RESEARCH

CENTRAL LONDON

QUARTERLY – OFFICES **Q1 2018**

CENTRAL LONDON RENTS REMAIN STABLE

SUPPLY STARTS TO DECREASE ACROSS THE MARKET

CENTRAL LONDON PRIME YIELDS REMAIN STABLE

EDITORIAL

Central London market indicators remain positive as we move past the first quarter of the year, with similar performance expected for the rest of 2018.

Since the referendum vote almost two years ago, we have become used to daily stories outlining the multiple negative scenarios that are likely to befall us as we approach Brexit in 2019. In addition, growing tensions between the US and China have raised fears of a trade war, which has the potential to cause significant damage to investment and jobs across the world.

Against this backdrop, it would not be unreasonable to assume that the London real estate market would be impacted.

However, once again the capital appears to have defied gravity, returning another positive set of results and reinforcing the city's position as one of the world's most attractive places to conduct business.

Occupier take-up of Central London office space has now registered above average levels for six consecutive quarters. The first quarter of 2018 saw 3.7 m sq ft of transactions, which is less than the preceding quarter but the strongest first quarter performance since 2010.

Take-up was certainly inflated by the inclusion of Deutsche Bank's pre-let of 550,000 sq ft at 21 Moorfields, EC2, a deal conditional on a planning consent which was granted in the first quarter. This transaction may have boosted the figures, but it should be noted that even without this pre-let, take-up for the quarter would have exceeded average levels.

The supply of office space in London is falling; the vacancy rate at the end of the first quarter was 6.8%, the lowest for almost two years. The tightening of supply along with the shrinking development pipeline has led to a noticeable increase in the demand for pre-lets. Occupiers are activating searches of all sizes well in advance of lease events, conscious of the need to secure preferred options. There is just 4.0 m sq ft of speculative space under construction in Central London due to be delivered before the end of 2019, roughly the equivalent of just six months of supply assuming current levels of take-up.

However, uncertainty over the economy continues to weigh upon both occupiers and landlords. Despite the tightening supply and thinning pipeline, rents have remained static in most markets. We expect rents to come under upward pressure as we get closer to Brexit, but until then we should not expect any significant rental movement.

There was little change in investor demand for London commercial real estate in the first quarter. Turnover totalled £2.25 bn, more than half the amount transacted in the same quarter last year. However, it has been some time since turnover accurately reflected demand; the reality is that the volume of capital targeting London assets vastly outweighs supply, and will continue to do so for the foreseeable future.

Overseas purchasers continued to dominate the investor profile, accounting for 90% of transactions in the first quarter. Buyers from Greater China accounted for more than half of all overseas money entering London property. We expect inflows from this region to continue, although tightening capital restrictions may affect the ability of investors to deploy capital.

Given the levels of demand, there has been no outward pressure on prime investment yields. In the City, the prime yield remained at 4.25%, while in the West End the prime yield was 3.50%.

Central London property remains competitive against not only other major global cities, but also against other asset classes; for the time being at least, we do not see the city's attractiveness waning.

In summary, despite potential headwinds in the form of Brexit, trade barriers and capital controls, the fundamentals of healthy demand and a lack of supply in the London real estate market remain in place across the spheres of both leasing and investment.

"Despite potential headwinds, the fundamentals of healthy demand and a lack of supply remain in place."

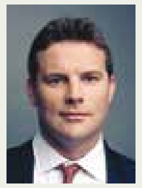
PATRICK SCANLON
Head of Central London Research

Please refer to the important notice at the end of this report

CENTRAL LONDON VIEW

WILLIAM BEARDMORE-GRAY
HEAD OF CENTRAL LONDON OFFICES

"The Central London market has remained remarkably resilient throughout the post-referendum period, and I expect this to continue despite potential headwinds in the global economy. Even with the spectre of Brexit, the 'pull' factors of the capital outweigh the 'push' factors in both the occupational and investment markets."



DAN GAUNT
HEAD OF CITY AGENCY

"City take-up remained well above long-term average levels in the first quarter as the financial sector rebounded, a reminder of the City's status as the global financial capital. Deutsche Bank's pre-let at 21 Moorfields was the largest transaction in the City since 2010, and represents a vote of confidence for the capital as we approach Brexit."

IAN MCCARTER
HEAD OF WEST END AGENCY

"As vacancy rates begin to fall, occupiers are increasingly aware that their options are becoming fewer. This has led to some requirements for top quality stock being launched earlier as they realise the importance of real estate in attracting and retaining talented staff. Demand remains constant but if we see demand rise we may see more pre lets in the West End."

NICK BRAYBROOK
HEAD OF CITY CAPITAL MARKETS

"Overseas money continued to dominate the City market. We have seen new entrants to the market from a variety of geographies which will challenge the dominance of Greater China. After peaking in the second half of last year supply is beginning to normalise, and we anticipate more competitive tension at the prime end of the market."

ANTHONY BARNARD
HEAD OF WEST END CAPITAL MARKETS

"Turnover in the first quarter of 2018 was significantly lower than the same quarter last year, this reflects an ongoing lack of supply of quality assets in the market rather than any weakening of demand. We continue to see strong demand from international buyers from the Far East and Middle East, although there has been increased interest from UK purchasers in active management opportunities ."

RICHARD PROCTOR
HEAD OF CENTRAL LONDON TENANT REPRESENTATION

"Occupiers' requirements remain focussed on maximising flexibility and agility against the backdrop of an uncertain economic outlook. Landlords able to provide this flexibility in terms, not just lease length but also ease and speed of occupation and exit, are in pole position to attract and retain tenants. The most successful landlords will be striving to work with their clients, their occupiers."

