RESEARCH

Q1 2009

M25 OFFICES

Investment, development & occupier markets

Knight Frank

HIGHLIGHTS

- Reflecting the decline in occupier sentiment, Q1 take-up in the M25 was down 43% on the last quarter and was the lowest quarterly total in nearly six years. Q1 take-up in the M3 was also down by 53% and by 33% in the M4.
- Active named demand increased by 19% in Q1, following successive falls in the previous two quarters. However, compared with Q1 2008, active demand is lower for all sectors except ICT and the public sector.
- The M25 vacancy rate decreased fractionally in Q1 from 7.4% to 7.3%. Conversely, the M4 vacancy rate increased from 10.0% to 10.6% and, in the M3, it increased marginally from 7.2% to 7.3%.
- Buying activity remains subdued in the investment market. Q1 brought a marked increase in investor interest, but focused exclusively on prime, long-income product. Consequently, prime yields are stabilising while the margin to secondary product continues to increase.

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M25 market

- M25 take-up totalled 377,000 sq ft in Q1, a fall of 43% on Q4 2008 and the lowest quarterly total since Q3 2003. Second-hand Grade A space accounted for 83% of total take-up in Q1, more than double the long term average of 40%.
- Of Q1's 29 transactions, no pre-lets took place and only one involved new accommodation, which was ALM's 2,630 sq ft acquisition of Unit 2, Maidenbower Business Park in Crawley. The largest transaction in Q1 was BUPA's acquisition of 34,516 sq ft at 3 Pine Trees, Staines, at an agreed rent of £31.00 per sq ft.
- Despite falling take-up, 532,000 sq ft of space was under offer at end Q1. Active demand in Q1 also rebounded by 9% from Q4 to stand at 5.36m sq ft. FBS demand increased by 37% in the quarter, following a sharp fall of 61% during the second half of 2008.
- The M25 vacancy rate decreased marginally from 7.4% to 7.3% in Q1. Just two development completions occurred which comprised Landid & RREEF's 185,000 sq ft refurbishment of Capitol, Bracknell and Standard Life's 31,250 sq ft development at 65 Woodbridge Road, Guildford.
- The reduced availability of funding has resulted in a complete absence of new speculative development starts over the last two successive quarters. At the end of Q1, the amount of speculative construction underway was down 37% from its six-year peak in Q3 2008.


Car insurance company Swiftcover.com acquired 21,536 sq ft at the Glashaus building in Cobham, Surrey.

KNIGHT FRANK VIEW

- Knight Frank has revised its take-up forecast for 2009 down to 1.5m sq ft, just under half the annual average. Take-up is forecast to recover in 2010 and 2011, driven by a combination of market churn from anticipated lease expiries and breaks and a good choice of attractively priced accommodation.
- Across the key M25 towns, Grade A net effective rents have reduced by an average of 25% since the end of 2007, a much more aggressive fall than was the case in the 1990s recession. With the market having reacted so quickly to the downturn in demand, moving forward we anticipate further reductions in net effective rents to be more muted before stabilising next year.
- From its current low base, the vacancy rate will tick up closer to 9.0% in the next 12 months as space currently under construction completes and the availability of tenant release space increases. However, with little or no additional speculative development, we expect the vacancy rate to remain below 10% throughout the recession.

Figure 1
M25 take-up

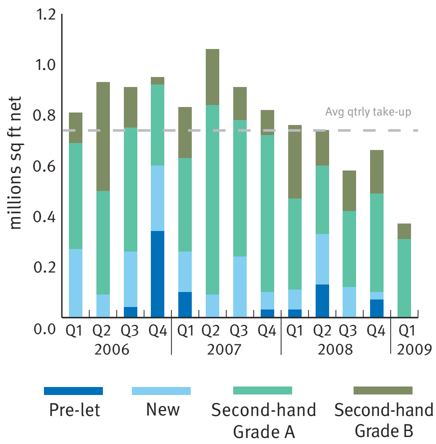


Figure 2
Space under construction in the M25

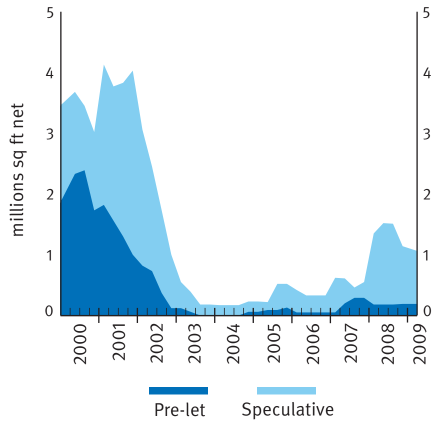


Figure 3
M25 active enquiries by sector

Manufacturing & Pharmaceuticals	25%
Financial & Business Services	18%
Retail, Distribution & Transport	16%
ICT	14%
Public Sector	11%
Construction & Engineering	6%
Other	10%

