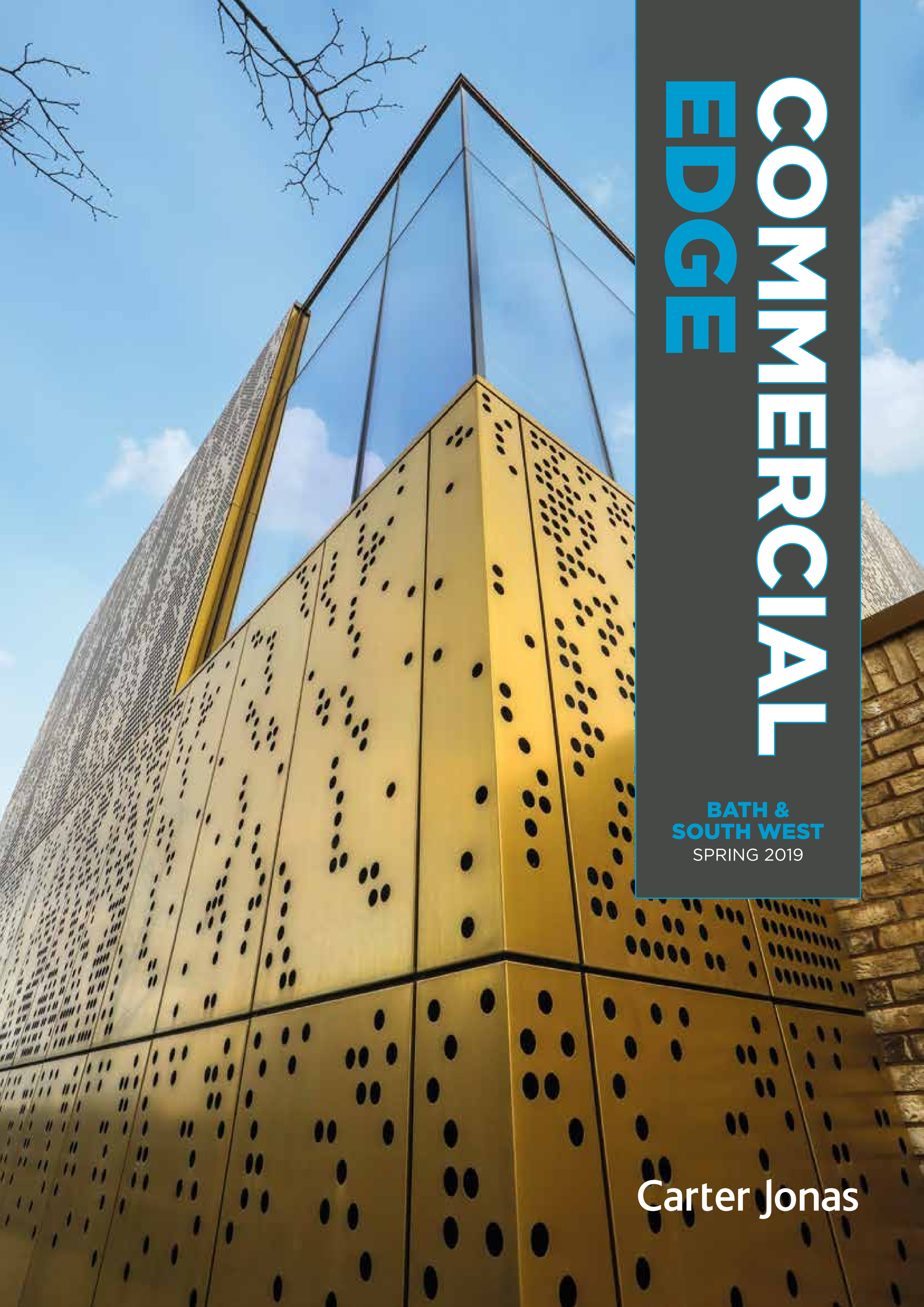


COMMERCIAL EDGE

BATH & SOUTH WEST

SPRING 2019

Carter Jonas

OUTLOOK SUMMARY

- There is an acute shortage of quality supply across the office market and limited or no speculative development. Demand has remained strong despite the wider economic uncertainty and there remains upward pressure on rental values.
- A number of potentially transformative office/mixed-use schemes are in the pipeline in Bath and Bristol. However, development will need to be phased to avoid replacing a problem of undersupply with one of oversupply, and the size and type of space provided will need to be appropriate for market demand.
- In the retail sector there is a trend towards smaller independents in many markets across the region. We believe this will help support city centre retail with institutional investors and other landlords being more flexible on covenant 'tests'.
- Occupier demand in logistics and e-commerce continues to be buoyed by structural change, and this is driving developer interest for speculative schemes across the region. However, as distribution requirements become increasingly bespoke, more occupiers are looking to buy land and develop their own buildings.

DRIVERS OF GROWTH

Our Commercial Edge report focuses on Bath and also considers the wider South West context, looking at the neighbouring markets of Bristol, Exeter, Swindon and Taunton.

Over the last five years, these five local authority areas combined have seen **economic growth** (GVA) of around 2.4% pa, above the UK average of 2.2% (Experian). Bristol has led the charge at 2.8% pa. These markets have a **diverse economic base, including a strong knowledge economy** and a market-leading higher education sector, with two universities in both Bath and Bristol.

Tourism is also a major sector, focussed on Bath, which has seen significant increases in hotel bed availability and occupation over the last two to three years, in addition to rapid growth of the Airbnb market. According to Visit Bath, the city sees nearly five million day visits per annum, over a million of which are overnight stays.

Population growth has been rapid over the last decade, with the five locations seeing growth of nearly 11%, an additional 110,000 people. Whilst this is expected to slow a little over the next decade, a rise of more than 6% is projected, above the national average. Bristol is forecast to see its population increase by 7.3% (Experian).

