A roller coaster ride
London Office Crane Survey
Summer 2020
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Since our last survey, the UK General Election and the confirmed exit from the EU provided much needed political stability and business confidence. The positive momentum that was felt in the real estate industry at the beginning of this year, however, quickly disappeared only a few weeks later as a result of the COVID-19 pandemic.

Business confidence has therefore been on a rollercoaster ride in the last few months. The high volume of new construction starts in our survey indicates the market was gearing up to increase supply on the back of much sought-after political certainty, something that has now been reversed due to COVID-19.

Welcome to Deloitte’s Summer 2020 London Office Crane Survey – a barometer of business and developer sentiment as well as future workplace supply.

Foreword
With social distancing measures and enforced lockdown, the potential economic impacts of the pandemic are becoming all too apparent. Our latest CFO Survey found that confidence among CFOs has declined to its lowest ever level and the revenues are expected to be 22% lower, on average, than their pre-COVID plans this year.

In the face of the economic downturn, businesses will begin reviewing their real estate requirements; reflecting upon costs, required occupancy ratios, ability to deliver and sustain critical functions, ease of access and connectivity, as well as overall resilience.

The current mass remote working is the largest workplace experiment the world has ever seen. As remote working practice is being normalised across the country, we speak to developers to assess confidence in the leasing market and what impact the homeworking can have on office demand going forward.

In an effort to understand changes in office construction in central London, our team of researchers have once again walked the streets across all the established and emerging submarkets. We have spoken to London’s established developers to understand their construction plans going forward, as well as their current concerns around the market.


In this edition we also discuss what the enforced homeworking will mean to the future of office demand, how firms will focus on wellness and healthiness, and we evaluate future supply levels and construction costs.

We would like to thank developers and contractors who assisted with the data and took part in our surveys, particularly during these challenging times.

In this edition, we also introduce an interactive microsite for the Crane Survey. It will allow you to navigate to the content you find most useful, including submarket snapshots and a development map.

We hope you find our survey results and insights useful and thought-provoking, and we welcome your feedback.
Key Findings

New construction starts: volume (million sq ft) and number

5m sq ft in new construction starts

Headline results

- Survey new starts reach 5m sq ft, with a third in just two schemes
- Total volume under construction is up by 29%
- Up to 60% of existing construction paused as a result of COVID-19
- Survey completions are down by 60%
- 44% space under construction is already pre-let
- Developers' confidence in leasing demand plunges
Percentage of pre-completion space let by sector:

- **38%** TMT
- **15%** Financial
- **12%** Serviced offices
- **12%** Professional
- **6%** Utilities
- **5%** Legal
- **4%** Corporate
- **4%** Insurance
- **4%** Other

**44%** of space under construction is let

Volume under construction (million sq ft):

- **15.3m**
  - **7.3m** The City
  - **2.6m** West End
  - **1.2m** Midtown
  - **0.9m** Southbank
  - **1.8m** King's Cross
  - **1.0m** Docklands
  - **0.4m** Paddington

112 schemes under construction

Outlook:

- **46%** of developers plan to reduce their pipelines in the next six months
- Fewer new starts in the next six to nine months
- Upcoming completions to be delayed by at least three months
- Flexible/home working to accelerate
- Office space likely to be de-densified
- More focus on health and wellness
Central London Crane Survey results
Submarket snapshots

Central London

Central London office pipeline

Let vs. available space under construction

Volume of new starts and completions

What sector is taking the most space?

New-build vs. refurbishment volume under construction

Source: Deloitte Real Estate
Summer 2020 London Office Crane Survey – findings

The UK General Election in December and the UK’s confirmed exit from the EU in January provided political certainty. The Deloitte CFO Survey: Q4 2019 reported the biggest ever increase in confidence and the property market saw a resurgence in the number of assets available for sale.

However, the positive momentum quickly and sharply dissipated only a few weeks later as a result of the COVID-19 pandemic. According to our latest CFO Survey, confidence among corporates declined to well below the levels seen at the height of the financial crisis in 2008.

IHS Markit’s UK construction index for April described a “survey-record decline”, significantly worse than the decline recorded in 2008 as construction work largely ground to a halt, and the lockdown started to hit the economy. The number of new real estate investment opportunities coming to market also plummeted as the lockdown presented inevitable physical challenges to marketing and due-diligence activities.

As we examine the latest survey results, covering the period between October 2019 and March 2020, what are the construction levels telling us about office supply levels in these challenging times? What will construction delays and enforced homeworking mean to the office market going forward?
Volume of new starts the highest on record, with a third in just two schemes

In the six months to March, there was five million sq ft of new construction across central London – the highest volume of new starts on record, and 42% up on the corresponding period last year. With both the 880,000 sq ft 40 Leadenhall and the 770,000 sq ft 8 Bishopsgate breaking ground in the period, these two developments accounted for 33% of all new construction volume. There is currently no known pre-let on either of the schemes.

