City & City Fringe Investment Market

Who is Buying?

European investors (39%) overtook Asian investors (34%) in terms of total volumes for the first time in over a year, transacting five and four deals respectively. The private Swiss client of UBS's purchase of Bloom, Clerkenwell EC1 enhanced their contribution with the substantial lot size of £218.5M/ £1,517 psq ft reflecting a reported 5.25% NIY. The long leasehold interest (6.35% geared) is predominantly let to Snap Group for a 7.7 year term certain.

UK investors completed the highest number of transactions with 9, but only accounting for circa 21% of the total volume, demonstrating once again their prevalence in the smaller more liquid lot size market, attracted to historically attractive pricing.

Who is Selling?

- The market is characterised by a lack of product newly available at market pricing.
- Historically low values have deterred the majority of landlords from selling unless there is some pressure to do so. Therefore funds meeting redemption requests, illustrated by Blackrock's sale of Watling House, EC4 for £67.7M/ £716 per sq ft/ 6.39% NIY, or landlords experiencing finance related events, remain the principle drivers.
- There are a number of vacant possession sales where vendors do not have the resource or appetite to refurbish/ redevelop, given all time high build costs exacerbated by additional costs required to meet modern ESG criteria. For example, 65 Fleet Street, EC4 was launched for sale in September by Jing Mei Holdings at a guide price of £100M/ £435 per sq ft with full vacant possession.

Overview

Total investment volumes were £868M in Q3 2023 across 20 transactions, a 76% increase on Q2's £495M (one of the lowest quarterly transaction volumes on record), but approximately 55% down on the long-term average. Q3 2023 was only 26% higher than during the same period in 2020 during the Covid-19 pandemic.

The 2023 running total stands at approximately £3Bn, which is 60% below the same point last year and 46% below Q3 2021.

Given the rising cost of finance, most activity has been for smaller lot sizes with the majority of deals transacting sub £20M, with just two deals of over £100M trading in Q3. These were Lion Plaza EC2 (£207.5M/ £785 per sq ft / NIY 6.01%) and Bloom, Clerkenwell EC1 (£218.5M/ £1,517 psq ft/ NIY 5.25% - reported).

Following further interest rate rises, prime City and City fringe yields have moved out 25bps to 5.25%, which is 125bps increase in 12 months. However, following the first plateauing of interest rates since Q4 2021, the pressure for yields to move out any further is somewhat relieved temporarily at least.

There is approximately £324M under offer over 12 transactions, the largest being 12 New Fetter Lane EC4 which is being sold by Nuveen to UBS for a reported £137.5M/ NIY 5.60%/ £965 per sq ft; a 20% discount to the original £170M/ NIY 4.50%/ £1,169 per sq ft guide price. The 2015 development is let to Bird & Bird for a further 12.5 years.

Investor appetite from core buyers remains for best-in-class office buildings with high ESG and sustainability credentials. ESG criteria remains top of the agenda for developers.

Headline Deals

- The sale of 8 Bleeding Heart Yard, EC1 (£45.25M/ 4.35%/ £1,580 per sq ft) provides a key data point for long let core income, trading at 90 bps lower than the prime yield of 5.25%. The newly developed freehold is let to Julius Baer for a 9.5 year term certain and demonstrates demand for best in class assets with long term income in the Farringdon sub-market.
- Allsop sold 107 Cannon Street, EC4 on behalf of AXA IM for £13.8M/ £881 per sq ft/ 6.39% NIY to a private Hong Kong buyer. The majority refurbished 1980s property is multi-let to six office tenants and two retailers with a WAULT of approximately 8.5 years to the earliest determination.

Direction of Travel

Given the first plateauing of interest rates after 14 consecutive rises, several market commentators are suggesting the market could have bottomed out. The next set of inflation figures and interest rate decision will be key in determining market sentiment going forward. There are cautious signs that the worst point has been reached and green shoots of recovery could be on the horizon in 2024, so long as inflation continues on its anticipated downward trajectory. In the next six months, we anticipate an increase in sales driven by finance related events as banks apply pressure to borrowers to sell at market pricing.

