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Savills World Research
UK Commercial

Spotlight
Leeds Office Market

Summer 2017

Toronto Square, the 88,200 sq ft building in Leeds, has been acquired for £22.2m by JP Morgan Asset Management.

SUMMARY

- Savills expect end of year take-up to reach 800,000 sq ft, 94% above 2016 and the best year on record.
- The Leeds office market has been extremely resilient through recent economic shocks with c.19,000 office based jobs being created over the past five years.
- The tech sector is expected to grow by 5.6% over next five years compared to 2.8% over last five.
- The 46,000 sq ft Burberry deal signifies the largest office letting in Leeds this year and sets a new rental tone for Leeds at £30 per sq ft.
- Whilst we expect overseas investors to remain a prominent player in the second half of 2017, we also expect the UK Institutions to resume activity.
- Leeds is now 100 basis points from its 10 year, prime equivalent yield all time low, representing a good buying opportunity.

"The 'West End' has seen significant developments over the last five years and we expect this to continue to grow as an office destination" Paul Fairhurst, Director, Office Agency, Leeds

Strong employment growth in key sectors fuels demand

Strong professional and financial services, strengthening digital and healthcare sectors alongside increased investment in city centre regeneration has ensured the city's resilience through uncertain economic times.

A key feature of the success has been the improved office offering, alongside enhanced amenities and infrastructure. £174m of government money has been ear-marked to improve transport in Leeds and this will help to better connect the growing city, increasing productivity and supporting major economic growth areas. The city saw 19,000 office based jobs created over the past five years, representing a growth of 12.4%, faster than the UK average of 10.9%.

Leeds' increasing employment opportunities, as well as the improved culture and leisure offering (Leeds has just been awarded fifth place in Lonely Planet's best in Europe list) is attracting a highly skilled workforce. The City region has a first class 'talent pool' providing 38,900 graduates per annum from two world class business schools and 9 universities.

The proposed HS2 line will also be a huge boost for the city economy. With the delivery of the second leg of HS2 into Leeds in 2033 this will create a potential 20,000 jobs, providing a catalyst for office development to the south of the station.

Office take-up ended the year at 415,000 sq ft, 42% down on the previous year and 25% down on the long term average. However, with HMRC/NHS Digital about to commit to a new regional HQ in the city totalling around 380,000 sq ft, Savills expects 2017 take-up to reach 800,000 sq ft, 94% above 2016 and the best year on record.

2017 has started strongly, with Burberry taking 46,000 sq ft of space in the second quarter of this year. They have moved 300 of their London staff to 6 Queen Street. We expect this trend of 'north-shoring' to pick up speed as occupiers recognise the attractions of the city.

The recent growth from the TMT sector is a welcome addition to Leeds' already strong Professional and Financial Services sectors. Indeed, many of the TMT companies based in the city, including Sky, are in expansion mode and very much thriving in the 'gigabit city'. Leeds' fibre network can tap into network speeds 100 times faster than the national average making it an attractive proposition for the growing tech scene.

Digital jobs in the region are predicted to grow at 10 times the rate of non-digital and the tech sector is expected to grow by 5.6% over next five years (compared to 2.8% over last five). This growth is driving Leeds city centre to expand south of the River Aire where Leeds is now home to over 8,500 digital and technology companies.

Google and Sky's increased presence within the city is an endorsement of the city's ability to nurture a growing tech hub. Google have selected Leeds as the first destination for its 'Digital Garage', situated at Leeds Dock. Google's initiative will help over 200,000 UK start-ups to develop digital skills. Over the last 18 months, Sky has also increased its staff within the city, from 40 to 650 and they are now expanding into another 25,000 sq ft in the city.

Incubator space at 'Platform' will also have an impact on nurturing tech and creative start-ups. Bruntwood has received grant funding to develop a creative/tech hub area within the building. This is initially on a part floor of 5,000 sq ft, but if successful, we expect this concept to grow around the city.

