Intelligent Investment

UK Mid Year Market Outlook 2024

REPORT

REAL ESTATE

CBRE RESEARCH

Contents

Introduction

2024 started with a renewed sense of optimism. While there was evidence of improved positivity with a pick-up in retail sales, consumer confidence, and a return to economic growth, there have been some less encouraging signs. Notably, the path of the inflation rate initially fell short of expectations as it all but levelled off, and investment volumes hit a record low. Still, as we find ourselves in the middle of the year, there are now stronger signs of a turning point. Now that inflation has reached the Bank of England's 2% target, the likelihood of an interest rate cut in August is high. As the cost of living pressures moderate, consumer demand will rebound. Overall, the improving economic backdrop is positive for both occupiers and investors, which should stimulate activity.

And, we are no longer living under the spectre of an impending election. The Labour party won a landslide victory, securing 411 seats. This gives the party a clear mandate and capability to drive its policy priorities. Our analysis of consumer confidence shows it increases in the period following an election in over 70% of the time. We expect this trend will be mirrored now and so the new Government will boost sentiment and provide a fillip to the economy.

From a real estate perspective, we particularly welcome the commitment made by the Labour party to reform planning. This has been an underlying challenge in our industry for some time, with the time taken to get residential planning permission doubling over the last 10 years.

The party has acknowledged that radical solutions are needed to boost housing delivery to the desired 1.5 million homes over the term of this Parliament. Executing a New Towns programme will be challenging. It will require substantial Government intervention (such as redefining the Green Belt to grey belt) and investment, but it is a vital initiative. The proposal to make the mortgage guarantee scheme permanent will also help support some first-time buyers who otherwise might not have been able to raise a deposit.

Other initiatives include plans to drive infrastructure projects, including allocating £1.8 billion to upgrade ports and build supply chains in the UK, and a review of business rates

Collectively, we believe these policies could be advantageous for both occupiers and investors and should stimulate activity.

01

Economic Outlook

ECONOMIC OUTLOOK

So far this year

- Inflation continued its steady descent, falling from 4% at the end of 2023 to the Bank of England's 2% target rate in May. This was helped by falls in food price inflation and falls in energy prices. Still, core inflation has remained sticky, falling from 5.1% to 3.5% over the same period, in large pushed by services inflation not falling as much; moving from 6.5% to 5.7%.

- The Bank of England base rate has remained unchanged at 5.25% since March 2023. However, market sentiment has shifted towards rate cuts, with two members voting to cut rates at the most recent meeting in June.
- The labour market remained solid but has recently weakened slightly. The latest data show unemployment has risen to 4.4%, coupled with a fall in notified job vacancies. In addition, the number of people who are economically inactive due to long-term illness has increased by 750,000 since the end of 2019. This has contributed to the overall labour force being virtually static since then. This has potentially exacerbated upwards pressure on wages. The indexation of the National Minimum Wage has contributed to nominal wage inflation remaining above long-term average levels at 5.6% (including bonuses) and the feed through of these costs has contributed to the stickiness of core inflation.
- GDP increased by 0.6% in the first quarter. This was a welcome respite from the falls in activity Q3 and Q4 2023. The strength of the service sector was a key component of growth. Consumer demand also picked up with retail sales bouncing back after a poor end to 2023.

ECONOMIC OUTLOOK

What's still to come

- Although inflation is now at the Bank's 2% target, we expect continued domestic inflationary pressures for the remainder of the year. This will lead to some volatility in the headline figure. We predict a slow decline in wage increases and services inflation. Some job shedding will put downward pressure on wage inflation and move it closer to long-term average levels.
- The Bank of England will maintain a cautious approach to interest rate cutting. Any movement will be data dependent, with MPC members keen to see inflation and wage growth solidly anchored at lower levels.
- Overall, there will be modest growth of around 1% across 2024 as a whole. Still, momentum will build through the year, and so annual GDP at Q4 will be higher at 2.0%.
- The main driver will be real income growth. This will reflect the acute drop in inflation and the more gradual slowdown in nominal wage growth. Interest rate cuts will also provide a boost to consumer and business demand.
- Risks to the outlook remain disruptors to the trajectory of inflation. Domestically sticky wage inflation and, globally, the Middle East conflict's proximity to energy markets, could both cause delays in interest rate cutting and dampen the growth outlook. The fiscal position is unlikely to change significantly following the election.

02

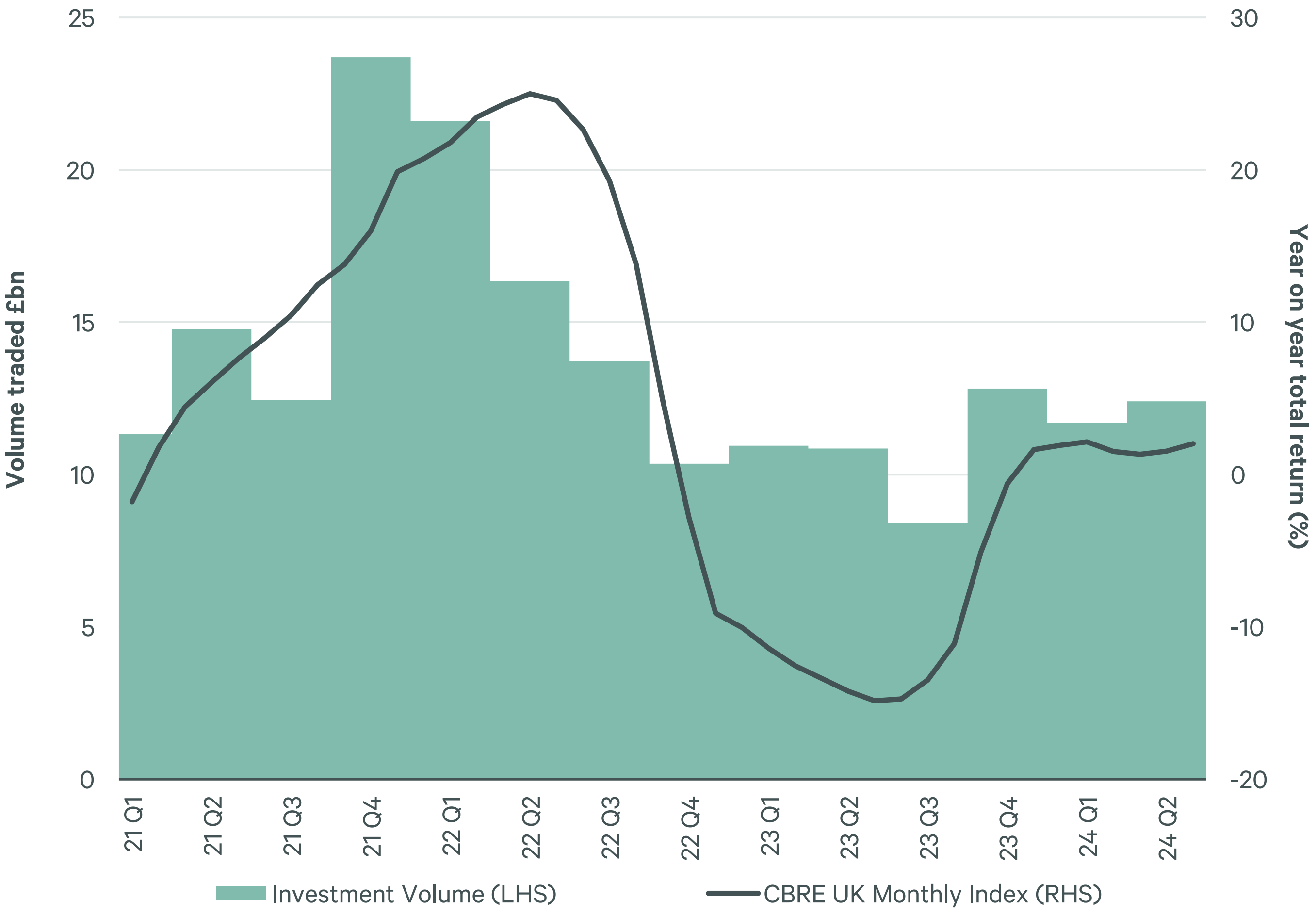
Investment

INVESTMENT

So far this year

- Investment returns for real estate have improved. Capital values in the industrial and retail sectors have stopped falling, and positive total returns reappeared at an all property level. Yet divergence in performance across sectors is still evident. Office capital values continued to fall in H1 2024, while rental growth was stronger for the industrial and multifamily sectors than in retail and offices.
- Transaction activity has been slower to improve, with investment volumes below their average level from the last decade. While there are signs that investor interest is now returning to the market, this has not yet crystalised into a notable increase in deals. However, activity is more resilient in the living sectors and there has been more liquidity for smaller lot sizes.
- There has been M&A activity in the UK listed real estate market, with two mergers concluded in H1. The listed sector saw large and persistent discounts to Net Asset Value through 2023 and into 2024. This has encouraged companies to propose transactions and other corporate actions that can capitalise on divergence between the stock market rating of the sector and the value of the underlying assets.
- Real estate debt markets remained liquid and, while higher interest rates have weighed on market activity, the cost of debt has eased over the last six months. Loan originations continue to be dominated by refinancing rather than new investments, but there is competition among lenders to refinance high quality assets. Distressed sales to resolve more difficult situations are still relatively uncommon.

