RESEARCH

Knight Frank

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPIER MARKETS **Q2 2016**

SOUTH EAST H1 TAKE-UP 15% AHEAD OF 2015

OCADO SIGN LARGEST M25 LEASE SINCE 2012

SALE OF GREEN PARK LARGEST DEAL SINCE 2013

FOREWORD

With the result of the EU referendum surprising most, the UK, as we move into the second half of the year, finds itself in uncharted territory. The initial market shock will pass quickly; we will learn of the full impact much further ahead. For now, the UK's decision to leave the EU will undoubtedly lead to a prolonged period of uncertainty.

Amid the turmoil, it is useful to remember that concern stemming from the prospect of a Brexit has been a factor in property decisions all year. Yet, some significant leasing and investment transactions have still completed. Speculative development schemes have been progressed. Fundamentally, the South East office market has being performing well despite the threat.

On the occupier side, interest in the South East has been strong, especially for new and good quality space. This has meant that total take-up in H1 is well ahead of both the equivalent period in 2015 and the long-term average at mid-year. Principally, large-scale regeneration, led by infrastructure improvement, has continued to widen the appeal of the region to potential occupiers. This 'place-making' investment will continue regardless of Brexit.

The number of office investment deals completed in 2016 has been low, clearly affected by concern over the EU referendum. Nonetheless, the £563m sale of Green Park in Q2, which follows the £330m purchase of the SEGRO office portfolio in Q1, demonstrates a continued appetite for investment opportunities in the South East. Interestingly, foreign buyers bought both. With the value of sterling falling sharply following the EU referendum, the favourable relative price of assets could provide a stimulus for further overseas interest.

In the coming months, both occupier and investor sentiment will become clearer. The suspension of open-ended fund redemptions has been the first real example of a negative effect post the vote. Whilst this situation has since stabilised, it is too early to discount further market volatility. Realisation, of course, is very different to threat.

EMMA GOODFORD
Partner, Head of National Offices

MARKET IN BRIEF Q2 2016

SOUTH EAST TAKE-UP

882,000sq ft

▼9%*

TAKE-UP (SQ FT)

M25	**815,100**	▲45.0%
M3	**102,900**	▼53.0%
M4	**349,100**	▼30.0%

SUPPLY (SQ FT)

M25	**6.7m** ►0%	New and Grade A space 76%
M3	**2.5m** ▲1.8%	New and Grade A space 78%
M4	**5.1m** ▲7.1%	New and Grade A space 89%

SOUTH EAST TRANSACTION VOLUME

£986m

▲100%

£66m
Mean lot size

5.25%
Prime Net Initial Yield

£563m
Sale price of Green Park
Largest transaction since 2013

19%
Buyers from the UK

***Note:** Arrow indicators reflect percentage change from Q1 2016

OCCUPIER MARKET

South East take-up at mid-year is 15% higher than recorded for the same period of 2015. Despite several large development schemes completing availability has stayed 19%-29% below the long-term average.

"Whilst Brexit will cause a short term market shock, opportunities will doubtless be created for both occupiers and landlords."

EMMA GOODFORD
Partner, Head of National Offices

Demand and Take-up

Following a dip in occupier activity in Q1 2016, office take-up in the M25 increased by 45% in Q2 to 815,100 sq ft. The 148,275 sq ft letting to Ocado at Hatfield Business Park supported the rise, with the deal representing the largest lease taken in the M25 catchment since 2012. The increase in Q2 meant that at mid-year, total take-up for 2016 reached 1.4m sq ft, the highest recorded for an H1 period since 2008.

In the M4, total take-up fell by 30% in Q2 to 349,100 sq ft. Nonetheless, this combined with a strong first quarter meant that take-up at mid-year reached 845,600 sq ft, 76% higher than recorded over the equivalent period in 2015. Most notably, the largest transaction in the M4 during Q2 was the 85,000 sq ft lease taken by technology firm Amadeus at Heathrow Business Park. This meant that the technology sector represents 36% of M4 take-up in H1 2016.

