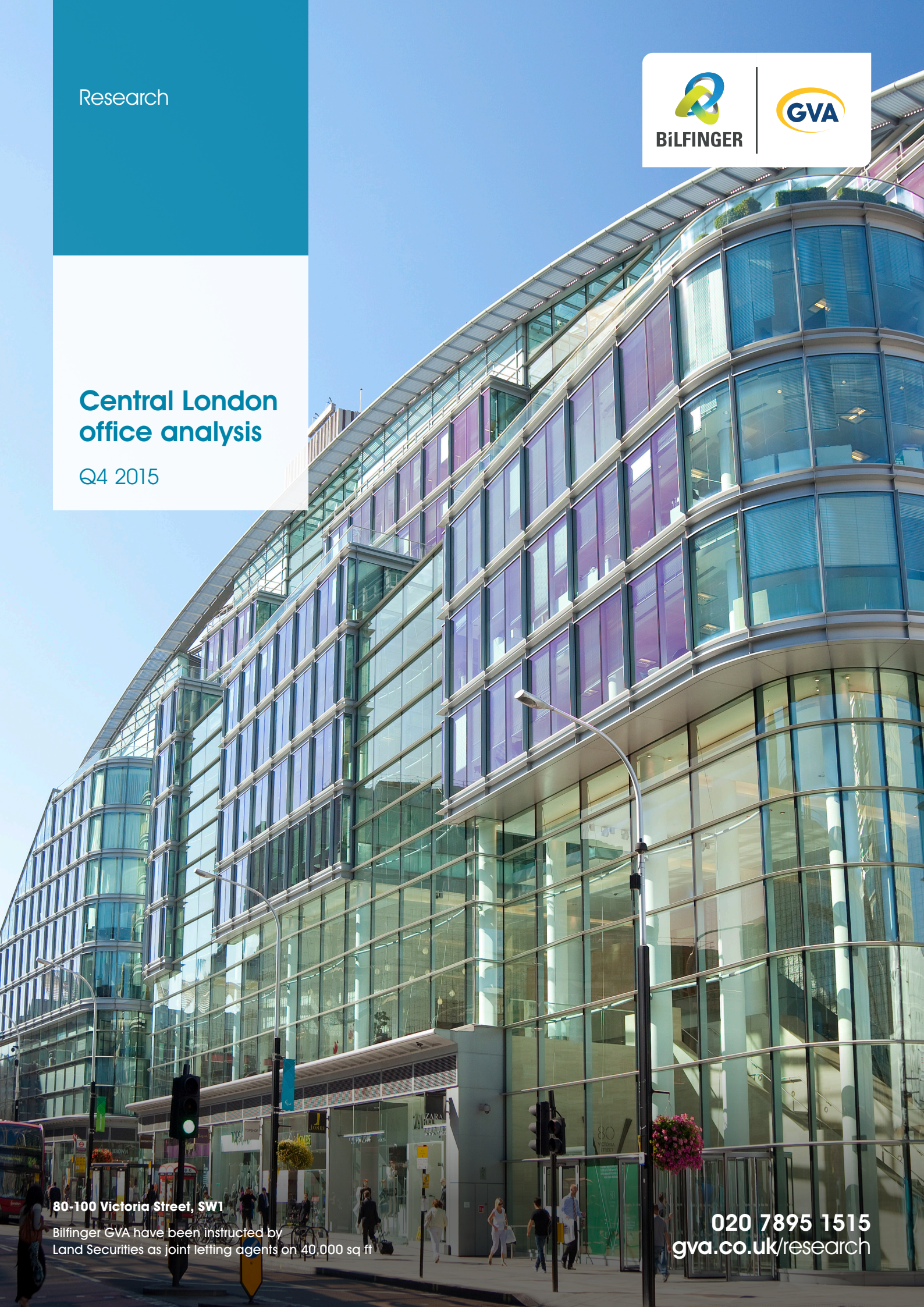
Research

Central London office analysis

Q4 2015



80-100 Victoria Street, SW1

Bilfinger GVA have been instructed by Land Securities as joint letting agents on 40,000 sq ft

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Central London

Market comment

Welcome to Bilfinger GVA's central London office analysis; a detailed account of our view of the market in Q4 2015.

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Steady as she goes?

Take-up for 2015 totalled a very reasonable 10.2 million sq ft, which despite being a bit of a drop off from the last two years, is still 5% above the long-term average and a reflection of the strong demand that continues to exist in the market.

Interestingly, if we were to compare the years of 2013/14/15 to the peak of the last market in 2005/6/7, take-up has been 5% higher this time round.

