

midtown

Bloomsbury Covent Garden Holborn / Kingsway King's Cross

New shape to the market. **Mindshare's** letting of over 78,000 sq ft at **Legal & General** and **Mitsubishi's Central Saint Giles, WC2**, was the largest deal on new space in Q4. Ground floor retail units are similarly letting well.

Farebrother let 27,776 sq ft on behalf of Ignis at
85 Gray's Inn Road, WC1, to **WB Bidco plc**,
a company formed at the direction of Warner Bros.
Entertainment Inc. and Shed Media.





Julian Hind

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Falling supply, stable take-up and increased demand will lead to pre-lettings and rental growth

The performance of the Midtown office market in 2010 was stronger than we expected and provides a platform for market improvements in 2011. 2010 was a year of 'two halves'. In the first half, take-up was 20% below average and supply had increased to peak at 3.2 million sq ft, an availability rate of 9.4%, by the end of the 2nd Quarter. In the second half, however, take-up was 16% above average and supply was cut back to 2.75 million sq ft by the 4th Quarter, an availability rate of 7.9%. Speculative construction contracted sharply during the year by 58% to just 323,000 sq ft in four developments, all of which will be completed by the end of the 3rd Quarter 2011. Investment also increased by 58% in 2010 to £1.25 billion, with prime initial yields tightening from 6% to 5.50%.

Active occupier demand for Midtown offices increased substantially in 2010, rising by 84% to 3.5 million sq ft. Demand from the media sector is greater than any other, totalling a quarter of all requirements by square footage. By the end of the year, media companies' share of take-up reached 42%, underlining Midtown's continuing occupier diversity. One of the other significant market features of demand in 2010 was the re-emergence of City occupiers. By the end of 2010, City-based occupiers were looking for over 700,000 sq ft of space, greater than demand from West End occupiers - just less than 600,000 sq ft. Existing Midtown occupiers though continue to have the largest chunk of total requirements, currently 1.16 million sq ft in all.

In 2011 we will see rental growth for the best quality space as a result of very low supply. At the end of 2010 the availability rate was 7.9%. When the availability rate dips below 8%, net effective rents start to rise. Our projection for the end of 2011 is an availability rate of around 6.9% as supply falls and take-up is sustained. The lack of 'multiple choices' for occupiers will also see a return to pre-letting, heralded by Bain & Company's acquisition of 92,000 sq ft at the planned refurbishment of 40 Strand, WC2, in the 4th Quarter 2010.

The hiatus in construction activity has provided a window for developers to revise planning consents to achieve configurations that better suit current occupier requirements. David Murray's Premier Property Group's Plumtree Court, EC4, is a good example. Consent for refurbishment and extension of the existing building has been superseded by a new 320,000 sq ft scheme which will be determined shortly. A key issue for all new schemes will be their ability to meet occupiers' growing environmental criteria, including Carbon Reduction Commitment, Energy Performance Certification and BREEAM Rating, as well as providing low total occupancy costs.

Take-up

Proactive Asset Management and differentiated marketing is essential

In 2010, take-up reached 1.9 million sq ft, a healthy increase of 11% on 2009 (Figure 1). Take-up increased during the year with 1.2 million sq ft let in the second half. Our projection for 2010 total take-up of 1.65 million sq ft was exceeded by 17%, driven by strong asset management plays and more innovative marketing on good quality buildings. Obsolete stock is sticking and will continue to do so, providing much-needed sites for new schemes.

