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IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

October 2024

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OCTOBER UPDATE

UK commercial property quarterly total return has risen to an annualised rate of over 7% as we approach the end of the year, which marks a definite improvement over the -7.6% and -0.8% annual total returns recorded in 2022 and 2023. The much-anticipated October Budget presented challenges, opportunities and unfinished business for the property sector. The outlook is cautiously positive but increases in the 10-year bond yield over the last seven weeks up to and immediately after the Budget will impact the cost of debt and scope for future inward yield shift.

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

1.8% ▲	£33.9bn	1.5% ▲	2.5% ◀▶	3.75% ▼	4.3% ▲
All Property quarterly total return, Sept 24	Investment volume, 2024 YTD	2025 GDP growth forecast	2025 average CPI inflation forecast	End-2025 Bank Rate forecast	End-2025 unemployment rate forecast

Challenges persist, but greater clarity, stability and liquidity will drive the first annual positive total return since 2021

UK commercial property quarterly total return edged up to 1.8% in September where it has effectively been oscillating since May. This is an annualised rate of over 7% as we approach the end of the year, which will mark a definite improvement over the -7.6% and -0.8% annual total returns recorded in 2022 and 2023. The outward drift of valuation yields has mostly run its course and has progressively eased the negative impact on capital values. This marks the end of the repricing that has occurred across all property sectors since 2022. Indeed, directly-observed yields in the market for several segments, notably industrial, have moved back in slightly over 2024.

The key event for October came at the end of the month as the new Chancellor of the Exchequer set out the first Labour Budget for 14 years, which is discussed in more detail in the Economy section. The overriding message of infrastructure investment and measures to boost employment are broad positives for the property sector, but higher employer national insurance contributions and substantive increases in minimum wages will impact business costs and could reignite concerns around inflation.

There has been volatility and an upward trend in the 10-year bond yield in the run-up to the Budget as various elements were leaked and in the days afterwards, reaching as high as 4.5% from a low point of 3.8% in mid-September. This could impact the trajectory of interest rates and the future cost of lending against property. Meanwhile, there was an underwhelmed response from the industry regarding the treatment of business rates, see here for more detailed comment and analysis from our head of business rates, Simon Green.

In terms of UK leasing markets, there may be challenges for occupiers but there is greater clarity, which will ease this aspect of hesitancy to commit to new space. **Industrial** leasing activity has reverted to pre-pandemic trend, with real diversity to occupier demand and a relatively subdued supply pipeline that will continue support headline rents. Further support in the form of greater incentives and more favourable lease terms all means that industrial continues to be the only sector with any real rental momentum.

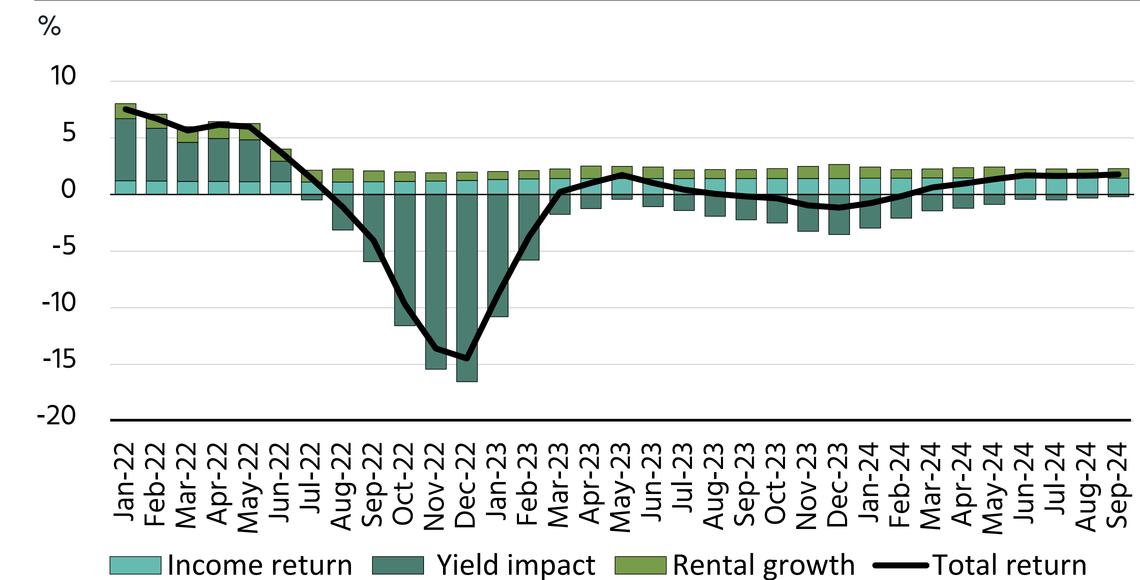
Office leasing activity continues to be defined by the sharp polarisation between prime space, with its low vacancy, relatively robust demand and rising rents, and secondary space, characterised by much higher vacancy and flat headline rents at best. In central London, office leasing activity is almost back to the pre-pandemic trend. However, regulation around refurbishments and energy efficiency continues to prolong the time taken to get leasing deals over the line, and fit-out costs continue to be problematically high.

