UK Cities

Knight Frank

H1 2023

OFFICE MARKET MID YEAR REVIEW 2023

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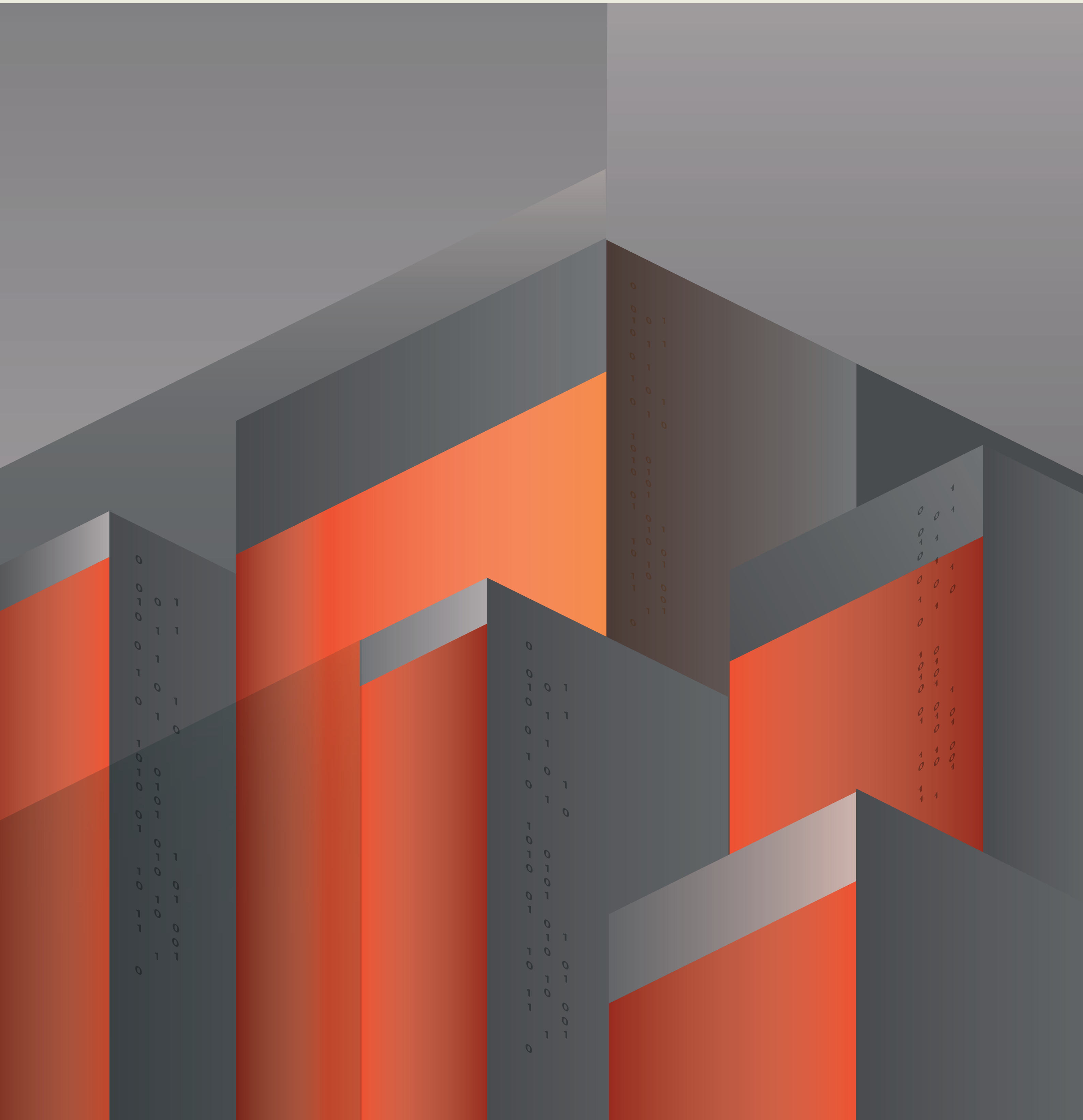


FOREWORD

BY DARREN MANSFIELD,
HEAD OF UK CITIES RESEARCH

Perhaps the most appropriate descriptor of the office market during the first six months of 2023 is challenging. Stubbornly high inflation, labour market shortages and successive interest rate rises have combined to mute economic growth forecasts and dampen market and business confidence. The result for real estate in H1 2023? Leasing and investment transaction activity has laboured, albeit encouragingly, interest has not been withdrawn.

