SOUTH EAST

AVISON YOUNG

EXECUTIVE SUMMARY

- In the office market, both occupiers and landlords are suffering due to the patchy demand and supply across the region, with some office submarkets having excessively high requirements whilst others are having to increase incentives to attract tenants.
- Retail in the South East is undergoing significant transformation, with changing consumer demands encouraging service and leisure growth on the high street while other sectors struggle. Demand is unevenly distributed between centres and the periphery, with the high cost of business rates causing retailers to defer decisions.
- The industrial market in the South East is categorised by growing demand with severe supply shortages. The region is becoming more attractive as London rents increase, offering connectivity to the capital, airports, seaports and the rest of the U.K.

Overall, the South East outlook for 2020 is significantly positive, with office and industrial growth continuing to counter retail decay and mild residential performance. This echoes trends expected across the U.K. Although the aggregated performance is strong, there remains considerable variation between the submarkets of the region, as historic and strategic locations outpace less well-connected areas.

High London rents combined with low availability are pushing some industrial and office occupiers out into the South East, bringing increases in demand. Companies are becoming more open to migrating from the congested capital to South East centres, with Hertfordshire in particular growing in popularity. The prospect of the Elizabeth line has encouraged demand along the proposed route and will continue to do so, particularly in key locations such as Maidenhead, Reading and Slough.

South East office suppliers are also responding to the flexible and serviced office demands which are increasingly popular locally and across the U.K., helping to keep demand strong across the region. Whilst we continue to see capital growth, office capital values are still only achieving two thirds of the pre-2008 levels. Rental growth remains at a modest but consistent pace as it has done throughout 2019. Over the year ahead, we expect the growth in capital value and rents to continue for the office market, stemming from the high population growth of the region combined with its proximity and connectivity to London.

KEY MARKET METRICS – 2020 EXPECTATIONS

Annual growth rates, estimated for year-end 2020 vs year-end 2019.

	OFFICE	RETAIL	INDUSTRIAL
Rental Growth	↑	↓	↑
Vacant Space	↓	↑↑	↓
Construction Levels	↑	→	↑
Leasing Volume	↑	↓	↑↑
Investment Volume (all sectors)		↑	

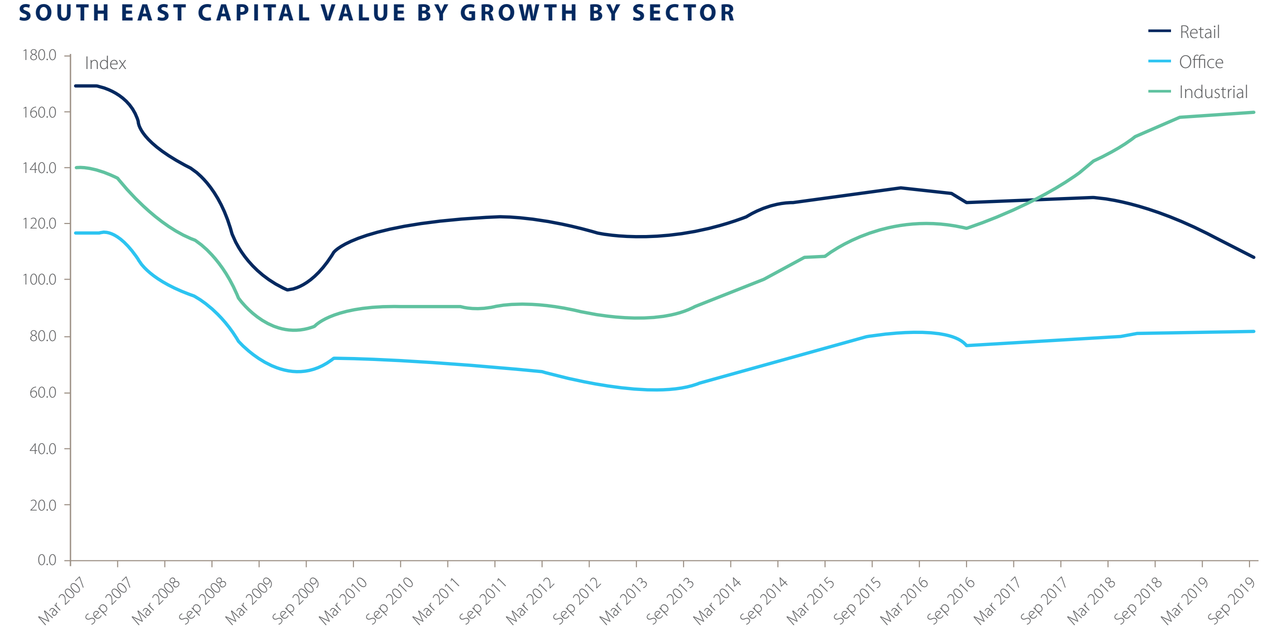
The outlook for 2020 for the South East office market remains cautiously positive, notwithstanding substantial economic or political jolts. Although vacancy rates are generally eroding across the region, there is significant variation between submarkets. Demand in Watford remains substantially greater than supply, resulting in local vacancy rates of below 3%. Landlords in Uxbridge, conversely, continue to offer increased incentives to try and attract occupiers in the supply-saturated submarket. The retail sector will continue to see challenges in the South East, mirroring wider trends across the U.K., with rents declining, capital values contracting and yields dropping.

