

Spotlight | 2017

Manchester: Where are the gaps?



Summary Manchester needs more development across all property sectors. Opportunities are strong for developers that can deliver stock into the mainstream market.

■ **Strong demand and low supply of Grade A offices is starting to drive up Grade B rents.** Looking forward we see this driving demand for serviced offices, light touch refurbishments, and fringe locations.
Pages 3-4

■ **Logistics occupiers will get more creative in their hunt for small-scale distribution locations,** taking space in office basements and off-pitch retail units.
Page 5

■ **Hotel supply in Manchester looks strong, bringing it in line with demand.** If the full 2018-20 pipeline is delivered it will increase total hotel supply by 20%.
Page 5

■ **Manchester's housing supply has accelerated dramatically, but it still doesn't meet need.** There are lots of opportunities in the mid-market.
Pages 6-7

■ **Manchester's planning environment is becoming more open to student housing.** Students moving to these schemes could free up affordably priced family homes.
Page 7

An ambitious Northern stronghold

Commercial and residential property supply must diversify to meet growing demand

It's an exciting time for Manchester. Seemingly immune to the destabilising influence of Brexit negotiations, property demand from Mancunian businesses and residents has grown steadily and looks set to continue on that trajectory. Manchester's ambition and strong economic outlook were some of the key drivers behind the North West's strength in our house price forecasts, and investment in HS2 will drive growth in the longer term.

If it is to meet that property demand and retain its competitiveness, Manchester needs to develop more property across all use classes. Here, we consider those uses nearest the top of the local agenda: residential, offices, hotels, and logistics, focusing on the city centre within and around the inner ring road.

Gaps in the market

Manchester's residential pipeline may be large, but it's not scary – the 7,000 homes identified under construction in the city centre make up just over two years of the city's need. Those schemes are also being targeted at a range of occupiers, from owner occupiers to young renters to students, which will help the market to absorb this accelerated level of supply. However, we do see potential risk in the concentration of new supply at higher price points, where the depth of resident demand is shallow. Developers may find their homes slow to sell or let if they keep competing to drive the biggest premium.

Demand for Grade A office stock in Manchester is so high that it's spilling into secondary stock, pushing up rental values there. We are

also seeing lower grade office stock eroded by conversion to other uses, leaving affordable office supply as thin as the graphene Manchester invented. This means that while 71% of office demand in Manchester is for stock below £25/sq ft, just 59% of available supply is at this price point. Serviced offices and "light-touch" refurbishment will help bring in more affordably priced stock in the short term. Longer term, we expect to see the core office market expand into areas previously seen as fringe.

Hotel development in Manchester and Salford is finally starting to meet supply, and the pipeline looks strong for the decade ahead – if all the beds in the pipeline are completed, that will equate to a 20% increase in supply by 2020. With supply and demand in balance, we expect revenue per available room to grow less quickly. This will give hotel operators less wriggle room in their margins.

Need for speed

Next day delivery is so last year. The trend now is for consumers to demand ever shorter delivery times, with some companies offering one hour delivery to the customer's door. With speed and ease of delivery the new battleground for retailers, demand for urban logistics space will be sure to increase.

Small, edge of town industrial units are growing more attractive to both occupiers and investors, but competition with industrial to residential developers may squeeze supply. With that, expect to see retailers and distributors becoming more adventurous in their choice of space. ■



The race for office space

The development pipeline will satisfy the demand for Grade A, but what about other needs?

Manchester's office market has been on a roll in recent years, with 2017 likely to be the fourth consecutive year of more than one million square feet of take-up. This has been driven by a combination of factors, including strong indigenous demand, an economy that is weighted towards growth industries, and a good track record in attracting footloose national requirements.

