COMMERCIAL

the Birmingham report
2018

FOUNDATION FOR THE FUTURE
A CITY OF PERPETUAL CHANGE

ON THE RISE:
SPACE AS A SERVICE
WE LOOK AT DEMAND, TRENDS AND WHAT'S HAPPENING NEXT

E-COMMERCE:
A GAME CHANGER FOR THE RETAIL AND LOGISTICS MARKETS

THE COMMERCIAL MARKET
How has **Birmingham** performed?

Brexit
THE IMPACT ON BIRMINGHAM

SPECIAL **BREXIT** FEATURE

HOW HAS THIS YEAR COMPARED TO LAST? CHECK OUT THE
STATS

the Birmingham report 2018

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Foreword

MATTHEW HAMMOND,
PwC

Matthew Hammond, regional chairman of PwC and the new chair of the West Midlands Growth Company.

The move to One Chamberlain Square in Birmingham is the largest single office investment PwC has made outside of London.

It comes as we are changing our footprint of how we operate in the UK. Roughly 60% of the people in our business are based in London, with 40% based around the rest of the UK. We are beginning to change that balance to 40%/60% to make the most of fast growing regions, like the Midlands.

That transition has already started. When I arrived in Birmingham three and a half years ago there were about 1,300 people working here. Since then, we've hired an additional 500 people, across almost all grades and school leavers.

Why Birmingham?

Firstly, the size of the Midlands economy made it an attractive destination.

Also, One Chamberlain Square is next door to a major train station connection that has experienced significant new investment – and Birmingham is now at the centre of the UK. rail network. Two minutes walk from our new place is the metro system, enabling us to further recruit talent from the whole of the West Midlands, with places like Wolverhampton within easy commutable distance.

Birmingham's international airport has just announced its draft masterplan 'The Midlands Gateway to the World'. We service clients in over 50 countries globally from the Midlands, which is reflective of our international client base. We have the benefit of many UK. listed companies also being based here and on top of that, there is a thriving entrepreneurial economy. PwC's 2018 Good Growth for Cities Index, which measures city performance across a range of measures, including work-life balance, new businesses and income distribution, placed Birmingham as the fifth fastest improving city, demonstrating the attractiveness of the Midlands to UK. business investment, foreign capital and investment.

Recruitment of talent is absolutely key. When we look at areas in which we wish to expand, decisions are based on whether we can access a broad range of experienced talent, but also new joiners from universities, higher apprentices and school leavers. We compliment this with looking for diversity in our talent base and our impact on place and social mobility. Five of the UK.'s top twenty universities are in the Midlands. The volume of talent is one aspect, but also Birmingham is 'sticky'. Graduates want to stay in the region.

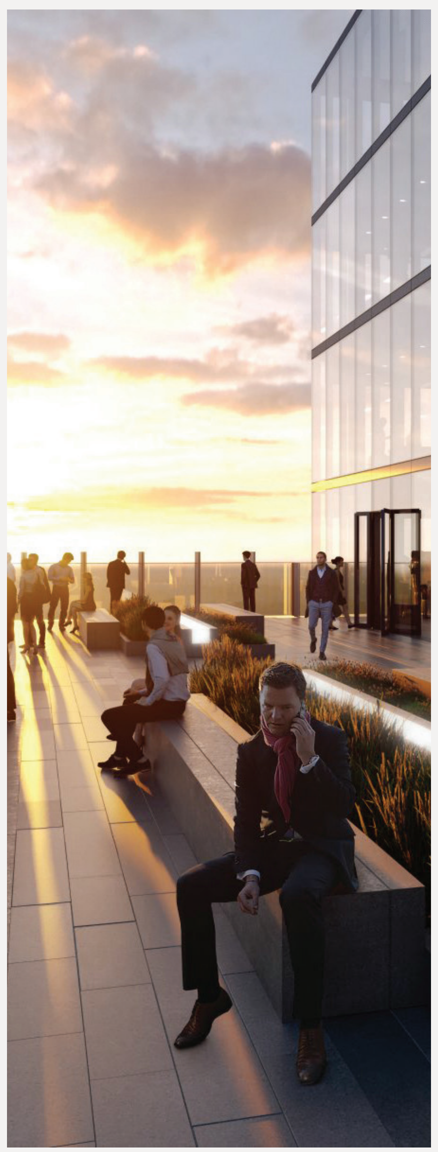
As for the city itself, our people keep telling me about the benefits of Birmingham, not least that they can rent or buy a home near to work. We also find our people want to enjoy the urban lifestyle, from outstanding theatre, arts, retail and leisure, not to mention the food scene – the city is blessed with several Michelin starred restaurants.

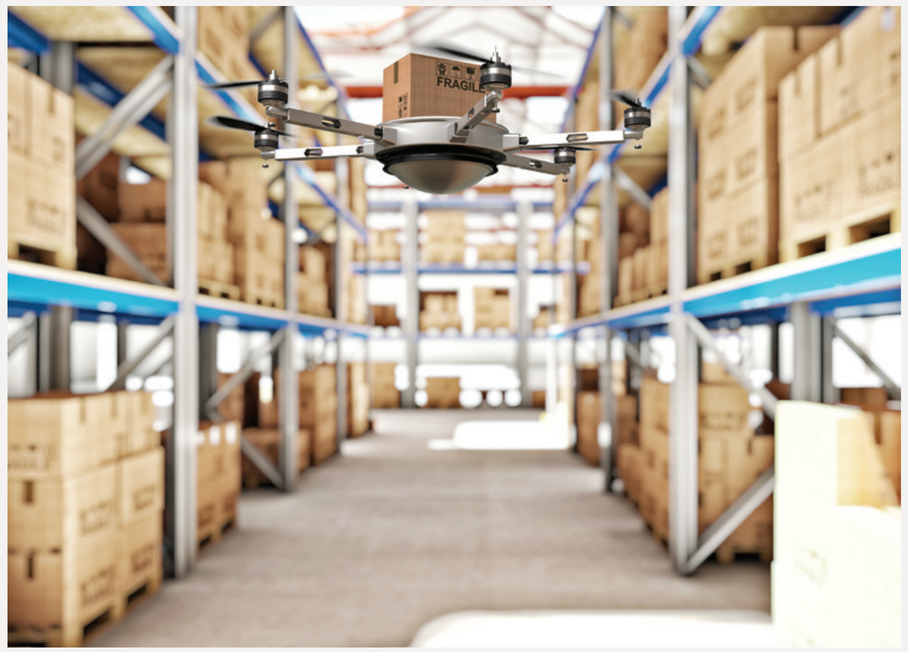
Birmingham has a reputation as a motor city. We should be proud of our industrial heritage and to be at the heart of the UK.'s road and rail networks. But even so, many of our staff live in the city and walk to work. This is part of a growing trend for a whole generation of non-car owners, and in this respect the great connectivity in Birmingham is key to them. I believe Birmingham will become one of the most walkable city centres in the UK. within the next decade, which is all supported by upgrades to connectivity.

Being a city this successful is about balance. I like to say Birmingham is big enough to matter, but small enough to have great connection between businesses. Birmingham is a place where leaders can make things happen.

CONTENTS

Overview





Written by
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and
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A City of Perpetual Change

"Without continual growth and progress, such words as improvement, achievement, and success have no meaning". Birmingham probably wasn't at the forefront of Benjamin Franklin's thoughts when this statement was made, but his comments very much resonate with the experiences of the city.

Birmingham is on a journey of growth. It is now the most populous UK. city outside of London after experiencing a rise of 16% in resident numbers since 2000. In fact, a recent study by the Centre for Cities reported that the city centre population of Birmingham

alone has risen by 163% since 2002. Birmingham boasts the youngest & most diverse population of any major city in Europe, with approximately 40% below the age of 25. Importantly, with 65,000 university students, Birmingham is second only to London in terms of nurturing the next wave of highly skilled employees. In short, the foundations of continued growth are being cemented and developed at an early stage.

Birmingham – open for business

Central to the attraction for young professionals has been the rise in employment opportunities. The number of highly skilled jobs in Birmingham has risen by 17% in just the past five years. International companies such as WSP, PwC, Barclays, ACS, Deutsche Bank, HSBC and RBS have all relocated parts of their operation to Birmingham in recent years, and thus have supported the offer of a defined career path to graduates. Many new jobs have been created through foreign direct investment (FDI). A total of 171 new FDI projects were recorded in the West Midlands during 2017/18, a 13% rise when compared to the previous year and the highest total of any UK. region outside of London. Importantly, Birmingham's attraction to fledgling companies also provides a strong future foundation, with the city named the UK.'s most entrepreneurial in 2016.

So why Birmingham?

In the last 10 years, there has been enormous strides in blending the mix of uses within developments, thus creating a sense of place, vibrancy and energy both within and immediately outside the working environment. Take a tour of the city and the progressive and positive changes are brought into stark context. Smart new apartments sit alongside new offices. Social amenities such as cafes, bars, restaurants, new green spaces, urban parks and gyms are aplenty and support the creation of a 'lifestyle' appeal. Birmingham has also most recently won the right to host the Commonwealth Games in 2022, an accolade perhaps unthinkable just a few years ago. Looking ahead, the skyline of cranes serves as indication of, not just an ongoing and escalating programme of new development, but that evolution to drive growth is a continual process.

Birmingham's digital revolution has begun

The core sectors such a professional services, the financial services and the public sector remain the mainstay of employment and therefore space demand in Birmingham, but new sectors are emerging and increasingly influencing the shape of Birmingham. Technology, for example, is both a disrupter and an opportunity. The sector is aiding the structural changes of traditional demand, but also increasing as a user of space in its own right. Jobs within the Technology sector, for example have increased by 13% in the past two years. The growth of Silicon Canal and Innovation Birmingham provide testament to this and further growth will be supported by the new £250m Midlands Engine Investment Fund.

> "There is nothing permanent except change."
> – Heraclitus

Co-working phenomenon – next stop Birmingham?

An interesting and significant consequence of technology start-up growth, although now universally used across industry types, has been an increase presence of co-working providers in Birmingham. This subsector has accounted for 22% of office take-up in Birmingham over the past 24 months, growth that perhaps typifies both a change in occupier preferences and the role of the workplace. Of the large providers, Regus has been most active with lettings at The Lewis Building and The Crossway. Competition is growing however, with US giant WeWork actively sourcing space in the city.

What next for Birmingham?

The next phase of Birmingham's growth is dependent on its ability to align with this ever-changing environment and appeal to growth industries. The office is no longer a place of operational containment. Instead, offices will serve increasingly as a place to improve communication, collaboration and innovation. As such, the office is positioned – either implicitly or explicitly – as an innovation lab, hub, a business accelerator or incubator.

Furthermore, occupiers, regardless of sector, are increasingly leaning toward buildings and places that can offer a comprehensive 'lifestyle' package, with personal amenity perhaps the future direction of travel. Wellbeing, for example, is one of the fastest growing global trends in office design, with an all round wellness package a growing part of talent management strategies and the way in which real estate supports this endeavour is of strategic importance. Similarly, educational facilities will support personal development, vitally important at a time of acute skill shortages and a need for more flexible, short-term forms of learning throughout an employee's career.

With business success increasingly predicated on the ability to generate and commercialise new ideas, the office has itself become more fundamentally linked to corporate competitiveness. This shift will drive new concepts in the use and design of office space, as well as add importance to location.

