COMMERCIAL EDGE

CAMBRIDGE

SPRING 2019

Carter Jonas

OUTLOOK SUMMARY

- Cambridge is a key UK growth hub. The challenge of accommodating this growth is considerable, with increasing pressure on the city's already constrained housing and transport infrastructure, and limited sites for commercial development. To maintain this growth, the city will need to provide both creative short term solutions and significant long-term investment.
- Despite the general economic and political uncertainty, office take-up has been consistently strong over the last three years. City centre grade A space is in very short supply, and with the increasing emphasis occupiers are now placing on the quality of space, the pricing gap between good and poor quality secondary space is widening.
- There has been limited industrial development and with the shortage of the mid-tech space demanded by the city's technology sector, some occupiers are retro-fitting traditional light industrial units to accommodate a combination of office, R&D and manufacturing space.
- Upward rental pressure in the office and industrial sectors means investor appetite for the city's commercial property remains very strong, maintaining yields at keen levels.
- Cambridge has retained its position as the top city for retail across the UK in 2018. Measured in terms of vitality, rental performance, tourist spend and future business expansion, Cambridge has shown resilience amid the growing uncertainty surrounding the future of the high street.

DRIVERS OF GROWTH

Cambridge has one of the most dynamic economies in the UK, underpinned by its leading universities and highly skilled labour force. It has a unique blend of start-ups and established businesses across the hi-tech, pharmaceutical, knowledge and creative sectors.

The city has seen **rapid economic growth of around 3% pa over the last five years**, compared with 2.2% for the UK. This has been accompanied by strong population growth, with more than 17,000 additional people estimated to be living in the city than a decade ago (Experian).

However, this **rapid growth is putting pressure on the city's housing and transport infrastructure**. House prices are around 4% below their 2017 peak, but this modest drop will have little overall effect. At present, the average house price in Cambridge is £438,911 which is 1.9 times the national average and 1.5 times the regional average.

Improved transport infrastructure is a key element to maintaining growth, and the Cambridge and Peterborough Mayor's office is championing a metro approach. It has floated ambitious plans for a partly underground metro system using high-tech electric vehicles that provide a rapid transit system into the city centre, avoiding some of the city's most congested roads. Discussions regarding financing the project are under way.

However, this is a medium to long-term term solution to a problem which is becoming urgent. In the short term, **using technology to better utilise existing infrastructure, and the introduction of congestion charging are potential options**.

In the longer term, the city's **connectivity will be further enhanced through its position as the eastern anchor of the Oxford - Milton Keynes - Cambridge growth corridor**, with both new road and rail links proposed. Five route options have been developed for reinstating the rail link between Bedford and Cambridge, and a public consultation is currently under way.

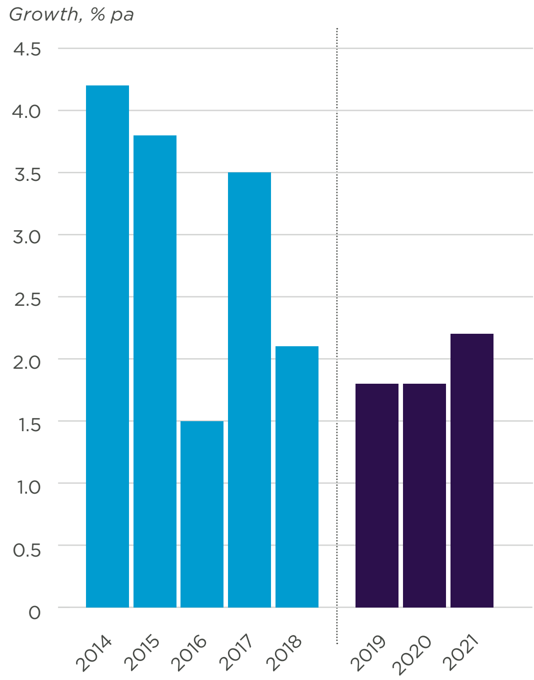
The Cambridgeshire and Peterborough Independent Economic Review's (CPIER) final report, published in September 2018, underlines the need to address these growth constraints. It concludes that in a globally competitive marketplace, **Cambridge must seek to address these issues or risk losing out on new occupiers coming into the market.**

The challenge of where to accommodate growth is considerable. The CPIER rightly identifies that one of the key attractions of Cambridge is its ability to facilitate agglomeration across a wide variety of specialist sectors. This, it concludes, points growth strategy away from dispersal outside of Cambridge and towards densification, as well as growth in the fringes and along key transport corridors.

