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Quarterly Review: Q1 2026

Top Five

- The onset of conflict in Iran has greatly increased uncertainty about the global economic outlook. A relatively short conflict will push global inflation temporarily higher and trim GDP growth, but the fallout would be manageable. A more prolonged disruption to energy supplies risks a much larger hit to activity, potentially a global recession, and would prompt a much broader monetary tightening cycle.
- Central London office take-up dipped below its 10-year quarterly average at the start of the year, though under-offers hint to an upturn in Q2. Weak demand did not prevent another fall in office availability, while vacancy dropped to 8.5%, a 4-year low in Q1.
- After a record end to last year, UK investment volumes disappointed in early 2026. Within this, London office transactions were roughly flat on the quarter at £2.3bn, a stark contrast to weakness in most sub-sectors and, aside from Q4 2025, the best outturn since 2023.
- Regional office take-up made a solid start to the year, supported by larger deals. Occupier demand is focused on prime, which continues to squeeze Grade A availability and has led to strong rental growth in some cities. Meanwhile, Q1 was the weakest quarter for South East office leasing in 3 years. And rising overall availability meant vacancy increased as well.
- Outside of London investment trends were very mixed. After a surge at the end of last year, South East offices saw investment volumes collapse in Q1, while regional office purchases rebounded albeit from a low base. In a weak overall industrial showing, regional multi-lets held up. And shopping centre transactions were dominated by a regional deal in Dudley.

1. Economic Overview

The onset of conflict in Iran has greatly increased the uncertainty about the global economic outlook, despite initial expectations of a brief disruption. So far, the main impact has been on oil prices, which quickly climbed from $70pb to above $100pb. They have largely stayed around this level since March despite a ceasefire, fluctuating with concerns about the Straits of Hormuz. The upward shift in oil prices is now being felt at the petrol pumps and beyond.

A relatively short conflict in Iran, as we expect in our baseline forecasts, would push global inflation temporarily higher and trim GDP growth, but the fallout would be manageable. Central banks that had already begun tightening (such as Japan and Australia) would raise rates further, and the ECB will also likely hike on concerns about escalating inflation expectations. By contrast, the Fed and, potentially, the Bank of England may still "look through" the shock and leave rates unchanged.

But after almost two months, no endgame is in sight, raising the prospect of more adverse scenarios. A more prolonged disruption to energy supplies risks a much bigger hit to activity, potentially a global recession and would prompt a broader monetary tightening cycle. With inflation expectations rising, most central banks would then tighten policy despite weaker demand. But as real income pressures intensify and inflation retreats, this tightening cycle would give way to rate cuts in 2027.

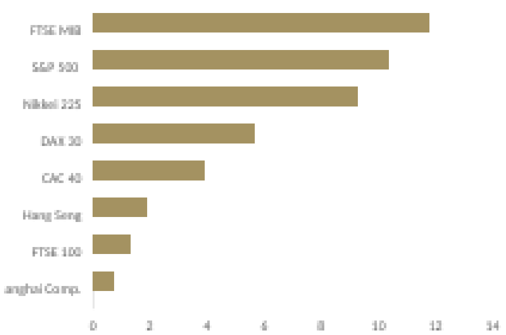
Currently, the economic data do not reflect the full impact of the crisis, though there have been early signs in the latest inflation figures. The economic news from the US has remained fairly upbeat, including the rebound in Q1 GDP growth, albeit partly driven by the reversal of the earlier government shutdown. Meanwhile, labour market data, while uneven, have not been bad as indicated by gloomy hiring surveys.

The US is less exposed to the war disruption than other developed economies. Higher oil prices are expected to result in softer US consumption in the near term than previously expected at the start of the year. But we doubt recent events will derail the momentum from the AI buildout. Thanks to strong AI-related investment, GDP growth is expected to average a respectable 2.4% this year and 2.5% in 2027, slightly stronger than last year's out-turn.

With US inflation now expected to stay above 3% y/y for longer that will keep policy rates on hold this year. If oil prices fall back sharply by early 2027, as our baseline assumes, then there would still be scope for the Fed to push through an interest rate cut next year, to take the fed funds target range to between 3.25%–3.50%.

