RESEARCH

Q3 2013

M25 OFFICES

Investment, development & occupier markets

HIGHLIGHTS

- Take-up was strong across all markets in Q3, reflecting a revival in business confidence and an increasing willingness among occupiers to execute relocations. This was particularly true of the M4, where take-up was 53% above the 10-year average.
- While Q3 take-up was largely accounted for by three sectors, TMT was responsible for a record 18 deals in the quarter, or 32% of the Q3 total. Notable TMT occupiers that acquired space included Apple, Rackspace and Siemens.
- Strong take-up and a single development completion in Q3 prompted a marked fall in supply. In the M25, the vacancy rate fell to a four year low of 7.4% during Q3 while, in the M4, the vacancy rate fell to 9.0%, its lowest level in over a decade.
- A resurgence of investor demand for South East offices was reflected in strong levels of activity in Q3. Transaction volumes reached £773m in the quarter, 80% above the 10-year average, while Q3's 32 deals was the highest number seen in a single quarter since Q3 2007.

DEMAND AND TAKE-UP

- Improving occupier sentiment was reflected in robust leasing activity in Q3. M25 take-up was 696,981 sq ft, the highest since Q4 2011 and 10% above the 10-year quarterly average.
- Of the M25's 36 deals, the largest saw Rackspace acquire 147,513 sq ft at Hyde Park Hayes, West London, which included an agreement to pre-let 127,000 sq ft at HPH5. The largest deal for existing space was Nexen's lease of 82,403 sq ft at The Stanza Building, Uxbridge, at an agreed headline rent of 32.00 per sq ft.
- The M4 saw strong take-up of 643,397 sq ft in Q3, up 72% on Q2 and 53% above the 10-year quarterly average. Activity consisted of 34 deals, the highest in a single quarter on record. In addition to Rackspace, the M4's other major deal took place in Hammersmith, where Dunnhumby agreed to pre-let 115,000 sq ft at 184 Shepherd's Bush Road.
- Despite a modest ten deals, M3 take-up was 438,392 sq ft in Q3, the second highest quarterly total over the past ten years. This was boosted by BMW's 305,000 sq ft acquisition of the former Nokia campus in Farnborough, one of the largest transactions ever seen in the M3.
- Across all markets, Q3 take-up was largely accounted for by three sectors – Manufacturing & FMCGs (28%), Retail & Transport (23%) and TMT (23%). However, with 18 deals in the quarter, TMT comfortably accounted for the highest proportion of transactions, with one notable example comprising Apple's acquisition within two buildings at Stockley Park, Heathrow, totalling 35,300 sq ft.

The Stanza Building, Uxbridge, where Nexen agreed to lease 82,403 sq ft at an agreed headline rent of £32.00 per sq ft. Knight Frank acted for the developers, Rockspring IM and Bell Hammer.

SUPPLY AND DEVELOPMENT

- Strong take-up in Q3 prompted a marked fall in availability. In the M25, the vacancy rate fell from 7.8% to 7.4% during Q3, its lowest level since Q1 2009. Similarly, the M4 vacancy rate fell from 9.7% to 9.0%, its lowest level in over a decade.
- The steepest fall in supply was seen in the M3, where the vacancy rate fell from 8.7% to 7.8% during Q3. However, this was largely due to the removal of Nokia's former Farnborough campus from the market following BMW's acquisition.
- While New and good quality Grade A space typically makes up 80% of M25 take-up, it currently accounts for just 62% of total M25 availability and stands at its lowest absolute level since Q3 2008. In contrast, New and good quality Grade A space accounts for 79% of total availability in the M4.
- Q3's only new speculative completion was Tor, Maidenhead, a 66,655 sq ft development by Rockspring, Blackrock and Bell Hammer. Speculative development has been broadly stable throughout 2013, with close to 1m sq ft underway across 11 schemes in the M25. Four schemes are in Staines, reflecting improved developer confidence in the market and its current shortage of supply.