Land release is a key constraint in bringing development forward. The city has recognised this need and is supportive of development on the edge of the city. In Q3 2018, specialist regeneration developer U+I was appointed to transform a water recycling centre in north Cambridge into a residential-led mixed-use urban quarter. The 120 acre site will be redeveloped over the next 15 years and is set to create over 5,200 homes and over one million sq ft of office space.

The new Local Plan, adopted in September 2018, introduced a presumption against the loss of commercial accommodation. Coupled with the fact that office capital values in prime locations are higher than those of residential, over the next few years we will see further residential development out of town, and continued development on existing commercial sites in certain locations.

Figure 1 Cambridge economic growth (GVA)
Source: Experian



CAMBRIDGE KEY ECONOMIC AND BUSINESS STATISTICS

Source: Experian, ONS, Thinkbroadband, Land Registry

	CAMBRIDGE	UK
ECONOMIC GROWTH LAST 5 YEARS	3.0% pa	2.2% pa
OUTPUT PER HEAD	£45,000	£26,600
EMPLOYMENT GROWTH LAST 5 YEARS	1.2% pa	1.5% pa
UNEMPLOYMENT RATE (ILO)	4.0%	4.2%
GCSE AND EQUIVALENT AVERAGE ATTAINMENT A CORE PER PUPIL	47.9	44.3*
ULTRAFAST BROADBAND COVERAGE (OVER 100 MBPS) % OF PREMISES	93.6%	56.2%
AVERAGE HOUSE PRICE	£438,911	£230,776
AVERAGE HOUSE PRICE GROWTH, 2018	1.6%	2.5%
CAMBRIDGE STATION, ENTRIES AND EXITS IN 2017/18	11.5 million	13th outside of London

**England*

"THE CHALLENGE OF WHERE TO ACCOMMODATE GROWTH IS CONSIDERABLE AND LAND RELEASE IS A KEY CONSTRAINT.

OFFICE MARKET

PRIME RENT
£41.50 PSF

2018 TAKE-UP
524,000 SQ FT

AVAILABILITY
786,000 SQ FT

> **WITH OCCUPIERS PLACING A LARGER EMPHASIS ON THE QUALITY OF SPACE, THE RENTAL GAP BETWEEN GOOD AND POOR QUALITY SECOND-HAND SPACE IS WIDENING.**

TAKE-UP

Take-up was 524,000 sq ft in 2018, below the long-term average of 700,000 sq ft pa, whilst the average transaction size was just under 5,000 sq ft across a total of 110 deals. Unlike 2014 and 2015, no 'super-deals' took place, which we consider to be over 75,000 sq ft to a single occupier. 2018 take-up would have been considerably higher if two transactions anticipated for Q4, totalling over 100,000 sq ft, had not fallen into 2019.

The two biggest deals of 2018 were 50,000 sq ft at the Eastbrook Centre let to Arm Holdings and 43,000 sq ft let at Building 1030, Cambourne Business Park to Carl Zeiss. There were other significant lettings including Mediatek taking 28,500 sq ft at Cambourne Business Park and Owlstone Medical acquiring 16,000 sq ft on Cambridge Science Park.

The prime office space at 50/60 Station Road saw a number of lettings with Amazon, Costello Medical and Samsung amongst those taking space. As a result, the property is now 90% pre-let or under offer, with completion due later this year.

There is a presence of serviced office and co-working space in Cambridge, with Regus and Central Working now operating in the city. Whilst the growth of this sector did not match that seen across the UK in 2018, a serviced office provider is due to enter the market this year with a 50,000 sq ft offering.

