D2 REAL ESTATE

An alliance member of BNP PARIBAS REAL ESTATE

2017

Channel Islands Office Market Review

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Contents

In conjunction with BNP Paribas Real Estate, I am delighted to present the second edition of our Office Market Review, which this year has been extended to include Guernsey. It has been an exciting time for the Company as the management team completed the acquisition of BNP Paribas Real Estate (Jersey) Ltd in October 2017 and we set up our Guernsey office in January 2018. We still retain an alliance with BNP Paribas Real Estate and are currently working with the London team on a number of high profile investment sales. For us, 2017 was a productive year with both take up and investment volumes exceeding the 5 year average and as a company we have been involved in the majority of the larger transactions. As investment volumes have surpassed 2016 levels in the UK, investors have looked to alternative markets in the search for yield and income security. This has led to the emergence of Middle Eastern investors to the Channel Islands market who have made some significant acquisitions. Research, market data and transparency will be key in identifying new investors going forward, which will become increasingly important as some significant investment opportunities come to the market in 2018.

Phil Dawes
Managing Director
D2 Real Estate

2017 Key Highlights

- Investment volumes have exceeded £150,000,000 across both Islands, which is a 5 year record
- Middle Eastern buyers have entered the market with the acquisition of 37 Esplanade for £45m
- Take up in Jersey has exceeded 200,000 sq ft which is again a 5 year record and in terms of take up as a percentage of total stock is comparable to some of the major UK regional cities
- Occupational demand in 2018 for grade A space across both Islands looks robust, however in Guernsey there is a lack of available grade A space
- The vacancy rate in Jersey has risen, albeit we anticipate this to fall as occupational demand for 2018 looks strong and further obsolete buildings are converted into alternative uses. 2017 has demonstrated that there is strong demand for secondary buildings, providing that flexible lease terms are offered at competitive rents and the accommodation is fit for purpose
- Prime headline rents in both Islands have remained stable, with Jersey at around £35psf to £40 psf dependant on the lease terms and Guernsey slightly higher at around £38/£44 psf, given the shortage of supply of grade A on the Island
- Prime yields of between 6.6% to 6.75% have been achieved during 2017. We expect these benchmarks to be exceeded, subject to length of lease, quality of covenant and rental tone

