

Spotlight Cardiff Offices

Spring 2017



Ardstone's 2 Kingsway, above, currently provides 41,000 sq ft of comprehensively refurbished Grade A office space.

■ The key deals during the first quarter were Cardiff University's 45,000 sq ft letting of Two Central Square, which is now fully occupied, and Network Rail taking 31,500 sq ft in St Patrick's House.

■ Strong take up has left the office market facing a shortage of supply. Wider market supply has fallen 5% to 1.2m sq ft since the end of 2016.

■ We expect top rents to remain stable at £25 per sq ft throughout 2017 following the steep jump from £23 during 2016.

■ The shortage of investment deals so far during 2017 has been largely down to the pricing mismatch between buyers and sellers, as well as the lack of pressure to sell.

■ Rising construction costs are now driving some investors to consider buying, rather than develop new stock, adding further downward pressure on prime yields.

■ We expect prime yields to remain stable going forward, with sustained demand for well let assets from the overseas market, who continue to benefit from a weak Sterling.

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 "Due to rising construction costs, parties are now buying existing rather than developing new stock, adding further downward pressure on prime yields." Ross Griffin, Director, Investment, Cardiff

➔ After the strongest year of take up for 15 years during 2016, the Cardiff office market has continued its strong run into 2017 as one of the UK's strongest outperformers post Brexit.

Local economy

The UK economy has started 2017 fairly modestly, with 0.3% growth recorded for the first quarter. Weak Sterling has added upward pressure on inflation which is squeezing output in consumer-facing subsectors.

Cardiff's economy, however, has seen 4.7% economic growth over the past five years and is expected to see growth rise to 10.1% over the next five years, above the UK average of 9.5%.

Strong economic growth is expected to filter into the employment market. Cardiff is forecast to see 3.8% office based employment growth over the next five years, according to figures from Oxford Economics. Much of this growth is expected to be delivered by the Professional, Science and Tech sector, which is expected to see growth of 7% during this period.

Electrification of the South West Mainline is set to complete in 2018 which will reduce journey time from the Cardiff to London by 15 minutes. We expect this to draw occupiers to the Welsh capital, with more digital startups taking advantage of established incubator and accelerator space in the city centre.

Occupational Market

Occupational take up in Cardiff reached 146,739 sq ft during the first quarter of 2017, 19% above the five year quarterly average of 123,000 sq ft. Cardiff's office market has remained strong and stable over the past 12 months as indicated by above average levels of take up in Graph 1.

The key deals during the first quarter were Cardiff University's 45,000 sq ft letting of Two Central Square, which is now fully occupied, and Network Rail taking 31,500 sq ft in St Patrick's House. Central Square continues to attract tenants from a range of business sectors.

A large part of Cardiff's recent success is down to the number of larger lot size deals. Over the past 12 months, 72% of Cardiff city centre's take up has come from deals over 10,000 sq ft, above the historic average of 52%.

The most active business sector during 2016 was Public Services, Education and Health, which accounted for 23% of take up. Professional Services followed closely behind, accounting for 22% of total take up, driven by Hugh James Solicitors pre-letting 100,000 sq ft at 2 Central Square during the final quarter.

Sonovate, a recruitment solutions firm, signed for 6,461 sq ft of "defurbished" space at 101 Cardiff. The building was inspired by the offices of Shoreditch, London with exposed services for a more creative

72%
of take up over the past 12 months has come from deals over 10,000 sq ft

feel. The UK regional cities are seeing more refurbished office space delivered with a creative fit-out to encourage collaboration.

