

*Investment, Development
& Occupational Markets*



M25 Offices

Issue 2 – A changing occupational strategy?
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FOREWORD



Emma Goodford
Partner
Head of National Offices

If an unresolved global health emergency was not enough to contend with, political wrangling with regard to Brexit is now resurfacing.

Nevertheless, the third quarter has offered some positivity and has shown that when circumstances allow, both occupiers and investors will engage and are looking beyond the immediate obstacles.

With COVID containment measures relaxed during the summer months, occupier activity in the South East registered a nervous increase. During Q3, 38 transactions were completed. This is the highest total in 2020. With all transactions below 50,000 sq ft however, take-up was low by historical comparison at 440,883 sq ft. This total is 44% below the 10-year quarterly average. Quality and flexibility are proving decisive. In Q3, 79% of take-up involved new or grade A space but 85% of deals had either a five-year term or a five-year break option.

Similarly, investment volumes for the South East in Q3 increased to £237m

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with 14 buildings traded during the period. Although volumes were 63% below the 10-year quarterly average, deal numbers were twice that of the second quarter. Given the fragility of the economic, political and business environment, investment interest will clearly remain defensive and focussed mainly on prime, long income assets in the coming months.

We are clearly far from a settled period. Longer-term planning though

is beginning to enter the narrative. How can businesses prepare for a different world of working? In this issue, we bring you our unique analysis exploring the potential of Hub and Spoke. Flexible working and a structure dispersed over a greater geography on paper appears to have many advantages not least environmental and social. The practicalities of implementing this model though are yet to be tested.

I have begun using the term ‘suburban’. Dismissed for many years, but now a positive as the leafy suburbs and rural areas begin to attract the attention of occupiers in greater number. The ‘business park’ also, again much maligned but able to combine proximity to workforce, parking and fresh air. A perfect tonic in the current climate? Interest is gathering momentum.

HUB AND SPOKE – REALISTIC OR IDEALISTIC?

Introduction

We are in an unprecedented period of uncertainty. The drive toward a gradual re-opening of offices stalled on 22nd September on new government advice, with working from home again a reality for many. This latest setback may be short-lived, but as longer-term adoption becomes hardwired to operational activity, it will certainly re-amplify the debate of the future role of the office for businesses.

The Covid pandemic has been a catalyst for people and companies to reassess working practices. In effect it is the biggest workplace experiment this century. Working from home has proved, technologically, an efficient stand in, but longer term cannot replicate the human contact needed to underpin a strong and progressive business culture. Collaboration and cohesion of working is personable, regardless of the technological advancements that have substituted in this time of crisis. Over the past few months, firms have been utilising social capital built up over many years. That banked capital cannot last forever. The office will therefore have a central role to play in a post pandemic world.

What will that role be? Individual business circumstances will clearly dictate, but various ‘new’ or ‘reinvented’ systems are being explored, each a hybrid model incorporating flexible solutions. The current crisis has emphasised that there are alternative ways of working to the established convention. Although this is mainly rhetoric so far, we can be sure though that the irreversible behavioural change created by the

pandemic has set in motion an interesting and pivotal period for space use strategy.

Diversification of the occupational footprint?

In suburban markets, the leading topic of debate is the possibility of ‘Hub and Spoke’ and the regional value this will bring to localised centres. In contrast to a heavily populated traditional HQ building, a ‘hub and spoke’ occupational configuration potentially offers the flexibility for employees to either work from a central hub or a dedicated, strategic spoke location. Notwithstanding the potential cost and time benefits, working closer to home, but not at home, could resolve the absence of social interaction, energise collaboration locally and beneficially separate working and personal life- all shortcomings of working from home.

Covid-19 has also underlined the need for future operational flexibility and contingency planning. A network of offices could offer the agility required for businesses to be able to react to incidents such as extreme weather events, a future virus outbreak, terrorism or another, yet unforeseen black swan event. Currently just 2.2% of businesses (across all sectors) operate from more than one site meaning operationally there is risk of a single point of failure.

