RESEARCH

Q3 2010 CENTRAL LONDON

Quarterly – Offices

Knight Frank

HIGHLIGHTS

- Take-up saw signs of recovery in the third quarter with levels rising by 29% across Central London. Demand fell by 11% due to some large requirements being satisfied this quarter, but we anticipate healthy take-up in the final quarter as significant volumes of space under offer in both West End and City markets transact.
- Availability continued to fall for the fourth consecutive quarter, as second-hand space began to be absorbed by tenants and the availability of new space remained thin. The development pipeline is still constrained in the short to medium-term, limiting the high quality options available to occupiers.
- The Central London investment market remained strong in Q3. Overseas investors continued to dominate market activity. Prime yields remained stable across both the City and the West End.

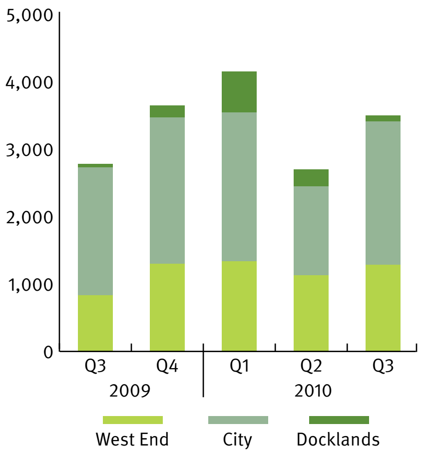
CENTRAL LONDON OVERVIEW

- **Take-up totalled 3.5 m sq ft, an increase of 26% from the same point last year.**
- **Availability totalled 19.6 m sq ft having fallen 20% over the last 12 months.**
- **Construction remained restricted falling a further 29% over the last year.**
- **Investment activity continued to improve in Q3, transaction levels 84% higher than the same quarter last year.**

Figure 1

Central London take-up by quarter & sub-market

Q3 2009 - Q3 2010 (000's sq ft)



Source: Knight Frank

Demand and take-up

Take-up across Central London saw signs of recovery in the third quarter with levels up by 29% from the previous quarter and 12% above the ten-year long-term average. The West End performed well witnessing a significant improvement in take-up levels over the last 12 months. In the City, there was a 62% increase in transactions although one large deal accounted for a third of all take-up.

Active demand fell back slightly in the third quarter, although this was mostly due to UBS transacting at 5 Broadgate. In Central London active demand has fallen by 21% to 6.6 m sq ft in the last 12 months. Going into the final quarter despite uncertainty over future financial sector regulation there is a significant quantum of space under offer which will hopefully help to keep take-up for the year at a healthy level.

Supply & development

Availability fell for the fourth consecutive quarter and now totals 19.6 m sq ft, 20% below its peak 12 months ago. Notably the availability of new and refurbished space has fallen by 35% over the same period despite the Heron Tower, which totals c415,000 sq ft and is due for completion in March 2011, entering the figures. Second-hand space availability in the West End has fallen by almost 1.0 m sq ft in the last 12 months, suggesting a slowing in the release of tenant space to the market.

The volume of space under construction speculatively has fallen by 29% in the last 12 months and now totals 3.1 m sq ft which is the equivalent of about 7 months take-up of new and refurbished space. Although some significant new schemes are planned to go ahead on a speculative basis, 2011 and 2012 will see the lowest levels of development completions recorded in Central London.

Investment

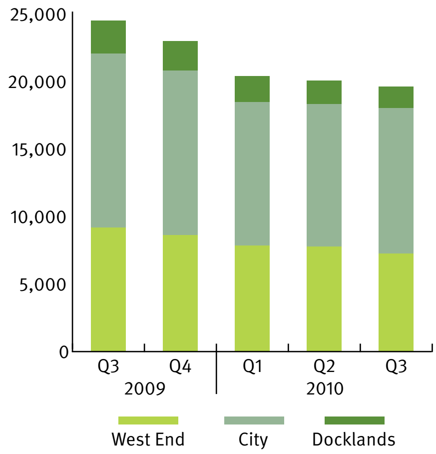
Overall investment turnover in Central London has remained strong, recording one of its highest levels since Q3 2007. However, much of this can be attributed to the sale of Alban Gate & The Thames Portfolio to Carlyle for £671 m. There is currently around £1.3 bn under offer in the City, suggesting turnover will remain strong in the final quarter of the year. In the West End on the other hand, turnover was lower than the previous quarter although Q2 turnover was artificially bolstered by the Knightsbridge Estate at £588 m. We still saw activity at levels above the long-term average and there is around £260 m under offer to take into the next quarter.

