



CAN REAL ESTATE TURBO CHARGE THE MIDLANDS ENGINE?

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FOREWORD

TFT, now in its 45th year, has been operating in Birmingham for 21 years. We have seen the challenges that the city has faced and have been part of its vision for change. Projects such as Smithfield, Brindleyplace, Paradise Circus and Civic House - while of course professionally interesting for our team - also exemplify the ambition of the West Midlands.

In this paper we pose the question whether the UK Industrial Strategy and the Midlands Engine will succeed. Of course, they have the potential, but we believe real estate is one, if not the key driver to Birmingham achieving the international status its size and economy deserve.

Regeneration schemes across the city are transforming spaces into high spec and high-tech offices that Millennial entrepreneurs demand. By contrast the region's traditional economic reliance on manufacturing far from looking old fashioned may yet prove to be the UK's Trojan Horse for growth in a post-Brexit UK.

I'd like to thank all those who have contributed to this thoughtful paper at such an interesting time for the West Midlands. Thomas Shelby, fictional son of the city - he of the Peaky Blinders - may not be the city's most admirable role model, but one thing's for certain: Birmingham's looking razor sharp.

Alan Pemberton, Managing Partner, TFT



EXECUTIVE SUMMARY

- Real estate has always been core to the evolution of both Birmingham and the wider West Midlands.
- The UK Industrial Strategy and the Midlands Engine, geared to improve economic expansion, productivity and skills, have the potential to be transformative and achieve a step change in the fortunes of the region.
- These strategic ventures will accelerate change that is already afoot. Birmingham is seeing increased exposure to high Gross Value Add (GVA) sectors, including tech, finance and the life sciences.
- Beyond the city other areas of the region are seeing traditional industries evolve into higher value strains of themselves.
- Birmingham is seeing record levels of take-up which have been met by record levels of development. Regeneration schemes across the city are delivering space for high value corporates and start-ups alike.
- The real estate sector must also rise to the challenge of new and emerging high value engineering in the West Midlands region.



SCHEME TO WATCH: The Smithfield Masterplan. *“The Smithfield site is one of most exciting transformational city centre developments, it will be the cornerstone to the wider regeneration of the Southern Gateway Area. We are thrilled to be involved in, The Forum development, providing the first new development on the Smithfield site.”*
David Medcraft, Technical Partner, TFT Birmingham

ECONOMIC BASELINE

Over recent years economic growth in the region has trailed that of London, Manchester and the South East. Despite an ongoing evolution in the region’s economy, the relatively greater contribution of manufacturing to output has tempered both Gross Value Added (GVA) growth and employment expansion.

In its latest forecasts, the EY ITEM Club expects the UK economy as a whole to slow over the coming two years to 1.7% in 2018 and 1.7% in 2019. From a West Midlands’ perspective, the improvement in export growth as a result of the weaker pound, will help output to an extent. Certainly, the Lloyds Bank Regional PMI Index (December 2017) found positive employment growth across the country, including those regions with a strong exposure to manufacturing.

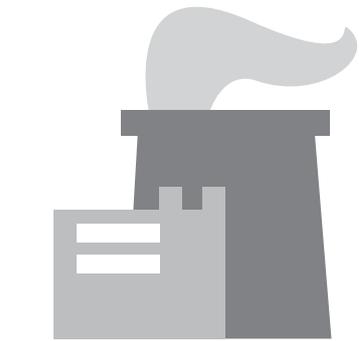
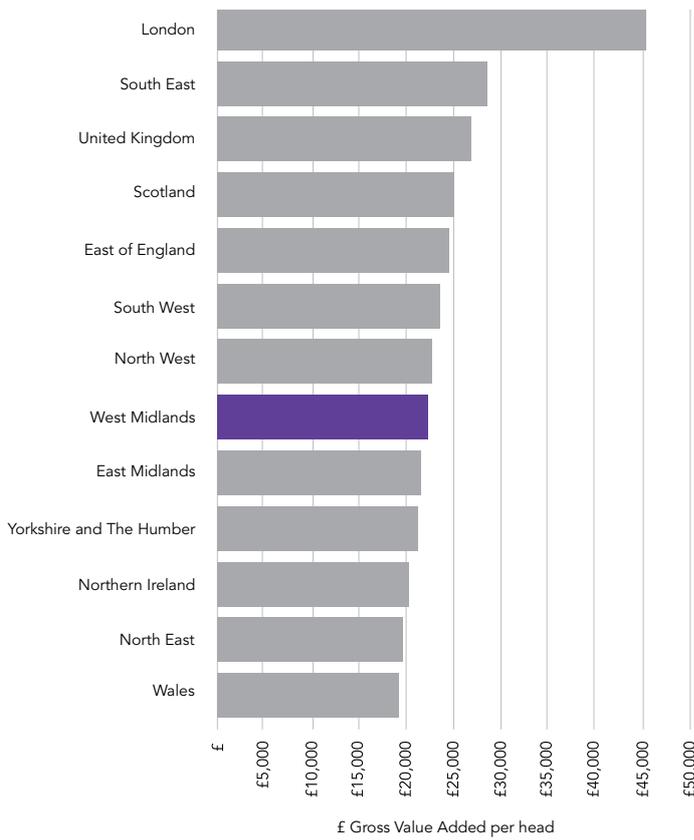
Looking ahead, further improvements to output will be driven by technological advances having a positive impact on productivity. This will contribute to output performance in the West Midlands: the region’s economy is expected grow faster between now and 2020 than it did in the previous three-year period (EY ITEM Club).