In the M3, take-up fell by 52.6% quarter-on-quarter with 102,900 sq ft let in Q2. As a result, M3 take-up at mid-year is 44% less than registered during the first six months of 2015. The largest transaction of Q2 was the letting of 20,400 sq ft to Pharmaceutical firm Mallinckrodt at Lotus Park in Staines. Interestingly, activity in Staines represents 23% of all take-up in the M3 region in 2016, continuing the upturn in occupier activity noted in 2015. The completion of 261,000 sq ft of new space in the past two years has supported the rise, thus serving to highlight the draw of new quality space to occupiers.

CarVal/Canmoors Interchange, Croydon where 18,000 sq ft was leased to Siemens

Availability

Despite 181,700 sq ft of new speculative space reaching practical completion during Q2, availability in the M25 was unchanged at 6.7m sq ft. This meant that supply remains 29% below the 10-year average and 9% lower than at the same point in 2015.

In the M4, the completion of 416,600 sq ft of new speculative space meant that the vacancy rate increased to 7.2% during Q2. Nonetheless, overall supply levels are 19% below the 10-year average.

Similarly, overall availability in the M3 recorded a small increase (1.8%) in Q2 to reach 2.5m sq ft at quarter end. Availability in the M3 catchment remains 23% below the 10-year average.

Across the markets (M25, M3, M4) a total of 3.2m sq ft of speculative space is set for delivery by the end of 2017. The majority (1.9m sq ft) is expected to reach practical completion before the end of 2016.

Comparison to the 10-year average

31% M25 take-up

29% M25 availability

1% SE active demand

FIGURE 1
M25 Take-up

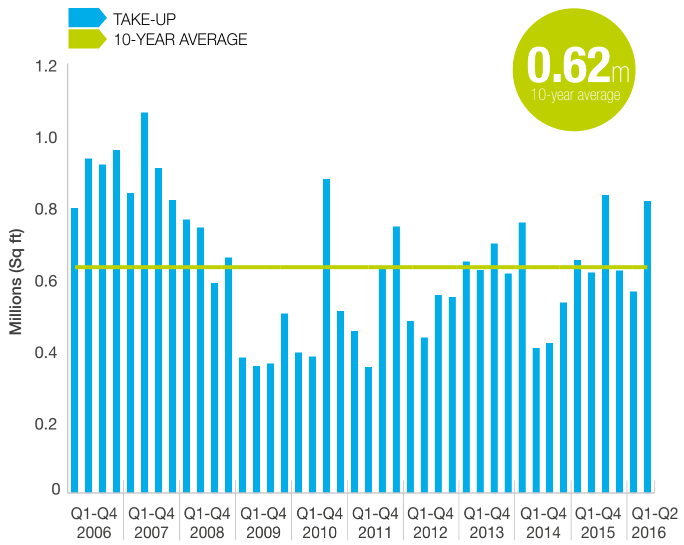
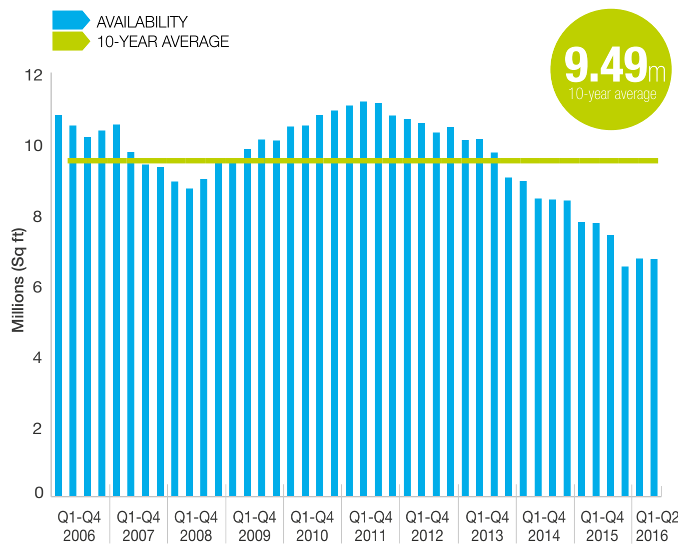


