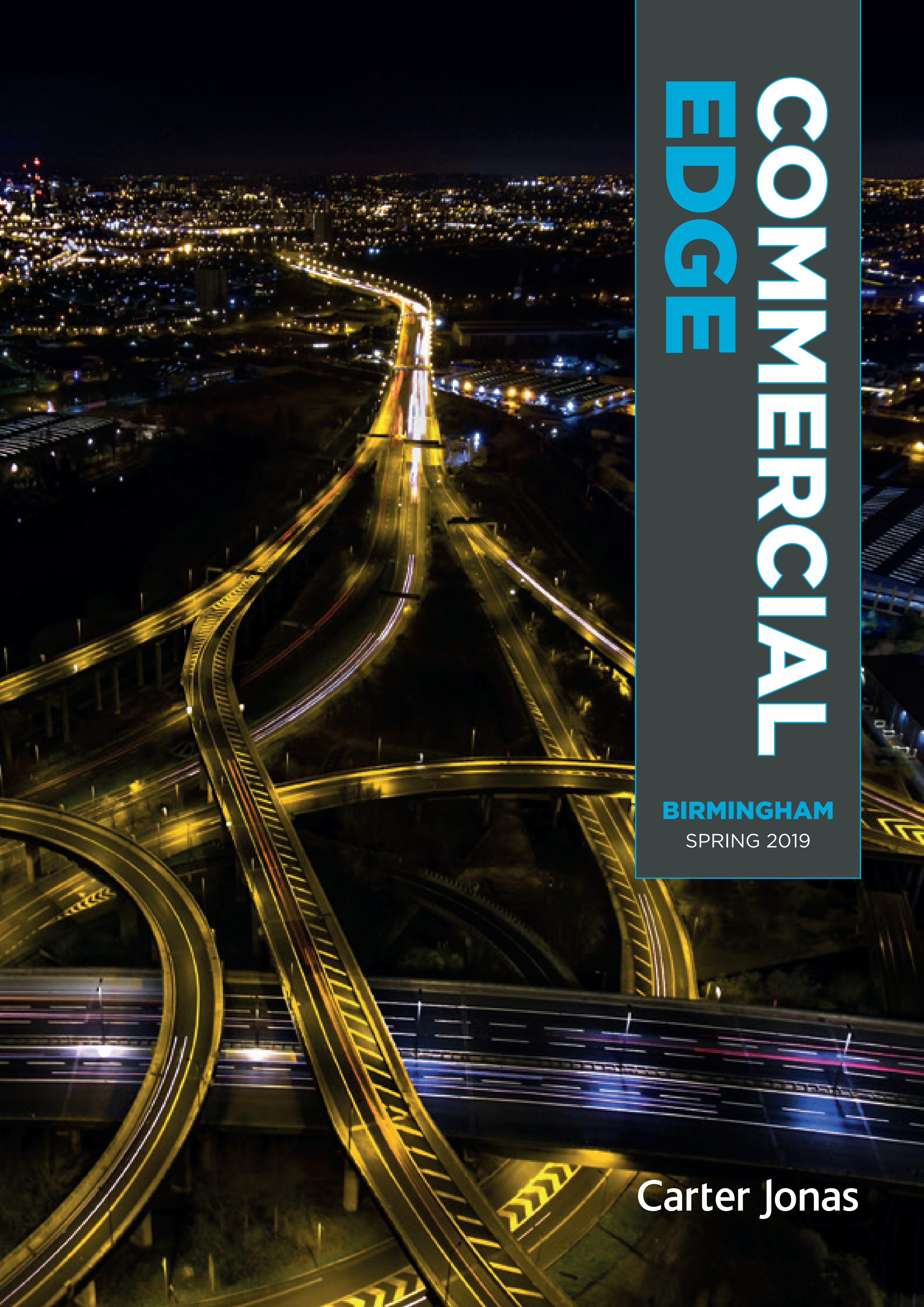


COMMERCIAL EDGE

BIRMINGHAM

SPRING 2019

Carter Jonas

OUTLOOK SUMMARY

- Birmingham has benefitted from a series of infrastructure and public realm enhancements in recent years, and HS2 will be a major catalyst for further investment and development. The city's profile will receive an additional boost from the 2022 Commonwealth Games and its status as a testbed for 5G mobile technology.
- Office availability is now at its lowest level in a decade, but this will change in 2019 with a wave of speculative development completing. We expect strong demand for this space and the prime city centre rent should push upwards towards the £35 psf mark.
- A raft of major regeneration schemes are under way or in the pipeline to further improve and extend the city core. These will provide new commercial space to cater for the city's growing employment base over the medium term.
- There is ongoing distribution demand from a variety of retailers and third party logistics operators. However, there is a severe lack of supply, limited speculative activity, and few available sites, putting upward pressure on rental and land values.
- Investor appetite for commercial property remains healthy, with continued interest from overseas buyers. A strong occupational story will underpin this over the coming year.

DRIVERS OF GROWTH

Birmingham has a population of just over 1.1 million, and 2.9 million people live within the wider West Midlands County conurbation (which also comprises the Wolverhampton, Coventry, Dudley, Sandwell, Solihull and Walsall local authority areas). This puts the wider Birmingham area on the same scale as Greater Manchester's 2.8 million people.

The city's population is forecast to grow by 5.6% over the next decade, as is the wider West Midlands County area (Experian). This is slightly ahead of the UK (5%) and well ahead of the West Midlands region (4.2%). Birmingham's employment is expected to grow by a similar 5.3%, again ahead of the UK (4.6%) and well ahead of the West Midlands region (3.7%).

Birmingham is at the centre of the West Midlands Combined Authority (WMCA). This has an elected Mayor, currently Andy Street, who is responsible for delivering the West Midlands' devolution programme, and is key for driving local growth initiatives and building on the opportunities offered by devolution.

Looking more widely, **Birmingham is a key part of the Midlands Engine**, a collaboration of 77 local authorities from across the West and East Midlands (plus a small number from surrounding regions). The Midlands Engine focusses on improving transport and skills, encouraging innovation, and promoting the Midlands as a major driver of the UK economy.

Birmingham has benefitted from **a series of infrastructure enhancements** in recent years, including the tram extension linking Snow Hill and New Street stations, redevelopment of New Street station to provide a greatly enhanced passenger experience, and the runway extension at Birmingham Airport.

