Take-up falls to historic low

Active requirements slip

Investment stock under offer rising

Knight Frank

knightfrank.com/research

THE LONDON OFFICE MARKET REPORT

Q2 2020

MARKET ROUNDUP

The vacancy rate across London has risen to 6.1%

◆

Weakest quarter on record for leasing

◆

An easing of global travel restrictions is boosting demand for London assets

1.26m sq ft

OF LEASING DEALS CONCLUDED DURING Q2

Requirements dip as COVID-19 stalls the market

With the market remaining essentially frozen for nine out of 12 weeks during Q2 due to lockdown restrictions which hampered property viewings and inspections, overall activity in London's office market has been subdued over the last three months.

Occupiers have, unsurprisingly, been reassessing relocation and expansion plans in the wake of the COVID-19 epidemic, primarily due to considerations around working from home provisions in the future, as well as some tentatively exploring the potential of more radical alternatives ranging from hub-and-spoke models, in an effort to create formal touch down points closer to employees' home postcodes, and a split of operations to include nearshoring.

Locating in London, a global financial centre, comes with the added benefits of agglomeration, hard to rival culture and arguably most importantly, access to unrivalled work environments that are a magnet for future talent. The war for talent is an issue we believe will transcend the COVID-19 crisis, especially as much of the economic fall-out thus far has been largely government induced. Indeed in our 2020 London Landlord and Investor Survey, attracting and retaining talent was the number one concern amongst businesses.

We are yet to record any occupier committing to such a shift and instead attention remains firmly centred on best-in-class space, almost irrespective of geography, as well as achieving enhanced environmental, social and governance aspirations and considerations. You can read more about this in our recently published *Covid-19 Series: Revisiting The 2020 London Report*.

In recent weeks however, there has been growing interest in second-hand / tenant release space as well, primarily as it can offer greater lease flexibility, reduced rents, an existing fit out and therefore a potentially shorter lead in period when compared to new space.

Total active requirements in the market slipped to 8.14m sq ft, down 12% on Q1 and almost a fifth lower than this time a year ago. This is also the first time in almost three years that demand has fallen below the long-term average of 8.56m sq ft.

Weakest quarter on record for leasing volumes

During Q2, just 1.26m sq ft of leasing transaction were recorded across London. This is lowest quarterly figure in our near 30-year time-series and is marginally worse than the weakest point during the GFC, when leasing volumes declined to 1.29m sq ft during Q1 2009.

Largest let of the quarter in Canary Wharf

The professional, corporate and finance sectors accounted for 54% of all lets, compared to 37% in Q1. The ITT sector followed at 17.3%. Most notably, there were no flexible office leases recorded during the quarter as the sector continues to grapple with the aftermath of the epidemic and the subsequent impact on demand for space, especially from non-enterprise businesses, i.e., those with less than 100 staff. That said, the number of viewings in this segment of the market has been steadily rising in recent weeks, following an easing of the nation-wide lockdown.

