London Office Market Report

Q2 2023

- Take-up remains below trend, but space under-offer and requirements rise in Q2.
- Rising available floor space is contained in relatively less buildings.
- Increasing interest rates brings further re-pricing of City assets.

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Executive Summary

Key Themes

1.

Take-up remains below trend, but space under-offer and requirements rise in Q2.

2.

Rising available floor space is contained in relatively less buildings.

3.

Increasing interest rates brings further re-pricing of City assets.

OCCUPIER DEMAND REMAINS RESILIENT DESPITE ECONOMIC CHALLENGES

During the quarter, the impact of stubbornly high inflation, disruptions to economic activity from strike action, and the growing expectation of further interest rate hikes has led to an easing in economic growth across London and the UK. Despite this increasingly challenging backdrop, London office occupier demand has been resilient. Moreover, a rise in active requirements and in space under-offer suggests sustained resilience.

Overall levels of business activity in London are continuing to grow, and outperform other UK regions, but the rate of growth has eased over the last three months. London is the only region to report an expansion in current business volumes, but growth in forward-looking indicators such as new business and future sentiment are slowing and at the lowest levels this year. This reduction in sentiment and the increase in economic uncertainty is likely to act as a brake on expansionary occupier demand.

DEMAND FOR PRIME SPACE REMAINS ABOVE TREND.

Leasing transactions totalled 2.11m sq ft this quarter, up 8.6% on the previous quarter, but 30% below the quarterly trend. Momentum in the market has slowed, with take-up over the last year totalling 9.67m sq ft - some 20.7% below trend. Demand is polarised around the quality of space. Annual take-up for prime space totals 5.91m sq ft, which equates to 61.1% of the total and some 5% above the long-term trend. The flight to better quality buildings has driven the post-pandemic recovery.

> "Business volumes in London are continuing to grow, and outperform other UK regions, but the rate of growth has eased over the last three months."

The legal sector continues to lead the market, with two of the three largest deals this quarter. Goodwin Proctor acquired 89,645 at Sancroft, EC4M, and Dentons LLP signed a 66,372 sq ft pre-let at 1 Liverpool Street, 26 months ahead of expected completion. Demand from law firms has boosted take-up from the professional services sector over the last year, which has accounted for 27.7% of all transactions and exceeds trend levels by 61.8%. The second largest deal was Chanel pre-letting the entirety of 36-38 Berkeley Square, which is expected to complete in mid-2024. Financial occupiers have also remained active, accounting for a third of deals this quarter and 28.5% over the last year, surpassing long-term averages for the sector by 15.4%. Non-banking financials, which include insurance firms, and investment managers accounted for 95% of financial services transactions in Q2. Take-up was further supported by the technology, media and telecoms sector and other corporate occupiers who have accounted for 14.3% and 13.5% respectively.

Despite lower transaction levels, active requirements increased to over 9m sq ft, and are almost 10% above the long-term average. The financial and professional services sectors account for more than 70% of all near-term demand. The number of transactions under offer has also grown during the quarter, rising to 3.23m sq ft. Some 2.5m sq ft of these transactions relate to offices currently available. If all deals are completed, availability would reduce to 23.3m sq ft and the vacancy rate would fall to 9.2%.

Demand for prime space has continued to drive rental tension in core submarkets, with prime rents rising to £135.00 per sq ft in the West

End Core and £77.50 in Southbank Core. Our rental forecasts are also being revised to account for the changing economic outlook. As the London economy strengthens between 2024-27, we expect stronger occupier demand, combined with a supply squeeze of prime space, to drive relatively strong-rental growth.