There has been a lot of talk about the city shifting Southwards to accommodate the growing tech sector, however, there has also been a shift from the traditional core westwards, over the last five years. Key developments include: Whitehall Riverside, Wellington Place and Central Square, all contributing to the shift in the city centre towards the West End.

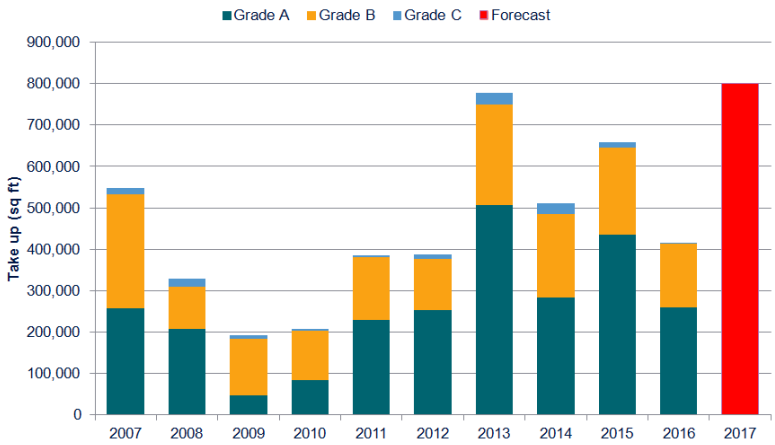
These contemporary developments have attracted more corporate occupiers including PwC, RSM Tenon, Equifax and Squire Patton Boggs. We expect this area to continue developing over the next five years, with schemes creating a truly mixed use environment.

Grade A supply continues to decrease

With increased demand anticipated this will have a marked impact on the supply figures. 3 Wellington Place (109,000 sq ft) is the only new development completing within the next 12 months. With only 130,000

GRAPH 1

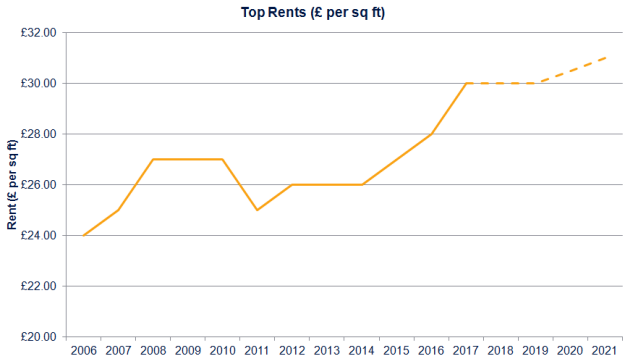
2017 take-up is expected to be the best on record



Graph source: Savills Research

GRAPH 2

Top rents hit £30 per sq ft in the first half of the year



Graph source: Savills Research

sq ft of Grade A supply on the market by the half year, and with average Grade A take-up equating to 256,000 sq ft per annum, Leeds currently only has 6 months worth of Grade A space available.

Key refurbishments available this year, include 'Platform' (120,000 sq ft) and 7 Park Row (40,000 sq ft), which will help the dwindling Grade A market as we wait for 250,000 sq ft of developments to come into the figures by 2019, which is likely to include: the Majestic and 4 Wellington Place.

With the HMRC/NHS Digital requirement set to represent the big ticket deal, plus an estimated two million sq ft of lease events anticipated by 2020, there is a growing need for city centre development.

The Burberry deal signifies the largest office letting in the city this year and at £30 per sq ft, sets a new rental tone for Leeds. This is an impressive 9% growth on top rents this year. To date, this has has only been achieved on the top two floors of 6 Queen Street, however, we expect this new rental high to be achieved on new developments, including 3 & 4 Wellington Place and Majestic as they come to market.

Rental pressure also continues to develop on good quality refurbished space across the city. Leeds has seen top refurbished rents rise 23% over the last five years, from £22 per sq ft in 2012 to £27 per sq ft in 2017. This closed the gap on the rental differential with new builds from £4 per sq ft to only 50p per sq ft.

