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IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

November 2024

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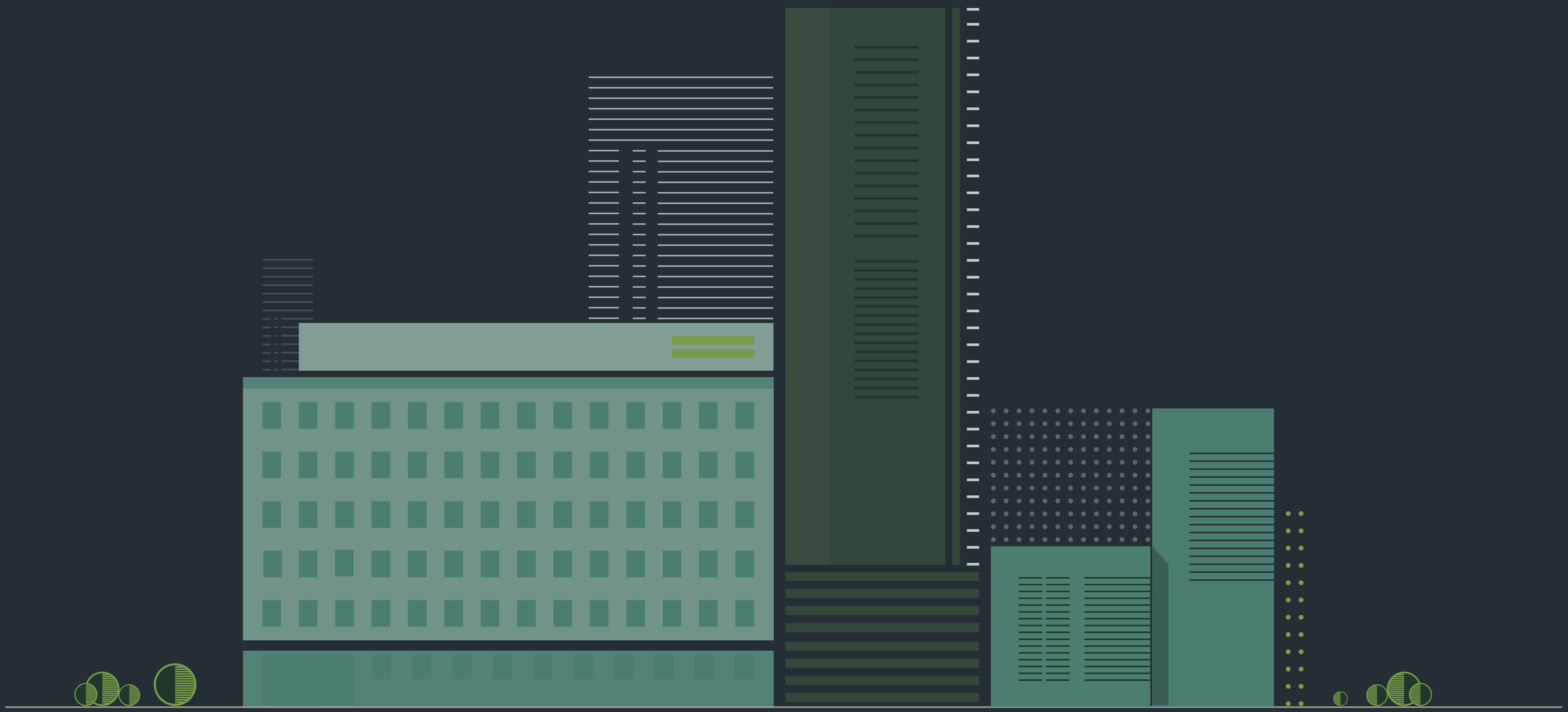

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NOVEMBER UPDATE

As we near the end of the year, the stark polarisation between prime and secondary continues for office and retail across both occupier and investment markets. In contrast, industrial lettings activity is diverse and effectively back to pre-pandemic rates, while rental growth is easily outperforming the other sectors. With the repricing that began in 2022 all but over, all sectors are now posting positive quarterly total returns. The outlook is cautiously optimistic, with a more supportive macroeconomic backdrop in prospect, albeit with myriad economic and geopolitical risks in the mix for 2025.