The inherent larger geographical footprint has advantages from a business growth perspective too. Ahead of the pandemic, employers were firmly engaged in a battle for talent. UK unemployment was historically low at just 4%. The situation was more acute in the South East at 3.1%. One

main challenge to recruitment was that geographical compromises such as commute distance, time and cost restricted the reach of businesses. The average commute in the South East is 72 minutes for example. In theory, workplace flexibility and a broader network of offices would mean that the potential talent pool widens.

Finally, from a more practical of view, employers would reclaim greater management control. Working at home has created challenges with regard to data privacy and health and safety. It is preferable for businesses to have work materials in a controlled environment to enable compliance with data privacy legislation, rather than confidential papers being present in a home environment. Employers also retain a duty of care to their employees in relation to their desk set up. This duty applies when working from home as well from the office. It is, of course

OVERALL RANKING AS A POTENTIAL HUB AND SPOKE LOCATION



Hammersmith	1
Reading	2
Bromley	3
Watford	4
Croydon	5
Wimbledon	6
Richmond	= 7
Woking	= 7
Uxbridge	9
Ealing	10

easier to manage and monitor that responsibility in an office environment. This is particularly relevant in the South East where Financial and Professional Services traditionally account for 25-30% of demand.

Few have embraced this concept so far. Why?

The upside for investors, developers and occupiers alike looks appealing, but few have embarked on this journey yet. Firstly, the pandemic is unresolved and adaptation and mitigation remain a priority. Firms are clearly going to be reluctant to pursue a new strategy without indication of the businesses environment in which they will be operating.

Viability is also unclear longer term. Businesses are unlikely to want to agree full lease terms on satellite offices while holding continuing liabilities in the core. Satellite occupations may further test the market. A landlord and tenant relationship based on service and increasingly flexible lease terms was already gaining traction prior to Covid-19 and has been more evident in 2020. In Q3, 85% of leases granted included 5-year breaks. A corporate push toward this type of configuration will clearly escalate this process, but landlords will be wary of

losing the potential to secure longer-term income.

Co-working and serviced office providers would be the obvious candidates to create this network. However, occupiers will understandably remain resistant to sharing office space with other firms. This will mean enterprise models will need to grow and adapt.

Limitations also exist from a market dynamic perspective. Office availability in many locations across the South East is an all-time low, with Permitted Development to residential use reducing stock levels. The pandemic has compounded this situation further by slowing construction and weakening both finance availability and appetite of developers to start pipeline schemes. This weak supply picture will need to be balanced with the demands of employees and businesses. Employees will demand from firms that the same space quality, connectivity and amenity provision is present regardless of location. Firms will also clearly target locations that are most convenient to their employees to avoid costly staff churn. In the current climate, preference may be toward business park locations where dispersed staff can drive and park.

Which South East locations suit this model?

If businesses adopt a more dispersed office footprint, markets in fringe London locations and across the wider South East region have the potential to offer spoke locations that work in tandem with Central London offices, creating hub-and-spoke office networks. Businesses need to decide how to plan and optimize their office space strategy in an efficient, connected and cost-effective manner. Businesses wishing to retain staff but devolve operations must consider the locations of their staff, their commuting routes and the local amenities on offer.

We have considered a range of metrics that will form part of the decision making process in a Hub and Spoke strategy.

Each individual business will prioritize locational factors differently according to their business model. For example, a primary consideration in a challenging economic environment might be to manage cost. In this instance, locations such as Hammersmith that has the highest office rent in the region will be less attractive as any cost benefit will be minimal.

Staffing, current and future remains a high priority. Careful assessment and understanding of current commuter patterns identifies the optimum location that minimises staff displacement and aids future recruitment. Our commuter route analysis ranks locations based on the number of people using that particular station (either entering or exiting the station or interchanges). This demonstrates the accessibility of a location from the wider region. Towns such as Reading and Woking score well in this analysis and of course, offer attractive rents.

The London commuter catchment measure is more specific and identifies the concentration of journeys from origin to Central London. It analyses travel times from these points of origin to each of the centres. Locations such as Hammersmith, Ealing and Wimbledon, effectively locations closest to London, have the highest scores, with the highest proportion of workers being able to access these locations within the specified commute time threshold.

Business links and thus travel times to London are also important for these locations. Our connectivity score rates centres based on their public transport links with London, using the speed

of journey and number of trains or tubes at peak times. Wimbledon, Hammersmith, Richmond and Woking score well here, with fast, regular trains into London.

