



Top Five

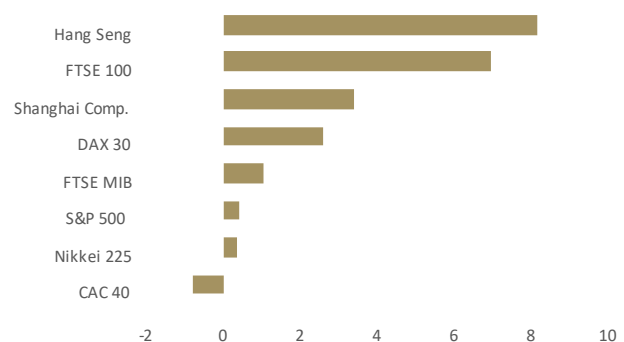
- There has been some improvement in global economic activity since the start of the year. But even so, global growth excluding China is likely to be slightly below trend in 2024. That holds true for the UK, which emerged from recession at the start of the year but where the recovery is set to be gradual.
- After a strong end to 2023, Central London office demand dropped back in Q1 2024. Take-up declined to 1.9m sq. ft., the lowest level since Q2 2021. The drop in tenant demand was evident across both the West End and City, while the Docklands saw a small rise. But with a significant amount of space under offer take-up looks set to rebound in Q2.
- Soft office demand was also evident outside of the capital. Take-up in the Big Nine regional cities in Q4 2023 was up only marginally on Q3 to a total of 1.92m sq. ft. That was only 2% above the 5-year average, which includes the disruption from Covid-19. Bucking the trend was Liverpool, which saw a rise in take-up to 143,000 sq. ft, up 43% on its 5-year average.
- Demand for logistics space fell back in Q1, with take-up of 4.5m sq. ft down from 8.8m sq. ft. in Q4 2023. But a contraction in the construction pipeline prevented a rise in availability, with the vacancy rate stable at around 5%. Meanwhile, Central London retail unit vacancy rates improved or were stable across all subsectors bar the City in Q4 and lettings also increased in the quarter.
- High financing costs have continued to weigh on property investment. Investment in Central London offices fell for the third quarter in a row in Q1 to £1.0bn, the lowest amount since the end of 2022. And office investment outside of London dropped to £520m, the lowest since the lockdowns of Q2 2020. But investment in shops held up, supported by two large deals in London.

1. Economic Overview

The latest data indicate some improvement in economic activity, particularly for industry, at the start of this year. World trade edged up in January and looks to have risen in February too. But even so global growth excluding China is likely to be slightly below trend in 2024. This will be driven by lacklustre consumer spending, particularly in Europe, where retail sales have been falling and consumer confidence remained historically low in March. And although inflation in developed markets should return to central bank targets by the end of this year, the softer inflation outturns in Europe compared with the US mean that the ECB and Bank of England are set to begin cutting rates before the Fed.

Higher than expected inflation in the US has weighed on equities in that market, with the S&P 500 underperforming most other indices over the past 40 days. (See Chart 1.) Nevertheless, inflation should ease later in the year. For example, supplier delivery times have shortened which is consistent with the resumption of core goods deflation. And a combination of slower wage growth and faster productivity growth is consistent with lower non-housing services inflation. Meanwhile, the slowdown in first-quarter US GDP growth to 1.6% annualised, from 3.4%, was more marked than expected, but it was principally due to a bigger drag from the net exports and inventories categories. Excluding those volatile items, final sales to private domestic purchasers, a better gauge of underlying momentum, expanded at a solid 3.1% pace.

Chart 1: Change in Selected Major Equity Market Indices over the Last 40 Trading Days



Source: Refinitiv

The euro-zone will remain close to recession until the second half of this year and the subsequent recovery is likely to be weak. Household real incomes will pick up only slowly and consumers will be cautious amid a softening labour market. Moreover, business investment is likely to stagnate due to soft domestic and foreign demand, and governments will tighten fiscal policy further. With inflation on track to reach its target in the second half of the year, the ECB is set to cut its deposit rate from 4% to 3% by year-end and to around 2.25% by the middle of 2025. While this should help to support activity next year, the effect of rate cuts will feed through only gradually so the boost to growth will be small.

