Commercial quarterly examiner

Economy | Offices | Industrial | Retail | Outlook

Q4 | 2024



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INVESTMENT MANAGEMENT

1. Key take aways

President Trump's tax, immigration and tariff policies may prove inflationary requiring higher interest rates to suppress demand and tempt investors to buy US government debt. Treasury yields have already shot up, pushing up bond yields around the world. The increased cost of debt erodes the money available to improve the UK's services' sector and improve its infrastructure which is at the core of the new UK government's growth agenda. If sterling were to fall against the dollar, the Bank of England is likely to maintain base rate at a higher level than otherwise would be required to support economic growth.

US stock markets have driven world stock markets to a second consecutive year of 20% plus returns in 2024. But the FTSE and other European markets had a quieter year. The FTSE All Share REIT index ended the year down -16% as gilts were sold off by investors and benchmark risk free yields softened. Industrial property specialist Prologis and Segro ended 2024 down 20.7% and 20.9% respectively.

The UK's first base rate cut was delayed until August last year and had a minimal effect on commercial property in Q3. However, a further 25 bp reduction to 4.75% in November made some contribution in boosting Q4 performance and led to better-than-expected results for 2024. MSCI's All Property total returns rose to 2.8% from 1.8% in Q3. For the year ending December 2024, total returns increased to 7.0%, up from 2.9% for the year ending September, as weak data from Q4 2023 was excluded. We consider that some of this improvement was down to sentiment rather than any fundamental shift in the market.

The interest rate outlook for 2025 is uncertain. The Bank of England cut rates again in February by a quarter point to 4.5%, but inflation is ticking up, and the Fed's reaction to the Trump administrations plans for tariffs remains unclear. Despite this, we anticipate that UK CRE recovery will continue, with total returns rising to 10% for 2025. But the downside risks have increased.

2. Introduction

We previously highlighted that the US's election result on 5th November was likely to have greater consequences for the UK than its own election. This looks to be coming true, at least in part, if President Trump's tax, immigration and tariff policies increase inflation and the budget deficit – requiring higher interest rates to tempt investors to buy US government debt.

Treasury yields have shot up, pushing up bond yields around the world. By early January, 30-year gilt yields had climbed to 5.45%, the highest in nearly three decades. Ten-year yields were at 4.82%, the highest since the financial crisis of 2007-09. Since year-end, gilt yields increased further but have since fallen back to the levels prevailing at the end of December. However, we have seen bank margins on debt for property loans increasing in the last 6 months, rising from around 2-2.50% to 2.50-3.0%.

Furthermore, to support the pound, the Bank of England may maintain base rate at a higher level than otherwise would be required to bolster economic growth. If sterling were to fall against the dollar, US goods would become more expensive in the UK, causing additional inflationary pressures.

3. The UK economy

The latest IMF "World Economic Outlook," published in October 2024, asserts that the global fight against inflation, which peaked at 9.4% year on year in the third quarter of 2022, has largely been successful, despite persistent price pressures remaining in some countries. In January's update to October's report, expectations of global headline inflation have increased from 3.5% to 4.2% in 2025 but fall back to 3.5% in 2026, below the average level of 3.6% achieved pre-pandemic between 2000 and 2019.

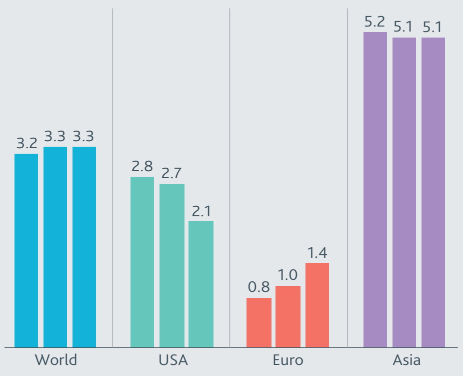
In January's update, the forecast for global growth remains unchanged at 3.3% in 2025 and 2026, below the 3.7% historical average. An upward revision in expectations for the US is offset by downward revisions in other major economies. The update warns that increased protectionist policies in the form of tariffs, could worsen trade tensions, reduce investment, decrease market efficiency, disrupt trade flows, and disrupt supply chains. Growth could suffer in the near and medium term, varying across economies (see Chart 3.1).

The IMF's forecast for UK GDP growth in 2024 has been downgraded from 1.1% to 0.9% and official data indicates that it grew by 0.9% in the 12 months to November. However, growth is expected to accelerate, faster than its European neighbours, to 1.6% in 2025 and 1.5% in 2026 as falling inflation and interest rates stimulate domestic demand (see Chart 3.2).

The latest data from the Office for National Statistics (ONS) indicates that the UK economy gained some marginal traction at the end of the year, rising by 0.4% in December, after a 0.1% rise in November. The economy rose by 1.2% in the three months to December, after showing no growth shown no growth in the three months to August. (see Chart 3.3).

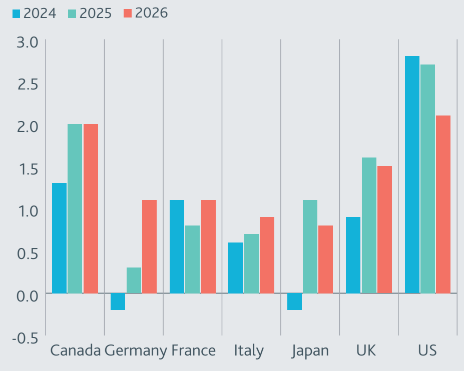
The service sector, which represents 80% of the UK's economy, grew by 1.2% in the three months to December 2024. Revised data suggests that the sector shrank by -0.1% in the three months to August. The largest positive contribution to the rise in services output in the three months to December 2024 came from Human health and social work activities, as the NHS rolled out winter flu and Covid vaccinations. Health sector output had previously fallen in the three months to August 2024 as Junior doctors embarked on a further round of industrial action. NHS England reported that 61,989 acute inpatient and outpatient appointments were cancelled as a result. The largest negative contribution to service sector growth in the three months to December 2024 came from administrative and support service activities.

3.1 Annual GDP growth projections by region (%)



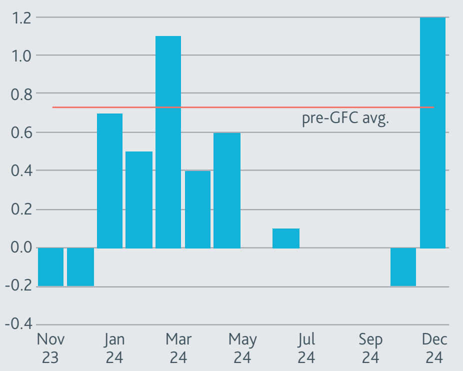
Source: IMF, Jan 2025

3.2 G7 annual GDP forecasts (%)



Source: IMF, Jan 2025

3.3 Rolling 3m UK economic growth (%)



Source: ONS, Oct 2024

Manufacturing output shrank by 0.7% in the three months to December 2024 and decreased by -1.2% in the 12 months to November. Output increased in only three of the 13 manufacturing subsectors. The largest positive contribution in that time from the manufacture of computer, electronic and optical products. Construction output is estimated to have grown by 0.2% in the three months to November. An increase in new construction work was driven by a 5.8% increase in new private industrial work (see Chart 3.4).

The new Government is so far struggling to make good on its promised focus on growth. Although the economy is now 3.1% above its pre-pandemic level, it is also 6.3% below its potential level based on the assumption that output continued at its post-GFC trend rate during Covid and its aftermath. Manufacturing is -9.7% below its February 2020 level (see Chart 3.5).

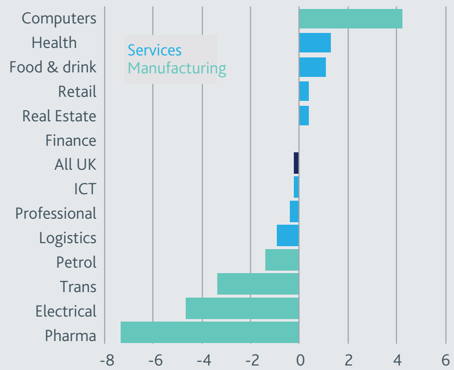
In the November's Monetary Policy report the Monetary Policy Committee (MPC) projects that four-quarter GDP growth will rise to almost 1.75% by the end of 2025 before falling slightly to 1.4% in the last year of the forecast. GDP growth in 2025 is projected to be stronger than in the August Report due to looser fiscal policy and lower interest rates. In addition, the measures announced in the Autumn Budget 2024 are expected to boost GDP by around 0.75% in the next 12 months, relative to the MPC's August projections. (see Chart 3.6).

Year on year CPI inflation peaked at 11.1% in October 2022 but fell to 1.7% in September as the MPC tightened monetary policy. After rising to 2.6% in November, driven by stronger core goods and food inflation, it fell back to 2.5% in December.

Core inflation excluding energy, food, alcohol and tobacco fell from 3.2% in September to 2.5% in December and is now only just above its long run average of 2.2%. Similarly, service sector CPI inflation which peaked at an annual 7.5% in the middle of 2023 has now fallen to 4.4% at the end of December from 4.9% in September (see Chart 3.7).

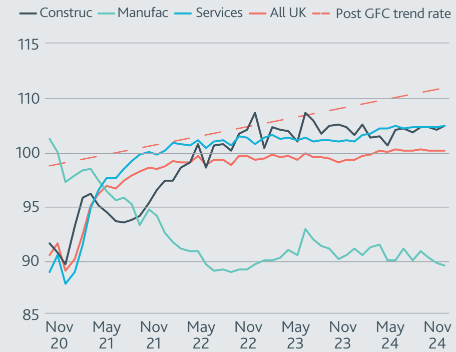
The largest contributor to December's CPI number came from the hospitality sector as the annual inflation rate for restaurants and hotels decreased to 3.4% in December 2024. This is down from 4.0% in November and is the lowest annual rate since July 2021. The largest downward contribution to the annual change in inflation came from the Transport sector and was mainly the result of changes in the pricing of motor fuels and second-hand cars, combined with a downward effect from air fares.

3.4 3m economic growth by sector (%)



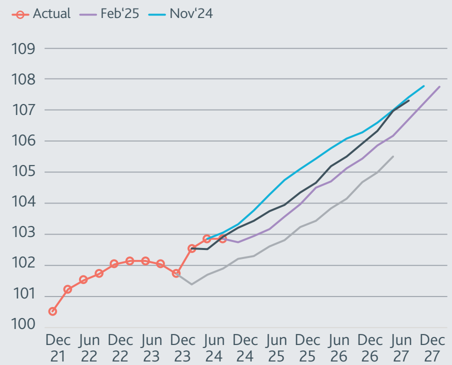
Source: ONS, year to November 2024

3.5 UK economic growth indices (Feb 2020=100)



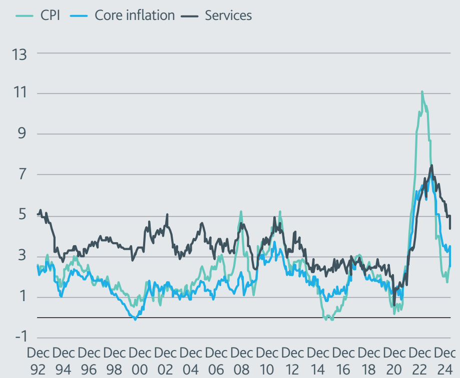
Source: ONS, Jan 2025

3.6 Actual GDP index and MPC forecasts Nov'23 – Aug'24



Source: ONS & Bank of England, Nov 2024

3.7 CPI inflation (%pa)



Source: ONS, Jan 2025

The annual rate of food price inflation increased to 2.0% in December from 1.8% in September but had previously peaked at 19.2% in March 2023. Downward contributions came from bread and cereals and mineral waters, soft drinks, and juices. Upward contributions came from fruit and sugar, jam, honey, syrups, chocolate, and confectionery (see Charts 3.8 & 3.9).

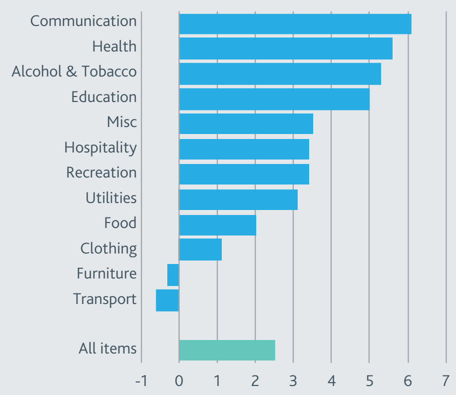
The annual rate of growth in employee earnings across the country rose again in Q4. Pay excluding bonuses increased by 5.6% in the three months to December compared to the previous year, a reduction from 6.0% recorded in September. Real regular pay growth increased to 2.2% in the year to November from 1.5% in August. The MPC follows this key metric closely and is now concerned that what it calls the "second round effects" of domestic prices and wages may now take longer to unwind (see Chart 3.10).