One of the themes of this cycle has been occupiers' willingness to commit to space early and pre-let. 2015 saw pre-letting continue, albeit to a lesser extent, falling from 3.5 million sq ft in 2014 to 2.2 million sq ft in 2015. However, this can be attributed to a low development pipeline and developers' increasing confidence in committing to speculative development. Certainly, occupiers' demand for new space is not in question, with 3 million sq ft of newly completed space accounting for 30% of take-up for the year.

Another theme during the last quarter was of companies pulling out of deals at the last minute, with inability to secure parent company or senior management consent often cited. With some requirements being reduced or shelved, there might be a hint of decreasing business confidence which could affect demand in some sectors in the short term.

Are you being serviced?

One of the big stories of 2015 was the substantial rise in demand for space from serviced offices providers which accounted for 1.5 million sq ft of take-up for the year, a 36% increase on 2014. What tells an even greater story is the fact that take-up for 2015 in this sector was larger than the entire take-up by serviced office providers for the five years 2009-2013.

During 2015 serviced offices made up 15% of take-up. To put this in geographical perspective, this was greater than city centre take-up in Manchester. It is evident that the sector is becoming an increasingly important factor in the central London office market.

Pretty vacant

With three consecutive years of strong take-up, availability has decreased substantially and is almost as low now as it was at the trough of the last supply cycle. However, what is markedly different from the last cycle is its length. In the last cycle we took 17 quarters to get to the bottom of the market from its peak. Comparatively, this cycle has seen a long, slow trundle of decreasing availability lasting for 27 quarters.

This long-term environment of low availability has had the knock-on effect of a long-term period of rental growth. Even if demand falters slightly, with the development pipeline for 2016 still limited, this is unlikely to change in the short term, with the low availability creating something of a supply 'safety net'.

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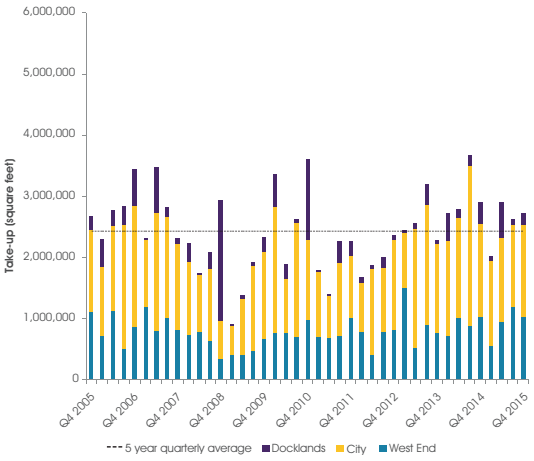
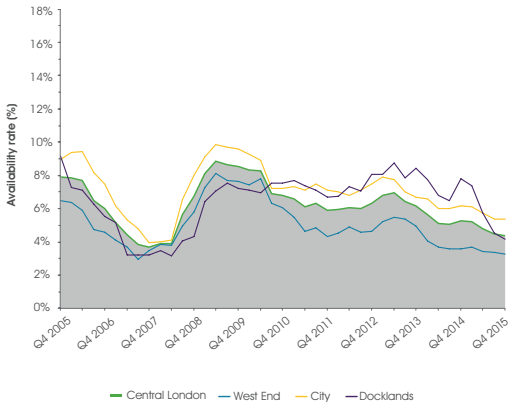
Central London Take-Up
Source: Bilfinger GVA, EGi, CoStar



Central London office availability rates
Source: Bilfinger GVA, EGi, CoStar



Central London

Occupier market

Take-up

Central London take-up for Q4 2015 totalled 2.6 million sq ft, in line with the previous quarter, but 8% above the five-year quarterly average of 2.4 million sq ft.

Take-up for 2015 totalled 10.2 million sq ft, which whilst 16% down on 2014, is still 5% above the five-year quarterly average of 9.7 million sq ft.

During Q4, activity was focused on the City and West End fringes, accounting for 833,800 sq ft and 731,500 sq ft respectively. Fringe Docklands was the only submarket to see below average take-up, down 21%.

The largest deal of the quarter was done by Royal Bank of Canada who took 245,000 sq ft at Brookfield's 100 Bishopsgate (EC2), due to complete in 2018. At 3 Waterhouse Square (EC1), WeWork took the entire 98,000 sq ft at a rent of £55.00 per sq ft. At Land Securities' Zig Zag Building (SW1), Deutsche Bank AG took 88,000 sq ft across six floors.

Take-up of on newly completed space made up 895,900 sq ft (34%) of take-up for the quarter, with pre-letting making up an additional 399,800 sq ft (15%). Second-hand grade A take-up made up 34% of the quarterly total and 953,000 sq ft.

Pre-letting during 2015 saw a marked decreased on 2014 levels, with 2.2 million sq ft transacted during the year, compared to 3.6 million sq ft in 2014. Nevertheless, take-up on new space was up from 2.6 million sq ft to 2.9 million sq ft.

