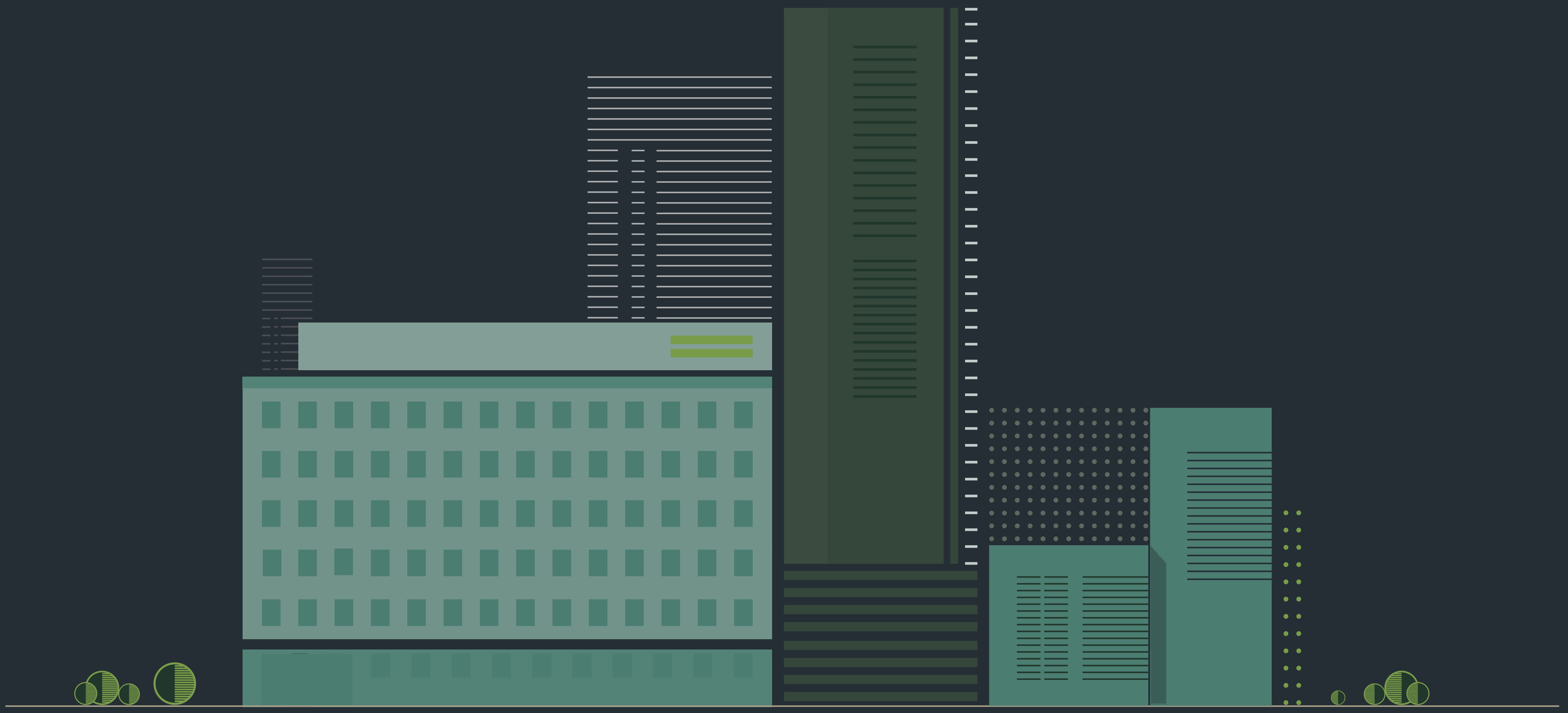
IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

