Research report

Invest in Bristol

March 2013

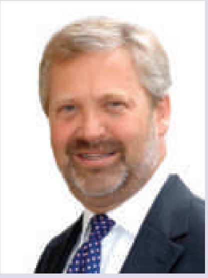
Foreword

For many years Bristol and its wider city region has justifiably been regarded as one of the UK's more prosperous and attractive areas, ranking highly for factors such as quality of life, a highly skilled workforce, low unemployment levels and strength in research, technology and knowledge-based industries.

But now it is raising its ambitions and looking to propel itself to world-class city status, capable of holding its own against the very best.

Two major events have signalled this turning point: the election of our first city mayor and the formation of the West of England Local Enterprise Partnership (LEP).

We believe there's every reason to think that the second most Googled UK city after London offers the best prospects for growth of all our regional cities and excellent opportunities to serious investors looking for alternatives to London's super-heated property markets.



David Mace
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GVA

Introduction

Despite the economic challenges over the past five years, Bristol has remained resilient, helped by the scale and diversity of its economy and the presence of a 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 and Bath Science Park is already a focal point for employers from such industries. Bristol is one of the UK's six 'Science Cities', in recognition of its contribution to science and innovation.

A number of recent changes and initiatives will provide a further boost. Bristol recently elected its first mayor, and has agreed its City Deal which will provide greater autonomy and investment to enhance infrastructure, drive economic growth and unlock some of the city's property assets.

The West of England LEP is focused on delivering employment growth through private sector investment and the Regional Growth Fund. There will be significant improvements to the existing transport infrastructure, with the LEP planning to distribute over £1 billion of investment for projects such as the Greater Bristol Metro.

Bristol Temple Quarter Enterprise Zone and the five Enterprise Areas will be allowed to keep the additional business rates they generate and will be key to delivering growth. Meanwhile, a range of other initiatives such as Business Improvement Districts will also benefit the city.

Our report focuses on the outlook for the property market, the drivers of growth and the opportunities that this will create in Bristol and the surrounding area of Bath, South Gloucestershire and North Somerset.

Local economy

Demographics and employment

Bristol is the largest city in the South West with a population of 428,000. By 2020, this is projected to reach 460,800, an 8.1% increase from 2010. According to the 2011 census, 70% of the population is of working age, whilst 17% is under the age of 15.

Bristol is a highly innovative city and is ranked ninth in the UK for the number of patent approvals per 100,000 residents in 2011. It benefits from a significant number of well-educated, highly-skilled workers. The presence of four universities, in and around the Bristol area, with the University of Bristol ranked amongst the top 100 in the world, is a considerable draw to employers.

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 to locate in the vicinity. Some of the city's most prestigious employers include Friends Life, Rolls Royce, GKN and Hargreaves Lansdown.

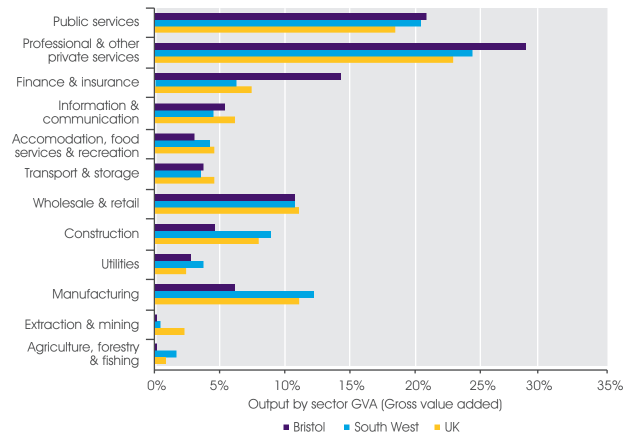
In particular, the city and surrounding area has attracted a considerable number of businesses from the defence, aerospace and hi-tech industries, and boasts the largest cluster of microelectronics companies outside of Silicon Valley in California.