UK Investment Market Overview 2017

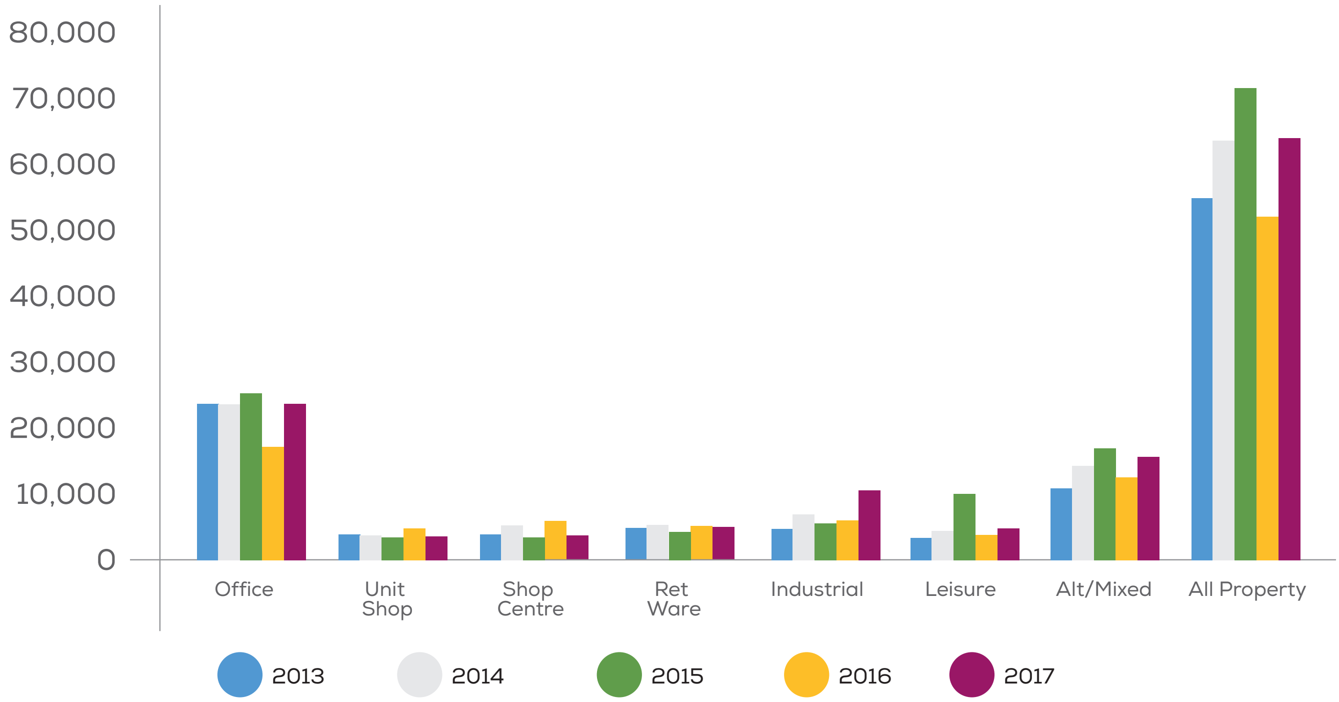
2017 Investment Volumes

As with any commercial property market the Channel Islands are influenced by global events. For example, what happens in Asia will impact yields in London which eventually filters out to the regions and the Channel Islands. At D2 Real Estate we view the market from a global perspective and constantly review trends in the UK and further afield that will ultimately influence what happens locally.

UK investment volumes over 2017 hit an impressive £63.9bn, up 23% on 2016 total volumes, as a low yield environment across most asset classes globally continued to channel overseas investment into the UK. With regards to Central London, the capital has performed well with total annual volume reaching £19.8bn, up 25% on 2016.

Overseas investment dominated over the course of the year with international buyers taking advantage of the currency play and lower competition from UK institutions who have remained net-sellers in the Capital. If we look at the office sector in 2017, £14.9bn was invested into Central London offices, 46% ahead of 2016. London on a global stage remains very attractive, indeed, 82% of capital originated from overseas in 2017, with Asia Pacific investors remaining very active deploying £7.47bn, roughly 50% of the total. Buoyed by demand from overseas investors, yields for prime stock remain at 4.00% in the City and 3.50% in the West End.

UK Investment Volumes by Sector (£ million)



Source: Property Data/BNP Paribas Real Estate Research

Regional Offices Performance

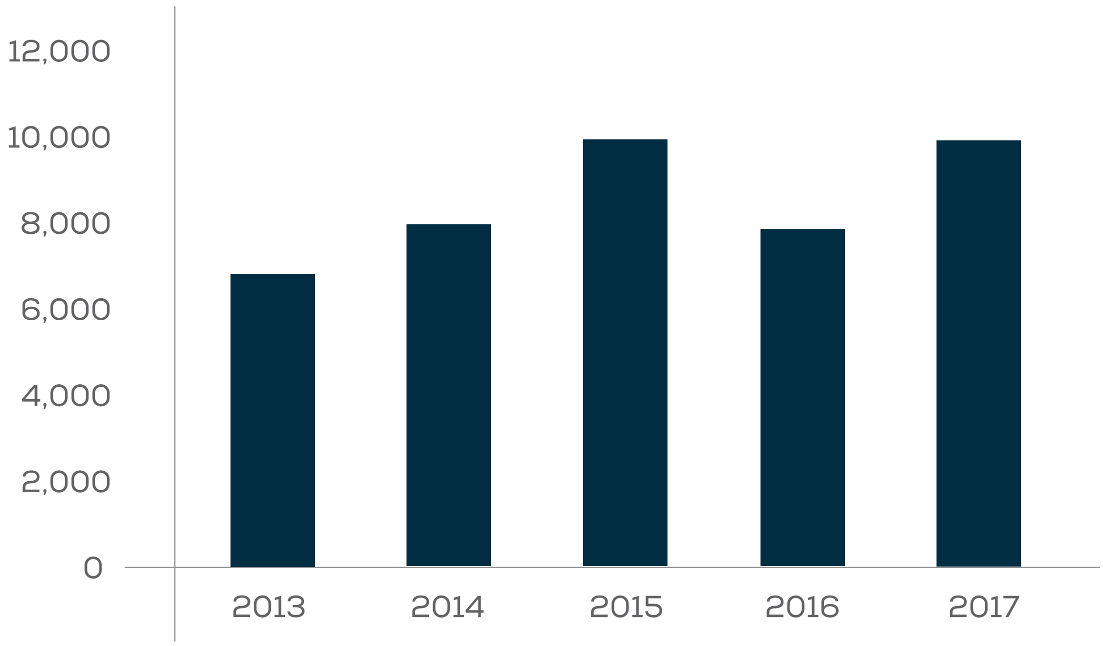
2017 witnessed strong investor appetite for regional assets, with investors showing a vote of confidence in UK regional office markets against a backdrop of continued uncertainty. Total regional office investment reached £9.4bn over 2017, up 18% on 2016 volumes.