June 2024

Read more

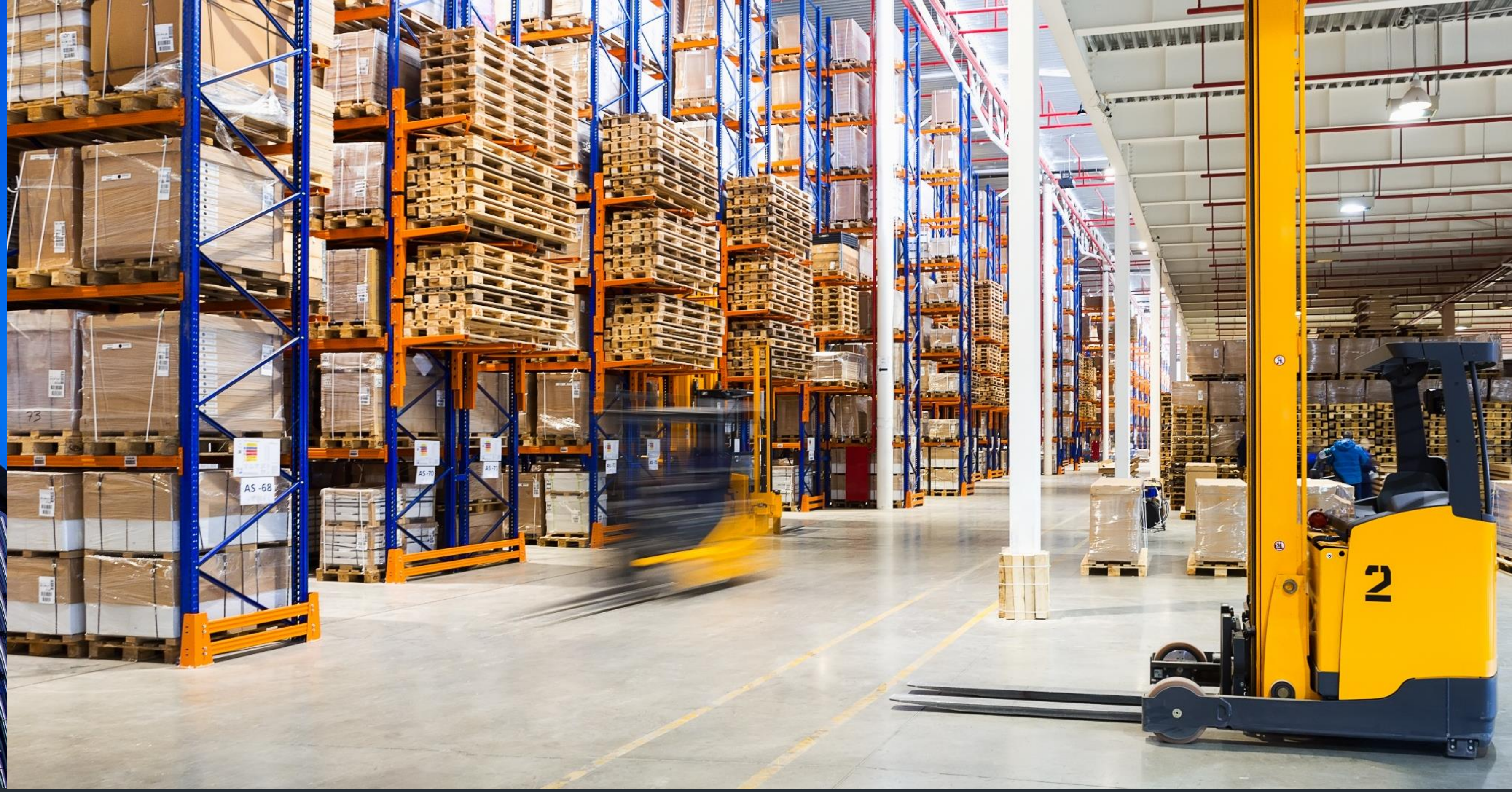


GERALDEVE
A NEWMARK COMPANY

JUNE UPDATE

UK commercial property performance continues to trend upwards, albeit relatively modestly. The slowing of outward yield shift has progressively eased the negative impact on capital values and marks the final stages of the repricing across all property sectors since 2022. There has been increased depth and breadth to the buyer pool for several months now, but the limiting factor has been the lack of investment supply. However, the volume of sellers has increased recently, and activity should pick up somewhat in H2.

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



1.4% ▲
All Property quarterly total return, May 24

£19.4bn
Investment volume, 2024 YTD

2.0% ▲
2025 GDP growth forecast

2.5% ▼
2025 average CPI inflation forecast

3.75% ▼
End-2025 Bank Rate forecast

3.7% ▼
End-2025 10-year government bond yield forecast

Stabilisation and recovery continues, but investment volumes remain low

UK commercial property performance continues to trend upwards, albeit relatively modestly. All Property quarterly total return was 1.4% in May, up from 0.9% in April. The slowing of outward yield shift has progressively eased the negative impact on capital values and marks the final stages of the repricing across all property sectors since 2022. Retail quarterly total return (shown on our new Momentum page) has outperformed the other sectors for the last three months, driven by its elevated income return.