With such a diverse and well-established employment base it is unsurprising that Bristol's unemployment rate is lower than that of the UK average at 7.1%, compared with 7.7% for the UK as a whole. Experian forecasts show full time equivalent employment growth of 1.4% pa for Bristol, ahead of the South West and UK figures of 0.9% pa over the next five years.

Economic output

The structure of Bristol's economy in comparison to the UK and South West in 2012 can be seen in Chart 1. The professional services and public services sectors are the largest contributors to the economies of Bristol and the South West. These sectors accounted for 49.5% of Bristol's output in 2012, and 44.6% of regional output. Finance and insurance businesses are also significant sources of economic output in Bristol at 14.3% compared to 6.7% for the South West region. Bristol outperforms the UK in business and finance services, thus illustrating the city's success in attracting major companies. This also demonstrates that Bristol isn't overly reliant on the public sector which means it has been less adversely affected by the government's ongoing austerity programme compared with many other regional cities.

Chart 1: Economic output by broad sector – UK, South West & Bristol (Source: Experian)



Commercial property market

Occupier market performance

Bristol's occupier market is still facing the challenges associated with the economic downturn. Following the financial crisis in 2007/2008, average rental values across all sectors have remained in decline. Although 2012 saw an increase in this rate across all sectors compared with 2011, rental performance should improve this year (see Chart 2).

We forecast that average office rents will increase by 0.6% this year. The retail sector (high street retail only) is forecast to experience the greatest decline in rental values (-2.3% pa). The industrial sector will see a slower rate of decline of -0.5%.

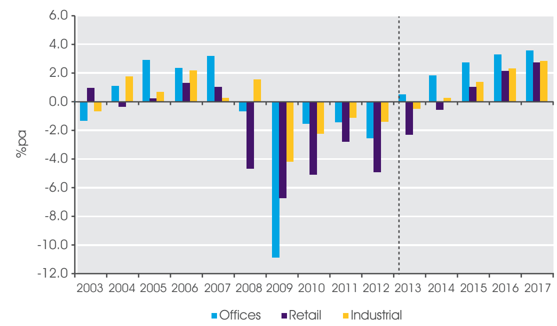
In the five years to 2017, offices are expected to see the greatest growth in rental values, reaching 3.5% pa by 2017. The retail sector will be the slowest of the sectors to see a recovery in rental growth, with positive growth not expected before 2015.

Output trends and outlook

Over the next five years, the sectors forecast to show the greatest cumulative growth in Bristol are finance and insurance services and construction, both of which are set to outperform the UK. Significant growth is also expected in the professional and other private services, and information and communication services, over the next five years, at 15% and 14% respectively.

Public services are expected to have the lowest cumulative growth rate over the five year period at 4%. So overall, there will be a rebalancing of the economy away from the public sector towards the professional services and information sectors. In the short term, output in Bristol is expected to grow by 12% up to 2017, exceeding the UK's growth rate of 10% over the same period.

Chart 2: Bristol annual rental growth (Source: IPD, REFL, GVA)



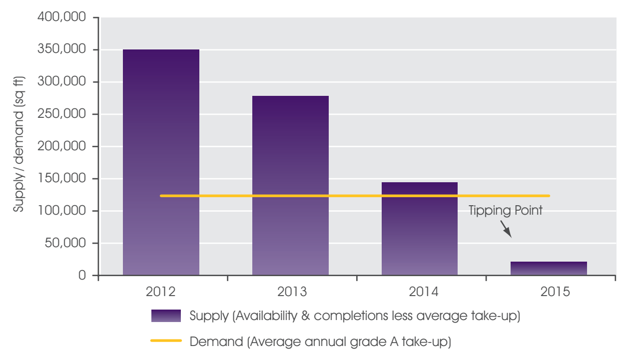
Office space supply/demand balance

At the end of 2012 there was approximately 350,000 sq ft of grade A space and an additional 450,000 sq ft of good quality grade B office stock available in Bristol.

Currently the only construction activity is at One Victoria Street, which is due to complete at the end of 2013. This lack of speculative development is likely to result in a shortage of A grade space as the existing supply is taken up.

