GVA

Real estate - contributing to growth in the West Midlands

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Introduction

This report provides a high level overview of the West Midlands commercial and residential real estate markets, the drivers that will underpin growth and the key developments that will ensure the region continues to prosper.

The West Midlands has a clear vision for economic expansion and is committed to establishing itself as a key growth region. Devolved power to the West Midlands Combined Authority (WMCA) will give the region's first Mayor, Andy Street the once in a lifetime opportunity to help transform the region and realise its full potential.

Its geography places the West Midlands at the heart of the UK's distribution network, and the introduction of HS2 and further development of Birmingham Airport will boost the region's connectivity and strengthen its position as a gateway to the global economy.

A host of regeneration schemes is set to change the retail, commercial and residential landscape in the West Midlands. Birmingham's Peddimore scheme is West Midlands' largest industrial development opportunity (and one of the biggest in the UK), and could add £350 million to the region's economy. The UK central hub is another significant development in Solihull, and Arden Cross is a key part of this scheme which will deliver up to 2.7 million sq ft of commercial space and 2,000 new homes.

The region has re-established itself as a high value manufacturing base, with particular strength in the automotive sector. The manufacturing sector in the West Midlands remains robust accounting for approximately 13% of the region's output, ahead of the UK average of 9%.

Brexit has undoubtedly created an uncertain economic outlook for the UK as a whole. However, over the years the West Midlands has diversified its exporting base and thus is less exposed to the EU and any negative implications of a Brexit trade deal compared to elsewhere in the UK.

The West Midlands Combined Authority and the Midlands Engine are two organisations underpinned by local authorities who are seeking to drive growth in the West Midlands and across the Midlands region respectively and are excellent vehicles to harness the region's potential. The strategic economic plan set out by WMCA has a clear objective to revitalise and develop strategically important locations, whilst the Midlands Engine's growth fund will provide Local Enterprise Partnerships with an additional £151m over four years to improve productivity, innovation and support growth.

Ian Stringer

Regional Senior Director

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What's driving the West Midlands' economic growth?

Economic growth in the West Midlands is expected to continue at an average growth of 1.5% pa over the next three years, slightly below the national average. A combination of sectors will underpin this growth in the region, with food services & recreation, wholesale & retail and transport & storage sectors likely to outperform.

Over the next five years, economic growth in Birmingham, Wolverhampton, Coventry and Warwick is expected to exceed the national average. Overall population growth in the West Midlands is healthy and comparable to the UK average at circa 0.6% pa. Coventry and Birmingham in particular are witnessing high levels of growth in their working age population compared to both the regional and national average.

Employment has been very strong in the West Midlands in recent years, and this is demonstrated by the full-time equivalent employment graph (see Figure 1). Over the next four years, modest growth is expected to continue despite the backdrop of political uncertainty. The West Midlands has experienced the largest increase in workforce jobs compared to other regions and an additional 96,000 jobs were filled in the year to March compared to the previous year according to Office for National Statistics (ONS). We believe further investment into the region will attract an array of new businesses and create more employment opportunities.

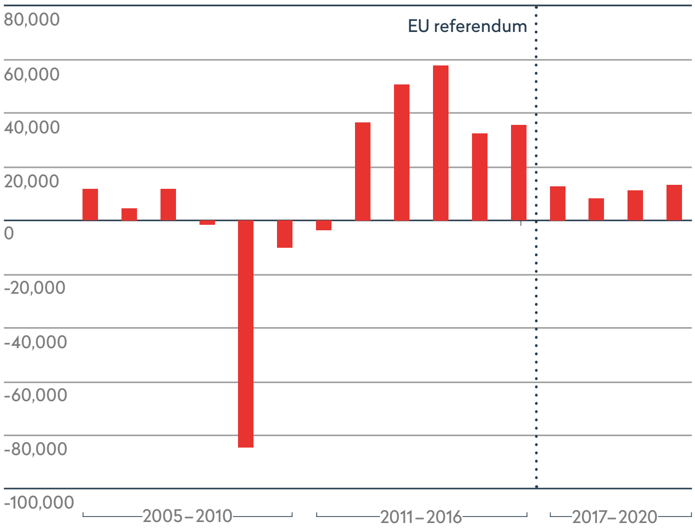
All-property average rental growth for the West Midlands experienced a milder slowdown following the EU referendum compared to the UK average and we expect the region to exceed the UK average in 2018 (see Figure 2). Subdued development levels have resulted in a shortage of prime stock and have insulated rental levels.

