RESEARCH

Q1 2012

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Following robust take-up in the second half of 2011, Q1 take-up was relatively subdued in the M25 and the M4, at 25% and 33% respectively below the 10-year quarterly average. In the M3, while Q1 take-up was 27% above the Q4 2011 total, it was 8% below average.
- The vacancy rate fell in both the M25 and the M3 during Q1, to 8.2% and 9.0% respectively. The M4 vacancy rate remained stable at 10.7% during Q1, its lowest level in three years.
- Q1 saw the first speculative development completion in the M25/M4 since Q3 2010. There is now 734,000 sq ft under construction in the M25, of which almost 400,000 sq ft is due to complete during the remainder of 2012.
- In the investment market, just 12 deals with a total volume of £126.3m transacted in Q1, its lowest level since Q1 2009. Yields for prime 15-year income remain at c.6.00%, unchanged since Q3 2011, while yields for secondary and tertiary stock continue to drift outwards.

Demand and take-up

- M25 take-up totalled 479,643 sq ft in Q1 2012, 38% below the Q4 2011 total but 6% higher year-on-year. The market was nevertheless active in Q1, with 38 deals following 37 in Q4 2011. Grade A space was less prominent than usual, accounting for only 58% of Q1 take-up compared with a long-run average of 78%.
- Q1's only M25 deal in excess of 50,000 sq ft took place in Guildford, where Detica acquired 60,041 sq ft at 170 Priestley Road, Surrey Research Park, at a headline rent of £24.00 per sq ft. Of the five deals involving brand new space in the M25, the largest was Swarovski's acquisition of 16,898 sq ft at Building 4, Chiswick Park, at a headline rent of £41.00 per sq ft.
- In the M4, Q1 take-up was subdued at 272,581 sq ft, down 56% on Q4 2011 and 33% below the 10-year quarterly average. However, the M4 saw its first pre-commitment in almost 18 months, with BBC Magazines agreeing to take 55,000 sq ft at the Vineyard Building, Hammersmith, which is to be extensively refurbished.
- The M3 region saw renewed activity in Q1, with 16 deals and total take-up of 213,970 sq ft, 27% above the Q4 2011 total and only 8% below the 10-year quarterly average. Two deals in Hook accounted for 25% of take-up, the largest of which comprised BMW's acquisition of 33,328 sq ft at Form 1, Bartley Wood Business Park.
- Total named active demand recorded a modest 4% fall during Q1 to stand at 5.86m sq ft. Financial & Business Services now accounts for the greatest share of demand, with 23% of the total (1.37m sq ft), marginally ahead of Manufacturing & FMCGs, with 19.4% of the total (1.14m sq ft).


Rockspring and Bell Hammer's The Stanza Building, Uxbridge is scheduled to complete in September 2012, providing 81,055 sq ft of new office space.

Supply and development

- Q1 saw the first speculative development completion in almost 18 months, with the delivery of BAM Property's Chiswick Green in West London, totalling 81,544 sq ft. Following a complete absence of completions in 2011, circa 400,000 sq ft is set to complete in 2012, with examples including the Stanza Building, Uxbridge (81,055 sq ft) and Velocity 1 & 2, Weybridge (103,592 sq ft).
- Speculative development activity has increased significantly over the past 12 months to stand at 736,000 sq ft in the M25, its highest level in three years. Of the eleven schemes under construction, ten are located within the Thames Valley.
- The M25 vacancy rate fell for a third successive quarter in Q1 to stand at 8.2%, its lowest level since Q3 2010. This is largely explained by consistently below average levels of space being released to the market over the past 12 months.
- The M4 vacancy rate was unchanged in Q1 at 10.7%, its lowest level since Q1 2009. Despite the completion of Chiswick Green, the amount of new space available in the M4 has fallen by 28% since peaking in Q2 2010. In the M3, relatively robust take-up in Q1 led to a notable reduction in the vacancy rate, from 9.6% to 9.0%.

