RESEARCH

Q4 2010

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Reflecting the coincidence of a number of major transactions in Q3, total take-up in 2010 improved substantially in all markets compared with 2009's low. In the M4, 2010 take-up was 6% above the annual average, although in the M25 and M3, 2010 take-up was 27% below average.

- Active named demand rebounded by 15% during Q4 to stand at 5.9m sq ft. Manufacturing & Pharmaceuticals continues to account for the largest share of demand, making up nearly one third of the total.

- The M25 and M4 saw a marginal increase in the vacancy rate during Q4, rising to 8.4% and 11.7% respectively. In the M3 region, the vacancy rate fell marginally from 8.3% to 8.1% in Q4.

- In the investment market, Q4's turnover of £369.7m was the highest since Q4 2007, with several large deals key to overall activity. Prime South East office yields remain at c. 6.25%, unchanged since Q1 2010.

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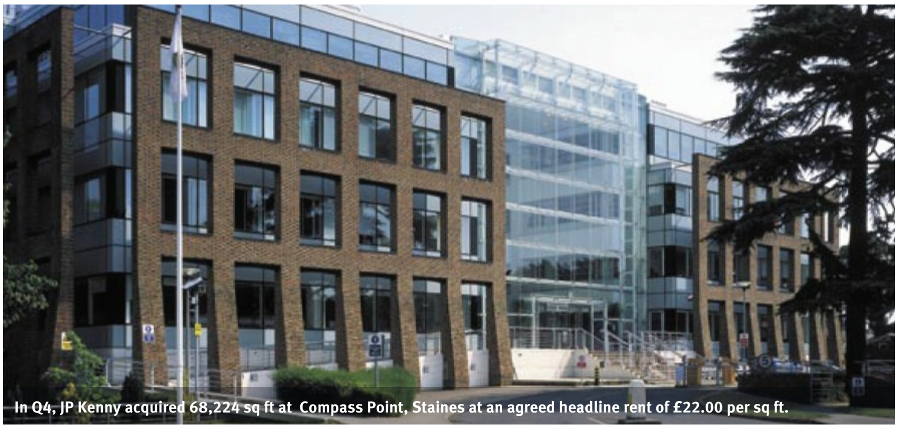
M25 market

- Total M25 take-up in 2010 reached 2.16m sq ft, recovering by 35% on 2009's record low, but 27% below the annual average. M25 take-up in Q4 of 508,158 sq ft was 42% below Q3, a quarter buoyed by four transactions in excess of 100,000 sq ft. Notably, however, Q4's 35 deals was closely in line with the 37 seen in Q3.
- Staines alone accounted for 26% of M25 take-up in Q4. JP Kenny acquired 68,224 sq ft at Compass Point at an agreed headline rent of £22.00 per sq ft, while Centrica acquired 36,765 sq ft at Orbis One and Orbis Three, following their 35,236 sq ft acquisition at Orbis Two in Q3.
- Active named demand rebounded by 15% in Q4 to stand at 5.90m sq ft, reflecting building confidence in occupier demand. ICT demand has almost doubled from Q4 2009 to account for 21% of the current total, while FBS demand has increased by 30%, to make up 18% of the current total.
- The M25 vacancy rate increased marginally from 8.3% to 8.4% during Q4. However, the volume of available new and second-hand Grade A space is falling, with increases to the vacancy rate in the last two quarters driven by the release of poorer quality, Grade B space to the market following lease expiries.
- Just one scheme commenced construction in Q4, BAM property's 81,544 sq ft Chiswick Green in West London. While 2010 has been a highly inactive year for new speculative development starts, several significant land deals occurred in Q4 2010 which should lend itself to new space being delivered in Chiswick, Uxbridge and two other key M25 centres in 2012.


In Q4, JP Kenny acquired 68,224 sq ft at Compass Point, Staines at an agreed headline rent of £22.00 per sq ft.

