At a Glance

SOUTH EAST OFFICE MARKET

April 2015

**HEADLINES**

- Take-up reached c.730,000 sq ft across the South East for Q1, down 2% on the final three months of 2014.
- Rents continue to move on, particularly for the South and West London markets, with occupiers continuing to pay ‘market setting’ rents, such as with LG and Cargill at Velocity.
- Investment market continues at a pace, with over £400m ploughed into South East offices, the biggest deal being the Rackspace Campus in Hayes being bought for £130m (6% NIY) by Threadneedle.

**TAKE-UP AND DEMAND**

- Take-up reached 726,000 sq ft for the first three months of 2015, which despite being down 9% on the quarterly average since 2009, is ahead of what we expect to see during traditionally the slowest quarter of the year.
- The Thames Valley saw c.480,000 sq ft transacted, which is the second best start to a year since 2008 and has seen it power ahead of the other two key South East markets, North M25 (34,260 sq ft) and South M25 (209,569 sq ft).
- The biggest deal of the quarter saw Gartner take a pre-let of a new 130,000 sq ft building on the site of their current home at Tamesis in Egham and ended a three-year search for the US-tech company.
- Rockspring succeeded in disposing of 75% of their Velocity scheme in Weybridge, with LG Electronics and Cargill taking 48,000 sq ft and 25,500 sq ft, respectively.
- There is certainly a renewed sense of optimism around the South East office market for 2015, despite a subdued 2014 for occupational take-up.
- Maidenhead is perhaps the best example of this, after seeing just c.40,000 sq ft transacted in 2014 the town has already seen 50,000 sq ft placed under offer this year.

**RENTS AND SUPPLY**

- Rents and supply dynamics continue to provide interest across the South East, with a definite two-speed market.
- Key locations like Reading, Weybridge and the West London sub-markets of Wimbledon, Hammersmith and Richmond have all seen their rental tone shift substantially in the last 12-18 months, with historically high rents being achieved.
- To emphasise the point the new Ruskin Square development in Croydon is quoting rents at £35 per sq ft (psf), where prime rents currently hover around £22 psf.
- Outside of these locations, it’s less of a positive story with traditionally key locations such as Bracknell and Slough, well behind the top rents achieved back in early and mid 2000s.
- Whilst we do foresee some rental growth, it’s a leap of faith to imagine Bracknell rents hitting the £34 psf Aptegritiy paid back at the height of the dot-com boom.
- Permitted Development Rights and a Lack of Grade A continue to be the themes on the supply front.
- Whilst speculative development has rebounded, once again it is confined to key locations with proven occupier demand, such as Reading, Uxbridge and Hammersmith.

2015 has started positively...

Rentals moved on in key locations...

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*At end Q1

Source: BNPRE Research

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INVESTMENT

- The investment market continues to be buoyant, with over £400m deployed into the region’s office market in the first three months of the year.
- UK Institutions continue to lead the way, with L&G, Threadneedle and Orchard Street conducting the three biggest transactions to date.
- Orchard Street’s £58.7m purchase of St George’s House in Wimbledon at 4.56% net initial yield, signifies where the market has now moved to, particularly as Threadneedle were marketing the building at £51.4m (5.25% NIY).
- The rental growth story, restricted Grade A supply and improved occupier sentiment across the South East, but particularly within the West London sub-markets, has encouraged investors to take the plunge at above quoting price.
- Moving through the remainder of the year, we anticipate two major themes.
- Yields will continue moving in for the best available stock, perhaps reaching historical lows, although how much of this type of product will appear on the market may curtail it, as well as hampering overall volumes.
- Whilst the second theme will be the refurbishment and development plays undertaken by investors, encouraged by the strong fundamentals, lack of Grade A, rental growth story and improved occupier sentiment already mentioned.
- Argentum in Hammersmith is an example of this. The building is highly reversionary, with passing rents at £30.48 and is currently under offer at better than £15m (c.4.4%). Whilst No. 1 Croydon was recently sold to Hermes for £36m at 7.33% (NIY) and is an example investors targeting assets to add value, with perhaps a residential play in the offing in Croydon.
- We expect to see more investors target “underperforming” assets, adding value through either letting up vacant space, achieving implementable planning permissions or delivering programmes of refurbishment or development.

Yields below long term averages but still further compression to be had...

THE AGENT’S OUTLOOK

Hugh White, Head of National Investment, provides his opinions and expectations for 2015...

- London’s continued population growth, a lack of supply of Grade A and the introduction of Permitted Development which has absorbed many secondary offices have created a ‘perfect storm’ which has led to notable rental growth.
- Established centres such as Hammersmith, Chiswick, Richmond and Wimbledon have already seen rental growth with the continued ripple effect ensuring quoting rents at Ruskin Square in Croydon are at £35 per sq ft.
- This occupational trend has been eagerly picked up on by investors, particularly the UK Institutions, who have recently purchased or are under offer on buildings including No 1 Croydon, St George’s House, Wimbledon, Argentum, Hammersmith & 26-28 Hammersmith Grove. We believe these investors will be rewarded by further rental growth over the next couple of years.
- As 2015 unfolds we anticipate agreed rents rising throughout the Thames Valley as the UK’s continued economic success radiates out from London.
- While occupier activity to date has been led by existing businesses expanding or seeking modern premises, we are yet to see new entrants in the market place from overseas, we are confident businesses from the emerging economies will wish to establish a presence in the UK and hence will help fuel rental growth.
- Within the context of South East offices complete or substantial business parks provide an attractive income return and hence will again come into the Institutions’ focus provided the fundamentals are in place.

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