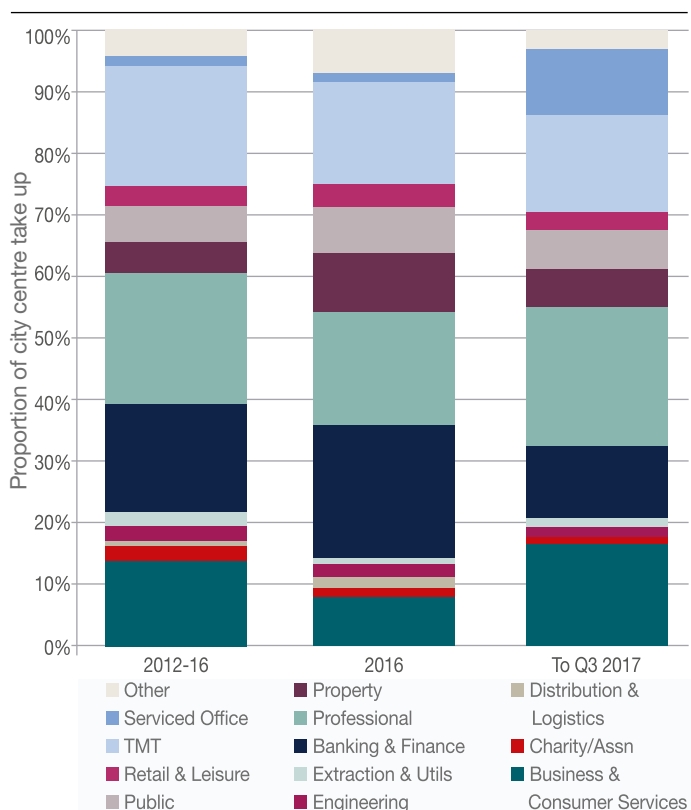
Looking purely at the macro-economic drivers of office demand the prospects for the next decade are equally strong, with the average annual growth in office-based employment for Manchester and Salford projected to be 1.7% per annum (compared to 1.4%pa over the last decade). This equates to a 34,123 rise in the number of office-based jobs, and a gross increase in office occupation of at least 2.9m sq ft.

According to Oxford Economics the areas that will see the largest growth are the Professional, Scientific & Technology and Administrative & Support sectors. Growth in these industries implies more need for mid-priced Grade A office space in the city, though the slowing projected growth of the Finance & Insurance sector will relieve some of the demand pressures at the absolute top end of the office market in quality and rental terms.

This change in the structure of the demand for office space in the city is already being seen in the take-up numbers, with 2017 seeing less activity from Finance and Technology, Media & Telecoms than has been the case in recent years.

Strong leasing activity, particularly of Grade A office space, has led to a continued fall in the availability of Grade A offices across Manchester and Salford. This is particularly acute in the centre of Manchester, where we estimate that there is only 340,235 sq ft of Grade A office space available compared to average annual take-up of such space of 350,588 sq ft. ■

FIGURE 2 City centre take up by business sector



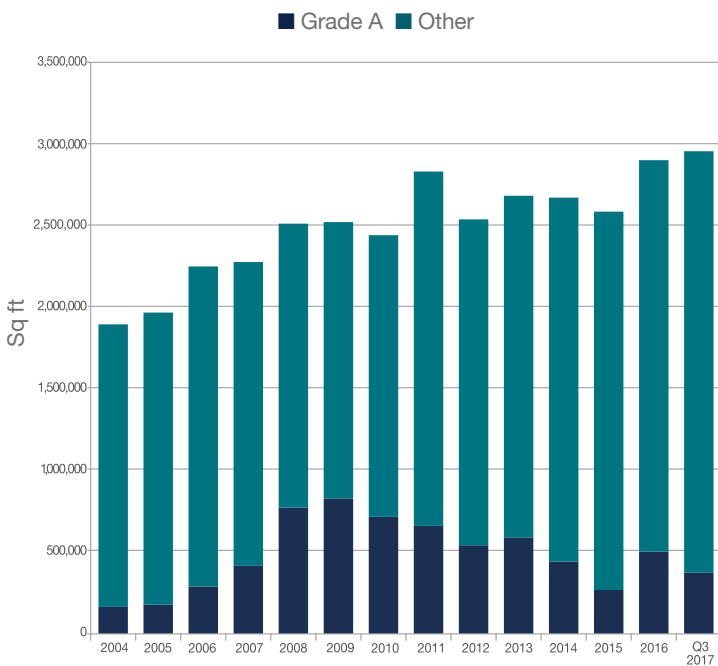
Source: PMA

FIGURE 1 Manchester and Salford office-based employment



Source: Oxford Economics

FIGURE 3 Office availability



Source: Savills Research

While the office supply/demand imbalance might appear less acute when we look at secondary space, the shortage of Grade A in the city has dragged up the rents on Grade B space. This means that at present only 59% of the available office space in Manchester & Salford can be leased at a rent of less than £25/sq ft, while 71% of the recent demand for office space has been at that price point.

While the development industry generally reacts well to a shortage of new high quality office space by building more of it or refurbishing existing buildings, shortages of more affordable office space are seldom so easily remedied. Indeed, the supply of cheaper office space is also being limited by change of use. While Manchester does not have an Article 4 Direction in place to limit change of use from office to residential under the PDR regime, it did secure an exempt area. The latest national research into change of use from office to residential by the British Council for Offices shows that this approach has been reasonably successful for Manchester, with only 39 notifications being received, 28 of which were granted, five refused and six that went ahead due to not requiring prior approval.

