

Sheffield central area activity report

Spring 2007

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St Paul's Place

Executive summary

- Mixed-used schemes have finally come of age in Sheffield with a number of significant long-term developments now underway, continuing the transformation of the city centre.
- The office market has reacted to the shortage of Grade A supply with 460,000 sq ft currently under construction, demonstrating considerable faith in the city. In early 2007, prime office rents are expected to break through the £20.00 per sq ft barrier.
- Investor appetite for Sheffield office product has never been stronger, driven in part by proven rental growth, major infrastructure improvements and a continuing supply of high quality buildings. As a result, yields compressed by 75bps during the course of 2006 to reach a prime yield of 5.0%.
- The city living market has also strengthened, with a number of high profile developers announcing their arrival with high quality landmark schemes, such as the City Lofts scheme which will form part of St Paul's Square.



Proposed office development at Holly Street

Offices

Sheffield is the principal commercial centre in South Yorkshire with an office stock of over six million sq ft. Having successfully diversified its economy and developed further the importance of financial and business services within the city, the current structure of employment is now similar to the national profile. The focus of current office market activity is largely centred within and around the Inner Ring Road. The largest transaction of 2006 was a pre-let to the Home Office of 120,000 sq ft at Riverside Exchange, while around 340,000 sq ft of speculatively built space is currently under construction. In the heart of the city centre, the CTP St James development at St Paul's Place has set a new benchmark in terms of quality and values and this has had an uplifting effect on the market as a whole. Sheffield's office market has received a number of accolades, such as being voted the number one location for Contact Centres amongst Tier 1 cities in the UK in 2005. In addition, IPD figures demonstrate that, in terms of overall investment performance, the city's office sector averaged returns of 15.9% p.a. over the past 5 years, outperforming all other key regional centres.

In relation to competing centres, it is still considered to be good value with the added advantage of a highly developed public transport system, two excellent universities, extremely good labour market demographics and quality of life advantages.

The strategy of using public funds to improve the quality of the offer and therefore raise values and improve viability has proved effective. The St Paul's Place scheme has set an example which other developers have sought to match and top specification buildings are now being delivered.

Demand

Demand in the CBD has continued to outstrip supply and sectorally is still dominated by business services and public sector organisations. Take-up in 2005 was a very disappointing 84,600 sq ft, compared to a long-term average of around 215,000 sq ft, which was a reflection of the limited supply of quality accommodation in the city centre. When good quality buildings have come to the market they have generally let relatively easily, as was evident in 2006 when Grade A space dominated take-up. The release of new space to the market resulted in 2006 reflecting a return to form, with take-up totalling 224,300 sq ft, albeit that this comprised only eight transactions of over 5,000 sq ft and was dominated by the significant pre-let to the Home Office. This continues a trend of larger deals dominating city centre take-up, as reflected by the average transaction size over the last 5 years of 21,650 sq ft within the CBD, compared to the out-of-town average of 11,000 sq ft. Out-of-town take-up accounted for another 94,520 sq ft giving a combined total of 318,865 sq ft.

Since 2000, while there has been some expansion in the market, the primary motivation for take-up has been relocations within the city, suggesting that companies based in Sheffield have remained loyal and have been investing in upgrading their accommodation. In the past five years, 32% of take-up has been as a result of expansion, 56% has been due to relocation and a further 11% a combination of both.

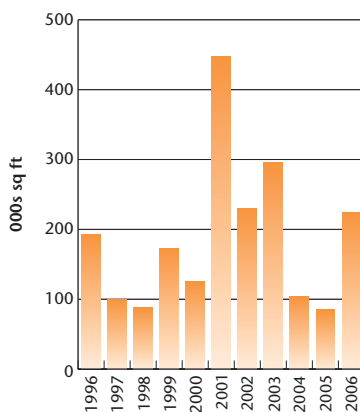
The highest office rent set in the city centre during 2006 was £18.50 per sq ft at No. 1 St Paul's Place on a suite of approximately 13,000 sq ft let to RBS. It is expected that, in early 2007, £20.00 per sq ft will be achieved on the second phase of the same scheme.

