



UNITED KINGDOM

# SOUTH EAST OFFICES

QUARTER 4 | 2019



### 2019 ANNUAL TAKE-UP

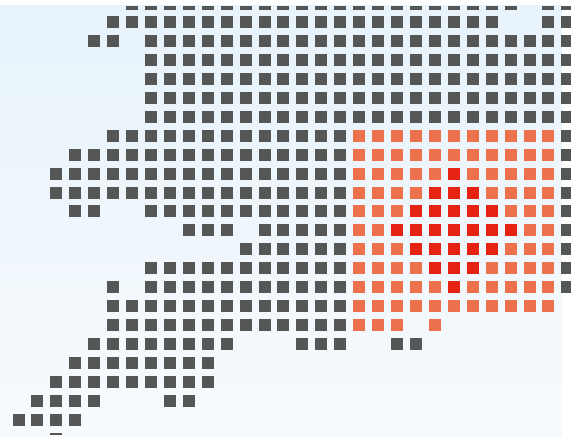
↓ **2.62m** SQ FT    ↓ **29%** YEAR-ON-YEAR

### 5 YEAR ANNUAL AVERAGE

↓ **26%**

### Q4 2019 TAKE-UP

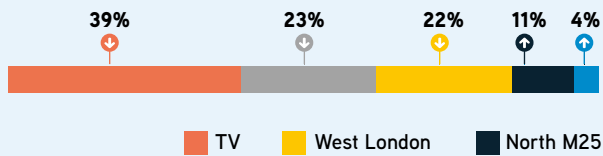
↑ **592,764** SQ FT    ↑ **7%** QUARTER-ON-QUARTER



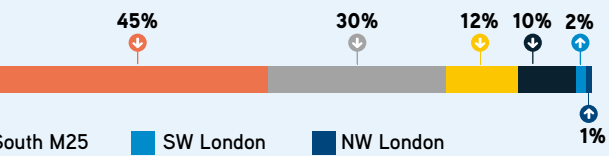
## MARKET HIGHLIGHTS

- South East leasing activity in Q4 2019 was strong, with 592,764 sq ft transacted. Quarterly take-up was 7% up on Q3 2019 levels.
- Take-up levels in 2019 were affected; however, by the uncertain political and economic climate in the UK. Total leasing activity reached c. 2.6 million sq ft, which was 29% lower than 2018 year-end take-up activity.
- The strong General Election result has seen sentiment in the South East office market improve, especially now that the uncertainty around Brexit is more relaxed. Compare this to take-up, at the time of the last General Election, Q3 2017, when quarterly take-up saw a total of 467,456 sq ft transacted, which was one of the weakest third quarters for occupier activity in the South East.
- Occupier demand for larger floorplates in 2019 was more prevalent. Leasing activity for office space from 20,000+ sq ft accounted for 55% of total annual take-up (1.45 million sq ft), equating to 39 out of 152 transactions. In Q4, there were just five deals in this larger sizeband, which accounted for 247,047 sq ft. Take-up in Q4, was dominated by the L'Oreal pre-let at The Gateway, White City for 120,000 sq ft. In addition, Surrey County Council took 56,205 sq ft at Midas House, Woking. These transactions along with Sovereign Housing Association who took 61,000 sq ft in Q1 at the Florence Building, Basingstoke were the three largest lettings of 2019.
- L'Oreal's commitment to White City is not only a strategic decision for the company but further reinforces White City as an established, innovative and thriving office market.
- Leasing activity in the 5,000 – 20,000 sq ft sizebands accounted for 117 deals out of 152, which underpinned take-up levels this year.
- Disregarding the L'Oreal deal, the Tech & Media sector dominated as the most active sector in Q4, accounting for 116,713 sq ft in nine deals. This sector remained dominant throughout 2019, transacting on 566,038 sq ft. The largest Tech & Media deal, which completed in Q1 was Bottomline Technologies who took 58,000 sq ft at Hive 3, Reading.
- Office take-up across the South East in 2019 was focussed on Grade A. 2019 saw roughly 1.8 million sq ft of Grade A offices transacted, whilst this was down on previous years, Grade A take-up accounted for, on average, 71% of take-up between 2017 and 2019. In Q4, 68% of total take-up was for Grade A office space.
- Supply levels in the South East continue to be eroded as vacancy levels are now at just 7.8% down from 11.2% in 2015.
- During 2019 there have been a number of newly built and refurbished developments that were released to the market including; Space, Woking (86,852 sq ft), 40 Clarendon Road, Watford (49,393 sq ft) and The Lantern, Maidenhead (20,000 sq ft). In terms of new build for 2020, the pipeline is very constrained, although JP Morgan's Building 5, Foundation Park, Maidenhead (68,425 sq ft) is due to complete by March 2020 making it the only new building out-of-town.
- Prime rents remain strong and mostly unchanged across the South East.
- We expect to see sentiment in the South East office market grow in confidence during 2020 as Grade A vacancy continues to fall.

