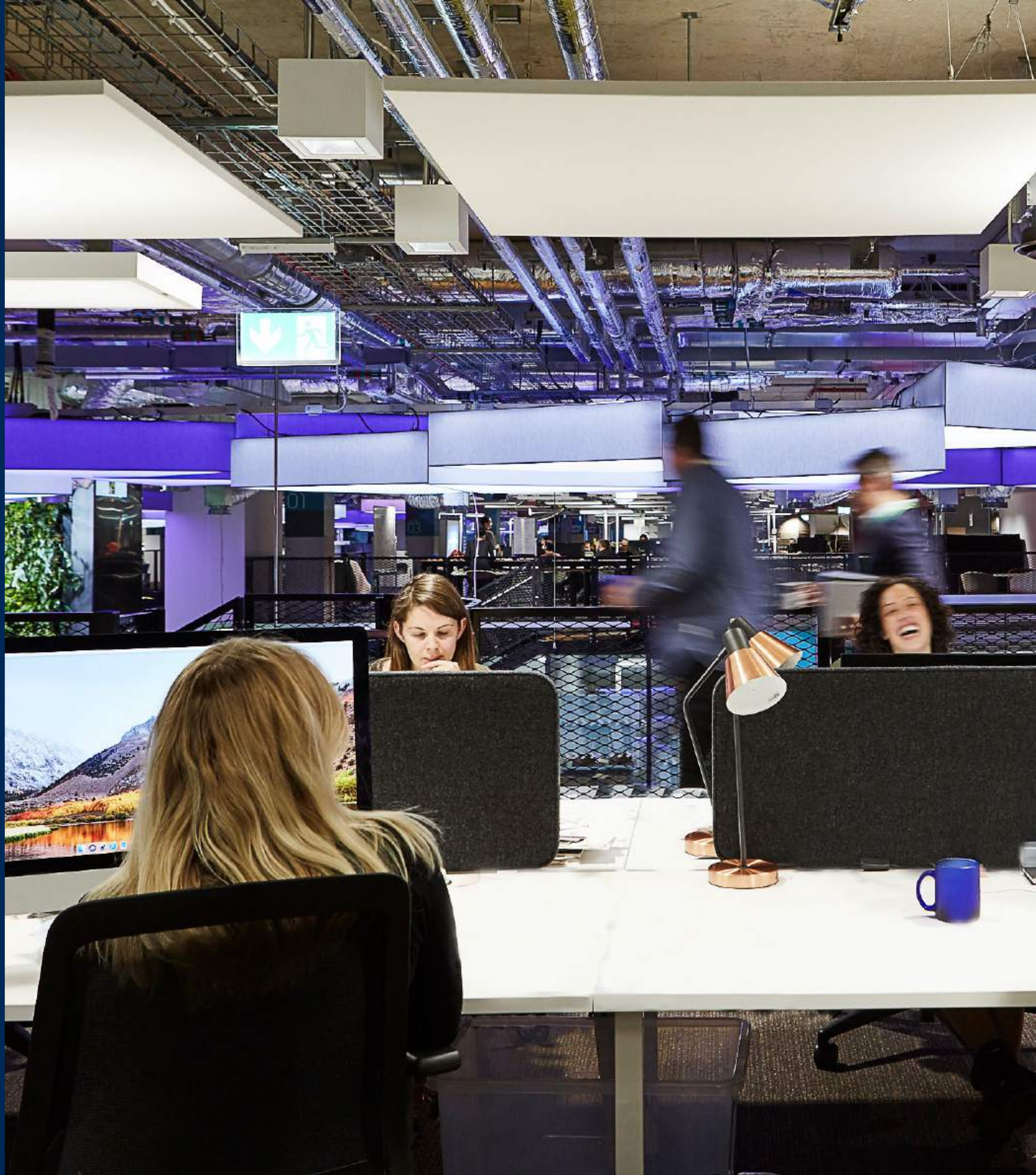
Demand for commercial property in London

What does the future hold?

Contents

Cover image: Kaleidoscope, Helical
Opposite: Plexal, the innovation company founded by Delancey, at Here East



1. Introduction

Towards the end of 2020, London First published 'what matters now?' – a compendium of views about the key issues facing London's commercial property industry. The report highlighted several short to medium term issues commercial asset owners were grappling with in the height of the coronavirus pandemic, such as the payment of rent, the importance of flexibility in both the planning and licencing regimes, and the challenge of supporting workers and visitors back to London's Central Activities Zone. The point of this work was not just to consider an important sectoral issue, but to also highlight the integral role that commercial property plays in the capital and the wider economy. As the report stated:

> *"The commercial property sector plays a critical role in supporting London's success: it provides the spaces where we work, shop and store goods; where we enjoy the city; and where visitors, from the rest of the country and globally, come for work and pleasure. And much of the sector is owned by pension funds and similar, long-term saving vehicles, making it an important part of millions of people's financial planning. So, the decisions that will be made by those that own and manage assets, and who determine the development pipeline for the city, who are facing a host of short-term challenges and medium-long term uncertainties, will be central to London and the UK's continued prosperity.*

A year later, we have returned to this theme. While there is still uncertainty about whether the worst of the pandemic is behind us, there is a growing focus from businesses about how to operate and ultimately normalise working arrangements in an evolving environment. For the office sector, there has been a move away from the traditional 9-5, five days a week occupancy model. For retail, the pandemic has accelerated a growing movement away from bricks and mortar to on-line commerce, which will have a profound impact on some of our high streets and shopping centres. The change in how we shop has, in turn, further underlined the ever-growing importance of industrial and logistics space.

This all has consequences for public policy. Many changes during the pandemic have come in at short notice, disrupting people's habits as they were starting to re-establish them, which has had a knock-on impact on the commercial property sector, and on the wider need to be more active in bringing people back to city centres, for example via the Mayor of London's Let's do London campaign. It has also underlined the importance of maintaining London's transport system, which is at the very heart of making the capital an attractive place to do business.

In partnership with CBRE, this report considers London's commercial property pandemic market and future demand in three key sectors: offices, logistics, and retail.

Angel Court , Mitsui Fudosan

This market analysis is complimented by capturing the views of the major players in London's commercial property market to understand the impact that the pandemic has had on their businesses and how they view the future. Finally, the implications for public policy are considered if future demand for space in these three sectors are to be met.

2 Executive summary

Market analysis

	The Covid market	Future demand
Offices – Central London	• All five of the main Central London markets saw take-up in 2020 and 2021 below trend levels due to a period of limited occupier activity. • Despite the period of low take-up volumes, space-takes rose above the Central London 10-year quarterly average in Q4 2021. A wide range of sectors were active in taking space in the last 12 months, including the creative industries and banking and finance sectors. • Completions for new and refurbished space remained above the market's average level in 2020 and 2021. Pipeline space continued to pre-let; at the end of Q4 2021, there was 12.0m sq ft of new development or refurbished space under construction, of which 35% was already pre-let or under offer. • Prime rents declined across all Central London markets during 2020 as market sentiment deteriorated, however recovery of rental values on the best quality space began in 2021.	• Post-pandemic, the rise of tech occupiers looks sets to continue, along with sectors such as life sciences, fintech and gaming. • The appetite for flexibility and flexible office space is expected to continue rising. • A potential 9% drop in demand for office space compared to pre-pandemic levels due to working from home trends. • However, space taken set to remain above average at approximately 13.5m sq ft per year. A total of 67.4m sq ft from 2022-2026. • According to CBRE forecasts, prime rents across all Central London submarkets are expected to exceed pre-covid levels during the forecast period to 2026.
Logistics – London and South East	• The South East reached take-up of over 8m sq ft in 2021, the majority comprising speculative developments. • The lack of available industrial land in and around London caused 75% of all deals closed between Q2 2020 and end of 2021 to be for smaller 'big box' units (those between 100,000 and 300,000 sq ft), a considerably higher percentage than any other UK region.	• The current vacancy rate in the South East region has compressed to just under 1.8% of the total stock, having been 6.2% at the end of 2019. • At the current monthly take-up demand, existing available space in the region (including speculative developments under construction), would only last 5 months. • CBRE forecasts prime logistics rents in London will continue increasing over the next five years at an annualised rate of 4.3%, with prices increasing at a stronger rate than in the initial forecasting period.
Retail – London	• Central London footfall tumbled to 80% below the baseline value in the initial national lockdown, however, this impact reduced in subsequent lockdowns and restrictions as retailers and consumers were better prepared. • According to the Local Data Company, the Greater London vacancy rate now stands at 10.3%.	• The volume of retail floorspace in the UK will need to decrease by 16% to reach the average sales densities of 2015-2020. • Repurposed retail space presents opportunities for both the more obvious customer-facing uses such as residential, hotels and workspaces, as well as back-office operational uses including last mile logistics and dark kitchens.

Industry perspective

From the development industry's perspective, key themes are emerging about the future of London's commercial property market:

- Being located in the capital will remain important, but there will be a loosening of the ties to traditional business neighbourhoods, including more opportunities outside of Central London.
- There will be more demand for high-quality, environmentally sustainable space that has been designed with wellness in mind.
- There is evidence already emerging of a two-tier post-Covid office market which is seeing a flight to quality and a shift away from secondary stock.
- What tenants want from both office and retail space seem to be converging – a flexible, tailored, customer orientated service that is mitigating impact on the environment and involved in the local community, helping to support their Environmental Social and Governance (ESG) credentials.
- Businesses are adopting an employee-led approach to the space they occupy with this increasingly relevant to staff recruitment and retention.
- The future of retail development lies in creating mixed-use schemes where more complimentary uses such as leisure and experiential retail can be introduced to support traditional retail. It's about creating interesting places with interactive formats.

