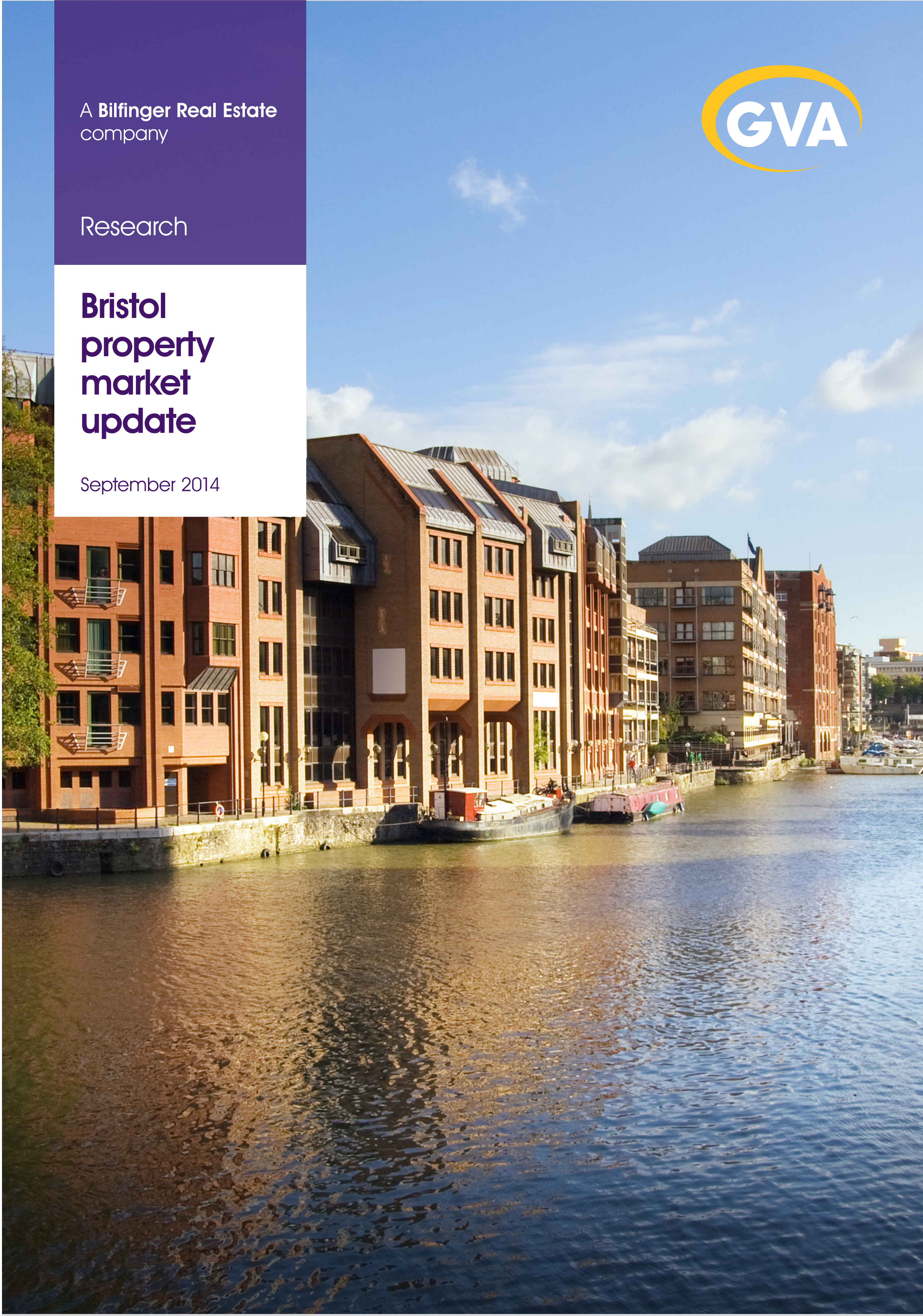

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Research

Bristol property market update

September 2014

Foreword

Bristol and its wider city region has for many years been regarded as one of the UK's more prosperous and attractive locations, ranking highly for its quality of life, skilled workforce and strength in research, technology and knowledge based industries. And more recently Bristol has been heralded as the most competitive and productive economy of any core city in the UK.