"While take-up was down 10% on the quarter, active requirements increased by 20%."

WEST END

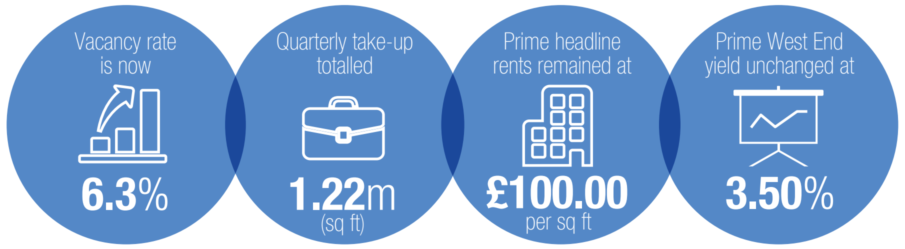


FIGURE 1
West End availability
(million sq ft)

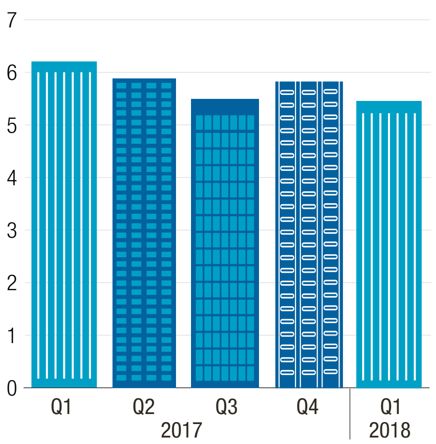
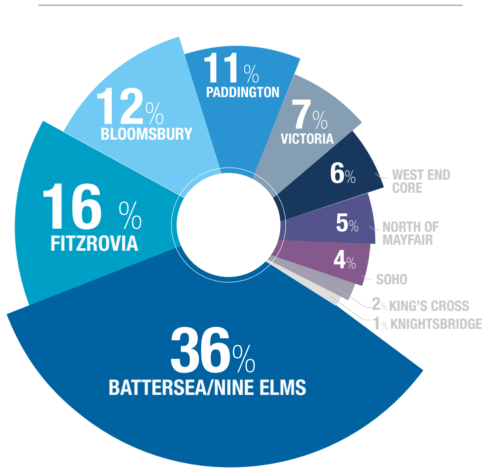


FIGURE 2
West End under construction by submarket
Q1 2018



Take-up

Take-up in the West End fell by 9% in the first quarter of the year, from 1.34 m sq ft in Q4 17 to 1.22 m sq ft in Q1 18, however, levels remained 6% above the long-term average of 1.15 m sq ft. Take-up in the Core increased 35% to 304,000 sq ft, the highest since Q4 2015, driven by the letting of 57,198 sq ft to KKR at 18-19 Hanover Square, W1. This is one of the few off-plan pre-lets seen in the West End over the last 20 years.

The financial sector was the most active sector during the first quarter of the year, accounting for 26% of all known deals, followed by the corporates with 21%. The TMT sector accounted for 20% and the business-to-business sector fell to just 11%; demand from co-working providers fell back in all Central London markets.

Active requirements

The TMT sector continues to dominate the demand profile, accounting for 48%, followed by the corporates with 24%. The number of active requirements over 50,000 sq ft focused on the West End fell by 16% quarter-on-quarter.

Supply & development

Supply fell by 6% from 5.83 m sq ft in Q4 17 to 5.47 m sq ft in Q1 18, marginally below the long-term average of 5.61 m sq ft. The current vacancy rate in the West End now stands at 6.3%, the lowest level in two years. The supply of new and refurbished space fell below 1.5 m sq ft for the first time since Q4 2015. There is just one building that could offer an occupier over 100,000 sq ft of new and refurbished space; 2 Television Centre, White City Place, W12.

There is currently 1.2 m sq ft under construction across the West End; however, 45% of this has already secured a pre-let. There is 370,000 sq ft still due to complete this year, which is currently available.

Prime rents and incentives

The prime headline rent in the West End Core remained stable for the fourth consecutive quarter at £100.00 per sq ft, with rent free periods remaining at 24 months on a 10-year lease.

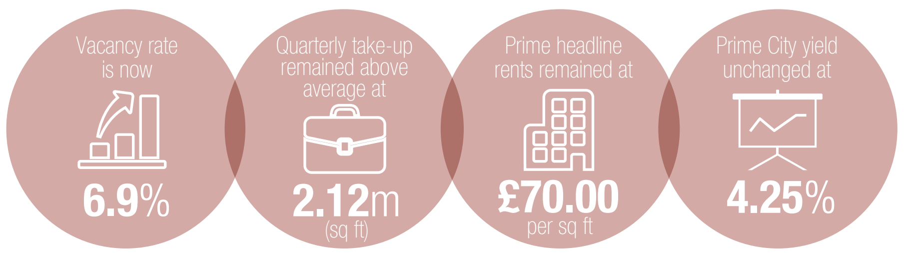
Investment

In the West End, investment transactions totalled £765 m in the first quarter of 2018 compared to £2.13 bn in Q1 2017, a drop of 64%, although this reflects an ongoing lack of supply of quality assets in the market rather than any weakening of demand. The number of transactions also fell year-on-year, with 15 in Q1 2018 against 20 in Q1 2017.

Two large transactions dominated the total turnover, Nan Fung's acquisition of Regents Quarter for £300 m and Savills IM's acquisition of 31 Great Portland Estate's Broadwick Street on behalf of a Taiwanese investor for £190 m. There is still enormous imbalance between available assets and investor demand, with its strong competitive pressure, particularly for good quality assets below £100 million. As a result, we are seeing premium prices being paid for these types of opportunities.

