- **Professor Tony Key**
- **CASS Business School**

Cass Business School
City of London

The economic issues effecting development over the next ten years

Tony Key, Professor Real Estate Economics

Estates Gazette Development London Conference

June 2006



the economy & London

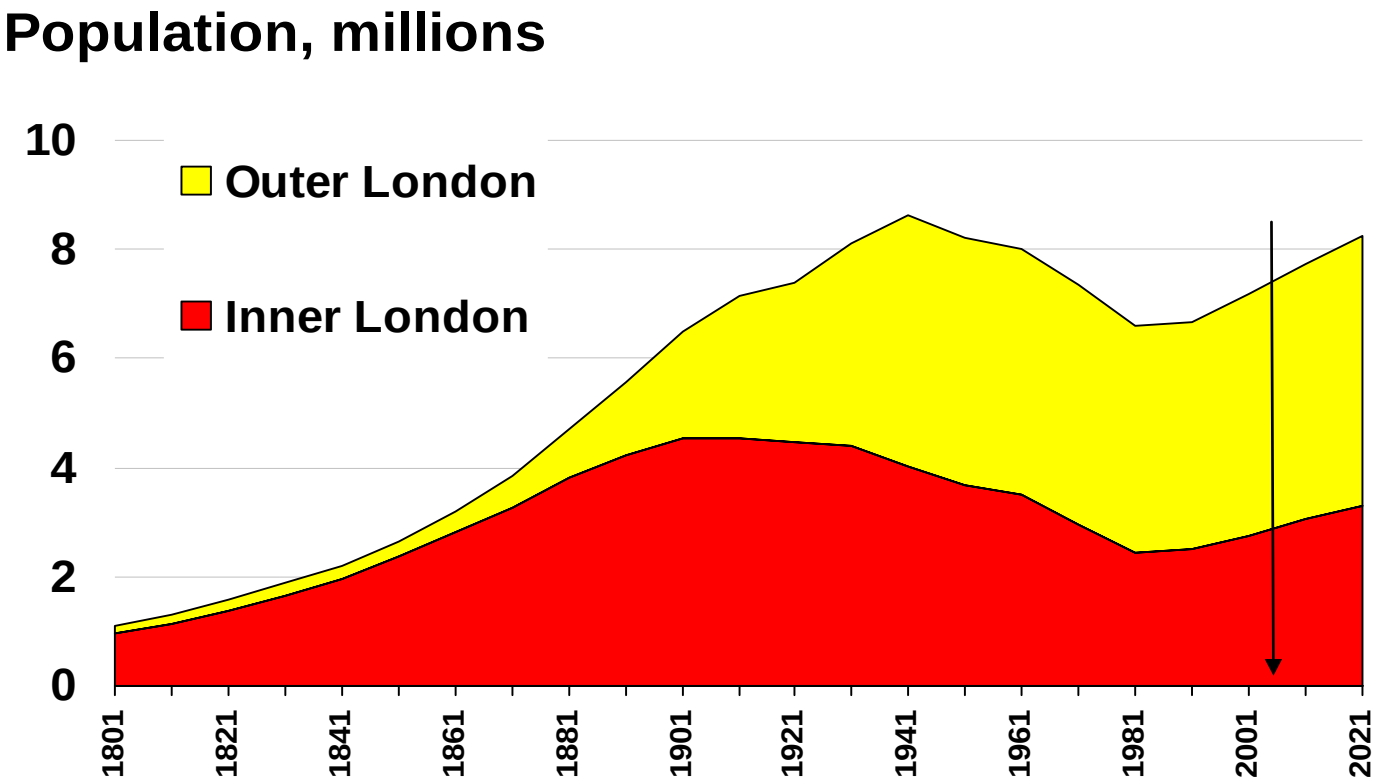
- the economic climate
- offices the key driver
  - a long term demand-supply framework

- issues
  - how much demand and land
  - rental and yield pricing
  - demand for where and for what

the UK economy – Groundhog decade

- averages 2006 to 2016:
  - GDP growth 2.5%
  - inflation 2%
  - base rate 4.5%
  - 10 year gilts 5%
  - 5 year swap 5%
- structural differences from the last 20 years
  - slightly slower decline in manufacturing jobs
  - a less growth in office jobs
  - a little less growth in consumption
  - major emphasis on energy saving

