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Quarterly Review: Q4 2024

Top Five

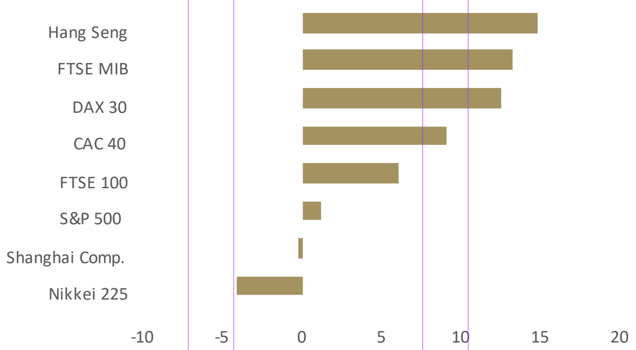
- The latest data suggest that, outside China, the world economy lost a bit of momentum heading into 2025. In the US, with downward progress on core inflation stalled the Fed will likely remain on the sidelines for at least the next 12 months. Meanwhile, in the UK despite recent data suggesting inflation will remain above target a sharp deterioration in jobs growth suggests the Bank of England will continue to cut rates gradually over the next year.
- There were tentative signs that London office leasing activity was picking up toward the end of last year, helped by a resurgence in the City. The improvement in take-up has helped London availability and vacancy rates stabilise, but they remain historically elevated. Due to construction delays a large amount of office space is due to complete this year, but beyond that the pipeline is much thinner.
- South East office take-up saw a small rise in Q4, but it remains considerably lower than the pre-pandemic average. By contrast take-up in the Big Nine regional cities is now in line with the 10-year average. The regional office pipeline looks very thin, which implies there may be supply shortages in the future, particularly for prime space.
- In other sectors, Central London retail availability across all major retail streets was under 9% in Q4. Logistics take-up dropped for the second quarter in Q4, which left take-up more-or-less unchanged compared to 2023 and still under the level seen just prior to the pandemic. But developers are becoming more confident about the demand outlook, with the pipeline expanding from 18.9m sq. ft. in Q2 2024 to 26.0m sq. ft. in Q4 2024.
- Investment in Central London offices dropped to £1.0bn in Q4, from £1.5bn in Q3. Transactions therefore remain subdued, with the total of £4.3bn invested in 2024 down from £11.4bn in 2019. Overall retail investment had a strong Q4 but that was concentrated in retail warehouses and shopping centres, so London retail underperformed. Office investment in the regions edged up to £610m across the South East and Rest of UK in Q4, but that still left investment historically low.

1. Economic Overview

The latest data suggest that, outside China, the world economy lost a bit of momentum heading into 2025. Around the turn of the year, manufacturing output kept treading water, retail sales weakened in advanced economies, and business survey indicators deteriorated or pointed to weaker activity in January. The two bright spots in developed markets have been a recovery in bank lending growth and a pick-up in employment growth. However, softer hiring intentions in many cases suggest that the rebound in jobs growth will not last. In China, activity has benefitted from policy support, and that should continue until mid-year, when the uplift from fiscal policy will fade and higher US tariffs will hurt exports. At this early stage, the data are consistent with global GDP growing at a below trend pace in 2025. This will help to lower inflation outside the US and allow most central banks to continuing cutting interest rates.

The US economy continues to do well, with GDP growing at a decent 2.3% q/q annualised in Q4 2024 and employment growth solid. However the Trump administration's policies, including tariffs and an immigration crackdown, may weigh on GDP growth over the course of this year. Market concerns about that, coupled with some reversal of the surge in tech share prices seen following Trump's victory, has meant US equities made minimal gains over the past 40 days.(see Chart 1). Nonetheless, with downward progress on core inflation stalled and tariffs likely to keep it close to, or above, 3% for much of this year, the Fed will likely remain on the sidelines for at least the next 12 months, leaving the fed funds target range at between 4.25% and 4.50%.

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



Source: Refinitiv

The euro-zone economy weakened toward the end of last year, with GDP growth seeing a rise of only 0.1% q/q in Q4. And more timely survey data suggests the economy remained stagnant in Q1. Along with weak employment growth, that supports the case for ECB policymakers to press on with interest rate cuts on the grounds that wage growth will ease significantly this year. However, indicators of price pressures may still worry policymakers. For example selling price expectations remained above their long-term averages, suggesting inflation will remain sticky in the short term.

