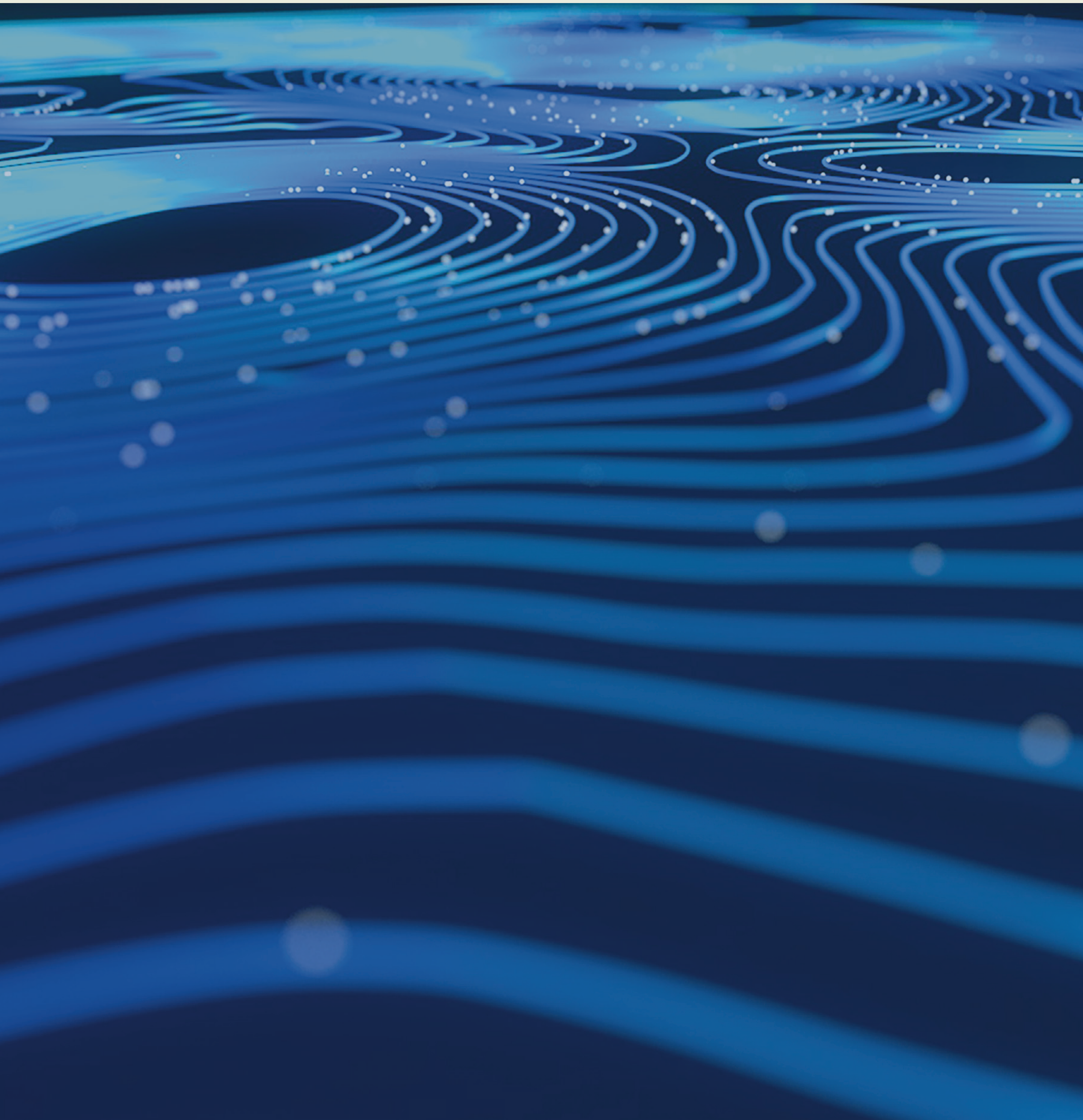
M25 & South East Market Report

Knight Frank

Q2 2023

Investment, Development & Occupational Markets

knightfrank.com/research



Key takeaways

1

Although active demand remained robust, transaction levels at mid-year were 25% below the long-term trend.

2

Oxford and Cambridge accounted for 44% of space let in Q2.

3

Vacancy registered a marginal increase, albeit Grade A availability remains low.

4

Targeted investment interest remains evident despite the rising cost of debt.

5

Yields shift outward to varying degrees as price discovery continues.

