RESEARCH

BRISTOL OFFICES

MARKET UPDATE **H1 2014**

Occupier market

- Occupier activity strengthened during the first half of the year in line with the improving economic backdrop. Take-up in H1 amounted to nearly 300,000 sq ft (in 71 transactions), up by 37% on H2 2013's level and marking the highest half-year of take-up since 2008. Nearly 180,000 sq ft of space was taken-up during Q2, representing the highest quarterly take-up since Q2 2008.
- Despite robust take-up, there were only two Grade A transactions in H1 – Parmenion Capital acquired 6,690 sq ft at 2 College Square for their expansion, while BDO expanded into a further 5,917 sq ft at Bridgewater House. Consequently, take-up of Grade A accounted for only 5% of total take-up in H1, with the remaining 95% made up of Grade B (42%) and C space (53%).
- Professional services remained the most active sector in H1, accounting for 42% of take-up. The Finance/Banking/Insurance and TMT sector followed in second and third positions, accounting for 17% and 13% of take-up respectively.
- Active requirements amounted to around 471,000 sq ft at the end of H1. Two of the larger requirements include OVO Energy, PwC and KPMG.
- There was a notable reduction in the number of developer purchases (and enquiries) of office space for conversion to residential use during H1, suggesting that many of the best opportunities have been taken amid improving occupier market conditions.
- Continued healthy take-up in combination with limited new completions has led to a notable decline in availability. Total availability stood at 1.58m sq ft at the end of June, its lowest level since 2009, representing a vacancy rate of 9.56%.
- Driven by improved economic and property market fundamentals, speculative development continues to account for the majority of space under construction (over 80% of space is currently under construction on a speculative basis).
- We expect 177,000 sq ft of speculative space to be delivered to the market in 2015. This comprises 2 Glass Wharf (92,000 sq ft), 66 Queen Square (59,000 sq ft) and Narrow Quay House (26,000 sq ft).
- The Bristol market is gradually moving in favour of the landlord – prime headline rents will be maintained at £27.50 per sq ft over the next 12 months although incentives continue to harden.

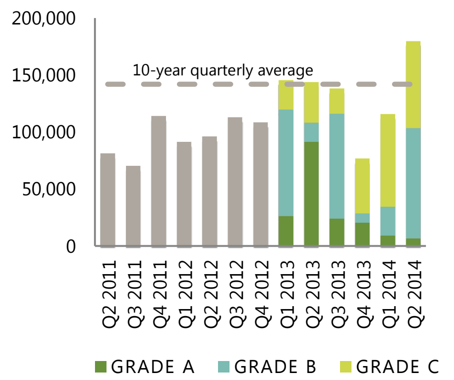
Agent's view

The loss of office floorspace to alternative uses (residential and student accommodation) is expected to diminish sharply as conversion opportunities become fewer in number as the office market improves.

Continued healthy demand is projected to lead to strong take-up levels in H2 2014. As a result, occupier incentives will diminish. Meanwhile, Grade B and C stock is expected to see some rental growth later in the year.

FIGURE 1

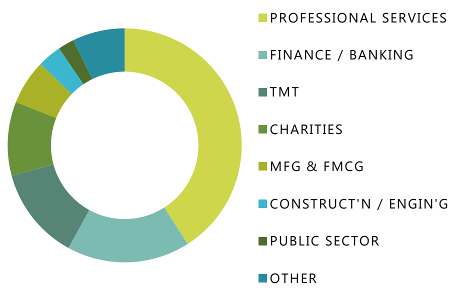
City centre take-up by grade (sq ft)



Source: Knight Frank LLP

FIGURE 2

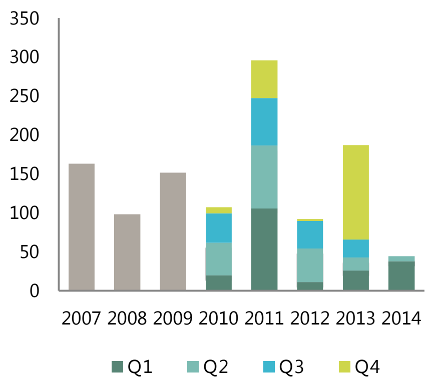
H1 2014 take-up by sector



Source: Knight Frank LLP

Bridgewater House - 111,000 sq ft of Grade A accommodation recently let to BDO and Barclays.

FIGURE 3
Bristol offices investment turnover (£m)



Source: Knight Frank LLP, Property Data

In February 2014, Knight Frank sold Corum 2 to Ashville Group on behalf of a private investor.

Investment market

- Investment activity in Bristol slowed in H1 2014 following a strong second half of 2013. Total H1 volume stood at £45m, declining from £147m recorded during H2 2013. However, the level of investment is broadly in line with the volumes recorded during the same period last year. Lower volumes this year to date are largely explained by the lack of supply in the market rather than any reduction of investor appetite, which remains strong.

- Improving market fundamentals and strong investor demand have led to yield compression for both prime and good quality secondary stock across the South West. Yields hardened by 75 bps over the last 12 months, pushing Bristol's prime office yield (for a 15-year lease) down to 5.50% at the end of H1 – its lowest level since Q4 2007.

- Due to the lack of stock available in the Bristol market, there were few notable transactions in H1 2014. The largest prime office investment was the purchase of The Paragon by Lothbury Investment Management for £29.45m, reflecting a net initial yield of 5.93% in March 2014. The property, built in 2009, comprises 75,653 sq ft of Grade A office space and is let to Ernst & Young, Thring Townsend, Mercer and Tesco Stores Ltd (6 year WAULT).

- We have also started to see stronger appetite for secondary / tertiary city centre stock from developers who are seeking change of use from offices to residential via Permitted Development Rights (PDR). For example, Marlborough House was purchased by Ropemaker Properties Ltd for £4.24m in March 2014, reflecting a net initial yield of 15.37%.

- Activity in the out-of-town office investment market has also been restricted by the lack of buying opportunities. Parkway North 1500 & 1600 was purchased by Dominvs Group for £3,300,000, reflecting a net initial yield of 9.50% in June 2014. The two buildings were let to three tenants with a WAULT of 4 years. Aztec West 2630 is also believed to be under offer at circa 7.00% at the time of writing (4.5 years unexpired).

TABLE 1
Selected investment transactions in H1 2014

Date	Address	Purchaser / Vendor	Price	NIY(%)
Feb 14	9-12 St James Parade	Kames Capital / Sanderling Estates	£4.60m	11.90
Mar 14	The Paragon, Victoria Street	Lothbury Property Trust / Invesco Real Estate	£29.50m	5.93
Apr 14	Marlborough House	Ropemaker Properties / LaSalle IM	£4.24m	15.37
June 14	Parkway North 1500 & 1600	Dominvs Group / Devonshire Metro Ltd	£3.30m	9.50

Source: Knight Frank LLP

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