In the UK, the 0.1% q/q rise in GDP in Q4 left the economy all but stagnating as businesses adjusted to higher taxes and more uncertainty from overseas. Moreover, there is nothing in the recent data that is consistent with the Bank hitting its 2.0% inflation target any time soon. For example CPI inflation in January was 3.0%, core CPI inflation was 3.7%, services CPI inflation was 5.0% and the three-month annual growth rate of average earnings in December was 6.0%, double the rate consistent with the 2.0% inflation target. Yet the Bank has continued to suggest that it intends to reduce interest rates further. That reflects two key judgements. First, the Bank assumes that April's rises in National Insurance contributions for employers and the minimum wage, which were announced in October's Budget, won't boost inflation much. Second, it is assuming that the loosening in the labour market since 2021/22 will prevent any second-round effects – i.e. wage growth will still slow as employees won't have enough job security to achieve pay deals that fully compensate for higher inflation. Overall, the Bank will likely juggle these growing two-sided risks by continuing to cut interest rates gradually over the next year.

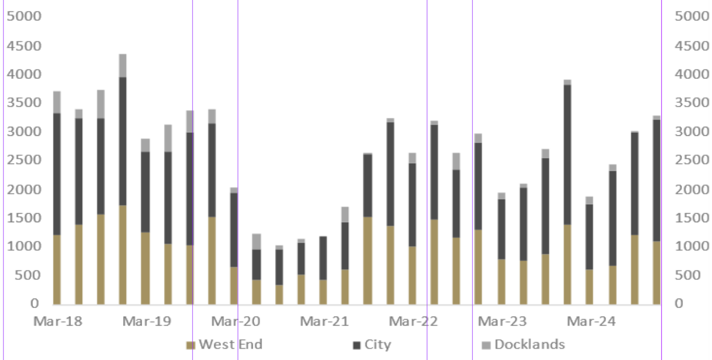
2. London

2.1 Occupational Market

There were tentative signs that London office leasing activity was picking up toward the end of last year. According to Knight Frank, having fallen to just 1.9m sq. ft. at the start of 2024, take-up had risen to 3.3m sq. ft. by the final quarter. A resurgence in the City helped drive that rise, where take-up almost doubled from 1.1m sq. ft. in Q1 2024 to 2.1m sq. ft in Q4 (see Chart 2). That said, take-up in Q4 was still lagging the Q4 average of 3.8m sq. ft. in the three years to 2019.

The recovery in take-up in the City in Q4 was supported by the largest deal of the quarter, with Moody's pre-letting 110,862 sq. ft. at 10 Gresham Street, which will become their European headquarters. Elsewhere in the City, Octopus Investors leased 91,127 sq. ft. at The Giltspur, EC1, and Alix Partners took 85,305 sq. ft. at One Millenium Bridge. The largest deal in the West End was for 79,789 sq. ft. at 21 Bloomsbury Street, with CAA Creative Artists paying £90 - £103 PSF for the space.

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



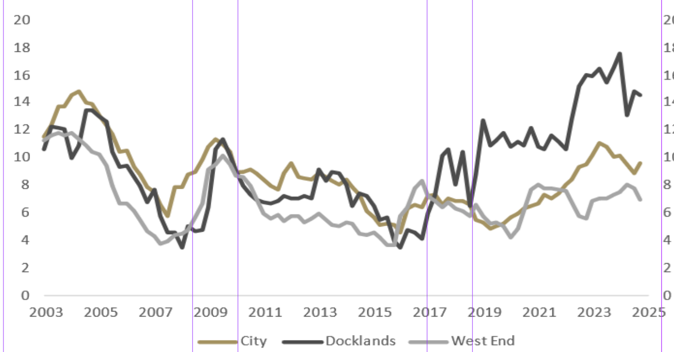
Source: Knight Frank

Around 60% of deals in the quarter were for new or pre-let space and at 23%, banking and finance made up the largest share of total take-up, supported by the Moody's and Octopus Investments transactions.

CBRE reported that under offers dropped back in Q4 as deals were completed before year end. At 2.6m sq. ft., under offers were down from 4.1m sq. ft. at the end of Q3 and below the long-term average of 3.5m sq. ft.

