Leeds Office Survey

Summer 2010

The next 12 months will be the best time of this cycle for occupiers to capitalise on attractive terms on which to acquire new office space.

City House, Leeds. 120,000 sq ft acquired by Bruntwood for office refurbishment. Savills advised.

- Take-up in the first half of 2010 reached 130,109 sq ft. Only 37% of space taken was Grade A specification.
- Looking at the size band of take-up in the first half of 2010, there has been an above average proportion of deals at the sub-5,000 sq ft bracket. There were no deals above 15,000 sq ft in the first half of 2010.
- Supply fell by 2% in the second quarter, and now stands at 1.6 m sq ft. The vacancy rate is currently 11.3% having fallen from its peak of 14.1% at Q3 2009.
- Given the need to cut costs, public sector demand will remain muted over the short to medium-term as Central Government embark upon the rationalisation process for departments.
- There has been a significant amount of transactional activity in the first half of 2010 and a number of UK institutions have recently launched regional prime office funds with a specific focus on Leeds.
- With restricted supply, we believe prime yields are around 6%, a fall of circa 50 basis points since our winter 2009 report, with potential to harden further.

Savills Research

savills.com/research

savills

Leeds Office Survey

Following a difficult 2009, there were little signs of a reprise in the first half of 2010. Take-up for the first six months of the year totalled 130,109 sq ft, 27% down on the same period last year with only 39% being Grade A. Political and economic uncertainty has weighed heavily on the Leeds office market in the first half of the year.

Forecasts for the remainder of the year suggest that total take-up will be in line or just below the 2009 levels.

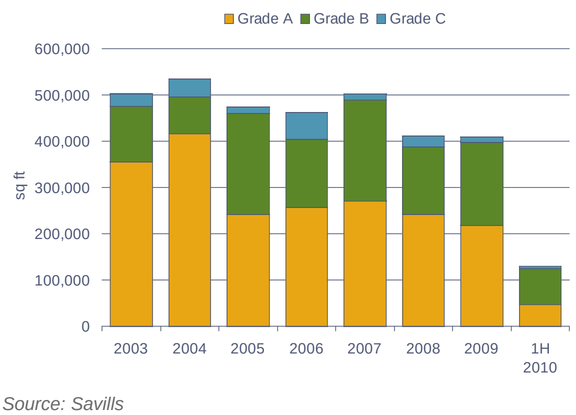
This drop in take-up in the first half of 2010 is partly due to the lack of larger requirements in the market. The most significant lettings to date, in terms of size, were both under 15,000 sq ft, which include 14,420 sq ft at 2 Wellington Place to British Sky Broadcasting and 11,600 sq ft at Westgate to Skills for Care Ltd.

Following June's emergency Budget the biggest threat to Leeds' recovery is the upcoming public sector job cuts and knock on effects this may have on private sector confidence.

Although this could potentially stifle confidence in the occupational market, the strength of the private sector may help to mitigate any adverse impacts. A higher proportion of the workforce is within 'Financial & Business Services' compared to the rest of the UK, with Leeds taking the position of the Financial Capital of Yorkshire.

A recent study by Local Futures forecast that Leeds could lose approximately 8,864 public sector jobs by 2016. However,on a positive note, this is only 8% of the total public sector jobs in the Leeds region. The expected recovery of the city's private sector should also help to insulate it from the adverse effects job cuts may have on the city.

Office take-up in the second half of 2010 is expected to be muted.



Source: Savills

Looking at the supply side, supply fell by 2% in the second quarter and now stands at 1.6 m sq ft. The vacancy rate is currently 11.3% having fallen from its peak of 14.1% in Q3 2009.

Supply fell in the second quarter and now stands at 1.6 m sq ft.

Source: Savills

Looking more closely at the type of space available in Leeds, in reality there are relatively few buildings for occupiers to take Grade A accommodation within the prime traditional core with Toronto Square (90,000 sq ft), a quality refurbishment at 10 South Parade (38,000 sq ft) and Broad Gate, an award winning development, (170,000 sq ft) on the Headrow, providing the best space in the traditional core at present.

The other alternatives for larger enquiries seeking large floorplates, we have to look at the two new buildings that have been developed on what is described as Leeds expanding core, namely The Mint on Sweet Street (118,000 sq ft) just to the south of the railway station and Latitude Red (120,000 sq ft) to the west of the city along Whitehall Road.

Looking to the future, although there appears to be a significant amount of Grade A space in the market, the development pipeline is muted, which should help re-balance the market over the next 12-18 months, which will enable the further erosion of supply. Savills estimate that rental growth will arrive in late 2011/early 2012 as a result of a severely restrained pipeline.

The attractiveness of occupational deals has swung towards the occupier and this year will mark the low point in the cycle. Deals during the next 12-18 months will consume the best current supply.

Another factor that may be in the minds of some tenants is the desire both to capitalise on a very tenant-friendly leasing market, and to avoid what might be a highly competitive market for Grade A buildings going forward. We predict that this will be the driving force behind demand going forward.

