RESEARCH

Knight Frank

REGIONAL OFFICES

OCCUPIER AND INVESTMENT MARKET SUMMARY **Q4 2013**

Economic overview

Sentiment has changed significantly from 12 months ago. The latest official figures reveal that the UK economy recorded a fourth consecutive quarter of robust growth in Q4 2013. Of particular relevance to the office markets, the dominant Services sector has been the main driver of the UK's recent recovery, with growth of 1.9% in 2013.

Evidence also suggests that growth is spreading beyond the capital to all the UK regions and across the main sectors of the economy. The latest PMI survey reveals a marked improvement in business confidence across all regions from 12 months ago, which suggests that occupiers will be more receptive to increasing headcount and upgrading their accommodation (Figure 1).

Occupier markets

Glasgow was the stand-out performer in the final quarter of 2013 with take-up of 367,879 sq ft. This was boosted by Scottish Power's substantial 220,000 sq ft pre-let of its new HQ building on Vincent Street, by far the largest transaction seen across the ten regional cities during 2013.

Leeds meanwhile closed a record-breaking year with strong take-up of 254,798 sq ft across 33 separate transactions in Q4. The city's largest deal was Leeds City Council's commitment to refurbish and expand Merrian House, which entailed a pre-let of an additional 50,000 sq ft.

Reflecting improving occupier sentiment during the past 12 months, the majority of the ten cities saw stronger take-up in 2013 compared with 2012. Across the ten cities combined, 2013 take-up also reached its highest level since 2008 and was 4% above 10-year annual average (Figure 2).

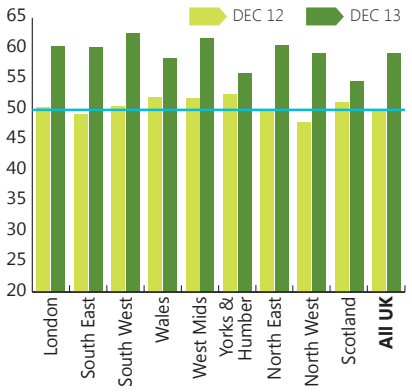
However, the positive overall picture in 2013 masks the significant variation in performance between the cities. While Bristol, Newcastle and Glasgow all enjoyed their best year of take-up since 2008, Leeds had an outstanding year, with take-up reaching a record high of 789,530 sq ft, or 57% above its ten-year annual average.

Aberdeen's market also remained firmly in expansionary mode in 2013, as the city continued to reap the benefits of substantial investment into the North Sea oil industry. The city recorded a third consecutive year of take-up above 700,000 sq ft, with 2013 take-up 51% above its ten-year average

With occupier confidence improving and developers remaining wary of undertaking speculative development, the falling availability of Grade A supply is now a key theme across the regional markets. Overall, Grade A supply has more than halved from its peak in 2009. The situation is arguably most acute in Leeds, although supply in Birmingham and Manchester is also under pressure in view of a high number of lease events in the pipeline.

FIGURE 1

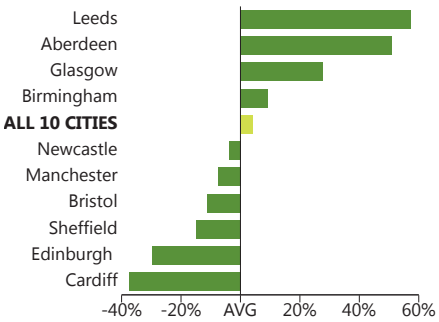
Purchasing Managers' Index (PMI)



Source: Markit Economics
Note: Figure above 50 denotes expansion

FIGURE 2

2013 take-up vs 10 year annual average



Source: Knight Frank Research

Scottish Power's 220,000 sq ft pre-let in Glasgow was by far 2013's largest deal across the ten regional markets. The 14-storey building recently commenced construction with completion expected in late 2015.