Expectation that Q4 2023 was the bottom of the investment market (outside of offices) has borne itself out. Completed transactions were subdued in the first half of 2024, mostly as a hangover from the dearth of activity at the end of 2023. Year-to-date investment is around half that of 2023, which was itself a low-volume year.

There has been increased depth and breadth to the buyer pool for several months now, but the limiting factor has been the lack of investment supply. However, the volume of sellers has increased recently and activity should pick up somewhat. It is arguably more acceptable to make assets available now that the bottom of the market was sufficiently long ago, plus the perceived risk of meaningful inward yield shift and price increases over the short term is limited, given the expected future cost of debt and relatively low yield carry.

Political uncertainty has been a reason for inaction for some investors and occupiers early in 2024. However, with the process brought forward to early July rather than later in the autumn as previously expected (along with the widely-anticipated Labour victory) there will be greater clarity for H2. Occupier markets continue to be challenging, but viewings have increased and enquiries are generally of a better quality, though getting terms agreed continues to be time-consuming.

Annual rental growth is still subdued for Offices and for Retail at around 2.5% and less than 1%, respectively. For Retail though this represents a current phase of stability having rebased significantly over the pandemic and from the time of the financial crisis to around 2013, with little positive rental growth between.

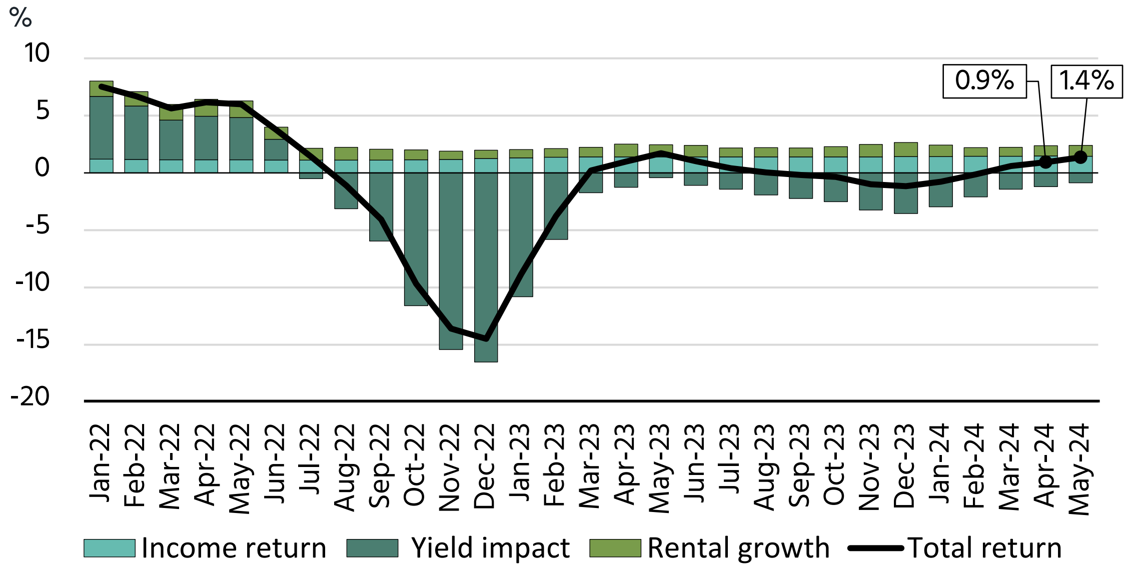
Meanwhile Industrial rental growth, which was strong over the pandemic, has fallen from an annual rate of around 13% late in 2022 to just over 6% and is the only major sector with any continued momentum. At the prime end of the market some rents are still edging up but many are now relatively stable, notably in the South East. Prime rents are determined by the cost of development and represent only a small proportion of the market (and occupiers that are willing and able to pay a premium).

Overrentedness is common in Retail where market rents have fallen. The opposite is the case for industrial markets where significant reversion is widespread. Most industrial occupiers, certainly in the smaller units, occupy secondary and refurbished space. Rents in this part of the sector are more freely subject to market forces and they have continued to rise and erode the gap with prime. Take-up may be lower than during the pandemic but the lack of development has tipped the balance. Part of the current delay for occupiers looking to re-gear and/or relocate is the education process on how much market rents have increased in the past few years.

