RESEARCH

Q1 2011

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- The M4 and wider Thames Valley is leading the recovery in the South East market. In the M4, Q1 2011 take-up marginally exceeded the ten year quarterly average while, in the M25, it was 30% below average.
- Reflecting the satisfaction of several key requirements, active demand reduced by 14% during Q1 to stand at 5.08m sq ft. Manufacturing & Pharmaceuticals continues to account for the largest share, making up one third of total demand.
- Speculative development activity has increased, rising gradually from an historic low in Q3 2010. However, development will continue to be limited over the medium term and largely confined to prime locations in the Thames Valley.
- In the investment market, the £480m sale of Chiswick Park brought Q1 turnover to £743m, a level not seen since 2005/06. Prime yields remained at c. 6.25% in Q1, unchanged since Q4 2009. However, a degree of yield compression is expected by year end.

Demand and take-up

- M25 take-up in Q1 2011 was 452,031 sq ft, an increase of 15% on Q1 2010 but 30% below the ten year quarterly average. Q1's 41 deals in the M25 followed 35 in Q4 2010, indicating the improving depth of demand in the market.
- The Thames Valley markets are leading the recovery. In the M4, Q1 take-up was 415,965 sq ft, 82% above the Q1 2010 total and marginally higher than the 10 year quarterly average. New and Grade A space dominates M4 activity, accounting for 92% of take-up over the last 12 months, compared with an average of 79% previously.
- Maidenhead saw four deals involving new space in Q1, including the quarter's largest transaction. In the town centre, Adobe acquired 50,000 sq ft at Market Street, a scheme which completed in Q4 2010.
- Hammersmith and Reading also saw significant activity in Q1. In Reading, PRA International acquired 43,039 sq ft at 500 South Oak Way, Green Park, while Hammersmith saw four deals totalling 65,753 sq ft.
- The positive picture in the M4 contrasts with the M3, where Q1 take-up of 146,698 sq ft was 38% below the ten year quarterly average. Of the nine deals in Q1, the largest comprised ACT Foundation's freehold acquisition of Sabre, Camberley, totalling 36,430 sq ft.
- Information, Communications & Technology and Manufacturing & Pharmaceuticals drove take-up in Q1, accounting for 31% and 26% of take-up respectively across all markets combined.
- Active named demand reduced by 14% during Q1 to stand at 5.08m sq ft. Reflecting the satisfaction of several key requirements, ICT demand reduced by 26%, albeit this is forecast to recover in Q2. Manufacturing & Pharmaceuticals continues to account for the largest share of demand, at 33% of the total.

In Q1, PRA International acquired 43,039 sq ft at 500 South Oak Way, Green Park, at an agreed headline rent of £27.50 per sq ft.

Supply and development

- The M25 vacancy rate climbed for a fifth consecutive quarter in Q1, albeit marginally, from 8.4% to 8.5%. However, the share of availability made up by New and Grade A space has fallen steadily, from a peak of 71% in Q2 2010 to 64% in Q1 2011, its lowest since Q2 2007.
- Reflecting the recovery in the Thames Valley, the M4 vacancy rate fell from 11.7% to 11.5% during Q1. Here, the supply of New and Grade A space has decreased by 10% since peaking in Q1 2010, set against a 31% increase of Grade B space over the period.
- The M3 vacancy rate also fell marginally during Q1, from 8.1% to 7.9%. Although take-up was subdued, very little stock was released to the market in the quarter. Poorer quality Grade B space currently makes up 45% of total M3 availability, compared with just 23% in the M4.
- Speculative development activity has increased over the last two quarters from a ten year low in Q3 2010. Following the commencement of BAM Property's Chiswick Green in Q4 2010, Q1's sole construction start comprised Rockspring and Bell Hammer's The Stanza Building, Uxbridge, totalling 78,850 sq ft.
- However, speculative development activity is set to remain highly selective over the next three years, with only 12 schemes in the pipeline likely to progress. 90% of this space is located in prime Thames Valley markets, where the supply of New and Grade A stock is limited.

