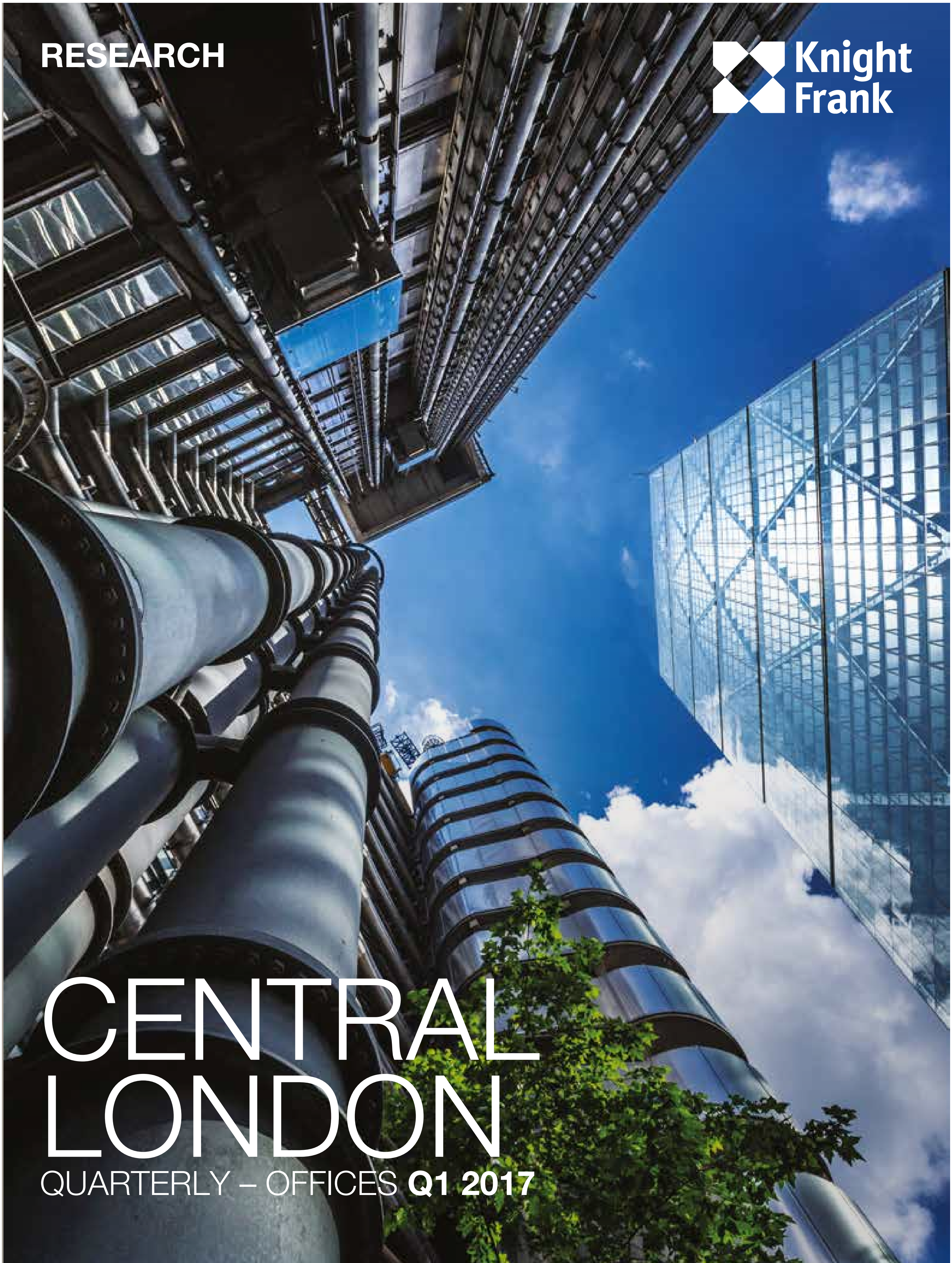
RESEARCH

Knight Frank



CENTRAL LONDON

QUARTERLY – OFFICES **Q1 2017**

CENTRAL LONDON RENTS REMAIN STABLE

CENTRAL LONDON PRIME YIELDS REMAIN STABLE

SUPPLY CONTINUES TO INCREASE ACROSS CENTRAL LONDON

THE RISE OF DIGITAL UBIQUITY

As an issue shaping occupier demand, leaving the EU will be gradually overshadowed in the next two years by the rise of Digital Ubiquity.

After the strong take-up recorded in Q4 last year, it would have been reasonable to expect a weak first quarter for occupier demand in Central London. Yet take-up has come in exactly at the long-term average – 3.10m sq ft. This cannot be dismissed as a few big deals inflating the figures. Deals of over 100,000 sq ft accounted for 17.5% of take-up, which is line with activity in the last ten years.