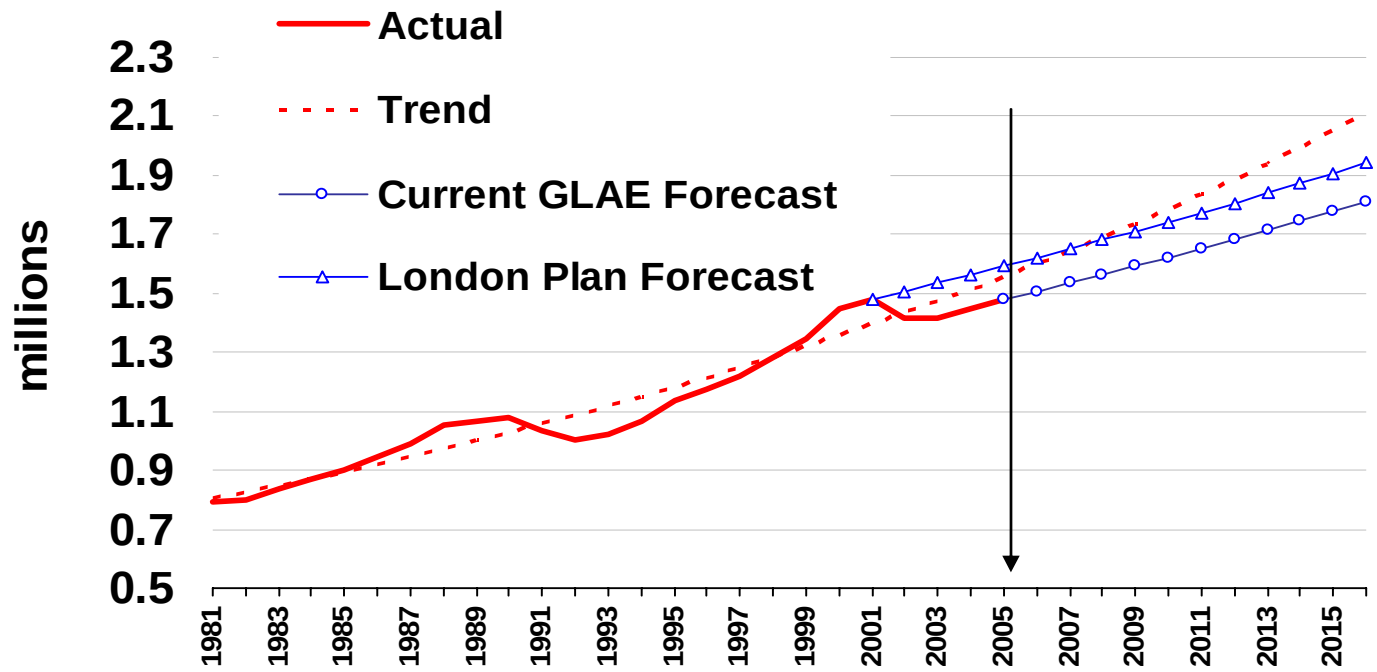
London – the rising tide



Source: www.demographia.com , the London Plan, GLA

the critical economic driver …

London financial & business services employment



Source: ONS, the London Plan, GLA Economics WP 14

F&BS jobs and office space …

- London trend growth rate 1980-2005 = 2.8% pa
- assumptions for the period 2001-2016
  - London Plan = 2.4%
  - London Office Policy Review (LOPR) 2004 = 2.5%
  - current GLA Economics forecast = 1.8%

- F&BS jobs, employment densities & net demand for stock
  - LOPR 2004 463,000 jobs at 175 sq ft each = 81m sq ft
  - or 329,000 jobs at 175 sq ft each = 58m
  - or 329,000 jobs at 150 sq ft each = 50m

the critical assumptions ....