Supply

At the start of 2007 there is virtually no Grade A office stock available within the city centre but a number of notable completions are expected by the middle of this year. Around 460,000 sq ft of space is currently under construction, of which circa 340,000 sq ft will be available in schemes such as Priority Sites' North Bank on Blonk Street, Carillion's No. 1 The Square and Velocity Estates' Velocity Two and Three. There is also a number of further identifiable schemes likely to commence in the next 12 months which in combination would bring forward an additional 300,000 sq ft, and collectively this new supply will equate to approximately 3.5 years' worth of demand. The shortage of accommodation which created this spate of development has filtered through to rents, which recorded a rise of more than 40% over the last four years, the highest increase of any of the UK's key regional office markets. In addition, there has been considerable yield compression and both indicators reinforce the increasing profile of the city and its improvement in performance during the last four years.

“Around 460,000 sq ft of space is currently under construction, circa 340,000 sq ft of which is speculative and seeking tenants.”

Figure 1
Sheffield city centre annual office take-up



Source: Knight Frank



The Home Office pre-let 120,000 sq ft at Riverside Exchange

Current enquiry levels indicate that a short-term oversupply is possible but, to establish itself as a mature office market, the city has for some time needed to offer occupiers a depth of choice, the historic lack of which has been suspected of holding back economic growth in the city, and the current development pipeline should address this.

Looking to the longer term, the completion of the Inner Relief Road provides some excellent office development opportunities and improvements in the civic realm have helped to link these sites with the central core. In addition, the lack of refurbishment activity has put undue pressure on the new development pipeline, with many old and unsuitable buildings being converted into residential schemes.

Investment

Investor appetite for good quality office product in Sheffield has never been stronger. This has in part been driven by proven rental growth, major infrastructure improvements and a continuing supply of high quality buildings as regeneration gathers pace, with a number of schemes being completed in 2007. These will provide the city with the high quality of accommodation demanded by modern occupiers. However, while the market waits for the completion of these schemes, few major investment transactions have occurred on existing buildings during 2006. Instead, investors have sought to acquire the best schemes prior to or during construction.

The main two areas of investment activity continue to be at the Heart of the City and Riverside Exchange schemes. The new 120,000 sq ft Home Office building at Riverside Exchange is currently under offer at a yield of sub 5%. The building is currently under construction and has been pre-let to the Home Office for a minimum term of 15 years at a rent of £16.00 per sq ft. The strength of investor demand is highlighted by Building No 2 St Paul's Place, a Grade A office building comprising approximately 75,000 sq ft, which is currently attracting a great deal of interest from potential investors.

In terms of the secondary office market, rents are between £14.00 and £16.00 per sq ft with yields around 6.0%. As an example, Norwich Union House, located on Pomona Street just outside the central ring road, sold during 2006 for £44m (net, SPB sale). The sale of the 131,614 sq ft office building reflected an initial yield of 6.1%. The property is let to Norwich Union Life & Pensions Limited with an unexpired term of 23 years.

Outlook

Sheffield has improved its profile as a decentralised office location and both rent and yield differentials with other key centres are rapidly disappearing, indicating that long-term investors see a future in the city and view it as offering growth potential. The challenge will be to manage the process moving forward, avoiding over-supply and ensuring that there is a clear differentiation of product and that the improvement in the quality of new product continues. Citywide office employment is forecast to increase by over 6,000 new jobs (excluding churn) over the next 10 years, driven by the continued expansion of the financial and business services sector. This growth in new office jobs indicates an additional requirement of around 1.3 million sq ft. With the addition of churn, as has been seen recently with the trend in local businesses upgrading their accommodation, office take-up citywide should remain steady at circa 300,000 sq ft p.a. The main strategic sites should benefit greatly from this.

