OFFICE MARKET REPORT 2017

Lambert Smith Hampton

MIDLANDS ENGINE

WELCOME

ADAM RAMSHAW
Head of Birmingham & East Midlands
Lambert Smith Hampton

Given all the political twists of the last 12 months, you'd be forgiven for thinking that the office market would have seen similar volatility. There have been several macro events with the potential to disrupt our market but, encouragingly, the occupier and investment markets have shown remarkable resilience.

Yes, the headline statistics around take-up would suggest the market has slowed. But, scratch the surface, and there is in fact an ongoing depth to occupier demand, with the number of deals being transacted remaining healthy in many of our markets.

Away from the day-to-day noise of political upheaval, the region's long-term economic prospects continue to be galvanised by positive recent developments closer to home, namely HS2's granting of Royal Assent and the inauguration of West Midlands' first mayor.

Investment appetite is unwavering, although the barriers to entry for speculative development remain too challenging for many. However, good quality office space is now in the pipeline as investors opt to refurbish and reposition existing stock. For now at least, this looks to be the most likely source of good quality product across most of the key markets.

The opportunities for growth and return on investment are abundant in the Midlands Engine region, we just need to be strategic about how we approach them. With this in mind, a forensic understanding of the market remains critical.

This report contains an overview of the office sector in our region and granular detail of the key locations. Being able to look at the past can be interesting, but understanding the present and capitalising on the future is where we will see the success.

Please contact our team of experts for further information. We would be delighted to help.

I wish you all the best for the remainder of the year.

Adam Ramshaw

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HIGH SPEED AHEAD FOR HS2

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"HS2 is a once-in-a-generation high-speed railway scheme that will unlock unprecedented levels of investment across the whole of the Midlands Engine region and generate tens of thousands of jobs", says Jeff Robinson, director of transport and infrastructure for Lambert Smith Hampton.

Phase one received royal assent earlier this year. At an estimated cost of £56 billion, HS2 is the largest national transport infrastructure project undertaken since the building of the motorways. When complete, it will connect London Euston with Birmingham city centre in just 49 minutes and will significantly address the capacity challenges facing the network.

According to the Midlands Engine Strategy: "HS2 has the potential to have a transformative impact on the Midlands economy, in particular around the new stations."

Birmingham is poised to benefit hugely from HS2, with a new railway station at Curzon Street and another in neighbouring Solihull. Improving connectivity across the city and beyond is a priority, with the Midland Metro expansion set to join up the city centre's major railway stations and extend across the region.

Other infrastructure improvements, such as the 2014 £500m runway extension at Birmingham International Airport, which is bringing in new long-haul flights into the city, and the £750m Grand Central redevelopment above New Street Station, have already had a hugely positive impact on both Birmingham's connectivity and business perceptions. The arrival of HS2 will be the final piece in the jigsaw of Birmingham's transformation to a truly world class city.

But it is not only Birmingham rail users that will benefit from HS2. It will provide the perfect opportunity for the Midlands Engine, the Government's flagship programme, to boost the fortunes of the region, which stretches from Shropshire in the west to Lincolnshire in the east and Aylesbury in the south up to the Peak District in the north.

HS2 is so much more than an improvement in connectivity. The Midlands had lagged behind London and the South East when it comes to skills and educational attainment and the building of HS2 will enable government and business to focus on closing that skills gap in the construction, engineering and technical sectors.

Opening the national construction headquarters in Birmingham has already created 1,500 jobs, while the city-based National College for High Speed Rail will, from September, start training the highly skilled engineers needed to deliver such ambitious schemes.

HS2 is projected to create or safeguard 104,000 jobs in the West Midlands, however, it's important to look further than the Birmingham conurbation: it is believed it could also create 74,000 jobs in the East Midlands.

Altogether, there are 11 Local Enterprise Partnerships (LEPs) working to ensure HS2 brings maximum benefit to the workforce in their respective regions. It is vital that they successfully increase the number of skilled workers because at the moment the region's skillset is about 15% below the England average.

HS2 will undoubtedly help to kickstart that: the combined forces of a focused Midlands Engine strategy to encourage businesses to invest in the region could in turn encourage graduates to stay in the region after they have completed their university studies.

In addition to HS2, £7bn of projects were unveiled at MIPIM in March, including the £2 billion for a UK central hub in Birmingham, which has secured investment from central Government, the West Midlands Combined Authority, HS2 and Highways England; the £1 billion plans to generate Nottingham city centre; £350 million of schemes in Stoke-on-Trent; and a £75 million plan for a space park in Leicester.

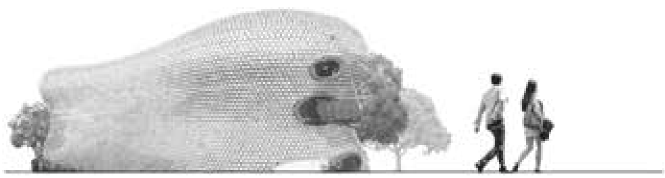
The positive feedback to the investment opportunities that Midlands Engine and HS2 will bring demonstrates that there is an appetite to redress the imbalance and weaknesses that have historically been a drag and had a negative impact on the region's economy, thus ensuring that the area has the skilled workforce it needs to thrive.

BIRMINGHAM
A CITY **TRANS**FORMED

1972
GRAVELLY INTERCHANGE
Affectionately referred to as 'Spaghetti Junction', this puts Birmingham at the heart of the UK's motorway network.

2014
BIRMINGHAM AIRPORT RUNWAY
The city's international status has been boosted by a £500m extension to the airport runway, linking the city directly to a host of long-haul destinations.

2015
MIDLAND METRO EXTENSIONS
Connections within the city have been greatly enhanced by the extension of the Midland Metro route, which now links with New Street Station.



2016
NEW STREET STATION REDEVELOPMENT
The city's main station has been completely transformed by a £750m redevelopment, and now serves 170,000 passengers a day.

2018
SPRINT BUS NETWORK
Operational from late 2018, a new high quality, tram-like bus service will improve journey times and connectivity.

2027
HIGH SPEED 2
With rail travel between Birmingham and London predicted to more than double in 20 years, HS2 will reduce Birmingham to London travel times to 49 minutes. HS2 will bring 26,000 new jobs to the region and provide significant extra capacity for passengers and freight within the UK and to continental Europe.

STRENGTH IN DEPTH

The Midlands Engine region is blessed with a diverse and innovative economy. While each of its major urban centres boasts its own sectoral strengths, the challenge for policy-makers and stakeholders is to bring these together so that the whole can become greater than the sum of its parts.

It only requires a glance at the adjacent charts to see the diversity of expertise across the Midlands Engine's major office markets. Ranging from engineering to professional services, six key sectors have been carefully selected for their importance in the knowledge economy to highlight where the concentrations of skills are relative to the UK average.

ENGINEERING

The region's reputation as a world-class hub for advanced manufacturing is emphatically reflected in levels of engineering employment. Derby, home to Rolls Royce, has engineering employment at nearly three times the national average, while Coventry's contribution to UK automotive production is reflected with engineering employment at 50% above the UK. The sector has also shown notable growth, with employment increasing by 15% over the past five years across the eight locations combined.

SCIENCE

The Midlands has been at the forefront of scientific endeavour and innovation since the industrial revolution. The majority of the region's key locations boast above average employment in scientific-based activity, most notably Coventry, Derby and Leicester, where the concentration of science-related employment is circa 30% ahead of the UK average.

PROFESSIONAL SERVICES

With a long-standing tradition as a hub for legal and accounting activities, Birmingham is the capital of professional services employment within the Midlands. Birmingham's employment in this sector stands 26% higher than the UK average, although Milton Keynes - which officially sits in the South East region - shows the strongest concentration of professional services employment, standing 41% ahead of the UK-wide position.

THE CREATIVE INDUSTRIES

Of the six sectors, the creative industries are the most underrepresented in the region. Birmingham, arguably its most cosmopolitan city, shows employment in the creative industries at 35% below the UK average. While London and several surrounding centres continue to dominate employment in the creative sectors, employment growth has nevertheless been significant in a number of locations over the past five years, such as Leicester (up 27%), Derby (up 25%) and indeed Birmingham (up 13%).

INFORMATION TECHNOLOGY & COMPUTING

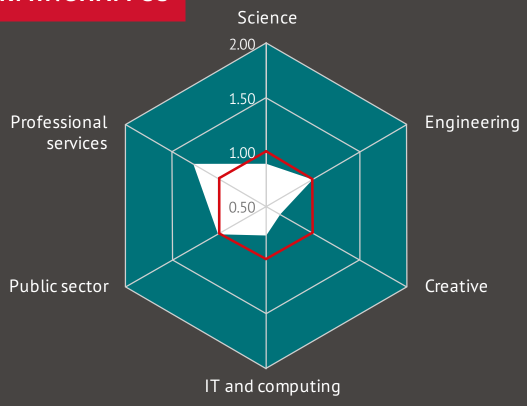
Several locations in the Midlands Engine are a hotbed of talent in information technology. Home to the University of Warwick, the Coventry / A46 market is one of the UK's leading employment hotspots outside of London and the South East. Elsewhere, Birmingham's out-of-town market features prominently, with significant presence of tech businesses including Fujitsu, Virgin Media and Specialist Computer Holdings. While some locations lag behind the nationwide level, employment growth has been notable in this sector, increasing by 14% across the eight locations combined over the past five years.

THE PUBLIC SECTOR

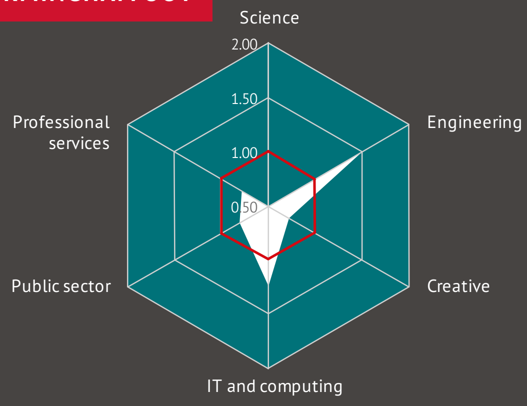
Across the UK, the public sector has been put under intense pressure as part of the Government's austerity drive. This has been reflected in the Midlands too, with public sector employment falling by over 10% in Northampton and Birmingham over the past five years. Encouragingly, none of the key locations appear heavily exposed to public sector employment compared with the UK; Nottingham has the strongest concentration at 18% above the UK overall position.

Employment location quotients

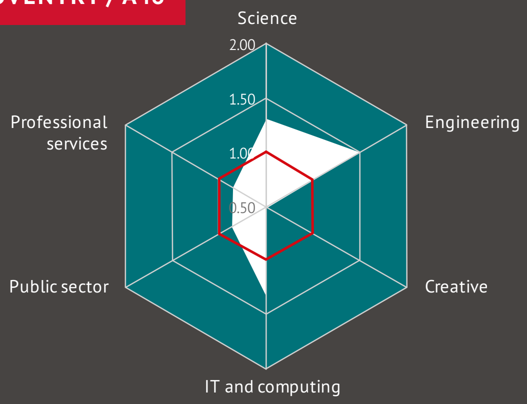
BIRMINGHAM CC



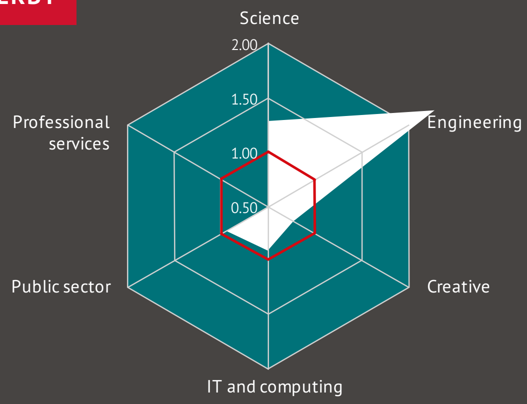
BIRMINGHAM OOT



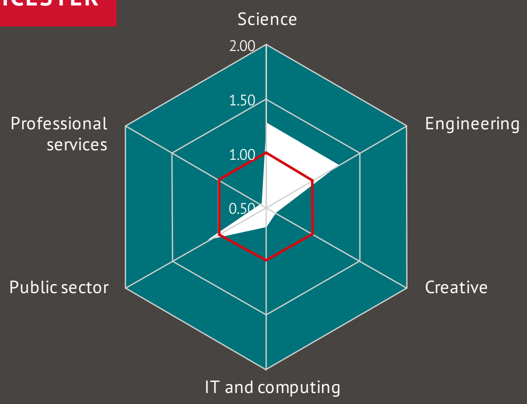
COVENTRY / A46



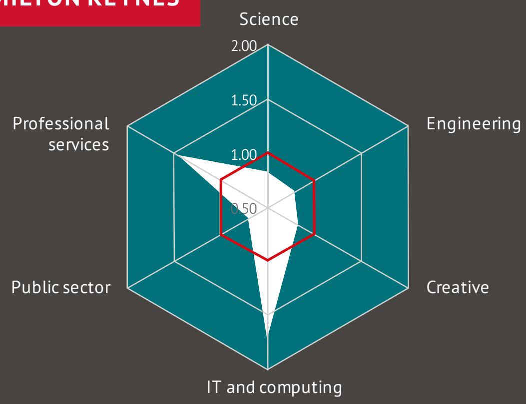
DERBY



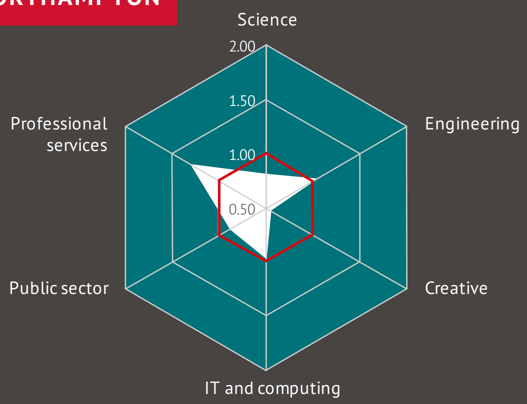
LEICESTER



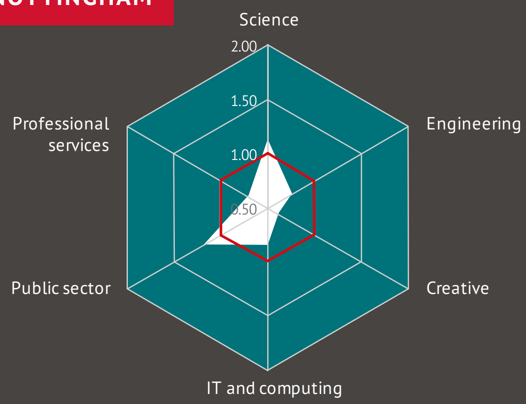
MILTON KEYNES



NORTHAMPTON



NOTTINGHAM



National average   Location employment quotient

Data source: EMSI, Lambert Smith Hampton

MEES REGULATIONS: THE CLOCK IS TICKING

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From 1 April 2018, the Minimum Energy Efficiency Standards set out under the Energy Efficiency Regulations 2015 (The 'MEES Regulations') will make it unlawful for landlords in England and Wales to let a building which fails to meet the minimum required EPC rating of E.

