RESEARCH

Q2 2010

M25 OFFICES

Investment, development & markets

Knight Frank

HIGHLIGHTS

- Q2 take-up in the M25 fell by a marginal 3% from Q1, while in the M3 it fell by 25% to just over a third of its long-term average level. In contrast, Q2 take-up rebounded significantly in the M4, rising 39% from Q1 to just 4% below the average.
- Active demand reduced by only 1% during Q2 following Q1's 29% rise. Manufacturing & Pharmaceuticals demand is up 60% from a year ago and makes up nearly one third of the total.
- The vacancy rate fell in both the M25 and the M4 in Q2, the latter following seven successive quarterly rises. With few schemes now left to complete, vacancy rates are now set to follow a downward trend, influenced only by the prospect of tenant released space.
- In the investment market, Q2's volume of £352m was a considerable 72% improvement on Q1, albeit sentiment cooled in the latter weeks of the quarter. Prime yields stabilised at 6.25% following a period of inward shift which began a year ago in Q2 2009.

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M25 market

- M25 take-up in Q2 was 380,263 sq ft, down a marginal 3% on Q1, but improving by 7% on the same quarter last year. However, Q2's 20 transactions compares to 31 in Q1, with Q2's average deal size of 19,031 sq ft 50% higher than the Q1 average.
- The largest transaction was Celgene's 75,000 sq ft acquisition at 1 Longwalk Road, Stockley Park, Heathrow at an agreed rent of £27.00 per sq ft. Of the four deals involving new space, only one exceeded 10,000 sq ft; Hospedia's 12,136 sq ft acquisition at Landmark Place, Slough at an agreed rent of £20.00 per sq ft.
- Second-hand Grade B space accounted for a sizeable 44% of Q2 take-up, twice the long term average proportion, due in part to London and Quadrant Housing Association's 58,833 sq ft acquisition at Cray House, Sidcup. This one deal also made up close to two thirds of total take-up in the South East quadrant.
- Following Q1's dramatic 29% rise, active named demand fell by just 1% during Q2 to stand at 6.39m sq ft. Manufacturing & Pharmaceuticals demand is up 60% on this time last year while, unsurprisingly, Public Sector demand has more than halved over the same period.
- The M25 vacancy rate fell from 8.1% in Q1 to 7.8% in Q2, its first fall since Q1 2009. This has resulted from the lowest amount of space being added to the market in any quarter in over two years, with tenant released space 42% below the quarterly average and landlord released space 55% below average.
- Speculative development has virtually ceased with Shepherd Development's 74,600 sq ft Market Street scheme in Maidenhead the only one still to be completed from the last cycle.

In Q2, Promethean acquired 8,431 sq ft at Clarion House in Maidenhead.

KNIGHT FRANK VIEW

- Take-up in the first half of 2010 has been as subdued as it was in 2009. However, with circa 1.2m sq ft presently under offer across the South East, take-up will rise in the latter half of 2010 putting it into line with our forecast for 1.85m sq ft for 2010 in total, a 15% improvement on 2009's low. Assuming the economic recovery remains on track, take-up is forecast to increase again in 2011 and 2012 with circa 5m sq ft of breaks and lease expiries anticipated over the period.
- Although activity is expected to improve gradually over the next 12 months, generally speaking, rental levels are forecast to remain flat until circa Q4 2011. However, particular centres characterised by robust levels of active demand combined with an undersupply of good quality space may show modest rental growth from early 2011. Examples include Uxbridge and Guildford.
- The fall in Q2's vacancy rate marks the start of a broadly downward trend in supply which is expected to continue for two years. While pre-letting activity may selectively occur for larger schemes, a fresh round of speculative development is unlikely for several years and, consequently, we expect vacancy rates to fall to circa 6% by end 2012.

