London Office Market Report

Q1 2023

- Take up softens but prime demand remains robust
- Availability increases with upcoming developments
- Prime yields stabilise in City and West End

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Executive Summary

Key Themes

1.

Take up softens but prime demand remains robust

2.

Availability increases with upcoming developments

3.

Prime yields stabilise in City and West End

ECONOMIC ACTIVITY IN LONDON BOUNCES BACK

The first quarter has seen economic activity surprising to the upside following a challenging end to 2022. The capital has been driving the near-term recovery in growth as new orders have risen to a 12-month high. Although, elevated levels of inflation remain a concern, the rate of price growth is decelerating as lower input prices are allowing companies to reduce prices charged to final customers. There has also been a slight improvement to numbers employed in London compared with the end of last year when headcounts were being reduced, however, employment growth is currently below the UK average.

Economic activity is likely to be under pressure from a renewed bout of increased scrutiny on the balance sheets of the banking sector. This follows the recent takeovers of SVB, Credit Suisse and First Republic banks and will impact the real economy through lower levels of consumer and corporate lending. The deflationary impact of a tighter lending environment has resulted in the forward interest rate curves pricing in lower long-term interest rates with the peak expected to be below 4% compared with just below 5% six months ago.

Recent positive news flow from business surveys is likely to lead to upward revisions of London GDP growth forecasts for 2023 which currently show almost no growth. From 2024-27, GDP growth is expected to be the strongest amongst other gateway cities in Europe.

> "From 2024-27, GDP growth is expected to be the strongest amongst other gateway cities in Europe."

TAKE-UP SOFTENS BUT NEAR-TERM DEMAND IS ROBUST

Lettings transactions in 2023 Q1 totalled 1.94m sq ft, down 33% compared with the previous quarter and 36% below the quarterly long-term trend. The strong finish to the end of 2022 and the timing of Easter are likely to have had an impact on leasing volumes last quarter. During the last 12 months, take-up has totalled 10.76m sq ft which is only 12% below the annual long-term trend.

The shift in occupier demand to best-in-class buildings continues to be a key feature of the London office market. During the last 12 months, take-up for new and refurbished space has been 6.65m sq ft exceeding the long-term average of 5.59m sq ft. Moreover, this level of activity is in line with pre-pandemic take-up of the best quality buildings. As a share of all lettings, new and refurbished space accounts for 62% and compares to a long-term average of 47.1%.

Two of the largest transactions in 2023 Q1 were by technology, media and telecoms occupiers. These include TikTok's pre-let of 140,000 sq ft at Verdant, 150 Aldersgate Street in Farringdon and Virgin Media's pre-let of 83,000 sq ft at 3 Sheldon Square in Paddington. Both developments complete in 2024. Pimco's letting of 106,000 sq ft at 25 Baker Street in Marylebone was the largest transaction in the West End was also a pre-let.

During the last 12 months, leasing activity has been dominated by financial and professional service occupiers, accounting for 26.0% and 28.4% of transactions respectively. Notable transactions include Clifford Chance's 321,000 sq ft pre-let at 2 Aldermanbury Square and Blackstones 230,000 sq ft relocation to Lansdowne House.

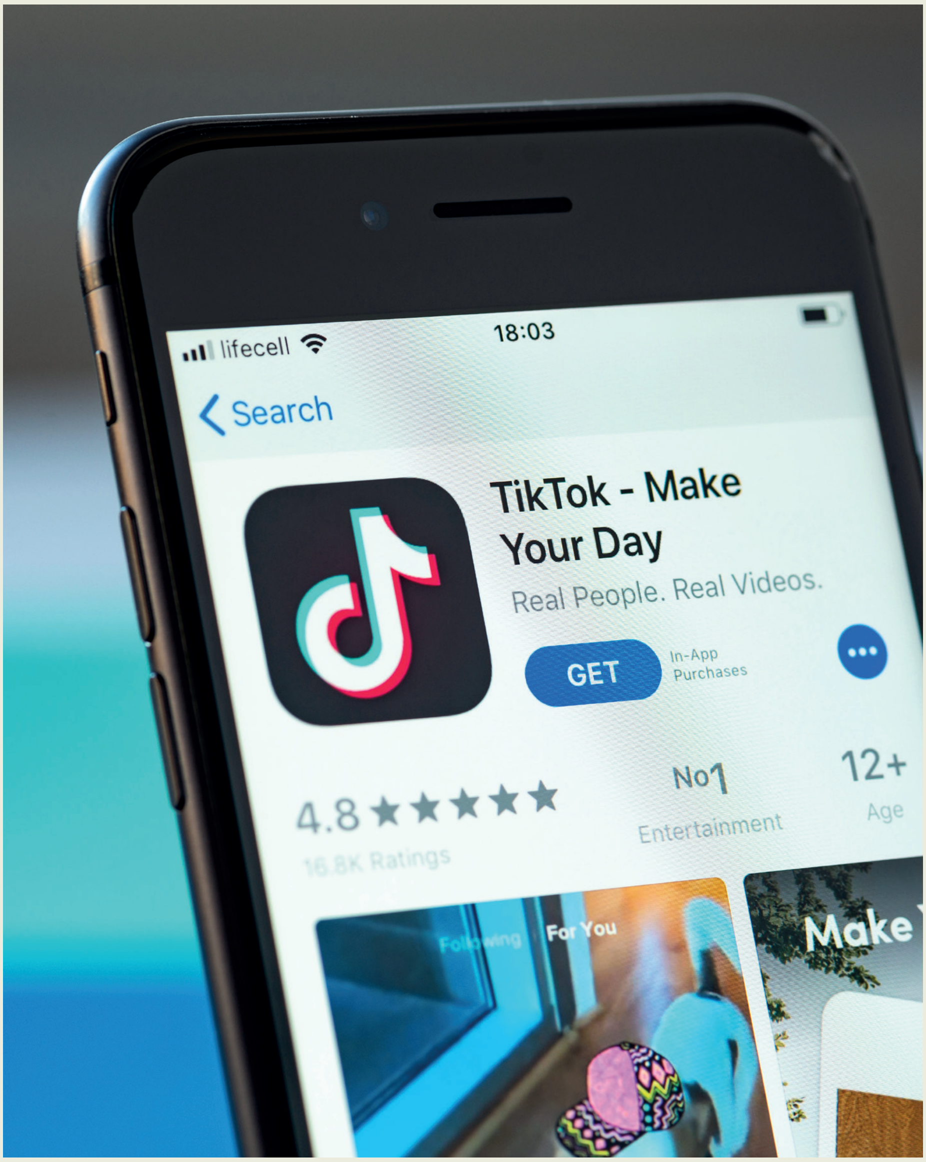
Lettings transactions by technology, media and telecoms occupiers totals 1.5m sq ft, down 40% compared with the previous year and 40% below the annual trend over the last 10 years.

