RESEARCH

M25 OFFICES

INVESTMENT, DEVELOPMENT & OCCUPATIONAL MARKETS **Q1 2019**

EXECUTIVE SUMMARY

Deal rate keeps pace despite Brexit concern

Occupier activity in the South East office market held firm in Q1 amid a deteriorating political backdrop. Despite initial fear of market apathy, 53 transactions were completed during the quarter, a number consistent with the long term trend.

With a high number of larger corporate requirements satisfied in 2018, 43 deals in Q1 2019 were below 20,000 sq ft. This meant that overall take-up during the quarter finished 13% below the 10-year quarterly average at 692,143 sq ft.

M4 and West London underpin market activity

Supported by two of the largest deals of Q1, including the letting of Abstracts Florence Building in Basingstoke, take-up in M3 market rose to 221,444, 27% above the 10-year quarterly average. However, the M4 market remained the main focus of occupier activity during the first quarter representing 63% of total space transacted. Take-up for the M4 reached 439,557 sq ft, 6% above the 10-year quarterly average. Notably, Reading and West London accounted for 38% of the South East total in Q1.

With 11 deals completed totalling 138,800 sq ft, Reading was the principal target of occupier interest. This total is 44% above the 10-year quarterly average for the town. Similarly, supported by occupiers extending beyond central London and new developments at White City, West London is registering take-up levels above trend. Take-up in West London during Q1 was 125,400 sq ft, 10% ahead of the 10-year quarterly average.

Supply squeeze ahead?

Availability remained a restraining factor to occupier activity. At the end of Q1, vacancy in all markets (M25, M3, and M4) finished around one fifth below their respective 10-year averages. The development pipeline offers little respite, with just 849,000 sq ft of speculative space set for delivery over the next 24 months. This equates to three months of take-up. Some key centres in the South East therefore will enter a supply squeeze in 2019 increasing the prospect of rental growth.

Solid start despite investor caution

Investment volumes reached £428m in Q1, broadly in line with the 10-year average for the period, despite the wider political uncertainty. The overall deal rate was also consistent with the long term trend, indicating a willingness to transact given the right opportunity. All but one investment deal in Q1 was below £50m. Indeed, higher value asset sales over the last 9-12 months have become less frequent as buyers seek clarity on Brexit and vendors choose to hold on to assets, given a lack of suitable stock to recycle their capital back into.

Domestic investment underpinning activity

Domestic investors accounted for 94% of total volumes in Q1, continuing the theme of 2018. With nine deals completed in Q1, UK Councils' spending continued strongly, accounting for 41% of investment volumes. UK Funds accounted for 32% of volumes during the quarter. Institutional requirements remain strong for core town centre opportunities in particular, whilst assets in secondary locations are increasingly being considered as potential sales. Overseas investors continue to monitor the market, with significant firepower available to be deployed at the right time, and for the right opportunity.

Prime yields remain stable

Prime yields remain unchanged at 5.00%, with significant capital looking to invest in core fundamentals, particularly for smaller lot sizes and in markets underpinned by a lack of grade A vacancy. However, there are very few sellers of prime stock, which will also help keep pricing stable. Secondary stock, however, may encounter some price softening in order to provide necessary liquidity.

"Despite political uncertainty, investment volumes in Q1 reached £428m, on par with the 10-year average for the period."

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

OCCUPIER MARKET

Despite a quarter-on-quarter dip, letting activity in the Q1 proved comparative to the same period in previous years. Vacancy levels remain well below the long-term average, with limited development on the horizon.

SOUTH EAST TAKE-UP

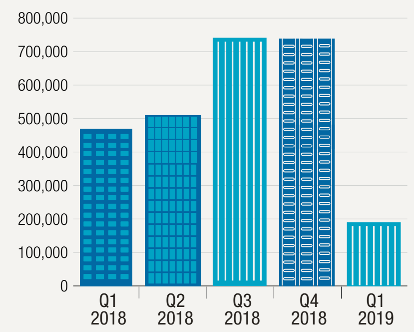
692k sq ft

▼-49%

	TAKE-UP (SQ FT)		SUPPLY (SQ FT)		Vacancy rate**
M25	187,713 ▼ -75%	M25	6.9m ▲ 4%		5.8%
	New and Grade A space 81%		New and Grade A space 75%		4.3%
M3	221,444 ▲ 32%	M3	2.4m ▼ -8%		6.1%
	New and Grade A space 81%		New and Grade A space 81%		4.9%
M4	439,557 ▼ -52%	M4	5.1m ▼ -8%		7.6%
	New and Grade A space 97%		New and Grade A space 94%		6.4%

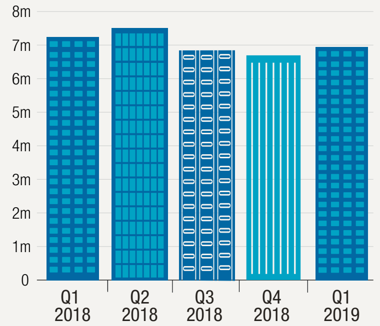
*Arrows reflect quarter-on-quarter change. ** Number in blue shows vacancy rate across all grades. Number in grey denotes vacancy rate for new and grade A office space.

