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Midtown on the up as South Bank reaches critical mass

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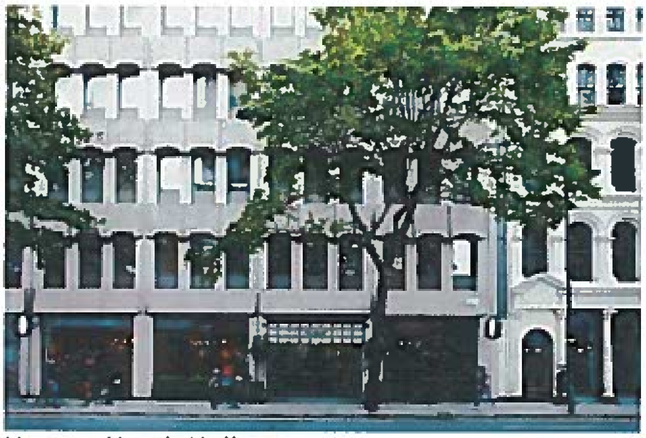
When the Hoxton Hotel opened its doors on High Holborn last September, it seemed to cement the arrival of a new era for Midtown.



Hoxton Hotel, Holborn

That a hip Shoreditch hotel would choose Holborn for its second site showed that the district had finally shaken its reputation as the slightly soulless heart of the city.

The area's burgeoning reputation as a destination in its own right has contributed to a substantial shift in the London office market. For many years, looking for an office in the capital involved a straightforward choice: east or west? Now, that simple decision no longer applies. Many office occupiers are willing to consider locations across the capital and Midtown will often be right at the top of the list. Accordingly, rents are going up and vacancy rates are plummeting.

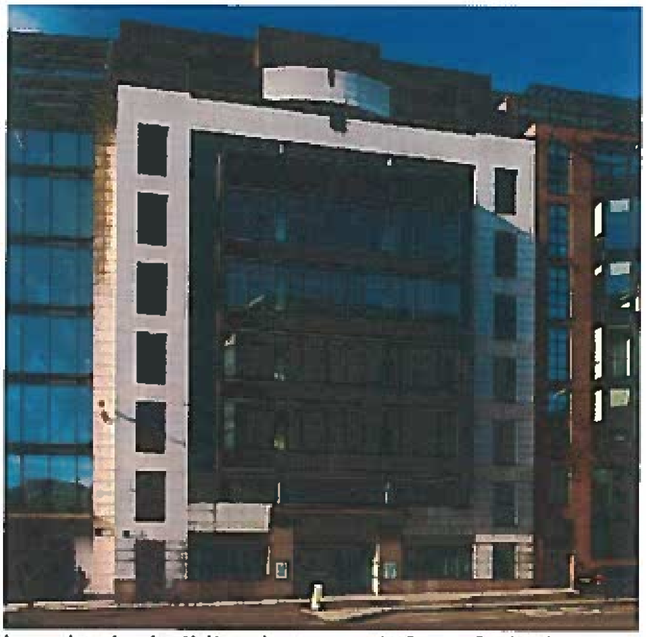
It's a similar story in South Bank, which is becoming an increasingly popular office destination, with rents and vacancy rates following a similar trajectory to Midtown. The question now is whether the two districts can cater to the rising demand.

Midtown heat

Ken Edwards is partner at Morgan Capital Partners, one of a number of investors bringing new space to the Midtown market. Last month, the firm partnered with AXA on its Pan European Value Fund to buy the 48,879 sq ft St Andrews House, just east of Chancery Lane. The vacant building will be fully refurbished to provide 55,000 sq ft over 12 storeys.

Edwards says Midtown now appeals to a broad range of occupiers that are helping drive up property values. "Within a stone's throw of our building we've got Deloitte, Goldman Sachs, Amazon, and a host of law firms," he says. "You pick up all those different types of occupier. Vacancy rates are at an all-time low – the low supply and strong demand is starting to drive rents and the projections are that rents will continue to grow for the next couple of years."