In addition, the education sector has continued to be active in the lettings markets. In 2022, there were 12 deals by education occupiers whilst in 2023 Q1 there have been a further six deals totalling 0.14m sq ft. Four lettings were to traditional universities and the remainder were to private education providers. Current requirements from the sector are at record and deals under offer to other educators, suggesting that demand from the sector will remain a growing component of the London market.

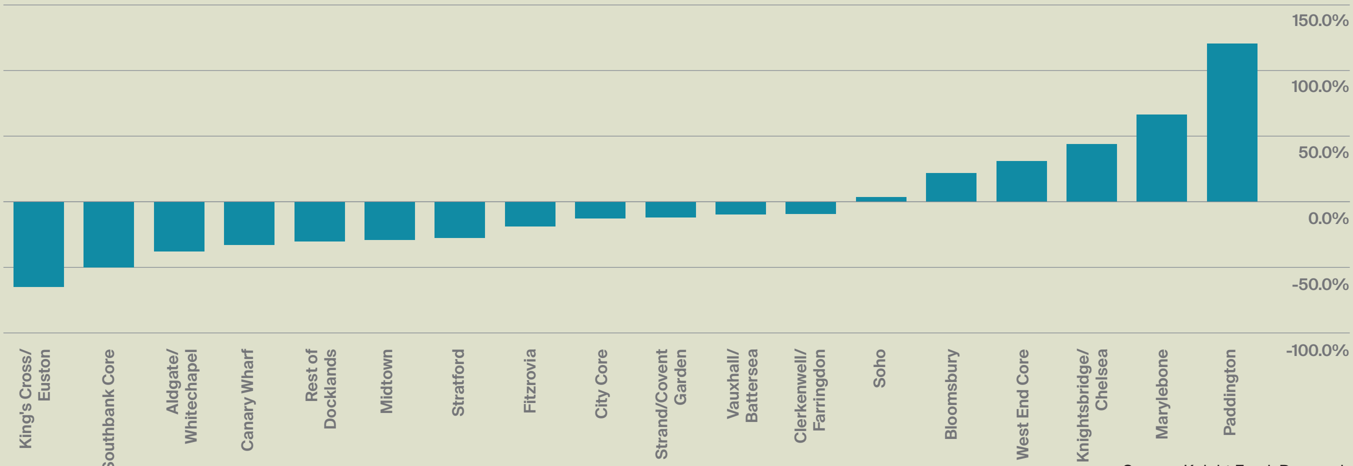
In 2023 Q1 Active requirements over 10,000 sq ft have risen to 8.41m sq ft, an increase of 1m sq ft from the previous quarter. Financials and professional services account for the majority of near-term space requirements with 3.0m sq ft and 2.2m sq ft respectively.

