RESEARCH

Q3 2010

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Across all three markets, take-up improved substantially in Q3. In the M25, take-up increased by a record 130% quarter-on-quarter, in the M4 it increased by 121% and, in the M3, it was up 142%.
- However, reflecting the completed transactions, active named demand reduced by 20% during Q3, its most significant quarterly fall in two years. Manufacturing & Pharmaceuticals continues to account for the largest share, making up nearly one third of total demand.
- Despite strong take-up, the M25 vacancy rate increased to 8.3% in Q3 following the return of 1.3m sq ft of space to the market. While the M3 vacancy rate also increased during Q3, to 8.3%, in the M4 it held steady at 11.6%.
- A quiet summer in the investment market was reflected in total Q3 turnover of £172.8m, down 51% from Q2. Prime South East office yields were unchanged for the second quarter running in Q3, at c. 6.25%.

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M25 market

- M25 take-up was 876,355 sq ft in Q3, a substantial 130% increase on Q2 and the largest quarter-on-quarter rise on record. Q3's 37 transactions compares to just 20 in Q2, while the average deal size in Q3 increased by 25% to 23,685 sq ft, accounted for by five major lettings in excess of 100,000 sq ft.
- Three deals at Chiswick Park in West London alone accounted for close to a third of Q3 take-up. QVC secured a pre-let of Building 8, totalling 126,000 sq ft, while Tullow Oil acquired Building 9, totalling 131,790 sq ft. Baker Hughes' acquisition of 22,090 sq ft at Building 5 was also the highest agreed headline rent in Q3, at £34.00 per sq ft.
- Active named demand fell by 20% in Q3 to stand at 5.13m sq ft, back to its Q3 2009 level. Information, Communications & Technology demand was the most robust sector, unchanged from Q2 at 1.2m sq ft. Manufacturing & Pharmaceuticals demand declined by 16% in Q3, but still accounts for the largest share, at 32% of the total.
- All speculative schemes which commenced in the mini-development boom of 2008 have now completed and, with finance for development restricted, the supply of new space will be eroded over the next two years. Nevertheless, Q3 brought the first speculative development start in the M25 since mid-2008, with Barratt Homes commencing construction of c.40,000 sq ft at Guildford Road, Woking.
- Despite strong take-up, the M25 vacancy rate increased from 7.8% to 8.3% during Q3. This was due to circa 1.3m sq ft of second-hand space being added to the market, just under two thirds of which was poorer quality, second-hand Grade B space. The largest addition was the return of CEG's refurbished Reflex (formerly Lakeside) in Bracknell, totalling 118,000 sq ft.


In Q3, Rackspace acquired The White House at Hyde Park Hayes, totalling 101,796 sq ft.

KNIGHT FRANK VIEW

- Following two years of subdued take-up, the turnaround in Q3 was dramatic but driven by the simultaneous conclusion of major, long-anticipated transactions. Knight Frank's forecast for total M25 take-up in 2010 has been revised up by 15%, to 2.1m sq ft. However, with space under offer halving during Q3 and active demand reducing in line with continued occupier caution, Q3's strong performance is unlikely to be repeated in Q4 2010 or the first half of 2011.
- Q3 activity was driven by major, internationally focused occupiers who have chosen to upgrade their accommodation at a time when value can be found in the market. However, a fuller growth-led recovery, sufficient to drive rental growth, requires the return of the core market, which involves more typical transaction sizes of c.15,000 to 25,000 sq ft.
- Across the South East Knight Frank expects rental recovery to be either flat or very gradual over the next 12 months, before gathering momentum in 2012. The highly restricted speculative development pipeline points to a likely shortage of new and Grade A supply across many towns two years from now, by which time the market should be more active with a forecasted improvement in the economy, prompting a more significant bout of rental growth.

