

Research

Autumn 2006

Cambridge office & industrial survey

Review of 2005/2006 and outlook for 2007 and beyond



Summary

- This year office take-up in and around Cambridge looks likely to exceed 2005's total of just over 500,000 sq ft. As at the end of July 2006 360,000 sq ft of office space had been leased.
- Take-up continues to be heavily dominated by the Technology sectors, and as such biased towards the out-of-town market. 71% of the space leased this year has been out-of-town.
- Office availability has continued to fall in 2006 and the market now has less than one and a half year's supply of office space available.
- Consequently the pressure on office rents has been upwards, though growth in City centre rents is being limited by the lack of Grade A stock.
- Investor demand for both office and industrial investments remains strong, though supply is restrained. This continues to drive prices upwards and yields down.
- The industrial leasing market remains undersupplied, particularly in and around the City centre. This has continued to drive rents upwards during 2006.
- We expect these trends to continue over the remainder of 2006 and into 2007. Thereafter the introduction of new City centre office space should drive a sharp upward movement in the office rents being achieved in that market.

Office market

Overview

The state of the Cambridge office market remains firmly in favour of the landlord, with rising demand and take-up and low levels of availability, particularly in the City centre. 2005 and 2006 have seen a recovery in tenant demand, particularly in the crucial Technology and Research sectors, against a background of limited new supply entering the market.

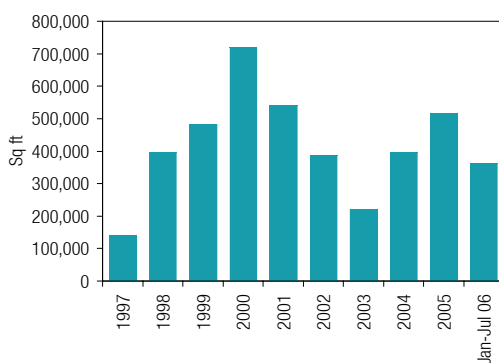
The impact on rents has been inevitable, with headline and net-effective rents steadily increasing both in and out-of-town on Grade A space.

Leasing market - take-up and supply

Despite the relatively restrained supply of office space on the market, 2005 saw a steady increase in the amount of office space leased in and around Cambridge. Just over 515,000 sq ft of office space was leased in 2005, continuing the upward demand trend that has been seen since the lows of 2003.

Despite some hesitation in the market towards the middle of this year, the first half of 2006 has seen very strong levels of demand for office space in Cambridge. This has led to a near record seven month period for take-up with the total space leased this year reaching 360,000 sq ft.

2006 looks likely to be the third consecutive year of increased take-up of offices in Cambridge

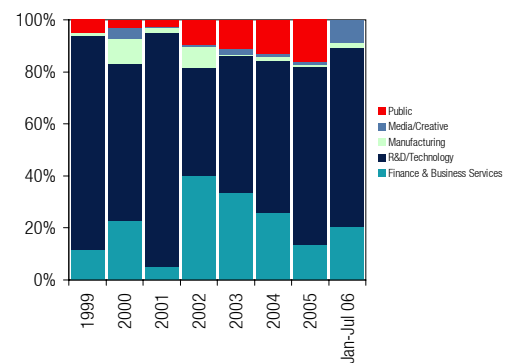


In our last report we commented upon the fact that the proportion of the space leased out-of-town as opposed to in-town had been rising for three years. This trend has continued into 2005 and 2006, with 82% and 71% respectively of the take-up being out-of-town rather than in the City centre. This is both a reflection of the types of companies that are in the market, and more importantly the lack of Grade A space in the City centre office market.

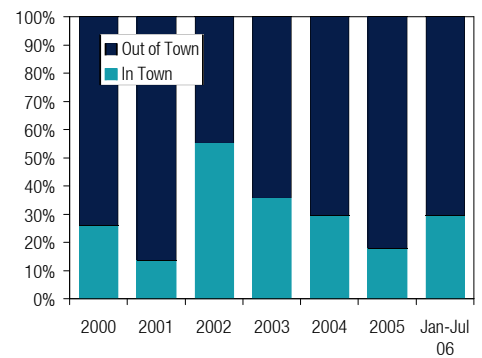
Cambridge has always been one of the top locations in the UK for demand from Technology and Research-related businesses. Indeed, over the last seven years these sectors have accounted for 67% of the office space leased around Cambridge. Since the slowdown in

the technology sector in the early part of this decade, its fortunes have been recovering and 68% of the office space leased in 2005 and 2006 has been to these types of businesses. The fact that this sector has a cultural bias towards campus-type environments explains why the take-up around Cambridge is so focused on the out-of-town business and science park markets.