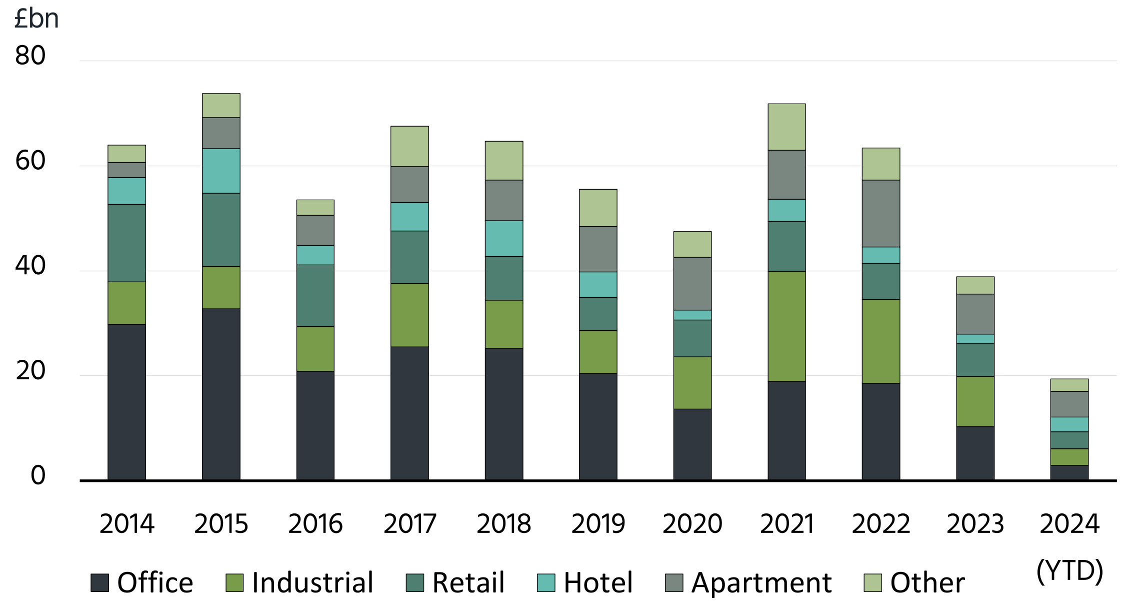
1.4%▲
All Property quarterly total return, May 24

