RESEARCH

Knight Frank

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPIER MARKETS **Q4 2013**

HIGHLIGHTS

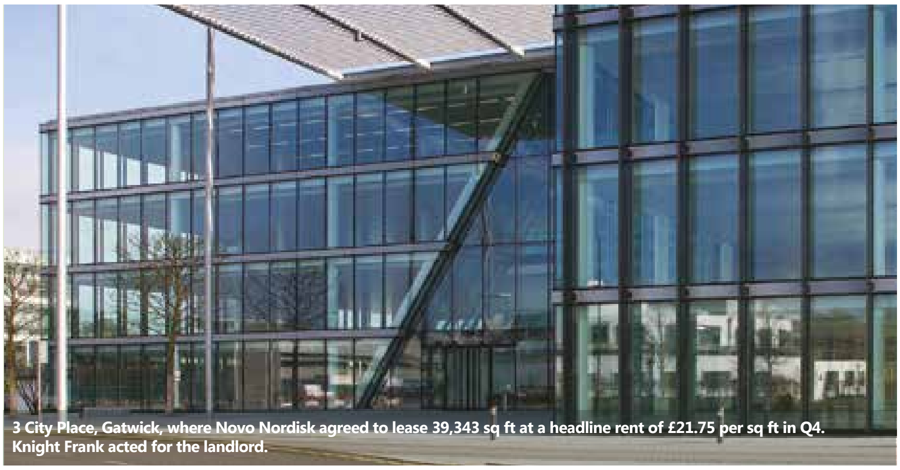
The return of consistent growth in the economy has brought a marked improvement in occupier activity, with take-up in the M25 reaching 2.58m sq ft in 2013, its highest annual total since 2008.

Availability has declined significantly across each of the main markets. The steepest decline was in the M4, where the vacancy rate fell to 8.3% in Q4, its lowest level in over a decade.

A resurgence of investor demand for South East offices since last summer was reflected in £1.48bn of turnover in H2 2013, the strongest half-yearly total since H2 2006.

DEMAND AND TAKE-UP

- Reflecting a marked improvement in occupier sentiment, take-up in the M25 reached 2.58m sq ft in 2013, its highest annual total since 2008. While Q4 take-up of 611,821 sq ft was the lowest of any quarter in 2013, activity consisted of 43 transactions, the highest number in a single quarter since Q3 2008.
- The M25's only deal in excess of 50,000 sq ft in Q4 took place in Bracknell, where Honda leased 69,624 sq ft at Reflex. Of the M25's eight transactions involving new space, the largest saw Novo Nordisk lease 39,343 sq ft at 3 City Place, Gatwick.
- M4 take-up was 427,899 sq ft in Q4, down 33% on Q3's impressive total but still in line with the ten year quarterly average. The M4's largest deal took place at FC200 in West London, where Bechtel leased 77,692 sq ft at a headline rent of £28.50 per sq ft. Reading was the M4's most active market with eight deals in Q4, including two at The Blade totalling 20,000 sq ft.
- In the M3, relatively subdued take-up of 123,943 sq ft in Q4 took the annual total for 2013 to 1.05m sq ft, 65% above the 2012 total and 11% above the ten year average. Woking was home to four of the M3's 11 deals, the largest of which was Yum's lease of 31,640 sq ft at Orion Gate.
- A notable feature of 2013 activity has been the diverse and balanced nature of demand. Across all markets, Manufacturing and Fast Moving Consumer Goods accounted for the largest share of 2013 take-up (16.9%), although TMT (15.9%), Retail & Distribution (15.5%) and Financial & Business Services (15.0%) each accounted for a similar share.



3 City Place, Gatwick, where Novo Nordisk agreed to lease 39,343 sq ft at a headline rent of £21.75 per sq ft in Q4. Knight Frank acted for the landlord.

SUPPLY AND DEVELOPMENT

- Strong take-up and relatively limited development completions have prompted a sharp fall in availability across the main markets. The M25 vacancy rate declined from 7.4% to 6.9% during Q4, its lowest level since Q2 2008.
- The steepest decline in availability was in the M4, where the vacancy rate fell from 9.0% to 8.3% during Q4, its lowest level in over a decade. Furthermore, the proportion of M4 availability made up of new space currently stands at 19%, a five-year low for the region.
- Total speculative development completions amounted to 367,000 sq ft in 2013, 40% below the 10-year annual average level. Q4 saw the completion of just two speculative schemes, namely Exton & Rockspring's Flow, Staines (61,854 sq ft) and Abstract's Renaissance, Croydon (99,083 sq ft), part of which was pre-let during construction in Q2 2013.
- Evidence suggests that developers are responding, helped by a significant improvement of investment demand. Resilient markets to the West of London and the Thames Valley are the main focus of speculative development, with construction activity in the M4 increasing by 86% during Q4 to stand at c.780,000 sq ft, its highest level since Q1 2009.

