UK Commercial – 2024

SPOTLIGHT
Savills Research

Central London Office Market Q4 2023

savills

● Leasing ● Development ● Investment

Occupational market

Take-up reached 9.9m sq ft across Central London following on from a busy final quarter of the year

Central London take-up during the final quarter of the year reached 3.6m sq ft across 218 transactions. This was up 22% on the long-term average for Q4, with leasing activity in the final month of the year having reached a near-record level. In fact, monthly take-up in December was the highest monthly take-up for Central London in over 13 years.

This brought overall year-end take-up to 9.9m sq ft, which was down 7% on the ten-year long-term average, with leasing activity in the West End remaining more subdued over the year. The City market, by contrast, was up 1% on the City long-term average, with take-up reaching 6.5m sq ft. It is however worth noting that whilst 2023's take-up was down on the long-term average, it is slightly above our predictions on the medium-term impact of agile working (a 10% fall in office space demand) for the London office market.

The final quarter of the year saw several key transactions, the largest of which was HSBC's pre-let of Orion's Panorama Scheme at 81 Newgate Street, EC1 (556,000 sq ft), which is due for completion in Q3 2025. In the West End, Millenium Capital pre-let BEAM's 50 Berkeley Square, W1 (175,300 sq ft). A transaction that will see the hedge fund return to its former offices after a complete overhaul and extension which is due for completion in Q1 2025.

There continues to be a clear preference from occupiers for office space with better sustainability credentials, with over half of the volume of space acquired during 2023, (56%), consisting of lettings in BREEAM-rated Excellent or Outstanding buildings.

What has been driving this demand?

The Insurance & Financial sector was the main driver of leasing activity across Central London, with sector take-up at its highest level on record. In total, the sector accounted for 36% of take-up, which equates to 3.3m sq ft. Demand from the Private Equity, Investment and Asset Management subsectors in the West End continues to remain resilient and outpace the availability of prime supply, with Mayfair/St James's submarket vacancy rate at 3.7%, the lowest across Central London.

Overall, we saw the the fourth-highest number of transactions to complete to the Insurance & Financial occupiers since our records began. We anticipate this strong level of demand from the sector will continue to drive leasing activity in 2024, with the sector currently accounting for 46% of active requirements.

The Tech & Media sector followed with a 13% share of take-up, with demand remaining subdued for the majority of the year. Sector take-up was boosted by ByteDance's pre-let of Topland & Beltane Asset Management's Verdant Scheme at 150 Aldersgate, EC1 (134,279 sq ft).

