

Quarterly transaction volumes Q1 2012 - Q1 2019

Source: Gerald Eve



Q1 2019 by numbers

- £387m** of South East offices transacted
- 5.25%** prime yields remained stable at 5.25% NIY
- 31** deals completed throughout Q1 2019
- 32%** of deals were completed by local authorities who were the most active buyers
- 57%** Institutions were the most active vendor, accounting for 57% of all transactions
- £211m** of South East offices are under offer across 18 deals and over £400m is on the market

Q1 2019 South East Office Investment Market Commentary

UK Economic Overview

The UK economy is enduring a soft patch, reflecting the recent slowdown in world trade and ongoing Brexit-related uncertainty. But provided that Brexit is 'orderly', we expect strengthening household spending power and looser fiscal policy to underpin a modest acceleration in GDP growth through 2019 and into next year, with GDP growth forecast at 1.4% this year and 1.9% in 2020.

Undoubtedly Brexit uncertainty is continuing to be a key headwind to the UK economy as negotiations have remained at the forefront of the headlines. This has led investors to exert a higher level of caution on key decisions in the near term, until the UK's relationship with the EU becomes clearer. However, if Brexit proceeds in an 'orderly' fashion we would expect the market to gather momentum in the second half of 2019.

South East Offices - Q1 Activity

Despite the challenging macro-economic and political environment, the resilience of the South East office investment market has been evidenced by a total transaction volume for Q1 2019 of £387 million. This is low in the context of the five year average (£575 million) but perhaps more than what would have been expected given the caution in the market. There were a total of 31 deals in Q1 2019, which reflects a significant amount of activity for lot sizes of sub-£20 million. Furthermore, there is over £400m available on the market. Our analysis shows that the majority of deals were located in the Thames Valley and South of the M25, which is reflective of the liquidity and attractiveness of the core town centre locations such as Brighton, Reading and Windsor.

In Q1 2019 the prime and secondary yield gap widened further for South East offices, highlighting that investors are becoming increasingly polarised. Investors will typically target either prime core assets to capitalise on secure income, or, less frequently, value-add opportunities to drive capital and rental growth. Prime yields in Q1 2019 remained stable at 5.25%.

The South East occupational market remains resilient, with growth in headline and net effective rents evidenced across most South East markets in Q1. This was driven by buoyant occupational demand and lack of good quality grade A availability, which has been further exacerbated by residential permitted development, and, the scarcity of speculative office development.

Retail Fund Redemptions

Following substantial redemptions in December 2018 and January 2019 a number of retail funds' cash positions were reduced to levels that triggered an element of forced selling. Whilst this was nationwide and across sectors, the window for purchasers to take advantage was limited and following selective disposals, normality has returned.

Q1 2019 key investment transactions

Property Name	Size (sq ft)	Price (£m)	Price (£psf)	NIY (%)	Purchaser	Status
1&2 Windsor Dials, Windsor	68,669	*£25m	£364	7.80%	VP	UNDER OFFER
Theta Building, Camberley	51,575	£13.4m	£260	7.80%	Surrey Heath Council	
Ashbourne House, Guildford	35,557	£12.75m	£363	7.00%	Rushmoor Borough Council	
Florence Building, Basingstoke	60,546	£29m	£472	4.00%	LGIM	
Watson House, Reigate	73,936	*£27.375m	£370	6.10%	M&G	ONES TO WATCH
CP House, Ealing	51,602	£23m	£446	3.93%	Overseas	
The Heights, Weybridge	349,903	*£145m	£414	6.50%	M&G	ONES TO WATCH
Victory House, Brighton	84,988	£36.5m	£429	4.83%	Exchanged	
Brinell Building, Brighton	65,253	£39m	£600	4.75%	Orchard Street	

*quoting prices

Local Authorities

Local authorities established themselves as the most active investor in 2018, accounting for 28% of total acquisitions. They retained the largest share in Q1 2019, accounting for £115.3m and reflecting 32% of the deals completed. The majority of local authority transactions in Q1 2019 were completions on assets marketed in Q4 2018. Since January, we have seen demand from local authorities fall as most have now spent their annual budgets. We anticipate activity from local authorities to reduce further in Q2 2019 as purchasing activity is becoming more in borough focused and as the pre-election period approaches the local authorities enter purdah. We anticipate a bounce back in demand in the second half of 2019.

