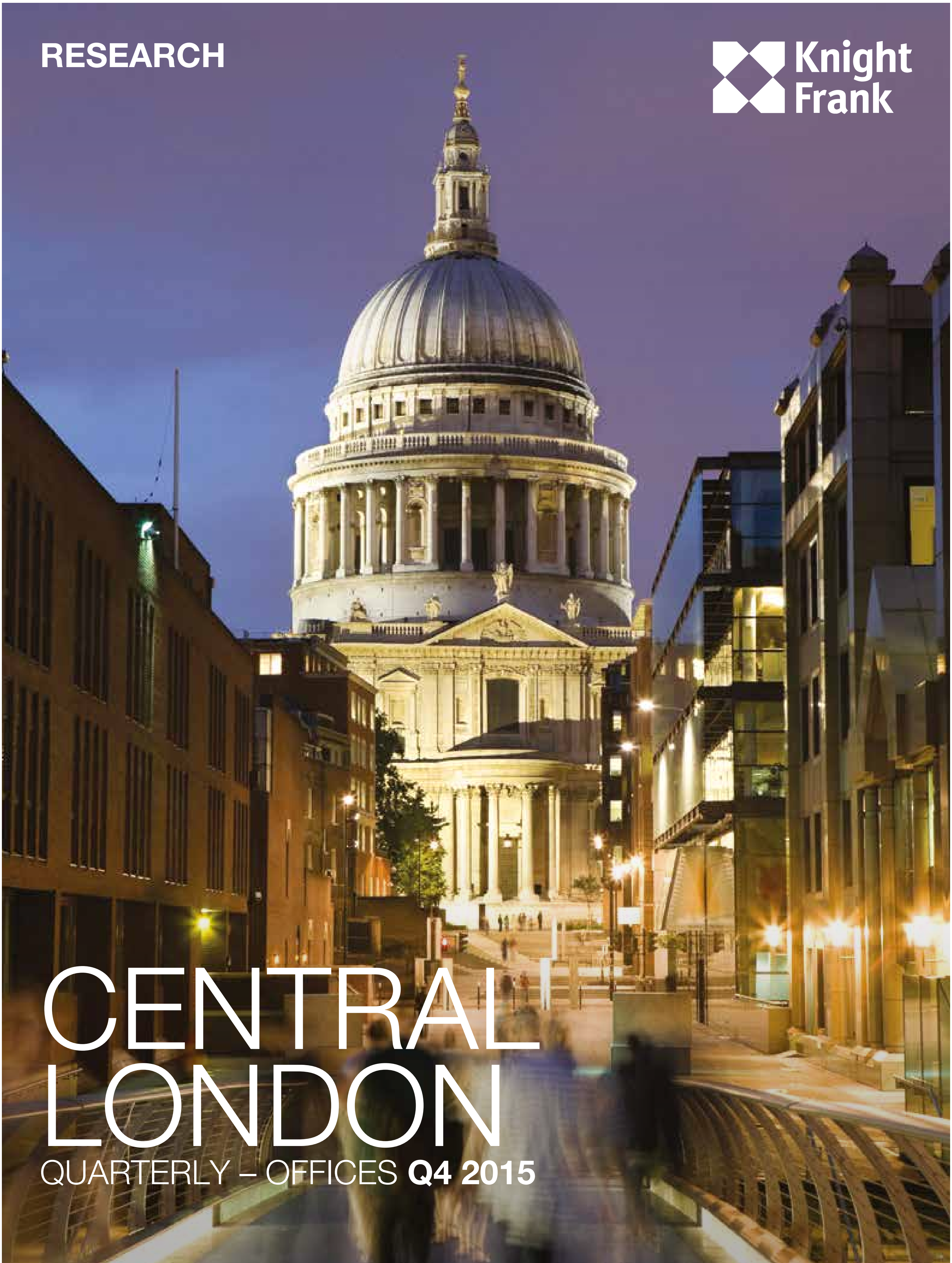
RESEARCH



CENTRAL LONDON

QUARTERLY – OFFICES **Q4 2015**

SUPPLY REMAINS CONSTRAINED

RENTS IN MOST DISTRICTS AT HISTORIC HIGHS

Q4 SURGE FOR INVESTMENT SALES VOLUME

CHIEF ECONOMIST'S VIEW

The roller coaster ride in the financial markets in January has cast a bearish shadow over sentiment in the property market. The main causes of concern have been the oil price slide, and weak growth in China.