Read more for the most recent occupier and investment updates, economics data and property forecasts.

+0.7% ▲	6.1% ◀▶	1.4% ▲	2.6% ◀▶	3.75% ▼	4.4% ▲
Office quarterly total return, Oct 24	Industrial rental growth, Oct 24	2025 GDP growth forecast	2025 average CPI inflation forecast	End-2025 Bank Rate forecast	End-2025 unemployment rate forecast

UK property

The polarisation between prime and secondary **office** markets continues to intensify. Demand for prime offices, especially in central London, has returned to its pre-pandemic rate. Lease events are driving relocations, while demand for flexible workspaces also feature as companies navigate hybrid working models. Available grade A options remain scarce, which is pushing prime rents and reducing incentives. In contrast, secondary office demand is weak, with high vacancies and flat or falling rents. These offsetting elements mean that UK office rents continue to bump along at low single digit annual rates of growth. Refurbishment regulations, energy efficiency requirements, and high fit-out costs continue to prolong negotiations and dampen momentum, particularly in the secondary market.

Office investment transaction volumes remain subdued and cross-border activity has fallen. Demand is selective and thins very quickly outside of best-in-class assets in key centres. More positively, after a heavy price correction for UK offices in particular, outward yield shift had slowed sufficiently by August 2024 to generate the first non-negative quarterly total return in two years. This improving trend continued into September and October.

Industrial take-up has effectively returned to pre-pandemic levels, with diverse occupier demand. Manufacturers have picked up some of the slack from retailers, driven by their ongoing need for supply chain infrastructure. The supply response for this sector is comparatively nimble and developers continue to limit speculative construction, which is helping to support headline rents. Industrial continues to be the only property sector with genuine impetus behind rental growth and it is easily outperforming the others.

The industrial investment market is one of the strongest and most active segments of commercial property. Liquidity has continued to improve throughout 2024, and there is now a greater depth of capital and more participants across the asset risk spectrum. Rental growth is driving quarterly total return, which continues to be some of the strongest across commercial property. The outlook is also cautiously positive, but the cost of debt is often still in excess of industrial property yields, which are some of the keenest in the market. This will limit the scope for future yield compression.

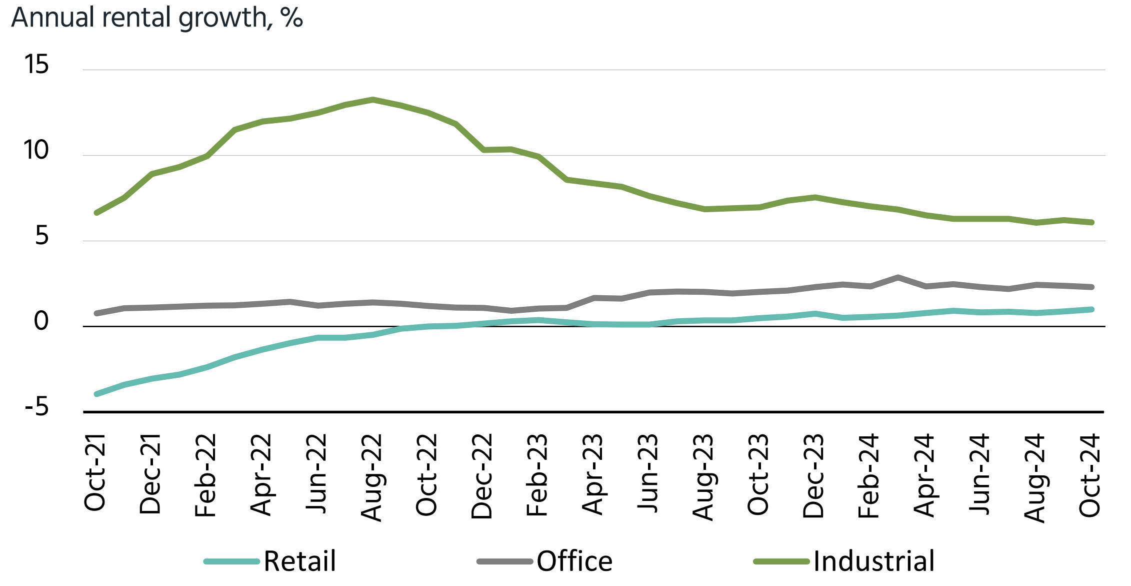
Activity in **Retail** lettings and investment markets continue to be subdued. Online shopping continues to challenge demand for physical stores, especially in non-prime locations. Experiential retail and omni-channel shopping models attract the most interest and there are greater signs of stabilisation for well-located assets in city centres where footfall tends to be higher.