- F&BS output – trend rate
- F&BS employment
  - productivity gains from use of IT, international competition
  - offshoring moving up the value chain
  - Lyons & Gershon reviews
- utilisation of office stock
  - alternative working practices
  - wireless technologies
  - energy conservation
  - current space planning targets
- none major in their own right, but all in the same

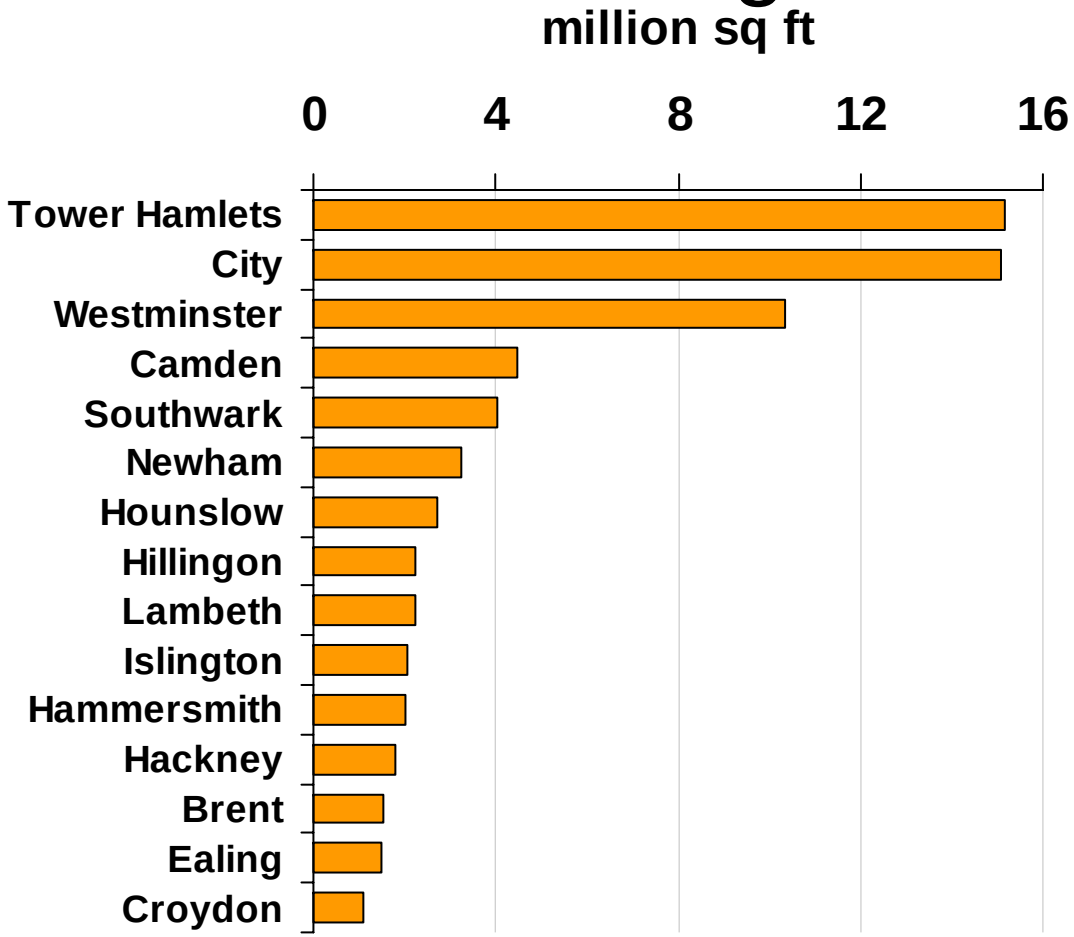
London office balance 2001-2016 – million sq ft

	Net Demand for Office Space		**Supply of Office Space**
LOPR 2004	81	Built 2002-2005	29
Lower F&BS Forecast	58	Under Construction	9
Lower F&BS + High Density	50	Planning Permits	38

Source: LOPR 2004, EGi London Office Database

- Following LOPR 2004 with a little updating
- At high demand growth
  - 43% total required built or started, 94% already in pipeline
- At low demand growth
  - 70% of required already built or started, 150% already in pipeline
- On any assumption, a generous overall supply?