REGIONAL ECONOMIC GROWTH RANKING
 ORDERED BY FORECAST GVA GROWTH,
 2017-2020

- LONDON
- SOUTH EAST
- WEST MIDLANDS**
- EAST
- SOUTH WEST
- EAST MIDLANDS
- SCOTLAND
- NORTH WEST
- WALES
- YORKSHIRE AND HUMBERSIDE
- NORTH EAST

Source: ONS, 2017 and TFT

However, despite this, the region is expected to continue to underperform the national average pace of economic growth over the coming three years. This is due to the structural make-up of the economy, with its relatively higher exposure to manufacturing and other lower value-added sectors, including the public sector. EY Item Club forecast the information and communications and professional services sectors will grow by 3.5% and 3.4% annually, respectively, until 2020. This contrasts with growth in the manufacturing sector of just 1% over the same time period.



“New and emerging industries and occupiers can be anticipated to place increasing demands on the region’s occupational property.”

Source: ONS, 2017 and TFT

A TIMELY CHALLENGE

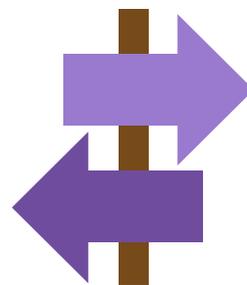
The challenge for the region, and Birmingham as its lead city, is to achieve structural change to rebalance its economy towards a more diverse economy with higher value-added sectors to deliver an improved level of output per head. This is essential to produce sustainable growth and rising incomes across the region. This process has already commenced with Birmingham seeing companies across technology, life sciences and finances all expanding in the city.

The Government is seeking to address regional disparities with the Midlands Engine for Growth vision. However, perhaps more significantly in the shorter term, the recent publication of the Government’s Industrial Strategy seeks to drive productivity improvements nationally, and specifically notes the automotive manufacturing as an area of focus. The opportunity in this area is compounded by HS2 and associated innovation in the rail and transport sector.

This does not mean moving away from core areas of niche expertise in the region, such as automotive manufacturing. In fact, there could not be a more opportune time to take up the mantle of this challenge.



Source: ONS



“The economy of the West Midlands is changing, and perceptions of the opportunity need to change with it.”

REAL ESTATE AS AN AGENT OF CHANGE IN ENGLAND'S SECOND CITY

Recent occupier activity in Birmingham, and across the wider region, indicates a process of diversification is underway to an extent. The largest lettings in Birmingham city centre over the last 24 months have been dominated by companies in the financial and business services sector, while the industrial market has seen the development of high tech space for the automotive industry, but also aligned sectors including drone technology and intelligent buildings.

A HISTORY OF REDEVELOPMENT AND REINVENTION

The property market will be an essential facilitator of this transformation. Two decades ago Birmingham was watching Brindleyplace edge onto the skyline, changing occupier and investor perceptions of the city. The ongoing development of the scheme and further regeneration and infrastructure projects across the region have a fundamental role in laying the foundations for change. Infrastructure is particularly important to achieve productivity gains and attract new occupiers to the region. The

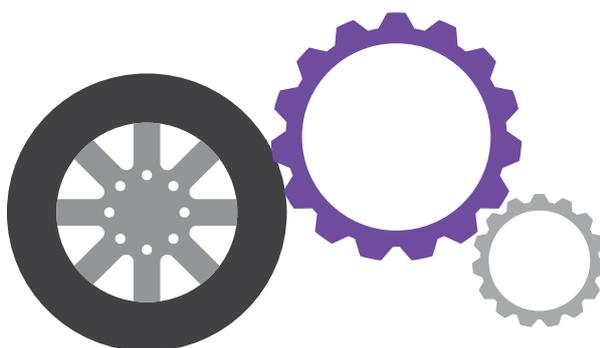
rebuilding of New Street station, in addition to the retail development of Grand Central, which opened in 2015, have had a transformative impact on Birmingham city centre. The city has also seen the extension of the Midland Metro into the city centre, as well as runway extension at Birmingham Airport to accommodate larger aircraft and build greater long-haul capacity.

