RESEARCH

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPIER MARKETS **Q4 2017**

EXECUTIVE SUMMARY

Transaction rate picks up in Q4

An increase in occupier activity resulted in 71 transactions in Q4, the highest quarterly total for 3 years. This upturn meant that take-up reached 924,400 sq ft for the quarter, 16% ahead of the 10-year quarterly average. Whilst all market (M25, M3 and M4) recorded an increase in take-up in Q4, strong demand for space along the M4 corridor meant that take-up during the final quarter breached 600,000 sq ft, the highest total for two years.

Despite the late flurry, a reflection of the year shows take-up in the South East marginally short of the 10-year annual average (-4%), nudging just passed the 3m sq ft mark. Individually, leasing levels in both the M25 and the M3 finished below the long term trend (-18% and -17% respectively). Supported by Technology demand however, the M4 registered take-up 14% ahead of the 10-year average.

More transactions, smaller requirements

Although the total number of deals in 2017 (233) was broadly in line with 2016 (237) and well ahead of the 10-year trend, significantly, only four transactions above 50,000 sq ft were completed during the year. This compares with 12 in 2016 and a 10-year average of 10 per year. In part, indecision relating to Brexit has led to a rise in lease extensions, meaning large requirements have been deferred. The high deal rate and low number of large deals is also reflective of a changing marketplace. Average deal size in 2017 was just 13,000 sq ft, the lowest level on record, with improvements in space efficiency and flexible working both supporting a size reduction in leases being sought.

Demand continues to diversify

In 2017, the South East again proved particularly attractive to the Telecoms, Media and Technology (TMT) occupiers, with the sector accounting for 27% of transactions. The majority of activity was registered in the M4 corridor, with TMT occupiers accounting for 33% of take-up. Whilst a strong showing from the TMT sector is a trend that has developed over the past few years, 2017 has been notable for the sharp rise in co-working/flexible offices. In a typical year, flexible office and co-working providers account for circa 2% of total take-up. In 2017 this was 11%, with new space being taken to support demand growth for 'Space as a Service' as occupiers seek greater flexibility.

Development cycle peaked in 2017

With 45 development schemes reaching practical completion, over 2.4m sq ft of speculative space came to the market in 2017, the highest annual total for 15 years. Although this contributed to vacancy increasing, rates in all markets still remained either consistent with or below the long-term average. The development schedule for 2018 and beyond is thinner. Just short of 1.3m sq ft of speculative space across 17 schemes is due to complete over the next 24 months, the majority of which will complete in H1 2018. Given this timing, vacancy will peak by mid-year 2018.

Large deals bolster the market

South East office investment volumes reached £1.4 billion in Q4 2017, the highest quarterly total since 2013. The strong finish to the year meant that total office investment in the South East in 2017 reached £3.7bn, 70% higher than the 10-year average and just short of the record total of 2015. Notably, £2.7bn (73%) of investment in 2017, was committed after the snap election in June.

With domestic buyers returning to the market and accounting for the majority of capital spent in 2017, deal numbers was up considerably with 122 transactions, the highest total since 2013. Significantly however, six transactions exceeding £100m were completed, all of which were bought by overseas buyers.

Upward pricing pressure in the South East

Prime yields finished the year at 5.00%, reflecting an inward movement of 25bps over the year. Even so, the differential between similar quality assets in the wider South East and Central London remains attractive, enticing both domestic and overseas buyers to the market. As such, an increasingly competitive marketplace could see prime yields harden further in 2018, particularly for prime stock.

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

OCCUPIER MARKET

Take-up rose significantly above the 10-year quarterly average, with Q4 registering the highest number of transactions in four years. Vacancy remained stable, albeit a peak in rates is expected in H1 2018.