So as the markets return and the focus for investment and development switches from London to the regions the big question is how will Bristol fare against the competing core cities in the Midlands and the North? Will Bristol grasp the opportunity by building on its recognised strengths and attractions and demonstrate a clear and deliverable agenda for growth? Most importantly how quickly can we respond to the structural changes taking place in our occupier markets and address the present shortages of prime property?

David Mace
Regional Senior Director, South West and Wales
GVA

Introduction

Without doubt there has been a significant shift in sentiment throughout all of our property markets over the past 12 months and a definite air of optimism. This has been fuelled by improved occupier demand and a seemingly insatiable appetite from institutional, private and overseas investors.

Despite the economic challenges over the past six years, Bristol has remained resilient, helped by the scale and diversity of its economy and its highly skilled workforce.

With four universities, Bristol and its surrounding area acts as a hub for innovation and research, attracting a wide range of employers from the knowledge-based, IT and hi-tech manufacturing sectors. Bristol is one of the UK's six 'Science Cities', in recognition of its contribution to science and innovation. In 2015 it also becomes the first UK city to hold the sought after title of European Green Capital.

Great strides have been made through the West of England LEP and the Bristol + Bath initiatives helping to create a unified and effective vehicle for promoting our regional message. The focus is on delivering employment growth through a combination of private sector investment and the City Deal and growths funds. There are significant planned improvements to the existing transport infrastructure with projects such as the Greater Bristol MetroBus and the electrification of the Bristol to London rail-line already in the pipeline.

Bristol Temple Quarter Enterprise Zone and the five Enterprise Areas are seen as key to delivering growth with the Bristol Arena currently taking centre stage.

Our report focuses on the recent performance of our local property market, the drivers of growth and the opportunities that this will create in Bristol.

UK's economic backdrop

- The UK's economy is in full recovery mode, output has now finally surpassed its pre-recession peak, and many property occupiers are assessing their requirements.
- The annual rate of GDP growth in Q2 was 3.2%, well above the 25 year average of circa 2.6% pa. Growth over the last five quarters has been consistently above trend, and recent survey evidence suggests this will continue in the short term.
- The level of employment has been remarkably resilient since the start of the financial crisis in 2008. With economic output now rising, employment growth has strengthened, and we expect growth of 2.5% this year compared with the 25 year average of 0.7% pa. This is helping to boost property occupier demand.
- The unemployment rate has fallen rapidly over the last year from 7.8% to 6.4%. This helps explain why wage growth is so weak (currently about a third of the annual CPI inflation rate).
- We think the overall economic outlook is very positive, although risks and problems remain. Interest rate rises are almost inevitable over the next year, although increases will be in small increments and spread over many years.
- Output per head remains well below its pre-recession peak, the annual budget deficit remains very high and is falling only slowly, and manufacturing exports could be adversely affected by continued weak Eurozone economic growth.
- The latest consensus forecasts expect strong economic growth of 3% this year, slowing to a near trend 2.5% next year and a slightly below trend 2.2% – 2.3% pa over the subsequent three years. This outlook should drive all property average rental growth to 2.8% by the end of this year, increasing slightly to 3% over the next three years.

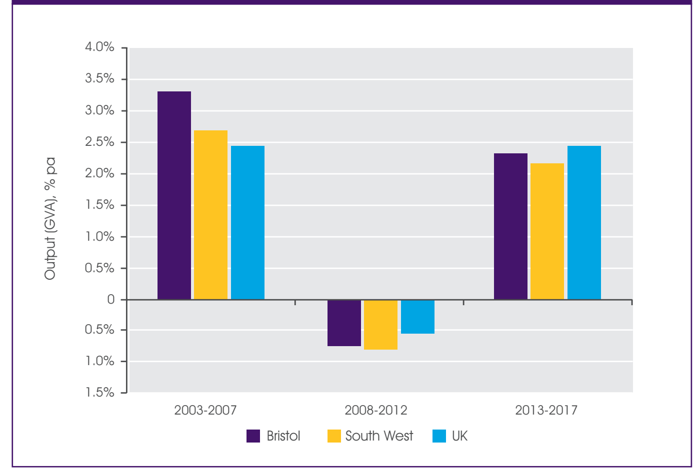
Bristol's economic outlook

- The South West has been one of the strongest performing UK regions over the last few years. Experian estimates that for the year to Q2 2014, its economy grew by 2.8%, which was only exceeded by London, and the wider south east.
- Bristol has outperformed both the South West and the UK in terms of output growth over the last decade, as figure 1 shows. Over the next five years, the city should continue see growth broadly in line with the national average.
- The South West has also seen healthy employment growth, and the region's unemployment rate of 5.3% is well below the UK average of 6.4%. Indeed, only the South East and Eastern regions of the UK have lower unemployment rates.