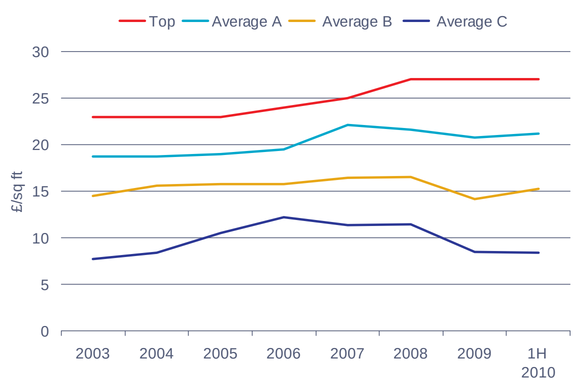
Leeds Office Survey

In respect of rents, the highest rent achieved in Leeds last year was on the top floor of Toronto Square where Zolfo Cooper paid £27 per sq ft for a suite of 7,050 sq ft. The headline rent has remained at this level in 2010, with a small deal signing at South Parade to Xafinity in May.

With only 10 South Parade (38,000 sq ft) coming to the market this year and no new development starts on the horizon without significant pre-lets, the expectation is that prime city centre rents will hold firm.

However, the same cannot be said of poorer quality refurbished space and space outside of the prime core where landlords are competing fiercely for occupiers and reducing rents significantly from the historic levels of £15 - £16 per sq ft to as low as £10 per sq ft in some instances

Grade A rents have held, while second-hand space remains competitive.



Source: Savills

Despite muted demand, there are positive signs emerging. In Oxford Economics European Cities and Regions Service (Summer 2010), Leeds was ranked 13th across Europe for GDP growth (2.8%) over the next 5 years, and ranked third in the UK. With recovery expected to be relatively strong, now may be the best time in the cycle for potential occupiers to take space.

In essence, the development pipeline is severely constrained. Even against a background of below average levels of tenant demand this will be enough to deliver a steady fall in the level of availability (particularly of Grade A office space) over the next three years. As demand begins to recover towards its long run average level, the fall in vacancy levels will accelerate.

Investment Market

The strong performance during the first half of 2010, sentiment is going to remain a big issue, whether it be consumer, investor or occupier.

Another factor that has emerged over the last few months to support a recovery is a slight increase in the availability of debt. Not only are there now more lenders in the market who are prepared to lend, we have noticed a slight improvement in the margins on offer, additionally, in some more secure investment deals, the loan-to-value has risen slightly. Lenders are clearly still in the comfortable position of being able to pick and choose their borrowers, but more competition is emerging.

As stated in our last office market report of Winter 2009, the market for office investments in Leeds remains polarised, with strong demand for prime well let offices from mainly institutional investors fuelled further by a scarcity of stock. It is still also apparent that there is a significant risk premium between the prime end of the market and secondary assets which may be compromised in terms of location, quality of covenant or poor specification.

There has been a significant amount of transactional activity in Q1 and Q2 2010 and a number of UK institutions have recently launched regional prime office funds, with a specific focus on Leeds. With restricted supply, we believe prime yields are around 6%, a fall of circa 50 basis points since our winter 2009 report, with potential to harden further.

There are concerns that the market is becoming over-heated and that the significant yield shifts have simply been a consequence of acute supply/demand imbalance and there is a risk that this trend could be reversed in the latter half of 2010 onwards if a significant amount of stock is brought to the market. However, vendors, particularly of prime product, remain scarce and this alone should support the outlook that yields are unlikely to materially re-correct.

Selection of investment deals:

BT Headquarters 1 Sovereign Street
The freehold interest in the property was brought to the market in April 2010 and sold in June for £40.1m reflecting a net initial yield of 6.75%

21/22 Park Place & 71/77 St Paul's Street
The freehold interest in the property was brought to the market in April 2010 and sold in June for 7.4m reflecting a net initial yield of 8.07%

1 Whitehall Riverside
The long leasehold interest was acquired in February 2010 for £51.3m, reflecting an initial yield of 6%. This transaction provides one of the clearest illustrations of the yield shifts in the space of less than 12 months having previously sold in April 2009 for £37.62m reflecting a net initial yield of 7.75%.

Leeds 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 1,000 sq ft.

For further information please contact:





Paul Fairhurst
Leasing & Development
0113 220 1207
pfairhurst@savills.com

Simon Lister
Investment
0113 220 1208
slister@savills.com

David Aspland
Business Space
0113 220 1218
daspland@savills.com

Patrick Carter
Leasing
0113 220 1203
pcarter@savills.com

Clare Burke
Research
020 7409 8791
cburke@savills.com

Savills is a leading global real estate service provider listed on the London Stock Exchange.
The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 180 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.
A unique combination of sector knowledge and entrepreneurial flair give clients access to real estate expertise of the highest calibre. We are regarded as an innovative-thinking organisation backed up with excellent negotiating skills. Savills chooses to focus on a defined set of clients, therefore offering a premium service to organisations with whom we share a common goal. Savills takes a long-term view to real estate and works hard to invest in long term and strategic relationships and is synonymous with a high quality service offering and a premium brand.