COMMERCIAL EDGE UPDATE

CAMBRIDGE

2018

Carter Jonas

CAMBRIDGE HAS BEEN A GROWTH HOTSPOT IN RECENT YEARS, BUOYED BY ITS STRENGTH IN SECTORS SUCH AS TECHNOLOGY, ENGINEERING AND PHARMACEUTICALS, WHICH IS UNDERPINNED BY ITS UNIQUE RESEARCH & DEVELOPMENT SECTOR AND THE UNIVERSITY OF CAMBRIDGE.

Several major employers have moved into, or expanded within the city in recent years. Perhaps the most notable of these is pharmaceutical heavyweight AstraZeneca, whose new global headquarters is due to complete next year.

Economic growth for 2017 was just under 3.5% which is twice the national average. Total output growth for 2018 is forecast at 1.9% (Figure 1). However, a number of sectors in the city significantly outperformed this growth rate, including computing & information services, media, and professional services. Cambridge University's Centre for Business Research has reported global turnover growth for Cambridge companies in 2017 as 14.4%, compared to the previous year's figure of 10.8%.

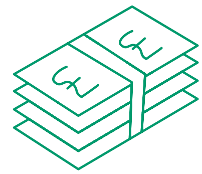
Cambridge has a rapidly expanding population, growing by 1.2% pa over the last five years, compared with 0.7% pa for the UK as a whole. Office-based sectors have seen an even faster rate of growth of 3.3% pa over the last five years. This has boosted demand for office space with strong take-up, leading to an acute shortage of good quality supply in the city centre.

Consumer expenditure has been rising at a much faster rate than the national average (an estimated 3.6% pa in Cambridge compared with 2.2% pa nationally). The city should continue to outperform the UK, although the differential is likely to reduce. The city's retail sector has continued to trade well on the back of a relatively affluent catchment and strong tourist sector. However, it is not entirely insulated from the broader changes sweeping through the UK's high streets, with an increase in vacant units in the city centre.

The greatest challenge for Cambridge stems from its success and rapid rate of growth. This has pushed up the cost of living, particularly housing. Indeed, the average house price in Cambridge is £450,400, 56% above the regional average, and almost double the national average (HM Land Registry, May 2018). Traffic congestion also remains a severe problem, and increased investment in innovative public transport solutions will be required to deliver capacity for future growth.

In the longer term, the city's connectivity will be further enhanced through its position at the eastern end of the Oxford-Milton Keynes-Cambridge growth corridor. This will not only improve east-west transport links but may help alleviate the city's growing housing pressures, and also help to foster a knowledge cluster across a number of key economic centres.

FOCUS ON INVESTMENT



3.5%
2017 ECONOMIC GROWTH

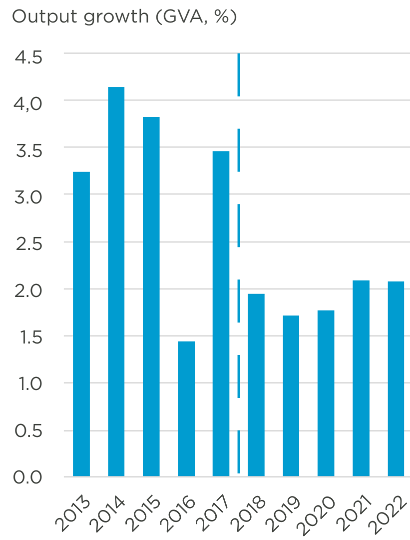
2.0% PA
EMPLOYMENT GROWTH
(last 5 years)

£170 MILLION
COMMERCIAL PROPERTY TRANSACTIONS
(H1 2018)

4.5%
PRIME OFFICE YIELD

Source: Experian, Property Data, Carter Jonas

Figure 1 Total Output Growth



Source: Experian

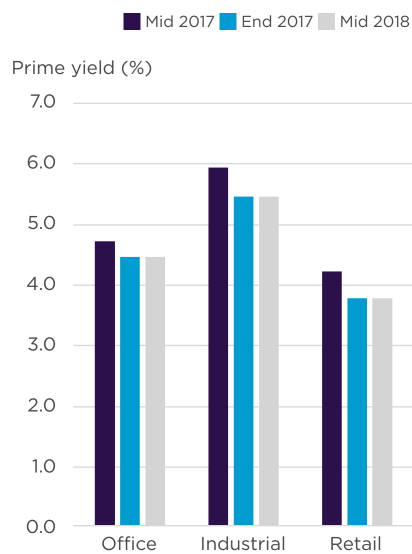
The city's strong economic fundamentals mean investor demand has remained strong this year. The UK funds are particularly active, along with the city's colleges as well as overseas interest.

Over £170 million has been transacted in the first half of the year, compared to a total of just under £100 million over the whole of 2017. The largest deal of the year so far has been the sale of Cambridge Research Park for £78 million by Rockspring to Royal London Asset Management. The park comprises 8 office properties and 9 mid-tech units, along with 13.5 acres of development land.