As in the previous quarter, the better-than-expected performance owes much to the on-going change in the composition of demand. In Q1, the Tech and Creative sector took over 700,000 sq ft of office space, towering over the finance sector at around 270,000 sq ft.

Take-up for Tech and Creative firms is running nearly 12% above long-term average, but this is perhaps generating a false impression of demand overall. By holding up so well, tech is disguising the clear weakening of finance activity. Meanwhile, Professional take-up was strong in part because some firms are consolidating and moving support jobs out of London.

Consequently, on demand we have a neutral situation. Some banks and lawyers reduce their London footprint (but do not leave entirely), then growth from the techs balances the books by absorbing the surplus space. The net result is average take-up, which is better than most would have expected nine months ago, but hardly the high-growth London we were so proud of back in 2015. So what might take demand above the average level in the future?

The answer relates to what I call Digital Ubiquity. I see this increasingly shaping office demand, as non-tech firms bring themselves in line with technology trends whose impact vastly overshadows the transitory phenomenon of Brexit.

At a time when there is concern over the outlook for the banking industry, we have the paradox of banks looking for new space to house their digital businesses. Some law firms are freeing up office space to start their own tech incubators and accelerators. Older tech firms are relocating from cheap out-of-town offices to trendy and more expensive central London districts, to be near the new wave in the digital revolution.

The tech and creative ethos and work practice is colonising the rest of the business world, as many firms are hurrying to adapt to the sudden and unexpected arrival of digital start-up competitors in their industries. Adaptation requires investment in reshaping the work environment, as people are the bedrock of an innovation economy, and a new office format can energise idea-sharing and communication.

This march to Digital Ubiquity was tentatively emerging trend in 2015, then it hit a road bump in 2016 with Brexit, which put a lot of business investment on hold temporarily. However, there are signs that Brexit is not going to be as disruptive as previously feared. The government is hinting at a transition deal, whereby EU rules will stay in place and free movement of labour continues beyond March 2019. In other words, we are heading for a compromise.

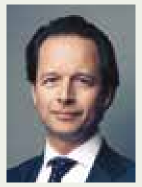
As this becomes more evident, the brakes on investment in the business world will be removed, and more non-tech firms will turn their attention back to transitioning to Digital Ubiquity. Most firms in the future, irrespective of industry, will operate the tech way, with knock-on implications for office demand.

In January there was widespread concern that banks would leave London en-masse, then in February the German Finance Minister told a conference "the financial centre of London will remain and be important to the EU economy as a whole". Brexit is receding as a threat to the outlook, and with employment levels currently at a record high, the pre-referendum trends in the London office market are resurfacing.

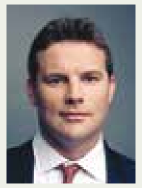
"Brexit is receding as a threat to the outlook, and with employment levels currently at a record high, the pre-referendum trends in the London office market are resurfacing."

JAMES ROBERTS
Partner, Chief Economist

CENTRAL LONDON VIEW



STEPHEN CLIFTON
HEAD OF CENTRAL LONDON OFFICES
"The theme emerging from the first quarter of 2017 has been 'business as usual' across Central London. Investment stock remains in high demand, occupier take-up is consistent with long-term average levels and supply is beginning to fall. The Central London market is in a good position to deal with the challenges this year may present."



DAN GAUNT
HEAD OF CITY AGENCY
"City availability rose significantly in the first quarter, which was largely a result of new developments coming to the market and space released through corporate activity. Levels will remain relatively high as new schemes enter the figures over the course of the year, however sentiment remains healthy and prime rents in all submarkets have remained stable."

IAN MCCARTER
HEAD OF WEST END AGENCY
"Conditions have improved in the leasing market, but there remains a lack of urgency in decision-making. We have seen the early activation of structural requirements from larger occupiers in anticipation of supply shortages later in the cycle. However, rent free periods have pushed out as landlords look to mitigate voids."

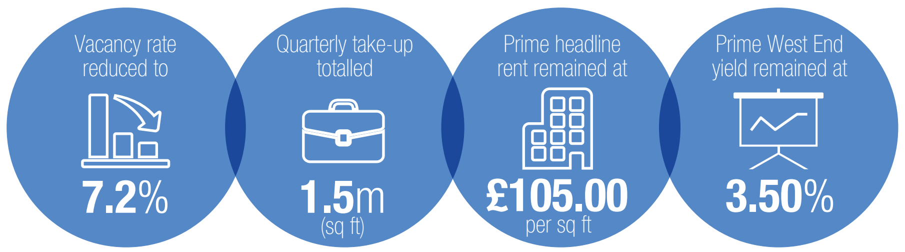
NICK BRAYBROOK
HEAD OF CITY CAPITAL MARKETS
"There was a significant increase in the amount of stock on the market in the first quarter as vendors look to capitalise on the weight of overseas money chasing trophy London assets. This will drive turnover levels as the year progresses. Yield compression remains likely as demand still outweighs supply."

