RESEARCH

Knight Frank

REGIONAL OFFICES

OCCUPIER & INVESTMENT MARKET SUMMARY **Q2 2014**

The improving economic backdrop is positive for the UK's key office markets. The UK economy recently recorded a sixth consecutive quarter of robust growth, taking output back to its pre-recession level. Of direct relevance of the office sector, Services is leading the economic recovery and is the main driver of employment growth.

Growth is also becoming more widespread. Markit's latest PMI survey for June 2014 reveals a marked improvement in business confidence across all regions from 12 months ago. This is especially true of the North East and South West regions, boding well for future office demand.

Occupier markets

The ten regional cities saw combined take-up of 1.41m sq ft in Q2, marginally below Q1's total but 15% above the five-year quarterly average. Q2 was arguably more active than Q1, however, given that take-up was less influenced by major deals – Q2 saw just one deal above 50,000 sq ft.

Manchester remains the clear stand-out performer. Following 315,000 sq ft of take-up in Q1, the city centre saw an impressive 484,000 sq ft of activity in Q2, almost three times the next strongest performers, Edinburgh and Bristol, which themselves saw robust activity (Figure 1).

No.2 Capital Quarter, Cardiff, was one of a number of new speculative schemes to commence construction in the regional markets during Q2

Manchester was home to the largest deal of the ten cities in Q2, with Slater & Gordon leasing 104,000 sq ft at 58 Mosely Street. Q2's second largest deal was seen in Cardiff – Southern Electric purchased Peterson House, Cardiff Gate Business Park, for its own occupation, totalling 46,581 sq ft.

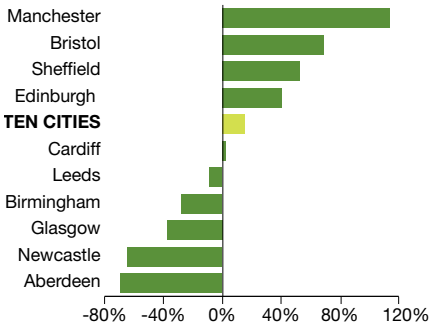
A number of cities that were peripheral to 2013's 'regional revival' have performed much better in 2014. Sheffield had its highest quarterly take-up in almost four years in Q2, while Cardiff has had its best half year since H1 2011. In contrast, Leeds and Aberdeen – the two star performers of 2013 – saw below average take-up in Q2 (Figure 2).

Active demand across the ten cities combined remains relatively robust, standing virtually unchanged overall from its level 12 months ago. Manchester boasts the highest level of active requirements, standing at circa 600,000 sq ft, while Birmingham and Leeds have both seen healthy increases in demand, rising by 15% and 29% respectively during Q2.

Grade A availability continues to ebb away in the absence of significant development completions, falling 14% year-on-year collectively. However, the most remarkable feature of Q2 has been the increase in speculative development activity – as at end Q2, 1.9m sq ft was under construction, a 37% rise from Q1. Aberdeen, Cardiff, Edinburgh Leeds and Sheffield all saw new schemes commence in Q2.

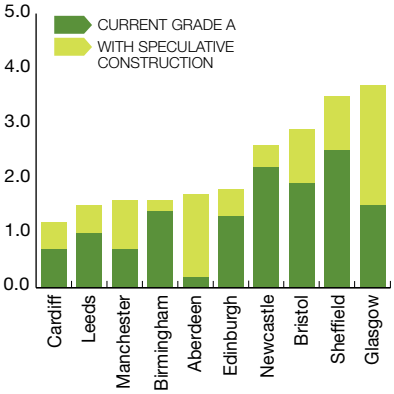
Following prime headline rental increases in Aberdeen, Bristol, Manchester in Q1, Edinburgh was the one market to see growth in Q2 – rising from £27.00 to £28.00 per sq ft. We expect rental growth to spread to other markets over the next 18 months, such as Cardiff, Newcastle and Sheffield, reflecting the completion of new Grade A developments (Figure 3).

