Deloitte.

Optimism despite inflation
London Office Crane Survey

Summer 2022

Contents

Foreword

Welcome to Deloitte's Summer 2022 London Office Crane Survey – a barometer of business and developer sentiment for over 25 years

The last few years have brought their fair share of turbulence to the London office market. Following Brexit, we were focused on the impact of financial services firms and their occupation of the city. The COVID-19 global pandemic and associated lockdowns have ushered in a new era of hybrid working that means organisations across many sectors are still questioning how much space is necessary. Russia's recent invasion of Ukraine has sparked a sharp uptick in inflation, especially for energy intensive manufacture of construction materials such as steel, cement, bricks and glass.

At the same time the world has been working out how to respond to the growing imperative of global warming and how we can live and work more sustainably. In the UK, the Minimum Energy Efficiency Standards (MEES) for offices will be expanding in 2023. Under the current regulations a minimum standard of EPC band E applies. It is unlawful to let an office which falls below this level. From April 2023 the same requirement will extend to existing lettings. More significant is the proposed bill currently going through parliament that if enacted as the current draft means that all offices will need to achieve EPC band B by 2030.

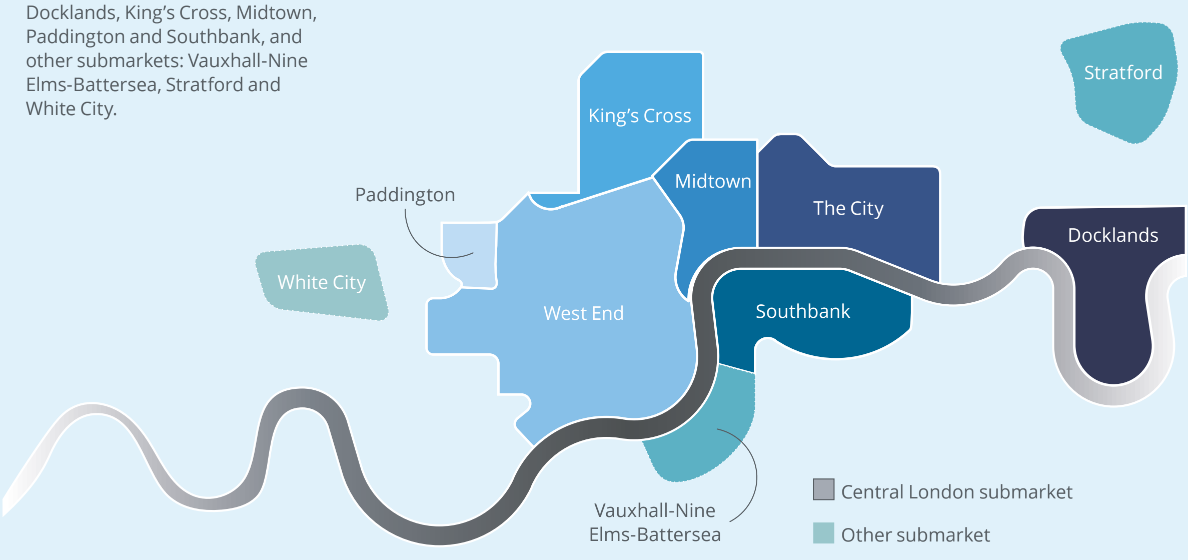
What?
A report that measures the volume of office development taking place across central London and emerging London submarkets.

Where?
London, covering the central office markets: The City, West End, Docklands, King's Cross, Midtown, Paddington and Southbank, and other submarkets: Vauxhall-Nine Elms-Battersea, Stratford and White City.

Who?
Developers building new offices or undertaking significant office refurbishment of 10,000 sq ft +.

When?
The survey covers the period from October 2021 to March 2022.

How?
Our team of researchers have walked the streets of central London and other London submarkets to monitor office construction. Our field research is then verified with direct industry links and in-house property experts.



There are some exemptions, where it is not technically feasible or not cost effective to achieve EPC band B, but broadly as only 15-20% of offices currently achieve EPC band A or B there would be a huge amount of work required to avoid many offices becoming obsolete.

In the Deloitte CFO Survey: Q1 2022, CFOs reported rising operating costs, with 46% of respondents describing them as 'significant'. They anticipate falls in operating margins, but three-quarters still expect revenues to rise over the next year. Uncertainties facing business are described as 'high' or 'very high' but even in this more challenging environment, CFOs remain focused on growth. Capital spending remains a strong priority for 21% of CFO's, down from 37% last quarter but considerably above the five-year average of 14%.

Current sentiment in the London office market depends on 'what hat you wear'. Significant increases in construction costs make starting new schemes difficult for developers and contractors. Leasing activity by occupiers improved through Q4 2021 and Q1 2022, and whilst not quite back to pre-pandemic levels, it is much higher than the previous quarters. Investor interest in the UK, and London in particular, remains high. Potential MEES legislation is a headache for owners but a potential opportunity for investors. If supply levels are constrained due to a lack of new starts and occupier demand for quality space continues then rents may continue rising making increased costs more bearable.

To understand the detailed changes in office construction in central London, our team of researchers have once again walked the streets across all the established and other submarkets. We have spoken to London's developers to understand their future construction plans. We have also spoken with funders to get their take on the market and especially the changes described above to MEES.

We would like to thank contributors, funders, developers and contractors, as well as those providing data and those that took part in our various surveys.

This edition is accompanied with our interactive microsite for the London Office 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.

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Key findings

The results of the Summer 2022 London Office Crane Survey highlight a brief pause as developers grapple with inflation, but **confidence remains strong** so this pause may be brief.

New starts fell by almost one-third, to 2.3m sq ft, below the ten-year average of 2.8m sq ft. However, as many as **36 separate schemes broke ground** during this period including 31 refurbishments and only **five new builds**.

We are likely to see **more new starts in the next survey**. There is currently 2.7m sq ft of planned office buildings in demolition phase and scheduled to start between April and September 2022.

Refurbishments are more prevalent, rising by 14%, to 2.1m sq ft and accounting for a record 91% of all new starts, amid growing awareness of the built environment's carbon contributions, occupier demand for more sustainable offices and incoming legislation.

At only 200,000 sq ft, the volume of new starts of **new-build construction was the lowest level** since we started tracking build types in 2015.

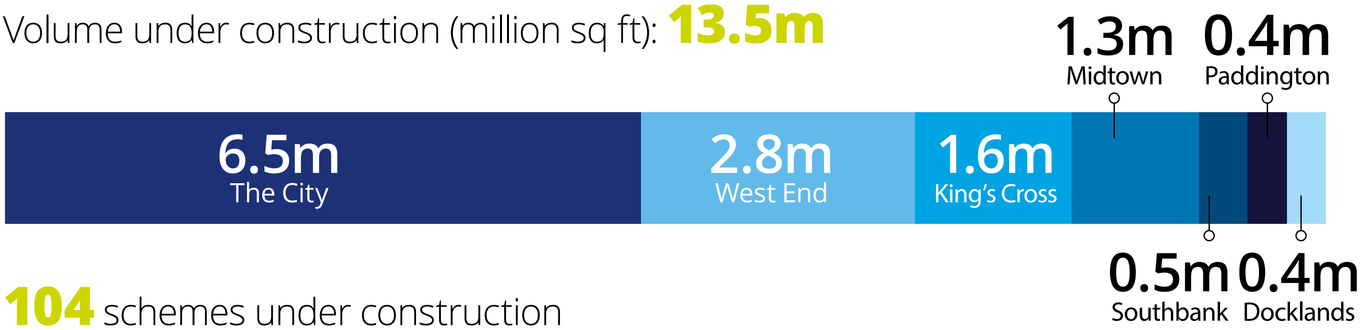
Midtown witnessed the highest level of new construction with seven new schemes, while other submarkets saw less or no new activity.

The amount under construction has increased by 4% to 13.5m sq ft and remains **above the ten-year average due to delayed completions**.

Survey office completions have fallen by half to 1.7m sq ft, below that expected and below the long-term average of 2.5m sq ft as some schemes saw delays.

But office completions in **2022 are expected to reach at least 7m sq ft**, potentially the highest since 2003.

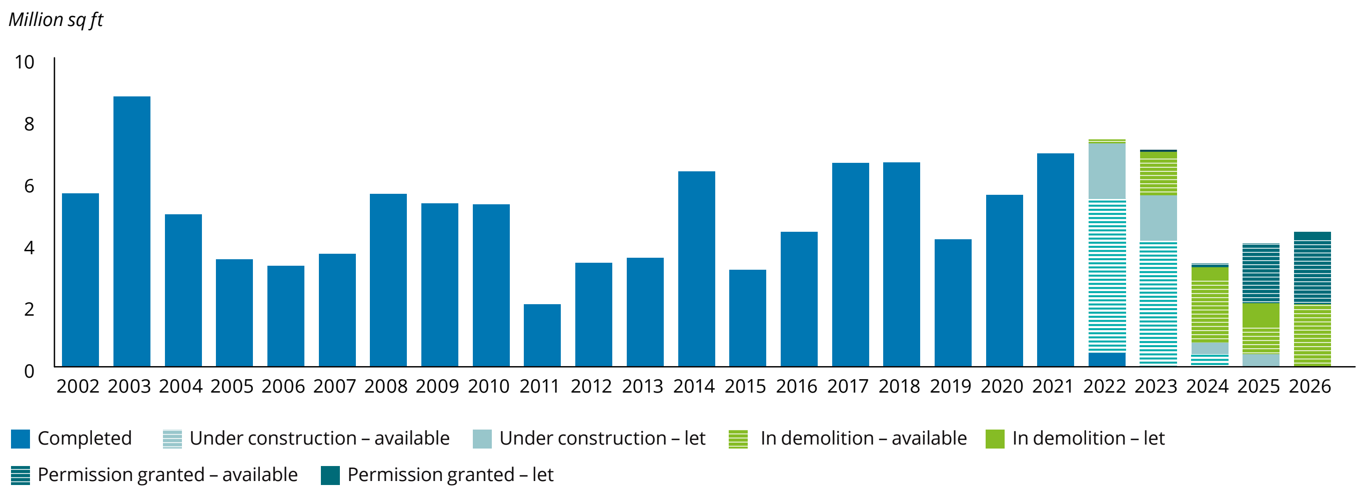
Volume under construction (million sq ft): **13.5m**



