RESEARCH

Knight Frank

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPATIONAL MARKETS **Q2 2018**

EXECUTIVE SUMMARY

Transaction rate – the highest for 10-years

Office take-up in the South East reached 792,837 sq ft in Q2, 2% above the 10-year quarterly average. Consequently, take-up at the mid-point of the year increased to 1,537,365 sq ft, 10% above the 10-year mid-year average. The market feels, and is, much busier than the take-up statistics reflect however. The reason? With 122 transactions completed in the first six months of 2018, H1 2018 has proved to be the most active H1 period for a decade.

Smaller deals are the new norm

Although deal number is up, 2018 is yet to record a single transaction over 50,000 sq ft. At the H1 juncture, average deal size in the South East study area is down to just 12,600 sq ft. This is the lowest recorded. A review of space under offer points toward a continuation of this trend into the second half of the year. At the close of Q2, just below 1m sq ft was under offer. Of this total, just two requirements are above 50,000 sq ft.

Flexible offices – the strongest sub-sector in 2018?

Flexible office providers continued to 'step up' their efforts to bolster coverage of South East office markets in Q2, with this business group accounting for 20% of take-up. Considered over the first six months of 2018, this subsector now accounts for 15% of total take-up. Interestingly, the motivation for space acquisition is to support operational growth, with all leases taken in 2018 completed without an end user pre-commitment.

Vacancy at a peak?

Vacancy in all markets edged up slightly during Q2. The M25 and M3 markets moved up to 6.2% and 6.8%, but importantly, both remained below their respective 10-year averages. In contrast, the M4 moved up to 10.2%, 70 bps above the 10-year average of 9.5%.

Moving forward, the development pipeline is limited. At H1 2018, just 795,150 sq ft of speculative space was under construction across all markets. Notably, only 497,600 sq ft of this total is due for delivery within the next 12 months. Accordingly, vacancy levels will begin to recede with the M4 in particular, falling back in line with the 10-year average from early 2019.

Investors continue to target the South East

South East office investment volumes reached £544 million in Q2 2018, a total on-par with the 10-year quarterly average. This meant that at mid-year, investment into South East offices nudged passed the £1bn mark reaching £1.2bn by quarter end. Notably, this total is 27% ahead of H1 2017 and 26% above the 10-year average for an H1 period.

UK Councils remain active buyers

The continued activity of UK councils remains a significant feature of the South East market. The acquisition of four office assets totalling £162m by Runnymede Borough Council meant that councils represented 30% of the market in Q2. Considered over the first six months of 2018, council spending on South East offices has increased to £332m or 27% of the market. Notably, UK councils have been responsible for three of the nine transactions exceeding £50m in 2018.

Pricing stable, but under pressure

Prime yields remained at 5.00% in Q2, now unchanged for three years. Significantly, over the same period, pricing in several of the major UK regional cities has moved to sub 5%. This means that, with central London offices at 3.50% for the West End and 4.25% for the city, South East offices are gaining further traction as an attractive opportunity for both domestic investors and overseas buyers targeting the UK.

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

OCCUPIER MARKET

Occupier activity remains strong, bolstered by sustained interest from flexible office providers. Although vacancy edged upward, development activity is now much reduced meaning levels will begin to recede from H2.

SOUTH EAST TAKE-UP

792,837 sq ft

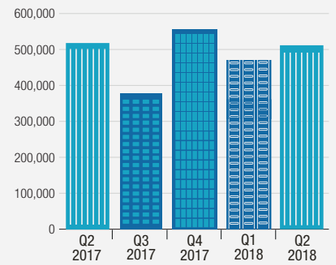
▲6%

	TAKE-UP (SQ FT)		SUPPLY (SQ FT)		Vacancy rate**
M25	511,344 ▲9%	New and Grade A space 85%	7.5m ▲4%	New and Grade A space 81%	6.2% / 5.0%
M3	229,386 ▲60%	New and Grade A space 100%	2.7m ▲10%	New and Grade A space 83%	6.8% / 5.6%
M4	335,873 ▼-11%	New and Grade A space 94%	6.8m ▲1%	New and Grade A space 90%	10.2% / 9.2%

*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)

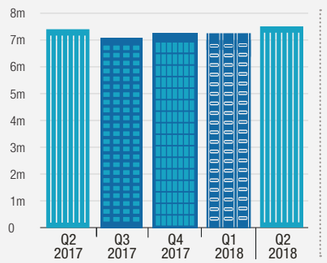


1.0m UNDER OFFER IN THE SOUTH EAST IN Q2 2018

EMMA GOODFORD
Flexible workspace providers are acquiring new stock in the South East at an unprecedented pace, as traditional business models become increasingly blurred and new working practices adopted. The challenge for landlords is to compete or embrace.

