RESEARCH

Q1 2010

CENTRAL LONDON

Quarterly – Offices

Knight Frank

HIGHLIGHTS

- Take-up increased to 4.2 m sq ft, the highest quarterly level since 2007. Growing occupier confidence and strengthening office market fundamentals suggest the Central London market is firmly in the upswing stage of the next cycle.
- Supply fell for the fifth consecutive quarter as a result of continued strong take-up, limited new development schemes and the marked slowdown in the release of space to the market by tenants. At the end of Q1 2010, the Central London vacancy rate was 9.0%.
- The lack of available development funding continued to place pressure on the speculative development pipeline. There is now 3.4 m sq ft under construction speculatively, 45% lower than at the same point 12 months ago.
- There was further yield compression as investor appetite for Central London offices continued to strengthen. Turnover totalled £1.7 bn, which is expected to rise during 2010 as confidence in the potential for rental growth during this cycle increases.

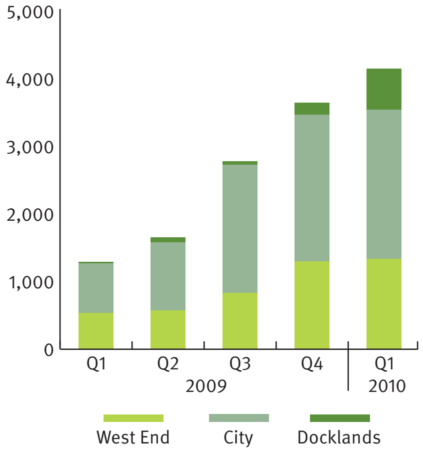
CENTRAL LONDON OVERVIEW

- **Take-up continued to rise to 4.2 m sq ft in Q1 2010, three times higher than 12 months ago.**
- **Availability fell to 20.4 m sq ft, reflecting a vacancy rate of 9.0%.**
- **Speculative development levels continued to fall.**
- **Yields tighten further as demand remained strong.**

Figure 1

Central London take-up by quarter & market sub-area

Q1 2009 - Q1 2010 (000's sq ft)



Source: Knight Frank

Demand and take-up

The recovery in leasing activity continued apace in the first quarter of 2010, with take-up levels increasing across all markets. Take-up totalled 4.2 m sq ft, the highest level since mid-2007 and almost 30% higher than the long-term average. Just 12 months ago, Central London was experiencing the lowest level of tenant activity since the early 1990's, yet now the market would appear to be firmly in the upswing stage of the next cycle.

There have been a number of large unit transactions this quarter that have captured the headlines. However, the City has seen the return of the 'middle market' of deals around 50,000 sq ft, while the West End has seen a marked increase in the churn of smaller deals that historically drive the market. Activity may fall back over the next few months as the general election looms, but the property fundamentals of this recovering market appear to be solid.

Supply and development

Availability has fallen significantly over the last six months as occupiers push ahead with transactions, and tenant-release space is withdrawn from the market in anticipation of future expansion. There is now 20.4 m sq ft available across Central London, 17% lower than the cycle's peak of 24.6 m sq ft in Q3 2009. Strong take-up and a slowdown in speculative construction has caused the volume of new and refurbished available space, which now totals 5.5 m sq ft, to contract by 30% over the last 9 months.

Development activity fell for the eighth consecutive quarter as the lack of available development funding continued to prevent new schemes commencing speculatively. There is now 3.4 m sq ft under construction speculatively across Central London, the lowest level since 2005. Although some speculative development is expected to begin over the next few months, construction levels are forecast to remain low for the remainder of 2010.

Investment market

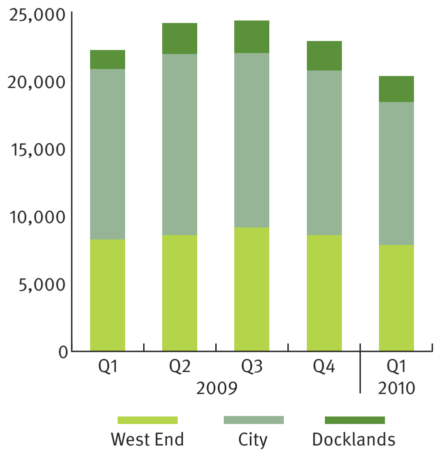
The investment market continued to gather strength in Q1 2010, recording £1.7 bn of transactions. The City and West End both showed significant increases in investor activity, although the overall turnover for Central London fell back from the previous quarter's exceptional level due to less activity in Docklands and ongoing supply restrictions. Overseas investors still account for the majority of activity in the West End, although the City saw domestic investors dominate for the first time since the beginning of 2008.