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City Leasing

Overview

Q3 witnessed an increase in demand for the Central London and City markets, improving on the previous quarters' take up to a total of 2.6M sq ft, with 52% accounted for by the City and City Fringe markets.

The flight to quality continues with over 75% of take up being Grade A this quarter. The majority of 8 Bishopsgate is now under offer or leased with only the upper floors remaining. Significant lettings to Kirkland and Ellis, Proskauer Rose and Wilson Sonsini have further driven activity from the professional and legal sectors. Many occupiers are now having to consider pre-let opportunities for 'Best in Class' product ahead of their lease expiries given the reduced pipeline expected in 2024 and 2025.

Take up for the year to date in the City and Fringes is at 3.9M sq ft and in line with the long term average. The under offers remain high with 3.8M sq ft under offer across Central London, with 1.5M sq ft under offer in the City and Southbank. This is a 14% increase on the previous year, which is largely driven by the current transaction to relocate HSBC from Canary Wharf to Panorama, St Pauls for 550,000 sq ft.

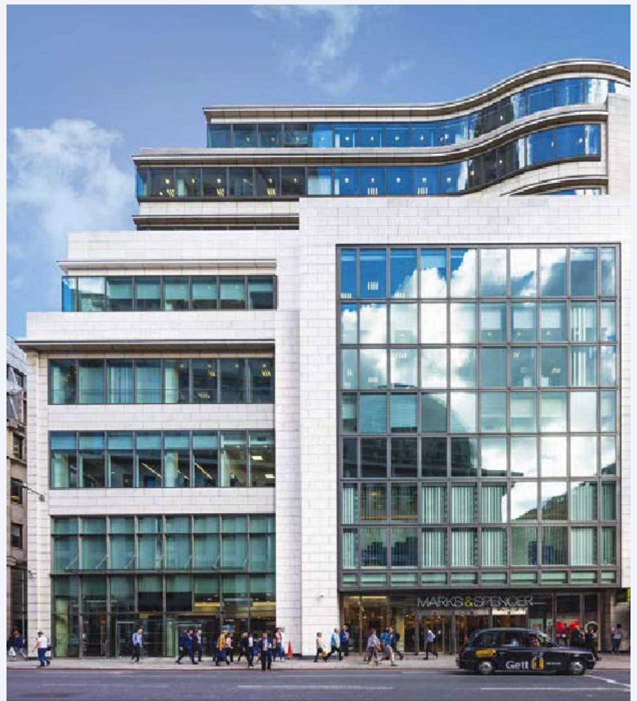
Total availability for the City remains at 10.8% with supply levels at 14.6M sq ft. By comparison Central London availability is 25.5M sqft, 9.5% vacancy. Second hand availability accounted for 17.3M sq ft, well above its long term average, with newly completed grade A at 4M sq ft, which is a 7% decrease on the previous quarter.

Prime rents continue to rise with typical Grade A rents at £77.50 per sq ft for the City. 'Best in Class' rents are now regularly achieving in excess of £100 per sq ft with evidence now witnessed at JJ Mack, Farringdon, 8 Bishopsgate and 22 Bishopsgate.

Many businesses are now working with a fixed routine of 4 days working from the office which has resulted in the increased demand for new office space and a reconfiguration of offices to encourage more modern ways of working.

Headline Market Deals

The theme of significant take up from law firms has continued into Q3 2023. Kirkland and Ellis took up the option space at 40 Leadenhall Street securing a further 173,500 sqft in addition to their original space take. Proskauer Rose relocated from Salesforce Tower to secure a new headquarters of 57,913 sq ft at 8 Bishopsgate and Wilson Sonsini signed for 32,584 sq ft at Eden House in Spital Square for a new central London headquarters.



70 Gracechurch Street

The Amp, Commercial Road

Headline Deals

Allsop transacted three significant deals this quarter which included the letting of 37,000 sq ft to Orega at 70 Gracechurch Street providing 650 workstations, the letting of 36,782 sq ft to Global University Systems at The Amp, Commercial Road on behalf of LaSalle and Trilogy and the letting of the part 19th floor of The Shard comprising 10,001 sq ft to Revantage on behalf of MPS.

