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Spotlight
Manchester Office Market

Quarter 1 2012

SUMMARY

■ 2012 has started quietly in the leasing market. However, there are a number of large active requirements that should be satisfied this year.

■ While Manchester will not be immune to the full effects of national and local government austerity, its strength in other industries will deliver steady employment growth.

■ Availability continues to fall, and only one-third of the currently vacant space is of Grade A quality. This will fall due to lack of new development and a steady recovery in take-up.

■ The general tone of rents is flat, but a new letting at Chancery Place has achieved a headline rent of £30/sq ft.

■ Investment evidence remains scarce, and we believe that prime yields continue to be supportable at their current level due to investor's risk-aversion. The spread between prime and secondary yields is widening.

"The City is strong in a number of sunrise industries that are expected to be the drivers behind the UK recovery."

Signs of recovery emerging in the leasing market?

- The dramatic bounce in office take-up that was seen in Manchester in 2010 was never likely to be repeated in 2011, but we had hoped for a better year than the eventual outturn of 673,570 sq ft.

- This was 23% down on the long-term average, with only 22% of the space let being of Grade A quality.

- However, the final quarter was the strongest quarter of the year at 246,000 sq ft, though this comparative strength has not been carried into the first quarter of 2012 when176,000 sq ft was leased.

- Manchester remains a diverse market in terms of occupier types, and the fact that it doesn't rely too much on either the Public sector or Banking & Finance should ensure that take-up recovers sooner than some other markets. This structural resilience is best illustrated by the current crop of larger requirements that include companies such as BUPA, Jacobs Engineering and Aviva.

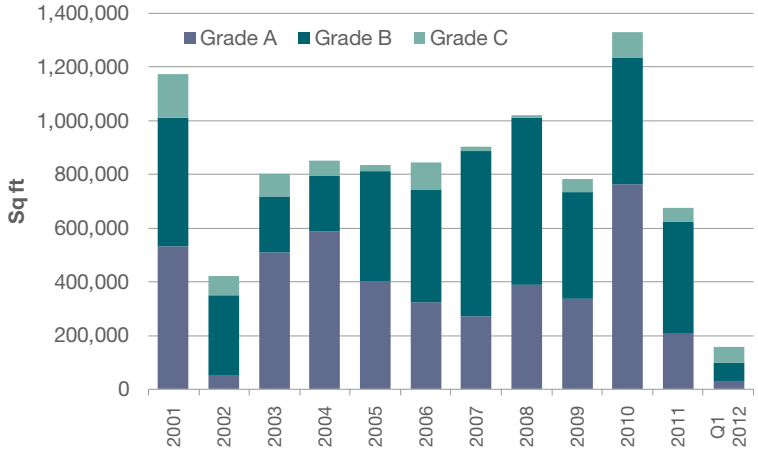
- One of the reasons why we have entered 2012 is more optimistic frame of mind is the fact that supply in Manchester appears to have peaked. We estimate that overall vacancy rate has fallen from 12% at the end of last year to 11.7% at the end of the first quarter of 2012. Grade A availability is now only 730,049 sq ft, only just over one-third of the total.

- The supply pipeline in Manchester remains highly restricted, with only 270,000 sq ft being speculatively developed by Argent and GMPVF. This will mean that larger tenants will be forced to look to pre-letting opportunities.

- The shortage of large Grade A space could also result in some demand diversion from the core to the fringe, and this might benefit Salford and South Manchester in the longer term.