FIGURE 1
M25 take-up

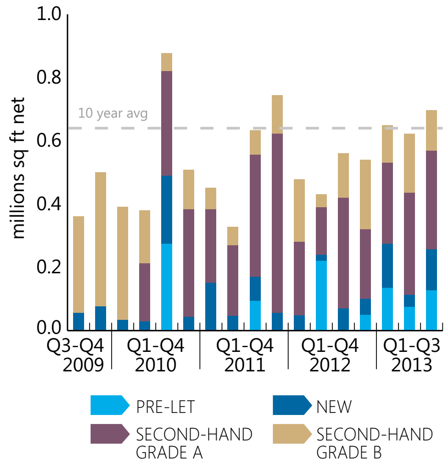


FIGURE 2
M4 take-up

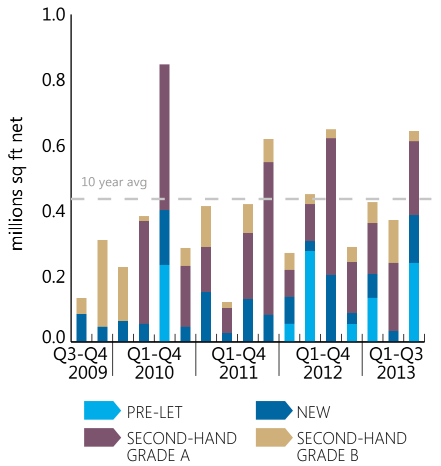
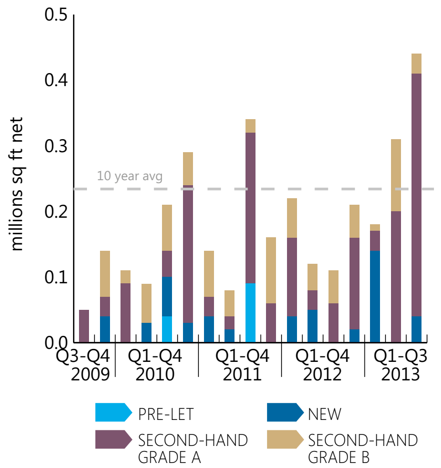


Figure 3
M3 take-up



Source: Knight Frank Research

MARKET STATISTICS

TABLE 1
Key town prime rents & forecasts

Town	Q3 prime rent (psf)	Rent free (months)
Basingstoke	£18.00 ▶	33 ▼
Bracknell	£20.00 ▶	36 ▶
Brentwood	£21.00 ▶	24 ▶
Chiswick	£49.00 ▲	18 ▼
Croydon	£24.00 ▲	24 ▼
Gatwick	£23.50 ▶	21 ▼
Guildford	£30.00 ▲	21 ▼
Hammersmith	£47.00 ▲	18 ▼
Heathrow	£32.00 ▲	24 ▼
Maidenhead	£32.00 ▶	21 ▶
Reading	£31.00 ▲	24 ▼
Slough	£22.50 ▲	32 ▶
Staines	£32.00 ▲	21 ▶
St Albans	£23.00 ▲	24 ▶
Uxbridge	£32.00 ▲	21 ▶
Watford	£23.00 ▶	24 ▶
West Malling	£20.50 ▶	24 ▶