Office supply shortages are a feature across all of the key markets. However, over the medium term, a number of schemes have the potential to deliver the type of high quality space required by today's occupiers, and will help to drive economic growth by attracting high quality employers.

Bath & North East Somerset Council's **Bath Quays South** scheme is now on site, with completion of the first phase targeted for 2020 at the earliest. This will deliver 46,000 sq ft of new build speculative offices (incorporating 10,000 sq ft floorplates) plus the refurbishment of an existing building to provide nearly 50,000 sq ft of studio space.

The **Bath Quays North** scheme is also moving forward, and the Council is due to announce its development partner very shortly. The scheme will provide a significant boost to the market, with the potential to provide around 200,000 sq ft of office space plus residential and complementary retail uses. A new, much needed, pedestrian and cycle bridge will also be provided across the River Avon.

In Bristol, several major regeneration schemes are proposed. These could significantly increase the commercial floorspace in the city centre, assist with regeneration, and provide additional dwellings to help cater for the rising population over the medium-long term. These include Broadmead; The Fire Station; McArthurs Warehouse and further development within the Temple Quarter Enterprise Zone surrounding Temple Meads station (commenced in 2012), where the University of Bristol is also building a new campus.

The region is benefiting from a number of **transport infrastructure enhancements**, the most high-profile of which is the **electrification of the rail line from London to Cardiff**. Although the project has suffered from delays and has been scaled back from the original proposals, the upgrade from London to Bristol Parkway is now operational, and work to complete the scheme from Parkway to Cardiff is under way. However, the upgrade of the route into Bath and Bristol Temple Meads has been postponed, with no definitive timescale.

Other major enhancements include **a new junction on the M49** enabling direct access to the Avonmouth and Severnside Enterprise Area, due for completion by the end of this year. North-south connectivity has been enhanced by the **dualling of the A350** around Chippenham in Wiltshire, benefitting towns to the south of the M4. In addition, the **Severn Bridge toll has now been lifted**, reducing road transport costs between the South West and South Wales and already adding economic attraction to the Welsh side of the bridge.