AVAILABILITY

Total available office space across the Cambridge market has fallen from 1.1 million sq ft at the end of 2017 to 786,000 sq ft at the end of 2018. The current availability represents just over one year's supply, although much of the demand will be satisfied by existing stock coming back to the market.

Interest in the CBD (CB1 and the Station Road area) remains positive, as Brookgate's 156,000 sq ft scheme at 50/60 Station Road is now almost complete and is largely pre-let. As such they, and the fund Aviva, will continue the redevelopment of the station area with the next phase at 30 Station Road. This will provide a further 79,000 sq ft of grade A office accommodation over seven floors. Once under construction and available for pre-let, we believe this building will be the catalyst for further prime rental growth, and until this point, prime rents will plateau.

With occupiers placing a larger emphasis on the quality of space, the rental gap between good and poor quality second-hand space is widening. There is an increasing amount of secondary space, particularly in the 5-15,000 sq ft bracket. Landlords would be advised to invest in their properties in order to upgrade space and make it more attractive to occupiers, minimise costly void periods and increase income.

There has been continued investment into the city's science and business parks over the last year, with Trinity College and TusPark Investments redeveloping a number of existing buildings in Cambridge Science Park totalling 360,000 sq ft; one of which was pre-let to Frontier Developments Plc. St John's College also reached practical completion on the Maurice Wilkes Building at St John's Innovation Park with 93% pre-let. Illumina are also developing a brand new 155,000 sq ft facility on Granta Park in Great Abington.

With the opening of Cambridge North station in 2017, the development of the mixed-use CB4 scheme is moving closer. Novotel has signed up a new four-star hotel, and we expect office development to commence later this year.

RENTS

At the end of 2018, prime rents in the CBD (CB1 and the Station Road area) had increased to £41.50 psf up from £38.00 psf at the end of 2017, which represents a rise of 9% over 12 months. This rent was achieved at 50/60 Station Road with Amazon expanding their footprint in the CBD, taking an additional 21,388 sq ft and bringing their overall total Cambridge footprint to almost 100,000 sq ft.

Outside of the CBD, the Northern Fringe (Cambridge Science Park, Cambridge Business Park and St John's Innovation Park) has also experienced rental growth with a 7.5% increase over the last year from £32.50 psf to £35.00 psf. The Maurice Wilkes Building, as the most recent speculatively developed building in the Northern Fringe, achieved at £35.00 psf for a 15-year term certain, with the new buildings at Cambridge Science Park also quoting this figure.

The CBD and Northern Fringe areas continue to be a landlords' market, with fewer tenant incentives on offer for grade A space. Over the last year, for a ten-year term certain, rent free periods have reduced from 12 months in 2017 to nine months in 2018.

