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LONDON MARKETS

London office property
performance and key themes

August 2023

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LONDON OFFICE MARKET SUMMARY

Occupier take-up was just under 2.2m sq ft in Q2 2023, a fall of 8% on Q1 and 22% below the five-year quarterly average. Barring the lows of the pandemic in 2020, Q2 was one of the quietest quarters on record for leasing activity since the GFC, driven by the difference in activity between the best and the rest.

Grade A rents in a third of our tracked submarkets rose this quarter. Covent Garden, Marylebone, Fitzrovia and Victoria all edged up by £2.50 per sq ft in Q2. Mayfair & St James's had the strongest uplift, rising from £135 to £140 per sq ft, up 3.7% from the previous quarter.

The availability rate increased by 0.6%-pts to 9.2% in Q2. This marks the third successive quarterly increase and the highest rate since Q2 2021. Headline availability figures contain wide submarket variance as submarkets like Canary Wharf, Midtown and Southbank are all well above the London average.

An estimated 1m sq ft completed in Q2 across six schemes, bringing the H1 2023 total to just under 2.3m sq ft. Development completions are expected to increase significantly to 5.5m in Q3, given the carry-over delayed work from earlier this year and from 2022.

Investment in Q2 was only £940m across 20 transactions. This is down by a half on Q1 and was more than 60% below the five-year quarterly average. The average deal size fell markedly to £46m in Q2 compared with £102m in Q1 reflecting the difficulty in raising debt for larger lot size purchases.

Existing EPC grades of space in the refurbishment pipeline show that landlords are focusing on the most cost-effective easy wins first. However, there is currently limited activity for offices further out from the regulatory deadlines as landlords are less willing to take on substantive upgrades due to high capex costs.

2.2m sq ft ▼ Take-up, Q2 2023	9.2% ▲ Availability rate, Q2 2023
£0.9bn ▼ Investment volume, Q2 2023	74% Refurbishment pipeline, existing EPC grade B, C & D

THE LONDON ECONOMY

GVA

	2022	2023	2024
London	5.5%	0.9%	1.5%
UK excl. London	3.7%	0.2%	1.2%

ILO UNEMPLOYMENT RATE

	2022	2023	2024
London	4.5%	4.6%	4.7%

OFFICE-BASED EMPLOYMENT GROWTH

	2022	2023	2024
Central London	1.7%	0.5%	0.8%

Source: Oxford Economics

LONDON FLASH PMI JUNE 2023

56.0 ▲
Business Activity Index
London remains the top performer of all UK regions but recorded the slowest rise in output over Q2.

54.9 ▼
New Business Index
Expansion of new business slowed to a five-month low but remains in positive territory.

68.2 ▼
Future Activity Index
Business confidence expectations in London weakened for the third consecutive month in June.

55.0 ▲
Employment Index
Steepest rise in staffing levels since August 2022, and recorded the strongest growth of all UK regions.

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

On balance, London PMI data expanded in June, but at more moderate rates. London looks set to materially outperform the regions this year, but prospects of higher interest rates for longer and "sticky" inflation means wider UK economic conditions are acting as headwinds.

London's expected GVA growth is now in positive territory following an upgrade for 2023 from -0.3% to 0.9%, although more moderate growth is now expected in 2024 due to this year's improvement.