FIGURE 1
M25 take-up

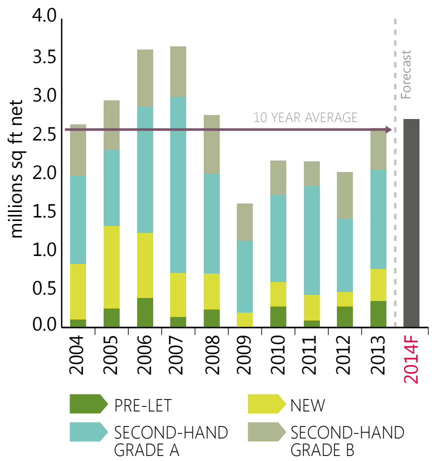


FIGURE 2
M4 take-up

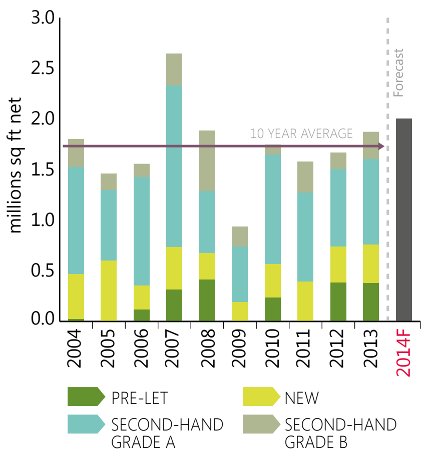
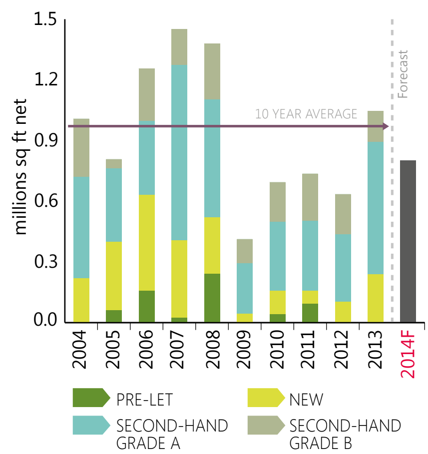


Figure 3
M3 take-up



Source: Knight Frank Research

MARKET STATISTICS

TABLE 1
Key town prime rents & forecasts

Town	Q4 prime rent (psf)	Rent free (months)
Basingstoke	£18.00 ▶	33 ▶
Bracknell	£20.00 ▶	36 ▶
Brentwood	£21.00 ▶	24 ▶
Chiswick	£48.00 ▲	18 ▼
Croydon	£24.50 ▲	21 ▼
Gatwick	£23.50 ▶	21 ▼
Guildford	£30.50 ▲	21 ▼
Hammersmith	£46.00 ▲	18 ▼
Heathrow	£30.50 ▲	24 ▼
Maidenhead	£32.00 ▲	21 ▼
Reading	£31.50 ▲	24 ▶
Slough	£22.50 ▲	32 ▶
Staines	£32.00 ▲	21 ▶
St Albans	£23.50 ▲	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

