Investment, Development
& Occupational Markets

M25 Offices

Q4 2020

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KEY TAKEAWAYS

1

Take-up in Q4 was 551,300 sq ft, the highest quarterly total of 2020 and a quarter-on quarter increase of 25%.

2

Total take-up for South East in 2020 finished marginally below 2m sq ft, 38% less than the 10-year average.

3

Total availability was 10.9m sq ft at the end of Q4 2020, 7% below the 10-year average.

4

Investment volumes increased 71% quarter on quarter to £407m.

5

In 2020, five deals above £100m completed, the highest number above this threshold since 2017.

EXECUTIVE SUMMARY

Stronger Q4 cannot mask the most challenging of years.

Although Covid restrictions tightened in Q4, positive news regarding the Covid vaccine underpinned an increase in occupier activity . Take-up during the quarter was 551,300 sq ft, 25% above Q3 and the highest quarterly total of the year.

Despite the improvement, annual take-up finished at 1.99m sq ft, 38% below the 10-year annual average and 26% less than recorded in 2019. Significantly, 121 deals completed, well below the annual average of 205, with only two deals above 50,000 sq ft recorded, against a long-term annual average of six.

Occupational demand – All change?

Looking ahead, constraints on business function and the movement of people will limit transactional activity in early 2021. Nonetheless, buoyed by the expected freedoms that the vaccine rollout could bring, occupiers are beginning to take a longer-term view meaning market engagement could rise as 2021 progresses. Our forecast therefore, anticipates take-up of 2.2m sq ft, an increase of 10% on 2020. Importantly, the much debated shift away from office based working is now widely expected to reverse. The realisation of challenges related to home working such as facility inequality, underpin this change in view. The pandemic has also accelerated structural change already present ahead of the crisis, meaning that the creation of centres of innovation and collaboration has grown in urgency. Operational resilience will undoubtedly, be at the forefront of thinking. Smart, high quality, tech enabled buildings alongside infrastructure conducive to agile working will therefore be in greater demand, as will buildings that address environmental objectives. Furthermore, new areas of demand will further develop in 2021. For the first time in our records, underpinned by Life Sciences, the Pharmaceutical and Healthcare sector accounted for the highest percentage of space acquired in 2020, 27%.

Vacancy rising, but no oversupply.

Market vacancy increased in each quarter of 2020, principally because of depressed transactional activity. At the end of 2020, total availability was 10.9m sq ft. Although this represents a rise of 15% over the year, current availability levels remain 7% below the 10-year average. Interestingly, Grade A space accounts for 76% of this total, the lowest proportion for five years. This means that although availability has risen in all grades, the sharpest rise was in Grade B space which is increasingly falling out of favour with occupiers.

At the time of writing just 900,000 sq ft of speculative development was due to complete in 2021. Beyond this, a further 69,000 sq ft will complete in 2022. With pipeline schemes likely to await indication of new demand and principally targeted on quality refurbishments in markets of under supply, the impact of development on vacancy will be minimal.

Final quarter push to complete deals.

A flurry of investment deals completed in Q4 meaning volumes rose 71% quarter on quarter to £407m. During the quarter, 23 transactions were agreed, the highest amount in any quarter for two years. As a result, investment volumes for 2020 increased to £1.93bn. Although this represents a 12% fall when compared to 2019, when considered against the wider UK average decrease of 27%, the South East has shown relative resilience to major market challenges.

Size matters.

An interesting statistic of 2020 was that five transactions completed with a sale price in excess of £100m. This is the highest total above this threshold since 2017. The five deals that were agreed accounted for 42% of total investment volumes during 2020 and therefore were a principle reason the South East outperformed many other UK markets. Furthermore, behind four of the five deals was international capital. During the year, overseas buyers accounted for 54% of investment volumes, the highest representation since 2011. Despite the political upheaval and Covid 19, international buyers have retained their interest in South East Offices.

Pricing to hold for best in class.

Prime yields moved out by 25bps in 2020 to 5.25%, with higher-risk assets predictably seeing a greater outward shift. The coming months may see further polarisation if previous market downturns are any guide, as an investor flight to quality is realised. In the short term, there will be fewer institutional buyers, which may create additional buying opportunities for cash ready investors, property companies and private buyers. A combination of a softening of vendors' pricing expectations and a deeper buyer pool should lead to investment volumes increasing as the year progresses.

OCCUPIER MARKET

Despite Covid restrictions being imposed in Q4, occupier take-up registered an improvement. Availability continued to show marginal increase although vacancy remains well below the long-term trend.