FIGURE 1
M25 Take-up (sq ft)



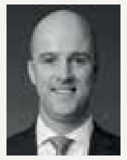
0.5m UNDER OFFER IN THE SOUTH EAST IN Q1 2019

FIGURE 2
M25 Supply (sq ft)



22% BELOW THE 10-YR AVERAGE IN Q1 2019

EMMA GOODFORD
Although the Q1 results were largely positive given the escalating level of uncertainty, 80% of the quarter's deals were sub 20,000 sq ft meaning larger corporates continue to show that they will play a waiting game if they can.



RODDY ABRAM
With both vacancy and future development well below the respective 10-year averages, an impending supply crunch is likely in some markets within the next 18 months.

Key transactions Q1 2019

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
The Florence Building, Basingstoke	60,546	Sovereign Housing Association	£21.50
Hive 3, Arlington Business Park, Theale	58,042	Bottomline Technologies	Freehold Sale
Ascent 3, Farnborough Aerospace Centre, Farnborough	45,788	Discover Financial	£28.00
3 Shortlands (1st,2nd & 6th flrs), Hammersmith	45,352	H & F Council	£40.57
Quantum House, Basingstoke	37,580	Arena Business Centre	Freehold Sale

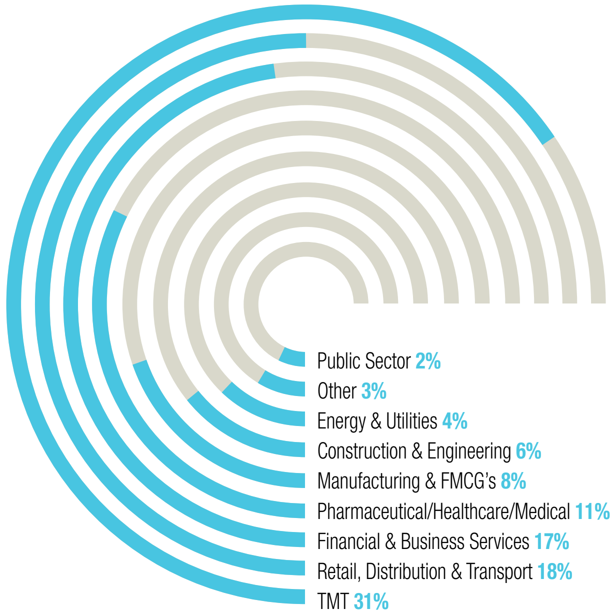
Source for all charts: Knight Frank Research

DEMAND

5.8msq ft

OF ACTIVE NAMED DEMAND IN THE SOUTH EAST

Active named demand



DEVELOPMENT

1.2msq ft

SPACE UNDER CONSTRUCTION IN THE SOUTH EAST

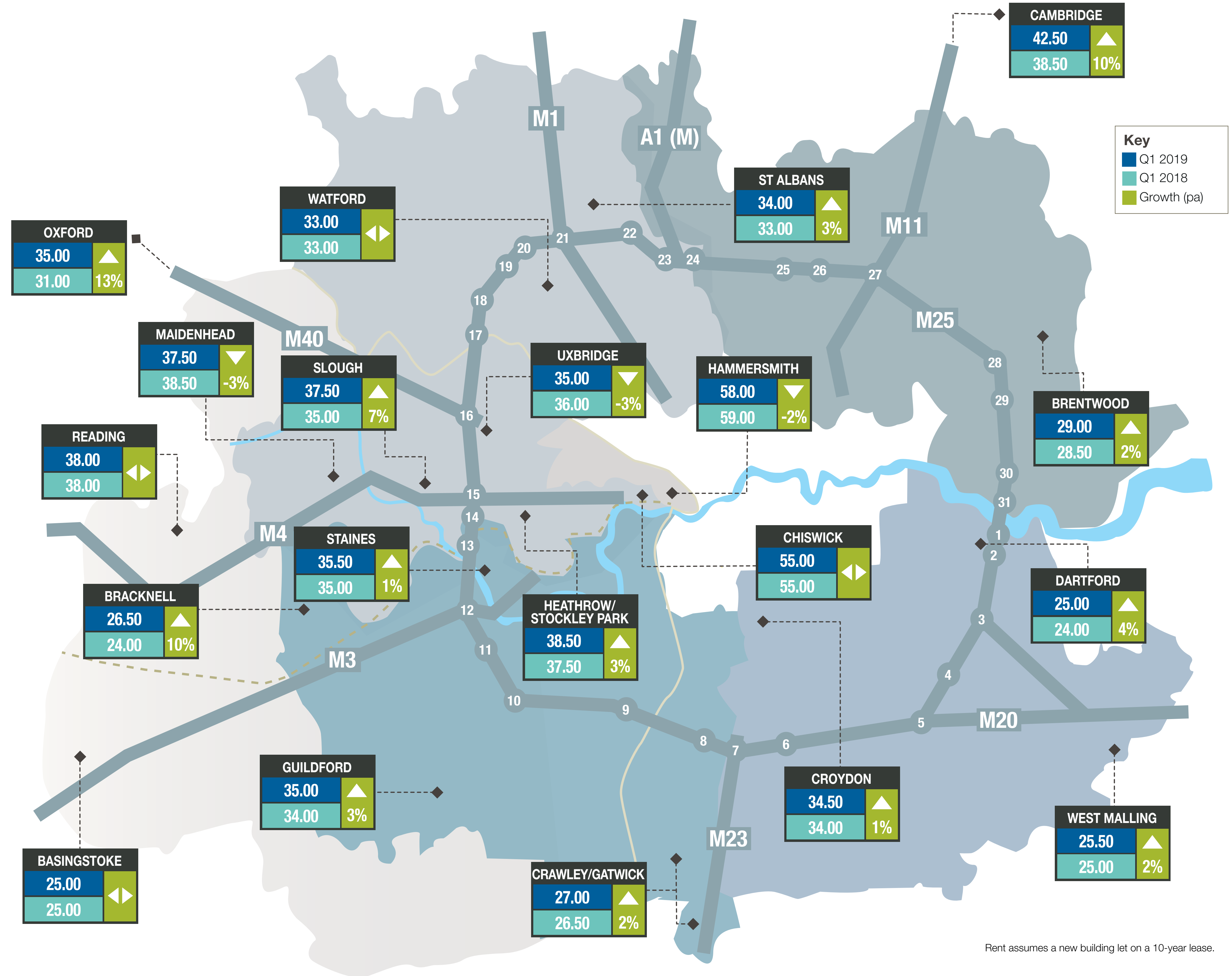
*This includes pre-let (0.3m sq ft) and speculative space (0.8m sq ft)

