Watermark, EC4

- **Supply decreases by 7.3% during Q3 2009, following a wave of transactional activity**
- **City vacancy rate reduces to 12.3%**
- **Quarterly take-up totals 128,600m², – the level is twice that of quarters 1 and 2 combined**
- **Prime City rents reduce to £457.50m² (£42.50ft²)**
- **Investment activity for Q3 2009 totals £2.3 billion**
- **Prime yields harden further to 6.25% - 6.50%**

City Contacts:
7 Princes Street, London EC2R 8AQ T: +44 (0)20 7796 5454

Research
Deborah Hayward deborah.hayward@kingsturge.com

Agency
Mark Bourne mark.bourne@kingsturge.com

Investment
James Beckham james.beckham@kingsturge.com

Lease Consultancy
Peter Joslin peter.joslin@kingsturge.com

Building Consultancy
Norman Hale norman.hale@kingsturge.com

A game of two halves

2009 has proven to be very much a game of two halves for the City office market. As the economy entered recession in January and the financial and business services sectors continued to make redundancies, any light at the end of the tunnel for this financial powerhouse seemed a very long way away. By the end of the year however the market seems as busy as ever.

The downturn which started in the financial sector caused an extreme change in fortune for the City of London office market, as occupiers switched off property requirements and made redundancies.

Consequently the supply of available space increased rapidly from 325,500m² (3.5 million ft²) to 882,500m² (9.5 million ft²) or the equivalent of 19 vacant Gherkins (30 St Mary Axe, EC3) as developers were left with the burden of empty space and negative rental growth, with rents falling from £699m² (£65.00ft²) to the low £457.50m² (£40.00's ft²).

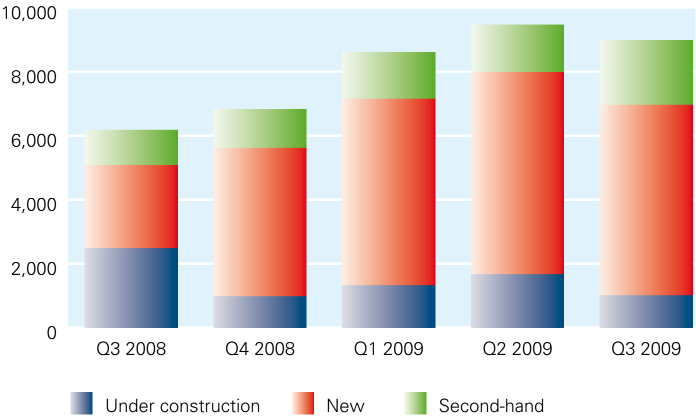
During the second half of the year however the market has seen a shift in sentiment as improving business confidence has started to percolate through to the City office market, with a number of major financial tenants reassessing their longer term property strategies.

Financial occupiers represent 48% of demand for City offices in 2009 to date, compared to just 26% during the same period of 2008.

These improving levels of demand, coupled with a very limited development pipeline beyond 2010 and a recent correction in supply, indicate that we have reached this cycle's nadir. If these trends continue throughout 2010, the negotiating boot will be transferred back towards the landlords, which could kick-start a whole new ball game.

Supply

Availability (000m²)



Supply turns a corner

Following a wave of transactional activity during the last 3 months the City office market experienced its first reduction (-7.3%) in supply for almost 2 years.

Consequently the amount of available space in the City office market now totals 834,600m² (8.9 million ft²) amongst 331 units.

Nevertheless this level of supply remains above average and is the equivalent to 2.2 years worth of long-term average take-up (1987-2008).

Vacancy 12.3%

This level of supply equates to a vacancy rate of 12.3% - with the City vacancy rate reaching a peak of 13.3% in the previous quarter – still somewhat lower than previous market downturns (2004: 16% and 1992: 18%).

Supply composition

Today's supply continues to be dominated by the delivery of new schemes via the development pipeline with prime space (that which is either newly constructed or refurbished) now representing 77% of total supply.

Whilst availability of prime space has not been at these levels since the mid-1990s, the recent improvement in confidence combined with competitive rents has encouraged a number of occupiers to reactivate requirements and a proportion of this prime surplus is starting to be eroded.

Tenant sub-letting

Recession driven tenant sub-letting remains under control with an improving business landscape and sentiment emerging.

Looking further ahead, we maintain that the proportion of Second-hand space will begin to escalate and potentially dominate supply later in the current cycle.

This will be initiated by the recent acquisition of prime space owing to lower rental levels leading to the market being inundated with the release of tenant space as they trade up.

Key availables (end Q3 2009)

- The Walbrook, EC4 37,393m² (402,504ft²) under construction, and due to complete Q4 2009
- Ropemaker Place, EC2 32,515m² (350,000ft²) new build completed Q2 2009.

Levels of development down 40%

Developers continue to manage the development pipeline and limit exposure.

There is currently 194,500m² (2 million ft²) of speculative space under construction to be delivered in the course of the next 12 months, with 79,300m² (853,500ft²) yet to be included within our supply numbers.

