RESEARCH

Q3 2012

CENTRAL LONDON

Quarterly – Offices

Knight Frank

HIGHLIGHTS

- Take-up remained below the long-term average in the third quarter, with 2.1 m sq ft of transactions completed. However, the technology, media and telecoms sector once again dominated the demand profile through searches across Central London and is likely to drive take-up into the next quarter.
- Availability fell to 16.3 m sq ft, reflecting a vacancy rate of 7.1%. The availability of second-hand space is at one of its lowest levels since mid-2008, however a number of speculative schemes are due to enter the supply figures in 2013.
- Investor demand for Central London commercial real estate remained strong with £3.1 bn transacted in the third quarter. This takes the total for the year to £10 bn, already 11% above the total for 2011. Overseas investors remained focused on prime Central London offices.

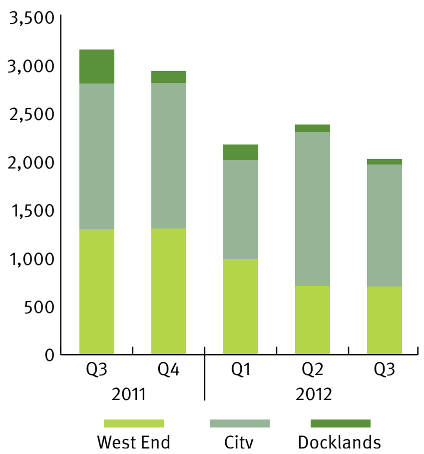
CENTRAL LONDON OVERVIEW

- **Take-up remained low at 2.1 m sq ft, 27% below the long-term average.**
- **Availability fell to 16.3 m sq ft, reflecting a 7.1% vacancy rate.**
- **Speculative construction fell to 5.4 m sq ft, 8% below the previous quarter.**
- **Investment turnover totalled £3.1 bn.**

Figure 1

Central London take-up by quarter & sub-market

Q3 2011 - Q3 2012 (000's sq ft)



Demand and take-up

Leasing activity across Central London remained muted in the third quarter, as the market continued to work through the uncertainty over the strength of the economy and the future of the Eurozone at the beginning of the year. Total take-up was just 2.1 m sq ft, 27% below the long-term average. While the news that the UK economy grew in the third quarter is welcome, the effects are unlikely to be seen across Central London until the first quarter of 2013 as the market tends to lag movement in the wider economy by 6 months.

Although take-up was disappointing, there was a noticeable improvement in sentiment across all markets over the summer.
In both the City and West End the technology, media and telecoms sector remained particularly acquisitive. Google is expected to complete the forward purchase at King's Cross Central during the final quarter, which will provide up to 700,000 sq ft of space. It has also been reported that Amazon has launched a large requirement in the order of 300,000 sq ft+. We expect the TMT sector to continue to drive market activity over the next 12 months.

Supply & development

Availability continued to fall across all markets for the second consecutive quarter and now totals 16.3 m sq ft, almost 20% below the long-term average. This reflects a vacancy rate of 7.1%. The supply of new and refurbished space is particularly low with just 4.8 m sq ft available to lease – well below the 7.8 m sq ft on the market at the same point in 2009. However, we expect availability to level out for the next 12 months as the new space being delivered balances out the falling levels of available second-hand space.

Much of the speculative development that commenced during 2011 will enter the availability figures from next quarter. There is currently 5.4 m sq ft under construction, 3.0 m sq ft of which is due to complete during 2013. This represents an opportunity for occupiers to secure new, quality space in advance of the rental growth that is expected from next year as the global economy strengthens.

Investment

Investment turnover totalled £3.1 bn in the third quarter, lower than the £3.9 bn transacted in the previous quarter but still 17% higher than the long-term average. Domestic investors accounted for around 38% of all transactions, with Hines / HSBC Alternative Investments behind the largest purchase of the quarter; the acquisition of Broadgate West I & II for £289 m. As has been the case for some time, overseas investors continued to dominate the purchaser profile with demand from sovereign wealth funds concentrated on large trophy assets in both the City and West End.

Demand from domestic investors was largely concentrated on smaller assets, with UK purchasers accounting for almost 60% of sub-£50 m transactions. The gap between Central London prime yields and government 10-year bonds remains wide enough for real estate in the capital to remain a competitive safe-haven investment.