SOUTH EAST TAKE-UP

924,400 sq ft

▲70%

TAKE-UP (SQ FT)

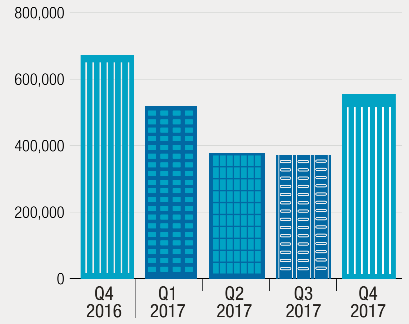
M25	555,900	▲50%	New and Grade A space 82%
M3	215,800	▲181%	New and Grade A space 83%
M4	601,400	▲70%	New and Grade A space 94%

SUPPLY (SQ FT)

			Vacancy rate**
M25	7.3m	▲ 2.0%	6.0%
	New and Grade A space 82%		5.0%
M3	2.3m	▼-1.0%	5.9%
	New and Grade A space 83%		4.9%
M4	6.5m	▲ 1.0%	9.8%
	New and Grade A space 94%		9.2%

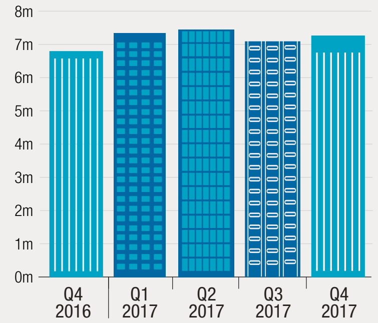
*Arrows reflect quarter-on-quarter change. ** Number in blue shows vacancy rate across all grades. Number in grey denotes vacancy rate for new and grade A office space.

FIGURE 1
M25 Take-up (sq ft)



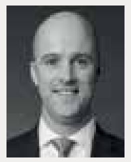
0.6m UNDER OFFER IN THE SOUTH EAST IN Q4 2017

FIGURE 2
M25 Supply (sq ft)



20% BELOW THE 10-YR AVERAGE IN Q4 2017

EMMA GOODFORD
An important trend to emerge has been the expansion of flexible office and co-working providers. With occupiers increasingly seeking term flexibility and inspirational spaces, we anticipate additional requirements from providers to satisfy both flexible and larger corporate demand.



RODDY ABRAM
While completions in 2017 were the highest for 15 years, the spike in development is now behind us. The resulting rise in vacancy will therefore be short lived, with levels expected to plateau in H1 2018 and gradually fall thereafter.

Key leasing transactions Q4 2017

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
Voyager Place, Maidenhead	56,750	FM Global	£31.50
184 Shepherds Bush Road, Hammersmith	45,925	WeWork	£50.00
Centenary House, Basingstoke	43,687	Kier Property	Confidential
Kennet Place (2nd, 3rd & 4th flrs), Reading	42,120	Instant Offices	Confidential
Maxis 2 (grd & 1st flr), Bracknell	41,846	Panasonic	£24.00

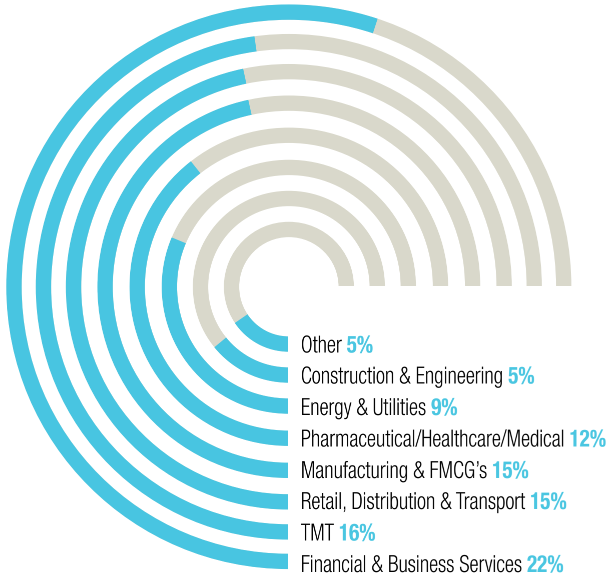
Source for all charts: Knight Frank Research

