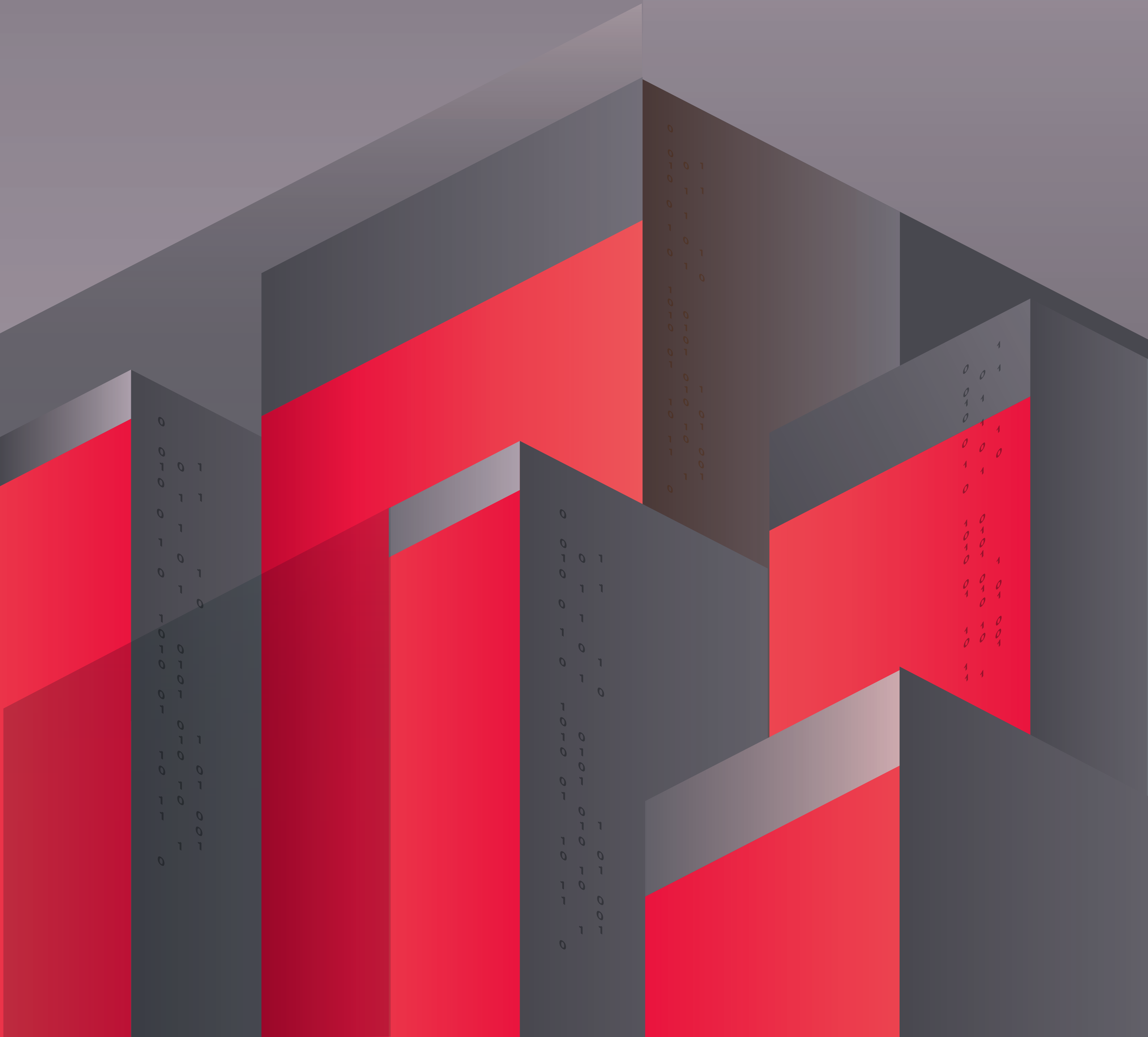
Knight Frank

# UK CITIES

## LOOKING BACK, MOVING FORWARD

2023



# FOREWORD

**ALASTAIR GRAHAM-CAMPBELL**
HEAD OF UK CITIES

Few predicted the tumultuous year that 2022 turned out to be. Political upheaval both here and overseas, a volatile economy with forecasts bouncing between recession and modest growth, and runaway inflation hitting levels not seen in more than a generation. Not quite the post Covid stability that businesses and the real estate industry were hoping for.

So, what can we expect in 2023?

For the real estate sphere, three overarching trends will dominate the coming 12 months. Cost, climate and change.

Cost is sure to lead the narrative. In 2022, all businesses needed to grapple with sharp rises in the cost of energy, labour and the much higher cost of debt. The construction sector perhaps, felt these pressures more acutely, meaning that development projects have needed constant reassessment and in some cases delay. As we move into 2023, consensus suggests that some of these pricing pressures have peaked. This is welcome news for all market actors and should enable firms to enact planning with greater cost surety. Development though, will remain constrained and selective for a while yet, as costs stay stubbornly high and market rates take time to catch up.

This challenge to supply comes at a time when there is a greater onus on the quality of the workplace. Office stock in many UK markets is now showing signs of obsolescence caused by age, future environmental conformity and changing occupier preferences. Vacancy rates for the best quality space are at critical lows in some of the major cities. This market disparity has already resulted in an uplift in office rents, and further rises can be expected in markets where this imbalance is most acute.

The pressure on supply will be compounded via a greater emphasis on addressing climate change. From an occupier perspective, environmental performance is a leading factor on location choice, a focus change that is further tightening the market. Similarly, the investor lens is sharpening, with equity and debt shifting towards green buildings and away from assets with no chance of meeting the required standard. In short, green is now very much a component of 'best or prime'.

But the requirement for the best space is just part of the workspace evolution. Change is underway, with the freedom to choose the optimum workplace now integral to the employee and employer relationship. Moreover, the greater prominence of innovation-led sectors, such as Life Sciences and next wave technology will add further complexity to the positioning of spaces in the market. The debate on quantum, use and type of office space will continue in 2023. Recent examples, however, show that rightsizing might not necessarily mean resizing.

Undoubtedly, a cautionary undertone will accompany every business decision in 2023. The business and real estate landscape is changing, but periods of dislocation have historically served as an impetus for innovation and the creation of new opportunity. I am sure that a retrospective view in 12 months will again show this to be true.

# WHAT THE UK STATS SAY

**ASHLEY HUDSON**
PARTNER, UK CITIES, BIRMINGHAM

**DARREN MANSFIELD**
PARTNER, COMMERCIAL RESEARCH

### NUMBERS POINT TO MARKET RECOVERY

Although the collective take-up for the UK Cities fell short of the long-term average, the market place felt very busy in 2022.

The number of deals completed confirms this observation, with over 1,100 occupier transactions recorded in 2022. Notably, this number is equivalent to the marketplace of 2019 and is 9% higher than the 5-year average.