Figure 2 Cambridge office / R&D take-up
Source: Carter Jonas

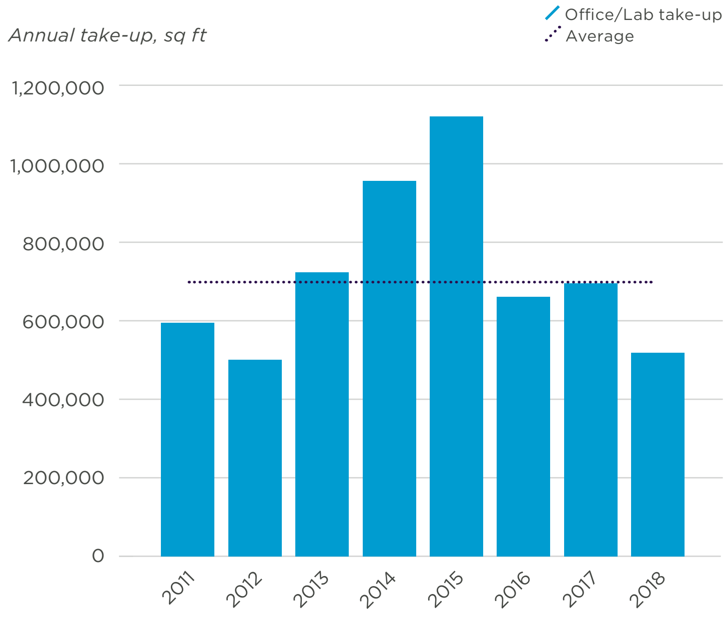
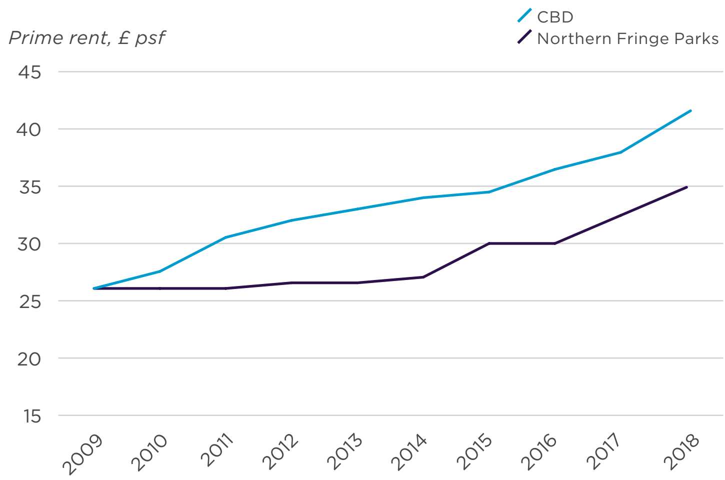


Figure 3 Cambridge Prime office rental trend
Source: Carter Jonas



INDUSTRIAL MARKET

PRIME RENT
£16.50 PSF

2018 TAKE-UP
495,000 SQ FT

AVAILABILITY
670,000 SQ FT

> **RENTS ARE SET TO INCREASE MODESTLY OVER THE NEXT 12 MONTHS, WITH THE OUT-OF-TOWN MID-TECH SECTOR LEADING THE WAY.**

The Cambridge industrial market is relatively small, serving local occupiers, national trade operators and the city's growing technology sector who require mid-tech space to accommodate a mixture of office, lab and manufacturing space.

Availability has risen over the last year, from around 530,000 sq ft at the end of 2017 to 670,000 sq ft at the end of 2018. There will be further space available in the market in 2019 as Salmon Harvester Properties completed on Cambridge South, Sawston in January which provides a further 67,931 sq ft. With take-up averaging 450,000 sq ft pa over the last two years, there is now at least 1.5 years' supply, set to increase in 2019.

Design and build is not a popular option as high land values make this very expensive, and this route is more suited to the larger distribution uses not typical of the Cambridge market.

A number of larger requirements of over 30,000 sq ft which entered the market over the last few years have not been satisfied. It is encouraging that there are now higher stock levels and larger buildings that will be able to absorb these requirements.

Mid-tech rents are increasing with Enterprise 5000 on Cambridge Research Park now quoting £12.50 psf on the vacant units. Previous deals in 2018 have achieved £11.00 psf, and should these quoting levels be achieved, this represents rental growth of 13.5% in just 12 months.

Whilst the headline achieved rent in Cambridge is £16.50 psf, recorded at Coldhams Lane on a 15-year term certain lease to Ridgeons, this is very much typical of the trade occupier market. For prime industrial, rents in the city centre have increased from £12.50 psf a year ago to £13.50 psf at the end of 2018, achieved at Unit 25 Clifton Road. We think a further modest increase is likely over the next 12 months, assuming current levels of demand are maintained as we expect.

Cambridge City Council has taken back control of Mercers Row, an estate located just off Newmarket Road. As a result, we may see a wider strategy take place.

Looking ahead, rents are due to increase modestly over the next 12 months, with the out-of-town mid-tech sector leading the way. Current demand levels for the city centre stock will also cause headline rents to increase.

RETAIL MARKET

PRIME RENT
£220 PSF (ZONE A)

VACANCY RATE
4%

The Cambridge retail market continues to be resilient against the headwinds facing the sector, assisted by more than seven million visitors annually. The city also serves a large catchment area, which encourages the strong level of trading in the city. However, there has been a modest rise in the number of vacant units in the city centre over the last year, with 25 units currently on the market offering over 44,000 sq ft, which is just 4% of the total stock, compared to 2.7% available in 2017.

