GVA

RESEARCH

The Big Nine

Quarterly update of regional office activity
Q1 2018

TOP PERFORMERS

MANCHESTER
Occupier Market

The 157,000 sq ft pre-let at 3 New Bailey to HMRC has headlined city centre take-up. This deal aside, Q1 demand still exceeded the quarterly average in both the city centre and out-of-town markets.

GLASGOW
Investment Market

There have been two substantial investment deals in Glasgow during Q1. In the out-of-town market Hermes acquired Skypark for £80 million and in the city centre Legal and General acquired 3 Atlantic Quay for £50 million.

Image: The Lumen, part of the Newcastle Helix development, Newcastle city centre

GPU and professional services ensure strong start to 2018

Carl Potter
National Head of Offices

The make-up of demand across the Big Nine office markets has continued in a similar fashion to last year with key deals to the Government Property Unit, indigenous professional services occupiers and co-working office space.

The deals to the Government Property Unit in Manchester and Glasgow have headlined take-up and are among the final GPU deals to be announced in the first phase of the Government's relocation strategy.

These deals have been supported by some significant transactions to indigenous professional services companies, such as lawyers Walker Morris (Leeds) and Irwin Mitchell (Manchester) as well as engineers WSP in Birmingham.

The co-working sector continues to expand and a handful of medium sized co-working office deals have completed in Q1, in out-of-town as well as city centre locations. Orega has taken space in Birmingham and Glasgow, Bizspace in Cardiff and Solihull and Work.Life in Manchester. We are expecting some larger deals later in the year.

Manchester has been the stand-out performer this quarter, both in the city centre and out-of-town markets. The key deals in Glasgow and Leeds meant they were the only other city centres to achieve above average take-up but out-of-town there has been a more even share of activity with seven of the nine cities above average.

Occupier sentiment is mixed. While there are a number of large requirements, we are noticing an increasing proportion of regears and a slowdown in demand amongst indigenous occupiers. However this may be explained by the uneven nature of take-up and a tightening of grade A supply.

With this low supply the largest deals continue to be pre-lets but there have been several speculative construction announcements this year including Atlantic Square and Cadworks in Glasgow, 100 Embankment in Manchester and the former Majestic Cinema restoration in Leeds. The imminent sale of the Haymarket site in Edinburgh has also raised expectations for progress on this key site.

Over the past two years, aside from obvious spikes in central government and serviced office take-up, there have also been more subtle changes in activity. Professional services take-up has been strong, particularly from legal services and accountancy as well as the insurance & asset management sub-sector. Conversely there has been a slowdown in activity from banks, media and health & social care compared to longer term averages.

Following my own move within GVA to take over the role of running our Birmingham Office the "National Head of Offices" baton will pass across to Charles Toogood from hereon. We hope you continue to benefit from our research into the UK's regional office markets, but as ever if there are any improvements you think we can make do contact us.

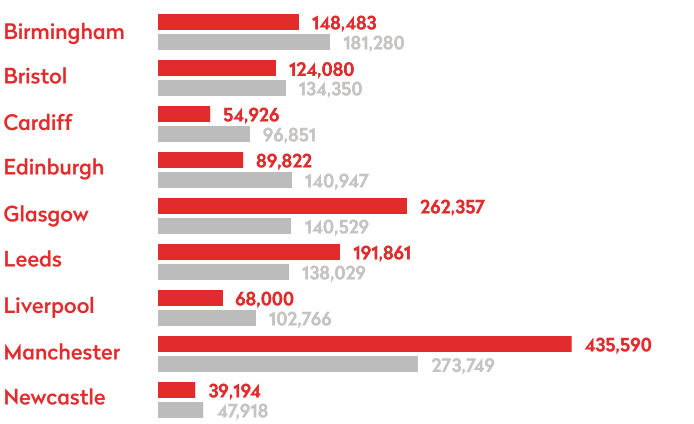
Occupier Data – Q1

City centre

TOTAL TAKE UP IN Q1

1,414,000 sq ft | **+13%** compared to the ten year quarterly average

TAKE UP (sq ft)



