RESEARCH

Q3 2012

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Take-up improved in Q3, driven by a resurgence of activity in the Thames Valley. In the M25, Q3 take-up was only 12% below the ten-year quarterly average with 35 transactions following just 20 in Q2. M4 take-up was its highest since Q3 2010 and 58% above average.

- Supply continues to fall, reflecting limited speculative development completions over the last three years. The M4 vacancy rate fell sharply in Q3 to 9.6%, its lowest level since Q3 2008, while the M25 vacancy rate fell to 7.9%, its lowest level in two years.

- New build construction activity stood unchanged at a three year high of 823,000 sq ft in the M25. Speculative development will increase further in Q4, with several new schemes forecast to commence in the Thames Valley.

- In the investment market, Q3 turnover was a robust £340m, 13% below Q2's level but nonetheless 7% above the five-year quarterly average. Activity for good quality secondary assets also improved in Q3, with vendors' aspirations now softening to a level which is proving attractive to buyers.

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Demand and take-up

- M25 take-up rebounded to 552,522 sq ft in Q3 2012, 27% above Q2's total and only 12% below the 10-year quarterly average. While Q2 take-up was skewed by Aker's major 215,755 sq ft pre-let at Chiswick Park, activity in the M25 market was more diverse in Q3, with 35 transactions following just 20 in Q2.
- The Thames Valley is significantly outperforming the wider South East market. In the M4, Q3 take-up was 649,788 sq ft, 44% above Q2's total and 58% above the 10-year quarterly average. Several large deals boosted take-up, including Huawei's 139,239 sq ft lease at 300 South Oak Way, Green Park, Reading and IMG's 107,459 sq ft lease at 5 Longwalk, Stockley Park, Heathrow.
- In contrast, the M3 corridor remains relatively subdued, with Q3 take-up 5% down on Q2's total and 54% below the ten-year quarterly average. Of Q3's 12 deals in the M3, none exceeded 20,000 sq ft, with the largest comprising Capita's lease of 17,417 sq ft at Benchmark House, Weybridge.
- New and Secondhand Grade A space continues to dominate the demand profile, accounting for 75% of M25 take-up and 96% of M4 take-up in Q3. The largest deal for brand new space in Q3 took place in West London, where ViaSat leased 51,716 sq ft at BAM Property's Chiswick Green at a headline rent of £39.00 per sq ft.
- Active demand slipped by 5% from Q2's four-year high to stand at 6.29m sq ft. While Financial & Business Services retains the greatest share of demand (24%), ICT and Retail, Distribution & Transport revealed notable growth over the past 12 months, up 20% and 33% respectively.

The largest deal in Q3 was Huawei's 139,239 sq ft lease of 300 South Oak Way, Green Park, Reading. Knight Frank acted for the landlord.

Supply and development

- Supply continued to edge down in Q3, reflecting limited speculative development since 2008 and consistently below average levels of secondhand space being released to the market. The M25 vacancy rate fell from 8.1% to 7.9% during Q3, its fourth successive fall and its lowest level in over two years.
- In the M4, robust take-up and the removal of several buildings from the market resulted in a sharp fall to the vacancy rate during Q3, from 10.7% to 9.6%, its lowest level in four years. In contrast, the M3 vacancy rate held steady at 8.7%.
- New build construction activity was unchanged in Q3, standing at a three year high of 823,000 sq ft in the M25 and accounted for by 11 schemes. Speculative development will increase further in Q4, with several schemes expected to commence within the key Thames Valley markets.
- Refurbishment activity expanded again in Q3 with six schemes underway in the M25 totalling 320,000 sq ft, a fivefold increase on Q3 2011. The latest scheme to come forward in Q3 was Carval & Canmoor's 180,000 sq ft redevelopment of Interchange, Croydon.