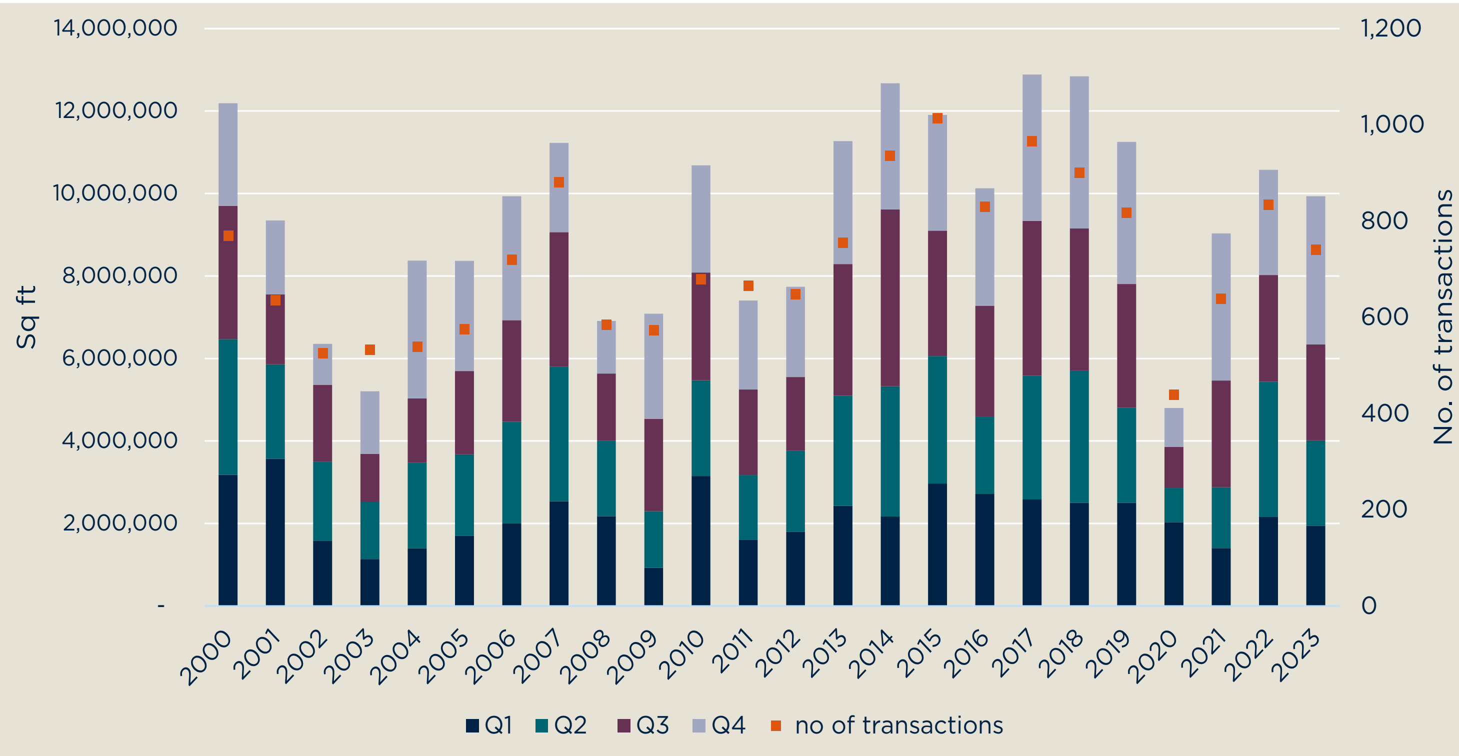
The Professional Services sector accounted for the next largest share of take-up, with 12%, with some of the strong demand we saw from law firms over the past couple of years, having spilled over into 2023. Notable transactions to the sector included Goodwin Procter's acquisition of the 5th to 7th floors at the Sancroft, EC1, and Kirkland & Ellis exercising its option on the 15th to 18th floors (85,000 sq ft), at Nuveen Real Estate & M&G's 40 Leadenhall development, EC3.

Whilst the Serviced Office Provider sector accounted for just 7% of leasing activity, over the year we saw a return of the sector, with over 675,000 sq ft having been acquired across 26 transactions. This was the highest level of activity we have seen from the Serviced Office Provider sector since the Pandemic, with a notable uptick in the number of operators signing up to management agreements.

Looking forward

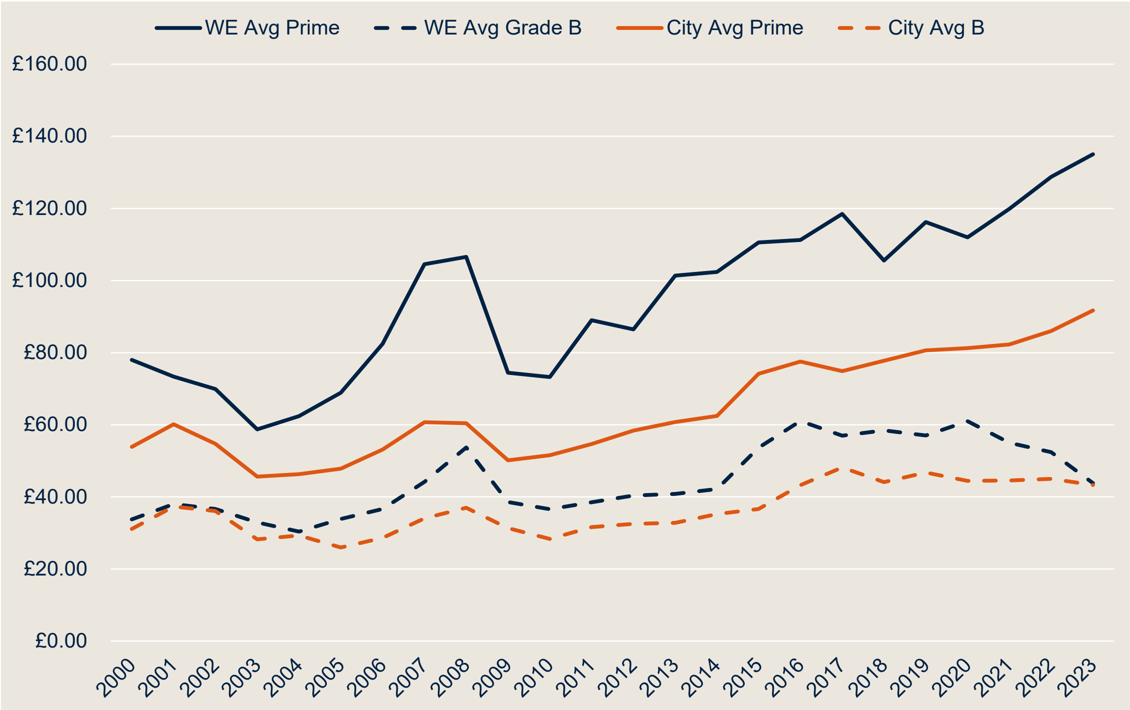
Based on our current economic outlook and office employment forecast for 2024, we expect to see slightly lower levels of leasing activity during 2024 and are currently forecasting take-up will reach 9.8m sq ft. This is down 9% on the long-term average but broadly in line with our predictions on the medium-term impact of agile working.