Birmingham, of course, continues to undergo huge change through largescale regeneration and transport infrastructure improvement. From an offices perspective, the city is rich in new development with schemes such as Snowhill, Paradise Circus and Arena Central all positioned with place creation on a micro and macro scale as a central strategy. Birmingham's attraction therefore is seemingly well positioned to catch the next generation of businesses. Evolution is and must be, a continuous process however.

Written by
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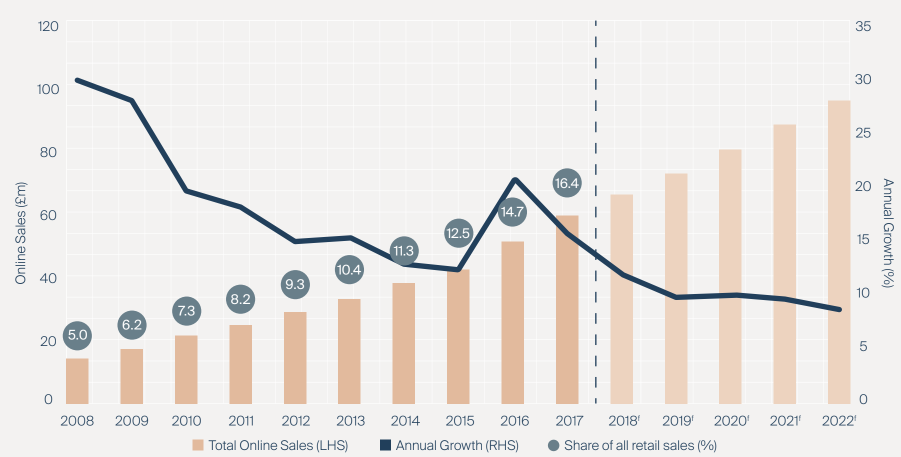
A game changer *for both* Retail & Industrial

The retail and industrial property sectors have long been bedfellows, but the latter is certainly stealing the duvet in terms of performance.

Both sectors are heavily embroiled in the e-commerce revolution, albeit with contrasting agendas. For retail, the rise of online has been both an opportunity and a huge challenge, often in unequal measure. For industrial, the street has been more one-way, as the widespread clamour for improved supply chain infrastructure has provided a massive fillip to the logistics market. These trends are playing out nationally, including Birmingham and its hinterland.

Figure c1 – UK. Online Sales 2008 – 2022f
Source: Mintel/Knight Frank



Total online sales are projected to reach £67 billion in 2018, and account for around 18% of all retail sales in the UK. Leading retail and consumer analytics firm CACI estimates that around £421m of this online spend originates in the immediate catchment area of Birmingham, the third highest figure in the UK., behind London and Glasgow.

However, the reality is that the dividing lines between channels are blurring to the point of becoming meaningless. The notion of online being in conflict with stores is increasingly tenuous – online works in collaboration with stores, rather in competition. The future is not online. The future is not stores. The future is about both, and how they seamlessly interact. Birmingham has experience in this with MADE.com opening a physical store at The Mailbox. It is also rumoured that other online retailers are looking to roll out similar 'showrooms'.

E-commerce is increasingly more about the qualitative than the quantitative. The single most significant factor of e-commerce is that it has dramatically changed consumer expectations. The rise of online has given rise to the 'anything, anytime, anywhere' on-demand consumer and the bar of expectation is higher than ever before. This has had an effect in how items are delivered as consumers are not willing to wait.

Many retailers have got ahead of themselves in their promises to consumers and are running before they can walk. Few have the necessary infrastructure to adequately cater for the huge demands that e-commerce is placing upon them. Most are making do with what they have, but this masks some serious operational shortcomings. This is giving rise to an increase in demand and development of 'last mile logistics' within city conurbations, typically of between 20k-100k sq. ft. to tackle this instant delivery need.

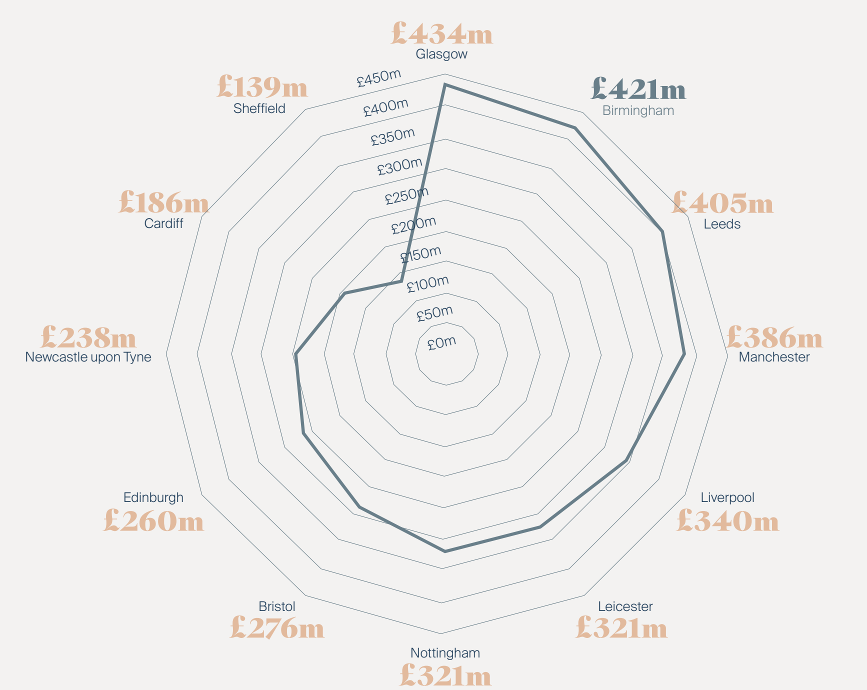
E-commerce is increasingly more about the qualitative than the quantitative

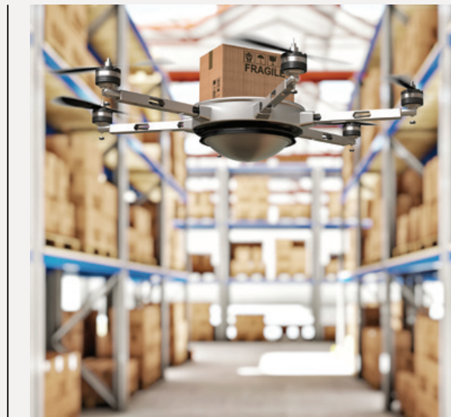
For all the progression of e-commerce, the main conundrum remains – how to fulfil lofty consumer expectations in an efficient and cost-effective manner. The need for retailers to have access to a more nimble and flexible supply chain remains a huge opportunity for the industrial market. Demand for new warehousing space is being driven as much by store-based retailers' making their multi-channel operations fit for purpose, as it is pure-plays scaling up their infrastructure to support their growth. This should see Birmingham well-placed to create a network of schemes and sites to further service this growing demand.

This is manifest in recent industrial take-up in and around Birmingham and the wider West Midlands region. To a degree, John Lewis set the tone by taking 50,000 sq. ft. of space on a 25 year lease at the Solihull Business Park at the end of 2013. More recently (July 2017), Argos, another key exponent of multi-channel retailing, took 69,000 sq. ft. on a 10-year lease at The Hub in Birmingham.

Other retail leasing deals in the area include lettings to upholstery operator DFS at Bullseye, Wednesbury (55,000 sq. ft. 10 years), value book and stationery retailer The Works at Black Velvet, Hams Hall, Coleshill (172,000 sq. ft. 20 years) and value furnishings retailer Dunelm at ProLogis Sideaway, Stoke (525,000 sq. ft. 10 years). The latter deal in particular highlights Dunelm's strategic intent to upscale the online side of its business.

Figure c2 – Online Spend in Largest Regional Cities 2018
Source: CACI/Knight Frank





We are predicting that this shift in retail use on the high street, and the change in city centre culture and consumer demand, will see repurposing of sites and premises to give further drive to the 'last mile logistics' market. With the incoming clean air zones, increasing reliance on public transport and growing inner city living, reducing car usage within the city, it could be that we see edge-of-city car parking redundant thus giving rise to mixed logistics and residential, or a new type of permitted development for existing multi-storey car parking and retail parks, for which the logistics sector is the target market.

It is not just sales but also returns that are demanding new space. These are typically smaller than regional distribution centres, but are serving a huge growth market and retailers are being forced to improve reverse supply chains to cope with the fallout from returns. It is thought £20bn of items bought over the internet are returned. However, there could still be room for further growth in the need for returns centres around the country, as the UK. has 25% returns for women's fashion ordered online (the category notching up the most returned items) compared with 70% in Germany. The ability to turn these around quickly means retailers and the third party logistics firms servicing them will need to invest further.

Last mile logistics remains something of the holy grail nationally, particularly in areas of high online shopping propensity and low industrial space availability.

In Birmingham, the imbalance is less pronounced with a healthy online shopper base, matched by appropriate industrial stock at affordable levels. With a national mismatch between where retail distribution sheds have historically been located (the North) and where online consumer demand is highest (London and the South East), maybe Birmingham benefits from the best of both worlds?

Written by
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Global Head of
Occupier Research

By Popular Demand

The most dominant recent trend in global real estate markets has been the dramatic rise of co-working.

Estimates suggest that there are now almost 18,000 co-working spaces around the world, accommodating almost 1.7 million workers – a growth of 3,500% and 8,000%, respectively, since 2010. Growth has been so dramatic that lettings to co-working operators have quickly become a mainstay in many global leasing markets, building on the more established serviced and flexible space that has featured since the mid-1990s.

This represents a structural shift for property towards the development of a flexible, customer-centric service rather than the simple provision of a fixed, rigid physical product. The onset of Space-as-a-Service.

The allure of Space-as-a-Service

Space-as-a-Service differs from traditional supply-side approaches in a number of important ways:

Flexibility: Typical UK. lease lengths, although shortening, still require occupiers to commit to a term that represents at least two business-planning cycles. This presents great risk to an occupier. Space-as-a-Service, gives the tenant greater control over the duration of their occupation.

Aligning space to need: Space-as-a-Service models enable the occupier to align the amount of space they take from the operator with their precise business needs, down to a workstation level. This negates the need to hold expensive, under-utilised space in support of future potential expansion and enabling rapid scale-up or scale-down.

Community & collaboration: Co-working models often bring people working for different organisations into closer proximity with the design of the space, increasing collaboration and creating communities.

Customer service & engagement: Space-as-a-Service operators flourish or flounder on the quality of customer service and engagement. At the heart of this engagement is a mission to provide experiential spaces that stimulate workplace satisfaction, happiness and ultimately, productivity.

Space-as-a-Service in the Birmingham Market

Over the last 18 months Birmingham has witnessed an explosion in flexible office provision. More than 20% of Birmingham transactions (approx 313,000 sq. ft.) have been divided between various flexible models such as co-working, traditional managed centres, and operators who are providing a fixed term, fully serviced office, to identified occupiers. Instant Offices and MSO have been notably active, acquiring a number of locations to provide space for contracted clients.

The 'new' co-working model also saw a number of entrants to the market. This part of the industry which is aimed at giving a sense of community and collaboration whilst tapping in to new industry and thinking, saw aggressive growth from a standing start with Spaces by Regus the most active.

