



COMMERCIAL EDGE UPDATE

BATH
2018

Carter Jonas

BATH HAS A DIVERSE ECONOMIC BASE, INCLUDING A STRONG KNOWLEDGE ECONOMY AND A LEADING HIGHER EDUCATION SECTOR. IT ALSO BOASTS A SIZEABLE TOURIST SECTOR WHICH HAS BEEN BOOSTED THIS YEAR BY THE DEVALUATION OF STERLING AND THE EXCEPTIONALLY HOT SUMMER WEATHER.

Against this backdrop, the city has seen strong economic growth, estimated at 2.5% in 2017, well above the national average of 1.8% (Experian). Economic growth is forecast at 1.5% pa over the next five years, in line with the UK average.

Bath has a growing population, and employment has risen by an estimated 1% pa over the last five years, adding a total of 5,000 additional jobs to the city's economy. Growth has been particularly strong in computing & information services and administrative & supportive Services. The city's unemployment rate is below the national average at sub-4%.

The consumer sector is particularly important and consumer expenditure has risen by an estimated 1.7% pa over the last five years, forecast to slow modestly to 1.3% pa over the next five years, broadly in line with the UK average.

Bath's commercial property markets are reflecting the city's growth, with strong occupier demand but a lack of supply holding back take-up in both the office and industrial sectors. This is creating upward pressure on rental values.

The city's retail market is also proving highly resilient against a challenging backdrop across the UK as the high street battles a string of retailer failures, the growth of online retailing and rising costs. Bath's ongoing low vacancy rate, strong footfall and list of retailers looking to acquire space is testament to this.

FOCUS ON INVESTMENT



2.5%
2017 ECONOMIC
GROWTH

1% PA
EMPLOYMENT
GROWTH
(last 5 years)

£750 MILLION
SOUTH WEST
COMMERCIAL
PROPERTY
TRANSACTIONS
(H1 2018)

5.25%
PRIME OFFICE AND
INDUSTRIAL YIELD

Source: Experian, Property Data,
Carter Jonas

The city has seen limited significant investment sales so far this year. A key deal has been the purchase of the Pinesgate scheme, which has consent for 113,000 sq ft of offices and a college building, although a revision of the planning to include some residential or student flats now seems likely.

Another transaction was Somerset Hall, a five-storey office building totalling nearly 24,500 sq ft, which sold at a yield of 4.84%. We believe this is a strong yield considering the building is let at below market terms on a new lease, reflecting the proposed redevelopment of the North Quays area over the coming years. Other transactions have included the sale of 24 Queen Square, an office building of circa 7,200 sq ft; and The Old Dairy, an office building comprising 11,000 sq ft.

The lower transaction volumes in Bath of circa £50 million in the first six months of the year reflect a wider trend in the South West market, with transactions across the region totalling £750 million, compared with just over £1 billion in the first half of 2017. This is reflective of a lack of suitable stock, with investor demand for quality product still very strong across a wide range of buyers.

Overall, we believe there has been further downward pressure on yields as investor demand continues to outstrip the available opportunities. However, there are clear divergences according to sector. In the industrial sector, where investor interest is

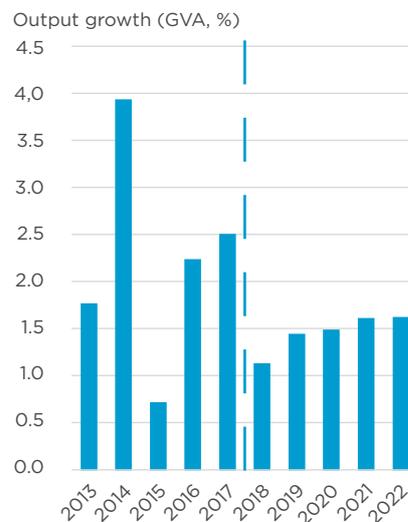


keenest, we have moved prime yields in by 25 basis points compared with the start of the year, to stand at 5.25%, reflective of the wider market in locations such as Bristol and Chippenham.