A record level of construction activity is currently underway in the city set to deliver substantial volume of office space over the coming years. Over 640,000 sq ft is currently underway, excluding pre-lets with a peak in activity to occur in 2019. Snowhill is the largest development in Europe outside London with the development due to complete in 2019 in the form of Three Snowhill, while Argent's £700m redevelopment of Paradise has seen the further approval of 280,000 sq ft of mainly office space at

One Centenary Way. The Mailbox shopping mall has undergone significant refurbishment works over the last five years and now attracts high-end luxury retail. Arena Central will also shortly welcome tenants.

GROWING OCCUPIER DEMAND

Infrastructure and regeneration projects such as these have had a positive impact on Birmingham city centre, helping it attract a large number of professional services firms, in particular the legal sector, which has achieved agglomeration benefits of critical mass, with ongoing expansion by London



“This strategy builds on the success that the UK automotive industry already enjoys. It aims to make the sector’s long-term future more secure, grow the UK share of the value chain and secure strong global competitive positions in low carbon research and development (R&D) and in premium and niche vehicles.”

Source: Department for Business, Innovation & Skills policy paper Driving success: a strategy for growth and sustainability in the UK automotive sector



SCHEME TO WATCH: *“Birmingham city centre re-development in progress. Demolition of the former library building to make way for the Paradise Circus development. Works are proceeding at pace with the main structure now in place.”*

James Bent, Partner, TFT Birmingham

based firms. The finance and insurance sector has also expanded in the city. Deutsche Bank employs 1,500 people in the city and have been joined by HSBC, who moved its UK retail arm from London to Birmingham in March this year. The new office is home to 2,000 staff, of which 1,040 were London roles.

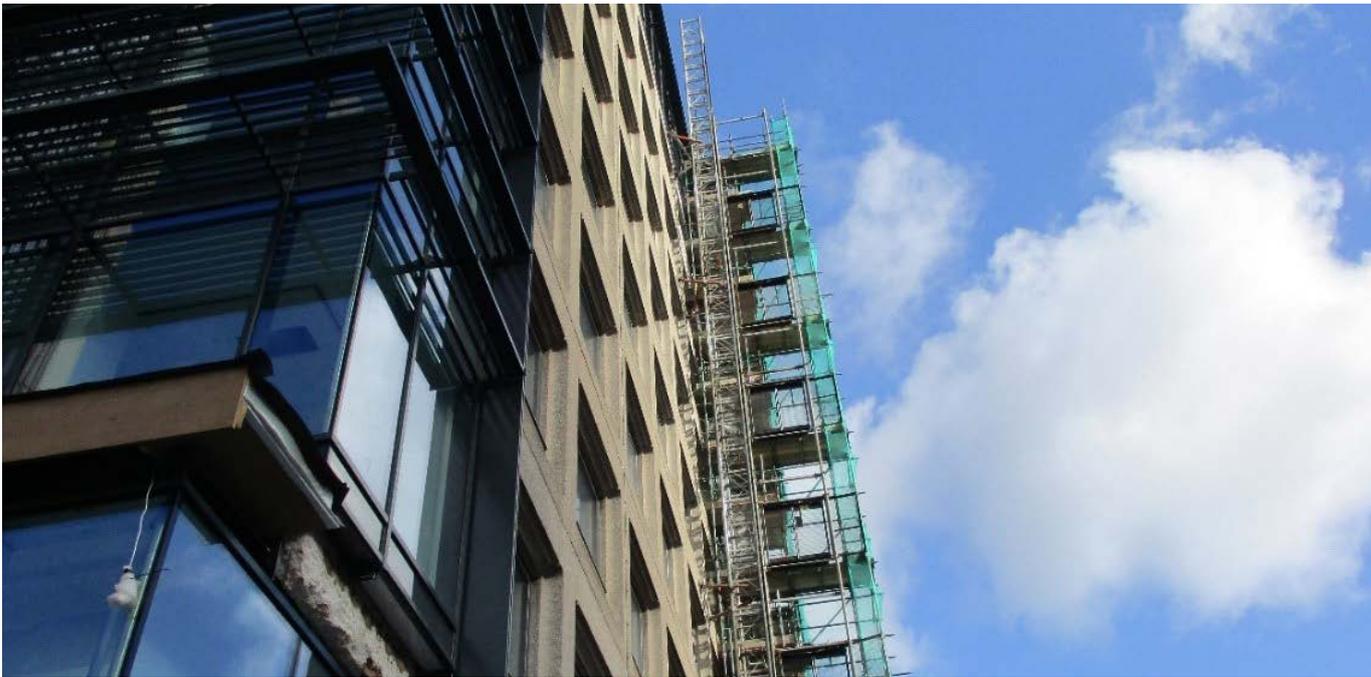
Meanwhile the public sector representation continues to grow with the announcement of HMRC’s move to Arena Central, forward funded by L&G. This follows the decision to move the HS2 headquarters to the city from Canary Wharf in 2016. In addition to over 1,000 jobs in the HQ function the city is also the focus for contractors who continue to absorb space in the city.

