Savills World Research
UK Commercial

Spotlight
Leeds Office Market

Winter 2017

Town Centre Securities have secured outline consent for 325,000 sq ft of office accommodation over three buildings at Whitehall Riverside.

SUMMARY

■ Take up in Leeds city centre has already reached a record 784,000 sq ft at end Q3 2017 and this is expected to total one million sq ft by the end of 2017.

■ There remains a limited availability of supply in the city centre, which has fallen to 1.1 million sq ft this year, the lowest level for four years.

■ Given the increase in top rents to £30 per sq ft earlier this year, we expect rental growth within the refurbished market over the next 12 months.

■ A record 60,000 sq ft of serviced office accommodation has been taken so far this year, as occupiers are on the lookout for more flexible lease terms.

■ A shortage of on-market investment opportunities in Leeds city centre has limited transaction volumes during 2017 as landlords look to hold long income.

■ Prime office yields in Leeds city centre stand at 5.25%, a 25 basis points inward movement from the start of 2017.

“With a tight supply schedule and only one newbuild speculative development under construction, competition will intensify among occupiers for Grade A space." Paul Fairhurst, Director, Office Agency, Leeds

Strong employment growth in key sectors fuels demand

Strong job growth has seen the unemployment rate fall to 4.3%- the lowest level since May 1975. However, subdued annual wage growth of 2.2%, coupled with CPI inflation rising to 3% has meant that real wages are continuing to fall.

September 2017's Lloyds Bank Regional Purchasing Managers' Index (PMI) shows Yorkshire is experiencing the fastest growing manufacturing and service sector growth region across the UK. Indeed, Leeds is forecast to see 5.1% office based employment growth over the next five years, driven by a high exposure to Professional, Science and Tech jobs, above the UK average of 4.6% over the same period.

Employers are increasingly weighing up the benefits of "northshoring" roles from Central London to regional cities in order to take advantage of both lower property costs and lower staff costs. Analysing economic output growth per head over the past five years provides us with an indication of the sectors in Greater London which are most likely to northshore. With average prime office rents in the City of London having risen over 27% during this period, occupiers are increasingly looking to reduce both wage costs and property costs by relocating to the regional cities.

Burberry have already relocated around 400 jobs from their Central London office to 6 Queen Street, Leeds in a move that saw top rents reach £30 per sq ft for the first time during the second quarter.

Lower real wage growth has continued to boost employer sentiment, which provides a key indication of future office demand, as we have seen across the UK regions since the EU referendum. Of the FTSE 100 CFOs surveyed by Deloitte at end Q3 2017, 12% expected to increase hiring over the next 12 months, a marked increase on the 1% recorded immediately post Brexit.

Whereas decision makers sat on their hands during the second half of 2016, occupiers have realised that "Brexit" is a process, not an event and occupational decisions must continue to be made. Seven months on from triggering Article 50, the self imposed deadline of March 2019 to leave the EU is rapidly approaching.

Occupational market

Take up in the Leeds city centre market reached 784,000 sq ft for the first three quarters of 2017, 60% above the five year average level for this stage of the year. Take up in the third quarter reached 556,000 sq ft, the largest quarter on record, driven by the GPU (Government Property Unit) pre-letting 7&8 Wellington Place. HMRC will occupy the 378,000 sq ft of space on its completion in 2020, making it the largest ever commercial property letting in Leeds. Leeds is on track to achieve one million sq ft of take by the end of 2017 (Graph 1).

Whilst Public Services accounted for 50% of take up in the city centre so far this year, Leeds' TMT sector has however had a comparatively quiet year, with take up reaching 86,000 sq ft, boosted by Sky signing for 26,000 sq ft at Central Square during Q3.

MEPC's 3 Wellington Place is the only newbuild speculative office development currently under construction in Leeds city centre and will provide an additional 110,000 sq ft of Grade A space on its completion in Q1 2018. The GPU reportedly have another large requirement in the city which could see a government hub emerge around Whitehall Road. 4 Wellington Place could be one of the next sites to be delivered, which would provide c.150,000 sq ft on its completion.