This is illustrated in Chart 3, which projects grade A supply assuming average annual grade A take up and taking into account the completion of One Victoria Street. This reveals that the market is expected to reach a tipping point towards the end of 2014, where average annual demand exceeds supply.

Chart 3: Bristol CBD grade A supply/demand balance
(Source: GVA)



Occupier demand has remained relatively resilient in Bristol despite the challenging economic environment. Recent demand has centred upon Temple Quarter with its strong transport connections and availability of larger floor plates. With its thriving, dynamic economy, and strong presence of large corporate firms, we expect demand in Bristol to remain healthy over the medium term.

Industrial market performance

As with most of the UK there has been limited speculative development in the industrial sector for more than four years. Only one scheme is currently on site: IM Developments trade park scheme at Longwell Green.

Concerns regarding void rates, patchy take-up and lack of funding have also stalled the 'break up ' market that formed a large part of Bristol's supply. Given that backdrop, supply is declining in certain sectors with buildings constructed post 2000 virtually non existent.

Take-up for greater Bristol in 2012 stood at 2.3 million sq ft, distorted by a single freehold design and build with ASDA at Avonmouth of 620,000 sq ft and a letting for Standard Life of 164,000 sq ft to Yankee Candle. At the peak of the development market the take-up figures exceeded 3.5 million sq ft.

Bristol's take-up in the market is broadly 75% warehousing, 25% industrial. The city acts as a gateway to the South West and Wales markets and acts as a distribution centre for many retailers. In recent years Bristol has attracted new regional distribution centres for Tesco, Co-op and Dixons, whilst other retailers such as Next and M&S remain with longer term aspirations for the region.

Prime rental levels have held well at £6 - £7 psf for the better stock and incentives are now declining as availability dwindles.

There are a considerable number of development options ready to deliver for market demand, particularly at Severnside, but none are sub 50,000 sq ft, the medium range that is the backbone of the market demand. Until demand really stabilises this situation is unlikely to change.

Retail market performance

The continued problems of the retail market are well documented with the end of 2012 and early 2013 already seeing the demise of major household names such as Comet, Jessops, HMV, Blockbuster and most recently Republic. As a major city, Bristol has not been immune, but as a relatively prosperous city, it has fared better than most regional centres.

In Broadmead, Cabot Circus is holding up fairly well and Quakers Friars has reinvented itself as a place to eat and meet whilst also providing the higher quality retail offer for Bristol city centre. There has been a significant shift in prime retail from West to East Broadmead leaving some inevitable voids in its path.

To the north of the city, The Mall at Cribbs Causeway continues to trade well with footfall and like-for-like sales in 2012 up on the previous year. The Mall together with The Venue Leisure Park draws on a wide regional catchment stretching along the M4 and M5 corridors with the pulling power of John Lewis. A number of recent lettings have been secured involving up-sizing of some existing retailers and the introduction of several new brand names.

Inevitably there are winners and losers in the retail market and those who have been quicker to adapt to change in retail habits and technology with a strong internet offer have fared better. With online sales increasing 10.1% in January and only moving in one direction, there will be a great demand for 'click and collect' services at major stores such as Next. This rapid growth in online spending, together with the requirement for distribution hubs, means that Bristol will be well placed to adapt to such changes.

The expansion of the food store sector continues but with particular emphasis on smaller convenience stores as the major operators compete for greater market share. Sainsbury's have recently secured planning for a large format store at the Memorial Stadium in Horfield and are still pursuing similar plans at Ashton Gate.

Investment market performance

The Bristol investment market has broadly followed the national trend. Over the last decade, commercial investment transactions have averaged nearly £400 million pa, with a lower average over the last five years of just under £300 million pa. This shows that investor demand remains strong although, unlike the boom period of the mid-2000s, it is restricted to high quality assets with strong covenants and in good locations.

City centre and out-of-town office transactions in Bristol totalled £90 million in 2012 compared to £240 million in 2011, down 60% (£108 million in 2010). There has been continued faith in the city for investment, demonstrated by Prudential who completed £52 million of transactions during 2012, representing nearly 60% of the total. In May 2012 they acquired Temple Circus for £26.3 million reflecting an initial yield of 7.38% and an average rent of £24.50 psf.