The local business environment will have equal standing in location choice. 'Place' and 'Vibrancy' measured by the concentration of company headquarters, growth businesses and amenities are vitally important to business culture as well as staff recruitment. Clustering for example, establishes a local pool of skilled talent suited to the industry, and encourages sector-specific suppliers and clients to establish a presence. Strategic partnerships happen more easily when the companies involved are local to each other. Thus, a self-perpetuating ecosystem is created.

We have analysed these and other factors across 49 of the South East markets to assess their potential as spoke locations. We understand the individual weighting will be unique to each business so therefore applied equal weighting to each measure. The table on page 3 shows the top 10 markets using a combined ranking. However, when assessed by individual factor the additional tables highlight

how placings can change according to priority.

Conclusion

The pandemic has re-ignited the 'dispersed workforce' debate. Firms are seeing an opportunity to offer workers increased freedom of choice in where they can do their jobs, while refining their office footprint. Convenient peripheral locations aligned to current commute patterns and coupled with lower rents and lower salary norms appear an attractive proposition in the current climate.

Embracing the hub-and-spoke model and providing flexible working solutions could be the answer to key human resource challenges. The new post Covid-19 office will need to be a collaborative hub, connecting employees and clients across digital and physical space. It will need to facilitate a better organisational culture, support education and inspire innovative ways of working. Will this mean a considerable shift toward occupational diversification and the development of satellite/spoke offices and co-working? Many South East markets could provide this solution.

MARKET DYNAMICS



Hammersmith	1
Reading	2
Slough	3
Bracknell	4
Basingstoke	5
Heathrow/Stockley Park	6
Chiswick	7
Croydon	= 8
Cambridge	= 8
Uxbridge	10

LONDON COMMUTER CATCHMENT



Wimbledon	1
Hammersmith	2
Bromley	3
Ealing	4
Richmond	5
Twickenham	6
Borehamwood	7
Kingston	8
Croydon	9
Watford	10

BUSINESS ENVIRONMENT



Hammersmith	1
Croydon	2
Reading	3
Milton Keynes	4
Brighton	5
Guildford	6
Oxford	7
Watford	8
Wimbledon	9
Richmond	10

RENT VALUE



Fleet	1
Hook	2
Welwyn Garden City	3
Camberley	4
Basingstoke	= 5
Borehamwood	= 5
Dartford	= 5
Sunbury	= 5
High Wycombe	= 9
West Malling	= 9

COMBINED CONNECTIVITY



Wimbledon	1
Richmond	2
Hammersmith	2
Woking	4
Bromley	5
Ealing	6
Reading	7
Watford	= 8
Maidenhead	= 8
Heathrow/Stockley Park	= 10
Sevenoaks	= 10