Birmingham will host the 2022 Commonwealth Games, providing a major boost to the city's international profile. A significant investment has been made in the Athlete's Village at Perry Barr, on the former Birmingham City University site. After the Games, the site is proposed to provide 1,400 homes, the catalyst for wider regeneration of the area.

The West Midlands be will a testbed for 5G (the next generation of mobile communications technology), with hubs in Birmingham, Coventry and Wolverhampton. Although there are still some uncertainties regarding the rollout, it should allow Birmingham to reap early benefits from the new technology and additional sites will be required to deliver it.

The **growing life sciences sector** is increasingly important, boosted by Calthorpe Estate's ongoing development at the Pebble Mill site, helping to position it as one of the UK's leading medical and life science locations.

However, **the real game-changer for Birmingham is HS2**. Phase 1 will connect London in 49 minutes (with phase 2 providing linkages northwards), and will shift perceptions of the city. With rising costs and heightened political uncertainty, it is possible that the scheme could be altered or the 2026 start date for phase 1 could be delayed. But a major change or cancellation would be highly controversial, given the scale of investment to date.

The new terminus at **Curzon Street will underpin wider development and regeneration**, and is at the centre of the Curzon Street Masterplan. Proposals include around 4.5 million sq ft of office space, over a million sq ft of B2/B8 space, 4,000 residential units, plus retail, hotel, leisure and other uses.

The long-term regeneration of the city centre is continuing and the Birmingham Development Plan 2031 sets out **the city's strategy for the delivery of commercial and residential development**. This will support long-term growth and extend the city's core, building on the Big City Plan, launched in 2010. Birmingham is already reaping the benefits, with Paradise Circus and Arena Central delivering not only much-needed grade A commercial space, but also major improvements to the public realm.

A number of other areas within the city centre have further transformational potential. **The 17-hectare Smithfield site is a significant regeneration scheme**. Strategically situated adjacent to the Bullring and New Street station, and close to the Curzon Street area, it is set to include culture, retail, leisure, business and residential, as well as the relocated Bull Ring retail markets. The scheme has recently taken another step forward with Lendlease announced as Birmingham City Council's development partner, and could get under way in 2022. Other locations with further commercial development potential include the Snow Hill district and Martineau Galleries.

