RESEARCH

The Big Nine

Quarterly update of regional office activity Q2 2018

TOP PERFORMERS

GLASGOW
Occupier Market

Glasgow city centre take-up recorded over twice the quarterly average during Q2, headlined by 111,000 sq ft deal to Clydesdale Bank at 177 Bothwell Street. There were a further eight deals over 10,000 sq ft to occupiers including the Scottish Executive and Regus.

EDINBURGH
Investment Market

The Edinburgh investment market accounted for the two largest deals of the quarter: New Uberior House to MAS Real Estate (£71 million) and The Mint, West Register Street (£53 million) at a record price for the city of £800 psf.

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

Out-of-town occupiers outperform

Charles Toogood
National Head of Offices

Occupational demand in the key regional office markets during the first half of this year has maintained the strong levels of the last four years. In fact take-up for H1 was the second most active start to the year in the last ten years.

During Q2 the out-of town market performed particularly well, 44% above average and was enhanced by some large deals in Bristol and Edinburgh to the education sector. City centre activity was boosted particularly by Glasgow; which saw over double the quarterly take-up with the most significant deal to Clydesdale Bank (111,000 sq ft).

For the first time in a year the headline figures have not been strengthened by any large GPA / HMRC deals. Nevertheless the public sector has remained active with a number of 20,000 to 30,000 sq ft deals to the Ministry of Justice, Environment Agency and the Scottish Executive.

As expected, strong co-working demand continues and amounted to 278,000 sq ft over the quarter, 16% of deals over 5,000 sq ft. This compares to the quarterly average of 148,000 sq ft since the regional boom started at the beginning of 2017. Of the nine cities, Birmingham leads this activity, accounting for 35% of take-up over the last 18 months, followed by Manchester (22%) and Leeds (12%). We are also starting to see substantial serviced office activity in Bristol.

Otherwise there has been an encouraging return to activity from sectors which have been relatively dormant recently, such as financial services and particularly banking. Similarly the computing and software subsector has seen an increased level of activity. Conversely demand from the professional services sector such as legal, accountancy and property services has been scarce this quarter.

On the supply side there is only 1.5 million sq ft of current grade A availability across the Big Nine, which equates to around nine months' supply based on past grade A take-up rates. Of the 4 million sq ft of office stock under construction, about 45% remains available, with Birmingham (3 Snowhill and 2 Chamberlain Square) and Manchester (125 Deansgate, Landmark and 100 Embankment) accounting for nearly 600,000 sq ft each.

This combination of healthy demand and tight supply continues to put pressure on headline rents. City centre rents are at a record high and rent free periods fell to a record low this quarter. Net effective rents have therefore increased by 5.8% over the year to Q2 2018. Similarly out-of-town headline rental growth has also been strong at 5.8%.

Market Data – Q2

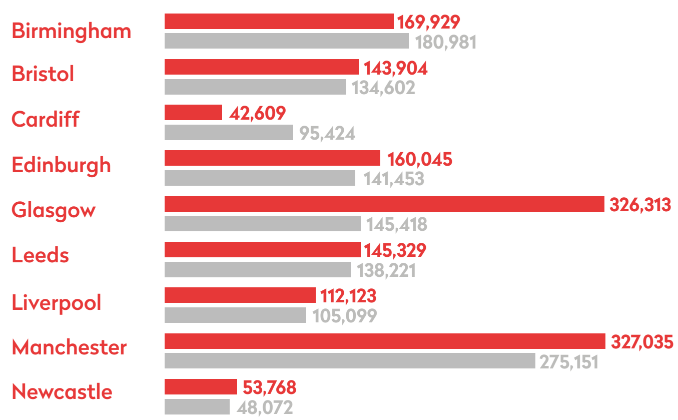
City centre

TOTAL TAKE UP IN Q2

1,481,055 sq ft | **+17%** compared to the ten year quarterly average

TAKE UP (sq ft)

