UK Commercial – September 2020

MARKET IN MINUTES

Savills Research

UK Regional Office Investment Market Watch

savills

Limited sellers see volumes fall

Investment volumes in the Greater London & South East and regional office market reached £2.09 billion in H1 2020 which was 31% below the long term average. After an initial strong start to the year, the lockdown restrictions imposed from the coronavirus pandemic has resulted in transactional activity falling in Q2 2020.

The prime yield across the regional office market moved to 5.00% in April 2020 as a result of the investor caution arising from the coronavirus pandemic and has continued to remain at that level. This, however, provides an attractive yield gap when compared to central London offices, City and West End prime yields stand at 4.00% and 3.75%, respectively highlighting the value the regional office market can provide.

The demand for prime assets with medium to long term income remained strong during the lockdown with the regional office market continuing to appeal to investors. This was exemplified by Tesco Pension Fund acquiring Halo, Bristol for £69.4 million. Furthermore, sale and leaseback opportunities have also proved attractive. BA Pension Fund bought Next Headquarters in Leicester for £48 million. Overseas investors accounted for 38% of investment in H1 2020, which was the highest proportion amongst all investor types. It's expected that throughout the rest of the year, UK institutions and overseas investors will continue to be active in the market, most notably in Q4 2020.

Regional Office Yields August 2020

	Prime	Secondary*	Spread
Aberdeen	6.50%	8.50%	200 bps
Birmingham	5.00%	6.75%	175 bps
Bristol	5.00%	6.75%	175 bps
Cardiff	5.50%	7.00%	150 bps
Edinburgh	4.75%	6.50%	175 bps
Glasgow	5.25%	6.75%	150 bps
Leeds	5.00%	7.25%	225 bps
Manchester	5.00%	6.75%	175 bps
M25	5.25%	7.00%	175bps

Source Savills Research

*Secondary yields refer to buildings in core locations of both a lower quality and rental price point

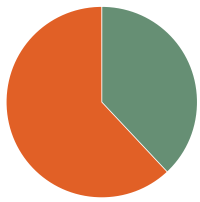
Key Stats

5.00%

Prime regional office yield

£2.09bn

Office investment volumes outside of Central London in H1 2020



38%

Overseas investors accounted for 38% of total investment in H1 2020 which was the highest proportion amongst all investor types

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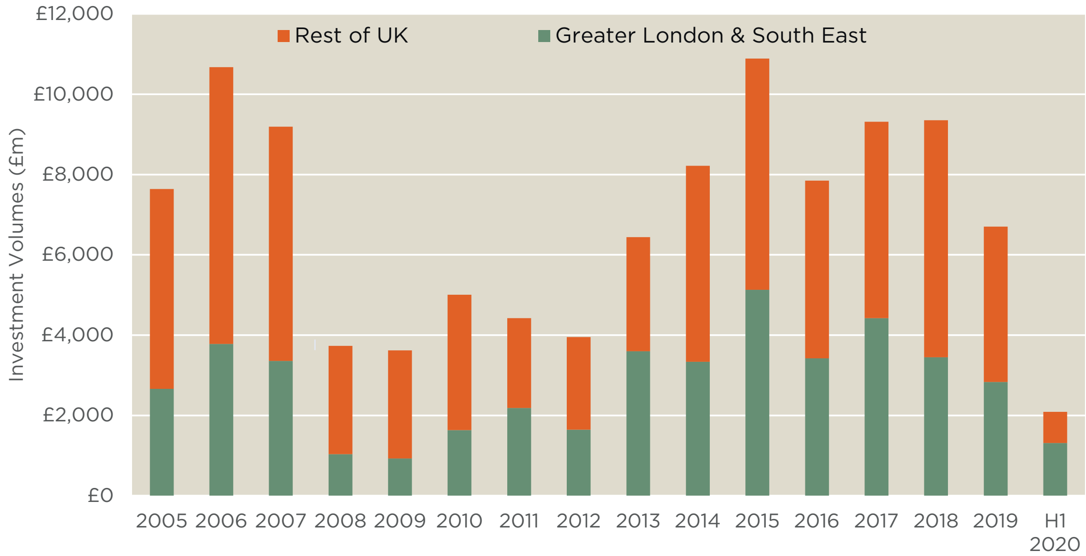
There were five deals recorded over £100m in H1 2020

Office Investment Volumes Volumes fall in Q2 2020 and total H1 2020 investment volumes were 31% below the long term average.



Source Property Data/Savills

Will there be a rise in demand for business park space as a result of Covid-19?