Major developments out of town also have the potential to add significantly to Birmingham's commercial and housing stock. For example at Langley, to the north east of the city, an urban extension of 6,000 homes is planned and the adjacent Peddimore could add significantly to the logistics and manufacturing stock (see the industrial market section).

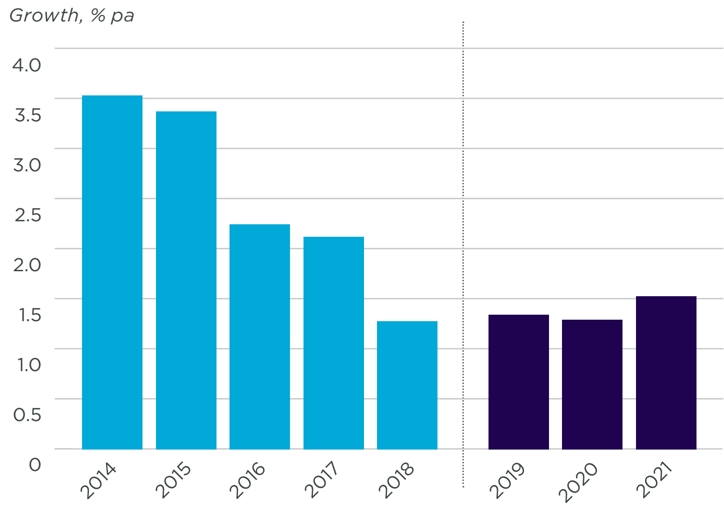
Other locations could also see significant commercial development, and the **UK Central Hub and HS2 interchange aims to maximise the potential of the new HS2 station at Solihull**. A special-purpose vehicle has been established to deliver the project across five separate sites, which together could provide more than eight million sq ft of commercial space, 77,500 new jobs and 4,000 homes over the next 20 years.

BIRMINGHAM KEY ECONOMIC AND BUSINESS STATISTICS

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

	BIRMINGHAM	UK
ECONOMIC GROWTH LAST 5 YEARS	2.8% pa	2.2% pa
OUTPUT PER HEAD	£23.510	£26,600
EMPLOYMENT GROWTH LAST 5 YEARS	1.8% pa	1.5% pa
UNEMPLOYMENT RATE (ILO)	6.7%	4.2%
GCSE AND EQUIVALENT AVERAGE ATTAINMENT 8 SCORE	45.7	44.3*
BUSINESS BIRTHS PER 1,000 PEOPLE 2017	5.9	5.7
ULTRAFAST BROADBAND COVERAGE (OVER 100 MBPS) % OF PREMISES	89.3%	56.2%
AVERAGE HOUSE PRICE (NOV 2018)	£187,756	£230,630
AVERAGE HOUSE PRICE GROWTH (YEAR TO NOV 2018)	6.2%	2.8%

Figure 1 West Midlands County economic growth (GVA)
Source: Experian



OFFICE MARKET

PRIME RENT
£33.00 PSF

2018 TAKE-UP
1.2 MILLION SQ FT

SPECULATIVE SPACE UNDER CONSTRUCTION
790,000 SQ FT

"DEVELOPERS HAVE HAD THE CONFIDENCE TO START A NEW WAVE OF SPECULATIVE CITY CENTRE DEVELOPMENT.

Birmingham has a diverse and growing employment base. In recent years, its buoyant office market has seen a number of occupiers in the banking and finance sector, such as HSBC and Deutsche Bank, take large amounts of space, benefitting from the city's high quality labour force and lower cost base compared with London.

City centre take-up totalled 754,000 sq ft in 2018, broadly in line with the 10-year average. This was considerably lower than the record-breaking one million sq ft let in 2017, a figure boosted by the Government Property Unit taking a pre-let of around 240,000 sq ft at Arena Central.

The 2018 total was achieved through **a healthy volume of small to medium sized deals**, with only one letting in excess of 50,000 sq ft (Birmingham City University, who took 118,200 sq ft at Belmont Works, Eastside). Other notable transactions in 2018 included engineering consultancy WSP taking 46,000 sq ft at the Mailbox and serviced office provider BE Offices taking around 40,000 sq ft at Somerset House.

