



Activating the workplace

Office Market 2015

Inside this report:

- Take-up increases to its highest level since 2001
- Speculative development doubles in the regions
- 11m sq ft of office space leaves the market for alternative uses since May 2013

**Lambert
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Welcome

The UK is very much back in business. Levels of activity improved across the length and breadth of the UK during 2014, reflecting the spread of economic recovery and confidence.

Occupiers have expanded headcount and upgraded their accommodation as business sentiment has improved, which has helped propel take-up in markets up and down the country: Edinburgh reported record activity; Manchester enjoyed its best year since 2001; Oxford, Cardiff, Bristol and Cardiff all posted take-up well ahead of their 10-year averages.

Renewed economic optimism has also fuelled the meaningful return of speculative development outside of London, with the amount of space under construction in the regional centres doubling since the end of 2013. Manchester, Edinburgh and Bristol are also leading the way here – although it is worth noting that we are considerably shy of the levels seen at similar points in previous cycles.

A similar picture emerges when we look at investor activity. Office investment in the regions climbed by 22% last year, yet was down slightly in Central London.

Many regional markets have also seen a significant amount of office stock leave the market for conversion to other uses. Our research reveals that approaching 8m sq ft of office stock has left the regional markets in the past two years, with locations such as Bristol, Slough, Watford and Hemel Hempstead all experiencing a considerable net loss of space.

Interestingly, the office space that remains is being used in ways that will have been unthinkable to all but the most progressive employers as recently as ten years ago. Occupiers are becoming ever more discerning regarding their offices, using them to create varied and stimulating working environments designed to enhance staff wellbeing and provide a means to communicate the culture of the business to both employees and clients. This trend has important implications for developers and landlords, and is something that we address in this report.

It's a fascinating time to be in the office sector. I hope that you find this research useful as you navigate through the market in 2015.

Tony Fisher

National Head of Office Agency
Lambert Smith Hampton

Executive summary

2014 was an excellent year for the UK office market

- UK-wide office take-up was 27.5m sq ft in 2014, surpassing 2013's total by 8% and its highest annual level since 2001.
- The strength of activity reflects the pace of economic recovery and renewed confidence among occupiers to expand headcount and upgrade their accommodation. The total size of the UK workforce increased by 2% during 2014, while business investment hit a record £175.5bn and was up 7% year-on-year.
- 2014 was another exceptional year for the Central London markets. Collectively, take-up increased by 11% from 2013 to its highest level since 2000, with pre-let activity accounting for nearly a third of take-up. Docklands take-up doubled year-on-year on the back of several major deals at Canary Wharf.
- The UK's economic recovery now has real traction beyond London and the South East, and this was reflected in the regional occupier markets: Manchester had its strongest year of take-up since 2001, while Edinburgh saw record take-up of 1.3m sq ft. Other markets where activity was significantly ahead of their ten-year annual averages included Oxford, Cardiff, Bristol and Glasgow.
- The one relative disappointment was the Thames Valley region, where 2014 take-up was down 33% on 2013's six-year high. However, the region saw impressive activity in the final quarter of 2014, indicative of a return to more sustained occupier demand throughout 2015.
- UK-wide grade A take-up increased by 5% year-on-year, compared with a 9% rise in grade B/C take-up. This can be put down to the diminishing supply of existing grade A space.

Availability falls to its lowest level since 2007

- UK-wide availability fell by a further 4% during 2014 to stand at 51.1m sq ft, despite a 19% rise in speculative development. This stems from both net absorption following strong take-up as well as the withdrawal of stock from the market for alternative uses.
- The drop in UK-wide availability was driven by Central London, where supply declined by 27% over 2014. In contrast, availability outside of the capital increased by 3% during 2014, to 40.9m sq ft, largely resulting from increasing levels of speculative development.

Speculative development doubles in the regions

- While Central London accounts for more than half of the UK's speculative development under construction, activity here fell by 11% year-on-year. In the regional markets, speculative development doubled in 2014 to reach 4.2m sq ft. Manchester, Edinburgh, Leeds and Reading are the key focus of activity.

Rents increase in most markets

- Prime headline rents increased in 26 of the 38 office markets covered in the report during 2014, a clear indication of the rising confidence among occupiers alongside falling supply of grade A space. Moreover, for the first time since 2007, not a single market recorded a decline in prime rents. The largest increase was in Slough, where prime headline rents moved up by 29%. The West End commands the highest rents at £115 per sq ft.
- IPD data reveals that UK office rents increased by 7.1% over the course of 2014, compared to just 3.4% in 2013. Furthermore, all of the UK's regions bar the North East achieved positive rental growth in 2014.

Office investment volumes highest since 2007

- 2014 was a stellar year for the UK investment market. Investment in UK offices reached £25.3bn in 2014, its highest annual total since 2007. While total volume was closely in line with 2013's level, the underlying share of activity shifted from Central London to the UK's regional markets.
- Strong investor appetite for Central London offices continued unabated, overwhelmingly driven by overseas buyers which made up 86% of activity. Volume in Central London fell short of 2013's record total, while investment outside the capital climbed by 22% from 2013 to £4.9bn, a testimony to rising investor confidence in the UK's regional occupier markets.
- Office total returns reached 22.3% for 2014, the strongest calendar year since 2006. Performance was driven by significant inward yield shift, particularly for good quality secondary assets. Notably, the South East matched London's West End with returns of 24% in 2014.

Manchester had its strongest year of take-up since 2001, while Edinburgh saw record take-up

Outlook for 2015

Healthy take-up expected in 2015

- The prevailing economic climate bodes well for activity in the UK's office markets in 2015. The latest official forecast is for respectable economic growth of 2.6% in 2015, although other forecasts are more bullish, putting 2015 growth ahead of 2014's level of 2.8%
- With occupier sentiment remaining healthy, we forecast UK-wide take-up to be in the order of 25m sq ft in 2015, which is 10% above the 10-year annual average. This certainly qualifies 2015 as a strong year, but would be down somewhat on 2014's 13-year high.
- Market activity will be partly constrained by a growing shortage of ready-to-occupy grade A space. While this may prompt an increase in pre-letting, the majority of occupiers seeking a relocation will simply defer their decision until stock becomes available.
- The best performing markets in 2015 will experience a combination of a spike in lease events alongside meaningful speculative development. We anticipate the Central London markets and Manchester to enjoy another good year in 2015, while take-up in the Thames Valley will rebound from its relatively subdued 2014 level.

Availability to fall further despite rising development

- UK-wide availability will edge down further in 2015, in spite of expectations of rising speculative development. We forecast total availability to drop below 50m sq ft for the time since 2007, reflecting a combination of increasing net absorption alongside the continuing withdrawal of office space from the market for alternative uses.
- Speculative development is forecast to increase by a further 15% from its current level to reach in excess of 10m sq ft by year end. Central London will remain the major focus, although many regional markets will see a handful of additional schemes commencing construction.
- The trend for development to be focused within town centres and around transport interchanges will characterise the new development cycle. This will often take the form of back-to-frame refurbishments, as developers seek to exploit the building's existing car parking ratios.
- The withdrawal of obsolete office space for conversion will continue, reflecting the steady growth of agile working practices and increasing demand for alternative uses. However, the pace of activity is likely to slow from 2014, given the increasing likelihood that the current permitted development right allowing change of use to residential will not be extended beyond May 2016.

Headline rental growth cycle is in full swing

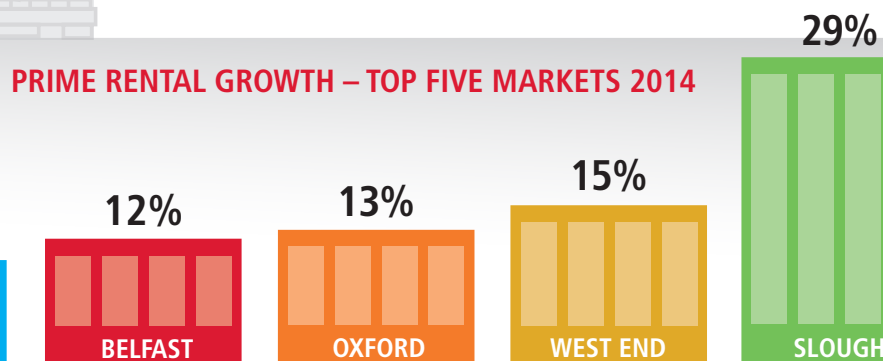
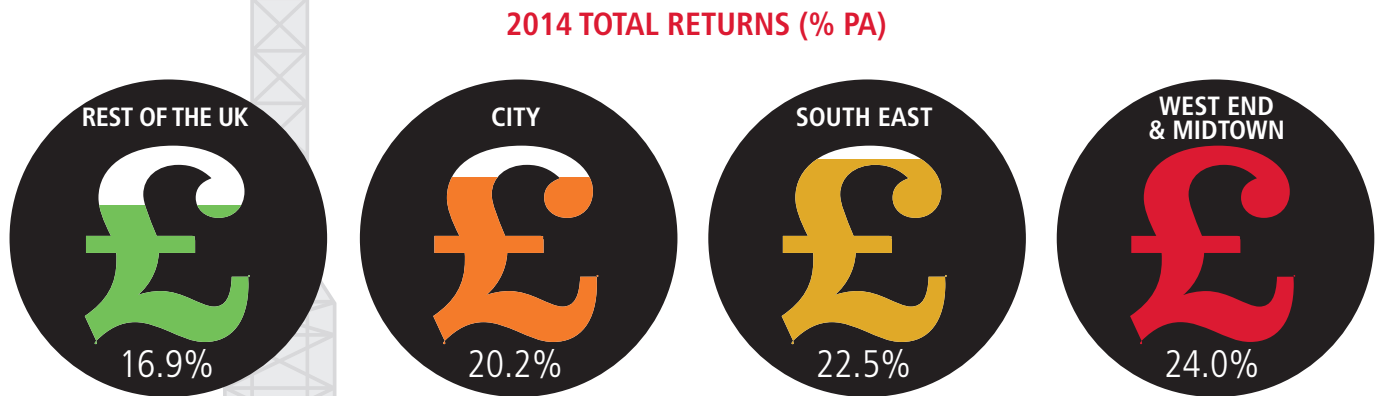
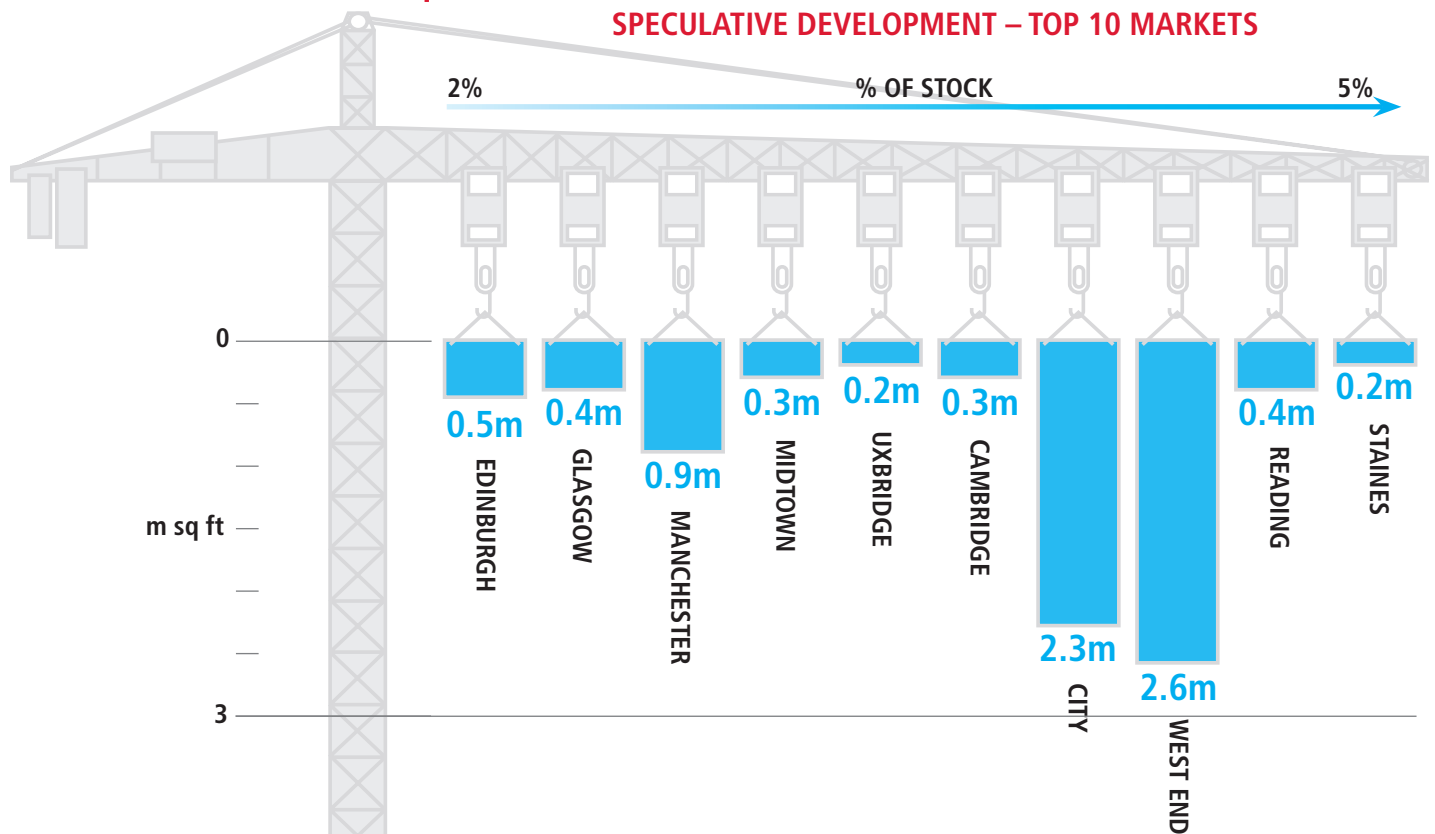
- From the confines of Central London and a select number of markets in the wider the South East, 2014 saw headline rental growth ripple out across the UK. Barring an unexpected economic shock, rents are on an upward trajectory generally across the UK, with our office agency network forecasting prime headline growth in 29 of the 38 markets in 2015.
- Rates of rental growth for good quality stock are likely to outpace inflation for several years at least, as the delivery of grade A supply to the market fails to keep up with demand. Indeed, meaningful rental growth will be vitally important in securing viability in the regional centres, having fallen significantly in real terms from 20 years ago.