In terms of numbers, 45 separate new projects commenced during the survey period, which is almost double the previous survey and the long-term average. It is, nonetheless, lower than the previous record, in Q1 2016, when 51 schemes broke ground.

The typical size of new developments has also expanded, by 49%, on the previous survey, to an average of 110,000 sq ft. This is because there were relatively fewer starts in smaller size ranges, especially in the 10,000 to 50,000 sq ft size band.

It is worth noting that our summer reports (covering October to March) have typically shown a higher volume of new starts than the winter reports (covering April to September). A number of large schemes also did not make it to the previous survey as they were still in the demolition stage at the end of October, most notably Paddington Square and Cargo, each delivering 360,000 sq ft. The obvious rise in new starts in this survey also indicates the level of significant confidence in the London office market prior to COVID-19, and reflects strong take-up and falling vacancy rates in London over the past couple of years.
Existing construction paused but unlikely to be abandoned

Government COVID-19 guidelines did not order construction work to stop, but the initial impact, particularly in central London, was that many contractors did close sites at least for a few weeks to consider how to operate safely. Social distancing, for example, will need to be implemented on sites, which differs depending on the stage of construction. For instance at 40 Leadenhall the piling works are largely machine-based and work can continue, although conducting detailed fit-out work will be a lot more challenging.

Contractors also need to consider how they operate changing and canteen facilities on site as well as factors outside their control such as how staff can safely get to and from sites on public transport. The success of the implementation of safe working will determine productivity and the overall impact on construction programmes and costs moving forward.

Another major influence on productivity and construction programmes will be the availability of construction materials. International procurement of such materials means that UK sites will depend on the COVID-19 regulations imposed in other countries as well as transport links between them. The availability of materials will again relate to the stage of construction, for example whether building materials are ordered, or whether an alternative material choice is viable or practical. Deloitte has seen anecdotal evidence of material shortages and hence associated price inflation.

“It is hard to see anyone backing a new scheme until market adjustment has happened.”

UK commercial property developer, March 2020
While there will inevitably be delays in construction programmes, permanently stopping construction that is already underway is unlikely. There were ten schemes equating to 1.4 million sq ft on the verge of commencing in mid-March which will undoubtedly be subject to review with on-site work delayed accordingly – whether that be a near-term postponement or a comprehensive re-think. We foresee very few developments being launched in the next six to nine months as decisions will be deferred until there is more stability in the market.

**New construction surged across most submarkets**

Over the survey period, October to March, new construction activity increased across most central London submarkets. **The City**, which experienced very little activity in the previous survey, saw 16 new developments commence, which will add 2.8 million sq ft of new or refurbished office stock. Apart from 40 Leadenhall and 8 Bishopsgate mentioned earlier, which account for 60% of new construction volume in the City, the submarket has another five new schemes of between 100,000 and 200,000 sq ft, equating to 24% of the total, and noticeably just 8% in the smaller range of 10,000 to 100,000 sq ft.

**The West End** continues to increase its construction activity, with 12 new starts breaking ground in the six months to March 2020, equivalent to 550,000 sq ft. As in previous surveys, the vast majority of new starts in the West End are of a smaller scale. The largest new construction site is the major refurbishment of Henrietta House. This office building comprises 143,000 sq ft and is scheduled to complete in Q4 2020.

**Southbank** was the third most active submarket, with seven new starts, amounting to 560,000 sq ft. This is the highest number of new starts we have recorded for this submarket. Given the recent planning consent for the 1.2 million sq ft redevelopment of Elizabeth House beside Waterloo Station, construction activity is likely to be maintained in this submarket. Similarly, Midtown witnessed six new construction starts, albeit mostly modestly-sized refurbishments. Both Midtown and Southbank have some of the lowest vacancy rates in central London, and are likely to continue to attract developer interest.

**Paddington** saw piling commence on two new sites in recent months. The Paddington Square development will comprise 360,000 sq ft, while Fifty Paddington will deliver 75,000 sq ft. Neither of these schemes have a known pre-let.

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**Central London: Volume of new starts by size range**

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Source: Deloitte Real Estate
Overall construction volume is up by almost a third

As a result of the considerable rise in new starts, the overall amount of office space in construction in this survey expanded to 15.3 million sq ft across 112 schemes. This represents a 29% uplift on the previous survey and is higher than the long-term average by 41%.

The boost in the volume under construction is due to a combination of higher volume of new starts, as discussed earlier, and very low completion levels in this survey. Many projects, such as the 1.3 million sq ft skyscraper at 22 Bishopsgate scheduled for completion earlier this year, have been delayed by a few months as contractors initially suspended work in response to COVID-19.

