RESEARCH

Knight Frank

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPIER MARKETS **Q3 2015**

M25 TAKE-UP IN Q3 HIGHEST FOR FIVE YEARS

M3 & M4 AVAILABILITY FALLS TO A HISTORIC LOW

INVESTMENT VOLUMES TO EXCEED £3BN IN 2015

"With vacancy levels continuing to fall, landlords that have committed to speculative development are now well placed to benefit from rising occupier demand."

EMMA GOODFORD
Head of National Offices

EXECUTIVE SUMMARY

The positive economic outlook for the UK continued to support growth in occupier activity in Q3 2015. All markets within the South East recorded a rise in take-up during the quarter with the M25 seeing the highest quarterly take-up for five years. Availability remained low, notably falling to unprecedented levels in some locations by quarter end. This supply and demand imbalance has maintained upward pressure on rents, with further rental growth expected in the final quarter of 2015.

Supported by the strengthening occupier market, investor interest in the South East has remained strong. Total turnover recorded over the past four quarters has now surpassed any 12 month period since 2005. With the weight of capital targeting assets in the South East markets growing, investment volumes are forecast to exceed £3bn in 2015, approaching the record level of £3.1bn recorded in 2006.

FORECAST AT A GLANCE

Forecast 2015 take-up (million sq ft)

	M25	M3	M4
	2.80	0.90	1.75
Change from January 2015:	▲	▲	◀▶

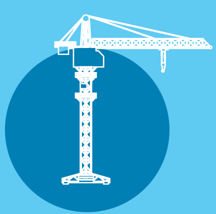
Take-up

M25 annual take-up predicted to be the highest since 2007

Occupiers from Financial and Business Services continue to drive new demand

Five deals in the M25 above 50,000 sq ft were completed in Q3, the highest quarterly amount since Q2 2014

Supply



Total space under construction in the M25 at a seven-year high in Q3 2015

Vacancy rate for New and Grade A stock in the M25 down to a 13-year low of 3.8%

Supply and demand imbalance to fuel further rental growth

OCCUPIER MARKET

Overall take-up across the South East markets increased by 63% in Q3 with availability falling to a historic low in some locations.

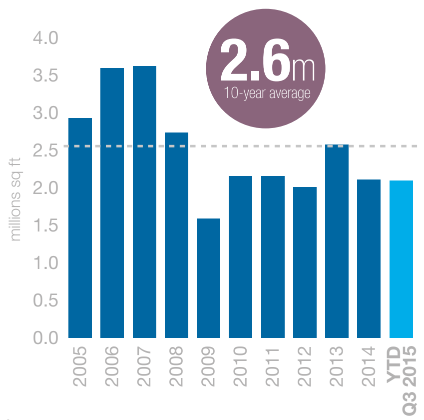
Demand and take-up

Following a dip in activity in Q2, take-up in the M25 market increased by 35% in Q3 to 831,940 sq ft. This represents the highest total for five years and is 31% above the 10-year average. The quarterly increase was supported by the significant pre-let of 110,000 sq ft at Manor Royal Business District to Elekta. This was one of five transactions completed over 50,000 sq ft during the quarter, the highest amount above this threshold since Q2 2014.

Take-up in the M4 market increased threefold during the quarter reaching 614,440 sq ft, the highest total for two years. The letting of 186,000 sq ft to Scottish & Southern Energy at Forbury Place underpinned the Q3 total. This represents the largest transaction in the M4 market since Q2 2012.

In the M3 market, take-up increased marginally (1%) during Q3 to 188,078 sq ft. This is 18% below the 10-year average. The letting of 43,000 sq ft at Chineham Park to technology distribution firm Exertis was the largest M3 deal in Q3.

FIGURE 1
M25 take-up



Source: Knight Frank Research

Supply and development

Overall availability in the M25 fell by a further 5% in Q3 to reach 7m sq ft. This is the lowest level of availability for the M25 market since Q4 2001. The quarterly decrease meant that the vacancy rate for the M25 fell from 5.7% (Q2 2015) to 5.4%, again the lowest since 2001.