£19.4bn
Investment volume, 2024 YTD

Quarterly total return and components
Source: MSCI

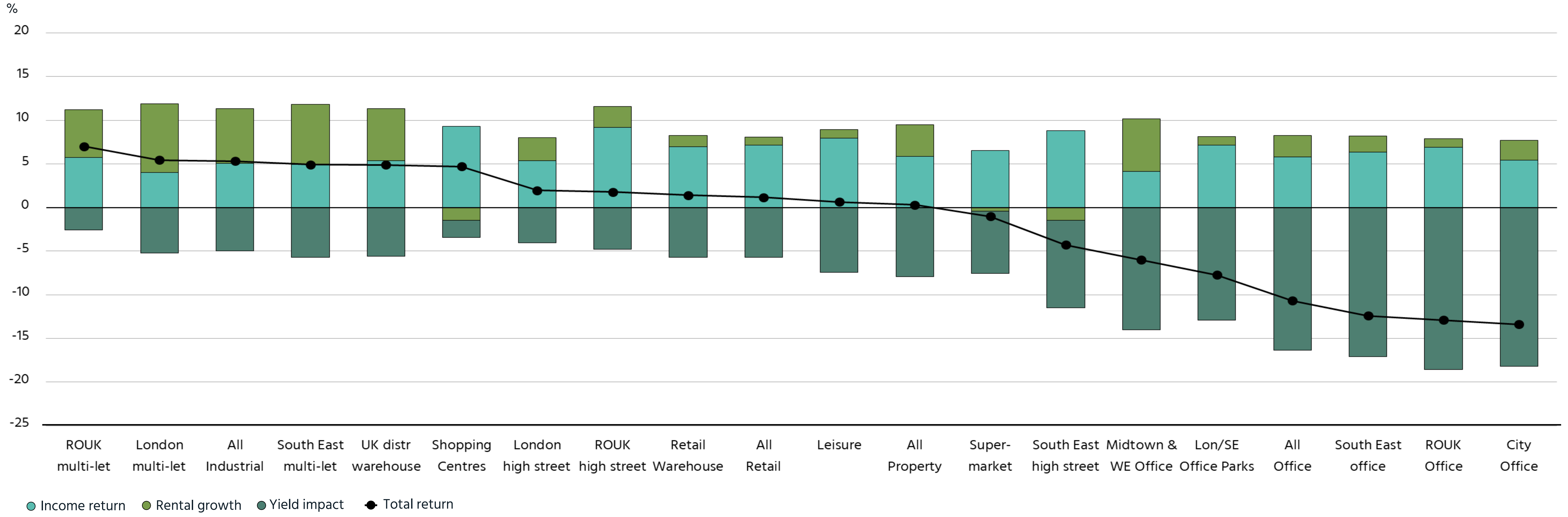


Investment volume by sector
Source: RCA



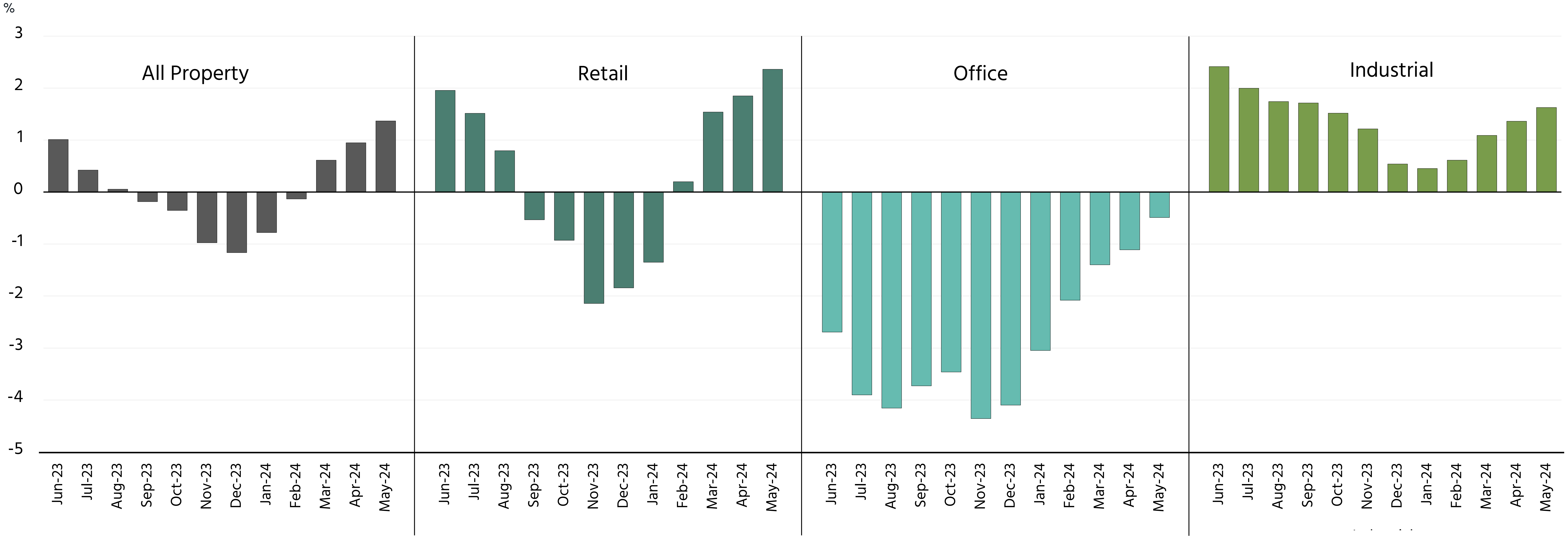
UK property segments

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



Sector momentum

Quarterly total return by sector
Source: MSCI



UK economy

UK GDP was essentially unchanged as expected month-on-month in April after the earlier-than-usual Easter boosted growth in March. Looking through the high frequency volatility in output, the economy has made up lost ground during the mild recessionary period in H2 2023, and timelier business and consumer sentiment indicators point to a continued modest recovery. The forecast for annual UK GDP growth continues to be 0.9% in 2024 and 2.0% in 2025.

CPI inflation hit the Bank of England (BoE) 2.0% target rate in May for the first time since July 2021. The continued downward trend was driven by base effects in food and energy prices. Headline inflation should now be kept around this rate over the coming months by various dampening factors, such as the 7% drop in the Ofgem energy price cap in July. Firms should also pass on to consumers some of the gains from their own easing cost bases. However, core inflation continues to be persistent – services inflation is a key measure of this and came in at 5.7% in May, which was only slightly down from the April figure and 0.4%pts above the BoE expectation. Consequently, the Bank Rate was kept on hold at 5.25% in June (in a “finely balanced” vote), with the August meeting the most likely time for the first cut as the economy continues its broader disinflationary trajectory.

