COMMERCIAL EDGE UPDATE

CAMBRIDGE
H1 2017

Carter Jonas

UK ECONOMIC OVERVIEW

THE SECOND QUARTER OF 2017 MARKED THE ONE-YEAR ANNIVERSARY OF THE UK'S VOTE ON EU MEMBERSHIP, THE OUTCOME OF WHICH MANY PREDICTED WOULD BE CATASTROPHIC FOR OUR ECONOMY. DESPITE THIS, AND IN THE FACE OF SUCH UNCERTAINTY, THE UK ECONOMY REMAINED BROADLY RESILIENT ALTHOUGH THE ROAD AHEAD STILL SEEMS TO BE ONE OF AMBIGUITY.

The Hung parliament outcome in the June General Election, resulting in various Government reshuffles, together with on-going Brexit negotiations will indeed keep everyone on a cliff's edge. Any effect from last year's Referendum vote was subject to a time lag, and a slowdown in UK economic growth as a result of the vote has been evident in this year's statistics.

As at Q2 2017, the second estimate of GDP showed an expansion of **0.3%** during the quarter. This was a modest increase from **0.2%** in Q1, but remains down on the **0.6%** achieved in Q2 2016. Services remained the largest contributor of growth, in particular the retail and film industry, offsetting the weaker performance of the manufacturing and construction sectors.

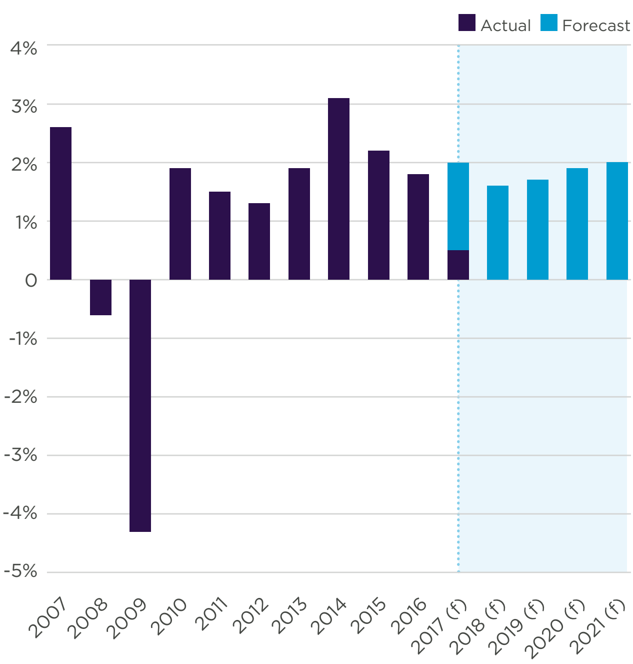
According to the Office of Budget Responsibility (OBR), GDP is forecast to expand by **2.0%** by the end of 2017, providing some indication that the sentiment is for the UK to withstand any major Brexit-related or other disruptions this year. HM Treasury consensus forecasts as at August 2017 however, suggest growth to be more subdued at **1.6%** by the year-end. Looking beyond 2017, while economic growth is likely to be more muted, the OBR forecasts a **1.6%** expansion for 2018, before increasing steadily back to **2.0%** by 2021, see **figure 1**.

Despite the somewhat negative sentiment last year, the weakened sterling bolstered exports and encouraged overseas investment. However, it also led to higher inflation. On an annual basis, the Consumer Price Index (CPI) increased by 2.9% in May 2017 - the highest value since June 2013 - before falling to 2.6% in June and July. It has since increased again to 2.9% in August, compared with just 0.6% during the same period last year, with consensus forecasts as at August 2017 suggesting the index will remain at this level at the end of the year.

The Bank of England has indicated that they will endure high inflation in the interest of supporting jobs and economic growth, thus an increase in interest rates, particularly in the short-term, was viewed as unlikely. However, following the MPC's latest August meeting, in which two members voted to raise the rate, some analysts may now wonder whether a rate rise could come as early as the year-end.

