Investment, Development
& Occupational Markets

M25 Offices

Q4 2019

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KEY TAKEAWAYS

1

Total take-up in 2019 was 15% below trend, but deal numbers were consistent with the 10-year average.

2

Crossrail locations accounted for 25% of deals in 2019.

3

The technology sector was the most active accounting for 27% of space acquired.

4

Office investment volumes were 12% below the 10-year average, principally due to political uncertainty.

5

Private equity accounted for 39% of investment volumes, up from 12% in 2018.

EXECUTIVE SUMMARY

Final quarter bounce deferred

The December UK general election curtailed any prospect of a significant change in market activity in Q4, albeit the result, largely welcomed by business, could translate to a more positive market in 2020. Take-up during the final quarter amounted to 717,900 sq ft, 12% below the 10-year quarterly average. This meant that the total amount of space leased in 2019 rose just above the 2.75m sq ft mark, 15% below the 10-year annual average and the lowest total recorded at this point of a year since 2011.

Lease events to drive demand in 2020?

The outlook for 2020 indicates improvement. At the end of 2019, close to 550,000 sq ft of space was under offer much of which should transact in Q1. In addition, the tightening supply environment will mean that occupiers are required to activate searches well ahead of lease events. With the number of breaks and expiries scheduled for 2021 at the highest level for five years, market activity in 2020 will be dominated by early movement to secure the best space.

Quality prerequisite but limited options

The drive toward acquiring the best quality space continues to dictate occupier behaviour. Analysis of take-up across the South East in 2019 reveals that leasing volumes of Grade B space was at 11% of the market, 50% below the long term trend.

With just 1.6m sq ft of speculative development completed in the past two years, occupier choice of quality space has shrunk as vacancy rates have fallen. At the end of 2019, vacancy in all markets (M25, M3 and M4) was between 70 and 160 basis points below the respective 10-year averages. This situation will only become more acute in 2020. The development pipeline indicates that just 836,000 sq ft of speculative space is set for completion in the next 24 months, with a greater propensity toward securing a pre-let the likely consequence.

South East office market resilient, but not immune

Fears of a potential downturn fuelled by the Brexit impasse meant that a degree of investor inertia took hold in 2019. The number of deals completed in the year was 25% fewer than in 2018 and 20% below the long-term trend. Consequently, investment volumes also fell short, finalising at £2.2bn, 12% below the 10-year annual average.

Significantly, although the number of higher-value sales was fewer than in recent years, it was the sharp reduction in sales within the £20m - £50m price bracket that was most notable. Just 15 transactions were completed in this sizeband, the lowest number since 2012. This demonstrates the 'wait and see' stance adopted by both buyers and potential sellers during the year.

Foreign buyers watching from afar

One of the main reasons for the subdued level of market activity in 2019 was a drop in demand from overseas buyers. Although responsible for two of the three transactions over £100m, the number of deals completed by foreign buyers represented 20% of the market down from 39% in 2018. With the exit date from the EU now decided, greater interest from international buyers is forecast with the South East offering comparative value to local markets.

Private equity influence gaining albeit councils are here to stay

Private equity money was dominant in 2019, accounting for 39% of investment volumes. Albeit at a lower percentage than in 2018, local authorities remained active, accounting for the highest number of acquisitions and 21% of total investment.

OCCUPIER MARKET

Although deal numbers were steady in 2019, most were of a smaller scale meaning leasing volumes suffered. Onward, impending lease events are at a five-year high. This, coupled with low supply, will force occupiers to engage early, boosting activity in 2020.

