Investment, Development
& Occupational Markets

M25 Offices

Q3 2019

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KEY TAKEAWAYS

1

Occupier take up in 2019 to date is below trend, but a strong Q4 is predicted.

2

Space under offer at the end of Q3 was the highest for 12 months.

3

The amount of speculative space under construction is low and represents just four months of take-up.

4

Investment volumes are on par with the long term average, albeit deal numbers are down.

5

Private equity investors account for more than a third of offices volumes, up from 12% in 2018.

6

Weight of capital continues to support market pricing for prime product.

EXECUTIVE SUMMARY

Occupiers wait on political clarity

Political wrangling continued to undermine market sentiment in Q3, as occupiers deferred major commitments until clarity on Brexit is known. Take-up during the quarter amounted to 727,000 sq ft, 10% below the 10-year quarterly average. This meant that the total amount of space leased so far in 2019 nudged just above 2m sq ft. This is 15% below the 10-year average for a Q1-Q3 period and the lowest total recorded at this point of a year since 2011. Encouragingly however, the amount of space under offer at the end of Q3 was 963,015 sq ft. This is 42% above the 10-year average and could indicate a busier final quarter.

Occupier options shrinking?

Supply could prove a restraining factor to satisfying latent occupier demand. Currently only 10 buildings in the South East are able to accommodate a requirement of self-contained space exceeding 50,000 sq ft. At the end of Q3, vacancy in all markets (M25, M3, and M4) was between 60 and 120 basis points below the respective 10-year averages. Given the low level of space being developed speculatively, the trajectory of vacancy is downward. The development pipeline indicates there is just 855,000 sq ft of speculative space set for completion before the end of 2021, with two thirds of this space out of town. Even so, by the end of 2021 vacancy in all markets is projected to be between 160 and 220 basis points below the long-term trend.

Crossrail: Not open but influencing occupier decisions

Locations along the Crossrail route are registering a disproportionate level of activity in 2019. During the year, 40 deals have been completed, well above the 10-year average of 35. Interestingly, the seven South East centres on the route account for 25% of the total spaced leased in the South East.

Investors continue to target the South East

Investment volumes for the first three quarters stand at £1.64bn, broadly in line with the long term average, albeit deal numbers are 9% down compared with historic levels. The sale of Croxley Park, Watford for £435m accounts for 26% of total volumes for the year, arguably skewing figures. Unsurprisingly, the single main issue holding back buyers is the ongoing political uncertainty, however there is significant equity looking to be deployed into the sector once this has been resolved.

UK buyers most active in 2019

UK buyers continue to dominate the market, accounting for 64% of total spend in 2019. This position was supported in Q3 by Portsmouth City Council's acquisition of Lakeside North for £138m. UK councils remain active market participants and are responsible for 18 out of 63 transactions completed during the year, with a market share of 27%. Goldman Sachs' acquisition of Croxley Park also further demonstrates the greater interest of private equity in the market. Private equity buyers account for the largest percentage of investment volumes in 2019, at 35%.

Prime yields hold firm

Prime yields remain at 5.00% in Q3 despite the wider political uncertainties. Overseas capital targeting UK property is close to record levels and investors are finding it increasingly difficult to find suitable stock to invest in, particularly for prime stock, which by definition is scarce. As such, the competitive marketplace is supporting pricing, particularly where there is a case for rental growth.

OCCUPIER MARKET

Although deal rate is comparative to trend, occupiers continue to hold back major commitments until Brexit clarity is determined. Even so, occupier choice is tightening with vacancy low by historical measure and development limited.