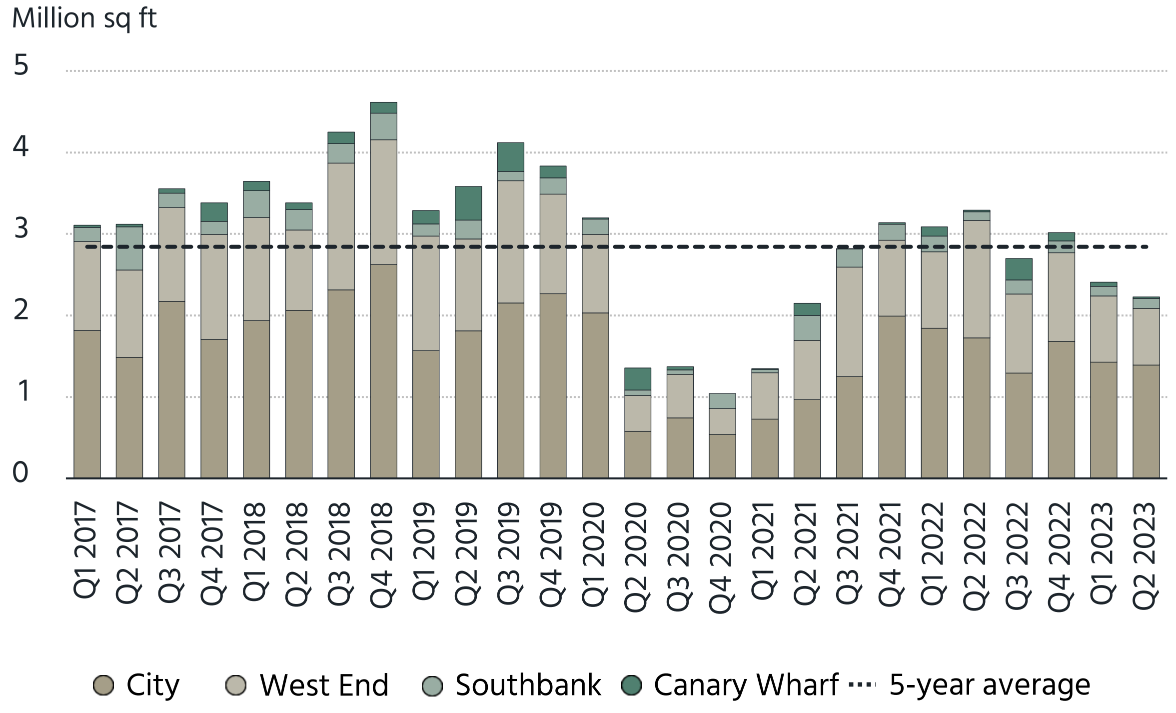
Unemployment is still expected to rise but Oxford Economics' forecast for 2023 was downgraded again in June from 5.2% to 4.6%, with a marginal rise to 4.7% expected in 2024. Job losses will be centred on sectors facing stronger economic headwinds, such as consumer-facing and manufacturing sectors.

Office-based employment forecasts have been upgraded from -0.4% to 0.5% for 2023. All office employment sectors are expected to record growth barring the financial and insurance sector, where employment is now expected to fall by -0.6% in 2023.

DEMAND

London office quarterly take-up by submarket

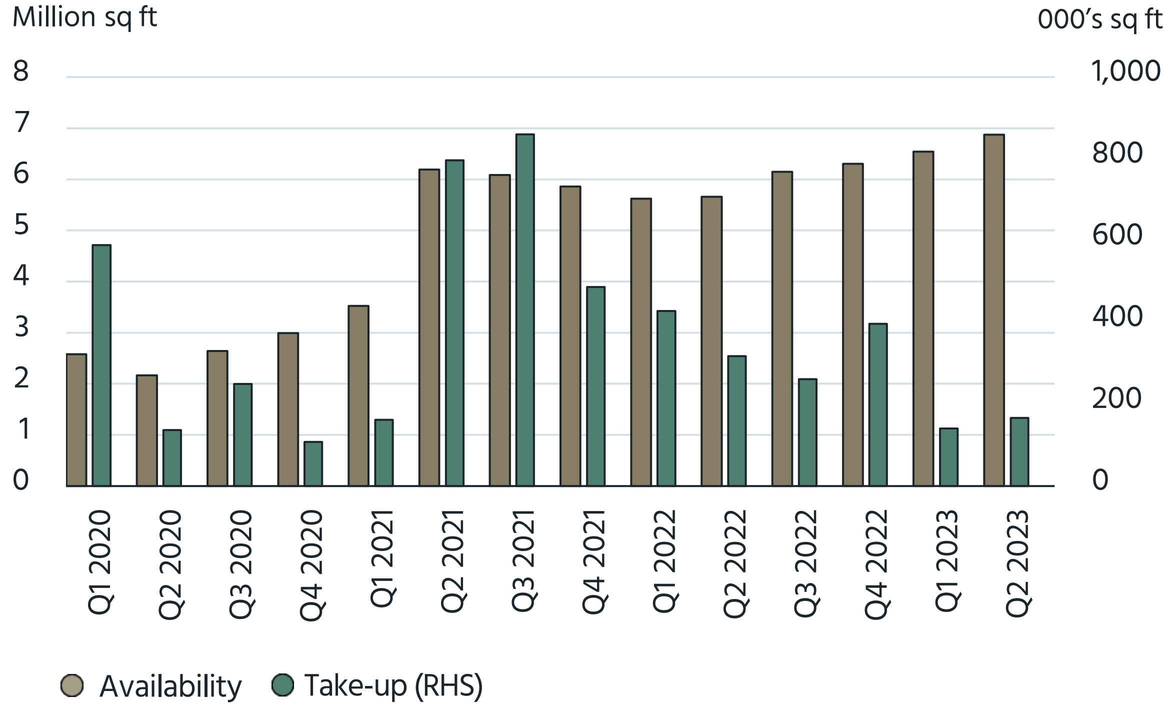
Source: Gerald Eve



Occupier take-up was just under 2.2m sq ft in Q2 2023, a fall of 8% on Q1 and 22% below the 5-year quarterly average. Barring the pandemic lows, this marks one of the quietest quarters on record for leasing activity since the GFC. Take-up in the broader City and Southbank remained relatively stable quarter-to-quarter but fell by about a fifth in the West End, with little activity to note in Canary Wharf. Economic sentiment weighed on occupier decisions this quarter. Prospects of sticky inflation and interest rates staying higher for longer means business decisions are being delayed, with subdued demand expected for the second half of the year.