But it is in the area of tech and media (TMT) which notable change is starting to take hold. We estimate around 15% of lettings in Birmingham were in the TMT sector in 2017. Vanti and Advanced Computer Software Group are important occupiers in the city, the latter creating 400 jobs over the last 12 months. Meanwhile, at the end of 2017 the city was finally chosen to host the 2022 Commonwealth Games, adding an estimated £750m boost to the local economy in addition to furthering diversity and creativity as the city prepares. The region’s creative collateral will be enhanced further as Coventry takes the lead at the UK’s City of Culture in 2021.

The range and depth of occupier activity in the city contributed to a record level of take-up in 2017, with the volume of floorspace let exceeding 1 million sq ft. Importantly, alongside the significant public sector lettings such as HMRC, there are signs of an upturn in a more diverse range of high growth business sectors. The service office operation iHub took 18,000 sq ft at Colmore Gate. Such space is important to business on short term contracts for example with HS2, but also to SMEs, many of which are focused in the tech and media sectors. Meanwhile, Alpha Works, a co-working serviced space opened at Alpha tower. Meanwhile, the Calthorpe Estates’ Edgbaston Medical Quarter has a concentration of business in the high value growth life sciences sector, combined with hospital and specialist case centres, with further development planned.

“Regeneration schemes across Birmingham are delivering space for high value corporates and start-ups alike...”





THE NEW FACE OF OLD INDUSTRY

The wider West Midlands region is building on its historical heritage to by re- inventing itself as a centre for advanced research and development, combined with the promotion of a cluster of cutting edge technology companies in the automotive sector in particular. Private sector investment in R&D and advanced manufacturing facilities in the region include operations at Tata Motors Technology Centre in Coventry, home to JLR, which is now Britain's largest carmaker.

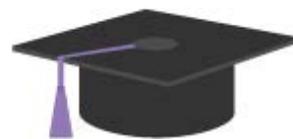
Such investment has driven the development of a series of 'innovation assets' including public-private research facilities such as the Manufacturing Technology Centre, the High Value Manufacturing Catapult (a technology and innovation centre) and the National Automotive Innovation Campus at Warwick University and the Manufacturing Institute being created by Coventry University in partnership with Unipart Group.

Furthermore, with the regional importance of HS2, the National College for High Speed Rail, was established to develop high skilled professionals for HS2 and beyond, at campuses in both Birmingham and Doncaster.

"Technological innovation will lead to a supply-side miracle, with long-term gains in efficiency and productivity."

DIVERSIFICATION, THE WAR FOR TALENT AND THE CHALLENGES FOR REAL ESTATE

Looking ahead, the West Midlands, like any other region, must continue to evolve to ensure it is fit for purpose to deliver growth as we look to the Fourth Industrial Revolution, as described by the World Economic Forum. Birmingham city centre has seen the growth of finance and business service representation in the city. A proportion of these jobs are in administrative and support roles. These are perhaps the most vulnerable to technological developments over coming years. For the city and the wider region, the imperative must be to build an ecosystem of high value-added businesses with greater built-in immunity to future technological threats.



"In the future, talent, more than capital, will represent the critical factor of production."

Schwab, World Economic Forum, The Fourth Industrial Revolution: what it means, how to respond

We identify three key areas in which real estate can, if allowed, help drive a transformative environment to support this goal.

(1) TO FACILITATE ECONOMIC DIVERSIFICATION

Birmingham has in recent years seen the growth of professional services and finance. The ICT sector has also expanded in the city. However, it remains the case that the government and HS2 are driving office space demand at present. Further high growth industries will be needed to achieve a step change in economic growth. This not only provides a protection to the local economy, greater diversity also supports the growth of associated companies, whether professional services, marketing and creative, and indeed retail and leisure.