TOP FIVE DEALS

City	Property	Occupier	Sq ft
Glasgow	Atlantic Square	Government Property Unit	187,000
Manchester	3 New Bailey	Government Property Unit	157,000
Leeds	Benson House, Wellington Place	Walker Morris	76,000
Leeds	The Mint	Dart Group	48,200
Birmingham	The Mailbox	WSP	46,100

HEADLINE RENTS (£psf)

Location	Rents (£)	Rent free (mths on 10 yr term)	Net effective rent*(£)	Net effective rent (£) Q1 2017
Edinburgh	34.00	18	29.75	28.00
Bristol	32.50	18	28.44	24.94
Manchester	33.50	24	27.64	27.64
Birmingham	33.00	24	27.23	25.60
Glasgow	30.00	18	26.25	25.50
Leeds	30.00	24	24.75	22.69
Cardiff	26.00	12	24.05	20.63
Newcastle	23.50	18	20.56	20.13
Liverpool	21.50	24	17.74	16.66
Average	**29.33**	**20.00**	**25.16**	**23.53**

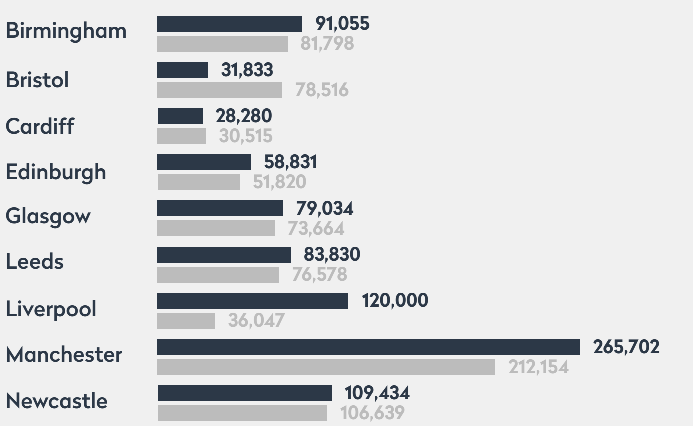
*including rent free period less three month fit-out.

Out-of-town

TOTAL TAKE UP IN Q1

867,999 sq ft | **+16%** compared to the ten year quarterly average

TAKE UP (sq ft)



TOP FIVE DEALS

City	Property	Occupier	Sq ft
Liverpool	Paddington Village	Royal College of Physicians	70,000
Manchester	The Malt House	Gamma	37,600
Birmingham	Trinity Central, Trinity Park	Beiersdorf UK	25,200
Birmingham	Zenith House, Solihull	Bizspace	23,750
Edinburgh	South Gyle BP	Instant Offices	23,500

HEADLINE RENTS (£psf)

Location	Rents (£)
Birmingham (Solihull)	23.50
Bristol	22.50
Leeds	22.00
Manchester (South)	20.00
Edinburgh	20.00
Newcastle	16.95
Glasgow	16.50
Cardiff	15.00
Liverpool	14.00
Average	**18.94**

Occupier activity

Birmingham
Demand in Birmingham city centre has continued on a positive note this year. Q1 take-up amounted to 148,000 sq ft, led by the 46,100 sq ft deal to engineering company WSP at The Mailbox, along with a handful of medium sized deals between 10,000 and 20,000 sq ft.

Encouragingly there are some inward investment requirements, such as the General Dental Council looking to fulfil a 20,000 sq ft move from London. With occupier confidence remaining high, we expect continued rental growth this year.

The strength of the co-working sector continues with Ashby Capital letting an additional 11,300 sq ft to Orega at The Colmore Building and in the out-of-town market Bizspace has taken 23,750 sq ft at Zenith House, Solihull. Another 25,000 sq ft deal to manufacturer Beiersdorf at Trinity Park boosted the out-of-town take-up figures to the highest level for the first quarter since 2013.

Bristol
The TMT sector has led Q1 activity in the Bristol market with key deals to Immediate Media (34,600 sq ft), Cookpad (11,000 sq ft) and advertising agency McCann Erikkson (8,400 sq ft). The potential requirement for the Department for Work and Pensions is expected to consider the next phase of Glass Wharf, alongside its existing base.

In spite of the below average take-up in Q1, there are number of medium sized requirements in the market. Out-of-town demand remains steady and a 5,500 sq ft deal at newly refurbished 140 Aztec West has recently completed at a record rent of £22.50 psf.