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

Note: ▲ = forecast for next 12 months

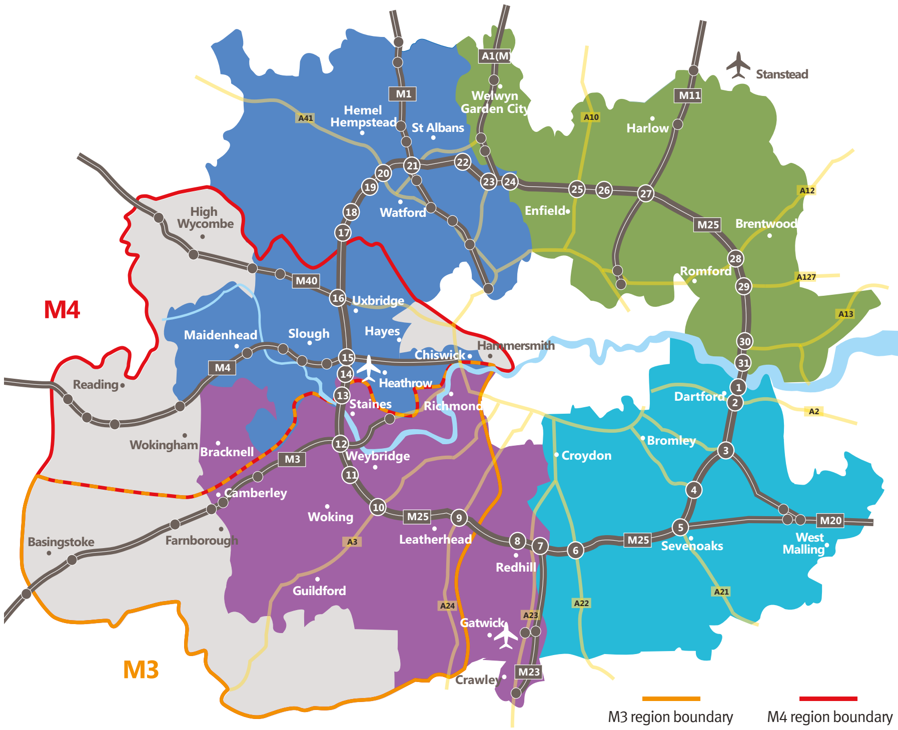


TABLE 2
Demand & Supply

Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**696,981**	394,813	139,211	109,843	53,114	**438,392**	**643,397**
Change Q3 13 vs Q2 13	**12%** ▲	127% ▲	-62% ▼	712% ▲	-27% ▼	**44%** ▲	**72%** ▲
Change Q3 13 vs Q3 12	**26%** ▲	21% ▲	30% ▲	100% ▲	-15% ▼	**315%** ▲	**-1%** ▼
Q3 pre-let (sq ft)	**127,00**	127,000	0	0	0	**0**	**242,000**
Q3 % New & Grade A (inc. pre-lets)	**81%**	95%	64%	85%	22%	**94%**	**95%**
Forecast 2013 take-up (m sq ft)	**2.50**	**1.10**	**1.00**	**0.20**	**0.20**	**1.15**	**1.90**

Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**9,738,055**	4,123,232	3,643,687	367,499	1,603,637	**3,188,683**	**6,208,624**
Change Q3 13 vs Q2 13	**-5%** ▼	-7% ▼	-3% ▼	-1% ▼	-5% ▼	**-12%** ▼	**-5%** ▼
Change Q3 13 vs Q3 12	**-6%** ▼	-7% ▼	-8% ▼	-28% ▼	13% ▲	**-13%** ▼	**-1%** ▼
Q3 % new	**13%**	11%	19%	15%	4%	**13%**	**20%**
Q3 % second-hand Grade A	**49%**	65%	45%	40%	21%	**54%**	**59%**
Q3 % second-hand Grade B	**38%**	24%	36%	45%	75%	**33%**	**21%**
Q3 vacancy rate (▲/▼ movement from Q2 13)	**7.4%** ▼	8.2% ▼	8.9% ▼	2.1% ◀▶	7.9% ▼	**7.8%** ▼	**9.0%** ▼

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**1,355,622**	662,416	414,123	0	279,083	**293,524**	**802,416**
Change 12 months	**19%** ▲	60% ▲	8% ▼	–	0% ◀▶	**1%** ▲	**0%** ◀▶
Pre-let	**360,151**	250,755	70,000	0	39,396	**70,000**	**390,755**

Source: Knight Frank Research

FIGURE 4
M25 active named enquiries by sector

FINANCIAL & BUSINESS SERVICES	24%	▼
MANUFACTURING & FMCGS	17%	▼
TECHNOLOGY, MEDIA & TELECOMS	14%	▼
RETAIL, DISTRIBUTION & TRANSPORT	14%	▼
PHARMACEUTICAL & HEALTH	10%	▲
ENERGY & UTILITIES	7%	▲
CONSTRUCTION & ENGINEERING	6%	▲
PUBLIC SECTOR	6%	▲
OTHER	2%	▼

Active demand is 5.80m sq ft at Q3 2013

Note: % = current share of demand
▲ = Movement in last 12 months (absolute terms)

In Q3, Maersk Shipping acquired 9,605 sq ft at 80 Moorbridge Road, Maidenhead. Knight Frank acted for the landlord, Aberdeen Asset Management.