Tenant-controlled take-up vs availability

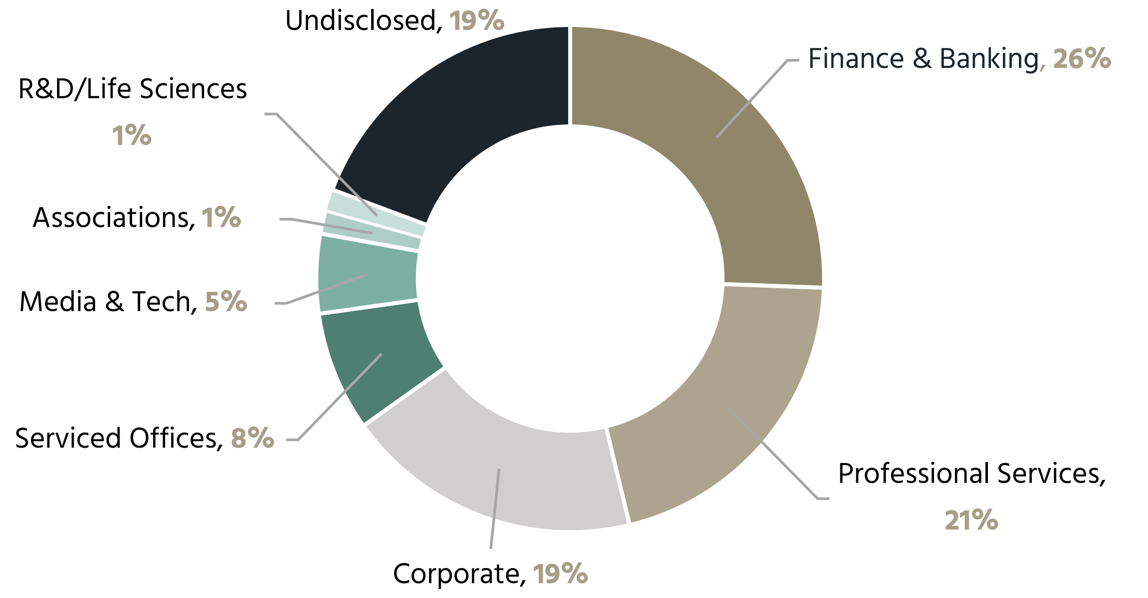
Source: Gerald Eve



Activity was underpinned by demand for prime and Grade A space in Q2, and pre-let activity accounted for 25% of take-up. Most of this was focused in the City, Mayfair & St. James's, and Farringdon & Clerkenwell. Occupiers continue to sub-let or assign unneeded space, but the overall quality of tenant-controlled available space is low following the leasing of the best quality accommodation from Q2 2021 to Q1 2022. The take-up of tenant-controlled space has been on a steady downward trend since peaking in Q2 2021, where it accounted for over a third of demand. This quarter it made up only 9% of demand and H1 2023 was the lowest half year since 2020.

Take-up by business sector, Q2 2023

Source: Gerald Eve



Finance & banking was the most active occupier sector in Q2. The sector made up just over a fifth of leasing activity, with insurance firms particularly active. Law firms continued to buoy demand from the professional services sector and were responsible for three out of the largest five leases this quarter. Demand from serviced office providers made a comeback as the sector recorded the second highest level of demand since Q3 2019. Based on data from Re-leased, the average lease length for offices has fallen to the lowest level on record, and the serviced office sector could benefit from growing demand for shorter leases and greater flexibility.