The first **Metro Mayor**, for the combined authorities of Bristol, South Gloucestershire and Bath & North East Somerset, has been appointed with an anticipated increase in the city's dynamism, leading to a more joined up regional strategy, and greater autonomy.

KEY ECONOMIC AND BUSINESS STATISTICS

Source: Experian, ONS, Thinkbroadband, Land Registry
**England*

	SOUTH WEST	UK
ECONOMIC GROWTH LAST 5 YEARS	2.4% pa	2.2% pa
OUTPUT PER HEAD	£23,695	£26,600
EMPLOYMENT GROWTH LAST 5 YEARS	1.5% pa	1.5% pa
UNEMPLOYMENT RATE (ILO)	2.9%	4.2%
GCSE AND EQUIVALENT AVERAGE ATTAINMENT 8 SCORE	46.5	44.3*
BUSINESS BIRTHS PER 1000 PEOPLE 2017	4.5	5.7
BUSINESS SURVIVAL RATE	45.8%	43.2%
ULTRAFAST BROADBAND COVERAGE (OVER 100 MBPS) % OF PREMISES	48.0%	56.2%
AVERAGE HOUSE PRICE	£256,427	£230,776
AVERAGE HOUSE PRICE GROWTH	2.9%	2.5%

Figure 1 Economic Growth by Local Authority
Source: Experian

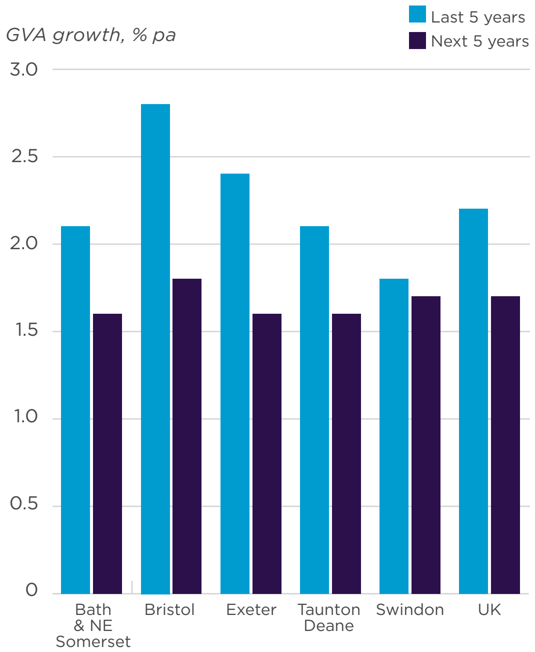
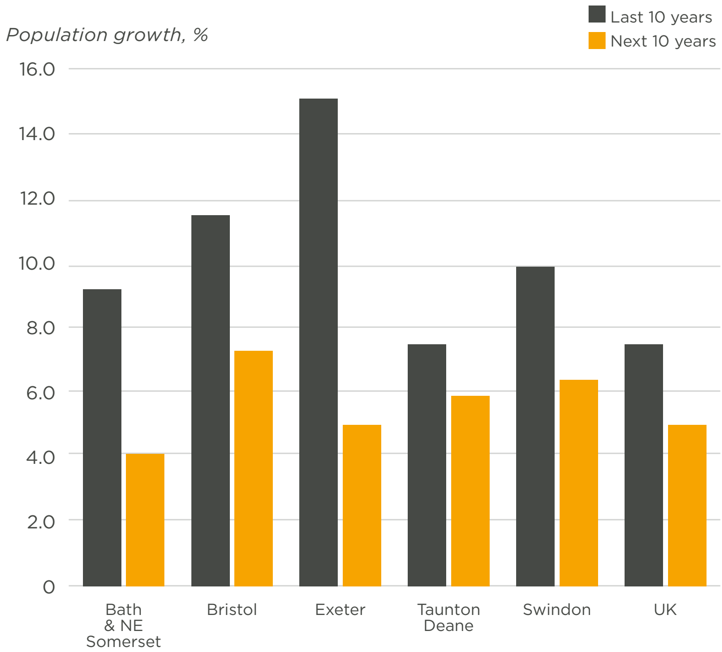


Figure 2 Population Growth by Local Authority
Source: Experian



OFFICE MARKET

PRIME RENT, BATH
£28.00 PSF

2018 TAKE-UP, BATH
115,000 SQ FT

AVAILABILITY, BATH
45,400 SQ FT

TAKE-UP IS BEING SUPRESSED BY A LACK OF QUALITY SUPPLY.