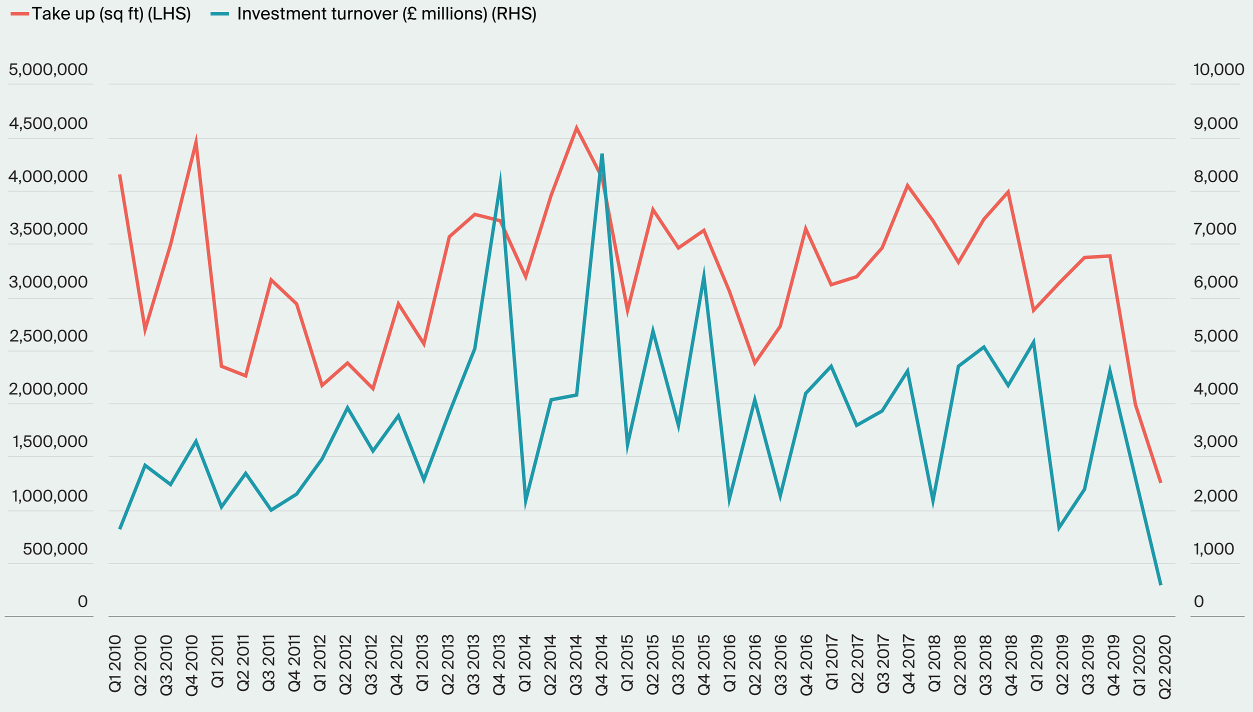
Of the 136 deals registered during the quarter, 80 were for under 5,000 sq ft of space. The biggest decline in leasing transactions was recorded in the 10-20,000 sq ft bracket (-57%).

The largest letting during the quarter and the only one in excess of 100,000 sq ft was BP's pre-let of 204,000 sq ft at Cargo in Canary Wharf. The second largest lease during Q2 was Covington and Burling's 85,500 sq ft lease at 22 Bishopsgate. Together, these two deals accounted for almost 23% of overall activity in the market.

Stable rents

Despite the subdued levels of activity for much of the quarter, prime headline rents have remained stable at £115.00 per sq ft in the West End, £72.50 per

London office market performance



Source: Knight Frank

sq ft in the City and £52.50 per sq ft in the Docklands. Rent free periods have however drifted by about three-months on 10-year leases in most submarkets and typically stand at between 24-27 months.

We are continuing to closely monitor tenant release space, which totalled almost 1m sq ft during Q2; however it is worth noting that only a modest percentage of this has been directly COVID-19 related. However, we do anticipate this trend will continue during the rest of 2020.

◆◆

Adding to the market complexities has been the severe shortage of purchasing opportunities

◆◆

The majority of the space released into the system was planned pre-epidemic, or has been a consequence of space consolidation due to pre-COVID M&A activity. This is likely to change as more space is released due to greater adoption of hybrid working patterns that allow for greater home working. For now, this figure remains substantially lower than the 8.1 million square feet increase in second hand space availability through the course of the Global Financial Crisis.

That said, this segment of the market faces the biggest challenge. With potential downside risks, including, but not limited to, a rise in unemployment as the government's furlough scheme ends and businesses accelerate the shedding of space due to potential changes to working patterns, we expect to see an even greater divergence in the performance of rents for prime and secondary space.

Lockdown restrictions hamper investment activity

The epidemic impacted global markets and London was no exception, with £2 billion worth of deals aborted as the UK went into lockdown. Just £595 million

transacted in Q2 – a fall of £2 billion when compared to Q1 and substantially down on the historic quarterly average of £3.4 billion.

That said, as the lockdown continues to ease, activity is ramping up, with international investors in particular showing a greater interest over the last few weeks. As we ended Q2, the total value of assets under offer was close to £3.5 billion – 97% up on 12-months ago and a fifth higher than Q1 2020.

Adding to the complexities has been the severe shortage of purchasing opportunities. The increased proportion of international investment in the London market and rising number of private investors has impacted the natural cycling of properties as many purchasers now buy for a long-term hold. This has driven a rise in interest in refurbishment opportunities. This is especially pertinent in our supply starved occupational market and strong demand for new office space means that nearly half of everything under construction is already spoken for.

Separately, there is the looming deadline for the government to secure a post-Brexit trading agreement with the EU, albeit London's safe haven status and proven track record of delivering secure sustainable returns and providing opportunities for wealth preservation are likely to trump near term Brexit concerns.

