Manchester Office Survey

Spring 2009

2009 is set to become a tenants' market as more attractive terms become available.

Piccadilly Place

- Take-up at the end of 2008 was a buoyant 993,001 sq ft (wider CBD take up totals 1,037,012 sq ft). These figures are the most impressive take-up figures since 2001.
- Enquiries recorded in early 2009 are 30% down on the same time last year.
- The vacancy rate stands at 11.1%. This is up from 8.9% at the same time last year.
- The development pipeline peaked in 2008, which should have a positive impact on the vacancy rate from this year.
- Lack of debt and the expectation that yields will soften further in early 2009, are causing investors to remain on the sidelines.
- At present, we believe prime equivalent yields in the city centre are 7%, which we estimate has shown a softening of 75 basis points over the second half of 2008.

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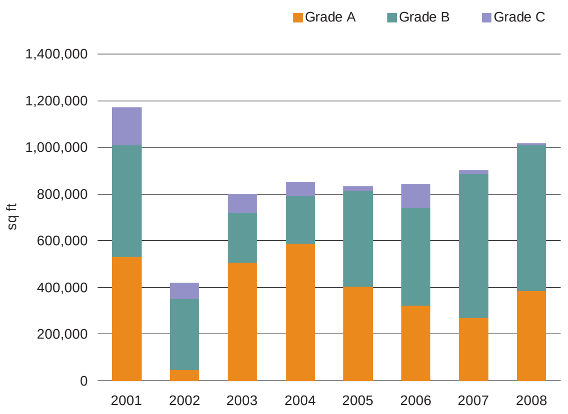
Take-up, Supply & Developments

Take-up at the end of 2008 was a buoyant 993,001 sq ft (wider CBD take up totals 1,037,012 sq ft). These figures are the most impressive take-up figures since 2001.

2008 take-up figures surpassed the five year average by 11% (five year average is 891,766 sq ft per annum), illustrating Manchester's confirmed resilience in the face of challenging economic times.

Analysing take-up by size band, 83% of the total number of transactions were for space below 10,000 sq ft. However, 2008 saw the larger end of the market hold up well. The most noteworthy deals being the acquisition of 50,000 sq ft by Bank of New York Mellon, 50,000 sq ft to the General Medical Council and 35,000 sq ft to BDO Stoy Hayward, who all took space at Spinningfields. All of these deals achieved some of the highest rents in 2008.

2008 saw the highest take-up figures since 2001.



Source: Savills

The biggest change in the supply/demand dynamic in Manchester this year has been on the supply-side with the arrival of all the 2008 speculative development completions into our availability figures. This pushed the percentage of space that is Grade A from under 30%, where it has been throughout 2007, to 45% at the end of the year.

However, during the fourth quarter a more positive picture began to emerge. Due to take-up figures reaching almost 300,000 sq ft as well as limited development completions coming on stream, total supply fell by 2% and now stands at 1.9 m sq ft.

The vacancy rate currently stands at 11.1%, which is up from 8.9% at the same time last year. On a positive note, the development pipeline peaked in 2008, which should have a positive impact on the vacancy rate going forward.

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Source: Savills

Looking at demand schedules at the beginning of 2008 there were serious Grade A enquiries of around 1 m sq ft. If we compare this to the enquiries in early 2009, at close to 700,000 sq ft this is 30% down on the previous years enquiries.

In the short term, occupational demand will no doubt remain subdued in 2009, with annual take up expected to be down on that seen in 2008. However, there are some signs of comfort. Unlike recessions of previous years, the profile of tenant lease events are very different. Gone are the years of 25 year lease commitment. The late 1990's and early 2000's saw the emergence of shorter term leases and/or five year break options, providing much greater lease flexibility to tenants. Consequently, many tenants have an option to relocate in the near future.

Our research indicates that there is a healthy level of latent demand still in the market. Savills are already tracking tenants with expiries and break options to ensure an accurate assessment of demand, while also looking to those who may be new to the market. If we we analyse lease events between 2009 and 2011, there are just over 1m sq ft of requirements potentially coming to the market within that timescale.

Targeting those occupiers with potential new requirements is set to become all the more important. Whilst many occupiers may elect to remain in their existing space or delay relocation until economic conditions improve, there will be those that will see 2009 as an opportunity to secure new premises on terms which may not be available in 12 months time. The hope is that this will provide a cushion for 2009 take-up figures.

Looking at take-up by business sector, the Professional sector and the Public Service sector dominated take-up in 2008, accounting for 22% and

Rents and investment

21% of space respectively.

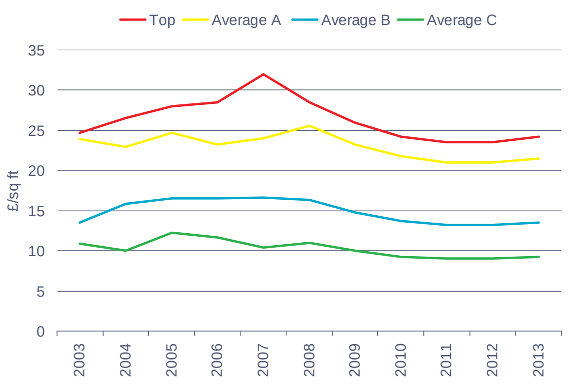
Looking forward, which sectors are likely to dominate the market in 2009?

