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Savills World Research
UK Commercial

Spotlight
Manchester Office Market Report

Summer 2016

Circle Square - a collaborative and connected space at the heart of Corridor Manchester surrounded by world leading centres of knowledge, science and technology, business, art, music and dance, providing up to 1.22 million sq ft of flexible, sustainable, Grade A office space.

SUMMARY

- With the outcome of the UK referendum now firmly sinking in, what does the result hold for the future of Manchester's office market?
- Despite the lack of trophy deals recorded during the first half of 2016, take up still remains in line with the first half long-term average.
- The second half of the year is likely to see significant lettings drop into the figures to bolster take-up. We therefore expect the year-end figures to hit one million sq ft.
- 2017/18 should be a good opportunity for the refurbishment market. Now could be the time for landlords to capitalise on this as occupiers may seek 'value for money' options.
- New enquiries have been more limited over the last month, but it remains too early to conclude if this is directly as a consequence of Brexit or a "seasonal adjustment".
- The investment market started strongly, with c.£300 million transacted in the first half of the year. This is 8% up on the first half of 2015 and 3% up on the five year average.

"With a robust occupational market and the possibility of increased 'north-shoring' to fuel demand, Manchester still has a lot to offer investors and occupiers"

Local economy

■ As with all major cities in the UK, the Manchester office market has entered a period of considerable uncertainty as the effects of the EU referendum unwinds within the UK office markets. With the outcome of the referendum now firmly sinking in, what does the result hold for the future of Manchester's office market?

■ Certainly at this point in time, the consequence of the vote on the UK economy is difficult to call and will only be evident over time. However, since the referendum result the Manchester occupational market has, to date, not witnessed any dramatic changes in market sentiment or feeling.

■ Arguably it is too early to draw any conclusions as to the impact of 'Brexit' but activity over the last few weeks is encouraging. Unlike the London market, where annual recorded take-up has oscillated significantly over the past five years, annual take up in Manchester has been relatively stable and we expect this to put the city in a good position going forward.

■ New Prime Minister Theresa May has indicated her intention to "bring the country together", which could suggest developing further infrastructure in order to deliver the 'Northern Powerhouse'.

■ Greater Manchester will also start to enjoy further financial autonomy to control its own spending after the Greater Manchester mayoral election takes place on 4th May 2017.

■ Manchester is expected to drive economic growth in the North West and Oxford Economics expect Manchester to see faster GDP growth than any of the other UK regional cities over the next five years.

■ Going forward, even taking into account current uncertainty, office GDP growth of 12.7% is expected over the next five years, which is above the UK average of 12%.

■ Historically, Greater Manchester's economic growth has been driven by the large-scale and rapid expansion of the service sector, particularly financial & professional services, which has seen employment growth of 11% over the last five years.

■ The city's impressive growth is attributable to a number of factors, including a strong professional and financial centre and a strengthening TMT sector, driven by the local enterprise partnerships.

■ Looking at employment growth over the next five years, even with Oxford Economics downgrading their forecasts in the light of Brexit, Manchester is still forecast to see a net additional 5,500 office based jobs, representing growth of 3.9%, which is above the UK regional average of 3.2%.

■ Nevertheless, this current uncertainty will inevitably affect business decisions. However, we believe there are certain sectors which are likely to withstand this.

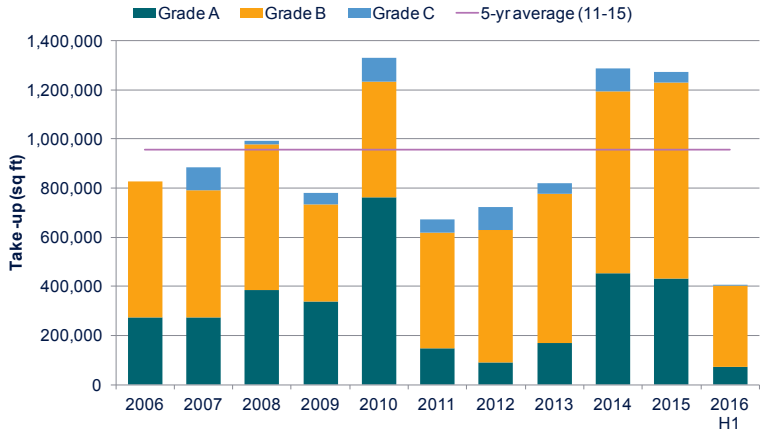
■ Indeed, areas which are expected to show strong growth over the next five years are professional, science & tech (3,800 net additional jobs) and administration & support (2,600 net additional jobs).

