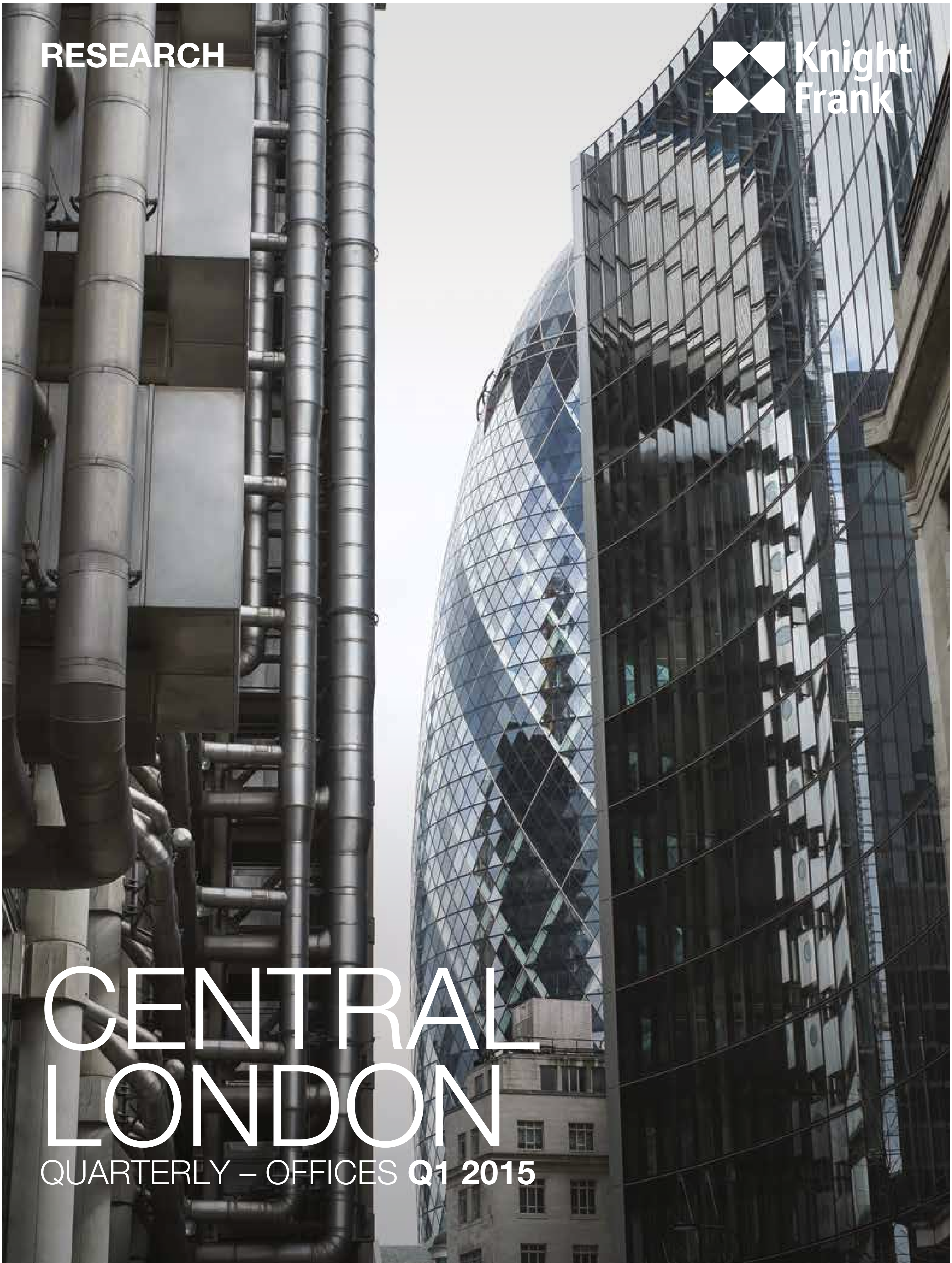
RESEARCH



CENTRAL LONDON

QUARTERLY – OFFICES **Q1 2015**

TAKE-UP MARGINALLY BELOW LONG-TERM AVERAGE

SUPPLY CONTINUES TO BE ERODED

YIELDS HARDEN ACROSS CENTRAL LONDON

CENTRAL LONDON CHIEF ECONOMIST'S VIEW

The Q1 figures continue a recent trend of the leasing market moving in the landlord's favour, but will tenants pay higher rents?