### ANNUAL TAKE-UP BY MARKET



### ANNUAL AVAILABILITY BY MARKET



### ANNUAL VACANCY BY MARKET

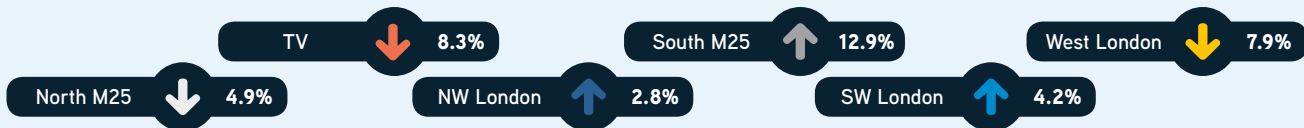


FIGURE 1: SOUTH EAST OFFICES QUARTERLY TAKE-UP BY YEAR

FIGURE 2: SOUTH EAST TAKE-UP BY SIZE BAND AND DEALS

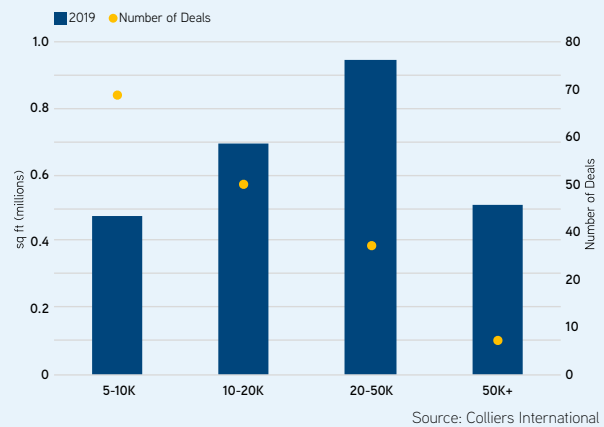
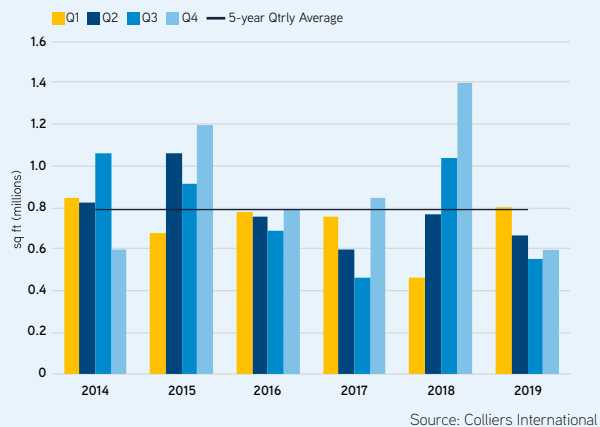


FIGURE 3: Q4 2019 % TAKE-UP BY BUSINESS TYPE

FIGURE 4: SOUTH EAST GRADED TAKE-UP (2017-2019)

