RESEARCH

Knight Frank

REGIONAL OFFICES

OCCUPIER & INVESTMENT MARKET SUMMARY Q3 2014

Despite concerns over growing economic headwinds in the Eurozone, recent official figures on the UK economy remain upbeat. UK GDP rose by 0.7% in Q3, and the IMF forecasts growth of 3.2% in 2014 – its strongest since 2007. Meanwhile, Markit's latest PMI survey reveals businesses remain firmly in expansion mode for every region except Scotland, a result which is likely to reflect recent uncertainty resulting from September's referendum on independence.

Occupier markets

The recovery in the UK's key regional markets is proceeding apace. For the ten cities combined, Q3 2014 take-up was its highest in four years and 40% above the 5-year quarterly average. The majority of cities saw take-up ahead of their averages, although Aberdeen and Glasgow were the standout performers in Q3, despite the uncertainty surrounding the recent referendum.

Glasgow saw 219,241 sq ft of take-up, underpinned by a flurry of key deals including Network Rail at 151 St Vincent Street (48,570 sq ft) and Clydesdale Bank at Granite House (31,425 sq ft).

Aker's 335,000 sq ft pre-let at Aberdeen International Business Park is Scotland's largest ever leasing deal. Knight Frank is the instructed agent at the development.

Meanwhile, Aberdeen boasted a record 647,874 sq ft of take-up, a figure which included two substantial pre-lets, namely Aker Solutions ASA at Phase 1 Aberdeen International Business Park (335,000 sq ft) and Wood Group at Site 38, Hareness Road, Altens (215,000 sq ft).

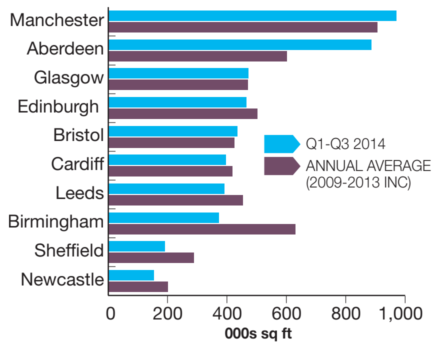
Collectively, 2014 is set to be the most active year for the regional markets since 2008. For the majority of markets, 2014 take-up to date is already above or close to the annual average for each of the previous five years (Figure 1). Aberdeen has already achieved a record year, while Manchester is certain to break the 1m sq ft mark for 2014.

Active demand remains robust, rising by 5% in Q3 overall. Birmingham, arguably the one underachiever thus far in 2014, saw a substantial 80% rise in demand in Q3, with HS2's imminent 110,000 sq ft deal at Two Snowhill set to boost Q4 take-up. Leeds is also expected to end 2014 strongly, with two prominent pre-let deals in the pipeline.

Developers are responding cautiously to the growing shortage of Grade A supply which characterises the majority UK's key regional markets (Figure 2). Collectively, speculative development activity climbed to a six year high of 2.2m sq ft by the end of Q3, despite several notable completions, such as One St Peters Square, Manchester. Glasgow is home to 20% of total activity, although healthy interest is already being seen for pre-let opportunities.

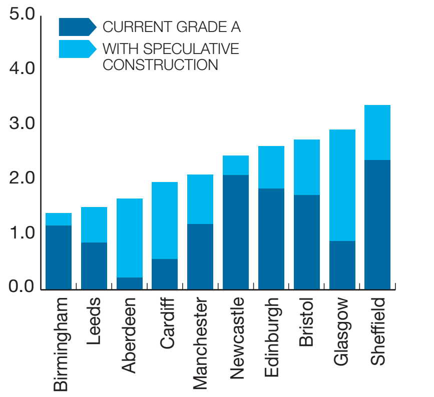
Prime headline rents remain under upward pressure. Two markets saw headline rents increase during Q3, with Glasgow rising to £29.50 psf and Leeds to £26.00 psf. Rental growth is expected to take place across the majority of markets over the next 18 months, with new development completions securing higher prime rental levels in Bristol, Birmingham and Manchester.