Volatile retail sales over 2024 reflect fluctuating consumer confidence, buffeted by economic and geopolitical events. Businesses are hesitant to commit to new leases, given the longstanding economic uncertainty that has now been compounded by increased cost burdens post-Budget. However, the significant rent rebasing leading up to and particularly during Covid means that overall annual UK retail rental growth has been positive over the past year, albeit only fractionally.

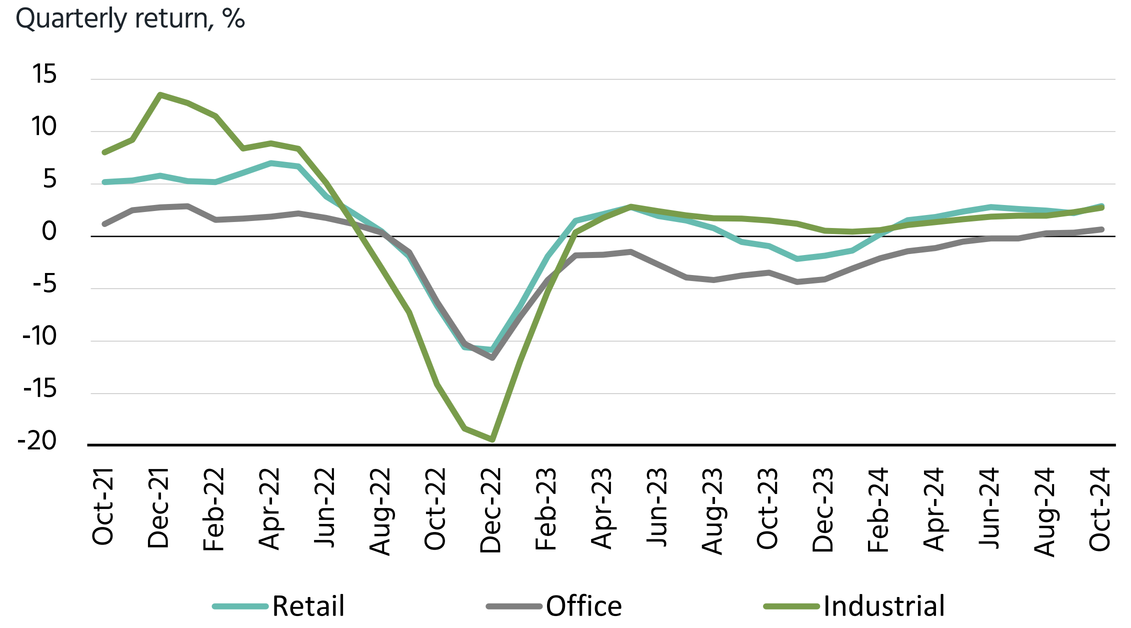
+0.7%
Office quarterly total return, Oct 24