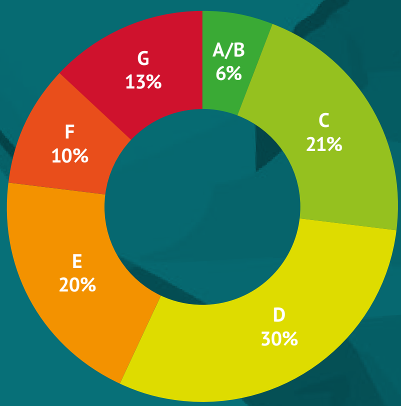
EPCs were introduced in 2008 and apply to the majority of privately rented commercial properties. While there are certain exemptions, unless landlords take due steps to prove and register these, those with a property failing to meet the E rating, are likely to find themselves unable to let their property or, if they let them, liable for penalties of up to £150,000 and for the infringement to be made public.

Initially, the MEES Regulations will only apply to the granting of new leases and lease renewals, but from 1 April 2023, they will extend to all active leases, making it unlawful for landlords to allow a letting to continue where the subject building has an EPC rating worse than E, unless they register an exemption.

HOW MANY PROPERTIES ARE AT RISK?

Nearly a quarter (23%) of UK office buildings currently have an EPC rating of F or G, according to figures from the Green Construction Board. While many Landlords are taking action on these properties prior to 1 April 2018, many are failing to recognise that buildings currently rated D and E risk being caught by the MEES Regulations as detailed below. These buildings account for a further 50% of all offices in the UK with a registered EPC.

Proportion of EPC ratings for UK offices (%)



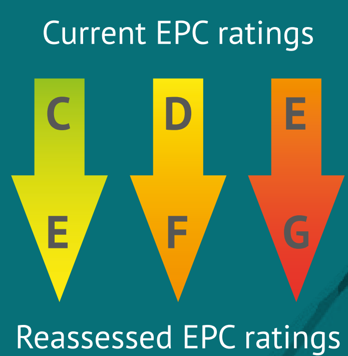
Source: Green Construction Board

WHY LANDLORDS SHOULD BE CONCERNED

EPCs were first required in 2008 upon a property being constructed, sold or let and are valid for up to 10-years. At that time, these were a simple requirement before a property could be transacted, as opposed to having any significant further use or implication. As such, the accuracy with which the early EPCs were prepared is subject to significant scrutiny.

In addition, through cyclical revisions of the Building Regulations, the measure of energy efficiency has markedly changed in the last 10 years and it is now far more difficult for a property to gain a good EPC rating.

With the above two factors taken into account, there is a high risk that many Landlords have D and E rated properties which, on reassessment today, would in fact be Fs and Gs and thus fall foul of the MEES Regulations in April 2018.



A TENANT'S ADVANTAGE?

Compounding the above effect is the increasing abundance of well-advised tenants savvy to the potentially huge benefit of being able to evidence that their leased property has an F or G rating.

First, let's take a look at dilapidations. For a tenant faced with a hefty dilapidations claim, a potential means of mitigating that claim would be to argue that works required to comply with the MEES Regulations are far greater than any repair works it is liable for under the dilapidations claim. Whilst this argument would not run for a D or E rated property, if that tenant had had a new EPC carried out immediately prior to lease expiry showing that the rating had dropped to an F, they could have a very strong position and the landlord would potentially be left with their property:

1. In disrepair
2. With no dilapidations settlement funds
3. In an unlettable condition unless they upgrade it to comply with the regulations.

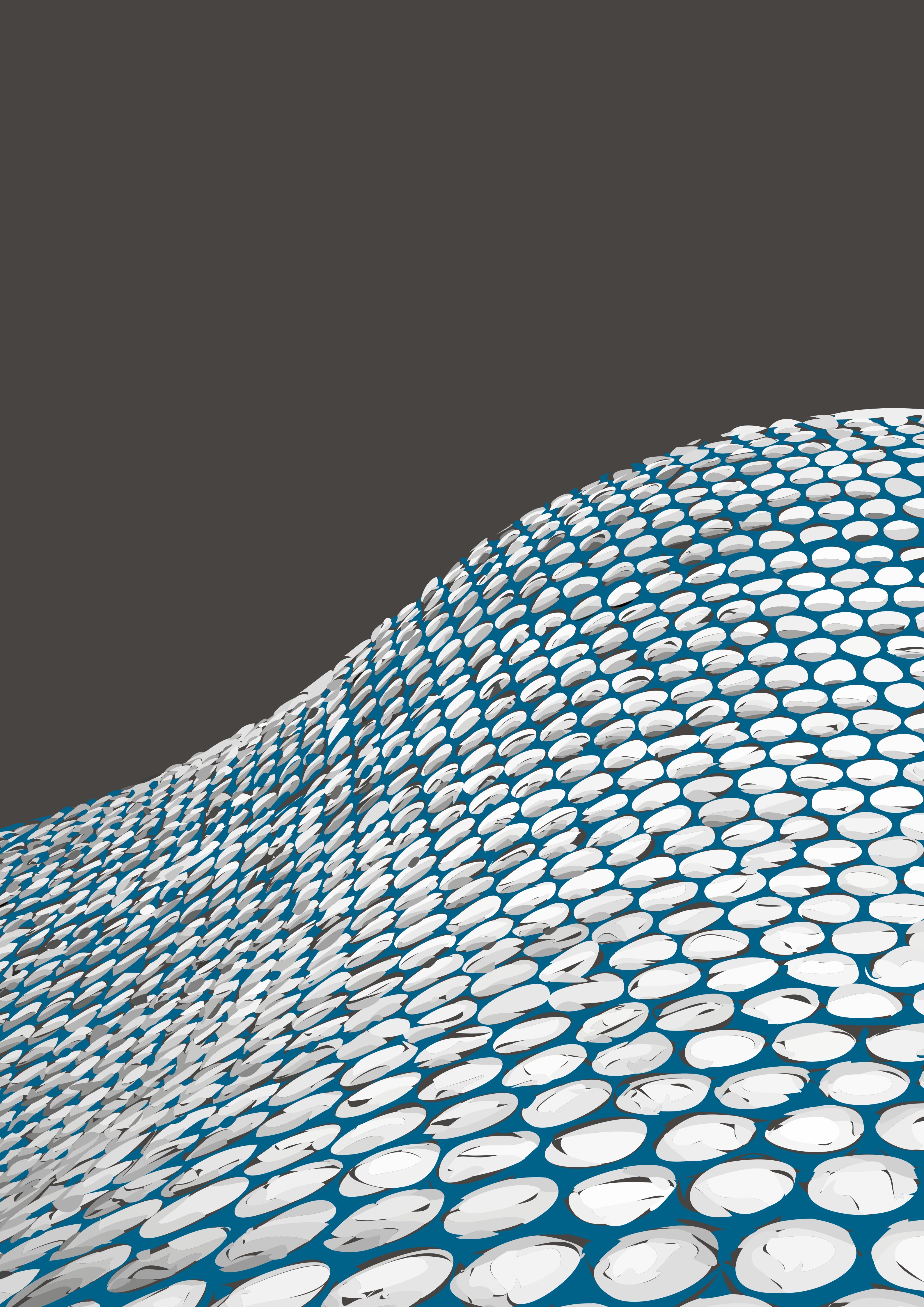
Rent reviews, lease breaks and lease renewals are further potentially contentious areas. Landlords holding rented property with a lease event post-1 April 2018 should be wary of well-advised tenants who may seek to run a similar argument to the dilapidations example above, demonstrating that the property would be unletable were they to end their lease, and using that evidenced assertion to bargain with the landlord for substantially favourable lease terms, or alternatively seeking to force their landlords to improve the subject building to comply and then seeking to claim a rent free period or reduction to compensate for the disruption.

WHAT ACTION CAN LANDLORDS TAKE?

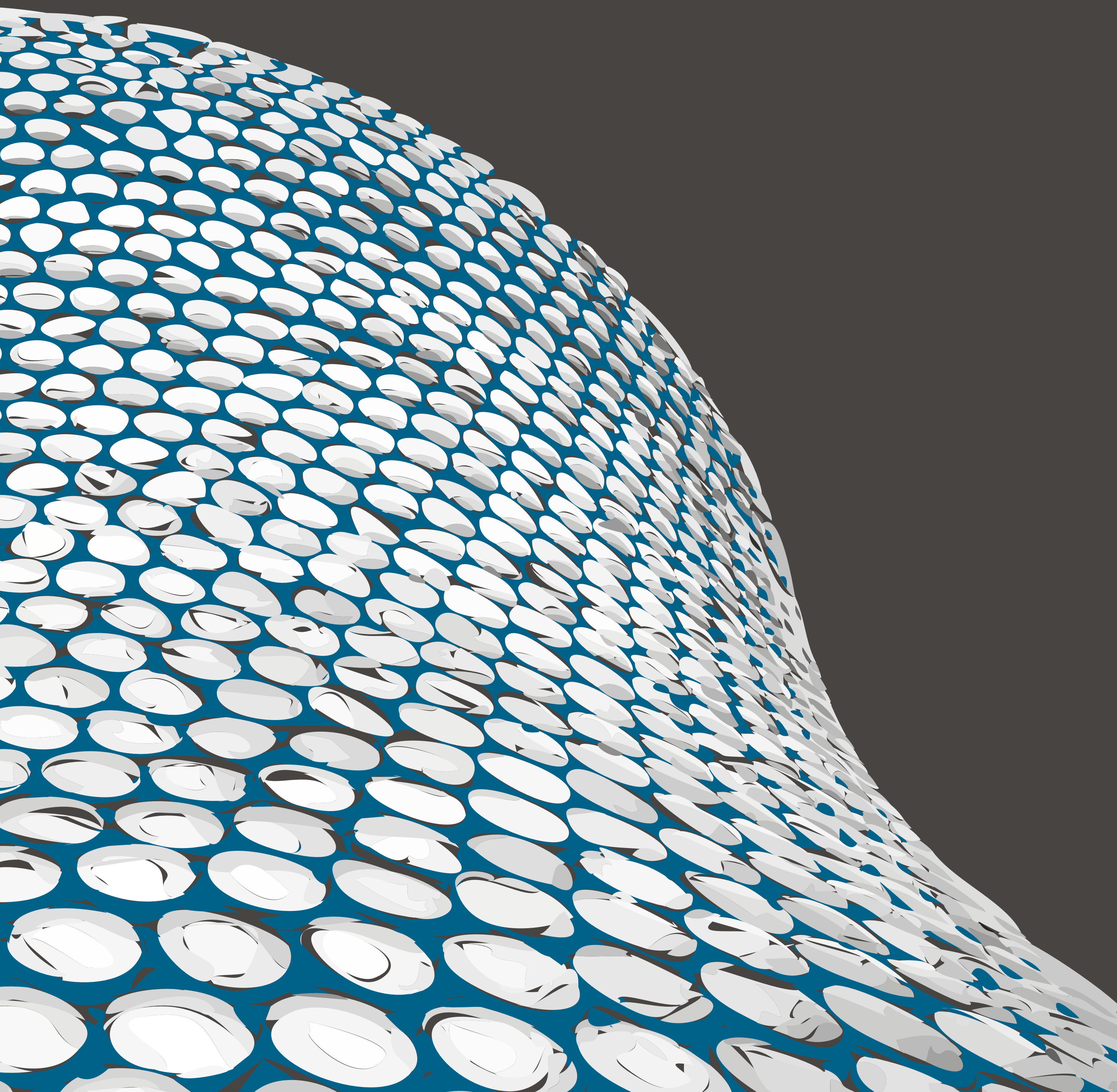
With over 70% of registered office properties carrying a D rating or below, and the significant liability that landlords face if they fail to comply with the standards, it is vital that landlords take the initiative with their tenants. The respective positions will vary massively according to whether it is the landlord approaching their tenant about the Regulations or vice versa.

It also must be noted that the risk potential of a property can only be judged individually, taking into account the validity of the existing EPC, the risk profile of the property failing the MEES Regulations, if re-assessed, the ability to recoup upgrade costs from the tenant, and the applicable exemptions (if any).

It should also be expressly noted that a blanket policy of having new EPCs carried out across property portfolios will inevitably prove very costly, where existing compliant properties will be needlessly downgraded as opposed to more refined strategies being put in place.



REGIONAL OVERVIEW



OCCUPIER MARKET OVERVIEW

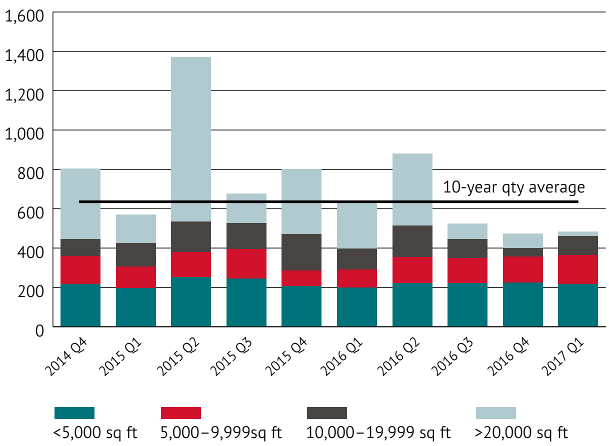
UNDER PAR TAKE-UP REFLECTS LACK OF LARGE DEALS

- Across the regions' eight key markets combined, office take-up was relatively subdued in each of the three quarters to Q1 17, underperforming the quarterly average by circa 20%. The recent pattern stands in real contrast with 2015, the region's strongest year of take-up since 2002.
- While the timing of this apparent slowdown coincides with last summer's EU Referendum result, this is an overly simplistic explanation. Under par take-up is entirely due to a lack of larger deals, while the smaller, busier end of the market has demonstrated both consistent and healthy levels of activity.
- The absence of large occupier deals is more accurately explained as a combination of a thinner period of major lease events compared with several years ago, alongside a greater degree of uncertainty from corporate occupiers, particularly in professional and financial services, stemming from last summer's Referendum.

