RESEARCH

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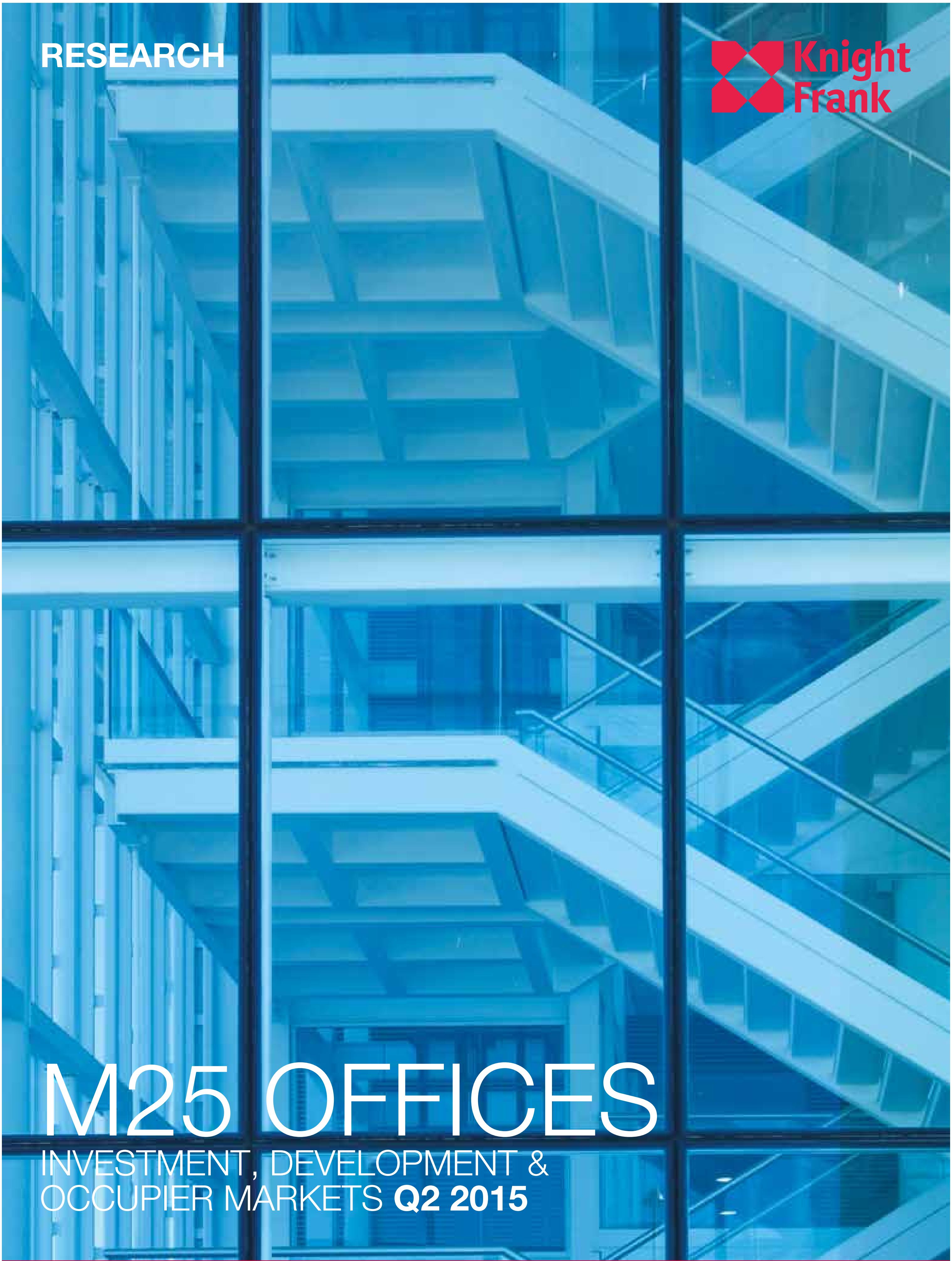


M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPIER MARKETS **Q2 2015**

RENTS RISING

M25 VACANCY RATE AT RECORD LOW OF 5.7%

PRIME YIELDS REMAIN STABLE AT 5.00%

"After a relatively quiet Q1, we have seen an increase in volumes which have been well received as rental growth takes off. There is a continued strong appetite to invest in the South East."

