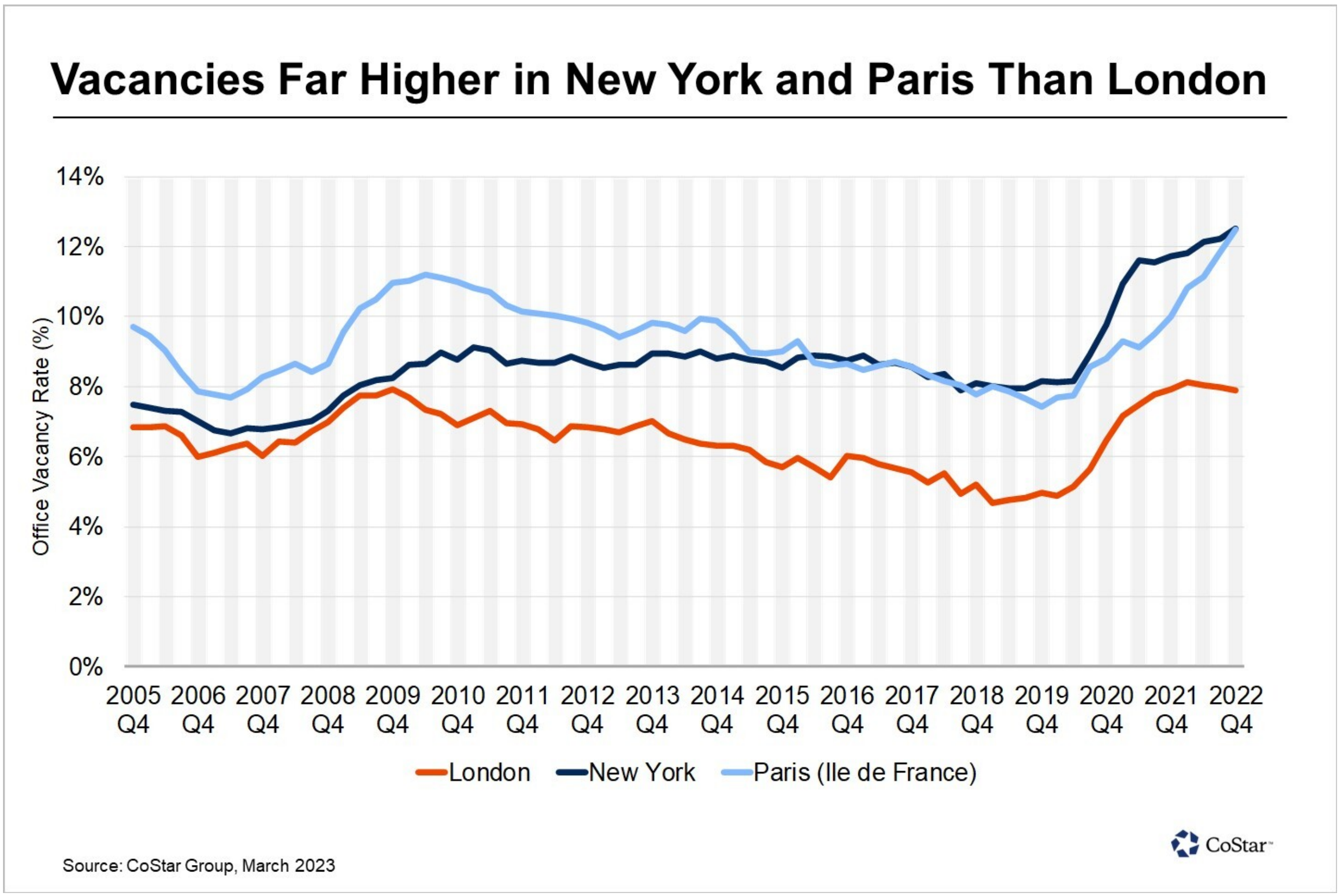
MIPIM

Mipim 2023: Office Demand Trends in London, New York and Paris

Vacancies Have Stabilised at Lower Levels in London but Yields Are Rising



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London, New York and Paris are three of the world's largest and most active office markets, but occupier and investor demand dynamics vary within and across these crucial gateway cities, according to a CoStar analysis published to coincide with the start of Mipim, the global real estate conference.

