Take-up stabilises

Availability edges higher

Investment turnover rebounds

Knight Frank

knightfrank.com/research

THE LONDON OFFICE MARKET REPORT

Q4 2020

MARKET ROUNDUP

Rents hold steady in most submarkets during Q4 2020

◆

56% of the development pipeline is pre-let

◆

Bumper Q4 for investment, with £4.93bn worth of deals transacting

Leasing activity stabilises in Q4

Leasing activity during Q4 2020 remained subdued, although at 1.13m sq ft, was marginally ahead of Q3 2020 (1.03m sq ft). Overall, 2020 registered 5.4m sq ft of leasing deals, 58% lower than 2019. The sharp decline is unsurprising given the complexities of Brexit, the pandemic and the UK's ongoing Lockdown 3.0, which has left London's office leasing market supressed, with occupiers deferring, or delaying decision making where possible.

That said, preleasing activity has persisted, with banking and financial businesses remaining notably active. Hines UK's 35,737 sq ft pre-let at The Grain House in the West End during Q4 is a prime example of this trend, which partly stems from the ongoing shortage of best-in-class office space, as we outline below.

The banking and finance sector accounted for almost 31% of lease transactions during the final three months of 2020, or about 346,000 sq ft. The largest banking and finance deal was by American Express, who re-geared their lease of 131,000 sq ft in Belgrave House.

The media sector was the next most active occupier group during Q4 2020, taking 239,000 sq ft of space, with the largest deal being a 9-month let by a film studio, who took 155,000 sq ft at the London Studios in Southbank.

Availability edges up

Turning to the availability of office stock next, 2020 ended with 17.6m sq ft of vacant

Photo by CoWomen on Unsplash

1.13m sq ft

OF LEASING DEALS CONCLUDED DURING Q4

office space, delivering a vacancy rate of 7.4%, which is above the long-term average of 6.7%. The 10-year average level of available office space stands at 15.5m sq ft, so we ended 2020 above this level, not least because of the rising volume of tenant release space.

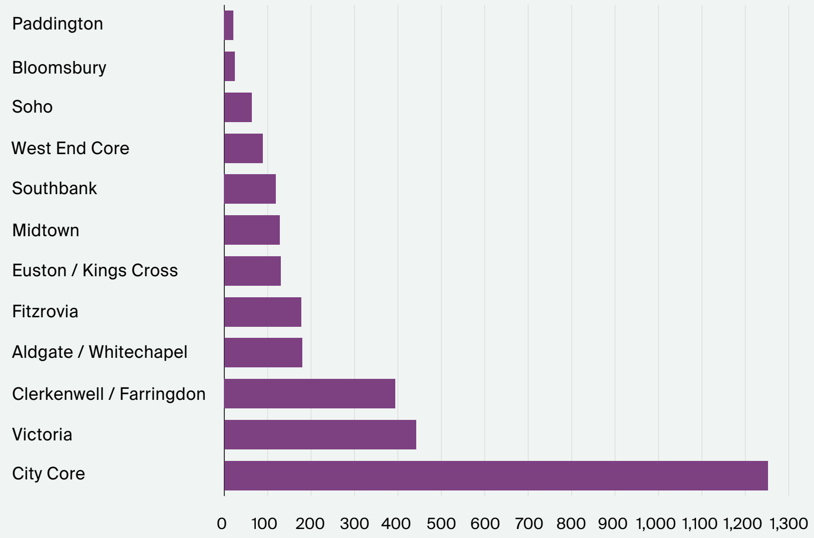
What is worth noting however is that as a proportion of total availability, at 8.9m sq ft, second-hand space accounted for 50% of all vacant office space, which is well below the historic annual average of 67%.

Clearly tenant release space has been a source of concern for landlords and investors since the outset of the pandemic, with 3.1m sq ft of space being released by tenants between March and December 2020. However, in assessing the quality of stock released, we have found that almost 51% falls into the Grade B (or lower category). With the ever sharpening focus amongst occupiers on lease flexibility, offices that deliver a rich workplace experience and space that helps further ESG ambitions, we are firmly of the view that poor quality, second hand space will be challenging to let and will likely experience diminished interest. That is of course unless this stock is refurbished to a new, modern standard that matches occupiers' expectations.

And the reason for this flight to quality by businesses? It is in part, linked to the war for talent. This was a well-entrenched pre-pandemic issue that was driving occupiers towards best-in-class space, as businesses turned to real estate to mitigate against the challenges of securing and

Tenant release space by submarket since March 2020

sq ft (000's)



Source: Knight Frank

retaining the best staff. And like many other market themes, COVID-19 has accelerated this behaviour.

