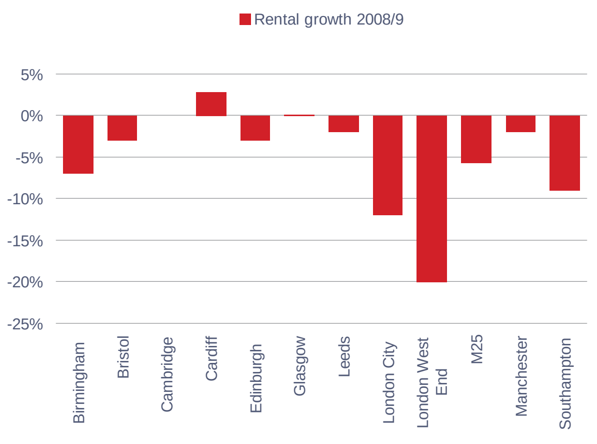
UK Office Market Report

Winter 2009

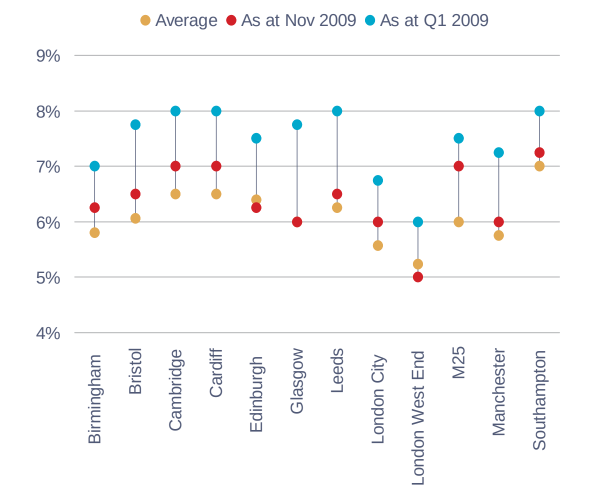
Investment confidence has grown in prime stock, whilst the occupational markets are still below trend.

Rents have fallen an average of 5% over all cities.



Source: Savills

Prime yields have moved in significantly since Q1.



Source: Savills

- The first three quarters of 2009 recorded lower levels of take-up in all cities, with deals being done with increasing levels of incentives.
- Fewer new developments will result in office supply levels falling this year and next. There will be a significant shortage of new space from 2011 onwards, in some cities.
- Vacancy rates are lower than in previous recessions, with limited new developments in the pipeline.
- All occupier requirements, across all cities, have fallen in the last six months. Demand is likely to remain restrained into 2010.
- We expect the London economy to come out of this downturn faster than the rest of the UK, but at a slower pace than we have seen following previous recessions.
- The bulk of rental falls have now happened in the City and West End; some regional office markets have further to go.
- With all cities now having shown some yield hardening, it is clear that the pick-up in investor sentiment for secure income is not a "blip".
- Another factor to consider both for the leasing and investment markets is the likely pace of the recovery in the debt markets and to what volumes of lending they will recover to.