The traditional market, of which most people are most familiar with, also saw extremely encouraging take-up demonstrating that there is still demand for this offer with iHub and Orega expanding.

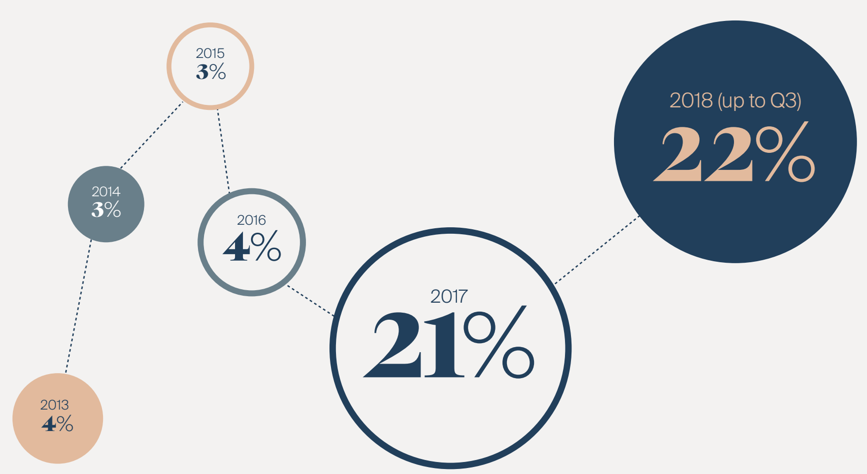
With traditional occupiers looking at flexible options to give them the ability to stretch their reach, it should give comfort to landlords that this will assist, rather than compromise leasing.

This, coupled with the announcement that WeWork and other 'challenger' brands are actively searching for solutions within the Birmingham market, demonstrates potential for further growth. All of this points to the structural shift in the market as some operators build scale while others look to create a more bespoke but highly serviced offering.

OPERATOR	LANDLORD	BUILDING	SIZE
Instant Offices	Bruntwood	Cornerblock	24,000 sq. ft.
	Kier Property	19 Cornwall St	17,000 sq. ft.
	Nurton Developments / VAX	2 Colmore Square	21,232 sq. ft.
BE Offices	Circle Properties	Somerset House	38,162 sq. ft.
Spaces by Regus	L&G	The Lewis Building	30,000 sq. ft.
	Longmead Capital	Crossway	80,000 sq. ft.
Regus	Kennedy Wilson	Apex	11,500 sq. ft.
Alpha Works (CEG)	CEG	Alpha	14,000 sq. ft. (additional space)
Orega	Ashby Capital	The Colmore Building	11,343 sq. ft. (additional space)
iHub	Aviva Investors	Colmore Gate	18,378 sq. ft. (additional space)

Figure c3 – Flexible Working Sector Take-Up

Source: Knight Frank



"Birmingham is not immune to this global trend and whilst being sluggish on the initial take-up, the city is catching up quickly."

Does a rising tide lift all boats?

The rise of Space-as-a-Service models presents conventional landlords – those with a proven record of providing high quality physical products but on fixed terms – with challenges.

Space-as-a-Service models have released the genie of customer service from the property bottle. While there will continue to be occupier demand for core space on longer leases, to capture all market demand, landlords will need to provide greater flexibility, cultivate customer relationships, become ever more understanding of the customer's business and be more responsive to their needs. Failure to do so will reduce the size of their addressable market and hence limit performance.

As landlords take on this challenge, the gap between conventional real estate product and Space-as-a-Service will converge. Convergence will see the co-working and conventional product co-exist but the distinction between the two will become increasingly meaningless.

"...the gap between conventional real estate products and Space-as-a-Service will converge."

Already we are seeing this co-existence within physical product with occupiers opting for buildings that provide circa 10–20% of total space on a flexible basis alongside more conventional 'core' occupancy. From a landlord's perspective this flexible provision becomes the lungs of the building giving firms the ability to expand or contract and bringing real vibrancy to the space.

As landlord's respond, either independently or in closer partnership with existing operators, all space will move towards showing those core characteristics that have driven the Space-as-a-Service phenomenon to date. Embracing Space-as-a-Service models is key to the vibrancy and competitiveness of not just the Birmingham market, but landlords themselves and these new disruptive models should be embraced.

For more on the evolution of Space-as-a-Service please take a look at (Y)OUR SPACE, Knight Frank's new flagship research document providing insights from the global workplace.

What impact has the serviced office model had on investment?

Investors have embraced the sector either by accepting leases to operators or establishing their own platforms.

The sale of Crossway, Great Charles Street by Dunedin Property /Angelo Gordon to Longmead Capital represented the first true example of a single-let serviced office building trading as an investment in the new era of Space-as-a-Service. The investment offered just over a 10 year term certain at £21.50 psf. with a conditional guarantee from Regus PLC. The purchase price was understood to be £30m representing a net initial yield of 5.75%. This yield paid demonstrated that investors clearly haven't been put off by this model which is further demonstrated by the edge of core location of the building.

Buildings such as 2 Colmore Square and 11 Brindleyplace (under offer at the time of print), both with significant levels of serviced offices, have also traded at strong levels demonstrating that purchasers are comfortable with this 'new' addition to the landscape.

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Property Matters

Occupational

The gravitational pull of the city continues to factor in occupier decision-making.

The role of property as a strategic tool to attract the best staff and assist operational efficiency is growing.

A shift in living habits and demands of the new work force mean that a greater focus on central locations is an important part of this changing picture. Together with technological innovation, it is aiding occupiers to achieve a lifestyle balance.

The huge investment in infrastructure in the city, which is in part driven by inward investment and public events such as the forthcoming Commonwealth games, will only serve the city well when targeting further jobs and growth.

Even though, as a city, Birmingham lost out on the relocation of Channel 4, via its bid, it has demonstrated that the city is able to compete for relocations. The loss of this should only galvanise determination toward securing the next big occupier.

Key Office Leasing Transactions (ytd 2018)

OCCUPIER	LANDLORD	BUILDING	SIZE
WSP	Brockton Capital	The Mailbox	46,100 sq. ft.
BE Offices	Circle Properties	Somerset House	38,162 sq. ft.
Secretary of State	London & Scottish Investments	Norfolk House	36,484 sq. ft.
Environment Agency	Canal and River Trust	Aqua	26,799 sq. ft.
Zurich Insurance	Ashby Capital	The Colmore Building	23,000 sq. ft.
General Dental Council of Great Britain	Legal & General	1 Colmore Square	22.043 sq. ft.
West Midlands Trains	TRIUVA KVG	134 Edmund Street	21,743 sq. ft.
Network Rail	Hermes Investment Management	Baskerville House	14,320 sq. ft.
Jacobs Engineering	Nurton Developments	2 Colmore Square	13,825 sq. ft.
Business Growth Fund	Legal & General	The Lewis Building	12,390 sq. ft.
Unity Trust Bank	HAIL	4 Brindley Place	10, 088 sq. ft.

Royal Institution of Chartered Surveyors

Most recently, the RICS have relocated their UK. Headquarters to Birmingham City Centre from a Coventry Business Park location. The principal decision metric behind this major relocation was to raise the profile of the organisation. The RICS acquired 30,000 sq. ft. at 55 Colmore Row at a headline rent of £33.00 psf.

Advanced Computer Software Group

ACS relocated all of their UK. staff to 65,000 sq. ft. at The Mailbox – this was the first large scale TMT relocation to the city and has been a catalyst for others to buy into the Silicon Canal. This relocation was driven by staff recruitment metrics, quality of life for staff and the ability to tap in to the growing TMT sector in Birmingham.

Hogan Lovells

Hogan Lovells have quadrupled the size of their occupation, taking 23,000 sq. ft. of space at The Colmore Building within Central Birmingham paying over £31.00 psf. to take advantage of the cost benefits such as lower wages and property costs etc, which can be secured by expanding the regional office footprint when compared to the London and the South East. We have seen a number of professional services firms relocate elements of their businesses to Birmingham. These are not back office jobs but high quality appointments who, in an ever globalised world, can carry out work in a number of locations.

Take-up

The take-up of Grade A accommodation repeatedly accounts for over 50% of total activity within central Birmingham. This is driven in part by the occupiers' seeking to raise the profile of their business and enhance their staff recruitment potential.

The wellbeing of staff and the workplace is shaping occupier decision-making. Access to open views, green walls, health and leisure facilities and high quality on-site catering is becoming as important as fresh air supply, the provision of bike racks or favourable BREEAM accreditation, for example.

From a supply perspective, the remaining available stock will have eroded further over the next six months. This will put the city at a historic low for availability at a point when demand from all sectors and inward investment has never been higher. The direct impact on rents should see growth accelerate to new highs and put increased pressure on the pipeline to react giving confidence to investors to keep pace up. The city must work towards a collaborative solution, with local government, developers and the investment community unified in the goal of redefining the core and the wider city to support future growth.

Key performance indicators

2018 to the end of **Q3** has recorded a take-up of **477,347 sq. ft.** with a balance of local churn and inward investment. We expect the remaining quarter to be considerably stronger.

We expect positive sentiment to dominate over the next 12 months with the announcement of **HS2** commencing construction at Curzon Street and the **Commonwealth Games** in **2022**. These two external factors will help drive and provide a continued resilience in Birmingham's economy, giving occupiers confidence to make the move.

As a consequence of the restricted new Grade A supply, refurbished buildings will step up to take the strain of current demand. Occupiers with lease events from **2020 – 2024** are now accelerating their strategy and focusing on the next wave of development. We expect to see some of these commit to new buildings well in advance of events.

At the end of **Q3 2018** Grade A new build availability was 120,000 sq. ft. with a maximum of **55,000 sq. ft.** available in a single building. This compares favourably to previous years and shows true net absorption and growth rather than recycling of occupiers.

We expect the flow of deals to increase as **Q4 2018** progresses due to transactions currently in solicitors hands completing and further demand being satisfied.

We are aware of a number of lettings currently in advance talks at city centre office buildings including The Lewis Building, One Colmore Square, The Colmore Building and Baskerville House as well as some pre-let discussions which may well be announce before the end of **2018**.

Rental levels being discussed are typically between **£28.00 and £35.00** psf.

Investment – Birmingham Offices

Currently there is a focus from the UK. institutions on CBD offices across the major UK. cities, tying in with the philosophy of seeking defensive investments offering long term returns. As a result, all the major funds have requirements for Birmingham if the ideal stock can be sourced. The past 24 months has seen an improved level of stock come to the market and interest has been high. As a result, investment volumes have risen, with several prime offices being traded during this period.

Since the beginning of 2017, office investment sales have amounted to just over £900m. Buyers have come from a range of sources including UK. institutions, Private Equity and overseas including newcomers to the market.

Key Investment transactions:

BUILDING	OCCUPIER	VENDOR	PURCHASER	PRICE
55 Colmore Row	Multi-let	IM Properties	European Cities Fund c/o TH RE	£98m (4.9%)
2 Colmore Square	Multi-let	Nurton Developments	Railways Pension Trustees	£95m (6.4%)
5 St Philips Place	Multi-let	Savills Investment Management	Royal London Asset Management	£45m (4.7%)
The Cube	Multi-let	Tristan Capital Partners	Talisker Corporation	£51m (6.3%)
3 Arena Central	HMRC	Miller Developments	Legal & General	£125m (3.7%)

Knight Frank currently report prime office yields in Birmingham at 4.75% and anticipate this level to be maintained for the foreseeable future.

