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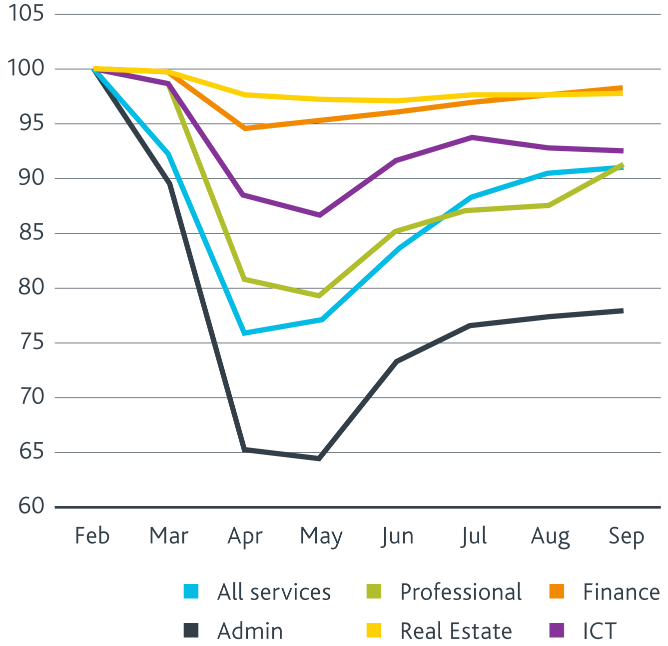
UK OFFICE MARKET REVIEW

QUARTER THREE | 2020

THE UK OFFICE MARKET

The macro-drivers of current demand for UK offices are weak. Service sector output remains 8.8% lower than the level in February, the last full month before lockdown. From the sectors that drive the demand for office space, only Public Admin and Defence remains above the level in February. Presumably, its robust performance was related to pandemic management. Real Estate and Finance & Insurance activities have also performed relatively strongly.

UK SERVICE SECTOR OUTPUT



Source: ONS

October's flash IHS/Markit PMI hit a 4 month low in October and the fresh lockdown measures are likely to result in far weaker Q4 growth than seen in Q3. Encouragingly, robust growth continues to be recorded for Business Services, IT & Computing and Financial Services.

Estimates from the Labour Force Survey for Q3 2020 show 32.5 million people aged 16 years and over in employment, 247,000 fewer than a year earlier and 164,000 fewer than the previous quarter. Unemployment has increased to 1.6 million or 4.8% from 1.3 million or 4.0% at the start of the year. The latest Bank of England projections indicate that unemployment will increase to 7.7% in the first half of 2021 and is likely to decline only gradually thereafter.

Just as employers were considering a gradual return to the office along came the second wave of the virus and Lockdown 2.0 as the Government insisted, "that you must work from home if you can effectively do so". The good news such as it is, was that the switch to home working was relatively easy after systems had been trialled and tested under Lockdown 1.0 and many businesses had continued to operate hybrid models of office and home working.

The announcement of the imminent roll-out of a vaccine will encourage some to say that patterns of occupation and the demand for office space will revert to "normal" after a brief respite. The US Department for Transportation has noted that air passenger travel reached its pre-9/11 peak 34 months after the attack on the Twin Towers in July 2004 and continued to grow thereafter.

But for others the Covid-19 pandemic has provided a catalyst to re-think the future of the workplace. It is possible that many businesses will seek to shrink their office estate and develop a 'flexi' model.

A further incentive is provided by the drive to net carbon neutrality by 2050. A reduction firstly, in the amount of space occupied in glass clad towers that require heating in the winter and air conditioning in the summer; and secondly, in the number of employees commuting will help shrink carbon footprints.

Land Securities hold £7.9bn of Central London office assets representing 67% of the Group's portfolio. In a November announcement to accompany its September 2020 half-yearly results it picked out what it saw as a number of key trends:

- London's continuing status and prospects as a global gateway city
- Beneficial network effects of mixing commerce, arts, science and power in one place
- Greater levels of remote working to become the norm
- Importance of sustainability, flexibility and workplace health and wellbeing
- Reversal of the trend to ever higher occupational densities
- Demand for modern, high quality, flexible space contrasted with the increased obsolescence of older buildings.

It is worth highlighting four trends which will come to dominate the Central London narrative in the next few years. Firstly, a short or medium term increase in occupier demand seems unlikely given the macro-economic background. Consequently, the market is faced with the prospect of increasing amounts of second hand or even obsolete space becoming available as businesses choose to upgrade their accommodation and re-locate to one of many soon to be newly completed developments.

Secondly, this increasing second-hand space will require increased asset management and not a little imagination from landlords to encourage take-up by business occupiers. Leases will become more flexible with frequent rolling break options, possibly negotiated in exchange for shorter rent free periods.

Thirdly, Brexit. Financial Services are not part of the trade deal that may or may not be concluded before the end of the year. From the start of 2021 “Passporting” will be exchanged for “Equivalence”; UK firms will only be able to serve EU clients if Brussels deem UK regulations closely aligned to the EU’s. Worryingly, equivalence is revocable on 30 days notice.

Lastly, and this is admittedly an outside bet, Stratford could be added to the ever growing list of fringe locations that have become mainstream, including Paddington, Kings Cross and the Southbank, as occupiers seek out better value. Stratford is already one of the most accessible locations in Central London served by High Speed 1 and Eurostar, London Underground and Overground and the DLR. The eventual completion of Crossrail will only improve its position.

In the regional office markets, Mailbox REIT, which owns Birmingham’s Mailbox development of the former Royal Mail site, has recently announced the postponement of its debut listing on the IPSX exchange. The beneficial owner of the REIT, M7 Real Estate, is currently in talks with Oxford Properties concerning a corporate buyout.

IPSX is a commercial real estate securities exchange dedicated to the trading of single institutional grade real estate assets. The growth of this platform in sufficient numbers has the potential to radically alter the way real estate fund managers operate.

UK OFFICE MARKET IN FIGURES

AVAILABILITY

Central London up 13% to 24.8m sq.ft.

Regional up 5% to 13.5m sq.ft.

AVAILABILITY RATE

Central London up from 8.2% to 9.2%

Regional up from 11.3% to 11.8%

TAKE-UP

Central London down 37% to 933k sq.ft.

Regional up 76% to 1.0m sq.ft.