Investors move further up the risk curve

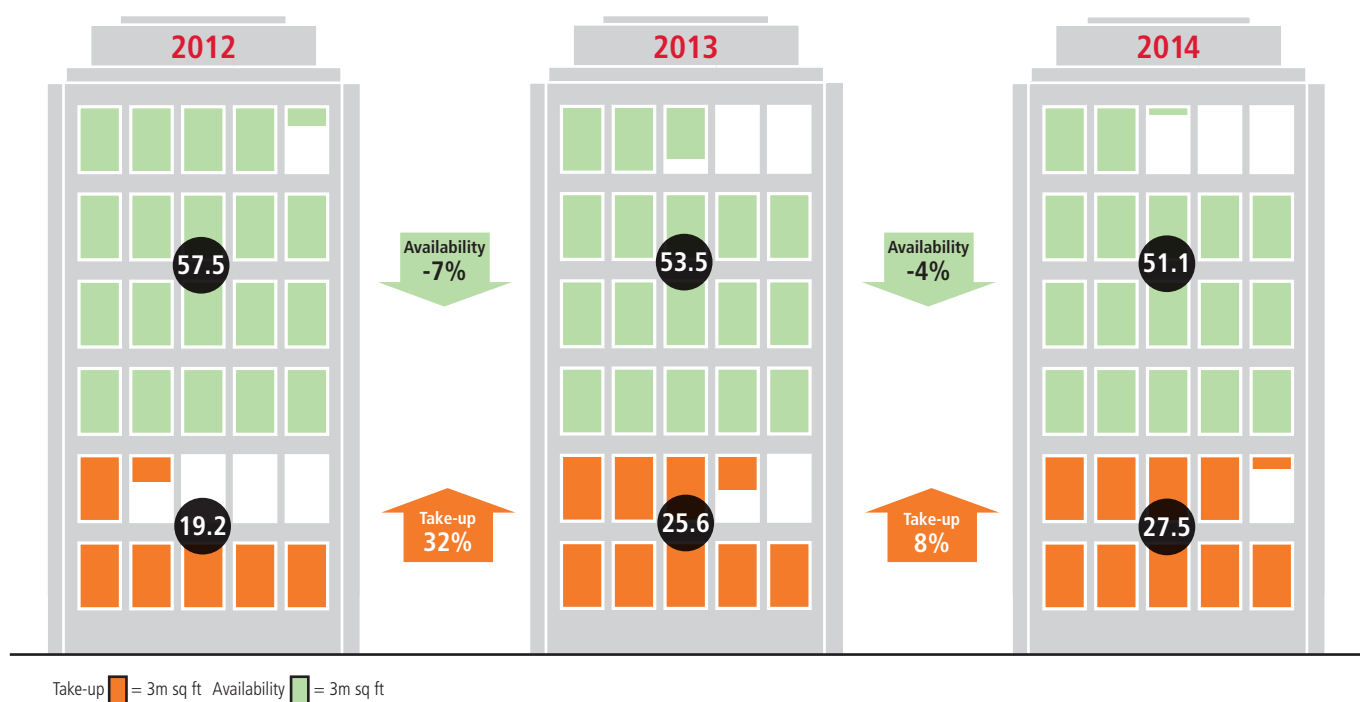
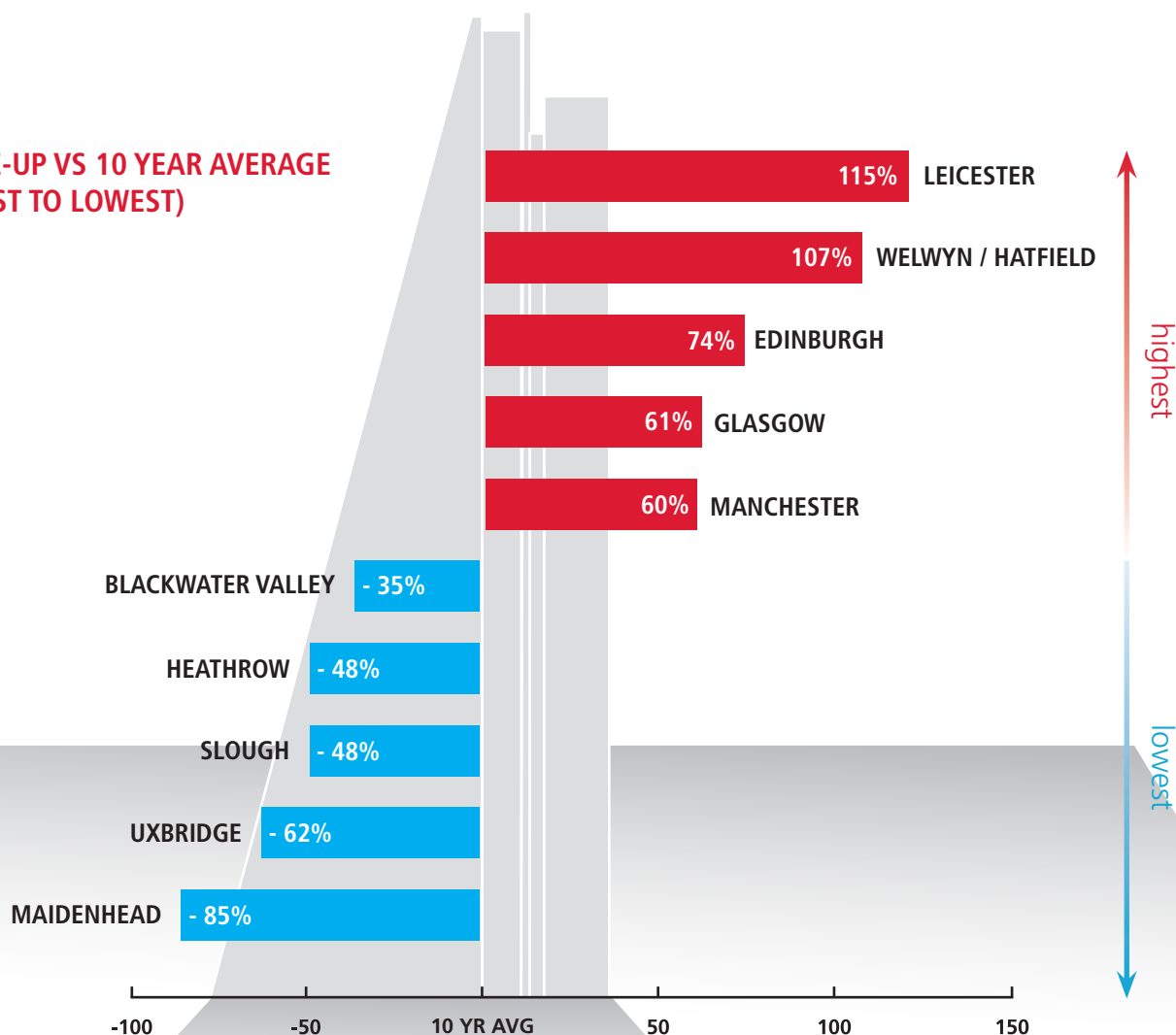
- We expect office investment volumes in 2015 to soften somewhat from 2014's impressive level, although the proportion of investment taken by the regional markets will increase in relation to London as investors seek higher returns.
- Investors will increasingly target value-add opportunities, particularly well located regional assets. This will be largely focused on stock with short income which offers good prospects for asset management.
- With an undersupply of prime stock, we expect an increasing number of institutional investors to take on development risk and fund speculative development, albeit focused on prime markets where grade A supply is limited relative to demand.

Rents are on an upward trajectory, with our office agency network forecasting prime headline growth in 29 of the 38 markets in 2015

Market snapshot



2014 TAKE-UP AND AVAILABILITY (M SQ FT)

2014 TAKE-UP VS 10 YEAR AVERAGE
(% HIGHEST TO LOWEST)

National and regional overview

2014 was an excellent year for the UK office market, reflecting both the pace of economic recovery and renewed confidence among occupiers to expand headcount and upgrade their accommodation. UK-wide office take-up was 27.5m sq ft, its highest in 13 years and 24% above the ten-year annual average.

While there was a 19% rise in speculative development, UK-wide office availability fell by a further 4% during 2014 to stand at 51.1m sq ft, its lowest level since 2007. The fall in supply largely reflects strengthening take-up and the withdrawal of poor quality stock from the market for alternative uses.

Demand

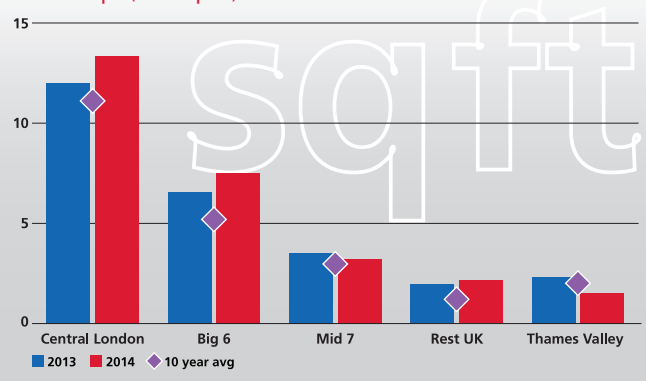
UK take-up in 2014 eclipsed 2013's level by 8% to reach its highest annual total since 2001. Overall, 2014 began in subdued fashion but activity accelerated during the course of the year, with Q4 2014 accounting for a third of total take-up. In contrast to the Big Six markets, Central London take-up was more evenly spread through the year, but Q3 2014 provided the strongest quarter.

Strong activity seen across the UK's office markets

2014 was another exceptional year for the Central London markets, which collectively accounted for the majority of the nationwide increase in take-up year-on-year. The four main Central London sub-markets recorded combined take-up of 13.4m sq ft in 2014, an increase of 11% on 2013 and the capital's strongest annual performance since 2000.

The UK's economic recovery now has real momentum beyond London and the South East, and this was reflected in healthy occupier activity extending more widely across the UK. While combined take-up outside the capital increased by a more modest 5% year-on-year, it reached 14.2m sq ft in 2014, 6% above the previous cycle high of 2007.

Take-up (m sq ft)



Source: Lambert Smith Hampton

Indeed, of the 34 regional markets we report on outside Central London, over half saw take-up rise year-on-year while 25 recorded activity in excess of their ten-year annual averages.

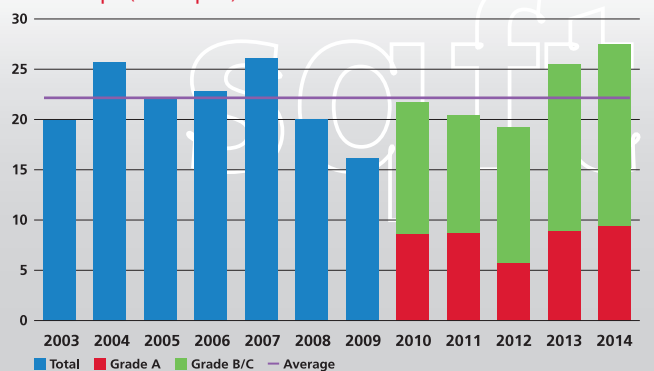
2014 was a year to remember for the Big Six markets, with combined 2014 take-up 43% ahead of the ten-year annual average. Manchester had its strongest year since 2001 with 2.1m sq ft of take-up, while Edinburgh saw record take-up of 1.3m sq ft.

However, against this positive backdrop, 2014 was an unexpectedly disappointing year for the Thames Valley region, with take-up down 33% on 2013's six-year high and 23% below the ten-year annual average. However, activity picked up significantly in the second half of the year which is indicative of a return to more sustained occupier demand throughout 2015.

Secondary stock increases its share of take-up

The majority of UK-wide take-up in 2014 was for grade B/C office stock, which accounted for over two thirds of activity. This can be put down to increasingly limited supply of existing grade A space, particularly in the regional markets where over 70% of take-up was grade B/C, compared with 40% in Central London.

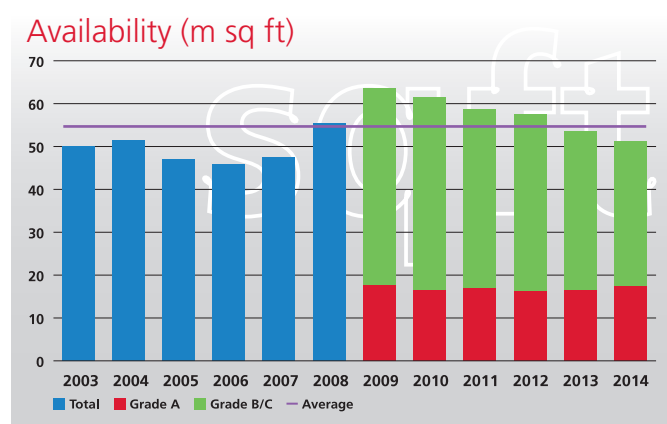
Take-up (m sq ft)



Source: Lambert Smith Hampton

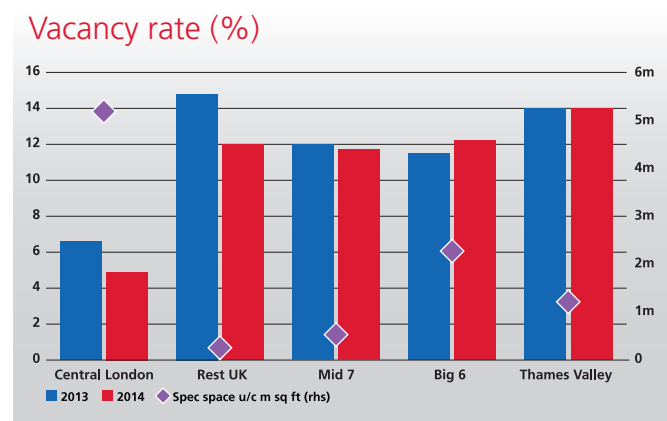
Supply

Across the UK as a whole, the amount of available office stock fell by 4% in 2014, following a 7% fall in 2013. The UK-wide vacancy rate now stands at 9.5%, its lowest level since 2007. However, the fall was driven by Central London, where supply declined by 27% over 2014 to leave 10.2m sq ft available and a vacancy rate of just 4.9%.



Source: Lambert Smith Hampton

In contrast, outside of Central London, availability increased by 3% during 2014 to 40.9m sq ft, equating to a vacancy rate of 12.5%. Given the strength of occupier activity, this rise largely reflects the inclusion of speculative development within our availability figures, which made a meaningful return to a host of markets around the UK in 2014.



Source: Lambert Smith Hampton

Speculative development doubles in the regions

Despite the overall fall in availability, grade A supply increased by 7% across the UK during 2014. This was driven by speculative development in the 34 markets outside of London rising to 4.2m sq ft. While this is more than double last year's level, it remains modest compared with the last cycle.

Central London continues to make up more than half of the UK's total speculative development at 5.2m sq ft, although activity here fell by 11% year-on-year. Central London grade A supply fell by 33% across 2014, despite the fact 5m sq ft of new and refurbished space completed in the year.

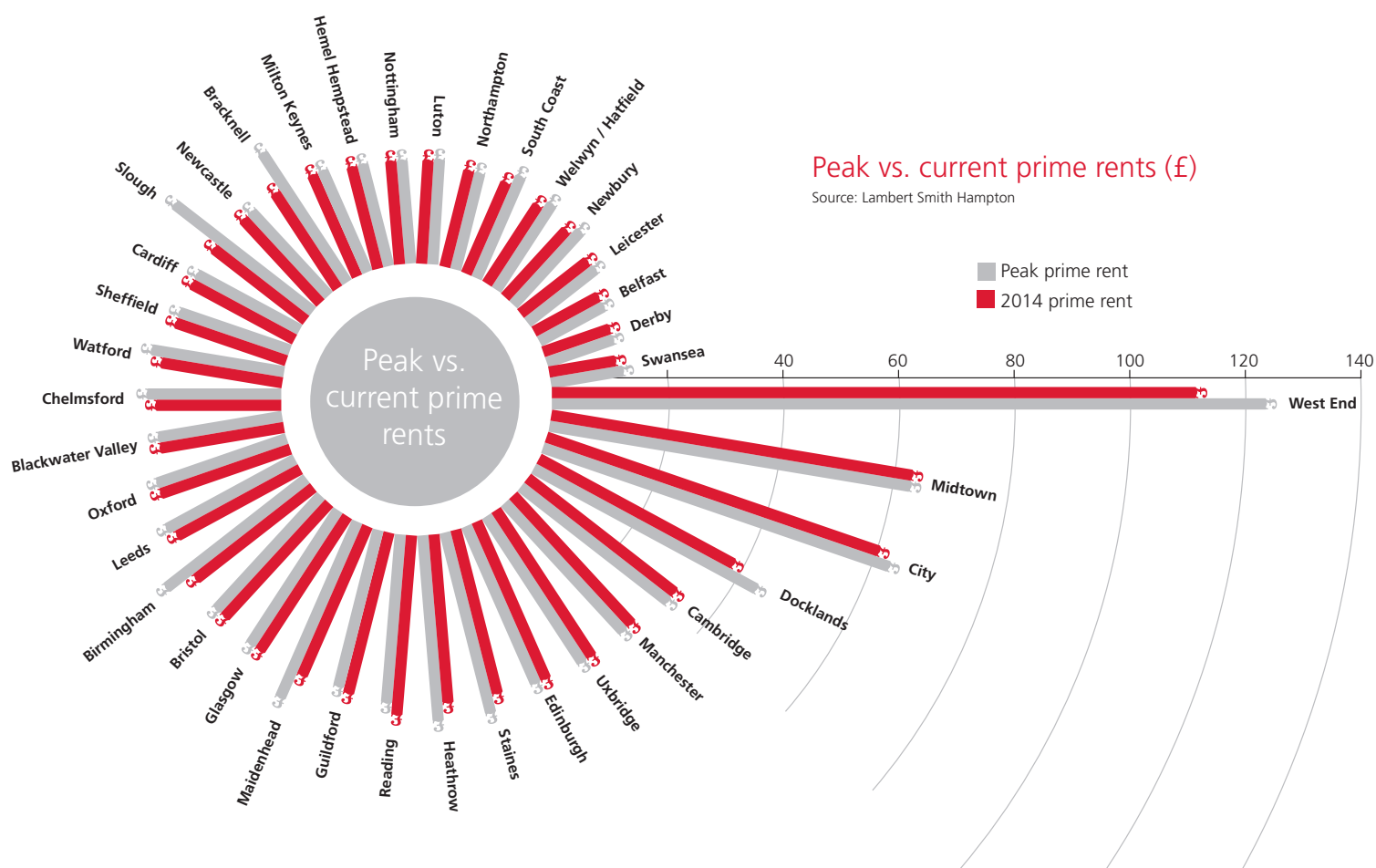
Of the five market groupings, the Big Six saw the sharpest rise in grade A availability, increasing 68% year-on-year and reflective of a revival in developer confidence in the UK's core office markets. Manchester has the largest amount of speculative development (870,000 sq ft), followed by Edinburgh (460,000 sq ft). Elsewhere around the UK, Reading, Staines and Cambridge are a key focus of development activity.