ANTHONY BARNARD
HEAD OF WEST END CAPITAL MARKETS
"Despite strong trading during the 1st quarter, the current severe imbalance between available assets and the current high level of demand is likely to be a key feature of the West End investment market moving through the year. Turnover will inevitably fall due to a lack of available stock, but the prime yield of 3.50% shows no sign of softening."

RICHARD PROCTOR
HEAD OF CENTRAL LONDON TENANT REPRESENTATION
"The vacancy rate has now reached a level at which occupiers have a much greater choice of options than a year ago. In our experience, it is those landlords offering flexibility on lease term and competitive incentive packages that are best placed to attract tenants in the current market."

"Prime yields have remained stable at 3.50%. Whilst this level remains low for the West End, the high levels of equity targeting West End assets means we expect yields to hold at this level."

WEST END



Take-up

Take-up in the first quarter of 2017 reached 1.47m sq ft, a rise of 44% on the previous quarter, and 27% ahead of the long-term quarterly average. Fitzrovia saw the largest share of market activity, contributing to 21% of total take-up. This included the largest transaction for the quarter: Arup's acquisition of 80 Charlotte Street, W1, totalling 133,590 sq ft. There were four transactions in excess of 50,000 sq ft during the quarter, however the demand for smaller units under 5,000 sq ft remained high, accounting for 80% of total transactions.

The professional services and TMT sectors were particularly active, accounting for 30% of total transactions each, followed by business-to-business with 12%. Take-up of new and refurbished stock totalled 558,142 sq ft in the first quarter, 52% above the long-term quarterly average.

Active requirements

Total active requirements fell by 18% on the quarter to 3.21m sq ft, largely due to a number of requirements transacting during the last three months, however this is 17% ahead of the long-term average and is broadly in line with the same quarter last year.

The demand profile was dominated by both TMT and corporates accounting for 37% and 20% of demand respectively. There are currently four requirements over 100,000 sq ft, and a further ten of 50,000 sq ft and over.

Supply and development

Availability across the West End totalled 6.19m sq ft at the end of the first quarter of 2017, a fall of 12% on the previous quarter, and the first time West End supply has fallen for five consecutive quarters. Despite this, availability is still 14% above long-term average levels and 26% ahead of the same point last year.

The decrease in supply can be attributed to a strong quarter of take-up, paired with a reduction in development completions in comparison to previous quarters. Another factor is the 26% fall in second-hand Grade A supply quarter-on-quarter. Looking forward, supply levels are likely to be kept in check by the severely restricted speculative development pipeline in 2017.

Prime rents and incentives

In the West End, the prime rent remained stable at £105.00 per sq ft for the second consecutive quarter. Rent free periods remained unchanged at 18-21 months on a typical 10-year lease.

Investment

West End investment turnover in Q1 2017 totalled £2.13bn, 42% ahead of the previous quarter and 78% above the long-term quarterly average of £1.20bn. A total of 20 transactions took place with an average lot size of £107m, up from £51m the previous quarter.

Prime yields remained at 3.50% for the ninth consecutive quarter. The continued strong levels of equity targeting West End assets, means that we expect yields for prime stock to hold at this level.

Overseas investors continue to show their appetite for West End investments, dominating Q1 2017 turnover by 69% of total transactions. This is demonstrated by Deka Immobilien's purchase of 1 Rathbone Square, W1, for £435m, reflecting an initial yield of 4.25%. CC Land Holdings also made a significant purchase at 1 Kingdom Street, W2 for £292m, reflecting an initial yield of 4.86%.

FIGURE 1
West End availability
Q1 2016-Q1 2017 (million sq ft)

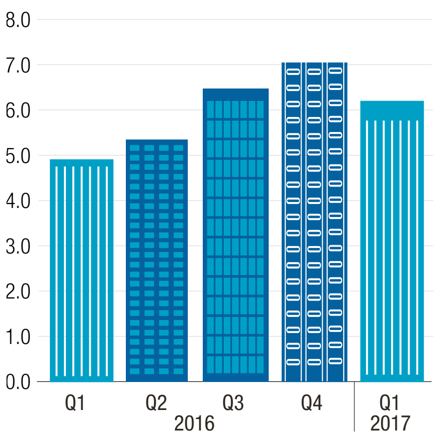
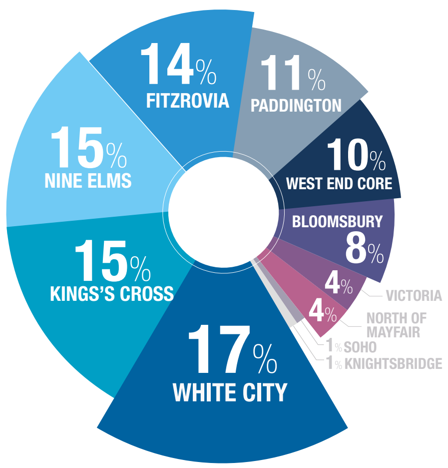
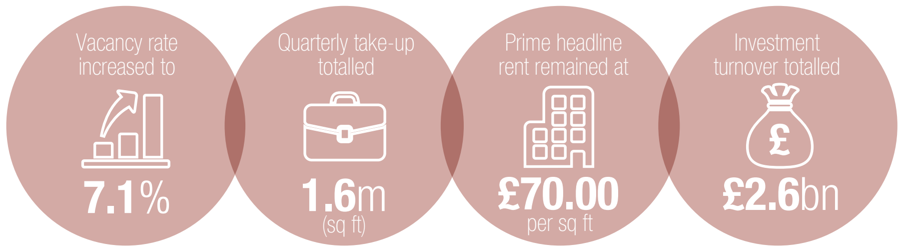