In the investment market, liquidity has continued to improve throughout 2024 (notably for industrial assets), and there is now a greater depth of capital and more participants across the asset risk spectrum. Prospects are improved, but the cost of debt is still often greater than property yields, which will limit the scope for yield compression. For some debt-backed buyers, deficit financing is an issue until rental income can be increased at future lease events.

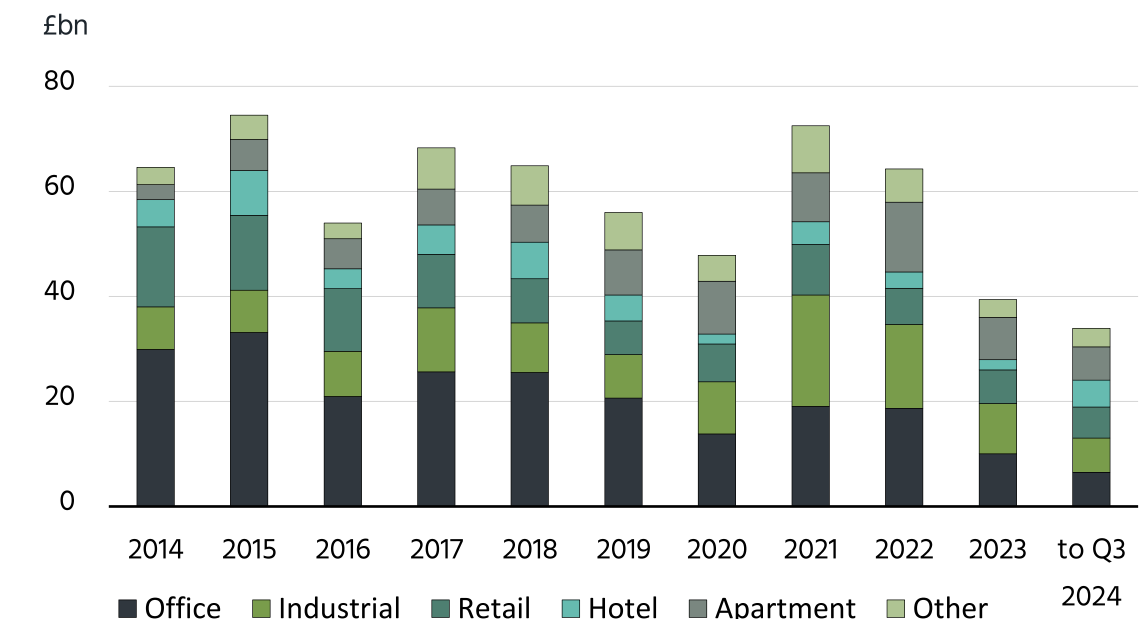
1.8%▲
All Property quarterly total return, Sept 24

