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# Channel Islands
## Office Market Review

JERSEY | GUERNSEY

# Contents

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2018 will be a year to remember for the commercial property market in Jersey. Gaspe House sold for £90m, the largest ever investment sale to have taken place in the Channel Islands which even in UK terms is significant. IFC1 achieved a yield of sub 6% closing the yield gap between the Channel Islands and UK regions. Take up was again extremely robust but most importantly the overall vacancy rate has fallen significantly with obsolete stock being converted to residential.

In Guernsey, take up volumes and investment activity is slightly behind at the moment, albeit we have seen increased occupational activity in 2018 compared to 2017 and we expect investment volumes to pick up in 2019, which is encouraging. Despite the Islands being less than a 15 minute flight away, they are very different and the two markets operate in alternate cycles.

One area where the two Islands are currently aligned is the increase in High Net Worths (HNW's) relocating, given the political uncertainty in the UK and Brexit. However with Brexit looming we cannot be complacent as any downturn in the UK real estate markets will have an impact, so stock selection and market intelligence will be key for 2019.

**Phil Dawes**
*Managing Director | D2 Real Estate*

# 2018 Key Highlights

- Investment volumes have exceeded £185,000,000, beating last year's total of £150,000,000.
- Yields for prime assets have fallen with the sale of IFC 1, developed by Jersey Development Company, achieving a yield of sub 6% and closing the yield gap with the UK regions.
- Gaspe House set a new record being the largest lot size to have ever transacted in the Channel Islands.
- Improving liquidity, given demand for prime assets led by HNW's, south east Asian investors and syndicates. This follows on from middle eastern investors who were active in 2017.
- Take up in Jersey was around 250,000 sq ft, well ahead of 2017 which was a 5 year record.
- Take up in Guernsey was in excess of 79,000 sq ft, a significant increase from 2017.
- The vacancy rate in Jersey as a percentage of total stock has fallen significantly from around 12% in 2017 to 7.5% by YE 2018. There is minimal Grade A space available in both Jersey and Guernsey.
- In Guernsey, headline rents of £42 psf have been achieved in 2018, slightly below £44 psf achieved in 2017.
- Prime headline rents in Jersey for floor plates of around 10,000 sq ft is now firmly established at £40 psf for the best space.
- We expect prime yields to compress further in 2019, however lease length and quality of the building will be the key driver of performance.

# UK Investment Market Review

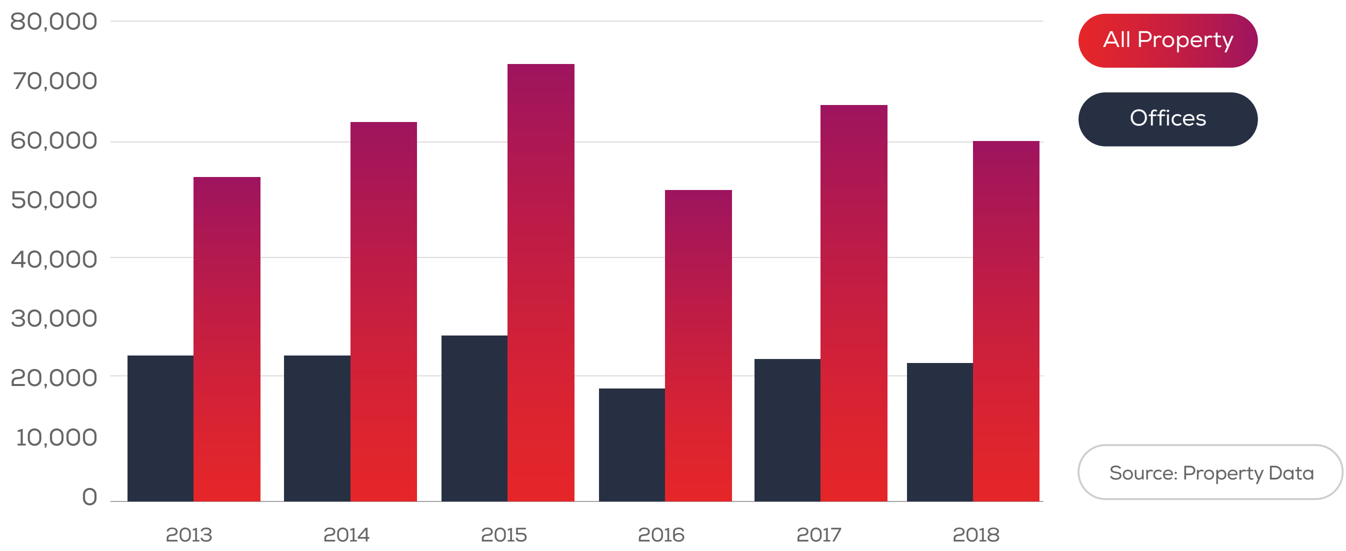
Investors prepared to invest in the Channel Islands are also likely to be seeking investment opportunities in the UK and further afield, so what happens outside the Channel Islands is therefore highly relevant. In 2018 we experienced significant yield compression in the UK regional office market which has resulted in falling yields and increasing values in the Channel Islands. Given the current UK political situation and BREXIT, there is a great deal of uncertainty. During these periods there is often very strong demand for the best assets, offering income security and long leases, enabling investors to ride out a possible downturn. Investments with occupational risk or secondary assets, in some cases, will trade at significant discount compared to prime assets and this has certainly been a feature in the Channel Islands in 2018.