There are a number of key buildings currently in the market:

- Bank House (under offer at circa £20m)
- The Colmore Building (£178m, 5.18%)
- 2 Brindleyplace (under offer quoting £31.75m)
- The Lewis Building (£136.3m, 5.75%)
- The Mailbox (£235.5m, 5.25%)
- 11 Brindleyplace (£40.3m)

With deals predicted to complete on some of these before the end of 2018 it could be a very positive year for Birmingham.

Investment – Industrial & Logistics

Over £420m of industrial stock has been traded in the West Midlands so far in 2018. A growing trend has been the establishment of major mandates given by large pension funds and private equity firms to specialist industrial investment managers to invest on their behalf. Examples include IO Asset Management (OBO Tesco Pension Fund), Harmsworth Pooled PUT (OBO Daily Mail Pension Fund) and M7 (OBO Blackstone), who have all created new investment platforms in 2018 resulting in them being highly acquisitive.

The clear focus on industrial reflects the anticipated levels of rental growth being predicted in the coming years, particularly in the distribution and logistics sector. Retailers are increasingly moving online, with well-located and accessible warehousing the linchpin for this rapidly growing sector. The West Midlands is ideally suited to capture this with 90% of the UK. being accessible within 4 hours.

The challenge in 2018 to match this demand has been the levels of stock. Supply is not keeping up with demand which has impacted on yields. The majority of transactions for single-let warehouses have been as a resulted of new lettings, pre-lets or lease regears.

Commentary: Birmingham is currently seeing unprecedented levels of population growth, impacting on the levels of demand from the online retailing supply chain. Knight Frank is forecasting this trend to continue to have a positive effect on rental levels and capital values. The industrial sector continues to perform other markets and supply is not maintaining pace with demand, despite increased levels of speculative development. Investors are being hamstrung by a lack of stock currently, it is the only sector with projected positive rental growth prospects in the short term.

Knight Frank currently report prime industrial investment yields in the Midlands at 4.5%.

BUILDING	OCCUPIER	VENDOR	PURCHASER	PRICE
Ansty Park, Coventry	Meggitt	Manse Opus LLP	Lime Property Fund	£73.4m (3.7%)
The Hub, Birmingham	Kitchencraft	IM Properties	NFU Mutual	£33.89m (4.63%)
DC3 Prologis Park, Fradley, Lichfield	Anixter	Prologis	Aberdeen Standard Life	£26.76m (4.45%)

Development

The hard facts could lead us to conclude that there is a significant volume of supply on the horizon in the city core.

However, on closer analysis, this gross figure of circa 1m sq. ft. over the next two years somewhat distorts the actual market dynamic. Of the current developments under construction, including Patrizia / SterlingPV's 103 Colmore Row, M&G Real Estate / Ballymore's 3 Snowhill and Hermes Investment Management / Argents 2 Chamberlain Square at Paradise we are seeing a significant level of advanced pre-let discussions with occupiers.

PwC have now committed to the remaining space in one Chamberlain Square meaning that this is fully pre-let prior to practical completion. Other developments under construction and included in the take-up figures are the pre-let to HMRC (240,000 sq. ft.) and the recently completed and occupied HSBC HQ (225,000 sq. ft.).

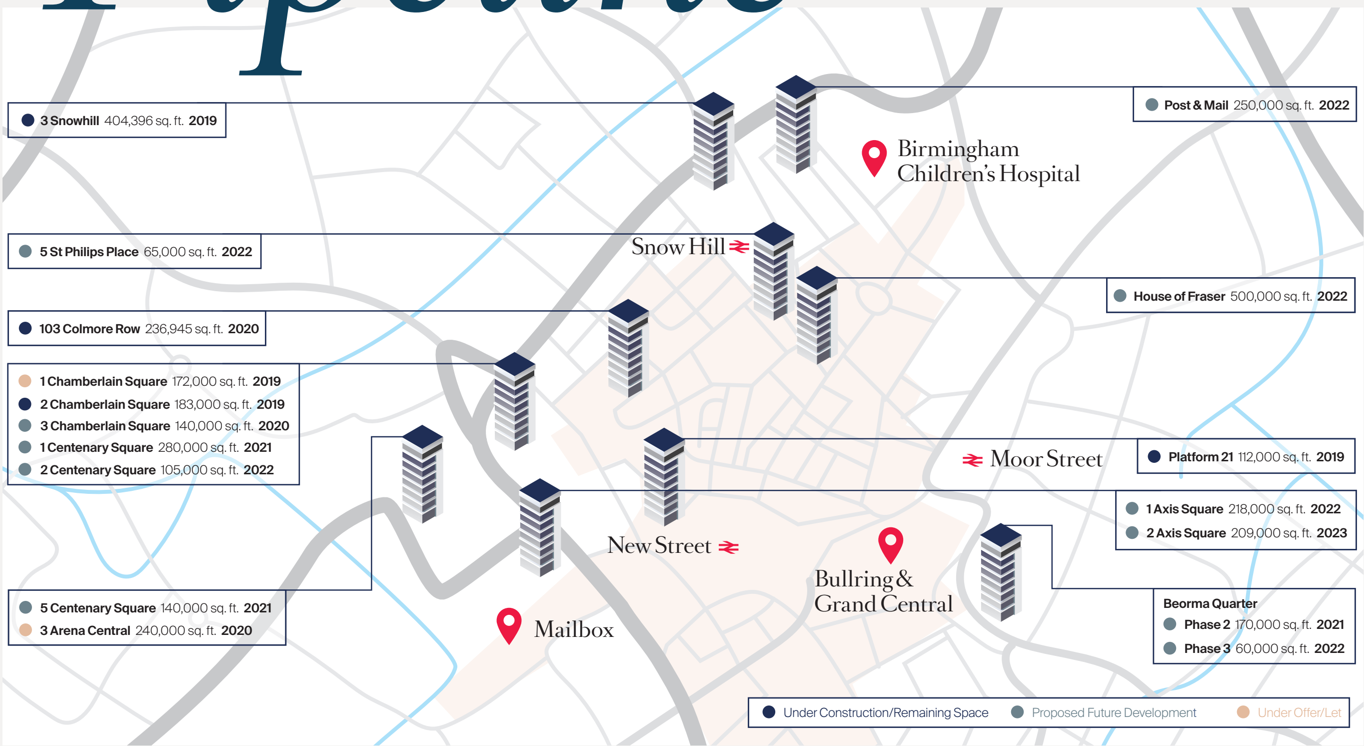
These leasing pre-lets, occupier sales, space under offer and those conversations with occupiers which are in advanced negotiations mean that the perceived levels of supply remaining can be misunderstood by those not in receipt of the full facts and can be hugely over estimated.

Availability is, and will, continue to be under pressure. Birmingham's development pipeline (2019 – 2022) is less than the 10-year average Grade A take-up, when considered over the same time frame.

Birmingham Pipeline


Beorma Quarter


Axis Square




103 Colmore Row


Paradise


HMRC HQ


Platform 21


3 Snowhill

Figure c4 – Birmingham Offices

Source: Knight Frank

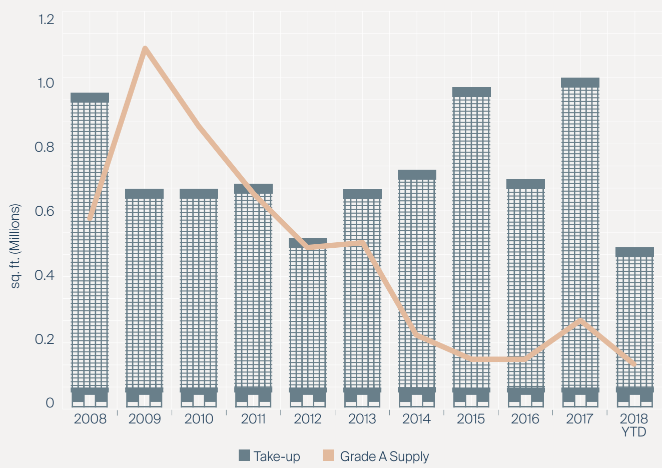


Figure c5 – Office Rents (£ per sq. ft.)

Source: Knight Frank

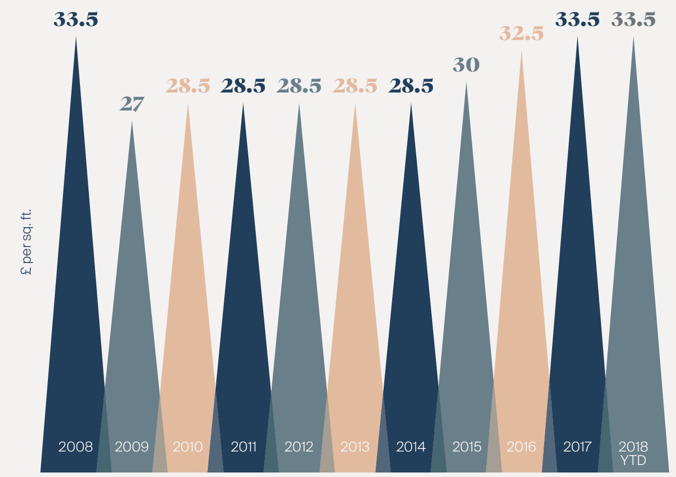


Figure c6 –Midlands Industrial (Take-up sq. ft.)

Source: Knight Frank

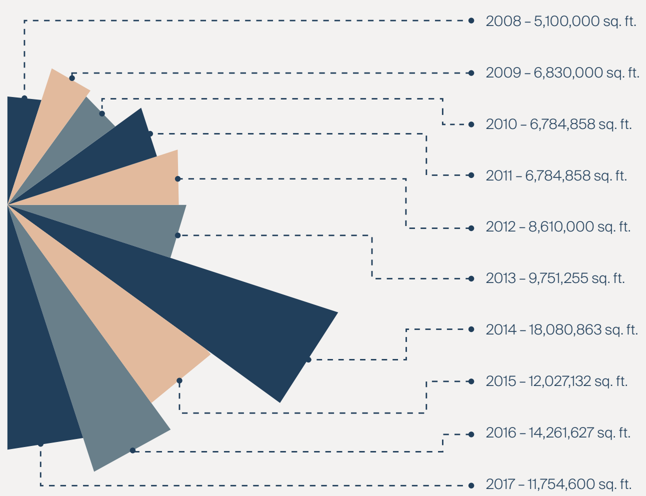


Figure c7 – Prime Yields %

Source: Knight Frank

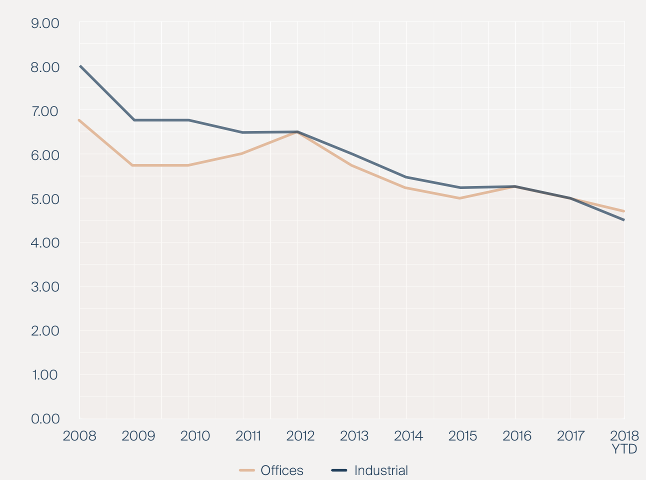
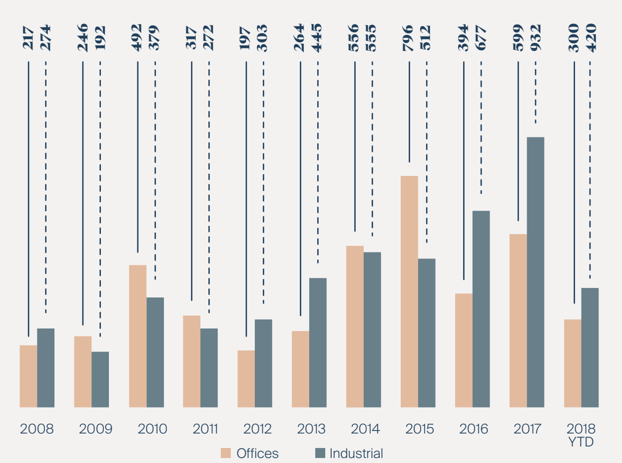