International buyers continue to dominate the market, accounting for 83% of market share by value in Q1 2018, with continued demand from Asian, the Middle Eastern and European Investors together with the re-emergence of the UK buyers. The prime yield in the West End remained at 3.50%.

CITY



Take-up

Take-up in the first quarter of the year totalled 2.12 m sq ft, an increase of 31% on the same quarter last year. Despite levels falling by 9% below the level recorded in Q4 17, demand was 24% above the long-term average. Furthermore, levels of take-up in the first quarter of the year have historically been lower than other quarters; we have not seen a Q1 take-up figure above 2.0 m sq ft since 2000.

Demand was dominated by the financial and the professional sectors during Q1, each accounting for 44% and 17% respectively. There were eight deals over 50,000 sq ft, the largest included occupiers such as Deutsche Bank, SMBC, Sidley Austin LLP, Mimecast and Charles Taylor. The City Core recorded the highest level of take-up since Q3 2010, 67% above the long-term average.

Active requirements

Total active demand in the City fell marginally (4%) from 4.5 m sq ft in Q4 17 to 4.3 m sq ft in the first quarter of the year, around 6% above the long-term average.

By the end of Q1 it was the financial sector that dominated the demand profile, accounting for 41% of active requirements, up from 39% the previous quarter. This was followed by the professional sector accounting for 21%, pushing the TMT sector to third place with 18% of the market share.

Supply & development

Supply levels in the City during the first quarter fell from 8.5 m sq ft in Q4 17 to 8.3 m sq ft in Q1, and nearly 12% below the long-term average. The current vacancy rate now stands at 6.9%. The supply of new and refurbished space fell from 2.8 m sq ft to 2.6 m sq ft quarter-on-quarter, the lowest level since Q1 2016.

There remains a lack of options for occupiers seeking larger units, with just six new and refurbished units able to offer more than 100,000 sq ft within the next six months. Looking at future pipeline, there is currently just under 8.0 m sq ft under construction due to complete within the next three years; however, almost half has already been pre-let.

Prime rents and incentives

The prime rent remained stable at £70.00 per sq ft for the tenth consecutive quarter. Rent free periods have remained at 24 months on a typical 10-year term certain.

Investment

Investment turnover during the first quarter totalled £1.49 bn across 21 deals, 50% down on the previous quarter and 20% above the long-term average of £1.87 bn. It should be noted that turnover in the first quarter of a year is historically lower than other quarters. Overseas purchasers accounted for 93% of all transactions during Q1 by volume; however, domestic purchasers remained active within the smaller lot size range, accounting for over 48% of all deals by number. There were five transactions that took place over £100m, all of which were acquired by overseas capital. Greater China investors were the most active accounting for £0.7bn reflecting 45% of turnover by volume, the majority of which is attributable to the purchase of Vanquish, 40 Leadenhall Street, EC3 which was also the largest deal of the quarter totalling £360 m.

Availability decreased 18% on Q4 17 to £4.9bn, (39%) of this figure was already under offer at quarter end, leaving just £3bn of investment stock available to buy. The prime yield in the Core remained at 4.25%.

"The financial sector dominates the City letting profile for the first time since Q3 2016, accounting for 44% of take-up."

FIGURE 3
City take-up
(million sq ft)

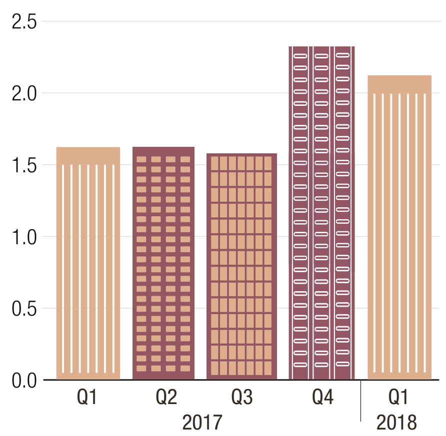
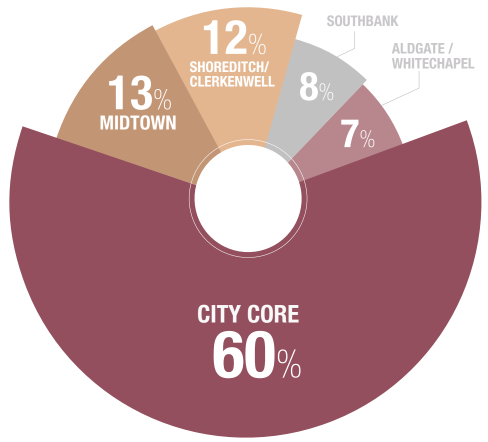