FIGURE 2
West End under construction by submarket
Q1 2017



CITY



Take-up

Take-up for the first quarter of 2017 totalled 1.62m sq ft, 19% below the level recorded in Q4 2016, but just 6% below the long-term average of 1.73m sq ft. The only submarket to record a growth in take-up from the previous quarter was Midtown, where levels increased by 58%.

The largest deal in the City, and across the entire London market, was the pre-letting of circa 256,000 sq ft to Freshfields Bruckhaus Deringer LLP at 100 Bishopsgate, EC2. The TMT sector continued to be the most active during Q1; the sector accounted for 39% of take-up, and half of the 10 largest deals. The professional sector was also buoyant, accounting for 32% of take-up.

Active requirements

Total active requirements increased by 24% from 3.65m sq ft in Q4 to 4.54m sq ft in the first quarter of the year, 12% above the long-term average. There was a significant rise in demand from both the TMT and financial sectors. Demand from the TMT sector increased by 77% totalling over 1.16m sq ft, while financial sector demand increased for the second consecutive quarter, totalling 1.47m sq ft, the highest level since Q2 2014.

Supply and development

City availability increased 12% from 7.70m sq ft at the end of 2016 to 8.60m sq ft by the end of Q1 2017, however levels are still 8% below the long-term average of 9.32m sq ft. The vacancy rate now stands at 7.1%, the highest level since Q3 2014. Despite the increase in supply, it should be noted that a significant amount (1.60m sq ft) of stock is currently under offer across the City. Supply of new and refurbished space totalled 3.39m sq ft on par with the long-term average.

There is currently 5.39m sq ft under construction speculatively, 14% above the level recorded the same quarter last year. There is just over 2.25m sq ft under construction due to complete this year; however 25% is already committed.

Prime rents and incentives

The prime rent remained stable at £70.00 per sq ft for the sixth consecutive quarter. Rent free periods remained unchanged from the previous quarter's level at 21-24 months on a typical 10-year term certain.

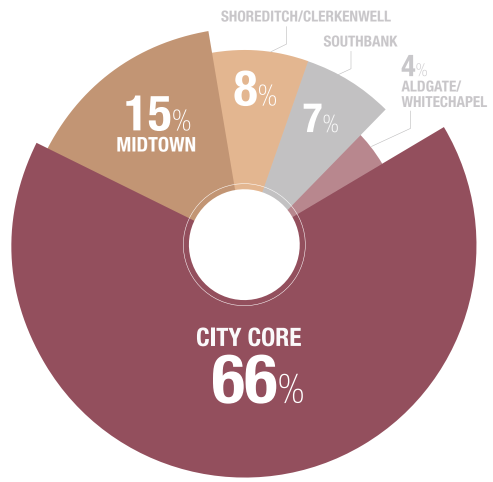
Investment

Investment turnover in the City was £2.59bn on par with the previous quarter and 42% above the long-term average. Overseas purchasers accounted for 87% of all transactions during Q1 by value. The largest transaction of the quarter was the purchase of The Leadenhall Building for £1.15bn which accounted for 44% of the total deal volume. Far Eastern investors continued to be dominant, accounting for 62% of total sales. There were seven transactions which took place over £100m, six of which involved overseas purchasers. Domestic buyers accounted for 17 of the 35 deals which took place being particularly active in the sub-£30m lot size range. The average lot size increased to £79m from £65m.

Availability rose by 86% totalling £4.13bn, although £1.29bn of this figure was already under offer. This is largely attributable to the top five properties on the market by price, which accounted for 51% of the total availability figure. There were ten properties on the market with a price of over £100m and three of these were under offer at the quarter end. The prime City yield remained unchanged at 4.25%.

FIGURE 3
City take-up
Q1 2016-Q1 2017 (million sq ft)

FIGURE 4
City under construction by submarket
Q1 2017



"The TMT sector once again dominated the City letting profile; the sector accounted for 39% of take-up. This business sector has been the most active in the City market for more than 12 months."

