

Manchester Office Survey

Summer 2010

The market remains two tiered with a contraction of larger floorplate supply, but fierce competition between landlords for smaller enquiries.



40 Spring Gardens, purchased by CCC Ltd for c.£45m (6% yield)

- Take-up in the first half of 2010 totalled 318,004 sq ft. This is 37% up on the first half of 2009. 34% of space taken was Grade A specification.
- Total supply now stands at 1.9 m sq ft. Grade A supply accounts for 43% of the total. The vacancy rate stands at 11%.
- The supply of Grade A, large floorplate accommodation has diminished with active occupiers now facing limited options within the prime core.
- Looking at take-up by business sector, the Professional Sector propped up the market in the first half of 2010, accounting for 24% of take-up.
- The levels of incentive available to tenants over the last two years are no longer available to occupiers seeking large floorplates on institutional terms. Sub 10,000 sq ft floorplates continue to attract record levels of rent free.
- Our view is that prime yields for the City are currently 5.75%. This shows a year-on-year hardening of yields of approximately 125 bps

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Take-up, Supply & Developments

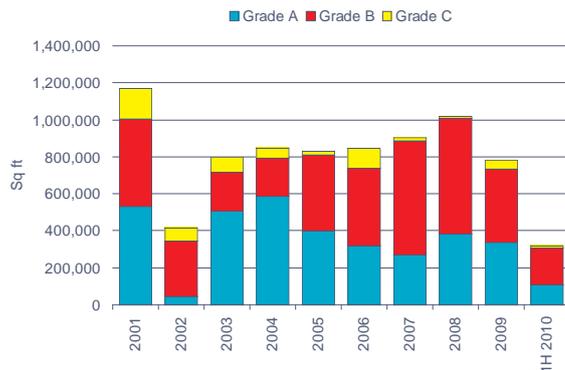
While the Manchester office market has proven itself far less volatile than some other markets over the last 20 years, no market has been immune from the global credit crunch and recession. Declining business confidence has restrained occupier demand and increased caution amongst lenders has stifled the development pipeline.

Take-up of office space in Manchester's City Centre in 2009 was 18% down on the previous years, with 809,099 sq ft leased.

Is demand in 2010 proving to be more resilient?

Take-up in the first half of 2010 totalled 318,004 sq ft. This is 37% up on the first half of 2009. 34% of space taken was Grade A. Although we predict the end of year figure will be in excess of 1 m sq ft, (five year average is 869,128 sq ft), this will be skewed by the Co-op committing to 328,000 sq ft within their new development.

Half year take-up is 37% up on the same period in 2009



Source: Savills

Looking at take-up by business sector, the Professional Sector propped up the market in the first half of 2010, accounting for 24% of take-up.

The Public Sector, which accounted for 21% in 2009, only accounted for 12% in the first half of 2010. Domination by the Public Sector will not be replicated in 2010 as the impact of budgetary constraints comes to fruition on Public Sector relocations.

However, on a positive note, the Mayfield Hub remains very much on the agenda but whether a public sector owned and funded scheme of this nature is deliverable in both the current economic and political climate remains questionable.

Active requirements in the Manchester office market have remained fairly steady throughout this year. 2010 will see an improvement in take-up, but we do not expect to see above average levels of leasing

activity until the recession is well behind us in 2011.

Elsewhere in the region the Greater Manchester brand has had a strong eighteen months with the success of attracting John Lewis, SPX and BSKyB to the region, fighting off strong competition from other regions. This is partly due to the availability of high quality accommodation in South Manchester, at reduced rents to Manchester city centre, and a strong pool of highly skilled labour within the area.

The supply-side in the short to medium term is more interesting. The development pipeline peaked in 2009, with only 450,000 square feet of new developments completing that year, with 2010 seeing no new completions.

Looking ahead to 2011 and beyond, the City has a situation where no new developments are planned to start without a pre-let.

Manchester office availability peaked in the second half of 2009



Source: Savills

Grade A supply has undoubtedly peaked and though pockets of Grade A supply remain available, only Carlyle's Piccadilly Place is able to accommodate 50,000 sq ft requirements on larger floorplates. This situation is likely to change when Credit Suisse place up to 180,000 sq ft at 3 Hardman Square back onto the market, following the break-up of Halliwells.

Looking longer term, there are clearly a number of larger office and mixed-use projects that could be delivered in and around Manchester over the next decade.

Some notable "non movers" in the last round of corporate relocations will be targeted as potential pre lets by those schemes that will come forward in the next round of development.

Argent in joint venture with GMPVF are well placed to drive the development of number 1 St Peter's Square

Rents & Investment

forward whilst Allied London will also be eyeing up pre-lets for the undeveloped plots within Spinningfields.

This low level of completions, combined with a modest recovery to average levels of take-up, will drive a steady fall in the vacancy rate over the next five years and a corresponding rise in rents. This may stimulate a speculative start of some of the schemes listed above, but even if all these are delivered over a five year period the level of completions will remain below average.

What effect has the down-turn had on rents?

The impact on the rents being achieved on the best space in the City centre has been surprisingly minimal, at least in headline terms. We estimate that top rents have fallen from £30 per sq ft at their peak, to their current level of £28.50 per sq ft. Over the last 12 months we have seen some rent stability but rent frees are yet to move back in.