During the quarter, nine deals completed over 50,000 sq ft, only one of which was over 100,000 sq ft.

Availability

During Q4 2015, availability across central London decreased from 8.7 million sq ft to 8.5 million sq ft. The vacancy rate therefore reduced to 4.4%, its lowest since Q2 2008 when the vacancy rate was down at 3.9%. There is still 20% more space than at the trough of the last cycle when availability bottomed out at 7.2 million sq ft (3.7%) in Q4 2007.

Availability is 17% down on the corresponding period last year when the vacancy rate was 5.3%, representing a reduction of 1.8 million sq ft in available space over the course of 12 months.

Development

During the quarter, nine buildings totalling 364,700 sq ft completed. Only one of these was over 100,000 sq ft with Bird & Bird's HQ at 12-14 New Fetter Lane (EC4) finishing during the quarter. During 2015, 4 million sq ft completed across central London, a 36% decrease on 2014.

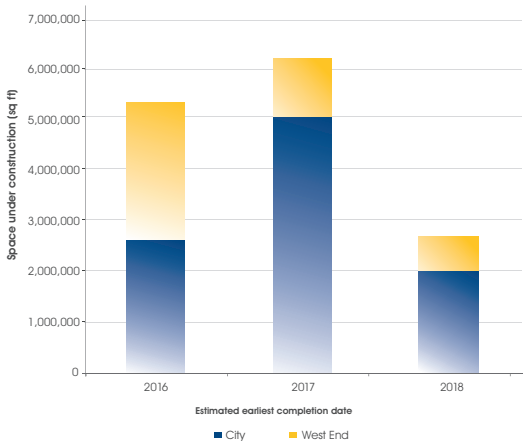
11 buildings totalling 1.2 million sq ft of development started during the quarter, following on from 1.7 million sq ft in the previous quarter. Four of the five largest starts were in the West End where Brockton Capital and Oxford Properties started refurbishing and extending the 350,000 sq ft Post Building (WC1).

There is currently 14.1 million sq ft under construction across central London, with 5.2 million sq ft sq ft (37%) due for completion before the end of 2016 and 6.1 million sq ft (43%) due before the end of 2017. Of the space currently under construction, 4.9 million sq ft (32%) has already been let, leaving 9.6 million sq ft of available space currently under construction. 2015 saw a total of 6.5 million sq ft of development starts.

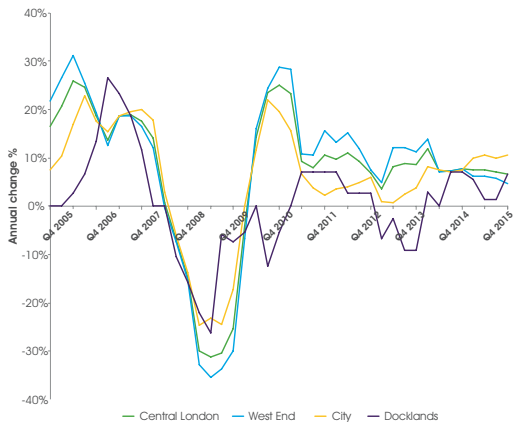
Rental growth

Central London prime rents grew by 1.1% during the quarter. The City and the West End grew by 2.4% and 0.5% respectively, while Docklands rents increased by 5.3%. Prime rents across all central London increased by 6.6% compared to Q4 2014. The Bilfinger GVA central London index now 17% above its previous Q4 2007 peak.

Central London office space under construction
Source: Bilfinger GVA



Central London prime rental growth
Source: Bilfinger GVA



Central London

Investment market

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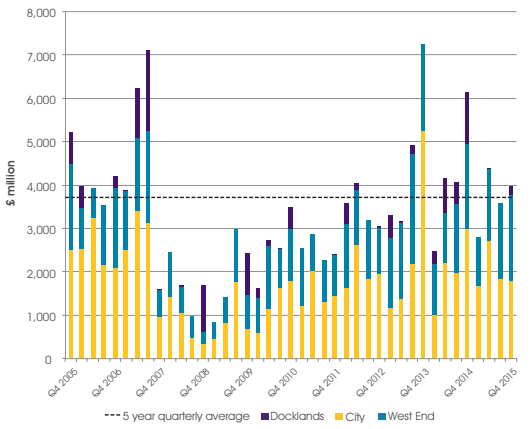
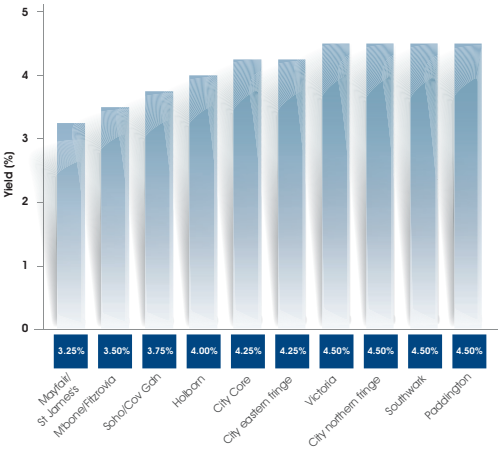
Central London office investment transactions
Source: Bilfinger GVA, PropertyData