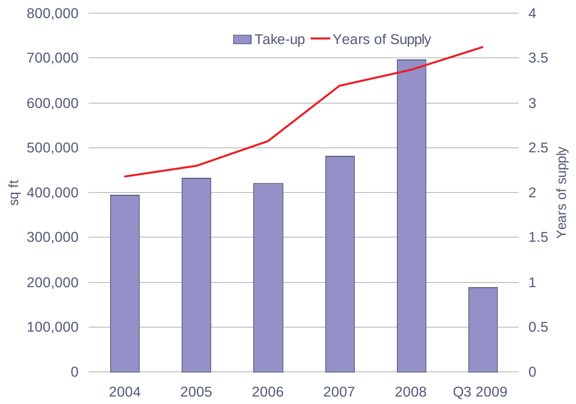
Birmingham, Bristol, Cambridge

Birmingham

Take-up in the first three quarters of 2009 in Birmingham's prime core, reached 188,094 sq ft, 69% down on the same time last year. Take-up by the end of the year is likely to be under 300,000 sq ft. 73% of this space was Grade A. The Public sector is underpinning the market in 2009, accounting for 42% of take-up. Total supply has risen in the third quarter of 2009 and now stands at 1.9 m sq ft. The current vacancy rate is now 16.5%. The highest rent achieved in 2009 is £28.20 per sq ft, which was achieved in Q3 on 3,564 sq ft of space at 9 Colmore Row. Headline rents are down 7% on the same time last year.

There is a depth of interest in prime, well let stock Although there is currently limited transactional evidence, we believe prime yields have now moved in from 7% to around 6.25% in the last quarter.

The Public sector is underpinning the market in 2009, accounting for 42% of take-up.



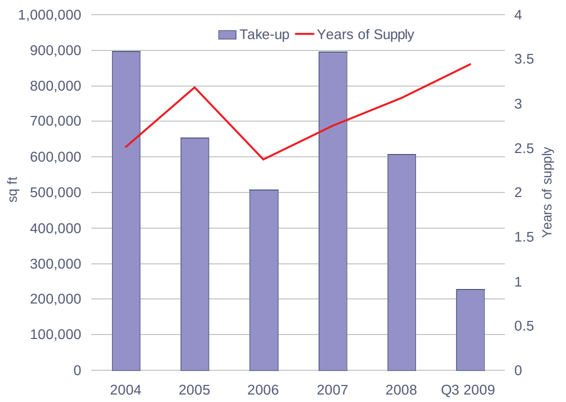
Source: Savills

Bristol

The city centre market has experienced the brunt of the downturn, with take-up over the first three quarters of the year totalling 228,365 sq ft. This is 54% down on the same period in 2008. For the remainder of 2009 it is unlikely there will be any significant return in demand. Despite falling occupier demand, availability of grade A space in the city centre remains relatively constrained. Headline quoting rents for grade A are holding, although quoting rents on second hand space have seen downward revisions. Incentives have also increased.

Overseas investors continue to be the biggest spenders, led by the German funds. Whilst the last recorded evidence is at 7.25% yields have moved in and we suspect that 6.5% would be achieved if there were a prime property in the market today.

Despite muted demand, supply of Grade A space in the city centre remains relatively constrained.



Source: Savills

Cambridge

At the end of quarter three take up was 190,000 so ft, down 49% on the five year average. Also, demand has declined, with a number of requirements being withdrawn from the market. However the third quarter of the year showed some promise of an early stage recovery with two major deals being completed totalling 40,000 sq ft. Prime headline rents are generally holding out, however, there is pressure on incentives and flexibility. Overall though, we are seeing that this pressure is starting to ease from the height of the recession during the end of 2008 into the early part of 2009.

Prime yields in Cambridge now stand at around 7%. Despite the recession and the decline in some areas of the market, Cambridge city centre has remained in demand with occupiers and investors alike.

Take-up in Cambridge is 49% down on the five year average.