This year, we expect to see solid levels of regional investment continue, with the current yield gap between Central London and the wider UK markets offering investor opportunities for attractive risk-adjusted returns.

This increased focus on regional assets has meant growing competition for well let, city centre offices, particularly in key regional hubs such as Manchester, Birmingham and Bristol with prime city centre yields hardening to n ew levels.

Looking forward, these will be supported by the return of inflationary pressure on headline rents within those grade A starved locations such as Bristol and Edinburgh. In recent months, Bristol has seen an increase in activity, with the purchase by a South Korean buyer of the landmark grade A office block at 10 Canons Way for £95.5 million at a Net Initial Yield of circa 5.15%. The new delivery of prime stock in cities such as Manchester and Birmingham, associated with their long-standing appeal to local occupiers, will also act as a stimulus on existing rental levels which we've already seen move into unchartered territory. Recently we have seen new headline rents in Birmingham and Bristol of £33.00 psf and £32.50 psf respectively; a clear demonstration that tenants' willingness to pay a premium for securing the most suitable space for their needs has not faltered.

Regional Offices* Investment Volumes (£ million)



Source: Property Data/BNP Paribas Real Estate Research
Note: Regional Offices refers to office transactions outside central London

Jersey Office Market Review 2017

Background

The office district in Jersey is concentrated in St. Helier, the Island's capital. Traditionally the heart of the office market in St. Helier was centred around Hill Street, Broad Street and Library Place due to their proximity to the States Chambers, Royal Court and prime retail areas of King Street and Queen Street.

The growth of St. Helier's office market in the 1970's and 1980's saw the piecemeal development of office buildings throughout the Town in locations such as Grenville Street, Colomberie, La Motte Street, New Street and Union Street. There was not, however, a distinct central business district. The Island Plan has identified the Esplanade as the primary area for office development and this area has been the focus for new office development and is now considered to be the prime office location.

Total stock currently stands at around 3,150,000, of which 320,000 sq ft was completed in late 2016 and 2017, and a further 65,000 sq ft is due to complete in 2018.

Take Up

2017 was a very strong year in terms of take up, with over 200,000 sq ft of space being let, an increase from 160,000 sq ft in 2016. This coincided with a number of high profile developments reaching completion in late 2016 and early 2017, namely Building 1 International Finance Centre, Gaspe House, 27 Esplanade and 29 Seaton Place, giving the opportunity for those tenants occupying inferior space to relocate. However, not all the take up centred around the prime Esplanade district, as around 45% (90,000 sq ft) was taken in non core locations.

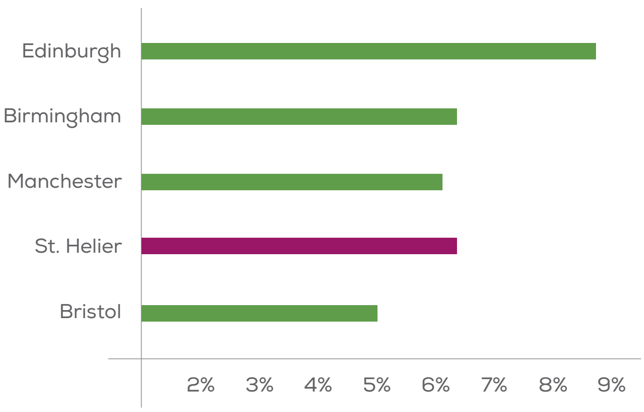
2017 has demonstrated that there is strong demand for secondary buildings provided that landlords are prepared to offer flexible terms, competitive rents as well as a good quality building.