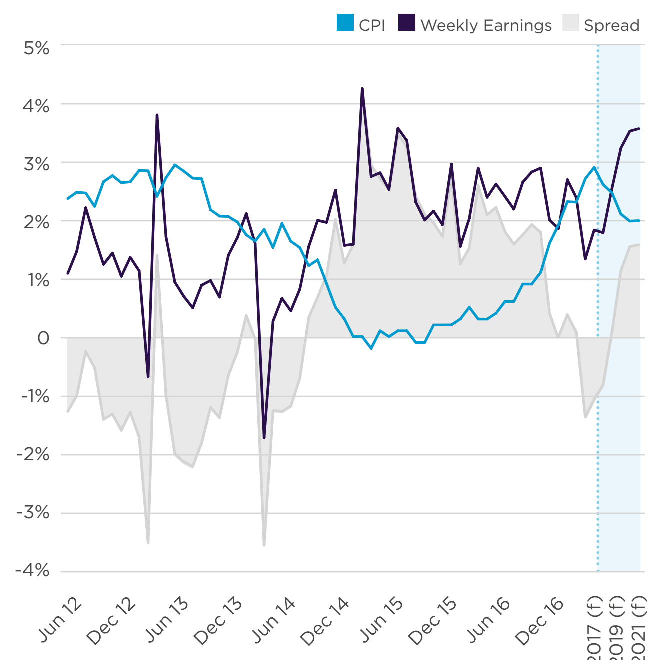
In terms of labour, the UK's unemployment rate fell for the fourth consecutive period to **4.3%** during May to July, from **4.9%** during the same period in 2016. However, slow wage growth continues to be a concern. With inflation growth currently outpacing that of real household incomes, see **figure 2**, consumer spending is expected to slow, which may restrain GDP growth during the coming quarters.

Figure 1 Annual GDP Growth



Source: ONS (to Q2 2017), OBR (March 2017)

Figure 2 Annual Growth of the Consumer Price Index & Average Weekly earnings



Source: ONS (to August 2017), Experian (June 2017 forecasts)

UK INVESTMENT OVERVIEW

A TOTAL OF £27 BILLION WAS INVESTED INTO THE UK'S COMMERCIAL PROPERTY MARKET DURING THE FIRST HALF OF 2017, MARGINALLY UP ON THE SAME PERIOD LAST YEAR, AND 26% ABOVE THE 10-YEAR AVERAGE FOR H1 TOTALS, SEE FIGURE 3.

Investment into the office sector dominated, totalling **£10.5 billion** during this period. The figure was bolstered by many deals in excess of **£100 million**, the largest being the sale of the Leadenhall Building in London in March, which traded hands to Chinese developer C C Land for **£1.15 billion**. Furthermore, the completion of 20 Fenchurch Street, also in London, in July for **£1.28 billion** at a **3.40%** yield will significantly bolster transaction volumes for this year.

In terms of growth sectors, the allocation of alternative assets continues to strengthen in the UK's investment market. During H1 2017, a total of **£5.3 billion** was invested into alternative property, more than double the level reached in H1 2016. Student property remains the largest driver, with investment totalling just below **£2.1 billion**.

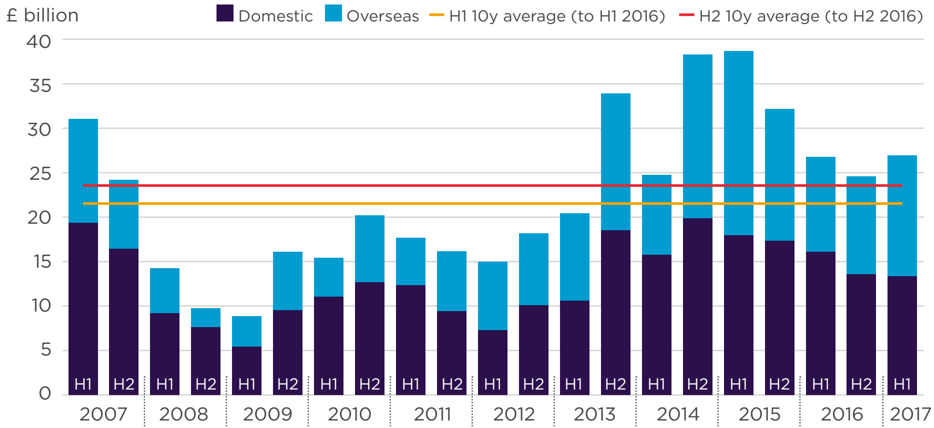
The retail sector continued to show signs of struggle, as it has done so for the last 12-18 months, with the exception of Central London and regional shopping centres. Investment totalled **£3.6 billion** in H1 2017, down by **29%** on the same period of 2016 and the lowest H1 result since 2012. This was in part due to low levels of supply, but also because of an increase in the desirability of assets in other sectors. In contrast, demand for industrial assets remained robust following strong performance in 2016. The first half of 2017 saw assets totalling **£3.8 billion** change hands, up by **21%** on H1 2016 and the highest H1 total since records began.

