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Savills World Research
UK Commercial

Spotlight
Manchester Office Market Report

Mid year 2015

One St Peter's Square, Manchester

SUMMARY

- Economic output in Manchester is forecast to grow by 4.6% in 2015, outpacing the region and the UK. This trend of better than average output growth is expected to continue for the next five years.

- Occupational demand remains strong, driven by both local businesses and a rise in northshoring. We expect that take-up for 2015 will exceed one million square feet for the second consecutive year.

- Investor demand for assets in Manchester remains strong, with investors looking to capitalise on the yield spread with London and the improving rental growth prospects.

- We are forecasting that the prime office rent in Manchester will reach £37/sq ft by 2019.

"The strengths of the City will remain its well established and diverse occupier base, its high level of graduate retention, and the projected strong growth in population."

Local economy

■ The major macro-economic topic of conversation in the region over the last six months has been the government's plans to create a "Northern Powerhouse". What this actually entails is still slightly vague, but what is known is that greater financial autonomy will be given to Greater Manchester to control its own spending, though not taxation.

■ The impact of the Chancellor's announcement of this has been rather dampened by the deferring of plans to improve local rail infrastructure. However, it is clear that some regional devolution is impending, and our opinion is that this is most likely to favour Greater Manchester and the North West.

■ Some might argue that by focusing on Manchester the government is taking an existing positive story and trying to take credit for it. Greater Manchester has been a major contributor to the fact that more professional services jobs have been created in the NW than Greater London over the last 12 months.

■ Indeed, 57,000 jobs have been created in central Manchester since 2011, which is more than double the rate of growth that has been seen in either the North West or the UK as a whole. Furthermore, employment growth in Manchester has been faster than in any large UK city, with the job creation being relatively broad-based across sectors.

■ The strong growth in Manchester's employment is down to a number of structural factors, including the City's well established strength in financial services, business services and education. The City has also benefitted from the return of 'Northshoring', where companies are moving or expanding out of London and the South East to take advantage of lower property and staff costs. These factors are underpinned by a rapidly growing population, especially of graduates and young professionals.

■ We remain relatively sceptical about the impact of the 'Northern Powerhouse' initiative for the whole of the NE and NW, and the outlook for the NW region will have more relation to these structural strengths in Manchester than any policy initiatives. This will mean that a small number of Local Authority areas will account for a large share of the region's overall growth, and the majority of these will be in Greater Manchester.

Occupational Market

■ 2014 was an exceptionally strong year in the Manchester office market, with total take-up reaching 1.3m sq ft, its second highest level in the last 15 years. This strength looks like it has continued into 2015, with the take-up in the first six months of this year reaching 663,525 sq ft.

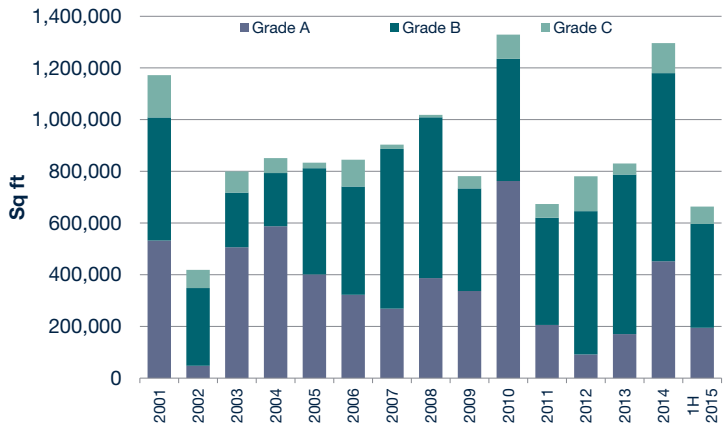
■ This strong transaction level is the result of seven lettings of over 20,000 sq ft in the first six months of 2015, compared to ten of the same size in the whole of 2014.

■ Overall the profile of tenant demand this year has been broadly similar to 2014, with the most active acquiring sector being Business & Consumer Services, closely followed by the Professions. The proportion of the total take-up that was driven by the TMT sector has fallen slightly over the last 12 months, and accounted for 13% of the space leased in the first half of 2015.

■ The level of active demand for office space in central Manchester remains healthy, driven both by local and national demand. It is notable that there has been a marked increase in requirements from the legal sector, with 'northshoring' clearly in vogue amongst London-based law firms.

