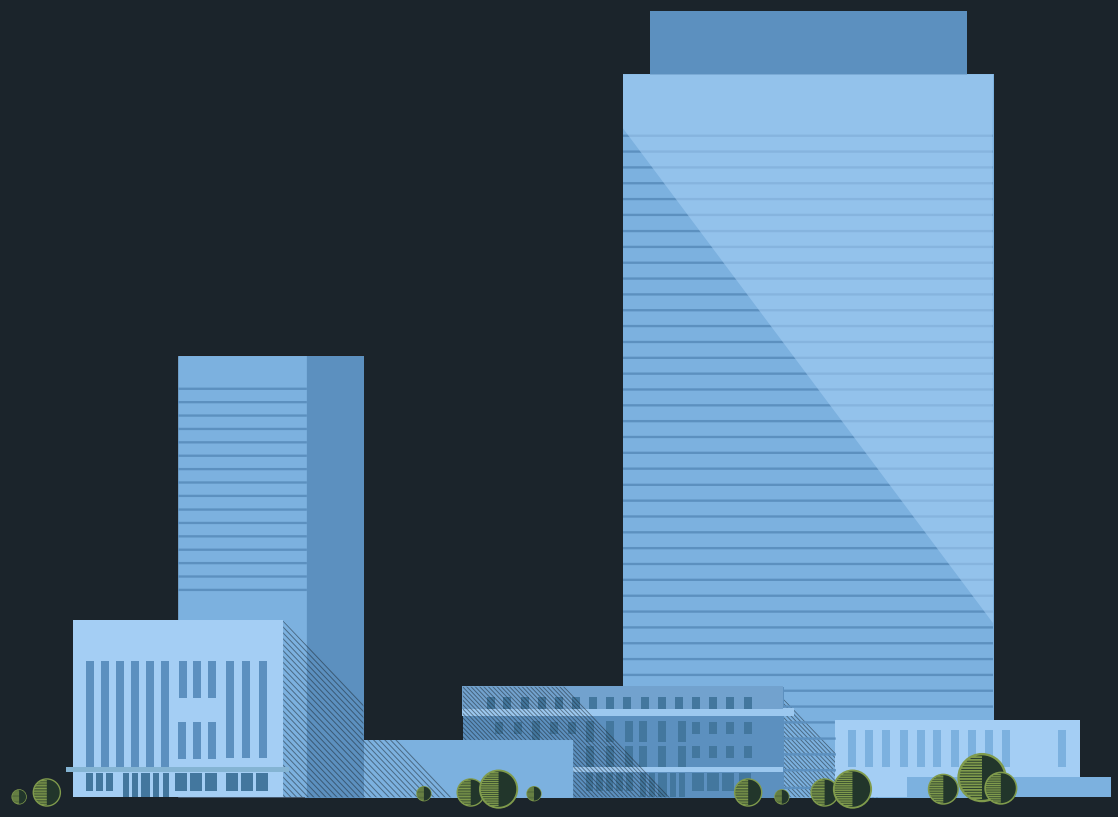
SOUTH EAST OFFICE INVESTMENT BULLETIN

Q4 2019



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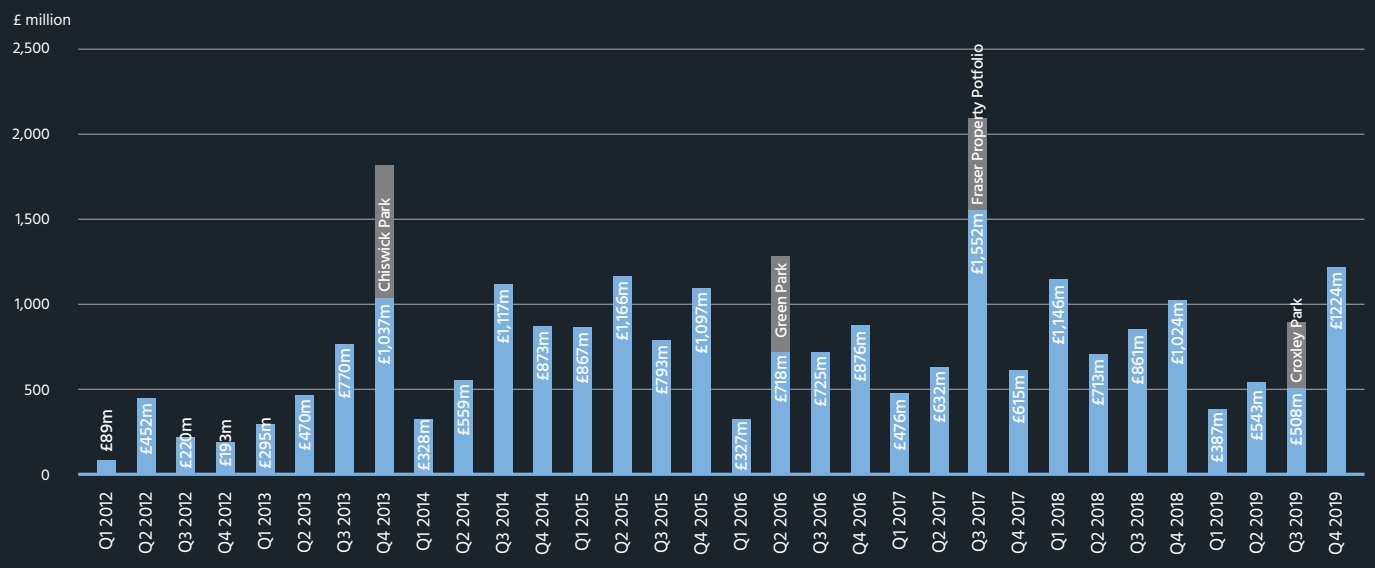
Q4 2019 BY NUMBERS

South East Office Quarterly Investment Volumes

Source: Gerald Eve



£1.224bn ∧

volume of south east offices transacted in Q4 2019

5.00% —

south east offices prime yields (Q4 2019)

47 ∧

deals completed throughout Q4 2019

£840m

of south east offices are under offer

33.1%

of deals were completed by institutions who were the most active purchaser

SOUTH EAST OFFICE INVESTMENT MARKET REVIEW – Q4 2019

Overview

The UK economy was characterised by political turbulence through the final quarter of 2019, as the country underwent a second Brexit extension and a general election. Q4 has traditionally been the most active period for investors, however Q4 2019 proved to be defined by a lack of stock as investors held back sales in the run up to the Brexit deadline. That said, a large proportion of deals carried forward from the summer completed before the year end, with 19 deals (c. £522m) completing in December once clarification on the general election was provided. Total transaction volume for 2019 totalled £3.16bn, reflecting a 16% drop on 2018. The total transaction volume for the quarter was £1.224bn, which exceeded Q3 volumes by 35% and by 17% on its respective quarter last year. Furthermore, the outcome of the general election has provided greater political clarity and with a clearer direction for the UK, investors appear more optimistic for 2020.

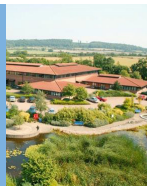
Amid the uncertainty, the deployment of capital remained focused on well-positioned core assets with strong tenant covenants. Institutions competitively targeted core prime opportunities providing security of income and liquidity and prime net initial yields held stable at 5.00%. The 'flight to quality' by institutions was a prominent trend for Q4, as they recorded £405m of acquisitions, establishing themselves as the most active investor by a notable margin.

The south east office occupational market has shown good levels of take-up and a fall in availability for the submarkets offering the best quality and most flexible stock in core town centre locations. This has provided a compelling opportunity for investors and developers targeting value add/repositioning assets.

Looking ahead we expect there to be a good appetite for Grade A south east offices as new opportunities are launched to the market and the more evergreen capital selectively returns in search of value and growth. The greater degree of political certainty will improve liquidity positions and in turn translate into higher transaction volumes for 2020.

Q4 key investment transactions

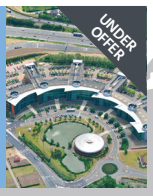
1 Caldecotte Lake Business Park
Size 172,055 sq ft
Price £35.25m (£205 psf)
NIY 7.65%
Purchaser Galliard Homes