GRAPH 1

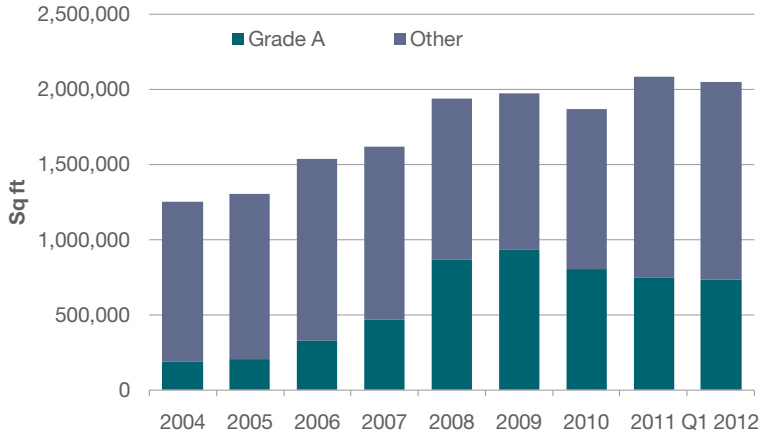
Manchester office take-up



Source: Savills

GRAPH 2

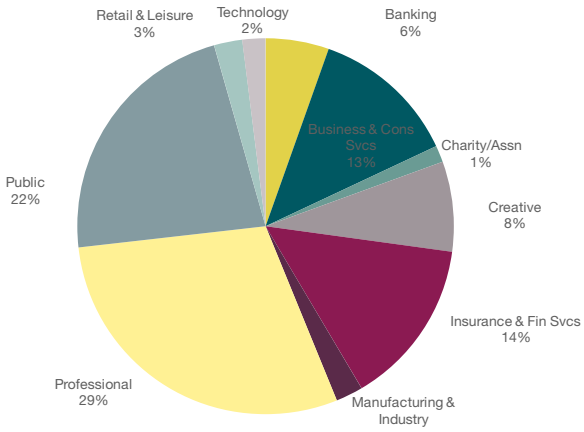
Manchester office availability



Source: Savills

GRAPH 3

Manchester office take-up by business type (2011)



Source: Savills

■ The real undersupply is already beginning to emerge at the smaller unit end of the market, and this is where we are beginning to see the beginnings of a recovery in headline rents. Typical of such space is the 6,820 sq ft at Chancery Place that was let by Savills to QBE Insurance in March this year for £30/sq ft.

■ £30/sq ft is the highest office rent achieved in Manchester since 2008, and represents a rise of 7.1% on 2011's highest rent. This rental recovery remains thin, and we are yet to see a similar rise in the average Grade A rent achieved, although the average Grade B rent achieved did rise in the first quarter of 2012.

Yield spreads widen in the investment market, as investors continue to prefer "prime"

■ The office investment market in Manchester remained fairly stable in the first quarter of 2012, with most owners unwilling to sell due to a lack of alternative places to reinvest.

■ Investment evidence has remained relatively scarce, though we understand that 4 Hardman Square at Spinningfields, with an average weighted unexpired term of seven and a half years is currently under offer at close to 6.5%.

■ We remain of the view that prime investments with around 15 years income security should achieve an initial yield of 5.75% to 6.00%.

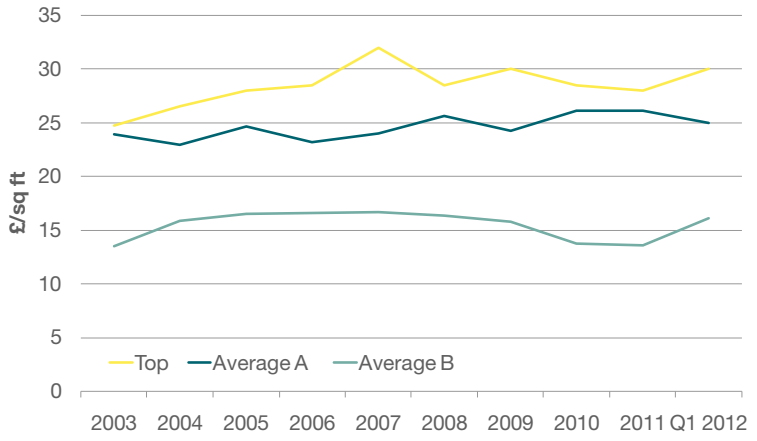
■ Away from the prime and secure end of the market we are still experiencing considerable yield divergence. At present we estimate that the spread between prime and secondary has widened to between 200 and 400 basis points, depending on location, which, at the upper end is wider than was seen in the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

■ While we would be the first to encourage a realistic assessment of letting risk, there is an increasingly supportable argument that the Manchester market is less overrented than some markets, and that the recovery of the leasing market may come sooner than some investors are expecting.