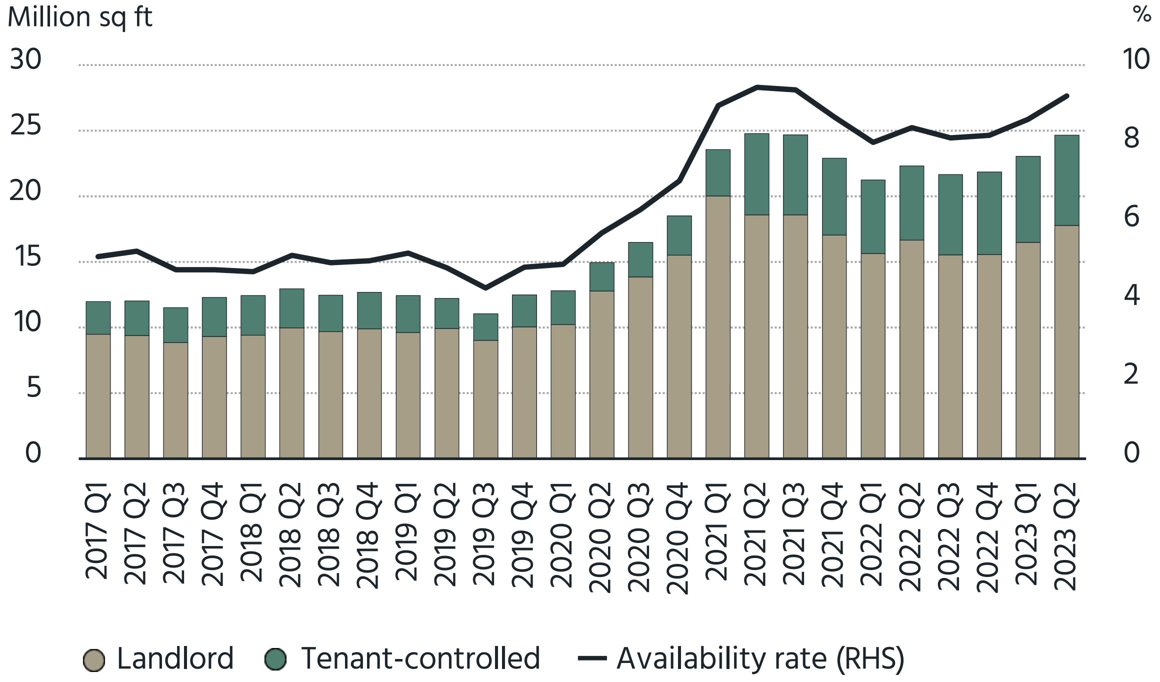
LONDON OFFICE RENTS AND INCENTIVES, Q2 2023

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

AVAILABILITY

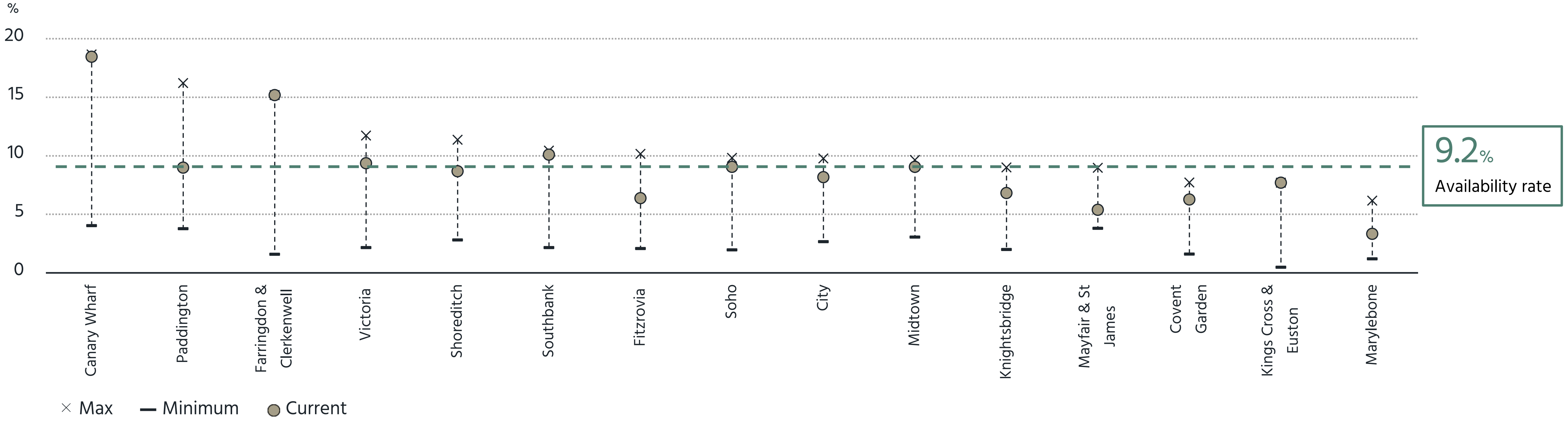
Availability by type of listing and rate

Source: Gerald Eve



Availability rate, historical range by submarket, Q1 2013 – Q2 2023

Source: Gerald Eve



The availability rate increased by 0.6%-pts to 9.2% in Q2. This marks the third successive quarterly increase and the highest rate since Q2 2021. Landlord-controlled availability rose again on the back of several comprehensive refurbishments appearing in the availability list and looking forward, there is over 1m sq ft currently available and undergoing refurbishment which could be added to availability in H2 2023. Set against a backdrop of weakening demand and a high volume of incoming supply, we expect the availability rate to surpass the pandemic high of 9.4% before year end.