The purchase of 1 The Square in Temple Quay followed in July at £12.6 million, showing an initial yield of 7.6%. Finally in October 2012, 2 College Square was purchased for £13 million at a similar yield with half the 51,800 sq ft building let to Cameron McKenna on a 15 year lease with a 10 year break clause.

In the secondary market there has been a significant fall in values and this was evidenced by the sale of Whitefriars for £6.5 million which reflects an initial yield of 20% and a capital value of £45 psf. The building totals 140,000 sq ft with 50,000 sq ft vacant (35%) at an average rent of £13.54 psf.

We estimate that Bristol saw a fall in all property capital values of around 3% in 2012, as a result of the fall in average rental values and the modest upward shift in yields. However, the rate of decline looks to have peaked last summer and we forecast only a very modest fall in capital values in 2013, as rental values and yields level off.

There is more optimism surrounding the start of 2013 with a number of larger transactions under offer. General consensus is that prime offices are now commanding yields 6.25 - 6.5% compared to 6% a year ago. This will begin to have a positive impact on total returns, which should rise from around zero in 2012 to more than 4% this year.

Looking further ahead, the outlook becomes more positive and from 2015 we forecast that the market should be producing a total return in excess of 8% pa. Chart 4 shows average annual total returns across all three sectors in Bristol.

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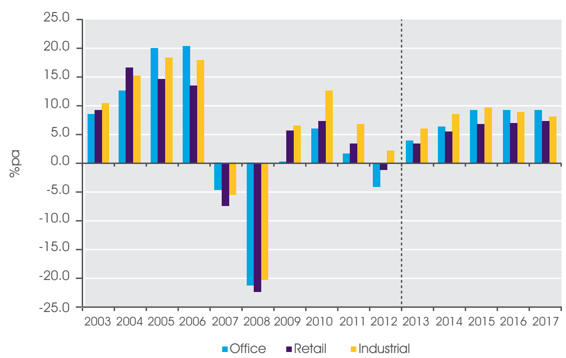
Chart 4: Bristol total return across all sectors (Source: IPD, REFL, GVA)



Residential market

There have been a number of successful residential developments in Bristol, particularly along the city's waterways which make attractive locations for city living. Both Crest Nicholson and Linden Homes are constructing new apartment blocks at Harbourside, where demand is strong from both owner occupiers and buy-to-let investors.

Major developments are also planned for the outskirts of Bristol. Most notable include Emersons Green, incorporating approximately 2,000 dwellings acquired by a consortium of house builders led by Taylor Wimpey. Other developments include the former Cadbury Factory at Keynsham, where 650 dwellings are planned, alongside 100,000 sq ft of office space and other supporting uses. However the closure of Filton Airport will undoubtedly provide the biggest development opportunity, releasing space for 5,700 new homes and 50 hectares of employment land.

GVA has been leading the disposal of three significant sites in Bath currently owned by the MoD. These sites represent a one-off opportunity to develop approximately 1,000 dwellings in prime Bath, which has been constrained of new housing development for decades.

Bristol, South Gloucestershire and Bath and North East Somerset have all experienced positive increases in house price growth over the last twelve months, ranging from 1.6% to 3.5%. According to the Land Registry, average house prices in Bristol stood at £169,677 at the end of last year, broadly in line with prices across the region as a whole, but higher than the average price of a house in England and Wales (£162,080). Land prices have been on the increase with several recent sales exceeding £1 million per acre.

Demand for housing is likely to increase in the future as the city's household growth rate is forecast to exceed that of the UK's, increasing by 18% by 2023, in comparison to the UK growth rate of 11%. This will have a considerable impact on Bristol's ability to meet future housing need.

Drivers of growth

Growth initiatives

In November 2012, Bristol elected its first mayor following the government's decision to replace local council cabinets with directly elected mayors. Bristol's newly appointed mayor, George Ferguson, now holds responsibility for managing the council's services and its annual £1 billion revenue.