### FIRMS ARE MORE DISCERNING ON SPACE QUALITY

A defining trend in 2022 was the pursuit of 'Best-in-class', with a sharpening focus on ESG, brand amplification in an increasingly competitive business landscape and talent attraction and retention.

While the percentages differ from city to city, collectively over 50% of take-up during the year was of new or grade A space. In some cities, the percentage was above 70% in 2022.

### GREEN ATTRIBUTES TO BE A 'GAME CHANGER'

Occupiers and investors alike are relentless in their pursuit of the green agenda and the office market is reacting positively. This presents the market with an opportunity to reposition existing assets and to achieve higher rents.

Across the UK cities, a Knight Frank study found that between 70-80% of office stock fell short of an EPC rating of B.

### HEADWINDS DIDN'T STALL RENTAL GROWTH

Despite headwinds created by Covid and more latterly the uncertainty from the UK political and the macro economic landscape, the drive for 'best' has fuelled rental growth for prime.

In 2022, 5 of 10 regional cities recorded rental growth. Looking back to the onset of Covid in March 2020, 8 of 10 regional markets have registered an uplift in prime rent.

### SUPPLY SQUEEZE AHEAD?

Although having risen during the past year, the lack of New and Grade A supply could be a restraining factor to occupier activity in 2023.

The weighted average vacancy rate for the 10 UK regional cities was 9.8% at year-end, compared to 8.9% at the end of 2021. New and Grade A space represents just 3% of total stock. In some cities, overall vacancy is circa 5% with New and Grade A availability representing less than 1% of total stock.

### REFINANCING TO DRIVE INVESTMENT BOUNCE IN 2023?

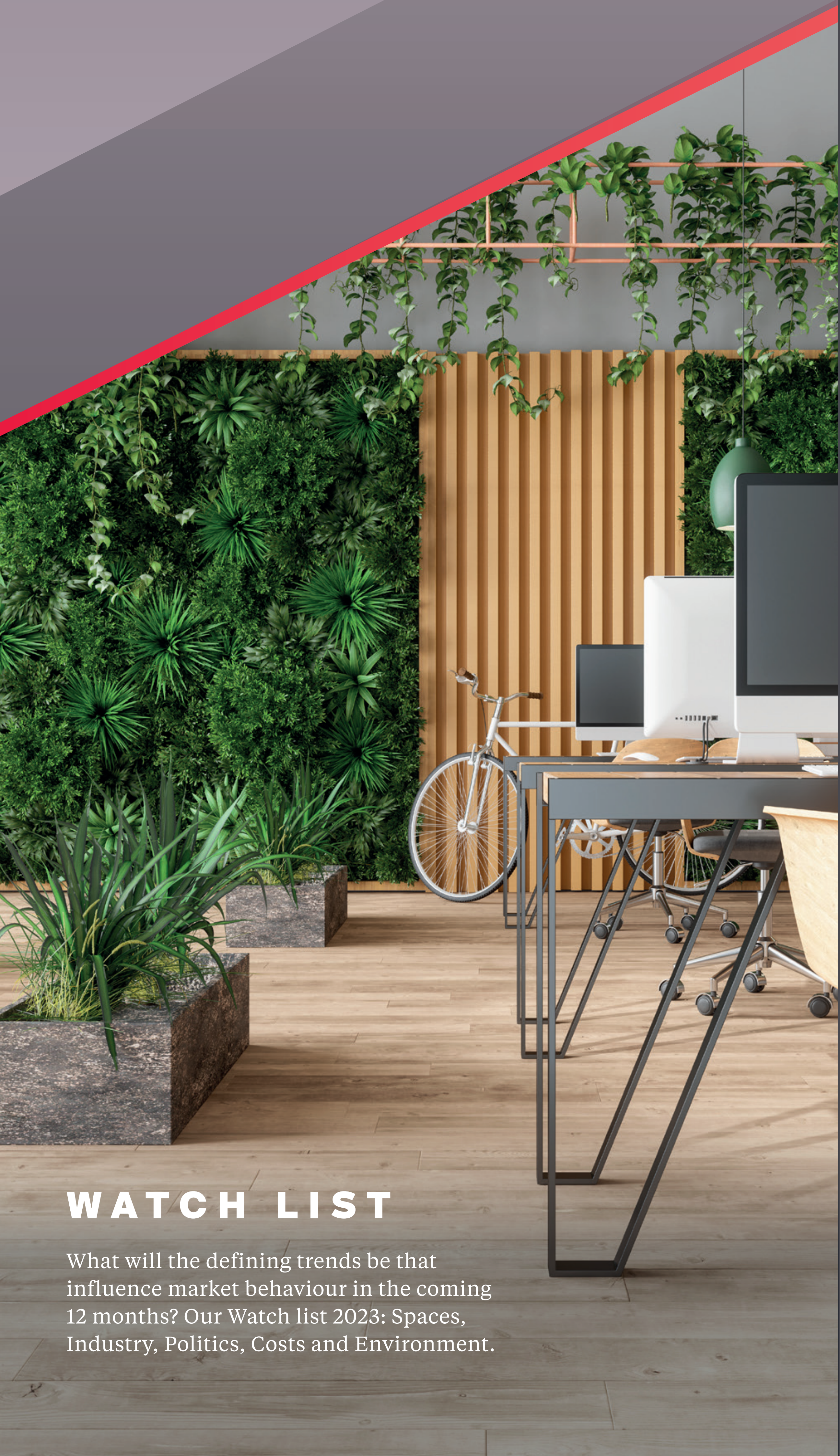
Investors were understandably hesitant in 2022, with the final quarter particularly slow due to the economic and political turmoil. More stabilised investment conditions and the recent repricing could serve to increase deal volumes this year resulting in some yield compression.

Investment volumes for the year finalised at £1.74bn, 20% less than in 2021. Lack of high value stock sales was a factor, with sales above £50m; the lowest in number since 2013.

### PRICING TO FIND ITS LEVEL QUICKLY

Turbulence within domestic and global capital markets led to rapid market repricing in 2022. Whilst price discovery proved challenging at the end of the year and led to a stalemate, the buyer pool has grown as we enter 2023. Opportunistic buyers are active and as stability continues, core and core-plus investors are returning in greater numbers. This growth in investor attention should lead to an increase in liquidity in the coming months and support the possibility of yield compression as the year progresses.

Prime office yields moved out by 50-100bps across the main regional markets in response to the sharp rise in swap rates and the erosion of the gap between UK gilts and office yields.



# WATCH LIST

What will the defining trends be that influence market behaviour in the coming 12 months? Our Watch list 2023: Spaces, Industry, Politics, Costs and Environment.

## WATCH LIST FOR 2023

# SPACES

*There has been no shortage of column inches dedicated to the future of the office over the last three years.*

The scale of disruption brought to the world of work by the pandemic has been matched only by the hyperbole attributed to assessments of the post-pandemic workplace.