AVERAGE RENT

City £59 psf

West End £66 psf

Birmingham £22 psf

Manchester £23.50 psf

INVESTMENT

Central London up 23% to £684m

Regional down 2% to £91m

YIELDS

City 4.10%

West End 3.75-4.0%

Birmingham 6.75%

Manchester 5.75%

DEVELOPMENT COMPLETIONS

Central London up 60% to 993k sq.ft. in 6 buildings

Regional down 40% to 99k sq.ft. in 3 buildings

UNDER CONSTRUCTION

Central London down 7% to 12m sq.ft. in 67 buildings

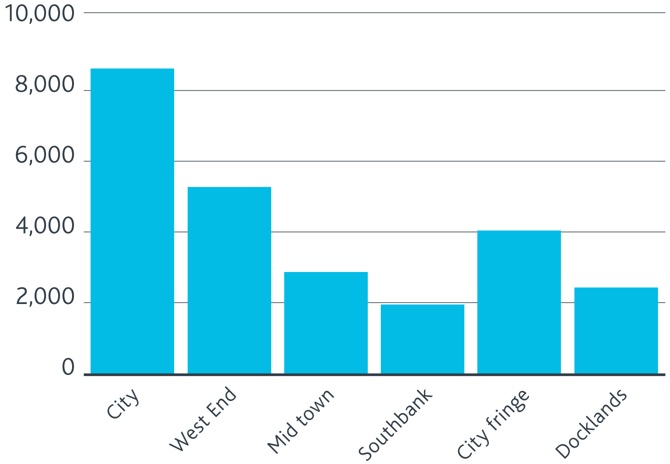
Regional up 3% to 5.7m sq.ft.in 35 buildings

CENTRAL LONDON IN BRIEF

Q3 AVAILABILITY

CENTRAL LONDON – KEY OCCUPATIONAL MARKETS

Q3 AVAILABILITY	000 FT²
City	8,516
West End	5,189
Midtown	2,829
Southbank	1,900
City Fringe	3,984
Docklands	2,395



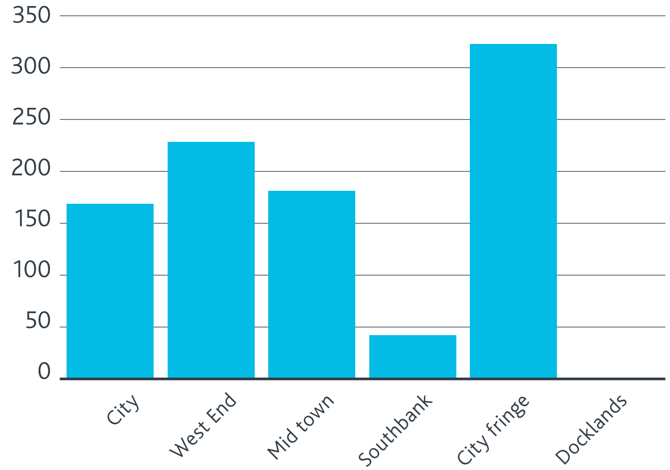
CENTRAL LONDON AVAILABILITY AND TAKE-UP

Q3 availability increased by 13% to 24.8m sq.ft. from 22.0m sq.ft. in Q2. In the 12 months to the end of September availability has increased by 23%.

Q3 take-up decreased by 37% to 933k sq.ft. from 1.5m sq.ft. in Q2. In the 12 months to the end of September take-up amounted to 10.0m sq.ft. and has decreased by 50% from 20.0m sq.ft. let in the year to September 2019.

Q3 TAKE-UP

Q3 TAKE-UP	000 FT²
City	166
West End	227
Midtown	180
Southbank	38
City Fringe	322
Docklands	0



KEY TRANSACTIONS Q3

BUILDING	SIZE	TENANT	RENT
280/290 Bishopsgate, EC2	153,000	Baker McKenzie	£58.00
210 Euston Rd, NW1	70,000	The Office Group	n/a
76 Turnmill St, EC1	38,000	JA Kemp	£69.50

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CENTRAL LONDON IN BRIEF

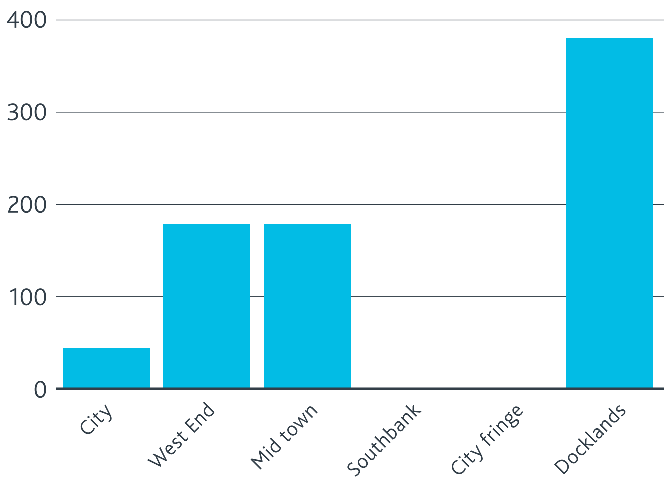
CENTRAL LONDON INVESTMENT

Q3 investment transactions increased by 23% to £684m from £555m in Q2. In the 12 months to the end of September investment amounted to £6.9m and has decreased 23% from £9.0m in the year to September 2019.

Q3 INVESTMENT VOLUMES

CENTRAL LONDON – KEY INVESTMENT MARKETS

Q3 INVESTMENT	£MN
City	45
West End	175
Midtown	174
Southbank	–
City Fringe	–
Docklands	368



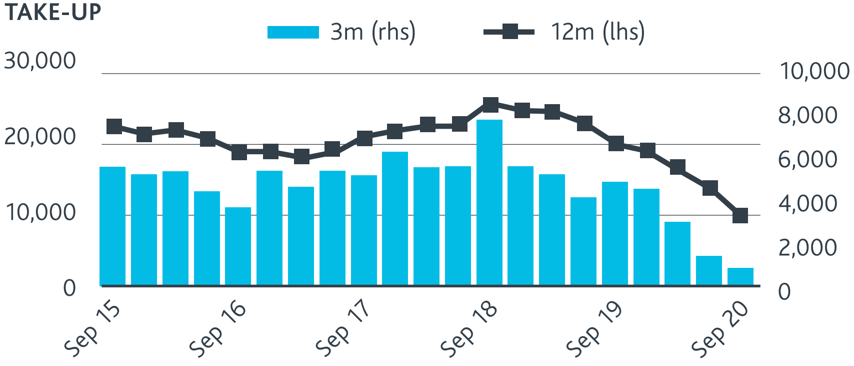
KEY TRANSACTIONS Q3

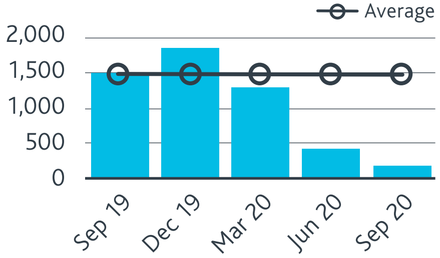
BUILDING	PRICE	PURCHASER	YIELD
25 Cabot Sq.	£367.9mn	Link REIT	4.70%
1 New Oxford St	£174mn	Sun Venture	4.20%
7 Soho Square	£78mn	Hines	4.00%
25 Hanover Sq	£40.5mn	Morgan Capital	2.80%
8/9 Stratton St	£36mn	Nat Bank of Egypt	n/a