Implications for public policy

While market forces will direct much of the investment and development that takes place in the future, there is a role for public policy to navigate, ease and indeed direct change to support London's economic recovery. Across the three sectors this report covers, there are emerging implications for public policy.

Office

- A flexible application of planning policy and property taxes to prevent secondary office stock from remaining empty.
- New tax incentives may be required to encourage the extensive retro-fitting of secondary office stock to meet ever increasing sustainability requirements.
- Re-purposing secondary office stock into residential use in commercial districts must be carefully managed as done poorly it will not only make for unhappy neighbours but could also undermine the agglomeration benefits of businesses locating in the city.

Logistics

- More work is required to encourage local areas to embrace last mile delivery uses on or near the high street.
- At the other end of the size spectrum, London will need to overcome its ostrich-like approach to contemplating land swaps in the green belt to accommodate industrial and logistics use on the edge of the capital.
- The pause in the government's planning reform proposals provide an opportunity for it to consider how it can better align its ambitions for housing growth with the need to support industrial and logistical growth.

Retail

- The creation of Use Class E, bringing together a range of commercial uses, was a welcome change that has already supported the transition for many ground floor retail units in London.
- It is the bigger and more fundamental change that both planning and town centre policies will need to address next. Here, a range of changes to public policy are required.
- For example, the GLA or relevant local authority should set up Meanwhile Use Registers for start-ups and SMEs to help maintain the vibrancy of high streets. And to aid bigger interventions, the GLA should provide boroughs with access to its Compulsory Purchase Order and land assembly expertise.

3 Market analysis

Offices

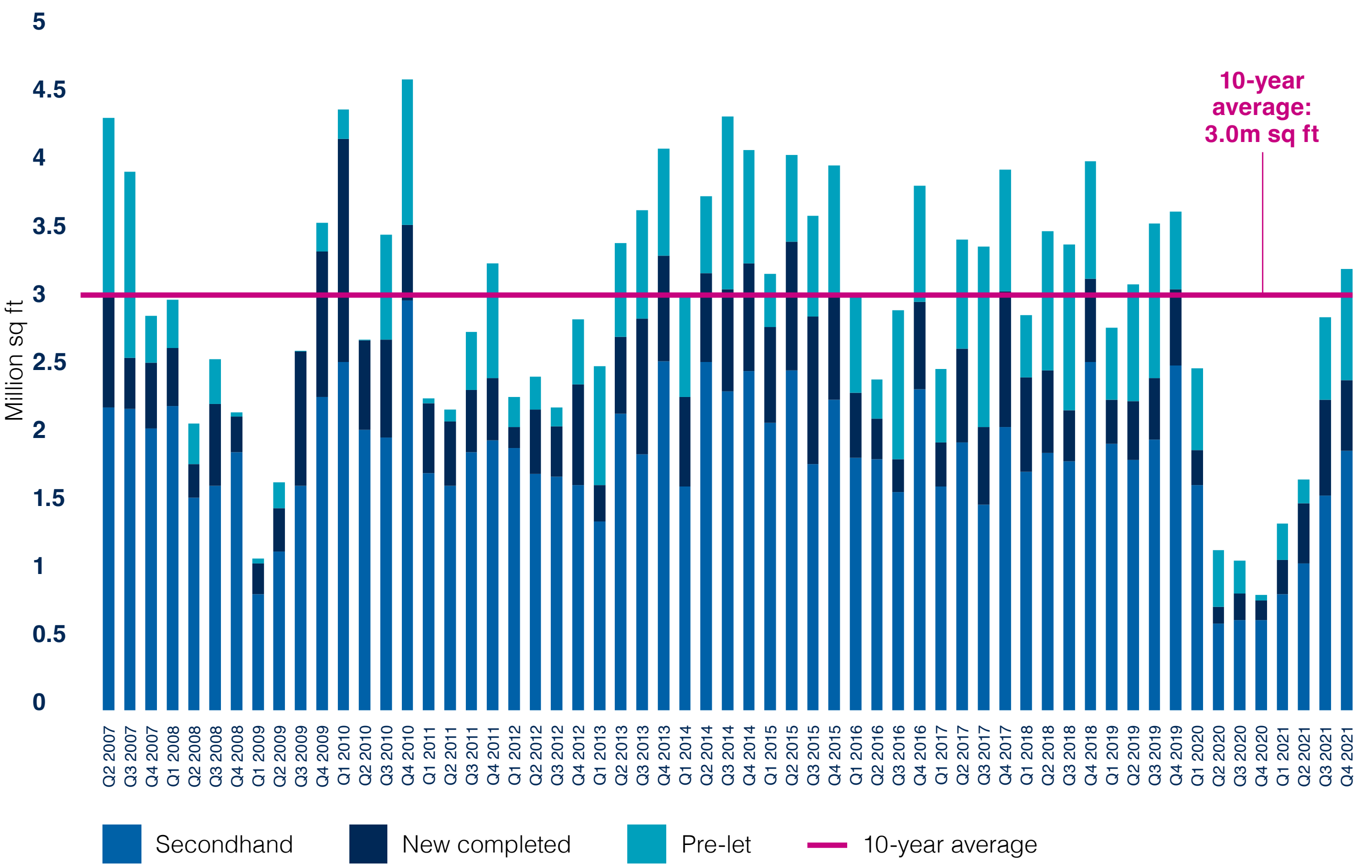
This analysis focuses on the Central London office market – the West End, City, Midtown, Southbank and Docklands – as the driving force of the sector and for which data is widely available. London does of course have a much wider office market, which is an important part of the capital's economy, but it is not the focus of this work.

The Covid market

Since the onset of the pandemic, the Central London office market has seen subdued demand relative to average levels – in the 12 months Q2 2020 – Q1 2021, office occupiers took 4.5m sq ft, relative to 12.8m sq ft in the previous 12 months. Throughout 2021 all five of the main Central London markets saw take-up remain below their long-term average levels, but all except Docklands saw stronger take-up in 2021 than the previous year.

In Q4 2021, Central London take-up totalled 3.2m sq ft, representing a 12% increase quarter-on-quarter and rising above the 10-year average level of 3.0m sq ft for the first time since Q4 2019. Throughout much of 2020-2021, pandemic-induced uncertainty led to hesitancy from occupiers in their real estate decisions, resulting in the low levels of take-up throughout the period. The data collected for Central London also indicated an increase in the number of short-term renewals, allowing tenants to extend their current occupation. Occupier take-up throughout 2021 indicates some recovery in market activity, totalling 9.1m sq ft (up 63% on the 2020 total and in Q4 2021, up 7% relative to the market's long-term quarterly average).

Figure 1: Central London office take-up



Source: CBRE Research, Q4 2021

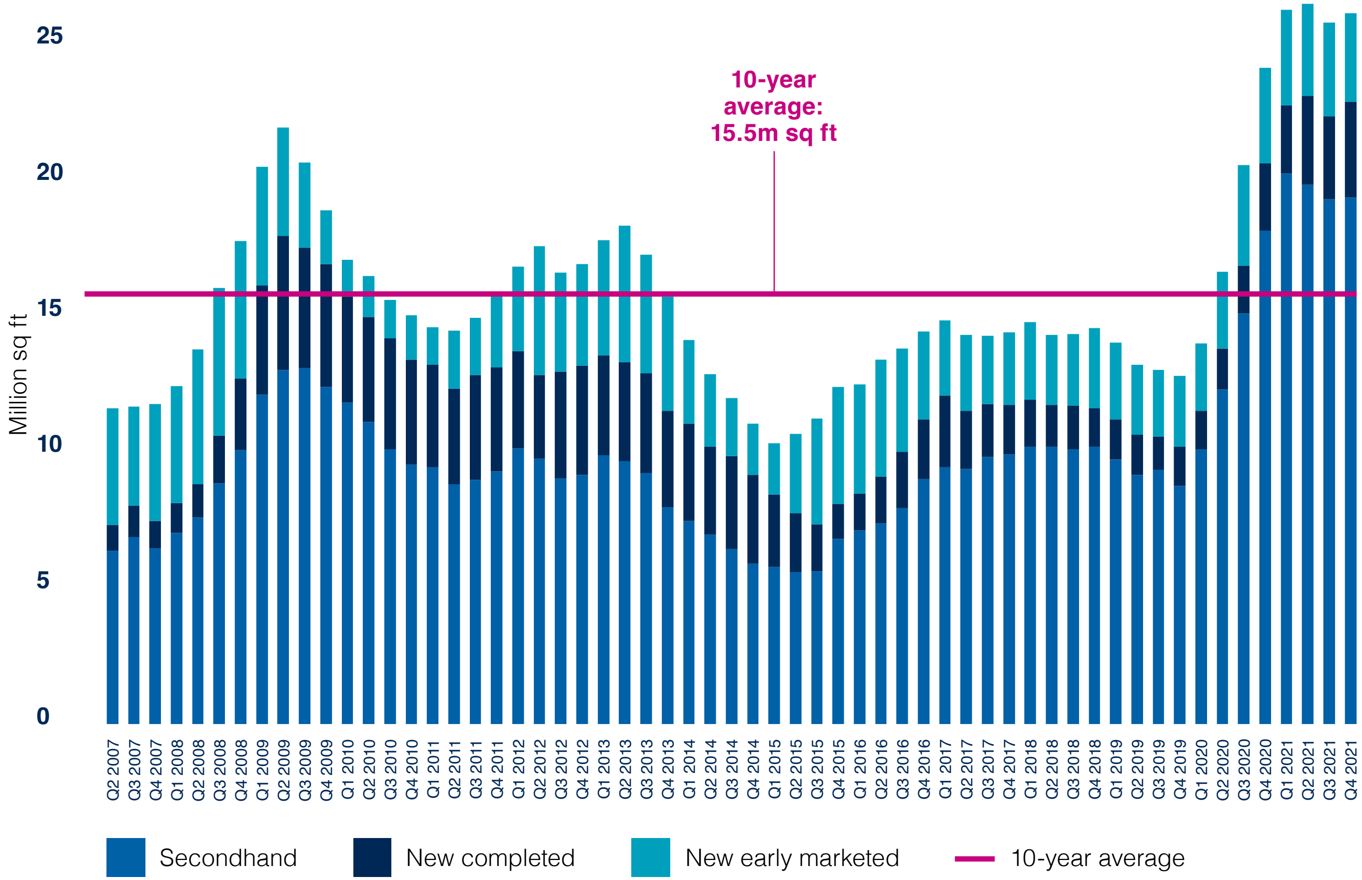
Despite subdued take-up volumes towards the beginning of the year, a wide range of sectors were active in taking space during 2021. Larger deals continued to transact in the last 12 months – transactions over 50,000 sq ft accounted for 38% of the year's take-up. The professional sector accounted for a third of these 50,000 sq ft+ space-takes; in particular legal services firms took 984,200 sq ft across 50,000 sq ft+ deals during the period. The creative industries were also particularly active, representing 29% of the 50,000 sq ft+ space-takes.

