RESEARCH

Knight Frank

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPATIONAL MARKETS **Q1 2018**

EXECUTIVE SUMMARY

◆ Transaction activity brisk in Q1

With 63 transactions completed, Q1 2018 proved to be the strongest start to a year for occupier activity since 2014. Despite the average deal size being the lowest for a quarterly period since 2008, the high deal number meant that take-up reached 744,500 sq ft. This total is on a par with the 10-year average for a Q1 period. Notably, a further 390,000 sq ft of space went under offer in Q1 in 32 deals. This brings total space under offer at the end of Q1 to 650,000 sq ft, which provides a strong foundation for Q2.

◆ ‘Space as a Service’ continues to roll out

Flexible office providers continued to aggressively acquire space in Q1 2018, with three transactions completing accounting for 70,000 sq ft. This continues the trend witnessed in 2017, which saw 11% of let space across the South East taken by co-working and serviced office firms. Interestingly, 82% of this space acquired in the past 15 months was in the M4 corridor; Reading accounted for 54% of take-up in this market, albeit some space was acquired to satisfy pre-committed occupier contracts.

◆ M4 vacancy continues to rise

With 2.9m sq ft of speculative development completed in the South East since the beginning of 2017, market vacancy has steadily risen. The main recipient has been the M4 corridor, where 2m sq ft of speculative space has come to market over the past 15 months. As a consequence, vacancy in the M4 has risen from 8.8% to 10.1% over this period. The current development schedule however, indicates that just 500,000 sq ft of speculative space is scheduled for completion over the next 12 months. This equates to four months of take-up. Therefore, although new completions and space release may lead to a small upward movement in next few months, we anticipate that vacancy levels will begin to retreat from mid-year 2018 and maintain a downward trajectory given the slowdown in new starts.

◆ Investors continue to target the South East

South East office investment volumes reached £696m in Q1 2018, a total 27% ahead of the 10-year quarterly average. Most notable is that the level of activity in Q1 2018 represents the strongest start to a year since 2011. Significantly, five transactions completed with a price tag above £50m. This compares to a long term quarterly average of three.

◆ UK buyer interest strengthens

Domestic investors accounted for 86% of investment capital spent in Q1 2018, further demonstrating the strengthening interest of UK buyers noted in 2017. The continued activity of UK councils is particularly noteworthy, with council spending on South East offices rising to £1.2bn since the beginning of 2016. This represents 17% of the market. The acquisition of 12 Hammersmith Grove by Spelthorne Council in Q1 2018 is the latest example of this, with Spelthorne Council now accounting for 50% of capital deployed by councils over the past 27 months.

◆ Pricing under pressure

Prime yields remained at 5.00% in Q1. Both overseas and domestic investors alike continue to receive and seek the benefit of higher yields outside of central London, even when the assets and covenants are of similar quality. As such, the competitive marketplace could see yields harden in the coming months, particularly for prime stock.

*The South East is defined in the technical note on the back cover

OCCUPIER MARKET

Occupier activity remains strong, albeit deal sizes continue to reduce. The development pipeline has dipped below 1m sq ft meaning vacancy levels will begin to decrease accordingly.

SOUTH EAST TAKE-UP

744,500 sq ft

▼ 19%

TAKE-UP (SQ FT)

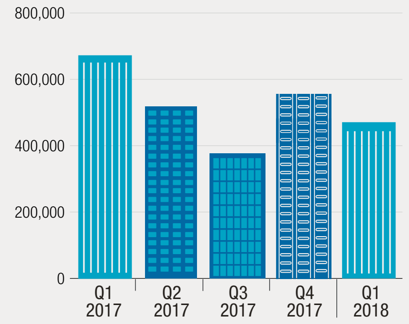
			New and Grade A space
M25	470,300	▼ -15%	84%
M3	143,650	▼ -33%	86%
M4	377,350	▼ -37%	92%

SUPPLY (SQ FT)

			New and Grade A space	Vacancy rate**	
M25	7.2m	◀▶ 0%	84%	6.0%	5.0%
M3	2.4m	▲ 4.0%	86%	6.2%	5.3%
M4	6.7m	▲ 3.0%	92%	10.1%	9.3%

*Arrows reflect quarter-on-quarter change. ** Number in blue shows vacancy rate across all grades. Number in grey denotes vacancy rate for new and grade A office space.

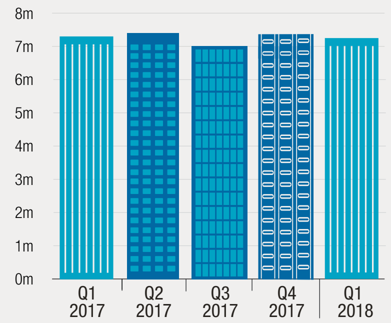
FIGURE 1
M25 Take-up (sq ft)



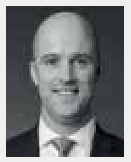
0.6m UNDER OFFER IN THE SOUTH EAST IN Q1 2018

EMMA GOODFORD
Despite a cautious undertone, occupiers are bringing new requirements to market to satisfy an agenda based on talent retention and operational flexibility and efficiency. Smaller scale deals remain prevalent, with the rise in flexible offices evidence of ‘just-in-time’ solutions gaining acceptance.