Delving deeper into the issue of tenant release space, we found that the City Core (42%), together with Victoria (14.6%), account for over half of all tenant-release space, underscoring our expectation that the impact of space returned to the market by tenants will have a greater impact at a submarket level, rather than at a London-wide level.

The pandemic has driven a structural change, accelerating the shift away from a rigid 9-5 working week.

Indeed, a good example of this was the 87,000 sq ft lease by Netflix at the end of last year in the Copyright building in Fitzrovia. The three-year-old, Derwent built scheme, is for all intents and purposes, a Grade A building. The high quality of the space meant it was rapidly reabsorbed, which accounted for 16.5% of all tenant release space in Fitzrovia, but just 2.8% of all tenant release space in London.

Insufficient pipeline development

What about the impact of the office development pipeline on future supply? With 56% of all stock under construction having already secured a pre-let, it's clear that the shortage of best-in-class offices is set to persist. And looking to the next 10-15 years, our newly launched Development Viability Index shows that of the 26.6m sq ft of speculative pipeline development we are tracking, just 12.3%, or 3.2m sq ft is likely to be delivered to published schedules over the next two to three years.

This compares to an average annual level of take-up of new and refurbished space of 5.3m sq ft, suggesting that the development shortfall that has defined the market since the Global Financial Crisis is set to persist.

The pandemic has of course driven a structural change, accelerating the shift away from a rigid 9-5 working week. Clearly flexibility around employee working patterns isn't a new phenomenon, but COVID-19 will have an impact not only on how businesses utilise offices, but also on how much office space they require in the future.

What does this mean for London's supply-starved Grade A office market landscape? We have run various scenarios to test the market's resilience to declining long-term take-up and even in the unlikely hypothetical scenario of a 30% decline in average take-up over the next three years, the market would still be faced with a shortfall of 7.6m sq ft.

Rental declines to be short-lived

We have factored these critical fundamentals into our rental growth model, overlaying our on-the-ground market experience. The end result? A projected decline in prime headline rents in 12 of the 18 submarkets we track of up to £2.50 per sq ft this year, before rents begin rising from 2022 onwards.

Our forecasts are predicated on a long-term structural shift in the market. This translates to a projection that occupiers are, on average, likely to shrink their existing office footprints by up to 10% over the next five years. We feel this qualitative assumption is realistic and

Occupiers are, on average, likely to shrink their existing office footprints by up to 10% over the next five years.

perhaps conservative – in the short to medium term at least, especially as the status quo has been fundamentally altered by the pandemic. However, the shortage of planned supply, combined with expected growth in new businesses means that every London submarket, even in such a scenario, will still see prime headline rents continue to rise.

Prime headline West End Core rents ended 2020 4.3% lower than 2019 at £110 per sq ft. 2021 is expected to see no change as COVID-19 is likely to remain a key dampener on both economic growth and sentiment, at least during the first half of 2021. Rents are expected to grow by 4.5% to £115 per sq ft during 2022, reaching £123 per sq ft by the end of the five-year forecast period.

In comparison, after falling by 3.4% in 2020, prime headline rents in the City Core are expected to end 2021 at £68.50 per ft, before a recovery begins in 2022, lifting rents to £72.50 per sq ft by the end of 2022. This equates to a rise of 5.8%.

