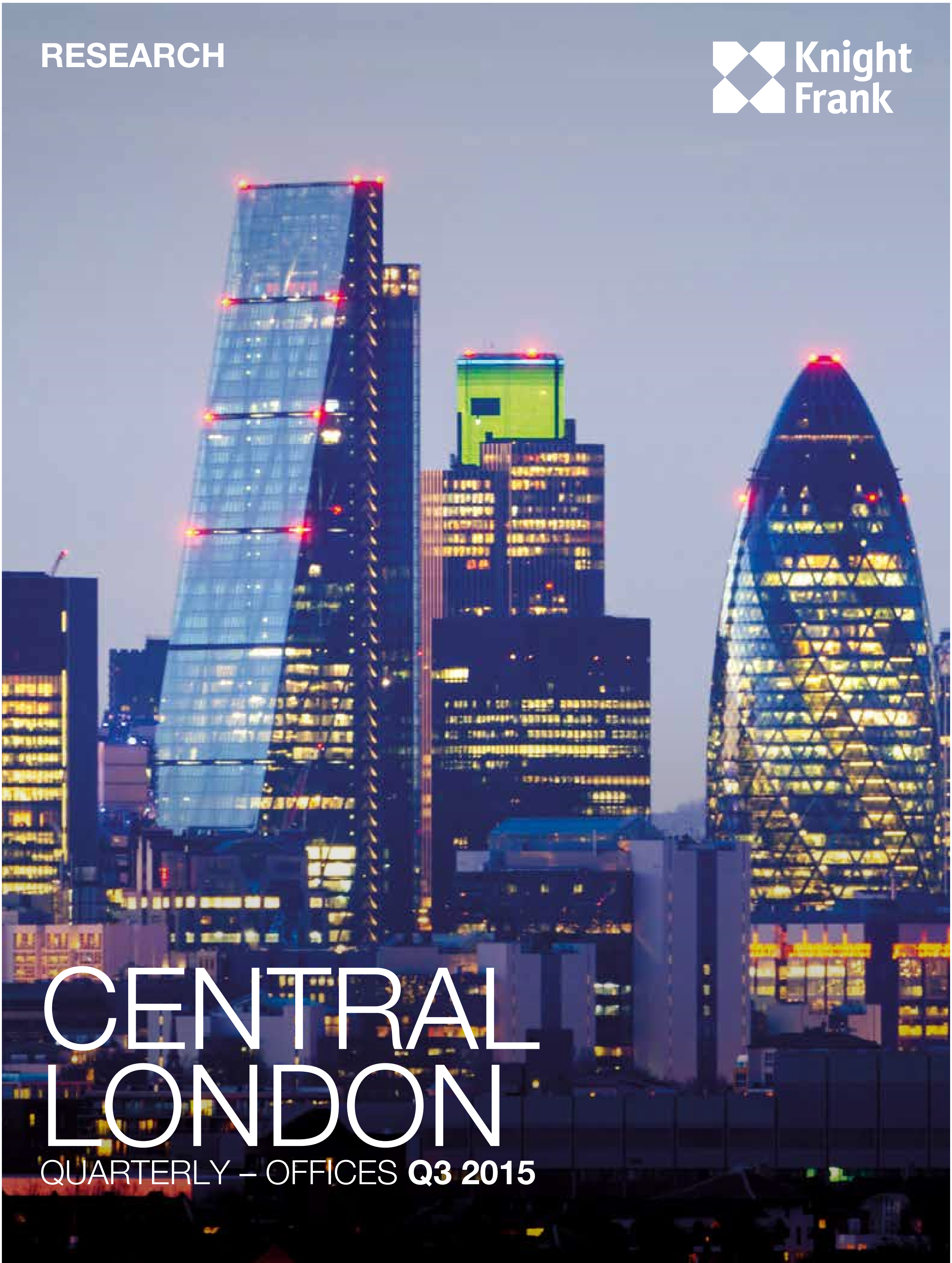
RESEARCH



CENTRAL LONDON

QUARTERLY – OFFICES **Q3 2015**

VACANCY RATE AT A 14 YEAR LOW

TECHNOLOGY, MEDIA AND TELECOMS LEADS DEMAND

INVESTOR INTEREST REMAINS STRONG

CHIEF ECONOMIST'S VIEW

We enter the autumn with the debate over the level of yields in the Central London market continuing to rage.