Grade A supply remains very low and there is only 105,000 sq ft of speculative space under construction. This includes 55,000 sq ft of the 95,000 sq ft Aurora, as well as L&G's 50,000 sq ft comprehensive refurbishment at Templepoint; both are due to complete in June.

Cardiff
The largest deal in Cardiff city centre in Q1 was to co-working company Bizspace, who have taken 15,900 sq ft at Trafalgar House. JR Smart have also recently signed 11,550 sq ft to Which? Ltd, their first tenant at 3 Capital Quarter. Along with 4 Capital Quarter, 165,000 sq ft of grade A space will be delivered this year to the market.

Elsewhere Yard Digital has taken 5,550 sq ft at the newly refurbished Capital Tower, joining other TMT occupiers such as Object Matrix and Recruit 121, who signed at the end of last year.

Edinburgh
Q1 take-up activity in Edinburgh city centre has been slow, amounting to 90,000 sq ft. However this comes off the back of a busy 2017 and there are a number of significant deals rumoured to be under offer on pre-lets. This includes a deal on refurbishment space that has yet to start and emphasises the diminishing supply of quality stock. Consequently rental growth on grade B stock has been strong, currently standing at £25–£27 psf, compared to £34 psf for prime space.

It is hoped that the imminent sale of Edinburgh's best development opportunity at The Haymarket will kick start some much needed supply and unlock further occupier activity. With the next spike in lease event activity expected in 2020, this might be well timed.

Glasgow
Some much needed grade A space has recently started construction in the Glasgow office market. BAM is underway at Atlantic Square having agreed a pre-let with HMRC on 187,000 sq ft building 1 and will start the 97,000 sq ft building 2 speculatively. FORE Partnership has also begun construction at the nearby 94,000 sq ft Cadworks. These schemes will complete in 2020, so the development gap will provide an opportunity for those landlords who are able to refurbish properties. In addition M&G has announced plans for a 277,500 sq ft scheme at 'The Grid' 33 Cadogan Street, subject to a pre-let.

There is a significant level of interest in the last remaining pockets of existing grade A space in the city centre at 1 West Regent Street and Vincent Plaza. There are also some significant large requirements active in the market.

Leeds
Leeds has continued the strong level of take-up activity seen over the second half of last year. This is thanks to two significant deals in Q1; 76,000 sq ft to lawyers Walker Morris at the recently refurbished Benson House, Wellington Place and 48,270 sq ft to the Dart Group at The Mint.

On the supply side, there is currently 300,000 sq ft of grade A stock available in the city centre, just under a year's take-up. A further 66,000 sq ft of refurbished space is under construction at Rushbond's major restoration of the former Majestic cinema, opposite the station.

Activity in the out-of-town market was led by a 15,150 sq ft deal to Pancredit Systems Ltd at Lawnswood Business Park as well as deals at Century Way to Balfour Beatty and Linden Homes.

Liverpool
The stand-out deal in Liverpool this quarter was in the out-of-town market, a 70,000 sq ft pre-let at the Spine, Paddington Village to the Royal College of Physicians. In the city centre financial planners Willson Grange took 10,520 sq ft at 12 Princes Dock. Otherwise the bulk of activity has been in the sub 5,000 sq ft range.

Looking forward, we are aware of a number of sizeable requirements including Global University Systems (40,000 sq ft), Taylor Wessing (18,000 sq ft) and Hapag Lloyd (10,000 sq ft).

Headline rents for grade B stock are continuing to increase as both supply and inducement levels diminish. The prime headline rent remains at £21.50 psf but we are expecting an increase this year.

Manchester
In one of the final GPU deals of the first phase, HMRC have agreed to take a pre-let on all 157,000 sq ft at 3 New Bailey in Salford on a 25 year lease. This deal aside, Q1 demand was still above the quarterly average in both the city centre and out-of-town markets, led by a 33,000 sq ft deal to lawyers Irwin Mitchell, who along with CBRE (11,000 sq ft) are the latest to take space at One St Peter's Square, which is now fully let.

There remains a healthy demand from the co-working sector as a number of London based operators consider replicating We Work's recent regional roll out. The news that GCHQ will be opening a Manchester base has excited the market but the exact location of the rumoured 50,000 sq ft facility is predictably shrouded in mystery.