Central London office yields
Source: Bilfinger GVA



Overview

Going into the final quarter of the year there was a substantial amount of investment product on the market, with opportunities ranging from short-term income deals to value-added opportunity in multi-let buildings. Much of the investment stock was an overhang of supply from earlier in the year when there was caution emanating from concerns over China and the Middle East, with a few examples of buyers pulling out of deals earlier in the year. Assets, which had seen near misses earlier in 2015, finally traded in the final quarter. Examples included the sale of Thames Court, which had been under offer twice throughout the year and eventually sold for £196 million, representing a yield of 5% Similarly 55 Bishopsgate had been under offer to a new Chinese entrant but was aborted and later sold to Schroders believed to be acting for a Swiss-based fund for £187.5 million, a yield of 4.9%.

The pool of active and determined investors is wide ranging but not as deep and robust as the market had thought. There were examples of price reductions at a number of very large assets including Broadgate Quarter which was being sold by Hines on behalf of HSBC Private Wealth. The asset had been marketed in June at a price of £430 million and despite initially going under offer in excess of asking price, it was subsequently sold to Blackstone for a reduced price of £416 million.

In the West End, there was something of a 'big sell-off' with some true 'trophy' assets coming to the market including The 'Economist Plaza', NFU's Grosvenor's Almack House and, Scottish Widows' 14 St George Street. A number of these significant transactions have already either been concluded or are firmly under offer. The question is, was this a case of prudent vendors selling assets in order to realise funds for re-investment in other asset classes/property investments, or was it prudent vendors calling the top of the market?

Transaction volumes

During Q4 2015, central London investment totalled £4 billion across 46 deals, marking an 11% increase on the previous quarter and a 7% increase on the five-year quarterly average. Investment for the whole of 2015 totalled £14.7 billion, which whilst 10% down on the total for 2014, is 21% up on the five-year average.

During Q4 the West End saw £2 billion transacted, in line with the corresponding period last year, but 33% up on the five-year quarterly average. The largest deal was the £498.5 million purchase of 123 Buckingham Palace Road (SW1) by a consortium led by GAW Capital, representing a net initial yield of 5%. The largest deal in the core was PonteGadea's purchase of Almack House (SW1) from Grosvenor for £232 million, a yield of 3.6%

In the City £1.8 billion was transacted across 20 deals, in line with the previous quarter but 10% down on the five-year quarterly average. The largest deal of the quarter was in the Southbank where the Blue Fin Building was sold by Time Inc to a JV of Oxford Properties and Temasek for £415 million, representing a yield of 4.75%. In EC3, Bilfinger GVA advised on HIH's £66 milllion sale of Friary Court (EC3) to Beijing Capital Holding for £66 million, a yield of 4.5%.

Overseas money continues to dominate, accounting for 2.8 billion during the quarter (71%) and £9.4 billion (64%) for the year. UK property companies and Institutions accounted for £2.2 billion each of investment for 2015. Whilst UK institutions are awash with funds, it is currently difficult for them to be competitive for the most 'prime' assets and are much more likely to chase assets in fringe markets with prospects for growth.

Yields

Q4 2015 saw yield compression in only one of our subareas, with the City eastern fringe seeing yields come in 25 basis points to 4.5%. During 2015, the only yields not to come in were City core and Holborn at 4.25% and 4% respectively. Prime yields in Mayfair and St James's remain at 3.25% for the third successive quarter. Whilst yields are historically low, the sheer weight of money chasing prime assets could be a continuing pressure on yields and yet further records could be broken during 2016.

