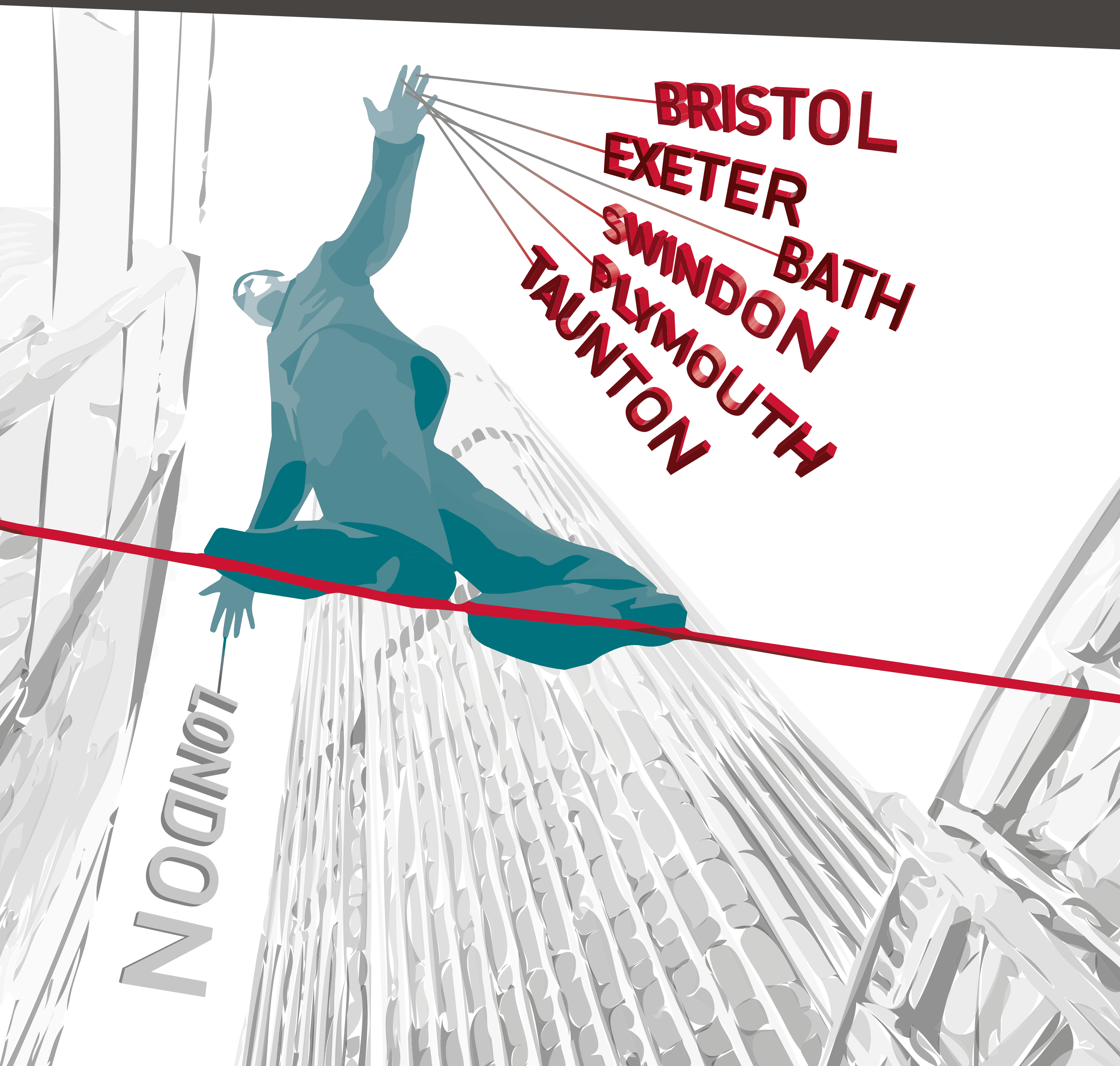
REGIONAL OFFICE MARKET REPORT 2016/17

Lambert Smith Hampton



SOUTH WEST POWERHOUSE

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WELCOME

DARREN SHEWARD
Head of South West Region
Lambert Smith Hampton

The South West of England is a truly special region. It combines a vibrant, innovative work environment with plentiful leisure opportunities, great transport links and an outstanding quality of life.

Not only does the South West provide a fertile breeding ground for quality graduates, with Exeter, Bath, Plymouth and Bristol universities all sitting amongst the top 50 learning establishments in the UK, it's also a national hub for creativity and innovation: the region is home to the UK's most productive hi-tech cluster and it generates the third largest digital turnover in the country (Source: Tech Nation 2016).

While the big cities in the region have embraced the changes enabled through the re-emerging private rented sector and permitted development rights – removing tired office buildings that were no longer fit for purpose – there are also the notable, big ticket changes that are helping to push the region forward.

First, Hinkley. It was on, then off, then back on again. And so the button is pressed for an £18bn nuclear power plant. What does this mean for the South West? Thousands of new jobs, a huge need for support services, accommodation for business, new road infrastructure, funding for schools, the list goes on. It will provide enormous investment and an annual estimated value to the local economy worth £100m.

Bristol Airport. It's now a major, expanding travel hub set to handle an estimated 10 million passengers a year, providing a gateway for worldwide investors and private visitors who want to spend in our region.

The Brunel legacy. We're seeing the biggest investment in the Great Western Railway since Brunel built the line over 150 years ago. Journey times from Bristol to London will be just one hour and twenty minutes, and just over one hour from Bristol to Heathrow, when the electrification of the line is complete, with faster, more reliable and improved connections from across the South West to the capital.

We're also benefiting from significant spend on our roads. Over £2 billion is being invested to improve the A303, the A30 and the M49, opening up a new strategic corridor to the South West, enabling us all to travel more efficiently – and get to our favourite surf beach in double quick time.

So, the next couple of years in the South West are going to be hugely exciting, not least with the recent news that the West of England devolution agreement is now set to go ahead, which will strengthen local powers and unlock around £1 billion of funding for our area. The South West still maintains its distinct, happy feel, but in a whirlwind of creativity and delivery, it is evolving and moving forwards at pace.

We hope you find this inaugural office market report of interest; if you would like any further information, please contact our team of experts – we'd be delighted to help.

Darren Sheward, Head of Region South West

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SOUTH WEST POWERHOUSE
Building a world class knowledge centre

"The idea of the knowledge driven economy is not just a description of high-tech industries. It describes a set of new sources of competitive advantage which can apply to all sectors and all companies, from agriculture and retailing to software and biotechnology".

Source: *New measures for the new economy*, Charles Leadbeater

The South West...

- **Has more people employed in Bristol and Bath in knowledge-based intensive businesses than Oxford and Cambridge combined (ONS).**
- **Is home to 7 leading universities, including Bristol and Exeter, two of the 24 research intensive, world-class universities that make up the Russell Group.**
- **Is the chosen location for a network of pioneering companies, including Airbus, Aardman, Intel, the Met Office, Atkins, Babcock, Rolls Royce and Dyson.**

"THE SOUTH WEST IS BLESSED WITH A TREMENDOUS RANGE OF COLLABORATIVE NETWORKS, FACILITIES AND ACTIVITIES, WHICH CREATES AN INNOVATION RICH ENVIRONMENT." INNOVATE UK

Key knowledge clusters in the South West

AEROSPACE AND ADVANCED ENGINEERING

The aerospace and advanced engineering industries are at the core of technological innovation in the South West and the region boasts a successful and well-established sector. Of the 15 world-leading aerospace industry giants, 14 have their bases, here including Airbus, BAE Systems, Rolls Royce and GKN, and overall, aerospace and advanced engineering is worth over £7 billion to the region (Source: Invest Bristol and Bath).

The region's highly skilled talent base means that amazing advancements in robotics, composites, 3D printing, and more, are happening here.

BUSINESS AND PROFESSIONAL SERVICES

Skills, infrastructure and strong business networks have all helped firmly establish the South West as a thriving financial and related professional services centre. Key sectors include accounting, law, property and management consulting, while newer, growing industries also include FinTech (financial technology) data services and cyber security. Bristol is now the UK's largest legal centre outside of London.

DIGITAL AND CREATIVE

Already home to hundreds of digital and tech start-ups, as well as more established TV, film and associated broadcast technology companies, including the BBC and Aardman, the South West is a magnet for creatives looking to relocate from London. The region's leading cluster is Bristol and Bath, aka Silicon Gorge, with digital expertise continuing to focus on software, gaming, media, hardware and devices. Recognised by Centre for Cities and McKinsey & Company as one of the two globally significant digital tech clusters in the UK, the sector employs over 60,000 digital workers across the wider region.

ENVIRONMENT AND LOW CARBON

The South West is a leader in environmentalism, sustainability and low carbon initiatives, supported by the region's strong engineering and tech sectors. The development of the new £18bn power station at Hinkley Point puts the South West at the forefront of nuclear research and the full ecosystem of low carbon innovation is here, from pioneering research to its execution and delivery.

TECH CLUSTERS

Silicon Gorge (Bristol and Bath)
£8.2bn total digital turnover
36,547 digital tech jobs

Exeter, Newton Abbot
Digital employment up 161% from 2011–2014
11,412 digital tech jobs

Truro, Redruth and Camborne
Digital turnover up by 153% from 2010–2014
1,380 digital tech jobs

(Source: TechNation2016)

UNIVERSITY PERFORMANCE IN UK RANKINGS

Bath University

Accounting:	2nd
Mechanical engineering:	4th
Economics:	6th

Bristol

Mechanical engineering:	3rd
Mathematics:	9th
Aeronautical engineering:	3rd

Exeter University

Medical technology:	5th
Materials technology:	8th
Engineering:	10th

University of the West of England

Land and property management:	6th

University of Gloucestershire
Town and country planning: top 10

Plymouth University
Ophthalmics and agriculture:top 10

WHO'S HERE?

Bristol: BBC, Airbus, Rolls-Royce, Aardman, Hargreaves Lansdown, Atkins, EDF

Plymouth: Burts Chips, The Range Group, Princess Yachts, RNO, Wrigley

Bath: Future Publishing, Rotork, Shift Active Media, Imaginarium,

Exeter: Flybe, Met Office, Renishaw, ATASS Sports, Blur Group

Gloucester / Cheltenham: Ecclesiastical Insurance, GCHQ, Avon Metals, GE Aviation Systems, Mears Group

Swindon: Nationwide, Zurich, Honda UK, Intel Corporation, Npower, WHSmith plc

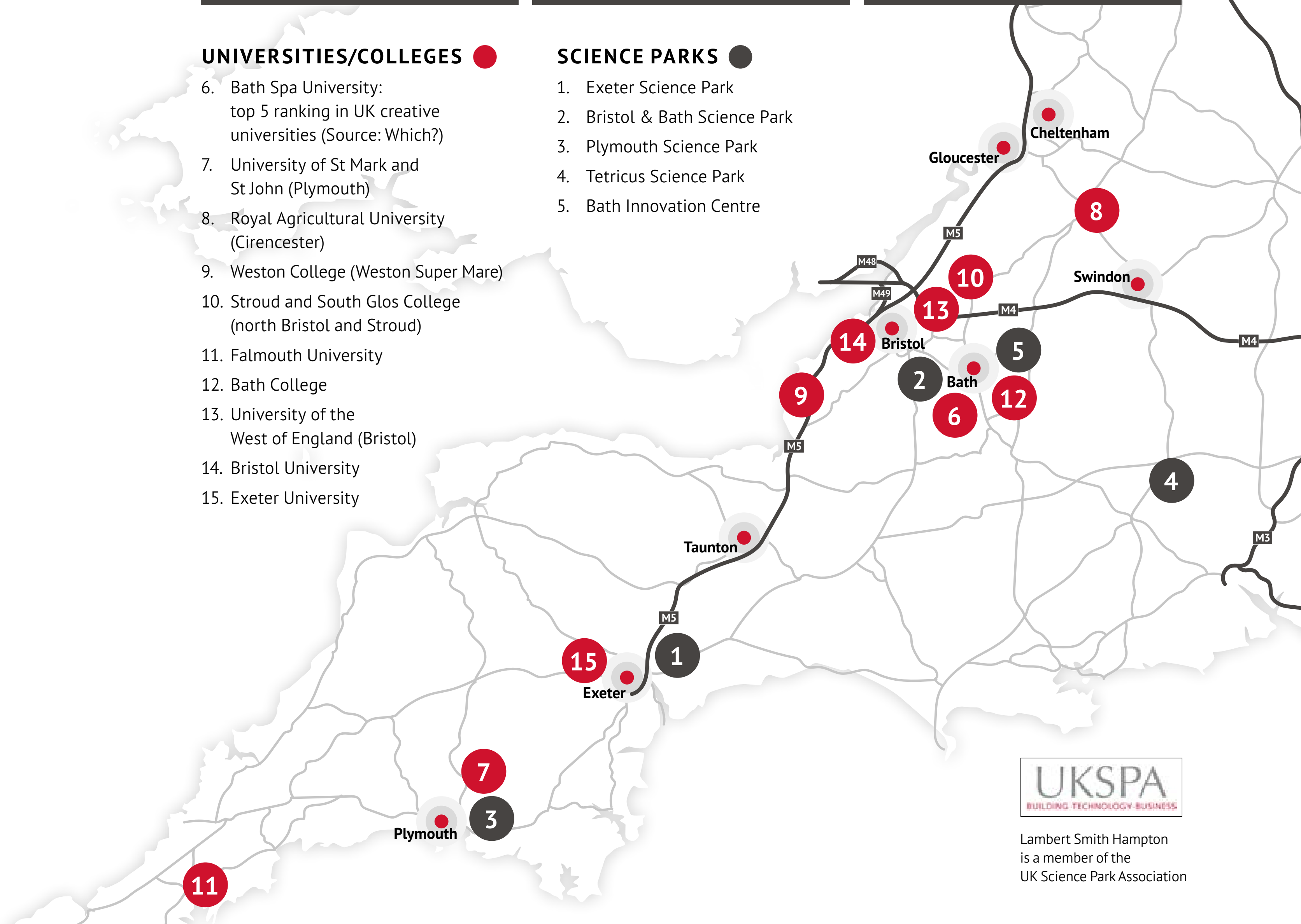
Taunton: Ashfords LLP, Hinkley

UNIVERSITIES/COLLEGES

6. Bath Spa University: top 5 ranking in UK creative universities (Source: Which?)
7. University of St Mark and St John (Plymouth)
8. Royal Agricultural University (Cirencester)
9. Weston College (Weston Super Mare)
10. Stroud and South Glos College (north Bristol and Stroud)
11. Falmouth University
12. Bath College
13. University of the West of England (Bristol)
14. Bristol University
15. Exeter University

SCIENCE PARKS

1. Exeter Science Park
2. Bristol & Bath Science Park
3. Plymouth Science Park
4. Tetricus Science Park
5. Bath Innovation Centre



UKSPA
BUILDING TECHNOLOGY BUSINESS

Lambert Smith Hampton is a member of the UK Science Park Association

REBALANCING THE UK OFFICE MARKET: a South West perspective

TIRED OF LONDON

London will always be at the heart of the UK's economy, but as millions of young professionals feel the pinch from spiralling housing costs and experience long, crowded commutes, does the solution for a better lifestyle lie elsewhere in the UK?