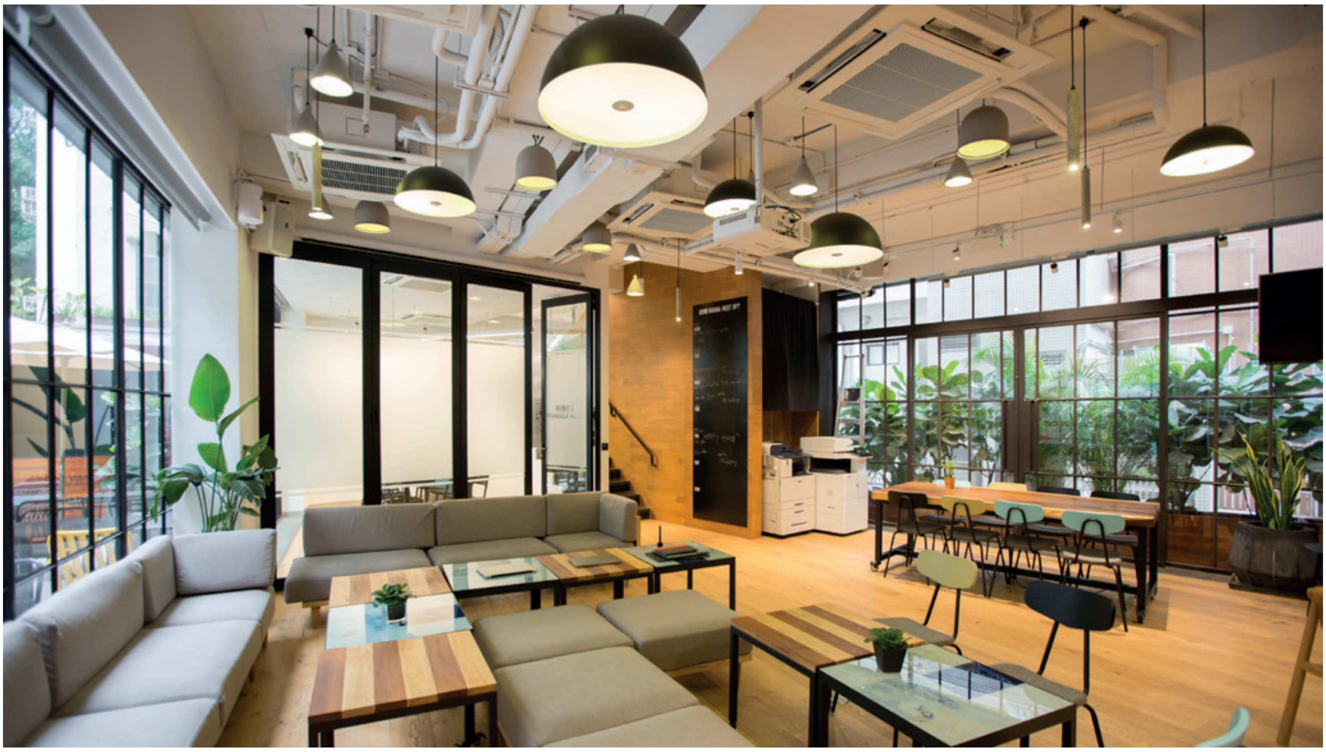
Yet whilst transactional levels have fluctuated against the backdrop of Covid-19, occupiers, typically, have not made knee-jerk or radical decisions about the quantum of real estate needed going forward. There have been examples of downsizing, but not the great offloading of space that was a characteristic of the period immediately after the Global Financial Crisis.

In 2023, lease events will be the main driver of occupier activity rather than substantial or sustained expansionary activation. Lease events will present an opportunity for occupiers to right-size and reimagine their portfolios and assets. Significant downsizing is unlikely, not least because economic conditions might fuel job insecurity and a further increase in return to office rates.

One key consideration for occupiers will be the purpose of the office space. The office will be a place for connection, collaboration and galvanising corporate culture. Many will realise that their existing space is in essence functionally obsolete – a product of a different era of work. This will be compounded by physical obsolescence, with many offices falling short of upcoming sustainability regulation.

Greater mobility of occupiers and a rise in relocations to secure the right space, in the right quantum and in the right place can be expected. Consequently, greater polarisation in the office markets of key UK cities will develop, as occupiers seek out best-in-class options against the backdrop of a tightening pipeline of high-quality space, itself a reaction to a slowing economy.

**Read the full article here:**
*www.knightfrank.com/uk-cities*



# INDUSTRY

*The sources and shape of office demand were already changing ahead of the Covid pandemic, with new working practices explored and new business segments born.*

The evolution of the market place will accelerate in 2023, with sources and shape of office demand to show further change. This transition will undoubtedly present new market challenges and responses, and ultimately alter the constitution of office markets across the UK Cities.

A business segment with high growth potential is Life Sciences, with the profile of the sector accelerated during the pandemic. Whilst the Golden Triangle (Cambridge, Oxford, London) grabs the headlines, over 50% of Life Sciences employment is already outside of this small area of the UK.

The technology sector will also continue to evolve. Whilst global technology giants are beginning to reduce headcount, the broader technology sector continues to evolve. Innovation such as advances in artificial intelligence, augmented reality and virtual reality is now touching many industry types and creating new businesses. A recent survey of over 100 UK Life Sciences and Tech companies indicated growth of 52% over the next three years. Both Life Sciences and Tech are therefore, sure to have a significant impact on market demand in 2023.

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**A recent survey of over 100 UK life science and tech companies indicated growth of 52% over the next three years.**

