RESEARCH

Knight Frank

Q2 2013

M25 OFFICES

Investment, development & occupier markets

HIGHLIGHTS

- Occupier activity has returned to healthy levels in the M25, with two successive quarters of robust take-up in H1 2013. Underling the improving depth of demand, the period also comprised 79 deals, the highest amount seen since H2 2008.
- Q2 take-up was spread relatively evenly across a variety of sectors, including Financial and Business Services, TMT and Retail. However, Pharmaceuticals & Health narrowly accounted for the highest share in Q2, with 18% of take-up across eight deals.
- Despite robust take-up, the M25 vacancy rate edged up from 7.7% to 7.8% during Q2. Conversely, the vacancy rate in the M3 and M4 markets fell marginally during Q2, to 8.7% and 9.7% respectively.
- Investment demand is increasingly buoyant, with turnover reaching £402m in Q2, 35% above 5-year quarterly average. Yields for prime 15-year income moved in from 6.00% to 5.75% during Q2, with demand significantly outweighing supply.

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Demand and take-up

- M25 take-up was 622,856 sq ft in Q2, taking the total for H1 2013 to 1.27m sq ft, the strongest total for the first half of a year since 2008. H1 2013 also saw 79 transactions in the M25, the highest since H2 2008 and indicative of improving depth to market activity.
- Q2 saw two pre-lets amounting to 76,000 sq ft. In Croydon, The Pension Protection Fund agreed to 40,241 sq ft at Abstract's Renaissance prior to its practical completion, while Henkel secured a 35,890 sq ft build-to-suit pre-let on their existing site in Hemel Hempstead.
- The M3 region, which was especially hard-hit by the downturn, saw strong take-up of 304,369 sq ft in Q2, 34% above the 10-year quarterly average. Of the 15 deals in the M3, the largest comprised Enterprise Rent-a-car's 46,866 sq ft lease at Assurance House and part of Integra House, Egham.
- The M4 was more subdued in Q2, with take-up of 373,047 sq ft, 13% below Q1 and 10% below the 10-year quarterly average. Reading accounted for almost half of M4 take-up and was home to Q2's largest deal, Reading Council's £10.65m owner-occupier freehold purchase of 85,000 sq ft at Plaza West.
- Q2 take-up was driven by a typically diverse range of sectors, including Financial and Business Services, TMT, and brand-names. However, unusually, Pharmaceuticals & Health was the most active sector in Q2, accounting for 18% of take-up across eight transactions. Furthermore, while total unsatisfied demand is broadly stable compared with last year, at c. 6m sq ft, demand from Pharma & Health has increased fourfold to c.650,000 sq ft.


In Q2, Akamai acquired 21,039 sq ft at X1A Aviator Park, Weybridge at an agreed headline rent of £28.00 per sq ft. Knight Frank acted for the landlord, P&O Properties.

Supply and development

- Despite robust take-up, availability in the M25 edged up by 1% during Q2 to leave the vacancy rate at 7.8%. The rise reflected an above average release of secondhand space to the market, particularly in the South East quadrant, where availability increased 20% during Q2.
- Conversely, the vacancy rate in the M3 and M4 markets fell to 8.7% and 9.7% respectively in Q2, with both areas seeing a lower than average amount of secondhand space released to the market.
- New and secondhand Grade A space accounts for the largest share of availability in the M4 region, making up 78% of the total. The opposite is true for the Eastern quadrants of the M25, where poorer quality Grade B space dominates.
- Q2's sole speculative completion was 10 Hammersmith Grove, West London, a brand new development by Development Securities and SWIP totalling 109,000 sq ft.
- Development activity was broadly stable during Q2, with just under 1m sq ft under construction across 10 schemes in the M25. The majority of activity is focused in Maidenhead, Staines and Chiswick, all of which have seen rental growth over the past 18 months.

