EXECUTIVE SUMMARY

- **Transaction rate – the highest for 10-years**

  Office take-up in the South East reached 792,837 sq ft in Q2, 2% above the 10-year quarterly average. Consequently, take-up at the mid-point of the year increased to 1,537,365 sq ft, 10% above the 10-year mid-year average. The market feels, and is, much busier than the take-up statistics reflect however. The reason? With 122 transactions completed in the first six months of 2018, H1 2018 has proved to be the most active H1 period for a decade.

- **Smaller deals are the new norm**

  Although deal number is up, 2018 is yet to record a single transaction over 50,000 sq ft. At H1 2018, just 795,150 sq ft of speculative space was under construction across all markets. Notably, only 497,600 sq ft of this total is due for delivery within the next 12 months. Accordingly, vacancy levels will begin to recede with the M4 in particular, falling back in line with the 10-year average from early 2019.

- **Vacancy at a peak?**

  Vacancy in all markets edged up slightly during Q2. The M25 and M3 markets moved up to 6.2% and 6.8%, but importantly, both remained below their respective 10-year averages. In contrast, the M4 moved up to 10.2%, 70 bps above the 10-year average of 9.5%.

  Moving forward, the development pipeline is limited. At H1 2018, just 795,150 sq ft of speculative space was under construction across all markets. Notably, only 497,600 sq ft of this total is due for delivery within the next 12 months. Accordingly, vacancy levels will begin to recede with the M4 in particular, falling back in line with the 10-year average from early 2019.

- **Investors continue to target the South East**

  South East office investment volumes reached £544 million in Q2, 2% above the 10-year quarterly average. Consequently, take-up at the mid-point of the year increased to 1,537,365 sq ft, 10% above the 10-year mid-year average. The market feels, and is, much busier than the take-up statistics reflect however. The reason? With 122 transactions completed in the first six months of 2018, H1 2018 has proved to be the most active H1 period for a decade.

- **Flexible offices – the strongest sub-sector in 2018?**

  Flexible office providers continued to ‘step up’ their efforts to bolster coverage of South East office markets in Q2, with this business group accounting for 20% of take-up. Considered over the first six months of 2018, this subsector now accounts for 15% of total take-up. Interestingly, the motivation for space acquisition is to support operational growth, with all leases taken in 2018 completed without an end user pre-commitment.

- **Pricing stable, but under pressure**

  Prime yields remained at 5.00% in Q2, now unchanged for three years. Significantly, over the same period, pricing in several of the major UK regional cities has moved to sub-5%. This means that, with central London offices at 3.50% for the West End and 4.25% for the city, South East offices are gaining further traction as an attractive opportunity for both domestic investors and overseas buyers targeting the UK.

OCCUPIER MARKET

Occupier activity remains strong, bolstered by sustained interest from flexible office providers. Although vacancy edged upward, development activity is now much reduced meaning levels will begin to recede from H2.

**SOUTH EAST TAKE-UP**

<table>
<thead>
<tr>
<th>MARKET</th>
<th>TAKE-UP (SQ FT)</th>
<th>VACANCY RATE**</th>
</tr>
</thead>
<tbody>
<tr>
<td>M25</td>
<td>511,344</td>
<td>9%</td>
</tr>
<tr>
<td>M3</td>
<td>229,386</td>
<td>60%</td>
</tr>
<tr>
<td>M4</td>
<td>335,873</td>
<td>-11%</td>
</tr>
</tbody>
</table>

**SUPPLY (SQ FT)**

<table>
<thead>
<tr>
<th>MARKET</th>
<th>SUPPLY (SQ FT)</th>
<th>VACANCY RATE**</th>
</tr>
</thead>
<tbody>
<tr>
<td>M25</td>
<td>7.5m</td>
<td>6.2%</td>
</tr>
<tr>
<td>M3</td>
<td>2.7m</td>
<td>6.8%</td>
</tr>
<tr>
<td>M4</td>
<td>6.8m</td>
<td>10.2%</td>
</tr>
</tbody>
</table>