Source: Knight Frank Research

Market statistics

Table 1

Key town prime rents & forecasts

Town	Q1 prime rent (psf)	Rent free (months)
Basingstoke	£19.00 ▼	24 ▲
Brentwood	£23.00 ▼	21 ▲
Gatwick	£24.00 ▼	24 ▶
Guildford	£26.00 ▼	21 ▲
Hammersmith	£34.00 ▼	24 ▲
Heathrow	£25.00 ▼	30 ▲
West Malling	£22.50 ▼	18 ▶
Reading	£27.50 ▼	24 ▶
St Albans	£24.00 ▼	21 ▲
Uxbridge	£25.00 ▼	24 ▲
Watford	£23.50 ▼	24 ▶

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

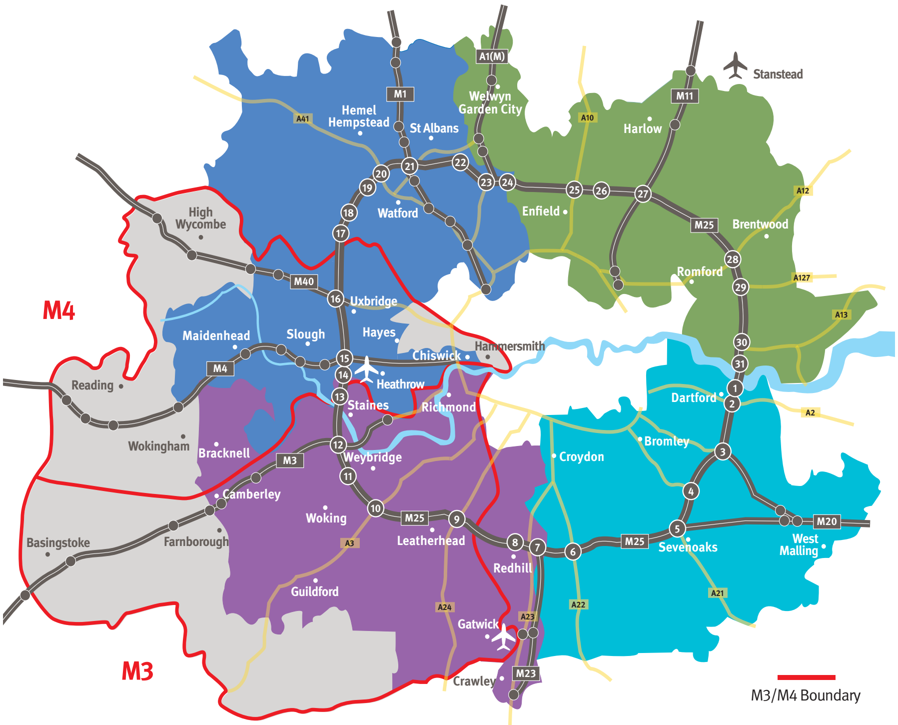


Table 2

Demand & Supply

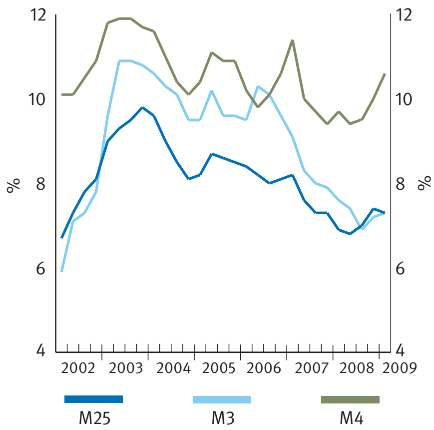
Take-up	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft	**377,464**	96,101	201,159	17,198	63,006	**167,798**	**214,194**
Change 3 months	**-43%** ▼	-73% ▼	5% ▲	-75% ▼	61% ▲	**-53%** ▼	**-33%** ▼
Change 12 months	**-51%** ▼	-65% ▼	-50% ▼	95% ▲	-23% ▼	**-56%** ▼	**-73%** ▼
Q1 pre-let (sq ft)	**0**	0	0	0	0	**0**	**0**
Q1 % take-up new & pre-let	**1%**	–	2%	0%	0%	**2%**	**10%**
Forecast 2009 take-up (m sq ft)	**1.5**	–	–	–	–	**0.8**	**1.0**

