savills

Spotlight
Birmingham Offices

Summer 2012

SUMMARY

- Office demand remained subdued over the first half of 2012 totalling 112,346 sq ft, 56% down on same period last year.
- Demand in the prime core has been more resilient with take-up down only 8%, highlighting occupiers 'flight to quality'.
- Availability has remained static with a vacancy rate of 14.3%.
- Top rents remain stable typically ranging from £28 to £29 per sq ft and we expect will hold at this level for the remainder of the year.
- Investment activity was muted over the first six months of the year totalling just over £48m.
- An increasing number of assets coming to the market on the back of redemption pressures and banks off-loading stock has seen prime yields soften to 6.25-6.5%.
- Limited investor appetite for regional offices at present means that we could see prime yields move out by the end of the year.

"Inevitably 2012 is proving challenging but with limited Grade A stock and early signs of increasing demand from key influencers such as the professional sector, there is a clear case for cautious optimism looking forward." Nick Williams, Head of Office Leasing

Tracking future occupier demand

■ It can be hard to look on the bright side in the face of continued newsflow surrounding the poor performance of the UK economy. In particular, public sector cuts have weighed heavily on Birmingham.

■ Oxford Economics Public Sector Cuts study commissioned by Savills and published towards the end of last year, highlighted the risks facing Birmingham in the wake of public sector austerity. While Oxford Economics outlook for the city was on the whole weak with a risk recovery ranking of 188 out of 406 (the higher the ranking the higher the risk), the city did score well in terms of demand and accessibility - key to driving private sector growth growing forward.

■ Forecasts point to 2.9% growth per annum in private sector office based employment through to 2016, marginally exceeding the 2.5% seen prior to the downturn in 2007. Good news for the Birmingham office market.

■ Some of this growth will come from new entrants to Birmingham, but we suspect that the bulk of this growth is likely to come from existing occupiers. Savills have been tracking these businesses, in particular high growth companies, in order to pre-empt future office requirements. Map 1 (on back page) shows office based firms in Birmingham and its surrounds employing over 25 people. Within the A4540 area alone we have identified just over 700 of these companies, close to 100 of which have seen sales growth in excess of 10% over the last three years (dots in red).

■ The growth seen by certain private sector companies is highlighted by the fact that outside London, Birmingham has the highest concentration of Britain's 100 largest private companies (based on sales) as tracked by the Sunday Times in their Top Track 100. The strength and size of the city's professional sector, which from a UK wide perspective is predicated to be one of the key growth opportunities, provides reassurance in terms of future office demand.

■ Council plans to create eight new economic growth zones in the city around logistics, medical technology, IT, media and the environment to help drive private sector growth, may prove beneficial in terms of office demand. Likewise, the plans to develop a £25m medical research centre in the city facilitated under new borrowing powers bestowed on key regional cities, could see spin-outs and attract new occupiers to the city. However, the potential benefit of these initiatives is likely to be felt over the longer term rather than have any immediate impact.

Occupational market

■ While pockets of private sector growth continue, for the time being at least this has not filtered through to office demand. Total take-up for the first half of 2012 was 112,346 sq ft (based on deals over 3,000 sq ft), 56% down on the same period last year. Demand for Grade A space held up better with take-up down 19%.

■ Demand in the prime core has been the most resilient with take-up down only 8% to 53,800 sq ft compared to the same period in 2011. This highlights the 'flight to quality' within the core office market.

■ Continued uncertainty over the strength of the economic recovery or rather absence of it, has stalled a number of a larger requirements. As a result deals have been dominated by smaller acquisitions. Over the first half of this year 57% of deals have been for under 5,000 sq ft as opposed to 42% last year.

■ Despite lack lustre take-up, availability has remained static holding at just over 1.6m sq ft. The absence of new development has helped to maintain supply levels, bringing the vacancy rate down to 14.3% compared to 17.6% in 2009.

■ In the prime core, availability is expected to become increasingly acute with only one new scheme, Two Snowhill, expected to be delivered next year. However, this will be augmented by a further 120,000 sq ft of refurbished space at 5 Brindleyplace.

