RESEARCH

Knight Frank

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPIER MARKETS **Q2 2017**

EXECUTIVE SUMMARY

Occupier demand holding firm despite political turbulence

Despite disruption from the political arena, office take-up in the South East reached 797,900 sq ft in Q2 2017, 4% short of the 10-year quarterly average of 830,000 sq ft. The steady level of leasing activity meant that total take-up for the year increased to 1.6m sq ft, 4% above the 10-year average for an H1 period. Encouragingly, six of the ten largest requirements under offer immediately before the UK general election have now exchanged, with the remainder all still active.

The South East remains a target for TMT firms.

The Technology, Media and Telecoms (TMT) sector was the most active business group in Q2, representing 30% of take-up. TMT occupiers now account for 25% of total space let in 2017, an equal percentage to the much larger Financial and Business Services sector. Significantly, the amount of space secured by TMT occupiers in H1 2017 is equal to that recorded at mid-year 2016. This demonstrates both the continuing appeal of the Thames Valley and M25 region to this business sector and its resilience to wider market disruption.

Development completions pushing up availability

With the development pipeline set to peak in 2017, availability remained on an upward trajectory in Q2. A further 510,000 sq ft of speculative space across six schemes reached practical completion in Q2. This meant that the rolling annual completions total for the South East increased to 2.4m sq ft, the highest level since 2006. Notably, four schemes totalling 350,000 sq ft completed in the M4 corridor where availability breached the 6m sq ft mark as a result. Although this represents the highest level for 3 years, the Q2 total is still 3% below the 10-year average for the M4.

Lack of opportunity hampers investment activity

Investment volumes for the South East reached £433m during Q2 2017, 20% less than in recorded in the first quarter. Despite the fall, investment sales at the mid-year point were £973m, 7.4% above the long-term average for the period. Interestingly, 49 deals have completed in 2017, almost double the amount recorded during the equivalent period in 2016. Average lot size in 2017 is lower however, with no sales above £100m completing so far this year. Tellingly, this position is demonstrative of the current lack of opportunity at the upper end of the market rather than low investor appetite, with the weight of capital seeking deployment remaining significant.

Prime yields hold firm in Q2

Prime office yields remained at 5.25% in Q2 for the fifth consecutive quarter. At this level, prime yields are 50 basis points above the market peak of 4.75% recorded in 2007. With investor appetite for prime products remaining at a high level, aggressive bidding will continue to be a factor of the market in the short term, especially given the lack of choice for would-be buyers. As such, yields remain under pressure and could tighten to 5.00% in the coming months.

*The South East is defined in the technical note on the back cover

OCCUPIER MARKET

Take-up in the South East has remained above the 10-year average in 2017 despite the changing political and economic climate. Development completions are at a 10-year high, with vacancy levels edging upward as a result.

SOUTH EAST TAKE-UP

797,900 sq ft

▲4%

TAKE-UP (SQ FT)

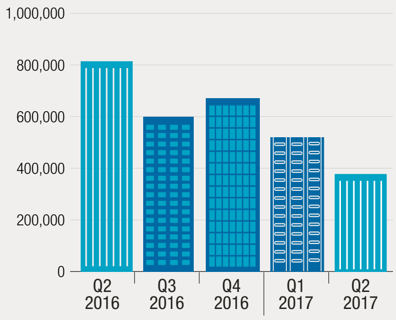
	Take-up	Change	New and Grade A space
M25	376,100	▼27%	83%
M3	214,400	▲61%	85%
M4	451,800	▲27%	97%

SUPPLY (SQ FT)

	Supply	Change	New and Grade A space	Vacancy rate**	
M25	7.4m	▲1.0%	81%	6.1%	5.0%
M3	2.5m	▼6.0%	78%	6.3%	5.0%
M4	6.1m	▲4.0%	91%	9.2%	8.3%

*Arrows reflect quarter-on-quarter change. ** Number in blue shows vacancy rate across all grades. Number in grey denotes vacancy rate for new and grade A office space.