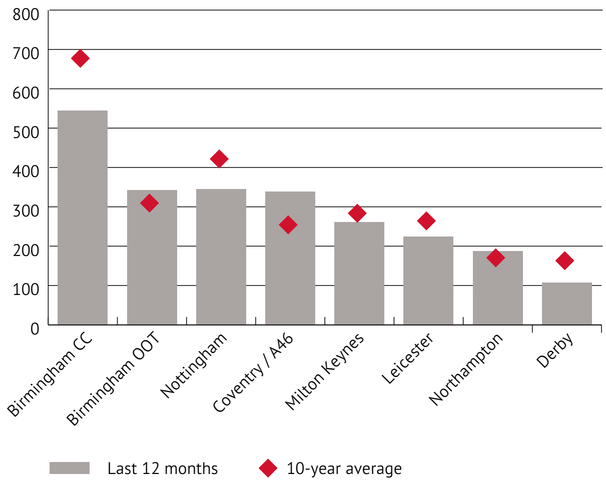
MIXED FORTUNES BETWEEN THE MARKETS

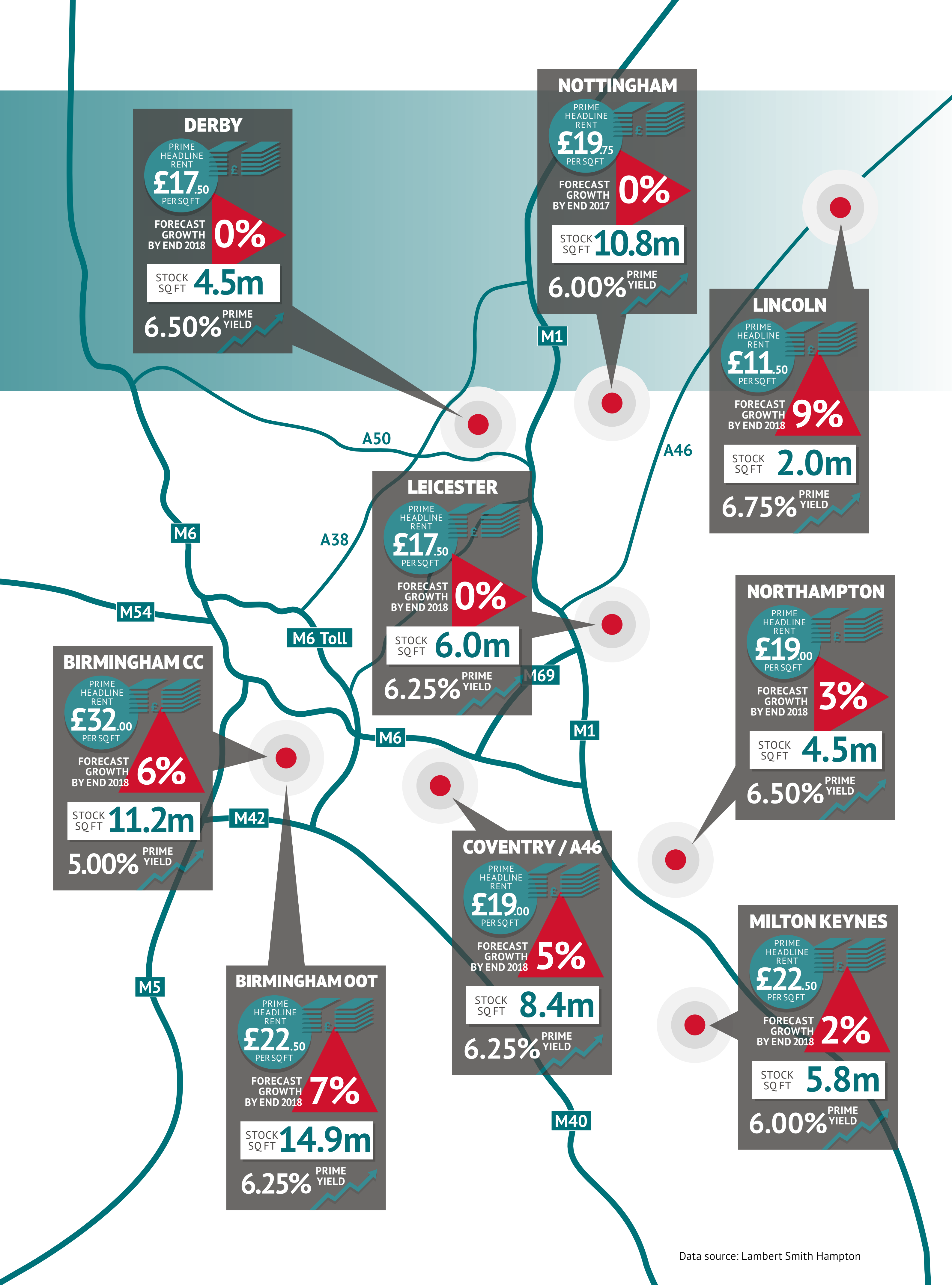
- Viewed over the past 12 months, three of the region's eight markets have seen take-up run ahead of their ten year annual average, namely Birmingham out-of-town (up 10%), Northampton (up 11%) and Coventry / 46 corridor, which was by a distance the region's standout performer, with take-up 33% ahead of average.
- Unsurprisingly, the above markets were spurred by the limited number of larger transactions seen across the region. Northampton was home to the region's largest deal over the past 12 months, Opus Energy's 85,000 sq ft lease at John Drydon House, while deals to TATA Technologies (63,000 sq ft) and National Grid (50,000 sq ft) underpinned Coventry's impressive performance.
- On the flipside, Birmingham city centre has suffered from a lack of large deals, with take-up standing 20% below average over the past 12 months. Indeed, the largest deal in the city post Referendum was Pinsent Mason's 19,448 sq ft lease at 19 Cornwall Street. Notably, however, the number of deals over the period actually exceeds that of the previous 12 months, despite exceptional take-up in 2015.

Midlands Engine take-up by size (000 sq ft)



Midlands Engine take-up by market (000 sq ft)





Data source: Lambert Smith Hampton

OCCUPIER MARKET OVERVIEW

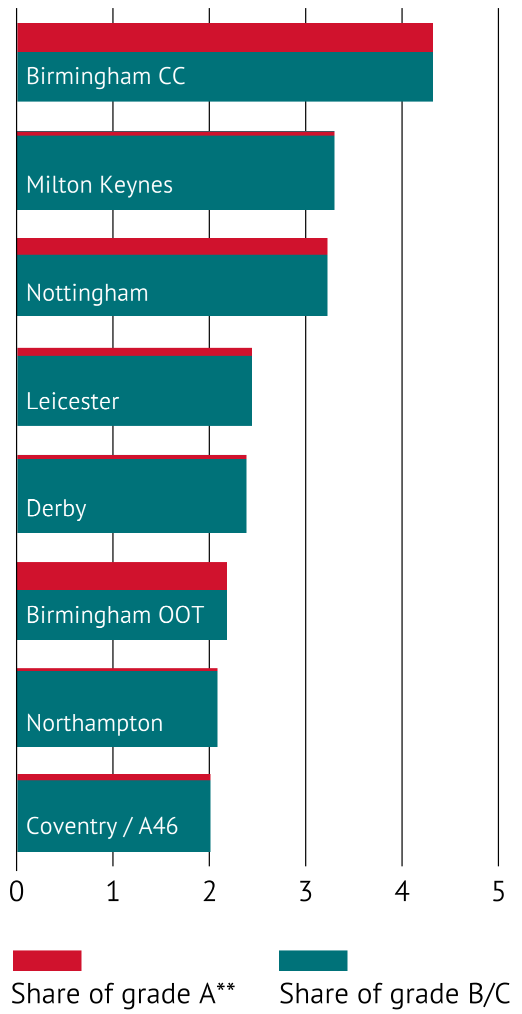
IMPROVING PICTURE AHEAD

- Viewed as a whole, the Midlands region has made a modest start in 2017, with Q1 take-up across the eight markets combined standing 22% below the long-term quarterly average. While June's surprise UK election result is hardly the tonic for an improvement in certainty and activity, there are grounds for optimism over the year ahead.
- First, there are a good number of larger deals either in solicitors' hands or expected to come forward which will change the complexion of take-up in 2017. Indeed, in Birmingham city centre, the Government Property Unit (GPU) is expected to confirm its location for its consolidated HMRC operations before year end, adding 250,000 sq ft to take-up.
- While 2016 and early 2017 have been something of a quiet period for the larger end of the market, we are aware of 160 lease expiries and breaks above 5,000 sq ft across the region's key markets, amounting to just over 3m sq ft of potential demand. Birmingham city centre leads the way, with lease events between 2018 and 2020 equivalent to almost 20% of its stock.

SUPPLY EBBS TO DECADE-LOW

- Availability in the Midlands markets has fallen steadily over the last four years, reflecting the absorption of grade A space from the previous cycle, pressure from alternative uses and negligible speculative development outside Birmingham. At the end of Q1 2017, availability across the eight markets combined was 7.7m sq ft, down 7% over the last 12 months and its lowest level since 2006.
- For all the markets combined, total availability equates to 3.0 years of supply based average rates of take-up, slightly below the UK regional office market average of 3.3. A common theme across all of the Midlands markets is the shortage of quality supply, which is now so acute that it is arguably acting as a brake on potential market activity.
- As at Q1 17, there was less than one year of grade A supply available in Coventry and Northampton, and little more than one year in Nottingham, Derby and Leicester. Positively, however, grade A supply has improved over the past year in Milton Keynes and Birmingham's out-of-town market, reflecting a number of comprehensive refurbishments.

Availability as years of supply*



* Years of supply defined as current availability divided by 10-year average take-up

**Grade A includes speculative space completing in next 12 months

Data source: Lambert Smith Hampton

BIRMINGHAM DOMINATES DEVELOPMENT

- Birmingham city centre is the one clear exception. Major improvements in transport infrastructure, both within and into the city, are boosting the market's long term prospects for inward investment and acting as a catalyst for speculative office development.
- Having been short on options until relatively recently, Birmingham city centre is now home to just over 1m sq ft of available grade A supply, largely reflecting a flurry of anticipated completions over 2017. While this equates to 3.1 years of specifically grade A supply, a number of prominent lease events in the pipeline and the GPU's major active requirement should allay any concerns.

SPECULATIVE DEVELOPMENT

THE REFURBISHMENT OPPORTUNITY

- Speculative development remains elusive elsewhere in the region. With over 1m sq ft under construction speculatively, development in Birmingham city centre is more than ten times that of the region's other key markets, with Milton Keynes and Birmingham out-of-town the only markets where space is being brought forward at the time of writing.
- In this cycle, the majority of new-build completions in the region have been occupier-led through pre-lets and purpose built agreements. This is especially true of the Coventry / A46 market, where the flourishing automotive industry is driving demand for high quality, often bespoke office solutions.
- However, as seen in Milton Keynes, Birmingham out-of-town and the A46 corridor, refurbishment of existing space has gone some way towards alleviating supply pressures. In the absence of new development completions over the next 12 months, investors with a detailed knowledge of the markets have a real opportunity to viably reposition assets and capture pent-up local demand.

RENTAL GROWTH TO BE POSITIVE BUT MUTED

- Despite tight supply conditions, prime headline rents have seen limited movement across the majority of Midlands markets over the past 12 months. The delivery of high quality supply has been key to securing growth, with both Birmingham's city centre and out-of-town markets recording a year-on-year uplift of 7%.
- By the same token, prime headline rents have barely moved forward in this cycle across the region's other key markets, largely because the product simply has not been made available. Indeed, rental levels will have to increase considerably in markets such as Leicester, Derby and Nottingham if new development is to become viable without public sector intervention.
- Near term expectations for prime rental growth have been reined in over the past year in light of the more uncertain economic environment. However, tight supply conditions will promote a degree of additional growth in a number of markets over the next 18 months as new or refurbished space lets up, led by the two Birmingham markets.

TRACKING DEMAND

Relocation triggers and drivers

What has motivated businesses to acquire new office space in the Midlands and what influences their choice of property? Our analysis of activity above 5,000 sq ft over the past 12 months reveals positive patterns, even if the number of larger deals was down on the previous year.

WHAT HAS PROMPTED RELOCATION?

Positively, despite a lack of inward investment moves over the past 12 months, the lion's share of office relocations across the Midlands markets were triggered primarily by a need to expand, accounting for 42% of deals above 5,000 sq ft. For the remaining deals, lease events were responsible for 38% of relocations, followed by corporate activity (11%), consolidation (8%) and, finally, contraction (2%).

The fact that expansion was the main trigger of activity is testament to ongoing confidence among occupiers. That said, expansion accounted for 50% of deals over 5,000 sq ft over the previous year, arguably suggesting that increased uncertainty has prompted a slight easing down on expansion decisions among larger businesses.

With regard to some of the region's largest deals over the past 12 months, TATA Technologies' decision to pre-let 63,000 sq ft in the Coventry / A46 market was a prime example of a move triggered by expansion, while Opus Energy in Northampton and Network Rail in Birmingham both involved consolidating from three buildings into one.

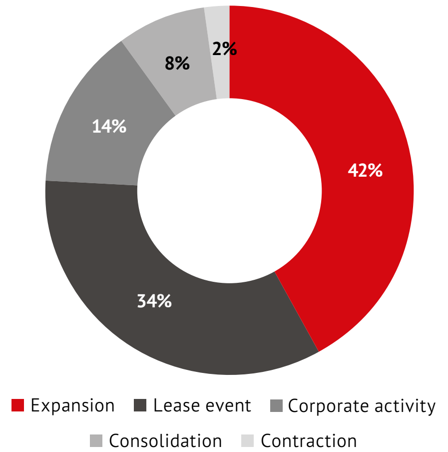
WHAT DETERMINES END CHOICE?

Beyond the trigger to move, location was the main driver for end choice across the region, accounting for 47% of deals above 5,000 sq ft over the last 12 months. This includes Manchester-based iHub's decision to open a serviced office facility in Birmingham at Colmore Gate, as it is well placed for commuters and businesses while also near to a range of eateries. Of the eight key markets, location was the main driver of decision for deals in the Coventry / A46 market (80%) and in Birmingham City Centre (64%).

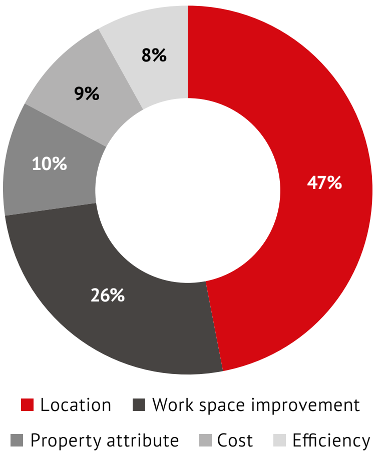
Workspace improvement was the second main driver for the choice of property, accounting for 26% of deals. This is a higher proportion than the previous 12 months when it accounted for 18%. For example, in Nottingham, Eversheds LLP moved to a more modern property at Water Court, a scheme of refurbished Victorian textile warehouses along the canal. Notably, Northampton had no moves due to workspace improvement, arguably reflecting a lack of quality stock in this market.

The last 12 months have seen a limited amount of inward investment into the Midlands. In contrast with 2014 and 2015, when Birmingham was chosen for major relocations from London by Deutsche Bank and HSBC, the region has seen no major inward deals.

Office move triggers (past 12 months)



Office choice drivers (past 12 months)



Looking ahead

While recent political events have done little to improve certainty on the UK's road to Brexit, an understanding of lease events does at least provide an indication of potential occupier demand over the next few years.

2018 COULD BE A BUSY YEAR

For all of the Midlands markets combined, there are just under 500 known lease events in excess of 5,000 sq ft between the middle of 2017 and the end of 2020. With the possible exception of Birmingham city centre, the quantum of forthcoming lease events is running far ahead of pipeline development, including both new-build and refurbishments.

While 2016 and early 2017 have been something of a quiet period for the larger end of the market, evidence suggests that 2018 will see an improvement in activity. The year will see 160 lease expiries and breaks above 5,000 sq ft across the region's key markets, amounting to just over 3m sq ft of potential demand.

Naturally, a significant proportion of lease events will not result in a relocation, but it is nonetheless an essential trigger of demand, particularly for occupiers of dated or poor quality space. The risk is that without the appropriate supply in place to attract this latent demand, occupiers will have little choice but to stay in situ, even if there is a desire to upgrade to an alternative building.