Figure 1
M25 take-up

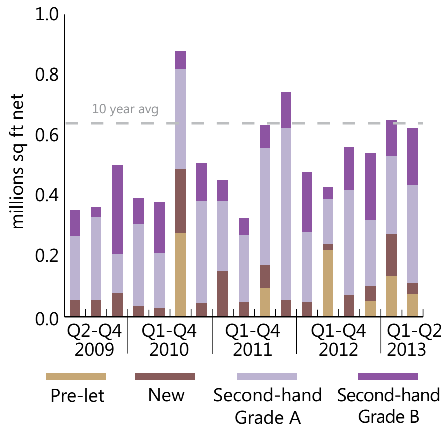


Figure 2
M4 take-up

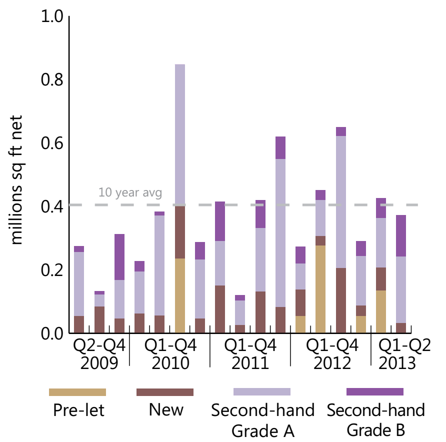
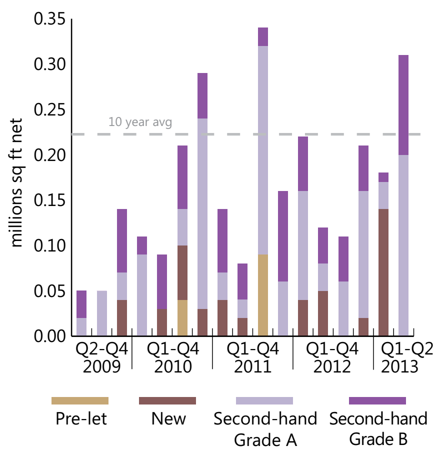


Figure 3
M3 take-up



Source: Knight Frank Research

www.KnightFrank.com

Market statistics

Table 1
Key town prime rents & forecasts

Town	Q2 prime rent (psf)	Rent free (months)
Basingstoke	£17.50 ▶	33 ▼
Bracknell	£20.00 ▶	36 ▶
Brentwood	£21.00 ▶	24 ▶
Chiswick	£47.50 ▲	18 ▼
Croydon	£24.50 ▲	24 ▼
Gatwick	£22.50 ▶	27 ▶
Guildford	£30.00 ▲	21 ▼
Hammersmith	£45.00 ▲	18 ▼
Heathrow	£30.00 ▲	24 ▼
Maidenhead	£32.00 ▶	21 ▶
Reading	£30.50 ▲	27 ▶
Slough	£22.50 ▲	32 ▶
Staines	£32.00 ▲	21 ▶
St Albans	£23.00 ▶	24 ▶
Uxbridge	£32.00 ▲	21 ▶
Watford	£23.00 ▶	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

