RESEARCH

Knight Frank

Q4 2012

M25 OFFICES

Investment, development & occupier markets

HIGHLIGHTS

- The resilience of the M4 corridor was reflected in total take-up of 1.67m sq ft in 2012, marginally ahead of the 10-year annual average. In contrast, activity in the M25 region and the M3 corridor was more subdued in 2012, with total take-up 20% and 29% below the 10-year average respectively.
- Active named demand stood at 6.32m sq ft at the end of Q4 2012, 3% above Q4 2011. Financial & Business Services continue to retain the greatest share of unsatisfied demand, accounting for 23% of the total.
- Speculative development in the M25 stands at 480,000 sq ft across seven schemes. Four new developments commenced in Q4, largely offsetting the 215,000 sq ft of completions seen in the quarter.
- Despite limited investment turnover of £173m, Q4 saw more deals than any other quarter in 2012. Yields for prime 15-year income remained stable at c.6.0% in Q4, unchanged since Q3 2011.

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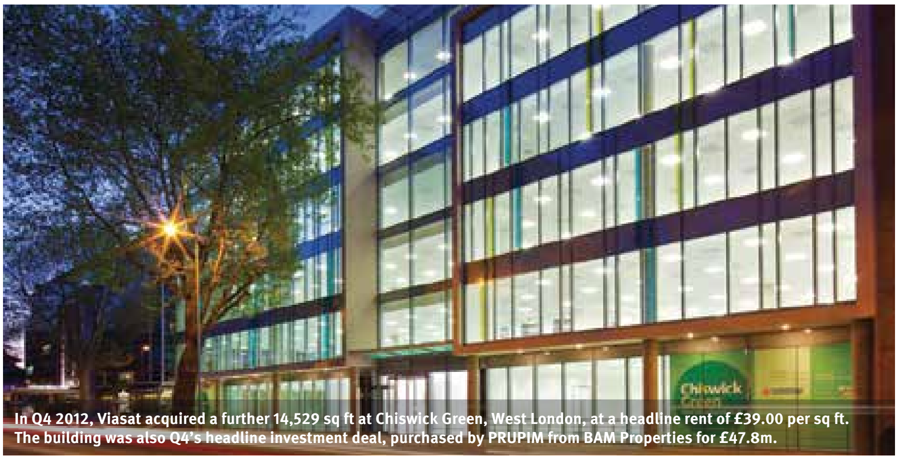
Demand and take-up

- M25 take-up was 546,958 sq ft in Q4, taking the annual total for 2012 to 2.02m sq ft, 20% below the 10-year annual average. Q4 was characterised by an absence of any major deals, with the one exception comprising Hasbro's 50,000 sq ft pre-let refurbishment at 4 The Square, Stockley Park, Heathrow.
- While Q4 take-up in the M4 was down 51% on Q3's level, the annual total for 2012 was a resilient 1.67m sq ft, marginally ahead of the 10-year annual average. Hammersmith was particularly active in Q4, accounting for seven of the M4's 24 deals, the largest of which was Medidata's 22,961 sq ft lease at the Metro Building.
- The only transaction in Chiswick accounted for Q4's highest achieved rent. Viasat acquired a further 14,529 sq ft at Chiswick Green at a headline rent of £39.00 per sq ft, taking their total occupation in the building to 75,000 sq ft.
- M3 activity improved in Q4 with take-up of 204,372 sq ft, 93% above Q3's subdued total. The standout transaction in the M3 was Lastminute.com's 18,313 sq ft lease at One Church Road, Richmond. The deal set a new headline rent for the Richmond market at £37.50 per sq ft, and reflects the robust conditions in the west London area.
- Active named demand remained stable throughout 2012 and stood at 6.32m sq ft at the end of Q4 2012, 3% above the same period in 2011. While Financial & Business Services continue to retain the greatest share of demand (23%), Retail, Distribution & Transport demand has increased by 37% since Q4 2011 to account for 19% of the total.


