RESEARCH

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPATIONAL MARKETS **Q4 2018**

EXECUTIVE SUMMARY

OCCUPIER ACTIVITY IN THE SOUTH EAST BELIES BREXIT CONCERN

A late flurry of occupier activity in Q4 meant that office take-up in the South East increased to the highest quarterly total since Q2 2007, with over 1.3m sq ft transacted. Consequently, take-up for the year increased to 4.1m sq ft, 34% ahead of take-up recorded in 2017 and the highest annual total since 2008. Analysis of the individual markets reveals that leasing levels for the year, in both the M25 and the M4, finished significantly above the long-term trend (+12% and +53% respectively). Take-up in the M3 fell just short of the 10-year average for the market area. Despite the delay, key centres on the Elizabeth line recorded 1.2m sq ft of take-up, 51% above the 10-year average.

2018 – THE RETURN OF THE LARGE CORPORATE REQUIREMENT?

With twelve deals over 50,000 sq ft completing, 2018 proved to be the year that latent corporate demand could wait no longer for a settled political environment. This group of transactions equated to 1m sq ft of take-up, with ten falling into the M4 market. Whilst the presence of the larger requirements were a particularly positive feature of the year, an upturn in mid-range transactions also was noteworthy. A total of 53 deals within the 20,000 sq ft – 49,999 sq ft range completed in 2018. This is the highest number in this size bracket since 2004.

CO-WORKING PROVIDERS MAKING A MARK IN 2018

The growth of co-working facilities across the South East market maintained momentum in 2018. Flexible office providers acquired 654,000 sq ft during the year or 16% of total take-up in the South East. This represents a significant rise compared to 12% in 2017. Interestingly, all leases taken in 2018 were to support business growth as opposed to satisfying an end user pre-commitment. The consequence of this could be a pause in activity from the sub-sector in 2019 as the newly acquired space is absorbed and the market matures.

INVESTOR APPETITE HOLDING FIRM

South East office investment volumes increased by 16% in the final quarter of 2018 to reach £809 million. The upturn in activity at the end of the year meant that total office investment in the South East in 2018 reached £2.7bn. Although this reflects a 25% decrease when compared to 2017, the 2018 total is 16% above the 10-year annual average.

UK COUNCILS – MOST ACTIVE BUYER GROUP

With nine deals completed in Q4 alone, UK council spending continued strongly. Supported by access to cheap debt, the subsector accounted for 19% of investment volumes during the quarter, second only to private equity in terms of capital committed. Consequently, investment by UK councils increased to £877m for the year across 21 deals. Notably, this means that council spending represented 32% of the market in 2018 making the subsector the largest buyer group of the year.

UK BUYERS DOMINATED THE MARKET IN 2018

In 2018, domestic investors accounted for 73% of total volumes, in contrast to 2017 when overseas investors accounted for approximately half of all volumes. UK Council spending supported the rise in market share, but sustained interest from UK institutions was also notable. UK Funds accounted for 25% of volumes for the year, focusing on larger, better quality assets in key strategic locations, whilst smaller assets in secondary locations were subject to sale as they churn their portfolios.

OCCUPIER MARKET

A surge in leasing activity in Q4 meant that take-up rose to the highest total since 2007. Vacancy continued to tighten, increasing the prospect of rental growth in key markets.

SOUTH EAST TAKE-UP

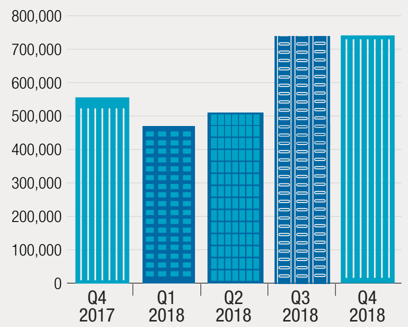
1.3m sq ft

▲ 12%

	TAKE-UP (SQ FT)		SUPPLY (SQ FT)		Vacancy rate**
M25	740,100 ◀▶ New and Grade A space 89%		6.7m ▼ -4% New and Grade A space 77%		5.6% 4.3%
M3	167,400 ▲ 128% New and Grade A space 98%		2.6m ▼ -2% New and Grade A space 82%		6.6% 5.4%
M4	910,200 ▲ 3.4% New and Grade A space 99%		5.5m ▼ -9% New and Grade A space 86%		8.3% 7.1%

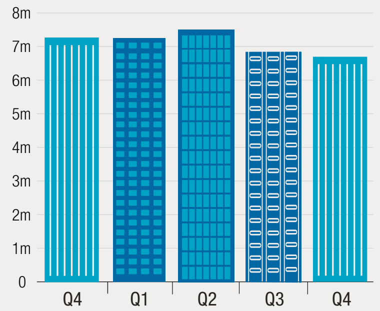
*Arrows reflect quarter-on-quarter change. ** Number in blue shows vacancy rate across all grades. Number in grey denotes vacancy rate for new and grade A office space.