Across the capital, leasing supply is falling and the vacancy rate at 5.4% is at its lowest since Q3 2007. Coincidentally, prime rents are now rising above their 2007 peak levels. However, the interesting rent statistics are those from 2006.

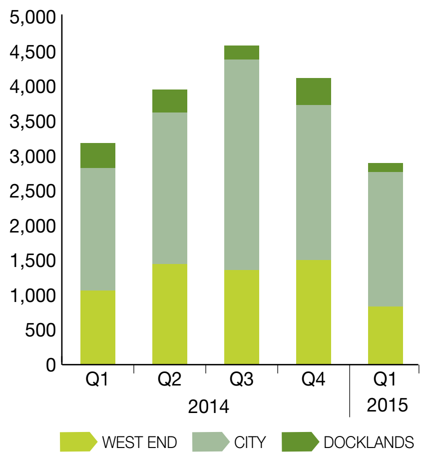
Many tenants across Central London, who have ten year leases expiring next year, who are probably reviewing their options now, face a nasty shock when they discover how high rents are on the open market. Based on prime rents, a typical West End tenant with a ten year lease expiring in 2016 is going to find rents are around 30-35% higher today than when they moved into their current office in 2006. For the City the equivalent figure is about 20%. Also, there is the double-whammy of the increase seen in business rates over this period – up over 70% for the West End core.

The tenant's reaction may be to stay put and regear. Yet more than at any time since 2007 they could today find that the landlord wants the space back.

FIGURE 1

Central London take-up by quarter & sub-market

Q1 2014 - Q1 2015 (000's sq ft)



This raises the question, will firms pay significantly more to remain in Central London?

Whether a firm stays depends on how key worker dependent they are, and what profit margins and growth prospects are like in their industry.

Because Central London is at the hub of such an extensive transport system, a firm based there can access a talent pool so geographically wide that a worker who lives in Cambridgeshire can be sat at a desk alongside one from Brighton or Swindon. Move that office from Central London to Berkshire and the pool of people who can, or are willing to commute there shrinks dramatically.

Talent-driven industries will be highly reluctant to rock the staff retention boat by leaving Central London. Salaries for many office-based firms typically account for around half of operating expenses, so an increase in property costs is far less significant compared to the damage caused by a surge in staff turnover.

Larger firms may look at moving support roles out to satellite offices in the regions. However, past experience suggests desks freed up tend to be used for headcount growth for fee-earning staff, so this tends to be a supply neutral occurrence.

As London's economy becomes dominated by high-value business services, the war for talented staff is becoming intense. Offices are increasingly viewed as a means of giving staff a work environment they are comfortable in, and matches their lifestyles. Our view is firms will pay more to be in the right location with the quality of offices that keep their talent happy, although we may see more use of flexible working to keep a lid on property costs.

Most firms are used to the idea that the majority of their business costs are higher now than they were in 2006. Why should property be viewed as different?

FIGURE 2

Central London availability by quarter & sub-market

Q1 2014 - Q1 2015 (000's sq ft)

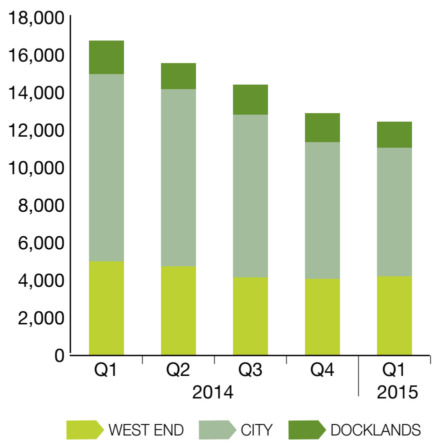
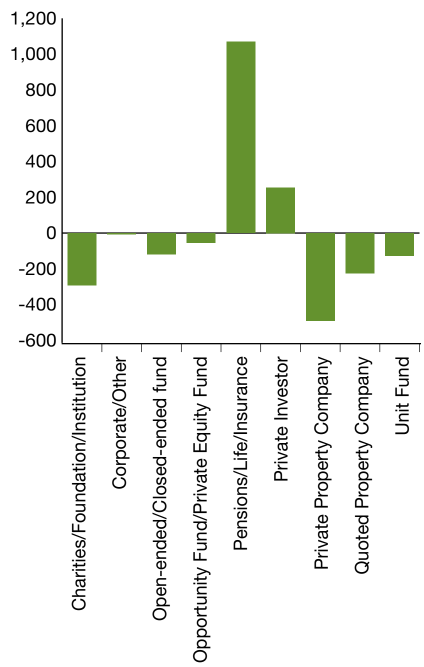