Critics regarded City and West End yields as too low a year ago when they stood at 4.5% and 3.75% respectively. Given yields have compressed further – to 4.00% for the City, and 3.50% for the West End – the question arises, have the critics been proved wrong or are we just further into bubble territory?

The reality for yields is there is no magic number that indicates fair value.

Value is dictated by a series of moving parts – interest rates, weight of money, comparative returns elsewhere, future rental growth, perceptions on the economic outlook, to name a few. How much weight is given to each will vary from one investor to the next.

Also, there is question of whether the investor is seeking 'fair' value, or trying to make a profit? Vacancy rates are at a fourteen year low in Central London, and they look set to achieve historic lows at some point in the next two years. For those who want to play the buy, refurb, and sell strategy, there is good reason to suppose rental growth will continue.

There are also changes in market dynamics that favour a buy/build/sell approach. For instance, it is now possible we will see rents in Shoreditch overtake the City Core, and it is such seismic changes that create opportunities for developers. This will draw the attention of developers to Whitechapel, Clerkenwell, and the less developed parts of Southbank, in search of a gentrification premium.

Conversely, a very long-term income investor may be more concerned with locking in the fundamentals of London property into their real estate portfolio. From one cycle to the next it varies which South East towns, or regional cities, deliver the best returns; but cycle after cycle, Central London is always one of the hot spots. People with long-term horizons are prepared to pay extra for that kind of certainty.

Moreover, like any market, Central London offices will continue to attract investment as long as there is a perception there is more upside to come. Few these days would view that as coming from yield compression, but the rent cycle continues to surprise.

Oscar Wilde once said: "I can resist anything except temptation". With new benchmarks for rents being achieved, there is still plenty to tempt the investor towards Central London offices.

"Vacancy Rates are at a fourteen year low in Central London, and they look set to achieve historic lows."

FIGURE 3
Central London net investment
Q3 2015 (£ m's)

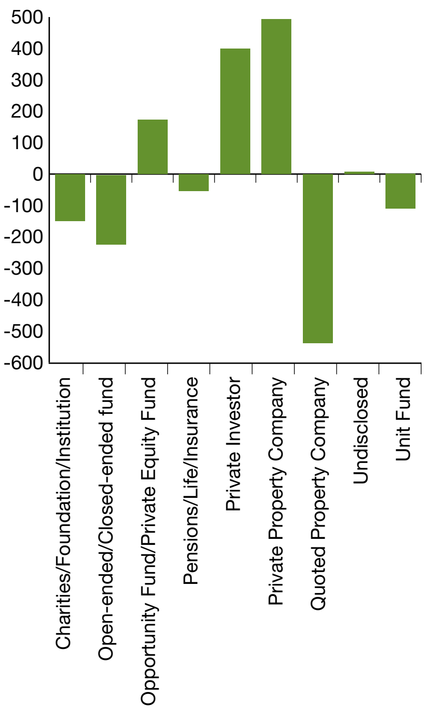


FIGURE 1
Central London take-up by quarter & sub-market
Q3 2014 - Q3 2015 (000's sq ft)

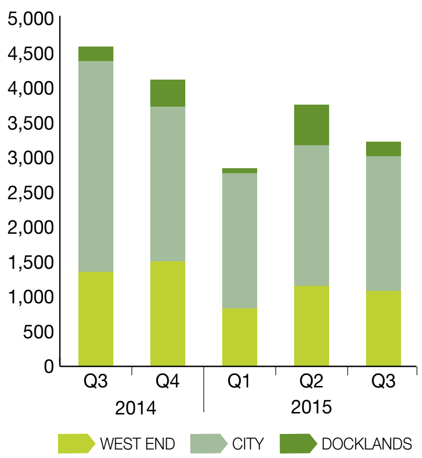
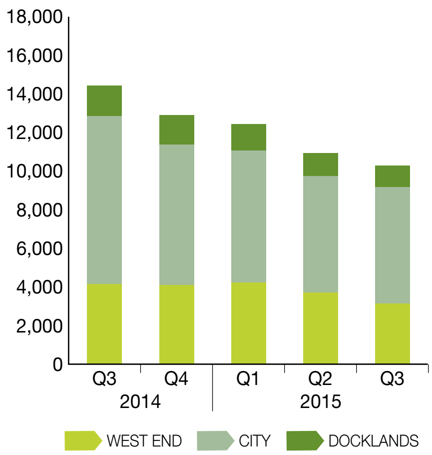


