SUPPLY STARTS TO DECREASE ACROSS THE MARKET

RESEARCH CENTRAL LONDON

RENTS REMAIN STABLE

CENTRAL LONDON PRIME YIELDS REMAIN STABLE

QUARTERLY – OFFICES Q1 2018
Since the referendum vote almost two years ago, we have become used to daily stories outlining the multiple negative scenarios that are likely to befall us as we approach Brexit in 2019. In addition, growing tensions between the US and China have raised fears of a trade war, which has the potential to cause significant damage to investment and jobs across the world. Against this backdrop, it would not be unreasonable to assume that the London real estate market would be impacted. However, once again the capital appears to have defied gravity, returning another positive set of results and reinforcing the city’s position as one of the world’s most attractive places to conduct business. Occupier take-up of Central London office space has now registered above average levels for six consecutive quarters. The first quarter of 2018 saw 3.7 m sq ft of transactions, which is less than the preceding quarter but the strongest first quarter performance since 2010. Take-up was certainly inflated by the inclusion of Deutsche Bank’s pre-let of 550,000 sq ft at 21 Moorfields, EC2, a deal conditional on a planning consent which was granted in the first quarter. This transaction may have boosted the figures, but it should be noted that even without this pre-let, take-up for the quarter would have exceeded average levels. The supply of office space in London is falling; the vacancy rate at the end of the quarter performance since 2010. The supply of office space in London is falling; the vacancy rate at the end of the quarter was 7.5%, which was slightly higher than the end of the first quarter of 2017. However, uncertainty over the economy continues to weigh upon both occupiers and landlords. Despite the tightening supply and thinning pipeline, rents have remained static in most markets. We expect rents to come under upward pressure as we get closer to Brexit, but until then we should not expect any significant rental movement.

Central London market indicators remain positive as we move past the first quarter of the year, with similar performance expected for the rest of 2018. Nevertheless, fears of a trade war, which has the potential to cause significant damage to investment and jobs across the world. Against this backdrop, it would not be unreasonable to assume that the London real estate market would be impacted. However, once again the capital appears to have defied gravity, returning another positive set of results and reinforcing the city’s position as one of the world’s most attractive places to conduct business. Occupier take-up of Central London office space has now registered above average levels for six consecutive quarters. The first quarter of 2018 saw 3.7 m sq ft of transactions, which is less than the preceding quarter but the strongest first quarter performance since 2010. Take-up was certainly inflated by the inclusion of Deutsche Bank’s pre-let of 550,000 sq ft at 21 Moorfields, EC2, a deal conditional on a planning consent which was granted in the first quarter. This transaction may have boosted the figures, but it should be noted that even without this pre-let, take-up for the quarter would have exceeded average levels. The supply of office space in London is falling; the vacancy rate at the end of the quarter was 7.5%, which was slightly higher than the end of the first quarter of 2017. However, uncertainty over the economy continues to weigh upon both occupiers and landlords. Despite the tightening supply and thinning pipeline, rents have remained static in most markets. We expect rents to come under upward pressure as we get closer to Brexit, but until then we should not expect any significant rental movement.

Central London property remains attractive to overseas investors, with demand continuing to outstrip supply. Overseas purchasers continued to dominate the investor profile, accounting for 90% of transactions in the first quarter. Buyers from Greater China accounted for more than half of all overseas money entering London property. We expect inflows from this region to continue, although tightening capital restrictions may affect the ability of investors to deploy capital. Given the levels of demand, there has been no outward pressure on prime investment yields. In the City, the prime yield remained at 4.25%, while in the West End the prime yield was 3.50%. Central London property remains competitive against not only other major global cities, but also against other asset classes; for the time being at least, we do not see the City’s attractiveness waning. In summary, despite potential headwinds in the form of Brexit, trade barriers and capital controls, the fundamentals of healthy demand and a lack of supply in the London real estate market remain in place across the spheres of both leasing and investment.

“Despite potential headwinds, the fundamentals of healthy demand and a lack of supply remain in place.”

PATRICK SCANLON
Head of Central London Research

“Despite potential headwinds, the fundamentals of healthy demand and a lack of supply remain in place.”

PATRICK SCANLON
Head of Central London Research
“While take-up was down 10% on the quarter, active requirements increased by 20%.”

WEST END

Take-up
Take-up in the West End fell by 9% in the first quarter of the year, from 1.34 m sq ft in Q4 17 to 1.22 m sq ft in Q1 18, however, levels remained 6% above the long-term average of 1.16 m sq ft. Take-up in the Core increased 35% to 304,000 sq ft, the highest since Q4 2015, driven by the letting of 57,198 sq ft to KKR at 18-19 Hanover Square, W1. This is one of the few off-plan pre-lets seen in the West End over the last 20 years.

