



Q2 2011 M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Take-up was subdued across the South East in Q2 2011. In the M25, Q2 take-up was just under half the quarterly average, although deals concluded in the first two weeks of July supports a strong rebound in take-up in Q3.
- Despite Q2's subdued figures, viewed bi-annually, M25 take-up in H1 2011 represents a marginal 1% improvement on H1 2010.
- Active named demand increased by 8% during Q2 to stand at 5.48m sq ft. Financial & Business Services and Manufacturing & FMCGs accounted for the largest share of demand, at 24% and 22% respectively.
- Development activity remains limited and stood unchanged in Q2, with an absence of any construction starts or completions in the quarter. A select number of additional speculative schemes are forecast to commence over the next six months.
- In the investment market, sentiment for prime South East stock has improved through the first half of 2011, with prime yields expected to harden from 6.25% to 6.00% by year end.

Demand and take-up

- Take-up across the South East was subdued in Q2 2011, reflecting an absence of large deals. M25 take-up was 327,951 sq ft, 14% below the Q2 2010 level and just below half the 10 year quarterly average.
- Following resilient take-up over the previous 12 months, the M4 was particularly quiet in Q2. Here, 10 deals took place totalling 119,834 sq ft, 69% down on Q2 2010 and 70% below the quarterly average. The largest deal in the M4 was in Slough, where NIL VIP Banqueting Ltd acquired 24,780 sq ft at 392 Bath Road.
- M3 take-up in Q2 was 77,602 sq ft, 66% below the quarterly average but only 9% below that of Q2 2010. The M3 saw the largest deal involving new space in Q2, where Autodesk acquired 21,322 sq ft at 392 Bath Road.

One Discovery Place. Farnborough at a headline rent of £18.50 per sq ft.

- The M25 North East quadrant saw a flurry of activity, however, with three deals totalling 68,103 sq ft taking place at Shire Park, Welwyn Garden City. Here, Tesco purchased the freehold of Buildings 3 and 5, totalling 57,770 sq ft - the largest of the 27 deals seen in the M25 in Q2.
- With 760,000 sq ft of space under offer at the end of Q2, take-up in the M25 region will increase in the latter half of 2011. Active named demand also recovered by 8% during Q2 to stand at 5.48m sq ft, with Financial & Business Services and Manufacturing & FMCG's accounting for the largest share of demand, at 24% and 22% respectively.



Figure 1
M25 take-up

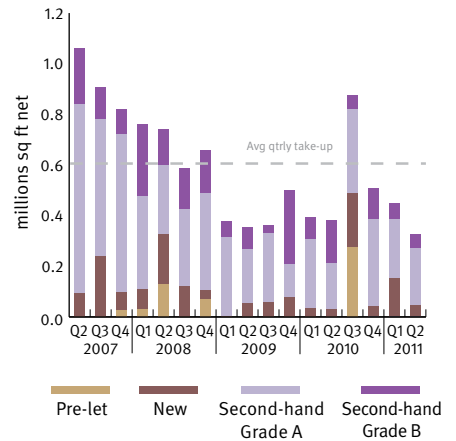


Figure 2
M4 take-up

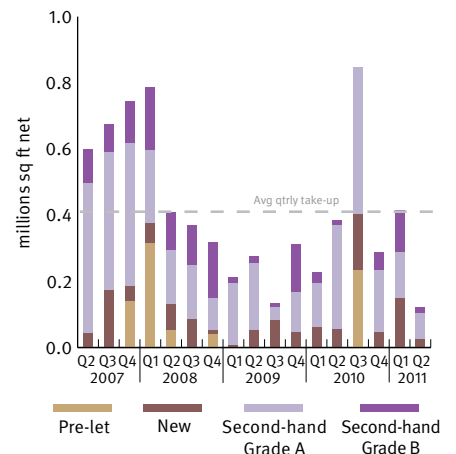
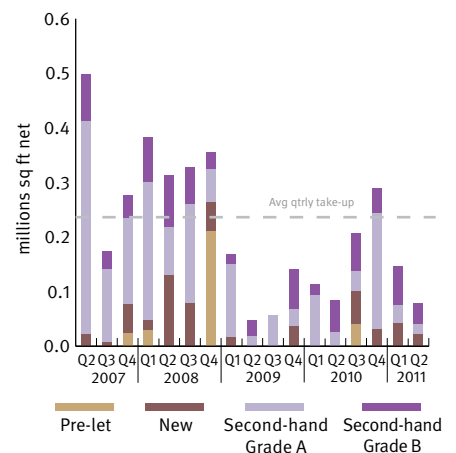


