London take-up rises above trend

Prime rents rise in West End

Yields under pressure from rising debt costs

Knight Frank

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THE LONDON OFFICE MARKET REPORT 2022 Q2

MARKET ROUNDUP

Occupier demand is robust with take-up rising above trend

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Lack of prime availability provides impetus for rental growth in West End

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Investor sentiment impacted by rising debt costs

The economic backdrop became increasingly challenging in 2022 Q2

Continued dislocation of global supply chains, war in Ukraine, rising energy prices and accelerating rates of inflation have led to significant weakening of business and consumer confidence. Business activity growth remains high in London but is softening as new orders and expectations for the future outlook have fallen amid rising levels of input inflation which is being passed on to the end consumer. Businesses continue to hire to contend with existing workloads but the pace of job growth is slowing.

These headwinds have prompted downward revisions by leading forecasters of economic growth in both the London and the UK economies. This is likely to lead to a moderation of demand in the next 12-18 months. As occupiers delay investment and relocation decisions whilst there is an increased level of uncertainty about the near-term economic outlook. However, many larger occupiers with near-term lease expiries are active in the pre-let market as the lack of current and future best-in-class buildings continues to be a feature of the London office market.

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Lettings activity in London has been incredibly robust in Q2. Take-up is c.543,000 sq ft higher than in Q1

◆◆

London offices remain resilient

Take-up across London was 3.19m sq ft, a quarterly increase of 20.5% and above the long-term trend of 3.08m sq ft. Almost two-thirds of the space leased was for new and refurbished space – a marked increase from just below 50% in 2022 Q1. Unlike the start of the pandemic, where demand was driven by a 'flight-to-quality', the rise in new and refurbished take-up this quarter was due to the completion of large deals that have been under-offer for an extended period.

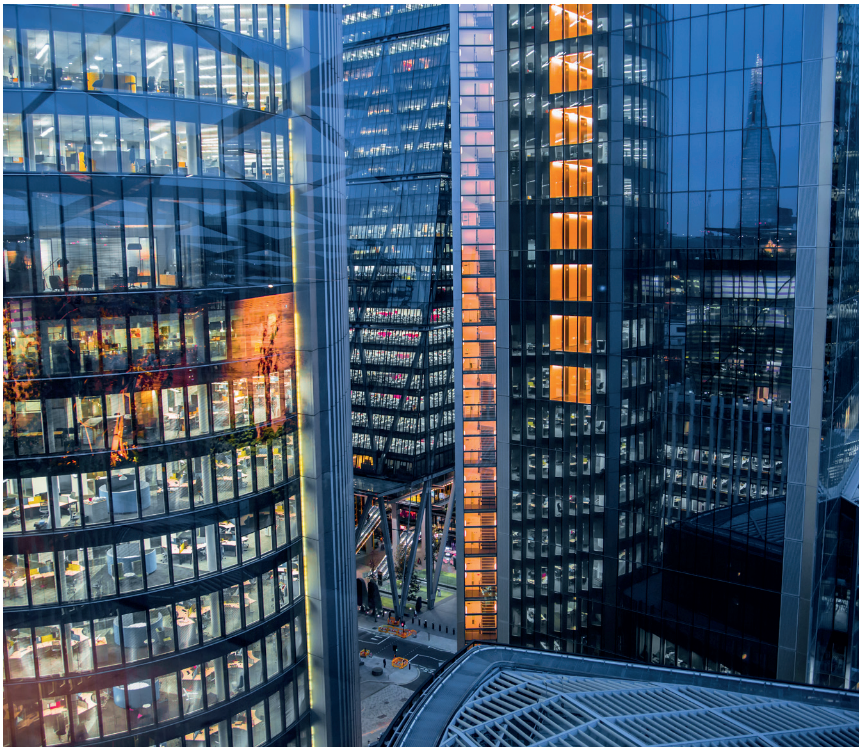
Slight rise in availability and future supply is modest

Availability has risen slightly to 20.41m sq ft from 20.1m sq ft in 2022 Q2 and reflects a vacancy rate of 8.3%. Although this is nearly 5m sq ft above the long-term average, excess vacant floor space is a greater issue in the City & Southbank compared with the West End. Speculative completions due in the next six months of 584,000 sq ft are the main factor driving the increase. Currently, 57% of available space in London is new and refurbished, however, there is variation between the main markets. In the City & Southbank the availability of new and refurbished buildings is 62% and above the average for London. Whilst in the West End this ratio falls to 48% and below the average for London. The future pipeline remains modest at 15.14m sq ft with a delivery timeframe of 2022-25. Just over 11m sq ft is space that is being built speculatively. This is 4m sq ft below the level implied by the long-term average levels of completions. In comparison to long-term average levels of take-up for new and refurbished buildings, the potential under supply of best-in-class buildings is 8.69m sq ft.