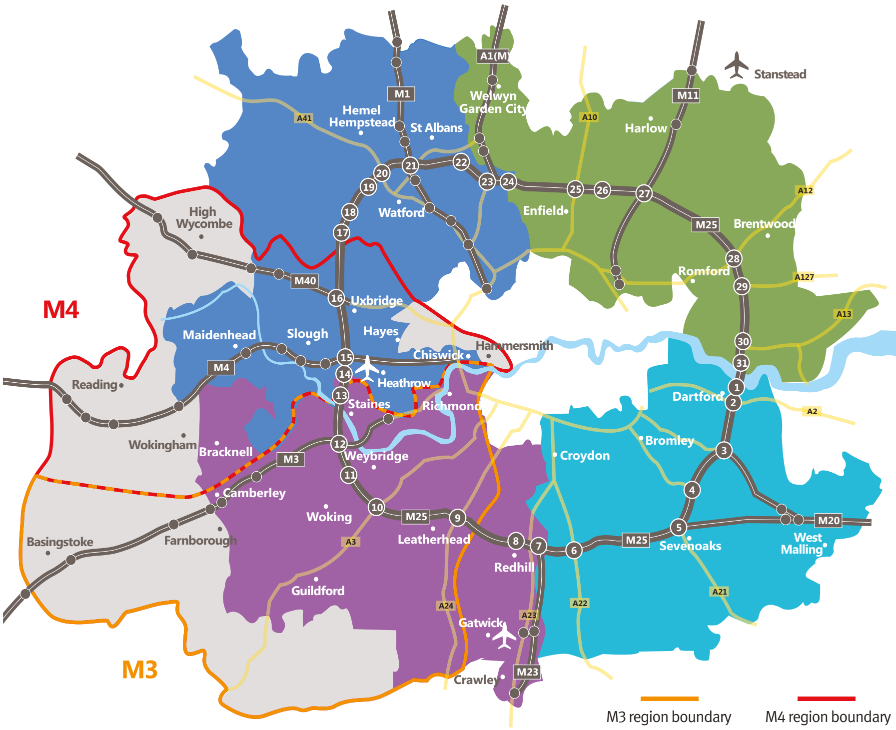


TABLE 2
Demand & Supply

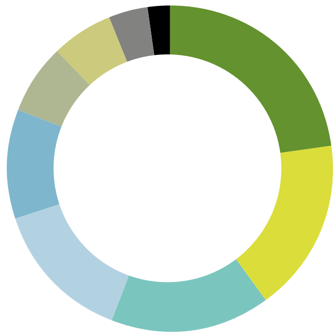
Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**611,821**	235,529	284,028	13,945	78,319	**123,943**	**427,899**
Change Q4 13 vs Q3 13	**-12%** ▼	-40% ▼	104% ▲	-87% ▼	47% ▲	**-72%** ▼	**-33%** ▼
Change Q4 13 vs Q4 12	**12%** ▲	-26% ▼	38% ▲	100% ▲	221% ▲	**-39%** ▼	**47%** ▲
Q4 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q4 % New & Grade A (inc. pre-lets)	**82%**	87%	90%	0%	58%	**95%**	**90%**
Forecast 2014 take-up (m sq ft)	**2.70**	**1.20**	**1.05**	**0.20**	**0.25**	**0.80**	**2.00**

Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**9,033,438**	3,938,886	3,368,508	310,515	1,415,529	**3,104,450**	**5,855,040**
Change Q4 13 vs Q3 13	**-7%** ▼	-5% ▼	-8% ▼	-16% ▼	-12% ▼	**-3%** ▼	**-6%** ▼
Change Q4 13 vs Q4 12	**-14%** ▼	-15% ▼	-15% ▼	-35% ▼	-2% ▼	**-16%** ▼	**-11%** ▼
Q4 % new	**14%**	12%	19%	17%	8%	**13%**	**20%**
Q4 % second-hand Grade A	**52%**	65%	44%	52%	33%	**57%**	**59%**
Q4 % second-hand Grade B	**34%**	23%	37%	31%	59%	**30%**	**21%**
Q4 vacancy rate (▲/▼ movement from Q4 13)	**6.9%** ▼	7.8% ▼	8.2% ▼	1.8% ▼	7.0% ▼	**7.6%** ▼	**8.3%** ▼

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**1,027,008**	729,245	297,763	0	0	**297,763**	**1,160,055**
Change 12 months	**-1%** ▼	102% ▲	-28% ▼	0 ◀▶	-100% ▼	**-8%** ▼	**52%** ▲
Pre-let	**250,755**	250,755	0	0	0	**0**	**390,755**

Source: Knight Frank Research

FIGURE 4
M25 active named enquiries by sector



FINANCIAL & BUSINESS SERVICES	23%	▼
MANUFACTURING & FMCGS	17%	▼
TECHNOLOGY, MEDIA & TELECOMS	16%	▼
RETAIL, DISTRIBUTION & TRANSPORT	14%	▼
PHARMACEUTICAL & HEALTH	11%	▲
ENERGY & UTILITIES	7%	▲
PUBLIC SECTOR	6%	▼
CONSTRUCTION & ENGINEERING	4%	▼
OTHER	2%	▼

Active demand is 5.27m sq ft at Q4 2013

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

The Blade, Reading, where Barton Willmore and Bracket leased 11,670 sq ft and 8,190 sq ft respectively during Q4. Knight Frank acted for the landlord.

