BNP PARIBAS REAL ESTATE

Real Estate for a changing world

CENTRAL LONDON OFFICE MARKET REPORT - Q1 2017

RESEARCH

Overview

'Resilient' has been the word most often used to describe Central London over the last 10 months. This resilience has been underpinned by the capital's solid property fundamentals which will continue to act as a draw for occupiers and investors throughout the upcoming Brexit negotiating period.

Low supply. Despite a rise in the vacancy rate in Q1 to 6.35%, it is still below the long term average and low in comparison to the historic trend. This cycle has seen lower levels of speculative office development due to rising construction costs and a lack of development finance.

Steady demand. 500,000 sq ft of new requirements were launched in Q1, an indication that sentiment amongst occupiers has improved. Three large lettings of >100,000 sq ft to Freshfields, Expedia and Arup have demonstrated that Central London continues to attract occupiers across all sectors.

Robust economy. With Central London and the UK economy working very much in tandem, a robust economic picture for the UK bodes well for the capital. UK GDP growth has been revised upwards expected to reach 1.8% in 2017 and Central London will be driving this with 2.2% growth expected.

Currency discount. With the City seeing yield compression of 25bps this quarter, pricing hasn't performed as some investors expected post Brexit. Discounts however have come in the form of sterling's devaluation. In the short term we expect to continue to see a 10-12% discount for buyers purchasing UK Real Estate in US dollars.

Infrastructure projects. Europe's largest infrastructure scheme Crossrail nears completion next year. The scheme will increase transport capacity and reduce journey times across the capital. London's future as a world class city relies on continued investment into infrastructure, this is why projects like the Northern Line extension, HS2 and Heathrow's expansion will be essential in securing this.

Q1 Stats... At a Glance

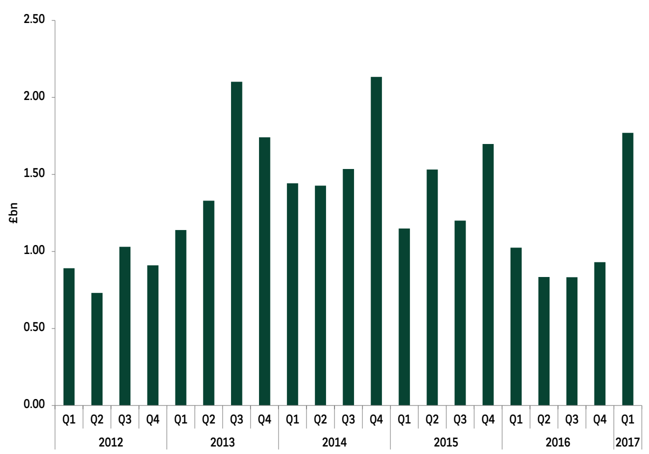
Total supply **13.69m** sq ft ▲ 11% on Q4 2016	**Vacancy rate** **6.35%** ▲ 62bps on Q4 2016	**UK GDP Growth** **1.8%** in 2017	**Central London GDP Growth** **2.2%** in 2017
Take-up **2.48m** sq ft ▼ 28% on Q4 2016	**Investment** **£4.06bn** ▲ 20% on LT ave	**City Yields** **4.00%** ▼ 25 bps on Q4 2016	**West End Yields** **3.50%** ▶ Remains stable