Figure 1

M25 take-up

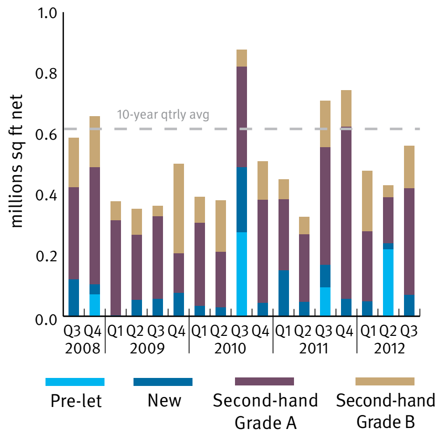


Figure 2

M4 take-up

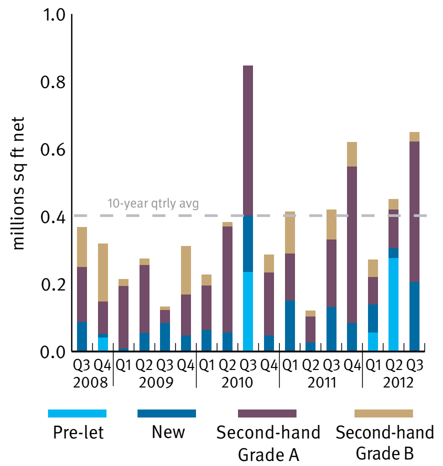
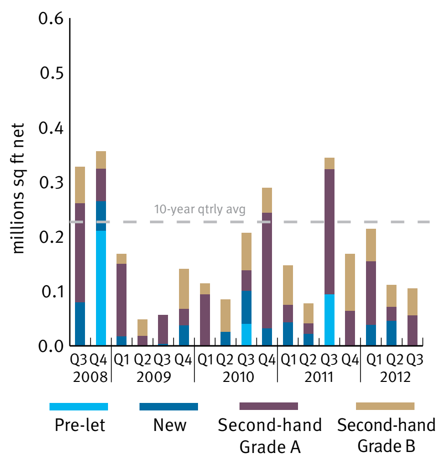


Figure 3

M3 take-up



Source: Knight Frank Research

Market statistics

Table 1

Key town prime rents & forecasts

Town	Q3 prime rent (psf)	Rent free (months)
Basingstoke	£17.50 ▼	36 ▶
Bracknell	£20.00 ▶	36 ▶
Brentwood	£21.00 ▶	24 ▶
Chiswick	£46.00 ▲	18 ▼
Croydon	£24.50 ▲	33 ▶
Gatwick	£22.50 ▶	30 ▶
Guildford	£27.50 ▶	27 ▶
Hammersmith	£43.00 ▲	21 ▼
Heathrow	£29.00 ▶	30 ▶
Maidenhead	£31.00 ▶	24 ▶
Reading	£30.50 ▶	30 ▶
Slough	£21.00 ▶	32 ▶
Staines	£30.00 ▲	21 ▶
St Albans	£22.50 ▶	24 ▶
Uxbridge	£30.00 ▲	24 ▶
Watford	£22.00 ▶	30 ▶
West Malling	£20.50 ▶	27 ▶

Based on new/Grade A building:
10,000 sq ft, 10 yr lease with no breaks
Note: ▲ = forecast for next 12 months