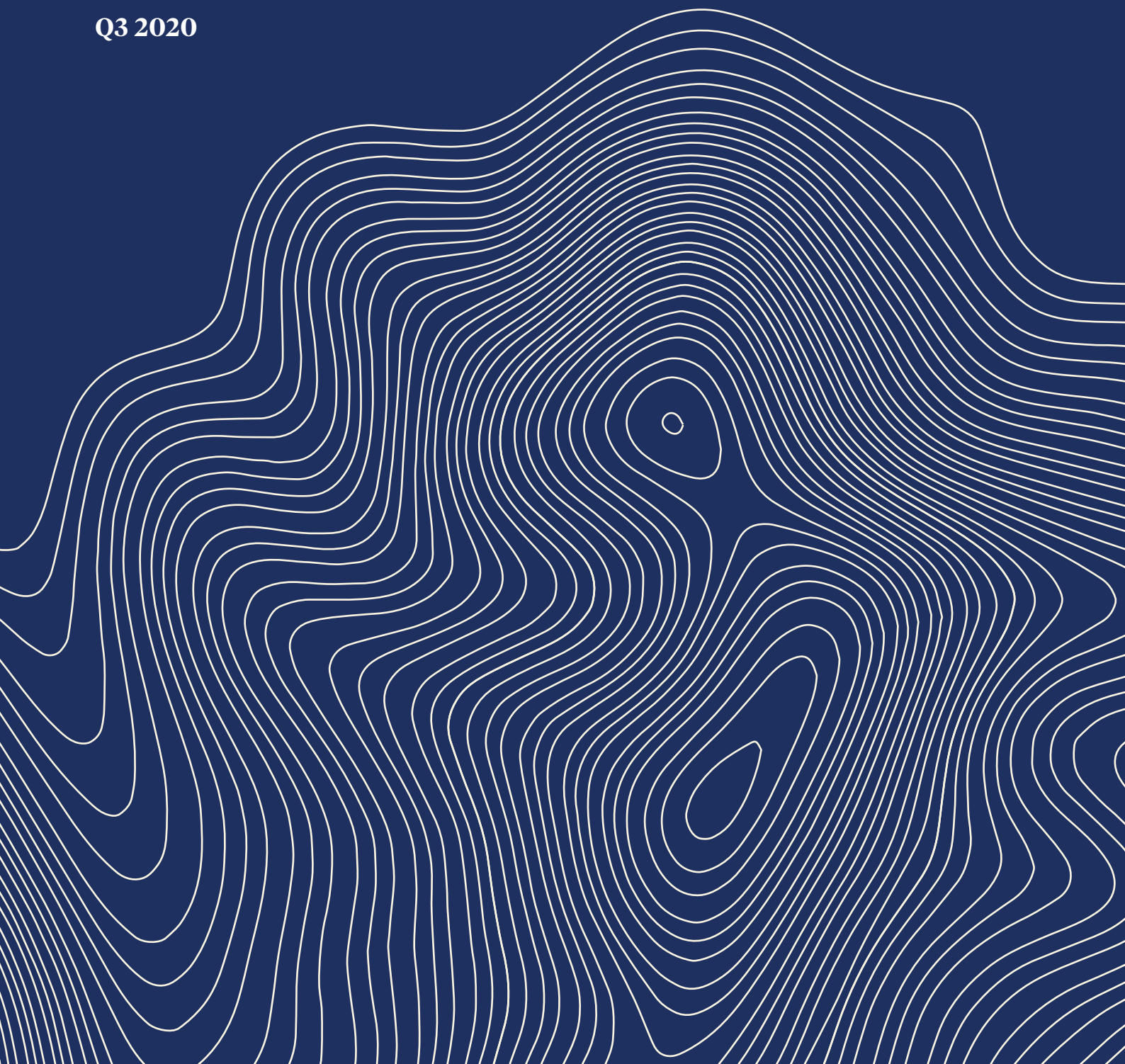
COMMUTER



Hammersmith	1
Reading	2
Wimbledon	3
Brighton	4
Richmond	5
Cambridge	6
Bromley	7
Woking	8
Watford	9
Chelmsford	10

Market Summary

Q3 2020



OCCUPIER MARKET

Market activity improved in the third quarter, although significant headwinds are hindering transactional levels. Availability has begun to edge upward, but vacancy rates remain significantly below historical levels.