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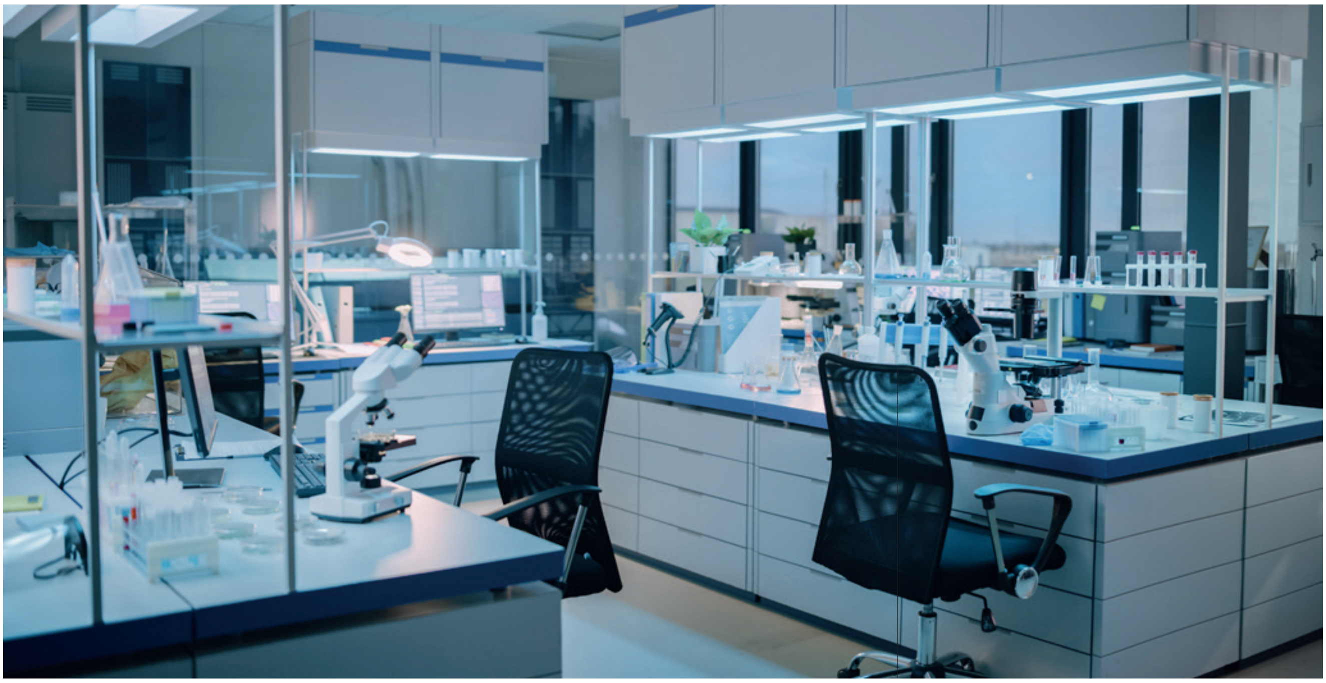
Actions to address the climate crisis is additionally beginning to change the business landscape, with new entities formed in response to greater global awareness. The energy sector is a good example, with many major firms pivoting towards renewables. Impact measurement additionally has become a component of corporate reporting. The creation of new businesses driven by the green agenda, can only grow as action intensifies.

Fundamentally, evolution is part of every business strategy. The supply-side will need to react and adapt to the changing dynamic, in order to capture future business.

**Read the full article here:**
*www.knightfrank.com/uk-cities*



# POLITICS

*The political arena and public sector are sure to have a significant influence on activity in the UK cities again in 2023.*

The last possible date of the next UK general election is January 2025, meaning much of the vote-winning policy trading will begin in 2023, as local MPs apply more pressure on the central government to address local concerns.

The much mooted levelling up programme will provide a topic of contention. With a target date of 2030, few examples exist to date of progress of the 12 missions outlined in the levelling up white paper of February 2022.

How this develops in 2023 may be dictated by the devolution. In December 2022, a devolution deal for the North East totalling £4bn was announced. A Mayor covering Northumberland, Tyne and Wear and County Durham will be elected as the North East follows the path of the West Midlands and Greater Manchester.

The relocation of the civil service may also be ramped up as political appeasement intensifies. The UK government's Places for Growth programme aims to relocate 22,000 civil service jobs out of London by 2030. This could have a significant impact for real estate and the UK regional cities, with an influx of civil service positions bolstering employment and securing viability for some development schemes.

It will be interesting to see the scale of any political or public sector action in 2023. Amid fiscal restraint, the UK government will be keen to cement the foundations of economic equality. The development of central workplaces located across the UK regions will be fundamental to its ambitions. This could be good news for office markets across the UK cities.

**Read the full article here:**
*www.knightfrank.com/uk-cities*

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**The UK Government 'Places for Growth' programme aims to relocate 22,000 civil service jobs out of London by 2030.**

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# BUILD COSTS

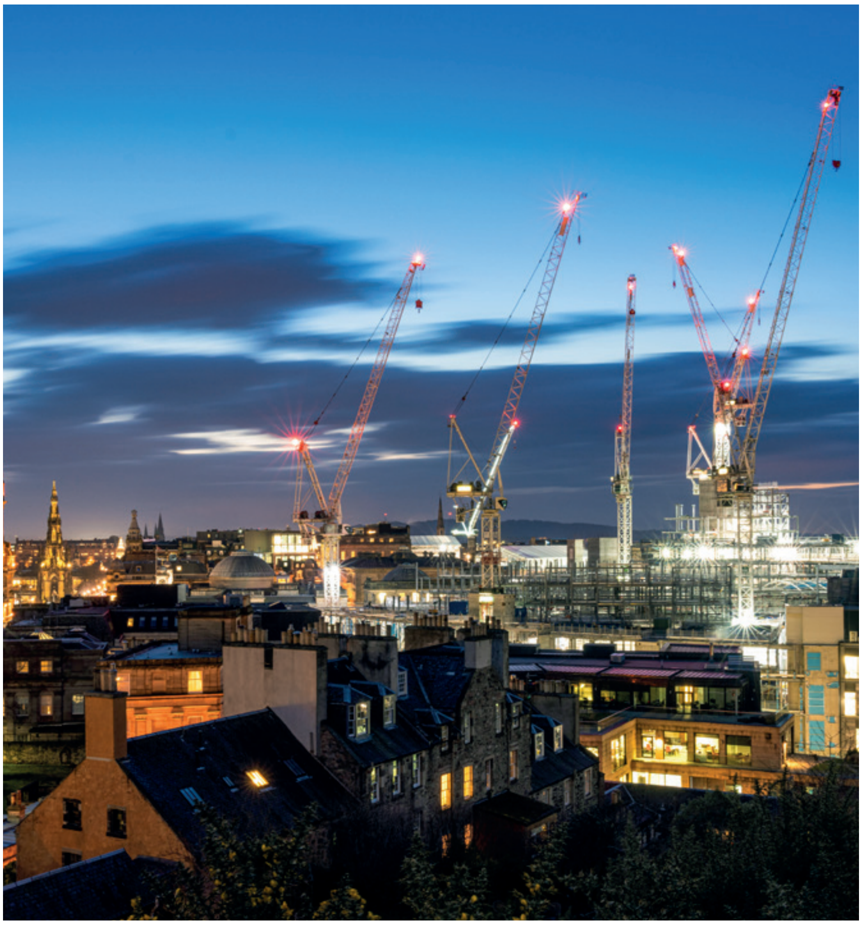
*The current construction and real estate landscape presents significant challenges, but also opportunities.*

The market recovery following the shocks of the Covid pandemic is gaining traction, with headline metrics on demand moving further into positive territory with each passing week. With supply still tight in many locations, imbalances are developing, further fuelling anticipation of rental growth and a need for a development response.

But with the cost of construction in the UK continuing to escalate, and additional expenditure increasingly required to respond to a tightening sustainability agenda, the pricing pressures on office development have never been greater as we begin 2023.