The city's **serviced office provision could ramp up further** this year, with WeWork looking to take a sizeable amount of space, and other providers also looking, reflecting the national trend of growth in this part of the market.

There have been only **limited speculative development completions** in the city centre over the last decade and several large requirements have been satisfied recently through pre-lets or purpose-build space. As well as HSBC's building at One Centenary Square, which completed in 2018, two prelet schemes are currently well underway. These are the Government Property Unit's 240,000 sq ft at Arena Central (to be principally occupied by HMRC); and PwC's 150,000 sq ft at One Chamberlain Square.

Limited development, combined with stock lost to other uses through permitted development rights, means that **availability is now at its lowest level in a decade**, and with only limited grade A space immediately available. **However, this will change in 2019**. The lack of supply and sustained occupier demand has given developers the confidence to start a new wave of speculative development that will add momentum to the market.

Key schemes due to be delivered are Three Snowhill; Two Chamberlain Square; and 103 Colmore Row, totalling nearly 800,000 sq ft. This takes the total space under way in the city centre to around 1.2 million sq ft, about two thirds of which is speculative.

Looking to the medium term, **HS2, further city centre regeneration and the array of schemes in the pipeline** will maintain momentum on the supply side, and population and employment growth will continue to drive occupier demand.

The out of town market is focussed around Solihull, with its excellent motorway connections and proximity to Birmingham Airport and Birmingham International railway station. This includes the market's two largest office parks at Birmingham Business Park and Blythe Valley Park.

Blythe Valley Business Park is considered to be one of the premier out of town locations, and is actively promoting more sustainable transport links into the city centre, as well as new amenities, bars and cafes. This reflects the wider trend of occupiers demanding access to excellent public transport and facilities. Other smaller but important business parks are also located in the area, including Birmingham International Park, Trinity Park, Solihull Business Park and FORE Business Park.

Locations elsewhere around Birmingham include Birmingham Great Park, a mixed use location to the south west of the city centre; Quinton Business Park; and Fort Dunlop. **Activity is being fuelled by young tech businesses** and start-ups and this is helping to drive up rents, particularly for hybrid office/lab space. St Modwen is planning **further development of the 468-acres Longbridge estate** (which includes the former MG Rover Works).

Out of town take-up in 2018 was over 20% above the 10-year average, at just over 400,000 sq ft. Key occupiers to take space included IM Group, Beiersdorf, BizSpace and Instant offices.

Total take-up across the Birmingham market in 2018 was 1.2 million sq ft, slightly below the 1.3 million sq ft recorded in 2017 but above the 10-year average (See Figure 2). **We anticipate another strong year in 2019, buoyed by new space arriving in the city centre.**

The prime city centre rent is £33.00 psf, unchanged over the last year, with a typical rent free incentive of 24 months. However, it will be interesting to see what rents are achieved as new space becomes available, and **we expect the prime rent to push upwards towards the £35.00 psf mark over the next year**. The prime out of town office rent has risen to £25.00 psf, compared with £23.50 psf a year ago, and may come under further upward pressure as city centre rents rise.

Figure 2 Birmingham office take-up
Source: Birmingham Office Market Forum, Carter Jonas

