

NEWCASTLE OFFICES

MARKET UPDATE H1 2014

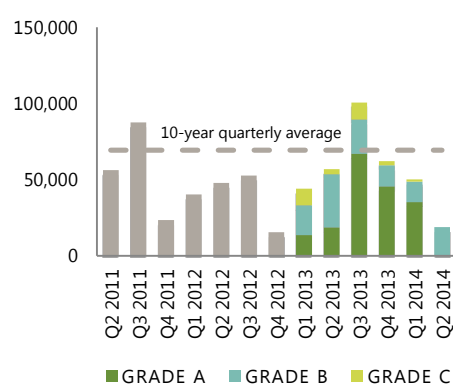
Occupier market

- Despite a definite sense that confidence among local occupiers is improving, city centre take-up was disappointing in Q2, with eight deals totalling 17,805 sq ft (Figure 1). The only deal in excess of 5,000 sq ft was Omlis's 5,074 sq ft at Tyne House. Activity was more healthy in the first quarter, however, where the figures were boosted by Teleperformance's 28,300 sq ft lease at Baltic Place, 2014's largest in-town Grade A transaction to date.
- It's fair to say that the out of town market has fared significantly better of late. Out of town take-up reached 168,000 sq ft in H1, the majority of which transacted in Q2. Q2 saw two deals in excess of 25,000 sq ft, the largest of which was Cofely Workplace's 26,996 sq ft acquisition of Q3 at Quorum Business Park. Elsewhere in the region another key deal was Parseq's 32,104 sq ft lease of One Victory Way unit at Doxford International Business Park.
- Total active demand presently stands at c. 200,000 sq ft. While this is down 37% from its position 12 months ago, the period was characterised by a number of large requirements which culminated in a significant spike in activity in Q3 2013. There are currently a good number of active requirements searching for over 10,000 sq ft, several of which are focusing on the city centre, and a number looking at Business Park locations.
- Evidence suggests that prime headline office rents in the city centre have remained static, at £21.50 per sq ft. The net effective rent equates to c. £17.50 per sq ft when rent free incentives are taken into account.
- As at end Q2, Grade A supply in the city centre – including Gateshead Quays - stood at 217,000 sq ft, down 11% year on year. Choice is now relatively restricted, and it could be argued that this may stymie levels of Grade A take-up moving forward.
- Stephenson Quarter remains the sole development which is currently under construction in the city centre. The prominent mixed-use development (inc. 35,000 sq ft of office space) is attracting a good level of interest from a range of occupiers. Other than the above, no city centre schemes are expected to commence construction during the remainder of 2014, and this is sure to put a continuing squeeze on Grade A availability. However, as market confidence continues to grow, many developers are starting to progress their plans for future schemes.

Agent's view

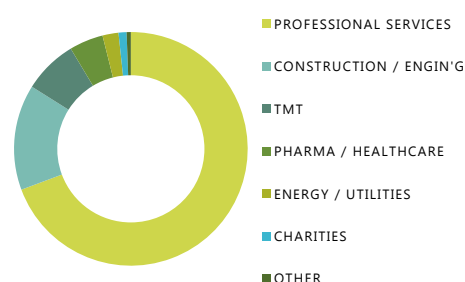
Looking ahead, the lack of Grade A stock in the city centre continues to cause concern, with just a small number of large Grade A floorplate options. This situation is likely to be exacerbated as market confidence improves and additional requirements come into the market. The market is also continuing to lose existing and future office development sites to residential and student accommodation, which may add to the challenge going forward. That said, the restriction of Grade A supply does bode well for an increase in headline rental levels, and we expect prime headlines rents to rise to £23.00 per sq ft during 2015.

FIGURE 1
City centre take-up by grade (sq ft)



Source: Knight Frank LLP

FIGURE 2
H1 2014 take-up by sector

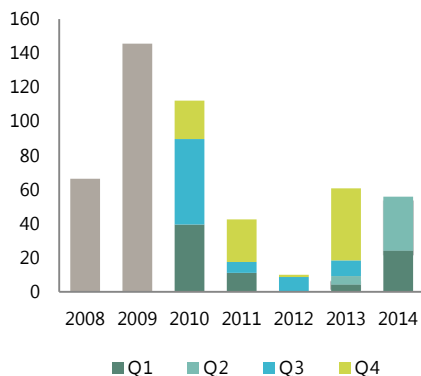


Source: Knight Frank LLP



FIGURE 3

Newcastle offices investment turnover (£m)



Source: Knight Frank LLP, Property Data



M&G Real Estate purchased 52 - 60 Grey Street for £3.865m from Mayfair Capital IM which reflected a net initial yield of 6.96%. Knight Frank sold the property, which attracted 10 bids prior to selling.

Investment market

- Increased demand for yield and value has prompted a revival in appetite for regional city centre office stock, particularly among the UK Institutions. While the core regional centres were the initial focus of regional demand 12 months ago, positive sentiment has spread to the UK's other major city centres more recently.
- This is clearly evident in Newcastle, which has seen a number of large lot-sizes change hands during the course of H1 2014. Despite being at the half-way point of the year, turnover for 2014 has already almost matched the total seen in 2013 (Figure 3).
- Evidence from recent transactional activity and general sentiment in the market suggests that prime, long-income yields in Newcastle stand at c. 6.00%, unchanged during Q2, but 25bps lower than at the start of the year.
- The largest deal in H1 was Standard Life's purchase of Central Square South from Parabola Estates. The modern office building, located to the rear of Newcastle's Central Station, sold for £21.5m, reflecting a net initial yield of 7.61% and carried a weighted average unexpired lease term of 4.5 years.
- This further emphasises the demand from UK Institutions for realistically priced regional assets. St James' Gate was also brought to the market during Q2 – a modern city centre office constructed in 2004 and let to Baker Tilly and Watson Burton with a WAULT of nine years. The vendor is seeking a purchase price of £17.44m reflecting a net initial yield of 7.50%.
- Both the out-of-town and secondary office investment markets have seen improvement although this has come from a low base. Evidence of yields hardening across the occupational markets has led to transactions taking place where previously stock was not trading. One notable example was the £17.5m sale of the Tesco Bank premises at Quorum Business Park which reflected a net initial yield of 8.01%.
- Several other out-of-town office investments have been introduced to the market post Q2, and it will be an interesting gauge of whether the out-of-town investment market continues to move in the right direction.

TABLE 1

Selected investment transactions in H1 2014

Date	Address	Purchaser / Vendor	Price	NIY(%)
Feb 14	Central Square South	Standard Life / Parabola Estates	£21.50m	7.61
Apr 14	Quorum Business Park, Q8	Undisclosed / Tritax Assets Ltd	£17.50m	8.10
Jan 14	Cobalt Business Park, 14	Standard Life / Merchant Place Dev Ltd	£10.35m	6.74
Apr 14	Grey Street, 52-60	M&G Property Fund / Mayfair Capital IM Ltd	£3.87m	6.96

Source: Knight Frank LLP



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