FIGURE 2
M25 Supply



Key leasing transactions Q2 2016

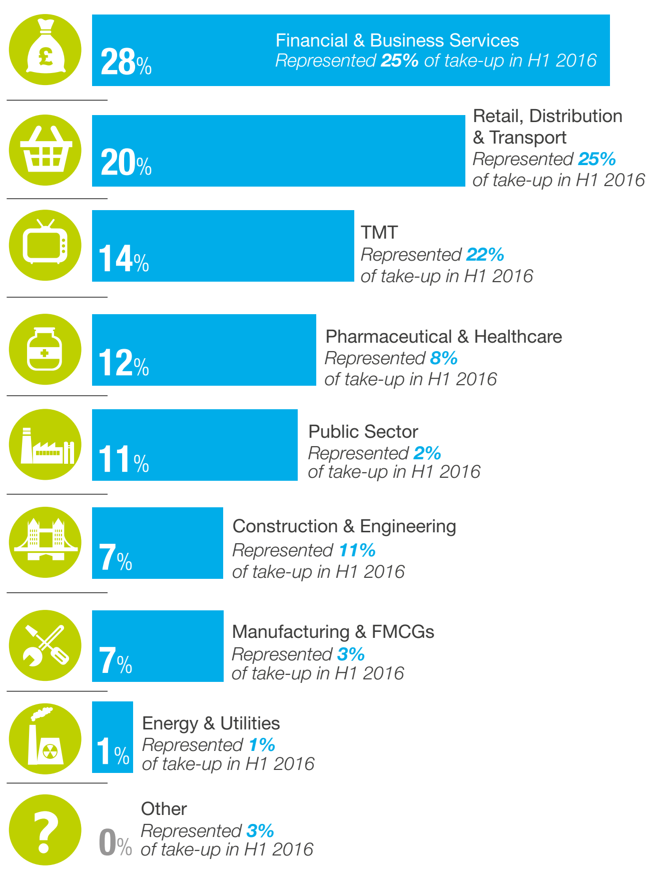
ADDRESS	OCCUPIER	SIZE (SQ FT)	RENT (PSF)
1 & 2 Hatfield Business Park, Hatfield	Ocado	148,275	£21.20
World Business Centre, Heathrow	Amadeus	85,000	£28.25
8 Bedford Park, Croydon	Superdrug	51,975	£26.50
Red Central, Redhill	Black & Veatch	22,300	£23.50
3 Lotus Park (2nd flr), Staines	Mallinckrodt	20,400	£34.50