Notably, office availability in both the M3 and M4 markets fell to a historic low in Q3. Availability in the M3 fell by 8% to reach 2.5m sq ft. This meant the vacancy rate for the M3 dipped to 6.1%, the lowest level since 2002. Similarly, availability in the M4 fell to 4.9m sq ft, a quarterly decrease of 2%. As a consequence, the M4 vacancy rate fell below 7% for the first time reaching 6.9% at quarter end.

The development pipeline across the South East markets (M25, M3 & M4) is set to deliver 2.7m sq ft before the end of 2017. Of this total, 2.3m sq ft is speculative.

5.4%
vacancy rate in M25

5.3m
active demand (sq ft)

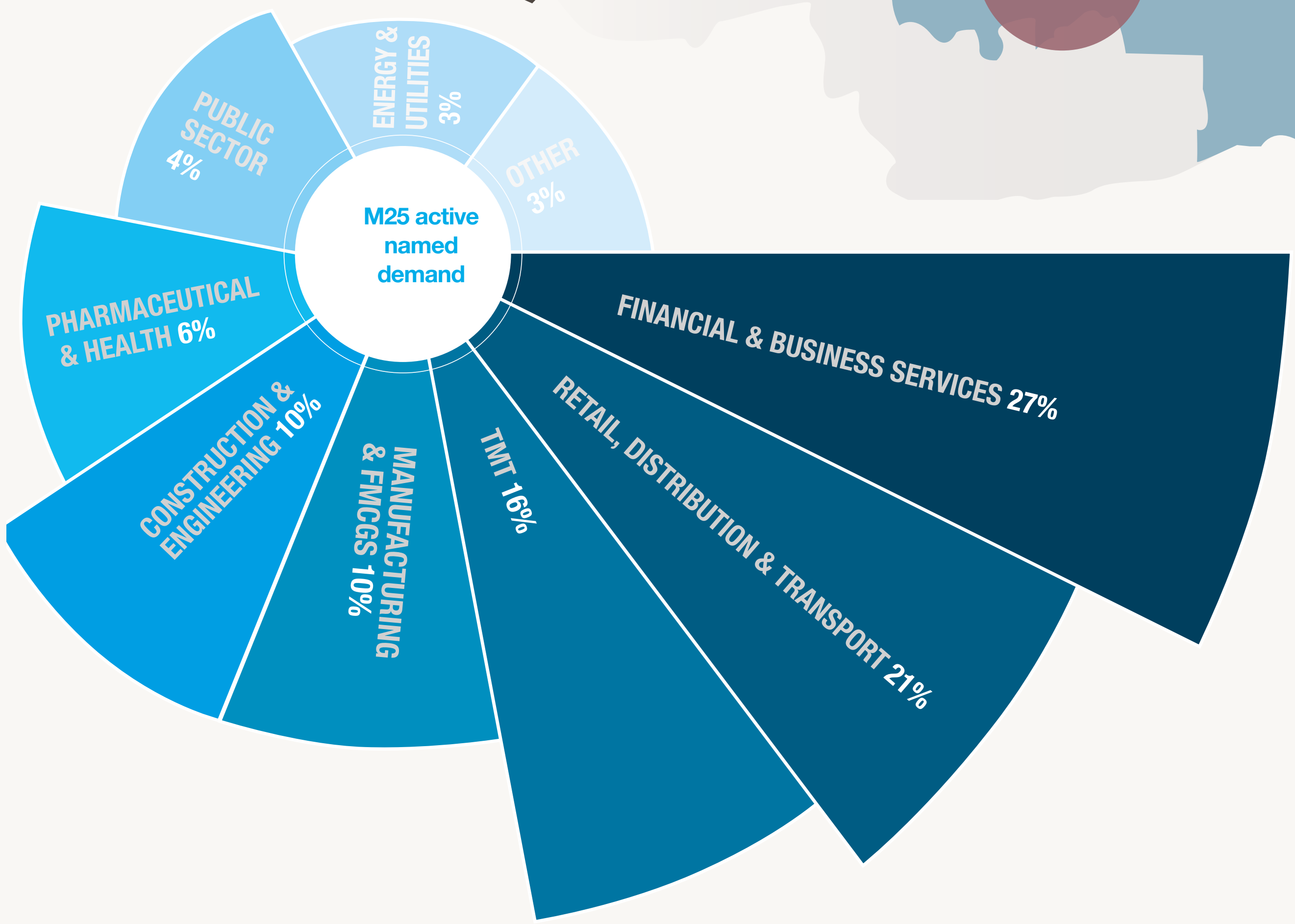
1.8m
sq ft under construction in M25

87%
of space under construction in the south east is speculative

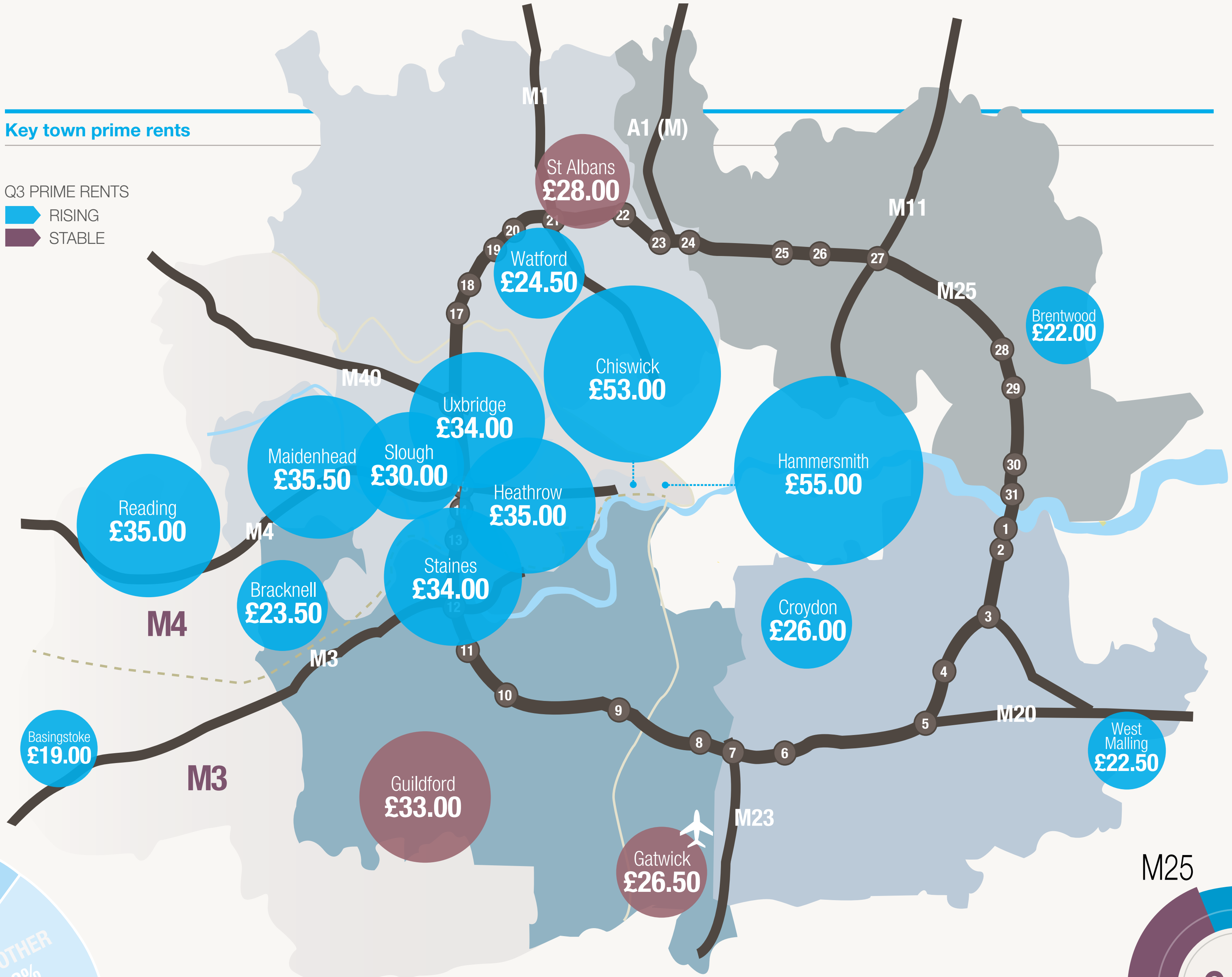
Forbury Place, 186,000 sq ft let to Scottish and Southern Energy.