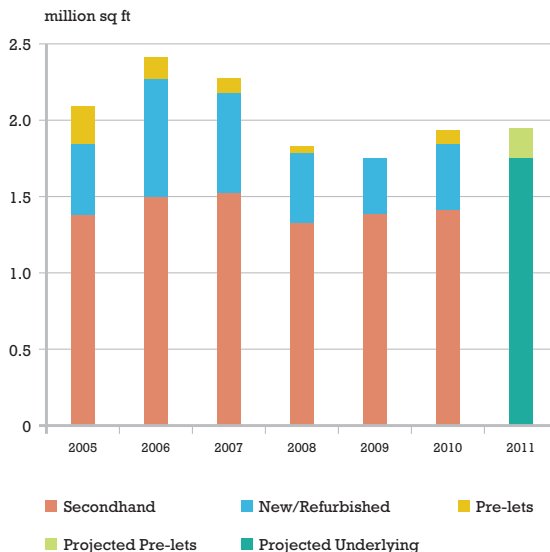
Pre-letting returned to the Midtown market in 2010 after an absence of two years (see Lettings Table). In the 4th Quarter, management consultancy Bain & Company committed to a 15 year lease at 40 Strand, WC2. Bain & Company currently occupy half the building but, following the relocation of the other tenant Mindshare to Central Saint Giles, WC2, it has agreed to lease 92,000 sq ft in a refurbishment from Land Securities. We believe the deal is the first in a string of pre-lettings that will support the market.

Take-up of new and refurbished space in 2010 totalled 438,000 sq ft (excluding the pre-let), an increase of 17% on 2009. In the 4th Quarter, new and refurbished take-up was 16% higher than in the 3rd Quarter, led by the completion of the first lettings at Legal & General and Mitsubishi's Central Saint Giles, St Giles High Street, WC2, including 78,453 sq ft to Mindshare. Midtown has an increasingly diverse occupier market, augmented by growth in demand from media sectors in particular.

Take-up of secondhand space increased only marginally for the second successive year in 2010, an increase of 2% to 1.4 million sq ft. In the 4th Quarter, secondhand take-up fell 3% to 412,000 sq ft, but was at a higher level than the six-year average of 355,000 sq ft per quarter.

In 2011 we expect Midtown take-up will be maintained at a similar level to that in 2009 and project total take-up of 1.95 million sq ft. Given the very limited choice of new and refurbished space, we believe 200,000 sq ft will be in pre-lets.

Figure 1: Annual Office Take-up 2005-2011



Source: **Farebrother**

Selected office lettings in Midtown

Occupier	Address	Grade	Sq ft	Reported Rent £psf
Bain & Company	40 Strand, WC2	Refurbished (Pre-let)	92,000	Conf.
Mindshare	Central Saint Giles, 1-13 St Giles High Street, WC2	New	78,453	Conf.
Seven Publishing	3-7 Herbal Hill, EC1	Secondhand (Grade A)	31,660	20.00
WB Bidco plc	85 Gray's Inn Road, WC1	Secondhand (Grade A)	27,776	26.86
London School of Business & Finance	New Court, 48 Carey Street, WC2	Secondhand (Grade B)	26,615	Conf.
Specific Media	Central Saint Giles, 1-13 St Giles High Street, WC2	New	25,291	Conf.
Bloomsbury Publishing	49-51 Bedford Square, WC1	Secondhand (Grade B)	23,480	26.80
Morgan McKinley Associates Ltd	Centrium, 2-18 Kingsway, WC2	Secondhand (Grade A)	18,652	43.00
Undisclosed	200 Gray's Inn Road, WC1 (5th floor rear)	Secondhand (Grade A)	18,576	35.00
Irwin Mitchell Solicitors	40 Holborn Viaduct, EC1	New	12,300	51.00
Amec Group Ltd	Lynton House, 7-12 Tavistock Square, WC1	Refurbished	10,500	38.00
St Ives plc	1 Tudor Street, EC4 16 Great Queen Street, WC2	New	10,136	42.00
New York University (London)	4-5 Bedford Square, WC1	Secondhand (Grade B)	9,637	34.00
Rosetta Stone	Procter House, 1 Procter Street, WC1	Secondhand (Grade A)	8,371	24.00
Company Pictures Ltd	New London House, 172 Drury Lane, WC2	Secondhand (Grade B)	7,800	26.50
The Foundry Ltd	The Communications Building, 48 Leicester Square, WC2	Secondhand (Grade B)	7,237	21.75
Bestseller United (UK) Ltd	46 Bedford Square, WC1	Secondhand (Grade B)	7,169	5.6m (Freehold)
Northrop Grumman Corporation International Ltd	Clareville House, 47 Whitcomb Street, WC2	Refurbished	7,007	37.50

