LONDON MARKETS

London office property
performance and key themes

February 2024

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LONDON OFFICE MARKET SUMMARY

Take-up in Q4 was 4.4m sq ft, the largest quarterly volume since Q4 2018. Activity in Q4 2023 was skewed by two large lettings by HSBC and Barclays totalling 1.4m sq ft, but even excluding these, core demand was above the long-term quarterly average. Annual take-up in 2023 was 11.8m sq ft, 3% lower than 2022.

Grade A rents in Marylebone rose 2.6% in Q4. There is limited Grade A availability in the submarket and quoting rents have risen for good quality space. More broadly, prime rents continue to outpace secondary counterparts across most West End and City core markets.

Availability fell for the second consecutive quarter in Q4, decreasing by 0.2%-pts to 8.8%. Several developments and full-scale refurbishments are in the pipeline which may put upward pressure on availability through 2024.

An estimated 2.2m sq ft of new office space completed in Q4 across 12 schemes. The volume of new completions in 2023 was just over 6m sq ft, the second highest on record behind 2018. Material costs are expected to fall for the first time since 2020 which may incentivise developers in 2024.

The volume of refurbishment activity is high, with almost 6m sq ft undergoing improvement. Landlords are undertaking works to meet EPC regulations and in response to occupier requirements for the best quality space.

The volume of investment in Q4 was £1.6bn across 32 transactions. This was an increase of 14% on Q3 but still 27% below the 5-year quarterly average. The total annual volume was £5.8bn in 2023, one of the lowest on record and 42% below 2022.

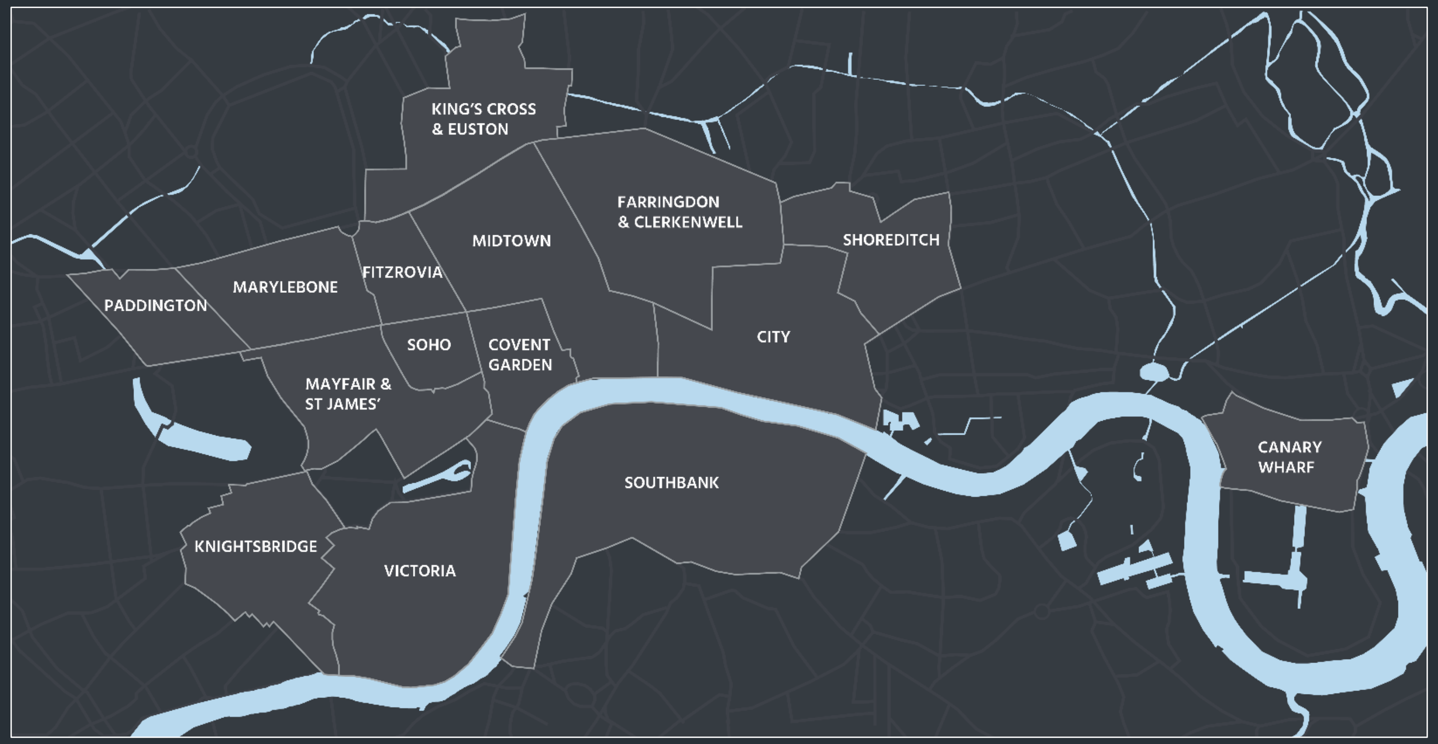
4.4m sq ft ▲
Take-up, Q4 2023

8.8% ▼
Availability rate, Q4 2023

£1.6bn ▲
Investment volume, Q4 2023

6.0m sq ft ▲
Under refurbishment, Q4 2023

GERALD EVE LONDON SUBMARKETS



THE LONDON ECONOMY

GVA

	2022	2023	2024
London	5.6%	1.1%	0.7%
UK excl. London	3.6%	0.6%	0.3%

ILO UNEMPLOYMENT RATE

	2022	2023	2024
London	4.5%	4.7%	5.1%

OFFICE-BASED EMPLOYMENT GROWTH

	2022	2023	2024
Central London	7.0%	3.8%	0.2%

Source: Oxford Economics

LONDON FLASH PMI DECEMBER 2023

58.2 ▲

Business Activity Index

An annual high as output rose sharply in December. London is a clear front-runner across the UK regions.

59.4 ▲

New Business Index

Fourth consecutive month of new business expansion, with strong growth from IT and financial firms.

73.8 ▲

Future Activity Index

Second consecutive monthly improvement with firms more confident on the outlook for 2024.

51.1 ▲

Employment Index

London recorded an increase in employment, but this was modest when set against the growth in new work.

Source: IHS Markit
Arrow indicates monthly change, above 50 signifies expansion

London continues to be the frontrunner for business activity compared with other UK regions. Several PMI measures improved in December and there's a more positive outlook for 2024.