November's Monetary Policy Report correctly assessed that CPI inflation would rise towards the end of 2024. It is projected to rise further to around 2.75% by the second half of 2025 as the impact of falling energy prices diminishes. Thereafter, CPI inflation is projected to return to around 2% in the medium term (see Chart 3.11). The MPC considers that the main risks to this outlook come from higher commodity prices and disruption to trade flows associated with developments in the Middle East, alongside other significant geopolitical uncertainties, leading to weaker economic activity as well as greater external inflationary pressures. This may be code for the possible economy consequences of Mr Trump's presidency.

In its Autumn Budget, the Government announced increases to Employer's National Insurance Contributions (NICs) as well as significant changes to the minimum wage. From April, the National Minimum Wage for 16-17 year olds and apprentices will rise by 18% and by 16.3% for 18-20 year olds. The National Living Wage for everyone over 21 increases by 6.7%. The Treasury estimates that this will benefit more than 3 million workers out of a total workforce of 33.78 million.

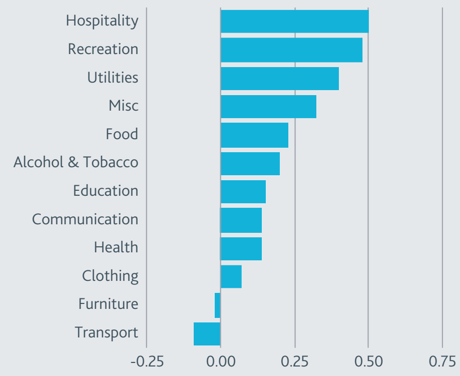
In the MPC's view, the Budget will also boost CPI inflation by "just under 0.5% at the peak". There is a risk that changes in the overall cost of employment for firms lead to greater cash-flow constraints for some businesses, particularly SMEs. The impact depends on how quickly the tax increase is transmitted into prices, wages, employment, or profit margins. The MPC's projections assume a small upward impact on company prices and, interestingly, a small downward impact on wages over the forecast period. There could also be upside risks by encouraging people into employment and increased consumer expenditure.

3.8 Inflation by sector (%) year to Dec 2024



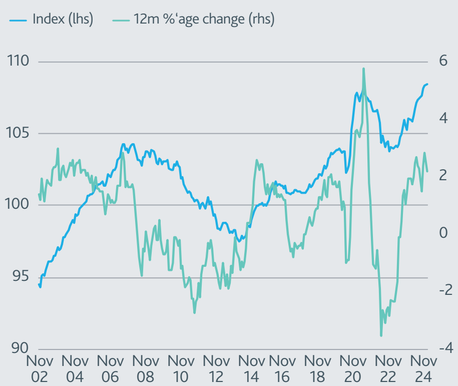
Source: ONS, Jan 2025

3.9 Contributions to Inflation by sector (%) year to Dec 2024



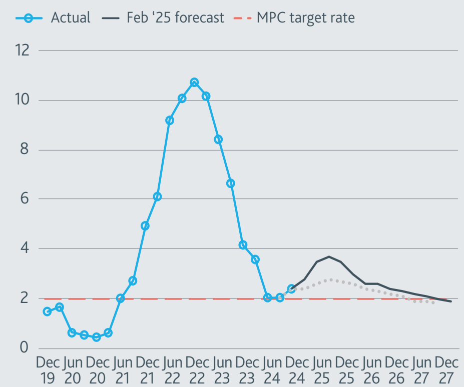
Source: ONS, Jan 2025

3.10 Real pay index, sa (May 2005=100)



Source: ONS, Jan2025

3.11 3.5 Annual CPI and MPC forecasts



Source: ONS & Bank of England, Jan 2025

4. Stock markets, interest rates & asset yields

The MSCI World Index, with large and mid-cap representation across 23 developed markets, completed a second consecutive strong year although performance decreased slightly from 21.2% in 2023 to 19.7% in 2024 on a hedged GBP basis. In USD terms the index gained 17.6% in 2023 and 21.1% in 2024. Performance was driven by the US which now makes up 70% of the index and the information technology sector which rose by 34%.

The FTSE 100 had a disappointing 2024 with gains of 5.7%. The market ended the year weakly, falling in Q4 following a rise in long-term bond yields, growing concerns about the new UK government's fiscal policies unveiled in its Autumn Budget and the UK macro-economic outlook.

European markets were supported as the European Central Bank (ECB) cut interest rates by 25 basis points in both October and December. ECB President Christine Lagarde signalled more cuts to come in 2025 as the single currency area wrestles with lacklustre growth. However, political instability in France and Germany as well, worries over trade wars after Donald Trump won the US election and fears of recession, drove markets down in Q4 and the Eurofirst 300 ended the year with modest gains of 6.75%

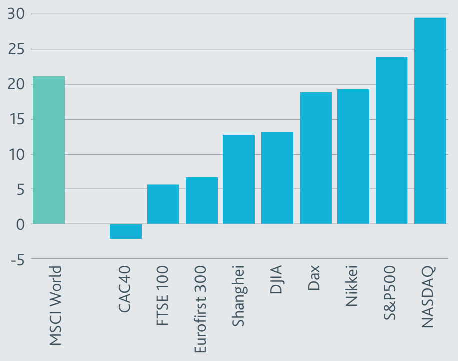
US shares rose higher in Q4 driven by Trump's election and Republican control of Congress.

The Fed's interest rate cuts were offset by concerns about persistent inflation, but the NASDAQ rose 29.6% in 2024 and the S&P500 finished the year 23.8% higher. Communication services, IT, and consumer discretionary sectors led the gains.

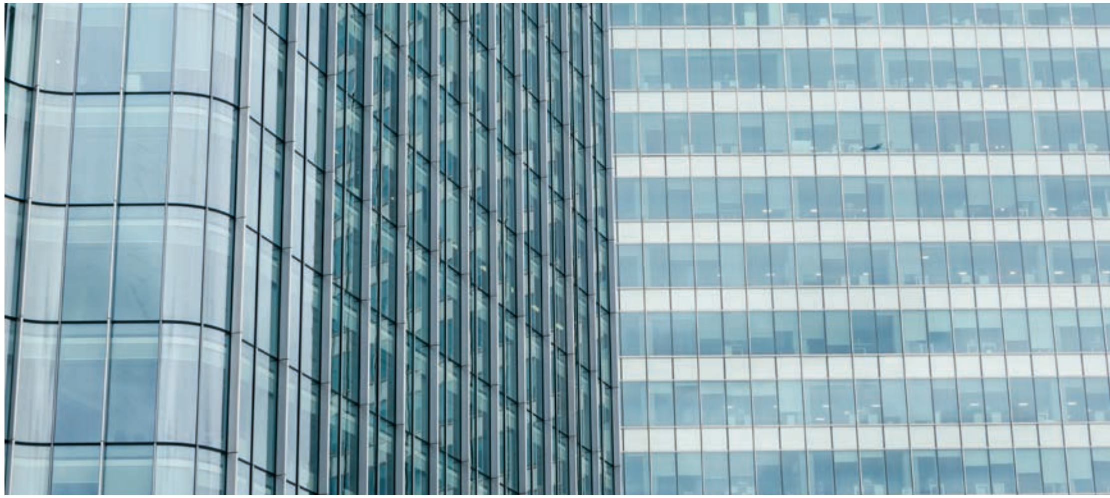
The Japanese equity market experienced gains of 5.2% during the fourth quarter and 19.2% in 2024. Weakness in the Yen bolstered the earnings outlook for large-cap exporters, allowing the market to finish the year on a high note. This optimism may not survive for much longer should President Trump's threatened tariffs become a reality. The prospect of heightened tensions with the US over trade and technology caused markets in China and Hong Kong to experience sharp declines in the fourth quarter (see Chart 4.1).

It was another strong year for tech stocks in 2024 supported by a strong economy in the US, investor appetite for AI and a 100 bp reduction in the Federal Funds Interest Rate to 4.5%. Trumps campaign promises of lower taxes and deregulation further boosted markets in November. But the Fed dampened the euphoria in December by warning of the persistence of inflation and signalled that only two further cuts of 25 bps could be expected in 2025. As a result, the dollar rose to two-year high and US and international markets were sold off.

4.1 World stock markets in 2024 (%'age growth)



Source: Yahoo Finance, Jan 2025



Post year-end, following news of start-up DeepSeek's AI advances, Technology stocks fell globally. The Nasdaq Composite dropped 3.0% but rebounded by 2% the next day. Nvidia saw a 9% increase after a 17% drop that erased $589bn from its market value.

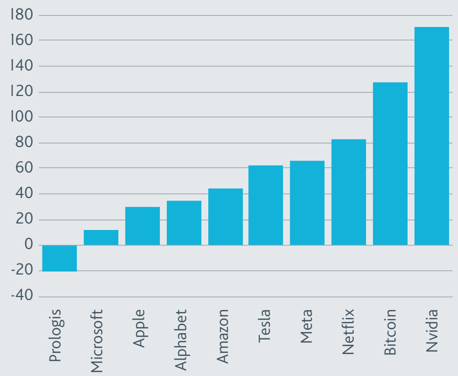
Investors in Prologis suffered from some unexpected volatility in 2024. Its share price fell again by -16.3% in Q4 having risen 12.4% a quarter earlier and fallen -13.8% in Q2 and ended the year down -20.7%. The largest logistic and warehouse real estate company in the world published one of its regular market insights in November noting that its logistics customers still had excess capacity, maintaining upward pressure on vacancy rates and downward pressure on market rents. However, it predicts that vacancy rates for large facilities greater than 500,000 square feet will fall by 100 bps or more in the US and Europe. Resumed expansion by large users who delayed decision-making in recent years, coupled with an approximately 65% year-on-year drop in new development completions, will produce a scarcity of large logistics buildings in many markets by the end of 2025 (see Chart 4.2).

If the performance of the FTSE REIT index provides any insights on the future performance of the underlying direct property market, next year is set to be disappointing for those who have been confidently pointing to a recovery (see Chart 4.3). The REIT index had outperformed the wider all share market in Q3 by 3.5 percentage points driven by expectations that lower interest rates and risk-free rates would lead to improved market conditions. But in Q4 the REIT index fell -15.8% and ended the year down -16.0% as gilts were sold off by investors and benchmark risk free yields softened.

Segro's share price fell by -19.8% in Q4 and -20.9% over the 12 months to December. The UK's largest real estate company said that the industrial and logistic occupier market had been quiet due to economic and political uncertainties but noted growing interest from occupiers in high-quality spaces in strong locations. Investors are also becoming more selective, mirroring the discerning approach of occupiers. Despite the economic headwinds Segro believes that the fundamentals of the sector remain strong benefiting from a diverse occupier base spanning various industries. Growth in 2025 is expected to be driven in particular by data centres and aviation. All Segro's 1.2 million sq.ft. of assets at Heathrow are fully let.

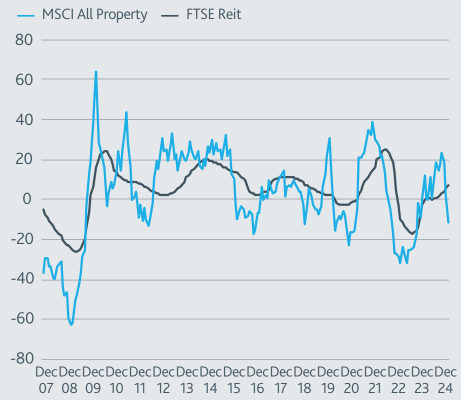
Land Securities share price fell by -10.3% in Q4 and -17.1% in 2024 but continued with its strategy of acquiring flagship shopping malls believing that the re-pricing of the sector is finally completed. During Q4 it announced its acquisition of Liverpool ONE. The REIT now owns seven out of the top thirty performing retail destinations in the UK. Their approach is to focus on these best-in-class destinations which continue to attract both brands and consumers. During the key Christmas period spending across Landsec's retail destinations increased by 3.8% year-on-year compared to the British Retail Consortium average spending growth of 0.4% (see Chart 4.4).

4.2 Tech & other selected stocks in 2024 (%'age growth)



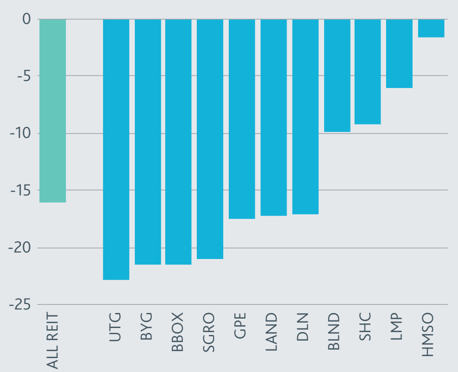
Source: Yahoo Finance, Jan 2025

4.3 Long term 12m total returns



Source: Yahoo Finance & MSCI, Jan 2025

4.4 UK REIT price movement in 2024 (%'age growth)



Source: Yahoo Finance, Jan 2025

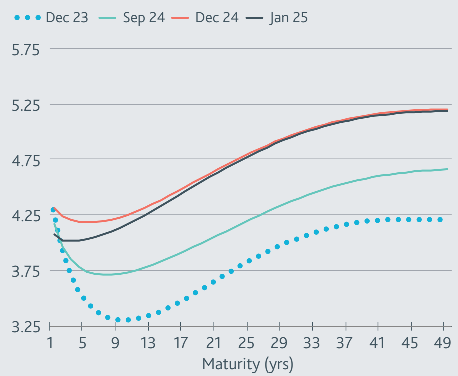
> "In Q4 the REIT index fell -15.8% and ended the year down -16.0% as gilts were sold off by investors and benchmark risk free yields softened."