Figure 1
M25 take-up

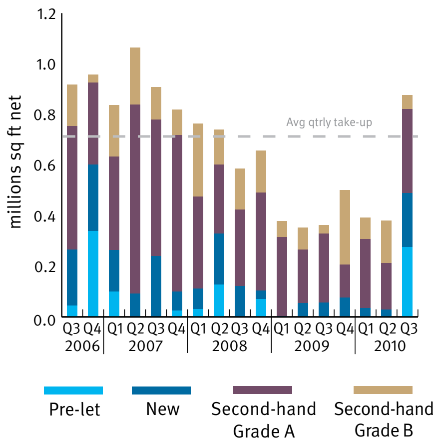


Figure 2
Space under construction in the M25

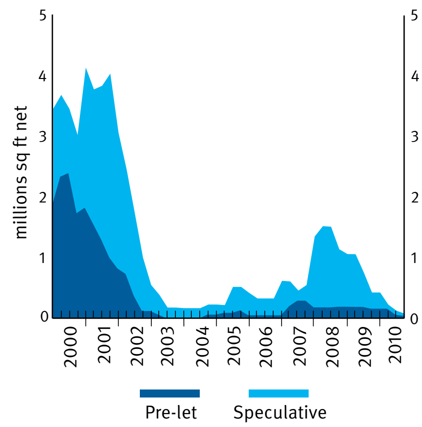
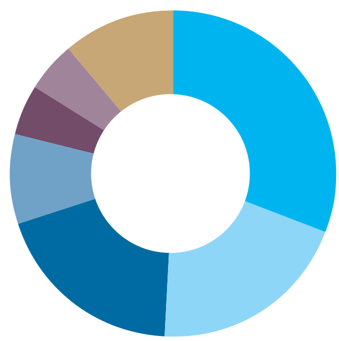


Figure 3
M25 active named enquiries by sector



Manufacturing & Pharmaceuticals	32%
ICT	24%
Financial & Business Services	20%
Retail, Distribution & Transport	8%
Construction & Engineering	4%
Public Sector	2%
Other	10%

Source: Knight Frank Research

Market statistics

Table 1

Key town prime rents & forecasts

Town	Q3 prime rent (psf)	Rent free (months)
Basingstoke	£18.00 ▼	32 ▲
Bracknell	£19.00 ▶	36 ▶
Brentwood	£21.00 ▶	24 ▶
Gatwick	£21.50 ▶	27 ▶
Guildford	£27.00 ▶	30 ▶
Hammersmith	£31.00 ▶	24 ▶
Heathrow	£27.50 ▶	33 ▶
Reading	£28.50 ▶	24 ▶
St Albans	£21.50 ▶	27 ▼
Uxbridge	£27.50 ▲	30 ▶
Watford	£21.00 ▶	30 ▶
West Malling	£21.00 ▶	18 ▶