■ Developer confidence would appear to have returned elsewhere in the city as Thomas Vale, in partnership with Birmingham City Council, are to develop the city's first speculative office building since 2008 at Birmingham Science Park, Aston. This will only deliver 30,000 sq ft, which will be underwritten by the Council. However, it does point to the tentative return of developer confidence driven

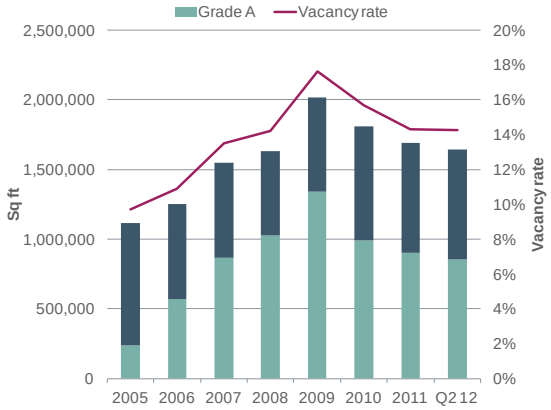
GRAPH 1

Take-up

Graph source: Savills Research

GRAPH 2

Availability levels remain static



Graph source: Savills Research

by the opportunity afforded by the absence of any new supply in the market.

■ This gap in supply is also behind Hines and Moorfield's extensive refurbishment of 5 Brindleyplace, expected to complete in Q412. Their pursuit of a refurbishment will allow them to deliver 'new' space ahead of the completion at Two Snowhill and could prove beneficial in terms of soaking up existing unsatisfied requirements.

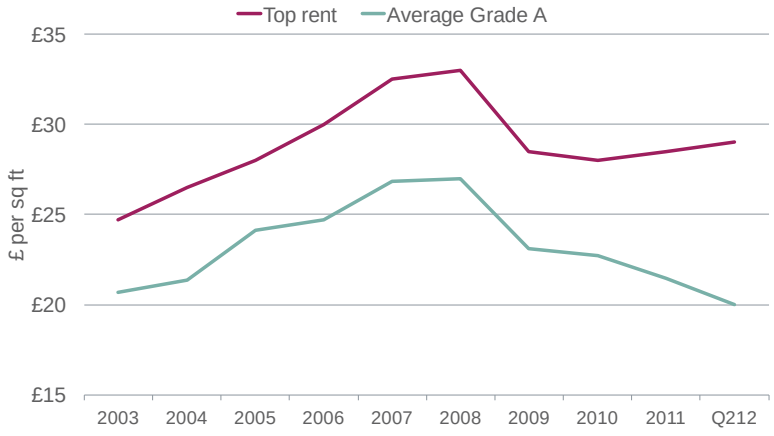
■ There was an upward movement in top rents during the second quarter with £29.00 achieved with QBE's 6,500 sq ft acquisition at 45 Church Street. While this deal was encouraging, the relatively small size of the transaction suggests that it may not be truly reflective and that £28.50 remains the top rental tone on new build Grade A schemes. Despite this apparent increase in top rents, average Grade A rents continued to decline over the first half of 2012, down 6.7% on the 2011 average.

■ With no new space being delivered into the market, top rents will continue to hold at current levels for the remainder of 2012. With economic conditions to remain challenging for the foreseeable future, we are unlikely to see a marked increase in rents until end 2013/14.

■ Despite a number of large requirements in the market, such as Shoosmiths 40,000 sq ft, we expect the smaller deals to continue to dominate. As a result we expect end of year take-up to be in the region of 240,000-250,000 sq ft. In the prime core we expect that demand will be more robust with end year hitting c110,000 sq ft.

GRAPH 3

Top rents holding



Graph source: Savills Research

Investment activity

■ Similar to that seen in the occupational market, investment activity over the first half of this year was subdued. Investment volumes totaled just over £48m, 81% down on that seen over the same period last year.

■ While completing in July and therefore not included in the first half investment volumes analysis, the most recent notable transaction is the £32.2m sale of 115 Colmore Row to Israel-based financial services company CLAL Insurance Enterprises Holdings at 6.5%.

