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London, Autumn 2018

OFFICE MARKET OUTLOOK

With four months to go before Brexit, we take a look a look at the health of Central London's office market by examining some of the key performance indicators.

Headline rents hold steady. Headline rents across the 18 Central London submarkets we monitor have remained surprisingly stable, but with modest easing in some subsectors. Incentives too appear to have peaked. As was the case in the lead up to the Brexit referendum, activity levels are expected to subside further as we race towards the March 2019 deadline. That said, against the grain of reduced take up, overall vacancy levels eased to an all time low of 5.6%.

New completions still weak. A low level of new stock has in part shielded the market from sharper rent falls, with c. 2.3 million sq ft completed between January and September. This compares to 4.6 million sq ft delivered last year and just over 3 million sq ft completed in 2016 (CoStar). The low level of construction starts over the last two years should, to an extent, help to mitigate further falls in rental levels.

Capital values stable almost everywhere. IPD/MSCI has shown 0.38% growth in capital values for Central London offices in Q3 and a corresponding 2.8% increase over the 12 months to the end of September. Interestingly, this is at odds with our data, which suggests values have been stable in Q3 and are in fact 4% to 6% down on this time last year, with the exception of South Bank, where limited availability and a flurry of deals has helped to boost values over the last 12 months.

Unrelenting international investment. Total international investment into Central London offices touched £3.6 billion in Q3, up from £3.3 billion in Q2. While UK institutions have curbed activity due to the perceived risks around Brexit, Middle Eastern, German and other European investors committed almost £2 billion in Q3 (Property Data). Clearly, risk perception is relative, with Middle East investors facing regional political and economic uncertainty, while European investors may be sensing a 'good deal' prior to the conclusion of the Brexit negotiations.

More stability going forward? Noting that Brexit uncertainty has largely been priced into the market for the last two years, we expect Central London office rents and capital values to end 2018 down c. 6% on 2017. With some clarity expected to emerge following a much anticipated Brexit deal this side of Christmas, the magnitude of rental and capital value drops in 2019 should slow to c. -2% and -3%, respectively.

In parallel, Central London office total returns are likely to slip from c. 5% by the end of 2018 to nearer 1-1.5% next year. As this will be weaker than equities, shares and gilts, funds will likely be channelled towards regional office markets in an even bigger way. Total returns beyond London and the South East are expected to remain at, or near the 9% mark, outperforming all other asset classes.

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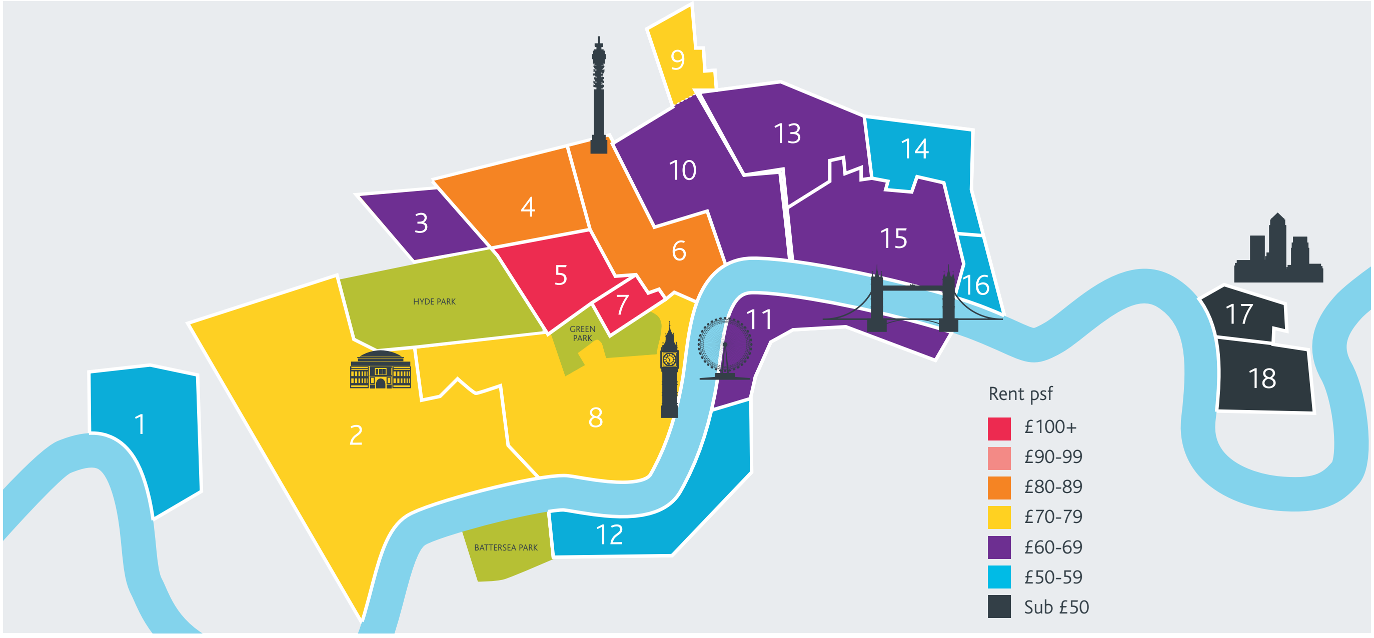
Central London office market heat map (Q3 2018)



Market	Submarket	Prime headline rent* (£ psf)	Q/Q % change	12 month % change	Prime capital values (£ psf)	Q/Q % change	12 month % change
Hammersmith	1. Hammersmith	50	0.0%	-9.1%	840	0.0%	-5.1%
West End	2. Kensington & Chelsea	70	0.0%	-9.7%	1,150	0.0%	-9.8%
	3. Paddington	63	0.0%	4.2%	1,070	0.0%	1.9%
	4. Marylebone	85	0.0%	-5.6%	1,690	0.0%	-3.4%
	5. Mayfair	110	0.0%	-8.3%	2,500	-0.6%	-9.1%
	6. Noho, Soho & Covent Garden	85	0.0%	0.0%	1,590	0.0%	-3.6%
	7. St James's	110	0.0%	-8.3%	2,500	0.0%	-7.4%
	8. Victoria, Westminster, Knightsbridge & Belgravia	73	0.0%	-9.4%	1,260	0.0%	-9.4%
Midtown	9. King's Cross	75	0.0%	0.0%	1,260	2.4%	1.2%
	10. Midtown	65	0.0%	0.0%	1,150	1.2%	-1.7%
Southbank	11. Southbank	65	0.0%	0.0%	1,190	14.4%	36.0%
	12. Vauxhall & Nine Elms	53	0.0%	-4.5%	690	0.0%	-4.8%
City	13. Clerkenwell & Farringdon	65	0.0%	0.0%	1,110	0.0%	4.2%
	14. Old Street & Shoreditch	59	0.0%	0.0%	1,020	0.0%	6.3%
	15. City Core	65	0.0%	-3.7%	1,230	0.0%	-4.3%
	16. Eastern City Fringe	53	0.0%	-4.5%	820	0.0%	-3.5%
Docklands	17. Canary Wharf	43	0.0%	-10.5%	690	-2.8%	-9.2%
	18. South Quay	35	0.0%	0.0%	500	0.0%	0.0%

Source: Cluttons | *Rents quoted are headline, not net effective
Prime rents are defined as the top quartile of headline rents: excluding penthouses and floors with large terraces, as well as suites in large, iconic towers.

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