AVAILABILITY INCREASE DRIVEN BY UPCOMING DEVELOPMENTS

Available space has risen 10.6% during the quarter to 23.9m sq ft which implies a vacancy rate of 9.5%, 2.8 percentage points above the long-term average. However, almost 3m sq ft is under-offer and would reduce the vacancy rate to 8.3% if all space is exchanged. The



London - Take-up by Submarket
% above/below trend

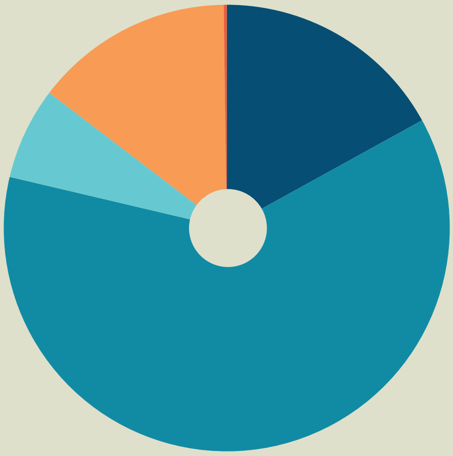


Source: Knight Frank Research

London – Investment by Buyer Nationality

£m

Europe	17%
APAC	62%
North America	7%
UK	14%
Rest of World	0%

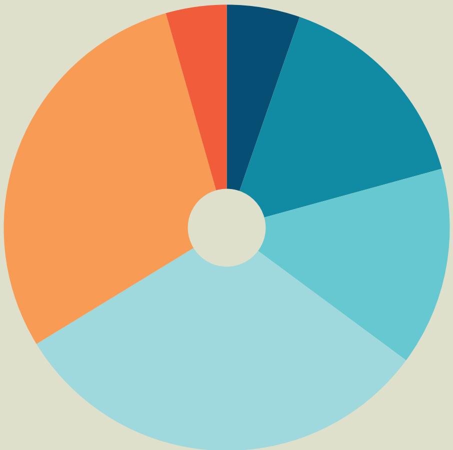


Source: Knight Frank Research

London – Investment by Buyer Type

£m

Corporate/Other	5%
Pensions/Life/Insurance	15%
Private Investor	14%
Private Property Company	32%
Quoted Property Company	29%
Sovereign Wealth Fund	5%



Source: Knight Frank Research

largest rise in availability occurred in the West End (1.2m sq ft) followed by the City (1.1m sq ft). The quarterly rise has mainly been driven by 1.7m sq ft of near-term speculative development completions and a further 0.79m sq ft of tenant release space.

Availability of new and refurbished space is 13.8m sq ft and contained in just over 40% of all vacant buildings. By sideband, the majority of new and refurbished availability is in 0-40,000 sq ft buildings. In the City and Southbank, 46% of available buildings are new or refurbished and 35% in the West End.

During the quarter there have been 1.53m sq ft of new starts in London, raising the under-construction pipeline to almost 17m sq ft and completing in 2026. Just below 30% of the pipeline is pre-let whilst 11.95m sq ft is being built speculatively. Compared with the average annual level of new and refurbished take-up suggests an under-supply of 9m sq ft prime space.

INVESTMENT ACTIVITY RISES AFTER STALLING IN Q4

Investment activity rose during the quarter by 56% to £2.3bn as investor demand returned following the uncertainty which ensued after the mini-Budget. The underlying trend is weak relative to historic levels of investment. Over the last 12 months there has been £10.2bn of transactions in London offices, which is 34% below the long-term annual trend.

Demand from private wealth investors accounted for the largest share of transactions at 41% and was followed by institutions at just below 25% and listed property companies at 8.6%. By nationality investors from Asia Pacific remain the most active group with 35% of transactions over the last 12 months, followed by the UK with a 24.3% share and European investors at 23%.

We have maintained prime yields in the City and Southbank and in the West End as the recent reduction in long-term interest rates has allayed some uncertainty regarding the extent to which central banks will raise policy rates. Although, recent events in the banking sector are likely to result in a tighter lending environment, we expect investment activity to become polarised as investors with below average levels of operational and financial leverage are able to source efficiently priced capital. Furthermore, valuations for secondary properties are likely to come under pressure from rising obsolescence which could lead to forced sales if investors aren't able to refinance their debt obligations.

Key transactions include the £350m acquisition of 1 New Street Square by Chinachem Group and CDL's purchase of St Katherine's Docks, E1 for £395m. Pricing of the latter transaction implies a yield of 7.2% and a capital value of £752 per sq ft and reflects the underlying future capital expenditure requirements of the asset.