SOUTH EAST Q4 TAKE-UP

551k sq ft

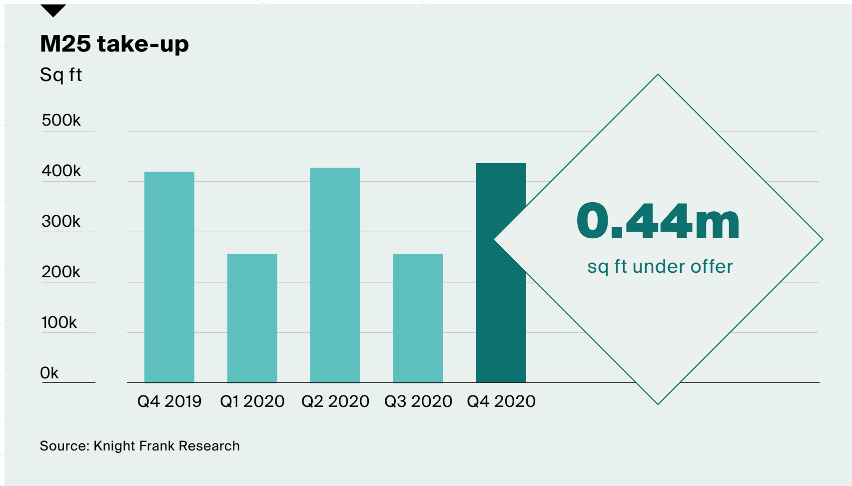
▲ 25%

Chiswick Park

Take-up and supply
Q4 2020

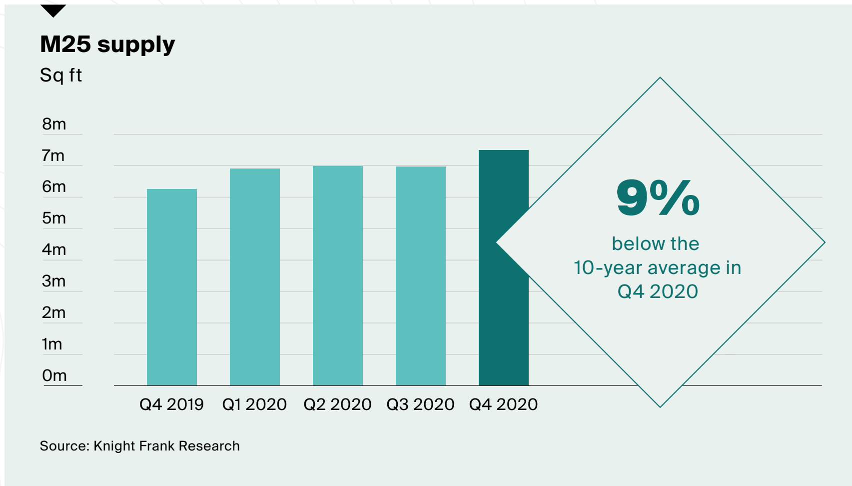
	TAKE-UP (SQ FT)	TAKE-UP (VS Q3 2020)	SUPPLY (SQ FT)	SUPPLY (VS Q3 2020)	VACANCY RATE
M25	436,084	▲ 71%	7.4m	▲ 7% New and Grade A space: 76%	6.2% New and Grade A space: 4.7%
M3	93,802	▼ -25%	2.7m	▼ 6% New and Grade A space: 77%	6.9% New and Grade A space: 5.3%
M4	147,898	▼ -9%	6.1m	▼ 4% New and Grade A space: 80%	9.3% New and Grade A space: 7.5%

Source: Knight Frank Research



Emma Goodford

Buoyed by the vaccine rollout, firms are now moving beyond the immediate challenges to formulate strategies inclusive of reimagining their office space. Requirements founded on ESG, flexibility and risk mitigation will begin to gather pace and serve to bolster new demand in H2 2021.



Roddy Abram

Vacancy increased marginally through 2020 but levels at year-end have remained well below the long-term average. Significantly, there has been few examples of tenant release space and with the development pipeline limited, tight supply will be a factor in many markets in 2021.

Key leasing transactions
Q4 2020

ADDRESS	SIZE SQ FT	OCCUPIER	RENT £ PER SQ FT
Eli Lilly Campus, Windlesham	244,992	UCB	Purchase/sale for Eli Lilly
350 Brook Drive, Green Drive, Reading	43,579	CGI	£31.00
6 Church Street West, Woking	28,932	DWP	£28.50
Building 3, Chiswick Park, Chiswick	28,333	Pladis	Confidential
One Springfield Drive, Leatherhead	19,154	RINA	£27.00