Executive Summary

OCCUPIER ACTIVITY WAS SUBDUED IN Q2 2023
Although leasing volumes in Q2 registered improvement, occupier activity in 2023 has reflected a marketplace of greater caution. Take-up for Q2 was 671,000 sq ft, 33% higher than recorded in the first quarter. However, the rise during the quarter was principally due to strong activity in Cambridge and Oxford, with the two markets accounting for 44% of space let and a third of deals completed during the quarter. With Oxford and Cambridge excluded, activity in the rest of the South East market laboured, with take-up 51% below the 10-year quarterly average for the region.

Consequently, total take-up in the South East for the year-to-date was 1.2m sq ft at the end of Q2, 25% below the 10-year average for an H1 period.

MARKET BOUNCE IN H2?
The next six months present a more positive picture. At the end of Q2, the amount of space under offer was above 1m sq ft for the first time since 2018. A further 5m sq ft of active named demand was present in the market at quarter end, the highest level since January 2022. Principally, lease events continue to dictate market interest across the broader market, with demand manifesting from earlier market engagement ahead of break or expiry dates.

VACANCY IS RISING, BUT THE BEST QUALITY SPACE REMAINS SCARCE.
Market vacancy increased to 7.8% in the second quarter, principally because of depressed transactional activity. At the end of Q2 2023, total office availability was 12.6m sq ft, representing a 5% rise over the past 12 months. Grade B space accounts for 26% of this total, well above the 10-year trend. However, the vacancy rate for new and Grade A space was 5.8%, which is still below the long-term market average.

At the time of writing, 3.6m sq ft of speculative development will be completed within the next 36 months. Of this total, 1.2m sq ft is in Oxford or Cambridge. With the pipeline schemes under increasing scrutiny regarding build cost inflation, finance costs and shifting yields, the future development landscape in the South East beyond this current cycle is expected to be thin and increasingly targeted.

INVESTMENT ACTIVITY STALLS IN Q2.
The continued rise of borrowing costs and the gap between purchaser and vendor pricing expectations proved a hurdle to the completion of deals. The second quarter registered transactions totalling £354 million, 35% below the volumes for Q1. Market polarisation is evident, with continued investor interest for income deals, especially smaller lot sizes where all equity deals are more likely, and opportunities to buy prime assets in strong locations. In contrast, secondary assets in weaker markets are proving increasingly challenging. UK Funds remain the biggest seller of South East offices in 2023, accounting for over 66% of sales as they continued to exit non-core assets.

PRICING DISCOVERY CONTINUES.
Pricing remains under pressure in response to rising swap rates and the erosion of the gap between UK Gilts and office yields. Prime office yields stood at 6.50% in Q2, albeit there has been little transactional evidence to confirm pricing at this level. Shorter income and prime multi-let yields continue to move out, with pricing for secondary assets drifting to yields of 10%+.

Occupier market

Leasing activity was slow in Q2, but with more than 1m sq ft of deals under offer, there is a more positive backdrop for H2. Vacancy is rising, but the supply of best quality space remains limited.

