RESEARCH

Q3 2009

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Take-up in the M25 remains subdued. Although Q3 take-up increased by 2% on the previous quarter, it rose from a low base, as Q2 recorded the lowest quarterly total in six years.
- At end Q3 active named demand stood at 5.1m sq ft, only 12% below the same quarter last year. The underlying source of demand has shifted, with Manufacturing and Pharmaceuticals demand increasing by more than a third.
- The vacancy rate increased in each of the markets in Q3: in the M25 from 7.6% in Q2 to 7.8%, in the M3 from 7.9% to 8.0% and, in the M4, the steepest change, from 11.0% to 11.6%. These levels remain relatively modest compared with those of previous downturns.
- In the investment market, demand specifically for prime and long-income assets intensified further in Q3 and their continuing scarcity in the market brought about a further quarter point hardening of prime yields, to 7.25%.

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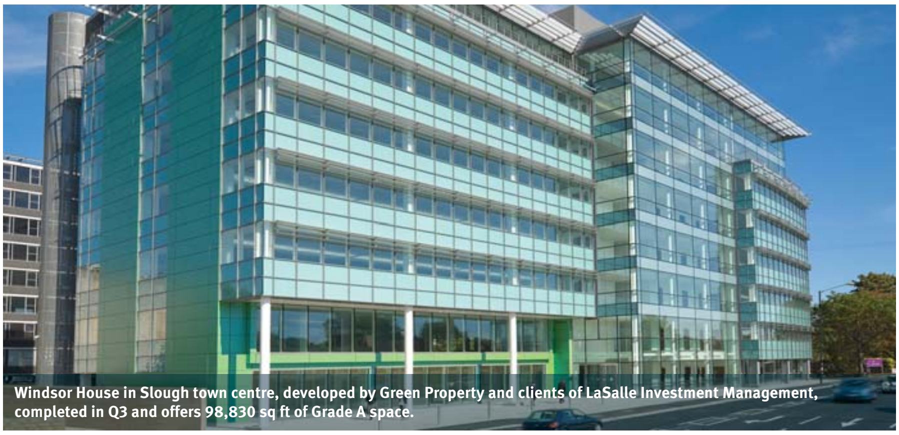
M25 market

- M25 take-up was 361,468 sq ft in Q3 2009, a marginal 2% increase on Q2. Take-up remains subdued, however, with the Q3 total 55% below the long-term quarterly average. New accommodation accounted for only 15% of take-up in Q3, while there has not been a single pre-let in 2009 to date.
- Of the 24 transactions in Q3, the largest deal was Epson's 54,000 sq ft acquisition at Westside, Hemel Hempstead while, as in Q2, Chiswick Park accounted for Q3's highest headline rent, with Ranbaxy's acquisition of c.4,000 sq ft at Building 4 for £34.00 per sq ft.
- Active named demand reduced by 3% from Q2 to stand at 5.1m sq ft but is only 12% below the Q3 2008 total. Demand from Financial & Business Services has actually recovered to the Q3 2008 level, while Manufacturing and Pharmaceuticals demand has increased by a third.
- The M25 vacancy rate increased from 7.6% to 7.8%, with six speculative completions accounting for 37% of total space released to the market in the quarter. Of these, the largest was Windsor House in Slough town centre, a 98,830 sq ft development by Green Property and clients of LaSalle Investment Management.
- At the end of Q3, the volume of speculative construction underway was down 81% from the peak level of Q3 2008. This has resulted from a complete absence of development starts over the last four quarters together with a sizeable 1.1m sq ft of development completions occurring over the period.


Windsor House in Slough town centre, developed by Green Property and clients of LaSalle Investment Management, completed in Q3 and offers 98,830 sq ft of Grade A space.