Initial estimates for London's GVA growth in 2023 improved from 0.9% to 1.1%, however the outlook for growth remains modest with 0.7% expected in 2024.

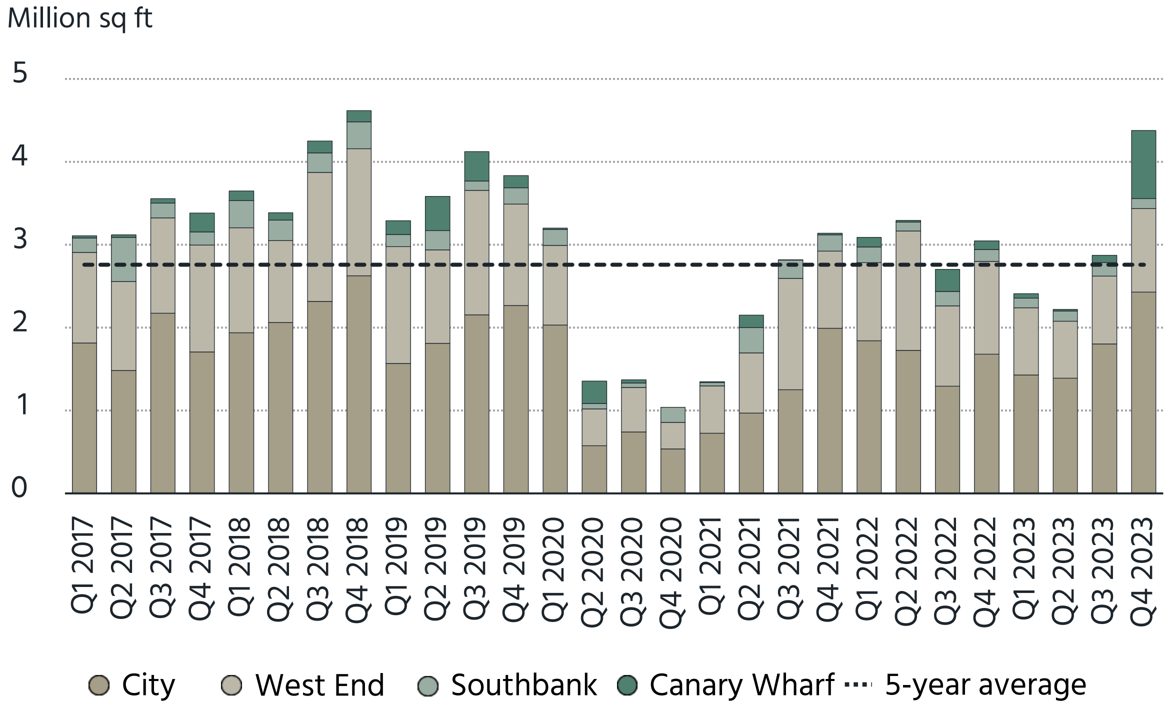
PMI responses on employment indicate companies are trying to do more with less. Both current and future business activity picked up in December's survey, but firms have been hesitant to increase headcount substantially, choosing instead to only recruit when necessary. The unemployment rate is expected to rise to 5.1% in 2024, the second upward revision to the outlook in the last six months.

Growth in office-based employment is expected to be 0.2% in 2024, driven by activity in the real estate and IT sectors. Financial services employment is expected to fall by -1.2% in 2024 as firms consolidate headcount due to pressures on margins from high inflation, dealmaking slumps and heightened geopolitical risk.

DEMAND

London office quarterly take-up by submarket

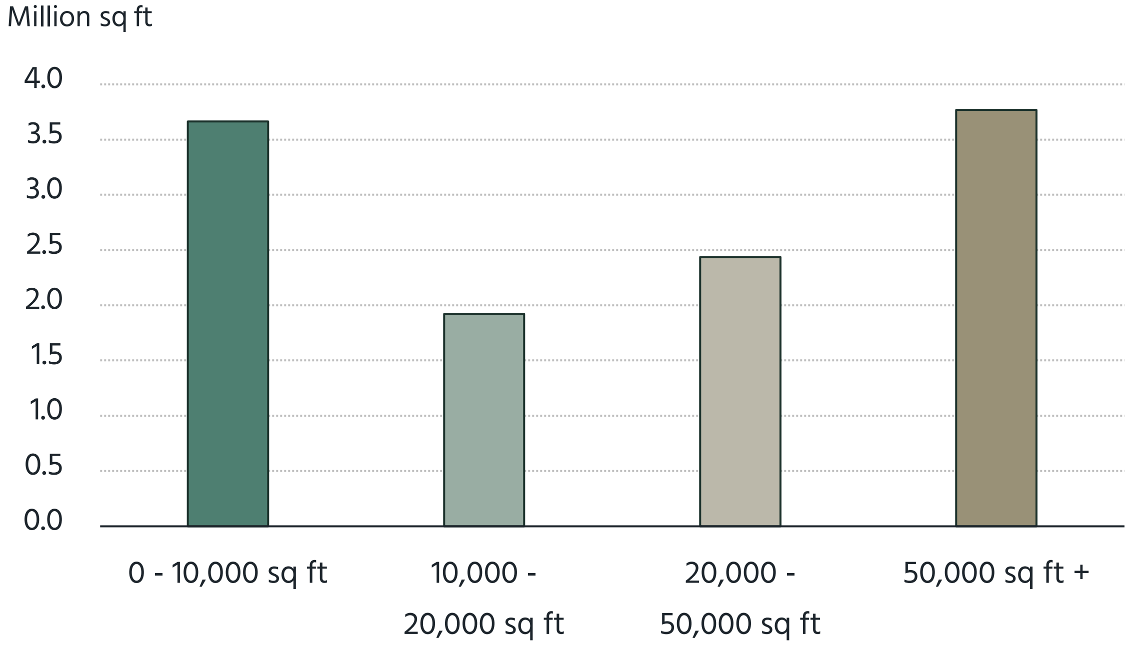
Source: Gerald Eve



It was a strong end to the year for occupier activity and take-up in Q4 rose to 4.4m sq ft, the highest volume since Q4 2018. The quarterly total was skewed up by two large lettings. Barclays signed a long-term extension on 820,000 sq ft in Canary Wharf, a positive sign for the submarket. Less positively, HSBC ended their occupation in Docklands, signing a 550,000 sq ft pre-let at Panorama, 81 Newgate Street in the City. Even excluding these exceptional lettings, Q4 was the most active quarter in 2023 and core demand was an above average 3m sq ft. Annual take-up in 2023 was 11.8m sq ft, only 3% lower than 2022, and a positive result given the weakened economic backdrop last year.