What can we expect from the next six months? The second half of 2023 does offer a more promising outlook.

Evident in H1 was that occupiers are now engaging with the market well ahead of lease events to secure the 'right space'. Active named demand is at the highest level since before the pandemic, with the return to the office gathering momentum as firms advocate an 'office first' stance in greater numbers. Expectations on supply are proving an incentive for earlier action, with vacancy at the prime end of the market low and future development constrained by high costs and softer market rates. As competitive pressure increases, a further uplift in prime rents can be expected.

For investment, the continued rise of borrowing costs and the gap between purchaser and vendor expectations proved a hurdle to the completion of deals in H1. As interest rates have risen, so too has a degree of risk aversion amongst real estate investors as pricing the fundamentals of performance becomes clouded by an uncertain outlook. Although interest rates increased again in August, the prospect of significant hikes beyond this is fading, with inflation now falling. This could settle pricing and unlock active capital in the market as investors finally have a benchmark to appraise opportunities.

Undoubtedly, the second half of 2023 will continue to present hurdles to market activity. Lease events, structural change and obsolescence of stock, though, are demanding occupier action, and this should create opportunities for developers and investors that proactively address the fundamental changes taking place.

Aberdeen

Although occupier activity proved slow in H1, the announcement of new North Sea oil and gas licences will create extra demand in the city.

Occupational - H1 2023

MARKET 2023 H1

107,100	Take-up (sq ft)	▼-58%	% change YOY
370,000	Grade A Supply (sq ft)	▼-9%	% change YOY
£32.50	Rent (£ per sq ft)	◀▶0%	% change YOY

2022 H1 Take-up 256,426 sq ft

2022 H1 Grade A supply 407,500 sq ft

2022 H1 rent £32.50 per sq ft

- **32** — No of deals

PROJECTIONS

- **0*** — Development Pipeline (U/C Speculative sq ft)
- **£32.50** — Yr End Forecast (per sq ft)

Investment - H1 2023

£13m	Investment Volumes	▲21%	% change YOY
8.25%	Prime Yield	▲125	change (YOY bps)

2022 H1 Investment Volumes £11m

2022 H1 prime yield 7.00%

- **% Stable** — Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

INVESTMENT ZONE STATUS ANNOUNCED

The announcement of the investment zone in the Northeast of Scotland is expected to significantly influence market activity.

Alongside Glasgow, the investment zone in the Northeast is set to help achieve the government's levelling up agenda, through economic growth and both job-related and education-based opportunities within the region.

The region will receive £80m of funding over a five-year period, having been selected due to its strength of research, economic need, and potential for growth. With investment zones focussed on research institutions and innovation in key sectors including technology and the green sector, the decision will help secure Aberdeen's position as one of the most attractive locations in the UK, and indeed Europe, for investment in low-carbon technologies across different sectors.

The money will be spent on targeted investments, tax reliefs and other incentives, aimed at attracting further investment to boost the local economies and more widely that of Scotland and the UK. As part of the devolution of powers, regional MPs, business leaders and universities will be at the heart of developing detailed proposals for the investment.

Birmingham

Despite heightened market uncertainty, occupier activity registered improvement in H1 2023. Investors remain positive on Birmingham, with several high value sales under offer.