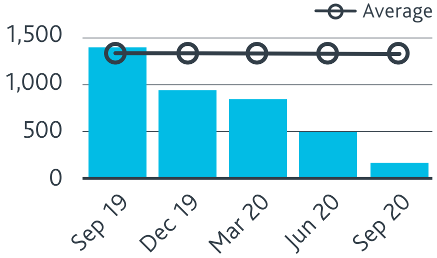
CENTRAL LONDON IN DETAIL

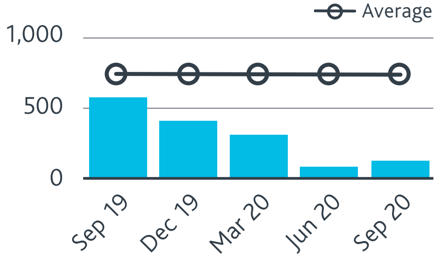
Q3 TAKE-UP

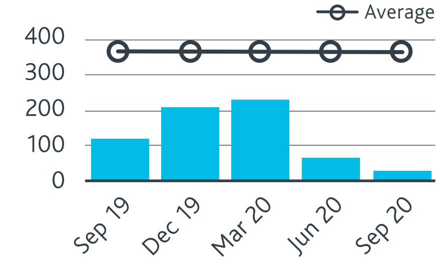
CENTRAL LONDON OFFICE TAKE-UP ('000 SQ.FT)

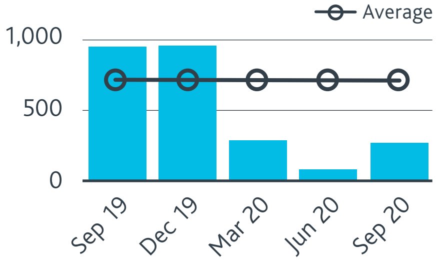


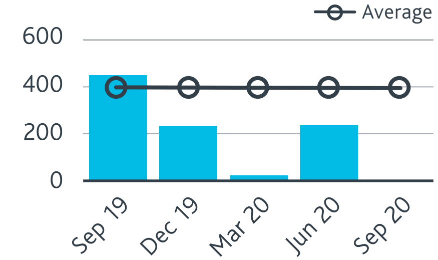












CENTRAL LONDON TAKE-UP AND RENTS

As a result of the pandemic lockdowns, take-up in Q2 and Q3 represents a substantial 76% decrease on the quarterly average rate of take-up over the last 10 years.

Across each of the core sub-markets of the City, West End and Midtown Q3 take-up was 80% or more below the 10-year quarterly average. In Q3 core City take-up fell 61% with lettings totalling just 166,000 sq.ft. compared to the 10-year average of 1.49m sq.ft. per quarter. The situation was similar across Central London's other sub-markets. Indeed no lettings at all were completed in Docklands, an outcome which was not even experienced during the GFC.

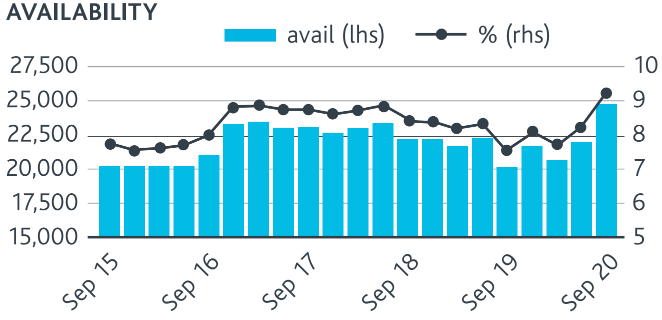
However, take-up actually increased between Q2 and Q3 in Midtown and the City Fringe as a result of lettings of 153k sq.ft. to Baker McKenzie at 280 Bishopsgate, EC2; 39k sq.ft. to JA Kemp at 76 Turnmill Street, EC1; 70k sq.ft. to The Office Group at 210 Euston Road, NW1; and 21k sq.ft. to Hardwicke Chambers at 1 Grays Inn Road, WC1.

Market rental values typically have a lagged reaction to macro-economic events. Consequently, in the core Central London markets decreases in rental values are barely visible as yet. But there are signs of a softening market as rent free periods start to lengthen. Typically, an occupier can expect to receive 26 months' rent free on entering a 10-year lease. This is a 3-month increase on the terms available in Q2.

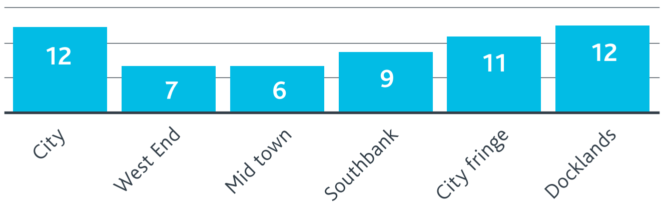
CENTRAL LONDON IN DETAIL

CENTRAL LONDON OFFICE AVAILABILITY AND DEVELOPMENT ('000 SQ.FT.)

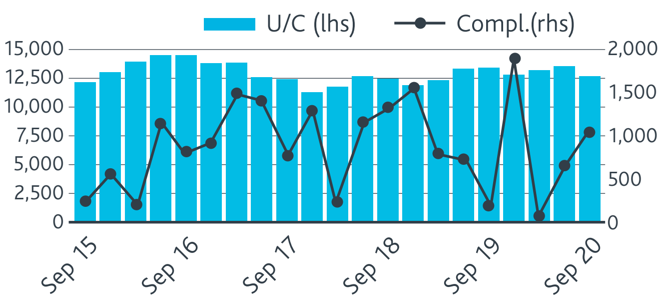
AVAILABILITY



AVAILABILITY RATES (%)



DEVELOPMENTS ('000)



CENTRAL LONDON AVAILABILITY AND CONSTRUCTION

Following the GFC availability peaked at 31m sq.ft. at which point the availability rate, defined as the total space available divided by the total stock of office space, across the whole of Central London was 12%. In the City and Docklands the availability rate climbed to 18% as the banking sector bore the brunt of the US housing crash and the collapse of markets in collateralised debt obligations.

Central London availability had been on a declining trend since the GFC, with the exception of Brexit related spike immediately after the referendum in mid-2016. However, in Q3 availability increased across every Central London sub-market. Availability has also increased across all bar one of the sub-markets on a 12-month view. The single exception is Docklands where there has there been a slight decrease in availability of 3% or 80,000 sq.ft.

AVERAGE RENT ACHIEVED (£psf)

RENT (£psf.)	Q3 2020	Q2 2020	Q3 2019
City	59.00	59.00	58.00
West End	66.00	65.00	64.50
Midtown	59.00	61.50	59.50
Southbank	52.50	53.50	50.50
City Fringe	57.50	57.00	56.00
Docklands	44.50	44.50	41.50

Source: CoStar

The availability rate in the City is now 12%. The West End and Midtown sub-markets have the lowest availability rate at 7% and 6% respectively. There is also a perception that the amount of "grey" space which is neither occupied nor on the market to let is growing. Businesses may be reluctant to shrink their real estate portfolios until the full implications of the pandemic inspired move to "WFH" have been revealed.