TIME TO REBALANCE

While London remains a magnet for talent and cultural diversity, these growing pressures reflect the unbalanced trajectory of the UK economy. As manufacturing has declined, in its wake, the services sector has become dominant, making up 80% of the market, compared with 46% in 1950. At the same time, London has emerged as a global hub for advanced services.

But is the capital becoming a victim of its own success? In April 2016, London First reported that London's housing crisis is a serious threat to its global competitiveness; it warned that unless the issue is addressed, by 2040, only financial sector workers would be able to afford to rent a flat in inner London, choking off the supply of talent in an array of other key sectors.

However, this London-centric view overlooks the important role the UK's key regional cities will have in helping the UK to compete on the world stage. Crucially, the political will to tackle the imbalance is gathering momentum. With sustained investment in transport infrastructure and the devolution of powers, greater economic potential is being unleashed in thriving regional centres like Bristol, Bath and Swindon.

THE CASE FOR RELOCATION

Historically, the business case for outward movement from London was cost saving. But forward thinking businesses are now also considering relocation for the sake of both their existing staff and future workforce.

Here, we assess the financial case for both businesses and staff.

THE BUSINESS PERSPECTIVE

Office space in central London has always commanded a cost premium over other locations, although this has become more substantial in recent years on the back of strong rental growth. By comparison, this rental growth has been relatively muted in the UK's core cities.

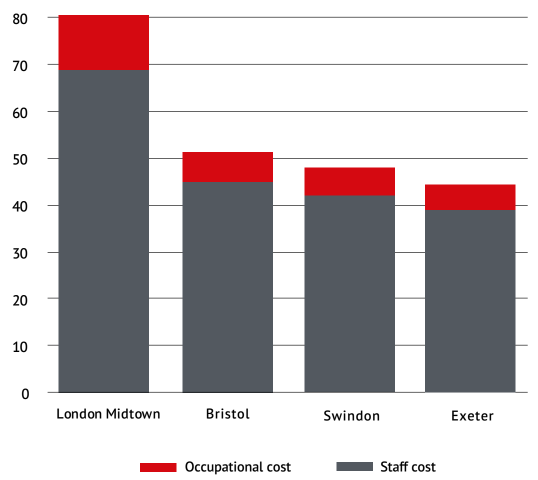
The cost differential is set to widen further from 2017 when the 2015 ratings revaluation takes effect. Its impact will be felt most acutely within London's emerging districts, where a steep rise in business rates liabilities is expected to add over 10% to total property costs.

While property costs are an important consideration, staff costs typically make up well over 80% of a business' expenditure.

Considered overall, the total cost of a single workstation (ie: staff and property) in a brand new building within London's Midtown costs £78,000 per annum, compared with £48,500 per annum in Bristol.

For a new-build office totalling 50,000 sq ft with 500 staff, the above equates to an annual cost of £24.3m in Bristol. Over a period of five years, the effective 'saving' from being located in Bristol instead of London's Midtown is £70m.

Total costs per workstation (£000s per annum)



Source: Lambert Smith Hampton, Office for National Statistics

THE STAFF PERSPECTIVE

In today's market, the average cost of a house in London's inner boroughs stands at almost ten times the average combined salary of a cohabiting couple, compared with just under five times in Bristol.

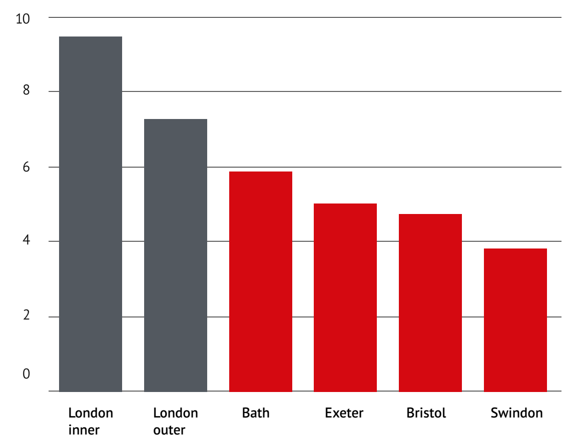
The average couple needs to save for 8 years to afford a deposit in London, rising from 3.8 years in 2007. This is almost twice as long as it takes in most other parts of the UK.

Owning a home outright in the capital is therefore becoming a distant prospect for many London professionals, even those earning decent salaries. Many opt to commute, but this can be expensive and time-consuming.

In contrast – rather than settling for a lifetime of renting or a grinding commute – by choosing core towns or cities, workers can afford to buy much more centrally if desired, minimising commuting distances and maximising their quality of life.

Statistics from ONS reveal that a record number of people in their 20s and 30s are leaving the capital for elsewhere in the UK. In the year to June 2014, the latest for which data is available, 68,500 more people left the capital than moved in – an 83 per cent increase on 2009.

House price to dual income ratio comparison



Source: Office for National Statistics, Land Registry, Lambert Smith Hampton

WHAT DOES THIS MEAN FOR THE SOUTH WEST?

From a purely financial perspective, the statistics supporting the case for a move to the South West speak for themselves, with staff costs and total occupational costs in some areas of the region typically half of those in the South East.

Even in our main city, Bristol, with its top drawer occupiers such as Aardman, Airbus, Intel and Rolls-Royce, not to mention two prestigious universities and a skilled graduate pool, the occupational costs are 40% below those in the capital.

In addition to this, the region's long-established appeal factors are evolving and improving. Its renowned educational establishments, dynamic towns and cities, highly skilled labour market and specialist concentrations of talent and innovation are flourishing.

As connectivity to London and beyond continues to increase, the South West is becoming a viable option for an outward move from London and the South East, evident in company relocations including Just Eat, Somo, Strava and Kainos.

Arguably, the choice for occupiers looking to relocate is, increasingly, not 'why' the South West, but 'why not'?

BRISTOL AND BATH:
Talent, technology and innovation

BRISTOL AND BATH ARE AT THE HEART OF THE SOUTH WEST ECONOMY, WITH PARTICULAR STRENGTHS IN HIGH TECH, ENGINEERING, AEROSPACE AND LOW CARBON. TOGETHER, THEY FORM ONE OF THE MOST PROGRESSIVE AND DYNAMIC REGIONS IN THE UK.

TECH HUB

Bristol and Bath's position amongst the global elite of tech centres has certainly been cemented in recent years. The inexorable spread of tech throughout all aspects of life helps put Bristol and Bath in an excellent position.

Businesses are investing heavily in the region to capitalise on its technology talent. Banks and institutions are developing tech centres to compete against the FinTech (financial technology) surge, for example, Aberdeen Asset Management's acquisition of Bristol based software developer, Parmenion Capital.

Tech thrives here, not only because of the region's exceptionally high skills base (proportionately the most qualified of any major city in the UK, including London), but because of the diversity of strong industry bases across the region.

ECONOMIC STRENGTHS

Bristol and Bath are home to a globally recognised aerospace and engineering cluster – 14 of the aerospace giants, including Airbus, BAE Systems, Rolls Royce and GKN, have bases here. The city of Bristol is also the largest regional legal centre in the UK outside of London and home to the highest value financial services community (source: The City UK).

A MAGNET FOR TALENT

For these kinds of clusters to thrive in a region like Bristol and Bath, they need the right supply of talent. And talent is attracted to the area not only because of jobs, but because of the strong reputation of the region as a place to live; Bristol was recently ranked by Forever Sports Magazine as one of the best places to live in the world (alongside Vancouver, Barcelona and New York).

This balance between lifestyle and credible industry has generated strong levels of new investment in the region, from Cray Supercomputers, which has established its European HQ here, along with Strava, the must-have digital companion for cyclists. Mapfre recently signed a lease on a newly refurbished 50,000 sq ft grade A development for its consolidated UK headquarters.

LOOKING TO THE FUTURE

Invest Bristol & Bath has a strong pipeline of ongoing interest that could amount to over 7,000 new jobs from major distribution units, new digital units for well-known consumer goods companies and major banks, and tech businesses who are realising that there is life outside London.

The demand for new housing and office stock is immense and the region is continuing to grow. 85,000 new homes are planned for the next 20 years for a population of only just over 1.1m, which constitutes aggressive growth.

Sites like the former Filton Airfield, which amounts to 142 hectares, was recently acquired by developer YTL Land and Property and will provide capacity for much of this growth, allowing for at least 2,000 new homes.

But these and other sites are not enough. The Local Enterprise Partnership and region's councils are currently reviewing additional growth points throughout the South West to accommodate the full growth demand. Inevitably, these will become serious investment opportunities of all kinds.

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EXETER:
Connectivity, lifestyle and potential for growth

IN RECENT YEARS, THE EXETER AREA HAS PROVED TO BE AN EXCELLENT DESTINATION FOR MANY GROWING AND DYNAMIC BUSINESSES WITH SIGNIFICANT PLANNED ECONOMIC AND RETAIL DEVELOPMENTS. THE EXETER ECONOMY IS IN A STRONG MARKET POSITION TO GROW FURTHER.

RESEARCH AND DEVELOPMENT

Exeter is home to a number of key organisations providing world class research, education and training. The University of Exeter is in the top one per cent of leading world universities and is the UK's 25th fastest growing organisation. It has particular strengths in medical healthcare, engineering, IT and bio-technology. The Met Office has its UK headquarters based in Exeter and is housing part of its next generation £97m high performance computer within the Exeter Science Park. The close proximity of specialists at these and similar organisations means that businesses located here have good access to the expertise needed for research and development.

INNOVATION

Over the last decade, Exeter has outperformed most UK locations for job creation, featuring in the top 2% for employment growth. Exeter has a significant number of smaller but innovative companies, including CrowdCube (the inventors of crowdfunding and the first company worldwide to trade in this market), Simpleware, e-cow, Lightfoot and RouteShoot Limited. At Exeter Science Park, Torrance Diamond Diagnostic Services (TDDS), a leading veterinary clinical pathology firm, has commissioned its own bespoke building to cope with increased demand.

CONNECTIVITY

Exeter has an International Airport, two rail routes into London (Paddington and Waterloo), major routes by road (M5 to Bristol), three Park & Ride schemes and joined up cycle routes within the city.

LARGE EMPLOYERS IN THE AREA:

Met Office	Flybe	Peninsula Bioventures
Alcoa Howmet	Goodridge	Supercat
Sitel	Graphic Plc	Thomson Reuters
Centrax Ltd	Heathcoat	The University of Exeter
EDF Energy	Hepco Motion	
Euro Tech Group	The Pennon Group	

LIFESTYLE

Exeter offers an excellent lifestyle that aids both recruitment and retention of key employees. Coast and countryside are both within easy commuting distance and it is possible to work in or near the city centre whilst enjoying a more rural existence. Areas of Outstanding Natural Beauty, such as the Dartmoor National Park, are a short drive away.

A huge attraction in the city is the award-winning Royal Albert Memorial Museum (RAMM); a multi-million pound refurbishment of the museum was completed in 2011.

Exeter's retail scene currently features most major national stores, including John Lewis, and is being refreshed this autumn with the opening of a new £13m remodelling of the Guildhall Shopping Centre. In addition, IKEA has plans for a new store to be built on the outskirts of the city centre within the next few years.

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REGIONAL INSIGHT

SOUTH WEST OVERVIEW

A snapshot of the South West region at a glance...

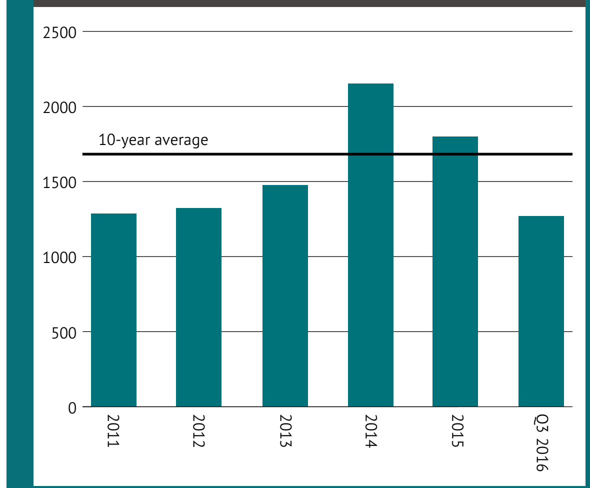
TAKE-UP SURPASSES EXPECTED LEVELS

Take-up in the South West region is expected to exceed trend levels of activity for the region (1.70m sq ft) for the third successive year in 2016. Five of our eight featured locations have run ahead of their 10 year average, with Bristol city centre and Plymouth performing particularly well.

Take-up to date is 1.27m sq ft and activity is expected to reach 1.74m sq ft for the year as a whole.

The majority of take-up across the region has been focused on good quality second-hand space, with the limited supply of grade A stock holding back activity. Activity is expected to be boosted by a number of high profile public sector relocations over the next few years and the final go ahead for the Hinkley Point project will boost demand from the construction and energy sectors.

South West take-up (000 sq ft)



THE NEED FOR DEVELOPMENT

In most locations, the fundamentals for development are now compelling and only construction costs and higher alternative use values are preventing much needed quality supply. In areas where availability is still high, it is generally poorer quality stock which does not meet the needs of the modern tenant. For the right product in the right micro location, we believe that tenant demand is there; occupiers will pay prime rents and take longer lease lengths, and the investment market will pay a strong market yield, so developers should proceed.

SUPPLY LEVELS DWINDLE TO 10 YEAR LOW

At 3.05m sq ft, supply at the end of Q3 reached its lowest level since 2005, with more than 40% of this based in the Bristol city centre and out of town markets.