Source: Savills

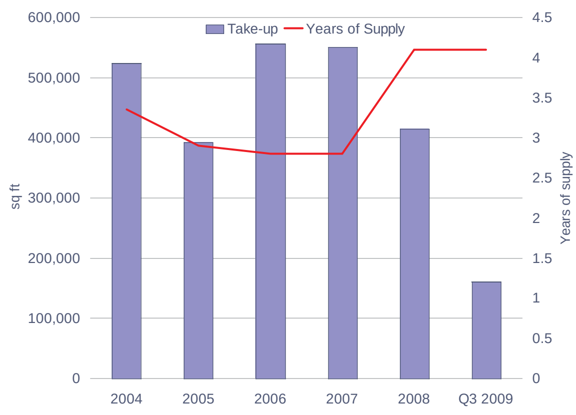
Cardiff, Edinburgh, Glasgow

Cardiff

2009 has seen low levels of occupier demand. Most regional UK cities have seen much lower levels of take-up with the expectation for Cardiff being a 28% fall in take-up in 2009 to 310,000 sq ft. Availability will have risen during the year to 1.35 million sq ft for the Cardiff area. Of this, there is around 270,000 sq ft of Grade A space available. Unlike many cities in the UK, Cardiff has witnessed an increase in the prime headline rent during 2009, to £21 per sq ft. The current expectation is for top rents to remain stable in 2010, although incentives are expected to rise, particularly on those offices that have been vacant for some time.

There is a depth of interest in prime, well let stock. Prime yields currently stand between 6.75% to 7% of which there is currently a lack of stock.

The expectation for Cardiff is an 28% fall in take-up by the end of the year.



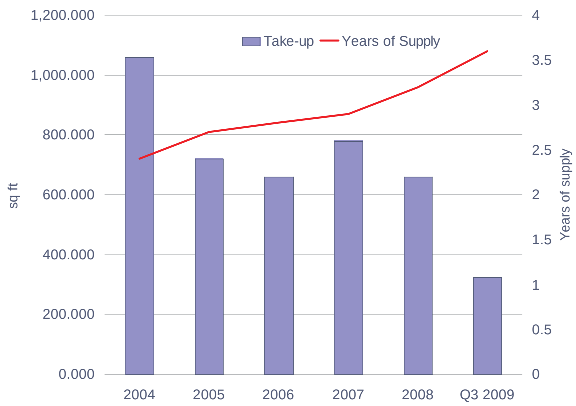
Source: Savills

Edinburgh

The take-up of office space in the first three quarters of 2009 was 323,000 sq ft, marginally lower than the same period of 2008. However, demand has held up better than in many other regional cities due to the continuing strength of office demand from the Public and Financial Services sectors. The City has now seen an increase of tenant returns of office space as a result of the recession, coupled with the completion of a number of new office developments over the last nine months this has swelled the total availability in the city to 2.8m sq ft. Prime headline rents have remained stable during the course of 2009, but rent free periods have lengthened. We expect to see falls in headline rents in the last quarter of 2009 and early 2010.

Edinburgh's office market has seen one of the most dramatic turn around in terms of yield profile. Prime yields have fallen from 7.5% at the start of 2009 to their current level of 6.25%.

Demand from the Public and Financial Services sectors has help cushion take-up figures.



Source: Savills

Glasgow

The Glasgow office market saw a spectacular increase in take-up in the third quarter of 2009. This was helped by a 126,000 sq ft letting at Broadway One to Tesco Personal Finance. Demand remains strong, with around 500,000 per sq ft of unfulfilled requirements in the market. On the supply side 2009 saw Glasgow's largest ever level of completions. Supply will peak at the beginning of 2010 and then begin to fall as demand absorbs existing stock. No further speculative development activity is expected until 2011. Headline rents remain at £28.50 per sq ft, albeit net effective rents have decreased as tenant incentive packages increase.

Prime yields have come in over the last quarter and now stands at 6%. Although currently there is limited transactional evidence, we envisage transactional volumes increasing over the next 3 months with Bothwell Street under offer and the Broadway One offfice Investment on the market.

The Glasgow office market saw a spectacular increase in take-up in the third quarter of 2009.