£33.9bn
Investment volume, 2024 YTD

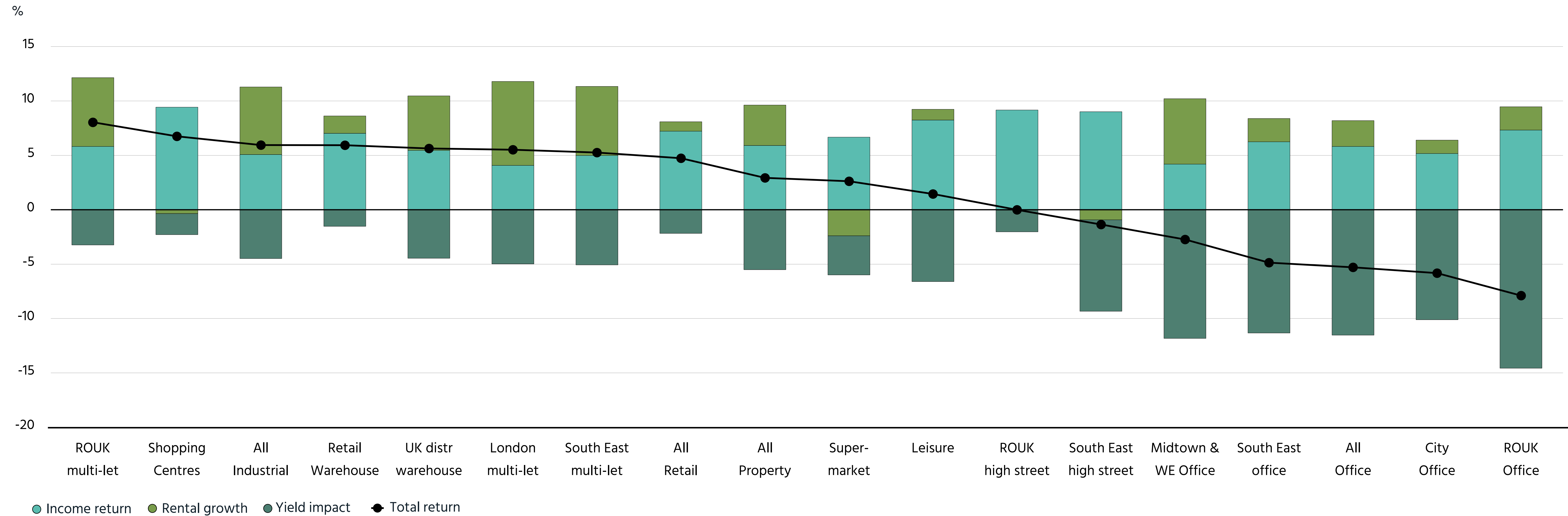
Quarterly total return and components
Source: MSCI



