

RESEARCH



**CARDIFF
CAERDYDD**
#RWC2015

CARDIFF

OFFICE MARKET
2015

STRONG TENANT DEMAND TO
SUPPORT RENTAL GROWTH

INVESTMENT TURNOVER
TO REACH RECORD LEVEL

NEW DEVELOPMENT
ATTRACTING MAJOR OCCUPIERS



“The key to Cardiff’s future is to address the issues modern day occupiers find most important – people, productivity and vibrant workplaces.”

MATT PHILLIPS
Managing Partner,
Knight Frank Cardiff

INTRODUCTION

Cardiff is a city in demand. As the city evolves further, interest is growing from major investors and occupiers.

As we head toward the end of 2015 it is encouraging to see that Cardiff is again attracting the attention of major occupiers, investors and developers. The decision by Legal & General (L&G) to commit to the Central Square scheme has provided another example of the growing recognition of Cardiff as a UK business centre. The scheme has a projected value of up to £400m, the largest transaction in Wales to date, and will serve to encourage other investors to consider the Welsh capital.

It is worth noting that the drivers behind a number of major developments in Cardiff are locally based businesses such as L&G’s partner, Rightacres Property Company and J R Smart. These family owned companies are putting together development strategies which are now attracting major inward investment into the city.

It is through supporting these and other developers that the appeal of Cardiff will align to needs of modern occupiers and a growth path will be secured.

On a city level, this means engaging the principles of place-making. Development schemes should not be considered as a singular, standalone project, but as contributing to a wider programme of

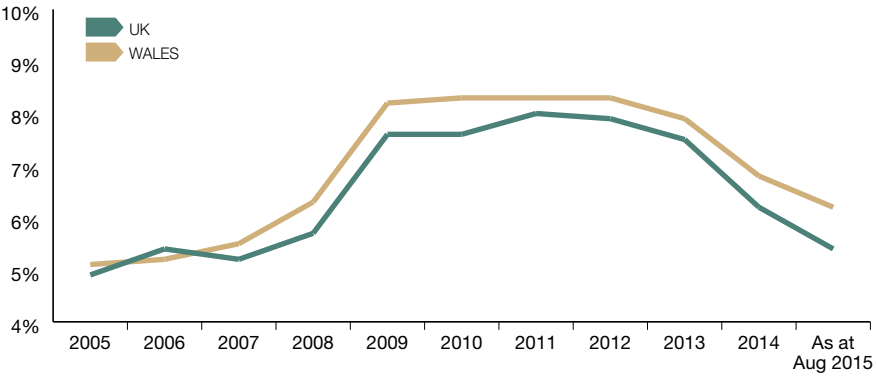
city improvement. Occupiers no longer consider real estate in isolation of its surroundings. Connectivity, amenity and culture are now strong ‘pull factors’ in the location choice of occupiers.

Equally, a vibrant, amenity rich and flexible workplace is viewed as an integral tool in achieving cost and productivity improvements – a key aim for occupiers. A modern workspace is supportive of a myriad of working styles that embrace technology and encourage collaborative working and creativity. This needs to be recognised and reflected in new development.

Fundamentally, property is an extension of a firm’s brand and culture. In this, it supports the ability of the occupier to not only win new business, but also attract and retain staff.

In Cardiff, the latter point is particularly relevant. Too often, the ‘home grown talent’ cultivated in the leading universities has left the region in pursuit of career opportunities. In addressing the limitations to progress - transport connectivity, restrictive planning, and limited employment opportunities - the civil authorities, with the support of modern development, will be positioning Cardiff for the next stage in its growth.

FIGURE 1
Unemployment rate in Wales



Source: Office for National Statistics

OCCUPATIONAL MARKET

Following the high level of take-up in 2014, strong occupier interest in Cardiff has continued throughout 2015. As new buildings come to the market, tenant interest is expected to increase which will support rental growth.

Take-up and demand

Total take-up in 2015 (up to end of Q3) has amounted to 303,002 sq ft, 24% less than at the same point last year. Letting activity has been constrained by the low availability of Grade A stock, which fell by 46% during 2014. However, the level of new active requirements remains strong at 301,000 sq ft, 9% above the 5-year average, meaning that take-up should increase.

Key transactions

The largest deal in 2015 was at Number 2 Capital Quarter where Public Health Wales agreed terms on 51,652 sq ft. The move will enable consolidation of several existing offices into the city centre.

In Q2, professional services firm Deloitte leased 40,821 sq ft at Six Park Street. The building is situated close to the developing business district and major transport links.

The AA leased 15,720 sq ft of newly refurbished space at Capital Tower, the Welsh capital’s tallest office building at 24 storeys. The motoring organisation has committed to a 10 year lease with the new space split over three floors.