Prime yields continued to tighten across the market. In the City, prime yields are estimated to be at 5.50%, while in the West End prime yields have fallen to 4.50%, which is a 150 basis point fall in 12 months. Prime yields remain under pressure as optimism over the prospects for the occupational market increases, and the Pound remains relatively weak.

Figure 2

Central London availability by quarter & market sub-area

Q1 2009 - Q1 2010 (000's sq ft)

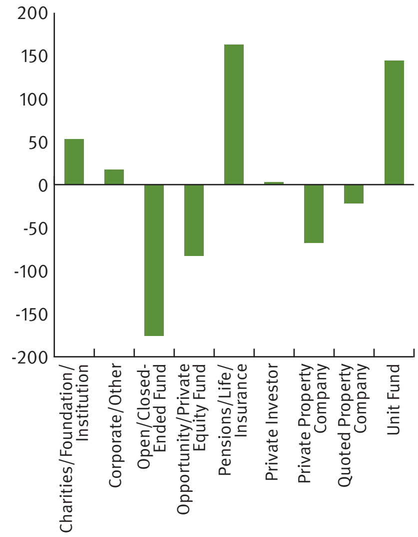


Source: Knight Frank

Figure 3

Central London net investment

Q1 2010 (£ m's)

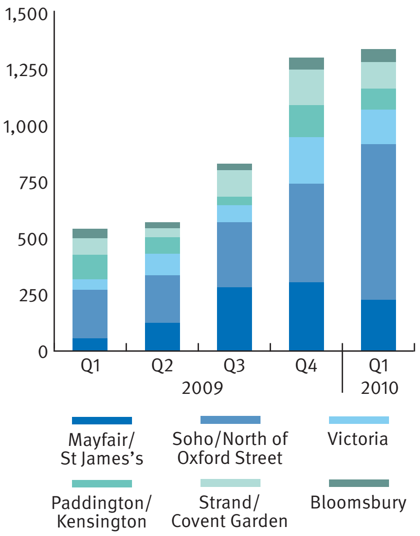


Source: Knight Frank

WEST END

- **Take-up rises for a fourth consecutive quarter to 1.3 m sq ft, up 3% on Q4 2009.**
- **Availability falls further to 7.9 m sq ft, reflecting a vacancy rate of 8.7%.**
- **Prime headline rents rose for the first time in two years to £72.50 per sq ft.**
- **Investment turnover increased by 19% reaching £945 m.**

Figure 1
West End take-up by quarter & market sub-area
Q1 2009 - Q1 2010 (000's sq ft)



Source: Knight Frank

Demand & take up

Take-up in Q1 2010 rose to 1.3 m sq ft representing 12 months of increased quarterly take-up. Levels were three times that of this time last year and 9% above the long-term average. There was a rise of 3% from Q4 with a gradual increase in all grades of space, although take-up of second-hand space was almost three times higher than that of the same quarter last year. There were a number of large transactions this quarter, with 12 deals over 20,000 sq ft, the largest deal was at 10 Triton Street where Aegis Group took 117,000 sq ft.

Active demand rose in Q1 2010 to 1.9 m sq ft indicating a healthy rate of replacement of requirements. However, we are anticipating a noticeable slow-down in occupier activity in the second quarter as occupiers place property decisions on hold pending the outcome of the general election.

Supply & development

Availability fell for the second consecutive quarter and now stands at 7.9 m sq ft. We foresee a further decline as market conditions continue to improve. There is increasing competition for the already constrained levels of new and refurbished space which has fallen to 1.7 m sq ft. The current vacancy rate is now 8.7%, a level not seen for over 12 months.

The volume of space under construction fell for the fifth consecutive quarter and now totals less than 1.0 m sq ft, its lowest level for 11 years. Levels should remain relatively steady during the rest of 2010.