Central London still has a large financial sector, and investment managers who counted sovereign wealth funds from emerging markets as clients are seeing outflows of money. For a range of non-financial industries, tapping the equity or debt markets for capital has become more difficult. There is also the impact on sentiment in corporate boardrooms – where new leasing requirements get signed off.

In the property investment market, we have seen a lot of capital flow into London from emerging markets in recent years. The worry is that it now flows out, although to date the signals on this are mixed with deals pointing to money moving in both directions. Many nations out East peg their currency to the US dollar, and an investor who believes that the peg will be abandoned soon may want to get money abroad before the devaluation.

The connection between the London office market and the embattled sections of the global economy is far from clear cut. Conventional thinking has always been that expensive oil was bad for net energy importers like the UK – so it feels disingenuous to say cheap oil is a problem for London. Indeed, during the second half of last year we saw well over £1 bn of Chinese investment in London.

Less spent at the petrol pump and on utility bills is more money for other forms of consumerism. For five consecutive years now, the largest source of office demand has been tech and creative firms, and it is very doubtful if the financial markets volatility will have much more than a road bump effect on London's digital juggernaut. Previous financial crashes have had a Darwinist effect on the hedge fund sector, with a new wave of funds stepping forward to replace the casualties.

For the investment market, the effect will be more apparent than for leasing. Rattled investors tend to initially apply their caution widely.

However, it is worth remembering how well Central London offices as an investment held up during the Euro Crisis of 2011 and 2012. Yields remained steady, but they did not soften. While the investment volume did fall in 2011 (from £10.3 bn in 2010 to £9.1 bn), it then rebounded in 2012 to £13.8 bn.

For the emerging markets downswing, London is very much on the economic periphery of the fall out, so there is even more reason to expect property in the Capital to repeat the resilience shown in 2011-2012.

When global financial markets turn volatile nowhere is unaffected, but some places are closer to the eye of the hurricane. In 2008, London was in the frontline, but in 2016 that is not the case.

"Many nations out East peg their currency to the US Dollar, and an investor who believes that the peg will be abandoned soon may want to get money abroad before the devaluation."

FIGURE 1

Central London take-up by quarter & sub-market

Q4 2014 - Q4 2015 (000's sq ft)

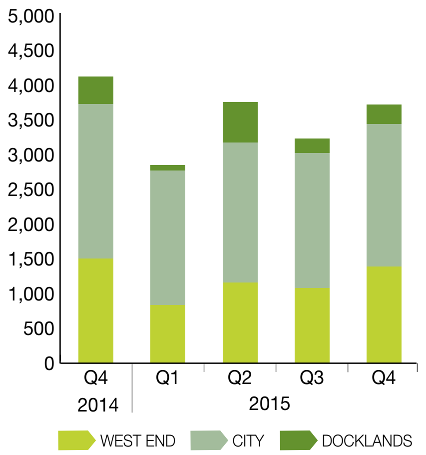
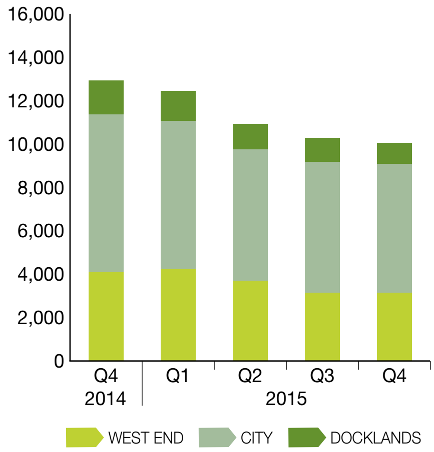


