



South Coast office market briefing 2016

Inside this report:

- Overview of occupier, investment and development markets
- Key transactions of 2015
- Comprehensive floor space statistics
- Forecast for 2016

**Lambert
Smith
Hampton**

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Executive summary

- Lack of supply remains critical
- Take-up suffering as a consequence
- First signs of speculative development emerging
- Rents will continue their upward trajectory

Market overview

Highlighting a lack of supply and improving demand, notable office buildings along the M27 corridor that had been vacant for some time are now fully let. These include Forum 1 and Spectrum – both on Solent Business Park, Spinnaker House in Fareham and Pavilion in Hedge End – almost all of this space has been let within the last 12 months. At the Eastern end of the corridor, significant buildings such as Langstone Technology Park have over 90% occupancy, there is very little supply in Portsmouth city centre and 1000 Lakeside is, in effect, fully let (although Capita is marketing 54,000 sq ft by way of an assignment or sub-lease).

Despite this positivity, there was a decline in enquiries during the second half of 2015, and in particular, in Q4. This is likely to have been influenced in part by global economic factors and also the continued fall in supply, with opportunities for businesses to relocate being constrained, prompting occupiers to renew leases within their current buildings. We anticipate a possible fall in take-up in 2016 as a result.

Supply

This reduction in supply is influenced by three main factors:

- Permitted development rights – conversion of offices to residential
- Improving occupancy rates
- No speculative office development for seven years

The expectation is that the trend of falling supply is set to continue and, as a result, prime rents along the M27 corridor will continue to rise and incentives will fall further in the short to medium term.

With office availability along the M27 corridor at just over 1.3 million sq ft, there is currently less than three years supply based on current take-up rates. Grade A space is particularly under pressure.

Demand

- During 2015, office take-up for the Solent region/M27 corridor was 507,610 sq ft – 17% higher than the ten year average of 428,911 sq ft
- The trend over three years has been one of steady improvement – from 337,366 sq ft in 2013 to 419,160 sq ft in 2014 and to over 500,000 sq ft in 2015.

Much of the occupier demand, in particular from corporate occupiers, has been due to business expansion and a preference to upgrade to higher quality office space. Modern working practices are changing, with a more agile working environment required, including open plan single floor plates, good breakout space and access to amenity in order to attract and retain the best staff.

Rents and incentives

Prime office rents along the M27 corridor have improved by circa 5-10% over the past 12 months where supply is particularly constrained and where building fundamentals of good location, high quality specification, market leading parking ratios and access to amenities are evident. Tenant incentives for open market lettings have fallen over the last 12 months. Where previously an 18 month rent-free period was typically required for a five year term, this has now fallen to circa 6-12 months in the current market.

Prevailing conditions have seen quoting rents for the best buildings along the M27 corridor increase in 2015, with refurbished space in Gateway House now being marketed at £19.50 per sq ft (M27 West) and at Lakeside in Portsmouth at £19 per sq ft (M27 East). Both provide excellent quality accommodation, with best-in-class parking ratios of circa 1:200 sq ft. Rents in Southampton city centre are now up to £20 per sq ft in Ocean Village for fully refurbished grade A space with a good parking ratio of circa 1:250 sq ft. Winchester has almost no supply and as a result, for the best buildings, rents in excess of £20 per sq ft would now have to be paid.

Headline rents and capital values

| Location | Grade A rents | Grade A capital values | Grade B rents | Grade B capital values |
|----------------------------------|---------------|------------------------|-----------------|------------------------|
| Southampton | £20.00 | £250.00 | £12.00 – £16.00 | £140.00 – £190.00 |
| Eastleigh and Chandlers Ford | £20.00 | £250.00 | £12.00 – £16.00 | £140.00 – £190.00 |
| Winchester | £25.00 | £375.00 | £12.00 – £19.00 | £200.00 – £250.00 |
| Fareham and Solent Business Park | £18.50 | £230.00 | £12.00 – £16.00 | £140.00 – £190.00 |
| Portsmouth | £19.00 | £240.00 | £12.00 – £16.00 | £140.00 – £190.00 |
| Havant and Waterlooville | N/A | N/A | £12.00 – £15.00 | £140.00 – £175.00 |