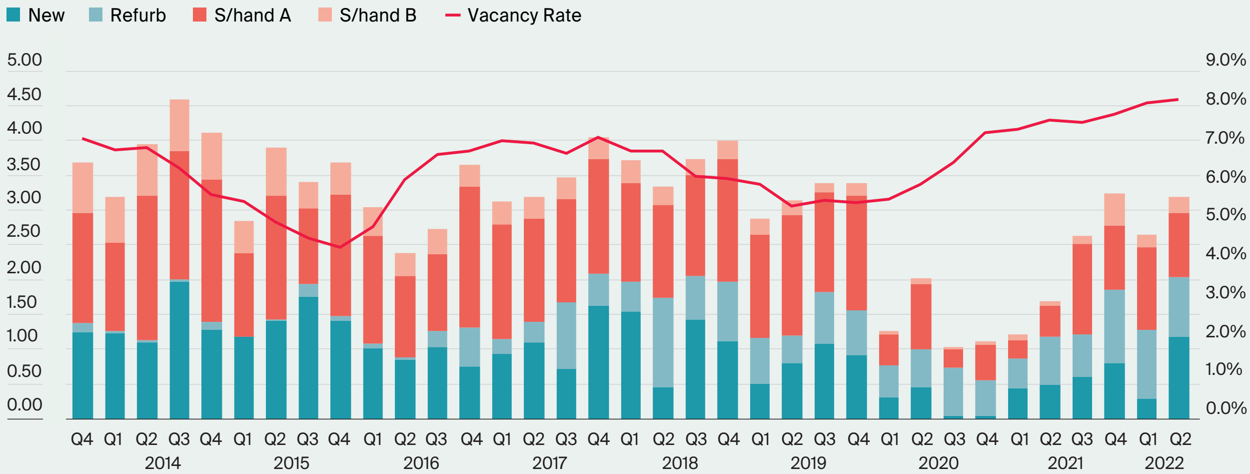
Strong occupational demand in West End

Across London there is a divergence in performance between the City & Southbank and West End markets. Although take-up rose by 12.7% in 2022 Q2 in City & Southbank, it remains below the long-term quarterly trend of 1.69m sq ft for a third successive quarter whilst availability has risen during this period. In contrast, take-up in the West End has risen in-line or above trend for a fourth successive quarter and has been combined with falling levels of availability.

The strength of demand and lack of available prime buildings has led to a rise in the rental tone across the West End. We have raised our assessment of current prime rents in all West



London – Take-up by quality and relative to vacancy rate
m sq ft



Source: Knight Frank Research

Investment in the London office market fell from £5.86bn to £3.18bn in 2022 Q2

End submarkets except Bloomsbury and King's Cross/Euston. We have also raised our prime rent in Canary Wharf from £50.00 per sq ft to £52.50 per sq ft amid growing evidence of demand increasingly focussed at prime buildings with negotiated rents above £50.00 per sq ft. We have kept prime rents unchanged in the City & Southbank. Rent-free periods remain unchanged at 21 months in the West End and 24-27 months in the City & Southbank for a 10 year lease.

As expectations for London and UK economic growth have been revised down in recent months, we have lowered our rental growth forecasts across London over the next five years. Our forecast annual average shows stronger growth in the West End submarkets. However, growth is front-loaded in 2022. Between 2023-26, rental growth is supported by low levels of available prime space and a modest future pipeline. Whilst occupier demand during this period is expected to rise in line with the improvements to GDP growth.

In the West End Core we expect average annual growth of 1.5% between 2022-26 and 1% in the City Core.

Prime yields rising in the City

The investment market has been especially strong in recent quarters. In 2022 Q2, transactions in London offices fell from £5.86bn to £3.18bn. Some of this fall can be attributed to a delayed seasonal slow-down usually expected in Q1. Sentiment has been impacted by rising interest costs with debt no longer accretive to income returns.