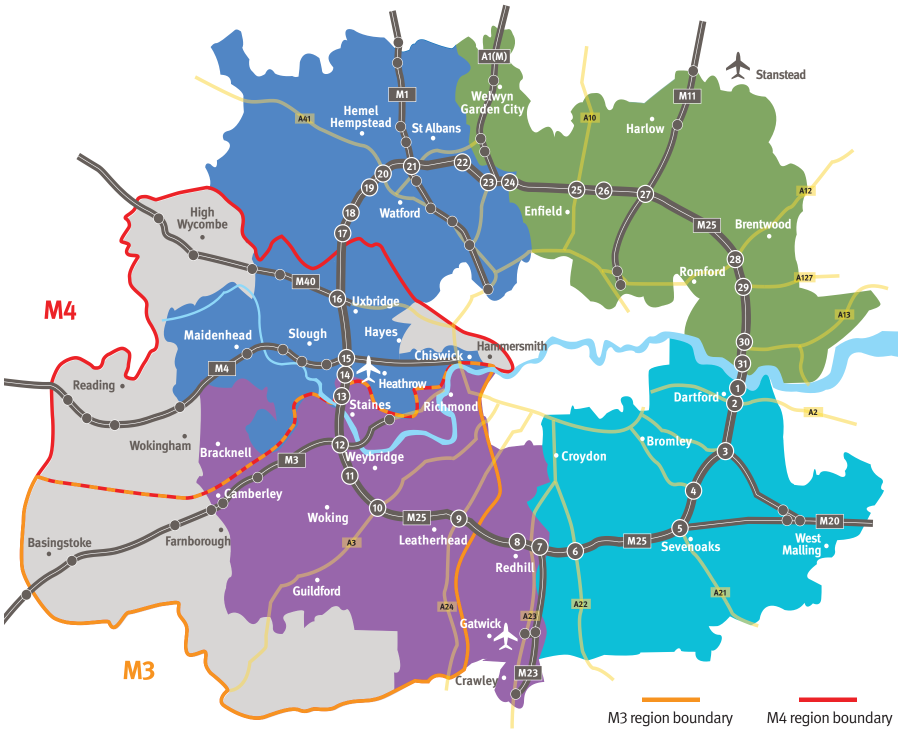


Table 2

Demand & Supply

Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**552,522**	327,540	107,360	54,827	62,795	**105,628**	**649,788**
Change Q3 12 vs Q2 12	**27%** ▲	-6% ▼	42% ▲	100% ▲	464% ▲	**-5%** ▼	**44%** ▲
Change Q3 12 vs Q3 11	**-13%** ▼	35% ▲	-72% ▼	100% ▲	1,184% ▲	**-69%** ▼	**54%** ▲
Q3 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q3 % New & Grade A (inc. pre-lets)	**75%**	87%	66%	73%	28%	**52%**	**96%**
Forecast 2012 take-up (m sq ft)	**2.1**	–	–	–	–	**0.55**	**1.65**

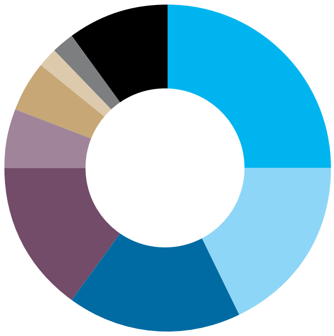
Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**10,302,225**	4,436,683	3,939,932	511,208	1,414,402	**3,675,616**	**6,246,637**
Change Q3 12 vs Q2 12	**-3%** ▼	-6% ▼	-2% ▼	15% ▲	2% ▲	**-1%** ▼	**-10%** ▼
Change Q3 12 vs Q3 11	**-9%** ▼	-11% ▼	-13% ▼	5% ▲	4% ▲	**-6%** ▼	**-14%** ▼
Q3 % new	**13%**	12%	17%	10%	4%	**10%**	**21%**
Q3 % second-hand Grade A	**49%**	58%	51%	40%	22%	**59%**	**59%**
Q3 % second-hand Grade B	**38%**	30%	32%	50%	74%	**31%**	**20%**
Q3 vacancy rate (▲/▼ movement from Q2 12)	**7.9%** ▼	8.8% ▼	9.6% ▼	2.9% ▲	7.0% ▲	**8.7%** ◀▶	**9.6%** ▼

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**822,771**	372,546	351,142	0	99,083	**312,158**	**482,103**
Change 12 months	**192%** ▲	132% ▲	334% ▲	–	100% ▲	**158%** ▲	**201%** ▲
Pre-let	**285,755**	215,755	70,000	0	0	**70,000**	**215,755**

Source: Knight Frank Research

Figure 4

M25 active named enquiries by sector



Active demand is 6.29m sq ft at Q3 2012

Financial & Business Services	24%	▼
Manufacturing & FMCGs	19%	▼
Retail, Distribution & Transport	17%	▲
ICT	15%	▲
Construction & Engineering	6%	▲
Public Sector	5%	▲
Energy & Utilities	3%	▲
Pharmaceutical & Medical	1%	▼
Other	10%	▲

Note: % = current share of demand
▲ = 12 month change (absolute terms)

In Q3, Russet Homes acquired 17,653 sq ft at 32 Tower View, Kings Hill, Kent. Knight Frank acted for the landlord, Liberty Property Trust (KHUT).