South East Asian investors expect to move first

In terms of sources of demand, we expect South East Asian investors to be the first out of the blocks, given that they are ahead of much of the world in terms of easing their lockdown restrictions. Only when global travel restrictions are eased in a meaningful way do we expect a real depth of demand to begin to materialise from this all-important group, who accounted for 21% of all purchases last year. For now private capital and UK managed capital are the most active given their long term time horizons and ability to deploy in advance of the easing of travel restrictions.

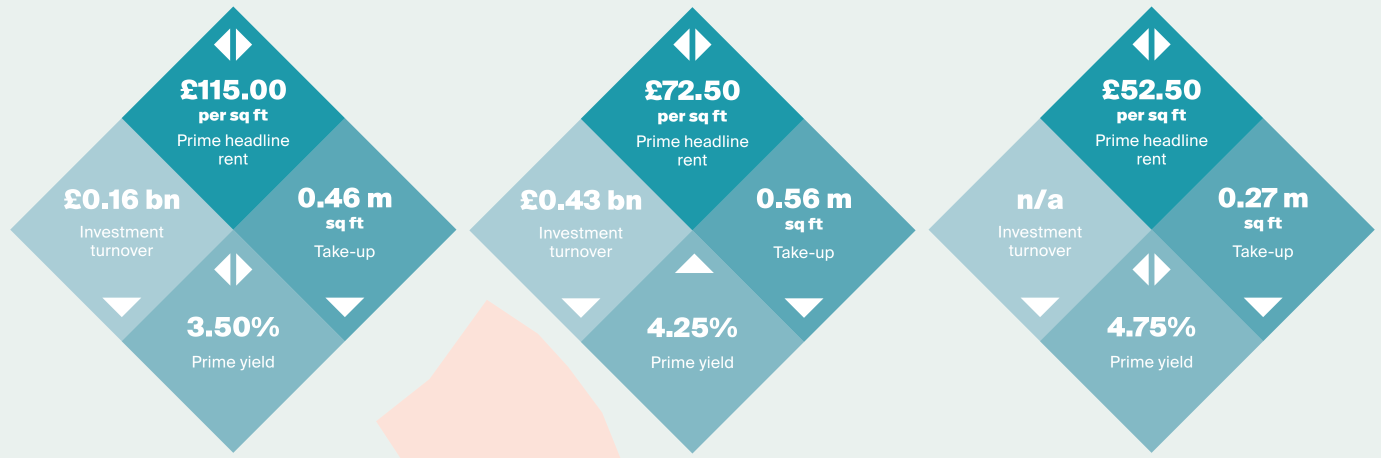
LONDON OFFICE MARKET

Performance dashboard Q2 2020

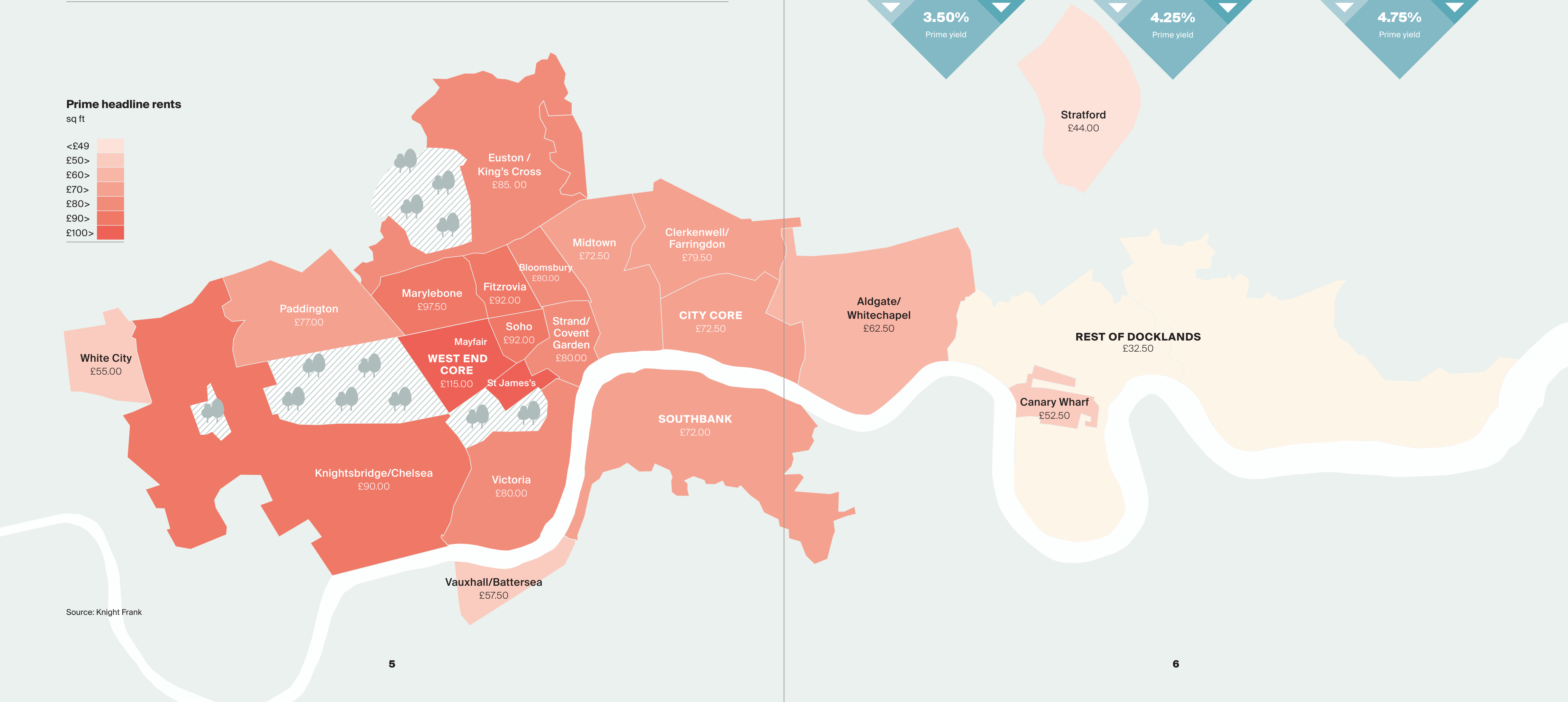
Key performance indicators