Source: Savills

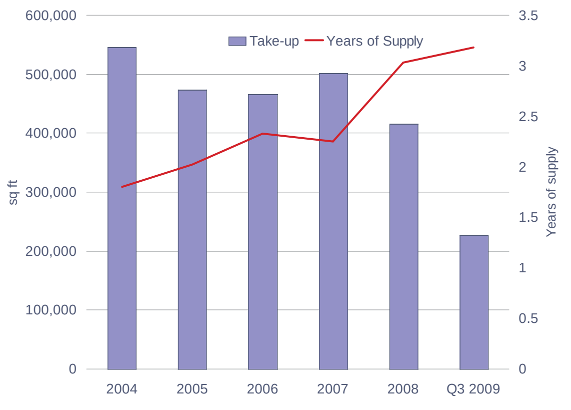
Leeds, London City & West End

Leeds

2009 has been slow in terms of occupier demand, with the first three quarters of the year totalling 275,104 sq ft, down 17% on the same time last year. The expectation for Leeds is a 25% fall in take-up this year based on the five year average, to 350,000 sq ft. Supply has remained stable over the last quarter and has held at 1.8 m sq ft. This equates to a vacancy rate of 12.6%. Top rents are holding up at £27 per sq ft. However, with the general decline in demand, landlords have re-evaluated their terms in the second half of the year.

A number of UK institutions have recently launched regional prime office funds, with a specific focus on Leeds. With demand outstripping supply, we believe prime yields are around 6.5%, hardening around 75 basis points in the last quarter with potential to harden further.

The expectation for Leeds is a 25% fall in take-up this year, based on the five year average.



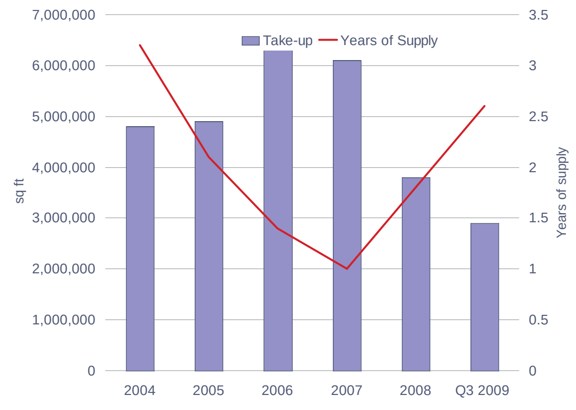
Source: Savills

London; City

As some confidence has begun to return to the world's financial markets, we are beginning to see an improvement in the City of London office market. Since the start of the year tenant demand has gradually improved and the total space leased to the end of September has reached 2.9 m sq ft (3.4 m sq ft to October). While this remains well below the long term average, it is broadly in line with the level reached in the same period of 2008. Due to the pick-up in demand and reaching the peak in the development pipeline, the vacancy rate has begun to fall and currently stands at 15.3%. We have seen an improvement in rents in some parts of the market during the latter part of 2009 and expect this to continue into 2010.

Investor demand for prime, secure income streams has intensified over the course of this year, and prime yields have moved in from 6.75% to 6% since March.

Take-up in the City of London increased significantly in the third quarter.



Source: Savills

London; West End

Take-up in the first nine months of the year reached 1.5 m sq ft, the lowest level in the last 20 years (1.9 m sq ft to October). However, due to the very restrained development pipeline and limited tenant returns, the vacancy rate in the West End remains low at 6.7%. This is also well below the levels reached in this market in the last two downturns. Headline and net effective rents have fallen sharply over the course of 2009, and we estimate that average prime rents are now around 50% lower than the peak level, having fallen by 20% this year.

Investor demand, particularly from overseas investors looking for long-term secure income streams, has been very strong this year. We estimate that prime yields have hardened from 6.25% to 5% over the last three months.

The vacancy rate in the West End remains low, due to the restrained development pipeline.