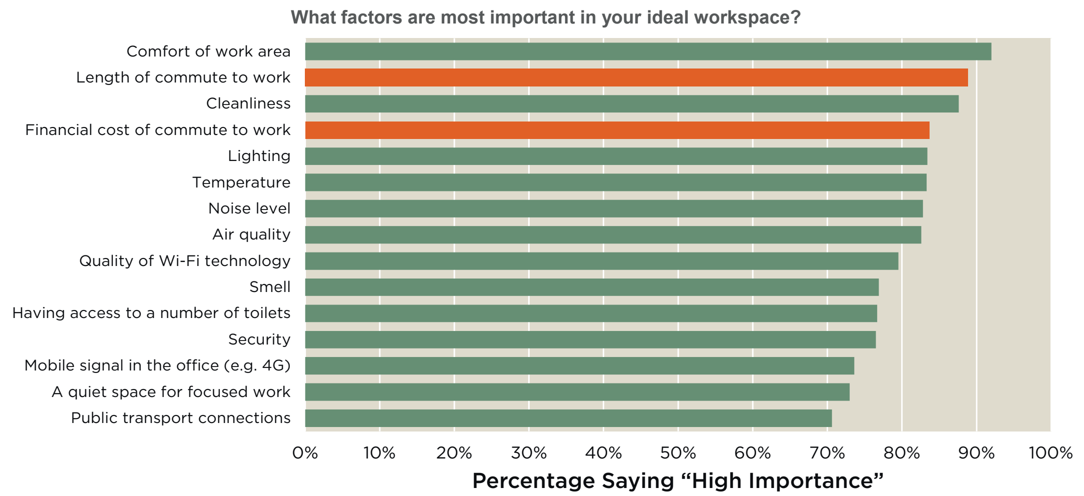
The hub and spoke corporate location model has gained traction in recent months with Covid-19 resulting in corporate occupiers evaluating their real estate costs and employees reviewing their daily commuting patterns.

Savills Office FiT Survey revealed that office workers with shorter commutes are more likely to return to the office. The survey showed that respondents with up to a 30 minute commute (one-way) disliked working away from the office by a factor of four when compared to those with the longest commute of above 1.5 hours. The importance of the commute to the office was highlighted by *Savills What Workers Want 2019 Survey*, the length and financial cost of the commute were the second and fourth most important factors (see chart below).

Business parks which are able to provide accessibility from a variety of different transport modes could potentially benefit from a hub and spoke model. The quality of office space on business parks has improved, notably in Greater London & South East which is reflected by average grade A rents increasing by 13% in the last five years. Investor demand for business park assets has also increased which was demonstrated in H1 2020 with CapitaLand acquiring Arlington Business Park, Theale and Tristan Capital Partners buying Reading International Business Park, Reading.

There is currently limited actual evidence of corporate occupiers adopting a hub and spoke model in light of Covid-19. Although Savills are aware of mid-sized corporates reviewing their real estate portfolio. The demand for office space remains healthy, solely focusing on Greater London & South East, there were 2.07 million sq ft of new requirements from April-August and 36 of these were above 20,000 sq ft which bodes well for take-up later in the year.

Commuting is of high importance to office workers Will office workers want to alter their commute in search of a greater work-life balance?

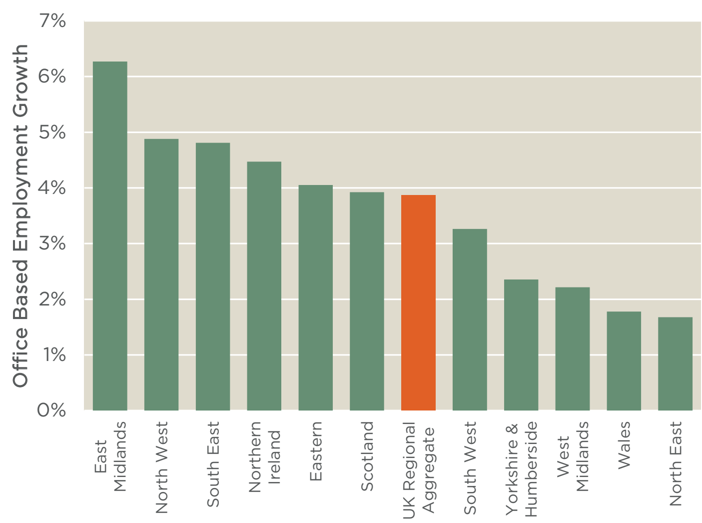


Source: Savills What Workers Want 2019 Survey

The future demand for office space has been much debated as a result of the acceleration of home working arising from Covid-19. Whilst employment growth forecasts may not be linked as strongly to office take-up going forward they still provide a good indicator of future office demand.

Oxford Economics forecast office based employment growth to be 3.9% in the next five years across the UK excluding Greater London. The region which is expected to experience the strongest growth in terms of volume of additional jobs created is the South East. There are 75,000 additional jobs forecast to be created in business sectors which are historically office based in the region in the next five years highlighting the scale of the recovery.

Office based employment forecasts Office based employment is forecast to grow by 3.9% in the next five years in the UK excluding Greater London



Source Oxford Economics

Savills team

Please contact us for further information

Mark Porter
Director
UK Investment
020 7409 9944
mporter@savills.com

James Vivian
Director
UK Investment
020 7409 8731
jvivian@savills.com

James Emans
Director
UK Investment
020 7409 8132
jemans@savills.com

Steven Lang
Director
Commercial Research
020 7409 8738
slang@savills.com

Simon Preece
Associate
Commercial Research
020 7409 8768
spreece@savills.com