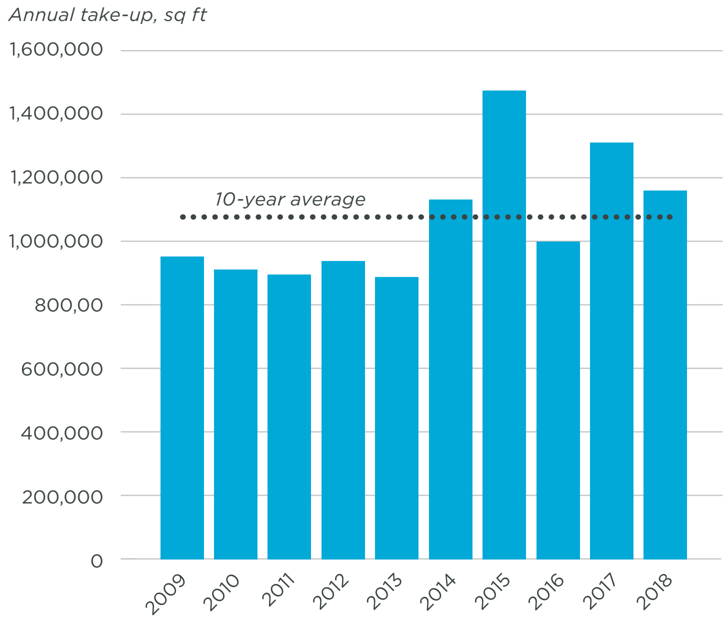
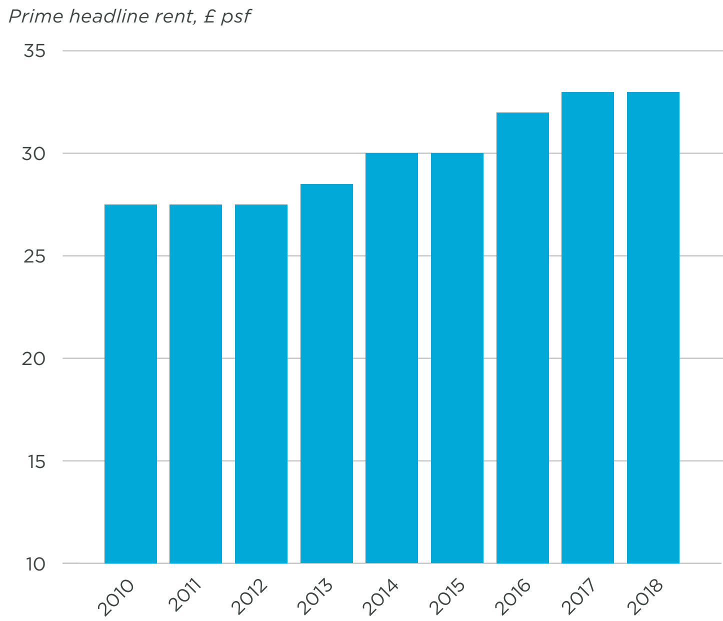
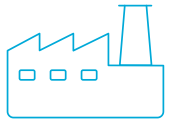


Figure 3 Birmingham City Centre prime office rents
Source: Carter Jonas



INDUSTRIAL MARKET



PRIME RENT
£6.75 PSF

WEST MIDLANDS COUNTY TAKE-UP, 2018
6.0 MILLION SQ FT

The economic base of Birmingham and the wider West Midlands has traditionally been focussed towards the manufacturing sector, which remains important today. Indeed, in recent years manufacturing has seen a resurgence, through sectors such as automotive (major employers include Jaguar Land Rover, BWM, MG and Rover), aerospace (with firms including Rolls Royce subsidiary Aero Engine Controls), and food production, with Kraft Heinz (formerly Cadburys) continuing to have a major presence. In addition, areas such as the life sciences are increasing in importance.

There are clearly concerns that slowing global and domestic demand, the struggling diesel market and potential Brexit implications are putting **pressure on the automotive sector**. Against this background, the recent announcements regarding downscaling of the workforce at JLR are not a surprise.

The city's position at the centre of the UK's motorway network means **Birmingham has evolved as a major distribution hub**, able to compete with the locations such as the "Golden Triangle" in the East Midlands.

Retailers with major distribution hubs include J Sainsbury, John Lewis and Argos, with several third party logistics operators, such as DHL, Europa Worldwide and Kuehne + Nagal, as well as the Royal Mail.

There is ongoing strong demand from a variety of operators, as retailers and their third party logistics partners adapt to growing online demand. Key transactions in 2018 have included:

- A 250,000 sq ft 15-year pre-let to KitchenCraft at The Hub, Witton at a rent of £6.25 psf
- A 124,000 sq ft global distribution hub for retailer Y International (a subsidiary of Abu Dhabi-based LuLu Group International) at the Advanced Manufacturing Hub in Aston
- Kuehne + Nagel took 268,000 sq ft at Merlin Park 2 at a rent of around £5.40 psf
- 106,000 sq ft was let to Parts Alliance Group at Prologis' Midpoint Park at a rent of around £5.30 psf

There is an undoubted **supply shortage of major distribution units and only very limited speculative activity**. However, there is some activity, for example The Hub at Witton, to the north of the city centre, where IM is building speculative units across a range of sizes for delivery in the first half of this year.