R&D and Technology businesses continue to dominate take-up...



...This leads to a continuing bias towards out-of-town office space



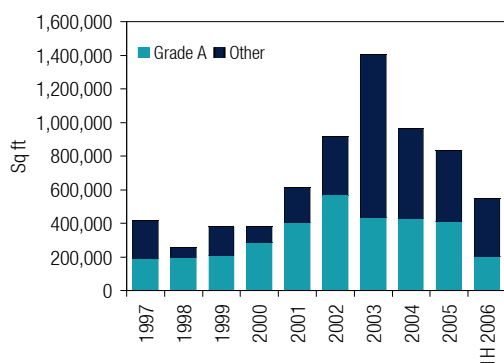
There are a number of significant office requirements in the City centre office market. All of these remain unsatisfied, but as new stock enters this market we expect to see the balance between take-up in the two markets becoming more even.

Until then shortages of supply will remain an issue, and for the first time since the late 1990's this is not just an issue facing the in-town market. While 70% of the available space is still in the out-of-town market, it is this location that has seen the biggest fall in availability over the last two and a half years.

As the chart overleaf shows, 2006 has seen a continuation of the downward movement in availability that we have been documenting for several years. As at the end of July 2006, we estimate that the total office availability in our survey area was 544,785 sq ft, 44% lower than it was at the end of 2004.

Office market

Office availability continues to fall in and around Cambridge



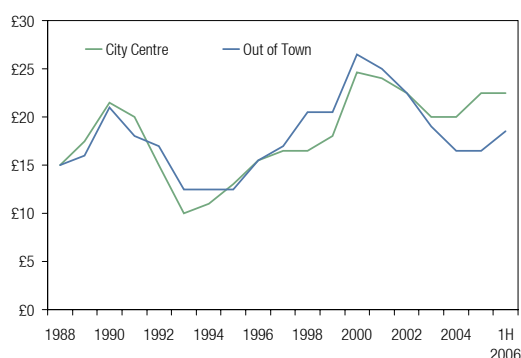
Given that the average annual take-up of office space in the survey area has been around 422,000 sq ft per annum over the last nine years this represents less than one and half year's supply of space. As a general rule of thumb we would describe a market as undersupplied if it has less than two years supply of space at any point in time.

Furthermore, only around one third of the available space is Grade A which is coincidentally the most in demand type of space, and likely to stay so in the future.

Leasing market - rents

In our last report on this market we stated that we expected "rents to stabilise at their current levels" due to shortages of good quality stock in the City centre. This has been the case with the top rent of £22.50/sq ft yet to be exceeded. The pick up in demand and corresponding fall in availability in the out-of-town market has put upward pressure on rents, and top rents in this market have risen to £18.50/sq ft during 2006.

Rents stable due to lack of supply in the City centre, but rising out-of-town



Investment market

In common with the rest of the South East's prime office markets the Cambridge investment market continues to be characterised by strong demand and low levels of liquidity. This has continued to drive up prices over the last six months. A new benchmark has been set with the sale of three buildings at Cambourne Business Park to L&G for £33m, reflecting a sub 6% yield. While there haven't been any Grade A deals in the City centre, we would expect the yield on this type of product to be in the 5.5%-5.75% range at present.

Looking ahead, we expect that liquidity will remain an issue and this will support prices, and may even yield to a further downward shift in yields. Investors will become more selective on product, looking more at rental growth prospects than just relying on yield movements to deliver returns.

Outlook

We expect that the sharp divide between the in-town and out-of-town market will be maintained over the next 18 months. While there is new stock due to be delivered to the out-of-town market on Capital Park and Cambourne in that period, there are no major developments or refurbishments programmed for the City centre until 2007/8.