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

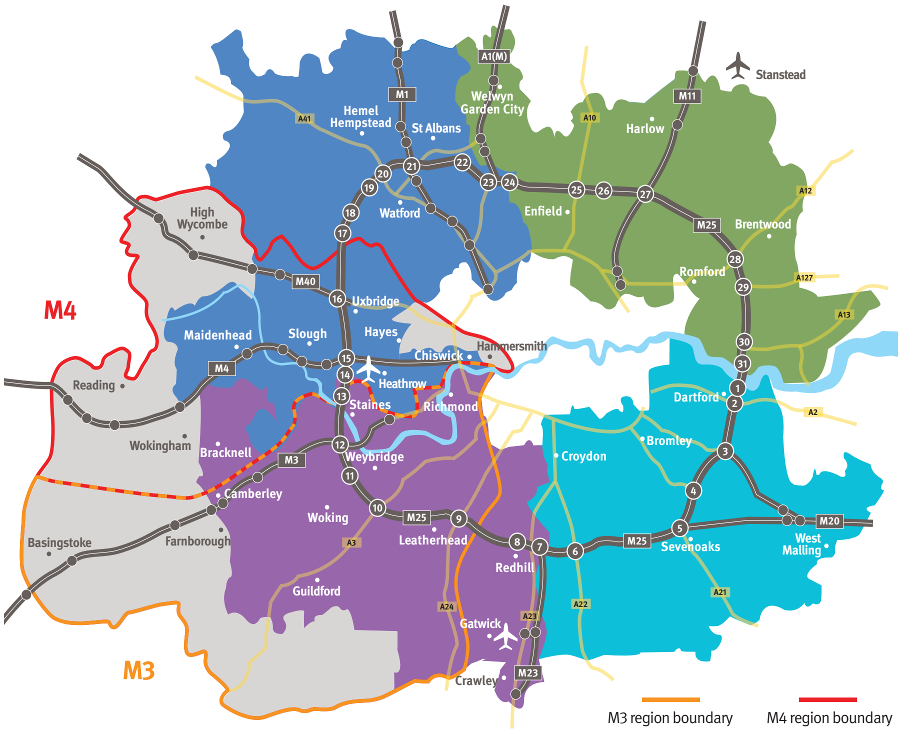


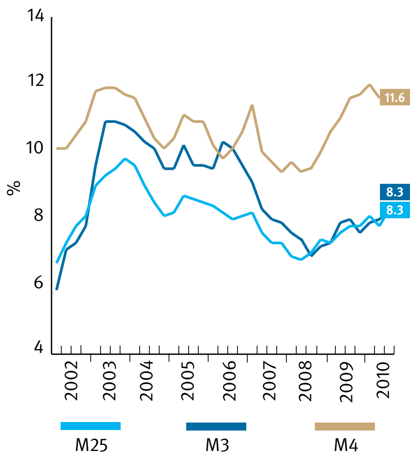
Table 2

Demand & Supply

Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**876,355**	616,465	205,352	0	54,538	**206,495**	**847,335**
Change Q3 10 vs Q2 10	**130%** ▲	243% ▲	88% ▲	–	-40% ▼	**142%** ▲	**121%** ▲
Change Q3 10 vs Q3 09	**142%** ▲	206% ▲	228% ▲	–	-38% ▼	**264%** ▲	**539%** ▲
Q3 pre-let (sq ft)	**274,884**	234,884	40,000	0	0	**40,000**	**234,884**
Q2 % take-up new & pre-let	**56%**	64%	44%	0	3%	**49%**	**54%**
Forecast 2010 take-up (m sq ft)	**2.1**	–	–	–	–	**0.6**	**1.8**
Availability	**M25**	**NW**	**SW**	**NE**	**SE**	**M3**	**M4**
Sq ft	**10,803,089**	4,959,989	4,384,520	437,445	1,021,135	**3,491,048**	**7,394,617**
Change Q3 10 vs Q2 10	**6%** ▲	5% ▲	9% ▲	-2% ▼	9% ▲	**4%** ▲	**0%** ◀▶
Change Q3 10 vs Q3 09	**7%** ▲	3% ▲	10% ▲	3% ▲	12% ▲	**4%** ▲	**1%** ▲
Q3 % new	**16%**	15%	20%	16%	7%	**19%**	**26%**
Q3 % second-hand Grade A	**49%**	56%	46%	42%	31%	**37%**	**51%**
Q3 % second-hand Grade B	**35%**	29%	34%	42%	62%	**44%**	**23%**
Q3 vacancy rate (▲/▼ movement from Q4 09)	**8.3%** ▲	9.8% ▲	10.7% ▲	2.5% ◀▶	5.0% ▲	**8.0%** ▲	**11.6%** ◀▶
Under construction	**M25**	**NW**	**SW**	**NE**	**SE**	**M3**	**M4**
Sq ft (net approx)	**119,500**	0	119,500	0	0	**80,000**	**0**
Change 12 months	**-83%** ▼	-100% ▼	100% ▲	–	-100% ▼	**100%** ▲	**-100%** ▼
Pre-let	**40,000**	0	40,000	0	0	**40,000**	**0**