Availability is now 43% below the peak level recorded in 2011, with a strong period of activity in 2014-16 reducing the supply of grade A and good quality second-hand space, and poorer quality city centre space being lost to alternative use.

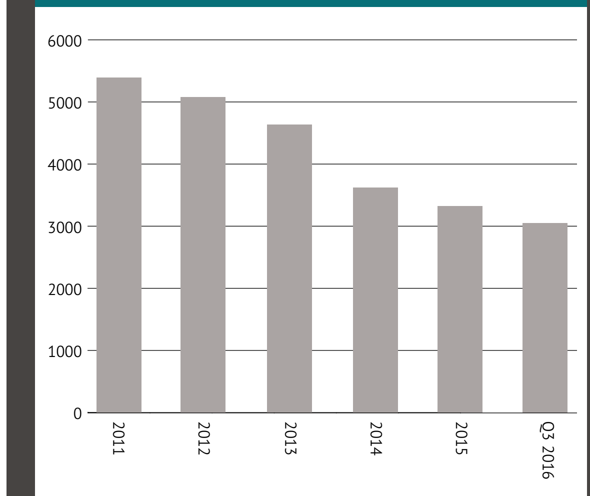
Permitted development has reduced the levels of poorer quality city centre stock on the market, with an estimated 2.3m sq ft of space lost to residential and other uses across our eight locations since 2012.

Grade A space is estimated to account for around 10% of overall stock on the market at the end of the third quarter, with the majority of space focused in Bristol city centre, where Cubex's Aurora building is providing 95,000 sq ft.

The availability rate had fallen to 8.2% at the end of Q3 2016, down from a 2011 peak of 13.8%. Half of our eight locations have availability rates below the regional average (Bristol city centre, Bath, Exeter and Gloucester/Cheltenham), with the highest levels of availability seen in the out of town market in Bristol and Swindon.

Based on 2015 take-up, availability in the South West represents 1.7 years supply.

South West availability (000 sq ft)



BRISTOL LEADS THE WAY IN DEVELOPMENT

The main focus of potential development activity is in the primary market of Bristol, although there are a number of regeneration schemes across the region (Bath, Swindon and Taunton), which may also serve to increase the supply of grade A space.

The only grade A scheme under construction at present is Aurora at Finzels Reach in Bristol's city centre; there is scope for a further 309,000 sq ft at CEG's Aspire and Salmon Harvester's Glass Wharf but these are not yet on-site.

The refurbishment of second-hand buildings will provide the main source of higher grade space in the short term, with rental levels outside of the Bristol market holding back the viability of new schemes.

RENTAL VALUES SET TO INCREASE

Prime headline rental values grew strongly in 2015, rising by 5.6% on average across the region, with the majority of locations, both city centre and out of town, seeing an improvement in values. The most significant increases in the year were seen in Bath (23.8%) and Exeter out of town (11.4%).

The pace of growth has eased in 2016, with prime rents growing by 1.9% on average. The Bristol market has been the main driver to growth in the year to date, with both city centre and out of town markets reflecting continued strong demand and shortage of grade A supply.

Prime rental growth is expected to be driven forward over the next five years by the continued shortage of good quality accommodation. The lack of speculative development will hold back the supply of new space into the market, whilst the supply of better quality second-hand space has continued to be eroded.

Over the forecast period, prime rents are expected to grow by 1.9% per annum, with the out of town market showing slightly stronger growth at 2.2% per annum, prompted by occupier requirements to improve their accommodation.

Data source: Lambert Smith Hampton

BRISTOL AND BATH THE FOCUS FOR INVESTORS

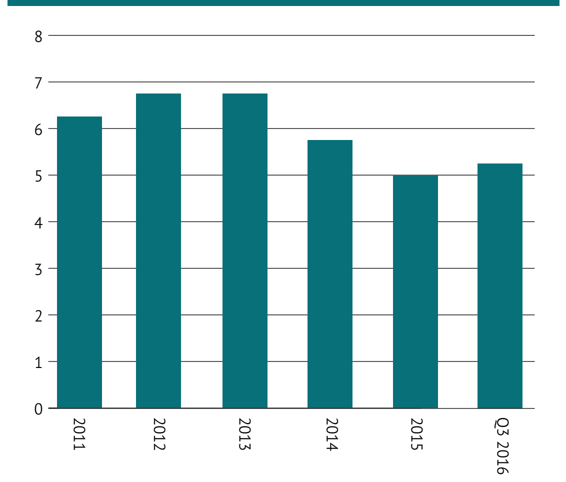
Following the Brexit vote, prime yields have remained keenest for city centre stock. The wider economic uncertainty is focusing demand on a 'flight to quality', with investors seeking prime locations and secure income. Prices are expected to remain stable for this prime product due to high demand and low supply.

Bristol city centre yields edged out by 25 basis points to 5.25% and this reflected the trend across the region, where yields increased by 25–75 basis points.

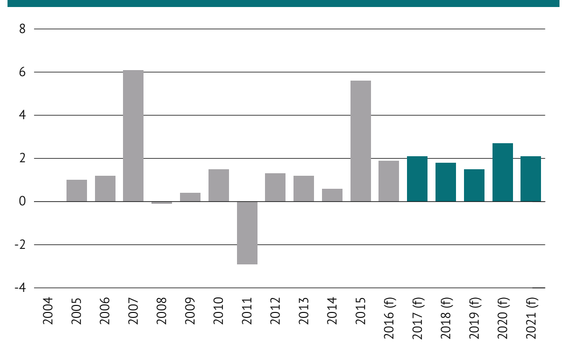
In the 12 months to the end of Q3 2016, approximately £500m of office stock transacted in the South West, which was 20% lower than the £630m transacted in the previous year.

Investors have focused attention on Bristol, which has accounted for 72% of the investment transactions for the year to date. The largest transaction in 2016 so far has been the purchase of the new EDF headquarters building, Bridgewater House, by a private investor for £56m, which reflected a yield of 5.35%.

South West prime yields (%)



South West prime headline rental growth (% per annum*)



INVESTMENT MARKET OVERVIEW

ACTIVITY

South West offices, particularly those in Bristol and Bath, remain at the top of investors' shopping lists, with a high level of demand for assets in the £5m to £20m bracket. This is due to a strong occupational market, low supply level and low passing rents in comparison with other large regional cities. Although quality and location are key, pricing continues to be stimulated by the strong demand for permitted development and the subsequent removal of obsolete office buildings from the market. The wider economic uncertainty is also sharpening demand for prime locations and assets with secure income and, for this type of product, prices are expected to remain stable, given the high level of demand and low supply.

Investors remain cautious about secondary assets where there has been a discount in pricing. The continued uncertainty over the potential of a 'hard Brexit' may cause markets to price-in too much risk, which could, in turn, lead to pricing opportunities in the most exposed sectors.

The supply of office accommodation across the region continues to be a major issue, with Bristol's supply now at its lowest since 2008/2009. Grade A stock accounts for just 16% of availability.

Despite a potential 5m sq ft of office schemes in Bristol city centre, any development is unlikely without pre-lets. Exeter currently has no available grade A supply in the city centre. With high build and land costs, and prime yields remaining strong, the key component to ensure the viability of future development is achieving higher rental levels for grade A accommodation across the South West.

The region has lost a total approximately 2.65m sq ft of office accommodation to student and residential conversions, largely as a result of permitted development. Multiple development sites across the region, originally outlined for offices, have had their planning use amended to a higher proportion of residential use (due to the robust market and rising residential prices) which has further reduced future supply of offices to the market.

BUYER PROFILES

£500m of office stock transacted in the South West in the 12 months up to the end of Q3 2016, which was 20% lower than the £630m transacted in the previous year.

The market has been more diverse than during the previous 12 months, when UK institutions accounted for 45% of the market. The £80m spent by institutional buyers since the start of Q3 2015 is a significant drop from the £266m seen during the preceding 12 months. Since the start of Q2 2016 institutional buyers have not been active in the market, given the uncertainty during the build up to the EU referendum and then the redemption crisis which followed the result. However, we are now seeing of a number of institutional requirements for the key centres of Bristol, Bath and Exeter.

The weak pound and resilient UK property market conditions have led to increased investment from overseas buyers. With investors increasingly being outbid in London, overseas buyers have become more comfortable with cities such as Bristol, Bath and Exeter. Total investment in the South West office market by overseas buyers was £130m in the 12 months up to end Q3 2016, outspending the UK institutions by over £50m and representing 26% of total activity.

Investment from property companies has remained a stable trend, with a £200m spend on South West offices in the last 12 months, accounting for 40% of the market. In comparison, during the previous year, property companies spent a similar volume, but this only accounted for 30% of the total spend. These buyers are continuing to purchase assets with voids and low passing rents, thereby providing asset management opportunities to add value, as well as acting as quasi-developers by refurbishing and converting obsolete buildings.

The last 12 months have also seen the arrival of local authorities to the national investment market. With pressure on growing budgets and interest rates at an all-time low, councils are now acquiring commercial property to make their balance sheets work harder and we expect this trend to continue across the UK.

Despite a handful of strategic asset purchases in the South West, such as Bristol's City Point, located opposite Bristol Temple Meads Railway Station within the city's Enterprise Zone, the region's local authorities are yet to emerge as major buyers. However, we expect to see their investment increase across the South West in the foreseeable future to mirror the likes of neighbouring regional centres, such as Southampton and Portsmouth.

BRIDGEWATER HOUSE, BRISTOL SOLD IN 2016 TO A PRIVATE OVERSEAS INVESTOR FOR £56M, REFLECTING A YIELD OF 5.35%

TRIMBRIDGE HOUSE, BATH SOLD IN 2016 FOR £6.5, REFLECTING A YIELD OF 5.85%

PRICING

As capital growth has stabilised, rental growth has become the driver of performance, with almost all major markets in the South West recording growth over the last 12 months. This has been reflected in the demand for asset management led opportunities as investors seek to capture rental growth, either through buying properties with voids or comprehensively refurbishing buildings.

Permitted development rights have continued to boost demand for these assets but commercial buyers have remained competitive in strong office locations. The Pithay in Bristol is a good example of this; the previous owner of the 180,000 sq ft office building had been seeking investment for a residential development but at the end of 2015, Resolution Property purchased the asset for £100 per sq ft, with plans to retain 120,000 sq ft for refurbished office use, an art gallery and restaurant, aimed at Bristol's growing creative and digital business community.

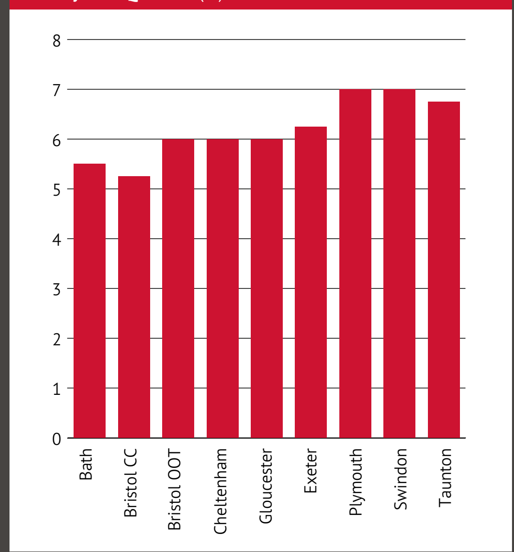
OUTLOOK

Following a volatile summer, triggered by uncertainty surrounding the UK's decision to leave the European Union, we are now witnessing stabilisation in the UK investment market.

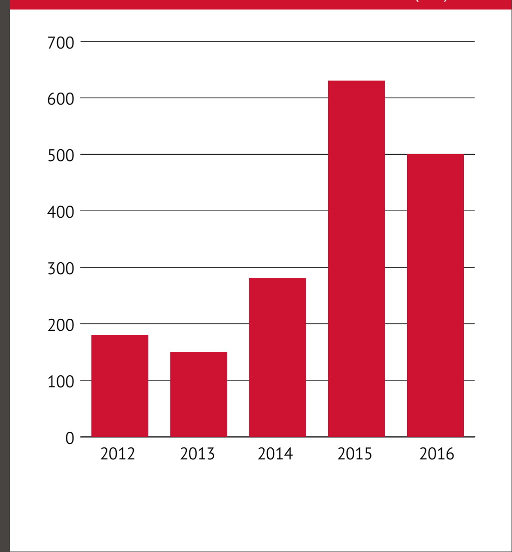
The South West boasts a wide range of corporate occupiers, with key players across a significant number of sectors and both the diversity of the existing occupier base and current high levels of demand are a positive.

However, it is inevitable that some medium term business decisions will be put on hold until the future becomes more predictable. Whilst this will have an impact upon pricing expectations in what is largely an internal rate of return (IRR) driven market, the UK's low interest rates should maintain the yield gap between property and government bonds.

Prime yields Q3 2016 (%)



Total office investment transactions South West (£m)



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DEVELOPMENT PROSPECTS

The South West office market has changed dramatically over the last three years as the Government's relaxation of Permitted Development (PD) has removed a significant amount of obsolete stock from the market.

Buildings in prime locations have been lost for good to the residential and student market, leading to shrinking supply and rental increases.

In other markets across the country, particularly the South East, PD has resulted in increasing speculative development, so why aren't we seeing cranes across the South West skyline?

Here, we assess each location's development potential.

BATH

Bath is a unique market. Demand has massively outstripped supply for a number of years; however, there are many constraints for development, such as the city limits, planning regulations and world heritage status. This has made it difficult to start building in Bath and several larger office occupiers, such as Creston and Parmenion Capital, have moved to Bristol to be able to grow. This lack of larger space has meant Bath has had to adapt its plans for the future and Bath Council has earmarked Bath Quays as a development to be brought forward; this will offer 250,000 sq ft of grade A supply to a market crying out for large, prime office buildings.

Other sites looking to benefit from this lack of supply include Ediston's Pinesgate, which is due to offer 110,000 sq ft to the market. However, occupiers want to remain in Bath's city centre, so development on the fringe is riskier and rents are traditionally lower.

BATH QUAYS NORTH AND SOUTH

BRISTOL CITY CENTRE

Bristol's city centre is the only area to see speculative development, with Cubex's Aurora due for completion in December 2017 and Castleforge Partner's comprehensive redevelopment at One Cathedral Square set for completion in summer 2017. The fundamentals driving both developments are increased demand and rents against reducing stock and incentives.

