MORTONS MARKET MONITOR - 2023

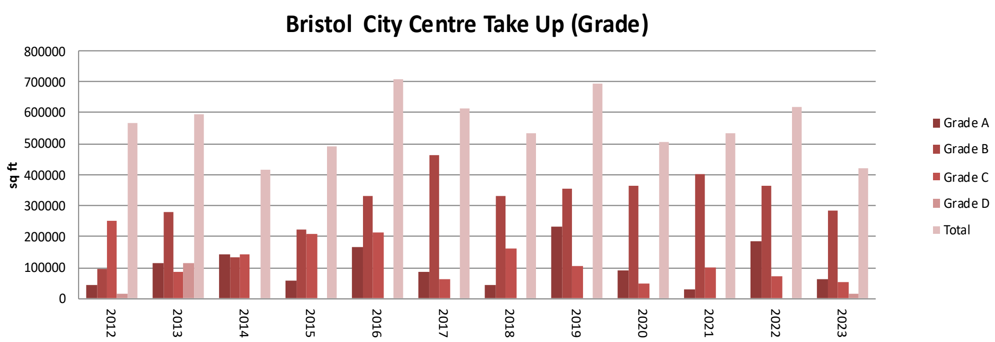
Bristol offices enjoy buoyant end to 2023. What now for 2024?

After a disappointing first three quarters, when just 225,997 sq ft was let, the final quarter of 2023 (one of the best in the last 10 years) saw a rush of deals complete to add a gloss of respectability to take-up figures for the Bristol city centre market.

The biggest deal of the first three quarters saw Evelyn Partners move from Portwall Place to 27,406 sq ft at EQ. That was then dwarfed by Dyson taking 66,317 sq ft at 1 George's Square in the final quarter: one of 34 deals over the three-month period, and which between them accounted for 193,183 sq ft.

	
Portwall Place – Evelyn moving out	Dyson – Moving in

The final 2023 tally came in at 419,180 sq ft – a 25% reduction on the five-year average of 554,813 sq ft which can readily be blamed on the economic situation and reduced confidence. But was that really the problem?



If you look at the nature of the deals done, it's plain that the situation is very nuanced. Hybrid working is pretty much the norm now, and most staff are coming into the office for an average of three days a week. Tenants are taking "posher" (and more expensive) space, to meet the demands of their staff, but they need less of it. In fact, typically 25% less.

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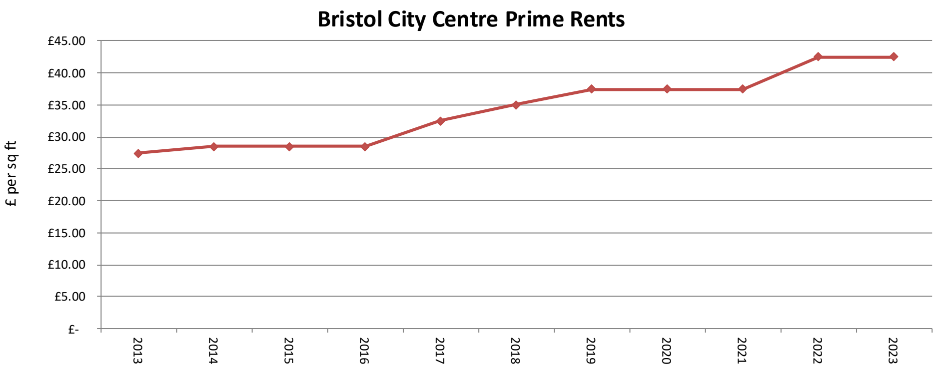
So, should we expect a re-set on annual take-up figures in future years? And will 2023 eventually come to be seen as an "average year"? It's a moot point, as Bristol still continues to attract inward investment, and it has a healthily diverse mix of sectors – some of which are distinctly in growth stages.