PRIME AVAILABILITY REMAINS LOW RELATIVE TO DEMAND

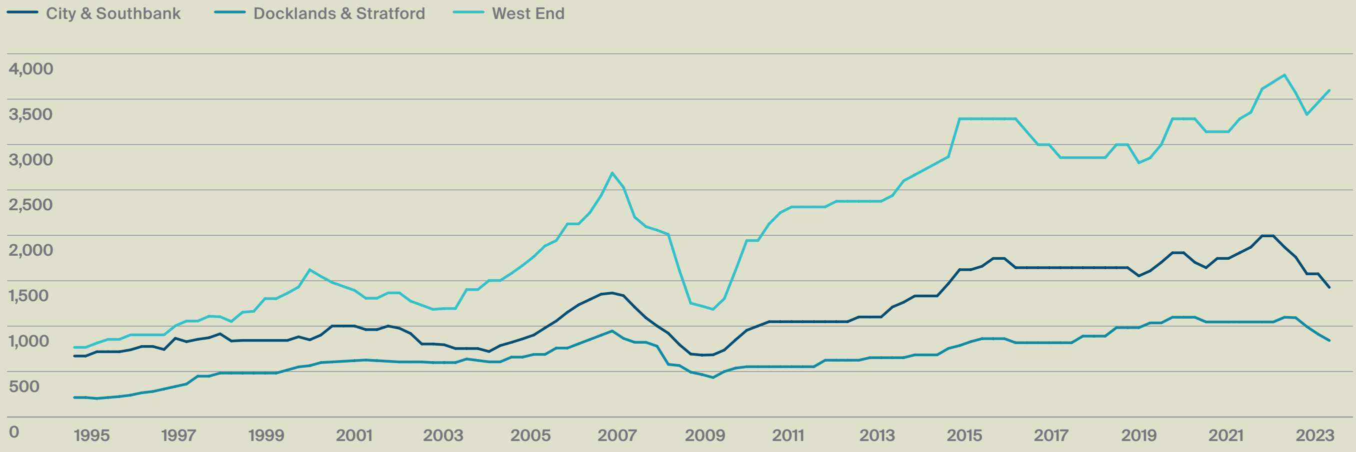
Availability has risen 7.5% to 25.8m sq ft this quarter, with the vacancy rate increasing to 10.2% against a long-term average of 6.8%. Of the 1.8m sq ft increase, 1.4m is attributable to upcoming developments, with tenant release space remaining stable at a quarter of all availability. The proportion of new and refurbished space remains elevated against historical levels, accounting for 58% of all market availability. Prime space remains concentrated in fewer buildings, with new and refurbished offices accounting for only 43.3% of available buildings, with 10 submarkets below this London average.

Available prime space is limited in larger size band buildings that are sustainable, well located and amenity rich. In the core City and West End submarkets there are only 15 buildings above 60,000 sq ft that have availability.

London - New/Refurb Availability
% of Available Floorspace, Number of Buildings (RHS)

Source: Knight Frank Research

London - Implied Capital Values
£ per sq ft



Source: Knight Frank Research

Compared with current active requirements, the lack of large prime floorplates becomes more apparent. There are currently twenty-four active requirements in the City for offices over 60,000 sq ft, compared to twenty-five prime buildings in the City Core. In the West End, there are twelve equivalent requirements against nine available buildings across the market, only nine of which are in central West End submarkets (West End Core, Fitzrovia, Marylebone, Soho, Strand/Covent Garden, Victoria). There are also a further twelve requirements where occupiers are considering options in both markets. As a result, many large occupiers are competing for prime space in central locations.

DEVELOPMENTS SPIKE IN 2023

There have been 12 schemes completed during the quarter, accounting for 1.81m sq ft, of which 18% has been leased. The largest schemes completed included 8 Bishopsgate in the City, and N2, Victoria in the West End.

There have been 1.1m sq ft of new construction starts and a total 16m sq ft of office space is under-construction and to be completed by 2026. Just under 30% of this pipeline has been pre-let whilst the remaining 11.5m sq ft is being built speculatively.

The expected level of development completions remains low, relative to average levels of take-up for the best quality buildings. By 2026, we expect a cumulative 9m sq ft under-supply of prime space across London. Over two-thirds of space under-construction in the ten largest schemes has already been pre-let.

RISING INTEREST RATES IMPACT MARKET UNCERTAINTY

Investment volumes fell 39.2% to £1.44bn, 61.7% below the quarterly long-term trend. Over the last 12 months, transactions have totalled £8.55bn, 44% below the annual long-term trend. During the quarter, 10-year UK government bond yields rose above the levels seen following the mini budget in 2022 and have impacted market liquidity. Reflecting the change in the financing environment, prime yields in the City and Canary Wharf markets have both softened by 50bps to 5.25% and 6.50% respectively. They are unchanged in the West End at 3.75%, as investor demand remains high for prime buildings with long and secure income streams. Transactions this quarter have been heavily focussed on value-add opportunities, representing 60% of deals. This suggests some risk appetite amongst investors as the leasing market for prime buildings remains robust.

The value of investment transactions this quarter has been heavily concentrated towards private capital (36%) and REIT's (34%) with institutional investment remaining subdued (10%) by the rising cost of debt. Capital from APAC (35%), United Kingdom (23%)
and North America (21%) also remain the most active sources of funds.

Overseas investor sentiment has been impacted by the appreciation in sterling against other leading currencies and higher hedging costs. Over the quarter the pound has risen by 2.5% against the euro and 2.8% against the US dollar. Similarly, sterling has risen by 11.9% against the Japanese yen and 2.7% against the HK dollar. However, the considerable re-pricing of London offices during the last 18 months offsets the impact of the stronger pound and capital values remain attractive in overseas currency terms.