Leasing activity by size band, 2023

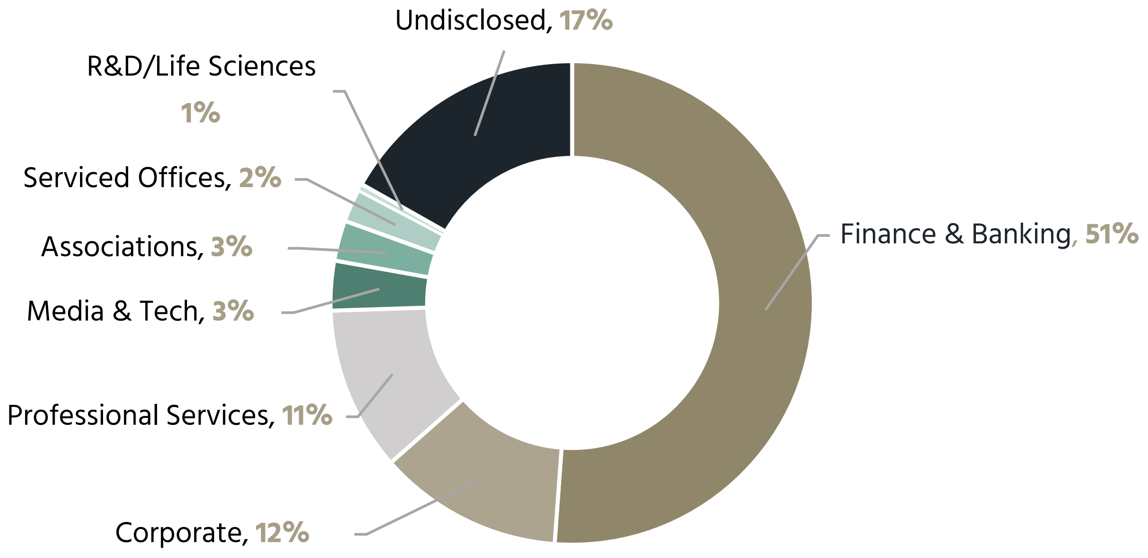
Source: Gerald Eve



Occupier demand in 2023 was focused on the smallest and largest size bands. SME tenants occupying smaller office space under 10,000 sq ft, are downsizing or staying in smaller spaces because of the effects of hybrid working on daily headcount. Lettings over 50,000 sq ft accounted for just under 32% of the annual leasing volume while lettings under 10,000 sq ft were just behind with 31% of all activity. There was a dearth of demand for 10,000 – 20,000 sq ft office space and barring the pandemic years, 2023 was the weakest year for activity in the size band since 2013.

Take-up by business sector, Q4 2023

Source: Gerald Eve

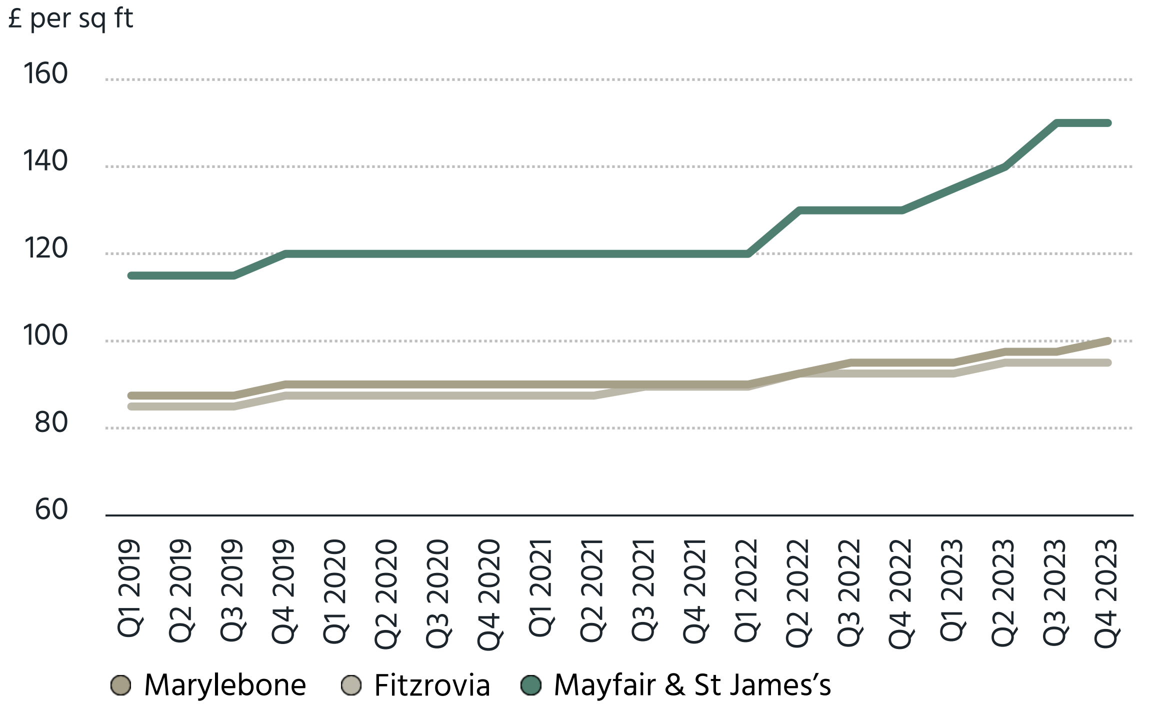


The finance & banking sector accounted for 51% of Q4 demand, boosted by the Barclays and HSBC lettings. By subsector, both banks and insurers were active, and there was some notable hedge fund activity in the West End. The professional services sector accounted for 11% of occupier activity, with law firms taking Grade A space in the City, Midtown and Farringdon & Clerkenwell. Corporate activity was focused on new HQ-style buildings as more than half of the leasing volume from the sector involved new or recently refurbished Grade A space.