Rents

Prime headline rents increased in 26 of the 38 office markets during 2014, a clear sign of the rising confidence among occupiers alongside falling supply of existing grade A space. This is also a substantial improvement on 2013 when prime rents increased in only 11 markets, with growth largely confined to London and the South East. Moreover, not a single market recorded a decline in prime rents in 2014 for the first time since 2007.

Of the markets that saw prime rental growth, Slough was the star performer. Rents rose by 29% during 2014 to reach £22.00 per sq ft, albeit from a relatively depressed level considering its historic peak of £32.00 per sq ft in 2001. Other markets to record strong rental growth in 2014 were the West End (15%), Oxford (13%) and Belfast (12%).

Prime headline rents increased in 26 of the 38 office markets during 2014, a clear sign of the rising confidence among occupiers alongside falling supply.



Along with many regional markets in the UK, recent prime rental growth belies the fact that rental levels have failed to match inflation over the past decade. Consequently, markets where rents continue to sit below peak remain significantly down in real terms, with Slough standing 50% below its 2001 peak despite the recent increase.

Looking at average rental growth as opposed to prime rents, IPD data show that UK office rents increased by 7.1% over the course of 2014, compared to just 3.4% in 2013. Furthermore, all of the UK's regions bar the North East achieved positive rental growth in 2014, while six regions saw average rents fall in 2013.

We forecast 29 of the 38 markets to record prime headline rental growth over the course of 2015. This positive momentum is also expected to remain over the medium term, with average UK-wide office rental growth of circa 5% per annum over the next five years.

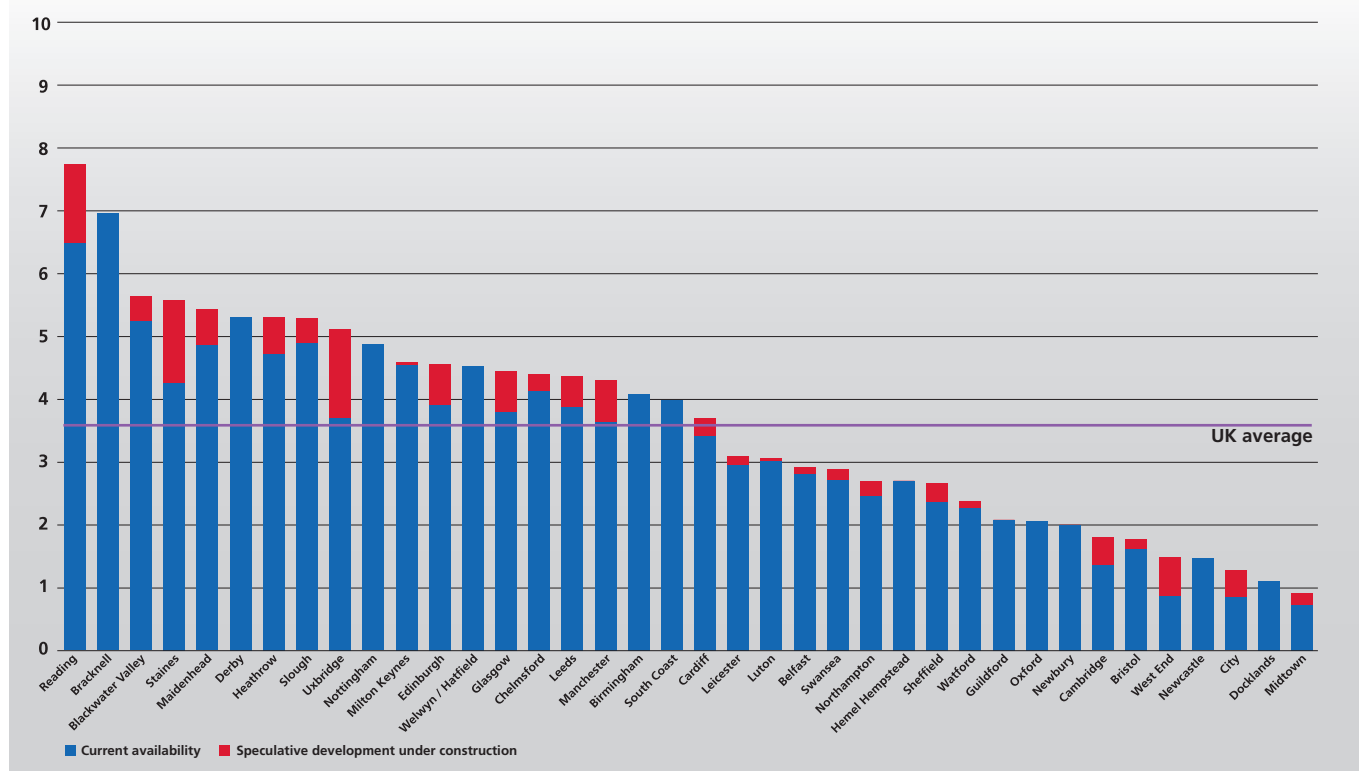
Market balance

The combination of average annual take-up and current availability can be expressed as the market balance, or 'years of supply' which is shown for every market we cover in the chart opposite.

The markets with the lowest level of supply in relation to their ten-year average take-up levels are each of the Central London markets, as well as Newcastle and Bristol. At the other end of the scale, Reading has the highest level of supply of any market although, with transformational rail infrastructure projects in the offing, developers have remained committed to this market.

When assessing which markets are well placed for further rental growth in 2015, those showing below average market balance will be the ones to look out for. However, as recent rental growth seen in Staines has demonstrated, occupiers are willing to pay high rents for the very best quality space, despite the degree of choice in the market.

Current market balance (years)



Source: Lambert Smith Hampton

The markets with the lowest level of supply in relation to their ten-year average take-up levels are each of the Central London markets, as well as Newcastle and Bristol.

Update on change of use

May 2015 marks the second anniversary of the extension of Permitted Development Rights (PDR) allowing offices to change to residential use in England without planning permission. Since coming into force, our research reveals that over 11m sq ft of office space has left the market for alternative uses. Put into context, this is equivalent to losing Reading's market from the UK's total stock of offices.

Withdrawal of office space accelerates in 2014

With the PD right scheduled to expire in May 2016, activity accelerated in 2014, with 6.8m sq ft of office space leaving the market, an area equivalent in size to the Oxford market. Unsurprisingly, London has provided an important focus of activity, particularly outer London, where residential values dwarf those of offices.

However, many regional markets have also seen substantial activity following the PDR. In the 34 regional markets we track outside Central London, approximately 8m sq ft of office stock has left the market since May 2013, 4.7m sq ft of which was in 2014. Bristol has provided a key hotspot, with over 1m sq ft of office removed, 800,000 sq ft of which was in 2014.

Understandably, markets which work well as commuter locations for London have also provided a focus. In Slough, for example, 6% of stock has gone for residential use, while the Hertfordshire markets – including Watford, St Albans and Hemel Hempstead – have collectively lost circa 900,000 sq ft of office space since 2013.

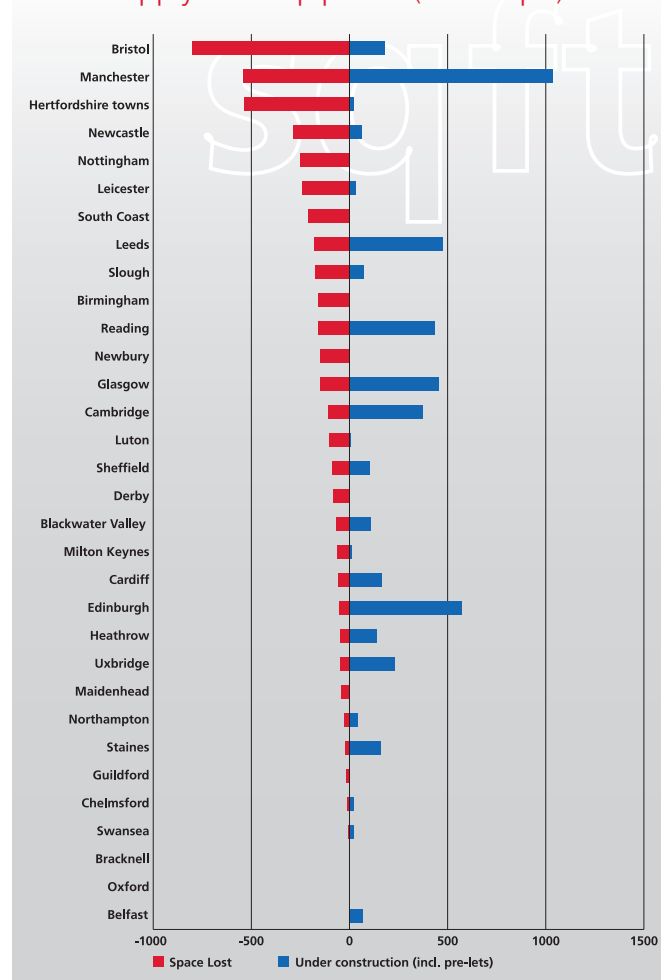
Has the UK's office supply already peaked?

The impact of planning policy on office supply, together with changing workplace practices, begs the question: has the UK's overall stock of office space peaked? At 9.4 m sq ft, speculative development currently underway exceeds the loss of office space in 2014 by 3m sq ft. However, a large proportion of office development involves either refurbishment of existing space or development on sites previously used for offices.

Evidence therefore suggests that the overall quantum of office space is entering into a gradually downward trend. However, positively, this should support the general improvement in the quality of supply and boost long term prospects for rental growth. In managing this change it is vital that planning policy is used to protect and enhance the established office cores across the UK's markets.

However, there is a great deal of uncertainty in the market surrounding what, if any, policy will be in place after the PD right expires in May 2016. The government consulted over extending or replacing the policy in July 2014 although no announcement has been made to date. Unless some form of extension is announced, landlords and developers must act quickly if the conversions are to be undertaken.

2014 supply lost vs pipeline (000s sq ft)



Source: Lambert Smith Hampton

The economic outlook

2014 was a very good year for the UK economy, the first year of genuine recovery since the great recession. UK economic growth was 2.8%, the strongest of the world's advanced economies, and was broadly-based both sectorally and geographically. The outlook is also positive, with the low inflation environment and rising real wages expected to support continuing robust growth over the next two years.

Business investment makes an emphatic return

A welcome feature of 2014 was the strong rebound of business investment in the economy. Investment increased by 7.3% during 2014, its strongest annual rate of growth in a generation. While the balance sheets of UK businesses have been in rude health for several years, the fact that investment returned as a key component of UK growth reflects a renewed willingness among corporates to expand and plan for the next cycle.

The return of the regions

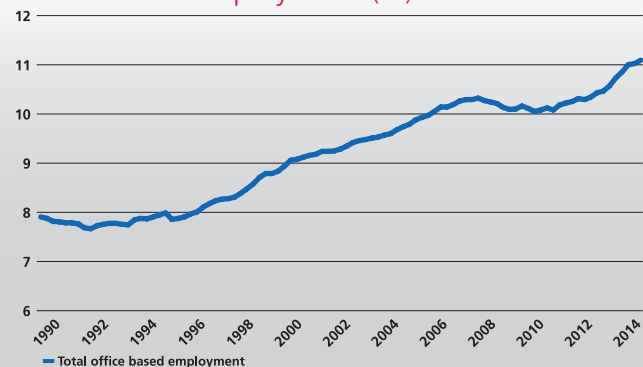
Another encouraging trend is the strengthening of business sentiment beyond London and the South East. While London remains in pole position, Markit's latest PMI survey reveals that businesses are now firmly in expansion mode across the majority of the UK's regions. This is being reflected in office market activity, with occupiers showing greater confidence to commit to relocations, boosting take-up around the UK.

The rise, and rise, of UK employment

Aided by the UK's relatively liberal labour market, robust economic growth has translated into rapid job creation over the past two years. The UK employment rate increased to an all-time high of 73.3% in January 2015, while unemployment has fallen steadily to a six-year low of 5.7%. This is especially true of office-type employment, where over one million new jobs have been created since the low of mid-2010.

Rising office-type employment bodes well for market demand, although this needs to be considered alongside changing working practices. Driven by advanced communications technology, many large corporates are seeking to increase space efficiencies and encourage agile working. This trend will focus demand on the best quality space, but may lead to accelerating levels of poor quality space overhanging the market.

Office based employment (m)



Source: ONS

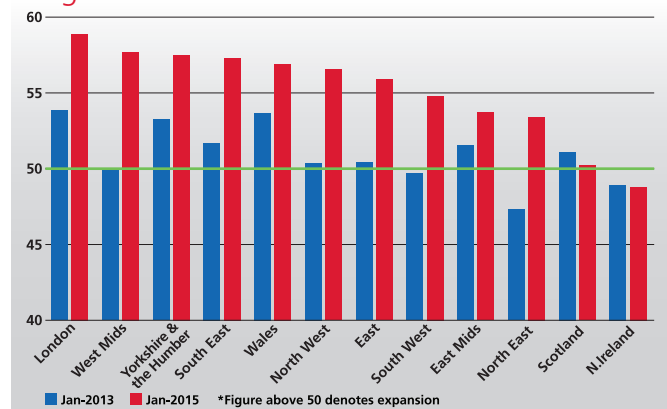
Consumers will drive growth moving forward

Despite the relatively poor state of the UK's public finances and the tenuous state of the Eurozone, the consensus remains positive over the outlook for the UK economy. The Office of Budget Responsibility's latest forecast is for growth of 2.5% in 2015, which is closely in line with 2014 performance, followed by robust growth of 2.3% in 2016.

The positive UK outlook is linked to the low inflation environment, driven by a sharp fall in oil prices since summer 2014. At the time of writing, inflation moved to a record low of 0% and is expected to average under 1% over the course of 2015. This is supporting rising real wages, which recently turned positive having been falling over the years following the recession.

With real wages expected to increase at their strongest rate in over a decade, consumer spending is set to return as the main driver of growth over the next 18 months, with investment set to decelerate. Positive as this is, it runs contrary to the government's long-held desire to rebalance the UK economy away from consumption towards production.

Regional PMI Indicator



Source: Markit

The office investment market

2014 was an also an exceptional year for the UK investment market, in terms of the scale of activity, extent of yield compression and total returns. Offices continued its dominance, accounting for 42% of the total £59.6bn invested in UK commercial property, while total returns in the sector reached 22.3%, its strongest calendar year performance since 2006.

Investment in UK offices was £25.3bn in 2014, rising by 1.2% on 2013 to reach its highest annual total since 2007. Underlining the renewed appetite for the regional markets, the underlying share of total investment outside of Central London increased from 24% in 2013 to 33% in 2014.

Overseas buyers crowd Central London

Strong investor appetite for central London offices continues, albeit volume of £17.1bn was down 10% on 2013's record high. Moreover, approaching half of 2014 volume took place in Q4, a period which saw a flurry of major lot-sizes bought by overseas investors, including St. Mary Axe (£726m) and HSBC Tower, Canary Wharf (£1.18bn).

Overseas investors dominate the Central London market. 2014 saw Far Eastern buyers flanked by North American buyers as the main sources of overseas inflow to the capital. Overseas investors made up 86% of total office volume in 2014 (rising from 71% in 2013), buying 55 of the 56 assets which sold for over £100m.

