COMMERCIAL EDGE

LEEDS CITY REGION

SPRING 2019

Carter Jonas

OUTLOOK SUMMARY

- The arrival of Channel 4 is raising the profile of Leeds and should act as a catalyst for further inward investment in the creative and media sectors.
- Significant investment in transport infrastructure will benefit the region over the coming years with short term improvements as well as the HS2 high speed rail line. These advancements will help to enable major commercial development, most notably in the South Bank area of Leeds.
- The key issue for the region's office market is a shortage of quality stock, and with limited completions of new build/ refurbishments in Leeds city centre, we could see prime rents pushing upwards from the current £30 psf mark. The shortage of stock is also true of markets such as York and Harrogate. Serviced offices will be a growing feature.
- The bespoke nature of demand and low volume of quality supply means the distribution market remains focused on design and build, although there have been some speculative starts in 2018. There is upward rental pressure due to the lack of supply, and we expect the prime rent to push upwards from the £6.25 psf mark over the next 12 months.
- Demand from property investors remains strong, with transactions rising to over £1 billion across the Leeds City Region in 2018, and strong interest from overseas buyers. With positive investor sentiment, limited buying opportunities and further rental growth potential for quality stock, office and industrial yields will remain at keen levels.

DRIVERS OF GROWTH

Leeds City Region is one of the UK's largest commercial markets, with office stock of more than 47 million sq ft and industrial stock of nearly 250 million sq ft. This makes up nearly 60% of the total commercial stock across Yorkshire and the Humber. The region covers 10 local authority districts and includes not only Leeds itself but also key locations such as Wakefield, Bradford, Harrogate and York. The total population is over three million, a figure that has increased by more than 6% over the last decade.

Experian estimates suggest the economic output across the Leeds City Region expanded by around 1.1% in 2018, a similar rate to the previous year. Forecasts imply the rate of **economic growth will accelerate to an average of 1.4% pa** over the next three years, assuming a favourable Brexit deal can be reached.

Leeds is the commercial hub of the wider region, and has **a diverse economic base**, with a strong presence in financial and professional services, as well as a growing "knowledge" sector. The arrival of **Channel 4** will also give the city a major presence in the creative and media sector, and should act as a catalyst for further inward investment in this key area. Indeed, it is currently in the process of selecting its preferred location within the city.

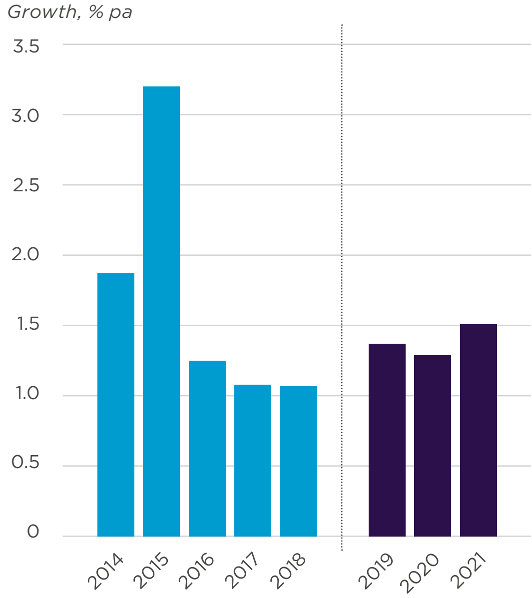
CHANNEL 4 COULD BE A GAME-CHANGER FOR LEEDS, AS A HOUSEHOLD NAME WITH GREAT SPIN-OFF OPPORTUNITIES.

Investment in transport infrastructure will benefit the region over the coming years. The most notable project is the **HS2 high speed rail line** which will deliver a new fast connection from London and Birmingham right into the heart of Leeds city centre, as well as a significant capacity increase. The new station will be integrated with the existing facilities, delivering a major transport interchange and easy access to the city centre and the South Bank area.

Although yet to receive Royal Assent, completion of HS2 is scheduled for 2033. It will drive a long-term increase in demand for commercial space in the city and aid in growing the Leeds City Region wider economy.

HS2 WILL BE A CATALYST FOR REGENERATION IN LEEDS, OPENING UP THE ENTIRE SOUTH BANK.