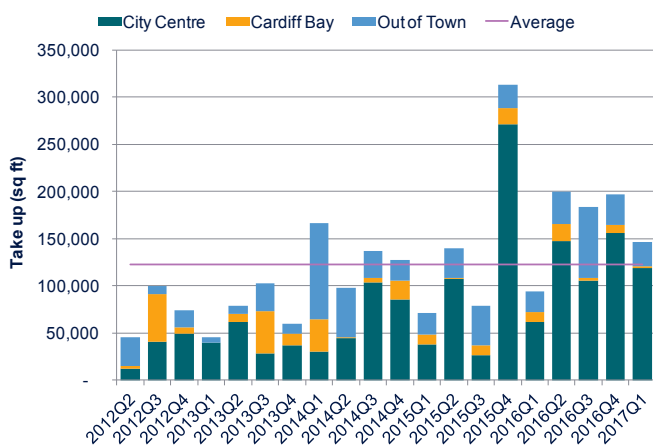
Strong demand has left the office market facing a shortage of supply. Wider market supply has fallen 5% to 1.2m sq ft since the end of 2016 (Graph 2). Current Grade A supply stands at only 155,000 sq ft, only enough for around one year's demand in the city centre.

We expect refurbished schemes to prosper in the next 12 months. Ardstone's 2 Kingsway (cover image), currently provides 41,000 sq ft of comprehensively refurbished Grade A space.

There is currently 224,000 sq ft of speculative developments underway in Cardiff city centre. JR Smart's mixed-use scheme, 3 and 4 Capital Quarter will provide a combined 165,000 sq ft of new office space, while One Canal Parade will provide a further 54,000 sq ft of space when complete during Q2 2017.

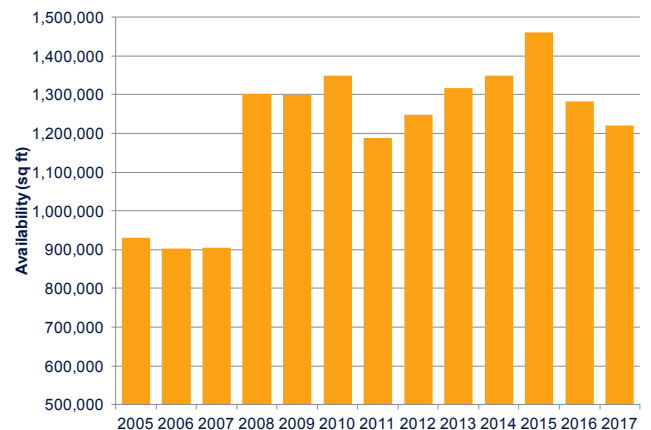
There is no speculative space under construction in Central Square, though around 200,000 sq ft of

GRAPH 1 **Take-up remains above the quarterly average**



Graph source: Savills Research

GRAPH 2 **Availability at lowest level since 2011**



Graph source: Savills Research

office space is planned at the new Interchange building.

Office to student redevelopments have also removed secondary space from the city centre market. Fitzalan Court is in the process of being converted into 256 student flats, whilst Caradog House will provide 378 student beds. However, the number of student conversions has fallen as the volume of secondary space has reduced.

Investment Market

Cardiff's office investment market saw 2016 end strongly, with the BT Data Centre and 1 Capital Quarter deals boosting Q4 2016's volume to £57m.

2017 has started more quietly (Graph 3), with office investment during the first quarter reaching £21m. Investors are seeking a "flight to quality", and the shortage of deals is largely down to the pricing mismatch between buyers and sellers. Transactions have included the sale of the Media Wales building just off Central Square acquired by Mayfair Capital, the disposal of Fusion Point 1 on Dumballs Road and the sale of Trinity Court on Newport Road.

Cardiff's prime yields currently stand at 6%. Sellers remain unwilling to dispose of well let, income producing assets, though we expect the second half of the year to become more active as more stock is added to the market. Rising construction costs are now driving parties to buy rather than develop new stock, adding further downward pressure on prime yields.

Outlook

Enquiries remain strong going forward, with HMRC's 270,000 sq ft requirement dominating the market. However, the market will also be driven by deals in the 5,000 to 10,000 sq ft size bracket and we expect take up to reach 650,000 sq ft by the end of 2017.

Cardiff is undergoing a structural shift of occupier and investor interest towards the station and redevelopment schemes.