Figure 1
M25 take-up

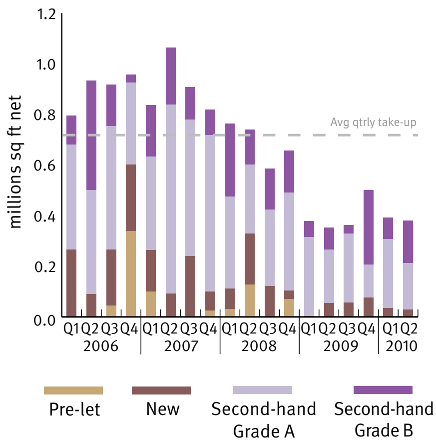


Figure 2
Space under construction in the M25

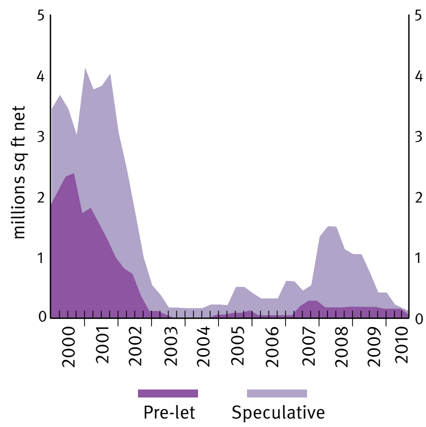
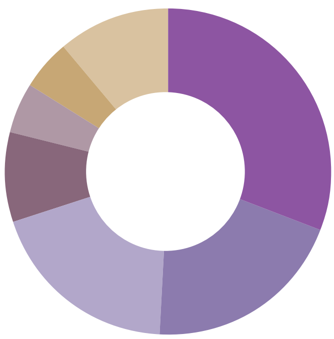


Figure 3
M25 active named enquiries by sector



Manufacturing & Pharmaceuticals	31%
ICT	20%
Financial & Business Services	19%
Retail, Distribution & Transport	9%
Public Sector	5%
Construction & Engineering	5%
Other	11%

Source: Knight Frank Research

Market statistics

Table 1
Key town prime rents & forecasts

Town	Q2 prime rent (psf)	Rent free (months)
Basingstoke	£18.00 ▼	32 ▲
Bracknell	£19.00 ▶	36 ▶
Brentwood	£21.00 ▶	18 ▶
Gatwick	£21.50 ▶	24 ▶
Guildford	£26.50 ▶	24 ▶
Hammersmith	£30.00 ▶	24 ▶
Heathrow	£27.00 ▶	33 ▶
Reading	£28.50 ▶	24 ▶
St Albans	£21.50 ▶	30 ▶
Uxbridge	£25.00 ▲	30 ▶
Watford	£21.00 ▶	30 ▶
West Malling	£21.00 ▶	18 ▶