TIM SMITHER
Head of National Offices Investment

EXECUTIVE SUMMARY

Second quarter sees rents rise, supported by a lack of supply, while strong investor demand continues to put downward pressure on yields.

The investment market across the M25 and Thames Valley office market has been exceptionally buoyant in the first half of 2015. Strong sentiment combined with a wall of money looking to invest is seeing pricing for good secondary stock continue to harden and putting pressure on yields.

Following subdued occupier demand in 2014 and in the first quarter, take-up in Q2 was marginally below the 10 year average; despite this rents have continued to rise supported by a lack of supply and we are forecasting further rises in rents in 2015.

FORECAST AT A GLANCE

Forecast 2015 take-up (million sq ft)

2.60	0.70	1.75
M25	M3	M4

Take-up

M25 take-up to be 30% up on 2014

Demand in line with 10-year average

Demand driven by growth and expansion

Q2 average deal size in the M25 was 14,700 sq ft

Supply

A third of all speculative space under construction in South East to be delivered this year

Vacancy rate for New and Grade A stock down to 4%

Rents to continue rising

OCCUPIER MARKET

M25 office take-up (615,435 sq ft) in Q2 was 52% up on the same period in 2014. Vacancy rate at lowest level since late 2001.

Demand and take-up

M25 office take-up remained healthy at 615,435 sq ft in Q2 2015, 5% lower than in the previous quarter and 3% below the 10-year quarterly average. Q2's largest deal was Virgin Atlantic's leasehold acquisition of the Leonardo Building in Crawley (110,000 sq ft).

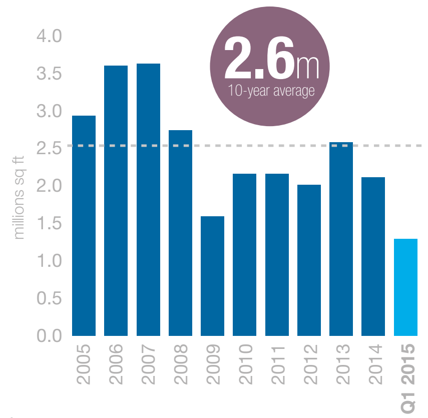
77% of office space taken in Q2 was New and Grade A.

M3 take-up amounted to 185,937 sq ft, just over half the level in Q1, and 18% down on the same period last year and 19% below the 10-year quarterly average.

Similarly, M4 take-up was modest at 211,972 sq ft, 21% down on Q1 and 31% lower than in the same quarter last year, reflecting a lack of larger deals.

Active named demand increased by 2% during Q2 to stand at 7.2m sq ft, which is the highest since Q2 2008.

FIGURE 1
M25 take-up



Source: Knight Frank Research

Supply and development

M25 availability fell by 5% to 7.4m sq ft in Q2 2015. New and good quality Grade A space accounts for 71% of total availability.

Vacancy rates across the main markets have fallen further to their lowest since the end of 2001. The M25 vacancy rate currently stands at 5.7%, while M3 and M4 vacancy rates are 6.6% and 7.1%, respectively. New and Grade A vacancy in the M25 market is now at a 14-year low of 4.0%.

Only 3 new speculative developments totalling ca. 144,000 sq ft of office space were completed in the South East in Q2.

There are currently 30 schemes under construction in the South East, a third of which is to be delivered this year.

7.2m
active demand (sq ft)