In contrast to this the smaller scale end of the market, notably around the traditional prime core of the City, has deteriorated, with a lack of interest in smaller floors. There remains downward pressure on these rents with no prospect of incentives reducing in the short term as the menu of options for a tenant remains strongly in their favour.

However, this market is expected to slowly follow suit over the course of 2010/2011, as the window of opportunity for those tenants looking for better quality space associated with larger floorplates should begin to close.

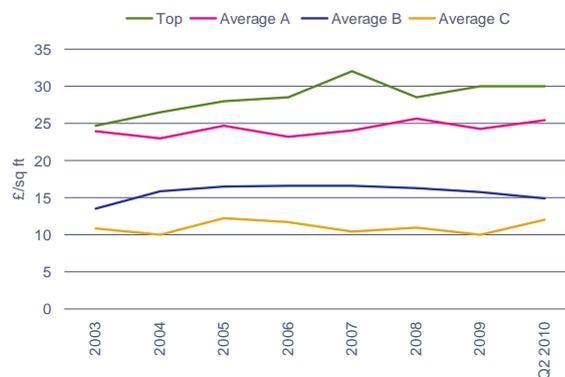
The smaller floorplate type stock of sub-10,000 sq ft remains exceptionally competitive with large numbers of landlords and developers seeking to mitigate their void office costs and in many instances pacify their lenders. Consequently many landlords are offering very tenant friendly terms in an effort to snare occupiers.

If we consider the complete absence of speculative development, a trend set to continue well into 2011/2012, it does provide some light at the end of the tunnel for landlords as occupiers seeking to relocate will need to compromise on some of their favoured criteria, most notably the ability to relocate to one floorplate.

In essence, the impact on this is that prime Grade A rents are likely to increase with incentives reducing somewhat in the short term on the remaining larger floorplate options in the market. In contrast the smaller floorplates will continue to experience downward pressure on rents in the short term.

We expect that both employment and demand for office space will again be on an upward path from 2011 onwards.

Top rents have remained stable in the first half of 2010



Source: Savills

Investment Market

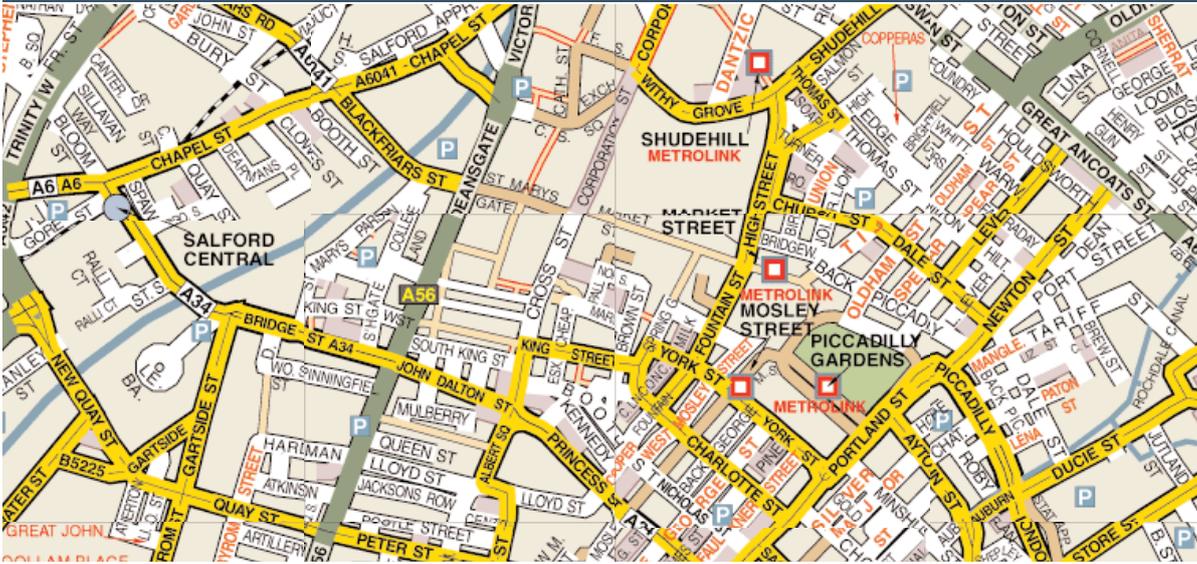
The final quarter of 2009 saw most funds return to the market as their cash weighting position grew uncomfortably high. With a lack of good calibre office investment product available (particularly in central Manchester), the inevitable happened and yields have hardened.

At the current time, the investment market is still almost exclusively institutional and cash backed. The debt markets are showing signs of easing, however the total cost of debt, including swaps and margins and the loan to value ratios still mean that debt buyers are unlikely to be the most competitive and vendors have a natural preference to sell to cash purchasers.

Despite this shortage of investment stock, the recent sales of 40 Spring Gardens (circa £45m 6%) to CCC Ltd and Direct Line House, Quay Street (circa 6% for 10 year income) to Aviva, underpins our view that prime yields for the City are currently 5.75%. This shows a year on year hardening of yields of approximately 125 bps.

The UK property market is still on a 'knife edge' in terms of sentiment and the recent stock market volatility has reminded investors that risks remain. In the short-term, property will recover at a slower pace.

Map and Contact information



Please note: we monitor space over 1,000 sq ft.

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.

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