The West Midlands has historically suffered from underinvestment in infrastructure but this has been turned around with the recent expansion of the Midland Metro, Birmingham Airport runway and the re-development of Birmingham's New Street station. The prospect of the High Speed Two (HS2) rail network has already given the economy a boost and its arrival will improve connectivity. Phase one will connect the West Midlands to London within 49 minutes and significantly improve capacity on key routes and is scheduled to be complete by 2026. The two stations built in Birmingham and Solihull will increase construction jobs and attract businesses, retailers and other services, generating thousands of other job opportunities. Phase two will further connect the region to Manchester and the East Midlands by 2033. The Midlands Connect Programme will ensure that intra-regional connectivity is also maximised for economic benefit.

Fig. 1

Annual change in West Midlands FTE employment

Annual change in full-time equivalent employment

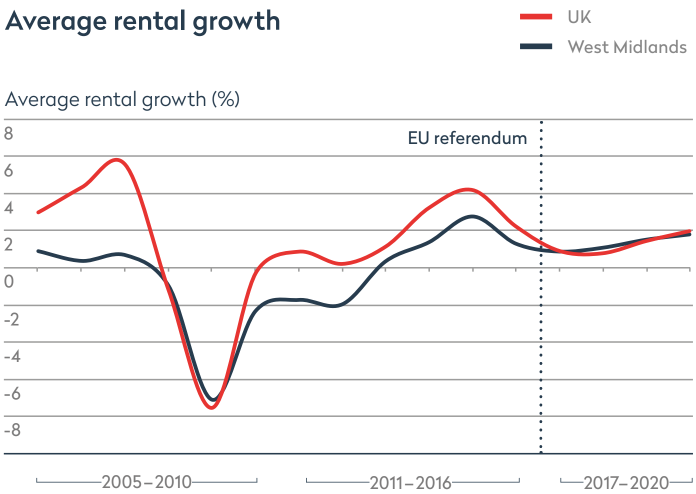


Source: Experian

Fig. 2

Average rental growth

Average rental growth (%)



Source: IPD Quarterly Index, REF, GVA

Investment appetite remains strong

The investment market recovered quickly from last year's mild post-referendum blip, and while some investors have adopted a 'wait-and-see' approach, the overall impact of the Brexit process on sentiment has been limited. Indeed, equivalent yields have seen some downward movement over the last 12 months, most notably in the industrial sector, although they are now levelling off.

The West Midlands investment market continues to benefit from strong demand, although the volume of transactions has fallen from its 2016 peak to a more normalised level, as Figure 3 shows. £1.4bn of transactions were recorded in the first half of 2017, of which nearly 40% has been from overseas investors.

We are also seeing a strong demand from a wide range of UK buyers including private individuals, local authorities and institutional investors, and defensive stock remains particularly highly sought after.

During the 12 months to June 2017, the industrial/distribution sector accounted for the highest proportion of transactions in the West Midlands, at 33%, up from 13.7% in 2016. This reflects the relatively strong rental performance of this sector and the positive outlook for logistics occupier demand, driven by structural change and e-tailing requirements. Indeed, total returns in the West Midlands industrial/distribution sector amounted to 10% over the 12 months to June, due to a combinational of downward yield shift and rental growth, well ahead of offices and retail at 1.4% and 0.8% respectively.

With the devaluation of Sterling following last year's referendum, commercial property will continue to be an attractive asset for overseas investors, and the historically wide gap between property and gilt yields will continue to make commercial property look good value (see Figure 4). In addition, rental growth, especially at the prime end of the market, and a relative scarcity of high quality investment opportunities should continue to underpin values, despite the obvious political and economic uncertainties of the next two years.