The consumer outlook for H2 2024 is cautiously optimistic. Retail spending data have been volatile over the past six months but there is a gradual recovery now that wages are growing in real terms following the sharp fall in inflation. And strengthening confidence suggests this will translate into spending growth, notwithstanding the lagged impact of past interest rate rises (notably relating to fixed-rate mortgages) that will weigh on activity. The continued freeze in most tax thresholds and allowances will negatively impact post-tax real wages and also limit the rate of recovery.

Business survey data are broadly positive and are consistent with domestic recovery and export market stability becoming more firmly entrenched. Encouragingly, manufacturing sentiment indicators which moved into growth mode in May were maintained in June. Interest rates and wage costs remain elevated and thus companies, particularly the smaller firms, are likely to remain under financial stress for much of 2024. However, these pressures are far less acute than during the global financial crisis, and the current rate of insolvencies appears to have recently peaked far lower than during that period.

2.0% ▲
2025 GDP growth forecast

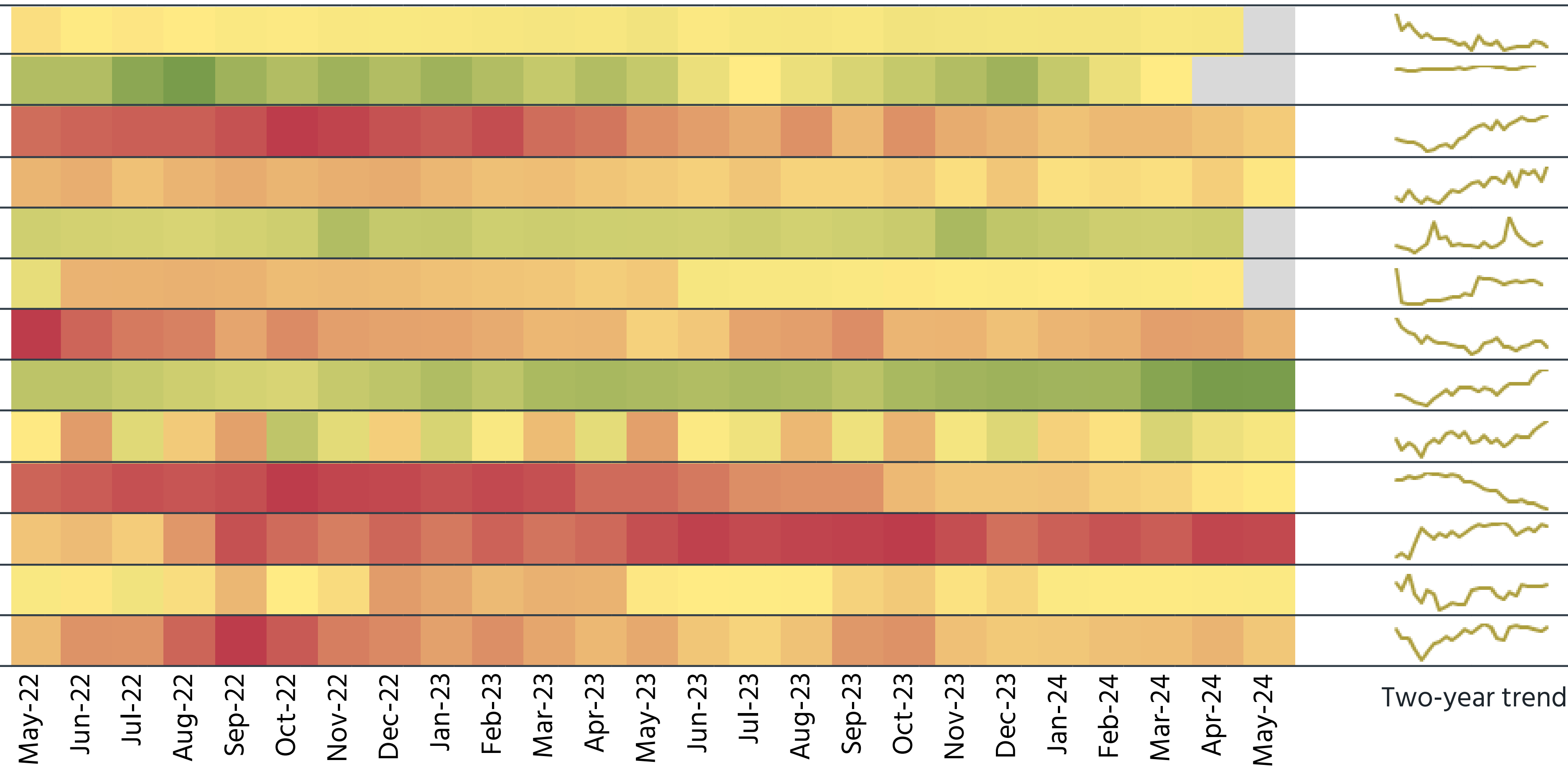
3.7% ▼
End-2025 10-year government bond yield forecast

