Office recovery strengthens

Fall in availability in the City

Investment turnover rises

Knight Frank

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THE LONDON OFFICE MARKET REPORT Q3 2021

MARKET ROUNDUP

Office recovery strengthens

◆

Demand is broadening

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Fall in availability

Office recovery strengthens

Momentum in the London office recovery gathered pace in Q3 2021 with a fourth successive quarter of rising take-up. Leasing transactions of 2.63m sq ft represented a quarterly rise of 54.9% - the highest quarterly change since Q3 2009. Take-up across London is now 12.4% below the long-run quarterly average of 3.00m sq ft. The post lockdown demand surge in the advanced economies has notably eased since Q2 2021 as dislocated supply chains, an energy crisis and cost pressures have slowed the pace of economic growth. More recently, the recent rise in Covid infections in the UK has raised concerns of a renewed wave of hospitalisations ahead of the winter flu season. Although, the high levels of vaccinations and rollout of the booster shot for those vulnerable should mitigate the burden on the public health system. Despite these headwinds, the UK economy is expected to outperform growth of other advanced economies albeit at slightly lower rates compared with previous quarters. This is also reflected by the positive revision to UK GDP forecasts recently made by the Office of Budget Responsibility (OBR). They now expect growth of 6.5% in 2021 compared with 4% previously. Whilst they have lowered their estimate for 2022 they have revised upwards their expectation for 2023.

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The capital has become the European hub for the tech sector attracting record levels of venture capital investment to drive future growth

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Amid the softening global backdrop the London economy has also experienced an easing in growth but not to the same extent as the rest of the UK. Mobility on public transport has been improving, residential rents are rising indicating people moving back and workplace occupancy is rising. Furthermore, independent forecasters Oxford Economics expect London to be the best performing major European city in the near-term and outperforming many leading city economies in the US. London has a greater concentration of skilled labour at a time when demand from fast growing companies for such individuals is especially high. Also, the capital has become the European hub for the tech sector attracting record levels of venture capital investment to drive future growth. The prospect of interest rate rises to curb inflation, unfilled vacancies and skill shortages are key downside risks to the outlook, whilst any financial markets deregulation could provide a positive stimulus to London.

The largest leasing deals in Q3 2021 were pre-lets or recently completed developments indicating demand for best-in-class space remains robust and large occupiers are prepared to pay a premium to secure space for future occupation significantly ahead of lease expiry. The largest deal in the City & Southbank submarket was the 160,000 sq ft pre-let at Stonecutter Court to Travers Smith. In the West End the largest deal was the 310,000 sq ft letting to Facebook at 1 Triton Square. Pre-lets in Q3 2021 were 22.9% of all transactions by floor space, which compares to the 8% recorded in Q2 2021.

Demand is broadening

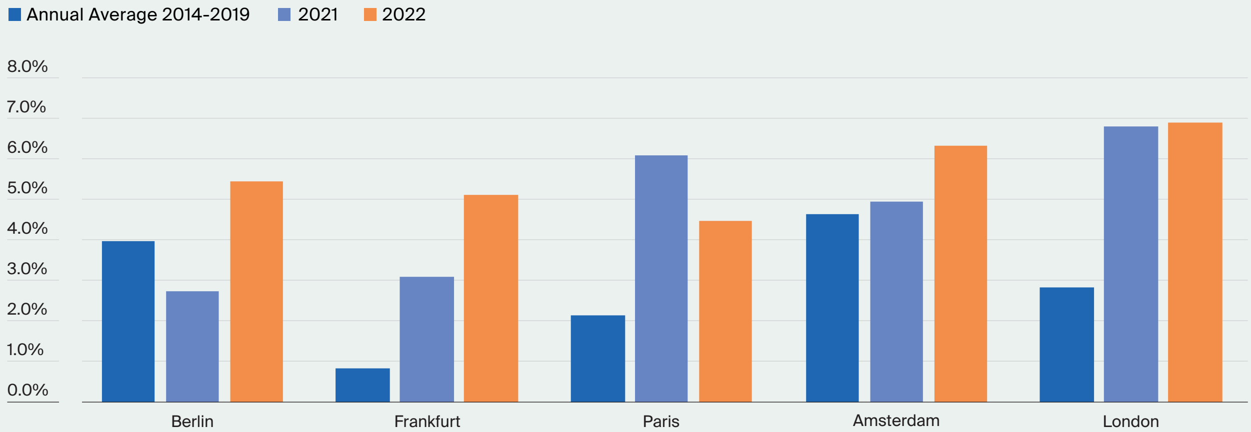
In Q3 2021, just over one-third of all lettings were to technology, media and telecoms companies, professional services accounted for 21% and financial services 15%. Take-up of flexible offices was 8% of activity which compares with no transactions in the previous quarter. There were a number of large pre-lets that transacted in the quarter, this meant that transactions of 100,000 sq ft+ accounted for 42.4% of all transactions this quarter by size.