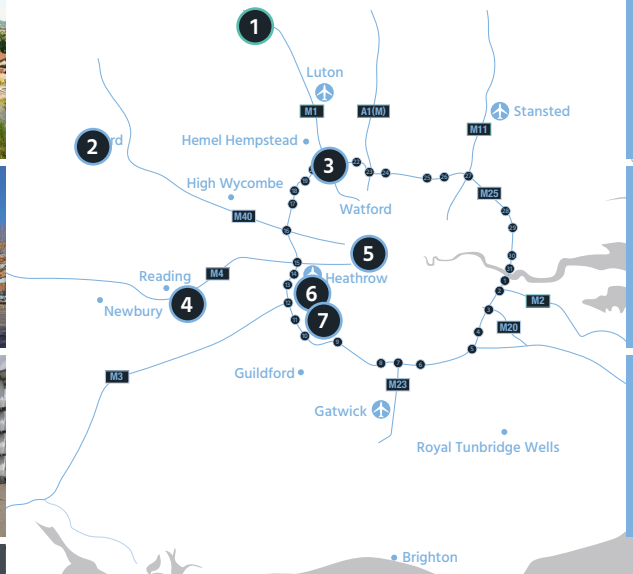


2 Seacourt Tower, Oxford
Size 176,442 sq ft
Price £81.3m (£461 psf)
NIY 4.76%
Purchaser Brockton Capital

3 ASOS, Leavesden Park, Watford
Size 197,364 sq ft
Price £86m (£436 psf)
NIY 5.40%
Purchaser Private Overseas

4 Reading International
Size 376,587 sq ft
Price £131m (£328 psf)
NIY 5.80%
Vendor DWS





5 Building 7, Chiswick Park
Size 333,984 sq ft
Price £300m (£898 psf)
NIY 5.18%
Vendor Blackstone

6 TWENTY, Kingston Road, Staines
Size 44,230 sq ft
Price £19m (£430 psf)
NIY 6.76%
Purchaser CLS Holdings

7 The Heights, Weybridge
Size 349,903 sq ft
Price £136m (£389 psf)
NIY 6.93%
Purchaser Kennedy Wilson

ACTIVITY BY INVESTOR TYPE (quarter on quarter)

-43% ∨
(Q4 total: £97m)

Local Authorities
Despite a rebound in investment activity in Q3, local authorities significantly reduced their total volumes in Q4, accounting for £97m of acquisitions. This has been a likely outcome from a combination of factors including; a refocused investment strategy on mainly 'in-borough' opportunities, a more critical selection approach following a run of negative press, general election, and the absence of lot sizes up to £20m offering security of income in excess of five years. Furthermore, in October 2019 the Government announced a 1% hike on the interest rate for new loans from the PWLB to commence with immediate effect. Despite a notable dip in volumes, local authorities were the second most active investor by number of deals, as they remained competitive for smaller lot sizes of c. £10m. We anticipate local authority activity to increase in H1 2020 as requirement parameters are moved and new opportunities are sourced.

511% ∧
(Q4 total: £405m)

Institutions
UK institutions were net vendors at the end of the year as they continued to experience volatility from redemptions on their open-ended retail funds. The largest outflows in 2019 were reported in the run-up to the election in December and the announcement by M&G that they were gating their fund. This placed increasing pressure on a number of other retail funds including those run by Aberdeen Standard Investments, Nuveen Real Estate, Aviva Investors and Columbia Threadneedle. Institutions had retrenched investment activity for much of the year, however significantly increased their activity in Q4. Institutions bolstered their position as the most active investor in Q4, accounting for £405m of acquisitions. The challenge for institutions remains sourcing opportunities, as off-market approaches will require premium pricing to tempt vendors into selling.

48% ∧
(Q4 total: £180m)

Property Companies
Property companies increased their activity from the previous quarter and accounted for a total of £180m over 13 deals, making them the most active investor by number of deals. Property companies have continued to capitalise on the market uncertainty and the withdrawal of institutional interest for core plus 6% + opportunities. CLS Holdings completing on four acquisitions in Q4 alone is a case in point. Property companies have also been very competitive bidders for value-add town centre repositioning/redevelopment opportunities, where rental growth and an undersupply in the market is evident.

434% ∧
(Q4 total: £214m)

Overseas Investors
Whilst the value of sterling jumped to its highest level for three years against the euro following the election result, the UK remains attractive to international buyers. Overseas investors were the third largest purchaser of south east offices during Q4, accounting for 18% of total transactions volumes. Despite transacting over £214m, overseas investors accounted for just four deals as they remain focused on larger, defensive, income-led deals that can generate attractive cash-on-cash returns. Recent political instability in Iran and Hong Kong coupled with the retrenchment of local authorities to an in-borough focus should see overseas investment increase in 2020.

