

RESEARCH



M25 OFFICES

INVESTMENT, DEVELOPMENT &
OCCUPATIONAL MARKETS **Q3 2018**



EXECUTIVE SUMMARY

◆ TAKE-UP TOPS 1M SQ FT FOR THE FIRST TIME IN THREE YEARS

Office take-up in the South East reached 1.2m sq ft in Q3, the highest quarterly total for three years. Consequently, take-up for the year increased to 2.7m sq ft, 30% ahead when compared to the equivalent period in 2017. Notably, 191 transactions had completed by the end of Q3. This total is 18% higher when compared to the same point in 2017 and is 28% ahead of the 10-year average for the period.

◆ BUOYANT M4

With the French advertising and public relations firm Publicis taking 211,000 sq ft at White City, take-up in the M4 rose to 880,067 sq ft, the highest quarterly total for eighteen years. This transaction detracted attention from the scale of market activity in Q3. During the quarter, 39 transactions were completed in the M4 corridor, a record total for the market. Interestingly, stripping out transactions in Hammersmith and Chiswick reveals that 2018 has been a very positive year for the core M4 locations. Take-up for the year in the core area had reached 1.1m sq ft by the end of Q3, the highest total recorded at the Q3 juncture for five years.

◆ QUALITY PREREQUISITE TO OCCUPIER REQUIREMENTS

The drive toward acquiring the best quality space continues to shape market activity. Analysis of take-up across the South East reveals that leasing volumes of Grade B space have dipped to 8.7% of the market in 2018, an all-time low. The effect of this trend is most acute in the M4 where just 3% of occupier transactions have involved Grade B property in 2018. This occupier focus on high quality space has meant that the spike in M4 vacancy, brought about by record levels of development in 2017, has quickly been eroded. As at Q3, vacancy in the M4 fell below the

10-year average of 9.5% to 9.2%. This is the lowest level since Q1 2017. Looking ahead, with only six speculative schemes totalling 433,000 sq ft scheduled to complete in the next 12 months, vacancy is forecast to dip below 8.5% by the end of 2019 providing a case for the next wave of new development.

◆ INVESTOR APPETITE HOLDING FIRM

South East office investment volumes increased by 27% in Q3 2018 to reach £693 million by quarter end. This total is 21% above the 10-year average for the region. This meant that at the Q3 mark, investment into South East offices had increased to £1.9bn. Although this is 17% less when compared to the same point in 2017, the total is 23% above the 10-year average for the period.

◆ UK COUNCILS SPENDING CONTINUES

The acquisition of Brockton's South East portfolio by Spelthorne Borough Council for £285m in Q3 provided further evidence of continued public sector spending on South East office assets. Considered over the first nine months of 2018, spending from this sector reached £725m by the close of Q3. Notably, this means that council spending represents 37% of the market in 2018 making the subsector the largest buyer group of the year so far.

◆ PRICING PRESSURE INCREASING

Prime yields remained at 5.00% in Q3, although prime reversionary assets are trading below this level. Expectations of future rental growth continues to underpin interest, with 30 out of 51 locations tracked across the South East market registering an uplift in prime rents in 2018, partly driven by a greater propensity toward 5-year lease terms or break options. In prime markets, with severe shortage of stock, competition is subsequently building, as investors look to deploy new funds or recycle capital.

OCCUPIER MARKET

Underpinned by several large transactions, occupier take-up passed 1m sq ft for the first time in three years in Q3. Speculative development remains limited. This coupled with falling vacancy means a supply shortage is looming.