As examined above, there was a deterioration in the macro-economic background in the final quarter of last year. The CPI inflation rate picked up from 1.7% in September to 2.6% at the end of November putting pressure once again on the pricing of UK risk-free assets. (see Charts 3.5 & 3.6). The yield on the 5-15 year gilt index softened by 57 bps in the fourth quarter and ended the year at 4.57%. This is reflected in the total return performance on the FTSE Actuaries 5-15 year gilt index in Q4 of -3.2%. Over the last 12 months, the gilt index has provided total returns of -3.1% and Q4's yield is 97 bps higher than it was at the start of the year.

As risk free rates expanded in Q4, the All Property initial yield itself hardened by 12 bps. Consequently, the property initial / gilt yield gap decreased by 70 bps to 0.76% (see Chart 4.7). After the shocks in the gilt market in Q4, UK CRE once again looks to be priced above fair value. Should gilt yields remain at their current level, it is possible that the nascent recovery in commercial property values will slow in 2025.

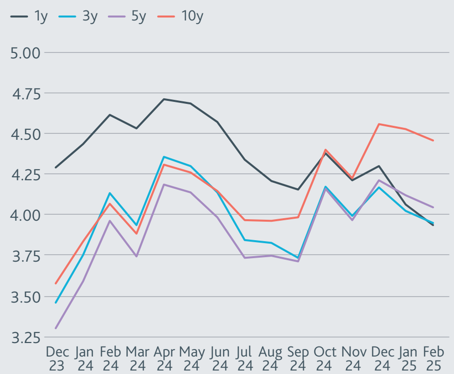
Direct property continues to offer a competitive income return compared to other UK asset classes. But gilts are now yielding more than 4.5% without the risk of holding and managing the assets and the dividend yield on REITs of 5.4% is attractive with the share price currently implying some large discounts to Net Asset Value (see Chart 4.8).

4.5 Gilt yield curve (%)



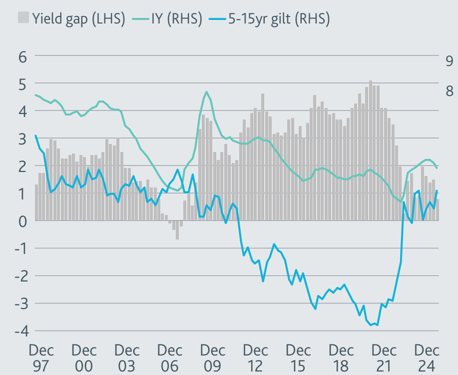
Source: Bank of England, Jan 2025

4.6 UK gilt yields



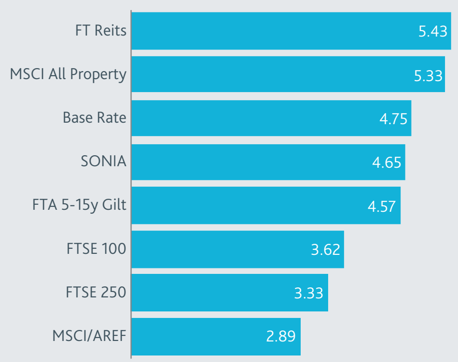
Source: Bank of England, Jan 2025

4.7 Property IY – Gilt yield gap (%)



Source: MSCI & Bank of England, Jan 2025

4.8 UK asset yields Q4 2024 (%)



Source: Yahoo Finance & MSCI, Jan 2025

5. Commercial property market performance

In Q4, All Property total returns, as recorded by the MSCI Monthly Index, increased by 100 bps to 2.8% from 1.8% in Q3. Capital values rose by 1.3% compared to a rise of 0.3% three months earlier. Property equivalent yields softened by 5 bp and contributed to a 0.6% increase in valuations. All Property market rental value growth in Q4 remained 0.9% as it was in Q3. Fourth quarter income returns amounted to 1.4% (see Charts 5.1 & 4.4).

Over the course of the fourth quarter, rental growth across the main commercial sectors in their widest sense showed retail increased to 0.7% from 0.4% in Q3 and offices remained stable at 0.4%. Industrial rental value growth increased to 1.5% from 1.4% a quarter earlier. Market rental values for shopping centres and retail warehouses remain positive but there is little improvement in rental values for the traditional high street shop segments (see Charts 5.2 & 4.5).

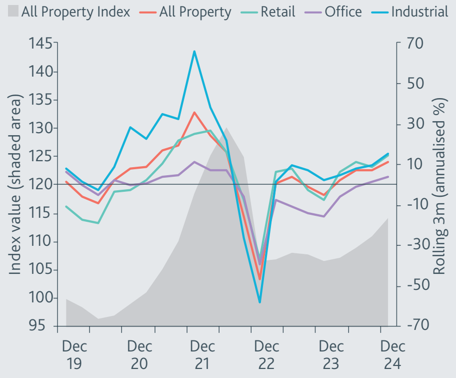
> "Year-on-year All Property capital growth finally turned positive in Q4 for the first time since October 2022, increasing to 1.1% in December from -2.8% in September."

In the 12 months to the end of December, All Property total returns increased to 7.0% from 2.9% in the 12 months ending September as a weak set of data in Q4 2023 was removed from the calculations.

Year-on-year All Property capital growth finally turned positive in Q4 for the first time since October 2022, increasing to 1.1% in December from -2.8% in September. Property equivalent yields have softened by 6 bps in the 12 months to December and contributed to a 1.4% drop in valuations over the course of the last 12 months. All Property rental values increased year-on-year by 3.3% and income return amounted to 5.9%.

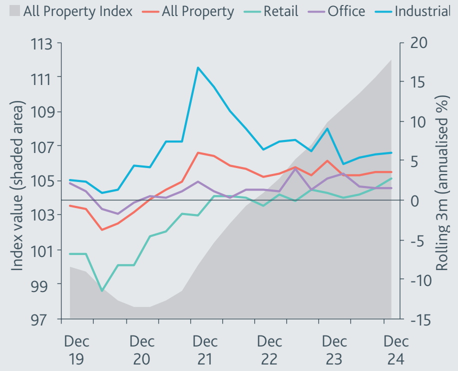
In the last three months, equivalent yields across all three sectors have hardened. Any downward adjustment has been limited for retail and industrials, but the office sector which suffered from a strong de-rate of 30 bps in September, re-rated in December by 21 bps. Office values have decreased by more than 33% since the downturn started in June 2022 but the latest data seems to suggest that the adjustment has at least temporarily run its course (see Charts 5.3 & 4.6).

5.1 Total returns (%) by sector



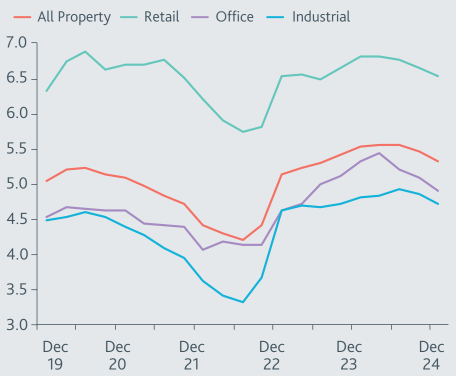
Source: MSCI, Jan 2025

5.2 MRV growth (%) by sector



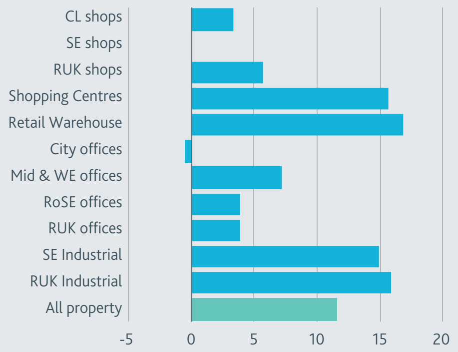
Source: MSCI, Jan 2025

5.3 Initial yield (%) by sector



Source: MSCI, Jan 2025

5.4 Total returns (%) by segment – Q4 2024 annualised

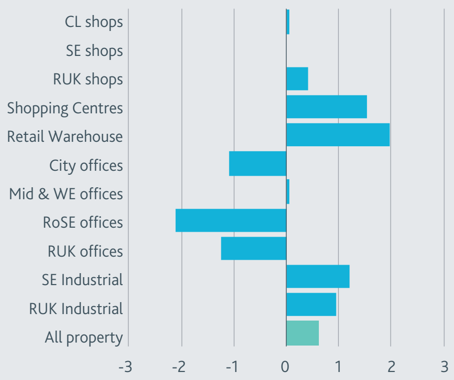


Source: MSCI, Jan 2025

Up until the end of August, the pace of recovery had been disappointing. The aftermath to previous downturns in both 1991-92 and 2008-09 was a period of vigorous capital growth. This has so far been lacking from the latest episode. (see Chart 5.7). But it now seems likely that cuts to the Bank Rate in August and November gave further impetus to any upswing. Confidence will also have been bolstered by a speech from the Governor of the Bank of England, Andrew Bailey, saying he was encouraged that inflationary pressures had not been as persistent as feared and holding out the prospect of the MPC becoming a "bit more aggressive" in cutting interest rates. Whether this more aggressive approach to monetary loosening survives after the latest moves on the capital markets and the return of Trumponomics is questionable. The next Bank of England rate decision will be announced on 20th March.

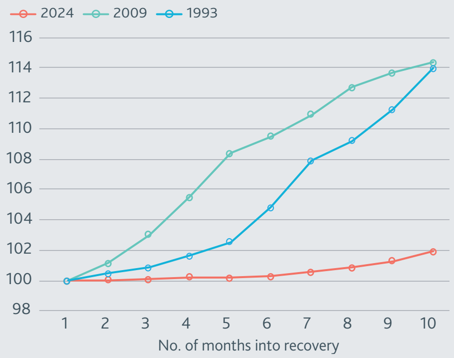
Tables 5.8 – 5.12 contain further performance data for UK commercial real estate in Q4 2024.

5.6 Yield impact (%) – Q4 2024



Source: MSCI, Jan 2025

5.7 The pace of recovery from market downturn by month



Source: MSCI & APR, Jan 2025

5.8 Total returns (%)

	Dec	3m	6m	12m
All Property	1.1	2.8	4.6	7.0
Retail	1.3	3.5	5.8	10.4
Office	0.5	1.0	1.4	-0.2
Industrial	1.3	3.6	6.0	9.2
Annualised				
All Property	14.0	11.5	9.4	7.0
Retail	16.8	14.7	11.9	10.4
Office	6.0	4.3	2.8	-0.2
Industrial	16.7	15.2	12.3	9.2

Source: MSCI, Jan 2025

5.9 Capital growth (%)

	Dec	3m	6m	12m
All Property	0.6	1.3	1.7	1.1
Retail	0.7	1.7	2.2	3.0
Office	0.1	-0.3	-1.3	-5.7
Industrial	0.9	2.3	3.4	3.9
Annualised				
All Property	7.7	5.4	3.4	1.1
Retail	9.0	7.0	4.4	3.0
Office	0.7	-1.2	-2.6	-5.7
Industrial	11.2	9.7	7.0	3.9

Source: MSCI, Jan 2025

5.10 Income return (%)

	Dec	3m	6m	12m
All Property	0.5	1.4	2.9	5.9
Retail	0.6	1.8	3.5	7.2
Office	0.4	1.4	2.7	5.8
Industrial	0.4	1.2	2.5	5.1
Annualised				
All Property	5.8	5.9	5.9	5.9
Retail	7.2	7.2	7.2	7.2
Office	5.3	5.6	5.6	5.8
Industrial	5.0	5.0	5.1	5.1

Source: MSCI, Jan 2025

5.11 ERV growth (%)

	Dec	3m	6m	12m
All Property	0.3	0.9	1.8	3.3
Retail	0.3	0.7	1.0	1.3
Office	0.1	0.4	0.8	2.1
Industrial	0.6	1.5	2.9	5.5
Annualised				
All Property	4.3	3.6	3.5	3.3
Retail	3.8	2.7	2.1	1.3
Office	1.2	1.6	1.6	2.1
Industrial	7.4	6.0	5.9	5.5

Source: MSCI, Jan 2025

5.12 Net initial yield (%)

	Dec	3m	6m	12m
All Property	5.3	5.5	5.6	5.5
Retail	6.5	6.7	6.8	6.8
Office	4.9	5.1	5.2	5.3
Industrial	4.7	4.9	4.9	4.8

Source: MSCI, Jan 2025

6. Investment in property

Reflecting a possible improvement in investor sentiment, All Property investment volumes, represented by the current value of investment transactions adjusted for capital growth, increased by 8% in Q3 compared to Q2. This was the first rise in activity in a year, admittedly off a low base. Nevertheless, third quarter transaction volumes were still -34% below their long run average. Illustrating that the transition to increased liquidity will not be a smooth journey, preliminary estimates suggest that investment volumes in Q4 decreased by 11% and were 41% below the long run average. As usual the latest numbers for Q4 are likely to be revised in the coming months (see Chart 6.1).

