

RESEARCH



M25 OFFICES

INVESTMENT, DEVELOPMENT &
OCCUPIER MARKETS **Q4 2015**

M25 TAKE-UP
HIGHEST SINCE 2008

TMT SECTOR ACCOUNTS FOR
30% OF SOUTH EAST TAKE-UP

INVESTMENT VOLUMES
REACH HISTORIC HIGH



“Despite a dip in activity in the final quarter, total take-up in the South East recorded a year-on-year increase. Availability remains well below the long term trend and this supply/demand imbalance continues to maintain upward pressure on rents.”

EMMA GOODFORD
Head of National Offices

EXECUTIVE SUMMARY

In 2015, headcount growth and the opportunity to upgrade space supported an increase in occupier demand. Total take-up in the South East increased by 18% during the year, despite activity in Q4 proving slower than expected. Encouragingly, the prospect of an EU exit or the changes to lease accounting has not served to delay occupier plans so far, despite some concerns. We anticipate that this positive occupier sentiment will continue in 2016.

At year-end, availability remains low, with a decrease of between 12% – 22% recorded across the markets during 2015. The development pipeline

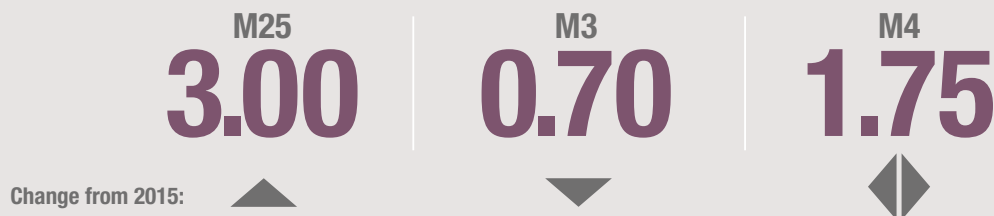
has increased in response, although the amount of new speculative space scheduled for delivery in the next 24 months is not sufficient to have an impact on vacancy rates. Given this market imbalance, strong rental growth is expected.

The prospect of a rise in rents has continued to attract a diverse range of investors to the market. Total turnover in 2015 was the highest on record, highlighting the weight of capital targeting opportunities in the South East during the year.

The depth of demand has served to fuel aggressive pricing, a feature of the market which is expected to continue in 2016.

FORECAST AT A GLANCE

Forecast 2016 take-up (million sq ft)



MARKETS TO WATCH

Expected prime rent by the end of 2017/24 months (£ per sq ft)

Croydon £37.50 20% pa	Bracknell £30.00 12% pa	Reading £40.00 7% pa
Slough £36.50 6% pa	Heathrow £38.50 5% pa	Maidenhead £39.50 5% pa

% pa = Compound annual growth rate up to the end of 2017/24 months

OCCUPIER MARKET

Total take-up in the South East increased by 18% in 2015 whilst supply levels registered the largest annual decrease on record.

Demand and take-up

Following an exceptionally strong Q3, take-up in the M25 market was on a par with the long term quarterly average in Q4 at 620,400 sq ft. This meant that total take-up in the M25 reached 2.7m sq ft for the year, an increase of 29% when compared to 2014. The 2015 total represented the highest level of take-up in the M25 recorded since the financial crisis of 2008, serving to highlight the improving depth of occupier demand during the year.

In the M3, a total of 187,100 sq ft was let in the final quarter, marginally less (1%) than in Q3. Despite the fall, total take-up for the year was 944,700 sq ft, an increase of 31% when compared to 2014. Importantly, thirteen transactions over 20,000 sq ft were

completed in the M3 catchment during the year. This compares to eight in 2014.

By contrast, with several large requirements in the M4 failing to complete before year-end, take-up fell by 42% in Q4 to 357,300 sq ft. The quarterly decrease meant that at year-end, take-up for 2015 totalled 1.45m sq ft, 4% less than in 2014.

Availability

Availability in the M25 decreased for the tenth consecutive quarter in Q4 to stand at 6.5m sq ft, a quarterly fall of 7.6%. This total remains the lowest level of availability for the M25 market since Q4 2001. Notably, availability fell by 22.3% during 2015. This is the largest annual decrease on record for the region.

At year-end, availability in both the M3 and M4 markets remained at a historic low level. Availability in the M4 fell by a further 4.7% in Q4 to 4.7m sq ft. This total is 27% below the 10-year average. Availability in the M3 was unchanged at 2.5m sq ft, 26% below the 10-year average.