Q2 2018
10 year quarterly average



TOP FIVE DEALS

City	Property	Occupier	Sq ft
Glasgow	177 Bothwell Street	Clydesdale Bank	110,955
Edinburgh	The Mint	Baillie Gifford	60,000
Manchester	8 First Street	WSP	53,839
Manchester	101 Barbirolli	Handelsbanken	39,934
Birmingham	Somerset House	BE Group	38,160

HEADLINE RENTS (£psf)

Location	Rents (£)	Rent free (mths on 10 yr term)	Net effective rent*(£)	Net effective rent (£) Q2 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	24.75
Cardiff	26.00	12	24.05	20.63
Newcastle	24.00	18	21.00	20.13
Liverpool	21.50	24	17.74	17.20
Average	**29.39**	**20.00**	**25.20**	**23.82**

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

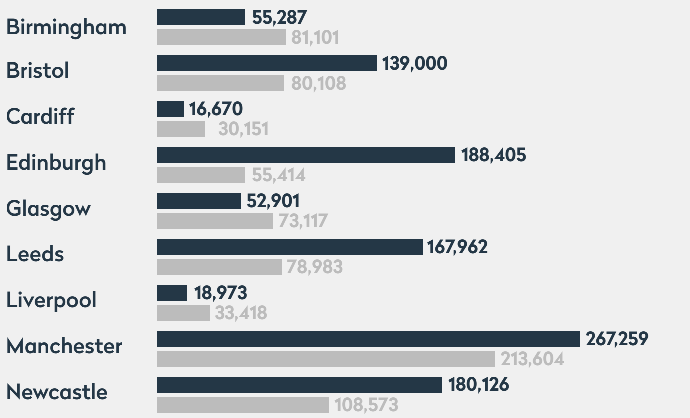
Out-of-town

TOTAL TAKE UP IN Q2

1,086,583 sq ft | **+44%** compared to the ten year quarterly average

TAKE UP (sq ft)

Q2 2018
10 year quarterly average



TOP FIVE DEALS

City	Property	Occupier	Sq ft
Edinburgh	525 Ferry Road	Edinburgh Palette	109,153
Bristol	HP3 + HP4 Stoke Gifford	University of the West of England	77,673
Edinburgh	11/12 Lochside Place	Diageo	43,801
Leeds	Optim, White Rose Office Park	Perform	39,422
Manchester	Lakeside 3400	Pure Offices	36,400

HEADLINE RENTS (£psf)

Location	Rents (£)
Birmingham (Solihull)	23.50
Leeds	22.50
Bristol	22.50
Manchester (South)	21.00
Edinburgh	20.00
Newcastle	16.95
Glasgow	16.50
Cardiff	15.00
Liverpool	14.00
Average	**19.11**

Market activity

Birmingham
169,000 sq ft of take-up during Q2 brings the first half of the year total to 318,000 sq ft in Birmingham city centre. The co-working office market has again dominated with BE Group taking 38,000 sq ft at the recently refurbished Somerset House and ihub taking a further 18,000 sq ft at Aviva's Colmore Gate.

The public sector remains active as managed office company Instant offices have facilitated a 21,000 sq ft deal for the Highways Agency and the Environment Agency has taken 27,000 sq ft in Aqua House.

Positive occupier sentiment is confirmed by the level of viewing activity and inward investment remains robust. We expect take-up to increase in the second half of the year as there are a number of deals in solicitors' hands and the GPA second phase requirement is at an advanced stage.

Bristol
It has been a strong quarter for Bristol, particularly in the out-of-town market, which has been boosted by the sale of 77,000 sq ft of the former Hewlett Packard HQ in Stoke Gifford to the University of the West of England. In the city centre market there has been a significant amount of co-working demand for the first time: Runway East has taken 30,000 sq ft at 1 Victoria Street and there are approximately 60,000 sq ft of deals in the pipeline including Regus Spaces at Programme and Desk Lodge at Unum House.

The shortage of grade A space means headline rents have jumped from £28.50 psf to £32.50 psf over the past year (and are rumoured to soon go higher). While there are a number of large schemes in the pipeline, a 60,000 sq ft speculative building at Glassfields looks likely to get underway soonest. In the immediate future occupiers will be relying on quality refurbishments to fulfil demand.