Several high-end restaurants opened in 2018, with Trinity, The Ivy Brasserie and Parker's Tavern all taking space. These complement the existing independent occupiers such as The Pint Shop, Varsity Hotel and Tabanco. The increasing spending power of overseas students, tourists and the growing technology sector contributes to the success of these higher end offerings, rather than national chain restaurants which are slowly being squeezed out of the market.

In terms of the retail sector, as previously reported, the Grafton Centre is part-way through a major refurbishment programme, and PureGym has now opened its doors. The food court currently consists of two restaurants, with further space available. While Mothercare has closed down, H&M and River Island have increased their footprints, expressing some confidence in the shopping centre.

The prime rent in Cambridge has decreased since the peak of £290 psf ITZA in 2015. Prime rents now stand at £220 psf ITZA which was achieved in June 2018 with the letting to Franco Manca on Market Street.

The Lion Yard is due to undergo a redevelopment, led by Aberdeen Standard Investments. There are a number of vacant units with a few pop-up shops filling these voids, indicating that landlords are willing to take a view on covenant strength in order to maintain rental income and keep the development plans in the pipeline.

After six years of renovation by Melford Capital, the opening of the University Arms Hotel instils confidence into the hotel sector, as it demonstrates the high demand for overnight stays and increasing tourist spend per capita. We understand that many of the rooms have been reserved by leading companies to cater for clients and visiting members of staff. Melford Capital have also acquired Hotel Felix, their second acquisition in the city after The University Arms Hotel.

The University Arms joins The Tamburlaine (4-stars), which opened in 2017 and the Varsity Hotel (4-stars). Looking ahead, Novotel will also be opening at Cambridge North station in a couple of years' time. This will provide an alternative to the Ibis Hotel, which is currently at the central Cambridge station.

COMMERCIAL PROPERTY TRENDS AND VALUES

INVESTMENT IN 2018
£315 MILLION

PRIME OFFICE YIELD
4.5%

PRIME INDUSTRIAL YIELD
5.5%

STRONG INVESTOR INTEREST IS MAINTAINING YIELDS AT KEEN LEVELS.

Investor appetite remains very strong, with investments in 2018 totalling £315 million, a significant increase on the £120 million purchased last year. The UK funds have been very active in 2018, and there has been interest from colleges and local authorities.

The largest transaction in 2018 was the sale of Cambridge Research Park for £78 million by Rockspring to Royal London Asset Management, reflecting a net initial yield of 4.9%. The park comprises eight office properties and nine mid-tech units, along with 13.5 acres of development land, which has planning permission for office, R&D and mid-tech space as well as for a hotel.

In July 2018, Cambridgeshire County Council acquired Brunswick House from Apache Capital for £38 million, reflecting a NIY of 4.76%. This yield is a record in the UK for a direct-let student accommodation asset outside the M25.

There were also some notable retail investment transactions. OLIM Property Ltd purchased the Sainsbury's supermarket on Coldhams Lane to the east of the city centre from Aberdeen Standard for £46.5 million, reflecting an initial yield of 4.65%. 59 St Andrews Street was also purchased by Emmanuel College from M&G Real Estate for over £32 million, reflecting a net initial yield of 4.8%.

Rental performance has been strong, with average all-property rental values rising by around 5% pa over the last five years (MSCI/REF/Carter Jonas), led by the industrial sector, where growth has exceeded 7% pa. This contrasts with the weakness of high street retail, where rental values have risen by an average of only 1% pa over the last five years, and have seen modest falls over the last two years of -2.5% (MSCI/REF/Carter Jonas).

We forecast a slightly lower rate of all-property rental growth of 4.25% pa over the next five years, as industrial decelerates a little, yet still a strong performance overall within the national context.