Rental profile

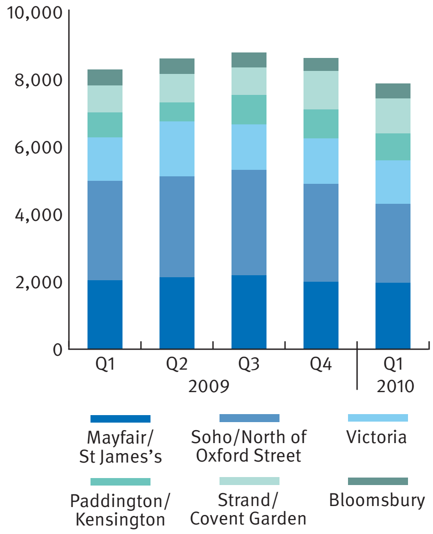
Prime headline rents rose for the first time in two years to £72.50 per sq ft. With falling supply of new and refurbished space, restricted pipeline and active demand still rising, rents are forecast to increase further during the rest of 2010 and have already risen significantly in Q2 2010. Rent free periods fell slightly to 21 months on a ten-year term certain.

Investment market

Turnover for the first quarter of 2010 rose by 19% from Q4 09 reaching £945 m, 23% higher than the ten-year long-term average. We estimate that there is £648 m of investment stock available at the quarter end with a further £194 m under offer. The largest transaction of the quarter was the sale of Victoria House, Southampton Row, WC1 which exchanged for £175 m 6.50%.

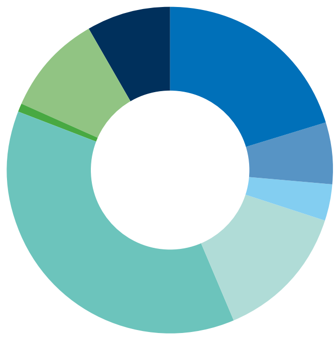
Private investors have been the most active buyers, accounting for 38% of all transactions. Whilst demand remains strong from overseas buyers, a number of large UK funds have signalled the way with the purchase of more short-term asset management opportunities being marketed. Prime yields have fallen 100 basis points over the last six months and are currently at 4.50% with further downward pressure.

Figure 2
West End availability by quarter & market sub-area
Q1 2009 - Q1 2010 (000's sq ft)



Source: Knight Frank

Figure 3
West End investment by purchaser
Q1 2010 (£ m's)



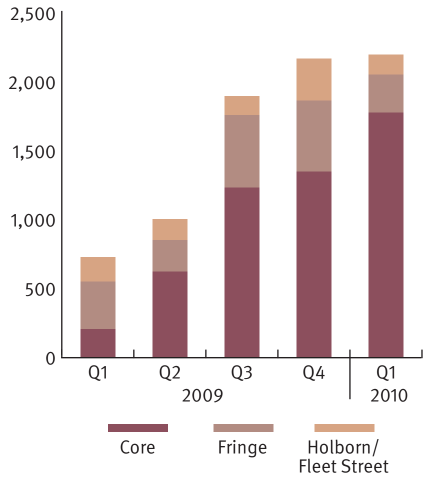
Corporate/Other	£192 m
Charities/Foundation/ Institution	£58 m
Open/Closed-Ended Fund	£35 m
Pension/Life/Insurance	£127 m
Private Investor	£353 m
Private Property Company	£8 m
Unit Fund	£94 m
Undisclosed	£77 m

Source: Knight Frank

CITY

- **Fourth consecutive quarter of rising take-up.**
- **Availability fell sharply, down by 1.6 m sq ft to 10.6 m sq ft.**
- **City prime normal rent increased to £46.50 per sq ft.**
- **Prime investment yields hardened by a further fifty basis points to 5.50%.**

Figure 1
City take-up by quarter & market sub-area
Q1 2009 - Q1 2010 (000's sq ft)



Source: Knight Frank

Demand and take-up

The City office market recorded its fourth consecutive quarter of rising take-up in Q1, with 2.2 m sq ft of space transacting. This is up markedly on Q1 09 (0.7 m sq ft), although that was the lowest point of the market downturn. Foreign banks, insurers, and law firms were the largest acquirers of space, reminding us of the variety of occupiers in the City and its international profile.

While the Q1 figures were encouraging, we caution that a modest slowdown is likely to follow in Q2. Activity in the City tends to move in waves, and given the high volume of deals transacted lately, plus the General Election, a 'pause-for-breath' is now likely. However, due to new requirements which have recently come to the market, demand will pick up again by Q3 or Q4.

Supply and development

Availability dropped sharply to 10.6 m sq ft, compared to 12.2 m sq ft three months earlier. This reflects a combination of strong take-up for new and refurbished space, and less speculative development activity. The level of speculative development currently under construction is now just 2.5 m sq ft, which will complete between now and 2012. To set this in context, the average annual take-up figure for new and refurbished space is 3.2 m sq ft per annum.