Chart 1: Central London take-up



Source Savills Research

Chart 2: Central London Average Prime and Grade B rents



Source Savills Research

Underlying levels of demand continue to remain relatively strong, with Central London active requirements at the end of the year standing at 11.4m sq ft, up 25% on the long-term average. Although following on from a busy Q4, at 2.5m sq ft, space under offer was down 5% on the long-term average.

Our latest analysis of active demand (occupiers currently actively seeking 10,000 sq ft or more) indicates that 68% of occupiers are taking the same amount of space or seeking to increase their footprint. A further 15% of occupiers with an active requirement over 10,000 sq ft are new entrants into the London market or currently based in Serviced Office space.

Central London rents

We have continued to see the intensification of occupier demand for best-in-class space result in continued prime rental growth despite the increase to supply across the market as a whole. The average City prime rent at the end of 2023 stood at £91.71 per sq ft, up 6.6% on the previous year, and the average Grade A rent stood at £68.59 per sq ft, up 2% on the previous year. Meanwhile, City Average Grade B rents at £43.33 per sq ft were down 3.7% on 2022.

Similarly, in the West End, the average prime rent stood at £137.25 per sq ft, also up 6.6% on the previous year. By contrast, average Grade B rents continued to decline in the face of continued occupier preference for the newest and highest specification space, and at £47.29 per sq ft, was down 10% on the previous year.

Our analysis indicates there continues to be a rental premium for office Buildings with a BREEAM certification, with rents achieved on BREEAM-certified transactions up 14% when compared to rents for office space in non-rated buildings. This premium increased for higher rated buildings, with average rents achieved during 2023 for BREEAM Excellent or Outstanding offices up 14% on the average rent achieved for office space rated Very Good or Good.

Despite the fact we saw the length of fit-out periods increasing over the year, rent-free periods across Central London remained stable during 2023, with the average rent-free period for the West End standing at 23 months and in the City at 24 months.

Central London supply

Total supply for Central London at the end of the year stood at 22m sq ft, equating to a vacancy rate of 8.5%, down 20 bps on the previous quarter but up 40 bps on Q4 2022. It is important to note that these levels of vacancy are still lower when compared to previous recessionary periods, for example, in the GFC, the vacancy rate peaked at 9.6%. In the Dot.com crisis of the early 2000's the vacancy rate went even higher, peaking at 13.2%.

Tenant-controlled space accounted for 18% of supply and, at 3.86m sq ft, was at its lowest level since June 2020. We have seen a 17% reduction to the quantity of tenant-controlled space since the start of the year and a 38% reduction since its Covid Peak in Feb 2021, with some tenant space having been withdrawn and with more businesses recalling employees and setting minimum weekly office days.

We are anticipating supply will increase over the coming year as a record level of development completions are expected and are forecasting the vacancy rate will reach 8.3% for the City and 7.9% for the West End by the end of 2024.

56%
of take-up during 2023 was in BREEAM-rated Excellent or Outstanding buildings.

36%
The Insurance & Financial sector accounted for over a quarter of 2023 take-up

11.4m sq ft
Active demand was up 25% on the long-term average

17.2m sq ft
is currently under construction

6.6%
Average prime rents across Central London were up significantly on the previous year

Development

Record level of development completions anticipated for 2024, although concerns over viability of certain schemes persist

During 2023, development completions across Central London reached 4.98m sq ft. This was up 5% on the long-term average but was significantly lower than the 7.5m we predicted at the start of 2023, with typical delays resulting in more schemes being pushed out into 2024 and beyond.

