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Significant repurposing of office space across UK, although tenant demand rising in the capital

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The Commercial property market in the UK showed some improvement in Q1 2024, according to the latest RICS Commercial Property – although certain areas of the market continue to struggle against structural headwinds.

Tenant demand rose in Q1, (+4%, from -7% net balance at the end of 2023), with the industrial demand indicator posting the most positive since reading Q3 2022 (net balance +14%) and office demand also rising for the first time since early 2022.

Tenant demand is however, becoming more split across location. In London, office demand significantly increased this quarter (from a net balance of +3% to +40%) while elsewhere in the UK the picture is either flat or slightly negative. Retail demand is also showing stronger momentum in London than other parts of the UK. Industrial property demand remains steady with most regions reporting positive demand sentiment.

In extra questions included in the Q1 survey, 89% of respondents noted that that are seeing some level of repurposing of office space for other uses. Moreover, when looking at the number of clients downsizing their office space requirements, 52% of respondents saw an increase in such activity over the past twelve months.

Looking ahead, rents are expected to rise over the next 12 months for both primary and secondary industrial sites. Prime office sites are also expected to see a rental increases. Significantly, secondary office units display negative rental projections, with remote working and the Domestic Minimum Energy Efficiency Standard (MEES) continuing to impact the commercial office sector. Indeed, tenants increasingly appear to prefer prime, energy-efficient units to minimise immediate costs as well as potential future retrofitting costs.

Regionally, London remains ahead of the rest of the country, with rent expectations at +54%, reflecting its significant lead in tenant demand. This represents the strongest reading for Central London prime office rents since Q1 2016.

RICS Senior Economist, Tarrant Parsons, said: “Although sentiment remains relatively cautious regarding the near-term outlook across the UK commercial property market, the latest survey results do show some signs of recovery coming through. For one, occupier demand growth now appears to be gaining traction slightly, supported by the broader economy seemingly returning to growth following a brief recession late last year. Moreover, the prospect of interest rate cuts later this year have already led to an easing in credit conditions across the sector, marking the first such improvement in our feedback since 2021. This should begin to support investment market activity as the year wears on, which, in turn, will likely see a more stable picture emerge for headline capital values.”

Dominic Collier, Senior Public Affairs Officer at RICS, said: “We welcome the latest survey results indicating signs of recovery starting to emerge. Yet at the same time, the uncertainly around non-domestic MEES is continuing to impact the sector. RICS is urging for decisive action in setting clear and achievable MEES targets.

“The current proposed timeline and trajectory are increasingly viewed as unrealistic, and there are concerns about the lack of implementation mechanisms. Without action, there is a risk that up to 50% of commercial buildings could be stranded by 2035. RICS is advocating, collaborating and engaging with key stakeholders such as the Department for Energy Security and Net Zero (DESNZ), and the Built Environment Committee, to drive meaningful progress and help establish clear, realistic, credible and forward-looking non-domestic property MEES targets.”