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

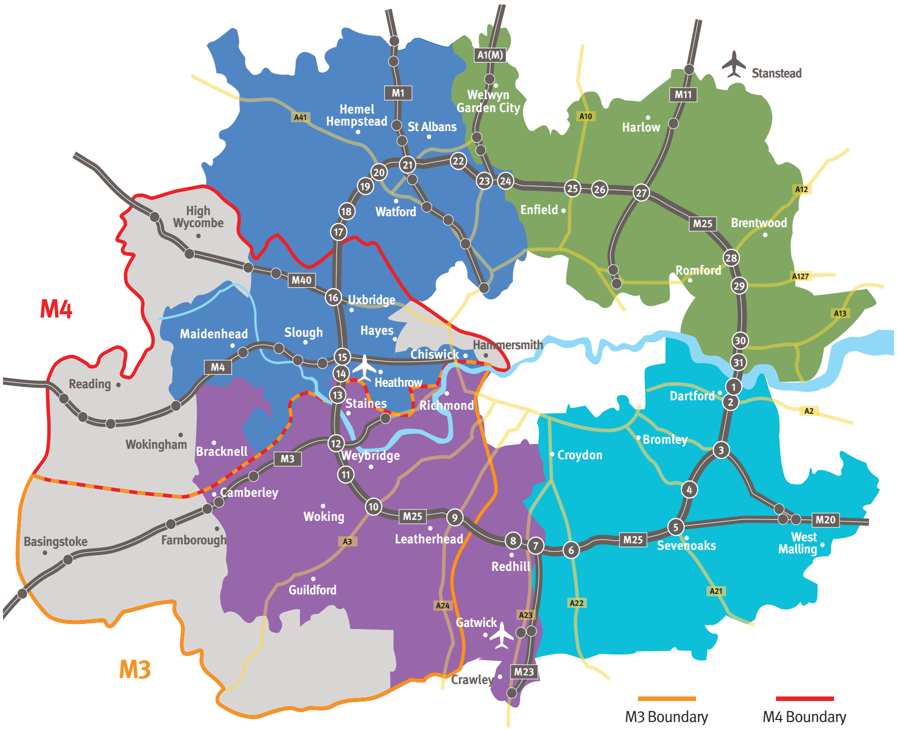


Table 2
Demand & Supply

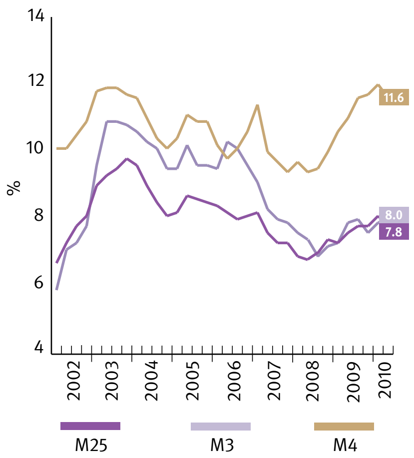
Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**380,263**	179,862	109,278	0	91,123	**85,324**	**382,809**
Change Q2 10 vs Q1 10	**-3%** ▼	20% ▲	-37% ▼	-100% ▼	42% ▲	**-25%** ▼	**67%** ▲
Change Q2 10 vs Q2 09	**7%** ▲	24% ▲	110% ▲	-100% ▼	78% ▲	**77%** ▲	**39%** ▲
Q2 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q2 % take-up new & pre-let	**8%**	11%	8%	0%	0%	**30%**	**15%**
Forecast 2010 take-up (m sq ft)	**1.85**	–	–	–	–	**0.65**	**1.35**

Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**10,158,621**	4,729,740	4,042,144	448,427	938,310	**3,364,496**	**7,390,514**
Change Q2 10 vs Q1 10	**-3%** ▼	-5% ▼	2% ▲	-17% ▼	-7% ▼	**1%** ▲	**-4%** ▼
Change Q2 10 vs Q2 09	**3%** ▲	-1% ▼	9% ▲	1% ▲	4% ▲	**1%** ▲	**6%** ▲
Q2 % new	**19%**	19%	23%	18%	8%	**23%**	**29%**
Q2 % second-hand Grade A	**52%**	58%	50%	39%	34%	**39%**	**54%**
Q2 % second-hand Grade B	**29%**	23%	27%	43%	38%	**38%**	**17%**
Q2 vacancy rate (▲/▼ movement from Q1 10)	**7.8%** ▼	9.4% ▼	9.9% ▲	2.5% ▼	4.6% ▼	**8.0%** ▲	**11.6%** ▼

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**131,186**	72,880	0	0	58,306	**0**	**107,880**
Change 12 months	**-83%** ▼	-77% ▼	–	–	-43% ▼	**-100%** ▼	**-93%** ▼
Pre-let	**58,306**	0	0	0	58,306	**0**	**35,000**