London office market

Performance dashboard 2023 Q2

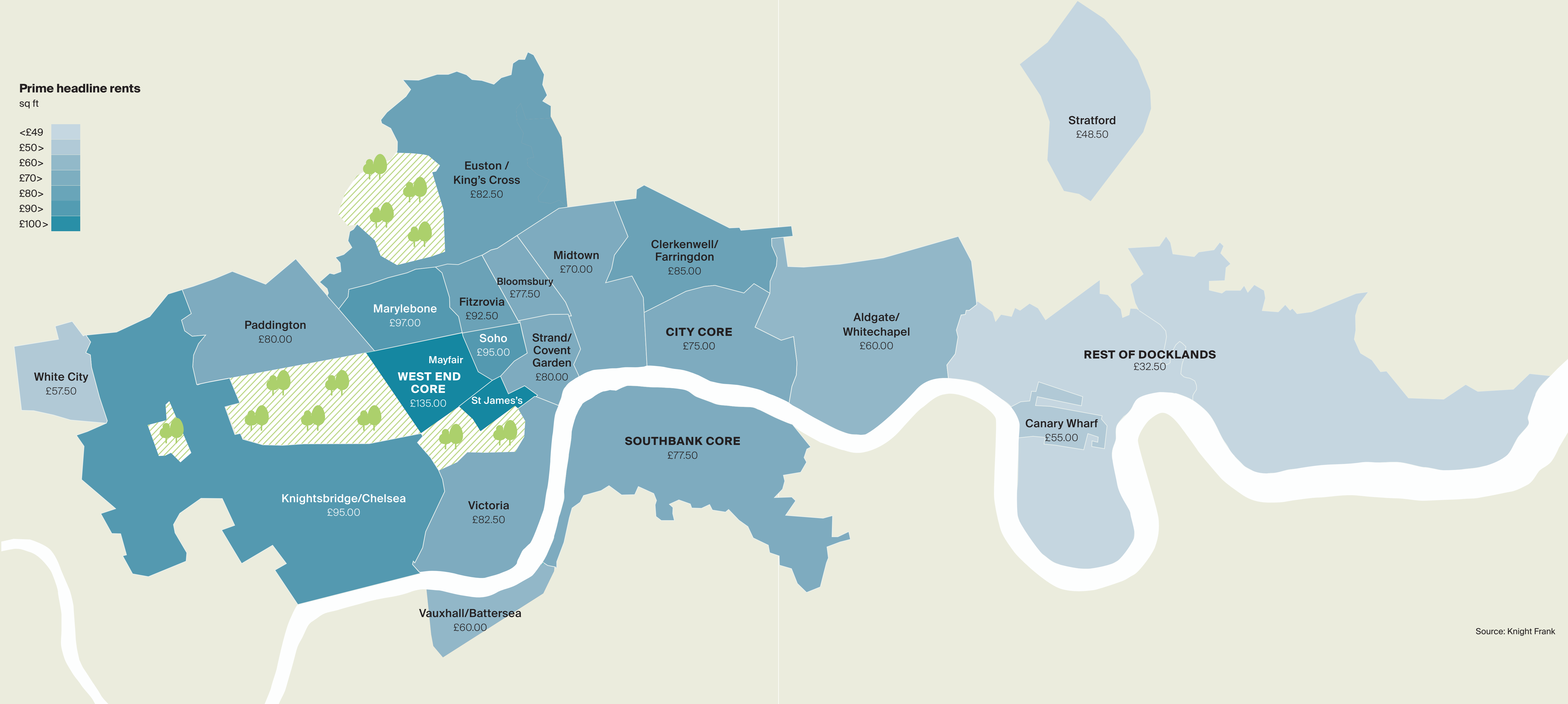
KEY PERFORMANCE INDICATORS

	▲ 2.11m TAKE-UP (SQ FT)	▲ 25.78m AVAILABILITY (SQ FT)	▲ 10.1% VACANCY RATE	▼ 16.07m UNDER CONSTRUCTION (SQ FT)
CHANGE ON				
2022 Q2	-33.9% ▼	26.3% ▲	1.9% ▲	6.1% ▲
LTA	3.0 million sq ft	15.89 million sq ft	6.8 %	10.86 million sq ft

WEST END	
▲ £135.00 Prime headline rent (per sq ft)	▼ 0.76 m Take-up (per sq ft)
▲ 0.88 bn Investment turnover	◀▶ 3.75% Prime Yield

CITY & SOUTHBANK	
◀▶ £75.00 Prime headline rent (per sq ft)	▲ 1.28 m Take-up (per sq ft)
▼ 0.53 bn Investment turnover	▲ 5.25% Prime Yield