DEMAND

4.7m sq ft

OF ACTIVE NAMED DEMAND IN THE SOUTH EAST

Active named demand



DEVELOPMENT

1.4m sq ft

SPACE UNDER CONSTRUCTION IN THE SOUTH EAST

*This includes pre-let and speculative space

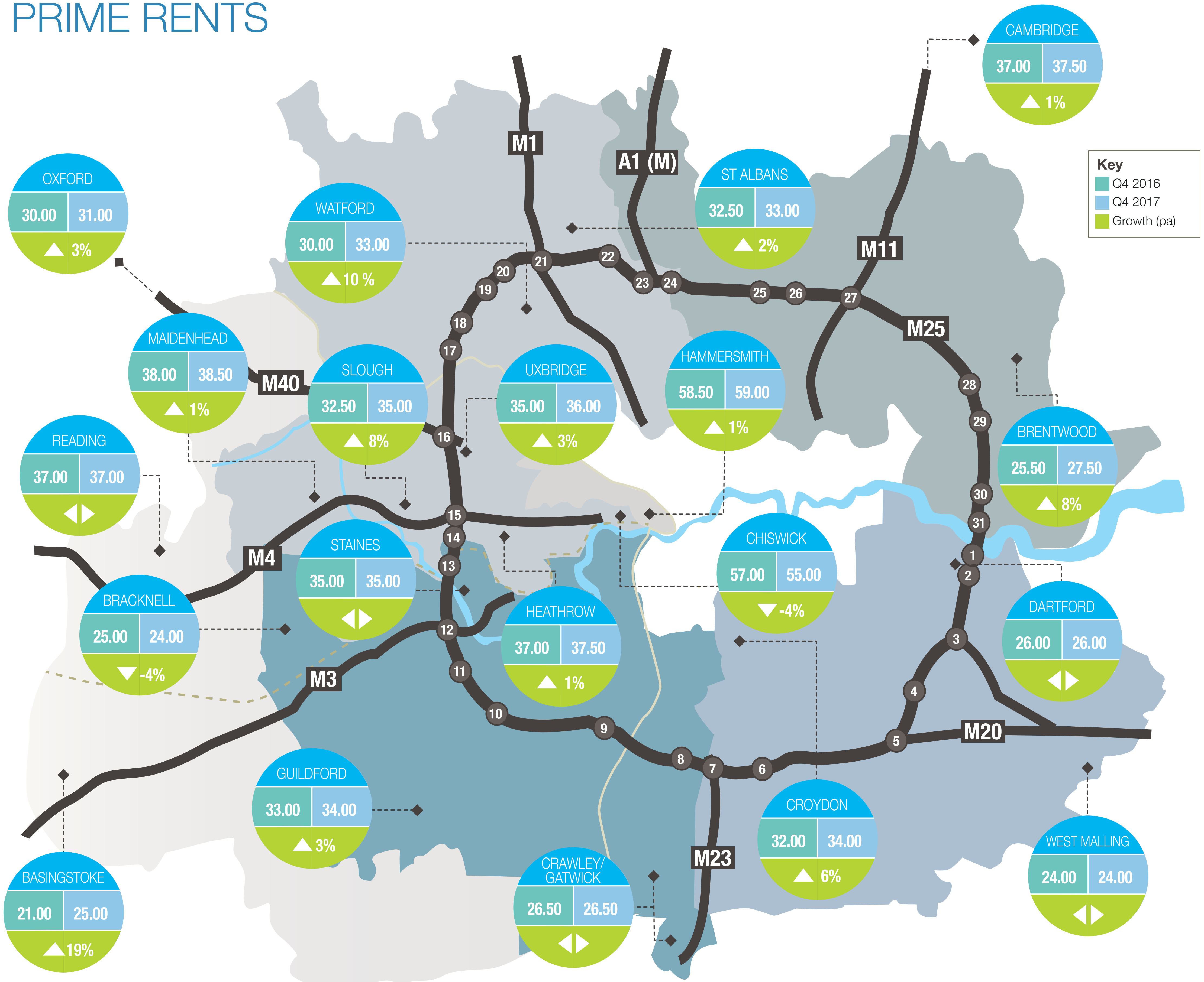
Speculative development (sq ft)