FIGURE 3

Central London net investment

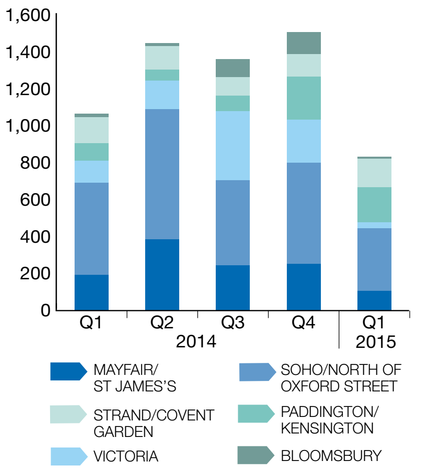
Q1 2015 (£ m's)



WEST END

- Take-up fell by 47% to 0.8 m sq ft
- Availability is now 18% below the long-term average
- Prime headline rents increased to £115.00 per sq ft
- Investment turnover in Q1 totalled £1.0 bn

FIGURE 1
West End take-up by quarter & sub-market
Q1 2014 - Q1 2015 (000's sq ft)



Demand

Take-up in the West End fell by 47% from 1.5 m sq ft at the end of 2014 to 0.8 m sq ft in Q1 2015, the lowest level since Q3 2012. After an exceptional 2014, the pause for breath was not unexpected and the outlook for 2015 does remain positive with tenant activity on the increase. There were just two deals over 50,000 sq ft during the quarter, with Facebook taking the top seven floors at 338 Euston Road totalling circa 65,000 sq ft and Aimia who took 57,000 sq ft at 80 Strand. Activity in the middle-market remained healthy, although there was a noticeable slowdown in the market for smaller units.

Despite the fall in transactions, more encouragingly, the level of active requirements increased by nearly 10% from 1.5 m sq ft to just over 1.6 m sq ft. Furthermore, market sentiment remains strong and we expect a return to form as the year progresses.

Supply

Availability in the West End by the end of Q1 2015 totalled 4.2 m sq ft, 14% below the same quarter last year and 18% below the long-term average of 5.6 m sq ft. The current vacancy rate is now 4.6%, well below the long-term average of 5.9%. Supply is particularly tight in the non-Core W1 market and the Northern Corridor. The vacancy rate in Victoria remains low at 1.2% although this sub-market will enjoy a wealth of new supply as development schemes come to fruition.

The volume of space under construction speculatively fell from 3.1 m sq ft at the end of Q4 to 2.5 m sq ft during the first quarter of the year as a number of schemes completed on site. These include 8 St James's Square, SW1 totalling 66,000 sq ft and 2 Fitzroy Place, W1 totalling just over 80,000 sq ft.

Rental profile

The prime headline rent rose for the fifth consecutive quarter, from £107.50 per sq ft to £115.00 per sq ft. This reflects an increase of 7.0% over the quarter, the highest quarterly growth since 2010 during the post-Global Financial Crisis recovery. Rent free periods have fallen to 15 months on a 10-year term certain in the prime Core market.

Investment

Investment turnover in the West End totalled just over £1.0 bn during the first quarter of 2015, on par with the long-term average and 35% higher than the same quarter last year. The level of transactions continues to be heavily influenced by the availability of stock. The first quarter saw pricing harden further, the prime yield fell from 3.75% to 3.50%, with downward pressure driven by weight of money and ongoing poor returns offered by other asset classes.