Figure 1
M25 take-up

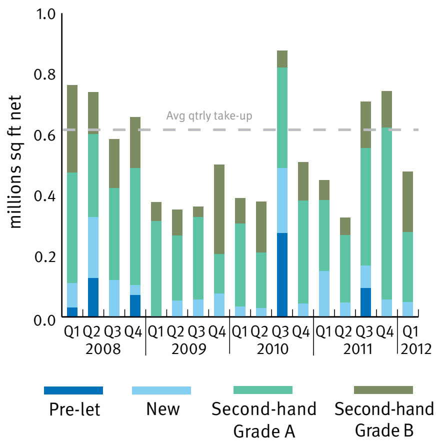


Figure 2
M4 take-up

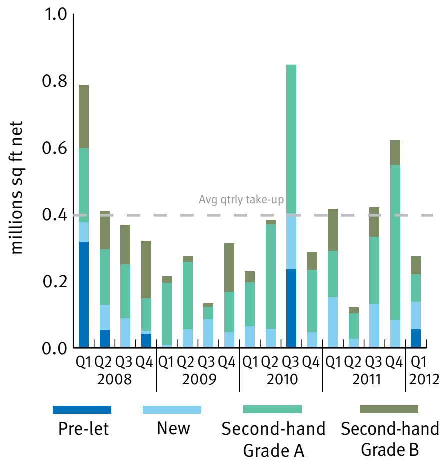
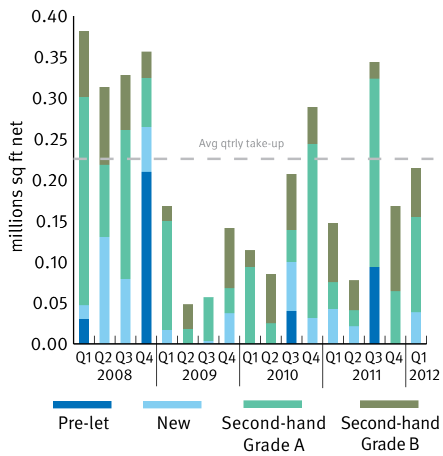


Figure 3
M3 take-up



Source: Knight Frank Research

Market statistics

Table 1
Key town prime rents & forecasts

Town	Q1 prime rent (psf)	Rent free (months)
Basingstoke	£17.50 ▶	36 ▶
Bracknell	£20.00 ▶	36 ▼
Brentwood	£21.00 ▶	24 ▶
Chiswick	£42.50 ▲	21 ▼
Croydon	£22.00 ▲	33 ▶
Gatwick	£22.00 ▶	30 ▶
Guildford	£27.50 ▶	24 ▶
Hammersmith	£37.50 ▲	21 ▼
Heathrow	£27.50 ▶	30 ▼
Maidenhead	£30.00 ▶	24 ▶
Reading	£30.50 ▶	24 ▶
Slough	£21.00 ▶	30 ▶
Staines	£28.50 ▲	21 ▶
St Albans	£22.50 ▶	24 ▶
Uxbridge	£29.00 ▲	24 ▶
Watford	£22.00 ▶	27 ▶
West Malling	£20.50 ▶	30 ▼

Based on new/Grade A building:
10,000 sq ft, 10 yr lease with no breaks
Note: ▲ = forecast for next 12 months