Continued strong levels of demand from occupiers for best-in-class space has resulted in pre-lets accounting for 23% of leasing activity during 2023. Whilst two thirds of pre-lets (by sq ft) were in the City market, the strong demand for best-in-class space across the West End Core is reflected by the fact that 16% of pre-lets (by sq ft) and 20% (by number of transactions) were in Mayfair.

Pre-letting activity

At present, a third of 2024's pipeline has already been pre-let. This is significantly lower when compared to the start of the previous year, where 60% of 2023's pipeline was already pre-let, although this is largely as a result of the delivery of the initial phases of Google's The Boulevard boosting overall pre-let completions volume for 2023.

Whilst pre-letting continues to be a significant driver of leasing activity, we have seen a reduction to the overall quantity of the pipeline that is let prior to completion. In the three years prior to Covid-19, 68% of development completions were let prior to completion, boosted by the higher level of demand from the Tech & Media sector during this period. By comparison, over the past three years, 55% of developments (by sq ft) have been been let prior to completion.

Development pipeline in 2024

Development completions are currently expected to reach a record high during 2024, with 8m sq ft scheduled for completion, although in reality are unlikely to reach this level with the typical timeline challenges. This high level of development completions is largely as a result of the record 3.1m sq ft of development completions currently scheduled for delivery across the West End and 2.6m sq ft in the City Core.

57% of the overall sq ft of developments scheduled for delivery during 2024 consists of new developments (as opposed to extensive refurbishments). The largest scheme scheduled to complete during 2024 is Nuveen Real Estate and M&G's 40 Leadenhall development, EC3, which is currently scheduled for completion in Q2. 75% of the c.870,000 sq ft, BREEAM Excellent office scheme space has already been pre-let to occupiers including Kirkland & Ellis, McGill, Acrisure and Chubb.

The West End market accounts for 40% of 2024's development completions, and the largest scheme scheduled for delivery is at Seaforth's Space House, WC2. The c.250,000 sq ft BREEAM Outstanding scheme is set to complete in Q2.

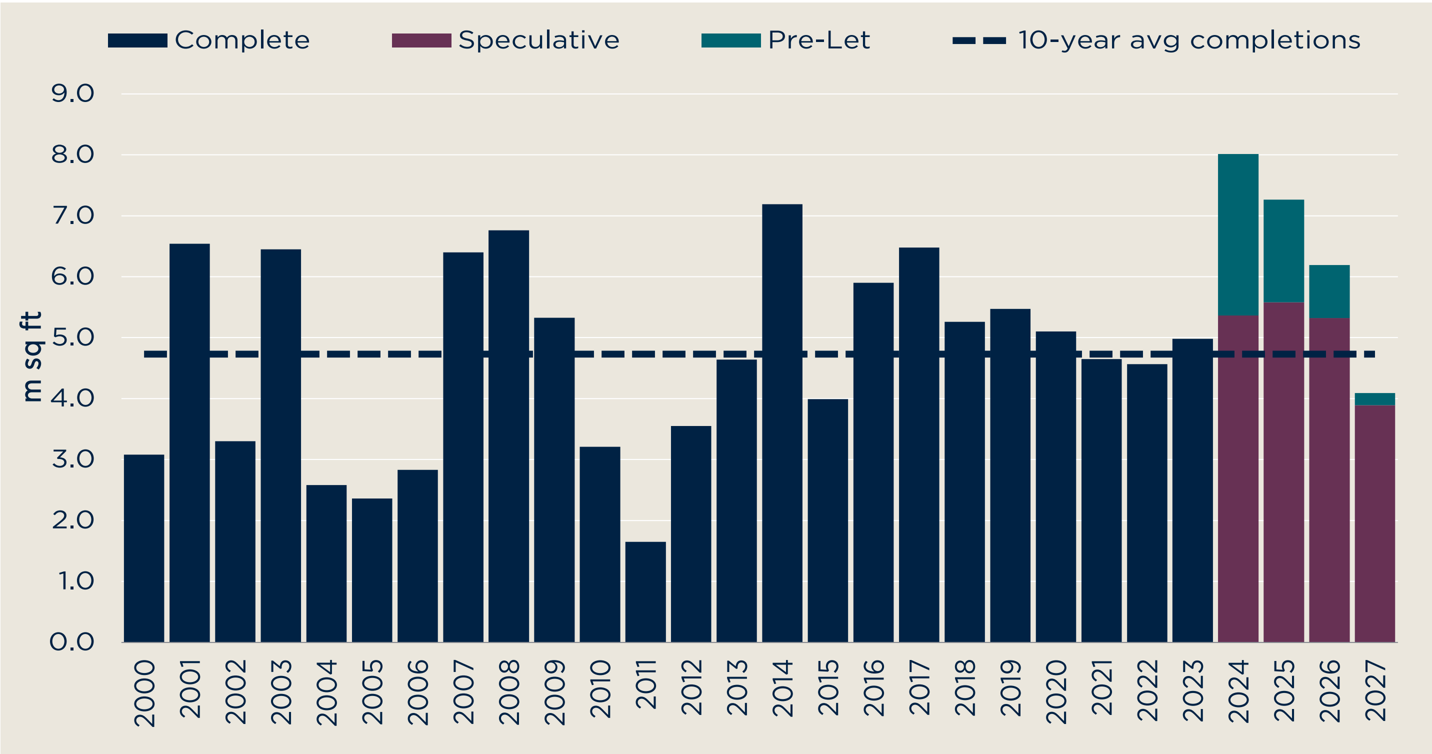
Overall development completions between 2024 and 2027 are expected to reach 25.6m sq ft, 21% of which has already been pre-let. A third of the overall sq ft scheduled for delivery over this period however is yet to start, and we anticipate development completions will be tempered by viability challenges for schemes that are not yet underway.