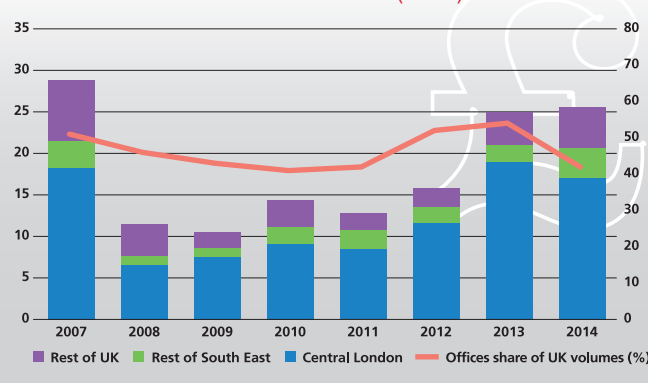
Domestic investors flood into the regions

However, fuelled by increasing confidence in the UK recovery and evidence of rental growth returning beyond London and the South East, office investment in the regions climbed by 22% in 2014 to reach £4.9bn. This was its highest level since 2007 and accounted for 20% of total 2014 UK office investment, its largest share of since 2010.

Meanwhile, investment in outer London and the South East increased by 69% year-on-year to £3.1bn, its highest level since 2006. This was boosted by Blackstone's £780m sale of Chiswick Park to China Investment Corporation in Q1, the largest office deal outside central London in 2014.

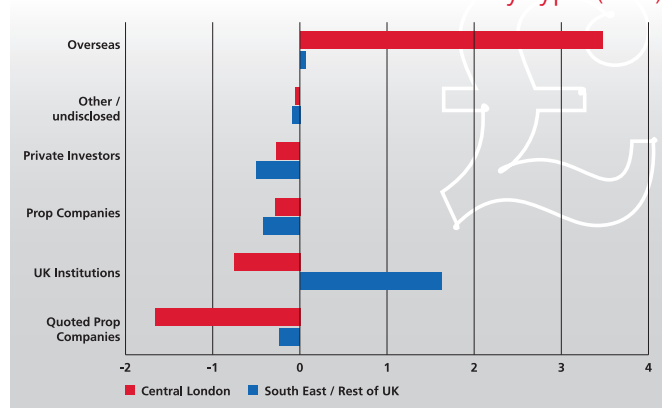
Strong weight of money has seen domestic investors flock into the regional markets, in search of higher income returns to those on offer in London. While overseas investors are acquisitive for regional large lot-sizes, domestic investors dominated activity in 2014, accounting for 78% of total volume in the regions. This is was especially true of the UK institutions, which were net investors into the regions to the tune of £1.6bn in 2014.

Offices investment volumes (£bn)



Source: Lambert Smith Hampton, Property Archive, Property Data

2014 net investment in UK offices by type (£bn)



Source: Lambert Smith Hampton, Property Archive, Property Data

Manchester was a key focus of institutional demand for regional offices. The city alone accounted for quarter of total regional volume during 2014, with major deals including M&G Real Estate's £320m purchase of Spinningfields and Schroders Property's £120m purchase of Piccadilly Gardens.

Yield shift drives 2014 performance

The sheer weight of money in the market prompted UK commercial property yields to move in sharply during 2014. Reflecting steep rises in pricing, IPD reports that UK office returns reached 22.3% in 2014, their strongest annual outturn since 2006. The West End showed the strongest returns in 2014, at 24.0%, although tellingly, the Rest of South East index was almost on a par, with returns of 23.9%.

Prime yields now stand at record lows in the Central London markets, with West End and City commanding pricing of 3.75% and 4.25% respectively. Despite pronounced yield shift in the regional markets over the past 18 months, their discount to Central London remains relatively large by historic standards, which should promote continuing activity during 2015.

Investment market outlook

Despite uncertainty around the outcome of the approaching election, evidence from 2015 suggests that investors have been relatively undeterred from buying – volume in the first two months of the year stands 15% higher than the same period in 2014.

However, we expect office investment volumes in 2015 to soften somewhat from 2014's level, although the proportion of investment taken by the regional markets will increase in relation to London as investors seek higher returns.

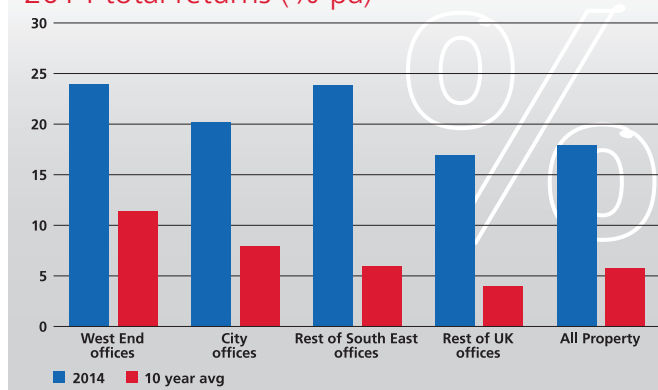
Downward pressure on prime yields will continue during 2015, reflecting the prevailing low interest rate environment, continuing weight of money in the market and, importantly, expectations of widespread rental growth.

With the discount in pricing between London and the regions standing relatively high by historic standards, prime yields in the core regional markets will harden further, approaching their historic lows of 2007. We also anticipate rising investor appetite for second tier regional centres, reflecting improving prospects for rental growth in these markets.

In search of higher returns, investors will increasingly target value-add opportunities. This will include stock offering short income which provides good prospects for asset management plays. However, assets compromised by location or physical configuration will continue to be significantly discounted.

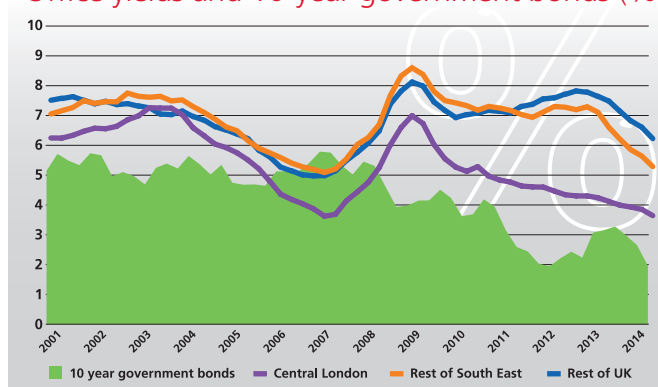
With an undersupply of prime stock, we expect an increasing number of institutional investors to take on development risk and fund speculative development, albeit focused on prime markets where grade A supply is limited relative to demand.

2014 total returns (% pa)



Source: IPD (quarterly digest)

Office yields and 10-year government bonds (%)



Source: IPD (quarterly digest)

Yield Profiles

	Prime (Q4 14)	IPD (Q4 14)	2014 transaction average
West End	3.75%	3.39%	4.43%
City	4.25%	4.13%	4.94%
South East	5.25%	5.29%	6.85%
Rest of UK	5.25%	6.23%	6.95%

Source: Lambert Smith Hampton, IPD (quarterly digest)

Activating the office

Occupiers are increasingly regarding their space as a resource which can add value to the business. A varied and stimulating working environment with access to amenities can enhance staff wellbeing and provide a means to communicate the culture of the business to both staff and clients. So, as occupiers become ever more discerning, how can landlords best respond to maximise long-term asset value?

For a century or more, the form and function of the typical office has been through various stages of evolution, reflecting changes in society and technological advances. Over the past decade another stage of evolution is firmly underway. Enabled by the adoption of wireless communications technology, the rise of 'agile working' is transforming the way occupiers utilise their office space.

There are several forces driving the latest evolution; the need to use space more efficiently, an increasing attention on staff wellbeing and the strategic use of space to communicate company values. As the economic recovery gains real traction and with development and refurbishment making a meaningful return, landlords need to carefully consider these trends and 'go the extra mile' in order to compete for tenants.

Using space more efficiently

The density of the typical office has increased significantly in recent years, as occupiers look to capitalise on agile working to save on property costs – in the short space of a decade, staff density levels have increased from circa 15m² per person to circa 10m². Our own research also shows that while the UK's overall stock of office space has barely changed since the recession, the number of people employed in office-type work has increased. However, in seeking to achieve 'spaceless growth', businesses are placing increasing importance on the quality of space that they do occupy.

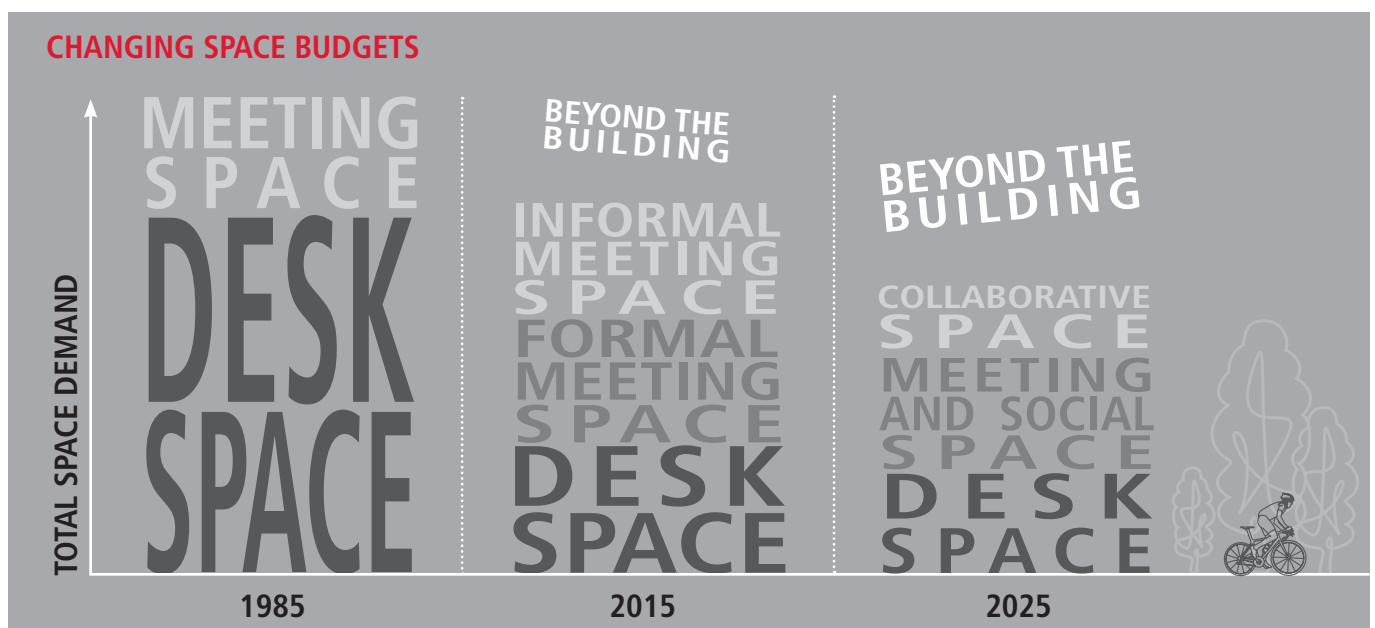
A focus on wellbeing

With the era of a 'job for life' largely consigned to history, employers recognise that staff wellbeing plays a vital role in attracting and retaining talent, as well as enhancing productivity. Offering choice is key, and the best employers are investing heavily to position their premises as both living and working environments which can be enjoyed by an increasingly diverse and sophisticated workforce.

The most progressive workplaces are those which provide a multiplicity of work settings, with an increasing emphasis on informal spaces. This includes both collaborative and quiet areas which are suited to different types of work and can cater to different personality types. Also, beyond the immediate work environment, access to a range of amenities offering refreshment, exercise and relaxation are other important ways that a building can support wellbeing.

Using space to convey brand identity

Businesses are increasingly using their workspace as a means to communicate the values and culture of the organisation. In today's world, businesses are having to work ever harder to differentiate themselves from their competitors, leading to careful consideration on fit-out design to give a sense of kudos to their staff and visiting clients. As working practices become more agile, the office is likely to serve increasingly as a focal point for the face-to-face interaction between staff and clients, intensifying this trend further still.



Source: Ramidus Consulting and City of London

Five areas for landlord action

Put simply, landlords who are in tune with these key drivers stand the best chance of maximising the return on their investments. The landlord's role needs to be reconsidered from a simple space provider to a creator of experience. Below we outline the five key steps that landlords are taking to meet this changing demand, before bringing this to life with three specially selected case studies.



Enhancing amenity

Within a multi-tenanted environment, allocating space for shared amenities enhances the building as a lifestyle experience to prospective occupiers. A wide variety of possible amenities can be incorporated into a building, which may be freely available, paid for via the service charge or provided as part of the tenant mix.

The more familiar amenities include cafés, bike storage and shower facilities. While the boom in cycling to work over the past decade has been accompanied by the provision of shower facilities and bike racks, some progressive landlords are installing ramps to allow uninterrupted cycle access into the building. Other types of amenity are also increasingly being provided, such as crèches and multi-faith prayer rooms, reflecting the increasing diversity and needs of today's workforce.

A building's offer can of course also be enhanced through the incorporating non-office tenants onto the rent roll, such as retailers and gyms on the lower floors. Increasingly, however, landlords are choosing to forgo potentially higher rental income in favour of a particular type of occupier to maximise the lifestyle of the building as whole. For example, to boost the appeal of The Angel building and the wider vicinity, its owner Derwent London resisted interest from a leading supermarket in favour of a Jamie's Italian and Hummingbird.

"For landlords, driving space efficiency is no longer the end game for maximising income. Buildings which offer a lifestyle to their occupiers, through the quality of shared spaces and amenities, increasingly have a competitive advantage over those which merely conform to the prescriptive standards of design and layout."

Ken Giannini,
Managing Director of Morgan Lovell



High quality shared spaces

Landlords and developers of multi-tenanted buildings are thinking much more carefully about the quality and amount of shared space available to staff throughout the building and visiting clients. Such spaces may include large seating areas within the atria, on-demand space, garden roof terraces and, in some cases, conferencing facilities.

Traditional models of space utilisation sought to maximise the net lettable area within the building at the expense of shared space, but this is changing. Landlords are increasingly opting to radically enhance the building's shared space to boost its appeal to occupiers, with higher rents offsetting revenue lost from sacrificing net lettable space.

This is particularly true of the entrance area, where upon refurbishment the atria may be vastly improved by the landlord to inject 'the wow factor' to prospective tenants. Much as the tenant's own choice of fit-out can be used to convey its values and culture, so too can the provision of high quality atria and entrance areas.



Flexibility and adaptability

With typical lease terms reducing substantially over the past two decades, landlords need to ensure that their offices are as flexible and adaptable as possible to cater to high churn and a range of requirements. Media and creative companies, in particular, have come to provide a major source of office demand over recent years, encouraging landlords to provide space which is easily divisible and adaptable to accommodate the sometimes rapid growth seen by occupiers in this sector.

Occupiers have increasingly diverse and high aspirations for their fit-outs. In response, landlords need to provide space which makes the fit-out as straightforward as possible and can allow for a wide variety of approaches. Typically, this takes the form of large floorplates where natural light can penetrate throughout and where the effectiveness of ventilation systems is not compromised by adding partitioning. Developers of newbuild offices should seek to add additional capacity in the service risers and install metering and controls on a floor by floor basis.

There is however a growing trend among occupiers for the 'raw aesthetic', where a building's services in terms of machinery and piping are left exposed. If this continues, landlords may in the future increasingly opt to go no further than shell and core when marketing the building.

4

Sustainability credentials

The recovery in the economy is likely to refocus occupier attention on the sustainable credentials of the buildings they occupy, as cost control becomes less

of an issue. Many sustainable design features are already associated with staff wellbeing, such as access to natural light and provision of bike spaces, but other sustainable features include on-site power generation from renewables, such as solar panelling and grey water recycling.

Landlords of newly developed or retrofitted buildings are increasingly likely to 'rubber stamp' the sustainability credentials of the building through recognised awards such as BREEAM. In turn, such awards can be used to reflect the occupier's own aspirations on the environment to its staff and clients. While sustainability is not uppermost on every occupier's agenda, some will be prepared to pay a higher rent to benefit from this kind of association.

5

The building as a community

Landlords who actively engage with occupiers to promote 'the community' of a building are often better able to attract and retain tenants, thereby maximising

the return on their investment. Such a relationship goes much further than the conventional arms-length landlord approach from essentially a provider of workspace to a lifestyle experience, more in keeping with a hotel.

A landlord may, for example, directly employ an on-site manager to administer shared amenities and organise concierge services, such as dry cleaning and car valeting. This may also extend further still, with the landlord actively encouraging special activities, such as farmers' markets and charity events which bring tenants together.

