



SOUTH EAST OFFICES

Q3 2017

Investment transactions totalled £1.15 billion in Q3, propelling volumes to the highest Q3 figure on record

- A buoyant investment market took 2017 volumes to end-Q3 to £2.12 billion, up 3.7% on the same period last year.
- Thames Valley offices continue to perform well, with 562,000 sq ft take-up in Q3 17, pushing take-up to date to 1.37m sq ft, in line with the same period over 2016.
- Rental growth has extended into Q3, albeit at a slower pace, with new headline rents being set in several towns.
- Based on data from industry benchmark MSCI, Total Returns for South East Offices stand at 9.6% (12 months to September 2017), surpassing All Office returns of 8.1%.



Q1-Q3 17
Thames Valley
take-up stands
at

1.37_m sq ft



Q3 17 South East
take-up, up 20%
on Q2 17

+20%



Income Returns
for 12 months to
end-September
2017

5.4%

Source: MSCI



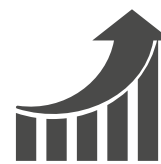
Q1-Q3 17
investment
volumes, up 3.7%
on Q1-Q3 16

+3.7%



Q3 17 Investment
volumes, up 151%
on Q3 16

+151%



Total Returns
for 12 months to
end-September
2017

9.6%

Source: MSCI



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LEASING

Following a slow start to the year, occupier activity rebounded in Q3 with take-up for the wider South East Office market reaching 730,000 sq ft, up 20% on Q2 2017.

The sub-20,000 sq ft size band continues to be the most active. There is currently a notable lack of lettings above this level, with larger occupiers continuing to postpone major decisions given the presently uncertain economic landscape.

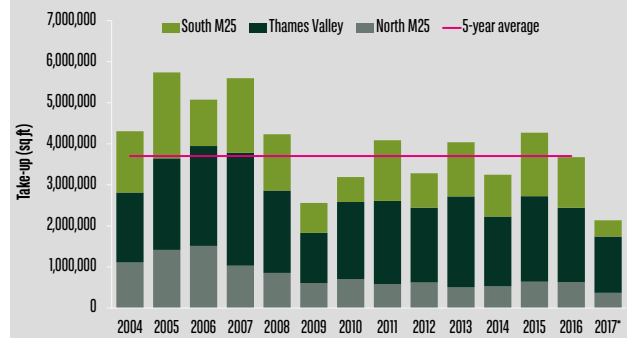
Despite market activity falling back over the first six months of 2017, market fundamentals are robust and the South East is well positioned going forward. Whilst supply has risen over 2017 to date, this is not alarming relative to historical benchmarks.

Development activity was the primary reason behind the rise in vacancy, however this has been far from widespread across the market. Speculative construction has instead been targeted within core locations, where demand for new Grade A office space has been high, and in close proximity to key transportation hubs, particularly within those markets situated along the Elizabeth Line such as Reading and Slough.

Nevertheless, vacancy has been kept in check by continued PDR conversions, despite some areas such as Stockley Park and a part of Bracknell now being subject to article 4 directives, which will restrict any future permitted development rights. Positively, the removal of obsolete stock for alternative use, alongside speculative development, has resulted in a steadily improving stock profile within the South East office market.

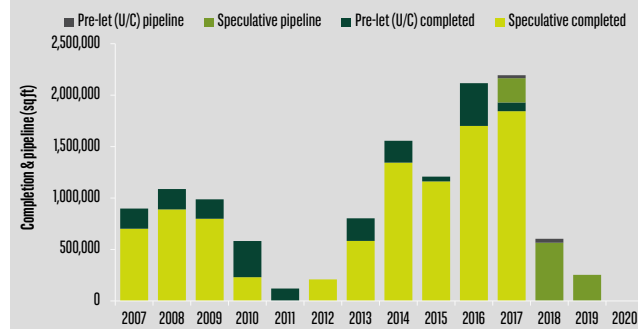
In terms of speculative activity, 2017 will be this cycle's peak with circa 1.93 million sq ft of speculative deliveries to end-Q3, and a further 264,000 sq ft scheduled for completion over Q4. This represents an increase of 4% on 2016. Based on developments currently under construction, completions in 2018 are expected to fall back to around 600,000 sq ft, falling back further in 2019. The potential for any future supply shocks from a development perspective is therefore low. This drop in development will likely be placing demand pressure on existing good quality supply going forward.