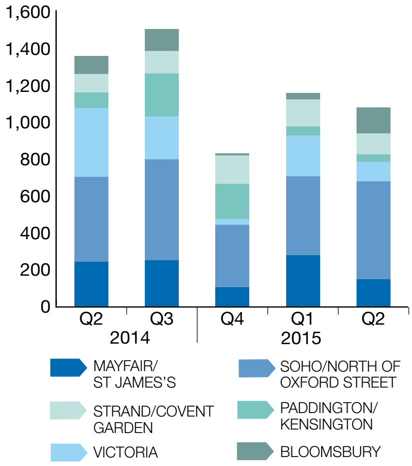
FIGURE 2
Central London availability by quarter & sub-market
Q3 2014 - Q3 2015 (000's sq ft)



WEST END

- Vacancy rate slumps to 3.4%, lowest since 1989
- Take-up down marginally to 1.1 m sq ft
- Prime headline rents remained at £115.00 per sq ft
- Investment turnover in Q3 totalled £1.4 bn

FIGURE 1
West End take-up by quarter & sub-market
Q3 2014 - Q3 2015 (000's sq ft)



Demand

Take-up in the West End was 1.1 m sq ft, which is down slightly on a quarter-on-quarter basis and just below the ten year average figure of 1.2 m sq ft. In part, this reflects a shortage of supply limiting choice for tenants, which we discuss below. Increased activity in the North and Covent Garden counterbalanced falls in take-up in the Core and Victoria.

The Technology, Media and Telecoms sector was the largest source of demand, with take-up reaching 424,000 sq ft, up from 295,000 sq ft in the previous quarter. This is in a large part thanks to Facebook taking 251,000 sq ft in the under construction One Rathbone Place. Also, King.com, a games developer, took 65,000 sq ft in Ampersand on Wardour Street in Soho.

Supply

The vacancy rate in the West End fell to 3.4%, which is the lowest level since 1989. This is also below the 3.8% seen in Q3 2000, which marked the height of the Dot Com boom in the West End. Availability in Q3 2015 fell by 18% quarter-on-quarter to 3.1 m sq ft, which is down 25% on an annual comparison. There was a sharp fall in the volume of second hand grade A space on the market – down 40% q-on-q to 946,000 sq ft.

The volume of space under construction in the West End was little changed on a quarter-on-quarter basis at 2.4 m sq ft. The proportion that is pre-let nearly doubled to 472,000 sq ft. Next year will see 1.4 m sq ft of speculative development complete, yet average take-up for new build and refurbished space is 1.5 m sq ft per annum. Another surge in deals on under construction space in Q4 (as occurred in Q3) would leave the 2016 pipeline looking thin.

Rental Profile

Prime Core headline rents remained unchanged at £115.00 per sq ft for a third consecutive quarter, although anecdotally demand for space priced over £90,000 per sq ft is relatively subdued at the time of writing. However, beyond the Core, most sub-markets recorded a quarter-on-quarter increase in rents.

Investment

The West End saw £1.4 bn worth of investment transactions in Q3, which is down significantly on the previous quarter (£2.3 bn) but is still above the long-term average figure of £1.2 bn. The first nine months of 2015 have seen transactions totalling £4.8 bn, compared to £3.8 bn for the equivalent period of 2014, partly due to the strong Q2 figure. Foreign buyers remain the largest source of demand, accounting for 56% of purchases by volume.

> "Beyond the Core, most sub-markets recorded a q-on-q increase in rents."