THE NEW FRONTIER

Central London is expanding, and White City is the latest new market on tenants' radars.

Central London has witnessed the birth of a number of new markets in recent times; the Southbank, Paddington and King's Cross to name a few. These markets have succeeded due to the quality of space constructed, extensive transport infrastructure (both existing and new), and the delivery of new amenity encouraging a mix of uses.

White City is the latest new market, and has a clear advantage over the other new office markets created in Central London over the last 20 years: much of the infrastructure, amenity and culture for which new areas strive is already in place.

The area has one of the highest ratings for public transport accessibility in London; Westfield London, Television Centre and nearby Notting Hill provide existing and planned leisure provision; and the future presence of Imperial College's campus, the Royal College of Art, and Soho House will contribute by offering an academic, creative and social environment

The office stock is dominated by the new White City Place development, offering 822,000 sq ft of space across four buildings:

- The MediaWorks, a 231,000 sq ft new building, has secured a 70,000 sq ft pre-let to online retailer Yoox Net-a-Porter, with a further 23,000 sq ft let to Huckletree
- Garden House, totalling 39,000 sq ft has been let to The Royal College of Art
- WestWorks, a new 296,250 sq ft building, is under construction and due for completion in Q2 2017
- 2 Television Centre, a new 273,000 sq ft speculative scheme under construction and due for completion in Q1 2018

The paucity of development pipeline space across Central London along with prime headline rents near all-time highs in the majority of submarkets, will drive tenants' searches towards attractively-priced, quality space. The relative discount of White City, where the prime rent is estimated to be £52.50 per sq ft with business rates of circa £17.00 per sq ft, suggests the area will increasingly feature in tenants' searches.

"Although take-up in Docklands has been uncharacteristically low, this is the first time levels have dropped below 50,000 sq ft in four years."

FIGURE 5
Canary Wharf availability
Q1 2016-Q1 2017 (million sq ft)

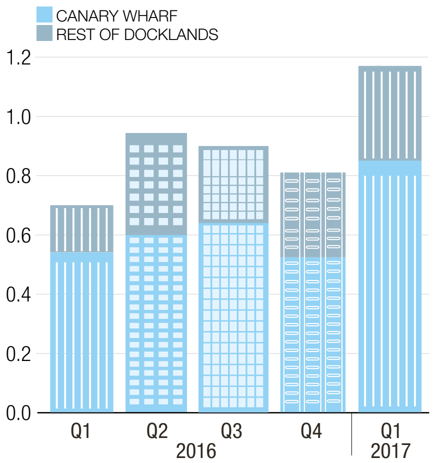
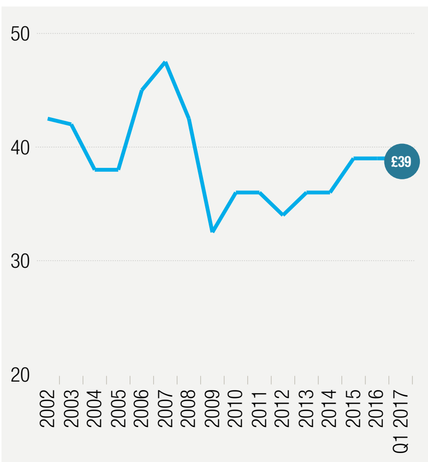
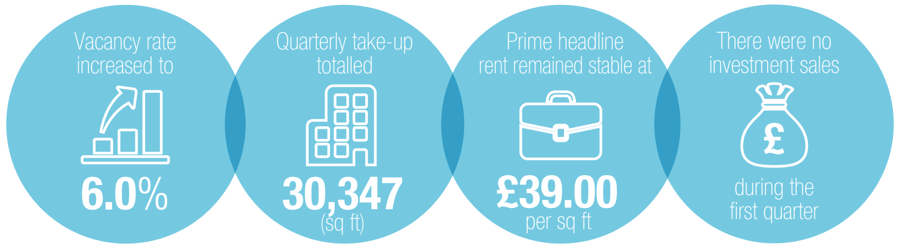


FIGURE 6
Canary Wharf prime headline rents
£ per sq ft



DOCKLANDS



Demand

Total take-up for Q1 2017 totalled just over 30,000 sq ft, the lowest figure for some years and well below the long-term average of 245,000 sq ft. The largest transaction of the quarter was at Capstan House, 1 Clove Crescent where Deliveroo acquired circa 15,000 sq ft on a short-term lease.

Take-up has been uncharacteristically low; this is the first time levels have dropped below 50,000 sq ft in four years. The level of take-up in Q4 2016 was the highest quarterly figure recorded in the last six years.

Active requirements

Total active requirements in Docklands increased by 18% to 709,000 sq ft, nearly 55% above the long-term average. The largest source of demand came from the corporate sector followed by the public sector.