Figure 1: Take-Up (2004-Q3 2017)



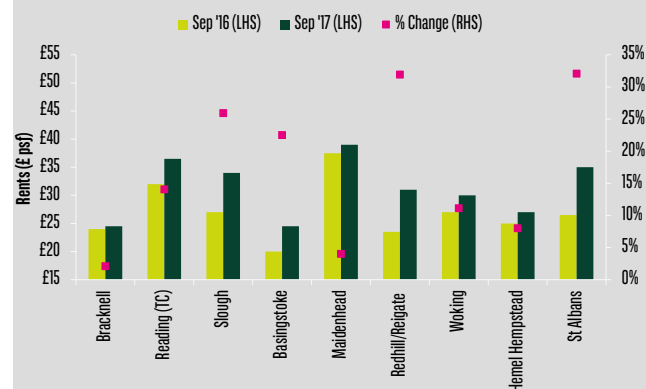
SOURCE: BNP Paribas Real Estate Research / Note: * As of end Q3

Figure 2: Development Pipeline



SOURCE: BNP Paribas Real Estate Research

Figure 3: Annual Rental Growth



SOURCE: BNP Paribas Real Estate Research

Rental growth has continued into Q3 2017, although at a slower pace. New schemes coming online have helped push headline rents up.

Focusing on activity within the South East submarkets, demand for Thames Valley offices has been steady, with 562,000 sq ft of take-up in Q3 17. Amongst some of the key deals, serviced office provider WeWork took 54,698 sq ft at 12 Hammersmith Grove, in Hammersmith, on a 20-year lease. In addition, Fiserv agreed to take 28,316 sq ft at The Porter Building in Slough. The US fintech giant is the first occupier to take space at the scheme since its completion in September.

In contrast, overall demand has slowed in the South M25 and North M25 submarkets over 2016-2017. However within these submarkets, certain towns have outperformed, recording solid take-up and rental growth. In particular the Watford market (North M25) has capitalised on its demand/supply dynamics with good level of rental growth being recorded on the very limited amount of available refurbished options and new Grade A supply. HCL Technologies' letting of 13,720 sq ft in June 2017 achieved a new headline rent of £32 psf, whilst at the beginning of the year, Salmon pre-let the 30,000 sq ft Clarendon Works scheme at a rent of £31.50 psf, the first speculatively developed building in the town centre for 15 years.

Elsewhere in the South East, despite some markets seeing relatively low levels of take-up, a number of towns have continued to record rental growth. Driven by the delivery of new Grade A supply, new prime rental levels



have been set in a number of locations including Maidenhead (£39.00 psf), Basingstoke (£24.50 psf), Slough (£34.00 psf) and Uxbridge (£36.50 psf).

Placing the South East in a national context, according to the latest MSCi Monthly Index for September 2017, "Rest of South East Offices" has continued to perform well, with annual Income Returns for the 12 months to end-September of 5.4%. At this level, the South East markets outperformed the City and Mid-Town & West End Office markets which registered annual Income Returns to September 2017 of 3.8% and 3.5% respectively.

// Flight-to-quality phenomenon continues to be prevalent. At the other end of the market, well located, low cost buildings are also being demanded. //

