OUR MARKET

The central London office market, where 97% of Derwent London's portfolio is located, plays a key role in the success of the capital by providing a home to a wide range of national and international companies.

London's economy is predominantly service-based and accounts for approximately 20% of national output. It remained resilient in 2012 despite the weakness in the UK economy as a whole. In central London, Derwent London's core market, office take-up was lower than average but the supply of space was constrained, thereby keeping vacancy rates below trend and providing the conditions for further rental growth. In addition London continued to be seen by investors as offering an attractive investment destination. Transaction volumes were at their highest level for five years, according to leading surveyors, CBRE.

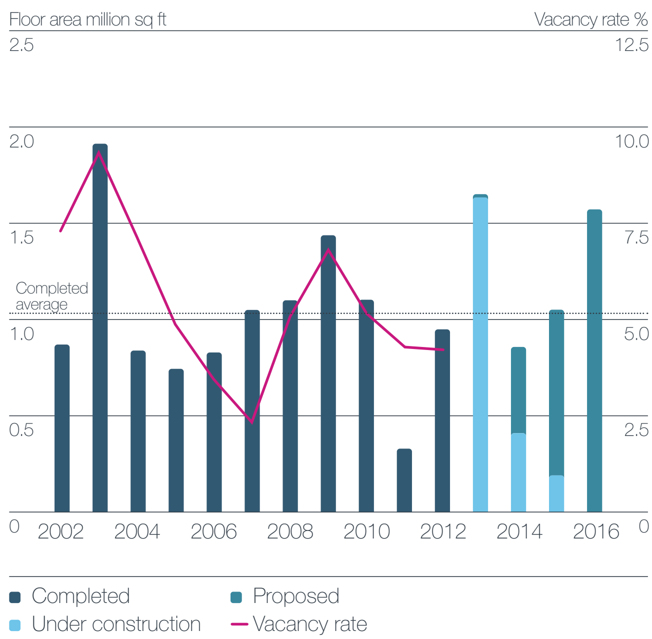
Economic backdrop
The lack of growth in the UK economy, with continued austerity measures and uncertainties within the Eurozone, provided the main economic backdrop to 2012. UK GDP was flat over 2012, compared with a rise of 0.9% in 2011. The UK base rate remained unchanged at 0.5%, whilst total employment reached an all-time high, rising 1.6% over the year and CPI inflation fell from 4.2% to 2.7%. London's economy proved more resilient than that of the country as a whole with its GDP growing 0.3% over the year, according to Oxford Economics.

Looking forward, the outlook for UK growth remains subdued. The Bank of England forecasts that the economy is likely to see a gradual recovery over the next three years with GDP growth of around 1% predicted for 2013, well below its historical average. In London the economy is expected to continue to outperform the country as a whole, notwithstanding some of the enduring banking issues, with GDP growth of 1.3% forecast for 2013 and 2.5% for 2014.

Central London office occupier market
The central London office market, where 97% of Derwent London's portfolio is located, plays a key role in the success of the capital by providing a home to a wide range of national and international companies. At the year end, the capital's office stock totalled approximately 221 million sq ft (20.5 million m²) – 49% located in the City, 42% in the West End and 9% in Docklands.

CBRE reported that central London office take-up in 2012 totalled 9.8 million sq ft (0.91 million m²), 7% lower than the previous year and 17% below the 10-year average. In the West End take-up was 16% below the average at 3.5 million sq ft (0.33 million m²) with the TMT sector comprising 23% of transactions. During 2012, West End active demand increased 15% with the TMT sector accounting for over 50% of year end requirements, suggesting that the low take-up at least in part reflects the low level of completions. Overall City activity was 12% below the 10-year average at 4.1 million sq ft (0.38 million m²).

West End office development pipeline



Source: CBRE

On the delivery side, West End development completions were fractionally below the 10-year average at 0.95 million sq ft (88,300m²) whilst City completions were just 0.51 million sq ft (47,400m²), 73% below the 10-year average. These relatively low levels of supply helped moderate the central London vacancy rate which was 5.3% at the year end. The West End vacancy rate declined slightly from 4.3% to 4.2% whilst the City rate decreased from 7.0% to 6.8% over the same period. With supply for both locations still below 10-year averages, the CBRE prime rent index showed further rental uplift with growth of 3.7% in the West End and 0.8% in the City over the year.

The level of West End completions is expected to rise considerably during 2013, but we expect that this space will be absorbed by the market, given current levels of demand and the level of pre-lets already agreed on these properties.

Central London office investment market

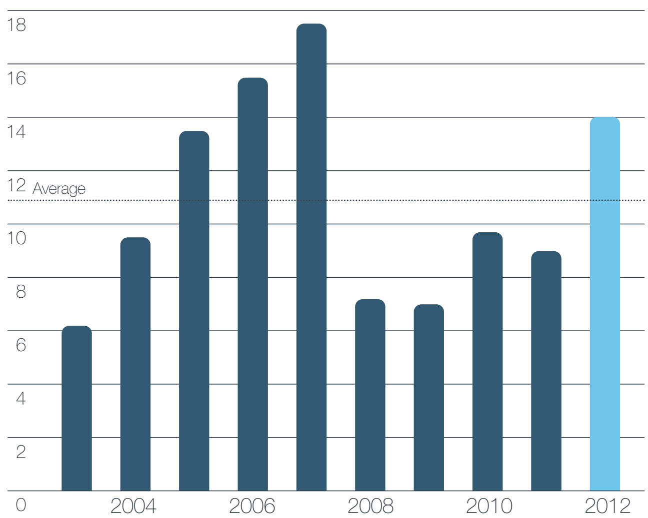
According to CBRE, central London office investment transactions totalled £14.0bn in 2012, 55% greater than 2011 and 28% above the 10-year average. London's status as an international safe haven persisted with the property market offering both rental growth and liquidity. Overseas investors accounted for 67% of acquisitions.

Prime yields were static throughout the year at 4.0% in the West End and 5.0% in the City.

The progress in the Crossrail project gained visibility during 2012. There was a flurry of acquisition and development activity around future Crossrail hubs such as Tottenham Court Road and Farringdon stations, where we have a large concentration of our portfolio, whilst Shoreditch, with its new High Street station, benefited from the completion of the London Overground orbital.

We note with interest the Government's plans to include conversion of offices to residential units within permitted development rights for three years, but do not believe that this will have a significant impact on our business.

Central London office investment transactions £bn



Source: CBRE