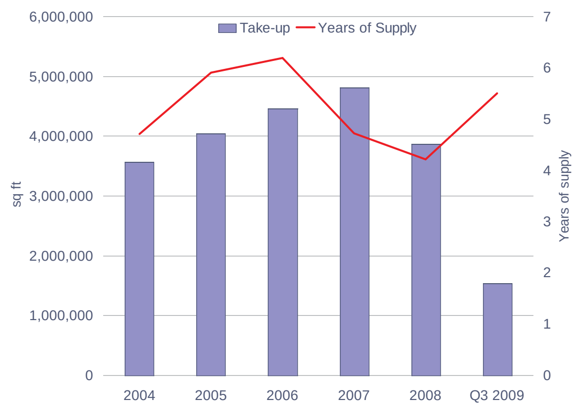
Source: Savills

M25, Manchester, Southampton

M25

With over 210 million sq ft of office stock, the M25 contains varied office markets. At the end of Q3 2009, take up was 1.4 million sq ft, compared to 3.2 million sq ft during the same period last year. Unsurprisingly, the deals that have been done involve enhanced incentives, with the rent-free period around 14 months on average and lease lengths have shortened. The technology sector accounts for 20% of take up; the financial and business services sector accounted for a quarter of the deals. Office supply is higher than anticipated due to the very weak demand levels. The supply of new space on the market has receded as developers have reigned in plans significantly. In terms of rents, deals are being done in core markets. Therefore, despite moving lower over the year, prime rents have remained resilient. Prime yields were 4.75% during 2007, but peaked at 7.5% for the first half of 2009. However, they have since fallen to 6.5%.

Take-up levels are well below average although prime rents have remained resilient



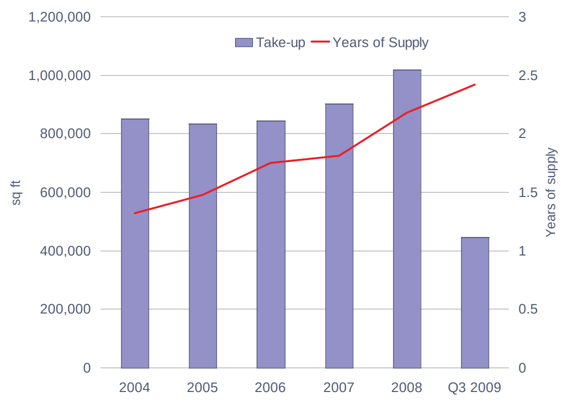
Source: Savills

Manchester

Manchester city centre take up remains resilient compared to other regional centres. Take up at the end of Q3 stands at 435,256 sq ft, but is anticipated to be in excess of 750,000 sq ft by the year end. This will largely be underpinned by the Manchester City Council letting of 145,000 sq ft. The vacancy rate stands at 12.3%, but this should now have peaked. Take-up has been driven by strong demand for Grade A space from both the public and private sectors. Longer term prospects for the city could be very positive, with further Public sector decentralisation out of London. Lack of new development coming to the market from 2010 should help minimise potential falls in rents.

Investors, including both the UK and German institutions are continuing to show signs of interest in the prime office sector and if vendors were willing sell, then we would anticipate prime yields to harden. As a result, we believe that prime yields for the city centre currently stand at around 6%.

Take-up in 2009 has been driven by strong demand for Grade A space.



Source: Savills

Southampton

Take-up has been limited over the last 12 months, with annual take up expected to see a notable decline by the end of 2009. Take-up at the end of Q3 is 45,000 sq ft, down 82% on the five year average. Supply of new buildings and space under 10 years old is limited. There has been only two speculative buildings having completed in the last 2 years, with nothing else under construction going forward. The availability of older stock has recently increased sharply, mainly due to Carnival Cruises release of space due to their move in to their new purpose built 150,000 sq ft HQ. Out of town there is more supply but this is concentrated at Solent Business Park. Rents have fallen by 9%, with a marked increase in incentives.

At Q3 2009 prime yields in Southampton are reported to stand at 7.25%. Moving in from 8% at the start of the year.

Take-up has been limited and rents have fallen by 9% over the year.

Source: Savills

Outlook

While the UK economy is yet to emerge from the recession, there are beginning to be signs of a recovery in confidence and activity. However, has the occupational market started to see signs of a recovery?