In Q4 2012, Viasat acquired a further 14,529 sq ft at Chiswick Green, West London, at a headline rent of £39.00 per sq ft. The building was also Q4's headline investment deal, purchased by PRUPIM from BAM Properties for £47.8m.

Supply and development

- Three schemes totalling 215,000 sq ft completed in Q4 – The Stanza Building, Uxbridge (82,403 sq ft), Velocity 1 & 2, Weybridge (106,400 sq ft) and St Johns House, Crawley (26,189 sq ft). Speculative construction activity in the M25 reduced by only 10% in Q4 to stand at 480,000 sq ft, with four new development starts largely offsetting the three completions.
- Developers are targeting key markets in the Thames Valley where demand is resilient and New and Grade A space is in short supply. Notably, three of Q4's new starts are located in Staines, namely Exton & Rockspring's Flow at The Causeway (60,000 sq ft), LaSalle IM and Bell Hammer's Strata (89,232 sq ft) and Aberdeen's 5 Pine Trees (57,000 sq ft).
- Availability edged up in Q4 having been on a downward trend through much of 2012. The M4 vacancy rate increased to 10.1%, rising from a four year low of 9.6% in Q3, while the M25 vacancy rate ticked up from 7.9% to 8.1% during Q4. In contrast, the M3 vacancy held at 8.7% during Q4, unchanged for three consecutive quarters.

Figure 1
M25 take-up

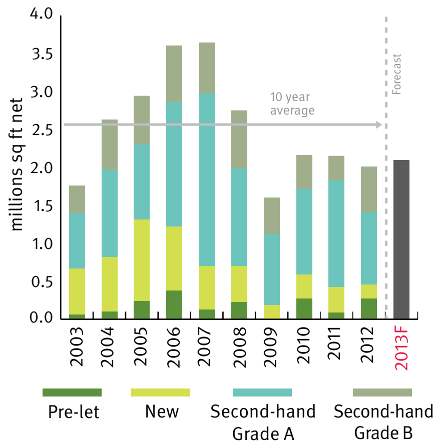


Figure 2
M4 take-up

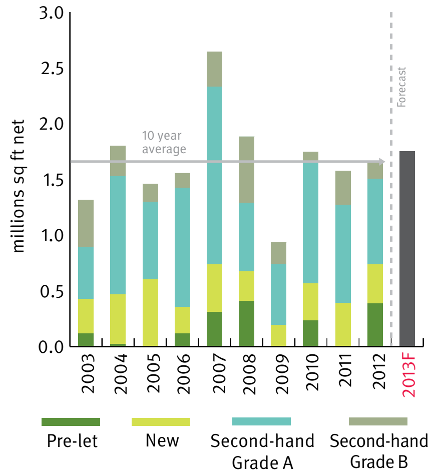
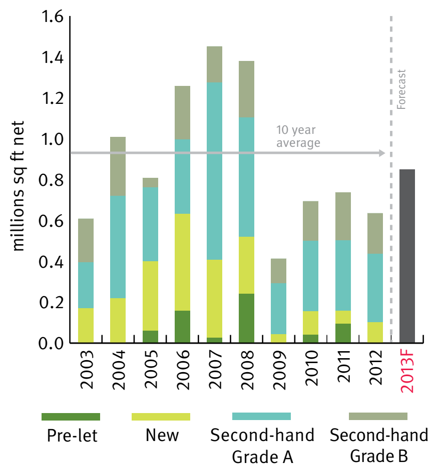