In terms of retail, 59 St Andrews Street was purchased by Emmanuel College from M&G Real Estate for over £32m reflecting a NIY of 4.8%. The breakdown in income was 75% from retail and 25% from offices. 511 Coldhams Lane, comprising six industrial units was sold by Dencora Estates Ltd to Travis Perkins for £9.7m.

Investment market performance has been strong, with returns in the office sector approaching 30% pa and industrial returns at more than 12% pa (MSCI Quarterly Index, June 2018). Prime yields have been stable over the first half of the year, at 4.5% for offices, 5.5% for industrial and 3.8% for retail (Figure 2).

Figure 2 Prime Yields



Source: Carter Jonas

OFFICE MARKET

£41.00 PSF
PRIME CITY CENTRE OFFICE RENT

8%
PRIME RENTAL GROWTH
(H1 2018)

700,000 SQ FT
AVAILABLE OFFICE SPACE

240,000 SQ FT
OFFICE TAKE-UP
(H1 2018)

Over 240,000 sq ft was transacted in the first half of the year, which is down 40% on 2017's strong H1.

With over 250,000 sq ft of offices already under offer, we expect a similar H2 and therefore a return to trend (600,000 sq ft on average over the last five years, excluding super deals of 75,000+ sq ft lettings to a single occupier). Key transactions during the first half of 2018 include:

- 50/60 Station Road (core station area) - 16,515 sq ft on the 7th floor let to Samsung at £41.00 psf
- 50/60 Station Road (core station area) - 21,388 sq ft on the 3rd floor let to Costello Medical at £38.00 psf
- Broers Building (city centre) – 3,772 sq ft let to Base4 Innovation at £36.00 psf
- Maurice Wilkes Building (North Cambridge) - 7,452 sq ft let to DarkTrace at £35.00 psf

Just under 700,000 sq ft of office and laboratory space is available within 11 miles of Cambridge city centre (an area that encompasses all of the surrounding business and science parks). The majority of this is out of town, most notably in Cambridge Research Park and Cambourne Business Park.

The only major city centre scheme currently under construction is 50/60 Station Road, due to complete in early 2019, which is part of the wider CB1 masterplan. Built speculatively, it has seen significant occupier interest during construction. On the back of this, developer Brookgate, will now look to speculatively develop 30 Station Road funded by Aviva, which will be closely followed by 10 and 20 Station Road.

There is over 85,000 sq ft of second-hand stock available in the northern fringe. Space is becoming available at Cambridge Science Park due to a number of redevelopments and company expansions, including the new building at No 26, of which all 65,000 sq ft has been pre-let to Frontier.

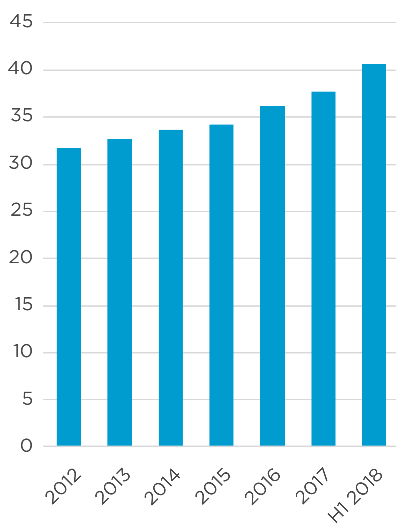
Phased re-development continues around the established science parks. AstraZeneca's global headquarters, totalling circa 850,000 sq ft, is due to complete next year, providing collaborative space for academic, healthcare and research teams.

There is plenty of smaller space available across the city's business parks, notably in the 5-15,000 sq ft bracket, which will present more affordable options for growing companies looking to cluster with like-minded firms. With Cambridge North station now open, the development of the CB4 scheme is now expected to commence in 2019, which will provide office space, 1,000 new homes, a four-star hotel and retail/restaurant offerings.

The prime (CB1 station area) rent has risen from £38.00 psf in Q2 2017 to £41.00 psf in Q2 2018, an 8% increase which reflects the restricted supply (Figure 3). The CB1 area retains a premium over the rest of the city centre due to its connectivity and sheer quality of the occupiers, despite having poor parking ratios. Meanwhile, prime rents in the northern fringe parks have reached £35.00 psf, compared to the previous rent in the same quarter last year of £31.75 psf. These rents were achieved at the Maurice Wilkes building on St Johns Innovation Park, the first speculatively built office in this area for over a decade. Rents in the out of town parks have also steadied and remain at £29.00 psf.