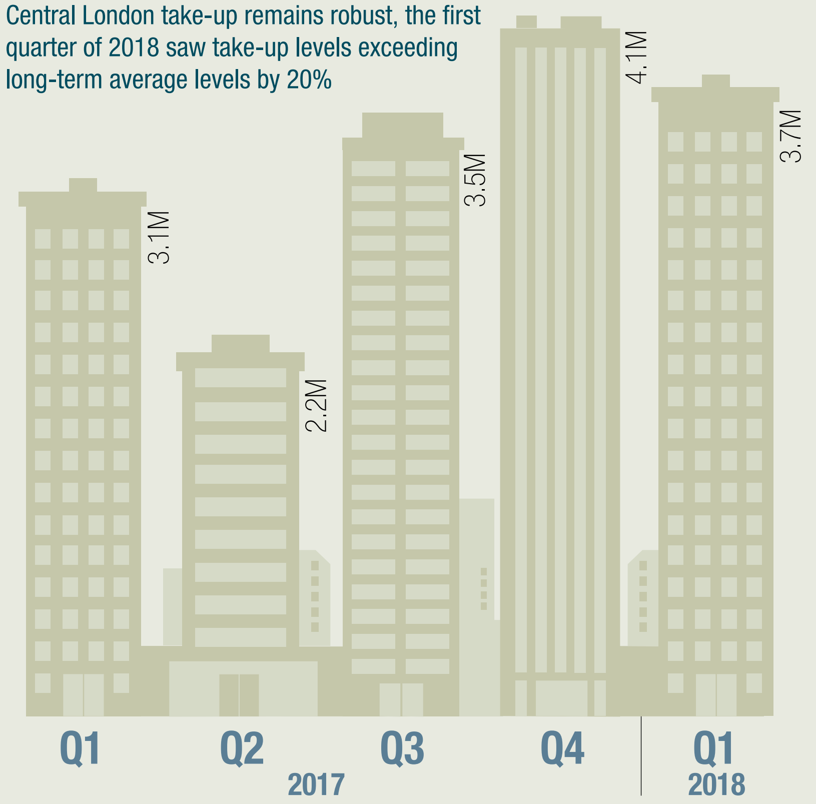
FIGURE 4
City under construction by submarket
Q1 2018



CENTRAL LONDON
Q1 2018 REVIEW

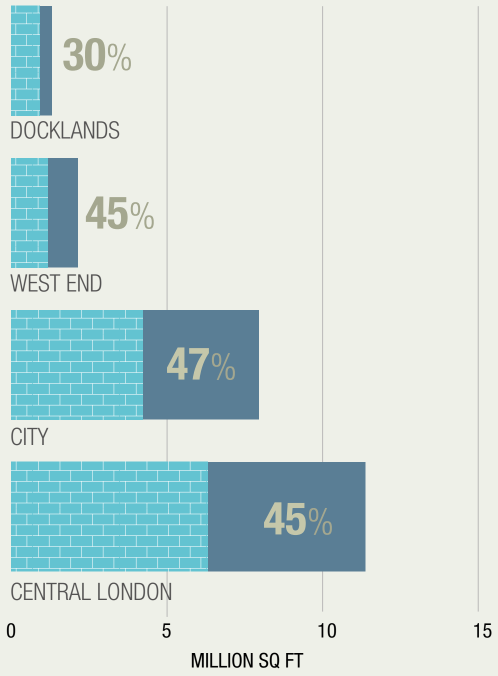
CENTRAL LONDON TAKE-UP (SQ FT)

Central London take-up remains robust, the first quarter of 2018 saw take-up levels exceeding long-term average levels by 20%