FIGURE 1
M25 Take-up (sq ft)



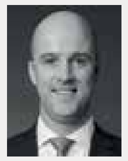
0.5m UNDER OFFER IN THE SOUTH EAST IN Q4 2018

FIGURE 2
M25 Supply (sq ft)



24% BELOW THE 10-YR AVERAGE IN Q4 2018

EMMA GOODFORD
A convergence of factors including Crossrail, co-working growth and TMT expansion supported a strong leasing market in 2018. At the same time, a lack of development and continued erosion of offices stock meant that a supply/demand imbalance has been created moving into 2019.



RODDY ABRAM
With only 800,000 sq ft of speculative office development due to complete in the next 12 months, vacancy will continue on a downward trajectory and subsequently fuel the likelihood of rental growth in 2019.

Key Leasing transactions Q4 2018

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
Leavesden Park, Watford	123,796	ASOS	£26.00
500 Brook Drive, Green Park, Reading	121,350	Virgin Media	c.£28.75
Victoria Gate, Woking	66,415	McLaren	£33.00
3 Forbury Place, Reading	56,399	Iqvia	c.£31.00
Davidson House, Reading	55,383	Regus	£34.00

Source for all charts: Knight Frank Research

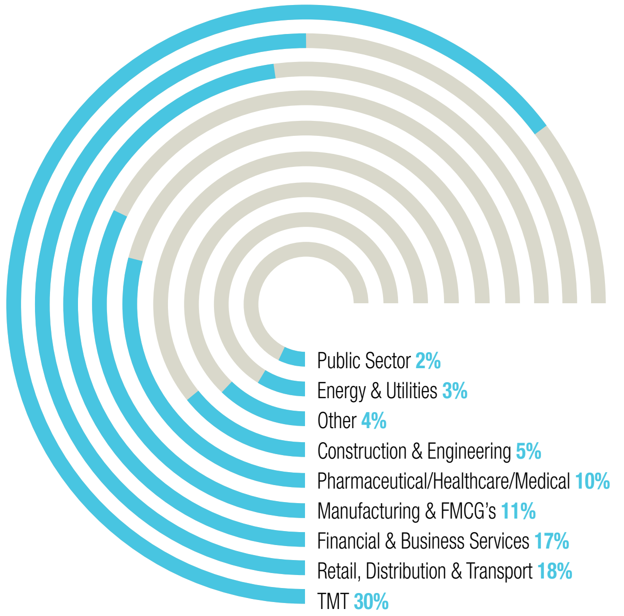
*The South East is defined in the technical note on the back cover

DEMAND

5.7m 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 speculative space (0.8m sq ft)

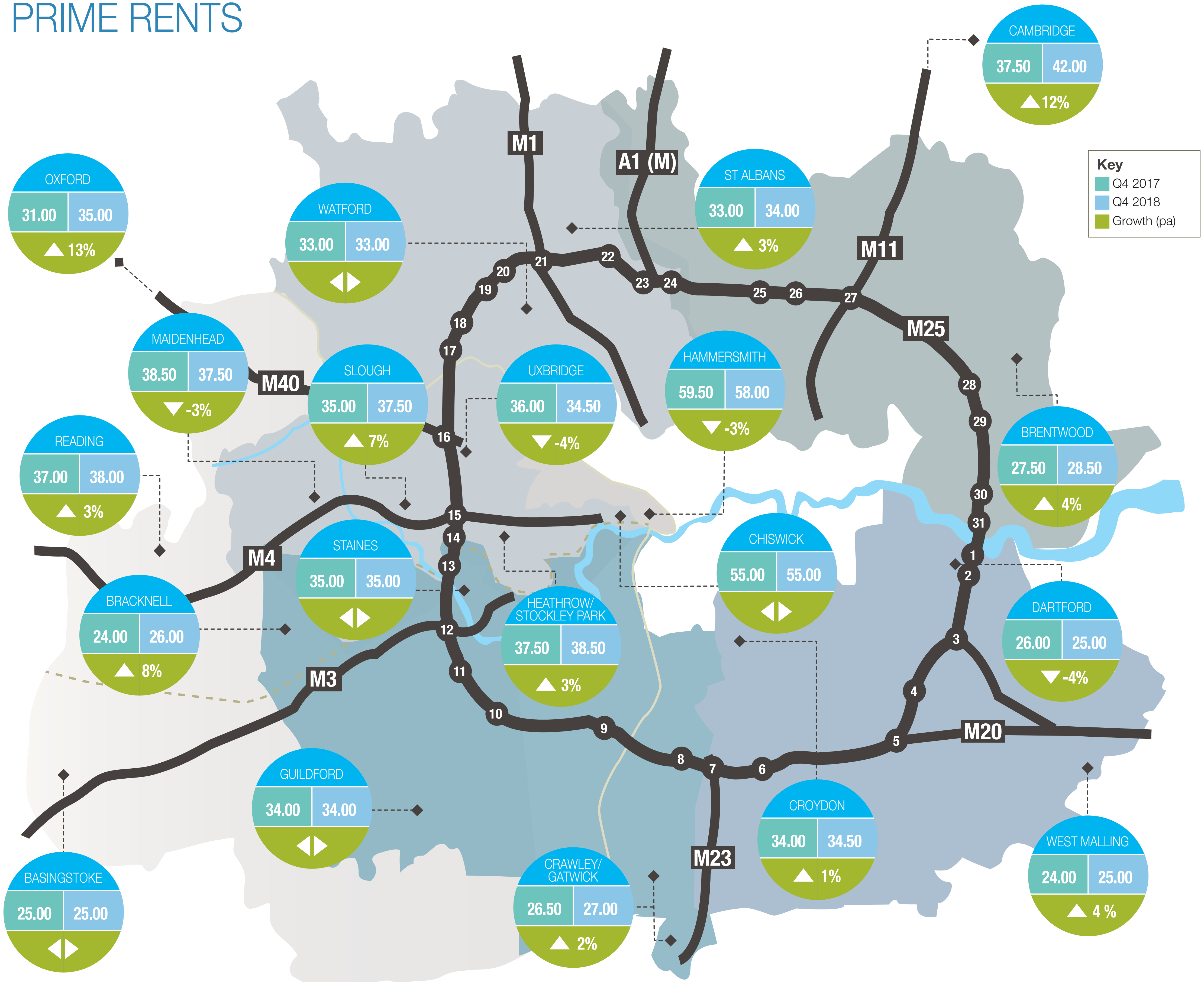
Speculative development (sq ft)