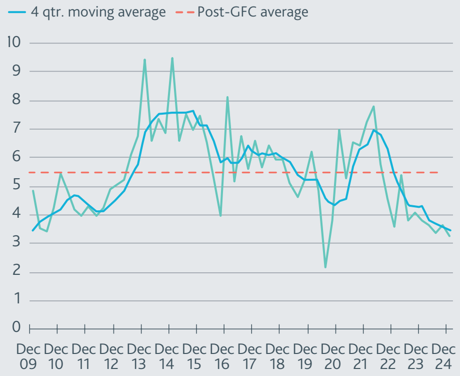
Retail made up 41% (by number) of investment transactions in Q3; offices represented a further 20% and industrials made up the remaining 38%. Preliminary figures for the whole year indicate that the retail sector accounted for 44% of transactions; offices 23%; and industrial 34%. Retail, office and industrial investment volumes so far recorded in Q4 are all lower than in Q3 (see Chart 6.2). Total investment volumes so far recorded for 2024 were also disappointing (see Chart 6.3).

> "In the last quarter of 2024, Central London office transaction volumes improved by a further 2%."

In a reflection of the upturn in the broader All Property investment market, volumes in the UK's key Central London office market increased by 37% in Q3 compared to Q2 but third quarter transaction volumes were still -57% below their long run average. Preliminary estimates for Q3 indicate that the momentum has carried into Q4. In the last quarter of 2024, Central London office transaction volumes improved by a further 2% (see Chart 6.4).

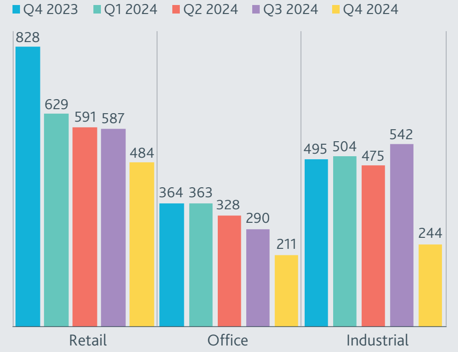
Midtown and West End made up 53% (by number) of Central London office investment transactions in Q3; City offices represented 28% and Fringe offices made another 19%. Preliminary figures for the whole year indicate that Midtown and West End accounted for 61% of transactions; the City 12%; and the Fringe markets of Docklands, Southbank and City fringe 27%. Central London investment volumes so far recorded in Q4 have decreased further across all sub-markets (see Chart 6.5). Reflecting the trend in the wider investment market, Central London office investment volumes so far recorded for 2024 were again disappointing (see Chart 6.6).

6.1 All property investment volumes (£bn)



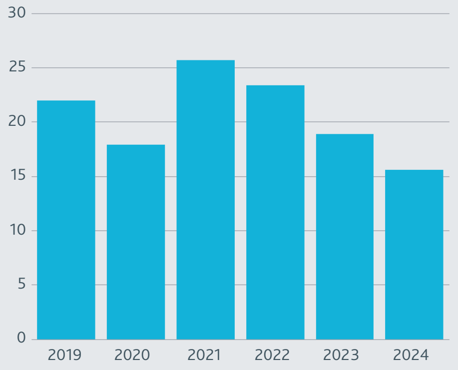
Source: CoStar, MSCI & APR, Jan 2025

6.2 UK investment transaction nos. by quarter



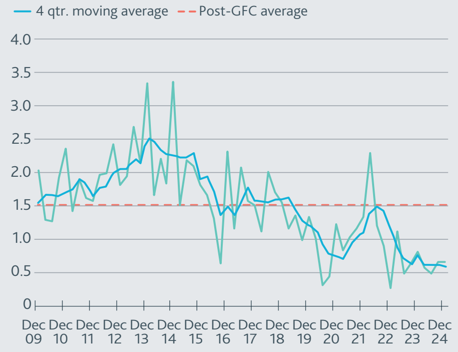
Source: CoStar, MSCI & APR, Jan 2025

6.3 UK investment volumes by year (£bn)



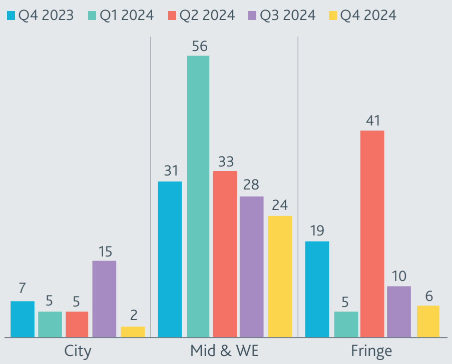
Source: CoStar, MSCI & APR, Jan 2025

6.4 Central London office investment volumes (£bn)



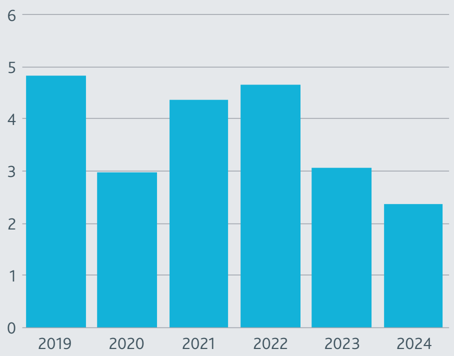
Source: CoStar, MSCI & APR, Jan 2025

6.5 Central London Office transaction nos. by quarter



Source: CoStar, MSCI & APR, Jan 2025

6.6 Cumulative Central London office investment transactions by year (£bn)



Source: CoStar, MSCI & APR, Jan 2025

7. Office focus

Office markets across the UK are being shaped by working from home and the push for net zero.

Despite directives from head offices mandating five day a week attendance for investment bankers, a hybrid approach to the working week has evolved across most other business sectors. Typically, an employee may be required to clock in at the office around three times a week.

Demand for ESG-friendly offices requires a workplace that is sustainable, socially responsible, and well-governed.

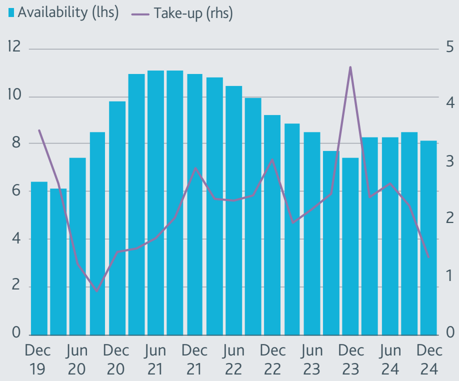
Post Covid, these two dynamics have been driving many businesses to reduce their office footprint and consolidate in better quality space. This has lessened the demand for sub-prime stock.

7.1 Central London offices

Occupational view

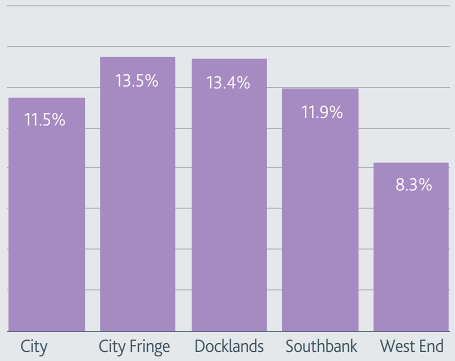
Average rents remain under downward pressure. Availability is increasing and take-up falling. Consequently, vacancy rates remain elevated and average rental levels have been falling post Covid. At the very top-end of the market rents are stable.

7.1 Central London office availability (m sf)



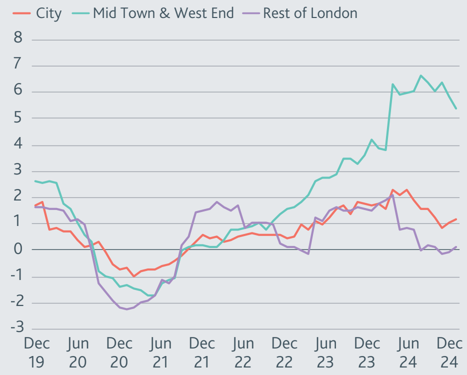
Source: CoStar, January 2025

7.2 Vacancy rates (%)



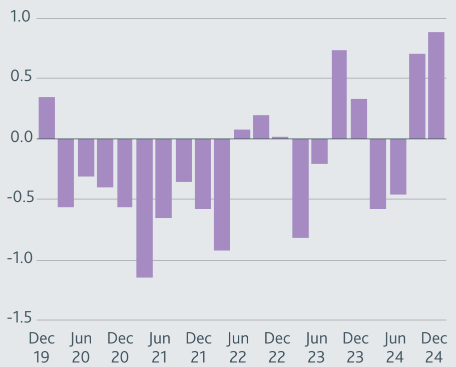
Source: CoStar, January 2025

7.3 12m market rental growth (%)



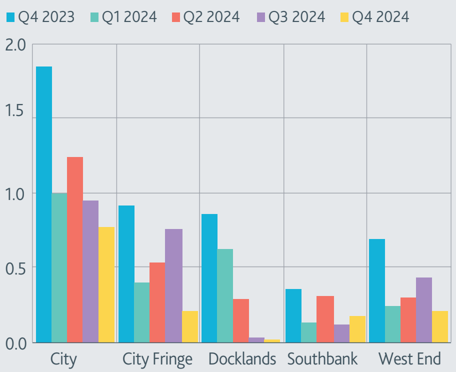
Source: MSCI, January 2025

7.4 Net absorption (m sf)



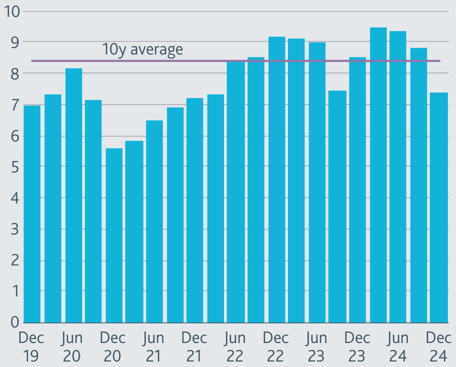
Source: CoStar, January 2025

7.5 Q3 2024 Quarterly take-up (m sf)



Source: CoStar, January 2025

7.6 Under construction (m sf)



Source: CoStar, January 2025

Office development activity is focused on the "Square Mile". The City of London accounted for almost 50% of all construction in the fourth quarter. Westminster has tighter planning regulations and West End development represents just 20% of total Central London activity.

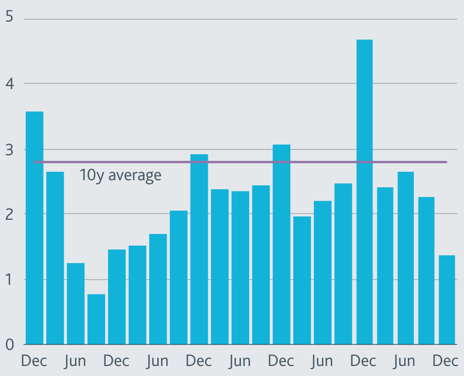
Occupiers demanding modern ESG friendly space have been attracted by the modern buildings coming out of the ground in the City. In Q4 the City supplied 56% of all offices let and 45% in the calendar year.

The more plentiful supply of this key product in the City means that headline rents are £85 psf, whilst in the West End they are at £137 psf.

The emergence of Cat A+ offices has enabled landlords to demand a premium rent for a turn-key product that has been fully fitted out with desks, meeting rooms and IT. These premium rents may be disguising some of the falls in average rents for mid-tier stock.

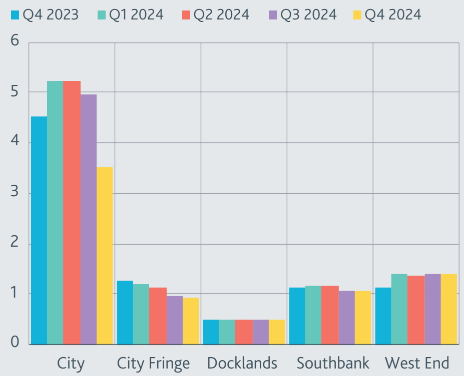
> "Nearly half of all office space let in 2024 in central London was in the City, with occupiers attracted by the modern buildings coming out of the ground."

7.7 Central London take-up (m sf)



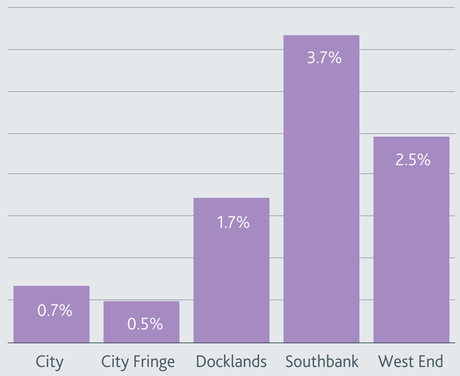
Source: CoStar, January 2025

7.8 Central London under construction (m sf)



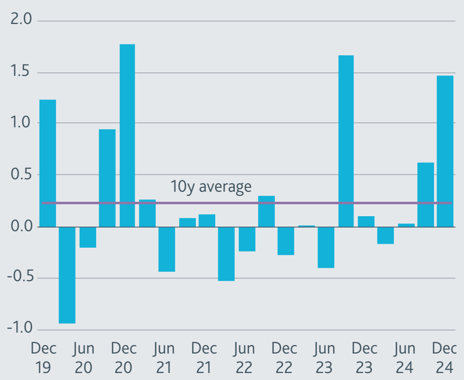
Source: CoStar, January 2025

7.9 12m MRV growth (%)



Source: CoStar, January 2025

7.10 Net completions (m sf)



Source: CoStar, January 2025

Investment view

Across Central London the investment market for offices has been improving since the second half of 2023. But no sub-markets, even the best performing West End, are yet sharing year-on-year capital growth in this cycle.