FIGURE 3

Prime rents and forecast (per sq ft)

	Q4 13	Q4 14 F	Q4 15 F
Aberdeen	£31.50	£31.50	£34.00
Birmingham	£28.50	£29.00	£30.00
Bristol	£26.75	£27.50	£28.00
Cardiff	£22.00	£22.00	£22.00
Edinburgh	£27.00	£28.00	£29.00
Glasgow	£28.50	£28.50	£30.00
Leeds	£25.00	£26.00	£26.50
Manchester	£30.00	£30.00	£32.00
Newcastle	£21.50	£21.50	£23.00
Sheffield	£20.00	£20.00	£20.00

Source: Knight Frank Research

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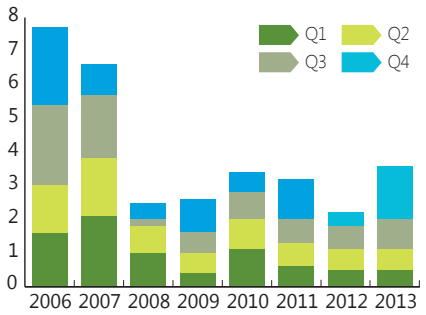
FIGURE 4
Regional office investment volumes
(£bn)



Source: Property Data

FIGURE 5 **Prime yields (%)**

	Q4 12	Q4 13	Yield sentiment
Aberdeen	6.50	6.00	▼
Birmingham	6.50	5.75	▼
Bristol	6.50	6.00	▼
Cardiff	6.50	6.00	▼
Edinburgh	6.50	6.00	▼
Glasgow	6.50	6.00	▼
Leeds	6.50	6.00	▼
Manchester	6.50	5.75	▼
Newcastle	6.75	6.25	▼
Sheffield	7.25	6.50	▼

Source: Knight Frank Research

In Q4 2013, Knight Frank advised L&G over their £54.82m purchase of Union Plaza, Aberdeen. 2013 was a record year for Aberdeen's investment market, with a number of prominent deals boosting annual turnover to £253.6m.

Investment market

Investment activity in the regional cities rose sharply in the latter half of 2013, as a wave of institutional money flowed into the regional markets. The arrival of the UK Funds to the market – alongside the already active private and overseas equity buyers – propelled investment turnover to £1.63bn in Q4 2013, the strongest quarterly total since Q3 2007. Q4 also accounted for 46% of 2013's total annual transaction volumes (Figure 4).

The resurgence of institutional demand has arisen in large part due to increased fund receipts, underpinned by the brightening UK economic backdrop. While conditions in the regional occupier markets have undoubtedly improved, arguably the main driver of investment demand has been the desire to exploit the perceived better value offered by the regions, compared with London and the South East.

The weight of money targeting the regional markets has given rise to significant price increases. Yields for prime stock have hardened by c.50 to 75 bps since Q1 2013 (Figure 5), although its ongoing scarcity means that pricing remains largely guided by sentiment. One notable exception is Aberdeen, where a number of prominent deals for long income assets have taken place on the back of a strong pre-let market.

With limited opportunities at the prime end, the recent acceleration in activity more accurately reflects the step-change in investors' attitude to risk. Investor appetite for good quality secondary assets, such as well-located shorter-income stock in the core regional markets, has increased sharply, and it is in this part of the market where yield compression has been most pronounced.

Moving forward, the scarcity of prime assets is expected to put prime yields under a degree of additional pressure in 2014. However, with yield compression easing, performance will need to be driven more by a stronger recovery in the occupier markets.

The tight levels of Grade A supply now evident across many cities have enhanced the prospects for rental growth over the next 12-36 months. We anticipate both domestic and overseas investors to capitalise on this, focusing on stock offering potential for active asset management, while the definition of 'good secondary' is expected to broaden as investors increasingly seek value-add opportunities.

Major regional office investment deals in Q4 2013

Date	Address	Purchaser	Price £m	Yield %
Dec-13	One Snowhill, Birmingham	Union Invest Management / Commerz Real	125.00	6.18
Oct-13	Birmingham Business Park and Lawnswood, Leeds	Canmoor Asset Management / Arlington Business Parks	70.00	NA
Dec-13	Union Plaza, Aberdeen	L&G / Stewart Milne	54.82	6.30
Dec-13	Portwall Place, Bristol	BlackRock UK Property / IBRC	51.50	6.90
Nov-13	150 Broomielaw, Glasgow	CLAL Insurance / Standard Life	42.00	6.35
Nov-13	Time Central, Gallowgate, Newcastle	Orchard Street IM / Credit Suisse Asset Man	24.68	6.14

Source: Knight Frank Research

Please refer to our bi-annual reports for more detailed accounts of the city markets http://www.knightfrank.co.uk/research/ROMP/

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