Figure 1 Economic Growth (GVA)
Source: Experian



The potential for additional space in Leeds is huge, and there will be a significant net gain in commercial space from the HS2 project, which will be a catalyst for regeneration in the area, opening up the entire South Bank.

Shorter term **rail improvements** are also under way. Work has recently started to enhance Leeds railway station, increasing capacity, providing improved pedestrian access and improving the experience for travellers. The **Northern Hub**, Network Rail's upgrade scheme, will also see the electrification of the Transpennine link between York, Leeds and Manchester and provide additional capacity.

A Strategic Transport Plan has been produced by Transport for the North (TfN), setting out the business case for improved road and rail links across the north of England. There are proposals for parkway stations at Thorpe Park in east Leeds, White Rose to the south of the city and Leeds Bradford Airport, although these are likely to be medium-long term enhancements.

A major reconfiguration of Leeds Bradford Airport is under way to improve the customer experience, and help manage its rapid rate of growth. A number of **road infrastructure improvements** are also shortly to commence or in the pipeline, most notably the £116 million Leeds East Orbital Road, which saw phase one start in Autumn 2018. This will link the M1 at Thorpe Park to the A6120, replacing the existing Outer Ring Road, not only easing congestion but also acting as a catalyst for development (mainly residential) along the route.

We believe these transport infrastructure upgrades are key to improving productivity in the north and making it a competitor to the Midlands Engine and the south east. This will also enable some of the longer-term commercial development opportunities such as the former Tetley Brewery site to reach their full potential.

LEEDS KEY ECONOMIC AND BUSINESS STATISTICS

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

	LEEDS	UK
ECONOMIC GROWTH LAST 5 YEARS	2.0% pa	2.2% pa
OUTPUT PER HEAD	£28,660	£26,600
EMPLOYMENT GROWTH LAST 5 YEARS	1.6 % pa	1.5% pa
UNEMPLOYMENT RATE (ILO)	4.3%	4.2%
GCSE AND EQUIVALENT AVERAGE ATTAINMENT 8 SCORE	44.6%	44.3*
BUSINESS BIRTHS PER 1,000 PEOPLE 2017	4.8	5.7
BUSINESS SURVIVAL RATE	41.9%	43.2%
ULTRAFAST BROADBAND COVERAGE (OVER 100 MBPS) % OF PREMISES	78.6%	56.2%
AVERAGE HOUSE PRICE	£183,902	£230,776
AVERAGE HOUSE PRICE GROWTH, 2018	3.6%	2.5%

OFFICE MARKET

PRIME RENT
£30 PSF

2018 TAKE-UP
1.06 MILLION SQ FT

SPECULATIVE COMPLETIONS 2019
65,000 SQ FT

“THE KEY ISSUE FOR 2019 IS A SHORTAGE OF QUALITY GRADE A STOCK.

Office take-up in Leeds totalled 1.06 million sq ft in 2018. Although this was 20% below the previous year, 2017 was a record high, boosted by the Government Property Unit’s pre-let of 378,000 sq ft at Wellington Place. Indeed, the 2018 figure is 20% above the 10-year average (see chart).

Key deals in Leeds in 2018 included 76,000 sq ft let to Walker Morris at 33 Wellington Street; 60,000 let to HMRC at 3 Wellington Place; 48,300 sq ft let to Dart Group at The Mint; and 26,000 sq ft let to the MOJ at 5 Wellington Place.