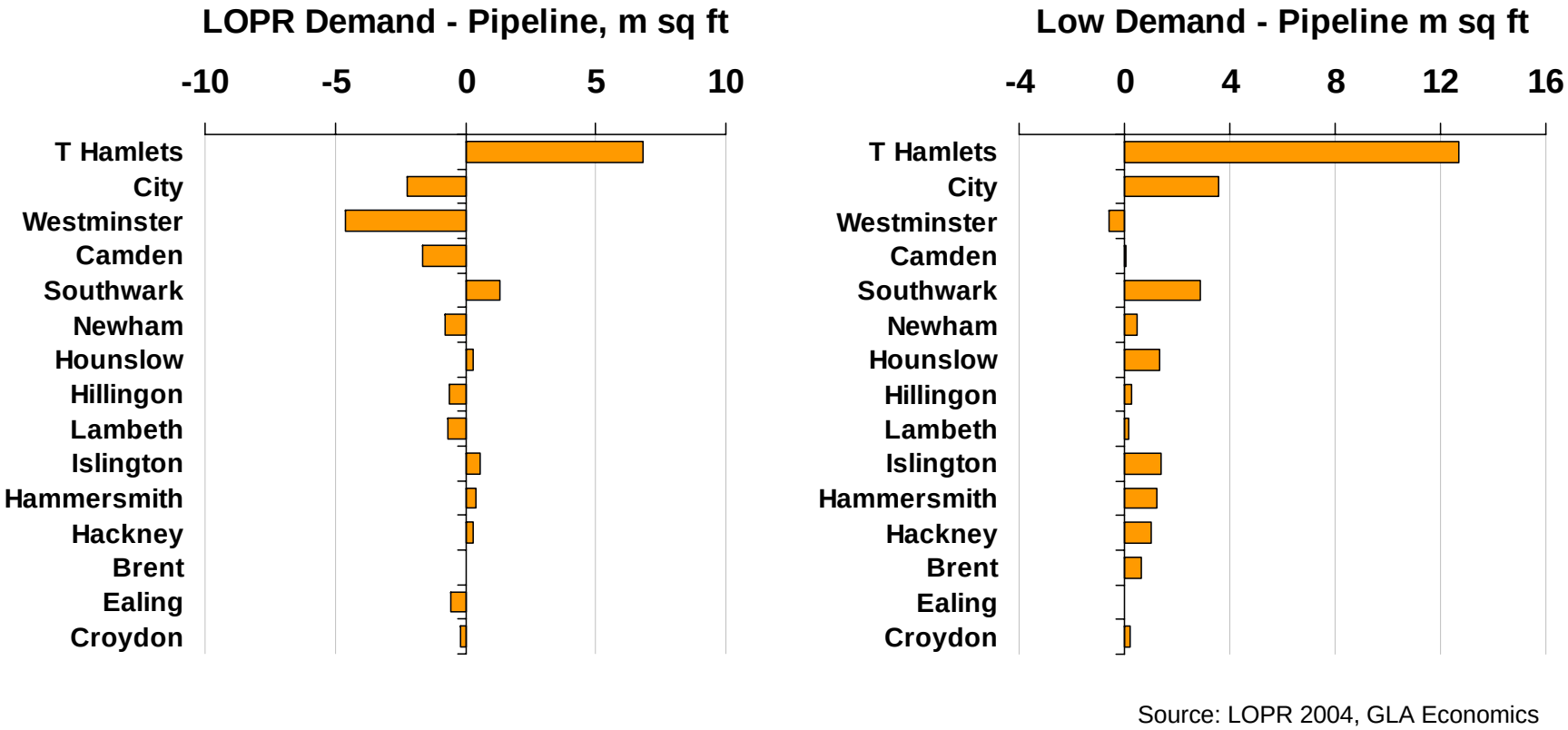
where the development is supposed to go …



Source: LOPR 2004

- LOPR 2004 assumption of 81m sq ft net demand
- 86% accounted for by 15 Boroughs with more than 1m sq ft net demand
- allocated by “trend, accessibility, availability”
- 23% in Docklands, Stratford?