Cardiff
Take-up in Cardiff over the first half of 2018 has been relatively low compared to the strong levels of the past few years. The largest deal in the city centre during Q2 was 6,000 sq ft to media company Splice at 101 St Mary Street. Elsewhere Dolmans solicitors took 5,500 sq ft at Capital Tower, the latest in a number of recent deals at the refurbished building. In the out-of-town market there were a handful of smaller deals at Cardiff Gate Business Park.

There is over 150,000 sq ft of new supply on the market as 3 Capital Quarter has recently completed and 4 Capital Quarter completes in March next year.

Edinburgh
Large deals in both the city centre and out-of-town have boosted take-up figures in Q2. Investment management company Baillie Gifford have pre-let the 60,000 sq ft Mint Building at 20 West Register Street and in the out-of-town market arts centre Edinburgh Palette have taken 109,000 sq ft at 525 Ferry Road.

On the supply side M&G are looking to appoint a development partner following the purchase of the Haymarket site and bring forward 350,000 sq ft of offices. In the meantime completion of 2 Semple Street (39,000 sq ft) is due next quarter, while the comprehensive refurbishment at 80 George Street (40,000 sq ft) completes at the end of this year. Both buildings are hoping to capitalise on the current lack of quality supply in the city.

Glasgow
City centre take-up during the first half of 2018 has reached 587,000 sq ft, which is higher than the long term annual average. A 111,000 sq ft pre-let to Clydesdale bank at 177 Bothwell Street was the largest deal in Q2, and follows the 187,000 sq ft deal to the Government in the first quarter at Atlantic Square.

In addition there were a number of medium-sized deals during Q2, including over 50,000 sq ft to Regus in two deals at 1 West Regent Street and 100 West George Street, 34,700 sq ft to the Scottish Executive (4 Atlantic Quay) and 20,000 sq ft to Webhelp (67 Hope Street).

Leeds
Total take-up for the first half of the year amounted to 589,000 sq ft in Leeds, a third above the 10 year average. Q2 city centre deals included three circa 20,000 sq ft deals to Investec and the Ministry of Justice at 3 and 5 Wellington Place respectively and new co-working company Gilbanks at 1 Park Row.

The out-of-town market recorded the highest total in almost five years with six deals over 10,000 sq ft and headlined by sports media company Perform taking 40,000 sq ft at White Rose Office Park, Lowell taking 16,000 sq ft at Leeds Valley Park as well as over 35,000 sq ft of activity at Thorpe Park.

Liverpool
Take-up in Liverpool city centre during Q2 amounted to 112,000 sq ft, just above the long term quarterly average. The two largest deals were to Everton Football Club who took 28,634 sq ft at the Royal Liver Building and Instant Group who took 19,746 sq ft at Watson Building. The majority of transactions were in the sub 5,000 sq ft bracket.

There is currently no available grade A space in the city. However following the 80,000 sq ft pre-let to the Royal College of Physicians at the Spine, Paddington Village (160,000 sq ft), this will start on-site later in the year and provide much needed grade A accommodation.

Manchester
It was more of the same in Manchester with continued strong performance during H1. The highlight of the quarter was the commitment made by WSP at 8 First Street which is particularly notable as the scheme was one of those delayed due to the collapse of main contractor Carillion. There remains strong demand from the co-working sector with the Regus 'Spaces' brand looking to react to We Work's moves within the city.