77%
of M25 office space taken in Q2 was Grade A and New

5.7%
vacancy rate in M25

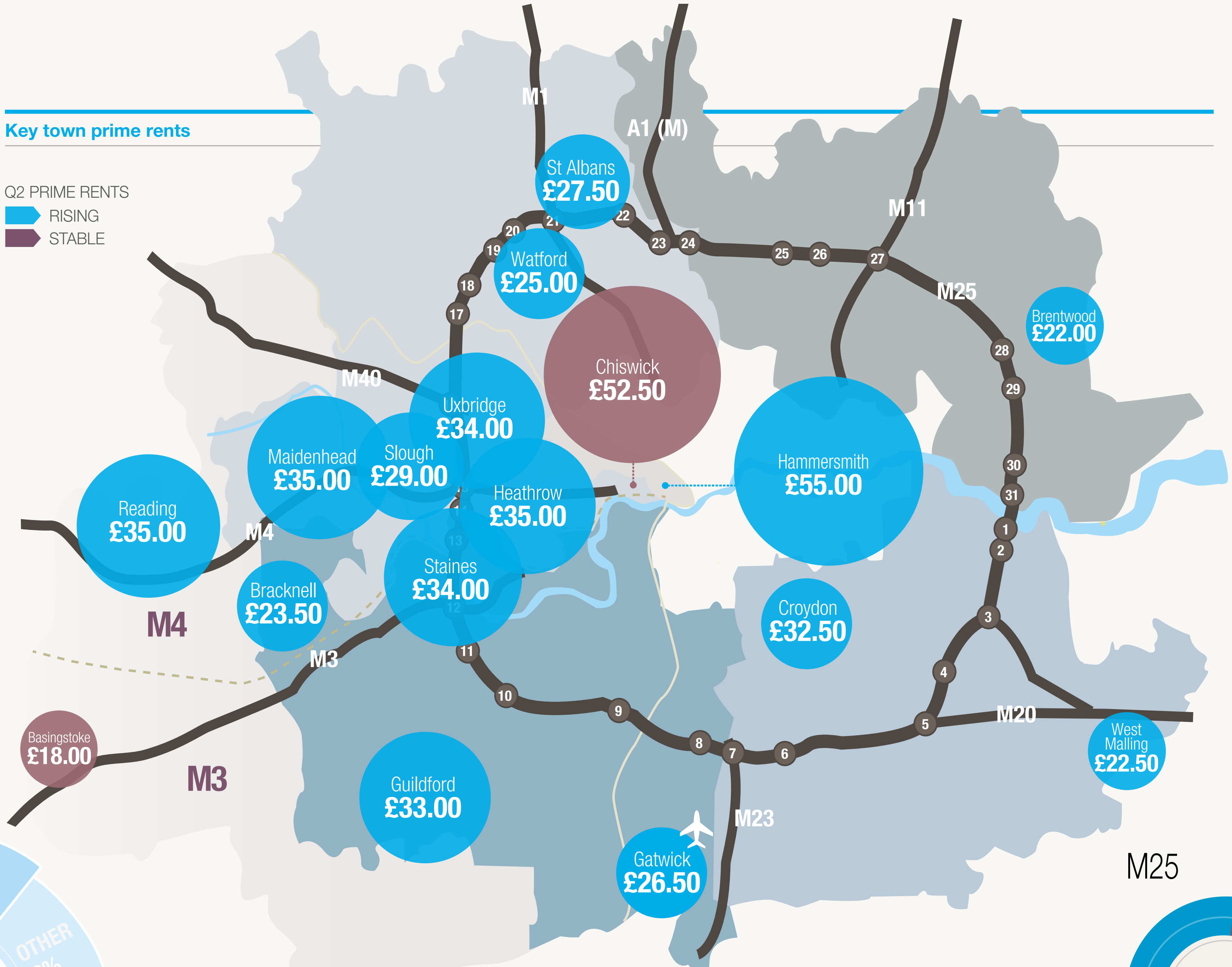
2.7m
under construction in M25 (sq ft)