SOUTH EAST TAKE-UP

727k sq ft

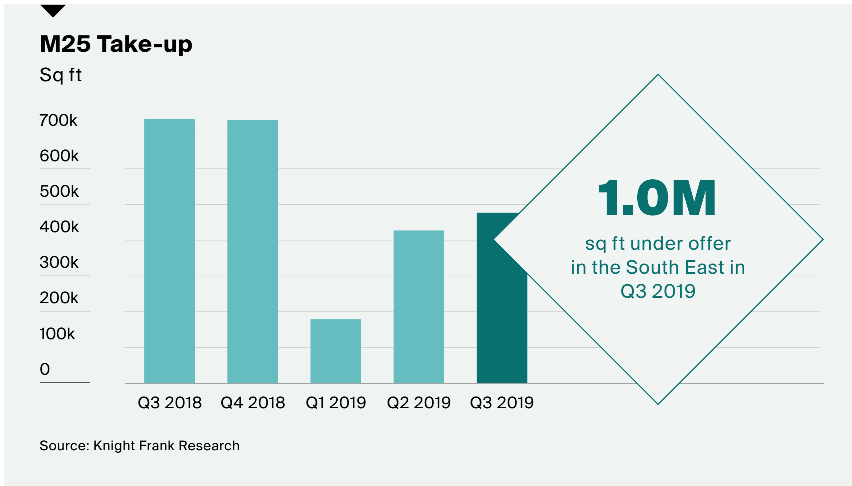
▲ 17%

Atlantic House, Reading

Take-up and supply
Q3 2019

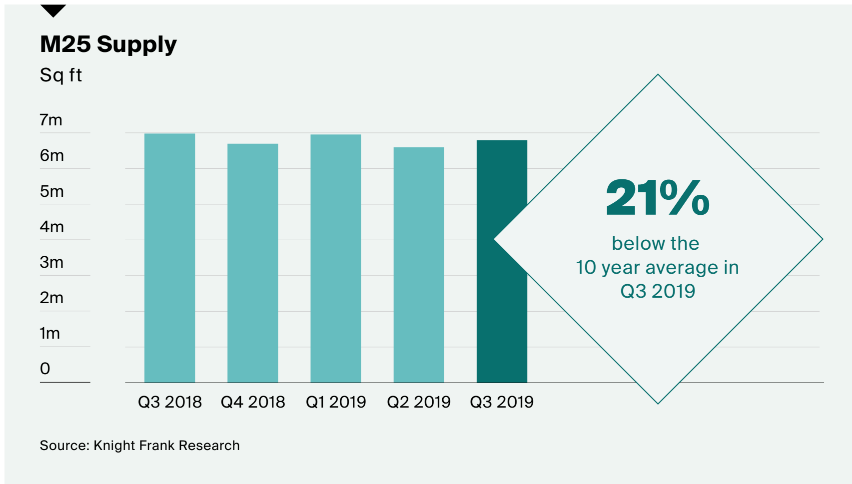
	TAKE-UP (SQ FT)	TAKE-UP (VS Q2 2019)	SUPPLY (SQ FT)	SUPPLY (VS Q2 2019)	VACANCY RATE
M25	481,713	▲ 11%	6.8m	▲ 3% New and Grade A space: 87%	5.7% New and Grade A space: 4.1%
M3	288,958	▲ 9%	2.5m	▲ 11% New and Grade A space: 93%	6.4% New and Grade A space: 5.2%
M4	368,359	▲ 35%	5.8m	▲ 4% New and Grade A space: 83%	8.7% New and Grade A space: 7.2%

Source: Knight Frank Research



Emma Goodford

Occupier sentiment is more positive than the take up data suggests. New enquiries, particularly in the western section of the M25 are buoyant and we've undertaken over 1m sq ft of building viewings in the last eight weeks.



Roddy Abram

A perfect storm is brewing. Vacancy rates are low at a time when the speculative development pipeline is limited. As such, refurbishments are sure to be an important factor to market balance in the short term.