DEMAND PIPELINE

The take-up increase across the markets meant that active named demand fell by 25% over the quarter to 5.3m sq ft. This total is 13% below the 10-year average. Financial and Business Services occupiers, typically the most active occupier group in the market, represented the largest percentage of enquiries in Q3 accounting for 27% of total demand. Interest from the Retail, Distribution & Transport sector also remained strong during the quarter accounting for 21%.



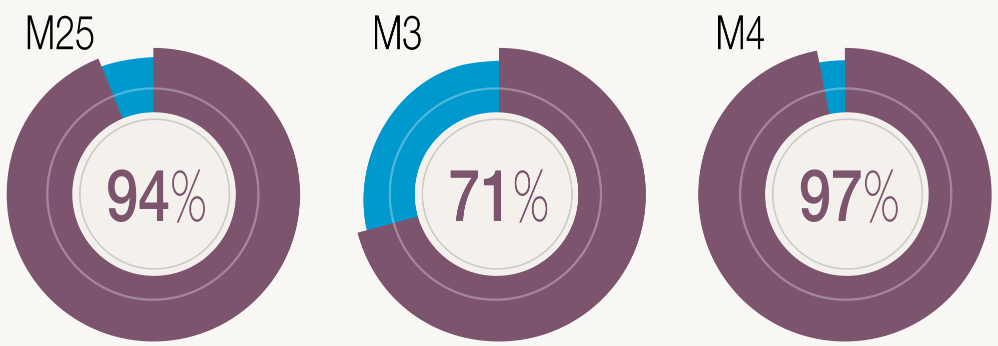
Key town prime rents



Demand & Supply

TAKE-UP	M25	M3	M4
sq ft	831,940	188,078	614,440
Change Q3 15 vs Q2 15	35% ▲	1% ▲	190% ▲
Change Q3 15 vs Q3 14	99% ▲	33% ▲	50% ▲
Q3 Pre-let (sq ft)	223,159	0	0
Q3 % New & Grade A (inc pre-lets)	94%	71%	97%
Forecast 2015 take-up (m sq ft)	**2.80**	**0.90**	**1.75**
AVAILABILITY			
sq ft	7,047,138	2,471,189	4,915,623
Change Q3 15 vs Q2 15	-5% ▼	-8% ▼	-2% ▼
Change Q3 15 vs Q3 14	-16% ▼	-10% ▼	-8% ▼
Q3 % New	20%	23%	22%
Q3 % second-hand Grade A	51%	54%	63%
Q3 % second-hand Grade B	29%	23%	15%
Q3 vacancy rate (▲/▼ movement from Q2 15)	5.4% ▼	6.1% ▼	6.9% ▼
CONSTRUCTION			
sq ft (net)	1,800,489	161,525	2,022,123
Change 12 months	65% ▲	-42% ▼	16% ▲
Pre-let (sq ft)	222,844	0	115,000

Q3 % New & Grade A take-up (Including pre-lets)



Q3 % NEW & GRADE A (INC PRE-LETS)

M25 New and Grade A vacancy rate at a 13-year low of 3.8%.

Q3 2015 vacancy rate (▲/▼ movement from Q2 15)

M25	M3	M4
▼ 5.7%	▼ 6.6%	▼ 7.1%
5.4%	6.1%	6.9%

Source for all charts: Knight Frank Research

775m

Transaction volume (£)

30m

Mean lot size (£)

5.00%

Prime NIY

INVESTMENT MARKET

A strong third quarter has seen South East investment volumes exceed £2.6bn for the year, with a number of large transactions expected to complete prior to the year end.

Q3 turnover stood at a healthy £775m across 26 transactions as investor demand continues to outstrip available product. This figure is 25% higher than 12 months ago and has meant that total investment for the year to date is now 46% ahead of the equivalent period in 2014.

Average lot sizes were 67% above the 10 year average, demonstrating increasing confidence in the market with investors committing larger sums to the region.

Prime yields remain at 5.00% NIY but investors will pay below this level to secure reversionary opportunities, as the occupational market continues to strengthen in most core centres.

As the main retail funds take a pause for breath, segregated funds are increasingly coming to the fore for good quality stock, particularly at the smaller end of the market.

