

REGIONAL OFFICES

OCCUPIER & INVESTMENT MARKET SUMMARY Q4 2014

The UK economic recovery accelerated in the final quarter, supported by the sharp fall in oil prices. Official figures show growth of 0.5% in Q4. This brings growth for the whole of 2014 to 2.6%, up from 1.7% in 2013, and the economy's best performance since 2007. The Bank of England is forecasting 2.9% GDP growth in 2015.

The UK service sector has been the main driver of the recent recovery, with overall service sector growth of 3.6% recorded in the year to December 2014. Markit's latest PMI services index also scored well above the 50 mark across all regions, which suggests more occupiers will be interested in upgrading their accommodation and taking additional office space in the future.

Occupier markets

The recovery across the key regional markets has continued. For the ten cities combined, 2014 take-up reached its highest level on record and was 27% above the 10-year annual average.

Both Aberdeen and Manchester breached the 1 million sq ft mark, with take-up of 1.04 million sq ft and 1.35 million sq ft, respectively in 2014. Although this is an exceptionally high level of take-up for Aberdeen, Manchester was the stand-out performer both in the final quarter and over the year as a whole with total take-up of 1.3 million sq ft in 2014.

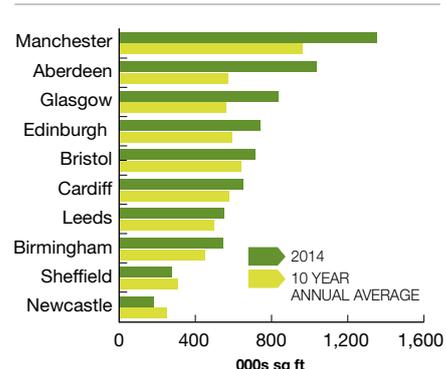
There was a wide variation in performance between the other cities however. Cardiff saw take-up almost double over the year, while Bristol enjoyed its best year of take-up since 2007. With the exception of Glasgow, Leeds and Newcastle, who had high levels of take-up the previous year, the remaining cities saw stronger demand in 2014 compared with 2013.

The diminishing Grade A supply that characterises the majority of the UK's regional office markets has continued unabated, with New and Grade A availability down 27% over the year. The situation is most acute in Birmingham, which currently has just over one year's supply of Grade A space available (including speculative developments). While Sheffield, Leeds and Glasgow have just over three years of Grade A supply. (Figure 2).

Not surprisingly given the level of take-up in Q4, active demand is slightly down on the previous quarter, but 3% up on 2013. Birmingham currently has the highest level of active requirements, at circa 600,000 sq ft.

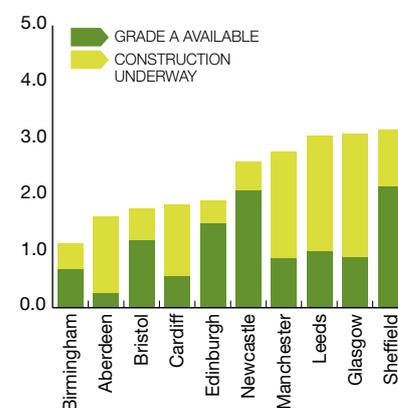
Looking ahead, with occupier confidence improving and developers responding cautiously we are likely to see continued pressure on supply for good quality space. Allowing for the imbalance prime rent levels are likely to rise in 2015 in Birmingham, Bristol, Leeds and Manchester.

FIGURE 1
2014 take-up vs ten year annual average



Source: Knight Frank Research

FIGURE 2
Years of Grade A supply



* Based on average Grade A take-up vs current availability
Source: Knight Frank Research

FIGURE 3
Prime rents and forecast (per sq ft)

	Q4 14	End 15 F	End 16 F
Aberdeen	£32.00	£32.00	£32.00
Birmingham	£28.50	£31.00	£32.50
Bristol	£28.50	£29.50	£29.50
Cardiff	£23.00	£23.00	£24.00
Edinburgh	£29.00	£29.00	£30.00
Glasgow	£29.50	£29.50	£30.00
Leeds	£25.00	£27.50	£27.50
Manchester	£32.00	£33.00	£34.00
Newcastle	£21.50	£21.50	£23.00
Sheffield	£20.00	£20.00	£22.00