The development pipeline across the South East markets (M25, M3 & M4) is set to deliver 3.5m sq ft before the end of 2017. Of this total, 3.1m sq ft is speculative. Interestingly, the addition of the new speculative space to availability in both the M25 and M3 would still not be sufficient to return these markets to long term average levels.

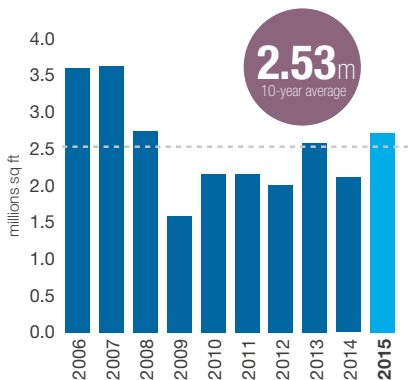
2.7m
total take-up for the year in M25 (sq ft)

29%
increase in M25 annual take-up compared to 2014

6.5m
availability in M25 (sq ft)

22%
decrease in M25 availability (Year end 2014-Year end 2015)

FIGURE 1
M25 take-up



Source: Knight Frank Research



Strata, 58,600 sq ft let to Service Now on behalf of LaSalle Investment Management

DEMAND

A notable trend of 2015 was a third consecutive annual increase in TMT sector take-up. Supported by the 58,600 sq ft letting at Strata in Staines to Service Now, TMT occupiers accounted for 30% of total take-up in the South East region in 2015, up from 23% in 2014. Significantly, the sector accounted for five of the ten transactions over 50,000 sq ft.

