

RESEARCH



M25 OFFICES

INVESTMENT, DEVELOPMENT &
OCCUPATIONAL MARKETS **Q2 2019**



EXECUTIVE SUMMARY

Deal rate maintained although leasing volumes reduced

Leasing volumes in the South East reached 622,352 sq ft in Q2, 23% below the 10-year quarterly average. Consequently, take-up at the mid-point of the year nudged 1.3m sq ft, 9% below the 10-year average for an H1 period. Although ongoing political uncertainty has meant that the market is experiencing greater caution, the lower level of space let is deceptive. With 102 transactions completed in the first six months of 2019, the deal rate in H1 2019 is consistent with the long-term trend for the period.

Latent 'mid-range' demand to drive activity in H2

Although overall deal rate is steady, requirements for 10,000 sq ft – 50,000 sq ft have been fewer in 2019. At the H1 juncture, 41 transactions have completed within this size bracket. This is 27% less than recorded in H1 2018 and 15% below the 10-year average for the period. Nonetheless, at the close of Q2, just below 600,000 sq ft was under offer. Of this total, 70% falls within the 'mid-range' size bracket.

Market activity contrasts at the mid-year juncture

The experiences of the South East market is somewhat polarised. At mid-year, the M3 is well ahead of its respective 10-year average (31%), with 486,654 sq ft transacted so far in 2019. Similarly, the M4 remains consistent with the long-term trend. Take-up has reached 704,115 sq ft, 5% above the 10-year average for the period.

In contrast, although an improvement was noted in Q2, deal number and take-up in the M25 were well short of the long term trend. A total of 59 transactions have completed in the first six months of 2019, short of the 10-year average of 70. Furthermore, just 613,870 sq ft has transacted. This is 38% below the 10-year average and is the lowest total recorded for an H1 period.

Subdued volumes but sustained demand

South East office investment volumes reached £357 million in Q2 2019, 41% below the 10-year quarterly average. This meant that with 70% of deals completed below £20m, investment volumes in H1 2019 reached £785m. This is 37% less when compared to the same point in 2018 and 24% below the 10-year average for an H1 period. Similar to the leasing market however, deal number has remained consistent with the long-term trend, with 44 transactions completed.

Buyer pool diversifying

Although UK councils remain the principal buyer of South East offices in 2019, capital sources continue to broaden. Council spending on South East offices represents 34% of the market in H1 2019. Importantly, private equity interest is increasing. This buyer group, largely absent from the market in 2018, accounted for 14% of investment volumes at mid-year.

Yield shift ahead?

Prime yields remained unchanged at 5.00% in Q2, albeit a lack of available prime stock to recycle capital is limiting transactions. There is evidence to suggest that secondary yields are beginning to move out given the uncertain political environment, with some buyers becoming more risk averse.

“Continued political uncertainty has encouraged a 'wait and see' stance to date for many occupiers.”

OCCUPIER MARKET

Ongoing political uncertainty continued to undermine market appetite in Q2 although deal rate is comparative to trend. Vacancy levels remain well below the long-term average meaning occupier choice is becoming limited.

SOUTH EAST TAKE-UP

622k
sq ft

▼ -49%



TAKE-UP (SQ FT)

M25 434,052 ▲ 141%
New and Grade A space 95%

M3 265,210 ▲ 20%
New and Grade A space 100%

M4 272,453 ▼ -37%
New and Grade A space 96%



SUPPLY (SQ FT)

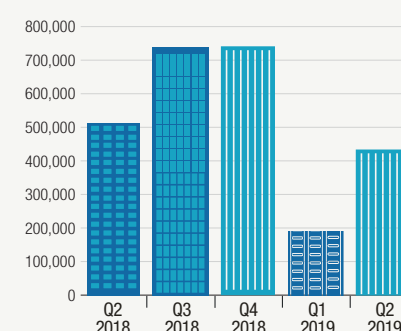
M25 6.6m ▼ -5%
New and Grade A space 73%
Vacancy rate** 5.5%
4.0%

M3 2.3m ▼ -5%
New and Grade A space 83%
5.8%
4.8%

M4 5.5m ▲ 7%
New and Grade A space 81%
8.2%
6.6%

*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)



