Flurry of post-election investment deals

No respite in supply shortage

New record rents forecast

Knight Frank

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THE LONDON OFFICE MARKET REPORT

Q4 2019

MARKET ROUNDUP

Speculative development completions fall to three year low of 27%

◆

Greater political clarity to unlock pent up investor demand

◆

£48.4 bn poised for deployment in London offices

2019: the year of resilience

2019 can best characterised as a year of resilience. Resilience in the occupational market and stronger investment activity, particularly once the General Election delivered the clarity many investors have been holding out for.

In the occupational market, total take-up declined to 12.8 m sq ft in 2019, from 14.8 m sq ft in 2018. Positively, activity has remained diverse, with the all-important professional services and finance & banking sectors continuing to expand, accounting for a 39% of all activity, followed by flexible offices (18%) and tech (16%). This diversity in take-up has persisted despite one of the most complicated and divisive political climates in recent memory; a testament to the resilience and attractiveness of London as a magnet for talent, businesses and investors. We explore this in more detail in our 2020 London Report, so please visit www.knightfrank.com/londonreport for more information.

12.8m sq ft

TOTAL OFFICE TAKE-UP DURING 2019

The persistence of expansionary activity amongst occupiers is set against a backdrop of limited options, particularly for larger offices. This is forcing some decision makers to seek out and commit to new space well in advance of lease events. In fact, total availability across London fell just shy of 13 m sq ft as we ended 2019, down on the 14.2 m sq ft available at the end of 2018.

This disparity has been a key driver behind the rising volume of pre-lets, which has resulted in falling speculative development completions – these stood at just 27% of all stock completed last year, compared to a long-term average of 57%. At the same time, for those unable to secure space to suit their requirements, re-gearing remains the only option. This goes some way to explaining the slight dip in take-up, notwithstanding the political uncertainty that has also weighed on the minds of some businesses, at least up until the General Election in early December.

Investment activity rebounds

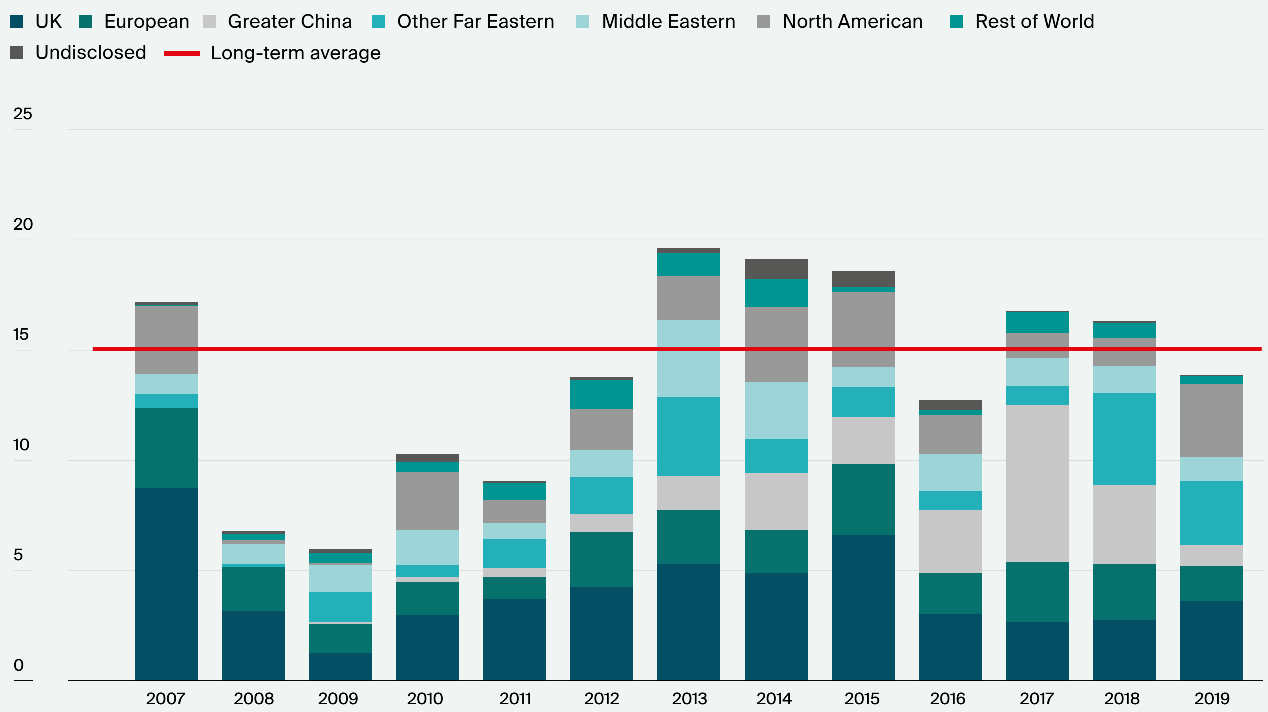
In the investment market, with the removal of one of the few confidence barriers – political uncertainty – following the General Election, we recorded a flurry of deals, which lifted the Q4 2019 investment turnover total to £4.6 bn; a 94% increase on Q3 2019. 2019 as a whole registered investment deals totalling £13.9 bn.