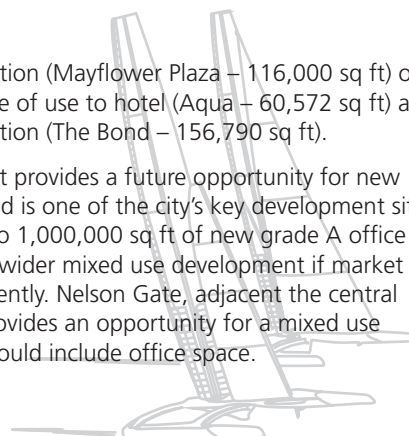
Southampton overview

Southampton city centre is considered the main commercial centre for the southern region, yet its office market has reached a crossroads. Permitted development rights changes, combined with an ageing supply and low rents, has resulted in approximately ¾ million sq ft of existing or consented office space within the city centre being lost to alternative uses, such as residential, hotels and student accommodation within the past 30 months.

There is currently no new office supply available in the city centre or in the immediate pipeline. Three of the major development sites earmarked for offices have recently been developed as

student accommodation (Mayflower Plaza – 116,000 sq ft) or are subject to change of use to hotel (Aqua – 60,572 sq ft) and student accommodation (The Bond – 156,790 sq ft).

Royal Pier Waterfront provides a future opportunity for new build office space and is one of the city's key development sites. It could provide up to 1,000,000 sq ft of new grade A office space as part of the wider mixed use development if market rents improve sufficiently. Nelson Gate, adjacent the central train station, also provides an opportunity for a mixed use development that would include office space.



Significant transactions of 2015

| Address | Occupier | Landlord | Size (sq ft) | Tenure | Rent (per sq ft) |
|--|------------------------|--------------------------|--------------|-----------|-----------------------|
| Forum 1, Solent Business Park, Whiteley, Fareham | HSBC | M&G | 70,300 | Leasehold | £15.50 |
| 1 Guildhall Square, Southampton | Southampton University | Southampton City Council | 23,760 | Leasehold | £19.15 |
| Gnd / 1st / 2nd floor, Cumberland House, Southampton | Regus | Kingsbridge Estates | 16,682 | Leasehold | £17.50 (quoting rent) |
| Southampton Science Park, Southampton | Chilworth Technologies | Southampton Science Park | 16,600 | Leasehold | £16.00 |
| Spinnaker House, Fareham | Wartsila | Horatio Properties | 13,239 | Leasehold | £17.50 (quoting rent) |
| Gateway House, Tollgate, Chandlers Ford | KPMG | Troika Developments | 12,446 | Leasehold | £18.25 |
| 4th floor, Charlotte Place, Southampton | Berrymans Lace Mawer | Mcaleer & Rushe | 11,766 | Leasehold | £15.00 |
| 1st and 2nd floor, East Wing, Eagle Point, Segensworth | Smoothwall | Skills Funding Agency | 10,227 | Leasehold | £12.00 |

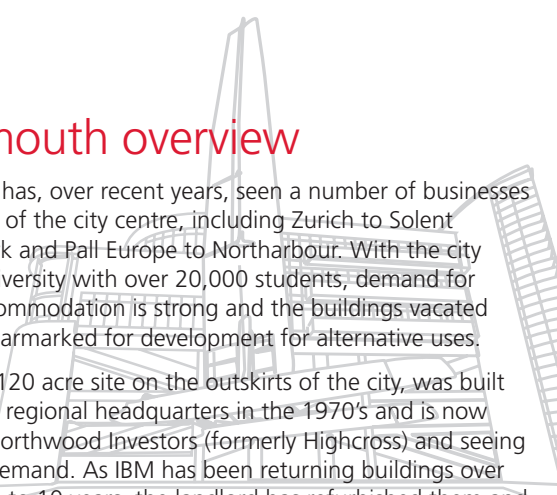
Portsmouth overview

Portsmouth has, over recent years, seen a number of businesses relocate out of the city centre, including Zurich to Solent Business Park and Pall Europe to Northarbour. With the city having a university with over 20,000 students, demand for student accommodation is strong and the buildings vacated have been earmarked for development for alternative uses.

