2013: LOOKING AHEAD, LOOKING UP

Andrew Meikle, the new head of investment at BNP Paribas Real Estate’s Birmingham office, comments on what the year ahead may hold for the region’s commercial property market:

“Having spent more than 15 years working within commercial property, I have investment, development consultancy and agency experience across the region, with a focus on the office and industrial sectors.

Within my new position at BNP Paribas Real Estate, I am responsible for the capital markets business across the Midlands, situated in the Birmingham office. The company itself has a dominant market share in the French and German real estate markets, both of whom are significant investors in the Midlands - so I will be working closely with such clients to promote further investment.

Office market – a mixed picture

Last year, the overall Birmingham office market disappointed in terms of investment volumes, with only £130m of transactions compared to £340m in 2011. However, the market is very much divided, as the city centre continues to struggle, the prime out-of-town market showed positive investment activity last year, principally due to pricing moving out significantly.

Inevitably the lack of occupier activity has impacted the city’s availability level. The market remains oversupplied in poorer second hand space, with those landlords in possession of long-term vacant office buildings continuing to review alternative uses. There is still limited prime vacant stock available in areas where the majority of demand is focused, namely on Colmore Row, Brindley Place and Snow Hill.

Unfortunately, we have also seen good quality assets, such as Baskerville House which is let to strong covenants, affected too. This is caused by the nature of the relatively short unexpired leases and the limited availability of debt. After nearly 18 months on the market, this landmark building is understood to be currently under offer at approximately 20% less than the original quoting price.
Recent buyers of prime offices have mainly been from overseas, typically seeking defensive assets that will provide steady modest returns on their capital where leveraging debt is viable. Overseas investors for prime offices tend to emanate from Germany, although this has reduced dramatically, Israel and to a lesser extent the Middle East. Sadly, with a few exceptions, UK institutions have a reduced appetite for larger prime offices typically more than £30m in value.

This year, we expect investors to continue to adopt a targeted strategy, focussing on high quality office stock with secure tenants or buildings with development potential/asset management opportunities in prime locations – all of which are in short supply in Birmingham.

Secondary office activity is expected to remain subdued, as increasing concerns over the occupational market, combined with a lack of lending from the banking sector, continues to detrimentally impact this market. Pricing for secondary assets outside of London has moved out significantly due to the weak economy.

In comparison to Manchester, Birmingham’s nearest true competitor, prime offices are trading at 0.5% net initial yield sharper than Birmingham, due largely to the perception that the city is 12 - 18 months ahead in terms of the under supply of vacant stock. It is only a matter of time until this trend moves to Birmingham.

**Industrial shortage**

The Midlands remains one of the UK’s core logistics regions, accounting for 14% of the stock available on the market, which equates to 20.4 million sq ft. However, the level of new logistics units available on the market continues to decrease across the UK and the Midlands is no exception, as there is currently only one year’s worth of new supply available.

On a more positive note, the distribution sector, while clearly impacted by the poor trading on the high street, has been buoyed by several factors, including this drastic under supply of grade A distribution space across the Midlands and a growing demand from online retailers – for example, Amazon has recently secured big units in Widnes, Rugeley and Dumfermline.

This sector is considered more defensive than most and therefore yields have remained steady overall. Encouragingly, logistics rental values fell almost in all regions except the East and West Midlands where values were slightly positive. Interestingly, vacant core prime property is now achieving headline quoting figures, something that has not occurred for a while.

Within the last 24 months, major UK and overseas investors have started acquiring good quality distribution units with short unexpired lease terms due to their confidence in the reletting/regearing
market. A recent example is at Logix Park, where Cabot, a US Pension Fund, acquired a 275,000 sq ft unit, in stiff competition with others. Pricing for these assets has moved with a net initial yield of 0.75% sharper than two years ago.

Moving forward, demand for modern multi-let industrial stock, which is situated close to motorway junctions will remain strong for the foreseeable future. Promisingly, a range of different investors continue to compete for the multi-let market including funds, private equity investors and property companies. This demand, coupled with a lack of speculative stock, will drive significantly more forward funding transactions for 2013.

**Looking up**

As we move further into 2013, the limited supply of grade A investment stock in Birmingham will see the office market typified by more secondary stock becoming available. With pricing moving out to a point where good quality secondary investments looks comparatively cheap - this will create a unique opportunity to invest and I suspect investment demand for such assets will grow accordingly. However, poor quality secondary offices will continue to deteriorate.

Within the logistics market, the challenge for occupiers is whether they can commit to longer leases. However, due to undersupply, longer leases will likely remerge, enabling further speculative and pre-let developments across the region.

Overall, UK growth is expected by the Government and we are all hoping for a more positive year – but it would be naive to think that it won’t still be a challenging market to operate within. Investors will continue to look carefully at their current assets and future acquisitions, whilst tenants will continue to postpone moves/expansions or where possible, downsize.”

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