In contrast to previous surveys, which revealed a construction decline in the City, in this survey volumes grew by 38%, to a total of 7.3 million sq ft, largely owing to the two large new starts. The City currently represents 48% of all the space currently under construction in central London. This is still below the almost nine million sq ft under construction in Q3 2016, when the City commanded 60% of total construction in central London.

The West End has been experiencing a steady rise in construction activity in the last few surveys. With 2.6 million sq ft underway, this submarket accounts for almost 20% of all activity in central London. The West End is the most active submarket in terms of the number of individual schemes under construction.

Central London: Office space under construction by submarket (million sq ft)

Source: Deloitte Real Estate
The boost in the volume under construction is due to a combination of higher volume of new starts and very low completion levels in this survey.

In Docklands, there is now one million sq ft under construction in five projects. The refurbishment of the 360,000 sq ft Cargo building, 25 North Colonnade in Canary Wharf, is set to complete later this year and is known to have secured a large pre-let from a utility firm.

The levels of office development remained relatively unchanged in other central London submarkets.

**Completions expected in 2020 are high, but expect delays**

Central London witnessed a 60% drop in completion volumes compared to our Winter 2019 survey, with only 1.2 million sq ft reaching practical completion in the six months to March. The largest completion was the refurbishment of 135 Bishopsgate, which will provide 280,000 sq ft of space to media and financial services firms in the City.

In the City, there is 4.1 million sq ft scheduled for completion in 2020 in 23 buildings, matching the 2018 levels in this area. Of all the space due to finish this year, 59% is already pre-let. Longer term, there are a number of large-scale developments in the pipeline in the City of London’s growing cluster that will likely be put on hold. Construction on the one million sq ft 1 Undershaft had been expected to start by the end of this year, the 760,000 sq ft Diamond was granted planning permission, while the proposed Bishopsgate Goodsyard promised to deliver 1.4 million sq ft of workspace in Shoreditch by 2023.

The uptick in construction activity in the West End in recent surveys will translate into 2.1 million sq ft of new and refurbished stock in 2020, the highest levels for the West End. The largest schemes to be delivered this year are the fully pre-let 80 Charlotte Street and 1 Triton Square, each comprising just over 300,000 sq ft of office accommodation. More than half (52%) of the 2020 stock in the West End is pre-let.

Nonetheless, with up to 60% of schemes under construction currently being suspended due to COVID-19, we expect three-to-six month delays with many of the 2020 completions postponed until next year. With more than half of the space already committed to across central London, it raises questions regarding move-in dates, as a number of tenants would have entered pre-completion letting agreements with developers.
Pre-letting remains strong but a drop in smaller requirements is likely

Providing the best quality office space is growing in importance for businesses wanting to attract and retain talent, with buildings increasingly seen as an integral part of an organisation’s brand. Continuing the trend from previous surveys, the pre-letting market remains strong, driven by limited ‘ready to occupy’ Grade A accommodation, especially for larger requirements. Space currently under construction is 44% let rising to 60% for sizes over 200,000 sq ft.

Pre-let rates vary widely by submarket. In relatively new office areas, like King’s Cross, the large-scale construction and redevelopment undertaken has been conditional on pre-letting. By contrast, the West End sees fewer pre-commitments because the scale of development is much smaller and, as an established area with high rents, the risk associated with speculative development is lower.

Given the disruption caused by the pandemic, we anticipate seeing businesses taking a three to six month break before committing to new office space. The majority of large pre-lets are strategic, five-year plans, often driven by lease expiries, and therefore unlikely to be abandoned. However, small to medium-sized requirements, especially those based on expansion, are likely to decrease over the coming months as tenants defer planned office moves and seek a short-term extension from their existing landlord until there is more business and economic certainty.

TMT continues to drive office demand

Unlike in the run-up to the previous financial crisis, when office demand was driven by financial services companies, today’s tenant base is more diverse, led by technology, media and telecoms (TMT), followed by financial services, professional services and flexible office providers. This diversity of occupier type provides the London office market with a degree of resilience.

TMT’s share of pre-let space under construction was 38% in the current survey. This confirms the continuing importance of the TMT sector in the London leasing market and we examine why this sector is likely to emerge least affected from the crisis in the Key themes and outlook section of the survey.

Serviced office providers’ appetite for London offices has remained steady in recent surveys, amounting to 12% of the space under construction. However, this is likely to change in the coming months as they reduce their office footprint in response to weaker tenant demand for short-term space. Conversely, the serviced office sector may see an uptick in demand from those occupiers who are unable to agree terms to extend their leases with their current landlord and who simply need short-term space to assess their accommodation needs. (See the Key themes and outlook section where we discuss the viability of this sector in these challenging times.)