UNLOCK OUR INSIGHTS

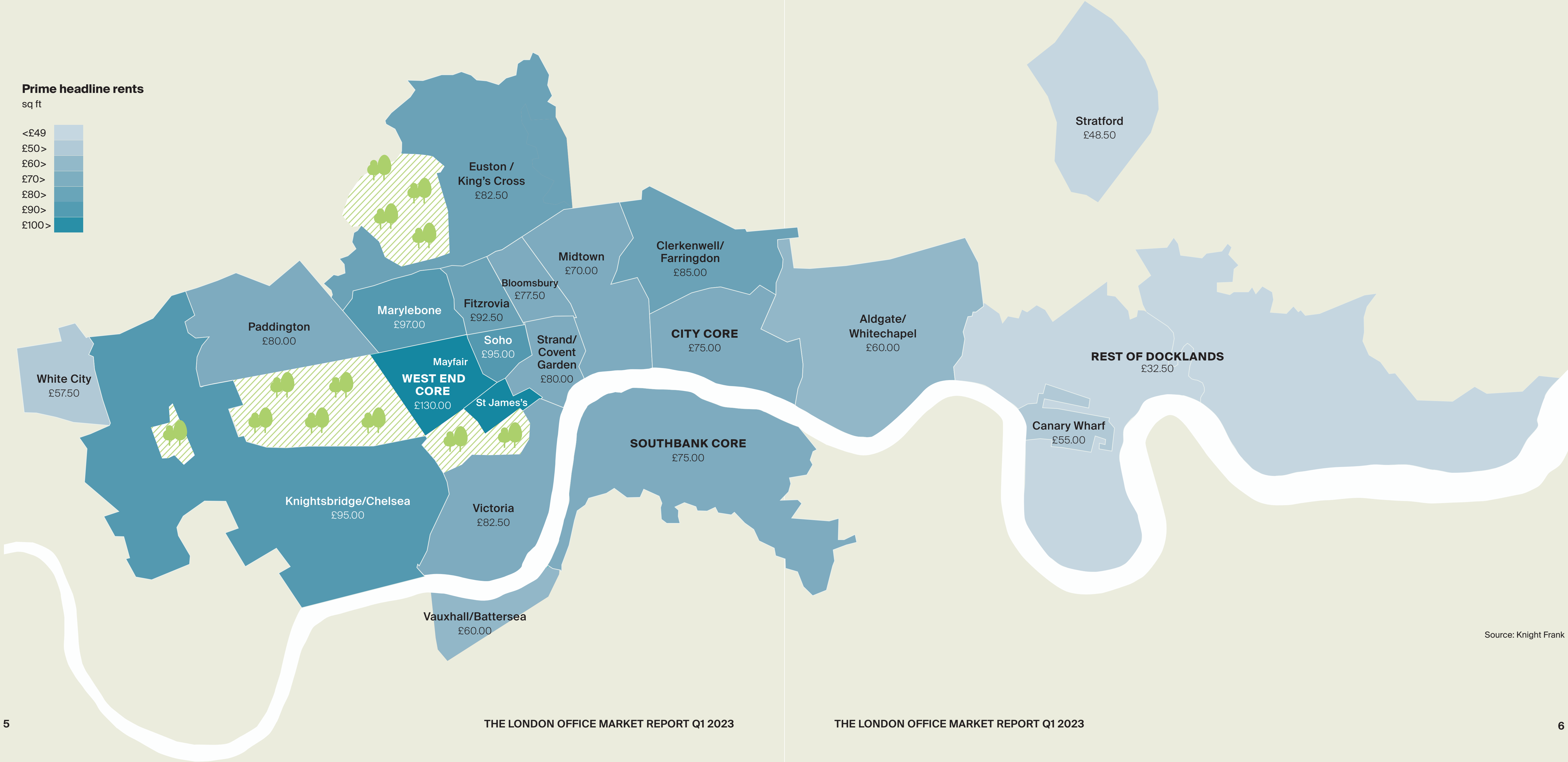
London office market

Performance dashboard 2023 Q1

KEY PERFORMANCE INDICATORS

	▲ 1.94m TAKE-UP (SQ FT)	▲ 23.95m AVAILABILITY (SQ FT)	▲ 9.50% VACANCY RATE	▲ 16.75% UNDER CONSTRUCTION (SQ FT)
CHANGE ON				
2022 Q3	-34.80% ▼	10.60% ▲	0.90% ▲	8.60% ▲
LTA	3.04 million sq ft	15.67 million sq ft	6.80 %	12.68 million sq ft

WEST END		CITY & SOUTH BANK		DOCKLANDS & STRATFORD	
▲ £130.00 Prime headline rent (per sq ft)	▼ 0.80 m Take-up (per sq ft)	◆ £75.00 Prime headline rent (per sq ft)	▼ 1.03 m Take-up (per sq ft)	◆ £55.00 Prime headline rent (per sq ft)	▼ 0.11 m Take-up (per sq ft)
▼ 0.76 bn Investment turnover	◆ 3.75% Prime Yield	▲ 1.38 bn Investment turnover	▲ 4.75% Prime Yield	◆ 0.13 bn Investment turnover	▲ 6.00% Prime Yield



Source: Knight Frank

The City and Southbank

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

◀▶ **£75.00**
Rent (per sq ft)

▼ **1.03 m**
Take-up (per sq ft)

▲ **13.81 m**
Availability (per sq ft)

▲ **1.38 bn**
Investment turnover

◀▶ **4.75%**
Prime yield

TAKE-UP OF NEW AND REFURB REMAINS HIGH

Take-up in the City and Southbank was just over 1m sq ft in 2023 Q1, down 30% compared with the previous quarter. During the last 12 months there have been 5.3m sq ft of lettings, which is 20% below the long-term annual trend.

Despite a 40% fall in Q1, take-up of new and refurbished space remains above trend and during the last 12 months has accounted for just below two-thirds of take-up.

