good quality of buildings, gateway to other markets and an excellent transport network.

We have seen such a variety of occupiers very publicly commit to London, such as Apple, Facebook, Wells Fargo, Amazon, Mimecast, Dentsu Aegis and LinkedIn. Whilst there have been some consolidations, there has also been a number of expansions, demonstrating occupiers' expectations for growth in the coming years.

Interestingly, one Central London occupier was more concerned with the risk to their business posed by artificial intelligence and technology than the repercussions of Brexit.

CONCLUSION

Occupiers

- Don't think that buildings have generally 'moved on' in the last 5-10 years.
- Have a dwindling number of options as both built supply and the development pipeline continue to decline.
- Need flexibility in the lease that allows a core space take but with options to grow or rationalise depending on business needs.
- Large occupiers seeking a move will increasingly need to start their search four years in advance of a lease event, especially if they want to locate in the core.
- This competition for core space will make fringe locations more desirable, especially with the rental savings available.

"LOCATION IS THE MOST IMPORTANT FACTOR AS ULTIMATELY AS AN OCCUPIER YOU CAN CHANGE A FAIR AMOUNT ABOUT A BUILDING."

A Central London Occupier

Landlords

- Think that they have made significant changes to their portfolios to attract pre-let occupiers.
- Need to find a way to offer flexibility to occupiers whilst achieving their business aims.
- Landlords hold the key to alleviating the tightening supply pipeline in Central London. They will need to bold and 'push the button' on developments, despite the ongoing political uncertainty.
- Flexible workplace providers are a potential threat to landlords seeking pre-lets, as occupiers are able to find a short-term solution and wait for the right building to come along.

"WE MIGHT DELIVER CERTAIN ASSETS SPECULATIVELY – TO FACILITATE CHANGE IN A LOCATION."

A Central London Landlord

OUTLOOK

The Central London office market is approaching a crossroads. There is a very real possibility that supply levels continue to fall to such a point that large-scale pre-lets become even more difficult to achieve. If landlords and developers do, however, commit to delivering additional space in the short to medium term across Central London then pre-letting could increase even further.

The rest of the UK looks set to see increased demand for pre-lets, drawing parallels with the London market in terms of the relatively low volumes of new space being delivered.

It will not be enough to deliver greater volumes of space though; landlords need to continue to align their strategies with the evolving needs of the occupier. Flexibility, in every sense of the word, is central to the potential success of future office schemes attracting pre-lets, alongside the provision of amenities and services that create a better working environment for employees. This will need to be balanced against landlords' valuation objectives.

Flexible workplace providers could be perceived as a threat to pre-letting. Flexible operators have the ability to provide a turnkey solution that could disrupt the status quo between landlords and occupiers seeking pre-lets. Alternatively, they could provide an opportunity for landlords to create partnerships, or improve their own flexible offering, giving prospective and existing tenants a new service that meets their changing needs.

What is clear from this report is that London continues to be a destination for a diverse profile of occupiers, who have committed to the capital for many years to come. Regional cities could stand to benefit from continued leasing activity from the Government Estate Strategy, as well as London occupiers looking further afield for cost-effective real estate options.