With the central core being extremely constrained in terms of site availability, development is likely to be funnelled towards The Moor and the Inner Ring Road where sites are potentially more plentiful. Much of the existing stock of accommodation is not suitable for refurbishment and is being absorbed by the residential sector, which further highlights the importance of the role of new development.

The investment in Sheffield by the regeneration agencies has had a significant positive impact on the city's office supply and, as predicted in previous reports, investors who have entered the market have made significant gains. Sheffield's primary strength has been its competitive rent levels and labour demographics, underpinned by the city's two central universities. This has now been enhanced by a dynamic office development sector which has grown in response to public sector initiatives.

“Prime yields are at 5.0%, reflecting an inward yield shift of 100 basis points in the last 12 months alone.”

Look out for

- Completions at Riverside Exchange, North Bank, Wards Exchange, The Square and Velocity.
- Starts at Holly Street, St Paul's Place, Arundel Gate and the Digital Campus.
- Rents of £20.00 per sq ft being achieved.



New lettings have occurred at Carmel House

Retail

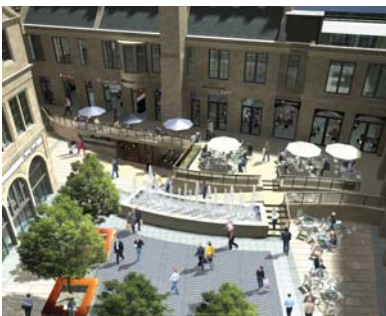
Hammerson and Sheffield City Council have recently signed the development agreement and lease for the £500m new Retail Quarter (NRQ). The scheme will comprise more than 100 stores, creating circa 860,000 sq ft of prime retail floorspace and taking in the existing Grosvenor House Hotel, John Lewis store and the Fire Service headquarters. In addition to this, RREEF (Deutsche Bank) have continued with their plans to redevelop The Moor scheme, which will house a new Sheffield Market and provide further retail space, above which will be offices, residential, hotels and student accommodation.

The development agreement recently signed by Hammerson defines timescales, standards of design and the quality of the proposed scheme between Barkers Pool, Moor Head and Pinstone Street. Enabling works are already underway to shift underground cables and pipes in preparation for the construction of Phase 1, which will start in early 2008. The new John Lewis store, which will anchor the scheme, is going partly on the site of the existing Wellington Street Fire Service headquarters, with the new headquarters and station being developed on a site at Eyre Street. The whole NRQ project is due to be completed by 2012.

The mixed use regeneration scheme will also include 300 apartments, 2200 car parking spaces and a transport interchange. It is the biggest private investment in Sheffield since Meadowhall, and one that is aimed at establishing Sheffield city centre as a top 10 retail destination.

In terms of other retail activity, rental growth has occurred on Fargate and prime rents are in excess of £250 per sq ft Zone A. New lettings have occurred at Carmel House to HSBC, 3G, H&M and Foot Locker, while River Island has taken 20,000 sq ft at Orchard Square.

The Carmel House redevelopment has recently been put to the market as an investment and is rumoured to be under offer at a purchase price of over £30m, representing an initial yield close to 4%.



Leopold Square is nearing completion

Leisure

The leisure market has continued to develop in line with the regeneration of the city centre.

A new leisure location at Heart of the City has now opened and tenants include Café Rouge, Café Nero and Piccolino. Rents at Heart of the City are approximately £18.00 per sq ft. There is further A3 space available in Phases 2 and 3 of St Paul's Place and also within the new City Lofts skyscraper which is currently under construction.

Leopold Square, the stunning redevelopment of the former Education Offices, is nearing completion and already named tenants include Zizzi, Popolo and Platillos (Wig & Pen) with further occupiers expected to be confirmed shortly.

The scheme also includes a 90 bedroom boutique hotel operated by Dublin-based PREM Group, and aims to boost the quality of leisure offer in the city centre to meet growing demand for business lunches and early evening dining. With the city living population steadily growing, we anticipate demand from occupiers will similarly increase. The scheme is due for completion in Spring 2007.