Despite the improvement in take-up, London availability and vacancy rates remain elevated. Knight Frank reported that the Central London vacancy rate ticked-up to 9.2% in Q4, from 9.1% in Q3. That compares to a pre-pandemic rate of around 5.7%. In particular, vacancy in the City and Docklands are historically high, with the rise in the West End less pronounced (see Chart 3).

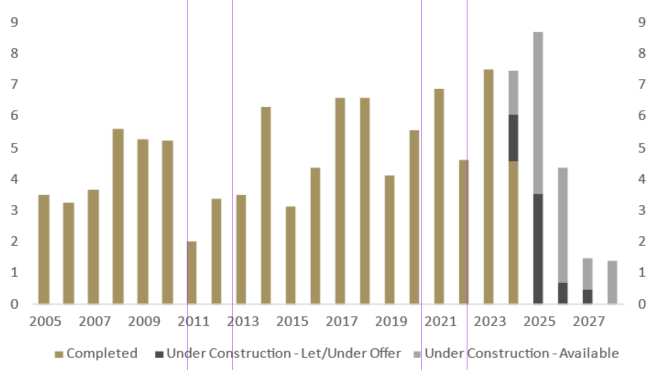
Chart 3: Central London Vacancy Rates (%)



Source: Knight Frank

Delays from the COVID-19 lockdowns, supply chain disruption, labour shortages and some contractor insolvencies have all conspired to delay London office developments and as a result the near-term pipeline is historically large. According to Deloitte, 8.9m sq. ft. of London office space is planned to complete in 2025, which would be the highest since the survey began in 2002 (see Chart 4). But beyond the next couple of years, the pipeline is much thinner, with only around 3m sq. ft. of space under construction and set to be completed in 2027 and 2028.

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



Source: Deloitte

Retail sales volumes jumped 0.7% m/m in January, which was largest rise since May 2024 and more than reversed the 0.6% m/m fall in December. The rise was supported by a 5.6% m/m surge in food sales, reflecting an increase in the amount households were eating at home at the expense of restaurants.

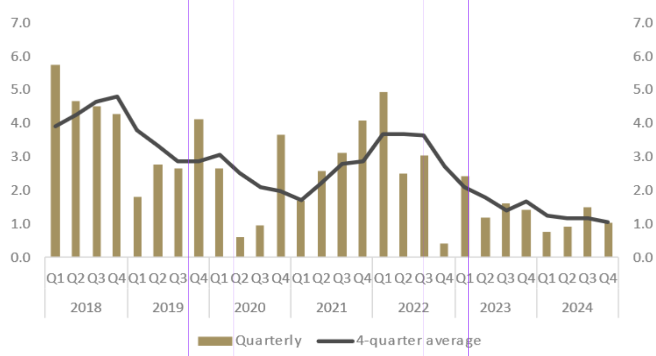
CBRE reported that availability across all major retail streets in London was under 9% in Q4, with the exception of Bond Street which is undergoing repositioning at the Northern and Southern ends. At 6%, availability was lowest in Regent Street, and the street also saw the second highest rental growth at just under 15% y/y to reach £800 PSF. Bond Street has the highest level of rents by some distance, which rose 6% y/y to £2,400 PSF.

2.2 Investment Market

Lambert Smith Hampton reported that investment in Central London offices dropped to £1.0bn in Q4, from £1.5bn in Q3. Transactions therefore remain subdued, with the total of £4.3bn invested in 2024 down from £11.4bn in 2019 (see Chart 5). A rise in interest rates at the start of the year suggests that weakness will continue into 2025. But longer-term interests are set to fall back and, combined with a stabilisation in capital values, that should drive a gradual recovery.

The largest deal in Q4 was in Midtown, where Greycoat bought 90 High Holborn for £180m from Polus Capital at a yield of 6.6%. Other deals included the Ellison Family purchasing 11-12 St James's Square for £162m and a couple of deals at around £140m – Ashby Capital buying The JJ Mack Building in the City at a yield of 5.85% and Ares buying 45 Pall Mall in the West End at a yield of 4.33%.