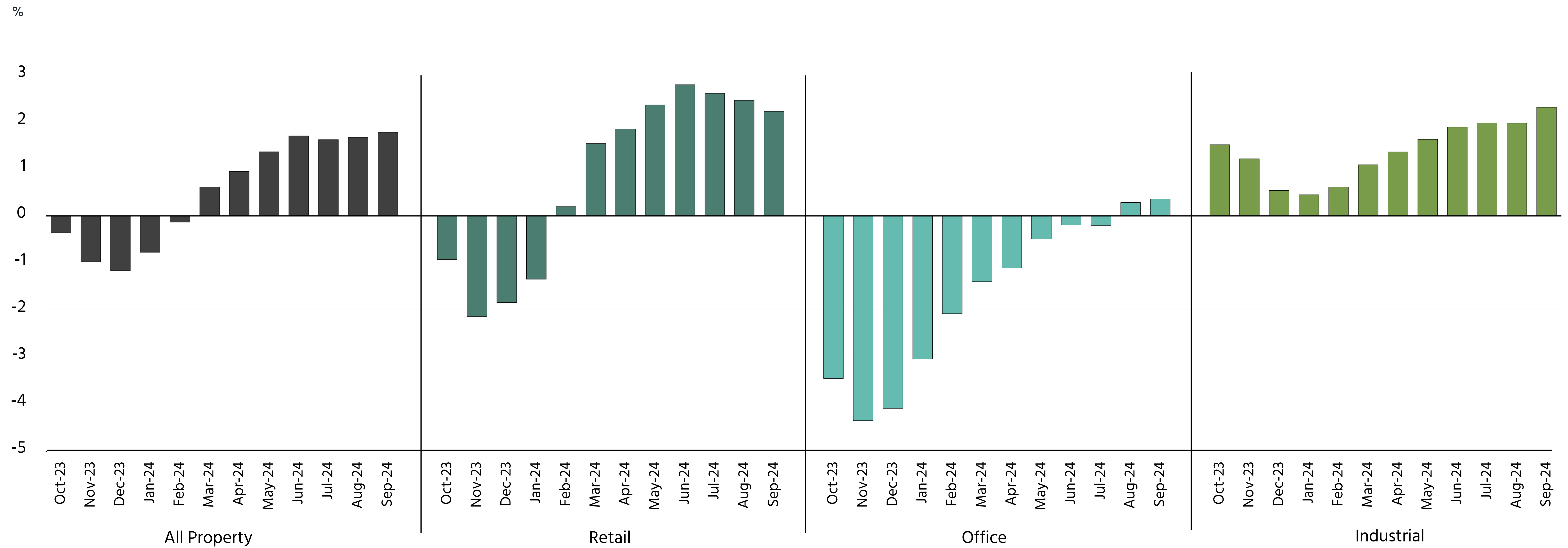
Investment volume by sector
Source: MSCI/RCA



UK property segments



Sector momentum



UK economy

After flatlining in June and July, UK GDP picked up 0.2% in August. The Q2 GDP growth rate was 0.5% and, with momentum from robust business survey data, Q3 GDP is estimated to have pushed on a further 0.3%. Annual GDP growth is expected to be 1.0% this year, followed by a steady but unspectacular increase to 1.5% in 2025. Consumer spending should lead the recovery, tempered by various fiscal constraints and the lagged impact of higher interest rates despite the rate-cutting cycle having started in August.

Annual CPI inflation fell sharply to 1.7% in September – the first time it has been below 2% since April 2021. However, it is expected to edge up again over the remainder of 2024, particularly given October's 10% Ofgem energy price cap rise and ongoing 'sticky' services inflation. After cutting by 25bps in August, a divided Monetary Policy Committee held the Bank Rate at 5% in September. A hawkish minority cite persistently high services inflation and uncomfortably strong underlying pressures, while a slim majority argue for a more dovish, forward-looking approach. Messaging suggests gradual steps down and the consensus is for the next 25bp cut to be in November. Market pricing that implied that the Bank Rate will fall another 100bps in 2025 to reach 3.75% may be reined in somewhat after announcements in the much-anticipated October Budget.

Much of the Budget content was as expected since so much was leaked ahead of time. However, the scale of the increases in current spending, capital spending, and taxation were larger than anticipated. Fiscal policy will be tightened over the next five years by less than the previous government planned. A new debt rule takes account of the benefits of investment as well as the costs and will have increased fiscal headroom by £22bn, which is around 0.6% of GDP. Meanwhile, most of the increase in tax will come from higher national insurance contributions from employers. This will indirectly impact the workforce, with estimates of a marginally higher future unemployment rate and lower private sector wage growth.