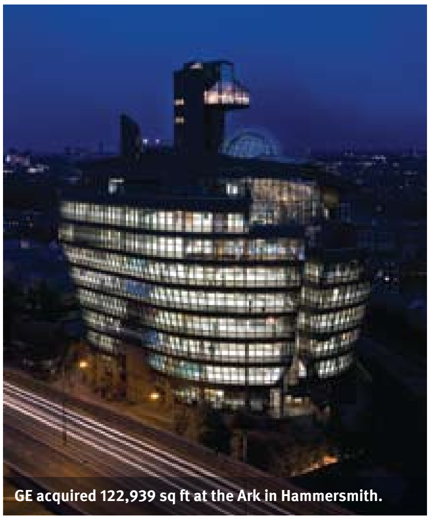
Source: Knight Frank Research

Figure 4
Vacancy rates



M4 & M3 markets

- The M4 market rebounded in Q2 with take-up of 382,809 sq ft, up 39% on Q1 and 67% higher than the Q2 2009 total. Take-up was buoyed by two substantial transactions, GE's 122,939 sq ft acquisition at the Ark, Hammersmith together with Celgene's acquisition at Stockley Park (see M25 section).
- Second-hand Grade A space accounted for 82% of M4 take-up in Q2 with new space making up a further 15%. Kaplan Financial's 12,424 sq ft acquisition at the Blade, Reading at an agreed headline rent of £28.00 per sq ft was the highest achieved on new space in the M4 in Q2.
- The M4 vacancy rate fell from a record high of 12.0% in Q1 to 11.6% in Q2, its first fall in seven successive quarters. Healthy take-up combined with a falling level of completions was key to this, with speculative development now 95% below the cycle peak in Q2 2008. Segro's 89,126 sq ft Building 1020 at Winnersh Triangle comprised the sole completion in Q2.
- In the M3, Q2 take-up was 85,324 sq ft, down 25% from Q1 and only a third of its average level. Of the five deals, the largest was Coral Racing's acquisition of 30,735 sq ft at Globe House, Woking. Of the two deals involving new space, the largest was First Drinks' 19,000 sq ft acquisition at Form 1, Bartley Wood Business Park, Hook, at an agreed headline rent of £19.00 per sq ft.
- In the M3, the vacancy rate edged up from 7.9% in Q1 to 8.0% in Q2, albeit it remains considerably below the M4 level. Of the space added to the market in Q2, tenant released space exceeded landlord released space with Buildings 110 and 150 at IQ Farnborough collectively totalling 91,521 sq ft available as a sub-lease following Fluor's substantial 210,000 sq ft pre-let completion.


GE acquired 122,939 sq ft at the Ark in Hammersmith.

KNIGHT FRANK VIEW

- The M4 market showed marked improvement in Q2, with a number of corporate occupiers either committing, or about to commit to, major transactions. Despite the uncertain economic outlook, such occupiers are realising the benefits of striking now before stock levels, and therefore choice, starts to reduce with rental levels in particular M4 towns currently offering very good value for money.
- The M3 has weaker prospects for a speedy recovery in activity than the M4. Demand is relatively thin while supply is skewed towards less attractive second-hand Grade B accommodation, which currently makes up 38% of total availability. However, as a consequence of a relatively lower level of development in the last cycle, particularly compared with M4, the vacancy rate in the M3 will continue to remain low thereby helping to keep headline rents stable.

Figure 5
M3 take-up

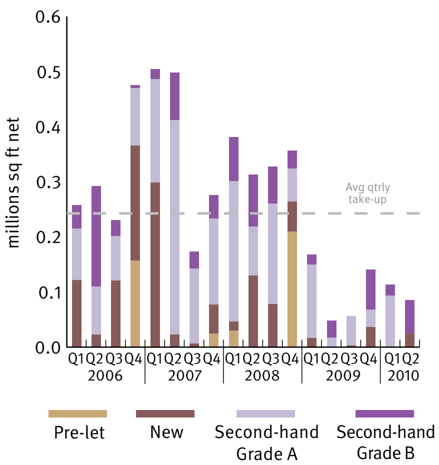


Figure 6
M4 take-up

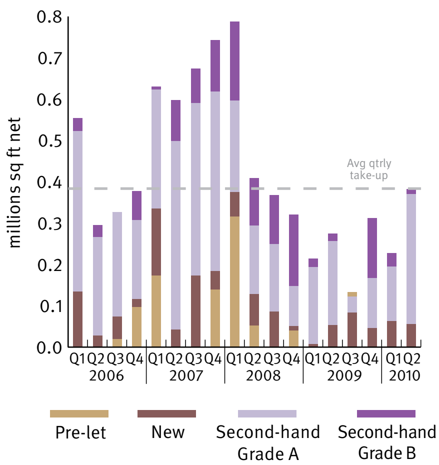
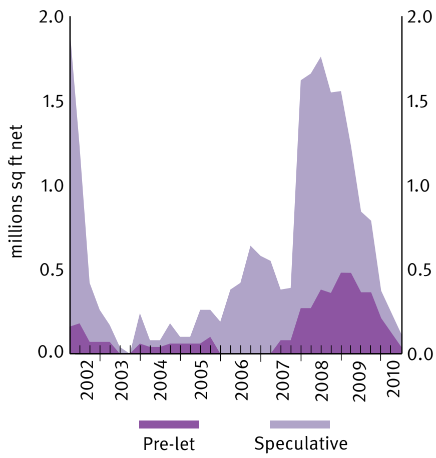