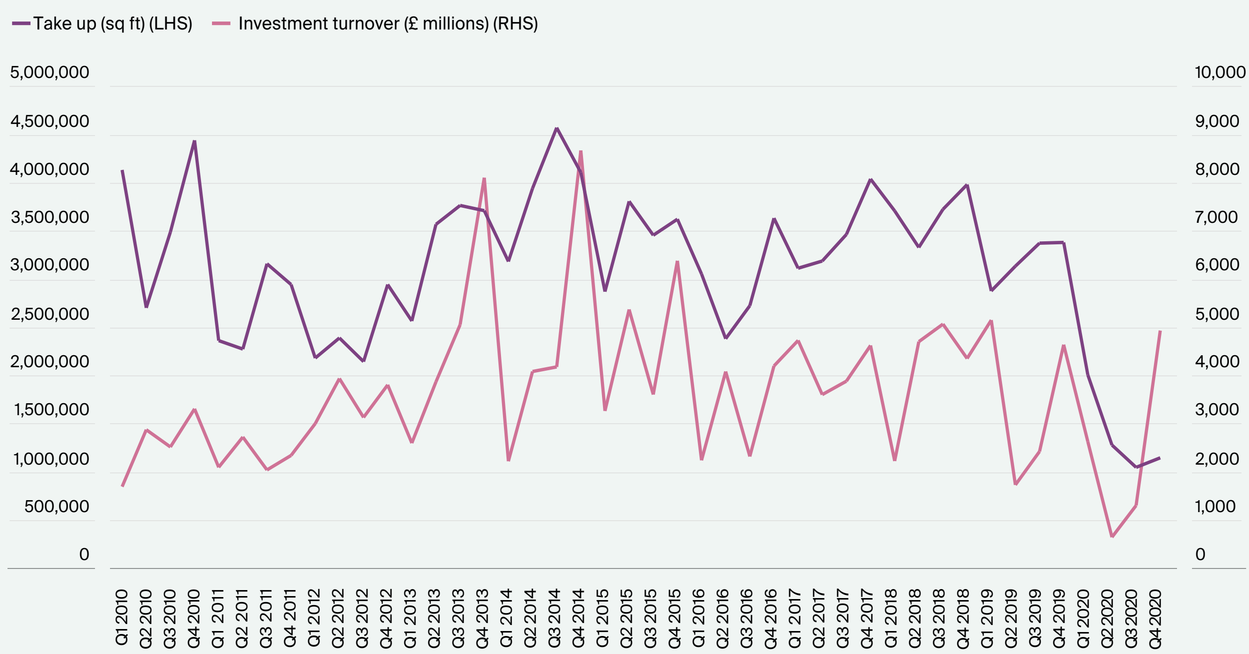
We forecast rents in the City Core will end 2025 at £80 per sq ft, which translates to an increase of 14.3% over the next five years, while in the West End Core, we expect rents to reach £123 per sq ft by the end of 2025, representing growth of 11.8%.

The 14.3% growth forecast for prime City Core rents over the next five years equates to an average increase of 2.7% per annum. This is significantly ahead of the forecast for UK inflation, which is forecast to remain below 2% over this period, meaning that London offices should offer real, inflation- adjusted rental growth and be a useful hedge against inflation.

Bumper Q4 for investment

The office investment market recorded £4.93bn of deals during Q4 2020, well ahead of the long-term quarterly average of £3.7bn.

London office market performance



Source: Knight Frank

KNIGHT FRANK 2021 GLOBAL CAPITAL TRACKER

USA & CANADA	£4.6bn	▲ 8%
UK	£4.8bn	9% ▼
MIDDLE EAST	£3.9bn	4% ▼
GREATER CHINA	£12.6bn	10% ▼
REST OF THE WORLD	£2.1bn	7% ▼
ISRAEL	£1.9bn	5% ▼
EUROPE	£5.8bn	▲ 9%
ASIA PACIFIC	£10.8bn	13% ▼
TOTAL	£46bn	5% ▼

*% indicates year on year change

The ending of the UK's second lockdown at the start of December, combined with an easing in global travel restrictions helped to boost activity to £2bn in December alone, taking the total for 2020 to £9.4bn.

Despite total investment turnover for 2020 being down on the long-term annual average of nearer £12.5bn, international investors, who accounted for 83% of all deals last year, remained the dominant force in the market. The top three largest sources of international capital in 2020 were Greater China (which encompasses Mainland China, Hong Kong SAR and Taiwan) (£1.6bn), Germany (£1.3bn) and Singapore (£1.2bn).

£46bn earmarked for London offices

Globally, all markets have faced extraordinary challenges, but prime London assets continue to demonstrate their liquidity all through the pandemic. As markets recover from the pandemic, the removal of the 'no deal Brexit' risk premium will be a further catalyst for activity. And as the world's number one city for cross border investment during 2020, the resilience of London's appeal cannot be understated.

And despite the UK's ongoing lockdown, London remains top of investor wish lists, supported by yields that remain above those of most major global cities. In addition, with the highest concentration of green buildings globally, at almost 3,000, London offers opportunities for 'green' investors and those looking to rebalance their carbon targets.

The attractiveness of London to international investors is best reflected in the results of our 2021 Global Capital Tracker, which is a measure of dry-powder, or the intent to deploy capital in London. The total figure this year is £46bn, a 5% decrease on 2020, but this is negligible in the context of the challenges posed by Brexit and COVID-19.

The top three sources of investible capital for London commercial real estate this year are: Greater China at £12.6 billion, Singapore with over £5 billion and the US with over £3 billion.

We explore this and other factors influencing London's office market in our recently launched 2021 London Report.