Occupational - H1 2023

MARKET 2023 H1

331,215 — Take-up (sq ft)
▲13% — % change YOY
2022 H1 Take-up 292,860 sq ft

54 — No of deals

648,564 — Grade A Supply (sq ft)
▲104% — % change YOY
2022 H1 Grade A supply 318,089 sq ft

£41.50 — Rent (£ per sq ft)
▲4% — % change YOY
2022 H1 rent £40.00 per sq ft

PROJECTIONS

429,000* — Development Pipeline (U/C Speculative sq ft)

£42.50 — Yr End Forecast (per sq ft)

Investment - H1 2023

£32m — Investment Volumes
▼-90% — % change YOY
2022 H1 Investment Volumes £318m

6.00% — Prime Yield
▲125 — change (YOY bps)
2022 H1 prime yield 4.75%

%
Stable — Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

CREATIVE INDUSTRIES GROWING IN BIRMINGHAM

The TV and Film industry is shifting the dynamics of the market in Birmingham. Its emergence is set to provide jobs and attract both occupiers and further investment into the local economy over the coming years.

The BBC has unveiled plans to move to the former Typhoo factory site to create a new purpose-built broadcast centre from 2026. The cutting-edge studio located in Digbeth champions sustainability and is set to achieve BREEAM 'outstanding' and an EPC A rating. A scheme developed by Stoford and funded by Aviva, it reinforces Digbeth's position as the emerging TV & Film epicentre of the Midlands.

Oval RE has also launched The Bond, a 40,000 sq ft complex focused on accommodating the creative industries which is attracting interest from several TV & Film occupiers. Steven Knight, director of Peaky Blinders, has recently launched the construction of a TV studio called Digbeth Loc. Studios, which is due to create over 700 jobs and add £30m to the local economy. Additionally, plans have been approved for MasterChef's new studios, Banana Warehouse, despite the show having been filmed in London since 2001.

Birmingham is emerging as a hub for the creative industries, and it is hoped that the aforementioned activity will act as a catalyst for further TV & Film productions to relocate and invest locally.

Bristol

A supply and demand imbalance has led to strong rental growth. Availability remains tight, but development is set to come through over the next 24 months.

Occupational - H1 2023

MARKET 2023 H1

148,744
Take-up (sq ft)

▼-61%
% change YOY

2022 H1 Take-up 377,884 sq ft

42
No of deals

84,786
Grade A Supply (sq ft)

▲54%
% change YOY

2022 H1 Grade A supply 55,216 sq ft

£42.50
Rent (£ per sq ft)

◆0%
% change YOY

2022 H1 rent £42.50 per sq ft

PROJECTIONS

611,909*
Development Pipeline (U/C Speculative sq ft)

£43.00
Yr End Forecast (per sq ft)

Investment - H1 2023

£25m
Investment Volumes

▼-85%
% change YOY

2022 H1 Investment Volumes £165m

5.75%
Prime Yield

▲75
change (YOY bps)

2022 H1 prime yield 5.00%

%
Weaker
Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

DEVELOPMENT SHIFTING MARKET BOUNDARIES
Upcoming development in Bristol is poised to have a major influence on the Bristol market moving forward. Bristol is a city with a CBD that moves in different directions, but the majority of new development is happening around Temple Meads railway station.

Baring's mixed-use development at Soap Works, Candour/Tristan Capital's super prime office Welcome Building and Bristol University's new 409,000 sq ft Temple Quarter Enterprise campus (TQEC) are all progressing and will make this part of the city one of the most desirable locations to live, work and study.

Education is a strong focus of the city's development. Phase 1 of the TQEC involves the 409,000 sq ft academic building at the centre of the Campus development, expected to open in September 2026. The building will provide teaching spaces for 4,600 students and 650 university staff. On completion the campus will provide over 100,000 sq ft of teaching and study space, over 45,000 sq ft of cutting-edge research labs and circa. 27,000 sq ft of space for Enterprise partners. The campus is expected to be the catalyst for a significant amount of change in the St Phillips Marsh area. In addition, the improvements to Temple Meads station will provide better access to the TQEC and the increased passenger capacity will allow greater access to the region, driving local economic growth.