Key occupier transactions
Q3 2019

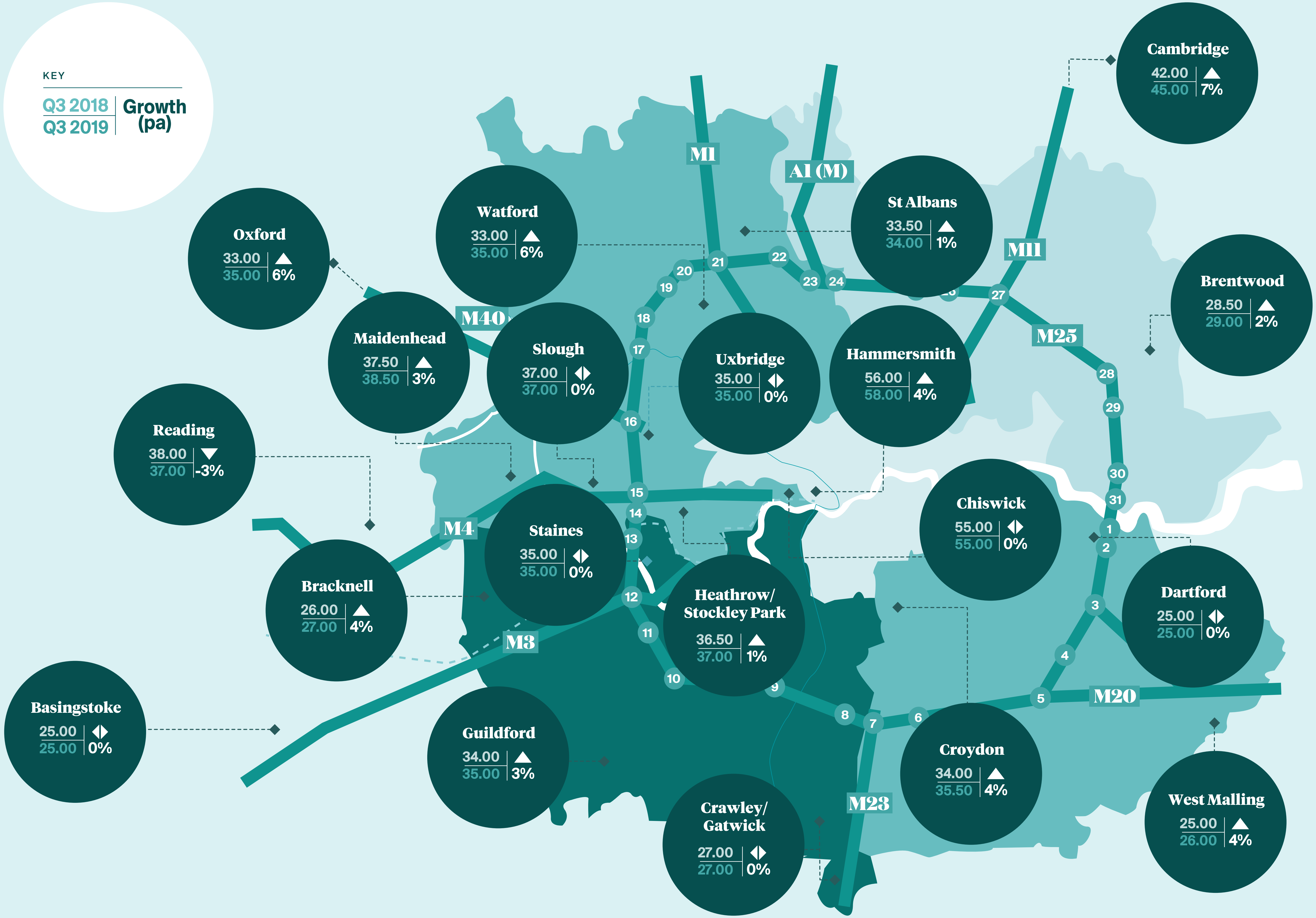
ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (£ PER SQ FT)
2000 Hillswood Business Park, Chertsey	100,142	Samsung	Confidential
100 Berkshire Place, Winnersh Triangle, Reading	54,938	Arena Business Centres	Confidential
2 New Square, Bedfont Lakes (2nd flrs), Heathrow	44,253	J Ray McDermott	£30
300 Dashwood Lang Road, Bourne Business Park, Weybridge	40,241	Astellas	£35
Atlantic House, Reading	38,577	Thames Valley Police	£8.25m (freehold purchase)

Source: Knight Frank Research

M25 OFFICES, Q3 2019

PRIME RENTS

£ PER SQ FT



Headline rent assumes a new building let on a 10-year lease.
Headline rent assumes a transaction over 10,000 sq ft new office space.