Whilst overall London availability has increased through 2023, this masks wide submarket variance. Canary Wharf for instance is an outlier and one of the markets driving elevated availability. Almost a third (2.1m sq ft) of overall tenant-controlled space (6.9m sq ft) comes from this submarket alone. HSBC's decision to vacate their office on Canada Square in Canary Wharf highlights the influence one submarket can have on the overall availability rate in London. Holding all other things equal, if this were in the market today it would increase the availability rate to 9.7%.

Canary Wharf accounts for 7% of central London's office stock but makes up 14% of availability. Other markets with above average availability include Farringdon & Clerkenwell, Midtown, and Southbank, caused either by weaker demand or new waves of incoming supply. On the other hand, core West End markets like Mayfair & St James's, Marylebone, and Fitzrovia are now well below the London average following strong rebounds in demand, and these submarkets all recorded an uplift in Grade A rents this quarter. Rising supply will dampen overall rental growth in 2023, with positive rental growth centred on the supply-restricted best-in-class portion of the market.

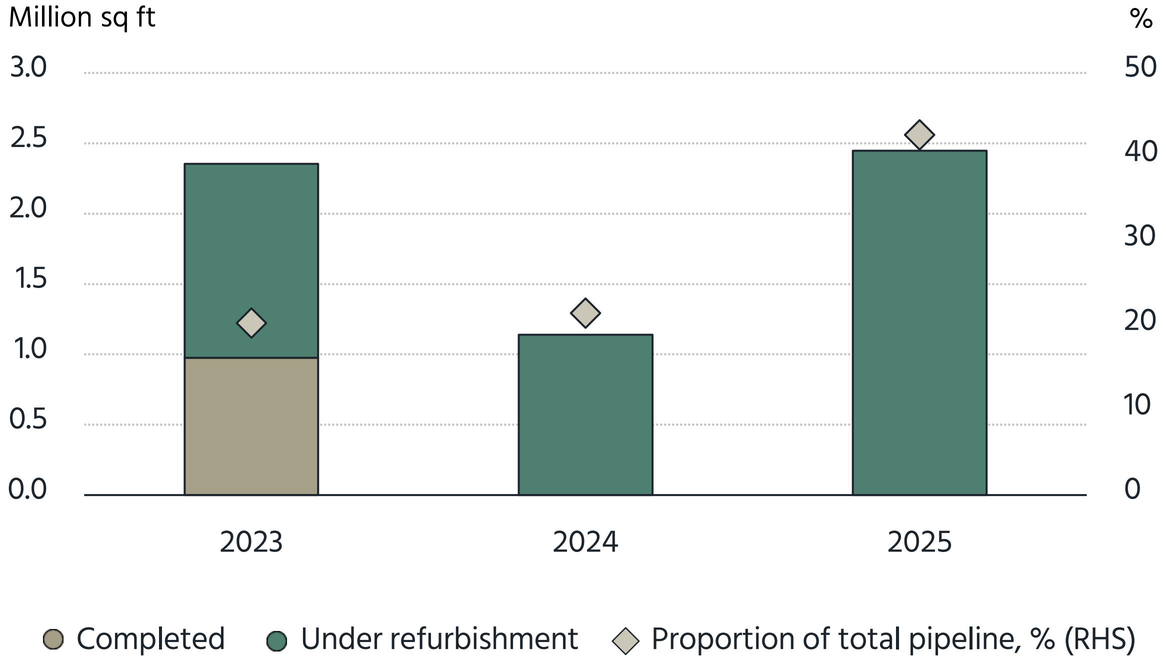
DEVELOPMENT

London office development pipeline, new builds

Source: Gerald Eve

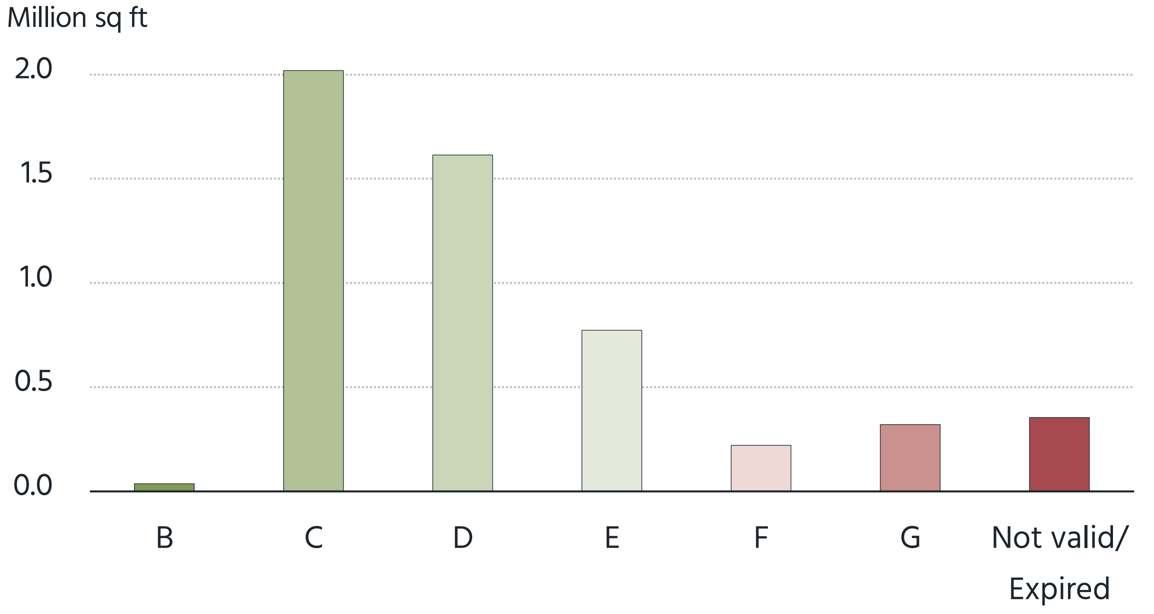
London office refurbishment pipeline

Source: Gerald Eve