Network Rail and Parsons Brinckerhoff both took space at the Welsh Government’s Number 1 Capital Quarter leasing 9,744 sq ft and 13,079 sq ft, respectively. Both have committed to a 10 year lease at a rent of £18.95 per sq ft.

Availability

Grade A availability increased by 7% in 2015 to reach 107,000 sq ft at the end of Q3. Despite the rise, availability remains significantly below (31%) the 5-year average of 156,000 sq ft. Grade A availability in the city centre remains particularly tight with only 6,250 sq ft at Number 1 Capital Quarter and 21,851 sq ft in 2 Callaghan Square being marketed.

The development pipeline, however, is strong with 254,000 sq ft currently under construction, 23% above the 5-year average. Schemes led by local developers account for the majority of activity, with the Rightacres scheme at 1 Central Square (135,000 sq ft) and JR Smart’s Number 2 Capital Quarter (85,000 sq ft) most noteworthy. Both schemes are receiving significant occupier interest, with law firm Blake Morgan already committing to 28,000 sq ft at Central Square and Public Health Wales taking 51,652 sq ft at Capital Quarter. These buildings are scheduled for completion early in 2016.

Headline rents

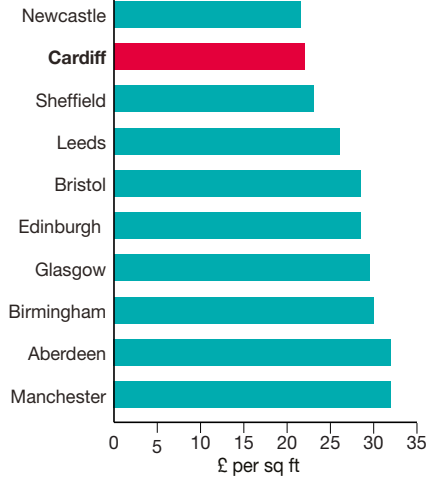
As at Q3 2015, prime headline rents remained at £22.00 per sq ft. However, as new quality stock comes to market, prime rents are expected to increase. Current forecasts indicate that prime rents will rise to £23 by the end of 2015 and £24 by the end of next year.

2015 (ytd) major leasing transactions

Building	Tenant	Sq ft	Rent	Date	Grade
Number 1 Capital Quarter	Parsons Brinckerhoff	13,079	£18.95	Q1	A
Capital Tower	AA	15,720	£12.50	Q2	B
Number 1 Capital Quarter	Network Rail	9,744	£18.95	Q2	A
Six Park Street	Deloitte	40,821	£12.00	Q2	B
Number 2 Capital Quarter	Public Health Wales	51,652	£18.95	Q4	A

“Prime rents are forecast to rise to £24 per sq ft in 2016.”

FIGURE 2
Prime rents in regional city centres



Source: Knight Frank Research

SECURING OCCUPIERS IN CARDIFF

Having a compelling rationale that links people, productivity and a vibrant sense of place is the key to attracting occupiers and further enhancing the competitive position of Cardiff as a business location.

1 LOCATION

Occupiers invest in a location. They are seeking cohesive, vibrant, dynamic and fun places to do business as this chimes with the needs of their staff. The city and the immediate surrounds of the office need to be amenity rich, have strong cultural appeal and be well connected to the rest of the city and beyond.

Wales is making a compelling case. More than 101 inward investment projects were secured in Wales during 2014/15 – 5% of the UK total and the strongest volume since the 1970s – creating or safeguarding circa 10,000 jobs.

2 WORKPLACE

A sense of place is an important attribute of a successful office building. Occupiers are seeking flexible workplaces that accommodate a range of working styles; allow people to collaborate; and which embody brand values and corporate culture. This has led to the growing popularity of Activity Based Working (ABW). The quality of the workplace, its amenity provision and connection to the outside are all crucial.

3 PEOPLE

An office occupiers primary cost and #1 source of competitive advantage are its people. Real estate and locational choice needs to emphasise the quality, quantity and cost profile of the local labour market.

Cardiff has a working age population of 240,000 people. 51% of those economically active are classified as being in high skilled occupations with 46% of the workforce educated to NVQ4 level or above.

4 PRODUCTIVITY

Modern occupiers recognise that real estate is more than a factor of production. It is an essential facilitator of productivity, creativity and efficiency. Occupiers are seeking vibrant, technology enabled workplaces that support collaboration and creativity. Productivity gains, though difficult to measure are key.

The CEO wants real estate to align to the wider business strategy and objectives.

The CFO wants real estate to represent a strong return on investment.

The HR director wants real estate to help win the war for talent and reduce exposure to expensive staff churn.