BIRMINGHAM LEADS THE WAY

There are some notable differences between the markets with regard to forthcoming lease events. Placed into context with stock levels, Birmingham city centre stands far ahead of the region's other markets, with all known lease events between 2018 and 2020 inclusive equivalent to almost 20% of its stock. This bodes very well for the letting prospects of the significant amount of space currently in the pipeline.

At the other of the scale, several of the key Midlands markets have significantly less potential demand in the pipeline, at least in relation to stock. Indeed, the total volume of lease events in each of the East Midlands region markets, comprising Leicester, Nottingham, Derby and Northampton, is equivalent to less than 10% of stock.

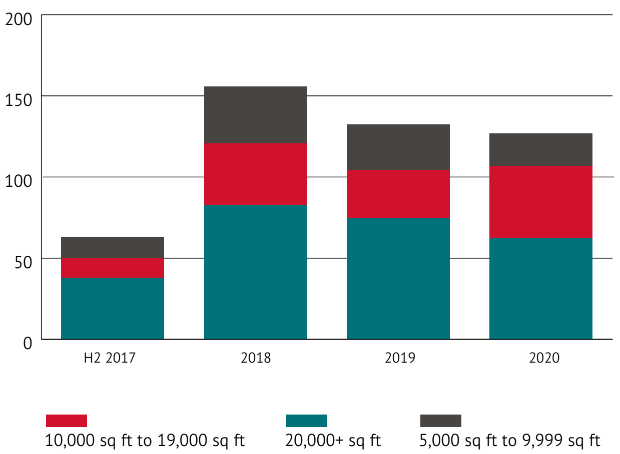
However, if all of this were to result in transactions, it would translate into a very strong level of take-up. The main issue in these markets is one of an acute lack of grade A supply, which generally consists of no more than several relatively medium-sized options. Without the provision of quality space, there will be little incentive to drive a relocation.

THE RISE OF THE REFURB

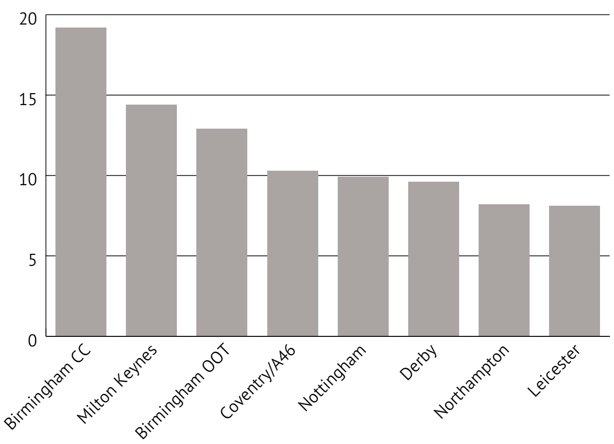
Investors will no doubt appreciate the compelling case for development in the region, but without real confidence of strong rental growth to come, they remain understandably wary at the current time. However, with availability of grade A space so restricted beyond Birmingham city centre, the dynamics in the market and the spike in lease events support the repositioning of existing buildings through refurbishment.

As millennials come to dominate the workforce, occupiers are becoming ever more discerning in their requirements. When considering refurbishments, landlords that can differentiate their offer to be more design-led and suited to increasingly flexible ways of working stand to benefit most.

Number of lease events in the eight key markets



Volume of lease events as share of stock (2018–2020, %)



Data source: Lambert Smith Hampton

INVESTMENT MARKET REVIEW

Despite the uncertain outlook, there remains confidence to invest in quality stock throughout the Midlands. With many of the region's markets starved of quality supply, well-informed investors have an opportunity to reposition existing assets and those brave enough to differentiate their product from the norm stand to benefit most of all.

STRONG VOLUME FLATTERS LIMITED ACTIVITY

On face value, investment in the Midlands made an impressive start to 2017. Across the entire region, £361m worth of offices changed hands during Q1, the highest seen in a single quarter in almost a decade and more than twice the quarterly average.

However, this was dominated by HSBC Alternative Investment's £260m (6.00% NIY) purchase at Brindleyplace, Birmingham from Lone Star. Although the asset is partly mixed-use, it was the largest office-led deal ever seen in the Midlands, replacing M&G's £230m forward purchase of Three Snowhill in Q1 2016.

Birmingham city centre has also been even more dominant than usual, making up 88% of total regional volume over the 12 months to Q1 2017. The city was host to Q1's two other headline deals, namely Qatari-based investor Alduwaliya's purchase of 111 Edmund Street for £21.5m (NIY 5.25%) and CBRE Global Investors' purchase of 2 St Phillips Place for £26.25m (NIY 6.3%).

While the above deals demonstrate international investor confidence in Birmingham, they should be considered alongside the fact that the whole region saw only 12 transactions in Q1, marginally below the quarterly average over the past ten years.

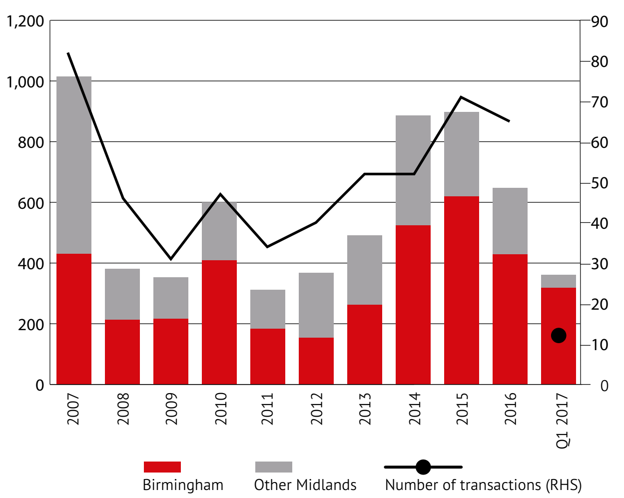
FRESH STOCK TO BOOST ACTIVITY

Though the market is thinner than it was in the boom of 2015, the limited depth to activity in Q1 largely reflected a lack of stock, as opposed to a drop-off in demand. Positively, since Spring, quality product has come to the market which will translate into busier transactional activity in the coming months.

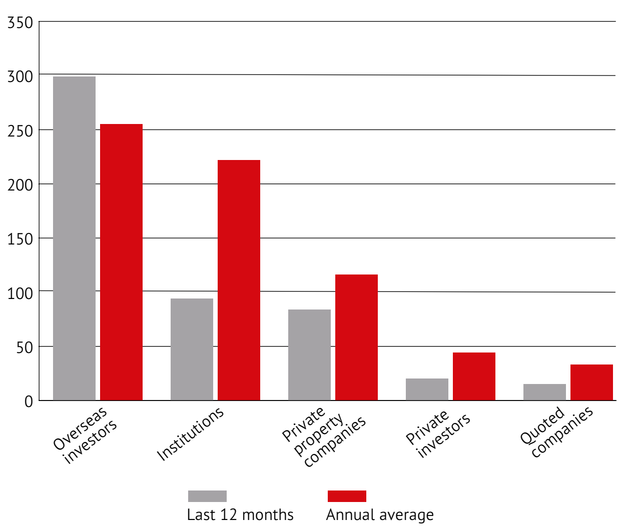
19 Cornwall Street in Birmingham city centre, soon to be Price Waterhouse Cooper's ex-Birmingham headquarters has recently come to market, providing a 'refurb and re-let' investment opportunity which has attracted serious investment interest from a number of parties. The majority of interest was mainly from private equity backed asset managers, while there was still some interest from funds and left field private buyers. Two other income driven deals are anticipated in the short term, boosting volume.

Admittedly, the recent election result has not provided the greater stability and certainty that was hoped for. While the move to a minority government brings fresh uncertainty to an already complex political environment, any impact is likely to fall disproportionately onto demand for riskier secondary assets, where sentiment was already fragile.

Midlands Engine office investment (£m)



Midlands Engine offices: volume by buyer type (£bn)



A BROAD MARKET PLACE

As with the UK's other regional office markets, institutions have traditionally dominated demand for large lot-sizes and quality product. However, this trend has been turned on its head over the past 18 months, reflecting a combination of increased appetite from overseas investors beyond the capital and a softening of institutional demand since 2015.

Driven by the aforementioned deals, overseas investors accounted for a substantial 53% of volume over the past 12 months. That said, at £43m, overseas investors were also the largest net sellers over the period, with several sales to domestic property companies.

With net purchasing of £45m, private property companies were the largest net buyers in the region over the past 12 months. Predictably, this has been focused at the smaller end of the market (i.e. sub £5m lots), although one sizeable deal was Clearbell Capital's £22m purchase of Blenheim Court, Solihull from Credit Suisse, in Q2 2016.

While last summer's Referendum result triggered a wave of institutional selling in Central London, its effect on fund behaviour elsewhere in the UK was relatively benign. Institutional buyers are now active in the region (evidenced by CBRE GI's purchase of 2 St Phillips Place in Q1), although overseas competition is aggressive.

Local authorities have emerged as significant buyers of UK commercial property over the past 18 months, using public finance to secure income streams. To date, their activity in the Midlands has been more limited in the office sector compared to the other mainstream markets.

PRICING HOLDS FIRM FOR QUALITY ASSETS

Despite the political turmoil engendered by the Brexit vote, transactional evidence suggests that pricing for prime, well-let assets has held firm over the past 12 months. The differential between prime yields and 10-year government bond yields remains attractive by historic standards, while there is a significant weight of global capital seeking to invest in the UK regions.

At 5.00%, there is a clear pricing disconnect between Birmingham and the region's other key markets, where prime yields range from 100 to 150 basis points higher. For income-seeking investors, the discount is sufficiently attractive to promote demand in the region's other locations, such as Milton Keynes, Nottingham and Leicester.

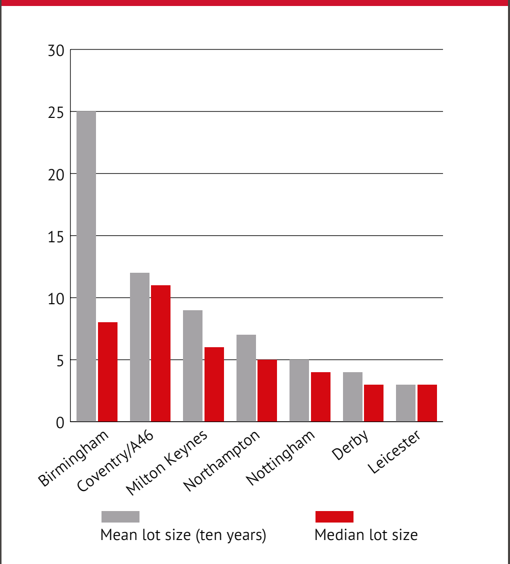
The problem for the region's other markets is that, unlike Birmingham, there is very little prime stock to target, both standing or in the pipeline. While developers remain wary of building speculatively, pre-letting is the only real means to create these sort of assets in the current environment.

RISK AND OPPORTUNITY

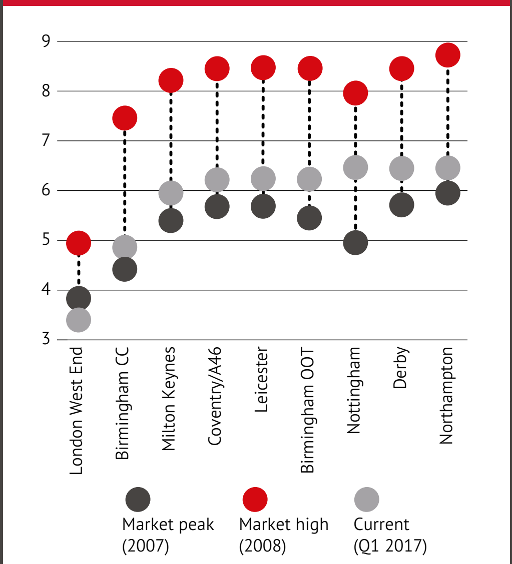
While the occupier markets have displayed resilience to the political turbulence, increased economic uncertainty has weighed on investor confidence towards secondary assets in the region, as it has elsewhere. However, with limited pressure to sell and supply levels broadly in check, falls in capital values will be relatively modest.

But with risk comes opportunity. Grade A space is in such short supply across the region that those investors who are prepared to take on the risk to reposition existing assets in the core micro-locations may reap significant rewards. To be successful, an intimate knowledge of the local markets is paramount, while an approach to differentiate the product from the conventional market offer could be advantageous.

Average lot size by location (2007 to 2017, £m)



Midlands Engine prime office yields (%)



Data source: Lambert Smith Hampton

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MARKET INSIGHT

BIRMINGHAM CITY CENTRE

Highlights

- **HS2's receipt of Royal Assent will provide another boost to Birmingham's prospects for inward investment.**
- **The Government Property Unit is expected to make a decision on its location in 2017, driving strong take-up for the year.**
- **Grade A supply will be boosted by the delivery of six developments by year end.**
- **Birmingham's prime headline rent is forecast to increase to £34.00 by the end of 2018.**

Demand

Take-up has been relatively subdued since the second half of 2016, largely due to a lack of major deals as opposed to a slowdown in the wider market. 2016 overall was nonetheless a good year, reflecting large deals to PWC (90,000 sq ft) and Network Rail (83,400 sq ft) in H1.

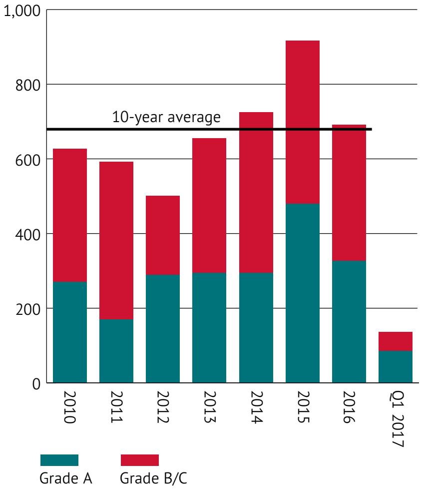
Total Q1 2017 take-up was 136,203 sq ft, up 40% from Q4 2016 and slightly ahead of the average for the first quarter. Q1's only deal in excess of 20,000 sq ft was Arcadis Consulting's 22,953 sq ft pre-let acquisition of 1st and part 2nd, Cornerblock, 2 Cornwall Street, which is presently undergoing extensive refurbishment.

Serviced office providers are gaining an increasing foothold in the market, partly driven by increased demand for flexible space among HS2 contractors. Q1's only other deals above 10,000 sq ft comprised iHub's lease of 18,378 sq ft Colmore Gate, Colmore Row, and Alpha Works' 14,200 sq ft lease at Alpha Tower, arguably the first genuinely co-working office environment in the city.

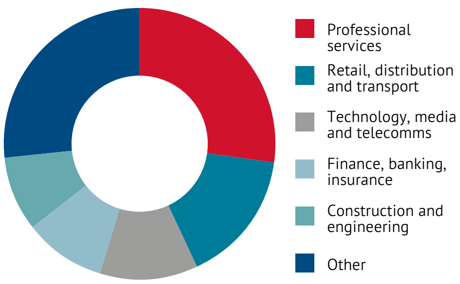
The Government Property Unit (GPU) is seeking circa 250,000 sq ft of prime offices in the city centre as it plans to consolidate its existing UK-wide central government departments. The decision on the location is expected during 2017 and will drive overall take-up.

The recent granting of Royal Assent to HS2 is another major boost to market prospects, both in the short term, and through longer term inward investment potential stimulated by its eventual arrival in 2026.