Figure c8 – Investment £m

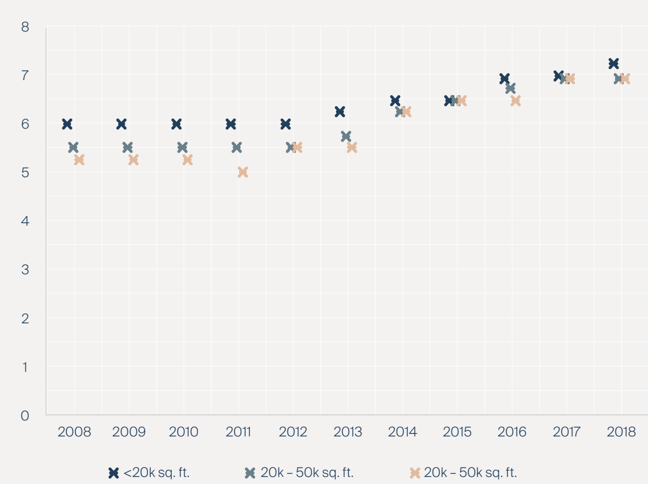
Source: Knight Frank/Property Data



Statistics are correct as at Q3 2018

Figure c9 – Industrial Rents (£ per sq. ft.)

Source: Knight Frank



Brexit

THE IMPACT ON BIRMINGHAM

Written by
JAMES ROBERTS
Chief Economist

Undaunted *by Brexit*

Expectations that Brexit would derail Birmingham's economy have proved wrong, as economic indicators show robust growth for knowledge industries

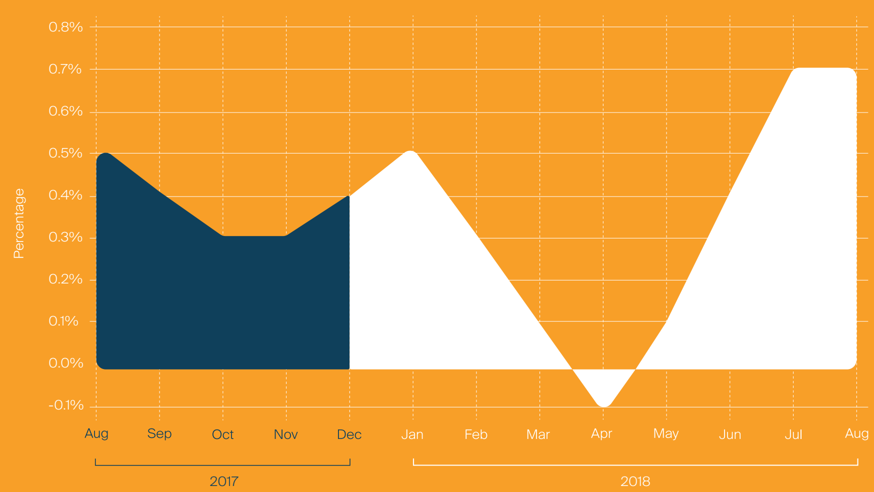
What is everyone so worried about?

The latest statistics from the Office for National Statistics (ONS) show impressive falls in unemployment in the West Midlands. In June 2016, the jobless rate was 6.1%, yet by August 2018 it had fallen to 4.7%. Workers in the West Midlands are more likely to be in a paid job than those in the Eurozone, where the unemployment rate is 8.1%.

With 2.8 million people in employment, the workforce of the West Midlands has never been larger. Around 120,000 new jobs have been created since the referendum to leave the EU. Moreover, the jobs being created are often high value roles in knowledge industries. The number employed in professional, scientific and technical jobs has increased by 22% since the referendum (or 43,000 roles), accounting for over a third of the increase in total employment. This bodes well for the West Midlands prospering in the new age of digital technology, bioscience, robotics and machine learning.

Figure b1 – UK GDP over the previous three months

Source: ONS



> The number employed in professional, scientific and technical jobs has increased by 22% since the referendum (or 43,000 roles), accounting for over a third of the increase in total employment.

Brexit Britain

Given the above figures, if Birmingham were in any other country in the world, everyone would be bullish on the outlook. However, it is located in Brexit Britain, so the mood is sombre. The political drift in Westminster grabs the headlines, and distracts from the very real growth we see in the economy.

The UK economic statistics are not at all in-line with the tone of the debate on Brexit. Over recent months, the Brexit discussion has darkened, but in parallel the GDP figures have gained momentum – see figure b1. However, the question remains, could the political situation become alarming enough to cause a slump in business confidence, resulting in an economic downturn?

To answer this, we need to look at the Parliamentary arithmetic. The House of Commons will always have an emergency brake on the government via a motion of no confidence. At present, it is thought that around 40 or 50 Conservative MPs are Brexit hardliners, as well as a dozen Labour MPs. To push through a hard Brexit, a government has to be sure it will keep the support of at least 326 MPs, and presently the Eurosceptics cannot muster the numbers to force through a no deal departure.

Kick the can

Given the vast majority of Parliamentarians would prefer something more moderate than a hard Brexit, the mathematics currently favours a combination of fudge and 'kick the can down the road'. This points to further political drift, but that is not a destabilising outcome. As we have established above, the UK economy is still growing despite the drift. If the politicians can only offer more of the same in 2019 and 2020, that is an outcome that still delivers growth and jobs.

We believe the UK Parliament will accept the ambiguously worded Withdrawal Agreement, clearing a path to a transition period, running to at least December 2020. After which we see a trade agreement on the Canada +++ model taking over, which has been hinted at by the EU's chief negotiator, Michel Barnier.

Long-term trends

As a result, in 2019 and 2020 we see the UK economy shaped more by long-term trends, like the digital revolution and the war for talent. Birmingham is expanding as a location for knowledge industries, as shown by growth in professional, scientific and technical job numbers. This puts it in a strong position to prosper in an economy driven by firms whose main capital is the minds and imaginations of their staff.

This brings us on to the war for talent, as in the future Birmingham's firms will compete fiercely for staff. Real estate will play its role in the war for talent, as more companies look for wow-factor offices to provide workers with an office that inspires and makes them feel valued.

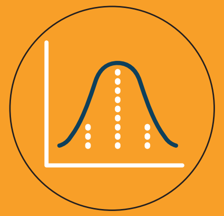
Risk Radar

Below are the four key risks facing Birmingham's economy, with our rating of one (low) to five (high) of the likelihood of occurring.

Labour Shortages

Likelihood **5**

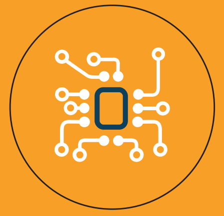
Unemployment in the UK is at its lowest for decades, and pay inflation is accelerating. Brexit has made immigration a political hot potato, so an intensification of the war for talent is certain. Expect more employers seeking wow-factor offices that boost staff morale.



The end of QE

Likelihood **4**

The Bank of England has indicated that interest rates are now on an upwards trajectory. However, rates are also expected to peak at lower levels than we were used to pre-2008. The risk premium offered by property yields will absorb most of the increase.



Tech Stumbles

Likelihood **3**

Stock market volatility in October reminds us that the tech sector is no stranger to boom / bust cycles. However, tech is also delivering a continuous flow of innovations that are transforming our lives. A stumble will happen one day, but remember a new cycle always follows.

Hard Brexit

Likelihood **3**

While both sides are pursuing a tough negotiating line, there have been regular hints from the UK and EU at a willingness to ultimately compromise. On the UK side, preparations for a no deal scenario have been minimal, which limits its ability to walk away from talks.

RESIDENTIAL

Knight Frank

the Birmingham report

2018

OUR 2019 PREDICTIONS

THE RESIDENTIAL OUTLOOK

BRINGING YOU THE MARKET TRENDS

PIPELINE CHALLENGES

DEVELOPMENT TRENDS AND HELP TO BUY

LETTINGS FOCUS

Brexit

THE IMPACT ON BIRMINGHAM

SPECIAL **BREXIT** FEATURE

HOW HAS THIS YEAR COMPARED TO LAST? CHECK OUT THE

STATS

the Birmingham report 2018

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Knight Frank

Foreword

IAN STUART
Chief Executive, HSBC UK

This autumn has been an exciting time for HSBC UK as we opened the doors of the head office of our new ring-fenced bank at 1 Centenary Square, Birmingham. This has been the culmination of many years of work, not only to develop the building, but also to create a brand new bank. Ring-fencing legislation comes into effect in the UK on 1 January 2019 and while the legislation didn't require banks to physically separate the head office of the ring-fenced bank from the non-ring-fenced bank, HSBC UK embraced the unique opportunity it presented to create a new and better bank for our customers.

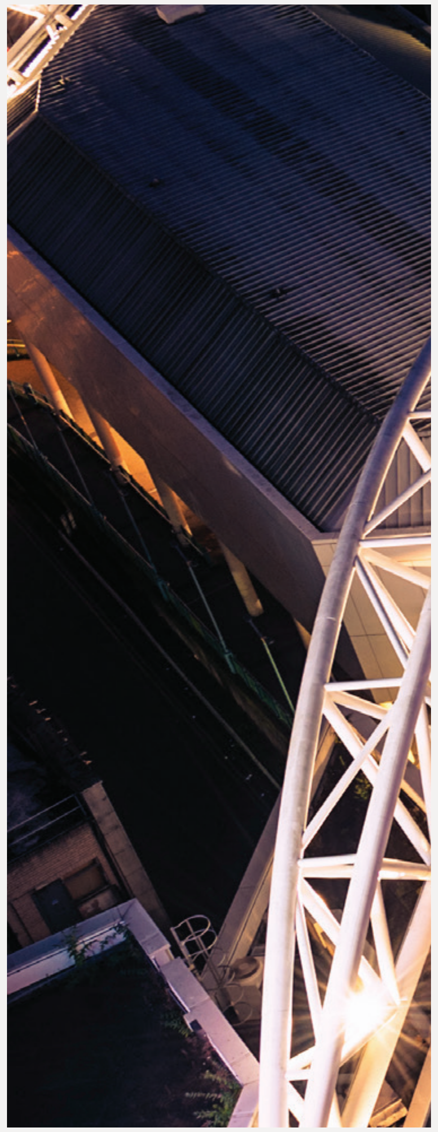
For HSBC, this signals a major vote of confidence in Birmingham and the West Midlands. We have made a long-term investment in the region with a 250-year lease on our 210,000 sq. ft. building and it has been an investment of over £200 million in the city. I'm often asked why we chose Birmingham and while all options were on the table when we first started thinking about this, Birmingham emerged as the clear winner. While there were many reasons for this, I'll outline a few.