Figure 1
M25 take-up

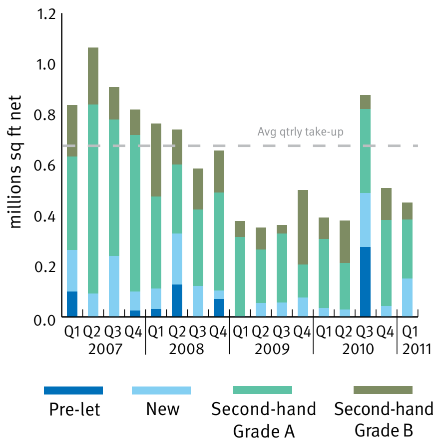


Figure 2
M4 take-up

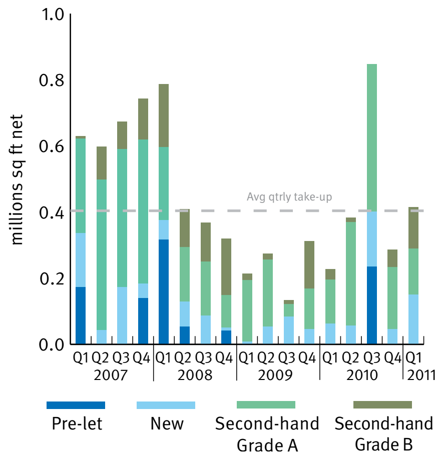
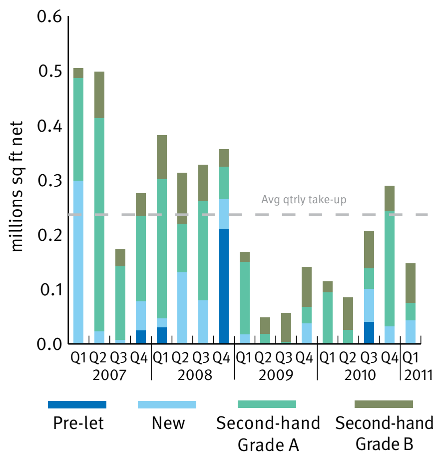


Figure 3
M3 take-up



Source: Knight Frank Research

Market statistics

Table 1
Key town prime rents & forecasts

Town	Q1 prime rent (psf)	Rent free (months)
Basingstoke	£18.00 ▶	33 ▼
Bracknell	£20.00 ▶	39 ▶
Brentwood	£21.00 ▶	21 ▶
Chiswick	£35.00 ▲	21 ▶
Croydon	£20.00 ▲	33 ▶
Gatwick	£21.50 ▶	30 ▲
Guildford	£27.00 ▲	24 ▼
Hammersmith	£31.50 ▲	21 ▼
Heathrow	£27.50 ▶	30 ▼
Maidenhead	£29.50 ▲	24 ▼
Reading	£30.00 ▶	24 ▼
Slough	£20.00 ▶	36 ▶
Staines	£28.00 ▲	24 ▼
St Albans	£22.00 ▲	24 ▶
Uxbridge	£28.00 ▲	24 ▶
Watford	£21.00 ▲	30 ▶
West Malling	£21.00 ▶	21 ▶

Based on new/Grade A building:
10,000 sq ft, 10 yr lease with no breaks
Note: ▲ = forecast for next 12 months