A good example of this was the Le Gallais Building, 54 Bath Street, comprising circa 35,000 sq ft, which was occupied by Royal Bank of Canada (RBC). RBC vacated the premises and relocated to the Esplanade and the landlord undertook a comprehensive refurbishment.

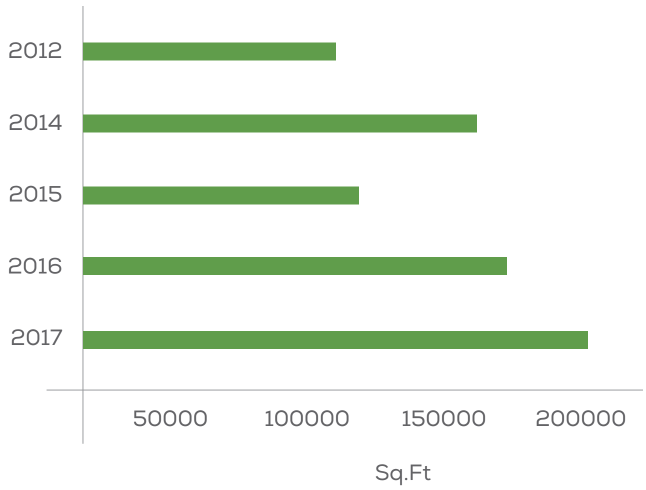
By the time the refurbishment was completed 95% of the space was prelet. One of the largest transactions that took place last year was the letting of Liberte House, La Motte Street, again a secondary location but good quality building. It is also notable that the serviced office operators have been acquiring premises, again demonstrating the demand for flexible lease terms.

Putting the overall numbers into context the 2017 take up represents 6.3% of the Island's total stock, compared to the likes of Bristol 5.1%, Edinburgh 9.0%, Birmingham 6.3% and Manchester 6.2%. It should be noted that some UK regional markets have benefitted from the UK Government's Property Unit (GPU) which has boosted take up.

December 2017 - take up as a percentage of total stock



St Helier take up



Source: BNP Paribas & D2 Real Estate Research

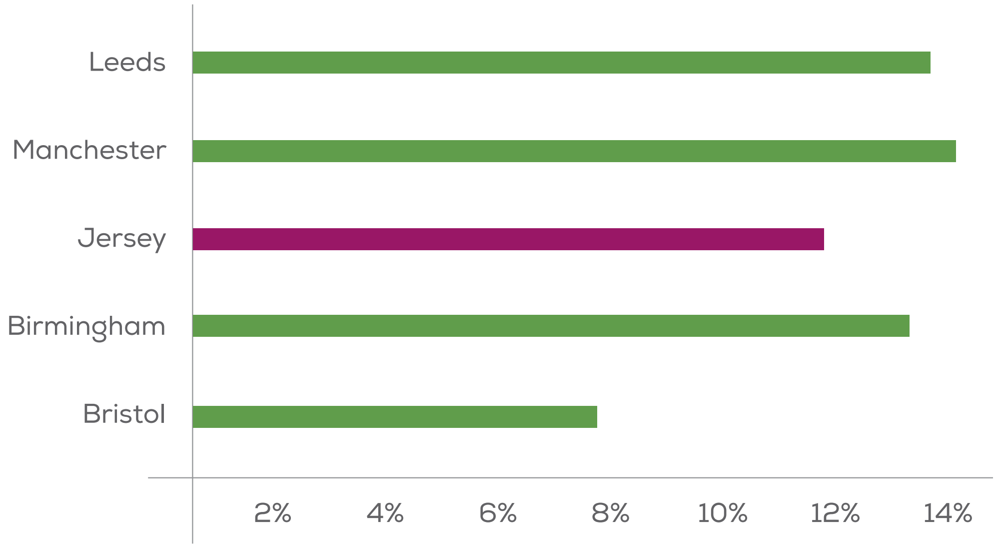
Vacancy Rate

As predicted in our 2016 Office Market Review the vacancy rate in St Helier has risen from around 8.5% to just under 12%. Given the current take up level allied with the number of enquiries and conversions to residential, we anticipate this surplus to reduce during the course of 2018, but much will depend on what approach owners of vacant secondary properties take, in terms of offering flexible lease terms, competitive rents, quality of space and ability to convert to alternative uses.

As at December 2017 there was around 83,000 sq ft of new prime grade a space available, which from an occupier perspective provides choice and enables them to adapt. Having available fit for purpose accommodation will also encourage businesses outside the Island to relocate.