Direction of Travel

The City office market has continued to see strong demand for 'Best in Class' stock as we enter Q4 2023. The knowledge of a tighter supply chain leading into 2025 and 2026 is likely to lead to increased pre-letting activity for off-plan prelets and prelets during construction. Many of the 'Best in Class' products are now witnessing an increase in rents and more upper floors continuing to break the £100 per sq ft barrier.

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West End Investment Market

Overview

Despite just the one rise in the base rate to 5.25% in Q3 (the highest it has been for the past 15 years) its direct impact on SONIA (Sterling Over Night Index Average) and all-in cost of debt on commercial property has led to a decline in the number of larger transactions and consequently one of the lowest quarterly volumes ever recorded in the West End.

We recorded just c. £362M either exchanged or exchanged and completed in 17 transactions with an average lot size of £21M. This brings the total Q1-Q3 volume to £1.58Bn in 51 transactions, which is 61% below the 5-year Q1-Q3 average of c. £4Bn.

A stark comparison of the current slowdown is that in Q3 2020 when the world was grappling with a pandemic and lockdowns the West End managed to record a volume of £697m – almost double.

The 10-year average annual volume for the West End is £7Bn – so as we enter the final quarter of what has been a highly turbulent year, despite there being c. £7.4Bn of stock on the market, we anticipate this period of price discovery to continue.

On a more positive yet personal note, the Allsop West End Investment team has been involved in 5 of the 17 transactions in Q3 – a 30% market share in the number of deals either exchanged or exchanged and completed.

Who is Active / Headline Deals

In the absence of larger transactions – only three transactions over £100M have completed in 2023 to date (one in Q1 and two in Q2) – investor activity in Q3 has largely focussed on the £5M - £20M bracket which appeals to private investors who can trade all equity and are looking to secure buildings in busy vibrant locations that are well connected. Of the 17 deals recorded in Q3, 76% were purchased by private capital or special purchasers / owner occupiers and only three transactions recorded above £20M. To put this in context, the average lot size across Q1-Q3 stands at c. £31M which is approximately 46% below the Q1-Q3 10-year average of c.£57M.

One of the largest transactions in Q3 was GPE's purchase of Soho Square Estate, W1 for £70M which reflects £1,218 per sq ft on the existing NIA. The mixed-use buildings are currently multi-let with vacant possession expected by March 2024. The site benefits from planning consent to deliver 90,000 sq ft of new Grade A office and prime retail space.

Aside from 30 Jamestown Road, Camden, NW1 which was purchased off market for £75M by a private investor for owner occupation, the only other transaction above £20M was the purchase of ENI House, 10 Ebury Bridge Road, SW1 by La Francaise for £55M reflecting circa 6.25% NIY and £879 per sq ft. The property is held on a new 125-year leasehold interest at a peppercorn rent and is single let to ENI UK Limited until February 2038 but subject to mutual break options in 2028 and 2033. The lease benefits from five yearly rent reviews linked to RPI compounded annually with the running yield expected to increase to circa 7.5% at the next review in December 2023.

The Allsop West End investment team has been involved in 5 of the 17 transactions in Q3 including advising Labtech Investments on their sale of 1-11 Hawley Crescent, Camden, NW1 to a private European investor. The building comprises 19,510 sq ft of offices let to Dr Martens until April 2027 and 5,058 sq ft of residential accommodation comprising six apartments let on ASTs. The property sold for c. £17M reflecting 6.23% NIY and £692 per sq ft.

Allsop also jointly advised a private Hong Kong investor on the sale of 301-305 Euston Road & 69-71 Warren Street, W1 which comprises two vacant freehold properties with dual frontage to Euston Road and Warren Street totalling 15,102 sq ft of office, retail and residential accommodation. After more than 40 inspections and two rounds of bids the property was purchased by Beyond Collaboration / Carey Group for £8.25M which reflected £546 per sq ft.

