FOREWORD

Whilst the last 12 months have been dominated by surprising election results, the regional real estate market has to date, held up well.

The only reaction in real estate terms was the period immediately post BREXIT, when some redemption-led distress was experienced from the major retail funds.

On the ground, the occupational and investment markets have proved largely resilient. Whether the economic uncertainty will start to influence occupier decision-making moving forward remains to be seen. Post the financial crisis, property has had a strong role and we see no sign of this ebbing. In a world where it has been difficult to find returns, property remains a relatively secure opportunity. Any recent hesitancy is about the right time to buy as opposed to any change in sentiment towards real estate.

Last year, we highlighted significant changes in location and type of office space that has seen demand by tenants. This has continued and is driven by other than HR managers calling “the war for talent”. Real estate decisions are increasingly being based on staff recruitment and retention as opposed to a decision based purely on costs. This is impacting on location, building appearance and how the space can be fitted out for employees. This is resulting in the role of the HR Director become far more important in the decision-making process. Activity, amenity and culture are now “strong pull factors” in the location choice of occupiers.

The city status.

To achieve its desired global city status.

MATT PHILLIPS

Managing Partner,

Knight Frank Cardiff

MANAGING PARTNER

“Cardiff must continue to embrace change in order to achieve its desired global city status.”

The rate of unemployment (%)

FIGURE 1

The rate of unemployment (%)

Source: ONS

OCCUPATIONAL MARKET

Occupier activity has remained brisk in 2016 supporting a high level of take-up. This demand for the prime office space has seen a new benchmark rent set for the city.

Take-up and demand

Overall leasing levels have remained on an upward trend in 2016 with take-up for the year reaching 485,456 sq ft at the end of Q3. Notably, this total is already above the 10-year annual average for the city and ahead of the equivalent point in 2015. The availability of newly developed stock at Central Square and Capital Quarter, in particular, has fuelled occupier interest. Driven by supply, Grade A take up in 2016 accounts for 28% of the transactions and although less than in 2015, this is much higher than the previous two years (2013 & 2014). The city centre remains the focus for the majority of occupiers with 66% of space transacted in the central business district.

Key transactions

The largest deal of 2016 to date has been the acquisition of 71,436 sq ft at One Central Square by MotoNovo Finance. The financial services company took the lower 5 floors of the building relocating to Central Square by MotoNovo Finance. The tenant agreed to expand its capacity.

One Central Square

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Wales at JR Smarts Number 2 Capital Quarter taking a lease of 12,505 sq ft in Q1. The largest Grade B deal of 2016 was the letting of four floors at Brunel House to HMRC. The government occupier committed to a total of 54,587 sq ft as the first part of a major government consolidation in the city centre. Cardiff University leased 25,900 sq ft over three floors in Friary House. The tenant agreed to carry out a major fit out of the space to expand its capacity.

Availability

As at November 2016, Grade A availability had risen to 185,000 sq ft with 137,000 sq ft in the city centre. Although this is an annual rise of around 70%, the current level of available Grade A space equates to just over one year’s supply of Grade A take-up. New Grade A supply is limited to the space in Number 2 Capital Quarter (18,190 sq ft) and One Central Square (4,000 sq ft). The remainder comprises high quality refurbished space at 2 Kingsway (40,964 sq ft), 2 Callaghan Square (21,851 sq ft) and St Patticks House (51,875 sq ft) currently being marketed.

The development pipeline remains strong with speculative developments underway at Number 3 Capital Quarter (74,000 sq ft), One Canal Parade (54,000 sq ft) and Two Central Square (48,000 sq ft), alongside the 150,000 sq ft pre-let BBC Wales Headquarters. It is understood that 2 major pre-lets will shortly be announced in relation to 2 Central Square.

Headline rents

The recent lettings at Central Square have seen prime headline rents increase for the first time since 2012, from the £22.00 per sq ft achieved at 3 Assembly Square, Cardiff Waterside. The prime headline rent now stands at £25.00 per sq ft and current forecasts indicate that prime rents will rise to £26.00 per sq ft by the end of 2017 as more new developments complete.