In the midst of such uncertainty, the industrial sector has shown great resilience. According to MSCI, as at June 2017 the sector was generating a **12.4%** total return on a 12-month annualised basis, ahead of the **2.2%** and **3.0%** total return for the office and retail sectors respectively, see **figure 4**.

Following the vote on EU membership last year, capital growth for each sector and at an all property level declined significantly, but 12 months on and capital values have started to recover. However these volatile movements, encouraged by wider macroeconomic national and global upheavals, has been problematic for many buyers. Income returns on the other hand have shown a more stable trend, and as such, investors have increasingly begun to redirect their search criteria to focus on longer-term income generating investment assets.

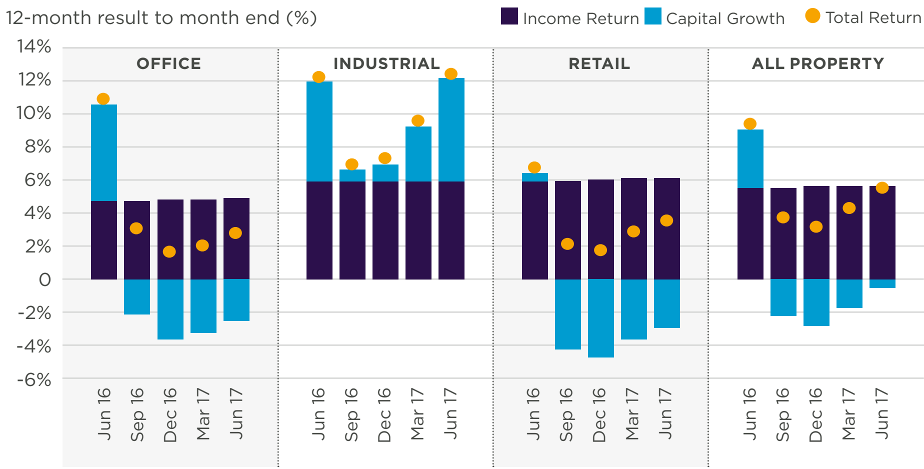
Over the last 12 months, Sterling has also devalued significantly, making the UK's investment market more desirable for overseas buyers. This has filtered through in this year's investment statistics, where overseas buyers accounted for **51%** of total investment in H1 2017, up from **40%** in H1 2016. The current investor split is also synonymous to levels achieved at the peak of the market between 2012 and 2015, before uncertainty prevailed.

Figure 3 UK commercial investment volumes*
**Office, industrial, retail, alternative, leisure and mixed use buildings*



Source: Property Data (correct as at July 2017)

Figure 4 Investment composition by sector, 12-month result to month end



Source: MSCI UK Monthly Index (June 2017)

CAMBRIDGE MARKET OVERVIEW

OFFICE/ LABORATORY SECTOR

Take-up in the Cambridge office and laboratory market, within an 11-mile radius of CB1, totalled **398,832 sq ft** during H1 2017. This was more than double the same period in 2016, where only **161,384 sq ft** was recorded. Notable transactions included the **59,000 sq ft** Grade A office letting to Amazon on floors 4-6 of One Station Square, CB1, while Astex leased **42,688 sq ft** in Q1 at 436 Cambridge Science Park.

Inside the historic city centre, **11,067 sq ft** of recently refurbished Grade A office space at Quayside was leased at **£36.36 per sq ft**, a new record for this non-established office location due to the excellent amenities available in the building, and its locality to shops, bars and restaurants on the river.