As a result, we have raised prime yields in the City & Southbank by 25bps to 4.00%. Yields in the West End and Docklands & Stratford have remained stable at 3.25% and 4.75% respectively. Prospects for further interest rate rises and a weaker economic outlook will likely place upward pressure on yields, however, this is offset to some extent by sterling's depreciation which translates to capital values looking attractive in overseas currencies to global investors whilst the potential to hedge against inflation will intensify demand for best-in-class buildings.

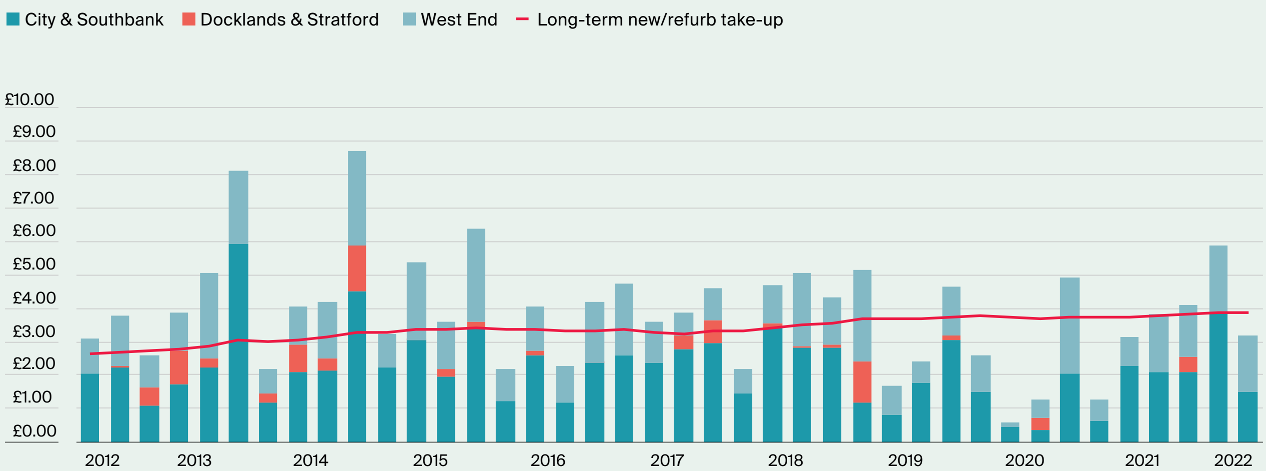
4.00%

CITY & SOUTHBANK PRIME YIELDS RISE BY 25BPS

UNLOCK OUR INSIGHTS

London investment volumes

£bn



Source: Knight Frank

THE LONDON OFFICE MARKET REPORT 2022 Q2

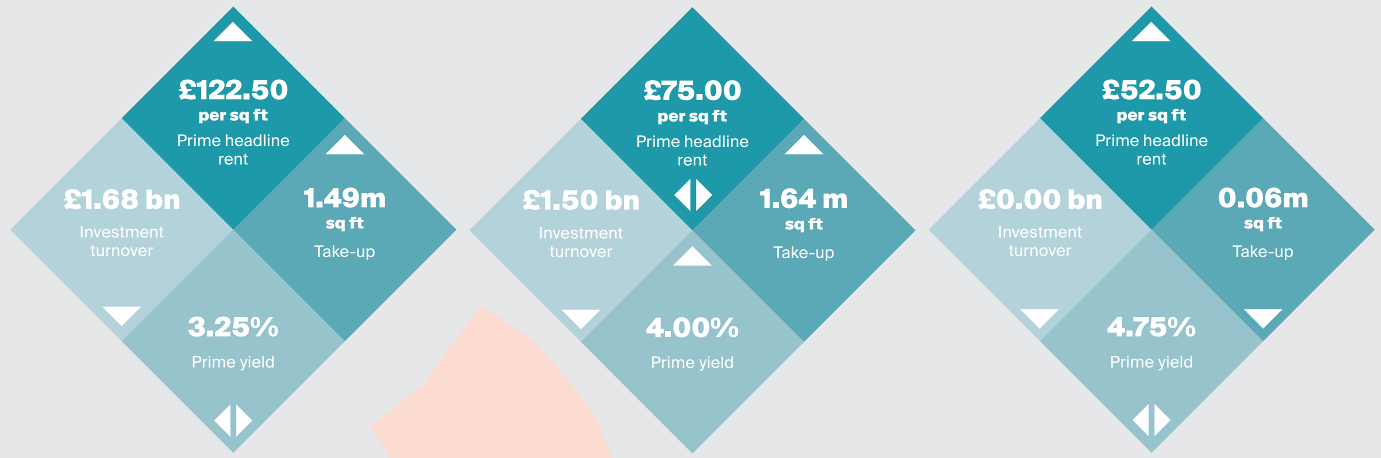
LONDON OFFICE MARKET

Performance dashboard 2022 Q2

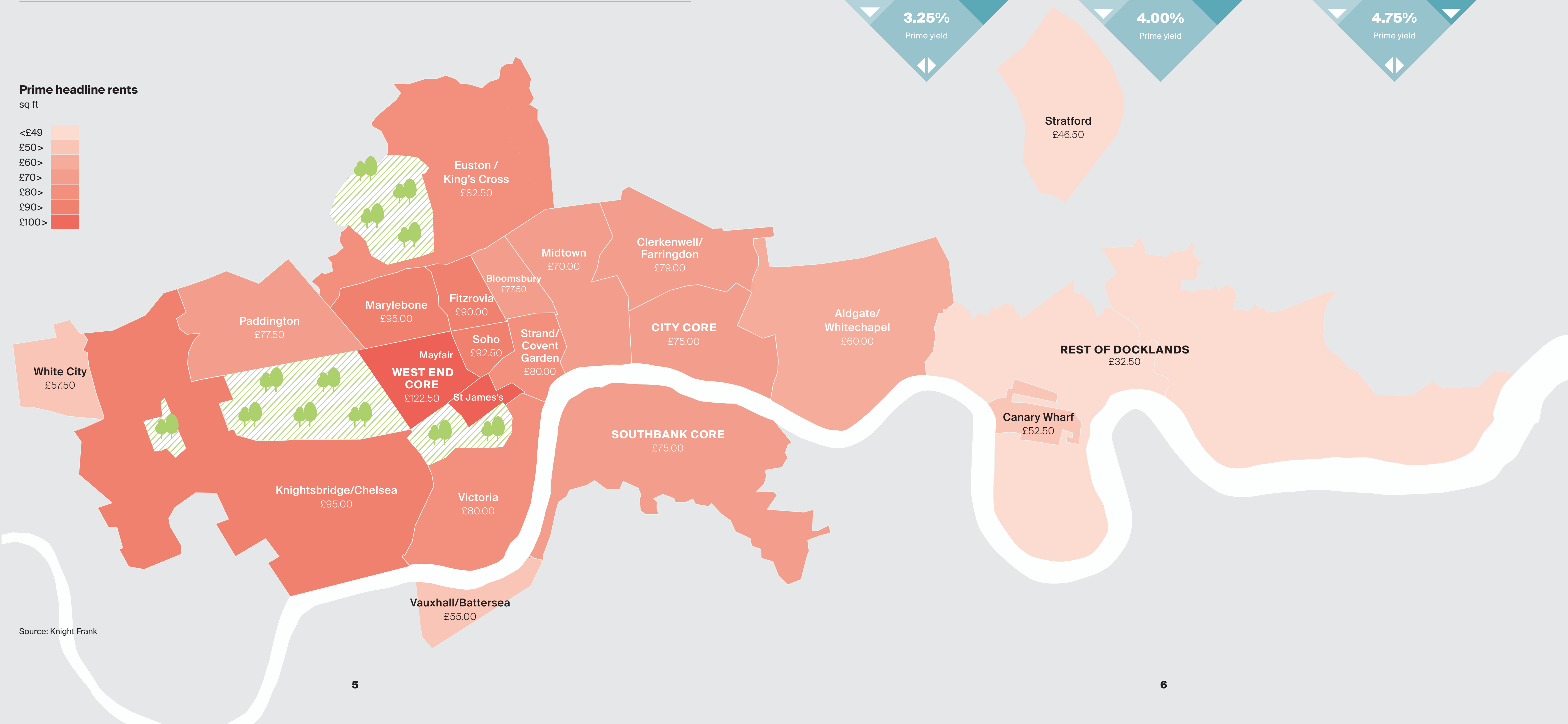
Key performance indicators

	▲3.19 m TAKE-UP (SQ FT)	▲20.41 m AVAILABILITY (SQ FT)	▲8.3% VACANCY RATE	▼15.14 m UNDER CONSTRUCTION (SQ FT)
Change on				
2022 Q1	20.5% ▲	1.5% ▲	0.1% ▲	-1.1% ▼
LTA	3.04 million sq ft	15.26 million sq ft	6.70%	9.26 million sq ft