Look out for

- The opening of the new Leopold Square leisure quarter.
- Further new additions to the city's leisure offer from independent restaurants and coffee shops.
- The redevelopment of The Moor to create new retail units.



Number 2 North Bank, developed by Artisan

City Living Demand

Investors currently comprise 65% of new home purchasers in the city centre, although this can vary depending on the development and unit type. Investment purchases are dominated by the individual investor who is increasingly seeking medium and long-term investments. Owner occupier purchasers generally lie within the 30-39 year age group and are often single or unmarried couples. One bedroom apartments at approximately £125,000 are currently witnessing the strongest demand.

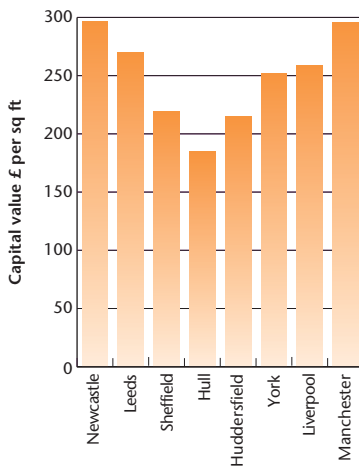
Supply

City living is a concept that arrived relatively recently in Sheffield and until recently there has been limited new supply. However, since 2000 the city centre has seen 2,600 units completed with a significant number consented and still to come through in a range of high profile schemes.

Sheffield City Council’s Affordable Housing Policy came into force in July 2006 establishing a 20% threshold for all new schemes. The viability of a number of schemes still awaiting planning may now be called into question, as developers may struggle to incorporate the new regulations.

To date a large part of the new homes market in Sheffield has been dominated by standard units with few distinguishing features. The St Paul’s scheme, currently under construction, is anticipated to alter this pattern of development by bringing 316 high specification Conran designed apartments to the market. Other high profile schemes currently under construction in the city centre include No. 2 North Bank, Velocity and Phase II of Wards Exchange.

Figure 2
Residential development index



Source: Knight Frank

Pricing

The majority of activity in Sheffield city centre at present is in the £150,000 to £200,000 band. Prices around £275 per sq ft have been achieved in the best schemes for the smallest units. Apartments within schemes of the highest specification have broken the £300,000 barrier. In the main, however, two bedroom apartments are achieving £165,000 and one bedrooms in excess of £110,000 within the medium quality schemes, which represent the majority of the market to date.