The financial sector was the most active sector during the first quarter of the year, accounting for 26% of all deals, followed by the corporates with 21%. The TMT sector accounted for 20% and the business-to-business sector fell to just 11%; demand from co-working providers fell back in all Central London markets.

Active requirements
The TMT sector continues to dominate the demand profile, accounting for 48%, followed by the corporates with 24%. The number of active requirements over 50,000 sq ft focused on the West End fell by 16% quarter-on-quarter.

Supply & development
Supply fell by 6% from 5.83 m sq ft in Q4 17 to 5.47 m sq ft in Q1 18, marginally below the long-term average of 5.61 m sq ft. The current vacancy rate in the West End now stands at 6.3%, the lowest level in two years. The supply of new and refurbished space fell below 1.5 m sq ft for the first time since Q4 2015. There is just one building that could offer an occupier over 100,000 sq ft of new and refurbished space; 2 Television Centre, White City Place, W12.

There is currently 1.2 m sq ft under construction across the West End; however, 45% of this has already secured a pre-let. There is 370,000 sq ft still due to complete this year, which is currently available.

Prime rents and incentives
The prime headline rent in the West End Core remained stable for the fourth consecutive quarter at £100.00 per sq ft, with rent free periods remaining at 24 months on a 10-year lease.

Investment
In the West End, investment transactions totalled £765 m in the first quarter of 2018 compared to £2.13 bn in Q1 17, a drop of 64%, although this reflects an ongoing lack of supply of quality assets in the market rather than any weakening of demand. The number of transactions also fell year-on-year, with 15 in Q1 2018 against 20 in Q1 2017.

Two large transactions dominated the total turnover; Nat-Fung’s acquisition of Regents Quarter for £330 m and Savills IM’s acquisition of 31 Great Portland Estate’s Broadwick Street on behalf of a Taiwanese investor for £180 m. There is still enormous imbalance between available assets and investor demand, with its strong competitive pressure, particularly for good quality assets below £100 million. As a result, we are seeing premium prices being paid for these types of opportunities.

International buyers continue to dominate the market, accounting for 83% of market share by value in Q1 2018, with continued demand from Asian, the Middle Eastern and European Investors together with the re-emergence of the UK buyers. The prime yield in the West End remained at 3.50%.

2017 2018

% of investment

FIGURE 1
West End availability
(million sq ft)

Supply & development
Supply levels in the City during the first quarter fell from 8.5 m sq ft in Q4 17 to 8.3 m sq ft in Q1, and nearly 12% below the long-term average. The current vacancy rate now stands at 6.9%. The supply of new and refurbished space fell from 2.8 m sq ft to 2.6 m sq ft quarter-on-quarter, the lowest level since Q1 2016.

Take-up
Take-up in the first quarter of the year totalled 2.12 m sq ft, an increase of 31% on the same quarter last year. Despite levels falling by 9% below the level recorded in Q4 17, demand was 24% above the long-term average. Furthermore, levels of take-up in the first quarter of the year have historically been lower than other quarters; we have not seen a Q1 take-up figure above 2.0 m sq ft since 2000.

Demand was dominated by the financial and the professional sectors during Q1, each accounting for 44% and 17% respectively. There were eight deals over 50,000 sq ft, the largest included occupiers such as Deutsche Bank, SMBC, Slight Austin LLP, Mmeacoast and Charles Taylor. The City Core recorded the highest level of take-up since Q3 2010, 67% above the long-term average.

Active requirements
Total active demand in the City fell marginally (4%) from 4.5 m sq ft in Q4 17 to 4.3 m sq ft in the first quarter of the year, around 6% above the long-term average.

By the end of Q1 it was the financial sector that dominated the demand profile, accounting for 41% of active requirements, up from 39% the previous quarter. This was followed by the professional sector accounting for 21%, pushing the TMT sector to third place with 18% of the market share.

Supply & development
Supply levels in the City during the first quarter fell from 8.5 m sq ft in Q4 17 to 8.3 m sq ft in Q1, and nearly 12% below the long-term average. The current vacancy rate now stands at 6.9%. The supply of new and refurbished space fell from 2.8 m sq ft to 2.6 m sq ft quarter-on-quarter, the lowest level since Q1 2016.

There remains a lack of options for occupiers seeking larger units, with just six new and refurbished units able to offer more than 100,000 sq ft within the next six months. Looking at future pipeline, there is currently just under 8.0 m sq ft under construction due to complete within the next three years; however, almost half has already been pre-let.

Prime rents and incentives
The prime rent remained stable at £70.00 per sq ft for the tenth consecutive quarter. Rent free periods have remained at 24 months on a typical 10-year term certain.