Figure 3
M3 take-up



Source: Knight Frank Research

Supply and development

- The M25 vacancy rate rose marginally during Q2 from 8.5% to 8.6%, its highest level since Q3 2005. However, the share of availability made up by New and Grade A space has fallen from a peak of 71% in Q2 2010 to 63% in Q2 2011, its lowest in 10 years.
- The M4 vacancy rate rose from 11.5% to 11.6% in Q2, reversing the fall seen in Q1. Similarly, the M3 vacancy rate edged up from 7.9% to 8.0% in Q2.
- Across the wider M25, tenant-release space in Q2 was only 116,000 sq ft, the lowest seen in any quarter on record and 68% below the five year quarterly average.
- Development activity was unchanged in Q2, with an absence of any new starts or completions. The only two speculative developments to commence during H1 are BAM Property's Chiswick Green development (81,544 sq ft) and Rockspring and Bell Hammer's The Stanza Building, in Uxbridge (78,850 sq ft).
- While speculative development is set to remain relatively muted, key centres will witness starts before year end. One example includes Rockspring and Exton Estates' Velocity at Brooklands, Weybridge, totalling 103,593 sq ft while Blackstone plan to develop Building 6, Chiswick Park, totalling 220,000 sq ft.

Market statistics

Table 1

Key town prime rents & forecasts

Town	Q2 prime rent (psf)	Rent free (months)
Basingstoke	£17.50 ▶	30 ▲
Bracknell	£20.00 ▶	39 ▶
Brentwood	£21.00 ▶	21 ▶
Chiswick	£37.50 ▲	21 ▶
Croydon	£19.00 ▲	33 ▶
Gatwick	£21.50 ▶	30 ▲
Guildford	£27.00 ▲	24 ▶
Hammersmith	£32.00 ▲	21 ▶
Heathrow	£27.50 ▲	30 ▶
Maidenhead	£29.50 ▲	24 ▼
Reading	£30.00 ▲	24 ▶
Slough	£21.00 ▲	30 ▶
Staines	£28.00 ▲	21 ▼
St Albans	£22.00 ▲	24 ▶
Uxbridge	£28.00 ▲	24 ▶
Watford	£22.50 ▶	27 ▶
West Malling	£20.50 ▶	24 ▶