Institutions

Institutions remain active buyers for long income and prime assets in core town centre and M25 locations. This was evidenced by Orchard Street's acquisition of the Brinell Building, Brighton (4.74% NIY) and Schroder's sale of Victory House, Brighton to NFU (exchanged at 4.83% NIY), both of which attracted competitive bids from several UK institutions. Refurbishment opportunities in core markets also remain in high demand as evidenced by FM Global's sale of Windsor Dials which offered a unique 68,669 sq ft refurbishment opportunity in the heart of a sought-after market with a constrained supply pipeline. The limited availability of value-add opportunities meant that there was a very competitive bidding process with over eight bidders.

Property Companies

Whilst industrial rents and capital values are at record highs, the market has seen property companies turn their focus to South East offices in search of yield arbitrage. Given that institutions remain focussed on a select number of core South East markets, property companies are taking advantage of attractive pricing for good quality offices in the more provincial South East locations. Furthermore, there continues to be depth to the lending market with competitive rates, which has favoured property companies and private equity investors. Notable deals by property companies include Dukesbridge, Reading which was acquired by Lipman Properties for £10.9 million.



Left to right: Victory House, Brighton 1&2 Windsor Dials, Windsor Brinell Building, Brighton

Overseas Investors
Overseas investors have maintained their presence in the market, with notable deals including the acquisition of CP House, Ealing for £23 million by an Israeli investor. Despite the relative weakness of sterling, overseas investors have reduced their exposure to the South East market in the short term as a result of ongoing Brexit concerns. This has impacted liquidity for larger lot sizes, including The Pinnacle, Milton Keynes and The Heights, Weybridge, both of which did not sell. We anticipate a resurgence in demand from overseas investors in the second half of 2019, as more clarity emerges on the UK's exit from the EU.

Private equity
Private equity investors remain keen to acquire South East offices and have raised significant capital to deploy as and when suitable repositioning opportunities arise. However, only one private equity purchase was recorded this quarter as geared double digit returns remain hard to find. An example of this was Aviva's Symphony portfolio which was dominated by South East office value-add assets attracting good private equity interest but not at acceptable pricing levels. The portfolio is now being broken up.

Outlook & Market Insight
We anticipate the Q2 transaction volume to be marginally above the Q1 results, provided greater clarity on Brexit is forthcoming and the weight of money withheld from the market in Q1 starts to return late into the quarter. Brexit uncertainty will undoubtedly remain ongoing for the immediate future and the chance of a 'no deal' looks more unlikely, however is still an option if the Government fails to muster a majority for a withdrawal agreement.
At the end of Q1 2019, £211 million of South East offices were under offer across 18 deals. Activity from local authorities will likely reduce in Q2 2019 as they enter purdah ahead of the May 2019 local elections, however we would expect overseas investors to increase their exposure to the market once we receive some certainty.

Prime yields will likely remain stable at 5.25%, although the yield spread between prime and secondary could widen further as institutions remain focused on core prime assets.

Whilst investors remain nervous about the outcome of the Brexit negotiations, they will take comfort in the strength of the occupier market. Rental growth will continue to be a key component of returns given robust occupational demand and the fact that speculative development remains muted.