The 10-year average annual volume for the West End is £7Bn – so as we enter the final quarter of what has been a highly turbulent year, despite there being c. £7.4Bn of stock on the market, we anticipate this period of price discovery to continue.

Soho Square Estate, W1

Direction of Travel

Looking forward, we estimate around £1BN+ "under offer" including a half share in the new development at 247 Tottenham Court Road, W1 (c. £80M), 125 Shaftesbury Avenue, WC2 (£150M), 55 St James's Street, SW1 (c. £70M) and 121-141 Westbourne Terrace, W2 (£85M) making up c. £385M of this total.

We have also tracked around £2.4Bn of West End stock in 34 opportunities launched to market in Q3 – albeit 50% of this is against three portfolio / estate sales including The Homax Portfolio (c. £600M – including 30 Broadwick Street W1, 95 Wigmore Street W1 and New Brook Buildings, Queen Street WC2), The Lotus Portfolio (c. £450M slice of the Langham Estate with bids received) and The Charlotte Estate, Fitzrovia (£115M - 29 assets owned by Shaftesbury Capital). We also understand The City Corporation are close to launching The South Molton Street Estate – 20 Freeholds along the east side of the street, for around £65M.

Pricing for freehold, trophy assets in core locations continues to be very resilient as demonstrated by the sale of 55 St James's Street, SW1. The property was redeveloped in 2015 and comprises a rare freehold mixed-use investment on a prominent corner site in St James's. The offices are let off £118 per sq ft overall which is now seen to be highly reversionary and with lease events in 2025/2026 there is the opportunity to drive the rental performance for the building. The property received 7 bids and is now under offer second time around to an Asian Family – understood to be around 4% c £70M and a capital value of c. £2,600 per sq ft. At the time of writing, it is yet to exchange with many investors watching closely as a test to where prime yields currently sit in the West End.

Whilst best bids have become much more of a rarity in 2023, the sale of 125 Shaftesbury Avenue, WC2 generated significant interest with 130+ inspections. The freehold property is being sold with vacant possession by Korean investors. The property received 13+ offers and following 3 rounds of bids went under offer to Mitsubishi Estates and Dutch developer Edge for c.£150M which reflects £843 per sq ft on the existing NIA – c. 16% below the asking price of £180M and 44% below the £267M they acquired the property for in 2018, with a prelet to WeWork.

The launch of Vogue House, 1 Hanover Square, W1 in Q3 has also attracted considerable interest with 60+ inspections and bids now received. The landmark building occupies a substantial corner site at the southern end of Hanover Square and provides the opportunity to comprehensively refurbish and extend the building to provide 88,000 sq ft of best-in-class office space. Offers were invited for the 85-year long leasehold interest in the region of £70M which reflects £1,115 per sq ft on the existing and £795 per sq ft on the proposed NIA. The level of interest shown for an 85-year leasehold interest further emphasizes the importance of location (location) (location) in investor decision-making. Vendor Condé Nast have stated in their invitation to bids that the successful buyer will not be able to use the name "Vogue House" but "One Hanover Square" should be a good enough alternative.

Looking at current supply in the West End we are tracking circa £7.4Bn of assets in opportunities either on the open market or withdrawn (but in many cases still buyable).

Through our mandate with Citi Private Bank, we are seeing an uptick in interest from Middle Eastern capital as long-term average pricing continues to adjust. There is also continued interest from Asia capital which we are seeing through our tie-up with Millennium Group.

There remains a significant weight of capital allocated to Central London from across the globe and given the amount of stock currently under offer, with bids called or recently launched to the market we expect the final quarter of the year to paint a more positive picture in terms of volume given the lot sizes at play – although perhaps the number of transactions will continue to remain subdued.

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West End Leasing Market

Overview

Q3 office take up has recovered well from a sluggish Q2 in the West End, with transactions increasing by 41%. There were double the number of transactions over 10,000 sq ft (22) than occurred in Q2 (11).

That said the year to date is still down 38% on the take up figures for the same point in 2022, standing at 2.4M sq ft following the more subdued first half of this year. More encouragingly the average deal size recorded for Q3 rose to over 5,000 sq ft for the first time this year.