The professional services group have been the occupier group with the largest share of take-up (40%) and more than twice the level of the next largest occupier group, financials (17.3%).

Headline prime rents in the core City and Southbank submarkets were unchanged in Q1 at £75.00 per sq ft. Rent free periods were also unchanged at 24-27 months for a 10 year lease.

FURTHER RISE TO AVAILABLE FLOORSPACE

Availability rose by almost 9% during the quarter to 13.8m sq ft which is a vacancy rate of 10.3% and just over 3 ppts above the long-term trend.

> "Take-up in the City and Southbank was just over 1m sq ft in 2023 Q1, down 30% compared with the previous quarter."

▼ 20%

During the last 12 months there have been 5.3m sq ft of lettings,

The rise was due in large part to a 20% increase in the availability of secondhand space. New and refurbished space accounts for 58% of all available space.

However, this space is concentrated in smaller sizeband buildings. In the City Core, for example, there are only 12 available buildings above 60,000 sq ft.

Development completions during the quarter were relatively small with only 0.32m sq ft of space completing over three schemes. Speculative space under construction is 10.1m sq ft and is scheduled to complete by 2026. In comparison to average levels of take-up for new and refurbished space, this suggests a shortfall of over 6m sq ft of best-in-class space.

INVESTMENT VOLUMES BOUNCE-BACK

Transactions in the City and Southbank rose by almost 150% to £1.4bn as investor demand returned following a weak out-turn at the end of last year. Greater levels of activity have been evident during Q1 as the peak in the interest rate cycle approaches, combined with attractive pricing for prime assets.

Over 90% of volumes were transacted by listed property companies (48.2%) and by private property companies (43.4%). Furthermore, attractive capital values particularly in overseas currencies provided the incentive for investors from the Asia Pacific region to account for nearly three-quarters of volumes.

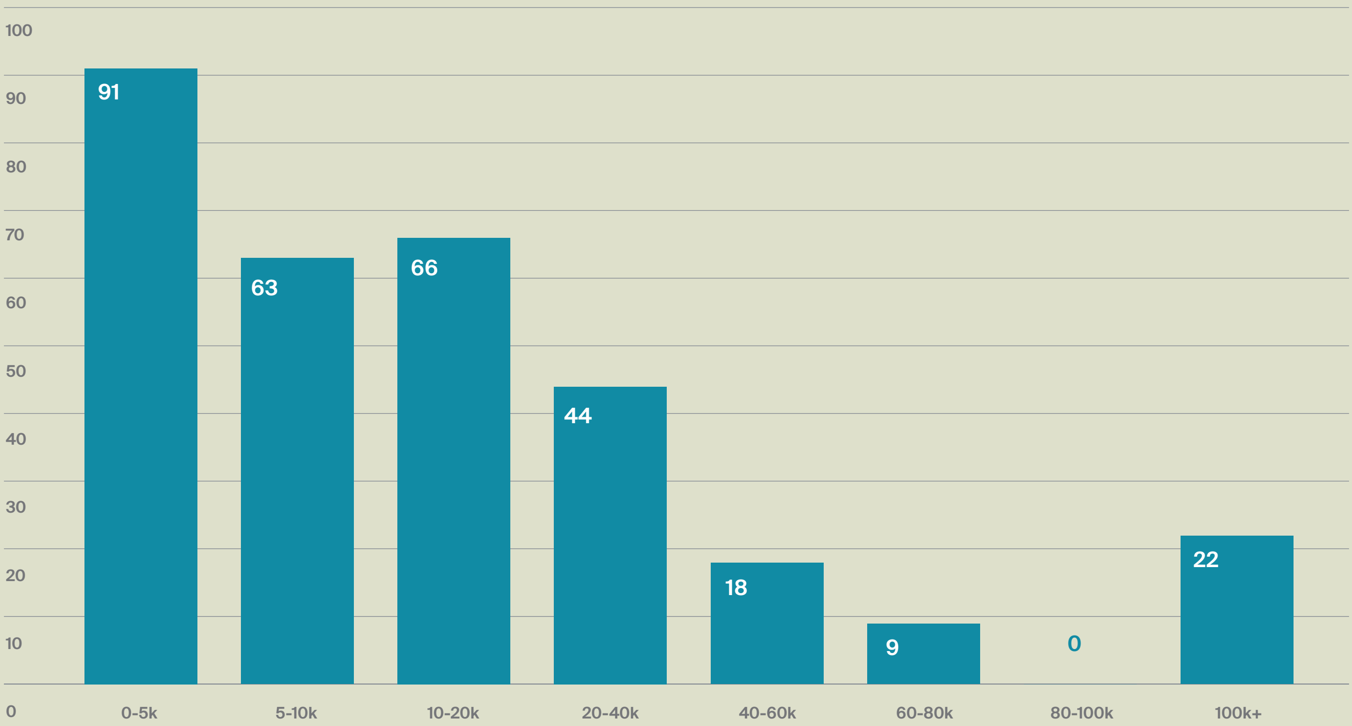
The largest transaction last quarter was the £395m sale of St Katharine's Docks, in the City fringe by Blackstone to CDL of Singapore and reflecting a net initial yield of 7.2%.