Friary Court, 65 Crutched Friars, EC3

Bilfinger GVA advised on the off market sale of this 75,000 sq ft building for £66 million on behalf of HIH Real Estate

West End Occupier market

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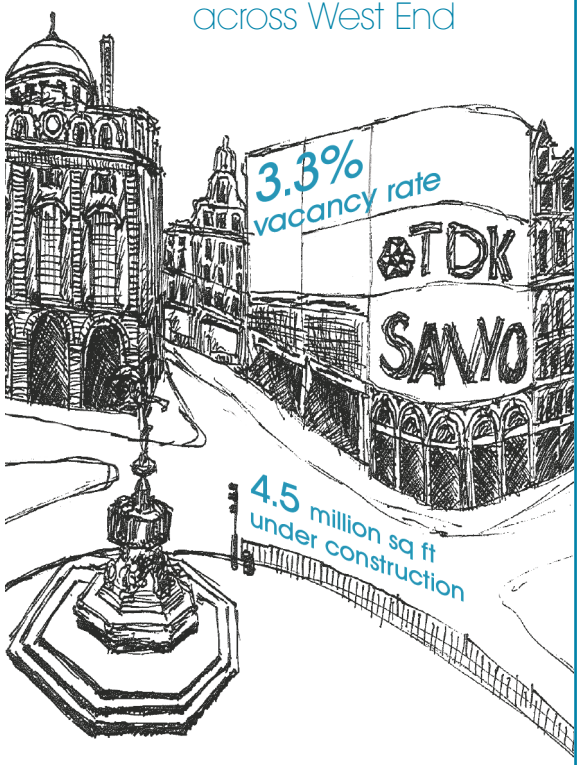
920,600 sq ft let
9% up on 5-year
quarterly average

£150 per sq ft
"super-prime" rent

4.7%
annual rental growth
across West End



Take-up

Take-up during the quarter reached 1.1 million sq ft which, whilst 8% down on the previous quarter was 28% above the five-year quarterly average. This strong end to the year meant that take-up for 2015 totalled 3.8 million sq ft, pretty much identical to the annual figures seen in 2013 and 2014.

In Victoria, Deutsche Bank acquired 92,000 sq ft at Land Securities Zig Zag building (SW1), leaving just one floor remaining. The largest transaction of the quarter in the core was Carlyle, whose lease at Lansdowne House (W1) expires in June 2018, taking 63,500 sq ft at 1 St James's Market (SW1). Carlyle paid up to £106 per sq ft with 30 months rent free. This deal was noteworthy because of the rarity of such a large requirement willing to pay in excess of £100 per sq ft, and Carlyle's desire to commit substantially ahead of its lease expiry in 2018, highlighting the lack of suitable space.

At the 'super prime' end of the market, four occupiers reportedly went under offer at 3 St James's Square (SW1) at levels ranging between £130 and £150 per sq ft, with the second floor at 8 St James's Square under offer at £157 per sq ft.

During Q4 2015 deals on pre-let space accounted for 139,600 sq ft and 35% of take-up across the West End. Deals on recently completed space made up a further 358,300 sq ft, and 30% of take-up for the quarter.

During 2015, lettings of new space made up 29% of take-up, with second-hand deals accounting for 35% of space let.

Availability

Availability decreased slightly during the quarter at 2.7 million sq ft, with the vacancy rate coming down slightly from 3.4% to 3.3%.

During the year, the amount of available space decreased by 9%.

Vacancy is now at its lowest since Q2 2007, when vacancy was at 3.0%. There is 9% more available space now than during 2007.

Development

151,294 sq ft completed across the West End during Q4 2015. The largest building to complete was Land Securities' refurbishment of the 90,000 sq ft 20 Eastbourne Terrace (W2). The West End saw 2 million sq ft of development complete during the year.

682,900 sq ft went under construction during the quarter across two buildings, including 350,000 sq ft at Brockton Capital and Oxford Properties' Post Building (WC1). In Victoria, two refurbishments started at AXA REIM's 103,000 sq ft The Department (SW1) and London & Oriental's 62,500 sq ft Buckingham Green (SW1). As of the end of Q4 2015, there is 4.5 million sq ft of development activity in the West End.

Rental growth

During the quarter, prime rents across the West End increased slightly by 0.5%. This means that prime rents across the market are up 4.7% on the year, which whilst robust, is the weakest annual growth since Q2 2010.

In Mayfair and St James's, prime rents remained stable at £120 per sq ft with rent free periods at 15 months. Net effective rents are now £105 per sq ft, 4% above the peak of the last cycle in 2007. Super-prime rents remain at £150 per sq ft.

In what was a strong quarter for West London, Hammersmith, Kensington and Paddington all saw rental growth of c.5%. Camden, Bloomsbury and Chelsea have seen the most rental growth in the last 12 months. Vauxhall, Camden and Kensington were the star performers during 2015.

City Occupier market

Take-up

Activity in the City in 2015 was very consistent: Q1 – 1.4 million sq ft; Q2 – 1.3 million sq ft; Q3 – 1.3 million sq ft; Q4 – 1.5 million sq ft.

It was a positive end to the year, with Q4 the busiest of the year, and 7.5% up on the five-year quarterly average.

2015 in total saw 5.6 million transact, 24% down on 2014, but in line with the five-year quarterly average.