253% ∧
(Q4 total: £222m)

Private Equity
Despite the rise in demand from institutions and property companies, private equity interest for south east offices proved very strong, accounting for £222m of acquisitions. Private equity investors established themselves as the second most active purchaser of the quarter following the completions of two significant asset management opportunities. We expect this to continue as some of the larger multi-let assets that have come to the market, such as Reading International, have attracted bids from several private equity houses.

Key deals, left to right: ASOS, Leavesden Park, Watford & Caldecotte Lake Business Park, Milton Keynes

Outlook and Market Insight

- At the end of Q4 c.£840 million of south east offices were under offer, across 29 deals.
- We expect 2020 investment volumes to surpass 2019 levels due to the more optimistic outlook. However, with the UK's exit from the EU scheduled for 31st January 2020 and trade negotiations due to conclude before 31st December 2020, this may mean H2 2020 could experience some volatility.
- We expect property companies and private equity investors to take advantage of pricing for secondary assets in good locations.
- Open market deals are expected to return, as new opportunities get formally launched to the market and the depth of buyers grows.
- The underlying fundamentals in the occupational market are expected to continue to drive rental growth.
- Prime yields are likely to remain firm at 5.00%.
- Institutions will continue to buy selectively in core markets.
- Fluctuations in sterling will continue to make the UK attractive to overseas investors.
- South east offices will remain attractive to investors compared to other asset classes and fixed income assets.

Q4 2019 key deals

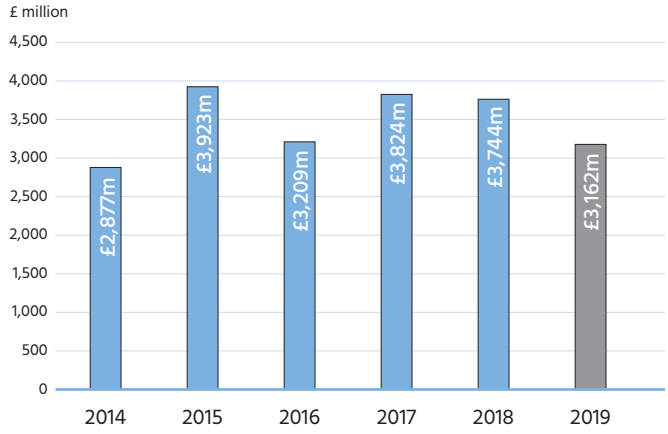
Property	Lettable area (sq ft)	Sold Price			Purchaser
		Yield (NIY)	Price	Price (psf)	
The Heights, Weybridge	349,903	6.93%	£136,000,000	£389	Kennedy Wilson
ASOS, Leavesden Park, Watford	197,364	5.40%	£86,000,000	£436	Private Overseas
Seacourt Tower, Oxford	176,442	4.76%	£81,300,000	£461	Brockton Capital
Caldecotte Lake Business Park, Milton Keynes	172,055	7.65%	£35,250,000	£205	Galliard Homes
TWENTY, Kingston Road, Staines	44,230	6.76%	£19,000,000	£430	CLS Holdings

Under Offer

Property	Lettable area (sq ft)	Asking Price			Vendor
		Yield (NIY)	Price	Price (psf)	
Building 7, Chiswick Park	333,984	5.18%	£300,000,000	£898	Blackstone
Reading International	376,587	5.80%	£131,000,000	£328	DWS

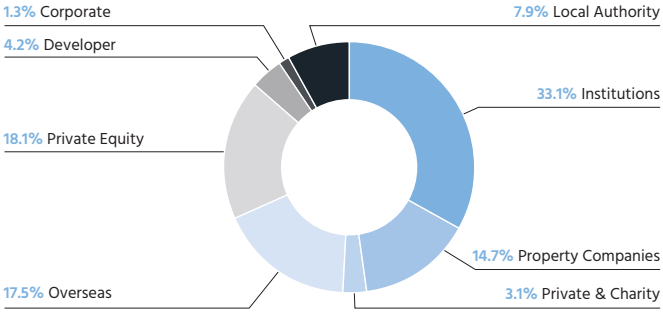
South East Office Annual Transaction Volumes