Prime yields remain unchanged at 4.75% as prospects for best-in-class offices remains relatively strong.

> "Transactions in the City and Southbank rose by almost 150% to £1.4bn as investor demand returned following a weak out-turn at the end of last year. "

City & Southbank - New/Refurb Availability by Sizeband

Number of Buildings 2023 Q1



Source: Knight Frank Research

MARKETS IN REVIEW

West End

£130.00

Rent (per sq ft)

0.80 m

Take-up (per sq ft)

6.34 m

Availability (per sq ft)

0.76 bn

Investment turnover

3.75%

Prime yield

"Take-up fell by 39.1% in the West End this quarter to 0.8m sq ft, the lowest level of lettings since 2021 Q2."

TAKE-UP MODERATES

Take-up fell by 39.1% in the West End this quarter to 0.8m sq ft, the lowest level of lettings since 2021 Q2. The reduction in deal flow this quarter means annual take-up was 4.8m sq ft and 3% above trend.

Although, take-up of new and refurbished space fell during the quarter, annual take-up remains 50% above trend and accounting for 57% of all transactions.

The financials sector continues to dominate the leasing market accounting for 38.9% of lettings during the quarter, 35.2% during the last year and over half of all current active requirements. Technology, media and telecoms occupiers were the only sector to increase take-up in the West End this quarter, led by Virgin Media's pre-let of 3 Sheldon Square, in Paddington.

Headline prime rents were stable across all submarkets except the West End Core, rising by £5 to £130 per sq ft. Rent free periods remain unchanged at c.24 months for a 10-year lease.

AVAILABILITY RISES DUE TO DEVELOPMENTS

Availability has risen 23.6% to 6.34m sq ft, the first rise since 2021 Q3. Near-term speculative development completions account for almost 1m sq ft of the rise in availability. Tenant release space of 0.2m sq ft also contributed to the rise in Q1.

The vacancy rate has increased from 5.6% to 6.9%, and above the long-term average of 6.1%. However, there is considerable variation by submarket and is especially low in new business districts with Elizabeth line stations.

Availability of new and refurbished buildings has risen to 62% of all vacant stock. A significant proportion is in smaller sizeband buildings (0-20,000 sq ft) whilst available space is limited in higher sizeband buildings particularly above 80,000 sq ft.

FUTURE SUPPLY IS MODEST

There are 4.2m sq ft of speculative completions expected by the end of 2026. Compared with the average annual level of take-up of new and refurbished space of 1.9m sq ft, this suggests a shortfall of best-in-class space during the next four years.

LOWER INVESTMENT TRANSACTION ACTIVITY

Investment volumes totalled £0.8bn this quarter, down 16.0% on Q4 and 47.4% below long-term quarterly trend levels. Transaction levels have been impacted by a lack of available, quality stock and by investors exercising some caution following the disruptions in the banking sector.

Private investors accounted for the largest share of transactions (37.8%) followed by institutions (36.4%). Both investor types were attracted by the re-pricing of prime buildings following a rise of 50bps to yields.