Source: Knight Frank Research

Figure 4
Vacancy rates



M4 & M3 markets

- M4 take-up was 847,335 sq ft in Q3, a substantial 121% increase on Q2 and more than six times the historic low of Q3 2009. Q3's strong performance was due to the occurrence of six transactions in excess of 100,000 sq ft, the most of this size seen in a single quarter on record.
- Outside Chiswick Park, Q3's other major pre-let occurred in Uxbridge, where Coca Cola pre-let 108,884 sq ft at Bakers Court, which will be refurbished. Elsewhere, major transactions included Quintiles' 121,350 sq ft acquisition of 500 Brook Drive at Green Park, Reading, and Rackspace's 101,796 sq ft acquisition of the White House and part of HPH3 at Hyde Park, Hayes, at an agreed rent of £16.50 per sq ft.
- The M4 vacancy rate held steady from its Q2 level at 11.6% while the supply of new space available has now peaked. At the end of Q3, there was not a single scheme left under construction in the M4 following the completion of Shepherd Development's 74,600 sq ft Market Street scheme in Maidenhead.
- In the M3, Q3 take-up was up 206,495 sq ft, a rise of 142% on Q2 and more than three times the Q3 2009 level. The largest transaction comprised Surrey Satellite's 40,000 sq ft pre-let at Surrey Research Park, the first pre-let in the M3 since Q4 2008.
- The M3 vacancy rate increased to 8.3% in Q3 from 8.0% in Q2. This was driven by 295,000 sq ft of second-hand space being returned to the market, with landlord released space accounting for close to three quarters of the total.


In Q3, Quintiles acquired PRUPIM's 500 Brook Drive at Green Park, Reading, totalling 121,350 sq ft.

KNIGHT FRANK VIEW

- In the M4 corridor, an analysis of anticipated lease events reveals Bracknell, Slough, Reading, Hammersmith and Uxbridge possess a combined 2.5m sq ft of breaks and expiries to end 2012. Consequently, these markets may provide a key focus for occupier activity and, given they are all heavily supplied with new and good quality second-hand space, should offer good value for money to prospective tenants.
- Despite strong take-up in Q3, the M3 has weaker prospects for a rebound in activity than the M4 as supply is skewed towards less attractive second-hand Grade B accommodation, which currently makes up close to half of total availability. However, within the M3's more robust markets, such as Guildford and Richmond, low supply of Grade A space has the potential to prompt a clear return of rental growth as occupiers activate requirements and compete for the limited space available.

Figure 5
M3 take-up

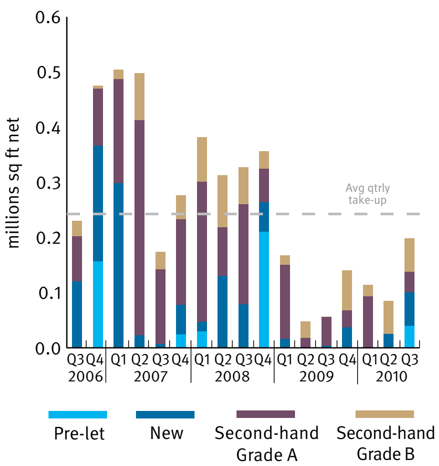


Figure 6
M4 take-up

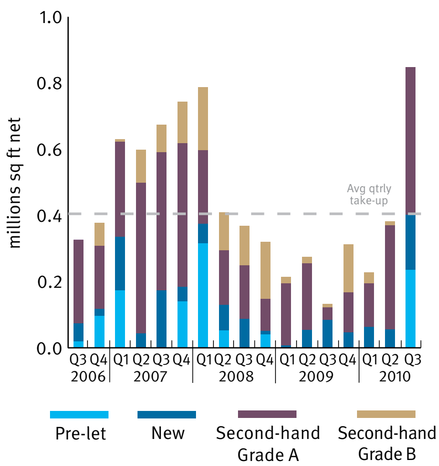
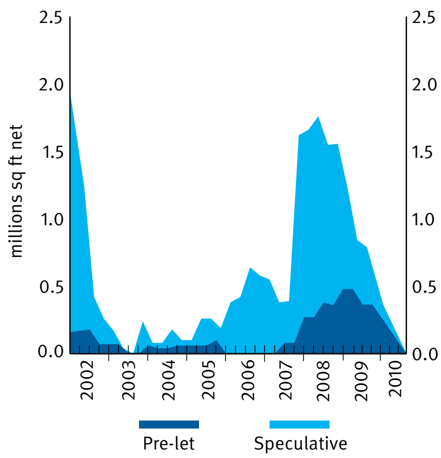