Overseas purchasers accounted for 54% of total sales by value, and pension/life/insurance companies were the most active during the quarter with 42% of the market share. The largest transaction of the quarter was the sale of Queensberry House, 3-9 Old Burlington Street, in which Norges Bank Investment Management purchased the freehold for £190.55 m, reflecting a NIY of 4.22% and a capital value of £2,080 per sq ft.

FIGURE 2
West End availability by quarter & sub-market
Q1 2014 - Q1 2015 (000's sq ft)

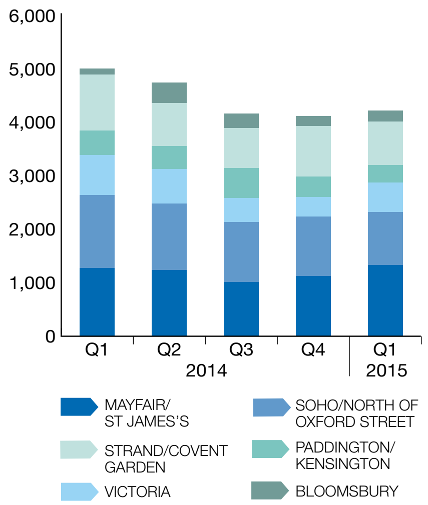
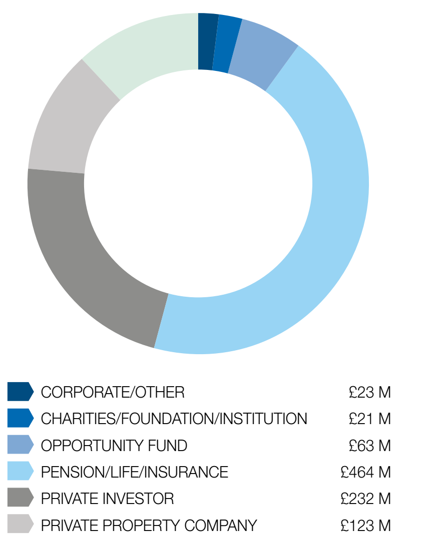


FIGURE 3
West End investment by purchaser
Q1 2015 (£m)



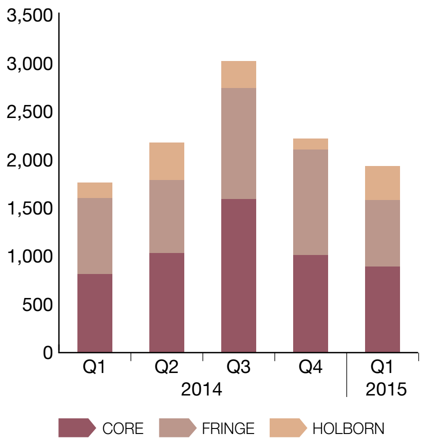
CITY

- Take-up totalled 1.9 m sq ft
- The vacancy rate fell to 5.7%, the lowest since 2001
- Prime headline rents rose to £65.00 per sq ft
- Investment turnover in Q1 reached £2.3 bn

FIGURE 1

City take-up by quarter & sub-market

Q1 2014 - Q1 2015 (000's sq ft)



Demand

After a particularly strong performance in 2014, activity levels in the City fell back in the first quarter of 2015. Take-up totalled 1.9 m sq ft, a fall of 13% on the previous quarter's level but above the long-term quarterly average of 1.8 m sq ft. The largest transaction of the quarter was Deloitte's pre-let of 1 New Street Square, EC4 totalling 258,000 sq ft. The markets surrounding the Core also attracted significant occupier interest, particularly from TMT and serviced office / collaborative space providers.

Active searches for City offices remain strong, with levels increasing to 4.5 m sq ft, 13% higher than the same point last year. This indicates a strong rate of replacement of requirements, particularly given the above-average levels of take-up seen over the last four quarters. Demand came from a mix of industries ranging from accounting to technology and finance to creative firms. This shows that the square mile's occupier base is continuing to diversify.