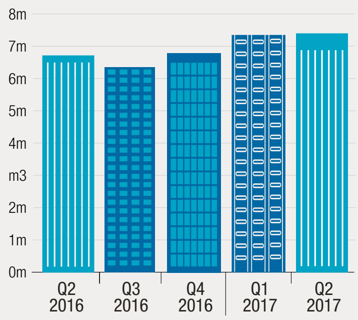
FIGURE 1
M25 Take-up (sq ft)



0.5m UNDER OFFER IN THE SOUTH EAST IN Q2 2017

EMMA GOODFORD
Although the UK general election raised uncertainty, it is reassuring that six out of the ten largest requirements under offer prior to the vote, have now exchanged. With the remaining four still live and active demand over 5m sq ft, this is a clear demonstration of continued occupier confidence.

FIGURE 2
M25 Supply (sq ft)



19% BELOW THE 10-YR AVERAGE IN Q2 2017

RODDY ABRAM
The benefits of clustering continue to draw TMT firms into the South East. Notably, the tech umbrella is now broadening with organisations whose principal business is not within the technology realm taking office space to support a growing digital representation.

Key leasing transactions Q2 2017

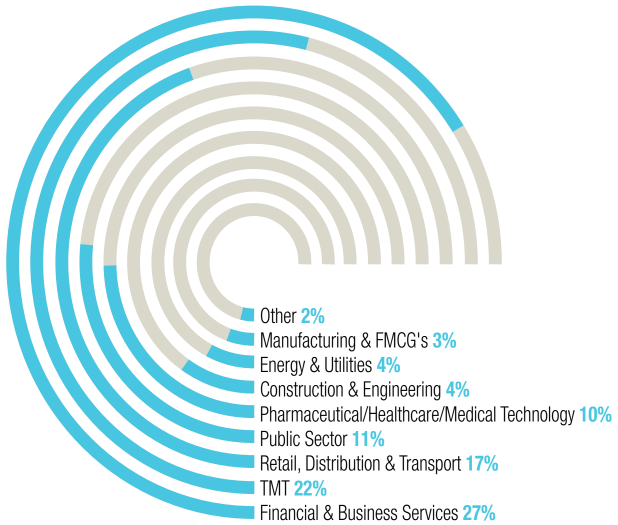
ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
The Florence Building, Basingstoke	60,546	The AA	£25.00
Westside One, Hemel Hempstead	42,860	Grass Roots	£25.50
9 Greyfriars Road, Reading	41,381	Spaces (Regus)	£32.50
Garden House, Hammersmith	38,860	Royal College Of Arts	£47.00
1 New Square, Bedfont Lakes, Heathrow	36,549	Birds Eye	£25.30