Source: Gerald Eve



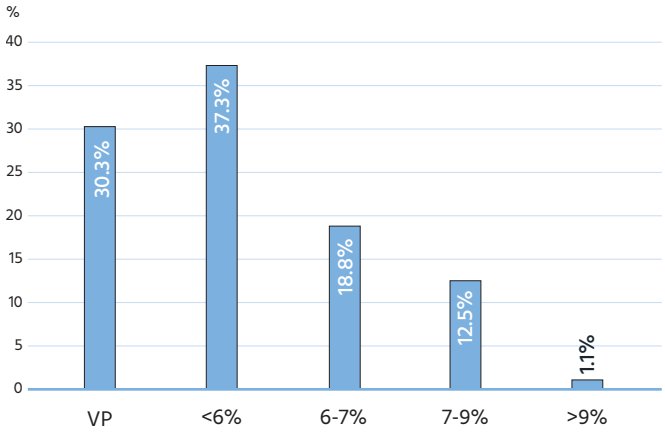
Purchasers by investor type, Q4 2019

Source: Gerald Eve



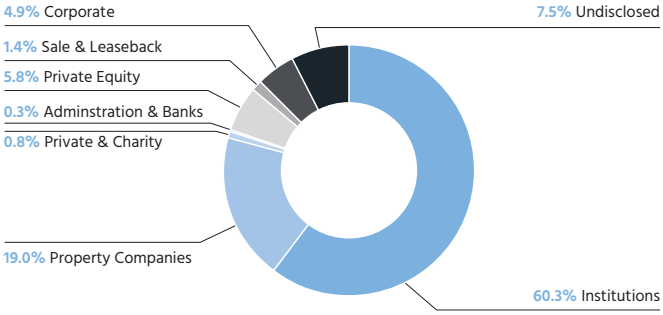
Q4 Investment Volume by Net Initial Yield Banding

Source: Gerald Eve



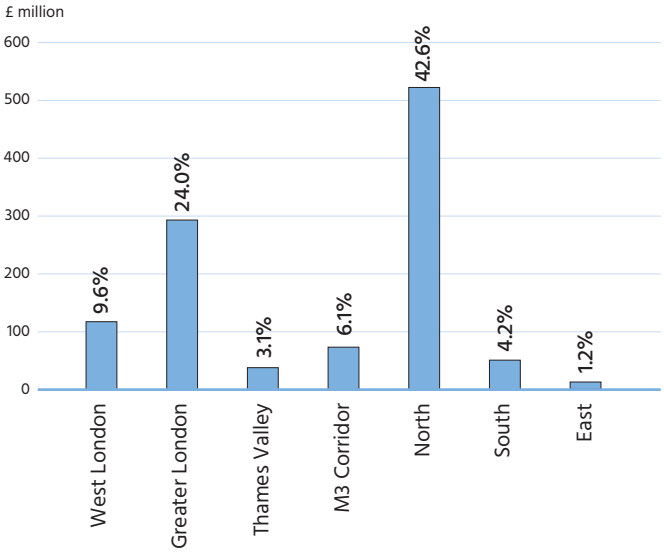
Vendors by investor type, Q4 2019

Source: Gerald Eve

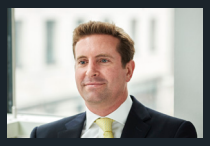


Q4 Investment Volume by South East Sub-Region

Source: Gerald Eve



South East office investment team



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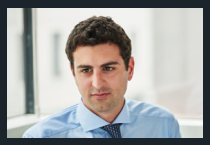

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Gerald Eve Corporate Finance

The Christmas period provided a much-needed pause for breath, with the uncertainty of the election behind us and a Government with a clear mandate to govern and an appropriate parliamentary majority in place. Brexit concerns exist, however it is felt that a lot of this uncertainty has been priced into the market.

The year has started with a flurry of transactions and lenders are back in the market with clear mandates to lend albeit, lenders are being very specific on asset classes with a reluctance to lend in certain areas, such as retail and a preference for pre-let commercial or residential (with pre-sales in place for larger schemes). Operating assets such as hotels, student and care/retirement homes remain fundable as well.

We believe that lenders will continue to exercise caution with their loan-to-value and interest cover ratios, but the large number of specialist funds in the market will continue to provide higher levels of leverage, albeit at a commensurate cost.

Gerald Eve Corporate Finance cover the whole of the debt market and can provide innovative solutions to your borrowing requirements.

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