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

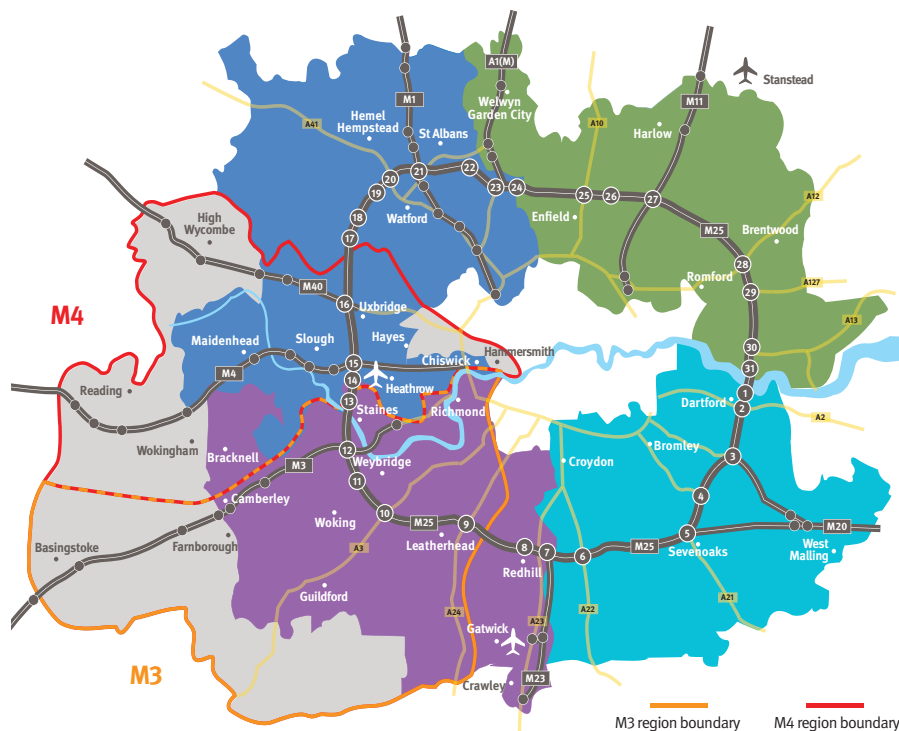


Table 2

Demand & Supply

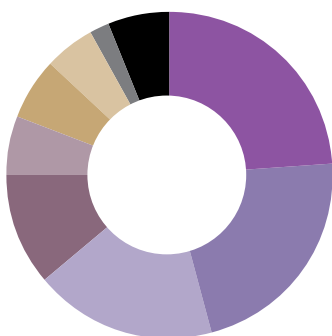
Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	327,951	120,498	108,961	68,103	30,389	77,602	119,834
Change Q2 11 vs Q1 11	-27% ▼	-39% ▼	-49% ▼	197% ▲	53% ▲	-47% ▼	-71% ▼
Change Q2 11 vs Q2 10	-14% ▼	-33% ▼	0% ▶	100% ▲	-67% ▼	-9% ▼	-69% ▼
Q2 pre-let (sq ft)	0	0	0	0	0	0	0
Q2 % take-up new & pre-let	14%	23%	17%	0%	0%	28%	21%
Forecast 2011 take-up (m sq ft)	2.3	-	-	-	-	0.6	1.8
Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	11,183,927	5,255,551	4,438,284	462,984	1,027,108	3,385,197	7,557,849
Change Q2 11 vs Q1 11	1% ▲	3% ▲	1% ▲	-13% ▼	1% ▲	1% ▲	1% ▲
Change Q2 11 vs Q2 10	10% ▲	11% ▲	10% ▲	3% ▲	10% ▲	1% ▲	2% ▲
Q2 % new	13%	13%	15%	12%	6%	13%	24%
Q2 % second-hand Grade A	50%	58%	48%	35%	29%	42%	54%
Q2 % second-hand Grade B	37%	29%	37%	54%	65%	45%	22%
Q2 vacancy rate (▲/▼ movement from Q1 11)	8.6% ▲	10.4% ▲	10.8% ▲	2.6% ▼	5.1% ▲	8.0% ▲	11.6% ▲
Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	268,894	160,394	108,500	0	0	108,500	160,394
Change 12 months	105% ▲	120% ▲	100% ▲	-	-100% ▼	100% ▲	120% ▲
Pre-let	40,000	0	40,000	0	0	40,000	0

Source: Knight Frank Research



Figure 4

M25 active named enquiries by sector



Active demand is 5.48m sq ft at Q2 2011

Financial & Business Services	24%
Manufacturing & FMCG's	22%
ICT	18%
Retail, Distribution & Transport	11%
Pharmaceutical, Healthcare & Medical	6%
Public Sector	6%
Utilities	5%
Construction & Engineering	2%
Other	6%



FORECAST AT A GLANCE

Take-up:

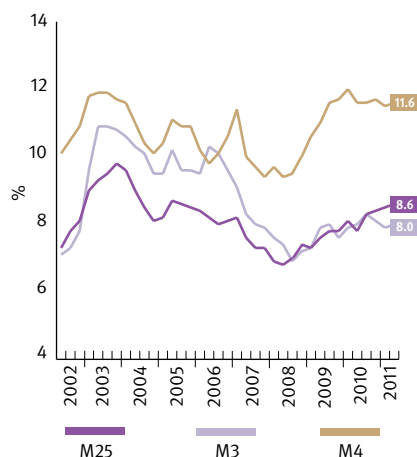
- Q2's subdued take-up can be regarded as a temporary set-back to the South East office market's gradual recovery. With a number of key deals having completed early in Q3 and a strong pipeline of deals under offer, we forecast M25 take-up in the latter half of 2011 to be approximately 40% higher than the first half.
- The Thames Valley will show the strongest rebound on Q2's figures, with a significant volume of space under offer in Reading, Marlow and Maidenhead. Evidence suggests the M3 will remain more subdued, with space under offer here representing just 15% of the wider M25 total.
- As the three year anniversary of Lehman's demise approaches, there is value in drawing comparison with the previous downturn of the early Noughties tech collapse. In that cycle, it took four years before take-up levels were consistently robust. In this cycle, we anticipate take-up to return to average levels by late 2012, driven in part by a new wave of demand from the ICT sector. We remain more cautious of Financial & Business Services activity due to the continuing uncertainty in the US and Eurozone economies.

Supply and rents:

- With development limited and few schemes likely to commence construction over the next 12 months, levels of New and Grade A supply will be steadily eroded to over the next two years. We forecast the that overall vacancy rate will remain broadly stable, as occupiers upgrade their space following lease events and expiries, vacating less attractive Grade B space.
- Recent transactional evidence indicates an uplift in headline rents in the most active, tightly supplied markets, such as Chiswick, Staines and Uxbridge. However, more widespread has been a hardening of incentives which, over the last 12 months, has translated into a 5% average increase in net effective rents.
- Aside from a number of prime centres, headline rents are likely to remain broadly flat over the next 18 months. However, net effective rents are likely to show more widespread improvement as rent free incentives are reined in. Underpinning this will be increasing competition among tenants for a diminishing supply of Grade A space.

Figure 5

Vacancy rates



Source: Knight Frank Research

Figure 6

Space under construction in the M25

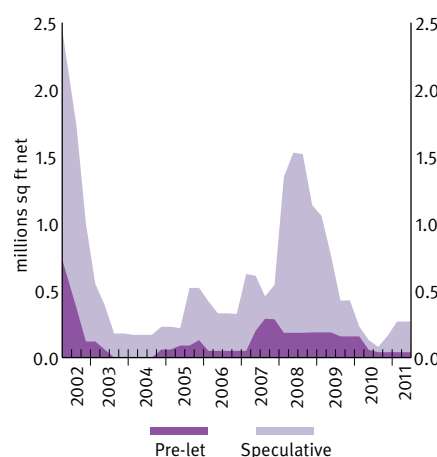
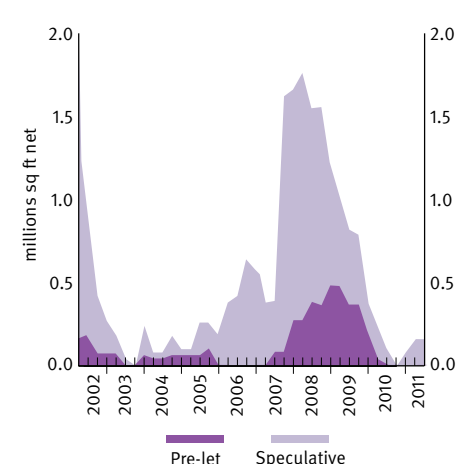


Figure 7

Space under construction in the M4



Q2 2011 M25 OFFICES

Investment, development & occupier markets

Investment market

Table 3
Key investment transactions Q2 2011

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
Grenfell Island, Maidenhead	201,079	£72.50m	7.25%	Castlemore / British Land
Sir William Siemens, Frimley	183,867	£42.35m	7.00%	Invista / USS
1 Longwalk, Stockley Park, Heathrow	71,374	£26.50m	7.21%	CBREi / RREEF
5 The Square, Stockley Park, Heathrow	71,653	£24.50m	8.75%	IVG / Oxygen Asset Management
Honeywell House, Bracknell	72,379	£19.10m	8.50%	F&C / Private overseas