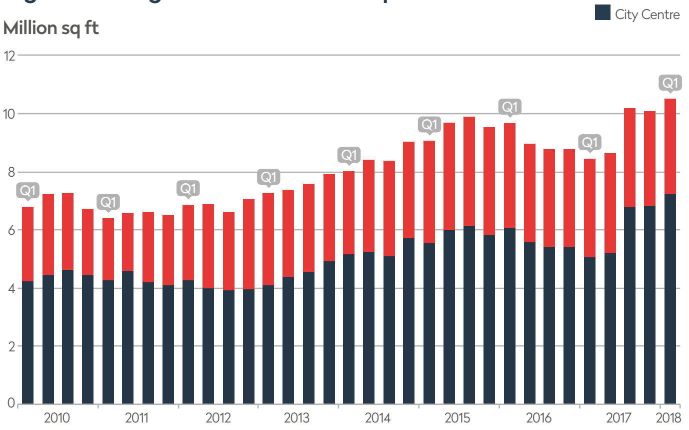
3 New Bailey will begin construction later this year, as will the speculative 166,000 sq ft 100 Embankment, a joint venture by Ask Real Estate, Tristan and Richardson who have agreed a forward funding pre-sale to Salford City Council.

Newcastle
The major share of take-up activity in Newcastle has been in the out-of-town market. The largest deal was 13,300 sq ft to utilities consultants Utility Alliance at Quorum Business Park, where there were two further deals over 5,000 sq ft to printing company Ravensworth and IT specialists TSG.

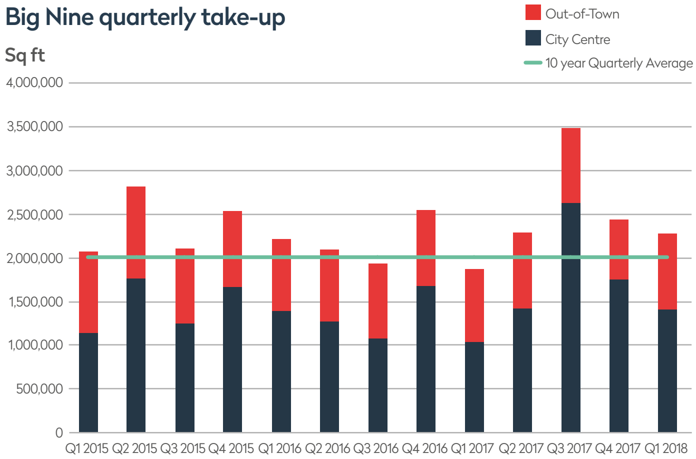
Key deals in the city centre included a 9,300 sq ft confidential deal at 50 Grey Street and Turner and Townsend taking 5,200 sq ft at Time Central. The city centre's key development site, Newcastle Helix (previously known as Science Central) is due to start speculative construction of the first office building, 100,000 sq ft The Lumen