St Andrews House: Morgan Capital and AXA



bought the building last month for refurbishment

Statistics from a number of agencies support Edwards' assertion. Data from CBRE suggests vacancy rates have hovered at around 3% for the past 12 months and are currently at 2.8%. As a result, rents rose 13% in Midtown last year to £65/sq ft and are projected to hit £71.50/sq ft in 2015. By 2017, rents could peak at £76/sq ft.

Dan Hanmer, senior director at CBRE, says rents are being driven partly by an influx of occupiers that are being pushed east by spiralling rents. "We're getting West End occupiers who are used to paying rents of 30%-40% more," he says. According to Hanmer, occupiers who would not previously have considered moving from a traditional West End location are now actively looking. "They can get their heads around coming to the right building and paying a discounted rent. From a landlord's perspective that's great news."

While Midtown's status as a prime office location may be a relatively recent phenomenon, it has not come entirely out of the blue. After all, it was nearly two years ago that internet giant Amazon endorsed the district when it took 210,000 sq ft at 60 Holborn Viaduct. So why has take-up continually outstripped supply?

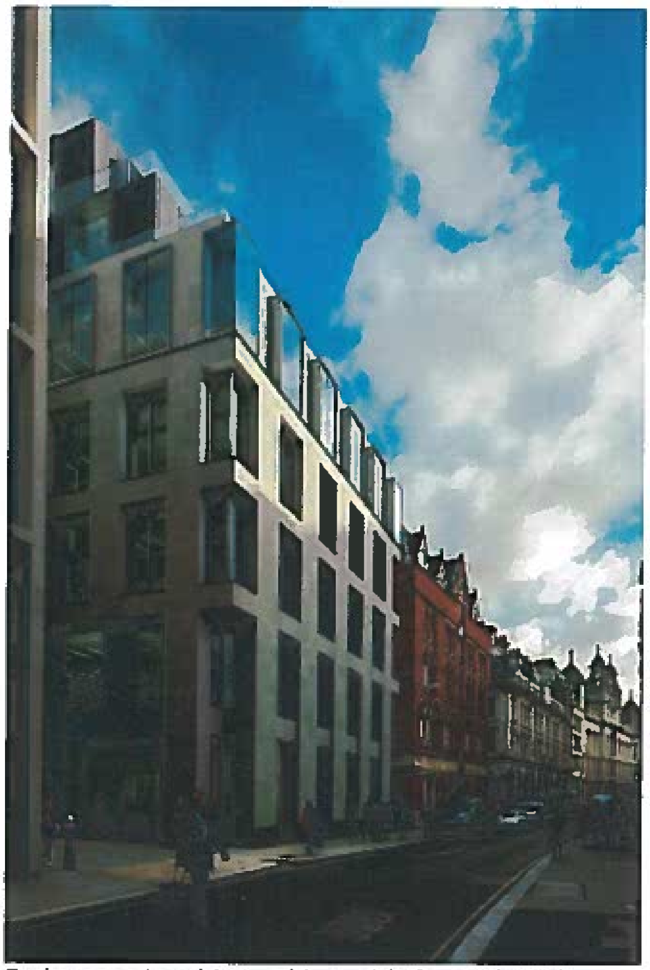
"There are a number of factors," says Mark Anstey, partner at Farebrother. "Midtown shares similar characteristics to the West End in that there's quite a lot of fragmented ownership. Buildings tend to be small, therefore it's difficult to create large-scale development sites. It's just more difficult in Midtown to buy and develop a large block. It's challenging to get big space on the market and quickly."

With opportunities few and far between, Anstey believes it is unlikely that supply will receive a boost any time soon. "If something got under way in the first quarter of 2015 it would take 12-18 months to deliver," he says. "It's unlikely that speculative development will have any kind of impact on the year in terms of availability. From that point of view, take-up is going to suffer, availability will come under significant pressure and we need availability for a healthy market. That said, if you're a landlord that's delivering in 2015, or have space on the market, you're going to be fairly bullish about your prospects."