FIGURE 2
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Q3 2014 - Q3 2015 (000's sq ft)

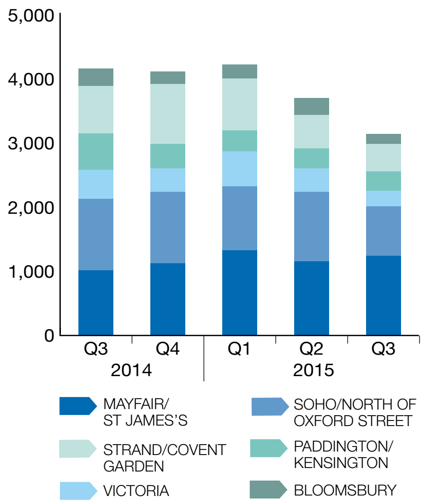
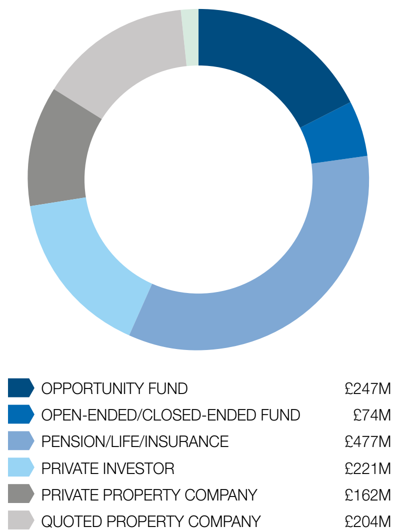


FIGURE 3
West End investment by purchaser
Q3 2015 (£m)



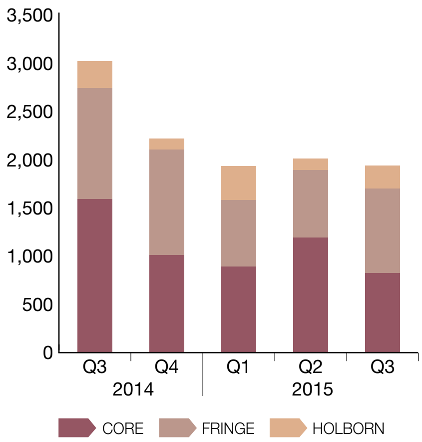
CITY

- Take-up totalled 1.9 m sq ft
- The vacancy rate remained at 5.1%
- Prime headline rents increased to £66.50 per sq ft
- Investment turnover totalled £1.95 bn

FIGURE 1

City take-up by quarter & sub-market

Q3 2014 - Q3 2015 (000's sq ft)



Demand

Take-up in Q3 reached 1.9 m sq ft, down 4% on the previous quarter, although this is 11% ahead of the long-term average. The largest share of market activity was located in the City Fringe, which included Ashurst LLP's pre-let of the Fruit & Wool Exchange, Brushfield Street, E1, totalling 275,536 sq ft, which was the biggest transaction of the quarter. Take-up of new and refurbished stock totalled 1.2 m sq ft in the third quarter, 72% higher than the long-term average, and buoyed by eleven transactions over 20,000 sq ft, compared with just six in the first two quarters of the year.

Active requirements remain strong, coming from a broad base of industries. Total active searches at the end of the third quarter of the year totalled 4.4 m sq ft, 5% above the long-term average. Financial occupiers account for 32% of active searches, followed by the professional sector with 16%.

Supply & development

Availability across the City remained stable at 6.0 m sq ft in the third quarter, following a considerable fall in supply in the first half of the year. Levels of supply are now 39% below the long-term average of 9.9 m sq ft. The vacancy rate stood at 5.1%, the lowest level since Q2 2001. The level of new and refurbished space continued its downward trend, falling 11% on the previous quarter totalling 1.9 m sq ft, the lowest since Q3 2007. There are just three buildings in the Core that could provide an occupier 100,000 sq ft of new and refurbished space within the next six months.

There is currently just under 8.3 m sq ft of space under construction in the City, albeit nearly 3.5 m sq ft is already pre-let. There is 1.2 m sq ft that is speculatively under construction in the Core that will complete by the end of 2016. Just four of these schemes are over 100,000 sq ft, 1 Angel Court, Creechurch Place, 8 Finsbury Circus and 1 King William Street.

Rental Profile

Prime rents increased to £66.50 per sq ft in the third quarter, a rise of 2.3% on the previous quarter, with further rental growth expected for the remainder of the year. Rent free periods have hardened slightly during the quarter, and now sit between 18 and 21 months on a typical 10-year term certain.

