

RESEARCH



M25 OFFICES

INVESTMENT, DEVELOPMENT &
OCCUPIER MARKETS **Q1 2017**



EXECUTIVE SUMMARY

◆ Occupier demand solid in Q1

Letting activity in the first quarter proved steady with overall office take-up in the South East just short (-3%) of the 10-year average for a first quarter period. In the M25 catchment, take-up reached 517,800 sq ft, 5% less than its respective Q1 average. Interestingly, deal number was up in the M25 when compared to Q1 2016, with an upturn in transactions in the 20,000-50,000 sq ft range most notable. Similarly, the M4 recorded 355,400 sq ft of take-up, with mid-range deals accounting for 44% of the total. In the M3, take-up reached 133,500 sq ft, a total similar to Q4 2016. At the end of Q1, the amount of space under offer in the South East totalled 600,000 sq ft, the majority of which is located in the Thames Valley.

◆ Retailers continue to target the South East

The largest occupier deal in Q1 was the 73,600 sq ft lease taken by online fashion retailer ASOS at Leavesden Park. Notably, retail firms have been responsible for six of 12 transactions over 50,000 sq ft in the past 15 months. Supported by the ASOS letting, the Retail, Distribution & Transport sector accounted for 25% of take-up in Q1 2017. This continues the trend from 2016 with the business sector representing 30% of take-up last year largely linked to online/technology based growth.

◆ Speculative completions create a rise in vacancy

With 20 development schemes reaching practical completion, vacancy rates increased across all of the South East submarkets during the first quarter. Over 800,000 sq ft of speculative space came to the market in Q1, this being the highest quarterly total for a decade. Vacancy rates in each submarket increased by 0.4% with the M25 rising to 6.1%, the M3 to 6.7% and the M4 up to 8.8%. Despite the increase, all remained well below respective long-term averages.

◆ UK buyers support investment volumes

In terms of actual deal numbers, Q1 2017 represents the most active start to a year since 2006, with 27 transactions completed. As a result, investment volumes reached £540m, lower than in Q4 2016 but 7.5% above the 10-year quarterly average for the region. Interestingly, UK buyers were responsible for 87% of investment turnover in Q1. This is in contrast to the experiences of 2016 when overseas buyers were dominant, accounting for 51%.

◆ Prime yields hold firm in Q1

Prime office yields remained at 5.25% in Q1, unchanged for the past 12 months. The weight of money targeting assets in the South East, coupled with the low level of stock, could result in yields hardening to 5.00% in the coming months. The prospect of genuine rental growth, cheap debt and most recently, a favourable exchange rate will further support investment in the South East in 2017.

OCCUPIER MARKET

Despite a quarter-on-quarter dip, letting activity in the Q1 proved comparative to the same period in previous years. Vacancy levels have begun to edge up but remain well below the long-term average.

SOUTH EAST
TAKE-UP
768,200
sq ft
▼ 19%



TAKE-UP (SQ FT)

M25 517,800 ▼ 23.0%

M3 133,500 ▼ 2.0%

M4 355,400 ▼ 18.0%



SUPPLY (SQ FT)

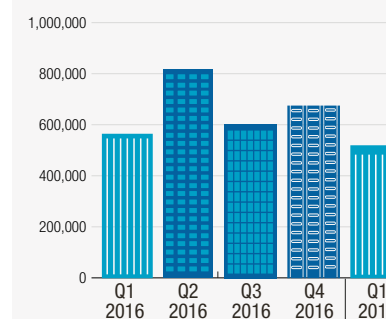
M25 7.3m ▲ 8.0%
New and Grade A space 81%

M3 2.6m ▲ 6.0%
New and Grade A space 77%

M4 5.9m ▲ 5.0%
New and Grade A space 90%

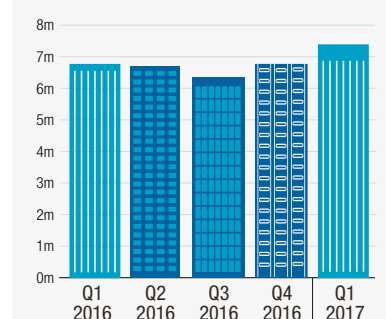
*Arrows reflect quarter-on-quarter change.

FIGURE 1
M25 Take-up (sq ft)



0.6m
UNDER OFFER
IN THE SOUTH
EAST IN Q1 2017

FIGURE 2
M25 Supply (sq ft)



20%
BELOW THE
10-YR AVERAGE
IN Q1 2017



EMMA GOODFORD

Although smaller requirements predominate in the South East, an interesting feature of Q1 was that eleven mid-range deals (20,000 – 50,000 sq ft) completed. This is the highest quarterly total within this size band since 2014.