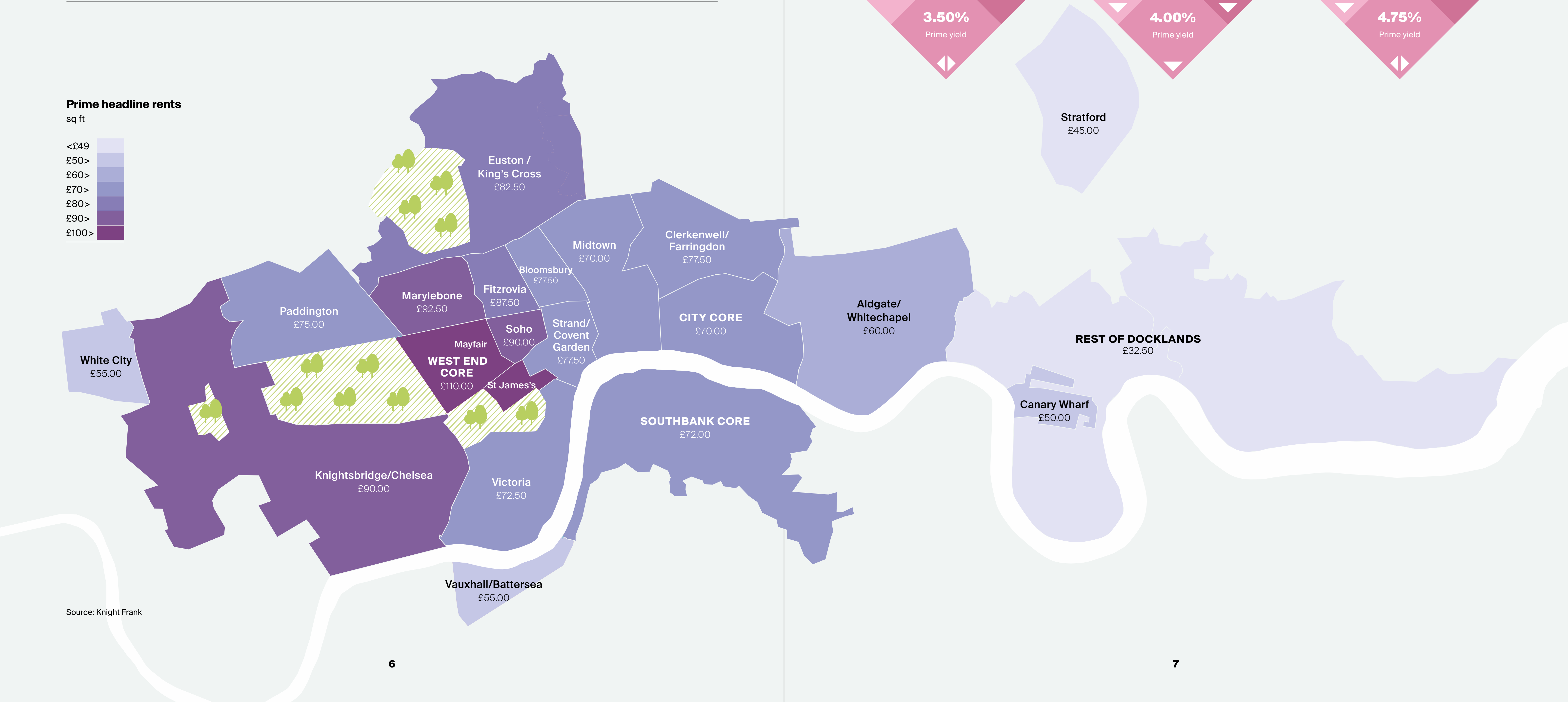
UNLOCK OUR INSIGHTS

LONDON OFFICE MARKET

Performance dashboard Q4 2020

Key performance indicators

	▲1.13 m TAKE-UP (SQ FT)	▲17.6 m AVAILABILITY (SQ FT)	▲7.4% VACANCY RATE	▼11.5 m UNDER CONSTRUCTION (SQ FT)
Change on				
Q2 2020	10% ▲	12% ▲	70bps	-10.0% ▼
LTA	3.2 million sq ft	15.0 million sq ft	6.7%	9.2 million sq ft



Source: Knight Frank

WEST END

- £110.00 per sq ft — Prime headline rent
- £2.87 bn — Investment turnover
- 0.52 m sq ft — Take-up
- 3.50% — Prime yield

CITY & SOUTH BANK

- £70.00 per sq ft — Prime headline rent
- £2.06 bn — Investment turnover
- 0.54 m sq ft — Take-up
- 4.00% — Prime yield

DOCKLANDS & STRATFORD

- £50.00 per sq ft — Prime headline rent
- £0.00 bn — Investment turnover
- 0.07 m 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