Birmingham CC take-up (000 sq ft)



Birmingham CC take-up by sector (past 12 months)



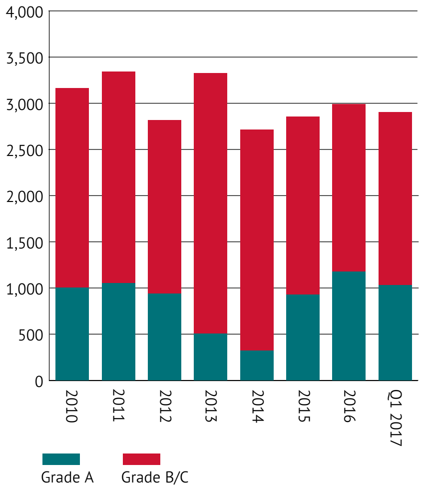
Current supply

Including space due to be delivered over the next 12 months, total availability edged down by 4% during Q1 2017 to stand at 3.05m sq ft. Based on average annual take-up, this equates to 4.3 years of supply, the highest of the key Midlands markets. However, approaching half of total supply comprises poor quality albeit economic grade C space.

Grade A supply has been boosted by the recent delivery of IM Properties' 55 Colmore Row (160,000 sq ft). Despite this, total ready to occupy grade A space stands at a relatively modest 400,000 sq ft and there are only a handful of buildings capable of accommodating larger requirements, examples including Baskerville House and The Colmore Building.

The same is also true of good quality second hand buildings. Of the 370,000 sq ft of grade B space available, there are relatively few options offering over 20,000 sq ft.

Birmingham CC availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Grade A share of supply	Q1 2017 headline rent (per sq ft)	Prime yield
-20%	4.3	35%	£32.00	5.00%

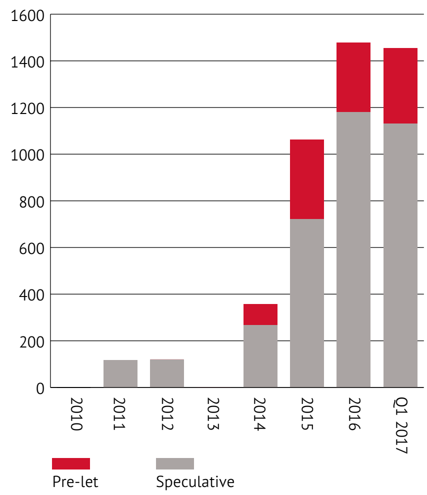
Development prospects

Reflecting concerted investment and a new found confidence in the city, grade A supply is set to be boosted significantly with circa 500,000 sq ft due to be delivered across six separate schemes by year end. All are extensive refurbishments, the largest of which are the Lewis Building (114,000 sq ft), Platform 21 (112,000 sq ft) and Cornerblock (110,000 sq ft).

The largest scheme in the pipeline is M&G and Ballymore's Three Snowhill, a major mixed-use development including 420,000 sq ft of office space. Completing in 2018, the 17-storey scheme forms a key milestone for the regeneration around the area of Snowhill station and signifies the extension of the business district northwards from the traditional core.

Looking further ahead, another potential scheme is 3 Arena Central. This recently received planning consent and proposes 241,000 sq ft. It is not yet known whether this will be brought forward speculatively, although the GPU is understood to have shortlisted this option as a preferred site for a pre-let commitment.

Birmingham CC under construction (000 sq ft)



Market rental values and yields

Birmingham's prime headline rent stands at £32.00 per sq ft, increasing 7% year-on-year. Despite the recent upward momentum, Birmingham is the only major regional UK market where the prime rents are yet to recover to their pre-recession level, indicating headroom for further growth as new supply is absorbed.

Birmingham city centre has completely dominated investment activity in the Midlands region, accounting for 88% of office volume over the past 12 months. This partly reflects HSBC Alternative Investment's £260m (6.00% NIY) purchase at Brindleyplace, the largest office-led deal ever seen in the Midlands. Evidence in the market indicates that prime yields have remained stable at 5.00% over the past 12 months.

Outlook

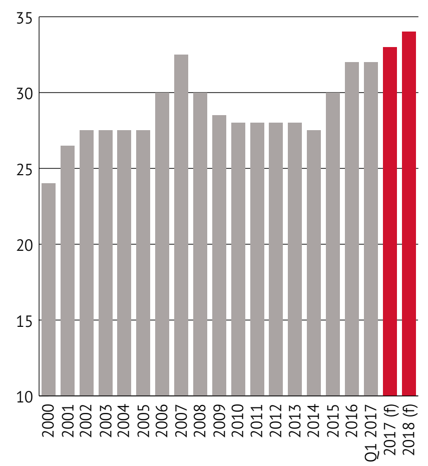
Birmingham is an exciting city, benefitting from a wave of investment which promises to elevate its status to a truly first class business destination over the next decade. On face value, the development pipeline appears sizeable, although a handful of major deals are all that is required to restore balance in the market.

While Birmingham is well-placed to withstand the wider political and economic uncertainty, more clarity over the future direction of the economy is arguably the only missing piece in the jigsaw before a fresh wave of inward investment comes to the city.

Despite the more uncertain environment and the volume of space coming into the market, confidence remains over prospects for rental growth. As newly delivered space is absorbed, prime headline rents are expected to increase to £34.00 per sq ft by the end of 2018.

2018 ▲ £34.00 per sq ft

Birmingham CC prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton (except Birmingham CC take-up which is BMOF/LSH)

BIRMINGHAM OUT-OF-TOWN

Highlights

- **The market has performed well, with take-up over the last 12 months up 10% on the 10-year average.**
- **Quality supply has been derived from extensive refurbishments, with a number in the pipeline.**
- **Blythe Valley Business Park is home to the market's first speculative development in eight years.**
- **Prime headline rents are expected to reach £23.00 per sq ft by year end.**

Demand

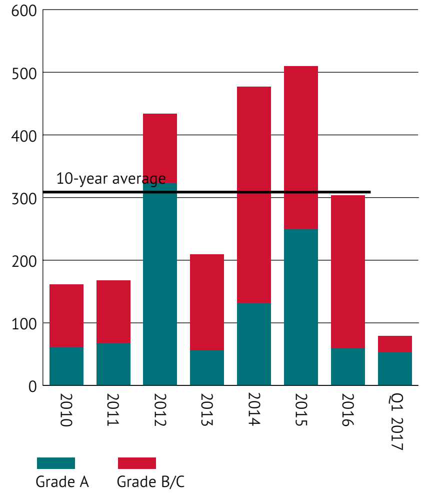
The Birmingham out-of-town market has been one of the region's best performing markets over the last 12 months. At 342,000 sq ft, take-up in the 12 months to the end of Q1 2017 was 10% above the ten-year average. While this was a robust level of activity, it was down 29% on 2015's record annual total.

In contrast to the city centre, where professional services predominate, the out-of-town market has a greater diversity of tenant types, spreading the risk across a range of industries. Construction and Engineering, TMT and professional services each accounted for a broadly equal proportion of take-up over the last 12 months at 19%.

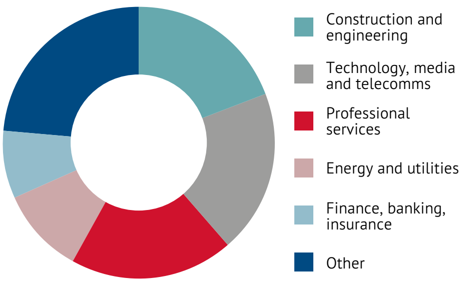
Accounting for a notable 38% of total Birmingham take-up over the last 12 months, the out-of-town market fared well in light of uncertainty in the market. The most notable deal was Uniper's 32,692 sq ft lease of Compton House at Birmingham Business Park back in Q2 2016, the only deal over 30,000 sq ft.

The market has made a decent start to 2017, with Q1 take-up of 78,537 sq ft up slightly on the ten-year quarterly average. Q1's largest deal was PKF Cooper Parry's 17,810 sq ft lease at One Central Boulevard, Blythe Valley Business Park, which sees the accountancy firm move from Edgbaston.

Birmingham OOT take-up (000 sq ft)



Birmingham OOT take-up by sector (past 12 mths)



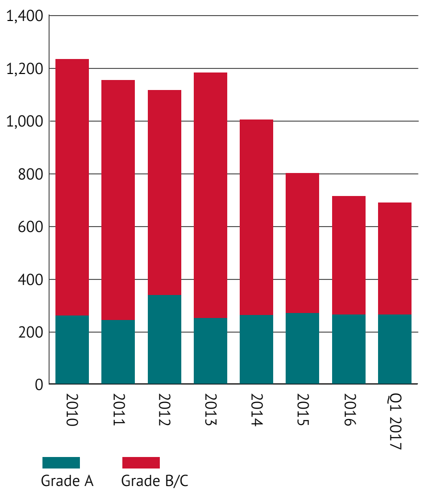
Current supply

The Birmingham out-of-town market covers a relatively broad geographical area, although the main focus of demand and quality stock is located within business parks around junctions 4 and 6 of the M42, the largest being Birmingham Business Park and Blythe Valley Park, Solihull.

While broadly stable across the last 12 months, availability has continued its downward trajectory. Having been starved of new product, supply stands at its lowest in well over a decade, at 710,000 sq ft. Against average annual take-up, this is equivalent to 2.2 years of supply, making it one of the tightest supplied of the eight Midlands markets.

The supply of quality space in the market has been partly addressed by high specification refurbishments of existing buildings. Examples include 31 Homer Road, Solihull (66,364 sq ft) and 2650 Kings Court, Birmingham Business Park (17,600 sq ft).

Birmingham OOT availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Grade A share of supply	Q1 2017 headline rent (per sq ft)	Prime yield
+10%	2.2	36%	£22.50	6.25%

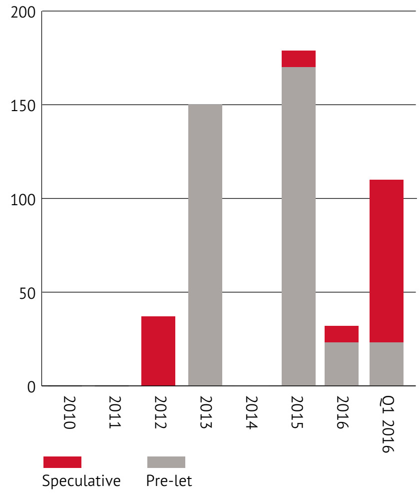
Development prospects

The market has seen the first new build speculative development since 2009 commence this year. FIRST at Blythe Valley Park, Solihull, will provide 15,081 sq ft and is due to complete in Q1 2018. IM Properties' decision to speculatively build the first standalone scheme in eight years is indicative of the greater degree of confidence in the market, following ProLogis's 15,591 sq ft office pre-let at Plot F, Blythe Valley.

Also demonstrating confidence in the market, St Alphege, Solihull was fully let soon after its back-to-frame refurbishment completed in early 2017. Forming part of a mixed-use scheme in the town centre, SOTI have leased the entire 9,142 sq ft.

Despite a lack of new build development, landlords have been focusing on refurbishments to bring quality space to the market. Several comprehensive refurbishments are currently underway, including 42,000 sq ft at Trigen House, Blythe Valley Park and 30,000 sq ft at The Crescent. While no further new builds are coming forward, several additional refurbishments are in the pipeline.

Birmingham OOT under construction (000 sq ft)



Market rental values and yields

Prime headline rents have increased 7% year-on-year to stand at £22.50 per sq ft at the end of Q1 2017. Several buildings are available at a higher quoting rent, such Trinity Central (25,000 sq ft) which is currently being refurbished and quoting £23.50 per sq ft. With quality supply under pressure, its landlord, Mucklow, is confident of achieving this level.

In the investment market, the most recent transaction was Canmoor Asset Management and Blackrock's £9.65m (NIY 7.84%) purchase of five buildings at Birmingham Business Park, let to tenants including Canon, Mitsubishi and IPS, from Matterhorn Capital. While there has been no recent evidence to confirm pricing, sentiment indicates that prime yields stand at circa 6.25%, representing a 125 basis point discount to Birmingham city centre.

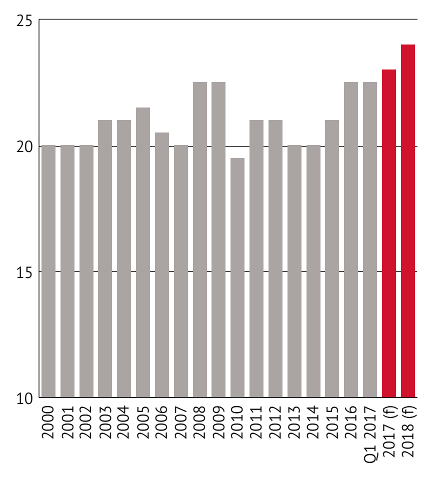
Outlook

Whether the higher quoting rent of Trinity Central will be achieved is yet to be seen but it is expected that prime headline rents will increase to at least £23.00 sq ft by the end of 2017. In addition, the scarcity of new build development down the pipeline should allow landlords to be more aggressive with incentives.

With active demand being broadly in line with a year ago, 2017 is expected to record another decent level of take-up and lease events in 2018 provide a good outlook into the following year. The wide tenant type base spreads risk surrounding the wider market uncertainty.

2018 ▲ £24.00 per sq ft

Birmingham OOT prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton (except Birmingham OOT take-up which is BMOF/LSH)

COVENTRY / A46 CORRIDOR

Highlights

- **The Coventry / A46 market has been the region's star performer over the past 12 months, with take-up 33% above average.**
- **Current availability equates to only 2.0 years of supply, the lowest of any key Midlands market.**
- **In the absence of speculative development, business park refurbishments have let-up well.**
- **Over the next decade, the Coventry city centre offer will be radically enhanced by major regeneration around Friargate.**

Demand

The Coventry market, which runs along the A46 corridor and encompasses Leamington Spa and Warwick, recorded strong take-up of 329,000 sq ft in 2016, 30% above the annual average. Advanced manufacturing, automotive and engineering businesses play a key part of the occupier profile.

2016 saw two sizeable transactions which together accounted for a third of annual take-up. In Q2, Tata Technologies committed to build a new 63,000 sq ft European headquarters at Tachbrook Park Drive, Leamington Spa, then, in Q3, National Grid leased 50,500 sq ft at Ashbrook Court, Central Boulevard Coventry.

Market activity has been solid in the first part of 2017, albeit lacking in major deals. Q1 take-up was 59,000 sq ft, the largest deal being Baldwin Accountants' lease of 8,559 sq ft at Siskin Drive, Middlemarch Park.

2017 promises to be another good year - active demand remains resilient while a number of notable deals are in solicitors' hands. In addition to the above pre-let, TATA is understood to have a requirement for a further 40,000 sq ft, reflecting the ongoing confidence of production sector occupiers.