St Helier overall vacancy rate as at December 2017

Source: BNP Paribas / D2 Real Estate Research



Rents

Rents in St Helier have risen slowly and steadily and unlike some UK cities the Channel Island occupational market does not experience the same level of volatility. Headline rents for larger suites (10,000 sq ft) in the grade A building have remained constant over the past 12 months and range between £35 psf and £37 psf dependant on the lease term. However smaller suites of up to 5000 sq ft have achieved £40 psf in Building 1 IFC.

For second generation buildings located on the Esplanade the headline rental tone is in the order of £29 psf for the better accommodation, albeit given the lack of availability there has been little in the way of transactional evidence. The rental differential between grade A prime and second generation prime on suites below 5000 sq ft is now becoming material in our view, which is likely to be a catalyst for headline rental growth.

Occupier Demand for 2018

We anticipate another strong year for 2018 and above the 5 year average of 152,000 sq ft. There are still tenants occupying sub standard space who are actively looking and as their leases become shorter these occupiers will be in a position to negotiate terms on new premises. We are currently aware of 14 live enquiries for 2018, providing a total of 168,000 sq ft, with the largest single requirement being for 60,000 sq ft.

Guernsey Office Market Review 2017

Background

Traditionally the office market was centred around Le Bordage, however over the past 15 years the prime pitch has shifted north, towards St Julian's Avenue, Glategny Esplanade and at Admiral Park, the latter being an out of town office development. The topography is significantly different from Jersey, which restricts the availability of potential development sites. With the lack of available sites and grade A supply, headline rents have remained constant, albeit the incentives offered tend to be higher when compared to prime buildings in Jersey.

Total stock currently sits at around 1.8m sq ft, with around 725,000 sq ft being considered as grade A. The only significant potential new development in Guernsey is No1 The Plaza (Admiral Park), comprising 61,343 sq ft, however a significant pre-let is required to commence the development.

Take Up

With no new developments and a limited amount of available grade A space it is not surprising take up has been subdued for the last few years. Indeed the only meaningful letting in 2017 has been to Mourant Ozannes in Royal Chambers (27,000 sq ft). Total take up for 2017 is estimated at circa 42,500 sq ft, slightly below the 2016 figure of around 57,000 sq ft.

Putting these figures into context the 2017 take up represents 2.4% of the Island's total stock.

Vacancy Rate

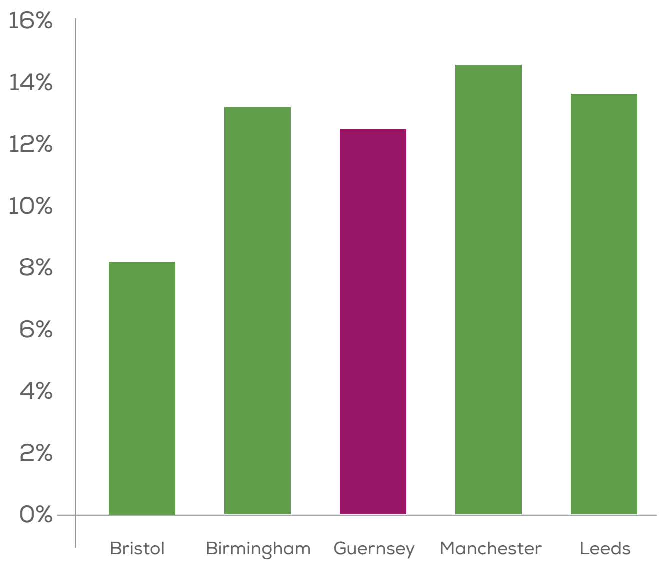
The market in Guernsey operates very much on a two tier system. There is an abundance of poor quality secondary and tertiary stock, much of which has been vacant for a number of years (estimated at around 190,000 sq ft). Such office buildings are often listed, which can hinder redevelopment and comprise small cellular offices. The floor to ceiling heights are often minimal, which restricts the retrospective installation of modern M&E equipment and makes their occupation impractical. In essence, they fail to meet the requirements of modern occupiers.

In contrast to Jersey the residential market has been relatively subdued over the past few years, so there has not been the volume of office conversions to residential. However the signs are that the residential market is improving.