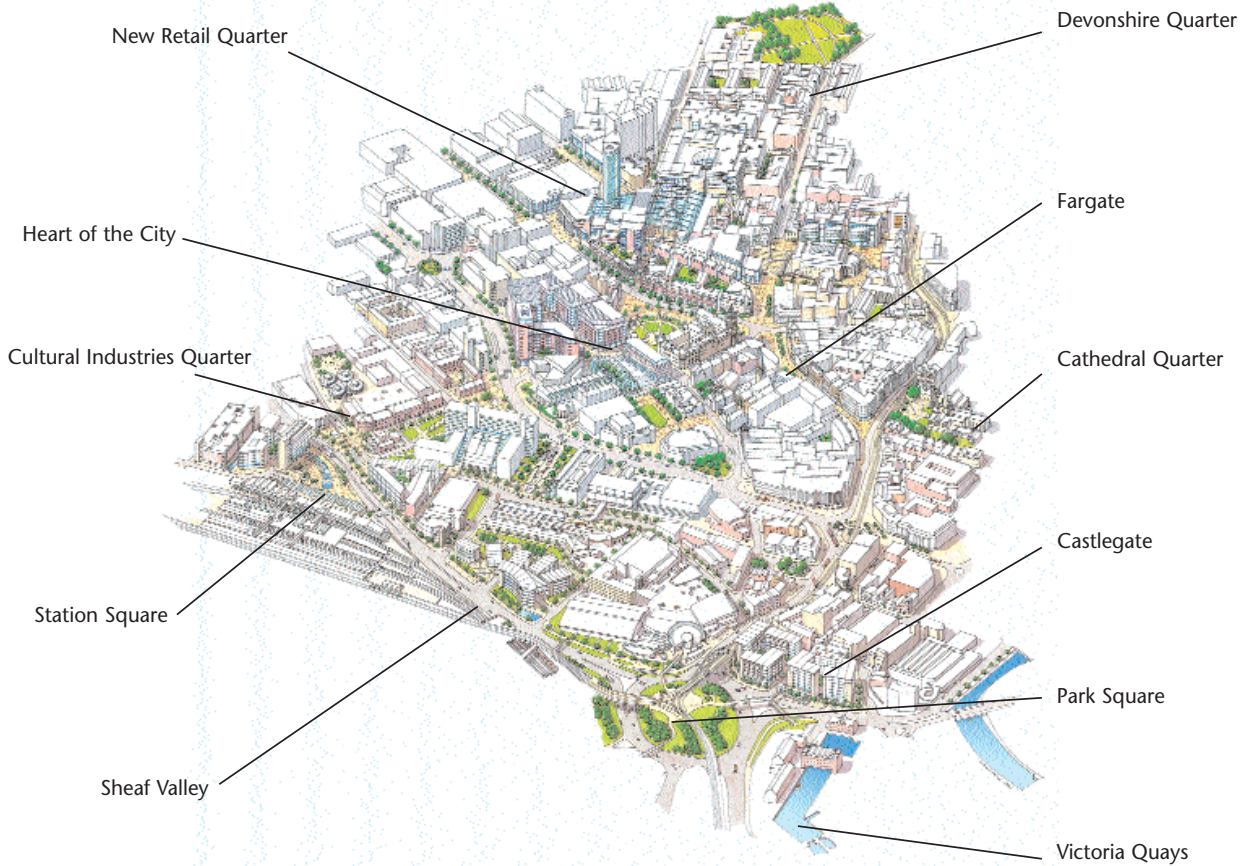
Affordability

Using a basic formula of average property price divided by average full time income, Sheffield records an affordability ratio of 5.3 making it the second most affordable major northern city after Liverpool. According to the Land Registry and ONS, average house prices and wages have broadly risen in tandem - both by 115% since 2000. The trend for key workers in the area, however, has not been as positive.

Overview

In Sheffield a comparatively low development pipeline relative to the larger northern cities, combined with average household growth, results in a healthy supply/demand indicator, the second best after Newcastle. This indicator would change considerably, however, if the current backlog of planning submissions were to be granted by the City Council.

Although the wider region of South Yorkshire has a low employment growth forecast (0.4% by 2009), Sheffield is expected to experience stronger growth. The city’s relatively good supply of affordable homes, the radical overhaul of its civic areas (due to the implementation of the Sheffield One Masterplan) and the expansion of its two universities are likely to increase company relocations and boost employment levels in the city.



Research

Claire Higgins Partner
 +44 (0) 207 861 1246
 claire.higgins@knightfrank.com

Agency and Development

Stephen Hodgson Partner
 +44 (0) 114 241 3907
 stephen.hodgson@knightfrank.com

Peter Whiteley Partner
 +44 (0) 114 241 3903
 peter.whiteley@knightfrank.com

Investment

Henrie Westlake Partner
 +44 (0) 113 297 2413
 henrie.westlake@knightfrank.com

James Bruce Associate
 +44 (0) 114 241 3909
 james.bruce@knightfrank.com

Retail and Leisure

Simon Hawkins Partner
 +44 (0) 113 246 1533
 simon.hawkins@knightfrank.com

Mark Rothery Associate
 +44 (0) 113 297 2449
 mark.rothery@knightfrank.com

Residential Development

Tearle Phelan Associate
 +44 (0) 114 241 3913
 tearle.phelan@knightfrank.com

Professional

Jeremy Wilson Partner
 +44 (0) 114 241 3908
 jeremy.wilson@knightfrank.com

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