South Bank rising

Footloose occupiers have also benefitted the South Bank, which, like Midtown, has risen in the estimations of office tenants in recent years. Statistics suggest the district is on a similar trajectory to the area just north of the river. According to CBRE, the two areas share a 20-year average vacancy rate of 4.8%. While Midtown is now down at 2.8%, South Bank has hit 2.5%. Last year saw rents increase 15.8% and, like Midtown, they're expected to see 10% further growth this year.

"I've seen four cycles at the South Bank where it's almost got there," says Paul Smith, co-head of central London agency and development at Colliers. "I really think it has got critical mass and it is a market that is there to stay."



Endurance Land is working with Scottish Widows to refurbish 35 Chancery Lane

Like Midtown, the South Bank's rise in popularity can in part be attributed to the number of bars, restaurants and hotels opening in the area looking to cater for the growing number of office workers. According to Smith, rising rents in the South Bank are likely to provide a new wave of development opportunities as existing tenants are forced to move on.

"There are a number of buildings where there are lease expiries over the next five years and there's no way the tenant is going to stay," he says. "The rents they pay will double. I think you will see quite a lot of development in the South Bank in the next five years."

The major focus for investors keen to get in on the rising market in Midtown and the South Bank is on buildings where there is potential for a rapid turnaround. In January, Frogmore acquired the 74,755 sq ft Weston House on High Holborn for £60.5m. The ground-floor retail is let to Waitrose and Fitness First and the lease expires on the upper floors in April, when a full refurbishment is planned.

"We've been active in Midtown for years, but the reason we really looked at Weston House was a timing issue," says Patrick Smith, director of acquisitions at Frogmore. "Being able to take vacant possession of the upper parts and do a comprehensive refurbishment absolutely hits the market at a time when supply is very, very tight. That was the main attraction."

Taking on a refurbishment project also provides an opportunity to bring a property to market with the widest possible appeal. To hit top rents it is important to design a building that will attract interest across the board.

"With Midtown, you have the TMT sector, but also the more traditional West End occupiers who don't want to pay West End rents," says Tim Allibone, director of asset management at Frogmore. "We'll be coming up with a refurbishment package that will appeal to all sectors."

Designing a scheme that is flexible enough to appeal to a broad range of tenants is not necessarily easy. Endurance Land is working on a couple of Midtown schemes, including a partnership with Aberdeen Asset Management on a major refurbishment and extension at 35 Chancery Lane.

Director Jonathan Fletcher explains the balance that has to be struck. "There are still traditional players in the legal and financial sector seeking space in the area, but also new entrants coming into the market," he says.

"The challenge is to create a building that can appeal to an eclectic mix of potential tenants. At Chancery Lane we have circa 10,000 sq ft floorplates that would work extremely well on a multi-let basis, but could also work as a single let for the entire 65,000 sq ft."

But while catering to a wide range of potential occupiers can be problematic, for the time being Midtown and South Bank both represent a landlord's market. Many developers can expect to see schemes taken off their hands before construction is completed.

"We're seeing occupiers with 2018 lease events looking for new premises now because of the perceived value they are going to get," says Hanmer. "We're starting to get competition on space. That's when rents can really jack-knife and that's really an occupier's worst fear. People are looking earlier to get strategies in place."

The sheer number of tenants out there means a high level of confidence exists among investors who can bring buildings to the market in the next two years. Alex Morgan, partner at Morgan Capital Partners, is confident his firm will be one. "We're pretty bullish about this year and next in terms of space being delivered to the market, probably into 2017," he says. "I don't think next year will see oversupply by any stretch, given how little is coming through in 2015."

There seems no doubt that Midtown and South Banks's time has finally come. It may just be a little while longer before everyone can get in on the action.