Office vacancies have moved upwards in all three cities since the pandemic began, with lockdowns, the rise of hybrid working and new office completions leading to millions of extra square feet being added to the market.

But some cities been more affected than others. New York registered 30 million square feet of negative net absorption, which measures change in occupancy over time, in 2020 and 2021. This sent the vacancy rate shooting up from 8% to 12%. And, despite a modest revival in demand in 2022, when net absorption turned positive by 1 million square feet, new office completions meant that its vacancy rate continued to rise. It now stands at its highest level in more than 25 years, with more increases likely.

London also registered demand losses during the pandemic, but to a lesser extent than its American counterpart. The UK capital saw seven million square feet of negative net absorption during the pandemic-blighted years of 2020 and 2021, with its vacancy rate rising from about 5% in early 2020 to 8% by the end of 2021. However, London's demand rebound was greater than New York's last year, with vacancies stabilising as a result. At 460 basis points, the vacancy spread between the two gateway cities is at its widest in over 20 years.

In Paris, vacancies have risen sharply across the Île-de-France region since reaching a near-record low in 2019. The vacancy rate has jumped from 7.5% four years ago to more than 12%. Upward vacancy movement in the French capital has accelerated in recent quarters thanks to an influx of new development and ongoing subdued demand, in contrast to the stabilising trend in London.

However, overall vacancy rates mask key differences by submarket and building quality within the three markets.

Rising vacancy in Paris has been driven almost exclusively by the inner and outer rims of Île-de-France, especially in the area known as the Première Couronne Nord – Aubervilliers, Clichy, Saint-Ouen and Saint-Denis – where vacancy has shot up to 25%. This is partly due to the frenzy of development around the Olympic Village. By contrast, vacancies in Paris Centre Ouest have been hovering around 4% throughout the past four years amid healthy demand and a dearth of development. This area contains the central business district, where vacancy is even lower at 2.5%.

