

RESEARCH



CARDIFF

OFFICE MARKET
2014

INCREASED TENANT DEMAND
PROMPTS NEW DEVELOPMENTS

GROWING UK AND FOREIGN
INVESTOR INTEREST

FIVE CATALYSTS FOR
FUTURE GROWTH



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MATT PHILLIPS
Managing Partner,
Knight Frank Cardiff

CARDIFF'S RISING TIDE

The last twelve months has seen a continuation of improved market conditions which has led to a notable improvement in both the investment and occupational sectors.

The South Wales recovery has continued to be dominated by Cardiff, where we have seen a substantial increase in new investors entering the market. In our report last year we highlighted a growing interest in the regional UK market by overseas investors. Since then we have seen significant acquisitions, including new entrants from China, Kuwait and the USA. We have also seen investors willing to increase their risk profile by acquiring good secondary investments.

The development market has also re-emerged with two major speculative office schemes under construction at JR Smart's Capital Quarter and Rightacres' Central Square scheme, which between them will deliver over 220,000 sq ft of grade A office space. JR Smart and Rightacres both have enviable track records of being willing to commit to speculative development and getting their timing right, and it is encouraging to see their confidence in the Cardiff office market.

The role of the public sector in the Cardiff property market is also noteworthy. Cardiff Council has formed a joint venture with Rightacres to redevelop Central Square, a major mixed use scheme located directly in front of the main railway station. The

area surrounding the bus station has been an eyesore for many years and this redevelopment is both overdue and welcomed. Winning of the relocation of the BBC Headquarters gives the project real momentum.

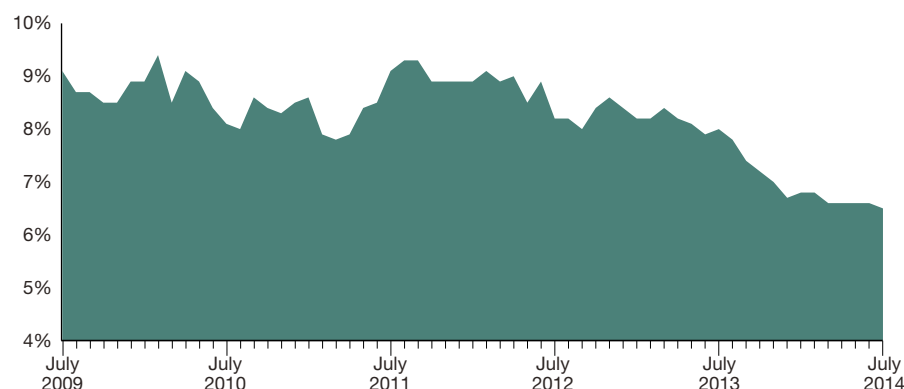
The Welsh Government have focussed on the land south of the railway station, buying Number 1 Capital Quarter from JR Smart and a prime 4.5 acre office development site from MEPC at Callaghan Square. Perhaps buoyed by their success at Number 1 Capital Quarter, which is 60% let, it would appear likely that they will now commence construction of Number One Callaghan Square, which is a 90,000 sq ft grade A office building. We believe an announcement could be made in the next month. If it is a green light, it becomes imperative that subsequent leasing deals are agreed on terms that do not undermine the open market, and hit investor confidence in the City.

The absolute key for Cardiff is to increase the occupier pool and ensure that the infrastructure, people, as well as available buildings are all in place to successfully compete for the much sought after footloose inward occupiers. The decision by US IT firm Alert Logic to set up their European Headquarters in Cardiff is encouraging, and it is vital that the City secures more wins like this. The universities will be important in this regard, delivering a high-quality workforce to attract employers, and tomorrow's entrepreneurs to build a thriving SME community.

Our view is that the public sector bodies should be applauded for their willingness to become involved in helping make Cardiff a more attractive proposition. However, we need the Welsh Government and Cardiff Council to ensure that they are working on an agreed and joined up master plan for the whole City including its waterfront, and the absolute key will be the delivery of new occupiers.

FIGURE 1

Unemployment rate in Wales



Source: Office for National Statistics

OCCUPATIONAL MARKET

Steadily improving occupier activity has produced healthy take-up throughout 2014. With continued demand and two new office buildings already under construction, Cardiff is firmly established in a new cycle.