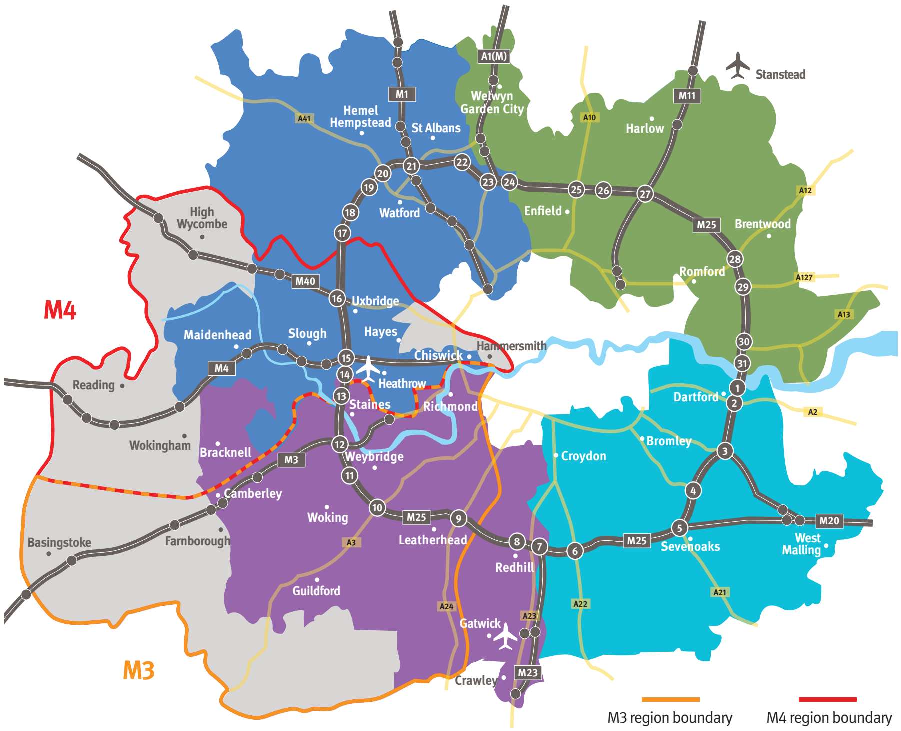


Table 2
Demand & Supply

Take-up	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft	**479,643**	181,609	157,540	94,143	46,351	**213,970**	**272,581**
Change Q1 12 vs Q4 11	**-35%** ▼	-60% ▼	-39% ▼	340% ▲	325% ▲	**27%** ▲	**-56%** ▼
Change Q1 12 vs Q1 11	**6%** ▲	-7% ▼	-26% ▼	311% ▲	134% ▲	**46%** ▲	**-34%** ▼
Q1 pre-let (sq ft)	**0**	0	0	0	0	**0**	**55,000**
Q1 % New & Grade A (inc. pre-lets)	**58%**	70%	81%	18%	8%	**72%**	**81%**
Forecast 2012 take-up (m sq ft)	**2.1**	–	–	–	–	**0.6**	**1.5**

Availability	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft	**10,684,940**	4,810,864	4,033,378	444,502	1,396,196	**3,825,717**	**6,969,668**
Change Q1 12 vs Q4 11	**-1%** ▼	2% ▲	-4% ▼	-16% ▼	6% ▲	**-6%** ▼	**0%** ◀▶
Change Q1 12 vs Q1 11	**-4%** ▼	-6% ▼	-8% ▼	-17% ▼	37% ▲	**15%** ▲	**-7%** ▼
Q1 % new	**13%**	13%	16%	12%	4%	**10%**	**22%**
Q1 % second-hand Grade A	**50%**	58%	51%	30%	26%	**57%**	**58%**
Q1 % second-hand Grade B	**37%**	29%	33%	58%	70%	**33%**	**20%**
Q1 vacancy rate (▲/▼ movement from Q4 11)	**8.2%** ▼	9.5% ▲	9.8% ▼	2.5% ▼	6.9% ▲	**9.0%** ▼	**10.7%** ◀▶

Under construction	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft (net approx)	**736,314**	372,953	361,156	0	0	**361,156**	**375,158**
Change 12 months	**174%** ▲	133% ▲	233% ▲	–	–	**233%** ▲	**134%** ▲
Pre-let	**0**	0	0	0	0	**0**	**0**

Source: Knight Frank Research

Figure 4
M25 active named enquiries by sector

Active demand is 5.89m sq ft at Q1 2012		
Financial & Business Services	23%	▲
Manufacturing & FMCG's	19%	▲
ICT	17%	▲
Retail, Distribution & Transport	14%	▲
Construction & Engineering	7%	▲
Public Sector	7%	▲
Utilities	3%	▼
Pharmaceutical & Medical	1%	▼
Other	9%	▲

Note: % = current share of demand
▲ = 12 month change (absolute terms)

In Q1, Intercall acquired 14,000 sq ft at 5 Arlington Square, Bracknell, at an agreed headline rent of £20.00 per sq ft. Knight Frank acted for Mapeley.