FORECAST AT A GLANCE

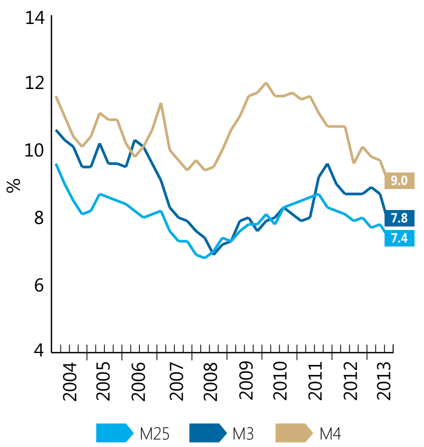
Take-up:

- The improving outlook for the UK economy is instilling occupiers with greater confidence to press ahead with relocation strategies. The short-term outlook remains encouraging, with the PMI business survey for the South East region reaching an all-time high of 62.7 during Q3 (above 50 denotes expansion). This positive sentiment will translate into continued robust market activity, with occupiers seeking to upgrade their accommodation and increase headcount.
- The pace of recovery has exceeded our initial expectations from 12 months ago. With a healthy 650,000 sq ft presently known to be under offer, our forecasts for total 2013 take-up have been revised significantly upwards. In the M25, 2013 take-up is now forecast to reach c. 2.5m sq ft, its highest annual total since 2008. In the M4, 1.9m sq ft is expected to transact, its highest level since 2007.
- However, it is notable that none of the current space under offer is within poorer quality Grade buildings. Over the next 12 months, markets which are currently well-supplied with New and Grade A space are arguably the best-placed to benefit from the recent upswing in demand. This is particularly true of those markets where lease terms remain attractive, such as Bracknell, Reading and Slough.

Supply and rents:

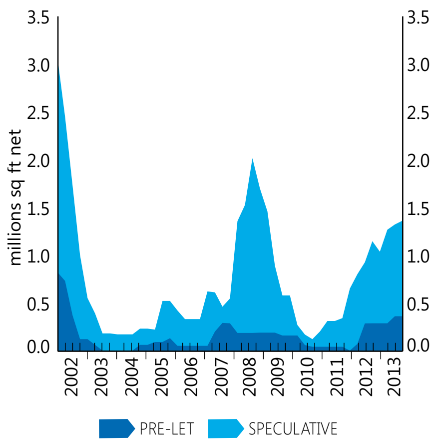
- Q3's marked fall in vacancy levels underlines the speed with which market dynamics can change in response to an upturn in occupier demand. With relatively muted speculative development underway, New and Grade A's share of total availability will reduce further over the next six months, as occupiers upgrade to better quality accommodation upon relocation.
- There is wide variation in supply between individual markets (Figure 7), and this has been a key determinant of recent rental growth. The tightest levels of Grade A supply are predominantly focused in West London and the prime Thames Valley markets, with rental growth likely to spread to other markets as their supply levels reduce in turn.
- Renewed investor confidence in shorter income stock is positive for the development market. Over the next 12 months, investors and developers are increasingly expected to target short income stock and land, with a view to subsequently repositioning buildings through refurbishment and developing new schemes. This activity will be restricted to tightly supplied markets where rental levels ensure viability.

FIGURE 5
Vacancy rates



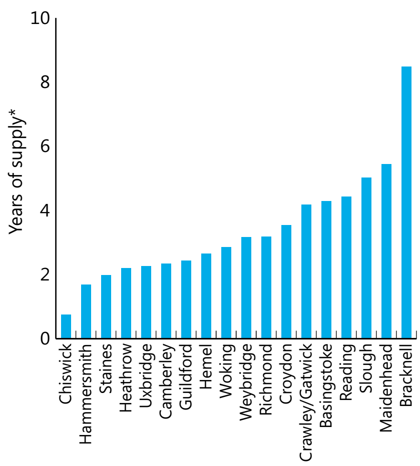
Source: Knight Frank Research

Figure 6
Space under construction in the M25



Source: Knight Frank Research

Figure 7
New & Grade A supply in key markets



Source: Knight Frank Research
*Based on average New & Grade A take-up vs current New & Grade A availability