Debt finance for speculative development is still close to non-existent, which threatens to keep supply tight for years to come – effectively it is impossible to deliver a new build scheme in 2011 and close to impossible for 2012. However, some investment funds are now stepping into the debt void left by banks and offering funding, plus there is still scope to deliver refubishments.

Rental profile

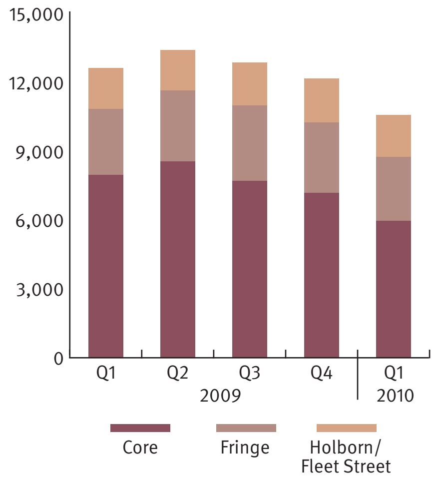
City Core prime normal rents increased to £46.50 per sq ft in Q1, up from £44.00 per sq ft three months earlier. Notably, rents in the Holborn sub-market edged ahead of the City Core for the first time, rising to £47.50 per sq ft. This suggests the strong rents being achieved pre-credit crunch in Holborn were not just a boom market excess.

Investment market

The investment transaction volume increased to nearly £690 m, up from £572 m in Q4 09 and £364 m in Q1 09 (the weakest quarter of the downturn). A notable development in the first quarter was a substantial rise in availability, partly due to the launch of the White Tower portfolio. Also, a number of recently let large prime buildings have come to the market.

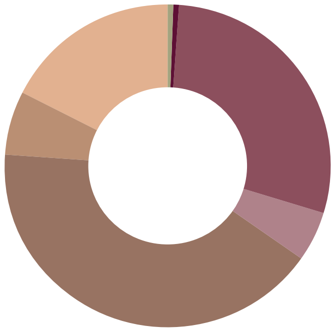
Prime yields hardened by 50 basis points to 5.50%; and we believe there is still further yield compression to come as demand is in our view set to increase in the face of more rental growth. UK retail property funds have seen a strong inflow of money, more banks are opening their books to lend again, and Sterling weakness continues to attract foreign buyers. Also, actuaries are now recommending pension funds to re-enter the market.

Figure 2
City availability by quarter & market sub-area
Q1 2009 - Q1 2010 (000's sq ft)



Source: Knight Frank

Figure 3
City investment by purchaser
Q1 2010 (£ m's)



Corporate/Other	£5 m
Opportunity Fund	£3 m
Pension/Life/Insurance	£198 m
Private Investor	£35 m
Private Property Company	£286 m
Quoted Property Company	£43 m
Unit Fund	£120 m

Source: Knight Frank

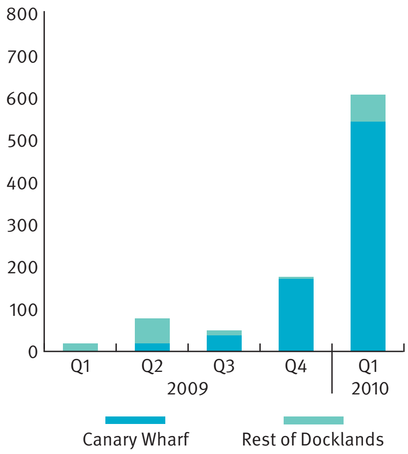
DOCKLANDS

- **Take-up rebounds on financial and public sector deals.**
- **Availability fell for a second quarter in a row.**
- **Prime rents at Canary Wharf start to rise.**
- **More investment stock comes to the market.**

Figure 1

Docklands take-up by quarter & market sub-area

Q1 2009 - Q1 2010 (000's sq ft)



Source: Knight Frank

Demand & take up

The Docklands market recorded take-up of 608,000 sq ft in Q1 2010, compared to 177,000 sq ft in the preceding quarter. 90% of take-up was in the Canary Wharf district, as Barclays Capital took 346,000 sq ft at 20 Cabot Square. This was part of a wider reshuffle of its occupation at Canary Wharf, whereby 300,000 sq ft at 40 Bank Street was handed back to landlord, Canary Wharf Group; which has since placed 200,000 sq ft under offer (excluding option space) to oil giant, Shell. Also, LOCOG, the organisers of the 2012 Olympic Games, signed on 135,000 sq ft at 10 Upper Bank Street.