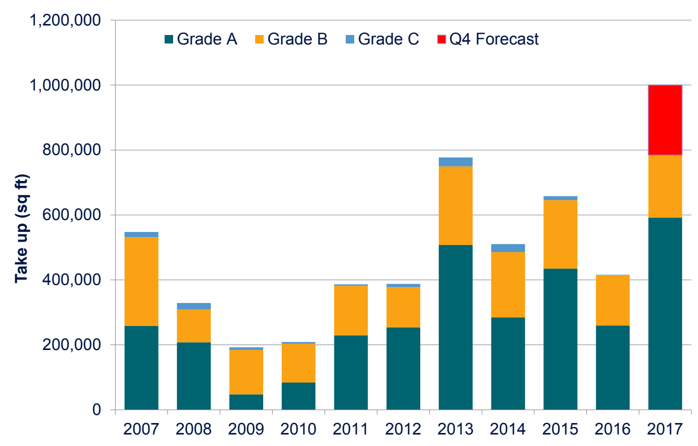
There is growing developer interest in a number of sites surrounding Whitehall Road, including Town Centre Securities' (TCS) Whitehall Riverside (cover image). TCS have secured detailed planning permission for up to 325,000 sq ft of office space in addition to a 10 storey car park. With city centre availability having fallen to only 1.1 million sq ft (Graph 2), of which only 391,165 sq ft is Grade A, we expect pre-letting activity to pick up during 2018.

Developers CEG have also submitted a planning application for their 1.1m sq ft mixed use South Bank scheme, which has the potential to provide an additional 35,000 jobs.

The redeveloped 7 Park Row, is also expected to complete before the end of this year, which will provide 40,729 sq ft of Grade A space upon its completion. 126,000 sq ft of space has been taken in deals under 5,000 sq ft in the city centre so far this year, and with falling availability for the c.

GRAPH 1

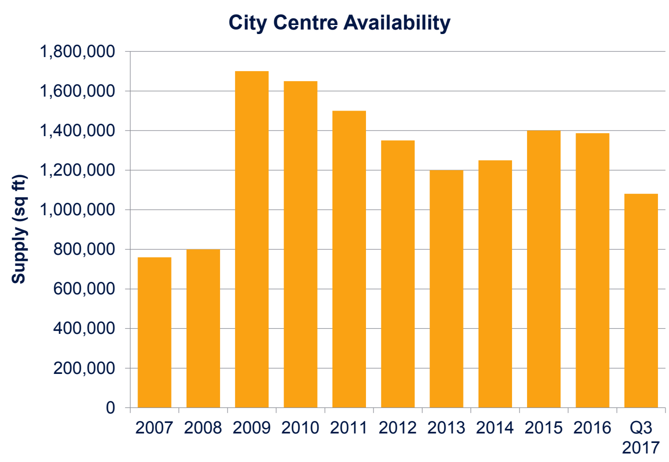
The GPU signing at MEPC's Wellington Place has lifted take up to record levels



Graph source: Savills Research

GRAPH 2

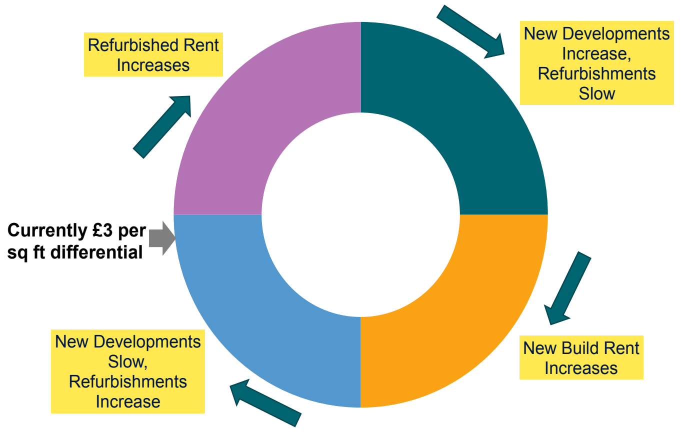
City centre availability now only stands at 1.1m sq ft



Graph source: Savills Research

GRAPH 3

After top rents hit £30 per sq ft rents, Savills forecasts refurbished rental growth



Graph source: Savills Research

5,000 floorplates, competition among occupiers will intensify into early 2018.

Top rents achieved £30 per sq ft for the first time during 2017 and now comprehensively refurbished stock is returning to the market, Leeds is at the stage of the cycle where we expect growth in top refurbished rents (Graph 3). Until £30 per sq ft was achieved earlier this year, the rental differential between new build and top refurbished rents stood at only £0.50 per sq ft. Now the market has rerated, the gap has widened to £3 per sq ft.

Savills estimated that Grade A space could achieve £32 per sq ft by the end of 2019 as the availability of Grade A space continues on a downward trend. Despite the hike in top rents to £30 per sq ft in Leeds, quoting rents for Prime Grade A space remain the most affordable across the "Big 6" regional markets. There remains room for growth in top rents further along the cycle.