- Bristol is the largest city in the South West with a population of more than 450,000. Strong growth is expected, with the population projected to rise by 30,000 over the next decade.
- The city has a well-balanced economy, including major contributions from sectors such as professional services, logistics and transport (boosted by its strategic location for access to the South West and South Wales) and TMT (Technology Media and Telecommunications)) such as Hewlett Packard and BBC Bristol, as well as energy and environmental services such as New Earth Solutions and GE Oil & Gas.
- However, it's the considerable contribution from sectors such as hi-tech manufacturing, defence and aerospace that help to make Bristol unique. Occupiers include Airbus UK, GKN Aerospace, Rolls Royce, BAE and MBDA Missiles. Bristol also boasts the largest cluster of microelectronics companies outside of Silicon Valley in California.
- The city has a highly educated, highly skilled workforce, buoyed by the presence of four universities in the wider Bristol area, including the University of Bristol, which is ranked amongst the top 100 in the world. This represents a major draw for employers, and has helped to underpin the city's employment growth.
- Linked to this is Bristol's track record as a highly innovative city, and has the highest number of net business start-ups per 100,000 people of all the eight English core cities (112.1 per 100,000 in 2011, and 86.7 in 2012). It is also the highest ranking of the core cities in terms of patents per 100,000 population, with 8.3 per 100,000, almost double the UK average. Recent successful start-up companies include Maplebird, which develops unmanned aerial vehicles, Hieta which specialises in manufacturing high performing metals for engine components, and XMos who develops multicore microcontrollers.
- Bristol's success is underlined by the recent Grant Thornton High Growth Index, which ranks the past and future growth potential of English towns and cities. This gave Bristol a score of 150, ranking it fourth in the UK.

- The city's world-class academic research and excellent provision for knowledge-based and hi-tech industries has helped to attract more than a third of UK-owned FTSE 100 companies.

Chart 1: Economic output growth – Bristol, South West and UK (Source: Experian, GVA)



Commercial property market overview

- The UK's commercial property construction sector is gearing up for the next cycle and activity in the main commercial property sectors is rising, albeit from a low base. This reflects a widening of activity from central London, as rising capital values, low tender price inflation, improving availability of finance and decreasing supply of prime space combine to improve viability.
- Undersupply is returning to the UK's key regional city centre office markets and developers have been seizing the opportunity to start schemes in a number of cities, including Bristol, where two schemes totalling more than 150,000 sq ft are now under construction.
- Lease expiries and rising corporate activity will generate increased demand for office space, and our recent report "Driving future growth: core cities and the knowledge economy" reveals the considerable opportunities our cities have to build on the knowledge and creative sectors to boost growth.
- Supply is generally higher in the regional out-of-town office markets but there has been an encouraging level of take-up and quality supply is now becoming tight in a number of locations across the UK, including the north Bristol market.
- Demand in the industrial and distribution sectors is not only benefitting from the cyclical upturn, helped by sectors such as the UK's booming automotive export industry, but also from the structural shift towards demand for e-tailing warehouse space.
- As a result, increased demand and requirements in the distribution market are outstripping the availability of good quality space across a number of markets. Design and build construction continues to dominate new supply as occupiers have increasingly specialised requirements and viability remains a concern.
- In the retail sector, rising consumer confidence, strong employment growth and heavy discounting continue to underpin buoyancy in retail sales volumes. However, continued price deflation is putting retailers under pressure, although an easing of the squeeze on household incomes should begin to feed through.
- Nationally, vacancy rates for high street retail property appear

to have improved slightly but are still high and in double figures. Whilst this reduction is encouraging given the combined effects of corporate retailer failures and managed programmes to reduce store numbers, it contrasts with sub-4% vacancy rates before the financial crisis.