Due to complete before Q1 2020

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

An upturn in activity in Q4 meant that investment volumes in 2018 were 16% higher than the long-term average. Even so, growing political risk is resulting in a ‘wait and see’ approach.

▲16%

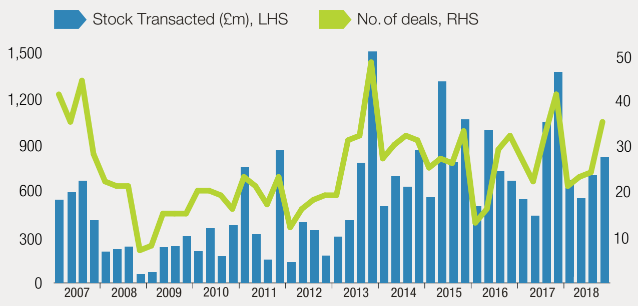
£809m
South East transaction volume
Percentage change reflects a comparison to Q3 2018

£23.1m
Average lot size

5.00%
Prime net initial yield

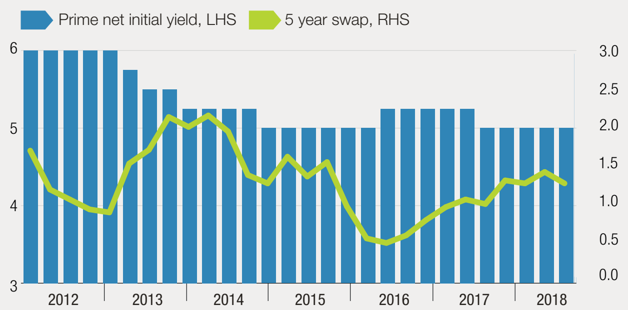
43%
Buyers from the UK
Q4 2018

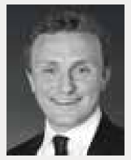
FIGURE 3
Investment volumes



TIM SMITHER
Despite the unsettled political environment, property fundamentals in the South East remain particularly positive and continue to support a case for investment.

FIGURE 4
Prime net initial yield and finance





SIMON RICKARDS
Investment volumes in 2018 were held back by a quieter than usual Q4, typically the busiest time of the year, with investors understandably taking a watching brief as wider political events unfold.

Key investment transactions Q4 2018

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
Microsoft UK Headquarters, Reading	£100.00	6.60%	Solutus	AIP Asset Management / Valesco Real Estate Limited
Westside, Hemel Hempstead	£65.10	6.60%	Tristan Capital	Gulf Finance House
Globeside, Marlow	£43.10	6.25%	Columbia Threadneedle	Buckinghamshire County Council
Coda Studios, Fulham	£40.50	7.21%	Columbia Threadneedle	Rockspring
Brinell Building, Brighton*	£39.00	4.75%	McAleer & Rushe	Orchard Street IM

Source for all charts: Knight Frank Research * Exchanged Dec 18, Completion 2019.

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
Capital Markets
+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
Commercial Research
+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 December 31st 2018.

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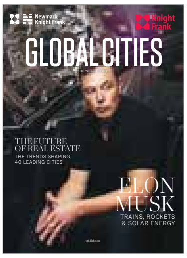

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