In addition to the devolved responsibilities of the mayor, Bristol recently agreed its City Deal, a major element of the government's localism agenda. The City Deal is an agreement between the government and Bristol City Council involving the devolution of power and designated financial support in return for the implementation of strategic plans for the delivery of jobs and economic growth at the local level. The deal incorporates the creation of a Public Property Board which will be accountable for the management of £1 billion of the council's assets. It will also help unlock land for housing provision and economic growth and encourage public and private investment.

The West of England LEP focuses on economic growth and investment in Bristol, Bath and Weston-super-Mare and sets out to build on the region's existing sector strengths of advanced engineering, aerospace, science/research and development and distribution, together with creative media and digital industries. The LEP aims to deliver over £1 billion private sector investment over the next three years and has a target of achieving 95,000 new jobs by 2030. It has already been voted the top performing UK LEP in terms of attracting foreign direct investment.

Stemming from the West of England LEP, the Regional Growth Fund (RGF) is a £2.4 billion fund that aims to support private sector projects and programmes with significant potential for economic growth, particularly in areas formerly dependent on the public sector.

Bristol benefits from three Business Improvement Districts (BIDs): Broadmead, Cater Business Park and Clifton village. Commercial properties within these BIDs pay a levy at a given percentage of their rateable value, whether premises are occupied or vacant. The revenue raised from businesses in these areas is subsequently used to improve local services, streetscapes and security provision.

Following the Portas Review focusing on Britain's ailing town centres, Bedminster in south Bristol was chosen as one of the initial 'Portas Pilot' towns to receive a £100,000 grant from the government to rejuvenate its town centre and stimulate local business growth.

Much of the future growth in the region will be delivered through the Bristol Temple Quarter Enterprise Zone and the five Enterprise Areas across the region. These locations have all been strategically chosen because of their existing strengths and future growth potential.

Bristol Temple Quarter Enterprise Zone – Temple Quarter covers an area of 70 hectares located in the heart of the city adjacent to Bristol Temple Meads railway station. It provides an excellent opportunity to attract high growth, creative and technology-based companies in a vibrant, dynamic community.

Temple Quay is already recognised as the prime office location for leading businesses including IBM, Canada Life, HSBC, Burges Salmon and Osborne Clarke. The West of England LEP is providing almost £21 million for infrastructure projects from funds granted by the RGF. Other significant projects include the proposed Arena as well as train electrification at Temple Meads.

Avonmouth Severnside – The area extends over 1,800 hectares along the Severn estuary, employing approximately 14,000 people in the manufacturing, warehouse and distribution, energy and waste processing industries. A new deep-water container terminal has already been approved at Avonmouth dock. The timescale is currently uncertain but, once construction begins, the terminal will be functional within three years. The terminal itself will support 1,800 new jobs and will secure the future of 8,000 existing jobs in the port. The development will be essential in ensuring the UK meets future demand - container volumes are set to increase to approximately 20 million TEU (20ft equivalent units) by 2030. The terminal will enhance Bristol's position as a distribution hub for the South West.

Emersons Green – The Bristol and Bath Science Park, located in the Emersons Green enterprise area in South Gloucestershire, opened in 2011 and is fast becoming the research and development capital of the region. It has the potential to create 6,000 jobs in the aerospace, defence, digital technologies and biotechnology industries.

This location provides excellent transport links, being in close proximity to the M32 and M4/M5 corridors and has the potential for a further 45 hectares of employment development. Existing occupiers on the park include B & R Industrial Automation, CensorNet Ltd, an internet security company and several 'cloud-based' software design companies such as Kbase Connect. The recently completed National Composites Centre (NCC) acts as a hub for academics and industry experts in the field of composites research and manufacturing, providing teaching facilities, workshop space and offices. Funding has just been approved for further expansion of the NCC.

Filton – Located along the northern fringe of Bristol, this area provides direct access to London, Cardiff, the Midlands and beyond via the M4/M5 interchange together with train services from Bristol Parkway railway station. Airbus, Rolls-Royce, GKN and the MoD Procurement Centre are already located in the area which has a strong history in the advanced engineering, aerospace and defence sectors.