GRAPH 1

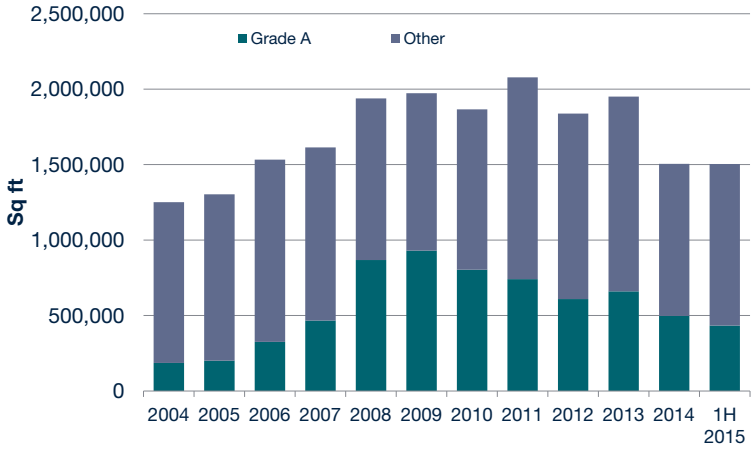
Take-up



Source: Savills

GRAPH 2

Availability



Source: Savills

■ Following a period of significant office development throughout 2006 – 2008 Manchester has experienced a continued erosion of Grade A supply. This has accelerated dramatically during the course of 2014 and early 2015. The completion of One St Peters Square in 2014 added approximately 270,000 sq ft of new Grade A accommodation to the supply of stock however it is anticipated this will be predominantly let by the end of 2015.

■ With continued pressure on supply, we estimate that the total Grade A availability in the CBD has now fallen below 500,000 sq ft for the first time since 2007. This figure is even lower for the best quality space, and we estimate that there is currently only 260,000 sq ft of the best quality space available in the market. We anticipate a further reduction in the level of availability throughout the second half of 2015 and early 2016.

■ As a result of the imbalance between healthy demand and limited stock as outlined above, a number of new build schemes have commenced development in the first half of 2015. These include One New Bailey Street, the XYZ Building, 101 Embankment, 2 St Peters Square, and One Spinningfields. These six projects will deliver just over one million square feet of new build space over 2016-2018.

■ There is also currently around 500,000 sq ft of significant refurbishments in the city centre office market.

■ The impact of the scarcity of Grade A stock is now starting to be felt, with top rents within the City Centre increasing. A headline rent of £32.00 psf was achieved in 2014 and we anticipate £34.00 psf will be achieved during 2015.

Investment market

■ Over the last two years the regional property markets have seen a significant increase in investor interest. This has been driven by two factors: firstly reducing risk aversion amongst investors post the global financial crisis; and secondly a desire to capture the economic and leasing market recovery that is rippling away from London.

■ 57% of all UK commercial property investment purchases in the first half of 2015 were outside London, and 43% of these purchases were by non-domestic investors.

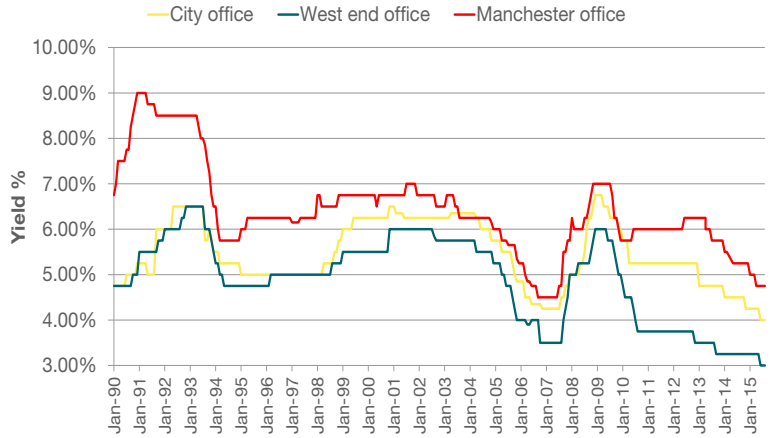
■ Over the course of 2014, UK institutions dominated the Manchester investment market, compared to 2013 where the bulk of demand was from overseas investment.

■ The first half of 2015 has already seen £298m of office investment transactional activity in Manchester, which while it is down on the same period in 2014, is higher than the average full year total for the preceding six years.

■ We estimate that the prime CBD office yield has remained stable at 4.75% over the first half of 2015.

GRAPH 3

Comparative prime office yields: Manchester & London



Source: Savills

However, there is clearly downward pressure on this, with investor demand for the City remaining strong.

Outlook

■ The economic outlook for Manchester is undoubtedly positive, and while we are not expecting a massive boost to the City's economy from the Northern Powerhouse initiative, it cant do any harm!

