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Fewer new developments has already resulted in office supply levels falling this year with a predicted shortage of new space in some cities, from 2011 onwards.

With regional office development pipelines at historic low levels, and little likelihood of a pick-up in development activity in the next 2-3 years, it will not take much of rise in tenant demand to drive a recovery in rents.

Current supply, in the majority of cities, has fallen over the course of 2010, with average years of supply over all UK cities standing at 2.9 years compared to 3.3 years at the same time last year.

Prospects for regional office rental growth are improving. With London offices now showing upward rental growth on both prime and average rents we believe it will only be between 12 & 18 months before we see sustained office rental growth in the regional markets.

The average prime yield is now 6.03% after peaking at 7% in March 2009. Prime yields have continued to harden as we go into 2011, albeit at a slower rate.

There will undoubtedly be winners and losers as we go into 2011 and the most successful regional office markets in 2011 remain the strong private sector towns and cities where public sector cuts are less relevant.

### UK Office Market Report

#### Winter 2010

2011 will remain challenging for some cities, however, the muted development pipeline will help underpin rents. Prime yields have continued to harden, albeit at a slower rate.

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**Signs of rental growth have started to emerge.**

- **Rental growth 2009/10**
- **Rental growth 2008/9**

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**Prime yield hardening has slowed.**

- **As at Q3 2009**
- **As at Q3 2010**

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**Source:** Savills

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- There will undoubtedly be winners and losers as we go into 2011 and the most successful regional office markets in 2011 remain the strong private sector towns and cities where public sector cuts are less relevant.
Birmingham

Take-up in the first three quarters of 2010 remained restrained in the prime core at 278,035 sq ft. End of year figures are expected to reach those similar to those achieved in 2009. Take-up is expected to improve as the economy enters a firmer recovery in 2011.

Although Birmingham currently has one of the higher vacancy rates, it has now fallen from its peak of 17.6% at the end of 2009 to 16.5% at the end of Q3 2010. With the lack of development completions coming through in the next couple of years, Birmingham should see a sharp fall in Grade A vacancy rates, and upward growth in net-effective rents from next year.

Birmingham is expected to see top rents grow by 2% by the end of 2010, with further growth anticipated during 2011.

Bristol

Following a difficult 2009, there were some signs of improvement during the first three quarters of 2010. Take-up for the prime city core totalled 352,468 sq ft, which was 8% up on the whole of 2009. Combined take up for in and out-of-town totalled 655,562 sq ft.

In terms of rents there has been a bounce back in city centre headline rents, with £27.50 per sq ft achieved at The Paragon. We expect headline rents to hold at current levels through to 2011/12 with incentives also holding steady. The lack of new stock coming to the market, with only Westmark’s WestOne development coming to the market this year and HDG Mansur completing 110,524 sq ft at Bridgewater House in 2011, will also help to maintain top rents.

Despite this demand/supply imbalance, further hardening in yields this year looks remote. Prime yields are now at 6%.

Cambridge

Cambridge is the only regional city to see rental growth in both 2009 and 2010. Prime rents are being driven upwards by lack of stock, especially in the city centre. The top rent in 2010 was achieved at 20 Station Road, at a rent of £28.18 per sq ft. Terms are agreed on a pre-let to Microsoft on 80,000 sq ft at £29.50 per sq ft, which is likely to complete in the new year. In 2011 we are expecting city centre rents for new stock to break £30 per sq ft.

At the end of Quarter 3, 2010 the approximate take-up was 250,000 sq ft, compared to the same point in 2009, where take-up reached 190,000 sq ft. This reflected another slow year for the Cambridge office market. It is expected that by the end of 2010 we will see take-up figures in the region of 350,000 – 400,000 sq ft, compared to 310,000 sq ft in 2009. However, this remains below the 5 year average of 500,000 sq ft.
Cardiff

Cardiff was one of the only cities to experience upward rental growth in 2009, when it reached £21 per sq ft. This was achieved at 5 Callaghan Square and 3 Assembly Square. Rents have remained static in 2010 and are expected to remain flat for the next 2 to 3 years. Positive rental growth is not expected until 2013.

Demand has been muted in 2010, with take-up expected to end the year at around 375,000 sq ft. This is similar to the total for 2009. The market has been biased towards the 5,000 sq ft to 15,000 sq ft size band, which saw a much higher proportion of deals in 2010, compared to the preceding five-year average. With below average levels of new supply coming to the market, a shortage of Grade A stock is anticipated in the short to medium-term.