Moreover, there has been a significant increase in take-up of secondhand space which accounted for 53.9% of all lettings, rising from 30.9% in Q2 2021 and indicative of a broader recovery in office demand. Occupier sentiment continues to improve with the number viewings and enquiries across London rising back to pre-pandemic levels, even with the typical summer slowdown, levels have been increasing on a weekly basis.

There has been a slight fall in active demand from 8.38m sq ft to 8.25m sq ft in Q3 2021. However, there was an increase in occupiers looking for space in the City submarkets at 5.2m

2.63m sq ft
LEASING DEALS DURING Q3

City GDP Forecasts
5 Year Annual % Change; Annual % Change



Source: Oxford Economics; Knight Frank Research sq ft rising from 4.79m sq ft in Q2 2021. Financial services make up 32% of active demand in Q3 2021, followed by the professional services with 27% and technology, media and telecoms companies with 24%.

Fall in availability

There was a marginal fall in availability across London to 18.71m sq ft - the first quarterly fall in availability since Q4 2019. The vacancy rate in London is 7.7% and is 1.1% above the long-run average. The largest decrease in availability at a submarket level occurred in the City Core, where availability decreased by 9.4% to 5.34m sq ft. Across London, 16.7% of available stock is comprised of new buildings while refurbished and secondhand space accounts for 83.3%.

Tenant release space actively being marketed has fallen 5% to 5.11m sq ft in Q3 2021. The majority of this space is secondary quality with 91% of tenant release space across London being secondhand grade A or lower. The City Core and Canary Wharf submarkets account for 50% of total tenant release space. Off market availability of tenant release space totals 1.59m sq ft, of which 64% is also contained in the City Core and Canary Wharf submarkets. Analysis of space released by tenants since the start of the pandemic has shown that 505,000 sq ft has either been let or withdrawn from the market.

Schemes that are currently under-construction, including off-plan and under-construction pre-lets, total 15.57m sq ft over a completion period of 2021-2025. Following a peak in completions between 2021-2023, the level of construction activity falls considerably, with only 550,000 sq ft currently under construction for completion in 2024. Post-pandemic structural demand is likely to increase for best-in-class buildings to meet with employee attraction/retention, wellness and Environmental and Social Governance requirements. Moreover, regulatory requirements will require the energy performance of the lettable stock to be significantly upgraded from current levels this will further raise demand for new and refurbished buildings.

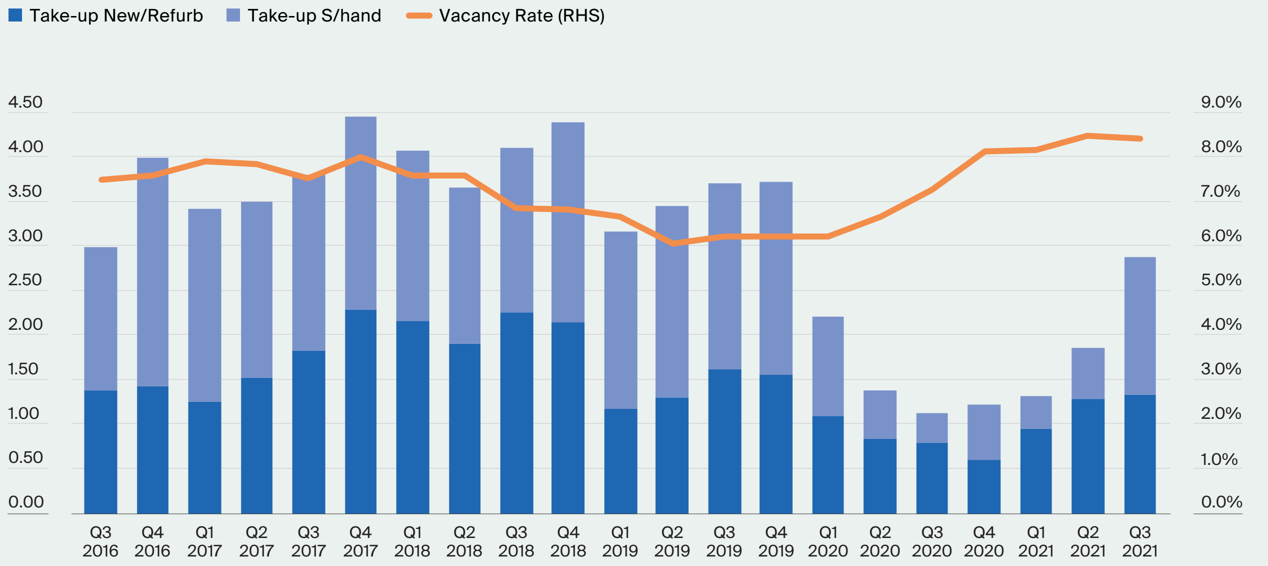
Investor appetite for prime London offices continues to be strong