	▼1.3 m TAKE-UP (SQ FT)	▲14.2 m AVAILABILITY (SQ FT)	▲6.1% VACANCY RATE	▲13.8 m UNDER CONSTRUCTION (SQ FT)
Change on				
Q1 2020	-36% ▼	8% ▲	0.4% ◀▶	14% ▲
LTA	3.2 million sq ft	15.0 million sq ft	6.7%	8.6 million sq ft

WEST END CORE | **CITY CORE** | **DOCKLANDS**



Prime headline rents
sq ft



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

£72.50	0.56 m	7.44 m	£0.43 bn	4.25%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

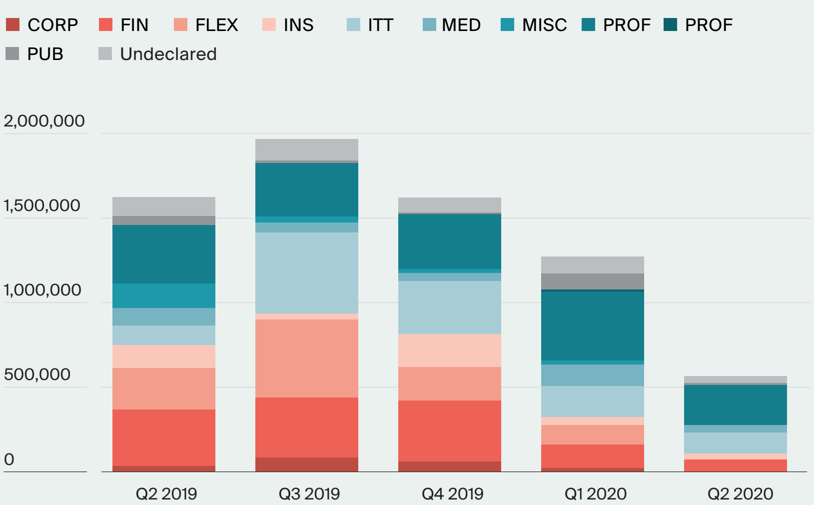
Take-up falls

The UK's lockdown restrictions following the COVID-19 epidemic drove a sharp slowdown in activity across all markets, with the City registering a 56% fall in the volume of office space leased during Q2, which translated into a little over 560,000 sq ft. This is 68% down on the long-term average and the weakest on record. The previous historic quarterly low was set in Q4 1992 (c.597, 000 sq ft).