FORECAST AT A GLANCE

- Knight Frank forecast take-up of 2.3m sq ft in 2011, a steady 5% improvement on 2010. Whereas a handful of major, opportunity-driven deals were key to take-up last year, we expect a higher frequency of transactions in the core 10,000 to 25,000 sq ft market in 2011, evidenced by improving size and depth of the current demand profile.
- The freeze on development activity over the last 12 months will ensure the vacancy rate stays under 9% in 2011. However, we expect refurbishment activity to increase this year, as occupiers seek to achieve cost savings and more flexible lease arrangements at their existing space.
- Prime, net effective rental levels have stabilised, falling only 2% in 2010 compared with a 21% fall in 2009. Although rents are expected to remain broadly flat in 2011, before gathering positive momentum in 2012, pockets of rental growth will be evident this year in key towns in the Thames Valley, where demand has been relatively robust and new and Grade A supply is limited.

Figure 1
M25 take-up

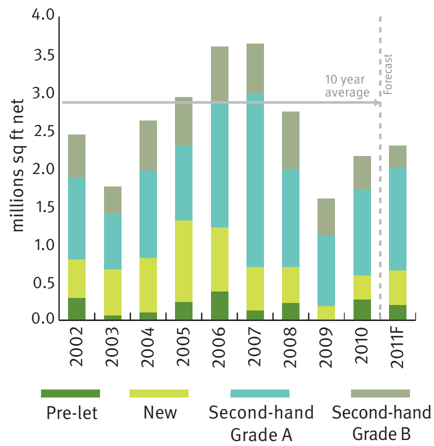


Figure 2
Space under construction in the M25

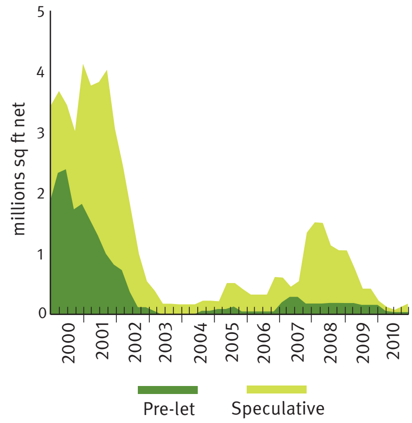


Figure 3
M25 active named enquiries by sector

Active demand is 5.90m sq ft at Q4 2010

Manufacturing & Pharmaceuticals	33%
Information, Communications & Technology	21%
Financial & Business Services	18%
Retail, Distribution & Transport	10%
Construction & Engineering	6%
Public Sector	4%
Other	8%

Source: Knight Frank Research

Market statistics

Table 1
Key town prime rents & forecasts

Town	Q4 prime rent (psf)	Rent free (months)
Basingstoke	£18.00 ▶	32 ▶
Bracknell	£19.00 ▶	36 ▶
Brentwood	£21.50 ▶	24 ▶
Chiswick	£35.00 ▲	24 ▼
Croydon	£20.00 ▲	33 ▶
Gatwick	£21.50 ▶	28 ▲
Guildford	£27.00 ▲	24 ▶
Hammersmith	£31.50 ▲	24 ▼
Heathrow	£27.50 ▶	33 ▼
Maidenhead	£29.50 ▲	30 ▶
Reading	£30.00 ▶	30 ▼
Slough	£20.00 ▶	36 ▶
Staines	£28.00 ▲	30 ▼
St Albans	£21.50 ▲	24 ▶
Uxbridge	£27.50 ▲	24 ▶
Watford	£20.50 ▲	30 ▶
West Malling	£21.00 ▶	21 ▶