RODDY ABRAM

Development completions in the M25 will peak in 2017, leading to a short-term increase in vacancy rates. Considering both historical take-up trends and the development pipeline, we anticipate that vacancy levels will stay below the long-term average.

Key leasing transactions Q1 2017

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
Block A, 100 Hercules Way, Leavesden Park, Watford	73,595	ASOS	£24.25
1 Pinehurst, Farnborough Business Park, Farnborough	48,829	INC Research	£27.00
1330 Arlington Business Park, Theale	38,374	Cornerstone Telecom	£26.00
2 Falcon Way, Shire Park, Welwyn Garden City	33,075	Tesco	Undisclosed
Centris, Vanwall Business Park, Maidenhead	30,574	SDL	Undisclosed

Source for all charts: Knight Frank Research

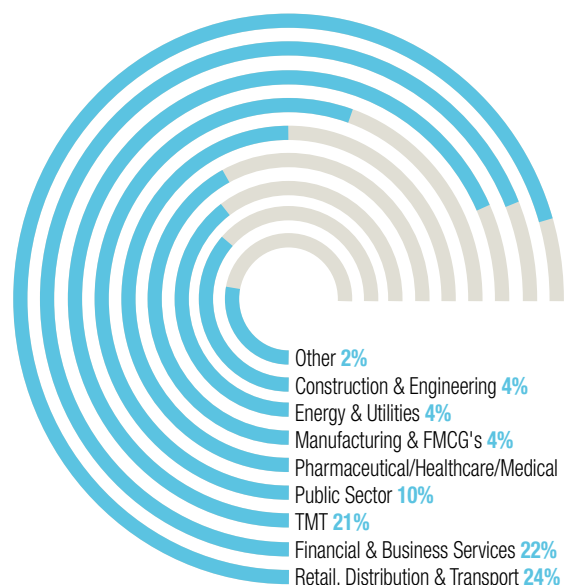
DEMAND

5.3msq ft

OF ACTIVE NAMED DEMAND
IN THE SOUTH EAST



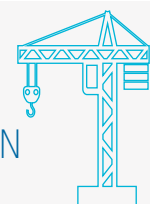
Active named demand



DEVELOPMENT

3.0msq ft

SPACE UNDER CONSTRUCTION
IN THE SOUTH EAST



*This includes pre-let and speculative space

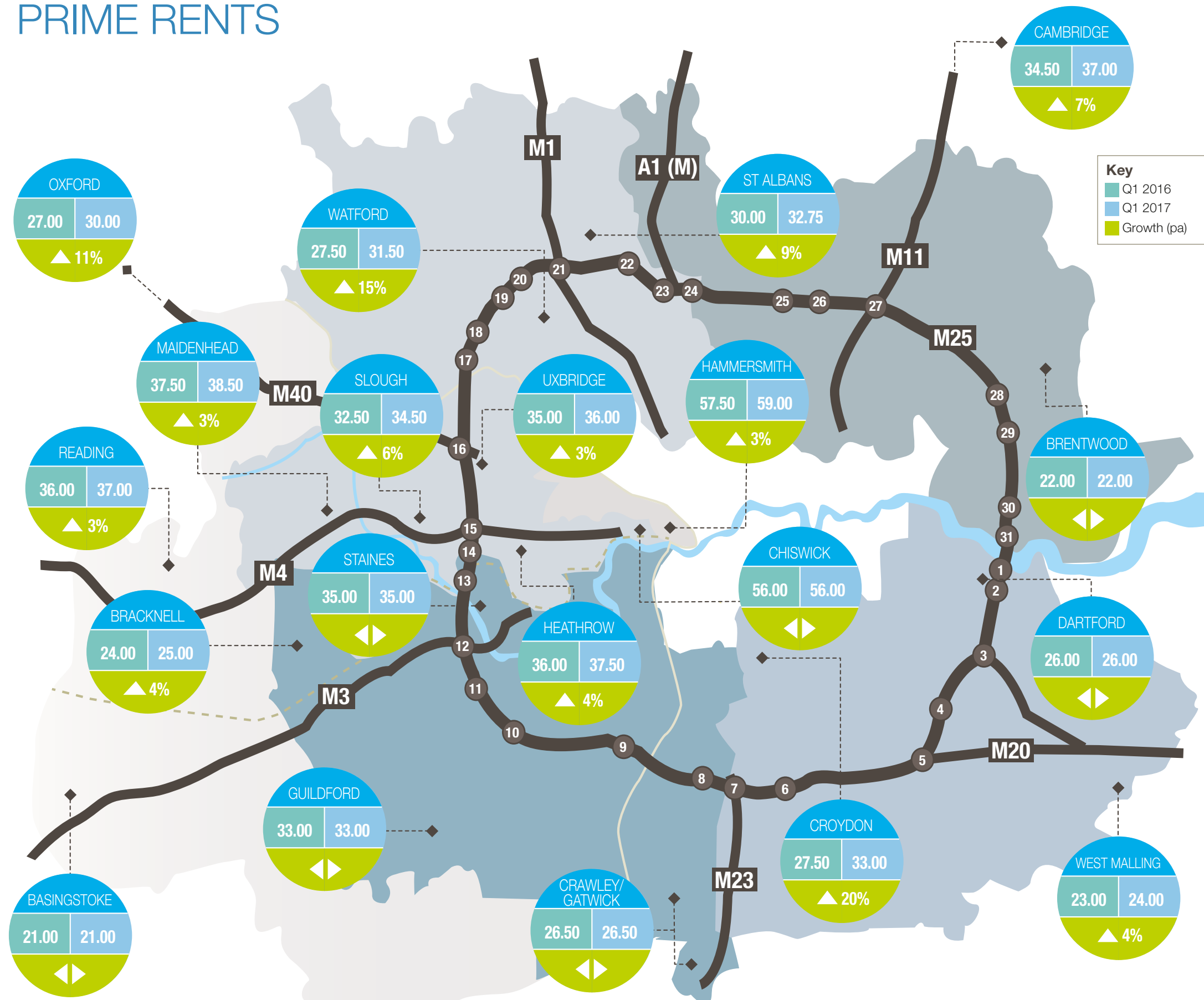
Speculative development (sq ft)