FIGURE 2

M25 Supply (sq ft)



16% BELOW THE 10-YR AVERAGE IN Q2 2018

RODDY ABRAM
The pressure on firms to offer high quality space to employees has meant that the number deals secured in 'new space' is at the highest level since 2008. With speculative development well below 1m sq ft, opportunities for occupiers will increasingly become limited.

Key Leasing transactions Q2 2018

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
Chineham Gate, Chineham Park	49,255	Vyaire	£21.00
1 Lyric Square, Hammersmith	39,845	The Office Group	N/A
One Globeside, Marlow	38,306	Amicus Therapeutics	£26.00
Interchange (2nd & 3rd flrs), Croydon	37,388	confidential	£32.00
fmr Magistrates Court, Richmond upon Thames	37,000	William Grant & Sons	£23m (sale)

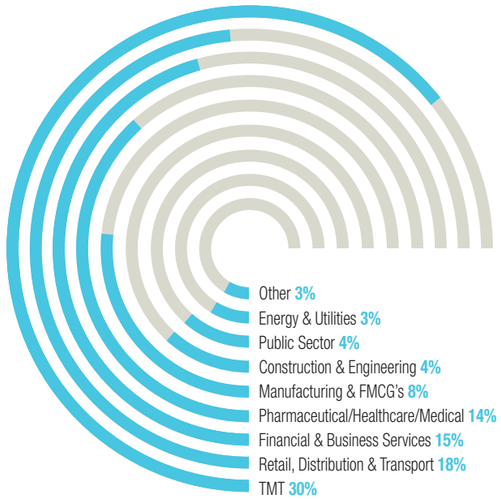
Source for all charts: Knight Frank Research

DEMAND

5.8m sq ft

OF ACTIVE NAMED DEMAND IN THE SOUTH EAST

Active named demand



DEVELOPMENT

0.9m sq ft

SPACE UNDER CONSTRUCTION IN THE SOUTH EAST

*This includes pre-let (0.1m sq ft) and space (0.8m sq ft)

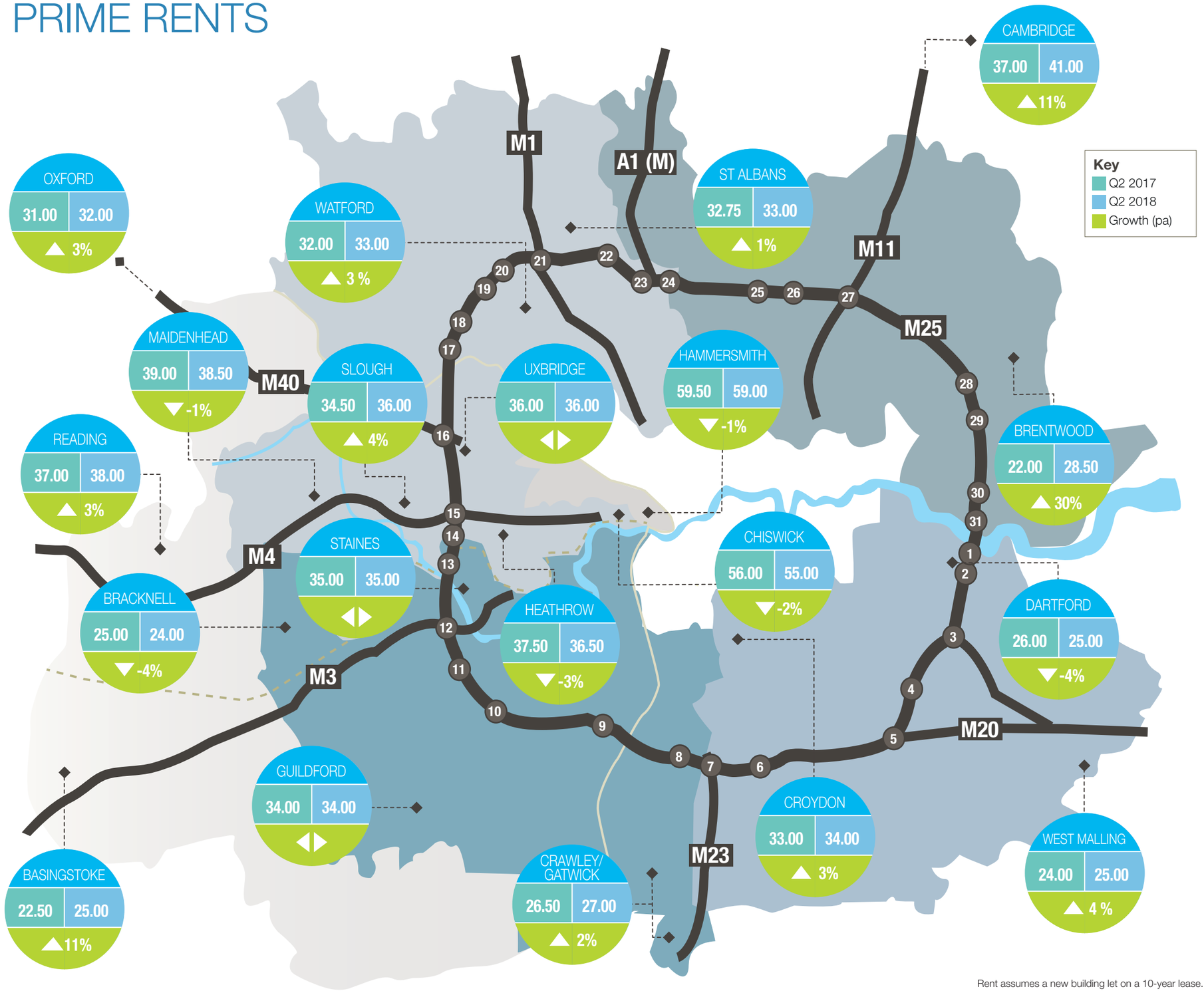
Speculative development (sq ft)