Developers’ confidence in leasing demand plunges

In the past few years, the central London office market could be characterised by sustained demand for new and refurbished office space, somewhat counter to expectations given Brexit-related uncertainties. The General Election in December 2019 brought the much needed political clarity and pointed to a boost in business confidence at the beginning of the year.

However, the sentiment changed dramatically only a few weeks later. Developers whom we interviewed at the end of March were far more pessimistic about the leasing market than six months earlier, with respondents either pointing to ‘much worse’ (57%) or a ‘little worse’ (43%) leasing demand. None of the developers interviewed felt that leasing conditions at the time were unchanged, or positive.

In the current circumstances, businesses are expected to delay or cancel office relocation plans as they prioritise cost reduction and preserving cash. Landlords will, therefore, find it more difficult to secure tenants leading to market readjustment in rents and rent-free periods.
**Keeping sites open is the biggest challenge for developers**

Prior to COVID-19, the biggest challenge to new construction was the lack of available sites (43%), followed by planning (24%) and construction costs (24%). As the building sites began to close down in response to COVID-19 government guidelines, the largest hurdle to development quickly switched to just being able to keep the construction sites open. Concern about tenant demand, confidence in the economy and willingness to invest in new projects are now also seen as major challenges to development.

“There is complete gridlock in the market created by the inability to undertake viewings, difficulties undertaking construction activities on site and the likely chaos which will ensue once the distancing measures are lifted.”

*London-based developer, March 2020*

**Central London: Total volume under construction per survey**

Source: Deloitte Real Estate
Central London submarket snapshots
Submarket snapshots
The City

The City office pipeline

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What sector is taking the most space?

- Financial: 29%
- TMT: 19%
- Serviced offices: 15%
- Legal: 12%
- Insurance: 11%
- Professional: 9%
- Education: 3%
- Other: 2%

Let vs. available space under construction

- Available: 39%
- Let: 61%

New-build vs. refurbishment volume under construction

- New-build: 25%
- Refurbishment: 75%

Source: Deloitte Real Estate
Submarket snapshots
West End

West End office pipeline

What sector is taking the most space?

Let vs. available space under construction

New-build vs. refurbishment volume under construction

Source: Deloitte Real Estate
Submarket snapshots

Midtown

Midtown office pipeline

What sector is taking the most space?

Let vs. available space under construction

New-build vs. refurbishment volume under construction

Source: Deloitte Real Estate
Submarket snapshots
Southbank and Docklands

Southbank office pipeline

Million sq ft

- Completed
- U/C available
- U/C let

Docklands office pipeline

Million sq ft

- Completed
- U/C available
- U/C let

What sector is taking the most space?

- Serviced offices

New-build vs. refurbishment volume under construction

- New-build
- Refurbishment

Let vs. available space under construction

- Available
- Let

Source: Deloitte Real Estate
Submarket snapshots
King’s Cross and Paddington

**King’s Cross office pipeline**

- Million sq ft
- Completed, U/C available, U/C let

**Paddington office pipeline**

- Million sq ft
- Completed, U/C available, U/C let

**What sector is taking the most space?**

- TMT, Corporate

**New-build vs. refurbishment volume under construction**

- New-build, Refurbishment

**Let vs. available space under construction**

- Available, Let

Source: Deloitte Real Estate
Emerging submarkets
Crane Survey results
Emerging submarkets see more activity

Following the lack of new construction starts in the previous three surveys, the emerging London submarkets (Stratford, Vauxhall-Nine Elms-Battersea, and White City) witnessed a 15% increase in volume under construction compared to our previous survey. There is currently 1.5 million sq ft under construction across five schemes, since one development completed and two launched in the six months to March.

In Stratford, the International Quarter S9 has now completed, providing 280,000 sq ft of space to Cancer Research UK and the British Council, while the International Quarter S4 broke ground in Q4 2019, and is expected to deliver 350,000 sq ft by the end of 2022. There is a total of 1.2 million sq ft of office pipeline with planning permission in this submarket, but many schemes are unlikely to embark on construction without a major pre-let. Stratford is one of the cheapest submarkets for occupiers, which could be in more demand for cost-conscious businesses in the weaker post-pandemic market.

In the Vauxhall-Nine Elms-Battersea submarket, part of the future phase stock at the Battersea Power Station was brought forward as the 200,000 sq ft scheme at 1 Electric Boulevard commenced in Q4 2019. The remaining stock of the future phase will be delivered in 2024. Both Battersea Power Station and One Embassy Gardens are scheduled to complete in late 2020, assuming there are no delays. This area is likely to start coming of age with the opening of the Battersea Power Station development, as well as the Northern line extension scheduled for autumn 2021. Vauxhall station is currently the nearest major station which means the area has lacked the transport connectivity occupiers crave.