Of the 57 deals registered during the quarter, 26 were for under 5,000 sq ft of space. The biggest decline in leasing transactions was recorded in the 10-20,000 sq ft bracket (-64%). There was just one deal over 50,000 sq ft, compared to four during Q1: Covington & Burling's 85,800 sq ft let at 22 Bishopsgate, EC2, which was also the largest letting in Q2.

As a result of the Covington and Burling deal, the professional sector (41.6%) accounted for the largest proportion of leasing activity, followed by ITT (22.1%) and Finance (12.9%). The largest lease deals in these sectors were CDW's 29,030 sq ft letting at One New Change, EC4 and the 11,464 sq ft let by ISAM Services (UK) Limited at 100 Bishopsgate, EC2, respectively.

City take-up by sector
sq ft



Source: Knight Frank

TAKE-UP REACHED
0.56m
SQ FT
IN Q2 2020

Active requirements slip

Active demand declined by 31% during Q2 to 3.51 m sq ft. The decrease is in large part due to businesses pausing expansion and relocation plans as they reassess their occupational strategies in the wake of COVID-19 and to account for greater home-working in the future. Active demand levels have now fallen below the long term average of 4.22 m sq ft and is the lowest level recorded since Q3 2014 (2.95m sq ft).

At the close of Q2, there were 13 businesses seeking over 100,000 sq ft in the City. There are just nine buildings available over 100,000 sq ft, with the largest two being 22 Bishopsgate, EC2 and Sixty London Wall, where approximately 435,000 sq ft and 324,000 sq ft was available at the end of Q2, respectively.

Relatively stable supply

Supply levels remained relatively stable during Q2, rising to 7.44 m sq ft, from 7.16 m sq ft during Q1. Despite a 22% year-on-year increase, overall availability still remains 11% below the long-term average of 8.31m sq ft.

At these levels, the overall vacancy rate in the City equates to 6.0% and 7.5% in the City Core, compared to a long-term average of 7.1% and 8.2% respectively.

And with 56% of the 3.87 m sq ft of office space due to complete this year already spoken for, the number of options for businesses is limited to 1.71 m sq ft. This factors for COVID-19 related construction delays, but this figure may drift further in the event of additional lockdowns.

◆◆

Total investment turnover was 71% down on Q1

◆◆

Investment down

Like the leasing market, investment activity was also sharply lower during Q2, primarily due to lockdown restrictions. Total investment turnover was 71% down on Q1, reaching approximately £430 m. The figure is also 47% lower than Q2 2019 and substantially below the long-term quarterly average for the City market of £2.12 bn. There were just two deals over £50 m: 10 Fenchurch Street for £95.2 m and a confidential deal in excess of £100 m.

There was just one transaction by domestic investors – 1 Knightrider Court, EC4 (£6.7 m). European investors accounted for almost £133 m worth of transactions, making them the most dominant investor group, accounting for about 31% of all transactions.

Investment activity rising as lockdown eases

While overall investment activity was down during Q2, as the government began to ease the lockdown restrictions in mid-June, we have seen an upturn in activity and interest, particularly from international investors. This is reflected in the fact that £2.65 bn worth of property was under offer as we closed out Q2 – 16% higher than Q1 and 182% up on Q2 2019.

MARKETS IN REVIEW

WEST END

◀▶ £115.00	▼ 0.46 m	▼ 4.32 m	▼ £0.16 bn	◀▶ 3.50%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Leasing activity declines

Take-up fell to 0.46 m sq ft during Q2, a 31% decrease on Q1 and 57% lower than the same period last year. The latest figure is also 62% below the long-term average of 1.22 m sq ft. The severity of the decline mirrors what has happened across London, with businesses pausing relocation and expansion decisions in the wake of the COVID-19 pandemic, with many now reassessing their occupational strategies, predominantly with a view to accommodate greater working from home.

The largest letting of the quarter was at 25 Golden Square in Soho, where 65,869 sq ft was pre-let to a business in the ITT sector.

Most leasing activity involved new and/or refurbished space, which accounted for nearly 50% of all leases, or about 206,000 sq ft.