RENTS

Core West End submarkets, Grade A rents

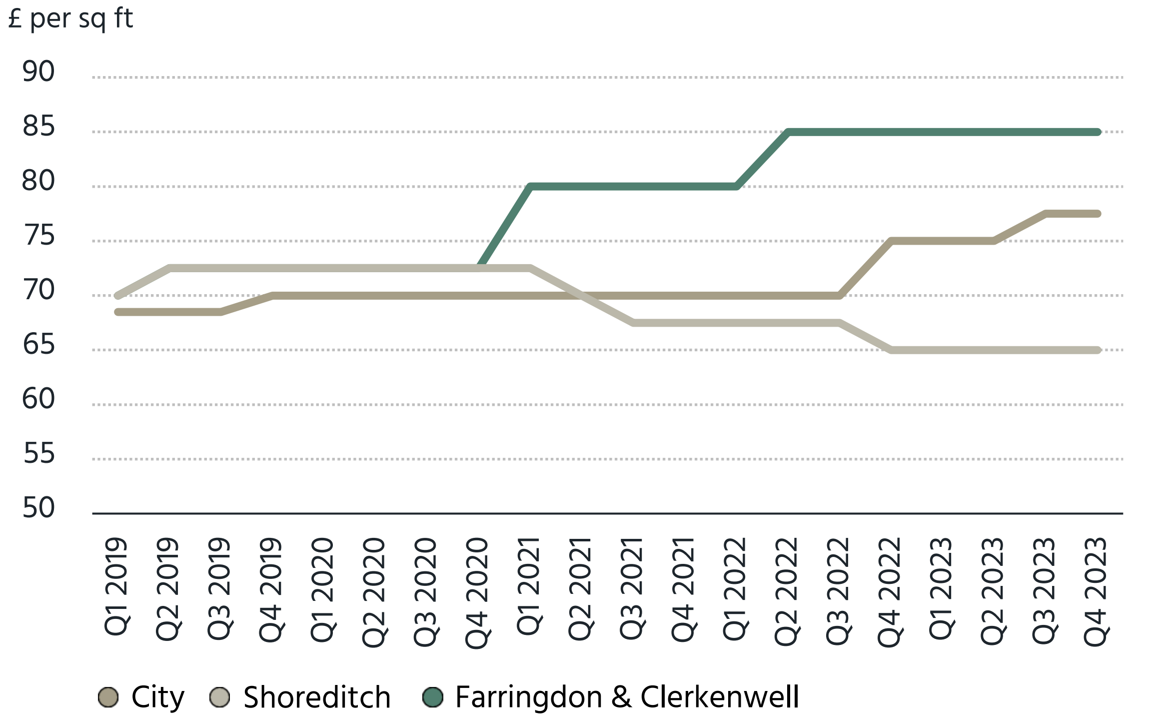
Source: Gerald Eve



Prime rents in Mayfair & St James's and Fitzrovia remained flat in Q4 at £150 per sq ft and £95 per sq ft, respectively. However, there is space under offer at higher rents which will likely provide evidence for positive growth in early 2024 in these submarkets. Grade A rents in Marylebone rose to £100 per sq ft in Q4. Only a few sizeable Grade A offices are available in the submarket and quoting rents have risen for good quality space, supported by strong occupier interest. Annual rental growth was 5% in Q4, with rents now 14% above the pre-pandemic level. Incentives across the West End remained unchanged in Q4, ranging between 21-24 months across the submarkets.

City submarkets, Grade A rents

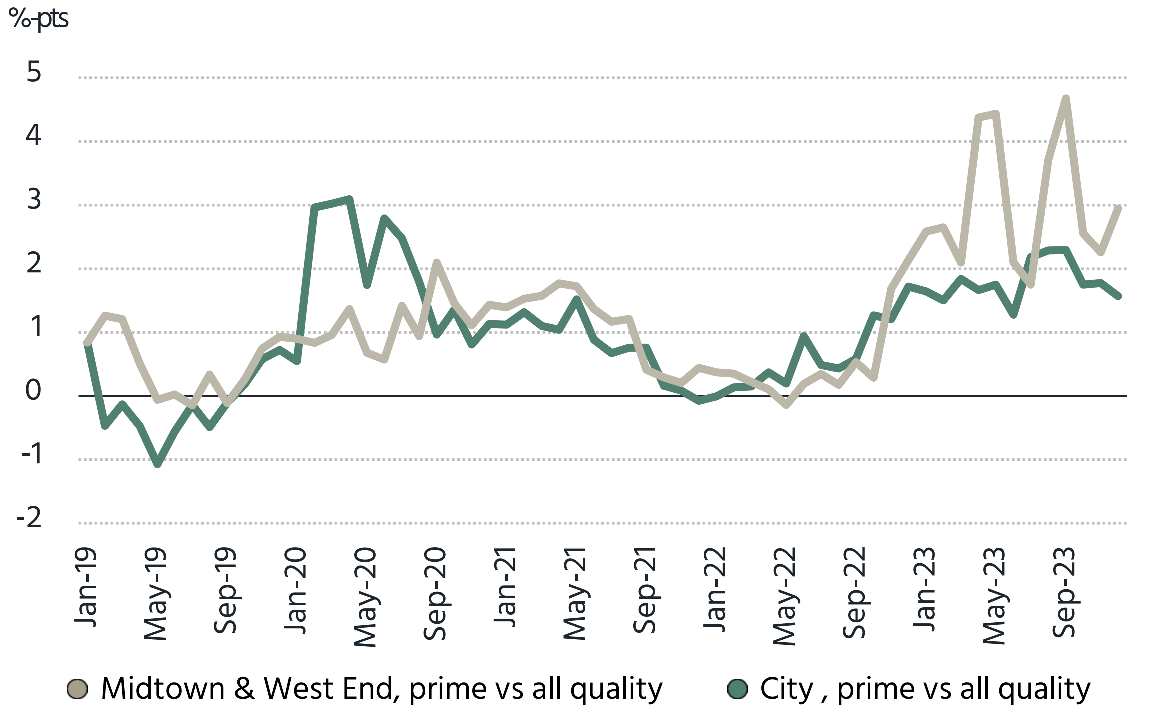
Source: Gerald Eve



Prime rents across City submarkets were flat in Q4, with little transactional evidence to suggest change. Some cost-conscious former West End occupiers have moved across to the City given the rental differential on offer, and this drift out could continue given the lack of available Grade A space in the West End. Anecdotal evidence suggests increased occupier interest for 'Grade A minus' space, driven by the shortage of the best quality accommodation. However, this is typically on a short-term basis as occupiers use this space as a stop-gap until better quality space becomes available. Increased competition for this kind of space could lift the floor for lower quality Grade A rents, in turn pushing overall Grade A rents higher over 2024.

