**CENTRAL LONDON OFFICE MARKET UPDATE**

**STATS AT A GLANCE**

- **£2.35 BN**
  - Q1 2018 office investment volumes

- **£4.30 BN**
  - Currently under offer in Central London

- **3.50%**
  - Prime yields in the West End remain stable in Q1 2018

- **4.00%**
  - City prime yields saw no movement in Q1 2018

- **5.56%**
  - Central London Q1 2018 vacancy rate, -5bps down on Q4 2017

- **30%**
  - Tenant space accounts for 30% of total supply, up from 20% in Q1 2017

- **3.71M**
  - Q1 2018 take-up is 20% ahead of the long term average quarterly figure and nearly 50% ahead of Q1 2017

- **22%**
  - Media Tech accounted for the largest share of take-up in the first quarter of 2018

**Brexit & the economy**

With further clarity emerging on a Brexit transition deal, agreement on citizens rights and the UK’s financial settlement, the result has been a boost to business confidence. The latest Deloitte CFO Survey reported an increase in optimism and positive sentiment about the long-term effects of Brexit. This has translated into an increase in demand for Central London offices. Indeed, levels are nearly 50% ahead of the same period last year.

The Bank of England’s survey shows hiring intentions are at above average levels, suggesting buoyant levels of demand are set to continue despite slow economic growth. First estimates for Q1 2018 suggest GDP grew by 0.1%. BNP Paribas forecast a steady upward trajectory over this year.

**Leasing**

Take-up figures in Q1 2018 reached 3.71m sq ft, up 20% on the long term quarterly average and 46% up on the same period last year. Unlike 2017, which saw >100,000 sq ft deals boost demand, the first quarter of 2018 has seen just three deals within this size band complete. Deals of <5,000 sq ft are up 25% on the previous quarter suggesting small to medium sized enterprises are reactivating property requirements after a year of adopting a ‘wait and see’ approach. We expect momentum to continue into Q2 with around 3m sq ft currently under offer.

The Media Tech sector drove demand with large lettings to Google and Mimecast. The Serviced Office sector (which acquired record levels of Central London office space in 2017) get off to a muted start with just 150,000 sq ft of take-up recorded in Q1 2018.

Despite high levels of development completions both last year and this year, large volumes of pre-letting activity has kept the vacancy rate below the long term average at 5.60%, down from 6.15% in Q4 2017. We do not foresee any substantial rises in vacancy this year despite occupiers continuing to rationalise their office needs. Second hand tenant space continues to increase in relevance, accounting for 30% of total supply, up from 20%, 12 months ago.

Prime rents are being maintained by low levels of new development and refurbished available space which bolstered 2017 volumes, can continue to move in from 3.56% in Q4 2017 to 3.49% in March 2018, with a lack of large trophy asset sales, which bolstered 2017 volumes, can be attributed to lower levels seen in Q1. This type of stock which is high on overseas buyers shopping lists, is in tight supply. Despite this, investor demand remains strong with significant capital circling Central London. Indeed, the latest INREV Investor Intentions Survey puts the UK as preferred European destination, with a large proportion of that targeting London.

The MSCI Central London initial yield continues to move in from 3.56% in Q4 2017 to 3.49% in March 2018, underpinning our view that prime yields remain at 4.00% in the City and 3.50% in the West End.

**Investment**

Q1 2018 Central London investment volumes reached £2.35bn, down on the long term average quarterly figure of £2.95bn. However, we do estimate a pick-up in activity in Q2 with £4.30bn currently under offer.

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Despite continued supply pressures the vacancy rate fell to 5.56%, representing a quarterly contraction of 59 bps.

The majority of submarkets experienced falls in vacancy, with the City market seeing the largest fall of 103bps to 6.16%.

Stratford was the only submarket to record a rise in rents in Q1 2018, reaching £45.00/sq ft. Rents remained static in all other submarkets.

Tenant supply has risen to 30% of total supply, which equates to 3.75m sq ft. 12 months ago tenant supply represented 20%.

Robust levels of demand for new development and refurbished stock has kept vacancy rates below average. Over the next three years (2018-20) we estimate space under construction totals 17m sq ft, of which 54% is already committed.

The majority of new development stock delivered in Central London this year will be in the City. 5.60m sq ft is due to complete, 60% is pre-let.
The West End take-up levels rose to 0.98m sq ft in Q1 2018, a 50% rise on Q1 2017 and a 22% rise on the 10-year average. No deals over 100,000 sq ft were recorded this quarter and buoyant levels of demand were the result of smaller deals. Deals in the <5,000 sq ft size bracket made up the majority of take-up with 62% of deals recorded in the band.

On a submarket basis, the majority saw take-up rise. Q1 2018 levels in Mayfair and St James’s totalled 0.26m sq ft, an increase on Q1 2017 of 40% and 20% on the 10-year average. In Victoria, take-up reached 0.40m sq ft, up 113% on Q1 2017 and 151% on the 10-year average. High levels of take-up can largely be attributed to final deals at Nova North, Nova South and Verde of which only 10,700 sq ft were recorded this quarter and a 14% share in Q1 2018. This demonstrates the increased importance of Serviced Offices as a key occupier in the market. The continuing importance of Media Tech and Banking & Finance sectors shows the resilience of the West End market in the face of economic headwinds.

West End overall supply fell from 3.25m sq ft in Q1 2017 to 3.08m sq ft in Q1 2018, a significant fall on the 4m sq ft 10-year average. The fall in supply can be attributed to healthy demand for existing stock, as well as a reduction in schemes beginning construction. Indeed, from Q1 2017 to Q1 2018 under construction supply in the West End fell 94%, buoyed by a number of pre-lets, further constraining supply. The West End vacancy rate (including under construction space due to complete within six months) was 4.52% in Q1 2018, significantly below the long term average of 5.89%.