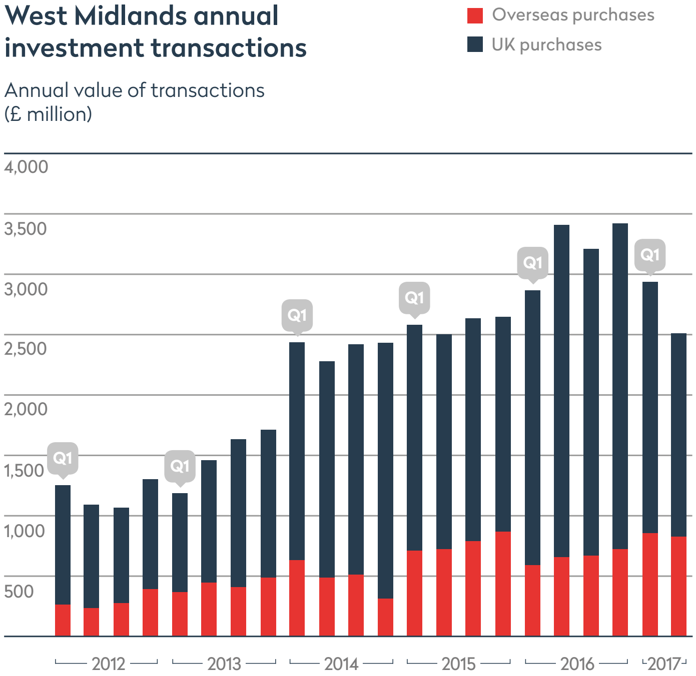
Expert View

The fact that nearly 40% of property investment in the West Midlands so far this year is from overseas buyers demonstrates the increased profile that the region has earned on the global stage.

Jonathan Hillcox – Senior Director, Investment

Fig. 3

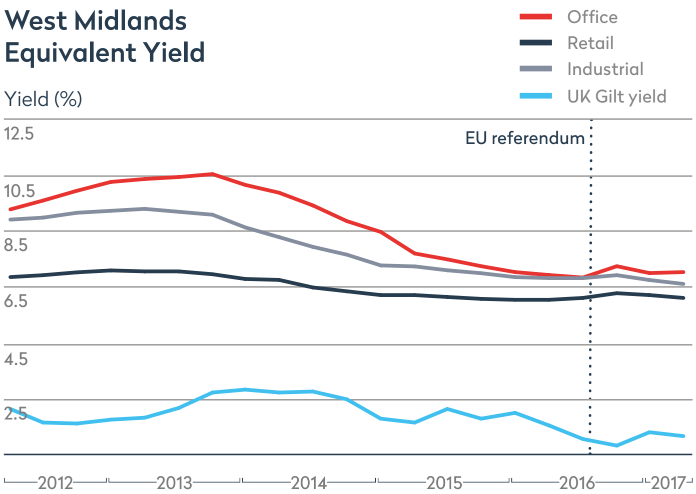
West Midlands annual investment transactions



Source: Property Data

Fig. 4

West Midlands Equivalent Yield



Source: IPD Quarterly Index

Office market

Stock with excellent onsite amenities remains the focus

The pace of average office rental growth in the West Midlands slowed over the past year to below 1% in the 12 months to June, compared to the peak last year at 6% (IPD quarterly Index). Average rental growth is likely to be subdued over the next year before picking up pace in 2019.

However, top end supply remains limited across the region, particularly within Birmingham but also outside the city centre where rental levels are generally not high enough to make developments viable without some form of public sector assistance. The uncertain economic outlook is likely to hinder further speculative development and most will only go ahead with a pre-let to an identified occupier or with local authority or LEP assistance underpinning the development in some way. As a result, we expect prime rental growth to outpace secondary stock rental growth.