Edinburgh

There is definitely no boom in demand ahead, but a gradual return to average annual levels of take-up, combined with only one development in the development pipeline, is likely to help see a significant fall in the vacancy rate during 2011.

By mid-to-late 2011 we expect to see net-effective rents beginning to rise, and this will be followed by headline rental growth in the most sought after locations in and around the city.

Prime office yields have stabilised at around 6%, however, the last few months has seen a slight softening in secondary yields.

Glasgow

With a rapidly depleting supply of new Grade A stock and an empty development pipeline for at least two years, this puts Glasgow in a very good position going forward.

The take-up figures for the first three quarters are around 400,000 sq ft, with the financial and legal sectors being the most prevalent. There remains a healthy number of larger requirements (20,000 sq ft plus) which have the potential to significantly increase total take-up figures for 2010.

Prime headline rents remain between £26 and £28 per sq ft and it is expected that, as the proportion of new Grade A stock decreases, coupled with a lack of new development, incentives will ease within the CBD. This may also result in an improvement to Grade A headline rents from 2011.
Leeds, London City & West End

Leeds

Demand has been muted in Leeds during 2010, with take-up in the first three quarters reaching 196,362 sq ft, down 36% on the previous year. End year figures are expected to be significantly below the 2009 total.

However, with the vacancy rate currently at 10.9% having fallen from its peak of 14.1% at Q3 2009, and with a limited development pipeline, supply should continue to fall during 2011.

There has been a significant amount of transactional activity in the first three quarters of 2010. With restricted supply, we believe prime yields are around 6%, a fall of circa 50 basis points since our Winter 2009 report.

London: City

Take-up soared in 2010, with the total take-up figure reaching 5 million sq ft by the end of the third quarter, which is an impressive 71% up on the same time last year.

2009 was seen as the bottom of the current cycle and since then, tenant demand has increased significantly, rent free periods have shortened and more importantly the amount of available space has fallen. The vacancy rate stood at 10.7% at the end of Q3 and is continuing to fall. This is down from 13.5% at the beginning of the year.

The top rent achieved in quarter three was £58.50 per sq ft, compared to £50 per sq ft the same time last year. 2011 is set to see an increase of 5.3% on top rents, with an overall growth of 20% between 2009 and 2011.

London: West End

Rents in the West End are expected to see an increase of 14% between 2009 and 2011. The top rent so far in 2010 is £100 per sq ft, which was achieved in June.

With no new significant developments entering the supply figures in Q3 supply fell to 6.7m sq ft, this is a vacancy rate of 5.5%. This is a fall of 18% from its peak in September 2009.

Demand in the West End has picked up significantly over the first three quarters of 2010. A number of large deals have contributed to this pick up in take-up, with 8 deals over 50,000 sq ft signing so far this year.

Take-up stands at 2.9m sq ft, 90% ahead of take-up achieved over the same period last year and 21% ahead of the long-term average.
M25, Manchester, Southampton

M25

The M25 is a more buoyant market than was expected 10 months ago in terms of take-up. There has been a positive ‘ripple out’ effect from Central London driven by rising corporate optimism levels. Our prediction of 2 million sq ft of take-up was reached at the end of October. Total take-up was expected to be 11% lower this year, but may now be slightly higher than the 2.3 million sq ft recorded in 2009.

Total availability is 5% higher than end-2009, with the highest levels of Grade A in the Western Sector. This will cater for corporate needs going forward and keep rents in check.

‘Hotspots’ with tight Grade A supply exist in town centre locations like Maidenhead, Windsor, Guildford and Staines. The development pipeline has been switched off, which will help re-balance the whole market over the next 12 months. Top rents achieved this year have remained static at £33 per sq ft.

Manchester

In terms of take-up, Manchester has out-performed the rest of the regional office markets during 2010. Despite 25% of this being attributable to the Co-op pre-let, quarter three saw the best take-up figures since our records began. Take-up is expected to be in the order of 1.25 million sq ft by year end, a 60% increase on the previous year. 59% of take-up to the end of quarter three was Grade A space.

With one of the lowest vacancy rates of all the regional office markets, the major concern for the city is the dwindling supply of large floorplate Grade A stock. Due to this, the levels of incentive available to tenants over the last two years are no longer available on institutional, larger floorplate accommodation.

Although incentives moved out substantially during the downturn, top rents have remained at around £28.50 per sq ft throughout, with rental growth expected in 2011.