6.1%
Industrial rental growth, Oct 24

Rental growth by sector
Source: MSCI

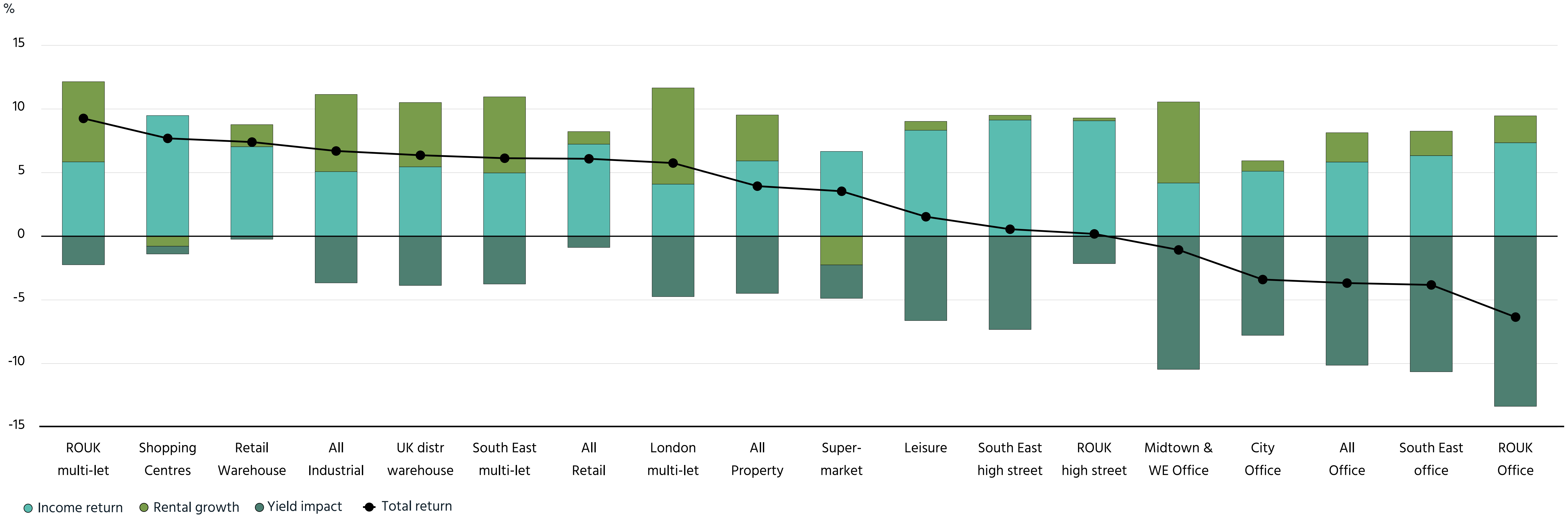


Total return by sector
Source: MSCI



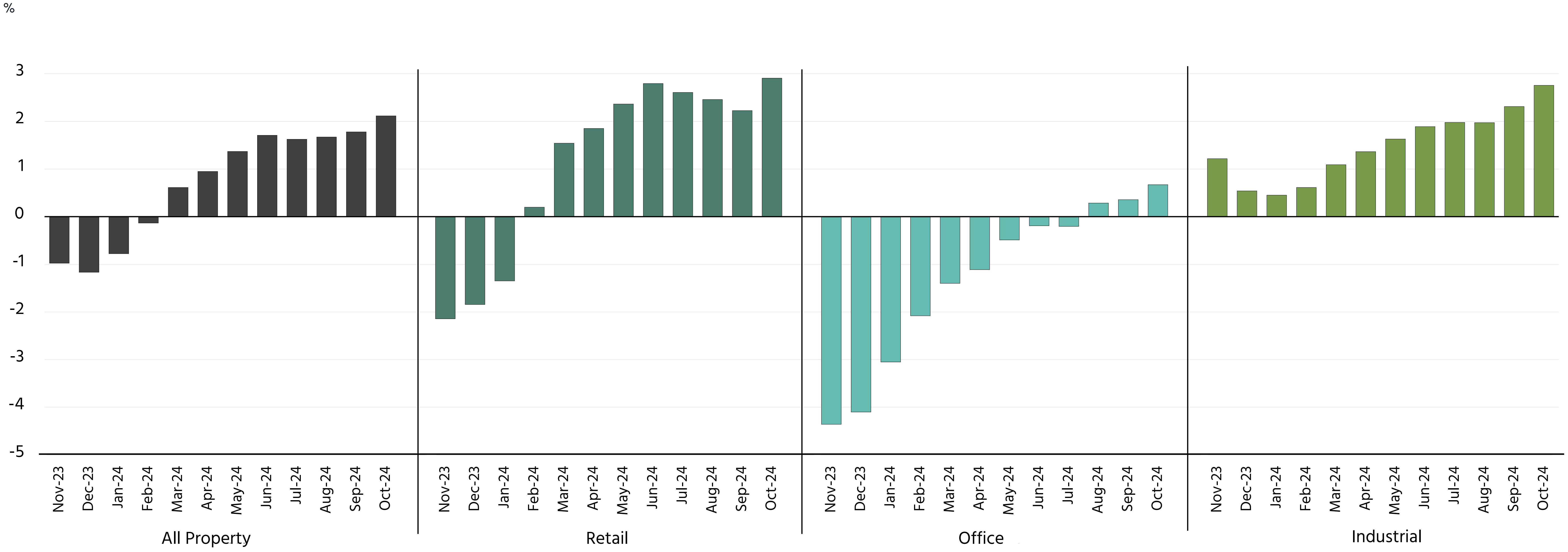
UK property segments

12-month return to October 2024
Source: Gerald Eve, MSCI



Sector momentum

Quarterly total return by sector
Source: MSCI



UK economy

UK GDP fell 0.1% month-on-month in September, rounding off a Q3 that came in at only 0.1% above Q2. This represents a marked deceleration from the first half of 2024. Timelier business surveys suggest underlying economic momentum remains broadly steady, if somewhat diminished recently. The flash composite PMI for November slipped fractionally into contractionary territory at 49.9, the first sub-50 reading in 12 months. Both services and manufacturing sectors reported declines, driven by weaker domestic demand, elevated energy and labour costs, and heightened geopolitical uncertainty. While a cautious recovery is still in prospect, GDP growth forecast for 2025 has been revised down slightly to 1.4%, while the inflation and unemployment projections post-Budget have been edged up.

Annual CPI inflation increased sharply to 2.3% in October. An uptick was expected, driven by energy price cap adjustments and strong base effects from this time last year. Inflation will be contained but is expected to drift up over the next several months into 2025, possibly as high as 3%, supported by further base effects, sticky service price inflation and ongoing wage pressures. In November, the Bank of England cut the Bank Rate by 25bps to 4.75%, reaffirming its gradual approach to loosening policy. Increased government tax and spend declarations have added around 50bps to both the 10-year bond yield and the future path for the Bank Rate implied by SONIA forward curves. Oxford Economics nevertheless continues to expect rates to fall to 3.75% by the end of 2025, though surely risks are to the upside.

The transmission of these interest rate cuts to household and corporate borrowing costs will be uneven. Firms may benefit more quickly, while many households will continue to refinance pre-2022 fixed-rate mortgages at higher rates. Fiscal tightening will also weigh on real household incomes, but with wage growth ahead of inflation they should continue to rise.

Household spending is expected to pick up moderately in 2025 and contribute to the broader recovery, possibly supported by dissaving. Confidence continues to be fragile and uncertain, particularly given rising energy costs and expectations that firms will potentially cut headcounts or slow wage growth to offset the increased National Insurance costs revealed in the Autumn Budget. More positively, new spending plans will provide a £48bn boost in day-to-day public spending over 2025-26, equivalent to 1.6% of GDP. This includes higher public sector pay awards and additional NHS funding.

