UK Cities | Trends for 2024

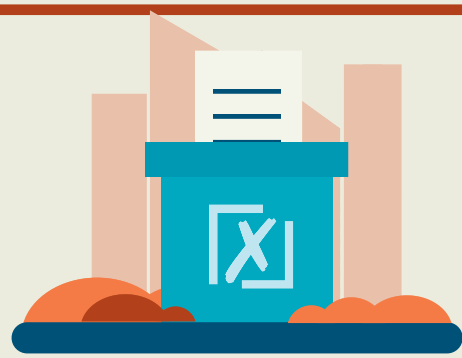
Knight Frank

1 Rents to rise as supply narrows

The UK office market faces a scarcity of prime space, a position that is pressuring tenants to secure spaces well ahead of forthcoming lease events. While overall vacancy rates have risen, high-quality space has remained limited, with the vacancy rate for new and grade A space less than 3%. The supply squeeze is most acute for those requiring large floorplates. With high construction costs, lower market rates and a switch to alternative use further restricting future supply, competition for space will intensify in the coming year. Consequently, prime rents are forecast to increase further by 3%-5% on average. Pre-letting activity or leases agreed during the construction process will also be a significant factor in the market in 2024.

2 Politics takes centre stage

Elections taking place in 2024 for Mayor in Birmingham and Manchester and the impending UK general election, will impact real estate markets and the landscape of the UK cities. Policy pledges will undoubtedly be frequent, with discussions around a new planning bill already a keenly debated topic. Political parties will also stress a commitment to climate change action, integrating net-zero mandates into real estate, including renewable energy projects and updated MEES requirements. Tax incentives and enterprise zones may emerge to woo voters. At a more local level, councils continue to face financial strain due to inflation, rising interest rates, and falling property values, with an estimated £5.2 billion required to tackle debt by April 2026. A 'fire sale' of assets is not expected, but the pressure is growing on councils to offload underutilised and investment properties to support the costs of providing local services. Birmingham City Council's recent sale of 29 disused buildings in February 2024 reflects this trend after their section 114 acceptance in Q3 2023. More examples will follow in 2024.



3 Stable is best for investors

In 2024, the trajectory of base interest rates will be a fundamental component of real estate market performance. At the time of writing, predictions indicate a cut of between 100 and 125 bps, albeit the timings are much in debate. Economists foresee cuts starting in May or June, with Oxford Economics expecting a 100-bps reduction by year-end to reach 4.25%. Capital Economics projects a 125-bps cut to 4% by year-end and 3% by 2025. Money markets anticipate four quarter-point cuts starting in June. With further interest rate hikes now unlikely, debt costs will remain steady, providing a pricing benchmark for buyers and sellers. Prime office yields will stabilise, encouraging more investment activity as investors take advantage of pricing that offers discounts compared to the long-term average.

4 Clean, healthy and green

Developers face challenges from high build costs, the proposed MEES requirements, and a heightened occupier focus leaning towards best-quality buildings. Office spaces across the markets must adapt, with flexibility, amenities and sustainability at the forefront of occupier strategy. ESG standards, including energy-efficient upgrades and green certifications, are increasingly vital for investors, occupiers and lenders. Although the MEES requirements remain under consultation, commercial developers and landlords are compelled to comply with the changing market mood. Approximately 79% of office spaces fall short of an EPC B rating, necessitating upgrade work to avoid depreciation or obsolescence. BREEAM 'Outstanding' certifications have shown to command a rental premium. All market actors will be active with a 'green' lens in 2024.

5 Space as a service intensifies

In 2023, serviced office providers such as Cubo, Orega, Re-defined, Regus, and Wizu expanded their presence in many UK regional cities, with this subsector taking 259,000 sq ft across 15 deals. Underpinning demand is an ongoing occupational review of the quantum and quality of floorspace now required, which in some cases is meaning a reduction and shift toward 'just in case' flex space. Occupiers of all denominations are exploring flex space as part of real estate strategies, especially when a temporary fix is required whilst longer-term space is secured. More are seeking higher levels of flexibility than afforded by conventional leased space. Flex space is also particularly important to the growth of the technology, creative and digital sectors. Typically, some of the most innovative and high-growth companies often strategise to shorter timeframes which are not conducive to traditional leases. Expect further expansion in 2024.

6 Demand sources to diversify in 2024

Whilst professional services remained the dominant source of office demand, occupiers derived from innovation, creative, and knowledge-intensive sectors are increasingly factoring in office demand schedules. The principal draw to the UK Cities is the existence of deep talent pools and strong connections to knowledge and research institutions. New sectors, economies and corporate collaborations are rapidly emerging in many of the UK's main cities. Education, advanced technology, life sciences and organisations related to ESG are growing in job creation and market influence. These also create off-shoot companies and clusters, necessitating headquarters and operational spaces. In 2024, expect a sharper supply-side response, with the creation of well-connected and imaginative workspaces to capture the shifting marketplace.