Source: **Farebrother**

Availability

Lack of choice and few starts will drive rental growth

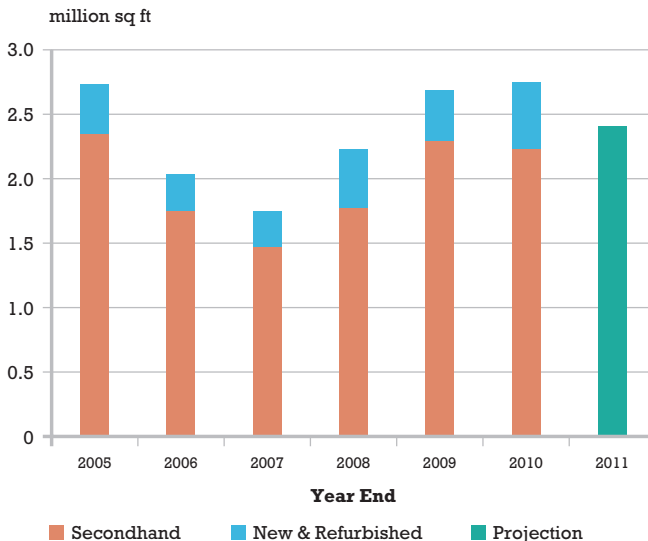
After two years of growth in office supply in 2008 and 2009, during which there was an aggregate increase of 55%, availability increased by only 2% in 2010 to 2.75 million sq ft (Figure 2). With an increase in Midtown stock during 2010 of 500,000 sq ft from 34.1 to 34.6 million sq ft, due to the completion of Central Saint Giles in particular, the availability rate, year-on-year, did in fact remain unchanged at 7.9%.

Our projection made at the end of 2009 was for supply to increase by 12% to 3 million sq ft during 2010. Supply peaked in the 2nd Quarter at a cyclical high of 3.2 million sq ft, a 9.4% availability rate. Subsequently, in just six months, availability fell by 15% due to strong take-up and some significant withdrawals, accelerating absorption of supply.

New and refurbished supply increased by 33% during 2010 from 390,000 sq ft to 520,000 sq ft. As with overall availability, however, new and refurbished supply peaked in the 2nd Quarter at 700,000 sq ft following the completion of 387,000 sq ft at Central Saint Giles and has since fallen by 25%. Central Saint Giles accounted for 55% of all new and refurbished space on the Midtown market. Elsewhere, new and refurbished supply is low and choice for tenants restricted, with just 3,000 sq ft in WC1, 15,000 sq ft in EC1 and 105,000 sq ft in EC4.

Available secondhand space fell just 3% in 2010 from 2.3 million sq ft to 2.2 million sq ft, peaking at 2.5 million sq ft in the 2nd Quarter. Available Grade A secondhand space fell 16% while supply of Grade B space increased by 18%. Our overall projection for the end of 2011 is for a reduction in supply of 12% to 2.4 million sq ft as a result of sustained take-up and just 323,000 sq ft of new and refurbished space coming onto the market.

Figure 2: Annual Office Availability 2005-2011



Source: **Farebrother**

Future supply

Speculative construction down 58% to 323,000 sq ft in just four developments in 2010