Source for all charts: Knight Frank Research

DEMAND

5.3msq ft
OF ACTIVE NAMED DEMAND IN THE SOUTH EAST

Active named demand



DEVELOPMENT

2.7msq ft
SPACE UNDER CONSTRUCTION IN THE SOUTH EAST

*This includes pre-let and speculative space

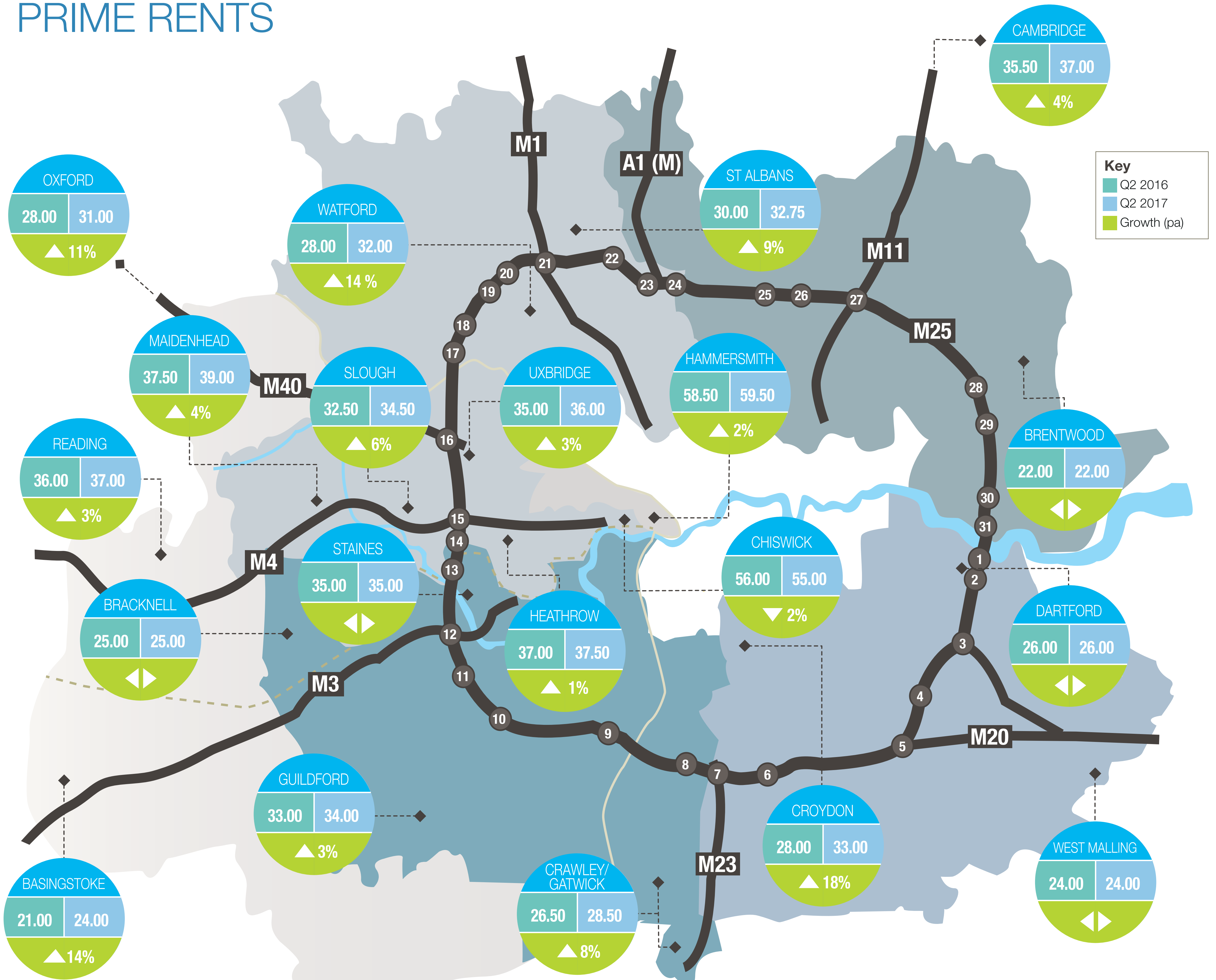
Speculative development (sq ft)

Due to complete before Q1 2019

M25	M3	M4
1.0m	0.6m	1.6m

Source for all charts: Knight Frank Research

PRIME RENTS



Rent assumes a new building let on a 10-year lease.

INVESTMENT MARKET

A shortage of stock continues to frustrate investors with investment volumes in Q2 the lowest since 2013. Pricing remains aggressive however, supported by the weight of capital targeting the South East.