In the UK, both regular private sector wage growth in February and services CPI inflation in March were both a bit higher than the Bank of England had expected. But given weak economic growth over the past two years, price pressures will soon ease and CPI inflation should fall below the 2% target in April and below 1% later this year. That may mean interest rates are first cut from 5.25% in June, if not in August, and fall to 3.0% next year. Meanwhile the 0.1% m/m rise in GDP in February all-but confirmed the recession ended at the start of this year. But the recovery is set to be slow, with GDP only likely to rise by 0.1% m/m in March and by 0.4% q/q in Q1 as a whole.

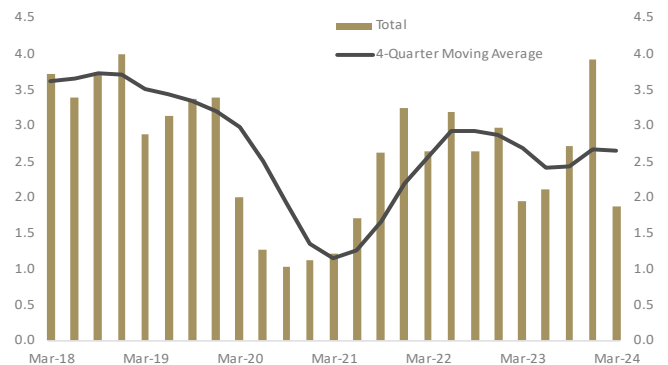
2. London

2.1 Occupational Market

After a strong end to 2023, Central London office demand slowed in the first quarter of 2024 in line with the usual seasonal pattern. According to Knight Frank, take-up dropped to 1.9m sq. ft., a 52% decrease on the previous quarter and the lowest level of demand since Q2 2021. (See Chart 2.) The drop in tenant demand was evident across both the West End and City, while the Docklands saw a small rise.

The rise in take-up in the Docklands was supported by the University of Sunderland taking 94,545 sq. ft. at 4 and 5 Harbour Exchange, which was the largest deal in the quarter. Other notable deals include Wise taking 85,324 sq. ft. at Worship Square and Grant Thornton taking 74,200 sq. ft. at 8 Finsbury Circus. But large deals were rare, with only five deals above 40,000 sq. ft.

Chart 2: Central London Office Take-Up (M. Sq. Ft.)



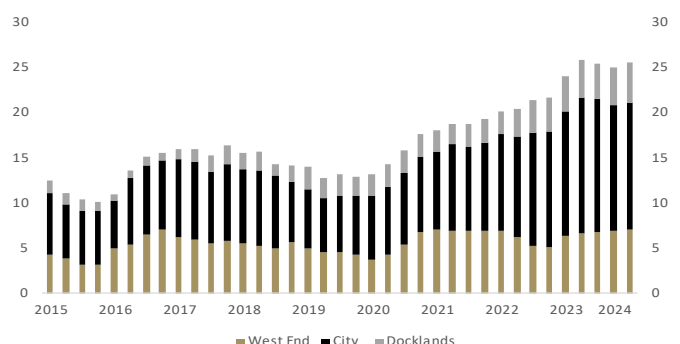
Source: Knight Frank

The demand for high quality offices continued to outperform, with the best quality offices accounting for 55.8% of take-up. That will in part reflect increased need for the most sustainable offices. Indeed, 60% of take-up in Q1 was for buildings with an EPC rating of A-B, which is close to the highest share since Knight Frank began tracking the data in 2019.

Looking ahead, take-up in Q2 is set to be stronger given the significant amount of space under offer. CBRE reported that under offers totalled 4.1m sq. ft. in Q1, 18% above the 10-year average. The largest of these was Citadel placing 250,000 sq. ft. under offer at 2/3 Finsbury Avenue.