SOUTH EAST Q2 TAKE-UP

671k sq ft

▲ 33%

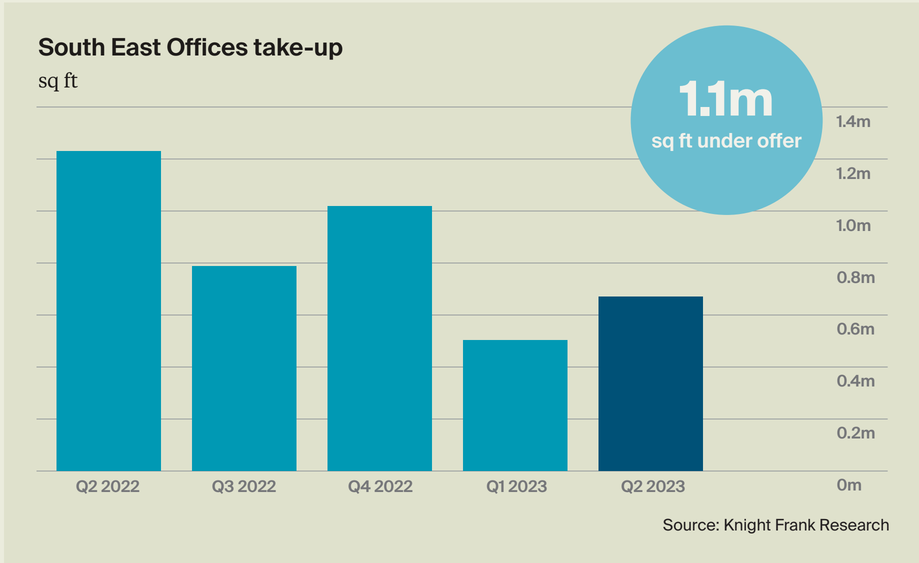
% difference compared to Q1 2023

One Hyde Park, Hayes

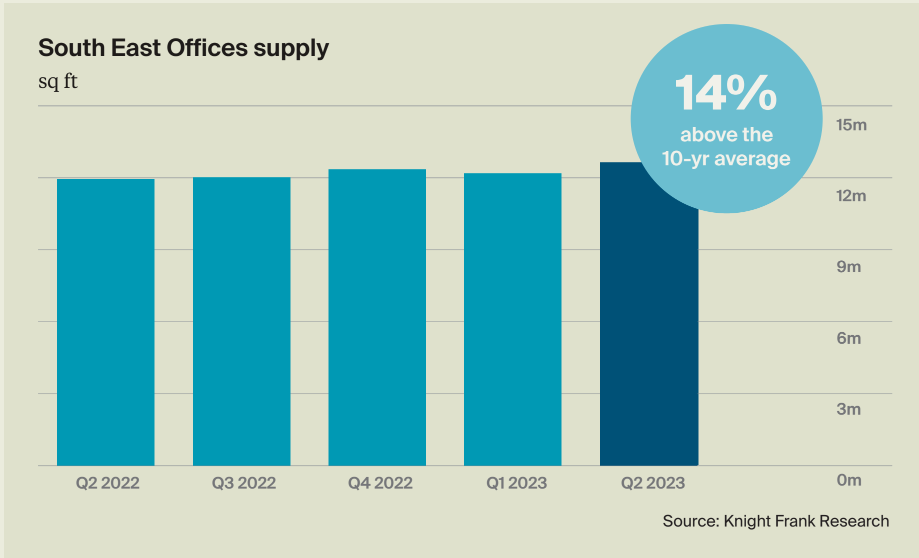
Take-up and supply Q2 2023

	TAKE-UP (SQ FT)	TAKE-UP (VS Q1 2023)	SUPPLY (SQ FT)	SUPPLY (VS Q1 2023)	VACANCY RATE
SE	671,205	▲ 33%	12.6m	▲ 3% New and Grade A space: 74%	7.8% New and Grade A space: 5.8%
M25	236,507	▼ -17%	8.6m	▲ 4% New and Grade A space: 69%	7.2% New and Grade A space: 5.0%
M3	85,587	▼ -27%	2.0m	▼ -11% New and Grade A space: 80%	5.3% New and Grade A space: 4.2%
M4	192,978	▲ 32%	7.5m	▲ 5% New and Grade A space: 78%	11.4% New and Grade A space: 8.9%

Source: Knight Frank Research



RODDY ABRAM
A more positive quarter than Q1 has been bolstered by strong activity in Cambridge and Oxford. The wider South East markets have been quieter, with occupiers unwilling to rush into transactions.



JACK RILEY
A strengthening level of pent-up occupier demand is evident, with c.£1m sq ft of space under offer that we're confident will transact in H2 and a healthy level of named demand at viewing or RFP stage.

Key Leasing transactions Q2 2023

ADDRESS	SIZE SQ FT	OCCUPIER	RENT £ PER SQ FT
Harwell Campus, Didcot.	145,000	Moderna	CONF
Priestley Building, Guildford	45,243	LGC	£40.00
1 Brentside Centre, Brentford	26,455	Oxford Business College UK Ltd	£22.00
Unity Campus, Cambridge	24,036	Domainex	£46.00
Eastwood House (part 1st Floor), Chelmsford	22,012	Arthur J.Gallagher (UK) Limited	£22.00