Sustainable development

The proportion of schemes (by sq ft) in the pipeline known to be targeting BREEAM Outstanding and Excellent now account for 67% of schemes being delivered over the next four years, this is up from 44% at the end of 2022, with the importance and awareness of sustainability and carbon emissions continuing to rise.

New developments account for 57% of the overall sq ft that will be delivered between 2024 and 2027, though there is an even split by number of schemes, with 51% of the current pipeline consisting of extensive refurbishments.

Chart 3: Central London Development Pipeline



Source Savills Research

Investment

Challenging macroeconomic environment sees turnover fall as inventors show preference towards smaller lot sizes

Whilst we saw a slight pickup in investment activity at the end of the year, with Q4 investment turnover reaching £1.85bn, up 34% on the previous quarter, turnover was down 67% on the long-term average for Q4.

This brought overall Central London investment turnover for 2023 to £7.1bn, down 57% on the long-term ten-year average and 49% on the five-year average. In common with the rest of the UK and European commercial property markets, 2023 saw lower transaction volumes following a challenging macroeconomic backdrop to the year and continued speculation on the future of the office. We continued to see strong investor preference for Core assets and, similar to the leasing market, many transactions that completed during the year were reflective of a flight to quality that we have seen play out during the course of the year.

The higher cost of finance and the rising development costs impacted investment activity for the larger lot sizes the most. In total only 17 transactions in excess of £100m completed over the year, down on the five-year average of 35. Investors from the Asia Pacific region (particularly institutional investors) accounted for both the majority of transactions in excess of £100m and turnover for the larger-sized transactions completing over the year, illustrating the continued trend of investment from Asia-Pacific into Central London offices.

Overall, Investors from the region accounted for the largest share of investment turnover (36%), up slightly from a 33% share of turnover in 2022.

Notable transactions

The largest transaction to complete in 2023 was Asian investor City Developments Limited's acquisition of the freehold interest in the 23-acre St Katharine Docks Estate from Blackstone for £395m, 7.29% NIY and £752 per sq ft. Located close to Tower Hill and London Fenchurch Street stations, the riverside and marina estate comprised of 451,135 sq ft of office and 74,314 sq ft of retail and ancillary accommodation, including a 185-berth fully serviced marina.

Another notable transaction to complete was the sale of Bloom, 48–50 Cowcross Street, EC1, which was acquired by UBS from HB Reavis (which was advised by Savills). Completed in 2021, the property is held long leasehold for a further 148 years, subject to a head rent of 6.35% of the rents receivable. Compromising 143,935 sq ft NIA of office and retail accommodation, the building is situated in a prime location immediately adjacent to the western entrance of Farringdon Station.

In the West End, there has also been a strong focus on prime retail, with some of the largest trades taking place on Old and New Bond Street including, 27 Old Bond Street (£143m) and Swan House, 32-33 Old Bond Street (£103.5m).