Bristol's grade A take-up has averaged 150,000 sq ft a year for the last 15 years, but with less than 120,000 sq ft grade A space available, the market is craving future supply.

Developments have a time lag and therefore, Castleforge Partners and Cubex have timed it right to coincide completion with completion with supply at its lowest level for fifteen years. Given that any schemes starting on site now will take 24 months to complete, what can we expect when these two have left the market?

There are other office developments that can come forward quickly, such as CEG's Aspire, Bouygues' The Anvil, Axa's Assembly and the joint venture between Skanska and Bristol City Council to deliver 250,000 sq ft at Temple Square. If all these sites were to come forward at the same time there would be a severe oversupply.

However, Bristol's development pipeline has policed itself. Of the 5 million sq ft of office space planned six years ago, 2.5–3 million sq ft is going to mixed use schemes, such as the Assembly development, leaving 1.7m sq ft of office space planned in Bristol city centre.

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BRISTOL OUT OF TOWN

The only out of town developments over the last few years have been pre-lets for specific occupiers. We are seeing some comprehensive redevelopments taking place, such as those at 800 and 1000 Aztec West. However, new development has been lacking due to levels of annual take-up and an oversupply, mainly obsolete space in places like Almondsbury. Recent changes to permitted development rights are expected to take effect over the next year; this will allow for the redevelopment of obsolete business parks, which will, in turn, lead to the right market conditions for development.

CHELTENHAM AND GLOUCESTER

The major schemes built here have always been on the outskirts of the towns, close to the motorway, and we believe these markets could justify speculative development. Cheltenham benefits from the presence of GCHQ, with contract-led work driving a lot of demand in the market.

Historically, Cheltenham rents have not been able to justify new build schemes; however, a lack of good stock has led to an increase in rents, which will start to justify new builds. Traditionally, Gloucester has suffered from a lack of rental growth, but with supply stifled, we expect rents to increase steadily here. This is likely to stimulate some development during 2017, especially near to GCHQ, which will continue to act as a catalyst for job creation.

EXETER

Exeter remains a popular market in the South West. The city centre has been greatly affected by permitted development rights, due to high demand for student schemes and city centre living. Exeter Business Park remains the prime out of town office location but there is limited space left for new development. Exeter Science Park, Skypark and Exeter Gateway are set to see new development and we expect these parks to increase rental levels. Exeter Science Park and Skypark have seen success with pre-lets on the park and they will begin to build speculatively in 2017.

PLYMOUTH

Plymouth has suffered due to a lack of relocations, regional or national. It is seen as a less accessible location than other cities in the South West, so rents remain lower and developments have not been brought forward. We do not anticipate any development on a speculative basis, however, we will see commercial development as part of a few mixed use schemes, such as Akkeron's Pavilions or Millbay. There are no planned stand alone office schemes in Plymouth; the only office development will be as part of mixed use developments where residential or retail will take the lead.

SWINDON

Swindon has a large supply of offices within the city centre and out of town markets, so there is little incentive for speculative development and future development will be triggered by pre-lets. This town centre has not experienced the dramatic impact of permitted development rights seen in other South West cities, due to a lack of student requirements and low demand for town centre living. Improvements in placemaking are required to attract both commercial and residential occupiers.

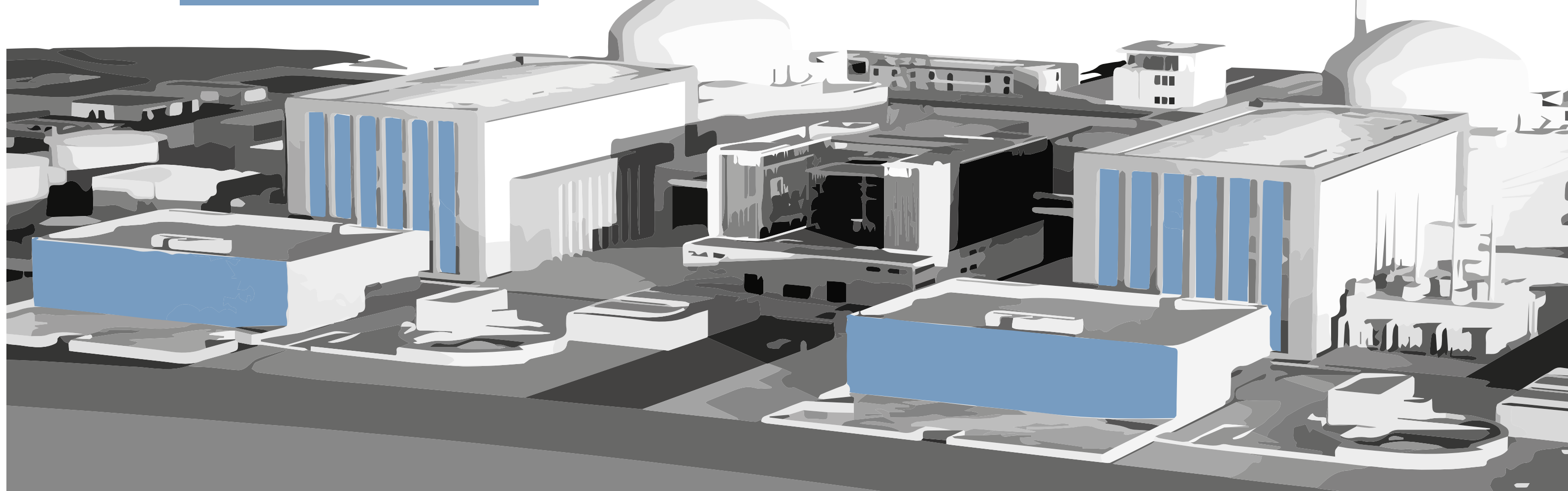
The question mark will be on the impact of the electrification of the railway, which is due to cut journey times to London. If that brings new occupiers to the market, it may tip the balance and we may see some development; however, this is not due until late 2017/18 at the earliest.

TAUNTON

Taunton is a market which has traditionally seen strong out of town demand but subdued demand for its centre. Blackbrook Business Park has always been the prime location for the town's office market, with the highest rental levels achieved on the park. The recent refurbishment of Tangier Central has proved there is still demand in Taunton's city centre, with a lot of the accommodation under offer. Taunton's city centre development, however, will continue to be centred around St Modwen's Firepool at 450,000 sq ft, which will deter any other sites coming forward.

We expect Hinkley Point to have a positive impact on both the town centre and out of town markets, which, in turn, will instigate development to meet increased demand.

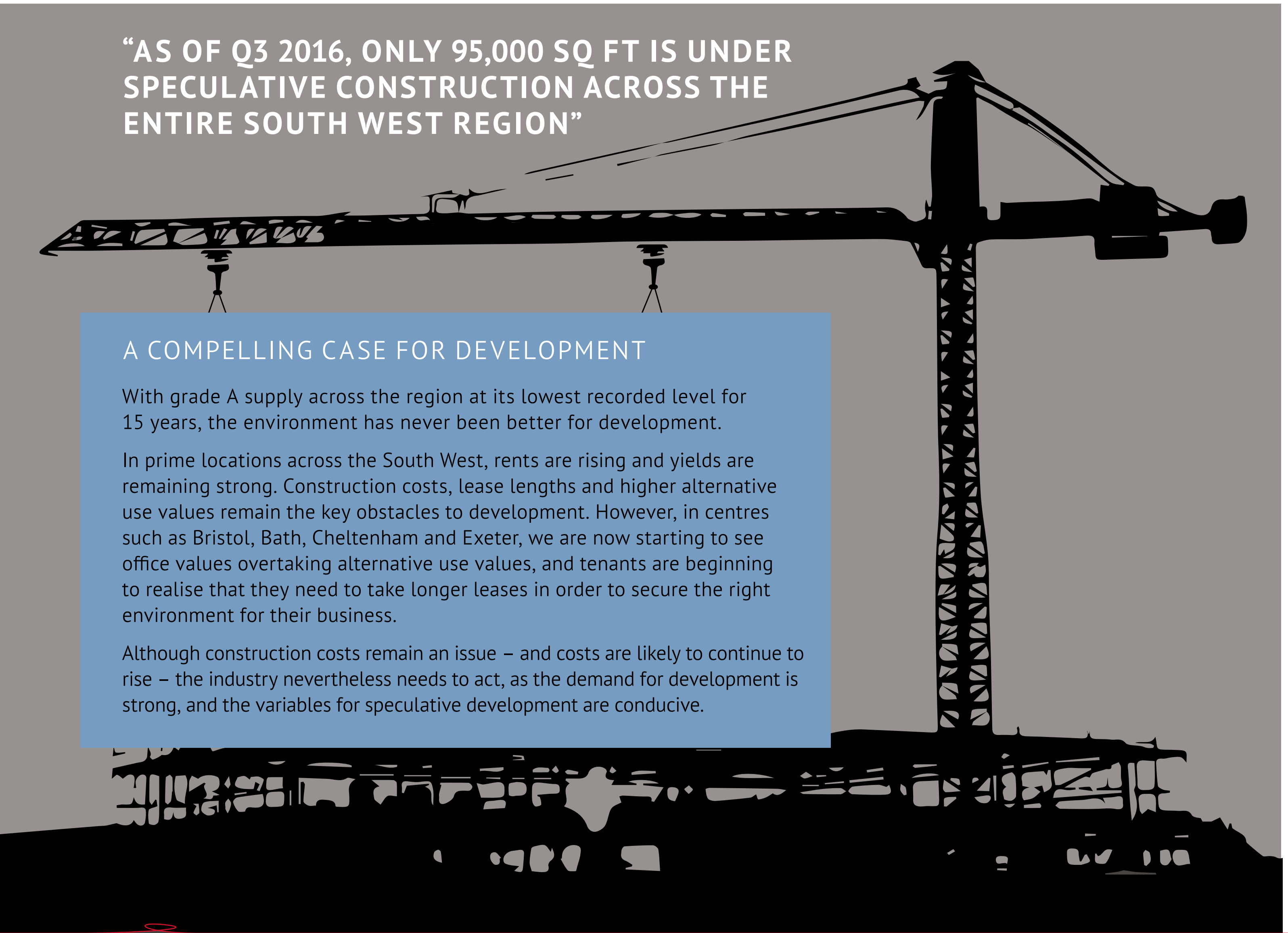
PROPOSED NUCLEAR POWER STATION AT HINKLEY POINT



DEVELOPMENT PROSPECTS (CONT)

SUMMARY

- Aside from the small amount of development in Bristol, 2016 has seen a lack of speculative build across the South West as a whole.
- One of the main reasons for a lack of development is increasing construction costs and the fact that the rent in many locations does not justify speculative build. Occupiers are demanding high quality space that will retain staff in a competitive market, but in order to do this, occupiers need to realise they have got to start paying a higher rent and take longer leases.
- Exeter, with both the Skypark and Science Park committing to building speculatively, will provide the market with much needed grade A accommodation. While these two developments will quench demand in the short-term, we believe that Exeter could be ripe for development in nine months to a year's time.
- Locations such as Gloucester and Plymouth are unlikely to see speculative development, but we believe that Cheltenham, and possibly Taunton, could see some speculative schemes moving forward due to the effect of GCHQ and Hinkley Point.
- Swindon is slightly oversupplied and may need to consider its obsolete offices or town centre options before it starts to look to new developments.
- Bristol's supply will continue to decrease as Aurora is the only scheme currently on-site; therefore, the shortfall in 2018/19 will create a perfect opportunity to build.
- Bath is massively undersupplied for all grades of offices; however, the city's micro market locations are unique and therefore the right sites are scarce. If a city centre site was available, then we would recommend development as soon as possible.



"AS OF Q3 2016, ONLY 95,000 SQ FT IS UNDER SPECULATIVE CONSTRUCTION ACROSS THE ENTIRE SOUTH WEST REGION"

A COMPELLING CASE FOR DEVELOPMENT

With grade A supply across the region at its lowest recorded level for 15 years, the environment has never been better for development.

In prime locations across the South West, rents are rising and yields are remaining strong. Construction costs, lease lengths and higher alternative use values remain the key obstacles to development. However, in centres such as Bristol, Bath, Cheltenham and Exeter, we are now starting to see office values overtaking alternative use values, and tenants are beginning to realise that they need to take longer leases in order to secure the right environment for their business.

Although construction costs remain an issue – and costs are likely to continue to rise – the industry nevertheless needs to act, as the demand for development is strong, and the variables for speculative development are conducive.

TRIGGERS AND DRIVERS

What motivates companies to acquire new office space in the South West Region, and what influences their choice of property?

TRIGGERS – WHAT IS PROMPTING RELOCATION?

Companies in the South West have traditionally based their relocation decisions around lease events; in 2012, 61% of moves in Bristol city centre were triggered by this. However, over the past three years, we can see a shift in triggers to include expansion and other corporate activity. This indicates that firms are now choosing to move when the time is right for them, rather than when they are forced to.

This is typical for a market that is recovering from a recession, and we can see that expansion has accounted for 29% of moves in 2016, while corporate activity triggered 32%. This is only marginally behind lease events which accounted for 33% of moves, with consolidation at just 5% and contraction at 2% of the overall total.

Occupier transactions, such as OVO taking space at Temple Back and Frazer Nash Consultancy's move to Narrow Quay House, are both examples of firms taking leases due to expansion rather than lease expiry. The deal at Bridgewater House to EDF Energy was triggered by corporate activity following the go ahead on Hinkley Point C, again indicating that moves into Bristol are not simply triggered by lease events.

DRIVERS – WHAT DETERMINES END CHOICE?

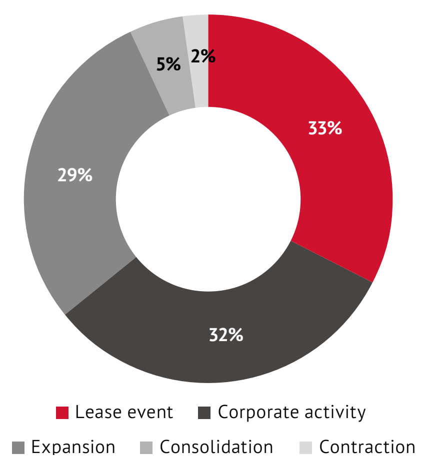
Location remains the most important factor in determining end choice. Over the past three years, its importance has strengthened, due to key factors such as local amenities, transport links and staff retention. As the primary driver, it stands at 11% higher than it did just three years ago and it is currently the key driver for nearly half (39%) of all moves.