The BCIS All Work Material Price Index rose by circa 18% in 2022, having already registered a double-digit rise the previous year. While the sharp rises in the cost of materials may have now plateaued, labour shortages and associated costs will maintain pressure on project costs in 2023.

Moreover, 'nice to have' has become the new norm. Organisations and investors alike now apply greater scrutiny to the environmental impact of real estate. This puts a greater onus on achieving a highly rated accreditation.



Whilst the balancing of labour and material costs are challenges with transparency for developers and construction firms, responding to the growing regulation and preferences of environmental responsibility is a more difficult task.

The combination of all of these cost pressures and the use of new suppliers will undoubtedly challenge build viability. Design teams will be under pressure to deliver more for less. It will be interesting to see what gives first.

**Read the full article here:**
*www.knightfrank.com/uk-cities*

# ENVIRONMENT

*Real estate's focus on the 'E' of ESG continues to gather pace and will have a far-reaching influence on market activity in 2023, and beyond.*

Regulation surrounding environmental impact is set to tighten, coinciding with the need for organisations and investors to further demonstrate environmental responsibility.

From 01 April 2023, the scope of MEES will extend to existing tenancies of most commercial property and will restrict a landlord's ability to continue to let property with an F or G-rating. Whilst this may not have an immediate impact on the main markets and properties at this rating are few – its implementation fires a starting gun on the path to enforcing a minimum EPC rating of B by 2030 in England and Wales. A recent Knight Frank study indicates that 4 of 5 office buildings across the UK regional cities do not have an EPC rating of B or better.

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> **Given the breadth of current and incoming drivers, and the speed at which ESG is developing in real estate, it is clear that all markets must adapt.**

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Greater transparency over the green credentials of an organisation is also required, with disclosure of carbon emissions and energy consumption required through UK policy vehicles such as Streamlined Energy and Carbon Reporting (SECR) and Phase 3 of the Energy Savings Opportunity Scheme (ESOS) respectively.

Given the breadth of current and incoming drivers, and the speed at which ESG is developing in real estate, it is clear that all markets must adapt. Investor and occupier focus is sharpening on ESG within real estate, with mindsets transcending any market turbulence. As we see conformity towards minimum standards becoming a reality, particularly in the case of EPCs and MEES, landlords might consider key environmental credentials as a point of differentiation and therefore opportunity. Consequently, reporting will be greater and market activity increasingly conducted through a 'green' lens in the coming year.

**Read the full article here:**
*www.knightfrank.com/uk-cities*

# CITY BY CITY

The view from the ground on the trends that will affect the market in 2023.

# ABERDEEN

*Supported by the high level of global oil prices, occupier take-up in 2022 was almost double that of the previous year. With availability increasing, the development pipeline has remained limited.*

## OCCUPATIONAL

### MARKET 2022

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 385,583 | 95% ▲ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 600,000 | 111% ▲ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £32.50 | 0% ↔ |

### PROJECTIONS

LEASE EXPIRIES 2023-2025 (SQ FT)
**350,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**0**

RENT FORECAST (PER SQ FT)
**£33.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £32m | 0% ↔ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 8.00% | 100 ▲ |

2023 PRIME YIELD FORECAST
**8.25%**

## We Know

- Investor interest has been positive towards Aberdeen in 2022
- Yields in Aberdeen in some cases were nearly twice that of other UK cities
- The occupational market dynamics have been good, underpinned by higher oil prices and an increase in offshore drilling activity
- Prime rents have remained stable over the last 12 months with a headline of £32.50 per sq ft
- The flight to quality has continued and whilst occupiers are, in general, taking less space, it is of a higher quality. As demonstrated by Shell and BP downsizing by 50%
- There is a lack of prime stock coming to market. Most is over-rented and recovery in tenant covenant is impacting marketability

## We Expect

- Oil prices to remain above US$80 per barrel in 2023 thus supporting the case for drilling activity in the North Sea to continue
- Grade A office supply in the city centre core to reduce further adding upward pressure on rents
- Older city centre stock to become increasingly attractive for upgrade projects if constructions costs allow
- Occupier demand to remain positive, centred on a strong ESG criteria
- The pressure on occupier costs to increase as service charges rise
- Increased activity from overseas buyers and 'yield hunters', albeit some funds may remain wary of the Aberdeen market
- A reduction of circa 20% in rateable values should help balance the cost of occupation

## We Question

- The expected scale at which employees will return to the office in 2023
- Whether the Empty Rates system needs an overhaul, given the rate of office demolition and increasing environmental pressure supporting refurbishment over new builds
- Whether occupier demand for best quality will fuel an uptick in new development or a rise in the repurposing of older buildings
- Whether the current level of build costs means development viability is challenged
- If we will see "real" property requirements being generated from the "Transition and Renewables" sector

# BIRMINGHAM

*Despite the heightened market uncertainty created by political upheaval, occupier activity registered steady improvement in 2022. Investors remain positive on Birmingham, with the city 'bucking the trend' in terms of investment volumes for the year.*

## OCCUPATIONAL

**MARKET 2022**

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 692,700 | 5% ▲ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 559,810 | -15% ▼ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £40.00 | 0% ↔ |

**PROJECTIONS**

LEASE EXPIRIES 2023-2025 (SQ FT)
**2,700,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**520,000**

RENT FORECAST (PER SQ FT)
**£42.50**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £392m | 150% ▲ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 5.75% | 100 ▲ |

2023 PRIME YIELD FORECAST
**5.50%**

## We Know

- Due to an outward yield shift during H2 2022, investment pricing in Birmingham moving into 2023 is at a level not seen since the aftermath of the Global Financial Crisis in 2008
- A market imbalance exists, with limited supply and strong occupier demand
- Broadly, investor caution is heightened, and interest is mainly focussed on core product
- Prime rent for offices has held firm over the last 12 months at a headline of £40 per sq ft
- Occupier demand remains strong, underpinned by an increasing number of corporates choosing Birmingham as a HQ location

## We Expect

- Investors to return to Birmingham in the first half of 2023, increasing competitive tension and firming up yields
- Overseas investors will be more active than UK institutions, as the market continues to mature with global corporates such as Goldman Sachs moving to the city
- The occupational flight to quality to further filter through to investor preferences, with 'best in class offices' that demonstrate impeccable green credentials to be top of the shopping list
- Rents to continue to grow reaching a new record of £42.50-£45 per sq ft as new office schemes come forward and a 'green premium' is factored
- Reuse of buildings to become more of a focus as landlords and occupiers look to a pathway to net zero
- Service charges to rise as landlords factor inflation of utilities and services