The Bath office market is in good health, with demand from a wide range of occupiers. The media and tech sectors have been the biggest growth areas in recent years, although we are yet to see a really sizeable letting.

Actual take-up is being suppressed by a **lack of quality supply**, and is also being partially obscured by the **large volume of serviced office space** coming onto the market over the past 18 months, which has absorbed a considerable volume of the smaller requirements. Smaller tech occupiers in particular are increasingly taking space in serviced offices, and so are not appearing in the direct take-up statistics.

Take-up in Bath has averaged just a little under 100,000 sq ft pa over the last decade, and **has been relatively consistent** within a range from 75,000 - 120,000 sq ft. The 2018 figure was strong and towards the top end of this range with 115,000 sq ft transacted (see Figure 3).

For occupiers, **the quality of the building** and its environment **is now more important than the location**. This is making it increasingly difficult to let some of the traditional low quality space available, despite the high level of overall demand, with most occupiers demanding open plan space on a single floor.

Given this, **occupiers are becoming increasingly footloose between Bristol and Bath**, and with the shortage of supply in Bath, several occupiers have chosen to locate in Bristol and the surrounding towns. However, quality supply in Bristol is also heavily constrained, which limits the extent to which this occurs.

Whilst no space is set to be delivered in Bath over the next 12 months, **development is moving forward**, with Bath & North East Somerset Council looking to deliver around 250,000 sq ft of floorspace to address the supply shortage and attract new occupiers to the city at Bath Quays (see "Drivers of Growth" section).

A key trend is change of use, and an increasing amount of **retail space is now being converted to offices**. Indeed, we believe as much as 100,000 sq ft could be converted over the next two to three years.

Rental growth has been strong in recent years, although it is decelerating due to falling affordability, and **average rents are now hardening more than prime**, with few deals now below £20.00 psf. We now view the prime rent as being £28.00 psf, up from £26.00 psf a year ago, although there have been a small number of outstanding deals which have achieved just over £30.00 psf. The £28.00 psf figure is not for grade A space, due to its current absence from the market, and we have no doubt that the true prime, grade A figure would be closer to Bristol numbers (see below).

In Bristol, take-up was above the long-term average in 2018, but was held back by the **lack of quality space on the market**. However, a number of schemes are on site that will deliver **additional space over the next two years**. This includes 200,000 sq ft at Temple Quarter, plus just over 90,000 sq ft at the Distillery, Glassfields, and space under refurbishment at 2 Trinity Quay. Out of town, there is a similar lack of supply and little space coming forward. The supply/demand imbalance is pushing city centre headline rents towards £35.00 psf.

Exeter city centre remains very tightly constrained. Although more than 70,000 sq ft of space completed in 2018, most of this was pre-let or has now been taken, and there is no development currently under way or imminent.

Take-up in **Swindon** was lacklustre in 2018 with transactions that totalled around 80,000 sq ft, and an average deal size of under 3,000 sq ft. The market continues to be focussed out of town, with a lack of quality stock in the town centre. There was only one significant transaction; housebuilder Bloor Homes' development of a headquarters building at Gateway North for its own occupation. The prime rent has been stable over the last year at £18.50 psf.

Overall supply in the **Taunton** market has been increasing, as a number of second-hand buildings have returned to the market either through lease expiries or as a sublet. With take-up healthy, and focused on smaller requirements, we do not anticipate much change in values during 2019.