Market at a glance

Big Nine rolling annual office take-up

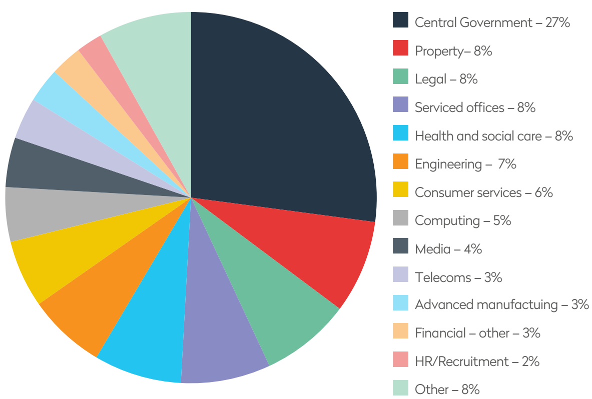


Big Nine quarterly take-up



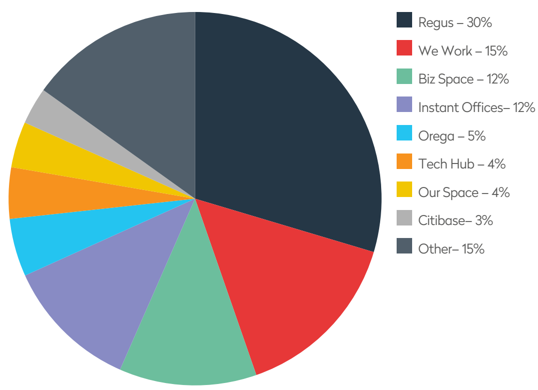
Big Nine take-up by sector – 2018 Q1

CC and OOT – over 5,000 sq ft – total 1.4 million sq ft

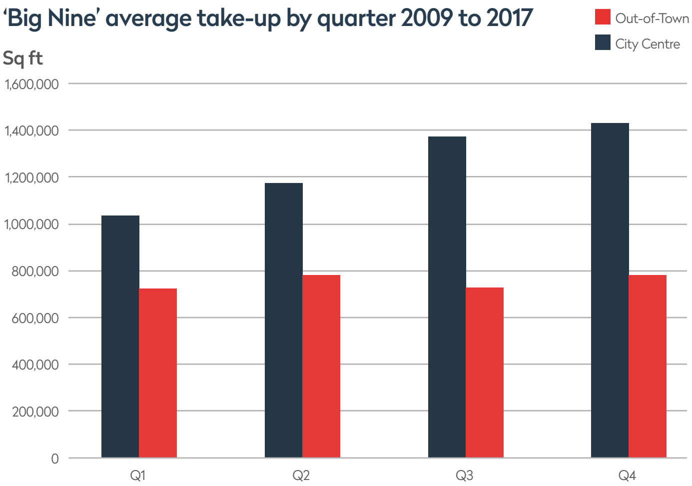


Serviced office take-up by occupier

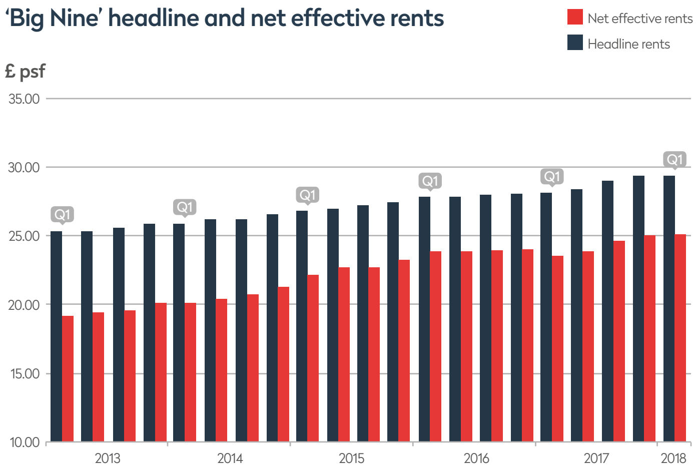
Deals over 5,000 sq ft – 12 months to Q1 2018



'Big Nine' average take-up by quarter 2009 to 2017



'Big Nine' headline and net effective rents



UK institutions take key deals in Q1

Mark Frampton
Senior Director, Investment

Sentiment in the regional office investment market has remained buoyant in the first quarter of 2018, following a very strong finish to 2017. 'Big Nine' office investment volumes during Q1 amounted to £652 million, 30% up on the ten year quarterly average of £500 million.

Similar to the occupier market, there were two exceptional deals, purchased by UK institutions during this period. Legal and General acquired India Buildings in Liverpool for £125 million, currently being refurbished for HMRC's move in 2019 and Aviva Investors are forward funding the £113 million purchase of Two New Bailey in Manchester. Other key purchases included 3 Atlantic Quay in Glasgow and 6 Queen Street in Leeds.

Total volumes for the 12 months to Q1 2018 amount to £3.37 billion, 68% up on the ten year average of £2bn. Demand for prime investments remains materially in excess of supply resulting in continued yield compression in the majority of the 'Big Nine'. The current strength of the regional occupier market is a key driver of this demand. There is continuing employment growth across the regional cities, which are benefitting particularly from the reorganisation of the government estate, together with ongoing regeneration and investment in local and regional infrastructure. These markets have also been helped by the net loss of grade B space to alternative uses.