Figure 1: Investment returns and investment activity, 2021–2024



Source: CBRE Research

INVESTMENT

What's still to come

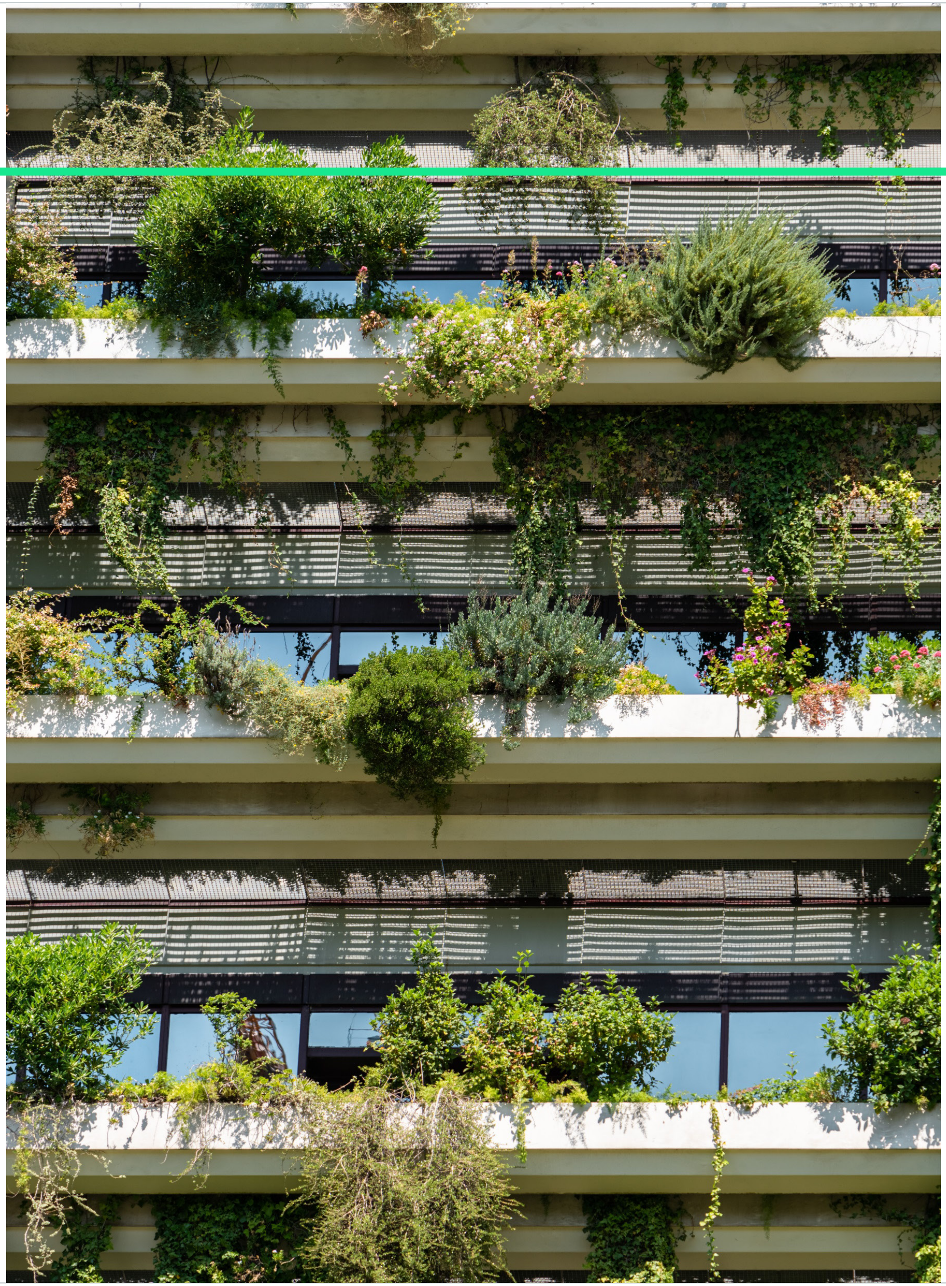
- We expect to see the improvement in investment returns continue through the second half of the year, with capital values bottoming out across all sectors and income return continuing to drive positive total returns.
- Our research has shown that investment at the trough of the market should be beneficial for those investors with capacity to act. However, investment into the right locations and assets will be key, as structural changes continue to affect occupier and investor demand in different sectors.
- We also expect transaction activity to gradually increase. Despite uncertainty around pricing, an improving outlook for interest rates, coupled with 18 months of relative inactivity, will lead some investors to deploy capital once more as they look to refresh and reposition their real estate portfolios.
- This should, in turn, facilitate sale of properties by investors that need to meet redemption or debt obligations. As noted in our Real Estate Market Outlook 2024, further disposals of real estate by UK defined benefit pension funds are likely as more schemes transition towards buyouts.
- Sentiment is improving in debt markets and both bank and non-bank lenders are looking to increase originations in the second half of the year. Industrial & logistics, data centres, and the living sectors are currently most favoured, but we expect liquidity across all sectors for financing high-quality, well-located assets with strong sponsors.
- Nonetheless, new lending will need to be balanced with the management of risks in existing loan books as the market recovers.

03

Sustainability

SUSTAINABILITY

So far this year



- The Financial Conduct Authority (FCA) introduced the anti-greenwashing rule for all registered financial firms in the UK. It mandates that any sustainability-related claim about financial products or services must be correct, clearly communicated, and capable of being supported by evidence. Asset managers should ensure marketing materials, reporting to clients and public disclosures are consistent with the anti-greenwashing rule. Breaking this rule could result in reputational damage and potential enforcement action from the FCA.

- Since February, all new developments in England over 25 m² must show they will achieve 10% biodiversity net gain to be granted planning permission. Despite some concerns the private market would not be able to meet demand for biodiversity units, CBRE is not aware of this preventing or delaying developments so far. However, the limited availability of biodiversity units for less common habitats, such as rivers and streams, has led some developers to adjust their plans. To date, we have noted a developer preference for achieving biodiversity gain on site rather than buying off site units from third parties.

- Developments and new renewable energy sources have been delayed due to limited grid capacity. Due to a backlog of connection and grid reinforcement requests, in some parts of the country new clean energy sources cannot come online or building heating electrification cannot be supported, delaying progress towards net zero. Illustrating the size of the backlog, the total connections queue is forecast to reach 800GW by the end of 2024, over four times the UK's anticipated electricity demand in 2050.

SUSTAINABILITY

What's still to come

- Labour's manifesto strongly hinted at increasing minimum energy efficiency standards by 2030 in the private rented sector. Due to the close deadline, it is reasonable to expect this regulation to be introduced in 2024. It has not been revealed which EPC grade would become the minimum requirement, but any increase will require investment from many landlords to prevent their properties becoming illegal to let. Starting to improve energy efficiency in 2024 will help landlords avoid supply bottlenecks as the deadline gets closer.
- Labour pledged to create Great British Energy with the aim of decarbonising the power grid. Great British Energy will be capitalised with £8.3bn to invest in renewable energy infrastructure. Even if spending is weighted towards the end of the Parliament, this could still mean hundreds of millions of public money invested into green energy infrastructure in 2024. This represents an opportunity for investors to co-invest in infrastructure projects and reduce risk by sharing it with the public sector.
- The UK Sustainable Disclosure Requirement (SDR) will become mandatory for FCA-regulated firms in December 2024. It aims to facilitate investment into sustainable products by introducing sustainability-related labels and disclosures. Despite similarities to the European Sustainable Finance Disclosure Regulation, the SDR represents a new disclosure mechanism which asset managers will have to prepare for if they are to attract capital targeting sustainable investments in the UK. Firms can start to apply sustainability labels to products voluntarily from July 2024, taking this approach could provide a first mover's advantage.

04

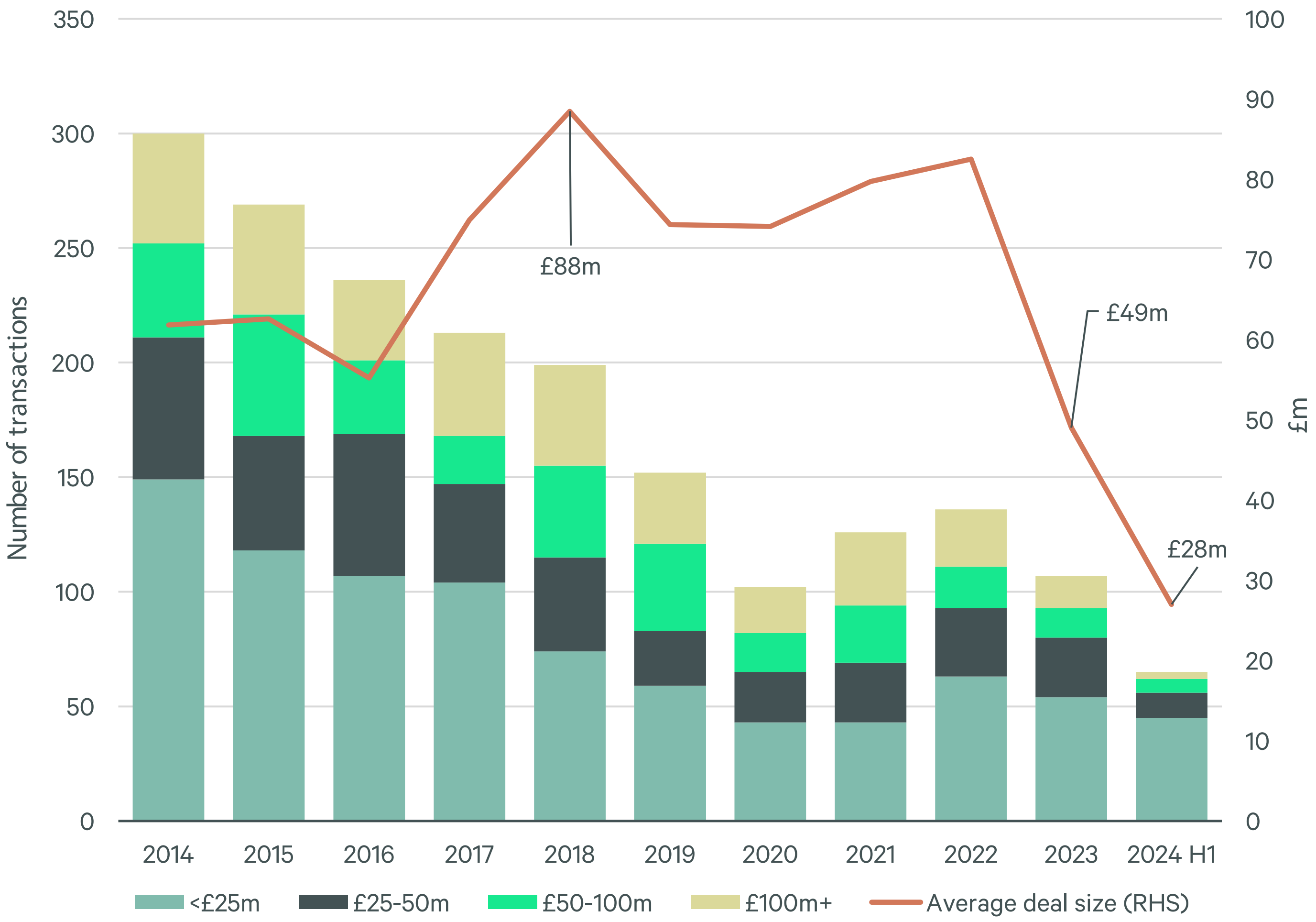
Office

OFFICE

So far this year

- Demand for the best quality office space within well located, high specification, and sustainable buildings remains strong. The majority of larger office lettings over the past year have been in new developments. During the same period, more than a third of the total Central London office take-up transacted at rents higher than the prevailing submarket prime level.
- The supply of secondhand space is above its historic average, and as occupier demands shift towards higher quality stock, some poor-quality units have been available for an extended period. These types of buildings are increasingly being purchased with the intention of change of use type. In Central London alone, this has amounted to more than £400m of offices either purchased or placed under offer during the year so far.
- Office investment transaction volumes have remained relatively weak at around a third of the 10-year trend. Muted volumes reflect uncertainties around asset pricing, debt costs, and the potential for further interest rate movements. The latest data shows that equity targeting London is around £19.18bn, 41% below trend levels.
- Driving lower investment turnover has been the relative illiquidity of larger lot sizes, leading to a fall in average deal size. Within the Central London market, the average deal size has fallen from £88m in 2018 to £28m now. Just two deals larger than £100m transacted across the UK during Q1 2024, compared to the five-year average of nine per quarter.
- Prime yields remain unchanged so far this year in 6 of the 11 UK office markets we track. However, in the other markets, yields continued to move outwards by between 25-50bps.

