SOUTH EAST OFFICE INVESTMENT BULLETIN

Q2 2020

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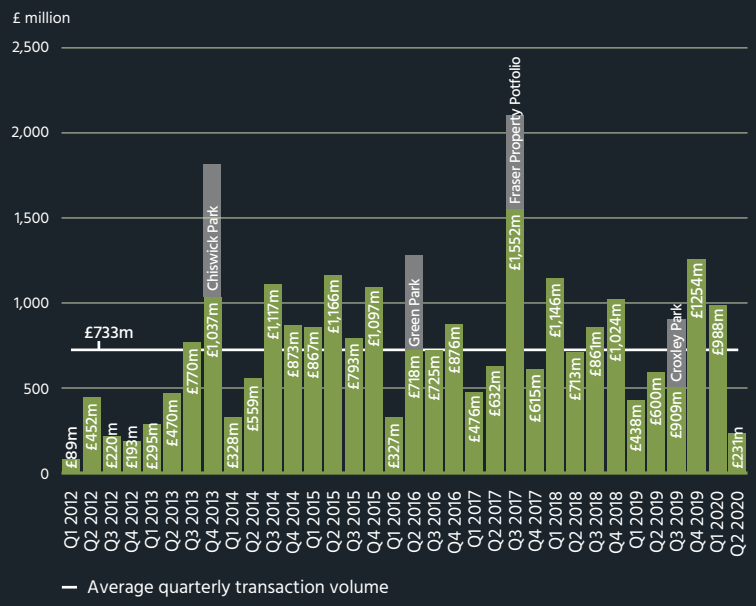
Q2 2020 BY NUMBERS

South East Office Quarterly Investment Volumes

Source: Gerald Eve



£231m

total volume of south east offices transacted in Q2 2020

13

deals completed throughout Q2 2020

5.00%

south east offices prime yields (Q2 2020)

3

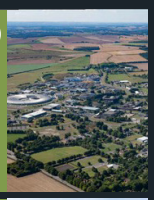
Local Authorities accounted for the largest number of acquisitions in Q2 2020

over £367m

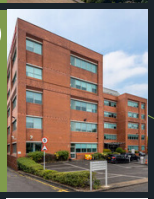
of south east offices were under offer or exchanged at the end of Q2 2020 across **22** deals

Q2 2020 key investment transactions

1 Harwell Science Campus, Oxford
Price £112.5m
NIY 4.75%
Purchaser Brookfield
Vendor U&I



2 Honeywell House, Arlington Square, Bracknell
Price £33m (£455 psf)
NIY 5.30%
Purchaser Runnymede Borough Council
Vendor L&G



3 145-155 King Street, Hammersmith
Price £18.6m (£650 psf)
NIY 4.60%
Purchaser Hammersmith & Fulham Council (Occupier)
Vendor Canada Life

4 Jubilee House, Warley Hill Business Park, Brentwood
Price £17m (£412 psf)
NIY 5.75%
Purchaser Brentwood Borough Council
Vendor EIDA Group

5 The Gate, Cowley Business Park, Uxbridge
Price £9.87m (£298 psf)
NIY 8.00%
Purchaser Monster Energy (Occupier)
Vendor BA Pension Fund

6 Building 3000, Hillswood Drive, Chertsey
Size 66,562 sq ft
Price £21.68m (£325 psf)
NIY 7.50%
Vendor Aviva

7 Meadows Business Park, Camberley
Size 155,244 sq ft
Price £26.8m (£173 psf)
NIY 6.50%
Vendor Seven Capital

SOUTH EAST OFFICE INVESTMENT MARKET REVIEW – Q2 2020

Outlook and Market Insight

At the end of Q1 2020 the unabated spread of Covid-19 meant unprecedented action had to be taken on a global scale. Lockdowns were enforced in over 100 countries by the end of March 2020 affecting billions of people and severely impacting the global economy. The global pandemic sent shockwaves across the entire real estate spectrum. Q2 2020 will indeed go down in history as a quarter dominated by uncertainty and a government-enforced lockdown like never before seen.

As a result, the south east office investment market in Q2 was characterised by investor caution. Government restrictions and lockdown measures prevented physical inspections and resulted in material uncertainty clauses being inserted into valuations, and in turn, most retail funds had to be gated. Stock markets tumbled as everyone tried to second-guess just how big the impact on the markets and consumer behaviour would be.

Towards the end of Q1 there were circa £775m of transactions under offer and around 2/3rds of these went on hold with transaction volumes for Q2 only totalling £231m across 13 deals, a 77% decrease on Q1 2020 and a 62% decrease on Q2 2019. This is the lowest quarterly volume that we have recorded as the south east office market has suffered from increased buyer caution and a lack of forced vendors willing to accept price reductions.