WEST END | **CITY & SOUTH BANK** | **DOCKLANDS & STRATFORD**



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

◀▶ 75.00	▲ 1.64 m	▲ 11.18 m	▼ 1.50 bn	▲ 4.00%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Take-up increases but remains below trend

City & Southbank take-up in 2022 Q2 totalled 1.64m sq ft, an increase of 12.7% on the previous quarter, and translates into an annual increase of 98.9%. This is slightly below the long-term average of 1.69m sq ft. Two of the largest deals of the quarter were pre-lets by legal services firms. Kirkland & Ellis pre-leasing 219,000 sq ft at 40 Leadenhall Street and Holman Fenwick Willan pre-leasing 62,000 sq ft at 8 Bishopsgate in the City Core. These transactions highlight the continued demand for best-in-class buildings to attract and retain highly talented professionals. The largest life science transaction in two years was a key feature of last quarter. MSD pre-leasing 195,000 sq ft at Belgrove House highlights the broadening of the King's Cross/Euston submarket as demand from life science companies continues to strengthen.

Rise in availability

Availability saw a slight quarterly increase of 4.0% to 11.18m sq ft. Driving this increase is c.1.5m sq ft of speculative completions due in the remainder of 2022 and space which completed last quarter. The vacancy rate has risen to 8.4% which compares to a long-term average of 6.7%.

LEASING ACTIVITY REACHED

1.64M

SQ FT IN 2022 Q2

Supply of new stock in the City & Southbank remains limited, at 18.0% of total availability. There is c.6.4m sq ft of speculative space under-construction which completes by 2025.

Prime at £75.00 per sq ft have remained unchanged with incentives remaining at 24-27 months on a typical 10-year lease term.

Investor sentiment affected by rising debt costs

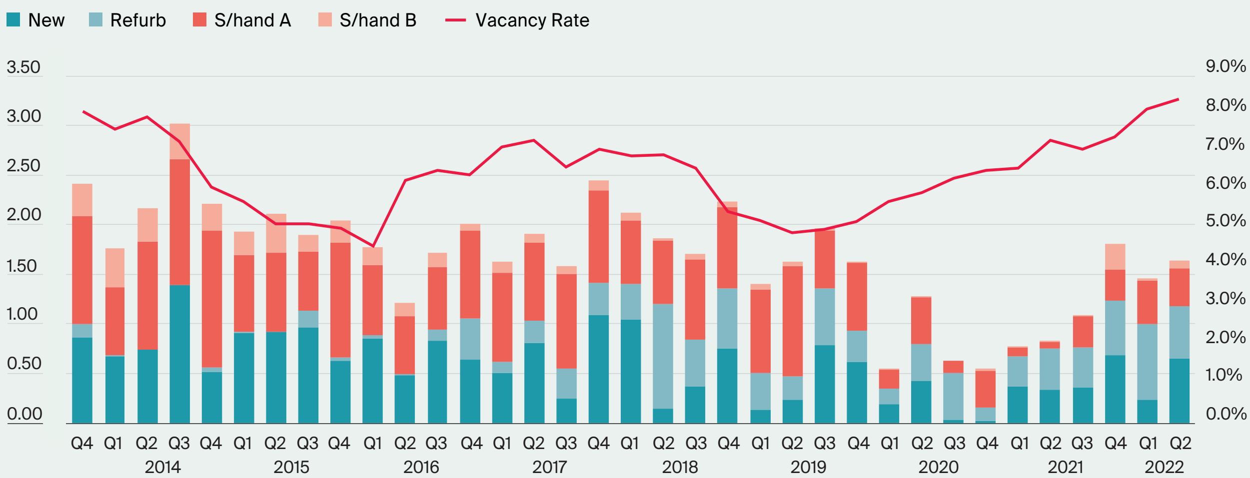
Total investment turnover reached £1.50bn, a 61.2% fall on the previous quarter and below the long-term quarterly average of £2.20bn. This decrease in part is due to a delayed seasonal slowdown and investor sentiment affected by the rise in financing costs. As a result we have raised our prime yields for the City & Southbank by 25 bps to 4.00%.

Pre-lets by law firms were again prominent with the largest leasing transaction completed by Kirkland & Ellis pre-leasing 219,000 sq ft at 40 Leadenhall Street, EC3

The largest deal of the quarter was Goldman Sachs's acquisition of Sancroft, 10-15 Newgate Street, EC1 for £370m. Another notable deal was the sale of 2 London Wall Place, EC2 by Brookfield to Hong Kong investor Kingboard for £302m.