Case studies

200 Aldersgate, London EC1

In 2010, Helical Bar was appointed by Deutsche Pfandbriefbank to reposition a 370,000 sq ft distressed asset, located in the City. The building was a blight to the area, having been vacant for seven years following Clifford Chance's relocation to Canary Wharf. Within two years of Helical completing the works, the building was home to 21 office tenants, including FTI Consulting, Philips 66, The Javelin Group and Maples & Calder. The asset was purchased by Ashby Capital for circa £230m in 2013.

The approach

Helical employed MoreySmith Architects to radically enhance the common areas of the building. A café and seating area was installed, modelled on the concept of an 'Executive Club' airport lounge. Bright vibrant reception areas were incorporated, featuring kinetic art to enhance the identity of the building. The existing roof terraces were remodelled with planting and decking, affording outdoor space to a number of occupiers.

New facilities were provided, including showers and changing rooms plus 225 bike spaces on the ground floor, accessed via a dedicated cycle ramp. The building is home to a 'Classic Club' Virgin Active gym, and one retail unit is leased to a Giant bike store. Recognising the increasing requirement for on-demand and expansion space, on-site conference facilities are available through ETC Venues, while serviced office provider i2 also have space within the building.



"Helical's vision was to transform the building into a vertical village, providing space which would appeal to a cross-section of the market. Ultimately, we wanted tenants to be proud to be based in an attractive and well managed building".

Gerald Kaye,
Director, Helical Bar

Horizon, Maidenhead

Situated in nine acres of Berkshire countryside, Horizon offers 82,555 sq ft of grade A office accommodation in the village of Hurley, just outside Maidenhead. CEG acquired the building in a portfolio purchase from the original developer's administrator. Prior to CEG's ownership, the building had failed to secure a single occupier for five years. It is now let-up, to tenants including Zetes, Sara Lee, Hospira and Leo Pharma.

The approach

A priority was to enhance the provision of shared amenities, so that it could be better positioned for multi-tenanted occupation. CEG sacrificed over 3,000 sq ft of the existing net lettable area to provide tenants with high quality shared communal areas, including a gym and café.

The building's picturesque location was compromised by a lack of public transport access to the building. CEG overcame this issue by providing a dedicated free-to-staff bus service to and from Maidenhead rail station.

CEG directly employs an on-site reception manager providing a concierge-style amenity to staff, including car valet and dry cleaning services. This dedicated service also promotes activities across the building, such as charity events and use of the grounds.



"Our approach was to bring life and a sense of community to what was essentially a high quality building. Our investment has paid off, with rents rising by over 30% between the first and last occupier".

Tom Gaynor,
Asset Manager, Commercial Estates Group

One Valpy, Reading

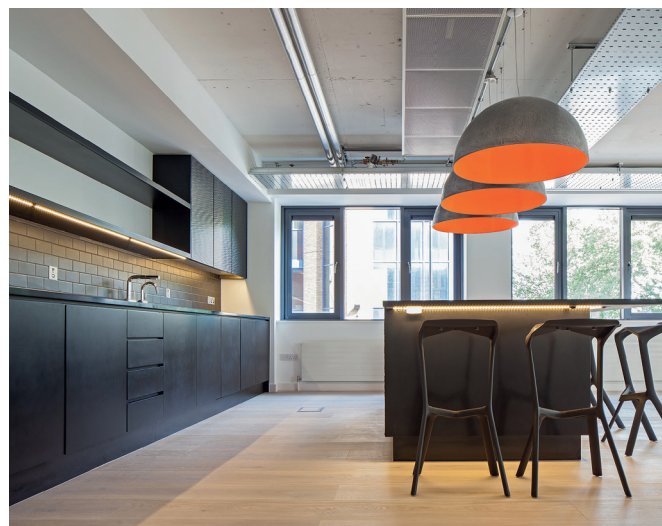
One Valpy comprises 60,000 sq ft of refurbished grade A space, and is conveniently located within two minutes walk of Reading Train Station. Landid and Brockton bought the 1980s-built asset with vacant possession in 2012 before reconfiguring the building. Following completion of works in September 2014, Mabey and Bullit Group have already acquired space, with additional space under offer.

The approach

The main challenge was to create space for the modern occupier within a dated structure. The entrance and foyer were reconfigured to improve the visual imbalance caused by the lift tower, completely transforming the whole aesthetic of the building.

The building was refurbished to 'Very Good' BREEAM certification and the space was specified to allow occupiers to 'plug and play' on arrival, making it suitable to a range of occupier requirements. The building's internal services were left exposed, giving a 'raw aesthetic' style which is becoming increasingly desirable.

An array of amenities and services were incorporated into the building, including a shower block and conference room facilities. A restaurant operator is about to occupy a newly built unit at ground level, offering subsidised food throughout the day, while the crèche in the adjacent building will offer concessions to the staff with young children.



"Our ambition was to provide not only high quality space but a service to our tenants. We took a number of bold steps over the aesthetic quality of the building, and supplemented this with a hotel-style concierge provider".

James Silver,
Development Director, Landid

Central London

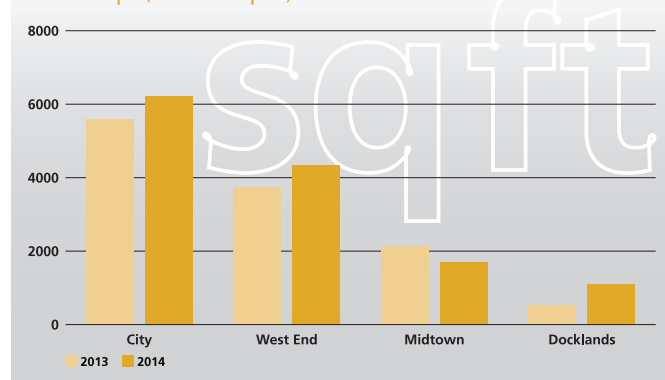
Demand

2014 was Central London's strongest year of office take-up since 2000. On an aggregate basis, take-up across the four main Central London submarkets combined was 13.4m sq ft, an 11% increase on 2013. The increase was driven by the continuing rapid growth in the creative industries, together with a resurgence of demand from financial occupiers. Much of the activity has been through pre-letting, which accounted for nearly a third of 2014 take-up.

Docklands take-up exceeded 1m sq ft in 2014 and was double 2013's total. This was largely driven by demand for grade A space in Canary Wharf, which included two major deals. In terms of volume, the City saw the largest take-up of the submarkets, accounting for 47% of the total in Central London.

Midtown was the only submarket to see a decline in take-up in 2014 compared to 2013. While Q3 was one of the best quarters on record for this submarket, a poor performance in Q4 meant the annual total was 1.7m sq ft, almost 20% below the 2013 total.

Take-up (000s sq ft)

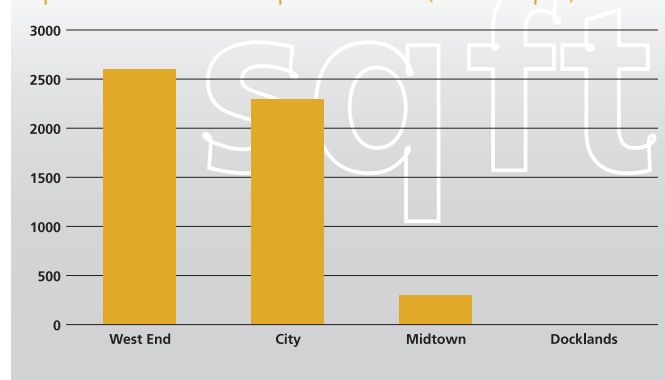


Source: Lambert Smith Hampton

Supply

At the end of 2014, availability in the four main submarkets totalled 10.3m sq ft, 20% below the level in 2013 and its lowest since 2007. Supply remains extremely tight in the West End, which has the lowest vacancy rate of the four submarkets at 4.2%. While the City still has the highest vacancy rate it fell significantly in 2014, dropping from 10.8% to 6.6%, on the back

Speculative development u/c (000s sq ft)

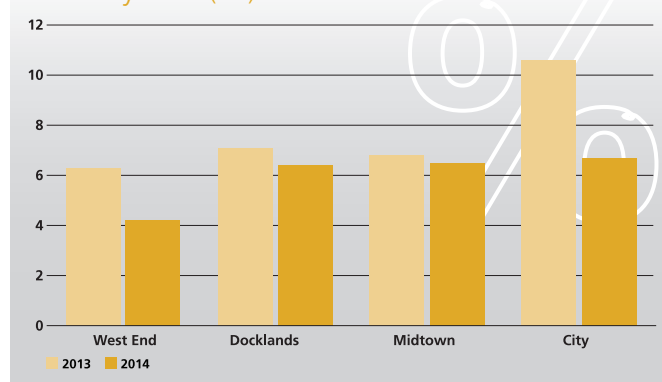


Source: Lambert Smith Hampton

of strong occupier demand from traditional financial occupiers and a growing presence of tech and creative occupiers.

While a significant 5m sq ft of development or refurbishment was delivered to the market in 2014, it has done little to alleviate grade A supply pressures. Almost 4m sq ft of development is expected to complete in 2015, of which around 50% has already secured pre-let. This, combined with historically low levels of secondary supply, points to a continuation in falling vacancy rates in 2015.

Vacancy rate (%)



Source: Lambert Smith Hampton

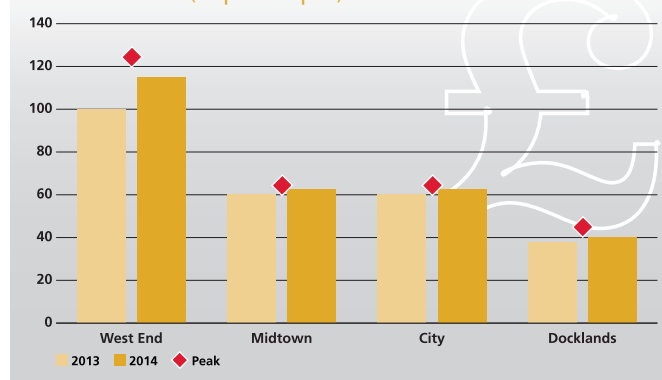
Rents

Prime rents increased in each of the four submarkets during 2014, albeit to a variable degree. The West End saw the largest rental growth, rising by 15% from £100 per sq ft to £115 per sq ft during 2014. This was confirmed by AGC Equity Partners' 11,818 sq ft letting of 33 Davies Street.

The City recorded the lowest increase in prime rents of the four submarkets, rising 4% in 2014 to £62.50 per sq ft. While the City saw the steepest fall in vacancy in 2014, it remains the most supplied submarket which explains the relatively modest rental growth.

We expect prime rental growth to continue in 2015 as the supply of grade A tightens further, with strong demand for new space and limited development. However 2016 is set to see more development come forward with the increase of supply expected to moderate rental growth. Total occupancy costs across Central London are also set to substantially increase after 2017 when the business rates revaluation takes place, putting further pressure on any rent rise and supporting our prediction of rents peaking during 2015.

Prime rents (£ per sq ft)

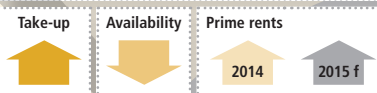


Source: Lambert Smith Hampton

West End

The West End continues to be the best performing Central London submarket in terms of rental growth and we expect this to continue given the prevailing pressure on grade A supply. While elevated, the current prime rent is still below its peak level of £125 per sq ft so there is definitely more scope for growth during 2015 as London's economy continues to prosper.

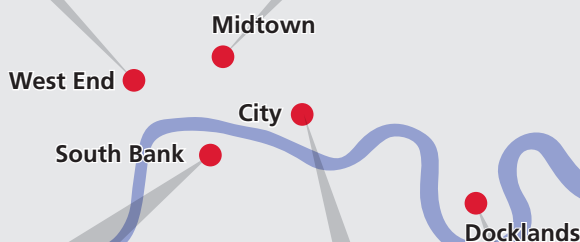
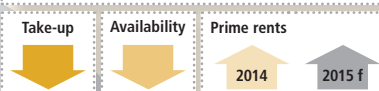
There is evidence already in 2015 to suggest further growth with £120 per sq ft achieved at 33 Davies Street and £150 and £185 per sq ft reported at 8 St James's Square.



Midtown

While 2014 take-up fell short of its 2013 level, it was nevertheless 6% above the ten-year average. Midtown has continued to establish itself as a market for the creative industries, with these occupiers accounting for around 50% of lettings in 2014.

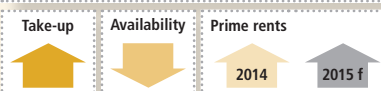
Midtown offers a central location and increasing accessibility due to Crossrail, while rents are typically more affordable than the neighbouring West End. The prime rent in Midtown stood at £62.50 per sq ft at the end of 2014, which is the peak prime rent achieved in the submarket. Around 1.3m sq ft of office space is due for completion in 2015, although almost 80% is already pre-let.



South Bank

Take-up in the South Bank area reached 1.3m sq ft in 2014, a slight improvement on 2013 and more than 50% above the ten-year average. Two successive years of healthy take-up has seen availability fall to its lowest level in three years, driven by large-scale office lettings, principally to media companies. The South Bank's largest deal in 2014 was Omnicom's lease of 370,000 sq ft at Bankside 2 & 3, one of the largest lettings in Central London.

Prime headline rents increased by almost 16% during 2014 to reach £55.00 per sq ft. With limited stock and ongoing robust demand, we expect growth to continue in 2015. Development is returning to the area, albeit mostly in mixed-use schemes that are some way from practical completion. While the wider market is performing well, areas such as Borough High Street are in transition, with poor quality properties being converted to residential.

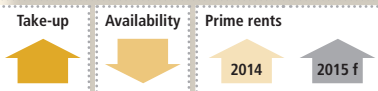


NB: South Bank not included in Central London statistics

City

At 6.2m sq ft, take-up in the City was the largest of all the Central London submarkets, with pre-letting making up a large proportion of total activity. The City was home to Central London's largest deal of 2014, which was Amazon's 431,000 sq ft pre-let of Principal Place in Shoreditch. The mixed-use 600,000 sq ft development is due for completion in 2016 and Amazon will take occupation in 2017.

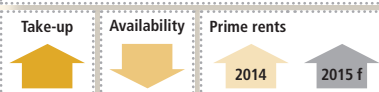
The City saw the smallest increase in prime rents of all main submarkets, moving 4% from 2013 to £62.50 per sq ft. Despite a substantial fall in availability, the City continues to have the highest vacancy rate of the four submarkets, standing at 6.7% at the end of 2014.



Docklands

Dockland's prime rent stood at £40.00 per sq ft at the end of 2014, rising from £37.50 per sq ft a year previously. Development in the Docklands has been predominantly residential-led, with no office space under construction throughout 2014. More recently, however, Canary Wharf Group is now on site at 1 Bank Street, which will provide 700,000 sq ft of office space.

Docklands saw the largest increase in take-up among the four submarkets, more than doubling on 2013 and largely comprising activity in Canary Wharf. This included two major deals; Société Générale's pre-let of 280,000 sq ft of 1 Bank Street, which was the largest Central London deal in Q4 2014, and EY's 205,000 sq ft letting of 25 Churchill Place.



The Big Six

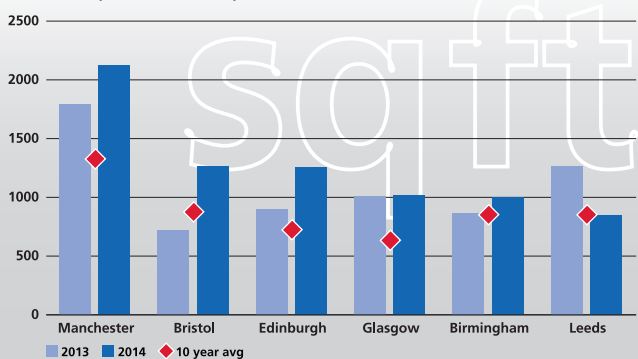
Demand

2014 was a year to remember for the Big Six markets. Reflecting the recovery in the economy and improving occupier confidence, overall Big Six take-up was 43% above the ten-year annual average while five of the Big Six markets saw take-up increase year-on-year.

Manchester enjoyed an exceptional year, with take-up reaching 2.1m sq ft, the highest of the Big Six markets and its strongest since 2001. However, with record quarterly take-up in Q4 2014, Bristol saw the largest year-on-year increase in take-up of any Big Six market, rising by 76% from 2013.

Similarly, Birmingham had an impressive final quarter, propelling total take-up for 2014 to a six-year high of 1.0m sq ft. Meanwhile, Glasgow and Edinburgh enjoyed take-up far in excess of their ten-year annual averages in 2014, up 62% and 74% respectively. Leeds was the only market which failed to see 2014 take-up clearly outperform its average, albeit this followed a stellar year in 2013.