Serviced office growth

Average lease length across the regional cities has fallen by 3% year on year, as occupiers are increasingly in search of more flexible lease terms. This has fuelled the growth of the serviced office sector in the regional cities, of which much activity took place in Manchester and Birmingham, accounting for 5.6% of take up across the regions. A record 60,000 sq ft of serviced office space has been taken in Leeds so far this year and we expect this market to increase again during 2018.

Out of town recovery

Occupier activity is also picking up outside the city centre, with a cluster of <3,000 sq ft deals in York during the third quarter. Zenith expanded its global headquarters by acquiring a further floor of 18,500 sq ft at CEG's Kirkstall Forge, while Smartcredit Ltd signed for 18,000 sq ft at Mayfield Business Park, Ilkley. Out of town take up has reached 258,000 sq ft for the year so far, 18% above the five year average for this stage and we expect this to reach c. 350,000 sq ft by the end of 2017.

Further development proposals at Thorpe Park Leeds could provide up to 940,000 sq ft of additional office space as a boost for the out of town market. Notable occupiers currently include IBM, National Grid, Atkins and United Utilities.

Keen pricing hampers investment transactions

Office investment activity so far during 2017 has been fairly limited in Leeds city centre, with volumes at the end of Q3 2017 reaching £77 million, 49% below the 10 year average for this stage in the year. This has largely been down to the shortage of prime assets available for purchase. Indeed, 71% of the volume of transactions as at end Q3 2017 has been below £20m lot sizes, the highest proportion since 2003 (Graph 4).

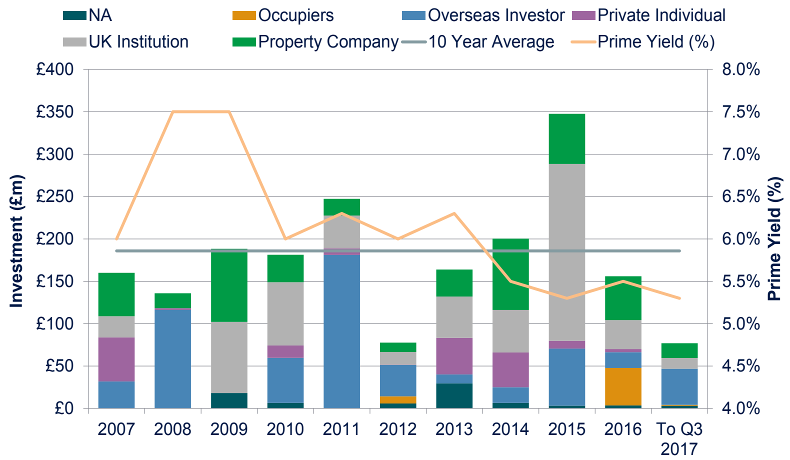
Landlords are looking to hold onto long income given the round-trip costs of buying and selling. With a number of prime assets having traded between 2014-16, the volume of tradable stock has fallen and the pricing mismatch between buyers and sellers will continue to limit transaction activity.

One such asset which did trade was the comprehensively refurbished 1 East Parade (image, page 4), which Schroders' Regional Office PUT acquired for £12.7 million, reflecting a 6.75% yield. With a number of assets under offer, we expect deals to complete during the final quarter and the end year total to remain in line with the c. £150m recorded in 2016.

A shortage of sellers in the market has contracted prime yields 25 basis points to 5.25% since the start of the year, which remains attractive relative to comparable regional cities. We expect yields to hold firm into 2018 as we see overseas investors increasingly look outside Central London as they become more familiar with the UK regional markets and benefit from a weak Sterling.

GRAPH 4

Office investment in Leeds during 2017 has been hampered by a shortage of sellers



Graph source: Savills Research

Headline stats, definitions and contacts

5.1%
office based employment growth over the next five years

1.1m
total available office space in Leeds city centre

110k sq ft
newbuild office development currently under construction (excluding pre-lets)

9%
growth in top rents since end 2016

Headline statistics	Take-up: in-town	Take-up: out-of-town	Top rents (£ per sq ft)	Prime yield
Q1-Q3 2017	784,000 sq ft	258,000 sq ft	£30 per sq ft	5.25%
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 refurbishments).
Grade B	Space previously occupied, completed or refur-bished in last 10 years.
Grade C	Space previously occupied, completed or refur-bished more than 10 years ago.

1 East Parade, above, was acquired by Schroders and provides 14,000 sq ft of refurbished space.

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