Speculative development (sq ft)
Due to complete before Q1 2020

M25	M3	M4
0.4m	0.3m	0.4m

Source for all charts: Knight Frank Research

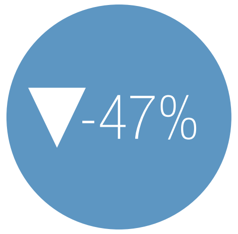
PRIME RENTS



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

INVESTMENT MARKET

UK buyers supported a solid start to the year, although a lack of willing sellers could limit opportunities and frustrate activity in future months.



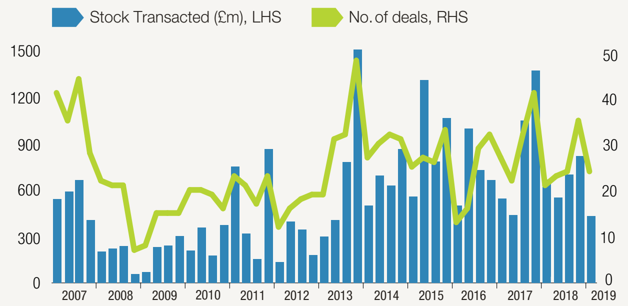
£428m
South East transaction volume
Percentage change reflects a comparison to Q4 2018

£17.8m
Average lot size

5.00%
Prime net initial yield

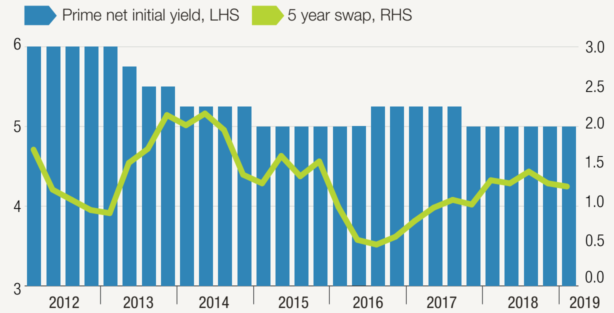
94%
Buyers from the UK
Q1 2019

FIGURE 3
Investment volumes



TIM SMITHER
Given the political turmoil, 2018 ultimately exceeded expectations in terms of volumes traded. 2019 has started relatively slowly from an investment perspective, although total volumes of £428m is broadly in line with the 10-year average for the period.

FIGURE 4
Prime net initial yield and finance



SIMON RICKARDS
We anticipate increased appetite from UK investors, attracted by low vacancy levels in the M25, ever improving infrastructure and attractive returns relative to other sectors.

Key investment transactions Q1 2019

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
St Georges East, Wimbledon	£52.72	4.36%	Aberdeen Standard	M&G
Victoria Gate, Woking	£40.00	5.00%	Aviva Investors	Woking Borough Council
Victory House, Brighton	£36.60	4.81%	Schroders	NFU
Florence Building, Basingstoke	£29.00	4.25%	Abstract Securities	L&G
Woking One, Woking	£27.20	5.40%	Palmer Capital / Wrenbridge JV	Woking Borough Council

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 2019.

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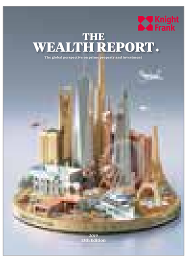

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