Cardiff

The number of deals in H1 2023 was above the long-term trend, albeit leasing volumes reflected smaller occupier footprints. Investment activity has been selective, with prime yields softening responding to the cost of debt.

Occupational - H1 2023

MARKET 2023 H1

148,463
Take-up (sq ft)

▼-31%
% change YOY

2022 H1 Take-up 214,708 sq ft

53
No of deals

282,813
Grade A Supply (sq ft)

▼-10%
% change YOY

2022 H1 Grade A supply 314,519 sq ft

£25.00
Rent (£ per sq ft)

◀▶0%
% change YOY

2022 H1 rent £25.00 per sq ft

PROJECTIONS

107,010*
Development Pipeline (U/C Speculative sq ft)

£30.00
Yr End Forecast (per sq ft)

Investment - H1 2023

£34m
Investment Volumes

▲126%
% change YOY

2022 H1 Investment Volumes £15m

6.50%
Prime Yield

▲100
change (YOY bps)

2022 H1 prime yield 5.50%

% Weaker
Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

CONNECTED CARDIFF

The South Wales Metro, a brand new multi modal transport network, is set to bolster transport connectivity in Cardiff.

Cardiff will be at the core of the Metro, which is being designed to improve the public transport options across Cardiff and the wider region. Proposals include a Cardiff Crossrail Tram Line and a new Cardiff Circle Tramline, due to complete in 2024 and 2028 respectively.

In January 2023 the Welsh Government confirmed £50m of funding for the Cardiff Crossrail which was matched by a further £50m of Levelling-Up funding from the UK Government. The committed money will enable the construction of a new rapid transport link from Cardiff Central to Cardiff Bay via Callaghan Square. This will include a regular tram service between Cardiff Central and Cardiff Bay, improvements to the environment around the existing and new station platforms, and a new highway layout that provides a safe separation between road, rail, cyclists, and pedestrians.

The arrival of the network will improve accessibility to jobs, education, and healthcare, and boost the local economy.

Edinburgh

Edinburgh has 'bucked the trend' in terms of occupier activity in H1 registering year-on-year improvement. Overseas buyers continue to target Edinburgh, with market dynamics supporting projections of rental growth.

Occupational - H1 2023

MARKET 2023 H1

239,004 ▲58%
Take-up (sq ft) | % change YOY
2022 H1 Take-up 151,715 sq ft

69
No of deals

696,555 ▲88%
Grade A Supply (sq ft) | % change YOY
2022 H1 Grade A supply 370,946 sq ft

£43.00 ▲8%
Rent (£ per sq ft) | % change YOY
2022 H1 rent £40.00 per sq ft

PROJECTIONS

57,000*
Development Pipeline (U/C Speculative sq ft)

£45.00
Yr End Forecast (per sq ft)

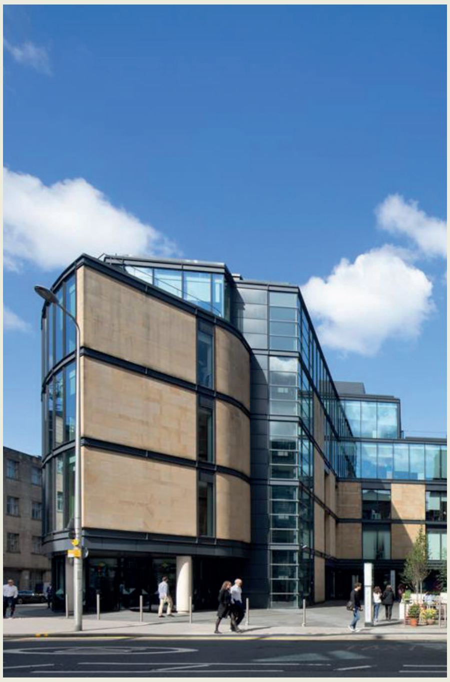
Investment - H1 2023

£73m ▼-51%
Investment Volumes | % change YOY
2022 H1 Investment Volumes £151m

5.75% ▲125
Prime Yield | change (YOY bps)
2022 H1 prime yield 4.50%

%
Stable
Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments



TIGHT SUPPLY FUELS RENTAL GROWTH

Occupier activity in Edinburgh is buoyant in the city centre with an acute supply-demand imbalance, supporting an upward trajectory in rental values. This mis-match is the key criteria influencing the market and reflects the historic nature of the city and its lack of development opportunities. Edinburgh also has a limited amount of grade B office stock suitable for refurbishment, as older buildings have been repositioned to hotel or residential use. The office development pipeline is modest compared to other regional centres and European capital cities.