1.4% ▲
2025 GDP growth forecast

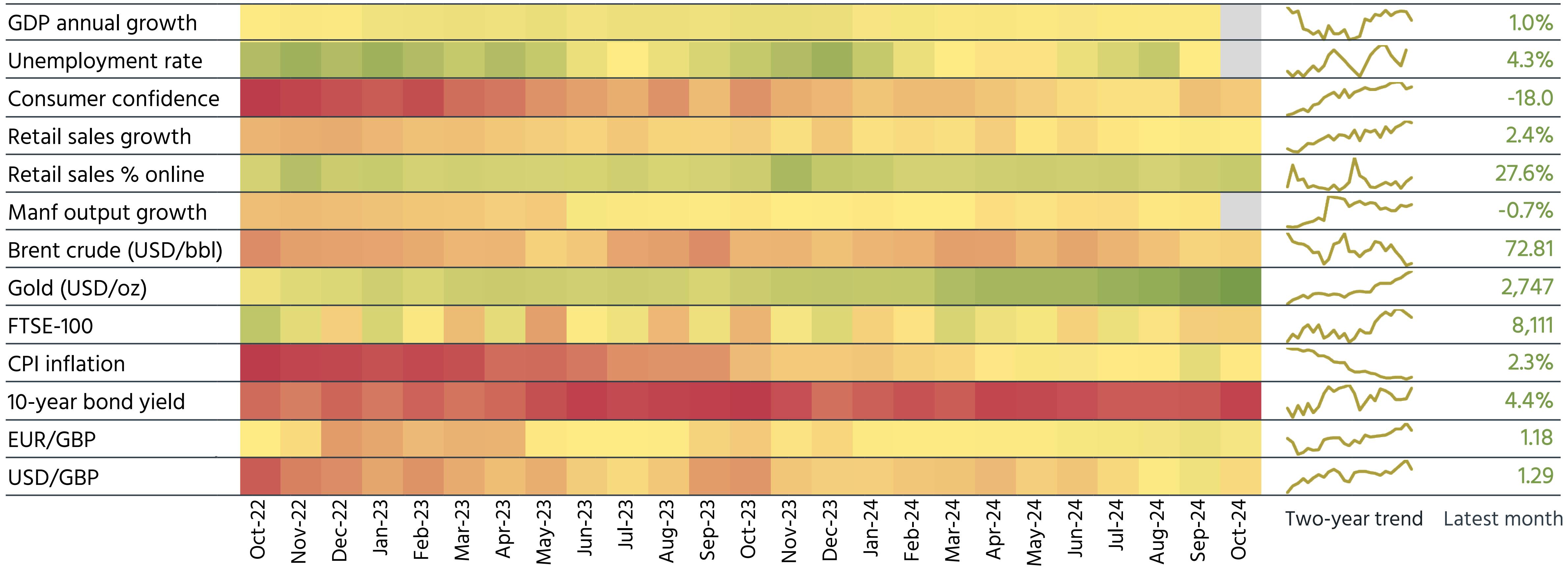
3.75% ▼
End-2025 Bank Rate forecast

2.6% ◀▶
2025 average CPI inflation forecast

4.4% ▲
End-2025 unemployment rate forecast

The monthly monitor

Source: Bank of England, IMF, ONS



Outlook

The second interest rate cut of this cycle occurred in early November. Despite market pricing post-Budget now taking a shallower trajectory, Oxford Economics has pencilled in a further 100bps reduction for 2025. Risks are very much to the upside but the cost of debt should continue to become more accommodating.

The potential benefit for property returns will be limited, given that property yields continue in the main to be below where the monetary fundamentals suggest they should be. The outlook is moderately positive and annual property returns should trend upwards over the medium term – notably in 2025 when there may be some small scope for inward yield shift for industrial in particular.

The resilience of the **Industrial** occupier market will continue to appeal to investors and continues to support prices that having corrected in late-2022 now remain relatively robust. Rental growth may have cooled, but this follows very strong advances in 2021/22. Void rates are likely to stop rising in 2024 and remain below previous downturns, which will sustain positive rental growth.

Office prime/secondary polarisation is set to continue as alternative working practices allied with EPC obstacles and the high cost of refurbishment continue to negatively impact occupancy and investment demand for secondary space. Meanwhile household real incomes and the average cost of debt should continue to improve, but the recovery will be tentative, and households and retailers will face ongoing challenges. The significant rise in **retail** yields and reset of rents over the last several years that has so negatively impacted capital values should provide a small offsetting cushion for retail assets in the form of relatively greater income return.

Total return and components by sector, November 2024 forecasts
Source: Gerald Eve, MSCI

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