▼20%

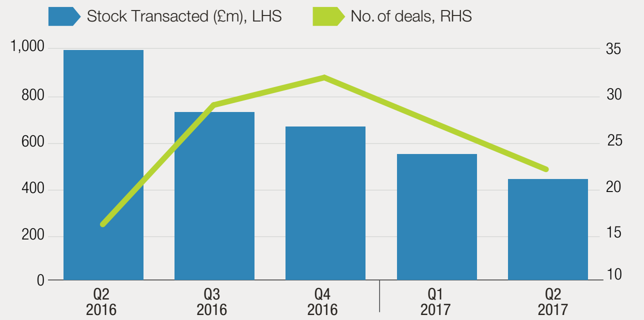
£433m
South East transaction volume

£20m
Mean lot size

5.25%
Prime net initial yield

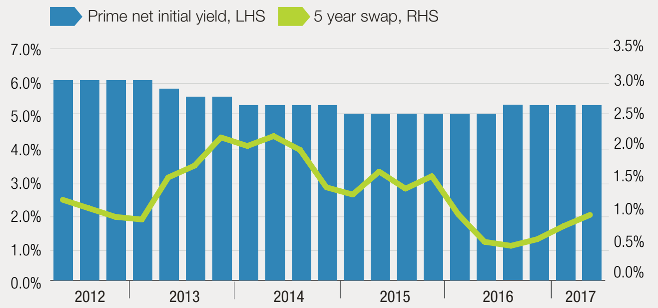
65%
Buyers from the UK

FIGURE 3
Investment volumes



TIM SMITHER
Q2 volumes slipped to their lowest levels for four years as vendors became reluctant sellers, principally due to a lack of investment opportunities for them to re-invest. This is particularly true at the prime end where a significant weight of capital continues to be frustrated by a lack of stock.

FIGURE 4
Prime net initial yield and finance



SIMON RICKARDS
We expect volumes to increase in the second half of the year, albeit second half volumes are likely to be at 'normal' market levels rather than anything exceptional. Most stock should sell if priced correctly, given the breadth of investor demand looking in the South East.

Key investment transactions Q2 2017

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
1 Queen Caroline Street, Hammersmith	£74.0m	5.65%	Brockton Capital	Tilad
Abbott House, Vanwall Business Park, Maidenhead	£35.4m	5.56%	AXA IM	Private Overseas
Lakeside House, Stockley Park	£25.9m	5.60%	Threadneedle	Tritax
Lucidus, Watford	£16.5m	6.20%	British Steel	M&G Real Estate
Hays House, Guildford	£9.9m	4.95%	Rockspring	Threadneedle

Source for all charts: Knight Frank Research

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TECHNICAL NOTE

- Knight Frank defines the M4 market as extending from Hammersmith, west to Newbury, incorporating Uxbridge and High Wycombe to the north and Staines and Bracknell to the south. Reading is also included. Existing built office stock in the M4 market totals 66m sq ft.
- The M3 market incorporates the main South West London boroughs and encompasses Leatherhead, Guildford and Basingstoke extending north to the M4 boundary described above. Farnborough and Camberley are also included. Existing built office stock in the M3 market totals 39m sq ft.
- The figures in this report relate to the availability of built, up-and-ready office/B1 accommodation within the M25 market. Vacant premises and leased space which is being actively marketed are included.
- All floorspace figures are given on a net internal area basis (as defined by the RICS).
- A minimum 10,000 sq ft (net) cut-off has been employed throughout. Major and minor refurbishment have been treated as new and second-hand respectively. Data is presented on a centre and quadrant basis. Classification by centre relates to the locational details contained within the marketing material for available properties. Classification in this manner is clearly somewhat arbitrary.
- Vacancy rate data is based on a total M25 stock measure of 121m sq ft (net), an M4 market stock of 66m sq ft (net) and an M3 market stock of 39m sq ft (net). Please note that a revision to total market office stock figures was applied in Q1 2017 to reflect 'change of use' permitted through the Town and Country Planning Order 2015 .
- Second-hand floorspace has been sub-divided into A and B grade accommodation, reflecting high and low quality respectively. Whilst subjective, this categorisation is based on an assessment of each property's age, specification, location and overall attractiveness.
- The South East is defined as the market area shown in the map on pages 4 & 5.
- Pre-let = The letting of proposed schemes not yet under construction and those let during the construction process.
- All data presented is correct as at June 30th 2017.

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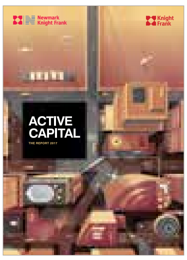

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