Birmingham Office Market Overview

Spring 2009

Tenants are set to benefit as more attractive terms become available in 2009.

Alpha Tower

- 2008 take-up in the prime core reached a buoyant 691,358 sq ft, which is 43% up on the same time last year (wider CBD take up totals 959,937 sq ft). However, going forward, we are predicting that 2009 and 2010 are likely to see below average take-up figures.
- At the end of 2008 supply stood at 1.6 m sq ft. Although, encouragingly, the development pipeline has now peaked and the overall vacancy rate in Birmingham should begin to decline from 2009 onwards.
- The highest rent achieved in 2008 is rumoured to be £33 per sq ft, which was achieved in quarter two. This created a new headline rent for the city, however, downward pressure on prime rents are expected going forward.
- The Professional sector dominated 2008, accounting for 46% of the space taken up. More interestingly, due to lettings to Barclays and Deutsche Bank, the Banking sector still has a presence in the market, taking a 25% share.
- Implications are that there is a depth of interest in prime, well let stock, which implies there is also an interest from investors for long lease stock, with a yield stability of around 7%.
- Lack of rental growth and concerns about tenant default are rising to the fore as reasons to delay acquisitions. However, we are of the view that sterling as a currency is significantly oversold, which presents a positive position for non-domestic investors.

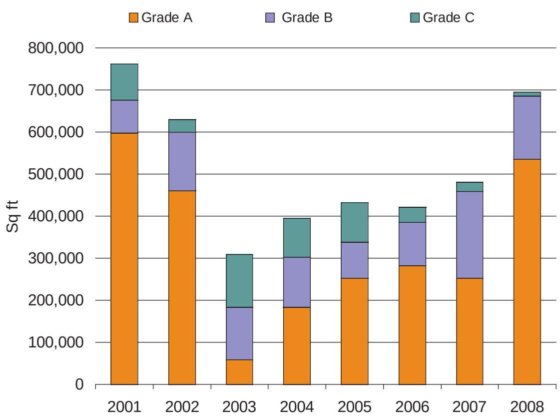
Leasing Market

Amidst the doom and gloom, Birmingham prime office core saw the best take-up figures since 2001.

2008's take-up in the prime core was a buoyant 691,358 sq ft (wider CBD take up totals 959,937sq ft). This surpassed the five year average by 43% (five year average is 485,285 sq ft per annum).

2008 saw a definite bias towards Grade A space with 63% of total take-up being Grade A. However this can be, in part, attributed to the two large pre-lets at Snowhill in the second and third quarters.

2008 take-up figures were up 43% on the five year average



Source:Savills

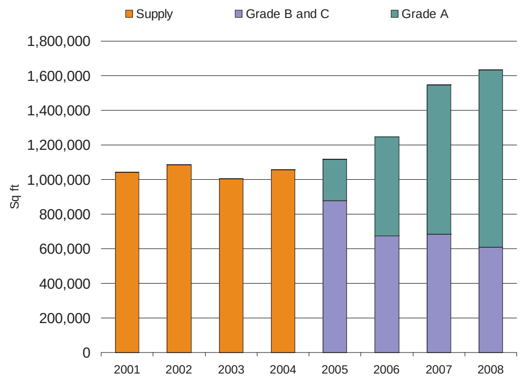
Analysing take-up by business sector, the Professional sector dominated 2008, accounting for 45% of the space taken up, however, interestingly, despite the current economic climate, the banking sector has maintained a significant presence in the market taking a 25% share. This shows encouraging signs for financial representation, which the city has historically lacked, with the notable acquisitions by Barclays at Snowhill and Deutsche Bank at Brindley Place.

Looking at the supply side of the equation, total supply increased by 16% during the fourth quarter and now stands at 1.6m sq ft. The current vacancy rate is now 14.2% which is up from 11.4% at the end of 2007. The proportion of the availability that is Grade A has also increased and now stands at 63% (up from 57% at the end of 2007).

On a positive note, the development pipeline has now peaked and the overall vacancy rate in Birmingham should begin to decline from 2009 onwards.

Lack of confidence and debt continues to weaken developer activity. Finance appears to be available for prime stock. Undoubtedly shorter leases and capex requirements, on developments or refurbishments, will prove almost impossible to secure in the current climate. This will significantly impinge the future development pipeline and therefore we anticipate medium term supply constraints.

The overall vacancy rate should begin to decline from 2009 onwards.



Source:Savills

Delay on these schemes may mean that we will see a limited amount of Grade A space coming to the market between 2010 to 2011, resulting in Birmingham seeing a possible undersupply of new Grade A space at a time when the occupational market is expected to pick up.

In the short term, occupational demand will no doubt remain subdued in 2009 with annual take up expected to be down on that seen in 2008. However, our research indicates that there is a healthy level of latent demand still in the market.