Birmingham is amongst the most important office markets in the UK, with prime headline rents now reaching £32 psf. The second half of 2017 is expected to see stronger activity than H1, headlined by the 240,000 sq ft Government Property Unit deal, alongside a handful of significant transactions, including engineering company WSP, RICS (relocation from Coventry) and the latest serviced office deal to Regus. There is currently around 285,000 sq ft of grade A space immediately available in Birmingham city centre, which equates to only a year's supply based on the ten year average grade A city centre take-up of 293,000 sq ft. There is also a further 750,000 sq ft (2.5 years' supply) of speculative space under construction at 3 Snowhill, Chamberlain Square and the comprehensive refurbishments at Cornerblock and The Lewis Building.

In **Coventry**, numerous pre-agreed schemes have given completion levels a boost in 2017, with over 310,000 sq ft already completed so far. Jaguar Land Rover's new research and development innovation centre located at Warwick University accounted for nearly 60% of the total area delivered. One Friargate has added 140,000 sq ft and the remainder of the scheme could add up to 2 million sq ft of office space.

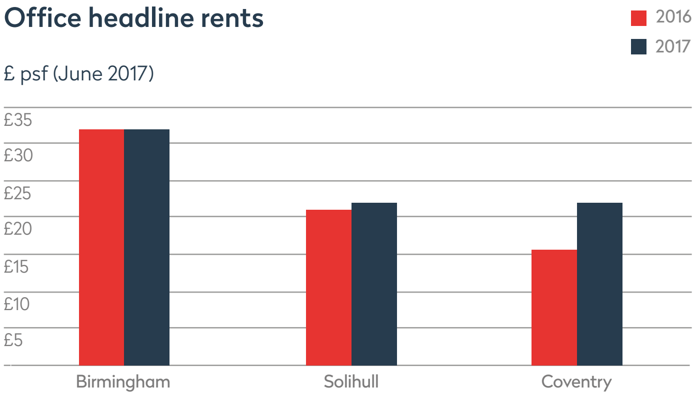
The availability of office space in Coventry has continuously fallen over the past seven years. The reduction has principally been driven by larger deals, typically above 10,000 sq ft. This has lowered vacancy rates to their lowest level since 2000.

Prime headline rents in the out of town Coventry market are at £18 psf, whilst the highest city centre rent have until recently been circa £16 psf. However, the Friargate development is a game-changer that is bringing prime office space to the heart of Coventry city centre. The Financial Ombudsman Service has recently taken a 10 year lease at One Friargate at a record rent around £22 psf, a noteworthy premium on the previous top city centre rent. Further development at Two Friargate is likely to be dependent on a substantial pre-let being agreed or some form of financial assistance through the West Midlands devolution deal.

Flexible workspace with on-site amenities that promote staff wellbeing is becoming increasingly important, and buildings that offer facilities with the right mix of quality and social amenities will be favoured by occupiers. One such example is Blythe Valley Business Park in **Solihull** where PKF Cooper Parry took 17,800 sq ft of offices in May and adapted it to include collaborative workspaces, a sports bar and even a Segway track to promote staff wellbeing. IM Properties the owner of Blythe Valley Business Park has further plans to expand the park, adding one million sq ft of commercial space and potentially creating over 7,000 jobs with an increasing focus on the delivery of onsite services and amenities to underpin occupier demand. Canmoor has also improved amenities and environmental initiatives on Birmingham Business Park and this, alongside inward regional investment has contributed towards the park achieving the lowest vacancy rate in a decade.

Fig. 5

Office headline rents



Source: GVA

Expert View

Average rental growth slowed over the last 12 months in response to muted demand. Whilst Grade A availability is in short supply, without public sector subsidy, development outside of Birmingham and Solihull remains constrained. Wellness and wellbeing is becoming a key consideration for occupiers in implementing relocation strategies.

