RESEARCH

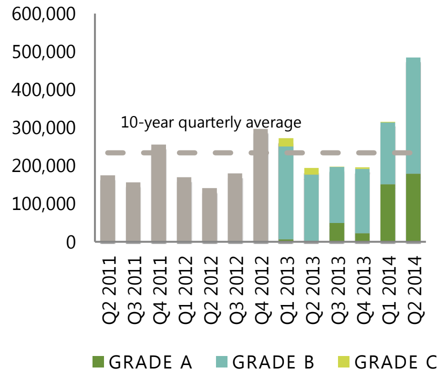
MANCHESTER OFFICES

MARKET UPDATE **H1 2014**

Occupier market

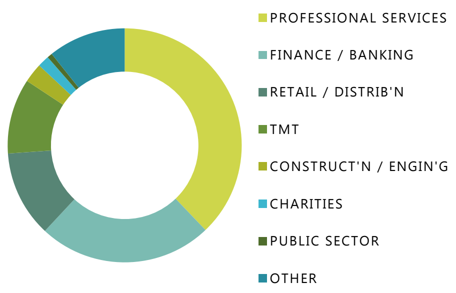
- In line with the improving economic backdrop, occupier demand was strong throughout the first half of 2014. Following 315,000 sq ft of take-up in Q1, 484,000 sq ft of space was transacted during Q2, the highest quarterly level since Q3 2010. With circa 800,000 sq ft of activity already this year, total take-up for 2014 will comfortably surpass the 10-year annual average.
- H1 saw a total of 173 deals in the city centre, of which 13 transactions involved units larger than 10,000 sq ft. The city saw three deals in excess of 50,000 sq ft. H1's largest transaction by far was Slater & Gordon's lease of 104,000 sq ft at 58 Mosely Street. The second largest deal saw Barclays committing to 82,000 sq ft at Piccadilly Place, while elsewhere Trader Media and Ford Capital leased 85,000 sq ft at First Street.
- 41% of take-up in H1 was made up of Grade A accommodation, while Grade B accounted for the remaining take-up.
- Similarly to H2 2013, Professional Services continued to dominate the Manchester occupational market, accounting for around 38% of total take-up. This was followed by Finance/Banking and Retail/Distribution which accounted for 24% and 12% of activity respectively.
- Meanwhile, active requirements reached 600,000 sq ft in Q2, unchanged over Q1's level but down from 650,000 sq ft at the end of 2013. There are a number of large requirements that are yet to be satisfied including PwC, DLA and E&Y.
- Driven by strong occupier activity and an absence of any significant completions over the last year, Grade A supply was further eroded during H1. Grade A availability currently stands at around 230,000 sq ft, reflecting a vacancy rate of around 13.7%. This is down from 370,000 sq ft a year ago.
- Consequently, occupiers are increasingly being left with no other option but to consider pre-let solutions. However, with improving economic fundamentals, there is the potential for speculative development to return to the market.
- Following a 3% increase in Q1, prime headline rents remained stable at £31.00 per sq ft in Q2. We expect rents to rise to around £32.00 per sq ft over the next 12 months driven by the continued shortage of occupier choice.

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

Agent's view

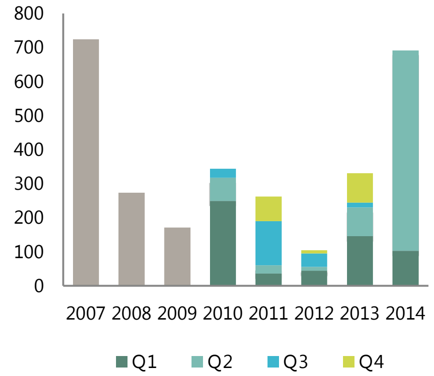
Prime headline rents are expected to increase in the short to medium term. In addition, incentive packages have reduced over the last year and, consequently, landlords are starting to benefit from higher net effective rents.

While further large corporate activity is expected, we anticipate the majority of activity to remain in the sub 5,000 sq ft range.

Rising rents coupled with the supply shortage in the city means that it is now only a matter of time before speculative development fully returns to the market.

Trader Media and Ford Capital leased a total of 85,000 sq ft at First Street in H1.

FIGURE 3
Manchester offices investment turnover (£m)



Source: Knight Frank LLP, Property Data

In May 2014, Cording Danmerc purchased Bridgewater House. Knight Frank acquired the property.

Investment market

- The revival of investor sentiment started in H2 2013 and continued into 2014. Strong demand for prime North West offices, mainly driven by the UK institutions, has translated into strong investment activity. H1 2014 volumes reached £691m, more than double the amount invested in the entire 2013. In H1, Manchester dominated the UK regional office market by accounting for 43% of the total investment and 22% of all deals in the ten regional cities we cover in our analysis.
- The vast majority of H1's investment volumes came in the second quarter, a period which saw two major lot-sizes change hands. M&G purchased the two RBS occupied buildings in Spinningfields for c.£320m (reflecting 4.80% NIY) and Schroders's purchased City Tower from Bruntwood for £132m (reflecting 7.00% NIY). Although the two deals dominated H1 turnover, the period saw a flurry of deals across the city, including several off market transactions (Table 1).
- Landlords, in particular local investors, property companies and private equity investors, are now capitalising on the improved market sentiment and depth of demand, and are choosing to bring their assets to the market. As a result, there are a number of buildings currently available to purchase, including Chancery Place and Ship Canal House.
- As with the UK's other core regional markets, strong investor demand for Manchester offices stock has prompted further yield compression through the first half of 2014. Prime office yields have hardened by 100 basis points since Q2 2013 to stand at c.5.25%, their lowest level since Q4 2007.
- With the demand for stock in the city outstripping the supply of investment product, we expect pricing to remain under pressure during Q3, with greater competition emerging for good quality secondary assets.

TABLE 1
Selected investment transactions in H1 2014

Date	Address	Purchaser / Vendor	Price	NIY(%)
Jun 14	Spinningfields	M&G Real Estate / Ernst & Young	£320.00m	4.80
May 14	City Tower, Piccadilly	Schroder UK Property Fund / Bruntwood Estates Ltd	£132.00m	7.00
Apr 14	Royal Exchange	Starwood Capital / M&G Real Estate	£45.00m	6.25
May 14	Bridgewater House*	Cording Danmerc / Bruntwood	Conf.	Conf.
Jan 14	Sunlight House	Scottish Widows / Aviva Investors	£34.50m	6.30
Mar 14	Churchgate / Lee House	Helical Bar Plc / Angelo, Gordon & Co	£34.00m	5.70
Jun 14	Direct Line House, Quay Street, 17*	Standard Life PAIF / Aviva Investors	£24.28m	5.62
Jun 14	St James's House, Charlotte Street, 7	BA Pension Fund / Stephen Elias	£20.90m	6.20

Source: Knight Frank LLP; Note: *Knight Frank acquired these buildings

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