104 schemes under construction

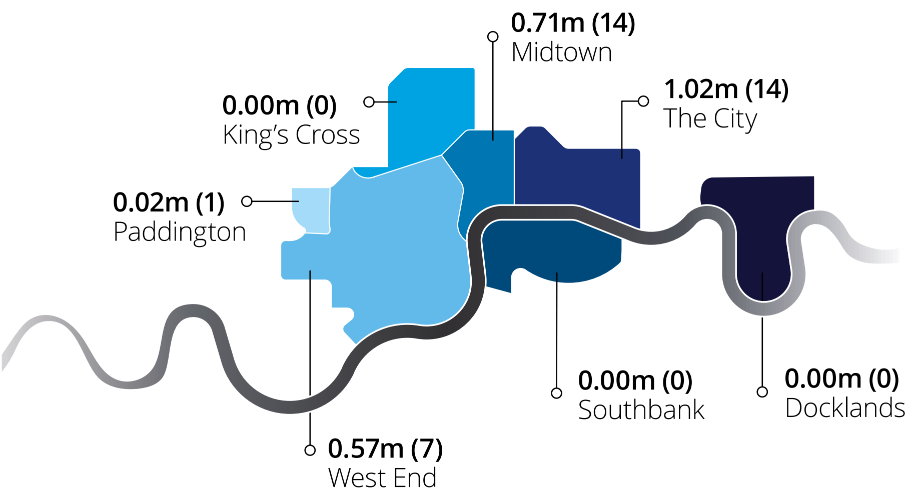
- Stronger levels of demand in the six months to March 2022 have marked a return to a **more normal levels of leasing activity**.
- **Developers remain optimistic about the leasing market** with 65% reporting that leasing demand was "a little better" and 14% suggesting a "much better" demand than six months earlier. However, 7% of respondents pointed to worse leasing demand than six months earlier, suggesting **some reservations**.
- **Cost is the biggest barrier to office development**, according to developers (100% of respondents), followed by costs of meeting ESG requirements (93%).
- Two-thirds of developers pointed to the **lack of clarity of what net zero means and the measures** set out to achieve those targets.
- **Two-thirds of developers will continue to increase their pipelines** in the next six months, however, 21% are planning to reduce them.
- With a minimum EPC requirement of B by 2030, 80% of London office stock will need to be upgraded, **an equivalent of 15m sq ft per annum**, three times the annual average of completions (5m sq ft)
- With a low supply of sustainable high-spec offices in central London, this presents a **huge investment opportunity**. Pursuing a refurbishment, rather than a new-build construction, is also a cheaper and a quicker option for investors in the current economic climate.

Central London: Future office development pipeline



Source: Deloitte

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



Total number of new starts
36

High (Q1 2016)
50

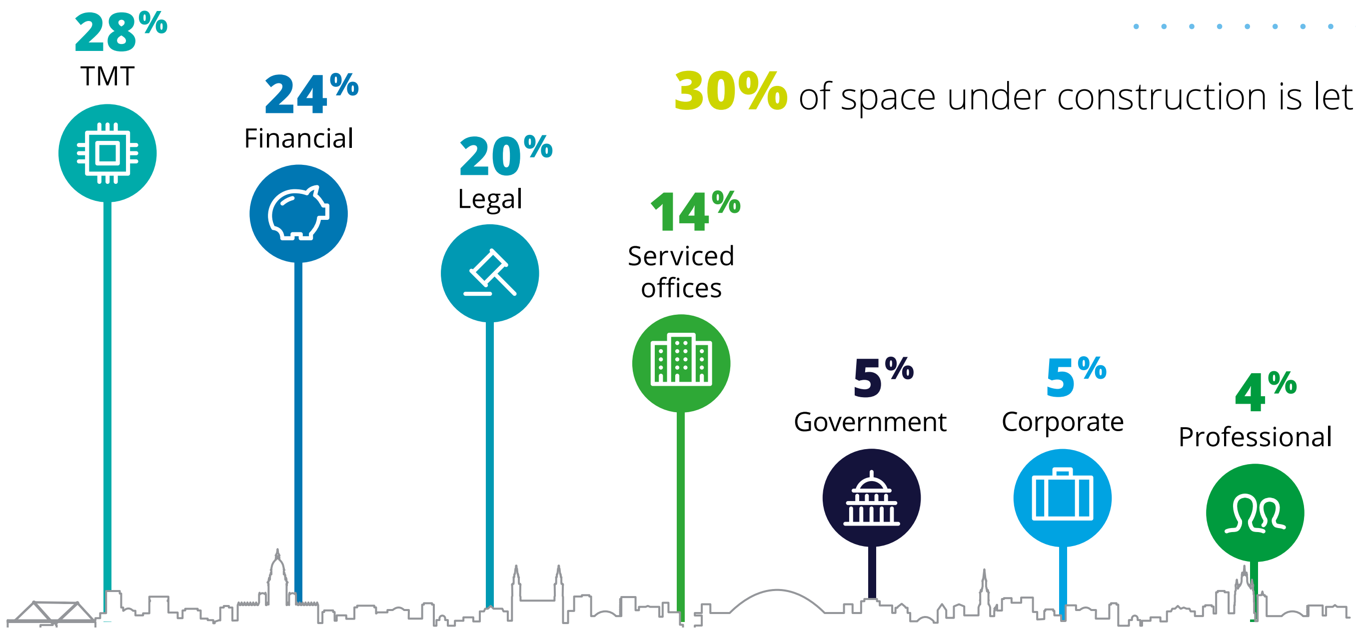
Ten-year average
30

Low (Q3 2010)
4

2.3m sq ft in new construction starts

Percentage of pre-completion space let by sector

30% of space under construction is let



Summer 2022 London Office Crane Survey findings

Summer 2022 London Office Crane Survey Findings

The end of pandemic restrictions and the unlocking of the UK economy was accompanied by a new and unforeseen geopolitical risk as a result of the War in Ukraine on 24 February. Economic sanctions interrupted the recovery of pandemic-disrupted global supply chains and accelerated inflation, elevating the level of uncertainty yet again.

In the London office market, leasing recovered from its 2020 pandemic-induced low, but demand has been heavily skewed to best-in-class space, with weaker stock finding significantly less favour. While companies are still navigating the challenges around returning to the office and the future of work, they are also faced with increasing demands to prioritise Environmental, Social and Governance (ESG) issues. The bar has been raised again and London office occupiers, developers and investors are looking to stay ahead of the curve.

The volume of new starts is down by a third

Deloitte's latest London Office Crane survey reported a drop in the volume of new starts by almost a third to 2.3 million sq ft between October 2021 and March 2022, the lowest level since the Winter 2019 survey. The total of new starts has also fallen short of the ten-year average of 2.8 million sq ft and is notably below the summer survey average of 3.3 million sq ft.

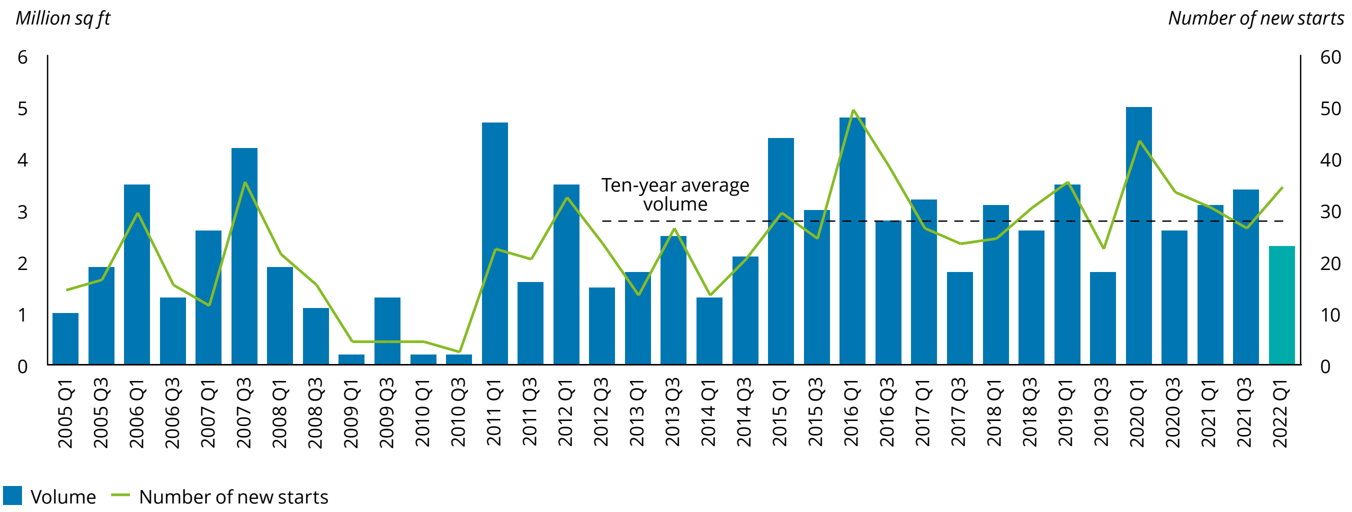
Despite the fall in volume, as many as 36 separate schemes broke ground during this period, exceeding by far the ten-year average of 30. As a result of more new starts, the average scheme size has shrunk by half since the previous survey to 64,000 sq ft and is below the long-term average of 100,000 sq ft. The higher proportion of smaller schemes was partly due to more refurbishments driven by Energy Performance Certificate (EPC) regulations and fewer new-build projects which tend to be of a larger scale.

The largest new start in the six months to March 2022 was the refurbishment of the 260,000 sq ft landmark Grade II listed Space House in Holborn. This Brutalist building was completed in 1968 and was first occupied by the Civil Aviation Authority. The redesign will include the construction of two new floors of office accommodation on top of the existing 15-storey tower, a top floor extension to the connected eight-storey block and reconfiguration of the internal cores and basement levels. Construction works are scheduled to complete in summer 2023.

Refurbishment of the 225,000 sq ft Millennium Bridge House was the second largest new start in central London and the biggest new project in the city. This 1980s building will be redeveloped and extended incorporating existing and new elements while minimising carbon production. The works are scheduled to complete in summer 2023.

Looking ahead, we are likely to see more new starts in the next survey. There is currently 2.7 million sq ft of planned office buildings in demolition phase and scheduled to start between April and September 2022. The most anticipated is the redevelopment of BT's former headquarters, the 729,000 sq ft 81 Newgate Street near St Paul's Cathedral. A substantial retrofit will transform this imposing 1980s office block by spring 2025 with sustainability credentials a key influence on design.

Central London: Volume and number of new starts per survey



Source: Deloitte

Refurbishments continue to rise as the EPC deadline looms

Refurbishments have been more prevalent in new office construction in central London for the last two years and this survey is no exception. Our data reveals that the volume of new refurbishments has risen by 14% in the six months to March 2022, to 2.1 million sq ft across 31 new starts and accounts for a record 91% of all new starts. With only five new starts, or 0.2million sq ft, being new-build projects in this survey, this is also the lowest level of new-build construction since we started recording the data in 2015.