There is presently no new construction activity in White City, but there are a number of schemes in the pipeline. The White City Gateway, which has yet to commence construction, has recently secured a large pre-let from L’Oréal. The convenient transport links and proximity to the new Imperial College campus and Westfield shopping centre are proving attractive to new occupiers. White City is also emerging as London’s hub for life sciences research and innovation, with Imperial College playing a key role in this ecosystem. The sector is expected to benefit from more investment and government spending on health-related research and development as a result of COVID-19.

Cost-conscious businesses could drive more demand in emerging submarkets

Construction activity in emerging submarkets is inevitably more volatile than in the more established and mature areas of central London. Development in these new submarkets often will not start until there is a tenant in place that will endorse the location and attract other businesses to the area. This occupier-led demand provides the stimulus for new construction, unless a developer steps in with a major ‘bold play’ proposition.

Of all the office space currently under construction in the emerging submarkets, 62% is pre-let, with the majority of available space in the International Quarter S4 and 1 Electric Boulevard. Stratford, Vauxhall-Nine Elms-Battersea and White City have been attracting a diverse range of occupiers for some time, from large tech firms, to serviced office providers, research charities and the public sector. However, as we emerge from the pandemic, more businesses are likely to reduce real estate spending and opt for either less space in a preferred location or perhaps cheaper alternatives in the emerging submarkets.
Emerging submarket snapshots
Stratford, VNEB and White City

Stratford office pipeline

VNEB office pipeline

What sector is taking the most space?

What sector is taking the most space?

New-build vs. refurbishment volume under construction

New-build vs. refurbishment volume under construction

Let vs. available space under construction

Let vs. available space under construction

Source: Deloitte Real Estate
As we emerge from the pandemic, more businesses are likely to reduce real estate spending and opt for either less space in a preferred location or perhaps cheaper alternatives in the emerging submarkets.
Key themes and the outlook
Key themes and the outlook

Recession weighs on corporate priorities

COVID-19 is having a significant impact on businesses and the economy. Predictions vary widely but it is clear that we will see a much sharper fall in GDP than during the 2008-09 financial crisis. According to the Deloitte CFO Survey: Q1 2020, businesses are expecting revenues to fall by 22% this year compared to pre-COVID-19 projections, while confidence among corporates declined to well below the levels seen at the height of the financial crisis in 2008.

Having dealt with short-term operational challenges around remote working, CFOs will now be focusing on building financial resilience, by raising or preserving cash to underpin their businesses. Deloitte’s latest CFO Survey also indicates that corporates have never adopted a more defensive stance, with a sharp focus on cost control, cash conservation, selling assets and debt reduction or deleveraging.

Businesses will also reassess their real estate needs. They will reflect on costs, required occupancy ratios, ability to deliver and sustain critical functions, ease of access and overall business resilience. This is likely to include postponing their office plans, seeking cheaper and less space than originally planned and pursuing rental concessions from landlords.

% of CFOs who rated each of the following as a strong priority for their business in the next 12 months

- Reducing costs
- Increasing cash flow
- Reducing leverage
- Introducing new products/services or expanding into new markets
- Disposing of assets
- Expanding by acquisition
- Increasing capital expenditure
- Raising dividends or share buybacks

Source: Deloitte CFO Survey: Q1 2020
Enforced homeworking will only accelerate the trend towards flexibility

The level of remote working currently in place throughout the world is the largest workplace experiment ever seen. As we settle into the new routines and new working practice is normalised, more people are expected to continue working from home on a regular basis. Similarly, businesses will be guided by the effectiveness and resilience of technology as well as cost pressures as they review their needs for office accommodation.

“Many firms will look for increasing flexibility and reduced space requirements with their employees working from home for more days of the week.”

Commercial property developer, April 2020

We are likely to witness an acceleration of the trend that has already been underway for some time, namely more agile working arrangements. According to Deloitte’s latest CFO Survey, 98% of corporates are expecting to increase flexible/home working longer term as a result of the COVID-19 pandemic.

Long-term effects of COVID-19 on business
Net % of CFOs who expect the following to increase in the longer term as a result of the COVID-19 pandemic

<table>
<thead>
<tr>
<th>Area</th>
<th>Net % of CFOs Expecting Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flexible/home working</td>
<td>98%</td>
</tr>
<tr>
<td>Pandemic planning by businesses</td>
<td>97%</td>
</tr>
<tr>
<td>Levels of corporate/household taxation</td>
<td>94%</td>
</tr>
<tr>
<td>Diversification and strengthening of supply chains</td>
<td>89%</td>
</tr>
<tr>
<td>Size and role of government in the economy</td>
<td>78%</td>
</tr>
<tr>
<td>Levels of corporate debt</td>
<td>52%</td>
</tr>
<tr>
<td>Regulation of the corporate sector</td>
<td>43%</td>
</tr>
</tbody>
</table>

Deloitte CFO Survey: Q1 2020

The clear benefits of homeworking include not only saving time but commuting costs as well. Flexible working enables many working parents to complete the school run or care for elderly relatives while maintaining a full-time job, a concept that could have seemed highly unlikely until recently.