Lakeside, a 120 acre site on the outskirts of the city, was built for IBM as a regional headquarters in the 1970's and is now owned by Northwood Investors (formerly Highcross) and seeing increasing demand. As IBM has been returning buildings over the past five to 10 years, the landlord has refurbished them and added significant amenity to the site.

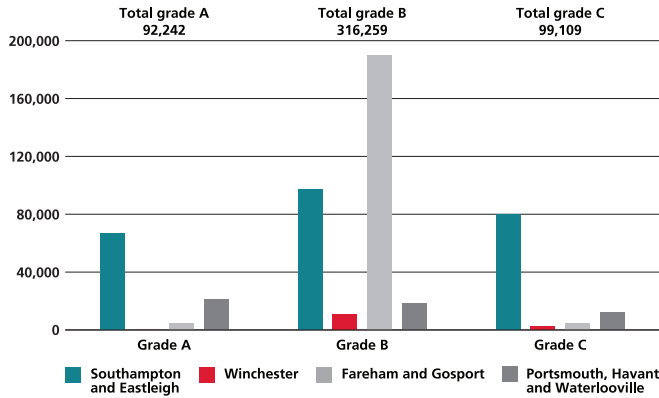
This proactive asset management (including tenant friendly deals), coupled with a location which provides excellent connectivity to the motorway network and an abundance of onsite parking has encouraged occupiers to relocate out of the city centre. Building 1000 (300,000 sq ft) is now fully let and as a result, rents have increased over the past five years from headlines reported at £14 per sq ft to £17-18 per sq ft in 2015 and incentives have fallen significantly.

Two further buildings (totalling circa 120,000 sq ft) were returned to the landlord in November 2015. These are being refurbished and Northwood is quoting a headline rent of £19 per sq ft for these buildings, of which 20,000 sq ft has already been let.

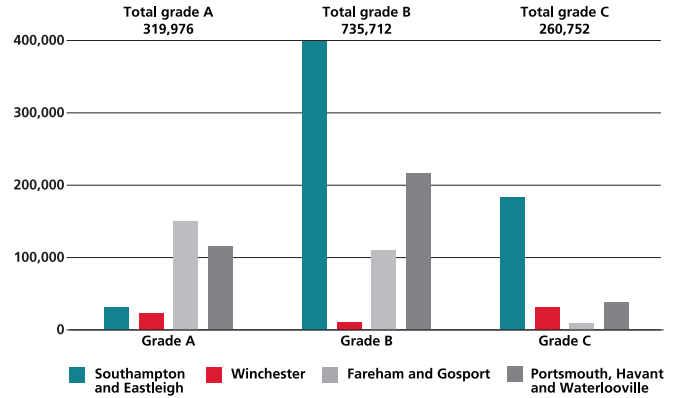


South Coast office market floor space statistics (>2,500 sq ft)