Source for all charts: Knight Frank Research

DEMAND

6.1msq ft
OF ACTIVE NAMED DEMAND IN THE SOUTH EAST

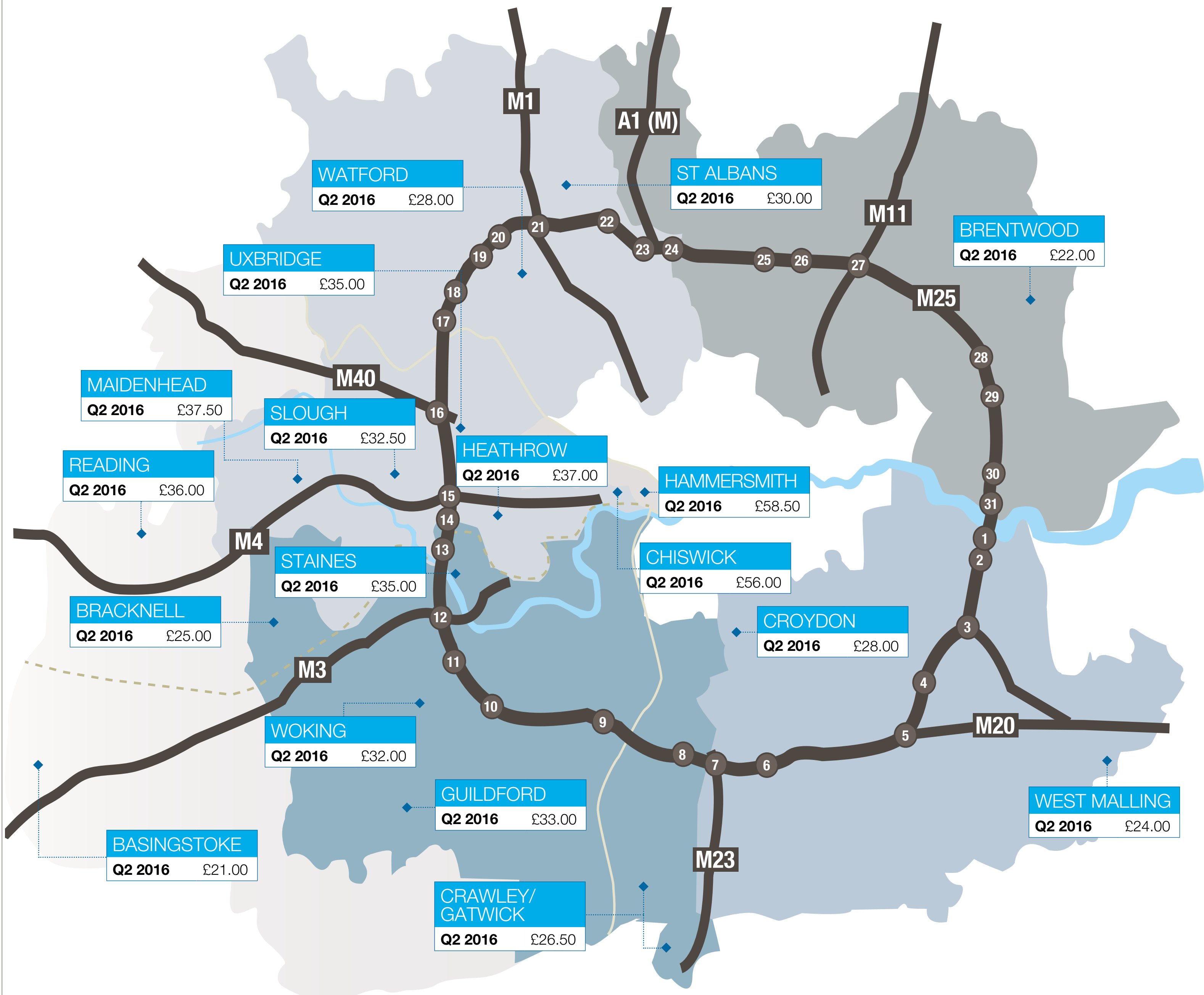
Active named demand



0.6msq ft
UNDER OFFER IN THE SOUTH EAST Q2 2016

Source for all charts: Knight Frank Research

Key town prime rents



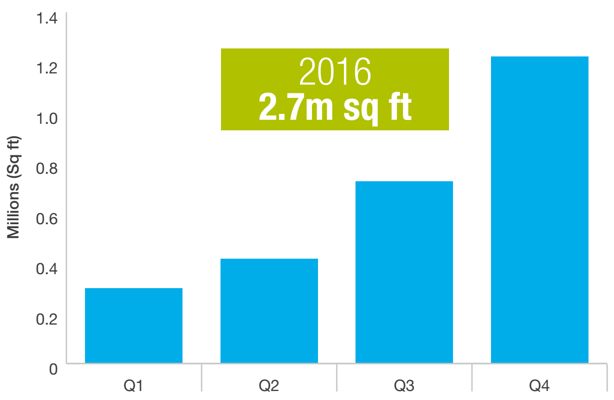
Rent assumes a new building let on a 10-year lease.

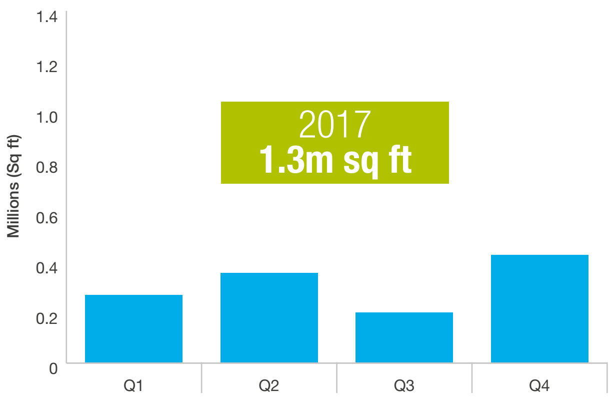
DEVELOPMENT

3.7msq ft*
UNDER CONSTRUCTION IN THE SOUTH EAST

*Pre-let and speculative

Speculative completions in the South East





Speculative Development (sq ft)

Due to complete before the end of 2017

M25	M3	M4
2.0m	0.6m	2.3m

INVESTMENT MARKET

With a 'wait and see' mentality prevailing ahead of the EU referendum, activity in the M25 office investment market in Q2 was muted.

"We expect to see a continued flight to quality and long income opportunities as the market once again focusses on property fundamentals."