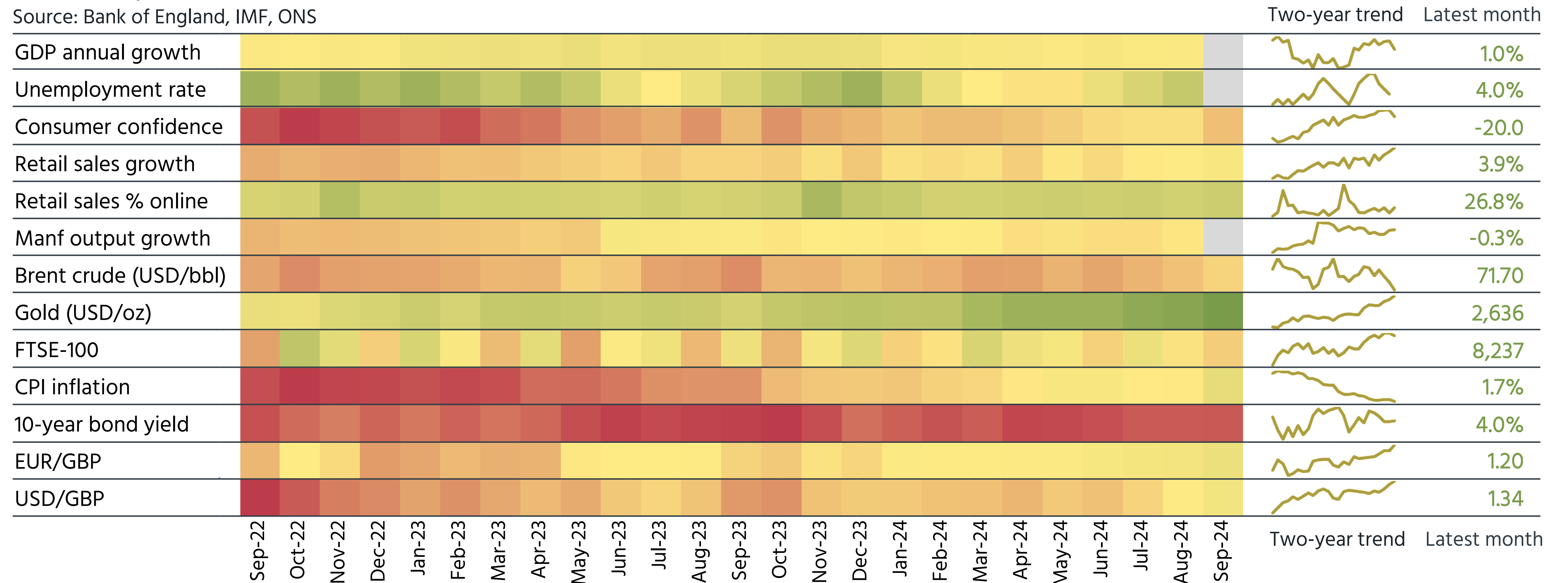
The consumer outlook for the remainder of 2024 and over 2025 is nevertheless cautiously optimistic. Retail spending data have been volatile over the year so far, but there is a gradual recovery now that wages are growing in real terms following the reduction of inflation back to around the target rate. The lagged impact of past interest rate rises will continue to weigh on sentiment and activity though, primarily as mortgage holders continue to move onto higher fixed rates. The income tax thresholds freeze to 2028 will also negatively impact post-tax real wages and temper the rate of recovery.

1.5% ▲
2025 GDP growth forecast

3.75% ▼
End-2025 10-year government bond yield forecast

2.5% ◀▶
2025 average CPI inflation forecast

4.3% ▲
End-2025 unemployment rate forecast



Outlook

The first of the long-awaited interest rate cuts occurred in early August and economics commentators expect a further 25bps reduction before the end of the year, taking the Bank Rate down to 4.75%. A further 100bps reduction is pencilled in for 2025 but there is every chance this could be reined in somewhat post-Budget. Nevertheless, the cost and availability of debt should continue to become more accommodating.

The upside potential 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 cautiously optimistic 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).