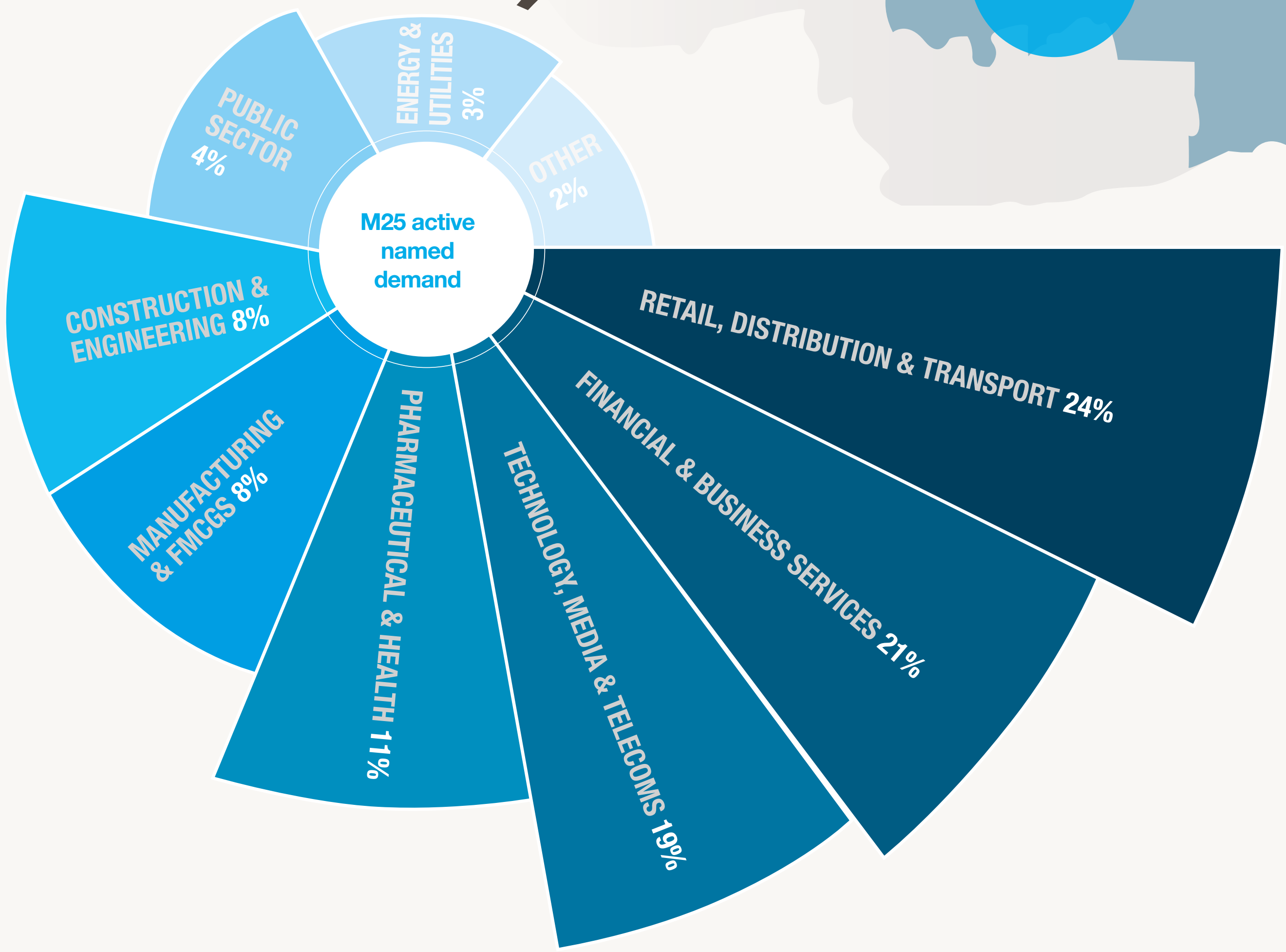
Q2's largest occupational transaction. Virgin Atlantic acquired The Leonardo Building , Crawley. Knight Frank acted for the Landlord (Abstract Securities).

MARKET STATISTICS

Active named demand currently stands at 7.2m sq ft and shows that the market remains balanced with occupier enquiries coming from a diverse range of sectors. The majority of Q2 enquiries came from the Retail & Distribution sector, which accounted for 24% of total demand, followed by Financial & Business Services (21%) and TMT (19%). Other sectors included Pharmaceuticals & Health (11%), Construction & Engineering and Manufacturing (both 8%).