FORECAST AT A GLANCE

Take-up:

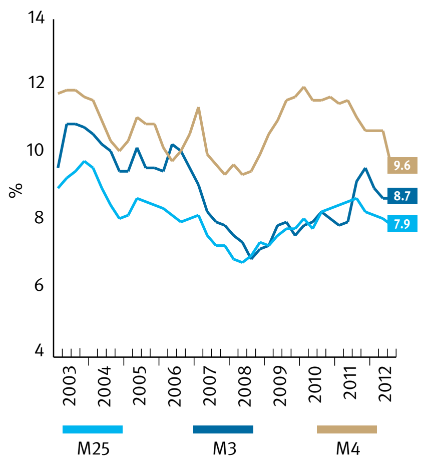
- As forecast, transactional activity improved in Q3 following a relatively subdued first half of the year, backed by a sizeable pipeline of space under offer across a range of sectors. M25 take-up is back on track to reach Knight Frank's forecast of 2.1m sq ft for 2012, almost exactly in line with the total for 2010 and only 15% below the 10-year annual average.
- While we did anticipate a relatively resilient performance in the Thames Valley, activity here has nonetheless surpassed expectations. Consequently, we have revised our 2012 take-up forecast for the M4 corridor from 1.5m sq ft to 1.65m sq ft, which is marginally above the 10-year average.
- The South East has long attracted companies from growing sectors of the global economy, and is well-positioned to benefit from the next cycle of growth. The technology sector and oil industry has been bucking the global economic headwinds for the last 24 months with Aker, Adobe and Huawei recently acquiring significant tranches of space.

Supply and rents:

- While economic conditions are set to remain challenging in the short term, the steady erosion of New and Grade A supply is likely to put further upward pressure on headline rents over the next two years, with strong growth already seen in the West London markets now rippling out more readily into other tightly supplied markets in prime Thames Valley centres.
- Grade A supply is reaching critically low levels in a number of key markets, particularly in the Thames Valley. For example, Hammersmith, Heathrow, Uxbridge and Gatwick now possess less than two years of New and Grade A supply based on average take-up, while Staines and Chiswick have less than one year of supply remaining.
- While banks, developers and institutional investors remain generally cautious, the looming supply crunch in specific locations will support a further increase in speculative activity over the next 12 months.

Figure 5

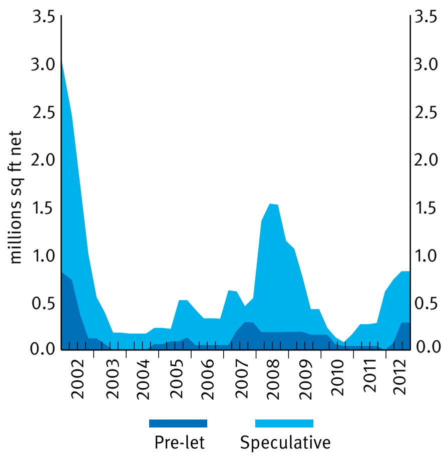
Vacancy rates



Source: Knight Frank Research

Figure 6

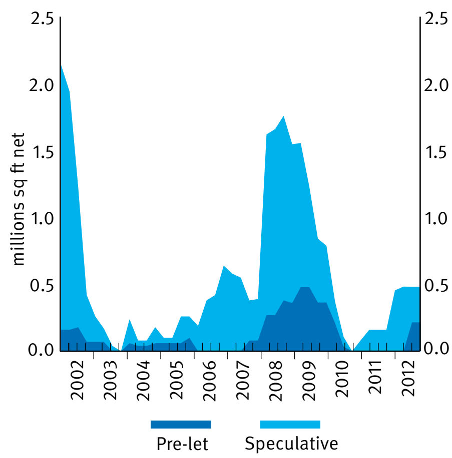
Space under construction in the M25



Source: Knight Frank Research

Figure 7

Space under construction in the M4



Source: Knight Frank Research

Investment market

Table 3
Key investment transactions Q3 2012

Building	Size (sq ft)	Price	Net Initial Yield	Vendor/ Purchaser
Marlow International, Marlow	231,016	£50.15m	8.88%	Avestus & Blackstone / London & Stamford
Market House, Maidenhead	75,400	£34.25m	6.00%	Shepherd Developments / Gatehouse
250 Brook Drive, Green Park, Reading	66,461	£19.50m	8.72%	AXA / Oxford Properties
41/43 Clarendon Road, Watford	51,246	£13.90m	7.44%	DTZ IM / British Steel Pension Fund
Building C, Zurich Centre, Solent Business Park	52,878	£13.50m	7.25%	L&G / Private