FIGURE 1
Q2 2014 take-up vs five year quarterly average



Source: Knight Frank Research

FIGURE 2
Years of Grade A supply



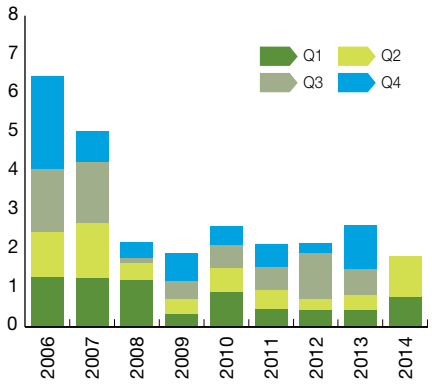
Source: Knight Frank Research

FIGURE 3
Prime rents and forecast (per sq ft)

	Q2 14	Q4 14 F	Q4 15 F
Aberdeen	£32.00	£33.00	£34.00
Birmingham	£28.50	£30.00	£32.50
Bristol	£27.50	£27.50	£28.00
Cardiff	£22.00	£22.00	£23.00
Edinburgh	£28.00	£28.00	£29.00
Glasgow	£28.50	£28.50	£30.00
Leeds	£25.00	£26.00	£26.50
Manchester	£31.00	£31.00	£32.00
Newcastle	£21.50	£21.50	£23.00
Sheffield	£20.00	£20.00	£22.00

Source: Knight Frank Research

FIGURE 4
Regional office investment volumes
(£bn)



Source: Property Data

FIGURE 5 **Prime yields (%)**

	Q2 13	Q2 14	Yield sentiment
Aberdeen	6.25	5.75	▼
Birmingham	6.00	5.25	▼
Bristol	6.25	5.50	▼
Cardiff	6.25	5.90	▶
Edinburgh	6.25	5.75	▼
Glasgow	6.25	5.75	▼
Leeds	6.25	5.75	▼
Manchester	6.25	5.25	▼
Newcastle	7.00	6.00	▶
Sheffield	7.25	6.25	▶

Source: Knight Frank Research

Cording Danmerc's purchase of Bridgewater House was one of many investment deals to take place in Manchester during Q2. Knight Frank acquired the property.

Investment market

Investment turnover in the regional office markets has been strong over the past nine months, reflecting the increasing confidence investors now have in the occupier markets and their desire for higher yield compared with Central London and South East. Just over £1bn of regional office assets changed hands in Q2 2014, taking total volumes for H1 2014 to £1.8bn, its strongest half year total since H2 2007 (Figure 4).

Manchester was the clear focus of investment activity in Q2. Of the ten regional centres, the city was home to one third of all the recorded deals and 67% of total investment volume. Even so, the majority of the markets saw Q2 volumes ahead of their 10-year quarterly averages – the three exceptions were Cardiff, Glasgow and Sheffield, where no transactions were recorded in the quarter, although the availability of stock is a key determinant of activity.

Manchester's strong performance was also underpinned by the sale of two major trophy assets to institutional investors in Q2, comprising M&G's purchase of Spinningfields (£320m) and Schroder UK Property Fund's purchase of City Tower (£132m). Buying opportunities of this magnitude are relatively rare in the regional markets, with Q2's other major deal in Birmingham, where Legal & General purchased Priory & Temple Court for £87.5m.

The strong weight of money chasing limited product continues to put pricing under pressure. Manchester and Birmingham command the keenest pricing, with yields hardening by 25 basis points in Q2 to stand at 5.25%, while Bristol also saw pricing harden by further 25 basis points to stand at 5.50% (Figure 5).

Prime yields have remained broadly stable across the UK's other regional cities in Q2, although the consensus remains that there is room for further inward yield shift before the year end. Despite the sharp increase in pricing over the past 12 months, the regional markets remain at a significant discount to those of Central London (Figure 5).

With the rate of inward yield shift expected to ease, income growth is likely to be the main driver of performance from 2015, as the recovery in the occupier markets accelerates. The declining availability of Grade A stock and evidence of rising rental tones should also tempt more investors down the development route.

Major regional office investment deals in Q2 2014

Date	Address	Purchaser / Vendor	Price £m	Yield %
Jun-14	Spinningfields, Manchester	M&G Real Estate / Ernst & Young	320.00	4.80
May-14	City Tower, Piccadilly, Manchester	Schroder UK Property Fund / Bruntwood Estates Ltd	132.00	7.00
Apr-14	Priory & Temple Court, Birmingham	Legal & General / Co-operative Bank	87.50	8.28
Jun-14	St Philips Place 5, Birmingham	Cordea Savills / Climate Change Capital	38.00	5.80
Jun-14	Aberdeen Energy Park	Moorfield Capital Partner / Buccleuch Property	32.80	8.75
Apr-14	Hanover Street 80, Edinburgh	Scottish Widows / West Coldstream	19.50	6.03
Jun-14	Quorum Business Park Q8, Newcastle	Undisclosed / Tritax Assets Ltd	17.50	8.10
Apr-14	Cobalt Business Park 14, Newcastle	Standard Life / Merchant Place Dev Ltd	10.35	6.74

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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