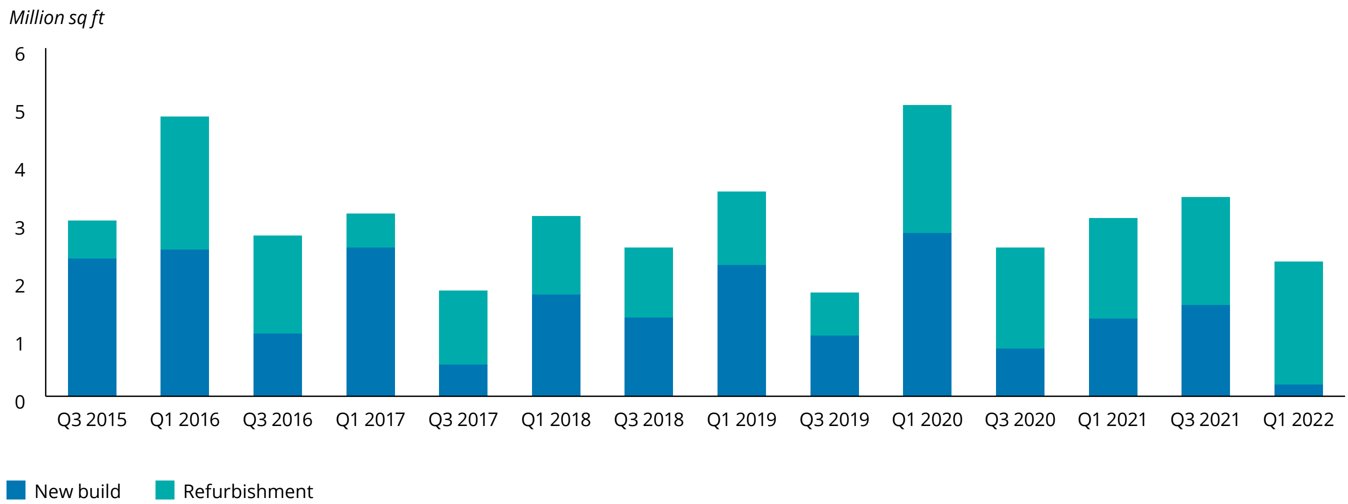
We are seeing more refurbishments as investors are increasingly looking to upgrade their buildings amid growing awareness of the built environment's carbon contributions, occupier demand for more sustainable offices and incoming legislation. Crucially, 20 million sq ft of London's office space, an equivalent to almost 10% of all office stock, has an EPC rating of F or G, meaning that it will be illegal for this space to continue to be let, even to existing tenants under regulations requiring a minimum EPC rating of E, coming into force in 2023. The new Minimum Energy Efficiency Standards (MEES), currently before parliament, will further require buildings to have a minimum rating of B by 2030. Only 15-20% of central London office space can be classed as A and B on the EPC rating scale, with the majority falling into the C to G categories. While an economic viability test will apply within the new legislation, it is clear that considerable upgrading will be required across swathes of existing stock.

The challenge, around whether to refurbish a building or demolish and rebuild new includes consideration such as: the suitability of the existing building, the ability and time to achieve a better planning permission, time to return the building to the market and of course the cost. Sustainability considerations, particularly if keeping the frame and foundations, can save 50% in embodied carbon, adds a new dimension to the challenge adding a 'carbon viability to the financial viability'. The recycling of existing stock may well offer stronger greener credentials than a new-build BREEAM outstanding project. There are, however, a number of challenges to refurbishment, that are examined in the Outlook section of this report.

A lot of attention is on new buildings, but new builds are a tiny fraction of our city's real estate. The most important thing is how we insulate and retrofit the homes and offices we've already got.

Cllr Geoff Barraclough Cabinet Member for Planning (Policy) and Economic Development at Westminster Council

Central London: Volume of new starts - new build vs. refurbished



Source: Deloitte

Midtown is the busiest submarket with new construction activity

New construction volume fell across all submarkets in the six months to March 2022, with the exception of **Midtown**, which saw as many as seven new schemes breaking ground, equating to 0.7 million sq ft (0.1 million sq ft in Winter 2021). In addition to Space House in Holborn mentioned earlier, a refurbishment is under way at Northcliffe House, the former Daily Mail offices south of Fleet Street. This 200,000 sq ft Grade II listed building is expected to complete in early 2023.

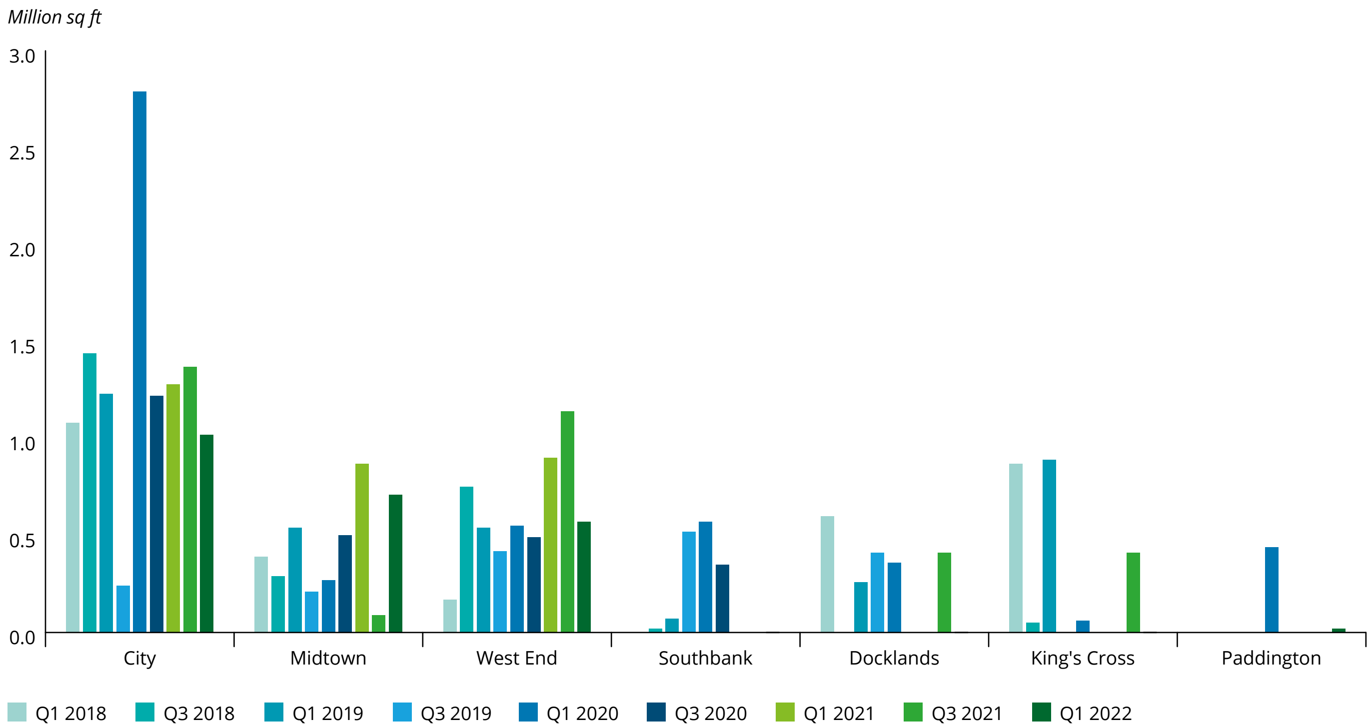
The City has experienced a 26% drop in new office construction since our previous survey (1.4 million sq ft) to 1 million sq ft in the current survey and has also fallen short of the long-term average of 1.3 million sq ft. Except for the 20,000 sq ft Aldgate Place (Phase 2), all new construction activity in the City has been refurbishment rather than new build.

In addition to the Millennium Bridge House mentioned earlier, a comprehensive 115,000 sq ft refurbishment of 11 Pilgrim Street is also underway near St Paul's. The developers are targeting BREEAM Excellent and expecting completion by mid-2023.

Following a high level of activity in previous surveys, new office construction in the **West End** has fallen by half to 0.6 million sq ft compared to the Winter 2021 survey, however, it remains in line with the long-term average (0.6 million sq ft). The West End has traditionally led the refurbishment market but during this reporting period it has seen three out of five projects starting new-build construction. This includes the 76,000 sq ft Twentieth Century House in Soho, the 65,000 sq ft 65 Davies Street near Bond Street tube station and the 20,000 sq ft 45-57 Marylebone Lane, north of Oxford Street.

There were no new starts in Southbank, King's Cross and Docklands.

Central London: Volume of new starts by submarket



Source: Deloitte

Overall volume under construction barely rises

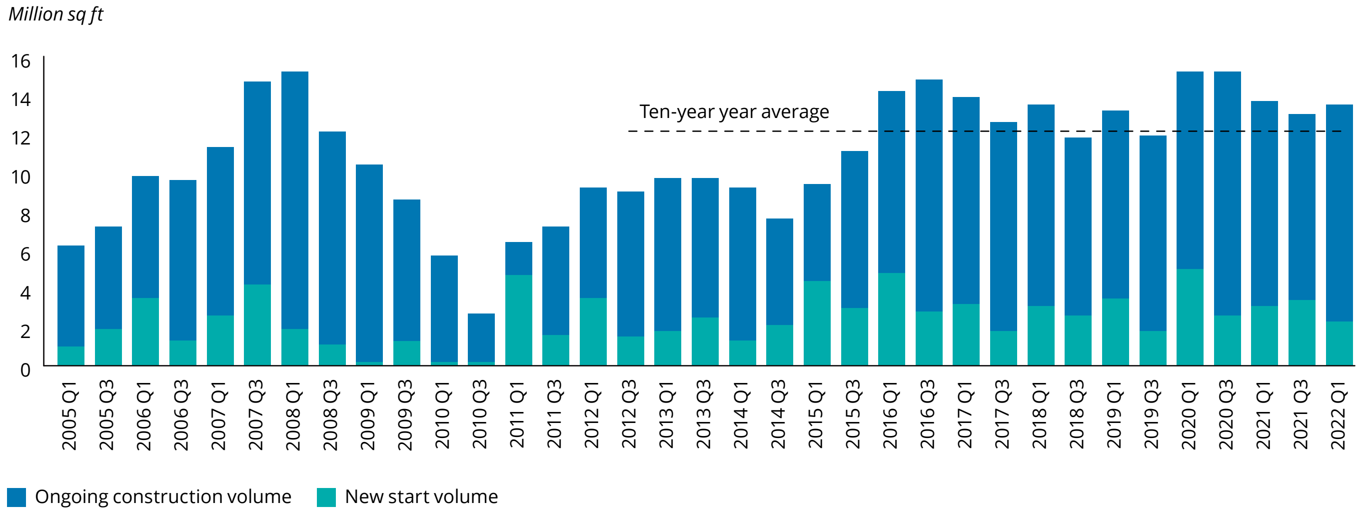
With the volume of both new starts and completions lower than in the previous survey, there was very little change in the total volume under construction in central London, with the overall amount increasing by 4% to 13.5 million sq ft. This remains above the ten-year average of 12.1 million sq ft for the fifth consecutive survey as more completions were delayed and there was a lower level of new starts, mainly because new construction is restricted to smaller refurbishments, while contractors struggle to offer fixed prices in the current economic climate.

The vast majority (83%) of ongoing construction works are partly due to delays in a number of large schemes. The 870,000 sq ft new Google headquarters in King's Cross has seen several delays due to complexity of the development, a protracted process of appointing contractors, as well as difficulty getting materials to the site. Other scheme delays were related to supply chain disruption, labour shortages and change in the plans for the development. The 162,000 sq ft Rowe in Whitechapel High Street is one such example, where the original plan to build six storeys was changed to a 12-storey building.

In terms of submarkets, overall construction levels in the City are in line with the long-term average of 6.5 million sq ft. The West End has been seeing more overall activity in the last few surveys, and currently accounts for almost a quarter of all central London office works. The Docklands witnessed the lowest level of construction recorded in the survey with only 0.4 million sq ft under way as of March 2022.