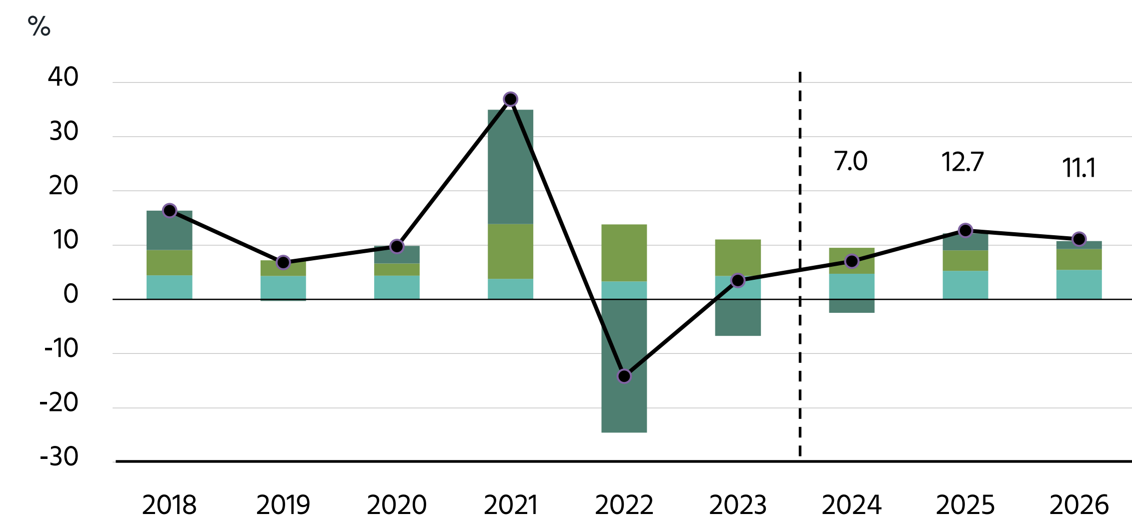
The resilience of the **Industrial** occupier market will continue to appeal to investors and continues to support prices that having corrected in late-2022 now remain relatively robust. Rental growth may have cooled, but this follows very strong advances in 2021/22. Void rates are likely to stop rising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

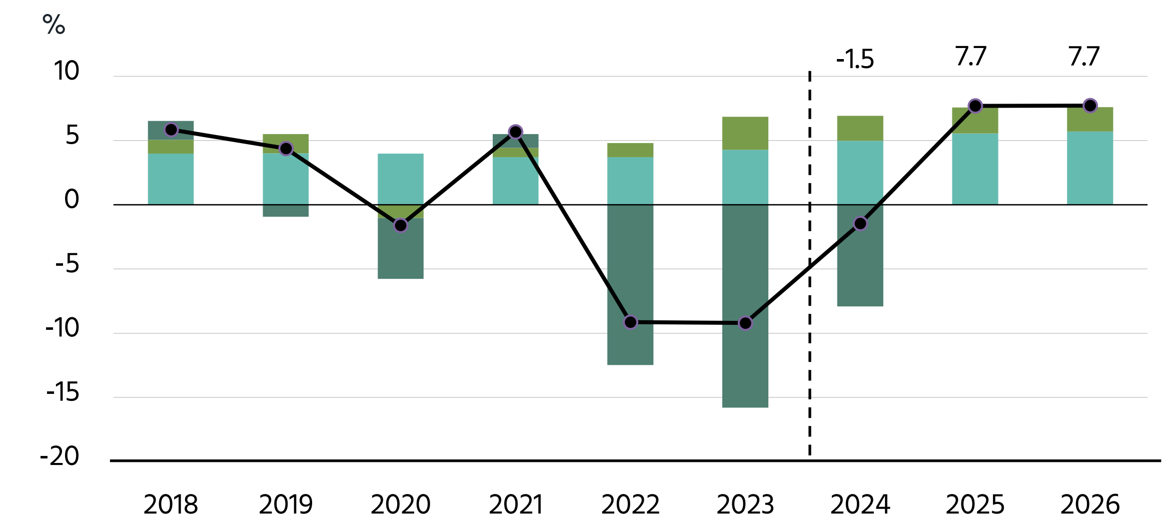
Total return and components by sector, October 2024 forecasts