London office refurbishment pipeline by existing EPC grade

Source: Gerald Eve



An estimated 1m sq ft completed in Q2 across six schemes, bringing the H1 2023 total to just under 2.3m sq ft. Around 3m sq ft was originally scheduled for completion in Q2 but has been delayed until Q3. Therefore, next quarter, the completion volume will ramp up as the carry-over plus the estimated Q3 volume, totals just under 5.5m sq ft. Additionally, much of the pipeline which completed in H1 was already pre-let. Of the remaining pipeline this year, only 24% is pre-let which may lead to development-led supply increases in some submarkets, namely Midtown, Shoreditch, and Southbank which have recorded little to no pre-let activity in upcoming schemes.

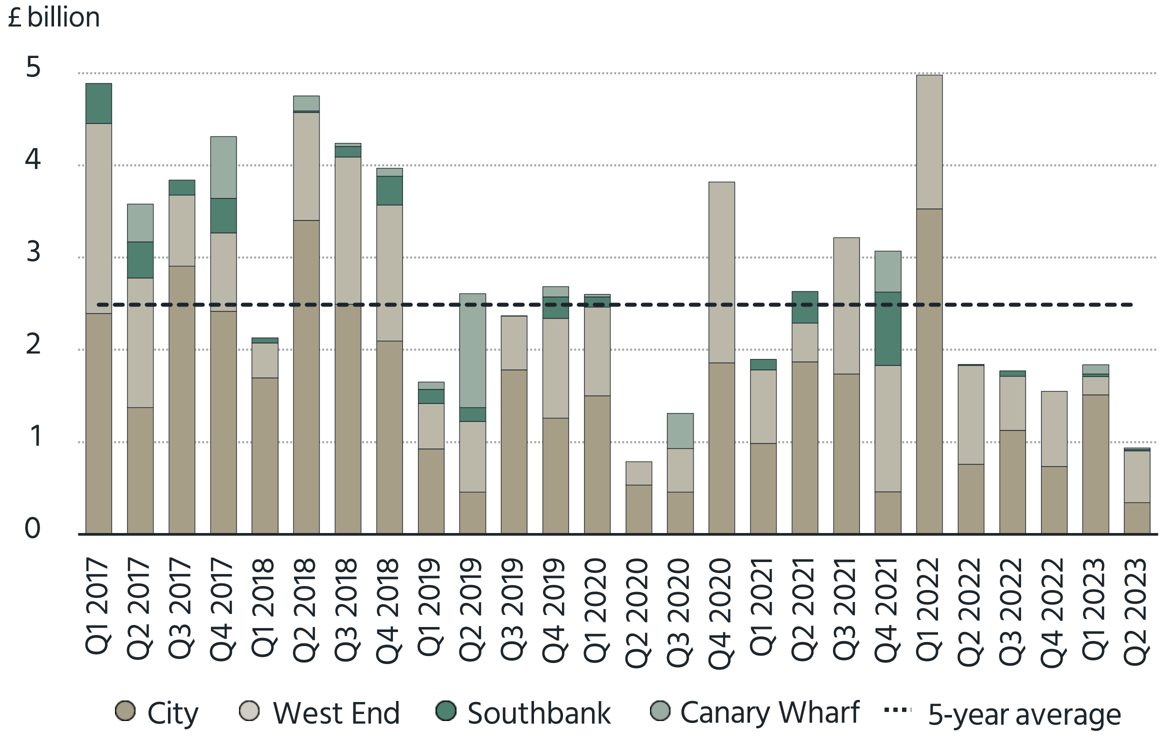
There is a large volume of stock coming to market through comprehensive refurbishments in the next few years. This year, just under 1m sq ft has been fully refurbished and 1.4m sq ft is set to finish in H2. Proportionally, both this year and next account for about a fifth of the total pipeline and estimates show roughly 1.1m sq ft will come online in 2024. The 2025 refurbishments are almost exclusively larger lot sizes in the City, totalling 1.5m sq ft across 6 buildings. We expect this pipeline to grow as landlords take steps to refresh secondary/poorer quality offices, a substitute for new developments given rising debt and development finance costs.