Interestingly, the impact of cost on the decision making process has fallen by 2% over the past three years, to just 14%. The only driver below this level is the specific need for a certain physical feature, such as parking or being self contained, which stands at just 5%.

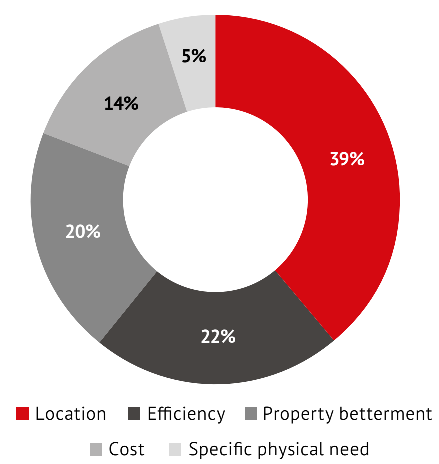
Of course, the position of the market in the economic cycle plays an important role in influencing move drivers, just as it does on triggers. However, there is another force that is becoming increasingly important. This is the value of the building as an 'asset' to the firm, in terms of what it can deliver by way of efficiency, staff motivation and retention. On site amenities and the ability to achieve property betterment has influenced the market by an increasing amount in recent years and it now accounts for 20% of all moves.

Many firms have found that they are occupying tired space that does not meet the needs of the modern occupier or the expectations of staff. This was demonstrated in the recent moves made by WYG to 90 Victoria Street and Civica to Spectrum, who have both stated property betterment as a key driver to their chosen property.

Office move triggers (past 12 months)



Office choice drivers (past 12 months)



Data source: Lambert Smith Hampton

In order to attract the best occupiers, particularly those relocating from London or South East, landlords should consider the following as integral parts of their building architecture and floorspace requirements

- Enhanced amenities
- Improved work/life balance
- Creative design
- Inspired shared spaces
- Flexibility and adaptability
- Sustainability
- Outdoor areas where possible

MARKET INSIGHT

BATH

Highlights

- **The Bath office market has been held back by a lack of grade A space.**
- **The primary source of new supply is at Bath Quays, where preparatory work for 200,000 sq ft of office space has already commenced.**
- **The availability rate has fallen to 5.3%, with an estimated 100,000 sq ft of office space having been converted to alternative uses.**
- **Prime office rents reached a new peak level at £26.50 per sq ft in Q3 2016 and have subsequently moved to £31.00 per sq ft following the deal at 20 Manvers Street.**
- **The most notable investment transaction in the year to date was the £6.5m purchase of Trimbridge House by Scotsgrove Holdings.**

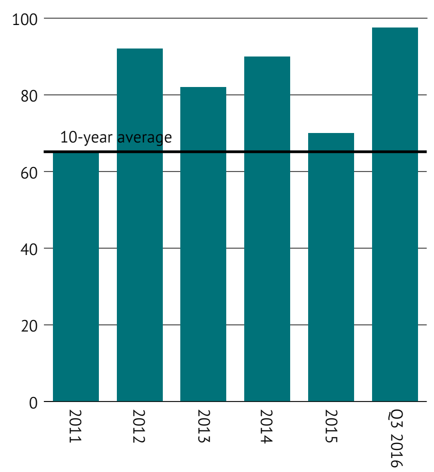
Demand

Take-up in the Bath office market has remained above the 10-year average (65,000 sq ft per annum) in each of the past five years.

2016 has continued this trend, with the year to date seeing a take-up of 80,136 sq ft, largely due to the letting of 20 Manvers Street. This has been the most significant deal in the city this year, and the building has been let in its entirety to two tenants, Chase de Vere and Parragon.

Bath has seen a good level of demand from technology, media and telecommunications occupiers over the past few years, with this sector complementing the traditional occupier base of financial and defence organisations.

Bath take-up (000 sq ft)



Supply

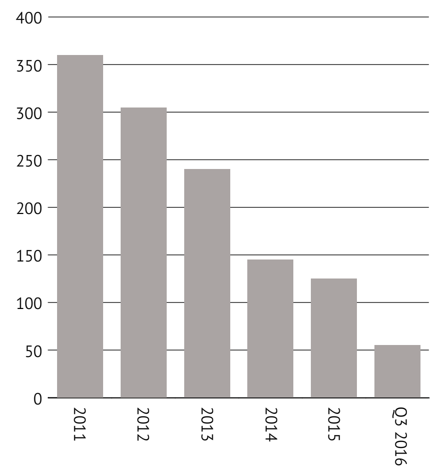
Supply scarcity has become acute in Bath, standing at less than a third of its level five years ago. Supply has been eroded over the past five years, falling from 360,000 sq ft in 2011 to 55,000 sq ft.

The main focus of the Bath office market is around the city centre and the edge of the city, with any out of town or business park office space located a significant distance from the city centre and its amenities.

The most significant addition to supply over the past 12 months has been the refurbishment of 20 Manvers Street. This building has provided 45,136 sq ft of high spec office space over six floors, with a new fourth floor extension added and will be ready for occupation in H1 2017. Aside from this, the majority of supply on the market is dominated by smaller buildings.

The availability rate had fallen to 5.3% at the end of Q3 2016, down from a recent peak of 18.1%, with approximately 100,000 sq ft of office stock being lost to other uses through permitted development. Q3 2016 levels of availability represent 1.4 years supply at historic take-up levels but now Manvers Street has completed, this will go down to 9 months of supply.

Bath availability (000 sq ft)



12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
+50%	**-66%**	**0.75**	**£31.00**	**5.50%**

Development

The main focus of potential development in Bath is along Bath's Enterprise Area, which follows the river through the city and is recognised as being the key zone for growth. Within this, the primary area of opportunity, at least in the medium term, is at Bath Quays South and North, where preparatory and the first stage flood defence works are scheduled to be completed by the end of 2016. In total, a mixed use scheme will provide 200,000 sq ft of new office space

There is additional new office space planned at 1 Pinesgate, where 113,000 sq ft of new office space has received outline planning approval, along with a new international college campus.

Market rental values and yields

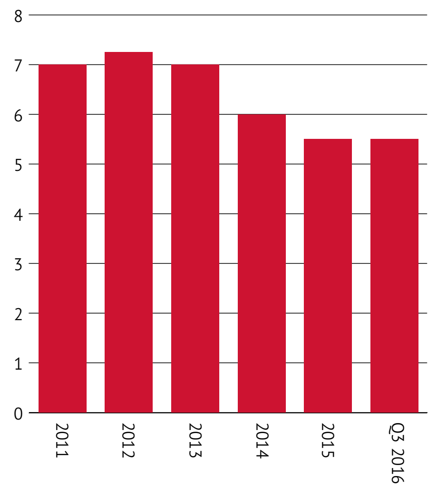
Prime headline rents moved to a new high in 2015, rising to £26.00 per sq ft, an increase of 23.8% from the previous year's level. Further growth has been seen in the first three quarters of 2016, with rents rising to £31.00 per sq ft.

Prime investment yields have remained at 5.50% following the Brexit vote, as investors have become less certain about the outlook for occupier demand and the UK economy in general.

There has been limited investment activity in the Bath market, although properties in the town are in demand.

The only transaction of note in the first three quarters of 2016 was the £6.5m purchase of the 21,675 sq ft Trimbridge House by local investment company Scotsgrove Holdings. The property is let to Investment Funds Direct, with their lease expiring in 2022. The purchase price reflects a net initial yield of 5.85%.

Bath prime yields (%)



Forecast

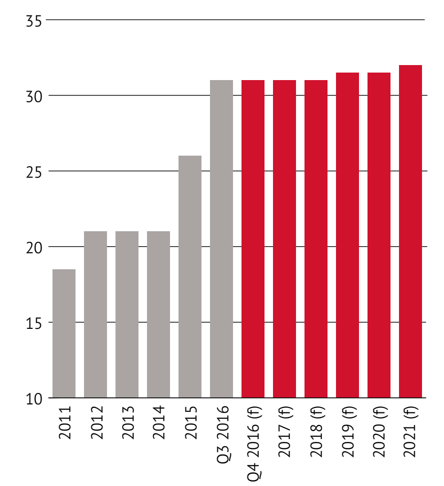
The recent letting of 20 Manvers Street has pushed prime rents upwards to a record £31.00 per sq ft in the city centre.

Following on from the strong growth in rents seen in 2015/16, the pace of increase is expected to level out and we would not anticipate any major increases over £31.00 per sq ft in the next five years.

However, any increase would be centred around Bath Quays, and therefore, we may see an increase in 2020/21.

2017 ▶ £31.00 per sq ft

Bath prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

BRISTOL CITY CENTRE

Highlights

- **Take-up has been robust in the first three quarters of 2016, with 515,700 sq ft of space acquired, with the year on target to surpass the 10-year average of 550,000 sq ft per annum.**
- **The two key transactions in 2016 have been an 81,200 sq ft letting to EDF at Bridgewater House, Finzels Reach, and a 63,000 sq ft freehold purchase of The Core by Direct Line.**
- **Supply is at its lowest level since 2009, while grade A space accounts for only 16% of the total.**
- **Grade A availability stands at 107,500 sq ft and the overall availability rate stands at 6.5%.**
- **There is potential for a further 5m sq ft of office schemes in the city centre market, although most are unlikely to commence without a pre-let being secured.**

Demand

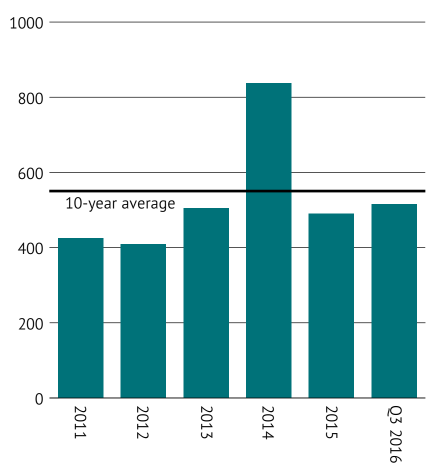
Take-up in Bristol City Centre has surged in the first three quarters of 2016, with 515,700 sq ft of transactions recorded, 26% ahead of the 10-year average.

The largest transaction in the year was EDF's lease of 81,200 sq ft at Bridgewater House in Q1, the largest city centre letting in Bristol for 10 years. EDF Energy's move to Bristol is attributed to the construction of the Hinkley Point nuclear power station. In addition, a further 63,000 sq ft was transacted at The Core, with Direct Line purchasing the freehold for £15.2m (approximately £241.00 per sq ft).

Aside from these two larger transactions, the majority of other activity in the city centre has focused on poorer quality space, with most lettings at less than 10,000 sq ft.

The key impetus behind activity in the city centre market over the next 12–18 months is expected to be the public sector, with a number of larger requirements from government bodies providing the thrust of demand. Bristol is identified as the favoured location for the first of HMRC's new regional offices, which is expected to open in 2017/18. At the time of writing, 3 Glass Wharf has been shortlisted as the preferred development for HMRC.

Bristol CC take-up (000 sq ft)



Supply

Supply has continued to tighten in the city centre, with an estimated 1.4m sq ft of older office buildings being lost to alternative uses through permitted development rights.

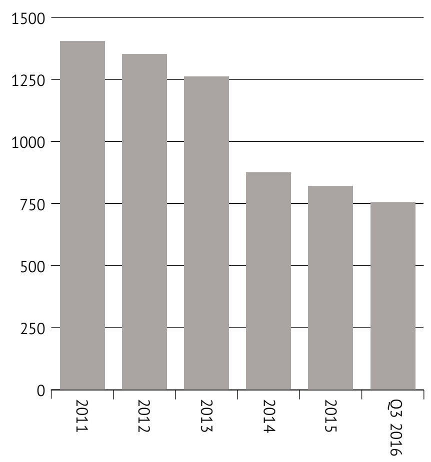
At the end of September 2016, there was just over 750,000 sq ft of space on the market, with around 16% of supply being grade A. Current availability represents just over one year of supply based upon current take-up figures.

The most significant addition to grade A supply over the next 12–15 months will be at the mixed use scheme, Finzels Reach, where Aurora will provide a further 95,000 sq ft of speculatively developed office space, due to complete in late 2017. The scheme is being built by Bristol developer, Cubex, with funding provided by Palmer Capital. Castleforge's One Cathedral Square will offer 56,883 sq ft to the market in April 2017.

Second-hand space also continues to tighten, with just 634,000 sq ft on the market in the city centre, although there are a number of refurbishments expected to complete over the next 12 months.

The availability rate fell to 6.5% at the end of September 2016, down from a peak of 10.9% at the end of 2011.

Bristol CC availability (000 sq ft)



12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
+16%	**-9%**	**1.3**	**£30.00**	**5.25%**

Development

There is potential for 5m sq ft of new office development in Bristol's city centre, although none have yet started on-site, with pre-lets being sought before construction. The majority of these sites will be mixed-use, which will therefore lower the amount of office space that will be provided.

One of the largest schemes is at CEG's Aspire, Temple Street, where 200,000 sq ft of space will be available via pre lets, with planning consent already confirmed.

A potential additional phase of development is at Salmon Harvester Property's Glass Wharf, where 37,160 sq ft has already been let to PwC in the existing building. The new phase would provide a further 109,000 sq ft of offices, with retail and leisure space on the ground floor.

Market rental values and yields

Prime headline rent in Bristol city centre established a new peak in Q3 2016, reaching £30.00 per sq ft and continuing the upward trend which commenced in 2011. Over this period, rents have increased by 9.4%, with the most significant increase seen in 2014.

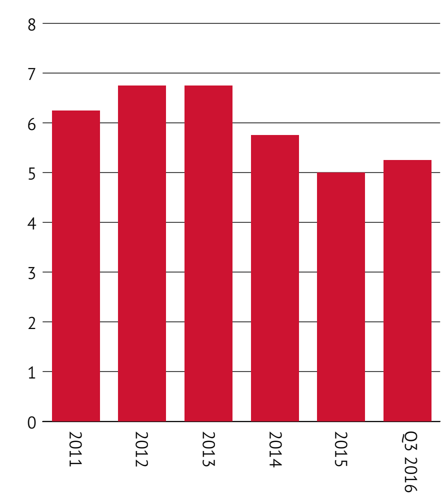
Secondary rents have also improved as supply has tightened across the city, with rents for good quality second hand space standing at £22.00 per sq ft and poorer quality space attracting rents of £18.00 per sq ft.