City & Southbank – Take-up by quality and relative to vacancy rate

m sq ft



Source: Knight Frank Research

MARKETS IN REVIEW

WEST END

▲ £122.50	▲ 1.49 m	▼ 6.17 m	▼ £1.68 bn	◀▶ 3.25%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Take-up above trend

Take-up in 2022 Q2 was 1.48m sq ft – a quarterly increase of 47.1% and 31.7% above the long-term average of 1.15m sq ft. Take-up in the West End has now been above trend for three of the last four quarters. Lettings of new and refurbished buildings accounted for 55% of all lettings.

In Knightsbridge/ Chelsea the prime rent is now £95.00 per sq ft. In the West End Core rents have risen by £2.50 per sq ft to £122.50

Finance & banking occupiers maintained their leasing strength accounting for the largest proportion of known occupier types (40%). This is demonstrated by Capital International Limited which was the largest transaction of the quarter leasing 221,746 sq ft at Paddington Square. The second largest deal was also at Paddington Square with PaymentSense occupying 75,897 sq ft.

Third quarter of falling West End availability

Levels of available space are now at 6.17 m sq ft, down approximately 700,000 sq ft on the previous quarter.

Completions amount to 132,218 sq ft, 53.2% below the 10-year average. There is 3.3m sq ft of speculative office space expected to deliver by 2025. The level of pre-lettings remain consistent with the previous year at 1.2m sq ft which is just below the 10 year average of 1.3m sq ft.

Rents increase while investment transactions remain steady

The strength of occupier demand for prime buildings and lack of existing availability has lead to rental tension in many West End submarkets. As a result we have raised prime rents in every submarket except Bloomsbury and King's Cross/Euston.

The largest increase was in Knightsbridge/ Chelsea (£5.00 per sq ft) where the prime rent is now £95.00 per sq ft. In the West End Core rents have risen by £2.50 per sq ft to £122.50 per sq ft.

The West End accounted for the majority of investment transactions for London with turnover of £1.68bn for the quarter across seventeen transactions totalling 1.51 m sq ft. Paddington Central was the largest sale of the quarter at £694m – a 4.3% yield to a Singaporean sovereign wealth investor. 40 Strand is the second at £195m to another Singaporean buyer.

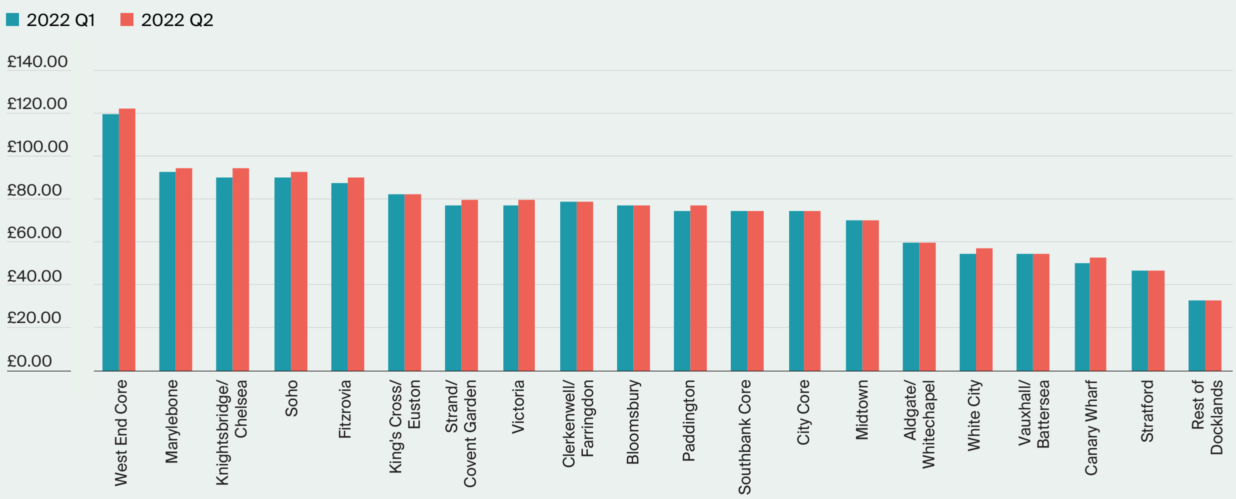
LEASING ACTIVITY REACHED

1.49M

SQ FT IN 2022 Q2

London - Submarket prime rents

£ per sq ft



Source: Knight Frank Research

MARKETS IN REVIEW

DOCKLANDS & STRATFORD

▲ £52.50	▼ 0.06	▲ 3.06 m	▼ £0.0bn	◀▶ 4.75%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Take-up decreases

