UK Commercial Market in Minutes
Regional office market revival

October 2013

Improving markets outside London

■ The continuing story across the board is strong demand for primary and good secondary assets with limited available stock.

■ This continued strong demand and lack of stock has maintained prime yields across most sectors with downward yield shifts in five sectors.

■ The regional office market has seen a 25bp yield shift this month, with a marked rise in investor interest driven by the expectation of an imminent rental recovery in some of the stronger regional cities. This is combined with the wide yield gap between London and the regions, which currently stands at 225 bps.

■ There is an increase in positive sentiment as we move through the fourth quarter. UK institutions and overseas investors are becoming more dominant in the regions and we expect investor appetite for regional offices will continue to increase as we move towards the end of the year.

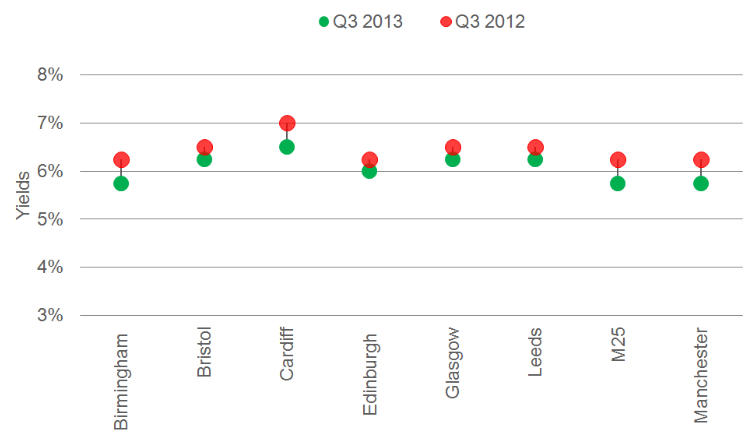
■ As well as increasing take-up levels, the regional office markets are beginning to show signs of under supply. Grade A supply is now falling in all major cities with an 11% decrease across the UK over the last 12 months.

■ With only c.1 million sq ft (10 schemes) of speculative office developments underway outside London, this is likely to fuel investor interest and subsequent pricing during the latter part of 2013 and into 2014.

■ Although it is unlikely we will see another yield shift in the regional office markets before the year is out, considering that the pressure on UK funds to buy has intensified, combined with improving confidence, we can not rule it out completely.

GRAPH 1

Regional office yields continue to move in



Graph source: Savills Research

TABLE 1

Prime equivalent yields

	Sept 12	Aug 13	Sept 13
West End Offices	3.75%	3.50%	3.50%
City Offices	5.25%↓	4.75%	4.75%
Offices M25	6.25%	6.00%↓	5.75%↓
Provincial Offices	6.25%↑	6.00%↓	5.75%
High Street Retail	4.75%	4.75%	4.75%
Shopping Centres	5.50%	5.00%↓	5.00%↓
Retail Warehouse (open A1)	5.25%↑	5.25%↓	5.25%↓
Retail Warehouse (restricted)	6.00%↑	6.00%↓	6.00%↓
Foodstores	4.50%	4.25%	4.25%
Industrial Distribution	6.25%↑	6.00%↓	6.00%↓
Industrial Multi-lets	6.00%	6.00%↓	5.75%
Leisure Parks	6.50%↓	6.25%↓	6.00%
Regional Hotels	7.00%	7.00%↓	6.75%

Table source: Savills

The professional and TMT sectors lead the way

■ The UK economic recovery gained momentum in the second quarter, and a further acceleration of growth looks likely in the third quarter, in what's looking like an increasingly broad-based and sustainable upturn. Indeed, the IMF's forecast for UK growth this year received a significant upgrade to 1.4%, up from July's estimate of 0.9%.

■ Anecdotally, there is widespread sentiment that UK businesses are doing better. Corporate profitability has been surprisingly robust during the past 12 months, with the CFO view of hiring over the next 12 months also looking positive.

■ According to the Office of National Statistics, private sector employment grew by almost 400,000 jobs, between June 2012 and June 2013, with the property sector seeing an impressive 10% rise in the second quarter. The largest increase in private sector employment over the year, outside London, were seen in Yorkshire and The Humber (82,000; 4.3%) and Scotland (62,000; 3.3%).

■ Although all northern regions have seen public sector job losses, interestingly, private sector employment growth has nearly four times offset the c.100,000 jobs the public sector have lost over the last 12 months. This will continue to support the occupational markets going forward as businesses become more confident to spend.

■ The more traditional office occupier, such as the professional sector, is showing some bounce back in the regions. The highest employment rise was reported in the North West, which saw professional services grow by 9.1% over the last 12 months.

■ However, the Technology, Media and Telecoms (TMT) sector, which has seen exceptional growth in Central London, has also gained momentum in the regions this year. This trend is expected to continue with Oxford Economics forecasting employment in this sector will grow by 9% in the UK over the next five years, which should start to translate into tenant demand as we go through 2014.

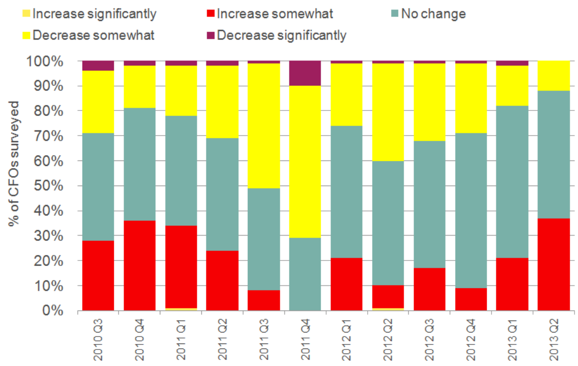
The return of sustainable regional rental growth

■ Increased tenant demand, alongside restricted Grade A supply, will result in prime rental growth in some of these strong regional cities. The markets predicted to see the biggest rental growth by the end of 2013 are the M25, driven by the M4 corridor, with an expected 8.6% growth. Outside the South we expect to see the biggest growth in Edinburgh at 9% and Manchester at 3%.

■ Whilst we won't see any drastic improvements in rents in all regional cities by the end of 2013, as the economic recovery really starts to take shape, we expect rental growth for prime space will pick up pace. This will be driven by lack of Grade A space as we go through 2014.

GRAPH 2

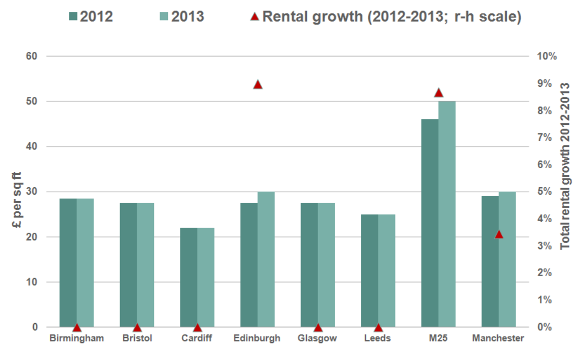
CFO view on hiring during next 12 months looks positive



Graph source: Deloitte

GRAPH 3

Positive signs of rental growth in the regional office markets



Graph source: Savills Research

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