Prime yield moved up by 25 basis points to 5.25% in the first three quarters of 2016 as investors reacted to increased uncertainty.

Investment activity in Bristol has remained strong, with more than £500m of office property transactions completing across the city centre and out of town markets since the start of 2015.

The largest city centre transaction in 2016 has been the £56m purchase of the 115,000 sq ft Bridgewater House, Finzels Reach, by a private investor. The building is let to EDF, Barclays and BDO and the purchase price reflects a net initial yield of 5.35%.

Bristol CC prime yields (%)



Forecast

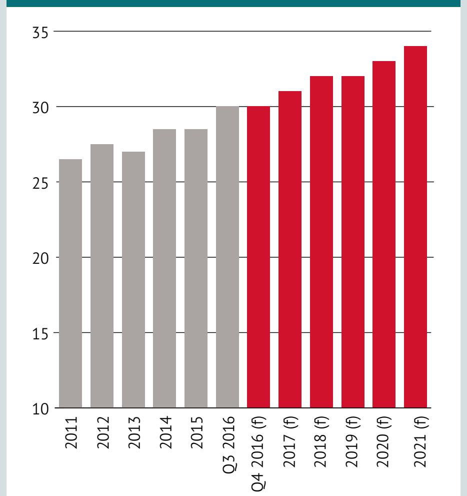
Prime rents have risen to £30.00 per sq ft at the time of writing, as the demand for grade A space remains strong. This upward movement equates to growth of 5.3% for this year as a whole.

Further growth is expected over the next few years, with prime values reaching £32.00 per sq ft by 2019 and £34.00 per sq ft by the end of the forecast period (2021).

Annualised growth over the full forecast period equates to 3.3% per annum.

2017 ▲ £31.00 per sq ft

Bristol CC prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

BRISTOL OUT OF TOWN

Highlights

- **Take-up for the year to date is 197,400 sq ft, a fall on the 10 year average of 311,218 sq ft.**
- **The largest transaction has been a 20,360 sq ft letting to Hoare Lea at 155 Aztec West.**
- **At 548,000 sq ft, supply has reduced significantly from the peak of 1.2m sq ft in 2011. There is an acute shortage of grade A space.**
- **Prime rents grew by 5% in 2015 and this has drawn investors' attention to the out of town market, with £47.8m of transactions completing in the first nine months of the year.**
- **While there is an acute shortage of grade A space, there are no schemes under construction.**

Demand

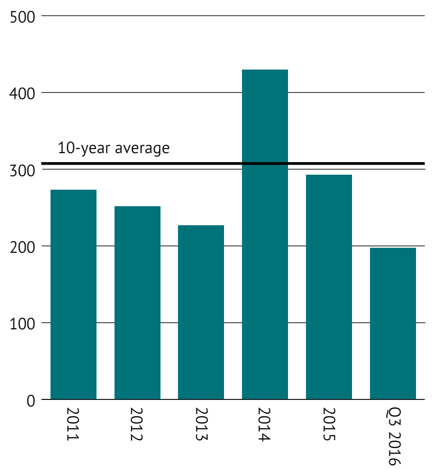
Following the high point in take-up in Bristol's out of town office market in 2014, of 429,676 sq ft, activity slowed to 292,000 sq ft of activity in 2015. This year has continued the trend, with take-up of 197,400 sq ft seen in the first three quarters of the year and an expectation that the year's total will be less than the 10-year average of 310,000 sq ft per annum.

Several significant transactions are worthy of note; a 20,360 sq ft letting at 155 Aztec West to consulting engineers, Hoare Lea, was the largest of the year so far, whilst CableCom took 18,600 sq ft at 1 Rivermead Court. Babcock is due to take 30,000 sq ft at 100 Bristol Business Park in Q4 2016, following their acquisition of 10,000 sq ft at 220 Bristol Business Park earlier in the year.

Demand remains robust for the Bristol market, although the lack of good quality accommodation in the out of town market is likely to curb activity.

There are a number of large public sector and defence-led contract requirements that may look to the out of town market for opportunities.

Bristol OOT take-up (000 sq ft)



Supply

Supply in the out of town market has continued to contract over the past five years, having peaked at 1.2m sq ft at the end of 2011. Total availability at the end of Q3 2016 stood at 548,000 sq ft, more than 56% down on the peak.

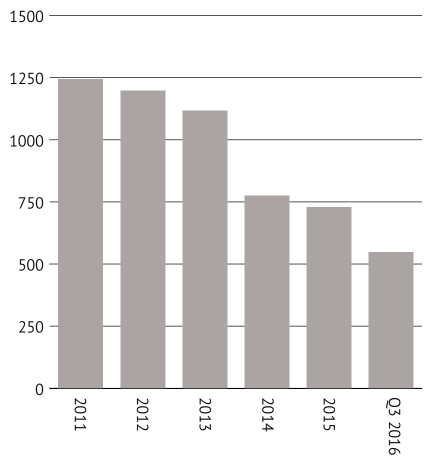
The main focus of out of town supply is second hand stock, with only 26,100 sq ft of grade A space on the market. The largest grade A accommodation available is at 2540 Aztec West, where there is 14,924 sq ft.

Second hand supply, which represents 95% of all stock currently being marketed out of town, is dominated by the 164,530 sq ft available at Parkview Office Campus. This one building alone accounts for 44% of grade B space on the market.

Poorer quality second hand space represents 26% of the out of town supply, with more than one third of this in units of less than 7,000 sq ft.

By the end of Q3 2016, the availability rate in the Bristol out of town market had fallen to 13.7%, although this figure reduces to 10.1% if poorer quality second hand space is excluded.

Bristol OOT availability (000 sq ft)



12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
-13%	-25%	1.7	£21.00	6.00%

Development

The main focus of good quality stock development in the out of town market is to the north of Bristol city centre, at Aztec West, Bristol Business Park, Parkway and Filton Business Park.

There is currently no new space under construction in the out of town market and development opportunities are limited.

In Q3 2016, Abstract purchased a major six acre development site to the south of Bristol Business Park at the former DuPont facility. The developer is currently in talks with the end occupier to develop a 100,000 sq ft headquarters building.

A number of defence-led contractors are looking for accommodation in the north Bristol region and we anticipate that these may look at pre-let opportunities.

Market rental values and yields

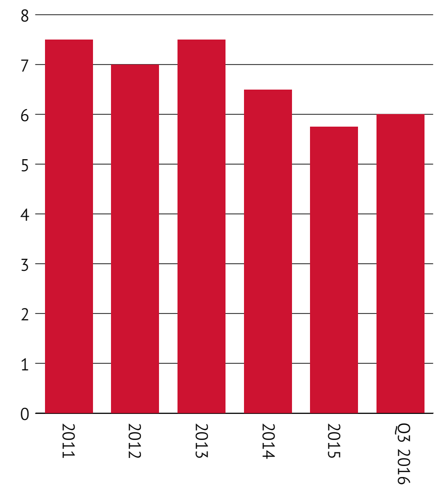
Prime headline rents in the Bristol out of town market increased to £21.00 per sq ft in 2015, growing by 5% over the year. Rents are still 10.6% below their previous peak of £23.50 per sq ft, which was established in 2007.

Tenant incentives have remained constant at two months rent free for every tenancy year for most of the out of town market, although Bristol Business Park, the premier park in this market, is able to offer similar incentive terms to the city centre market which are 1 to 1.5 months per year.

Prime yield moved out by 25 basis points in the lead up to the EU Referendum and have remained stable at 6.00% since then.

There have been several business park transactions over the first three quarters of 2016. The largest of these was the purchase of the 63,860 sq ft TSB HQ building at Key Point, Almondsbury, by an overseas investor for £16.8m, which represented a net initial yield of 5.70%.

Bristol OOT prime yields (%)



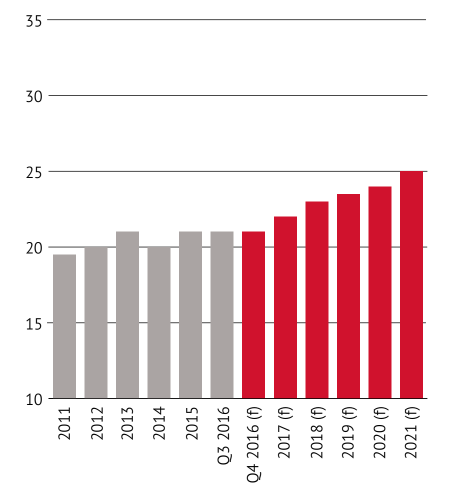
Forecast

The lack of supply, particularly grade A, in the out of town market is expected to drive rental growth, with rents reaching their previous peak (£23.50 per sq ft) by 2019.

Over the full forecast period, prime out of town rents are expected to rise to £25.00 per sq ft, equating to rental growth of 3.1% per annum.

2017 ▲ £23.00 per sq ft

Bristol OOT prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

CHELTENHAM / GLOUCESTER

Highlights

- **2016 take-up in Gloucester is in line with the annual 10-year average.**
- **In Cheltenham, take-up is running ahead and is already at the 10-year average of 50,000 sq ft at the end of Q3 2016.**
- **Supply remains constrained in Gloucester and has fallen significantly in Cheltenham, to 130,000 sq ft, due to permitted development conversions.**
- **Prime headline rents have edged up slightly over 2016, due largely to the tight supply conditions.**

Demand

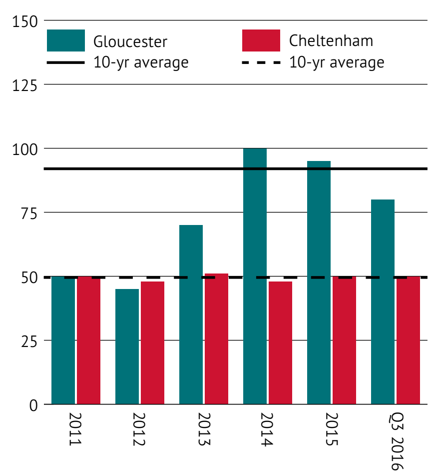
Take-up in Gloucester has remained at around the long term average of 90,000 sq ft per annum for the past two years. In the nine months to the end of September, take-up was 80,000 sq ft. Activity in Cheltenham has been better than average during 2016, with 50,000 sq ft of lettings completed.

The most significant transaction in Gloucester over the past few years has been the 51,800 sq ft letting to Horizon Nuclear Power at Goodman's Gloucester Business Park, which accounted for 40% of the activity in the year. The company moved in to the bespoke developed building in Q4 2015.

Aside from the Horizon deal, activity in Gloucester and Cheltenham has been focused on smaller transactions, the majority under 10,000 sq ft.

GCHQ remains the principal occupier in the area, acting as a focal point for employment and business in the two towns. GCHQ occupies more than 1.1m sq ft of space in Gloucester, representing more than one third of the town's office stock.

Glos/Chelt take-up (000 sq ft)



Supply

While supply has edged up slightly to 150,000 sq ft in the first three quarters of 2016, up from 140,000 sq ft, availability remains very tight. Based on historic trend levels of take-up (140,000 sq ft per annum), current availability represents just over one year of supply.

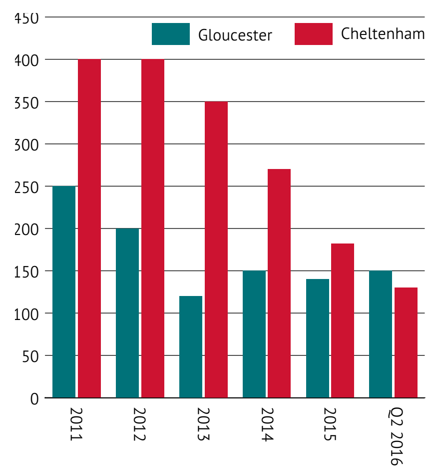
The Cheltenham office market has seen a massive decrease in supply due to permitted development conversions. These have taken place over the past two years, with examples including the 60,000 sq ft Chelsea Building Society's headquarters building, the 60,000 sq ft Kraft headquarters and the 28,000 sq ft Pate Court all being converted over the past eighteen months. This has meant that Cheltenham's supply has decreased from 400,000 sq ft in 2011 to just 130,000 sq ft in 2016.

The out of town market dominates in both Gloucester and Cheltenham, with Goodman's Gloucester Business Park and parks around GCHQ in Cheltenham providing the primary locations.

The building at 5210 Valiant Court represents the main opportunity for occupiers at Gloucester Business Park, offering 21,200 sq ft of space. Opportunities at Cheltenham's business parks are restricted to pre-let or pre-sale agreements.

The levels of availability in both Gloucester and Cheltenham are close to their record low points, with Gloucester's availability rate standing at only 4.8%, whilst Cheltenham's availability rate is even lower, at 3.6%.

Glos/Chelt availability (000 sq ft)



	12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
Cheltenham	+13%	-28%	2.1	£22.00	6.00%
Gloucester	+9%	1%	1.8	£20.00	6.00%

Development

The main development activity in Gloucester is focused around the regeneration of the site between the main shopping area and the Docks, known as the Quayside and Blackfriars area. This seven acre site is to be a mixed use scheme, centred around the provision of 2,000 new homes and new municipal offices.

The main regeneration focus in Cheltenham is more incremental, with no major sites identified for development. The recent Brewery redevelopment has improved the town centre offer, but is retail based.

Both markets have seen a number of older office properties in the town centre move to residential use through permitted development, particularly in Cheltenham.

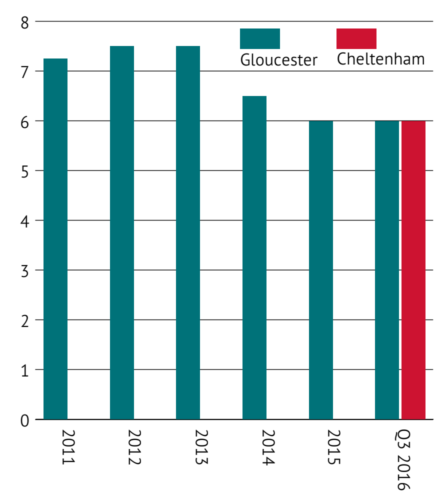
Market rental values and yields

Prime headline rents in Gloucester are dominated by the out of town market, with out of town rents standing at £20.00 per sq ft compared to £11.75 per sq ft in the town centre. Cheltenham, on the other hand, has a stronger town centre offering, with prime rents at £22.00 per sq ft, compared to £18.00 per sq ft out of town.

Prime yields remained in line with the previous year over the past nine months, with prime yields in both Cheltenham and Gloucester standing at 6.00%.