Institutions and Sovereign Wealth Funds which dominate the market for £100m+ assets remain reluctant to call the bottom of the market and are probably more focused on the current geo-political uncertainties and interest rate contortions.

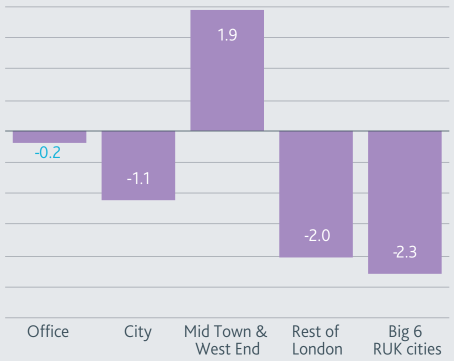
However, there is evidence that smaller and more nimble PropCos are increasingly interested in assets priced in the tens of millions offering a value-add opportunity for permitted changes of use away from offices. Examples include, hotel operator, JMK, acquiring St. Clements House, EC4, and Criterion Capital securing 1 Princes Street, EC2, again for a hotel conversion. Investors will also consider conversions to residential and even student accommodation.

With capital values still falling, buildings will eventually become viable for retro-fitting to meet current occupier requirements and trends, including demand for CatA+ premises.

The weaker pound may now encourage more overseas investors back into the market.

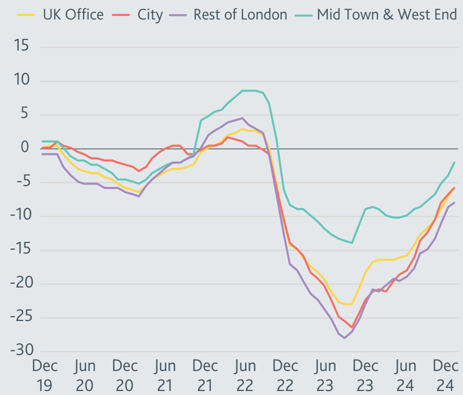
Globally, funds' appetite for core strategies is regaining traction but riskier value-added strategies still dominate. Within Europe, the UK remains the destination of choice for real estate asset allocators. But demand is for Residential and Industrial/Logistics assets not offices.

7.12 12m total returns Q4 2024 (%)



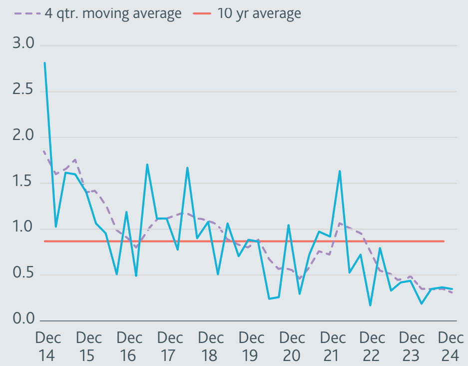
Source: MSCI, January 2025

7.13 12m capital growth (%)



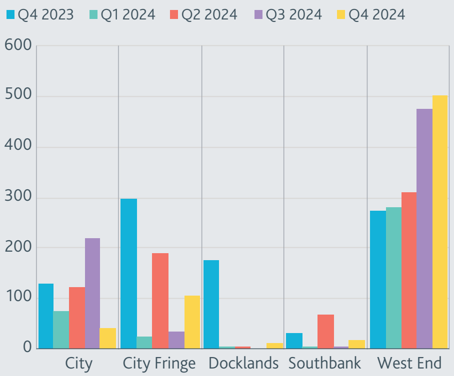
Source: MSCI, January 2025

7.14 Central London office investment volumes (£bn)



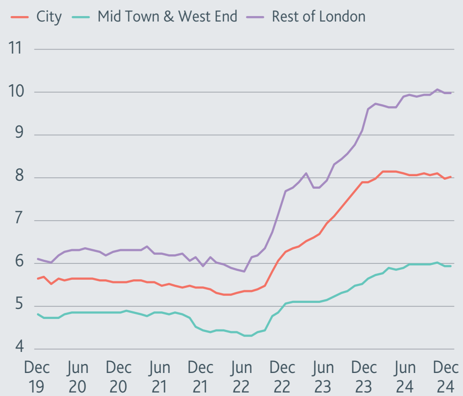
Source: CoStar, January 2025

7.15 Central London office investment volumes (£bn)



Source: CoStar, January 2025

7.16 Equivalent yields (%)



Source: MSCI, January 2025

> "With capital values still falling, buildings will eventually become viable for retro-fitting to meet current occupier requirements and trends, including demand for CatA+ premises."

Central London offices
Summary tables

7.18 Availability (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
City	8.13	8.48	8.97	▼
City Fringe	3.88	3.95	3.64	▼
Docklands	2.75	2.76	2.82	▼
Southbank	2.69	2.38	1.94	▲
West End	3.27	2.68	2.72	▲

Source: CoStar, January 2025

7.19 Take-up (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
City	0.77	0.94	1.09	▼
City Fringe	0.21	0.75	0.41	▼
Docklands	0.02	0.03	0.17	▼
Southbank	0.18	0.12	0.21	▲
West End	0.20	0.43	0.41	▼

Source: CoStar, January 2025

7.20 Vacancy rates

	Q4 2024	Q3 2024	5y avg.	Trending
City	11%	12%	13%	▼
City Fringe	13%	13%	13%	◀▶
Docklands	13%	13%	14%	◀▶
Southbank	12%	12%	9%	◀▶
West End	8%	8%	7%	◀▶

Source: CoStar, January 2025

7.21 Prime rents (£ psf)

	Q4 2024	Q3 2024	Trending
City	£85 psf	£85 psf	◀▶
West End	£137 psf	£135 psf	▲

Source: Cluttons, January 2025

7.22 Completions ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
City	1,424	275	349	▲
City Fringe	37	190	114	▼
Docklands	0	0	22	◀▶
Southbank	0	104	38	▼
West End	0	115	47	▼

Source: CoStar, January 2025

7.23 Construction ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
City	3,527	4,950	4,529	▼
City Fringe	911	949	1,288	▼
Docklands	476	476	357	◀▶
Southbank	1,062	1,062	684	◀▶
West End	1,383	1,383	955	◀▶

Source: CoStar, January 2025

7.24 12m MRV growth

	Q4 2024	Q3 2024	5y avg.	Trending
City	2.4%	2.3%	1.7%	▲
Mid Town	3.0%	4.6%	1.8%	▼
West End	6.4%	5.6%	2.3%	▲
Rest of London	0.4%	0.1%	0.3%	▲

Source: MSCI, January 2025

7.25 Average rents (£ psf)

	Q4 2024	Q3 2024	Trending
City	59.50	58.40	▲
City Fringe	57.50	55.20	▲
Docklands	48.80	47.10	▲
Southbank	62.90	63.20	▼
West End	78.90	77.30	▲

Source: CoStar, January 2025

7.26 Investment volumes (£ bn)

	Q4 2024	Q3 2024	5y avg.	Trending
City	41.76	129.35	685.60	▼
City Fringe	105.53	296.25	228.19	▼
Docklands	12.45	175.00	59.05	▼
Southbank	19.17	31.51	75.66	▼
West End	501.50	272.94	417.20	▲

Source: CoStar, January 2025

7.27 Prime yields

	Q4 2024	Q3 2024	Trending
City	5.50%-5.75%	5.50%-5.75%	◀▶
West End	4.00%-4.25%	4.00%-4.25%	◀▶

Source: Cluttons, January 2025

7.2 Rest of UK offices

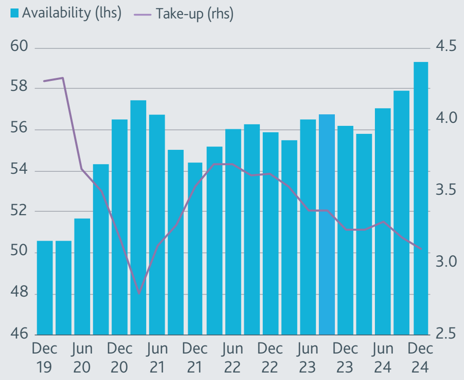
Occupational view

A similar picture of increasing availability and falling take-up is evident in the South East and Rest of UK office markets. Vacancy rates across all the "Big 6" regional office markets are 10% and range from 8% in Leeds and Edinburgh to 12% in Manchester. In the South East, office vacancy rates in Oxford and Cambridge are also 10%.

The Manchester office market has experienced an increase in leasing activity recently, with several large deals for new space being agreed. This includes the Bank of New York Mellon, which signed the largest UK regional office letting in three years in August by leasing the entire 200,000 square feet at Noma's 4 Angel Square. The strong uptake of new buildings has been balanced by tenants moving out of poorer quality and lesser rated buildings.

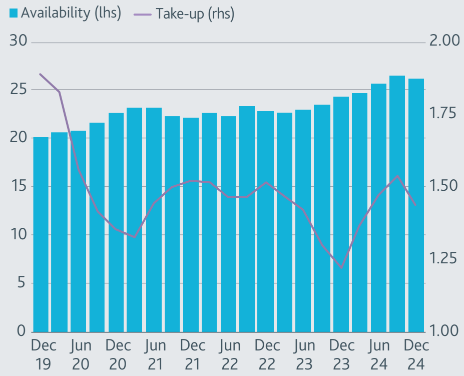
> "The Manchester office market has experienced an increase in leasing activity recently, with several large deals for new space being agreed."

7.28 Rest of UK office availability & Take up (m sf)



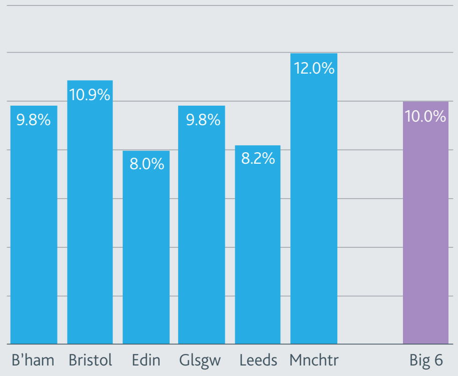
Source: CoStar, January 2025

7.29 South East and Eastern office availability & Take up (m sf)



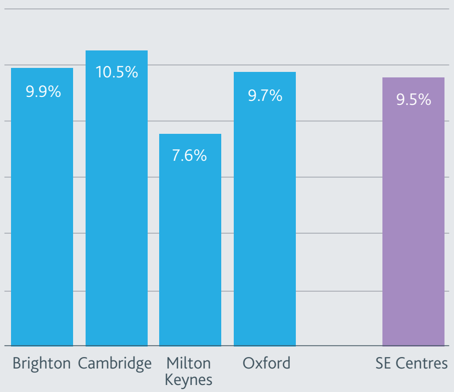
Source: CoStar, January 2025

7.30 Big 6 vacancy rates



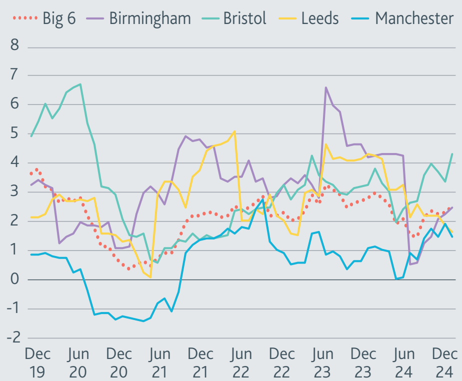
Source: CoStar, January 2025

7.31 South East & Eastern vacancy rates



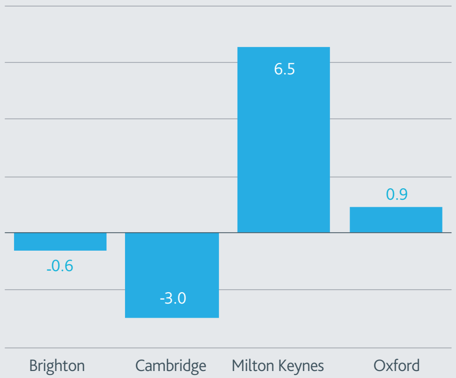
Source: CoStar, January 2025

7.32 12m market rental growth (%)



Source: MSCI, January 2025

7.33 SE Centres - 12m MRV growth (%)

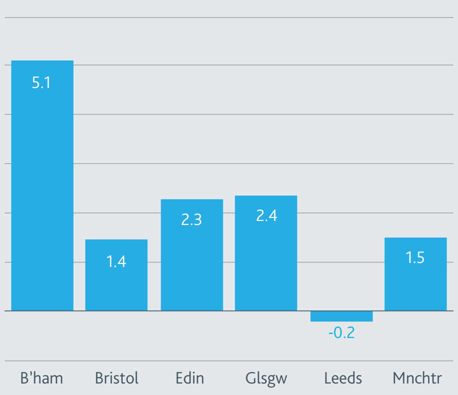


Source: CoStar, January 2025

Prime rents in the UK's "Big 6" grew by an average 2.5% in 2024 led by Bristol where market indices show rental growth of more than 4% in the year to December. Sub-prime assets have continued to see rents falling post Covid.