Source: Knight Frank Research. GIA

Prime Rents

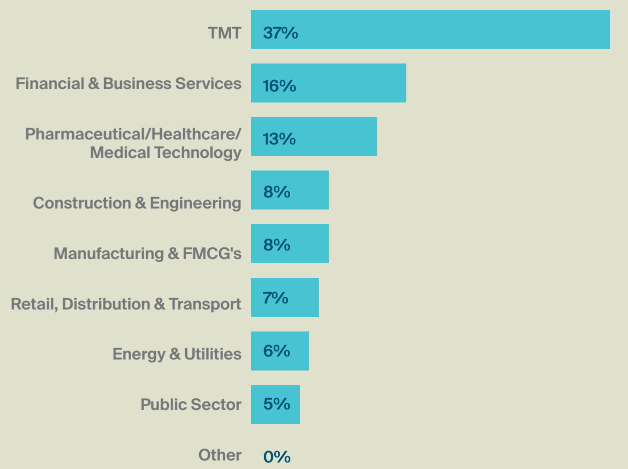
£ per sq ft

ACTIVE DEMAND: 5.0M SQ FT

Named demand in the South East

Active named demand by sector

Q2 2023



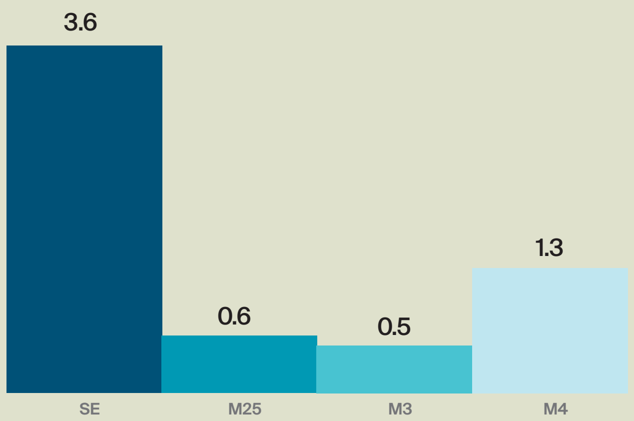
Source: Knight Frank Research

DEVELOPMENT: 4.2M SQ FT

Space under construction in the South East

Speculative development

Sq ft due to complete before 2026



Source: Knight Frank Research

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.

Investment market

Rising borrowing costs and the continuing difference between purchaser and vendor expectations meant that investment volumes were suppressed in H1. Pricing remains under pressure in response to rising swap rates and the erosion of the gap between UK Gilts and office yields.