Key town prime rents





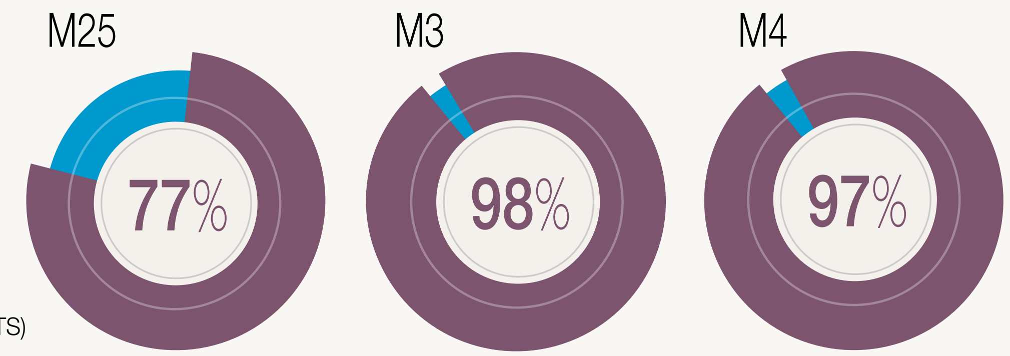
Demand & Supply

TAKE-UP	M25	M3	M4
sq ft	615,435	185,937	211,972
Change Q2 15 vs Q1 15	-5% ▼	-52% ▼	-21% ▼
Change Q2 15 vs Q2 14	52% ▲	-18% ▼	31% ▲
Q2 Pre-let (sq ft)	109,685	0	0
Q2 % New & Grade A (inc pre-lets)	77%	100%	97%
Forecast 2015 take-up (m sq ft)	**2.60**	**0.70**	**1.75**

AVAILABILITY	M25	M3	M4
sq ft	7,407,466	2,685,297	5,016,462
Change Q2 15 vs Q1 15	-5% ▼	-0.2% ▼	-2% ▼
Change Q2 15 vs Q2 14	-12% ▼	-7% ▼	-11% ▼
Q2 % New	17%	23%	17%
Q2 % second-hand Grade A	55%	52%	69%
Q2 % second-hand Grade B	29%	25%	15%
Q2 vacancy rate (▲/▼ movement from Q4 14)	-5.7% ▼	6.6% ◆	-7.1% ▼

CONSTRUCTION	M25	M3	M4
sq ft (net)	1,730,314	109,100	2,675,451
Change 12 months	63% ▲	-77% ▼	59% ▲
Pre-let (sq ft)	109,685	0	115,000

Q2 % New & Grade A take-up (Including pre-lets)



Q2 % NEW & GRADE A (INC PRE-LETS)

New and Grade A vacancy is at a new low of 4.0%.

Q2 2015 vacancy rate (▲/▼ movement from Q1 15)

M25	M3	M4
▼ 5.9%	▼ 6.6%	▼ 7.3%
5.7%	**6.6%**	**7.1%**

Source for all charts: Knight Frank Research

1,296m
Transaction volume (£)

48m
Mean lot size (£)

5.00%
Prime NIY

INVESTMENT MARKET

The South East investment market has seen exceptional levels of turnover in the second quarter of 2015 and investor demand significantly outstrips supply, both at the prime and secondary ends of the market.

Investor demand continues to strengthen, with Q2 turnover reaching £1.3bn, a record for the South East, excluding the sale of Chiswick Park in 2013.

This is 154% ahead of the 10 year average, and a 135% increase on Q1, as vendors looked to take advantage of buoyant market sentiment and a largely frustrating Q1.

Q2 was characterised by a number of particularly large lot sizes, with the largest four transactions being over £100m and accounting for 45% of turnover, as UK Institutions favour larger, deliverable assets.

Prime yields remain at 5.00% NIY but investors will consider paying below this where significant rental growth is anticipated, particularly in West and South West London, and dominant main Thames Valley centres.

We anticipate yields to continue to harden throughout the year, with equivalent yields becoming increasingly focussed upon as rental growth comes through.

The secondary market continues to harden, with US Opportunity fund money increasingly frustrated by a lack of deliverable product, albeit we expect more secondary stock to be deliverable in Q3.

We expect the weight of money looking to invest will continue for the foreseeable future, encouraged by attractive yields and an ever improving occupational market.

New Square, Bedfont Lakes, Heathrow. Knight Frank acquired for M&G from Aberdeen Asset management.

> "Investor demand for South East offices continues to significantly outweigh available product, putting downward pressure on yields."