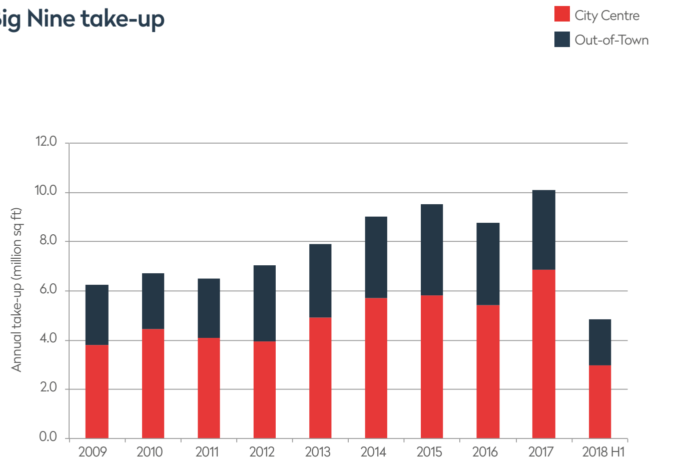
In the out-of-town market Airport City is finally gathering traction as the Hut Group commit to 50,000 sq ft within 4M, rumoured to be the forerunner to a much bigger requirement in excess of 200,000 sq ft, which may come to fruition later this year.

Newcastle
Take-up in Newcastle has reached the highest quarterly total for three years, headlined by two 30,000 sq ft out-of-town deals to Hays Travel and Tommy Tippee. The city centre has been dominated by a number of medium-sized deals to professional service firms including lawyers DWF (7,500 sq ft) and engineering firm Patrick Parsons (7,400 sq ft) at Central Square. Newcastle University took the largest city centre deal of 13,600 sq ft at Northumberland House.

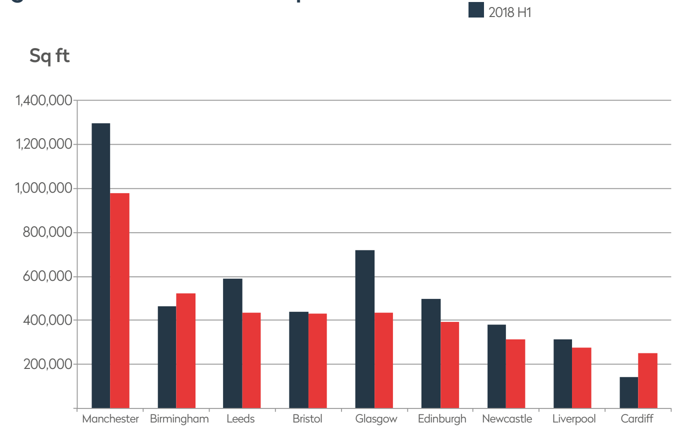
In terms of supply 108,000 sq ft The Lumen building at Newcastle Helix is about to start construction and is expected to complete at the end of 2019. The developer is Legal & General in conjunction with Newcastle City Council. There is potential for the 107,000 sq ft Spark to follow on from The Lumen, also funded by L&G.