A large proportion (74%) of the 50,000 sq ft+ deals transacting in 2021, which included eleven of a total twelve deals larger than 100,000 sq ft, were within newly completed buildings, or deals for pre-let space. Despite the pandemic's impact on market sentiment, many occupiers continue to prioritise the need for high quality space to support recruitment and retention and the ESG agenda.

Space under offer at the end of 2021 was up 81% relative to the Q4 2020 level and remained above trend level for the second consecutive quarter, indicating improved occupier sentiment. At the end of Q3 2021, under offers reached the highest level of space under offer since before the pandemic, though it has since declined as transactions completing increased in Q4 (as is typical of the final quarter of the year). At the end of 2021, 1.7m sq ft (43%) of the space under offer was located in the West End, and 1.6m sq ft (43%) in the City.

The availability of Central London offices increased each quarter from the end of 2019 to Q2 2021, with a total 13.4m sq ft of supply coming onto the market during that period (+107% on the Q4 2019 level). At the end of 2021, there was 25.5m sq ft of available space, compared to the 10-year quarterly average of 15.5m sq ft. At the end of Q4 2021, the vacancy rate stood at 9.3%, relative to 3.8% at the end of 2019.

Figure 2: Central London office availability



Source: CBRE Research, Q4 2021

Second-hand supply in Q4 2021 totalled 18.9m sq ft – 90% above its trend level and accounting for around 74% of the total availability of office space. Secondhand availability increased rapidly during 2020 and in May 2021 reached 19.9m sq ft – the highest level recorded in Central London according to CBRE data tracked from 1990. This was in part due to the release of sub-lease or assignment space by tenants onto the market. Data indicates that in recent months this space has begun to be withdrawn from the market at a quicker pace than it is being added, hence second-hand supply has decreased from its peak to 18.9m sq ft.

Both newly completed availability and new early marketed supply (that is not yet ready to occupy but will become so within 12 months) were above their respective 10-year quarterly averages in the last year, accounting for the remaining 26% of the supply at the end of 2021. Development completions for new and refurbished space remained above the market's average level in 2021. At the end of Q4 2021, there was 12.0m sq ft of new development or refurbished space under construction.

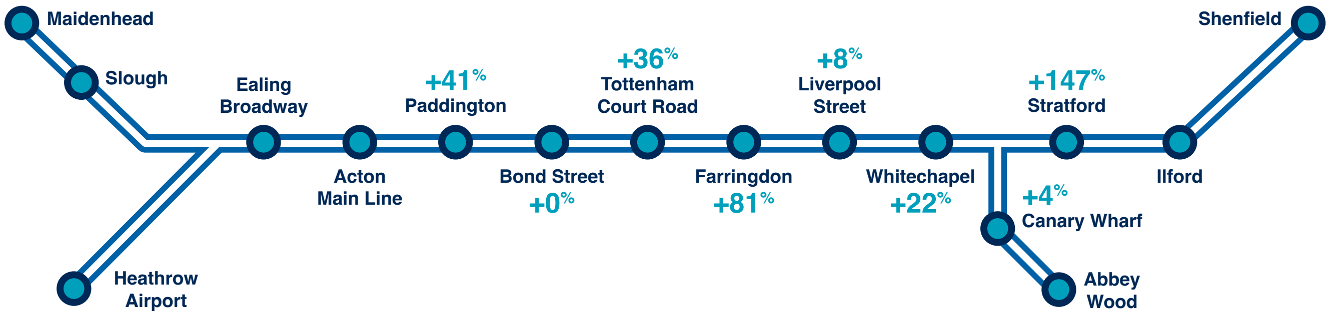
Prime rents declined across all Central London markets during 2020, as market sentiment deteriorated. The rental impact varied by submarket, with negative growth particularly apparent in the West End. As a result, rent-free periods were extended and additional incentive packages became more common. Following falls in rental values since the beginning of the pandemic, rental values on prime office space began to show signs of recovery in 2021, with numerous markets at or above their pre-pandemic levels. This demonstrates the occupier's continued preference and willingness to pay for high quality space, while rents on poorer quality space are expected to see a slower recovery. In line with the flight to quality, the best space in the Mayfair and St James's submarkets has seen the most significant growth since the start of the pandemic (+9%). Despite the rental increases, not all markets saw prime rents at their pre-pandemic level.

Future Demand

Historically, some of the strongest Central London office markets have developed around transport hubs which has proved important for office occupiers in providing an accessible and desirable workplace. New transport infrastructure such as the Northern Line extension which opened in September 2021, and Crossrail, which is due to open in 2022, are likely to help transform emerging locations across London. Figure 3 shows that despite pandemic-induced rental falls, markets situated close to Crossrail stations have already seen significant rental uplift and remained resilient.

Recently established office markets such as Paddington, Clerkenwell/Farringdon and Stratford have also seen notable rental growth relative to their previous cycle peaks. In the last ten years, the Clerkenwell/Farringdon market in particular has seen an influx in creative occupiers, accounting for 39% (1.2m sq ft) of the market's total demand. Post-pandemic, the rise of tech occupiers looks set to continue, along with sectors such as life sciences, fintech and gaming.

Figure 3: Office rental performance at core Crossrail stations: current rents relative to pre-global financial crisis peak



Source: CBRE Research, Q4 2021

The 2021 CBRE EMEA occupier survey provides an insight into how quickly a return to the office could happen across EMEA office markets. Some key highlights are:

- Smaller companies were bringing back their workforce to the office quicker than medium-sized or larger companies, with over 60% of smaller companies surveyed allowing full access.
- 80% of companies expected to conduct work entirely or mostly from the office with only 15% expecting a majority-remote workforce as the norm.
- In the UK sample it was initially thought that office occupancy would most likely settle at a steady-state by Q4 2021, but the appearance of the new Covid variant – and consequent introduction of further winter restrictions – have clearly delayed this.

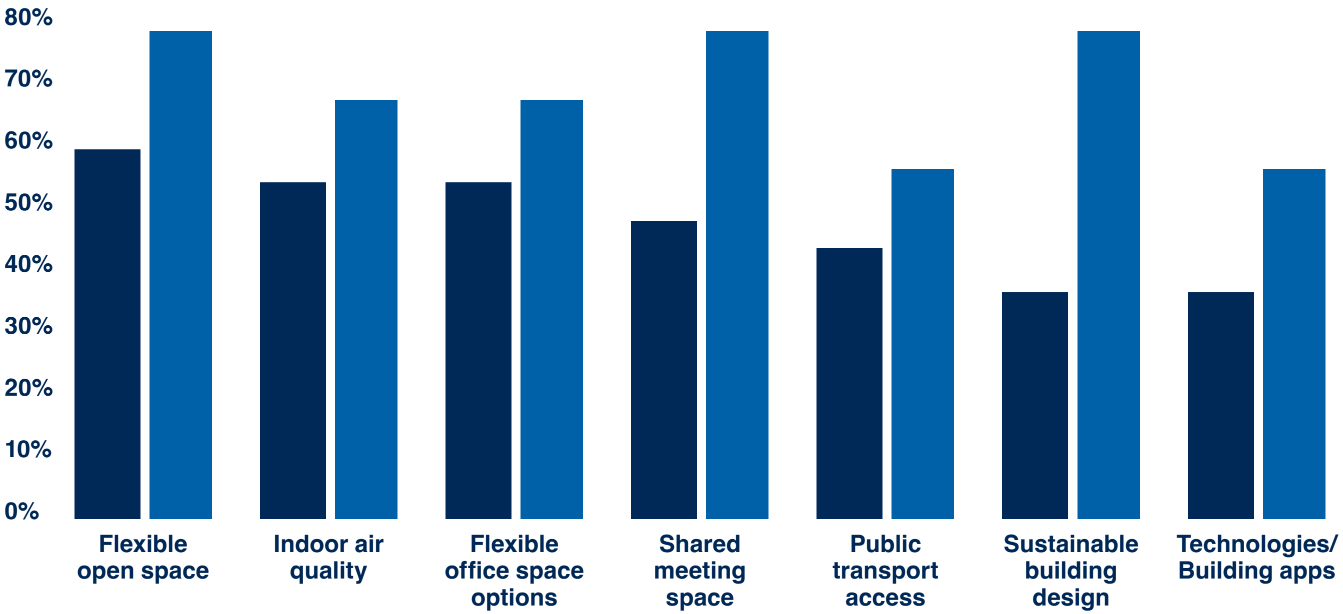
The survey also found that appetite for flexibility and flexible office space was expected to continue rising in the following two years, allowing companies to test different workspace or occupancy models, and to provide more choice of work location and environment to employees.