Several large US banks, some of them Canary Wharf occupiers, have reported strong first quarter earnings. Given the high exposure of Docklands to the financial sector, and investment banking in particular, this bodes well for the long-term outlook. Currently MF Global is in advanced negotiations on space at 5 Churchill Place, demonstrating renewed financial sector interest in Canary Wharf offices.

Supply & development

Availability in Docklands fell to 1.9 m sq ft, having peaked at 2.4 m sq ft in Q3 2009. Crucially, little tenant sub-let space came to the market from the Canary Wharf based banks during the downturn, other than Citi and Bear Stearns (JPMorgan) which kept supply levels manageable. With the investment banks reporting profits again, we believe those tenants with 'grey' space will now gradually reoccupy it.

There is still no clear indication on the future of the former Lehman Brothers headquarters, 25 Bank Street. Lehman Brothers in administration have now vacated the building, while Nomura will soon be relocating staff to Watermark Place. The total potentially available will be c. 900,000 sq ft excluding space sub-leased to 2013.

Rental profile

The tone of prime rents in Canary Wharf on whole floors edged up from £32.50 per sq ft at the end of last year to c. £35.00 per sq ft at the end of Q1 2010. For part floors higher rents have been achieved.

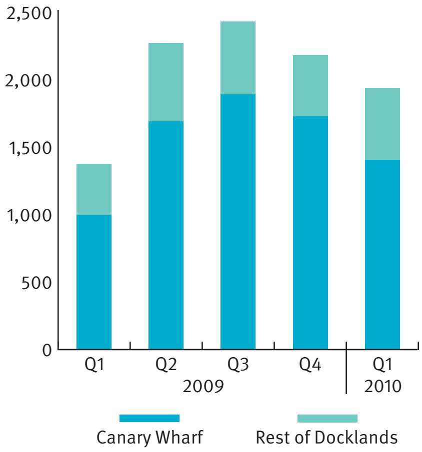
Investment

Following the big deals recorded in Q4 of last year, such as the sale of the HSBC tower, Q1 saw a low level of activity with investment turnover of just £20 m. This relates to the sale of One Park Place, a vacant building with substantial redevelopment potential, to Canary Wharf Group. However, two large lot size investments have come to the market – Golfrate's East India Dock and Hammerson's Exchange Tower – which may help to buoy activity levels later in the year.

Figure 2

Docklands availability by quarter & market sub-area

Q1 2009 - Q1 2010 (000's sq ft)

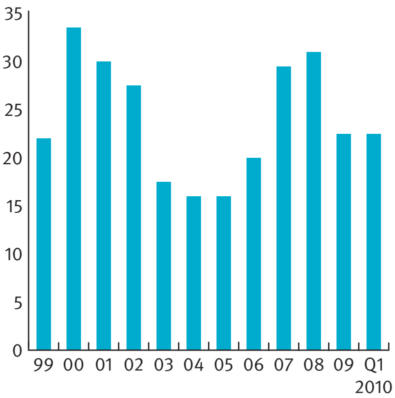


Source: Knight Frank

Figure 3

Rest of Docklands prime rent

1999-2010 (Prime £/sq ft)



Source: Knight Frank

Key statistics

Central London office market

Availability (m sq ft)	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	3 months % change	12 months % change
West End	8.29	8.62	9.22	8.64	**7.88**	-8.8%	-4.9%
City	12.65	13.42	12.90	12.18	**10.59**	-13.0%	-16.3%
Docklands	1.38	2.28	2.44	2.19	**1.94**	-11.2%	40.9%
Central London	22.32	24.32	24.55	23.01	**20.42**	-11.3%	-8.5%

Vacancy Rate (%)	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	3 months % change	12 months % change
West End	9.2	9.5	10.2	9.5	**8.7**	n/a	n/a
City	10.8	11.4	11.0	10.4	**9.0**	n/a	n/a
Docklands	6.4	10.6	11.4	10.2	**9.1**	n/a	n/a
Central London	9.9	10.8	10.9	10.2	**9.0**	n/a	n/a

Take-up (m sq ft)	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	3 months % change	12 months % change
West End	0.54	0.57	0.83	1.30	**1.34**	2.9%	146.8%
City	0.73	1.01	1.90	2.17	**2.20**	1.5%	200.6%
Docklands	0.02	0.08	0.05	0.18	**0.61**	244.3%	3139.1%
Central London	1.29	1.66	2.78	3.65	**4.15**	13.7%	220.6%