While this is down on 2018, London has still emerged as the number two destination globally for commercial property investment, behind Paris; a stunning achievement given the political backdrop for much of last year (RCA). And 2020 looks set to be a bumper year, with our Global Capital Tracker suggesting some £48.4 bn is waiting in the wings around the world for deployment in London's office market. The challenge? Just £2.3 bn worth of stock is currently available, excluding stock that is under offer, spread across 40 assets.

The availability of stock aside, returns from London's office market still outperform most other European cities and indeed many other global gateway cities. While this may be true, the weight of capital vying for a slice of London, coupled with the strength of rental growth forecast across the city means that prime yields will come under pressure this year, compressing by 25-50 bps in both the City and West End, from 4.00% and 3.50% at present, respectively.

Total availability across London fell just shy of 13.0 m sq ft as we ended 2019, down on the 14.2 m sq ft available at the end of 2018.

London Investment turnover by nationality
£ billions



Source: Knight Frank

LONDON OFFICE MARKET

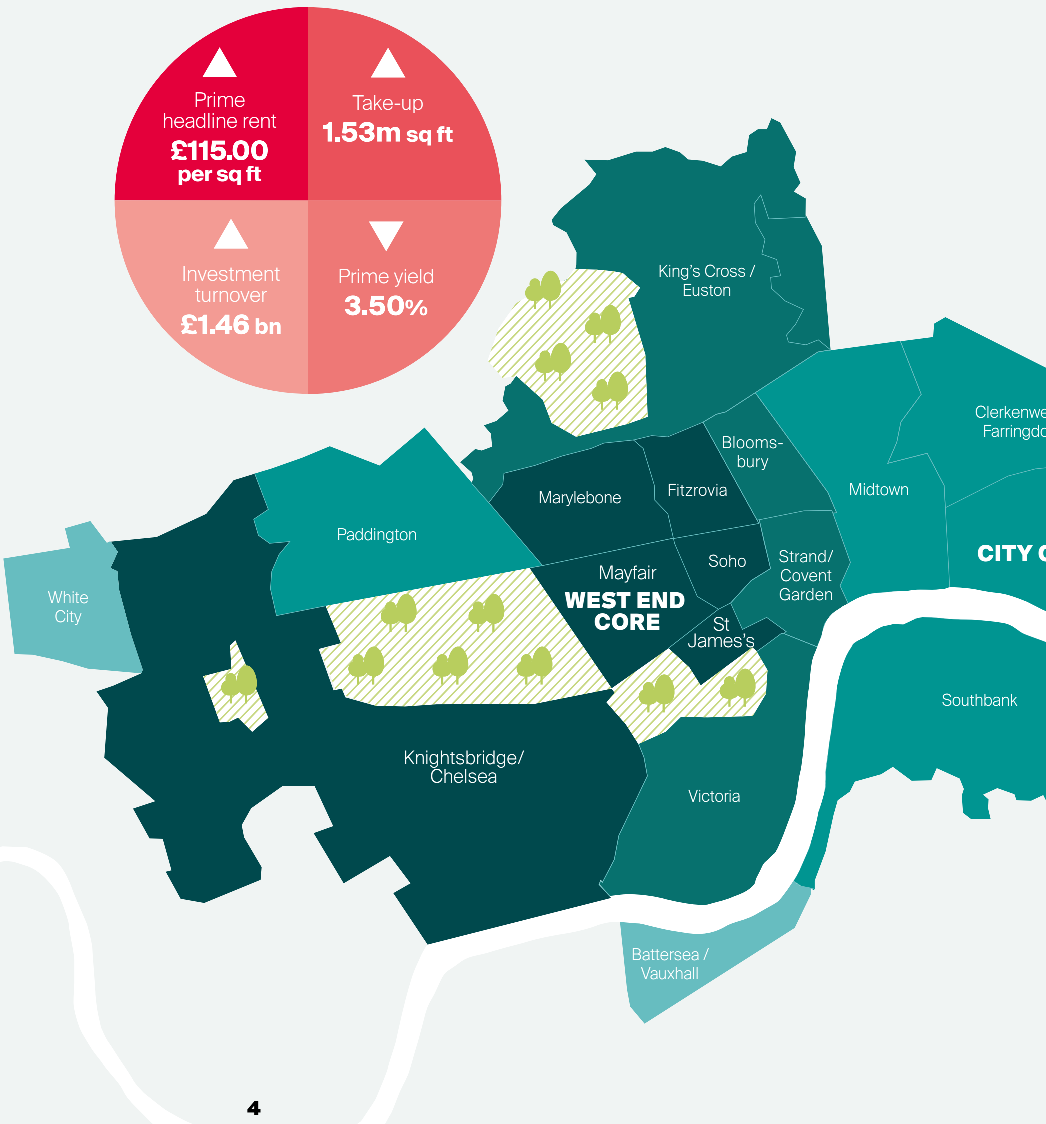
Performance dashboard Q4 2019

Key performance indicators

	£3.4m TAKE-UP (SQ FT)	13m AVAILABILITY (SQ FT)	▲ 5.7% VACANCY RATE	▲ 13m UNDER CONSTRUCTION (SQ FT)
Change on				
Q3 2019	0% ▲	-1% ▼	2% ▲	3% ▲
LTA	3.3 m sq ft	15.3 m sq ft	6.7%	9.2 m sq ft