Across the whole of Central London, development completions in the 9 months to September have amounted to 1.7m sq.ft. in 17 buildings, principally in the City and West End. Examples include, 100 Liverpool Street, EC2 providing 546k sq.ft. of which 93% is let; and 336,500 sq.ft. at 80 Charlotte Street, W1 where 100% of the available space has been let.

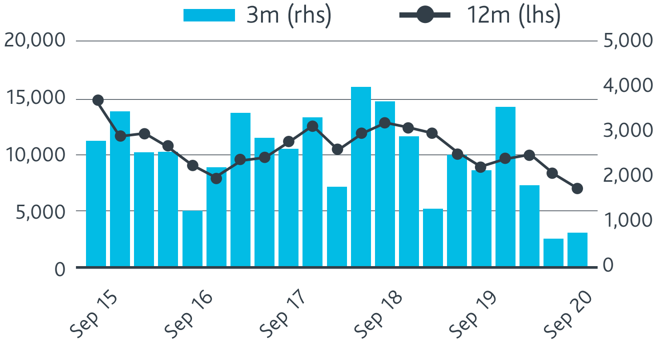
There is a further 12m sq.ft. under construction in 67 buildings representing a 30% increase on the long run average development pipeline of 9.3m sq.ft. However, 7.7m sq. ft, or 64% of this space, has been pre-let.

Six of the seven largest construction projects are located in the City or City Fringe including 1.4m sq.ft. at 22 Bishopsgate, EC2 which is 58% let and 910,000 sq.ft. at 40 Leadenhall Street, EC3, which is only 4% let. The largest project in the West End is at 31 London Street, Paddington Square, W2 where 438k sq.ft. is being built.

The City contains the largest current development pipeline both absolutely and proportionately relative to its total office stock. Here, developments totalling 1.8m sq.ft. completed in the last 12-months and a further 5m sq.ft. is under construction representing 42% of the total Central London development pipeline.

CENTRAL LONDON IN DETAIL

CENTRAL LONDON INVESTMENT (£mn)



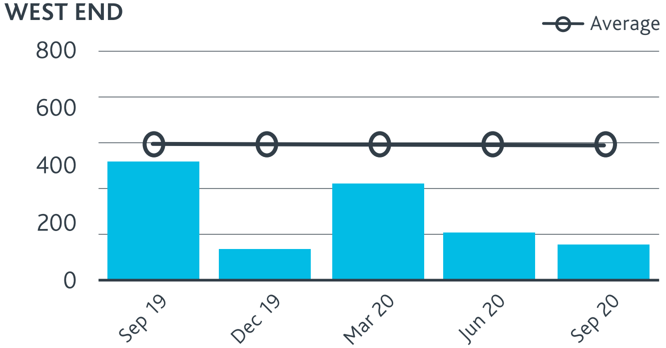
INVESTMENT VOLUMES

Average investment volumes of £723m in Q2 and Q3 were 61% lower than Q1's total of £1.84bn and 73% lower than the long run quarterly average of £2.7bn.

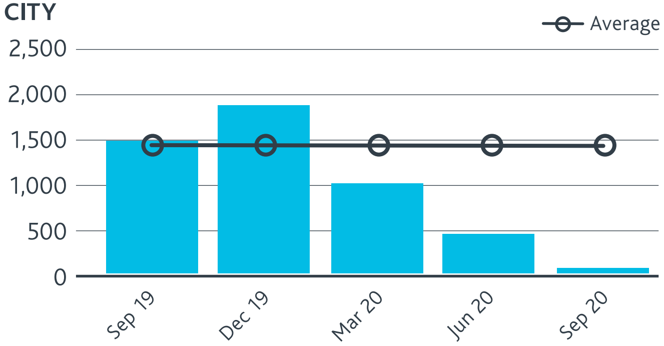
Investment in the core Central London markets of West End, Midtown and City of London decreased by 70% from £1.76bn in Q1 to £533m per quarter in Q2 and Q3. The quarterly 10-year average investment in these core markets is £2.26bn.

Investment in the fringe Central London markets of Docklands, Southbank and City Fringe amounted to £380m in Q3. A quarter earlier no transactions were recorded. The quarterly 10-year average investment in these core markets is £442m.