Analysis by CBRE suggests that Central London will see a 9% fall in office demand as a result of working from home during the pandemic. However the realised potential for increased flexibility will be muted by office space becoming less dense (due to wellness strategies and communal spaces for hybrid working) and peak occupancy requirements (the capacity required if all employees were in the office). Due to the timing of lease events, it is assumed that this one-off drop in demand will materialise over a 3 years. The association between the number of jobs and square footage occupied will weaken further because of this fall (which will accelerate an existing market trend), however overall rising employment and a strengthening economic landscape should sustain overall growth in market demand.

According to the CBRE EMEA occupier survey, enabling flexibility, technological integration, wellness and sustainability will be important within the building of the future. While previous iterations of the survey have highlighted real estate cost and availability and locational convenience as the most influential in building selection, it is clear that demands are increasingly pointing towards a high functioning, tech-enabled building that supports collaboration.


Hanover Square, Mitsui Fudosan

Figure 4: "What will be the most in-demand building amenities in the future?"



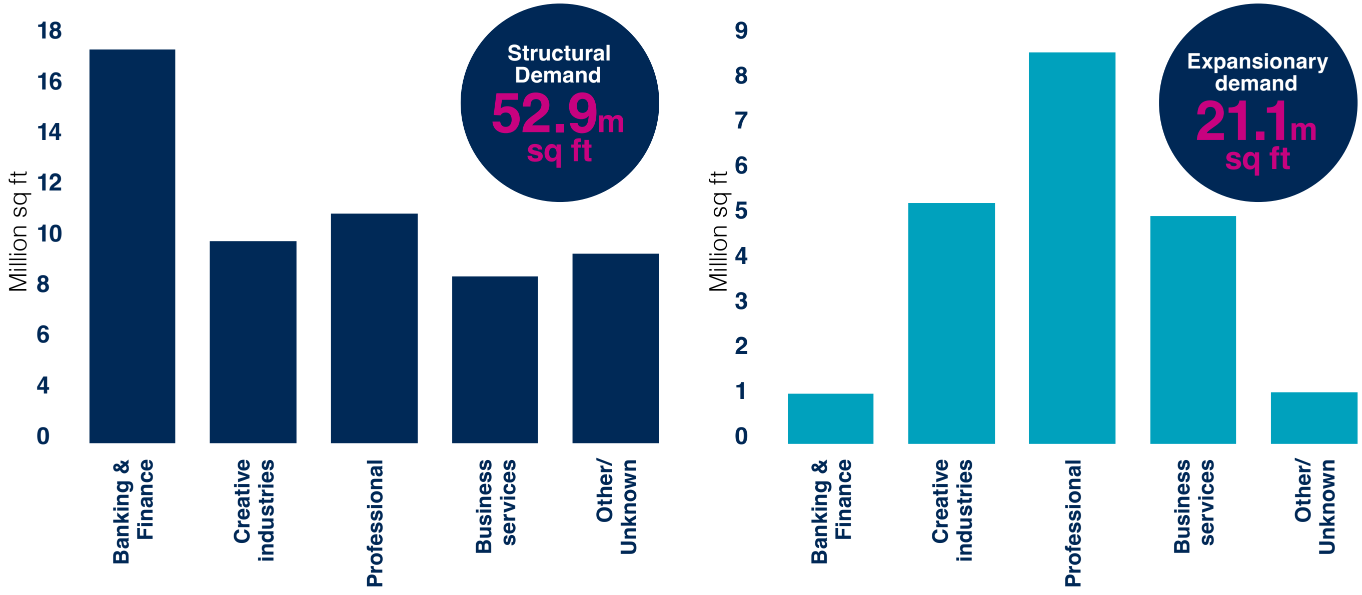
Source: EMEA Occupier Sentiment Survey, CBRE Research, 2021

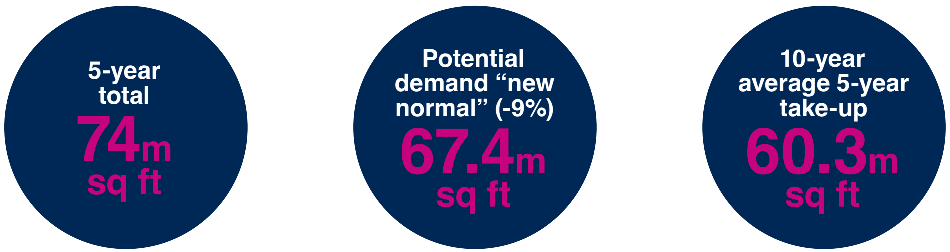
The Central London market has already seen a transition emerging, from location-driven occupier space-takes (where tenants were focused heavily on a particular submarket), to the prioritisation of building quality. The ties that bound certain types of occupiers to specific Central London boundaries have broken down as a result of improving transport links, widened amenity offer (in the East vs the traditionally amenity-rich West) and variations in occupational cost across submarkets. From Q3 2014 to Q4 2021, 57% of all deals greater than 20,000 sq ft have been either: occupiers moving from one Central London market to another; occupiers expanding their footprint without giving up existing buildings; new entrants to the Central London market boundaries; or serviced office operators.

Demand for office space (Figure 5) is driven by both structural demand (the 'churn' of occupier movements due to lease expiry or breaks) and expansionary demand (new demand, driven by jobs growth). These two types of demand combined are expected to total c.74.0m sq ft over the next five years, on average 14.8m sq ft per year, compared to the 10-year average for occupier take-up of 12.1m sq ft per year. When considering a potential 9% drop in demand compared to pre-pandemic levels due to new working from home trends, space-takes are expected to remain above average at approximately 13.5m sq ft per year (total 67.4m sq ft over the 5-year period). Expansionary growth is expected to be led by the professional, business services and creative industries sectors, while banking and finance accounts for a notable proportion of London's structural demand.

Forecasts by CBRE in January 2022 estimates that market take-up will strengthen and remain high relative to 2021 throughout the forecast period to 2026. Total space-takes are expected to rise year-on-year to 2023.

Figure 5: Expectations for demand, Central London offices





Source: CBRE. Expansionary demand assumes 115 sq ft for every new person employed

Forecasts by CBRE in January 2022 expect prime rental growth across all markets and submarkets throughout the forecast period to 2026. In 2022, all markets and submarkets are expected to see prime rents rise or remain stable, with rental growth resuming across all submarkets during 2022. For submarkets that haven't already seen prime rents reach or exceed pre-covid levels in 2021, this is forecast to occur between 2022 and 2023.

Forecasts suggest that during the five-year forecast period, overall growth will remain positive across all markets, demonstrating positive average annual growth rates for the period 2022-2026. By the end of the forecast period in 2026, prime rents in the City are expected to reach £84.00 psf, and prime rents in the West End forecast at £139.00 psf.

Logistics

This analysis focus on London and the wider South East as the two areas combined are regarded as one interrelated wider market for the purposes of the logistics sector.

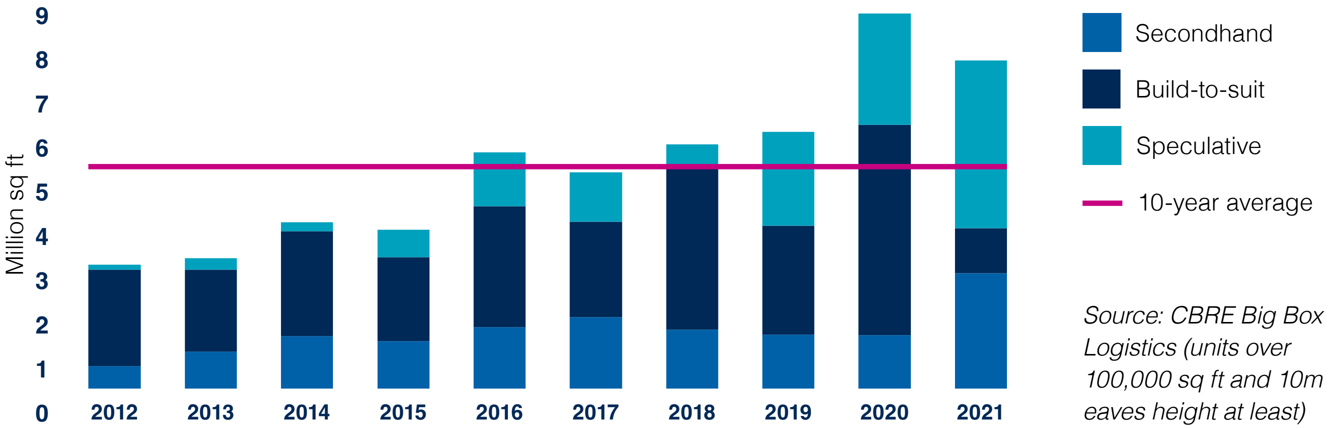
The Covid market

The logistics sector has seen an increase in demand as a result of both Covid and Brexit, with occupiers looking to improve their supply chain's resilience against external shocks. The UK was already the European country with the highest e-commerce penetration (online sales as a percentage of total sales) before the pandemic, but the ratio increased even further, from 19% in Q4 2019 to 32% in Q2 2020, thereby leaping by 5-10 years of e-commerce sales growth. The ratio remained high even after the reopening of non-essential retail.