	Transaction volume	Mean lot size	Mean NIY
Q2 2011	£315.14m	£15.01m	8.31%
Change 3 mths	-58% ▼	-54% ▼	119bps ▲
Change 12 mths	-11% ▼	-15% ▼	23bps ▲

INVESTMENT VIEW

- Following Blackstone's £480m acquisition of Chiswick Park in Q1, PRUPIM's Green Park is presently under offer to Oxford Properties for £415m, reflecting 8.17% NIY. These two transactions are the largest ever seen in the South East.
- Headline deals in Q2 included Invista's sale of Sir William Siemens Square, Frimley for £42.35m, reflecting 7.00% NIY. Bidding for the asset was very competitive, demonstrating the weight of money seeking prime stock in the South East.
- Sentiment for prime South East stock has improved through the first half of 2011 as investors consider more attractive yields outside Central London. Consequently, as demand outweighs supply, we expect prime yields to harden from 6.25% to 6.00% by year end. The definition of good quality secondary has also widened, with investors accepting slightly more risk in exchange for a greater number of buying opportunities.
- A number of institutional investors have been looking at the key M25 towns such as Maidenhead and Reading town centres, where there is a shortage of prime space. For example, Davidson House on Forbury Square, Reading is presently under offer at a price considerably in excess of quoting, reflecting a yield of 6.50%.



Figure 8
£m investment volumes and lot size

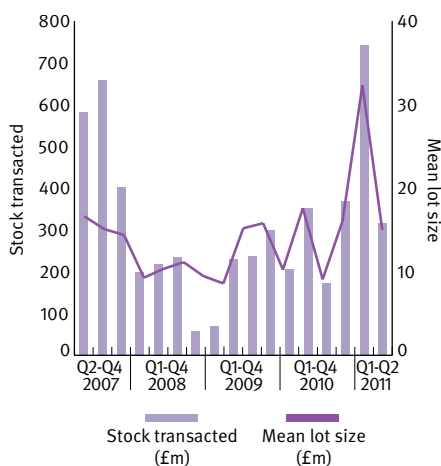


Figure 9
Mean initial yield & finance

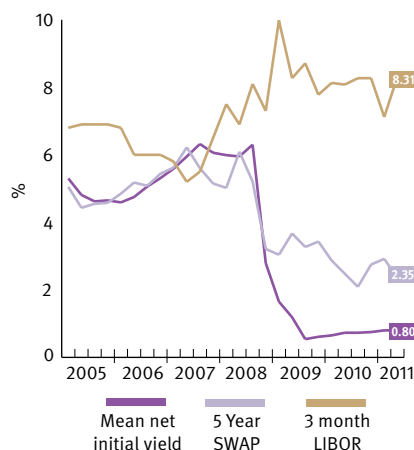
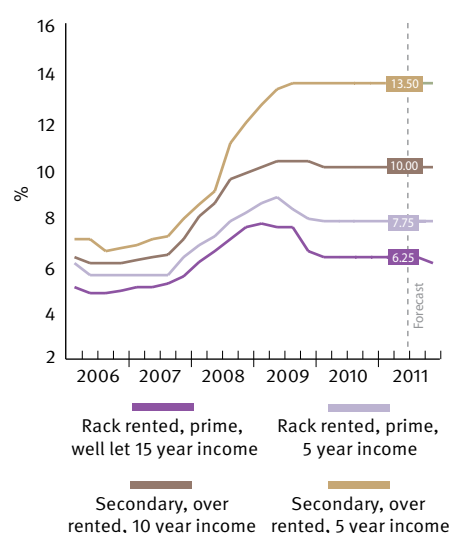


Figure 10
Yield forecasts



Source: Knight Frank Research



Americas

USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia

Australia
New Zealand

Europe

UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa

Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia

Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
Thailand
Vietnam

The Gulf

Bahrain
Abu Dhabi, UAE

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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 June 30th 2011.

Front cover image: 500 South Oak Way, Green Park, Reading

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