RESEARCH

Knight Frank

NEWCASTLE OFFICES

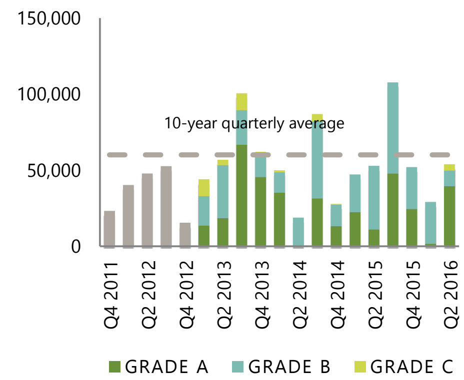
MARKET UPDATE **H1 2016**

Occupier market

- Much of H1 was overshadowed by the run-up to the EU referendum which took place in June 2016. While the full impact of the outcome to exit the EU has yet to be fully captured, take-up data for H1 does suggest that uncertainty may have been a factor behind the fall in take-up within the city.
- Total take-up reached 83,212 sq ft, which represents a fall of 42% on H2 2015 and signifies the lowest half-year take-up since H1 2014.
- However, activity did show to have improved between quarters, with take-up in Q2 rising by 84% on Q1. This provides some room for optimism for H2, which typically fare better than H1.
- Professional Services were the standout occupier group in H1, accounting for 58% of total take-up. This was largely due to the deal involving Convergys, which took 35,000 sq ft at 'The Rocket, Stephenson Quarter' for an undisclosed rent in Q2. Knight Frank advised Convergys on the deal.
- Grade A office space were most favourable amongst occupiers, accounting for 50% of total take-up. Interestingly, over 90% of all Grade A office deals in H1 took place in Q2.
- The strong appetite for Grade A office space within the city centre continues to re-iterate the need for speculative office developments. As of Q2, active requirement totalled 400,000 sq ft, which is double the level of available Grade A office stock.
- With no new schemes under construction, competition for limited Grade A office stock is likely to rise and lead to upward pressure on rents, which have been relatively stable over the last five years.
- As a result of the current supply and demand imbalance, there has been a number of refurbishments starts this quarter, which could serve to be a short term solution to the current absence of new office developments.
- Prime headline office rents remained at £22 per sq ft in Q2 2016 following a marginal increase in Q4 2015. However, DAC Beachcroft, which already occupies space in Wellbar Central, did take an additional 4,507 sq ft at £23 per sq ft.
- Nonetheless, occupiers will be reminded that Newcastle city centre remains one of the most cost-effective office locations amongst other regional cities.

FIGURE 1

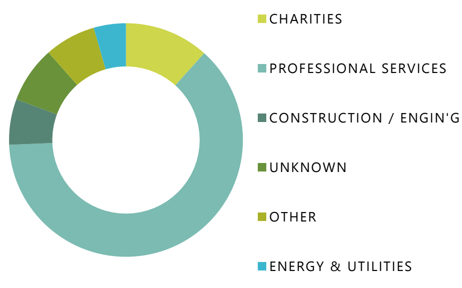
City centre take-up by grade (sq ft)



Source: Knight Frank LLP

FIGURE 2

H1 2016 take-up by sector



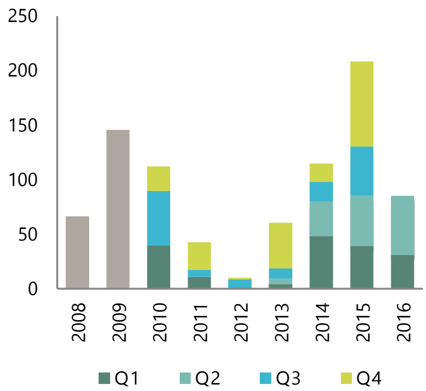
Source: Knight Frank LLP

Agent's view

While take-up in the city centre did represent a fall on H2 2015, it is important to note that this was on the back of one of the strongest half-year periods recorded in the city. In addition, uncertainty formed by the wider eco-political environment had undoubtedly been a factor behind the slow in take-up activity. The recent growth in prime office headline rents does reflect the highly competitive occupier market and we expect much of the appetite to remain while the market awaits the completion of refurbished space and new office schemes.

In Q2, Convergys took 35,000 sq ft at 'The Rocket'

FIGURE 3
Newcastle offices investment turnover (£m)



Source: Knight Frank LLP, Property Data

Earl Grey House, a multi-let office and leisure scheme, was sold for £11.88m to Regional Office PUT in February 2016

Investment market

- Investment volumes in H1 totalled £86m, which is relatively consistent with the levels recorded over the last two years for the same period (2014 - £80m, 2015 - £85m)
- Transaction volumes in Q2 were considerably higher than Q1, mainly due to the deal involving Lime Property Fund, which purchased 100,000 sq ft office block which forms part of Newcastle University Business School for £50m. More importantly, this deal represents the second highest office transaction ever recorded in the city.
- Heavily weighted to the above deal, UK institutions accounted for 72% of the total investment volumes in H1, while property companies represented the remaining 28%.
- Prime office yields for Q2 remained unchanged at 6.00% for the tenth consecutive quarter. However, with the uncertainty surrounding the 'Brexit' likely to have a dampening impact on investor sentiment and on asset prices, prime office yields could soften in the foreseeable future.
- Based on the latest results, it is difficult to measure the real implication of the UK's decision to exit the EU. Given that investment volumes have remained relatively consistent with previous periods, there is limited evidence to suggest that the EU referendum has had a negative impact on investor sentiment in H1.
- As a result, further judgement should be reserved for H2, which is anticipated to provide a better indication on the initial effects of the 'Brexit'.

TABLE 1
Selected investment transactions in H1 2016

Date	Address	Purchaser / Vendor	Price	NIY
Jun-16	Newcastle University Business School	Lime Property Fund / Undisclosed	£50.00m	N/A
May-16	Balliol Business Park	Metnor Properties / Kennedy Wilson Europe	£2.25m	N/A
Apr-16	Newcastle Business Park	Canal & River Trust / RPU Group	£1.92m	6.00%
Feb-16	Grey Street, 75-85	Regional Office PUT / Matterhorn Capital Ltd	£11.88m	7.61%
Jan-16	Citygate	EPIC Reit / Hanro Ltd	£18.95m	6.57%

Source: Knight Frank LLP

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