Investment

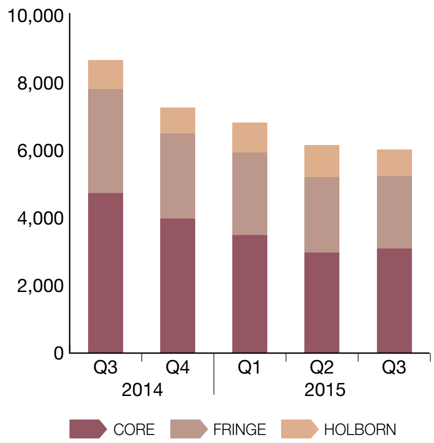
Investment turnover in Q3 totalled £1.95 bn, 36% below the previous quarter's level but still above the long-term average of £1.86 bn. The market saw fewer transactions involving lot sizes greater than £100 m. There were five such transactions, down from 10 in the previous quarter. Looking forward, we expect turnover levels to increase in the final quarter of the year. There was around £4.0 bn of stock available or under offer at the quarter-end, 82% of which involved lot sizes in excess of £100 m.

City office yields remained at their lowest recorded level of 4.00% for the third consecutive quarter, although lower yields are achievable on reversionary stock. Overseas investors dominated the purchaser profile, accounting for 74% of all transactions. Property companies were the most active sellers, accounting for 47% of sales by value, a trend expected to continue into the Q4 as more stock is released into the market.

FIGURE 2

City availability by quarter & sub-market

Q3 2014 - Q3 2015 (000's sq ft)



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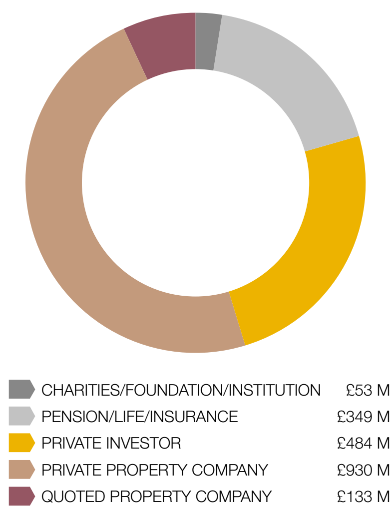
City investment by purchaser

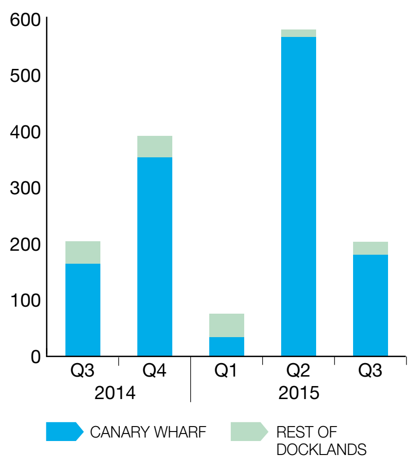
Q3 2015 (£m)



DOCKLANDS

- Take-up totalled 204,000 sq ft
- The vacancy rate declined to 5.2%
- Prime headline rents increased to £39.00 per sq ft
- Investment turnover totalled £235 m

FIGURE 1
Docklands take-up by quarter & sub-market
Q3 2014 - Q3 2015 (000's sq ft)



Demand

Take-up in Q3 at 204,000 sq ft was significantly down on the 582,000 sq ft of deals recorded in the previous quarter. Canary Wharf continues to dominate the market, accounting for 89% of deals by floor space. However, take-up levels in Docklands are historically volatile from one quarter to the next, as the market often sees large pre-let deals which can briefly boost the figures. The largest deal in Q3 was Crossrail acquiring 44,000 sq ft at 1 Westferry Circus.

We see Docklands leasing demand increasing in the next year, due to the low levels of supply in other parts of Central London, and the considerable rent discount the market offers. Prime rents at Canary Wharf are 41% lower than those in the City Core, 39% below Southbank, and 29% less than Aldgate/ Whitechapel. We see more tenants drawn eastwards in search of high specification offices at affordable rents.