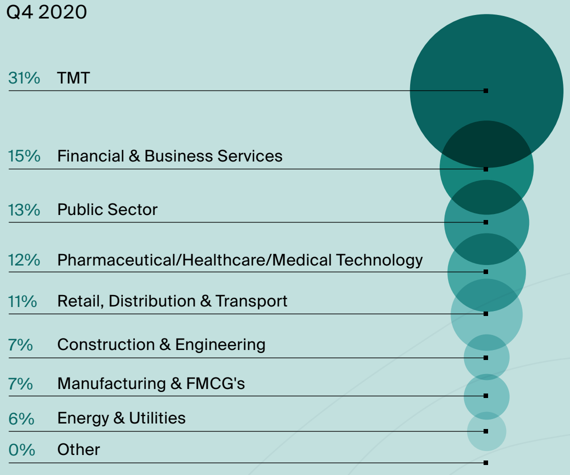
Source: Knight Frank Research

ACTIVE DEMAND: 4.5M SQ FT

Named demand in the South East

Active named demand by sector

Q4 2020



Source: Knight Frank Research

DEVELOPMENT: 1.6M SQ FT

Space under construction in the South East

*This includes pre-let (0.6m sq ft) and speculative space (1.0m sq ft)

Speculative development

Sq ft due to complete before Q1 2022

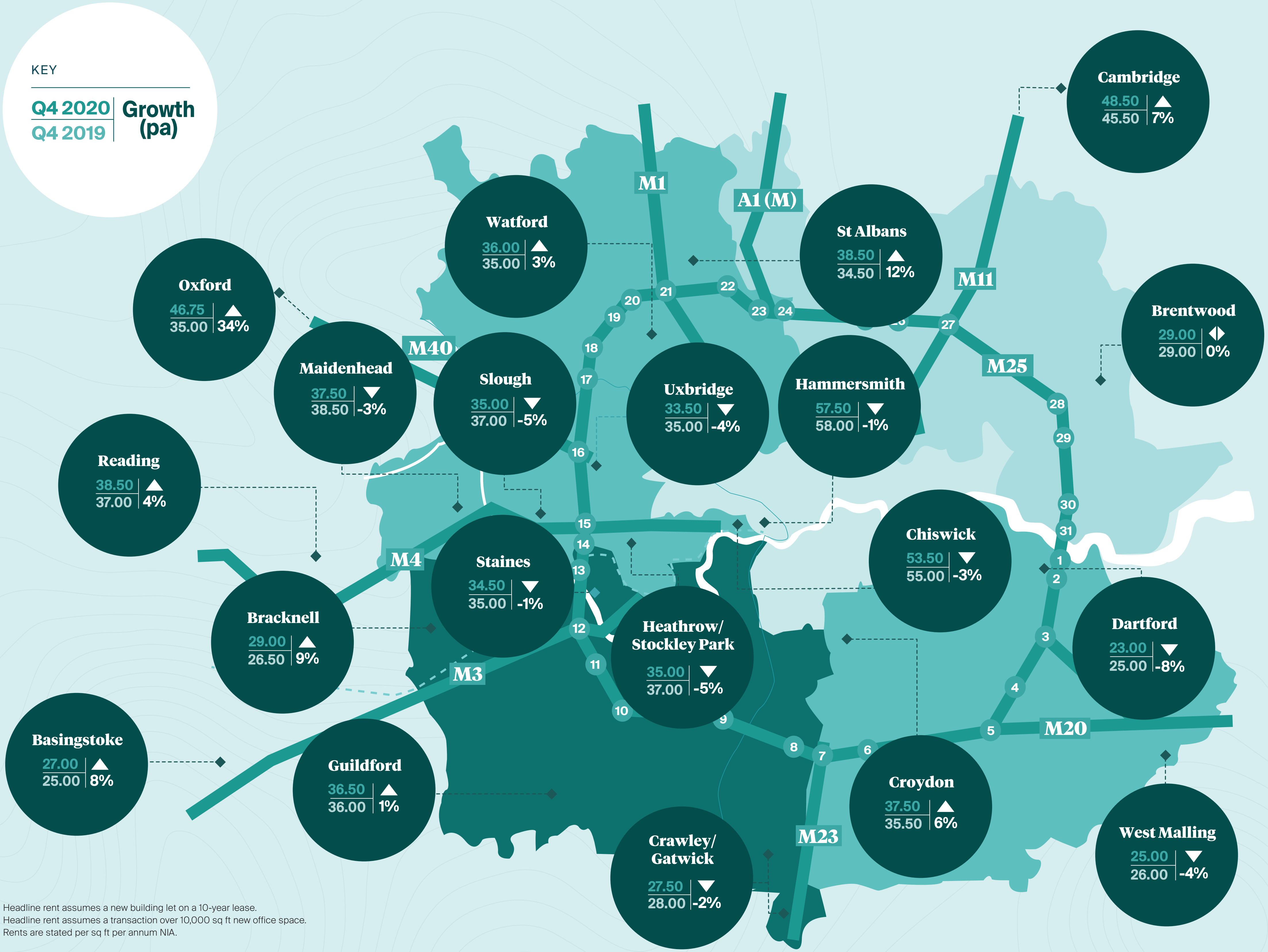
Source: Knight Frank Research

Source: Knight Frank Research

M25 OFFICES, Q4 2020

PRIME RENTS

£ PER SQ FT



Headline rent assumes a new building let on a 10-year lease.
Headline rent assumes a transaction over 10,000 sq ft new office space.
Rents are stated per sq ft per annum NIA.