Figure 2: Central London office investment transactions by size band and average lot



Source: CBRE

OFFICE

What’s still to come

– There is 9.1m sq ft of office development currently under construction in the UK which could complete this year. If these come to fruition, this year's completions will exceed average levels. The Central London market accounts for nearly 60% of this upcoming development space. Despite the high level of completions expected, increased occupier demand for high-quality space will cause this space to be absorbed quickly. As a result, 40% of the UK under construction pipeline to 2028 is already pre-let or under offer. The proportion of pre-let space varies by market and is as high as 63% in the City of London and 42% in Leeds.

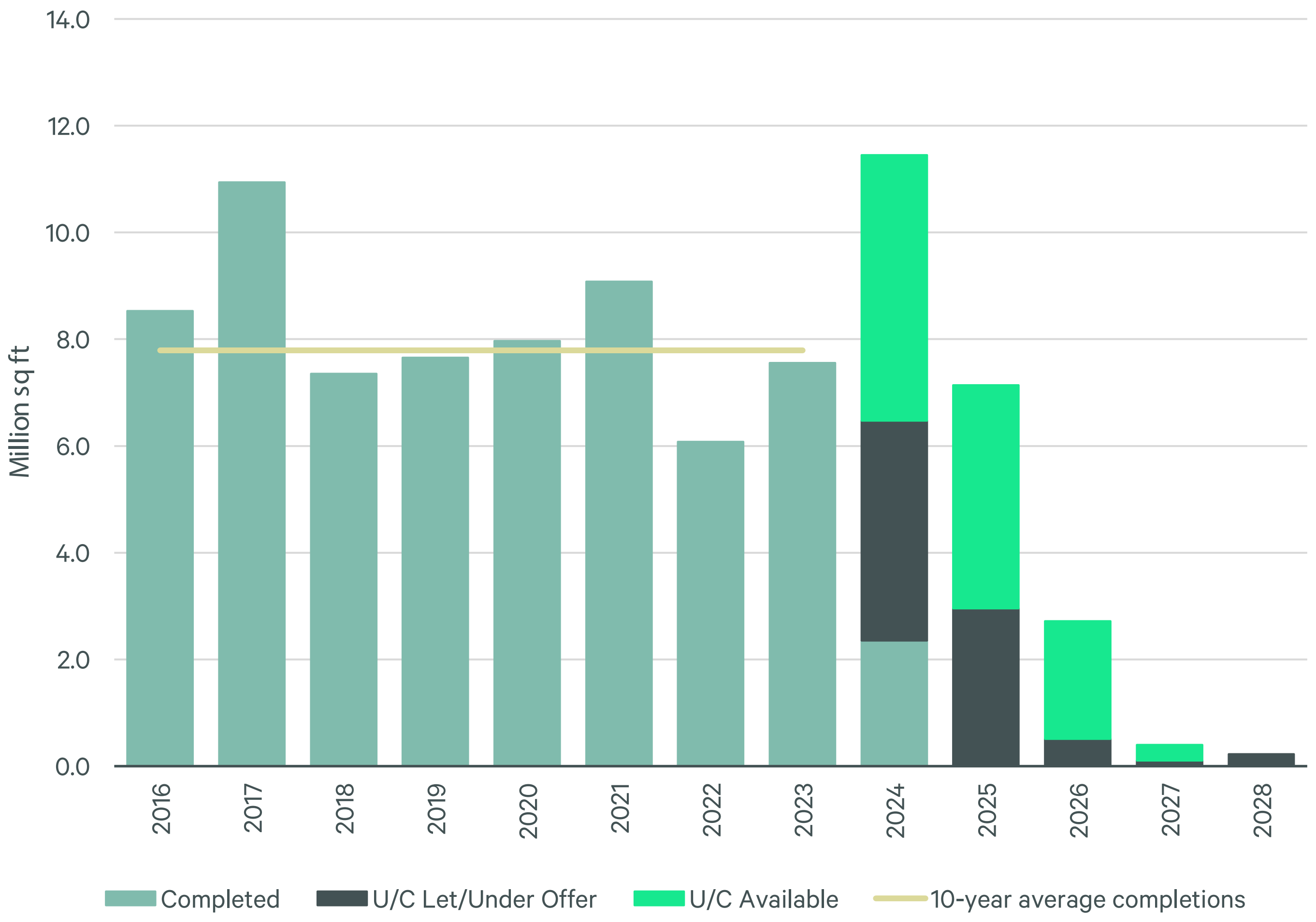
– We do not expect construction starts to maintain their recent pace due to high debt and construction costs, and an increasingly challenging planning environment. Therefore, we expect lower levels of development completions after 2025. In the longer term, we anticipate a higher propensity for refurbishments and material re-use in construction to sustainably regenerate obsolete stock. We also expect more buyers to transact with an intention to repurpose offices.

– Broader sentiment and investment activity will be boosted by a cut in interest rates and stabilising yields. Following repricing, the market could see an increase in core investment purchases as returns become more attractive.

– The key geographies with capital targeting London are Europe (34%) and East Asia (25%). All Asian capital accounted for 40% of the total equity targeting the market.

– In the markets we forecast, we expect prime yields to remain relatively flat for the remainder of this year.

Figure 3: UK office developments, under construction pipeline



Source: CBRE

05

Industrial & Logistics

INDUSTRIAL & LOGISTICS

So far this year

- Take-up started slowly this year but caught up in Q2. This said, there is still some caution in the market, with deals taking longer to complete. Demand continues to be led by third-party logistics operators, contributing a third of all take-up. Manufacturing occupiers also remain active, accounting for over a quarter of take-up in the first half of 2024.
- The latest CBRE vacancy rate now stands at 5.75%. In prior quarters the vacancy rise was largely driven by new speculative completions, but in Q2 the increase was led by a return of secondhand units to market. The development pipeline continues to moderate. Around 19m sq ft of new space is currently under construction, 45% below the same time last year.
- Prime rents have grown in most regions in the first half of the year, excluding Inner South East, South West and Scotland. However, the rate of growth has slowed. In the 12 months to Q2 2024, the UK's prime rent* grew by 7.8%, below the prior year (16.3%).
- In Q1 2024 investment volumes increased year-on-year, however this was from a low base. Volumes remain below the preceding 10-year average, and investors continue to be selective in their target acquisitions. With limited movement seen in the debt market, the prime big box logistic yield has remained stable at 5.25%.

*Weighted by capital value

Figure 5: UK I&L Vacancy Rate

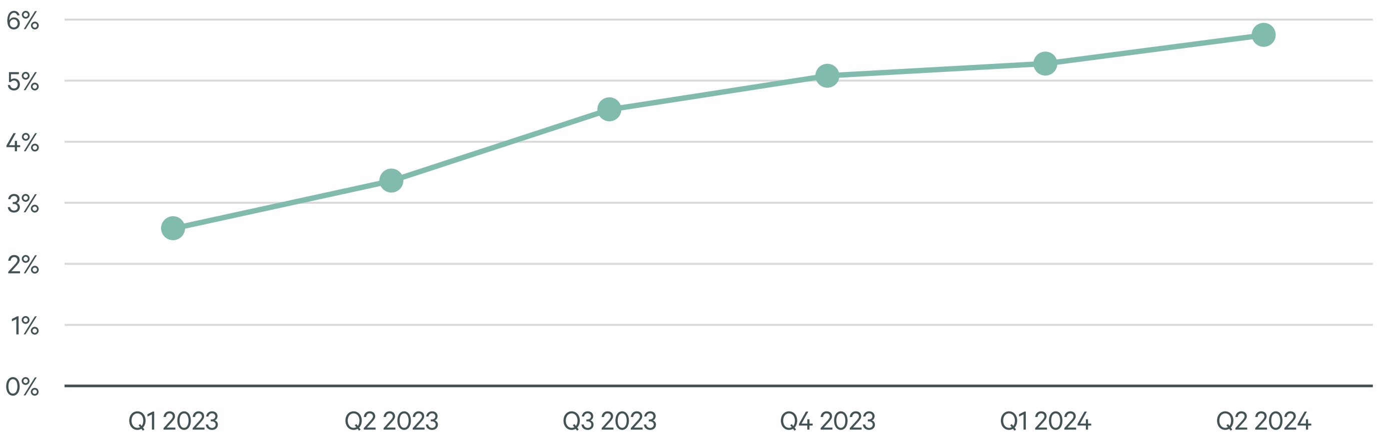
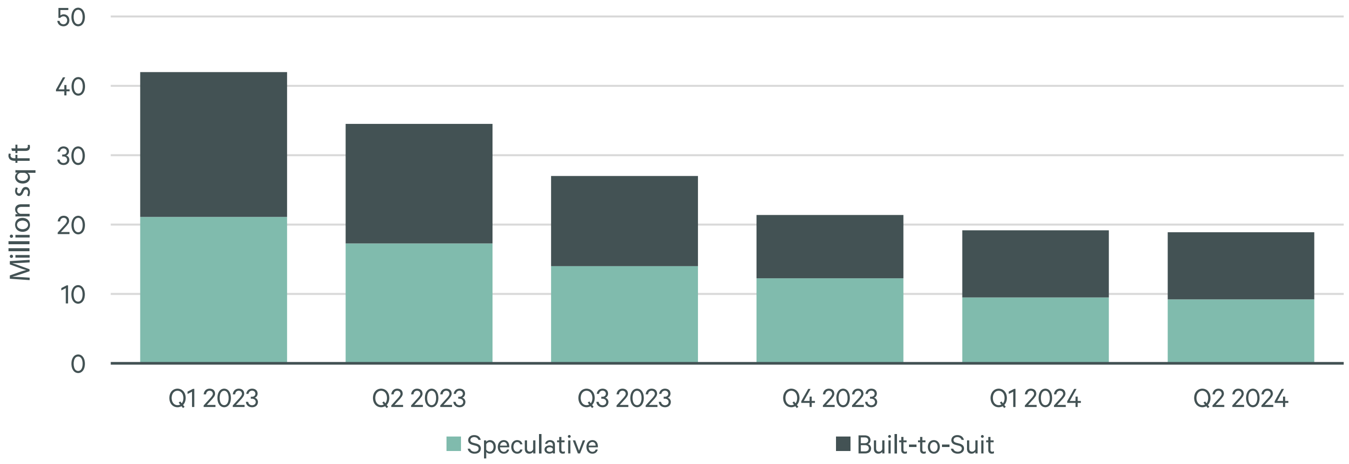


Figure 6: UK I&L Under Construction Pipeline



Source: CBRE

INDUSTRIAL & LOGISTICS

What's still to come

- Occupier demand is expected to remain stable throughout the rest of 2024, with third-party logistics operators and manufacturers continuing to have the greatest requirements. Outside of these sectors, some additional demand will be generated by retailers looking to expand or modernise their warehouse networks. In the medium-term, the outlook for demand is more positive, according to CBRE's 2024 European Logistics Occupier Survey, 58% of occupiers plan to expand in the next three years.
- We anticipate vacancy rates will continue to rise across all UK regions. However, by the end of the year the average UK vacancy rate is likely to remain below the 10-year pre-pandemic average. The continued slowdown of the development pipeline will further help the sector's supply and demand dynamics.
- Prime rents are expected to continue to grow in the second half of the year. Assets which offer strong sustainability credentials, and a good provision of power supply, are likely to outperform others, as these factors become increasingly important to the occupier.
- Full year investment volumes are expected to be on par or marginally ahead of last year. Although more stock is being brought to market, this is from a very low base. And with availability remaining constrained, investors will increasingly consider assets with a broader range of lease structures. While in recent months assets offering reversionary potential were the target of many investors, with more muted occupier performance, stable income assets such as long-term leases or index-linked leases are becoming more attractive. Despite an increase in activity, until debt costs reduce more meaningfully, pricing is expected to remain largely unchanged.