The current office supply/demand situation is by no means critical, and we expect that the continued rise in serviced office provision in Manchester and Salford will reduce some of the pressure on supply at the more flexible/affordable end of the market. Furthermore, the rising popularity of light touch refurbishments will mean that more Grade B and C quality office space can be brought back into economic use for comparatively affordable rents.

Another factor that will be important in satisfying the city's future need for office space will be the steady expansion of the core area. Submarkets such as Oxford Road, the Irwell corridor and Ancoats, that were previously thought of as fringe, will become more core due to improving infrastructure and occupier perceptions. ■

Shortages of all grades of office space are emerging, but this is more acute at 'affordable' rents



59% of the office space available to rent is at a rent of £25/sq ft or below



71% of the demand in the last three years has been at rents of £25/sq ft or below



There is currently only seven months supply of office space at £25/sq ft and below



But 11 months' supply of office space at rents of above £25/sq ft

Hotel delivery is picking up

Hotel supply and demand is becoming well balanced

Manchester and Salford's hotel development pipeline has been relatively active over the last decade, and the rate of delivery is expected to increase in 2018-2020. While the last decade has seen a high level of applications for new hotels, the actual delivery of new rooms has been comparatively restrained. This has changed over the last two years, and we expect to see a steady development pipeline going forward.

It is clear from the city's recent RevPAR trends that the hotel market is broadly in balance. While RevPAR grew by an above average 5.7% in 2016, it has grown by only 0.4% in the year to September 2017. This puts Manchester towards the bottom of the UK city rankings, and indicates that supply of and demand for rooms is broadly in balance. It is worth noting that this probably has more to do with the addition of 874 new rooms to the supply this year, than any decline in demand.

Looking ahead, the key driver for hotel demand and revenue outside London tends to be GDP growth. While the outlook for the UK has generally been revised upwards over the last 18 months, we are still looking at a period of lower than average output growth. Hotel operators will also be challenged by further pressure on their operating margins, not least from inflation and a heavy dependence on non-domestic staff.

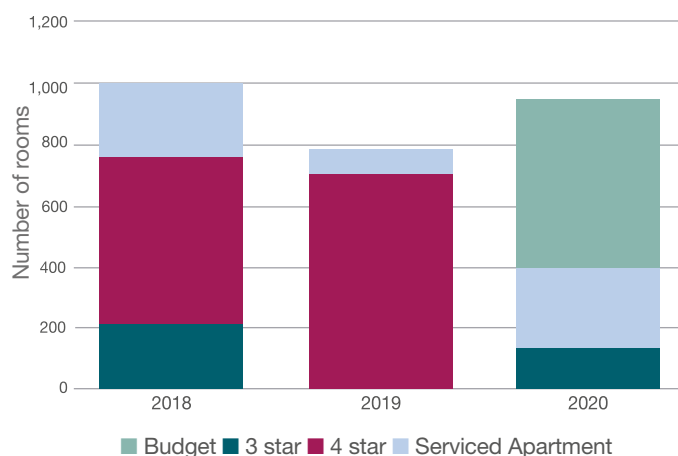
The hotel development pipeline in Manchester and Salford is expected to remain fairly well supplied, with 2,713 beds due for delivery in 2018-2020. If all these beds are delivered over that period then this will equate to a 20% increase in supply.

The biggest gain in number of rooms over that period is in the 4 star segment, and in terms of percentage change in the serviced apartment market. This pipeline, combined with modest increases

in demand and performance, is probably all that the city needs to satisfy demand and maintain viability for the immediate future.

While some European and global cities have either experienced or speculated that the emergence of alternative lodging models such as Airbnb is a challenge to either hotel viability or housing provision, this is less true in the UK and specifically in Manchester. Thus, for example, while Airbnb rentals in Paris account for nearly 2.5% of the total residential stock in the city, in London they are only 0.8% and Manchester only 0.4%. ■

FIGURE 4 Manchester and Salford hotel pipeline



Source: Savills Research

URBAN LOGISTICS

Instant gratification could lead to more warehouse-type space in the city core

While parcel delivery by drones or autonomous vehicles is still some years away, the trend that is very prevalent at the moment is customer demands for shorter and shorter delivery times. What started with same day delivery a year or two ago is now pushing down to two or even one hour delivery from click to your door.

Whether we really need our internet shopping orders quite so immediately is debatable, but for many retailers the speed of their delivery and ease of returns is seen as the new battleground and this is already affecting logistics requirements. Small multi-let industrial estates on the edges of major conurbations or residential areas are becoming increasingly institutional in both their occupier and investor profile, and yields on some estates in London have pushed below 3% in some instances.

