For the fourth consecutive year, total take-up in the UK regions, excluding London, surpassed the long-term average of 9.1m sq ft, reaching an impressive 9.6m sq ft, despite a year of political uncertainty (Graph 1, pg 4).

Perhaps unsurprisingly, regional supply levels have continued to fall across the UK regional markets, particularly within the M25 market (Graph 3, pg 5).

Static or positive rental growth is forecast across a number of regional office markets in 2017 (Graph 4, pg 6).

Following a very weak third quarter, UK regional office investment volumes bounced back during the final quarter of 2016, to reach £1.4bn, 15% above the 10-year quarterly average.

While we expect overseas investors to remain prominent in 2017, we also expect the UK Institutions to resume activity.

UK regional prime office yields remain attractive at 5.25%, and having stabilised post EU referendum, we expect them to remain at this level.

“Regional office markets are structurally under-supplied, and with occupational demand remaining resilient, we continue to see great opportunities in 2017 and beyond.” - Jon Gardiner, Head of National Office Agency
With some major infrastructure projects, improved office product and increasingly attractive retail and leisure offering, the occupational and investment markets in UK regional cities are holding strong in the wake of the EU referendum.

Business As Usual
The UK economy is estimated to have grown by 1.8% during 2016, a strong performance given the initial uncertainty following the EU referendum, and only marginally below the 2.2% recorded during 2015, according to figures from Oxford Economics.

The Monetary Policy Committee (MPC) have also recently upgraded their 2017 economic growth forecast to 2.0% from 1.4% in November 2016.

However, a number of challenges face the economy during 2017. The first of these will be rising inflation. With weaker Sterling leading to rising input costs, this will continue to cut developer margins. Oxford Economics forecast CPI inflation to reach 3% by the second half of the year. This is ultimately slowing real wage growth, and having a knock on effect to the high street. At 62% of GDP, consumption is the key driver of economic growth, which could suggest growth figures below that of 2016.

With the UK regions’ economy well balanced across a range of sectors and therefore more resilient to Brexit, we see this as a driver of continued growth. We expect some London based occupiers looking to save on property costs to relocate their back office functions to regional cities with large talent pools.

Occupational Dynamics
For the fourth consecutive year, regional take-up has surpassed the long term average of 9.1m sq ft. Total take-up reached an impressive 9.6m sq ft, despite a year of political uncertainty (Graph 1, pg 4).

Any signs of a post referendum ‘slow down’ during the third quarter were briskly brushed aside, with a bumper final quarter of take-up reaching 2.4m sq ft, the strongest quarter since Q2 2015. On the whole, the same level of occupational demand was recorded during the first half and second half of the year, with no post referendum slowdown evident.

Leading the outperformers during 2016 were Bristol and Cardiff, who recorded take-up improvements of 42% and 10% on 2015’s levels respectively, with Cardiff achieving its highest level of take-up in 15 years.

A key driver of occupational demand in these markets was the Government Property Unit (GPU) requirements consolidating into regional hubs in order to reduce costs.

HMRC also pre-let 180,000 sq ft at One Ruskin Square, Croydon, part of the Ruskin Square regeneration scheme, which will provide up to 1.25 million sq ft of office space when complete.

We expect the GPU to be the key contributor to acquisitions over 100,000 sq ft in cities including; Birmingham, Manchester, Leeds, Cardiff, Edinburgh and Belfast, during 2017.

However, the most active business sector during 2016 was the insurance and financial services sector, accounting for 1.2 million sq ft (15%).

With some major infrastructure projects, improved office product and increasingly attractive retail and leisure offering, the occupational and investment markets in UK regional cities are holding strong in the wake of the EU referendum.

ROOM FOR GROWTH
Office based employment growth remains positive in the UK regional cities

We expect the majority of the key regional cities to see the strongest office based employment growth over the next five years (see map).

The fastest growing sectors going forward are administrative and tech based employment, forecast to rise 7.2% and 6.3% respectively. Bristol, Edinburgh and Manchester are all set to see faster tech based employment growth than Greater London over the next five years.

Positive sentiment has started to increase and according to Deloitte’s CFO survey, 11% of CFOs expect to increase hiring over the next 12 months. This represents a marked increase on the 1% who expected hiring to increase immediately post EU referendum.

We expect the ‘northshoring’ trend to continue over 2017 as London based occupiers move their front and back office functions to the UK regions to take advantage of lower property and staff costs.

Given that the UK unemployment rate stands at only 4.8%, in line with the level recorded during 2005, we do not expect to see as aggressive employment growth as seen previously. The UK economy is already operating at near full capacity, which could suggest opportunities for wage growth going forward.
floorspace in-town, occupiers have been forced to look to the periphery during 2016, with total fringe/out of town take-up reaching 2.8 million sq ft, eclipsing the record level set during 2014.