FIGURE 2
M25 Supply (sq ft)



20% BELOW THE 10-YR AVERAGE IN Q1 2018



RODDY ABRAM
With just three schemes starting in the M4 in the last 6 months, we will soon begin to see a reduction in the vacancy rate. Occupiers with larger requirements still consider the market to offer enough choice, with links to London featuring on a greater number of searches.

Key leasing transactions Q1 2018

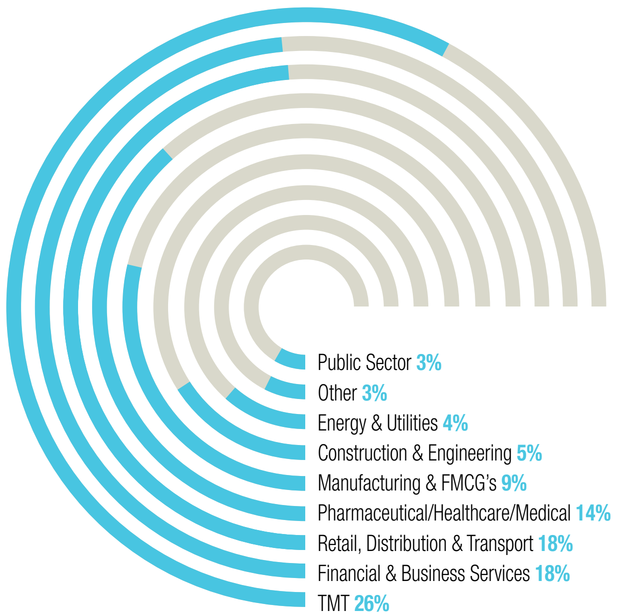
ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
270 Bath Road, Slough	47,214	Stanley Black & Decker	£27.50
Stone Cross, Brentwood	39,490	Sky CP	£28.25
Thames Tower (8th,9th & 14th flrs), Reading	38,032	Ericsson	£38.00
The Crescent, Viables Business Park, Basingstoke	32,700	Vision RT	£11.25
Renaissance, Croydon	28,845	Green Networks	£34.00

Source for all charts: Knight Frank Research

DEMAND

4.6msq ft
OF ACTIVE NAMED DEMAND
IN THE SOUTH EAST

Active named demand



DEVELOPMENT

0.9msq ft
SPACE UNDER CONSTRUCTION
IN THE SOUTH EAST

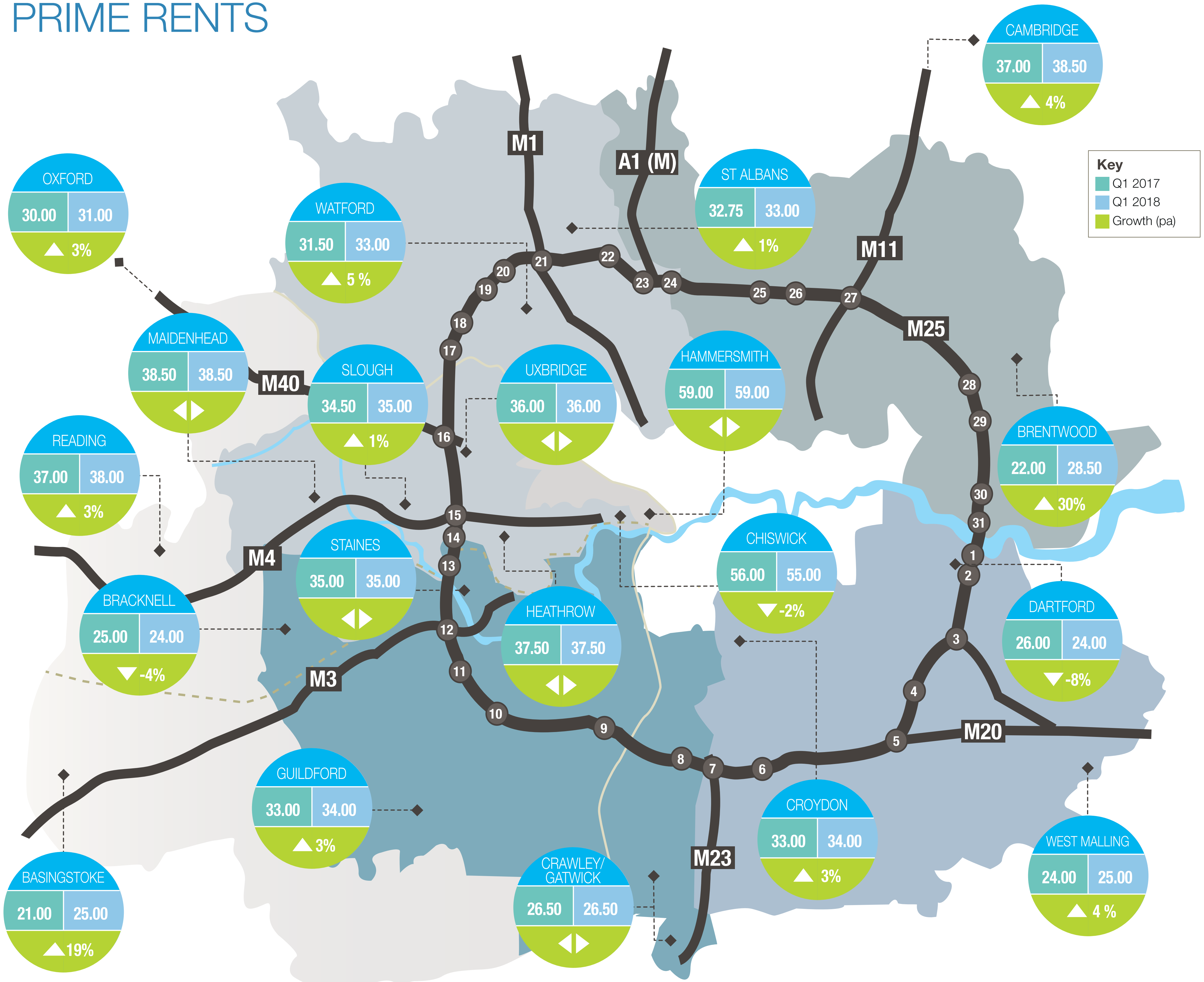
*This includes pre-let and speculative space