There were a total of 76 lease transactions during Q2

Availability creeps up

As has been the case across London, availability crept up during the quarter, reaching 4.32 m, from 3.98 m sq ft during Q1. This was driven in large part by a growing amount of secondary space, which increased by 14% in Q2 to just over 2.9 m sq ft. Unsurprisingly, the rising levels of supply have lifted the vacancy rate in the West End to 5.0%, from 4.6% during Q1.

Despite this, there is just 461,000 sq ft being developed speculatively, with almost 68% of everything under construction already pre-let. We are currently tracking three business requirements for over 100,000 sq ft; however there is just one scheme that can accommodate demand of over 100,000 sq ft.

In total, we are tracking 1.49 m sq ft of active requirements. This compares to a long-term average of 2.06m sq ft.

Professional services and ITT dominate take-up

The professional (20.4%) and ITT (18.6%) sectors were the most active in the quarter, with the total amount of space leased by each sector reaching 88,000 sq ft and 81,000 sq ft, respectively. There were a total of 76 lease transactions during Q2, with 71% being for space under 5,000 sq ft. The average deal size was 5,694 sq ft.

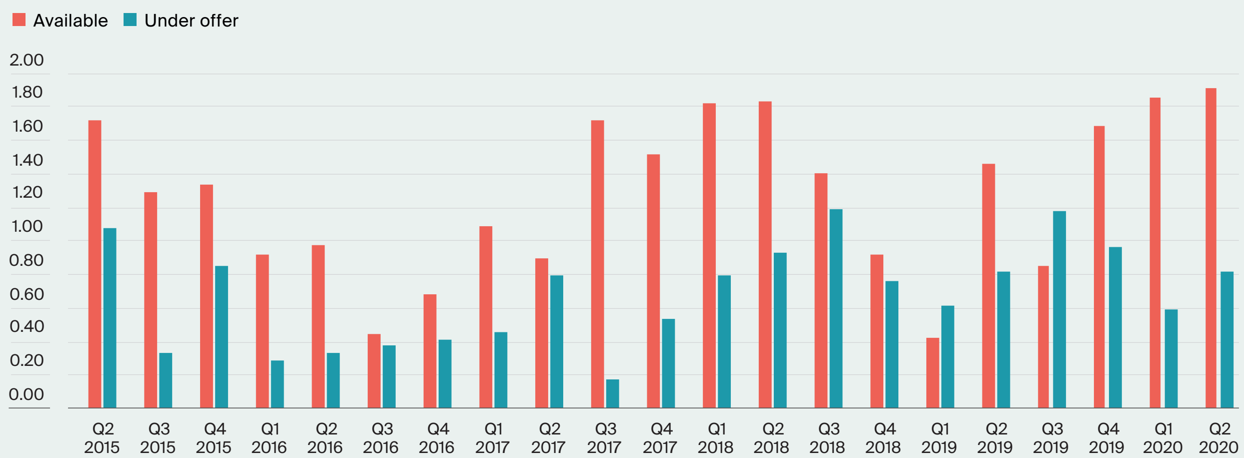
Investment activity recedes

As with other markets in London, investment turnover declined in the West End, falling by 85% to £0.16 bn during Q2. Activity has however been showing signs of recovering as global lockdown restrictions are eased, with the total amount of stock under offer rising by 39% during Q2 to £0.82 bn, bringing the number of deals in train in line with levels recorded 12-months ago.

The largest transaction in Q2 was Angelo Gordon and Beltane's purchase of Marylebone House, NW1 for £48.5 m.

TAKE-UP FELL IN Q2 TO
0.46m
SQ FT

West End investment history
£ bn



Source: Knight Frank

MARKETS IN REVIEW

DOCKLANDS & STRATFORD

◀▶ £52.50	▼ 0.27 m	▲ 2.48 m	▼ £0 m	◀▶ 4.75%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Occupier activity surges

Take up in the second quarter of 2020 reached 267,000 sq ft, up on the 93,000 sq ft recorded in Q1. The largest transaction of the quarter in the Docklands occurred in Canary Wharf, where BP acquired 204,000 sq ft at Cargo, 25 North Colonnade. There were two other leasing deals in Canary Wharf during the quarter. These were Bart's NHS Health Trust acquiring 45,000 sq ft at 20 Churchill Place, and IPC systems acquiring 18,000 sq ft at 40 Bank Street.