DOCKLANDS & STRATFORD	
◀▶ £55.00 Prime headline rent (per sq ft)	▲ 0.07 m Take-up (per sq ft)
▼ 0.19 bn Investment turnover	▲ 6.50% Prime Yield



Source: Knight Frank

MARKETS IN REVIEW

The City & Southbank

Arrows throughout the report show how values have increased, decreased or stayed the same since the last quarter unless specified

£75.00
Rent (per sq ft)

▲ 1.28 m
Take-up (per sq ft)

▲ 15.11 m
Availability (per sq ft)

▼ 532.58 m
Investment turnover

▲ 5.25%
Prime yield

QUARTERLY RISE IN TAKE-UP

Q2 saw 1.28m sq ft of take-up in the City & Southbank, an increase of 24.2% on the quarter, although below the long-term quarterly trend of 1.65m sq ft. The largest transactions were for new and refurbished space, demonstrating continued demand for best-in-class space. More than 70% of transactions during the quarter were for prime space.

Near-term demand is supported by 4.42m sq ft of active requirements down 3.1% on the previous quarter, but 2.3% above the long-term trend.

Whilst space under-offer in the City & Southbank is 2.3m sq ft.

Professional and financial occupiers continue their dominance of take-up, representing 26.5% and 29% of the total respectively. The largest deal of the quarter was Goodwin Proctor (UK) LLP acquiring 89,645 sq ft at the redeveloped Sancroft building. The move for the law firm is an expansionary one, doubling their current footprint at 100 Cheapside. The second largest deal was for another legal firm, Dentons LLP, who have acquired 66,372 sq ft at 1 Liverpool Street. There was further space let

"Q2 saw 1.28m sq ft of take-up in the City & Southbank, an increase of 24.2% on the quarter" at Sancroft to Convene who will manage the amenity space upon their occupation. During the quarter prime rents were unchanged across the City. In Southbank Core, prime rents have risen by £2.50 to £77.50 per sq ft, as lettings at the Shard and Arbor (Bankside Yards) raise the rental tone in the submarket.

NEAR-TERM COMPLETIONS RAISE AVAILABILITY

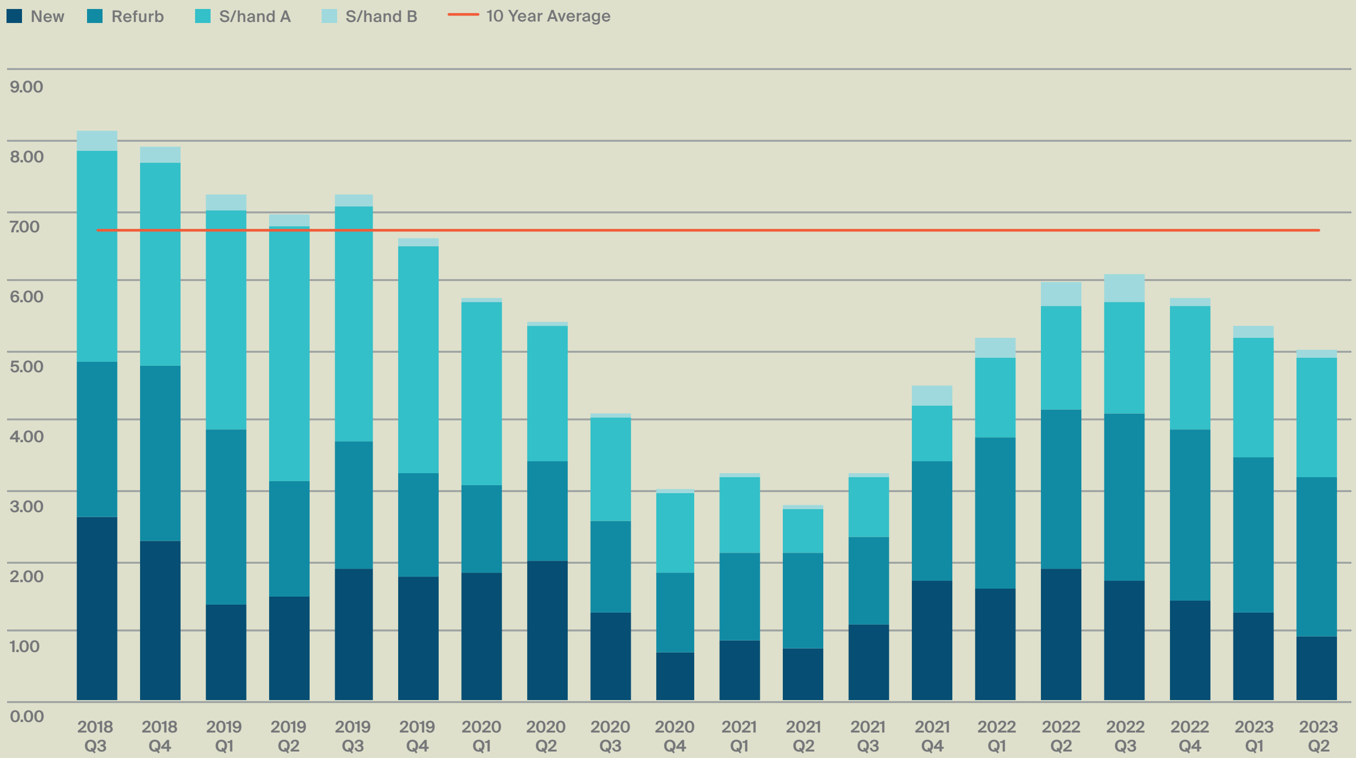
Availability rose by 9.5% over Q2 to 15.12m sq ft and has taken vacancy rates to 11.1%. Almost 60% of available floorspace is new and refurbished, driven largely by 1.6m sq ft of speculative completions in the market over the next six months. In terms of number of buildings, prime availability as a share of all availability falls to 46% and is particularly low in higher size band buildings. For example, in the City Core, there are only three available buildings between 60 – 80,000 sq ft and only 11 above 80,000 sq ft.