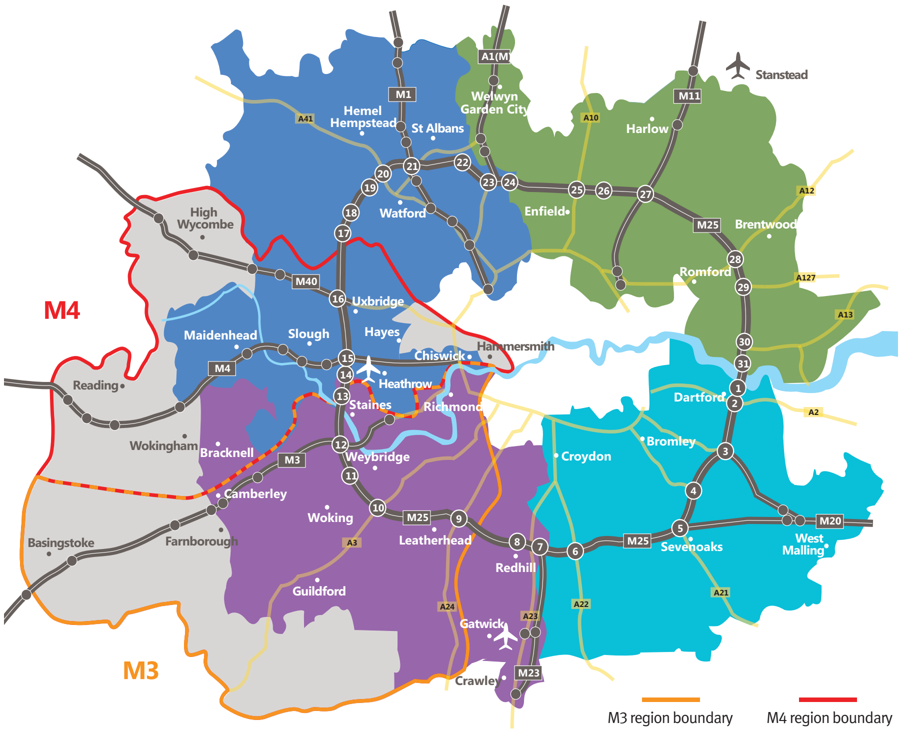


Table 2
Demand & Supply

Take-up	**M25**	NW	SW	NE	SE	M3	M4
Sq ft	**622,856**	173,792	362,800	13,523	72,741	**304,369**	**373,047**
Change Q2 13 vs Q1 13	**-4%** ▼	-41% ▼	34% ▲	-72% ▼	128% ▲	**69%** ▲	**-13%** ▼
Change Q2 13 vs Q2 12	**44%** ▲	-50% ▼	379% ▲	100% ▲	553% ▲	**173%** ▲	**-17%** ▼
Q2 pre-let (sq ft)	**75,286**	35,890	0	0	39,396	**0**	**0**
Q2 % New & Grade A (inc. pre-lets)	**70%**	88%	60%	0%	88%	**64%**	**65%**
Forecast 2013 take-up (m sq ft)	**2.10**	**1.00**	**0.85**	**0.10**	**0.15**	**0.85**	**1.75**

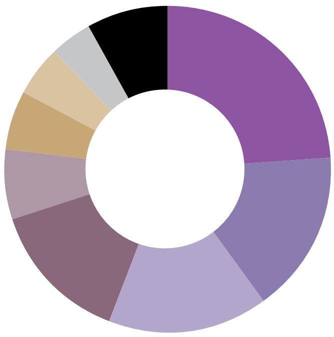
Availability	**M25**	NW	SW	NE	SE	M3	M4
Sq ft	**10,212,834**	4,408,350	3,752,548	372,428	1,679,508	**3,608,884**	**6,556,564**
Change Q2 13 vs Q1 13	**1%** ▲	1% ▲	-4% ▼	-8% ▼	20% ▲	**-3%** ▼	**0%** ◀▶
Change Q2 13 vs Q2 12	**-4%** ▼	-7% ▼	-7% ▼	-16% ▼	21% ▲	**-3%** ▼	**-6%** ▼
Q2 % new	**13%**	12%	19%	14%	4%	**12%**	**21%**
Q2 % second-hand Grade A	**49%**	63%	46%	43%	19%	**57%**	**57%**
Q2 % second-hand Grade B	**38%**	25%	35%	43%	77%	**31%**	**22%**
Q2 vacancy rate (▲/▼ movement from Q1 13)	**7.8%** ▲	8.7% ◀▶	9.2% ▼	2.1% ▼	8.3% ▲	**8.7%** ▼	**9.7%** ▼

Under construction	**M25**	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**1,321,250**	729,298	312,869	0	**279,083**	**293,524**	**997,345**
Change 12 months	**43%** ▲	96% ▲	-11% ▼	–	182% ▲	**-19%** ▼	**59%** ▲
Pre-let	**360,151**	250,755	70,000	0	39,396	**70,000**	**215,755**

Source: Knight Frank Research

Figure 4

M25 active named enquiries by sector



Active demand is 6.53m sq ft at Q2 2013

Financial & Business Services	20%	▼
Manufacturing & FMCGs	17%	▼
Technology, Media & Telecoms	15%	▼
Retail, Distribution & Transport	14%	▼
Pharmaceutical & Health	10%	▲
Construction & Engineering	7%	▲
Energy & Utilities	6%	▲
Public Sector	4%	▼
Other	8%	▼

Note: % = current share of demand
▲ = Movement in last 12 months (absolute terms)

In Croydon, the Pensions Protection Fund pre-let 40,241 sq ft at Renaissance, prior to completion. Knight Frank acted for the landlord, Abstract Securities.