Equities have been riding the roller coaster over recent weeks. (See Chart 1.) At the start of the Iran conflict, all markets corrected sharply. But most soon made back their losses. In the US, buoyant earnings and more favourable sentiment towards AI have helped drive the strongest recovery, after an equivocal start to the year. The other big movers in the last 40 days were in Japan and Europe boosted by the ceasefire and prospect of a swift end to the conflict. Elsewhere, the UK after a solid start to 2026 has lagged over recent weeks given heightened concerns about energy prices and political risks.

Chart 1: Change in Selected Major Equity Market Indices over the 40 Trading Days to 6/5/26 (%)



Source: LSEG

The euro-zone economy had lost a little pace even before the Iran war began. And prospects are now extremely sensitive to the severity and duration of the increases in energy prices. Our baseline forecasts are for a brief conflict with fuel prices peaking by mid-year and then gradually declining. If so, headline inflation would peak just over 3%, though rates would then drop back in 2027.

Given that the ECB would probably raise interest rates by 50bp this year to avoid spillovers, though it would be able to reverse those hikes during next year, as inflation heads back to its target. Meanwhile, GDP growth is expected to slow to a crawl for a few quarters in the central scenario, but recession will be avoided. As a result, anaemic growth rates of sub-1% p.a. are expected this year and next. Nonetheless, with no resolution in sight, risks of more adverse outcomes will remain for the region.

The UK economy was already vulnerable before hostilities, with inflation rates higher than elsewhere. The stagflationary effects of the leap in energy prices in our baseline will likely push CPI inflation to a peak of around 4.0% later this year. And real GDP is now set to grow by just 0.7% in 2026, compared with 1.0% before the conflict, with that rate rising only to 1% y/y next year.

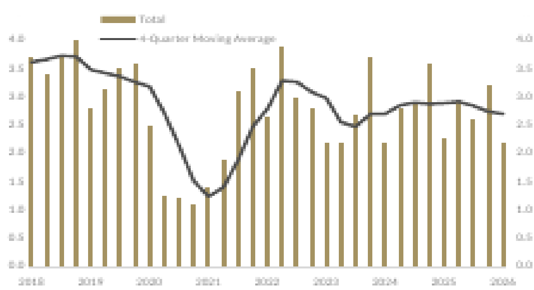
The changes in the macro outlook have removed any prospect of rate cuts this year. We think that interest rates will stay at 3.75% despite above-target inflation. But with the labour market particularly weak, rates could still be cut in 2027, although much will depend on a swift resolution of the current Middle East conflict and a rapid reversal in fuel prices.

2. London

2.1 Occupational Market

Central London office take-up dipped markedly at the start of this year. CBRE reported 2.2m sq. ft. of space let in Q1, down 11% on a year before and about one quarter below the 10-year average. (See Chart 2.) While it is normal to see a weaker first quarter, the figure marked a 3-year low for activity. This in part reflected a particularly low deal flow,

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



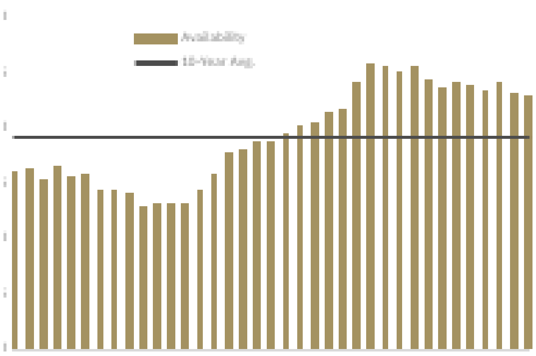
Source: CBRE

There was a dearth of larger deals too, with just eight lettings over 50,000 sq. ft. in early 2026. Most notable was BP International taking 195,200 sq. ft. of new space at the Ink Building in the Southbank. That helped to tip the balance towards new space in Q1, reinforced by solid pre-let activity, so that the second hand share was unusually low (at under 40% of take-up). Banking and finance was the top sector for demand, followed by business and professional services.

More encouraging, under-offers increased slightly in Q1, pushing the total above the 10 year average according to CBRE. That list included a handful of 100,000 plus sq. ft. properties, the largest of which was YY London in Docklands (at 273,400 sq. ft.). Once again, the majority of under offers remained either for new space or pre-lets, suggesting that occupiers continue to seek higher quality offices.

There was another drop in London office availability in 2026 Q1. Totals inched down to 22.9 m sq. ft. from 23.0 m sq. ft. in Q4 according to Knight Frank. (See Chart 3.) Levels remain well above their pre-pandemic averages, though it appears the peak is now well passed. The decline in Q1 supply reflected reductions in the City and Docklands, as West End supply increased once again. As a result, Central London vacancy dropped to 8.5% at the start of 2026, a 4-year low.