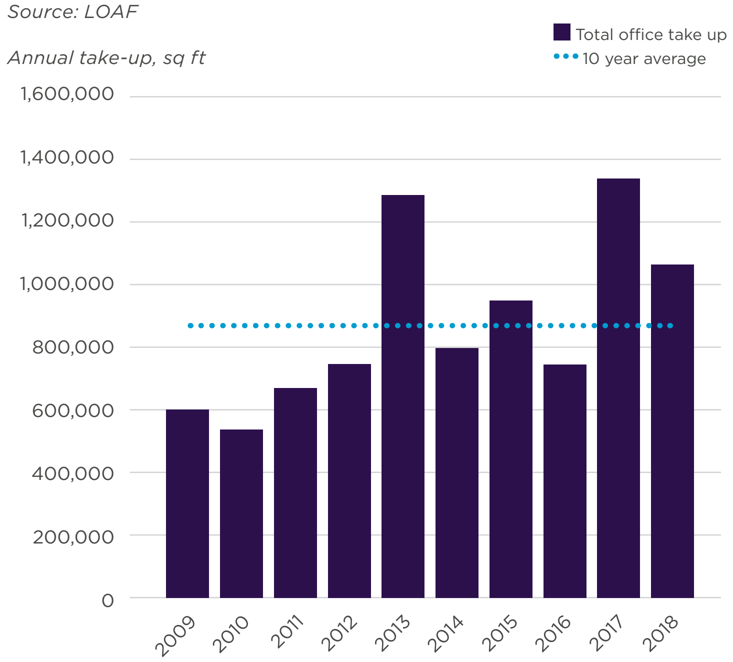
The key issue for the market is a **shortage of quality stock,** and the refurbishment of The Majestic (totalling 65,000 sq ft) is the only speculative building coming forward this year. As yet, there have been no lettings at the scheme, although Channel 4 is an obvious contender, with its 30-40,000 sq ft requirement.

Construction of the Government Property Unit’s pre-let building at 7 & 8 Wellington Place (MEPC/Hermes/St James’ Securities) is now well under way and should complete by the end of 2019. MEPC has progressively developed the **Wellington Place scheme**, which has near-full occupation, and has now started speculative construction of the next 155,793 sq ft phase at 4 Wellington Place, illustrating continued confidence in the market.

Future expansion of the office market will be focussed towards the South Bank area. A number of office schemes have already come forward, including Sovereign Square, and the new southern entrance to the railway station now provides a direct pedestrian link to the area. CEG has commenced development of its South Bank site. The initial phase is approximately 30,000 sq ft, which is likely to be delivered in mid-end 2020. This should be followed by a second larger phase of circa 134,000 sq ft, which will form part of a much broader mixed-use scheme.

Although the **Leeds out of town market** has seen few large lettings, it fared well overall in 2018, with just under 400,000 sq ft let, accounting for 38% of the city’s total. This was the highest annual total during the last decade, and nearly 25% up on 2017.

Figure 2 Leeds office take-up
Source: LOAF



In 2018, there were just short of 100 transactions, with the average size being 4,100 sq ft. The two largest deals were to media firm Perform Group at White Rose Office Park (39,400 sq ft), and Bupa at Kirkstall Forge (23,700 sq ft).

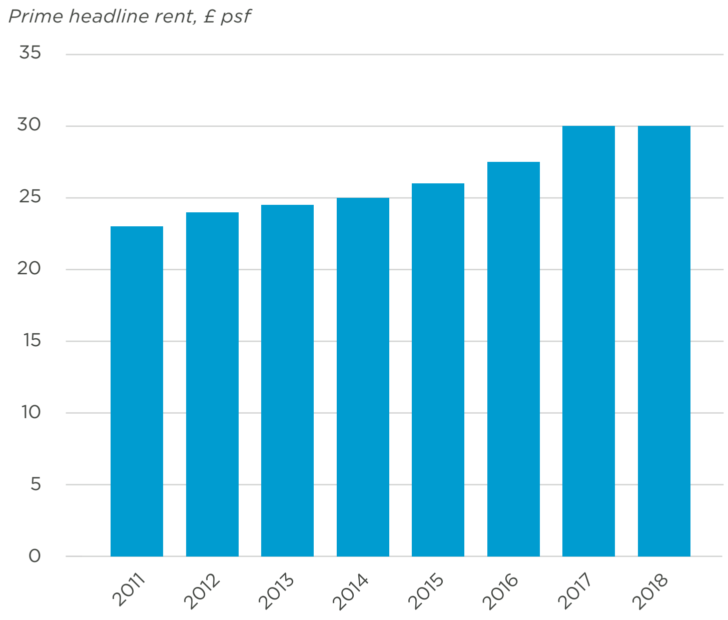
Until now, there has not been any large-scale **serviced office provision** in Leeds, although niche providers have had a presence. For example, Gilbanks at One Park Row has seen strong occupier interest, with a smart, corporate offering. However, one of the largest city centre lettings in Q4 was to a serviced office specialist, reflecting a wider trend across the UK as the sector continues to disrupt the traditional leasing model.