Prime headline rents
per sq ft

WEST END



Source: Knight Frank

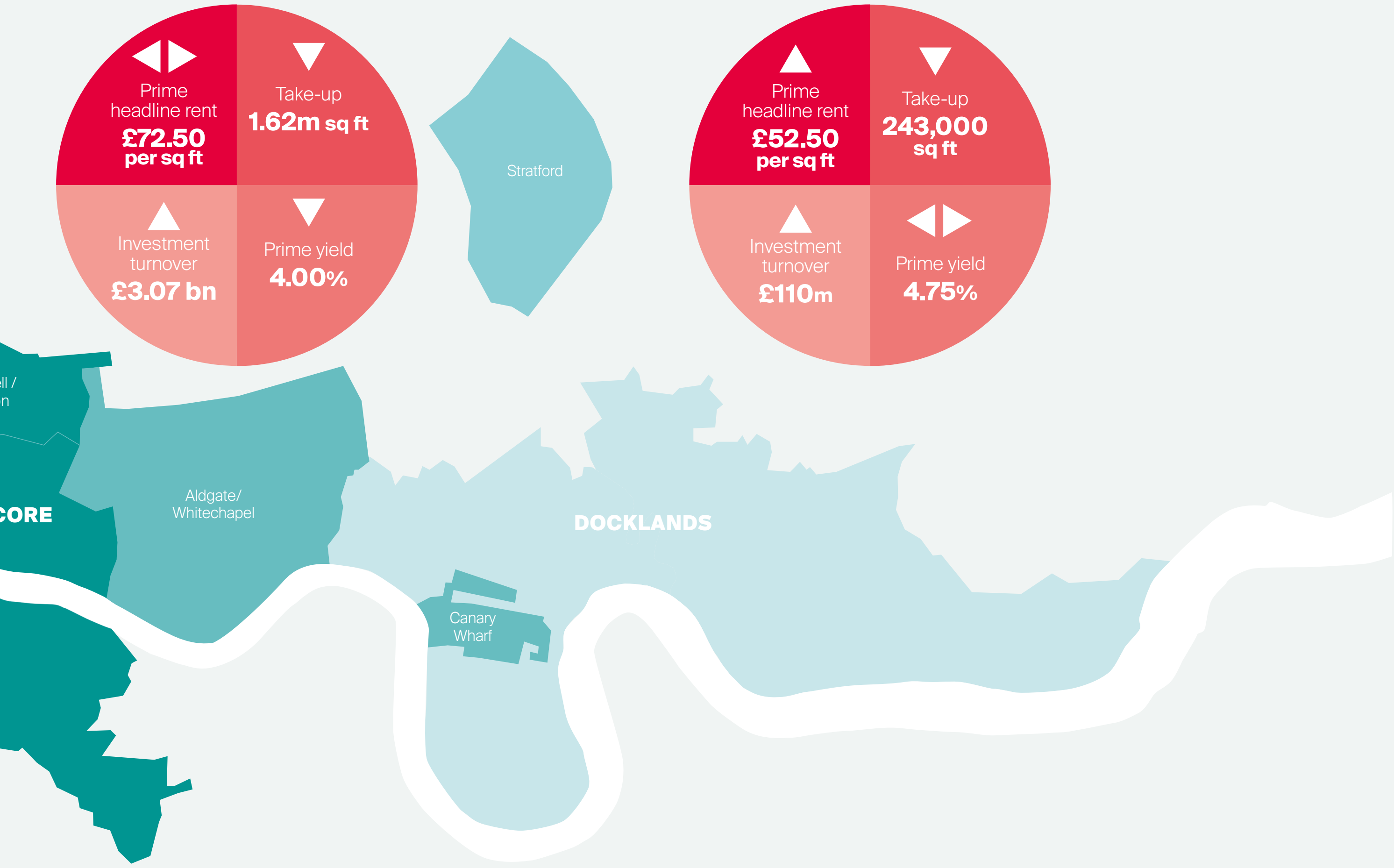
4.00%
CITY YIELD

3.50%
WEST END YIELD

4.75%
DOCKLANDS YIELD

CITY

DOCKLANDS



MARKETS IN REVIEW

THE CITY

£72.50	1.62 m	6.43 m	£3.07 bn	4.00%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Robust occupier activity

The political disruption in the lead up to the General Election in December contributed to the fall in quarterly take-up levels, which fell 18% to 1.6 m sq ft. For 2019 as a whole, take-up reached 6.6 m sq ft.

There were 111 deals during the fourth quarter, five of which were over 50,000 sq ft, compared to seven in Q3. This takes the total number of deals for the year to 444, which is the lowest number in the last ten years, albeit some of this may be offset by an increased volume of coworking deals. The average deal size in the City now stands at a little over 14,000 sq ft, however, 62% of transactions were below 10,000 sq ft.

The largest deal during Q4 was Apple Pay's acquisition at 22 Bishopsgate, EC2, totalling 156,442 sq ft; however, it was the professional services sector that accounted for the largest proportion (23%) of take-up in 2019, followed by finance and banking (20%) and flexible offices (19%).

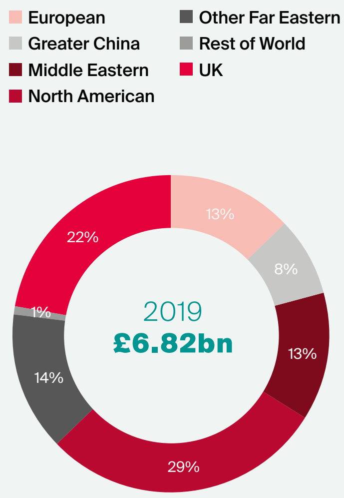
Despite the strong level of occupier activity, tightness of supply has meant that a greater number of businesses are considering lease regears, especially those in modern buildings who are taking a more cost effective route.

Active requirements still above average levels