FORECAST AT A GLANCE

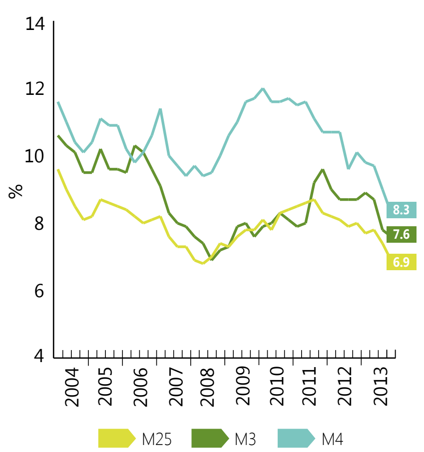
Take-up:

- Improving growth in the economy coincided with an increase in occupier activity in 2013, with total take-up for the year surpassing our expectations from 12 months ago. We are also encouraged by the prospects for 2014. The latest PMI business survey for the South East region stands at an all-time high of 63.3 (above 50 denotes expansion), indicating that occupiers will be more receptive to increasing headcount and upgrading their accommodation.
- Knight Frank forecast a further improvement in take-up, in line with the return to more consistent growth in the UK Services sector. M25 take-up for 2014 is forecast to surpass 2013's level to reach 2.7m sq ft, which is marginally above the 10-year annual average. With the key markets in the Thames Valley expected to continue to outperform, our forecast for take-up in the M4 is 2.0m sq ft in 2014, or 15% above the 10-year average.
- With its diverse occupier base and an anticipated spike in lease events, the South East market's prospects are positive beyond 2014. Improvements to transport infrastructure, such as Crossrail and Heathrow Terminal, will also secure the South East's position as a key UK foothold for inward investment from the world's fast growing emerging markets, such as China and Latin America.

Supply and rents:

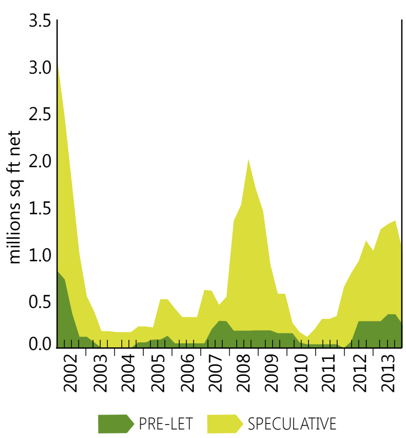
- Given the more settled economic outlook, arguably the biggest threat to market activity now lies with the limited availability of new and good quality secondhand product. With relatively limited speculative development underway, New and Grade A's share of total availability will reduce further over the next six months, as occupiers upgrade to better quality accommodation upon relocation.
- The current dynamics of supply and demand point to continuing rental growth in 2014. While deals in excess of £30 per sq ft have been relatively sporadic over the past 18 months, we expect a host of transactions in the key Thames Valley markets to achieve rental levels comfortably in excess of this level during 2014, with examples including Heathrow, Staines, Maidenhead and Reading.
- Speculative development activity is expected to increase over the next 12 months, buoyed by investors' renewed appetite for short income stock and development risk. The best prospects for new and refurbishment schemes will be in those markets where rental levels ensure viability and current levels of available space are limited relative to demand (Figure 7).

FIGURE 5
Vacancy rates



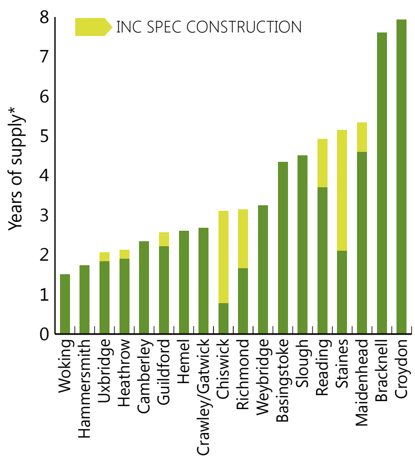
Source: Knight Frank Research

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 10 year average New & Grade A take-up vs current New & Grade A availability