Figure 7
Space under construction in the M4



Source: Knight Frank Research

Q3 2010

M25 OFFICES

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Investment market

Table 3

Key investment transactions Q3 2010

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
194,196,198 Cambridge Science Park	108,550	£36.00m	6.50%	Trinity College Cambridge / L&G
Building 1600, Arlington Business Park, Reading	57,103	£13.23m	10.40%	Invista / Praxis
55/57 Clarendon Road, Watford	46,521	£11.01m	7.75%	Aviva Investors / ING
A&B Bartley Wood Business Park Hook	60,579	£8.23m	9.75%	Royal London / Church of England PF
Rourke House, The Causeway, Staines	15,166	£5.64m	8.25%	Canada Life / Threadneedle

	Transaction volume	Mean lot size	Mean NIY
Q3 2010	£172.8m	£9.09m	8.27%
Change 3 mths	-51% ▼	-48% ▼	19bps ▲
Change 12 mths	-27% ▼	-42% ▼	-44bps ▼

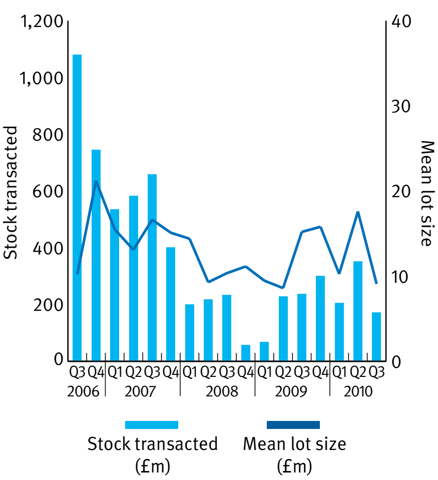
KNIGHT FRANK VIEW

- A quiet summer in the investment market was reflected in Q3's volume of £172.8m, a 51% fall on the Q2 total. Institutional demand remains robust for prime assets with long income, but buying opportunities are few and far between. With transactional evidence for prime product limited, prime yields were unchanged for the second quarter running, at c 6.25%.
- A more cautious approach from the UK funds seen since May, linked to the fragile outlook for the economy and occupier markets, has disproportionately impacted on demand for good secondary stock. Reflecting the dampening of demand for shorter income assets and rising supply, yields for good secondary product softened by 25bps to c. 8.25% in Q3.
- The supply of good secondary product will continue to increase as the banks release more stock towards the end of the year. While this is likely to prompt a further 25bps of yield softening for these assets in the last quarter, this will allow private investors and property companies to re-enter the market, boding well for transactional activity.

Trinity College Cambridge purchased 194,196 and 198 Cambridge Science Park from Legal and General for £36m, reflecting a net initial yield of 6.50%.

Figure 8

£m investment volumes and lot size



Source: Knight Frank Research

Figure 9

Mean initial yield & finance

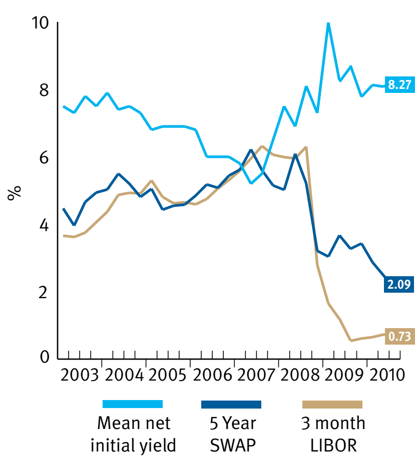
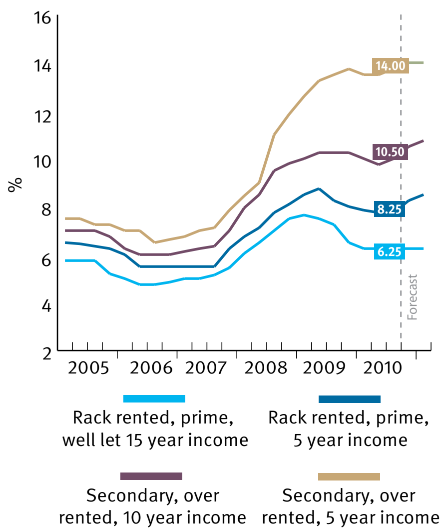


Figure 10

Yield forecasts



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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 2010.

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