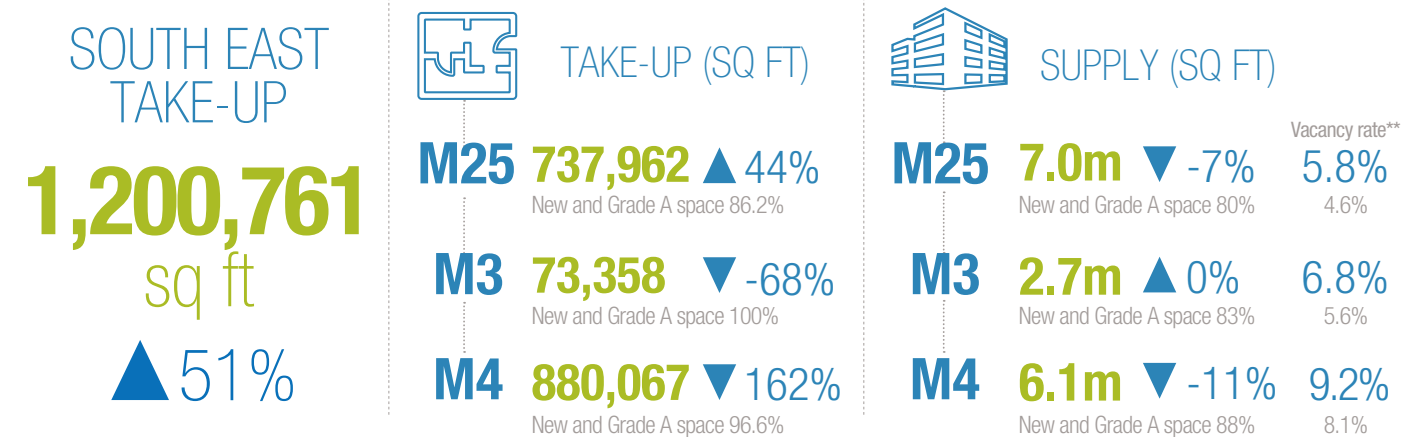
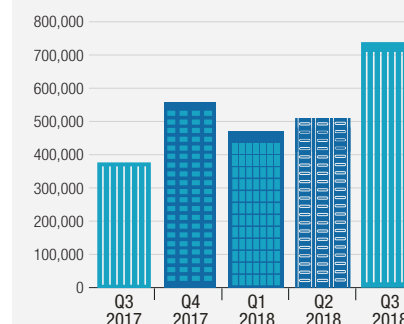


FIGURE 1
M25 Take-up (sq ft)



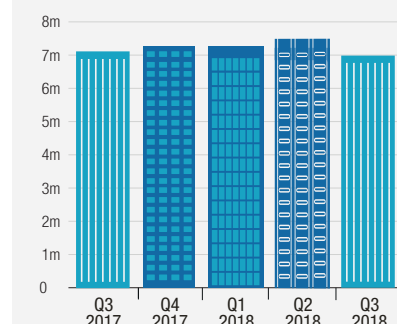
1.1m
UNDER OFFER
IN THE SOUTH
EAST IN Q3 2018



EMMA GOODFORD

Despite the challenges emanating from the political arena, we are seeing sustained interest in the South East office market. Notably, five transactions over 50,000 sq ft completed in Q3. This demonstrates not only that deals are happening frequently, but that they also have the potential to happen at scale.

FIGURE 2
M25 Supply (sq ft)



22%
BELOW THE
10-YR AVERAGE
IN Q3 2018



RODDY ABRAM

The scale of occupier activity in Q3 conveys positive sentiment across the South East. Whilst uncertainty lingers, strong demand and eroding supply continues to support stable rental tones. As vacancy reduces, the market imbalance will test the appetite of developers to begin the next wave of development.

Key Leasing transactions Q3 2018

ADDRESS	SIZE (SQ FT)	OCCUPIER	RENT (PSF)
2 Television Centre	211,175	Publicis	£50.00
25 Windsor Road	108,897	Slough Borough Council	£40m (FREEHOLD SALE)
Building 7, Chiswick Park (7th, 8th & 9th flrs)	85,274	Pernod Ricard	NA
410 Thames Valley Park	71,676	Sanofi	£31.00
2 Forbury Place	43,864	KPMG	£37.50

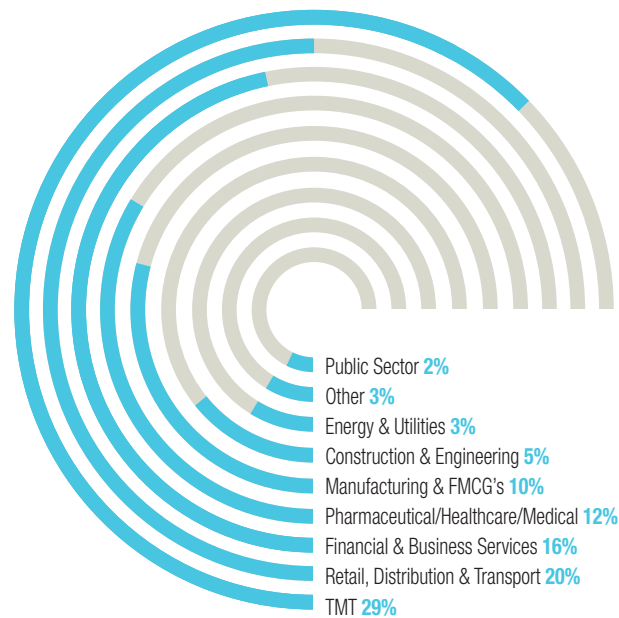
Source for all charts: Knight Frank Research