Overseas investors have recognised the potential for growth in regional locations (32% of investment volumes in 2017) and have taken advantage of a weaker Sterling, albeit the data shows this enthusiasm has waned over the last 12 months. Domestic buyers have dominated the market in Q1 (90% of volumes) led by the UK institutions and investment managers. With uncertainty in the short term future and investors leaning to low risk grade A buildings let to strong covenants with secure long-term income, pricing on these core assets will continue to harden as demand exceeds supply.

While there remains a weight of money targeting secondary markets and more opportunistic investments, we are seeing a pricing mismatch between vendors' and purchasers' expectations resulting in a lack of opportunity and deal flow in this area. Where there is a strong occupational market and a shortage of grade A stock, there will continue to be interest in secondary assets with refurbishment opportunities.

The recovery in the out of town market continues although activity has tempered from last year's exceptional level of activity which saw over £1 billion in acquisitions by Frasers and Spelthorne Council alone. Key deals in Q1 included Hermes' purchase of Skypark for £80 million and Aztec 500 at Aztec West for £32 million. The regional cities continue to provide a yield advantage over London. Prime yields range from 4.75% in Birmingham and Manchester, to 5.75% and 6% in Newcastle and Liverpool (see table). There is therefore 100 basis point differential between the 'Big Nine' cities and a further 150 basis points over London West End.

We hope you find this, our first investment commentary to the Big Nine report beneficial and your feedback is always welcome and appreciated.

Investment Data – Q1

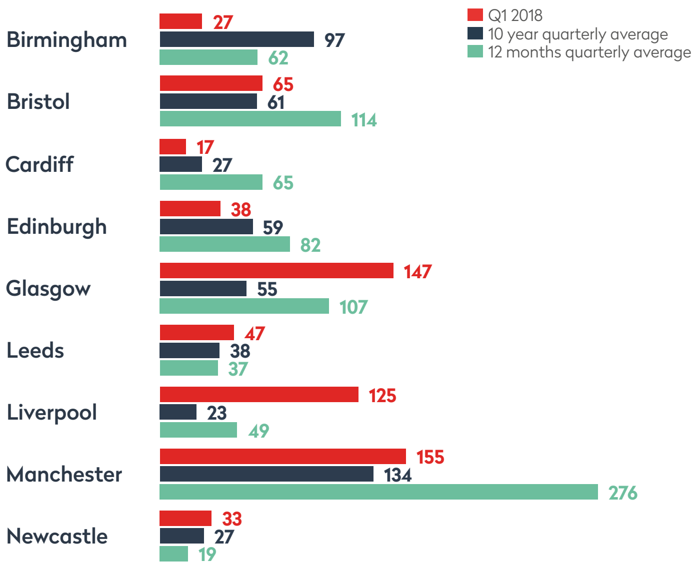
TOTAL INVESTMENT VOLUMES IN Q1 2018

£652 million

Compared to

£500m (ten year quarterly average) **£1.2bn** (previous quarter – Q4 2017) **£689m** (a year ago – Q1 2017)

BIG NINE INVESTMENT VOLUMES (£ million)



PRIME CITY CENTRE YIELDS

Location	Q4 2017	Q1 2018	Trend for last 12 months	Peak (2007)
Birmingham	4.75	4.75	↓	4.50
Bristol	5.25	5.00	↓	5.00
Cardiff	5.50	5.50	→	5.00
Edinburgh	5.00	5.00	↓	4.75
Glasgow	5.25	5.25	↓	4.75
Leeds	5.50	5.25	↓	4.75
Liverpool	6.00	6.00	→	5.50
Manchester	4.75	4.75	→	4.50
Newcastle	6.00	5.75	↓	5.25