06

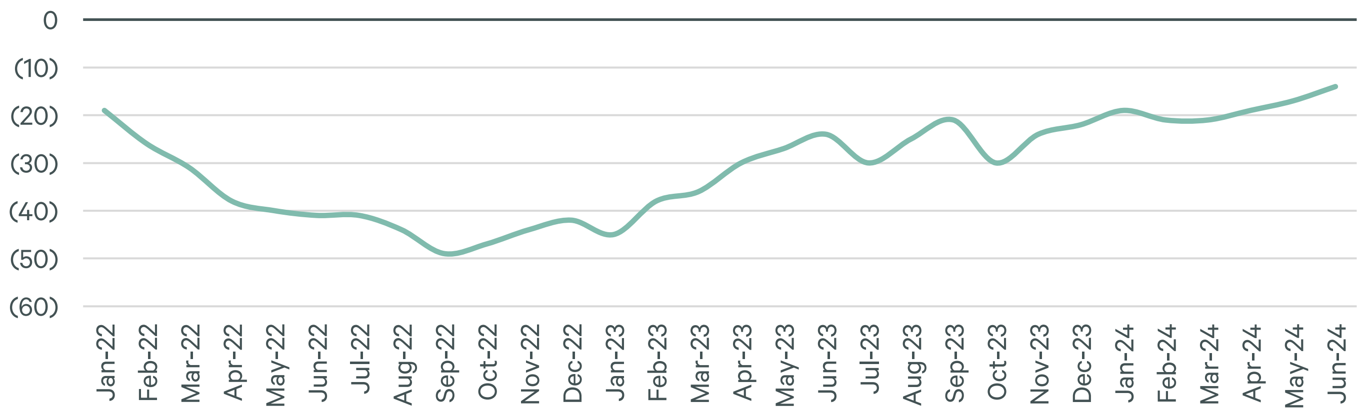
Retail

RETAIL

So far this year

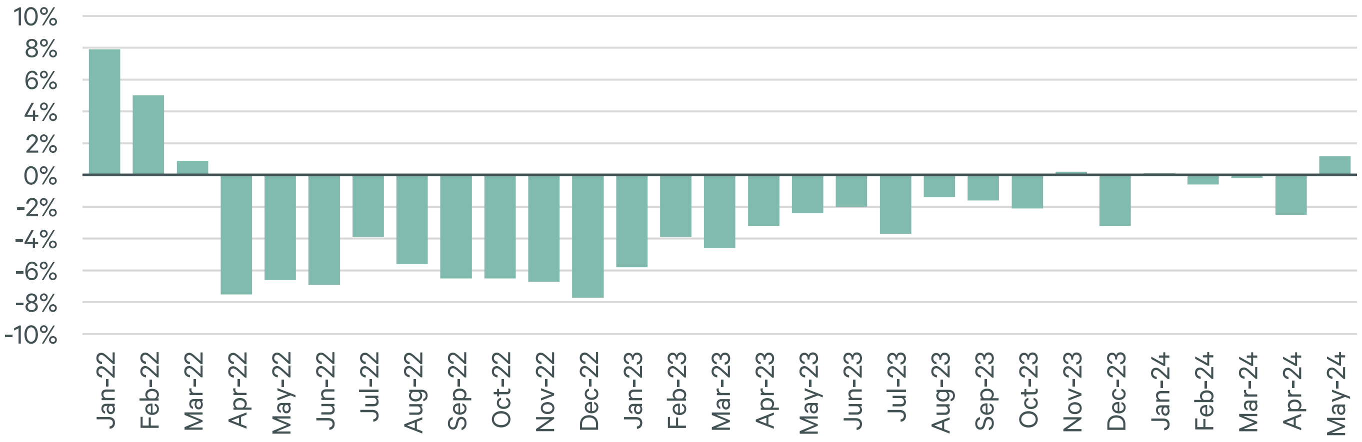
- Consumer confidence has continued to improve in the first half of the year. The latest data was 10 points higher than the same time last year. Encouragingly, consumers are feeling more optimistic about their own personal finances in the next 12 months.
- Sales volumes have begun to show signs of improvement in the latest month's data, up 1.2% year-on-year. However, they remain below pre-pandemic levels. This suggests that although consumers feel better about their personal finances, their spending remains cautious.
- The proportion of sales transacted online has remained in line with 2023. Occupiers continue to focus on delivering a seamless omnichannel experience. For example, Primark recently announced plans to expand its Click & Collect service to all UK stores by the end of 2025.
- The number of store openings and closures stayed in balance so far this year, and the all-retail vacancy rate held at 11.7%. Retail Parks remain the most popular among occupiers and the sub-sector's vacancy rate continues to compress, with prime parks sub 2%. This said, the Shopping Centre vacancy rate also saw some improvement in Q1 2024, reaching its lowest level since 2020. Some of Central London's key streets now have low levels of availability, which has created competitive tension and driven rental growth.
- With improving levels of investor interest, the prime Retail Park yield has sharpened by 25 bps. Meanwhile High Street and Shopping Centre yields have remained stable. The first half of the year has delivered some significant transactions such as Norges' purchase of Meadowhall's remaining stake, which gained good interest from multiple bids. However, transactional activity has been largely limited to off-market deals, and this shortage of supply has led to relatively subdued volumes overall.

Figure 7: UK Consumer Confidence Index



Source: GfK

Figure 8: UK all retailing sales volumes (excl fuel), year-on-year % change



Source: ONS

RETAIL

What's still to come

- In the second half of the year the economic backdrop will continue to improve. The current path of inflation, coupled with the first base rate cut from the Bank of England, will help support the continued recovery of consumer confidence.
- Retail sales volumes are expected to remain ahead of last year in H2 2024. This said, consumers remain cautious around big-ticket item spending, so we expect the sales uptick will be moderate. The balance of sales between in-store and online will remain broadly consistent with H1 2024.
- Outside of the limited number of high-profile examples such as Ted Baker or The Body Shop, there is currently little evidence of distress in the occupier market. Though we will continue to see cases of portfolio repositions, the vacancy rate will remain broadly stable in H2 2024.
- Occupiers that are on the expansion trail will continue to focus on high footfall locations that help to build brand profile and deliver strong consumer experience, or easily accessible locations that help to fulfil online orders. As such, the vacancy rates and rental growth of major cities such as London, prime shopping centres and retail parks will continue to outperform – with some now at pre-pandemic levels.
- Investor sentiment was relatively positive in H1 2024, and we expect this to continue in the second half of the year. The forecast base rate cuts could lead to improved pricing for some retail sub-sectors – namely Retail Parks, and this should result in a greater number of sales coming to market in H2 2024. Though investor confidence on Shopping Centre performance has improved, and institutional investors are starting to return to the market for prime assets, availability of stock will remain a limiting factor of investment into the sub-sector.

07

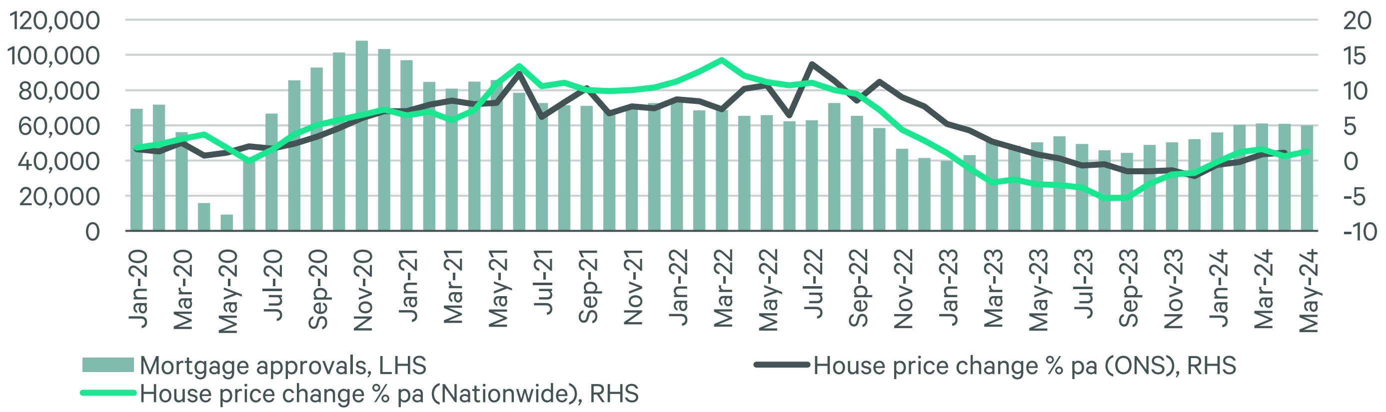
Residential

RESIDENTIAL

So far this year

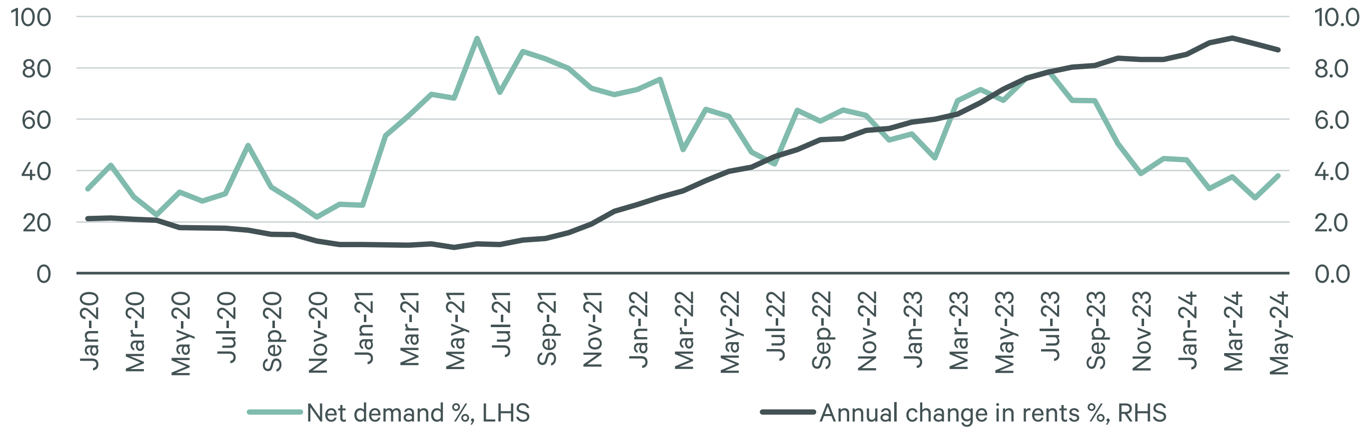
- The sales market improved at that start of 2024, with mortgage approvals up 30% so far this year, compared with the same period of 2023.
- House prices also rebounded. At the time of writing, the Nationwide House Price Index showed annual house price growth of 1.5%. The ONS also reported positive annual house price movement, of 1.1%.
- In contrast to the sales market, the rental market has been more muted compared with 2023, with the pace of rental growth slowing. The rate of annual rental inflation across the UK (as recorded by the ONS) had increased for 33 consecutive months, but fell for the first time in April, to 8.9%. At the time of writing, it had slowed further to 8.7%.
- Similarly, HomeLet, (which track rental changes on new tenancies), reported annual growth of 7.7%, at the time of writing. This was the lowest growth rate since August 2021 and down from a peak of 11.1% in November 2022.
- This deceleration reflects lower inflation combined with affordability constraints, with tenants unable to afford higher rents in the current market. This has led to falling demand and a lower rate of growth.
- CBRE's latest Multifamily Index continued to track strong performance in the Build-to-Rent sector. However, residential investment has been muted so far in 2024, with volumes down 15% in Q1 compared with the same period of 2023. But positively, values have broadly stabilised, meaning yields have remained flat. Albeit the recent abolition of Multiple Dwellings Relief (MDR) could negatively impact values in certain instances.