FIGURE 2

Central London availability by quarter & sub-market

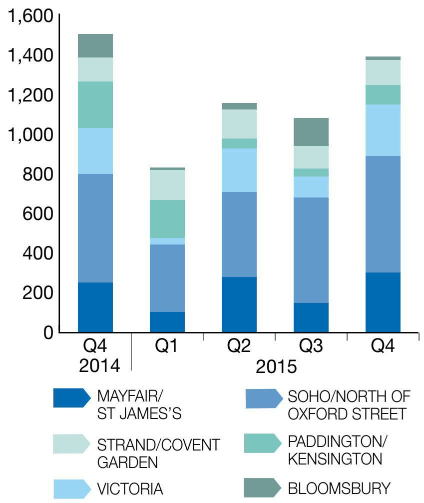
Q4 2014 - Q4 2015 (000's sq ft)



WEST END

- Vacancy rate remained stable at 3.4%
- Take-up rose to 1.4 m sq ft, strongest quarter of 2015
- Prime headline rents remained at £115.00 per sq ft
- Investment turnover in Q4 totalled £2.7 bn, second-highest on record

FIGURE 1
West End take-up by quarter & sub-market
Q4 2014 - Q4 2015 (000's sq ft)



Demand

Strong leasing activity across the majority of West End submarkets produced a significant rise in take-up for the final quarter. Take-up in Q4 2015 totalled 1.4 m sq ft, the highest since the corresponding quarter the previous year, and 18% above the long-term average. Take-up of new and refurbished space was particularly high; there was 760,000 sq ft of space of this grade transacted during the final quarter, more than double the average and accounting for more than 50% of all transactions.

Total take-up for the full year was 4.5 m sq ft, 5% below the long-term average. However, demand for new and refurbished space was particularly robust throughout the year. In excess of 2.0 m sq ft of this grade of space was let during the year, the highest annual total since 2000. There was a continued focus of occupier demand on development stock, with requirement sizes increasing. There have been more 100,000 sq ft pre-lets in the West End in the last 24 months than in the preceding five years.

Supply

The vacancy rate in the West End remained stable at 3.4%, which is the lowest level for more than 25 years. There is now 3.2 m sq ft available to lease, a fall of 23% over the course of the last 12 months. Availability levels are now 66% below their peak in 2009 after the Global Financial Crisis, with little sign of any significant increases on the horizon.

The volume of speculative space under construction in the West End remained broadly unchanged on a quarter-on-quarter basis; however levels are now 24% lower than at the same point last year. Given the availability of new and refurbished space is 42% below average, options for occupiers are likely to remain limited over the next 12 months at least.

Rental Profile

Prime Core headline rents remained unchanged at £115.00 per sq ft for the fourth consecutive quarter, partly due to the relatively high vacancy rate of 5.8% in the West End Core. The prime rent remained unchanged across the majority of the West End submarkets.

Investment

Investment turnover in the final quarter of 2015 totalled £2.7 bn, the highest since the final quarter of 2014 and the second-highest on record. There was £852 m of stock under offer at the quarter-end, suggesting a strong start to 2016. There were six sales in excess of £100 m during the fourth quarter, the largest being Hong Kong syndicate Gaw Capital's purchase of 123-151 Buckingham Palace Road, SW1 for £500 m at a net initial yield of 5.04%. This takes the annual total to £7.4 bn, 52% above the long-term average and the highest on record.

Overseas purchasers dominated in the final quarter, accounting for almost 90% of transactions by volume. Over the course of the year, domestic investors accounted for just 33% of purchases. The prime yield remained stable for the fourth consecutive quarter at 3.50%.

FIGURE 2
West End availability by quarter & sub-market
Q4 2014 - Q4 2015 (000's sq ft)