Current supply

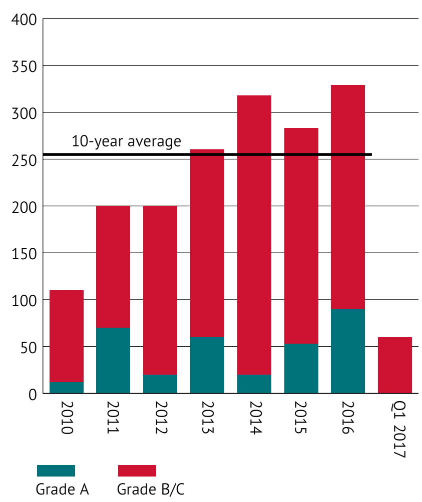
The market covers a broad geographical area and there is a clear distinction between the modern business park settings such as Tachbrook Park, Ansty Park and Middlemarch Business Park from Coventry city centre, which is characterised by an overhang of dated, poor quality stock.

Supply continues to diminish, reflecting a combination of robust market activity and a virtual absence of speculative development. Total availability edged down during Q1 2017 to stand at 513,000 sq ft, 40% below its 2010 peak. Based on average take-up, this equates to only 2.0 years of supply, the lowest of the Midlands' key markets.

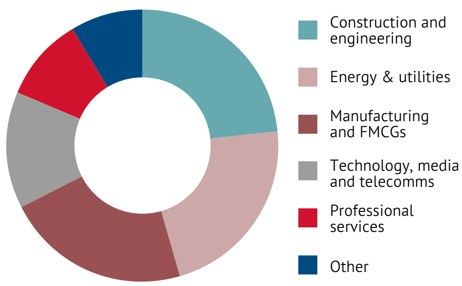
Quality requirements are typically satisfied through either larger purpose-built pre-lets or refurbished stock. Middlemarch Business Park, Coventry has enjoyed letting success recently following design-led refurbishment by its owner Evenacre, with demand stimulated by recent road infrastructure improvements around the site.

Elsewhere, Nurton Developments has recently delivered a comprehensive refurbishment at One Warwick Technology Park, which provides 38,000 sq ft of grade A space. As the only sizeable, high quality space building in the market, interest has been strong, with a significant proportion already understood to be under offer.

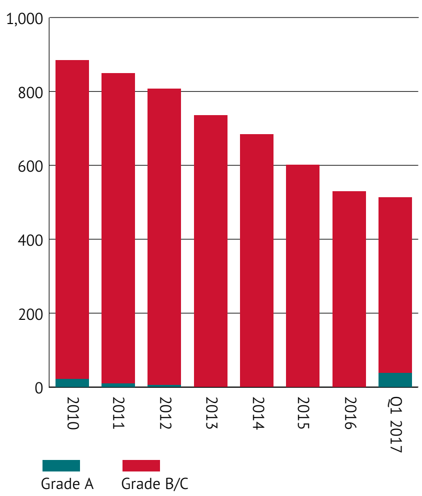
Coventry take-up (000 sq ft)



Coventry take-up by sector (past 12 months)



Coventry availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Years of grade A supply	Q1 2017 headline rent (per sq ft)	Prime yield
+33%	2.0	8%	£19.00	6.25%

Development prospects

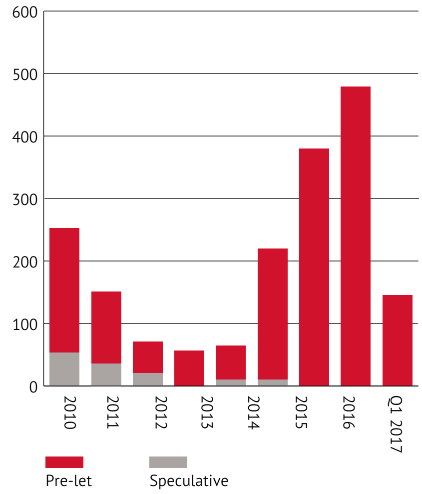
While speculative development has been elusive, quality stock has been delivered via purpose-built pre-lets. These are dominated by the region's broad base of automotive, advanced manufacturing and technology occupiers, who by nature are more likely to require bespoke solutions.

One major purpose build development is set to complete imminently. Jaguar Land Rover's new National Automotive Innovation Centre (NAIC) , Westwood will help to secure the Midland's long-term future as a major focus of innovation in the automotive industry.

Coventry Council's 145,000 sq ft pre-let at Friargate in Coventry city centre is the only ongoing development in the market. Jointly developed between Standard Life, Network Rail and the Council, Developed by Cannon Kirk, it forms an initial stage of a major regeneration project within the city centre, including redevelopment of the train station, up to 2.3m sq ft of new office space and an enhanced public realm.

Interest is being sought over a second proposed office building at Friargate. While several parties have expressed serious interest, the sizes of the potential pre-lets are not sufficient to trigger the development in the currently uncertain environment.

Coventry under construction (000 sq ft)



Market rental values and yields

Tight supply and rising build costs are putting upward pressure on rental levels. Evidence from deals either completed or in solicitors' hands indicates that headline rents for good quality refurbished stock have increased around 6% to £17.50 per sq ft in recent months, while headline rents will reach a new high of £19.00 per sq ft should One Warwick Technology Park achieve its quoted level.

Despite limited recent evidence, sentiment indicates that prime yields in the Coventry / A46 market have stood unchanged at 6.25%. While investment demand typically focuses on modern business park assets, IM properties' £17.3m purchase of Sherbourne House in Coventry city centre in Q3 2016 is testament to the increasing interest in the city flowing from the potential of Friargate.

Outlook

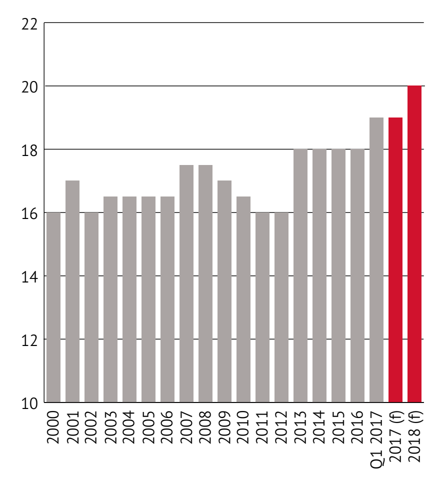
The imminent arrival of the NAIC is testament to the strength of expertise in the automotive sector and future prospects for the market. The University of Warwick is also key stakeholder in fostering innovation and promoting this vital business cluster, boosting the area's long-term inward investment potential.

Notwithstanding the wider economic uncertainty, the dynamics of supply and demand in the market bode well for rental growth over the next 18 months. With quality space in short supply, landlords and investors are already opportunistically repositioning assets through refurbishments, which in time could provide the catalyst for new-build speculative development.

The regeneration piece in Coventry city centre is more challenging. While quality product is desperately needed, further progress at Friargate requires a major pre-let before the developer will commit. If a solution can be found, we would expect rental levels to increase to over £20.00 per sq ft.

2018 ▲ £20.00 per sq ft

Coventry prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

DERBY

Highlights

- **Q1 2017 saw a marked improvement in occupier activity following a poor 2016.**
- **Overall availability remains limited with a lack of grade A space and large floorplates.**
- **Pre-lets are required to trigger office development and prevent further sites changing to residential or student accommodation use.**
- **Growth in prime headline rents will be dependent on new build stock being delivered to the market.**

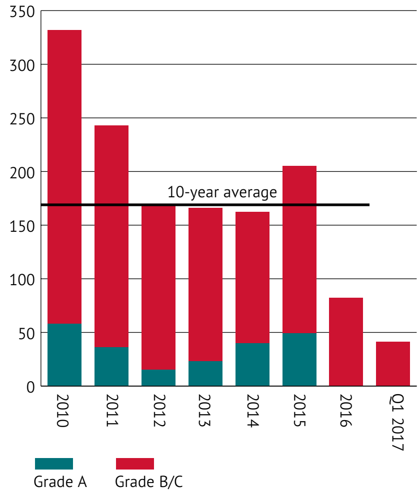
Demand

At 80,000 sq ft, take-up was subdued in 2016, down 47% on 2015. Market activity, as measured by the number of deals, was also weak, with only 27 transactions occurring in 2016. However, following the subdued 2016, activity in the first quarter of 2017 has started well with take-up of 41,000 sq ft across 19 deals.

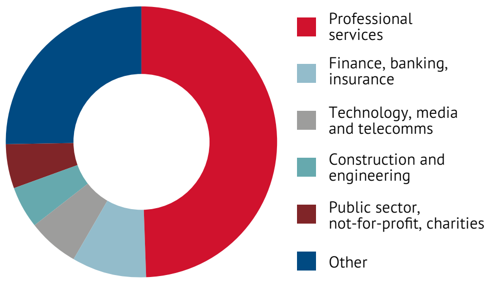
Activity has been concentrated at the smaller end of the market, with 86% of deals over the past 12 months being under 5,000 sq ft. Churn of second-hand space is characteristic of the market and, due to a lack of supply, 2016 was the second successive year without either a single grade A deal or a deal above 10,000 sq ft.

The largest transaction during the past year was Donaldson Associates' lease of 5,990 sq ft at Kelvin House, RTC Business Park. Professional services is the main driver of demand, while town centre stock provides the main focus of activity.

Derby take-up (000 sq ft)



Derby take-up by sector (past 12 months)



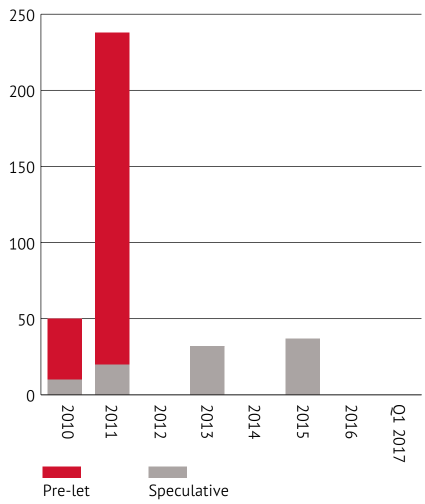
Current supply

Availability has halved from its 2014 peak to stand at a ten-year low of circa 395,000 sq ft. Based on average take-up, this equates to 2.4 years of supply, amongst the lowest in the region. Moreover, almost half of availability requires extensive refurbishment, further increasing pressure on supply.

A lack of development has left the market starved of grade A space, which accounts for only 10% of total supply. The largest available grade A properties include 9,250 sq ft at Bridge Street and 6,063 sq ft at Pullman Business Park. A number of good quality grade B options are also available in-town, including 24,000 sq ft at Laurie House and 13,000 sq ft at Cardinal Square.

Office supply continues to be eroded by redevelopment projects, particularly conversion to city centre residential and managed student accommodation. Examples include St Peter's House in Gower Street and Roman House in Friar Gate.

Derby availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Grade A share of supply	Q1 2017 headline rent (per sq ft)	Prime yield
-34%	2.4	10%	£17.50	6.50%

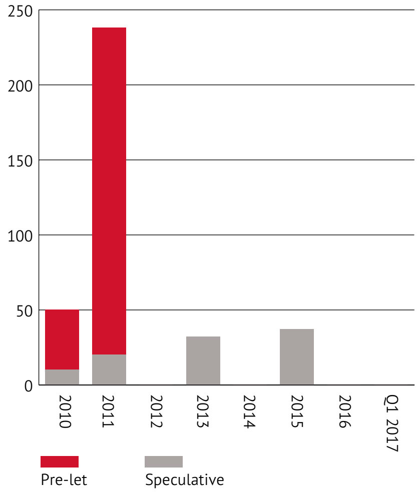
Development prospects

Despite the shortage of prime space, there are no speculative developments either under construction or in the immediate pipeline. However, Midland House (18,324 sq ft) on Nelson Street has been earmarked for refurbishment and when complete, could help to partially alleviate the supply issues.

The last vacant site on Locomotive Way at Pride Park is currently the best development site in the city. While planning consent is in place, a significant pre-let will be required before development can commence.

Around 100 acres of land is also available at Infinity Park for design and build mixed-use commercial projects from 5,000 sq ft. Elsewhere, it has been indicated that land at the former Derbyshire Constabulary Divisional HQ at Cathedral Green will come forward as a mixed-use project including a hotel, residential and office accommodation. For now, however, this remains an off-plan discussion.

Derby under construction (000 sq ft)



Market rental values and yields

Prime headline rents have been unchanged in Derby since 2015, standing at £17.50 per sq ft. Although there has not been the space available in the prime locations to confirm this level.

Current sentiment indicates no change in prime office yields in Derby and they continue to stand at circa 6.50%. However, investment activity has been scarce since the first quarter of 2016 and therefore there is no transactional evidence to confirm where yields currently stand.

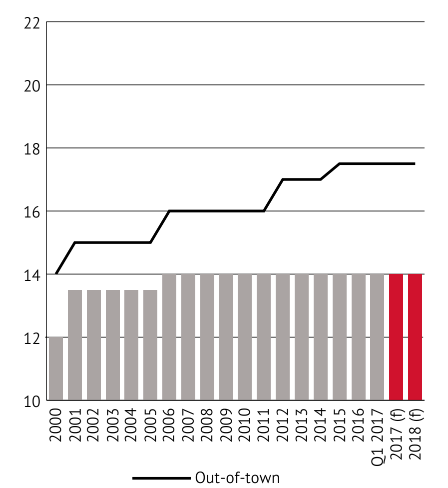
Outlook

Activity in the Derby market in 2017 has started well. To sustain this positive start, new build or good quality refurbished office stock is required to satisfy current requirements and attract good quality tenants.

With no development in the pipeline, prime headline rents are expected to remain at their current level for the rest of 2017 and into 2018. That said, Derby is starting to attract technology and innovation occupiers and the iHub at Infinity Park has been very successful. We anticipate that Infinity Park will continue to lead the way and speculative development on this site may well occur in the next 12 months triggering a step-change in prime headline rents.

2018 ▶ £17.50 per sq ft

Derby prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

LEICESTER

Highlights

- **Take-up in 2016 was broadly in line with the average but weak compared to 2015's record.**
- **While grade A space is extremely limited, a range of quality grade B options are available.**
- **During 2016 there was circa 14,000 sq ft of speculative development completed and a large pre-let of 50,000 sq ft to Mattoli Woods.**
- **A large pre-let has the potential to trigger growth in prime headline rents.**

Demand

Take-up reached 242,068 sq ft in 2016, down 51% on the record year of 2015 but only 8% below the 10-year average. 2016's largest deal was out-of-town; Hanson's lease of 23,535 sq ft at One Marlborough Court, Watermead Court. Activity in the first quarter of 2017 has been relatively subdued, with a total of 41,499 sq ft transacted, down 30% on the same period of 2016.

Activity has been dominated by small deals, with transactions below 5,000 sq ft accounting for 89% of deals over the past 12 months. There have only been three transactions above 10,000 sq ft in the past 12 months which, in addition to the Hanson deal, comprised Access Group's 18,700 sq ft lease at Loughborough Science Park and BHW's 10,268 sq ft lease at Eldon Street in the town centre.

Demand continues to be focused out-of-town, particularly on the business parks adjacent to Junction 21 of the M1. Professional services remains the key occupier sector in the Leicester market, although the only professional services occupier to take in excess of 10,000 sq ft over the past 12 months was BHW Solicitors at Eldon Street.