Firstly – our historical connections. We already had a strong connection with Birmingham – our roots in the UK began here in 1836 with the opening of the first branch of the Birmingham and Midland Bank. We already had 2,000 employees based in the city and the relocation of around 1,000 head office roles to Birmingham now takes our total employment in the city to around 3,500. Secondly – the location. Birmingham is at the very heart of the UK – 90% of the UK population live within a four-hour drive and it has the fastest growing population in the country. It is already the home of UK manufacturing, a hub for the automotive, food and aerospace industries, which made it even more attractive. More practically as an investor, we needed a solid base from which to operate and somewhere with a large, talented workforce to recruit from. A location with a large financial services sector already in place, which we knew HSBC could slot into.

Thirdly – quality of life. When considering relocating colleagues, we wanted to find somewhere that they would want to move to. They needed somewhere with a fantastic quality of life – with affordable and decent housing, and the amenities our employees would want – culture, and a cosmopolitan vibrancy. Finally – we had tremendous support from the West Midlands Growth Company who provided us with excellent market information, introductions to the local business community and a relocation and familiarisation service for our employees.

The next phase for us is very much about settling in to our new home, continuing to build relationships here and playing our part in civic and community life. We are excited to be in a region that has much to celebrate. The vibrancy, energy and passion of the region is reinforced by two major, recent wins, which will see Birmingham host the Commonwealth Games in 2022 and Coventry become UK City of Culture in 2021. The region is making waves on a global scale, and we are committed to firmly embedding ourselves in this culture.

Overview



Written by
GRÁINNE GILMORE
Head of UK Residential Research

Birmingham Rises

Birmingham continues to outperform many parts of the UK when it comes to house price growth.

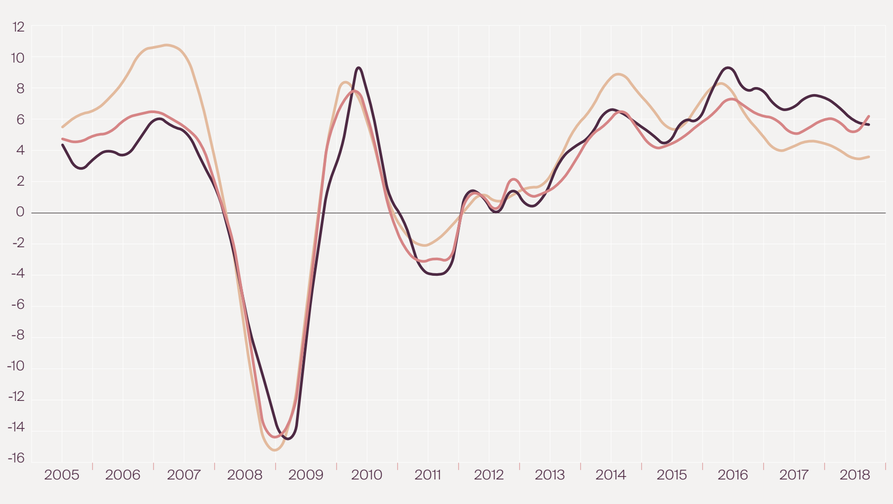
The average rate of house price growth across the UK was 3.5% in the year to September. However, house prices in Birmingham rose by 5.5% over the same period, according to official data.

The pace of house price growth was in line with that seen in the West Midlands as a whole, where prices were up an average of 6.1% on the year.

Over the last decade, average prices in Birmingham have climbed by 45%, yet, despite this increase, housing is more affordable in the city than across the UK on average, according to the affordability index recently compiled by the Office for National Statistics (ONS). First-time buyers in the West Midlands typically use 29% of their take-home pay to cover monthly mortgage payments each month, compared to those in the South East of England, who use 38% of their salary each month, data from Nationwide shows.

The pace of house price growth across the UK has been slowly softening in recent years, and this broad trend has been seen in Birmingham, too – the rate of growth in 2016 was close to 10% per annum. In terms of transactions, Birmingham has also broadly tracked the trends seen in the wider UK market (as seen in figure r2). Yet the total number of homes sold in Birmingham in the 12 months to the end of May this year was 3.6% higher than the previous 12 months, while total sales across England and Wales were down 1.5% over the same period.

Figure r1 – House Prices, Annual % Change
Source: Knight Frank Research/ONS



Housing markets across the country respond to many of the same broader stimuli, such as economic growth, changes in household income and political uncertainty, especially with Brexit on the near horizon. However, the local picture has a strong impact, especially in regional markets which are largely domestically-driven and needs-based. The fundamentals of the Birmingham economy remain strong.

Birmingham's economy expanded faster than the wider economy of the West Midlands during the last decade, and is set to continue outpacing the regional average over the next ten years, with an 18% increase in Gross Value Added, a measure of economic output between now and 2028, compared to 15.5% in the West Midlands as a whole.

Employment growth in the city is also projected to gather pace, rising by 10% over the next decade, compared to a 6% rise during the last ten years, according to Experian. Indeed the population is set to grow from 1.1 million today to 1.3 million by 2040.

1.1 million
Population in Birmingham

1.3 million
Forecast Population, 2040

Figure r2 – Housing Transactions
Source: Knight Frank Research/Land Registry

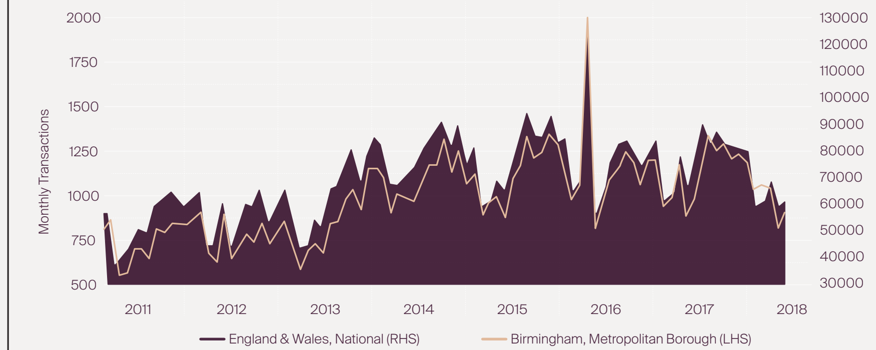
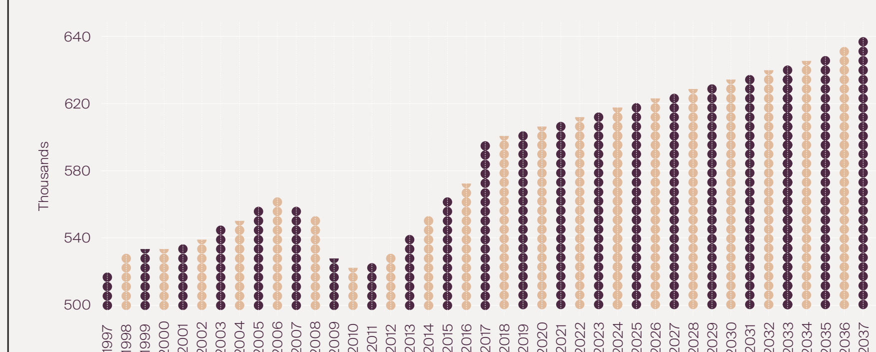


Figure r3 – Workforce Jobs, Birmingham
Source: Knight Frank Research/Experian



The draw of employment is a key factor attracting new people into Birmingham (as reflected in Ian Stuart's comments on page 24), but when combined with housing affordability and the lifestyle on offer in Birmingham, it is clear why the city has retained its spot as the most popular destination for Londoners moving out of the capital (as shown in figure r9).

Knight Frank forecasts that residential property prices in the West Midlands will rise by 10.8% over the next five years.

Although there are risks to the downside in the short-term, given Brexit uncertainty, there is also potential for urban areas to outperform.

Written by
MARK EVANS
Head of Regional Residential Development

Supply & Demand

Birmingham's population has risen by **12%** the last decade, with an additional **108,000** people living in the city.

It is set to continue climbing, with the latest ONS data suggesting that an additional 3,145 households will be created every year.

The supply of new homes in Birmingham, especially in the city centre, has picked up markedly in recent years, as examined below. However, the latest local plan for Birmingham identifies a need for 2,555 homes a year. This is still lower than the household need figures for Birmingham (3,577 per annum) as identified in a recent Government consultation.

While this mismatch between planned supply and demand data continues, the number of overall housing starts in Birmingham has been rising steadily since 2014, and the residential development pipeline is looking fuller than it has in more than a decade.

We have identified around 4,507 residential units currently under construction on larger schemes (30+ units) in central Birmingham, as shown on the development map on page 31. It is worth noting that two-thirds of these schemes have more than 100 units, while more than 40% have more than 200 units, and these larger schemes will be completed over a longer time-frame.

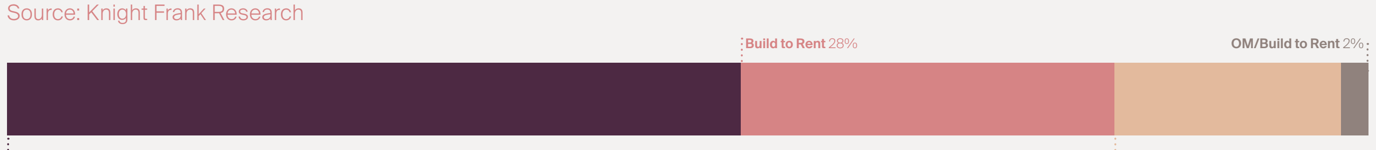
There are a further 4,781 residential units in larger schemes which have planning, but have not yet started, in and around the city centre.

These units will not all be entering the sales market however. Some 30% of the new homes currently under construction will be entering straight into the rented sector, as they are Build-to-Rent or Multihousing schemes. This sector of the market is examined in more detail on page 33.

Looking further back in the pipeline, there are signs that increased levels of development could continue. Planning has been sought for an additional 4,605 units – however, some are in very large regeneration schemes, which will take years to build out, and planning consent has yet to be achieved.

Future supply in Birmingham also needs to be considered in terms of upcoming policy moves.

Figure r4 – Total Percentage of Development Pipeline
Source: Knight Frank Research



Help to Buy

The Help to Buy Equity Loan has helped around 170,000 buyers onto the property ladder across England between 2013 and March 2018. In Birmingham, some 1,532 buyers have used the Help to Buy Equity Loan over this time, accounting for a third of all new-build sales completed and registered with the Land Registry over the same period. It is worth noting however, that this is not a complete like-for-like comparison, as the Land Registry data may slightly undercount new-build sales, especially transactions including the sale of 6 or more units.