Homeworking is unlikely to herald the end of the office

With the pandemic forcing large numbers of employees to work from home, many were quick to announce the death of the office. Some businesses will undoubtedly look to remote working to reduce their real estate footprint, while others will seek to future-proof their existing offices, with ‘de-densification’ likely to take place. Agile arrangements may work for many employees, but not everyone has the type of living space where they can work productively, feel motivated and not experience isolation. Some industries such as financial services, insurance or the legal sector will also find it considerably more challenging to function away from the office due to cyber-security risks.

The office building of the future is likely to become a hub for innovation and collaboration and office facilities will increasingly need to be top quality, supplied with the level of amenities that give the employees a positive and engaging experience.

With social distancing measures expected to remain in place for some time, businesses will focus on de-densification of their existing premises, something that would mean a reversal of the previous trend. As seen in China, workers may be asked to access buildings in staggered shifts to minimise potential exposure. Employers will need to provide more space between desks, and layouts that make it easier for workers to move around without being too close to one another.

“Once CEOs realise technology does work from home, it will lead to more desk sharing and by nature a smaller demand. We will also see more people working from home one or two days per week. However, it has also dispelled any myth that we can all work from home – people need interaction in most jobs, which also re-enforces the need for a central office space.”

Property asset manager, April 2020
Sustainability agenda to continue, with a spotlight on wellness and ‘healthy’ buildings

In previous surveys we discussed how environmental, social and governance (ESG) issues have risen up the agenda for businesses, governments and society.

Corporates increasingly recognise that to attract and retain employee talent, particularly among younger generations, they have to provide office accommodation that aligns with ESG principles through, for example, energy-efficiency, low carbon dioxide emissions and the use of sustainable materials.

Consequently, landlords and developers who do not follow the ESG agenda are exposed to related risks that may lead to accelerated obsolescence and falling property values. In late 2019, 23 of the largest property firms signed up to the Better Buildings Partnership, pledging to tackle the growing risk of climate change by delivering net zero carbon portfolios by 2050. This applies to both new and existing office schemes, and covers operational and embodied carbon for the whole building, including the energy consumed by their tenants.

The debate on embodied carbon in buildings is likely to intensify challenging the notion as to whether existing buildings should be demolished to make way for newer models, and in doing so waste the embodied carbon. Therefore, we anticipate there will be a stronger focus on remodelling and refurbishment, where buildings can be recycled and adapted to suit demand, without having to be demolished and rebuilt.

In the light of COVID-19, the trend towards workplace health and wellbeing will speed up. Air quality will be one of the most important factors for building and tenant health, with an emphasis on fresh air, ventilation and air filtration. Tenants will no doubt also be asking questions about the ‘healthiness’ of their building, and the measures in place to prevent and mitigate the spread of infectious diseases.
Tech likely to emerge in a stronger position than other sectors

The technology sector, which has been sustaining London office demand in the last few years, appears to be the most resilient in the face of the current crisis. According to the latest techUK survey, only 6% of respondents felt a cessation of trading/doing business was a likely outcome in the short term, implying a degree of strength.

Large technology firms were some of the first to embrace remote working for all their employees and to build on infrastructure which make the transition to homeworking smoother, such as using collaboration centres, cloud storage and tele-conferencing facilities.

Although not immune from the effects of the pandemic, the tech sector is likely to emerge in a stronger position than those who were already lagging.

With swathes of the world’s population experiencing lockdown, remote working has also boosted those tech start-ups that specialise in video conferencing, workplace management and collaboration platforms. The more established tech giants are offering their tools for free, in the hope that people who start using them in a crisis may continue once normality returns. Because people and businesses have now been compelled to embrace these tools and adjust to the ‘new normal’, we are likely to see a greater adoption of many other technologies in future including robotics, the Internet of Things and the use of big data.

Neil Ross, Policy Manager for Digital Economy, techUK

Q. How is the tech sector coping in light of COVID-19 disruption?
While only 6% of respondents in our recent survey felt a cessation of trading/doing business was a likely outcome in the short term, it was raised as a potential concern by nearly 30% of respondents if restrictions remained in place for a long period of time.

Supply chain disruption is also seen as a concern. While the UK has not implemented any restrictions at borders and ports to date, tech firms would anticipate a slowdown if staffing levels are impacted. However overall the tech sector is in a good place to manage the crisis, but is not immune from it effects.