Take-up (000s sq ft)



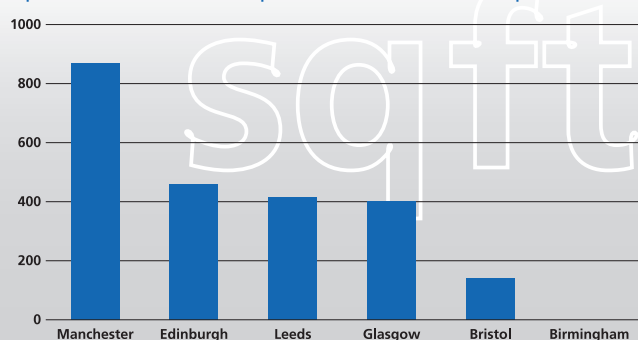
Source: Lambert Smith Hampton

Supply

A shortage of good quality supply has increasingly come to characterise the Big Six, and developers are now responding to this opportunity. At the end of 2014, 2.3m sq ft of space was under construction on a speculative basis across the six markets, double the level 12 months previously, with development underway in five of the six cities.

Manchester is the main development focus, with 870,000 sq ft under construction across six schemes, twice 2013's level.

Speculative development u/c (000s sq ft)



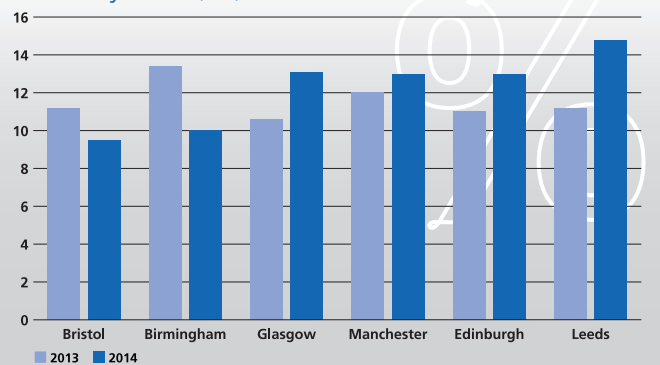
Source: Lambert Smith Hampton

Leeds has seen the strongest increase in activity, rising six-fold on 2013's level to stand at 472,000 sq ft across five schemes.

Four of the Big Six markets saw a rise in vacancy levels from last year, a result which largely stems from increased development activity seen in Leeds, Manchester and Edinburgh. The one exception was Glasgow, which posted an increase in the vacancy rate from just 10.7% to 13.0% during 2014 despite no additional development starts during the year.

Birmingham and Bristol were the two cities to see a fall in vacancy rates during 2014. Birmingham had the strongest decline, reflecting an absence of development starts and robust take-up during 2014. Indeed, only 18% of Birmingham's office availability comprises grade A space, the lowest of any Big Six market.

Vacancy rate (%)



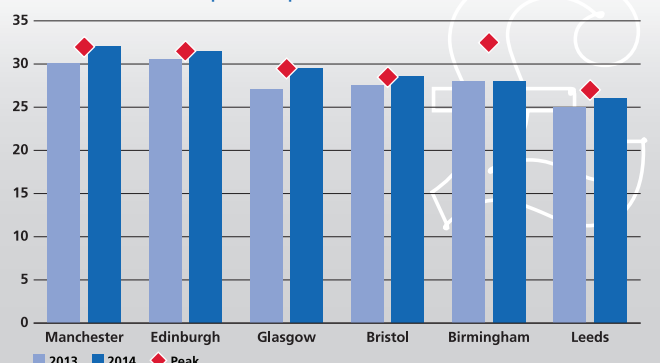
Source: Lambert Smith Hampton

Rents

Five of the Big Six markets recorded a rise in prime headline rents during 2014, while prime rents in Bristol, Manchester, Glasgow and Edinburgh all moved to a new peak level. In terms of growth, Glasgow was the best performer in 2014, as rents increased by 9% to £29.50 per sq ft. This was on the back of several pre-lets at BAM Property's 110 Queen Street.

Birmingham was the only Big Six market not to register an increase in prime headline rents during 2014, arguably a result of a lack of brand new space delivered to the market. Despite increased development in the Big Six, the ongoing erosion in existing grade A supply will put further upwards pressure on prime headline rents over the next two years. Indeed, we expect the delivery of brand new space in markets such as Leeds, Manchester and Birmingham to be key in setting new headlines rents during 2015.

Prime rents (£ per sq ft)

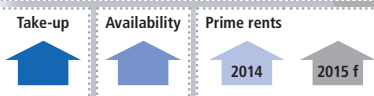


Source: Lambert Smith Hampton

Glasgow

2014 was an exceptional year, with in excess of 1m sq ft of take-up, over half of which was in the city centre. With a flurry of large deals, 2014 take-up was also marginally ahead of 2013's level, despite Scottish Power's 225,000 sq ft pre-let that year. 2014 saw a clear improvement in occupier confidence, with activity linked to the cycle of office lease breaks and expiries over 2016-2018.

Glasgow has three speculative developments under construction totalling 455,000 sq ft, all of which are due to complete in 2015. They have already secured a number of pre-lets, reflecting strong demand for the very best quality space. However, this new supply is unlikely to be sufficient to satisfy the quantum of impending lease events over the next three years.

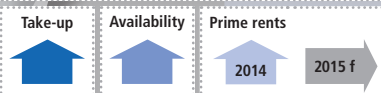


Edinburgh

Take-up in Edinburgh reached a record 1.3m sq ft in 2014, a 39.7% increase on 2013. Availability increased due to 340,000 sq ft coming forward speculatively at Tiger Development's Haymarket scheme, although existing supply fell 4% on the back of strong take-up during 2014.

Headline rents for prime grade A stock within the city centre remain largely unchanged at £31.50 per sq ft although generous incentive packages continue to bear down significantly on the net effective rent.

Activity in the out-of-town office market has also increased with Scottish Prison Services, Version 1 and SFQC acquiring office space at Edinburgh Park and South Gyle.

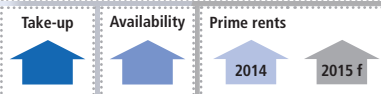


Manchester

There are presently six speculative schemes underway in excess of 100,000 sq ft in the city centre. Elsewhere, speculative development is set to return to the South Manchester market, with Manchester Airport Group confirming an imminent start of 75,000 sq ft at Airport City.

Supply pressures are predicted to drive city centre prime rents to £35.00 per sq ft over the next 18 months, although this upward momentum will slow as new completions are delivered. Rental growth in buildings providing substantially refurbished space remains strong. A number of these have recently secured headlines in excess of £20.00 per sq ft for the first time, a trend we expect to continue in 2015.

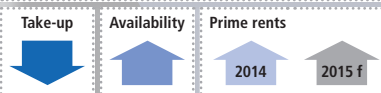
Work has started on the Ordsall Cord rail extension which will boost accessibility to development along the River Irwell once it completes by the end of 2016.



Leeds

Following 2013's ten-year high of take-up, speculative development made an emphatic return to the city centre during 2014, with a total of 473,000 sq ft currently under construction. However, with no schemes scheduled to complete in 2015, we predict that prime rents will continue to increase, reaching a new headline of £27.00 per sq ft.

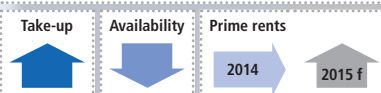
In contrast with the city centre, the out-of-town markets have been slower to recover. However, as stock continues to diminish during 2015, we expect the fortunes of these markets to change dramatically and rents to potentially return to their pre-recession headlines of circa £18.50 per sq ft.



Birmingham

HS2's lease of 100,000 sq ft at 2 Snow Hill builds on the inward investment trend set by Deutsche Bank, who took 134,000 sq ft in the city in 2013. This is testament to the infrastructure investment which has already seen the delivery of an airport runway extension and, in 2015, will see the completion of a revamped New Street Station, an extended Metro service and a much improved retail offer (which includes a flagship John Lewis store and Grand Central shopping centre).

With stronger confidence among developers and investors, a number of schemes which relied on securing pre-lets are now expected to be brought forward speculatively. That confidence has been driven by a chronic scarcity of Grade A supply and the resultant hardening of incentive packages with significant rental growth anticipated in 2015.

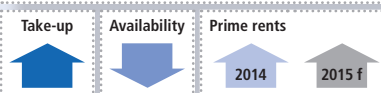


Bristol

2014 was Bristol's strongest year of take-up since 2007. Renewed demand for grade A space coupled with a lack of speculative development will leave the market with negligible existing grade A supply within the next 12 months.

For the first time, prime headline rents in the city centre are expected to exceed £30.00 per sq ft during 2015. The timing is now right for speculative development at the prime city centre sites and we expect schemes to come forward around Victoria Street and Temple Quarter.

Incentives in all markets will continue to decrease, with change of use via permitted development removing a significant proportion of grade B/C space from the market. The out-of-town market will also improve, with prime locations recording rental growth for the first time in five years.



The Mid Seven

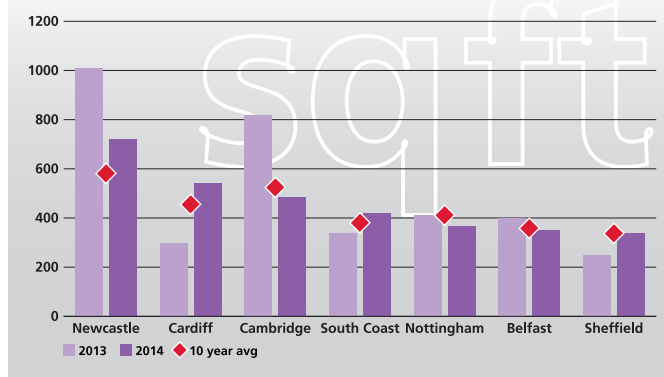
Demand

Viewed in aggregate, the Mid Seven markets saw a modest reduction in activity year-on-year, with take-up in 2014 down by 7% overall. The performance was nevertheless positive in its historic context, standing 7% above the ten-year annual average, and indicative of ongoing robust sentiment among occupiers.

The pattern of activity was relatively mixed between the seven markets. The South Coast and Sheffield recorded healthy year-on-year increases in take-up in 2014, although Cardiff was the clear stand-out performer with 2014 take-up rebounding by 83% from 2013's subdued total.

Newcastle and Cambridge experienced the largest year-on-year decreases in take-up, down by 29% and 41% respectively. However, both markets saw exceptional activity in 2013, with 2014 signifying a return to more 'normal', but nevertheless robust, levels of activity. Cambridge and Nottingham were the only two Mid Seven markets where 2014 take-up fell short of their ten-year averages, albeit down by just 7% and 10% respectively.

Take-up (000s sq ft)

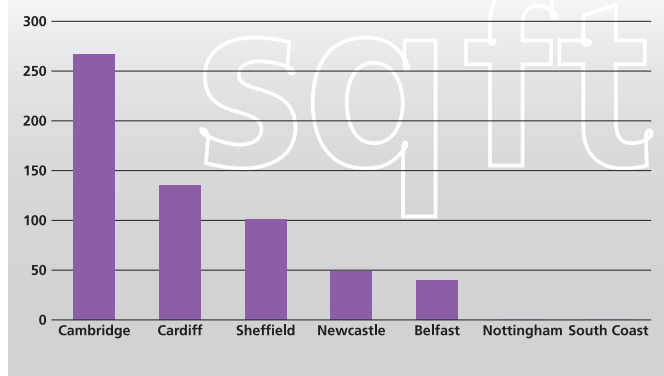


Source: Lambert Smith Hampton

Supply

The Mid Seven markets collectively saw a slight reduction in the vacancy rate, falling from 12.0% to 11.7% during 2014. However, as with take-up, the year-on-year movement in supply levels varied between the Mid Seven markets. While vacancy rates decreased marginally in the South Coast and Sheffield, Newcastle saw the biggest drop, with vacancy reducing to a ten year low of 8.7%.

Speculative development u/c (000s sq ft)

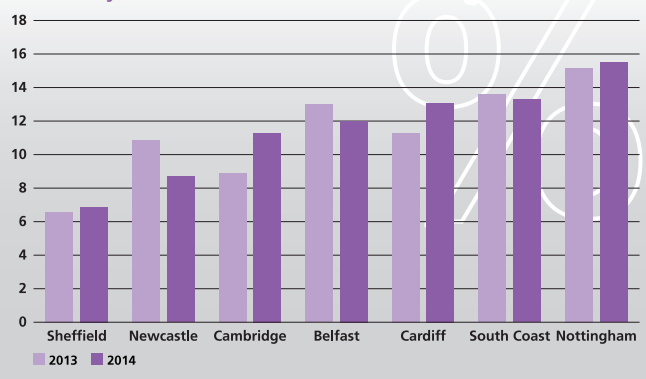


Source: Lambert Smith Hampton

Speculative development in the Mid Seven increased by 152% year-on-year to stand 592,000 sq ft, with construction underway in five of the seven markets. Cambridge is a key focus, with 235,000 sq ft of on site across seven schemes, the largest of which is Station Square, a mixed-use development by Brookgate. Consequently, Cambridge saw the largest increase in vacancy levels, rising by 27% year-on-year. Similarly, vacancy in Cardiff has increased by 16%, partly reflecting the commencement of Phase 1 Central Square.

The only market to record a rise in the vacancy rate but no new supply coming forward is Nottingham, which has the highest vacancy rate of the Mid Seven markets, at 15.5%. However, Nottingham has a severe shortage of available grade A space, which accounts for just 9% of the market's total availability (compared with 23% across the Mid Seven combined).

Vacancy rate (%)



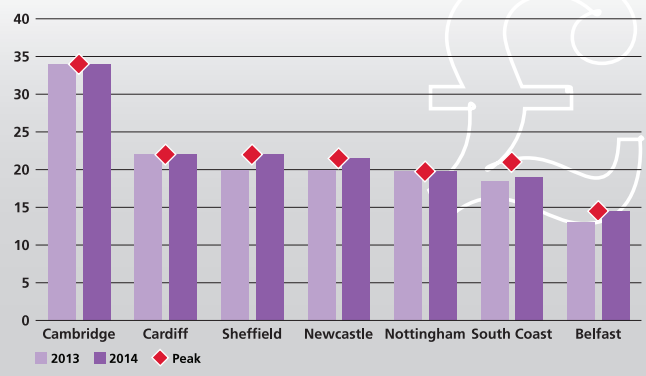
Source: Lambert Smith Hampton

Rents

2014 brought firm evidence that rental growth is spreading from the UK's core office locations into the UK's mid-tier markets. Following Cambridge's 10% growth in 2013, four other Mid Seven markets recorded rental growth during 2014. The strongest rise was in Belfast, where prime rents increased 12% to £14.50 per sq ft, followed by Newcastle, where rents increased by 10% to £21.50 per sq ft.

The outlook for rental growth is much improved for the Mid Seven markets. We expect current developments and imminent starts to be key in driving prime rents forward over the next 18 months. Rental growth will also play an important role in ensuring viability for additional, much-needed new-build space over the medium term.

Prime rents (£ per sq ft)

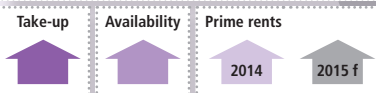


Source: Lambert Smith Hampton

Sheffield

Q4 2015 will see the completion of 3 St Paul's Place, Sheffield's first speculative office development since the recession. We expect its completion to establish a new headline rental level of £22.00 per sq ft; the first increase since 2008.

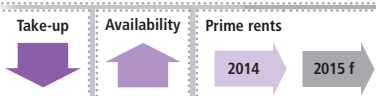
Elsewhere in the city centre, the continued conversion of secondary office space for student residential accommodation has led to a dwindling supply of good quality Grade B space. In turn, this has prompted with a hardening of both rents and incentives on secondary space.



Nottingham

No new offices have been delivered to the market for years. Despite increasing pressure on supply and occupier demand for prime space, developers remain wary given the amount of secondary stock still on the market.

2014's largest deal was the Q4 letting of 62,000 sq ft at Castle Wharf in Nottingham city centre to Parexel, which set a new headline rent high of £15.00 per sq ft for 'grade B+' space. While prime rents are likely to remain stable, we expect further rental growth for good quality second hand space during 2015.

