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Savills World Research
UK Commercial

Spotlight
Manchester Office Market

Autumn 2012

SUMMARY

■ We expect that the full year total for take-up in Manchester this year will exceed last year's take-up of 699,000 sq ft.

■ Availability has continued to fall during the second half of 2012. Grade A availability in the City is now at its lowest level since 2007.

■ Achieved rents fell in the third quarter of 2012, primarily due to a lack of lettings of such space. We remain of the view that the prime achievable office rent in Manchester is currently £30/sq ft.

■ Prime office yields have also remained untested over the last quarter. We estimate that the best achievable is now in the 6.00%-6.25% range.

■ Looking ahead, we expect that the lack of newly built Grade A space in the City core will put further upward pressure on prime rents over the next 18 months.

■ South Manchester has seen a recovery of sorts, with year-to-date figures exceeding City centre take-up.

"In 2013 Grade A stock will continue to become increasingly scarce. Mid-tier product will need to differentiate on price or quality"

Take-up in 2012 improves, but remains below average

■ Leasing activity in the third quarter of 2012 was another steady, but below average quarter. In the city centre office market 154,749 sq ft was leased, reflecting a slight improvement on the total for the second quarter of 2012.

■ This brings the total for the first nine months of 2012 to 483,539 sq ft, and we expect the full-year take-up this year to exceed 2011's total of 699,000 sq ft.

■ A notable trend this year has been the very low level of Grade A leasing activity. We estimate that only 13% of the space leased this year has been of Grade A quality, the second lowest level in the last 12 years. The most obvious reason for this is the generally low level of business confidence both locally and nationally. Furthermore, the banking and finance sector, which has traditionally paid the highest rents, has been particularly inactive over the last two years. Q4 will however show dramatic improvement.

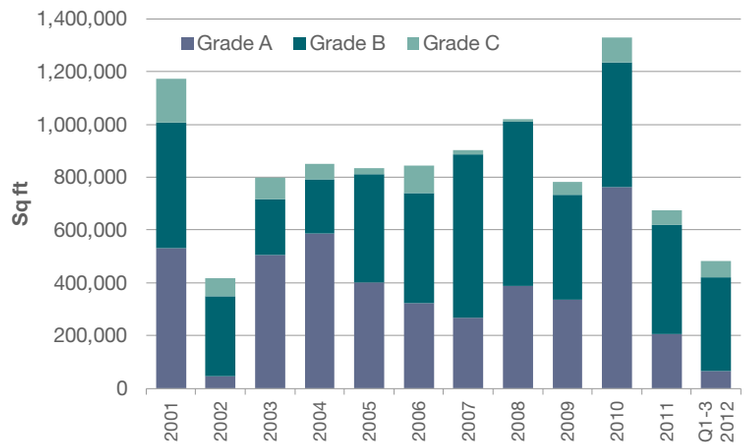
■ As we commented in our last report there are still a number of large tenant requirements that are yet to be satisfied in Manchester. Since then more has been revealed about one of them - the mysterious "Project Tomorrow". Not only is this a very large acquisition by a TMT business (180,000 sq ft in 20 buildings), but it is also a test of concept that could be rolled out to other cities in the future. This is a strong vote of confidence in Manchester's continued attraction as a credible location for inward investment in the UK.

■ As Graph 3 shows, tenant demand in 2012 has been very diverse, with the most notable changes being the absence of banking sector and the rise in the Telecommunications, Media and Technology sector to account for 26% of the office space leased in Manchester this year.

■ Availability has picked up slightly this year, primarily as a result of the addition of 3 Hardman Square to the market. However, despite this the Grade A availability has continued to fall, and we estimate that only one-third of the available office space

GRAPH 1

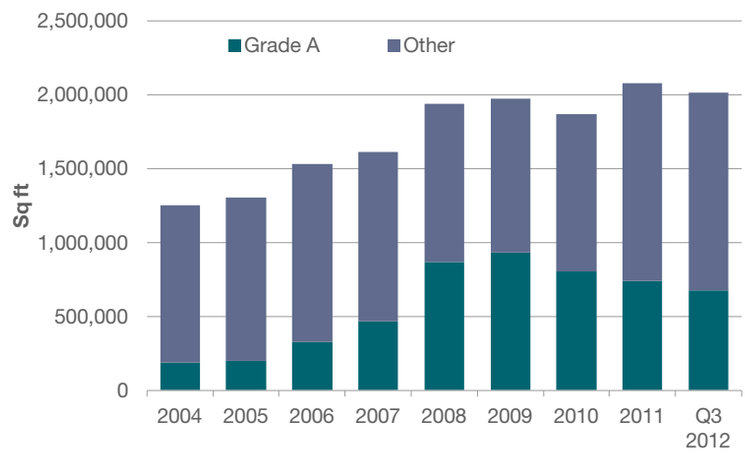
Manchester office take-up



Source: Savills

GRAPH 2

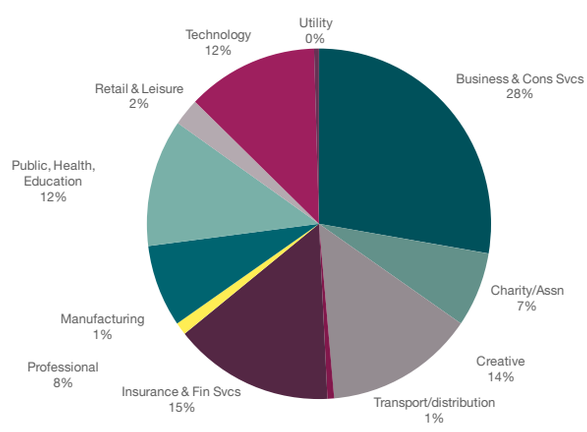
Manchester office availability



Source: Savills

GRAPH 3

Manchester office take-up by business type (2012)



Source: Savills

in central Manchester is of Grade A quality.

