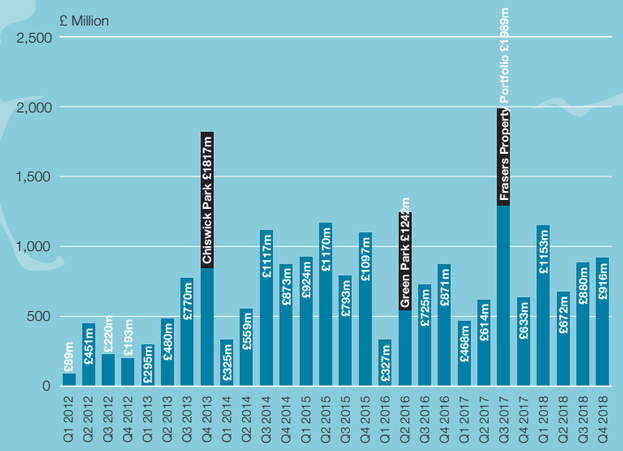
2018 SOUTH EAST OFFICES INVESTMENT BULLETIN

2018 REVIEW AND 2019 PREDICTIONS

Quarterly transaction volumes Q1 2012 - Q4 2018

Source: Gerald Eve



2018 by numbers

£3.62bn ^

of South East offices transacted in 2018, 5.5% above the 5 yearly average of £3.42bn.

5.25%

Prime yields throughout 2018 remained stable at 5.25% NIY.

FRASERS PROPERTY

The two largest deals of 2018 were Spelthorne Borough councils acquisition of the Landid/Brockton Portfolio (£285m) and Farnborough Business Park (£174.6m), acquired by Frasers Property International.

48%

of transactions in West London and the Thames Valley.

28%

Local Authorities were the most active buyers in 2018, accounting for over 28% (£1bn) of the market and more than doubling their acquisition volume in 2017.

£24.5m

SOLD

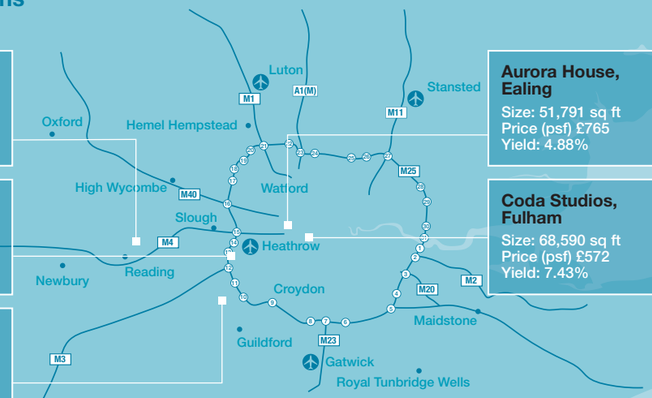
Average deal size was £24.5m in 2018, a 2% increase from the previous year.

Q4 key investment transactions

Microsoft Campus, Uxbridge
Size: 246,138 sq ft
Price (psf) £406
Yield: 6.31%

Future House, Staines
Size: 69,052 sq ft
Price (psf) £492
Yield: 5.60%

Victoria Gate, Woking
Size: 63,580 sq ft
Price (psf) £645
Yield: 4.75%



Aurora House, Ealing
Size: 51,791 sq ft
Price (psf) £765
Yield: 4.88%

Coda Studios, Fulham
Size: 68,590 sq ft
Price (psf) £572
Yield: 7.43%

2018 South East Office Investment Market Commentary

Overview
South East office transactions volumes remained robust in 2018, which transpired to be year of mixed investor sentiment. Transaction volumes totalled £3.62bn across 148 deals, a 2.4% fall on volumes seen in 2017 (£3.7bn) but slightly ahead of the 5 year average transaction volume of £3.42bn. A year-on–year fall was largely anticipated as 2017 was one of the strongest years for investment volumes in the current cycle.
The average deal size in 2018 was £24.5m, slightly ahead of the previous year (£24.0m).

Q4 2018 saw £916m of transactions, a 3.9% increase from the £880m transacted in Q3, but slightly lower than expected as Brexit uncertainty increased during the final two months of the year and a number of deals were pushed into 2019. Rising political uncertainty in Q4 negatively impacted investor demand towards the end of the year particularly for larger assets in excess of £50m. The decreased liquidity of larger lot sizes in Q4 was evidenced by a fall in the average lot size transacted, which was £19.92m, a 30% fall on average lot size seen in Q3 2018 (£28.4m).