Speculative development (sq ft)
Due to complete before Q1 2019

M25	M3	M4
0.4m	0.4m	0.5m

Source for all charts: Knight Frank Research

PRIME RENTS



Rent assumes a new building let on a 10-year lease.

INVESTMENT MARKET

Investment volumes in Q1 2018 reached the highest first quarter total since 2011. Domestic buyers were most active, supported by continued interest from UK councils.

▲29%

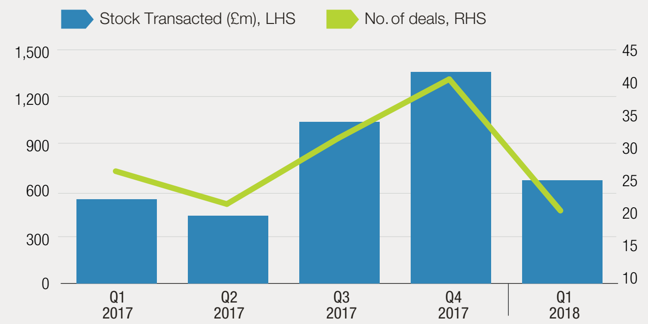
£696m
South East transaction volume
Percentage change reflects a comparison to Q1 2017

£31.5m
Mean lot size

5.00%
Prime net initial yield

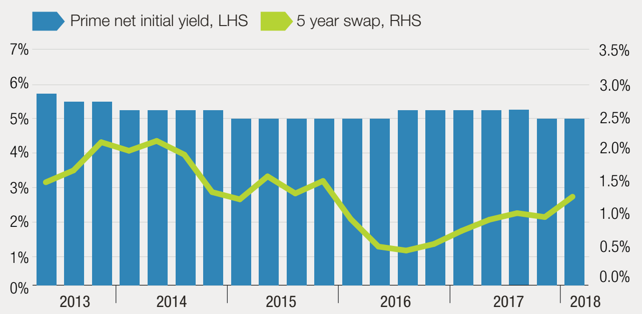
86%
Buyers from the UK

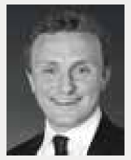
FIGURE 3
Investment volumes



TIM SMITHER
The breadth of global investor demand looking to get into the market continues to increase, with the South East looking like relative good value to our broad base of overseas private clients.

FIGURE 4
Prime net initial yield and finance





SIMON RICKARDS
There remains significant levels of cash looking to be deployed into the South East, with volumes being held back only by a lack of deliverable stock, particularly at the prime end. We expect this trend to continue for the foreseeable future.

Key investment transactions Q1 2018

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
12 Hammersmith Grove	£170.00	5.25%	Aberdeen Standard Investments	Spelthorne Borough Council
NATS	£82.00	5.23%	Greenridge Investment Management	RBS Pension Fund
The Aircraft Factory	£63.00	6.42%	Westbrook	Legal & General
Imperial Place	£62.50	6.39%	Cromwell	First Property Group
Harman House	£51.00	6.90%	Pramerica	CLS

Source for all charts: 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. Existing built office stock in the M4 market totals 66m 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.
- 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 4 & 5.
- 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 March 31st 2018.

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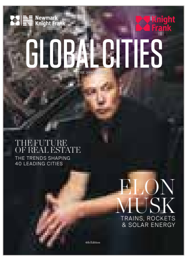

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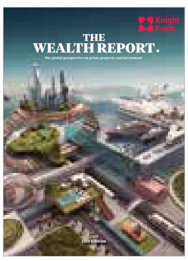

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