TIM SMITHER
Partner, Head of National Offices Investment

Investment volumes increased, principally due to the sale of Green Park to Mapletree, which accounted for circa 57% of the quarter's transaction volumes. As such, Q2 turnover was twice that of Q1 at £986m. However, excluding this significant transaction, volumes were 16% down on the 10-year quarterly average, primarily because of 'Brexit' concerns.

Tellingly, the total number of transactions in Q2 was well below the long-term average of 25 per quarter, with only 15 transactions completing. Notably, the acquisition of Green Park, the landmark office park in Reading, by Singaporean sovereign wealth fund Mapletree is the second largest transaction on record in the market. The transaction demonstrates continued overseas interest in the M25 market.

Conversely, the majority of UK investors have assumed a more cautious outlook, explaining the below average number of transactions for this quarter.

The decision by a number of fund managers, following the vote, to close their open-ended funds has been well documented and its publicity has fuelled negative sentiment. With the situation now settling, and some transactions concluding, buyers are looking to take advantage of pricing corrections.

Demand remains strongest from overseas investors, benefiting from the falling value of the pound, particularly US Dollar denominated funds. Long income remains particularly attractive due to the continued low interest rate environment and as such, we expect pricing to remain robust for longer leases, especially to strong covenants.

As post-Brexit transactions complete and subsequently provide more clarity on pricing, we expect an increase in stock levels in H2. As such, investment volumes are set to improve and will exceed £2bn for the year, ahead of the long-term average for the market.

Green Park purchased by Mapletree for £563m

Change 12 months (Q2 2015 - Q2 2016)

24% Transaction volume

37% Mean lot size

25bps Prime NIY

FIGURE 3
Investment volumes

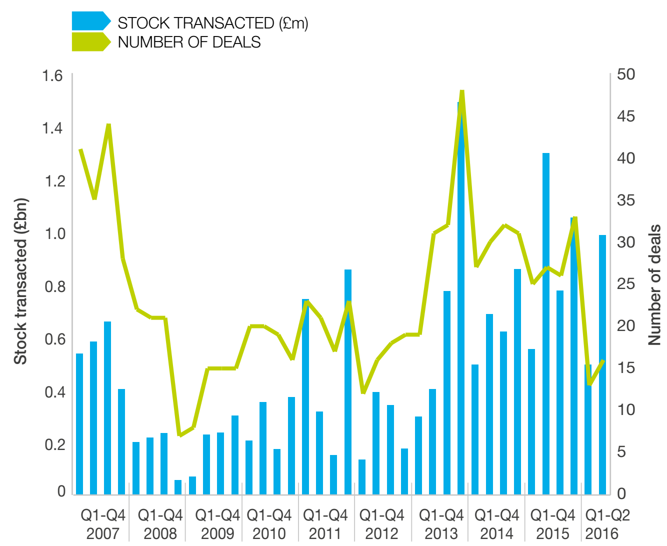
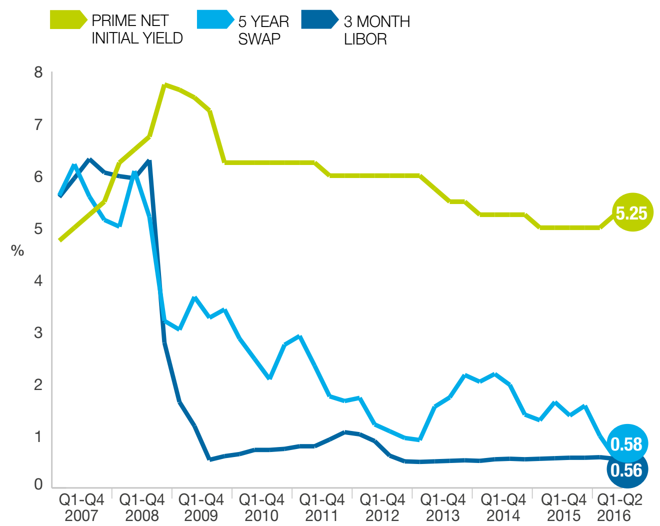