Based on an average delivery of c. 185,800m² (2 million ft²) speculative completion per annum predicted levels of development activity are 40% lower than the norm in 2010 and again in 2011 with a development gap emerging in 2012 – where no major schemes are planned.

Completions

Four schemes totalling 17,700m² (190,800ft²) completed during Q3 2009.

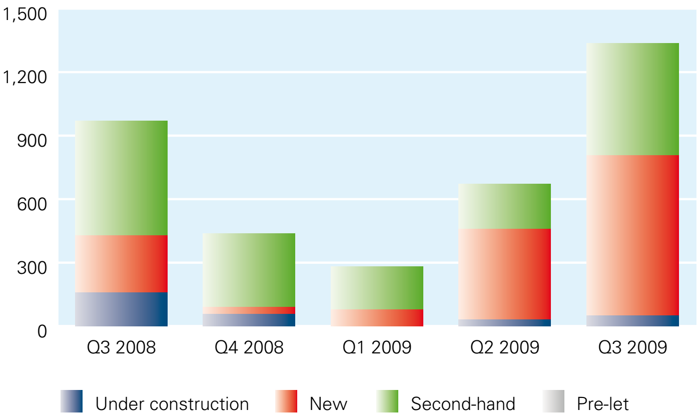
This included 1 Lothbury, EC2 (10,735m²/ 115,552ft²) where Bank of China has now purchased the 150-year leasehold interest from the Roche family for its own occupation. The freehold is owned by the Bank of England.

City availability

000m²	Q2 2009	Q3 2009	Year ago
New / Refurbished	594.8	552.5	241.7
Second-hand	150.8	188.4	102.7
Available U/C	154.2	93.4	229.4
Planning permission	93.6	32.5	40.3
Completions	132.9	18.6	56.2

Demand

Take-up (000m²)



Take-up rallies

Letting activity in Q3 2009 totalled 128,600m² (1.3 million ft²) which reflects a 90% increase on the previous quarter and is more than double the amount of space transacted during the first two quarters combined.

The signature deal of the quarter was Nomura at Watermark, EC4 where the Japanese Investment Bank acquired 50,300m² (541,000ft²). Nomura, who took over Lehman's London operations last year, will become one of London's largest occupiers with almost 92,902m² (1 million ft²) across two City buildings. Nomura however, are not the only major occupiers looking for a piece of the action, with another 278,700m² (3 million ft²) of requirements looking to be satisfied.

Media giants Bloomberg were also linked Watermark to satisfy their 37,200m² (400,000ft²) requirement. The Nomura transaction has been the catalyst for improvement across the market with a number of significant occupiers now acquiring space or placing space under offer.

Lawyers Pinsent Masons' placed the entirety of 30 Crown Place, EC2 16,882m² (181,718ft²) under offer, consolidating its two London offices. Investment manager Blackrock and financial services company Macquarie went head to head competing for space at the Drapers Garden scheme, EC2, with Macquarie finally placing 21,367m² (230,000ft²) under offer as of the end of October.

In fact out of the 20 or so major schemes which have recently completed or are set to complete during 2010 only one building, The Walbrook, 40,876m² (440,000ft²) remains available in its entirety.

This domino effect continues with US law firm Stephenson Harwood placing 10,219m² (110,000ft²) at 150 Cheapside, EC2 under offer, thus forcing Majedie Investments and TLT Solicitors, who were under offer here to look elsewhere.

Occupiers sensing tentative improvements to the economy have reactivated requirements hoping to capitalise on the suppressed rental market. In fact, the City office market saw more than 111,500m² (1.2 million ft²) of leasing activity during Q3 2009 – the level is twice that of Q1 and Q2 combined and with a further 92,900m ² (1 million ft²) under offer 2009 looks set to be better than expected.

Looking beyond 2009 there remains over 278,700m² (3 million ft²) of live (active) requirements in the City today and a further 271,600m² (4 million ft²) of potential requirements looking to be satisfied, City office demand looks to be in the healthiest shape for at least 2 years. Over 100 companies are currently looking to either relocate or expand within the City from a variety of business sectors.

Key transactions (Q3 2009)

- Orrick Herrington & Sutcliffe acquired 3,972m² (42,752ft²) of New space at 107 Cheapside, EC2
- News International acquired 17,344m² (186,696ft²) of second-hand grade A space at Trinity Tower, Thomas More Square, E1,
- In the largest deal since 2007 Nomura acquired 50,260m² (541,000ft²) at Watermark Place, EC4