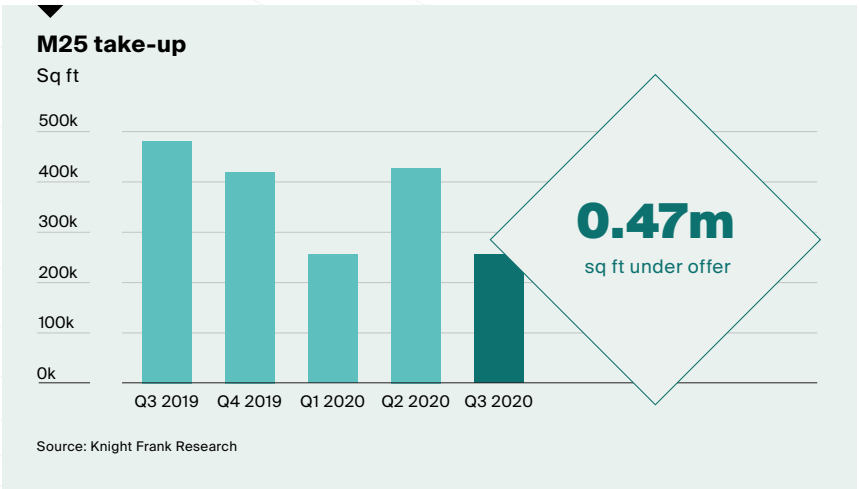


HPD Software acquired 12,600 sq ft at 22 Worple Road

Take-up and supply
Q3 2020

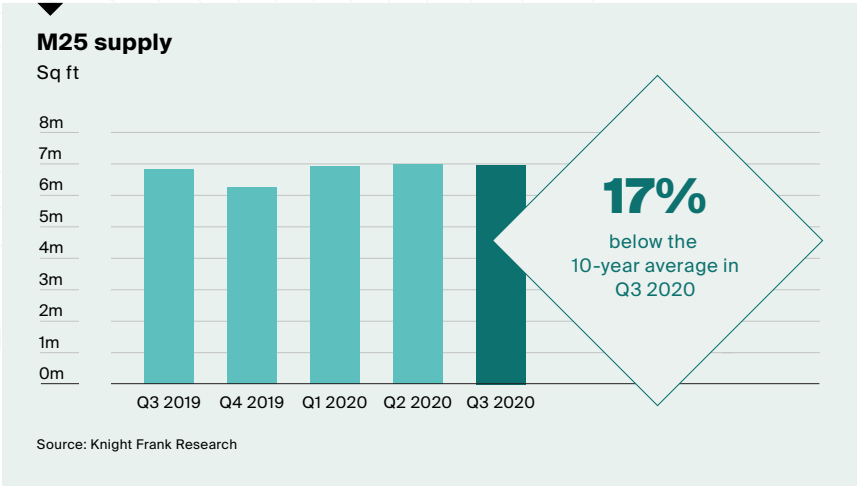
	TAKE-UP (SQ FT)	TAKE-UP (VS Q2 2020)	SUPPLY (SQ FT)	SUPPLY (VS Q2 2020)	VACANCY RATE
M25	255,528	▼ -40%	7.0m	▲ 0% New and Grade A space: 78%	5.8% New and Grade A space: 4.5%
M3	124,693	▲ 44%	2.6m	▼ -3% New and Grade A space: 78%	6.5% New and Grade A space: 5.1%
M4	162,916	▲ 111%	6.0m	▼ -2% New and Grade A space: 81%	8.9% New and Grade A space: 7.3%

Source: Knight Frank Research



Emma Goodford

Despite an uncertain outlook, occupiers are engaging in the market galvanised by a fear of not being able to secure space in markets of low supply. Cost will of course be a key consideration, but a deep analysis of location is gaining traction as firms look beyond the immediate headwinds.



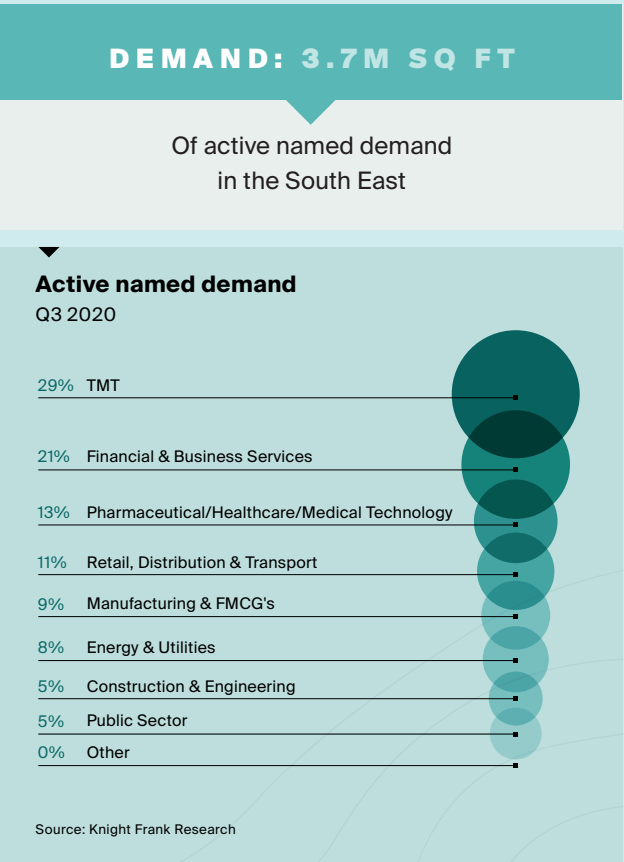
Roddy Abram

Although take-up remains volatile, low supply and a constrained development pipeline indicates that the vacancy rate will remain below the long term trend as we approach 2021.