With build costs high, many new and existing schemes are under review with some plans changing direction to an alternative use. There are two recent examples of this - 28 St Andrew Square, Aviva, selling a consented redevelopment opportunity for a change of use to a hotel and 9/10 St Andrew Square, Patrizia, selling a tenanted office for redevelopment for hotel use. Other schemes have not started on site as planned and are subject to review and value engineering.

While rental growth is evident, severe build cost inflation coupled with yield compression has amounted to this hiatus in the development pipeline. For existing stock that is under refurbishment or construction, this is positive. However, Edinburgh is in need of new product to accommodate this buoyant time in the market.

Glasgow

Market hesitancy about future space needs and a slow return to the office indicate that occupier demand remains short of the long-term trend. The rising cost of debt and a shortage of sellers meant investment activity in H1 was limited.

Occupational - H1 2023

MARKET 2023 H1

134,650 — Take-up (sq ft)
▼-35% — % change YOY
2022 H1 Take-up 208,021 sq ft

54 — No of deals

652,769 — Grade A Supply (sq ft)
▼-9% — % change YOY
2022 H1 Grade A supply 717,079 sq ft

£36.00 — Rent (£ per sq ft)
▲3% — % change YOY
2022 H1 rent £35.00 per sq ft

PROJECTIONS

736,029* — Development Pipeline (U/C Speculative sq ft)

£30.00 — Yr End Forecast (per sq ft)

Investment - H1 2023

£65m — Investment Volumes
▼-72% — % change YOY
2022 H1 Investment Volumes £231m

6.50% — Prime Yield
▲150 — change (YOY bps)
2022 H1 prime yield 5.00%

% Stable — Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

RIGHT PLACE, RIGHT TIME, RIGHT PRODUCT

In Glasgow, the recent letting to Pinsent Masons at Lucent, 50 Bothwell Street, provides evidence of "build it and they will come" for the highest quality space.

Lucent is an amenity rich refurbishment that meets all the ESG criteria with significant wellbeing facilities. It has set a record rent for Glasgow beyond current new build rental levels, which reflects the increased build costs and level of amenity. It demonstrates that for the right product in the right location, occupiers are willing to pay a premium. Some occupiers are willing to pay such rents for the right product to fulfil their ESG goals but also to encourage staff to return to the office and attract future talent.

Working from home has been popular in Glasgow, thus occupiers are seeking space that not only meets their standards in terms of design and ESG, but also has a "wow factor" to encourage staff to use the space. Buildings that cannot offer this may struggle to attract occupiers going forward, leading to further polarisation of the Glasgow office market, as the strongest space gains clear ground.

Leeds

Occupier take-up in the first six months of 2023 was the highest for an H1 period since 2019. Demand for best-in-class is driving rental uplift, with further rises expected in 2023.

Occupational - H1 2023

MARKET 2023 H1

402,274
Take-up (sq ft)

▲59%
% change YOY

2022 H1 Take-up 252,323 sq ft

65
No of deals

233,934
Grade A Supply (sq ft)

▼-32%
% change YOY

2022 H1 Grade A supply 341,910 sq ft

£37.00
Rent (£ per sq ft)

▲9%
% change YOY

2022 H1 rent £34.00 per sq ft

PROJECTIONS

556,287*
Development Pipeline (U/C Speculative sq ft)

£38.00
Yr End Forecast (per sq ft)