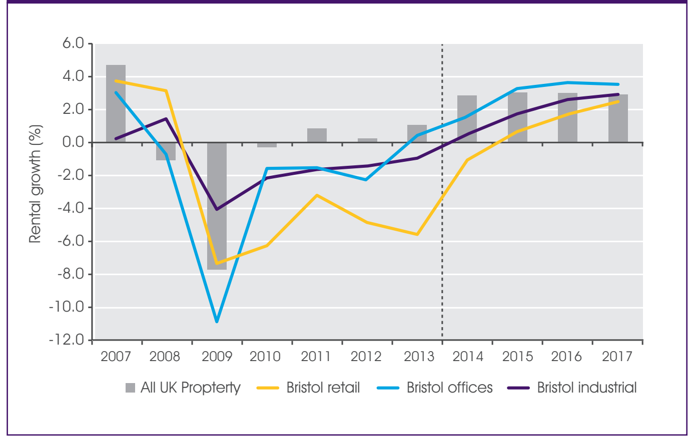
- There will continue to be a significant polarisation between stronger performance in the UK's top retail centres where retailers are concentrating their resources, and secondary centres which will continue to see high levels of vacant units.
- With occupier demand recovering and the supply of good quality property continuing to diminish, the rate of all property rental growth is accelerating. Figures from the IPD Monthly Index show that average UK all property rental value growth reached 2.2% pa in August, compared with -0.1% a year ago. However, there are sharp differences according to sector, location and quality.
- In the South West, high street retail rental values fell by -2.6% over the year to August, office rental values rose by +1.4% pa and industrial rental values fell by -0.8% pa (IPD Monthly Index, August). However, taking just the last three months, industrial rents are now rising, by +0.1%.
- We expect UK all property rental growth to be around +2.8% this year, accelerating slightly, to almost +3% pa over the next three years.
- Turning to Bristol, our forecasts suggest a continued upswing in rental growth, which we think will rise towards the national average over the next three years. Offices are likely to see the strongest rental growth, forecast at 1.6% for this year, and more than 3% pa from 2015 to 2017. The industrial sector should see positive growth this year of 0.5% rising to 2.9% pa by 2017.
- Retail rental rents are expected to continue falling in 2014 (-1.1%), as structural changes continue to impact the market. We expect modest growth to return in 2015 (0.6%), accelerating to 2.4% pa by 2017. Our projections for rental growth in Bristol versus the national average are illustrated in chart 2.
- The following sections examine the occupier markets in Bristol for each of these main commercial sectors, as well as the residential market. We then examine the outlook for Bristol's commercial property investment market.

Bristol commercial property market

City centre office market

- Bristol city centre has a total office stock of approximately 16.5 million sq ft.
- Total office availability has been steadily reducing over recent years with the increase in occupier demand coupled with the loss of office buildings to mainly residential uses. This has been driven by the recent relaxation of planning regulation under Permitted Development Rights allowing change of use without the need for planning consent.
- We estimate that approximately 450,000 sq ft of office space has already been sold for residential conversion. This includes buildings such as Westgate, Lewins Place, Norfolk House and Froomsgate House which combined have taken a total of 325,000 sq ft office space out of the market.
- Approximately 1 million sq ft of office space could eventually be converted to residential use. This compares with the total current supply of available city centre office space of approximately 1.5 million sq ft.
- New Grade A supply stands at 220,000 sq ft with a further 158,500 sq ft currently under construction at 66 Queen Square and 2 Glass Wharf. Total Grade A supply stands at approximately 367,000 sq ft including high quality speculative refurbishments such as 1 Victoria Street and 25 King Street.

Chart 2: Rental value growth - Bristol versus UK
(Source: IPD, REFL, GVA)



- Demand for city centre office space has steadily been improving over the last 12 months with take up for the first half of 2014 hitting just under 300,000 sq ft This compares to a total of 505,000 sq ft for the whole of 2013, which included a non-core deal of 85,000 sq ft when Imperial Tobacco built a new global headquarters on its own land in south Bristol.
- Demand for prime Grade A space has been disappointing over the last year. However, given the recent letting of 70,000 sq ft to OVO Energy at 1 Rivergate, Temple Quay plus other requirements such as PWC (25 – 30,000 sq ft), KPMG (40,000 sq ft), and Mapfre Abraxas (up to 70,000 sq ft) and a raft of smaller requirements take-up should improve significantly.
- Prime Grade A rental values are currently £27.50 psf but we understand that PWC is under offer on the top two floors of Salmon Harvester's 2 Glass Wharf development at a headline rent of £28.00 psf.