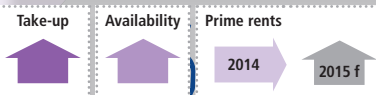


Cardiff

Take-up in Cardiff rebounded in 2014, rising 83% above 2013's subdued total. Reflecting a lack of existing grade A space, demand has largely focused on secondary stock, in turn prompting a hardening of incentive packages on grade B space.

Several speculative developments are underway which are helping to reposition the market, including One Central Square (135,000 sq ft), No. 2 Capital Quarter (85,000 sq ft) and the refurbishment of Two Kingsway (40,000 sq ft). Rightacres' Central Square development is designed by Foster & Partners and will be anchored by the BBC.

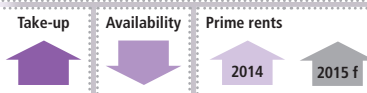
Underlining developer confidence in the city, prime grade A quoting rents are expected to rise to £25.00 per sq ft over the next 18 to 24 months as high quality product is delivered to the market.



South Coast

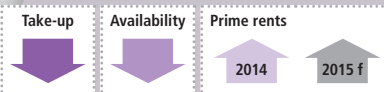
Grade A space is very limited along the M27 corridor and particularly within Southampton. Poorer quality office space is also reducing as developers seek conversions to alternative uses. With a lack of supply in the city centre, a number of major occupiers including HSBC and KPMG have relocated to M27 business park locations.

Tenant incentives are reducing and prime rents are set to increase, with grade A rents likely to reach £20.00 per sq ft in Southampton city centre during 2015. With some major residential, commercial and leisure developments underway across the Solent region, the optimism generated should see growth and investment continue.



Newcastle upon Tyne

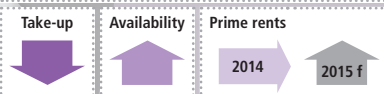
Newcastle had another strong year of take-up in 2014, despite the fact it was some way down on 2013's impressive level, with notable activity in the out-of-town market. Two speculative developments are on-site and due to complete in summer 2015, comprising The Rocket, Stephenson Quarter (35,000 sq ft) and LiveWorks, Quayside (14,000 sq ft). The Rocket is expected to establish a new headline rent for the city of c. £22.50 per sq ft.



Cambridge

AstraZeneca's forward sale of its 850,000 sq ft HQ at the BioMedical Campus is already having a significant impact on the wider office market dynamic. The increasing shortage of supply is increasingly working in the landlord's favour and we expect upward pressure on rental values across all market subsectors in Cambridge.

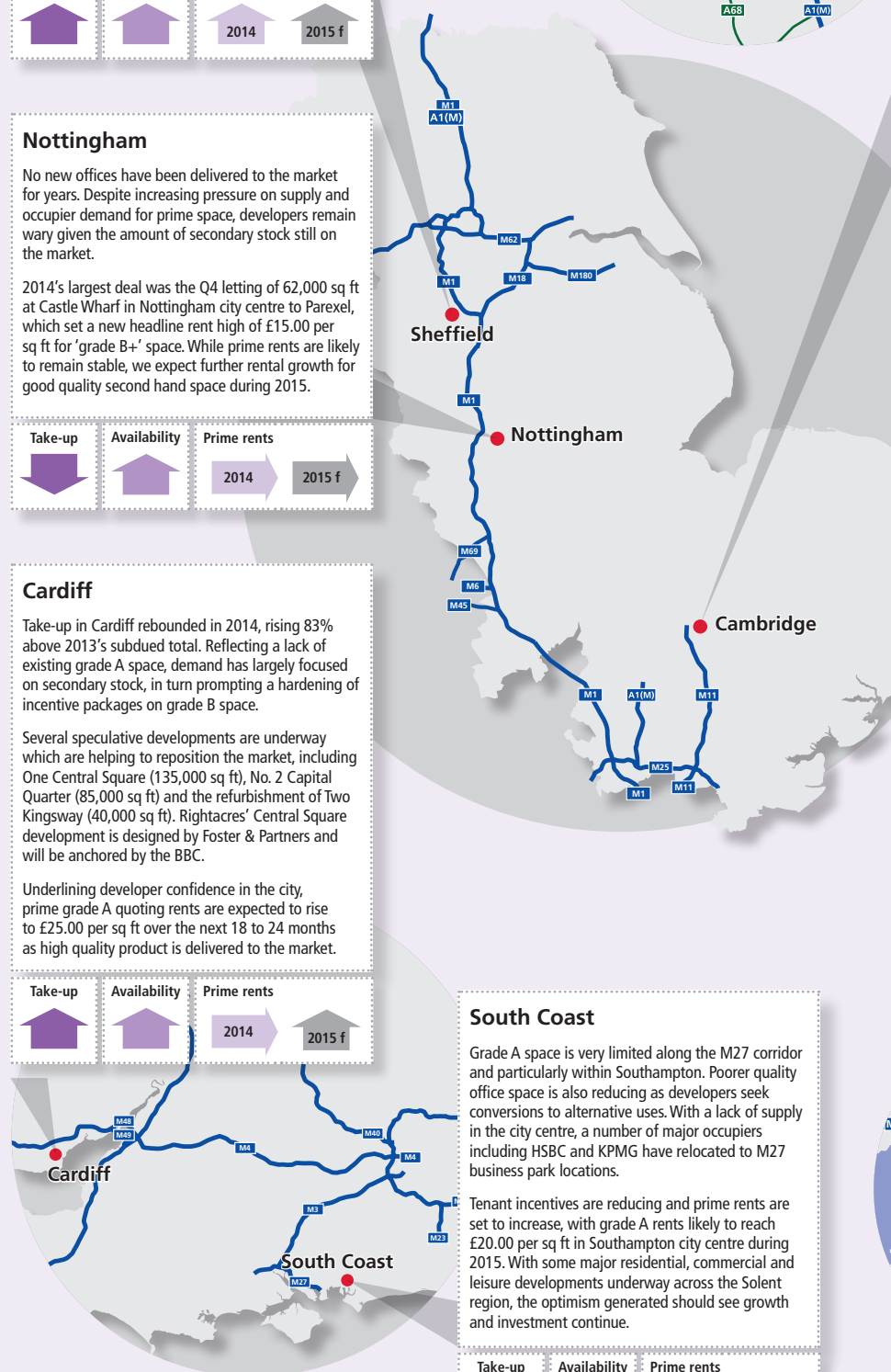
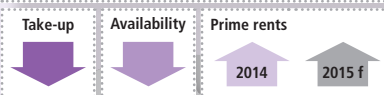
Prime headline rents are expected to reach £37.00 per sq ft during 2015 as new space comes forward around Cambridge station, while ten-year term certain leases will be secured on all new builds. With limited capacity for development in the city centre, occupiers will increasingly have to compromise on their space solutions. Out-of-town parks and science parks will capitalise, with new space and new record rental tones.



Belfast

Belfast has just a handful of available large floorplate options for grade A space, although the CQ1 scheme will provide around 50,000 sq ft upon completion in Q2 2015. Prime rents are expected to rise to £16.00 per sq ft in 2015, while limited grade A stock will give rise to clear rental growth for good quality second hand space.

The announcement that Northern Ireland's corporation tax could be cut to match the 12.5% rate within the Republic would make Northern Ireland an even more attractive location to foreign direct investment, tempting new entrants into the market place.



Thames Valley

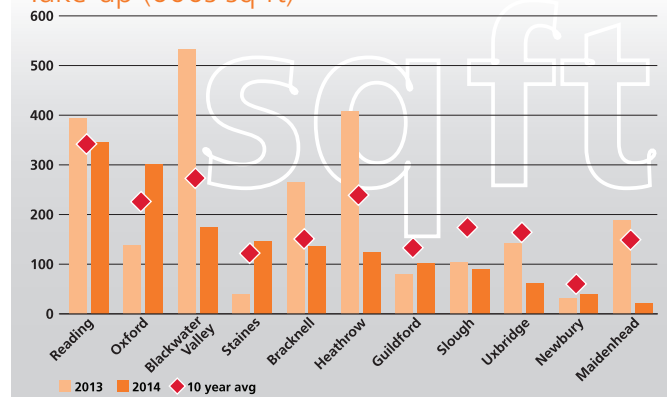
Demand

At 1.5m sq ft, take-up in the Thames Valley was disappointing in 2014, down 33% on 2013's six-year high and 23% below the ten-year annual average. However, take-up rebounded strongly after an extremely subdued first half of 2014, with Q4 take-up of 775,000 sq ft accounting for almost half the annual total.

Eight of the 11 markets recorded a year-on-year fall in take-up, although the decline was most marked in Maidenhead, which saw just a single deal of 21,800 sq ft. Guildford and Staines recorded year-on-year increases, although Oxford was the star performer, with 301,000 sq ft of take-up, 34% above its ten-year average.

Subdued take-up during the first half of 2014 can be regarded as a market 'hangover' to the significant release of pent-up demand seen in 2013. The return to form in the final quarter of 2014 is encouraging, and indicative of a return to more sustained occupier demand throughout 2015.

Take-up (000s sq ft)



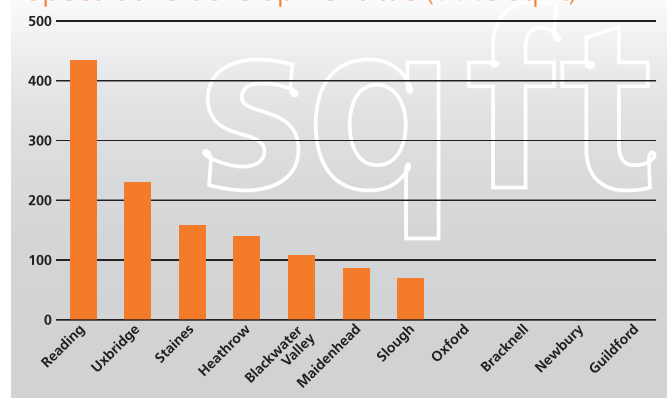
Source: Lambert Smith Hampton

Supply

The overall vacancy rate was broadly stable during 2014, edging down from 14.0% to 13.9%. While availability stands at its lowest level since 2007, the level of grade A availability has increased sharply over the past 12 months, rising from 29% to 41% of the total. This partly reflects a doubling of speculative development, with 1.3m sq ft under construction within seven Thames Valley markets at the end of 2014.

Reading is the main focus of activity, with five schemes accounting for 42% of total space under construction across

Speculative development u/c (000s sq ft)

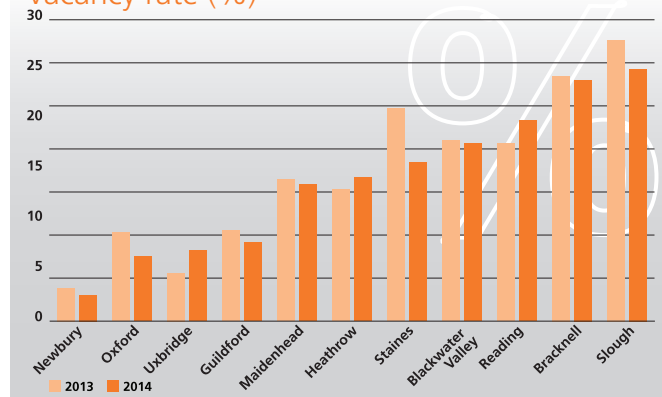


Source: Lambert Smith Hampton

the Thames Valley, the largest of which is 1 Forbury Place (185,000 sq ft). Uxbridge is home to the largest single development in the Thames Valley with 230,000 sq ft underway at Landid and Brockton's Charter Place.

Those markets seeing little or no development starts over the last 12 months have seen their vacancy rates fall. The one exception is Staines where, despite two schemes commencing during the year, the vacancy rate fell by a quarter to stand at 15.8%. 2015 is expected to see an acceleration of development activity, although this is relatively modest in comparison with previous cycles and the majority of anticipated schemes comprise major refurbishments.

Vacancy rate (%)



Source: Lambert Smith Hampton

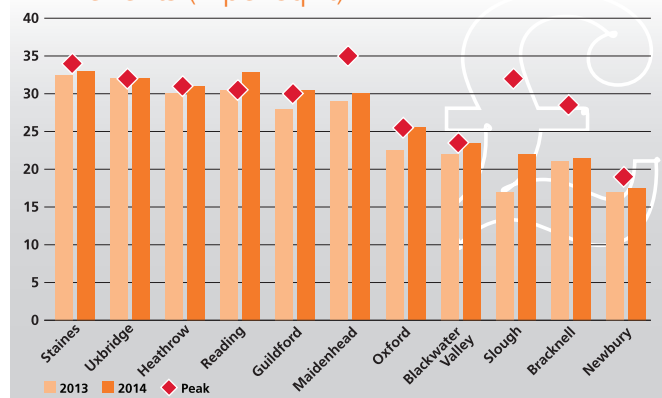
Rents

Prime headline rents increased within ten of the 11 markets during 2014, reflecting a tightening of existing grade A supply. Uxbridge was the only market which failed to register an increase, albeit strong growth took place during 2013.

Slough posted the strongest increase in prime rents of any market, albeit from a depressed level, rising by 29% to reach £22.00 per sq ft. Oxford also saw rents rise by 13% on 2013's level to a new high of £25.50 per sq ft, following QinetiQ's lease of 5,215 sq ft at 101 Park Drive, Milton Park.

The Thames Valley area has moved into a clear cycle of rental growth and, barring any economic shock, we expect upward momentum to continue over the medium term. However, pricing remains considerably below peak levels in real terms, while rents in a number of markets, such as Bracknell and Staines, continue to stand far below their historic peak in nominal terms.

Prime rents (£ per sq ft)

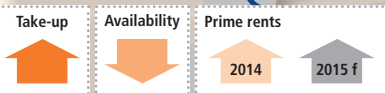


Source: Lambert Smith Hampton

Oxford

There is an acute shortage of available grade A space in Oxford and South Oxfordshire, currently totalling 29,000 sq ft and with very little coming through in the pipeline.

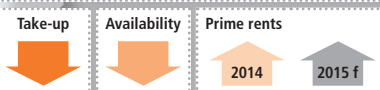
MEPC speculatively developed 101 and 102 Park Drive at Milton Park, both totalling around 28,000 sq ft, achieving rents of £25.50 per sq ft. With very little available accommodation in Oxford city centre, activity will remain focused out-of-town, with headline rents expected to rise to £26.50 per sq ft before the end of 2015.



Maidenhead

The market eagerly awaits the arrival of Crossrail and WRaTH. Crossrail will provide a single, faster, more convenient route into Central London and WRaTH will bring Terminal 5, Heathrow to within 16 minutes of the station.

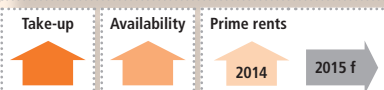
Investors are competing for limited stock, while occupiers are beginning to position themselves on the back of Maidenhead as a Crossrail destination. With the new developments of Point and TOR now completed, prime rents are set to exceed £30.00 per sq ft once more in the town centre.



Slough

Confidence is returning to the market as preparation continues for Crossrail and WRaTH. Investors are now committing to speculative development, with SEGRO's 234 Bath Road (69,965 sq ft) underway and set to complete in Q1 2016, and the refurbishment of 25 Windsor Road also progressing.

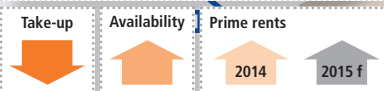
Slough is a hotspot for permitted development, with circa 300,000 sq ft of office space leaving the market for change of use to residential and other alternative uses, cleansing the overhang of supply.



Heathrow and Uxbridge

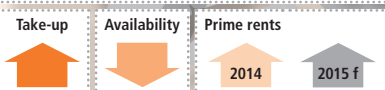
At Heathrow, Gilead's lease of 2 Roundwood Avenue, Stockley Park established a prime headline rent of £31.00 per sq ft in 2014. With grade A availability restricted to 4 The Square, we are confident that this will be surpassed in 2015. Aberdeen Asset Management and Exton Estates are currently on site with the 140,000 sq ft redevelopment of 4 Roundwood Avenue (now known as The Bower Building) although this is not expected to be delivered until Q2 2016.

Close to half a million sq ft of grade A accommodation will be delivered to the Uxbridge market over the next 12 to 24 months. Brockton and Landid are now on site with Charter Place (230,000 sq ft), Aviva has gained planning consent for The Belmont scheme adjacent to the station (124,000 sq ft) while Goodman plans to speculatively build out 1 and 5 at Uxbridge Business Park.