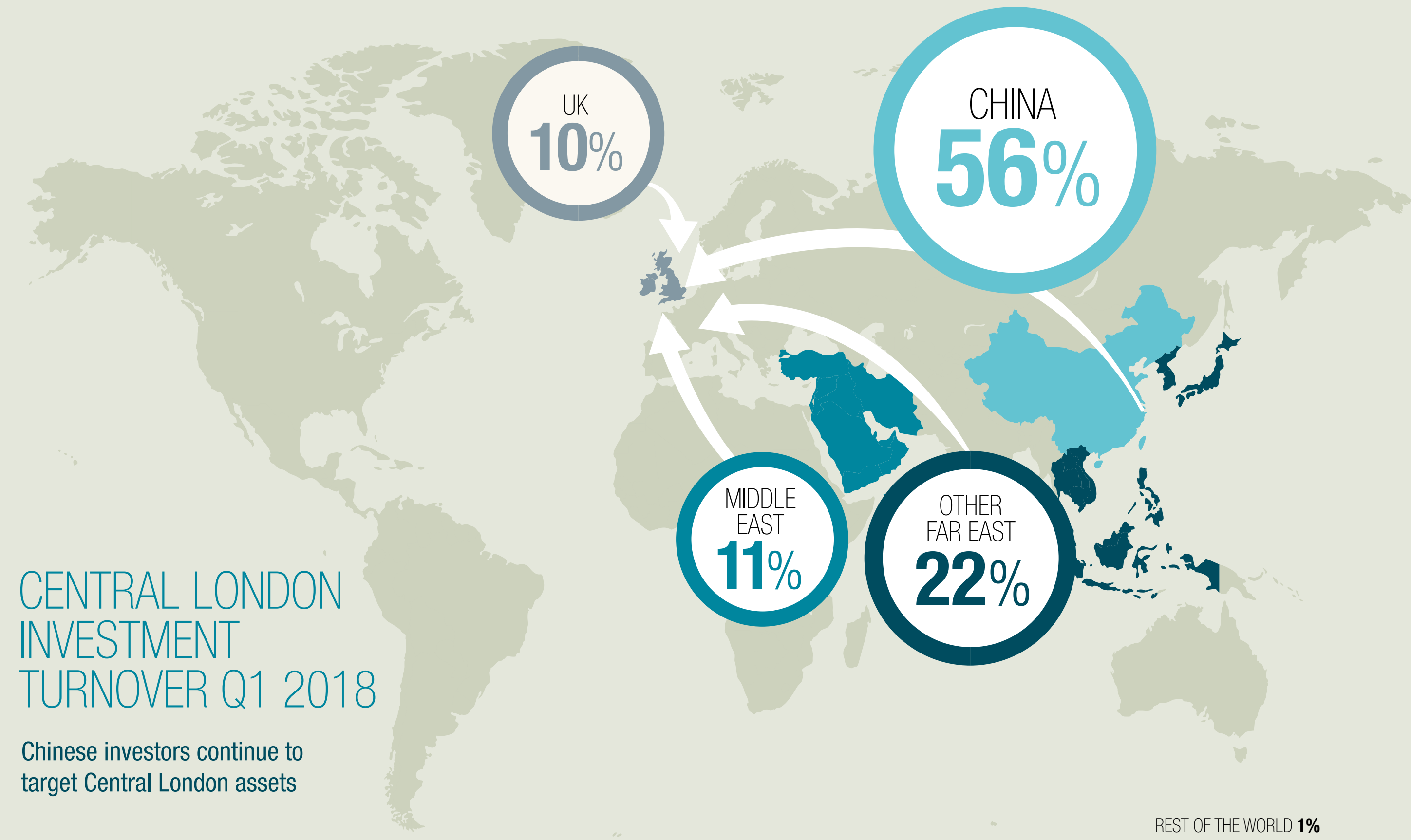
CENTRAL LONDON DEVELOPMENT PIPELINE

45% of the Central London pipeline between now and 2021 is already committed.



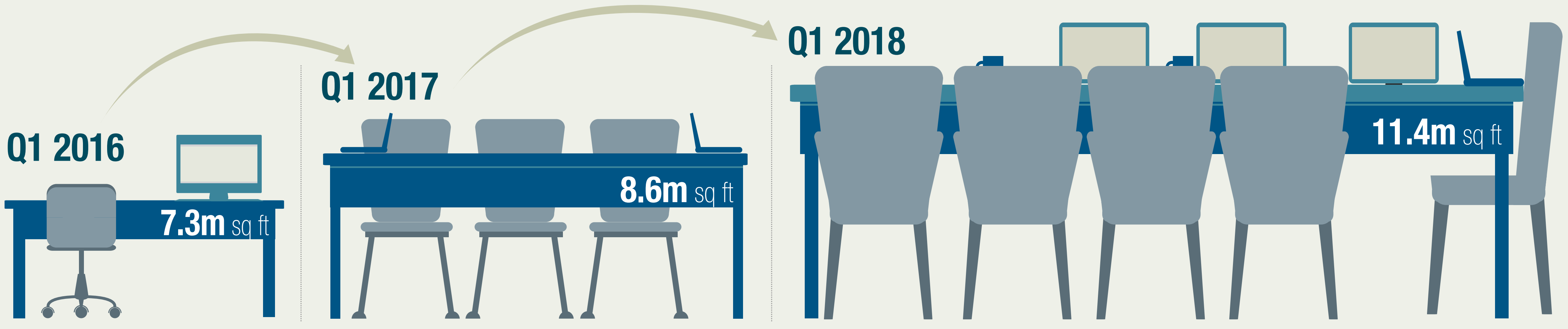
CENTRAL LONDON INVESTMENT TURNOVER Q1 2018

Chinese investors continue to target Central London assets



ACTIVE REQUIREMENTS

Occupiers appetite to acquire space in Central London continues despit Brexit, with an increase of almost 200% in active searches since Q1 last year.



"Docklands witnessed above average take-up levels, buoyed by two of the largest Central London deals during Q1, totalling a combined 136,000 sq ft."

FIGURE 5
Docklands availability
(million sq ft)

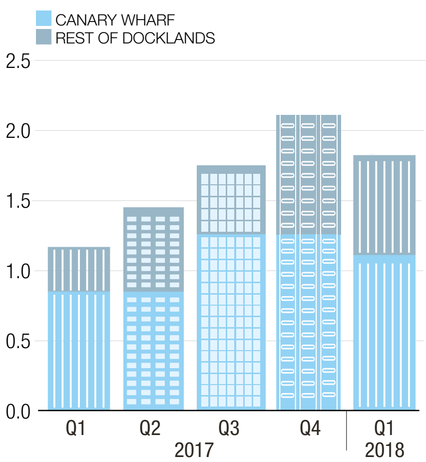
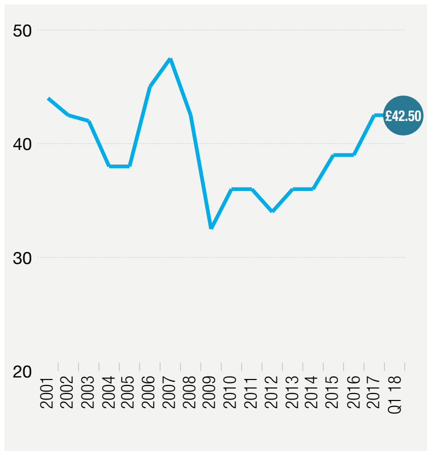
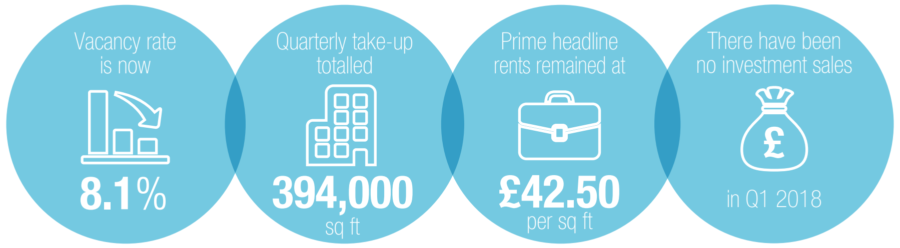


FIGURE 6
Canary Wharf prime headline rents
£ per sq ft



DOCKLANDS



Take-up

Take-up in the first quarter totalled 393,837 sq ft, 3% higher than the previous quarter and 70% above the long-term average of 233,677 sq ft. The number of deals increased by 64% quarter-on-quarter. The largest deal of the quarter was the letting of circa 91,000 sq ft at 15 Wood Wharf, E14 to Ennismore, the fourth largest deal across Central London in Q1.