Once again, across Central London the majority of the activity was from overseas investors, who accounted for around 70% of turnover. Central London property is still keenly priced, with prime yields remaining steady across both markets.

Figure 2

Central London availability by quarter & sub-market

Q3 2009 - Q3 2010 (000's sq ft)

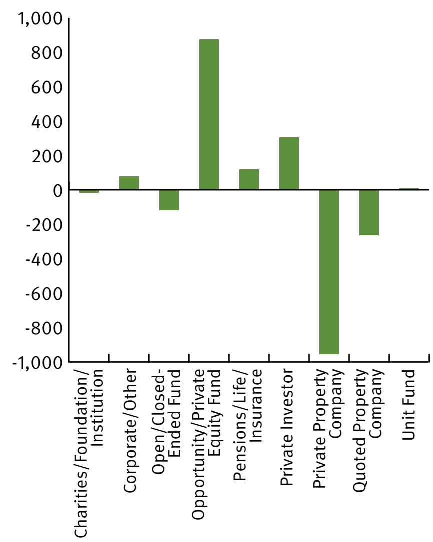


Source: Knight Frank

Figure 3

Central London net investment

Q3 2010 (£ m's)



Source: Knight Frank

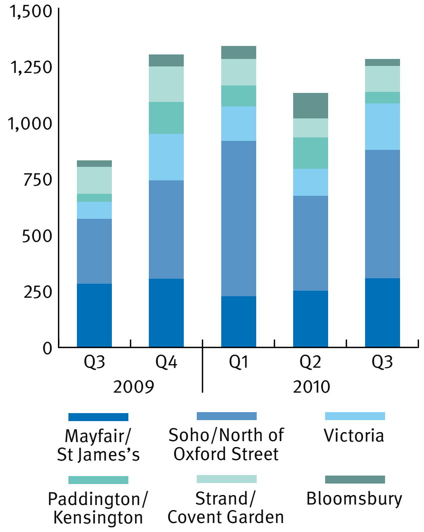
WEST END

- **Take-up in Q3 2010 was 1.3 m sq ft, up 13% on the previous quarter.**
- **Active demand totalled 1.9 m sq ft, 8% below the same quarter last year.**
- **Vacancy rate now stands at 8.0%, with availability falling to 7.3 m sq ft.**
- **Prime headline rents remained at £82.50 per sq ft.**

Figure 1

West End take-up by quarter & sub-market

Q3 2009 - Q3 2010 (000's sq ft)



Source: Knight Frank

Demand & take-up

Take-up in the West End increased by 13% in Q3 2010 to 1.3 m sq ft, 9% above the ten-year long-term average. We have seen a significant recovery in transactions, with levels 54% higher than the same quarter last year. Whilst we have seen growth over two consecutive quarters, there was a further fall in take-up of new and re-furbished space. Although we did see levels of second-hand take-up rise 25%, highlighting the lack of quality options on the market. The largest deal of the quarter was at 20 Triton Street where Lend Lease took 80,000 sq ft at British Land's new development.

Active demand fell by 10% in the third quarter from 2.1 m sq ft to 1.9 m sq ft as a number of medium to large requirements were satisfied. The sector that saw the greatest fall in demand was the professional sector, falling 49% in the last three months.

Supply & development

Availability fell for a fourth consecutive quarter to 7.3 m sq ft taking the vacancy rate in the West End to 8.0%, the lowest level since Q4 2008. Levels of new & refurbished space are still restricted, falling a further 15% this quarter. We expect availability to continue to decline in the short-term due to the low level of development completions over the next twelve months.

The volume of space under construction speculatively increased by 71% in the third quarter from 0.8 m sq ft to 1.4 m sq ft. Five new schemes went under construction including British Land's Regents Place 3 & 4 on the NEQ site (c360,000 sq ft) and Land Securities' 62 Buckingham Gate (c255,000 sq ft). Although the medium-term pipeline will still be constrained as these schemes are not due for completion until mid-2013.