Supply & development

Availability continued its downward trend, with the quarter-end figure totalling 6.8 m sq ft. This is 33% below both the long-term average and the same point last year. The vacancy rate is now 5.7%, the lowest since 2001. We expect supply to tighten further during the course of 2015. There has been 9.3 m sq ft of space let in the last 12 months, which makes the 6.8 m sq ft currently available look worryingly low from a tenant's perspective.

The expected shortfall in supply is unlikely to be compensated for by the development pipeline. There is currently 1.7 m sq ft under construction speculatively and due for completion in the next three years. Considering there was 3.6 m sq ft of new and refurbished space taken up in the City in the last 12 months, we would expect to see a significant increase in pre-letting activity over the course of 2015.

Rental Profile

The scenario of diminishing supply and above-average demand has placed further upward pressure on rental values. The prime headline rent rose for the second consecutive quarter to £65.00 per sq ft. This represents growth of 8.3% in just six months.

Investment

The investment sales volume was down in comparison to the strong £4.6 bn transacted in Q4 2014, but at £2.3 bn was markedly higher than the long-term average of £1.8 bn. The City office prime yield hardened to 4.00% although 10-year Gilt yields were at c1.6% at the time of writing, so there is a positive spread of 240 bps. Just 12 months ago, the spread was 176 bps.

There were four sales in excess of £100 m during the quarter, three of which involved North American purchasers. The dominance of overseas investors in the City continued in the first quarter with only 37% of purchases involving domestic investors.

Given the low vacancy rate and the growing expectation that rents could rise further, we expect investors to continue to favour assets with either some availability or development sites.

FIGURE 2

City availability by quarter & sub-market

Q1 2014 - Q1 2015 (000's sq ft)

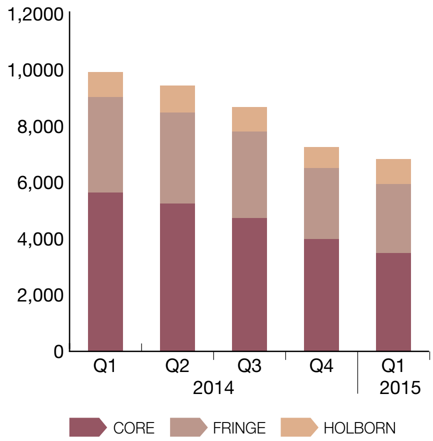
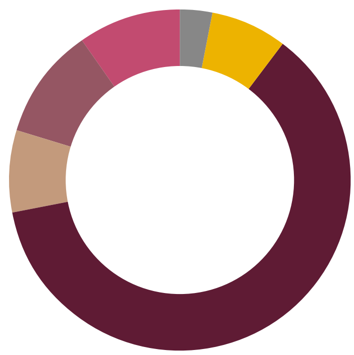


FIGURE 3

City investment by purchaser

Q1 2015 (£m)

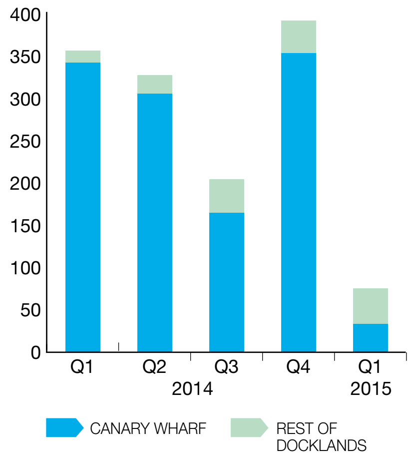


CHARITIES/FOUNDATION/INSTITUTION	£72 M
OPPORTUNITY FUND	£166 M
PENSION/LIFE/INSURANCE	£1,409 M
PRIVATE INVESTOR	£173 M
PRIVATE PROPERTY COMPANY	£243 M
QUOTED PROPERTY COMPANY	£219 M

DOCKLANDS

- Take-up fell 81% to 76,000 sq ft
- Availability fell by 10% to 1.4 m sq ft
- Prime headline rents increased to £37.50 per sq ft
- There were no investment sales during the first quarter of the year

FIGURE 1
Docklands take-up by quarter & sub-market
Q1 2014 - Q1 2015 (000's sq ft)



Demand

The final quarter of 2014 saw take-up levels at their highest for four years, so a fall in demand during Q1 2015 was unsurprising. Take-up in Docklands fell by 81% from 393,000 sq ft in Q4 2014 to 76,000 sq ft during the first quarter of the year. Despite the fall in demand, tenant activity remains positive, with nearly 200,000 sq ft under offer in Canary Wharf alone.