SOUTH EAST TAKE-UP

718k sq ft

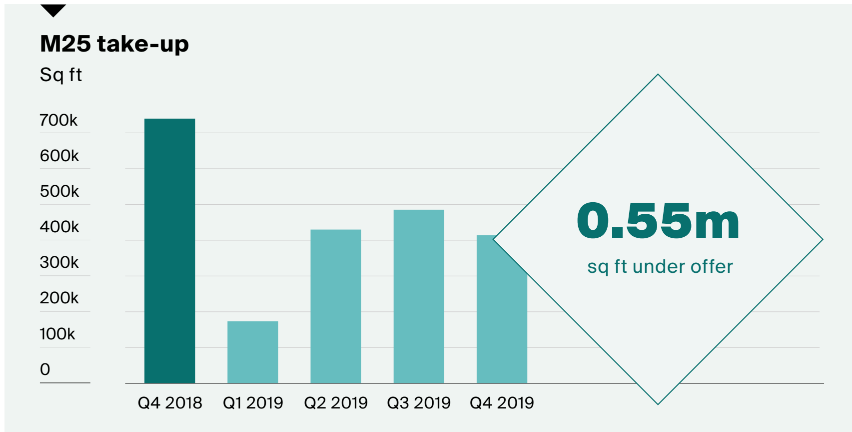
▼ -1%

Porter Building, Slough

Take-up and supply
Q4 2019

	TAKE-UP (SQ FT)	TAKE-UP (VS Q3 2019)	SUPPLY (SQ FT)	SUPPLY (VS Q3 2019)	VACANCY RATE
M25	419,378	▼ -13%	6.3m	▼ 8% New and Grade A space: 77%	5.2% New and Grade A space: 4.0%
M3	127,661	▼ -56%	2.5m	▼ 1% New and Grade A space: 81%	6.3% New and Grade A space: 5.2%
M4	425,371	▲ 16%	5.6m	▼ 3% New and Grade A space: 80%	8.5% New and Grade A space: 6.8%

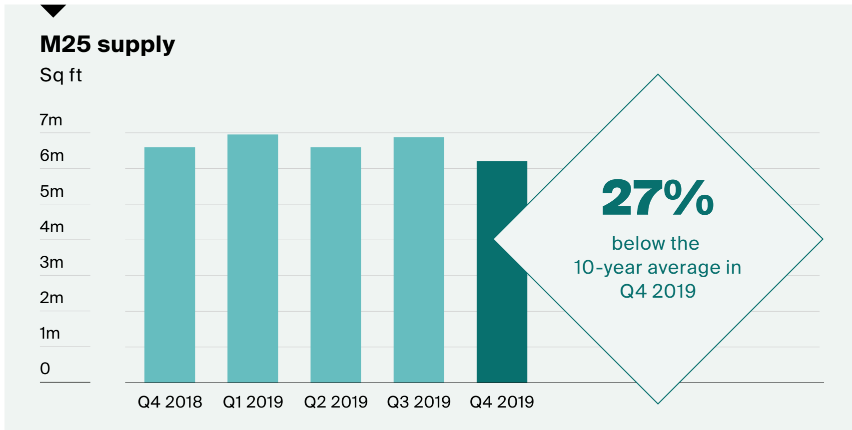
Source: Knight Frank Research



Source: Knight Frank Research

Emma Goodford

2020 will see occupiers activate requirements in greater number to satisfy impending lease events and a drive to quality. Those that do will be met with a picture of tightening supply, a scenario that could fuel pre-letting and spark an uptick in refurbishment projects.



Source: Knight Frank Research

Roddy Abram

Where vacancy rates have dipped to acute levels, competitive pressure will serve to drive asking rents upward whilst shortening rent free periods. The highest growth is likely to be in locations that are talent magnets, such as those with a strong educational connection.