The recent closure of Filton Airfield has created significant development opportunities for employment land and 5,700 new homes. Airbus has also commenced its £70 million Airbus Business Park focusing on the aerospace sector.

Bath 'City of Ideas' – Covering an area of 98 hectares, the area has the potential to provide 9,000 new jobs and 2,000 new homes right in the heart of this World Heritage city of international status. Located close to the city's new transport interchange, with direct links to London and Bristol, its attractive waterfront setting is perfectly placed to build on Bath's reputation as a successful hub for innovation and creativity.

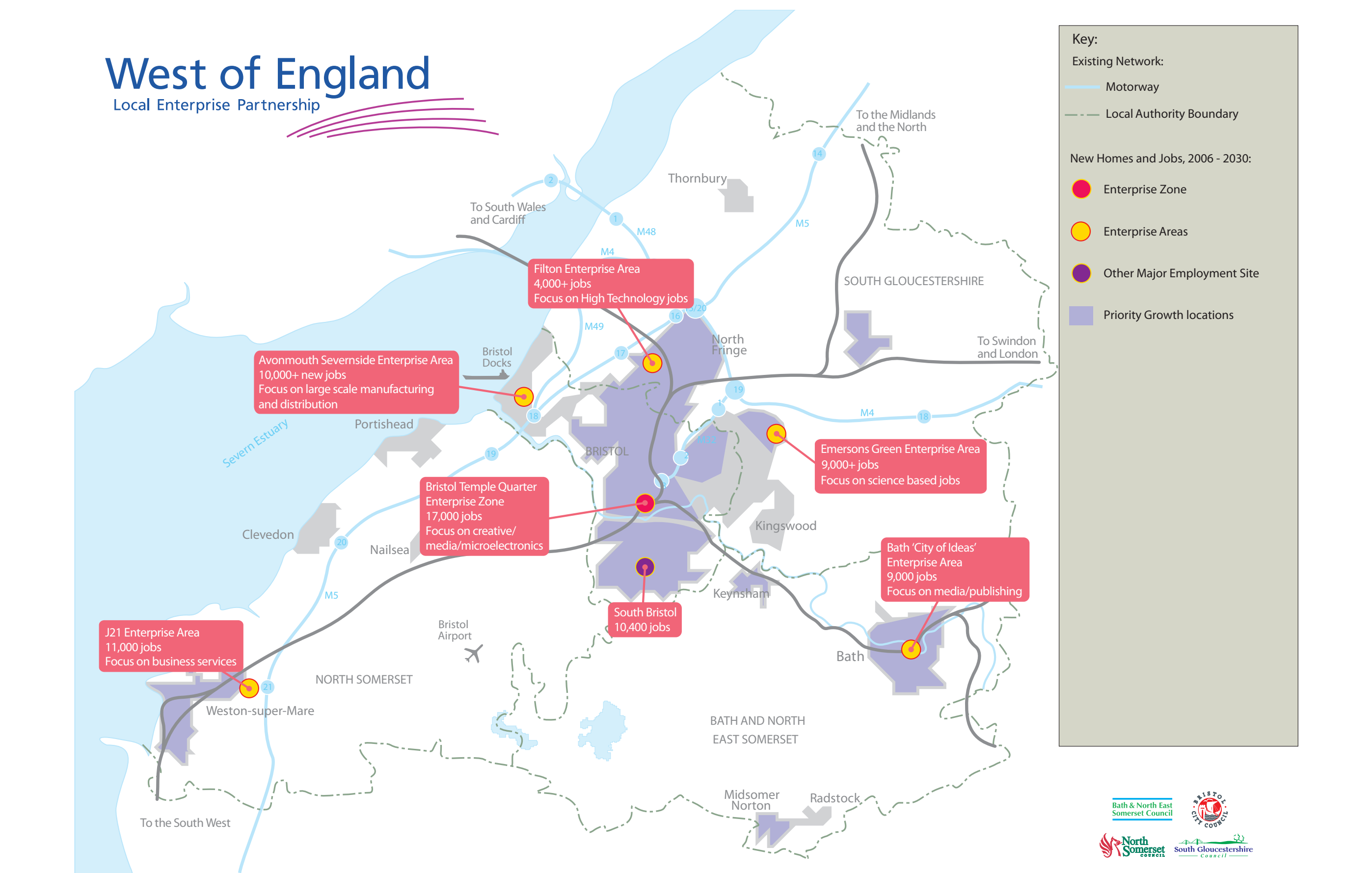
Weston Junction 21 – Located in Weston-super-Mare, the enterprise area covers 72 hectares of employment land strategically positioned on the M5 corridor with excellent access to nearby Bristol Airport and Portbury Docks. Knightstone Housing's regional headquarters is currently under construction at Weston Gateway Business Park, representing the second largest office development to start on site outside of London in 2012. St Modwens has recently commenced speculative office development at Locking Parklands as well as new housing.