Prime rental levels in core markets are now above pre-pandemic levels

Rising levels of sentiment and low levels of availability for best-in-class space has led to a rise in prime rents in core submarkets where agreed rents are above the market average. Prime rents in the City Core have risen to £75.00 per sq ft from £72.50 per sq ft in Q2 2021, £117.50 in the West End Core from £115.00 per sq ft in Q2 2021. Prime rents in the core submarkets are now above pre-pandemic

London Offices

m sq ft (LHS); % of stock (RHS)



Source: Knight Frank Research

levels. Incentives are unchanged at 27 months in the City and are 24 months in the West End for a 10-year lease term.

The improvement in near-term occupier demand and low levels of availability for prime space has led to a positive revision to our forecasts of prime rental growth in the City Core, Clerkenwell/ Farringdon, Southbank and West End Core submarkets. Stronger growth in 2021-22 is driven by lower levels of availability of prime space and above trend levels of growth in the London economy. In subsequent years (2023-25), our projections for prime rental growth are lower due to the moderation in economic growth that is expected from the impact of Brexit, tighter government spending and tax rises. The average annual growth in the City Core between 2021-25 is 3.6% compared with 3.0% in Q2 2021. In the West End Core, the average is 3.4% from 2.8% in Q2 2021. The risks to our forecasts is largely balanced as rising global headwinds are offset to some extent by the diversified nature of the London economy, high vaccination rates, increase in global capital inflows, mobility and office occupancy improving.

Investment turnover above long term quarterly average

Investor appetite for prime London offices continues to be strong as the easing of restrictions and greater levels of international travel drove £3.85bn of transactions across London, a rise of 23% on Q2 2021, and above the long-term average level of £3.78bn. European and North American investors accounted for the majority of turnover at 35% and 22% of purchasers respectively. The largest transaction of Q3 2021 was the acquisition of Times Square, 160 Queen Victoria Street, EC4 by Generali.

The rise in long-term interest rates in Q3 2021 was offset by the weight of investor capital and improving expectations of rental growth. Moreover, sterling's fall further increases the attractiveness of London office capital values to international investors. Prime yields were stable in Q3 2021. In the City & Southbank prime yields were 4.00%, in the West End Core were 3.50% and in the Canary Wharf submarket were 4.75%. However, expectations are high for a significant increase in cross border capital flows with a broader pool of investors that are attracted by the inflation hedge characteristics and improvement in occupier markets, especially as the pricing of London office assets has remained stable as long-term interest rates have risen and other gateway office markets look comparatively more expensive without the same upside potential.

Furthermore, our recent active capital report shows cross border capital will reach record levels in 2022. The UK is expected to be a significant beneficiary of these flows, with the office market in particular favoured by global investors.