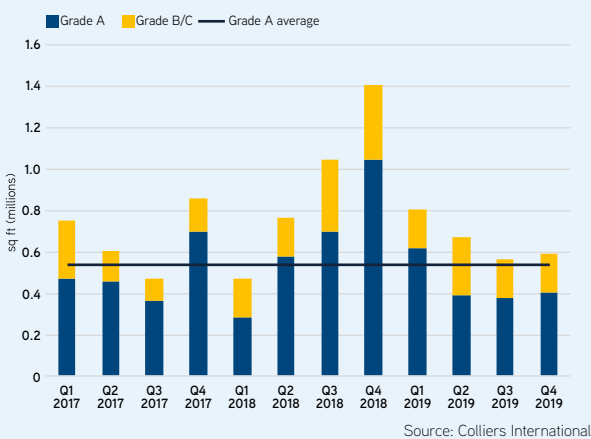
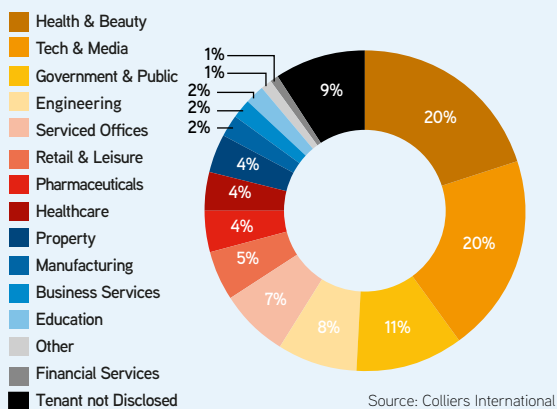
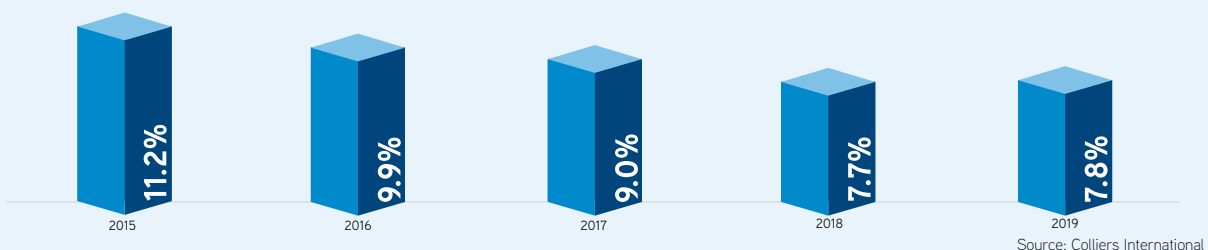


FIGURE 5: SOUTH EAST OFFICE TOTAL VACANCY



# BREXIT IMPACT ON SOUTH EAST LEASING MARKET SEGMENTS

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## Brexit and impact on domestic demand

South East office leasing markets have weathered Brexit in line with the resilience of the main UK regional cities. On reflection, this resilience may be explained by the exposure of these office markets to services that support the UK 'real economy' (production, distribution and consumption). These parts of the economy are linked more closely with the 'supply side' functions of servicing a growing population. Demographic growth alone has been a resilient driver and accounts for the relatively steady growth of domestic demand. Furthermore, growth in the population, including the working aged population, continues unabated. This is linked to normal UK domestic population growth, but also to ongoing positive net immigration. In fact, the real economy outperformed the balance sheet economy (financial and related professional services) for the last 12 quarters, reflecting the limited impact of Brexit (the leave vote) and impending Brexit on performance of the real economy.

## Brexit and impact on business investment

Despite the relative resilience of the real economy and the businesses that support it, the sustained economic uncertainty that arose from the political impasse in Parliament began to take its toll. Of great importance to property leasing markets, is expansionary business investment. In contrast to 'market churn', which is driven by contractual lease breaks and rent reviews, expansionary demand arises when businesses choose to invest in expansion.