Prime yields in Bath's office market have been stable at 5.25%, and the sector remains highly attractive given the strong occupational market and tight supply. However, the lack of product is clearly a constraint.

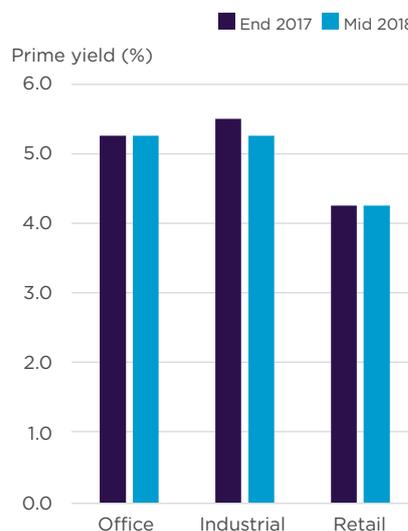
We have noticed a decrease in the number of potential purchasers for retail property, although this is likely to reflect a greater caution around the sector nationally rather than specific issues with the market in Bath, and yields could potentially see some upward movement over the next year. The prime yield is currently 4.25%.

Figure 1 Total Output Growth



Source: Experian

Figure 2 Prime Yields



Source: Carter Jonas

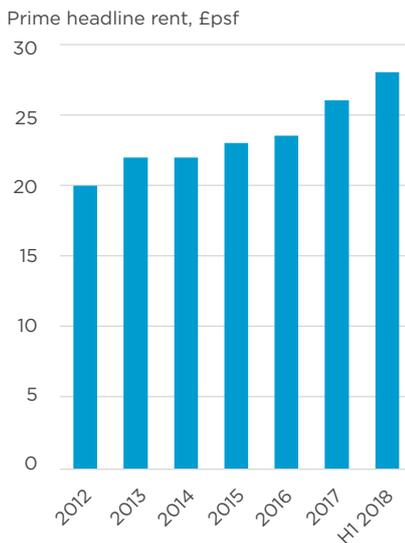
OFFICE MARKET



£28.00 PSF
PRIME
OFFICE
RENT

8%
PRIME RENTAL
GROWTH (H1 2018)

Figure 3
Prime city centre office rents



Source: Carter Jonas

Office take-up in the first half of 2018 was circa 50,000 sq ft, broadly in line with the five-year average. However, this is not reflective of demand, which is being held back by a chronic lack of available space.

Although availability increased modestly during the first half of 2018 it remains extremely low. Just 63,500 sq ft was available in mid-2018 (for occupation within 12 months), giving a vacancy rate of circa 4% of stock. The city is losing potential occupiers to nearby Bristol (which also has a supply shortage, but its larger scale means there are still more options for tenants).

The imbalance between supply and demand will continue until Bath Quays is delivered. The Local Authority is due to commence the 90,000 sq ft Bath Quays South development this year and has shortlisted developers for Bath Quays North, which has the potential to deliver over 200,000 sq ft of additional office space. This scheme received outline planning consent in August this year and the developer is due to be selected by the end of the year.

Bath has seen impressive rental growth amid the continued shortage of supply. The prime headline rent has risen from £26.00 psf at the start of the year to £28.00 psf currently, an increase of nearly 8%. However, a two-tier market has emerged. Better quality, centrally located open plan space with air conditioning is generally priced at £25.00 to £28.00 psf, whilst traditional style offices are typically priced at £19.00 to £24.00 psf. Typical rent-free incentives remain at six months on a 10-year term.

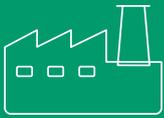


Rental increases mean that many occupiers will continue to find their costs rising sharply at rent review and lease renewal, whilst many landlords will be pleasantly surprised at the rate of growth. The upward pressure on rents has recently resulted in office occupiers securing two development sites in the city, both of which would have previously been converted to residential use.