The corporate sector was the most active in the market during Q1 accounting for 46% of transactions, followed by TMT with 23%.

Active requirements

The level of active requirements has continued to fall since HMRC's acquisition last quarter. Active demand in the Docklands now totals 280,000 sq ft, but we are also aware of a significant number of Central London-wide requirements totalling 1.10m sq ft that will consider Docklands options. The finance sector was the most active in the market accounting for 54% of total active requirements.

Supply and development

Supply in Docklands decreased by 13% quarter-on-quarter to 1.83m sq ft in Q1 2018, however this level is still 22% ahead of the long-term average. The current vacancy rate in Canary Wharf now stands at 7.3%, with the wider Docklands market at 8.1%.

The commercial pipeline remains particularly tight with 1.29m sq ft under construction and due for completion by the end of 2021, 30% of which is already pre-let. There are a number of other development sites capable of being delivered in 2020, but are likely to remain on hold until a pre-let is secured.

Rental Profile

The prime headline rent remained stable at £42.50 per sq ft for the second consecutive quarter.

Investment

There were no investment sales during Q1 in Canary Wharf or the wider Docklands market. The lack of stock in this market will continue to influence the investment turnover figures for the foreseeable future. Key available stock includes 1 Westferry Circus which is now under offer with a quoting price of £122.5m; and 1 Cabot Square in Q4, now on the market with a quoting price of £475m.

OFFICES AND A TWO-TIER CURRENCY

Central London offices are less of a bargain for those holding dollars, but euro buyers can still purchase at a discount.

Over the last year, the pound has displayed Jekyll and Hyde characteristics, which has had implications for the Central London office market. This has taken the form of a compare and contrast between sterling's performance against two major currencies – the US dollar and the euro. As a result, the London office market might see less Asian and more European investment this year.

In the summer and autumn of 2016, the pound tumbled in value by roughly equal measure against the US dollar and the euro in the aftermath of vote to leave the EU. There was a widespread expectation that the UK economy faced a recession, due to deteriorating business confidence at the time, and expectations (which proved incorrect) that international firms would move large numbers of jobs abroad.

The recession never came, a situation which should have ensured a sterling rebound. However, since the winter of 2016/2017 the pound has fared better against the dollar than the euro. Compared to a year ago, the pound has risen by 8.4% against the dollar – reversing most of the post-referendum losses – but fallen nearly 4.0% against the euro.

The continued weak performance against the euro reflects the risk of a hard Brexit, which could result in a tariff barrier where none currently exists. In contrast, trade between the US and the UK will still continue on existing terms after March 2019, so the pound has gained on a general decline for the US dollar against major currencies in the last year.

Sterling weakness against the US dollar post-referendum provided a welcome boost for the Central London office investment market, by drawing capital from Greater China – the renminbi and Hong Kong dollar are both linked to the greenback. Hong Kong investors acquired Central London office assets totalling £6.6 bn in 2017, accounting for 39% of sales by volume. As we move further into 2018 though, the dollar denominated buyers may become a less significant source of demand now the currency advantage has eroded.

However, this brings us back to the still devalued euro / pound exchange rate. At present, the Brexit uncertainty is dampening the rate, but 2018 is a year in which negotiations have to move towards greater clarity, irrespective of whether the end state is soft or hard Brexit. The final agreement needs to be available in draft form by the autumn in order to receive governmental approval from the UK and the EU 27 ahead of the March 2019 deadline. If there is not to be a final deal – the much feared cliff edge – similarly we will probably know that before the end of the year.

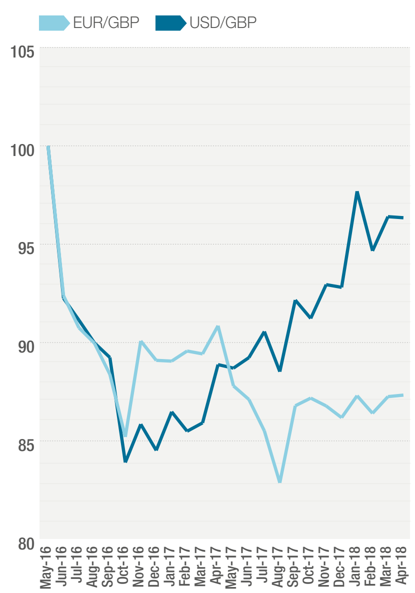
This means that for Brexit, now is the maximum time of uncertainty, and euro denominated buyers will polarize between those who believe the final deal will be a compromise, and those who expect a cliff edge. For the former, buying back into the Central London office market now offers the maximum opportunity, when the exchange rate is in their favour and yields look attractive relative to cities like Paris and Berlin.

No one has a crystal ball and can say conclusively whether the UK is heading for a soft or hard Brexit. Yet, investing is about pre-empting the market, and for euro denominated investors the question for 2018 is "do we get back into London offices in anticipation of a soft Brexit"? After all, if a compromise Brexit deal is announced, the exchange rate will reprice in seconds.

"Investing is about pre-empting the market, and for euro-dominated investors the question for 2018 is: do we get back into London in anticipation of a soft Brexit?"