■ The strengths of the City will remain its well established and diverse occupier base, its high level of graduate retention, and its forecast strong growth in population.

■ With office rents in London now at record high levels, the 'northshoring' story is not going to go away. We estimate that the cost saving per employee for a company considering a move or expansion from central London to Manchester could be as high as £10,000 per person per annum in property costs, and £10,000 per person per annum in staff costs.

■ Inward investment from London-based businesses will undoubtedly focus on the core and the cluster of planned new developments that we listed earlier.

■ We expect that the availability of the best quality space will remain restrained, even with these planned completions. This will continue to put upward pressure on prime rents, and our latest forecast is that the top rent in central Manchester will reach £37/sq ft by the end of 2019. This represents a healthy 3.2% per annum growth in prime rents.

■ Of course, too much inward investment could be a challenge for the City if it drives up property and staff costs and reduces the potential cost savings for an inward investing business.

■ This kind of prime rental growth will undoubtedly displace some businesses from the higher rented core areas, and we expect to see some decentralisation taking place in Manchester (similar to the trend that has been seen in central London office markets in recent years).

■ While there are a number of refurbishment projects in the pipeline,

our analysis of the current level of availability and the historic levels of lettings at different rent bands points to a high level of undersupply of lower rented space. For example, 80% of the lettings over the last decade have been at rents in the £10-£25/sq ft range, but currently only 60% of the available office space is in these rent bands.

■ We believe that this represents a refurbishment opportunity for existing landlords, and we expect to see a rise in such activity in edge of core areas such as the Northern Quarter and Piccadilly.

■ The major barrier to the delivery of mid-priced refurbished office stock will remain owners' hopes for change of use to residential. However, the rising office rents across the CBD are increasingly making office development and refurbishment a comparatively attractive option compared to residential.

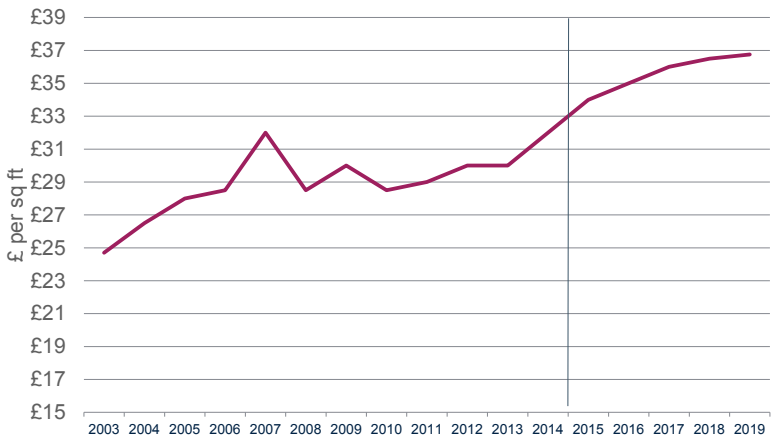
■ The outlook for the investment market also looks positive, with an unprecedented volume of investor demand focused on the UK at the moment.

■ We expect to see more domestic and non-domestic investor demand focused on Manchester and the North West due to both the yield spread to London, and investor's desire to capture the the economic and leasing market recovery.

■ While prime office yields in London are now at record lows, this is not the case in Manchester where the current prime yield of 4.75% is still 50bps above its lowest ever level. This, combined with a period of better than normal office rental growth should intensify investor demand over the next few years, and put further downward pressure on prime yields in the City.

GRAPH 4

Outlook for prime Manchester office rents



Source: Savills

Property criteria	Transactions and supply recorded for units in excess of 1,000 sq ft.
Study area	City centre as broadly delineated by the inner ring road.
Top rent	Highest rent achieved in one of more transactions during given period.
Grade A	All new development (including speculative schemes reaching practical completion within six months, plus major refurbishments).
Grade B	Space previously occupied, completed or refurbished in last 10 years.
Grade C	Space previously occupied, completed or refurbished more than 10 years ago.

Savills Manchester Office Agency & Investment

Patrick Joynson
Leasing
0161 277 7216
pjoynson@savills.com

James Evans
Leasing
0161 277 7238
jevans@savills.com

Richard Lowe
Leasing
0161 277 7203
rlowe@savills.com

Peter Mallinder
Investment
0161 277 7211
pmallinder@savills.com

Oliver Foster
Investment
0161 277 7212
ofoster@savills.com

Nick Okell
Investment
0161 277 7293
nokell@savills.com

Mat Oakley
Research
020 7409 8781
moakley@savills.com