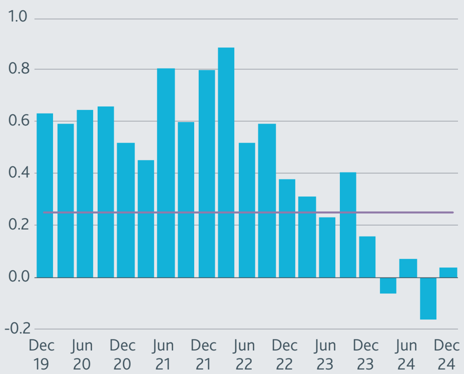
In 2024 net development completions, meaning more new space is being supplied than demolished, have been positive in the South East but neutral in the rest of the UK office market. Away from the major regional centres development activity is very limited.

7.34 Big 6 - 12m MRV growth (%)



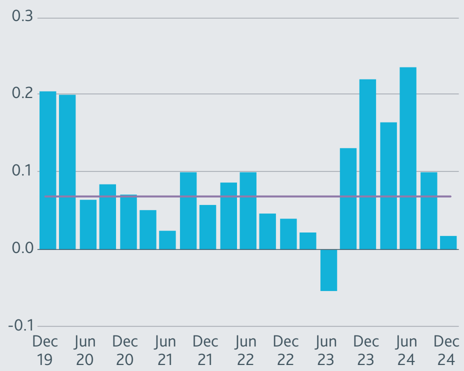
Source: CoStar, January 2025

7.35 Rest of UK net development completions (m sf)



Source: CoStar, January 2025

7.36 SE & Eastern net development completions (m sf)



Source: CoStar, January 2025

> Prime rents in the UK's "Big 6" prime rents grew by an average 2.5% in 2024 led by Bristol where market indices show rental growth of more than 4% in the year to December."

Investment view

Mirroring the property cycle in London, the investment market for regional offices has been slowly recovering since reaching very low volumes at the end of 2023. Nevertheless, market indices show that the average total return performance across all "Big 6" centres remained negative in 2024. The standout exception was Edinburgh where total returns amounted to 5.4% but capital growth was barely positive.

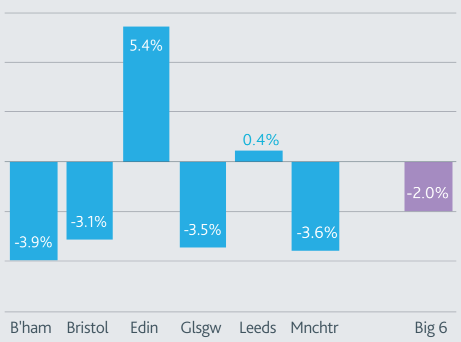
Investment yields for offices may see them stabilising across the board during 2025, whilst prime yields have largely achieved this.

The sale by RER London of Surrey County Hall in Kingston to London Square, a specialist residential developer focused on Greater London, illustrates one of the trends currently at work in the South East's office market.

Over the last five years Manchester has been the recipient of 30% of inward office real estate investment into regional "Big 6" offices. However, in 2024 Bristol became the target for 28% of investment volumes.

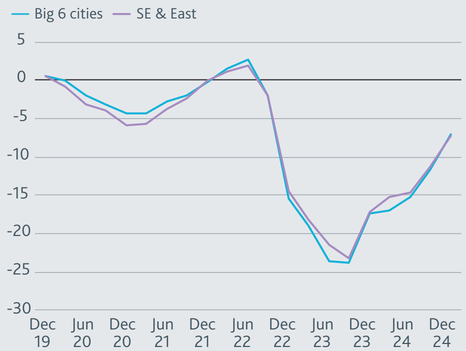
EQ Bristol on Victoria Street completed in 2023 is the city's first development committed to Net Zero and offers 200,000 sf with Restaurants, Bars, Café's and a Fitness Studio together with cycle parking. Headline rents of £48 psf are the highest across all the UK's leading regional markets. It is currently under offer to self-described contrarian, value-oriented UK investor, Melford Capital. The price is estimated to be around £100m which would represent the largest regional office sale of 2024.

7.38 Big 6 - 12m total returns Q4 2024 (%)



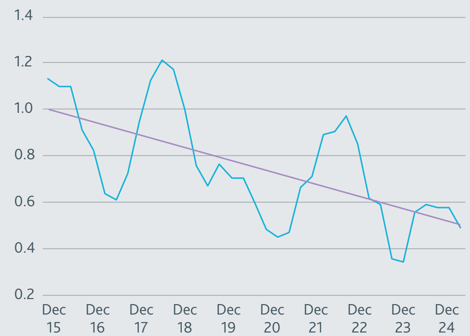
Source: MSCI, January 2025

7.39 Big 6 - 12m capital growth (%)



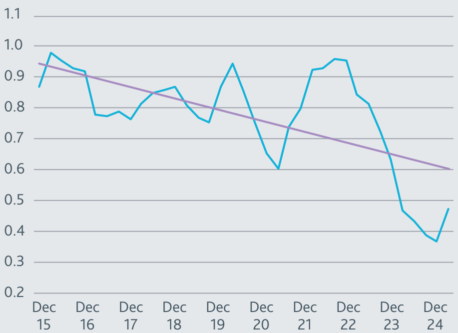
Source: MSCI, January 2025

7.40 Big 6 office investment volumes and trend (£bn)



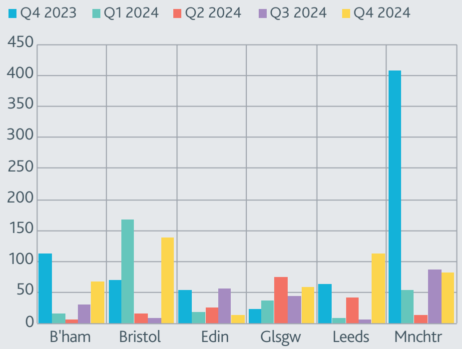
Source: CoStar, January 2025

7.41 South East & Eastern office investment volumes and trend (£bn)



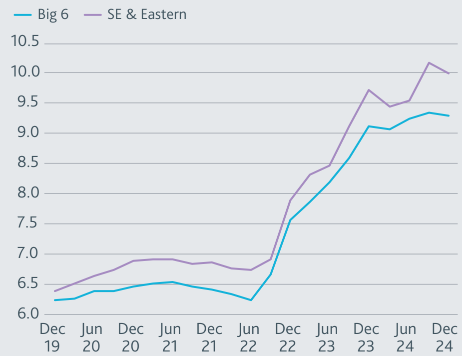
Source: CoStar, January 2025

7.42 Big 6 office investment volumes (£m)



Source: CoStar, January 2025

7.43 Equivalent yields (%)



Source: MSCI, January 2025

> "Market indices show that the average total return performance across all "Big 6" centres remained negative in 2024."

7.44 Featured investment transactions

Building	Price (£m)	Yield	Buyer
EQ, Victoria St. Bristol	103.00	7.25%	Melford Capital
10 Victoria St. Bristol	23.75	7.02%	Schroders
Surrey County Hall	23.75	7.02%	London Square

Source: Cluttons, January 2025

Rest of UK offices

Summary tables

7.45 Availability (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
Big 6	28.08	27.45	25.51	▲
Eastern	8.12	8.10	6.39	▲
Rest of UK	31.24	30.44	30.00	▲
South East	18.04	18.36	16.69	▼

Source: CoStar, January 2025

7.46 Take-up (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
Big 6	1.76	1.81	1.79	▼
Eastern	0.24	0.45	0.41	▼
Rest of UK	1.20	1.36	1.57	▼
South East	0.82	0.96	1.01	▼

Source: CoStar, January 2025

7.47 Vacancy rates

	Q4 2024	Q3 2024	5y avg.	Trending
Big 6	10%	10%	9%	◀▶
Eastern	8%	8%	6%	◀▶
Rest of UK	8%	7%	7%	▲
South East	9%	9%	8%	◀▶

Source: CoStar, January 2025

7.48 Average rents (£ psf)

	Q4 2024	Q3 2024	Trending
Big 6	21.70	21.80	▼
Eastern	21.00	20.80	▲
Rest of UK	14.20	14.10	▲
South East	24.20	24.20	◀▶

Source: CoStar, January 2025

7.49 Completions ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
Big 6	927	477	607	▲
Eastern	52	299	186	▼
Rest of UK	26	72	451	▼
South East	322	36	271	▼

Source: CoStar, January 2025

7.53 Construction ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
Big 6	1,860	2,752	4,723	▼
Eastern	1,187	1,239	1,143	▼
Rest of UK	2,809	2,828	3,176	▼
South East	1,479	1,794	1,962	▼

Source: CoStar, January 2025

7.50 12m MRV growth

	Q4 2024	Q3 2024	5y avg.	Trending
South East	1.4%	1.9%	1.4%	▼
Birmingham	3.2%	3.0%	2.3%	▲
Bristol	3.8%	3.9%	2.6%	▼
Edinburgh	4.6%	4.4%	2.4%	▲
Glasgow	4.4%	4.6%	1.7%	▼
Leeds	4.4%	5.5%	1.9%	▼
Manchester	1.9%	2.9%	1.0%	▼

Source: MSCI, January 2025

7.51 Headline rents (£ psf)

	Q4 2024	Q3 2024	Trending
Manchester	£42.00	£42.00	◀▶
Bristol	£47.00	£47.00	◀▶
Birmingham	£42.00	£42.00	◀▶
Leeds	£37.00	£37.00	◀▶
Newcastle	£32.00	£32.00	◀▶

Source: Cluttons, January 2025

7.52 Investment volumes (£ m)

	Q4 2024	Q3 2024	5y avg.	Trending
South East	461.25	147.10	565.92	▲
Birmingham	67.64	30.28	81.59	▲
Bristol	138.89	8.78	75.19	▲
Edinburgh	14.21	55.71	74.17	▼
Glasgow	58.18	45.18	58.62	▲
Leeds	112.10	7.80	60.28	▲
Manchester	81.56	85.97	151.60	▼

Source: CoStar, January 2025

7.54 Prime yields

	Q4 2024	Q3 2024	Trending
M25 / Thames Valley	7.5%	7.5%	◀▶
Prime Regional Centres	7.0%-7.25%	6.75%-7.0%	▲
Secondary Regional Centres	11.00%+	11.00%+	◀▶

Source: Cluttons, January 2025

8. Industrial focus

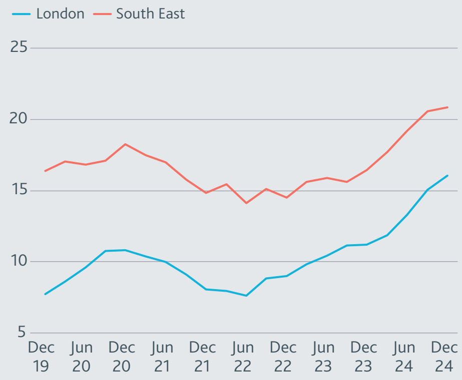
In the space of ten years, the representation of the industrial sector within the UK's All Property institutional commercial real estate market has doubled.

Industrials now contribute 40% by value to market level indices; back in December 2014 the sector amounted to 19%.

In those ten years industrial capital values have grown by 72% whilst the value of the office and retail sectors has fallen by 20% and 36% respectively. The increased weight in industrial is partly the "denominator" effect in action. Namely the value of industrial assets has grown in comparison to those in the retail and office sectors. It is also partly because institutions have actively rebalanced their portfolios driving investment demand.

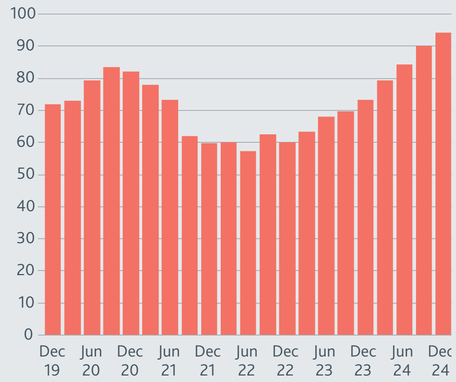
Strong occupational demand for logistics space has driven outstanding levels of rental growth especially during the Covid years when the phrases "last mile" and "fulfilment centres" became familiar. Annual market rental value growth peaked in 2022 at 18% in London and 11% in the South East and Rest of UK and was down to 4% by the end of last year. The slowdown in rental growth has partly been driven by increased occupational costs including business rates and energy.