INVESTMENT MARKET

TABLE 3
Key investment transactions Q4 2013

Building	Size (sq ft)	Price	Net Initial Yield	Vendor/ Purchaser
Enterprise House, Uxbridge	122,983	£52.25m	5.78%	SWIP / M&G Real Estate
King Portfolio (Stockley Park, Leatherhead, Croydon)	164,000	£48.20m	7.50%	SWIP / Aviva Investors
Vision Park, Cambridge	89,945	£28.50m	6.00%	JP Morgan / Royal London Asset Management
5 The Square, Stockley Park, Heathrow	71,560	£26.00m	8.25%	Oxygen / M&G Real Estate
100 Berkshire Place, Reading	53,806	£12.10m	7.25%	Praxis / Oaktree Capital

	Transaction volume	Mean lot size	Mean NIY
Q4 2013	£704.5m	£15.3m	7.65%
Change 3 mths	-9% ▼	-37% ▼	107bps ▼
Change 12 mths	307% ▲	68% ▲	61bps ▼

INVESTMENT VIEW

- A clear resurgence of investor demand since last summer was reflected in strong levels of activity in the second half 2013. Q4 turnover of £705m took the total for H2 2013 to £1.48bn, the strongest half-yearly total since H2 2006. It also boosted volumes for 2013 as a whole to £2.2bn, the highest annual total since 2007.
- The recent surge of activity has been driven by the UK Funds, who are in a position to deploy significant amounts of capital and continue to seek better value outside Central London. However, overseas investors, such Middle Eastern and US opportunity funds, are also increasingly competing for South East stock.
- While it remains to be seen whether recent levels of turnover will be matched in Q1 2014, continuing strong demand among domestic and overseas investors is likely to put prices under further pressure. Yields for prime 15-year income are expected to harden by a further 25 bps from 5.50% during the first half of 2014.
- Buoyed by strengthening sentiment in the occupier market, investors are also expected to increasingly consider opportunities higher up the risk curve. However, interest will be predominantly restricted to buildings in proven markets which offer good re-letting and / or re-development potential.

In Q4, Royal London Asset Management purchased One Gloucester Place, Brighton from Aviva for £11.0m, reflecting a net initial yield of 6.66%. Knight Frank acted for the vendor.

FIGURE 8
Investment volumes and lot size

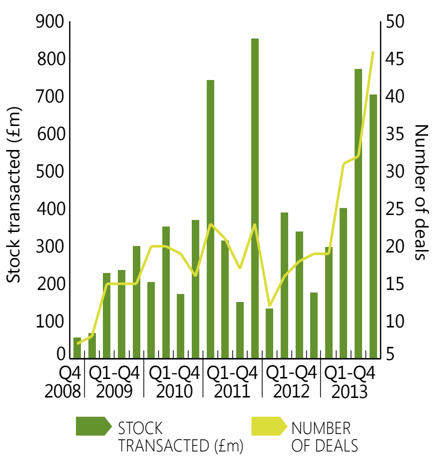


FIGURE 9
Mean initial yield & finance

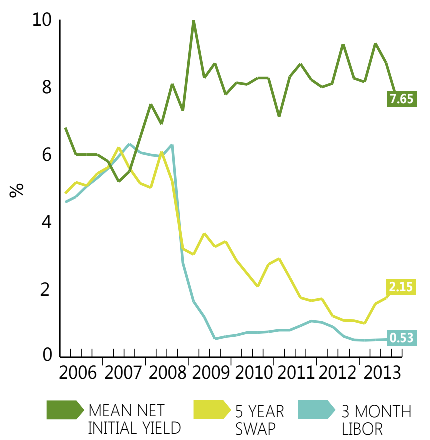
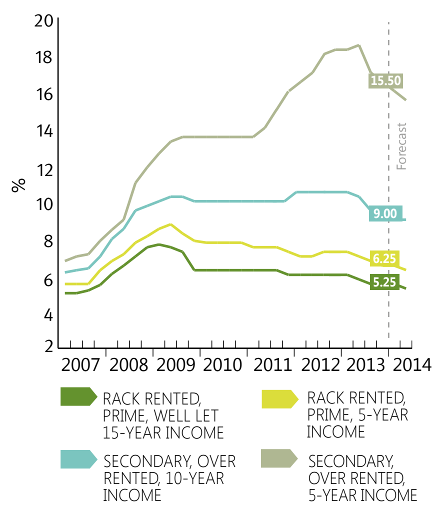


FIGURE 10
Yield forecasts



Source: Knight Frank Research

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 December 31st 2013.

Front cover image: Internal picture of the Stanza Building, Uxbridge

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