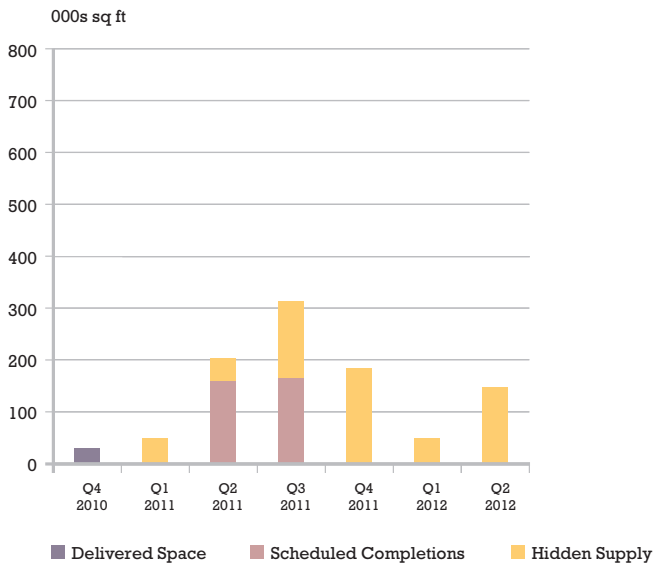
During 2010 construction activity in Midtown was low, as it was in 2009, when work on only 39,000 sq ft began. In 2010, starts were made on 229,000 sq ft of speculative space in a handful of schemes, but as square footage in completions outweighed starts, the pipeline remains nowhere near big enough. The level of speculative space under construction at the end of 2010 was down 58% from 776,000 sq ft to 323,000 sq ft.

Completions of space under construction at the end of the 4th Quarter are concentrated in the 2nd and 3rd Quarters of 2011 (Figure 3). There was only one start in the 4th Quarter, the refurbishment of 33,000 sq ft at 10 Fetter Lane, EC4, due for completion in the 2nd Quarter 2011. Also in the 2nd Quarter are the completions of 105,000 sq ft of brand new space behind a retained façade at UK & European's 1 Kingsway, WC2, and GMS's 22,500 sq ft refurbishment of Conquest House, 37-38 John Street, WC1. In the 3rd Quarter, Prudential is scheduled to complete its refurbishment of 163,000 sq ft at 2 Waterhouse Square, EC1.

Even taking into account prospective starts, including new buildings such as 12-14 New Fetter Lane, EC4, major refurbishments such as Africa House, 64-78 Kingsway, WC2 and refurbishments outside planning such as 150 Holborn, EC1, there will be an absence in the market of new and refurbished space throughout 2011 and 2012. Large new and refurbished schemes can take 18 to 24 months to complete, there is therefore an opportunity to deliver smaller, quicker refurbishments to meet demand. The scheme at 10 Fetter Lane is a good example.

Figure 3 also illustrates hidden supply of 600,000 sq ft in 15 buildings expected to be released over the eighteen months to the 2nd Quarter 2012, primarily as a result of lease events and occupier relocation. A proportion of this space is likely to be refurbished to meet occupier demand and will help drive up rents.

Figure 3: Future Supply 2010-2012



Source: **Farebrother**

Investment



Alastair Hilton



Universities Superannuation Scheme's purchase of **7 Savoy Court, WC2**, for £45.4 million, reflecting a yield of 6.25% was the largest transaction in Q4.

Sentiment remains robust as key ingredients for investment performance are in place

In 2010, total investment transactions in Midtown increased a significant 58% to £1.25 billion, from £790 million in 2009. As investor appetite for Midtown remained strong, as anticipated, the market improved in 2010, with demand for both prime and secondary assets from a diverse range of investors. There is currently significant interest in the prime end of the market and although general illiquidity in this sector is challenging, we expect that prime yields at the end of 2010 of circa 5.50% will come under pressure to move in further, particularly as Midtown provides a discount to West End and City markets.

Investors were attracted by a strong leasing market in which take-up grew in the second half of 2010 and supply fell. The prospects are for further reductions in supply throughout 2011 and 2012 and low levels of development activity, both expected to underpin rental growth. The potential for rental growth will encourage pro-active asset management in order to create better investment returns. As supply tightens over the next few years there is likely to be a greater tendency for occupiers to re-gear rather than relocate, due to the intrinsic costs of moving.

There was a 64% fall in completed transactions by value in the 4th Quarter, to £136 million (See selected transactions table), however, deals totalling c. £800 million including major buildings such as River Court, 120 Fleet Street, EC4 (£304 million), 60 Victoria Embankment, EC4 (c.£190 million) and 65 Fleet Street, EC4 (£148 million) are scheduled to complete in the 1st Quarter 2011. The biggest completed transaction of the 4th Quarter, was the sale of 7 Savoy Court, WC2, by Redevco to the Universities Superannuation Scheme for £45.4 million, reflecting a yield of 6.25% and a capital value of £771 per sq ft. The building is occupied by Booz & Company on a lease to 2017.