Active demand dipped by 7% in the final quarter of last year, to 5.2 m sq ft. The decline is largely due to several requirements being fulfilled at the end of 2019. Having said that, the number of requirements for office space are still 23% ahead of the long-term average.

We are currently aware of 15 businesses seeking over 100,000 sq ft, however, there are just five buildings available that can meet these requirements.

Turnover by purchaser nationality
% share



Source: Knight Frank

Supply remains tight

Supply levels remained relatively stable between Q3 and Q4 at 6.4 m sq ft, but are 24% down on the long-term average. This equates to a vacancy rate of 5.2% in the City market and 7.1% in the City Core, compared to a long-term average of 7.3% and 8.3% respectively. There is approximately 1.7 m sq ft under offer across the City, which will likely drive down vacancy rates in Q1 2020.

And with 57% of the 4.7 m sq ft of office space due to complete this year already spoken for, the number of options for businesses will be limited to just a little over 2 m sq ft. Assuming average levels of new and refurbished take-up, this would translate into just nine months of supply.

TAKE-UP REACHED
6.6m
SQ FT
IN 2019

Further yield compression likely

Turning to the investment market, demand has risen sharply and the total value of assets under offer currently stands at £1.1 bn, up 45% year-on-year. The rising demand and dearth of assets available to purchase has led to yields compressing by 25 bps to 4.00% for 10-year income.