As the chart below shows, despite strong quarters of business investment post the great financial crisis, business investment has been a relatively dormant driver of the UK economy over the last two years. According to the ONS, business investment has contracted modestly in six out of the last seven quarters, including Q2 19 when the UK economy as a whole is estimated to have contracted outright for the

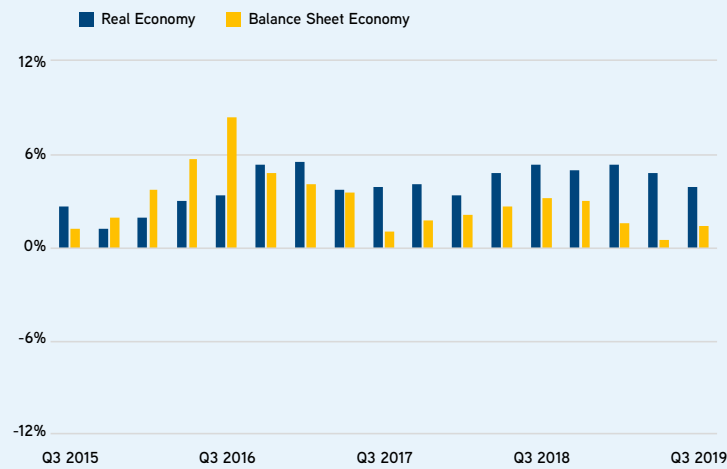
first time since Q3 15. The latest PMI data suggests that a modest Q4 19 contraction is also possible.

Companies are reported to have reasonable cash reserves, but in 2019 in the absence of political, economic and, especially, regulatory certainty, investment plans were shelved. This is one reason why the Conservative government argued that 'getting Brexit done' would result in a surge in 'pent-up' business investment in 2020. Increasingly, businesses are worried less about what the specifics of any eventual deal will be, and are more concerned to know that there is simply a deal agreed whose broad outlines are generally understood. Furthermore, for many businesses regulatory and tax stability arising from a stable Conservative government may be enough to begin a new business investment cycle.

In many instances, though, improved certainty remains linked to sterling, both as a driver of import costs, but also as a determinant of achievable export prices. While the election result has brought renewed confidence and a rebound in sterling, exporters may still remain nervous that further sterling appreciation may undermine their markets.

While improvements in leasing demand may be at hand, until these remaining uncertainties are remedied, then expansionary business investment may remain muted and leasing demand will remain linked primarily to churn in some market segments. Certainly, small-to-medium sized enterprises will remain very cautious until the path of their order books becomes clearer. The latest purchasing manager indices suggest that business order books have weakened over the last three months across most regional markets with businesses in many regions reporting outright declines. Interestingly, London is beginning to see a rebound. This may be a harbinger for recovery for the wider UK economy.

## ECONOMIC GROWTH RATES (GVA %Y/Y NOMINAL)

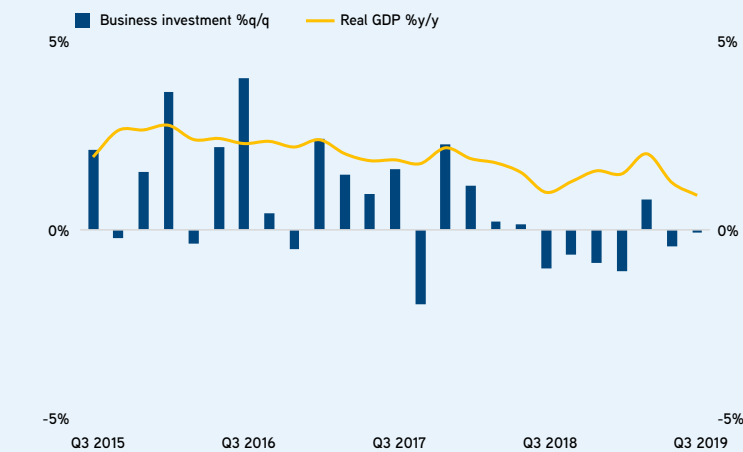


Source: ONS as modelled by Colliers International

*The real economy has outperformed the balance sheet economy for the last 12 quarters.*