Construction remains on hold on both the 214,000 sq ft Frameworks Building and the 191,000 sq ft Market Building in Canary Wharf as the developer awaits a pre-let or a decision to build speculatively. There are several schemes in demolition stage where construction work has stalled by minor planning issues or redesigns, combined with market demand considerations or funding in a minority of cases. The largest scheme that has not progressed from demolition is the 246,000 sq ft 125 Shaftesbury Avenue, most recently occupied by WeWork, Facebook and Nisbets. It showed no outward signs of activity as of the end of March 2022.

Central London: Total volume under construction per survey



Source: Deloitte

Completions are down but 2022 will see a surge of new supply

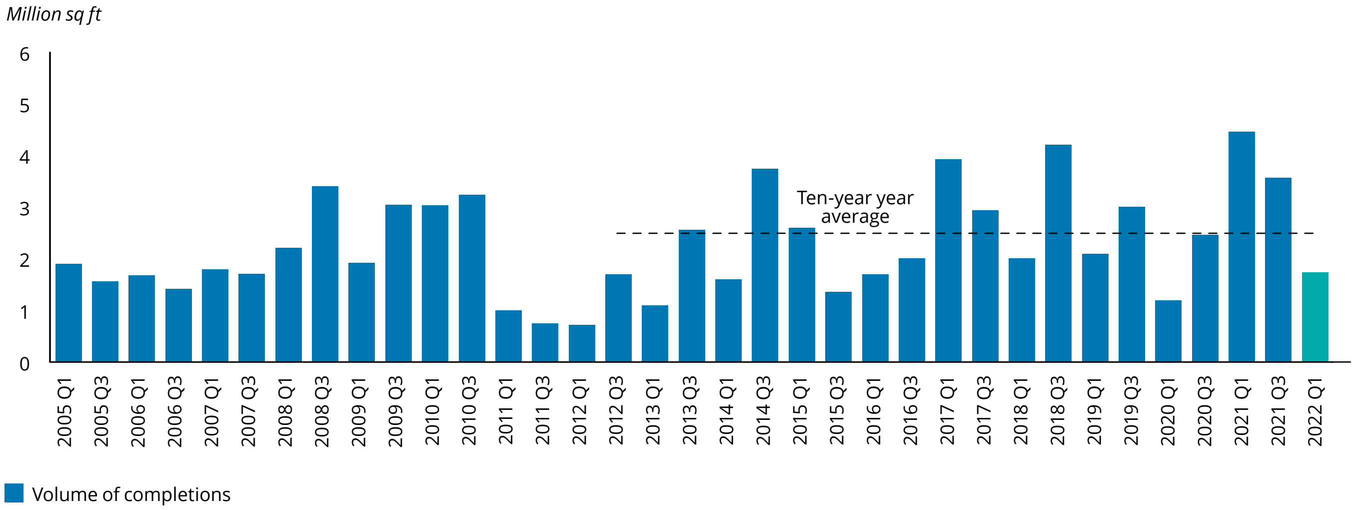
Following strong completion levels in our previous two surveys, office deliveries in central London fell by half to 1.7 million sq ft between October 2021 and March 2022. This is also below the long-term average of 2.5 million sq ft and significantly lower than our previous estimates. Many of the completion delays are related to supply chain disruption and labour shortages.

The largest completion between October 2021 and March 2022 was the refurbishment of the 280,000 sq ft Duo at 280 Bishopsgate in Spitalfields. The scheme is close to being fully let, with digital group Cognizant recently taking 53,000 sq ft, Abrdn swapping Bow Bells House for 42,000 sq ft at this scheme and Getty Images securing 10,000 sq ft. This is in addition to the 153,000 sq ft pre-let from the global law firm Baker MacKenzie which was the biggest transaction at the height of the pandemic in 2020.

Nonetheless, we expect the next six months to be strong for office completions with at least four million sq ft due to be added to the central London office stock between April and September 2022. Notably, office completions in 2022 are expected to reach at least seven million sq ft. Should all space complete on schedule, this would be the highest annual figure since 2003, a year in which a wave of new towers completed in Docklands and the iconic Gherkin topped out in the City.

One of the most anticipated office deliveries this year is the 770,000 sq ft 8 Bishopsgate, a speculative project which commenced shortly before the pandemic started in 2020. The 564,000 sq ft 21 Moorfields, located directly above an existing Moorgate station and a future Crossrail ticket hall, is also nearing completion and will become Deutsche Bank's new London headquarters.

Central London: Total volume of space completed per survey



Source: Deloitte

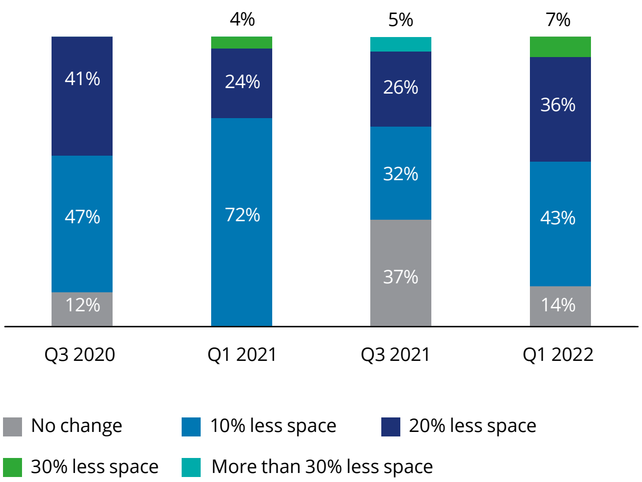
Office demand improves but is yet to return to pre-pandemic levels

The London office leasing market has recovered from its 2020 pandemic-induced low, but it has not recovered to pre-pandemic levels. 2021 saw moderate office demand of over nine million sq ft as occupiers continue to reconsider their space needs. However, stronger levels of demand in the six months to March 2022 have marked a return to more normal levels of leasing activity. Having said that the majority of occupier demand remains for best-in-class office accommodation with ESG credentials.

According to our survey results, developers and landlords remain optimistic about the leasing market with 65% reporting that leasing demand was "a little better" and 14% suggesting a "much better" demand than six months earlier. This compares to 55% of respondents who indicated "a little better" leasing market and 35% - much better in the previous survey. However, for the first time since our Winter 2020 survey, 7% of respondents pointed to worse leasing demand than six months earlier, suggesting some reservations.

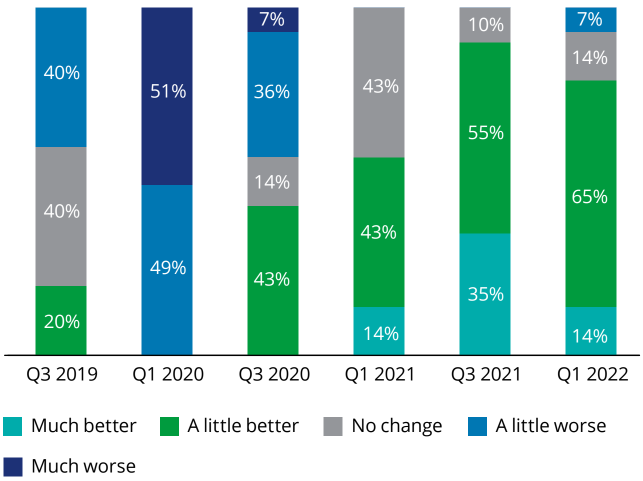
More developers and landlords are also expecting a fall in the level of occupier demand for office space as a result of hybrid ways of working than in our previous survey. Almost half of respondents (43%) are anticipating demand to fall by up to 10% and more than a third (36%) are predicting occupier demand will drop by up to 20%. Only 14% is suggesting that there will be no long-term impact on the tenant demand, compared to over a third (37%) in the previous survey.

Landlord Survey: 'What impact will homeworking have on the amount of office space tenants will be taking long term?'



Source: Deloitte

Landlord Survey: 'Compared to six months ago, how do you currently perceive leasing market?'



Source: Deloitte

It is possible that over the longer term the overall stock in London will decrease by between 10% and 20% because of flexible working. However, the remaining stock will need to be of a much higher standard in terms of sustainability, technology and amenities to meet occupier requirements.

Peter Ferrari, Chief Executive, Ashby Capital

Flexibility and ESG credentials dictate tenants' decisions

With the limited availability of prime office space with the right ESG standards and amenities for their existing and potential employees, occupiers are likely to need to pre-let offices significantly in advance of lease events on their existing buildings, especially for large requirements.

According to our latest results, pre-letting activity remains broadly similar to previous surveys, with almost a third of space under construction being committed to by a tenant. One of the most notable pre-lets in the six months to March 2022 was Allen & Overy who secured 254,000 sq ft at 1-2 Broadgate. The law firm chose this building so that it can achieve its goal of reducing absolute carbon emissions by 50% by 2030. With JLL taking the remaining 114,000 sq ft, 1-2 Broadgate is already fully pre-let ahead of its completion in 2025.

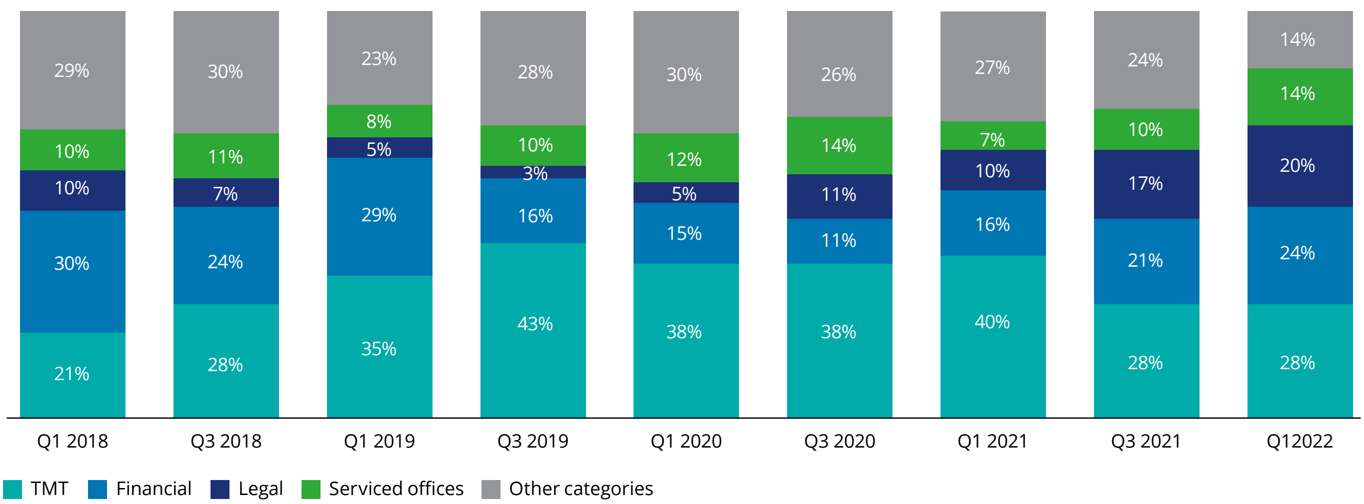
Despite a lower proportion than in our recent surveys, the Technology, Media and Telecommunications (TMT) sector continues to dominate central London office demand with 28% of space under construction pre-let by this sector. Financial Services have increased their share of pre-commitments in recent years to almost a quarter (24%) of all pre-lets, while the Legal sector currently accounts for 20% of pre-let space under construction, up from 5% only two years ago.