Figure 3 Bath office take-up
Source: Carter Jonas

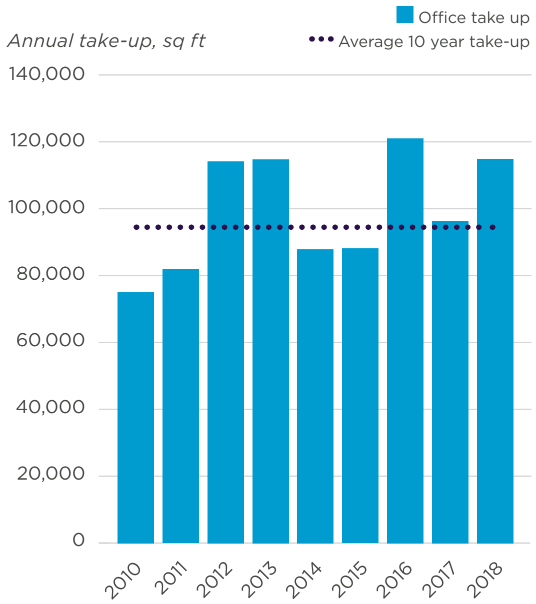


Figure 4 Bath prime office rents
Source: Carter Jonas

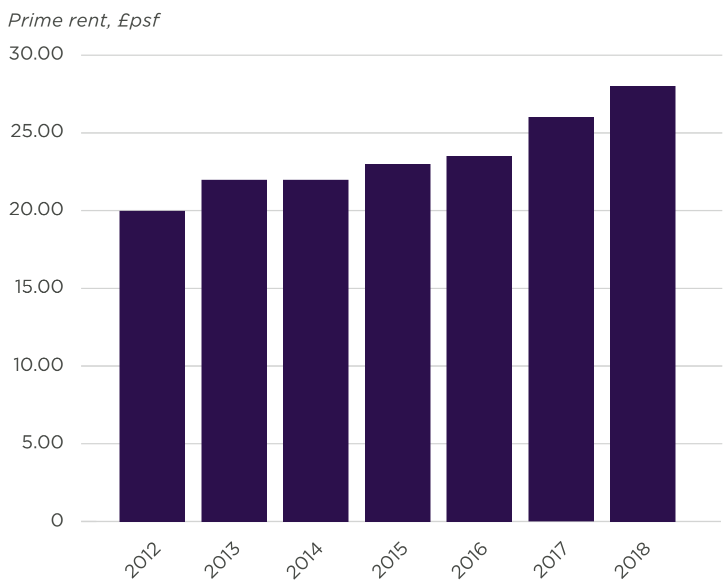


Figure 5 Prime office rents
Source: Carter Jonas

INDUSTRIAL MARKET

PRIME RENT, BATH
£12.50 PSF

2018 TAKE-UP, BATH
15,000 SQ FT

AVAILABILITY, BATH
23,000 SQ FT

The supply and demand imbalance of industrial stock persists across the region. Although the industrial market continues to show signs of resilience (particularly those industries involved in logistics and e-commerce), Brexit uncertainty is affecting the decision-making process for some occupiers. Headline rents on balance have remained unchanged with tones in the main reflecting £8.50 - £8.75 psf for Bristol and £7.50 psf for Swindon.

Nevertheless, we have seen a tremendous amount of change across the industrial landscape over the last two years with **Bristol's large distribution developments** at Avonmouth, and DPD and ALD Automotive at Emmersons Green. **The dualling of the A350 around Chippenham is benefitting towns to the south of the M4.** These are now a focus for new development, with Dick Lovett's Land Rover and BMW now co-locating with Herman Miller, The Culina Distribution Centre, Travelodge, Starbucks and Greggs.

BATH INDUSTRIAL STOCK LEVELS ARE NOW CRITICAL, WITH FEW IF ANY OPPORTUNITIES FOR NEW DEVELOPMENT.