JAMES ROBERTS
Partner, Chief Economist

FIGURE 7
EUR/GBP and USD/GBP indices
100 = May 2016



Source: Bank of England

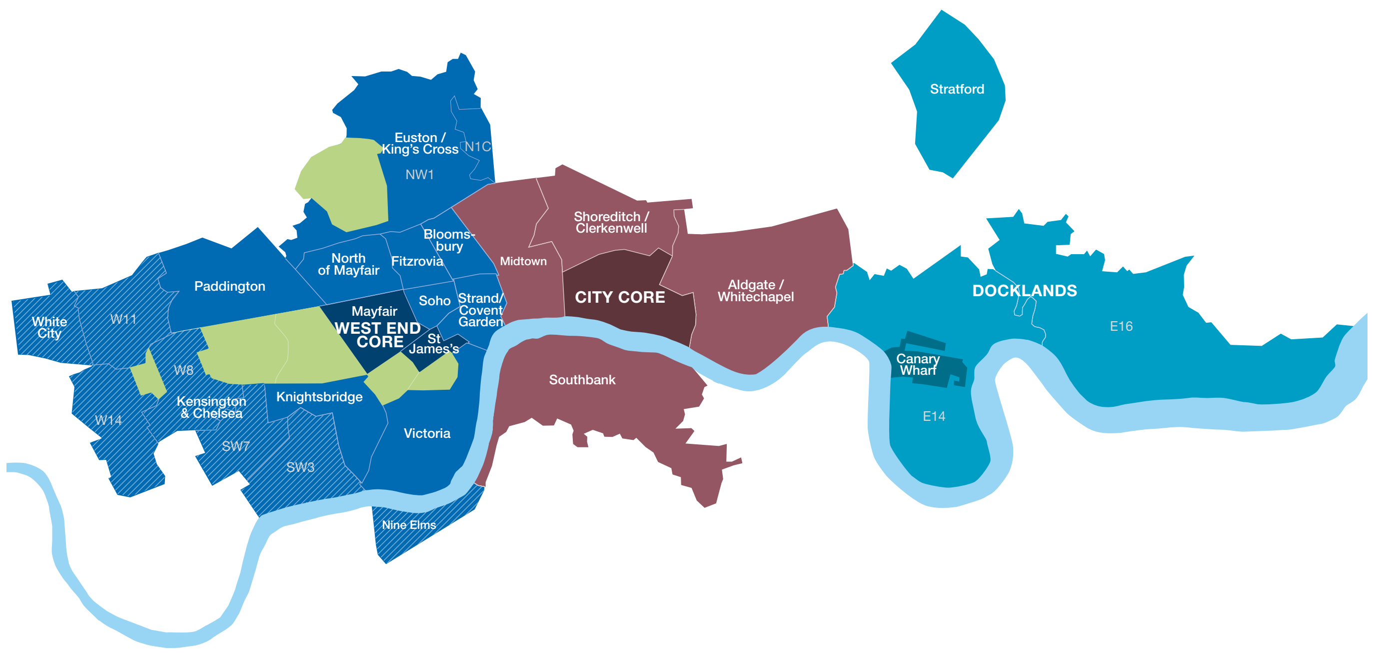
KEY STATISTICS

Central London office market

		Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	% CHANGE 3 mths	% CHANGE 12 mths	Long-term quarterly average
AVAILABILITY (sq ft)	West End	6.19 m	5.88 m	5.48 m	5.83 m	**5.46 m**	-6%	-12%	5.64 m
	City	8.60 m	8.84 m	7.95 m	8.46 m	**8.27 m**	-2%	-4%	9.36 m
	Docklands	1.17 m	1.45 m	1.75 m	2.10 m	**1.83 m**	-13%	56%	1.50 m
	Central London	15.96 m	16.17 m	15.18 m	16.39 m	**15.56 m**	-5%	-3%	16.50 m
VACANCY RATE	West End	7.2%	6.9%	6.4%	6.8%	**6.3%**	n/a	n/a	6.3%
	City	7.2%	7.3%	6.6%	7.1%	**6.9%**	n/a	n/a	8.0%
	Docklands	6.0%	7.3%	10.2%	10.6%	**8.1%**	n/a	n/a	7.2%
	Central London	7.1%	7.1%	6.9%	7.3%	**6.8%**	n/a	n/a	7.3%
TAKE-UP (sq ft)	West End	1.47 m	1.24 m	1.65 m	1.34 m	**1.21 m**	-10%	-18%	1.16 m
	City	1.62 m	1.91 m	1.58 m	2.33 m	**2.12 m**	-9%	31%	1.72 m
	Docklands	0.03 m	0.05 m	0.25 m	0.38 m	**0.39 m**	3%	1200%	0.23 m
	Central London	3.12 m	3.20 m	3.48 m	4.05 m	**3.72 m**	-8%	19%	3.09 m
ACTIVE REQUIREMENTS (sq ft)	West End	2.21 m	2.13 m	2.31 m	2.8 m	**3.36 m**	20%	52%	1.88 m
	City	4.54 m	4.64 m	4.01 m	4.46 m	**4.27 m**	-4%	-6%	4.06 m
	Docklands	0.67 m	0.70 m	0.73 m	0.50 m	**0.28 m**	-44%	-58%	0.41 m
	Unspecified	1.17 m	1.15 m	1.40 m	2.88 m	**3.44 m**	19%	194%	1.60 m
	Central London	8.59 m	8.62 m	8.45 m	10.64 m	**11.35 m**	7%	32%	7.95 m
UNDER CONSTRUCTION (sq ft)	West End	3.31 m	3.16 m	2.12 m	2.35 m	**2.14 m**	-9%	-35%	2.46 m
	City	8.30 m	8.43 m	8.69 m	8.52 m	**7.95 m**	-7%	-4%	5.99 m
	Docklands	0.70 m	0.70 m	0.90 m	0.96 m	**1.29 m**	34%	84%	0.96 m
	Central London	12.31 m	12.29 m	11.71 m	11.83 m	**11.38 m**	-4%	-8%	9.41 m
INVESTMENT	West End	£2.13 bn	£1.22 bn	£0.67 bn	£1.15 bn	**£0.76 bn**	-34%	-64%	£1.24 bn
	City	£2.59 bn	£2.37 bn	£2.78 bn	£2.95 bn	**£1.49 bn**	-49%	-42%	£1.84 bn
	Docklands	£0 bn	£0 bn	£0.41 bn	£0.71 bn	**£0 bn**	-100%	n/a	£0.40 bn
	Central London	£4.72 bn	£3.59 bn	£3.86 bn	£4.81 bn	**£2.25 bn**	-53%	-52%	£3.48 bn