2.5% ▼
2025 average CPI inflation forecast

3.75% ▼
End-2025 Bank Rate forecast

The monthly monitor

Source: Bank of England, IMF, ONS



	Latest month
GDP annual growth	0.6%
Unemployment rate	4.3%
Consumer confidence	-17.0
Retail sales growth	1.2%
Retail sales % online	26.2%
Manf output growth	0.4%
Brent crude (USD/bbl)	81.11
Gold (USD/oz)	2,327
FTSE-100	8,275
CPI inflation	2.0%
10-year bond yield	4.3%
EUR/GBP	1.17
USD/GBP	1.27

Outlook

With interest rates having peaked at 5.25% and expectations of cuts starting in August, the cost and availability of debt should continue to become more accommodating. But the upside potential for property returns will be limited, given that current commercial 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.

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 is from very strong rates in 2021/22. Void rates and default 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. For **retail**, eroded real incomes and the elevated cost of debt should begin to turn a corner but households and retailers are nevertheless in for 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 in the form of relatively greater income return.

Total return and components by sector, June 2024 forecasts

Source: Gerald Eve, MSCI

Contact

Research

STEVE SHARMAN
Partner
ssharman@geraldeve.com
Tel. +44 (0)20 7333 6271

BEN CLARKE
Partner
bclarke@geraldeve.com
Tel. +44 (0)20 7333 6288

Capital Markets

JOHN RODGERS
Partner
jrodgers@geraldeve.com
Tel. +44 (0)20 3486 3467

Agency

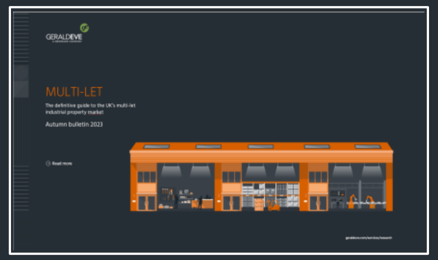
CHARLES SPICER
Partner
cspicer@geraldeve.com
Tel. +44 (0)20 3486 3739

Valuation

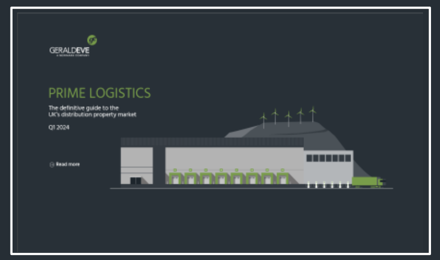
RICHARD MOIR
Partner
rmoir@geraldeve.com
Tel. +44 (0)20 7333 6281

Our advice and recommendations are underpinned by the in-depth analysis of our award-winning research team. With a particular focus on investment, London offices and industrial, our researchers work closely with the agency teams to produce market-leading reports recognised for their detail and practical insight.

Further Insight

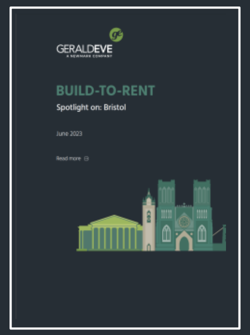


Multi-Let
Autumn Bulletin 2023



Prime Logistics
Q1 2024

London Markets
Q1 2024



Bristol BTR
June 2023

More planning reform - or is it?
August 2023

RACC newsletter
September 2023

Rating update - Spring budget
March 2024

Biodiversity net gain: another blossoming requirement
August 2023

Spotlight on energy and infrastructure
November 2023

Business rates:
What independent schools need to know, 2024

SUBSCRIBE HERE

geraldeve.com/services/research