Occupiers have been attracted out of town due to availability of larger floorplate stock and cheaper rents, particularly in the Manchester and Glasgow markets. Glasgow’s take-up in the out of town market exceeded the city centre following the University of the West of Scotland’s 225,000 sq ft pre-let of the Eco Campus.

However, occupiers’ appetite for new accommodation is evidenced by 44% of the 3.6m sq ft currently under construction across the UK regions being pre-let (Graph 2, pg 4). Three Snowhill, (cover page) is set to provide 420,000 sq ft when complete in 2019 and marks the largest regional speculative development on record.

A number of regional cities witnessed growth in top rents over the course of 2016. Rents jumped 9% to £25 per sq ft at Cardiff’s Central Square scheme, while Birmingham’s top rents rose 8% to £32.50 following PwC’s part pre-let of One Chamberlain Square.

Investment Dynamics
Following a very weak third quarter, UK regional office investment volumes bounced back during the final quarter of 2016, to reach £1.4bn, 15% above the 10 year quarterly average.

This boosted the UK regions’ total office investment for 2016 to £6.1bn, marking a very strong recovery following the UK referendum outcome.

With the UK regions generally less exposed to financial services than London, regional office investment

A NEW ERA OF REFURBISHMENTS

High quality refurbishments supply new space

There remains a shortage of Grade A office space across the regional office markets, and with developers currently holding off for pre-lets, refurbishments are providing the majority of good quality space going forward.

As investors’ risk appetite on speculative new build has fallen, investors have taken advantage of asset management opportunities through high quality refurbishments. This has squeezed the rental differential between comprehensive refurbishments and new developments across the UK regions.

In Bristol, this currently stands at as low as £0.50 per sq ft and occupiers are now looking at prelets for lot sizes as low as 20,000 sq ft, which has not been seen before.

We are now seeing a better quality of refurbished product being delivered to the market, which is driving average rents upwards. One such comprehensive redevelopment is 55 Colmore Row, which provides 112,000 sq ft of Grade A space in Birmingham city centre, whilst Neo, Manchester (overleaf) provides 52,000 sq ft of refurbished space aimed towards tech.

We expect a shortage of Grade A office space and improved office produce to drive rents forward in the regional cities during 2017.

Due to the shortage of Grade A

of space taken, which marked a record year. Key deals include: Swinton Insurance taking 165,000 sq ft at 101 Embankment, Manchester, whilst MotoNovo Finance took 72,000 sq ft at One Central Square, Cardiff.

The tech sector remained an important contributor to take-up during 2016 and accounted for 20% of the number of transactions. This sector has traditionally contributed to the smaller end of the market, with a number of start-ups taking accommodation throughout the regions.

This has proven particularly prominent in the Manchester market, where Co-op Digital acquired 45,000 sq ft of accommodation during the final quarter, whilst a number of other tech based occupiers clustered around Media City, Salford Quays.

Micro-chip designer, Cirrus Logic’s 70,000 sq ft letting at Quartermile, Edinburgh marked the largest regional tech deal last year. Edinburgh witnessed the highest proportion of tech take-up of all the UK cities.

Regional supply levels have continued to fall across the UK regional markets, particularly within the M25 market (Graph 3, pg 5). Some of this loss can be attributed to the conversion of circa three million sq ft to residential through PDRs. In Leeds, we have also seen a large volume of office space converted to educational use, as councils are increasingly trying to promote a mixed-use environment.

Due to the shortage of Grade A
volumes remained 9% above the five year average, whilst Greater London recorded volumes 21% below their five year average.

During 2016, 28% of the UK’s total office investment took place in the UK regions, above the long term average of 23% (Graph 7, pg 6).

Sentiment within the regions remains positive as investors increasingly look to them amid concerns over the affordability of London’s stock.

The South East remained the most heavily invested region outside London, with office investment reaching £1.9bn. The North West also saw investment deals exceed £1bn, with the majority of deals in Greater Manchester, including Deka Immobilien’s purchase of One St Peter’s Square.

The most active purchasers during 2016 were the overseas investors, who contributed £2.4bn, 41% above the five year average of £1.7bn.

At a more granular level, it was the German funds who were the most active overseas investor during 2016, investing a total of £555m, 28% of the overseas total (Graph 6, pg 6). Far Eastern investors followed closely behind, with a total of £339m invested, largely skewed by Mapletree Investment’s £560m purchase of Green Park, Reading, the largest regional investment deal during 2016.

One particularly active investor sub-type during 2016 has been local councils, who have acquired a record £338m of office stock, over twice the 10 year annual average. 85% of these deals occurred in the second half, as local councils searched for price cuts post EU referendum, including Leeds City Council’s £44m purchase of 3 Sovereign Square, Leeds.

One of the key drivers of the overseas demand during 2016 was the weaker Sterling and this has continued into 2017. The key deal so far during the first quarter of 2017 has been HSBC’s £260m purchase of 3, 4, 5, 6 & 9 Brindleyplace, representing a yield of 6%.