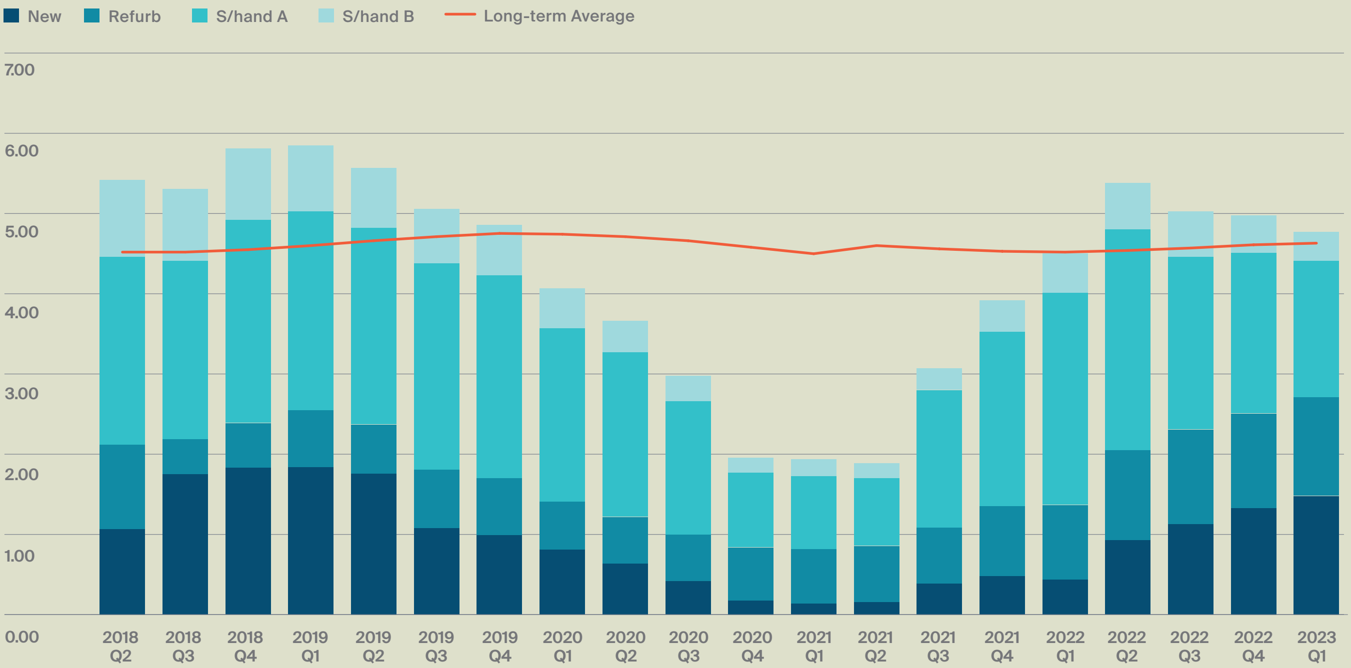
▲50%

Annual take-up remains 50% above trend and accounting for 57% of all transactions

Investors from Asia Pacific and Europe were the most acquisitive, representing 36.8% and 34.7% of transactions. Following a period of no activity, North American investors returned during the quarter with a 20% share.

Prime yields in the West End have remained stable at 3.75% as investor demand remains relatively strong for best-in-class buildings that are a hedge against inflation.

West End - 4 Qtr Take-up by Grade
m sq ft



Source: Knight Frank Research

MARKETS IN REVIEW

Docklands & Stratford

£55.00

Rent (per sq ft)

0.11 m

Take-up (per sq ft)

3.80 m

Availability (per sq ft)

0.13 bn

Investment turnover

6.00%

Prime yield

“Although, lettings activity remains modest with transactions 32% below the long-term annual trend, demand has been focussed on better quality buildings.”

TAKE-UP REMAINS LOW

There was 0.1m sq ft of take-up in 2023 Q1, a quarterly fall of 31.6%. Although, lettings activity remains modest with transactions 32% below the long-term annual trend, demand has been focussed on better quality buildings.

During the last 12 months, lettings of new and refurbished space has accounted for 60% of all transactions.

The education sector was the largest occupier group during the quarter with just over 70,000 sq ft of lettings. The top three transactions of the quarter were all from the education sector, with Teeside University’s take-up of 26,720 sq ft at Here East, Queen Elizabeth Olympic Park, the largest of the quarter.

Active demand has more than doubled in Docklands and Stratford with 0.3m sq ft of requirements. This increase can be attributed to the public sector which accounts for three-quarters of the requirements total.

Prime rents are unchanged in Docklands but have risen by £1 in Stratford to £48.50 per sq ft. Rent free periods are between 27-30 months for a 10-year lease.

AVAILABILITY IS BROADLY UNCHANGED

A rise in vacant new and refurbished space offset almost a 1% fall in secondhand availability, leaving the overall level broadly unchanged at 3.8m sq ft. and a vacancy rate of 15.9%.

31.6%

There was 0.1m sq ft of take-up in 2023 Q1, a quarterly fall

For the second consecutive quarter there have been no development completions. The under-construction development pipeline is almost 1m sq ft and completes by 2024.

The largest scheme is the 415,000 sq ft YY London, 30 South Colonnade and completes this year. In Stratford, there are 560,000 sq ft of schemes under-construction and across four schemes.

TWO INVESTMENT TRANSACTIONS

£0.1bn was transacted in Q1. The largest being 117 Columbus Court in Canary Wharf. The value-add asset transacted for £99.8m and was acquired by GIC Real Estate and Oaktree Capital Group.

Prime yields in Docklands and Stratford have risen by 50bps to 6.00%, as investor demand has a greater focus on the more liquid London markets.