TOP FIVE CITY CENTRE DEALS – Q1 2018

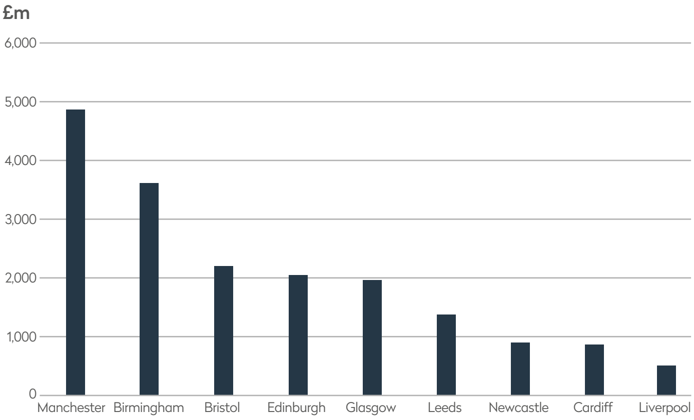
Date	Property	City	Purchaser	Vendor	Price	NIY
Mar-18	India Buildings	Liverpool	Legal & General Property	Shelborn Asset Management	£125,000,000	3.85%
Mar-18	2 New Bailey Sq	Manchester	Lime Property Fund	English Cities Fund	£113,000,000	3.25%
Jan-18	3 Atlantic Quay	Glasgow	LPI Income Property Fund	Moorfield REF III LP	£50,000,000	3.65%
Mar-18	6 Queen Street	Leeds	Swiss Life	Rockspring PIM Ltd	£37,000,000	5.4%
Jan-18	99 Haymarket Terrace	Edinburgh	PATRIZIA Immobilien AG	Catalyst Capital	£28,300,000	7.0%

TOP FIVE OUT OF TOWN DEALS – Q1 2018

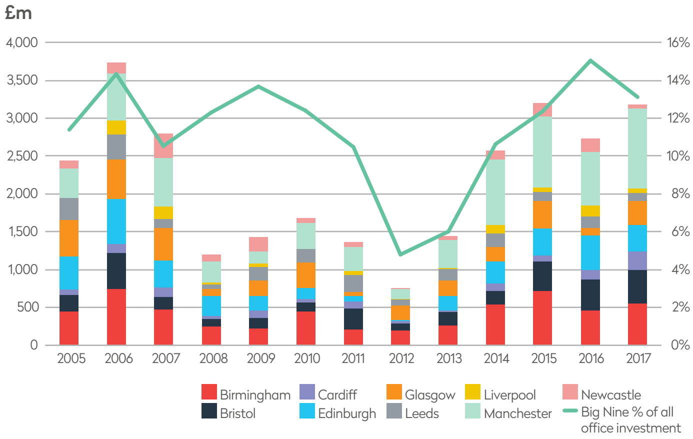
Date	Property	City	Purchaser	Vendor	Price	NIY
Mar-18	Skypark, Elliot Place	Glasgow	Hermes REIM	Lone Star	£80,000,000	7.16%
Mar-18	Aztec 500	Bristol	Sidra Capital	Aberdeen Standard	£32,250,000	6.69%
Jan-18	Bristol Parkway North	Bristol	Threadneedle UK PAIF	Catalyst European PF	£5,575,000	7.87%
Feb-18	Wolverhampton BP	Wolverhampton	Landlark Investments	Peveril Securities	£4,565,000	6.45%
Mar-18	Marquis Court, Team Valley	Gateshead	Bronze Investments	Undisclosed	£2,300,000	n/a