Data from MSCI shows how the UK Institutions’ risk appetite has fallen since the EU referendum outcome. Between the second and third quarter of 2016, “negligible” risk occupiers as a percentage of total fund portfolios increased from 54% to 60% whilst average lease length across offices extended from 10.2 years to 12.8 years. Well let, income producing assets with a strong covenant profile are top of investors’ agenda.

2017 Outlook
Looking forward, we expect 2017 to be another active year, despite current economic uncertainty. Total regional office take-up is expected to see a 3% rise on last year, with large Government Property Unit requirements set to represent the big ticket deals. However, with 8 million sq ft of known lease expiries over the next five years, there also remains underlying demand for new space.

The strongest outperformers expected in 2017 are Leeds, Cardiff and Bristol who are expected to see take-up growth of 126%, 38% and 31% on the five year average respectively.

With supply levels at its lowest on record, we expect it to remain below the long term average as we go through 2017. We expect the total quantum of supply in the development pipeline to reduce from 2018 as speculative development starts are put on hold.

39% of 2016’s regional office investment came from overseas investors.
on good quality refurbished space across the city, as illustrated by Bruntwood’s successful refurbishment of Neo, Manchester, which secured a number of pre-lets with rents pushing between £25-£30 per sq ft.

While we expect overseas investors to remain prominent in 2017, we also expect the UK Institutions to resume activity, with Essex County Council pension fund purchasing 201 Deansgate, Manchester, during the first quarter of this year, an example of this.

Relative to Government bonds, the income from property still remains attractive. 10-year bond yields now stand at around 1.25% (Graph 8, pg 6), and with uncertainty still prevalent, we do not expect a rate rise anytime soon.

Investors will be also paying particular attention to the price of Brent Crude oil over the coming months, which currently stands at $51 per barrel. Oil was the best performing major asset class during 2016, rising in value by 47%. With a higher than average proportion of employees on flexible contracts in the Aberdeen market, we expect take-up in Aberdeen to see a marked improvement on the last couple of years.

UK regional prime office yields remain attractive at 5.25% (Graph 5, pg 6), and having stabilised post EU referendum, we expect them to remain at this level. With City of London prime yields standing 125 bps lower and West End prime yields 200 bps lower, regional investment opportunities remain attractive as we go through the year.

With the UK regions seeing stronger rental growth prospects and lower volatility in capital values than the Central London office market, we expect investors to increase their exposure to regional offices as a value pick for 2017.

YEAR OF THE PRELET

Chris Meredith, Director of leasing, Bristol highlights his key themes

2016 was another impressive year for the Bristol city centre office market. Take up was close to the record years of 2014 and 2007, indeed Grade A take up in the City Centre accounted for 42%, the highest level since 2007. Both Grade A and Grade B availability in the City Centre remains heavily constrained with only one speculative building on site, that of Aurora which is the next phase of Finzels Reach, a development by Cubex Land/Palmer Capital.

Not only is the current existing supply in the City Centre at a record low but the deliverability of fully consented and funded sites for pre-lets is also causing headaches for some occupiers. Assembly Bristol by AXA/Bell Hammer is one such site which is able to offer such a scheme benefitting from up to 300,000 sq ft of offices in 3 different buildings. Public realm will be at the heart of Assembly, together with extensive waterside spaces, rooftop gardens and a mix of indoor and outdoor amenities making it a new type of destination for occupiers.

TMT, professional and public service sectors continue to dominate City Centre take with several landlords tailoring their buildings to suit the changing face of occupier requirements.
**Key Charts**

**GRAPH 4**
Positive rental growth is still expected

![Graph showing rental growth forecast](image1)

*Graph source: Savills Research, Oxford Economics*

**GRAPH 5**
Average prime yields remain at 5.25%

![Graph showing yield comparison](image2)

*Graph source: Savills Research*

**GRAPH 6**
German investors were the most active into UK regional offices during 2016

![Pie chart showing investor distribution](image3)

*Graph source: Savills Research, Property Data*

**GRAPH 7**
UK regional investment volumes remain strong in the wake of the EU referendum

![Graph showing investment volumes](image4)

*Graph source: Savills Research, Property Data*

**TABLE 1**
Definitions

<table>
<thead>
<tr>
<th>Property criteria</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Property criteria</td>
<td>Transactions and supply recorded for units in excess of 1,000 sq ft.</td>
</tr>
<tr>
<td>Top rent</td>
<td>Highest rent achieved in one or more transactions in the given period.</td>
</tr>
<tr>
<td>Grade A</td>
<td>All new development (including speculative schemes reaching practical completion within six months, plus major refurbishments).</td>
</tr>
<tr>
<td>Grade B</td>
<td>Space previously occupied, completed or refurbished in the last 10 years.</td>
</tr>
<tr>
<td>Grade C</td>
<td>Space previously occupied, completed or refurbished more than 10 years ago.</td>
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Please contact us for further information

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