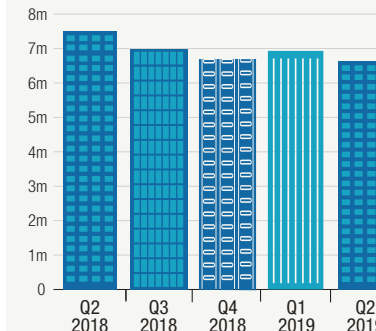
0.6m
UNDER OFFER
IN THE SOUTH
EAST IN Q2 2019



EMMA GOODFORD

Continued political uncertainty has created a 'wait and see' stance for many occupiers. If this underlying demand resurfaces in Q3 choice will be limited, with some markets experiencing the lowest vacancy rates on record.

FIGURE 2
M25 Supply (sq ft)



22%
BELOW THE
10-YR AVERAGE
IN Q2 2019



RODDY ABRAM

Despite market disruption, active demand is holding firm. As vacancy reduces further, the market imbalance could test the appetite of developers to begin the next wave of development.

Key transactions Q2 2019

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
West Works (5th flr), Hammersmith	50,431	Li & Fung	£52.00
50/60 Station Road (prt Grd & 1st flrs), Cambridge	48,365	WeWork	–
1 Causeway Park, Staines	46,695	Gartner	£34.50
5 The Square, Stockley Park (2nd & 3rd flrs)	36,633	Canon	£35.50

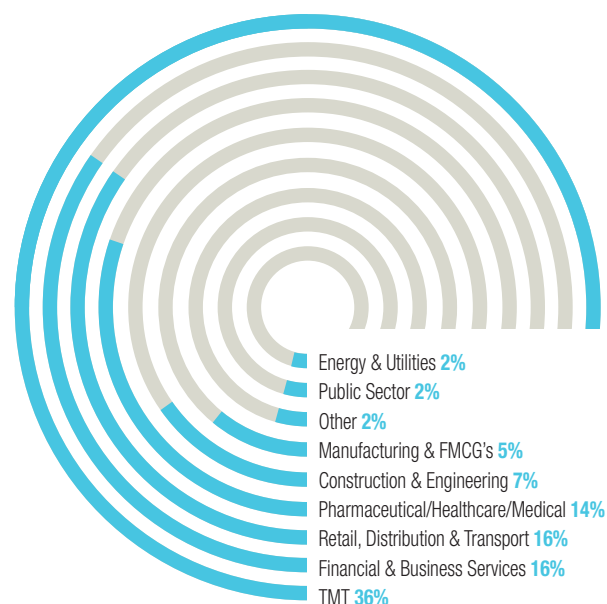
Source for all charts: Knight Frank Research

DEMAND

5.3msq ft
OF ACTIVE NAMED DEMAND
IN THE SOUTH EAST

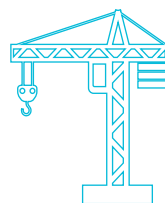


Active named demand



DEVELOPMENT

1.3msq ft
SPACE UNDER CONSTRUCTION
IN THE SOUTH EAST



*This includes pre-let (0.3m sq ft) and speculative space (1.0m sq ft)