■ Looking to the future supply pipeline there is little new to say. While Hines are close to completing the purchase of their 50% stake in the former Odeon cinema site, we do not expect their planned 14 storey tower to proceed until a substantial pre-let has been secured.

■ This leaves Argent's 1 St. Peter's Square as the only speculative office development planned for central Manchester, and this will not be delivered until the first quarter of 2014.

■ Headline rents have remained flat for the whole of this year, and while there has not been a letting at £30/sq ft in the second half of 2012, this remains the top rent achievable in the City core.

■ We had expected to see more downward pressure on incentives this year, but this has not emerged. In common with all of the rest of the UK's office markets there remains a lack of confidence amongst both tenants and landlords. We do not expect to see a shortening of the rent-free periods on mid-tier product in the City until business confidence improves.

Investor focus continues to be on prime, with some big deals brewing

■ Investor interest in Manchester continues to be heavily skewed towards prime buildings with long-term secure income streams. Typical of this is the interest in the forward sale of the Co-op's new HQ near Victoria Station. We understand that there has been significant interest in this investment, particularly from risk-averse, non-domestic investors. The combination of a high quality building and covenant is exactly the type of investment opportunity that is in vogue across the world at present.

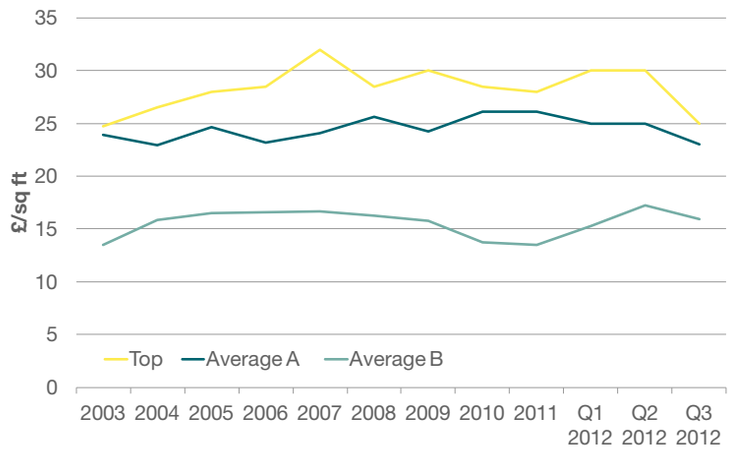
■ The other major investment deals that are in the pipeline are the sale of Exchange Quay in Salford, and ITV's old site on Quay Street. These are both large sites/assets that are likely to appeal to investors who are looking to create value, rather than just a safe-haven. At the time of writing we understand that Exchange Quay has gone to best bids, and Quay Street is under offer to Genr8.

■ Prime office yields in Manchester have remained untested over the last quarter. We remain of the view that prime investments with around 10 years income security should achieve an initial yield of 6.00% to 6.25%.

■ Away from the prime and secure end of the market we are still experiencing considerable yield divergence. At present we estimate that the spread between prime and secondary has widened to between 200 and 400 basis points, depending on location, which, at the upper end is wider than was seen in the early 1990's recovery.

GRAPH 4

Manchester headline office rents achieved



Source: Savills

Market snapshot

James Evans, director of office leasing in Manchester, looks behind the statistics

With the year end rapidly approaching, eyes will soon turn to year end take up figures and the respective health of Greater Manchester's office sub markets. Indications are that the City centre will have a reasonable year with take up exceeding 2011, whilst the out of town market is likely to significantly outperform last year's results.

Throughout the year much has been made of the "centralisation" of larger corporates and how this potentially will see an increased level of demand for City Centre offices from traditional out of town occupiers. BUPA and Jacobs Engineering are two notable examples of businesses historically based out of town that have considered a move into Manchester City centre for the purposes of better connectivity and ease of recruitment from a larger demographic catchment.

It remains to be seen what happens with these requirements, but this trend has continued throughout the year, with over 100,000 sq ft of demand currently in the market through requirements of this nature. More latterly these appear to be focussed out of town rather than in town, but with the season of goodwill upon us, it seems multi national corporates are realising the benefits of bringing their large families under one roof!

Gazing forward to 2013 we believe the key to leasing success will be attention to detail and differentiation. Grade A stock will continue to become increasingly sparse and therefore will naturally be differentiated. Our recommendation to clients who operate in the mid tier markets is that to be successful in such a competitive market place there is an absolute necessity for attention to detail, whether it be management or front of house first impression, without the basic fundamentals done to the absolute maximum, you don't stand a chance.

Beyond this, product must be differentiated from the sea of competing buildings. Price is one way of doing this but so is quality or the way a building is refurbished. Conservative "same old, same old" buildings will continue to under perform, those who exercise some creative thought and stand out from the pack will be the winners in 2013.

OUTLOOK

Top rents to rise by 3-5% in the next 18 months

■ Manchester remains the UK's second largest city office market, and one of the most credible destinations for domestic and international investment. We expect that this, combined with a gentle pick-up in local tenant confidence and demand will support a return to normal levels of leasing activity in 2013 and beyond.

■ The main story of 2013 will undoubtedly be one of steadily falling Grade A office availability in the City. We expect that the remaining space in Belvedere and Chancery Place will all be absorbed over the next six months.

■ The lack of newly built Grade A office space in the core will put further upward pressure on prime office rents in the City, and we are projecting that these will grow by 3% - 5% during 2013 and 2014.

■ Away from the new-build market we expect to see downward pressure on rent-free periods and incentives on Grade A space across the City during the first half of 2013. This will then be followed by rising rents where there are localised supply shortages.

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.

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