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

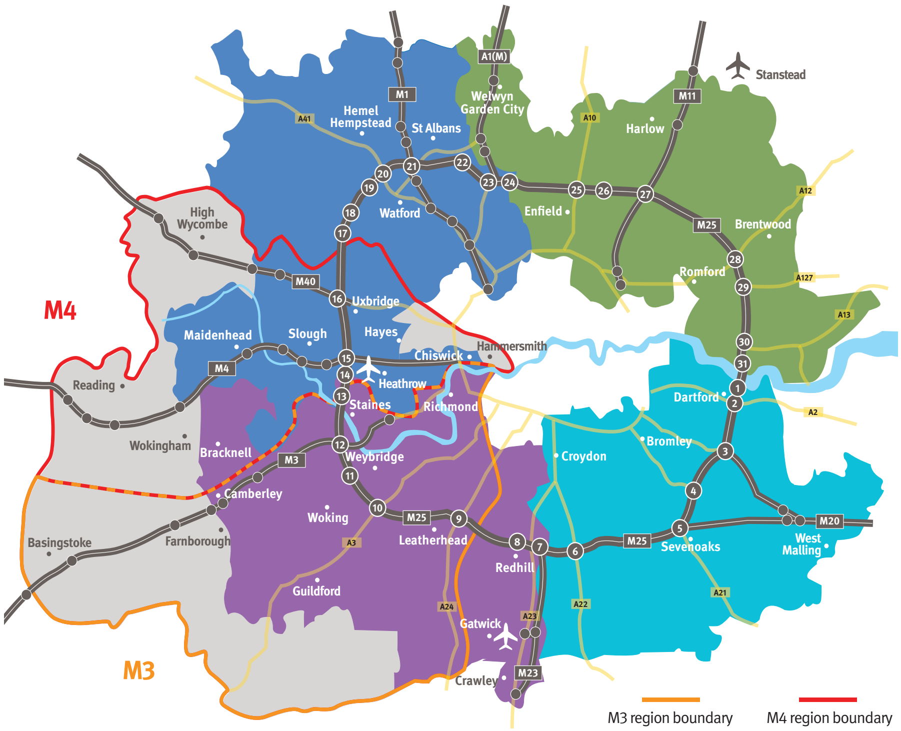


Table 2
Demand & Supply

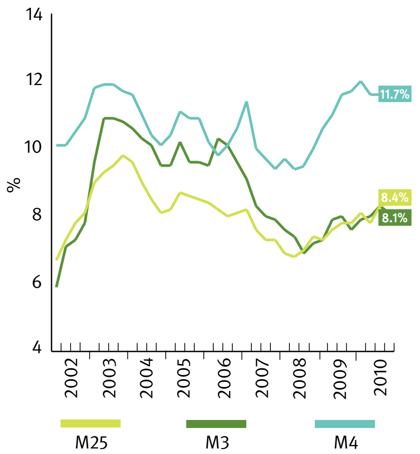
Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**508,158**	203,841	299,063	0	5,254	**288,992**	**286,412**
Change Q4 10 vs Q3 10	**-42%** ▼	-67% ▼	46% ▲	0 ◀▶	-90% ▼	**40%** ▲	**-66%** ▼
Change Q4 10 vs Q4 09	**1%** ▲	54% ▲	-6% ▼	-100% ▼	-83% ▼	**106%** ▲	**-8%** ▼
Q4 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q4 % take-up new & pre-let	**8%**	6%	10%	0	0%	**11%**	**16%**
Forecast 2011 take-up (m sq ft)	**2.3**	–	–	–	–	**0.6**	**1.8**

Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**10,931,116**	5,067,558	4,427,928	484,663	950,967	**3,416,421**	**7,456,443**
Change Q4 10 vs Q3 10	**1%** ▲	2% ▲	1% ▲	11% ▲	-7% ▼	**-2%** ▼	**1%** ▲
Change Q4 10 vs Q4 09	**9%** ▲	3% ▲	18% ▲	3% ▲	4% ▲	**7%** ▲	**0%** ◀▶
Q4 % new	**15%**	16%	16%	11%	7%	**14%**	**26%**
Q4 % second-hand Grade A	**51%**	56%	48%	53%	33%	**40%**	**53%**
Q4 % second-hand Grade B	**34%**	28%	36%	36%	59%	**46%**	**21%**
Q4 vacancy rate (▲/▼ movement from Q3 10)	**8.4%** ▲	10% ▲	10.8% ▲	2.7% ▲	4.7% ▼	**8.1%** ▼	**11.7%** ▲

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**161,544**	81,544	40,000	0	0	**80,000**	**81,544**
Change 12 months	**-62%** ▼	-53% ▼	-80% ▼	–	-100% ▼	**-62%** ▼	**-90%** ▼
Pre-let	**40,000**	0	40,000	0	0	**40,000**	**0**