Figure 7
Space under construction in the M4



Source: Knight Frank Research

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Investment market

Table 3
Key investment transactions Q2 2010

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
Wimbledon Bridge House, Wimbledon	166,841	£58.00m	7.10%	AEW Europe / Hermes REIM
Guildford Business Park, Guildford	261,200	£55.22m	9.00%	Crown Estate / Legal & General
200 Berkshire Place, Winnersh Triangle	67,238	£20.10m	9.26%	PRUPIM / Threadneedle
165 Bath Road, Slough	45,462	£13.42m	7.75%	Matrix Securities / Private Investor
Assurance House, Egham	39,491	£12.83m	8.70%	ING / Threadneedle
Fairmount House, Leatherhead	29,383	£11.00m	6.00%	CBRE Investors / Private Investor

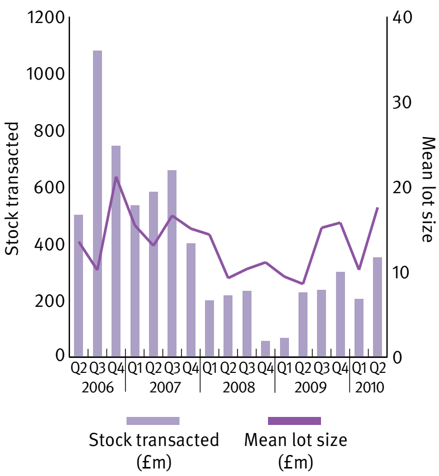
	Transaction volume	Mean lot size	Mean NIY
Q2 2010	£352.0m	£17.60m	8.08%
Change 3 mths	72% ▲	72% ▲	-5bps ▼
Change 12 mths	54% ▲	16% ▲	-19bps ▼

KNIGHT FRANK VIEW

- Q2's volume of £352m was a considerable 72% improvement on Q1, albeit sentiment cooled in the latter weeks of the quarter, as it has for other sectors. This is in light of renewed economic uncertainty from the government's austerity measures and, internationally, new risks to the global economic recovery such as the euro debt crisis.
- Prime South East yields stabilised at 6.25% in Q2, bringing an end to a period of inward shift which began in Q2 2009. With prime assets still relatively sought after and buying opportunities scarce, prime yields should hold firm. However, the renewed uncertainty has impacted particularly on demand for good secondary assets with fund requirements thinning markedly as occupational market risk is reconsidered.
- We believe yields for good secondary product peaked in Q2 at 7.75% and, with the supply of good quality secondary assets also increasing, yields will soften across the South East by as much as 50bps over the remainder of 2010, particularly if more bank-released stock arrives to the market.

Legal & General purchased Guildford Business Park from The Crown Estate for £55.22m reflecting a net initial yield of 9.00%.

Figure 8
£m investment volumes and lot size



Source: Knight Frank Research

Figure 9
Mean initial yield & finance

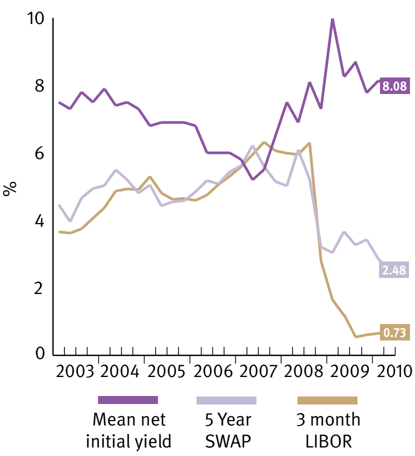
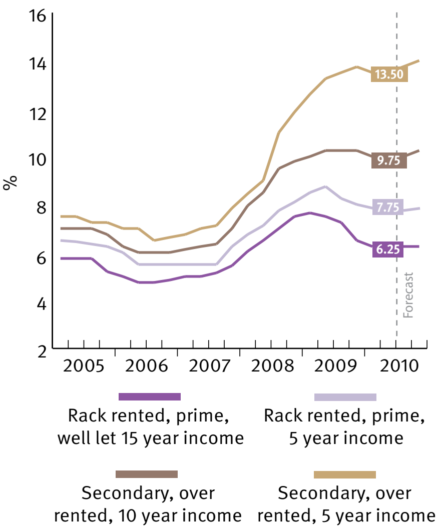


Figure 10
Yield forecasts



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Commercial Research
Claire Higgins
Partner, Head of Commercial Research
+44 (0) 20 7861 1246
claire.higgins@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 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 June 30th 2010.

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