Market at a glance

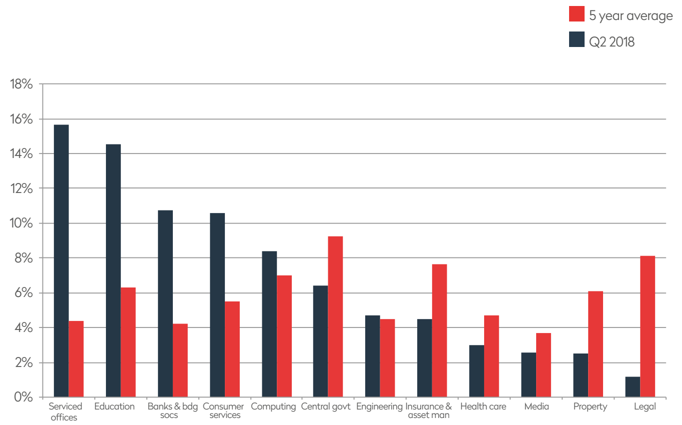
Big Nine take-up



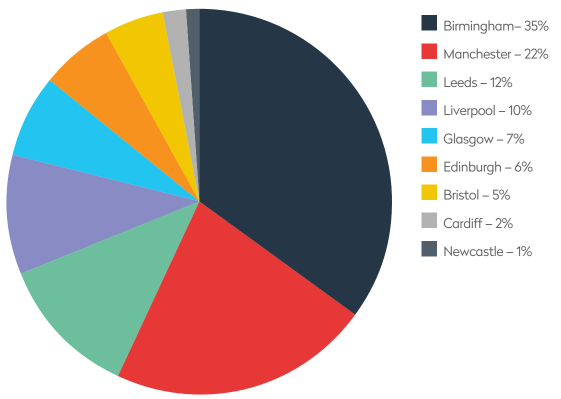
Big Nine CC and OOT take-up



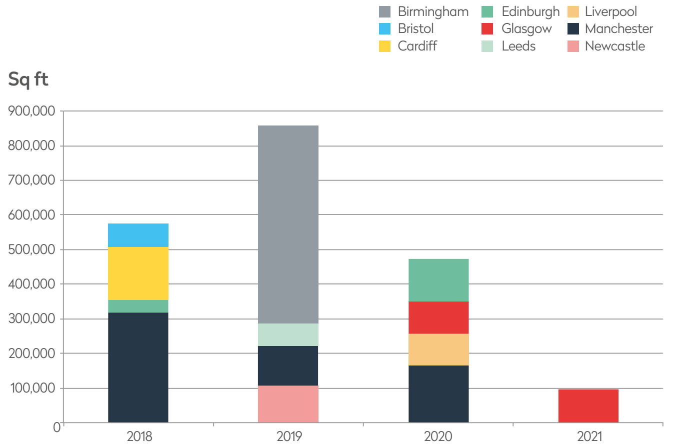
Big Nine take-up by sectors – 2018 Q2



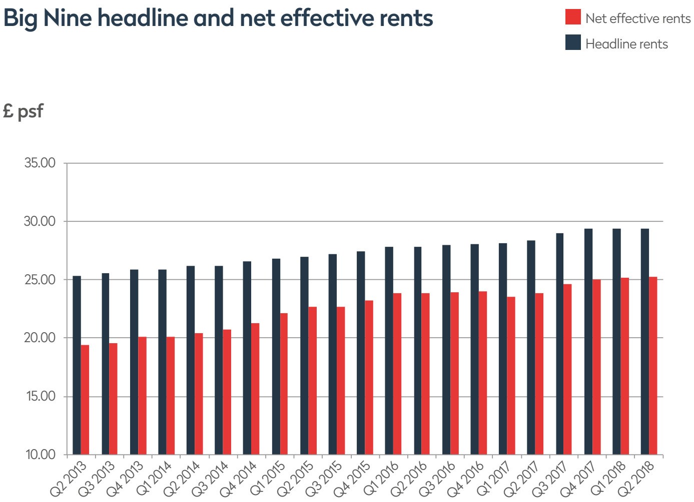
Take-up of co-working office space 2017 to 2018 H1



Big Nine speculative completions



Big Nine headline and net effective rents



Overseas investors take key deals

'Big Nine' office investment volumes during Q2 amounted to £500 million. This is just short of the ten year quarterly average of £510 million but up on the corresponding quarter last year when £380 million was transacted. Total volumes of £3.6 billion for the 12 months to June are still materially up on the ten year average of £2 billion.

Edinburgh has seen the strongest activity this quarter accounting for the largest deal, the sale of New Uberior House to MAS Real Estate for £71 million. There has also been over £100 million of activity in Leeds with key deals of 1 Park Row and City Point. Despite this, Manchester remains the standout performer over the last 12 months, followed by Bristol (see chart).

A number of the larger deals have been completed by overseas buyers this quarter, increasing share to a third of activity, the highest proportion for over a year. Whether this is likely to continue will depend much on how the Brexit negotiations affect confidence in the Pound.

The key domestic purchasers active in Q2 include CCLA Investment Management and West Midlands Pension Fund. There has been a slowdown in transactions from local authorities, which may well be the result of recent guidance notes stating that the preference for investment is 'within borough'.

During this quarter there has been an increasing polarisation in the market for both stock and location. A more risk averse environment has encouraged buyers towards quality stock and a commitment to more established locations. Low risk, grade A buildings with secure long-term income, let to strong covenants continue to receive very strong interest.