■ There remains a tertiary segment of the investment market that is generally unfundable, however we do believe that for some regional markets such as Manchester now may be the time to rediscover the joys of Grade B.

GRAPH 4

Manchester headline office rents achieved



Source: Savills

Market snapshot

Patrick Joynson, head of office agency in Manchester, looks to the future

"Disappointing", "depressed" , and "dire" were just some of the adjectives muttered by Manchester's letting agents when discussing the office market in 2011. At least there was some comfort in knowing that others were having difficult conversations with clients as they thumbed through equally thin enquiry schedules. It appears we were all guilty of trying to comfort clients by favourably comparing "our" office market with other "much worse off" provincial towns! Although I fear the "least worst option" argument is somewhat akin to a stockbroker telling a client that although he's lost 20% of their wealth he should be delighted to hear he's "out performing the market" that lost 25 %!

Well that was 2011 with take up 50% down from it's peak but what does 2012 hold in store for the office landlord? Well there is no doubt that there is more of a spring in the step of their letting agents. Take up for the quarter was 37% greater than the first quarter of 2011. Enquiry schedules are beginning to bulk out with active requirements.

BUPA (160,000 sq ft) and Jacobs (90,000 sq ft) are keeping the market guessing but both look like they may land this year. One Manchester office agent could soon have everyone buying him drinks for the next month if his secretive and somewhat intriguing occupier gives the green light to their Project Digital requirement of 150,000 sq ft in 15 separate offices. And we should not forget the slightly stuttering requirement for 40 - 70,000 sq ft of Aviva that again may break cover in the next few weeks as might our old friends at Panones who are still to make a decision on their 90,000 sq ft relocation.

These are all champagne deals which if they come off this year will makes several landlords and agents very happy. Indeed if BUPA and Jacobs choose the City Centre over out of town, then in total 550,000 sq ft of the quality city centre office stock could be devoured. In this event the pendulum of power will swing firmly back in favour of landlords for the first time in ten years. And that means a return to notable rental growth.

OUTLOOK

Supply-driven recovery ahead?

■ Manchester is tradtionally seen by many non-locals as part of an amorphous post-industrial region called "the North". Actually the City is strong in a number of the sunrise industries that are expected to be the drivers behind the UK recovery. The City's strength in media, new media, education and biotech are all factors that will insulate it against the drag of public sector austerity.

■ Public sector cuts will hit Manchester, and our recent national study into these cuts predicts that Manchester could lose between 10 and 18,000 public sector jobs during this downturn and recovery.

■ However, the City's strength in other areas will ensure that employment growth actually continues, with overall empployment forecast to rise by 2.5% between 2010 and 2014. This will make Manchester one of the top five strongest recovering cities in the UK.

■ We expect that the office market will see a gentle recovery in demand, back to average annual levels of take-up from this year. Smaller unit demand will continue to be satisfied by existing stock, albeit with a dwindling supply of Grade A space. Larger requirements will be forced into the pre-let market, and this may in turn stimulate some speculative development in the medium to long-term.

■ Grade A availability will continue to fall, and we expect to see upward pressure on rents continuing in the sub 10,000 sq ft market. This will gradually spread into the larger size bands over the next two years, starting with upward pressure on pre-let rents.

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.

Savills Manchester Office Agency & Investment

Please contact us for further information

Patrick Joynson
Leasing
0161 277 7216
pjoynson@savills.com

James Evans
Leasing
0161 277 7238
jevans@savills.com

Peter Mallinder
Investment
0161 277 7211
pmallinder@savills.com

Oliver Foster
Investment
0161 277 7212
ofoster@savills.com

Mat Oakley
Research
020 7409 8781
moakley@savills.com

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