Investment
Investment turnover during the first quarter totalled £1.49 bn across 21 deals, 50% down on the previous quarter and 20% above the long-term average of £1.87 bn. It should be noted that turnover in the first quarter of a year is historically lower than other quarters. Overseas purchasers accounted for 93% of all transactions during Q1 by volume; however, domestic purchasers remained active within the smaller lot size range, accounting for over 48% of all deals by number. There were five transactions that took place over £100 m, all of which were acquired by overseas capital. Greater China investors were the most active accounting for 60.7bn reflecting 45% of turnover by volume, the majority of which is attributable to the purchase of Vanquish, 40 Leadenhall Street, EC3 which was also the largest deal of the quarter totalling £360 m.

Availability decreased 18% on Q4 17 to £4.8bn, (39%) of this figure was already under offer at quarter end, leaving just £3bn of investment stock available to buy. The prime yield in the Core remained at 4.25%.
CENTRAL LONDON Q1 2018 REVIEW

CENTRAL LONDON TAKE-UP (SQ FT)
Central London take-up remains robust, the first quarter of 2018 saw take-up levels exceeding long-term average levels by 20%.

CENTRAL LONDON DEVELOPMENT PIPELINE
45% of the Central London pipeline between now and 2021 is already committed.

CENTRAL LONDON INVESTMENT TURNOVER Q1 2018
Chinese investors continue to target Central London assets.

ACTIVE REQUIREMENTS
Occupiers appetite to acquire space in Central London continues despite Brexit, with an increase of almost 200% in active searches since Q1 last year.

Q1 2016 7.3m sq ft
Q1 2017 8.6m sq ft
Q1 2018 11.4m sq ft
Docklands witnessed above average take-up levels, buoyed by two of the largest Central London deals during Q1, totalling a combined 136,000 sq ft.

Take-up
Take-up in the first quarter totalled 393,837 sq ft, 3% higher than the previous quarter and 70% above the long-term average of 233,877 sq ft. The number of deals increased by 64% quarter-on-quarter. The largest deal of the quarter was the letting of circa 91,000 sq ft at 15 Wood Wharf, E14 to Ennismore, the fourth largest deal across Central London in Q1.

Active requirements
The level of active requirements has continued to fall since HMRC’s acquisition last quarter. Active demand in the Docklands now totals 280,000 sq ft, but we are also aware of a significant number of Central London-wide requirements totalling 1.10m sq ft that will consider Docklands options. The finance sector was the most active in the market accounting for 54% of total active requirements.

Supply and development
Supply in Docklands decreased by 13% quarter-on-quarter to 1.83m sq ft in Q1 2018, however this level is still 22% ahead of the long-term average. The current vacancy rate in Canary Wharf now stands at 7.3%, with the wider Docklands market at 8.1%.

Over the last year, the pound has displayed Jekyll and Hyde characteristics, which has had implications for the Central London office market. This has taken the form of a compare and contrast between sterling’s performance against two major currencies – the US dollar and the euro. As a result, the London office market might see less Asian and more European investment this year.

In the summer and autumn of 2016, the pound tumbled in value by roughly equal measure against the US dollar and the euro in the aftermath of vote to leave the EU. There was a widespread expectation that the UK economy faced a recession, due to deteriorating business confidence at the time, and expectations (which proved incorrect) that international firms would move large numbers of jobs abroad.

The recession never came, a situation which should have ensured a sterling rebound. However, since the winter of 2016/2017 the pound has fared better against the dollar than the euro. Compared to a year ago, the pound has risen by 8.4% against the dollar – reversing most of the post-referendum losses – but fallen nearly 4.0% against the euro.

The continued weak performance against the euro reflects the risk of a hard Brexit, which could result in a tariff barrier where the euro reflects the risk of a hard Brexit, which could result in a tariff barrier where any trade between the US and the UK still continue on existing terms after March 2019, so the pound has gained on a general decline for the US dollar against major currencies in the last year.

Sterling weakness against the US dollar post-referendum provided a welcome boost for the Central London office investment market, by drawing capital from Greater China – the remmbi and Hong Kong dollar are both linked to the greenback. Hong Kong investors acquired Central London office assets totalling £6.6bn in 2017, accounting for 39% of sales by volume. As we move further into 2018 though, the dollar denominated buyers may become a less significant source of demand now the currency advantage has eroded. However, this brings us back to the still devalued euro / pound exchange rate. At present, the Brexit uncertainty is dampening the rate, but 2018 is a year in which negotiations have to move towards greater clarity, irrespective of whether the end state is soft or hard Brexit. The final agreement needs to be available in draft form by the autumn in order to receive governmental approval from the UK, and the EU 27 ahead of the March 2019 deadline. If there is not to be a final deal – the much feared cliff edge – similarly we will probably know that before the end of the year.