Q1 2019 key deals

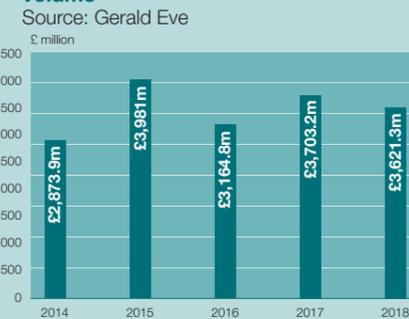
Property	Lettable area (sq ft)	Current AWULT to break	Current AWULT to expiry	Sold Price			Vendor	Purchaser
				Yield (NIY)	Price	Price (psf)		
Brinell Building, Brighton	65,253	10 yrs	12 yrs	4.75%	£39,000,000	£600	McAlee & Rushe	Orchard Street
CP House, Ealing	51,602	1.4 yrs	1.9 yrs	3.93%	£23,000,000	£446	Zurich Insurance	Overseas
Florence Building, Basingstoke	60,546	-	20.0 yrs	4.00%	£29,000,000	£472	Abstract Securities	LGIM
Theta, Camberey	51,575	4.4 yrs	10.2 yrs	7.80%	£13,400,000	£260	Kennedy Wilson	Surrey Heath Council
Ashbourne House, Guildford	35,557	3.0 yrs	8.8 yrs	7.00%	£12,750,000	£363	Aberdeen Standard	Rushmoor Borough Council
Victory House, Brighton	84,988	-	7.7 yrs	4.83%	£36,500,000	£429	Schroders	Exchanged

Ones to watch

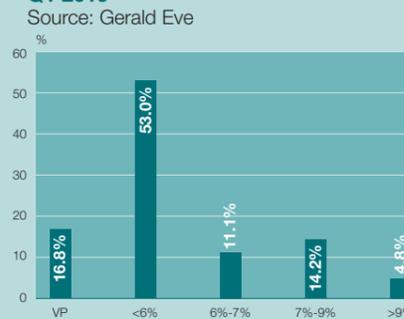
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1&2 Windsor Dials, Windsor	68,669	-	-	-	*£25,000,000	£364	FM Global	Under Offer
Watson House, Reigate	73,936	7.0 yrs	10.0 yrs	6.10%	*£27,375,000	£370	M&G	Available
The Heights, Weybridge	349,903	3.9 yrs	5.0 yrs	6.50%	*£145,000,000	£414	M&G	Available

*quoting prices

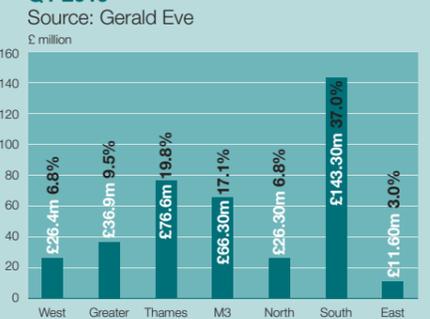
South East office annual investment volume



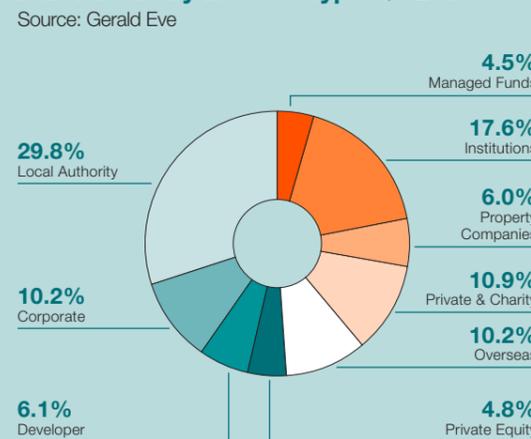
Investment volume by net initial yield, Q1 2019



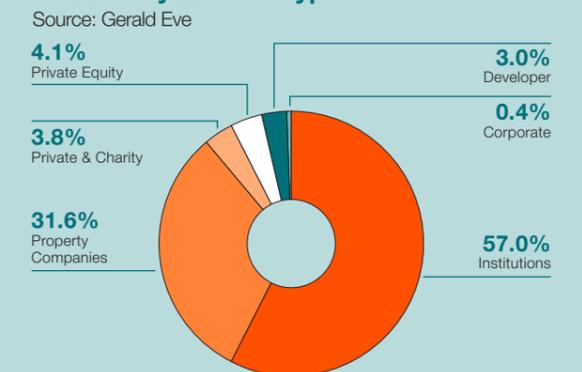
Investment volume by sub-region, Q1 2019



Purchasers by investor type Q1 2019



Vendors by investor type 2019



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