The largest deal of the quarter was done by Royal Bank of Canada who took 245,000 sq ft at Brookfield's 100 Bishopsgate (EC2), due to complete in 2018. At 3 Waterhouse Square (EC1), WeWork took the entire 98,000 sq ft at a rent of £55.00 per sq ft.

Pre-letting for the quarter made up just 260,132 sq ft, 17% of total take-up, with take-up on new space accounting for 352,900 sq ft (24%). Second-hand space totalled 882,100 sq ft, and 59% of take-up for the year.

During 2015, pre-letting accounted for 1.3 million sq ft (25% of total take-up), a 45% decrease in the equivalent figure for 2014. Take-up of newly completed space accounted for 1.7 million sq ft and 31% of take-up for the year. Second-hand space made up 47% of activity for the year.

Availability

Availability in the City decreased from 5.0 million sq ft to 4.9 million sq ft, with the vacancy rate stable at 5.4%. Availability is 13% down on the corresponding period in 2014 and at its lowest since Q2 2008.

Development

During the quarter 212,800 sq ft completed across four buildings, with the largest being TIAA-Henderson's development of Bird & Bird's 138,300 sq ft 12-14 New Fetter Lane (EC4). In total, 2 million sq ft completed during 2015.

Construction started on 550,000 sq ft across six buildings during the quarter including Blackstone's 238,300 sq ft Old Bailey (EC4), due for completion in 2017. During 2015, there were 25 new starts totalling 4.3 million sq ft.

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There is now 9.6 million sq ft under construction in the City. Of this, 2.6 million sq ft is due to complete in 2016, with 5 million sq ft earmarked for 2017 and 2 million sq ft due for completion in 2018.

Rental growth

Prime rents in the City increased by 2.4% during the quarter, with prime rents up 10.5% on the year, the highest rate of annual rental growth since Q1 2011.

The Insurance sector saw the biggest change during the quarter, increasing 4% to £62.50 per sq ft. Prime rents in the area are now 9% up on the same time last year, although Shoreditch and Clerkenwell saw the biggest rental increases, with both areas seeing prime rents of £65.00 per sq ft, compared to £52.50 per sq ft and £55 per sq ft respectively at this time last year.

Prime headline rents in the City core increased 3.9% during the quarter, surpassing the 2007 peak of £65.00 per sq ft. The City core was the last submarket in the City and West End to pass its 2007 peak headline rent, with net effective rents still 4% down on 2007 levels.

Rent free periods were relatively stable across the City submarkets, with the only movement coming in Clerkenwell and Waterloo where incentives moved out 3 months and came in 3 months respectively. We expect to see a tightening of rent free periods in 2016.

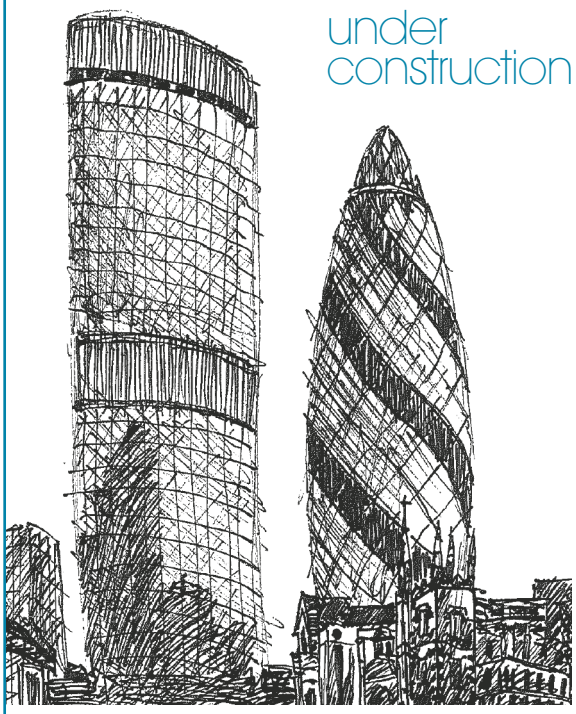
1.5 million sq ft take-up
7.5% down on the 5-year quarterly average

25% of take-up accounted for by pre-lets

5.4% vacancy rate

£67.50 per sq ft prime rents

9.6 million sq ft under construction



Docklands occupier market

Take-up

Q4 2015 was an active quarter with eight deals completing in Docklands, totalling 192,400 sq ft of take-up, nearly double the previous quarter and 6% up on the five-year quarterly average. This means that take-up for the year totalled 960,900 sq ft, 13% down on last year when 1.1 million sq ft was transacted. Thomson Reuters remain under offer on 330,000 sq ft at 5 Canada Square, which should mean a strong start to 2016.