Charles Toogood - Senior Director, Offices

Retail market

Location determines occupiers' success

Retailers are continuing to demand newer, modern stores which fit brand images, but often cannot be accommodated in towns without significant redevelopment of the existing stock. As a result, demand for retail is strong in **Birmingham** where there are opportunities to strategically place flagship stores in new developments such as Grand Central. The former Pavilions shopping centre will be converted into a 150,000 sq ft Primark, one of the largest in the UK.

The announcement by Intu that it will undertake a £100 million renovation of the Merry Hill shopping centre has attracted a wave of retailers to either expand or take new space. TAG Heuer opened its first store in the West Midlands in April, whilst Next will open a 75,680 sq ft store by next year.

The 560,000 sq ft City Centre South scheme will aim to increase **Coventry's** attraction as a major retail and leisure destination in the West Midlands. The proposal is expected to complete in 2022, subject to planning permission and will include a hotel, cinema and several retail units anchored by a large department store.

The remodelling of the Mander Centre in **Wolverhampton** will create 10 large retail units. Debenhams has agreed to take a 93,000 sq ft store, opening in autumn 2017.

Cannock's new designer outlet, Mill Green will feature 130 high-end retailers plus restaurants and is expected to open in early 2019. The 307,000 sq ft McArther Glen style development will attract customers from all over the West Midlands, and create more than 1,200 jobs.

Against the backdrop of a slowing economy and increased pressure on consumers, we expect average rental values to be broadly flat over the next two years.

Expert View

The general outlook for the next 12 months is steady although the stronger towns and cities will continue to outperform the secondary and tertiary retail locations where the impact of the recent rates revaluation could potentially increase the number of vacant units.

Paul Brewer - Director, Retail, Hotels and Leisure

Industrial and logistics market

Structural change underpins growth

The West Midlands retains its strong manufacturing sector dominated by the automotive industry, where firms such as Jaguar Land Rover and The London Taxi Company continue to expand. Demand for distribution warehouses and logistics centres has been driven by e-tailing businesses remodelling their delivery network to cope with consumer demands for shorter delivery times. The West Midlands remains a prime location given its proximity to key motorway links.

Jaguar Land Rover officially opened its Special Vehicle Operations (SVO) technical centre at Prologis Park Ryton in mid-2016. The firm also leased a further 469,000 sq ft this year across two buildings at the same park, expanding its manufacturing operations in **Coventry**.

Online retail giant Amazon announced it will open a fulfillment centre at the former Jaguar Land Rover site in Coventry. The 430,000 sq ft site at Lyons Park is a prime distribution location, situated within the 'golden triangle' meaning 89% of England and Wales is within a 4-hour drive. Once the scheme is completed in 2018, it is anticipated over 1,600 full-time jobs will be created.

The speculative development of three distribution units, totalling 579,000 sq ft at Imperial Park developed by M&G Investments completed in summer 2017. The investment reflects developers' confidence in the region's continued ability to attract a range of distribution and manufacturing occupiers.

Appliance manufacturer Beko acquired the final two units totalling 345,000 sq ft at Birch Coppice Business Park, **Tamworth** on 15 year terms at £6.20 psf and £6.74 psf.

M6DC, a 372,000 sq ft single distribution unit, completed in June 2017. The grade A facility is situated in **Cannock**, at the centre of UK's distribution network and benefits from a competitive workforce.

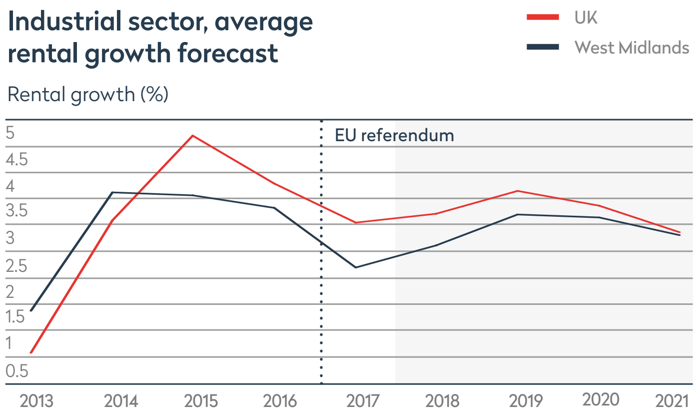
Birmingham remains a sought-after location for the industrial sector and a large number of enquiries are specific to the wider Birmingham area. Occupiers are becoming more focussed on 'sustainable' facilities to maximise efficiency and maintain their corporate image, particularly national companies. Due to these pressures, occupiers are seeking to trade up from secondary space on lease expiry. Argos recently took a 69,300 sq ft energy saving logistics building in Witton for last mile internet delivery services, reflecting the growing appetite for sustainable facilities.