There remains a weight of money for prime opportunities but scarcity means that pricing is very competitive. As such, sentiment remains upbeat, led by the continuing health of the occupational market. For example pricing on The Mint in Edinburgh reached a record £800 psf for the city, which was acquired by Hines for £53 million following the pre-let to investment managers Baillie Gifford.

Similarly in the out-of-town market good quality product in prime locations is selling well. Barwood Capital and db symmetry have recently sold Manchester Green office park near the airport for £20 million following a refurbishment programme.

The lack of development stock and quality existing supply continue to put pressure on yields. The average prime yield across the Big Nine is currently 5.17% compared to 5.42% a year ago. The average equivalent yield for all regional offices according to the MSCI index stabilised during Q2 at 5.9%, which compares to 6.1% a year ago.

Looking forward to the next quarter there are some significant deals under offer including the £50 million Imperial Tobacco building in Bristol, and 40 Torphichen Street and Blenheim House in Edinburgh for £35 million and £30 million respectively. Minerva House in Leeds has attracted a lot of interest and is rumoured to be under offer for over the asking price of £20 million.

One of the most significant new buildings to be put on the market during the quarter is The Admiral Building in Cardiff, which has a guide price of £80 million.

Mark Frampton
Senior Director, Investment

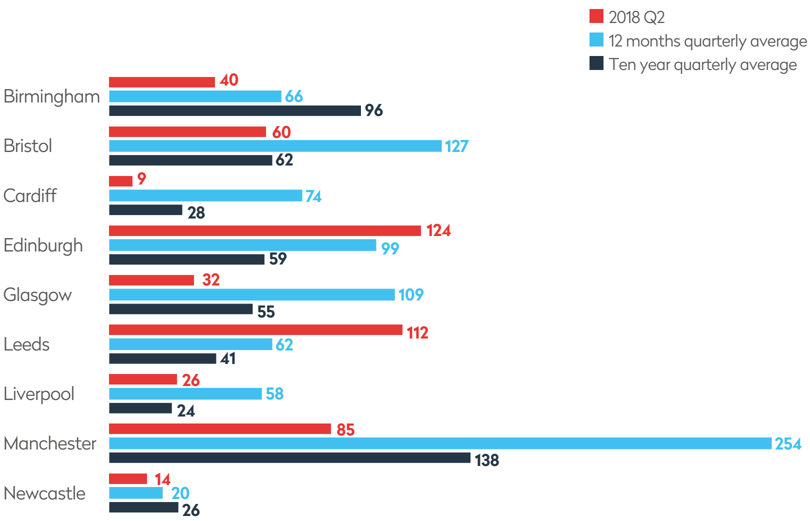
Market Data – Q2

TOTAL INVESTMENT VOLUMES IN Q2 2018

£500 million

Compared to
£510m (ten year quarterly average) **£792** (previous quarter – Q1 2018) **£380m** (a year ago – Q2 2017)

BIG NINE INVESTMENT VOLUMES (£ million)



PRIME CITY CENTRE YIELDS

Location	Q1 2018	Q2 2018	Trend for last 12 months	Peak (2007)
Birmingham	4.75	4.75	↓	4.5
Bristol	5.00	5.00	↓	5
Cardiff	5.50	5.50	→	5
Edinburgh	5.00	4.75	↓	4.75
Glasgow	5.25	5.00	↓	4.75
Leeds	5.25	5.00	↓	4.75
Liverpool	6.00	6.00	→	5.5
Manchester	4.75	4.75	→	4.5
Newcastle	5.75	5.75	↓	5.25