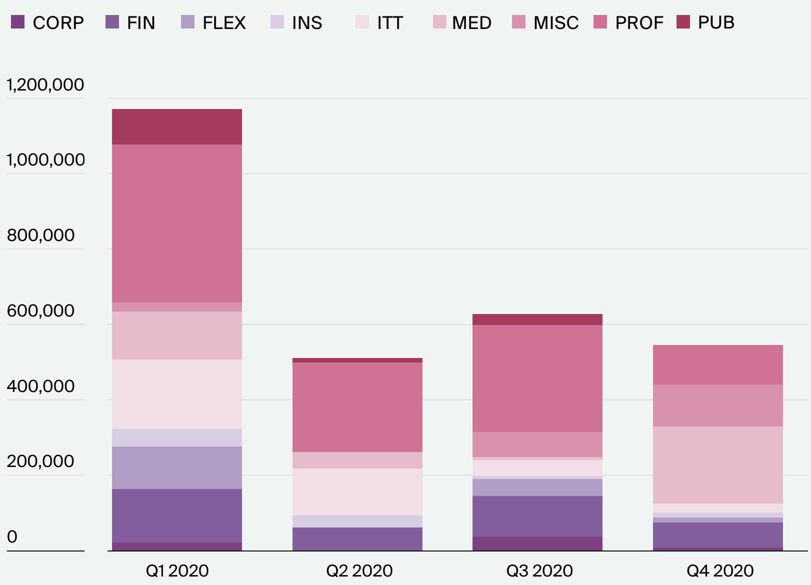
£70.00	0.54 m	8.37 m	£2.06 bn	4.00%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Take-up falls

COVID-19 has had a significant impact on leasing activity across all markets, with the latest lockdown stalling a return to the office and an expected subsequent increase in leasing activity. In the City & Southbank, take-up fell by 13% between Q3 2020 and Q4 2020, which translated into deals totalling 545,447 sq ft. This was 69% down on the long-term average of 1.74m sq ft.

The largest proportion of take-up was in the 100,000 sq ft+ bracket (28.4%), followed by 10-20,000 sq ft (23.0%) and 5-10,000 sq ft (16.0%). Of the 32 leasing deals recorded during the quarter, 18 were for under 10,000 sq ft of office space. There were two transactions over 50,000 sq ft: A 155,000 sq ft let at The London Studios, 72 Upper Ground and City University London's 72,441 sq ft let at 33 Finsbury Square. As a result of

City take-up by sector
sq ft



Source: Knight Frank

OFFICE AVAILABILITY REACHED
8.37m
SQ FT
IN Q4 2020

these deals, the media and marketing sector (37.5%) accounted for the largest proportion of overall leasing activity.

Rise in active demand

Active demand increased by 33% during Q4 to 3.75m sq ft. However, this figure remains below the long-term average of 4.18m sq ft.

At the close of Q4, there were 13 businesses seeking over 100,000 sq ft in the City & Southbank. There were thirteen buildings available over 100,000 sq ft, with the largest two being 22 Bishopsgate, EC2 and Sixty London Wall, where 435,303 sq ft and 324,621 sq ft was available at the end of Q4, respectively.

The professional services sector, at 2.18m sq ft (58%) accounted for the largest share of active requirements, followed by the TMT sector (0.5m sq ft) (13%).

Availability increases

During Q4 2020, there was a 5% increase in office availability, which rose to 8.37m sq ft, from 7.99m in Q3. This sits above the long-term quarterly average of 8.32m sq ft. At these levels, the overall vacancy rate in the City & Southbank equates to 6.5% and 8.6% in the City Core, compared to a long-term average of 7.0% and 8.0%, respectively.

In terms of overall availability, 5.17m sq ft is new and refurbished space, while 3.20m sq ft falls into the second-hand space category.

On the development front, no new schemes broke ground during Q4 2020 across the City and Southbank, while

Photo by Étienne Godiard on Unsplash

The UK's rapid vaccine rollout and removal of the Brexit deal/no-deal uncertainty paved the way for a rise in confidence in the investment market.

1.87m sq ft of new schemes completed, 49% of which remains available.

Surge in investment activity

There was a significant rise in investment activity during Q4 2020. The UK's rapid vaccine rollout and removal of the Brexit deal/no-deal uncertainty paved the way for a rise in confidence in the investment market. Total investment turnover saw a 489% increase on Q3 2020, reaching £2.06bn, taking the total for 2020 to £4.32bn.

There were eight transactions over £50m and five transactions over £100m. The largest deal in the quarter was One and Two New Ludgate for £552m, purchased by Singapore's Sun Ventures, followed by 1 London Wall Place for £480m, which was bought investors from the UAE. The sale of Atlantic House for £265m at 45-50 Holborn Viaduct was the third largest transaction of the quarter.