Due to complete before Q1 2019

M25	M3	M4
0.6m	0.5m	0.7m

Source for all charts: Knight Frank Research

PRIME RENTS



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

INVESTMENT MARKET

Investment volumes reached the highest quarterly total for four years in Q4 2017. Both domestic and international buyers continue to vie for opportunities sustaining pricing pressure.

▲2%

£1.4bn
South East transaction volume

£33.1m
Mean lot size

5.00%
Prime net initial yield

40%
Buyers from the UK

FIGURE 3
Investment volumes

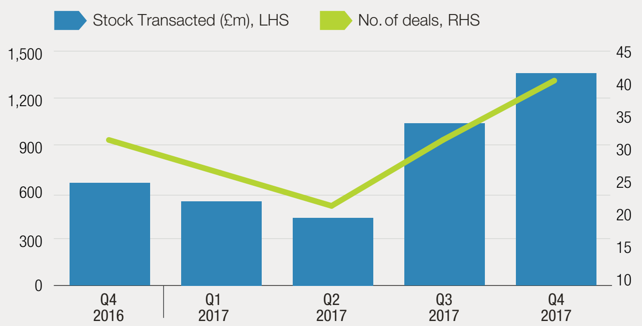
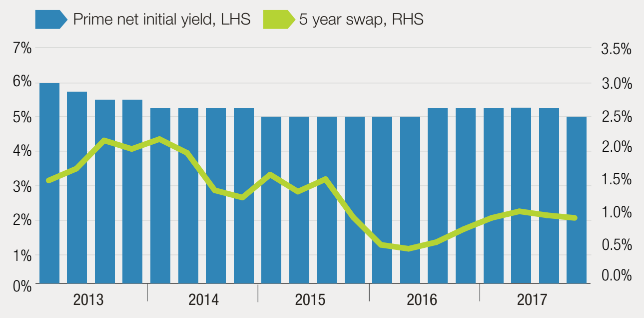
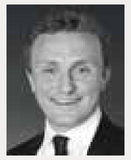


FIGURE 4
Prime net initial yield and finance



TIM SMITHER
The re-emergence of UK funds as an aggressive buyer of prime assets was the main market change in 2017. Opportunities have proved scarce however, meaning capital reserves will carry into 2018. This competitive pressure may drive prime yields below 5%.



SIMON RICKARDS
With numerous different types of investor looking at the South East office market, it is likely to be a lack of deliverable stock that may hold back volumes in 2018 as opposed to any lack of buyer demand.

Key investment transactions Q4 2017

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
Winnersh Triangle, Reading	£365.00		Oaktree	Frasers
Farnborough Business Park, Farnborough	£175.00	6.60%	Harbert / XLB	Frasers
Dukes Court, Woking	£72.35	6.64%	Aerium	Woking Borough Council
255 Hammersmith Road, Hammersmith	£57.98	7.18%	SLI	Fore Partnership
The Blade, Reading	£41.58	7.38%	Aviva	Northwood

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.
- 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 December 31st 2017.

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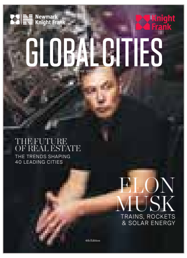

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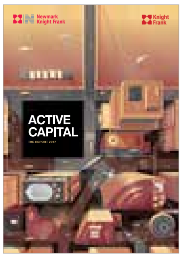

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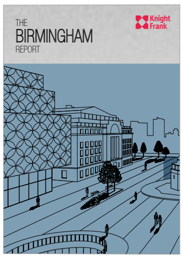

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