

# REGIONAL OFFICES

## OCCUPIER & INVESTMENT MARKET SUMMARY Q2 2015

The UK economy strengthened during the second quarter, providing a solid economic backdrop for the UK's key regional office markets. Official figures show GDP growth of 0.7% in Q2, up from 0.4% in Q1, bringing the annual rate of growth to 2.6%. Growth in Q2 was mainly driven by the service sector at 0.7%, and a one per cent growth in industrial production.

Looking ahead to the second half of 2015, we expect to see the economy continue expanding broadly in line with current growth and the OBR's forecast of 2.4% GDP growth in 2015. Markit's latest UK PMI services index scores also sit comfortably above the 50 mark that divides growth and contraction, indicating strong occupational demand in the period ahead.

### Occupier markets

Regional offices saw a surge in occupier demand in the second quarter. One other remarkable feature of Q2 has been the increase in pre-letting activity – which has boosted take-up of New and Grade A space.

The ten regional cities monitored saw combined take-up of 2.08m sq ft in Q2, 51% ahead of Q1's total and 49% above the five-year quarterly average.

Take-up in Q2 rose across all the city centres monitored, with the exception of Glasgow – where there is an oversupply of Grade B space for which there is limited demand.

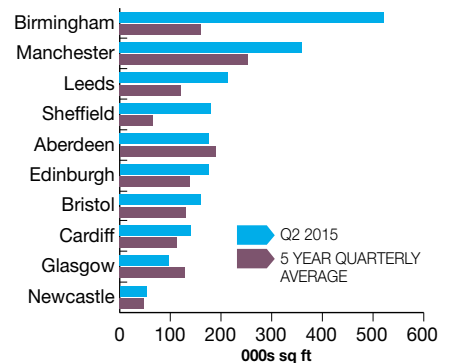
Birmingham was the clear stand out performer in Q2. Total office take-up in Birmingham city centre rose four-fold from 129,403 sq ft in Q1 up to 521,136 sq ft in Q2, boosted by a number of large transactions, the most significant of them being the 212,000 sq ft pre-let to HSBC at Arena Central. Manchester also made a significant contribution to the Q2 total with city centre office take-up of 359,829 sq ft in Q2.

The increase in pre-letting activity has impacted on New and Grade A availability, the situation is most acute in Birmingham, which currently has just over one year's supply of Grade A take-up left. At the end of Q2 New and Grade A availability stood at 2.2 m sq ft, down 17% over the year.

Active requirements across the ten cities combined currently stands at 4.4m sq ft. Birmingham has the highest level at circa 945,000 sq ft.

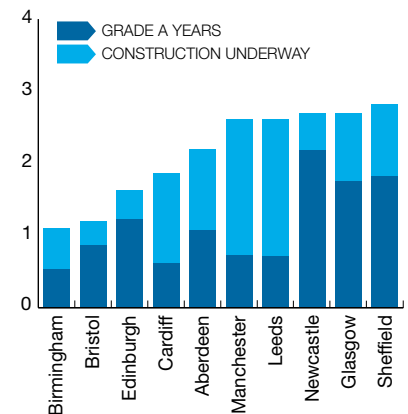
Following prime headline rental increases in Birmingham and Leeds in Q1, Edinburgh was the one market to see growth in Q2 – rising from £28.00 to £29.00 per sq ft. We expect rental growth to spread to the other markets over the next 18 months (Figure 3).

FIGURE 1  
Q2 2015 take-up vs five year quarterly average



Source: Knight Frank Research

FIGURE 2  
Years of Grade A supply



\* Based on average Grade A take-up vs current availability  
Source: Knight Frank Research

FIGURE 3  
Prime rents and forecast (per sq ft)

	Q2 15	End 15 F	End 16 F
Aberdeen	£32.00	£32.00	£32.00
Birmingham	£30.00	£31.00	£33.50
Bristol	£28.50	£29.50	£31.00
Cardiff	£22.00	£23.00	£24.00
Edinburgh	£29.00	£30.00	£32.00
Glasgow	£29.50	£29.50	£30.00
Leeds	£26.00	£27.50	£27.50
Manchester	£32.00	£33.75	£34.75
Newcastle	£21.50	£22.00	£23.00
Sheffield	£20.00	£22.00	£22.00