Supply & Development

Availability in the Docklands market fell to 1.1 m sq ft in Q3, down from 1.2 m sq ft in the previous quarter. This is well below the 1.6 m sq ft that was on the market a year earlier, demonstrating how quickly the market in Docklands has moved in the landlord's favour.
The situation is more acute in the core market of Canary Wharf where the vacancy rate stands at 4.2%, compared to 5.2% for Docklands as a whole.

1 Bank Street, a scheme totalling 700,000 sq ft in which Société Générale will occupy circa 280,000 sq ft upon completion in 2018, is the only new development under construction. A refurbishment of 7 Westferry Circus (180,000 sq ft) is scheduled to complete in Q1 of 2016.

Rental Profile

Prime rents increased at Canary Wharf to £39.00 per sq ft, up from £37.50 per sq ft in Q2 and £36.00 per sq ft a year ago. Given the fall in supply in Docklands, and the substantial rent discount offered by Canary Wharf against other Central London submarkets, we see rents rising further in the next year.

Investment

The third quarter saw the disposal by German funds group KanAm of 30 South Colonnade at Canary Wharf. The global headquarters of news agency Reuters, the building was bought by HNA, a new Chinese entrant to the market. They paid £235 m for the building, which was ahead of the asking price, offering a 5.00% yield on just over four and a half years of unexpired term. The deal is one of several recently across London which shows demand from Chinese investors has held up remarkably well despite the economic slowdown there.

"We see more tenants drawn eastwards in search of high specification offices at affordable rents."

FIGURE 2
Docklands availability by quarter & sub-market
Q3 2014 - Q3 2015 (000's sq ft)

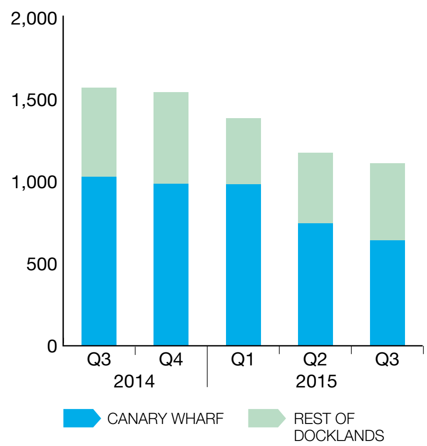
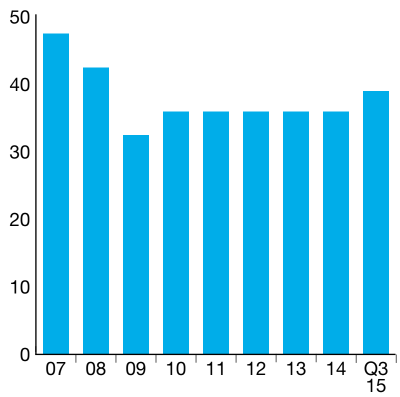


FIGURE 3
Canary Wharf prime rent
2007 - Q3 2015 (Prime £/sq ft)



KEY STATISTICS

Central London office market

Availability (m sq ft)	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	3 months % change	12 months % change
West End	4.17	4.08	4.23	3.84	**3.15**	-18.0%	-24.5%
City	8.68	7.27	6.83	6.04	**6.03**	-0.1%	-30.5%
Docklands	1.58	1.55	1.39	1.18	**1.12**	-5.5%	-29.4%
Central London	14.43	12.90	12.45	11.06	**10.30**	-6.9%	-28.7%

Vacancy Rate (%)	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	3 months % change	12 months % change
West End	4.5	4.4	4.6	4.2	**3.4**	n/a	n/a
City	7.3	6.1	5.7	5.1	**5.1**	n/a	n/a
Docklands	7.4	7.2	6.5	5.5	**5.2**	n/a	n/a
Central London	6.2	5.6	5.4	4.8	**4.4**	n/a	n/a

Take-up (m sq ft)	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	3 months % change	12 months % change
West End	1.37	1.51	0.83	1.16	**1.09**	-6.5%	-20.8%
City	3.02	2.22	1.94	2.02	**1.94**	-4.0%	-35.8%
Docklands	0.20	0.39	0.08	0.58	**0.20**	-64.8%	-2.0%
Central London	4.59	4.12	2.85	3.76	**3.23**	-14.1%	-29.7%