The heightened interest for prime assets resulted in yields compressing by 25bps to 4.00%.

MARKETS IN REVIEW

WEST END

£110.00	0.52 m	6.69 m	£2.87 bn	3.50%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Rise in leasing activity

West End leasing activity reached 521,959 sq ft during Q4 2020, which represents a 51.6% increase from the previous quarter. However, take-up remained below the long-term average of 1.16m sq ft. For 2020 as a whole, 1.95m sq ft worth of lease deals were recorded.

Of the 70 transactions registered during the quarter, the greatest number of deals were in the 0-5,000 sq ft bracket (47 deals), followed by the 5-10,000 sq ft bracket (16 deals).

The largest proportion of take-up involved new and refurbished space, which accounted for 52.0% of all leases, or 271,191 sq ft. The banking and finance (54.5%) and miscellaneous (20.7%) sectors dominated take-up in the quarter, with the total amount of space leased by each sector equalling 278,680 sq ft and 105,796 sq ft, respectively.

The largest proportion of take-up involved new and refurbished space.

There were two lettings during the quarter over 50,000 sq ft: The 131,300 sq ft American Express lease re-gear at Belgrave House, which was the largest West End deal during Q4 2020, followed by a 58,648 sq ft lease re-gear at 40 Portman Square to CPPIB, a banking and finance tenant.

Hines UK's 35,737 sq ft lease at The Grain House was the third largest letting in the quarter.

Active demand grows

There was an 11.8% increase in active demand during Q4, rising to 1.52m, from 1.36m in Q3. However, active demand was still below the long-term average of 2.06m sq ft.

The banking and finance sector, at 0.82m sq ft (54%) accounted for the largest share of active requirements, followed by corporates (0.26m sq ft) (17%).

Availability increases

As with other markets in London, availability increased during the quarter, reaching 6.69m, from 5.22m during Q3. New and refurbished availability grew by 41% during Q4 to 2.2m sq ft, and secondary space increased by 21.3% to 4.5m sq ft.

Unsurprisingly, the rising levels of availability have lifted the vacancy rate in West End to 7.7%, from 6.1% during Q3. In the West End Core, the vacancy rate stood at 9.7% at the end of 2020, up on the long-term average of 7.2%.

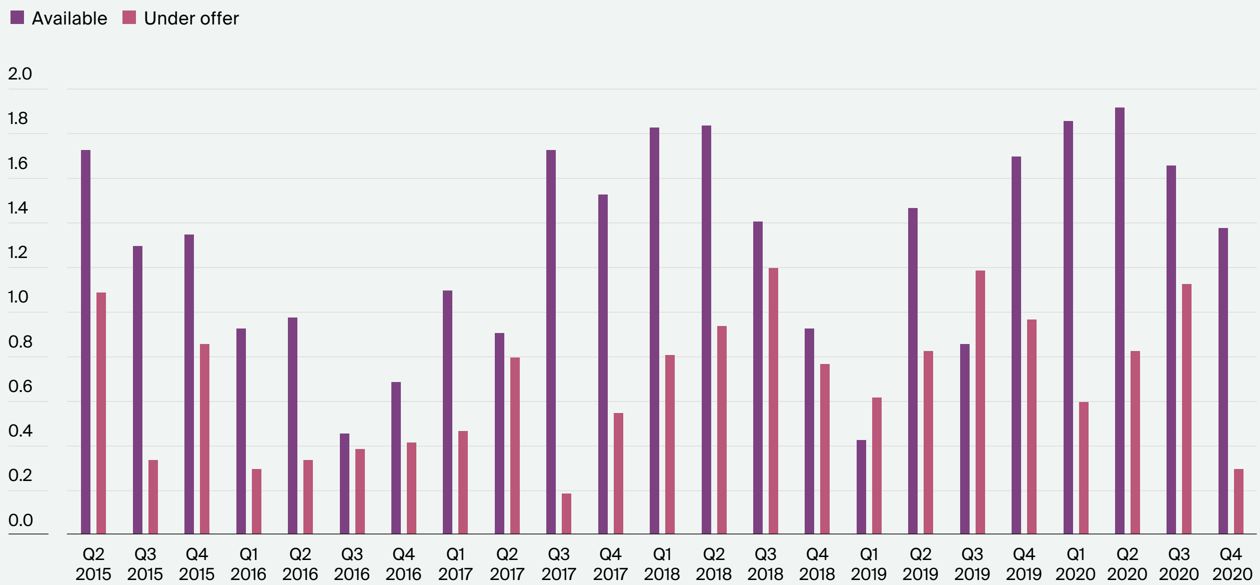
On the development front, no new schemes broke ground during Q4 across the West End, while 180,000 sq ft of new schemes completed.