Occupiers from across industries are increasingly needing offices with a fit-out that reflects hybrid working styles and are flexible enough to adapt as future needs evolve. Critically, tenants' own commitments to sustainability have redefined what offices they want to occupy in the future and how quickly they need to move to achieve those targets. Tenants are more likely than ever to reject offices that do not meet certain ESG criteria.

> It looks like businesses would need a smaller office footprint but a higher specification. Now that means that second class, or secondary or old office buildings, will be less attractive. It's a good opportunity to repurpose them for other uses and residential may be one of them but conversions need to be properly controlled.

Cllr Geoff Barraclough, Cabinet Member for Planning (Policy) and Economic Development at Westminster Council

Central London: Percentage of pre-completion lettings by sector



Source: Deloitte

Financial districts turn to life sciences

The City and Canary Wharf are turning to life sciences in a bid to diversify beyond their traditional type of offices and previous core market of finance. With the expansion of the UK's wider professional, scientific and technical sectors, accelerated by the pandemic, life sciences outperformed other office-based sectors in terms of employment growth during 2020 and have continued to do so. Furthermore, there was a record level of investment into the UK life sciences sector in 2021, supported by the government's agenda to invest in research and development, as well as technological advances.

The Canary Wharf Group has recently announced plans to develop a 750,000 sq ft life sciences focused lab on their 3.3-hectare North Quay site, next to the new Elizabeth Line (Crossrail) station. The 22-storey tower will be the first phase in the creation of the largest commercial wet lab-enabled life science building in Europe, by 2026. With the NHS moving offices to 20 Cabot Square and the NHS property division moving to 10 Cabot Square, a life sciences cluster is gradually taking shape in the area.

In Whitechapel, to the east of the city, plans have been submitted by NHS Property Services to develop a life sciences cluster with a variety of small, medium and large commercial life science companies co-locating to 902,000 sq ft of modern lab-enabled buildings. Its owners are reportedly aiming to fill it with a mixture of biotech start-ups, academics, clinicians and more established pharmaceutical companies.

Elsewhere, Stanhope and Mitsui Fudosan have recently submitted plans for a major extension to the British Library at St Pancras, which will create a new 600,000 sq ft life sciences scheme. The area is already home to the Francis Crick Institute and the Alan Turing Institute, which is headquartered in the British Library, as well as medical charity the Wellcome Trust and University College London in nearby Euston/Fitzrovia. Stanhope is also behind the life sciences development at Royal Street close to St Thomas' Hospital, as well as White City Place Gateway.

Developers are no doubt seeking to take advantage of rapid growth in the sector and the UK's traditional strength in science, centred around the so-called Golden Triangle of London, Oxford and Cambridge. Developers have realised that it is reasonably easy to add limited additional specifications to the shell and core of an office to allow it to be fitted out as a lab and to appeal to this strengthening occupier base. While the life sciences sector will likely remain a modest part of central London office demand, it will certainly shape the next stage of market evolution.

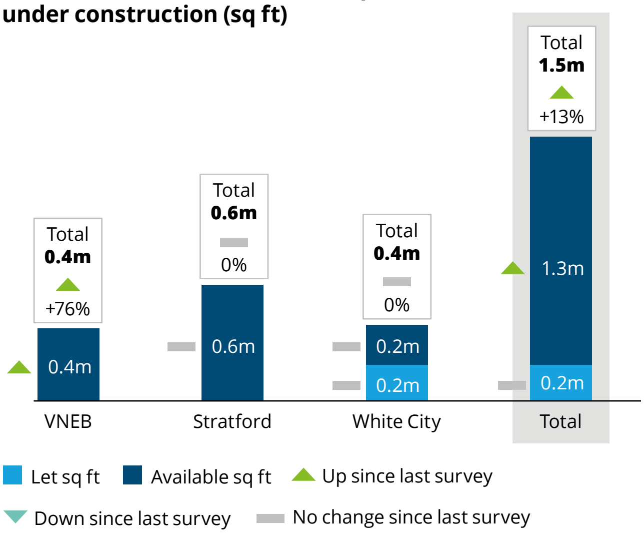
Other submarkets

Other submarkets

Vauxhall – Nine Elms – Battersea – the only submarket with new construction

In other London submarkets, there were two new starts between October 2021 and March 2022, both in **Vauxhall – Nine Elms – Battersea** (VNEB). The largest new start was the 120,000 sq ft Nine Elms Park Plot A. Developers are planning to use smart technology and target sustainability ratings of BREEAM Outstanding, Wired Certified Platinum and WELL Platinum-enabled. Construction started at the end of 2021 and is due to complete in late summer 2023. The submarket also saw new construction of mixed-use development Graphite Square in Vauxhall, which will include 54,000 sq ft of office space, with completion scheduled in 2024. Since Nine Elms and Battersea Power Station tube stations opened in late 2021, the area has benefited from connections to the City and West End and to the wider London transport network.

Other submarkets: Total office space under construction (sq ft)



Source: Deloitte

There were no new starts or completions in **Stratford**. Since the London Olympics in 2012, Stratford has certainly come of age thanks to infrastructure improvements, including the soon-to-open Elizabeth Line, and has become home to a number of organisations in the government as well as TMT sectors. With office rents in Stratford remaining competitive compared to central London, the office market continues to grow with the 1.2 million sq ft International Quarter London in the pipeline. Construction of MU2, part of Sugar House Island, is well under way and will bring 290,000 sq ft of office space ranging from small creative workspaces to state-of-the-art headquarters along Stratford High Street. MU2 is expected to complete early 2023.

In **White City**, works continue on the 285,000 sq ft Gateway Central Building, 25,000 sq ft Gateway West and the 115,000 sq ft 1 Wood Crescent. All three are scheduled to complete in early 2023. With life sciences demand for affordable lab space now outstripping supply, especially from early-stage life sciences companies, White City offers competitive rents compared to central London. The proximity to the talent and research facilities at Imperial College's new White City Campus, clinical teams at nearby Hammersmith Hospital and good transport links are all likely to encourage more office development in the coming years.

In the South East of London, Art-Invest received planning permission for a 1.5 million sq ft office-led scheme in **Canada Water**. This is the largest office development in the UK since the beginning of the pandemic. The works are expected to start in spring 2023. This development will be a neighbour to British Land's 53-acre Canada Water masterplan, which has planning consent for 2.4 million sq ft of office accommodation. Australian pension fund Australian Super has recently invested £290 million for a 50% stake in British Land's project.

Key themes and outlook

Key themes and outlook

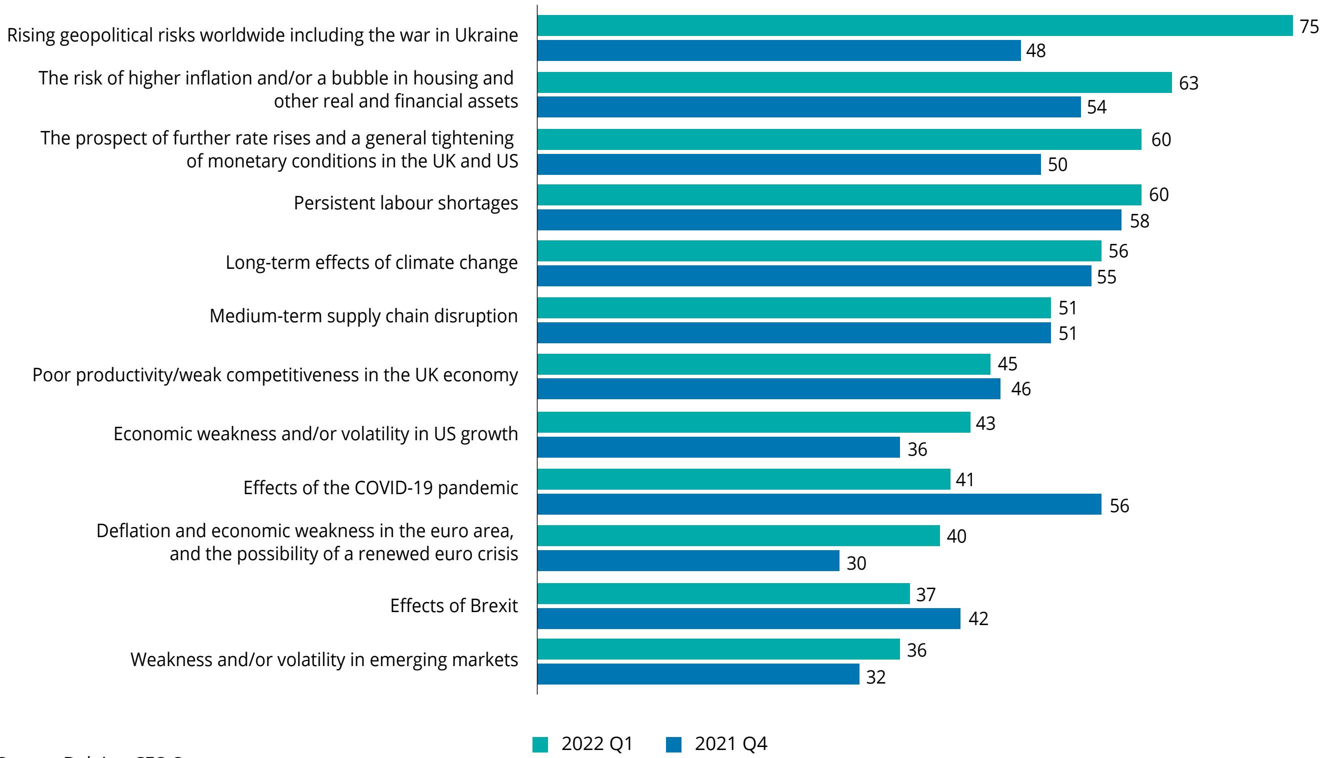
Geopolitics and rising inflation heighten the level of uncertainty

The level of economic and financial uncertainty facing businesses has risen in the last few months as UK inflation is at its highest in 40 years, reflecting surging international energy prices as a result of the war in Ukraine as well as supply chain disruptions. According to the Deloitte CFO Survey: Q1 2022, over half of CFOs (56%) say that the level of uncertainty facing their business is 'high' or 'very high'. This is, however, below the levels seen during the pandemic in 2020.

In terms of risks, geopolitics has risen sharply as the top challenge facing CFOs' businesses. Except for the pandemic during Q2 and Q3 2020, geopolitics is higher than any other risk factor since the question was first asked in 2014.