The most significant industrial and logistics development opportunity in recent years is now available at Peddimore, Birmingham. It has the potential of creating 3 million sq ft of warehousing and industrial space and up to 10,000 jobs adjacent to a new settlement of up to 6,000 homes and associated infrastructure at Langley.

Industrial rental growth is forecast to outperform both office and retail markets in the West Midlands. We expect average rental growth for the West Midlands as a whole, of 2.5% pa over the next two years. Coventry, Sandwell, Birmingham and Stoke-on-Trent all have above average forecasts.

Fig. 6

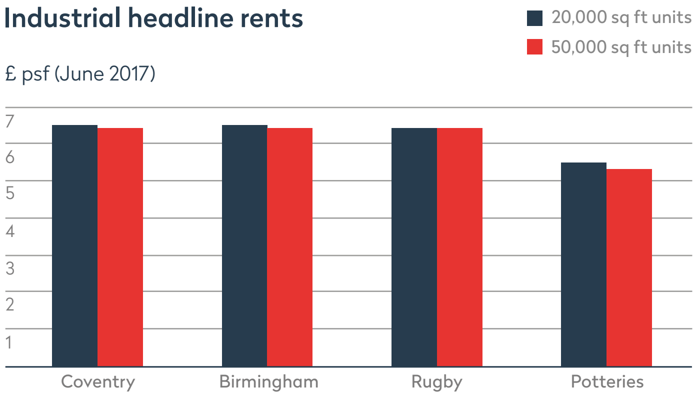
Industrial sector, average rental growth forecast



Source: GVA, IPD, REF

Fig. 7

Industrial headline rents



Source: GVA

Expert View

We predict that the demand for good quality industrial buildings in the West Midlands will continue to exceed the supply of the existing stock, increasing pressure to see more new development.

David Willmer – Senior Director, National Industrial and Distribution Team

Residential

Top employers have driven the inward migration of highly skilled workers to the West Midlands.

Regional improvements in infrastructure have attracted an increasing number of businesses to set up or relocate to the West Midlands, particularly larger and higher quality employers. **Birmingham** has been the largest winner with banking giants such as HSBC and Deutsche Bank as well as HS2 relocating offices from London over the last five years. This trend is continuing, the latest example being the prospect of Channel 4's relocation to the region.

Average house prices for the West Midlands rose by 3.6% in the year to June, above the UK average of 2.8%, according to the Nationwide House Price Index. Aspirational areas such as **Solihull**, **Warwick**, and **Leamington Spa** all witnessed above average increases in house prices as did the city living market in Birmingham, Coventry and Wolverhampton.

Low wage growth in real terms has traditionally acted as a constraint on house price growth in the region. However the confirmation of HS2 has been a game-changer and has encouraged more high tech manufacturing and white collar firms to expand or move into the region. These employers have supported inward migration of skilled workers and we expect average wages to rise faster than the national average. This has been complimented by the retention of a highly skilled student population.

There has been a high demand for city centre living in Birmingham, driven by the influx of big employers and improvements in the skilled labour and student retention rate. The considerable undersupply in the "city living" market has supported strong growth in both sales values and rental growth.