Key leasing transactions
Q3 2020

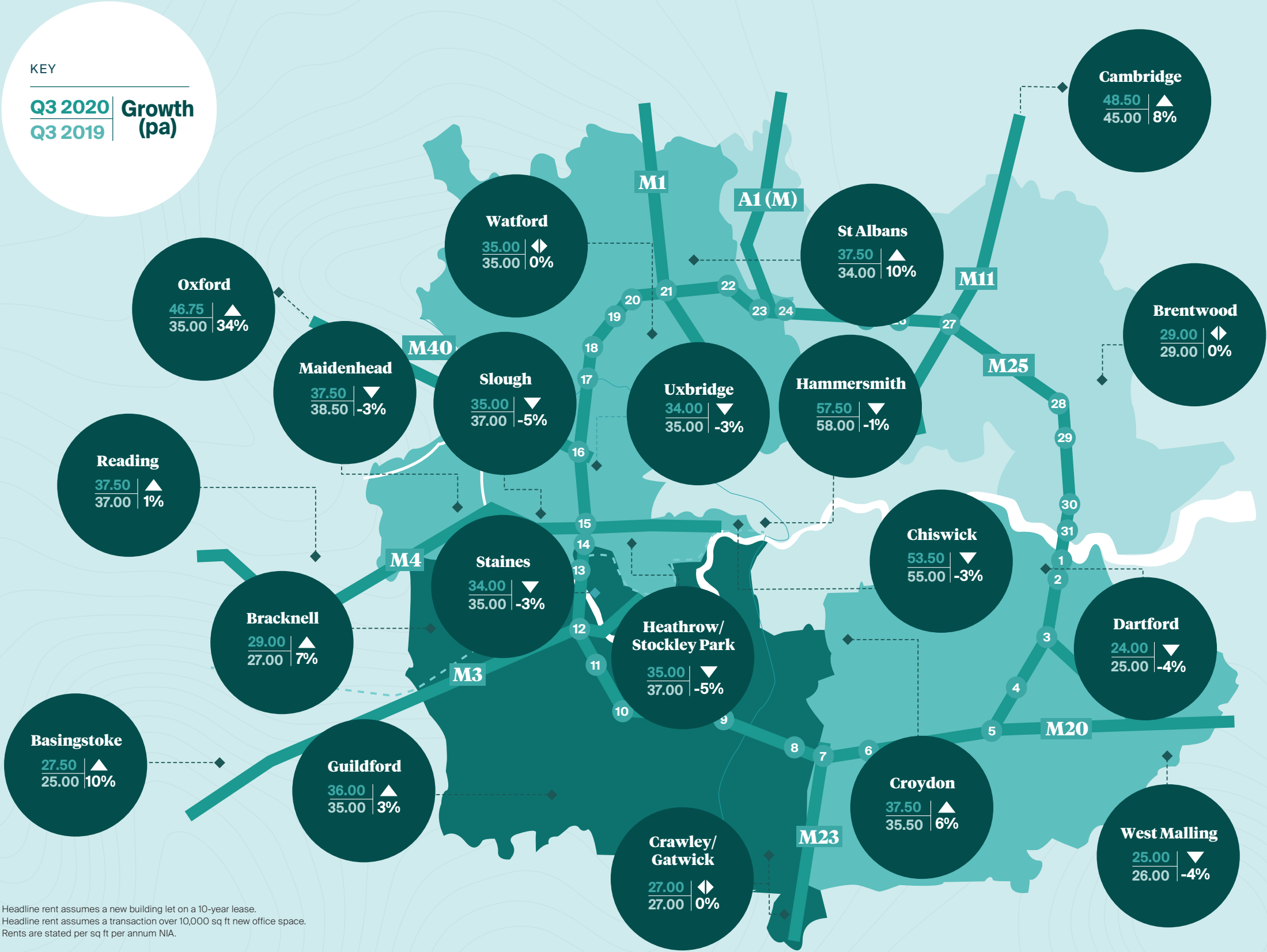
ADDRESS	SIZE SQ FT	OCCUPIER	RENT £ PER SQ FT
Electric House, Croydon	48,451	South Bank University	Confidential
Ascent 1, Farnborough Aerospace Centre, Farnborough	37,000	Philips	£29.00
210, Winnersh Triangle, Reading	31,571	Hewlett Packard Enterprises	£28.00
3 Uxbridge Business Park (2nd flr), Uxbridge	27,200	Bristol Myers Squibb	£35.00
Ascent 1, Farnborough Aerospace Centre (2nd flr), Farnborough	24,326	Infor	£29.00