US Opportunities Fund money remains focussed on the South East, where it can secure enhanced returns close to Central London, and we are also seeing increasing amounts of private investors bidding on stock, both from the UK and Overseas.

We expect a busy fourth quarter, with volumes for 2015 likely to exceed £3bn as UK and overseas investors continue to find value in the South East market.

Velocity 1&2, Weybridge

“Investment volumes to exceed £3bn in 2015.”

Change 12 months (Q3 2014 - Q3 2015)

25% Transaction volume

54% Mean lot size

-25bps Prime NIY

FIGURE 2
Investment volumes

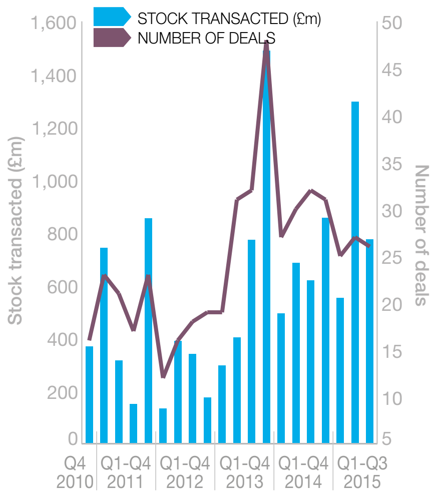


FIGURE 3
Prime net initial yield & finance

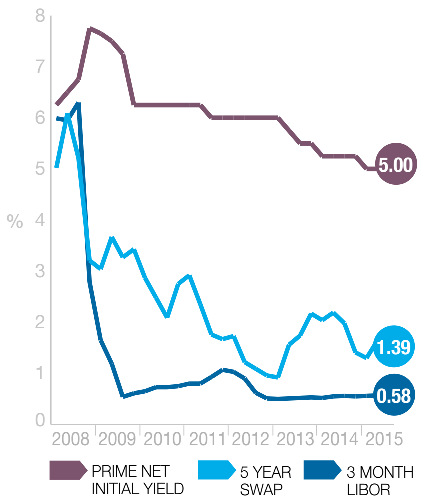
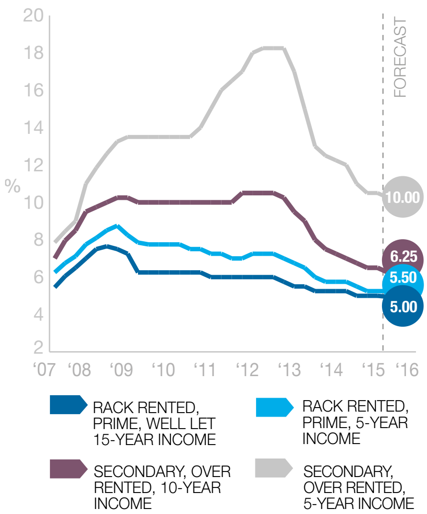


FIGURE 4
Yield forecasts



Key investment transactions Q3 2015

BUILDING	SIZE (SQ FT)	PRICE	NET INITIAL YIELD	VENDOR / PURCHASER
Velocity 1&2, Weybridge	106,400	£56.10m	5.70%	Rockspring & Exton Estates / Orchard Street
The Atrium, Uxbridge	156,500	£55.90m	5.68%	Aviva / Blackrock
5 Arlington Square, Bracknell	97,172	£38.00m	5.98%	Goodman / CCLA
2 Charlotte Place, Southampton	79,766	£15.80m	7.59%	McAleer & Rushe / Columbia Threadneedle Investment
Argentum, Hammersmith	25,424	£15.78m	4.22%	Merseyside Pension Fund / Royal London Asset Management

Source for all charts: 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 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.
- 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 2015.

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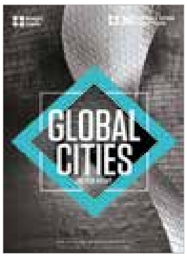

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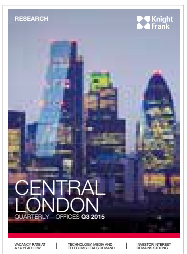

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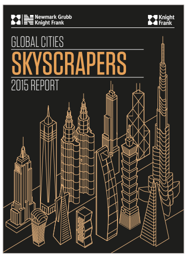

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