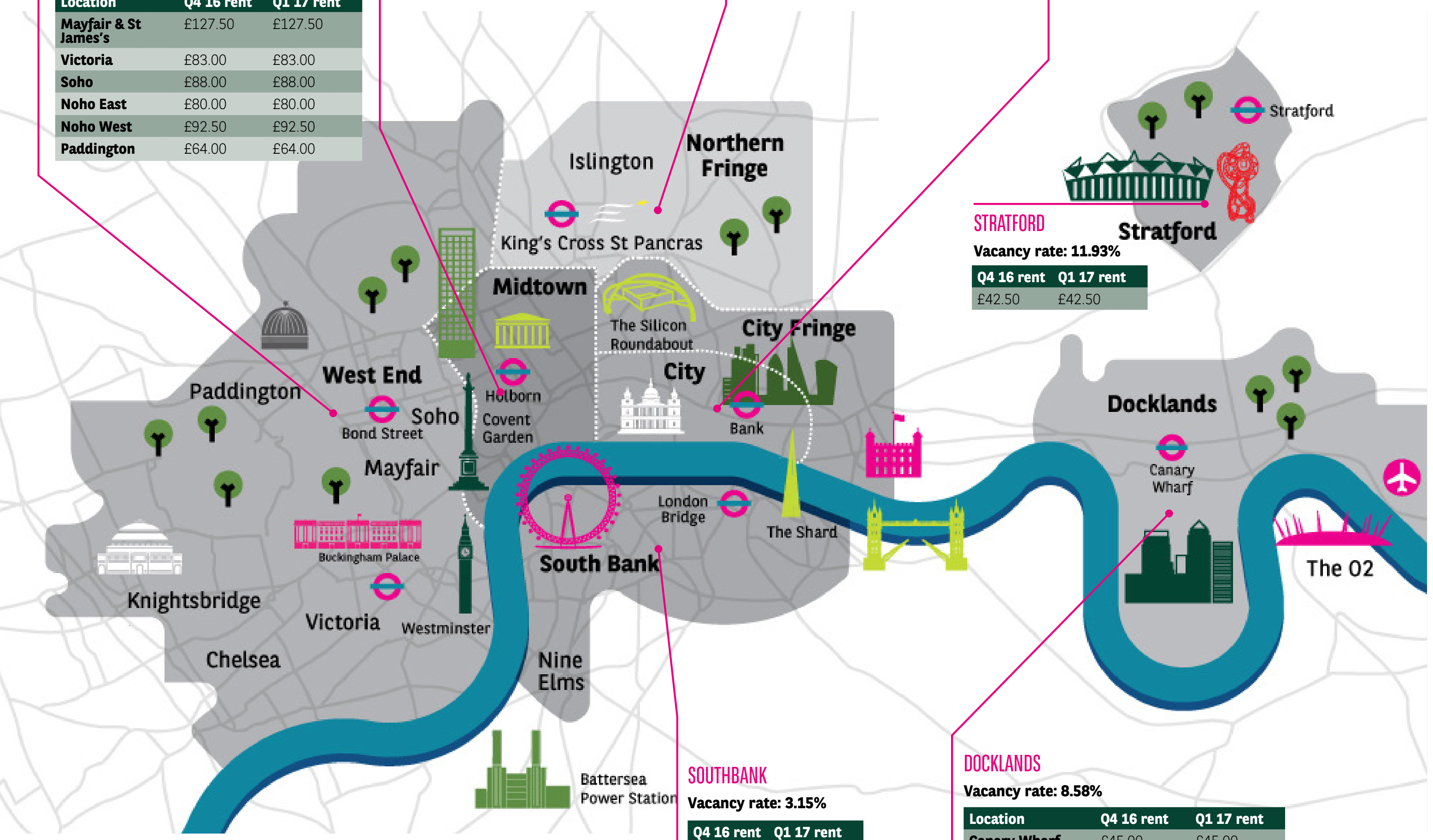
Office rents & vacancy rates

WEST END (W1, SW1, NW1, W2, SW3, SW7 & W8)

- Take-up levels for Q1 2017, whilst improving on the previous two quarters, remain subdued. At 0.61 million sq ft, levels continue to fall below the market's five year average.
- The Professional Services sector again posted a key share of demand, rising from 17% in Q4 2016 to 27% at Q1 2017. A significant proportion of this was accounted for by the substantial 133,600 sq ft letting to Arup Group at 80 Charlotte Street.
- Despite unexceptional levels of demand, supply has fallen by 6% to stand at 3.03m sq ft, with take-up outweighing secondary releases and the limited levels of new development coming online.
- Q1 2017 has seen prime rents remain static, as is the case across all of the Central London submarkets. This follows rental decline over 2016, where a lack of transactional evidence and subdued market conditions prompted prime rental levels to fall 5.6% to £127.50 psf. At this level, prime rents are, however, still 6.25% above the market's pre-recession peak.
- Following the positive end to 2016, investor activity remained encouraging over the first quarter of 2017, returning investment volumes of £1.77 bn, the highest quarterly total since end-2014.
- Overseas investors continued to dominate the investor profile and Asia Pacific investors were the most active. However, the largest transaction in terms of size comprised German investor Deka Immobilien's acquisition of One Rathbone Place. The building, let to Facebook on a 15 year term in September 2016, was sold for £435m, reflecting a net initial yield of 4%.
- A further key transaction was the sale of the multi-let 7-8 St James's Square to a private Asian investor. The scheme, which has previously achieved record rental levels for the Central London market, was sold for £245.9 million, a capital value of £3,425 psf and yield of 3.69%. The Square has attracted high investor interest in recent months.
- Whilst the investment picture in the West End was fairly positive over Q1 2017, sentiment remains cautious. Prime yields stand at 3.50% in Q1.