TOP FIVE CITY CENTRE DEALS – Q2 2018

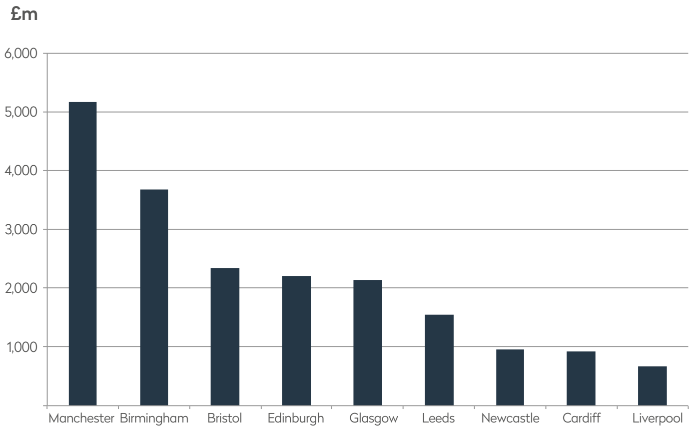
Date	Property	City	Purchaser	Vendor	Price	NIY
May-18	New Uberior House	Edinburgh	MAS Real Estate	Aerium Finance Ltd	£71,000,000	5.81%
Jun-18	West Register Street	Edinburgh	Hines	Chris Stewart Group	£53,000,000	4.5%
Jun-18	1 Park Row	Leeds	CCLA Investment Man	Evans Property Group	£35,600,000	4.43%
Jun-18	26 Spring Gardens	Manchester	Bet365 Group Ltd	AM Alpha GMBH	£31,500,000	5.25%
Jun-18	1 Rivergate	Bristol	West Midlands Pension Fund	UKCP REIT Ltd	£27,600,000	6%

TOP FIVE OUT OF TOWN DEALS – Q2 2018

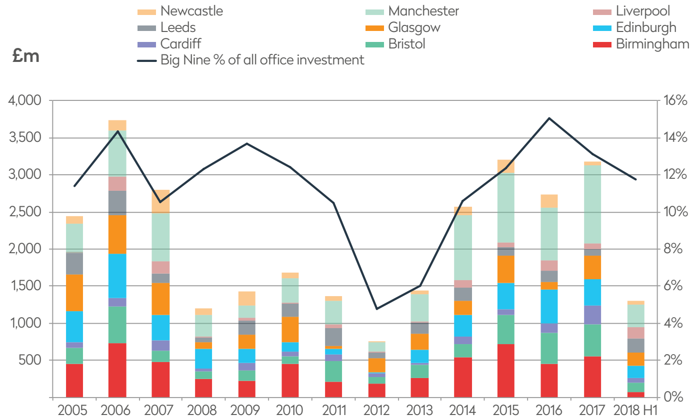
Date	Property	City	Purchaser	Vendor	Price	NIY
Apr-18	Manchester Green	Manchester	Squarestone Growth	Barwood Capital	£20,500,000	8.57%
May-18	Century Way	Leeds	Private investor	Commercial Estates Group	£12,000,000	7.30%
May-18	1 Didsbury Point	Manchester	Cervidae Consultancy	Titanium Real Estate	£11,000,000	8.56%
May-18	Glasgow Airport BP	Glasgow	Undisclosed	Aviva Life & Pensions UK	£7,300,000	9.15%
Apr-18	710 & 720 Aztec West	Bristol	Circle Property Plc	Dominvs Group	£4,200,000	7.90%

Market at a glance

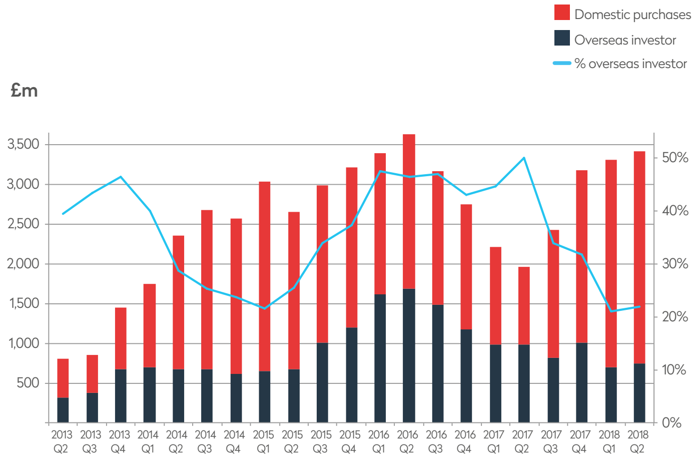
Big Nine investment volumes 2009 to 2018 H1