Figure 3
M3 take-up



Source: Knight Frank Research

Market statistics

Table 1
Key town prime rents & forecasts

Town	Q4 prime rent (psf)	Rent free (months)
Basingstoke	£17.50 ▶	36 ▶
Bracknell	£20.00 ▶	36 ▶
Brentwood	£21.00 ▶	24 ▶
Chiswick	£46.50 ▲	18 ▼
Croydon	£24.50 ▲	18 ▼
Gatwick	£22.50 ▶	30 ▶
Guildford	£27.50 ▶	27 ▼
Hammersmith	£43.00 ▲	18 ▼
Heathrow	£29.50 ▲	27 ▼
Maidenhead	£32.00 ▶	21 ▶
Reading	£30.50 ▶	24 ▶
Slough	£21.00 ▶	32 ▶
Staines	£32.00 ▲	21 ▶
St Albans	£22.50 ▶	24 ▶
Uxbridge	£32.00 ▲	21 ▶
Watford	£22.50 ▶	30 ▶
West Malling	£20.00 ▶	27 ▼

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

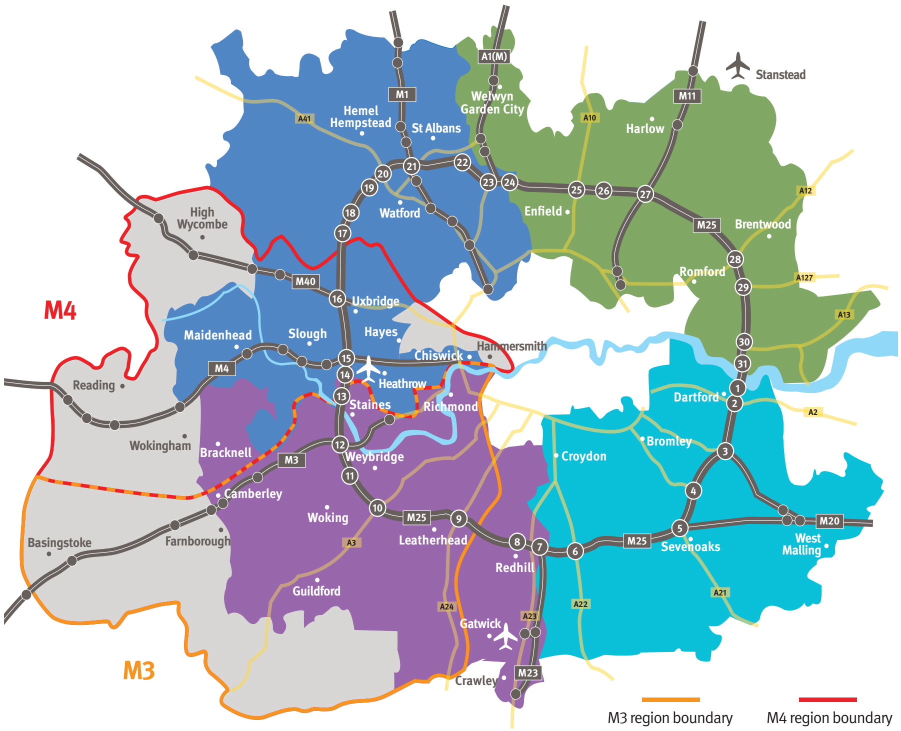


Table 2
Demand & Supply

Take-up	M25	NW	SW	NE	SE	M3	M4
Sq ft	**546,958**	317,172	205,359	0	24,427	**204,372**	**291,957**
Change Q4 12 vs Q3 12	**-1%** ▼	-3% ▼	91% ▲	-100% ▼	-61% ▼	**93%** ▲	**-51%** ▼
Change Q4 12 vs Q4 11	**-26%** ▼	-30% ▼	-20% ▼	-100% ▼	124% ▲	**22%** ▼	**-53%** ▼
Q4 pre-let (sq ft)	**54,062**	0	0	0	0	**54,062**	**54,062**
Q4 % New & Grade A (inc. pre-lets)	**60%**	40%	85%	NA	100%	**76%**	**84%**
Forecast 2013 take-up (m sq ft)	**2.10**	1.00	0.85	0.10	0.15	**0.85**	**1.75**