Other developments

Incorporated within the City Deal is a Transport Devolution Positive Agreement which has enabled greater control over the funding of a range of infrastructure improvements. Transport in particular is undergoing some significant enhancements with the aim that improved infrastructure and service provision across the region can positively impact economic output.

The Local Sustainable Transport Fund, announced last June, is a commitment of £40 million from government and local business partners. This investment will be used to reduce carbon emissions, stimulate growth and encourage greater connectivity between local centres whilst encouraging people to be more active

Location of Enterprise Areas (Source: West of England LEP)



and involved in community projects. Grants range from £500 – £100,000 and are awarded to a variety of recipients including schools, community groups and local authorities.

The Bristol Metro Bus consists of three interlinked bus routes (Ashton Vale to Temple Meads/Bristol City centre, North Fringe to Hengrove, and South Bristol Link). These are receiving ongoing investment in order to reduce congestion, improve journey times and transform wider public transport travel across the region.

The Greater Bristol Metro will receive £94 million of funding as part of the City Deal. Phase 1, which will incorporate a shuttle service between Bristol Temple Meads and Bath, is due for completion in 2016 and phase 2, which will provide a local service between Bristol and Swindon, is planned for completion in 2018/2019.

The Bath Transportation Package will see £34.3 million invested in transport infrastructure to tackle traffic problems and support economic growth.

Rail electrification between Bristol Temple Meads and London is due for completion in 2017. There is scope for this to be extended to Weston-super-Mare and beyond. The key benefit will be improved journey times.

Bath & North East Somerset, Bristol and South Gloucestershire authorities have received circa £1.4 million from the government to expand Wi-Fi coverage in public spaces and upgrade the existing network, including the installation of super fast broadband.

Plans are in place to develop provision for new nuclear power generation at two sites in the region. Hinkley Point C, near Bridgwater, and a new plant adjacent to the existing Oldbury nuclear plant in South Gloucestershire would both provide substantial benefit to the regional economy. Work has already begun on securing a licence for the construction of Advanced Boiling Water Reactors on the 150 hectare site at Oldbury which has been outlined by the government as strategically suitable for new nuclear development. A decision on Hinkley Point is imminent, pending a response from the Planning Inspectorate.

Triodos Renewables has recently purchased a four turbine wind energy project at the Wessex Water sewage treatment works in Bristol. The turbines will generate 8.2MW of power, enough to power nearly 5,000 homes.

Conclusions

The outlook for Bristol and the surrounding areas of Bath, North East Somerset and South Gloucestershire is very positive.

Growth forecasts are above UK average, rents and yields are steady, stocks of office, industrial and new-build residential property are approaching historic lows and significant investments in the local transport infrastructure are planned.

In the office sector we predict the supply and demand cycle will reach a tipping point in late 2014 leading to the return of speculative development in the city centre.

The city's new mayor and high-performing LEP provide an unprecedented focus and catalyst for growth, meaning opportunities abound for cash-rich, savvy investors to capitalise on Bristol's stored-up potential.

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