## 2018 Investment Volumes

Investment activity continues to be fairly resilient against the current political and economic backdrop. At the time of writing UK investment volumes in Q4 2018 reached £16.1 billion, the second best performing quarter of the year, behind the £16.2 billion achieved in Q3. This takes the total for 2018 to £60.4 billion, just 8% down on 2017.

Circa 43% of total UK investment across 2018 came from overseas investors, compared to a share of circa 49% in 2017, suggesting that domestic investors have slightly increased their exposure this year.

### UK Investment




## 2018 Regional Office Performance

Focusing on UK Office investment outside Central London, volumes over 2018 reached £9.3 billion, falling marginally short of the £9.4 billion reached in 2017.

Overseas investors remained the largest investors into offices outside Central London, however this fell 23% on the levels recorded in 2017. UK Institutions, however, increased their investment into regional offices over 2018, rising 45% on 2017 levels.

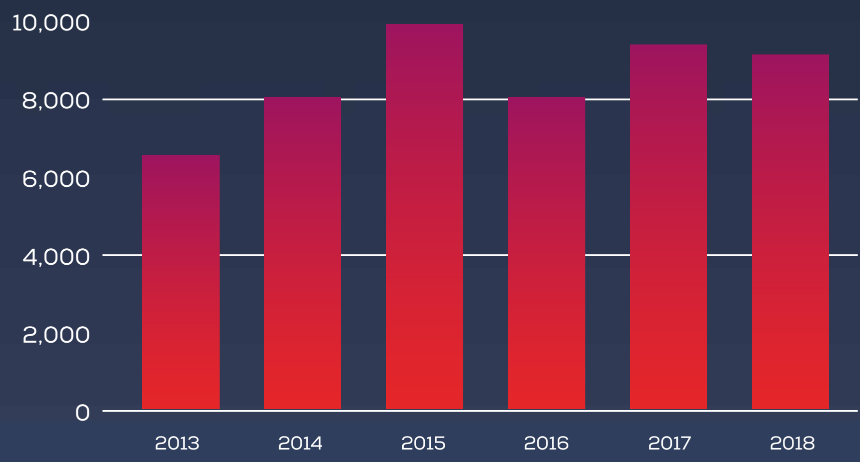
Prime yields in the Big Six and South East recorded some inwards movement over 2018, with a number of cities and the South East seeing prime yields move in to stand at 4.75% at Q4.

Following a record-breaking 2017, expectations were for a slower 2018. However, Big Six CBD take-up levels for 2018 reached 5.34m sq ft, matching 2017, with strong take up in Glasgow and Manchester helping boost overall levels. The public sector was again a key driver of demand, however we also saw the fulfilment of key requirements from a number of other sectors.

2018 saw vacancy fall across all of the Big Six cities with take-up, limited speculative development and conversion of obsolete stock to alternative uses impacting levels of existing supply. Average vacancy at Q4 2018 stood at 9.6%, down from 11.5% at Q4 2017.

Focusing on the rental picture, prime rents are now at record highs for all the Big Six markets. Further growth could potentially be seen in 2019, especially in supply starved markets like Edinburgh which are due to see limited speculative development delivered over the next few years.

## Regional Offices Investment




Source: Property Data

# Channel Island's Investment Market Review 2018

## 2018 Investment Overview

Whereas most of the investment activity in 2017 took place in Guernsey, 2018 was very much Jersey's turn. This activity was a result of the significant development pipeline that was completed in 2016 and 2017, which provided Grade A stock let on long leases to good covenants. 2018 was always going to be a key year for the investment market and it didn't disappoint!

Gaspe House (165,000 sq ft) was the first to sell and at £90m (6.16%) was the largest investment transaction ever to have taken place in the Channel Islands. This was quickly followed by the sale of IFC1, at just under £44m reflecting a yield of 5.94%, easily surpassing the best yield achieved in recent years. In total over £185,000,000 worth of stock was transacted in 2018. As well as the prime assets, other sales included several second-generation buildings let on short leases and a portfolio offering a medium-term development opportunity.