Source: Gerald Eve, MSCI

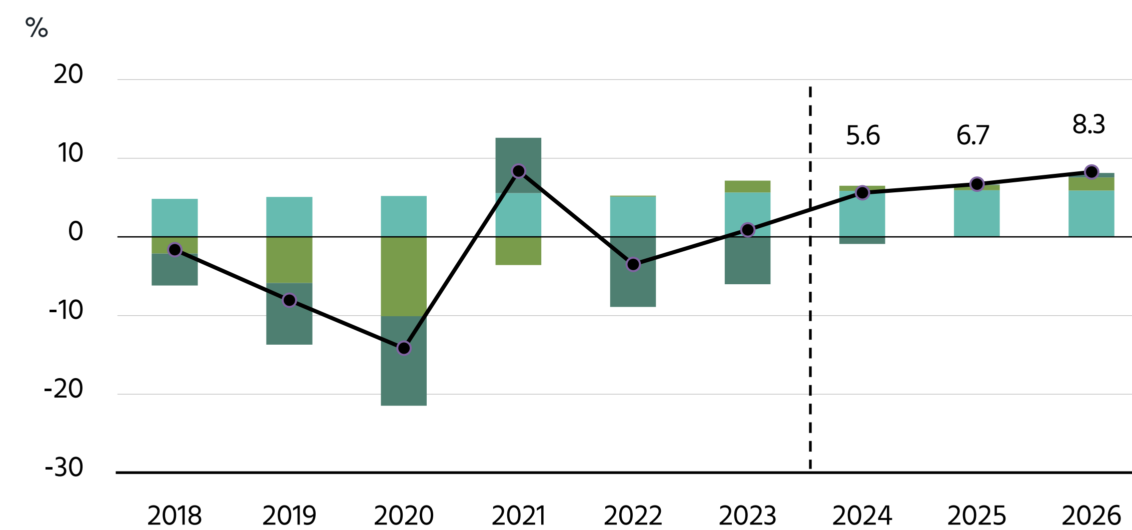
Industrial



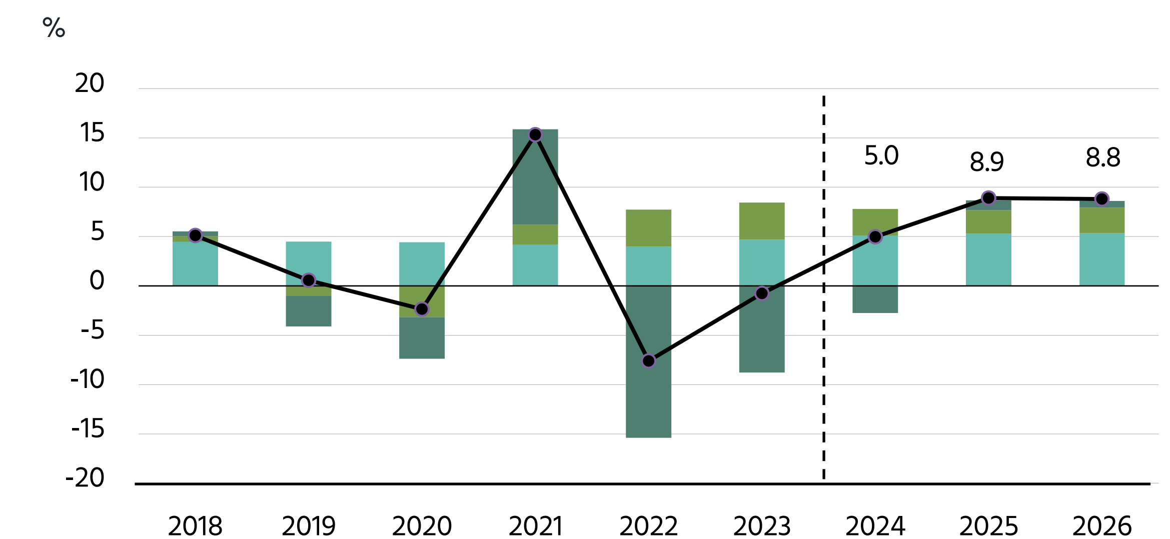
Office



Retail



All Property



Income return | Rental growth | Yield impact | Total return

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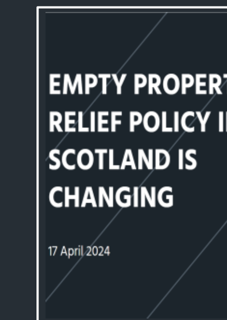

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