Rising inflation, the prospect of further interest rate rises and persistent labour shortages also rank high on the list of corporate concerns. For CFOs, elevated uncertainty is increasingly a fact of life that has to be managed and mitigated. In addition, business confidence in the construction sector fell in March to a 17-month low, according to the S&P Global/CIPS UK Construction Purchasing Managers' Index. This again reflects the growing concerns of UK companies regarding inflationary pressures and the economic impact of the war in Ukraine. However, this pessimistic outlook was in contrast to CFOs remaining upbeat on the prospects for revenue growth, with three-quarters expecting revenues to be higher in a year's time.

Risk to business posed by the following factors
Weighted average ratings on a scale of 0-100 where 0 stands for no risk and 100 stands for the highest possible risk



Source: Deloitte CFO Survey

Unexpected events can occur. COVID-19 was one which has had a massive impact on companies' culture. Another risk today is inflation, which coupled with a recession, could severely impact the demand and cost side.

Peter Ferrari, Chief Executive, Ashby Capital

Investment and lending activity returns to pre-pandemic levels

The London office investment market had a bumper start to the year with £5 billion transacted in Q1 2022, according to Property Data. This was 25% above the ten-year quarterly average and the highest quarterly total since Q4 2019. The largest transactions in recent months were made predominantly by foreign investors that appeared undeterred by uncertainty related to geopolitical issues and pandemic-disrupted supply chain recovery. Korea's National Pension Service bought UBS's headquarters at 5 Broadgate, for more than £1.2 billion; Google acquired Central St Giles for £762.5 million for its own occupation and Singapore's Ho Bee Land paid £718 million for 52-54 Lime Street.

Commercial real estate lending activity has bounced back to pre-pandemic levels, according to the latest report from Bayes Business School, formerly Cass. New lending volume in 2021 reached £49.8 billion, more than the £43.8 billion registered in 2019, and 48% higher, year-on-year, than 2020. The real estate finance market has managed to navigate the challenges of recent years well, a resilience that has been attributed to both the discipline and the diversity of lenders.

EPC requirement is added stress on owners with older stock.

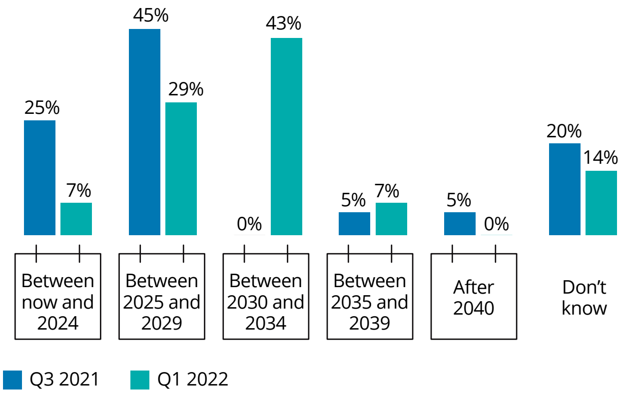
London-based asset manager

New EPC regulations to trigger a flurry of investment in refurbishment

Minimum Energy Efficiency Standards (MEES) are evolving at pace with a step change in requirements starting over the next ten years. Since 2018 a minimum EPC rating of E has been in place for new tenancies, but from 1 April 2023 this is set to change, and the same rule will apply to all existing leases. This means that it will be unlawful for a landlord to continue to let a commercial property with an EPC rating weaker than E. The 2023 changes are a precursor to reaching a new target set out in the government energy white paper that was unveiled in December 2020 to achieve net zero emissions by 2050. New minimum energy efficiency standards currently before parliament will require commercial buildings to have a minimum rating of B by 2030. Buildings that do not meet those requirements will become unlettable in most cases.

What this means in practice is that 10% of central London office stock with a current EPC rating of F or G, an equivalent to 20 million sq ft, will be unlettable when new regulations come into effect in 2023. Crucially, with only 15-20% of central London offices with an A or B rating, an astonishing 80% of London offices could potentially become unusable by 2030 unless they are upgraded. This will have a significant impact on the office market as approximately 15 million sq ft will need to be upgraded annually to meet these requirements, almost three times the typical office completion levels. As a result, we expect to see a flurry of investment transactions in the coming years as many owners would prefer to sell a building rather than commit to a refurbishment, while others will be forced to bring properties up to a B standard themselves.

Landlord survey: 'By when do you think all your new developments will be net zero?'



Source: Deloitte

ESG standards: proliferation and perceived lack of clarity

Two-thirds of landlord and developer respondents to our survey highlighted a lack of definition and clarity regarding terminology such as 'Net Zero', coupled with a seemingly ever-expanding range of ESG related benchmarks as a cause for confusion. These are understandable and well-founded concerns and observations.

The quest to achieve Net Zero is gaining momentum but is inevitably driving a need for greater understanding as to exactly what it means. Firstly, how to address embodied and "new" carbon within either standing assets or new construction, and secondly, carbon associated with the operation of a building. Accounting for Scope 1, 2 and 3 emissions in respect of asset operation is aiding the transition but understanding and addressing the implications is arguably at a formative stage within the sector.

> There is lack of clarity about which ESG standards to adhere to and this is creating more uncertainty and therefore risks.
>
> **European Bank**

The evolution of MEES is currently gathering momentum and therefore also market focus. To date, and notwithstanding broader Building Regulations requirements, MEES stands alone as a legally enforceable tool through the EPC metric. Yet it solely addresses energy efficiency in terms of 'design capability' rather than in operation or the broader ESG or sustainability agenda. Also addressing energy efficiency, but in operation rather than design capability, is the National Australian Built Environment Ratings System (NABERS UK) which origins are from Australia and may well form the basis for future regulatory Operational Energy Ratings.

More broad-based ESG-related accreditations in the form of Building Research Establishment Environmental Assessment Method (BREEAM) and Leadership in Energy and Environmental Design (LEED), together with the annual benchmarking program run by Global Real Estate Sustainability Benchmark (GRESB) are voluntary but increasingly well supported and subscribed. As are accreditations such as WELL Building and Fitwel which arguably focus more on the 'S' within ESG by principally addressing Wellbeing factors within buildings.

It is perhaps illustrative of both the relative infancy of recognition of the importance of the ESG agenda within real estate as well as the rapid evolution of its gravitas that we are witnessing a proliferation of related standards, assessments and indeed associated vocabulary.

Importantly, the standards aid transparency and therefore have a role in guiding market choice – there is danger and risk however in 'green washing' as overly simplistic reference to accreditations papers-over the cracks of variable knowledge to inform decision making.

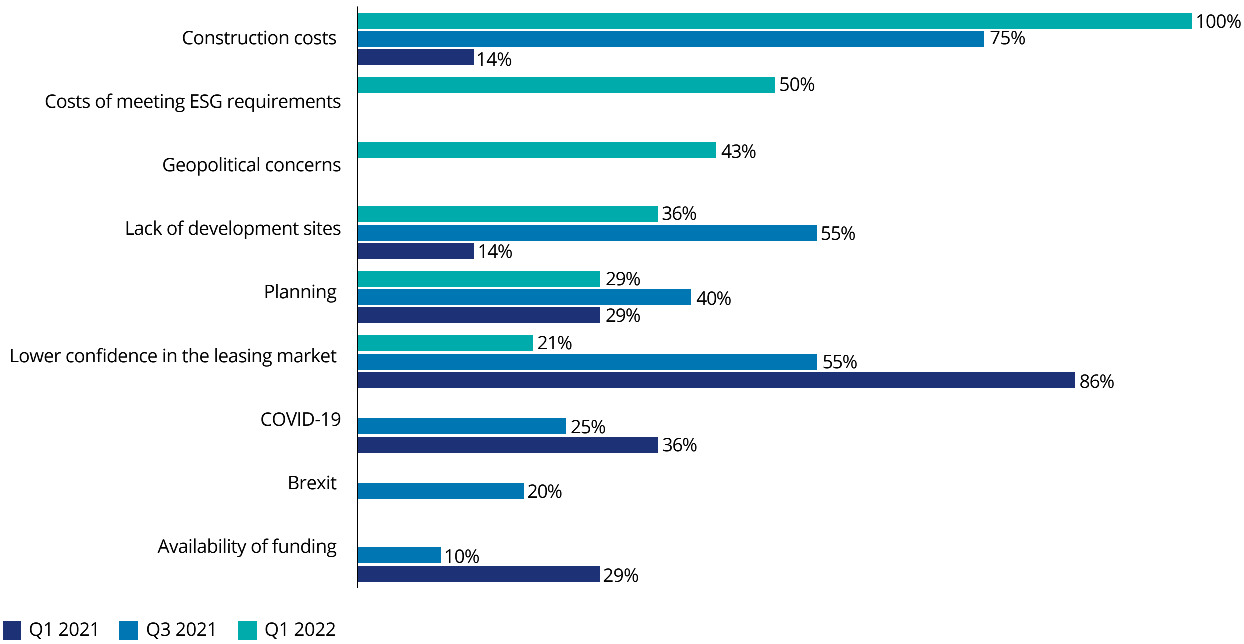
Cost as the biggest barrier to refurbishment

In our survey all developers pointed to cost as the most significant barrier to refurbishment. There is little surprise in this response given both the prevailing inflationary environment and also the well-documented challenging supply chain issues that currently prevail.

The ESG agenda is heightening this challenge – particularly in respect of inferior-grade stock in non-core locations. The concept of 'stranded assets' is increasingly referenced as the ESG/carbon-viability (or potential) of a project is set against the financial viability of undertaking major works. Working within the physical limitations of buildings requiring upgrading to address rapidly evolving working practices as well as ESG requirements is not necessarily a new challenge, but it is currently a key area of focus.

Of course, some buildings lend themselves well to refurbishment, innovative upgrading and visionary re-positioning – achieving strong ESG credentials and occupier appeal. For others it is more challenging. Whether that be the retrofit of period and/or listed buildings or more modern buildings with sub-optimal thermal qualities and internal layouts configured in an era of less agile working practices. Certain regulatory requirements, notably MEES, are subject to an economic viability test, however, with occupier expectations evolving minimum statutory compliance does not necessarily ameliorate the risk of marketplace obsolescence.

Landlord survey: 'What are the top three challenges to development today?'



Source: Deloitte

More active and responsible asset ownership is needed

In the absence of capital expenditure to bring a building up to B standard, some landlords could consider selling the property. Potential buyers are likely to be investors, such as private equity firms, with better access to the funds needed for extensive refurbishment. With a low supply of sustainable high-spec offices in central London, this presents a huge investment opportunity. Pursuing a refurbishment, rather than a new-build construction, is also a cheaper and a quicker option for investors in the current economic climate, defined by rising costs and uncertainty.

> Owners with a passive interest in office buildings are less likely to able to meet the costs of refurbishing the office and they will sell. Typically, they haven't set aside funds to meet this capital expenditure. These properties are likely to be bought by private equity companies who have funds and can meet the costs of refurbishments.

Mark Hatcher, Managing Director, Ares Management

However, investors will also need to be more involved in operations of the business and collaborate with a tenant on reducing a building's carbon footprint. Gone is the era of collecting rents every quarter or not regularly checking office buildings. With occupier requirements continually evolving, asset owners will need to build a closer relationship with their client and provide "a flexible service that is hands-on".

> Owning an office space is now an operation business. It is key to build a community, establish a relationship with tenants. Help tenants reduce their carbon footprint. The best landlords are the ones that embrace that and see tenants as customers.

