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With record land sales and 30% spike in London investment in H1, what next for Central London office markets in 2022?

3 years ago

Demand for development sites in Central London led to a 143% spike in commercial and mixed-use land transactions in H1 2022 compared to the same period in 2021, with £1.8 billion transacted and a further £1 billion of land deals set to complete in H2.

Savills has reviewed activity in 2022 to date and is forecasting the trends for the Central London office markets for the rest of the year.

Steady occupier activity with H1 take-up 13% above the 10-year long-term average, and 70% of occupiers actively looking for space over 10,000 sq ft currently seeking to acquire the same amount or more space, and the vacancy rate falling 50 basis points to 7.6%, has supported developer confidence, according to Savills. The international real estate advisor says that it expects 2022 total take-up across Central London to reach approximately 10 million sq ft, in line with the long-term average, although occupiers are scrutinising their future space commitments in ever more detail, and may pivot towards less, but higher quality space, in Q4 and early 2023.

Savills says occupiers' continued activity has buoyed investment, but the challenging macro-economic climate for debt-backed buyers tempered activity in Q2 and will continue for the rest of the year. Nonetheless, central London investment activity in H1 reached £9 billion, 30% up on the 10-year average, with £7 billion of purchasable stock on the market – up 22% in terms of volume year-on-year – by the end of June 2022, with £5 billion of stock under-offer, weighted towards large lot sizes. Risk premiums on London assets continue to look attractive compared to other key global cities, says Savills, with the depreciation of sterling also making core long-income assets attractive to international investors.

Key statistics/forecasts:

Development

- 143% spike in commercial and mixed-use central London development transactions in H1 2022 compared to H1 2021, with £1.8 billion trading across 32 transactions. Circa. £1bn of development deals under offer; total 2022 volume expected to be just shy of with the recent annual average of £3.3 billion.
- Development completions from now until 2026 forecast to reach 30.4 million sq ft, although increased material pricing is impacting project costs and timescales. On paper, based on current statistics, Central London development activity would reach a record 9 million sq ft during 2023, with completions in the City at their highest level in over 30 years, but Savills says this is unlikely to transpire given the aforementioned delays.
- 18% of new developments and extensive refurbishments expected to be delivered over the next four and a half years have been pre-let and around 5% of remaining speculative space is under offer
- Around 40% of refurbishments by number of schemes are now targeting a BREEAM rating of Excellent or Outstanding – up 15% on the quantity recorded at the end of H1 2021. While new developments account for 66% of the overall sq ft that will be delivered of this standard, by number of schemes there is an equal split with refurbishment projects (51% new build / 49% refurbishments).

Oliver Fursdon, head of Savills central London commercial development team, comments: “H1 2022 was an exceptional time for the London land market. The current inflationary headwinds will remain a factor going forward, and whilst they will put some pressure on project viability, they have not come as a surprise and are countered to some extent by the positive occupational environment. In this context, the challenge for developers and landlords will remain the need to find a balance between delivering best in class space, but with the backdrop of challenging regulatory and planning environment, and what it means for refurbishment and/or redevelopment of buildings.”

Investment

- H1 turnover reached £9 billion, up 30% up on the 10-year average, despite rising macro pressures, although Q2 activity was subdued as a result of market volatility
- International investors accounted for 77% of H1 turnover. Institutional investors accounted for 43% of H1 turnover, up 6% on the same period YOY.
- Purchasable stock on the market stands at £7 billion, up 22% on the volume at the end of the same period last year. £5.0 billion of stock is under offer.
- Investor focus on core long income secure assets, and for office buildings with high green credentials, will support the pricing of best in class assets in Central London, with the city remaining an attractive destination for investors due to currency discounts and risk premiums.

Richard Garside, head of central London investment at Savills, says: “With a good handful of landmark transactions driving investment volumes for H1, all eyes are on the larger deals under offer and in the market for the second half of the year. The rapid increase in interest rates spiked market uncertainty which quickly fed through to purchaser confidence and pricing. However, as London’s office leasing story remains robust and as debt rates have come back in, plus the benefit of more favourable sterling for the overseas buyers, we are starting to see the bid-ask spread narrow and more opportunist bidders being replaced by groups seeking to take advantage of a less competitive market place.”

Occupational

- H1 take-up up 13% on the 10-year long-term average at 5.2 million sq ft; 2022 total take-up across Central London to reach approximately 10 million sq ft.
- 70% of occupiers actively looking for space over 10,000 sq ft currently seeking to acquire the same amount or more space, only 13% looking to reduce space.
- Central London vacancy rate dropped 50 basis points (the largest inwards movement since Q4 2017) to 7.6% at the end of H1.
- Increasing occupier scrutiny on future space commitments could result in more cost driven decisions and a focus on 'less, but better quality, space' or opting for alternative locations versus compromising on quality, resulting in lower levels of leasing activity or a potential rise in sub-leasing activity in during 2023.

Jon Gardiner, head of central London office agency at Savills, comments: "The first half of 2022 has performed ahead of the long-term average and demonstrates resilience in Central London's office market whilst reinforcing the important role that the office plays for businesses. Looking ahead, the clear global and domestic, economic and political headwinds, may well impact decision-making for businesses but at the present time we are encouraged by the depth of demand in the market particularly for the very best product."