West End Investment Volumes





WEST END

Vacancy rate: 4.51%

Location	Q4 16 rent	Q1 17 rent
Mayfair & St James's	£127.50	£127.50
Victoria	£83.00	£83.00
Soho	£88.00	£88.00
Noho East	£80.00	£80.00
Noho West	£92.50	£92.50
Paddington	£64.00	£64.00

MIDTOWN

Vacancy rate: 8.90%

Location	Q4 16 rent	Q1 17 rent
Covent Garden	£80.00	£80.00
Holborn	£67.50	£67.50

NORTHERN FRINGE

Vacancy rate: 2.17%

Location	Q4 16 rent	Q1 17 rent
King's Cross	£76.00	£76.00

CITY

Vacancy rate: 7.22%

Location	Q4 16 rent	Q1 17 rent
City	£69.00	£69.00
City Tower	£80.00	£80.00
City Fringe	£65.00	£65.00

STRATFORD

Vacancy rate: 11.93%

Q4 16 rent	Q1 17 rent
£42.50	£42.50

SOUTHBANK

Vacancy rate: 3.15%

Q4 16 rent	Q1 17 rent
£63.00	£63.00

DOCKLANDS

Vacancy rate: 8.58%

Location	Q4 16 rent	Q1 17 rent
Canary Wharf	£45.00	£45.00
Rest of Docklands	£32.00	£32.00

WEST END investment

Q1 2017: £1.77 bn

45%↑ change Q-on-Q

73%↑ on LT ave

CITY investment

Q1 2017: £1.75 bn

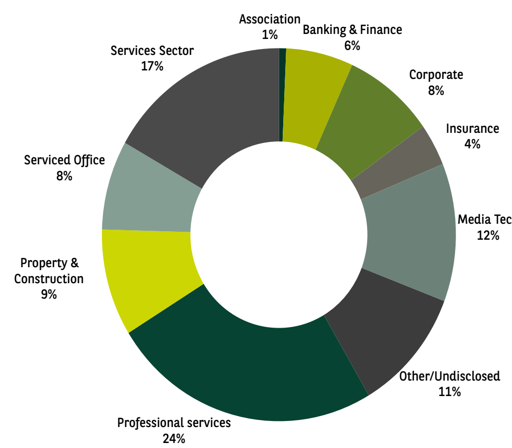
27%↓ change Q-on-Q

12%↑ on LT ave

CITY (EC1, EC2, EC3, EC4 & E1)

- Following the recovery of Q4 2016, take up slowed slightly over Q1 2017, standing at 1.34m sq ft down from 1.59m sq ft during the last quarter of the year. At this level take up is, however, in line with the market's long run average.
- The Professional Services sector drove take-up over the quarter, boosted by law firm Freshfields' commitment to 255,000 sq ft at the currently under construction 100 Bishopsgate. The scheme has now achieved 65% occupancy, with completion not due until 2019.
- City supply has risen once again over the quarter to stand at 6.23m sq ft, driven by secondary releases and speculative completions. Despite this rise, supply levels remain 15% below the long-run average.
- 2017 has already seen 780,000 sq ft of new space complete, with a further 3.5m sq ft projected to complete across the remainder of the year. Whilst this will constitute one of the highest annual completion levels recorded for the City market in recent years, in positive news only around 50% of this new stock remains available.
- Rental levels in both the City and City Fringe markets have remained flat over Q1 2017, standing at £69.00 psf and £65.00 psf respectively.
- Similarly to the occupier market, investment volumes for Q1 2017 also fell back on the previous quarter, totalling £1.75bn. This fall back does, however, follow a particularly strong finish to 2016 and at this level volumes are 12% ahead of the quarterly long term average.
- Volumes were substantially boosted by one key transaction: the sale of the Leadenhall Building to Hong Kong investor CC Land for £1.15bn, reflecting a net initial yield of 3.5%. The sale of this trophy building constitutes continued overseas investor interest and confidence in the capital.
- In the initial aftermath of the Brexit vote, falls in City office capital values led to a marginal outward movement in prime yields from 4% to 4.25%. Q1 2017 has seen yields harden, with 25bps compression moving yields back to the level recorded pre-referendum.

City take-up by business sector



MIDTOWN (WC1 & WC2)

- In a quarter where take-up figures across the capital have dwindled below the long-term average in all submarkets, Midtown has been the anomaly. Midtown take-up was above the long term average of 0.27m sq ft for the second consecutive quarter after a lull period during 2016. Take-up reached 0.35m sq ft, with large deals to Mckinsey at The Post Building (96,999 sq ft) and COS at 1 New Oxford Street (60,096 sq ft) helping to boost figures.
- Its well-established location between The City and West End serves as a gateway to a variety of diverse occupiers, with Midtown being one of the most diverse sub markets in Central London. Similar to previous quarters the Professional Services dominated take-up during Q1 2017, accounting for 35% of total take-up. Although it must be noted that this majority was almost solely due to the deal to Mckinsey. The Media Tech and Retailer sector closely followed with 18% and 17% of total take-up respectively.
- Despite good levels of letting activity, vacancy rates have once again increased over the initial quarter, with supply currently standing at 1.77m sq ft equalling a vacancy rate of 8.90%. This 139bps increase on Q4 2016 is due to 42,580 sq ft of tenant space coming back to the market at Mid City Place during Q1 along with 104,238 sq ft of newly avaible stock.
- However, encouragingly 20% off supply is under offer and this along encouraging demand and declining development activity over the next 2 years will place pressure on supply.
- Similar to the slowdown in the final quarter of 2016, Q1 2017 investment volumes for Midtown were somewhat unimpressive, with only £150m being transacted 55% below the 10 year long term average.
- The most prominent investment deal of the quarter was the Karlin Real Estates's sale of 18 Gray's Inn Road. The vendor was represented by BNP Paribas Real Esate and was sold to a private Middle Eastern purchaser.