Just under 1m sq ft of speculative space was completed in Q2, whilst 10.08m sq ft remains currently under-construction. Almost 30% of this space is already leased. Notable completions include 8 Bishopsgate EC2, The Carter EC4 and the Northcliffe EC4, with 8 Bishopsgate comprising just over half of the completed speculative space. Six new schemes were started during Q2, totalling 0.9m sq ft.

INVESTMENT SLOWS

The investment market for assets in the City & Southbank suffered from lower levels of liquidity as sentiment was weighed-down by higher interest rate risk. Transaction volumes fell by 61%, resulting in a total of £0.53 bn for the quarter. The largest deal of the quarter was the sale of Sancroft, Newgate Street, EC1 which was acquired by Greycoat and Mitsui Fudosan for £315m. The development is located within the amenity rich Paternoster Square neighbourhood and was also home to two out of five of the largest leasing transactions seen during Q2. Investors from APAC were the most active group of buyers with 59% of transaction volume during the quarter, followed by North America (19%), and the United Kingdom (18%). Listed property companies represented 61% of acquisitions, while private investors and property companies accounted for almost a fifth of total volumes. The majority of transactions were for assets where investors were willing to underwrite a degree of near-term leasing risk, indicating investor confidence in the outlook for the prime leasing market. Higher interest rates have led to a further re-pricing of City & Southbank assets in Q2. Prime yields have moved-out by a further 50bps to 5.25%.

City & Southbank - 4 Qtr Take-up By Grade
m sq ft



Source: Knight Frank Research

MARKETS IN REVIEW

West End

▲ **£135.00**

Rent (per sq ft)

▼ **0.76 m**

Take-up (per sq ft)

▲ **6.60 m**

Availability (per sq ft)

▲ **883.62 m**

Investment turnover

◀▶ **3.75%**

Prime yield

> "Take-up totalled 0.76m sq ft in Q2, a mild decrease on the previous quarter and 32.7% below the quarterly long-term trend"

Take-up totalled 0.76m sq ft in Q2, a mild decrease on the previous quarter and 32.7% below the quarterly long-term trend. Take-up was above trend levels in only two West End submarkets – Knightsbridge/Chelsea and West End Core. Transactions for the best quality space was 0.43m sq ft, 7% below the quarterly long-term trend and representing 57% of all lettings.

The largest transaction of the quarter was Chanel Ltd pre-letting 88,327 sq ft at 36-38 Berkeley Square, W1J, 12 months ahead of completion. The second largest transaction was at the Lucent building, 1 Sherwood Street, W1D where a confidential financial occupier has pre-let 49,287 sq ft. Financial firms remain the dominant occupier group in the West End, accounting for 42.4% of transactions.

Short-term demand prospects are underpinned by almost 2m sq ft of active requirements, which is up by 1.4% during the quarter and in-line with the long-term trend. Almost one-third of active requirements are from financials followed by professional services (21.3%) and other corporate occupiers (18.8%).

The shortage of prime space has driven further rental growth in the West End Core, with rents rising by £5 to £135.00 per sq ft. Rent free periods are unchanged at 24 months on a typical 10 year lease.

AVAILABILITY RISES FOR A SECOND SUCCESSIVE QUARTER.