Corporates dominate take up

With British Petroleum's pre-let at Cargo, 25 North Colonnade, the corporate sector was by far the leading occupier sector in Q1, accounting for 76% of take-up. It was the largest deal of the quarter across London and the second largest leasing deal in London to date this year. The public sector was the second largest occupier in the Docklands for Q2, accounting for 17%, followed by TMT (7%) of take up in Q2. The financial sector has acquired the majority of stock over the last 12 months, totalling 448,000 sq ft, equating to 38% of space let in Canary Wharf.

There is currently 720,000 sq ft under construction in the Docklands and Stratford markets

Active requirements continue to be robust

Looking at active requirements in this market, demand decreased by 37% quarter-on-quarter. Levels however are still above the long-term average of 500,000 sq ft. Furthermore, we are tracking a number of occupiers currently located in other submarkets across London who are actively considering the Docklands and Stratford market as part of their wider search. There are currently two active requirements from businesses looking for space in excess of 100,000 sq ft in the Docklands.

Supply increases

Supply increased by 10% quarter-on-quarter totalling 2.48 m sq ft at the end Q2. Supply of new and refurbished stock now totals 1.16m sq ft. Across the Docklands and Stratford there are ten options which could provide an occupier with 100,000 sq ft or more.

Pipeline remains tight

Looking ahead at the pipeline, there is currently 720,000 sq ft under construction in the Docklands and Stratford markets, however, 52% of this has already secured a tenant. There is 212,000 sq ft due to complete in 2020 at 20 Water Street, Wood Wharf, E14 (211,000 sq ft), which is currently fully available.

No investment activity this quarter

There were no investment transactions that took place in the Docklands this quarter. There is a limited supply of investment stock with just three assets available in Canary Wharf, two of which are under offer. In the wider Docklands there is currently just one asset available to purchase.

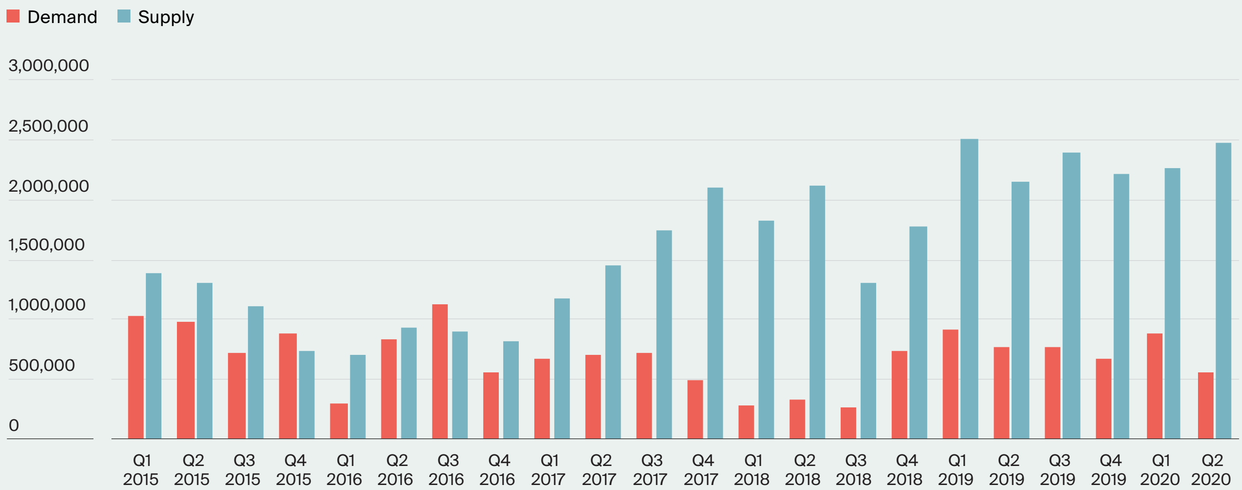
THE CORPORATE SECTOR WAS BY FAR THE MOST DOMINANT SECTOR