## We Question

- The scale of occupational interest in some peripheral areas and secondary buildings, and if examples of alternative use will begin to increase in 2023
- The impact of Hybrid working on office use and whether this will lead to more innovative co-working operations in offices that provide flexible solutions to larger occupiers
- The low level of supply and limited availability of new sites will mean that the bigger, medium dated schemes will be brought forward such as Rackhams, The Drum or Grand Central
- The reported scale of space reduction that some occupiers are targeting. Our own discussions reveal that new high-quality space is experiencing a spike in occupation
- The impact of rising costs of development and finance and what impact this will have on market rent and development delivery

# BRISTOL

*Occupier activity in Bristol was strong in 2022, with take-up returning to the level recorded before the Covid pandemic. During the year, Bristol recorded the highest level of annual rental growth of any regional city.*

## OCCUPATIONAL

### MARKET 2022

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 620,211 | 15% ▲ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 58,060 | -83% ▼ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £42.50 | 12% ▲ |

### PROJECTIONS

LEASE EXPIRIES 2023-2025 (SQ FT)
**1,500,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**587,040**

RENT FORECAST (PER SQ FT)
**£44.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £177m | -49% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 5.75% | 50 ▲ |

2023 PRIME YIELD FORECAST
**5.75%**

## We Know

- Despite a challenging year, Bristol city centre take-up for 2022 exceeded 600,000 sq ft, higher than the long-term average
- Availability at year-end was 5.8% of total stock. This remains close to an all-time low
- Prime office rents have remained stable throughout the year at £42.50 per sq ft
- Occupiers are increasingly focused on buildings that provide more than just office space. Tenant amenity and collaboration space has never been more important

## We Expect

- Bristol's new Clear Air Zone will make the city centre a more attractive environment and free up road space for public transport and cycling
- With Temple Meads railway station being refurbished, proximity to the station will be an important factor in location choice for existing and incoming firms
- The development pipeline of new space is limited going into 2023 and will underpin rental growth without causing an oversupply
- Repricing to continue throughout 2023 to reflect high cost of debt and significantly higher levels of cap ex required to create offices that are aligned with investor and occupier demand
- The market to be increasingly polarised between the "best and the rest"

## We Question

- Whether fund requirements on ESG targets align or exceed occupier expectations, and whether there is a high level of knowledge surrounding the benefits of ESG credentials
- Whether the abolition of a Bristol mayor and the return to a committee run council will have a positive impact on future development in the city
- If working from home will be as prevalent as in recent years or even in other UK markets. Hybrid working is here to stay but Bristol's city centre is getting its buzz back

# CARDIFF

*An increase in occupier demand in 2022, meant that take-up reached the highest level in five years. Although deal numbers were the same as the previous year, a shortage of higher value stock sales restricted investment volumes in 2022.*

## OCCUPATIONAL

### MARKET 2022

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 459,074 | 87% ▲ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 273,568 | -22% ▼ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £25.00 | 0% ◂▸ |

### PROJECTIONS

LEASE EXPIRIES 2023-2025 (SQ FT)
**1,100,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**107,010**

RENT FORECAST (PER SQ FT)
**£30.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £26m | -63% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 6.25% | 50 ▲ |

2023 PRIME YIELD FORECAST
**6.00%**

## We Know

- Occupiers and investors have become far more discerning, with buildings that demonstrate the highest ESG credentials high on the agenda
- Demand for office space in Cardiff bounced back in 2022, with take-up above the pre Covid trend level
- The gap between headline rents in Cardiff and other major UK regional cities widened in 2022
- The pipeline of future supply tightened in 2022, with new office space limited to 1 John Street (2024 delivery) and 1 Central Quay (start on site in early 2023)
- The recent confirmation of the £100m funding for the Cardiff Crossrail link between the city centre and Cardiff Bay will re-unite the city

## We Expect

- Prime rents in Cardiff city centre to increase to £30 plus per sq ft, with the delivery of the next new development
- The focus on ESG to further dictate specification and increase build cost, albeit occupiers will be willing to pay this premium to secure the best space
- Yields to continue to widen between prime and secondary stock that requires significant capital expenditure
- The number of sales of office stock from vendors who prefer, or are required to, exit rather than refinance to rise during the year
- To see more flexible and serviced office providers enter Cardiff to cater for greater demand for flexibility and accommodate fast growth companies
- Further investment in the South Wales Metro following the announcement of funding for Cardiff Crossrail

## We Question

- The viability of some proposed development to be questioned given the current position of build and finance costs
- The longevity of organisations, the Public Sector in particular, continuing to work from home
- Whether the presence of three large universities will derive greater demand from innovation driven sectors such as Technology and Life Sciences

# EDINBURGH

*Despite demand improving in the second half of the year, take-up in 2022 fell short of the long-term average. Overseas buyers continue to target Edinburgh, with supply dynamics supporting future projections of rental growth.*

## OCCUPATIONAL

### MARKET 2022

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 512,667 | -10% ▼ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 465,557 | -36% ▼ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £40.00 | 0% ↔ |

### PROJECTIONS

LEASE EXPIRIES 2023-2025 (SQ FT)
**1,000,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**57,000**

RENT FORECAST (PER SQ FT)
**£45.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £207m | -30% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 6.00% | 150 ▲ |

2023 PRIME YIELD FORECAST
**5.75%**

## We Know

- Prime office yields are hard to gauge due to lack of transactional evidence
- The occupier market dynamics remain strong, with very limited supply and sustained demand
- Investors are extremely cautious of costs related to their ownership and are very risk averse. Service charges, utility costs, 'greening' and PPMs are being put under high levels of scrutiny
- Knight Frank predicted that the continuing supply-demand imbalance, and a vacancy rate of less than 1% for new-build Grade A space, could push Edinburgh's headline rent above £42.50 per sq ft in early 2023
- There are many investors still looking for an Edinburgh office asset to add to portfolios, but stock is very limited

## We Expect

- Investment transactions to increase in 2023 as pricing settles and confidence returns to the investor market
- The imbalance between occupier demand and available supply will continue in 2023, fuelling further rental growth
- Edinburgh Council to be pro office redevelopment in the central business district and continue to be strict in the historical areas
- Utility costs to have an effect on service charges and potential landlord shortfalls
- The gap between prime and secondary to continue to grow, with amenity offering increasingly becoming a differentiating factor

## We Question

- If the council will be more proactive in allowing new development in the coming year, thus removing the supply drag on the market
- The scale that rental levels will need to increase to in order to allow new developments to be feasible
- The accuracy of predictions of occupier downsizing, as office occupation is now strong and space is being used in a less intensive way
- When will European institutions, and particularly the German funds, return to the Edinburgh office investment market

# GLASGOW

*Market hesitancy about future space needs and a slow return to the office, meant that occupier take-up in Glasgow finished short of the long-term trend. Although deal numbers were down in 2022, investment volumes were consistent with the 5-year annual average.*

## OCCUPATIONAL

### MARKET 2022

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 395,672 | -35% ▼ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 598,735 | 5% ▲ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £35.00 | 0% ◆ |