The **prime headline office rent** in Leeds city centre is £30.00 psf, unchanged from a year ago, although a 15% increase on the level three years ago (see rental growth chart). The typical rent free incentive is currently 18 months (assuming a 10-year lease). Out of town, the prime rent is £23.50 psf as achieved at Kirkstall Forge, an increase on the £22.00 psf we reported a year ago. With the continued shortage of quality supply, further rental growth is possible this year, and it will be interesting to see if The Majestic refurbishment manages to exceed the £30.00 psf mark.

Elsewhere in the city region, **York city centre** is highly constrained, with no recent completions or space under construction, and the city has seen little movement in rental values. However, the mixed-use York Central regeneration scheme, close to the city’s railway station, has the potential to add a large amount of commercial space, with up to 940,000 sq ft of office space proposed. An outline planning application was submitted in August 2018.

Harrogate continues to have an acute shortage of space, and rental levels have increased accordingly. Demand is focused on local SMEs, with lettings in the sub-5,000 sq ft bracket. Meanwhile, Wakefield provides a cheaper alternative to Leeds, with top asking rents in the £13-13.50 psf bracket. The market has been relatively quiet over the last year, although there have been a handful of transactions in the 5-10,000 sq ft bracket.

Figure 3 Leeds city centre prime office rents
Source: Carter Jonas



RETAIL MARKET

PRIME RENT
£250 PSF (ZONE A)

DESPITE CHALLENGING CONDITIONS THE LEEDS MARKET REMAINS ROBUST

Conditions in the UK retail market remain challenging. It is likely that more retailers will seek rent reductions, go into administration, or become online-only in 2019. The relentless shift towards online retailing continues, and internet sales exceeded 20% of total retail sales for the first time in the run up to Christmas.

Against this backdrop, the market in **Leeds city centre has been robust** over the last year, buoyed by the city's strong retail offer and large catchment population. There have been relatively few significant transactions, although fashion retailer Khaadi has taken space at Trinity Leeds, and JD sports has taken space on Briggate. However, vacancy rates have crept up a little, in common with other centres such as Harrogate, and the broader national trend. The prime Zone A rent in Leeds remains at approximately £250 psf.

Out of town, The Springs at Thorpe Park has opened its doors. This 350,000 sq ft development has added a much-needed retail and leisure element to the existing business park, reflecting the amenities that occupiers now expect their staff to be able to access, and this should help attract office tenants. The Springs has been largely occupied by national retail operators, including River Island, Next and TK Maxx, and leisure operators including Odeon and Pure Gym.

The **retail warehousing** market is highly polarised. In the prime market, some core covenants are in trouble, creating downwards pressure on rents and capital values. However, some occupiers such as Aldi and Lidl are doing well. This is creating a considerable differential in rental values across the market.

INDUSTRIAL MARKET

PRIME RENT
£6.25 PSF

2018 TAKE-UP
1.4 MILLION SQ FT

Demand for distribution space continues to be fuelled by retailers adapting their logistics models to manage the changing distribution patterns associated with online retailing. Given the sustained period of strong demand, there is now a lack of existing stock, and few suitable sites for development.

Carter Jonas acting for DB Symmetry managed to secure a pre-let to a world leading retailer who is currently onsite at Darlington in the North East delivering 1.5 million sq ft of distribution logistics accommodation. This was the largest pre-let deal in the North East for a number of years.

Furthermore, Muse Developments have recently secured forward funding for a new 361,000 sq ft unit at Logic Leeds.

Although there are some exceptions, the market is **mainly occupier-driven**. Corporates such as Amazon and the big supermarkets require a bespoke specification and a high level of automation, delivered within tight deadlines, focused on the M1, M62 and M18. These occupiers will pay higher rents to reflect the higher build costs in order to gain operational efficiency, and this results in a wide range of land values, with sites fetching anywhere from £150,000 per acre to £400,000 per acre.

This, together with the low level of quality space available, means **the market remains focused around the design and build route**. This was exemplified in 2018 by Standard Life Pooled Property Pension Fund's forward-funding of 361,000 sq ft let to technology distributor Premier Farnell at Logic Leeds.