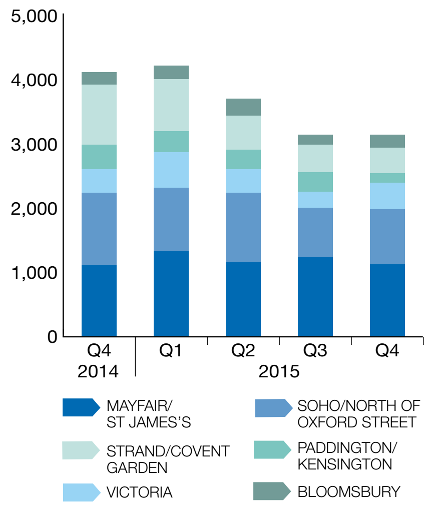
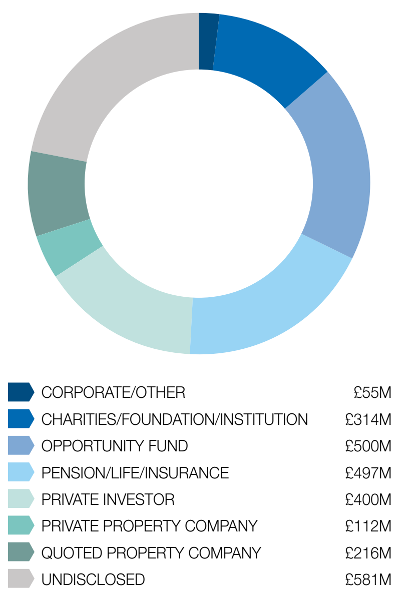


FIGURE 3
West End investment by purchaser
Q4 2015 (£m)



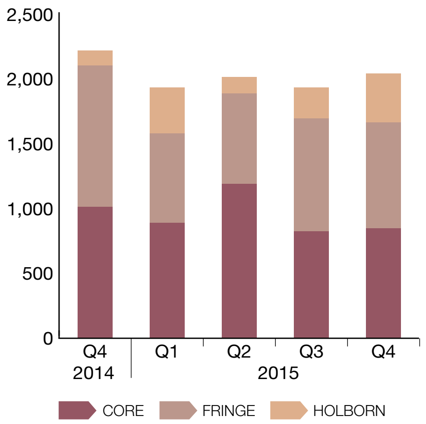
CITY

- Quarterly take-up totalled 2.0 m sq ft
- Availability fell to 5.9 m sq ft, lowest for 15 years
- Prime headline rent rose to £70.00 per sq ft
- Investment turnover in Q4 totalled £3.4 bn, the highest on record

FIGURE 1

City take-up by quarter & sub-market

Q4 2014 - Q4 2015 (000's sq ft)



Demand

Quarterly take-up totalled 2.0 m sq ft in the final quarter, up 5.4% over the quarter and 15% above the long-term average. City take-up has been remarkably consistent over the course of 2015, with each quarter returning between 1.9m and 2.0 m sq ft. As a result, take-up for the year reached just below 8.0 m sq ft. This is 11% above the long-term annual average.

The largest share of market activity was located in the City Core, contributing to 42% of total take-up. This included the largest transaction for the quarter; 100 Bishopsgate, EC3, totalling 218,000 sq ft. Take-up of new and refurbished stock totalled just 657,000 sq ft in the fourth quarter. Following three quarters of standout take-up results, the decline reflects a lack of new available stock to satisfy large requirements. As a result, take-up of second-hand Grade A stock doubled to record 1.2 m sq ft.

Active requirements have fallen over the quarter, primarily due to a number of large pre-commitments. Total active searches at the end of the fourth quarter of the year totalled 3.7m sq ft. Financial occupiers accounted for 26% of active searches, followed by IT & Telecommunications with 17%. Of note, Media and Marketing occupier searches more than doubled over the quarter to account for 13% of total active requirements.

Supply & development

Availability across the City fell marginally by 2% from 6.0 m sq ft to 5.9 m sq ft in the fourth quarter. Levels of supply are now 40% below the long-term average of 9.8 m sq ft. The vacancy rate contracted to 5.0% over the quarter, remaining at its lowest level since Q2 2001. The level of new and refurbished space increased in the fourth quarter, up 26% totalling 2.4m sq ft. This remains 29% below the long-term average level. There is just one building in the Core that could provide an occupier with 100,000 sq ft of new and refurbished space within the next six months.

There is currently just under 8.5 m sq ft of space under construction in the City, albeit 3.8 m sq ft is already pre-let. There is 1.0 m sq ft that is speculatively under construction in the Core that will complete by the end of 2016. Just two of these schemes are over 100,000 sq ft, One Angel Court, EC2 and Creechurch Place, EC3.