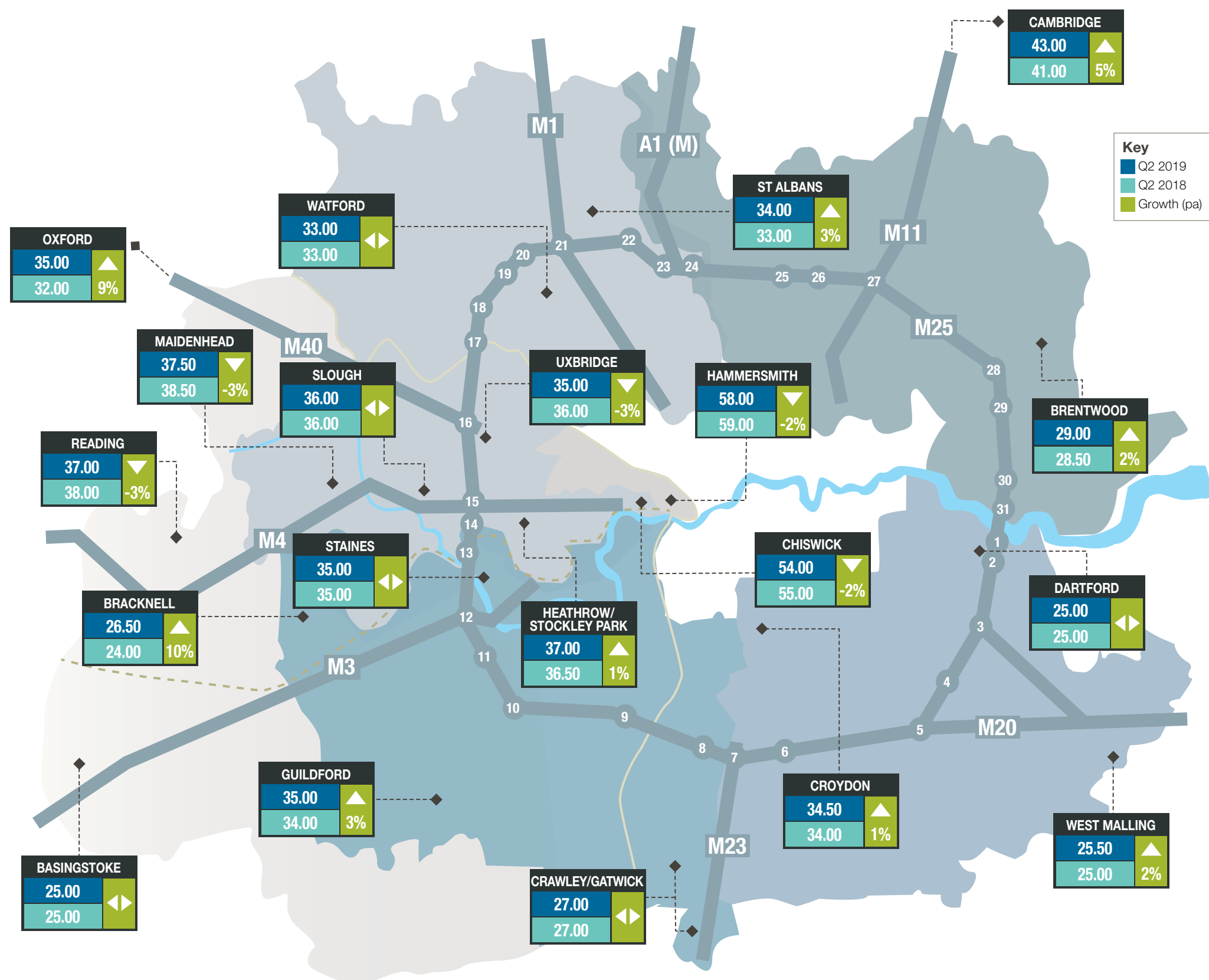
Speculative development (sq ft)

Due to complete before Q1 2020



Source for all charts: Knight Frank Research

PRIME RENTS



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

INVESTMENT MARKET

Alongside the challenges stemming from the political arena, a shortage of stock continues to frustrate investors. Pricing for prime stock remains solid, supported by the weight of capital targeting the South East.

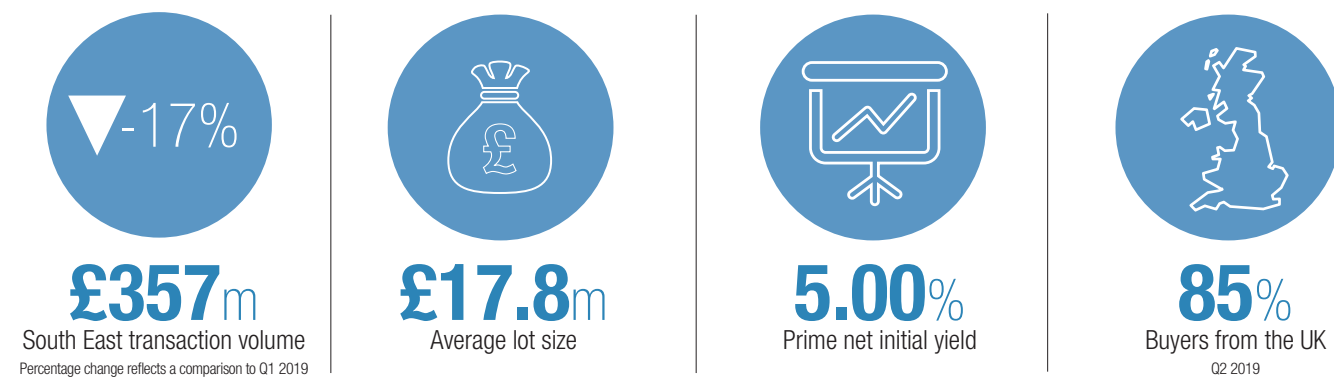
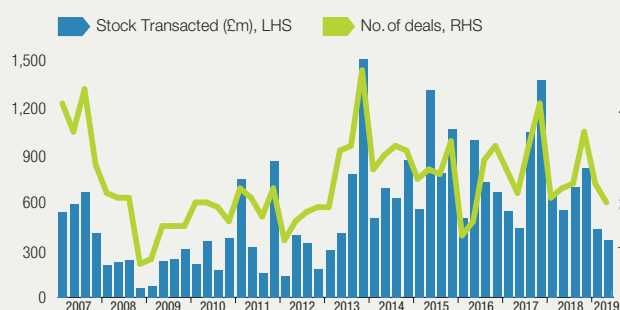