High demand and low levels of supply has had a significant impact on availability and rising rents. With 2016 take-up at **662,357** and assuming similar levels of take-up in 2017, there is approximately 18 months of supply, of built and available stock, which as at H1 2017 stands at **825,000 sq ft**.

While CB1 has seen the highest office rents of **£38.00 per sq ft**, the northern cluster at the Cambridge Science and Business Parks are closing the rental gap. This was evidenced by two pre-let deals at The Maurice Wilkes Building on St Johns Innovation Park this year, to Darktrace in March and PWC in September totalling 32,008 sq ft and both at **£31.75 per sq ft**.

Looking ahead, for the remainder of the year, prime rents are expected to increase towards **£39.00 per sq ft** in the central area and towards **£33 per sq ft** on the northern fringe business and science parks.

£38.00

OFFICE RENTS (£psf)
Q2 2017

£11.00[1]

INDUSTRIAL RENTS (£psf)
Q2 2017

£290.00

RETAIL RENTS (ZA £psf)
Q2 2017

31.3%

GVA GROWTH FORECAST
(2016-2026)

8.5%[2]

AVERAGE ANNUAL HOUSE PRICE GROWTH
2016

Sources:
Rents - Carter Jonas
House price growth - Land Registry
Economy - Experian Economics (June 2017)
Business start-ups - ONS
Conservation areas and Listed buildings - Historic England

[1] Estimated prime rents, based on 10,000 sq ft (GIA), brand new unit in a prime location, with 45-50% site cover and 10% office content, and a lease term of 5-10 years
[2] Cambridgeshire

INDUSTRIAL SECTOR

Despite an increase in speculative development activity, the availability of good quality industrial space in Cambridge remains tight, with rents continuing to rise. Headline rents are now peaking at **£11.00 per sq ft** and lease terms on existing, second-hand stock have remained stable, with landlords still considering five-year terms.

As a result of supply constraints, occupiers are being pushed to take poorer quality second-hand space or options further afield as the availability of new stock has dropped significantly. Consequently, any good quality secondary stock that comes to market is letting relatively quickly. Freehold availability is minimal, with landlords taking advantage of the high demand and rental increases seen over the past few years, and this trend is only set to continue.

“THE AVAILABILITY OF NEW STOCK HAS DROPPED SIGNIFICANTLY

The restricted supply of industrial sites has resulted in many occupiers opting to remain and renew existing leases, particularly once they are established and given the shortage of units close to Cambridge city centre. In addition, there is continued pressure on city centre and edge of centre brownfield industrial sites given that a number could have potential for redevelopment into office, residential or mixed-use schemes.

11.7%

EMPLOYMENT GROWTH FORECAST
(2016-2026)

4,860

NUMBER OF BUSINESS START-UPS
2016

12

NUMBER OF CONSERVATION AREAS
(2016)

67

NUMBER OF GRADE I LISTED BUILDINGS
(2016)

RETAIL SECTOR

The retail provision in Cambridge is one of high quality and its high streets and shopping centres continue to attract strong levels of footfall. According to Cambridge Business Improvement District (BID), an average of approximately **700,000** people visited Cambridge’s high streets in May, up by almost **12%** on a year earlier. The excellent weather during this period was a key driver in encouraging keen shoppers, despite concerns surrounding the inflationary tightening of household incomes throughout the country. Additionally, in June, Cambridge was named the UK’s best place to shop in terms of retail vitality, according to Harper Dennis Hobbs’ top 1,000 retail centres in the UK.

Town centre retail rents remained stable at **ZA £280 per sq ft** as at June 2017, for units in the Grand Arcade, **£10.00 per sq ft** below its pre-recession peak. The high street areas have performed slightly better, but have been unable to surpass the prime rent of **ZA £290 per sq ft** achieved last summer.

In terms of new tenants, Tesla leased a unit in the Grand Arcade, while in the Grafton Centre, Decathlon and The Entertainer recently occupied space. The Grafton Centre, which is still undergoing refurbishment and expansion, has the potential to attract more retailers and leisure providers upon completion, including hotel and gym operators, helping to diversify the already varied offering currently present in the centre.

