SOUTH EAST OFFICES
FEBRUARY 2017

The Headlines

1) Take-up reaches 3.5m sq ft
Take-up reaches 3.5m sq ft, but this is a fall of 17% year-on-year.

2) Investment volumes above average
Investment into South East offices is up 23% on 5-year average (2011-15) with £3.05bn deployed into the region.

3) Overseas investors target South East
Overseas investors made up nearly half of the total volume of purchases in the region over 2016, demonstrating the continued attractiveness of the South East, despite the uncertainty created by the EU Referendum.

2016 End Year stats... at a glance

Take-up
3.5m sq ft
▼ 17% 2015 vs 2016

Prime yield
5.25%
▼ 0 bps last 3 months

Total Supply
14.9m sq ft
▼ 2% on end 2015

Investment volume
£3.05 bn
▼ 23% 5-yr average (11-15)

Leasing
Take-up reached 3.5m sq ft – down 17% overall on 2015 but just 5% down on the 5 year average.

The Thames Valley dominated as usual and accounted for c.50% of all deals by sq ft – with 123 deals completed in the Thames Valley. (69 in the South M25 and 38 in the North M25). 71% of all deals in the Thames Valley were of Grade A – demonstrating occupiers desire to acquire the best buildings in core locations, in order to attract and retain the best staff.

There were 11 deals greater than 50k sq ft in 2016 – the same as 2015. There was a shortfall in the 30,000-50,000 sq ft sq size band, where there was a 65% fall in the number of deals year-on-year, and a similar theme was witnessed in the other smaller size brackets, all showing falls in deal numbers of c.20% or greater.

Prime rental levels continued to increase in core locations across the South East, partly driven by the tight supply dynamic but also by occupiers desire to secure the best possible space often paying ground breaking rents. Record rents have been paid in Maidenhead (£37.50 psf), Reading (£35.00 psf) and Hammersmith (£57.50 psf) to name just a few examples. With a wave of new buildings reaching completion and with quoting rents in the likes of Stockley Park and Reading at £39.50 psf, the hope is rental growth will continue into 2017.

We do think the rental growth story in 2017 will be less pronounced, as significant amounts of new and refurbished stock comes to the market in many South East locations. MSCI average annual rental growth for South East offices has been slowing for some time, from a peak of c.5% in mid-2015, to 2.7% annual growth by end of November 2016.

That said, occupiers will continue to pay premium rents for the best space and if we can start to see a greater flow of migration from Central London, then many of those occupiers will undoubtedly be less rent sensitive than local occupiers who are use to paying lower market rents.

Source for all charts BNP Paribas Real Estate / Property Data / RCA
In deal volumes alone, the South East investment market held up well and saw £3.05 billion transacted, which is 23% ahead of the 5-year average from 2011 to 2015, although this should be taken against the context of a 17% drop in year-on-year volumes.

It’s impossible to talk about the market without mentioning the EU Referendum, but, notwithstanding a pause over the summer, the South East has emerged relatively unscathed, so far. For long-dated income and good-quality assets in core locations, there remains a large pool of investors willing to take the plunge, mainly from overseas and the UK local authorities.

Where the market has slowed significantly is for more ‘value-add’ opportunities, particularly in secondary locations, as the rental outlook has slowed significantly. Most rental forecasts now predict muted, if any growth. So, whilst 10 Hammersmith Grove sold twice in a matter of months, some active management sales have failed to widely stimulate the market.

That is not to say the final half of the year was a doom and gloom scenario. Brockton bought (£68m/6.1% NIY), and then sold (£103m/5.06% NIY), 10 Hammersmith Grove for a significant profit. Gatehouse Bank purchased at Windsor Office Park (£56.25m/5.71% NIY) and Runnymede Council have bought Hitachi House in Staines (£10.1m/5.06% NIY).

Nevertheless, since the referendum the main segment of the South East office market to witness activity has been assets from a pan-European or global standpoint. Investors are utilising this stock as a financial instrument against which they can leverage attractive cash on cash returns. The two main players in this segment are overseas investors and the UK local authorities.

Moving throughout 2017, there is no doubt that the political uncertainty in the UK will weigh on investors’ minds, particularly when looking at assets from a pan-European or global standpoint. However, set against the uncertainty of various European elections and the rhetoric of the new US President, the UK may well be seen as the safer and more stable option.

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Speculative developments

- Thames Tower, Reading (Landid and Brockton Capital) 186,475 sq ft. completion Q1 2017. Austin Fraser, a recruitment firm, has recently signed a 10 year lease for 14,000 sq ft on the 11th floor.
- 10 Hammersmith Grove, Hammersmith, 122,744 sq ft, let to various tenants including Fox, Phillip Morris and Accor. Brockton sold the asset for £103m to Tai United.
- BP Campus, Sudbury-on-Thames, Spelthorne Borough Council bought the campus for £360m. The lease to BP has 19 years unexpired.
- Hitachi House, Staines, Runnymede Council purchased the building for £10.1m reflecting a yield of 5.06%.

Agent’s Outlook

The South East office market saw a rental revolution over the last 12 months with 50% of South East locations covered by BNP Paribas Real Estate showing rental growth. This illustrates that for the right product occupiers will pay market breaking rents and that for far too long, many South East locations have been under-valued.

Whilst it’s difficult to see the same levels of growth over the next 12 months, landlords should remain resolute. The best buildings will continue to command record rents in many prime locations as recruitment and retention and the need to have high quality space continue to drive decision making.

Landlords will in many cases need to adopt more flexible leasing strategies, particularly in the larger multi-let buildings. In addition, building design and occupier amenities will need to continually evolve as occupiers strive for the best possible working environments to recruit and retain the best staff and to make them as happy and productive as possible particularly given the increase in “millennials” coming into the workplace.

2017 will also see the supply issues in most South East locations being addressed with a number of speculative schemes reaching completion. 2016 saw 1.64 million sq ft of new or refurbished space delivered into the South East market with a further 2.45 million sq ft coming on to the market in 2017.

Delivery of completed refurbishments post 2017 falls away considerably and the lack of 2018 deliveries will almost certainly drive occupiers into making earlier decisions in 2017, in order to secure the best quality buildings.

Finally, 2016 did see notable moves out of Central London with the likes of Body Shop, Maersk, Rank, Macquarie Bank and EDF Energy all relocating. Most moves were to Greater London locations, however, we expect that with the recent rating revaluation and the narrowing of the completion of the Elizabeth line, 2017 will see more occupiers relocating further out of Central London.
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