Chart 3: Central London Office Availability (M. sq. ft.)



Source: Knight Frank

CBRE reported Central London development completions were just shy of 6m sq. ft. last year, higher than previously estimated. That was a decade high in building activity, but the forecast for 2026 suggests a further rise. (See Chart 4.) The pipeline thereafter drops away sharply, falling to below par levels from 2027. That likely reflects current developer caution, but given the ongoing robust demand for prime office space, these totals are expected to rise closer to the time.

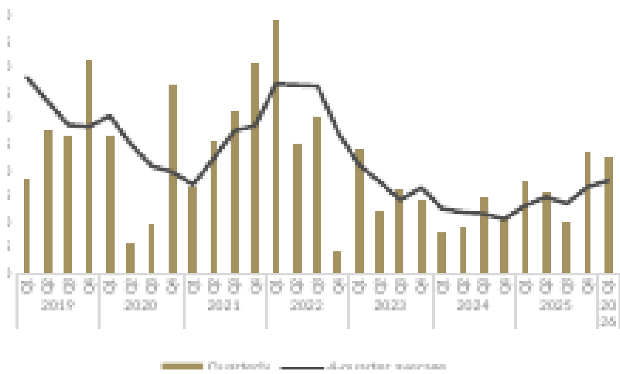
Chart 4: Central London Development Pipeline (M Sq. Ft.)

Source: CBRE

2.2 Investment Market

After a record end to last year, overall UK investment volumes disappointed in early 2026. Lambert Smith Hampton (LSH) report London's contribution to the total fell by 16% on Q4, though it still held up better than elsewhere in the UK. Within this, office transactions were roughly flat on the quarter at £2.3bn, a stark contrast to weakness in most sub-sectors and, aside from Q4 2025, the best outturn since 2023. (see Chart 5.) This continues an 18-month trend of gradual recovery in investment.

Chart 5: Central London Office Investment (£bn)



Source: Lambert Smith Hampton

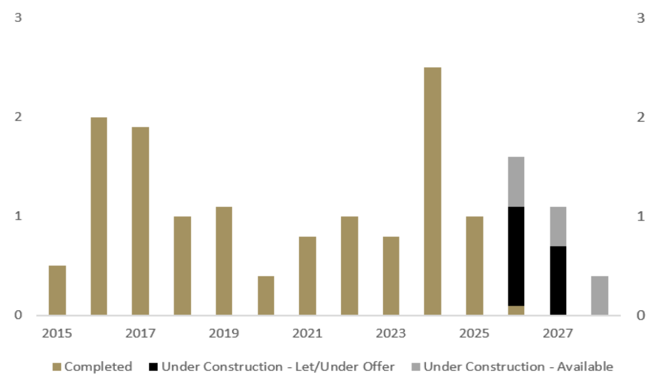
Large-scale deals were again vital in underpinning the resilience of Q1 transactions in the capital's offices, with eight deals above £100m. Of these, the largest was Daibiru Corporation's £300m purchase of Warwick Court, closely followed by Norges Bank buying the Fruit And Wool Exchange for £285m, both in the City. And, despite the knock to investor sentiment from events in the Middle East, prime office yields in Central London offices were unchanged in Q1 at 3.75%.

3. Rest of UK

3.1 Occupational Market

Regional office take-up made a solid start to the year. Big Ten leasing reached 1.1 million sq. ft in Q1 2026, down on a year ago, but ahead of the 5-year average according to BNP Paribas. This figure was supported by an increase in larger deals, most notably two large government-related lettings - GPA's 114,967 sq. ft. in Manchester and DWP's 100,000 sq. ft. in Sheffield.

Chart 6: South East Office Pipeline (M. Sq. Ft.)



Source: CBRE

While regional letting activity is below pre-pandemic levels, there remain many large office requirements active across UK cities, but with a limited supply of high-quality office space to meet them and few developers willing to build.

Regional occupier demand remains focused predominantly on prime buildings, which continues to squeeze Grade A availability. In Q1 2026, BNP Paribas estimated Grade A vacancy hit just 2.2% on average across the Big Ten markets, down 21 basis points on Q4. That tightness was reflected in Big Ten prime rents rising by 5.4% y/y in Q1. Indeed, both Birmingham and Bristol saw rent levels hit new highs and initial quotes for new developments suggest that they will continue to climb.