FORECAST AT A GLANCE

Take-up:

- Q1's level of take-up is on target to meet Knight Frank's full-year forecast for 2012, at 2.1m sq ft in the M25 and 1.5m sq ft in the M4, or 15% and 8% below the 10-year annual average respectively. Although take-up activity is typically more volatile in the M3, its resilient performance in Q1 suggests that take-up in 2012 may exceed our forecast of 0.6m sq ft.
- While the Treasury's consensus forecast points to anaemic medium term growth of the UK economy, it is also well documented that corporate balance sheets are in robust health. Beyond 2012, this may give rise to more buoyant property market activity in the South East, through mergers and acquisitions or growth in staffing requirements.
- Knight Frank's analysis of 20 key markets in the South East also reveals that a spike in lease events is anticipated over 2013-15, amounting to 8m sq ft over the period. A number of locations show a high incidence of lease events on Grade B space, which may provide the strongest prospects for take-up - this equates to over 10% of total stock in Bracknell, Crawley, Guildford, Heathrow and Slough.

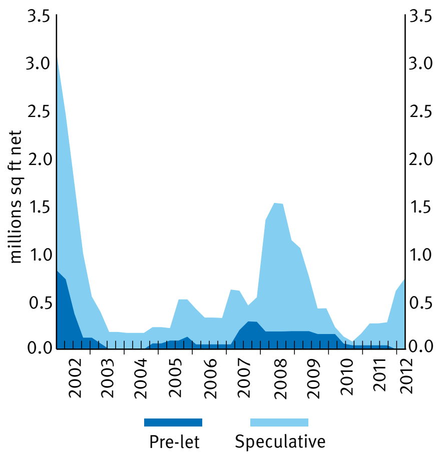
Supply and rents:

- As Grade A supply diminishes, Knight Frank expects continued growth in headline rents within tightly supplied, resilient markets in the Thames Valley and West London, including Chiswick, Hammersmith, Uxbridge, and Staines. In contrast, however, the majority of markets will continue to see flat headline rents with, at best, a slight hardening in concessions over the coming year.
- The rise in speculative development activity seen over the past six months is indicative of renewed confidence in the market, with a number of UK Funds financing development while the banks remain on the sidelines. However, development is likely to remain focused in tightly supplied markets to the west of London and the Thames Valley, where occupier activity has been relatively resilient and rental growth recently evident.
- Alternatively, landlords may undertake cost-effective refurbishment projects in markets where forthcoming lease events at Grade B classified accommodation significantly exceed available Grade A space. For example, up to 2016, Richmond, Woking and Croydon each have over three times more Grade B lease events in the pipeline than Grade A space available.

Figure 5
Vacancy rates

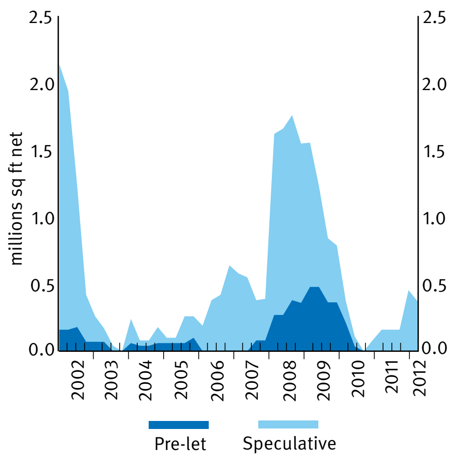
Source: Knight Frank Research

Figure 6
Space under construction in the M25



Source: Knight Frank Research

Figure 7
Space under construction in the M4



Source: Knight Frank Research

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Investment market

Table 3
Key investment transactions Q1 2012

Building	Size (sq ft)	Price	Net Initial Yield	Vendor/ Purchaser
Energis House, Reading	108,263	£22.6m	8.71%	SWIP / PRUPIM
SABMiller House, Woking	64,398	£16.25m	7.98%	Threadneedle / PRUPIM
65 Woodbridge Road, Guildford	30,505	£12.11m	6.25%	Standard Life / Mayfair Capital
2 Longwalk, Stockley Park, Heathrow	48,639	£7.10m	Vacant Possession	IVG / Chester Properties