Availability of such sites for tenants will be tightened by the new light industrial to residential PDRs that came into effect on the 1st October 2017, and while these only apply to buildings of less than 5,380 sq ft, EGi research shows that Manchester has a cluster of suitably sized schemes to the east and north of the city centre.

We also expect to see distributors and retailers coming up with more creative solutions to their need for storage space close to their customers both for deliveries and returns. These could include basements of office buildings, under-utilised car parks, and off-pitch and unwanted retail units.

Everything in moderation

Manchester needs to build more homes to help support its economic growth: housing demand is greatest in the mid market

Manchester needs more homes

Greater Manchester's housing need is 11,254 homes per year, according to the draft Greater Manchester Spatial Framework. A little over a quarter of that need, 3,120 homes per year, is concentrated in Manchester local authority.

We've seen growing housing delivery in the city recently, but it's still not enough. Net housing delivery in Manchester was 1,792 homes in 2016-17, a shortfall of over a thousand homes. Some commentators have expressed concern that the supply pipeline in Manchester looks full, as there are c.7,000 homes under construction due to complete by 2020. But that supply only addresses just over two years of need.

Manchester will need to accelerate this level of development to meet the housing needs of its expanding economy, but across a wider range of price points and housing types meaning areas outside the city centre will need to contribute more.

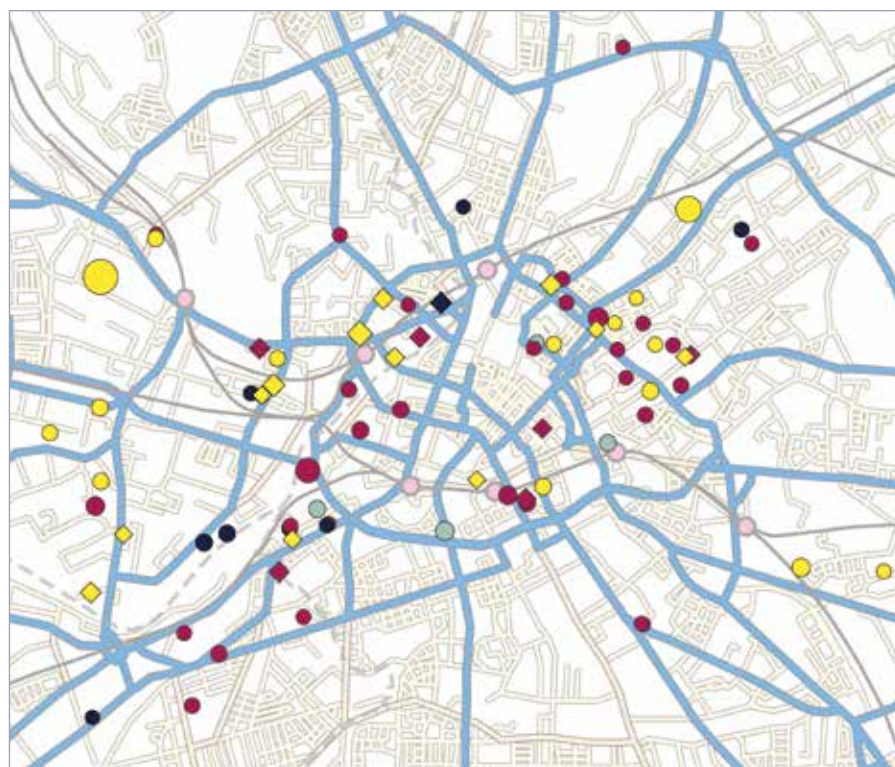
Diversify and conquer

Much of the residential pipeline in Manchester comprises city centre flats, that means future supply needs to be more varied with a recognition that there's a range of different households looking to live in Manchester. This provides a range of development opportunities.

Manchester has traditionally taken a very strict view on purpose-built student accommodation (PBSA). But with upcoming changes to planning policy, developers may be able to build PBSA schemes in select zones across the city. Our research has shown that student numbers grow fastest at highly ranked universities, such as the University of Manchester. High quality housing for students and young professionals will help Manchester maintain its high graduate retention rate, boosting the city's attractiveness to employers.

There are also opportunities to help house Manchester's ageing population. The number of people in Manchester aged over 65 is set to grow twice as fast as the total population over the next ten years, hitting 61,000 by 2027. We have observed a trend of older people moving back to cities to live closer to leisure, healthcare, and shopping facilities. Building homes that allow these people to age comfortably in place will free up family homes in the suburbs and could help reduce the strain on social care services.

