# Birmingham Office Market overview

## Summer 2009

**Declining business confidence, on the back of worsening economic conditions, has resulted in muted demand throughout the first half of the year.**

*Natwest Tower*

- Take-up in the first half of 2009, in the prime core, reached 104,297 sq ft. (wider CBD take up totals 197,036 sq ft). 79% of space in the prime core was Grade A. Take-up is 73% down on the same time last year.
- Total supply has remained stable in the second quarter of 2009 and stands at 1.7 m sq ft. The current vacancy rate is now 15.1%
- The highest rent achieved in 2009 is £28 per sq ft, which was achieved in quarter two on 8,600 sq ft of space at 11 Brindley Place.
- The Public sector is underpinning the market in the first half of 2009, accounting for 63% of take-up.
- 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. Yields have stabilised at around 7%.
- Going beyond 2009, investors are likely to look to the next tier in order to pick up a bargain. (That is assets offering mid-range income security).

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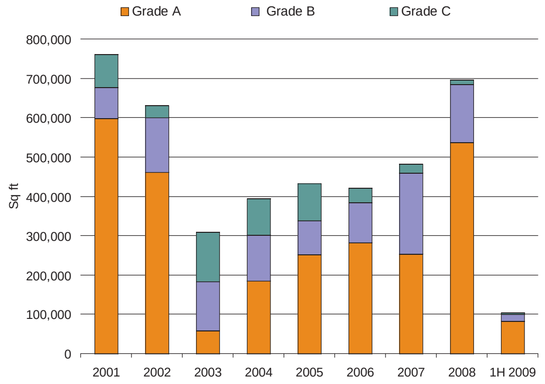
# Leasing Market

As with all major cities in the UK, the Birmingham office market is entering a period of considerable uncertainty as the effects of the global financial turmoil unwinds within the UK office markets. London has been badly affected and the ripple effect has reached other UK cities including Birmingham, the result of which has meant considerably less transactional activity during 2009.

2008 was a particularly good year for take-up with figures reaching a buoyant 691,358 sq ft, which was 43% up on the same time the previous year.

However, going forward, we are predicting that 2009 and 2010 are likely to see below average take-up figures. Take-up in the first half of 2009, in the prime core, reached 104,297 sq ft. (wider CBD take up totals 197,036 sq ft). This is 73% down on the same time last year. However, 79% of take-up was Grade A.

**Take-up is down 73% on the same time last year**



*Source: Savills*

The most significant letting to date, in terms of size, is by a Government department. The Highways Agency took 55,939 sq ft at the Cube over the first half of the year, at a rent of £25 per sq ft.

The dominant business sector in 2008, was the Professional sector, accounting for 45% of the space taken, however, it is the Public Sector which is underpinning the market in the first half of 2009, accounting for 63% of take-up.

Although the Lyons report has reached its targets, due to its success, the Government is continuing the principles behind the scheme. Phase 2, will involve up to 20,000 jobs relocating out of London. The current Lyons report comes to an end in March 2010 with the next phase likely to start directly afterwards. However, this time around the report should be more beneficial for the regional cities.

Enquiry levels have fallen when compared to the same stage in 2008, however, there is still a steady trickle of occupier activity with a number of reasonable sized requirements remaining unsatisfied.

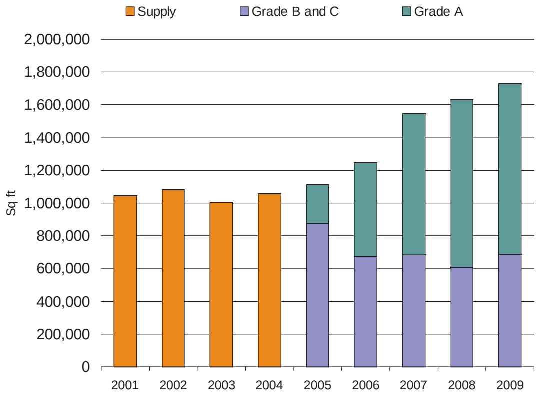
Looking forward, we expect that a few of the requirements in the City should start looking seriously for space during the second half of this year, with a number of Public Sector enquiries, likely to take space in the next 12-18 months.

Looking at the size band of take-up in the first half of 2009, there has been an above average proportion of deals at the sub-10,000 sq ft bracket reflecting a bias towards the smaller end of the market.

If we analyse lease breaks and expiries there are just under 1m sq ft of requirements potentially coming to the market between 2009 and 2011. Although Birmingham is likely to see a lack of inward investment over the next couple of years, take-up will be underpinned by indigenous occupiers taking advantage of the current market.