Take-up was 0.06m sq ft in 2022 Q2 down 67.3% on the previous quarter and is below the long-term quarterly average of 0.22 m sq ft. The largest leasing deal occurred in Canary Wharf, where an undisclosed occupier leased c.19,000 sq ft at 1 Cabot Square. A key deal that took place this quarter involved Genomics England, a government funded company which sequences patient genomes for the NHS. They leased 18,000 sq ft 1 Canada Square. This illustrates how the occupier base is diversifying in Docklands & Stratford.

Availability increases

Availability in Docklands & Stratford saw a 21.0% increase on the previous quarter, totalling 3.06m sq ft. This remains above the long-term average of 1.83m sq ft. The increase reflects c.415,000 sq ft of speculative completions in the next six months.

Second-hand space accounts for 44.6% of all availability. The vacancy rate is 12.8%, up on the 10.6% recorded last quarter.

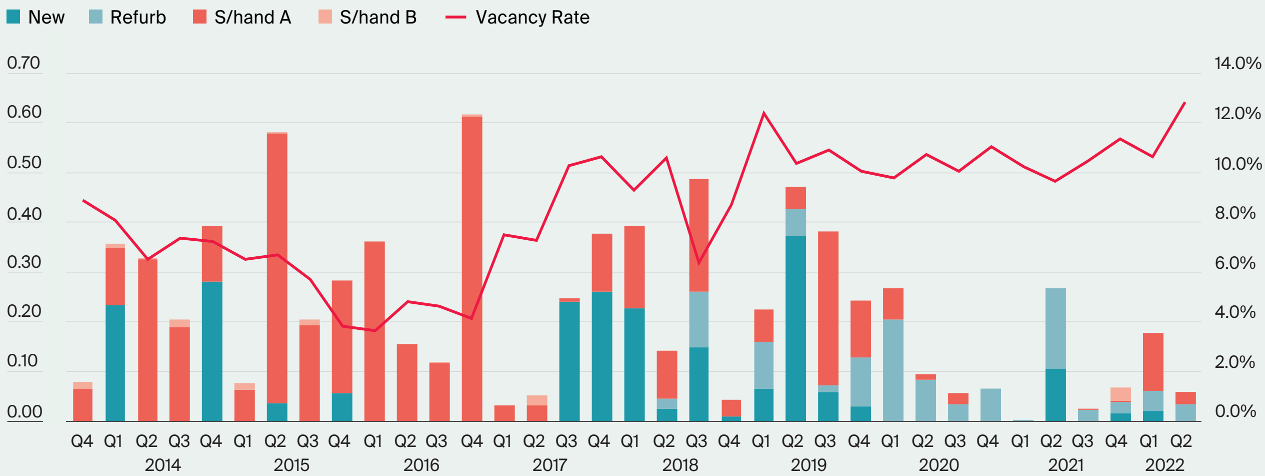
The future pipeline is very limited with only 758,000 sq ft currently under construction and due to complete by the end of 2024 – all of this space is speculative.

Prime rents rise in Canary Wharf

Prime rents have risen this quarter to £52.50 per sq ft. This rise is due to demand focussing on better quality buildings where negotiated rents are above the previous benchmark. Incentives remain at 30 months on a typical 10-year lease term.