Figure 9: Mortgage approvals and house price growth, UK



Source: Bank of England, ONS, Nationwide

Figure 10: Net demand and change in rents, England and Wales



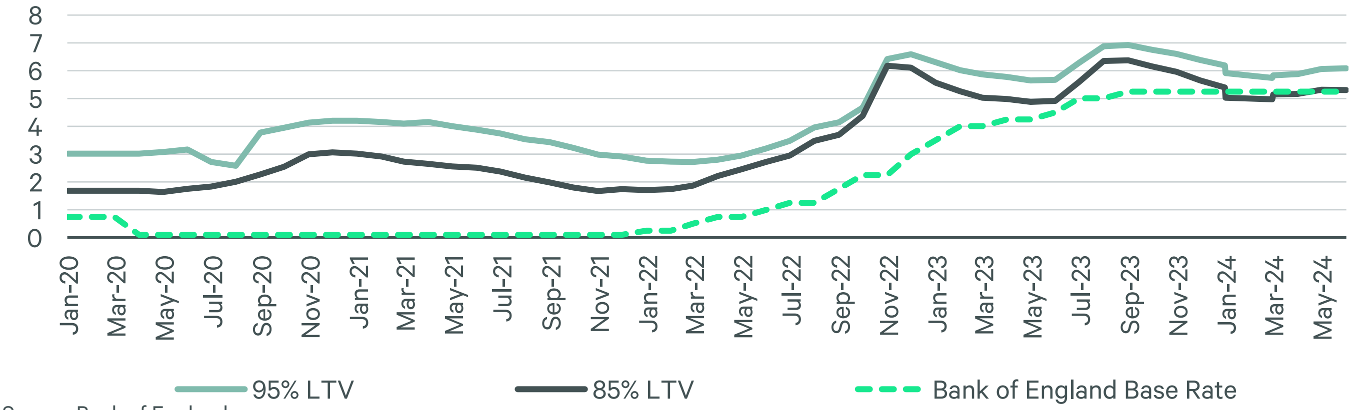
Source: RICS, ONS

RESIDENTIAL

What's still to come

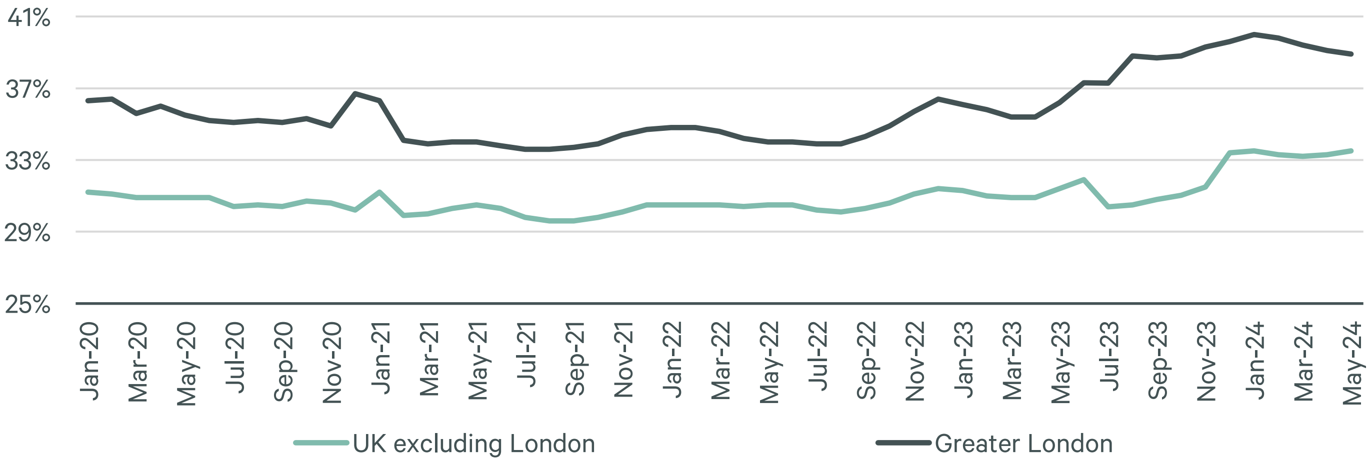
- Renewed uncertainty around the future path of interest rates has dampened sentiment most recently. However, we expect this to be a temporary lull and our outlook for the sales market remains broadly positive.
- Mortgage rates will be the main determinant of activity for the remainder of the year. These have risen recently but are still well below their peak of last summer. We continue to forecast an initial base rate cut in Q3 2024, which could be a fillip for homebuyers and the residential investment market.
- We forecast UK house prices to increase by 1% in 2024 and for sales volumes to recover by 10%. Both measures have been upgraded from our previous forecast made at the end of last year.
- We do not expect Labour's planned 1% additional stamp duty surcharge on non-UK resident buyers to have a material impact on overseas buyer demand. However, the continuation of the Mortgage Guarantee Scheme is positive news for first-time buyers.
- Tenant affordability will dictate the pace of rental growth for the remainder of the year, but this will take time to feed through. As a result, we expect the rate of rental growth to continue to slow but remain strong in 2024, at 6.4%.
- Investment into Build-to-Rent will continue to face challenges common to other residential sectors, including higher financing costs and the recent abolition of MDR. However, a robust under offer pipeline means we are cautiously optimistic that investment will pick-up throughout the remainder of 2024, particularly if interest rates fall as expected.

Figure 11: Two-year fixed mortgage rate and Bank of England base rate (%)



Source: Bank of England

Figure 12: Proportion of income spent on rent



Source: HomeLet

Affordable Housing

AFFORDABLE HOUSING

So far this year

- There has been an increase in the number of transactions across the affordable housing sector at the start of 2024, both for stock transfers and s.106 opportunities.
- The stock rationalisation market has also been particularly buoyant this year, with a significant increase in the size of the portfolios and total number of units traded. In addition, more for-profit Registered Providers (RPs) are now becoming active in this segment of the market which has traditionally been the reserve of the not-for-profit providers.
- There has also been more development transactions so far in 2024. Most recently, Edmund de Rothschild Real Estate Investment Management bought a £34m residential development opportunity in Newbury. It is understood that this will form part of its affordable housing fund.

- Other notable transactions have included M&G acquiring three stabilised portfolios totalling 370 properties from Hyde, CHP. In addition, Park Properties (HSPG), MTD (William Pears) acquired 458 homes from A2Dominion, and New Arch (Octopus Real Estate) purchased 180 homes from Golding Homes.
- There has also been renewed interest in establishing new RPs and the trading of RP entities. For example, Rosewood (a for-profit RP owned by Inland Homes) was recently traded to Thriving Investments, a fund manager operated by Places for People. Additionally, Quartz Housing Limited (a subsidiary of Civitas Investment Management) recently achieved RP status with the Regulator of Social Housing.
- Yields for some affordable tenure types, particularly rented, continued to soften at the start of the year. However, the rate which they moved out was slower compared with 2023.

AFFORDABLE HOUSING

What's still to come

- Activity in the sector is rebounding. With renewed interest from investors, and confidence from a broad stabilisation of values, it's likely that investment will pick-up in the second half of 2024.
- The stock rationalisation market will remain particularly active. Many RPs are reviewing their business strategies with disposals of existing stock being increasingly considered as an option, with both for-profit and not-for-profit providers active in this segment.
- However, investment, particularly for development opportunities, will likely be predominantly driven by for-profit RPs, which are still a minority participant in the overall affordable housing sector. Many of the traditional providers will still need to concentrate on upgrading their existing portfolios. As a result, the G15 group of London housing associations confirmed that its members are reducing their development programmes by up to a third. This will be replicated across the country, translating into a reduction in the development pipeline and delivery of new affordable homes.
- The 2023/24 rental cap will continue to impact the finances of many housing associations. It is forecasted that this will result in an overall loss of £3.2bn in rental income, which is further dampening investment appetite.
- In contrast, the lifting of the Local Housing Allowance Freeze in April 2024 will have a positive impact on the sector.
- Still, while challenges remain, the strong start to the year is encouraging and current momentum means we maintain a positive outlook for the remainder of 2024.