In the past, overseas-based companies in the tech sector have tended to choose Bristol over Bath, due mainly to its size. However, Bath's reputation as a creative, media and tech hub has risen in recent years which has enabled it to attract US-based companies such as Funko and ioMosaic. The city has a high business start-up rate, helped by spinouts from its two universities (as well as those in Bristol), and a large proportion of deals are from these sectors. They are also underpinning the high demand for serviced office space, of which a considerable amount has been delivered over the last two years.

We see scope for further rental increases over the next 12 months, which we expect to reach close to £30.00 psf by mid-2019.

INDUSTRIAL MARKET



£12.00 PSF
PRIME
INDUSTRIAL
RENT

10,000 SQ FT
AVAILABLE
INDUSTRIAL
SPACE

6,800 SQ FT
INDUSTRIAL
TAKE-UP
(H1 2018)

Bath's industrial market is characterised by a severe shortage of supply. Given the lack of available land there is a very limited opportunity for speculative construction. This is likely to persist, particularly as values in the PRS and student accommodation sectors are so much higher. However, we are confident that any new supply would let very well, with local demand from a wide range of potential occupiers.

Prime rents in Bath for new build units of less than 3,000 sq ft have been stable at £12.00 psf during the first half of 2018, but with the lack of supply and healthy demand, we see rents moving towards £12.50 psf over the next 12 months.

There is also a severe shortage of supply in nearby Bristol, which has resulted in a fall in take-up this year, with few very large transactions, and indeed no transactions in the 100,000+ sq ft bracket. The Swindon market has also seen restrained take-up, although in the first half of the year Swindon boasts

the largest deal in the area, a 375,000 sq ft design and build distribution unit for B&Q. This is a sharp contrast to last year, as occupiers such as Amazon and DHL (both in Avonmouth, Bristol) now appear to have finished their current round of large acquisitions.

Good quality stock in the right price range is letting well. However, there appears to be a lack of developer confidence to build speculatively, despite the strong level of underlying demand. The rapidly changing retail market means that the type of space demanded can change quickly, and this may be causing increased nervousness about building speculatively.

We are seeing an increasing trend towards occupiers buying the land and developing the units themselves, with recent examples including Amazon and Lidl. As a result, many of the large transactions have been for land, rather than traditional design and build. This appears to be driven by the perceived high cost of design and build coupled with the desire for greater control by the larger operators as well as bespoke fit out requirements.

A number of transport infrastructure enhancements will benefit the market. A new junction on the M49 will connect into the Avonmouth and Severnside Enterprise Area, and is due to be completed by December 2019. In addition, the lifting of the Severn Bridge tolls at the end of the year will help connectivity into South Wales, and the dualling of the A350 in Wiltshire will enhance north-south connectivity, benefiting areas such as Melksham.



RETAIL MARKET



£205 PSF
PRIME ZONE A
RETAIL RENT

0.8%
2018 PROJECTED
CONSUMER
EXPENDITURE
GROWTH
(EXPERIAN)

The exceptionally hot and dry summer weather has led to a record number of visitors to Bath. The city's retail vacancy rate is very low and has been broadly stable over the last six months. Despite this, there is a perception that vacancy has increased across the city. In reality, it is simply taking longer to occupy units, with retailers taking more time to commit to sites, and it is also taking longer to obtain the necessary planning consents for fit-outs.

The SouthGate area continues to grow in popularity and indeed there are currently no vacant units in the SouthGate centre. Over the last year, occupancy has increased in Union Street and the New Bond Street area, and the fringe market also remains strong, with vacant units tending to re-let quickly.

There is a wide range of retailers looking for space, with the footwear sector particularly active (the sector is relatively insulated from the effects of e-commerce), as well as the banking sector, where the national

trend towards branch closures is reversing, particularly outside of the 'big four' banks.