Source: Knight Frank Research

Renaissance, Croydon

INVESTMENT MARKET

Despite the political impasse, a number of large deals have transacted in 2019 meaning volumes have held firm. The buyer pool has become increasingly diversified, with no one buyer type dominating.

+140%

£855m
South East transaction volume*

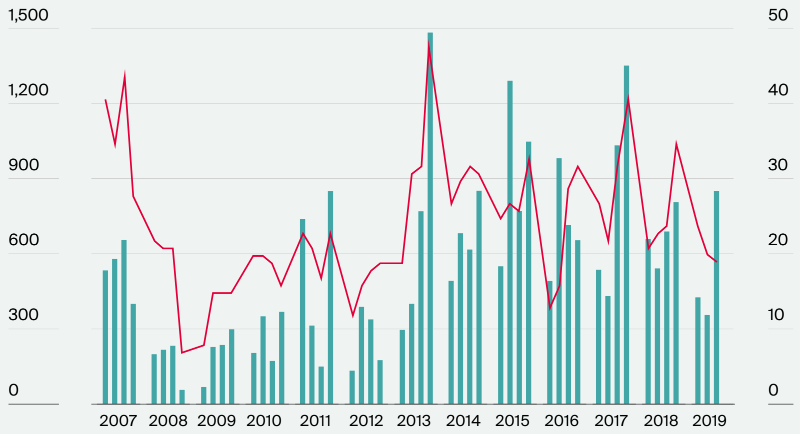
£45m
Average lot size

5.00%
Prime net initial yield

64%
Buyers from the UK

* Percentage change reflects a comparison to Q2 2019

Investment volumes

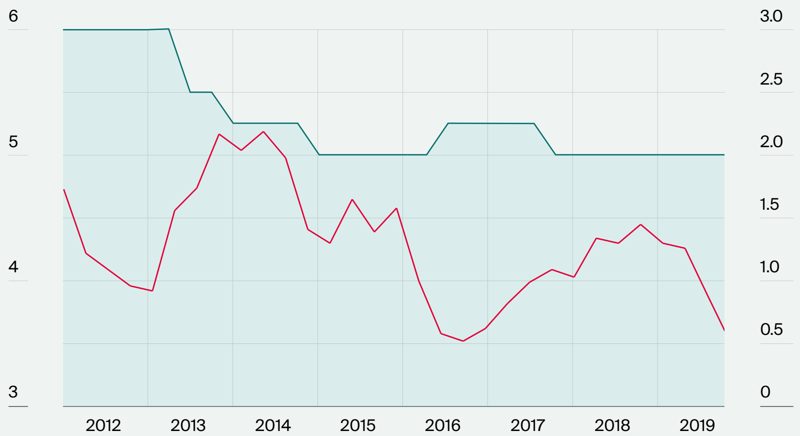


Source: Knight Frank Research

Tim Smither

The fundamentals in the South East remain robust; very tight supply in most markets and limited pipeline coming through, coupled with significant pent-up occupier demand and relatively attractive pricing all give reasons to be upbeat.

Prime net initial yield and finance



Source: Knight Frank Research

Simon Rickards

Despite the wider political uncertainty, we have seen the breadth of buyers grow with Councils, Middle Eastern investors and well backed asset managers and residential developers all currently active in the marketplace.