Purpose-Built Student Accommodation

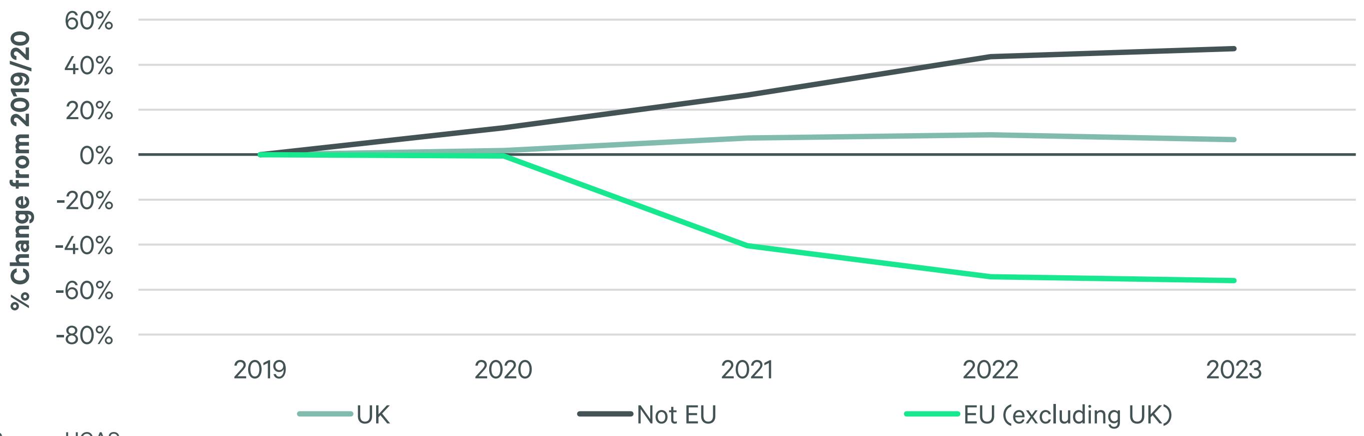
(PBSA)

PURPOSE-BUILT STUDENT ACCOMMODATION

So far this year

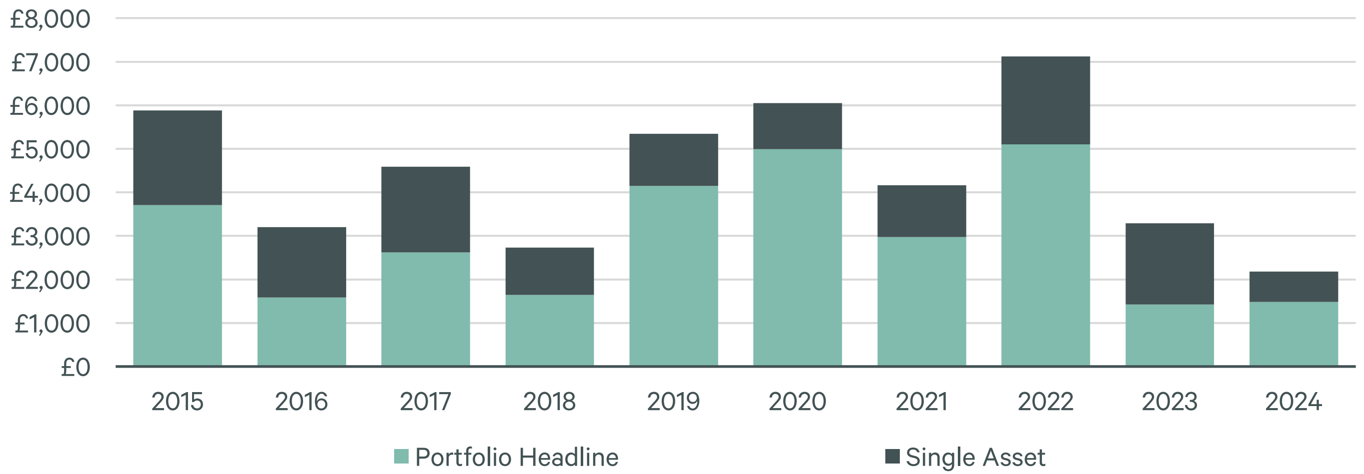
- Demand for higher education remains robust, with 2024/25 applications (as at the January application deadline) to the University and Colleges Application Service (UCAS) broadly level with 2023/24. UK domestic applicants were stable, and demand from non-EU international students was strong. In contrast, applications from EU international students fell 3% year-on-year.
- In its May report, the Migration Advisory Committee concluded that there was no evidence of abuse of Study and Graduate Immigration Visas by international students from India, Nigeria, China, and Pakistan. As a result, the Government backtracked on its plan to restrict graduate visas. It's now unlikely that any additional regulation will be introduced for international students until at least the next academic year.
- Relative to the start of 2023, investment into PBSA has been strong so far in 2024. The sector has attracted £2.1bn of investment year-to-date, almost three times higher than the same period of 2023.
- Investment volumes in H1 2024 were boosted by Mapletree's £1bn acquisition of an 8,200-bed portfolio located in the UK and Germany. In addition, Unite sold a 3,000-bed portfolio to PGIM for £184m. So far this year, there have been six transactions that have exceeded £100m, compared with just one in the same period of 2023.
- A higher degree of due diligence has continued to delay some transactions this year, particularly in relation to building safety. Nevertheless, current investment continues to highlight strong demand for student accommodation.
- Like the previous cycle, expectations for strong rent growth and total returns have counteracted any potential yield movement. As a result, yields have remained stable across the sector so far in 2024.

Figure 13: 2024/25 UCAS undergraduate applications by domicile



Source: UCAS

Figure 14: PBSA investment volumes (millions), UK



Source: CBRE

PURPOSE-BUILT STUDENT ACCOMMODATION

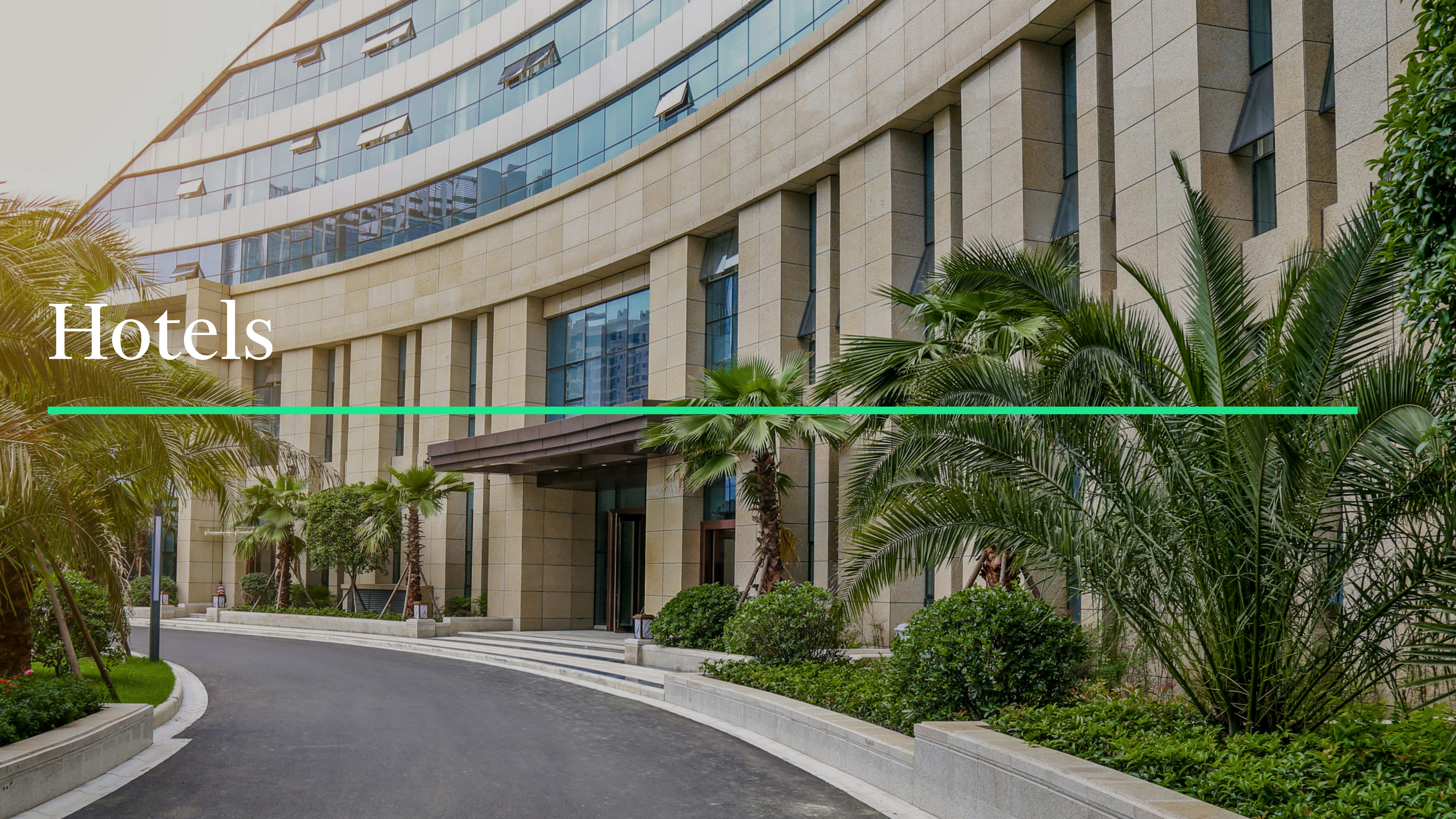
What's still to come

- Supply will remain constrained, and low, compared with previous years. This will continue to be compounded by the falling number of Homes for Multiple Occupation, as private landlords leave the sector.
- Viability will remain challenging and impacted by building safety requirements, sustainability measures, and higher debt costs.
- Rental growth for the 2024/25 lettings cycle looks strong. At the headline level, advertised rents for PBSA are 14% higher than the previous cycle. On balance, we expect actual rent growth of 5-10% for this cycle.
- However, while this growth is positive for investors and developers, it contrasts with the below inflation increase to the maintenance loan (of just 2.4%). This means that many domestic students could be priced out of some of the PBSA market, which could impact overall demand and let-up across this lettings cycle.
- The abolition of Multiple Dwellings Relief (MDR) came into effect on 1 June. As a result, some properties could be exposed to a 4% rise in stamp duty, which could impact pricing of some transactions throughout the remainder of 2024.
- Overall, deal activity is expected to increase in the second half of 2024. However, the MDR abolition and higher debt costs will continue to impact activity, and cash buyers will maintain their advantage in the current market. Demand will remain strongest for assets with limited safety issues and strong sustainability credentials.