In the past the Channel Island investment market suffered from the perception it was illiquid. 2018 proved that for the right asset there is significant demand from new investors, outside the traditional core. For IFC we received 7 bids, ranging from syndicates, HNW's, overseas investors & specialist funds. In respect of Gaspe House, this asset was acquired by a syndicate partly backed by Chinese investors and the underbidder was an investment bank from south east Asia. These are all new entrants to the investment market, along with middle eastern investors who were active in 2017, which is extremely encouraging and shows real confidence in the market and jurisdiction as a whole.

Given the political uncertainty in the UK, both Islands have benefitted from an increased number of HNWs relocating to each Island, some of whom have also relocated their businesses. They have the potential to make a real difference to the economy through local investment and provide another pool of buyers for commercial property investment thereby bolstering the liquidity in the market.

Although the yield gap between the UK regions and the Channel Islands is narrowing, Channel Island's investments still offer excellent value. For the prime assets an investor can buy long term income to excellent covenants at a discount to the UK and with a strong local banking offering, they can achieve very healthy cash on cash return in excess of 10%. There are also a number of key legislative differences which are attractive to investors such as no security of tenure and minimal rates etc.

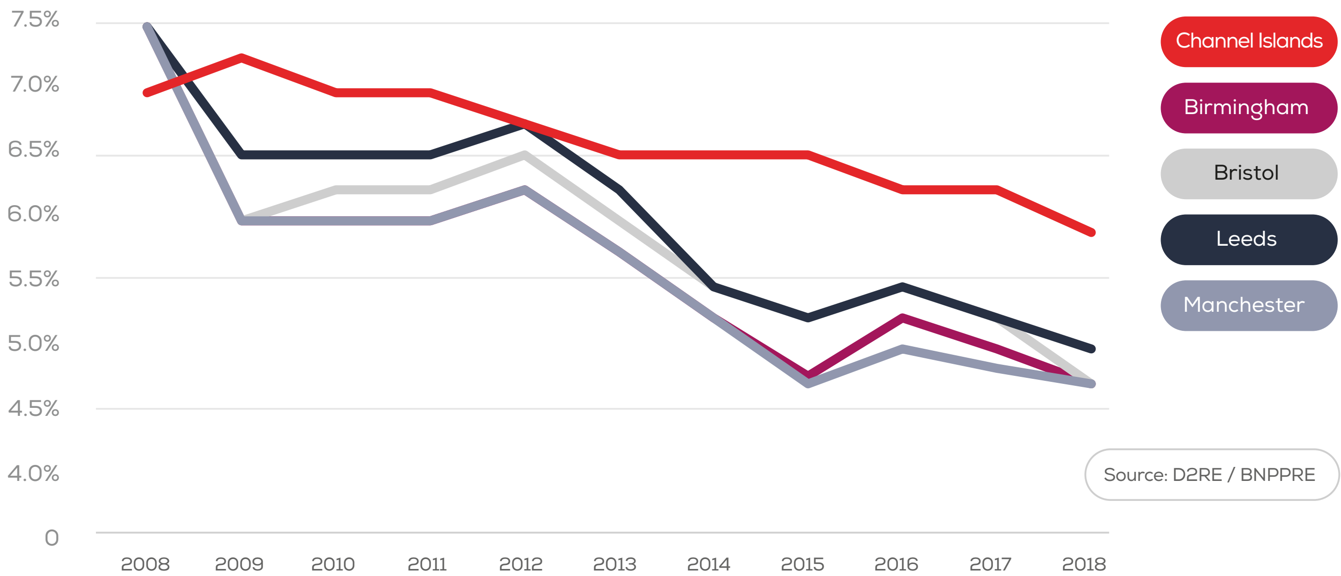
# Commercial Property Investment Outlook for 2019

2019 looks like a strong year for investment in both Islands as there are several prime assets likely to come to the market, such as Dorey and Martello Court in Guernsey, IFC 5 and 27 Esplanade in Jersey.

In terms of Brexit and the uncertainty in the UK we can see a two-tier market developing, with the yield gap widening over the course of the year:

- Those assets displaying defensive qualities, such as long leases let to strong covenants are likely to outperform and we can see yields compressing further in 2019 for the best assets. There is still strong appetite to lend from local "on Island" banks for the right asset and indeed UK banks, so cash on cash returns of 10% per annum should still be achievable even with yield compression.
- Those assets let on short leases, particularly where there is letting risk are vulnerable. That's not to say there aren't opportunities, but the yield must reflect the risk and any acquisition must be backed up with a robust business plan, supported by sound local market knowledge and ideally have minimal debt.

## Prime Yields



# Jersey Occupational Office Market Review 2018

## Background

Over the past few years we have witnessed a huge change to Jersey's office market, with the prime office district now firmly established along the Esplanade in St Helier.