Urban consumers, such as Londoners, have much to do with the accelerated e-commerce boom and with the race to improve delivery times and expectations. In order to meet these increasing demands, goods need to be stored closer to the capital, creating the main driver for logistics space in London and the South East.

During the second quarter of 2020 – the first full quarter after the outbreak of the pandemic – take-up in the South East and London region for big box logistics units soared to an all-time record high of 4.1m sq ft. This was mainly due to the urgent requirements from online retailers which saw their orders increasing well above their forecasts. In 2021, the South East reached take-up of over 8m sq ft, the majority comprising speculative developments (see Figure 6). Despite being 12.6% down on 2020's take-up level, the region accounted for the third largest portion, 18.9% of the UK's aggregated take-up for 2021.

Figure 6: UK South East Logistics Take-up (including London)



Source: CBRE Big Box Logistics (units over 100,000 sq ft and 10m eaves height at least)

Since the onset of the pandemic, demand has remained robust in the South East but is constrained by the lack of available land and units, which is the main reason for the decrease in take-up and is pushing big box occupiers further up the M1. In 2021, close to half of the space was taken up by retailers both in-store and online (17 deals), with a further 24% from third party logistics distributors, also very often linked with fulfilment of online orders. Other booming sectors were food delivery companies and dark kitchens, which often take smaller, lower quality industrial units as long as they are within inner London areas.

The lack of available industrial land in and around London caused over 75% of all deals closed between Q2 2020 and end of 2021 to be for smaller 'big box' units (those between 100,000 and 300,000 sq ft), a considerably higher percentage than any other UK region. Those limitations in sizes and land availability complicate generating economies of scale inside warehouses and some occupiers have decided to create internal mezzanines to make better use of the available floorspace, or they are locating up north, meaning higher environmental and transportation costs.

The greatest challenge, however, is for units close to London having enough car parking spaces. For the last leg of the e-commerce/business-to-consumer supply chains, most logistics companies use warehouses to exchange from larger trucks into smaller vans to cover the different city-delivery routes. This requires large yards for manoeuvring and plenty of space to park the vans, which means low building-to-site ratios.

Future demand

Available logistics space in the wider South East region has consistently decreased since the peak of 6.5m sq ft at the end of 2018 to the current 2.9m sq ft. There has been an accelerated response from developers speculatively building any suitable site as soon as planning permission is granted, but this is not enough. At the current monthly take-up demand, current available space in the region (including speculative developments under construction), would only last 5 months.

Even more acute is the lack of ready-to-occupy units, those warehouses previously occupied (second hand) or speculative developed and completed, but still vacant. The current vacancy rate in the South East region has compressed to just under 1.8% of the total stock, having been 6.2% at the end of 2019. The rate has more than halved during 2021 alone due to the need of occupiers for immediately operational space. All occupier's logistics expansion plans were disrupted during the pandemic, meaning that gradual acquisitions via built-to-suit schemes are not always quick enough to cover their requests – this is also visible in 2021 take-up (see Figure 6).

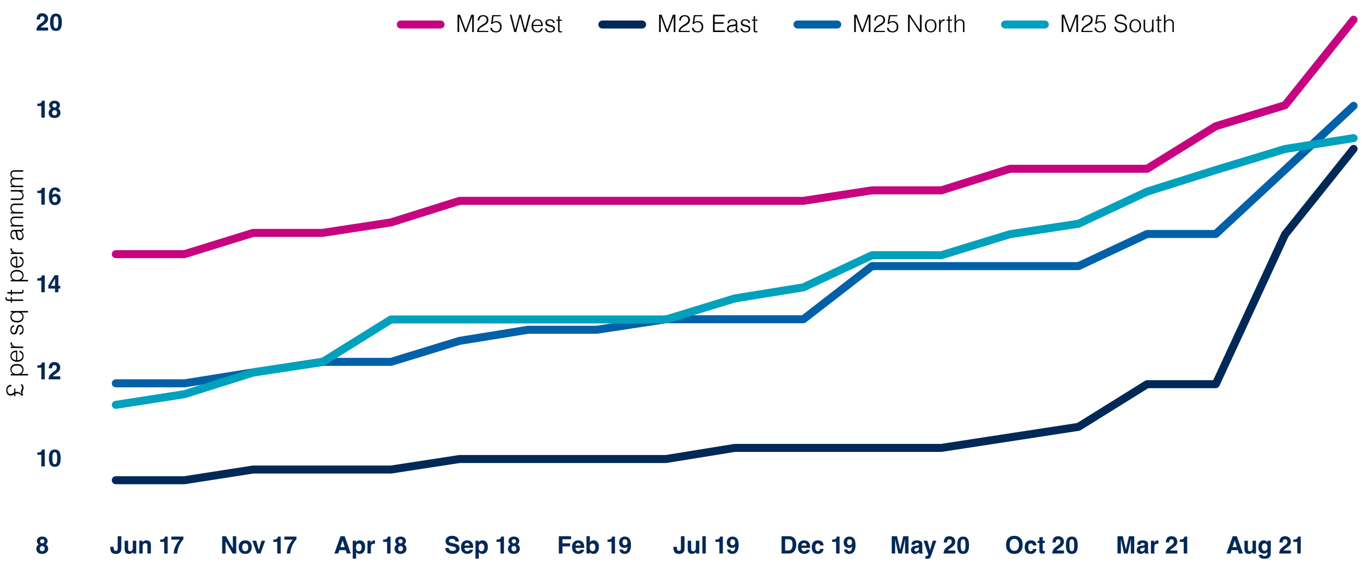
In 2020, CBRE undertook a survey of over 100 of the major warehouse occupiers in Europe to understand how their needs and challenges have changed due to the pandemic. The highlights were:

- 42% of respondents required additional short-term storage as a result of Covid.
- 35% accelerated their transitions to online channels in the last 18 months.
- 27% speeded up their real estate expansion plans as a result of the pandemic.
- 64% of online retailer respondents said expansion in urban locations is a high priority.
- 47% said they will need more flexible storage solutions in the future.
- 33% will restructure their supply chains to improve resilience against external shocks like Covid.
- 25% will require long-term additional facilities to increase safety stocks or to open and expand more distribution channels (online).

The supply/demand imbalance has led to considerable rental growth within the inner M25 markets (see figure 7). The Western side remains the most expensive submarket for big box units, with hotspots like Heathrow and junctions in the M4 and A40 having achieved 33.3% rental growth in the last 4 years. This had a catch-on effect on the other submarkets, with the East recording increases of 78.9%, the North in Enfield of 53.2% and the South achieving 46.8% rental growth in just 4 years, with booming demand in Croydon and its surroundings.

CBRE forecasts prime logistics rents in London will continue increasing over the next five years at an annualised rate of 4.3%, with prices increasing at an even stronger rate in the initial forecasting period. This growth is linked to the continued expansion of online sales and delivery services. Units with less operational restrictions will be even more in demand, and multi-storey developments and underground schemes should become more common in the next few years.

Figure 7: Big Box Logistics Prime Rents Evolution



Turancan Salur, General Manager, Getir UK

Typically, we are seeking to lease warehouse space that is 2,000-3000 sq ft and the pandemic has created opportunities for us to secure such space. Since we started operating in London in January 2021, we have rapidly expanded in the UK and now have over 115 stores (known as gstores) across the UK, over half of which are in London. We like to open our 'gstores' close to areas with high residential populations, which allows us to support economic activity and vitality in local areas. To support our gstores, we have opened a large hub in London that supports our distribution network across the city. We want to contribute to the areas we operate in and breathe life into spaces that may have been left empty, as well as looking after the environment around us. Our delivery fleet to customers is all electric and we have covered over 7 million miles in only 11 months – mostly in London. This means less petrol and diesel cars on the roads, making them cleaner, safer and quieter, which is a great result for London residents. London was chosen as the first city for our international expansion because of its diversity and willingness to try new ideas. Following the success of this launch, we now operate in 20 cities and towns in the UK, as well as 8 other countries (the US, France, Germany, Spain, Italy, Netherlands, Portugal and Turkey).

Beddington Park, Prologis

Retail

This analysis focuses on London but draws in data for the wider UK as well.

The Covid market

The retail real estate market has arguably suffered the most as a result of the pandemic. This sector, above all others, has experienced a dramatic acceleration of trends already present in UK retail prior to the pandemic.