Prime yields throughout 2018 remained stable at 5.25% NIY (although we are witnessing deals below this), in line with 2017, however, the yield spread has widened in Q4 2018, particularly for short let assets on business parks, as property companies and private equity funds priced in political instability.

South East occupational markets remained resilient throughout 2018 with total take-up hitting c.3.9m sq ft. Occupier confidence returned to the market with a number of high profile lettings being agreed including Sanofi's 71,000 sq ft letting at Thames Valley Park in Reading. The South East office market is still characterised by a severe lack of speculative development, while permitted development has eroded stock in many markets. Rental growth is polarised but is being evidenced across many of the South East markets, which continues to drive returns and draw investors to the sector.

Local Authorities
Local authorities were the most acquisitive investor type, accounting for over 28% of total acquisitions throughout 2018, totalling £1,02m across 30 separate acquisitions. Local authorities more than doubled their acquisition volume compared to 2017 (£445m).

Local authorities demand is being driven by the need to bridge shortfalls due to cuts in central government funding. Spelthorne and Runneymede have been the most active, building up substantial portfolios of south east office investments. Whilst the majority of local authorities prefer to acquire in borough there are a number that continue to acquire further afield, an example includes Mid Suffolk Council's acquisition of West Park House in Southampton (5.98% NIY / £5.095m).

We expect this to continue in 2019.

Institutions
Institutions followed overseas investors in terms of acquisition volumes, acquiring a total of £673m, 19% of total acquisitions. Although institutional demand and acquisition volumes increased in 2018 vs 2017 (£545m), institutions have remained net sellers of South East offices over the last two years. Institutional sales accounted for 43% of all South East office sales.

Institutional requirements throughout 2018 tended to focus on South East industrial as opposed to offices. Throughout 2018 institutions sought to divest their business park offices and focus on core town centre and M25 locations. Notable institutional acquisitions include Aviva's acquisition of Aurora in Ealing for £38m.

Property Companies
Property companies remained acquisitive throughout 2018, purchasing a total of £548m, representing 15% of all acquisitions. Property companies completed 29 separate acquisitions throughout 2018, meaning they were the most acquisitive by number of deals, with an average deal size of £23m.

Property companies continued to favour the South East office market as it offers comparative value in terms of yields against industrial, less perceived market risk vs retail, the option to convert to residential under permitted development and rental growth in markets where supply remains constrained. Notable deals include First Property's acquisition of St Mark's House in Horsham for £28.15m / 6.65% NIY / £194 psf.

Q4 2018 key deals

Property	Lettable area (sq ft)	Current AWULT to breaks	Current AWULT to expiries	Sold Price			Vendor	Purchaser
				Yield (NIY)	Price	Price (psf)		
Microsoft Campus, Reading	246,138	-	8 yrs	6.31%	£100,000,000	£406	Receivership	Valesco Group
Coda Studios, Fulham	68,590	-	1.9 yrs	7.43%	£39,225,000	£572	Columbia Threadneedle	Rockspring
Aurora House, Ealing	51,791	-	9.8 yrs	4.88%	£39,600,000	£765	Moorfield Group	Aviva
Future House, Staines	69,052	-	9.5 yrs	5.60%	£34,000,000	£492	La Salle IM	Roebuck Asset Management
Victoria Gate, Woking	63,580	-	20 yrs	4.75%	£41,000,000	£645	Aviva	McLaren

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Key deals, left to right: Microsoft Campus, Uxbridge, Coda Studios, Fulham

Overseas Investors
Overseas investors accounted for £568m (16%) of total acquisitions. Overseas investors more than halved their 2017 investment volumes of £1.16bn. The decreased exposure was linked to overseas investment focusing on central London and increased perceived risk in the UK due to Brexit concerns resurfacing in the second half of 2018.

Despite a decline in overseas investment in 2018, overseas investors accounted for the largest average deal size of all investor types at £47m, indicating their preference for larger offices and business parks. High profile overseas acquisitions included the £100m / c.6.60% acquisition of the Microsoft Campus on Thames Valley Park, Reading by a consortium of South Korean investors.