Until very recently (2016) many of the large corporate occupiers had no choice but to occupy multiple sites throughout St Helier. The floorplates on offer were relatively small by modern day standards and there were only two buildings that were BREEAM rated, both of which were fully let.

Developers recognised the opportunity and during the past few years we have seen several high profile buildings being developed, namely, Gaspe House (165,000 sq ft), Buildings 1 and 5 of The International Finance Centre (140,000 sq ft), 27 Esplanade (71,000 sq ft) and 5/6 Esplanade (50,000 sq ft) which is currently under construction with the majority being prelet.

Once completed, demand for these BREEAM rated Grade A offices has been strong and they have enabled the likes of Royal Bank of Canada, UBS, BNP Paribas, JTC and Sanne Group PLC etc to consolidate their operations into one building, resulting in an improved working environment and ultimately cost savings. With the exception of 5/6 Esplanade (still under construction) all these buildings are either let or terms have been agreed and we now have a shortage of new Grade A space, albeit we expect ICF 6 to commence in Q2 2019.

Total stock currently stands at around 3,050,000 sq ft which is slightly below YE 2017 figures despite the new developments, as several obsolete buildings have now been converted to residential use or have been designated for a change of use.

Of the total stock available we estimate that just under 600,000 sq ft is Grade A BREEAM rated. Given the relatively low percentage of BREEAM rated buildings compared to the overall stock, there is now a significant rental gap between the new "super prime" buildings and the prime "second generation" buildings located on the Esplanade.

## Take Up

2018 was again an excellent year with around 250,000 sq ft of stock being let (this includes the 30,000 sq ft prelet to Barclays at 5/6 Esplanade), well ahead of 2017 (200,000 sq ft) and 2016 levels (160,000 sq ft). It was encouraging that the newly completed developments all let well in 2018 and record rents were achieved in the best buildings.

The secondary market also performed well with approximately 130,000 sq ft of the overall take up being for secondary buildings (90,000 sq ft in 2017).

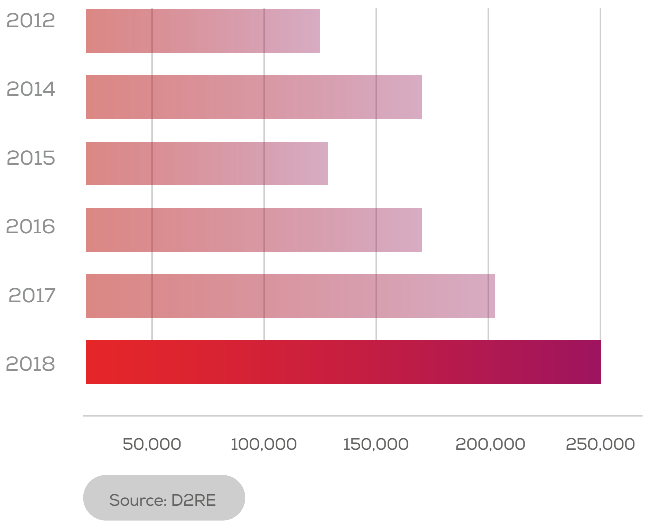
However this market was dominated by the States of Jersey who have taken just under 80,000 sq ft, so investors looking at high yielding opportunities in secondary locations need to be cautious. There are certainly tenants out there for good quality buildings, however any requirement is likely to be for smaller floor plates and tenants will require flexible lease terms, at competitive rents. The larger requirements, such as the States of Jersey mentioned above, are relatively rare.

In the prime market although the majority of lettings have been to existing Jersey companies seeking to upgrade, we have also seen several new companies relocating their businesses to Jersey. These operators demand high quality space and are less sensitive to the overall rent and lease term. Although the footprints are relatively small, up to 5000 sq ft, this is an encouraging development.

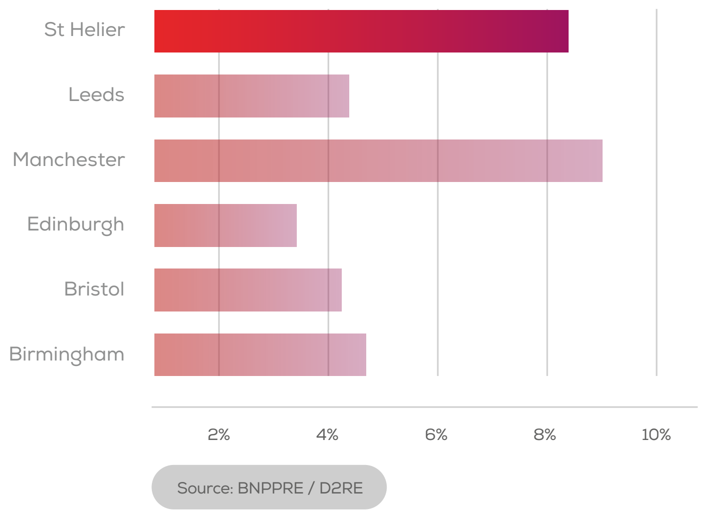
The demand for quality space has also benefitted the serviced office market and we have seen several operators taking space in the brand new BREEAM rated buildings. They can offer the best working environment but with flexibility, which is extremely important to many companies.