76%

OF TAKE-UP

Demand and supply in the Docklands

sq ft



Source: Knight Frank

KEY STATISTICS

	Q4 19	Q1 20	Q2 20	% CHANGE 3 MONTHS	% CHANGE 12 MONTHS
TAKE-UP (SQ FT)					
West End	1.53 m	0.66 m	0.46 m	-31%	-57%
City	1.62 m	1.27 m	0.56 m	-56%	-65%
Docklands	0.24 m	0.09 m	0.27 m	197%	-43%
Total London	3.38 m	2.00 m	1.26m	-36%	-59%
AVAILABILITY (SQ FT)					
West End	4.35 m	3.75 m	4.32 m	15%	-3%
City	6.43 m	7.16 m	7.44 m	4%	22%
Docklands	2.21 m	2.26 m	2.48 m	10%	15%
Total London	12.99 m	13.17 m	14.24 m	8%	12%
VACANCY RATE					
West End	5.0%	4.6%	5.0%	n/a	n/a
City	5.2%	5.7%	6.0%	n/a	n/a
Docklands	10.9%	10.2%	11.2%	n/a	n/a
Total London	5.7%	5.7%	6.1%	n/a	n/a
UNDER CONSTRUCTION (SQ FT)					
West End	5.60 m	4.89 m	5.37 m	10%	12%
City	6.15 m	5.92 m	7.74 m	31%	15%
Docklands	1.20 m	0.91 m	0.72 m	-21%	-63%
Total London	12.95 m	12.10 m	13.84m	14%	3%
DEVELOPMENT COMPLETIONS (SQ FT)					
West End	0.06 m	0.08 m	-	-	-
City	0.42 m	0.68 m	0.22 m	-68%	-52%
Docklands	-	0.30 m	-	-	-
Total London	0.48 m	1.06 m	0.22 m	-79%	-80%
INVESTMENT TURNOVER					
West End	£1.46 bn	£1.08 bn	£0.16 bn	-85%	-81%
City	£3.07 bn	£1.48 bn	£0.43 bn	-71%	-47%
Docklands	£0.11 bn	£0.03 bn	-	-	-
Total London	£4.64 bn	£2.59 bn	£0.59 bn	-77%	-65%
PRIME YIELDS					
West End	3.50%	3.50%	3.50%	n/a	n/a
City	4.00%	4.00%	4.25%	n/a	n/a
Docklands	4.75%	4.75%	4.75%	n/a	n/a

Source: Knight Frank

CONTACTS

HEAD OF LONDON OFFICES

William Beardmore-Gray
william.beardmore-gray@knightfrank.com
+44 20 7861 1308

CO-CHAIR LONDON OFFICES

Philip Hobley
philip.hobley@knightfrank.com
+44 20 7861 1192

Angus Goswell
angus.goswell@knightfrank.com
+44 20 7861 5150

LONDON CAPITAL MARKETS

Nick Braybrook
nick.braybrook@knightfrank.com
+44 20 7861 1309

Jamie Pope
jamie.pope@knightfrank.com
+44 20 3909 6814

Anthony Barnard
anthony.barnard@knightfrank.com
+44 20 7861 1216

LONDON LEASING

Dan Gaunt
dan.gaunt@knightfrank.com
+44 20 7861 1314

Ian McCarter
ian.mccarter@knightfrank.com
+44 20 7861 1506

LONDON TENANT REPRESENTATION

Richard Proctor
richard.proctor@knightfrank.com
+44 20 7861 5159

LONDON LEASE ADVISORY

Simon Austen
simon.austen@knightfrank.com
+44 20 7861 1341

STRATEGIC ASSET MANAGEMENT

Tim Robinson
tim.robinson@knightfrank.com
+44 20 7861 1194

VALUATIONS

Rupert Johnson
rupert.johnson@knightfrank.com
+44 20 7861 1284

STRATEGIC CONSULTING

Neil McLocklin
neil.mclocklin@knightfrank.com
+44 20 3909 6836

FLEXIBLE OFFICE SOLUTIONS

Amanda Lim
amanda.lim@knightfrank.com
+44 20 3826 0661

LONDON DEVELOPMENT

Andrew Tyler
andrew.tyler@knightfrank.com
+44 20 7861 1319

LONDON RESEARCH

Faisal Durrani
faisal.durrani@knightfrank.com
+44 20 7861 1234

Atif Ludi – Lead data analyst, City
atif.ludi@knightfrank.com
+44 203 869 4766

Faisal Ghani – Data analyst, West End
faisal.ghani@knightfrank.com
+44 20 7861 1250

Recent market-leading research publications

COVID-19 Series – Revisiting the 2020 London Report

London Offices Spotlight Q2 2020

COVID-19 Series – London Serviced Office Market

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

Knight Frank Research Reports are available at knightfrank.com/research

Knight Frank

Newmark Knight Frank