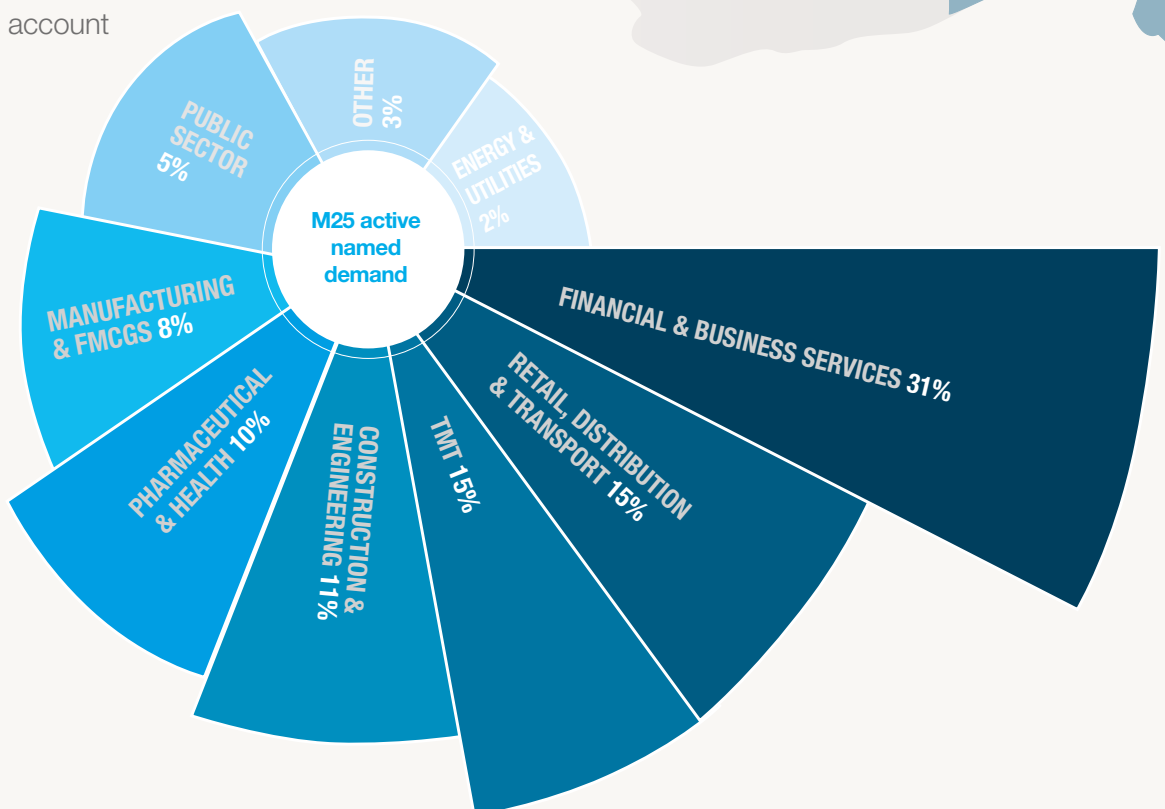
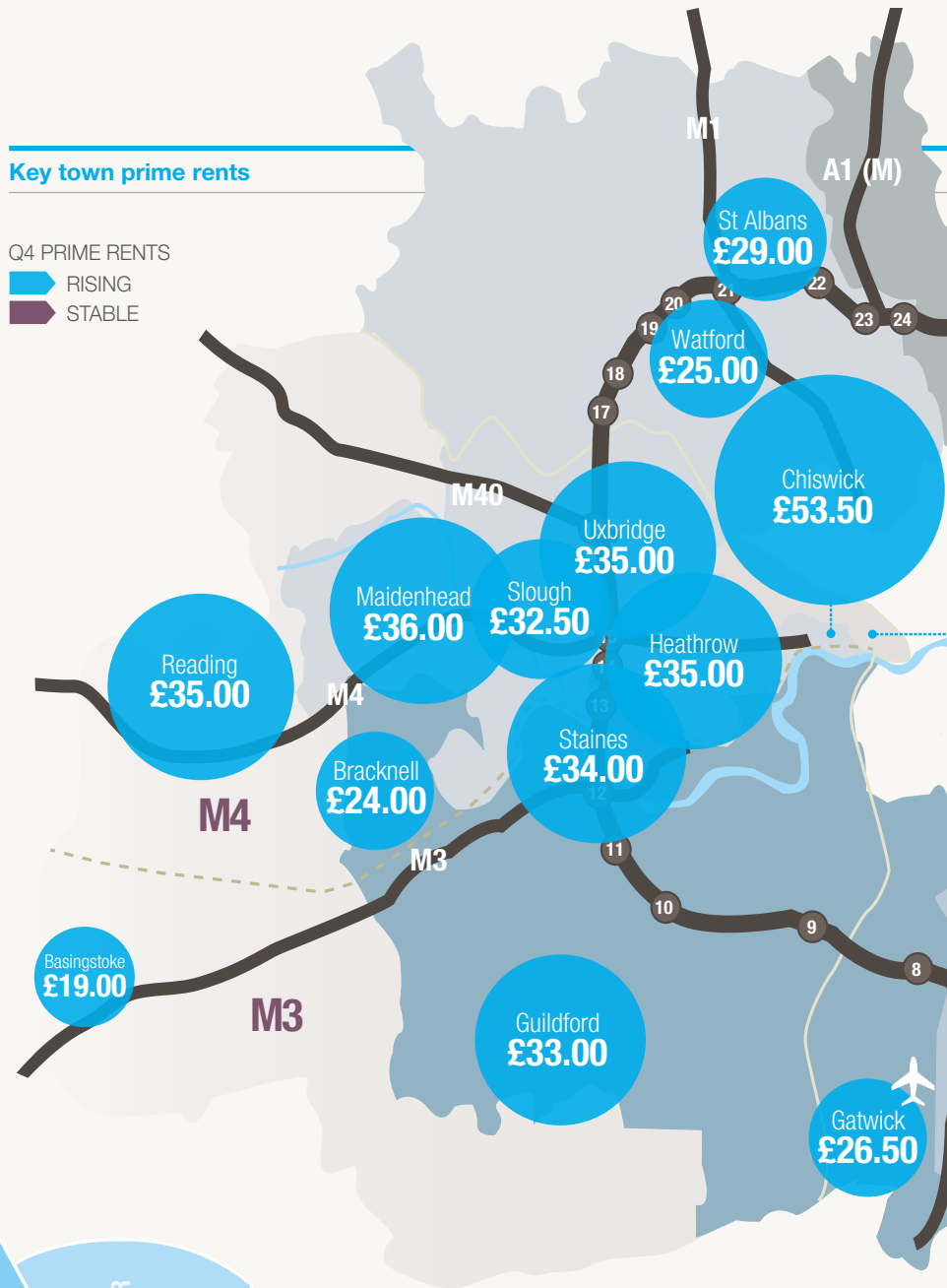
Demand Pipeline:

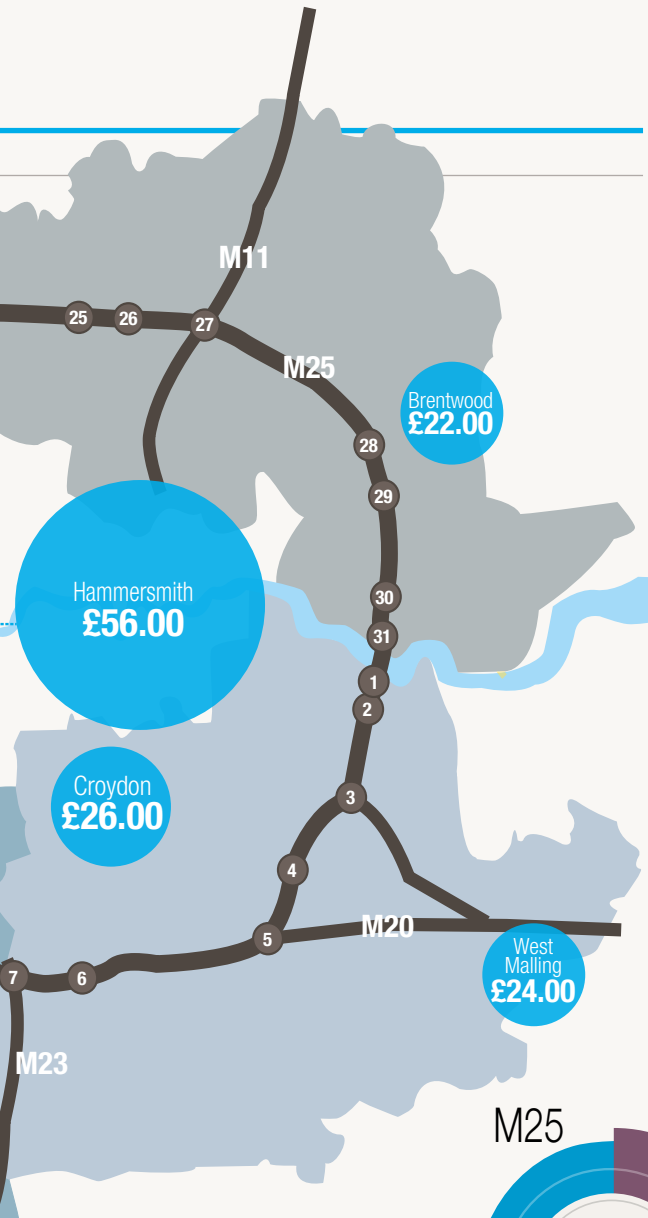
The South East markets continue to attract interest from a diverse range of occupiers. Active named demand totalled 5.6m sq ft in Q4 2015, 4.8% higher when compared to Q3 2015. Occupiers from the Financial and Business Services sector represented the largest percentage of requirements, accounting for 31%. The TMT and Retail, Distribution & Transport sector both account for 15% of enquiries.

Key town prime rents

Q4 PRIME RENTS

- ▶ RISING
- ▶ STABLE





Demand & Supply

TAKE-UP	M25	M3	M4
sq ft	620,390	187,131	357,298
Change Q4 15 vs Q3 15	-25% ▼	-1% ▼	-42% ▼
Change Q4 15 vs Q4 14	17% ▲	102% ▲	-32% ▼
Q4 Pre-let (sq ft)	28,858	0	0
Q4 % New & Grade A (inc pre-lets)	71%	64%	90%
Forecast 2016 take-up (m sq ft)	3.00	0.70	1.75

