



SOUTH EAST OFFICES OCCUPIER & INVESTMENT MARKET REVIEW

DTRE RESEARCH REPORT
FEBRUARY 2021

5 THINGS YOU NEED TO KNOW ABOUT SOUTH EAST OFFICES IN FEBRUARY 2021

1

Occupier take-up in 2020 has reached **2.7m sq ft**, the worst year since 2009



2

From **once lockdown was lifted in July**, we saw close to **1.5m sq ft of leasing deals**



3

Investment volumes have totalled **£2.3bn**, down 16% year-on-year



4

Yields have been maintained on prime, long-let income but drifted elsewhere



5

Yields for secondary properties with vacancy and/or capex risk **will move further out** as institutional investors shy away



OCCUPIER MARKET

The South East Office leasing market has struggled over the last 12 to 18 months. Firstly, it was the hesitation around Brexit and then from March last year it was the uncertainty created by the pandemic. The result when looking at the data has been a year of limited take-up, with just 2.7m sq ft of take-up, the worst year we have on record since 2009.

However, there are positives to be had. Q3 and Q4 saw levels of activity return after the market virtually stopped in Q2, when only a touch over 330,000 sq ft transacted, the single worst quarter on record.

From once lockdown was lifted in July, we saw close to 1.5m sq ft of leasing deals, closer to the quarterly average of 790,000 sq ft we have seen in the last 5-year since Q1'16.

In terms of trends, we saw 165 deals in 2020, down 24% year-on-year, but within that we saw 90 deals over 10,000 sq ft, which is broadly in-line with the 5-year average of 95 deals per annum over 10,000 sq ft.

Therefore, it's easy to see where the market stalled, it was in the sub 10,000 sq ft sector, typically dominated by small businesses and once the pandemic hit, they were unwilling and in many cases unable to undertake office moves, where as the evidence suggests that bigger corporates and government requirements were able to be acted upon, as witnessed with Three Mobile's 110,000 sq ft deal at Green Park in Reading.

There were significant lettings to Pladis at Chiswick Park, MathWorks in Cambridge, Native Antigen Company in Oxford and CGI in Reading and the market was buoyed by not only the circulation of, but by outward progress of significant requirements from the likes of Three, Canon, Amazon and Creative Assembly, all reported to be seeking around 100,000 sq ft. We are optimistic that the confidence being expressed by these large corporates will permeate through the rest of the market in due course.

On the supply-side, Grade A new build product is becoming increasingly scarce with no new offices currently under construction in the market without a pre-let in place. This lack of Grade A supply will push down on demand through the next few

years.

The relatively thin level of Grade A supply across the South East market has contributed to headline rents remaining resilient, whilst an acknowledgement from many Landlords of the pressure on capital of occupiers has seen incentive offers increase in an attempt to unlock deals and persuade occupiers to move, something that we expect to continue.

IT'S EASY TO SEE WHERE THE MARKET STALLED, IT WAS IN THE SUB 10,000 SQ FT SECTOR

Despite the doom and gloom in the year-end take-up numbers and as we alluded to in our last report just a couple of months ago, the future of the office remains bright and whilst working from home will be incorporated into the 'new normal', the importance of the office has become perhaps even more important during this period of lockdown.

Q4 saw the debate around the future of the office continue, with all sides continuing to hypothesise what impact the pandemic might have on future office occupation and requirements.

On one hand, whilst the trend over the last 10 years has been for occupiers to reduce footprint in a move rather than to grow, and we do expect this to continue as a trend, DTRE are not anticipating seeing significant downsizes due to changes in working practices following the pandemic.