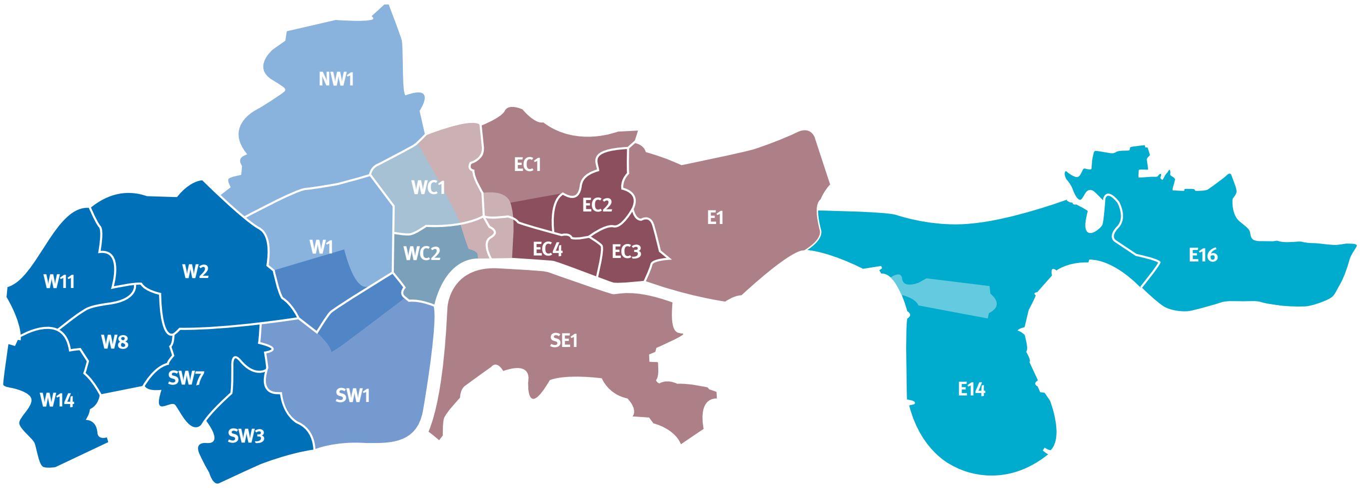
Active Demand (m sq ft)	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	3 months % change	12 months % change
West End	0.82	1.49	2.07	1.79	**1.88**	5.1%	129.9%
City	3.56	4.12	3.64	4.67	**3.73**	-20.1%	4.6%
Docklands	0.07	0.35	0.33	0.50	**0.48**	-4.0%	583.5%
Unspecified Central London	1.76	1.63	2.30	1.24	**0.88**	-29.3%	-50.3%
TOTAL Central London	6.22	7.59	8.34	8.20	**6.86**	-16.3%	10.4%

Under Construction (m sq ft)	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	3 months % change	12 months % change
West End	2.57	2.57	2.17	1.70	**1.44**	-15.4%	-44.0%
City	6.17	5.26	4.48	4.73	**3.83**	-19.2%	-38.0%
Docklands	0.72	0.98	0.00	0.00	**0.00**	n/a	-100.0%
Central London	9.46	8.81	6.66	6.43	**5.26**	-18.2%	-44.3%

Investment (£ m)	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10	3 months % change	12 months % change
West End	262.5	776.5	877.6	794.2	**944.9**	19.0%	260.0%
City	363.7	712.0	596.5	572.0	**689.8**	20.6%	89.7%
Docklands	0.0	0.0	0.0	1135.5	**20.0**	-98.2%	n/a
Central London	626.2	1488.5	1474.1	2501.7	**1654.7**	-33.9%	164.2%

Source: Knight Frank

The Central London office market



The West End

Mayfair/St James's
Mayfair and St James's refers to 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.

Soho/North of Oxford Street
Soho/North of Oxford Street refers to NW1, and W1 (excluding Mayfair).

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

Paddington/Kensington
Paddington/Kensington refers to SW3, SW7, W2, W8, W11, W14.

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

Strand/Covent Garden
Strand/Covent Garden refers to the area of WC2 bounded by Kingsway, Aldwych, Victoria Embankment, Charing Cross Road and New Oxford Street.

The City

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

Fringe
Fringe refers to SE1, E1, EC1 (excluding EC1A and EC1N), and EC2A.

Holborn/Fleet Street
Holborn/Fleet Street refers to EC1N, EC4A, EC4Y, WC1 (excluding Bloomsbury), and WC2 (excluding Strand/Covent Garden).

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 Royals Business Park (excluding Canary Wharf).

RESEARCH

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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.

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

Newmark Knight Frank Global