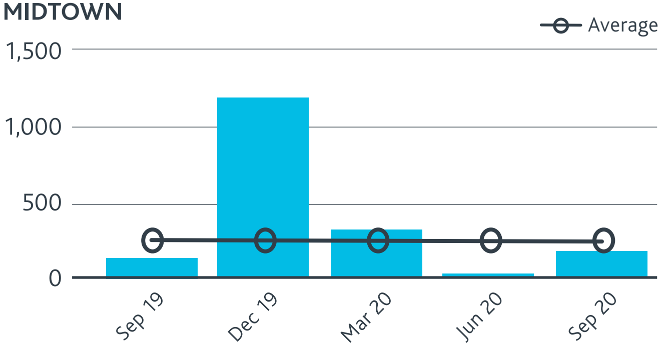
WEST END



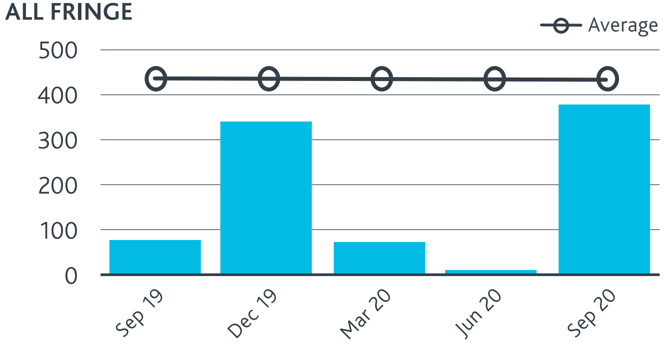
CITY



MIDTOWN

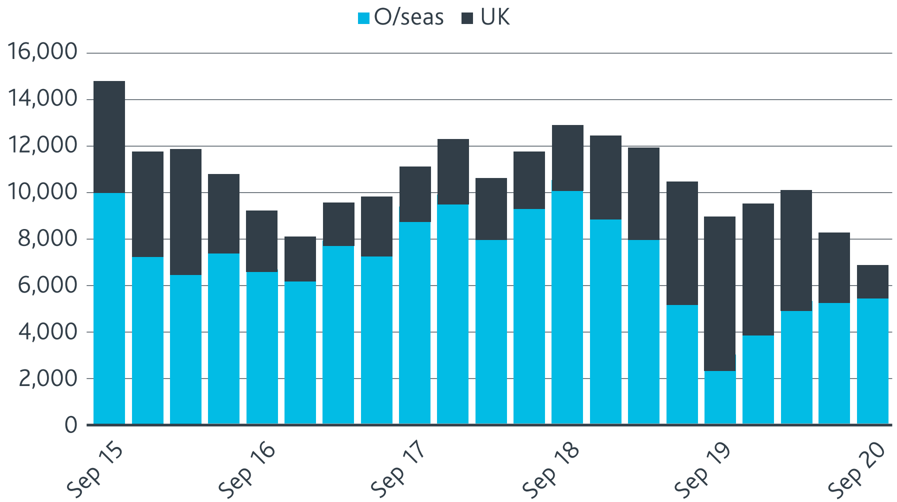


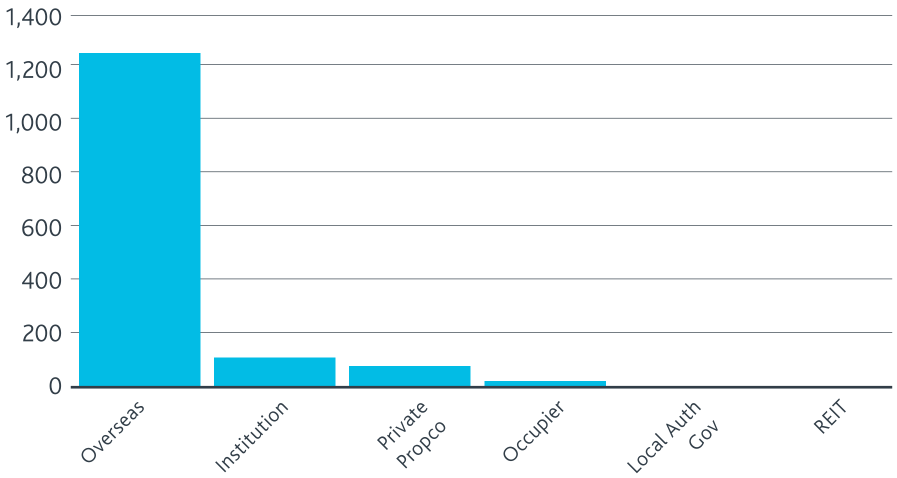
ALL FRINGE



CENTRAL LONDON IN DETAIL

ROLLING 12M DOMESTIC v OVERSEAS INVESTMENT (£mn)





INVESTOR TYPE

In the last 10-years, overseas investors have on average accounted for 67% of investment spending on Central London offices each quarter. In Q2 and Q3 total investment spending from all sources amounted to £1.45bn of which 86% or £1.24bn came from overseas investors.

Nine of the ten largest purchases in 2020 were made by overseas investors including Link REIT from Hong Kong that acquired 25 Cabot Square, E14 for £367.9m; and the Malaysian Employees Pension Fund that acquired Premier Place, EC2 for £322m. L&G were the largest UK investor with the purchase of 14-26 Great Smith Street, SW1 for £300m.

CAPITAL VALUES

Capital values in the core Central London markets have deceased by 3% in the 9 months to the end of September 2020 driven by a decline in rental values of 1% and a softening of yields that contributed -2%. In the fringe markets capital values have decreased by 6% in Docklands and 4% in the City Fringe.

YIELDS (%)

YIELDS (%)	Q3 2020	Q2 2020	Q3 2019
City	4.10	4.10	4.10
West End	3.75-4.00	3.75-4.00	3.75-4.00
Midtown	4.75-5.00	4.75-5.00	4.75-5.00
Southbank	4.25-4.50	4.25-4.50	4.25-4.50
City Fringe	4.75-5.00	4.75-5.00	4.75-5.00
Docklands	4.75	4.75	4.75

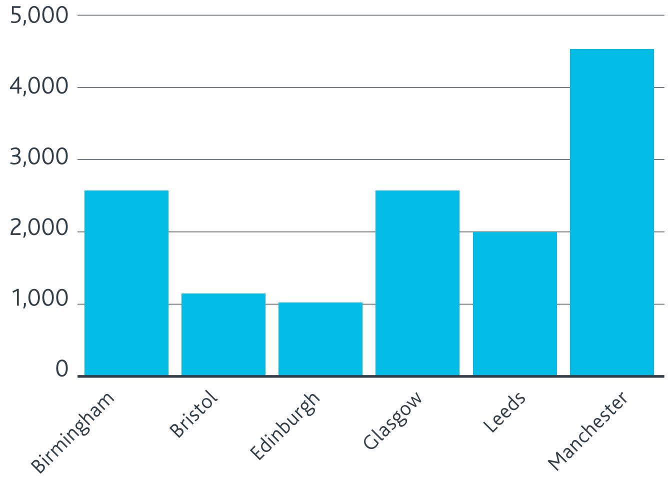
Source: Cluttons

REST OF UK IN BRIEF

Q3 AVAILABILITY

REST OF UK – KEY OCCUPATIONAL MARKETS

Q3 AVAILABILITY	000 FT²
Birmingham	2,510
Bristol	1,211
Edinburgh	987
Glasgow	2,495
Leeds	1,911
Manchester	4,366



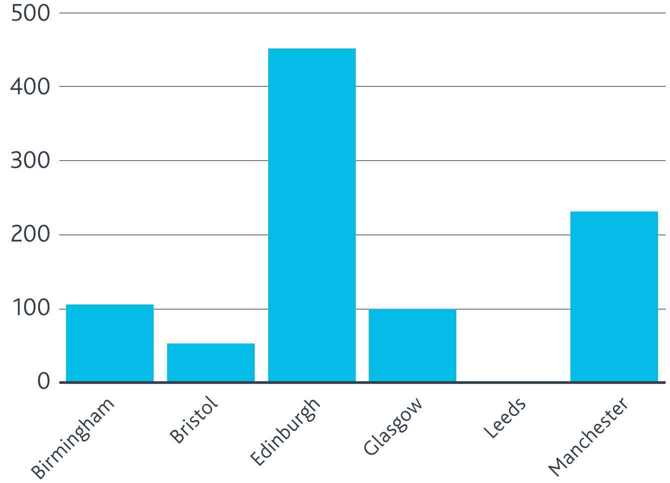
REST OF UK AVAILABILITY AND TAKE-UP

Q3 availability increased by 5% to 13.5m sq.ft. from 12.8m sq.ft. in Q2. In the 12 months to the end of September availability has increased by 12%.

Q3 take-up increased by 76% to 1.0m sq.ft. from 577k sq.ft. in Q2. In the 12 months to the end of September take-up amounted to 4.4m sq.ft. and has decreased by 28% from 6.1m sq.ft. let in the year to September 2019.

Q3 TAKE-UP

Q3 TAKE-UP	000 FT²
Birmingham	112
Bristol	47
Edinburgh	453
Glasgow	97
Leeds	67
Manchester	238



KEY TRANSACTIONS Q3

BUILDING	SIZE	TENANT	RENT
Haymarket Edinburgh	280,000	Ballie Gilford	n/a
310 St Vincent St Glasgow	28,400	Westcot Credit Services	£25.00
City Sq Leeds	22,200	Knights	£34.00

REST OF UK IN BRIEF

REST OF UK INVESTMENT

Q3 investment transactions decreased by 2% to £91m from £93m in Q2. In the 12 months to the end of September investment amounted to £650m and has decreased 57% from £1.5bn in the year to September 2019.