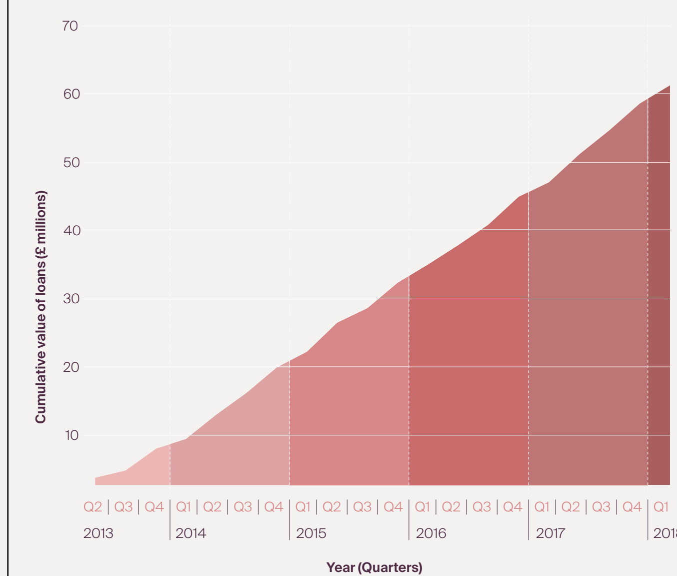
Take-up of Help to Buy in the city centre is lower than the broader market however, as the Equity Loan has only really been offered by developers since 2016.

Developers now looking at starting schemes will be mindful that the scheme is set to continue past the initial cut-off point of 2021, but in a limited form. It will be available for first-time buyers only, and there will be a capital value limits applied on a regional basis up to 2023. For the West Midlands, the scheme will be available on homes with a value up to £255,600 between April 2021 and March 2023.

"..the best located and highest spec schemes will be at an advantage"

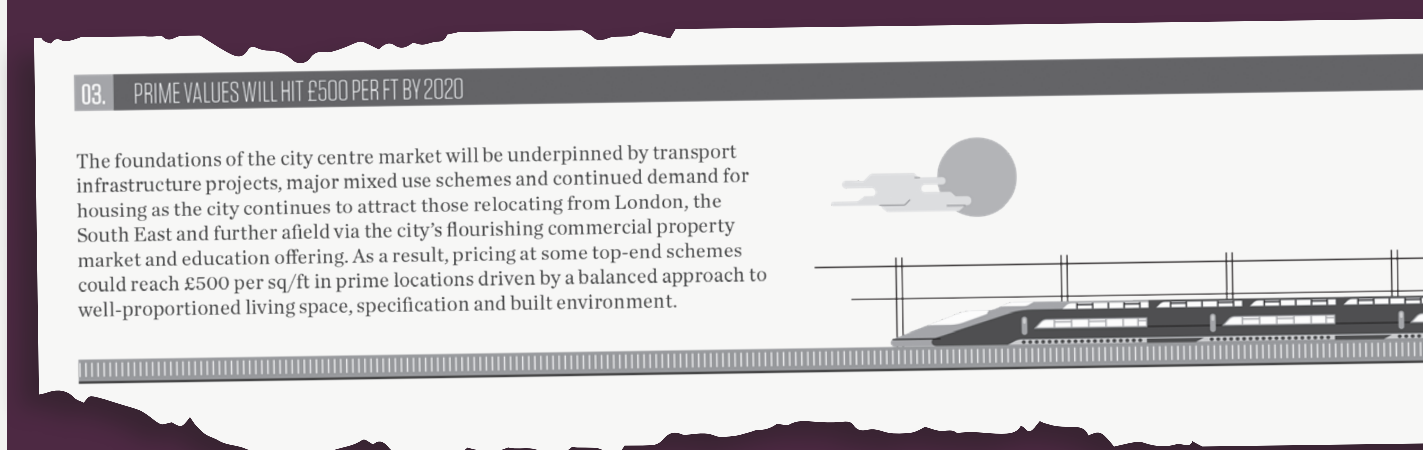
The overall development picture has changed substantially since we first published the Birmingham report three years ago. The new-build market is maturing, with schemes being developed across the spectrum in price and tenure. However, as such, there is more competition for buyers in the market now, and past evidence suggests that schemes which are the best located and built to the highest specification will be at an advantage in this market.

Figure r5 – Total value of Help to Buy Equity Loans, Birmingham Source: Knight Frank Research/MHCLG



1,532 H2B Sales, Birmingham, 2013 – Q1 2018

4,553 Total new-build sales, Birmingham, 2013 – Q1 2018 (Land Registry)


03. PRIME VALUES WILL HIT £500 PER FT BY 2020

The foundations of the city centre market will be underpinned by transport infrastructure projects, major mixed use schemes and continued demand for housing as the city continues to attract those relocating from London, the South East and further afield via the city's flourishing commercial property market and education offering. As a result, pricing at some top-end schemes could reach £500 per sq/ft in prime locations driven by a balanced approach to well-proportioned living space, specification and built environment.

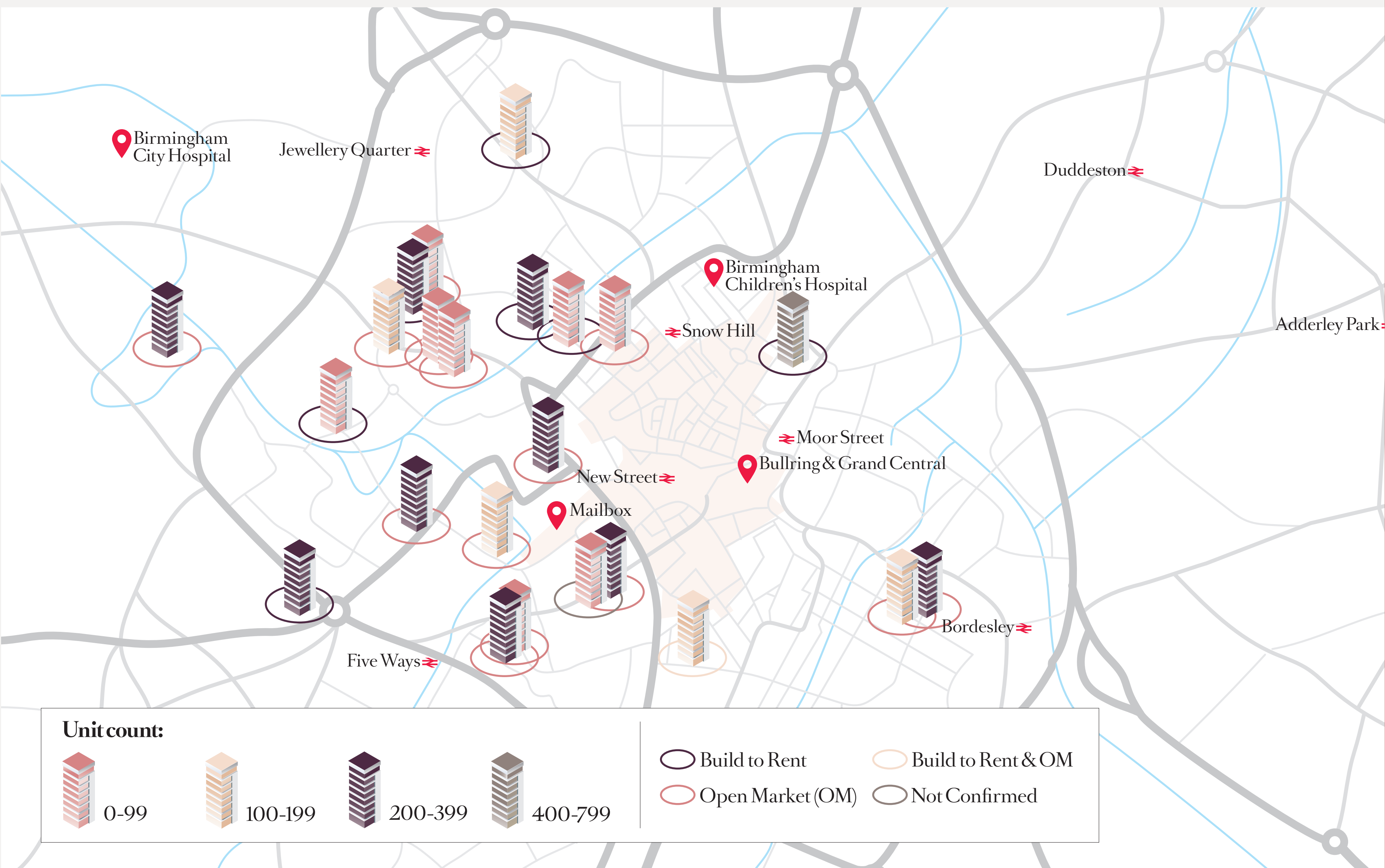
"Two years ago, in our annual Birmingham Report, I predicted prime residential values in the city could reach **£500 psf**. At the time, prime values were capping out at around **£400 psf**, so I will admit my comments raised a few eyebrows. But what was becoming very clear in 2016, and why my prediction was backed with a degree of confidence, was the momentum that was building across the city.

For a decade, there had been a lack of new development, never mind new city centre homes built to the very highest specifications and standards, with an array of amenities on offer which were simply not there in 2008. The best-in-class residential developments are now being priced at **£450 psf**, and values are still rising. When you look at the companies which are opening offices here, the expertise in the talent pool and the lifestyle on offer in the city, the transport upgrades, you can see why Birmingham looks like good value."

Written by
WILL JORDAN
Head of Birmingham Residential Development

Birmingham Residential Pipeline

Our development map shows key schemes currently in planning or under construction in the centre of Birmingham, both for the sales and rental markets. It is worth noting that some of the larger schemes identified on the map have the potential to be phased and delivered over a number of years, rather than over the next 12–18 months.



The Development Land *Market*

Development land values in Birmingham, especially towards the city centre, have risen strongly over the past five years, reflecting the pick-up in economic growth and activity in the market.

Land prices in 2013 were averaging around £12,000 to £16,000 per unit, compared to more than £35,000 today. However, over the last six to nine months, the pace of growth has slowed.

While there is a deep pool of investment for Birmingham development land, with interest from overseas as well as domestic developers, large and small, the slowing growth in land prices is partly a function of the maturing development market in the city centre, as examined on page 29.

There are also some policy changes that are already being factored into the land market in Birmingham. These include the increasing discussions weighing up the advantages of off-site contributions versus on-site Affordable Housing.

Also, the new draft National Planning Policy Framework (NPPF) outlines further requirements for Affordable Housing for Local Authorities across England.

As an example, in London, where the Mayor has initiated a fast-track planning system for schemes with 35% Affordable Housing, and 50% Affordable Housing on Government-owned land, this change is being reflected in land prices in the capital.

Likewise, the changes in this area in Birmingham will likely ensure that the market does not return to the exuberance in pricing seen in 2014.

Rising construction costs are also an increasing consideration for those preparing bids on development sites in Birmingham, as in some cases this will affect viability.

The cost of construction for new-build dwellings has risen by 13% since the start of 2016, and is up 34% over the last decade, according to official figures.

In short, demand remains strong, but there are several key changes to the policy and fiscal landscape that will now play a part in land pricing in the year to come.