The Point, Maidenhead

INVESTMENT MARKET

Transactional activity improved as investors navigated Covid restrictions to identify buying opportunities. Confidence toward market engagement is beginning to grow, particularly for long let prime property, as the Covid vaccine rollout gathers pace.

▲ 71%

£407m
South East transaction volumes*

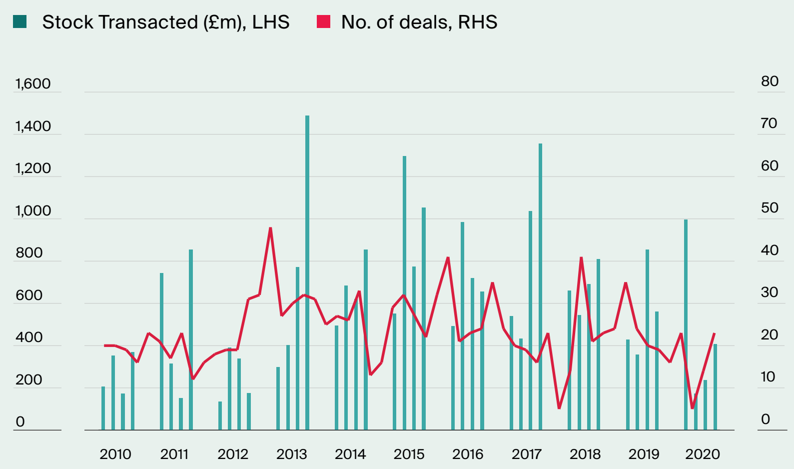
£17.7m
Average lot size

5.25%
Prime net initial yield

59%
Buyers from the UK

* Percentage change reflects a comparison to Q3 2020

Investment volumes

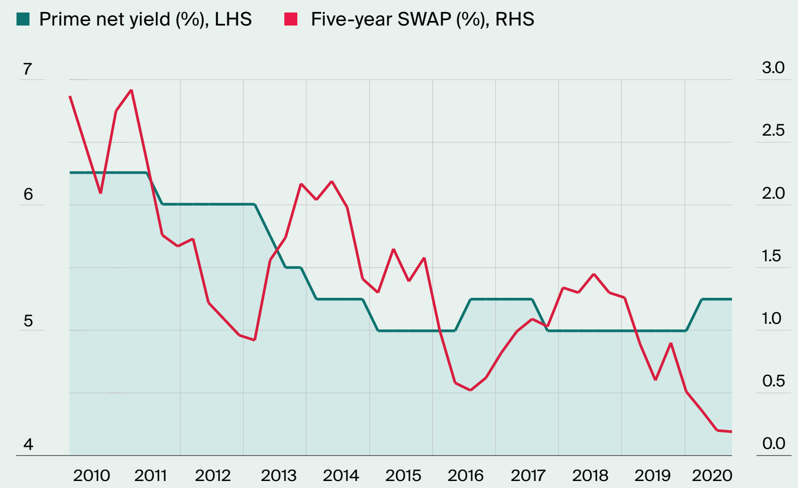


Source: Knight Frank Research

Simon Rickards

2020 finished with a flurry of activity that boosted volumes and we have seen renewed investor focus since the beginning of January as the vaccine rollout has gathered pace. We are seeing greater numbers of core-plus buyers enter the market, looking to take advantage of a significant pricing shift in this sphere.

Prime net initial yield and finance



Source: Knight Frank Research

Tim Smither

Pricing for prime income has held relatively firm, and for government let income we would argue it hardened during the pandemic. Add to that the increasingly popular Life Sciences sector, and you have significant levels of equity looking to be deployed at the prime end of our market.

Key transactions
Q4 2020

ADDRESS	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
The Point, Maidenhead	£38.86	6.25%	Aegon Asset Management	Corum XL
Onslow House, Guildford	£38.50	6.85%	Aberdeen Standard Investments	Corum XL
Langstone Technology Park, Havant	£32.00	8.73%	Angelo Gordon/Trinity	AIMCo/XLB
5 The Square, Stockley Park	£25.70	9.06%	M&G Real Estate	Darin Partners
Wavendon BP, Milton Keynes	£25.00	9.54%	M&G Real Estate	Colmore Capital

Source: Knight Frank Research

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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 31st December 2020.

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