Spread between prime and all quality rents by submarket

Source: Gerald Eve, MSCI



The combination of keen occupier interest and a general lack of supply of the best quality space has meant that rental growth on prime space has continued to outperform the broader market in most markets in 2023. According to MSCI monthly data, prime West End annual rental growth reached 7.2% in December, 2.9%-pts above the all-quality measure. In the City, prime rents recorded a slower growth of 4.2% annually, but this was still 1.6% above the all-quality measure. The gap between the 'best and rest' will widen further over 2024, with high demand and tight supply supportive of continued rental growth for prime offices in most London submarkets.

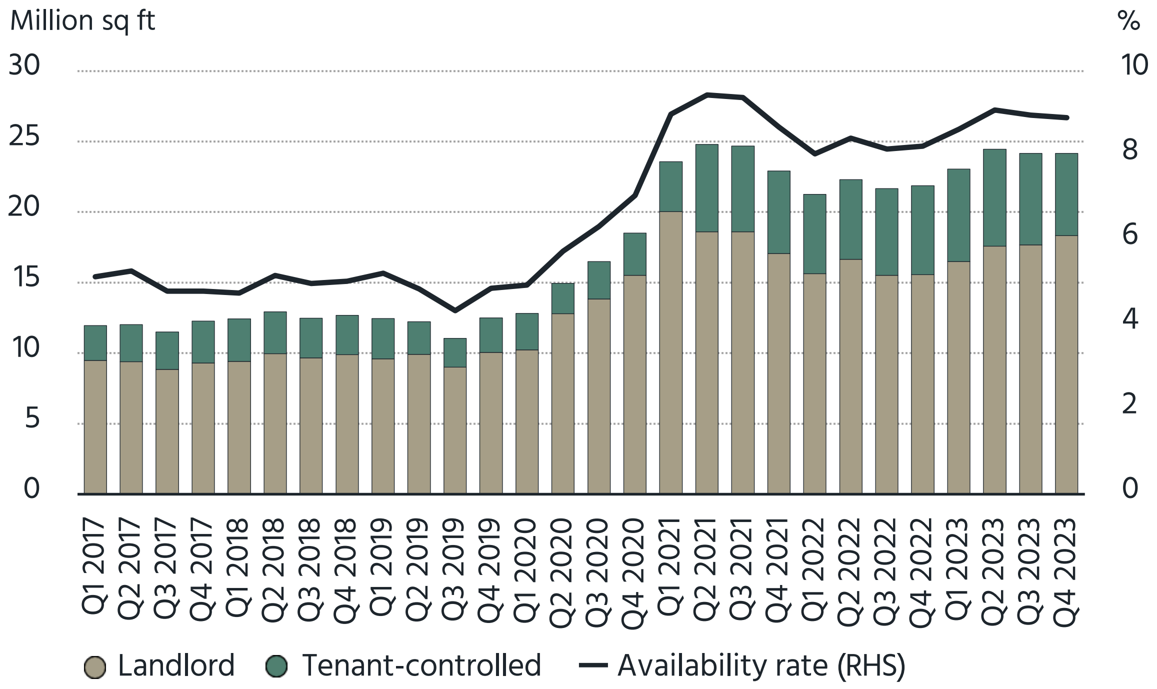
RENTS AND INCENTIVES BY SUBMARKET

Typical achievable headline rent for 'Grade A' space let on a typical 10-year lease on a mid-level floor with no terrace.

AVAILABILITY

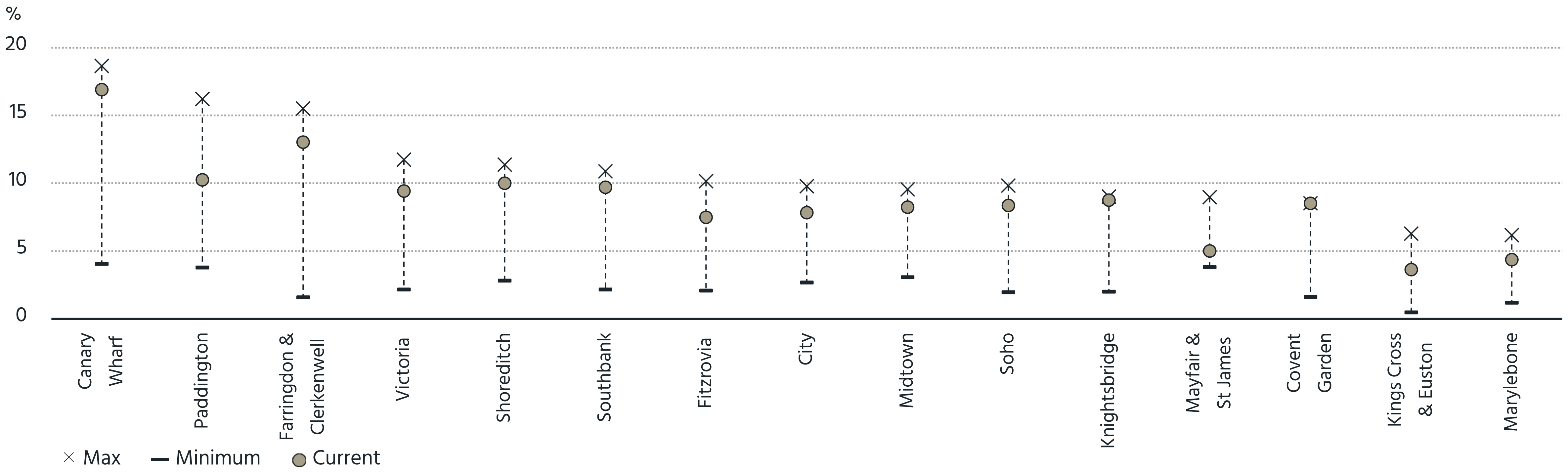
Central London availability by type of listing and rate

Source: Gerald Eve



Availability rate and historical range by submarket, Q1 2013 – Q4 2023

Source: Gerald Eve



Availability fell for the second consecutive quarter in Q4 as the rate decreased by 0.2%-pts to 8.8%. Landlord availability rose from 17.7m sq ft to 18.1m sq ft driven by the addition of newly-completed refurbishments and developments. Tenant-controlled availability however has fallen by around 1m sq ft since Q2 2023 and is now at its lowest volume since Q2 2022. This fall was driven by strong occupier interest in such space, with around 700,000 sq ft let in 2023 and nearly 500,000 sq ft in H2 alone. Availability seems to have stabilised at around 9%, but there are several developments and full-scale refurbishments to come forward which are likely to put upward pressure on availability through 2024.