■ The legal and accountancy firms are likely to see higher levels of business due to Brexit, and thus are likely to see stable or higher than expected levels of leasing. The legal sector in particular will have a considerable increase in workload when the task of reviewing and re-writing the law and regulation books becomes pertinent.

■ We believe 'north-shoring' will remain a theme over the medium term, as businesses seek to control costs in a more uncertain world. With companies nervous about spending capital, there could be even more

GRAPH 1

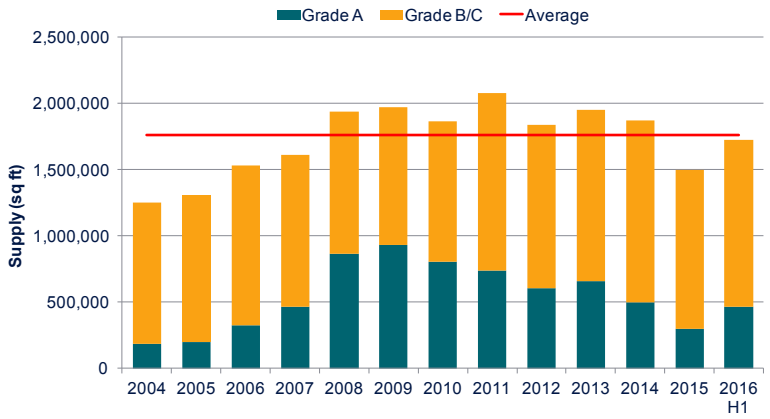
Take-up remains robust



Source: Savills

GRAPH 2

Grade A availability is currently at 2007 levels



Source: Savills

reason for occupiers to take their back (or middle) office functions to regional cities. Even if London rents start to fall, the gap between Manchester and London is still wide and when factoring in staff costs, the savings will be significant.

Occupational Market

■ Take up in Manchester city centre reached 415,257 sq ft in the first half of 2016. Despite the lack of trophy deals, take-up still remained in line with the first half long-term average.

■ A number of key deals have been delayed and are expected to take place during Q3 2016. We therefore expect the end year figures to hit one million sq ft (10 year average take-up is 990,000 sq ft).

■ The fear is most notably about occupiers deferring decisions due to uncertainty, however, the immediate evidence is that where lease events are impending, decisions are still being made.

■ One of Manchester's greatest strengths is the diverse nature of its occupier. Unlike many provincial cities it doesn't overly rely on the public sector or banking & finance.

■ The key to the city's success is striking a balance between attracting inward investment to the city and at the same time nurturing and maintaining the smaller SMEs within the city.

■ The overall profile of tenant demand in 2016 is broadly similar to 2015. However, looking at the first half of 2016 the proportion of the total take-up that was driven by the TMT sector has increased and accounted for 21% of the space leased, up from 17% recorded during 2015.

■ Looking at deals size, 51% of the total floorspace taken in the first half, was below 5,000 sq ft, above the long term average of 32%. This has been driven largely by the abundance of TMT firms and start-ups moving to the city.

■ Looking forward, 101 Embankment is rumoured to be under offer in its entirety (157,000 sq ft), a decision which still stands post referendum. This appears to illustrate resilience in the market. Consequently, the Department of Work and Pensions are now back in the market looking for up to 80,000 sq ft

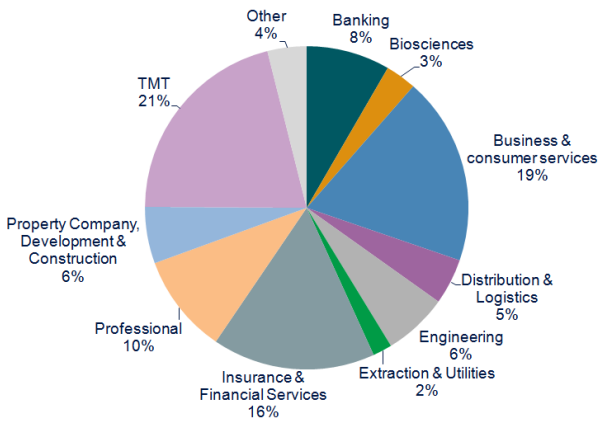
■ The total availability in the CBD has now fallen below 1.6 m sq ft, on par with 2007 levels. This figure is even lower for the best quality space, and we estimate that there is currently only c.460,000 sq ft of the best quality space available in the market (it was double this in 2009).