According to CBRE, Q1 was the weakest quarter for South East office leasing in three years. Take-up totalled 421,200 sq. ft. across the region (in units over 10,000 sq. ft.), only half the level seen at the end of 2025 and well below the five-year average. The largest deal of the quarter was AVEVA Group's letting of 80,000 sq. ft. at Cambridge Science Park, while TMT was the most active occupier sector.

South East office availability increased to 16.5m sq. ft. at the end of Q1, broadly in line with the 5-year average for supply. While availability is still well below the peaks of two years ago, there is little sign of it trending back down towards pre-virus levels of sub-10m sq. ft. Meanwhile, CBRE estimate that the vacancy rate increased to 9.2% in Q1, compared with 8.9% in Q4 2025.

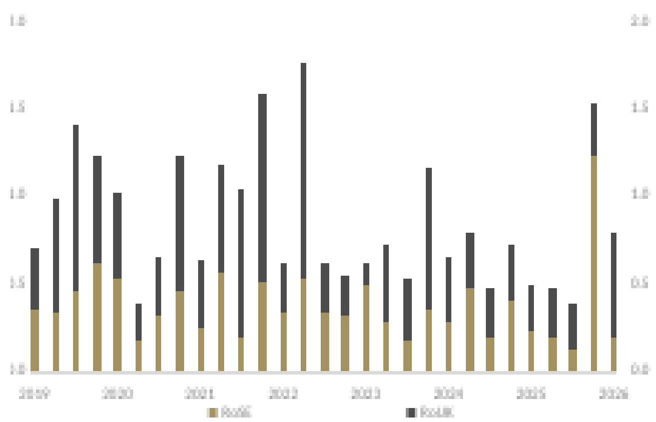
The office development pipeline remains limited in the South East. After an average 2025 for new supply, there were two development completions in Q1 2026, totalling just 80,000 sq. ft. of new and refurbished space. There is currently 3.1m sq. ft. of space in the pipeline for the next 2-3 years, although a third of this is already pre-let. (See Chart 6.)

Outside the office sector, CBRE reported UK logistics take-up recovered in Q1 to total 5.3m sq. ft. in Q4. Despite the improvement, activity is still closer to pre-pandemic levels than the elevated rates seen just after the pandemic. Regionally, the East Midlands dominated activity, with a share of over 45%, followed well behind by the West Midlands and the North East.

3.2 Investment Market

After a surge at the end of last year, South East offices saw investment volumes collapse in Q1. The £0.2bn transacted compared with the 10-year-high of £1.2bn in Q4, and was well below the usual quarterly averages. Cold River's £27m purchase of Quilter House in Southampton was the largest deal in the region.

Chart 7: Rest of UK and Rest of South East Office Investment



Source: Lambert Smith Hampton

By contrast, UK regional office purchases rebounded in early 2026. Volumes doubled to £612m in Q1, the highest in almost 3 years. This buoyancy was underpinned by several £50m-plus deals, the largest by some margin of which was BNY Mellon's £114m purchase of 4 Angel Square in Manchester. In contrast to stability in the capital, regional prime office yields moved out by 25bps to 6.75% in Q1, the first increase since the end of 2023. And having stabilised last year, secondary yields also rose.

Industrial investment slumped in Q1, down a third on the 3-year highs recorded in late-2025, thanks largely to weakness in distribution warehousing. But regional multi-lets held up, with Rest of UK purchases of £482m up a third on Q4, albeit still trailing the quarterly average. That included the quarter's largest deal, Chancerygate's £155m acquisition of the World Freight Terminal at Manchester Airport. Industrial prime yields remained steady in Q1, although rising gilt yields and global political uncertainty have had a negative impact on sentiment according to LSH.

Retail volumes halved to £1.2bn in Q1 and were a third below their 5-year average level. Shopping centres fared relatively well within this, but transactions were dominated by a single regional deal, Redical's £290m purchase of Merry Hill, Dudley. Retail warehouse volumes remained subdued in contrast, with Ashtrom's £103m purchase of Team Valley, Gateshead from Ares the most notable deal.

The Iran conflict may have ended the prospect of further declines in higher yielding retail subsectors such as shopping centres. While sentiment has been knocked, prime retail yields were broadly stable in Q1. And after the recent re-pricing, the retail sector may be better placed to withstand a correction than elsewhere.

For more information:

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