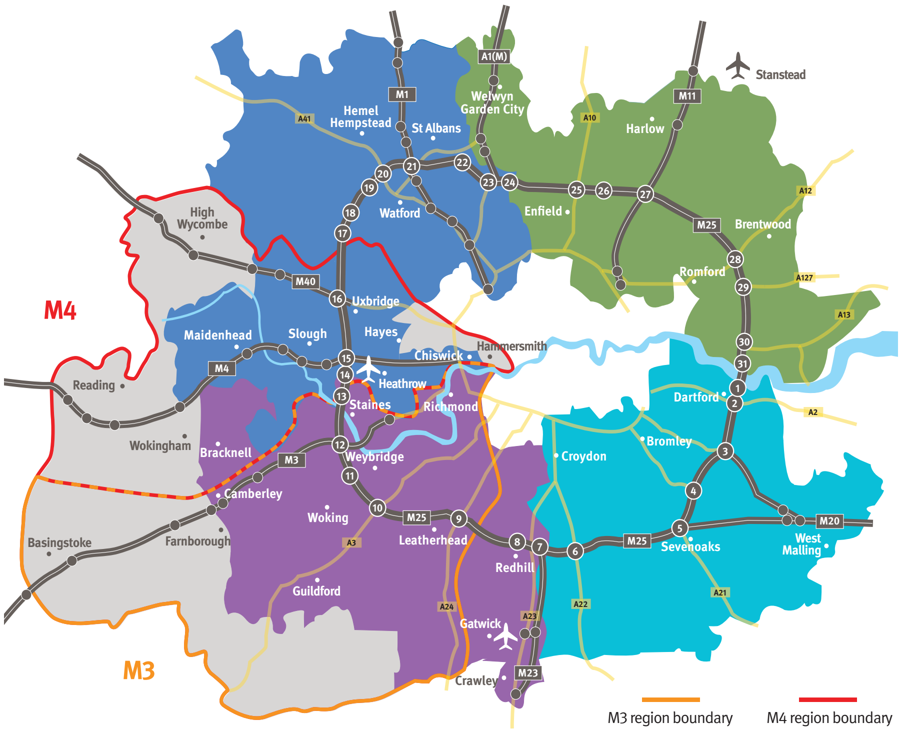


Table 2
Demand & Supply

Take-up	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft	**452,031**	196,095	213,209	22,927	19,800	**146,698**	**415,965**
Change Q1 11 vs Q4 10	**-11%** ▼	-4% ▼	-29% ▼	100 ▲	277% ▲	**-49%** ▼	**45%** ▲
Change Q1 11 vs Q1 10	**15%** ▲	30% ▲	23% ▲	337% ▲	-69% ▼	**29%** ▲	**82%** ▲
Q1 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q1 % take-up new & pre-let	**33%**	53%	29%	0	25%	**29%**	**36%**
Forecast 2011 take-up (m sq ft)	**2.3**	–	–	–	–	**0.6**	**1.8**

Availability	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft	**11,067,983**	5,119,444	4,401,596	534,035	1,012,908	**3,337,291**	**7,507,251**
Change Q1 11 vs Q4 10	**1%** ▲	1% ▲	-1% ▼	10% ▲	7% ▲	**-2%** ▼	**1%** ▲
Change Q1 11 vs Q1 10	**6%** ▲	3% ▲	11% ▲	-1% ▼	1% ▲	**0%** ◀▶	**-1%** ▼
Q1 % new	**14%**	14%	16%	10%	7%	**14%**	**24%**
Q1 % second-hand Grade A	**50%**	56%	48%	47%	31%	**41%**	**53%**
Q1 % second-hand Grade B	**36%**	30%	36%	43%	62%	**45%**	**23%**
Q1 vacancy rate (▲/▼ movement from Q4 10)	**8.5%** ▲	10.2% ▲	10.7% ▼	3.0% ▲	5.0% ▲	**7.9%** ▼	**11.5%** ▼

Under construction	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft (net approx)	**268,894**	160,394	108,500	0	0	**108,500**	**160,394**
Change 12 months	**16%** ▲	-7% ▼	100% ▲	–	-100% ▼	**-48%** ▼	**-57%** ▼
Pre-let	**40,000**	0	40,000	0	0	**40,000**	**0**

Source: Knight Frank Research

Figure 4
M25 active named enquiries by sector

Active demand is 5.09m sq ft at Q1 2011	
Manufacturing & Pharmaceuticals	33%
ICT	18%
Financial & Business Services	18%
Retail, Distribution & Transport	11%
Public Sector	6%
Construction & Engineering	5%
Other	9%

An artist's impression of The Stanza Building, Uxbridge. Rockspring and Bell Hammer commenced construction of the 78,850 sq ft scheme in Q1.

FORECAST AT A GLANCE

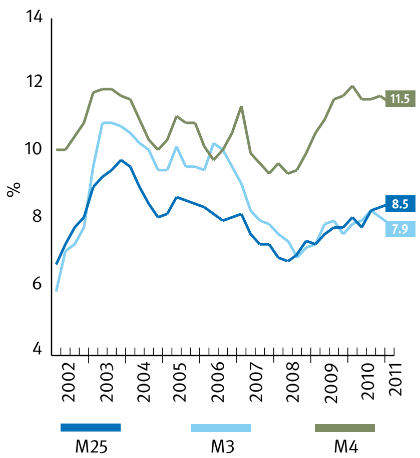
Take-up:

- In the M25, we forecast take-up of 2.3m sq ft in 2011, a 5% increase on 2010. This reflects improving occupier confidence and more transactions in the core 10,000 to 25,000 sq ft market. Key locations in the Thames Valley will continue to lead the recovery, providing the focus for take-up and the best prospects for short term rental growth.
- However, our 1.8m sq ft forecast for M4 take-up in 2011 is on a par with 2010's total. While the frequency of transactions is expected to show marked improvement, we do not anticipate another round of major, 100,000 sq ft plus deals which crucially underpinned M4 take-up in 2010.
- In the M3, Q1's subdued activity is in line with our forecast for 0.6m sq ft take-up in 2011, a fall of 15% on 2010's total. Demand in the mid-section of the M3 market, stretching from Camberley to Basingstoke, will remain thin, although notable exceptions exist elsewhere, with better prospects for Staines and prime Surrey towns such as Weybridge and Guildford.