Figure 2

Central London availability by quarter & sub-market

Q3 2011 - Q3 2012 (000's sq ft)

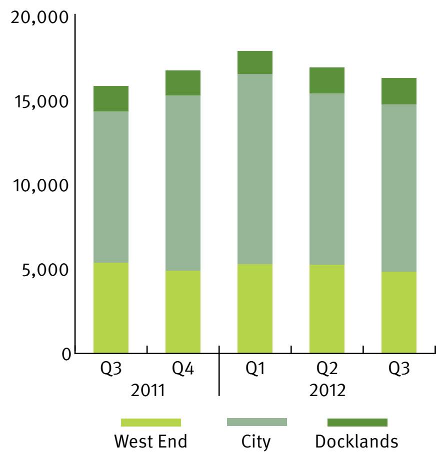
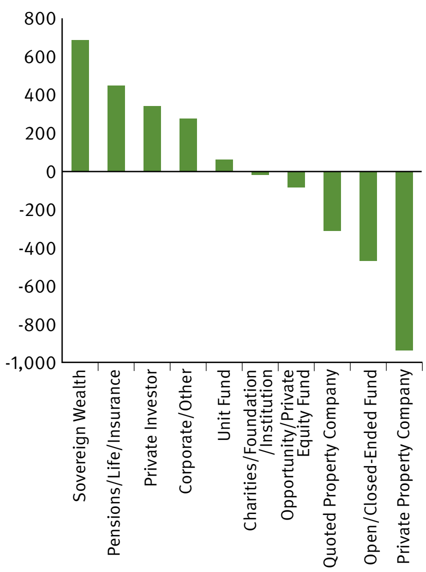


Figure 3

Central London net investment

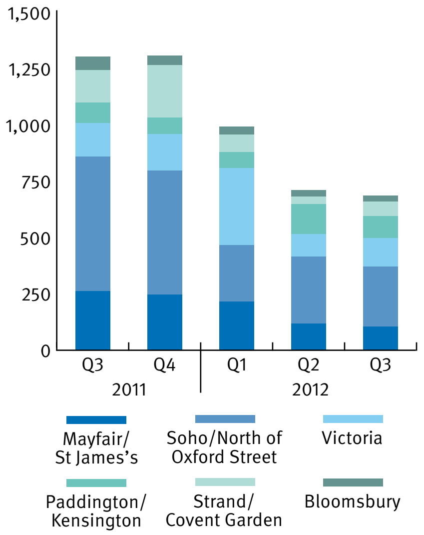
Q3 2012 (£ m's)



WEST END

- **Take-up remained unchanged at 0.7 m sq ft.**
- **Availability fell by 7% to 4.9 m sq ft.**
- **Prime headline rents remained at £95.00 per sq ft in the Core.**
- **Investment turnover totalled £1.1 bn.**

Figure 1
West End take-up by quarter & sub-market
Q3 2011 - Q3 2012 (000's sq ft)



Demand & take-up

Take-up in the West End remained unchanged at 0.7 m sq ft, although this is 45% below the level recorded at the same quarter last year. The economic uncertainty has resulted in low levels of occupier activity, but with over 1.0 m sq ft under offer, we expect take-up to pick up towards the end of the year. There were eight deals over 20,000 sq ft, double the number recorded in Q2, with the largest deal at Oxford House, 76 Oxford Street, W1 in which Publicis took a short-term lease totalling 44,412 sq ft.

The volume of active identified searches has increased by 12% to 2.5 m sq ft in Q3 2012, the highest level recorded since Q4 2007. There are nearly 40 active requirements in the West End over 20,000 sq ft compared to 21 at the same time last year.

Supply & Development

Availability fell for the third consecutive quarter to 4.9 m sq ft, the lowest level since Q2 2008 and 32% below the long-term average. The vacancy rate in the West End is now 5.3%, compared to 5.9% for the same quarter last year. Levels of available new & refurbished space are now 43% below the long-term average.

The volume of space under construction speculatively is currently at 1.6 m sq ft up marginally from 1.5 m sq ft recorded in Q2 2012. There is nothing currently under construction that will complete during 2014. With availability continuing to fall and a number of significant pre-completion lettings taking place the supply of good quality stock will continue to decline.

Rental Profile

The prime headline rent remained at £95.00 per sq ft in the Core, with rent free periods at 18 months on a 10-year term. The very limited stock of prime units is attracting steady interest. The highest rent achieved this quarter was at 3 Burlington Gardens, W1 in which £105.00 per sq ft was achieved on a 10-year term.