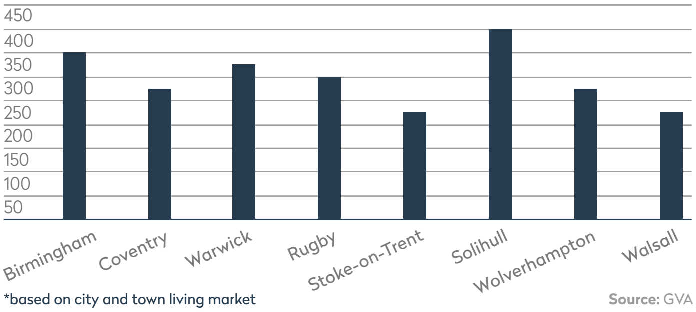
Strong population growth of 4% is forecast for the next five years, increasing the significance of key regeneration schemes across the region. The residential development forming part of the mixed use schemes around the Birmingham Smithfield markets and Birmingham Curzon masterplan will create around 4,000 units whilst the Icknield Port Loop scheme will see a development of a minimum of 1,150 units, and construction is due to commence imminently. A selection of key regeneration schemes are summarised in the next section.

Relatively few residential units are available in the Private Rented Sector (PRS) and the market is still fairly immature in the region. Birmingham is leading the way in the PRS market however, there are only 1,500 units under construction across five principle schemes. Exchange Square is one of the larger schemes which will deliver 603 luxury rented apartments by the end of 2018, followed by The Beacon, which is expected to deliver 337 units within a similar timeframe.

Fig. 8

Average sales price*

£ psf



*based on city and town living market

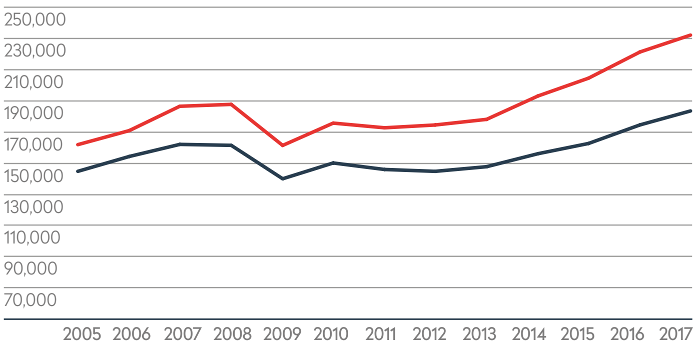
Source: GVA

Fig. 9

Average house prices

England & Wales
West Midlands

(£)



Source: Land Registry

Expert View

The West Midlands residential markets are typical of the national housing crisis – a lack of housing supply, notably that of City Living accommodation, will continue to drive strong "above average" sales and rental growth. Only the emergence of the private rental sector in the region has the ability to soften these increases. The residential markets in the West Midlands have historically been restrained by low average wages but the attraction of major employers and retention of a significant highly skilled student population in the region is helping to remove this constraint.

Mark Birks - Senior Director, Land and Development

Major regeneration schemes that will transform the West Midlands

In this section we have included a selection of key schemes that will help to drive growth and transform the West Midlands over the next 10-15 years. However, this is by no means an exclusive list.

1 Friargate, Coventry City Centre

Scheme: 2,350,000 sq ft of Grade A office space, two hotels, 400 new homes plus shops and restaurants are proposed.

Overview: The £700 million project will transform Coventry city centre. One Friargate just completed and will house Coventry City Council and the Financial Ombudsman Service. The scheme will refresh the arrival experience, attract new businesses, and drive economic growth by generating up to 15,000 jobs.

2 Westside, Wolverhampton

Scheme: Commercial, retail, residential and leisure

Overview: This 2.73 hectare site is a huge development opportunity that will be phased over five years. The development will include restaurants, bars, contemporary apartments, a multi-screen cinema, a hotel and a multi-storey car park. Phase 1 is expected to commence in early 2018 and complete in 2020, phase two is scheduled to complete by 2022.

3 Arena Central, Birmingham

Scheme: Commercial office led mixed use.

Overview: Home to HSBC's ring fenced Retail Bank which has moved its HQ from Canary Wharf to 210,000 sq ft in Birmingham along with approximately 2,000 jobs. Totalling up to I million sq ft negotiations are also well progressed on a further quarter of a million sq ft pre-let in Building Three. The remainder of the scheme consists of three further office buildings, public realm, Crowne Plaza Hotel and Holiday Inn Express.