REST OF UK – KEY INVESTMENT MARKETS

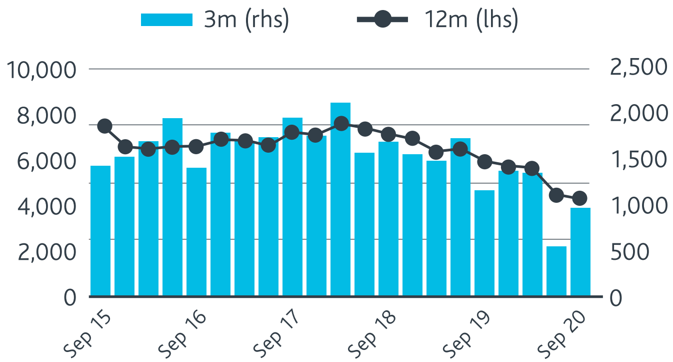
Q3 INVESTMENT	£MN
Birmingham	5
Bristol	–
Edinburgh	–
Glasgow	40
Leeds	–
Manchester	46

KEY TRANSACTIONS Q3

BUILDING	PRICE	PURCHASER	YIELD
Bromielaw, Glasgow	£40mn	Elite Prtnrs	n/a
Deansgate, Manchester	£25mn	Catella APAM	6.25%
Brown Street, Manchester	£21.5mn	CBRE Global Inv	6.00%
Harborne Road, Birmingham	£4.8mn	Merica	n/a

REST OF UK IN DETAIL

REST OF UK OFFICE TAKE-UP ('000 SQ.FT.)



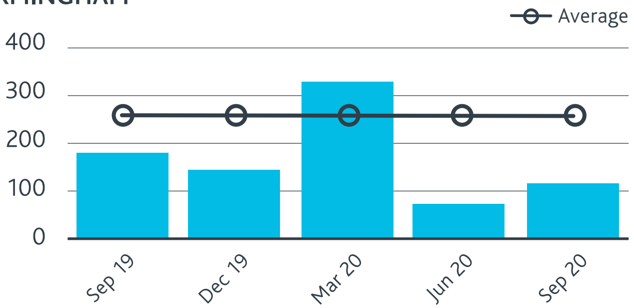
REST OF UK TAKE-UP AND RENTS

As in the Central London markets, take-up in the regional office markets in Q2 and Q3 represents a substantial decrease on the quarterly average rate of take-up over the last 10-years. The solitary exception being Edinburgh where 453k sq.ft. was let in Q3 compared to 10-year quarterly average take-up of 167k sq.ft.

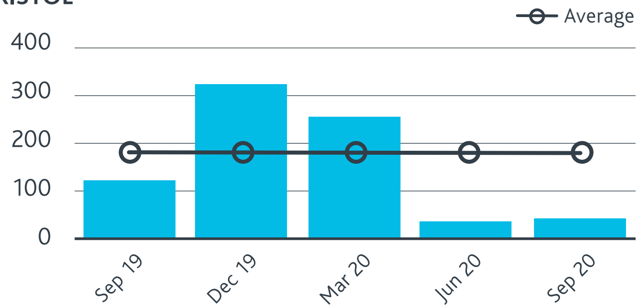
Across all six key regional markets Q3 take-up was up 76% compared to Q2, supported by the Edinburgh numbers but the rolling 12 month total has decreased by 4% from the total achieved in the 12 months to last June and by 28% from take-up in the 12 months to September 2019.

Market rental values in the regional office markets have also reacted slowly to the pandemic recession. Across all centres rental values have deceased by just 0.4% in the 9 months to the end of September 2020. But this average masks variations in rental growth between increases of 1.0% in Birmingham and 2.3% in Bristol; and decreases of 1.0% in Manchester and 0.7% in Edinburgh.

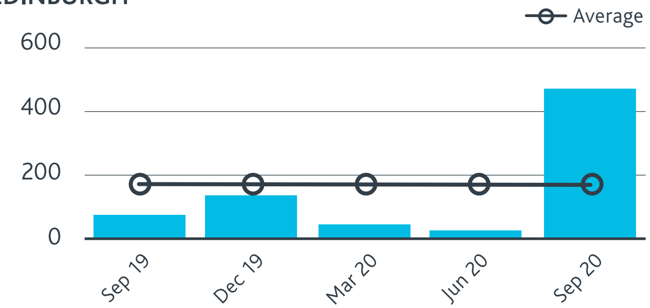
BIRMINGHAM



BRISTOL



EDINBURGH



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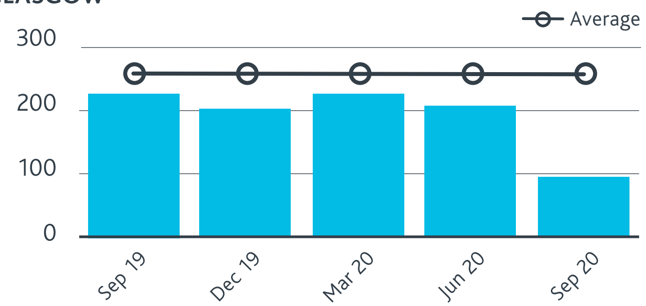
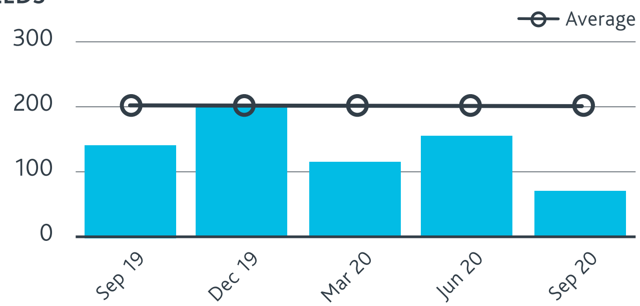
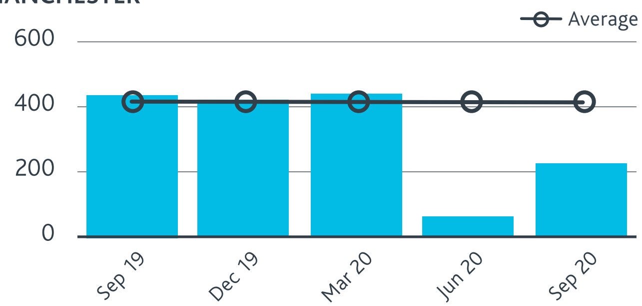