The largest deal of the quarter was at 10 Upper Bank Street totalling circa 27,000 sq ft, which was let to Mastercard on a 9-year lease, at an agreed rent of £38.00 per sq ft.

Supply

Following the steady level of take-up over recent quarters, the level of supply continued to erode with current availability now at 1.4 m sq ft, the lowest level since Q1 2009. In Canary Wharf, availability totalled 986,000 sq ft, the lowest level since Q4 2010 and 40% of which is available in just two buildings.

Rental profile

Prime rents in Canary Wharf rose by 4% from £36.00 per sq ft to £37.50 per sq ft, the first increase since Q2 2010.

Investment

There were no investment sales that completed during the first quarter of the year, following an unprecedented annual turnover last year. The lack of transactions is a result of the lack of stock in this sub-market, there are just two assets on the market in Canary Wharf, one of which is already under offer.

5 Churchill Place is under offer at a quoting price of £240 m, which reflects a NIY of 4.90% and a capital value of £765 per sq ft.

FIGURE 2
Docklands availability by quarter & sub-market
Q1 2014 - Q1 2015 (000's sq ft)

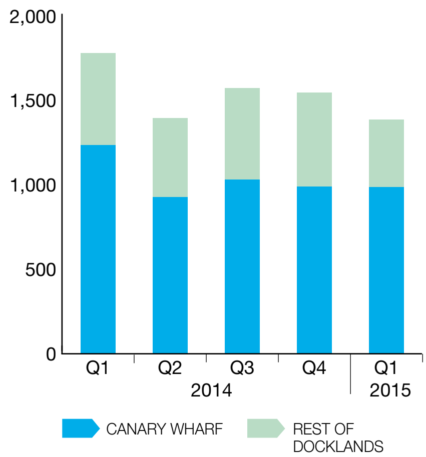
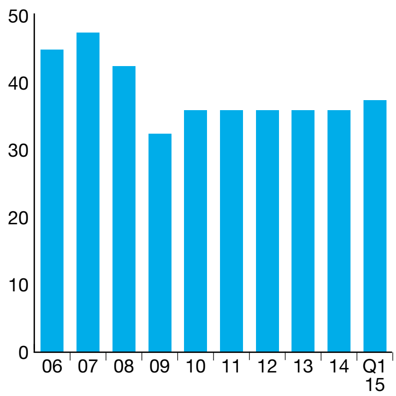


FIGURE 3
Canary Wharf prime rent
2006 - Q1 2015 (Prime £/sq ft)



KEY STATISTICS

Central London office market

Availability (m sq ft)	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	3 months % change	12 months % change
West End	4.90	4.90	4.90	4.90	**4.90**	4.90	4.90
City	9.97	9.45	8.68	7.27	**6.83**	-6.1%	-31.5%
Docklands	1.73	1.40	1.58	1.55	**1.39**	-10.3%	-19.7%
Central London	16.60	15.60	15.16	13.72	**12.45**	-9.3%	-25.0%

Vacancy Rate (%)	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	3 months % change	12 months % change
West End	5.3	5.2	4.5	4.4	**4.6**	n/a	n/a
City	8.4	7.9	7.3	6.1	**5.7**	n/a	n/a
Docklands	8.1	6.5	7.4	7.2	**6.5**	n/a	n/a
Central London	7.2	6.7	6.2	5.6	**5.4**	n/a	n/a

Take-up (m sq ft)	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	3 months % change	12 months % change
West End	1.07	1.45	1.37	1.51	**0.83**	-45.0%	-22.4%
City	1.78	2.18	3.02	2.22	**1.94**	-12.6%	9.0%
Docklands	0.36	0.33	0.20	0.39	**0.08**	-79.5%	-77.8%
Central London	3.21	3.96	4.59	4.12	**2.85**	-30.8%	-11.12%

