UK Offices

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Headlines

- **The great divide…** the gap between the capital and the rest of the country will widen, with London experiencing a reversal of fortune, leading the office market recovery in 2010 – led by the traditional financial sector.
- **Demand will remain under pressure outside London…**as the public sector squeeze begins, though central government relocations and banking may provide upside. Of the major centres, Manchester and Bristol are best placed for recovery.
- **Worst is over for rents…** London will be the only market to see prime rental growth in 2010 (after 35-40% peak to trough fall). In the regions, the correction has been milder (only 7-10%), so growth will take longer to return, though next year's drop is expected to be less steep.
- **London hotspot - Canary Wharf…** Healthiest London sub-market occupier appetite set to drive vacancy back to single figures within the year.
- **Developers will begin to look beyond the downturn…** Speculative starts set for a return particularly in London where shortages of prime space will emerge by 2012. In Central London we may well see occupiers return to pre-letting to satisfy their future requirements.

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1 Vacancy has risen in most markets during 2009, but despite the high levels of availability, grade A space remains in short supply in some key locations. After the completion of existing developments, little new supply is planned, bringing the **potential for space shortages and pressure on rents during the recovery**.

2 Prospects for demand have improved, but **there are risks to the outlook**. Regional markets have relied heavily on **local public sector deals** to support take-up in the downturn and may be hit harder, as the government battles to

cut its huge fiscal deficit post-election. **Relocations from central government in London provide potential opportunities** for larger regional centres, but plans are currently unclear and experience suggests that this will be a slow process.

3 **Private sector deals** - notably corporates, business and professional services, and TMT's - **should help offset any weakness**. There may also be regional opportunities within UK banking, as Lloyds and RBS are forced to sell off brands and networks.

4 On the basis of past demand and current supply, Manchester and Bristol are most likely to lead the regional recovery after 2010. The Scottish cities have fared better than expected during the recession, but are likely to be slow to revive. Currently the biggest concerns are for Birmingham and Leeds, however, where over-supply and a reliance on the public sector make for the weakest prospects.

5 Outside of London, falls in office rents have been less aggressive. Nonetheless, prime rents dropped in all markets this year at an annual rate of 7-10%, with Birmingham worst hit. **Regional rents are set to fall further** in 2010, though the worst of the adjustment is now over and the **rate of decline is expected to slow.**

6 In H1 2009, regional office property markets saw a further sharp slowdown in demand. But in Q3 2009, office take-up rebounded unexpectedly strongly and **the latest evidence suggests that the revival has continued into the final quarter.** Markets outside of London made a strong contribution, with demand in Manchester, Glasgow, Liverpool, Nottingham and Newcastle holding up best.

7 **Regional markets were also well represented in the biggest UK office deals of 2009**. The largest involved the Co-op (325,000ft^2) and Greater Manchester Police Authority (240,000ft^2) (both in Manchester), Birmingham City Council (196,000ft^2), Nottingham City Council (213,619ft^2) and Npower (220,000ft^2 in Sunderland).

8 While London’s short-term future is bright, longer-term uncertainties remains. Political pressures to tax bank bonuses are currently intense and it is likely that other EU nations will follow (temporary) UK moves. Moves to tighten bank regulation are also expected in the wake of the financial crisis. London’s position as Europe’s financial capital is not likely to be undermined, but these moves will have an impact.

CENTRAL LONDON OFFICES

1 London has reached this cycle's nadir, with rental recovery to begin in 2010 predominantly on prime rents where landlords will tighten incentives and hold out for higher rents.

2 In the City supply will reduce, but the proportion of Second-hand space will increase as tenants "trading up" release space back to the market – the proportion of second-hand space will move from 20% to 40% by year end. We forecast prime City rents to reach £47.50ft² (10.5% uplift) by end 2010 and incentives to harden to 24 months rent-free (33-36 end 2009) on a 10 year lease.

3 Following the sharpest office rental declines in the UK last year, West End prime rental growth will be driven by the limited development completions beyond 2010 and the resulting two-tier market of scarce Prime Grade A new builds and oversupplied Secondary Grade B.

4 The West End will see a return of the boutique financial organisations, coupled with an acute shortage in supply, will drive rental growth on new Grade A space in Mayfair and St James's. For the West End we forecast prime rents to approach £70.00ft² (7.6% uplift) by end 2010 and incentives to harden to 18 months rent-free (24 end 2009) on a 10 year lease, with continuing evidence of "froth rents" in excess of £80.00 ft².

5 Some confidence has returned amongst financial occupiers, consequently City office demand is in its healthiest shape for at least 2 years, with at least 3 million ft² of active requirements looking to be satisfied within the City from a variety of business sectors. Therefore we anticipate City office take-up to improve towards 3.5 million ft² in 2010 – with the majority of the prime surplus being absorbed by the traditional financial sector.

6 We will see further internationalism of the City occupier and investor base

7 Selective shortages of prime space will emerge following the improving levels of demand during 2009; therefore we will see the return of the Pre-let together with a number of brave speculative starts.

8 Business rates – with the 2010 rating list coming in to effect, London occupiers will see significant increases in Rateable value for 2010 – City prime uplifts to be in the region of 15-20% compared to 5-10% previously.

9 City prime yields will return to the long-term average of 5.8% and will harden further if the scarcity of supply continues.

10 Central London take-up in 2010 is forecast to reach the levels seen in 2008 rising back towards the long-term trend from 2011.

11 Take-up next year will come from a variety of sectors thus reducing the market's exposure to a single business area. Recent signs of improvement in demand figures suggest there will be further activity from the TMTs and Financials, as well as the return of the Professional and Service sectors keen to take advantage of lower rents and improved incentives.

12 London hotspots - Canary Wharf will see a surge of major transactions during 2010 which will rapidly drive vacancy downwards with shortages of space emerging next year. Active tenants include BarCap, MF Global and Blackrock.