Summary

Over the past 2 years, development has increased significantly, with the current pipeline the highest of the past 10 years. Alongside amenity and connectivity improvement, a high calibre office environment forms an essential part of the offer that major occupiers are using to attract and retain talent. As such, in tandem with new development, the market for refurbishment is flourishing. The appeal of Cardiff continues to grow and on-going developments and future projects will further strengthen this position.

Key leasing transactions 2016

<table>
<thead>
<tr>
<th>Building</th>
<th>Tenant</th>
<th>Sq ft</th>
<th>Rent</th>
<th>Date</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number 1 Capital Quarter</td>
<td>WSP</td>
<td>19,658</td>
<td>£19.25</td>
<td>Q1</td>
<td>A</td>
</tr>
<tr>
<td>Number 2 Capital Quarter</td>
<td>Opus Energy Limited</td>
<td>12,505</td>
<td>£20.00</td>
<td>Q1</td>
<td>A</td>
</tr>
<tr>
<td>Priory House</td>
<td>Cardiff University</td>
<td>29,000</td>
<td>N/A</td>
<td>Q2</td>
<td>B</td>
</tr>
<tr>
<td>Brunel House</td>
<td>HM Revenue &amp; Customs</td>
<td>54,587</td>
<td>N/A</td>
<td>Q2</td>
<td>B</td>
</tr>
<tr>
<td>One Central Square</td>
<td>S3 Advertising</td>
<td>6,004</td>
<td>£25.00</td>
<td>Q2</td>
<td>A</td>
</tr>
<tr>
<td>One Central Square</td>
<td>MotoNovo Finance</td>
<td>71,436</td>
<td>£22.00</td>
<td>Q3</td>
<td>A</td>
</tr>
<tr>
<td>One Central Square</td>
<td>Julian Hodge Bank</td>
<td>16,663</td>
<td>£22.00</td>
<td>Q3</td>
<td>A</td>
</tr>
</tbody>
</table>

Source: Knight Frank Research

FIGURE 2

Prime rent as at Q3 2016 (£ per sq ft)

Source: Knight Frank Research
DEVELOPING A CAPITAL CITY

Enhance the Skill Base
Cardiff’s ambition of being a leading city for economic and cultural development is fully intrinsically linked to the availability of a skilled and educated workforce. As the global economy becomes more knowledge-based, in order to sustain a competitive advantage, Cardiff needs to ensure that it is continually attracting and retaining top talent. The city needs to foster a climate which will support Cardiff as a desirable choice for future graduates.

Deliver the Cardiff Capital Region
For the Cardiff City Region to be a leading economic and cultural hub, targeted investment in key industries and infrastructure is required. Cardiff and the wider region, aligned to key needs of households and businesses, Transporthub, businesses and investors; together with robust economic growth and effective delivery of social care, will create a strong and diverse economic environment for the region.

Grow Office, Retail & Leisure Facilities
The provision of high quality office accommodation is important but it is necessary to support businesses and employers that want to expand and grow their operations. Cardiff is already a leading UK office market with headline rents rising to £22.00 per sq ft. in 2015.

Establish Cardiff as a UK Media & Creative Hub
The creative industries are the fastest growing sector globally. Cardiff is an established home for independent TV production companies and a major centre for creative industry activity in the UK. Cardiff City Council is currently supporting the establishment of a Creative Hub to provide the appropriate infrastructure in addition to the right type of facilities. This city needs to embrace TMT firms more to establish a major centre for creative work and business support. Success in this goal will establish Cardiff as a major centre for creative industry activity in the UK.

Conclusion
Cardiff’s achievements in the development of a capital city are reflected in its strong economy and enhanced quality of life. The city is a major player on the international stage with a strong and diversified economy. Cardiff has progressive policies and effective delivery of social care, which will ensure the Cardiff region is the leading region in the UK.

SHAPING THE FUTURE

2016
N.1 Capital Quarter sold by Brookfield for £21 million while No 2 Capital Quarter is completed by JR Smart. Headline rents finally move to £22.00 per sq ft.

2015
Cardiff return for the future: development of the Cardiff Capital Region and Cardiff Council through the Cardiff Square redevelopment. The redeveloped Cardiff Square includes a 65,000sq ft new leisure development in the Carrefour store.