FORECAST AT A GLANCE

Take-up:

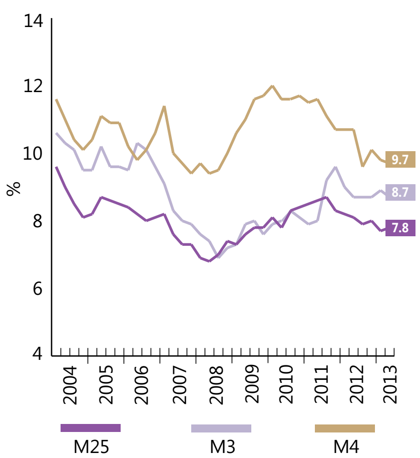
- The first half of 2013 has seen encouraging levels of activity, pointing to a broader revival in business confidence and a renewed willingness to commit among occupiers. Prospects for a sustained improvement have also been boosted by the latest forward-looking business surveys, which reveal that the UK services sector growth reached a three year high in June.
- Just as the upturn in the UK economy has surpassed analysts' initial expectations, the rebound in occupier activity has exceeded our own – at the mid-point of 2013, M25 take-up has already reached 62% of Knight Frank's initial forecast of 2.1m sq ft for the full year. With space under offer standing at a healthy 840,000 sq ft, an upward revision to our forecast for 2013 take-up is anticipated.
- However, occupier demand will remain overwhelmingly focused on the best quality accommodation, and it is telling that poorer quality Grade B buildings account for just 15% of space presently under offer. In the short-term, locations that are already well-supplied with Grade A space, such as Reading, Maidenhead and Ealing, are therefore best-placed to benefit from the upturn in activity.

Supply and rents:

- With business confidence improving, securing high quality space is becoming one of the key challenges occupiers now face. Many locations are heading towards a crunch in Grade A supply by the end of the year, particularly in the West London markets and the prime Surrey towns, many of which have less than two years of Grade A supply is available (Figure 7).
- Reflecting falling supply and improving sentiment, we anticipate rental growth to extend beyond West London to other markets in the Thames Valley and prime Surrey towns over the next 12 months. A number of deals achieving headlines rents in excess of £30 per sq ft are imminent, and this will instil greater confidence among developers to bring speculative schemes forward.
- There is growing appetite for speculative development, partly thanks to a renewed willingness to lend among fund investors. By the end of 2013, we expect a further 560,000 sq ft of development to come forward across a dozen schemes, focused predominantly in the Thames Valley, where landlords are confident of rental growth. Some of this will take the form of back-to-frame refurbishments, which benefit from historic parking ratios.

Figure 5

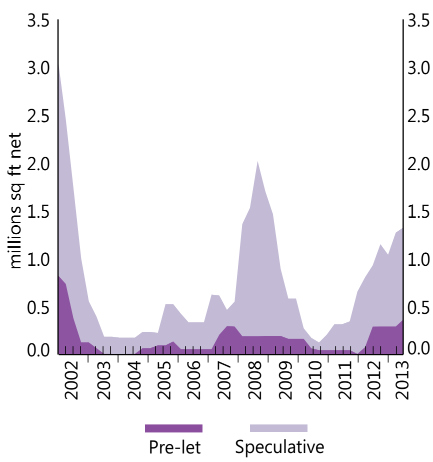
Vacancy rates



Source: Knight Frank Research

Figure 6

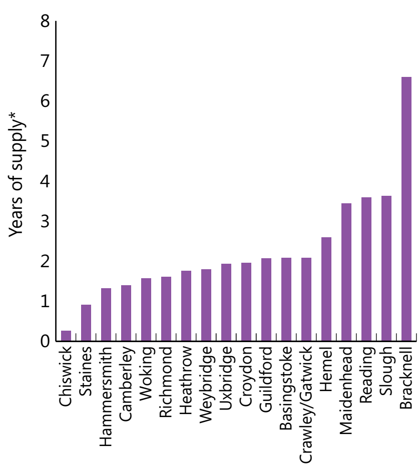
Space under construction in the M25



Source: Knight Frank Research

Figure 7

New & Grade A supply in key markets



Source: Knight Frank Research

* Based on average New & Grade A take-up vs current New & Grade A availability

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M25 OFFICES
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Investment market