The largest transaction in Cheltenham over the past year was the £14.0m purchase of the multi-let 81,150 sq ft St James House by Kames Capital, which reflected a yield of 5.8%.

Glos/Chelt prime yields (%)



Forecast

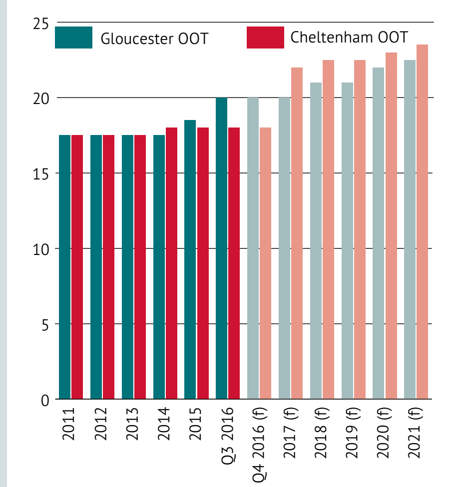
Gloucester is expected to continue to be dominated by the out of town market, with prime rents growing to £22.50 per sq ft by the end of the forecast period. However, the differential between the town centre and out of town markets should narrow, with town centre rents expected to grow by 5.1% per annum over the forecast period, compared to 2.3% per annum in the out of town market.

Cheltenham, on the other hand, has a stronger town centre market and, whilst prime rents in town are marginally higher at the end of Q3 2016, at £22.00 per sq ft compared to £18.00 per sq ft out of town, the differential is expected to be eroded over the forecast period, with both rents moving to circa £23.50 per sq ft.

Cheltenham (out of town)
2017 ▶ £22.00 per sq ft

Gloucester (out of town)
2017 ▶ £20.00 per sq ft

Glos/Chelt prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

EXETER

Highlights

- **Take-up for the year to date is 85,000 sq ft and this is expected to be boosted in the final quarter by several large transactions.**
- **Supply has fallen to 225,000 sq ft, representing an availability rate of 6.9%, the lowest since 2010, with the majority of good quality space located out of town.**
- **There is no grade A space available in the city centre.**
- **The main opportunities for new development are at St Modwen's Skypark and Exeter Science Park.**
- **Exeter prime rents reached a new record level of £19.50 per sq ft, with out of town rents growing by 11.4% in 2015 on the back of strong demand for space in the business park market.**

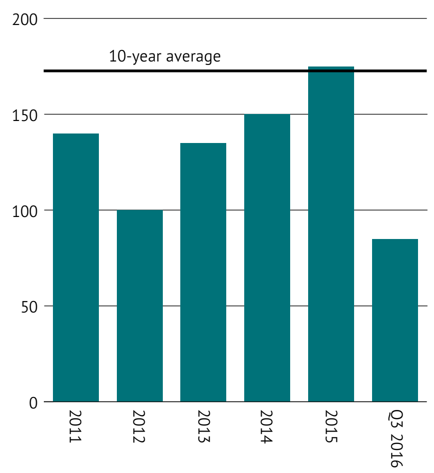
Demand

Take-up in the first three quarters of 2016 has slowed, with only 85,000 sq ft of activity recorded, due largely to a lack of suitable stock rather than a drop off in demand. However, with several large transactions due to complete in Q4, the year is expected to end with a total take-up approaching the five year average take-up level of circa 140,000 sq ft.

There are a number of larger requirements in the market which will be difficult to satisfy from existing stock, however there remains a reluctance from occupiers to opt for pre-let opportunities.

Large occupiers are likely to target out of town opportunities to satisfy requirements; there is limited supply available in the city centre following a number of older office buildings converting to alternatives uses through permitted development.

Exeter take-up (000 sq ft)



Supply

Supply has continued to reduce, falling to 225,000 sq ft by the end of Q3 2016. Grade A supply is limited to the out of town locations, where pre-let opportunities exist.

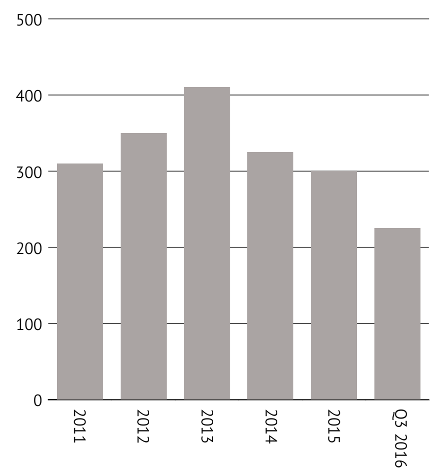
The first speculative schemes are due to start at Skypark and Exeter Science Park. These will deliver 42,000 sq ft between them, centred around junction 29 of the M5.

There is no grade A availability in the city centre, following the letting of the final suites at Valad's The Senate, Southernhay. The 70,000 sq ft building has been the main focus of city centre letting activity, with a range of occupiers in both professional and financial services.

The availability rate has fallen to its lowest rate since 2010, standing at 6.9% at the end of Q3 2016.

Current levels of availability represent 1.2 years of supply, and this is expected to reduce further given the strong demand for space and only limited new space being developed.

Exeter availability (000 sq ft)



12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
-28%	-25%	1.2	£19.50	6.25%

Development

The primary opportunities for new development are focused to the east of the city at St Modwen's Skypark Business Park, adjacent to the airport, Exeter Science Park, at junction 29 of the M5, and Exeter Business Park.

At Exeter Science Park, a second new development is under construction, the Met Office's new 'super computer' building. This will add to the 20,000 sq ft Science Park Centre which provides opportunities for start-up and growing science and technology businesses. The new building will be ready for occupation in early 2017.

Market rental values and yields

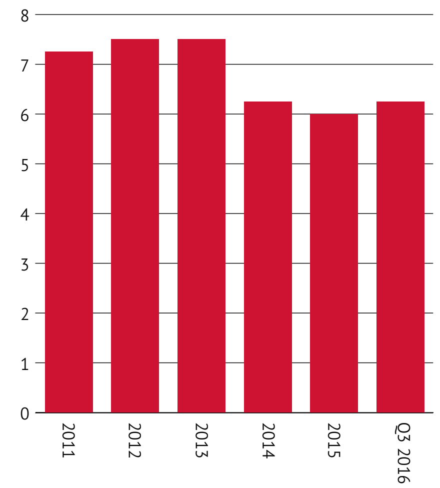
Exeter's prime headline rent reached a new record level of £19.50 per sq ft, with out of town rents growing by 11.4% in 2015 on the back of strong demand for space in the business park market.

Prime city centre rents have not surpassed the previous peak, having returned to £16.50 per sq ft in 2016, due to the lack of grade A space.

Prime investment yields have risen by 25 basis points from their end of 2015 level, standing at 6.25% at the end of Q3 2016, although there has been limited evidence in the market.

The only transaction of note in 2016 has been the confidential purchase of Barratt Homes offices at Matford Business Park for £1.5m from Mayfair Capital. The purchase price reflected a net initial yield of 6.90%.

Exeter prime yields (%)



Forecast

Prime rents are expected to stabilise at the newly established peak of £19.50 per sq ft for the out of town market over the next few years, with further growth expected in 2018, when values are forecast to move to £20.00 per sq ft.

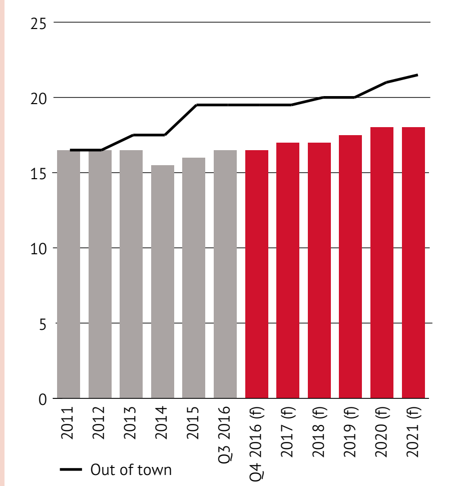
The city centre market will see prime rents edge up to a new peak of £17.00 per sq ft over the next few years, achieving that level by 2018.

Over the full forecast period, prime out of town rents are expected to grow by 2.3% per annum, whilst city centre values will grow at a slightly lower rate of 2.1% per annum.

Exeter out of town
2017 ▶ £19.50 per sq ft

Exeter city centre
2017 ▲ £16.50 per sq ft

Exeter prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

PLYMOUTH

Highlights

- **Take-up to date in 2016 is 120,000 sq ft, boosted by a 50,000 sq ft Plymouth International Business Park letting in Q3.**
- **Supply is under pressure, with the majority focused on second-hand space.**
- **The primary source of space is out of town, with the latest addition to stock being the 20,000 sq ft Business Centre at Plymouth Science Park.**
- **Out of town prime rents increased by 21.9% to £19.50 per sq ft in 2015 and are expected to remain at this level for some time.**
- **Prime city centre rents have remained at £15.00 per sq ft for the past five years and are not expected to change during the forecast period.**

Demand

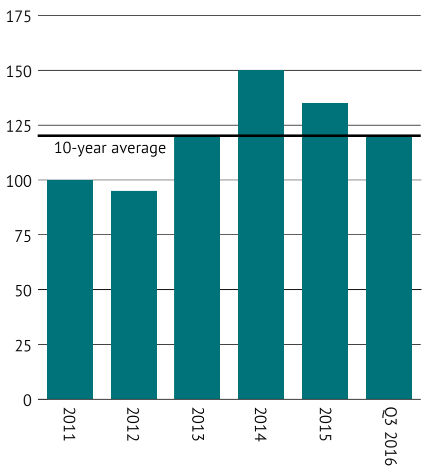
Total activity in the year to date reached 120,000 sq ft, and with take-up for the whole year expected to reach 150,000 sq ft, this will be the fourth year in succession that demand has exceeded the long-term average.

Take-up was boosted in the third quarter of the year with the 50,000 sq ft letting to US outsourcing company, Sitel, at The Ship on Plymouth International Business Park. This letting provides a huge boost for the Plymouth economy, with the company expected to create up to 700 new jobs.

Further good news for the Plymouth economy followed with the announcement that mobile phone operator EE was returning all customer service call centre functions to the UK. The move is expected to create a total of 140 new jobs for the area by the end of 2016.

In addition to the Sitel transaction, there was also a 23,000 sq ft letting to Plymouth City Council at God TV's Drakes Hill Court in the first half of the year.

Plymouth take-up (000 sq ft)



Supply

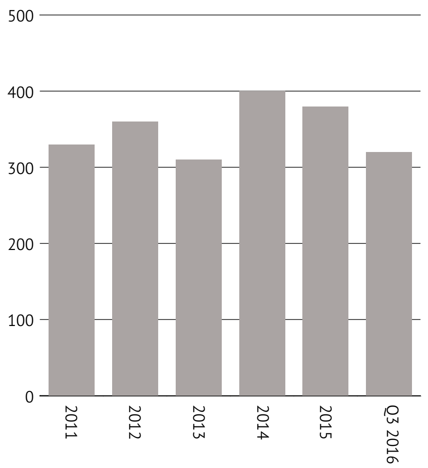
The supply of office space dipped below 350,000 sq ft for the first time in three years following several years of strong take-up in 2015/16. Total availability was 320,000 sq ft at the end of Q3 2016.

The majority of supply is focused on second-hand space, with better quality buildings primarily consisting of refurbished stock. The most recent new build space is at Plymouth Science Park, where a new 20,000 sq ft Business Centre offers start-up space for small businesses.

The primary source of supply is focused around a number of business parks, with city centre stock dispersed across the city as there is no defined business district.

The availability rate fell to 11.1% at the end of September, the lowest level since 2013. This represents 2.6 years of supply.

Plymouth availability (000 sq ft)



12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
+28%	-16%	2.6	£19.50	7.00%

Development

The ongoing redevelopment of Plymouth's city centre has seen a number of schemes announced over the past 12 months. While there are numerous construction projects currently on going, none of these will provide office space.

The construction of the city's tallest building, the 22 storey Beckley Court, has commenced, with completion expected in mid 2017. The tower will provide 507 student beds and is a symbol of the thriving higher education sector in the city.

The most recent announcement has been the purchase of properties at Colin Campbell Court and the Boulevard by Plymouth City Council, with demolition having commenced in order to provide a mixed residential and retail scheme at the 4.3 acre site. Both these schemes were originally due to include offices but the low level of demand for this type of use in the city meant that planning was changed.

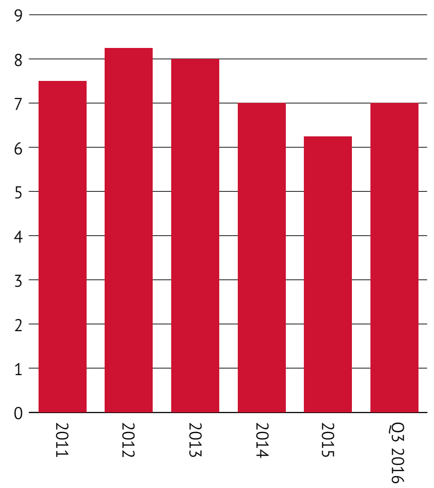
Market rental values and yields

The out of town market has been the primary focus of activity over the past few years, with prime rents moving to £19.50 per sq ft in 2015, an increase of 21.9% in a year. Prime city centre rents have remained at £15.00 per sq ft for the past five years, despite a restricted supply of grade A space.

Investment yields have moved out by 75 basis points over the first three quarters of 2016 as investors remained concerned about the outlook for rental value growth in the city.

There have been limited investment transactions over the past few years but one notable purchase was the £2.1m acquisition of The Ship by local developer Burrington Estates. The building had previously been ear marked for demolition but the current owners have turned the fortunes of the former local newspaper headquarters around.

Plymouth prime yields (%)



Forecast

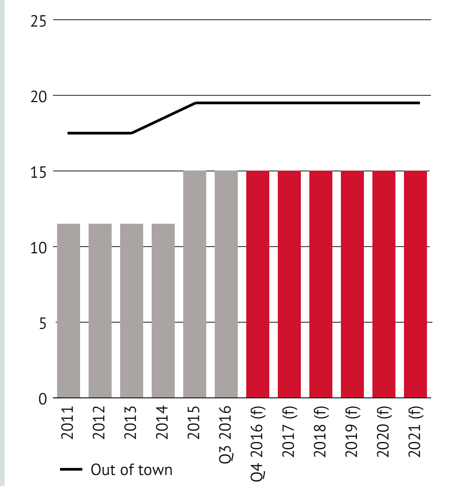
The strong growth in out of town rents in 2015 has reduced the potential for further growth over the forecast period.