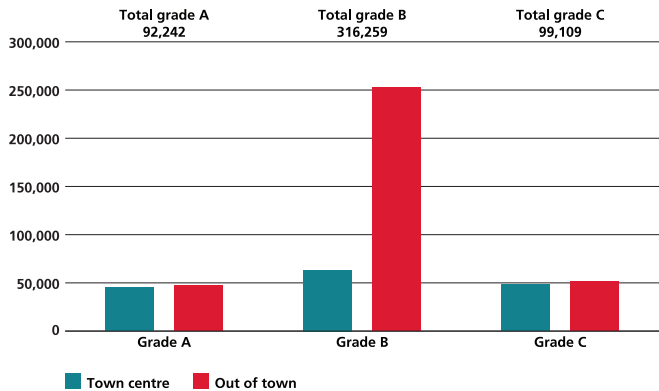
2015 take-up by town and grade



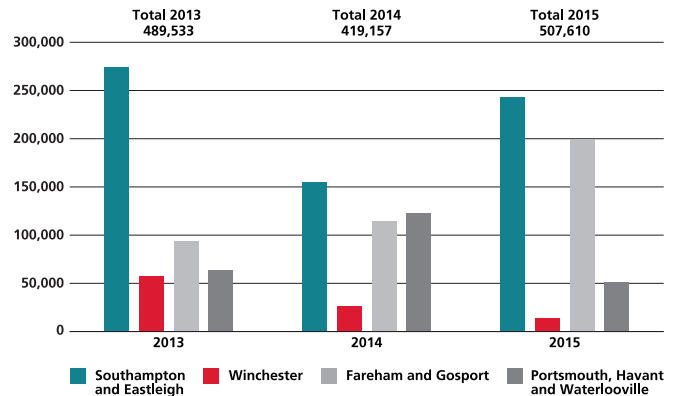
2015 availability by town and grade



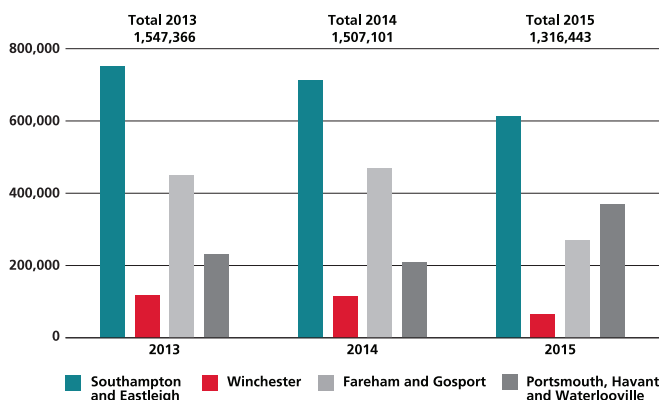
2015 take-up by grade and type



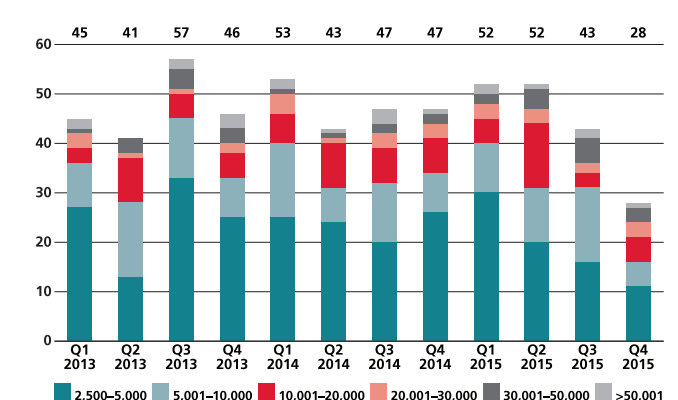
2013 – 2015 take-up



2013 – 2015 availability



2013 – 2015 enquiries



Development market commentary

Speculative development has not been seen along the M27 corridor for over 10 years. However, an indication of the rapidly changing market is the new 30,600 sq ft speculative grade A office currently under construction at Southampton Science Park. It is being built as a consequence of full occupancy, a thriving collaborative working environment, excellent connectivity, good onsite facilities and continued strong demand.

Office development on a pre-let basis on the central South Coast has also been almost completely dormant since Carnival's 160,000 sq ft headquarters was built at 100 Harbour Parade, Southampton, in 2009.

In subsequent years, a well-documented over-supply of offices was prevalent, which, along with subdued demand, resulted in a fall in headline rents and an increase in tenant incentives.

That scenario began to change in 2013, when legislation governing permitted development rights altered to allow the conversion of office buildings to residential. With a relatively weak office occupier market, developers took advantage of low capital values, resulting in a significant volume of secondary office supply (particularly in town and city centres) being purchased for alternative uses.