KNIGHT FRANK VIEW

- The relatively robust pattern of active demand is at odds with the subdued levels of take-up because much of this demand is currently manifesting itself in lease re-gearing and renewal activity. To minimise void risks, landlords have become much more willing to offer existing tenants terms and incentives which reflect those available in the open market.
- With net effective rents reducing by an average of just 2% across the key towns in Q3, there are clear indications that headline rents have stabilised and incentives are peaking. Later next year, when economic growth becomes more assured and take-up shows sustained recovery, we forecast those towns undersupplied with quality space to see net effective rents begin rising again.
- Vacancy rates will not reach the levels seen in previous downturns. The mini-development boom which peaked last year is incomparable with that of eight years ago. Some markets which are tightly supplied have a good case for a speculative development in the medium term, albeit this is heavily reliant on an improvement in credit conditions.

Figure 1
M25 take-up

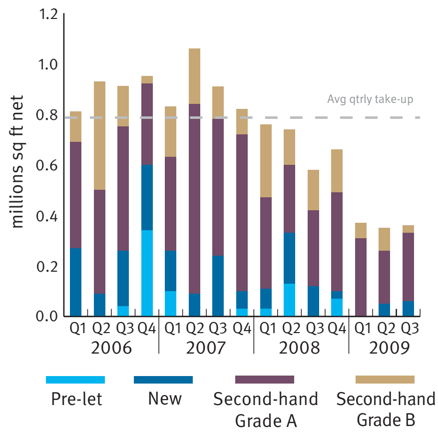


Figure 2
Space under construction in the M25

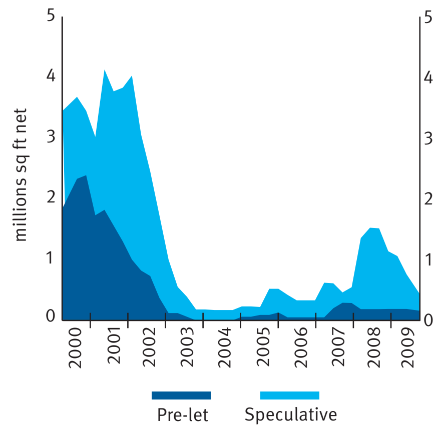


Figure 3
M25 active named enquiries by sector

Manufacturing & Pharmaceuticals	31%
Financial & Business Services	17%
Construction & Engineering	12%
ICT	11%
Public Sector	9%
Retail, Distribution & Transport	8%
Other	12%

Source: Knight Frank Research

Market statistics

Table 1

Key town prime rents & forecasts

Town	Q3 prime rent (psf)	Rent free (months)
Basingstoke	£19.00 ▼	30 ▲
Brentwood	£21.00 ▼	27 ►
Gatwick	£24.00 ►	27 ►
Guildford	£26.00 ►	24 ►
Hammersmith	£35.00 ▼	27 ▲
Heathrow	£25.00 ►	30 ▲
Reading	£28.50 ►	24 ►
St Albans	£22.50 ►	27 ►
Uxbridge	£24.00 ►	27 ►
Watford	£21.00 ►	27 ►
West Malling	£22.00 ►	21 ►