### PROJECTIONS

LEASE EXPIRIES 2023-2025 (SQ FT)
1,900,000

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
442,029

RENT FORECAST (PER SQ FT)
£36.00

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £243m | -1% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 6.00% | 75 ▲ |

2023 PRIME YIELD FORECAST
6.00%

## We Know

- Examples of tenant release space are beginning to emerge. The release of 100,000 sq ft of previously new best in class pre-let Grade A space was a shock to the market
- Major refurbishment schemes are now competing, with some best-in-class corporate release space. This could lead to slower fill rates of vacant space in 2023
- There is greater locational polarisation in the market, with high quality buildings in central locations being preferential and peripheral options struggling to attract occupiers
- Although the sale of 177 Bothwell Street skewed investment volumes in 2022, it highlights continued demand for well let offices with strong fundamentals

## We Expect

- With securing best quality dictating occupier criteria, competitive pressure will create upward pressure on prime meaning a new headline rent of circa £36-37 per sq ft to be achieved
- Development viability to be scrutinised more intensely, meaning a slowdown in development starts until clarity on prime yields is achieved
- As refinancing of loans mature, the level of stock coming the market for sale will increase
- The existence of hybrid office buildings to grow, with significant percentages of floorspace fitted out by landlords and reallocated to plug-and-play
- The make-up of buildings to be inspected more closely, with cladding and insulation on built stock subject to particular scrutiny

## We Question

- The scale of development that will be initiated given the level of build and finance costs
- The rate at which city centre office building will re-occupy, as hybrid working solidifies as the 'new normal' working practice for many firms
- If Glasgow will follow the experiences of many cities and see a rise in repurposing and alternative use of undesirable office buildings. Some examples of new Build-To-Rent schemes have performed well
- Whether the emergency legislation on evictions and rent freeze will put a drag on the rate at which build-to-rent schemes are actively pursued by developers

# LEEDS

*An increase in occupier demand in the second half of 2022, meant that Leeds accounted for its highest percentage of overall regional take-up since 2019. Demand for best-in-class is driving rental uplift, with further rises expected in 2023.*

## OCCUPATIONAL

### MARKET 2022

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 600,020 | -3% ▼ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 514, 456 | 47% ▲ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £36.00 | 6% ▲ |

### PROJECTIONS

LEASE EXPIRIES 2023-2025 (SQ FT)
**1,700,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**486,916**

RENT FORECAST (PER SQ FT)
**£38.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £153m | -37% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 5.75% | 50 ▲ |

2023 PRIME YIELD FORECAST
**5.75%**

## We Know

- Given the turmoil in the capital markets and projections regarding the economic outlook for 2023, investors are now assessing the markets with greater caution
- Indicative pricing is out of balance with fundamentals and long-term yield
- Market dynamics remain generally positive going into 2023, with limited supply and a stable pipeline of occupier demand
- Competitive pressure for best quality has led to the prime rent for Leeds rising to a new headline of £36 per sq ft over the past 12 months
- The newest schemes in Leeds are considering targeting £38 per sq ft, supported by the supply imbalance and where exemplary quality and ESG credentials are present
- Quoted headline rents targets will increase to £38 per sq ft by March 2023

## We Expect

- Investors waiting for bargain pricing will have missed the window by early 2023, as competition bolsters pricing and firms up yields
- UK institutions to remain cautious in 2023, with activity underpinned by international buyers incentivised by the favourable rate of sterling
- Investors to be selective in choice, targeting best in class new build and refurbishments and buildings where a green premium can be applied
- Organisations to change stance on hybrid working and become firmer on employee time in the office, thus supporting occupational demand in the market
- Renew, reuse or repurpose to be an overarching mantra of the office market in Leeds in the coming year

## We Question

- With some secondary stock already being withdrawn from the market and set on a path of alternative use, how much will follow and what will the impact be on Leeds as a commercial hub
- With organisations experimenting with different models of office space, will this initiate an influx of third-party flexible office providers, or will landlords advance their own flexible offering
- The rate at which employees will return to the office and how organisations will overcome any barriers creating resistance
- How developers will balance the rising costs of projects with the rate of increase in rents. If the former outpaces the latter, the scale at which the delivery of new stock will suffer

# MANCHESTER

*Leasing volumes again exceeded 1m sq ft during 2022, with Manchester representing 22% of regional take-up. At fourteen, Manchester recorded the highest number of investment transactions of any regional city in 2022.*

## OCCUPATIONAL

**MARKET 2022**

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 1,218,443 | 13% ▲ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 709,000 | -15% ▼ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £40.00 | 4% ▲ |

**PROJECTIONS**

LEASE EXPIRIES 2023-2025 (SQ FT)
**2,800,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**692,169**

RENT FORECAST (PER SQ FT)
**£45.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £438m | -37% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 5.75% | 100 ▲ |

2023 PRIME YIELD FORECAST
**5.75%**

## We Know

- Offices in Manchester remain sought after by investors, but the rising cost of debt has meant that pricing discovery has begun
- Despite some organisations reducing floorspace footprints, occupier demand holds firm, with take-up exceeding all UK Cities outside of London
- Quantity is being replaced with quality, with over 40% of all transactions in new Grade A space – an expectation that buildings offer strong ESG credentials
- As flexibility has risen up in organisational importance, a supply side response has emerged. The majority of new Grade A buildings have secured a flexible operator which has attracted interest from occupiers
- The occupier trend of ‘flight to quality’ continues. Having recently achieved the first letting at £40 per sq ft, we have witnessed further rental growth, with space now under offer at £42.50 per sq ft

## We Expect

- A rise in demand for new space. A greater emphasis on the importance of office by employees, with less dominance on hybrid working
- Innovation led sectors such as Digital Tech, Advanced materials and Life Sciences will continue to generate new demand, with diversification of businesses models creating new work streams
- Rents to increase to £45 per sq ft as the flight to quality continues and new products are delivered
- The importance of ESG will drive refurbishment opportunities for investors
- A rise in demand for fully fitted space taken on conventional leases at a premium rent
- Yields to stabilise supporting surety for development appraisals
- Service charges will rise as landlords factor the rising costs of utilities – adding pressure to ensure the services show value for money

## We Question

- The longevity of business models that adopt a dominant work from home policy, given the rising importance of learning and development in organisational growth
- Whether the balance of hybrid working will skew towards ‘office first’
- What level of price adjustment is required to ensure a development is viable
- The full impact of rising construction costs. Rental growth isn’t enough to give developers confidence to build speculatively
- What will help ‘plug the gap’ whilst there is a lag in the delivery of new stock
- The next phase of growth within the city. Areas that were once seen as fringe locations are now part of the ‘City Core’. Occupiers are prepared to relocate away from the ‘former’ prime areas to secure the right type of space. This will give greater emphasis to the market for schemes located in the former fringe