The decline in take-up contributed to a rise in availability in Q1. Total available space in Central London rose 25.6m sq. ft., close to the highest level since 2004. (See Chart 3.) Availability in the City is particularly high, up around 40% on its 20-year average, which compares with 20% above average for the West End. That is also reflected in vacancy rates, with the City rate having now been above 10% since the start of 2023. The Docklands vacancy rate also rose again to just under 18% in Q1, up from just 4% in 2016.

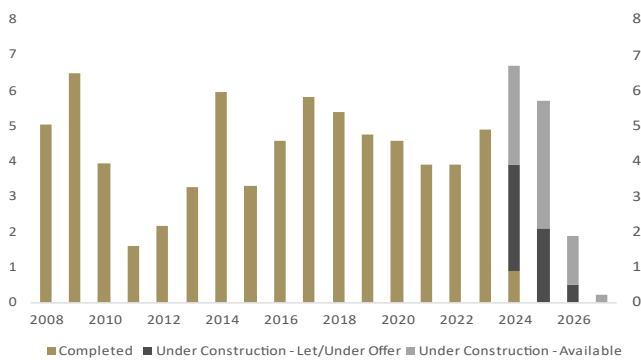
Chart 3: Central London Office Availability (M. Sq. Ft.)



Source: Knight Frank

Availability is also rising due to a relatively high level of completions. Central London office completions in 2023 were the highest since 2017, and 2024 is set to exceed that. (See Chart 4.) But a relatively large share of that space has been pre-let. Indeed, Knight Frank report that the pre-let share increased to around 38% in Q1, the highest since the start of 2021.

Chart 4: Central London Development Pipeline (M. Sq. Ft.)



Source: CBRE

Retail sales volumes were worse than expected in March, but still rose by 1.9% q/q in Q1, bringing the retail downturn to an end. And as inflation falls, rising real housing incomes will support retail activity throughout 2024.

Knight Frank reported that Central London retail unit vacancy rates improved or were stable across all subsectors bar the City in Q4, which saw an increase to 24.9%. Lettings also increased in the quarter, with Oxford Street seeing the most activity followed by Convent Garden and Knightsbridge.

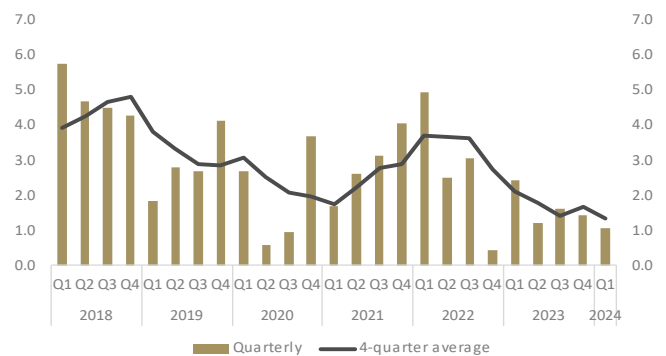
London hotels performed well in Q4. Knight Frank report occupancy increased to 82.1%, up 4.1% compared to a year ago despite the addition of 3,100 rooms. A recovery in overseas visitors helped drive that improvement, with passenger arrivals to London's three main airports now just 5% below 2019 levels.

2.2 Investment Market

Lambert Smith Hampton reported that investment in Central London offices fell for the third quarter in a row in Q1 to £1.0bn, the lowest amount since the end of 2022. (See Chart 5.) And office investment across the UK accounted for just 17% of all transactions, the lowest since records began in 2000.

The low level of transactions in London meant there were only two deals for over £100m in the quarter. RLAM purchased a 50% stake in British Land's 1 Triton Square for £193m, and 5 Churchill Place in Canary Wharf was sold for £110m to Menomadin Group.

Chart 5: Central London Office Investment (£bn)



Source: Lambert Smith Hampton

Overall retail investment is outperforming thanks to a strong performance in the shops subsector, and was the only core sector to see above-trend activity in Q1. That was supported by a couple of significant London deals. Blackstone purchased 31,000 sq. ft. of luxury retail space at 130-134 New Bond Street for £230m at a net initial yield of 3.9%. And Shaftesbury Capital bought 21 James Street in London for £75m at a 5.2% net initial yield.