In Q1 2020 29 properties were brought to market, 7 of which are currently under offer, whilst 2 have since completed. Q2 was in stark contrast to this as only 7 properties were brought to market, highlighting the clear change in vendor confidence. Overall the total number of offices currently under offer in the south east market has reduced to approximately £367m across 22 deals.

The most notable transaction to have exchanged in Q2 was Tristan / Alchemy buying Reading International for c£120m, which is viewed as a big positive for the market. Despite the prevailing conditions, an investor being able to complete a business plan underwrite on an asset where there is occupational risk illustrates buyer commitment to the sector. Whilst there is a delayed completion and a NDA to hide any discount, it highlights underlying investor confidence in the occupational market, supported by historically low vacancy rates pre-Covid-19.

Rent collection statistics for the office market as evidenced in Remit Consulting's survey demonstrated that offices were the strongest performing asset class by a wide margin (71%) in terms of March rent collection when compared with the industrial (62%) and retail (47%) sectors. Despite this, investors remain cautious on the longer-term impact of Covid-19 and rent collection at the June quarter day will be an important barometer of the health of UK plc, especially given the ongoing removal of landlords' rights to enforce payment.

Reading International Business Park, Reading RG2 6DH

ACTIVITY BY INVESTOR TYPE (quarter on quarter)

Local Authorities
Local authorities accounted for £68.6m of the total quarterly transaction volume in Q2 2020 across 3 deals, equating to 19.7% of total volume. These deals include Runnymede Borough Council's purchase of Honeywell House (£33m/5.30%) and Brentwood Borough Council's purchase of Jubilee House (£17m/5.75%). This marks a quarter-on-quarter decrease of 8.2%. It is likely the latest government consultation on using the PWLB for commercial property investment will affect council activity this year. However, with the need to replace income not going away, we expect alternative sources of funding to be utilised so local authority spending could increase again later this year.

Institutions
Following a strong performance in Q4 2019, institutions remained quiet in Q1 2020, with this trend continuing into Q2 with no purchases recorded. Instead, we have seen institutions act as net sellers in Q2 although with most retail funds remaining gated for most of the quarter, this has prevented any forced activity, unlike what was experienced in the immediate aftermath of the Brexit vote. It is expected that this trend will continue throughout H2 of 2020. Aviva are the dominant institutional vendor with seven properties either on the market or under offer, including Eton House in Richmond, which is receiving good interest, and, Building 3000, Hillswood Drive in Chertsey which is currently under offer.

Property Companies
Property companies accounted for 1.4% of the total transaction volume in Q2 marking a significant 95% decrease from Q1 2020, and a 98% fall from the volumes achieved in Q2 2019. Despite the figures showing a downturn for property company activity, we expect this to increase over Q3 as property companies view this period as a buying opportunity due to the potential to acquire institutional quality assets at a discount.

Overseas Investors
Overseas investors accounted for 2.2% of the total transaction volume in Q2 2020 through Cew Capital's purchases of Regent House in Cheltenham (£4m/5.60%), and Queen Square House in Bath (£3.8m/5.00%), which Gerald Eve advised on. Although this marks a significant decrease on the activity seen in Q1 2020, overseas investors are likely to continue to selectively take advantage of the favourable exchange rate as we move through 2020.

Private Equity
Private equity accounted for 48.6% of the total transaction volume in Q2 2020, with Brookfield's acquisition of U&I's 50% stake in the Harwell Science Campus development the single largest transaction of Q2 2020. Although this suggests a high level of activity, these statistics are distorted as it all comes from this one major deal. In general, private equity houses have significant dry powder waiting to enter the market, but in order to hit high double-digit returns vendor pricing aspirations will have to shift.

Occupiers
Following no occupier-purchaser deals in Q1 2020, Q2 2020 saw occupiers involved in 3 deals, which whilst a low figure, is the same number of occupier deals recorded in all of 2019. This includes Hammersmith and Fulham Council's acquisition of their head office at 145-155 King Street in Hammersmith, and notably, Monster Energy also purchased their head office at The Gate, Cowley Business Park, Uxbridge at 8.00% NIY.

Key deals, left to right: The Gate, Cowley Business Park, Uxbridge & Meadows Business Park, Camberley

Outlook

Prime yields remain at 5.00% but there is a lack of transactional activity to support this. Yields on secondary assets have softened as investors price in risk on tenant covenants and vacancy. However, yields for 10 year + income deals remain firm and continue to attract overseas and cash-on-cash focused interest.