Investment

Turnover in the third quarter totalled just under £1.1bn, 23% below the previous quarter but 18% above the long-term average of £0.9bn. This quarter saw two significant high profile transactions in the West End with the sale of 60 Sloane Avenue, SW3 for £129 m to CapInvest, reflecting a net initial yield (NIY) of 4.74% and 23 Savile Row, W1 sold to Quantum Global for £218 m with a NIY of 4.23%.

A third of all West End acquisitions in the last year have been purchased with aspirations of conversion to residential. Overseas investors continued to dominate the market accounting for 64% of all purchases by value. Exceptional demand for freehold assets in the core coupled with continuing low levels of availability continues to sustain prime yields at 4.00%.

Figure 2
West End availability by quarter & sub-market
Q3 2011 - Q3 2012 (000's sq ft)

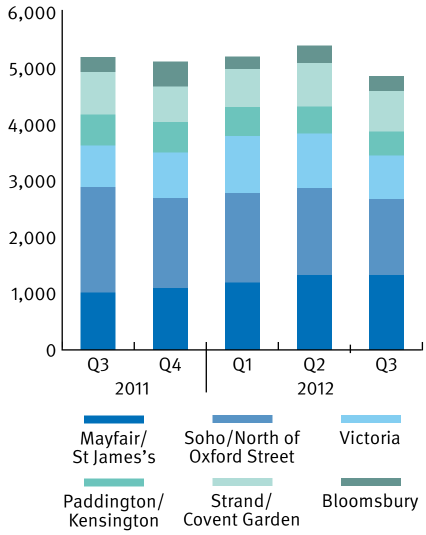
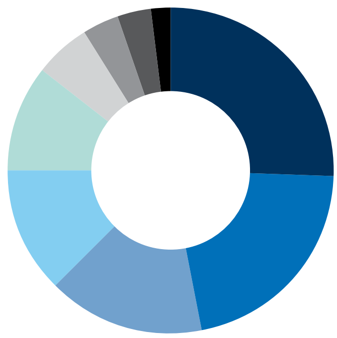


Figure 3
West End investment by purchaser
Q3 2012



Private Investor	263 m
Sovereign Wealth	218 m
Private Property Company	158 m
Pension/Life/Insurance	128 m
Corporate/Other	105 m
Unit Fund	57 m
Quoted Property Company	37 m
Charities/Foundation/ Institution	35 m
Open-ended/ Closed-ended fund	18 m

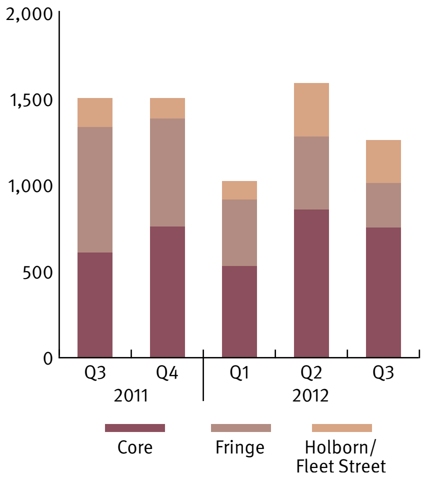
CITY

- **Take-up at 1.3 m sq ft was consistent with recent quarters.**
- **Vacancy rate currently 8.5%, versus a long-term average of 10.2%.**
- **Prime headline rents unchanged at £55.00 per sq ft.**
- **Investment turnover was £2.0 bn, double the level of Q3 2011.**

Figure 1

City take-up by quarter & sub-market

Q3 2011 - Q3 2012 (000's sq ft)



Demand and take-up

City take-up was 1.3 m sq ft in Q3, which is consistent with the level of demand we have seen in the last 18 months. While take-up is below average, it has not deteriorated to the kind of levels seen in late 2008 / early 2009, suggesting a soft patch for demand not a serious downturn. The technology, media and telecoms (TMT) sector remains a bright spot. Take-up from TMT firms for Q1 to Q3 reached 930,000 sq ft, a 39% increase on the same period of 2011.

Major deals of the quarter include insurer, RJ Kiln, acquiring 78,000 sq ft at the under construction 20 Fenchurch Street, EC3, and Nationwide Building Society taking 54,000 sq ft at 1 Threadneedle Street, EC2. We expect more insurance sector deals to transact in the coming months, with Miller under offer at 70 Mark Lane, EC3 (81,000 sq ft). There is also anecdotal evidence of more activity by the fund management industry, such as M&G's deal at Watermark Place (35,000 sq ft).