The impacts are most prevalent in secondary retail markets, outside of prime areas which are remaining resilient. The South East retail sector had high exposure to the closure of well-known high street retailers such as Mothercare throughout 2019, which has had a significant impact on demand for retail space in shopping centres in particular.

Many shopping centres are the focal point of the repurposing of town centres to better serve modern local needs, providing greater affordability, flexibility and residential spaces alongside place-making amenities.

Although the aggregated performance is strong, there remains considerable variation between the submarkets of the region as historic and strategic locations outpace less well-connected areas.

SOUTH EAST CAPITAL VALUE BY GROWTH BY SECTOR



Source: MSCI

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High streets are also continuing to evolve, with convenience, health and leisure offerings becoming more prevalent. Reflecting the stronger growth in online retailing, comparison goods retailers are increasing click and collect services in their bricks and mortar stores to provide a more efficient option for time-savvy consumers. Larger comparison destinations are able to entice greater spending from less frequent customer visits by offering experiences including leisure, health and public realm. These trends are largely in response to the increasing market share of ecommerce and consumer preferences shifting towards more experiential and service.

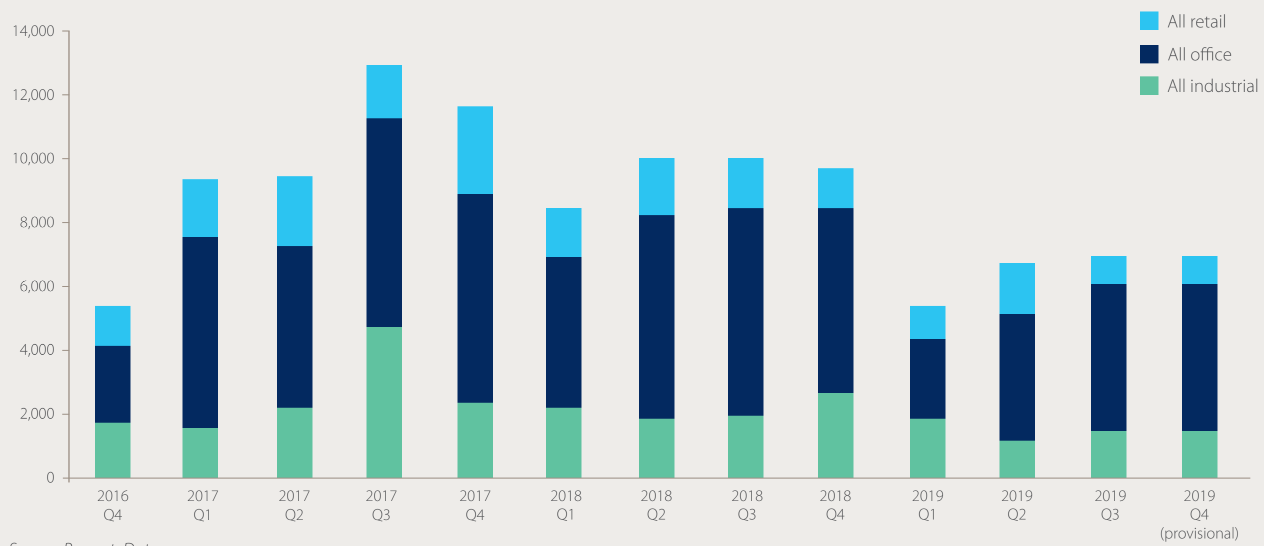
The South East industrial market is expanding significantly. The sector is growing consistently with capital value increasing for 40 consecutive months. This is expected to continue during 2020 with high take-up forecast. Industrial rents are increasing steadily as demand booms, largely due to the thriving ecommerce market and the prime location of the South East for last-mile logistics, along with close proximity to major airports, shipping ports and motorway connectivity with the rest of the U.K.

Industrial supply, however, is significantly curtailed in the South East. This comes as industrial spaces are converted into alternative uses, primarily residential in response to London's housing crisis as commuters are being pushed out to the South East. This trend is impacting both the big shed and multi-let markets, although the former is more restricted due to its greater spatial requirements. Rental growth is expected to achieve 4% and capital value is expected to increase by 5% over 2020. Developers are looking to capitalise on this with circa 5 million sq ft of big box schemes in the pipeline, including five projects over 200,000 sq ft, much of which is speculative. In addition to the current pipeline, there remains a bullish weight of capital to invest in the South East industrial market. The heavily imbalanced supply and demand dynamic could bring pressure on local authorities to relax the restrictions on greenbelt development.

High prices and Brexit turbulence have been subduing the South East residential market, but real wage growth and the continued presence of the housing crisis across the U.K. suggests that the South East will see mild residential growth in 2020.