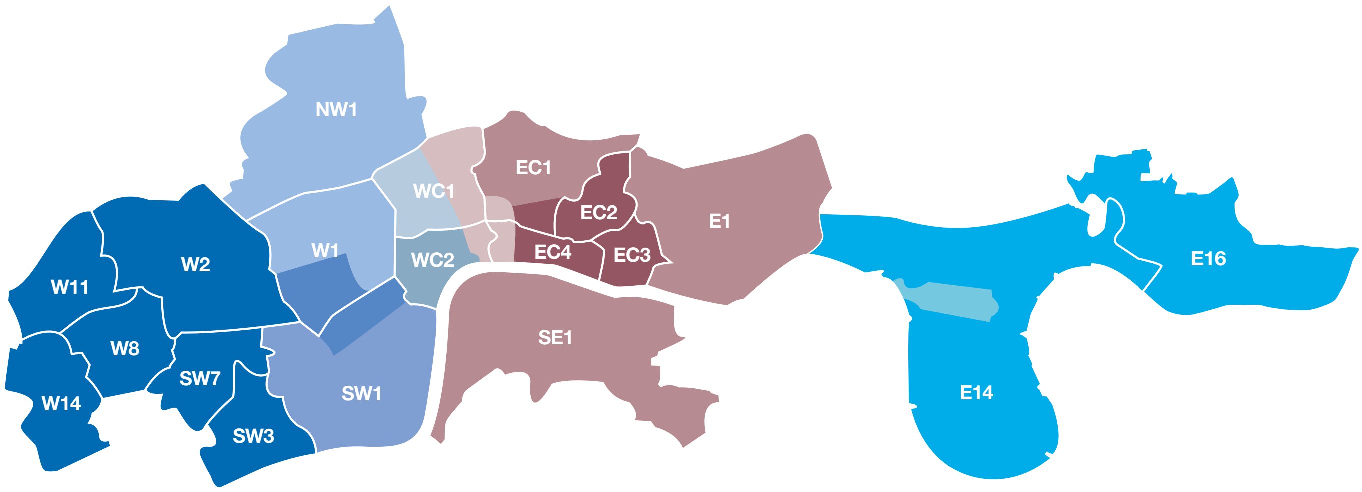
Active Searches (m sq ft)	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	3 months % change	12 months % change
West End	1.09	1.51	1.64	1.59	**2.34**	47.2%	114.7%
City	2.95	4.30	4.46	4.23	**4.36**	3.0%	47.6%
Docklands	0.97	0.94	1.03	0.98	**0.72**	-26.5%	-25.8%
Unspecified Central London	0.78	0.51	1.65	1.83	**1.27**	-30.5%	62.9%
TOTAL Central London	5.79	7.25	8.78	8.63	**8.69**	0.6%	50.0%

Under Construction (m sq ft)	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	3 months % change	12 months % change
West End	2.67	3.09	2.50	2.40	**2.42**	0.7%	-9.5%
City	4.03	4.74	5.08	6.17	**8.25**	33.6%	104.6%
Docklands	0.00	0.00	0.00	0.70	**0.70**	0.0%	n/a
Central London	6.70	7.83	7.58	9.27	**11.36**	22.6%	69.6%

Investment (£ m)	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	3 months % change	12 months % change
West End	1899.0	2771.8	1031.1	2317.3	**1405.4**	-39.4%	-26.0%
City	2146.5	4603.6	2281.5	3035.4	**1948.4**	-35.8%	-9.2%
Docklands	353.7	1333.3	0.0	19.3	**235.0**	n/a	-33.6%
Central London	4399.2	8708.7	3312.6	5372.0	**3588.8**	-33.2%	18.4%

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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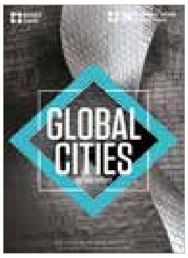

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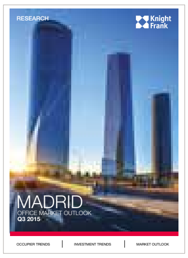

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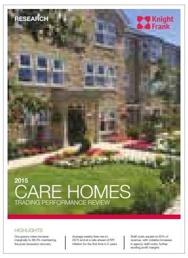

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