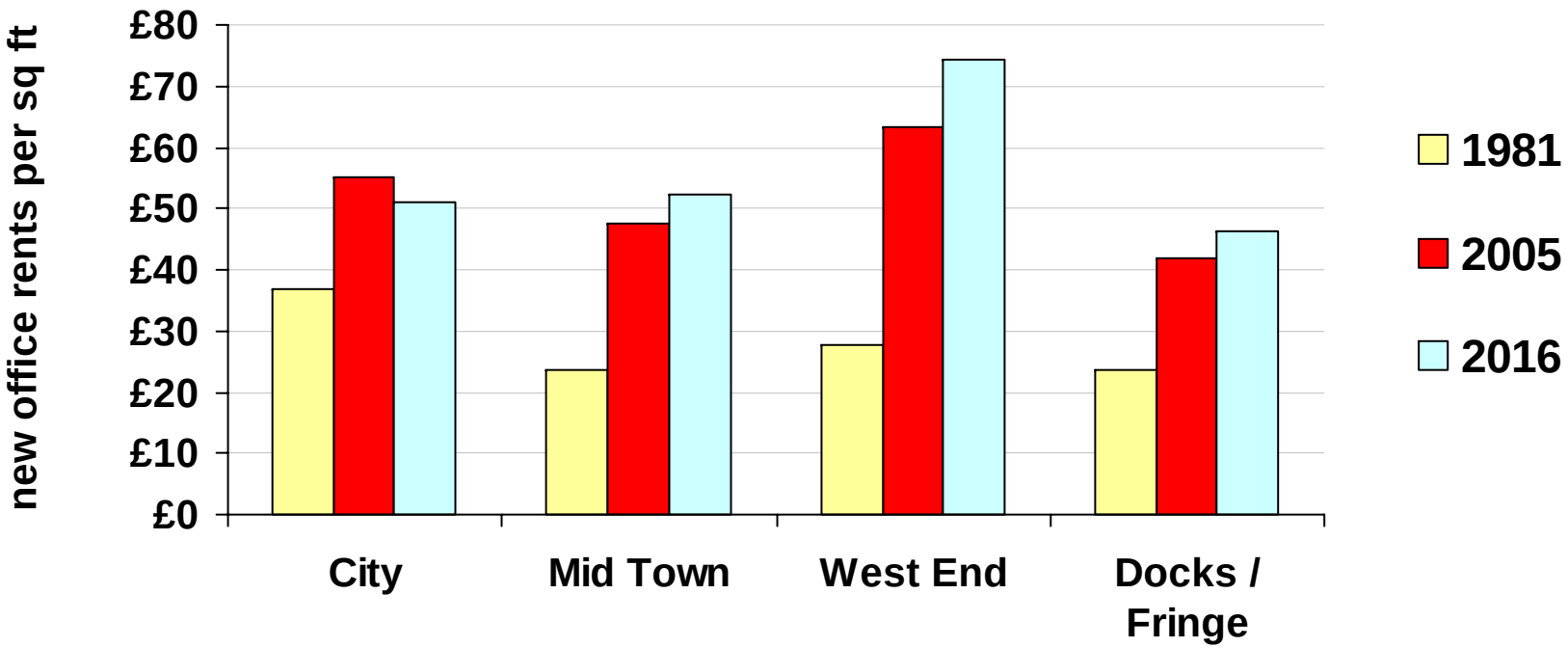
… and the supply pipeline



Source: LOPR 2004, GLA Economics

- On high demand assumption, current shortfalls only in core locations
- On low demand assumptions, any shortfall only in West End