Availability rose for a second consecutive quarter and by 4.1% to 6.6m sq ft. This implies a vacancy rate of 7.1% which is 1% above the long-term trend. New and refurbished space accounts for almost two-thirds of availability, due in part to c.400,000 sq ft of speculative completions in Q2. The availability of new and refurbished buildings is much lower at 38%.

Notable completions last quarter include N2 Victoria, SW1, and One Wood Crescent, W12. The former comprises nearly 159,215 sq ft, of which 63% has been pre-let to financial occupiers. The latter is the latest completion in White City, and half of its 109,844 sq ft has been pre-let to global fashion company PVH.

The under-construction development pipeline has 3.94m sq ft of speculative space. Almost 1.5m sq ft of space under-construction has already been pre-let. The largest schemes under-construction include the 650,000 sq ft Google Campus in King's Cross/Euston, Future Olympia (508,705 sq ft) in Knightsbridge/Chelsea and Portland House (264,387 sq ft) in Victoria.

▼ 33%

Annual West End take-up 32.7% below the quarterly long-term trend

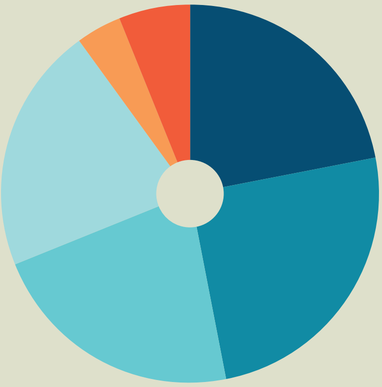
INVESTMENT TRANSACTIONS RISE

There was £0.9bn of investment transactions in Q2, which is an increase of 16.9% on the previous quarter. The largest deal of the quarter was Hines acquiring Film House, W1 for £130m from WeWork's Investment Arm, Arc. The second largest transaction was 20 Rathbone place, W1 which JP Morgan Chase & Co acquired for £61m. There has been less activity from European and APAC purchasers, with buyers from the UK (25%), and North America (21%) being more active in the second quarter. Private capital (high net worth individuals and private property companies) was the main investor type, accounting for almost one-quarter of all transactions. Over half of transactions can be categorised as assets which require some capital expenditure, signalling confidence in the future leasing market.

West End – Investment volumes by Buyer Nationality

% of investment 2023 Q2

APAC	22%
UK	25%
Europe	22%
North America	21%
Middle East	4%
Undisclosed	6%



Source: Knight Frank Research

West End – Investment volumes by Buyer Nationality

% of investment 2023 Q2

Corporate/Other	9%
Opportunity Fund/PE Fund	7%
Private Investor	29%
Pensions/Life/Insurance	15%
Private Property Company	18%
Quoted Property Company	17%
Undisclosed	5%

Source: Knight Frank Research

MARKETS IN REVIEW

Docklands & Stratford

£55.00	Rent (per sq ft)
▼ 0.07 m	Take-up (per sq ft)
▲ 4.38 m	Availability (per sq ft)
▼ 18.50 m	Investment turnover
▲ 6.50%	Prime yield

"There was six lettings in Docklands & Stratford totalling just over 70,000 sq ft. This is down 37% on the previous quarter and almost 70% below the long-term quarterly trend."

TAKE-UP SOFTENS

There was six lettings in Docklands & Stratford totalling just over 70,000 sq ft. This is down 37% on the previous quarter and almost 70% below the long-term quarterly trend. Five of the six transactions occurred in Docklands (Canary Wharf) and included BP International relocating its trading operations from 20 Canada Square to Cargo, 25 North Colonnade, E14 (24,506 sq ft) and HCA International Limited at 40 Bank Street, E14.

Other corporate occupiers accounted for 71% of transactions last quarter followed by financials, and technology, media and telecoms, both accounting for 14% each.

Active requirements have reduced to 220,000 sq ft, with the public sector (42%), and financial services (38%) being most active. Near-term demand from the technology, media and telecoms sector has risen substantially during the quarter, but is not sufficient to offset lower levels of requirements from professional services and the public sector.

RISING AVAILABILITY

Availability rose by 8.3% during the quarter to stand at 4.38m sq ft. The increase is due, in part, to 214,333 sq ft of speculative space completing in the next six months, together with 1.9 m sq ft of tenant release space. This latter grouping represents 46% of total availability. Accordingly, the vacancy rate has risen by 0.9 percentage points to stand at 16.5%. This rate is 7 percentage points above the long-term trend. Availability in this submarket is almost evenly split between new and refurbished and second hand space.