- Third quarter take-up was an impressive 140,613 sq ft, bringing the 2014 year to date total to 395,719 sq ft. Full year take-up looks on course to exceed the 10 year average figure of 465,000 sq ft.
- The most significant leasing activity has been in the city centre. British Gas secured expansion space at 3 Callaghan Square adjacent to their Cardiff Headquarters. HSBC completed a sub-lease from Eversheds in 2 Callaghan Square. At Capital Quarter, Finance Wales and US IT occupier Alert Logic snapped up the first space in Number 1.
- The largest letting of the year to date was International Baccalaureate's 48,694 sq ft move at Cardiff Gate Business Park, where they relocated to upgraded accommodation.
- The supply of prime grade A stock remains limited, with only 32,000 sq ft available in the city centre and 40,000 sq ft in Cardiff Bay.
- The redevelopment of the bus station and surrounding buildings forming Central Square has gained momentum with BBC Wales Cymru's decision to relocate its headquarters to the city centre. The broadcaster has committed to occupy a new 150,000 sq ft headquarters opposite the train station entrance in 2018.
- Construction is underway on two speculative office schemes, with JR Smart progressing with Number 2 Capital Quarter (85,000 sq ft), and Rightacres on site at 1 Central Square (135,000 sq ft). The Welsh Government is also likely to confirm its intention to develop the 90,000 sq ft Phase 1 at Callaghan Square (South). The completion of all three of these buildings would deliver over 300,000 sq ft of much needed grade A space early in 2016.
- Named occupier requirements are in excess of 300,000 sq ft including Deloitte, Legal & General, Blake Morgan, Geldards, Public Health Wales and Parsons Brinckerhoff. These potential relocations could bring several second hand buildings back to the market, creating refurbishment opportunities.
- Headline rents remain at £22 per sq ft in Cardiff Bay and £21 per sq ft in the City Centre. Net effective rents continue to improve for prime space due to a shortage of grade A stock. We expect headline figures to move to £23 per sq ft during the next 12 months.

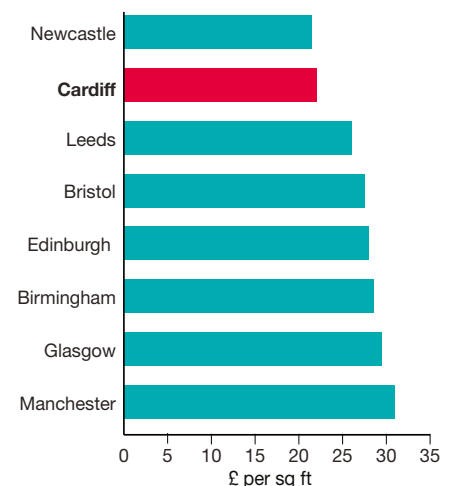
"Full year take-up looks on course to exceed the 10 year average figure of 465,000 sq ft."

2014 (ytd) major leasing transactions

Building	Tenant	Sq ft	Rent	Date	Grade
3 Callaghan Square	Centrica/ British Gas	14,666	£21	Q2	A
Number 1 Capital Quarter	Alert Logic	9,823	£19	Q3	A
Number 1 Capital Quarter	Finance Wales	22,324	£19	Q3	A
2 Callaghan Square	HSBC	12,500	£19	Q3	A
Sterling House	International Baccalaureate	48,500	£12	Q1	B

Source: Knight Frank Research

FIGURE 2
Prime rents in regional city centres



Source: Knight Frank Research

CARDIFF'S FUTURE:

5 CATALYSTS FOR GROWTH

Within the business community there is now a desire to see Cardiff expand as a driving force and 'store front' for the Welsh economy. The key elements are in place:

- Growing creative, financial and life sciences industries.
- A strong academic community, and well-educated workforce (40% of Cardiff workers have a degree or equivalent qualification).
- Capital city status.

The question is how does Cardiff move to the next level, and raise awareness on an international stage of the benefits the city offers? Here are Knight Frank's five key elements for energising Cardiff in the next decade.

1 CONNECTING

By 2017 the mainline rail link to London Paddington will be electrified, cutting journey times by 15 minutes. Direct flights to Birmingham and Manchester airports have encouraged more Middle Eastern investors to look closer at those cities. Similarly, Cardiff Airport needs

more scheduled flights to global business destinations in order to attract overseas investment. The Metro programme linking the city region, via rail, bus, and cycling schemes, will improve commuting, and boost the 'weekend economy' of retail and leisure.

2 ACCOMMODATING

Cardiff's development plan calls for 41,000 homes to be developed by 2026, and we see a growing private rented housing sector as being part of the solution. The universities

are accounting for a larger share of the city's economy and population, necessitating more student housing. New shops and leisure property will also be required to match this growth.

3 RECYCLING

Not all firms can afford prime offices, and rents in Cardiff are among the most competitive of the leading UK cities. This is an advantage that should be maintained, making it essential to refurbish a

proportion of existing stock as affordable offices. Similarly, some older office buildings in secondary locations can in the future pass to other uses such as housing or student accommodation.