Q. What are the biggest challenges facing the tech sector in the coming years?
Access to talent and digital skills remains a key problem. The UK’s future immigration and skills systems are central policy considerations for the sector, especially once the Brexit transition period has ended.

The tech sector has been the subject of a large amount of regulation and new policymaking as governments seek to better manage the digital economy. Uncoordinated and untargeted regulation and policymaking can damage business conditions through the creation of uncertain business environments: this can be particularly damaging in fast moving and innovative sectors such as tech. To prevent this, regulation and policymaking should be developed in partnership with industry.

The EU remains the biggest and most important market for UK tech companies. With the status of this trading relationship unclear, but certain to change at the end of the transition period, clear guidance and sufficient time to implement new rules will be needed to allow the sector to adapt effectively.

Q. Is tech likely to stay committed to London post COVID-19?
There are agglomeration benefits to being in large cities like London. Tech wants to be in London as the city draws in young, highly educated, international and open-minded talent. As long as London continues to be a destination favoured by these kinds of people then tech companies will see benefits in locating here to draw on this pool of talent.
Can co-working survive social distancing?

Co-working providers expanded to such an extent in recent years that traditional landlords had to respond with their own flexible space offerings. Its fundamental appeal has been a re-creation of the best aspects of an office environment, while enabling and fostering connection and collaboration among like-minded peers.

Following the enforced lockdown and work-from-home orders, the co-working sector has inevitably witnessed a collapse in demand for short-term office space. HubbleHQ reported a 90% drop in serviced offices and co-working transactions at the end of March, with many firms resorting to discounts and extended rent-free periods. Others reduced the number of open offices or have made redundancies.

Serviced office providers have taken on operational risk, assuming high occupancy levels while being committed to long-term leases with building landlords. The start-ups and SMEs (small and medium-sized enterprises) that typically use co-working facilities will have less resilience in the economic downturn, while investors in co-working companies will also come under financial pressure.

However, the sharp fall in demand for short-term accommodation could be mitigated by businesses looking for temporary accommodation after being displaced by the lockdown.

With social distancing measures likely to remain for some time, the co-working shoulder-to-shoulder business model will be tested. Even though some providers have announced plans for more space between desks and layouts with more room to move around, this will translate into fewer tenants and a fall in rental income.

London office pipeline is likely to be re-balanced

In terms of London’s long-term office pipeline, there is currently 27 million sq ft that is either underway or has planning permission but is yet to start. This is a 5% reduction survey on survey and a 17% decline over the last two years, revealing a gradual reduction of future supply levels in the London office market. The developers we spoke to for this survey also say they plan to decrease their construction activity. Compared to six months ago, almost half will now look to downscale their development programmes in the next six months.

“A few weeks ago the development market was gearing up to increase supply on the back of much sought-after political certainty, however that has now been undone. I can’t see many new ‘buttons being pushed’ in the foreseeable future.”

Commercial property developer, March 2020

Central London: Office pipeline forecast

Source: Deloitte Real Estate
In the light of the economic downturn, we will inevitably see fewer new construction starts. Securing construction finance might prove more challenging in the coming months and there is also a nervousness among developers regarding rents. Should a significant rise in vacancy happen at the same time as a fall in occupier demand, it is likely to lead to downward pressure on rents.

There will inevitably be a rise in office availability in the short term, especially in those large office schemes due to complete in the next 12 months while occupiers revisit and defer their relocation requirements and intentions. Additionally, the supply levels in the second-hand market are at risk of increasing if there is a significant failure in the flexible office sector. However, given low availability prior to COVID-19, the market should be able to absorb some of the increase in supply in the short term:

“Because we have come from an environment with a low vacancy rate across central London before the pandemic, the market should be able to absorb this increase over time needing just the equivalent of an average ten-year annual take-up.”

Tony McCurley, Senior Advisor, Deloitte Real Estate

The delays foreseen in new stock completions and very little new construction expected in the next six to nine months will mean that we are likely to see a rebalancing of London office supply levels in the coming years.
“Enforced homeworking will undoubtedly have effect, perhaps on occupational densities and a move away from hot-desking. The office, however, will retain an important place for businesses and economies to function. The human interaction is being missed by many and the productivity of home working feels lower than that of using more formalised workplaces.”

London-based developer, April 2020
Construction cost and workload sentiment survey
Construction cost and workload sentiment survey

To complement the London Office Crane Survey, Deloitte’s cost consultancy team carry out a bi-annual construction market survey, capturing market sentiment on workload and price. Our survey was carried out as the COVID-19 related lockdown started and so captures some of the initial sentiment.