office top rents – a trend forecast



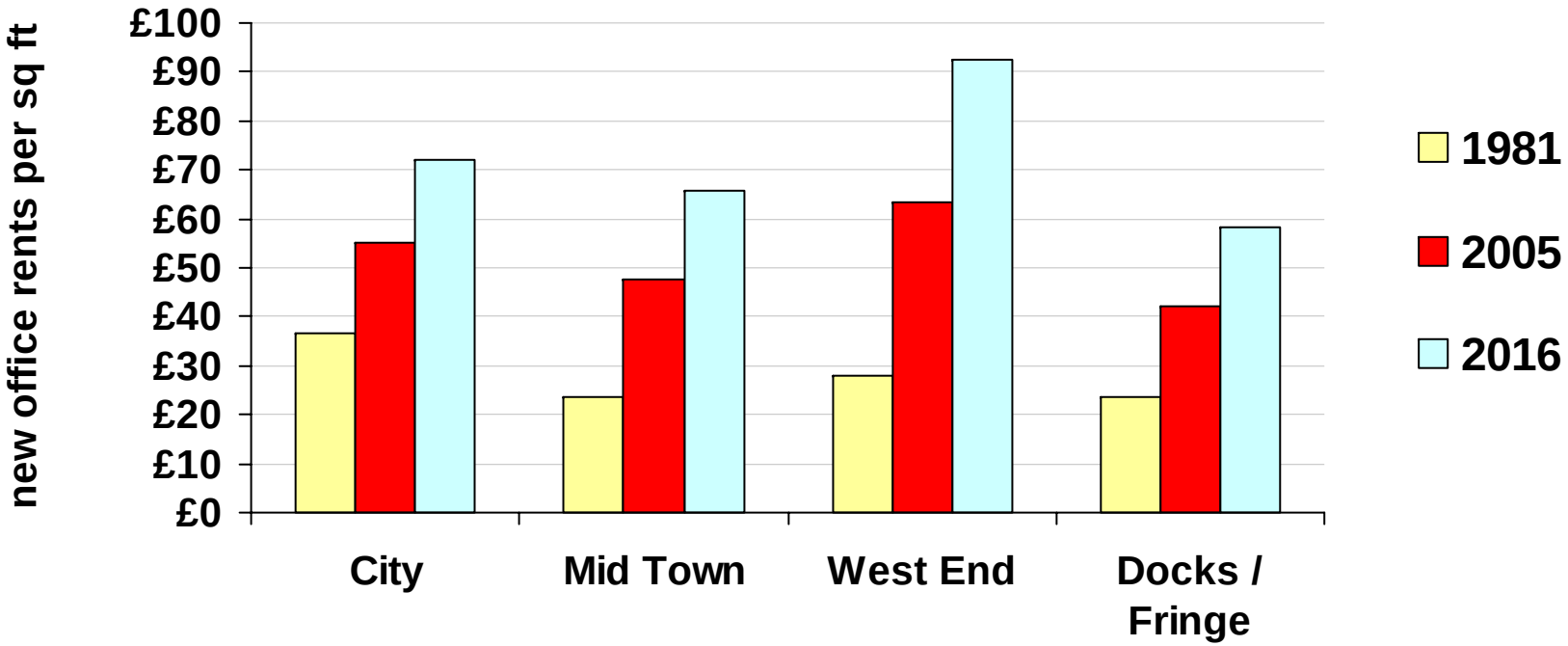
- Central London trend real rental growth since 1980: -1.7% pa
- range from City (-3.1%) pa to West End (-1.0% pa)
- trend forecasts assume 2.5% pa future inflation
- City rents 2016 8% down on today, West End 18% up

Source: IPD, EGi London Office Database

a more generous rental trend?

- overall demand vs land supply
  - once and for all effect of 1980s planning relaxation?
  - diminishing supply of core / fringe strategic sites?
  - but still a very flexible supply outside West End
- construction costs
  - building for energy efficiency & conservation
  - added costs of mixed use
- alternative uses
  - more pressure from residential
  - more explicit choice of uses
- allow rental growth up to 1% over inflation?

office top rents – with a break in real trend



- assumes City in line with inflation at 2.5%
- West End at inflation +1%
- Mid-Town & Docks / Fringe a little levelling up toward City at inflation +0.5%

Source: IPD, EGi London Office Database

London offices investment pricing

- a chronically overpriced market?
  - 25 year return below all-property, risk 1.5 times all-property
  - virtually no change in yield relative to all-property average
- due to global investor demand?
  - weighting of UK investors halved from 35% to 17%
  - balance by overseas investors to more than half the market
- current yield pricing for rental spike

the upshot

- the “commodity” office stock
  - large single use buildings, average location quality & accessibility
  - demand driven by merger / consolidation more than growth
  - (over) generous supply and wide choice of strategic locations
  - minimal upward pressure on rents, some upward shift in yield
  - should be looking to consolidate in most accessible locations
  - switch other parts of strategic reserve to other uses
- the “quality” office stock