Fig 1: South East office leasing volumes fell to the lowest level of take-up since 2009

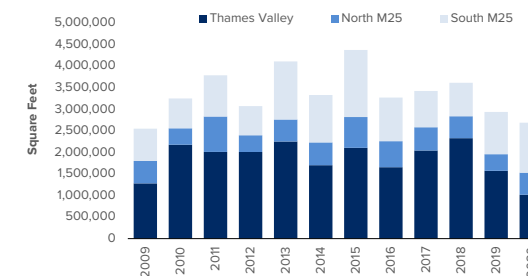


Fig 2: China Investment Corporation (CIC), advised by DTRE, signed Pladis for a 30,000 sq ft headquarters at Chiswick Park



INVESTMENT MARKET

2020 saw a 16% decrease in activity year-on-year, with £2.3bn of investment transactions. Unlike the leasing market, we did not see the bounce in Q4, with only £380m of deals completing, comprising just 19% of the annual volume

Fig 3: Volumes fell and average yields moved out as Covid-19 impacted the South East office investment market

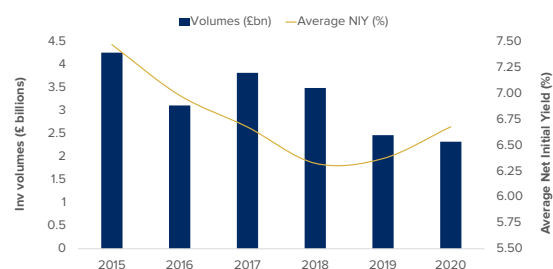


Fig 4: DTRE advised XLB & AimCo on the sale of Aviator Park for £25.75m



In a similar vein to the leasing market, the South East office investment market has undergone a difficult year. That isn't surprising given Brexit uncertainty and the global pandemic creating a difficult market, in which not surprisingly, volumes and the number of deals have dropped.

Whilst the year saw deal volumes decline it also saw the average yield being achieved move out. In Q4, the average yield across eighteen deals came in at 6.91% NIY, versus 6.46% witnessed across twenty-four deals in Q1. Whilst this could be construed as a crude average it no doubt points to the fact that on average, yields have moved out by close to 50bps.

Where yields have been sustained it has been on prime, long-let income, with examples being Aviva's purchase of 20 Station Road in Cambridge, let to Apple for ten years for £63m/4.85%. In November we saw Savills IM dispose of York & Wellington House in Feltham, let to Secretary of State for 12 years for £14.9m/4.7%. Moving forward we do not see this trend for 'long and strong' changing anytime soon.

The continued success of the vaccine rollout means that a return to the office inches closer for many of us, but many of the trends either created or accelerated by the pandemic are yet to be fully understood.

Will everybody cram back into lifts in multi-let offices in crowded city centres? Or as DTRE have championed, will the Business Park return to favour with occupiers, and therefore investors? Will the leafy South West London suburbs of Richmond, Putney, Wimbledon and Kingston maintain their

current popularity? We believe they will.

2020 SAW A 16% DECREASE YEAR-ON-YEAR, WITH £2.1BN OF INVESTMENT DEALS OCCURRING THROUGH THE YEAR

Whilst we don't expect the office market to really get going until Q2 of this year, particularly as international travel into the UK is now heavily restricted. Once we do get going, we do expect to see yields for secondary properties with vacancy and/or capex risk to move further out as institutional investors shy away from these assets.

However, these type of assets may well bring new investors into the UK market as investors look to capitalise on cheap day one yields. In addition, DTRE have also started to see the shoots of recovery from institutional buyers in South East offices, with good quality town centre assets being the focus, much as they were before.

WRITTEN BY



Robert Taylor
020 3328 9106
robert.taylor@dtre.com

DTRE
2nd Floor
Coin House
2 Gee's Court
London W1U 1JA

DTRE

www.dtre.com

OFFICE INVESTMENT TEAM



Simon Glenn
020 3328 9094
simon.glenn@dtre.com



James Cook
020 3328 9102
james.cook@dtre.com



Harry Glatman
020 3328 9112
harry.glatman@dtre.com

OFFICE AGENCY TEAM



Johnny Bray
020 3328 9098
johnny.bray@dtre.com



Alex Lowdell
020 3328 9099
alex.lowdell@dtre.com



Hannah Davies
020 3328 9108
hannah.davies@dtre.com

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