Key availability

Site	Availability	Comments
Temple Building, Finzel Reach	165,000	Seeking pre-lets
1&2 Bank Place	237,133	Seeking pre-lets – alternative uses under consideration
Redcliffe Square	140,000	Forms part of mixed residential, office and hotel scheme
One Glassfields	184,560	Forms part of mixed use scheme – alternative uses under consideration
Cabot Gate	142,995	Planning to be amended. Seeking pre-lets
33-49 Victoria Street	83,252	Subject to change of use to residential
Aspire	258,000	Seeking pre-lets
Redcliffe Wharf	30,000	Seeking pre-lets

Total	1,240,940	

North Bristol office market

- The north Bristol business parks market comprises approximately 6 million sq ft of office space and is largely situated around the northern fringe from Aztec in the west to Emersons Green in the east.
- Prime office rents currently sit at around £19.50 psf following recent lettings at Hempton Court on Aztec West which is down from the pre-recession high of £23.50 psf.
- There has been no speculative office development in this market since Terrace Hill completed Brabazon Office Park in Filton in 2008 and we are now seeing a lack of supply of larger buildings in good locations. With no planned development for the foreseeable future the supply situation could become critical unless existing buildings come back to the market to plug the gap.
- Demand in the business park market has remained fairly resilient throughout the recession. Total take up for 2013 hit 230,000 sq ft which was down on the long term average but the first half of 2014 has already seen 220,000 sq ft transacted. The year-end figure is likely to look very positive with the recent letting of 64,000 sq ft at Keypoint, Almondsbury to TSB and the imminent letting of 38,000 sq ft in 740 Aztec West to Alcatel Lucent.

Key availability

Site	Availability	Comments
East Works, Gypsey Lane	60 acres	Outline consent granted for B1, B2, B8 uses
Filton Business Park	70 acres	Outline consent granted for B1, B2, B8 uses allocated as an Enterprise Area
Harlequin Office Park	3.5 acres	60,000 sq ft built to date with planning for a further 50,000 sq ft
Phase 3 Hempton Court	10 acres	310,000 sq ft left to be built. (Original consent 400,000 sq ft
Bristol & Bath Science Park	39 acres	Outline Planning for 853,000 sq ft of which 140,000 sq ft built to date and a further 80,000 sqft is under construction at the National Composites Centre. Allocated as an Enterprise Area

Industrial market

- The latest Bristol take up data suggests a strong first six months of 2014. Our number one concern is the declining supply of high quality space, which mirrors the trend we are also seeing in many other parts of the UK. However, there is limited speculative development on site at Warmley in North Bristol and at Avonmouth a proposed 3 unit speculative scheme by St Modwen is currently going through the planning process.
- Demand is still quite patchy, led by companies serving the changing retail markets and a resurgent trade counter sector. On-going development deals are indicating some very strong rental growth in the next six months with prime appraisal led deals such as Vertex Park at Emmersons Green and Chancerygate's landholding at Great Western Park in Yate. Guide rents are rumoured to be approaching £8.00 psf.
- Land values have remained stable at £300,000 - £450,000 per gross acre; prime rents at £6.50 - £7.50 psf. The shortage of the stock is improving rental growth prospects at the tertiary end of market with rents of £4.00 - £5.00 psf, and incentives are moving in from 12 months plus on a five year lease.
- Freehold availability is virtually non-existent, and this is generating upward pressure on values for ageing stock. Tender costs for new build construction are racing ahead and refurbishment or break ups of larger units to meet demand may start to make financial sense in the near future.
- Bristol take up figures for June 2013 – June 2014 stood at 2,243 million sq ft (IAS) and 40 acres of development land was transacted.
- Supply in Bristol is now at its lowest level for 10 years with particular gaps in the 30,000 sq ft – 100,000 sq ft range, where demand is now particularly strong. Many strategic sites are ready to go but concerns over the true level of sustainable demand have kept the brakes on the speculative market and institutional funders are yet to have an appetite for the city.
- Parcel operators are providing the key requirements in the market with DPD / Geopost seeking to conclude a deal in North Bristol, as well as in Bridgwater, Cardiff and Exeter.
- There is emerging land availability at Filton Airfield and on Former Rolls Royce land adjacent to it. Emersons Green will be an interesting barometer of the market and could be a trigger for some significant relocations.