Source: Knight Frank Research



PRIME RENTS

£ PER SQ FT








Clarendon House, Cambridge sold to M&G Real Estate


INVESTMENT MARKET

With a ‘wait and see’ approach the overriding stance, activity in the South East investment market remains muted. Quality and long income opportunities dominate interest, as the market continues on a defensive path.

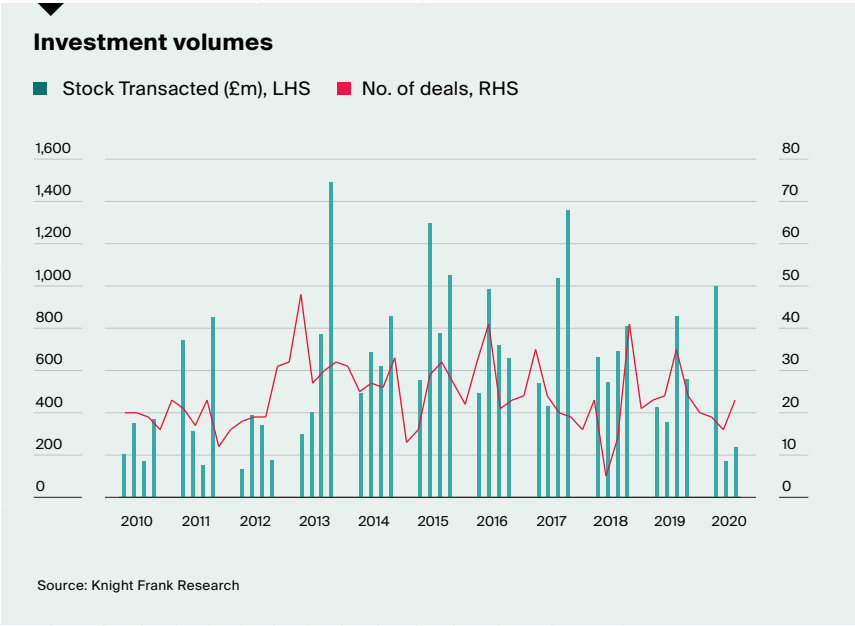
**37%**
£237.1m
South East transaction volume*