UNLOCK OUR INSIGHTS

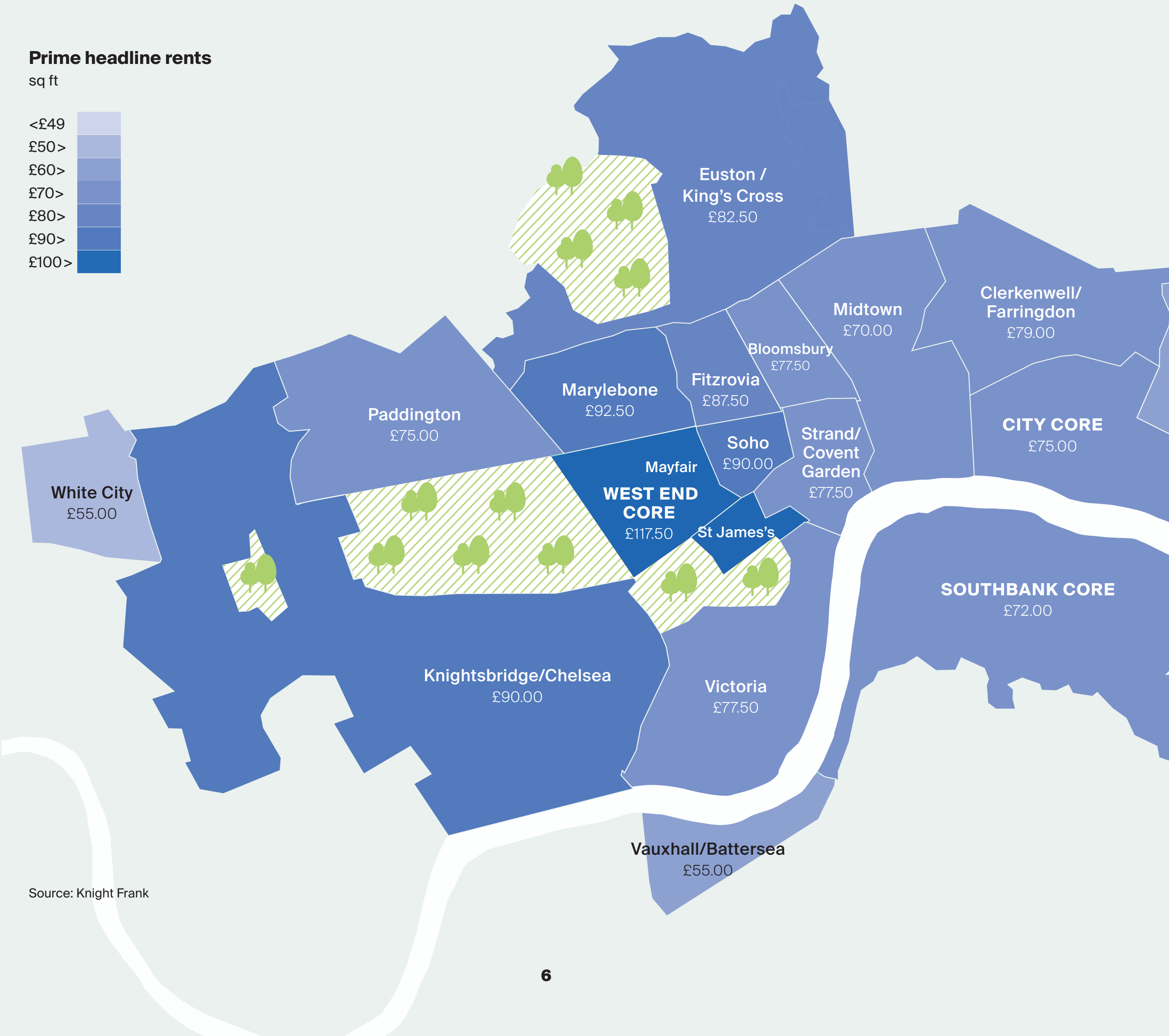
LONDON OFFICE MARKET

Performance dashboard Q3 2021

Key performance indicators

	▲2.63 m TAKE-UP (SQ FT)	▼18.71 m AVAILABILITY (SQ FT)	▼7.7% VACANCY RATE	▲14.23 m UNDER CONSTRUCTION (SQ FT)
Change on				
Q2 2021	54.9% ▲	-0.2% ▼	-	9.4% ▲
LTA	3.0 million sq ft	15.07 million sq ft	6.70%	9.21 million sq ft