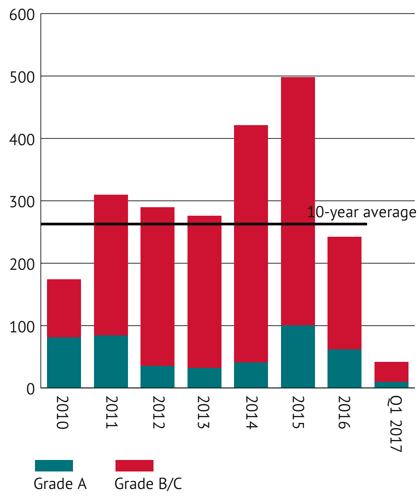
Current supply

Other than Birmingham city centre, Leicester is the only key market in the Midlands to have seen an increase in supply over the past 12 months, albeit the rise was marginal. At 657,000 sq ft, total availability is equivalent to 2.5 years of supply based on average take-up. However, availability of grade A is negligible, with the only options at Colton Square in the town centre, the largest of which is 14,877 sq ft.

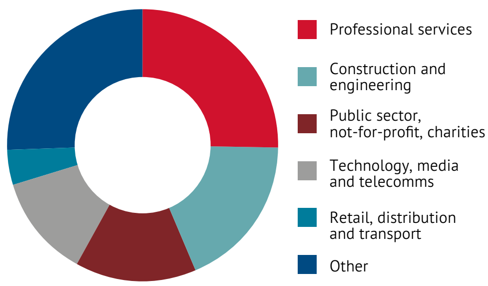
Availability is evenly split between the town centre and out-of-town locations. There is a reasonable supply of quality grade B accommodation. For example, in town there are a number of circa 20,000 sq ft options at Humberston House, Charles House and Mercury Place.

2016 saw commencement of a major mixed use development at the former New Walk Centre, including 50,000 sq ft of new office space pre-let to Mattoli Woods. Stephen George and Partners has also recently announced commencement of the build of their new £1.7m headquarters at Grove Park, Enderby.

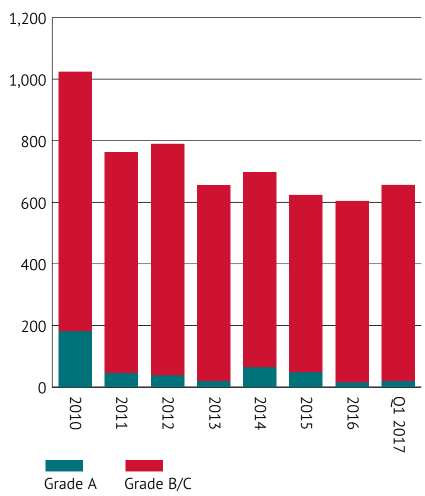
Leicester take-up (000 sq ft)



Leicester take-up by sector (past 12 months)



Leicester availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Grade A share of supply	Q1 2017 headline rent (per sq ft)	Prime yield
-15%	2.5	3%	£17.50	6.25%

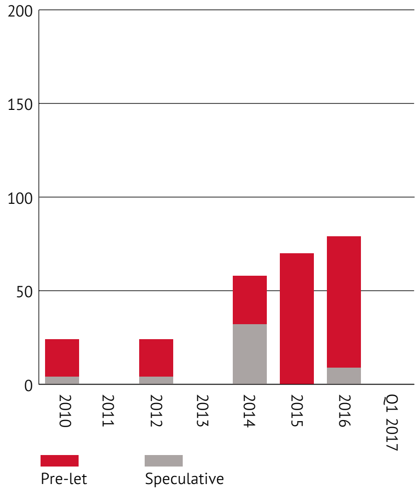
Development prospects

Speculative development completions amounted to only 14,000 sq ft, comprising DW Hicks' unit at Thurmaston Lane (4,400 sq ft) and Leicester City Council's Friars Mill (9,400 sq ft).

Out-of-town, Phase 2 of Watermead Business Park provides development opportunities on a design and build basis from 5,000 to 50,000 sq ft. As the only premium office development on the north side of the city, it is well connected to main arterial roads and only 10 minutes from the M1, however to kickstart further development on this site, pre-lets are required.

The recent announcement of the Loughborough and Leicester Science and Innovation Enterprise Zone is expected to attract business, investment and development. It consists of three sites: two in Loughborough and one in Leicester, to support science and hi-tech manufacturing businesses over the next 25 years. While worthy, the specificity of activity in these zones excludes development of conventional office space.

Leicester under construction (000 sq ft)



Market rental values and yields

Prime headline rents have remained unchanged since 2015, standing at £17.50 per sq ft.

Prime office yields stand circa 6.25% in the Leicester market. A number of transactions over the past 12 months provide supporting evidence on pricing, particularly those in the Grove Park development. For example, a unit at Grove Park was sold for £1.47m, reflecting a net initial yield of 6.5%, and another was sold for £2.06m, reflecting a net initial yield of 6.1%.

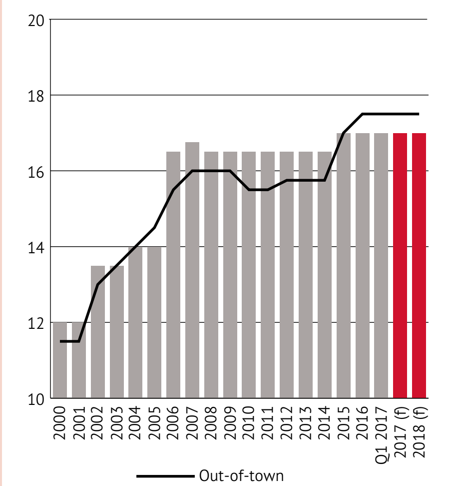
Outlook

Demand in Leicester is stable, but without new stock becoming available either through new builds or good quality voids, it is unlikely that take-up for 2017 as a whole will surpass the annual average of 263,000 sq ft.

With Grove Park now entirely built out and a scarcity of land near Junction 21 of the M1, demand for good quality office accommodation is outstripping supply. There is the potential that rents will move forward with the next large pre-let in the Leicester market, but there will be little upward movement until this happens.

2018 ▲ £17.50 per sq ft

Leicester prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

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MILTON KEYNES

Highlights

- **Prime headline rents are expected to climb to £23.00 per sq ft over the next 12 to 18 months.**
- **Strong demand for residential conversions is helping to clear the market of obsolete stock.**
- **With a lack of development since the recession, refurbishments are a key element of the market.**
- **AW James is in the final planning stages for a 115,000 sq ft speculative scheme in the city centre.**

Demand

Since the surge of activity in 2015, Milton Keynes has seen more subdued levels in the recent months. Take-up in 2016 was down 8% on the high of 2015 but was 12% above the 10-year average, supported by a number of large deals.

While the number of deals in 2016 was down 22% year-on-year, the average deal size was 18% higher at 4,751 sq ft, reflecting the boost of larger but fewer deals. 2016's largest deal was Bunnings' (formerly Homebase) 53,000 sq ft lease in-town at Witan Gate House and the largest since Q3 2015 when Santander leased 69,200 sq ft at MK Central.

Moving into the start of 2017, Q1 was very quiet. Milton Keynes recorded only 27,475 sq ft of take-up, well below the 10-year quarterly average of 70,000 sq ft. There were only nine deals in the quarter, the largest being Alliance Automotive's 8,600 sq ft lease at Eskan Court out-of-town.

Positively, a number of deals are in the pipeline which should bring a boost to Q2/Q3 take-up. This includes serviced office provider iHub at MK Central (26,000 sq ft), Energie Property UK at Icon, Kiln Farm (20,000 sq ft) and Bovis Homes at St Annes House, Caldecotte Lake Business Park (10,000 sq ft).

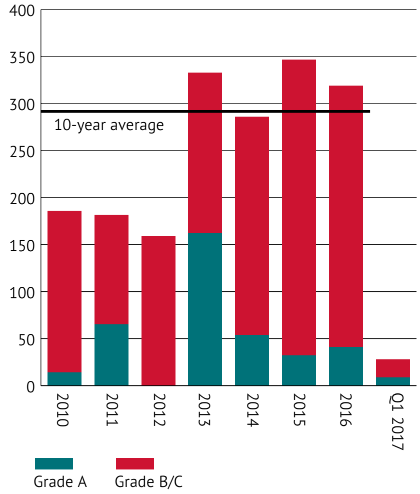
Current supply

Availability has fallen 5% year-on-year to stand at 917,278 sq ft. In context with average take-up, this is equivalent to 3.3 years of supply, closely in line with the UK regional market average of 3.1 years. The largest single floor plates of circa 20,000 sq ft are located in town at Ashton House and out-of-town at K2 Kents Hill.

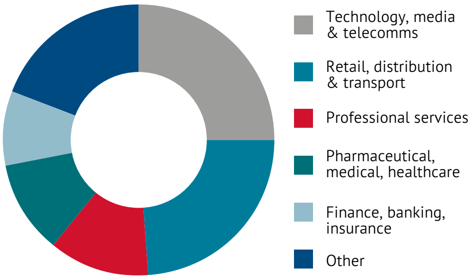
Grade A supply has increased over the last 12 months, partly reflecting the delivery of Victoria House to the market. The building extends to 37,500 sq ft, with 16,900 sq ft available after Grant Thornton's pre-let. A number of extensive refurbishments are also available, such as Atrium (69,000 sq ft), K2 Kents Hill (41,270 sq ft) and Affinity (41,000 sq ft).

Meanwhile, office conversion to residential has taken a significant amount of secondary stock out of the market. In 2016, 68,132 sq ft of office stock was lost to residential with further potential for over a quarter of a million sq ft to leave the market. This includes 19,000 sq ft at Grant Thornton House and 18,257 sq ft at Tower Gate House.

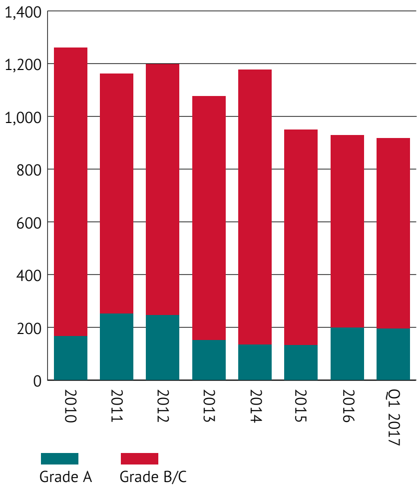
Milton Keynes take-up (000 sq ft)



Milton Keynes take-up by sector (past 12 months)



Milton Keynes availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Grade A share of supply	Q1 2017 headline rent (per sq ft)	Prime yield
-8%	3.3	21%	£22.50	6.00%

Development prospects

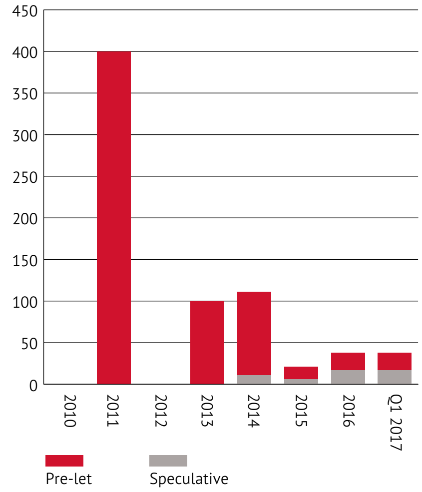
Following the Q2 2017 completion of Victoria House, there are no developments currently under construction. Given the Milton Keynes Development Partnership's (MKDP) mandate to secure a pre-let, Grant Thornton pre-let 50% of the scheme at the beginning of 2016, with 16,900 sq ft available.

Elsewhere, AW James is in the final consultation stages of speculatively developing circa 115,000 sq ft of offices within the Leisure Plaza district adjacent to the Plaza shopping centre. Capable of providing sizeable floorplates, the proposal will be attractive to potential inward investors.

Sterling Property Developments and MKDP are in the planning and design stages of the office-led mixed-use towers on a 1.5 acre site situated on Midsummer Boulevard. In addition to office space, the development could include a skyline restaurant and private residential space alongside an enhanced public realm.

Out-of-town, Woodlands Business Park has planning permission for up to 150,000 sq ft of offices arranged over six acres within four buildings of between 25,000 and 60,000 sq ft. However, owner, Barwood Capital, will not speculatively build without a pre-let in place.

Milton Keynes under construction (000 sq ft)



Market rental values and yields

Prime headline rents have remained stable at £22.50 per sq ft over the 12 months to the end of Q1 2017. This level was achieved at the beginning of 2016 by Grant Thornton's pre-let at Victoria House and the remaining space has a quoting rent of £23.00 per sq ft but is yet to attract a tenant.

The out-of-town market has achieved £22.00 per sq ft, following Daqri Monographics' lease at Garforth Place in Q2 2016. This represented a substantial 26% increase from the previous prime rent of £17.50 per sq ft.

Prime yields have remained broadly stable over the year at 6.00%, although the keenest yield over the last 12 months was Capital London's £6.7m purchase of Bank House in Q3 2016, reflecting 5.56% NIY. 2017 has already seen two notable investment transactions, namely Phoenix House (NIY 7.25%) and Elder House (NIY 8.33 %), both of which were purchased by private investors for £11m.

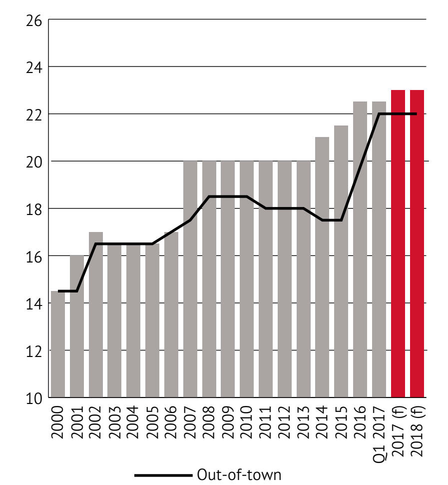
Outlook

Despite the recent subdued levels of take-up, prime headline rents are expected to reach £23.00 per sq ft in the near future given the lack of new build options available. Out-of-town, £22.00 per sq ft is not likely to be exceeded as currently there is no suitable supply to achieve higher rents.

Viewed as a positive impact on the market, office conversion to residential is consolidating supply and further stock taken out of the market could see investors commit to development. Once construction commences, AW James' development at Leisure Plaza will bring a boost to the office offer and the wider appeal of the city centre as a business location.

2018 ▲ £23.00 per sq ft

Milton Keynes prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

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NORTHAMPTON

Highlights

- **Take-up in 2016 was strong, albeit skewed by one large transaction.**
- **Northampton continues to suffer from an acute shortage of grade A stock.**
- **There is pent-up demand from quality occupiers, although refurbishment projects will help to alleviate this later in 2017.**
- **Rising construction costs and a lack of options could push prime headline rents to in excess of £20.00 per sq ft.**

Demand

At 182,000 sq ft, take-up in 2016 was relatively healthy, up 45% on 2015 and 7% above the 10-year average. However, the figure was boosted by Opus Energy's 90,000 sq ft acquisition of John Dryden House in Q2 2016.

Activity in the first quarter of 2017 reached a respectable 31,811 sq ft, an improvement on Q1 2016 (25,440 sq ft) and Q1 2015 (26,336 sq ft), but not enough to suggest 2017 as a whole will surpass the annual average.

Notably, for the first year in a decade, no grade A space was let during 2016. Prominent grade B deals included 12,000 sq ft at Sol House let to Simply Business (which now occupies 22,000 sq ft) and 8,612 sq ft at Electus, Northampton Business Park let to Online Direct.