Investment turnover surged to just over £3 bn in the final quarter of 2019, up 73% on Q3. Despite this, investment turnover in the City (£6.8 bn) was the lowest since 2011.

MARKETS IN REVIEW

WEST END

▲ £115.00	▲ 1.53 m	▼ 4.35 m	▲ £1.46 bn	▼ 3.50%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Influx of deals boosts take-up

The final quarter in 2019 witnessed somewhat of a comeback in terms of office take-up in the West End market, which reached just over 1.5 m sq ft, up by 49% quarter-on-quarter and 24% higher than the long-term average. The West End saw a flurry of transactions at the end of the year, resulting in the highest level of quarterly take-up in 2019. Despite the heightened political uncertainty throughout the year, total take-up in 2019 closed at 4.8 m sq ft, just 2% below the long-term average.

Competition for large Grade A units

In the pre-let market, activity remained strong. L'Oréal (UK) Limited completed the largest transaction in the West End, acquiring approximately 120,000 sq ft at Gateway Central, White City, W12, in Q4. Sony Music Entertainment, G-Research and Diageo Plc all entered into pre-lets of over 100,000 sq ft in 2019 and we anticipate that competition for Grade A units over 50,000 sq ft will remain a significant market driver in 2020.

Appetite from flexible providers declines

The financial sector dominated take-up during 2019, accounting for 24% of all deals, followed by tech (19%) and corporates (15%). The finance sector acquired approximately 840,000 sq ft, up 8% year-on-year. There were three significant deals from key financial occupiers in H2 2019; Bridgepoint Capital Group Ltd, Nationwide Building Society and Apollo Global Management LLC, who all took units in excess of 50,000 sq ft. The appetite from the flexible office sector significantly declined, acquiring half the volume of stock in 2019, from 875,000 sq ft in 2018 to just 429,000 sq ft.

FINANCIAL SECTOR ACCOUNTED FOR

24%

OF ALL DEALS IN 2019

By the end of the year, active demand had fallen by less than 5% and remained on-par with the long-term average of 2.1 m sq ft. We are currently tracking 16 active requirements looking for units of 50,000 sq ft or more, seven of which are looking for over 100,000 sq ft.

There are currently just three units that could offer an occupier 100,000 sq ft or more across the entire West End market. This depth of demand continues to push occupiers to launch their requirements earlier and to widen their London search in order to secure

sizeable units, within an amenity rich building and location.

Further rental growth to come

Prime rents in the West End Core are currently £115 per sq ft, reflecting a 9.5% increase year-on-year, which are now equivalent to levels seen prior to the EU referendum. The paucity of supply, coupled with an increased level of pre-let activity within an already restricted pipeline, is driving rental growth, with West End rents set to reach £133 per sq ft by the end of 2024, which equates to an increase of 15.7% in the next five years.

There will be rental growth across all West End markets, with Soho, Fitzrovia, Paddington and the Strand/Covent Garden markets looking at growth between 13.7-16.6% over the next five years. Rent free periods remain at 21-24 months, on a typical 10-year term.

Vacancy rates fall

Supply levels continued to recede, with availability reaching almost 4.4 m sq ft at the end of the year, the lowest level of supply since Q4 2015. In the last 12 months, supply has fallen by 24%, with new and refurbished stock totalling just 870,000 sq ft, well below (39%) the long-term average of 1.4 m sq ft. The current vacancy rate in the West End now stands at 5%, compared to a long-term average of 6%.

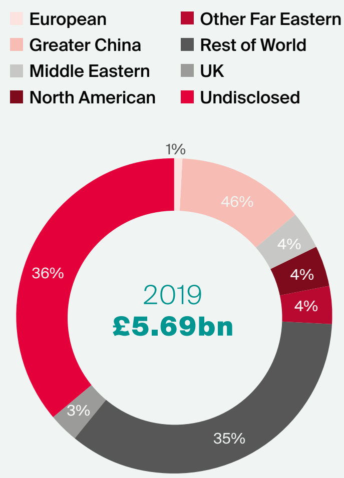
Looking at the development pipeline, there is currently 5.6 m sq ft under construction across the West End, 64% of which has already secured a tenant. There is just under 2.3 m sq ft under construction and due to complete by the end of the year however, just 44% is untenanted. This equates to less than seven months of supply, assuming average levels of new and refurbished take-up.