Availability	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft	**9,482,406**	4,861,917	3,354,626	427,403	864,405	**3,057,431**	**6,728,643**
Change 3 months	**-1%** ▼	-3% ▼	4% ▲	-5% ▼	-5% ▼	**1%** ▲	**6%** ▲
Change 12 months	**6%** ▲	13% ▲	5% ▲	-18% ▼	-7% ▼	**-4%** ▼	**10%** ▲
Q1 % new	**16%**	17%	19%	13%	2%	**23%**	**22%**
Q1 % SH Grade A	**52%**	61%	48%	12%	34%	**59%**	**40%**
Q1 % SH Grade B	**32%**	22%	33%	75%	64%	**18%**	**38%**
Q1 vacancy rate (▲/▼ movement from Q4)	**7.3%** ▼	9.6% ▼	8.2% ▲	2.4% ▼	4.3% ▼	**7.3%** ▲	**10.6%** ▲

Under construction	**M25**	NW	SW	NE	SE	**M3**	**M4**
Sq ft (net approx)	**1,056,284**	532,985	359,861	0	163,438	**294,535**	**1,555,126**
Change 12 months	**-24%** ▼	-26% ▼	-46% ▼	0% ▶	100% ▲	**-24%** ▼	**-4%** ▼
Pre-let	**188,306**	100,000	30,000	0	58,306	**240,000**	**479,000**

Source: Knight Frank Research

Figure 4
Vacancy rates



M4 & M3 markets

- M4 take-up in Q1 fell by 33% on Q4 2008 and was 73% below the Q1 2008 total, the largest fall of its kind on record. In addition, only 12 transactions took place in the M4, the lowest number in any quarter for five years.
- The largest transaction in the M4 also brought Q1's highest headline rent. Halcrow acquired 85,672 sq ft at EMI House, Hammersmith, at an agreed rent of £32.00 per sq ft. There was just one transaction involving new accommodation, comprising Wrigley UK's 8,218 sq ft acquisition at 1420 Arlington Business Park, Theale, at an agreed headline rent of £28.00 per sq ft.
- The M4 vacancy rate increased from 10.0% to 10.6% in Q1 due partly to five completions, including PRUPIM's 500 and 550 South Oak Way, Reading which provide 86,180 sq ft of Grade A accommodation. The amount of new accommodation available in the M4 is at its highest level since Q1 2005.
- M3 take-up in Q1 fell by 53% on Q4 2008 and was 56% below the Q1 2008 total. Of the 14 transactions in the M3, UAV Tactical System's acquisition of 3,500 sq ft at 250 Fowler Avenue, IQ Business Park comprised the sole transaction for new accommodation in the M3.
- The M3 vacancy rate increased marginally from 7.2% in Q4 2008 to 7.3% in Q1. Of the 267,000 sq ft of space brought to the market in Q1, 65 Woodbridge Road, Guildford, a 31,253 sq ft development by Standard Life, comprised the only new development completion.

In Q1 PRUPIM completed the development of 500 and 550 South Oak Way at Green Park, Reading, which collectively provide 86,180 sq ft of new office space

KNIGHT FRANK VIEW

- In the M4 corridor, the largest impact on net effective rents has been in those towns where supply greatly outstrips annual demand levels. From an occupier's perspective, established centres such as Bracknell and Maidenhead provide a window of opportunity for tenants to secure quality accommodation on very favourable terms over the next 18 months.
- Take-up in the M3 corridor in 2009 will not come close to the high levels witnessed in 2008. However, relative to the M4, the restricted supply of new accommodation and limited development pipeline will ensure that downward pressure on rents is rather less severe than elsewhere.

Figure 5
M3 take-up

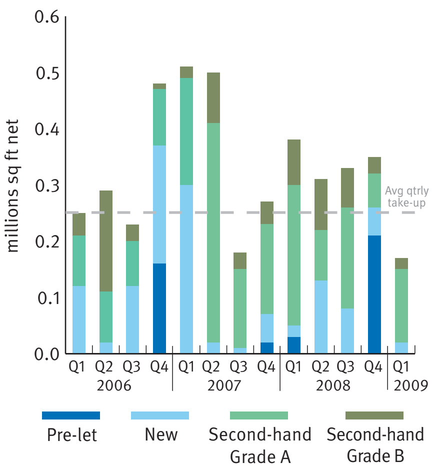


Figure 6
M4 take-up

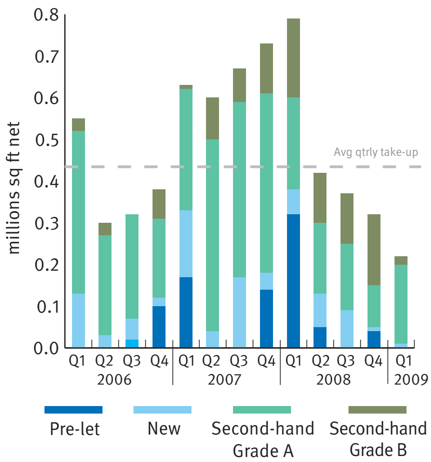
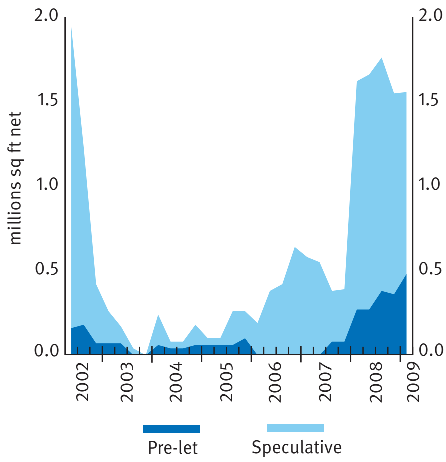