Analysis of existing EPC grades of space in the refurbishment pipeline highlights that landlords are focusing attention on the most cost-effective easy wins first. Over 70% of the refurbishment pipeline has an existing EPC grade of B, C or D which may only require light touch retrofits to align with, or surpass, upcoming EPC deadlines. This is a double-edged sword for sustainability-linked refurbs in that it's a positive investors are willing to take on improvements, but the lack of refurbishment activity on lower EPC-graded space raises obsolescence risk. For offices further out from the regulatory deadlines, landlords are less willing to take on upgrades given high capex costs.

INVESTMENT

Quarterly investment volume by broad market

Sources: Gerald Eve, Real Capital Analytics



Investment market activity was quiet in Q2 with only £940m invested across 20 transactions. This is down by nearly a half on Q1 volumes and was more than 60% below the 5-year quarterly average. There were more transactions this quarter than in Q1, but the average deal size fell markedly to £46m compared with £102m in Q1. There were only two acquisitions on lot sizes in excess of £100mn, the largest of which was the acquisition of Sancroft, 10-15 Newgate for £315m through a joint venture between APAC investor Mitsui Fudosan and Greycoat.

On the buy-side, overseas investors were the most active with purchases totalling just over £680m. APAC investors continued to drive overseas capital inflows, with large lot size transactions totalling nearly £460m across four acquisitions. North American investors were much more active in Q2 following a period of hiatus. The investor group concluded three investments totalling £170m – the first quarter that activity from this sub-group exceeded £100m since Q1 2022.