FIGURE 5 Residential pipeline in the city centre



Build to rent	For Sale	Pre planning
◆ 1000	● 1000	● Application
◆ 2000	● 2000	● Permission
◆ 3000	● 3000	● Under construction

Source: Savills

Pricing pressure

While the total volume of supply should be no cause for concern, the price point it's aimed at might be. Housing in Manchester as a whole is relatively affordable, new build values in the city centre are out of reach for many aspiring first time buyers. Average new build values in the city centre currently sit at around £375 psf and there are examples of the £500 psf threshold being broken in prime locations.

Those residential developments at the very top end of the market are competing for a smaller pool of occupier demand so developers looking to build in Manchester are likely to find a richer seam of opportunities in the mainstream market going forward.

Already we have seen increasing activity from professional build to rent operators such as L&G, La Salle and M&G, who have substantially widened their geographical focus beyond the capital. Faced with more competition this is likely to mean buy to let landlords will either have to step up the quality of their offering or, where they are heavily geared, look at exiting the sector. Overall, however, this should increase the range of housing options to younger households who are critical to Manchester's economic future. ■

Who lives in Manchester?



Students

Age range:
18-22 and beyond

2015/16 Full Time students:
65,000

- Manchester's universities are some of the best in the country, attracting students from worldwide.

- At 51%, graduate retention is second only to London, showing Manchester's employers benefit hugely from having them here.

- Student accommodation demand will remain strong. Regardless of price point, all will want to be in the city centre or next to campus.



Young professionals

Age range:
25-34

2017 Population: 115,000
2027 Population: 109,000

- ONS projects falling numbers in this group over the next ten years.

- Development can help reverse this trend by providing more affordably priced flats in the city centre. This will boost Manchester's labour pool and make it a more attractive location for employers.



Families

Age range:
35-64 and children

2017 Population: 171,000
2027 Population: 195,000

- Manchester will need more family-friendly accommodation to house its growing population.

- Most development currently sits in the city centre, which is less suitable for families. There's massive untapped opportunity in the surrounding suburbs.



Older people

Age range:
65+

2017 Population: 51,000
2027 Population: 61,000

- Older peoples' attitudes toward city centre living are improving, with ageing Baby Boomers keen to live near leisure and care facilities.

- They prefer larger properties that can be adapted for their care needs as they age.

- We also expect some demand for smaller flats from "Silver Splitters" – older divorcees.

THE SLATE YARD

Students and young professionals are the dominant occupier group in the city centre

Legal & General's new Slate Yard scheme, next to Spinningfields, demonstrates that the dominant occupier groups for city centre build to rent are students and young professionals – 80% of occupiers are under the age of 35, 50% under 25. Rents include high speed Wi-Fi, security, car club membership, and 24/7 concierge, with no fees and the option to bring your pets. From March 2018, residents will also have access to a gym included in their rent.



Though young professionals make up a large proportion of residents, the sectors they work in are incredibly broad. No single sector makes up more than 12% of residents, with people working in sectors as diverse as education, healthcare, television, public services, and construction.

Over a quarter of people living at the Slate Yard are full time students, around half of whom are post-graduates. For those residents moving to Manchester from other university towns, having internet, concierge and a car club all included in the rent makes getting settled into life in the city substantially easier.

Aside from students and young professionals, the Slate Yard is home to people from six months to seventy years of age. The diversity of residents demonstrates that this kind of product appeals to people from all parts of society, and is a valuable addition to Manchester's housing stock. ■



savills.com

Savills development We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team

Research

Lawrence Bowles

Residential Research
0207 299 3024
lbowles@savills.com

Mat Oakley

Head of Commercial Research
0207 409 8781
moakley@savills.com

Jacqui Daly

Residential Investment Research
0207 016 3779
jdaly@savills.com

Marie Hickey

Hotel, Leisure & Retail Research
0203 320 8288
mhickey@savills.com

Kevin Mofid

Industrial & Logistics Research
0203 618 3612
kmofid@savills.com

Manchester office

James Evans

Head of Manchester Office
0161 277 7238
jevans@savills.com

Rob Haslam

Planning
0161 602 8249
rhaslam@savills.com

Adam Mirley

Development
0161 602 8658
adammirley@savills.com

Tom Cunningham

Hotel & Leisure
0161 244 7709
tcunningham@savills.com

Jonathan Atherton

Industrial
0161 277 7207
jatherton@savills.com

Peter Mallinder

UK Investment
01612 777211
pmallinder@savills.com

Savills plc: Savills is a leading global real estate service provider listed on the London Stock Exchange. The company was established in 1855 and has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has more than 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East. This report is for general informative purposes only. It may not be published, reproduced or quoted, in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. While every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.