Continuing deterioration throughout 2009 has been evident in most regions. As we move towards the end of the year, the demand picture across the regional markets remains mixed. The City of London leasing market was the first of the UK office markets to see a downturn in demand. As such it should come as no surprise that it appears to be the first where some signs of recovery in tenant confidence is beginning to emerge.

However, rents have continued to fall in a number of regional cities throughout 2009. Aside from the big declines in the Central London markets, regionally, Birmingham and Southampton saw the largest decline in headline rents from the end of 2008 to Q3 2009 of 7% and 9% respectively.

Over the course of 2009, falling take-up, rising supply and the threat of empty building rates have resulted in landlords offering longer rent free periods and shorter more flexible leases to occupiers. However, there are signs that rents are starting to stabilise, with rent free periods starting to come in in some cities.

Looking at the supply side, current supply in all cities remains above the long term average. Although, encouragingly, the development pipeline peaked in 2008 as the financial crisis resulted in developers' retreating from the market. We should see the UK vacancy rate peak this year and start to decline thereafter. It is inevitable that in most sectors and locations there will be a significant shortage of new space from 2011 onwards.

Although rents have continued to fall and the majority of cities have seen muted demand, moving towards the end of the year, it is clear that the sentiment in the investment market has changed significantly from the beginning of the year. Buyers currently out weigh sellers, as they sense the bottom of the cycle. Furthermore, the distress that many new entrants to the market have been hoping for has not emerged. Because of this we expect that prices will continue to rise on the best, and begin to stabilise on the rest, but volumes could remain low for some time.

Focus in the UK property investment market has shifted towards a narrow band of prime investment stock offering stronger fundamentals including longer-term income streams and let to strong covenants. Consequently, this prime end of the market has seen yields begin to move in.

The average prime yield is now 6.25% after peaking at 7% in March this year.

However, as concerns about further falls in headline rents begin to recede, investor confidence will broaden out from just focusing on the long term, secure income streams. This may well take some pressure off the prime market but it will also begin to stabilise secondary pricing once it has reached a sensible differential to prime.

Looking specifically at regional investment, despite the muted occupational demand in most regions, office yields in the UK's key regional markets strengthened in the second half of the year. Yields have hardened by around 75 - 100 basis points in the majority of the regional office markets in the last quarter. Edinburgh was the first to harden by 75 basis points in the second quarter, with the majority of the other regions moving in during the third quarter. This improvement follows two years of softening yields, which is being driven by an increasing amount of capital chasing a shortage of prime stock.

So, when will developers start building again?
The combination of falling rents, rising yields and cautious lenders has meant that for many developers in the UK, speculative office development is looking increasingly challenging.

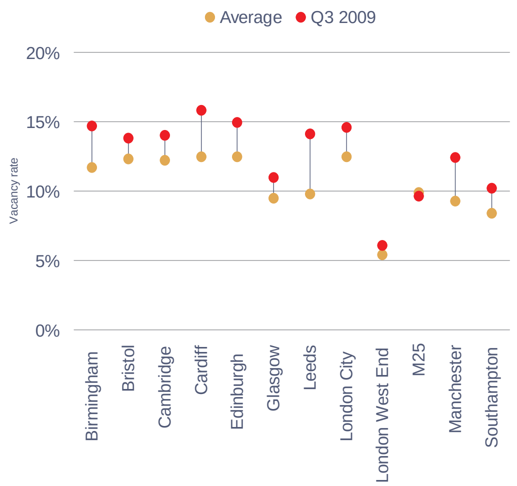
With a complete absence of debt funding for speculative development and consequently no pipeline of Grade A stock, the supply pool will contract in the short term, which in turn will start to see rental incentives reduce from the levels that we believe have now peaked. There will undoubtedly come a point when tenant demand is strong enough, and rents are rising fast enough to convince even the most cautious lender of a scheme's viability.

There are also ongoing concerns about the strength of the economic recovery. Although it would be brave to start developing now, against this background, those who do start over the next year are best positioned to take advantage of the recovery and the next rental peak.