KEY STATS

OFFICE RENT (PSF) & YIELD	INDUSTRIAL RENT[1] (PSF) & YIELD	RETAIL RENT (ZA PSF) & YIELD	YEAR-END OUTLOOK

1 OXFORD

RENT	YIELD
30.00 ↔	5.50% ↓
£10.00 ↔	5.50% ↔
£300.00 ↔	4.00% ↓

FOCUS ON OXFORD

ECONOMY: The economic profile of Oxfordshire remains robust and the county's drive to improve infrastructure and transport links will continue to add to its growth story. The Oxfordshire Infrastructure Strategy (OxIS) aims to put plans in place for **100,000** new homes and in excess of **85,000** new jobs between 2011-31. Based on external forecasts, that is a **27.7%** increase in jobs during the two-decade period. Looking specifically at Oxford, the key projects identified within the OxIS all relate to transport. This includes improvements to the A420 Corridor, the A34 Chiltern Junction, in addition to adding a super cycle route that circles most of the city centre. Strategic sites for additional housing capacity have also been identified at both the northern and southern areas of the council area, as well as in the areas surrounding the Oxpens development site.

INVESTMENT: Investment activity in Oxford slumped during the first half of 2017, with only one asset trading, compared with five during the same period of 2016. The acquisition of the **4.86 hectares** Yarnton Nurseries, for **£10.3 million** by investment manager Newcore Capital, comprised a garden centre, restaurant and various other retail outlets. At full occupation, the site generates a turnover of approximately **£15 million**. Despite the lack of deals, July saw the completion of a 50% stake of the Milton Park campus for **£200 million**, making investment in 2017 the highest on record, with five months remaining. The acquisition is Canada Pension Plan's first in Oxford, and may pave the way for more international firms to invest in Oxford's commercial property market.

2 NORTHAMPTON

RENT	YIELD
£14.00 ↔	7.25% ↔
£6.50 ↑	5.25% ↓
£95.00 ↔	6.75% ↔

3 BIRMINGHAM

RENT	YIELD
£32.50 ↑	5.00% ↔
£6.75 ↑	5.25% ↓
£320.00 ↔	4.50% ↔

4 BATH

RENT	YIELD
£23.50 ↑	4.75% ↔
£11.00 ↔	5.00% ↓
£205.00 ↔	4.50% ↑

FOCUS ON BATH

ECONOMY: Tourism and education continue to be the main drivers of economic growth in Bath. Regarded as a university town and with its heritage status, the city continues to attract footfall. On-going rail connection improvements between Bath and London, due for completion this year, will provide more accessibility for Bath, crucial in supporting further growth for the City. The proportion of high-educated residents in the city continues to sit ahead of the regional and national averages. A total of **45.6%** of the city's residents were educated to NVQ4 level and above, compared with **38.0%** for both the South West region and the UK as a whole.

INVESTMENT: The first half of 2017 has indeed set a positive tone for the rest of the year in Bath's investment market. A total of **£60.4 million** was invested into the city's commercial property market, double that of the same period in 2016 and the highest H1 total on record. This was primarily due to the joint venture acquisition of Roseberry Place – a site of brownfield land with planning consent for a PRS and mixed-use scheme – for **£50.5 million** by Legal & General Property and PGGM. Though the lack of supply is an issue for the city, this deal reflected a **4.25%** yield, setting a positive tone of strong pricing and high demand for Bath. Looking specifically at pricing of the various sectors, prime retail yields are continuing to soften. Where prime retail units were achieving close to **4.00%** last year, the city is now seeing yields edge closer to **4.50%**. The scarcity of sales activity in the office sector has maintained yields static, while pricing in the wider South West industrial market have tightened by circa **25** basis points to **4.75-5.00%**.