As the online retail distribution sector now requires highly bespoke warehousing solutions, developers are cautious about committing to large speculative schemes, but are more confident to build small to medium-sized units. A shortage of well-located sites for distribution use is adding to the problem, and **it is challenging to satisfy occupier demand**.

This is putting upward pressure on rental values, and our prime industrial rental index shows that **the Midlands saw growth in headline rents of 3.2% in 2018**. This compares against CPI inflation of 2.1%. In Birmingham, the prime headline rent is £6.75 psf, a rise of 17% over the last five years.

Given the shortages of land and pressure from higher-value uses **industrial land values increased sharply in 2018**, by 18% across the Midlands, compared with an average across the UK of just over 8%. Birmingham is a particular hotspot, and we regard the typical land value for unrestricted B1(c), B2 & B8 use in a prime location as £750,000 per acre, compared with £550,000 two years ago.

A significant development of up to three million sq ft of manufacturing and logistics space is planned at Peddimore. A planning application was submitted in January this year and IM has been appointed as the preferred development partner for the first phase of 37 acres. The scheme will include a new junction connecting to the A38.

RETAIL MARKET

PRIME RENT
£310 PSF (ZONE A)

Despite the headwinds faced by the UK retail sector, vacancy rates in Birmingham are relatively low. The city centre market has benefitted from significant investment in the new Bullring shopping centre, and more recently from Grand Central at the redeveloped New Street station.

Whilst there have inevitably been a number of store closures over the last year, other outlets have opened their doors, with **plenty of activity in the bars and restaurants sector**. These include Comptoir Libanais and @pizza at Grand Central; The Ivy brasserie, Gino D'acampo My Restaurant, and Serve at Temple Row; Pinocchio at the Mailbox; and Tim Hortons on the corner of New Street and Lower Temple Street.

Lush Spa has opened a new relocated store on New Street, their largest globally, and other retailers to open their doors include the H&M flagship store, relocated from the Pavilions and Harvey Jones Kitchens at the Mailbox. **This spring will see further momentum, with the opening of Primark's new 160,000 sq ft store** in the former Pavilions shopping centre, which it now owns.

There is some uncertainty over the major **House of Fraser** department store. Initially earmarked for closure, it was reprieved following the sale of House of Fraser, but owner Legal & General now has plans to redevelop the building to include office space, retail and leisure and hotel use.

Outside of the city centre, **Intu is investing in a major refurbishment of the Merry Hill shopping centre**. This will include the development of a 150,000 sq ft leisure extension and restaurant quarter. Intu purchased the remaining 50% stake in this major regional shopping centre in 2016.

COMMERCIAL PROPERTY TRENDS AND VALUES

INVESTMENT IN 2018
£1.5 BILLION

OVERSEAS BUYERS % OF TOTAL INVESTMENT
33%

PRIME OFFICE YIELD
4.75%

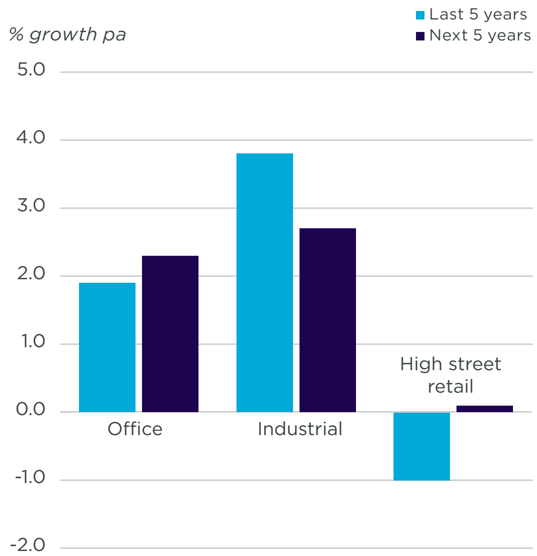
PRIME INDUSTRIAL YIELD
4.75%

Investor appetite remains strong, and transactions in and around Birmingham totalled just over £1.5 billion in 2018, an almost identical figure to 2017.