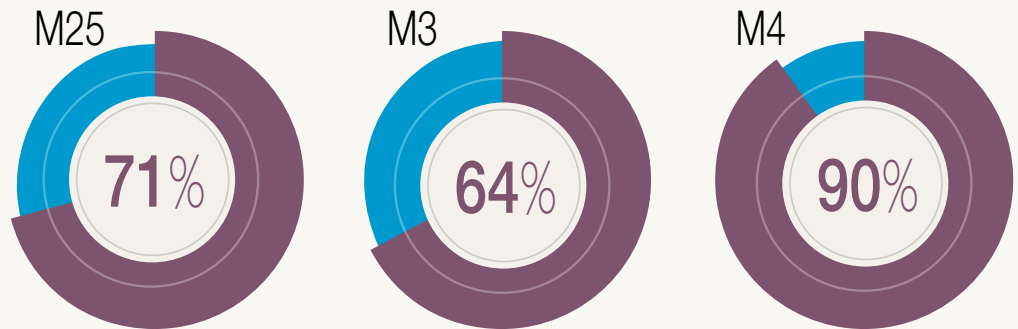
AVAILABILITY

sq ft	6,514,871	2,474,134	4,684,694
Change Q4 15 vs Q3 15	-8% ▼	0% ◆	-5% ▼
Change Q4 15 vs Q4 14	-22% ▼	-12% ▼	-14% ▼
Q4 % New	20%	19%	21%
Q4 % second-hand Grade A	51%	55%	63%
Q4 % second-hand Grade B	29%	26%	16%
Q4 vacancy rate (▲/▼ movement from Q3 15)	5.0% ▼	6.1% ◆	6.6% ▼

CONSTRUCTION

sq ft (net)	2,116,516	200,025	2,717,260
Change Q4 15 vs Q4 14	35% ▲	-44% ▼	32% ▲
Pre-let (sq ft)	251,702	0	115,000

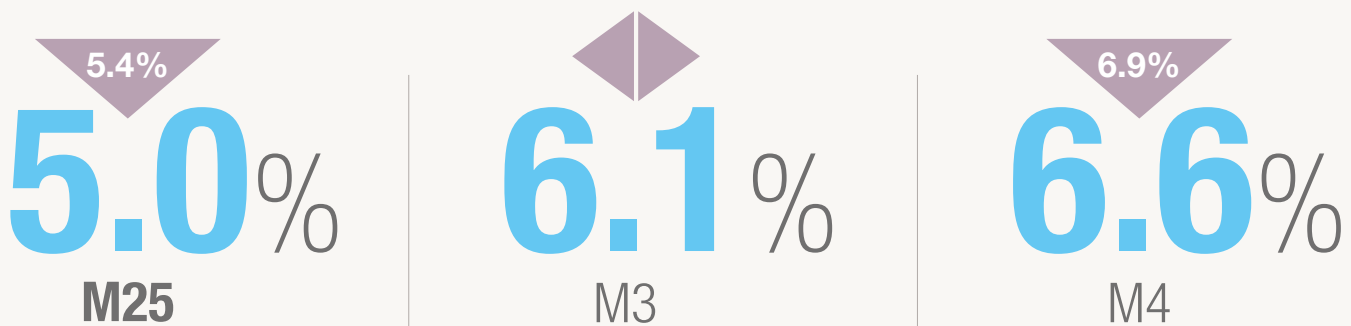
Q4 % New & Grade A take-up (Including pre-lets)



■ Q4 % NEW & GRADE A (INC PRE-LETS)

M25 New and Grade A vacancy rate lowest since 2001 at 3.5%.

Q4 2015 vacancy rate (▲/▼ movement from Q3 15)



1.05bn

Transaction volume (£)

31.9m

Mean lot size (£)

5.00%

Prime NIY

INVESTMENT MARKET

Investment turnover increased by 36% in Q4 2015 reaching £1.05 bn by quarter end. A total of 33 deals were completed, the highest number of the year, with the average lot size rising to £31.9m, 77% ahead of the 10-year average.

A strong final quarter meant that total investment in 2015 rose to over £3.7bn, a historic high for the South East region. This figure eclipses the previous peak of £3.1bn recorded in 2006 and represents a 38% increase when compared to last year.

Whilst the larger UK funds slowed their rate of acquisition during the second half of the year, they were replaced by significant inflows of overseas money. International purchasers are increasingly being attracted by the strong underlying fundamentals of the wider South East market and the relatively high returns on offer in a low interest rate environment.

The Ho Bee Land (Singaporean) purchase of Apollo & Lunar in Croydon for £99m and the Harbert (US) purchase of Kings Hill Business Park in Kent for £105m in Q4 are prime examples of overseas investors committing large amounts of capital to South East offices.