Prime headline rents
sq ft



Source: Knight Frank

WEST END

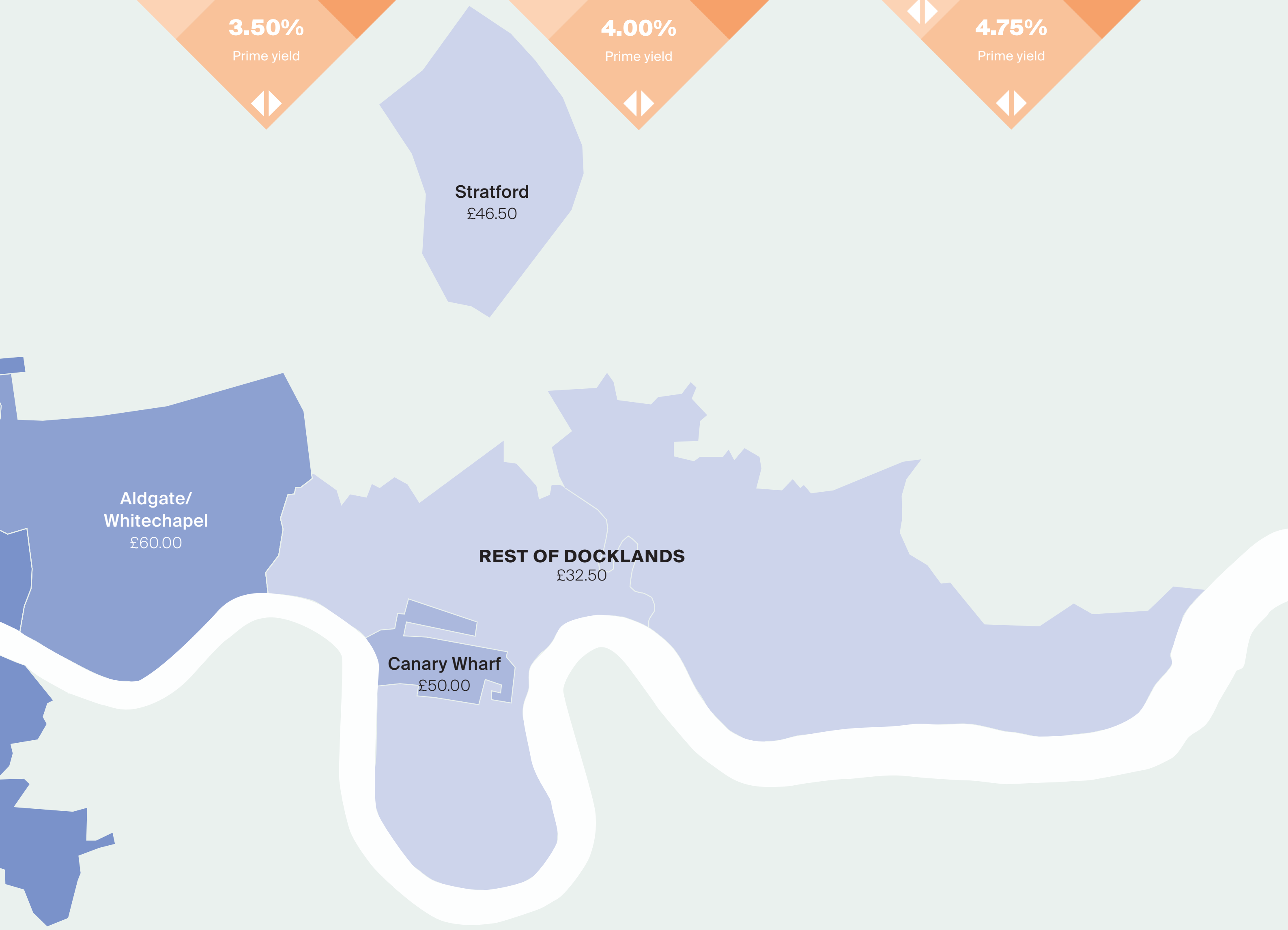
- £117.50 per sq ft — Prime headline rent
- £1.75 bn — Investment turnover
- 1.52m sq ft — Take-up
- 3.50% — Prime yield

CITY & SOUTH BANK

- £75.00 per sq ft — Prime headline rent
- £2.10 bn — Investment turnover
- 1.09 m sq ft — Take-up
- 4.00% — Prime yield

DOCKLANDS & STRATFORD

- £50.00 per sq ft — Prime headline rent
- £0.00 bn — Investment turnover
- 0.02m sq ft — Take-up
- 4.75% — Prime yield



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	▲ 1.09 m	▼ 9.30 m	▼ £2.10 bn	◀▶ 4.00%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Continued improvement in take-up

Take-up rose substantially in the City & Southbank market by 31.6% to 1.09m sq ft, although take-up still remains 0.59m sq ft below the 10-year quarterly average. The largest deal transacted was Travers Smith's pre-let of 160,000 sq ft at Stonecutter Court. This was one of four 100,000+ sq ft lettings, with take-up remaining largely focused on the City Core submarket.

Furthermore, a majority of take-up was of new and refurbished stock, highlighting the ongoing flight to quality among occupiers. Financial and professional services firms were responsible for most of the activity across the quarter.

Availability and vacancy rate both fall

Q3 2021 saw availability contract by 3.2%, down to 9.3m sq ft, compared to

the 10-year quarterly average of 8.20m sq ft. The vacancy rate also dropped fractionally to 7.1%, although this too remains above the long-term average.

Active requirements surpass 5m sq ft

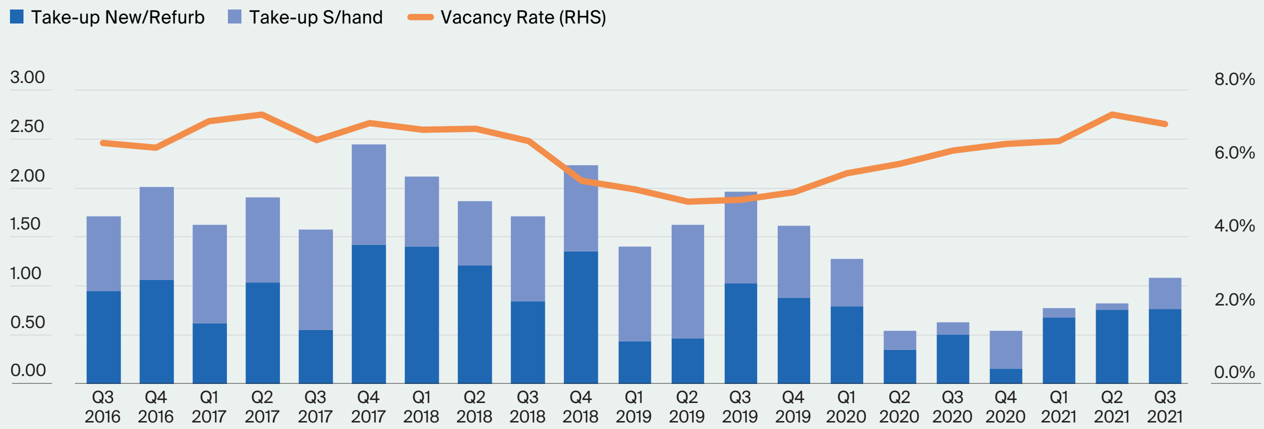
The demand for office space within the City and Southbank rose 11.8% during Q3 2021, the only major London submarket to see such growth. Active requirements reached 5.21m sq ft, 1.00m sq ft above the 10-year quarterly average.