08

Operational Real Estate

Hotels

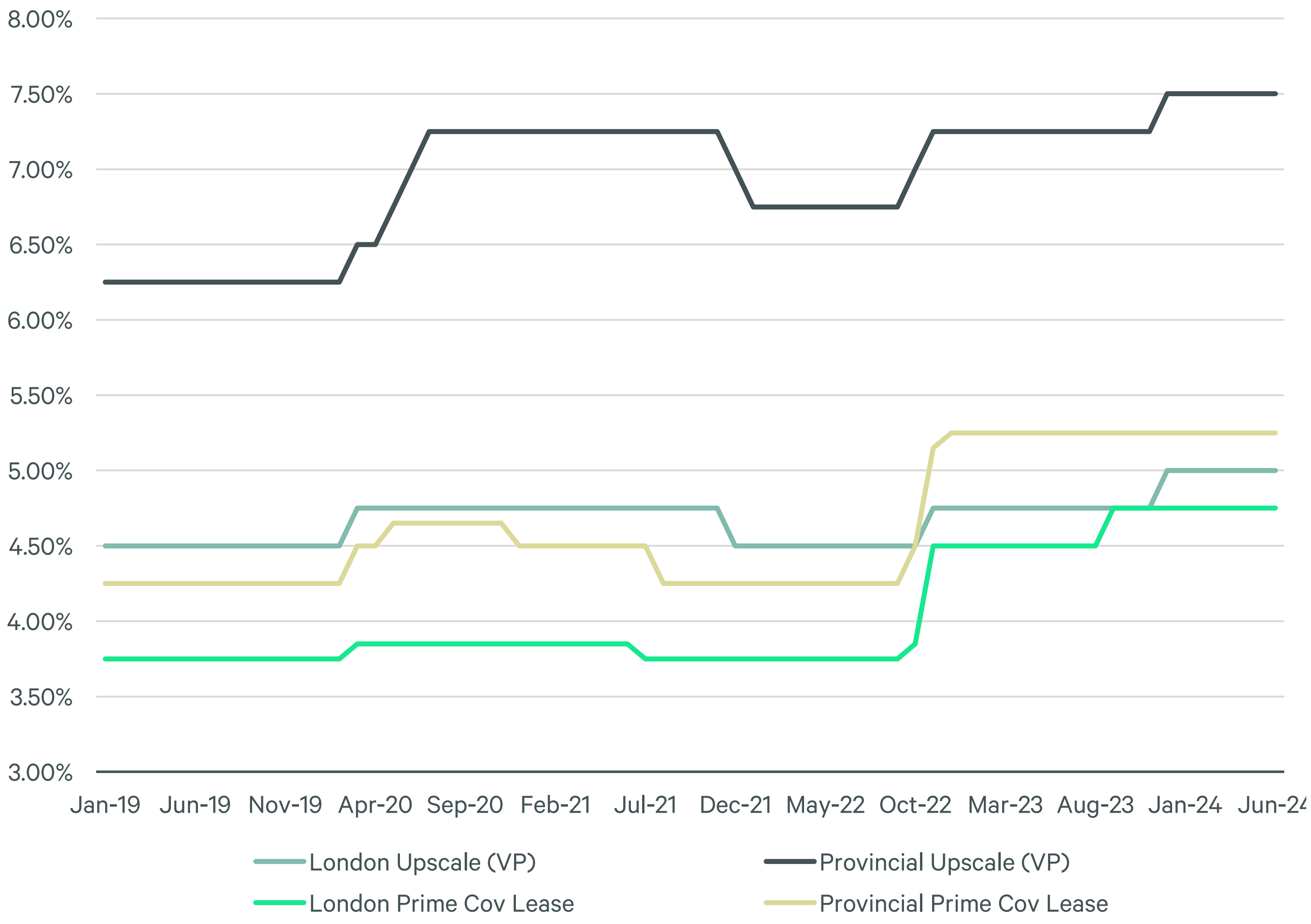


HOTELS

So far this year

- 2023 saw a subdued investment market in which a number of transactions failed to conclude. While the anticipated interest rate cuts in H1 2024 did not materialise, the debt markets stabilised, providing investors increased confidence that correctly priced assets would trade successfully. This can be evidenced in a number of CBRE sales processes where the bid-ask spread contracted, with investors re-entering the market for the first time since 2019.
- Hotels across the UK have benefitted from significant growth in Average Daily Rate (ADR) –+27% vs 2019 – and strong occupancies, resulting in substantial Revenue per Available Room (RevPAR) performance. Looking ahead to the second half of 2024, it is expected that ADR growth will be moderate versus when compared to prior year. This is reflective of the UK's inflationary environment impacting domestic leisure spend, in addition to a prolonged return of the international tourism markets.
- High levels of inflation continue to challenge departmental profitability most notably in payroll, further impacted by a lack of skilled workforce. With the backdrop of moderate revenue growth and cost increases, GOP conversion remains stable with operators now focusing on occupancy to grow profitability. An upcoming challenge is the anticipated business rates revaluation in April 2026.

Figure 15: CBRE house yields



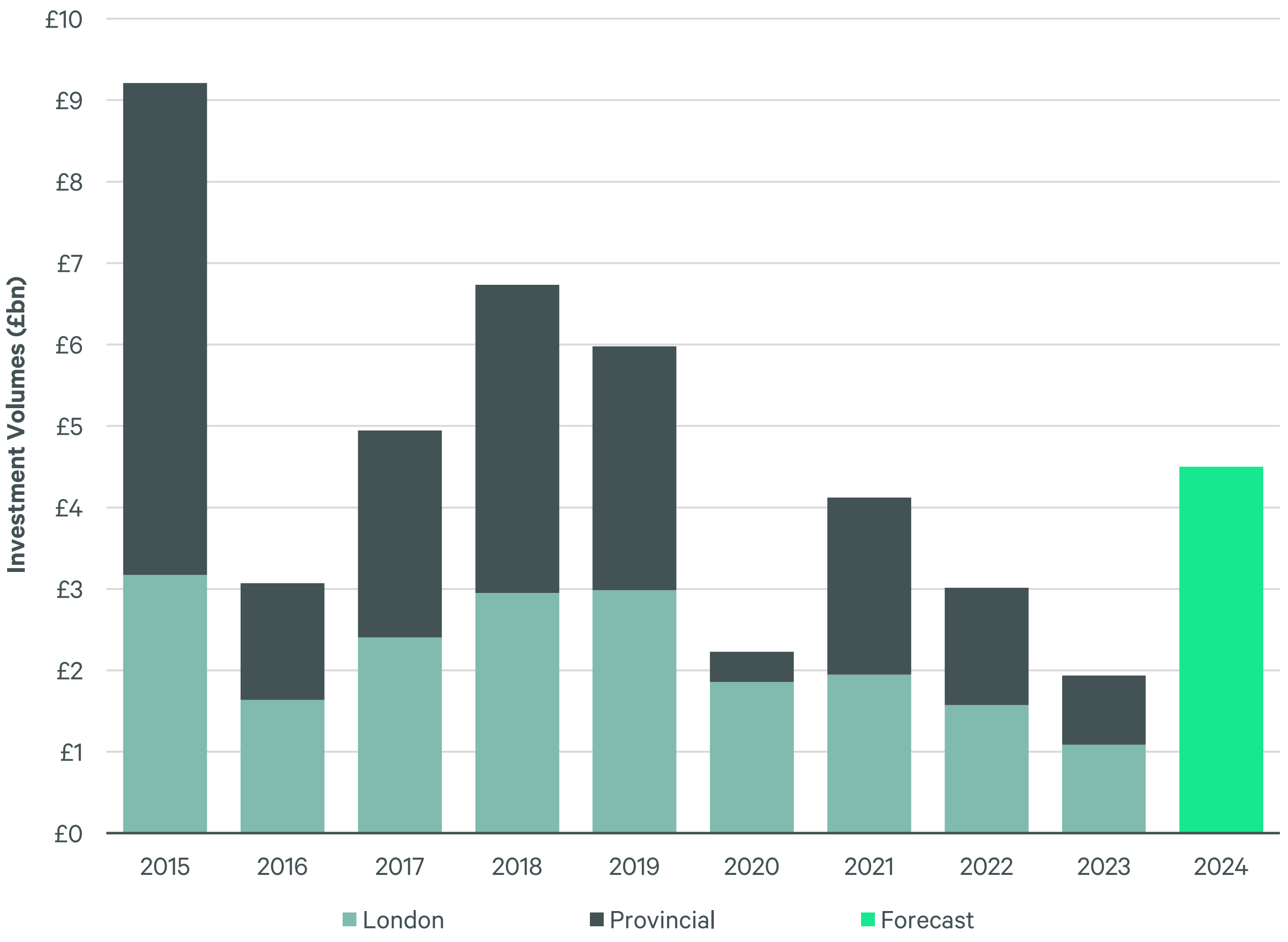
Source: CBRE

HOTELS

What's still to come

- There has been strong demand for domestic leisure destinations, which has particularly benefitted regional UK areas including coastal towns. But pressures on household disposable income could lead to a slight cooling in domestic leisure demand.
- The pickup in international overnight visits across the UK has benefited the hotel sector significantly. We expect this trend to continue, with levels expected to exceed 2019 volumes. Growth in tourism numbers to London will further cement its reputation as a global destination for business, entertainment, and events.
- Following strengthened investor sentiment, 2024 volumes have already exceeded that of full year 2023, with c.£2.4bn of transactions recorded vs c.£2bn last year. We forecast year-end 2024 volumes to exceed £4.5bn, reflective of some of the large hotel portfolios that have sold and are live in the market including ADIA's Marriott Portfolio (£900m), together with some significant single asset transactions.
- As operators realise the impact technology can play in hotel operations, it is likely to play a central role in the customer travel experience. With artificial intelligence (AI) consistently improving and becoming more prevalent, it has the possibility to improve the personalisation of customers' experience. For instance, online bookings would recognise the guest's preferences for their stay and propose suitable room suggestions. Guest check-in could become more personal too, with staff already having knowledge of guest hospitality preferences.

Figure 16: Hotel investment volumes (£bn), UK



Source: CBRE

Leisure & Pubs

LEISURE & PUBS

So far this year

- There was a robust surge for pubs over the Christmas period, with the first year-on-year volume as well as price increase, since early 2023. However, the first quarter of the year saw a reduction in customer occasions due to pricing increases.
- Costs pressures persist and many cinema operators are struggling with occupancy levels which remain low. The actors and writers strike has meant many film releases previously salted for 2024 have been postponed until 2025.

LEISURE & PUBS

What's still to come

- As ever, the advent of better weather benefits pubs with outside space. Even those with TVs but no garden, should benefit proportionally as England (and to a lesser degree Scotland's) progress in the Euro 2024 competition.
- We have started to see increased corporate and investment activity in pubs as sellers have recognised that margins and profitability have been eroded and have repriced accordingly.
- The cinema market continues to be challenging for most operators. Even with corporate restructuring, high debt levels and lower attendance mean that rentals are often only at sustainable levels. Moreover, cinema audience numbers will improve but only if studios make product available.
- It is anticipated the market will still be weak as we progress through 2024, but with the improving film slate and more parties entering the sector, an element of price compression may occur by 2025. Improved liquidity and falling base rates later in 2024 will likely lead to an uptick in activity.

Healthcare

HEALTHCARE

So far this year

- Healthcare investment activity has started to return in 2024, with volumes so far double the same period in 2023. The return has been driven by a reduction in the bid-ask spread for healthcare investment opportunities.
- Moreover, when marketing healthcare opportunities in 2024, CBRE have received a higher number of bids from a wider range of investors than in 2023. This increased investor appetite for healthcare reflects the sector's attractive lease features, strong underlying operational performance and the ability to make a positive social impact.

HEALTHCARE

What's still to come

- The flight to quality for healthcare assets will continue and we are already seeing materially increased demand for value-add assets with a number of large-scale elderly care opportunities currently in the market.
- While elderly care remains an active segment of the market, there has been a surge in private hospital investment activity, and we expect this to continue following the refinancing of Medical Properties Trust and multiple investment opportunities in this sector of the market.


Senior Living

SENIOR LIVING

So far this year

- The sale of new homes in 2024 have been steady, but subdued, reflecting the challenges in the wider residential market. Many prospective buyers of homes in senior living schemes are struggling to quickly sell their current property. Typically, buyers are selling a property worth £1–2m, a price range currently experiencing a bottleneck in the residential market. As a result, operators are increasingly seeing long reservation periods.
- Still, there are differences across the sector. Operators are noting that re-sales in more mature and established villages are outperforming new build sales. This resilience emphasises the importance of building a community within the overall complex.

- High construction costs and land constraints have led to muted levels of completions over the past year, with limited new units coming to the market through 2024.
- Given the difficulties surrounding viability, operators have been looking to capitalise on larger regeneration schemes, such as Audley's commitment to the wider Brent Cross masterplan.