Source: Knight Frank Research

Figure 4
Vacancy rates



M4 & M3 markets

- 2010 take-up in the M4 totalled 1.75m sq ft, 87% higher than the low point of 2009 and 6% above the ten year average. Q4 take-up of 286,412 sq ft appeared subdued in comparison with Q3, when six deals in excess of 100,000 sq ft contributed to record quarterly take-up of 847,355 sq ft.
- As in Q3, out-of-town accommodation was key to Q4 take-up, accounting for 88% of the M4 total. Reading was particularly active, accounting for five of Q4's 19 deals. Of these, Pega System's 22,589 sq ft acquisition at One Reading Central, raised the town's headline rent to £30.00 per sq ft.
- The M4 vacancy rate increased marginally to 11.7% in Q4, from 11.6% in Q3. However, with just a single scheme having commenced in 2010, the amount of new space available will be eroded in 2011.
- In the M3 region, Q4 take-up was 288,992 sq ft, up 40% on Q3 and the strongest since Q4 2008. This took the M3 total for 2010 to 694,676 sq ft or 27% below the annual average. Over the last two years, the southern section of the M3 region has seen the majority of take-up, with the core M3 corridor area, stretching from Camberley to Basingstoke, performing relatively poorly.
- The M3 vacancy rate fell from 8.3% to 8.1% during Q4, buoyed by relatively healthy take-up in the southern section of the M3 region. However, in contrast with the M4, poorer quality second-hand Grade B space makes up close to half of total availability in the M3, with new space slipping to just 14% of the total, the lowest on record.

In Q4, Knight Frank acted for the vendor over the £3.3m freehold purchase of Drayton Hall, West Drayton, totalling 29,792 sq ft.

M3 & M4 VIEW

- In the M4 corridor, Knight Frank forecast take-up of 1.8m sq ft in 2011, closely in line with the 2010 total. This reflects an improvement of activity in the core 10,000 sq ft to 25,000 sq ft market in tandem with fewer 100,000 sq ft + deals than last year. Tightly supplied markets in West London, namely Chiswick, Uxbridge and Hammersmith, offer the best prospects for rental growth in 2011.
- In the M3, 0.6m sq ft of take-up is forecast for 2011, a fall of 15% on the 2010 total. The weaker outlook reflects a lack of depth in demand coupled with the predominance of poorer quality of supply, particularly in the mid-section of the M3 corridor. However, demand is expected to remain robust elsewhere in the M3 region, notably along the London side of the M3 including Staines, Richmond and Weybridge.

Figure 5
M3 take-up

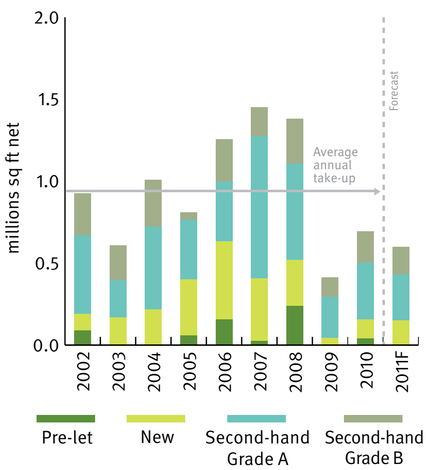


Figure 6
M4 take-up

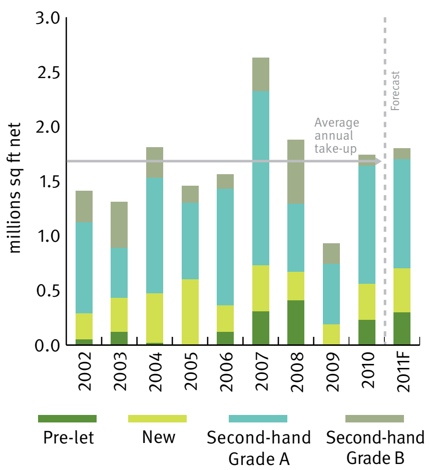
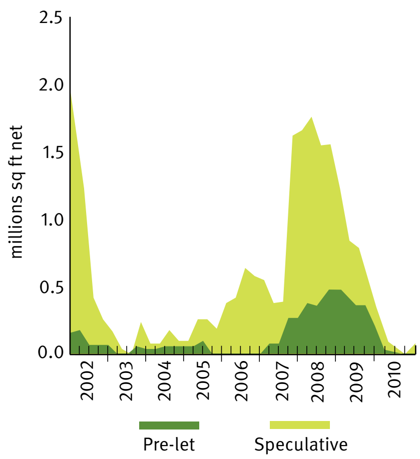