Although the Lyons report has reached its targets, due to its success the Government is continuing the principles behind the scheme with another 400,000 sq ft of named Government requirements looking to take space in Birmingham. Indeed, it is this sector that will underpin take up over the next 12 months.

Currently, there is also a considerable amount of activity in the Professional sector, with over 400,000 sq ft of pent up legal requirements circulating the market. There is hope that some will choose to take advantage of the current state of the market to achieve very attractive terms.

Unlike previous recessions, the profile of tenant's lease events are very different this time around. Gone are the years of 25 year lease commitment with the late 1990's and early 2000's seeing the emergence of shorter term leases and/or five year break options which have provided much greater lease flexibility to tenants. Consequently, many tenants have an option to relocate in the near future. If we analyse lease breaks and expiries there are just under 1m sq ft of requirements potentially coming to the market between

Leasing & Investment Market

2009 and 2011.

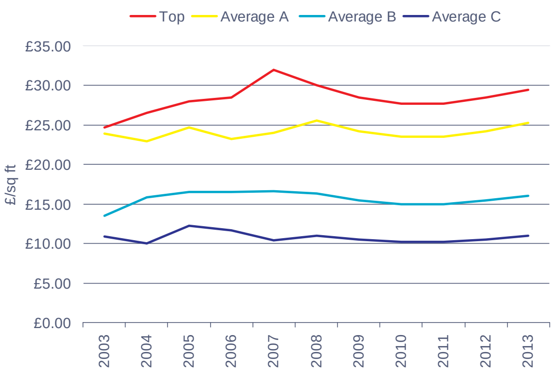
Those tenants who are coming up to a lease event will have the choice of staying put and renegotiating their lease terms, or moving and taking advantage of falling rents and lengthening rent-free periods. There will be some who choose to take advantage of the state of the market to achieve very attractive terms which may not be available in 12 months time.

Arguably from a property occupational perspective, there is no better time to relocate than now. The hope is that this will provide a cushion for 2009 take-up figures.

Looking forward, what are the city's prospects for 2009?

To date, headline rents have held up relatively well, but given the continuing turmoil and the expected increase in supply from both developers and occupiers, we forecast rents to fall by 5% and incentives to increase during 2009.

Downward pressure on prime rents are expected in the short term.



Source:Savills **Forecast*

The shoots of recovery in the occupational market are expected from 2010 as the low levels of development completions begin to impact on availability.

2009 and 2010 will be a period of below average take-up. However, beyond this we expect the market to level out as the supply is gradually absorbed.

Investment Market

Only five significant deals transacted during 2008. However, the positive news is that two deals have contracted within the first two months of 2009.

5 St Phillips Place, New Star's Grade A refurbishment signed at a yield of 6.9% for between £30 and £35 million. The building is two thirds government let at 26.50 per sq ft (this was acquired two years ago for 4.5%) The other deal is the Mitchell and Butler head quarters on Fleet Street, let on a 35 year lease. This was bought for a client of Moorfield, for a price in excess of 30 million, at a initial yield of 8%.

Further deals are on the horizon. This confirms the view that yields are stabilising and demand is improving.

We expect that while investors, particularly non-domestic, are becoming increasingly convinced that the UK is a "buy", lack of debt and the expectation that yields will soften further in early 2009, are causing investors to remain on the sidelines.

However, the Implications are that there is a depth of interest in prime, well let stock, which implies there is also now a proven interest from investors for long lease stock, with a yield stability of around 7%.

Jonothan Holmes, head of investment in Savills Birmingham office, commented that:

"We reasonably anticipate yield compression from Q1 2010 onwards. We are firmly of the view that the market is oversold for prime stock and the yield gap is too high, relative to conventional benchmarking criteria (five year gilts, swaps and Libor) and historic long term average prime yields. However, secondary stock (with reference to age, specification, location and lease structure) may well have further to go."

While we are seeing the market revert to traditional fundamentals in accordance with property specifics rather than being purely sector led, this has got to be the right approach for the market and industry. We anticipate this status quo will be maintained for the foreseeable future.

Lack of rental growth and concerns about tenant default are rising to the fore as reasons to delay acquisitions. However, we are of the view that Sterling as a currency is significantly oversold, which presents a positive position for non-domestic investors. We expect to enjoy the benefit of increased levels of overseas investment as a consequence.

It is also worth mentioning the most significant development project in the region, which is the redevelopment of New Street Station with anticipated phase completion between 2010 and 2013 and we understand all of the finance is in place to deliver this. This development will re-rate the attraction of Birmingham city centre from an occupier and therefore an investor perspective.

Birmingham Map & Key Contacts

Definitions

Grade A: New developments (including speculative schemes reaching practical completion within the next 6 months).

Grade B: Space previously occupied, completed or refurbished in the last 10 years.

Grade C: Space previously occupied, completed or refurbished later than 10 years.

Note: We monitor space over 3,000 sq f**t.**

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