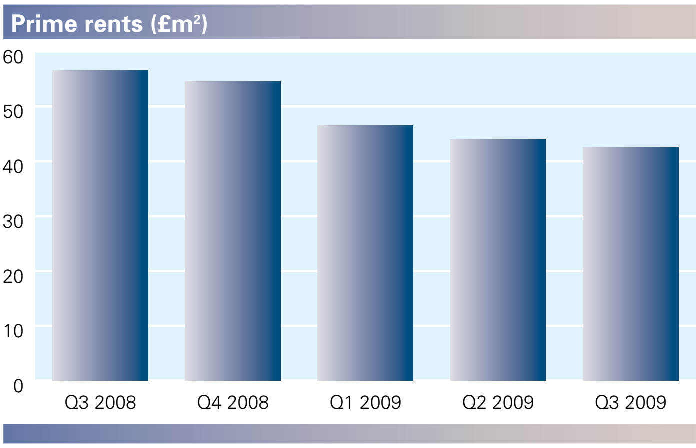
Under offer

- The level of space placed under offer increased by 20% during Q3 2009 to 111,000m² (1.1 million²). This includes:
- Macquarie Bank at Drapers Gardens, EC2 16,722m² (180,000ft²)
- Pinsent Masons at Crown Place, EC2 16,882m² (181,718ft²)

City take-up

000m²	Q2 2009	Q3 2009	Year ago
New / Refurbished	39.8	25.0	24.9
Second-hand	19.6	48.6	50.4
Under construction	2.8	54.9	14.8
Pre-let	0.0	0.0	0.0
Under offer	74.3	111	54.8

Rents



Rents bottom out

Prime rents reduced by a further 3.2% during Q3 2009 to £457.50m² (£42.50ft²) with tenants still able to achieve incentives in the region of 33-36 months rent free on a 10-year lease.

However, with improving levels of demand and very limited pipeline for 2010 and 2011 we consider Q3 2009 to be the lowest point in this cycle for prime rents. Secondary rents will remain under pressure throughout 2010.

Net rents

Based on these incentives, prime net rents have reduced to £304.00m² (£28.25ft²), this represents a 52% fall from the peak (of 2007).

This clearly demonstrates the inherent value for tenants in this market and the willingness of landlords to maintain asset values and avoid empty rate voids.

Looking ahead

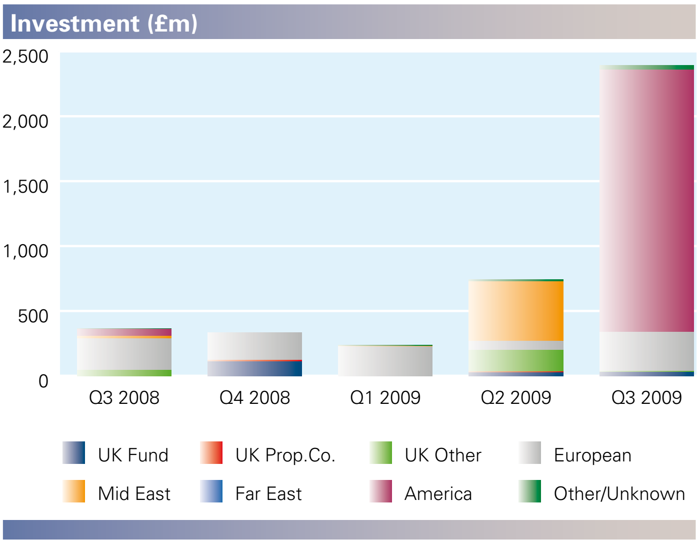
However incentives are set to harden and rents are likely to improve over the next six months as tenants face competition for the best space.

We anticipate landlords will start holding out for higher rents, as evidenced at the Walbrook, EC4, where Minerva are thought to be holding out for a rents above £538.00m² (£50.00ft²), knowing they have a fairly unique product in terms of size in the current market.

Rental value growth (RVG – IPD monthly data)

IPD monthly data for September 2009 shows RVG for City offices over Q3 2009 to be -3.6%. Over the last nine months (Q1-Q3) RVG was -16.7%. This equates to annualised figure of -21.6%.

Investment



Investment activity improves

On the face of it City investment levels are improving: Q3 2009 activity more than tripled to £2.3 billion, with the total for 2009 to date being £3.3 billion - a 55% increase on a year ago.

Blackstone's purchase of a 50% stake in Broadgate somewhat distorts this total however. Blackstone paid £77 million for the 50% stake in Broadgate, one of London's biggest office landmarks, but it will also take on £1.97 billion of securitised debt. Removing such "mega" deals the market is rolling along at c. £350 million per quarter.

Prime yields, which were at 7.00% Q1 2009, are now circa 6.25% - 6.50%.

The City investment market is more international than ever with overseas investors representing a 93% market share. These include investors from: USA, Spain, Germany (less so than at the start of the year), Russia, India, the Far East and the Middle East, the list goes on.

Values are now rising because of a lack of suitable stock (strong covenants, 10-15 year leases) is highly limited. Frustrated demand is beginning to cascade down to 7-8 years income and yields to harden further over the next 12 months.

The City office market continues to present a compelling opportunity for long-term investors seeking value amongst prime assets.

Prime yields remain above average (at 6.25% in Q3 2009 against a long-term average of 5.8%) and prime rents remain below average – although not as low for as long as we first thought (Q3 2009 £42.50ft² - average £49.50ft²) presenting a sensible buying rationale but only if you can source the right product.