Global asset manager

Office workers are in no hurry to return

The pandemic has been a catalyst for fundamental changes to the way office space is being used. Hybrid working is here to stay so is the office where employees can collaborate, innovate and upskill with colleagues. Health and wellbeing considerations are also a central component to new development plans.

Even though the requirement to work from home was lifted in January 2022, employees have not yet fully returned to their offices. The average weekday journeys on the Underground in March and April 2022 (excluding days when the tube strike took place) were just over 60% of pre-pandemic levels, according to Transport for London. Occupancy levels were at 26% across the UK at the end of April 2022, lower than pre-pandemic levels of about 60%, with London following this trend according to Remit Consulting.

Organisations have been making efforts to lure workers back to the office with the quality of the working environment a key part of this initiative, for example providing cinema rooms, spinning studios, bars, restaurants and roof terraces. Landsec launched a campaign last summer to entice more people back into central London by offering discounts at local bars and restaurants, and wellbeing and music events. The Landsec campaign is designed to remind people that the office is more than just a desk and a screen and that there are elements that cannot be replicated when working at home.

> More firms will become like Google and Facebook which have always had a flexible work culture. They have recognised the need to provide good amenities in the workplace to encourage employees to come into the office.

Peter Ferrari, Chief Executive, Ashby Capital

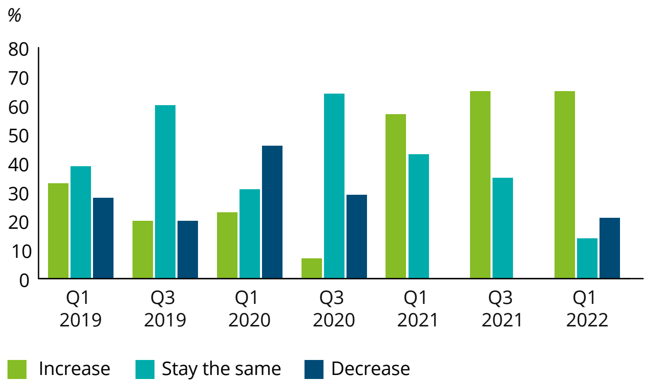
As far as amenities go, Google's new 870,000 sq ft headquarters in Kings Cross will come with a 25-metre swimming pool, a 200-metre rooftop running trail and a large sports hall with views over London. As part of its plan to expand its UK workforce, the tech giant has also recently bought the 15 storey Central Saint Giles development for £730 million. Elsewhere, Microsoft is drawing up plans to leave its UK headquarters in Reading for new office space in central London as it looks to compete with the likes of Apple, Google and Facebook.

The race for talent is intrinsic to an organisation's success and sustainability. Real estate, as both an outward representation of a brand and a hub for staff, is a key part of that equation. With office costs continuing to be a fraction of wage bills, broadly 15% and 55% of total costs respectively, businesses are increasingly looking for high-quality office space as part of their strategy to attract both new talent as well as retain existing staff. Resilience and growth in Grade A rental levels is evidence of this focus for occupiers.

> For the new generation of young people coming into the workforce, it is not just about the employer but also the place of work.

London-based developer

Landlord survey: 'Compared to six months ago, how do you expect your pipeline to change in the next six months?'



Source: Deloitte

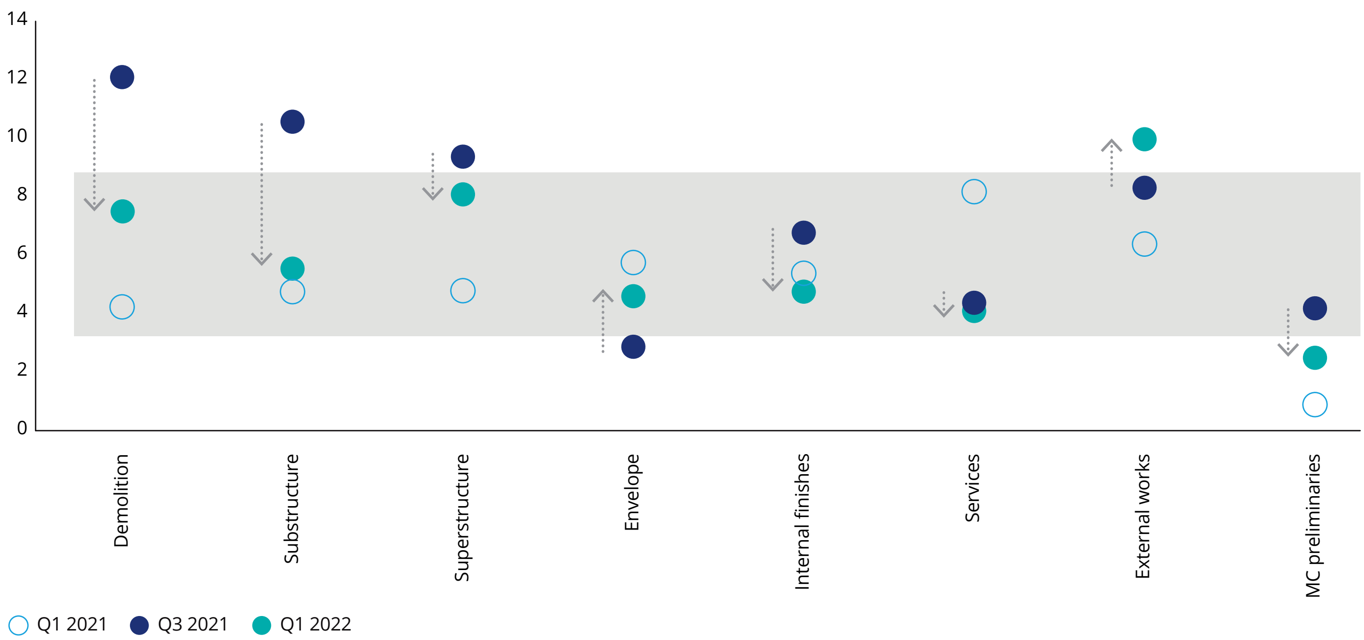
Construction cost and workload sentiment survey

Construction cost and workload sentiment survey

To complement the London Office Crane Survey, Deloitte's cost consultancy team carries out a bi-annual construction market survey, capturing market sentiment on workload and price. The construction industry is busy. But our developer survey has highlighted construction prices as the most significant risk for office developments. COVID-19 and Brexit are being displaced by commodity and energy prices, exacerbated by the conflict in Ukraine, as the main drivers for material prices increases. Will these inflationary pressures continue?

Growth in workload expectations slows

Workload – Change in sentiment over the next 12 months (%)



Source: Deloitte

Data from the trades completing our Construction Market survey showed that while all expect growth in the next 12 months, most expect the pace of that growth to slow significantly. This is consistent with similar findings by the Office for National Statistics (ONS), the Construction Products Association (CPA) and IHS Markit. Our London Office Crane Survey highlights that construction levels continue to remain above the long-term ten-year average

In the chart on previous page, the arrows indicate the change over the past six months in predictions of the future workload level. All trades predict a rise in workload (all the blue dots are positive) but most predict that the rate of increase will slow.

Anecdotal evidence indicates that starting new projects is being hampered by the volatility in market prices of materials and hence an inability or difficulty to agree fixed price contacts. The larger the project the greater the risk and therefore perhaps unsurprisingly, the new starts recorded in the crane survey data in this period are generally much smaller schemes.

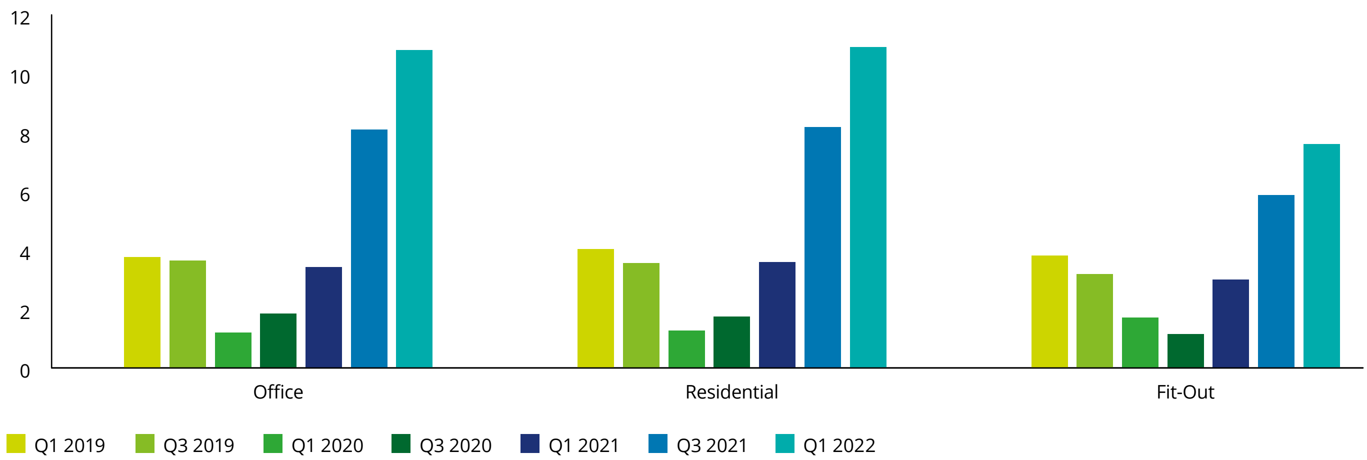
Trades are clear that prices are only going one way – up!

Sentiment around both costs and prices is very clearly moving upwards, and significantly. 12 months ago, trades were predicting an average rise over the following 12 months of around 3.4% for commercial office projects, and 3.0% for fitout projects. In our previous survey, six months ago, these numbers had increased to 8.1% and 5.9%, respectively. In our latest survey trades are predicting an increase of 10.8% for office projects and 7.6% for fit-out projects. The rate of increase for offices is higher as this reflects the exposure to significant increases in energy prices that affect materials such as the steel, cement and glass.

The fixed price nature of many construction projects means that contractors are working on projects that they priced 12 or 18 months ago and are now facing thin or more likely negative margins, the impact of which may play out in the coming months. As described above, the ability to close out contract negotiations on new projects will inevitably lead to delays and/or the need to consider risk sharing between contractors and clients.