The largest deal of the quarter was at 25 Churchill Place (E14) where EY took an additional 55,700 sq ft across two floors. The professional services firm already occupy 205,000 sq ft in the building. The building is now fully let.

There is currently strong demand from public sector bodies and cost sensitive companies, with this likely to translate to take-up in early 2016.

Availability

Available space decreased from 0.9 million sq ft to 0.8 million sq ft during the quarter, with over half of this space available from occupiers. The vacancy rate decreased from 4.6% to 4.2% during the quarter, its lowest since Q4 2008.

During 2015, availability in Docklands decreased by 46%, a reduction of over 700,000 sq ft. Despite this substantial fall, availability is still 33% higher than the trough of the last cycle.

Development

Whilst construction is yet to start in Docklands, there is preparation work being done at Wood Wharf (E14) as well as the earmarked 1 Bank Street (E14), which is yet to start as work continues on land reclamation around the site. Similarly at 1 Park Place (E14), work is yet to start, although the site has been cleared.

During the quarter, JP Morgan shelved plans to sell its Riverside South development site, which was down to a shortlist of three interested parties and expected to fetch close to £400 million. The area had originally been earmarked for a 1.9 million sq ft European HQ for the bank.

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Rental growth

In Canary Wharf, prime rents increased from £38 per sq ft to £40 per sq ft, with rent free periods stable at 21 months. There continues to be a wide disparity in asking rents between landlord space and space available on a sub-let from occupiers, and there is a belief that once the remaining occupier space lets, prime rents will increase sharply.

Outside the Wharf, rents increased from £31 per sq ft to £32.50 per sq ft with rent free periods staying at 21 months. It is expected that by the end of Q1 2016, rents in South Quay 3 will be at levels significantly in excess of this.