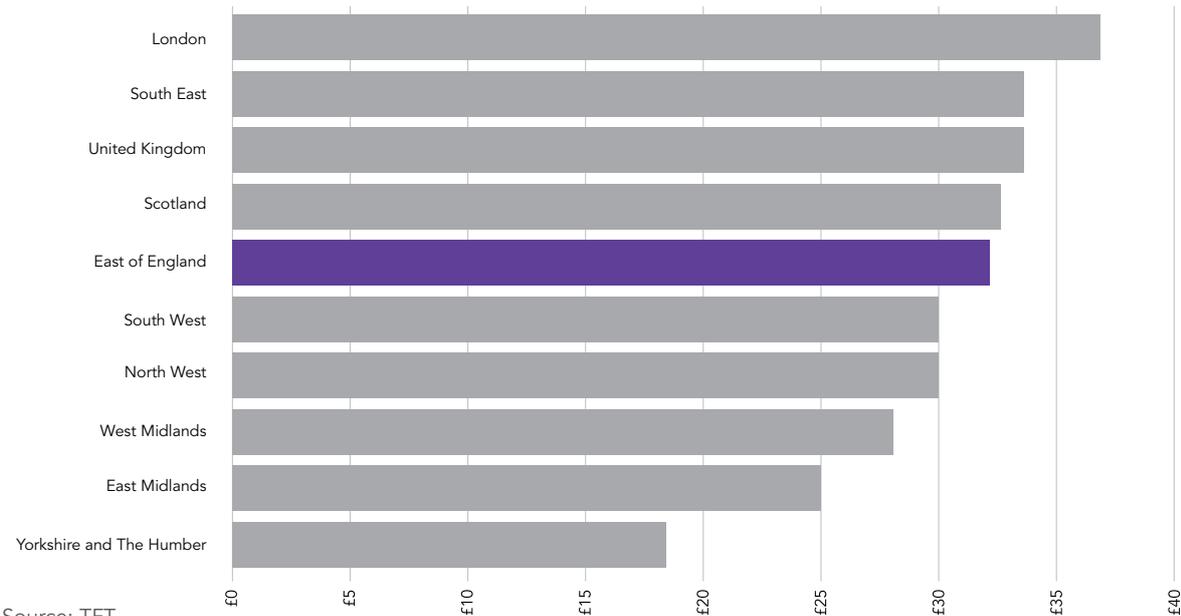
The city has seen a high level of take-up over recent years placing pressure on rents. Reflecting confidence in the city, the development pipeline is now substantial however, with 0.7m sq ft due to complete by year-end 2018. This will help manage rents, particularly for start-ups and many of those in the creative industries, which are more cost sensitive. The recent expansion in architect practice representation in the city demonstrates not only perceptions of future work flows, but also the power of the combination of accessibility and affordable quality office space.

However, investors and developers can contribute further by ensuring the provision of further flexible space which will be supportive to business growth. This includes incubator space and flexible offices such as iHub and Alpha Works which meets the needs of a range of occupiers, including tech and media companies and SMEs who are looking for agility as well as cost and idea sharing through co-working solutions.

The opportunity presented by HS2 adds to the diversity of the region's economic base and creates further pressure on business space. Contractors and engineering firms with a range of size and technical requirements will need to be accommodated. Some will be for short periods, while others will meld into the long term industrial base of the region.

New workspaces for digital and creative businesses are opening. This is illustrated by Assay Studios that opened in 2016 and is home to Deliveroo, and John Lewis's new Tech Hub for Innovation. However further space meeting the needs of large companies such as these, as well as smaller start-ups are needed. More start-ups were registered in Birmingham for the last three years to 2016, than any other city in the UK outside London (Source: Centre for Entrepreneurs). This expansion in small business creation is driving demand for smaller flexible business space in the range of 1,000-5,000 sq ft. It is also behind the strong take-up of the quality refurbished office stock coming to the market. There is equally a shortage of industrial space suitable for the new industrial age, which will be essential to facilitate the evolution of high value manufacturing and technology businesses in the future.

CITY CENTRE RENTS, JANUARY 2018





SCHEME TO WATCH: *“TFT is appointed on the 4 St Philips Place refurbishment project which is ideally placed to meet the demand for smaller more flexible office space of 1,000-5,000 sq ft” - David Medcraft, Technical Partner, TFT Birmingham*

“There is a sufficient agglomeration of automotive and motorsport-related activity and expertise in the area to attract and retain these [specialist supplier and technology developer] firms. In addition, a number of the firms interviewed were already serving major German and Japanese automotive manufacturers, indicating an ability to compete internationally at the highest level.”

Source: Research paper by Amison and Bailey

(2) TO ATTRACT AND DEVELOP TALENT

The Birmingham Chamber of Commerce’s recently published Birmingham Economic Review, notes a skills shortage, particularly in the area of high skilled workers in demand by higher value industries as an issue for the city going forward. This point is also noted in the latest Tech nation report, which sees the city placed well below the average in terms of companies’ perceptions of cities with an adequate supply of skilled staff. However, the chart below also highlights the city’s potential given its geographical location. With access to London still highly prized by companies, particularly those making a move out of the capital or South East, Birmingham’s sub 90-minute travel time is a significant advantage. Clearly HS2 and the extension of the Midland Metro will enhance accessibility further.

However, the high skills shortage in the city is undoubtedly holding the city back in its potential to attract start-ups and relocating businesses. This extends beyond the city centre as the region as a whole builds on its niche areas of high value expertise, creating economic synergy with city centre tech and professional services firms.