Domestic buyers return

Investment turnover in the West End witnessed a significant rebound in Q4, totalling nearly £1.5 bn, more than double the level recorded in the third quarter. In a market overshadowed by political uncertainty and the shortage of investment opportunities, encouragingly, total turnover for 2019 reached £5.7 bn, which is 3% above the long-term average and the highest level of annual turnover since 2015. It should be noted that the resale of Battersea Power Station accounted for 28% of turnover in 2019.

Overseas investors accounted for 63% of turnover by value. However, domestic buyers accounted for 55% of transactions by number. Prime yields in the West End Core have compressed by 25 bps to 3.50%. Further compression is likely this year of between 25-50bps as demand strengthens.

Turnover by purchaser nationality
% share



Source: Knight Frank

MARKETS IN REVIEW

DOCKLANDS & STRATFORD

▲ £52.50	▼ 243 k	▼ 2.21 m	▲ £110.2 m	◀▶ 4.75%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Robust occupier activity

During the final quarter of 2019, take-up in Canary Wharf totalled 151,000 sq ft, accounting for 62% of the market's quarterly take-up. Total take-up in the Docklands market reached 243,000 sq ft in Q4, down on the 382,000 sq ft recorded in the previous quarter. We noted two transactions in Stratford in Q4. The first at Here East, totalling 30,000 sq ft, which was acquired by the Liverpool Media Academy and the second at 1 Westfield Avenue where the Ministry for Housing Communities acquired 21,000 sq ft.

Despite the fall in quarterly take-up levels in Q4, the Docklands and Stratford market was the only market that saw annual growth in 2019. Annual take-up was the highest level seen since 2010 and up 25% on the long-term average.

As is the nature of this particular market, almost 50% of take-up during the year was attributable to just two transactions: EBRD taking a 359,000 sq ft pre-let at 5 Bank Street, E14, and WeWork's acquisition of 283,000 sq ft at 30 Churchill Place, E14. Overall, take-up of new and refurbished stock totalled 751,000 sq ft and was the highest annual figure since 2006.

Financial sector dominates

The financial sector was by far the most dominant sector in Q4, accounting for 41% of take-up, followed by the public sector (20%) and insurance (13%). It is still the financial sector that has acquired the majority of stock over the last 12 months, totalling 471,000 sq ft, which equates to 36% of all space let.

ANNUAL TAKE-UP HIGHEST SINCE 2010

25%

ABOVE THE LTA

Active requirements remain strong

Looking at active requirements in this market, demand fell by 13%, albeit, levels are still well above the long-term average at 484,000 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.

Supply dwindles as predicted

We highlighted in our Q3 report that with the strength in occupier demand during 2019 it was likely availability in the Docklands and Stratford market would begin to fall. As predicted, supply fell by 8% quarter-on-quarter, totalling 2.2 m sq ft at the end of the year. Supply of new and refurbished stock was the lowest it has been since Q4 2018, totalling 684,000 sq ft.

Restricted supply in Stratford

Availability in Stratford remains limited to just less than 160,000 sq ft, across two buildings: Here East, E15 (99,000 sq ft) and 2 Redman Place, E20 (59,000 sq ft) albeit, a proportion is already under offer.

There are just six units across the entire Docklands and Stratford market that could provide an occupier with 100,000 sq ft or more. The largest include 1 Cabot Square, E14; 40 Bank Street, E14; and The Import Building, Republic, E14.

More than a third of the pipeline is committed

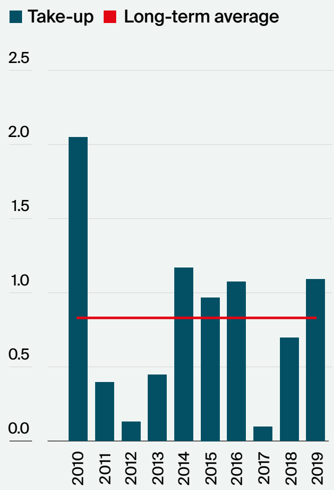
Looking at the development pipeline, there is currently 1.2 m sq ft under construction in the Docklands and Stratford market; however, 37% has already secured a tenant. There is 552,000 sq ft due to complete in 2020 across two buildings; 20 Water Street, Wood Wharf, E14 (211,000 sq ft) and Cargo, 25 North Colonnade, E14 (341,000 sq ft) both of which are fully available.

Above average investment

There was one investment transaction during the fourth quarter; 17 Columbus Courtyard, E14, was purchased for £110.2 m, reflecting a NIY of 5.73% and a capital value of £585 per sq ft. Turnover for 2019 totalled almost £1.4 bn, up by 50% on the long-term average. The supply of investment stock is extremely limited, with just two assets available in Canary Wharf. In Stratford, there are two assets on the market, with a number of opportunities available at International Quarter London, E20.