Covent Garden is one of the submarkets where development activity is impacting availability. The addition of a full refurbishment and a new development to availability in Q4 pushed the rate up to 8.5%, with these two listings making up a third of total availability. This supply dynamic is also noticeable in Southbank where new developments have kept supply elevated for the last three quarters. The availability rate in the submarket is now on par with the peak reached during the pandemic. Availability in Knightsbridge increased to a near historic high in Q4 too, as new space at Sixty Sloane, a newly renovated mixed-use development became available.

Availability in core West End markets remains low, particularly for best-in-class space. The availability rates in both Mayfair & St James's and Marylebone are around 5%, with tight Grade A supply contributing to positive rental growth in 2023. In the City, strong demand over 2023 has pushed the availability rate down. It now stands at 7.8%, nearly 1%-pt lower than it was in Q4 2022. Availability in Canary Wharf fell meaningfully for the first time in a year in Q4. The withdrawal of space previously available for sub-let was behind the fall, but the availability rate remains the highest across all London submarkets.

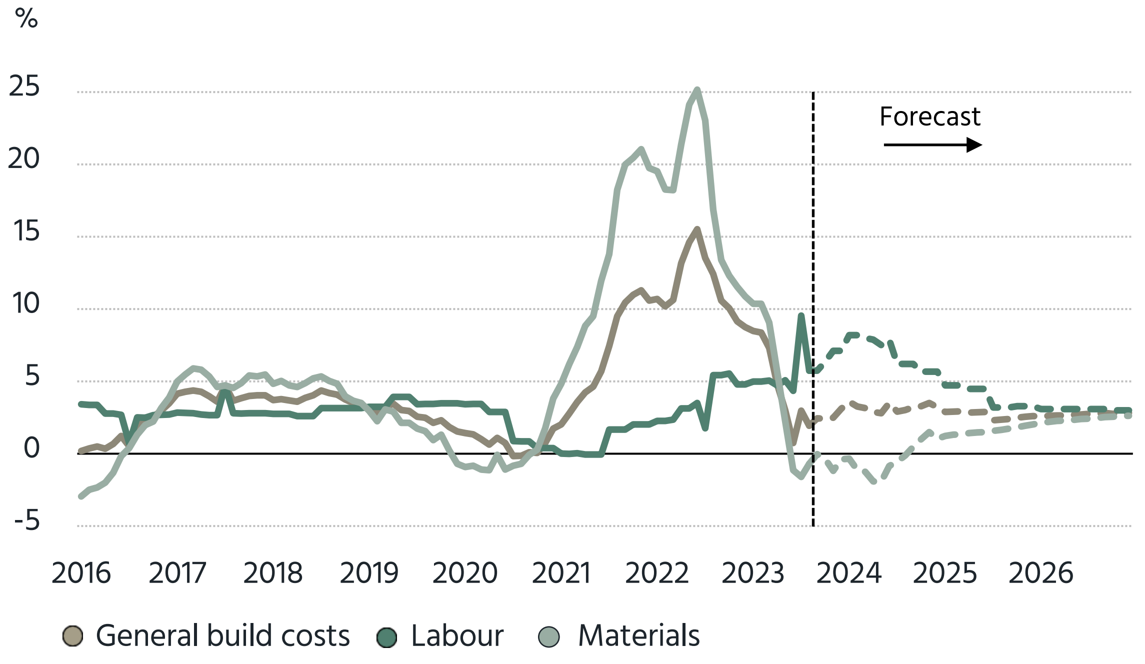
DEVELOPMENT

London office development pipeline, new build

Source: Gerald Eve

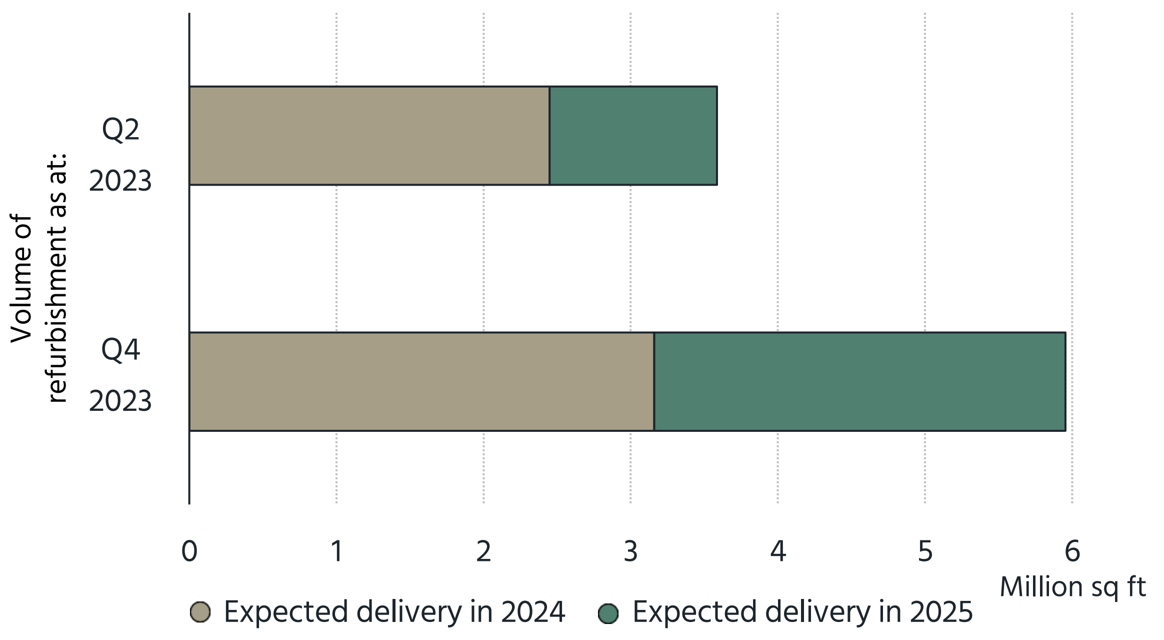
Annual build costs growth by type

Source: BCIS



Refurbishment pipeline and expected year of completion

Source: Gerald Eve



An estimated 2.2m sq ft completed in Q4 across 12 schemes. The annual volume of completions in 2023 was just over 6m sq ft, driven in part by the delayed delivery of space originally scheduled for 2022. Nearly 630,000 sq ft of new refurbishments completed in Q4, which brought the total for the year to just over 2m sq ft. Development timescales continue to slip though and there were several sizeable developments due for completion in Q4 which are now earmarked for delivery early in 2024. However, more positively, nearly 36% of the 2024 pipeline is already pre-let, with the largest schemes almost entirely leased up.