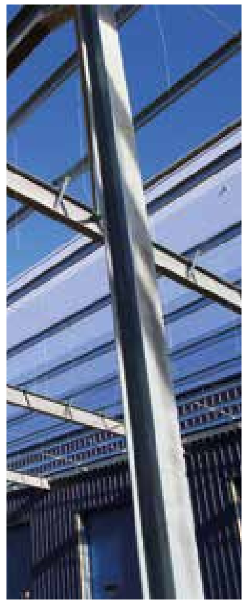
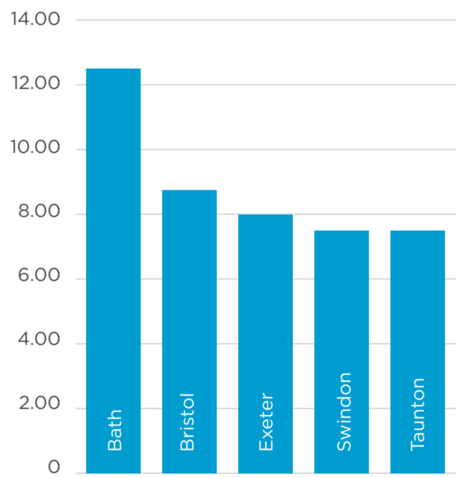


Figure 6 Prime industrial rents
Source: Carter Jonas



Swindon is the clear winner in terms of 'big box' transactions for 2018, with the design and build letting of 375,000 sq ft to B&Q at £6.25 psf and the letting of DB Symmetry's 211,000 sq ft building to Iceland at £6.75 psf, the latter representing the largest speculative development in the region. The biggest deal in Bristol extended to 115,000 sq ft at Horizon 38 which was let to automotive parts supplier Apec Braking at £7.25 psf.

Developer interest for speculative new build across the region is now more evident with demand for sites becoming stronger. Bristol has been the front runner for speculative new build commencing or nearing completion. **The focus for development is around the new junction on the M49 at Avonmouth**, where the developers Richardson Barberry have purchased around 40 acres for £12.9 million to undertake speculative development. Construction is now underway and will deliver 556,475 sq ft in 12 buildings adjacent to Amazon, The Range and Lidl.

Bath industrial stock levels are now critical, with few if any opportunities for new industrial development. With more industrial buildings being lost to other uses the exodus of good companies continues. This year the Pickfords Warehouse on the Lower Bristol Road is being redeveloped for student accommodation.

Those companies looking to serve the Bath market are being **forced to seek opportunities outside the city**. For example, Roper Rhodes acquired 200,000 sq ft at Portishead in Bristol, Hawker Joinery relocated its workshops to Frome, and AJ Removals satisfied the storage arm of its business at Hallatrow. Nevertheless, Thomas Firbank Removals have managed to buck the trend by taking a compound on the Lower Bristol Road.

With the severe shortage of supply and healthy demand, **rents for small business units would easily top £12.50 psf** should the opportunity for speculative construction arise.

There is a **growing trend by occupiers looking to buy land and develop their own buildings**, following in the footsteps of Amazon, Lidl and The Range. The main driver is the desire for greater control as well as bespoke fit-out requirements.

RETAIL MARKET

PRIME RENT, BATH
£205 PSF ZONE A

BATH VACANCY
STABLE

"WITH MORE UNIQUE AND QUIRKY OFFERINGS IN BATH, WE SEE A TIME OF EVOLUTION AHEAD.

Given the turbulence being experienced across the UK retail market, Bath has had a relatively good year, although conditions are less favourable in some of the surrounding market towns.

The backdrop will remain challenging, and it is likely that further national operators will go into administration or seek CVA arrangements this year. However, Bath has the ingredients to fare better than many other locations, given its **healthy tourism sector and an above average number of independent retailers.**

Vacancy rates in Bath have remained fairly stable over the last year and are still very low compared to national trends. It is taking longer for transactions to complete, with occupiers being more cautious, and some landlords are having to be more accommodating to secure transactions in vacant units.

Retailers are becoming more selective in terms of the units they want to occupy, with a preference for modern units, and newer units are re-letting much more quickly. Repairing liabilities are a big issue, especially due to the type of stock in secondary locations. In contrast, **prime stock in good condition tends to let without problem**. The overwhelming majority of retail properties in Bath city centre are listed, and these now require an EPC, which is increasing timescales further, particularly as the interpretation of the legislation is not straightforward.