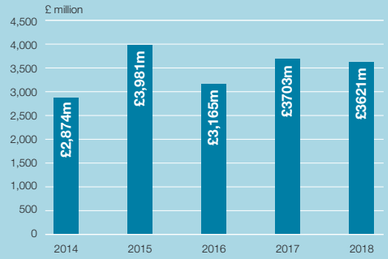
Private Equity
Investment from private equity funds remained fairly muted throughout 2018 as prime pricing remained stable, coupled by a lack of distressed sales and value-add opportunities. Private equity funds have also seen increased competition for VP offices from residential developers in the South East market due to permitted development. Private equity funds accounted for £303m (8%) of total acquisitions and tended to target office portfolios of scale, such as Ares's acquisitions of the Equinox Portfolio (£140m) and Westbrook's acquisition of the Acute Portfolio (£41m).

Developers
Although residential developers remained prevalent in the South East market, their appetite started to slow in 2018 with a total £151m of acquisitions, representing a decrease of 25% on 2017 volumes. The second half of 2018 saw a marked slowdown in the permitted development market as more Article 4 directions came into effect and given increasing concerns over residential values.

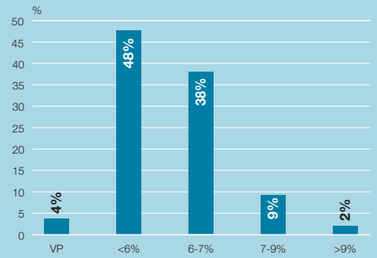
South East Office Investment Market 2019 Predictions

- Prime yields are likely to remain firm at 5.25% due to expected robust local authority demand and institutions continuing to selectively purchase in core markets.
- We expect the yield spread between prime and secondary to widen in the first half of 2019, due to Brexit concerns impacting investor sentiment.
- Rental growth is likely to be a key component of returns due to the lack of speculative development/refurbishment activity.
- We anticipate the local authorities to continue acquiring South East offices throughout 2019 given their upcoming funding gaps and the availability of finance from the Public Works Loan Board.
- We expect private equity and property companies to remain acquisitive throughout the first half of 2019, with the aim of capturing discounted pricing amid political uncertainty.
- We expect the number of permitted development deals to slowdown, especially in out of town locations. In markets where office stock has become eroded and rental growth is evidenced, speculative office refurbishment may start to look more viable than residential conversions.
- During the second half of 2019 we expect overseas investor demand for South East offices to increase due to the weak pound and the potential for more clarity surrounding Brexit.

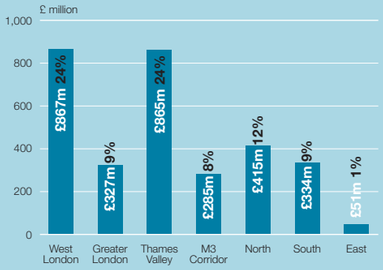
South East office annual invesment volume
Source: Gerald Eve



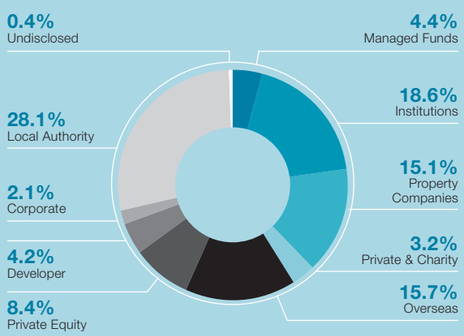
Investment volume by net intial yield, Q4 2018
Source: Gerald Eve



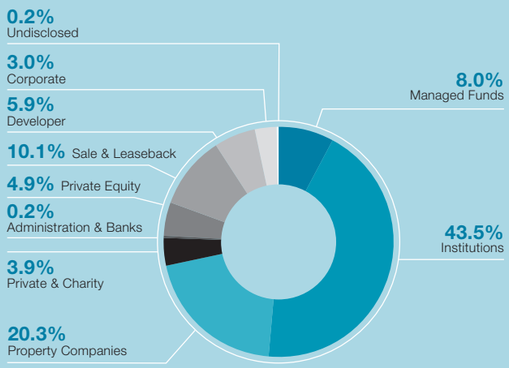
Investment volume by sub-region, Q4 2018
Source: Gerald Eve



Purchasers by investor type 2018
Source: Gerald Eve



Vendors by investor type 2018
Source: Gerald Eve



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