Putting these figures into context the 2018 take up represents 8.2% of the Islands total stock, compared to the likes of Bristol 4.3%, Edinburgh 3.3%, Birmingham 4.6% and Manchester 9%.

## St Helier 'Take Up'




## Take Up as a % of Total Stock



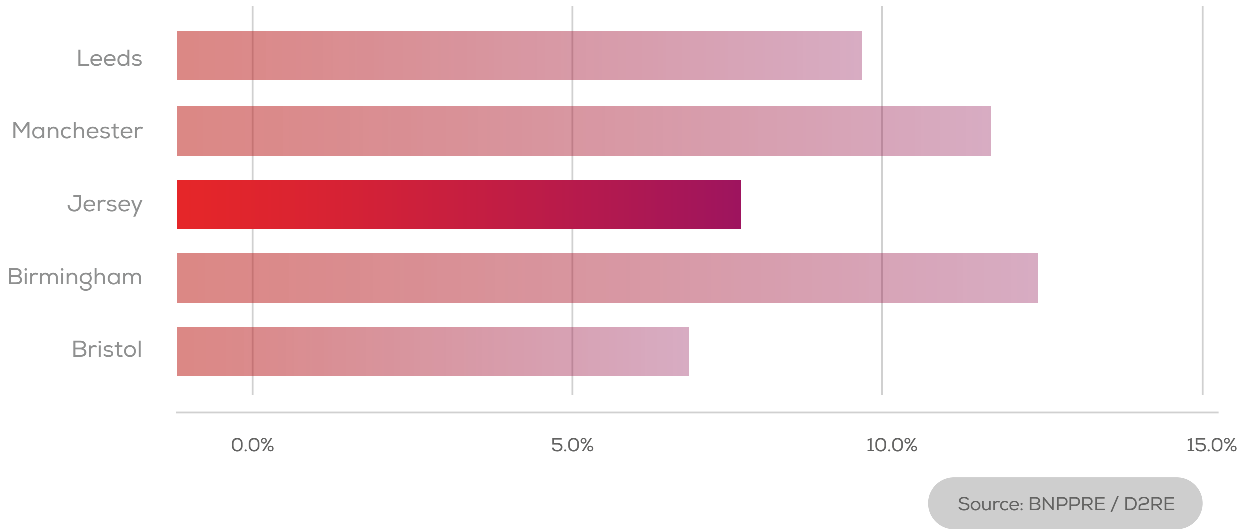

# Vacancy Rate

Given the public's interest surrounding St Helier's vacancy rate as the new developments on the Esplanade were under construction, it is particularly encouraging that the overall vacancy rate has now fallen below the historic average and all the new prime space is let or under offer.

As at YE 2017, as the new Esplanade offices were completed the vacancy rate increased to around 12%, still comparable to the UK regions, but high for Jersey standards. The vacancy rate has now fallen to around 7.5% well below the UK regional cities. The States of Jersey has undoubtedly helped in this regard by taking space in secondary locations, thereby freeing up the obsolete buildings they used to occupy so that they can now be redeveloped for alternative uses. In our 2017 report we anticipated several other obsolete buildings would be converted in 2018 and this has come to fruition, with the redevelopment of La Motte Chambers, Kleinwort Benson House and West House and Wellington House likely to follow shortly. The booming residential market has certainly helped.

In terms of the new BREEAM rated buildings on the Esplanade there is virtually no available space, albeit once 5/6 Esplanade is completed in 2019 there is likely to be around 20,000 sq ft available assuming no further prelets. For prime second generation buildings on the Esplanade, Castle Street and Seaton Place there is approximately 40,000 sq ft available and prospects for letting this space is reasonable, providing the space is refurbished and offered on a floor by floor basis on flexible terms.

## St Helier Vacancy Rate Compared to UK Regions (December 2018)




# Rents

Headline rents for suites up to 10,000 sq ft in the prime Grade A buildings in St Helier have now increased to around £40 psf for 15 year lease terms and a 15 month incentive package.

For second generation buildings located on the Esplanade the headline rental tone is in the order of £30 psf (2017 £29 psf) and we are now seeing several lettings achieving this level of rent, which is encouraging for landlords as there has been little in the way of transactional evidence in recent years.