Change 3 months

135% Transaction volume

117% Mean lot size

0bps Prime NIY

FIGURE 2
Investment volumes

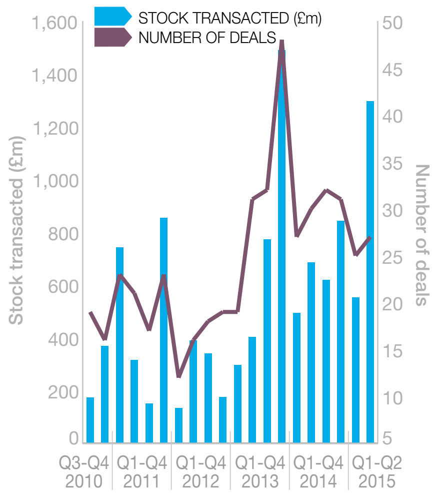


FIGURE 3
Prime net initial yield & finance

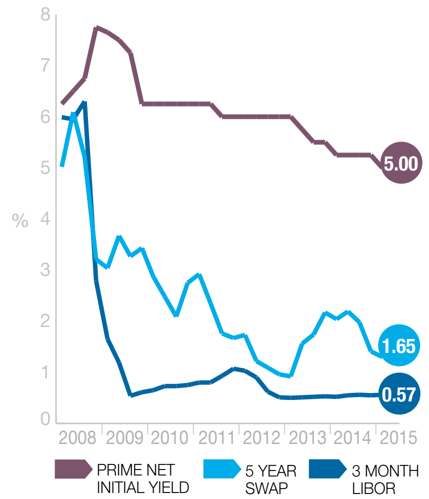
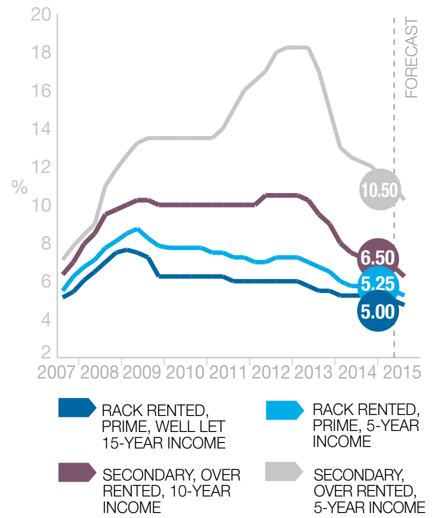


FIGURE 4
Yield forecasts



Key investment transactions Q2 2015

BUILDING	SIZE (SQ FT)	PRICE	NET INITIAL YIELD	VENDOR / PURCHASER
New Square, Bedfont Lakes, Heathrow	375,039	£166.80m	5.43%	Aberdeen Asset Management / M&G Real Estate
Compass Portfolio	452,233	£135.50m	6.50%	Private / Legal & General Property
Apex Plaza, Reading	220,419	c. £90.00m	c. 5.55%	M&G Real Estate / Legal & General Property
FC200, Park Royal	167,203	£74.05m	6.75%	Wainbridge Ltd / Legal & General Property
Flow, Staines	63,799	£38.17m	5.17%	Rockspring / NFU Mutual
Kings Wharf, Reading	53,385	£8.45m	6.55%	Hansa Invest / Royal London Asset Management

Source for all charts: Knight Frank Research

COMMERCIAL BRIEFING
For the latest news, views and analysis of the commercial property market, visit knightfrankblog.com/commercial-briefing/

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 69.4m 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 130m sq ft (net), an M4 market stock of 69.4m sq ft (net) and an M3 market stock of 42.0m 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 2015.

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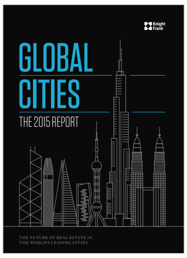

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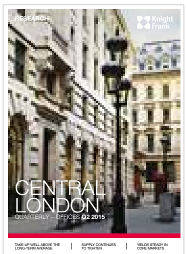

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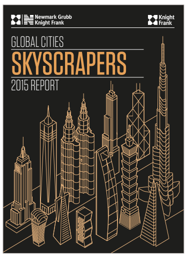

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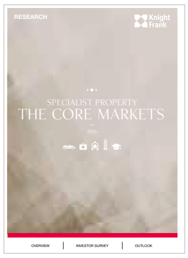

Specialist Property Report - The Core Markets 2015

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