5 BRISTOL

RENT	YIELD
£28.50 ↔	5.50% ↓
£8.50 ↑	5.50% ↓
£180.00 ↔	5.25% ↔

6 EXETER

RENT	YIELD
£16.00 ↔	6.25% ↔
£7.50 ↑	5.50% ↔
£190.00 ↔	5.00% ↔

7 MANCHESTER

RENT	YIELD
£33.50 ↔	5.00% ↔
£7.00 ↑	5.25% ↔
£300.00 ↔	4.00% ↔

8 COLCHESTER

RENT	YIELD
£13.50 ↔	6.75% ↔
£7.00 ↑	6.00% ↔
£170.00 ↔	6.00% ↔

9 LEEDS

RENT	YIELD
£30.00 ↑	5.25% ↔
£6.25 ↑	5.00% ↔
£250.00 ↔	4.75% ↔

FOCUS ON LEEDS

ECONOMY: Leeds was ranked fifth on the Lonely Planet's Best in Europe 2017 list, the only UK entry in the top 10, a significant boost for tourism in the city. With its major transport connections, diverse use of land and excellent cultural environment, the city remains central to the UK's Northern Powerhouse. Population and GVA forecasts for the city look to expand by **6.8%** and **25.0%** respectively by 2026, both indicators ahead of the county, region and the whole of the UK. The arrival of HS2 will be a contributing factor to the city's growth story, in addition to other schemes such as the Leeds South Bank, Enterprise Zone and East Leeds Extension. These projects, among others, will further diversify the city, not just in the region but nationally.

INVESTMENT: The first half of 2017 saw just **£71.9 million** worth of commercial deals trading hands in Leeds, significantly lower than the amount transacted in H1 2016 and the lowest H1 deal volume since 2003. A low volume of investment stock has hampered activity, despite demand remaining prominent. The largest deal of 2017 so far was JP Morgan's purchase of an office building on Toronto Square for **£22.2 million**, reflecting a **4.45%** yield. Although pricing for the "best in class" buildings has tightened somewhat since the end of 2016, the general sentiment is that yields for prime, good quality buildings remain unchanged at **5.25%**. Retail and industrial yields also remained static at **4.75%** and **5.00%** respectively, unchanged from their 2016 year-end position.

10 YORK

RENT	YIELD
£18.00 ↔	7.25% ↔
£6.00 ↑	5.25% ↔
£220.00 ↔	4.50% ↔

11 CAMBRIDGE

RENT	YIELD
£38.00 ↑	4.75% ↔
£11.00 ↑	6.00% ↔
£290.00 ↔	4.25% ↔

FOCUS ON CAMBRIDGE

ECONOMY: Cambridge continues to excel in terms of economic development, and the robustness of the city's economy is a great growth model for the rest of the UK. According to research produced by the Cambridge Ahead Growth Group, a panel dedicated to the successful growth of the city in the long-term, the combination of the rate of growth of companies in Cambridge, various infrastructure projects and increased activity, in terms of turnover and development, of the life science sector, are expected to contribute to the positive forecast figures over the next five years. Benefit claimant count in the town has fallen back to **0.7%** as at June 2017, after increasing to **0.8%** at the end of 2016, while gross weekly earnings, by place of residence as at the end of 2016, totalled **£589.10**, close to **10%** above the national average. Looking ahead, employment growth in Cambridge is due to slow, increasing by just **1.0%** to **76.6%** between 2017 and 2020.

INVESTMENT: Investment activity in Cambridge totalled **£18.7 million** during the first half of 2017, up from just **£3.1 million** transacted in H1 2016. However, both years continue to reflect a lower level of investment activity than previously witnessed in the city. The acquisition of an industrial asset in Trafalgar and Viking Way for **£11.6 million** by Legal & General Property in Q1 was the largest deal of the year so far and reflected a **6.30%** yield. Although this is a slight softening of industrial yields that were achieved 18-24 months ago, the sector continues to be in high demand. Prime office and retail yields remain unchanged from their position at the end of 2016, at **4.75%** and **4.25%** respectively.