Both out of town and city centre prime rents are expected to maintain their current levels over the next few years, with little prospect of increases.

Plymouth out of town
2017 ▶ £19.50 per sq ft

Plymouth city centre
2017 ▶ £15.00 per sq ft

Plymouth prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

Highlights

- **Take-up for the year to date has been notably subdued at 83,000 sq ft, compared with the 10-year average of 204,000 sq ft.**
- **Supply is now 53% below the peak level seen at the end of 2011, with total space on the market standing at 625,000 sq ft.**
- **There is provision for 600,000 sq ft of new office space in the town's regeneration plans, although this is unlikely to progress until a pre-let is confirmed.**
- **Prime rents returned to their previous peak level of £18.50 per sq ft in the out of town market, some six years after the figure was recorded for the first time. Town centre rents established a record high of £17.25 per sq ft at the end of 2015.**

12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
-21%	-9%	3.0	£18.50	7.00%

Demand

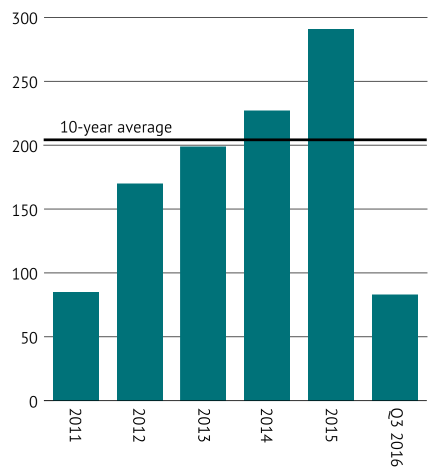
Take-up in 2016 to date has been particularly subdued, with just 83,000 sq ft of activity recorded. Full year activity is expected to reach 120,000 sq ft, a fall on the 10-year average of 204,000 sq ft and 59% below 2015's peak of 291,000 sq ft.

The current year's activity has been characterised by a lack of large lettings. The most significant transaction in 2016 was a 17,000 sq ft letting at Isambard House, Churchward, to The Pets at Home group, which will relocate its head office from Wantage in Oxfordshire.

The second largest transaction in the year to date was the 10,200 sq ft letting to another new entrant to the area, BeWiser Insurance, at York House Edison Park, which took offices in Swindon, whilst retaining its original Andover building. Aside from these two transactions, the majority of activity has been focused on lettings of less than 10,000 sq ft.

Demand for space in the town is primarily linked to the electrification of the Great Western railway line, with requirements from Network Rail, First Engineering Services and Atkins all linked to the development of the route.

Swindon take-up (000 sq ft)



Supply

Supply has continued to reduce, falling to 625,000 sq ft at the end of Q3 2016. Availability is now at its lowest level in more than 10 years, having fallen by 53% from 1.3m sq ft in 2011.

Ready to occupy grade A space is relatively scarce, with the majority being good quality refurbished stock. The largest building currently on the market is the 76,100 sq ft Trilogy at Kemberley Business Park.

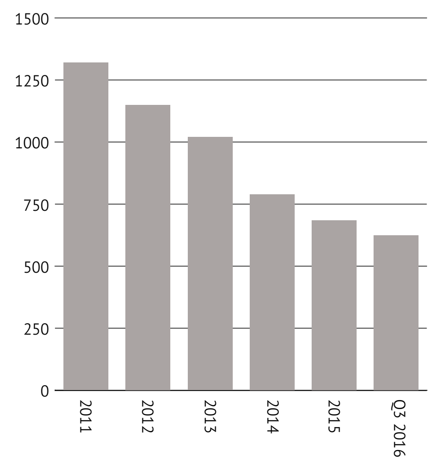
In the town centre, the recent refurbishment of Focal Point has provided 35,000 sq ft of well specified space to the market.

Poorer quality space still accounts for approximately 30% of overall availability, despite an estimated 200,000 sq ft of office floorspace being converted to residential use through permitted development.

The availability rate had fallen to 12.5% at the end of September 2016, down from a peak of 25.3% at the end of 2011.

Based upon 2015's record level of take-up, current availability represents just over two years of supply. However, this rises to 3 years when applying the 10-year average take-up level.

Swindon availability (000 sq ft)



Development

The regeneration of Swindon town centre is driving the future of the town as a business location. Current plans have identified a 20 acre site between the retail centre and the station as the proposed new business district, with 600,000 sq ft identified for office development.

The council's development partner, Muse, has already completed phase one of the regeneration plans with the construction of an assisted living residential building and an 850 space multi-storey car park. Phase two, a new NHS health centre, is already under construction.

Market rental values and yields

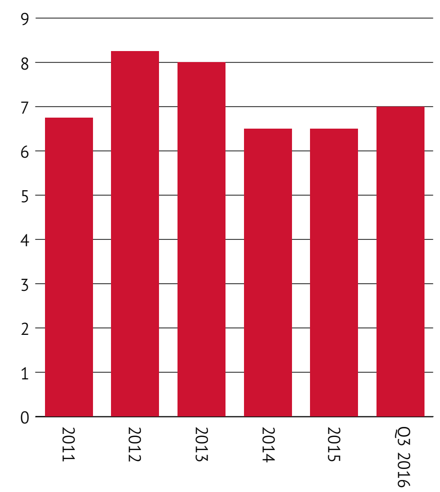
The out of town market in Swindon is the favoured location for occupiers, with prime out of town rents standing at £18.50 per sq ft at the end of Q3 2016, compared to £17.25 per sq ft in the town centre.

The differential between out of town and town centre rents has narrowed significantly over the past few years, with town centre rents growing by 15.0% since the end of 2013, and out of town rents increasing by 5.7% .

Prime yields have moved up to 7.00% over the first three quarters of 2016, an increase of 50 basis points from their end 2015 position.

The number of transactions of office properties has remained relatively subdued over the past few years. One of the most notable transactions in 2015 was the £15.9m purchase of the 103,000 sq headquarters of Arval UK, at Windmill Hill Business Park, by private equity company Palm Capital.

Swindon prime yields (%)



Forecast

The differential between out of town and town centre prime rents is expected to increase over the next few years with the out of town market likely to see rents grow steadily over the forecast period, whilst town centre rents remain stable.

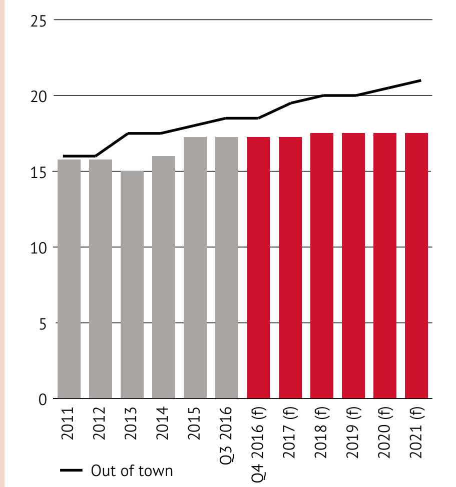
Prime out of town rents are expected to set new highs in the next three years, reaching £20.00 per sq ft by 2018 and exceeding that level by 2020/21.

Growth over the five years of the forecast period is expected to average 3% per annum for the out of town market, whilst town centre prime rents will grow at a more modest 0.3% per annum.

Swindon out of town
2017 ▲ £18.75 per sq ft

Swindon town centre
2017 ▶ £17.25 per sq ft

Swindon prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

BATH
BRISTOL CC
BRISTOL OOT
CHELT / GLOS
EXETER
PLYMOUTH
SWINDON
TAUNTON

TAUNTON

Highlights

- **Take-up in 2016 to date is 105,000 sq ft, a marked fall compared with 2015 but in line with the annual average.**
- **Current availability totals 200,000 sq ft, which equates to 1.4 years of supply based on the long term average.**
- **Hinkley Point C will bring significant investment into the area. Official figures estimate an annual benefit of £100m to the local economy.**
- **Prime rents in the out of town market are expected to grow at 4.4% per annum in the period to 2021, rising to £21.00 per sq ft, whilst town centre rents will achieve £18.50 per sq ft.**

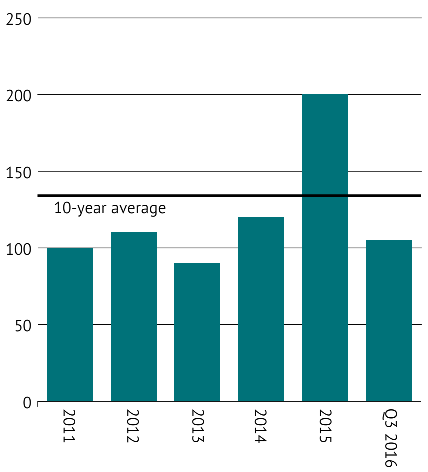
Demand

2015 was a record year for take-up in the Taunton market, with 200,000 sq ft of transactions, more than 50% above the 10-year average of 135,000 sq ft. 2016 take-up has returned to the long-term level with 105,000 sq ft being let in the first three quarters. Activity has been focused on lettings of less than 7,500 sq ft to local occupiers.

Taunton provides a business location for a range of industry sectors, although local government and the service sector are the principal occupiers, particularly given the strategic location of the town between Bristol and Exeter.

Hinkley Point C will bring in significant investment to the area and we expect a positive impact on both the town centre and out of town markets.

Taunton take-up (000 sq ft)



Supply

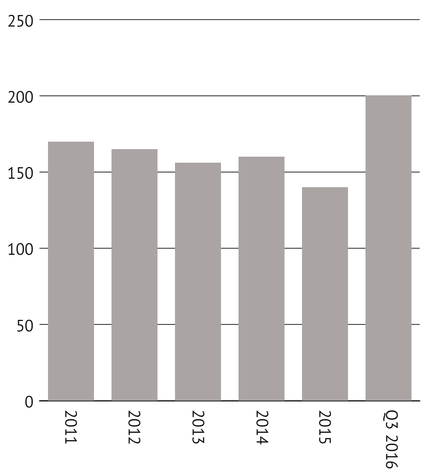
Supply moved up to 200,000 sq ft in Q3 2016 from the 10 year average of 140,000 sq ft, due primarily to the release of the recently refurbished Tangier Central to the market in the summer, which added 62,375 sq ft of town centre stock to availability. Tangier Central secured its first letting shortly after launch, with consultant engineers, WSP Parsons Brinkerhoff, taking 1,998 sq ft.

The out of town market in Taunton is dominated by Blackbrook Business Park, which is situated to the east of the town, close to J25 of the M5. The park was built by local developer, Summerfield, which has retained ownership in the majority, and provides 300,000 sq ft of office accommodation.

Permitted development has reduced the overall stock of offices in Taunton by an estimated 100,000 sq ft, with a number of buildings being sold for residential conversion in 2015/16. The availability rate increased to 11.5% at the end of September 2016, as the reduction of town centre supply impacted on overall stock on the market.

Current availability represents one year of supply based on 2015's record levels of take-up, increasing to 1.4 years when compared to the 10-year average.

Taunton availability (000 sq ft)



12 month take-up vs 10-year average	% difference between last 12 months' supply	Years of supply	Q3 2016 headline rent (per sq ft)	Prime yield
+14%	42%	1.4	£17.50	6.75%

Development

There has been a dearth of new office schemes being brought forward in Taunton over the past few years. The Firepool mixed use scheme, a 16 acre former cattle market site, is at the centre of the town's regeneration plans. This scheme will comprise a mixture of offices, retail and residential uses, with restaurants and leisure facilities fronting the river.

Market rental values and yields

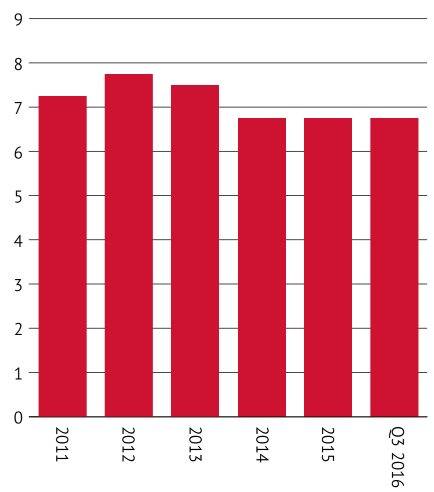
The differential between prime town centre and out of town rents narrowed in 2015, with out of town rents growing by 6.1% to move to on par with town centre rents at £17.50 per sq ft.

The main opportunities for rental growth in the out of town market remain at Blackbrook Business Park, although opportunities for further development remain limited at present.

Prime investment yields remained stable at 6.75% in spite of the increased uncertainty in the economy and the property market following the vote to leave the EU.

There have been few office market investment transactions in recent years, with a general lack of stock coming to the market. The Taunton market is dominated by local investors who rarely trade ownerships.

Taunton prime yields (%)



Forecast

The out of town market is expected to continue to drive the Taunton office market over the next few years, with prime rents growing to £20.00 per sq ft by 2020. This is expected to increase to £21.00 per sq ft by the end of the forecast period.

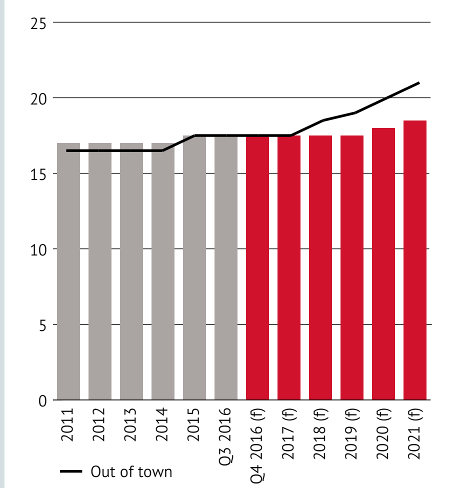
The town centre market has seen a relatively low rate of growth, following the sharp increase in rents in 2010, and this is expected to continue over the forecast period. Prime town centre values are expected to rise to £18.50 per sq ft by 2021 from their current level of £17.50 per sq ft.

The overall growth in out of town and town centre rents over the period to 2021 is expected to average 4.4% per annum and 1.3% per annum respectively.

Taunton out of town
2017 ▶ £17.50 per sq ft

Taunton town centre
2017 ▶ £17.50 per sq ft

Taunton prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

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