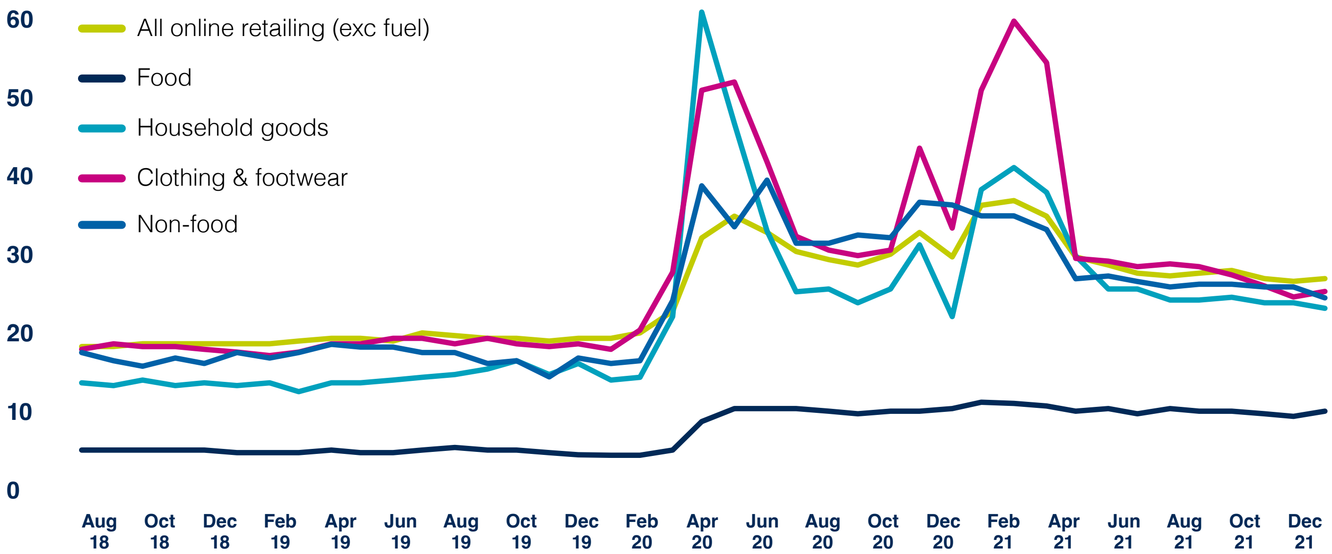
From the start of the pandemic, recurrent restriction periods resulted in Greater London's footfall falling to record lows. Analysis of Global Mobility Data (Figure 8) indicates footfall tumbled to 80% below the baseline value in the initial national lockdown, however this impact was reduced in subsequent lockdowns and restrictions as retailers and consumers were better prepared. In line with footfall reduction, online sales increased significantly across the UK. ONS data (Figure 9) indicates national penetrations pushed above 30% in restriction periods, peaking at 36% in February 2021.

North Audley Street, Grosvenor

Figure 8: Google Mobility Data – 7-day average – Retail and Recreation (% change to baseline value*) in Greater London

*Source: Macrobond, Google Mobility Data; * The baseline is the median value, for the corresponding day of the week, during the five week period 3 Jan – 6 Feb 2020.*

Figure 9: UK online penetration by category (%)*



Source: ONS, December 2021; Value seasonally adjusted, percentage rates.*

While the government's plan B measures dented footfall performance in December 2021, it has already begun to recover. However, reduced numbers of international tourists in the capital remains a constraint, with the GLA estimating that spending in central London by tourists, both domestic and overseas, in 2020 fell by £10.9bn [2]. With a major domestic tourism campaign launched by the Mayor of London in May 2021, there has been a strong focus on attracting UK residents to bolster the market. The recovery period of the international tourism market is less clear, influenced by government policy in response to new variants, such as travel restrictions, and recent changes to the VAT refunds scheme for overseas visitors.

In line with lockdown restrictions easing, the levels of online sales have dropped. Since the re-opening of non-essential retail in April 2021, online sales have remained below the 30% threshold. CBRE anticipates that while levels are likely to pick up again, this growth will be slower compared to the initial surge, and eventually flatten. CBRE's recent ecommerce research highlighted the electrical and clothing and footwear sectors as the most vulnerable to the growth in online sales with subsequent floorspace reduction of these sectors in the short-medium term is anticipated.

Throughout the pandemic there has been a general absence of market activity, with many central London streets seeing an increase in vacancy rates since the start of the pandemic. According to the Local Data Company, the Greater London retail vacancy rate now stands at 10.3%. As a result, in some locations rental levels have been challenged and/or incentive packages have increased.

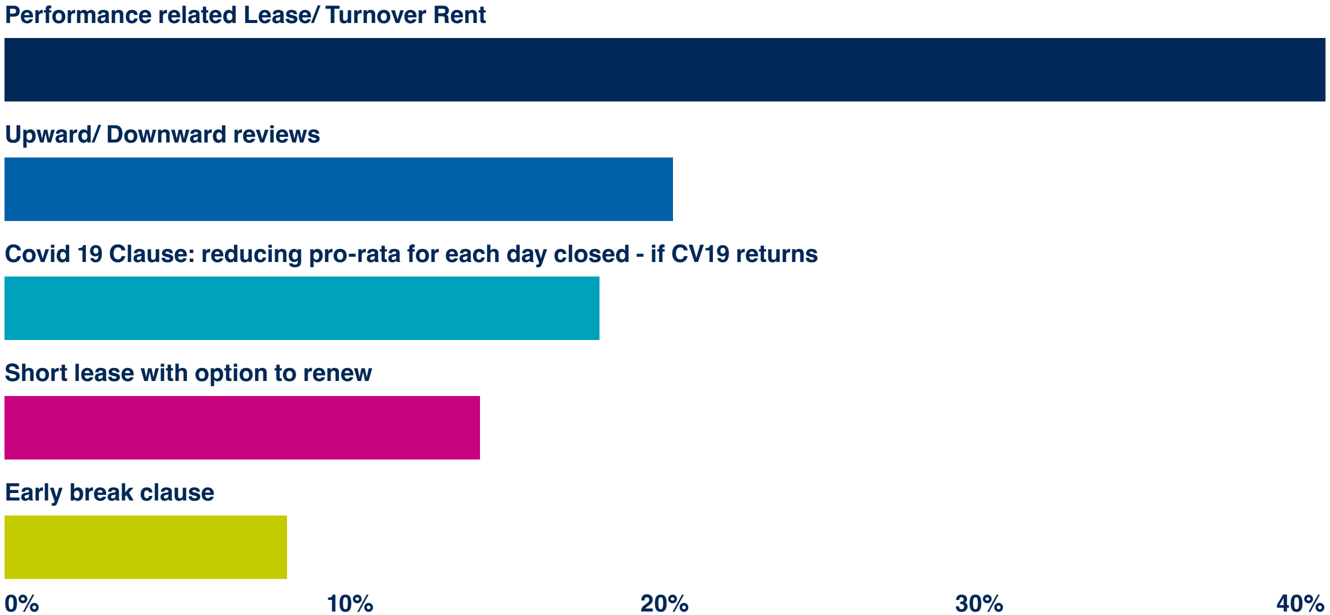
2 *Lost worker vs. tourism expenditure in the Central Activities Zone (CAZ), GLA Economics: October 2020.*

In June 2020, CBRE interviewed 80 UK occupiers, with 40% considering turnover rents as the most important factor for future leases (Figure 10). Throughout this challenging period landlords and tenants have been working closely to preserve occupation and vibrancy of locations where possible.

In many cases, space take up has been driven by the restructuring of existing portfolios, with occupiers seeking out previously unattainable locations and better suited units in opportunistic relocations. However, there have also been new entrants to the market, including brands that had previously operated solely online, or in a wholesale format.

Additionally, as restrictions ease and with pent-up demand for social interaction, the London restaurant and leisure property market has experienced a good level of demand. In Q4 2021, CBRE recorded 534,000 sq ft of leasing requirements for central London, with 69% of these requirements from food & beverage and leisure operators. Two main drivers for activity are a consolidation from the larger organisations and a rise of independents occupying the vacuum left by medium sized businesses who have fallen victim to the harsh economic environment of the pandemic. Locations with good public realm and outdoor space, as well as fitted sites are particularly attractive in the current market.

Figure 10: Retail Survey - Going forward, which of the following would you most like to see in new leases



Source: CBRE Research, UK Retail Flash Survey June 2020

Future demand

Whilst there is clear demand for physical stores in the right location amongst occupiers, as online penetrations continue to grow, it is anticipated that there will be a reduction in the retail floorspace required. CBRE estimate that the volume of retail floorspace in the UK will need to decrease by 16% to reach the average sales densities of 2015-2020. Key sectors identified by CBRE as the most resilient to market forces include health and beauty, food and beverage and groceries. Repurposed retail space presents opportunities for both the more obvious customer-facing uses such as residential, hotels and workspaces, as well as back-office operational uses including last mile logistics and dark kitchens. Although redevelopment costs must be carefully considered in these scenarios.

Subject to continued easing of covid restrictions, there is reason to believe that rental conditions in key locations will rebound in 2022. CBRE's Retail Resilience paper, published in 2019, highlighted London as one of the most resilient locations in the country. The drivers established in this paper attributed resilience to factors such as the presence of tourism, an affluent local population and university students. Whilst both the tourism and student market have been impacted by the pandemic, these market fundamentals remain, and numbers are expected to return. However, the growing partnership between landlords and occupiers will be crucial to navigate the rapidly evolving retail landscape particularly on issues such as the restructuring of business rates valuation.

Post-pandemic, the retail sector still has a range of wider market trends to contend with. However, significant opportunity remains in certain locations - London has strong market fundamentals which bolster its resilience credentials. Despite challenging trading conditions, in CBRE's study of Company Voluntary Agreement outcomes Central London performs well when compared to the UK average. The capital has seen a smaller proportion of stores closed, and a greater proportion of stores retained.

Luke Holland, Head of Central London Retail CBRE

We are seeing a surge in requirements and increased take up of key store space across Central London with landlords becoming more open to base and turnover leases, resulting in more of a partnership approach with occupiers. Resultantly, we have seen a positive start to 2022 as occupiers continue to search for flexible lease structures and fewer, but more dominant stores.

Jace Tyrrell, Chief Executive and Alice Murphy, Head of Partnerships, Property, New West End Company

There is a surplus of retail space not only in the West End but across the capital as well, and clearly this has placed a downward pressure on rents in some areas. The pandemic has continued the shift towards online shopping, and this is having a knock on effect on how retailers are utilising their physical space. Businesses are going to need to maximise the space they currently have – seeking more value from it and higher intensity of use. It's likely that the New West End Company area will see more health and lifestyle uses at ground floor level. Many of our retailers are turning their shops into an immersive experience to showcase their products and strengthen brand loyalty. These stores are a global shop window which is why it's so important that the West End is able to welcome back large numbers of international tourists as soon as possible. Flexibility of use to help existing and new retailers adapt to the changing nature of the market will be really important in the future.