This means that for Brexit, now is the maximum time of uncertainty, and euro denominated buyers will polarize between those who believe the final deal will be a compromise, and those who expect a cliff edge. For the former, buying back into the Central London office market now offers the maximum opportunity, when the exchange rate is in their favour and yields look attractive relative to cities like Paris and Berlin.

No one has a crystal ball and can say conclusively whether the UK is heading for a soft or hard Brexit. Yet, investing is about pre-empting the market, and for euro-denominated investors the question for 2018 is: do we get back into London in anticipation of a soft Brexit? JAMES ROBERTS Partner, Chief Economist
# Key Statistics

## Central London Office Market

### Take-Up (sq ft)
- **West End**: 1.47 m, 1.24 m, 1.66 m, 1.34 m, 1.21 m
- **City**: 1.62 m, 1.91 m, 1.58 m, 2.33 m, 2.12 m
- **Docklands**: 0.03 m, 0.05 m, 0.25 m, 0.38 m
- **Central London**: 3.12 m, 3.20 m, 3.48 m, 4.05 m, 3.72 m

### Construction Requirements
- **West End**: 2.21 m, 2.13 m, 2.31 m, 2.8 m, 3.36 m
- **City**: 4.54 m, 4.64 m, 4.01 m, 4.46 m, 4.27 m
- **Docklands**: 0.67 m, 0.70 m, 0.73 m, 0.50 m, 0.28 m
- **Central London**: 8.59 m, 8.62 m, 8.45 m, 10.64 m, 11.35 m

### Availability (sq ft)
- **West End**: 6.19 m, 5.88 m, 5.48 m, 5.83 m, 5.46 m
- **City**: 8.60 m, 8.84 m, 7.95 m, 8.46 m, 8.27 m
- **Docklands**: 1.17 m, 1.45 m, 1.75 m, 2.10 m, 1.83 m
- **Central London**: 15.96 m, 16.17 m, 15.18 m, 16.39 m, 15.56 m

### Vacancy Rate
- **West End**: 7.2%, 6.9%, 6.4%, 6.8%, 6.3%
- **City**: 7.2%, 7.3%, 6.6%, 7.1%, 6.9%
- **Docklands**: 6.0%, 7.3%, 10.2%, 10.6%, 8.1%
- **Central London**: 7.1%, 7.1%, 6.9%, 7.3%, 6.8%

### Long-term Quarterly Average
- **West End**: 1.62 m, 1.91 m, 1.58 m, 2.33 m, 2.12 m
- **City**: 2.21 m, 2.13 m, 2.31 m, 2.8 m, 3.36 m
- **Docklands**: 0.03 m, 0.05 m, 0.25 m, 0.38 m, 0.28 m
- **Central London**: 8.59 m, 8.62 m, 8.45 m, 10.64 m, 11.35 m

### % Change
- **West End**: 20% to 52% to 1.88 m
- **City**: 4% to 6% to 4.06 m
- **Docklands**: 44% to 58% to 0.41 m
- **Central London**: 8% to 19% to 3.09 m

Source: Knight Frank Research

### The Central London Office Market

#### West End
- **West End Core**: refers to Mayfair and St James’s, 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.
- **North of Mayfair**: refers to the area north of Oxford Street, west of Portland Place.
- **Fitzrovia**: also known as Noho, refers to the area north of Oxford Street, east of Portland Place.
- **Soho**: refers to W1B, W1F, and W1D.
- **Euston/King’s Cross**: refers to NW1 and N1C.
- **Strand/Covent Garden**: refers to WC2, excluding Strand/Covent Garden.
- **Kensington/Chelsea**: refers to SW3, SW7, SW1X, which includes Brompton, Knightsbridge, Chelsea, and South Kensington.
- **West End Core**: refers to Mayfair and St James’s, 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.

#### City
- **City Core**: refers to EC2 (excluding EC2A), EC3, EC4 (excluding EC4A and EC4Y), and EC1A.
- **Midtown**: refers to EC1N, EC4A, EC4Y, WC1 (excluding Bloomsbury), and WC2 (excluding Strand/Covent Garden).
- **Shoreditch/Clerkenwell**: refers to EC1 (excluding EC1A and EC1N), and EC2A.
- **Aldgate/Whitechapel**: refers to E1.
- **Southbank**: refers to SE1.

#### Docklands
- **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**: refers to E14 and E16 including the Royal Business Park (excluding Canary Wharf), and Stratford E20.

Source: Knight Frank Research
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.

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

Important Notice
© Knight Frank LLP 2018 – This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank LLP for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is not allowed without prior written approval of Knight Frank LLP to the form and content within which it appears. Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members’ names.

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Global Cities Report - 2018
Active Capital – The Report 2017
The London Report 2018
The M25 Report - 2017

Knight Frank Research Reports are available at KnightFrank.com/Research