Much has been written since the outbreak of Covid-19 about the future of the office and what affect the working from home revolution will have on occupier markets going forward. We believe that whilst businesses can function with staff working remotely for a period of time, if this is extended for too long, they will start to suffer. Collaboration, interaction, communication and training are all best suited to an office environment and whilst we are likely to see changes in office design to take heed of the post-Covid world, the office will always be part of the corporate culture. We think there will be a movement towards multiple locations to give occupiers increased flexibility in terms of footprint and lease commitments and the core south east markets should be a benefactor of this.

South east office vacancy rates remain close to the long-term lows and speculative development continues to be muted. Therefore, we believe that there are a number of towns that offer robust and defensive characteristics at attractively high-income yields when compared to other asset classes.

Greater numbers of off-market deals are expected to occur, as vendors seek to avoid fully marketing assets, coupled with optimistic purchasers that make direct approaches amongst the uncertainty.

Q2 2020 key deals

Property	Sold Price			Purchaser	Vendor
	Yield (NIY)	Price	Price (psf)		
Harwell Science Campus, Oxford	4.75%	£112,500,000		Brookfield	U&I
Honeywell House, Arlington Square, Bracknell	5.30%	£33,000,000	£455	Runnymede Borough Council	L&G
145-155 King Street, Hammersmith	4.60%	£18,600,000	£650	Hammersmith & Fulham Council (Occupier)	Canada Life
Jubilee House, Warley Hill Business Park, Brentwood	5.75%	£17,000,000	£412	Brentwood Borough Council	EIDA Group
The Gate, Cowley Business Park, Uxbridge	8.00%	£9,874,000	£298	Monster Energy (Occupier)	BA Pension Fund

Under Offer

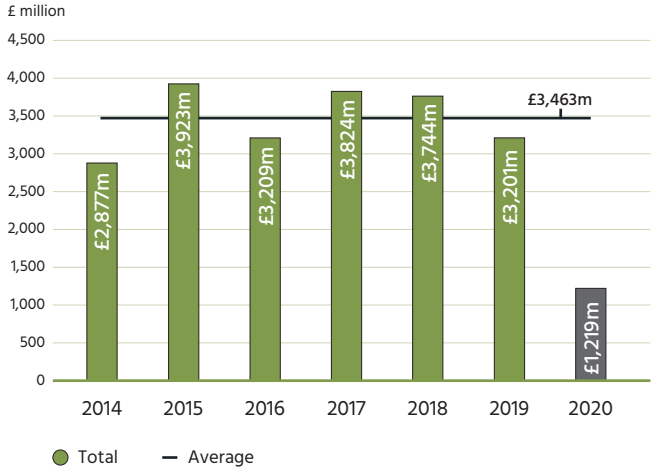
Q2 2020 has seen DWS move Reading International from under offer to exchanged.

Both of the following properties were under offer before the start of Q2 2020, and have remained so throughout, illustrating the static nature of the current market.

Property	Lettable area (sq ft)	Asking Price			Vendor
		Yield (NIY)	Price	Price (psf)	
Meadows Business Park, Camberley	155,244	6.50%	£26,800,000	£173	Seven Capital
Building 3000, Hillswood Drive, Chertsey	66,562	7.50%	£21,680,000	£325	Aviva

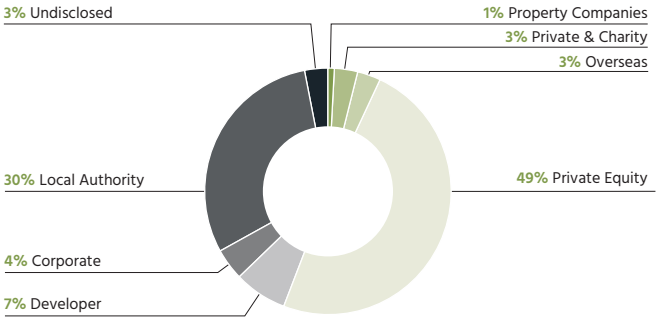
South East Office Annual Transaction Volumes