With construction costs rising and a very constricted supply, prospects for rental growth for BREEAM Grade A buildings is good, particularly for the smaller suites. Even for the larger lettings there are now limited sites available on the Esplanade so Landlord's owning those sites should be in a strong negotiating position.

# Prospects for 2019

We expect 2019 to be a quieter year both in terms of live enquiries and availability of space. With the exception of 5/6 Esplanade, there is very little supply of prime space and it will take several years to build IFC 6 or any of the other potential sites on the Esplanade. In terms of live enquiries we are aware of circa 125,000 sq ft, so down from 2018.

We expect the vacancy rate to reduce further, as more obsolete buildings are converted to residential, putting more pressure on supply. As a consequence, we expect modest rental growth to feature in 2019 for the best "super prime" buildings and prime "second generation" buildings.

# Guernsey Occupational Office Market Review 2018

## Background

St Peter Port saw similar levels of development back in the 2000's as Jersey is currently experiencing, with the development of Admiral Park, a 230,000 sq ft out of town business park and in St Peter Port a number of high quality buildings were developed along St Julian's Avenue and Glategny Esplanade. These two areas are now recognised as the prime office locations in Guernsey.

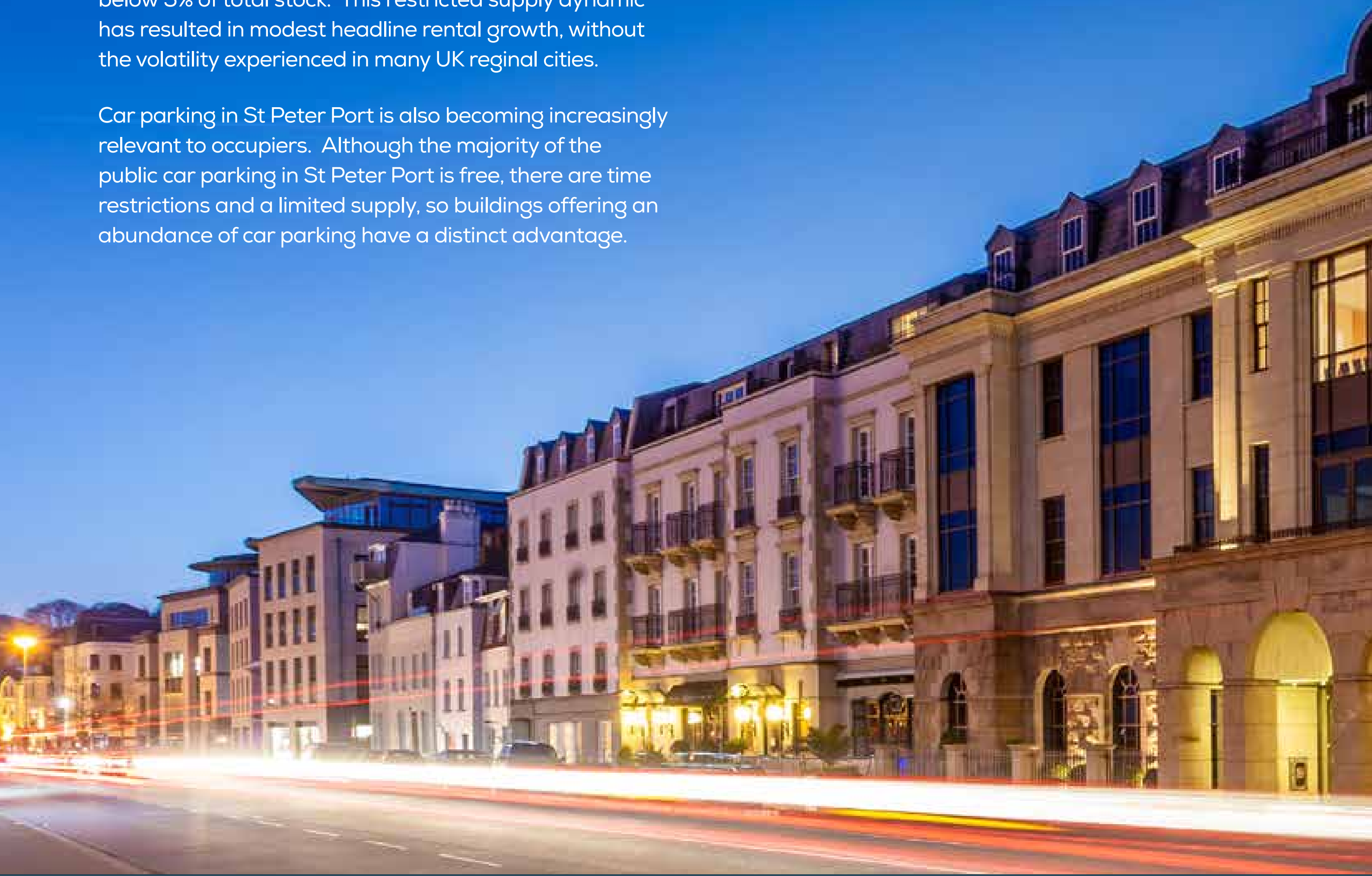
As a result of this development during the 2000's the best sites with sea views have now been developed, in addition to this the topography restricts further development along the coast. The Island Development Plan, which was released in 2016, only identifies potential sites at Admiral Park within the Office Expansion Area. This seriously restricts future development.