Hotel investment surged to a five-year high of £1.7bn in Q1, which included MCR Hotels purchase of the BT Tower in London for £275m.

3. Rest of UK

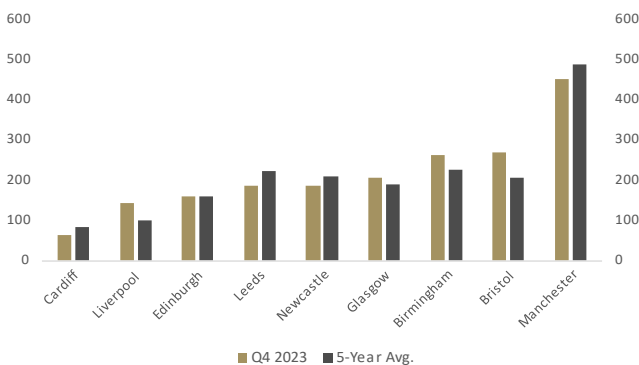
3.1 Occupational Market

In contrast to Central London, which had a strong final quarter of 2023, Avison Young reported that take-up in the Big Nine regional cities was up only marginally on Q3 to a total of 1.92m sq. ft. That was only 2% above the 5-year average, which includes the disruption from Covid-19. In particular, Manchester had a weak quarter, as did Leeds. (See Chart 6.) By contrast, Liverpool saw take-up of 143,000 sq. ft., up 43% on its 5-year average.

As in London, demand continues to be concentrated in high quality, smaller offices. Avison Young reported that the volume of city centre deals 25,000 sq. ft. or larger accounted for just 24% of all take-up in Q4, compared with an average of 31% in the five years before the pandemic.

Key deals in the Big Nine regional cities in Q4 included Dyson leasing 66,317 sq. ft. at 1 George’s Square Bristol and Mills & Reeve’s taking 32,088 sq. ft. at One Centenary Way in Birmingham. In the out-of-town market, Curtis Instruments took 37,742 sq. ft. at 2 Kloppers Way, Monkton, Newcastle.

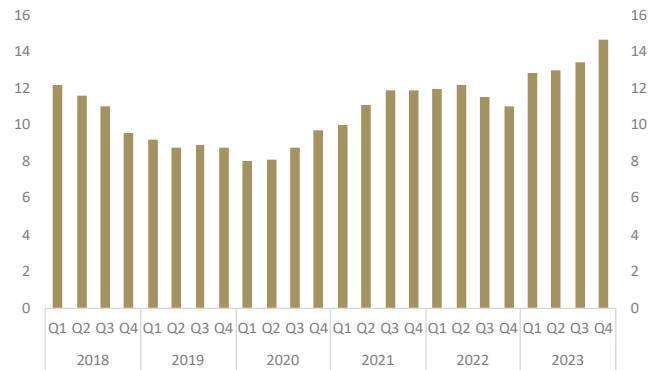
Chart 6: Big Nine Regional City Take-Up (000s Sq.Ft.)



Source: Avison Young

The relatively weak level of demand in Q4 contributed to a rise in availability across the Big Nine regional cities. Avison Young reported 14.6m sq. ft. of available space in Q4, up 9% on the previous quarter and the most since the end of 2016. (See Chart 7.) The vacancy rate increased to 9.5%, but within that Liverpool supply was relatively tight with a vacancy rate of 5.4%. At the other end of the spectrum, Birmingham had the highest vacancy rate at 11.3%, followed by Leeds at 10.9%.