Given the competition for skills, the city needs to look to its own asset base. Birmingham benefits from a young population when compared with other cities in the UK, however its education and skills profile is weak. This skills gap is a deterrent to potential occupiers moving to the city, particularly in the high value sectors the city needs to attract. The need to equip the city’s young people with the skills in demand by employers of the future is recognised. It is notable that Birmingham saw net in-migration of 6,016 people from London in 2016, more than to any other UK city. This has been driven by strong job creation in the city, but also the relative poor

affordability of London to live and to do business. This financial stick will inevitably stimulate further moves to accessible regional centres such as the West Midlands, but this must be combined with the carrot of an exciting and diverse urban environment. The competition between cities for skilled workers is intense and will become more so. HSBC has recently highlighted the challenge as it sought to move staff from London. Real estate whether in the form of housing, the urban fabric or workspace plays a fundamental role to the attraction and retention of skilled young workers.

(3) TO TRANSMIT CONFIDENCE AND VITALITY

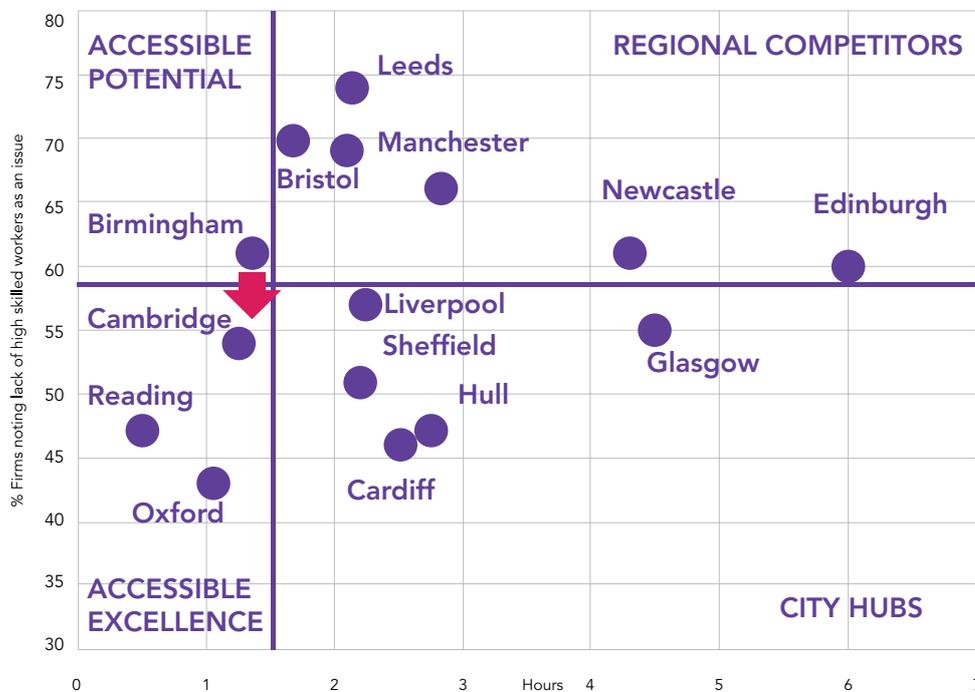
The role of real estate in the attraction and retention of businesses and skilled workers goes beyond the provision of physical space; the transformation of the West Midlands economy will also depend on confidence and a local dynamism. The physical fabric of the region and in particular Birmingham can help support and stir confidence and pride.

There are indicators of actual and perceived positive change. The Demos-PwC Good Growth for Cities Index measures the current performance of a range

of the largest UK cities, and all Local Enterprise Partnership areas in England, against a basket of ten indicators based on the views of the public and business as to what is key to economic success and wellbeing. In the latest report covering 2015/6 data, Greater Birmingham and Solihull is rated average, but significantly, is found to be the most improved city in the UK against the basket of indicators. The analysis particularly notes the city's strength in the areas of work-life balance and high levels of entrepreneurship and new business creation, all-important to the development of a high-value economic base.

This is a positive shift, but, there is clearly further work to do to move the region ahead of the average. Tech Nation who compares clusters across the UK found Birmingham to be amongst the lowest rating in the country in terms of "Digital growth optimism". The region is not capitalising on its locational strength, academic credentials and industrial heritage.

Whilst the headline grabbing [new build development] schemes dominate the Birmingham City Centre skyline there are a growing number of second hand buildings which are being transformed by carefully considered and value add refurbishment schemes. These refurbishment schemes are enhancing the mix and quality of space available



Note: Cities are plotted by shortest train journey to London against the extent to which tech companies note a shortage of high skilled staff as an issue for the location.