Due to complete before Q1 2019

M25	M3	M4
0.3m	0.4m	0.4m

Source for all charts: Knight Frank Research

PRIME RENTS



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

INVESTMENT MARKET

Investment volumes at mid-year were 26% ahead of the 10-year average for the period. Competitive pressure continues to build for prime opportunities.

22%

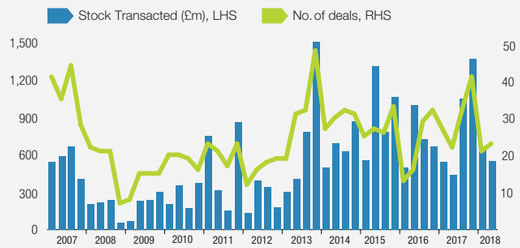
£544m
South East transaction volume
Percentage change reflects a comparison to Q1 2018

£22.7m
Mean lot size

5.00%
Prime net initial yield

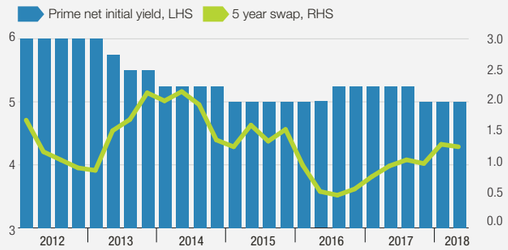
85%
Buyers from the UK

FIGURE 3
Investment volumes



TIM SMITHER
In the South East we continue to see buyers attracted to income as property offers a stable return against other asset classes. We expect this to continue for the foreseeable future.

FIGURE 4
Prime net initial yield and finance



SIMON RICKARDS
Genuine rental growth potential is driving pricing in prime town centre locations. The rationale? Invest in the right building in the right location and the current letting prospects support the potential to achieve prime rental tones.

Key investment transactions Q2 2018

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
Pinetrees, Staines	£80.70	Undisclosed	Aberdeen Standard Investments	Runnymede Council
Cambridge Research Park, Cambridge	£78.01	5.98%	Rockspring Property Managers	RLAM
White Building, Reading	£50.25	5.73%	Boultbee Brooks / CBREGI	Aberdeen Standard
Volkswagen Financial Services Uk, Milton keynes	£50.15	4.83%	UK and European	Runnymede Council
Sigma House, Basildon	£28.25	6.55%	Legal & General Property Ltd	Black Sand Real Estate Investments Ltd

Source for all charts: Knight Frank Research

CONTACTS

National Offices

EMMA GOODFORD
Partner
Head of National Offices
+44 20 7861 1144
emma.goodford@knightfrank.com

RODDY ABRAM
Partner
National Offices
+44 20 7861 1280
roddy.abram@knightfrank.com

ASHLEY DREWETT
Partner
National Offices
+44 20 7861 1156
ashley.drewett@knightfrank.com

WILL FOSTER
Partner
National Offices
+44 20 7861 1293
will.foster@knightfrank.com

Capital Markets

RICHARD CLAXTON
Partner
Head of UK Capital Markets
+44 20 7861 1221
richard.claxton@knightfrank.com

TIM SMITHER
Partner
Head of National Offices Investment
+44 20 7861 1277
tim.smither@knightfrank.com

SIMON RICKARDS
Partner
+44 20 7861 1158
simon.rickards@knightfrank.com

Research

WILLIAM MATTHEWS
Partner
Head of Commercial Research
+44 20 3909 6842
william.matthews@knightfrank.com

DARREN MANSFIELD
Associate
+44 20 7861 1246
darren.mansfield@knightfrank.com

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.
- 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 2018.

Knight Frank Commercial Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

The M25 Report – 2018

Global Cities Report – 2018

The Wealth Report – 2018

Active Capital: The Report – 2018

Knight Frank Research Reports are available at **KnightFrank.com/Research**

Knight Frank

Newmark Knight Frank