8.1 London & South East availability (m sf)



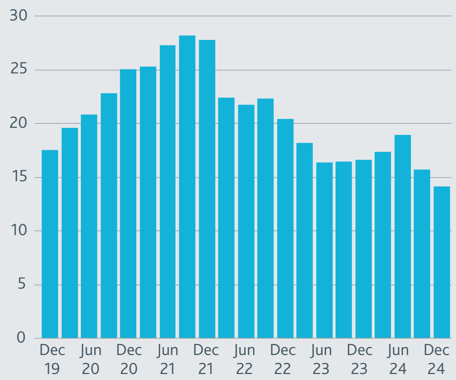
Source: CoStar, January 2025

8.2 Rest of UK availability (m sf)



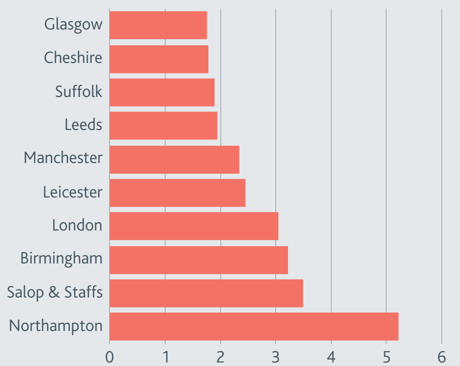
Source: CoStar, January 2025

8.3 Take-up (m sf)



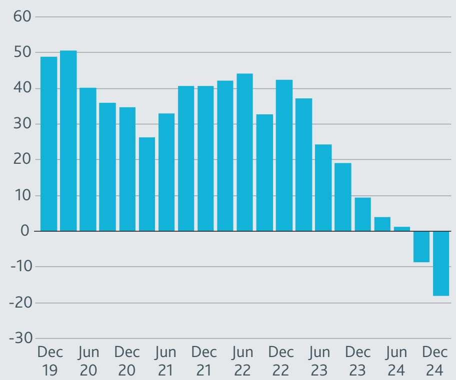
Source: CoStar, January 2025

8.4 2024 take-up by top 10 centres (m sf)



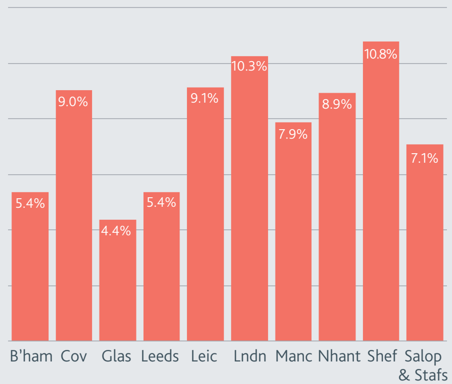
Source: CoStar, January 2025

8.5 All UK 12m net absorption (m sf)



Source: CoStar, January 2025

8.6 Vacancy rates



Source: CoStar, January 2025

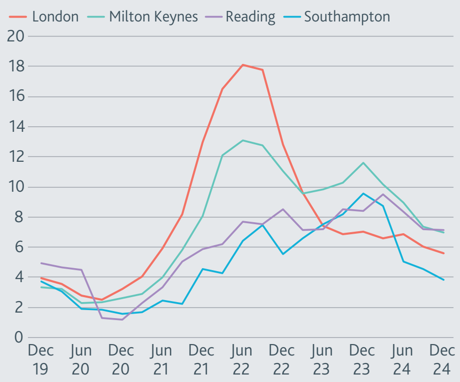
The industrial market is segmented between **Logistics** being 50,000+ sf of warehouse space; smaller **Light Industrial** units for local distribution, and smaller scale manufacturing and repair workshops; and Specialised space for large scale manufacturing, R&D, Cold Storage and data centres. Most of the UK's stock of industrial space belongs to the logistics segment (66%) whilst 26% is **Specialised** and less than 10% Light Industrial.

8.1 Occupational view

Availability of Logistics stock to let across London, the South East and Rest of UK has been increasing since the end of 2022. UK wide take-up of space has been in decline in recent quarters and net absorption has been negative in the last two quarters meaning that more space is being made available than has been let. It is possible that 2024's year of elections created a reluctance to transact against an uncertain geo-political background.

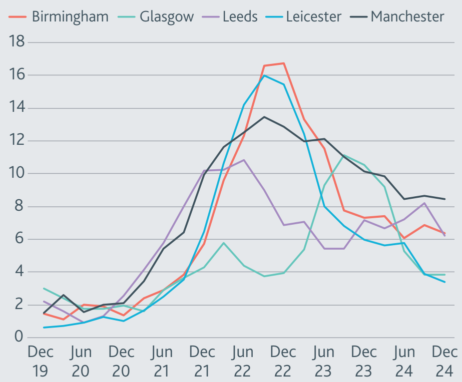
The ONS has recently estimated a "golden logistics triangle" that is within a four-hour drive of 90% of the British population covering 289 square miles in the West Midlands and demonstrates how widespread this market has become. In 2024 the demand for space in the UK's regions was greatest across Northampton but also Shropshire, Staffordshire and around Birmingham, within the ONS's definition.

8.7 12m MRV growth rates



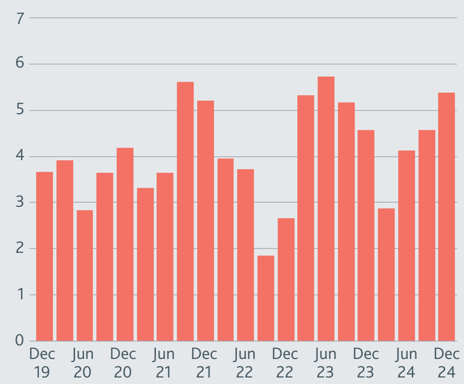
Source: MSCI, February 2025

8.8 12m MRV growth rates



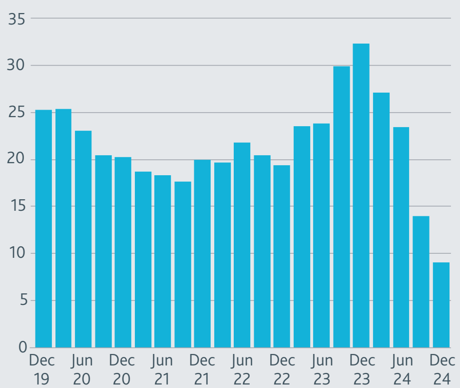
Source: MSCI, February 2025

8.9 London & South East 12m net development completions (m sf)



Source: CoStar, January 2025

8.10 Rest of UK 12m net development completions (m sf)



Source: CoStar, January 2025

Of the 40.3 million sf of logistics space under construction in Great Britain, 15% is concentrated on Northampton. London is the next biggest development centre with 6% of total space under construction. Lidl's Belvedere Distribution Centre in Bexley will provide 470,000 sf at a rent of approx. [£16.50] psf.

Logistics operators have been driven by demands from their retail sector clients to adopt ESG policies leading to an increased demand for green buildings with an A or A+ EPC rating. Operators are setting targets, with DHL for example seeking to achieve 100% net-zero carbon warehousing by 2025. However, the availability of such space is limited and the demand is unlikely to be met soon as the amount of development under construction has fallen from 62 million sf in 2022 to 40 million sf at the end of 2024. A sharp increase in building costs and an almost simultaneous fall in capital values has brought the viability of many proposed schemes into question.

> "Availability of Logistics stock to let across London, the South East and Rest of UK has been increasing since the end of 2022."

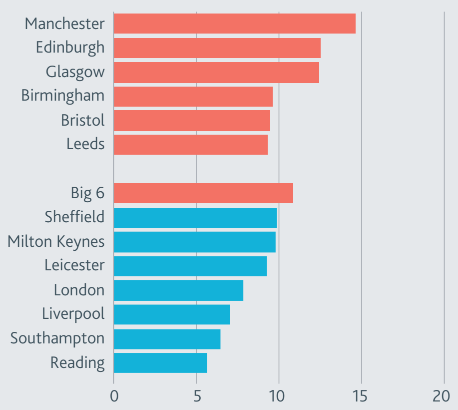
8.2 Investment view

Investment demand for logistics space has resulted in significant levels of capital growth, supported by market rental value increases and lower yields. Annual capital value growth reached 40% in London and 30% in the South East and the rest of the UK in 2022. After the interest rate induced impact on values of 2022-23, values are once again improving and were up 4% in the 12 months to the end of 2024.

The superior investment performance of the industrial sector and many of its key centres compared to the All Property average has yet to be reflected in a sustained recovery in investment volumes traded. London and the South East experienced some improvement in liquidity in the second half of 2024 but any increase in Rest of UK activity has been limited.

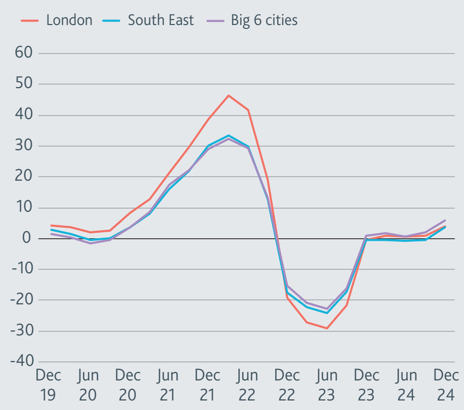
> "Investment demand for logistics space has resulted in significant levels of capital growth, supported by market rental value increases and lower yields."

8.11 Key centre 12m total returns



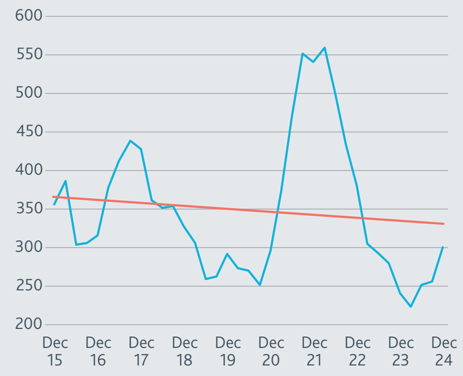
Source: MSCI, January 2025

8.12 12m total returns



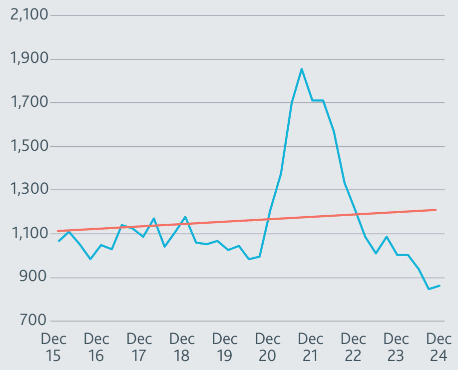
Source: MSCI, January 2025

8.13 London & S.East investment volumes and trend (£m)



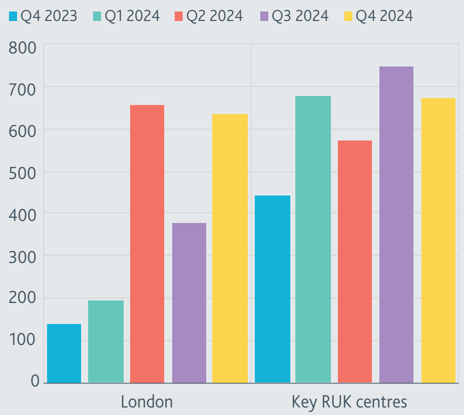
Source: CoStar, January 2025

8.14 Big 6 cities investment volumes and trend (£m)



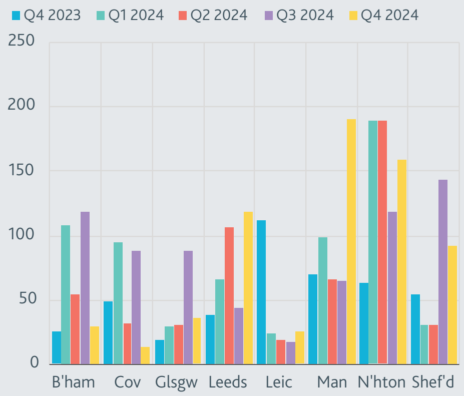
Source: CoStar, January 2025

8.15 Industrial investment (£m)



Source: CoStar, January 2025

8.16 Key centre investment (£m)

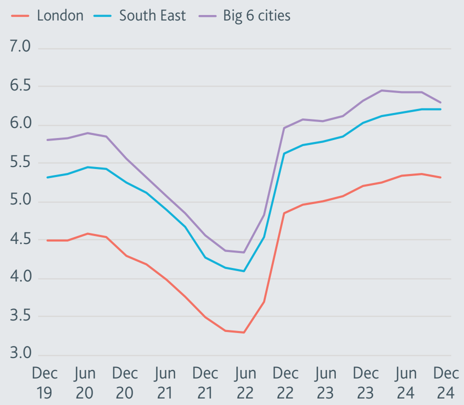


Source: CoStar, January 2025

Investor preference is currently limited to London and a handful of key regional centres centred around Birmingham, Manchester and Leeds. London accounted for 41% of all transactions in 2024 across a selection of Great Britain's strongest locations. Assets for sale in these locations may command investment yields of 5.5%. Investors will only be tempted outside these centres by a significant price discount of up to 150 bps.