## REAL GDP AND BUSINESS INVESTMENT

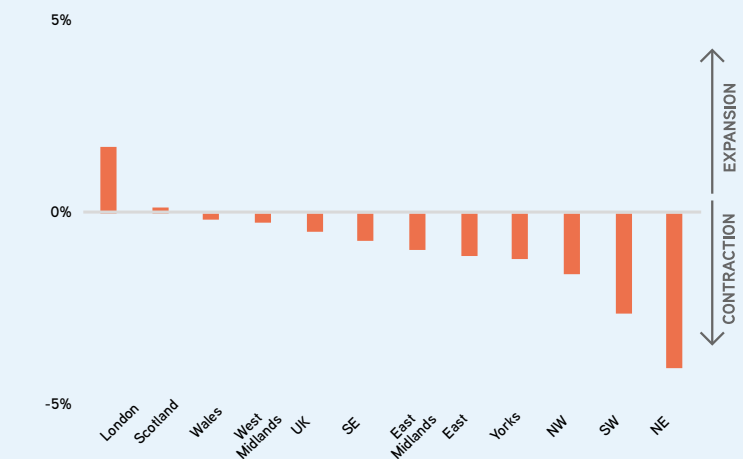


Source: ONS

*Business investment has contracted modestly in five of the last six quarters.*



## PURCHASING MANAGER INDICES



Source: : IHS Markit, December 2019

*Business order books have weakened over the last three months with business in many regions reporting outright declines.*



# INVESTMENT COMMENTARY

Following the December 2019 General Election, much needed stability returned to the South East office market. As a result, Q4 2019 volumes exceeded those of Q4 2018, albeit annual transaction volumes for the year were lower than those achieved in 2018.

There were 44 South East office investment transactions in Q4 2019 totalling approximately £1.2 billion. Q4 witnessed the largest proportion of 2019's annual investment volumes and transaction numbers.

Across 2019, there were 140 transactions totalling £3.15 billion, which were down 20% on those achieved in 2018, where £3.5 billion was transacted. By comparison, 2019 transaction volumes were down 10% on those achieved in 2018. Q4 2019 volumes exceeded those of Q4 2018 (£0.929 billion) by approximately 30%, signifying renewed investor confidence at the start of 2020.

The key trends of Q4 2019 were:

- Office business park transactions accounted for approximately 44% of total investment volumes and attracted the most diverse group of buyers. Seven different buyer groups completed on business park transactions in the quarter.
- Overseas investors were particularly active accounting for a 35% market share of transaction volumes, with a preference for larger lot sizes.
- Private equity buyers, who were absent in Q3, had the second highest transaction volumes of the quarter, accounting for £247 million (20%).
- Property companies had the largest market share by transaction number accounting for nine transactions out of 44 in the quarter (20%).
- Continued demand remains for defensive assets in town centres or those offering long income secured against strong covenants.

Of the £1.2 billion transacted in Q4 2019 approximately 25% was accounted for across six transactions as identified below:

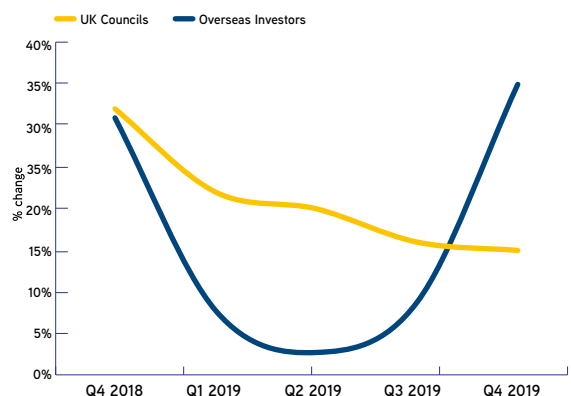
- PSP Investments/Aviva Investors JV acquired CB1, Cambridge for £250 million
- Kennedy Wilson acquired The Heights, Weybridge for £136 million
- Elite acquired the government income Bruton and Stratton Portfolios for £115 million
- An overseas investor acquired 100 Hercules Way, Leavesden Park, Watford for £86 million
- Brockton Capital acquired Seacourt Tower and Retail Park, Oxford for £80 million
- A South Korean client of KFIM acquired 2000 Hillswood Business Park, Chertsey for £60 million

There remains a diverse group of buyers in the market with the largest market share attributed to property companies at 20%, overseas investors (16%), councils (15%), private investors (9%), private equity (9%), REIT (9%), residential developers (9%) financial institutions (9%), owner occupiers (2%) and an industrial developer (2%) who all invested in Q4 2019.