Due to complete before Q2 2018



Source for all charts: Knight Frank Research

PRIME RENTS



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

INVESTMENT MARKET

A return of UK buyers to the South East market characterised a strong start to 2017. A shortage of investment stock threatens to frustrate investors in future months however, with the market imbalance adding pressure on pricing.

18%

£540m

South East transaction volume

£20m

Mean lot size

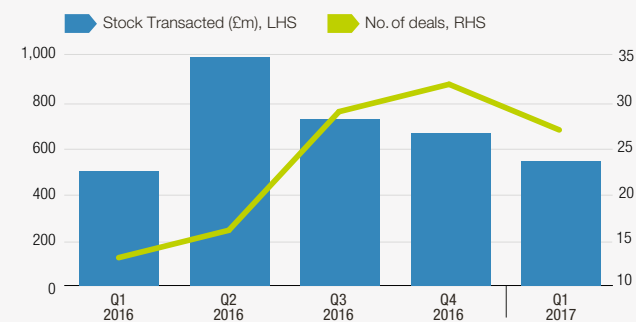
5.25%

Prime net initial yield

87%

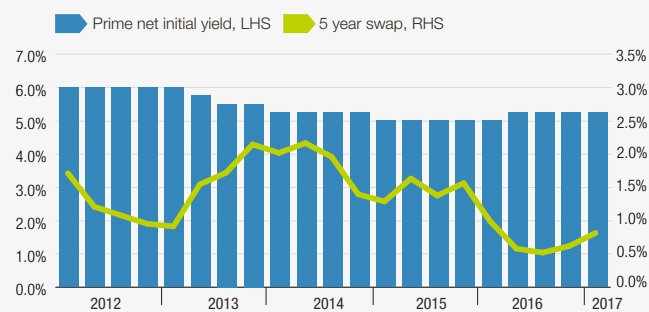
Buyers from the UK

FIGURE 3
Investment volumes



TIM SMITHER
With investors taking stock of market conditions, we had anticipated a slow start to the year, but the high deal rate in Q1 has been encouraging. A continuing concern for investors that are considering an exit strategy on current holdings is where to reinvest given the lack of stock.

FIGURE 4
Prime net initial yield and finance



SIMON RICKARDS
With the councils, overseas investors and U.K. Funds all looking to invest, coupled with a lack of product, we expect pricing for long income and prime multi-let assets to sharpen during the year, particularly with a number of occupational markets now delivering genuine rental growth.

Key investment transactions Q1 2017

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
Carphone Warehouse, Acton	£83.50	4.9%	Crosstree	Imperial College
L&G Campus, Kingswood	£65.25	6.2%	Receivership	Legal & General
Chiswick Green, Chiswick	£65.10	5.3%	M&G Real Estate	Runnymede Borough Council
Reading Bridge House, Reading	£35.70	7.8%	M&G Real Estate	Topland
1 Olympic Way, Wembley	£35.50	N/A	Private	Quinata

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



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



RICHARD CLAXTON
Partner
+44 20 7861 1221
richard.claxton@knightfrank.com

Research



DR LEE ELLIOTT
Partner
Head of Commercial Research
+44 20 7861 5008
lee.elliott@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. Existing built office stock in the M3 market totals 39m 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 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 has been 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 March 31st 2017.

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