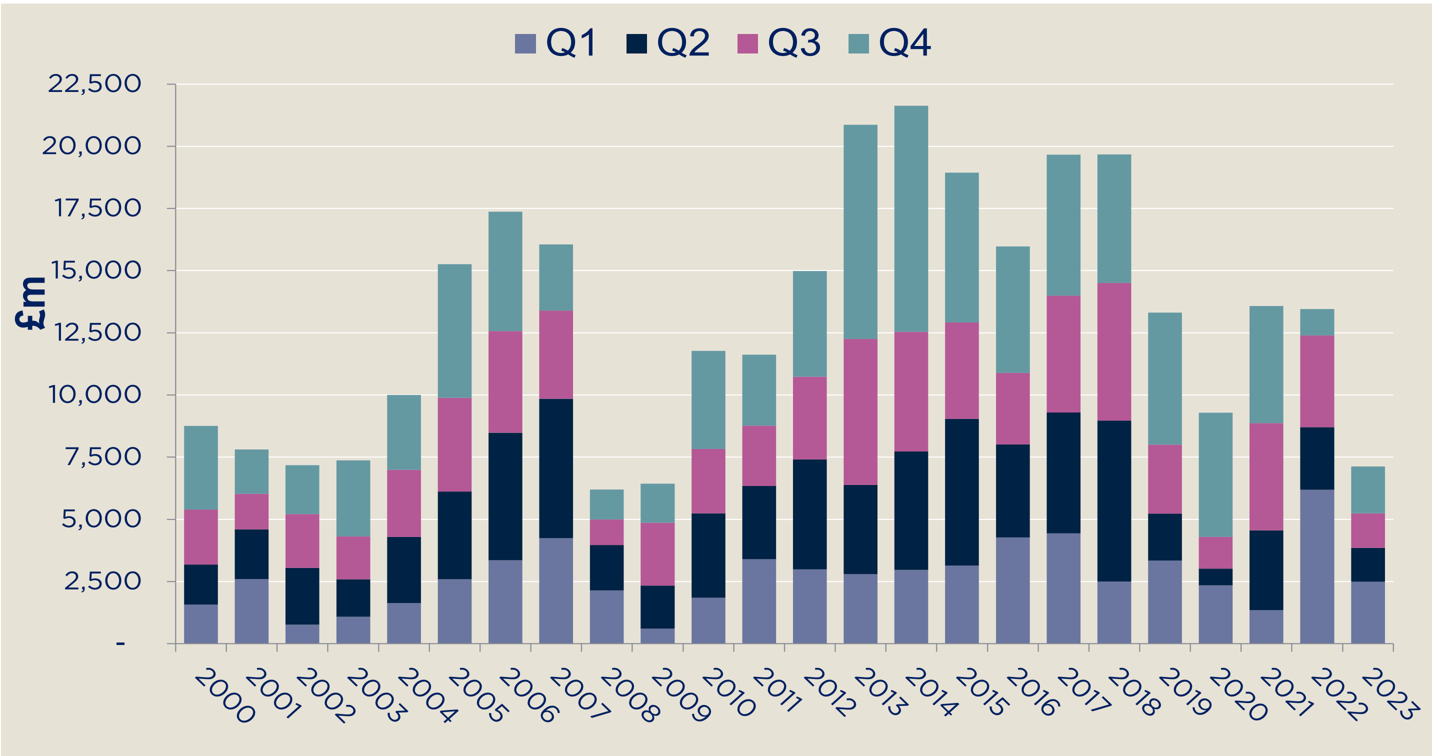
Investment activity for the year was mainly dominated by the purchase of smaller assets, with sub £50m transactions accounting for 77% of the number of transactions to complete during 2023. At 126, the number of sub £50m transactions was only down 7% on the average quantity completing annually over the past five years. Domestic investors were the most active purchasers of smaller assets across Central London and accounted for 39% (by turnover) and 44% (by number) of sub £50m transactions.

UK investors also accounted for the second largest share of overall Central London investment turnover with 16% share (£1.93bn) and were followed by European investors who purchased £1.1bn worth of assets over the year.

Institutional investors accounted for 31% of Central London turnover by purchaser type, type – over the past decade, institutional investors have accounted for 44% of investment turnover. private investors and property companies followed both with a 16% share.

Going forward, with interest rates having stabilised and offices returning to higher occupancy levels, we expect we could see a boost to investment activity during 2024, although, with a general election, we could see the typical pause in activity in the lead-up to this. At the end of 2023, we held our City yield at 5.25% and our prime West End yield at 4%.

Chart 4: Central London Investment



Source Savills Research

Savills Commercial Research

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