Supply and development

Supply levels increased by 44% quarter-on-quarter from 0.81m sq ft in Q4 2016 to 1.17m sq ft in the first quarter, but still below the long-term average of 1.41m sq ft. The vacancy rate increased from 4.1% to 6.0%. Availability continues to comprise second-hand stock, with no new or refurbished supply on the market since Q3 2015.

There is no new & refurbished stock due to be delivered to the market until Q2 2019, and there is still just one building in Canary Wharf that is under construction: 1 Bank Street totalling 700,000 sq ft, which is not due for completion until 2019. There are a number of other development sites capable of being delivered in 2019, but are likely to remain on hold until a pre-let is secured.

Rental profile

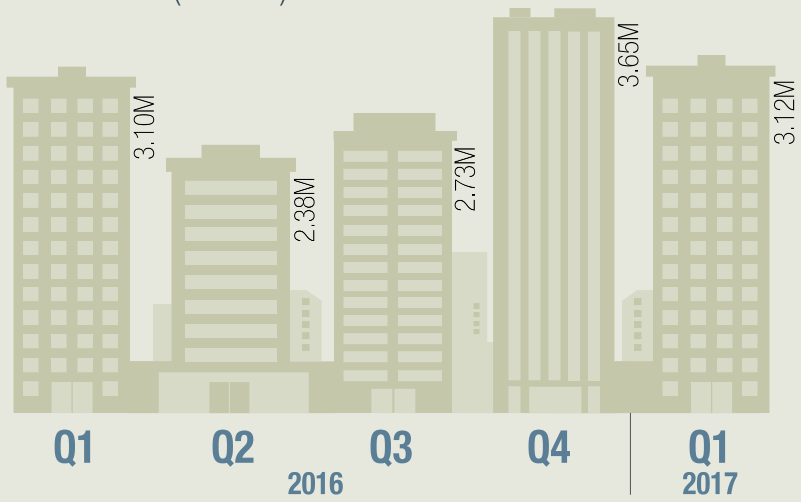
The prime headline rent remained stable at £39.00 per sq ft for the sixth consecutive quarter.

Investment

There were no investment sales during Q1 in Canary Wharf or the wider Docklands market. There is just one asset for sale in Canary Wharf; 20 Canada Square which is currently on the market for £418m, reflecting a NIY of 5.25% and a capital value of £720 per sq ft. The lack of stock in this market will continue to influence the investment figures for the foreseeable future.

CENTRAL LONDON Q1 2017 REVIEW

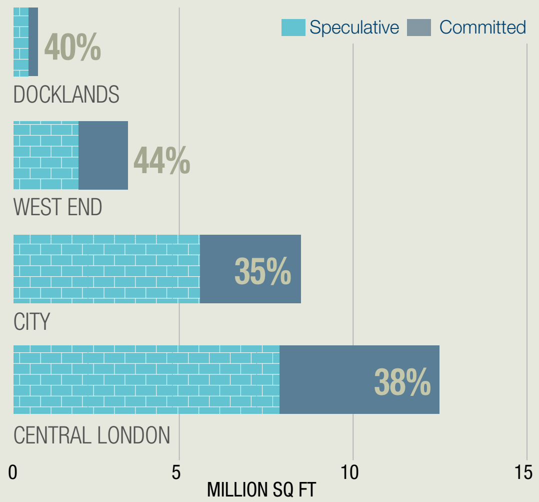
CENTRAL LONDON TAKE-UP (SQ FT)



Central London take-up remains healthy, the first quarter of 2016 saw take-up reach long-term average levels and exceeded the long-term Q1 average by 12%

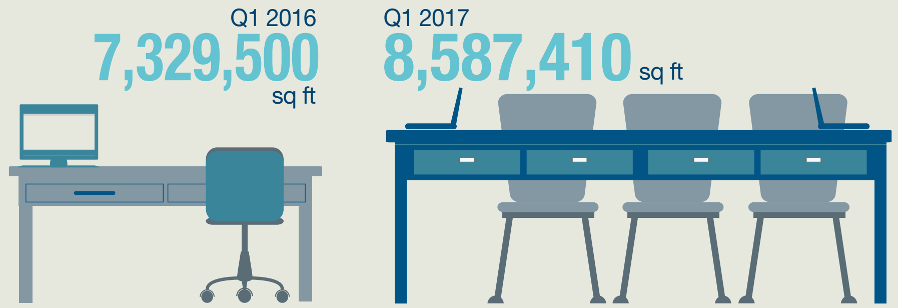
CENTRAL LONDON DEVELOPMENT PIPELINE

38% of the Central London pipeline between now and 2020 is already committed.