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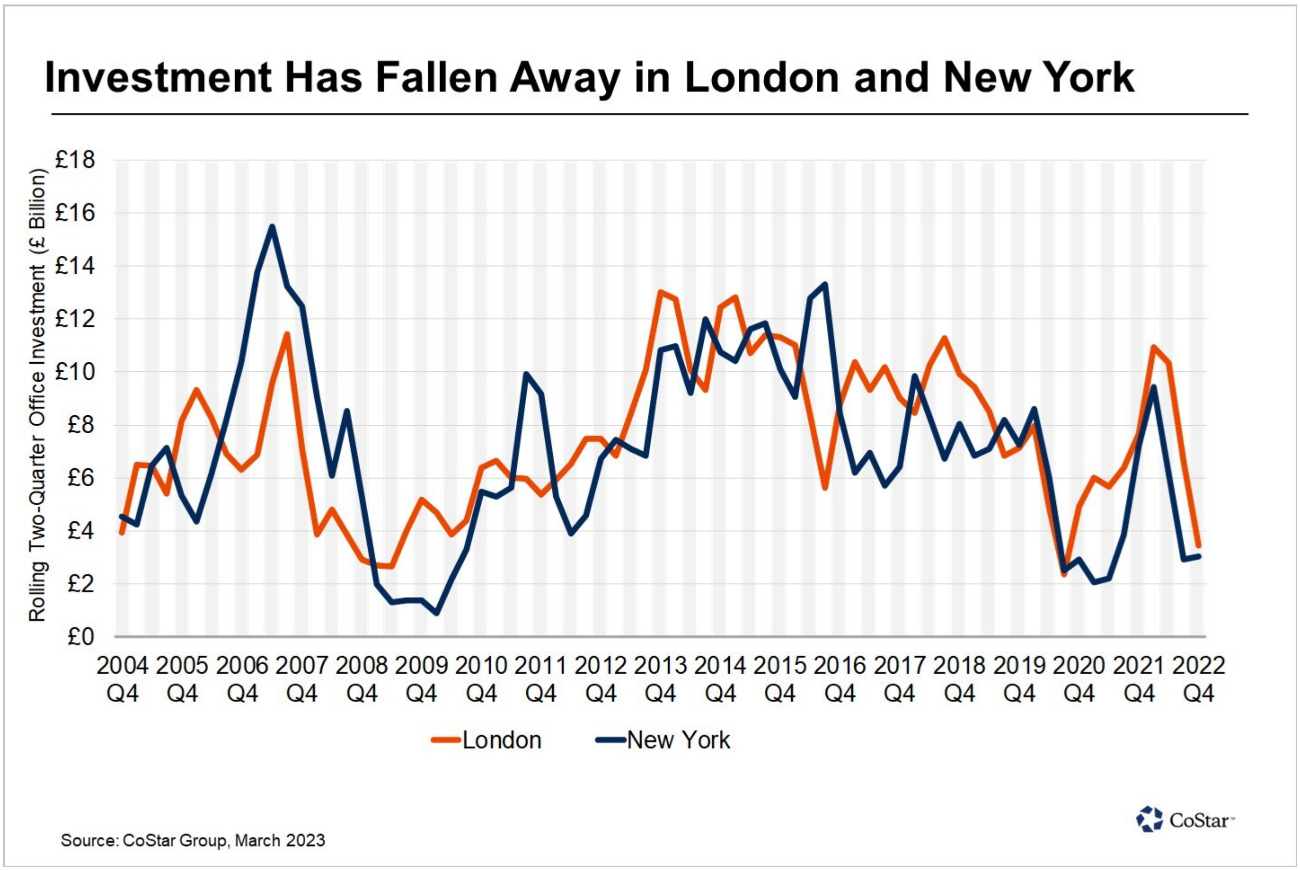
It is a similar story in London, with vacancy rates as low as 3% in some centrally located submarkets such as Paddington, Westminster and Southbank West, as well as outlying ones like Harrow and Enfield. The West End, London's most expensive office area, has led the recovery, thanks to improving demand and a lack of development, whereas vacancies remain in double-digits in submarkets in Docklands and the City. West London submarkets like Hillingdon, Chiswick and Hammersmith have vacancy rates above 12%.

Some New York submarkets have also suffered disproportionately. Vacancy rates are above 15% in a dozen submarkets, including traditional Manhattan hotspots like Chelsea and Greenwich Village, and above 20% in the likes of Upper West Side and Brunswick West. Vacancies in the Financial District are also about 20% as banks continue to release space on to the market for sublease. A wave of new supply is likely to put upward pressure on vacancies in Penn Plaza/Garment, Hudson Square and the Plaza District, too, as will further lay-offs by tech firms.