Strong investor interest is maintaining yields at keen levels, with the prime office yield at 4.5% and industrial at 5.5%. Prime retail yields have moved out from 4.5% to 5.0%, which typifies the current lack of confidence in the high street.

CAMBRIDGE RENTS AND YIELDS SUMMARY

	PRIME RENT (£ PSF)	CHANGE OVER 2018	FORECAST NEXT 12 MONTHS	PRIME YIELD
OFFICE	£41.50	↑	↑	4.5%
INDUSTRIAL	£16.50	↑	↑	5.5%
RETAIL Zone A	£220	↓	↔	5.0%

Figure 4 Cambridge Average all property rental growth projections
Source: MSCI, REF, Carter Jonas

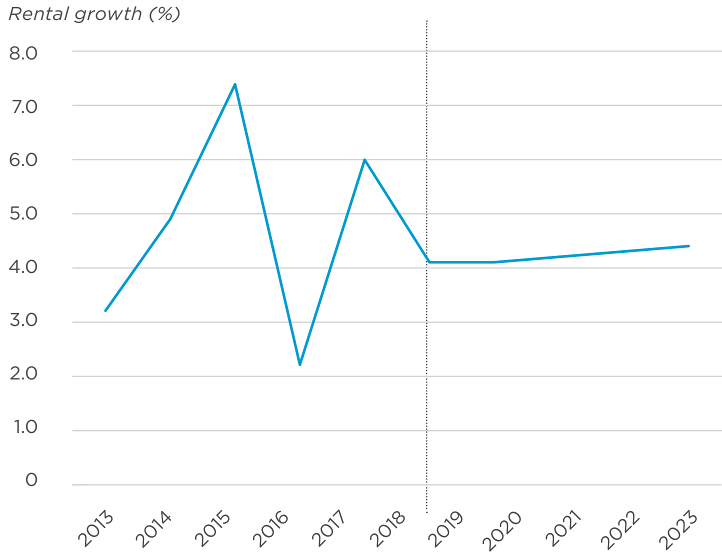
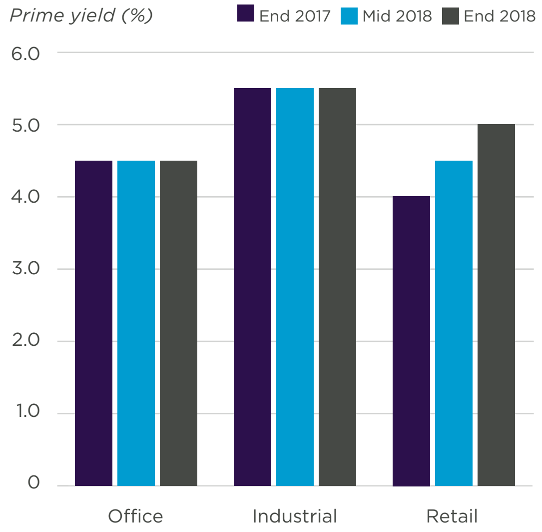


Figure 5 Cambridge prime yields
Source: Carter Jonas



THIS PUBLICATION IS PART OF THE 2019 COMMERCIAL EDGE RESEARCH SERIES.

To download a copy of the full reports, please visit:
carterjonas.co.uk/commercialedge

ABOUT CARTER JONAS

Carter Jonas LLP is a leading UK property consultancy working across commercial property, residential sales and lettings, rural, planning, development and national infrastructure. Supported by a national network of 33 offices and 700 property professionals, our commercial team is renowned for their quality of service, expertise and the **simply better advice** they offer their clients.

Find out more at **carterjonas.co.uk/commercial**

01223 315716
One Station Square, Cambridge CB1 2GA
cambridge@carterjonas.co.uk

Contacts:

Will Mooney Head of Eastern Commercial
01223 558032 | will.mooney@carterjonas.co.uk

Scott Harkness Head of Commercial
020 7518 3236 | scott.harkness@carterjonas.co.uk

Daniel Francis Head of Research
020 7518 3301 | daniel.francis@carterjonas.co.uk

Follow us on Twitter, LinkedIn & Instagram

Carter Jonas