Rental profile

The prime headline rent remained at £82.50 per sq ft, but with availability continuing to fall, we expect to see a further increase in rental levels before the year end. Rent free periods have fallen slightly this quarter and are now at 19 months on a ten-year term certain.

Investment

Turnover in the third quarter was £915 m, nearly 50% lower than last quarter when the purchase of the Knightsbridge Estate for £580 m skewed the figures. This is still 19% above the ten-year long-term average. The two largest transactions of Q3 accounted for 35% of total turnover, the largest being the purchase of Grand Buildings by a Private Russian Investor from Istithmar for £174 m reflecting a 5.12% NIY.

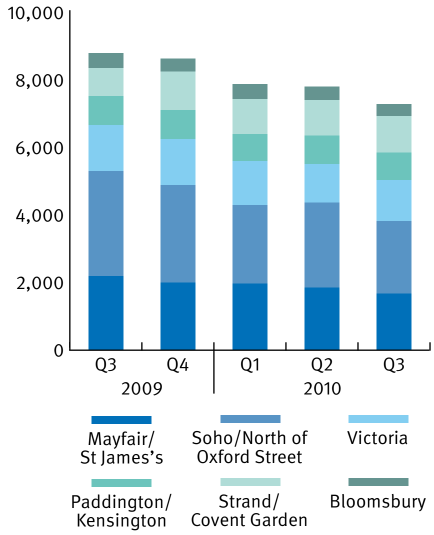
Overseas private investors continued to be the most active purchasers, accounting for more than half of all acquisitions by value.

Demand remains strong for prime stock in the Core and added value instructions, although with vendors' pricing expectations exceptionally high and a thin market at the £100 m+ level some larger assets are struggling to sell. Prime core West End Yields remain at 4.25%.

Figure 2

West End availability by quarter & sub-market

Q3 2009 - Q3 2010 (000's sq ft)

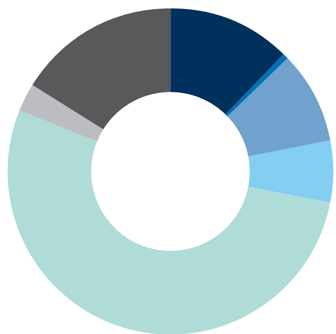


Source: Knight Frank

Figure 3

West End investment by purchaser

Q3 2010 (£ m's)



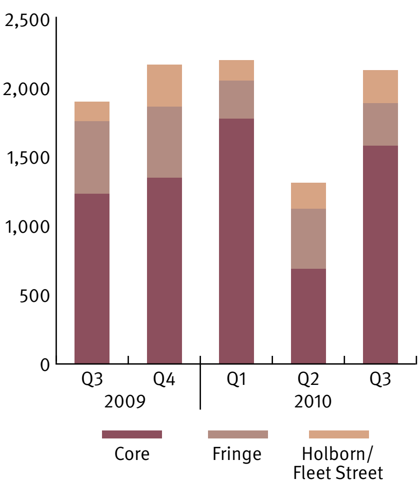
Corporate/Other	£113 m
Opportunity Fund	£6 m
Open-ended/ Closed-ended Fund	£84 m
Pension/Life/Insurance	£55 m
Private Investor	£487 m
Private Property Company	£25 m
Quoted Property Company	£146 m

Source: Knight Frank

CITY

- **Take-up rises to 2.1 m sq ft, but one deal accounted for a third of activity.**
- **Availability edged up to 10.8 m sq ft as the Heron Tower entered supply.**
- **City prime normal rent increased to £52.50 per sq ft.**
- **Strongest quarterly investment transaction volume since 2007.**

Figure 1
City take-up by quarter & sub-market
Q3 2009 - Q3 2010 (000's sq ft)



Source: Knight Frank

Demand and take-up

Take-up increased to 2.1 m sq ft in Q3, up from 1.3 m sq ft in the previous quarter, although one deal, the pre-let by UBS of the 700,000 sq ft 5 Broadgate, buoyed the figures. The middle market of 100-200,000 sq ft deals was not in evidence, as many medium-sized occupiers were reluctant to press ahead with office searches due to uncertainty on the business outlook. The volume of sub-100,000 sq ft deals increased, overwhelmingly driven by structural demand.