Based on new/Grade A building:
10,000 sq ft, 10 yr lease with no breaks

Source: Knight Frank Research

Note: ▲ = forecast for next 12 months

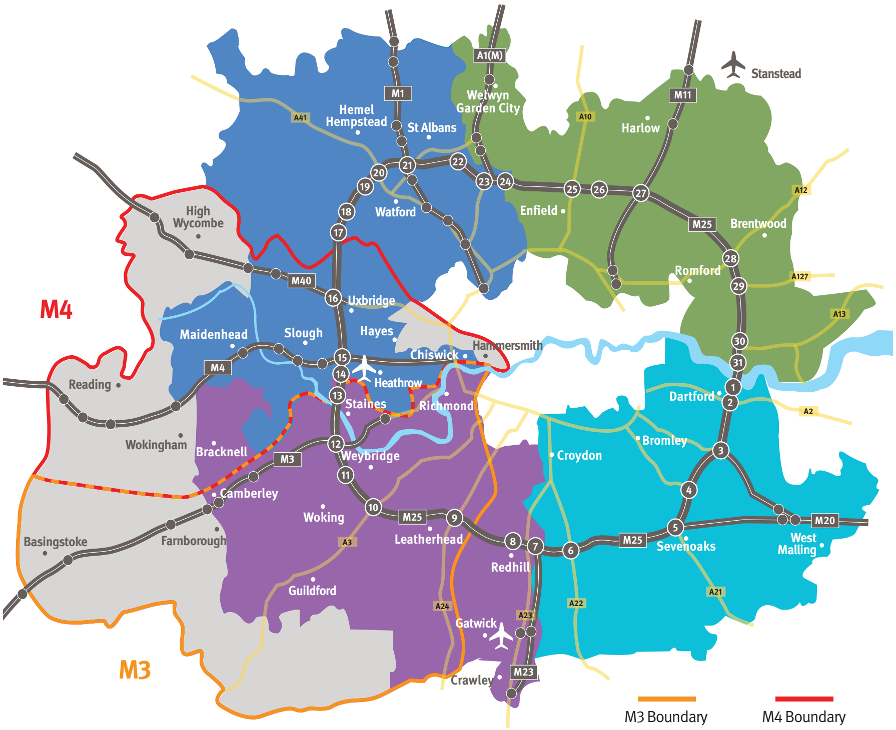


Table 2

Demand & Supply

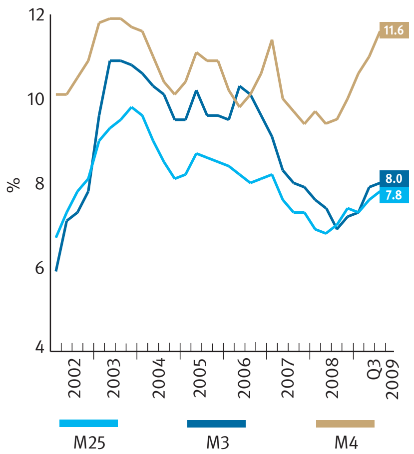
Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**361,468**	201,587	62,676	9,500	87,705	**56,674**	**132,561**
Change 3 months	**2%** ▲	-15% ▼	21% ▲	-35% ▼	71% ▲	**18%** ▲	**-52%** ▼
Change 12 months	**-38%** ▼	-20% ▼	-80% ▼	– ▼	269% ▲	**-83%** ▼	**-64%** ▼
Q3 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q3 % take-up new & pre-let	**15%**	17%	15%	0%	14%	**6%**	**63%**
Forecast 2009 take-up (m sq ft)	**1.5**	–	–	–	–	**0.4**	**0.9**

Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**10,113,545**	4,799,698	3,974,160	424,621	915,066	**3,350,567**	**7,352,752**
Change 3 months	**3%** ▲	1% ▲	7% ▲	-4% ▼	2% ▲	**1%** ▲	**5%** ▲
Change 12 months	**13%** ▲	2% ▲	37% ▲	-8% ▼	0% ►	**15%** ▲	**23%** ▲
Q3 % new	**19%**	20%	19%	16%	13%	**22%**	**25%**
Q3 % second-hand Grade A	**51%**	58%	50%	15%	27%	**41%**	**57%**
Q3 % second-hand Grade B	**30%**	22%	31%	68%	61%	**37%**	**18%**
Q3 vacancy rate (▲/▼ movement from Q2)	**7.8%** ▲	9.5% ►	9.7% ▲	2.4% ▼	4.5% ▲	**8.0%** ▲	**11.6%** ▲

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**425,396**	172,880	194,210	0	58,306	**210,000**	**841,775**
Change 12 months	**-73%** ▼	-75% ▼	-74% ▼	–	-6% ▼	**-45%** ▼	**-52%** ▼
Pre-let	**158,306**	100,000	0	0	58,306	**210,000**	**364,000**