Chart 5: Central London Office Investment (£bn)



Source: Lambert Smith Hampton

Retail investment across the UK had a very strong Q4, with the £3.1bn transacted the largest since Q2 2015. But with retail warehouses and shopping centres driving that rise London once again underperformed. CBRE reported that London retail investment totalled just £103m in Q4, bringing the annual total to £886m, below historic trends. The largest deal was a US property company's purchase from Crosstree of 180-205 Old Street at a yield of 6.93%, with Co-Op, Argos and Marks & Spencer key tenants. Overall Central London prime retail yields edged back to 3.7%, ranging from 4.25% in Regent Street to 2.75% in Bond Street.

Hotel investment had another strong quarter in Q4, driven by KKR and Baupost Group buying the £900m Adia portfolio. The portfolio consists of 33 UK Marriott hotels, including the London Marriott Hotel Country Hall in Westminster and London Marriott Hotel Regents Park.

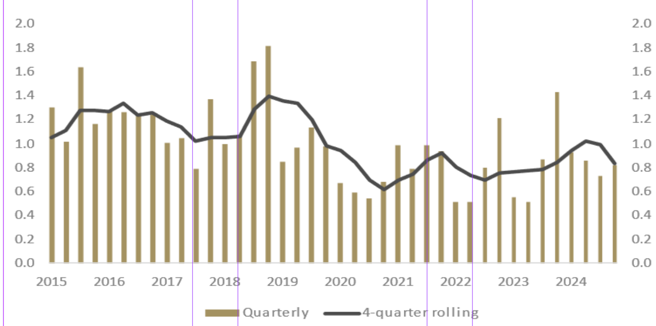
3. Rest of UK

3.1 Occupational Market

South East office take-up saw a small rise to 818,000 sq. ft. in Q4, with modest increases across the M25, M3 and M4 markets. But even so that meant take-up averaged just 835,000 sq. ft. in 2024, slightly down on 2023 and considerably lower than the pre-pandemic average of around 1.2m sq. ft. (see Chart 6). Key deals in Q4 included Novo Nordisk taking 61,020 sq. ft. at The Iverson Building, Oxford and Total Energies taking 36,346 sq. ft. at Kingswood Fields, Tadworth.

Beyond the South East, take-up in the Big Nine regional cities totalled 2.2m sq. ft. in Q4, more-or-less unchanged from the previous quarter and in line with the 10-year average. Within the total, Cardiff and Edinburgh saw significantly higher-than-average take-up driven by two Lloyds deals. In Edinburgh, Lloyds pre-let 282,500 sq. ft. at Port Hamilton and in Cardiff, they pre-let 110,000 sq. ft. at John Street.

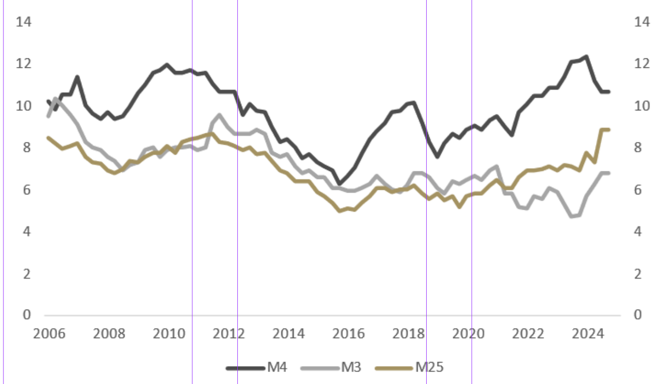
Chart 6: South East Office Take-Up (M. Sq. Ft.)(000s Sq.Ft.)



Source: Knight Frank

In line with London, South East office vacancy rates are elevated, particularly the M4 market which remains above 10% (see Chart 7). Vacancy rates in the M25 and M3 markets are lower but have increased over the past couple of quarters, with M25 vacancy rising from 6.9% at the end of 2023 to 8.9% by the end of 2024. In the Big Nine regional cities Avison Young report that the availability rate increased to 8.7% in Q4 from 7.9% in Q3, in line with the 10-year average of 8.8%.