However, we are now starting to see this gap widen again as top rents have jumped from £27.50 to £30 per sq ft.

Sentiment improves in the investment market

Leeds city centre office investment volumes for 2016 were £182 million, broadly in line with the long term average of £190 million per annum. Although Q1 2017 has started the year slowly reaching £35m, we are now beginning to see improved sentiment within the market.

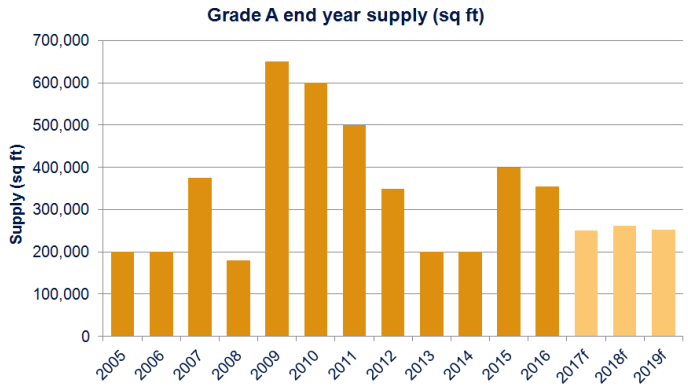
The most significant deal this year, to date, is Toronto Sq, the 88,000 sq ft building which sold for £22.2m to JP Morgan Asset Management. We understand that a number of assets which have been on the market for some time are now either in solicitors hands or close to completion.

Local councils have been a particularly active investor sub-type in the UK regions during 2016 as they searched for value post EU referendum. This investment activity included Leeds City Council's £44m purchase of 3 Sovereign Square, Leeds (which was also the largest office transaction in Leeds in 2016). Whilst we expect overseas investors to remain a prominent player in 2017, we also expect the UK Institutions to resume activity as a large number of funds are sat on high levels of cash reserves.

UK regional prime office yields remain attractive at 5.25%. Leeds prime office yields trail behind those achieved in Manchester and Birmingham by around 25 basis points and currently stands at 5.5%. Having stabilised post EU referendum, we expect yields to remain at this level.

GRAPH 3

Grade A supply continues to fall due to lack of development completions



Graph source: Savills Research

Expert view

Matthew Jones, development director in Leeds, gives his view on the market

In the last development cycle in Leeds' city centre, over 1,000 residential apartments were developed per annum on average between 2002 and 2007. Are we to see a re-emergence of the residential apartment market over the coming years?

Since 2008 there has been limited city centre development with no more than 300 apartments having been constructed. Our view is that this about to change with the emerging build-to-rent market and demand for market-sale housing in the city centre will start to increase.

Leeds city centre has witnessed an increase in the number of planning applications and planning permissions granted for new build developments across the city.

A recent planning application has been made by Vastint on the former brewery site, which includes up to 850 apartments. This will provide further focus in the South Bank area which will no doubt generate further development potential over the coming years.

We predict that Leeds is now at the start of a significant city centre residential development pipeline, which will help to develop residential alongside the office and retail developments currently being undertaken and planned creating a real mixed-use feel to the city.

Over the last three years Leeds city centre has seen over 15 residential/mixed used sites being sold for between £300,000 to £2,200,000 per acre.

Currently there are very few sites available and demand from developers and investors is high, which will lead to competitive bidding for any sites that come onto the market.

Overall the market is in a good place and I would expect to see several additional tower cranes across the city centre in the next two years, helping to deliver a new wave of residential supply into the Leeds city centre market.

Headline stats, definitions and contacts

6%
office based employment growth over the next five years

6
months worth of Grade A office supply in city centre

109k sq ft
office development currently under construction (excluding pre-lets)

9%
rental growth on Grade A offices since end 2016

Headline statistics	Take-up: in-town	Take-up: out-of-town	Top rents (£ per sq ft)	Prime yield
Full year 2016	415,000 sq ft	308,294	£27.50 per sq ft	5.5%
End 2017 outlook	↑	→	↑	→

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 refurbish-ments).
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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