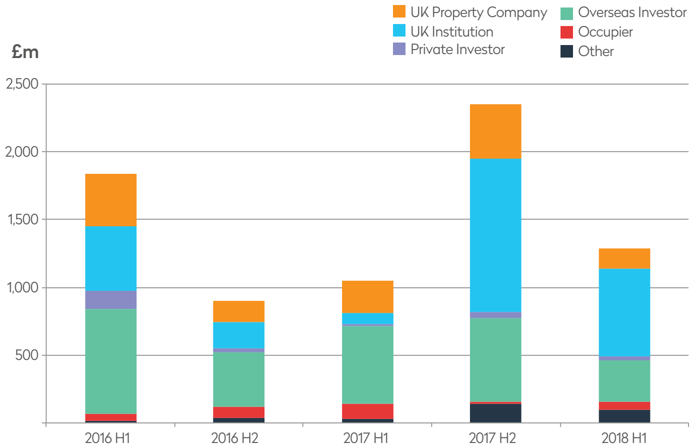
Big Nine investment volumes by city



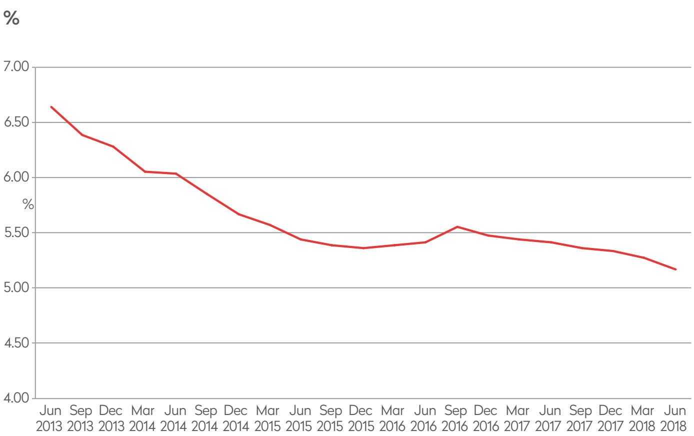
Big Nine rolling annual investment transactions



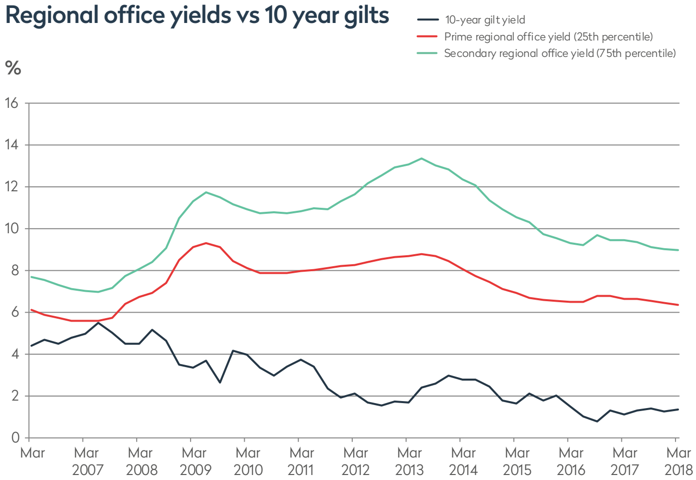
Big Nine investment volumes by investor type



Average Big Nine prime yield



Regional office yields vs 10 year gilts



Source: GVA, Property Data, MSCI

Outlook

— Take-up is holding up well across the 'Big Nine' as the core regional cities are benefitting most from relocation strategies of government and private companies. Over time this will lead to an increase in the number of people commuting to the largest regional cities.

— The annual level of new construction orders across the office sector has fallen for the seventh consecutive quarter. Speculative development and refurbishments will remain conservative and pre-letting will likely satisfy the largest requirements where supply is tight.

— The gap in rents between new builds and refurbished buildings has narrowed significantly during the last few years and this trend should continue in the short term.

— We are expecting investment volumes to remain robust due to the continued weight of money but with increasing caution as the Brexit deadline looms.

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

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