Given the bespoke nature of the product demanded by retailers and their logistics operators, **developers are cautious about building speculatively**. However, there have been some speculative starts in 2018, for example the two units at Cross Green for property specialist Towngate, close to junction 45 of the M1 motorway.

The **prime headline rent** for the small-medium sized shed market remains at £6.25 psf, with rent free incentives typically 12-18 months on a 10-year lease. There is **upward rental pressure** due to the lack of supply, and we expect the prime rent to push upwards from the £6.25 psf mark over the next 12 months.

> **“ DEMAND FOR DISTRIBUTION SPACE CONTINUES TO BE FUELLED BY RETAILERS ADAPTING THEIR LOGISTICS MODELS TO MANAGE THE CHANGING DISTRIBUTION PATTERNS ASSOCIATED WITH ONLINE RETAILING.**

Manufacturers are typically seeking space under 200,000 sq ft, with rents in a band from £5.50 to £6.50 psf across Yorkshire. **Purchasing is a popular option**, and can achieve significant cost savings as there are no land holding costs, financing costs, or developer profit. Secondary units can be purchased for £20 psf, with modern units at £60-80 psf.

COMMERCIAL PROPERTY TRENDS AND VALUES

TOTAL INVESTMENT IN 2018
£1.03 BILLION

OVERSEAS % OF TOTAL INVESTMENT
25%

PRIME OFFICE YIELD
5.0%

> **PRIME OFFICE YIELDS STAND AT 5%, AND QUALITY STOCK REMAINS HIGHLY SOUGHT AFTER.**

Demand from property investors remains strong, with more than £1 billion transacted across the Leeds City Region in 2018, a significant increase on the £765 million purchased in 2017. It is notable that 25% of transactions in 2018 were by overseas investors.

There have been **several sizeable transactions** during the second half of the year, most notably in the office sector. 1 City Square was purchased by APAM on behalf of its client, Britannia Invest A/S. The price paid was £32.3 million, representing a yield of just under 5.1%. The 108,000 sq ft building is multi-let to occupiers including Deloitte, with some space currently vacant. Another city centre building, The Cube, has been purchased by Town Centre Securities for £12 million. The 72,000 sq ft building contains both office and leisure uses.

Out of town, Lawnswood Business Park has been purchased by Hillview Real Estate for £26.5 million, at a yield of 8.3%. The park consists of eight office buildings let to a wide variety of occupiers. Other recent transactions in the region include the purchase of Beck Retail Park in Wakefield by a Middle Eastern investor for £37.5 million and the purchase of Gallagher Leisure Park in Bradford by Columbia Threadneedle for just under £19 million.

With positive investor sentiment and a limited opportunity to buy stock, office and industrial yields remain at keen levels. The prime industrial yield has moved down to 5.25%, compared with 5.5% a year ago and more than 7% five years ago, illustrating the extent to which it has become the sector of choice in the new era of internet retail.

Prime office yields stand at 5%, and **quality office stock remains highly sought after**. However, prime retail yields have moved out to 5.25%, compared with the 4.75% we reported a year ago, reflecting the more challenging long-term outlook for the high street.

LEEDS RENTS AND YIELDS SUMMARY

	PRIME RENT (£ PSF)	CHANGE OVER 2018	FORECAST NEXT 12 MONTHS	PRIME YIELD
OFFICE	£30.00	↔	↑	5.0%
INDUSTRIAL	£6.25	↔	↑	5.25%
RETAIL (ZONE A)	£250	↔	↔	5.25%

Figure 4 Leeds average all property rental growth projections
Source: MSCI, REF, Carter Jonas