Docklands & Stratford - 4 Qtr Take-up by Sector

m sq ft

Source: Knight Frank Research

Key Statistics

	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	% CHANGE 3 MONTHS	% CHANGE 12 MONTHS	10-YEAR QUARTERLY AVERAGE
AVAILABILITY (SQ FT)								
West End	6.83 m	6.17 m	5.21 m	5.13 m	6.34 m	23.6%	-7.1%	5.27 m
City & Southbank	10.75 m	11.18 m	12.48 m	12.72 m	13.81 m	8.6%	28.5%	8.41 m
Docklands & Stratford	2.53 m	3.06 m	3.63 m	3.81 m	3.80 m	-0.3%	50.1%	1.99 m
London	20.11 m	20.41 m	21.32 m	21.66 m	23.95 m	10.6%	19.1%	15.67 m
VACANCY RATE								
West End	7.5%	6.8%	5.7%	5.6%	6.9%	1.3%	-0.6%	6.1%
City & Southbank	8.1%	8.4%	9.3%	9.5%	10.3%	0.8%	2.1%	6.8%
Docklands & Stratford	10.6%	12.8%	15.2%	16.0%	15.9%	0.0%	5.3%	9.1%
London	8.2%	8.2%	8.6%	8.7%	9.6%	0.9%	1.4%	6.8%
TAKE-UP (SQ FT)								
West End	1.01 m	1.49 m	1.17 m	1.31 m	0.80 m	-39.1%	-21.1%	1.13 m
City & Southbank	1.46 m	1.64 m	1.18 m	1.50 m	1.03 m	-31.4%	-29.3%	1.68 m
Docklands & Stratford	0.18 m	0.06 m	0.30 m	0.16 m	0.11 m	-31.6%	-36.3%	0.22 m
London	2.65 m	3.19 m	2.65 m	2.98 m	1.94 m	-34.8%	-26.7%	3.04 m
ACTIVE REQUIREMENTS (SQ FT)								
West End	1.85 m	1.03 m	1.40 m	1.43 m	1.96 m	37.4%	5.9%	1.97 m
City & Southbank	4.43 m	4.18 m	5.04 m	4.59 m	4.60 m	0.3%	3.7%	4.29 m
Docklands	0.75 m	0.12 m	0.11 m	0.15 m	0.30 m	104.4%	-59.7%	0.57 m
London-wide	1.35 m	2.54 m	0.91 m	1.31 m	1.55 m	19.0%	15.0%	1.80 m
London	8.39 m	7.86 m	7.46 m	7.47 m	8.41 m	12.7%	0.3%	8.64 m
SPEC UNDER CONSTRUCTION (SQ FT)								
West End	4.95 m	5.29 m	5.64 m	5.31 m	5.89 m	10.9%	18.8%	3.27 m
City & Southbank	9.60 m	9.10 m	9.46 m	9.36 m	9.88 m	5.6%	2.9%	6.42 m
Docklands & Stratford	0.76 m	0.76 m	0.76 m	0.76 m	0.98 m	29.0%	29.0%	0.77 m
London	15.31 m	15.14 m	15.86 m	15.42 m	16.75 m	8.6%	9.4%	10.46 m
DEVELOPMENT COMPLETIONS (SQ FT)								
West End	0.45 m	0.13 m	0.28 m	0.71 m	0.12 m	-83.1%	-73.6%	0.29 m
City & Southbank	0.13 m	0.74 m	0.78 m	0.45 m	0.32 m	-28.8%	155.9%	0.58 m
Docklands	0.14 m	0.06 m	0.00 m	0.00 m	0.00 m		-100.0%	0.11 m
London	0.72 m	0.93 m	1.06 m	1.16 m	0.44 m	-61.8%	-38.0%	0.98 m
INVESTMENT TURNOVER								
West End	£1.99 bn	£1.68 bn	£1.30 bn	£0.90 bn	£0.76 bn	-16.0%	-62.0%	£1.44 bn
City & Southbank	£3.83 bn	£1.50 bn	£2.00 bn	£0.56 bn	£1.38 bn	147.1%	-64.1%	£2.16 bn
Docklands & Stratford	£0.05 bn	£0.00 bn	£0.00 bn	£0.00 bn	£0.13 bn		193.9%	£0.21 bn
London	£5.86 bn	£3.18 bn	£3.30 bn	£1.46 bn	£2.26 bn	55.4%	-61.4%	£3.81 bn
PRIME HEADLINE RENTS (PER SQ FT)								
West End	£120.00	£122.50	£125.00	£125.00	£130.00	4.0%	8.3%	3.2%
City & Southbank	£75.00	£75.00	£75.00	£75.00	£75.00	0.0%	0.0%	3.2%
Docklands & Stratford	£50.00	£52.50	£55.00	£55.00	£55.00	0.0%	10.0%	4.3%

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

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

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General Note
This report has been prepared by Knight Frank Research, the research and consultancy division of Knight Frank. Knight Frank Research gratefully acknowledges the assistance given by the London office teams in the compilation and presentation of this material. Certain data sourced from LOD. All graph data sourced by Knight Frank.

Technical Note
The following criteria have been adopted in the preparation of this report.

i. All floorspace figures quoted in this report refer to sq ft net.

ii. Take-up figures refer to space let, pre-let, or acquired for occupation during the quarter.

iii. Availability refers to all space available for immediate occupation, plus space still under construction which will be completed within six months and which has not been let.

iv. Availability and take-up are classified into three grades: New/refurbished: Space under construction which is due for completion within six months or space which is currently on the market and is either new or completely refurbished.
Second-hand A Grade: Previously occupied space with air-conditioning.
Second-hand B Grade: Previously occupied space without air-conditioning.

v. Demand figures quoted in this report refer to named requirements for over 10,000 sq ft.

vi. Under construction figures quoted in this report refer to developments of over 20,000 sq ft which are currently underway. They do not include properties undergoing demolition.

vii. Investment figures quoted in this report refer to accommodation where the majority of income/potential income is from office usage and comprises transactions of £1 m and above. The data includes standing investments, site purchases and funding transactions.

viii. This report is produced to standard quarters.
Quarter 1: January 1 – March 31,
Quarter 2: April 1 – June 30,
Quarter 3: July 1 – September 30,
Quarter 4: October 1 – December 31