FIGURE 1
2014 YTD take-up vs annual average



Source: Knight Frank Research

FIGURE 2
Years of Grade A supply



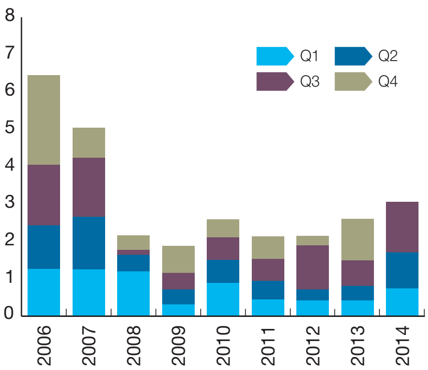
Source: Knight Frank Research

FIGURE 3
Prime rents and forecast (per sq ft)

	Q3 14	End 14 F	End 15 F
Aberdeen	£32.00	£32.00	£33.00
Birmingham	£28.50	£29.50	£31.00
Bristol	£27.50	£28.00	£29.00
Cardiff	£22.00	£22.00	£23.00
Edinburgh	£28.00	£28.00	£29.00
Glasgow	£29.50	£29.50	£30.00
Leeds	£26.00	£26.00	£27.00
Manchester	£31.00	£31.00	£33.00
Newcastle	£21.50	£21.50	£23.00
Sheffield	£20.00	£20.00	£20.00

Source: Knight Frank Research

FIGURE 4
Regional office investment volumes
(£bn)



Source: Property Data

FIGURE 5 **Prime yields (%)**

	Q3 13	Q3 14	Yield sentiment
Aberdeen	6.25	5.75	
Birmingham	6.00	5.25	
Bristol	6.25	5.50	
Cardiff	6.25	5.90	
Edinburgh	6.25	5.75	
Glasgow	6.25	5.75	
Leeds	6.25	5.75	
Manchester	6.25	5.25	
Newcastle	7.00	6.00	
Sheffield	7.25	6.25	

Source: Knight Frank Research

In Q3, Aviva Investors purchased 1 St James' Gate from Caudwell Properties for £18.01m. Knight Frank acted for the purchaser.

Investment market

Investment activity in the regional office markets was exceptional in Q3, with £1.30bn of assets changing hands, the highest seen in a single quarter since Q3 2007. Total volume for 2014 to date now stands at £3.1bn, already eclipsing the annual total for each of the last six years (Figure 4).

Q3's impressive turnover reflects an increase in buying opportunities since summer, as some investors have sought to capitalise on significant price increases over the past 12 months. While major lot-sizes were key to Q3 turnover (the largest 10 deals accounted for 75% of turnover), the quarter saw 40% more transactions than the 5-year quarterly average – indicative of the ongoing depth of investment demand.

As with Q2, Manchester was again key to Q3 activity, with two major transactions comprising Schroders's purchase of City Tower, Piccadilly (£132m) and Legal & General's purchase of 1 Piccadilly Gardens (£75m). However, Birmingham also saw a significant £185m of activity, albeit this was dominated by M&G's £140m purchase of Two Snowhill, which was Q3's largest deal across all markets.

Despite a substantial weight of money continuing to target regional office stock, evidence in the market suggests that pricing was broadly stable in Q3. Across the ten key regional markets, prime office yields held firm, with Birmingham and Manchester continuing to command a premium over the UK's other core markets, at 5.25% (Figure 5).

Pricing across the regional markets is expected to remain relatively stable over the next six months, with the increased supply of stock allowing investors to be much more selective than was possible earlier in the year. Indeed, sentiment suggests that vendor's pricing aspirations have moved ahead of reality for certain secondary assets, particularly where there is little scope for repositioning.

With evidence of rental growth returning in the core regional markets, investor appetite is likely to focus more readily on well–located, short income stock where income can be enhanced through active asset management. Also, in search of higher returns, the restricted availability of Grade A stock in some markets may also tempt more investors to selectively engage in new-build speculative development.

Major regional office investment deals in Q3 2014

Date	Address	Purchaser / Vendor	Price £m	Yield %
Sep-14	Two Snowhill, Birmingham	M&G Real Estate / Hines UK	140.00	6.00
Jul-14	1 Piccadilly Gardens, Manchester	Legal & General / Europa Capital Partners	75.00	5.64
Sep-14	110 Queen Street, Glasgow	Deutsche Asset & Wealth / BAM Properties	70.00	n/a
Sep-14	Chancery Place, Brown St, Manchester	NFU Mutual Insurance / Alanis Capital	57.00	5.05
Aug-14	Aberdeen Energy & Innovation Parks, Aberdeen	Moorfield / Buccleuch Property	35.45	8.42
Jul-14	11 Brindleyplace, Birmingham	Benson Elliot Capital / Argent Real Estate	30.02	3.90
Sep-14	Maersk House, Altens, Aberdeen	Private Investor / Private Investor	28.50	6.02
Aug-14	1 St James' Gate, Newcastle	Aviva Investors / Caudwell Properties	18.01	7.00

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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