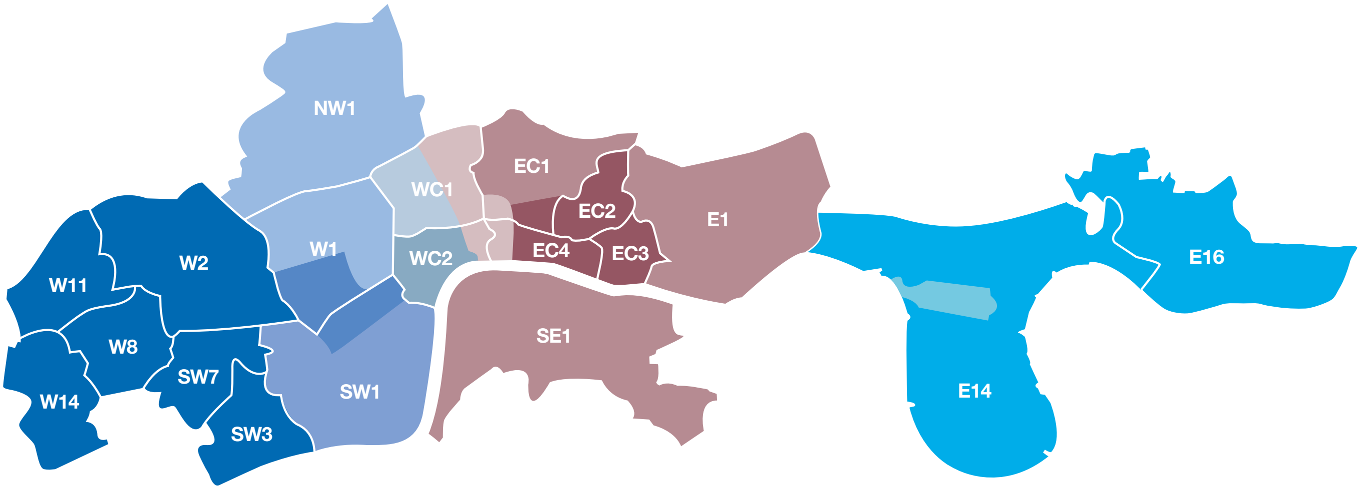
Active Demand (m sq ft)	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	3 months % change	12 months % change
West End	1.39	1.75	1.09	1.51	**1.64**	8.6%	18.0%
City	3.96	5.08	2.95	4.30	**4.46**	3.7%	12.6%
Docklands	0.22	0.99	0.97	0.94	**1.03**	9.6%	368.2%
Unspecified Central London	1.98	1.38	0.78	0.51	**1.65**	223.5%	-16.7%
TOTAL Central London	7.55	9.20	5.79	7.25	**8.78**	21.1%	16.3%

Under Construction (m sq ft)	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	3 months % change	12 months % change
West End	2.60	2.31	2.67	3.09	**2.50**	-19.1%	-3.8%
City	4.71	4.52	4.03	4.74	**5.08**	7.2%	7.9%
Docklands	0.53	0.00	0.00	0.00	**0.00**	n/a	-100.0%
Central London	7.84	6.83	6.70	7.83	**7.58**	-3.2%	-3.3%

Investment (£ m)	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	3 months % change	12 months % change
West End	762.2	1135.2	1899.0	2771.8	**1031.1**	-62.8%	35.3%
City	1164.7	2107.3	2146.5	4603.6	**2281.5**	-50.4%	95.9%
Docklands	262.0	828.8	353.7	1333.3	**0.0**	-100.0%	-100.0%
Central London	2188.8	4071.3	4399.2	8708.7	**3312.6**	-62.0%	51.3%

Source: Knight Frank Research

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).

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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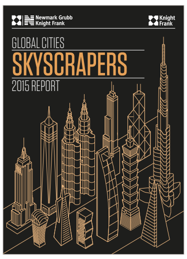

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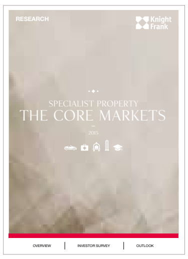

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