Staff want real estate to represent a more engaging, effective, social and satisfying workplace, although their precise needs will vary according to demography and job type.

CARDIFF OFFICE MARKET 2015

RESEARCH



OCCUPIER DECISION MAKING

Promotion of a real estate solution needs to be tailored to the specific interests of the variety of individuals influencing the occupiers real estate decision;

CEO

£
CFO

HR

Staff

Director



Two Capital Quarter

CAPITAL MARKETS

Investor appetite for good quality regional stock continues to strengthen. A combination of relative value against the South East and a recovering occupational market has resulted in yield compression for both prime and good secondary office investments.

Investor appetite for regional opportunities has grown considerably in 2015, with investment outside of London up to Q3 reaching the highest total for the period (Q1-Q3) since 2007. Activity in Cardiff has grown in unison, although a lack of prime stock has limited transactions. As at Q3, investment volumes for the year amounted to £61m, on par with the 5-year average. With the Central Square acquisition by Legal & General due to complete in Q4, total investment in 2015 is expected to reach the highest annual total for the city on record.

The commitment from Legal & General to the Central Square regeneration scheme reflects improving confidence in Cardiff as a centre of growth and opportunity. The scheme will have a potential capital value in the order of £400 million when fully completed. The first phase of office development is expected to complete in Q1 2016 with BBC Wales relocating to Central Square by 2019.

The Central Square success is the latest example of where significant progress on regeneration projects across the city has attracted the attention of major investors. This follows on from the regeneration of Callaghan Square which was developed by MEPC and subsequently sold to National Grid, Credit Sussie and Capital Trust.

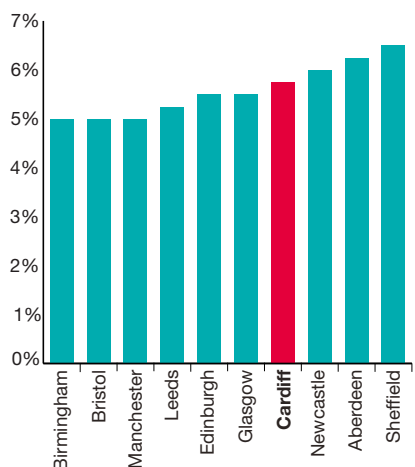
AVIVA's continued investment in Cardiff Waterside also provides another good example. As further opportunities become viable, these, alongside planned infrastructure improvement, will fuel further inward investment. For example, we expect to see strong interest for both No 1 and No 2 Capital Quarter when they come to market.

In 2015, the range of potential buyers for assets in Cardiff has grown with the sale of Belmont House in June providing a good example. The mixed use building, which sold for £34.6m, attracted fierce bidding from UK pension funds, opportunity funds as well as overseas investors. Overseas buyers, attracted by the relative safety of investment in the UK without the Central London price tag, are increasingly competing with domestic buyers for assets in major regional centres. This added demand is leading to price inflation in some cases.

Prime yields have moved in by 15bps in 2015 to 5.75%. Significantly, this is the lowest level since 2007 although still above the market peak of 5.00%. While demand from UK institutions is expected to become more selective, the significant weight of overseas equity targeting the regions will maintain pressure on yields. Therefore, prime yields are forecast to remain below 6% into 2016.

“The case for investing in Cardiff has become more compelling due to strengthening tenant demand and yield differential to neighbouring markets.”

FIGURE 3
Prime yields in UK office markets



Source: Knight Frank Research

2015 (YTD) Major Investment transaction in Cardiff and the Region

Building	Price £m	Yield %	Date	Purchaser	Vendor
Central Square, Cardiff	£400m	n/a	Nov 15	Legal & General	Rightacres
Belmont House, Cardiff	£34.6m	6.08%	Jun 15	Lancashire County Council Pension Fund	Legal & General
Global Reach, Cardiff	£6.84m	8.41%	Jun 15	Stainton International JV	Joint Administrator

Source: Knight Frank Research

KNIGHT FRANK VIEW

Vibrant, amenity rich and well-connected workplaces are the key to Cardiff's further progression as a business location.

To ensure that Cardiff attracts further inward investment and captures the attention of occupiers from growth sectors, the city must offer the right blend of workplace options, infrastructure and amenity. Achieving this will require a strengthening of connectivity both into and around the city. Development of new modern commercial space will follow.

Modern occupiers are seeking talent. The universities will therefore form a

critical element to the future of the city. Cardiff needs to do better at nurturing this important resource and ensuring that career paths are in place to retain 'home grown' talent within the region.

Cardiff is now increasingly recognised as a business location on the world stage. Only through building on the strong foundations already in place will the city continue to progress and secure the investment required for further growth.

“Cardiff is firmly established as major UK city capable of competing on the world stage.”



Central Square

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