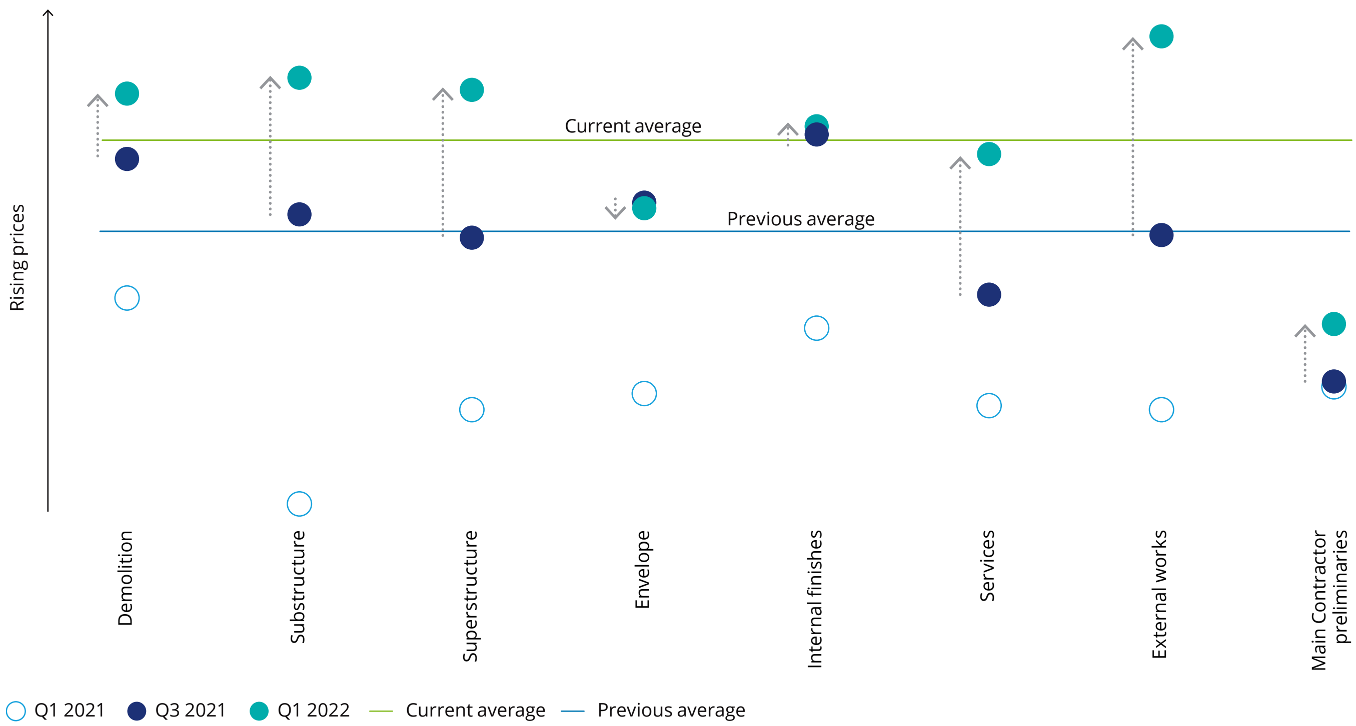
The graph overleaf shows the results from individual trades which again highlight significant increases in how trades perceive prices will change in the next twelve months. Prices are expected to increase by around 11% on average, up from 8% six months ago, similar to the figure for offices given below.

Price change expectations over the next 12 months; inside M25 (%)



Source: Deloitte

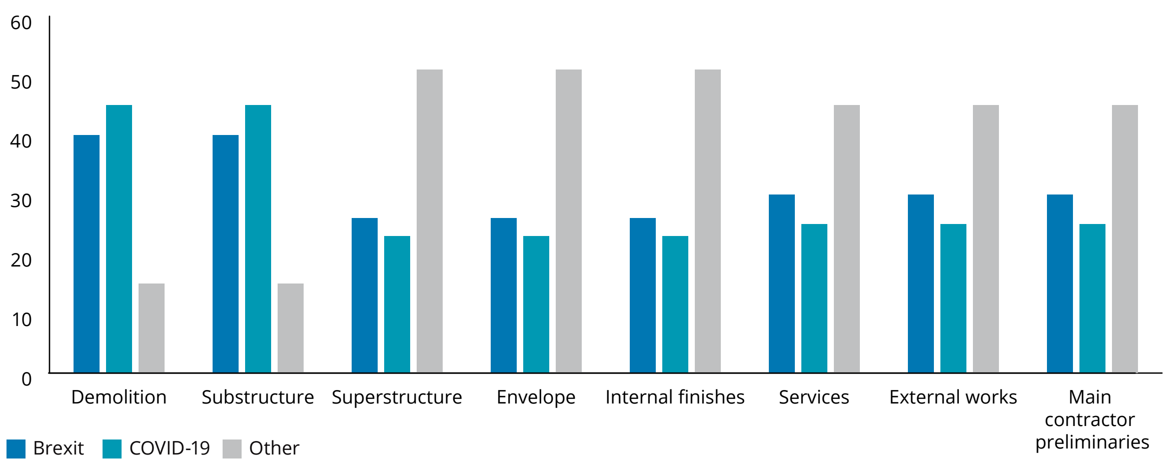
Price change sentiment for the next 12 months



Source: Deloitte

Growth in workload expectations slows

Prices: What is driving the anticipated price changes? (%)



Source: Deloitte

So, what is driving the price increases? The chart above and the responses from trades make it clear that COVID-19 and Brexit are generally no longer the key reasons. While supply chain disruption due to strict COVID-19 lockdowns in countries like China are still relevant for some products, but increasingly the current price increases reflect the high energy intensity of manufacturing many construction materials and the associated significant increases in oil and gas prices.

A potential strategy to avoid the worst impact of the price increases is to follow the sustainable route of refurbishment: keeping the energy intensive steel and concrete elements of existing buildings and hence reducing the embodied carbon impact of the scheme. This is reflected in our crane survey results for new starts, where the volume of refurbishments is broadly consistent with the last two surveys whereas new-build new starts are much reduced this time.

Survey responses as well as industry news have tended to focus on price increases for materials as these have been far more volatile. More domestic inflationary pressures may become apparent in labour costs if workload levels continue to grow across the construction industry, as our survey suggests.

Will the price increases reverse?

We asked survey respondents whether they thought the current rise in prices was temporary or permanent.
The chart below provides results on a trade-by-trade basis.

There is roughly a 60:40 split in favour of permanent price rises. We interpret this split to mean that the froth or volatility of prices will settle, and the supply and demand imbalances caused by COVID-19 will ease over time. Less clear is the timeframe: reducing energy prices or changing oil and gas suppliers will not be easy or quick given the current geopolitical environment.

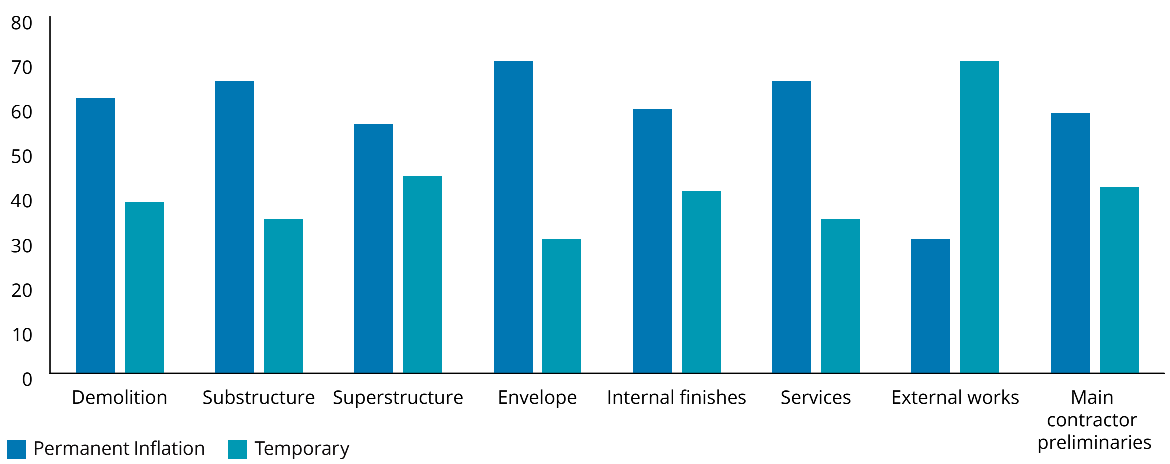
ONS price data for the 12 months through to February 2022 shows the following material price changes and confirms the reduction in excessive timber prices caused by house-building activity in the US but still a 23% annual rise.

Material price increases in the last 12 months

Material	Increase in the 12 months to Feb 22	Increase in the first 6 months (Feb 21 to July 21)	Increase in the second 6 months (Aug 21 to Feb 22)
Structural steel	+36%	+48%	-8%
Concrete reinforcing bars (steel)	+44%	+37%	+5%
Imported sawn timber	+23%	+56%	-21%
Ready mixed concrete	+13%	+6%	+7%

Source: ONS

How much is the rise in prices permanent or temporary? (%)



Source: Deloitte

London versus the regions: plenty of room to level up

London versus the regions: plenty of room to level up

London has outpaced the regions

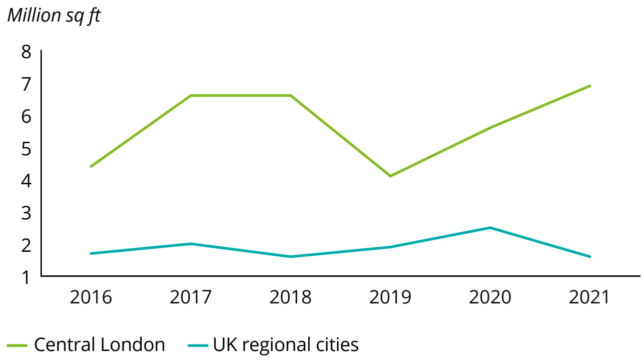
Over the past six years, Deloitte has run four regional crane surveys alongside the London Office Crane Survey. Comparing them demonstrates the scale of the so-called "levelling-up" challenge facing the government.

The London office construction market continues to dominate the UK scene. Annual office completions in central London increased by 57%, from 4.4 million sq ft to 6.9 million sq ft between 2016 and 2021. Both 2022 and 2023 are projected to see at least 7 million sq ft in office completions.

In contrast, the combined completions in the four regional cities – Belfast, Birmingham, Leeds and Manchester – grew by a modest 6% during the same period.

In the 12 months to December 2021, trends in office completions differed between the regions and the capital. Completions decreased by 36% across the regional hubs, from 2.5 million sq ft to 1.6 million sq ft, while London saw an increase of 23%. It appears that London developers bounced back more quickly from the disruption caused by the pandemic. Completions have reduced overall in the regional markets because of the hesitancy to start new schemes during 2020 and 2021 or due to delays in project programmes.

Volume of office completions – Central London and regional cities (Belfast, Birmingham, Leeds and Manchester)



Source: Deloitte

The volume of office completions in the regions decreased in 2021 in three of the four cities. Belfast saw the volume of office space completions decrease by 14% to 346,000 sq ft. Only 82,000 sq ft was delivered in one office building in Leeds, compared with 667,000 sq ft in 2020. Due to delays, the volume of office completions in Manchester fell by 66% to 405,000 sq ft over the 12 months to December 2021. Of the schemes aiming to complete in Manchester between January and December 2021, 60% moved the date to 2022. In a survey of construction businesses, the main reasons cited for the delays were the consequences of COVID-19 (80%) and supply chain issues (70%).

In contrast, office delivery in Birmingham increased from 210,000 sq. ft in 2020 to 752,000 sq ft in 2021. This was largely attributed to delays caused by the pandemic in 2020 shifting completion dates to 2021. Similarly, London also saw office completions increase from 5.9 million sq ft in 2020 to 6.9 million sq ft in 2021 for the same reason.

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Further information

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