Selected transactions in Midtown

Address	Size sq ft net	Vendor	Purchaser	Reported Price £m
7 Savoy Court, WC2	52,117	Redevco	Universities Superannuation Scheme	45.4
Staple Inn Estate, WC1	43,705	Tonstate	Private Overseas	22.5
24-28 Bloomsbury Way, WC1	45,095	HSH Nordbank AG	WPP Group	17.5 (Owner occupier)
12-14 New Fetter Lane, 43 Fetter Lane, EC4	54,856 (Permission for 135,000)	Great Capital Partnership	Great Portland Estates	Portfolio sale
17-19 Bedford Street, WC2	15,934	GMS Estates	Dukelease	10.65
Dyer's Buildings, EC1	24,515	Structadene	Private Overseas	8.6
46 Bedford Square, WC1	7,169	Legal & General UK Property Trust	Bestseller United	5.6 (Owner occupier)
3-5 Queen Square, WC1	8,629	Dalton Rey	UK Fashion & Trade Association	5.25 (Owner occupier)
94 Saffron Hill, EC1	17,260	AXA Real Estate Investment Managers	Private Investor	4.97
20 Kingsway, WC2	17,825	Private Investor	London School of Economics	Conf.
40 Hatton Garden, EC1	14,599	Johnson Matthey plc	Estel Property Investments Ltd	3.65
Dolphyn Court, 10-11 Great Turnstile, WC1	8,355	Apperley Estates	The Mary Ward Centre	3.4 (Owner occupier)
CTS House, 7 Upper St Martin's Lane, WC2	4,950	CTS Horizon Ltd	ESVI Ltd	3.35

Source: **Farebrother**



Dan Ridgers



Destination dining. Wolseley creators Jeremy King and Chris Corbin are to open a sister, 13,500 sq ft restaurant at **UK & European's 1 Kingsway development**. Farebrother is agent for the eight upper office floors of the 130,000 sq ft new office, residential and leisure scheme.

Demand hampered by lack of well-configured units

Midtown has been very successful in recent years in attracting major office occupiers from the West End. West End restaurants are following hard on the heels of their clientele. In a highlight 4th Quarter letting at 1 Kingsway, WC2, Jeremy King and Chris Corbin, owners of The Wolseley restaurant, leased the 13,500 sq ft ground floor unit at UK & European's 130,000 sq ft iconic scheme for a new, as yet unnamed, European-style offer. Due to open later in the Summer, the deal adds more destination dining to Midtown's retail and leisure offer, following Sir Terence Conran's recent investment in Lutyens at 85 Fleet Street in 2009.

Other major lettings include Co-operative Food's completion on 8,500 sq ft of retail space on basement and ground floors at Golden Cross House, 456-459 Strand, WC2. The lease is for 15 years at an initial rent of £350,000 per annum. At 82-83 Strand, WC2, Julian Metcalfe's sushi chain Itsu leased its fourth Midtown unit, taking 2,132 sq ft on basement, ground and mezzanine at £170,000 pa from Westbrook on a 10 year lease with four months rent free.

In Covent Garden, Capital & Counties continued to sign-up luxury retailers, with Ralph Lauren's 'Rugby' brand taking 5,703 sq ft at 43 King Street, WC2, on a 15 year lease. Opening is scheduled for Autumn 2011.

Although immediately east of Midtown, the opening of One New Change in October 2010 on Cheapside will have a significant impact on Midtown retail and leisure markets. The performance of the Centre, which operates on three levels, promotes seven-day trading and focuses on office worker, tourist and residential markets, will be closely monitored. Tenants already include leading retailers such as Banana Republic, Hugo Boss, H&M, Reiss and Gap, as well as footwear, accessory, jewellery and restaurant brands.

Within Midtown's principal 'high streets' lettings to occupiers such as these is hampered by the absence of larger, well-configured units and an inability to establish clusters of like-minded retailers to drive rental growth. Some landlords are already responding.

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