UK councils continue to reduce their market share as evidenced by Q4 2018 (32%), Q1 2019 (22%), Q2 2019 (20%), Q3 2019 (16%), Q4 2019 (15%). This is partly attributed to the HM Treasury increasing the margin, which is applied to PWLB interest rates for new council loan advances.

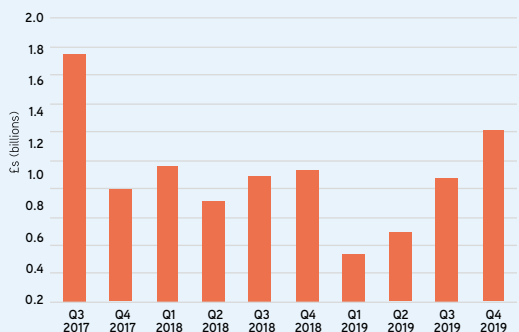
As Council spending has reduced, overseas investors have increased their market share as evidenced by Q1 2019 (8%), Q2 2019 (3%), Q3 2019 (9%), Q4 2019 (35%). We anticipate their buying share will continue to increase in light of the renewed political certainty and the favourable currency markets.

## COUNCILS VS OVERSEAS INVESTORS GROWTH IN INVESTMENT VOLUMES



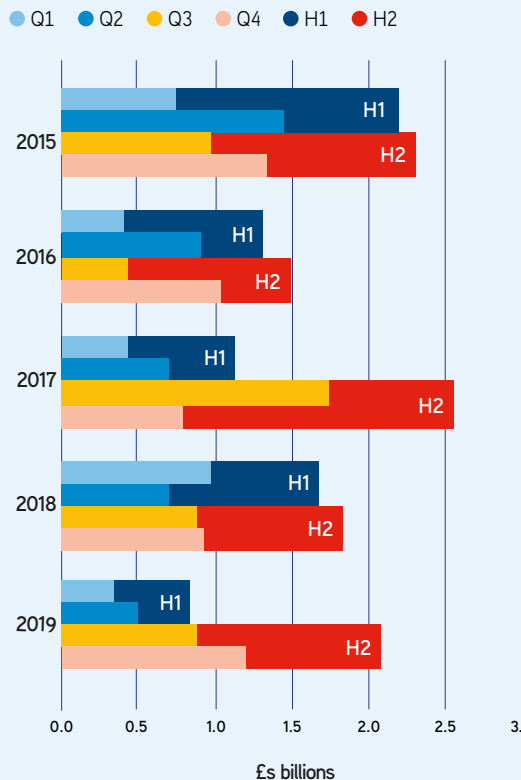
Source: Colliers International

### INVESTMENT VOLUMES BY QUARTER



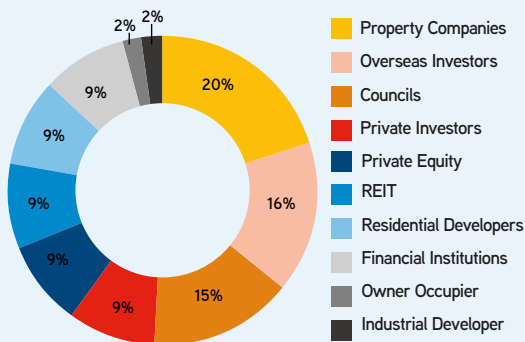
Source: Colliers International

### INVESTMENT VOLUMES/COMPARISON BY QUARTER



Source: Colliers International


### INVESTMENT MARKET SHARE BY NUMBER OF TRANSACTIONS



Source: Colliers International