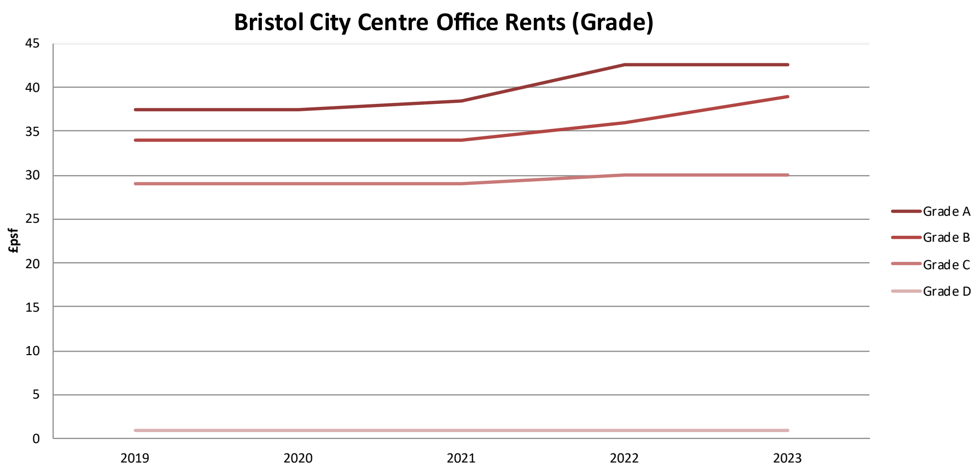
From a landlord's perspective, the situation isn't all "downside" as tenants are prepared to pay significantly more than in the past per square foot, increasing the capital value of their asset.

Rental levels

Which brings us neatly onto rents. 2023 saw "Prime A" rents maintained at £42.50 sq ft, but there are deals in solicitors hands reflecting c £45 – £46 sq ft. That not only bodes well for 2024 (and future supply). It also keeps Bristol in line with other major regional cities, and so makes the City a competitive centre for inward investment.



The gap between Prime A and quality new refurbished space which ticks all of the ESG boxes moved out slightly during the year but these buildings still command rents of up to £37.50 psf. Those offices which won't make the new EPC standards, and which run the risk of not being lettable, are finding it increasingly difficult to find tenants – and rents reflect that.



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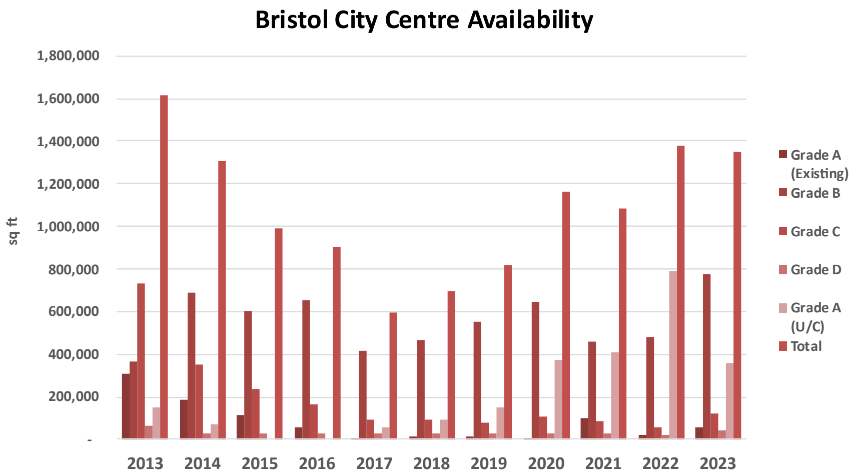
Supply side

Bristol currently enjoys a healthy level of supply in all categories from brand new Grade A through to Grade B plus – refurbished space to meet the ESG credentials now in demand.



A number of new and refurbished buildings are coming through the pipeline, providing a total of some 640,000 sq ft of good quality space between them.

		
EQ	The Welcome Building	The Fairfax
		
One Hundred	Crescent	3 Rivergate

		
One Redcliff	Assembly C	Assembly B

The question for 2024 will be when (or if) we will see the next round of developments coming forward. The increase in the pricing of debt, higher construction costs and yields being pushed out have made appraisals less favourable for landlords and developers. It will be the contrarian (and well-funded) Developers, Landlords or Propcos who will spot the opportunity to undertake the next phase of development or refurbishment to take us through 2025 and 2026; and which – at present – run the risk of being undersupplied, not least with several major lease events in the offing.

The level of demand last year, together with the rents being negotiated on deals this year, should reassure the market. Build costs, which were increasing rapidly – plateaued in February 2023. We just need the cost of debt to start coming down. We are also waiting for some investment sales to crystallise yields and give some confidence to investors.

During past downturns, various funds have been in a position to go ahead and kickstart new schemes – and then been miles ahead of the game when the market returned to normal. A number of big schemes are currently sat waiting, complete with detailed planning consent in place. There is plenty of speculation in the market as to which of them will press the green button first.

Right space, right place

Looking forward, for occupiers who want space today, tomorrow and in two years' time, from their perspective, it will be advantageous to maintain the current situation where they have at least two options for negotiations, so new schemes coming forward will be helpful.