Source: Knight Frank Research

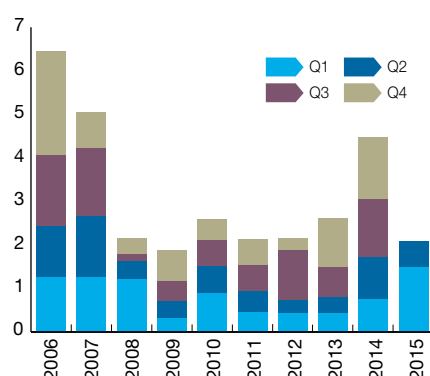


HSBC's 212,000 sq ft pre-let at Two Arena Central, boosted take-up in Birmingham in Q2.

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FIGURE 4  
Regional office investment volumes (£bn)



Source: Property Data

FIGURE 5 Prime yields (%)  
Reflects 10 year income

	Q2 14	Q2 15	Yield sentiment
Aberdeen	5.75	6.25	↕
Birmingham	5.25	5.00	▼
Bristol	5.50	5.25	▼
Cardiff	5.90	5.75	▼
Edinburgh	5.75	5.50	▼
Glasgow	5.75	5.50	▼
Leeds	5.75	5.25	▼
Manchester	5.25	5.00	▼
Newcastle	6.00	6.00	▼
Sheffield	6.75	6.75	▼

Source: Knight Frank Research



Knight Frank acquired 66 Queen Street, Bristol, on behalf of Aviva Investors in June 2015 for £32.7m

## Investment activity

Despite strong occupier demand, the investment market in Q2 was relatively subdued with the total volume of transactions down to £0.6bn. However, this follows a strong Q1, taking the total volume for H1 2015 to £2.09bn, which is the strongest first half since 2007 (Figure 4).

Bristol, Manchester and Birmingham were the clear focus of investment activity in Q2, accounting for over half of total investment turnover. Bristol in particular saw some sizeable transactions, including the off-market purchase of Templeback by Orchard Street Investment Management in June 2015 for £58.5m, reflecting a net initial yield of 5.34%, and Aviva Investors' acquisition of 66 Queen Square for £32.7m, at a net initial yield of 4.94%.

There was a notable lack of activity in Scotland's main markets in Q2, though this differed from city to city: Aberdeen saw just one investment sale transacted during the quarter, while investment activity slowed to £9.5m in Edinburgh in Q2, Glasgow fared better with office investment transactions totalling £50.79m in Q2.

While Prime yields had hardened at the beginning of 2015, they have remained broadly stable since, with the spread of yields across core regional markets unchanged at 175 bps in Q2. Birmingham and Manchester have retained their premium over the UK's other core markets at 5%, closely followed by Bristol and Leeds, which both stand at 5.25% (Figure 5).

We expect the investment market to remain relatively stable in 2015. Notwithstanding the fact that yields are approaching historic lows, there is scope for further yield compression over the next 6 to 12 months, albeit there may be a shift in investor appetite for prime liquid assets over enhanced yields.

## Major regional office investment deals in Q2 2015

Date	Street	Purchaser / Vendor	Price £m	Yield %
Jun-15	Templeback, Bristol	Orchard Street Investment Management/Benson Elliot	58.50	5.34
Jun-15	Helmont House, Cardiff	Knight Frank IM/Bishopsgate LT PFUT	34.00	6.08
Jun-15	66 Queen Square, Bristol	Aviva Investors PT/Skanska Project Development	32.78	4.94
Jun-15	31 Stockwell Street, Glasgow	Ambassador Group/Fortress Investment Group	26.00	8.20
Jun-15	KCA Deutag HQ, City South Business Park, Aberdeen	Private Investor/Dandara	23.50	6.03
Jun-15	54 Hagley Road, Birmingham	Opus Land Palmer Capital Partners/Westbrook Partners	23.00	7.80
Jun-15	John Dalton Street, Manchester	Tesco Pension Fund/The Crown Estate	17.20	NA
Jun-15	Spectrum, Bristol	Maddox Property Partners/West Register	14.10	4.18

Source: Knight Frank Research

Please refer to our bi-annual reports for more detailed accounts of the city markets <http://www.knightfrank.co.uk/research/ROMP/>



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