Source: Knight Frank Research

Figure 4
Vacancy rates



M4 & M3 markets

- Q3 take-up in the M4 was 132,561 sq ft, a decrease of 52% on Q2 and the lowest quarterly total in six years. However, with 14 transactions in Q3 following only 17 in Q2, the reduction in take-up quarter on quarter is largely explained by the occurrence of a major letting in Q2 – Canon's 93,000 sq ft acquisition at 3 The Square, Heathrow.
- In Q3, the largest letting in the M4 corridor took place at Green Park, Reading, where Thames Water acquired 43,142 sq ft at the recently completed 550 South Oak Way from PRUPIM for a term of 25 years.
- The M4 vacancy rate increased from 11.0% to 11.6% in Q3, its highest level in over five years. Four completions totalling 299,045 sq ft accounted for a significant 45% of space delivered to the market in Q3, the largest comprising Standard Life Investments and Neptune Land's 135,000 sq ft Ealing Cross development in West London.
- With only three transactions, M3 take-up in Q2 was 56,674 sq ft, an increase of 18% on Q2's record low but 64% below the Q3 2008 total. Of these deals, the largest comprised Stevens & Bolton's 46,000 sq ft acquisition at Wey Court, Guildford at a rent of £26.50 per sq ft.
- The M3 vacancy rate increased in Q3, from 7.9% in Q2 to 8.0%. The relatively small increase was a result of the lowest amount of space being released to the market in any quarter since Q3 2007, with one speculative completion comprising Sackville Development's 39,835 sq ft Milton Park scheme in Egham.


PRUPIM's 550 South Oak Way, at Green Park, Reading completed in March 2009 and recently let to Thames Water on a 25 year lease.

KNIGHT FRANK VIEW

- In the M4 corridor, the speed at which net effective rents recover will vary markedly between markets due to strong differences in supply levels. In contrast with Bracknell and Maidenhead, for example, inner locations including Uxbridge, Heathrow and Chiswick have exhibited robust levels of take-up this year, relative to supply, which bodes well for the stabilisation and eventual recovery of prime rental levels.
- Following extremely low levels of take-up in the M3 corridor, our forecast for total take-up in 2009 has been revised downward to 0.4m sq ft, close to two thirds below the annual average. However, the M3 corridor's proportion of new supply compared with the M4 and a complete absence of speculative construction will keep the vacancy rate below 10%.

Figure 5
M3 take-up

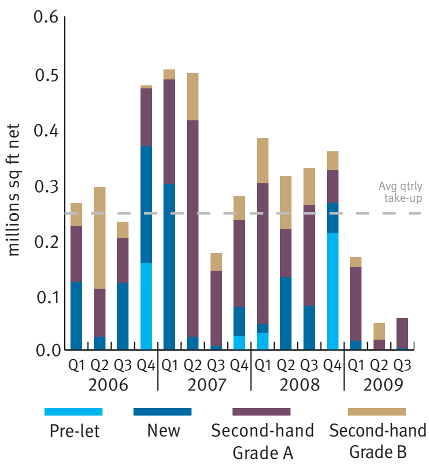


Figure 6
M4 take-up

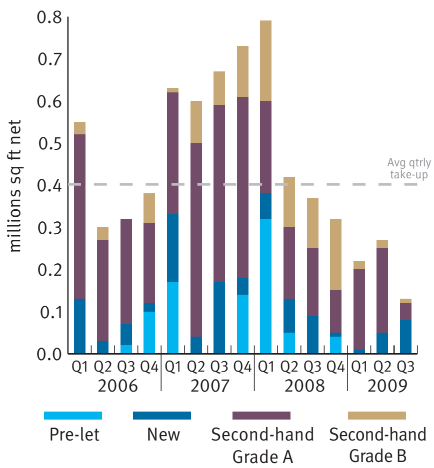
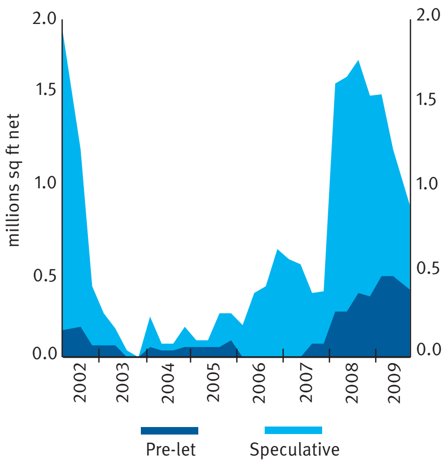