Source: Knight Frank Research

THE CENTRAL LONDON OFFICE MARKET



WEST END

West End Core – West End Core refers to Mayfair and St James's, the area bounded by Oxford Street, Regent Street and Park Lane in W1 and by Green Park, St James's Park and The Mall in SW1.

North of Mayfair – North of Mayfair refers to the area north of Oxford Street, west of Portland Place.

Fitzrovia – Fitzrovia also known as Noho, refers to the area north of Oxford Street, east of Portland Place.

Soho – Soho refers to W1B, W1F and W1D.

Euston/King's Cross – Euston/King's Cross refers to NW1 and N1C.

Victoria – Victoria refers to SW1 (excluding St James's) and SW1X.

Bloomsbury – Bloomsbury refers to the area of WC1 bounded by Euston Road, Southampton Row, New Oxford Street and Tottenham Court Road.

Strand/Covent Garden – Strand/Covent Garden refers to WC2, west of Kingsway.

Paddington – Paddington refers to W2.

Kensington/Chelsea – Kensington/Chelsea refers to SW3, SW7, W8, W11, W14.

Knightsbridge – Knightsbridge refers to SW7 and SW1X, which includes Belgravia.

White City – White City refers to W12.

Nine Elms/Battersea – Nine Elms refers to SW8.

CITY

City Core – City Core refers to EC2 (excluding EC2A), EC3, EC4 (excluding EC4A and EC4Y), and EC1A.

Midtown – Midtown refers to EC1N, EC4A, EC4Y, WC1 (excluding Bloomsbury), and WC2 (excluding Strand/Covent Garden).

Shoreditch/Clerkenwell – Shoreditch/Clerkenwell refers to EC1 (excluding EC1A and EC1N), and EC2A.

Aldgate/Whitechapel – Aldgate/Whitechapel refers to E1.

Southbank – Southbank refers to SE1.

DOCKLANDS

Canary Wharf – Canary Wharf refers to the area comprising Canary Riverside, Westferry Circus, Columbus Courtyard, Cabot Square, Canada Square, Blackwall Place and Heron Quays (East).

Rest of Docklands – Rest of Docklands refers to E14 and E16 including the Royal Business Park (excluding Canary Wharf), and Stratford E20.

COMMERCIAL RESEARCH

William Beardmore-Gray, Partner
Head of Central London
+44 20 7629 1308
william.beardmore-gray@knightfrank.com

Patrick Scanlon, Partner
Head of Central London Research
+44 20 7861 1345
patrick.scanlon@knightfrank.com

James Roberts, Partner
Chief Economist
+44 20 7861 1239
james.roberts@knightfrank.com

Victoria Shreeves, Associate
Central London Research
+44 20 3826 0636
victoria.shreeves@knightfrank.com

Hayley Blackwell, Associate
Central London Research
+44 20 7861 1241
hayley.blackwell@knightfrank.com

General Note

This report has been prepared by Knight Frank Research, the research and consultancy division of Knight Frank. Knight Frank Research gratefully acknowledges the assistance given by the West End, City and Docklands Offices in the compilation and presentation of this material. Certain data sourced from LOD. All graph data sourced by Knight Frank.

Technical Note

The following criteria have been adopted in the preparation of this report.

i. All floorspace figures quoted in this report refer to sq ft net.

ii. Take-up figures refer to space let, pre-let, or acquired for occupation during the quarter.

iii. Availability refers to all space available for immediate occupation, plus space still under construction which will be completed within six months and which has not been let.

iv. Availability and take-up are classified into three grades:
New/refurbished: Space under construction which is due for completion within six months or space which is currently on the market and is either new or completely refurbished.
Second-hand A Grade: Previously occupied space with air-conditioning.
Second-hand B Grade: Previously occupied space without air-conditioning.

v. Demand figures quoted in this report refer to named requirements for over 10,000 sq ft.

vi. Under construction figures quoted in this report refer to developments of over 20,000 sq ft which are currently underway. They do not include properties undergoing demolition.

vii. Investment figures quoted in this report refer to accommodation where the majority of income/ potential income is from office usage and comprises transactions of £1 m and above.
The data includes standing investments, site purchases and funding transactions.

viii. This report is produced to standard quarters.
Quarter 1: January 1 – March 31,
Quarter 2: April 1 – June 30,
Quarter 3: July 1 – September 30,
Quarter 4: October 1 – December 31

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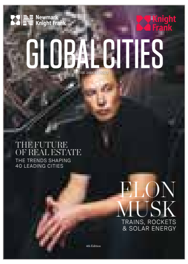

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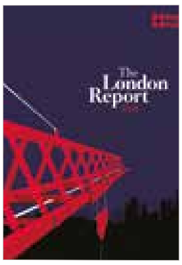

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