▲ 8.3%

Availability rose during the quarter to 4.38m sq ft

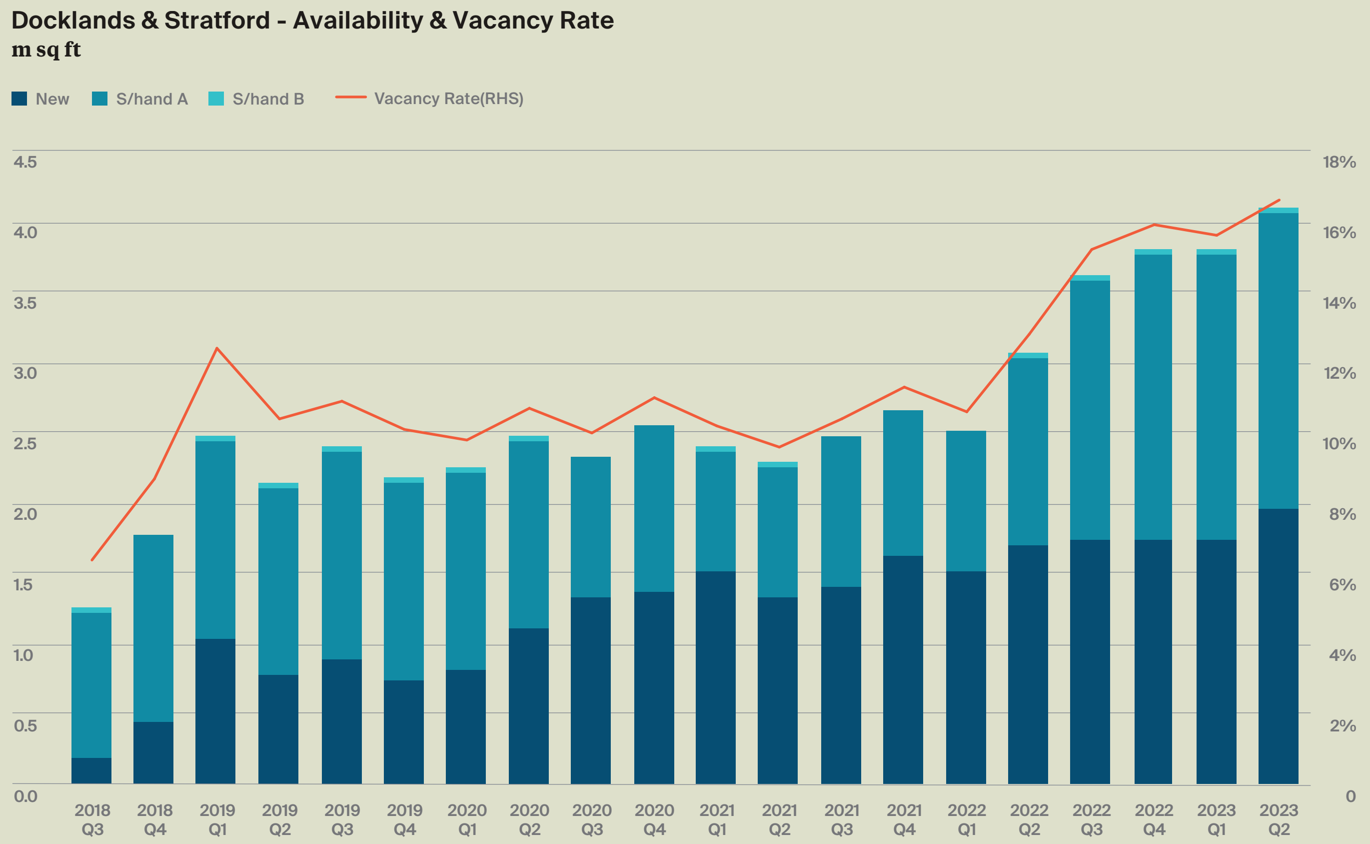
MINIMAL CONSTRUCTION ACTIVITY

Completions during the quarter include YY London, 30 South Colonnade in Canary Wharf, which comprises 414,812 sq ft of speculative space. There are no further schemes under-construction in the Canary Wharf submarket.

There are two schemes currently under-construction in Stratford – the Turing Building (343,890sq ft) which is expected to complete in 2024 and the Chimney Walk development which will deliver just under 200,000 sq ft of speculative space later in 2023.

FURTHER RISE IN YIELDS

AEW's purchase of Harbour Island, E14 for £18.5m was the only investment transaction in the market in Q2. The rise in interest rates and lack of liquidity in investment markets where debt plays an important role has led to a further 50bps rise in yields to 6.5%.