Delivering new schemes into undersupplied markets is focusing many developer's minds on how to re-capitalise to start their best projects. While we don't expect to see a boom in development, we expect that 2009 and 2010 will be the quietest years of this cycle in terms of starts.

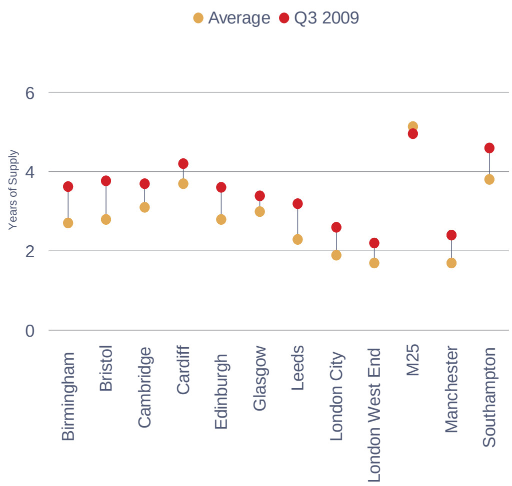
Comparisons

The vacancy rates in most cities are still above the long term average, but have now peaked.



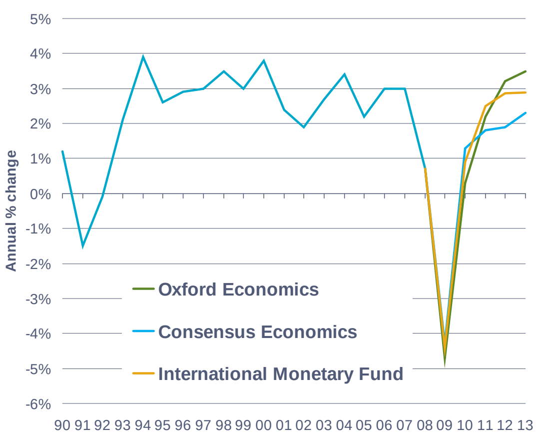
Source: Savills

The 'years of supply' are still above the long term average in all cities.



Source: Savills

Q4 2009 / 2010 to mark the beginning of the economic recovery and trend growth to 2013



Source: Oxford Economics; Consensus Economics; IMF

The UK vacancy rate will have peaked in 2009, due to the lack of development completions in 2010 and beyond.

Source: Savills **Forecast*

There has been negative rental growth in 2009, but restrained development pipelines will drive the recovery.

	2008	2009*	2010*	2011*
Birmingham	£30.00	£28.00	£27.50	£28.00
Bristol	£27.50	£26.50	£26.50	£27.00
Cambridge	£25.00	£25.00	£25.00	£26.00
Cardiff	£20.00	£21.00	£21.00	£21.00
London City	£76.00	£48.40	£50.50	£55.00
Edinburgh	£29.50	£28.50	£28.00	£28.50
Glasgow	£28.50	£28.50	£28.00	£28.00
Leeds	£27.00	£27.00	£26.00	£27.00
M25	£35.00	£33.00	£32.50	£33.50
Manchester	£28.50	£28.50	£30.00	£30.00
Southampton	£21.50	£19.00	£19.00	£20.00
London West End	£120.00	£88.00	£91.00	£98.75

Source: Savills ** forecast*

Definitions & Contacts

Definitions & Statistical Notes

UK top prime rent

Highest rent achieved in one or more transactions.

Years of supply

By dividing the current availability in the market area by annual average take-up (representing an average market level) creates the 'years of supply'. Savills have used the average for the last full year of data (2008) and periods stretching back 5 years (to beginning of 2004).

Grade A space
All new development (including speculative schemes reaching practical completion within six months, plus major refurbishments).

Grade B space
Space previously occupied, completed or refurbished in last 10 years.

Grade C space
Space previously occupied, completed or refurbished more than 10 years ago.

Total office stock

Total level of office space

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