West End deals uptick hailed as sign of a market recovery

By Catherine Moore Thu 7 September 2023

Savills report highlighting raft of July office deals, plus increased footfall, suggest market is on the up again.

Source: Shutterstocck/Vittorio Caramazza

Looking up: the West End remains an attractive market for international investors in times of global uncertainty

Positive news seems to be such a rarity these days, so it is little wonder the market sat up and took interest when Savills published its latest West End research showing an uptick in commercial real estate (CRE) investment in the capital's heart.

The study highlights five deals totalling £102.2m across the West End in July, bringing turnover this year to date to £1.92bn. It also estimates £4.1bn of stock is available across 87 opportunities, the highest volume this year to date. While this may be improvement from a low base, it is still improvement. And coupled with Shaftesbury Capital's recent announcement of plans to sell £100m of West End assets, could it be a sign that the confidence to cut deals is gradually returning?

Ros Morgan, chief executive of the Heart of London Business Alliance, says these developments mark a general upward trajectory for the West End, which she believes is "well and truly on the road to recovery, with footfall increasing by 13% year on year and international visitors up 25% in the same period".

She adds: “Smart and sustainable workplaces are in demand, delivering the potential for prime rental growth and attracting billions in global capital to London real estate assets.”

We are well and truly on the road to recovery, with footfall up 13%

Ros Morgan, Heart of London Business Alliance

Fergus Keane, head of central London investment markets at BNP Paribas Real Estate, agrees, adding that the West End “remains a highly sought-after location for investors due to its strong fundamentals”.

These fundamentals include rental growth, the wealth preservation characteristics of its property, the strength of its leisure offering and an attractive occupier base.

Positive factors

Keane says various factors contribute to the market’s success, including lack of the right kind of supply, fewer stressed assets and in other parts of the capital. The latter means “many investors can be equity focused and therefore less reliant on debt than they would possibly need to be in other London locations”.

Chris Perkins, M&G Real Estate’s head of UK capital markets, says the resilience and value preservation of West End property “appeals to international investors in times of heightened global uncertainty”.

He adds: “Private investors in particular are seeking ‘generational assets’ that remain in portfolios for decades, without the priority for short-term returns. Asia Pacific investors are also increasing in numbers, predominantly led by Singaporean capital, while US capital is active in the value-add space.”

But the West end market still faces some challenges. Paul Cockburn, a director in Savills’ central London investment team, acknowledges there have been improvements in the West End, but highlights that the market still has some way to go on the road to recovery.

“Turnover is still muted, so when we talk about uptick, it’s early days,” he says. “Although we’re seeing investor interest bringing enhanced liquidity, we’re yet to see price improvements. We’re still getting to grips with why, but enhanced demand is almost certainly a function of price falls and a sense that pricing is bottoming out, as well as no material risk of deeper discounts.

“Buyers, most of whom already have assets, are also seeing a very defensive occupational market, especially on better-quality stock. They are seeing through the turmoil in the US market that offices do have a place in a portfolio, provided they are the right ones.”

Keane stresses that a recovery in asset prices “hasn’t quite hit” yet, but adds “there is more evidence of transactions taking place” recently.

Perkins emphasises that “the West End has always been the UK’s most resilient CRE market”. Demand for future-proofed grade-A workspace in the West End has strengthened in recent years, he adds, “resulting in continued rental growth”, which is “attractive to investors in a market starved of prime stock”.

Retail investment in traditional West End locations is also “in high demand”, says Keane. BNP Paribas recently revealed that, based on off-market activity, retail-led investments would exceed £1bn by July, compared with around £1.2bn transacted in the West End’s office sector over the same period.

“This was interesting, as volumes across these sectors are never normally this close,” Keane says.

Investment benefits

Morgan believes that “with Heart of London’s planned improvements to the public realm, growth in the West End will only continue”. She adds: “Our projects will preserve and enhance central London’s unique character and real estate, providing high-quality spaces for workers, visitors and residents.”

These projects include creating an Arts Quarter in the streets behind the National Gallery, Leicester Square and Piccadilly Circus.

Meanwhile, Cockburn feels “the focus on quality will continue, as it’s what occupiers want and will give the best cashflows for buyers”.

Perkins adds: “The weight of capital looking to deploy in the West End is significant, especially for lot sizes below £100m. There is no indication that investor demand will dampen, and the liquidity of prime West End assets has proved resilient through economic cycles, providing confidence for investors. Medium-term investor sentiment is also positive, as inflation is tamed and interest rates begin to trend down.”

We need to see more evidence of deals to say we’ve reached the bottom

Fergus Keane, BNP Paribas

Keane stresses that for offices, "we need to see more evidence of deals to comfortably say we've reached the bottom of the market".

"The acquisition of 55 St James's Street will be a flag in the ground if it goes ahead," he adds, referring to a rumoured £76m deal to buy Lothbury Investment Management's office asset. "It will prove there is liquidity in the market – with or without banks and price discovery. We will still need more though, and I think it will be another three to six months before we can truly call the bottom."

Despite these positives, the planning system presents "a massive hurdle", according to Keane, and planners "will lean more favourably" towards retrofitting. He adds: "This might eliminate some investors who might prefer to knock a building down and start again; we might find some of them looking at other areas as a result."

Marks & Spencer's legal challenge over levelling-up secretary Michael Gove's decision to refuse the retailer's proposed redevelopment of its flagship Marble Arch store will be watched closely.

Long-term prospects

Regarding the West End's longer-term outlook, Cockburn says: "The market will struggle to progress if we see continued macro uncertainty and interest rates continuing to rise."

Perkins also stresses that while the outlook feels positive, "potential headwinds might mean increased distress as lenders call in loans, higher-for-longer debt rates and heightened geopolitical risks".

In terms of UK-wide CRE investment, BNP Paribas' latest research suggests that while this year will see continued challenges, the outlook should improve in 2024.

A total of £18.5bn was spent on UK CRE in the first half of 2023, the report says, less than half the volume for the same period last year. The firm expects total volumes to reach £41bn this year, down a third on last year and the long-run average, but it predicts a 15% rise to £47bn by the end of 2024.

Keane believes investors may remain "on the sidelines as they refrain from decision-making in volatile conditions". BNP Paribas expects rate cuts in Q2 2024, bringing "marginal improvement to the market", but Keane says "many investors will still be tempted into waiting for borrowing costs to fall further before acting".

Meanwhile, Cockburn predicts that with regard to a pricing recovery, "it could be a long journey on cap rates, as they will, to some extent, correlate with lending rates and the risk-free rates, which are expected to remain high for some time".

He adds: "With best-in-class offices, we expect strong rental growth on newer, sustainable assets. This will offset some of the yield shift, but only once investors truly understand the shortage of grade-A offices and lack of choice corporate tenants have when looking to move."

But Perkins remains largely optimistic, stating that a recovery in CRE investment in the capital at least is "likely to be quicker than experienced in previous downturns".

He says that while the 1980s and 1990s development boom "led to sustained downturns in central London office rents, with massive oversupply and a trough lasting more than four years", today's West End market "has an undersupply of grade-A offices and remains an attractive investment proposition to many overseas investors not impacted by the UK economic difficulties".

Perkins concludes: "The recovery side of the curve is therefore likely to be steeper than previous cycles."