Figure 3
Prime city centre office rents

Prime headline rent, £psf



Source: Carter Jonas

INDUSTRIAL MARKET

£13.50 PSF
PRIME INDUSTRIAL RENT

576,000 SQ FT
AVAILABLE INDUSTRIAL SPACE

215,000 SQ FT
INDUSTRIAL TAKE-UP (H1 2018)

Circa 215,000 sq ft of industrial space transacted in the first half of the year which is in line with last year's performance (approximately 220,000 sq ft H1 2017). 300,000 sq ft of new speculative space has come onto the market in the first half of the year. Two of the speculatively built units at Buckingway Business Park are now let, and three of the nine mid-tech units at Enterprise 5000 on Cambridge Research Park are currently under offer.

This demonstrates confidence in the Cambridgeshire industrial sector, with developers looking to capture this buoyant market, including Salmon Harvester starting construction on site at Cambridge South, Sawston, to provide over 60,000 sq ft of industrial units next year.

Over 1 million sq ft of industrial space has been designated to alternative uses over the last 15 years, forcing developers to look to these out of town locations to provide the units required to keep up with demand.

There is approximately 576,000 sq ft of industrial space currently available, a slight increase from 530,000 sq ft at the start of the year, but lower than the 817,000 sq ft 5-year average. The current availability rate of 6.9% is considerably below the five year average of 10.1%, and there is very much a lack of freehold options.

The prime industrial rent in Cambridge has increased to £13.50 psf, compared with £12.50 psf at the start of the year. Second hand units are circa £8.00 psf, with £6.75 psf out of town. Trade counter rents remain between £14.50 and £16.50 psf.

RETAIL MARKET

£290 PSF
PRIME ZONE A RETAIL RENT

1.0%
2018 PROJECTED CONSUMER EXPENDITURE GROWTH (EXPERIAN)

Cambridge is a very popular destination for tourists from around the world, attracting over 5 million visitors each year. The University buildings, River Cam and quaint city streets prove attractive along with the relaxing shopping experience offered by independent shops and traditional high street brands. There is also a wide range of pubs, restaurants and cafes as well as a number of hotels.

This has helped the Cambridge retail market to perform well in light of the challenges facing the UK high street retail sector. However, the city is not completely isolated and high street retailers are generally showing caution and putting aggressive expansion plans on hold. The number of vacant units has seen a modest rise as some occupiers have vacated space. There are currently 27 available units, with Lion Yard and the Grafton Centre offering the most vacant space.

Despite a slowdown in the national food & beverage market, there is still healthy demand from a number of restaurant and leisure operators in Cambridge. The first half of 2018 has seen The Ivy Brasserie open on Trinity Street as well as the five-star University Arms Hotel, following a multi-million pound refurbishment undertaken by Melford Capital.

A notable transaction in 2018 so far includes Franco Manca taking 636 sq ft on Market Hill on a 5-year lease at £110,000 pa. Take up has been led by these smaller units, particularly with independent occupiers thriving as their unique offering appeals to consumers.

Prime locations, including the two largest shopping centres, the Grand Arcade and the Grafton Centre, are reportedly trading well. The prime rent remains unchanged from the end of 2017 at £290 psf (Zone A), although rents are falling in some secondary/tertiary locations.

As previously reported, the Grafton Centre is currently undergoing a major refurbishment which will enhance the retail and restaurant offering, as well as reconfiguring the former BHS unit. Puregym has also secured planning consent to occupy part of this, with a planning application also submitted for a hotel.

Elsewhere, the Old Ticket Office, pub and restaurant, has opened next to Cambridge station, and Network Rail plans for another restaurant in the near future. One Station Square and 50/60 Station Road are also offering space for retail and leisure.

Aberdeen Standard Investments has also submitted plans for a new city quarter attached to the Lion Yard area that surrounds St Andrew's church. This is to include restaurant space, a hotel and a rooftop terrace.

PROPERTY MARKET TRENDS

		PRIME RENT (MID-2018)	CHANGE OVER H1 2018	FORECAST NEXT 12 MONTHS	PRIME YIELD (MID-2018)
VALUES	**Office**	£41.00 psf	↑	↑	4.5%
	Industrial	£13.50 psf	↑	↔	5.5%
	Retail	£290 psf ZA	↔	↔	3.8%

		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**	240,000 sq ft	Below average	700,000 sq ft	↓
	Industrial	215,000 sq ft	In line with average	576,000 sq ft	↑

	TOTAL TRANSACTED H1 2018	6-MONTHLY AVERAGE (LAST 5 YEARS)
INVESTMENT MARKET ACTIVITY	£170 million	£100 million pa

OUTLOOK

- Over the next six months, prime office rents will remain stationary at £41.00 psf. Looking further ahead, we anticipate this figure increasing towards £45.00 psf as the CB1 development continues.
- Demand will focus on mid-tech (laboratory and workshop space) as the city's technology sector continues to thrive.
- Retail rents will come under pressure although we expect the city centre will show some resilience against a challenging picture for the UK high street. We do not expect any further increases in prime retail rents over the next 1-2 years.
- A review of the Local Plan is imminent, and we anticipate there will be a deeper consideration for the extension to science and research parks to facilitate the anticipated increase in jobs.

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