The residential Local Market saw a 17.5% upturn in the volume of sales completed in 2017 and a drop in stock levels of around 5%. Enquiries were particularly strong from first time buyers looking to spend circa £400,000. If this trend continues then this may result in suitable offices being converted to satisfy demand.

In terms of the prime market, what is now happening in Jersey took place in Guernsey back in the 2000's, where developers identified the opportunity and built offices to meet the demand from corporates occupying inefficient space. There are a couple of potential sites but further development is unlikely without a significant pre-let.

St Peter Port Vacancy Rate December 2017



Vacancy Rate (continued)

As a result, and given St Peter Port's topography, which restricts development opportunities there is a chronic shortage of modern grade A space, with around 40,000 sq ft of built grade A being potentially available. The positive result of this from an investor perspective is that rental values are less volatile with a top headline rent of £44 psf being achieved in 2017, albeit there were incentives.

We estimate the vacancy rate as at December 2017 to be around 12.75%.

Rents

Whilst the secondary market has stalled over the past 5-6 years, in the wake of the financial crises and a surplus of obsolete stock, the prime office market has performed rather better. This has predominantly been due to the relatively low volume of prime stock in Guernsey which has helped maintain headline rents in excess of those achieved in Jersey. Whilst demand remains at a reduced level from that which was experienced in the early to mid 2000's, the limited supply means that there is still a high occupancy rate. With no significant area of land zoned for office development in the new Island Development Plan (2016) and little in the way of prime office developments in the pipeline, this trend looks set to continue.

Despite headline rents in excess of £40 psf being achieved, these have tended to be one off deals (ie best suites with sea views etc) or have been achieved through granting significant incentives. In our opinion the general tone for headline rents for grade A buildings is in the region of £38/£39 psf, compared to £35/£37 for larger suites in Jersey. Both are higher than Bristol, at £30 psf which demonstrates the relative scarcity of supply and high build costs.

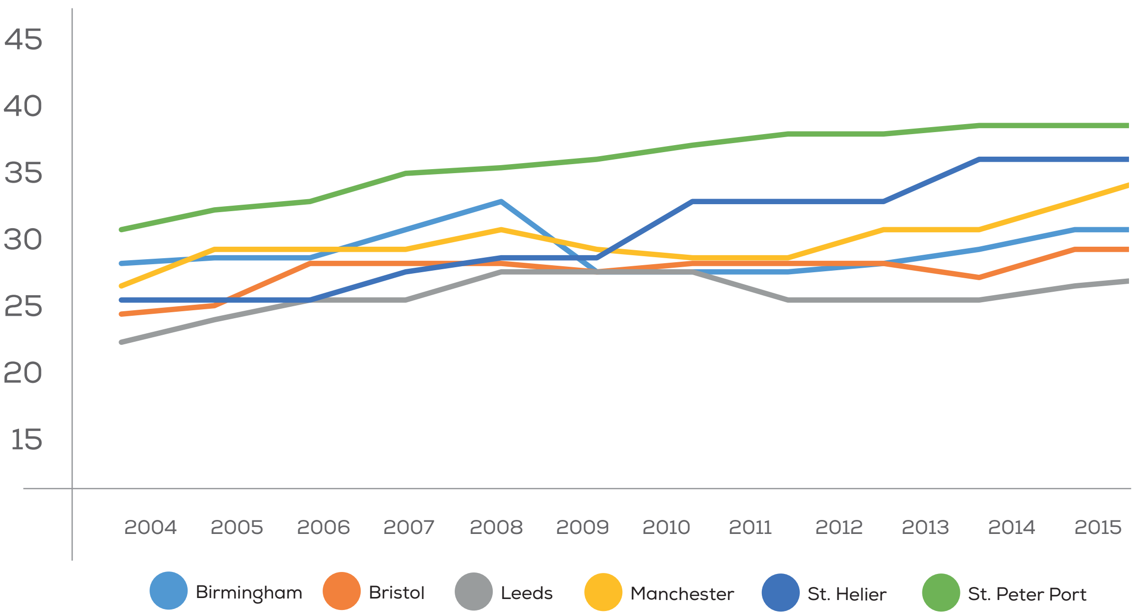
Rents for secondary accommodation varies significantly, with the tone being £20 - £30 per sq ft in the Bordage, and £15 - £20 per sq ft on suites above shops.