Canary Wharf take-up

sq ft millions



Source: Knight Frank

▲ £72.00	▲ 60k	▼ 306k	▼ £847.3 m
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER

Supply shortage hindering occupier activity

There were just 10 deals in the Southbank during the fourth quarter, none of which were over 15,000 sq ft. This takes the total number of deals for the year to 42, which is less than half the long-term average, albeit this was only 11% below the number of transactions in 2018. The average deal size in Southbank now stands at a little over 8,000 sq ft, compared to a City average of 14,000 sq ft. That said, 76% of transactions in Southbank were below 10,000 sq ft.

The professional services sector accounted for the largest proportion (27%) of take-up in 2019, followed by flexible offices (26%); however, it is the flexible office sector that has leased the most space (645,000 sq ft) in Southbank over the last three years.

Supply is the lowest on record

Availability in Southbank decreased by 35% quarter-on-quarter from 475,000 sq ft in Q3 to 306,000 sq ft by year-end. Supply levels remain significantly below the long-term average of just under 1 m sq ft. There is virtually no new, or refurbished stock available, with the bulk of stock available in second-hand buildings. It is therefore not surprising that the vacancy rate in Southbank is a mere 1.6%; the lowest level in London.

Future supply heavily restricted

There were no development completions in Southbank during 2019. Looking forward to the development pipeline, there is currently one scheme under construction that is due to complete this year, albeit, the building is fully committed to The Office Group. There is a further 289,000 sq ft under construction and due to complete by 2021, all of which is fully available.

Investment turnover impacted by lack of availability

Investment turnover reached £287 m in the final quarter across four transactions making it the highest quarter for investment transactions in 2019. The largest deal in Q4 was Mitsubishi's purchase of The London Studios, 72 Upper Ground, SE1, for £145.6 m.

Turnover for the year reached almost £850 m across 15 transactions, which was 11% down on 2018 and 8% below the long-term average. The largest transaction of the year was the sale of Royal Street, SE1, for £265 m in Q1.

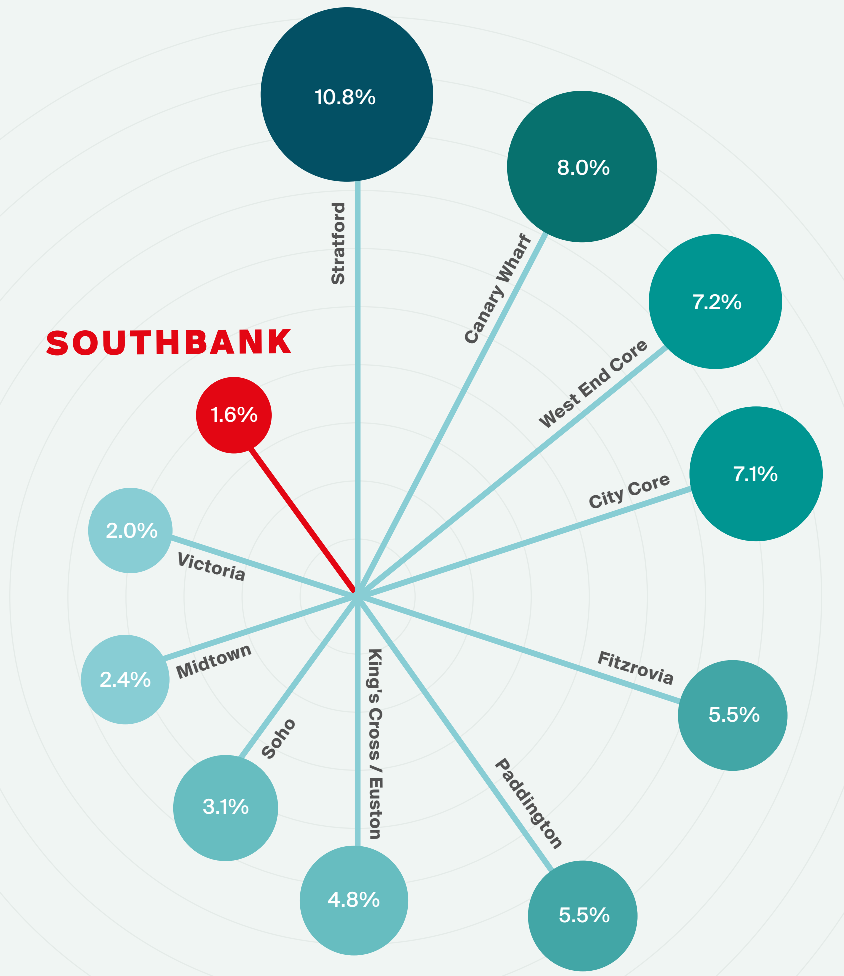
Domestic purchasers accounted for 31% of transactions in 2019, followed by the US with 31% and Japan with 20%.