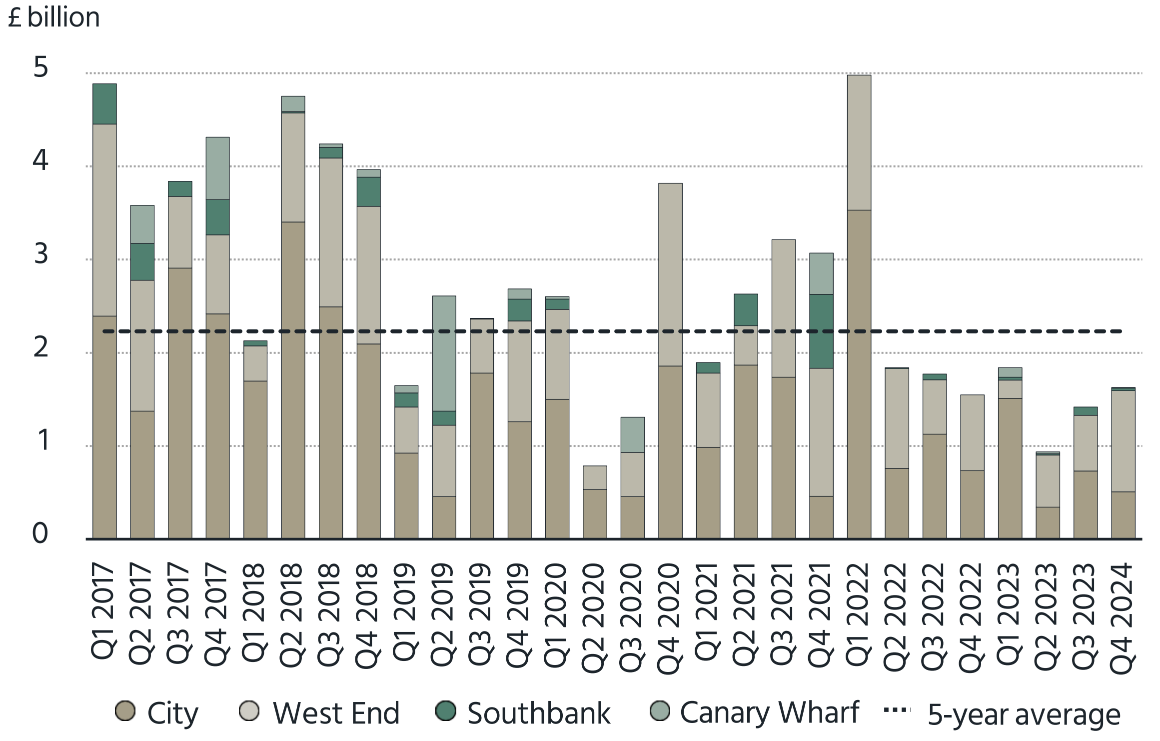
Development activity in the London office market has been impacted by high and unpredictable build costs for the last few years. The cost of materials in particular has fluctuated significantly since peaking at 25% annual growth in June 2022. However, an easing of supply chain pressures and a reduction in energy costs suggests that the growth in the cost of materials is expected to turn negative in 2024 for the first time since 2020. A cooling in cost pressures may incentivise developers, especially as rents for best-in-class space continue to grow. General build costs are still expected to grow by 3.2% in 2024, but this represents a much more tolerable rate compared with 2021/22.

Despite this improved outlook, current new build development decisions continue to be impacted by restricted availability of debt finance and elevated construction costs. Many landlords and investors have favoured more cost-effective refurbishments over new build developments to tap into occupier demand for good quality accommodation and meet EPC regulations. This is a growing trend and the volume of refurbishments in the pipeline has increased by two-thirds since Q2 2023. In Q4, 6m sq ft of refurbished office space is expected to be delivered before the end of 2025, compared with 3.6m sq ft which was underway at the end of Q2 2023.

INVESTMENT

Quarterly investment volumes by submarket

Sources: Gerald Eve, Real Capital Analytics



The volume of investment in Q4 was £1.6bn across 32 transactions. This was up 14% on Q3 but still 27% below the 5-year quarterly average. The total annual volume in 2023 was £5.8bn, one of the lowest on record and 42% below the volume traded in 2022. Smaller lot-size transactions continued to drive activity, with only a handful of acquisitions on lots over £100m. By number of deals, nearly three quarters of all investments were under £50m in Q4. Activity in the West End propped up the overall quarterly volume with just under £1.1bn transacted. The largest acquisition in Q4 was the purchase of the Langham Estate portfolio through an Elliot Management and Oval Real Estate JV for just under £350m.

Overseas investors were the most active investor group in Q4, with acquisitions totalling £753m across 17 transactions. European investors in particular were active, with purchases totalling £422m over nine transactions. Nearly all acquisitions were for lot sizes under £50m. UK property companies were the second most active group, acquiring £632m of office space across eight transactions.