■ Despite the 12 years unexpired lease to Eversheds this deal reflected the continued shift in prime yields first seen during the second half of 2011. Prime yields now range between 6.25% to 6.5% reflecting a 75bps softening on Q211, bringing it marginally above the 6.25% average for Prime UK regional offices.

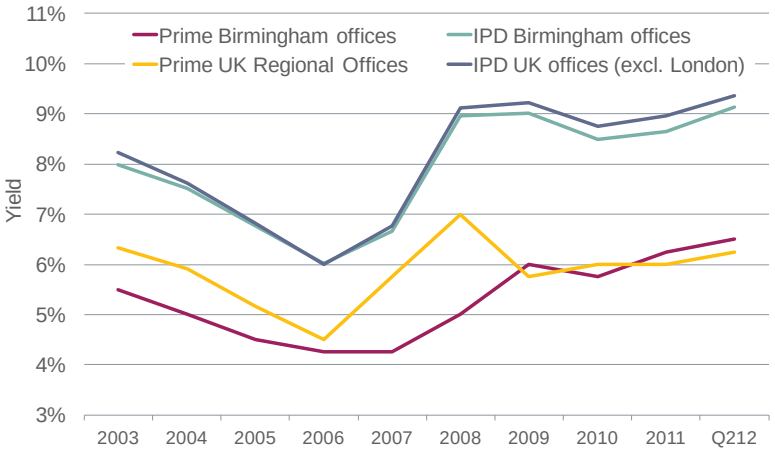
■ Average yields measured by IPD have seen a similar softening to c.9% although at a slower rate than seen across the UK regional office market where yields average approximately 9.4%.

■ This softening in prime yields is in response to an increasing number of assets coming to the market on the back of redemption pressures and banks looking to off-load stock. Wider economic uncertainty has also had a part to play.

■ Given that there is currently limited investor appetite for regional offices, we expect that yields may move out further by the end of the year and it is unlikely that we will see a return to yield hardening until a significant improvement in rental growth emerges. With top rents not expected to see growth until end 2013/4 it may be another 12-18 months until we see downward shifts in prime yields.

GRAPH 4

Yields softening as stock levels increase

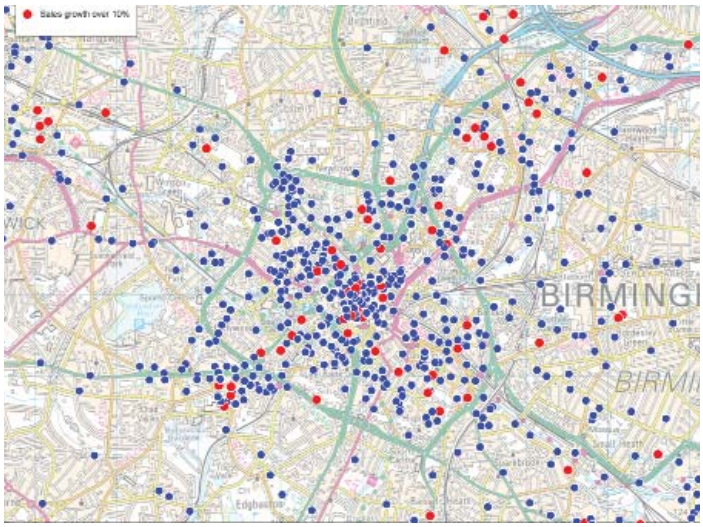


Graph source: Savills Research

Headline statistics	Take-up: Total	Take-up: Prime Core	Top rents (£ per sq ft)	Prime yield
Full year 2011	537,672 sq ft	153,646 sq ft	£28.50	6.25%
1H2012	112,346 sq ft	53,827 sq ft	£29.00	6.25-6.50%
End of year outlook	↓	↓	→	↑

MAP 1

Identifying Birmingham's growth companies



Graph source: Savills Research; Experien (dots are an approximate of location based on postcode)

Definitions & statistical notes	
Property criteria	Transactions and supply recorded for units in excess of 3,000 sq ft
Prime Core	Transactions and supply recorded for prime units in excess of 3,000 sq ft in the city centre and Brindleyplace
Top rent	Highest rent achieved in one or more transactions in the 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 the last 10 years
Grade C	Space previously occupied, completed or refurbishment more than 10 years ago

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