INVESTMENT MARKET

TABLE 3
Key investment transactions Q3 2013

Building	Size (sq ft)	Price	Net Initial Yield	Vendor/ Purchaser
IQ Winnersh, Winnersh	1.27m	£245.1m	7.35%	Segro / Oaktree & Patrizia AG
Building 8, Chiswick Pk, Chiswick	135,000	£70.75m	4.75%	Schroders / Standard Life
Stanza Building, Uxbridge	82,400	£43.09m	5.72%	Rockspring / NFU
Future House, Staines	68,239	£23.63m	7.54%	Invesco / LaSalle IM
4 Roundwood Avenue, Stockley Park, Heathrow	131,190	£22.00m	13.69%	CBRE Global Investors / SWIP
Capital Court, Uxbridge	58,853	£21.20m	5.96%	Orchard Street / RLAM

	Transaction volume	Mean lot size	Mean NIY
Q3 2013	£772.76m	£24.15m	8.72%
Change 3 mths	92% ▲	86% ▲	58bps ▼
Change 12 mths	128% ▲	28% ▲	55bps ▼

INVESTMENT VIEW

- A resurgence of investor demand for South East offices was reflected in strong levels of activity in Q3. Volumes reached £773m in the quarter, 80% above the 10-year average, while Q3's 32 deals was the highest number in a single quarter since Q3 2007.
- With confidence returning to the occupier markets, there is a collective sense that the South East presently offers good value, with UK Funds and overseas Opportunity Funds under pressure to spend outside Central London.
- Bidding for prime and good secondary assets has become increasingly competitive, particularly in West London and the Thames Valley, with pricing often 100 basis points ahead of quoting. Yields for prime 15-year income moved in from 5.75% to 5.50% in Q3, following a further 25 basis point shift in Q2.
- Strong levels of demand will remain throughout the final quarter, with both the UK Funds and overseas investors keen to invest before the year-end. However, the one possible constraint to activity is the relative lack of stock available on the market, a situation which is likely to put further pressure on pricing.

In Q3, M&G Real Estate purchased Renaissance, Croydon from Abstract (Croydon) Ltd for £33.35m, reflecting a net initial yield of 6.27%. Knight Frank acted for the vendor.

FIGURE 8
Investment volumes and lot size

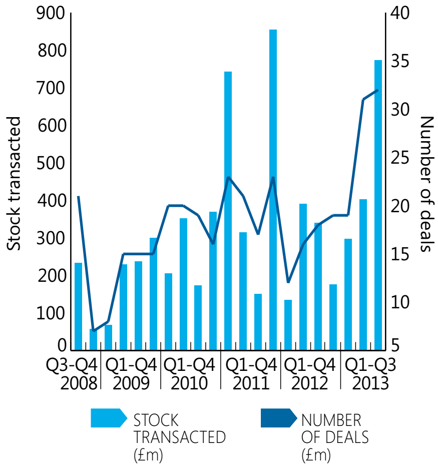


FIGURE 9
Mean initial yield & finance

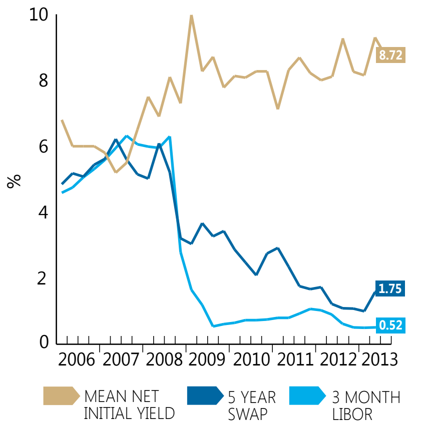
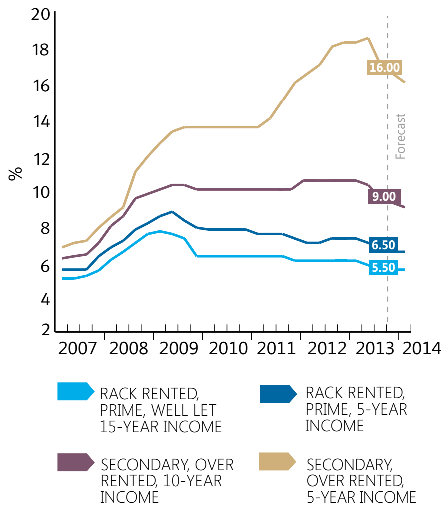


FIGURE 10
Yield forecasts



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 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 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 2013.

Front cover image: The Stanza Building, Uxbridge