4 Industry perspectives

Having outlined how the market has fared during the pandemic and set out forecasts for how it will perform in the future, how are developers responding? We asked some of the capital's leading developers and asset owners how they see the future of the commercial property market and how their strategy and plans have changed in response to the pandemic.

Claire Barber
Asset Management Director
Cadogan Estate

Chelsea has recovered more quickly from the pandemic, due to two main factors – the strong residential catchment which provides a significant consumer base for both the retail and office markets, meaning there is comparatively less reliance on tourism. The other is Cadogan's extensive ownership and curation of the area which has aided resilience. There is a focus on independent brands and community uses, neighbourhood retailing such as the butchers, cheesemongers and cafes with al fresco dining, complemented by destination retail and continual animation through marketing events and initiatives. Customer experience, aesthetic and the ease of luxury shopping is important for the area. Similarly, there is an attraction to working in an office in the local area, where vacancy is low. The final stage of recovery for the Estate will be the return of international tourists, particularly for Sloane Street. Going forward there will be continued focus on curation of the area including the public realm, to keep it vibrant and diverse.

Richard Smart
Manging Director
London CBRE

London continues to hold its allure for occupiers, which has been reflected in the strong uptick in the leasing market at the end of Q4 2021. The trend towards occupiers seeking the best quality and amenity rich space is holding strong as businesses seek to magnetise the office. Pressure remains on the property sector to take action and actively decarbonise the built environment, which many businesses are building into their ESG strategies. For the retail sector there are encouraging signs of recovery in the market as footfall continues to improve, however London's shopping streets will need to work hard to reinvent themselves to keep up with consumer demands and changing retail habits.

Mare Street Studios, Workspace

Daniel Dawe
Director of Investment
Delancey

We see opportunities to create value in the London office market, which is in a state of accelerated change following the pandemic. The occupational and investment markets are characterised by a flight to quality (sustainability, wellness, amenity, connectivity, and customer service), responding to factors such as the war for talent, an increasing prevalence of hybrid working and heightened pressure to tackle climate change. Factors which we think may lead to a two-tier market. Build to core refurbishment projects are therefore an interesting proposition. Such projects will need to have ESG in mind and deliver low-carbon solutions with better airflow and have employee wellness at their heart. A green, flexible, collaborative and amenity rich workplace will increasingly be a factor in helping to attract employees back to the office and support recruitment and retention. Repositioning offices in this way is costly however and faces inflationary headwinds and many secondary offices will lack the fundamentals enabling them to be repositioned at today's values. If there is a glut of secondary stock left empty, planning rules will need to adapt to help bring these assets back into use. We also see opportunities for high street retail in London. While, at a macro level, there is too much floorspace and not enough demand, in the right locations where rents look broadly stable, there are opportunities to acquire at sensible pricing.

Paul Williams

Chief Executive
Derwent London

We are seeing an acceleration of the polarisation of the office market with a flight to quality, particularly for net zero carbon buildings. Whilst office occupation is still currently below pre-pandemic levels, we are seeing occupiers reconfigure and plan for peak occupation rather than shed space. Of our top 50 tenants questioned in July 2021, over 80% expect to maintain or increase headcount in the next 6 – 12 months which is an increase from 55% a year ago. Occupiers are less wedded to specific locations and their space requirements are being driven by an employee up rather than management down approach – a war for talent. The days of the a 'let and forget' relationship between landlord and tenant are long dead, and closer relationships with our customers are imperative. We are looking to provide more long-life, loose fit, low energy buildings that are adaptable; all driven by the broader challenge of addressing the climate emergency. The pandemic has increased our move towards net zero carbon and in turn given us a greater focus on providing 'intelligent', tech-enabled buildings – 55% of our portfolio will be 'intelligent' by 2023 – that are all electric, provide natural ventilation and designed with wellness in mind. The retail aspect within many buildings remains important as an amenity for occupiers, and its performance will be supported across a mix of uses. We will retain our bigger, greener buildings for longer and may sell secondary stock where the opportunity to refurbish to a significantly improved specification is harder to achieve.

Paul O'Grady

Location Director, Belgravia
Grosvenor

Although the office market initially fell off a cliff, the rebound has been strong, and things are settling with micro-markets emerging and performing differently. Lots of businesses are contemplating their space requirements and for developers and asset owners, it will be about finding the right product and contract to meet these needs and being able to offer customer-centric and flexible terms and solutions. We are seeing a similar picture in the retail sector in terms of different parts of our estate being impacted in different ways depending on location. Belgravia, for example, remained buoyant throughout as it has a more domestic customer base and neighbourhood tenant mix, whereas areas more dependent on international tourism have gone through a more challenging period. Rental trends are variable but there have been increases in some areas which is perhaps not what you would expect given the wider circumstances. The key thing for us has been to offer pro-active, bespoke support to our tenants whether that has been through rental concessions, increased marketing, extending the eat out to help out offer, or, in some instances, directly investing in their business. The pandemic has accelerated existing market trends and is quickly shifting the relationship between landlord and tenants from a vertical to horizontal relationship. What tenants want from both office and retail space seem to be converging – a flexible, tailored, customer orientated service that is also hitting all the ESG credentials.

Robin Dobson

Director of UK Development &
Project Management, Hammerson

The trends we are seeing in London are also present in other cities in the UK. In London, we are looking at the future through three large schemes: Bishopsgate Goodsyard, Brent Cross and Centrale & Whitgift in Croydon. In terms of the office market, there is already a lack of high-quality stock in the market which is helping to accentuate a flight to quality and a shift away from secondary stock where you can't achieve the benefits delivered by new development in terms of wellness and sustainability. Occupiers are having to readjust to an employee-led approach to the space they occupy with businesses increasingly thinking about how they can attract people back to the office. While being located in the capital will be important, there will be a loosening of the ties to traditional business neighbourhoods. For retail, there is huge consolidation going on and it appears to be the end for huge monolithic developments. The future of the sector lies in mixed-use schemes supported by good infrastructure where more complimentary uses can be introduced to support traditional retail. It's about creating interesting places with interactive formats.

Matthew Bonning-Snook
Property Director
Helical

The future of the office is a spacious, flexible, high-quality, smart and sustainable building that is amenity rich with outdoor space and a focus on health and wellbeing. A building that matches and can also adapt to the occupier's developing aspirations and brand. The emphasis placed by occupiers on sustainability is now equally matched by investors – there is clearly a green premium in the office sector and a brown discount. Transport infrastructure will continue to play an important role in where businesses want to locate, for example, we are yet to see the full impact of Crossrail which will help to create even more accessibility and influence location choice. In the light of the pandemic, we will be more selective about what we develop – it will only be of the highest quality. A broader challenge for the City of London will be how it deals with obsolescent offices which cannot be adapted to meet modern demand; while change of use to residential does offer a way forward, it must be done is in organised way – a pepper potting of residential may restrict future growth.

Oliver Knight
Head of Offices & Myo
Landsec

The pandemic has accelerated the trends that were already present in the office sector. We have given a lot of thought about what an office is for and what a business wants from their space. For Landsec, it's about three principles: partnership – delivering the right solutions for our customers over time; experience – providing a high-quality experience for individuals and guests through tailored services and access to a range of amenities; and sustainability – a strong focus on health, wellbeing and, aligning our 2030 NZC ambitions with those of many of our customers. We have honed our office product range to cater for these principles and to meet evolving customer needs. We will continue to build the traditional large HQ providing a blank canvas for companies to fit out and pay rent on a quarterly basis. However, we now also cater for small requirements through Myo, our flex office business which provides space for 10-150 people on flexible leases with a range of services included in the monthly rent as well as amenities such as meeting rooms to serve all our customers. And we have Customised, a turnkey solution with the option of managed services, aimed at the middle customer set of 50-200 people which will have many of the features of Myo, but in a self-contained space. We are accelerating our shift to being an operational, customer service orientated business. A good example of this is 'Dashwood' in the City of London, near Liverpool Street, where we have delivered all three of our office products in one building providing a range of choices for customers from short to long term leases and zero hassle fully serviced to self-delivered.

Tomoo Nakamura
Managing Director
Mitsui Fudosan UK

Despite the twin challenges of Brexit and the pandemic, London has not lost its status and will continue to be a strong global city and financial centre. There will be more demand for high-quality, sustainable office space and we expect to see rental inflation in buildings that have strong ESG credentials. There is evidence already emerging of a two-tier, post-Covid office market, with competition for the best space and conversely an accelerated risk of obsolescence for older, less desirable buildings. We are therefore positive about the development prospects in London and want to do more; we have always been selective in the opportunities we pursue, and this will be even more the case in the future with a focus on good infrastructure and best in class amenities. The long term impact of the pandemic is yet to fully play out, but we expect sectors including tech and life sciences to emerge as winners and we will seek to deliver office accommodation that meet the needs of these businesses and their evolving occupational needs.

Tom Knight
Portfolio Director
Portman Estate

There was an undersupply of Grade A office space in the West End going into the pandemic and as we come out the other side, there is a clear flight to quality. As a result, the current demand for Grade A stock (with strong ESG credentials) has remained robust. A new approach is however required for secondary office stock, and we are considering a turnkey solution across certain sections of our portfolio, with the Estate picking up refurbishment costs and providing an all-inclusive service. In a couple of our newly developed office buildings, we are turning the top floor into hospitality experiences and this approach could become increasingly prevalent. The retail market is challenging in general, and we have worked closely with our boutique retailers to help maintain occupancy levels. It is pleasing to see the return of office workers in greater numbers since September 2021 along with domestic travellers and more recently the return of international visitors, which is bringing growing numbers of visitors to Central London. In parts of our estate, such as Baker Street and Edgware Road, we are proactively seeking to create new retail destinations to help improve the retail mix of the area.