Occupier Demand for 2018

We anticipate that 2018 will be a stronger year for take up. We currently have 7 potential enquiries from occupiers looking for prime space, totalling 83,000 sq ft. The largest being for 20,000 sq ft. The challenge will be to find the suitable buildings at the right rent to satisfy these occupiers.

Prime Headlines Rents

Source: BNP Paribas / D2 Real Estate Research



Channel Island Investment Market Review

With annual UK volumes reaching £63.9bn which is 23% ahead of 2016, primarily driven by overseas investors, yields for prime central London asset have fallen to 4.00% in the City and 3.50% in the West End. This has radiated out to the regions where yields have fallen and key deals such as 3 Hardman Square, Manchester, One Cathedral Square, Bristol and 5 St Philips Place, Birmingham have all achieved yields of 5% or below.

The investor demand in the UK and falling yields has resulted in investors looking to alternative markets and 2017 was an exceptional year for the Channel Island investment market. During the course of 2017 over £150,000,000 worth of stock was transacted, which was almost double that achieved in 2016.

Key deals included the sale of Royal Chambers, Guernsey to the Channel Island Property Fund for £46.7m weighted average unexpired lease term (WAULT) 13.8 years, Royal Bank Place, Guernsey for £26m (11 years unexpired) and 37 Esplanade, Jersey (WAULT 10.8 years) to middle eastern investors for £45m. The remainder of the deals were to private investors, with lots sizes ranging between £2m to £12.45m.

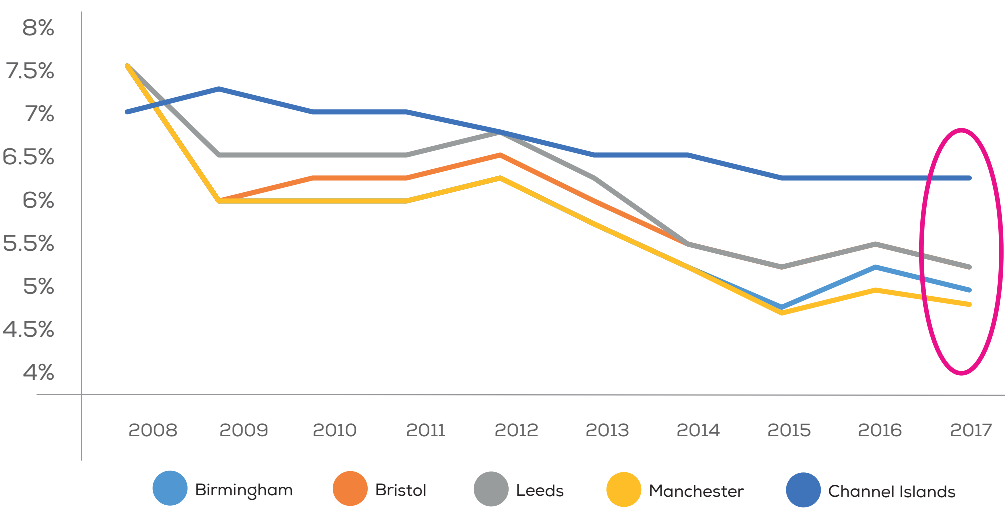
Yields on prime assets achieved 6.6% to 6.75% in 2017, but in each case the rental tone and lease length varied and none of the assets sold were new, with lease lengths of 15 years term certain at market rental value.

In an increasingly volatile world, Channel Island investments display excellent defensive qualities, the key attractions being summarised below:

- Leases on prime assets are generally for 15 years
- Rental growth has been steady without the volatility experienced in the UK
- Rent reviews are on a 3 yearly review pattern and often incorporate fixed increases
- High proportion of tenants are from the financial services or banking sectors
- There is not an oversupply of grade A stock, particularly in Guernsey, so there are opportunities for landlords to regear leases, particularly as there is no security of tenure
- Significant yield gap between Channel Island and UK prime yields

During the course of 2018 we expect several of the brand new BREEAM rated buildings, let to grade A covenants will come to the market and it is likely that 2017 investment volumes will be exceeded. As demonstrated with the graph below the yield differential between prime Channel Island yields and UK prime yields is significant and we would expect this gap to reduce during the course of the year.

Prime Yields Source: BNP Paribas / D2 Real Estate Research



Regional Cities	Bps
Birmingham	-125
Bristol	-100
Leeds	-100
Manchester	-140

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