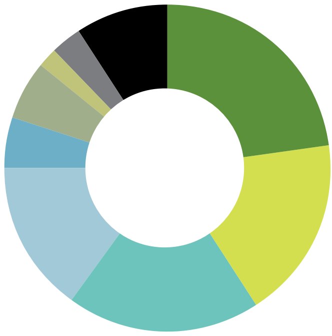
Availability	M25	NW	SW	NE	SE	M3	M4
Sq ft	**10,459,528**	4,608,552	3,939,945	474,027	1,437,004	**3,700,187**	**6,547,238**
Change Q4 12 vs Q3 12	**2%** ▲	4% ▲	0% ◀▶	-7% ▼	2% ▲	**1%** ▲	**5%** ▲
Change Q4 12 vs Q4 11	**-3%** ▼	-3% ▼	-6% ▼	-10% ▼	9% ▲	**-9%** ▼	**-6%** ▼
Q4 % new	**14%**	13%	20%	11%	4%	**14%**	**21%**
Q4 % second-hand Grade A	**51%**	62%	49%	43%	23%	**59%**	**60%**
Q4 % second-hand Grade B	**35%**	25%	31%	46%	73%	**27%**	**19%**
Q4 vacancy rate (▲/▼ movement from Q3 12)	**8.0%** ▲	9.1% ▲	9.6% ◀▶	2.7% ▼	7.1% ▲	**8.7%** ◀▶	**10.1%** ▲

Under construction	M25	NW	SW	NE	SE	M3	M4
Sq ft (net approx)	**765,911**	360,351	306,477	0	99,083	**306,477**	**469,908**
Change 12 months	**26%** ▲	-4% ▼	32% ▲	–	100% ◀▶	**153%** ▲	**3%** ▲
Pre-let	**285,755**	215,755	70,000	0	0	**70,000**	**215,755**

Source: Knight Frank Research

Figure 4

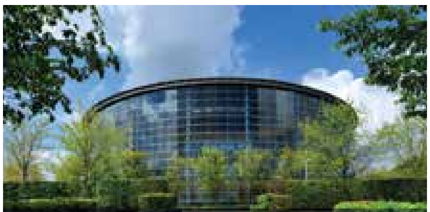
M25 active named enquiries by sector



Active demand is 6.32m sq ft at Q4 2012

Financial & Business Services	23% ▼
Manufacturing & FMCGs	18% ▼
Retail, Distribution & Transport	19% ▲
ICT	15% ▼
Construction & Engineering	5% ▼
Public Sector	6% ▲
Energy & Utilities	2% ▼
Pharmaceutical/Healthcare & Medical	3% ▲
Other	9% ▲

Note: % = current share of demand
▲ = change last 12 months (absolute terms)



The largest deal in Q4 was Hasbro's pre-agreement to lease 50,000 sq ft at 4 the Square, Stockley Park, Heathrow. Knight Frank acted on behalf of the landlord, Legal & General.

FORECAST AT A GLANCE

Take-up:

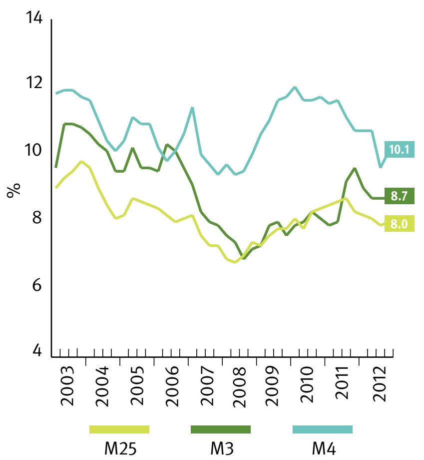
- With consensus forecasts indicating muted UK economic growth of sub-1% in 2013, short-term occupier activity will remain driven predominantly by churn, as opposed to business expansion. Positively, Knight Frank's analysis reveals that the market is moving towards a spike in lease event-driven demand, starting in 2013 and peaking in 2015, as a raft of historic leases expire.
- In the M25 area, Knight Frank forecast take-up of 2.1m sq ft in 2013, a modest 5% improvement on 2012 but 15% below the 10-year average. However, our 2013 forecast for the M4 corridor is more bullish at 1.75m sq ft, or 5% above the annual average, with the Thames Valley markets set to continue to outperform the wider region. M3 take-up is forecast to rebound from 2012's subdued performance, with 0.85m sq ft anticipated in 2013.
- Take-up is forecast to see further improvement beyond 2013, as lease event activity gathers momentum and UK economic growth returns to trend. With its resident pool of talent and significant improvements to infrastructure underway – such as Crossrail – the Thames Valley is well-placed to continue to attract inward investment, particularly from software and hardware technology companies.