	Transaction volume	Mean lot size	Mean NIY
Q3 2012	£339.66m	£18.87m	9.27%
Change 3 mths	-13% ▼	-23% ▼	116bps ▲
Change 12 mths	125% ▲	113% ▲	58bps ▲

INVESTMENT VIEW

- South East investment turnover was a robust £340m in Q3, 13% below Q2's level but nonetheless 7% above the five-year quarterly average. Moreover, unlike previous quarters, Q3 activity was not heavily skewed by one or two major transactions, and is indicative of an improving depth of demand.
- Appetite for prime, long-income assets remains buoyant, particularly among overseas investors. The £34.25m purchase of Market House, Maidenhead by Middle Eastern investor Gatehouse was arguably Q3's headline deal, confirming pricing at c. 6.00%, a level unchanged for four successive quarters.
- The UK funds remain reasonably active, particularly for shorter-income, high quality assets where there is potential to add value through active asset management. However, they are highly selective, focusing on well-located buildings in tight markets with strong re-letting prospects. Yields for prime, five-year income softened by 25bps during Q3 to stand at 7.25%.
- Q3 also saw some indication of a revival of interest in good quality secondary assets. With yields for this type of stock ranging between 10% and 14%, vendors' aspirations are finally softening to a level which is proving attractive to those parties looking to invest in asset management plays, including UK Funds and overseas opportunity funds.


In Q3, a private investor purchased Building C Zurich Centre, Solent Business Park from L&G for £13.50m, reflecting an initial yield of 7.25%. Knight Frank acted for the vendor.

Figure 8
£m investment volumes and lot size

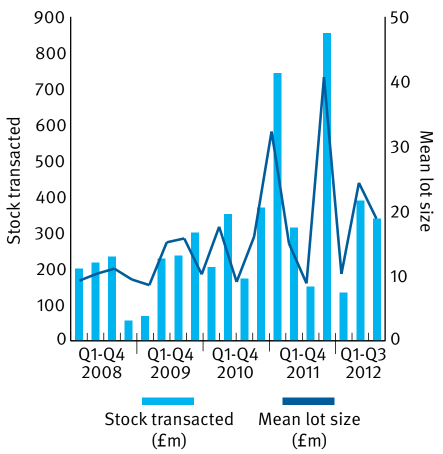


Figure 9
Mean initial yield & finance

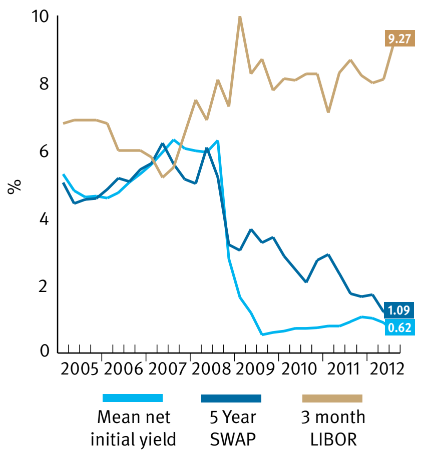
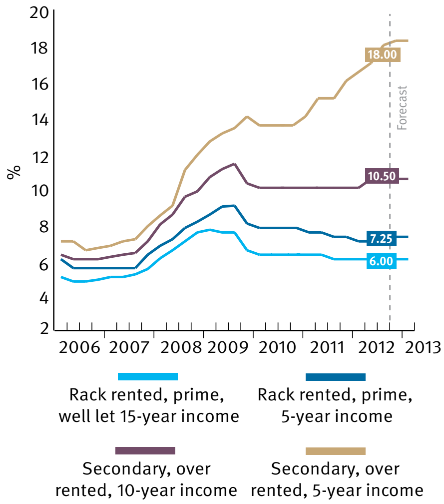


Figure 10
Yield forecasts



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 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 2012.

Front cover image: The Blade, Reading

Newmark Knight Frank Global