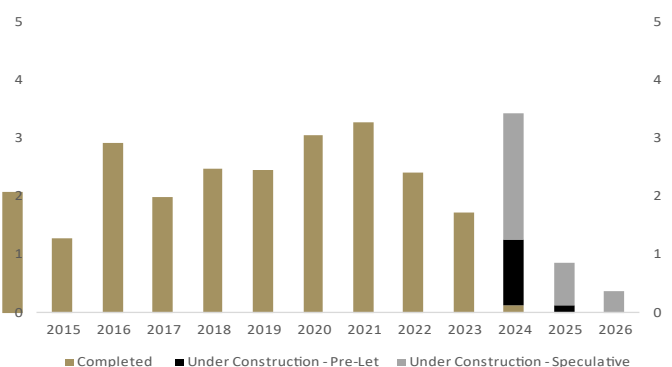
Chart 7: Big Nine Availability (M. Sq. Ft.)



Source: Avison Young

Availability increased despite a relatively low level of completions in 2023. Across the Big Nine just 1.7m sq. ft. of space was completed, the lowest annual total since 2015. (See Chart 8.) But activity is set to pick-up in 2024, with 3.4m sq. ft. of space due to complete. Of that, 2.2m sq. ft. is still on the market, which points to a further rise in availability in 2024.

Chart 8: Big Nine Pipeline (M. Sq. Ft.)



Source: Avison Young

CBRE reported that logistics take-up fell back in Q1 to 4.5m sq. ft, from 8.8m sq. ft. in Q4 2023. But a contraction in the construction pipeline prevented a rise in availability, with the vacancy rate stable at around 5%. Indeed, the amount of space under construction had fallen from 42.9m sq. ft. at the start of 2023 to 19.6m sq. ft. by Q1 2024. Once again, the Midlands saw the bulk of that take-up, with locations within the ‘Golden Triangle’ accounting for close to 60% of leasing activity. And third-party logistics firms dominated, accounting for 70% of all take-up.

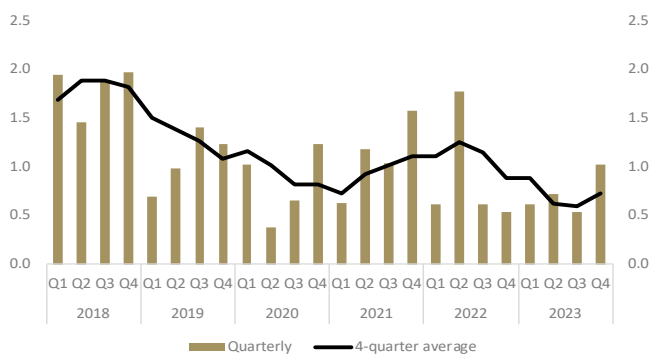
Key deals in Q1 included Yusen Logistics taking 1.2m sq. ft. at SEGRO Logistics Park in Northampton, Brake Bros taking 465,000 sq. ft. at Hemel 465, Hemel Hempstead and Open Box leasing 451,919 sq. ft. at Campus 450, Daventry.

Regional hotel occupancy saw a steady improvement over 2023, although the pace of that improvement slowed over the course of the year. Knight Frank reported occupancy of 72.5% by Q4 2023, three percentage points below 2019 levels. Regional hotels saw an increase in Average Daily Rate to £101 in Q4, helped by demand from corporates and business events.

3.2 Investment Market

In line with London, office investment in the regions fell back in Q1. Lambert Smith Hampton reported investment of £520m across the South East and Rest of UK, the lowest amount since the lockdowns of Q2 2020. (See Chart 9.)

Chart 9: Rest of UK and Rest of South East Office Investment (£bn)



Source: Lambert Smith Hampton

Industrial investment bounced back from a weak Q4, but at £1.6bn was still 32% below its quarterly trend. Only two deals completed for over £100m, including Ares Management paying £212m for a 1.2m sq. ft. portfolio from RLAM.

Retail investment continued to be supported by deals in the supermarket space. In Q1, Waitrose agreed a sale and leaseback of 11 stores with M&G for £125m.

The surge in investment in the hotel sector was driven by Starwood Capital paying around £800m for a ten hotel portfolio from Edwardian Group. The properties include Radisson Blu hotels across the UK.

For more information:

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