West End prime rents remained at £115.00 per sq ft, a -9.8% annual fall. We expect rental growth to return by 2020. Rental growth has become increasingly polarised between submarkets, streets and buildings, so rental growth in certain submarkets may return earlier than in others.

Investment volumes in the West End market totalled £0.39bn in Q1 2018, falling 43% on Q1 2017 and 160% on the 10-year average and West End yields are currently stable at 3.50%.

The Banking and Finance and Media Tech sectors made up the majority of demand during the quarter, accounting for 15% and 17%, respectively. Interestingly, the Serviced Office sector that accounted for 4% of take-up in 2017, took a 14% share in Q1 2018. This demonstrates the increased importance of Serviced Offices as a key occupier in the market. The continuing importance of Media Tech and Banking & Finance sectors shows the resilience of the West End market in the face of economic headwinds.

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The Banking and Finance and Media Tech sectors made up the majority of take-up.

Banking & Finance and Media Tech sector take-up shares.

Q1 2018 saw vacancy drop on previous quarters and the 10-year average of 5.89%.

4.52%
Q1 2018 West End vacancy rate.

The City saw strong levels of take-up in Q1 2018 reaching 1.76m sq ft, the highest level of quarterly take-up since Q4 2014. Boosting levels were five lettings under construction including SMBC acquiring 161,151 sq ft at 100 Liverpool Street, EC2 and Sidley Austin taking 135,545 sq ft at the Can of Ham, 70 St Mary Axe, EC3.

The Banking & Finance sector demonstrated their commitment to the City in Q1 and dominated demand levels accounting for 27% of take-up. The Media Tech sector, which was joint top with Banking & Finance in 2017, made up 17% of take-up.

Noticably absent were Serviced offices, who accounted for 15% of last year’s take-up, in Q1 that diminished to just a 1% share. With the likes of WeWork still very much in expansion mode, we expect to see more activity from this sector over the coming 12 months.

2018 is expected to see 5.40m sq ft of development completions in the City, the highest on record. This may signal the signs of an oversupply in the pipeline however on closer inspection 60% is already committed leaving only 2.20m sq ft available. As a result, the vacancy rate has fallen to 6.36%, its first substantial fall in nine quarters.

The majority of new stock being delivered this year is in the City Core, 100 Bishopsgate, The Scalpel and Can of Ham will dramatically change the skyline of the City. The City fringe accounts for just a quarter of completions contributing to a current undersupply in this submarket. As a result, the value proposition in comparison to the City core has diminished with rents in the two submarkets both standing in the high to mid £60's.

Following the trend seen across Central London, City investment volumes were down on the long term average reaching £1.12bn, representing a 29% fall. Encouragingly however, £3.30bn is under offer which will contribute to stronger volumes in Q2. Overseas investor appetite for City assets shows no signs of abating with non-domestic capital making up three quarters of Q1’s total.

Despite continued Brexit worries, the City of London’s standing as a top global financial centre remains. Indeed, the capital retained its number one spot in the latest Z/Yen Global Financial Centres report. Furthermore, in a survey of senior financial professionals by Duff & Phelps, London stole New York’s crown as world’s top financial centre. Both are major votes of confidence in the City of London’s long term future as a key global financial hub.
Midtown take-up reached 0.26m sq ft in Q1 2018, a 35% decline on Q1 2017 and a 12% decline on the 10-year average. The largest deal of the quarter was to Regus at 60 St Martins Lane where the Serviced Office operator took 31,820 sq ft. As a result the sector took the largest share of take-up, accounting for 23%, up from the 2017 level of 13%. Professional services also took up a large proportion of take-up during the quarter at 17%, in line with the market’s historic association.

Supply levels in the Midtown market totalled 0.96m sq ft and were down on Q1 2017 and the 10-year average by 83% and 42% respectively. Every grade saw supply drop off with new existing supply dropping most dramatically reflecting strong interest for Grade A Midtown offices, during Q1.

Midtown investment volumes totalled £0.59bn in Q1 2018, an 88% rise on the 10-year average.

Under construction supply dropped 10% from Q4 to Q1 reflecting pre-lets at the Post Building where McKinsey took a further 26,540 sq ft on their previous option, as well as a muted development pipeline. Indeed, there are currently three developments (The Post Building, 29 Floral Street and 44 Eagle Street) projected to complete by the end of Q3 2018, of which 39% is pre-let.

The vacancy rate has fallen from 8.80% 12 months ago to 4.69%

4.69% Q1 2018 vacancy rate

Supply levels in Southbank were up marginally on Q4 2017 levels at 0.52m sq ft, however, supply has followed a steady declining trend with levels currently 99% below the 10-year average. This decline is primarily due to strong take-up for Grade A stock, as well as a reduction in under construction availability as fewer schemes enter the market.

The Property sector made up the majority of demand making up 94%. Following closely behind was the Media Tech sector which made up 32%. The high proportion of Media Tech companies within the Southbank market demonstrates the market’s resilience and its ability to attract smaller start-ups to a modern and vibrant setting.

Prime rents stand at £65.00 per sq ft, in line with Q4 2017 levels but an annual increase of 3.2%, reflecting good demand within a supply constrained submarket.

Q1 2018 saw vacancy drop by 23% compared to the previous quarters and the 10-year average.

2.67% Q1 2018 Southbank Vacancy Rate.

Property & Construction took the largest share of take-up in the quarter.

34% Percentage share of Property & Construction in Southbank take-up.