Source: Knight Frank Research



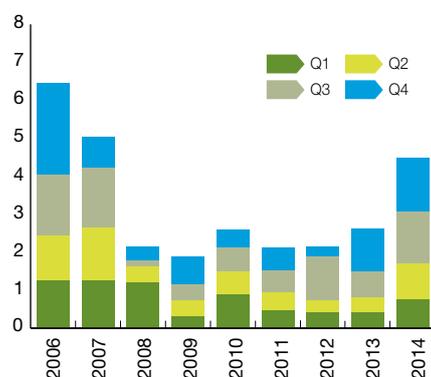
Rockspring's 69,955 sq ft Grade A "BREEAM Excellent" development at 6 Queen Street is scheduled for completion by 2016

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FIGURE 4

Regional office investment volumes (£bn)



Source: Property Data

FIGURE 5 Prime yields (%)

Reflects 10 year income

	Q4 13	Q4 14	Yield sentiment
Aberdeen	6.00	5.75	◆
Birmingham	5.75	5.25	◆
Bristol	6.00	5.50	◆
Cardiff	6.00	5.90	◆
Edinburgh	6.00	5.75	◆
Glasgow	6.00	5.75	◆
Leeds	6.00	5.75	◆
Manchester	5.75	5.25	◆
Newcastle	6.25	6.00	◆
Sheffield	6.50	6.25	◆

Source: Knight Frank Research



Largest deal across 10 regional markets in Q4 – Legal & General purchased Aberdeen International Business Park comprising 335,000 sq ft for £127 million.

Investment activity

The regional office market had an outstanding year in 2014 with the total volume of investment transactions back to pre-recession levels at a seven year record high of £4.5bn.

The final quarter saw the largest quarterly volume of transactions, boosted by a flurry of activity in December that brought the total for Q4 2014 to £1.44bn, which is more than double the 5-year quarterly average (Figure 4).

Scotland featured prominently in Q4. Following the 'No' vote and the sharp drop in oil prices, two of the largest investment transactions both in excess of £100m were recorded in Aberdeen. In November Legal and General acquired Aberdeen International Business Park for £127m at a yield of 5.75% and in October Aviva Investors purchased Marischal Square for £107m. While in December, Port Hamilton in Edinburgh was also acquired by HSBC for £105.5m, reflecting a yield of 5.1%.

Other sizeable investment transactions in Q4 were recorded in Birmingham, Manchester, Leeds and Bristol. In fact over the year 2014 as a whole Manchester proved to be most attractive regional centre with total office investment transactions breaching the £1bn investment mark.

While there is a considerable weight of money targeting office stock in core regional markets, evidence suggests that prime office yields were broadly stable in Q4, with Birmingham and Manchester continuing to command a premium over the UK's other core markets, at 5.25%, having previously moved down 50 bps in the first half of the year (Figure 5).

With regional offices forecast to be the lead performer we expect investor demand to remain strong in 2015 and to see a substantial weight of money continue to target core regional markets. Given the diminishing supply of Grade A stock available to purchase this should lead to more activity in the secondary market and trigger further speculative development.

Major regional office investment deals in Q4 2014

Date	Street	Purchaser / Vendor	Price £m	Yield %
Nov-14	Aberdeen International Business Park, Aberdeen	Legal & General Property/ Abstract Group, Aker ASA	127.00	5.75
Oct-14	Marischal Square, Aberdeen	Aviva Investors/Aberdeen City Council	107.00	NA
Dec-14	Port Hamilton, Edinburgh	HSBC (HAIL)/ Aberdeen Asset Management	105.50	5.10
Dec-14	House of Fraser, Birmingham	Legal & General / Europa Capital Partners	74.00	6.54
Dec-14	4 Hardman Square, Manchester	St Jame's Place PF	31.02	4.95
Dec-14	6 Queen Street, Leeds	Rockspring Hanover PUT/CDP Ltd	30.00	NA
Dec-14	Kings Orchard, Bristol	Aviva Investors/IVG	29.75	5.95
Dec-14	151-155 St Vincent Street, Glasgow	Aberdeen Asset Management/ Hermes REIM	27.80	6.38

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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