DEMAND

6.3msq ft
OF ACTIVE NAMED DEMAND
IN THE SOUTH EAST



Active named demand



DEVELOPMENT

0.8msq ft
SPACE UNDER CONSTRUCTION
IN THE SOUTH EAST



*This includes pre-let (0.1m sq ft) and speculative space (0.7m sq ft)

Speculative development (sq ft)

Due to complete before Q1 2019



M25
0.3m

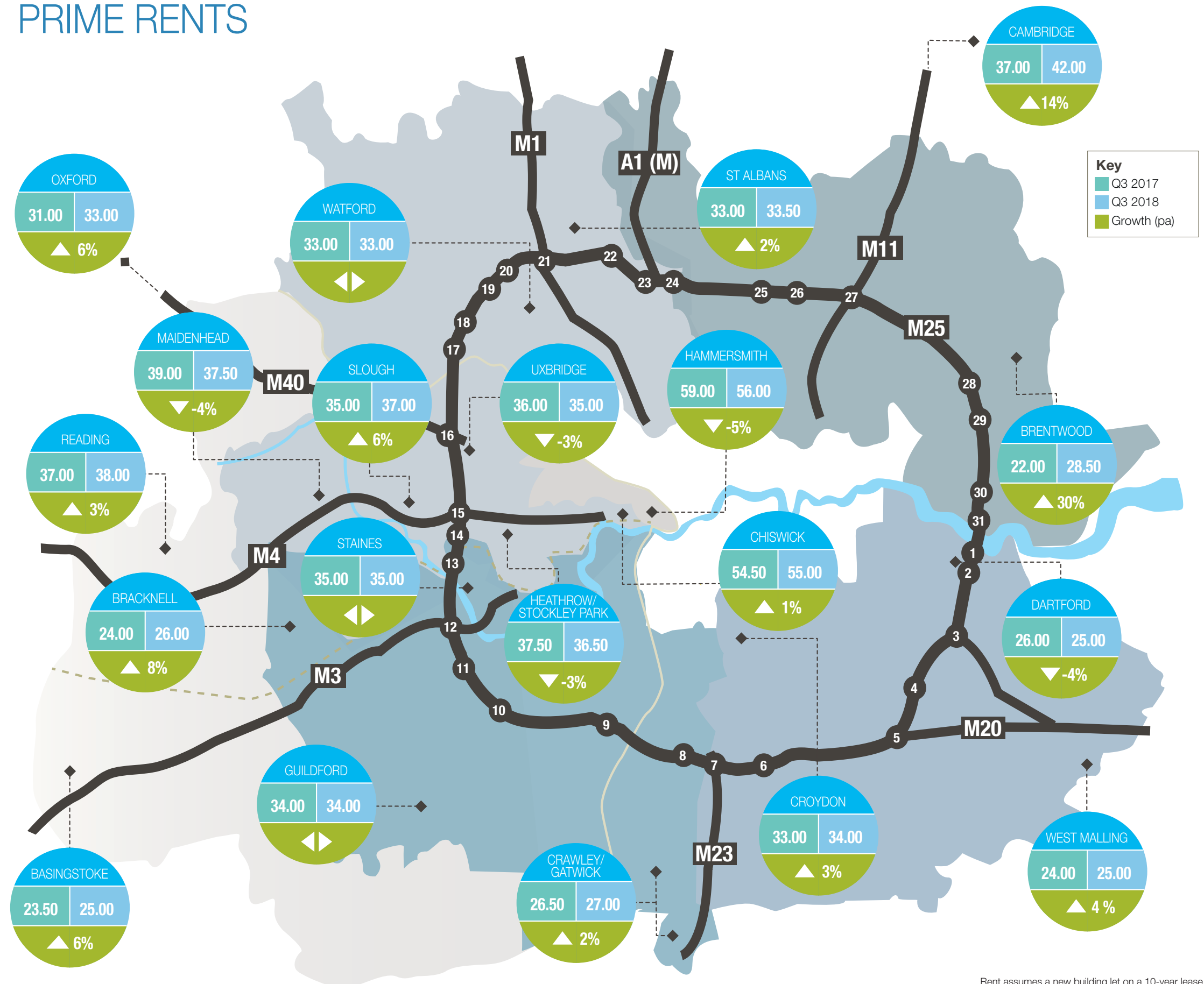


M3
0.3m



M4
0.4m

PRIME RENTS



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

INVESTMENT MARKET

Local authority spending on office stock continued to underpin investment volumes in the South East, with councils representing 37% of the market in 2018. Pricing remains stable, although levels are being tested for prime reversionary assets.