Source: TFT, Tech Nation, National Rail

within the Central Business District for SMEs to the corporates who now demand cutting edge design, integrated tech, sustainability and wellbeing initiatives to attract top talent to their businesses – all at affordable rental levels.

It is in the interests of investors and developers vested in the city to instrument change. The provision of appropriate space and significantly the environment demanded by young high skilled worker is within its reach. Brindleyplace had a transformative impact on perceptions of Birmingham from both within and from the outside. Developments now coming forward, in and around the city and its hinterland, have the same transformative potential.

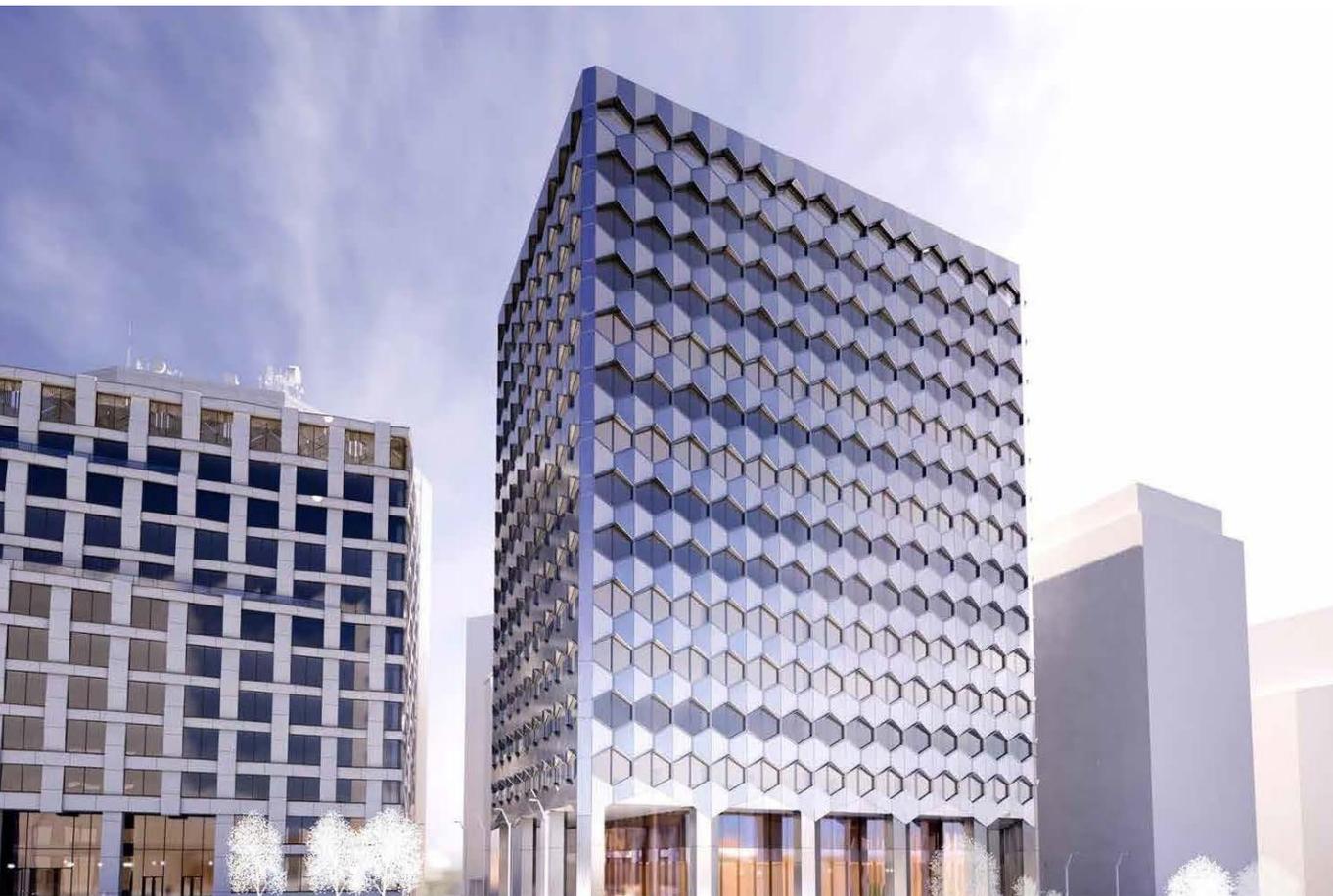
WILL BIRMINGHAM DELIVER?

Birmingham is seeing office construction at its highest rate in a decade, with developments such as Three Snow Hill and Arena Central taking Birmingham to a new level. The breadth and depth of business activity in the city, combined with an emerging new are of high value manufacturing and transport infrastructure engineering, is helping shift the West Midlands economy.