- 1 Hammersmith**
12 Hammersmith Grove
54,698 sq ft taken by WeWork on 20 yr lease term, £55 psf
- 2 Slough**
The Porter Building
Fiserv acquired 28,316 sq ft on a 10 yr lease term
- 3 Uxbridge**
The Charter Building
Spaces acquired 20,000 sq ft on a 10 yr lease term, £31 psf
- 4 London, W6**
Foundry
Completed in Q3 17, 110,000 sq ft major refurbishment
- 5 Reading**
2 Forbury place
Completed in Q3 17, 191,000 sq ft of new grade A supply
- 6 Guildford**
Cathedral Square
Completion due in Q4 17, 73,000 Sq Ft
- 7 Woking**
Victoria Gate
Completion due in Q4 17, 66,415 sq ft of new supply
- 8 Slough**
The Porter Building
Completion due in Q4 17, 115,000 sq ft major refurbishment
- 9 Heathrow**
World Business Centre 4
85,000 sq ft forward commitment purchased by Spelthorne Borough Council for £45.8M, c. 5% NIY
- 10 London, W5**
Ealing Gateway
£50m purchase by Aviva from TH Real Estate, c. 3.98% NIY
- 11 Reading**
The Blade
£39M purchase exchanged by Northwood Investors, c. 7.5% NIY

INVESTMENT

Q3 2017 volumes reached £1.15 billion, up 151% on Q3 2016. This constitutes the strongest Q3 on record, taking the total to end Q3 2017 to £2.12 billion, an increase of 3.7% compared to the same period last year.

Volumes have largely been driven by Overseas investors who accounted for 69% of total investment in Q3, equalling Q4 2011's all-time high.

UK Institutions have continued to be relatively timid in re-entering the market. That said, well-let and well positioned assets are still attracting strong interest from domestic investors.

In July Standard Life Investments Property Income Trust purchased the 41,721 sq ft Pinnacle in Reading for £13.2m at a net initial yield (NIY) of 6.15%. Furthermore, Fidelity UK Real Estate Fund acquired Phoenix House in Reading for £20.5m at c. 6.24% (NIY). Local Authorities also remain a major aspect of the investor mix.

As evidenced, Overseas players have taken the centre stage this quarter with a raft of transactions, signifying that the market has heated up, following a paucity of activity post EU-Referendum.

Amongst the most notable deals TPG Real Estate's acquisition of the £450 million Arlington Portfolio from Australian developer Goodman and Legal & General has injected further confidence into the market. Furthermore, Blue Horizon Investors' acquisition of 10 Hammersmith Grove for £112m at a NIY of 4.7% is a clear indication that investors are willing to pay a premium for the right product.

In addition, although not accounted for in our Q3 statistics, Singapore-based Frasers Centrepoint announced in September that it had entered into an agreement to purchase four freehold business park assets, three of which are located in the South East; Winnersh Triangle in Reading (£365m), Chineham Park in Basingstoke (£142m) and Watchmoor Park in Camberley (£42m).

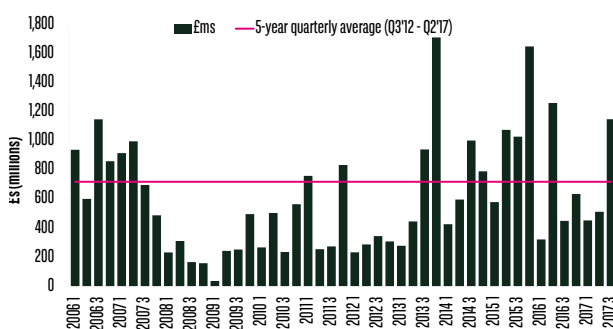


Investment activity over Q3 defied recent political and economic uncertainty. Investors focus has not only been on well-let buildings, but more encouragingly, it has witnessed a continuation of recent trends, with buyers also looking to execute Value-Add strategies in core locations.

This increased confidence in the market has been reflected in key performance measurements, and pushed Total Returns to near-double digit level. As highlighted by the latest September Monthly MSCI Digest, "Office - Rest of South East" recorded annual Total Returns of 9.6%, outperforming other segments such as "City Offices" (9.2%), "Mid Town & West End Offices" (5.7%) and "Rest of UK Offices" (8.1%).

The South East office investment market continues to be relatively liquid. The current investment landscape allowing for Core, Core-Plus and Value-Add strategies to be executed.

Figure 4: Investment Volumes



SOURCES: BNP Paribas Real Estate Research / Property Data / MSCI

Figure 5: MSCI Total Returns