4 BUILDING

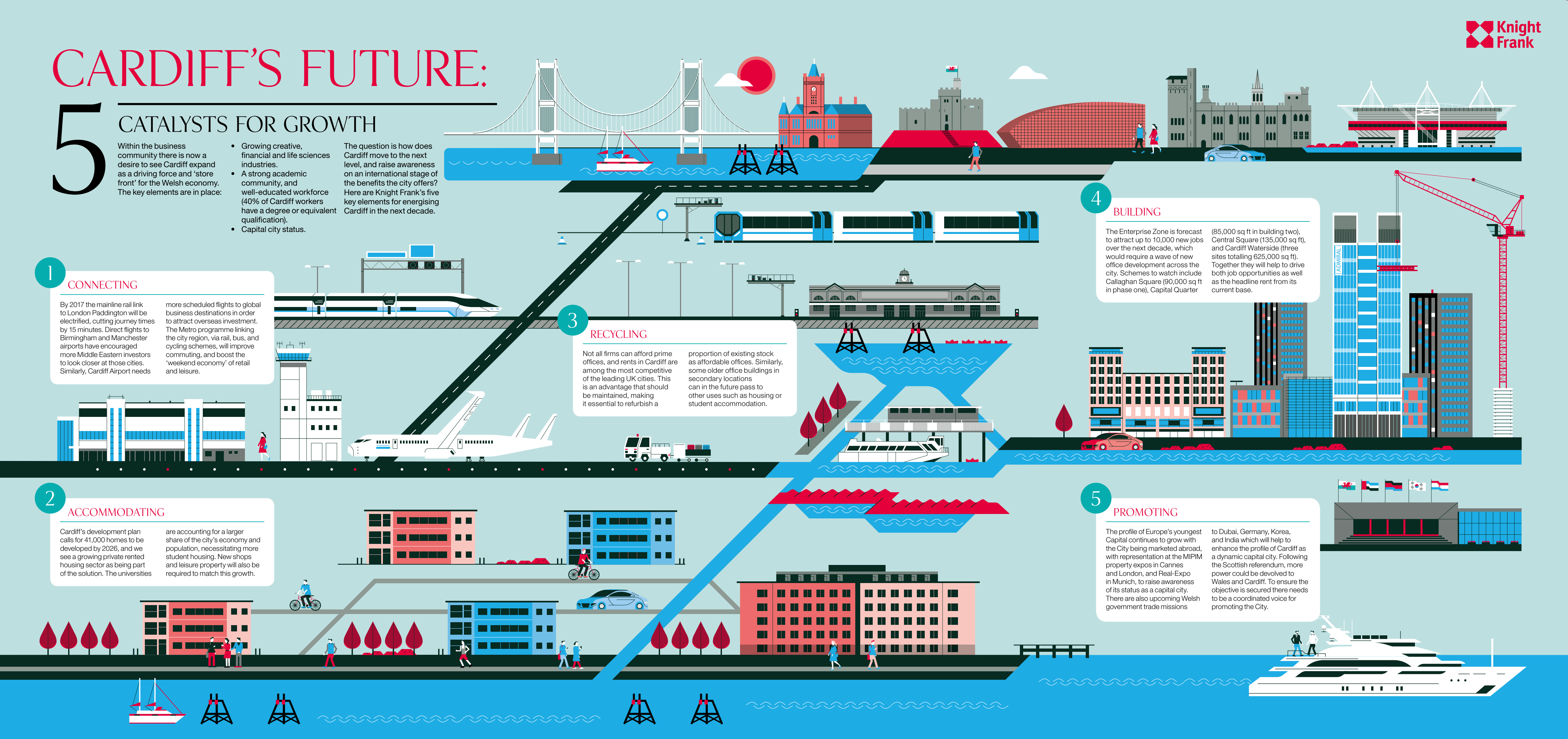
The Enterprise Zone is forecast to attract up to 10,000 new jobs over the next decade, which would require a wave of new office development across the city. Schemes to watch include Callaghan Square (90,000 sq ft in phase one), Capital Quarter

(85,000 sq ft in building two), Central Square (135,000 sq ft), and Cardiff Waterside (three sites totalling 625,000 sq ft). Together they will help to drive both job opportunities as well as the headline rent from its current base.