The strongest demand comes from professional services firms, accounting for 23.5% of all requirements in the City. The second largest sector for active demand was finance, totalling 19.9%. The overall effect of this demand drove up prime headline rents by 3.4% to £75.00/sq ft. The disparity between the level of demand for and availability of best-in-class space explains the 8.4% drop in investment turnover during Q3 2021 to £2.1bn.

Development completions down but construction gaining pace

Completions within the City & Southbank fell 17.5% to 0.36m sq ft. 7.65m sq ft of space is currently under construction, a rise of 6.3% on Q2 2021 and 27.1% more than the 10-year quarterly average. Of this, 70.7% is speculative, totalling 5.41m sq ft of developments which complete by 2023.

City & Southbank
m sq ft (LHS); % of stock (RHS)



Source: Knight Frank research

MARKETS IN REVIEW

WEST END

▲£117.50	▲1.52 m	▲6.93 m	▲£1.75 bn	◀▶3.50%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Take-up above long-term quarterly average

Q3 2021 saw a 151.4% increase in take-up across the West End with 1.52m sq ft of lettings, above the 10-year quarterly average of 1.11m sq ft. The headline deal was Facebook's letting of the newly completed development at Triton Square, totalling 310,000 sq ft. The second largest deal was the 134,000 sq ft letting at King's Cross Central by The Office Group. Second-hand space accounted for 1.09m sq ft of take-up, up from 0.45m sq ft in Q2 2021, an increase of 142.2%. The tech, media and telecoms sector was the largest driver of take-up with 22.1% of all leasing activity. This was closely followed by the financial services sector with 20.5%.

Active requirements fell to 1.31m sq ft, a 0.24m sq ft decrease on Q2 2021. 52.6% of requirements are from the technology, media and telecoms sector; 22.1% is from the finance sector, and 9.5% is from professional services firms.

For the second consecutive quarter, prime headline rents in the West End Core submarket increased 2.2% to £117.50 per sq ft.

Prime headline rents increase

For the second consecutive quarter, prime headline rents in the West End Core submarket increased 2.2% to £117.50 per sq ft. Prime rents also rose in Victoria to £77.50 per sq ft from £72.50 per sq ft in Q2 2021. This rise can be explained by the combination of continuing strong demand for best-in-class space and low levels of available prime space. The volume of office space under construction also rose during Q3 2021 by 12.4% from the previous quarter to 5.76m sq ft. Of this, 3.87m sq ft is currently speculatively under construction.

Availability stabilising

Availability within the West End rose 0.9% to 6.93m sq ft. This is 1.8m sq ft above 10-year quarterly average. An overwhelming majority of this space is second-hand stock, highlighting the bifurcation of the office market – demand is increasingly focused on new and refurbished best-in-class office space. The vacancy rate was unchanged at 7.8%, 1.7% above the long-term average.

Investment turnover more than doubles

A 110.1% rise in investment turnover saw volumes jump from £0.83bn up to £1.75bn. This indicates a strong uptick in the desirability of space in the West End market.