Rental Profile

The prime rent increased to £70.00 per sq ft in the fourth quarter, a rise of 5.3% on the previous quarter, and 12% on the year, with further rental growth expected in 2016. Rent free periods have remained stable during the quarter sitting between 18 and 21 months on a typical 10-year term certain.

Investment

Investment turnover in the fourth quarter totalled £3.4 bn, up 77% on the previous quarter and significantly above the long term average of £1.9 bn.

At the end of 2015, availability appeared relatively high at £3.7 bn, well above the long-term average of £2.7 bn. However, 70% of this was under offer, leaving just £1.2 bn available for sale. Availability at the end of the fourth quarter involved 13 large lot properties of over £100 m, accounting for 78% of total availability.

Prime City office yields have remained at a record low 4.00% for the entirety of 2015, although lower yields have been achieved for reversionary stock. Overseas investors dominated purchaser profile, accounting for 67% of all transactions. Despite this, UK purchasers remained very active in the smaller lot size bracket and accounted for 60% of total deals over the quarter.

FIGURE 2

City availability by quarter & sub-market

Q4 2014 - Q4 2015 (000's sq ft)

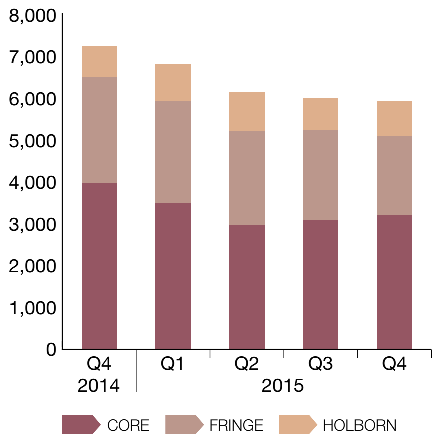
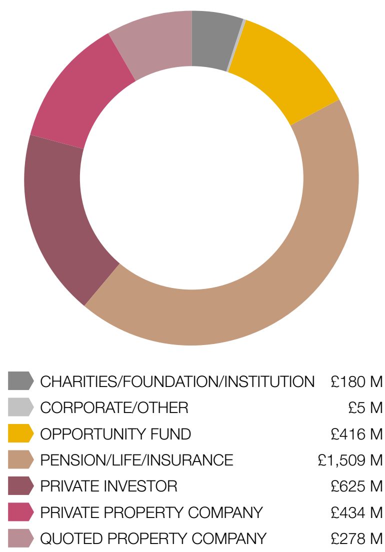


FIGURE 3

City investment by purchaser

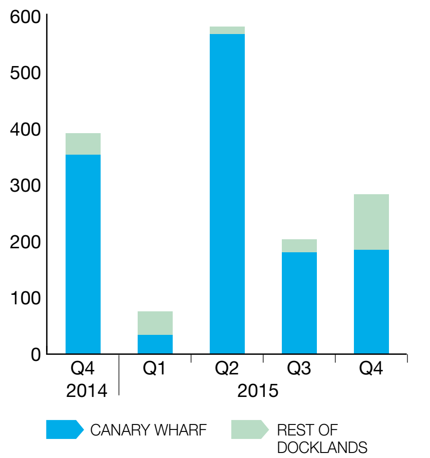
Q4 2015 (£m)



DOCKLANDS

- Take-up totalled 283,000 sq ft, 9% above the long-term average
- Availability fell to 744,000 sq ft, 47% below average
- Prime headline rent remained at £39.00 per sq ft
- Investment turnover in Q4 totalled £196 m

FIGURE 1
Docklands take-up by quarter & sub-market
Q4 2014 - Q4 2015 (000's sq ft)



Demand

The final quarter of 2015 saw above-average take-up in Docklands of 283,000 sq ft, taking the total for the year to 1.1 m sq ft, 10% above the long-term average. Leasing activity in the Canary Wharf submarket accounted for 84% of all transactions during 2015, as demand remained buoyant. Unsurprisingly, the financial sector accounted for the majority of take-up during the year; financial occupiers acquired almost 60% of all space let.

There was only one transaction in excess of 100,000 sq ft during 2015; Deutsche Bank acquired 389,000 sq ft at 10 Upper Bank Street, E14 in the second quarter. Interestingly, 61% of all leasing transactions involved units of less than 50,000 sq ft in 2015, which is considerably higher than the annual average of 37% for this market.