SENIOR LIVING

What's still to come

- A general improvement in the economic backdrop, especially expected reductions in interest rates, is likely to boost activity in the wider residential market. This should feed through to the senior living market, thereby reducing reservation timings, and increase sales in new villages.
- Affordability will be a key driver for the sector if more schemes are developed for a mid-market offering, while a lack of consented and deliverable schemes may also impact immediate investment.
- The Leasehold and Freehold Reform Bill provided some certainty around the structure of Deferred Management Fees. This should assure investors about the security of income going forward.
- More operators are offering a rental option as a key investment decision, rather than as an after-thought in driving occupancy. Given the success of existing rental products and continued rental growth, we expect this trend to continue with a greater focus on dedicated and purpose-built rental provision and platforms.
- The Older People's Housing Taskforce have submitted their final paper with recommendations and highlight the senior living market as having a key role in unlocking the wider housing crisis. Should Labour take the recommendations forward, it could further stimulate growth into the sector.

Roadside & Automotive

ROADSIDE & AUTOMOTIVE

So far this year

- In the operational Petrol Filling Station (PFS) market, demand from purchasers has remained strong. This has been driven by high fuel margins and a drive to secure 'future proofed' sites suitable for electric vehicle charging, combined with a more traditional petroleum & convenience offer.
- In the investment market, PFS transaction volumes have remained relatively weak with a lower-than-average number of transactions in the sector. Average net initial yields have moved out 149bps since 2022, while average fuel margins for operators have increased. Vacant Possession values have held despite the challenging investment climate.

- In April 2024, Group 1 Automotive Inc, announced that it had entered into a definitive agreement to acquire Inchcape plc. This is the latest takeover in the UK car dealership market following other high-profile takeovers including: Lithia's acquisition of Jardine Motors; Sytner's acquisition of Rybrook; Lookers selling to Global Auto Holdings and Constellation Automotive's acquisition of Marshall.
- Vacant possession transactions in the car showroom sector have primarily been driven by Cazoo entering administration in May 2024. Cazoo sold five leasehold sites to companies that form part of the Constellation Automotive Group.
- In the car showroom market, prime yields have moved out by 50bps since 2022. The outlook is improving, although transactions have not recovered to pre-2022 levels.
- In H1 2024, the number of electric cars now on UK roads reached one million for the first time.

ROADSIDE & AUTOMOTIVE

What's still to come

- The remainder of 2024 could see more platform sales as owners assess their portfolio strategies amid the growing adoption of electric vehicles. Operator mergers are also likely to continue as operational value in the sector remains strong.
- Transaction demand will remain for high quality core assets. The adoption of a dual-fuel strategy will continue to drive demand for larger plot sizes in the PFS sector.
- There have been very few car park investment transactions in the last 12 months. We anticipate activity in this sector will increase in H2 2024.
- Despite the economic and political headwinds, operators in the PFS market continue to perform well and we expect investor appetite to return for well-located assets that are 'EV ready' and backed by strong tenant covenants.
- CBRE research indicates that average annual returns are 377bps higher than the long-term average if you invest at the trough of the market across all property types. H2 2024 is likely to present investors with opportunities to acquire long-term strategic assets.

Self Storage

SELF STORAGE

So far this year

- The self storage sector remains a strong preference for major investors, with operators remaining committed to scaling their existing businesses via organic growth or inorganic acquisitions. 2024 investment volumes have already surpassed previous levels. Notable deals include the shareholder approved cash purchase of AIM listed Lok'nStore for £378M. Debt remains a key underwriting consideration.
- Occupancy has dropped over the last 12 months and demand has now normalised following exceptional performance during the post-pandemic period. However, the slight decline in occupancy has been more than offset by the growth in rental rates, leading to an increase in both revenues and bottom-line.
- Operators have seen strong demand in the lead up to the summer, and there is a belief that we have reached an inflection point in the market.

SELF STORAGE

What's still to come

- If mortgage rates remain high in H2 2024, it will impact those households that need to renew their mortgage. This will continue to be a driver of demand for self storage as people undertake conversions, de-clutter, and need help with issues caused by their inability to move to a suitable living environment.
- Yields have compressed as the reputation and understanding of the sector has grown for both customers and investors. Heading into H2 2024, the self storage sector is expected to continue to receive interest from investors seeking to benefit from a robust trading environment.
- Operators remain optimistic despite the recent softening residential market and the cost of living crisis.

09

Data Centres

DATA CENTRES

So far this year

- Available data centre capacity in London has plummeted this year as providers struggle to keep pace with strong demand. The most recent data show the London vacancy rate fell to an all-time low of 11%. London represents about 80% of UK market supply.
- Higher rents haven't deterred some of the world's largest technology companies from buying data centre space as quickly as it has become available in London. As a result, take-up rose to 42MW in the first quarter, compared to 17MW in the same time period last year.
- Most of the space has been taken up by hyperscalers wanting to expand their presence in London. This is partly a defence play – they need to ensure they satisfy their data centre needs, and to stop competitors accessing the limited space. Meanwhile, more businesses need to house the necessary equipment in colocation data centres that will help them deliver productivity gains or generate new revenue from digital services.
- However, providers are struggling to find the necessary resources required to build new data centres. Developers are often inhibited by a lack of appropriate land in London with the requisite power, which is a critical element of any data centre operation. This issue is especially pronounced in the western corridor of the city. Land acquisition costs have risen as well, which makes the total cost of data centre ownership higher and project profitability potentially harder to achieve.

DATA CENTRES

What's still to come

- Due to the shortage of appropriate land and power for data centre purposes in London, developers are looking further afield for the land and power required to build and run data centres. It's more likely to find these resources in areas outside of London.
- Virtus, a London-based data centre provider, purchased land in Saunderton, north west of London, that it will use to develop specialised data centres on. Virtus aims to deliver 75MW of data centre supply for organisations looking to deliver artificial intelligence (AI) services from colocation data centres.
- It is expected that companies looking to house equipment that powers AI services will drive unforeseen demand for data centre capacity in the UK. We expect deal size to grow in accordance with AI-specific requirements.
- London take-up in 2024 will rival the all-time high recorded in 2022, due largely to demand from hyperscalers, but also newer companies that require AI infrastructure.
- Due to the challenges faced by providers in meeting the demand for data centre capacity, take-up is expected to exceed supply for the third consecutive year in London. If our forecasts are accurate, London will experience its third consecutive supply-demand imbalance, with a delivery of 96MW of new supply and 130MW of take-up.

10

Life Sciences

LIFE SCIENCES

So far this year

- Take-up for life sciences companies in the first half of the year was modest at 130,000 sq ft. A low first half take up broadly correlates with historic trends, but it also reflects a lack of readily available lab space.
- A significant collaboration was announced in February between the Francis Crick Institute, BlackRock/Reef at Tribeca, and British Land at Regent's Place to accommodate commercial companies working across AI/biotech and health, who are broadly aligned with the Institute's scientific goals.

- Specifically, the collaboration with British Land will provide 30,000 sq ft of fitted lab and write-up space at 20 Triton Square, Regent's Place, as well as 52,000 sq ft at Reef's Tribeca development in King's Cross.
- Venture capital funding appears to have stabilised and is projected to exceed 2023 levels. If these levels continue, it could potentially reach around £3.43bn, making it the third-largest year on record. However, deal activity in London has declined, which is notable given that London accounted for 50% of VC investments in 2023, but only 20% in the first half of 2024.

LIFE SCIENCES

What’s still to come

- The development pipeline for the rest of the year looks promising, with purpose-built lab spaces expected to be completed at Apex in London, Granta Park in Cambridge, and Nebula in Milton Park, Oxford. Outside the Golden Triangle, Bruntwood SciTech’s Citylabs 4.0 in Manchester is also due for completion, as well as Birmingham Health Innovation Campus (BHIC). This growth of the sector in Manchester is further solidified by Kadans receiving planning permission for their Upper Brook Street development.
- The investment market is anticipated to rebound. Following the partial sale of 1 Triton Square to Royal London, we observe signs of investors and developers shifting focus away from the delivery of projects. They are likely to seek new opportunities to deepen their investments in the sector or to exit their holdings upon project completion.
- We are beginning to witness the emergence of a two-tier market for life sciences spaces, with both repurposed office spaces and purpose-built lab spaces becoming available. Both types will serve distinct purposes, with more affordable sites offering cash-conscious biotech's viable options for relocation within strong ecosystems.
- The conclusion of the election adds a layer of certainty for foreign investors. Positively, Labour has outlined plans to increase government R&D spending as well as maintaining participation in the European Horizon scheme.

Contacts

Jennet Siebrits
Head of UK Research
jen.siebrits@cbre.com

Ruth Hollies
Senior Director, Head of European Forecasting
ruth.hollies@cbre.com

Daniel Jones
Senior Analyst, Economics & Forecasting
daniel.jones@cbre.com

Steven Devaney
Director, UK Research
steven.devaney@cbre.com

Toby Radcliffe
Associate Director, UK Sustainability Research
toby.radcliffe@cbre.com

Simon Brown
Senior Director, Head of UK Office Research
simond.brown@cbre.com

Miranda Botcherby
Director, Head of UK Industrial & Logistics and Retail Research
miranda.botcherby@cbre.com

Scott Cabot
Director, Head of UK Residential Research
scott.cabot@cbre.com

Alice Marwick
Director, Head of OPRE Research
alice.marwick@cbre.com

CBRE

Contacts

Tom Morgan
Executive Director, OPRE, Healthcare, UK
tom.morgan@cbre.com

Miles Auger
Head of UK Hotels
miles.auger@cbre.com

Sarah Livingston
Executive Director, OPRE, Healthcare, UK
sarah.livingston@cbre.com

Tom King
Executive Director, OPRE, Leisure, UK
tom.king@cbre.com

Oliver Close
Senior Director, Self Storage, OPRE, UK
oliver.close@cbre.com

Andrew Jay
Head of Data Centre Solutions,
Advisory & Transaction Services, Europe
andrew.jay@cbre.com

Joanne Henderson
Executive Director, Head of Life Sciences, Europe
joanne.henderson@cbre.com

Kevin Restivo
Head of Data Centre Research,
Advisory & Transaction Services, Europe
kevin.restivo@cbre.com

Richard Dakin
Europe Head, Investment Banking
and Debt & Structured Finance
richard.dakin@cbre.com

Colin Thomasson
Head of UK Investment Properties
colin.thomasson@cbre.com

Kaela Fenn-Smith
Managing Director, ESG Consultancy, UK&I
kaela.fennsmith@cbre.com

Richard Smart
Managing Director, London
richard.smart@cbre.com

Paul Farrow
Executive Director, Head of UK Industrial & Logistics
paul.farrow@cbre.com

Graham Barr
Head of UK Retail
graham.barr@cbre.com

Luke Mills
Managing Director, UK Residential
luke.mills@cbre.com

Andrew Saunderson
Executive Director
Head of UK Residential Capital Markets
andrew.saunderson@cbre.com

Justin Carty
Executive Director, Affordable Housing, UK
justin.carty@cbre.com

Thomas Mudd
Senior Director, Affordable Housing, UK
thomas.mudd@cbre.com

Oli Buckland
Executive Director, Residential Capital Markets, UK
oli.buckland@cbre.com