LEEDS



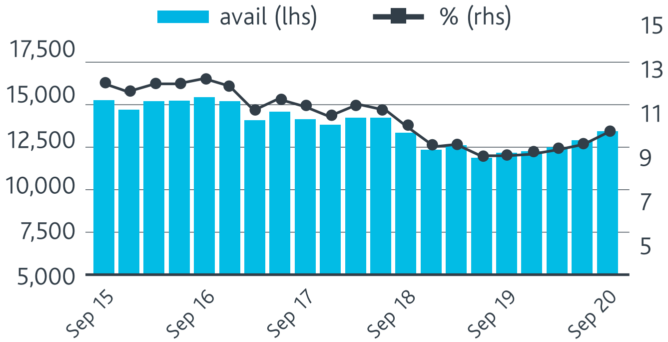
MANCHESTER



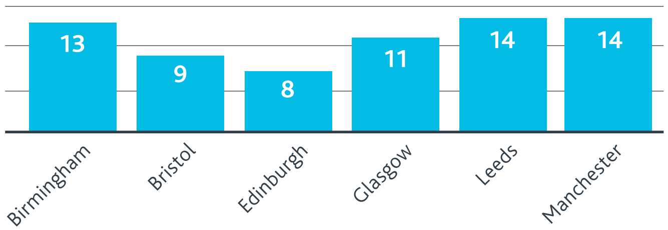
REST OF UK IN DETAIL

REST OF UK OFFICE AVAILABILITY AND DEVELOPMENT ('000)

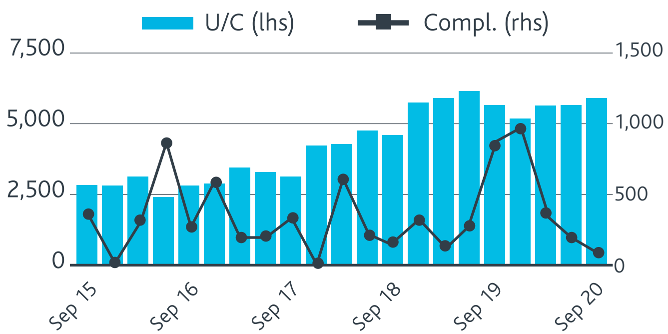
AVAILABILITY



AVAILABILITY RATE (%)



DEVELOPMENTS ('000)



REST OF UK AVAILABILITY AND CONSTRUCTION

Regional office availability had been on a declining trend since the end of 2014. However, in Q3 availability increased across every regional market with the exception of Leeds where availability decreased by 2% from 1.94m sq.ft. to 1.91m sq.ft.

In the 12 months since September 2019 regional office availability has increased by 12%. Edinburgh office availability has increased by 47% to 987k sq.ft. from 672k sq.ft. And availability in Leeds has increased by 54% to 1.9m sq.ft. from 1.2m sq.ft. in September 2019.

Across all the regional markets the availability rate continued to rise after the GFC and peaked at 18% in 2014 possibly reflecting the stagnation caused in regional economies by "austerity". By the end of 2019 the availability rate had declined to 10.7% compared to its long-run average of 13.6%. However, since the start of the year the availability has edged back up to 11.8%. Birmingham, Glasgow, Leeds and Manchester all have double digit availability rates. The availability rate in Bristol is 9% and Edinburgh 8%.

Regional office development completions in the 9 months to September have amounted to 588k sq.ft. in 7 buildings. Manchester was home to four of these including Landmark, St. Peter's Square where 90% of the 182k sq.ft. building remains available; and 100 Embankment comprising 166k sq.ft. which remains vacant.

Other substantial regional office completions in 2020 have included The Majestic, a former night club in City Square, Leeds where 75% of 68k sq.ft. is let to occupiers including Channel 4; and the Unite Building, Jennens Road, Birmingham where 55k sq.ft. has been fully let.

There is a further 5.74m sq.ft. under construction in 35 buildings representing a substantial 91% increase on the long run average size of the development pipeline amounting to 3.0m sq.ft. However, at least 70% of this space has been pre-let.

Barclays 470k sq.ft. campus at Clyde Place, Glasgow is fully let; and of 313k sq.ft. being developed at 177 Bothwell Street, Glasgow only 76k sq.ft. is available. In Manchester, Manchester Goods Yard at 23 Quay Street comprising 283k sq.ft. is fully let; and Building 1, Circle Square has 124k sq.ft. available out of a total of 283k sq.ft.

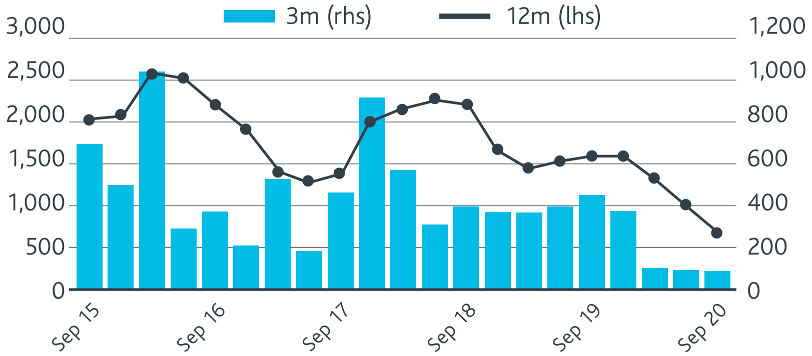
AVERAGE RENT ACHIEVED (£psf)

RENT (£psf)	Q3 2020	Q2 2020	Q3 2019
Birmingham	22.00	22.00	21.00
Bristol	25.00	24.50	24.00
Edinburgh	22.50	23.00	20.00
Glasgow	17.50	22.00	21.00
Leeds	23.00	23.50	21.50
Manchester	23.50	23.50	21.50

Source: CoStar

REST OF UK IN DETAIL

REST OF UK INVESTMENT (£mn)

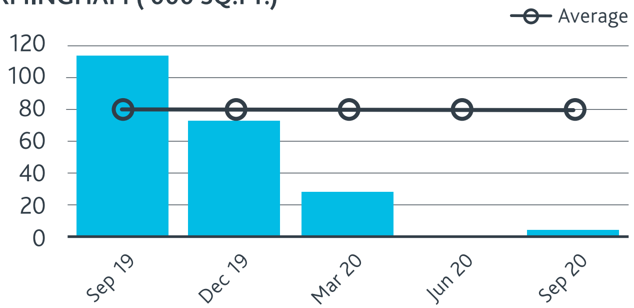


INVESTMENT VOLUMES

Investment in the six regional office markets decreased by just 2% from £93m in Q2 to £91m in Q3. However, average investment volumes in the regional office markets during Q2 and Q3 of £92m represent a substantial 73% decrease on the quarterly average rate of investment over the last 10-years of £342m.

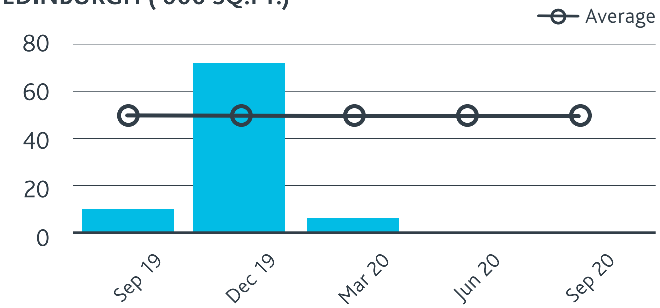
There have only been 11 transactions above £10m in the nine months to September. Key transactions include Tesco Pension Fund's £70m purchase of Finzels Reach, Bristol; and CBRE Global Investors £21.5m purchase of 30 Brown Street, Manchester.