Investment activity rebounds

Like the City & Southbank, there was a significant rise in office investment activity in the West End, increasing by 442% to £2.87bn during Q4. During the quarter, there were 13 transactions over £50m and nine transactions over £100m. The largest deal in the quarter was 50% of The Nova Estate (£435m), purchased by Singapore's ARA, followed by a 75% share of the British Land portfolio, including 10 Portman Square, bought by Allianz Real Estate for £401m. 159 New Bond Street was the third largest deal during Q4 and was sold to a French purchaser for £305m. Another prominent deal during Q4 was the £177m sale of the Clarges Estate in West End Core.

Prime yields during Q4 2020 held firm at 3.50%.

West End investment history
£ bn



Source: Knight Frank

MARKETS IN REVIEW

DOCKLANDS & STRATFORD

£50.00	0.07 m	2.55 m	0 m	4.75%
RENT (PER SQ FT)	TAKE-UP (SQ FT)	AVAILABILITY (SQ FT)	INVESTMENT TURNOVER	PRIME YIELD

Stable occupier activity

Take up in the final quarter of 2020 reached almost 70,000 sq ft, an increase on the 56,000 sq ft recorded in Q3. The largest transaction of the quarter occurred in Stratford, at Here East, where Sports Interactive acquired 26,000 sq ft.

Leasing activity was mainly focused in Stratford this quarter, with all but one leasing deal transacting at Here East. The only deal to transact in the rest of the Docklands and Stratford happened at The South Quay Building, where Fairmort acquired c.4,000 sq ft.

Corporate and tech firms dominate

Corporate and technology occupiers dominated take up in Docklands & Stratford in Q4, accounting for 54% & 46% of take-up, respectively. Along the Sports Interactive deal, Plykea also acquired space at Here East during the quarter, adding further to the mix of occupiers at the Stratford campus.

Leasing activity was mainly focused in Stratford this quarter.

Active requirements fall

Looking at active requirements in this market, demand decreased by 23% quarter-on-quarter, with levels falling below the long-term average of 500,000 sq ft. However, we are tracking a number of occupiers currently located in other submarkets across London who are actively considering the Docklands and Stratford markets as part of their wider search.

The professional services sector, at 0.18m sq ft (74%) accounted for the largest share of active requirements, followed by the flexible offices sector (0.03m sq ft) (12%).

Supply increases

Supply levels in the Docklands and Stratford increased by 5% quarter-on-quarter, totalling 2.55 m sq ft at the end Q4. Supply of new and refurbished stock now totals 1.38m sq ft.

Across the Docklands and Stratford there are eleven units which could provide an occupier with 100,000 sq ft or more.

Development Pipeline

There is currently 0.72 m sq ft under construction in the Docklands and Stratford market, however, 52% of this has already secured a tenant.

ACTIVE REQUIREMENTS DECREASED BY

23%

IN Q4 2020

There are two schemes currently under construction in the Docklands and Stratford due to complete in 2021, with 346,000 sq ft available across 20 Water Street in Wood Wharf and Cargo, 25 North Colonnade.