Market at a glance

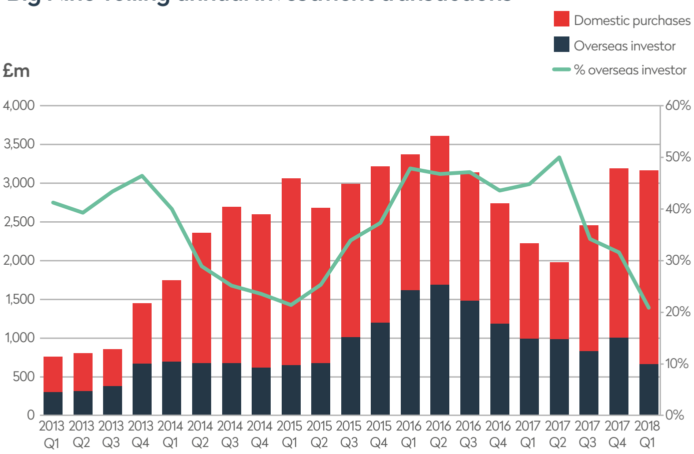
Big Nine invesment volumes 2009 – 2017



'Big Nine' investment volumes by city

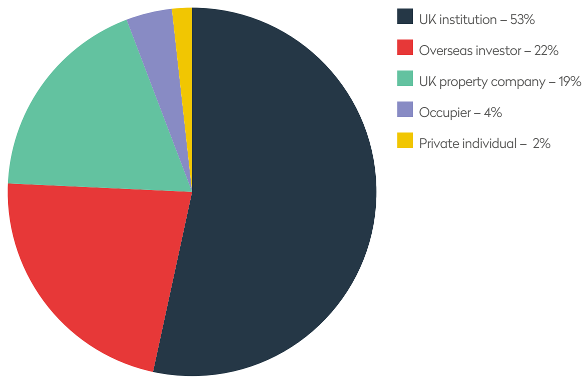


'Big Nine' rolling annual investment transactions

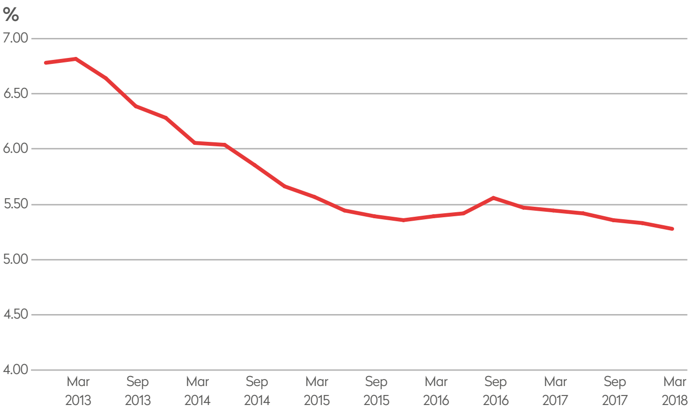


'Big Nine' investment volumes by investor type

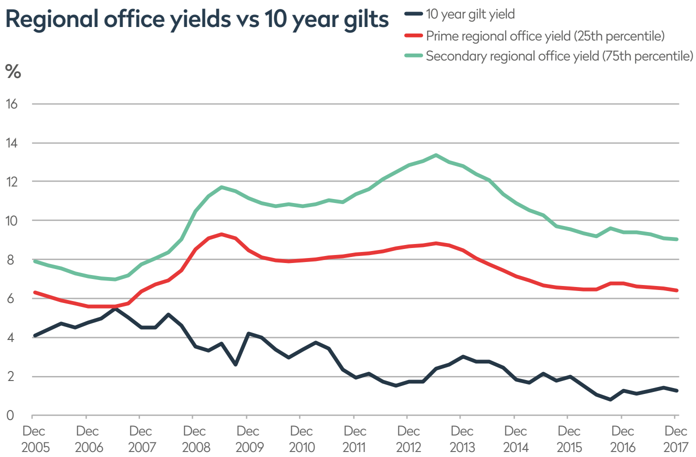
12 months to Q1 2018



Average 'Big Nine' prime yield



Regional office yields vs 10 year gilts



Source: GVA, Property Data, MSCI

Outlook

— We expect further significant deals from the serviced office sector this year. In the longer term the newly formed Government Property Agency will initiate further phases of the government's plan to move more civil servants out of London.

— Demand for quality space will continue to erode supply, which is already tight. Current availability levels will be supplemented with a conservative amount of speculative development, some comprehensive refurbishments and pre-lets for the largest requirements. The lack of grade A stock is expected to mean continued interest in quality secondary stock.

— The current optimism of investors to the regional office sector, along with the weight of money, scarcity of institutional grade supply and yield differential with London will continue to support investment volumes this year. We expect UK institutions to remain the dominant buyer. Following total returns of 9% for 2017 we expect a more modest return in 2018, dominated by income return.

— Although rising interest rates will reduce the gap between gilt yields and regional property yields a little, the gap will remain historically wide and so commercial property will continue to look attractive.

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

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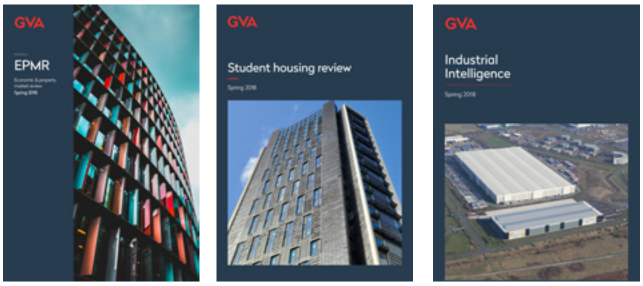

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