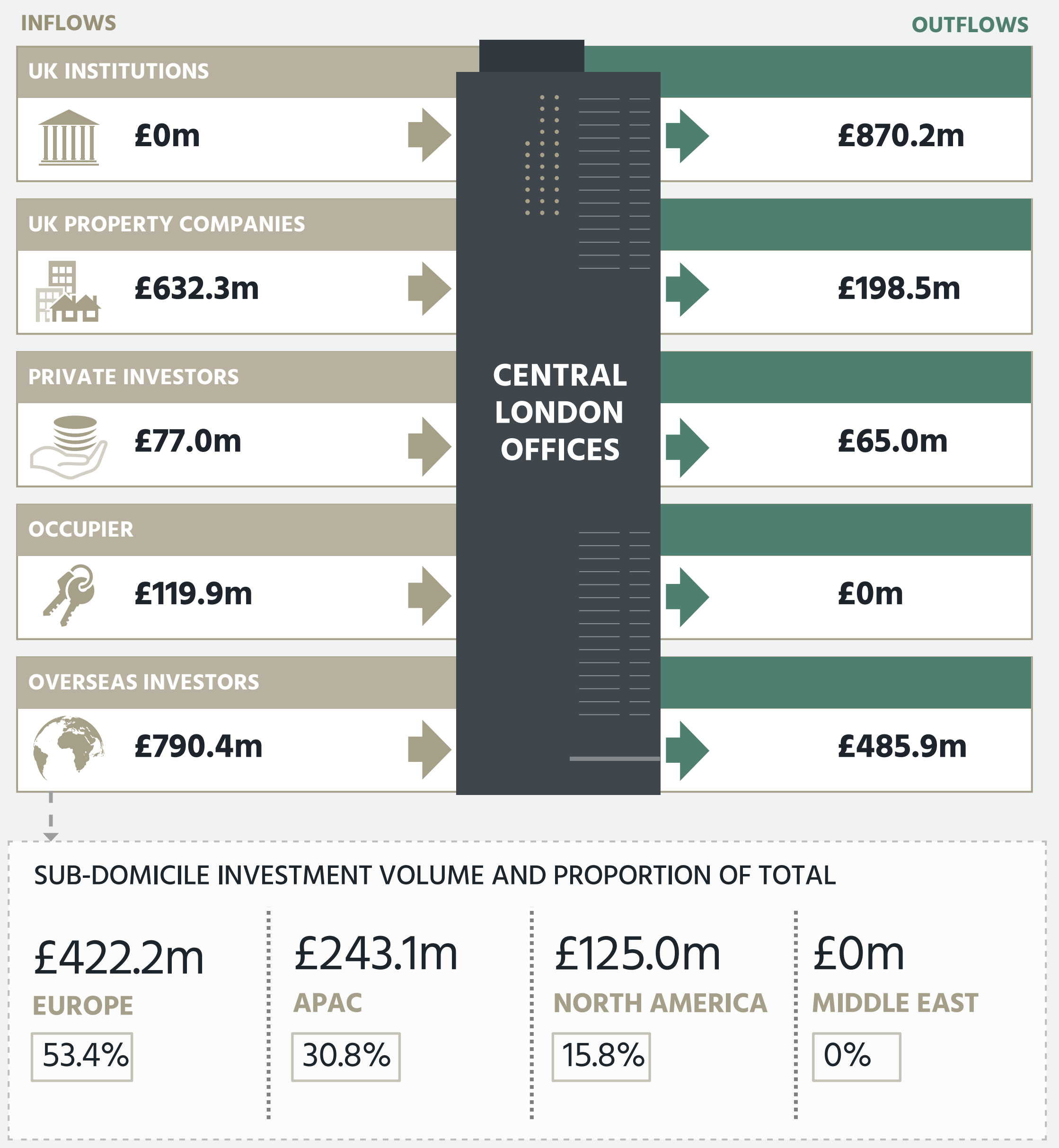
On the sell-side, UK institutions were noticeable active, disposing of £870m across 15 transactions, the majority of which were smaller lot-sizes in the West End. For overseas investors, North American were the largest divestor group, with £335m sold in Q4.

The outlook for monetary policy in 2024 has improved from just a few months ago. Inflation has decelerated and sentiment from economic commentators suggests monetary policy will be more accommodative in 2024. However, views over the timing of cuts are varied, with some forecasters suggesting cuts as early as May and others expecting action in H2.

An improving economic backdrop and robust occupier demand for good quality stock will create opportunities in the London office market in 2024. Upcoming refinances and issues surrounding LTV ratios and ICRs given the 2022 price correction means there could be an increased number of sellers in 2024. Defined benefit pension funds have been and will continue to reduce allocations to real estate, while listed vehicles have been pursuing sales to reduce LTV ratios. These conditions will improve liquidity and investment volumes are expected to increase in 2024.

CENTRAL LONDON OFFICE CAPITAL FLOWS, Q4 2023

Sources: Gerald Eve, Real Capital Analytics



GERALD EVE IN THE MARKET

RECENT LETTINGS

103 Wigmore Street, W1

Acting on behalf of the landlord, Duke Street Property, we have let 12,000 sq ft over the newly refurbished 2nd floor to Fenwick, who will relocate staff from the iconic department store on New Bond Street following the sale to Lazari in December 2022.

Please contact Rhodri Phillips or James Lunn for more information.

Stratford, E20

We have advised on a 90,000 sq ft disposal in Stratford, successfully leasing 3 floors to a single occupier, at the high-quality Grade A building in December 2023.

Please contact Amy Bryant for more information.

ACTIVELY MARKETING

The Pulman, 20 Thayer Street, W1

On behalf of The Howard de Walden Estate, we have recently launched a brand-new office and retail development in the heart of Marylebone, comprising 18,000 sq ft of premium grade offices over Levels 1 to 4.

Please contact Rhodri Phillips or James Lunn for more information.

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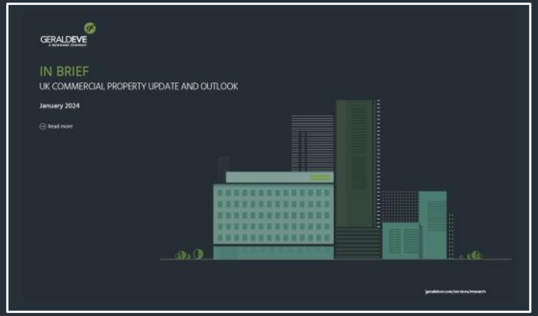
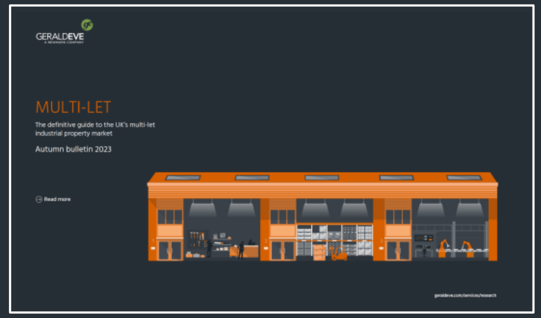
FURTHER INSIGHTS



In Brief
January 2024



Multi-let
Autumn 2023

Prime Logistics
Q4 2023

For further information on all our Research, visit our website **here.**

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