London Square, Guildford

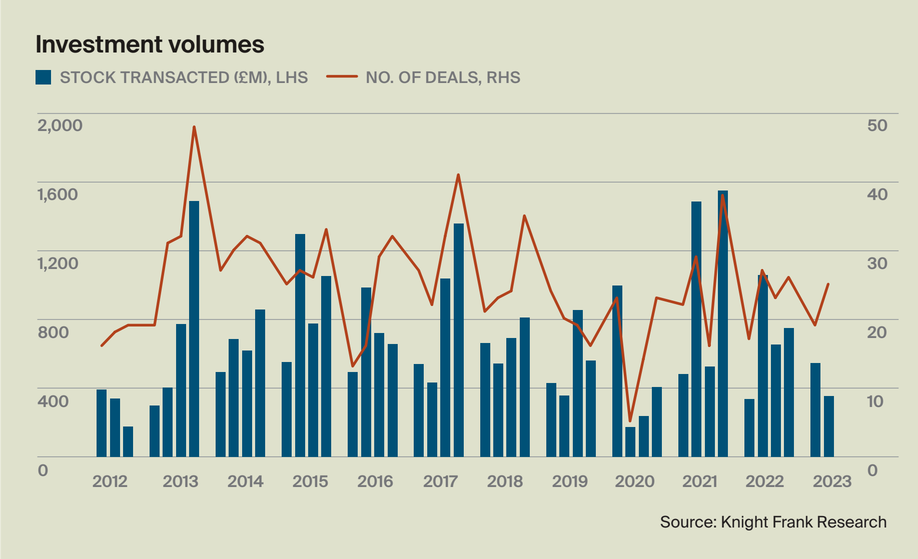
£354m
South East transaction volumes

£14m
Average lot size

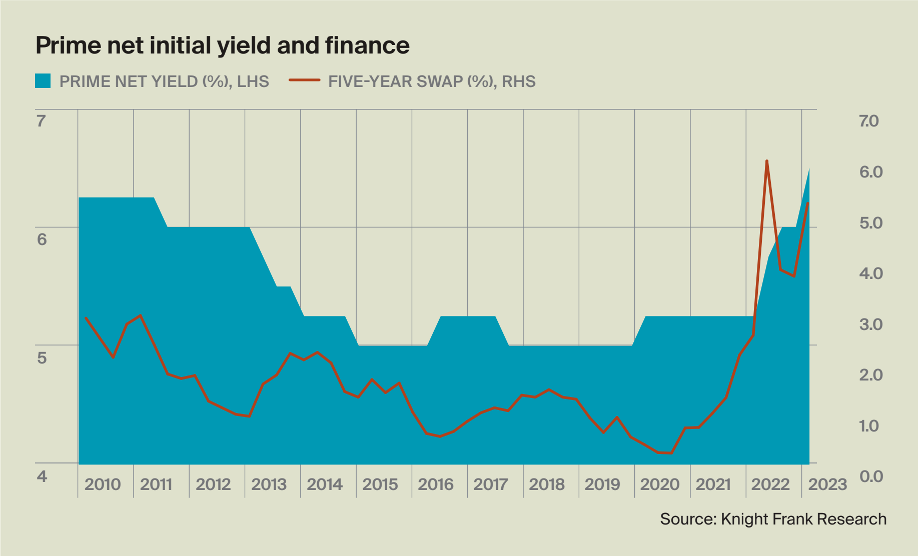
6.50%
Prime net initial yield

40%
Buyers from the UK

Footnote: Headline statistics are representative of Q2 2023



SIMON RICKARDS
There remains significant interest from investors for income deals and prime assets in the right locations, whereas secondary assets in weaker markets are proving increasingly challenging.



HENRY WYLD
One of the most significant factors affecting activity is the cost of debt, which remains high relative to the low levels seen in recent years. With pressure from lenders growing, the 'sell rather than refinance decision' will serve to increase stock in the market.

Key transactions Q2 2023

ADDRESS	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
Liberty House, 76-80 Hammersmith Road, Hammersmith	£50	na	APAM	McAleer & Rushe Group
Sand Martin House, Peterborough	£47	4.75%	L&G	Peterborough City Council
London Square, Guildford	£41	9.35%	M&G	Sidra Capital
Clearwater Court, Vastern Road, Reading	£35	8.70%	abrdn	Glades Capital
Carnival House, 100 Harbour Parade, Southampton	£33	7.25%	Aviva Investors	Private Investor

Source: Knight Frank Research. GIA

South East & Greater London Offices

Roddy Abram
Partner
Head of South East &
Greater London Offices
+44 20 7861 1280
+44 7899 001 028
roddy.abram@knightfrank.com

Jack Riley
Partner
South East & Greater London Offices
+44 20 7861 5375
+44 7867 002 484
jack.riley@knightfrank.com

Andy Nixon
Partner
South East & Greater London Offices
+44 20 3909 6830
+44 7973 924 947
andy.nixon@knightfrank.com

Ashley Drewett
Partner
South East & Greater
London Offices, Lease Advisory
+44 20 7861 1156
+44 7799 478 834
ashley.drewett@knightfrank.com

Andrew Wood
Partner
South East & Greater London Offices,
Tenant Representation
+44 20 7861 0662
+44 7800 500 752
andrew.wood@knightfrank.com

Capital Markets

Simon Rickards
Partner
Head of South East & Greater London
Office 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

Henry Wyld
Partner
Capital Markets
+44 20 7861 1520
+44 7774 833 478
henry.wyld@knightfrank.com

Charles Hobart
Partner
Capital Markets
+44 20 7861 1212
+44 7825 608 962
charles.hobart@knightfrank.com

Freddie Owen
Partner
Capital Markets
+44 20 7861 1225
+44 7774 109 666
freddie.owen@knightfrank.com

Life Sciences

Emma Goodford
Partner
Head of Life Sciences & Innovation
+44 20 7861 1144
+44 7831 581 258
emma.goodford@knightfrank.com

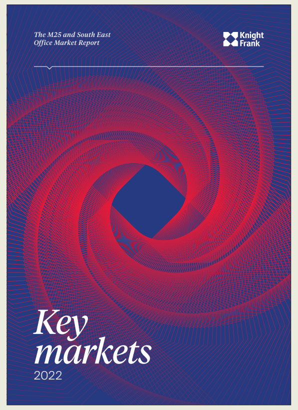
Research

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

Jodie Gibson
Analyst
+44 20 7861 1024
jodie.gibson@knightfrank.com

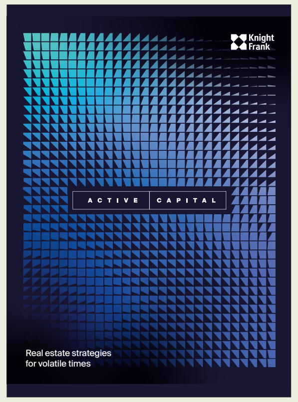
Recent market-leading research publications



M25 Key Markets

M25 - The Next Chapter

The London Report



Active Capital

UK Cities

(Y)OUR SPACE

UK Life Sciences

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. The market statistics quoted as 'South East' or 'South East Study Area' are inclusive of Cambridge, Oxford and Brighton.
- 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 June 2023.

Knight Frank