FIGURE 4
Prime net initial yield & finance



Key investment transactions Q2 2016

BUILDING	SIZE (SQ FT)	PRICE	NET INITIAL YIELD	VENDOR	PURCHASER
Green Park, Reading	1,400,000	£563.00	Undisclosed	Oxford Properties	Mapletree
184 Shepherds Bush Road, Hammersmith	118,845	£97.15	4.60%	Precis Holdings	Alduwaliya
3M Headquarters, Bracknell	184,330	£77.00	6.94%	Aprirose	Greenridge
200 Hammersmith Road, Hammersmith	66,280	£59.15	4.69%	BP Pension Fund	Royal London
King's Court, Woking	81,954	£41.75	5.75%	Lamron Estates / SJR Properties	Royal London

Source for all charts: Knight Frank Research

EAST MEETS WEST

Stretching 60 miles and scheduled to stop at 40 stations, the Elizabeth line will transform travel across London and the South East. The line will drive growth in the local economies it serves, boosting employment and supporting property development across the spectrum.

READING

UNDER CONSTRUCTION
593,117 sq ft

TAKE-UP
276,414 sq ft
10-YR HALF YEARLY AVERAGE
184,377 sq ft

AVAILABILITY
1,057,902 sq ft

KEY DEAL 2016
Thales
111,000 sq ft at Green Park

OPINION

The transformation of Reading continues at pace. The town, already the largest office market on the Elizabeth line outside of Central London, will see just short of 600,000 sq ft of new office space delivered over the next 24 months. This will complement the on-going major infrastructure and amenity improvements adding further to the appeal of the town. With organisations continuing to move functions away from Central London, Reading looks set to benefit.

MAIDENHEAD

UNDER CONSTRUCTION
0 sq ft

TAKE-UP
63,609 sq ft
10-YR HALF YEARLY AVERAGE
56,592 sq ft

AVAILABILITY
525,541 sq ft

KEY DEAL 2016
The Pearce Building
over 20,000 sq ft to two occupiers at £37.50 psf

OPINION

Maidenhead has led the way with the best rent achieved along the Elizabeth line outside of Greater London. The town desperately needs The Landings development to progress in the town centre to make the town more attractive to London occupiers. Having said that, Maersk have decided to relocate additional employees from Central London on the back of the Elizabeth line offer. An injection of good quality retail, amenity and housing would boost the appeal of the town further.

SLOUGH

UNDER CONSTRUCTION
377,273 sq ft

TAKE-UP
131,730 sq ft
10-YR HALF YEARLY AVERAGE
66,545 sq ft

AVAILABILITY
441,592 sq ft

KEY DEAL 2016
Thames Motor Group
18,400 sq ft at Bath Road

OPINION

Slough is experiencing a transformation similar to that of Reading. The town has never really had a 'town centre' office offer and the developments close to the station will significantly change the town. New office developments, amenity improvements and crucially a journey time of 33 minutes to Bond Street will increase occupier interest. The presence of a high number of digital infrastructure companies on Slough Trading Estate will be particularly attractive to creative industry occupiers.

HEATHROW

UNDER CONSTRUCTION
336,530 sq ft

TAKE-UP
103,964 sq ft
10-YR HALF YEARLY AVERAGE
91,351 sq ft

AVAILABILITY
521,007 sq ft

KEY DEAL 2016
Amadeus
85,000 sq ft pre-let at World Business Centre

OPINION

The Elizabeth line will significantly improve links between Heathrow and a number of central London stations. Bath Road and Stockley Park make up the main areas of the Heathrow market with the latter, due to its proximity to the airport, attracting significant interest from foreign companies. A number of high quality development schemes are underway which should draw additional occupier attention.

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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 72m 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 132m sq ft (net), an M4 market stock of 72m 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.
- The South East is defined as the market area shown in the map on pages 6 & 7.
- 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 2016.
- **Front Cover: 5 The Square, Stockley Park**

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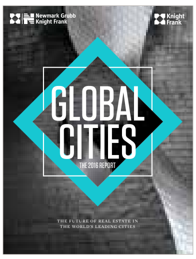

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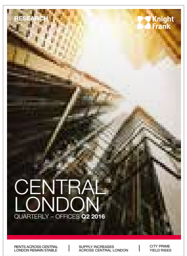
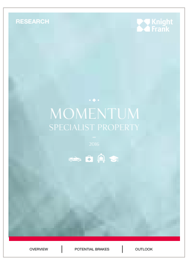


Central London
Quarterly Q2 2016



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