TAKE-UP IS
0.06M
SQ FT ▼

Docklands & Stratford – Take-up quality and relative to vacancy rate
m sq ft



Source: Knight Frank Research

KEY STATISTICS

						% CHANGE		
	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	3 MONTHS	12 MONTHS	10-YEAR QUARTERLY AVERAGE
AVAILABILITY (SQ FT)								
West End	6.86 m	6.93 m	6.86 m	6.83 m	6.17 m	-9.6%	-10.1%	5.24 m
City & Southbank	9.60 m	9.30 m	9.77 m	10.75 m	11.18m	4.0%	16.4%	8.19 m
Docklands & Stratford	2.29 m	2.48 m	2.65 m	2.53 m	3.06 m	21.0%	34.1%	1.83 m
London	18.75 m	18.71 m	19.29 m	20.11 m	20.41 m	1.5%	8.8%	15.26 m
VACANCY RATE								
West End	7.8%	7.8%	7.6%	7.6%	6.8%	-0.7%	-1.0%	6.1%
City & Southbank	7.3%	7.1%	7.4%	8.1%	8.5%	0.3%	1.1%	6.7%
Docklands & Stratford	9.7%	10.5%	11.3%	10.6%	12.8%	2.2%	3.2%	8.5%
London	7.7%	7.7%	7.9%	8.2%	8.3%	0.1%	0.5%	6.7%
TAKE-UP (SQ FT)								
West End	0.56 m	1.44 m	1.36 m	1.01 m	1.49 m	47.1%	146.3%	1.13 m
City & Southbank	0.83 m	1.09 m	1.81 m	1.46 m	1.64 m	12.7%	98.9%	1.69 m
Docklands & Stratford	0.27 m	0.02 m	0.07 m	0.18 m	0.06 m	-67.3%	-78.3%	0.22 m
London	1.66 m	2.55 m	3.24 m	2.65 m	3.19 m	20.5%	87.9%	3.04 m
ACTIVE REQUIREMENTS (SQ FT)								
West End	1.55 m	1.31 m	1.53 m	1.85 m	1.03 m	-44.5%	-33.8%	2.01 m
City & Southbank	4.66 m	5.21 m	4.28 m	4.43 m	4.18 m	-5.8%	-10.3%	4.21 m
Docklands	0.75 m	0.64 m	0.63 m	0.75 m	0.12 m	-84.1%	-83.9%	0.56 m
London-wide	1.43 m	1.08 m	1.12 m	1.35 m	2.53 m	87.7%	77.9%	1.86 m
London	8.38 m	8.25 m	7.57 m	8.39 m	7.86 m	-6.3%	-6.2%	8.65 m
SPEC UNDER CONSTRUCTION (SQ FT)								
West End	3.31 m	3.87 m	3.25 m	3.82 m	5.29 m	6.7%	3.2%	2.85 m
City & Southbank	4.98 m	5.41 m	5.94 m	7.09 m	9.10 m	-5.2%	26.4%	5.70 m
Docklands & Stratford	0.52 m	0.65 m	0.90 m	0.76 m	0.76 m	0.0%	10.0%	0.71 m
London	8.81 m	9.94 m	10.09 m	11.68 m	15.14 m	-1.1%	16.4%	9.26 m
DEVELOPMENT COMPLETIONS (SQ FT)								
West End	0.05 m	0.21 m	0.33 m	0.45 m	0.13 m	-70.7%	144.4%	0.28 m
City & Southbank	0.29 m	0.17 m	0.17 m	0.13 m	0.74 m	485.2%	151.4%	0.56 m
Docklands	0.34 m	0.00 m	0.00 m	0.14 m	0.06 m	-56.1%	-82.4%	0.11 m
London	0.69 m	0.38 m	0.51 m	0.72 m	0.93 m	30.4%	35.3%	0.96 m
INVESTMENT TURNOVER								
West End	£0.84 bn	£1.75 bn	£1.57 bn	£1.99 bn	£1.68 bn	-15.5%	98.9%	£1.45 bn
City & Southbank	£2.29 bn	£2.10 bn	£2.10 bn	£3.87 bn	£1.50 bn	-61.2%	-34.3%	£2.20 bn
Docklands & Stratford	£0.00 bn	£0.00 bn	£0.44 bn	£0.00 bn	£0.00 bn			£0.22 bn
London	£3.13 bn	£3.85 bn	£4.12 bn	£5.86 bn	£3.18 bn	-45.7%	1.5%	£3.87 bn
PRIME HEADLINE RENTS (PER SQ FT)								
West End	£115.00	£118.00	£118.00	£120.00	£122.5	2.1%	6.5%	2.6%
City & Southbank	£73.00	£75.00	£75.00	£75.00	£75.00	0.0%	3.4%	3.2%
Docklands & Stratford	£50.00	£50.00	£50.00	£50.00	£52.50	5.0%	5.0%	3.8%

Source: Knight Frank

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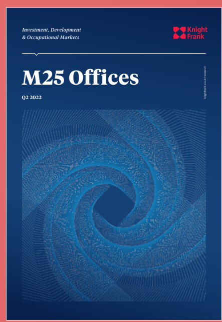

M25 Offices Q2 2022

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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