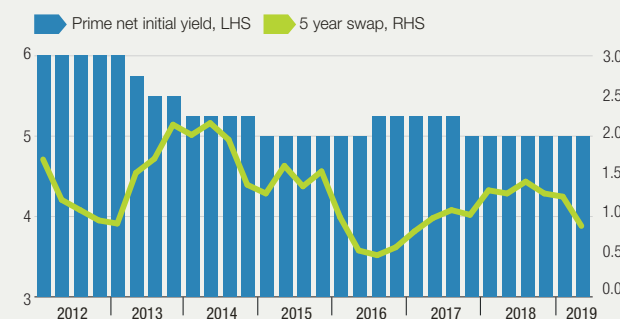
FIGURE 3
Investment volumes



TIM SMITHER

We are without a doubt in period of uncertainty, and volumes reflect this. That said, opportunities exist and we are seeing Institutional Funds continue to be active in the prime area of the market.

FIGURE 4
Prime net initial yield and finance



SIMON RICKARDS

In Q2 we have seen the emergence of Private Equity money. There seems to be real appetite to invest, with the amount of capital waiting to be deployed increasing.

Key investment transactions Q2 2019

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
1 - 3 Ironbridge, Stockley Park	£56.00	NA	GlaxoSmithKline	Prologis
Ditton Park, Slough	£41.30	7.50%	Broadcom	Kennedy Wilson
Four10, Thames Valley Park, Reading	£38.00	5.35%	Royal London Asset Management	Reading Borough Council
One Eton Street, Richmond	£34.00	5.50%	Aberdeen Standard Investments	Europa Capital Partners
Frimley4 Business Park, Frimley	£23.20	7.54%	Investream Ltd	Rushmoor Borough Council

Source for all charts: Knight Frank Research

CONTACTS

National Offices



EMMA GOODFORD
Partner
Head of National Offices
+44 20 7861 1144
emma.goodford@knightfrank.com



RODDY ABRAM
Partner
National Offices
+44 20 7861 1280
roddy.abram@knightfrank.com



WILL FOSTER
Partner
National Offices
+44 20 7861 1293
will.foster@knightfrank.com



ASHLEY DREWETT
Partner
National Offices
+44 20 7861 1156
ashley.drewett@knightfrank.com



ANDREW WOOD
Partner
National Offices – Tenant Rep
+44 20 7861 0662
andrew.wood@knightfrank.com

Capital Markets



RICHARD CLAXTON
Partner
Head of UK Capital Markets
+44 20 7861 1221
richard.claxton@knightfrank.com



TIM SMITHER
Partner
Head of National Offices Investment
+44 20 7861 1277
tim.smither@knightfrank.com



SIMON RICKARDS
Partner
Capital Markets
+44 20 7861 1158
simon.rickards@knightfrank.com

Research



WILLIAM MATTHEWS
Partner
Head of Commercial Research
+44 20 3909 6842
william.matthews@knightfrank.com



DARREN MANSFIELD
Partner
Commercial Research
+44 20 7861 1246
darren.mansfield@knightfrank.com

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 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 2019.

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