Retailers are becoming more selective in terms of the units they want to occupy, with a preference for modern units. We are therefore likely to see a polarisation between older and newer units, with newer ones re-letting much more quickly.

The pressures on some of the UK's larger retail chains continue, and the uncertainty over the future direction of the House of Fraser group under its new ownership is clearly a concern for the city's retail market. Demand from local and niche operators is holding up better than the national multiples.

Food & beverage operators are becoming more selective, but a number are actively looking for space. However, Bath has not been immune from the series of CVAs, administrations and retrenchments affecting the sector this year, with casualties including CAU, Carluccio's, Jamie's, Burger & Lobster and Chimichanga. This has had an adverse impact on Milsom Place in particular.

Whilst there is limited new supply in the offing, the North Quays office scheme would incorporate a retail and leisure element. The scope of this will become clearer once a developer is selected later this year, although there is a planning stipulation that its offer should not compete with the city centre.

The current prime rent, applicable to Old Bond Street, parts of New Bond Street and Milsom Street, is £205 psf Zone A, unchanged from the start of the year. We believe this will mark the peak of the current cycle.



PROPERTY MARKET TRENDS

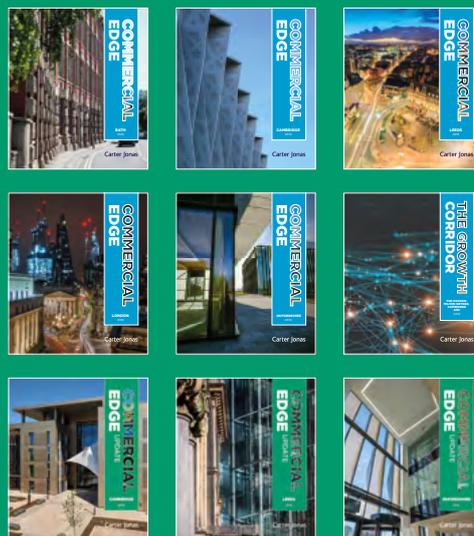
		PRIME RENT (MID-2018)	CHANGE OVER H1 2018	FORECAST NEXT 12 MONTHS	PRIME YIELD (MID-2018)
VALUES	Office	£28.00 psf	↑	↑	5.25%
	Industrial	£12.00 psf	↔	↑	5.25%
	Retail	£205 psf ZA	↔	↔	4.25%
		H1 2018 TAKE-UP (SQ FT)	TAKE-UP COMPARED WITH 5-YR AVERAGE	CURRENT AVAILABILITY (SQ FT)	CHANGE OVER H1 2018
BUSINESS SPACE ACTIVITY	Office	50,000 sq ft	In line with average	63,500 sq ft	↑
	Industrial	6,800 sq ft	Below average	10,000 sq ft	↑
		TOTAL TRANSACTED H1 2018		6-MONTHLY AVERAGE (LAST 5 YEARS)	
INVESTMENT MARKET ACTIVITY		£50 million		£48 million	

OUTLOOK

- An acute shortage of supply will continue in both the office and industrial sectors. Bath Quays should provide a substantial amount of new office stock, and this has just moved a step closer with the granting of outline planning consent.
- We see scope for further rental increases over the next 12 months in the office and industrial sectors.
- We expect prime office rents to reach close to £30.00 psf by mid-2019.
- Over the last two years Bath's retail sector has benefitted from an increase in overseas tourism resulting from Sterling's devaluation following the EU referendum. Post-Brexit, this could reverse if visitors from the EU are deterred from coming to the UK.
- A number of transport infrastructure enhancements are coming forward that will improve Bath's connectivity, including the lifting of the Severn Bridge tolls and the dualling of the A350. The delayed London to Bristol rail electrification, whilst a frustration, has had little material impact, although the eventual reduction in journey times and improved reliability and capacity on the route will increase the city's attractiveness and credibility.

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