Figure 7
Space under construction in the M4



Source: Knight Frank Research

Q4 2010

M25 OFFICES

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Investment market

Table 3
Key investment transactions Q4 2010

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
Apollo & Lunar House, Croydon	440,000	£78.00m	6.95%	Green Properties / Harel
Adelphi House, Reading	29,792	£7.29m	7.65%	Private Investor / F&C
IHG Group HQ, Broadwater Park, Denham	97,233	£32.65m	6.93%	Tritax / Gatehouse Bank
BSI Tower, 389 Chiswick High Road, Chiswick	143,410	£31.33m	9.35%	Carlyle Group / Canmoor & Harbart
Grosvenor House, Redhill	50,723	£12.60m	9.30%	Wereldhave / Orbit

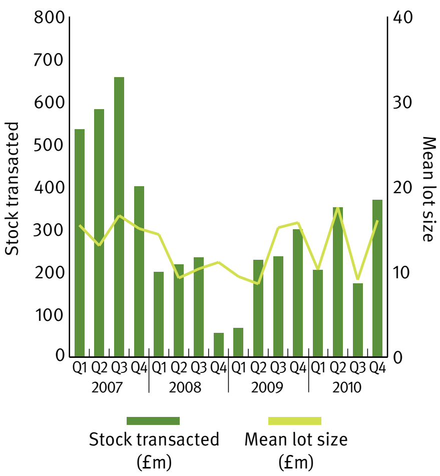
	Transaction volume	Mean lot size	Mean NIY
Q4 2010	£369.65m	£16.07m	8.16%
Change 3 mths	114% ▲	77% ▲	-11bps ▼
Change 12 mths	23% ▲	-20% ▼	+38bps ▲

INVESTMENT VIEW

- Q4's investment turnover of £369.7m was more than twice the Q3 level and the highest since Q4 2007. With five transactions of over £30m, large lot sizes were key to the rise rather than an increase in the number of transactions.
- The prime end of the market remains stable, with prime 15 year income yields holding steady at 6.25% in Q4 and unchanged since Q1 2010. An ongoing shortage of prime opportunities, coupled with a healthy level of requirements from UK and overseas funds should ensure that prime yields at least remain stable in the coming year, with a slight hardening a possibility.
- Institutional activity is expected to remain robust during the first half of 2011, as funds sell out of poorer quality assets and continue to invest in prime opportunities. Income will remain key, with buyers increasingly focused on the occupational and refurbishment risks associated with short let and secondary stock.
- Given the shortage of prime stock, appetite for higher yielding, mid-term income has strengthened both from UK funds and private buyers. Yields for this type of product range between 7.50% and 10.00%, with pricing depending on strength of location, likely refurbishment costs and the potential for lease re-gears.

In Q4, Gatehouse Bank purchased the IHG Group HQ building at Broadwater Park, Denham from Tritax for £32.65m, reflecting a net initial yield of 6.93%.

Figure 8
£m investment volumes and lot size



Source: Knight Frank Research

Figure 9
Mean initial yield & finance

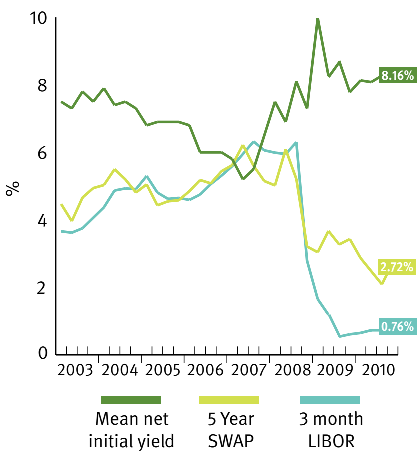
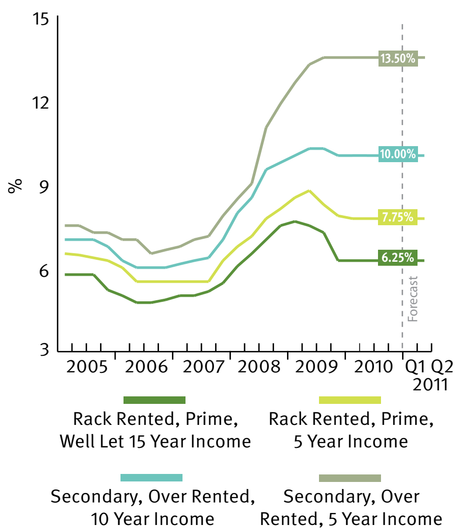


Figure 10
Yield forecasts



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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 December 31st 2010.

Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members' names.

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