Key transactions
Q3 2019

ADDRESS	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
Croxley Business Park, Watford	£435.00	2.50%	Columbia Threadneedle	Goldman Sachs
Lakeside North, Portsmouth	£138.00	7.03%	Northwood Investors	Portsmouth Council
Renaissance, Croydon	£58.00	4.93%	M&G Real Estate	Royal London Asset Management
Brinell Building, Brighton	£39.00	4.75%	McAleer & Rushe	Orchard Street Investment Management
Vantage, Brentford	£28.35	8.50%	Columbia Threadneedle	Resolution Capital

Source: Knight Frank Research

FUTURE GAZING

DEMAND: 4.0M SQ FT

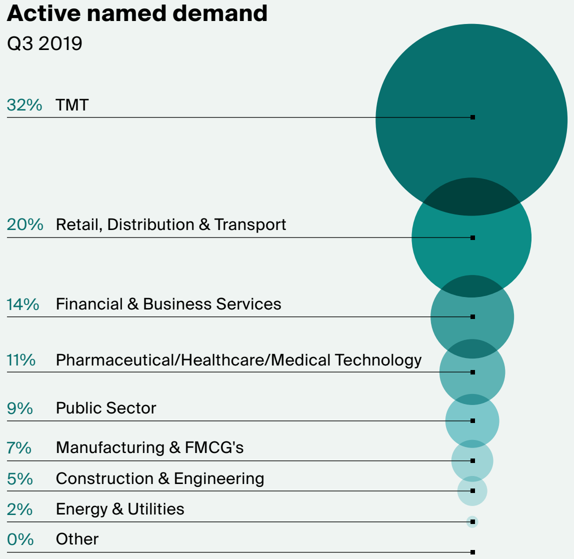
Of active named demand
in the South East

DEVELOPMENT: 1.1M SQ FT

Space under construction in the South East

*This includes pre-let (0.3m sq ft) and speculative space (0.9m sq ft)

Active named demand
Q3 2019



Source: Knight Frank Research

Speculative development
Sq ft due to complete before Q1 2022

Source: Knight Frank Research

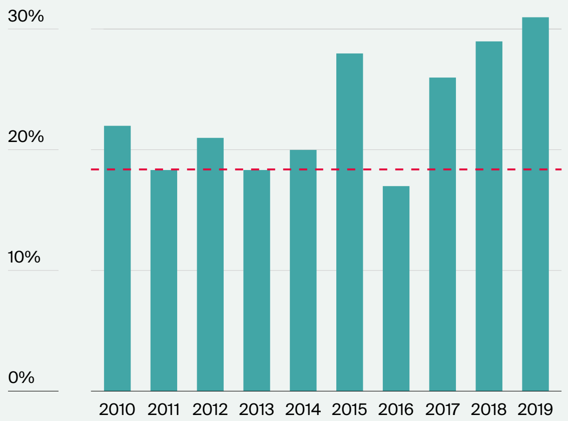
TECHNOLOGY GROWTH AHEAD?

The influence of the technology sector on the economic fortunes of the UK continues to grow. Since 2002, the economic output from tech industries has grown from 10% to 15% of total UK GVA, with an upward trajectory forecast for the next 10 years.

This picture of growth is mirrored in the scale of demand for office space. Following the dot com crash in 2001, new space requirements from technology firms have steadily risen, reaching the highest in 20 years in 2018 with 77 transactions completed. Consequently, the sector representation has grown from 9% of South East office take up to 32% at the end of Q3 2019. Interestingly, the percentage of take-up attributed to technology occupiers has exceeded the long-term average for four of the past five years.

A study of technology employment levels indicate that this trend will continue. In the South East alone, employment in the technology sector is forecast to rise by 13% over the next 10 years. Growth on this scale will continue to generate new requirements and sustain current occupational footprints through the next decade.

Technology sector take up
Q3 2019



Source: Knight Frank Research

Source: Knight Frank Research, Oxford Economics

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(Y)OUR SPACE
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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.
- 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 1st November 2019.

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