There is now a limited supply of prime space and the vacancy rate for prime stock has consistently been well below 5% of total stock. This restricted supply dynamic has resulted in modest headline rental growth, without the volatility experienced in many UK reginal cities.

Car parking in St Peter Port is also becoming increasingly relevant to occupiers. Although the majority of the public car parking in St Peter Port is free, there are time restrictions and a limited supply, so buildings offering an abundance of car parking have a distinct advantage.

In terms of the secondary stock there is an oversupply and many of the buildings are listed or difficult to convert to alternative uses which has resulted in a relatively high vacancy rate. As the residential market improves, which has been apparent in 2018, we will hopefully see some of this stock being converted. Planning policy can obviously stimulate development and as the market improves should be reviewed where appropriate.

Total stock currently sits at around 1.8m sq ft, with around 500,000 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 prelet is required to commence the development.



# Take Up

We estimated that take up in 2017 was in the region of 42,500 sq ft, albeit 27,000 sq ft was accounted for in one deal, being the letting to Mourant Ozannes of part of Royal Chambers. It is encouraging that the market in 2018 has been more active with tenants signing up to around 79,000 sq ft of stock during the year. The demand is centred around the prime buildings and there have been very few lettings involving secondary buildings.

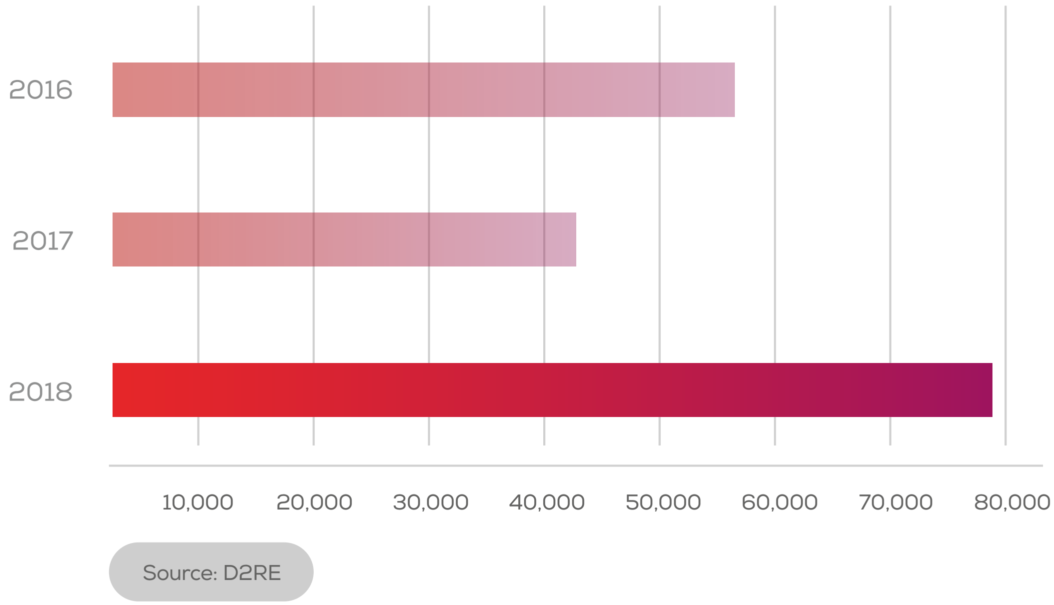
We expect this theme to continue during 2019 as there are a healthy number of enquiries in the market but the challenge will be to find suitable stock.

Take up in Guernsey has been driven by existing occupiers seeking to expand or downsize, which is similar to Jersey, with the majority of the enquiries being for suites up to 10,000 sq ft, albeit there are a number of larger requirements currently in circulation.

The serviced office market in Guernsey has been frustratingly slow. Occupiers are very price sensitive, especially when there is an oversupply supply of cheap secondary accommodation. In our view the best chance of success will be offering a premium product, but we are in a catch 22, as without the demand operators won't invest and without the space we can't prove demand. This may change as the economy improves.

Overall 2018's take up represents over 4% of the Island's total stock, an increase from 2% in 2017, which is positive.