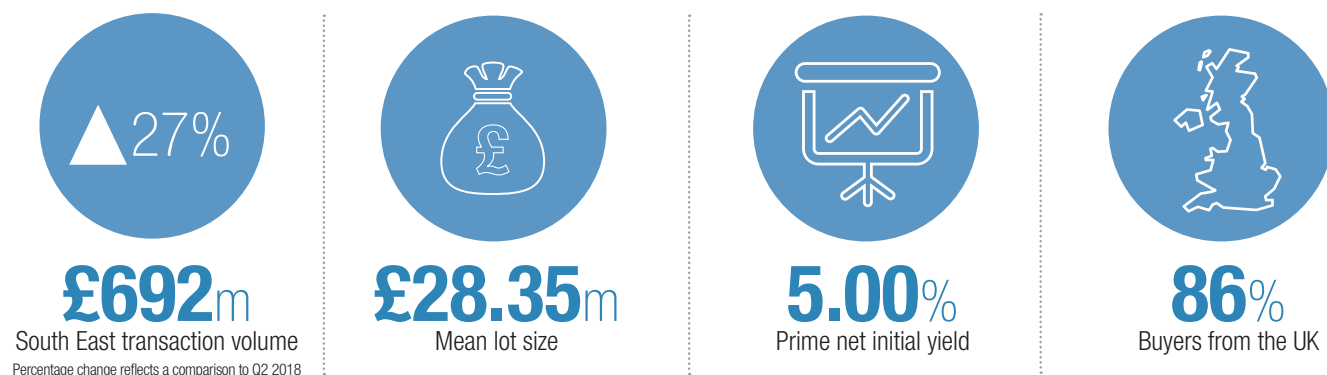
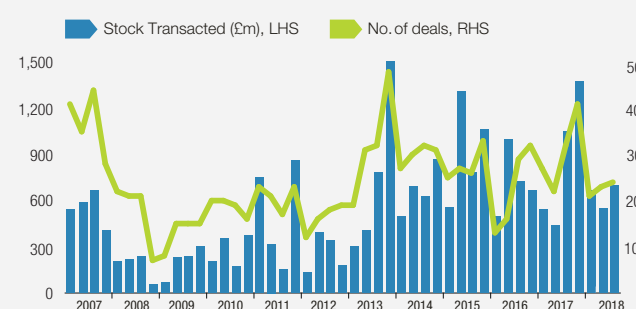


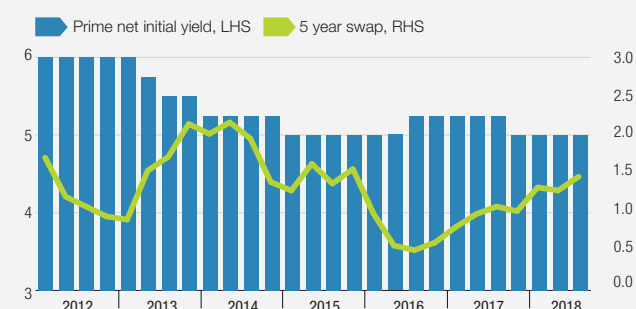
FIGURE 3
Investment volumes



TIM SMITHER

With plenty of capital looking to be deployed we predict an active end to the year, with the potential for volumes to reach £3 billion by year end.

FIGURE 4
Prime net initial yield and finance



SIMON RICKARDS

The South East market attract a global investor audience; however, UK councils continue to dominate transaction volumes. In fact, figures for 2018 show that Council spending makes up 37% of the market, an increase from 15% in 2017.

Key investment transactions Q3 2018

BUILDING	PRICE (£M)	NET INITIAL YIELD	VENDOR	PURCHASER
South East portfolio	£285m (Net)	5.00%	Brockton/Landid	Spelthorne Borough Council
Strata, Staines	£46.5m	6.00%	LaSalle IM	M&G Real Estate
Pinnacle House, Wimbledon	£41.00	5.40%	Aviva Investors	EPIC
TOR, Maidenhead	£35.03	5.75%	Blackrock / Rockspring	M&G Real Estate
4 The Square, Heathrow	£34.50	6.55%	Legal & General	Dimah Capital Investment Company

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 September 30th 2018.

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