Concerns over the possibility of a double-dip recession and the shape of future financial markets' regulation are casting a shadow over sentiment. Of the two issues, we view the financial regulation as the main potential threat to the recovery, and we expect this to remain a brake on activity until the issue is settled. However, this does create the possibility of a demand fillip if the new regime proves to be appropriate not onerous, as tenants on the sidelines now will probably reactivate searches.

Supply and development

Availability increased slightly to 10.8 m sq ft, up from 10.5 m sq ft in Q2, as The Heron Tower (415,000 sq ft) entered the supply figures. As this was a long expected pipeline addition to supply we are not viewing this increase as greatly significant. Second-hand availability remained unchanged, as the smaller deals which dominate the demand profile are only causing supply to churn for this grade of space. Stronger expansion-led demand will be necessary to erode second-hand supply.

While as of quarter-end the volume of speculative space under construction had fallen to 1.7 m sq ft, in October joint ventures were agreed which will probably start development of 20 Fenchurch Street (627,000 sq ft) and The Leadenhall Building (617,000 sq ft). Both are scheduled to arrive in 2014, however the pipeline for 2011 to 2013 still appears inadequate compared with average levels of take-up.

Rental profile

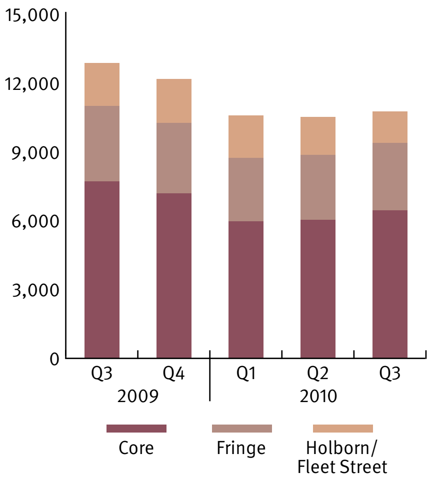
City Core prime normal rents increased to £52.50 per sq ft, up from £50.00 per sq ft at the end of Q2. Since quarter-end rents have nudged up further, and the tone by late October is in excess of £53.00 per sq ft, with deals on tower / trophy space in the high £50s. Rent free periods are now at 21 to 24 months for a ten-year deal.

Investment market

The City investment transaction volume increased to £1.6 bn, its highest level since 2007. As with take-up a large deal inflated the figures. Carlyle's purchase of Alban Gate and the Thames Portfolio for £671 m accounted for 41% of activity. Foreign investors continue to dominate the market, as UK funds have struggled to find properties of appropriate lot sizes.

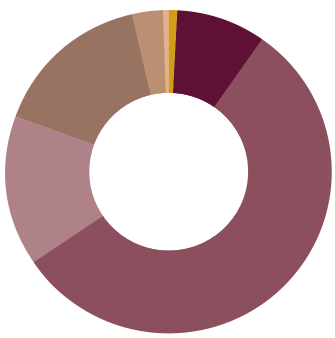
Prime yields remained unchanged at 5.25%, which has been driven well below the long-term average level of 5.65% in the face of on-going rental growth. The historically low gilt yields and a consensus view that interest rates will remain low for now, are keeping prime looking relatively good value for now. However, buyer interest continues to move up the risk curve in search of better returns, easing downwards pressure on prime yields. The market remains characterised by a lack of quality stock in the middle market.

Figure 2
City availability by quarter & sub-market
Q3 2009 - Q3 2010 (000's sq ft)



Source: Knight Frank

Figure 3
City investment by purchaser
Q3 2010 (£ m's)



Corporate/Other	£17 m
Open-ended/ Closed-ended Fund	£143 m
Opportunity Fund	£917 m
Pension/Life/Insurance	£248 m
Private Investor	£257 m
Private Property Company	£53 m
Unit Fund	£5 m

Source: Knight Frank

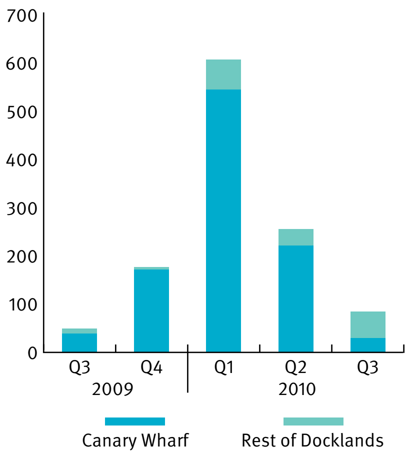
DOCKLANDS

- **Take-up was low in Q3, but activity has picked up in October.**
- **Positive signals from financial occupiers.**
- **Availability declined for the fourth quarter in a row.**
- **Prime rents at Canary Wharf unchanged.**