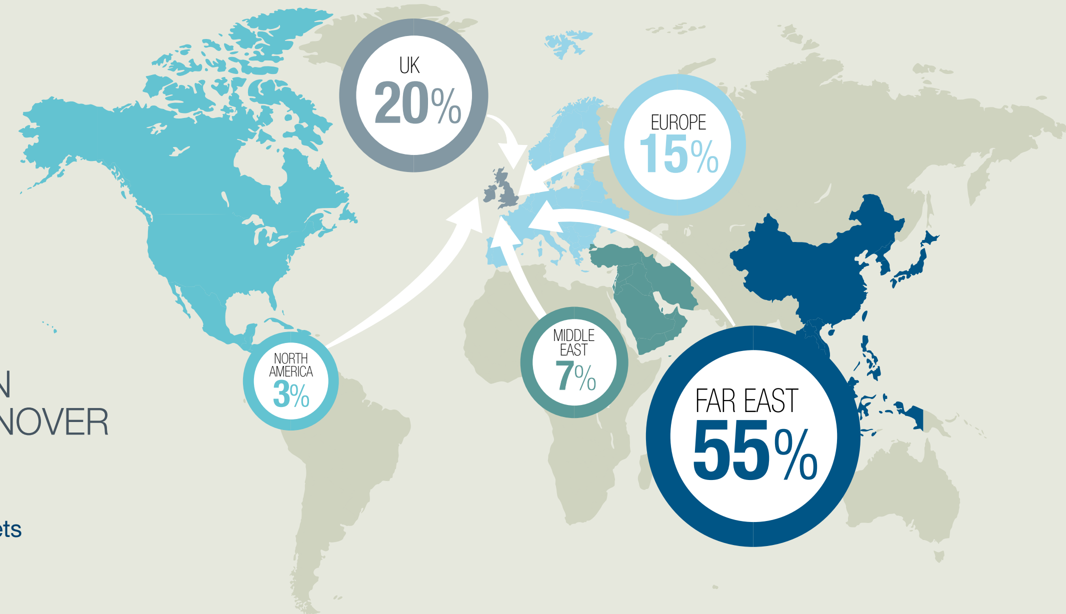
ACTIVE REQUIREMENTS

Despite Brexit, occupiers' appetite to acquire space in Central London continues with a 17% increase in active searches since Q1 last year