Paul Weston
Senior Vice President
Regional Head UK, Prologis

Rents in the logistics sector have grown considerably during the pandemic. In London, prices have been fuelled by a lack of land supply in general and specifically the historic loss of industrial land to other uses such as housing which has exacerbated the problem further. When you throw into the mix the challenges of securing industrial and logistic uses through the planning system, this is creating difficulties for the sector to expand to meet demand. There is a lot of heat in the market which is likely to remain well into 2022. We have invested £500m into London over the past few years largely through acquiring assets capable of repurposing and it looks like the capital's logistics needs will have to increasingly be met through intensification of sites including multi-level development. Politicians need to develop a better understanding of the vital role the sector plays and ensure there is a joined-up approach between housing growth and the need for more industrial and logistics space – given the nature of our economy you can't have the former without the latter. This may require some bold thinking such as supporting logistics development on poor-quality greenbelt land.

Alan Holland
Managing Director
Greater London, SEGRO

While many of the current features of the warehouse and industrial market have been present for some time, two big themes that will drive the future market are consumer habits and wellness and amenity. Consumers have a thirst for on-demand services, and this has made its way into the retail sector helping to fuel ever expanding logistics requirements to meet demand. In terms of the type of space occupiers want, buildings that are designed with wellness in mind and that are providing high-quality amenities are top of the list which historically has not always been the case in the logistics sector. The pandemic has definitely shifted occupiers' expectations about the type of space they want and increasingly brought into the market a more diverse range of customers such as the digital and creative industries. SEGRO's aim is to provide customers with an end-to-end service from big space outside of London to something around the M25 all the way through to last mile logistics space in inner London.

David McArthur
Head of Investment
The Howard de Walden Estate

Overall, the estate's prime location, as well as the diversity across our portfolio, means that we have fared better than most over the last year. Our healthcare portfolio has performed especially well, with an increase in rental and investment value – perhaps unsurprising given its counter-cyclical nature. Our retail and leisure portfolio, meanwhile, was significantly impacted by the multiple lockdowns. However, it is now performing well with a host of new retail and restaurant signings since January 2021. We worked closely with our occupiers to support them during Covid-19, offering support in varying forms. While retail constitutes only 15% of our portfolio, it plays a vital role in placemaking and underpins our other sectors. Our strategy remains focused on occupier mix to ensure Marylebone Village remains a coveted place for years to come. Our grade A office space has performed well. Demand from occupiers for best-in-class space remains strong and we have secured a number of new lets since the pandemic hit. We are also creating flexible, plug and play opportunities and offering shorter, all-inclusive leases to ensure our offices complement hybrid working models. Looking forward, we are focused on delivering quality and maintaining diversity across our portfolio. We're confident in the long-term outlook of the Estate.

Martyn Evans
Creative Director
U+I

Our commercial office spaces are typically part of genuinely mixed-use developments, often partnerships with public sector bodies that create places where people can live, work and play. We want our developments to become ecosystems with amenities onsite and buildings that have a strong focus on wellbeing and sustainability - not just a narrow definition that focuses on net zero carbon rather one that focuses on providing a broader, sustainable place. We think that demand for mixed-use destinations and placemaking will lead future development, and mono-cultural property development will become less common. A flexible product will be key not just in in terms of how the floorspace is arranged but also in terms of uses in a building. Increasingly buildings will be flexible shells and must have the dexterity to move from being an office to a laboratory and back again. We have a small ground floor retail portfolio in areas such as Deptford, Canning Town, Bromley and Hillingdon. Pre-Covid the focus for this space was convenience retail, but post-Covid given the local vibrancy in these areas due to hybrid working, it opens up the potential for a more diverse type of occupier and the renewed success of town centres.

Graham Clemett
Chief Executive
Workspace Group

Demand for our product is strong with both enquires up and occupancy increasing – utilisation of space is now reaching 60% per cent compared to 20% earlier in 2021. Our aim is to double our presence in London which is based on the belief that there are a broad and growing range of SMEs looking for the type of space we can provide and the flexibility we offer. In recent months we have seen demand coming from a very broad range of sectors such as e-commerce, film and television and the tech industry. Our focus has traditionally been on more central London locations, however, we are seeing more opportunities slightly further afield in middle to outer London in emerging areas such as Bow and Deptford. Generally, mindsets have become more accepting and attracted by the benefits of flexible space as a result of the pandemic. We aren't making any significant operational changes to the business as a result of Covid, but it has re-emphasised the importance of being located in areas of good accessibility and the need to engage with local communities and take account of the wider social and sustainability agenda.

5 Implications for public policy

London's commercial property market is going through a period of change, as shown by the industry perspectives in the previous section. In some instances, the long-term trends and broader shifts in society had already sown the seeds of what we are now witnessing, and the pandemic has simply accelerated it, but in others, the pandemic has kick-started a transformation. The challenge for London is how to harness these changes in the commercial property market to help support economic growth.

In the short term, the commercial property sector has had to, and may have to continue to, deal with the impact of a lack of footfall and drop in office occupancy in Central London driven by both domestic and internal restrictions, which due to the nature of the pandemic, are often introduced at short notice. It is therefore important that at appropriate times action is taken to attract commuters and visitors, including international tourists, back to the capital through marketing London at home and abroad. And that London's public transport network – the heartbeat of the capital – receives sufficient investment to keep the city moving now and in the future.

In the medium to long term, while market forces will direct much of what happens, there is a role for public policy to navigate, ease and indeed direct change to support London's economic recovery. Across the three sectors this report covers, there are some emerging implications for public policy as set out below.

Premier Park, SEGRO

Office

The growth of working from home will not spell the end of the office. Indeed, the demand for high-quality office space in Central London remains high and space taken over the medium term is predicated to exceed the recent average. But with this flight to quality comes the potential obsolescence of secondary office space if it cannot easily be refurbished or re-purposed. A flexible approach is therefore required, particularly in relation to planning policy and property taxes, to support this secondary stock from remaining empty. New tax incentives may be required to encourage the extensive retro-fitting of such office stock to meet the ever-increasing sustainability requirements which will require significant investment to achieve. This must, however, be balanced with the need to plan for change. Pepper potting of residential uses in commercial districts will not only make for unhappy neighbours but could also undermine the agglomeration benefits of businesses locating in the city.

Mare Street Studios external, Workspace

Logistics

As has been apparent for a while, London and the wider South East is going to have to think imaginatively about how it provides sufficient land to meet the demand for logistics space. On the one hand, London planning policy has shown welcome innovation in recent times, seeking to encourage co-location with industrial uses and supporting intensification of sites. But on the other hand, there is still more to do in terms of local areas embracing last mile delivery uses on or near the high street, and at the other end of the size spectrum, an ostrich like approach to contemplating land swaps in the green belt to accommodate industrial and logistics use on the edge of the capital. While the political focus in London and nationally is rightly centred on increasingly housing supply, this cannot be done in a silo. Every new home is another customer for an online delivery which can only be supported by a 21st century industrial and logistics network. The pause in the government's planning reform proposals provide an opportunity for it to consider how it can better align its ambitions for housing growth with the need to support industrial and logistical growth. And at a London level, there is scope for the GLA to provide city-wide leadership and strategy relating to freight, servicing and deliveries (FSD) through both the creation of a FSD 'Czar', producing a single integrated FSD strategy in London and implementing this, where relevant, in the London Plan[2].

2 *For more information see, For the goods of the city, A new approach to freight, servicing and delivers traffic, London First: July 2021.*

Retail

Out of the three sectors analysed in this report, retail faces the biggest challenges. In the right locations, the evidence suggests new or existing retail space will flourish. And for London's great estates and long-term asset owners/ investors, retail will continue to be a key part of their wider curation of an area, the glue that binds other uses, such as office space, together into a place. The creation of Use Class E, bringing together a range of commercial uses, was a welcome change that has already supported the transition for many ground floor retail units in London. It is the bigger and more fundamental change that both planning and town centre policies will need to address next such as the re-purposing of shopping centres and wholesale changes to some struggling high streets. Here, a range of changes to public policy are required. For example, the GLA or relevant local authority setting up Meanwhile Use Registers for start-ups and SMEs to help maintain the vibrancy of high streets. And to aid bigger interventions, the GLA providing boroughs with access to its Compulsory Purchase Order and land assembly expertise[3].

North Audley Street, Grosvenor

3 For more information see, Planning Manifesto for High Streets and Town Centres, London First: January 2020.

Our mission is to make London the best city in the world in which to do business.

London First was set up by business leaders with the belief that by harnessing business assets we can drive positive change. We operate as a business campaigning force, with over 175 members, and are uniquely placed to champion the city:

- We've done it before: back in the 1990s, London's prospects looked bleak. Business leaders came together to lead when others wouldn't;
- We've achieved a lot: over the past three decades, we've campaigned for the creation of the office of London Mayor and Transport for London, for Crossrail, for congestion charging and for expansion at Heathrow; we incubated Teach First and created the UK's largest annual jobs and careers fair for school leavers, Skills London;
- We give London's employers a powerful voice, prioritising the critical interventions needed to keep our capital competitive and connecting with allies to create solutions that help our country succeed as one.

Now, we're stepping up once again. With our members – and the millions of people they employ in the UK – we are pursuing an agenda that will keep London at the forefront of global business, working with and for the whole UK.

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