Figure 7
Space under construction in the M4



Source: Knight Frank Research

Investment market

Table 3

Key investment transactions Q1 2009

Building	Size (sq ft)	Price	Net initial yield	Vendor/ Purchaser
The Zurich Centre, Fareham	100,181	£22.05m	7.95%	Goodman / Hildane
Capital Court, Uxbridge	54,378	£10.98m	11.01%	Capital & Counties / Standard Life
Renaissance, Basingstoke	70,510	£9.80m	11.45%	ING Real Estate / Benedict Estates
100 Berkshire Place, Reading	55,531	£8.25m	14.30%	Aviva Investors / Praxis Holdings
Venture House, Staines	18,263	£4.50m	9.25%	RLAM / Praxis Holdings
Gateway, Guildford	17,466	£5.10m	8.00%	Henderson / Starfield Properties

	Transaction volume	Mean lot size	Mean NIY
Q1 2009	£68.6m	£8.6m	9.98%
Change 3 mths	6% ▲	-7% ▼	+264bps ▲
Change 12 mths	-66% ▼	-7% ▼	+245bps ▲

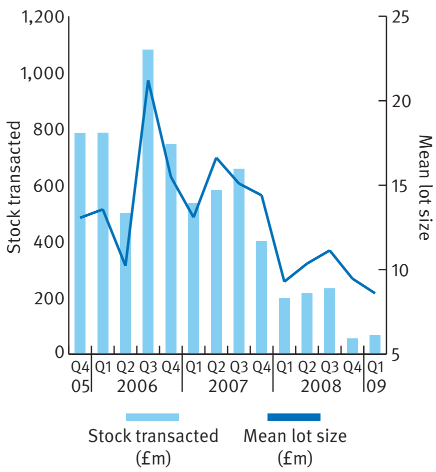
Hildane purchased The Zurich Centre in Fareham from Goodman for £22.05m reflecting an initial yield of 7.95%

KNIGHT FRANK VIEW

- After a terrible 2008 for the investment market, Q1 2009 has at least brought a marked increase in investor interest if not renewed buying activity. However, the lack of available debt continues to be a problem and the deteriorating occupational market is being considered in even the strongest office centres.
- Investors looking at South East offices are predominantly private property companies and private investors and, while overseas investors are rumoured to be active, their focus lies within Central London and the UK's regional centres. Investors remain largely defensive, however, with fundamentals of long income, sound covenant and location remaining key.
- With more active buyers in the market, yields for this kind of prime asset have stabilised if not hardened, with several bids on properties improving from recent market levels. Yields on secondary properties with shorter income and questionable covenants are continuing to move upwards.

Figure 8

£m investment volumes and lot size



Source: Knight Frank Research

Figure 9

Mean initial yield & finance

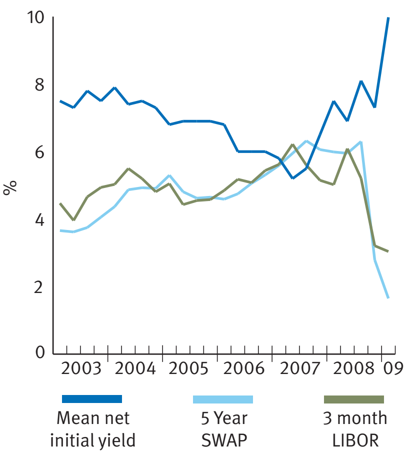
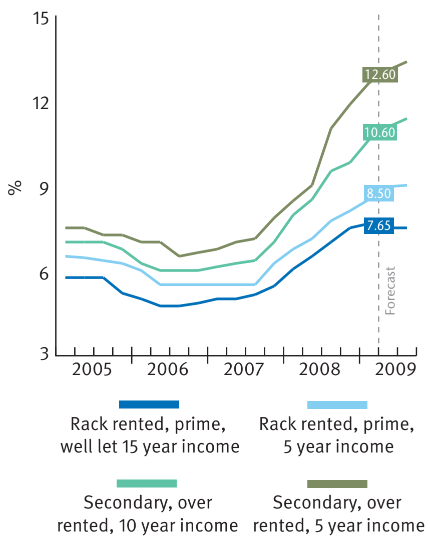


Figure 10

Yield forecasts



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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), and figures quoted have been rounded to the nearest thousand sq ft.
- 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 2009.

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