A clear expectation of decreases in workload over the next 12 months

Expectations around workload have been on somewhat of a rollercoaster in the last few months. In the main part of this report we describe 5 million sq ft of new London office projects having started in the survey period – “the highest volume of new starts on record”. At the beginning of March, the IHS Markit/CIPS UK Construction PMI reported February sentiment as the “sharpest rise in construction output since December 2018.”

Workload sentiment for the next 12 months

![Workload sentiment chart]

Source: Deloitte Real Estate
Only a month later as the full impact of COVID-19 was starting to be understood the IHS Markit report headline was “Construction work declines at steepest rate since April 2009”. The report published at the beginning of May described a “survey-record decline”, significantly worse than the decline recorded in 2008/9.

Initially as the UK government implemented lockdown across the country many construction sites, particularly in cities such as London were closed. During April, the Construction Leadership Council (CLC) produced site operating procedures based on Public Health England guidance to maintain operative safety and social distancing. This has allowed contractors to consider restarting construction on more sites, but at what is likely to be lower productivity levels. A major challenge remains with respect to operatives getting to and from sites and the need in city locations to consider using public transport.

The actual impact on individual projects will very much depend on the type, scale and stage of projects. Achieving social distancing during early demolition, excavation and piling works, done largely by mechanical plant, is much easier to consider than the challenges of labour intensive fitting out work as projects are nearer completion.

Therefore, it is inevitable that as a consequence of site closures in March and April, productivity reductions on restarted works and reductions in the start of new schemes, workload levels in the next 12 months will reduce significantly.

**Price sentiment falls dramatically**

Price sentiment in previous surveys remained stubbornly upward. In our Winter 2019 survey, while we saw some reduction in workload expectations, levels of expected price rises barely changed, remaining close to the previous average. Contractors were confident of being able to pass on labour and material price increases.

### Price change sentiment for the next 12 months

![Price change sentiment for the next 12 months](image)

Source: Deloitte Real Estate
In this survey, for the first time in four years, some trades are expecting zero change or price reductions. In the survey we ask contractors about the drivers behind their prices, and consider the key issues affecting labour, materials and overheads, and profit.

**Labour**

In previous surveys we have highlighted the UK industry’s failure to attract young construction workers at a pace to match retirement among older workers, with contractors in the London market in particular relying on substantial numbers of non-UK workers. Respondents to the current survey have highlighted concerns about the ability to maintain apprenticeships this year. This strategic imbalance clearly remains. Whilst primarily off the front-page at the moment, Brexit is likely to reduce the availability of foreign labour.

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Materials

Prior to COVID-19, material prices had been a major driver in the upward direction of overall construction costs. In the short term materials, particularly those sourced outside the UK, may be harder to procure due to production outages and global transport problems. This may lead to substitutions (if possible), project delays (with potentially exponential cost impacts), stockpiling and opportunity pricing. Current oil prices will help to reduce the cost of some materials and transport but this is likely to be a short-term situation as oil producers reduce capacity to increase prices.

A general reduction in construction levels may see price decreases as producers seek to protect their own businesses by being more competitive.

In addition, Brexit may add tariffs to materials sourced from Europe.

Overall though we believe that material prices will generally continue to provide an upward pressure on construction prices.

Short-term reductions in labour prices due to COVID-19 may lead to longer term increases as the UK continues to struggle to find enough construction labour.

Current site closures due to COVID-19 mean that some foreign labour may have already been lost. The associated drop in workload may produce a temporary balance between labour supply and demand, while reduced productivity may soak up some labour, but if new projects fail to start due to a delayed recovery we could see an over-supply of labour and associated price reductions.

Government was already looking to focus on infrastructure projects prior to COVID-19, promoting infrastructure projects may well be a mechanism to help stimulate the future economy. This relies upon ‘shovel-ready’ projects and labour that can flex between different construction sectors.

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Overheads and profit

Since the financial crash of 2008-09 contractors have generally sought to prioritise profit over turnover. In our latest survey 85% of respondents said their priority was maintaining and improving profits and only 15% were prioritising turnover. Contractors therefore may be in a better position to weather the impact of a downturn.

COVID-19 though is unprecedented and it is too early to determine the severity of the impact on UK contractors. Cash flow will remain crucial and the length and shape of the downturn will be critical. Many respondents are expecting (hoping) that social distancing requirements may be relatively short term.

The impact of overheads and profit as a driver of price changes in the next 12 months increased significantly in the latest survey. In an effort to maintain cash flow we are likely to see a drop in margins when pricing new work. The impact on individual organisations will be a function of their pipeline of future work already secured, as well as the need to cover overheads and the amount of labour they employ directly.

Current contractor tender returns are understandably seeking to exclude the impact of COVID-19 related measures. This pushes the problem up the supply chain and is likely to have the impact of further delaying the start of new projects.

Business priorities

![Graph showing business priorities between Q3 2019 and Q1 2020](image)
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