4 Stoke-on-Trent City Centre

Scheme: Commercial, leisure, residential and retail

Overview: This regeneration programme includes Smithfield, Unity Walk and Century Street. Two offices have completed at Smithfield and planning permission has been granted for the Hilton Garden Inn hotel at the 435,000 sq ft retail and leisure development at Unity Walk. A further 5.3 hectares of residential development opportunity at Century Street could create 330 homes.

5 Birmingham Curzon

Scheme: Infrastructure, commercial, residential, retail and leisure

Overview: The Birmingham Curzon HS2 station will be at the heart of the wider 141 hectare Curzon Masterplan. Construction of the new rail terminus is expected to complete by 2026. The Curzon scheme will support the development of 4,000 residential units and 600,000 sq ft of commercial space. Circa £3.1 billion GDP impact and up to 36,000 jobs is predicted over the lifetime of the programme.

6 UK Central Hub & HS2 interchange, Solihull

Scheme: Commercial, residential and infrastructure.

Overview: UK Central Hub is a cluster of five sites, including Birmingham Airport, the National Exhibition Centre, Jaguar Land Rover, Arden Cross and the new HS2 Interchange station. The Urban Growth Company will drive the development and aims to provide 8 million sq ft, with two thirds dedicated to commercial use and the remainder for up to 4,000 homes.

7 Paradise, Birmingham

Scheme: Commercial, retail and leisure

Overview: Paradise is an exciting and dynamic new place for business and leisure. The first phase is underway with two grade A office buildings at Chamberlain Square. PWC will take occupation of 90,000 sq ft at One Chamberlain Square in early 2019. Phases two and three will see further office buildings, public squares and a hotel, scheduled to complete by 2026. The development will bring over 12,000 jobs to the city centre.

8 Black Country Land Development

Scheme: Residential and commercial

Overview: The West Midlands Combined Authority has contributed £53 million to clean up 364 hectares of brownfield land across the Black Country by 2026. The remediated land would be used to deliver a garden city and support growth in the manufacturing sector. Up to 13,500 homes and 12,000 jobs are expected to be created.

9 Longbridge, South Birmingham

Scheme: Commercial, retail and leisure

Overview: The third phase of the £1 billion regeneration project is underway which includes a £20 million leisure scheme. The first two phases have already rejuvenated the area by attracting national retailers with Marks & Spencer and Sainsbury as anchor tenants. Over 100,000 sq ft of prime office space and over 350 homes have been delivered. Up to 2,000 homes will be built and 10,000 jobs created.

Arena Central, Birmingham

Langley/Peddimore, Birmingham

Birmingham Curzon

Longbridge, South Birmingham

Paradise, Birmingham

Friargate, Coventry City Centre

10 Langley/Peddimore Development, Birmingham

Scheme: Residential and industrial

Overview: The Langley development will provide a sustainable urban extension of 6,000 homes plus schools and community facilities. Peddimore is a 175 acre employment site capable of accommodating circa 3 million sq ft. It is adjacent to the Langley site and will offer a development opportunity to support the regional manufacturing and logistics sectors and boost economic growth.

11 Wolverhampton Canalside and City Interchange

Scheme: Commercial and residential

Overview: This urban regeneration programme covers 9.2 hectares and provides a development opportunity to create over 600 new homes, high quality offices, restaurants and infrastructure improvements.

12 Smithfield, Birmingham

Scheme: Mixed development – commercial, retail and residential

Overview: The 14 hectare Smithfield scheme is a once-in-a-generation opportunity to transform the heart of Birmingham city centre. The site will deliver over 3.2 million sq ft of new mixed-use floorspace, more than 2,000 homes and create up to 3,000 new jobs. A 15-year development programme is projected with construction likely to commence in 2019/20.

Should you wish to discuss any details within this report please get in touch.

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