Some secondary parts of Bath city centre have seen rents fall whilst others have seen stable rents. The **current prime rent**, applicable to Old Bond Street, parts of New Bond Street and Milsom Street, is £205 psf Zone A. Bath's main shopping centre, **the SouthGate Centre is trading well** and has no vacancies at the time of writing. However, in other locations such as Milsom Street, Old Bond Street, and New Bond Street there are several long-standing voids, resulting in downward pressure on rents in this area for poorly configured units.

Overall, shoe shops, hairdressers and service outlets are trading well and seeking space. **Cafes and restaurants also performing favourably** with new openings of Comptoir Cuisine and Beckford Bottle Shop in Bath. The big chain caterers are scaling back, especially those that have expanded too quickly. This has left a gap for smaller independents, who are taking the vacated space at slightly cheaper rents. We have also seen a number of prime requirements satisfied in the banking sector.

This overall trend is having a positive impact as the **market is becoming more differentiated from the 'identikit' high street**, with more unique and quirky offerings, which is in line with consumer trends. Indeed, Bath already has a significantly above average volume and quality of independent retail provision and this is a major attraction for visitors, complementing its historical significance as a tourist hub. Overall, we see a time of evolution ahead.

COMMERCIAL PROPERTY TRENDS AND VALUES

INVESTMENT IN 2018*
£729 MILLION

PRIME OFFICE YIELD, BATH
5.0%

PRIME INDUSTRIAL YIELD, BATH
5.25%

*Bath, Bristol, Exeter, Swindon and Taunton

> **TRANSACTION VOLUMES ARE BEING RESTRICTED BY THE LACK OF BUYING OPPORTUNITIES.**

Across Bath, Bristol, Exeter, Swindon and Taunton, commercial property investment totalled £729 million in 2018, a little above the £688 million recorded in 2017.

In Bath itself, **investor demand remains strong for office stock** but transaction volumes are being restricted by the lack of buying opportunities, and there have been few sizeable transactions. The rapidly changing retail market means that the industrial sector continues to be popular for corporate as well as private investors. Nevertheless, they are discerning with their choice and proposals.

Strong demand and low supply has resulted in **further yield compression over the last year**. The prime office yield has moved down from 5.25% at the end of 2017 to 5%, and indeed there have been two recent transactions at sub-5%.

The fortunes of the retail sector reflect the national trend, with **few funds seeking retail stock** in the city and there is a notable absence of private investor or property company intent. Where retail has sold, it is generally covenant led. It is also worth noting that the Local Authority in Bath has purchased other lots and has the largest stake in the retail sector in the city.

Given this, and in contrast to the office and industrial sectors, yields have moved upwards over the last year. The prime retail yield is now 4.5%, although in many cases office transactions are showing lower yields than retail ones. Given current pricing and the resilience of Bath's retail sector, we believe that **quality retail in the city represents good value**.

Key transactions in Bath during 2018 have included:

- Cambridge House, Henry St - this office-dominant property with some retail accommodation and gym, extending to 51,580 sq ft was the most significant mixed-use sale in 2018. It was sold off-market for £20.8 million in Q3 2018 at a NIY of 4.65%.
- 41 Southgate (HSBC) - this space was purchased by an Aviva managed fund for in excess of its asking price, showing an initial yield of 5.2%.
- Somerset Hall – a prime office building, in need of some modernisation but let on a long lease to a government covenant, purchased for £7.45 million representing a net initial yield of 4.84%.

Average office and industrial rental values across the South West region have seen robust growth over the last five years, with both sectors achieving just under 5% pa (MSCI/REF). Industrials were the star performer of 2018 (see Figure 8), with rental growth estimated at 5.1%, well above offices (2.8%), although growth is likely to decelerate over the next two years. Average retail property is likely to see a further fall in rental values, and we expect industrial to continue outperforming over the next three years, although the rate of growth will ease as the chart shows.