**£16.9m**
Mean lot size

**5.25%**
Prime net initial yield

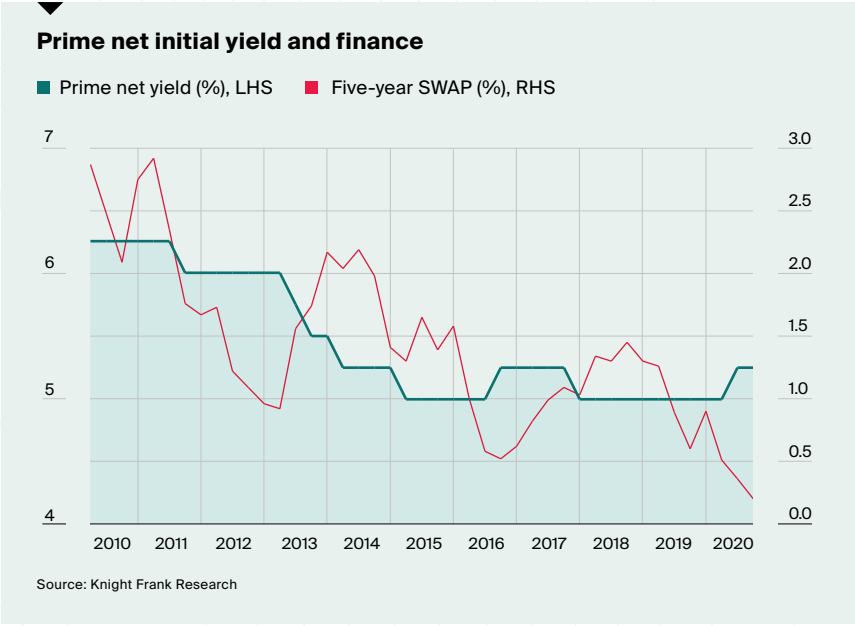
**73%**
Buyers from the UK

* Percentage change reflects a comparison to Q4 2019



Simon Rickards

Although investor sentiment has been hit by concerns for the occupational market, interest in prime assets with strong covenants and long income is holding firm across a wide variety of investor types.



Tim Smither

Despite challenges to market confidence building as we edge toward year-end, interest in prime opportunities is holding firm. The lack of prime product and flight to quality means greater polarisation with regard to pricing is beginning to emerge.

Key transactions

Q3 2020

ADDRESS	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
One Cambridge Square, Cambridge	£45.00	n/a	Brookgate	Schroders
Building 3000, Chertsey	£20.80	7.80%	Aviva	KAMCO/M7
Keats House, Leatherhead	£19.30	6.80%	Longmead	Corum XL
Mountbatten House, Southampton	£17.50	7.60%	Private	Castleforge
Buildings 4&5 Thames Valley Park, Reading	£16.00	n/a	Microsoft	Baumont Real Estate

Source: Knight Frank Research

NATIONAL OFFICES

Emma Goodford



Partner
Head of National Offices
+44 20 7861 1144
+44 7831 581 258
emma.goodford@knightfrank.com

Will Foster



Partner
National Offices
+44 20 7861 1293
+44 7789 878 007
will.foster@knightfrank.com

Roddy Abram



Partner
National Offices
+44 20 7861 1280
+44 7899 001 028
roddy.abram@knightfrank.com

Ashley Drewett



Partner
National Offices, Lease Advisory
+44 20 7861 1156
+44 7799 478 834
ashley.drewett@knightfrank.com

Andrew Wood



Partner
National Offices, Tenant Representation
+44 20 7861 0662
+44 7800 500 752
andrew.wood@knightfrank.com

Jack Riley



Partner
National Offices
+44 20 7861 5375
+44 7867 002 484
jack.riley@knightfrank.com

CAPITAL MARKETS

Simon Rickards



Partner
Head of National Offices Investment
+44 20 7861 1158
+44 7787 844 384
simon.rickards@knightfrank.com

Tim Smither



Partner
Capital Markets
+44 20 7861 1277
+44 7876 145 909
tim.smither@knightfrank.com

Richard Claxton



Partner
Head of UK Capital Markets
+44 20 7861 1221
+44 7774 826 558
richard.claxton@knightfrank.com

RESEARCH

William Matthews



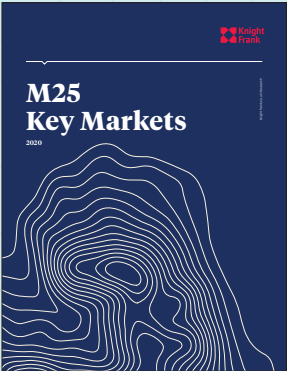
Partner
Head of Commercial Research
+44 20 3909 6842
+44 7973 621 692
william.matthews@knightfrank.com

Darren Mansfield



Partner
Commercial Research
+44 20 7861 1246
+44 7469 667 194
darren.mansfield@knightfrank.com

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M25 Report



(Y)OUR SPACE

TECHNICAL NOTE

- Knight Frank defines 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.
- 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.
- 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.
- 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 121m sq ft (net), an M4 market stock of 66m sq ft (net) and an M3 market stock of 39m sq ft (net). Please note that a revision to total market office stock figures was applied in Q1 2017 to reflect 'change of use' permitted through the Town and Country Planning Order 2015.
- 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.
- The South East is defined as the market area shown in the map on pages 6 & 7.
- 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 30th September 2020.

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