Supply and rents:

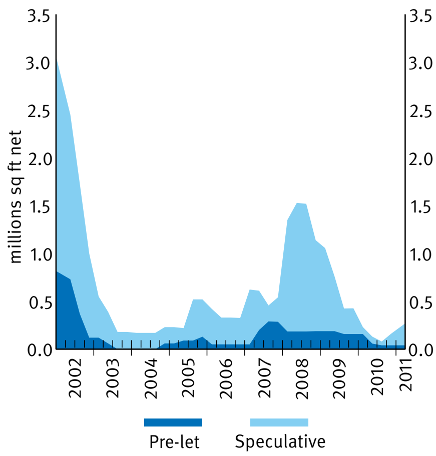
- Vacancy rates are expected to remain relatively stable over the next 18 months, with the steady absorption of New and Grade A supply counterbalanced by a rise in Grade B space. With development completions likely to be limited over the next two years, the New and Grade A vacancy rate (i.e. excluding Grade B) is on course to reach a twelve year low of 4% by 2013.
- The pattern of falling headline rents is firmly behind us, with Q1 transactional evidence indicating a hardening of rent free incentives in the most active markets. Over the coming 12 months, headline rental levels will be broadly flat although hotspots of growth are expected in locations characterised by critically low levels of Grade A space in context with recent take-up.
- These hotspots are located in the Thames Valley, stretching to the West of London. Key towns to watch include Richmond (0.9 years supply), Uxbridge (1.2 years supply), Staines (1.8 years supply) and Hammersmith (2.5 years). Consequently, speculative development can be justified in these areas over the next 24 months, finance permitting.

Figure 5
Vacancy rates



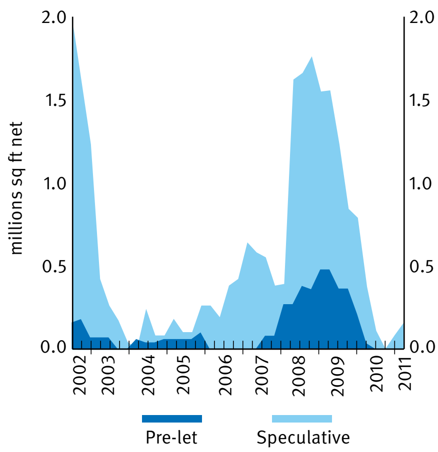
Source: Knight Frank Research

Figure 6
Space under construction in the M25



Source: Knight Frank Research

Figure 7
Space under construction in the M4



Source: Knight Frank Research

Investment market

Table 3
Key investment transactions Q1 2011

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
Chiswick Park, Chiswick	1,124,408	£480.0m	6.35%	Schroders / Blackstone
CB1, Cambridge	83,582	£37.10m	6.00%	Brookgate Ltd / Orchard Street
5 The Square, Stockley Park, Heathrow	71,653	£24.50m	8.75%	IVG / Oxygen Asset Management
CT2 & CT3 Centrium, St Albans	47,016	£13.38m	7.54%	Orchard Street / ING
Bourne House, Staines	26,300	£8.38m	9.21%	Greater Manchester Pension Fund / Standard Life

	Transaction volume	Mean lot size	Mean NIY
Q1 2011	£743.16m	£32.31m	7.12%
Change 3 mths	101% ▲	101% ▲	-104bps ▼
Change 12 mths	263% ▲	215% ▲	-101bps ▼

INVESTMENT VIEW

- Blackstone's £480m purchase of Chiswick Park in Q1 ranks as the biggest ever office deal in the South East investment market. Taken alone, it accounted for 65% of Q1 turnover, boosting the total to £743m, the highest quarterly total since Q4 2006.
- Another major deal is in the pipeline, with PRUPIM expected to sell Green Park, Reading, to another overseas investor in the next few months. These deals underline the strength of investor appetite for large lot-sizes offering asset management opportunities in proven locations.
- Despite the headlines generated by Chiswick Park, sentiment was broadly unchanged in the first quarter. With buying opportunities in short supply, prime yields held steady at c. 6.25% in Q1, a level unchanged since Q4 2009. However, with signs that spending pressure is increasing, prime yields are expected to harden by 25bps to c. 6.00% by the year end.
- Interest in short income, prime assets has strengthened among UK Funds, reflected in a 25bps hardening of yields to 7.50% in Q1. This improving sentiment is linked to a more optimistic assessment of medium term occupier performance, albeit confined to prime locations in the South East, such as key Thames Valley towns and Cambridge.