Source: Gerald Eve



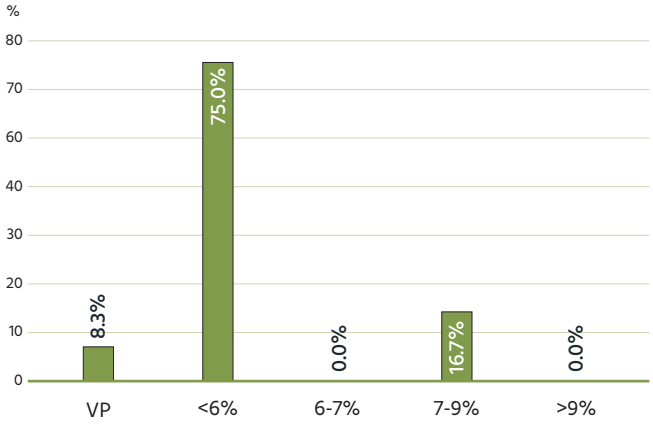
Purchasers by investor type, Q2 2020

Source: Gerald Eve



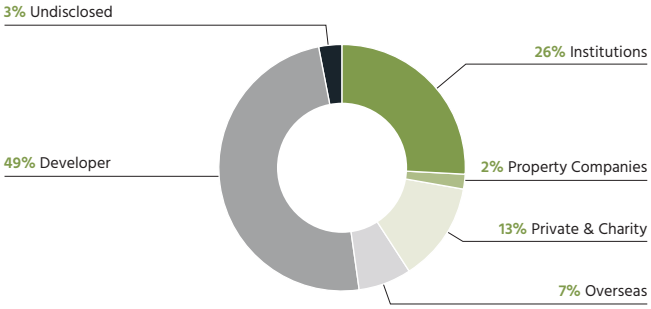
Investment Volume by Net Initial Yield Banding, Q2 2020

Source: Gerald Eve



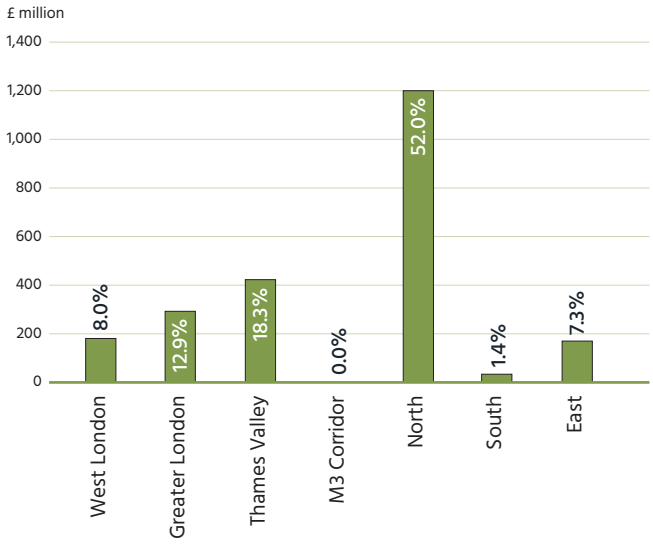
Vendors by investor type, Q2 2020

Source: Gerald Eve



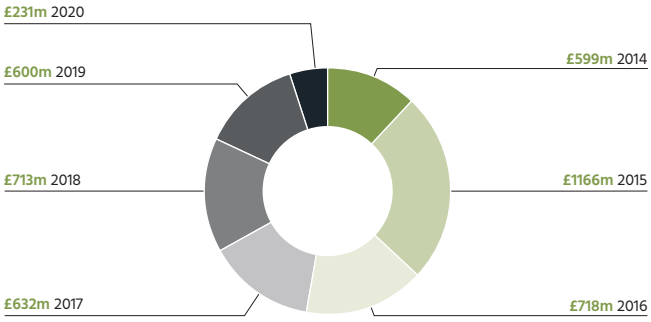
Investment Volume by South East Sub-Region, Q2 2020

Source: Gerald Eve

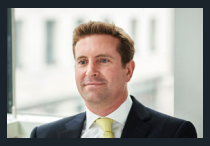


Q2 Transaction Volume Comparisons

Source: Gerald Eve



South East Office Investment Team



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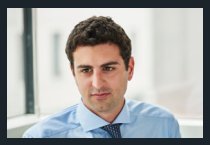

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Gerald Eve Corporate Finance

The Debt Market

The UK real estate debt market contracted over Q2 2020 as the effects of lockdown impacted lenders' appetites and stretched their operational resources. The number of new transactions reduced and development transactions remained flat, however lenders remain willing to consider new opportunities, albeit with lower loan to value (LTV) ratios and higher interest cover requirements than pre-Covid-19.

Despite these headwinds, debt pricing has remained low, due in no little part, to a Bank of England Base Rate of 0.1%, LIBOR falling, and, 3 and 5 year swaps at 0.12% and 0.16% respectively (as at 23rd June 2020). In the main, these reductions have offset rises in lender margins and have also allowed those on floating rates to benefit from falling interest costs.

We continue to see lender demand for well-let office properties but there remains a strong focus on the tenant covenant and lease length. Properties with shorter leases (less than 5 years) will be harder to finance, with underwriting based off vacant possession values and lenders will typically not want single tenant re-letting risk during the term of their facility.

Gerald Eve Corporate Finance offers a range of debt and equity solutions for investors and the team are currently progressing a number of office investment lending requirements for clients, as well as speculative office development finance.

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