Bristol key industrial / Distribution deals since June 2013

Address	Sq ft	Purchaser / Tenant	Vendor / Landlord	Price/ deal	Use
Central Park Avonmouth	176,000 sq ft on 16 acres	Farmfood	Dizengoff / Roxhill	New build Freehold sale – Price Not disclosed	B8
Former Morrison RDC, Cribbs causeway	385,000 sq ft	The Range, CDS Superstores	Morrison	New 6 year lease – sub £4.00 psf	B8
Western Approach Avonmouth	70,000 sq ft	Davies Turner Distribution	Ex Focus	New 3 year lease	B8
Chittening Avonmouth	63,000 sq ft	WH Malcom	Port Of Bristol	Not known	B8
First Avenue, Portbury	52,000 sq ft	AP Burt	Auto Trader Group	New Lease- £4.50 psf	B2
Unit 5 Patchway Trading Estate, Cribbs Causeway	73,100 sq ft	Lidl	JLL Inv man	New Lease - £4,00 psf	B8

Retail market

The retail sector continues to recover with significantly fewer administrations of household names over the last year compared with the previous 12 months. This is borne out by a reduction in shop vacancy rates for the third successive quarter, although high street vacancy rates are still high at 10%.

- In August 2014 AXA Real Estate Investment Managers acquired Land Securities' 50% stake in Cabot Circus/Quakers Friars for £267.8 million, for China's Ginko Investment. Current rent roll of £17.3 million per annum with Cabot Circus extending to 830,000 sq ft and Quakers Friars a further 170,000 sq ft.
- Recent lettings in Cabot Circus include Pull and Bear (a

subsidiary of Inditex), who took 6,000 sq ft for only their second store outside London. Other lettings include Lloyds Bank, Smiggle, Vans, Joy, Hotter Shoes and Echo along with restaurants TGI Friday's and Five Guys. Current Zone A rents in Cabot Circus stand at approximately £175 psf with East Broadmead at approximately £125 psf.

- Quakers Friars is reinventing itself as the 'place to eat' and has planning permission to convert a further 3-4 of the retail units into restaurants. Demand is holding up for this use but retail in Quakers Friars is still a challenge.
- The Mall at Cribbs Causeway is trading well with footfall and sales up over the last 12 months. The centre is consistently in John Lewis' top five performing stores by turnover and in M&S' top 10.
- There has been a high level of activity at the Mall over the last 12 months. Lettings include Jack Wills, Joules, Office, Superdry, Lakeland, Pret a Manger, Regis, Warehouse, Clinton Cards, Ernest Jones and Fat Face. There has also been significant upsizing in the last 12 months, including River Island, Gap, Top Shop/Top Man and Fraser Hart. In total there have been 30 new lettings/relocations and 20 lease renewals.
- There are proposals for an extension to The Mall, with a major planning application due to be submitted shortly.

Investment market performance

Investor demand

- 2013 saw a return to normality for the South West investment market, with approximately £1.3 billion of investments concluded across the region, a rise of almost 100% from the 2012 level of only £690 million.
- The first two quarters of 2014 have seen transactional volumes totalling £760 million, which is on par with the same period last year.
- In Bristol, very few office transactions have completed in the first two quarters of 2014 with only £53 million concluded so far. This is wholly down to lack of supply rather than demand which remains extremely buoyant.

Chart 3: South West investment transactions
(Source: Property Data, GVA)