Southbank projected to see some of the highest rental growth in the next five years

The prime rent in Southbank increased to £72 per sq ft in the fourth quarter, reflecting an increase of 6.7% year-on-year. Rent free periods have remained at 18-21 months on a typical ten-year lease for the second consecutive quarter.

Due to the attractiveness of Southbank as an area to occupiers and a limited amount of speculative construction, we believe rental growth in Southbank will reach 15.3% by the end of 2024 – making it one of the London submarkets with the highest projected rental growth over this period.

Submarket vacancy comparison
Vacancy rate



Source: Knight Frank

KEY STATISTICS

	Q1 19	Q2 19	Q3 19	Q4 19	% CHANGE 3 MONTHS	% CHANGE 12 MONTHS
TAKE-UP (sq ft)						
WEST END	1.26 m	1.05 m	1.03 m	1.53 m	49%	-11%
CITY	1.40 m	1.62 m	1.97 m	1.62 m	-18%	-28%
DOCKLANDS	0.22 m	0.47 m	0.38 m	0.24 m	-37%	500%
TOTAL LONDON	2.88 m	3.14 m	3.38 m	3.39 m	0%	-15%
AVAILABILITY (SQ FT)						
WEST END	4.94 m	4.47 m	4.59 m	4.35 m	-5%	-24%
CITY	6.53 m	6.08 m	6.14 m	6.43 m	5%	-4%
DOCKLANDS	2.51 m	2.15 m	2.40 m	2.21 m	-8%	24%
TOTAL LONDON	13.98 m	12.70 m	13.13 m	12.99 m	-1%	-8%
VACANCY RATE						
WEST END	5.8%	5.2%	5.3%	5.0%	n/a	n/a
CITY	5.3%	4.9%	4.8%	5.2%	n/a	n/a
DOCKLANDS	12.1%	10.4%	10.8%	10.9%	n/a	n/a
TOTAL LONDON	6.1%	5.5%	5.6%	5.7%	n/a	n/a
UNDER CONSTRUCTION (SQ FT)						
WEST END	5.08 m	4.80 m	5.65 m	5.60 m	-1%	49%
CITY	6.11 m	6.72 m	5.99 m	6.15 m	3%	8%
DOCKLANDS	1.95 m	1.95 m	0.91 m	1.20 m	32%	-26%
TOTAL LONDON	13.14 m	13.47 m	12.55 m	12.95 m	3%	17%
DEVELOPMENT COMPLETIONS (SQ FT)						
WEST END	0.20 m	0.62 m	0.02 m	0.06 m	200%	-77%
CITY	0.73 m	0.45 m	0.89 m	0.42 m	-53%	-53%
DOCKLANDS	0 m	0 m	1.25 m	0 m	-100%	0%
TOTAL LONDON	0.93 m	1.07 m	2.16 m	0.48 m	-78%	-59%
INVESTMENT TURNOVER						
WEST END	£2.75 bn	£0.87 bn	£0.62 bn	£1.46 bn	135%	1%
CITY	£1.15 bn	£0.82 bn	£1.77 bn	£3.07 bn	73%	9%
DOCKLANDS	£1.25 bn	£0 bn	£0 bn	£0.11 bn	0%	38%
TOTAL LONDON	£5.15 bn	£1.69 bn	£2.39 bn	£4.64 bn	94%	7%
PRIME YIELDS						
WEST END	3.75%	3.75%	3.75%	3.50%	n/a	n/a
CITY	4.50%	4.50%	4.25%	4.00%	n/a	n/a
DOCKLANDS	-	4.75%	4.75%	4.75%	n/a	n/a

Source: Knight Frank

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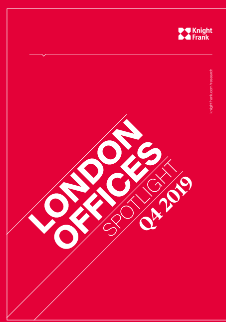

London Offices Spotlight Q4 2019

The London Report 2020

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

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