In Q1, Blackstone purchased Chiswick Park from Schroders for £480m, reflecting a net initial yield of 6.35%.

Figure 8
£m investment volumes and lot size

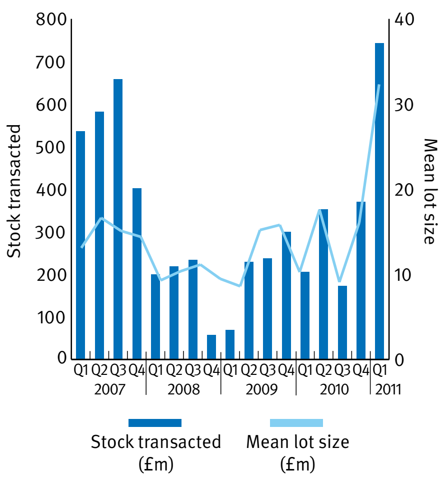


Figure 9
Mean initial yield & finance

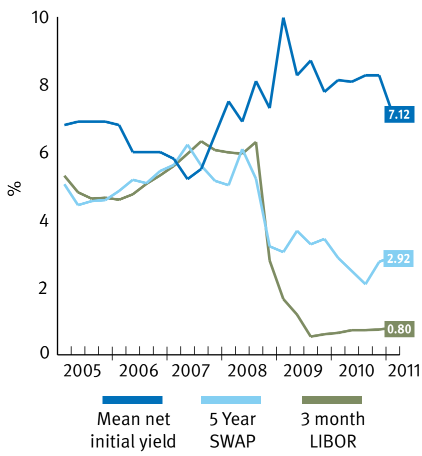
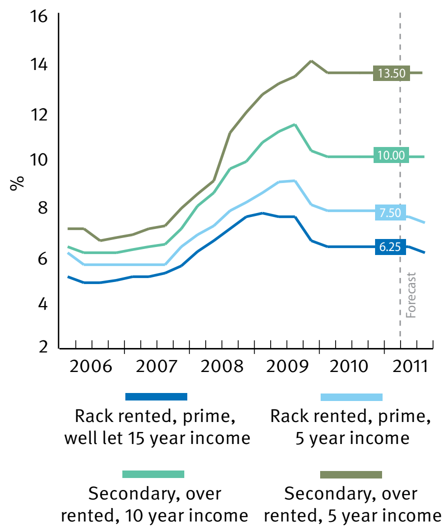


Figure 10
Yield forecasts



Source: Knight Frank Research

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Commercial Research
James Roberts
Partner, Head of Commercial Research
+44 (0) 20 7861 1239
james.roberts@knightfrank.com

Oliver du Sautoy Associate
+44 (0) 20 7861 1592
oliver.dusautoy@knightfrank.com

Investments
Peter MacColl
Partner, Head of Investments
+44 (0) 20 7861 1211
peter.maccoll@knightfrank.com

Tim Smither Partner
+44 (0) 20 7861 1227
tim.smither@knightfrank.com

South East Offices
Emma Goodford
Partner, Head of South East Offices
+44 (0) 20 7861 1144
emma.goodford@knightfrank.com

Will Foster Partner
+44 (0) 20 7861 1293
will.foster@knightfrank.com

Landlord and Tenant
John Woolsey Partner
+44 (0) 20 7861 1142
john.woolsey@knightfrank.com

Ashley Drewett Partner
+44 (0) 20 7861 1156
ashley.drewett@knightfrank.com

Technical Note

- Knight Frank define 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 62,392,070 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. Existing built office stock in the M3 market totals 41,927,373 sq ft.
- 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.
- The market definition used, shown in the map on page 3, is based on Local Authority District boundaries.
- 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 128m sq ft (net), an M4 market stock of 63m sq ft (net) and an M3 market stock of 42m sq ft (net).
- 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.
- 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 2011.

Front cover image: Staircase at 500 South Oak Way, Green Park, Reading

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