BIRMINGHAM ('000 SQ.FT.)

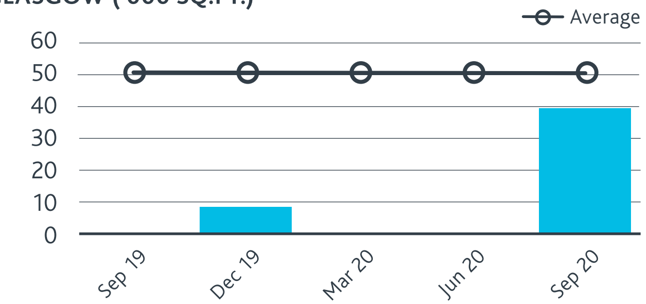


BRISTOL ('000 SQ.FT.)

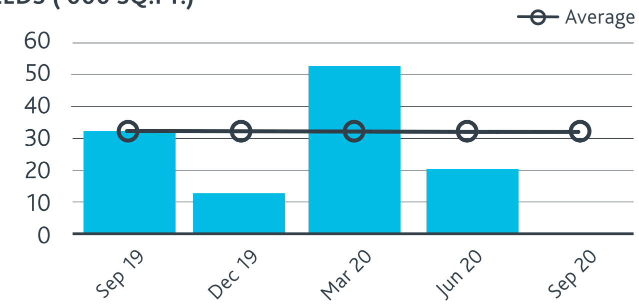
EDINBURGH ('000 SQ.FT.)



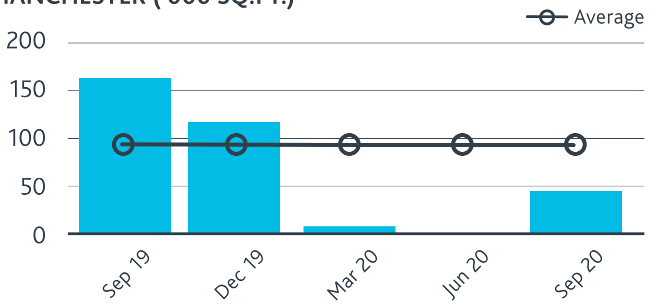
GLASGOW ('000 SQ.FT.)



LEEDS ('000 SQ.FT.)



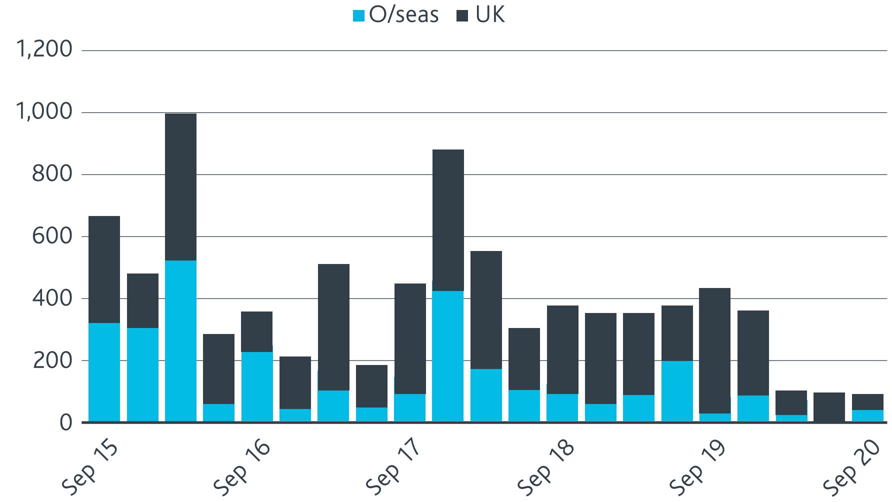
MANCHESTER ('000 SQ.FT.)

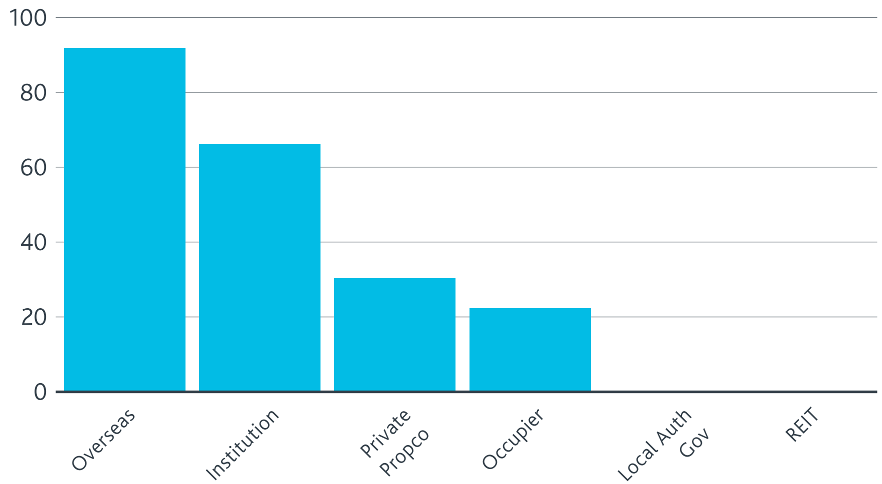


CLUTTONS

REST OF UK IN DETAIL

ROLLING 12m DOMESTIC v OVERSEAS INVESTMENT (£mn)





INVESTOR TYPE

In the last 10-years, overseas investors have on average accounted for 36% of investment spending in the six regional office markets each quarter. In Q2 and Q3 total investment spending from all sources amounted to £184m of which 22% or £40m came from overseas investors.

Only two of the eleven £10m plus transactions were made by Overseas investors. These were Elite Partners Capital £40m acquisition of 150 Broomielaw, Glasgow; and the purchase of 3-4 The Embankment, Leeds by UKRO from Hong Kong for £20.5m.

CAPITAL VALUES

Capital values in the regional office markets have deceased by 3.4% in the 9months to the end of September 2020 driven by a decline in rental values of just 0.4% and a softening of yields that contributed -3%. Capital values have decreased by 6% in Manchester and 4% in Glasgow and Birmingham. In Leeds office capital values have remained stable so far.

YIELDS (%)

YIELDS (%)	Q3 2020	Q2 2020	Q3 2019
Birmingham	6.75	6.75	6.75
Bristol	6.00	6.00	6.00
Edinburgh	6.25	6.25	6.25
Glasgow	7.25	7.25	7.50
Leeds	6.75	6.75	7.00
Manchester	5.75	5.75	6.00

Source: CoStar

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