

PROPERTY REPORT: OFFICE BUILDINGS

Canary Wharf singing a red-hot tune

Record sale price for 8 Canada Square, healthy yields are signs of bullish market in London

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LONDON -- Canadians will remember Canary Wharf as the project that toppled Olympia & York Developments Ltd. during the recession of 1992. Despite its rocky start, the land development is now one of London's most desirable business districts.

Proof of this came last month, with the sale of 8 Canada Square to Spanish real estate company Metrovacesa for a staggering £1.1-billion (\$2.3-billion).

With this latest in a string of record-breaking deals, it's clear that Britain's chief city hasn't been this hot since the Great Fire of 1666, and industry observers expect the market to continue on this trend.

In the past year, London's commercial real estate market has raised eyebrows more than once. CityPoint, the 35-storey office tower on Ropemaker Street, sold for £520-million last year, then was flipped for £650-million in April. Late last year, the 41-storey landmark known as "the Gherkin" at 30 St. Mary Axe, sold for £630-million.

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Statues of two large, snarling lions flank the entrance to 8 Canada Place, a 45-storey, 1.1-million-square-foot tower that was purchased by Metrovacesa, the largest publicly traded commercial real estate company in Spain. The building is entirely occupied by HSBC, which spent £580-million on the property before it became bank's global headquarters in 2002.

Metrovacesa was one of "a dozen" serious bidders, according to Vivienne Grafton, HSBC's head of property. For £1.1-billion, the Spanish real estate company gets a 998-year lease to the tower and a contract with HSBC committing the bank to a 20-year leaseback for £43.5-million a year plus inflationary increases.

"Looking at conditions in the property market, we believed it was favourable to move forward with the transaction," Ms. Grafton said, adding that the sale is part of an overall "restructuring" of the bank's property portfolio.

"It releases capital for us to plow into other areas of the business," she said. "There is a view that we can reinvest in the company over all. We are not a property company per se, and we can make better use of this money within the HSBC environment."

With yields on Canary Wharf properties sitting at about 4 per cent, this makes a lot of sense: Even British government bonds are yielding about 5 per cent these days.

And, HSBC is not alone. Royal Bank of Scotland is also reported to be placing two Canary Wharf towers, totalling 1.7 million square feet, on the block.

While banks are unloading these assets because of their low yield in the short term, other institutional investors, such as pension funds, are picking them up because of their long-term prospects. With its 20-year lease, the deal with HSBC gives the building "bond-like characteristics," said Tony McCurley, executive vice-president of CB Richard Ellis in London, which handled the transaction for HSBC.

Particularly in the Docklands, the prospect of solid long-term returns are good, he said. Rents there sit at £45 a square foot, compared with £60 in the City, traditional home to the headquarters of banks and multinationals and Canary Wharf's chief competition. They reach £100 in London's West End. The vacancy rate in Canary Wharf sits at 3.5 per cent.

Even with 16 construction cranes dominating the skyline of the City, CB Richard Ellis is projecting that rents will rise 20 to 25 per cent over the next two to 2½ years. London could see as many as 20 new skyscrapers in the next eight years. Some are the talk of the town, with popular names such as "Shard of Glass" or "Cheese Grater."

The new buildings won't affect rental availability, as much of the new construction is preleased to companies such as Merrill Lynch and Deutsche Bank, Mr. McCurley said. The towers are going up as companies consolidate from multiple London locations into a single building, and because of corporate expansion, particularly as London continues to grow as the world's leading financial services centre.

Prices in the Docklands, and the Canary Wharf project at its heart, will continue to rise as financial services companies migrate to London, Mr. McCurley said. These companies like grade-A buildings, and they can go up more easily in the Docklands, which is free from the planning restrictions in history-rich areas such as the City and the West End.

"Canary Wharf, as a market, has matured," and provides competition for all of central London, Mr. McCurley said. Because it doesn't have many of the planning issues of central London, the Docklands district "can deliver top-quality buildings very quickly."

The Docklands area, named Isle of Dogs in the 1200s because it was home to royal kennels, was a busy port area until it was heavily bombed in the Second World War. London began working on redevelopment at the beginning of the 1980s, and in 1987 signed a deal with O&Y to build a 12.2-million-square-foot development at Canary Wharf, centred around Canada Square. It has since become London's new home for financial services companies, and many of the newspapers that made Fleet Street legendary have moved there.

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