Figure 7
Space under construction in the M4



Source: Knight Frank Research

Investment market

Table 3
Key investment transactions Q3 2009

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
Wimbledon Bridge House, Wimbledon	168,635	£40.0m	10.00%	PRUPIM / AEW Europe
SABMiller House, Woking	64,114	£16.9m	7.70%	Invista / Threadneedle
3 Valleys Water, 1700 Hatfield Business Park	88,114	£21.8m	7.38%	Goodman / Hildane
Oxfam, 2700 Oxford Business Park	87,341	£21.7m	7.35%	Goodman / Oakwood
Aurora, 71-75 Uxbridge Road, Ealing	50,206	£15.3m	8.20%	Royal London Asset Management / Threadneedle
Tempus Court, Guildford	26,825	£7.48m	8.20%	Liverpool Victoria / Henderson Global Investors

	Transaction volume	Mean lot size	Mean NIY
Q3 2009	£237.0m	£15.80m	8.71%
Change 3 mths	3% ▲	4% ▲	+44bps ▲
Change 12 mths	1% ▲	42% ▲	+66bps ▲

AEW Europe purchased Wimbledon Bridge House in SW19 from PRUPIM for £40m, reflecting a net initial yield of 10.00%.

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- Reflecting the strong revival of investor sentiment since Spring, the total investment turnover volumes for Q2 and Q3 combined, at £466m, is more than two and a half times the level seen in the previous two quarters, when buying activity was extremely subdued.
- The significant weight of money now seeking exposure in South East offices remains defensive, focused on secure, long-income assets or prime buildings in strong locations. As buyers seek further weighting in property and funds begin to see net-inflows, the continued scarcity of such assets will lead to further yield compression over the next six months.
- The lack of prime product and strong pressure to spend will increasingly tempt investors to consider assets offering greater yield, such as mid-term income assets. Nevertheless, this is decoupled from the secondary markets, where pricing remains difficult, with hold costs and refurbishment costs still challenged by depressed rental and asset values.

Figure 8
£m investment volumes and lot size

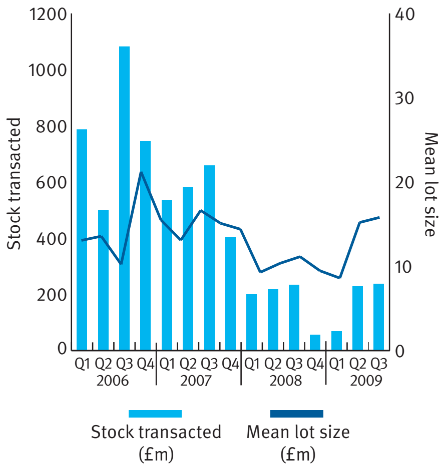


Figure 9
Mean initial yield & finance

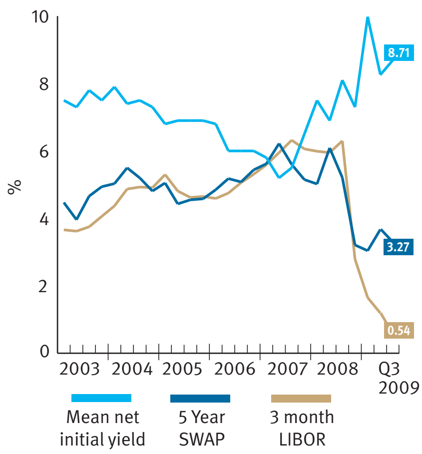
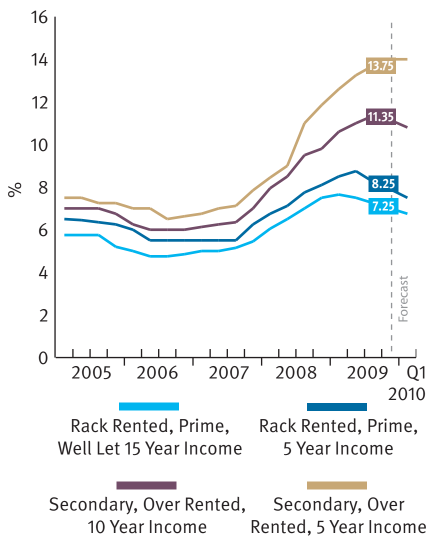


Figure 10
Yield forecasts



Source: Knight Frank Research

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Technical Note

- Knight Frank define the M4 market 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 September 30th 2009.

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