### Q4 2019 INVESTMENT HIGHLIGHTS

● Size (sq ft) ● Term Certain ● Price ● Net Initial Yield ● Purchaser




**CB1, CAMBRIDGE**

- 248,500
- N/A
- £250,000,000
- N/A
- AVIVA / PSP Investments JV




**BRUTON & STRATTON PORTFOLIO**

- 294,224
- 8.8
- £115,000,000
- 4.45%
- Elite




**THE HEIGHTS, WEYBRIDGE**

- 349,000
- 3.85
- £136,000,000
- 7.06%
- Kennedy Wilson




**SEACOURT TOWER, OXFORD**

- 171,000
- N/A
- £80,000,000
- N/A
- Brockton Capital



**100 HERCULES WAY, LEAVESDEN PARK, WATFORD**

- 196,000
- 14
- £86,000,000
- 5.66%
- Overseas Investor



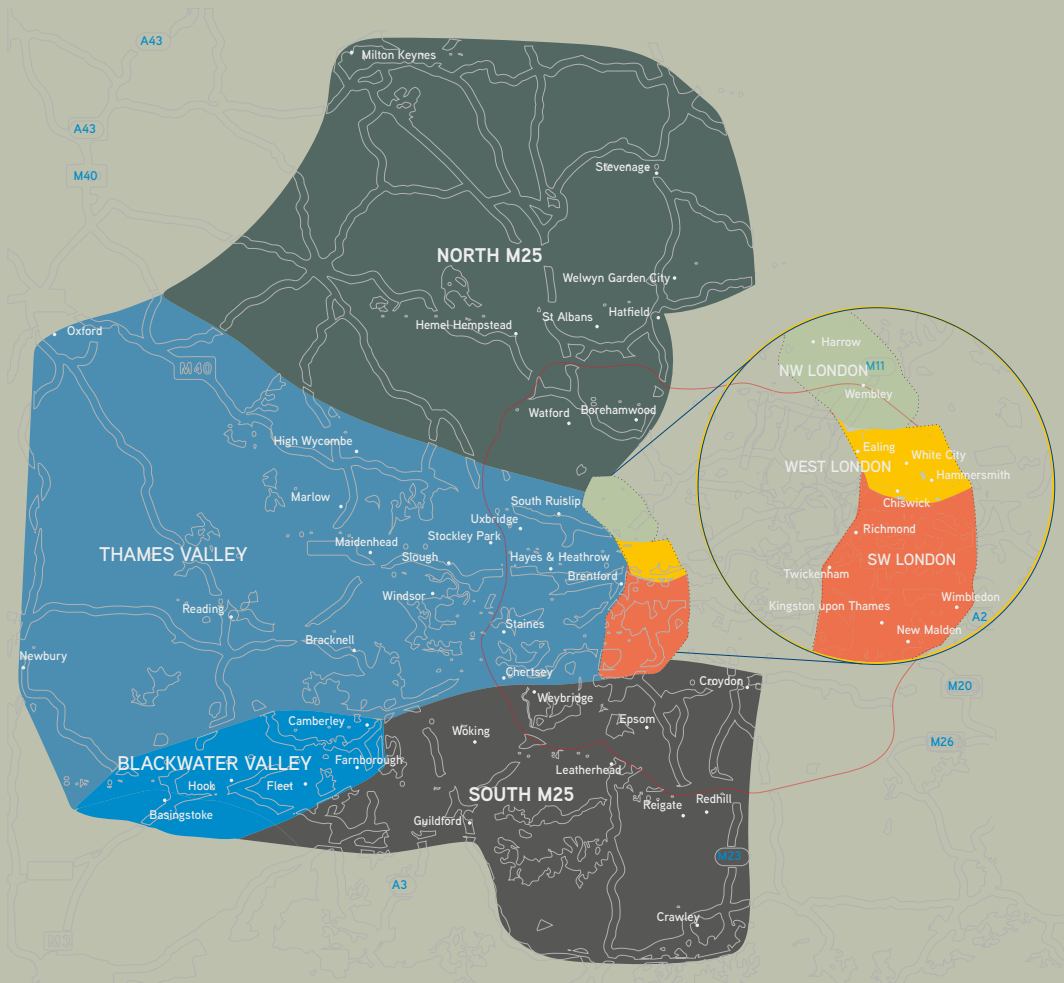
**2000 HILLSWOOD BUSINESS PARK, CHERTSEY**

- 100,142
- N/A
- £60,000,000
- N/A
- South Korean client of KFIM

Source: Colliers International

# METHODOLOGY AND CHANGES TO STATISTICAL ANALYSIS

Colliers International South East Offices has changed our geographic boundaries to separate out NW London, West London and SW London. The map below provides a detailed representation of the towns and cities included in these groupings.



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