This conversion scenario was further encouraged with the Solent region's cities having strong universities and being gateways to the world. Both Portsmouth and Southampton have been under-supplied for modern student accommodation and hotel facilities and, as a result, a significant amount of office floor space (both existing buildings and sites with planning consent) has been lost to these alternative uses.

During the corresponding period, the occupier market recovery has gathered pace, with take-up increasing year on year and effectively doubling between 2012 and 2015.

The stage is set for the next wave of office development. In theory, it has already started with a pre-let to Selex ES Ltd of a new build 24,500 sq ft office in Millbrook, Southampton, in 2014, although this was at the company's existing site and was connected to a 124,500 sq ft warehouse facility, also let to Selex. Of perhaps greater significance was the collaboration between Lloyds Register and the University of Southampton, which resulted in a 110,000 sq ft office pre-let completing at Bolderwood Campus in 2015, with the company relocating 400 staff from both London and Southampton.

2015 saw major businesses such as HSBC and KPMG move out of city centre locations as a result of a lack of supply of sufficient size and quality in the city centre and availability along the M27 corridor. The supply of grade A buildings both in and out of town is now becoming particularly constrained.

Development sites at Royal Pier Waterfront in Southampton, Lakeside Northharbour in Portsmouth and Chilcomb Centre in Winchester may as a result, see new offices built as supply continues its steady decline. Chilcomb Centre, Winchester may be the first to see development activity and is currently under discussion for the development of circa 90,000 sq ft of grade A office space, with quoting rents at £25 per sq ft. Southampton Airport also offers a prime site for development as the necessary transport infrastructure is already in place.

At present, development is only likely on a design and build or pre-let basis. If rents and capital values recover sufficiently though, it is conceivable that we could see speculative offices built along the M27 corridor within five years.

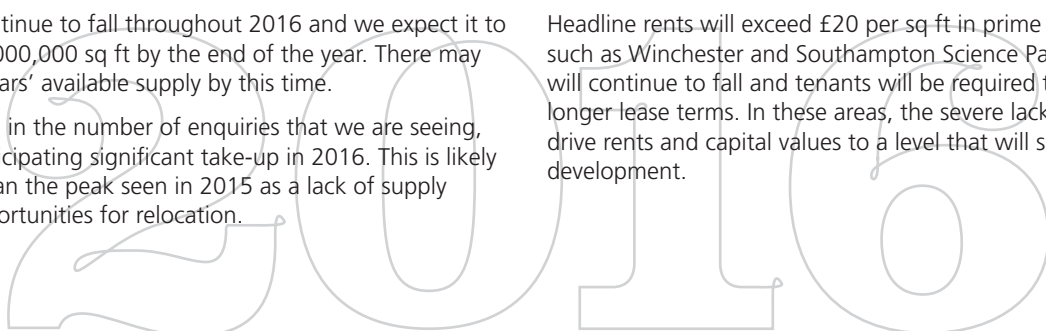
Predictions for 2016

- **Supply will fall to below 1,000,000 sq ft by the end of 2016**
- **Take-up will fall as supply constrains opportunities for relocation**
- **Prime rents will continue their upward trajectory and tenant incentives will reduce**
- **Pre-lets and design and build deals are possible in prime locations, such as Winchester and Southampton Science Park**

Supply will continue to fall throughout 2016 and we expect it to drop below 1,000,000 sq ft by the end of the year. There may be only two years' available supply by this time.

Despite the fall in the number of enquiries that we are seeing, we are still anticipating significant take-up in 2016. This is likely to be lower than the peak seen in 2015 as a lack of supply constrains opportunities for relocation.

Headline rents will exceed £20 per sq ft in prime locations such as Winchester and Southampton Science Park. Incentives will continue to fall and tenants will be required to commit to longer lease terms. In these areas, the severe lack of supply will drive rents and capital values to a level that will support new development.



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Transport to telecoms: we have experience of an extremely wide range of sectors.

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We value lateral thinking and celebrate enterprise, with a focus on delivering more for our clients. By looking beyond the obvious, we consistently generate impressive results.

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Due to space constraints within the report, it has not been possible to include both imperial and metric measurements.

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