Table 3 **Key investment transactions Q2 2013**

Building	Size (sq ft)	Price	Net Initial Yield	Vendor/ Purchaser
Abbott House, Vanwall Business Park, Maidenhead	76,662	£29.90m	6.64%	Aviva / AXA
British Gas, Oxford Business Park	81,470	£29.10m	5.95%	Goodman / Charles Street Buildings
121 Kings Road, Reading	95,600	£18.11m	14.38%	IVG UK Ltd / SWIP
2 Roundwood, Stockley Park, Heathrow	93,570	£18.00m	13.37%	Ignis / Europa
Walton Green, Walton-on-Thames	30,952	£12.85m	6.66%	Hibernian / Capital Trust

	Transaction volume	Mean lot size	Mean NIY
Q1 2013	£402.22m	£12.97m	9.30%
Change 3 mths	35% ▲	-17% ▼	115bps ▲
Change 12 mths	3% ▲	-47% ▼	119bps ▲

INVESTMENT VIEW

- Investment demand for South East offices is increasingly buoyant, reflecting a combination of heightened overseas interest, strong pressure to spend among the UK Funds and an improving outlook for the occupier market.
- Total turnover reached £402m in the quarter, the highest since Q4 2011 and 35% above the five-year quarterly average. There were also no deals of over £100m to skew the picture, with Q2's 31 transactions the most seen in a single quarter since Q3 2007.
- Reflecting the weight of demand, yields for prime 15-year income moved in from 6.00% to 5.75% during Q2, while yields for prime mid-term income also hardened by 25bps to c.7.00%.
- Overseas interest is now emanating from all around the globe, with capital from the Middle East and Asia-Pacific seeking predominantly prime, long income opportunities. There is also strong demand from the UK Funds and US private equity buyers for shorter income stock offering potential for asset management.
- Although the market for poorer quality secondary and tertiary assets remains relatively thin, evidence suggests that pricing has now at least found its floor, with yields in this sector of the market holding steady in Q2.

One of Q2's headline deals was AXA's £29.9m purchase of Abbott House, Vanwall Business Park, Maidenhead, from Aviva, reflecting a net initial yield of 6.64%.

Figure 8
£m investment volumes and lot size

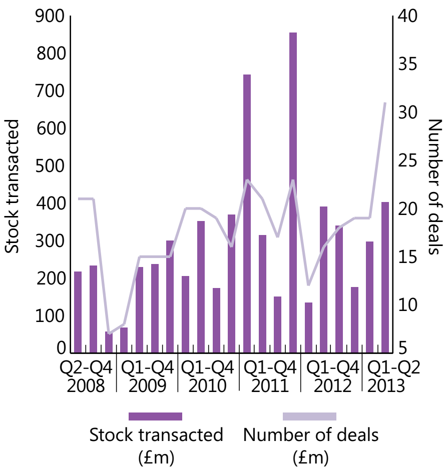


Figure 9
Mean initial yield & finance

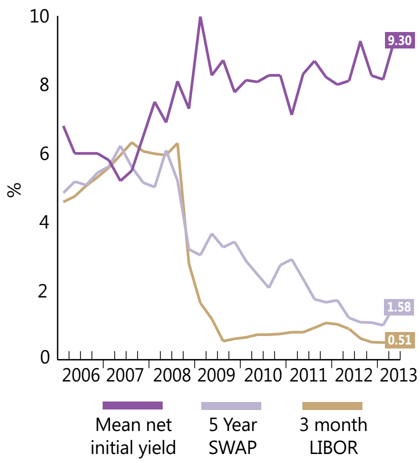
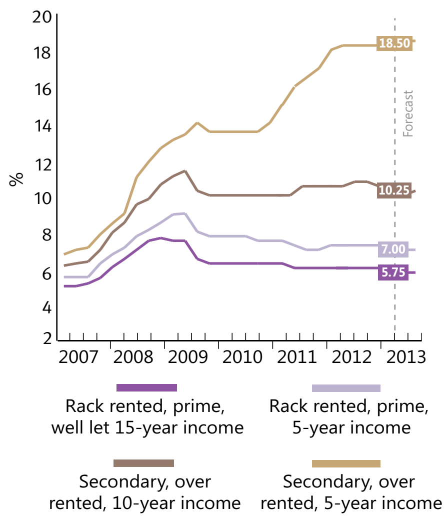


Figure 10
Yield forecasts



Source: Knight Frank Research

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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 66.5m 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 42.0m 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 63.5m 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 2013.

Front cover image: The Stanza Building, Uxbridge (internal shot)