Key leasing transactions
Q4 2019

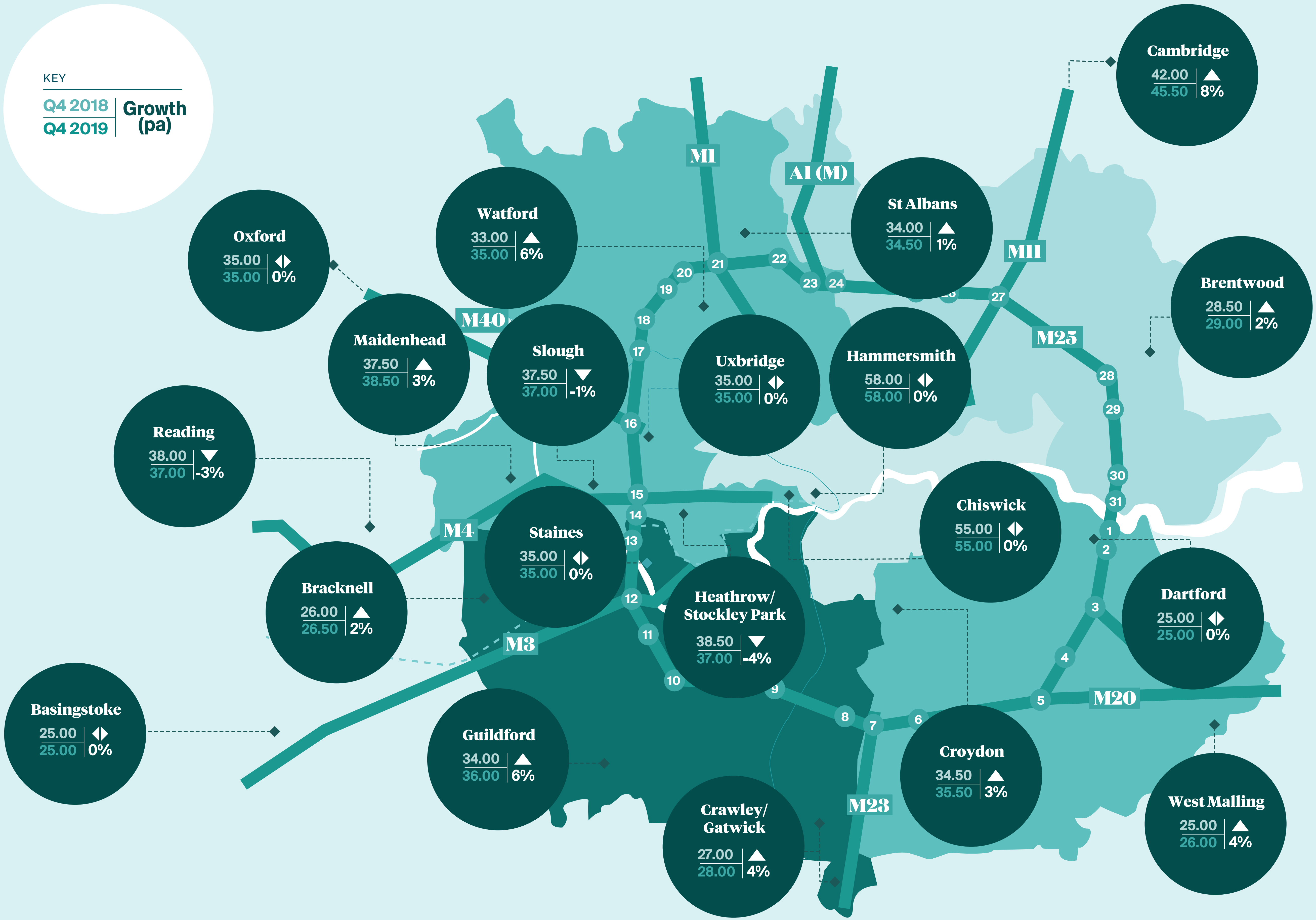
ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT
Gateway Central, White City	120,217	L'Oreal	>£60.00
Mallards Reach, Maidenhead	37,544	Maersk	Confidential
Metro Building (6th, 7th & 8th flrs), Hammersmith	34,320	Mindspace	£53.00
Stokes House, Leatherhead	28,789	Thames Valley Police	Freehold Sale
The Porter Building (3rd flr), Slough	27,400	Mattel	£34.00

Source: Knight Frank Research

M25 OFFICES, Q4 2019

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.

Source: Knight Frank Research

ASOS, Leavesden Park

INVESTMENT MARKET

Political risk dominated the market in 2019 resulting in a 'wait-and-see' approach from investors and reduced investment volumes. Buyer interest has not diminished, however, meaning greater political stability in 2020 could reignite transactional activity.

-35%

£561m
South East transaction volume*

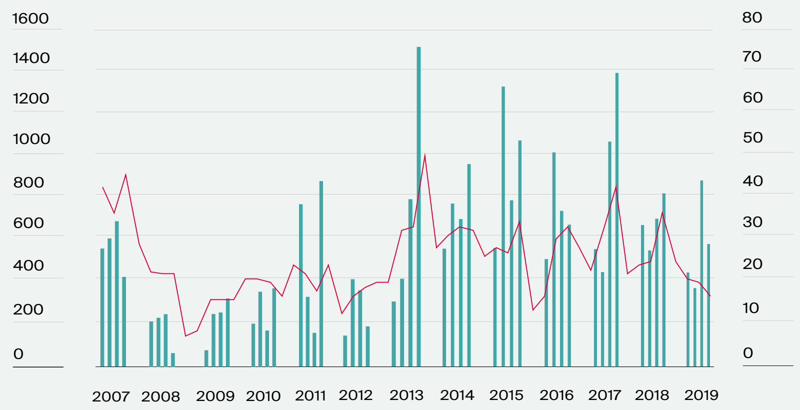
£35m
Mean lot size

5.00%
Prime net initial yield

59%
Buyers from the UK

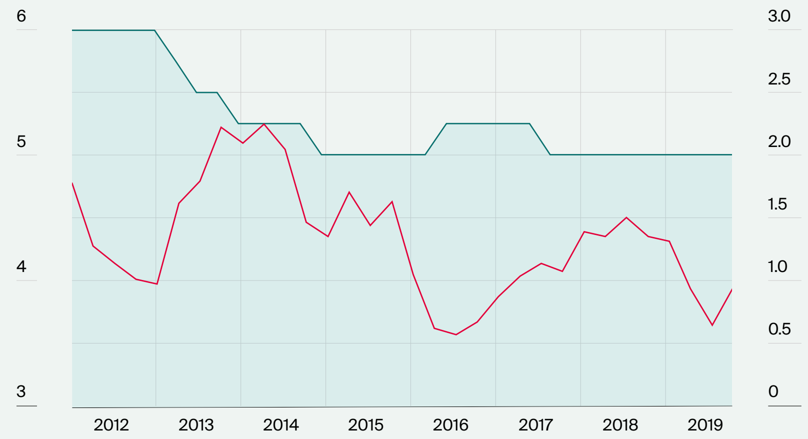
* Percentage change reflects a comparison to Q2 2019