Supply & Development

Availability fell to 744,000 sq ft, 47% below the long-term average and the lowest since 2008. This represents a vacancy rate of 3.4%, significantly below the wider Central London market. Supply in the Docklands market has been on a downward trend for the last five quarters, and this is expected to continue during 2016.

The development pipeline remains extremely thin in the Docklands market. There is no space under construction and due to be delivered between now and 2019. The next potential speculative space to be delivered is 420,000 sq ft at 1 Bank Street, E14, where Societe Generale pre-let 280,000 sq ft at the end of 2014. The scheme is expected to be completed in Q1 2019.

Rental Profile

The prime headline rent remained stable at £39.00 per sq ft for the second consecutive quarter. As supply continues to tighten across Central London, we expect upward pressure on prime rents during 2016.

Investment

Investment turnover in the final quarter was £196 m taking the total for the year to £450 m. This is well below the long-term annual average level of £1.1 bn, and significantly lower than the 2014 which saw £2.8 bn of investment stock transacted. However, it ought to be noted that turnover in the Docklands market has traditionally been heavily influenced by availability levels.

The outlook for turnover in the early 2016 is positive. As we finished 2015, the freehold interest in 17 Columbus Courtyard, E14, quoting £132.3 m was under offer, while the £435 m freehold interest in 1 Cabot Square, E14 was available for purchase.

> "The prospect of tightening supply and solid demand will place upward pressure on rents in 2016."

FIGURE 2
Docklands availability by quarter & sub-market
Q4 2014 - Q4 2015 (000's sq ft)

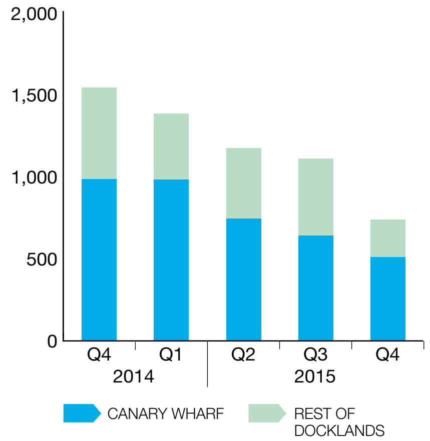
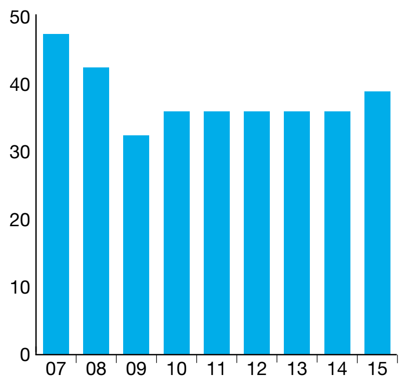


FIGURE 3
Canary Wharf prime rent
2007 - 2015 (Prime £/sq ft)



KEY STATISTICS

Central London office market

Availability (m sq ft)	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	3 months % change	12 months % change
West End	4.08	4.23	3.84	3.15	**3.15**	0.2%	-22.7%
City	7.27	6.83	6.04	6.03	**5.94**	-1.6%	-18.3%
Docklands	1.55	1.39	1.18	1.12	**0.74**	-33.3%	-52.0%
Central London	12.90	12.45	11.06	10.30	**9.83**	-4.5%	-23.8%

Vacancy Rate (%)	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	3 months % change	12 months % change
West End	4.4	4.6	4.2	3.4	**3.4**	n/a	n/a
City	6.1	5.7	5.1	5.1	**5.0**	n/a	n/a
Docklands	7.2	6.5	5.5	5.2	**3.5**	n/a	n/a
Central London	5.6	5.4	4.8	4.4	**4.2**	n/a	n/a

Take-up (m sq ft)	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	3 months % change	12 months % change
West End	1.51	0.83	1.16	1.09	**1.39**	28.5%	-7.7%
City	2.22	1.94	2.02	1.94	**2.05**	5.5%	-7.9%
Docklands	0.39	0.08	0.58	0.20	**0.28**	38.7%	-27.4%
Central London	4.12	2.85	3.76	3.23	**3.72**	15.3%	-9.7%