This shortage of new space in the City centre will continue to inhibit Grade A rental growth until suitable stock is delivered to the market. In the out-of-town market we believe that there is likely to be further upward rental growth on the best schemes, and this will start to narrow the rental gap between the two markets.

Despite the strong start to 2006, we expect that leasing activity will be slower in the second half of this year. However, this will still bring the total take-up for this year to an above trend 500,000 sq ft. At present, our forecast for 2007 is for a similar level of take-up, the majority of which will continue to be on the City's business, science and research parks.

The inevitable impact of these steady levels of demand will be a continued fall in the level of availability in the market. As we stated earlier the Cambridge office market is already undersupplied, particularly with Grade A space, and this situation is unlikely to change over the next 18 months. Over that period we would expect to see more demand entering the City centre market and this bodes well for the rents that will be achieved on the office element of the new station development. Given that some of the City's professional services businesses have been looking for space for over 12 months the question has to be raised about whether they will lose patience with the slow pace of the development pipeline and look to fringe or out-of-town schemes to satisfy their immediate space needs?

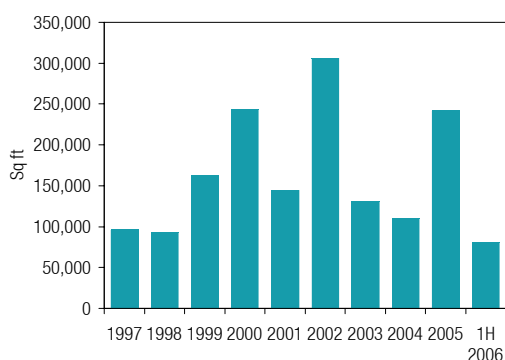
Industrial market

Supply & Demand

The balance between the supply of and demand for industrial space in and around Cambridge continues to be firmly in favour of the landlord. This has continued to drive rents on industrial property upwards over the last 18 months.

Take-up in 2005 was actually well up on the two previous years, at just under 250,000 sq ft. 2006 has started well, though it is unlikely that this year's total will exceed that of 2005. Despite this, we expect it to be in line with the historic average of around 150,000 sq ft per annum.

Industrial take-up strong in 2005 and 1H 2006

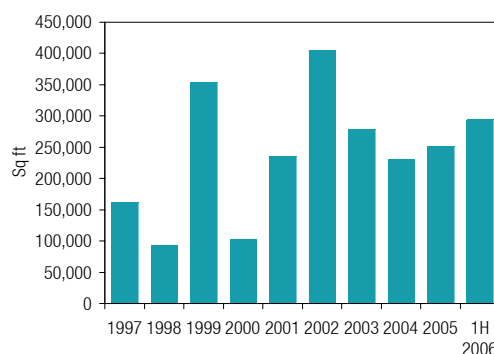


The majority of demand for industrial space in the area continues to be from distribution-related businesses rather than manufacturers.

The story on the supply side continues to be one of restricted supply, though availability has risen by around 60,000 sq ft over the last year and half. This is still only equivalent to just over one year's supply at last year's level, and as such we would class this market as undersupplied. There is a particular shortage of larger units, with only two units of 20,000 sq ft or over currently available, and none

in the development pipeline for delivery in the next six months.

Supply rose in 2005/6 but the market remains undersupplied



Rents & Investment

The imbalance between supply and demand in this market has continued to drive rents upwards over the last two years with the top rent being achieved on smaller City centre units now exceeding £10/sq ft. Larger units in similar locations, or in close proximity to the City can be expected to achieve rents of between £8 and £9/sq ft.

Investor demand for this type of property, both well-let and vacant, remains strong. Given that the supply/demand imbalance is unlikely to move in favour of the tenant in the short to medium term, the prospects for further upward rental growth in the 2006 and 2007 look pretty good. Investor demand also continues to be fuelled by the prospects of converting City centre industrial sites to residential uses.

Definitions:

This survey covers supply, demand, rental and investment trends for office units of 3,000 sq ft and over, and industrial units of 5,000 sq ft and over.

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