BATH RENTS AND YIELDS SUMMARY

	PRIME RENT (£ PSF)	CHANGE OVER 2018	FORECAST NEXT 12 MONTHS	PRIME YIELD
OFFICE	£28.00	↑	↑	5.0%
INDUSTRIAL	£12.50	↑	↑	5.25%
RETAIL Zone A	£205	↔	↔	4.5%

Figure 7 Bath prime yields
Source: Carter Jonas

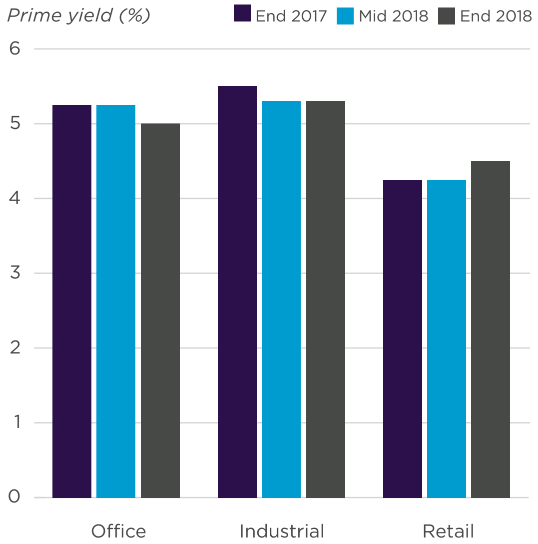


Figure 8 South West average rental growth projections
Source: MSCI, REF, Carter Jonas

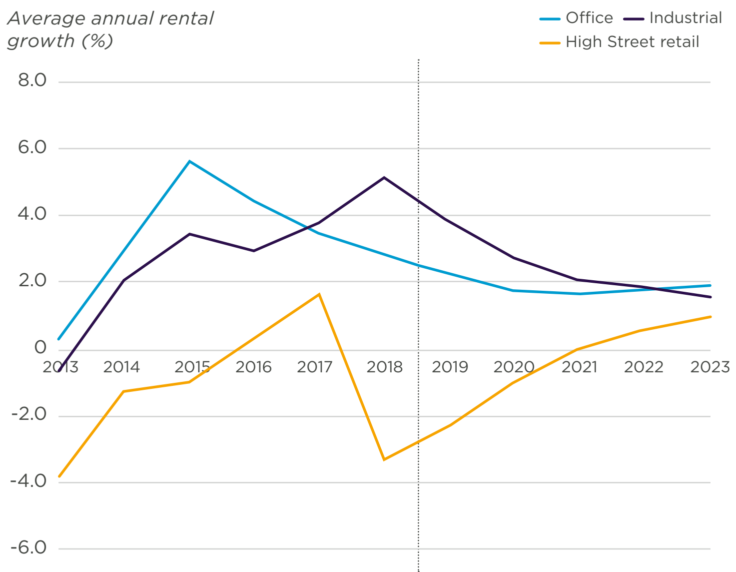
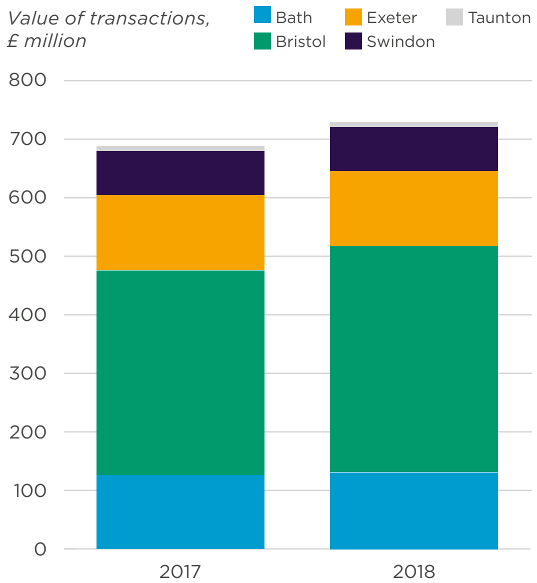


Figure 9 Investment transactions
Source: Property Data, Carter Jonas



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