12 NORWICH

RENT	YIELD
£16.50 ↔	6.50% ↔
£6.00 ↑	6.00% ↔
£190.00 ↔	5.00% ↔

13 LONDON

CITY

RENT	YIELD
£67.50 ↓	4.25% ↔
£13.50[2] ↑	4.50%[2] ↔
£300.00 ↔	4.00% ↔

WEST END

RENT	YIELD
£115.00 ↓	3.50% ↔
£16.00[3] ↑	4.50%[2] ↔
£2,225 ↔	2.25% ↔

FOCUS ON LONDON

ECONOMY: London, the city that was expected to diminish in the wake of the EU referendum vote, has shown great resilience. Despite on-going concerns as to how the negotiations will affect employment growth, and with some firms preparing themselves for a "worse case" scenario, the city remains a global powerhouse and continues to attract talent and tourism. As at December 2016, **51.9%** of London's population was educated to NVQ4 level or above, ahead of the 3**8%** national level. A number of firms from a broad spectrum of industries have also committed themselves to the UK, and in particular London, over the last 12 months, abolishing concerns of a "hard Brexit". While HSBC and Bank of America plan to relocate out of the country, Deutsche Bank, Amazon and BMW are among many firms who intend to stay, or move to the UK. Breaking ties with Europe will undoubtedly hinder growth of the City's economy, however looking ahead, the opportunity to form new relationships with the rest of the world will keep London competing on a global scale.

INVESTMENT: Investment turnover in Central London totalled **£10.1 billion** during the first half of 2017, up by **30%** on the same period last year and **37%** above the 10-year average for H1 volumes. This figure was heavily supported by the sale of the Leadenhall Building in the City, which transacted for **£1.15 billion**. However, deal quantities did lag with **237** transactions taking place during this period, a significant reduction on the **296** deals that traded in H1 2016. Confidence of UK institutions into the Central London market seems to have been regained this year. A total of **£613 million** was invested by UK institutions in H1 2017, well on its way to exceed the **£857 million** transacted in all of 2016. In terms of pricing, office yields in the West End and City have tightened again. Following a modest outward shift in 2016, prime office yields are now in the region of **3.50%** and **4.25%** in the West End and City respectively. Conversely, retail yields have shown a degree of stability, remaining in the region of **2.25%** in the prime retail patches of Bond Street and Oxford Street.

Source: Carter Jonas, Experian Economics (June 2017)

[1] Estimated prime rents, based on 10,000 sq ft (GIA), brand new unit in a prime location, with 45-50% site cover and 10% office content, and a lease term of 5-10 years
[2] London East, e.g. Beckton, Barking, Dagenham
[3] London West, e.g. Heathrow

38 OFFICES ACROSS THE COUNTRY, INCLUDING 13 IN CENTRAL LONDON

- Bangor
- Basingstoke
- Bath
- Birmingham
- Boroughbridge
- Bury St Edmunds
- Cambridge South
- Cambridge North
- Cambridge Central
- Edinburgh
- Harrogate
- Kendal
- Leeds
- Marlborough
- Newbury
- Newbury - Sutton Griffin
- Northampton
- Oxford
- Peterborough
- Shrewsbury
- Suffolk
- Taunton
- Truro
- Winchester
- York

- National HQ One Chapel Place
- Barnes
- Barnes Village
- Fulham Bishop's Park
- Fulham Parsons Green
- Holland Park & Notting Hill
- Hyde Park & Bayswater
- Knightsbridge & Chelsea
- Marylebone & Regent's Park
- Mayfair & St James's
- S. Kensington & Earl's Court
- Wandsworth
- Waterloo

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

01223 315716

One Station Square, Cambridge CB1 2GA

cambridge@carterjonas.co.uk

Report Compiled By:

Will Mooney Partner, Commercial
01223 558032 | will.mooney@carterjonas.co.uk

Colin Brown Partner, Planning & Development
01223 326826 | colin.brown@carterjonas.co.uk

Catherine Penman Head of Research
01604 608203 | catherine.penman@carterjonas.co.uk

Sebastian Denby Surveyor, Business Space
01223 346640 | sebastian.denby@carterjonas.co.uk

Additional contacts:

George Fellowes Associate, Business Space
01223 346645 | george.fellowes@carterjonas.co.uk

William Rooke Partner, Development/Investment
01223 326815 | william.rooke@carterjonas.co.uk

John Russell Associate, Property Management
01223 326818 | john.russell@carterjonas.co.uk

Richard Love Partner, Architecture & Building Consultancy
020 7518 3299 | richard.love@carterjonas.co.uk

Nick Brammar Partner, Valuation & Professional Services
01223 326807 | nick.brammar@carterjonas.co.uk

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