Newbury

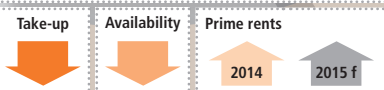
Newbury has suffered from poor rates of take-up and rental growth post-recession, with activity hampered by a lack of grade A supply. Occupiers such as Bayer (70,000 sq ft) and Aricent (18,000 sq ft) have very limited choice when considering potential office relocations. That said, we believe a prime rent of £17.50 per sq ft will be set in 2015/16.



Bracknell

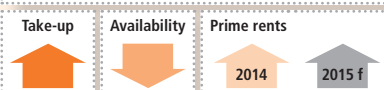
Despite a degree of rental growth in 2014, Bracknell continues to offer relative value when compared to other Thames Valley centres. While take-up has been strong in view of this, supply remains over 1m sq ft, albeit 330,000 sq ft of this exists in three large buildings.

There is scope for further rental growth in 2015 while maintaining the market's attractive discount to the likes of Reading and Maidenhead. This will be assisted by the long-awaited £200m regeneration of Bracknell town centre, which is breathing new life into the market.



Staines

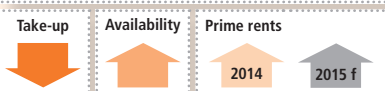
Staines was one Thames Valley market to see robust, above average take-up in 2014. This was driven by VMware's leasehold acquisition of Flow 1 and 2 at a headline rent of £33.00 per sq ft. Staines has seen significant development interest over the past 12 months, with 5 Pine Trees completing in 2014 and Strata and Building 3, Lotus Park under construction. We expect prime rents to climb again in 2015, as these schemes let-up.



Reading

Reading town centre is a key focus of development and refurbishment activity, with around 500,000 sq ft coming forward speculatively. Developers are seeking to capitalise on the improved rail infrastructure (new rail station, Crossrail and WRaTH), with the expectation that demand will be generated from businesses outside of Reading, particularly in London.

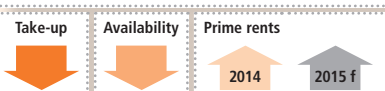
With over 1m sq ft available, Reading's out-of-town market has a significant legacy of office supply. However, Pepsi's decision to acquire over 100,000 sq ft at Green Park demonstrates the ongoing lure of high quality space offering large floor plates, good car parking and ready access to the M4 corridor.



Blackwater Valley

Below average take-up in 2014 was propped up by 70,000 sq ft of lettings at Royal Pavilion, Aldershot on discounted inclusive rental terms.

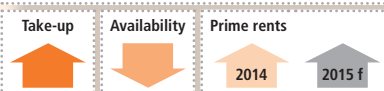
The completion of two new speculative buildings at Farnborough Business Park in Q2 2015 (48,567 sq ft and 59,643 sq ft) should establish a new rental high for the area's premier business park. Elsewhere, while rents will rise for grade A space, secondhand space will be heavily discounted given the high level of supply and limited tenant demand.



Guildford

Guildford's out-of-town market is expected to attract the lion's share of activity in 2015, as occupiers become increasingly frustrated by a lack of choice in town. While further prime rental growth in the order of 5% is expected in 2015, the lack of new stock in the town centre might prevent this.

Two consented sites in the town centre, each of 90,000 sq ft, were sold for residential development in 2014. However new speculative development at Walnut Tree Park (buildings of 12,000 sq ft and 24,000 sq ft) is due to commence in Q2 2015.



Rest of the UK

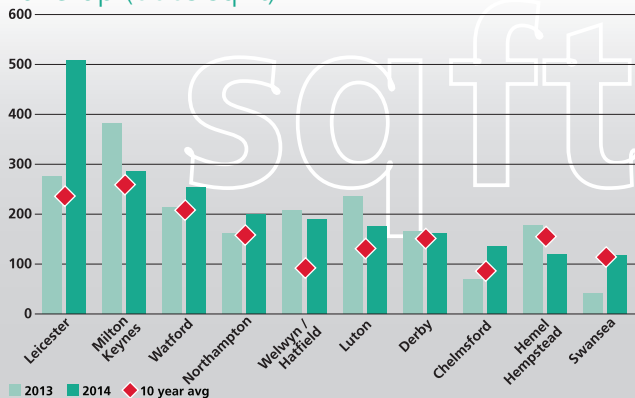
Demand

Following a strong year in 2013, the ten office markets which make up the Rest of the UK enjoyed another marked increase in activity in 2014. In aggregate, take-up in the Rest of UK markets increased by 11% year-on-year, and was 35% above its ten-year average.

Given the potential impact of the changing nature of occupier demand on non-core regional markets – such as centralisation, fewer office locations and agile working – this positive result is rather unexpected, and is best explained by a significant improvement in business confidence to expand headcount and upgrade accommodation across the UK, regardless of location.

Half of Rest of the UK markets saw year-on-year increases in activity in 2014, while all but one recorded take-up ahead of their ten-year annual averages. Leicester and Welwyn/Hatfield were the standout performers, with 2014 take-up more than double their respective ten-year averages.

Take-up (000s sq ft)

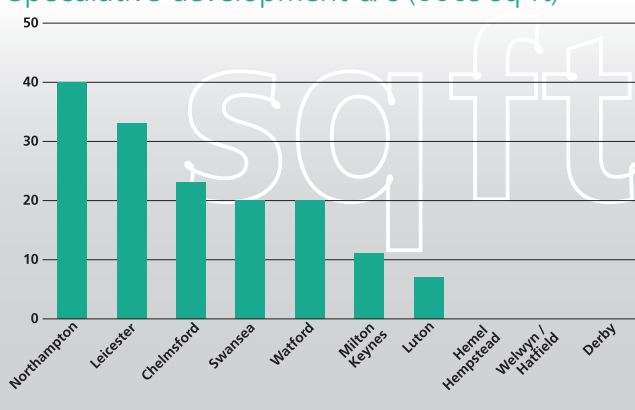


Source: Lambert Smith Hampton

Supply

The vacancy rate increased in six of the markets in 2014, although in all cases the rise was marginal. While Derby has the most elevated vacancy rate by a clear margin, at 20.1% at the end of 2014, over half of availability comprises relatively unattractive, borderline-obsolete grade C space. Notably, the four markets which saw a fall in their vacancy rate were all in the East region.

Speculative development u/c (000s sq ft)

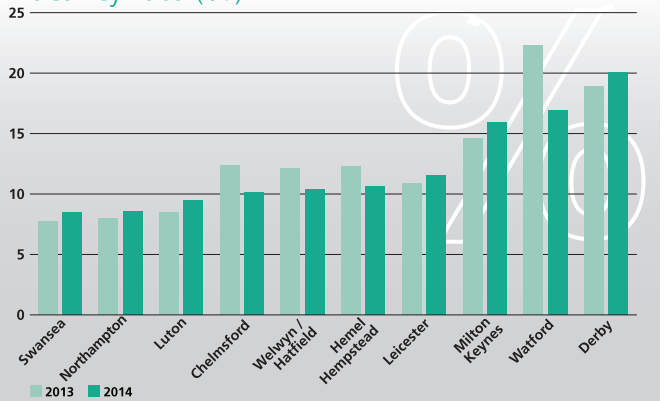


Source: Lambert Smith Hampton

One trait shared by a number of the rest of UK markets is a severe shortage of available grade A space. This is certainly the case in the East Midlands, with grade A making up approximately 10% of total availability in Leicester, Northampton and Derby, and also applies to Chelmsford (6%) and Milton Keynes (11%). Moving forward, it is critical that new supply is delivered in these markets if activity is going to be sustained at robust levels.

Speculative development made a fuller return to the Rest of the UK markets during 2014, although it remains muted, standing at 153,000 sq ft overall. Development has spread from three to seven of the ten markets, with Northampton showing the most activity with 40,000 sq ft coming forward at Innovation Cube.

Vacancy rate (%)



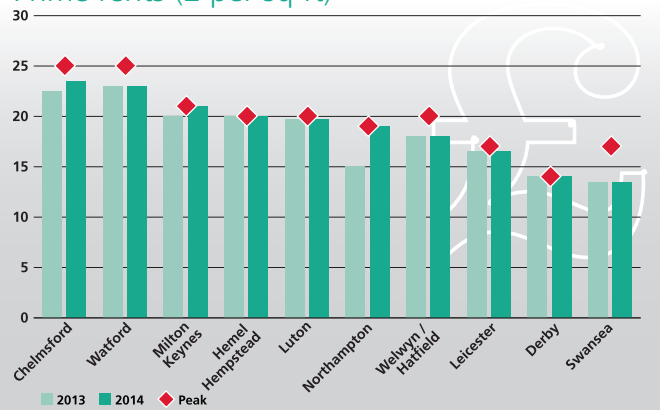
Source: Lambert Smith Hampton

Rents

In contrast with the UK's larger office markets, evidence of prime rental growth in 2014 was more limited across these smaller centres. That said, with good quality supply diminishing, upward pressure on rents has been seen in net effective rents through a hardening of incentive packages.

Northampton was the one clear exception to the rule in 2014, with headline rents rising from a low level of £15.00 per sq ft to £17.00 per sq ft. This reflects the severe shortage of existing grade A space and the impending arrival of new grade A stock to the market. As the recovery in the economy gains further traction, we anticipate more of the smaller markets will see rising prime rents, as and when new space is delivered to the market.

Prime rents (£ per sq ft)

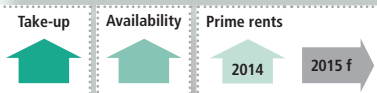


Source: Lambert Smith Hampton

Northampton

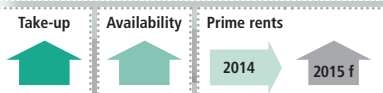
The town centre is on the cusp of a renaissance with over £500m of investment planned over the next four years. The key office scheme in the pipeline is the Kier Property-led FOUR Waterside which will deliver up to 225,000 sq ft in central Northampton.

With under 10,000 sq ft of grade A space available, prime rents are set to return to their previous peak of £17.50 per sq ft. Occupiers are also considering pre-let options, reflecting the lack of choice in the market.



Derby

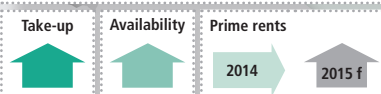
Derby will see a number of large office buildings converted to residential use during 2015, as was seen in Nottingham in 2013. With grade A space accounting for only 9% of availability, we expect upward pressure on rental levels in 2015 as occupiers start to compete more actively for the limited quality stock that remains.



Leicester

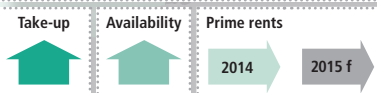
Grade A supply remains extremely tight, both in town and out-of-town. However, the latter will receive a boost with 33,000 sq ft completing at Watermead Business Park in June which is expected to set a new headline rent for the out-of-town market of £17.00 per sq ft.

Within the city centre, two key inward investment deals totalling 85,000 sq ft are due to be completed in Spring 2015. This will put added pressure on existing supply, with headline rents at Colton Square now at an historic high of £17.00 per sq ft.



Swansea

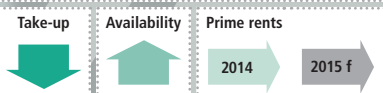
Demand remains dominated by indigenous companies with little by way of inward investment during 2014. One speculative city centre office development is set to complete in Q4 2015, bringing approximately 15,000 sq ft of new grade A space to the market. While headline rents are not expected to increase beyond their current levels, incentive packages will continue to harden.



Luton

The market continues to be restricted by poor quality stock in the town centre and limited development out-of-town. Prime rents show a marked discount to other south eastern markets, despite Luton's excellent road, rail and air connections.

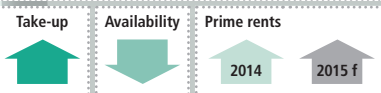
However, Luton has benefitted from significant infrastructure spending which will help to support the delivery of Napier Park. The 60 acre brownfield redevelopment of the former Vauxhall Motors site includes 340,000 sq ft of design and build grade A office opportunities.



Chelmsford

2014 was Chelmsford's strongest year of take-up since 2008. With a marked improvement in demand in the latter half of 2014, 2015 is expected to outperform last year.

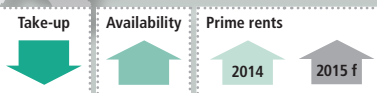
The area around Chelmsford station is a hive of activity. Genesis has completed its 24,000 sq ft upgrade of the former Anglia Ruskin University Law Building (24,000 sq ft), while Phase 2 of this site - known as City Park West - will provide a further 41,000 sq ft. Bellway is seeking pre-lets for a proposed 60,000 sq ft development on the former Marconi site, with quoting rents of £26.00 per sq ft.



Milton Keynes

Milton Keynes is severely undersupplied with grade A space, the level of which hardly befits its status as the UK's fastest growing city. With over 8,000 jobs created over the last 12 months and road infrastructure improvements due to commence in 2015 (A421 link to Junction 13 of the M1), Milton Keynes is well placed for development.

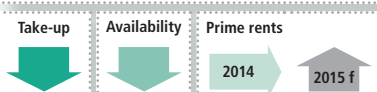
The lack of grade A space has driven a sharp movement in rental growth for refurbished space, with rents reaching around £19.00 per sq ft. Grant Thornton is expected to take a pre-let of circa 20,000 sq ft at Victoria Square, which will see the delivery of much needed grade A space to the market and set a headline rent of circa £22.00 per sq ft during 2015.



Hemel Hempstead

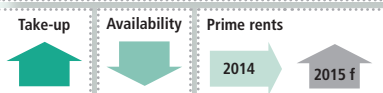
While take-up in Hemel Hempstead improved year-on-year, activity slowed significantly in the latter half of 2014 reflecting a dwindling supply of stock. Hemel has been affected by Permitted Development Rights, with large swathes of offices leaving the market for residential conversion.

However, two sizeable buildings are coming back to the market, namely 90,000 sq ft at Breakspear Park and 145,000 sq ft at Diamond Point. Both are due to be refurbished and, once completed, will be two of only a handful of offices that can accommodate larger requirements in Hertfordshire.



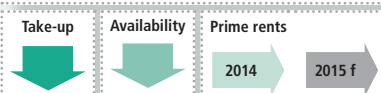
Watford

Take-up in Watford was robust in 2014, surpassing the pre-recession peak of 2007. Rents have steadily increased, particularly around the main office hub of Clarendon Road, with prime rents expected to rise to £24.00 during 2015. Permitted Development Rights have reduced the levels of supply within the town and, while this is putting upward pressure on rents, it could restrict take-up as choice becomes more restricted.



Welwyn / Hatfield

With little new office development coming forward and keen developer interest in residential conversions, Welwyn / Hatfield is one of the few Hertfordshire locations where there are still good levels of availability. There remain several grade A buildings in Welwyn, some of which are still seeking an occupier since their completion in the previous cycle.



Our office agency team

Whether you're an investor, developer or occupier, in the corporate or public sector, a local business or an international brand, we can help with all your office property needs.

We have a proven track record of delivering results: securing the best locations, maximising office space and reducing organisations' property costs.

Each year we let, acquire or sell around 7m sq ft of office space – transacting around 40% of many of the regional office markets. This means our clients benefit from our deep understanding of their market and its likely requirements.

With a national network of offices across the UK, we can provide detailed, on-the-ground advice for every major town and city.

Our services include:

- For landlords: advice to maximise asset value, letting, marketing strategy, enhancing rental values and filling voids
- For tenants: advice on dealing with leasing issues such as subletting, assignments and disposal
- For businesses looking to relocate: everything from finding you the right office space to negotiating terms and seeing the transaction through to completion
- For developers: office agency advice throughout the process, from pre-letting through to marketing of the finished office property.

About us

We are a commercial property consultancy working with investors, developers and occupiers in both the public and private sectors across the UK and Ireland.

Amazon to Zurich: we have partnerships with the complete A to Z of the best organisations in Britain and Ireland.

Transport to telecoms: we have experience of an extremely wide range of sectors.

Capital markets to construction consultancy: we serve an incredibly diverse range of commercial property disciplines.

We value lateral thinking and celebrate enterprise, with a focus on delivering more for our clients. By looking beyond the obvious, we consistently generate impressive results.

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Details of Lambert Smith Hampton can be viewed on our website www.lsh.co.uk

Due to space constraints within the report, it has not been possible to include both imperial and metric measurements.

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