Overseas investors accounted for 33% of the total investment value, only marginally down on the 37% recorded in 2017. This underlines the city's attractiveness as a key UK market, as well as its favourable pricing compared with London and the South East. Key transactions across the sectors included:

- TH Real Estate purchased 55 Colmore Row on behalf of its European Cities Fund for £98 million, reflecting a net initial yield of 4.9%. The vendor was IM Properties.
- 2 Colmore Square was bought by the Railway Pension Trustees for £95 million, reflecting a net initial yield of 6.4%.
- Royal London Asset Management has purchased the Kings Norton Business Centre for £134 million, reflecting a net initial yield of a little over 4%. The low yield reflects a mix of uses on the 60-acre estate, with more than 800,000 sq ft including last-mile distribution, production, showroom and office space, and more than 80 occupiers.
- Korean-based Hana Financial Group has purchased Gallagher Shopping Park in Wednesbury for £175 million, representing a net initial yield of around 5.2%. Occupiers include Currys, Harveys Furniture, and Furniture village.

Figure 4 Birmingham average annual rental growth forecasts by sector
Source: MSCI, REF, Carter Jonas



BIRMINGHAM RENTS AND YIELDS SUMMARY

	PRIME RENT (£ PSF)	CHANGE OVER 2018	FORECAST NEXT 12 MONTHS	PRIME YIELD
OFFICE	£33.00	⟷	↑	4.75%
INDUSTRIAL	£6.75	↑	↑	4.75%
RETAIL Zone A	£310	↓	↓	4.5%

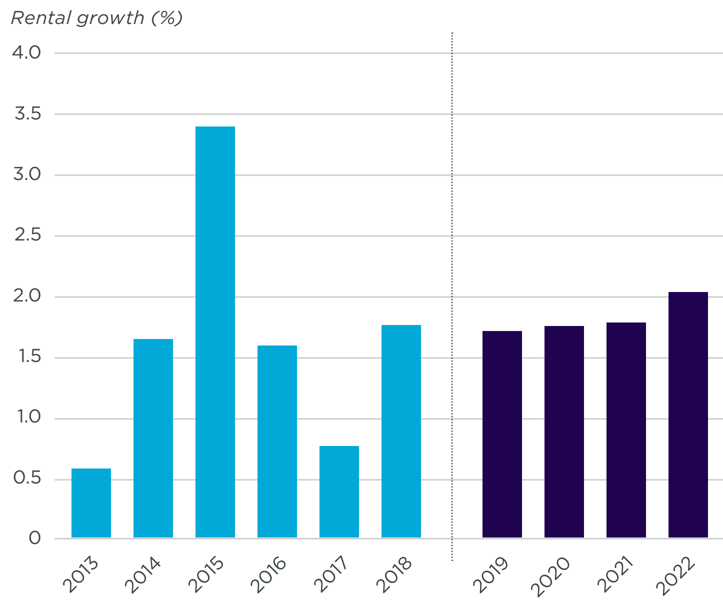
Industrial yields have seen significant downward movement in recent years, as the sector has continued to benefit from the changes to logistics networks from the ongoing retail revolution. **Prime industrial yields have reached 4.75%**, compared with 5.25% two years ago. Prime office yields also stand at 4.75%, with prime retail yields at 4.5%.

Average commercial rental values in Birmingham have risen by around 1.8% pa over the last five years, based on the MSCI index, but with significant sectoral variation. The industrial sector saw the city's strongest performance, with average rental growth of nearly 4% pa, compared with 2% pa for the offices sector. High street retail saw a modest fall in average rental values (-1% pa), reflecting falls nationally.

> **THE LEVEL OF OVERSEAS INVESTMENT UNDERLINES BIRMINGHAM'S ATTRACTIVENESS AS A KEY UK MARKET**

Over the next five years, we expect a similar rate of all property rental growth in Birmingham, but with slightly stronger performance from offices and retail. **Industrial growth will ease a little, to a projected 2.8% pa, but should remain the strongest performing sector** (see Figure 4).

Figure 5 Birmingham average all property rental growth projections
Source: MSCI, REF, Carter Jonas



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