Southampton

With muted take-up and rising supply, 2009 has been followed by arguably even tougher market conditions in 2010. Take-up in the city centre at the end of Q3 was 50,000 sq ft and whilst this is still low, enquiries are increasing. Out of town, take-up was at about 40,000 sq ft at the end of Q3 but there are generally more enquiries in the market for out of town space.

Southampton is one of only two cities which has seen an increase in supply over the last 12 months. This includes a greater supply of new and modern premises concentrated at Solent Business Park.

Headline rents of circa £19.50 per sq ft are still achievable but only with substantial rent free periods.
This time last year the picture was bleak with low demand, rising supply and negative rental growth across the UK.

A year is a long time in the property market. In most cities, supply is starting to fall and with an anticipated return to average take-up levels from early 2011 onwards, there are signs that rents are starting to stabilise. In some cities rent free periods are starting to decrease. Average rental growth over all cities is 2% between 2009/10, compared to a 5% decline over the period of 2008/9.

However, although sentiment has improved since the end of 2009, the market remains challenging for many of the regional cities. Most regions are being driven by the churn of smaller enquiries. The principal drivers of demand in normal market conditions, the Professional and Financial Services, are much less active. Indeed, many investors are questioning the likely strength of the recovery in the face of public sector austerity.

Following October’s spending review there has been much focus on how public sector austerity will hit some regions more than others. Uncertainty resulting from this is stifling public sector demand and this is likely to remain the case in the medium term. Rental growth will not emerge until job creation in the private sector picks up. Encouragingly, according to Deloittes, 344,000 jobs have been created in the private sector this year, with private sector employment set to improve over the next 12 months.

There will undoubtedly be winners and losers as we go into 2011 and the most successful regional office markets in 2011 will be the strong private sector towns and cities where public sector cuts are less relevant.

Looking at the supply side, encouragingly, current availability in the majority of cities has fallen over the course of 2010, with average years of supply over all UK cities standing at 2.9 years compared to 3.3 years at the same time last year. The overall UK vacancy rate has fallen to 13.3% from its peak of 15.8% in 2009. With the lack of developments coming out of most cities in the next few years, it is inevitable that in most locations there will be a significant shortage of new space from 2011 onwards.

The question is, will 2011 be the year of a return to office rental growth?

With London offices now showing upward rental growth on both prime and average rents we believe that office rental growth at a national level will move into positive territory over the next 12 months.

In terms of income growth for offices, the central London markets are showing the best prospects. Top rents are forecast to increase by 20% in the City and 14% in the West End by 2011, largely driven by the restricted supply of Grade A space and the capital’s better economic prospects.

Manchester, Cambridge and the M25 also present attractive opportunities. Our rental forecasts for these three cities point to between 5.3% and 6.5% growth in 2011, largely driven by a shortage of Grade A stock and improving occupier demand.

Will 2011 be the year of a return to office rental growth?

Source: Savills

With regional office development pipelines at historic low levels, and little likelihood of a pick-up in completions in the next 2-3 years, it will not take much of a rise in tenant demand to drive this recovery in rents. However, cities that are highly vulnerable to public sector cuts will deliver little or no rental growth in 2011.

Looking specifically at the investment market, the collapse of the commercial property market which ‘bottomed-out’ in early 2009 saw values halve from their peak in mid-2007. However, since then, pricing recovered significantly in Q1 2010. Transaction volumes are at lower levels, but as 2010 comes to a close we are seeing higher level of transactions compared to last year. The majority of investors remain relatively risk adverse, focussing on acquiring prime, well-secured assets displaying strong property fundamentals.

Prime yields have undoubtedly stabilised over the last six months. The average prime yield is now 6.03% after peaking at 7% in March 2009. Prime yields have continued to harden during 2010, albeit at a slower rate.
Comparisons

The vacancy rates has now peaked in most cities.

The 'years of supply' are starting to fall in most cities.

Source: Savills

UK cities GDP growth between 2010 and 2015.

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<th>European Ranking</th>
<th>City</th>
<th>% change (2010-2015)</th>
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<tr>
<td>25</td>
<td>Cardiff</td>
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Source: Oxford Economics

Due to a lack of development completions throughout the UK, the vacancy rate will continue to fall.

With regional office development pipelines at historic low levels, signs of upward rental growth should be apparent from 2011.

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<td>£95.00</td>
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</table>

Source: Savills
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 (2009) and periods stretching back 5 years (to beginning of 2005).

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.

For further market information please contact:

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 180 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.