## St Peter Port Take Up




# Vacancy Rate

Guernsey continues to have a two tier market. There is an over supply of poor quality secondary and tertiary stock, much of which has been vacant for a number of years. 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 terms of the prime market, it is a very different story. There has been no development since the late 2000's and there is minimal planned development in the pipeline and very few prime sites available resulting in a chronic shortage of modern Grade A space. The planned new development that is available will not proceed without a sizable pre-let.

With the volume of poor quality secondary space, the overall vacancy rate in Guernsey is high at just under 13%, similar to 2017. However, the vacancy rate in the prime sector is sub 3%, which is good news for landlords as rents remain high but does restrict occupiers in terms of choice and we suspect it would be a major consideration should a business be considering relocating to the Island.

# Rents

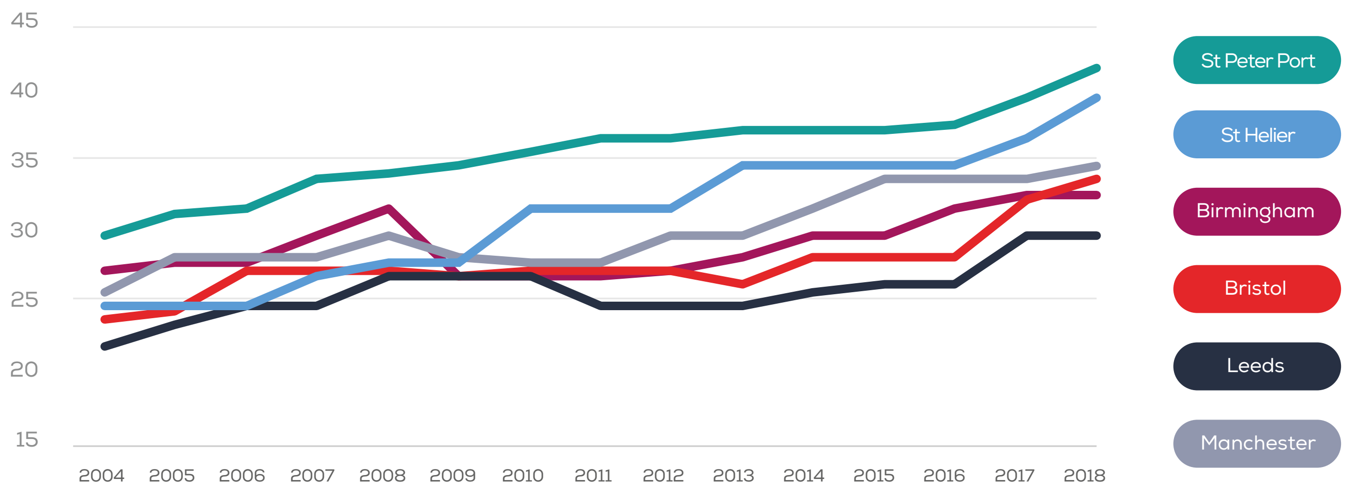
On the face of it the prime office market has performed reasonably well over the past few years, predominantly due to the relatively low volume of stock in Guernsey which has helped maintain headline rents in excess of those achieved in Jersey. £44 psf was achieved in 2017 and £42 psf has been achieved in 2018. However, in recent years in order to achieve these high headline rents large incentives packages have been agreed.

In 2018 we have witnessed a slight change and we now are seeing competition from occupiers for the best space. As a result, the incentive package being offered to tenants is reducing and hopefully these deals will complete in 2019, setting a new tone.

In our opinion the general tone for headline rents for Grade A buildings is in the region of £38/£39 psf, this assumes a standard incentive package ie one month's rent free for every year of the lease and a uniform car parking rate.

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, however, as mentioned much of this space is virtually unlettable in its current condition, particularly if the car parking ratio is poor.

Prime Rents




Source: D2RE / BNPPRE

# Prospects for 2019

We are looking forward to 2019 and expect it to be a strong year. There are a number of enquiries in circulation, four of which are over 10,000 sq ft, with the total being for around 87,000 sq ft. There is also some prime space likely to come to the market and we have clients who are prepared to refurbish older stock that will come on stream in the latter part of 2019. We expect prime rents to remain relatively constant throughout 2019, however we anticipate incentive packages to reduce.

With the volume of vacant secondary office space it would be good to see some of the obsolete space converted to residential, thereby reducing the overall vacancy rate. Without this, we expect the overall vacancy rate to remain stubbornly high, albeit, it will be business as usual in the prime sector with very little availability. There is however a degree of optimism concerning conversions, as the residential market has picked up significantly during 2018 in terms of the number of transactions, to the point that throughout Q3 of 2018 there were 251 transactions which is the most seen since 2011. The Open Market stock of houses is also starting to sell, and residential agents are optimistic that this trend will continue into 2019, partly due to the uncertainty of the UK and Brexit.

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