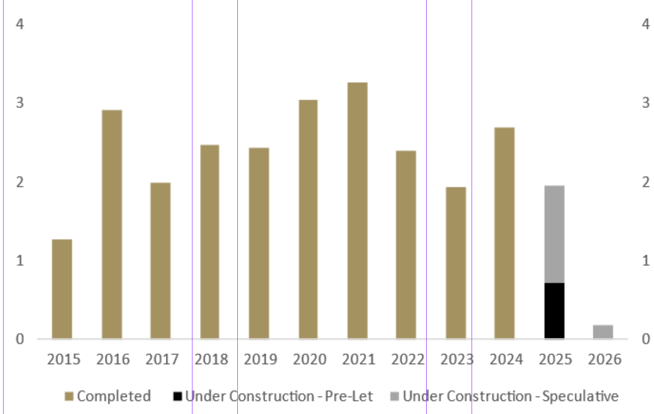
Chart 7: South East Office Vacancy Rates (%)



Source: Avison Young

Beyond 2025 the regional office pipeline looks very thin. According to Avison Young, after expected completions of 1.95m sq. ft. across the Big Nine cities in 2025, just 180,000 sq. ft. is due to complete in 2026 (see Chart 8). That implies there may be supply shortages in the future, particularly for prime space. The bulk of that development is concentrated in Manchester, where just under 1m sq. ft. of office space is under construction, of which 19% is let at Jackson Row.

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



Source: Avison Young

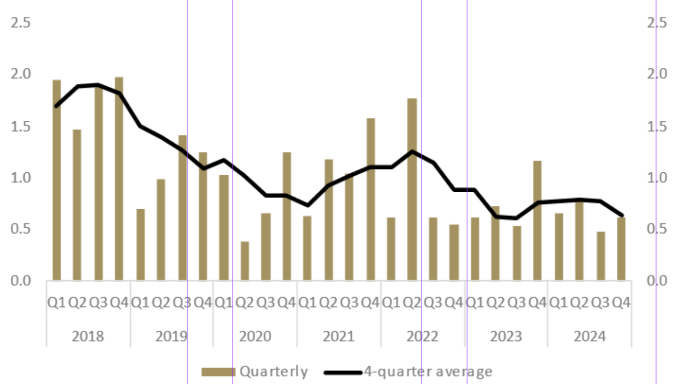
CBRE reported that logistics take-up dropped for the second quarter in a row in Q4 to 4.3m sq. ft., the lowest since Q3 2023. Take-up for 2024 as a whole totalled 21.3m sq. ft., similar to 2023 but under the 25m sq. ft. recorded prior to the pandemic in 2019. Over 2024, take-up was concentrated in the West and East Midlands, which accounted for 20% and 34% of activity respectively. The East Midlands prime big box yield was unchanged at 5.25%.

The recent weakening in take-up has led to a substantial rise in availability and vacancy rates over the past couple of years. At 5.6% in Q4, vacancy has increased from 1.2% in Q2 2022. But developers are becoming more confident about the demand outlook, with the pipeline expanding from 18.9m sq. ft. in Q2 2024 to 26.0m sq. ft. in Q4 2024.

3.2 Investment Market

Office investment in the regions edged up to £610m across the South East and Rest of UK in Q4, but that still left investment historically low. Indeed, at £2.54bn for 2024 as a whole, transactions activity was down 40% compared to 2019 (see Chart 9). Notable transactions in Q4 included Melford Capital Partners purchasing EQ, Temple Meads, Bristol from JLL for £103m and Ashtrom Properties bought Central Square, Wellington Street, Leeds for £78m from M&G Real Estate.

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



Source: Lambert Smith Hampton

Industrial investment had a strong quarter in Q4, with the total of £2.72bn the highest since Q3 2022. That helped boost investment for the year to £8.2bn, up from £6.8bn in 2023. Over Q4 the South East multi-let subsector saw a record £787m of transactions. That included Chancerygate/GIC buying Questor Industrial Estate in Dartford for £145.6m at a yield of 5.16%.

Retail transactions were once again supported by a strong quarter for retail warehouses, with the £1.4bn of investment in Q4 the highest since Q2 2007. That included Redevco buying the M7 Retail Portfolio for £518m at an initial yield of 6.00%. Shopping centres saw a lot of activity, with investment volumes reaching £1bn for the first time in eight years. Almost half of that total was accounted for by one deal though, with Land Securities paying £490m for a 92% state in Liverpool One at a yield of 7.5%.

For more information:

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