Supply and rents:

- 2012 saw strong growth in prime headline rents in selected markets in west London, with record highs achieved in Chiswick and Richmond. Over the year ahead, we anticipate this growth to extend westwards to other key markets along the Thames Valley, with headline rental values in the early £30s per sq ft being more readily achieved in markets such as Maidenhead and Uxbridge.
- The continuing erosion of good quality supply is fuelling this anticipated rental growth. While the M25 as a whole has 3.5 years' worth of New and Grade A supply available, levels are critically low in a number of markets, such as Chiswick (0.5 years), Staines (0.9 years), Richmond, Hammersmith (1.4 years) and Uxbridge (1.7 years).
- Developers with access to funding are well-placed to consider speculative development or refurbishment projects in established markets where forthcoming lease breaks and expiries are high relative to current Grade A supply. Croydon is one such example, where the ratio of Grade B lease events (up to 2016) to current Grade A supply stands at 4:1.

Figure 5

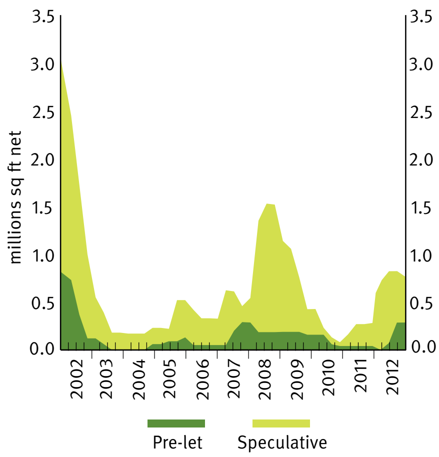
Vacancy rates



Source: Knight Frank Research

Figure 6

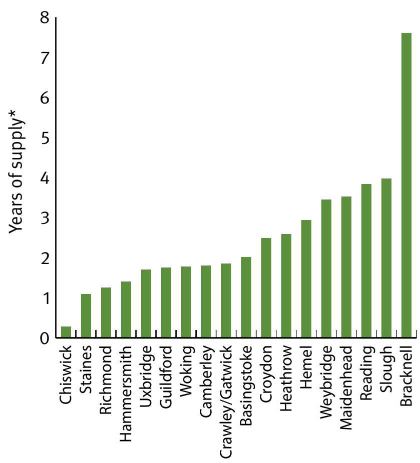
Space under construction in the M25



Source: Knight Frank Research

Figure 7

New & Grade A supply in key markets



Source: Knight Frank Research
* Based on average New & Grade A take-up vs current New & Grade A availability

Q4 2012
M25 OFFICES
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Investment market

Table 3
Key investment transactions Q4 2012

Building	Size (sq ft)	Price	Net Initial Yield	Vendor/ Purchaser
Chiswick Green, West London	82,307	£47.84m	6.28%	BAM Properties / PRUPIM
P&G, The Heights, Weybridge	109,000	£33.68m	7.49%	Gatehouse / Private
Lakeside House, Stockley Park, Heathrow	71,129	£15.10m	8.24%	Royal London / Threadneedle
1 Arlington Square, Bracknell	82,215	£8.10m	16.75%	Novell / Threadneedle
Bishops Wharf, Guildford	15,600	£4.90m	8.50%	Private / CBRE GI