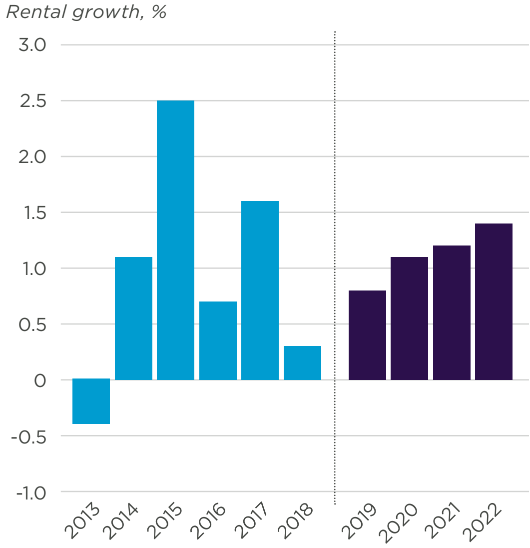


Figure 5 Leeds average annual rental growth forecasts by sector
Source: MSCI, REF, Carter Jonas

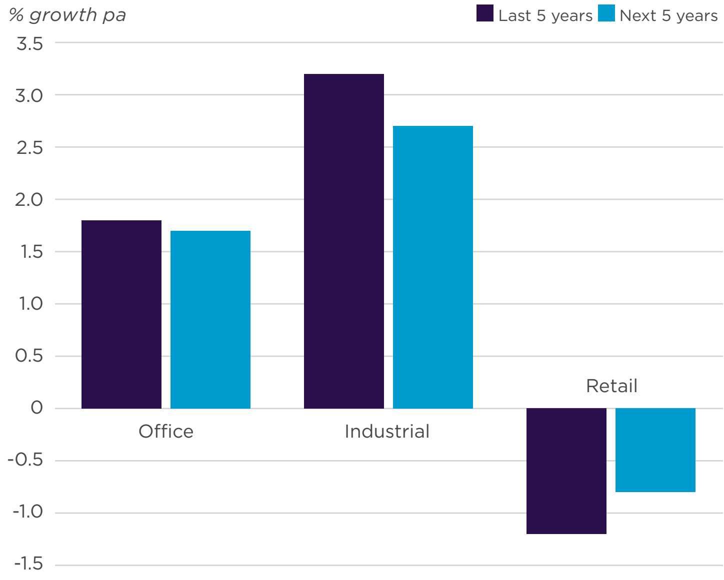
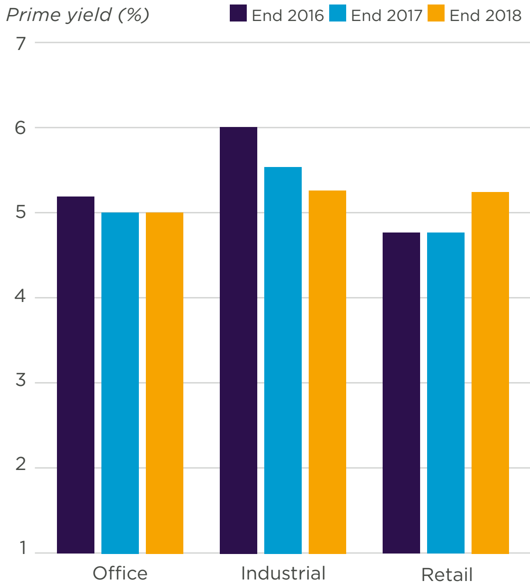


Figure 6 Leeds prime yields
Source: Carter Jonas



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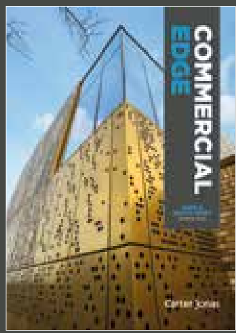

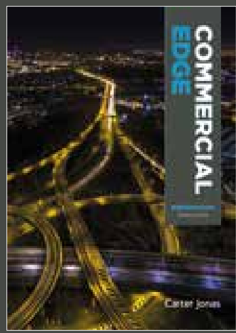

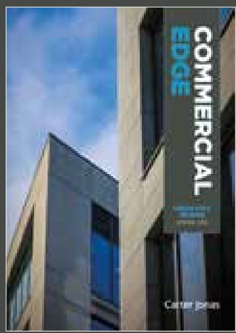

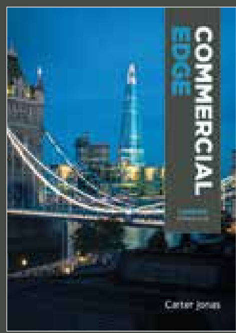

ABOUT CARTER JONAS

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