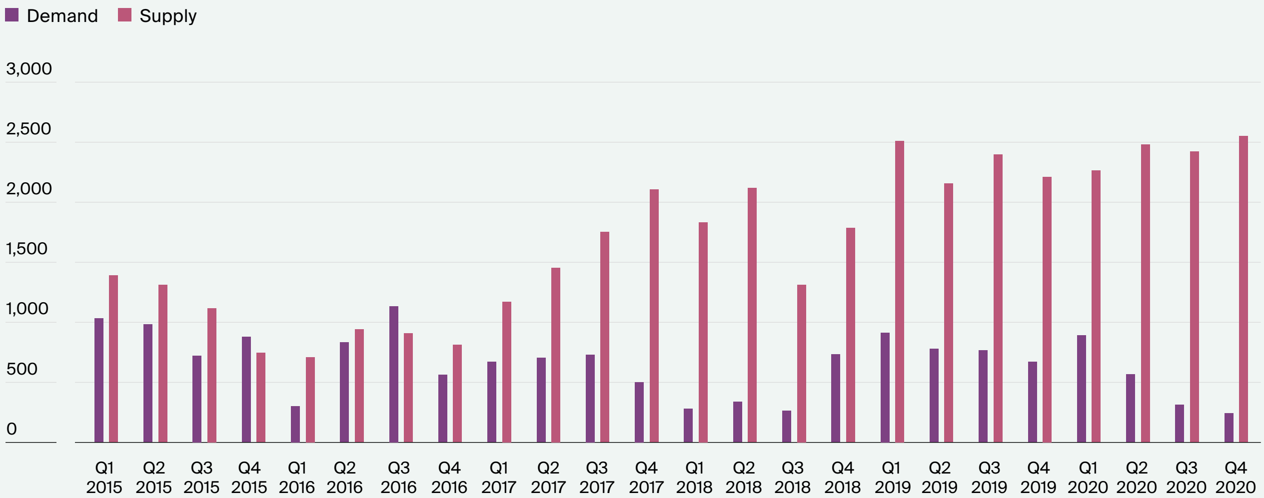
Investment

There were no investments transactions that took place in the Docklands and Stratford this quarter. The supply of investment stock remains exceptionally limited, with just two assets available in Canary Wharf. In the wider Docklands and Stratford market there was only one asset available to purchase at the end of Q4 2020.

In more recent news, Q1 2021 has seen 20 Canada Square in Canary Wharf go under offer.

Photo by Saufi Mazlan on Unsplash

Demand and supply in the Docklands and Stratford
sq ft



Source: Knight Frank

KEY STATISTICS

					% CHANGE	
	Q1 20	Q2 20	Q3 20	Q4 20	3 MONTHS	12 MONTHS
TAKE-UP (SQ FT)						
West End	0.66 m	0.43 m	0.34 m	0.52 m	52.9%	-66.0%
City & Southbank	1.28 m	0.54 m	0.63 m	0.54 m	-14.3%	-66.7%
Docklands & Stratford	0.09 m	0.27 m	0.06 m	0.07 m	16.7%	-70.8%
Total London	2.00 m	1.26m	1.03m	1.13 m	9.7%	-67.0%
AVAILABILITY (SQ FT)						
West End	3.68 m	4.28 m	5.33 m	6.69 m	25.5%	55.9%
City & Southbank	7.16 m	7.47 m	7.99 m	8.37 m	4.8%	30.2%
Docklands & Stratford	2.26 m	2.48 m	2.42 m	2.55 m	5.4%	15.4%
Total London	13.10 m	14.23 m	15.74 m	17.61 m	11.9%	36.2%
VACANCY RATE						
West End	4.2%	4.9%	6.1%	7.7%	n/a	n/a
City & Southbank	5.7%	6.0%	6.3%	6.5%	n/a	n/a
Docklands & Stratford	10.8%	11.2%	10.9%	12.2%	n/a	n/a
Total London	5.6%	6.1%	6.7%	7.4%	n/a	n/a
UNDER CONSTRUCTION (SQ FT)						
West End	4.89 m	5.37 m	4.48 m	4.22 m	-5.8%	-24.6%
City & Southbank	5.92 m	7.74 m	7.61 m	6.57 m	-13.7%	6.8%
Docklands & Stratford	0.91 m	0.72 m	0.72 m	0.72 m	0.0%	-40.0%
Total London	12.10 m	13.84 m	12.81 m	11.51 m	-10.1%	-11.1%
DEVELOPMENT COMPLETIONS (SQ FT)						
West End	0.08 m	0 m	0.29 m	0.18 m	-39.3%	193.3%
City	0.68 m	0.22 m	1.03 m	1.87 m	81.6%	345.2%
Docklands	0.30 m	-	-	0.00 m	-	-
Total London	1.06 m	0.22 m	1.32 m	2.05 m	55.3%	327.1%
INVESTMENT TURNOVER						
West End	£1.08 bn	£0.16 bn	£0.53 bn	£2.87 bn	441.5%	96.6%
City & Southbank	£1.48 bn	£0.43 bn	£0.35 bn	£2.06 bn	488.6%	-32.9%
Docklands & Stratford	£0.03 bn	-	£0.38 bn	£0.00 bn	-100.0%	-100.0%
Total London	£2.59 bn	£0.59 bn	£1.26 bn	£4.93 bn	291.3%	6.3%
PRIME YIELDS						
West End	3.50%	3.50%	3.50%	3.50%	n/a	n/a
City & Southbank	4.00%	4.25%	4.25%	4.00%	n/a	n/a
Docklands & Stratford	4.75%	4.75%	4.75%	4.75%	n/a	n/a

Source: Knight Frank

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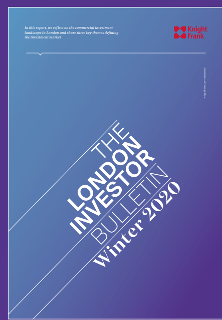

The London Investor Bulletin Winter 2020

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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