■ Although one million sq ft of developments are being built between 2016 to 2018, this is still manageable, with Manchester's pipeline up to 2018 over 50% pre-let.

■ 2017/18 should also be a good opportunity for the refurbishment market, with currently around 500,000 sq ft of significant refurbishments in the city centre office market.

GRAPH 3

TMT firms accounted for almost a quarter of take-up



Source: Savills

■ Now could be the time for landlords to capitalise on this as occupiers may seek greater 'value'.

■ With market uncertainty in the UK, potential occupiers are likely to go for a good refurbishment as a cost saving exercise. We expect to see some rental growth within the refurbishment market, however, this will be balanced against appealing to the 'cost conscious' occupier.

■ Headline Grade A rents have grown from around £28.50 per sq ft in 2010 to circa £34 per sq ft in the first half of 2016. This upward pressure on headline rents is anticipated to last in the short term.

■ One major unknown is the future plans of the largest corporates in Manchester. In the event of weaker economic growth, not only would this create a slowdown in demand, but also an increase in supply if occupiers place their space into the market.

■ Although we expect a very gentle rise in the vacancy rate over the next couple of years, it will remain low enough that it does not stimulate significant falls in the rents being achieved.

Investment Market

■ Manchester has been a key focus for investors into the UK regional office market and 2015 saw circa £640 million of office investment transactional activity in the city, well above the 10 year average of £428 million pa.

■ 2016 has started strongly, with c.£300 million already being transacted. This is 8% up on the first half of 2015 and 3% up on the five year average.

■ Many investors are currently taking stock, while the impact of the 'Brexit' vote is considered. This may mean that some deals will be delayed and re-negotiated, however, the smaller end of the market (sub £5 million) remains buoyant.

■ We have already seen an increase in regional office investment volumes from overseas investors in 2016. This investor type made up 70% of investment volumes in Manchester in the first half of the year, surpassing the long term average.

- This trend is likely to continue as overseas investors take advantage of the reduced competition and currency play.

- We expect the third quarter of the year to be quieter; however, an increase in transactional levels during the final quarter of the year is anticipated, with more stock coming onto the market and more clarity of the impact of the EU referendum on pricing.

- Investors are looking for any evidence that 'Brexit' is impacting on occupational markets. However, structurally the Manchester market is in a very good position, with robust take-up, low levels of supply and positive rental growth.

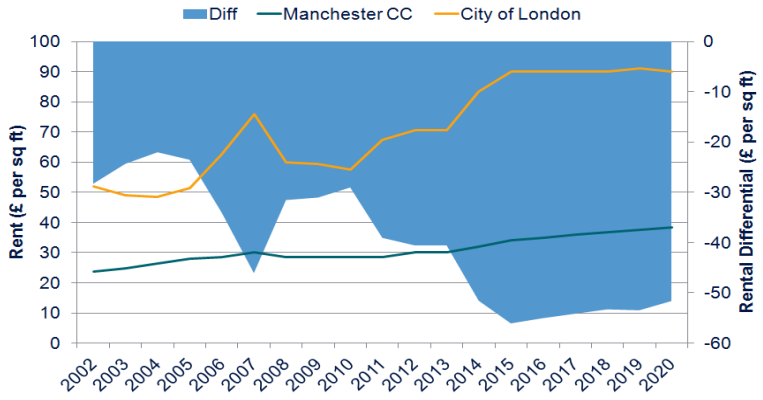
- There was always going to be more focus on longer term income deals, regardless of Brexit and this will intensify going forward.

- The market has moved into the phase of the cycle where the majority of the total return will be driven by income growth, rather than capital value growth and Manchester is well placed to deliver this.

- Caution and reduced transaction levels in the months ahead are almost certain, but in fact there remains a number of opportunities for the right buyer. With a strong occupational market and the possibility of increased north-shoring to fuel demand, Manchester still has a lot to offer.

GRAPH 4

The Manchester and City of London rental differential is currently at its widest



Source: Savills

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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