Reflecting the supply position, out-of-town stock attracts the majority of demand - accounting for 85% of take-up in the past 12 months. Opus Energy's major transaction in Q2 2016 was exceptional, with the remainder of activity made up of smaller transactions to a diverse range of occupiers.

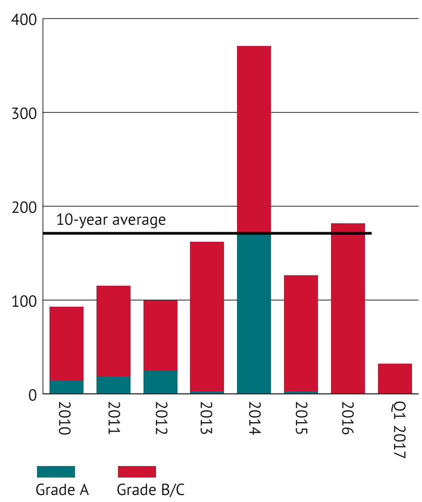
Current supply

Availability in Northampton has reduced by 41% from its peak in 2012 to stand at 351,986 sq ft, which is equivalent to 2.1 years of supply. However, the main concern relates to the lack of quality product, with grade A space accounting for only 5% of total availability. Furthermore, over half of current available stock is poor quality grade C space and requires extensive refurbishment to appeal to potential occupiers.

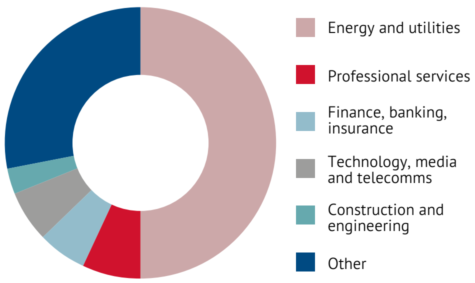
The only grade A stock available comprises the recently completed Innovation Centre in the town centre. Sizeable grade B options are available, albeit they are all out-of-town, with 19,111 sq ft at Britannia House, 17,588 sq ft at 900 Pavillion Drive and 12,275 sq ft at 500 Pavillion Drive. In town, circa 10,000 sq ft grade B floorplates are available at Oriel House and Midsummer House.

There is pent-up demand from good quality tenants that is going unmet as a result of the constraints on supply. With limited options for potential occupiers, there is an opportunity for landlords to consider refurbishment of sub-standard buildings.

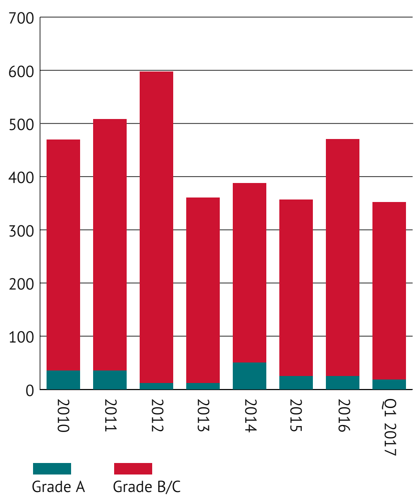
Northampton take-up (000 sq ft)



Northampton take-up by sector (past 12 months)



Northampton availability (000 sq ft)



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12 month take-up vs 10-year average

+11%

Years of supply

2.1

Grade A share of supply

5%

Q1 2017 headline rent (per sq ft)

£19.00

Prime yield

6.50%

Development prospects

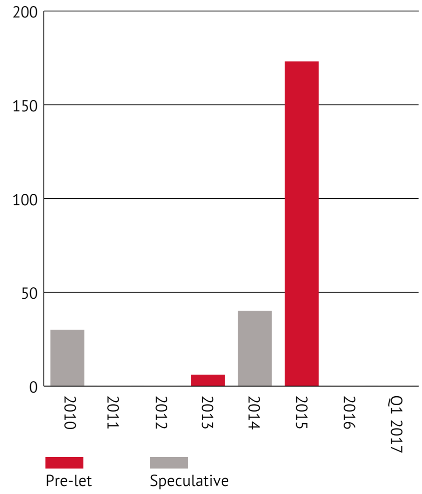
While there is no development currently underway, there are ambitious policies and plans for town centre regeneration which include a dedicated enterprise zone and new build office development. The Waterside Enterprise Zone offers a range of office and industrial sites across 120 hectares stretching from Sixfields in the west across the town centre.

FOUR Waterside is a proposed Northampton Borough Council backed development within the Waterside Enterprise Zone which, when delivered, will provide 60,000 sq ft of prime office space and the first new open market office development in recent years.

The third phase at Waterside Way is also offering design and build options from 4,500 sq ft to a maximum of 85,000 sq ft. This site is only five minutes drive from the town centre and is accessible from the A45. It is also situated close to the new University of Northampton Waterside Campus, due for completion in September 2019. This new campus brings significant investment in infrastructure, including a new bridge over the River Nene.

Northamptonshire County Council has recently initiated a move into its new purpose built accommodation. The £53m Project Angel building in the town centre has consolidated 2,000 staff into high quality, modern accommodation. Its former premises at Century House and Riverside House are due to undergo transformational refurbishments and are already attracting attention from prospective tenants.

Northampton under construction (000 sq ft)



Market rental values and yields

Prime headline rents increased by 3% during 2016 to stand at £19.50 per sq ft. With limited grade A space available, refurbishments are attracting headline rents of £17.00 to £18.50 per sq ft. Century House and Britannia House are two refurbishments which will be available later in 2017, and are being marketed at circa £18.50 per sq ft.

Sentiment indicates that prime yields have remained stable at 6.50%. While there has been very little transactional activity to confirm this level, Nene House was recently sold for £2.7m, reflecting a net yield of 6.41%. More recently, German real estate fund Real IS placed Barclaycard's 310,000 sq ft office campus at Northampton Business Park onto the market. At £56.7m, the asking price reflects a net initial yield of 7.00% and its sale will provide a useful barometer of investment appetite for this sort of product.

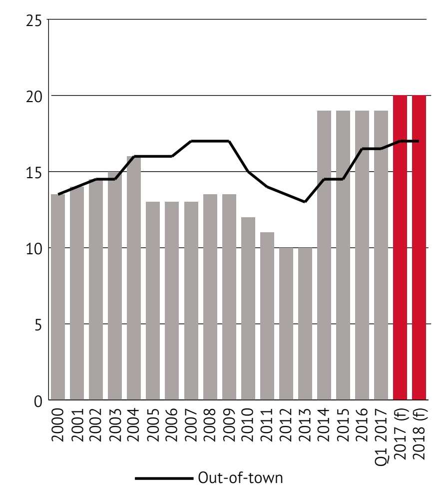
Outlook

While the first quarter performance in 2017 is stronger than that of previous years, the lack of prime space and large floorplates means that take-up in 2017 as a whole is unlikely to surpass the 10-year annual average (170,112 sq ft).

There is, however, the potential for rents to increase over the next 12 months and breach £20.00 per sq ft, but this is entirely dependent upon the delivery of new build or premium quality refurbished space. Northampton has unfulfilled demand from good quality occupiers and a surplus of poor quality stock which, if refurbished, would appeal to these tenants.

2018 ▶ £20.00 per sq ft

Northampton prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

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NORTHAMPTON
NOTTINGHAM

NOTTINGHAM

Highlights

- **2016 saw the lowest level of transactional activity in five years.**
- **An acute shortage of grade A space, particularly in the city centre, is a barrier to satisfying quality requirements.**
- **Nottingham's prime headline rent has remained unchanged for six years at £19.75 per sq ft.**
- **Professional services demand is gradually giving way to the technology and bio-science sectors.**

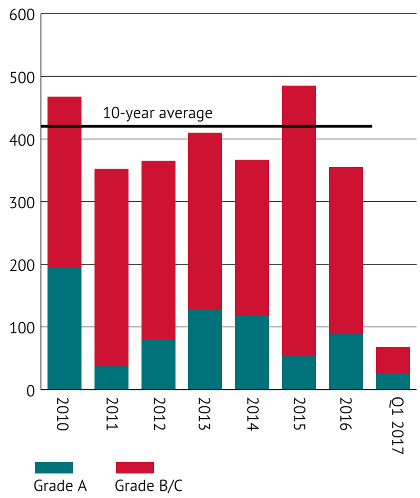
Demand

During 2016, Nottingham city centre and out-of-town markets combined recorded take-up of 354,183 sq ft, its lowest level since 2011. Take-up was notably subdued in H2 2016, down almost 50% on the same period in 2015. At 67,809 sq ft, activity in the first quarter of 2017 was muted compared with Q1 2016 (76,733 sq ft).

Activity in the past year has been driven by smaller transactions, with 74% of deals involving units under 5,000 sq ft. However, 8% of deals were for large floorplates over 10,000 sq ft, with notable grade A transactions including Eversheds' 18,867 sq ft lease at Water Court and Sumo Digital's 11,058 sq ft lease at Castlebridge Office Village.

Out-of-town demand accounted for approximately two-thirds of take-up in the past 12 months although there were no out-of-town grade A transactions over 10,000 sq ft. Professional services was the key sector, responsible for a third of all lettings including 8,577 sq ft to Ingeus at Maid Marian Way and 4,663 sq ft to Approach Personnel at Chase Park.

Nottingham take-up (000 sq ft)



Current supply

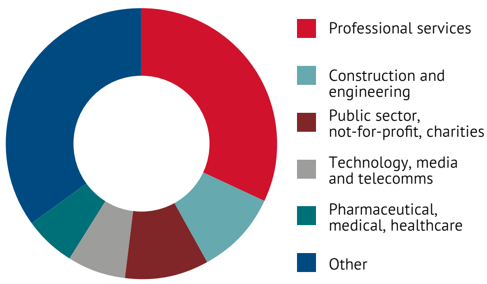
Total availability in the wider Nottingham market stands at circa 1.3m sq ft, down 34% from its peak in 2014. In context with average take-up, this is equivalent to 3.2 years supply. Nottingham's current availability is heavily weighted by grade B accommodation, accounting for almost two-thirds of total stock.

Supply of quality stock is the primary concern. At circa 164,000 sq ft, grade A space accounts for 12% of overall stock. While this is a small increase compared with 2015 (156,000 sq ft), this is primarily due to refurbishment projects in the city centre. Examples include 1 Royal Standard Place (27,038 sq ft), Canalside House (19,967 sq ft) and Fothergill House (16,899 sq ft).

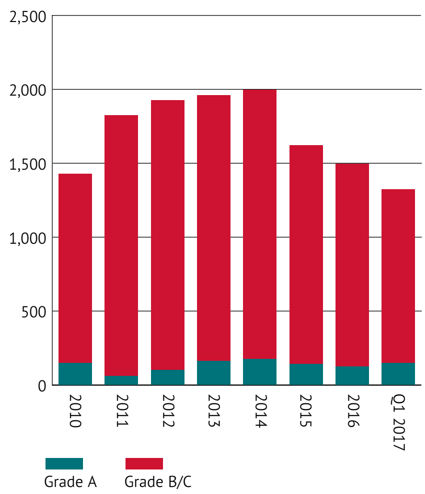
Out-of-town, quality space is concentrated at Sherwood Business Park. A number of sizeable grade B options are also available both in and out-of-town. These include Aspect House (27,078 sq ft), Equinox House (22,700 sq ft) and Waterfront House, Beeston Business Park (21,500 sq ft).

Supply continues to be impacted by change of use to residential and student accommodation, with Stanley House the most recent example (32,224 sq ft). Around 20% of total built stock has changed use over the last decade, albeit this trend has begun to slow in the last two years.

Nottingham take-up by sector (past 12 months)



Nottingham availability (000 sq ft)



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12 month take-up vs 10-year average	Years of supply	Grade A share of supply	Q1 2017 headline rent (per sq ft)	Prime yield
-18%	3.2	11%	£19.75	6.00%

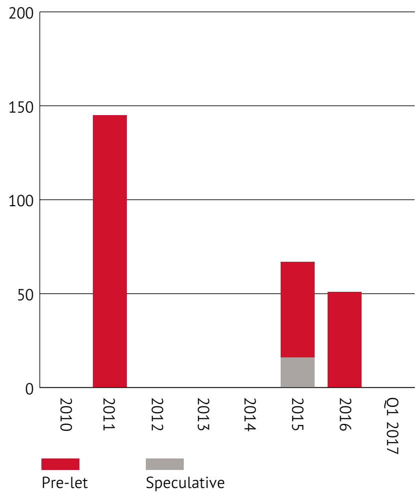
Development prospects

Nottingham's office market continues to rely on refurbishment of existing stock to satisfy the local market which goes some way to make up for the lack of new build in recent years. However, it does not provide the large modern floorplates that would appeal to some of the city's large occupiers who are currently situated in poor quality accommodation.

The extension of BioCity, comprising development of the Discovery Building, has recently completed. While this development is welcomed, it will provide a combination of office and laboratories for the life sciences sector and does not provide conventional office space or cater for the wider market.

Nottingham offers some excellent development sites, including Station Street, Unity Square, Guildhall, Angel Row and the Eastside area, but they require significant investment in order to be brought forward. The site at Angel Row in the city centre has the advantage of local government support which enhances the potential for pre-letting. However, the site currently houses the city's main library and no development will be approved before a consultation has been completed over its relocation.

Nottingham under construction (000 sq ft)



Market rental values and yields

Nottingham's prime headline rent has remained unchanged at £19.75 per sq ft for six years. That said, high quality refurbishment projects, for example 1 Royal Standard Place, are quoting £20.00 per sq ft, indicating that headline rents have the potential to start edging upwards.

Prevailing sentiment indicates that prime yields in Nottingham remain at circa 6.00%, with a number of transactions in the past 12 months providing supporting evidence. One example investment deal in the last 12 months was PITCH's £6.9m purchase of 37 Park Row, reflecting a net yield of 6.1%.

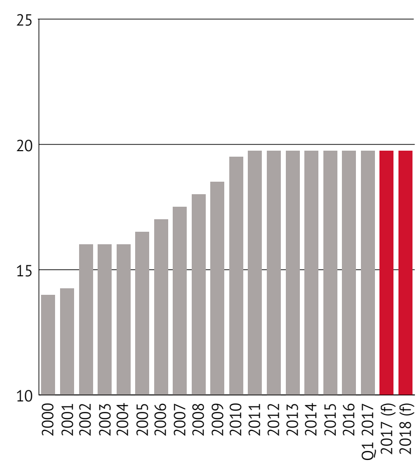
Outlook

Despite a healthy level of requirements, activity is arguably being constrained by a shortage of grade A supply. Refurbishments are expected to let-up well, with overall take-up in 2017 set to exceed 2016's total. Nottingham has been heavily reliant on the professional services sector for many years, but the technological, bio-science and creative industries are going to be important going forward.

Due to the ongoing political and economic uncertainty it is unlikely that new speculative developments will come forward in the next 12 to 18 months. However, with local government support the site at Angel Row is attractive for development and we remain of the view that the next pre-let will see a step change in prime office rents in Nottingham.

2018 ▶ £19.75 per sq ft

Nottingham prime rental values forecast (£ sq ft)



Data source: Lambert Smith Hampton

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