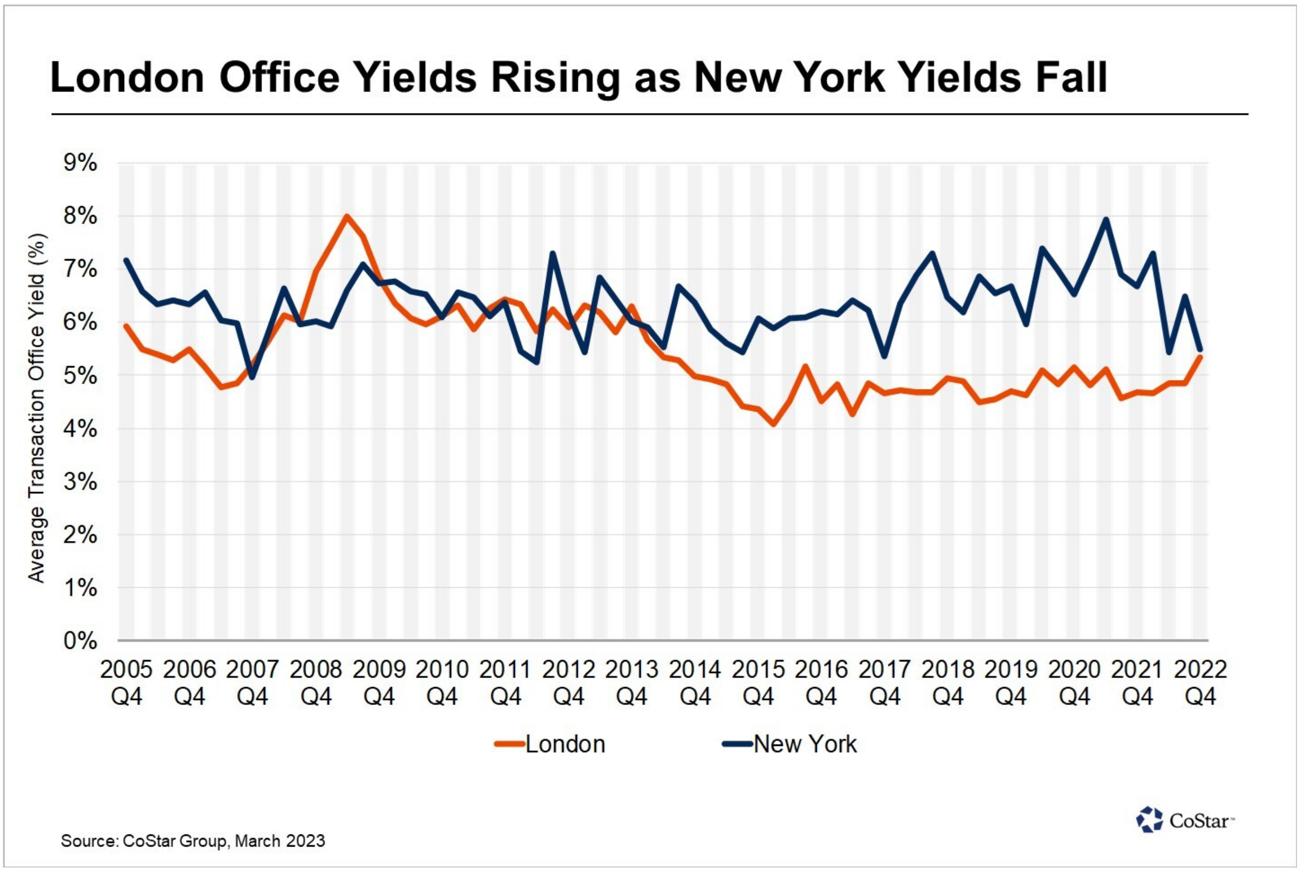
There is also a flight-to-quality trend playing out in all three cities, as firms prioritise high-quality space to lure back staff, welcome clients and meet growing environmental commitments even as most take less space overall amid an ongoing pivot to hybrid working.

High-profile examples in London include law firm Clifford Chance reducing its floor space by more than half in signing a 328,000-square-foot prelet in the City late last year. Net absorption in the best-quality, 5 Star buildings has been strongly positive throughout the past three years, with all the demand losses coming in buildings rated 4 Star or below. Similar trends are playing out in New York. This pattern is likely to continue in the near term in all three cities.



In the investment market, volumes have fallen across the board in recent quarters. Rising interest rates have increased the cost of debt and cooled investor demand, while also creating uncertainty over pricing.

Rolling two-quarter investment has slumped below £4 billion in both London and New York, on par with the lows reached during the early part of the pandemic and in the aftermath of the financial crisis in 2009.



Yields, or cap rates, have risen, too. Average transaction yields have nudged up to 5.3% in London, a nine-year high and an increase of 70 basis points year-over-year as data emerges to support anecdotal evidence of falling prices. Yields have risen in Paris, too, albeit amid limited transactional evidence.

Rising yields in London means that the spread between average office yields in London and New York is now closer than it has been in a decade, with average yields actually compressing in New York in recent quarters after a big jump during the pandemic. This is in stark contrast to the vacancy picture in the two cities.

However, Victor Rodriguez, CoStar's senior director of market analytics in New York, explains that the downward trend in New York is being driven more by investor preferences and sample size than by renewed confidence in underlying fundamentals.

"There is still a hefty amount of price discovery underway in New York City for office buildings. Demand for buildings with 20%-plus vacancy levels is very low and what we are seeing is transaction volume being driven largely by trophy buildings. When trophy buildings do not sell, then volume craters."

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