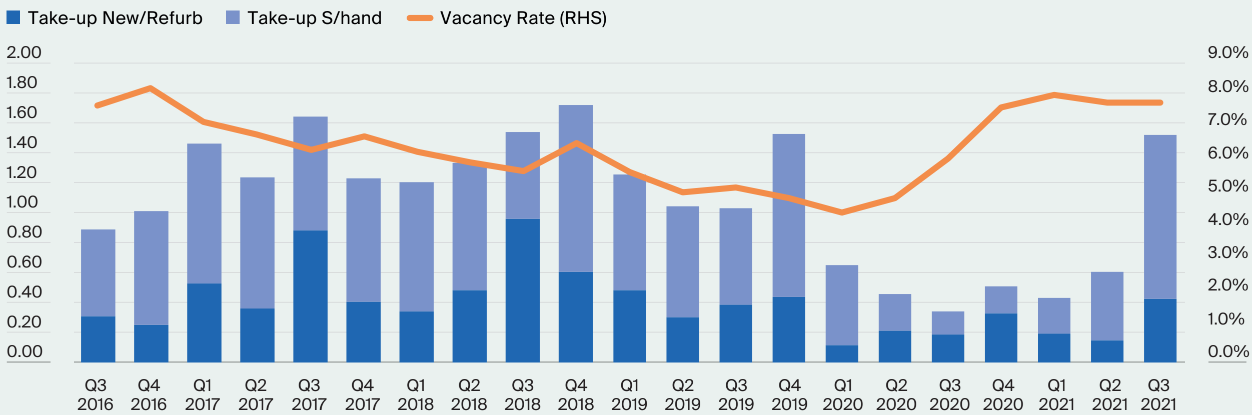
LEASING ACTIVITY REACHED

1.52M

SQ FT IN Q3 2021

West End

m sq ft (LHS); % of stock (RHS)



Source: Knight Frank Research

MARKETS IN REVIEW

DOCKLANDS & STRATFORD

£50.00	▲ 0.02	▲ 2.48 m	£0bn	4.75%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Take up rises

There was very little leasing activity in the Docklands & Stratford market with only two deals taking place which totalled 0.02m sq ft – a fall of 91.1% compared with Q2 2021. Annual take-up is 0.36m sq ft and is 97.1% below the long-term average. The ANZ leasing of office space at Cargo, 25 North Colonnade accounted for the majority of take-up in Q3 2021.

Availability rises

Across the quarter, total availability within the Docklands and Stratford submarket rose to 2.48m sq ft, an increase of 8.5% on Q2 2021. 960,484 sq ft of space was released by tenants over the past three months, a majority of which was second-hand Grade A stock.

Active requirements above long-term average

Despite active requirements dropping by 0.11m sq ft from last quarter (a fall of 14.7%), the longer-term picture for demand is more positive. 642,500 sq ft of office space is currently sought by firms within the Docklands, which represents a 107.3% increase compared with the figure for Q3 2020. Amongst this group of eight companies, the financial and tech sectors dominate. Current active requirements remain 100,000 sq ft above the ten-year quarterly average.

Investment still absent but development gathers momentum

The vacancy rate rose by 1.0% over Q3, reaching 11.6%. This is 3.1% above the 10-year quarterly average. For the second consecutive quarter, no investment transactions were undertaken for offices within the Docklands & Stratford market. The volume of office space under construction grew to 0.82m sq ft in the third quarter, 36.7% above the ten-year quarterly average. 171,503 sq ft of this space is pre-let, with the largest development, situated at YY London, 30 South Colonnade, totalling 415,000 sq ft.

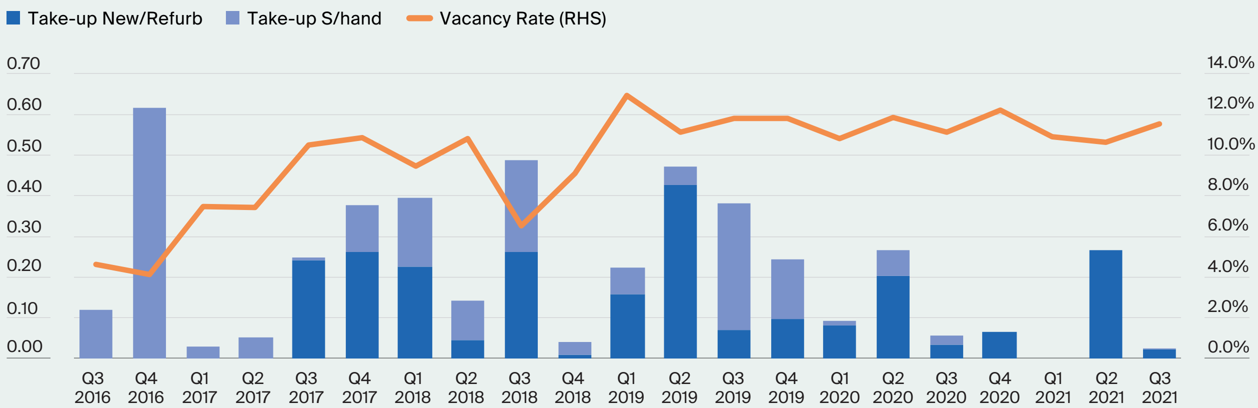
ACTIVE DEMAND IS

0.64M

SQ FT

Docklands & Stratford

m sq ft (LHS); % of stock (RHS)