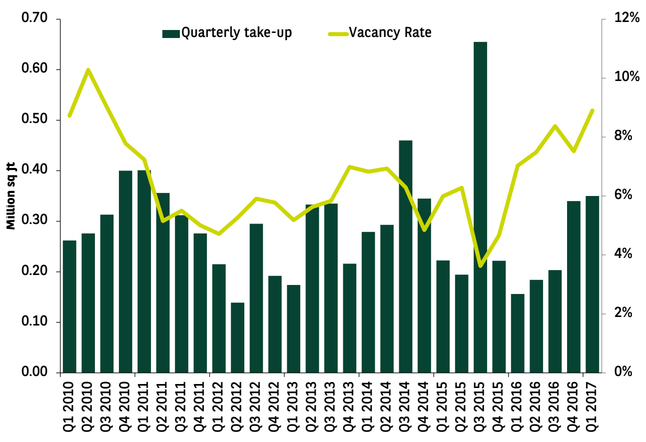
MIDTOWN take-up

Q1 2017: 0.35m sq ft

4% ↑ change Q-on-Q

30% ↑ on LT ave

Midtown Take-up & Vacancy Rate



Data

	CENTRAL LONDON	WEST END	CITY	DOCKLANDS	MIDTOWN	SOUTHBANK	N1
Take-Up (m sq ft)	2.48	0.61	1.34	0.04	0.35	0.11	0.02
Change Q-on-Q	-28.36%	11.82%	-15.74%	-92.85%	3.95%	-69.94%	44.99%
Change Y-on-Y	-19.63%	-16.62%	-8.79%	-88.16%	124.40%	-36.47%	-88.35%
Availability (m sq ft)	13.69	3.03	6.23	1.64	1.77	0.59	0.09
Change Q-on-Q	11.00%	-6.21%	8.62%	84.12%	18.48%	11.26%	-24.90%
Change Y-on-Y	32.56%	14.54%	41.47%	69.55%	28.95%	-5.74%	159.12%
Vacancy Rate (%)	6.35	4.51	7.22	8.58	8.90	3.15	2.17
Change Q-on-Q (bps)	63	-30	57	392	139	32	-72
Change Y-on-Y (bps)	163	57	221	356	206	-32	131

Major leasing deals

PROPERTY	SQ FT	TENANT	RENT £PSF
100 Bishopsgate, EC3	255,299	Freshfields	High £60's
Angel Building	136,657	Expedia	Conf.
80 Charlotte Street, W1	133,600	Arup Group	£75.00
The Post Building, WC1	96,999	Mckinsey	Mid £70's
2 Waterhouse Square, EC1	88,800	ITV	Conf.

PROPERTY	SQ FT	TENANT	RENT £PSF
21 Lime Street, EC3	31,269	Antares Underwriting	£71.00
The Lighthouse Building, Pentonville Road, N1C	16,316	Vivo	£73.50
The Adelphi, WC2	12,938	Finsbury PR	£110.00
Grand Buildings, 1-3 Strand, WC2	10,464	Dark Trace	£94.00
7 Clarges Street, W1	8,134	Fortress Investment Group	£120.00

Major investment deals

PROPERTY	CAPITAL VALUE £M	PURCHASER	YIELD
The Leadenhall Building, EC3	1,150	CC Land Holdings	3.50%
One Rathbone Square, W1	435	Deka/ WestInvest	4.00%
One Kingdom Street, W2	292	CC Land Holdings	4.86%
Ampersand, 178 Wardour St, W1	260	Emperor Group	2.91%
8 Fitzroy Street, W1	197	Arup	3.40%

PROPERTY	CAPITAL VALUE £M	PURCHASER	YIELD
65 Fleet Street, EC4	160	JMI Group	5.56%
132-142 Hampstead Road, NW1	130	Secretary of State for Transport	n/a
Exchequer Court, St Mary Axe, EC3	105	Am Trust	5.48%
Fox Court, 18, Gray's Inn Road	101	Union Invest	5.10%
13-17 Fitzroy Street	98.5	Workspace Group	4.60%

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