Source: Knight Frank Research

Key Statistics

	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	% CHANGE 3 MONTHS	% CHANGE 12 MONTHS	10-YEAR QUARTERLY AVERAGE
AVAILABILITY (SQ FT)								
West End	6.17 m	5.21 m	5.13 m	6.34 m	6.55 m	3.3%	6.1%	5.31 m
City & Southbank	11.18 m	12.48 m	12.72 m	13.81 m	15.11 m	9.4%	35.2%	8.53 m
Docklands & Stratford	3.06 m	3.63 m	3.81 m	3.80 m	4.11 m	8.3%	34.3%	2.04 m
London	20.41 m	21.32 m	21.66 m	23.95 m	25.78 m	7.6%	26.3%	15.89 m
VACANCY RATE								
West End	6.8%	5.7%	5.6%	6.9%	7.1%	0.2%	0.3%	6.1%
City & Southbank	8.4%	9.3%	9.5%	10.2%	11.1%	0.9%	2.7%	6.9%
Docklands & Stratford	12.8%	15.2%	15.9%	15.6%	16.5%	0.9%	3.7%	9.3%
London	8.2%	8.6%	8.7%	9.5%	10.1%	0.6%	1.9%	6.8%
TAKE-UP (SQ FT)								
West End	1.49 m	1.17 m	1.31 m	0.80 m	0.76 m	-5.2%	-49.2%	1.12 m
City & Southbank	1.64 m	1.18 m	1.50 m	1.03 m	1.28 m	24.2%	-22.1%	1.65 m
Docklands & Stratford	0.06 m	0.30 m	0.16 m	0.11 m	0.07 m	-36.9%	23.0%	0.22 m
London	3.19 m	2.65 m	2.98 m	1.94 m	2.11 m	8.6%	-33.9%	3.00 m
ACTIVE REQUIREMENTS (SQ FT)								
West End	1.03 m	1.40 m	1.43 m	1.96 m	1.99 m	1.4%	93.5%	1.99 m
City & Southbank	4.18 m	5.04 m	4.59 m	4.60 m	4.46 m	-3.1%	6.6%	4.30 m
Docklands	0.12 m	0.11 m	0.15 m	0.30 m	0.22 m	-28.7%	80.4%	0.57 m
London-wide	2.54 m	0.91 m	1.31 m	1.55 m	2.39 m	53.6%	-5.9%	1.81 m
London	7.86 m	7.46 m	7.47 m	8.41 m	9.04 m	7.5%	15.1%	8.67 m
SPEC UNDER CONSTRUCTION (SQ FT)								
West End	5.29 m	5.64 m	5.31 m	5.89 m	5.42 m	-7.9%	2.6%	3.41 m
City & Southbank	9.10 m	9.46 m	9.36 m	9.88 m	10.08 m	2.1%	10.8%	6.67 m
Docklands & Stratford	0.76 m	0.76 m	0.76 m	0.98 m	0.56 m	-43.0%	-26.4%	0.78 m
London	15.14 m	15.86 m	15.42 m	16.75 m	16.07 m	-4.1%	6.1%	10.86 m
DEVELOPMENT COMPLETIONS (SQ FT)								
West End	0.13 m	0.28 m	0.71 m	0.12 m	0.43 m	259.5%	224.6%	0.29 m
City & Southbank	0.74 m	0.78 m	0.45 m	0.32 m	0.94 m	190.0%	26.8%	0.60 m
Docklands	0.06 m	0.00 m	0.00 m	0.00 m	0.41 m		591.4%	0.12 m
London	0.93 m	1.06 m	1.16 m	0.44 m	1.78 m	302.3%	91.2%	1.01 m
INVESTMENT TURNOVER								
West End	£1.68 bn	£1.30 bn	£0.90 bn	£0.76 bn	£0.88 bn	16.9%	-47.3%	£1.43 bn
City & Southbank	£1.50 bn	£2.00 bn	£0.56 bn	£1.48 bn	£0.53 bn	-63.8%	-64.4%	£2.13 bn
Docklands & Stratford	£0.00 bn	£0.00 bn	£0.00 bn	£0.13 bn	£0.02 bn	-86.0%	0.0%	£0.19 bn
London	£3.18 bn	£3.30 bn	£1.46 bn	£2.36 bn	£1.44 bn	-39.2%	-54.8%	£3.75 bn
PRIME HEADLINE RENTS (PER SQ FT)								
West End	£122.50	£125.00	£125.00	£130.00	£135.00	3.8%	10.2%	3.3%
City & Southbank	£75.00	£75.00	£75.00	£75.00	£75.00	0.0%	0.0%	2.7%
Docklands & Stratford	£52.50	£55.00	£55.00	£55.00	£55.00	0.0%	4.8%	4.3%

Source: Knight Frank. Notes: London active requirements includes unspecified target locations. Percentage point difference for vacancy rate.

We like questions. If you've got one about our research, or would like some property advice, we would love to hear from you.

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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 London office teams 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