Although the Lyons report has reached its targets, due to its success, the Government is continuing the principles behind the scheme. Indeed, Manchester continues to be successful in attracting and retaining large public sector bodies. The recent 50,000 sq ft acquisition by The Parliamentary Health & Service Ombudsman was a notable "win" for the city and with a further 250,000 sq ft of public sector requirements active, it is this sector that is likely to underpin take up over the next 12 months. Furthermore, a handful of the larger professional service providers which include solicitors and accountants, have yet to relocate within the city and it is likely a number of these will commit during 2009 and benefit from exceptional tenant incentives.

What is the likely impact on rents going forward?

Although market conditions gradually worsened throughout 2008, prime rents in the city centre have held at around £28.50 per sq ft. This was achieved on 5,000 sq ft at 3 Hardman Square to Ecclesiastical in the last quarter. However, the top rent for 2008 was £32.50 per sq ft, which was achieved at the Zenith back in quarter one.

Rent free periods are likely to increase in 2009 with rental cuts expected.



Source: Savils

It would appear that 2009 is set to become a tenants' market. Rent free periods are likely to increase with rental cuts expected, with Savills predicting that top rents will fall by 9% in 2009.

Rents on refurbished secondary space have already started to come down with prime rents expected to follow, although the relatively constrained amount of new development coming to the market should help minimise potential falls.

Looking forward, what are the city's prospects for 2009?

The combination of contracting demand and increased supply will lead to falling rents and increased incentives to occupiers. Occupational demand will no doubt remain subdued in 2009, with annual take up expected to be down on that seen in 2008.

Although occupational demand will soften until 2010, suggesting that there may be some short-term oversupply in 2009, with limited supply forecast for 2010/2011 it is possible that there will be an under supply from late 2010 onwards. If this is the case, the result of this will be reducing incentives and increasing rents. However, if the current downturn is prolonged and a larger amount of occupier space is released to the market, the recovery period is likely to move out.

Investment

While investors are becoming increasingly convinced that the UK is a "buy", lack of debt and the expectation that yields will soften further, are causing investors to remain on the sidelines.

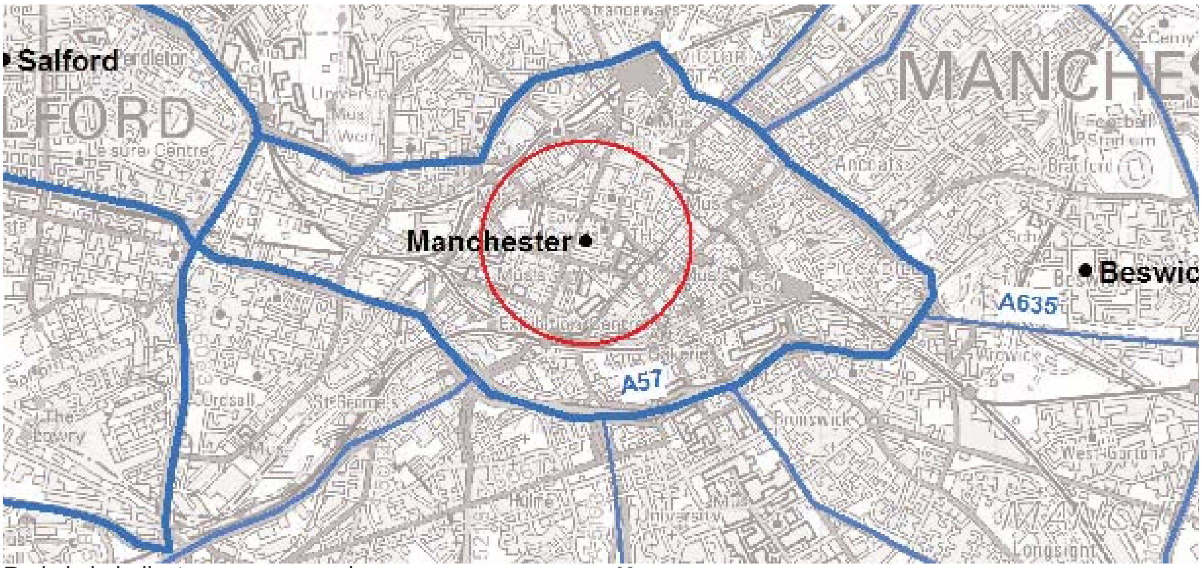
At present, we believe prime equivalent yields in the city centre stand at 7%, which we estimate has shown a softening of 75 basis points over the second half of 2008. Whilst it is difficult to make general comments, it is fair to say that good quality second hand buildings with a good letting history have re-rated to 8.5%.

The most significant deals in the last quarter have been at 2 Hardman Street, Spinningfields, which was acquired by HANSAinvest at a net initial yield of 6.75% and at 4 Hardman Square, Spinningfields, which was purchased by BP Pension Fund at a net initial yield of 6.95%.

During the next few months, investors will be keenly watching for signs that the fiscal stimulus, low interest rates and a recapitalised banking system will, at some stage, cause the economy to show signs of bottoming out.

Lack of rental growth and concerns about tenant default are rising to the fore as reasons to delay acquisitions. However, we are of the view that Sterling as a currency is significantly oversold, which presents a positive position for non-domestic investors. We expect to enjoy the benefit of increased levels of overseas investment as a consequence.

Map and Contact information



Red circle indicates area covered**.**

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

Key

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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