Key Leasing transactions Q2 2018

<table>
<thead>
<tr>
<th>ADDRESS</th>
<th>SIZE (SQ FT)</th>
<th>OCCUPIER</th>
<th>RENT (PSF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chineham Gate, Chineham Park</td>
<td>49,255</td>
<td>Vyaira</td>
<td>£21.00</td>
</tr>
<tr>
<td>1 Lyric Square, Hammersmith</td>
<td>39,845</td>
<td>The Office Group</td>
<td>N/A</td>
</tr>
<tr>
<td>One Gloseide, Marlow</td>
<td>38,306</td>
<td>Amicus Therapeutics</td>
<td>£26.00</td>
</tr>
<tr>
<td>Interchange (2nd &amp; 3rd frs), Croydon</td>
<td>37,388</td>
<td>confidential</td>
<td>£32.00</td>
</tr>
<tr>
<td>1m Magistrates Court, Richmond upon Thames</td>
<td>37,000</td>
<td>William Grant &amp; Sons</td>
<td>£23m (sale)</td>
</tr>
</tbody>
</table>

*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.

Knight Frank Research

Source for all charts: Knight Frank Research
DEMAND

5.8m sq ft
OF ACTIVE NAMED DEMAND
IN THE SOUTH EAST

DEVELOPMENT

0.9m sq ft
SPACE UNDER CONSTRUCTION
IN THE SOUTH EAST

*This includes pre-let (0.7m sq ft) and space (0.2m sq ft)

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

Source for all charts: Knight Frank Research

PRIME RENTS

Active named demand

Energy & Utilities 3%
Public Sector 4%
Construction & Engineering 4%
Pharmaceutical/Healthcare/Medical 14%
Retail, Distribution & Transport 18%
TMT 30%

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

Rent
Growth (pa)
INVESTMENT MARKET

Investment volumes at mid-year were 26% ahead of the 10-year average for the period. Competitive pressure continues to build for prime opportunities.

22% South East transaction volume
£544m

£22.7m Mean lot size

5.00% Prime net initial yield

85% Buyers from the UK

FIGURE 3
Investment volumes

Stock Transacted (£m), LHS
No. of deals, RHS

TIM SMITHER
In the South East we continue to see buyers attracted to income as property offers a stable return against other asset classes. We expect this to continue for the foreseeable future.

FIGURE 4
Prime net initial yield and finance

Prime net initial yield, LHS
5 year swap, RHS

SIMON RICKARDS
Genuine rental growth potential is driving pricing in prime town centre locations. The rationale? Invest in the right building in the right location and the current letting prospects support the potential to achieve prime rental tones.

Key investment transactions Q2 2018

<table>
<thead>
<tr>
<th>BUILDING</th>
<th>PRICE (£m)</th>
<th>NET INITIAL YIELD</th>
<th>VENDOR</th>
<th>PURCHASER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pinetrees, Staines</td>
<td>£80.70</td>
<td>Undisclosed</td>
<td>Aberdeen Standard Investments</td>
<td>Runnymede Council</td>
</tr>
<tr>
<td>Cambridge Research Park, Cambridge</td>
<td>£78.01</td>
<td>5.98%</td>
<td>Rockspring Property Managers</td>
<td>RLAM</td>
</tr>
<tr>
<td>White Building, Reading</td>
<td>£50.25</td>
<td>5.73%</td>
<td>Boulbee Brooks / CBREGI</td>
<td>Aberdeen Standard</td>
</tr>
<tr>
<td>Volkswagen Financial Services Uk, Milton Keynes</td>
<td>£50.15</td>
<td>4.83%</td>
<td>UK and European</td>
<td>Runnymede Council</td>
</tr>
<tr>
<td>Sigma House, Basildon</td>
<td>£28.25</td>
<td>6.55%</td>
<td>Legal &amp; General Property Ltd</td>
<td>Black Sand Real Estate Investments Ltd</td>
</tr>
</tbody>
</table>

Source for all charts: Knight Frank Research

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Research
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 June 30th 2018.

Knight Frank Commercial Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

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