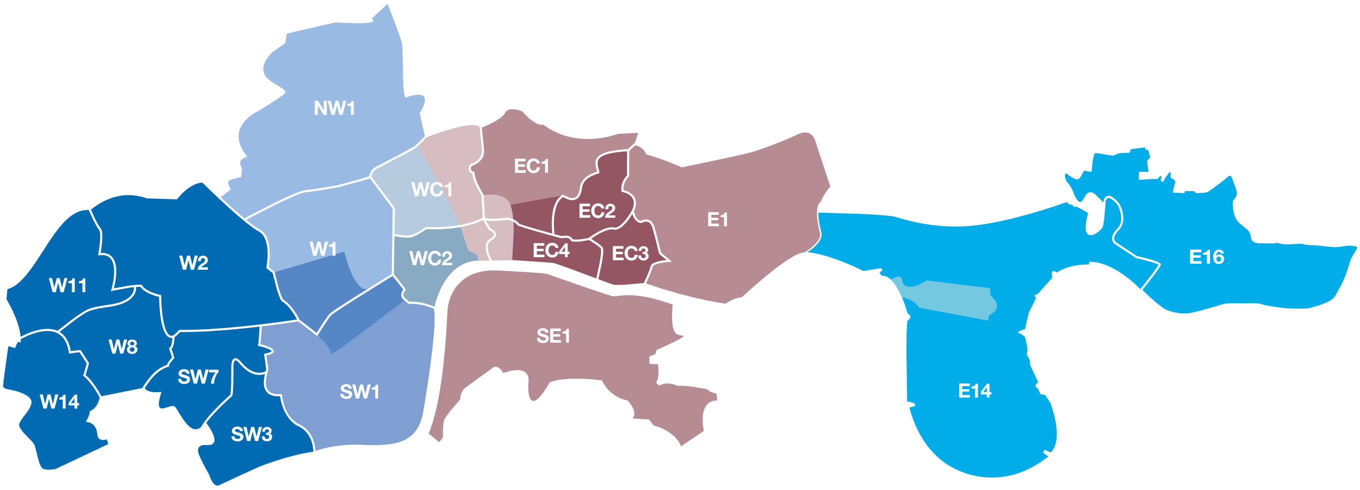
Active Searches (m sq ft)	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	3 months % change	12 months % change
West End	1.51	1.64	1.59	2.34	**2.59**	10.5%	71.3%
City	4.30	4.46	4.23	4.36	**3.73**	-14.3%	-13.2%
Docklands	0.94	1.03	0.98	0.72	**0.88**	21.7%	-6.8%
Unspecified Central London	0.51	1.65	1.83	1.27	**0.70**	-44.8%	37.6%
TOTAL Central London	7.25	8.78	8.63	8.69	**7.90**	-9.1%	8.9%

Under Construction (m sq ft)	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	3 months % change	12 months % change
West End	3.09	2.50	2.40	2.42	**2.96**	22.5%	-4.2%
City	4.74	5.08	6.17	8.25	**8.55**	3.6%	80.3%
Docklands	0.00	0.00	0.70	0.70	**0.70**	0.0%	n/a
Central London	7.83	7.58	9.27	11.36	**12.21**	7.4%	55.9%

Investment (£ m)	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	3 months % change	12 months % change
West End	2771.8	1031.1	2317.3	1405.4	**2675.4**	90.4%	-3.5%
City	4603.6	2281.5	3035.4	1948.4	**3447.7**	76.9%	-25.1%
Docklands	1333.3	0.0	19.3	235.0	**196.1**	-16.6%	-85.3%
Central London	8708.7	3312.6	5372.0	3588.8	**6319.2**	76.1%	-27.4%

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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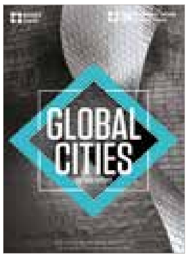

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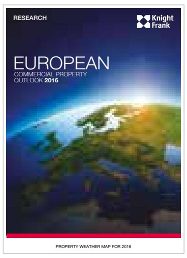

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