Interior – Civic House, Birmingham

SCHEME TO WATCH: *“Situated on the edge of Paradise Circus, Civic House has undergone a back to frame refurbishment transforming it from a drab 1980’s concrete framed multi-occupied office building to flexible serviced office accommodation fit for the next generation of tech savvy businesses. This scheme really demonstrates the potential that can be delivered by the reconfiguration of existing buildings to deliver quality space at the right rental level and balancing the risk and return on capital invested. There are still numerous buildings in Birmingham which are ready to be brought forward for refurbishment and our investor and banking clients are keen to deploy significant levels of capital into these refurbishment schemes.” - James Bent, Partner, TFT Birmingham*



SCHEME TO WATCH: *“In August 2017, 3 Arena Central secured Birmingham’s largest pre-let in over a decade with the Government Property Unit committing to take the full building on a 25 year lease to house some 3,600 civil servants and a number of functions, including the HMRC’s Midlands regional hub. 3 Arena Central is a prominent centre piece of the Arena Development in central Birmingham. Once completed in early 2020, it will provide 240,000 sq ft of Grade A commercial space over ground and 13 upper floors with 3 levels of basement parking beneath. TFT are acting as Fund Monitor on behalf of Legal & General. - Chris Gibbons, Partner, TFT Birmingham*

The region is forecast to see a pace of economic growth over the coming three years, second only to London and the South East (EY ITEM Club).

The region is at a pivotal position. International research has demonstrated that for the most part, the economic growth of cities outpaces that of regional hinterlands. This is the case in the West Midlands at present, with higher value activity focused in Birmingham.

However, the reinvented automotive industry is supporting high technology manufacturing and R&D in the wider region. Research undertaken by the Centre for Cities find that sector specialisation in a location can have a significant impact on achieving a higher pace of GVA growth. Cambridge and

Reading’s success in the ICT sectors are held up as examples. However, scale is also important. Critical mass and a diversified economy are essential for sustainable success. As noted in a previous TFT report, international evidence suggests cities benefit from agglomeration through higher productivity.

This presents a tremendous opportunity for the West Midlands, not just to raise economic output for the region as a whole but also for Birmingham to experience synergist growth: to move into the Accessible Excellence quadrant of the chart above. Real estate is a facilitator of both the scale and specialist industry requirements. The property sector was central to Birmingham’s transformation in recent decades, combined with major infrastructure improvements and city led coordination. The real

estate sector will now need to play a new role in delivering scale and an eclectic dynamism to attract both business and high-skilled workers, not only in the city centre, but across the region as a whole. This presents a great challenge for both the delivery of infrastructure demanding of a 21st century economy but also the coordination of strategy and investment.

To be effective the sector and major occupiers will need to work closely with individual cities in the region and well as the Black Country Consortium. The Birmingham City Plan, a two-decade masterplan for the city centre, seeks to transform the built environment and with it the economic potential of the city. This includes the regeneration and transformation of the 42-acre Smithfield area of the city, one of the largest city development sites in Europe.

However, beyond city boundaries devolution has provided the region with the opportunity to take a strategic and holistic approach to its future in the form of new West Midlands Mayor and the West Midlands Combined Authority (WMCA) that he chairs. The devolved powers, which now also include key issues of housing, skills and digital technology, in addition to transport and other key functions, provide the WMCA to deliver a strategic vision for growth in the region.

The property sector will need to provide its expertise to help steer this oversight, but it is our view the direction has the potential to be transformative.

CONCLUSIONS

1 New and emerging industries and occupiers can be anticipated to place increasing demands on the region's occupational property. The real estate sector holds a fundamental role in the delivery of the region's mission to achieve a step change in future economic prospects.

2 The UK Industrial Strategy and the Midlands Engine, geared to improve economic expansion, productivity and skills, have the potential to be transformative and achieve a step change in the fortunes of the region. These will be underpinned by the West Midlands Combined Authority under the leadership of the new West Midlands Mayor.

3 Beyond the city other areas of the region are seeing traditional industries evolve into higher value strains of themselves. The automotive and aerospace industries have seen a new lease of life with transport engineering joining the fray as HS2 pushes new engineering boundaries. These industries are supported by new research and education facilities which will deliver skills in demand by business.

4 Regeneration schemes across the city are delivering space for high value corporates and start-ups alike. The momentum must be maintained to meet demands for a diversity of business space at a range of cost points. Encouraging this diversity is essential to achieve a sustainable economic structure. It also delivers an urban fabric and vibe essential to attracting and retaining high skilled workers and presenting a confident face to future business occupiers.

5 Perceptions need to change in order to deliver suitable space to accommodate burgeoning growth and avoid the leaching of potential to other regions. Speculative space is needed, but we believe investors will be rewarded through the higher performance achievable on such space. The economy of the West Midlands is changing, and perceptions of the opportunity need to change with it.



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