SOUTH EAST OFFICES
OCCUPIER & INVESTMENT MARKET REVIEW

DTRE RESEARCH REPORT
NOVEMBER 2020

DTRE | RESEARCH

5 THINGS YOU NEED TO KNOW ABOUT SOUTH EAST OFFICES IN NOVEMBER 2020

1

Occupier take-up to end Q3 has reached **1.45m sq ft**, down 43% on the same period in 2019

2

The disparate nature of the South East market offers occupiers plenty of 'Covid-secure' office alternatives, from **Business Parks to leafy London suburbs**

3

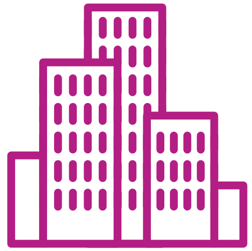
Investment volumes have totalled **£1.7bn across 55 deals by the end of October,** down 12% year-on-year

4

Pricing has drifted for nearly all asset types since March, but for **long and strong income, pricing remains firm**

5

The death of the office is widely exaggerated and with a vaccine on the horizon, the 'return to the office' won't be far behind



OCCUPIER MARKET

The South East office market has suffered significant challenges as a result of the COVID-19 pandemic, with the future of offices the talk of much debate. Looking at take-up numbers and investment volumes is rather futile in this climate as they don't make pretty reading, however, there's plenty of room for optimism, as we'll discuss...

It's unsurprising to report that take-up so far this year has reached just 1.45 million sq ft, 43% below the same point of 2019 and 47% below the 5-year average.

Whilst demand has undoubtedly slowed there have been interesting deals, including Pexip, a video conferencing business and direct competitor to Zoom, who took 15,000 sq ft at Earley East in Reading at £33 psf, a record rent for Thames Valley Park. Pexip doubled their size requirement over lockdown, demonstrating that there'll be plenty of 'winners' emerging from the pandemic, as well as sadly, some 'losers'.

BUSINESSES MUST RE-IMAGINE THEIR OFFICES AND THEIR ROLE IN CREATING BOTH SAFE AND PRODUCTIVE WORKPLACES

When the first lockdown hit in March, we all retreated from the office and set up our own office at home and due to modern technologies it has, in the main, been a relative success. The result has been that offices across the South East have remained, by and large, vacant since that point and businesses have been re-evaluating the importance of the office to a modern company.

Whilst it's difficult to imagine in locations such as central London, The City and other key regional cities a return to pre-Covid levels, particularly with the commute involved for many office workers, the South East office market holds many key advantages over its rivals due to its disparate nature.

Firstly, the South East office market is home to some of the best Business Parks in the country, with large floor plates that allow for plenty of personal desk space, significant levels of open green space for recreation outside of the buildings and plentiful car parking, and in an era of social distancing, this could be key for occupiers moving forward.

Secondly, the suburbs as a place to locate your offices has taken on a whole new meaning. The buzzword in offices is the 'Hub and Spoke' model and although we are yet to see meaningful take-up for this model, we predict a changing pattern as we emerge from lockdown and proceed into 2021.

Suburban locations will become increasingly attractive over the near term. Locations such as Richmond, Wimbledon, Putney and Hammersmith are both able to attract younger workers and offer that London lifestyle, but without the difficulties of cramming onto packed commuter trains or into overly busy lifts and staircases. Importantly also, they offer a discount to the West End, The City and other more 'fringe' Central London locations. Think 'suburban not urban'.

Any reports of the 'end of the office' are premature in the extreme. The office plays a crucial building block in the formation of a culture within a business and whilst at the beginning of the home working era of 2020 productivity levels were sustained, the ONS last month reported that 24% of businesses had seen a decrease in productivity when workers logged on from home.

With hopefully a vaccine around the corner, then the return to the office will not be far behind, albeit with demand perhaps focussed on different locations than we imagined 12 months ago.

Fig 1: Earley East Thames Valley Park - 58,500 sq ft of Grade A Business Park space remains

Fig 2: Horizon, Epsom - Kennedy Wilson Europe, advised by DTRE, disposed of the building to CIFCO last month

INVESTMENT MARKET

Investment volumes in the South East office market reached £1.7bn by the end of October, a fall of just 12% year-on-year, as lockdown restrictions and home-working saw the early year momentum in the market dissipate.

Fig 3: Frasers advised by DTRE, purchased the Cisco Systems Campus at Lakeshore, 9-11 Bedfont Lakes earlier this year

Fig 4: Straits Capital bought Bourne Business Park in Weybridge for £80m

Investment volumes to the end of October reached £1.7bn across 55 different transactions, which in volume terms is down just 12% year-on-year, and is a remarkable result given the on-going economic and public health crisis.

Where a difference created by the pandemic can be spotted is threefold, firstly, in the number of transactions that have completed, secondly, the lot sizes of completed deals and finally, in pricing.

So far this year 56 deals have completed compared to 84 by the same point in 2019, a fall of 33%.

Secondly, whilst ten deals over £40m completed this year, an increase of 43% year-on-year, seven of the ten completed in Q1, prior to the first lockdown. The average lot size since March is just £24.3m, compared to £44m pre-lockdown, highlighting investors nervousness in deploying large capital to the market in the current climate.

Finally, the average net initial yield achieved has drifted north to 6.9% from 6.6% last year. Again, until end-March this was 6.26%, post-March, average yields have been 7.32%.

Whilst investment volumes are down and pricing has drifted, sentiment has definitely improved amongst investors since the Summer, although unfortunately, with the introduction of a second nationwide lockdown, we now do not envisage that improved sentiment to result in increased levels of trading anytime soon.

Across the board, yields have drifted for nearly all asset types, with only the pricing on long-let income to secure covenants remaining firm.

The appetite for long and strong income has only grown in 2020 with a prime example including KWRE's sale, advised by DTRE, of Horizon Epsom to CIFCO for £7.97m/5.21%. The building is single-let to the NHS on a new ten year lease.

Whilst Delta Properties sold the Amadeus Building in Heathrow for £15.54m/5.00%, which is let for a further sixteen years to the Secretary of State.

PRICING HAS DRIFTED FOR THE MAJORITY OF ASSETS BUT FOR 'LONG AND STRONG INCOME' PRICING REMAINS FIRM

Moving forward we do not see this trend for 'long and strong' changing anytime soon. However, the news last week of a vaccine coming over the horizon could bring about an eagerly anticipated 'return to the office' and can only be viewed as a positive for the investment market.

Moving through the rest of the year and into Q1 2021, we expect to see the UK institutions continue to rotate out of South East offices, particularly assets requiring cap-ex or with short WAULTs. Additionally, with the return of international travel from Q1 next year we expect to see overseas investors return with a vengeance, which allied to the weight of private equity money waiting in the wings for price corrections, could see a busy start to next year.

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