Supply & development

Availability in the City continued to decline in Q3, falling to 9.9 m sq ft, compared to 10.1 m sq ft in the previous quarter. This takes the vacancy rate to 8.5%, which is well below the long-term average of 10.2%. Of the sub-markets, the Holborn / Fleet Street area has the most constrained level of supply, with the vacancy rate of 4.4% – its lowest level since 2001.

There is currently 3.5 m sq ft of speculative space under construction, down from 4.0 m sq ft in Q2. The pipeline completing over the next six months is mostly refurbishments, which account for 85% of the space coming through.

Rents

Prime headline rents remained unchanged at £55.00 per sq ft for a typical grade A 10,000 sq ft floor plate. However, smaller high quality floor plates near the Bank of England are achieving rents above this level.

Investment

The City investment transaction volume in Q3 was just over £2.0 bn, compared to £2.5 bn in Q2 2012, but well in excess of the same point in 2011. With turnover already at over £6 bn so far for 2012, despite the Jubilee and The Olympics, this year is set to exceed the already impressive turnover for 2011 This is further evidence that the City continues to benefit from strong overseas buyer interest, which accounted for 61% of transactions by value. Foreign buyers have now accounted for 73% of purchases this year.

The largest deal of the quarter was the purchase of Broadgate West I & II by Hines and HSBC Alternative Investments for £289 m, reflecting a net initial yield (NIY) of 6.7%. Also, Peterborough Court, which is let to Golman Sachs, sold for £281 m to Qinvest, reflecting a NIY of 6.2%. An example of a prime deal is Korea Life buying 1 Wood Street for £136 m, reflecting a NIY of 5.2%. Going forward, we expect to see examples of sub 5.25% yields being paid for those assets that precisely match the requirements of overseas investors seeking best in class prime stock offering long, secure income streams.

Figure 2

City availability by quarter & sub-market

Q3 2011 - Q3 2012 (000's sq ft)

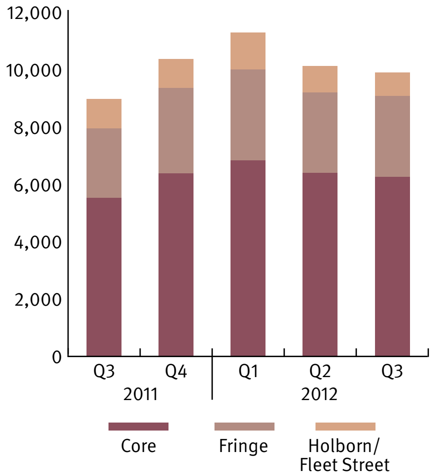
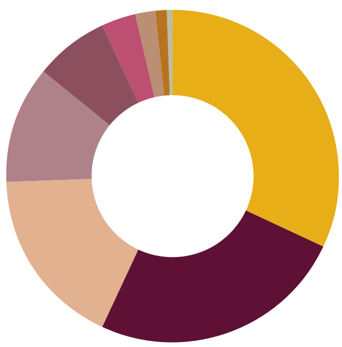


Figure 3

City investment by purchaser

Q3 2012

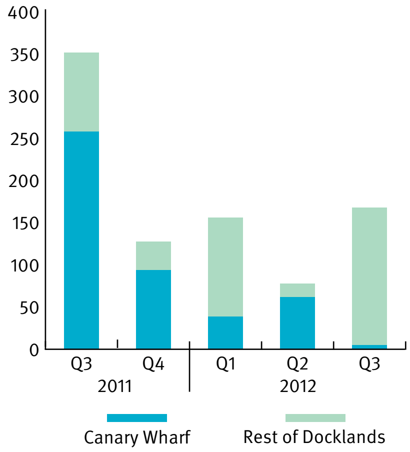


Pension/Life/Insurance	656 m
Sovereign Wealth	508 m
Private Investor	357 m
Corporate/Other	237 m
Private Property Company	148 m
Unit Fund	66 m
Opportunity Fund	40 m
Quoted Property Company	23 m
Charities/Foundation/ Institution	8 m

DOCKLANDS

- **Take-up for Q3 increased to 169,000 sq ft.**
- **Availability stood at 1.5 m sq ft.**
- **Prime headline rents remained steady at £36.00 per sq ft.**
- **More investment stock is marketed.**

Figure 1
Docklands take-up by quarter & sub-market
Q3 2011 - Q3 2012 (000's sq ft)



Demand & take-up

Docklands take-up more than doubled off of low levels, rising from 78,000 sq ft in Q2 to 169,000 sq ft in Q3. However, the vast majority of activity was accounted for by the Financial Ombudsman Service's acquisition of 160,000 sq ft at 1 & 2 Harbour Exchange Square. Also, Padero Consulting took 3,600 sq ft at 40 Bank Street on the 19th floor.