Investment - H1 2023

£20m
Investment Volumes

▼-75%
% change YOY

2022 H1 Investment Volumes £80m

6.25%
Prime Yield

▲100
change (YOY bps)

2022 H1 prime yield 5.25%

%
Stable
Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

EDUCATION AND LEARNING EQUALS EMPLOYMENT
Education is set to influence the market in Leeds. Knight Frank has acquired the former home of Leeds Building Society for the Department for Education, who are due to open a National Mathematics School in September 2023. The building will undergo a comprehensive refurbishment ahead of this date, demonstrating a shift to education providers demanding best-in-class space. The school will accommodate 80 year 12 students upon opening, which will double the following year as they move to year 13 and a new cohort arrives.

In regards to lettings, Knight Frank pre-let 55,000 sq ft of space at Trevelyan Square to Leeds Trinity University in Q4 2022. Following refurbishment, it will be home to circa. 1,000 students from September 2024, very much focused on STEM courses. Importantly, it will bring more students to Leeds city centre, allowing for greater collaboration between universities and businesses, and will help to meet the employer demand for such skills.

The above market activities align with Leeds' city ambition by blurring the lines between business and education, with a key focus on STEM subjects.

Manchester

Although leasing volumes show a year-on-year decrease, deal numbers were consistent with the five-year average in H1. Availability is now the lowest for three years, an imbalance that will fuel rental growth.

Occupational - H1 2023

MARKET 2023 H1

390,470
Take-up (sq ft)

▼-15%
% change YOY

2022 H1 Take-up 461,960 sq ft

110
No of deals

551,471
Grade A Supply (sq ft)

▼-40%
% change YOY

2022 H1 Grade A supply 912,159 sq ft

£40.00
Rent (£ per sq ft)

▲4%
% change YOY

2022 H1 rent £38.50 per sq ft

PROJECTIONS

692,169*
Development Pipeline (U/C Speculative sq ft)

£43.00
Yr End Forecast (per sq ft)

Investment - H1 2023

£43m
Investment Volumes

▼-84%
% change YOY

2022 H1 Investment Volumes £265m

5.75%
Prime Yield

▲100
change (YOY bps)

2022 H1 prime yield 4.75%

%
Stable
Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

MAJOR CORPORATE OCCUPIERS TARGET MANCHESTER

A flurry of occupier activity is poised for Manchester.

The city is on the cusp of securing three significant lettings, BNY Mellon, Autotrader and JP Morgan, with the latter opening its first office in the city. The accumulative total of approximately 450,000 sq ft would absorb a large chunk of the current supply and development pipeline, putting further pressure on the already limited amount of space under construction and supporting the rise in prime rents to £45 per sq ft and beyond.

Importantly, the aforementioned deals should inject confidence for further development to commence, adding to the development pipeline with projected delivery times across the next few years when supply will be at a record low.

Due to the current limited supply pipeline, occupiers are reviewing space requirements far ahead of future lease events, in order to secure the desired space in a supply constrained market.

This will likely lead to several 'pre-lets' and a continuation of deals being concluded on space under construction – a race to get in first. This activity is likely to also put a great emphasis on how landlords reposition their asset in order to secure longer term lease renewals now, with the lure of refurbished space and introduction of a wider range of high quality building amenities – along with improving the property's 'green credentials'.

No 3, Circle Square, Manchester – Bruntwood SciTech

Newcastle

Office take-up in the city centre dipped in H1 2023, although it stayed broadly consistent with the long-term average. However, prime rents have registered an increase, demonstrating competition for the best quality space.