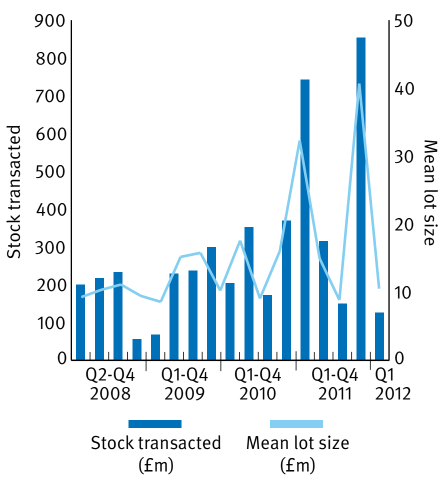
	Transaction volume	Mean lot size	Mean NIY
Q1 2012	£126.30m	£10.5m	8.00%
Change 3 mths	-85% ▼	-72% ▼	-34bps ▼
Change 12 mths	-83% ▼	-67% ▼	88bps ▲

INVESTMENT VIEW

- Investment turnover during Q1 was limited to £126.3m in 12 transactions, the lowest quarterly volume since Q1 2009. While the Eurozone debt crisis impacted negatively on sentiment, Q1's subdued activity also reflected a shortage of buying opportunities for prime, or 'near prime' assets. Positively, however, current market activity points to a marked improvement in turnover in Q2.
- UK Funds continue to focus on prime town centre assets, albeit they are becoming increasingly risk averse. When suitable opportunities do arise, competitive bidding ensues. We believe that prime yields for 15-year income remain at c.6.00%, although there was no evidence at this level during Q1.
- Demand from overseas investors remains focused on large, £20m+ lot sizes, where there is scope to enhance returns through active asset management. Demand also remains for 10-year income assets, particularly among Middle Eastern investors.
- While there has been a notable increase in the availability of secondary stock, investor appetite is comparatively thin given void risk and banks' unwillingness to lend. That said, pricing levels on poorer quality secondary and tertiary stock are becoming more realistic, opening up a small but growing market for opportunity-driven private investors.


In Q1, PRUPIM purchased SABMiller House, Woking from Threadneedle for £16.25m, reflecting a net initial yield of 7.98%.

Figure 8
£m investment volumes and lot size



Source: Knight Frank Research

Figure 9
Mean initial yield & finance

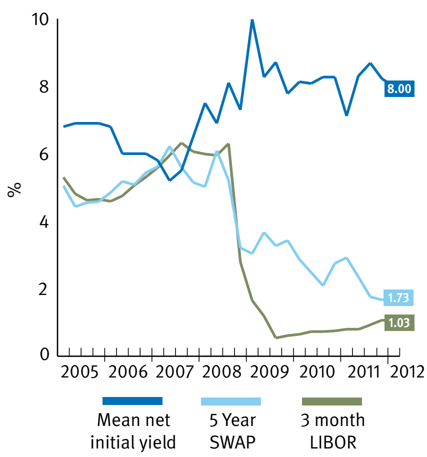
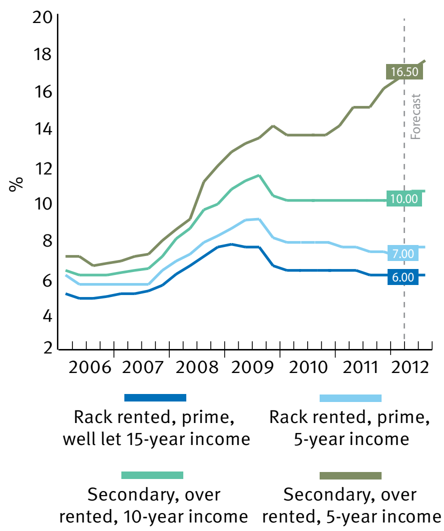


Figure 10
Yield forecasts



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Technical Note

- Knight Frank define 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 62,392,070 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 41,927,373 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.
- The market definition used, shown in the map on page 3, is based on Local Authority District boundaries.
- 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 128m sq ft (net), an M4 market stock of 63m sq ft (net) and an M3 market stock of 42m sq ft (net).
- 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.
- 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 March 31st 2012.

Front cover image: The Blade in Reading (Aviva & PMB Holdings Ltd)

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