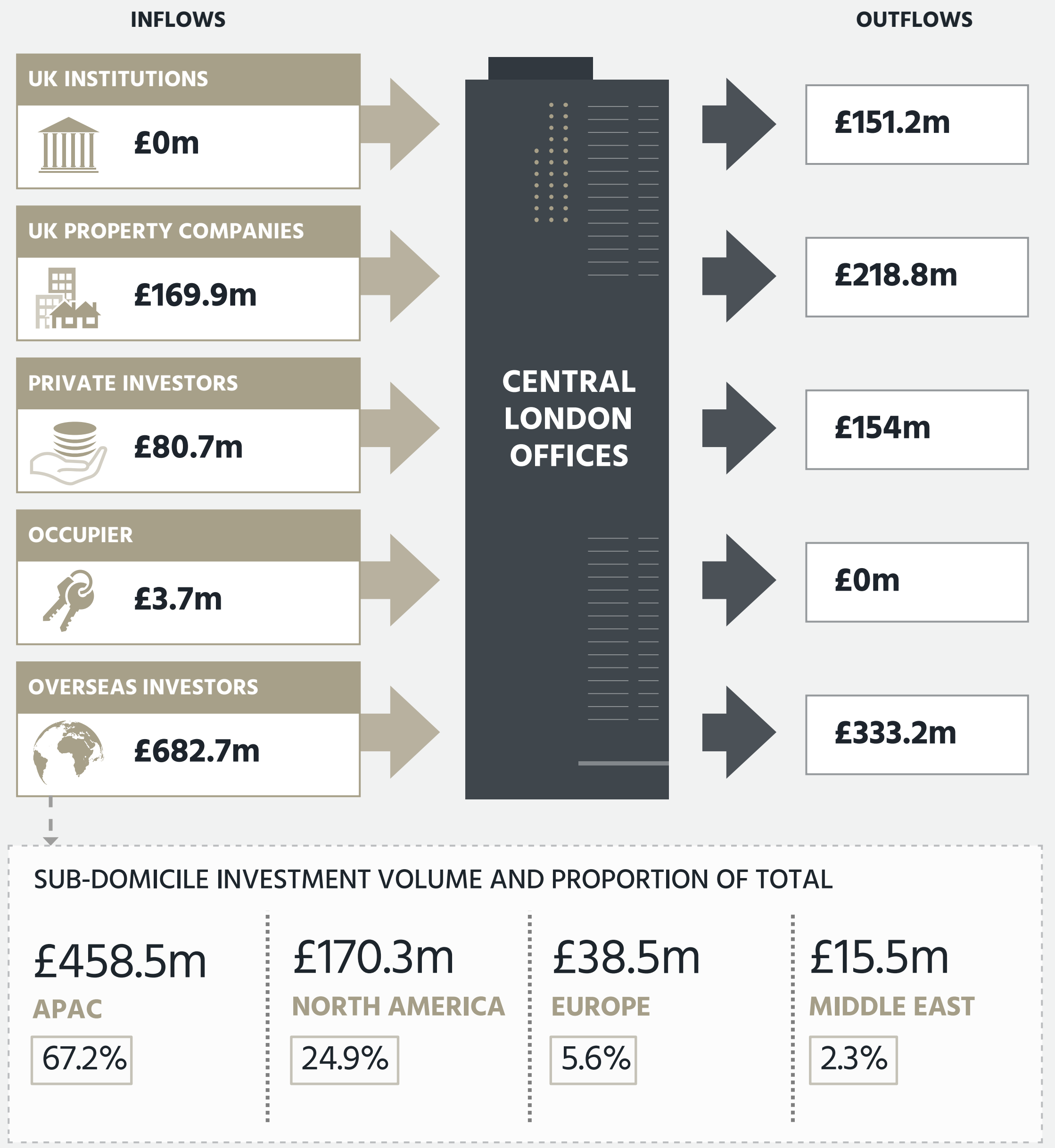
However, the relative market illiquidity meant that valuation yields across London office segments edged out only slightly between March and June. Monthly MSCI June data show current all-quality equivalent yields in the City at 6.9%, an outward shift of 42bps over three months, while the West End and Midtown segment is at 5.2%, recording a much smaller move of only 5bps.

Sentiment improved slightly towards the end of the quarter, and several sales campaigns came to market as investors grew more confident on achievable pricing. There is still strong demand for core and value-add product, but stock selection is heavily dependent on good location and the underlying occupier demand.

Submarkets where incoming supply is low and demand is high will garner the most interest. The shift towards all-equity purchases on smaller lot sizes in these areas could be a feature of H2 as investors increasingly look to value-add stock at discounted prices. Build cost growth has slowed materially compared with 2022, meaning these projects are more viable.

CENTRAL LONDON OFFICE CAPITAL FLOWS, Q2 2023

Source: Gerald Eve, Real Capital Analytics



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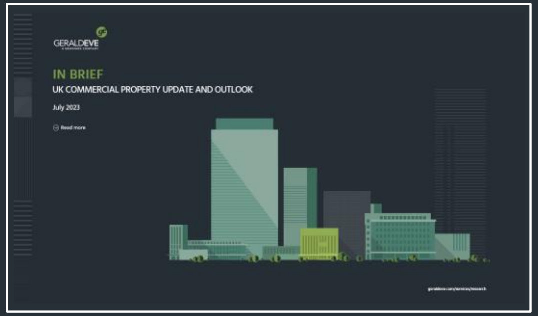
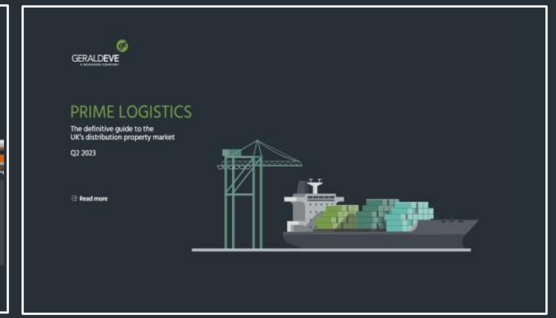
FURTHER INSIGHTS



In Brief
July 2023

Multi-let
July 2023



Prime Logistics
Q2 2023

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