Occupational - H1 2023

MARKET 2023 H1

86,213 — Take-up (sq ft)

▼-32% — % change YOY

2022 H1 Take-up 127,220 sq ft

25 — No of deals

333,700 — Grade A Supply (sq ft)

▲22% — % change YOY

2022 H1 Grade A supply 274,542 sq ft

£29.00 — Rent (£ per sq ft)

▲7% — % change YOY

2022 H1 rent £27.00 per sq ft

PROJECTIONS

40,993* — Development Pipeline (U/C Speculative sq ft)

£30.00 — Yr End Forecast (per sq ft)

Investment - H1 2023

£41m — Investment Volumes

▲7% — % change YOY

2022 H1 Investment Volumes £39m

6.25% — Prime Yield

▲50 — change (YOY bps)

2022 H1 prime yield 5.75%

% Weaker — Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

CHANGING MARKET FABRIC OF NEWCASTLE

The market influencer for Newcastle is the completion of Bank House. It is the long anticipated first phase of office development on Motcomb Estate's Pilgrim Street development, a major regeneration scheme in the heart of Newcastle City Centre.

The building offers 120,000 sq ft of BREEAM 'excellent' accredited space over 12 floors and has panoramic views across the city. The building is highly sustainable, being all electric and achieving an EPC A rating.

Two pre-lets were achieved ahead of completion, totalling 25,000 sq ft. Since completion in April 2023, two further lettings have been achieved, alongside a new headline office rent of £29.00 per sq ft. Quoting rents at Bank House have now broken £30.00 per sq ft, with the top two floors marketed at £32.00 per sq ft.

The rest of the development is underway, which includes the construction of the new 465,000 sq ft HMRC offices which will become home to 11,000 employees. It also includes the conversion of the former police and fire station, which is being transformed into a 5* luxury hotel, and the historic Worswick Chambers which is due to open next year as a 30,000 sq ft food and beverage destination.

The combined scale of development on East Pilgrim Street will be transformational for the city.

Sheffield

The completion of several development schemes pushed up availability in H1. Although investment transactions were few, investor interest remains upbeat given the relative discount Sheffield offers compared with other regional centres.

Occupational - H1 2023

MARKET 2023 H1

137,936 ▼-33%
Take-up (sq ft) | % change YOY
2022 H1 Take-up 204,379 sq ft

36
No of deals

300,000 ▲161%
Grade A Supply (sq ft) | % change YOY
2022 H1 Grade A supply 115,000 sq ft

£26.50 ▲6%
Rent (£ per sq ft) | % change YOY
2022 H1 rent £25.00 per sq ft

PROJECTIONS

371,759*
Development Pipeline (U/C Speculative sq ft)

£30.00
Yr End Forecast (per sq ft)

Investment - H1 2023

£6.5m ▼-53%
Investment Volumes | % change YOY
2022 H1 Investment Volumes £14m

6.75% ▲50
Prime Yield | change (YOY bps)
2022 H1 prime yield 6.25%

% Weaker
Yr End Prime Yield Forecast

*inclusive of new builds and comprehensive refurbishments

DEVELOPMENT SHAPES SHEFFIELD'S OFFICE MARKET
Landmark offices are being delivered in the city core which will help shape the city moving forward.

Sheffield City Council and Queensberry are on site at the Heart of the City II development with two new office buildings. Isaacs comprises 39,000 sq ft and has secured its first letting of 13,000 sq ft to Henry Boot Plc. Elshaw House comprises 72,000 sq ft and is fully electric targeting BREEAM 'excellent' and EPC A. It is expected to set new headline rents on completion.

At West Bar Square, Urbo and Peveril Securities, Legal & General and Sheffield City Council have commenced works on their first building – 100,000 sq ft of Grade A office space due for completion in 2024.

RBH Properties are delivering the Pennine Five Campus within the city centre, comprising five buildings totalling 230,000 sq ft around a landscaped courtyard and offering over 400 car parking spaces. Phase 1 has been 57% let, phase 2 is under offer and phase 3 is to follow.

At Sheffield Digital Campus, Endeavour has recently been completed by Scarborough Group. The grade A office building comprises 65,500 sq ft of space and is fully let to BT Group Plc who committed during the construction period. This will be reflected in Q3's take-up.

The UK's first investment zone in South Yorkshire focused on advanced manufacturing could also have an important influence on the Sheffield office market. The region stands to benefit from an estimated 8,000 new jobs and £1.2bn of private funding by 2030.

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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

Knight Frank