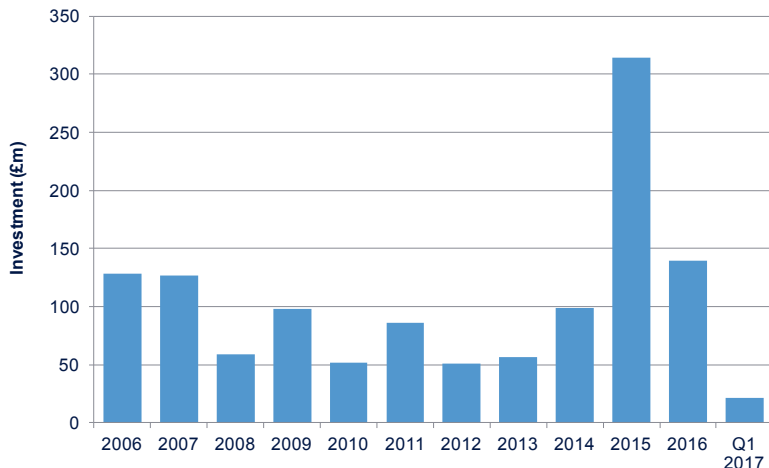
We expect top rents to remain stable at £25 per sq ft throughout 2017 following the steep jump from £23 during 2016. Occupiers will be willing to pay the premium rents to be located in new and refurbished buildings.

Overseas investors and property companies remain on the lookout for prime assets around Central Square in search of long income. There remain attractive opportunities in fringe locations however, which has driven secondary yields in, especially where there are strong asset management opportunities.

Cardiff remains an attractive opportunity compared with other UK regional cities, with prime yields sitting 75 bps above the UK average prime. We expect prime yields to remain stable going forward, with sustained demand for well let assets from the overseas market, who continue to benefit from a weak Sterling. ■

GRAPH 3

Office investment has started 2017 more quietly



Graph source: Property Data

CARDIFF OFFICES SHIFT UP A GEAR

Gary Carver, Director of Office Agency highlights his key themes

One of Cardiff's challenges going forward is how to tackle congestion in the city centre. By encouraging cycling to work, we expect this to have a direct impact on the design of office space in the city.

Showers and changing rooms are already becoming more important to tenants looking to take space as they acknowledge that increasing volumes of workers need room to get ready for the day ahead.

Providing more secure bike storage will therefore become increasingly important in the design of Cardiff office buildings in the years to come. While these amenities have been included for many years in new and refurbished space, they're set to be taken to the next level with more room given over to such amenities which will be fitted out at a much higher spec.

Take Cardiff's Castlebridge offices, for example: secure basement parking and impressive new shower and changing facilities have been incorporated into the building, which is also focused on its proximity to cycle paths and routes that run through the city, a major draw for new tenants.





2 Kingsway in the city centre has undergone a major high quality refurbishment and provides ample, secure cycle storage with showers.

According to Savills What Workers Want survey, 90 per cent of Cardiff office workers rank their length of commute as important. Turning to cycling may well be faster than driving when taking into account rush-hour traffic and help fulfil their expectations.

Increased cycling is a trend that we expect to continue in the coming years. Cardiff's occupiers are looking to take better quality space as new office developments complete and refurbished space becomes available and as such, escaping the rush hour jam is likely to become a bigger issue. New ways of travel will become increasingly important and occupiers will therefore expect cycle provision to be a key consideration in their buildings.



Headline stats, definitions and contacts

 3.8% office based employment growth over the next five years	 650k Office take up forecast for 2017	 219k Grade A speculative office space currently under construction	 £25 per sq ft Top rents in Cardiff city centre
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	Take-up (sq ft):	Top rents (£ per sq ft)	Prime yield
Full year 2016	675,305	£25	6.25%
Q1 2017	146,739	£25	6.00%
End of 2017 outlook	➔	➔	➔

Definitions & statistical notes

Property criteria	Transactions and supply recorded for units in excess of 1,000 sq ft
Top rent	Highest rent achieved in one or more transactions in the given period
Grade A	All new development, plus major refurbishments
Grade B	Space previously occupied, completed or refurbished in the last 10 years
Grade C	Space previously occupied, completed or refurbished more than 10 years ago

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