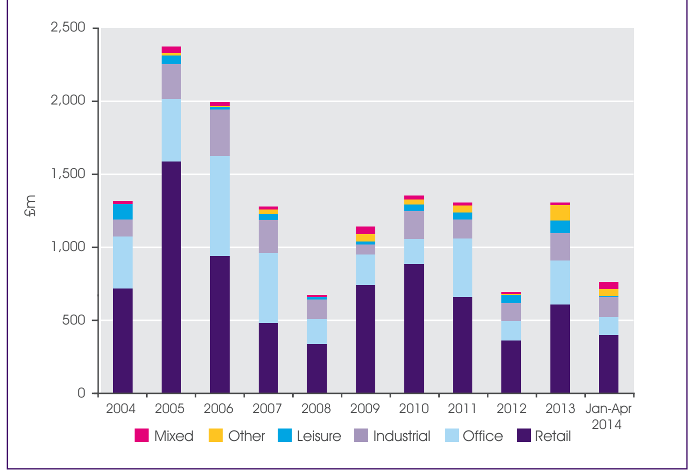
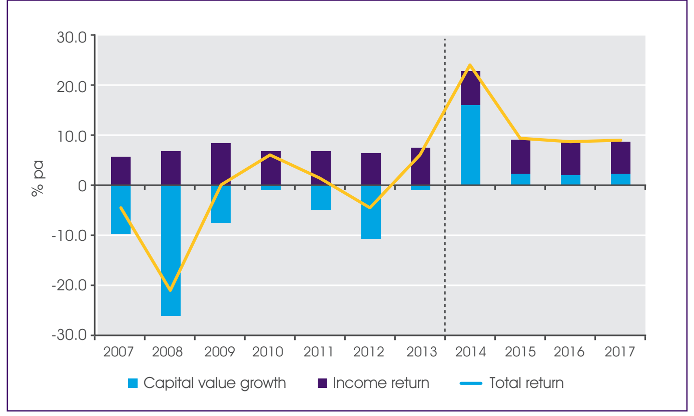


Chart 4: Total returns - Bristol offices
(Source: IPD, REFL, GVA)



Yields trends

- At the UK level, average all property equivalent yields have moved in by 45 basis points since the start of the year and by 80 basis points since their peak in the middle of 2013 (IPD Monthly Index).
- This downward movement has been particularly focused on good quality secondary property, which saw a fall of 63 basis points between December 2013 and June 2014, whilst at the prime end yields have fallen by a more modest 29 basis points.
- Although UK government bond yields have risen over the last year, they remain low by historical standards. 10-year gilt yields are circa 2.5%, compared to an average of nearly 5% from the late 1990s until the global financial crisis. As global economic recovery continues both short and long term interest rates will rise towards more 'normal' levels.
- Prime in-town office yields have moved down to circa 5.75%, and this is evidenced by the off market purchase by Lothbury of The Paragon', Victoria Street, Bristol, for an initial yield of 5.93% early in 2014.

Outlook for performance

- There is still a considerable weight of money looking to invest in UK commercial property and with an increasingly positive sentiment towards the occupier market, the current high level of domestic and overseas demand for UK property looks set to continue this year and into 2015.
- The result will be further downward pressure on yields, particularly for good quality secondary property in the South West markets. The yield gap between London and the South West has already started to narrow, but remains historically high and so we think this trend has some way further to run.
- We are now forecasting total returns of 24% for Bristol offices in 2014, above the UK average of circa 20%. We then expect performance to reduce to circa 8% in 2015 as the downward yield movement ends and rental growth becomes an increasingly important component of performance.
- The market is currently lacking stock, and with an estimated £8 of available capital for every £1 of available supply, competition will remain intense!

Residential land

The housing market has been leading the economic recovery and outperforming the commercial sector in the last three years. There is no doubt that government initiatives have assisted the housing market, particularly 'Help to Buy', which has positively increased the sales rates of house builders. Most of the national house builders are reporting significant increases in revenue and profits over the last 12 months.

The Bristol residential market has been buoyant and growing fast in recent years. All of the national house builders are in the market to secure land opportunities and many have been successfully acquiring and promoting land in the city.

Bristol's housing market is split into two parts; the city centre apartment market and the traditional housing market within the city's suburbs.

The key traditional housing development sites underway on the outskirts of the city include;

- Lyde Green, Emerson's Green – Taylor Wimpey, Persimmon, Barratt & Linden Homes
- Highbrook Park, Harry Stoke – Crest Nicholson
- Charlton Hayes, Filton – Bovis, Barratt & Bellway
- Somerdale, Keynsham (Former Cadbury Factory) – Taylor Wimpey

In addition to these large developments, there are a number of major housing sites being promoted on the fringe of city centre;

- Cribbs Causeway and Patchway New Neighbourhood – approximately 5,700 dwellings
- Frenchay Hospital – approximately 490 dwellings

London West End
London City
Belfast
Birmingham
Bristol
Cardiff
Dublin
Edinburgh
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Leeds
Liverpool
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