5 PROMOTING

The profile of Europe's youngest Capital continues to grow with the City being marketed abroad, with representation at the MIPIM property expos in Cannes and London, and Real-Expo in Munich, to raise awareness of its status as a capital city. There are also upcoming Welsh government trade missions

to Dubai, Germany, Korea, and India which will help to enhance the profile of Cardiff as a dynamic capital city. Following the Scottish referendum, more power could be devolved to Wales and Cardiff. To ensure the objective is secured there needs to be a coordinated voice for promoting the City.





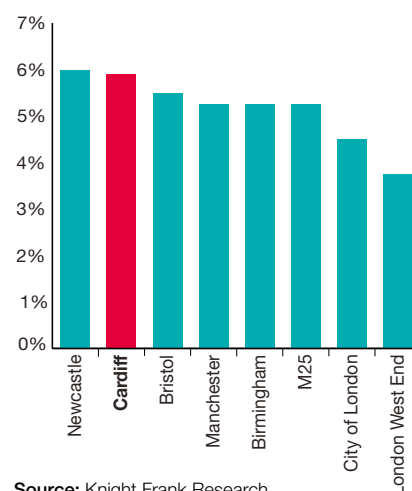
THE INVESTMENT MARKET

Like the rest of the major regional markets we have witnessed a significant improvement in sentiment and appetite for commercial property in Cardiff in the last 12 months. The regional markets are deemed to offer good value compared to the heated Central London and South East markets, and consequently any opportunities that are priced correctly have generated significant interest and fierce bidding.

“In the last 12 months buyers originating from China, USA and Kuwait, have all invested in Cardiff and the region.”

- Cardiff and the region is particularly benefitting from the increased appetite for good secondary investments. Until recently, investor appetite focussed on long-let, good quality office stock in established locations. However, with a lack of available prime stock and the hardening of prime yields, investment demand for established, good quality secondary and shorter income prime stock has increased in the last 6-12 months.
- We are also witnessing a more diverse profile of buyers with an increasing number of overseas investors joining the traditional UK Institutions in targeting the major regional markets. In the last 12 months buyers originating from China, USA and Kuwait, have joined the likes of Legal & General and Fidelity, in buying in the Cardiff City Region.
- While Cardiff has always attracted strong interest, given its status as one of the major regional centres and a capital city in Europe, the rationale for investing here is particularly compelling at present.
- Investors are being increasingly attracted by the infrastructure improvements and the major developments/regeneration projects which are under way. The drive by the public sector to attract more inward occupiers and the attractive demand/supply dynamics will all have a positive impact on the Cardiff Office market.
- Going forward we expect these buoyant market conditions to continue into 2015 although we do expect a temporary reduction in activity in the lead up to the UK general election, which is scheduled for May 2015.
- We expect an increasingly diverse range of buyers to target Cardiff who will be attracted by the relatively high returns on offer and the cities growing profile reflecting opportunities for rental growth.
- As the occupational market improves and headline and net effective rents rise, this will also have a very positive impact on the investment market and enable yields to harden further.

FIGURE 3
Prime yields in UK office markets



Source: Knight Frank Research

2014 (ytd) major investment transactions Cardiff and Region

Building	Price £m	Yield %	Date	Purchaser	Vendor
Admiral Newport	18.40	6.42	Oct-14	W P Carey*	Scarborough
Croescadarn Close, Pentwyn	2.835	12.00	Jul-14	F&C	Undisclosed
Crickhowell House, Cardiff Bay	40.5	5.36	Mar-14	Kuwaiti Family Trust	Aprirose REI*
Wilcox House, Celtic Gateway	8.28	9.05	Feb-14	Chinese Private Investor	LaSalle Investment Management*
Fusion Point, 2 Dumballs Road	11.2	8.57	Jan-14	Fidelity UK REF	Fusion Point Development*
Hodge House, St Mary Street	18.863	9.00	Dec-13	Legal & General Property*	Aberdeen Asset Management

Source: Knight Frank Research

* Indicates Knight Frank represented this party.

KNIGHT FRANK VIEW

We believe Cardiff should assume the role of being the driving force behind delivering a strong and vibrant Welsh Economy.

This requires the City to build on its success in attracting new occupiers and investment, particularly from 'sun rise' industries, like technology, scientific R&D, and creative firms, complementing the traditional financial and business service industries already here. Growth must be supported by public policy at both national and local levels.

To secure this vision, investment into transport connectivity into and around the City, as well as the capital's profile among potential new occupiers and investors, needs to be addressed without delay. Cardiff is increasingly competing on a world stage, and a competitive, world-class City is essential to winning inward investment.

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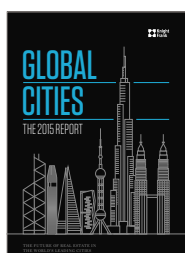
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