At Canary Wharf, a new technology firms' incubator is to be established on the 39th floor of One Canada Square, the flagship tower on the estate. Branded Level39, it will open early next year and target tech firms serving the financial sector. The move should help Canary Wharf increase its exposure to the rise of the East London Tech City.

Supply & Development

Availability was 1.5 m sq ft, and has been around this level for two years now. It is widely assumed that the investment banks in Docklands are holding 'grey' space off-market, although there is no way of knowing how much, or the banks' long-term intentions for the space. The vacancy rate is currently 7.2%, which is in line with the central London figure of 7.1%.

The 540,000 sq ft 25 Churchill Place remains the only scheme under construction – of which around 220,000 sq ft is pre-let to EMA. It is scheduled to complete in Q3 2013.

Rental Profile

Prime rents remained unchanged at £36.00 per sq ft, although there is a lack of transactional evidence to confirm this figure. We expect future transactions to reveal downwards pressure on rents and incentives.

Investment

The Docklands market saw no investment transactions in Q3. This comes at a time when the volume of stock on the market is increasing. Evans Randall has brought 5 Canada Square to the market for an asking price of £575 m. This is a 515,000 sq ft building let to Credit Suisse for a further 15 years.

Other new stock coming to the market includes 15 Westferry Circus, which is on sale for £129.5 m, reflecting a net initial yield of 6.00%. Also, Thames Quay is for sale, which is an office complex where there is a proposed residential development that has yet to secure planning consent.

Figure 2
Docklands availability by quarter & sub-market
Q3 2011 - Q3 2012 (000's sq ft)

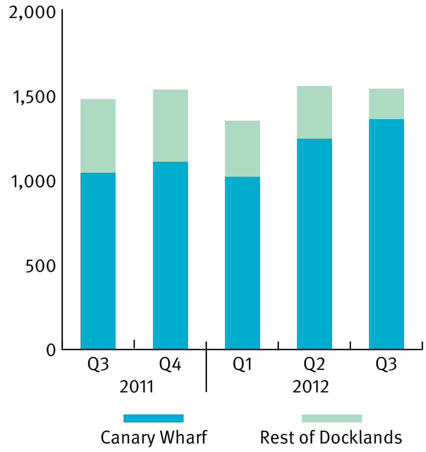
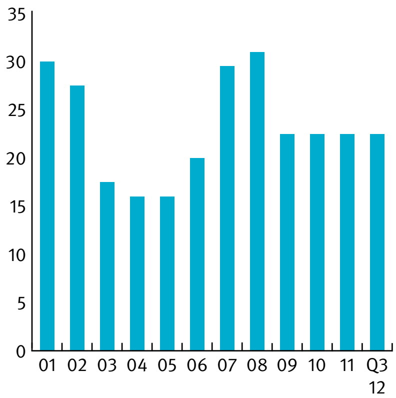


Figure 3
Rest of Docklands prime rent
2000-Q3 2012 (Prime £/sq ft)