Figure 1

Docklands take-up by quarter & sub-market

Q3 2009 - Q3 2010 (000's sq ft)



Source: Knight Frank

Demand & take-up

Take-up in Q3 at 84,000 sq ft was relatively low, although this market typically has a 'stop-go' pattern to activity. Since quarter end HSBC have acquired 83,000 sq ft on three floors at One Canada Square, as they refurbish their headquarters on a rolling basis. Given the speculation on the future of HSBC's occupation in the UK, this is an encouraging development.

Outside of Canary Wharf the largest deal signed in Q3 was Qicomm taking 22,500 sq ft at City Reach 1 at Greenwich View Place. Generally speaking, the market outside of Canary Wharf has seen subdued demand this year, although levels of enquiries have picked up since Q1 2010.

Supply and development

Supply in Docklands edged down to 1.6 m sq ft, the fourth consecutive quarter in which availability has fallen. This takes the vacancy rate to 7.3%, while at Canary Wharf the level is lower still at 7.1%. Outside of Canary Wharf the vacancy rate is 8.0%. Given the HSBC deal, and the absence of any development activity, supply remains under pressure for now.

Media speculation continues on whether JPMorgan Chase may yet pull out of the proposed Riverside South development (1.8 m sq ft), though there has still been no announcement at the time of writing.

Rental profile

Prime rents in Canary Wharf on whole floors remained unchanged at £36.00 per sq ft compared to three months ago. Outside of Docklands prime rents were also steady at £22.50 per sq ft. The relatively low vacancy rates have not proved a catalyst for strong rental growth, suggesting landlords remain cautious.

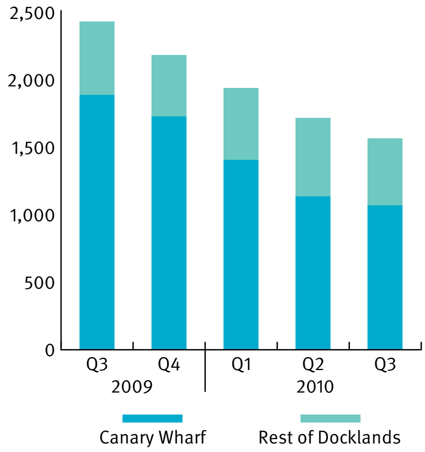
Investment market

The third quarter only saw one office investment deal, with the freehold of the 43,000 sq ft Limehouse Court selling for £5.8 m, reflecting a net initial yield of 6.43%. The deal was above the asking price of £5.5 m.

Figure 2

Docklands availability by quarter & sub-market

Q3 2009 - Q3 2010 (000's sq ft)

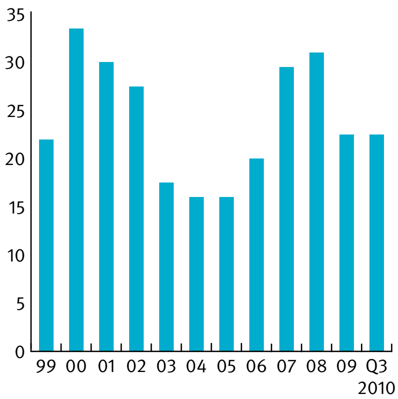


Source: Knight Frank

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)	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	3 months % change	12 months % change
West End	9.22	8.64	7.88	7.81	**7.29**	-6.6%	-20.9%
City	12.90	12.18	10.59	10.54	**10.77**	2.2%	-16.5%
Docklands	2.44	2.19	1.94	1.72	**1.57**	-8.8%	-35.7%
Central London	24.55	23.01	20.42	20.07	**19.63**	-2.2%	-20.0%

Vacancy Rate (%)	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	3 months % change	12 months % change
West End	10.2	9.5	8.7	8.6	**8.0**	n/a	n/a
City	11.0	10.4	9.0	9.0	**9.2**	n/a	n/a
Docklands	11.4	10.2	9.1	8.0	**7.3**	n/a	n/a
Central London	10.9	10.2	9.0	8.9	**8.6**	n/a	n/a