In terms of supply the vacancy rate in the West End has remained constant at 7.2% of total stock. Completions of new space being delivered to the market continue to sit above the long-term average for developments, but key to the continued progression of the market is that much of this newly delivered space (81%) continues to be pre-let.

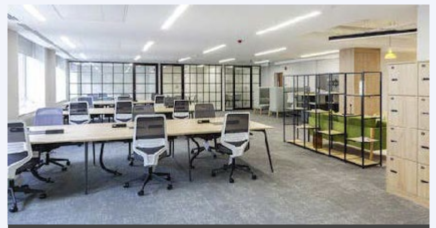
The managed / flex sector of the market continues to perform strongly with many operators, after a period of consolidation, back out actively seeking new sites, in addition to many large landlords continuing to increase the roll out of their own flexible and fully managed office solutions. It will be interesting to monitor how the well documented and continued restructuring of the WeWork empire will affect both the demand and supply dynamics of the market. At its peak the brand occupied over 4M sq ft in Central London – whilst this has been substantially reduced of late to c. 3M sq ft, it still has the potential to significantly alter the landscape of offices in Central London.

Headline Allsop Deals

The transactions undertaken by the Allsop West End Leasing team recently continue to exhibit the key themes we are seeing across the wider market.

Firstly, the demand for high quality, fully fitted turn-key solutions continues to dominate the sub 5,000 sq ft market across the West End and Midtown markets. We were pleased to let an outstanding suite on behalf of CBRE IM at York House, 23 Kingsway, WC2 comprising 2,500 sq ft to financial services provider Centralis Group at a rent equating to £72.50 per sq ft.

Secondly, the demand for high quality space in the core Mayfair and St. James's submarkets shows no sign of abating. We have seen competitive bids for several offices we are marketing, and the lack of supply continues to increase the rental profile in the area. We were pleased to follow up recent lettings in 6 Chesterfield Gardens, W1 with a deal on the 3rd floor comprising 8,000 sq ft to oil traders Tupras Trading. This follows on from the recent lettings on the ground floor to Kallos Gallery and a private family office. Further space in the building is due to come available in Q1 2024.



York House, 23 Kingsway, WC2

38 Berkeley Square, W1

Headline Market Deals

Pre-letting activity of the best new schemes has remained robust in the West End. Most notably Moelis & Co securing 50,000 sq ft over 2nd and 3rd floors in Derwent London's 25 Baker Street at a headline rent equating to £100.00 per sq ft. This now takes the scheme to over 60% let with well over a year still to go before scheduled PC.

In addition, Audley Properties has backed up recent success at 31 St. James's Square, SW1 with a letting of 34,000 sq ft to Symmetry Investments at a headline rent equating to £136.00 per sq ft. The building has just reached completion with the only remaining floor in the 100,000 sq ft scheme not pre-committed (but understood to be under offer).

Interestingly this quarter we have seen an uptick of activity in the Grade B sector of the market for the first-time post pandemic. This was predominantly driven by John Lewis's decision to relocate to One Drummond Gate, SW1, securing 108,500 sq ft at a rent understood to be in the £30's per sq ft. This transaction does appear to fly in the face of the well documented "flight to quality" and whilst perhaps a small exception to the rule, could indicate an increased desire from certain occupier groups to find occupational solutions at the lower value end of the market.

Direction of Travel

The West End office occupational market continues to perform strongly despite wider economic uncertainties, and against wider expectations for the sector.

The supply/demand balance is currently at a crucial juncture, with the continuing high performance of the pre-letting market becoming key to keep the overall vacancy rate subdued.

Appetite from smaller occupiers will continue to be exclusively for fully fitted offices offering flexibility of occupation, whether this be on a fully managed or traditional lease basis. Their desire to keep initial capital expenditure to a minimum will render smaller offices that don't provide turn-key occupational solutions incredibly difficult to market and let successfully.

The managed / flex sector has become a substantial part of the West End leasing market in a relatively short space of time. We see the influence of this part of the market only continuing to grow in response to the demands from occupiers both large and small.

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