Looking at the supply side of the equation, encouragingly, total supply has remained stable in the second quarter of 2009 and stands at 1.7 m sq ft. The current vacancy rate is now 15.1% (13.1% at Q2 2008). 60% is Grade A quality (up from 52% at the end of 2008).

**Total supply has remained stable in the second quarter of 2009**



*Source: Savills*

With weaker economic conditions across the UK, especially in the financial sector, occupiers are likely to release ‘grey’ space onto the market. This will mean that in many markets disposal of occupier-controlled space will pose significant challenges. However, with a number of sites being mothballed and a lack of development activity in the short term, when the market does return, Grade A space is likely to be limited. This will be especially prevalent in the prime Core, with new Grade A supply tipified by Church Street and Colmore Plaza.

# Leasing & Investment Market

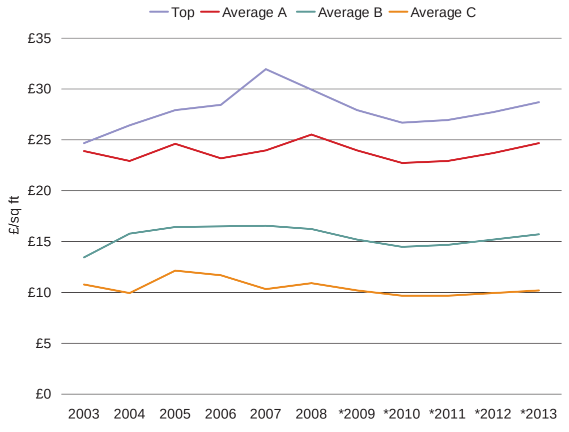
Delays on these schemes may mean that we will see a limited amount of Grade A space coming to the market between 2010 to 2011, resulting in Birmingham seeing a possible undersupply of new Grade A in 2012 and beyond. This will be at a time when the occupational market is expected to pick up. and there is likely to be excellent opportunities for developers to capture the market “ahead of the pack”.

The highest rent achieved in the first half of 2009 is £28 per sq ft, which was achieved in quarter two on 8,600 sq ft of space at 11 Brindley Place. However, in line with lower levels of demand, downward pressure on top rents are set to increase. This is already starting to filter through. Headline quoting rents are holding at £28 - £30 per sq ft in the prime CBD, however, with the general decline in demand, landlords may need to re-evaluate terms in the second half of the year.

Quoting rents on second hand space have seen some downward revisions with rent free periods having been extended.

We predict that take-up will return to average levels by 2011/12, but will be below average in 2009 and 2010. This will have a dragging effect on both headline and net effective rents. Thereafter, rents will stabilise, before beginning to recover in 2011 as a result of the shortage of Grade A office space.

**Top rents are set to fall by 7% over the year**



*Source: Savills (*forecast*)

This recovery will be led by the prime CBD where supply will continue to be low. If more tenant space returns to the market then the timing of the recovery may be delayed, but the rental fall should be limited by the reduced development pipeline.

**Investment Market**

In terms of investment activity there are some signs of stabilisation with some purchasers starting to return to the market. There have been two significant transactions in 2009 totalling approximately £60 million as follows:

5 St Philips Place - in January 2009 Climate Exchange Capital acquired New Star's interest in this 65,000 sq ft Grade A office building for £30.5 million, reflecting a net initial yield of 7%.

Mitchell & Butler HQ, Fleet Street - 95,000 sq ft HQ building together with 120 bed hotel was acquired by Moorfield Group in January 2009 for £30 million, reflecting a net initial yield of 8.3%.

Whilst these are the only City Centre transactions to have completed thus far it is understood that 7, 8 and 10 Brindleyplace, owned by Argent Development Consortium, is currently under offer at approximately £95 million, reflecting a net initial yield of 7.75%. Generally the opportunity was well received by a broad investor base.

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

“We have seen positive signs of yield stabilisation at the prime end of the market and are therefore reasonably confident that yields have bottomed out. This is not to say that we wont see further capital value decline but we anticipate these being driven by over-renting (the return of top slicing) and tenant defaults.”

Going beyond 2009, investors are likely to look to the next tier in order to pick up a bargain.(assets offering mid-range income security). With some banks now starting to tackle their loan books with increased confidence, we may start to see an increase in these secondary stock levels. It will be these assets in good locations, that offer some form of redevelopment potential, which are likely to offer the greatest long term opportunities.

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.

Negative 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.

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%.

# Birmingham Map & Key Contacts

**Definitions**

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| **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 ft. |

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