Take-up (m sq ft)	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	3 months % change	12 months % change
West End	0.83	1.30	1.34	1.13	**1.28**	13.4%	54.2%
City	1.90	2.17	2.20	1.32	**2.13**	62.0%	12.0%
Docklands	0.05	0.18	0.61	0.26	**0.08**	-67.0%	69.4%
Central London	2.78	3.65	4.15	2.70	**3.50**	29.4%	25.6%

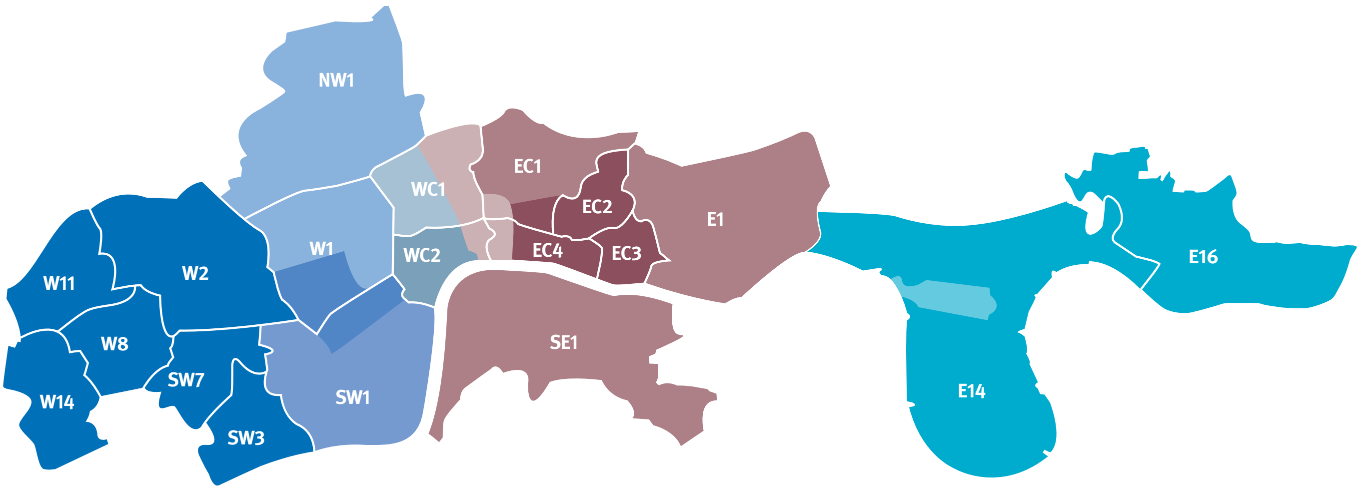
Active Demand (m sq ft)	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	3 months % change	12 months % change
West End	2.07	1.79	1.88	2.11	**1.91**	-9.7%	-8.0%
City	3.64	4.67	3.73	4.34	**3.05**	-29.7%	-16.2%
Docklands	0.33	0.50	0.48	1.00	**0.00**	-100.0%	-100.0%
Unspecified Central London	2.30	1.24	0.88	0.89	**1.64**	85.3%	-28.7%
TOTAL Central London	8.34	8.20	6.86	9.92	**6.60**	-33.5%	-20.9%

Under Construction (m sq ft)	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	3 months % change	12 months % change
West End	2.17	1.70	1.44	1.25	**1.36**	8.2%	-37.6%
City	4.48	4.73	3.83	3.30	**1.88**	-43.0%	-58.0%
Docklands	0.00	0.00	0.00	0.00	**0.00**	n/a	n/a
Central London	6.66	6.43	5.26	4.55	**3.24**	-28.9%	-51.3%

Investment (£ m)	Q3 09	Q4 09	Q1 10	Q2 10	Q3 10	3 months % change	12 months % change
West End	877.6	794.2	944.9	1685.0	**915.3**	-45.7%	4.3%
City	596.5	572.0	689.8	1029.6	**1638.2**	59.1%	174.7%
Docklands	0.0	1135.5	20.0	134.6	**5.8**	-95.7%	n/a
Central London	1474.1	2501.7	1654.7	2849.2	**2559.4**	-10.2%	73.6%

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