Source: Knight Frank Research

KEY STATISTICS

	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21	% CHANGE 3 MONTHS	% CHANGE 12 MONTHS	10-YEAR QUARTERLY AVERAGE
AVAILABILITY (SQ FT)								
West End	5.33 m	6.69 m	7.04 m	6.86 m	6.93 m	0.9%	30.0%	5.13 m
City & Southbank	7.99 m	8.37 m	8.61 m	9.60 m	9.30 m	-3.2%	16.4%	8.20 m
Docklands & Stratford	2.33 m	2.56 m	2.30 m	2.29 m	2.48 m	8.5%	6.6%	1.74 m
Total London	15.65 m	17.62 m	17.95 m	18.75 m	18.71 m	-0.2%	19.5%	15.07 m
VACANCY RATE								
West End	6.1%	7.7%	8.1%	7.8%	7.8%	n/a	n/a	6.1%
City & Southbank	6.3%	6.5%	6.6%	7.3%	7.1%	n/a	n/a	6.8%
Docklands & Stratford	11.1%	12.2%	10.9%	10.6%	11.6%	n/a	n/a	8.5%
Total London	6.6%	7.4%	7.5%	7.7%	7.7%	n/a	n/a	6.7%
TAKE-UP (SQ FT)								
West End	0.34 m	0.51 m	0.43 m	0.60 m	1.52 m	151.4%	341.1%	1.11 m
City & Southbank	0.63 m	0.55 m	0.77 m	0.83 m	1.09 m	31.6%	73.4%	1.68 m
Docklands & Stratford	0.06 m	0.07 m	0.00 m	0.27 m	0.02 m	-91.1%	-57.4%	0.22 m
Total London	1.03 m	1.12 m	1.21 m	1.70 m	2.63 m	54.9%	156.1%	3.00 m
ACTIVE REQUIREMENTS (SQ FT)								
West End	1.36 m	1.53 m	1.86 m	1.55 m	1.31 m	-15.3%	-3.4%	2.05 m
City	2.82 m	3.75 m	3.96 m	4.66 m	5.21 m	11.8%	84.7%	4.21 m
Docklands	0.31 m	0.24 m	0.28 m	0.75 m	0.64 m	-14.0%	107.3%	0.54 m
London-wide	2.92 m	2.04 m	1.43 m	1.43 m	1.08 m	-24.1%	-62.8%	1.88 m
Total London	7.40 m	7.56 m	7.53 m	8.38 m	8.25 m	-1.6%	11.4%	8.68 m
SPEC UNDER CONSTRUCTION (SQ FT)								
West End	2.14 m	1.99 m	2.31 m	3.31 m	3.87 m	16.9%	80.9%	1.65 m
City & Southbank	4.72 m	4.12 m	4.60 m	4.98 m	5.41 m	8.7%	14.7%	3.66 m
Docklands & Stratford	0.34 m	0.34 m	0.55 m	0.52 m	0.65 m	25.4%	91.8%	0.38 m
Total London	7.20 m	6.45 m	7.46 m	8.81 m	9.94 m	12.8%	38.0%	5.69 m
DEVELOPMENT COMPLETIONS (SQ FT)								
West End	0.29 m	0.18 m	0.13 m	0.52 m	0.21 m	-60.0%	-28.3%	0.31 m
City	1.03 m	1.87 m	0.51 m	0.44 m	0.36 m	-17.5%	-64.8%	0.58 m
Docklands	0.00 m	0.00 m	0.21 m	0.34 m	0.00 m	-100.0%		0.61 m
Total London	1.32 m	2.05 m	0.85 m	1.30 m	0.57 m	-56.1%	-56.7%	1.50 m
INVESTMENT TURNOVER								
West End	£0.54 bn	£2.87 bn	£0.64 bn	£0.83 bn	£1.75 bn	110.1%	227.0%	£1.40 bn
City & Southbank	£0.35 bn	£2.06 bn	£0.63 bn	£2.29 bn	£2.10 bn	-8.4%	503.6%	£2.16 bn
Docklands & Stratford	£0.38 bn	£0.00 bn	£0.00 bn	£0.00 bn	£0.00 bn		-100.0%	£0.22 bn
Total London	£1.26 bn	£4.93 bn	£1.26 bn	£3.12 bn	£3.85 bn	23.2%	204.7%	£3.78 bn
PRIME HEADLINE RENTS (PER SQ FT)								
West End	£110.00	£110.00	£110.00	£115.00	£117.50	2.2%	6.8%	n/a
City & Southbank	£70.00	£70.00	£70.00	£72.50	£75.00	3.4%	7.1%	n/a
Docklands & Stratford	£50.00	£50.00	£50.00	£50.00	£50.00	0.0%	0.0%	n/a

Source: Knight Frank

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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

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