Today's tenants recognise that the quality of the working environment is a big factor in the continuing issue of recruiting and retaining talent. Occupiers have a good understanding of what quality space now costs: they recognise it when they see it and they are prepared to pay for it.

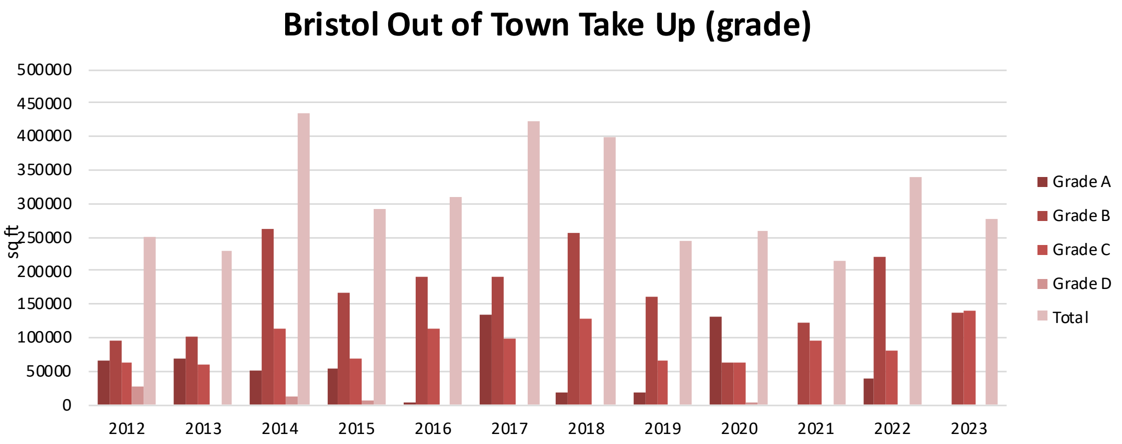
The other point becoming very clear is that good access and public transport are now critical search criteria for occupiers. With reduced car access into the city centre, along with fewer car spaces for offices, tenants expect to be just a 10 to 20-minute walk from the station for commuting – and which also gives them fast and easy access into London.

Hand in hand with that, tenants are expecting flexibility: both physically (with floorplates that are readily divisible); and contractually – including tenant-only break clauses.

Green lease provisions are also very much the start of discussions, with tenants expecting their landlord to use suppliers and utilities with green credentials.

Out of town

Somewhat in contrast, and in spite of a quiet last quarter, North Bristol's 276,867 sq ft total for the year was only just below the five-year average. It was also down from 2022's take-up figure of 340,000 sq ft but well up on 2021's 215,000 sq ft.



Rental growth here has not moved for some time (c£16.50 to £23.50 sq ft), with very little new space coming through to test the market. That may well change, however, as CEG has completed its comprehensive refurbishment of 1000 Aztec West. Quoting rent for the 73,000 sq ft available is £28.50 psf.

Aztec 1000

North Bristol has a lot of old stock, albeit some of it is now being taken up by other uses. Introducing a building with the same sort of ESG credentials as the Grade A stock in the city centre might just move the dial – and encourage other landlords locally to follow suit.

Office obsolescence: turning an obstacle into an opportunity

Finally, "Office obsolescence". Which sounds like a worrying topic… but needn't be.

The issue of "Dilaps" is always hanging over a tenant as they come up to the end of their lease. At that point, the tenant is obliged, under the dilapidations clause, to reinstate the building to the specification when they first occupied.

The problem is, that doing this would be pretty pointless as well as expensive. In the intervening years, expectations and requirements around EPC, layouts, amenities and so on have moved on light years. If they fail to upgrade the space to the new standards, landlords will find it impossible to let the space. The value will plummet and the building might even become one of those that ends up getting a change of use.

Against that, refurbishing to the new standards is not cheap. Certainly the funds being recouped from an exiting tenant will not cover them. And not all landlords will have monies set aside to do that work.

Moreover, under The 1954 Landlord and Tenants Act, if a landlord is going to make any significant improvement, the tenants can vacate with a limited liability.

However, it's not all bad news.

In the last 10 years, rental levels have typically gone up by 50%. That can make a refurbishment well worth the investment: significantly boosting the landlord's rent and the building's capital value in the process.

From a tenant's perspective, it can provide a bargaining tool for exiting their lease, including extending the lease (to give the landlord time to get funding in place) or even agreeing to remain in place while refurbishment goes on around them.

As a tenant or as a landlord, this provides an opportunity if seized earlier enough to negotiate an arrangement that provides a win-win solution.

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