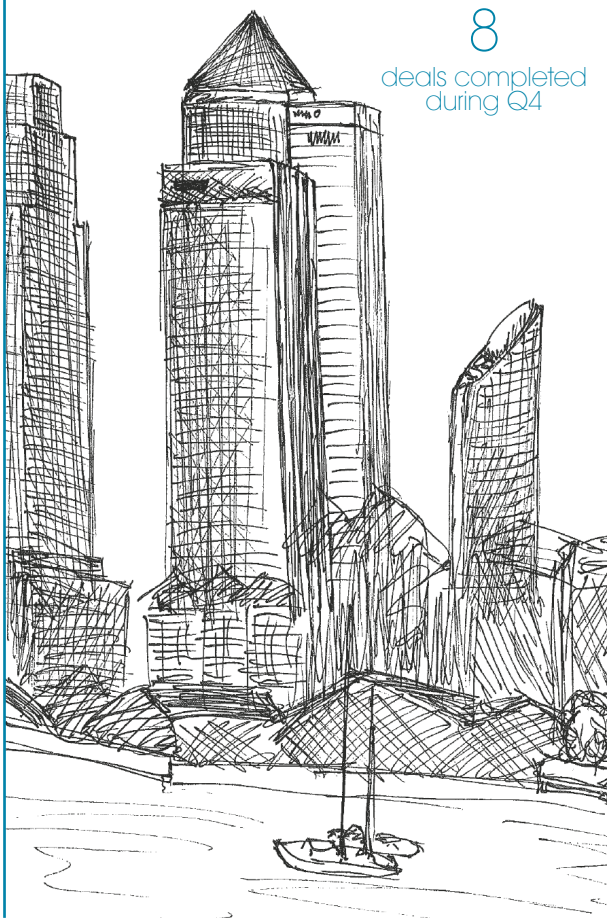
960,900 sq ft
Take-up in 2015

4.2%
vacancy rate

192,400 sq ft
Take-up in Q4 2015

Prime rents
£40.00 per sq ft

8
deals completed during Q4



20 Churchill Place, E14

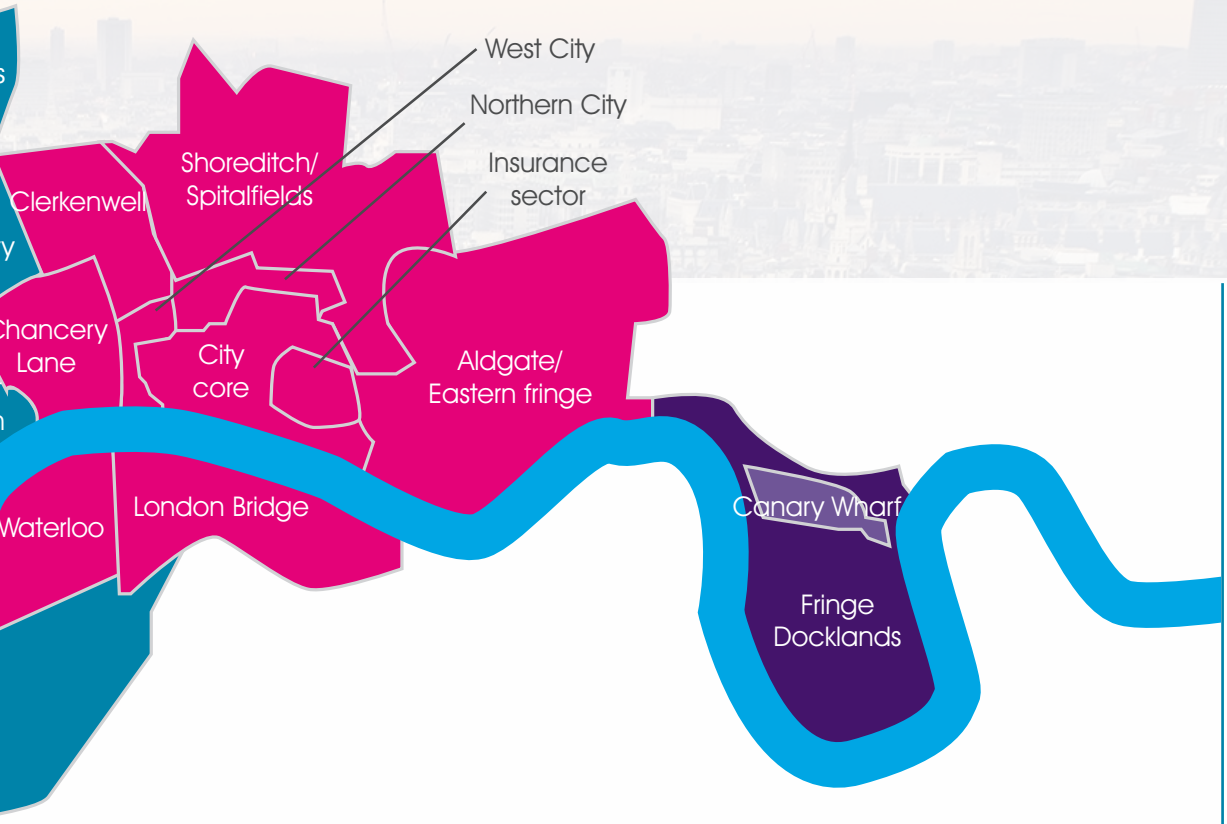
Bilfinger GVA have acquired 35,000 sq ft on behalf of a private client

City

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Central City Core	£67.50	20	£21.52	£99.27
Chancery Lane	£63.50	15	£25.14	£98.89
City Eastern fringe	£55.00	21	£17.24	£82.49
Clerkenwell	£65.00	18	£14.28	£89.53
Insurance Sector	£62.50	21	£22.29	£95.04
London Bridge	£59.50	18	£19.02	£88.77
Northern City	£63.50	21	£17.44	£91.19
Shoreditch	£65.00	18	£11.88	£87.13
Waterloo	£59.50	15	£19.02	£88.77
West City	£67.50	20	£19.18	£96.93

Docklands

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Canary Wharf	£40.00	21	£16.17	£66.42
Docklands fringe	£32.50	21	£11.63	£54.38
Stratford	£37.00	24	£7.50	£54.75



West End

Area	Prime rent (£ per sq ft)	Rent free period (months)	Business rates	Total occupancy costs (inc. service charge and building insurance)
Belgravia / Knightsbridge	£100.00	15	£45.39	£155.64
Bloomsbury	£72.50	17	£25.50	£108.25
Camden	£55.00	18	£17.34	£82.59
Chelsea	£100.00	15	£33.15	£143.40
Covent Garden	£85.00	15	£28.56	£123.81
Euston	£75.00	18	£28.56	£113.81
Fitzrovia	£85.00	16	£26.01	£121.26
Fulham	£45.00	18	£16.32	£71.57
Hammersmith	£55.00	18	£18.87	£84.12
Kensington	£65.00	17	£23.46	£98.71
King's Cross	£82.50	17	£23.46	£116.21
Mayfair	£120.00	15	£46.92	£177.17
Mayfair "super-prime"	£150.00	15	£52.02	£212.27
North of Oxford St	£97.50	16	£40.80	£148.55
Paddington	£67.50	17	£26.15	£103.90
Soho	£95.00	15	£33.15	£138.40
St James's	£120.00	15	£46.92	£177.17
Vauxhall	£55.00	20	£15.10	£80.35
Victoria	£85.00	17	£30.09	£125.34

London
Birmingham
Bristol
Cardiff
Dublin
Edinburgh
Glasgow
Leeds
Liverpool
Manchester
Newcastle

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