CENTRAL LONDON INVESTMENT TURNOVER Q1 2017

Overseas investors continue to target Central London assets



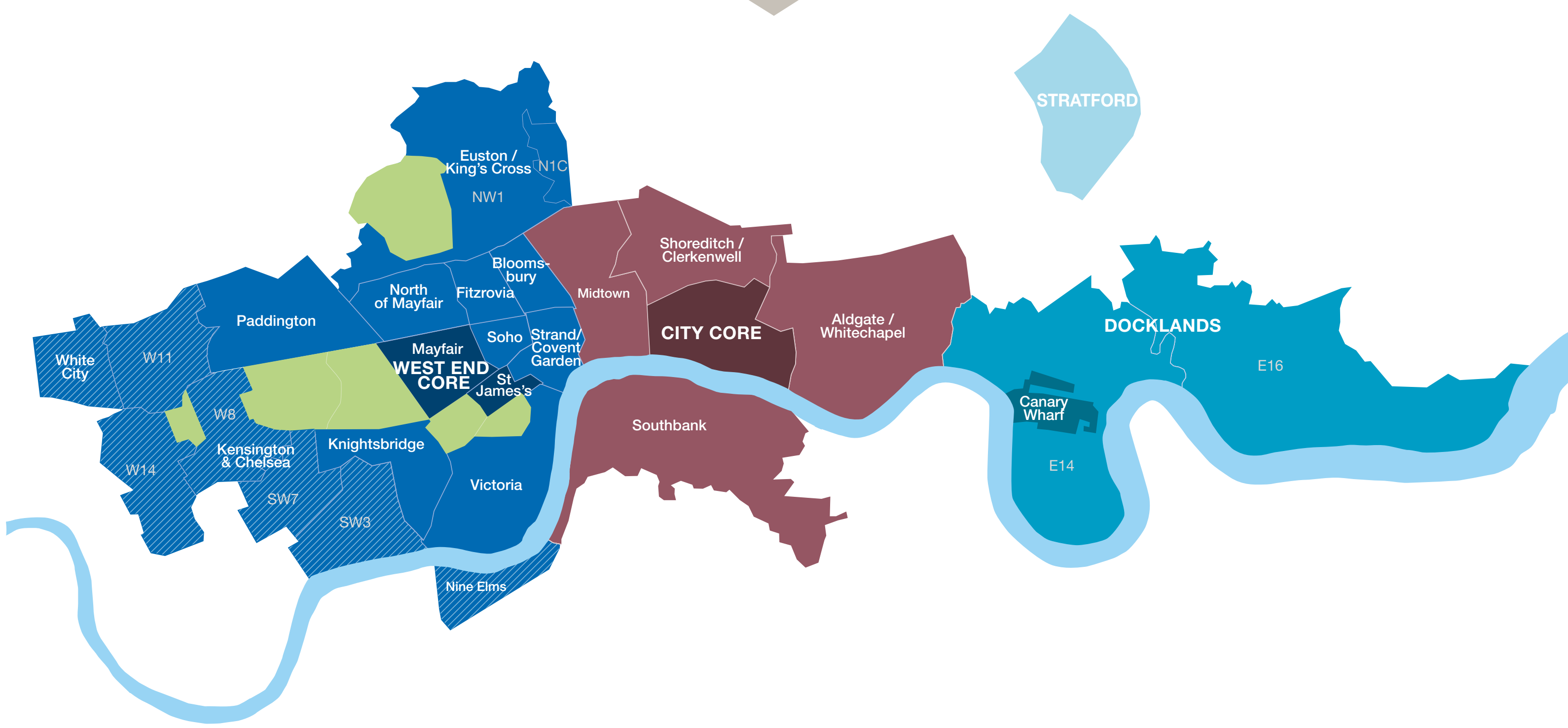
KEY STATISTICS

Central London office market

		Q1 16	Q2 16	Q3 16	Q4 16	Q1 17	% CHANGE 3 mths	12 mths	Long-term quarterly average
AVAILABILITY (sq ft)	West End	4.91 m	5.35 m	6.52 m	7.04 m	**6.19 m**	-12%	-12%	5.44 m
	City	5.37 m	7.32 m	7.62 m	7.70 m	**8.60 m**	12%	12%	9.32 m
	Docklands	0.71 m	0.94 m	0.91 m	0.81 m	**1.17 m**	44%	44%	1.41 m
	Central London	10.99 m	13.61 m	15.05 m	15.55 m	**15.96 m**	3%	3%	16.17 m
VACANCY RATE	West End	5.8%	6.4%	7.8%	8.3%	**7.2%**	n/a	n/a	6.1%
	City	4.6%	6.3%	6.6%	6.4%	**7.2%**	n/a	n/a	8.0%
	Docklands	3.5%	4.8%	4.6%	4.1%	**6.0%**	n/a	n/a	6.8%
	Central London	5.0%	6.2%	6.8%	6.9%	**7.1%**	n/a	n/a	7.2%
TAKE-UP (sq ft)	West End	0.92 m	1.01 m	1.37 m	1.02 m	**1.47 m**	44%	60%	1.16 m
	City	1.77 m	1.22 m	1.24 m	2.01 m	**1.62 m**	-19%	-8%	1.73 m
	Docklands	0.36 m	0.15 m	0.12 m	0.62 m	**0.03 m**	-95%	-92%	0.25 m
	Central London	3.05 m	2.38 m	2.73 m	3.65 m	**3.12 m**	-15%	2%	3.20 m
ACTIVE REQUIREMENTS (sq ft)	West End	2.36 m	2.49 m	2.69 m	2.71 m	**2.21 m**	-18%	-6%	1.89 m
	City	3.57 m	3.30 m	4.09 m	3.65 m	**4.54 m**	24%	27%	4.05 m
	Docklands	0.30 m	0.83 m	1.13 m	0.56 m	**0.67 m**	20%	123%	0.39 m
	Unspecified	1.10 m	1.98 m	1.62 m	1.65 m	**1.17 m**	-29%	6%	1.56 m
	Central London	7.33 m	9.09 m	9.53 m	8.57 m	**8.59 m**	0%	17%	7.89 m
UNDER CONSTRUCTION (sq ft)	West End	2.91 m	2.89 m	3.48 m	2.94 m	**3.31 m**	13%	14%	n/a
	City	8.69 m	8.78 m	9.39 m	10.30 m	**8.30 m**	-19%	-4%	n/a
	Docklands	0.70 m	0.70 m	0.70 m	0.70 m	**0.70 m**	0%	0%	n/a
	Central London	12.30 m	12.37 m	13.57 m	13.94 m	**12.31 m**	-12%	0%	n/a
INVESTMENT	West End	£0.98 bn	£1.36 bn	£1.13 bn	£1.50 bn	**£2.13 bn**	42%	117%	£1.20 bn
	City	£1.23 bn	£2.58 bn	£1.16 bn	£2.65 bn	**£2.59 bn**	-2%	111%	£1.82 bn
	Docklands	£0 bn	£0.13 bn	£0 bn	£0.04 bn	**£0 bn**	-100%	n/a	£0.44 bn
	Central London	£2.21 bn	£4.07 bn	£2.29 bn	£4.19 bn	**£4.72 bn**	13%	114%	£3.46 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 – 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).

STRATFORD

Stratford – Stratford refers to E20.

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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. 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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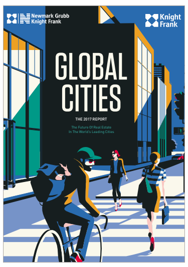

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