2014
Aberdare Road 75 sells for £21.5 million to Schroders

2013
All smart companies in the development of the 1 Capital Quarter, with headline rents to £20.00 per sq ft.

2012
Cardiff city centre reaches £20 million ceiling. Callaghan Square, 1 Capital Quarter, and St Williams House complete the development of No 3 Callaghan Square. The combined net rental value in City Centre is £30 million (6.14% net initial yield).

2010
BMC business village completed

2008
Steel Pension Fund investment to British Steel Pension Fund

2007
Savills for £25 million to Kuwaiti investor for £46 million (4.75% net initial yield).

2006
J.R. Smart commences construction of No 1 Capital Quarter

We stand on the EDGE and must not fail
Investment market

In a year dominated by politics rather than property deals, it is unsurprising that transactional activity in 2016 has been more subdued when compared to 2015.

Total office investment sales recorded over £100m in Q4 2016 according to Knight Frank. Although this is 15% less than the full year total for 2015, if measured against the same period historically the 2016 total is 40% below.

The acquisition of 3 & 4 Callaghan Square for £32.1m by Deutsche Asset & Wealth Management is the largest transaction to complete in Q4 2016. The properties are located in Cardiff’s central business district and current tenants include British Gas, the British Transport Police Authority and Zurich Insurance. This is one of four transactions over £10m to complete in 2016.

The sale of No 1 Capital Quarter to an overseas investor for circa £21.75m is the second largest transaction to complete. The £18.1m acquisition of Churchill House to Oval Real Estate. Notably, at the same point in 2015 only one transaction over £10m to complete.

The key investment transactions 2016

<table>
<thead>
<tr>
<th>Address</th>
<th>Price £m</th>
<th>Purchaser</th>
<th>Yield %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cardiff Square 3 &amp; 4</td>
<td>£31.10m</td>
<td>Deutsche Asset &amp; Wealth</td>
<td>6.05</td>
</tr>
<tr>
<td>Capital Quarters, 1</td>
<td>£21.75m</td>
<td>Undisclosed</td>
<td>6.65</td>
</tr>
<tr>
<td>One Kingsway</td>
<td>£18.14m</td>
<td>Cheam Capital</td>
<td>5.38</td>
</tr>
<tr>
<td>2-3 Charlotte Square</td>
<td>£13.00m</td>
<td>Real Estate</td>
<td>5.30</td>
</tr>
</tbody>
</table>

Source: Knight Frank Research

In doing so, Cardiff intelligently, is embracing a city that is starting to deliver results, but it is evident that further work is required as Europe and the rest of the UK are now established. The acceleration of the rail links set to decrease journey times to London, which is positive, although the road and rail infrastructure in the city remains underdeveloped. The rail metro system and rail link would be a significant step if fully implemented.

Landlords with DIF and beyond, the outlook for this investment market in Cardiff is promising. Following a dip in sentiment before and after the EU referendum, confidence is returning buoyed by the strength of the occupational and development return.

Driving the shifts in purchaser profile is the globalisation of capital, with equity increasingly focused toward overseas investors. Large scale target markets leading the way in London, Paris, Sydney and New York are the top targets for overseas investors. Strategic opportunities in both the retail and leisure offering alongside industrial and logistics assets are continuing to remain strong.

The properties are located in Cardiff employing around 1,700 TMT businesses of the digital GVA contribution to the UK economy. The TMT sector is now worth £81bn or 5% of GDP. Firms from a Technology, Media and Telecom (TMT) background are certainly more attuned to an audience in Cardiff. Moving away from its industrial past and status as a core for public sector occupiers, facilities such as Techniquest, Wales-CDL, Knotty&Tide and Goldfinch alongside Cardiff’s business technology parks and the BBC Drama Village, Port Teigr provide expertise and an environment that encourages co-working, facilities such as Tramshed Tech, Techniquest, the University of Wales-CDL, Knotty&Tide and Goldfinch alongside Cardiff’s business technology parks and the BBC Drama Village, Port Teigr.

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Cardiff will continue to attract strong interest, particularly for prime assets. Cardiff will remain more challenging given a weaker return expectations are high meaning particularly lot sizes in excess of £10m. The market for secondary assets may remain more challenging given a weaker appetite to risk. However, increasing amount of US private equity continues to target opportunities in this spectrum, particularly for sizes in excess of £10m.

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