Positioning London for the Future: Quantum vs Quality

In this year's London Report, we look at the implications to the landlord from how occupier requirements are increasingly driven to amenity rich buildings and locations. Moreover, we compute amenity provision scores and show how these relate to the expected shortfall of new and refurbished buildings in many of London's submarkets. We also show the results of our capital gravity modelling of cross border investment flows to show £9.5bn of transactions in 2023 and that private investors are likely to be a key player.

The London Report 2023

EXECUTIVE SUMMARY

THE FACTS

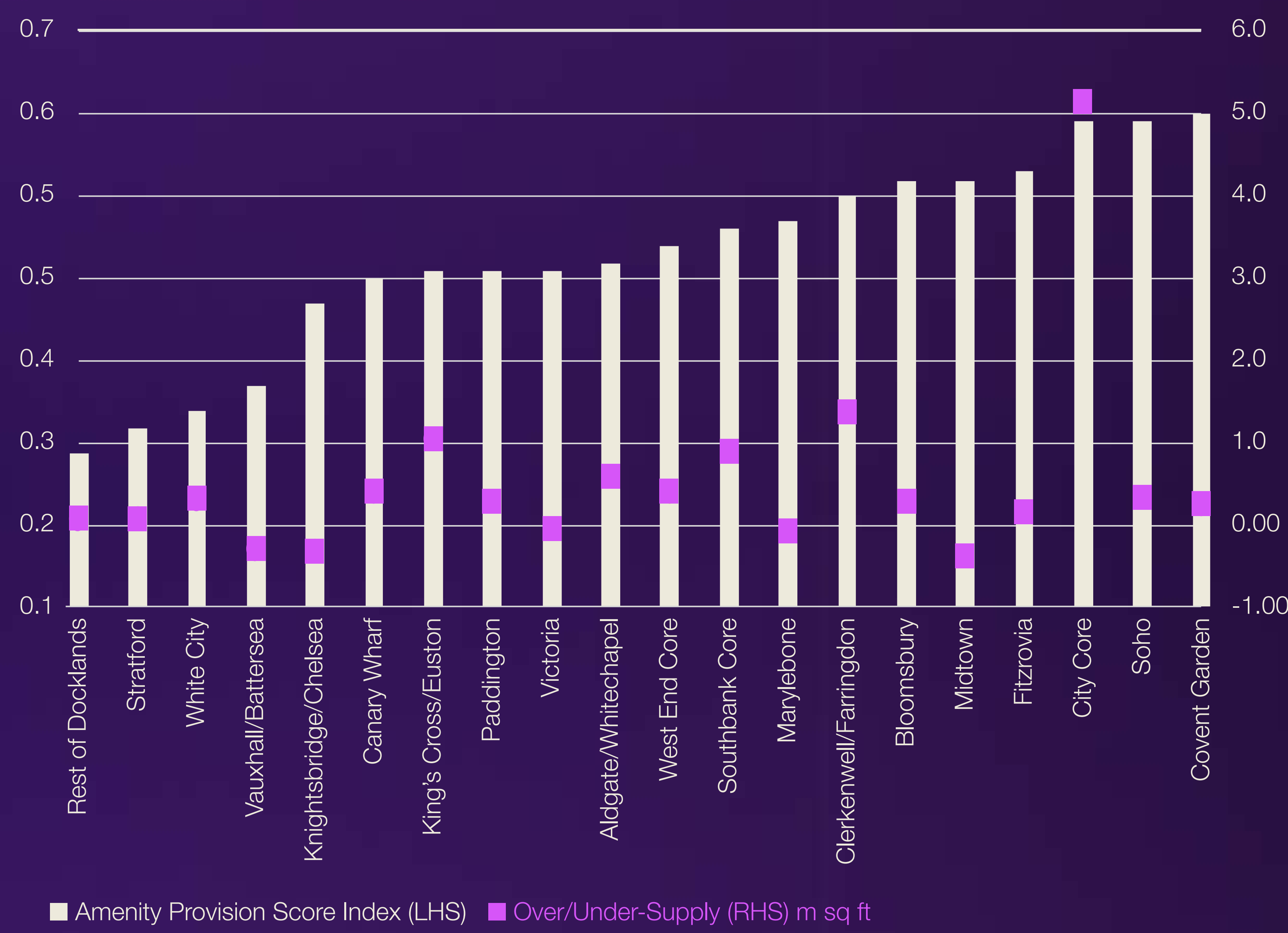
11m sq ft
EXPECTED UNDER-SUPPLY OF BEST QUALITY BUILDINGS (2023-26)

7m sq ft
LEASE EXPIRIES (2023-27) OF FLOORSPACE WITH AN EPC RATING BELOW C

£9.5bn
FORECAST TRANSACTIONS IN LONDON OFFICES IN 2023

£2.4bn
EXPECTED TRANSACTIONS BY PRIVATE INVESTORS IN 2023

AMENITY PROVISION SCORES AND NET PRIME AVAILABILITY



Shabab Qadar
M: +44 7890 027 925
E: Shabab.Qadar@knightfrank.com

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The London Report 2023

QUANTIFYING OBSOLESCENCE RISK

We believe a structural shift in demand for better quality buildings is unlikely to be filled by the current pipeline under construction, providing development opportunities in those locations with an under supply of new and refurbished buildings. We've calculated 'Amenity Provision' scores by aggregating the quantity and quality of key amenity categories, including Arts and Culture, Education, Health and Wellbeing, Hospitality, Retail and Transport. Furthermore, we've used geospatial techniques to account for proximity of amenities to offices. The top five London submarkets with the highest amenity provision scores include Covent Garden, Soho, City Core, Fitzrovia and Midtown.

QUALITY V QUANTUM – WHAT'S NEXT FOR OCCUPIER DEMAND?

The Knight Frank Cresa Global Corporate Real Estate Sentiment Index has identified three key dynamics that will shape the future profile of occupier demand:

Structural demand: There are 23.5m sq ft of lease expiries (484 occupiers) on office space of over 20,000 sq ft in London between now and 2027.

Reshaping the workplace: Most occupiers remain intent on redesigning and reconfiguring their office space, drawing particularly upon greater amenities and services to make their office more compelling to their staff.

The Martini Syndrome: Working anytime, anyplace, anywhere, envisaged at the start of the pandemic, is not an outcome for most occupiers, an office first stance, combined with greater acceptance of flexible working is, and this will have implications for office occupancy and utilisation rates.

COMPETING FOR GLOBAL CAPITAL

The investment landscape changed considerably during 2022 as interest rates rose rapidly to curb accelerating inflation across the developed economies. This has precipitated a marked slowdown in London office transactions in recent months. The results of our recent Global Capital Tracker Survey suggest the weight of money targeting London offices is likely to fall in 2023. Higher levels of risk aversion will provide greater opportunity for private capital to be deployed as we see a moderation in actual transaction volumes this year. We are forecasting transaction volumes of £9.5bn, slightly below the long-term trend of £9.8bn.

BACK TO BASICS

As interest rates have risen, so too has a degree of risk aversion amongst real estate investors as pricing the fundamentals of performance becomes clouded by an uncertain outlook. We believe current pricing reflects an above average risk premium compared with the long-run average. Moreover, higher obsolescence risk and weaker prospects for rental growth in average quality buildings will see a return of wider yield spreads to prime.

LONDON OFFICE INVESTMENT TRANSACTIONS BY REGION 2023 £BN