Comparison goods retailers are increasing click and collect services in stores to provide a more efficient option for time-savvy consumers whilst the larger comparison destinations are able to entice greater spending from less frequent customer visits by offering experiences including leisure, health, and public realm.

SOUTH EAST INVESTMENT BY SECTOR



Source: PropertyData

The trend will be encouraged further by the infrastructure developments and the push factors out of London. House prices in the region have been reporting modest but positive growth throughout 2019. Election pledges carry significant implications for the South East housing market, with large lumps of funding promised to build new housing across the country. This, combined with reduced government funding for first time buyers, is likely to subdue growth in the South East residential market as supply increases whilst demand remains flat.

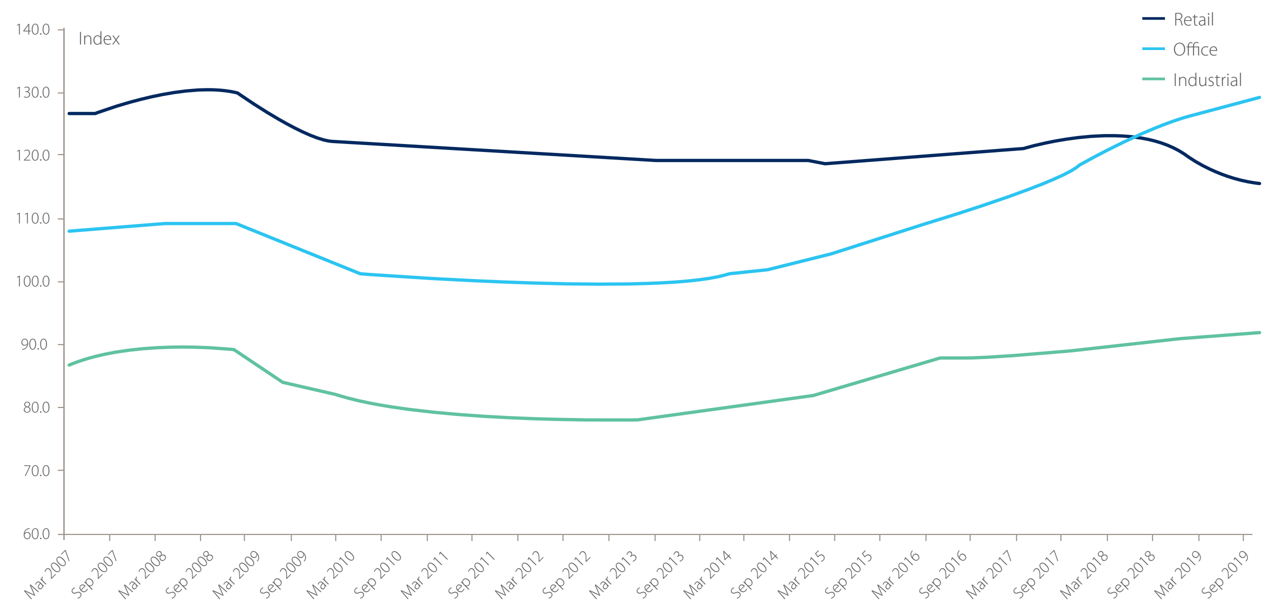
The hotels market in the South East continues to generate considerable rental growth as observed over the past year. This growth has been matched by significant increases in investment, reaching £271 million in the year to November 2019 compared with £152 million during the same period a year ago. Following trends observed across the rest of the U.K., this investment is composed of a substantial commitment from overseas investors who account for 56% of the total investment, up from 49% in the previous year.

The increasing attractiveness of the U.K. market due to the weaker pound along with the strong performance of the hotel sector over the past year has helped to drive this investment.

The hotel market's performance in the South East is expected to continue over the next year, although at a slower pace, with rental growth and strong investment anticipated. The largest deal of the period was the £150 million purchase of Sofitel Gatwick North by BAe Pension Fund in Q4 2019.

Investment in the South East has been subdued in all sectors in 2019. The office sector has received 38% less investment in 2019 compared to 2018, whilst investment in the industrial and retail sectors declined by 23% and 24% respectively. These figures reflect the unwillingness to invest whilst the uncertainty of Brexit remains prevalent which has particularly affected foreign investor interest. High land values have also deterred potential investors. In 2019 there were only two transactions which exceeded £100 million in the South East: the aforementioned £150 million purchase of Sofitel Gatwick North; and Lakeside North Harbour in Portsmouth, with Portsmouth City Council purchasing the site for £138 million in Q3 2019. However, the considerable infrastructure improvements on the horizon for the South East, namely the Elizabeth line, combined with growing congestion in London which is causing spill over into the surrounding area, suggests that there will be considerable investment in the South East in 2020.

SOUTH EAST RENTAL VALUE GROWTH BY SECTOR



Source: MSCI

The South East industrial market is expanding significantly. The sector is growing consistently in capital value, increasing for 40 consecutive months, and will continue to do so over 2020 with high take-up forecast.

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