# NEWCASTLE

*Office take-up in the city centre dipped in 2022, although stayed broadly consistent with the long-term average. During the year prime rents increased by 8%, demonstrating the level of competition for best quality.*

## OCCUPATIONAL

**MARKET 2022**

| TAKEUP (SQ FT) | % CHANGE YOY |
|---|---|
| 237,310 | -63% ▼ |

| GRADE A SUPPLY (SQ FT) | % CHANGE YOY |
|---|---|
| 193,735 | -37% ▼ |

| RENT (£ PER SQ FT) | % CHANGE YOY |
|---|---|
| £28.00 | 8% ▲ |

**PROJECTIONS**

LEASE EXPIRIES 2023-2025 (SQ FT)
**1,500,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**135,973**

RENT FORECAST (PER SQ FT)
**£30.00**

## INVESTMENT

| 2022 INVESTMENT VOLUMES | % CHANGE YOY |
|---|---|
| £57m | -7% ▼ |

| 2022 PRIME YIELD | CHANGE (YOY BPS) |
|---|---|
| 6.25% | 25 ▲ |

2023 PRIME YIELD FORECAST
**6.00%**

### We Know

- Occupier preference has centred on best-in-class, with 83% (sq ft) of take up in the city centre in 2022 being in Grade A buildings
- Organisations are incorporating space strategy as part of a wider environmental responsibility agenda
- Occupier activity rebounded in 2022 with deal numbers returning to pre-Covid levels
- A new city centre headline rent of £28 per sq ft was set in 2022 at Bank House, but this is still low in a UK regional context
- Demand from occupiers seeking Cat B fitted space is increasing, thus incentivising landlords to ready space

### We Expect

- A shortage of new office stock in medium term due to the increasing viability gap
- Prime rents in Newcastle City Centre to increase to £30 in 2023 as low supply creates competitive pressure
- Landlords across the market to invest further in delivery of fitted Cat B space to meet continued increase in demand
- Backed by occupier demand for flexible and fitted space, several serviced office operators to acquire space in 2023, to capitalise on current low levels of serviced space in the market

### We Question

- Development viability will be challenged over medium term due to cost inflation and any new scheme that advances will require a significant pre-let
- The long-term future of some offices completed in the 1990's or 2000's without significant investment in ESG, wellness and amenities
- The effect that significant increases in service charge may start to have on market rents, particularly for older stock

# SHEFFIELD

*Despite several development schemes reaching completion, availability finished the year close to the long-term average. Although investment transactions were few, investor interest remains upbeat given the relative discount Sheffield offers compared with other regional centres.*

## OCCUPATIONAL

**MARKET 2022**

TAKEUP (SQ FT)
**308,578**

% CHANGE YOY
**-15%** ▼

GRADE A SUPPLY (SQ FT)
**175,000**

% CHANGE YOY
**52%** ▲

RENT (£ PER SQ FT)
**£26.00**

% CHANGE YOY
**4%** ▲

**PROJECTIONS**

LEASE EXPIRIES 2023-2025 (SQ FT)
**400,000**

DEVELOPMENT PIPELINE (U/C SPECULATIVE SQ FT)
**225,370**

RENT FORECAST (PER SQ FT)
**£27.00**

## INVESTMENT

2022 INVESTMENT VOLUMES
**£16m**

% CHANGE YOY
**-63%** ▼

2022 PRIME YIELD
**6.75%**

CHANGE (YOY BPS)
**50** ▲

2023 PRIME YIELD FORECAST
**6.75%**

## We Know

- Occupier activity is back in line with the long-term average for Sheffield
- Recent significant deals have focused in the city centre, including the letting to BT of the speculative final phase of Scarborough Property Group's 65,000 sq ft Endeavour Building at Sheffield DC, due for completion in 2023
- Headline rents have moved forward for prime Grade A space over the last 12 months
- Occupiers are focusing on the environmental credentials of offices to a degree, to help meet self imposed carbon reduction targets
- Amenity related to wellbeing and social experience is proving increasingly attractive to occupiers

## We Expect

- Rents on new prime City centre buildings to move to £27 per sq ft in 2023 , with £30 per sq ft predicted further ahead
- A rise in the refurbishment and upgrade of older buildings to improve energy performance and EPC ratings, as well as work space and social environments
- More use of external areas, including roof spaces for exclusive breakout spaces
- Flight to prime for corporate and public sector enquiries
- Increased demand for serviced and flexible offices. IWG and Spaces have just committed to a new centre of approximately 30,000 sq ft at RBH Properties Pennine Five development

## We Question

- The direction of organisational working practices - how will firms strike the balance of dynamic working and delivering the right office and workspace to retain and attract talent
- Impact of rising costs and the influence that escalation will have on both new development, and operational running costs of business premises
- Whether the new year will bring a greater emphasis on place. Successful city centres need more than just office space. The creation of new mixed-use retail and hospitality venues at the Sheffield Council's, heart of the city development will improve Sheffield's amenity offer to benefit the wider central market
- The scale of new office demand that Sheffield's two Universities could derive, given growth of innovation led sectors

## We like questions. If you've got one about our research or would like some property advice, we would love to hear from you.

### Head of UK Cities

**Alastair Graham-Campbell**
Partner
+44 20 7861 1219
alastair.graham-campbell@knightfrank.com

### Aberdeen

**Eric Shearer**
Partner, Office Head
+44 1224 415948
eric.shearer@knightfrank.com

### Birmingham

**Ashley Hudson**
Partner, Office Head
+44 1212 336443
ashley.hudson@knightfrank.com

### Bristol

**Steve Oades**
Partner, Office Head
+44 1179 174548
steve.oades@knightfrank.com

### Cardiff

**Matt Phillips**
Partner, Office Head
+44 2920 440122
matt.phillips@knightfrank.com

### Edinburgh

**Alasdair Steele**
Partner, Office Head
+44 1312 229622
alasdair.steele@knightfrank.com

### Research

**Jodie Gibson**
Analyst, Commercial Research
+44 207 861 1024
jodie.gibson@knightfrank.com

### Glasgow

**John Rae**
Partner, Office Head
+44 1415 666029
john.rae@knightfrank.com

### Leeds

**Henrie Westlake**
Partner, Office Head
+44 1132 972413
henrie.westlake@knightfrank.com

### Manchester

**David Porter**
Partner, Office Head
+44 1618 337725
david.porter@knightfrank.com

### Newcastle

**Peter Bowden**
Partner, Office Head
+44 1915 945003
peter.bowden@knightfrank.com

### Sheffield

**Peter Whiteley**
Partner, Office Head
+44 1142 413903
peter.whiteley@knightfrank.com

### Research

**Darren Mansfield**
Partner, Commercial Research
+44 20 7861 1246
darren.mansfield@knightfrank.com

### Research

**Stephen Ryan**
Graduate, Research
+44 203 540 0043
stephen.ryan@knightfrank.com

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