	Transaction volume	Mean lot size	Mean NIY
Q4 2012	£173.00m	£9.11m	8.26%
Change 3 mths	-49%	-52%	-101bps
Change 12 mths	-80%	-76%	-8bps

INVESTMENT VIEW

- Q4's limited turnover of £173m reflected a lack of large lot-size deals as opposed to negative investor sentiment, with Q4's 19 transactions the highest number seen in any quarter during 2012.
- Q4's notable deals included PRUPIM's £47.8m purchase of Chiswick Green, west London and a Middle Eastern investor's £33.68m purchase of Proctor & Gamble's HQ at The Heights, Weybridge. The transactions reflect the strength of appetite among both UK institutions and overseas investors for good quality office stock in robust locations.
- Yields for prime 15-year income held at c.6.00% in Q4, a level unchanged throughout 2012. While demand for prime stock will remain buoyant, buying opportunities are likely to remain in short supply which is likely to preserve pricing at its current level throughout 2013.
- Knight Frank expects demand for secondary product to strengthen in 2013, as investors increasingly target opportunities higher up the risk curve. There are a number of institutions who now have both the capital and the appetite to invest in shorter-income stock in the South East, albeit their focus will be on well-located assets, at a price which reflects sensible re-letting prospects.

In Q4, Threadneedle purchased Lakeside House in Stockley Park, Heathrow from Royal London for £15.1m, reflecting a net initial yield of 8.24%. Knight Frank acted for the vendor.

Figure 8
£m investment volumes and lot size

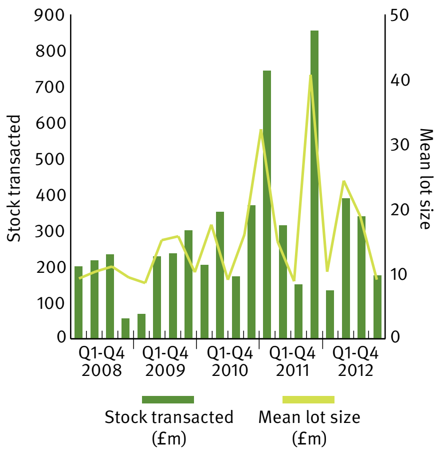


Figure 9
Mean initial yield & finance

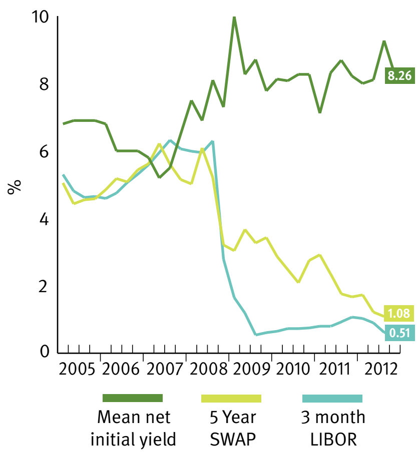
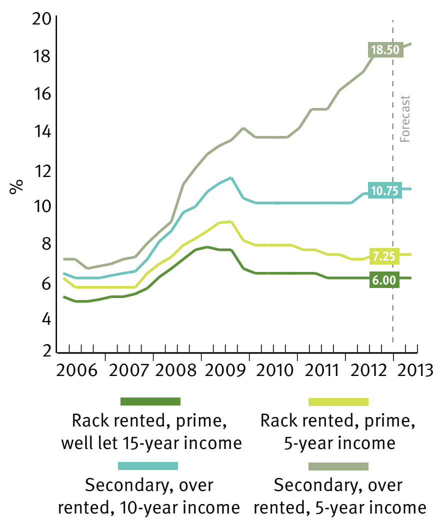


Figure 10
Yield forecasts



Source: Knight Frank Research

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Knight Frank

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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 December 31st 2012.

Front cover image: The Stanza Building, Uxbridge (internal shot)

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