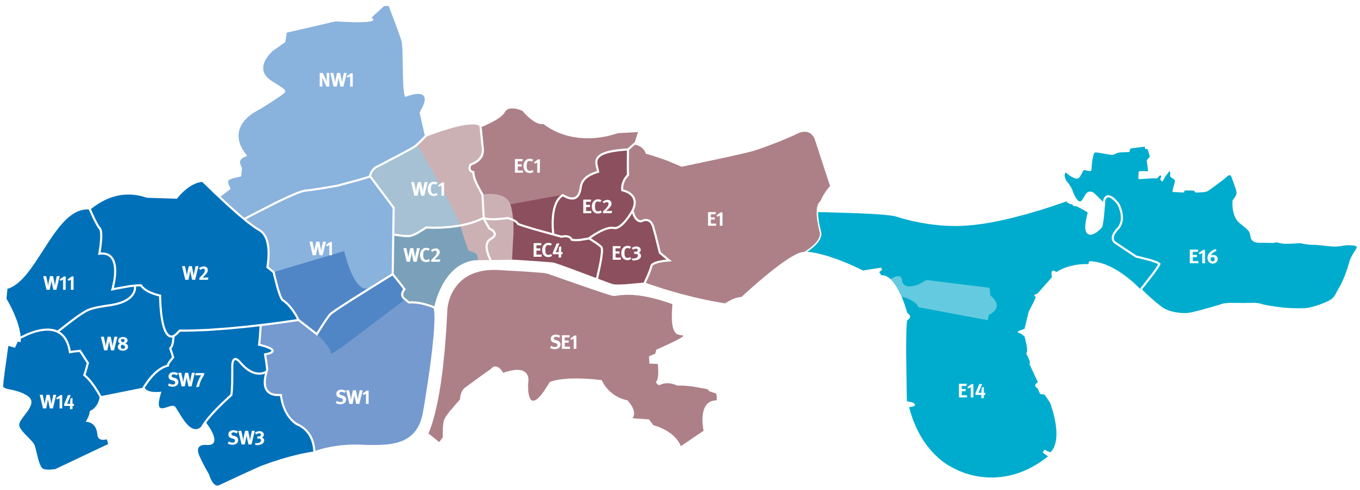
Key statistics

Central London office market

Availability (m sq ft)	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	3 months % change	12 months % change
West End	5.39	4.92	5.30	5.28	**4.87**	-7.7%	-9.6%
City	8.99	10.39	11.29	10.14	**9.92**	-2.2%	10.3%
Docklands	1.48	1.54	1.51	1.56	**1.54**	-0.9%	4.2%
Central London	15.86	16.85	18.10	16.98	**16.33**	-3.8%	3.0%
Vacancy Rate (%)	**Q3 11**	**Q4 11**	**Q1 12**	**Q2 12**	**Q3 12**	**3 months % change**	**12 months % change**
West End	5.9	5.4	5.8	5.8	**5.3**	n/a	n/a
City	7.7	8.9	9.6	8.6	**8.5**	n/a	n/a
Docklands	6.9	7.2	7.1	7.1	**7.2**	n/a	n/a
Central London	6.9	7.3	7.9	7.4	**7.1**	n/a	n/a
Take-up (m sq ft)	**Q3 11**	**Q4 11**	**Q1 12**	**Q2 12**	**Q3 12**	**3 months % change**	**12 months % change**
West End	1.31	1.31	0.99	0.71	**0.71**	-0.8%	-45.8%
City	1.51	1.51	1.03	1.60	**1.26**	-20.8%	-16.2%
Docklands	0.35	0.13	0.16	0.08	**0.17**	114.9%	-52.3%
Central London	3.17	2.95	2.18	2.39	**2.14**	-10.4%	-32.4%
Active Requirements (m sq ft)	**Q3 11**	**Q4 11**	**Q1 12**	**Q2 12**	**Q3 12**	**3 months % change**	**12 months % change**
West End	1.25	1.72	2.03	2.23	**2.40**	7.8%	91.6%
City	4.62	4.07	4.27	4.54	**4.00**	-12.1%	-13.5%
Docklands	0.22	0.22	0.22	0.24	**0.15**	-38.3%	-31.2%
Unspecified Central London	1.05	1.89	1.83	2.10	**2.20**	4.8%	109.4%
TOTAL Central London	7.14	7.90	8.36	9.11	**8.75**	-4.0%	22.5%
Under Construction (m sq ft)	**Q3 11**	**Q4 11**	**Q1 12**	**Q2 12**	**Q3 12**	**3 months % change**	**12 months % change**
West End	1.70	2.02	1.87	1.95	**2.03**	4.1%	19.6%
City	3.80	4.25	5.09	5.81	**5.40**	-7.1%	41.9%
Docklands	0.00	0.00	0.53	0.53	**0.53**	n/a	n/a
Central London	5.50	6.26	7.49	8.28	**7.95**	-4.0%	44.6%
Investment (£ m)	**Q3 11**	**Q4 11**	**Q1 12**	**Q2 12**	**Q3 12**	**3 months % change**	**12 months % change**
West End	958.0	803.8	966.1	1380.7	**1065.2**	-22.9%	11.2%
City	1047.9	1493.4	1565.7	2542.6	**2043.0**	-19.6%	95.0%
Docklands	0.0	13.6	447	0	**0**	n/a	n/a
Central London	2005.9	2310.8	2978.8	3923.3	**3108.2**	-20.8%	55.0%

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).

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. 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

Newmark
Knight Frank
Global