> "Currently we are experiencing a vast amount of interest in the Birmingham land market brought on by the HS2 effect and continual strong employment in the city. With the increased competition, the developers will have to ensure they are the "best in show" in order to attract the correct purchasers or tenants."

Written by
STUART EUSTACE
Partner, Residential
Capital Markets

Not Letting Up

The growth of the private rented sector (PRS) in Birmingham continues apace, with the most recent estimates showing that a quarter of all households in the wider city are in the PRS.

The growth of the sector comes despite the policy changes, including a cut to mortgage interest relief available for those with a buy-to-let property and the additional 3% stamp duty payable on investment properties.

Average asking rents have risen by 16% for all properties in Birmingham compared to late 2014, a sharper rise than seen across the rest of England.

Asking rents for two-bed flats have risen even more strongly, as the chart below shows.

The rental market is particularly strong in the city centre, with the choice of more flexible tenure being a driver for many of those living in the rented sector.

As the mortgage relief changes continue in 2019 and 2020, some landlords may review their portfolios and decide to adjust their lettings positions.

Any contraction in the supply of rented property will likely be made up for by the expansion of the budding Build-to-Rent model in Birmingham – the provision of institutionally funded purpose-built rental accommodation.

So far, much of this development has been based in London or Manchester, but now other cities are starting to see growth in this sector, especially where the fundamentals of rental demand and rental affordability coalesce.

This can be clearly seen from the development map on page 31 which shows that around a third of new supply in the Birmingham market has already been identified as BTR, with the possibility of several more schemes being added to this list.

Figure r6 – Asking Rents, Birmingham
Indexed 100 = Q42009. Source: Knight Frank Research

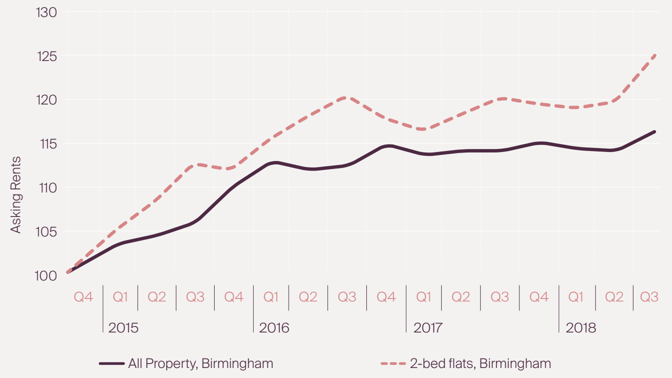
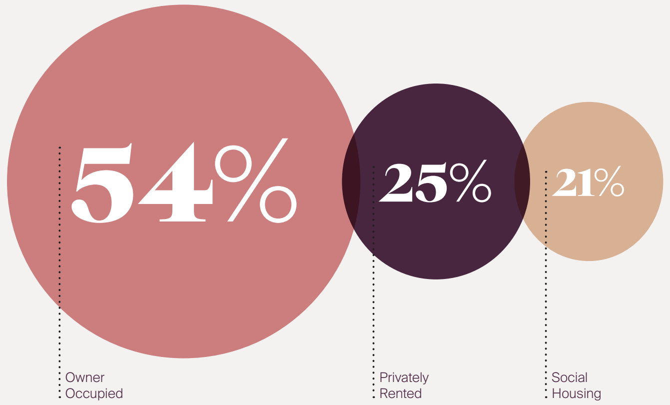


Figure r7 – Housing Tenure, Birmingham
(Local Authority) Source: Knight Frank Research/Experian



Build-to-Rent

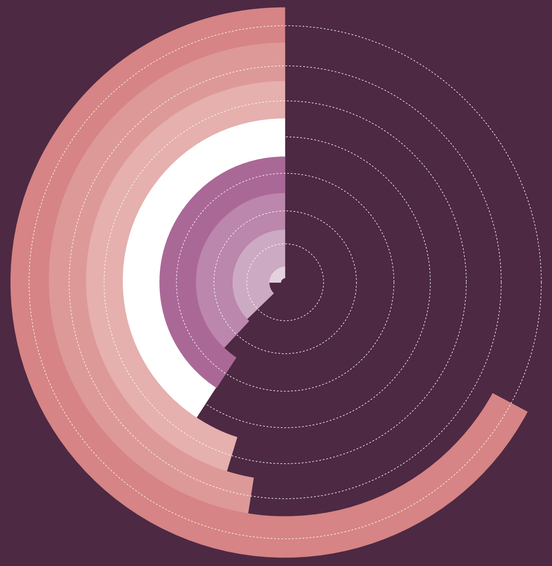
The major movement in the BTR or Multihousing market in Birmingham this year has been around pricing adjustment, with net yields now being priced at 4.25%, in from 4.5%. This movement should see several deals announced in the city by the close of 2018 and early 2019.

Marketing of units recently started at The Forum, which is the city's first purpose-built BTR building, with practical completion expected by the end of the year. No doubt the market will observe absorption rates closely.

A fuller picture will emerge next year with three more schemes coming to the rental market. There is strong investor demand to be in Birmingham, but at the right price and in the right location. In 2019 and 2020, the market in Digbeth will be worth watching, underpinned by the council announcing their development partner for the Smithfields regeneration project and the opening of the Metrolink extension in 2022.

Expanding Talent Pool

Figure r8 – Graduate Retention Rates
% of final year university students planning to remain in the city or town in which they studied.
Source: Knight Frank Student Survey



"Recruitment activity levels remain highest across the UK regions, with Birmingham, Manchester and Milton Keynes producing the strongest rates of net fee income growth"

– Recruitment Consultants, Robert Walters Group, Q3 2018 Trading Update

Figure r9 – Total outward migration by destination, from London, 2017 Source: Knight Frank Research/ONS

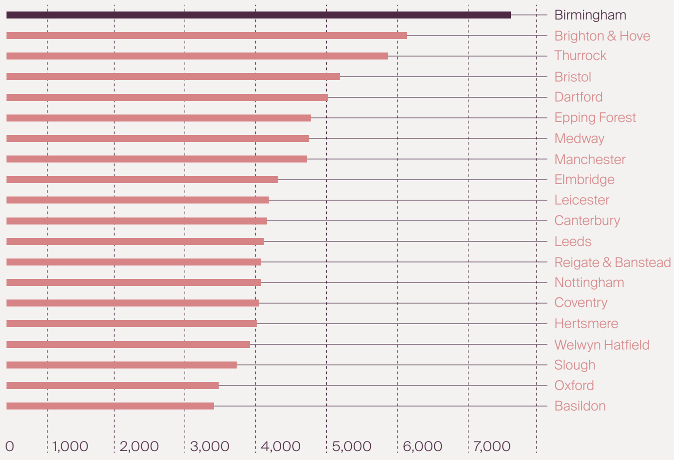


Figure r10 – Age of those moving to Birmingham from London, UK 2017 Source: Knight Frank Research/ONS

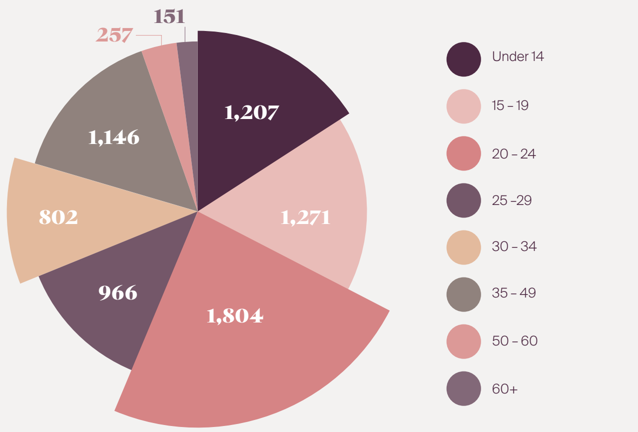


Figure r11 – Construction Costs, New-build Homes Indexed, 100 = Jan 2008. Source: UK Department for Business

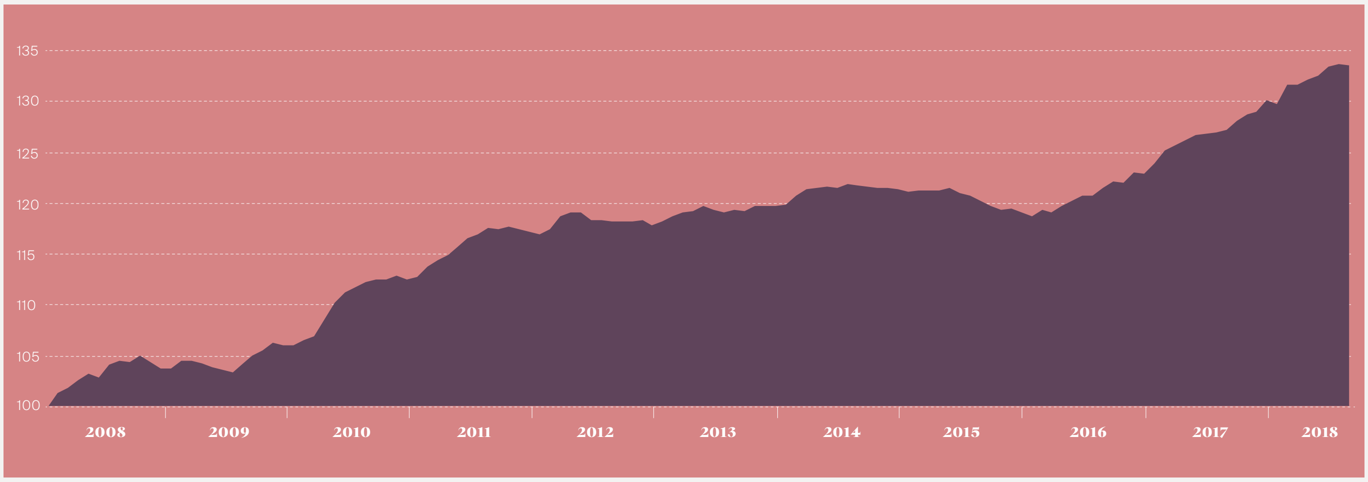


Figure r12 – Residential Development Pipeline, Q4 2018, Birmingham Source: Knight Frank Research

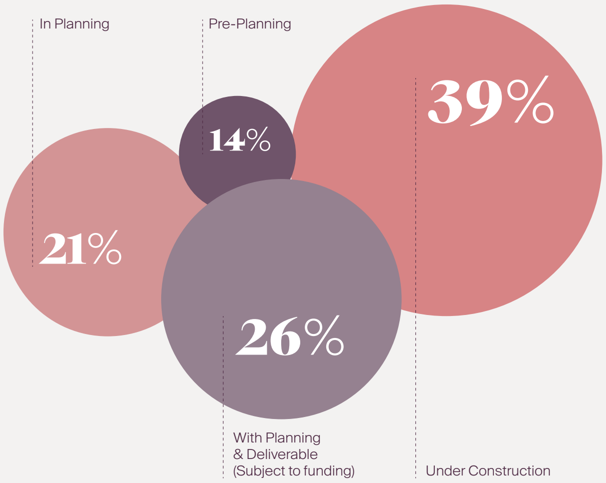


Figure r13 – Number of private unit starts, Birmingham Source: Knight Frank Research/DCLG