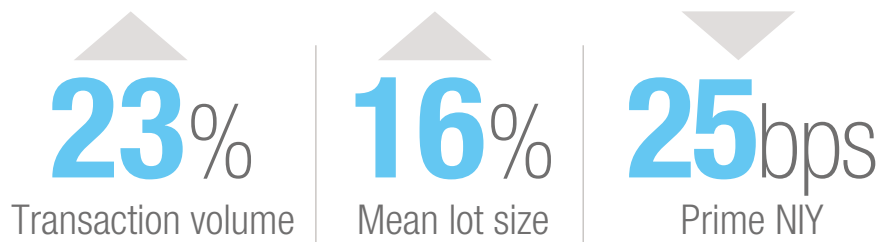
Prime rack rented yields stand at 5.00% NIY, stable for the last four quarters, with both UK funds and overseas investors keen to secure the very best income, let to strong covenants.

We expect strong demand for South East offices to continue in 2016, with both domestic and overseas investors buoyed by the strengthening occupational market.



Avaya House, Cathedral Hill, Guildford

Change 12 months (Q4 2014 - Q4 2015)



“The strengthening occupational market will continue to attract the attention of both domestic and international investors, further fuelling competition for prime assets”.

FIGURE 2
Investment volumes

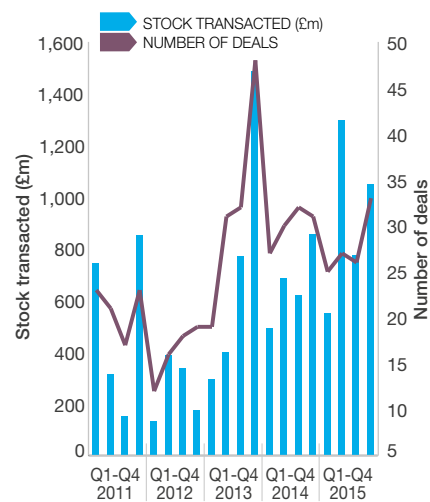


FIGURE 3
Prime net initial yield & finance

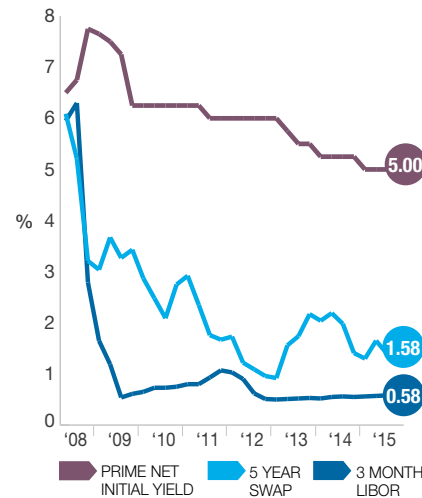
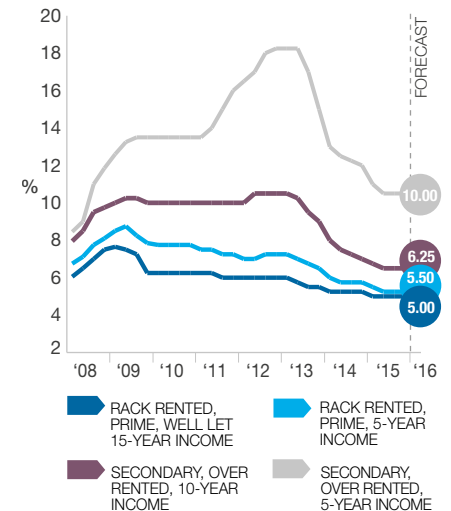


FIGURE 4
Yield forecasts



Key investment transactions Q4 2015

BUILDING	SIZE (SQ FT)	PRICE	NET INITIAL YIELD	VENDOR / PURCHASER
Kings Hill Business Park, Kent	485,585	£105.75m	7.33%	Liberty & Doughty Hanson / Harbert
Apollo & Lunar House, Croydon	441,797	£99.00m	5.27%	Harel & CLAL / Ho Bee Land
Amec Foster Wheeler Campus, Reading	365,832	£98.30m	7.62%	4 Charity Foundation / AR Capital
NATS, Solent Business Park, Fareham	259,529	£70.00m	6.25%	Private Overseas / Greenridge
Kett House, Cambridge	35,637	£20.35m	4.69%	IM Properties / Kames Capital

Source for all charts: Knight Frank Research



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 69.4m 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 42.0m 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 130m sq ft (net), an M4 market stock of 69.4m sq ft (net) and an M3 market stock of 42.0m 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 2015.

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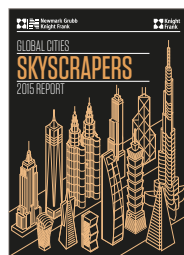
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