Investment volumes



Source: Knight Frank Research

Prime net initial yield and finance



Source: Knight Frank Research

Simon Rickards

2020 could see yields harden particularly for prime where a premium is likely to be achieved for the very newest and best in class assets. We also expect the significant amount of equity chasing core-plus assets to support improved pricing for good secondary stock where cap-ex costs are not prohibitive.

Tim Smither

We expect volumes to return to their long-term average next year, as buyers re-engage after an extended period of politically generated uncertainty. That said, a lack of opportunities to recycle capital could mean vendors are reluctant to sell. This could frustrate the significant levels of equity looking to be deployed.

Key transactions
Q4 2019

ADDRESS	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
The Heights, Weybridge	£136.00	7.07%	M&G Real Estate	Kennedy Wilson
Leavesden Park, Watford	£86.00	5.40%	Kennedy Wilson	Private overseas
Seacourt Tower, Oxford	£81.50	4.75%	BA Pension Fund / Vantage Asset	Brockton Everlast
Colworth Park, Bedford	£63.00	6.00%	Fiera Real Estate	Angelo Gordon
2000 Hillswood Drive, Chertsey	£60.00	5.07%	Astellas Pharma	KFIM

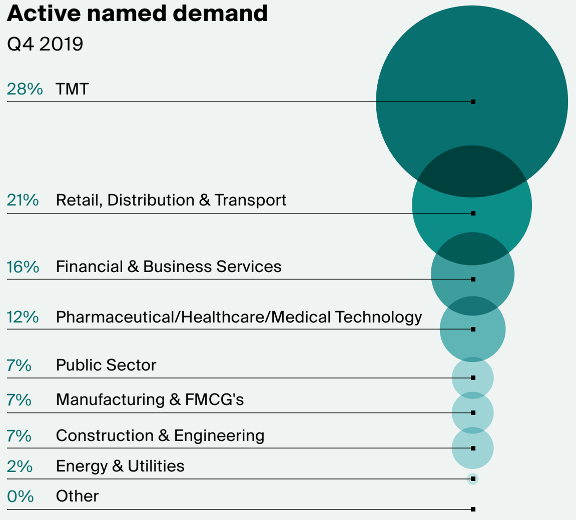
Source: Knight Frank Research

FUTURE GAZING

DEMAND: 4.3M SQ FT

Of active named demand in the South East

Active named demand
Q4 2019



Source: Knight Frank Research

DEVELOPMENT: 1.2M SQ FT

Space under construction in the South East

*This includes pre-let (0.3m sq ft) and speculative space (0.9m sq ft)

Speculative development
Sq ft due to complete before Q1 2022

Source: Knight Frank Research

CROSSRAIL – A DECADE OF INFLUENCE

Where businesses locate is influenced by multiple factors; including labour, customer base, transportation and cost. With the UK near full employment, labour retention and supply is cited as the most important single factor in location choice. Fundamentally, ease of access to the workplace greatly improves employee experience ensuring lower staff churn, as well as broadening the pool of resources to fulfil future staffing needs.

Crossrail is the foremost transport infrastructure change in the South East. From the outset of its construction the project attracted the attention of both occupier and developers alike. Over the past decade, just over 4.7m sq ft of office space has been built or redeveloped in the main commercial centres served by Crossrail. This totals more than a third of all development completions for the South East. Occupier demand has followed with the locations in the 'Crossrail corridor', attracting 27% of total take-up in the South East over the past 10 years. Looking forward, the delay in opening seems to have done little to dampen activity. Against a backdrop of much reduced occupier activity, projects where construction is underway account for 48% of the total for the wider South East market. The Crossrail effect is clearly here to stay.

Technology sector take-up
Q4 2019

Source: Knight Frank Research

Source: Knight Frank Research, Oxford Economics

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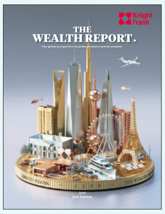

The Wealth Report

Active Capita

London Report

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 31st December 2019.

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