Value added asset managers will target purchases of multi let assets with a strategy focused on gaining vacant possession and refurbishing to drive rental growth. Core investors with a buy and hold strategy prefer to buy long and secure income on a big box and accept market levels of rental value growth.

8.17 Equivalent yields



Source: MSCI, February 2025

8.18 Featured investment transactions

Building	Price (£m)	Yield (%)	Buyer
Tesco Warehouse, Daventry	105.00	4.2% (NIY)	Sunrise Real Estate
Morrisons Warehouse	58.0	6.8%	Slate Asset Management
Kuehne & Nagel, Derby	86.2	5.4%	M7 Real Estate
Enfield Distribution Park	89.8	3.4%	SEGRO
Harold Hill Industrial Estate	18.2	5.0%	ICG

Source: Cluttons, January 2025

8.19 Investment yields

Yields	Q4 2024	Q3 2024
Prime Distribution Sheds -Omrv	5.25%-5.50%	5.25%-5.50%
Secondary Distribution Sheds	6.00%-6.25%	6.00%-6.25%
Prime Industrial Within M25	4.75%-5.00%	4.75%-5.00%
Prime Industrial Regional	5.25%-5.75%	5.50%-6.00%
Secondary Industrial Estate	6.50%-7.25%	6.50%-7.25%

Source: Cluttons, January 2025

"Investor preference is currently limited to London and a handful of key regional centres centred around Birmingham, Manchester and Leeds."

Industrial focus

Summary tables

8.20 Availability (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	18.63	17.57	12.85	▲
South East	25.15	25.02	20.20	▲
Logistics Triangle	47.61	46.30	35.64	▲
Manchester	12.75	11.68	8.45	▲
Leeds	7.59	7.96	6.01	▼
Rest of UK	115.91	110.79	92.69	▲

Source: CoStar, January 2025

8.21 Take-up (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	0.73	0.94	1.14	▼
South East	1.29	1.68	2.40	▼
Logistics Triangle	3.37	3.62	5.65	▼
Manchester	0.69	0.73	0.96	▼
Leeds	0.65	0.68	0.83	▼
Rest of UK	7.43	8.06	9.71	▼

Source: CoStar, January 2025

8.22 Vacancy rates

	Q4 2024	Q3 2024	5y avg.	Trending
London	8%	8%	6%	◀▶
South East	7%	7%	5%	◀▶
Logistics Triangle	6%	6%	5%	◀▶
Manchester	6%	5%	4%	▲
Leeds	4%	5%	4%	▼
Rest of UK	6%	5%	5%	▲

Source: CoStar, January 2025

8.24 Completions ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	961	130	437	▲
South East	779	1,194	1,344	▼
Logistics Triangle	2,986	1,146	3,571	▲
Manchester	287	627	400	▼
Leeds	357	0	542	▲
Rest of UK	3,624	2,333	6,312	▲

Source: CoStar, January 2025

8.25 Construction ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	4,003	4,856	3,026	▼
South East	7,806	8,162	6,667	▼
Logistics Triangle	12,149	15,032	14,467	▼
Manchester	1,445	1,709	1,699	▼
Leeds	1,497	1,056	2,553	▲
Rest of UK	19,819	21,871	27,546	▼

Source: CoStar, January 2025

8.26 12m MRV growth

	Q4 2024	Q3 2024	5y avg.	Trending
London	5.6%	6.0%	8.3%	▼
South East	4.6%	6.5%	6.6%	▼
Logistics Triangle	5.6%	6.8%	7.0%	▼
Manchester	8.4%	8.6%	8.6%	▼
Leeds	6.2%	8.2%	6.6%	▼
Rest of UK	4.3%	6.1%	5.3%	▼

Source: CoStar & MSCI, January 2025

8.27 Average rents (£ psf)

	Q4 2024	Q3 2024	Trending
London	19.70	19.70	◀▶
South East	12.70	12.60	▲
Logistics Triangle	8.70	8.70	◀▶
Manchester	7.90	7.90	◀▶
Leeds	7.40	7.40	◀▶
Rest of UK	7.90	7.80	▲

Source: CoStar, January 2025

8.28 Investment volumes (£ bn)

	Q4 2024	Q3 2024	5y avg.	Trending
London	634.71	378.79	530.34	▲
South East	255.31	345.27	408.95	▼
Logistics Triangle	288.97	448.36	631.19	▼
Manchester	190.56	64.06	118.37	▲
Leeds	118.48	43.85	113.72	▲
Rest of UK	820.18	822.03	1155.13	▼

Source: CoStar, January 2025

8.28 Prime yields

	Q4 2024	Q3 2024	Trending
Prime Distribution Sheds –Omrv	5.25% - 5.50%	5.25% - 5.50%	◀▶
Secondary Distribution Sheds	6.00% - 6.25%	6.00% - 6.25%	◀▶
Prime Industrial Within M25	4.75% - 5.00%	4.75% - 5.00%	◀▶
Prime Industrial Regional	5.25% - 5.75%	5.50% - 6.00%	▼
Secondary Industrial Estate	6.50% - 7.25%	6.50% - 7.25%	◀▶

Source: Cluttons, January 2025

9. Retail focus

The other side of the growth of occupier and investment demand for industrial and logistics property has been a long drawn-out decline of the physical retail space.

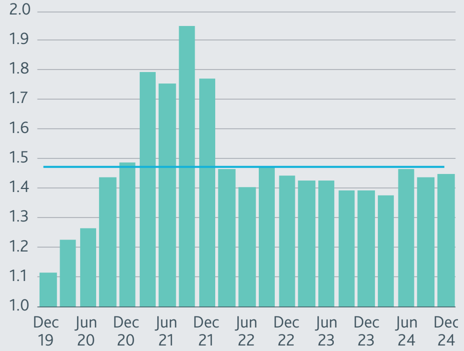
Empty and boarded shops were at first blamed on "unfair" competition from out-of-town retail parks who benefitted from cheaper rents, free car parking and lower business rates.

The ONS first started monitoring online sales in 2008 when internet sales represented just 4% of all UK retailing. But the writing had been on the wall for some retailers well before then. Amazon started selling books in 1995 and began selling CDs in 1998. Apple introduced the first iPod in 2001 with a 5GB hard drive capable of storing about 1,000 songs. Early retail casualties included Borders books, Books etc, Tower Records, Virgin Megastores and Woolworths.

Online penetration of retail sales peaked at 37% during the second lockdown of early 2021 at which point the internet accounted for 65% of all clothing and footwear sales. After the removal of all pandemic restrictions, internet sales fell to 25% within 18 months and have remained at that level ever since.

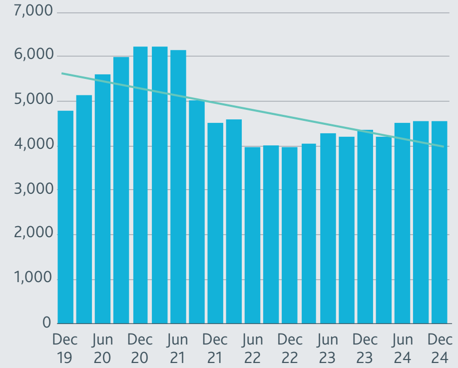
UK shopping centres, retail parks, and high streets saw a 2.2% decline in footfall compared to the previous year. High Street footfall decreased 2.2% and shopping centres experienced a 3.3% drop. Retail Park footfall remained unchanged.

9.1 Central London shop availability ('000 sf)



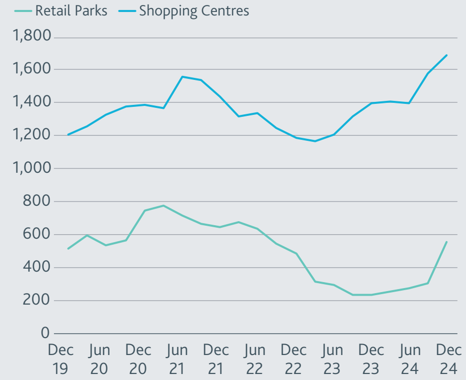
Source: CoStar, January 2025

9.2 South East shop availability ('000 sf)



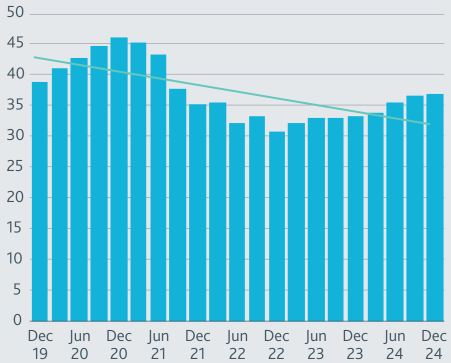
Source: CoStar, January 2025

9.3 South East retail availability ('000 sf)



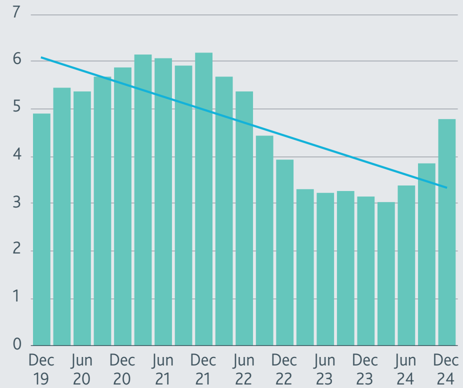
Source: CoStar, January 2025

9.4 Shop availability (m sf)



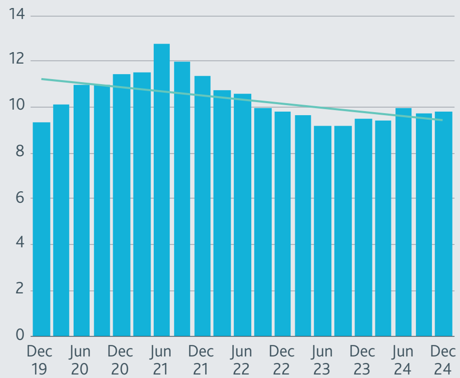
Source: CoStar, January 2025

9.5 Retail Park availability (m sf)



Source: CoStar, January 2025

9.6 Shopping Centre availability (m sf)



Source: CoStar, January 2025

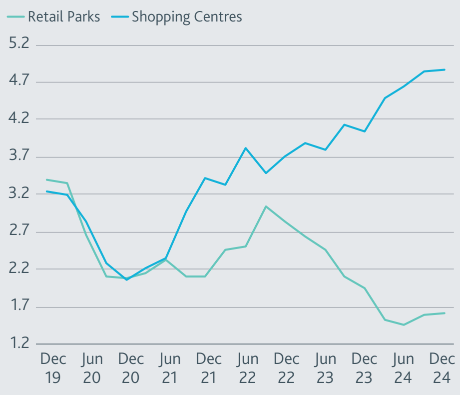
According to the BRC In-Store Non-Food sales increased by 0.4% year on year in December, against a decline of 2.9% in December 2023. However, online Non-Food sales increased by 11.1% year on year in December, against a decline of 0.8% in December 2023. As usual the UK weather has been cited as an important factor. Online sales were apparently boosted by some bleak winter weather, particularly in electronics and homeware, as storms Darragh and Bert kept shoppers off the High Street and behind their laptops.

Next reported that online Christmas sales grew by 6.1% but retail sales fell by -2.1% on a like for like basis compared with the same period last year. Although M&S reported like for like Clothing, Home and Beauty sales were up 1.9% over the Christmas period but store sales fell 1.5%. Other smaller specialist clothing and footwear specialists, like Quiz and Shoe Zone, faced challenges.

9.1 Occupational view

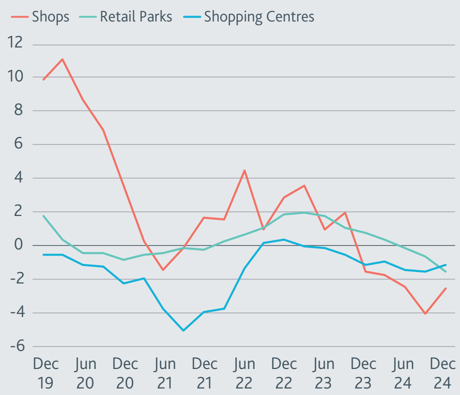
The availability of retail space had been on a declining trend since the UK economy first started to re-emerge after Covid. But recent quarters have seen an uptick in availability across all three retail segments. Net absorption of traditional retail space and Shopping Centres has been negative for at least the last year despite a welcome increase in the take-up of vacant shopping centre space.

9.7 Rolling 12m take-up (m sf)



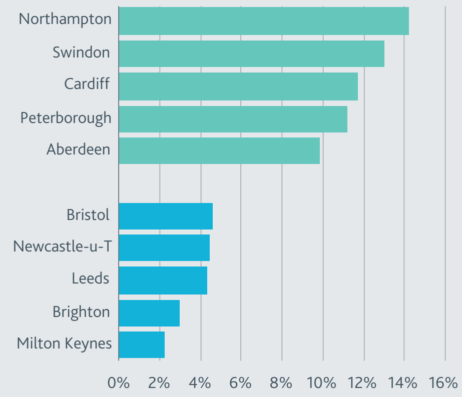
Source: CoStar, January 2025

9.8 All GBR 12m net absorption (m sf)



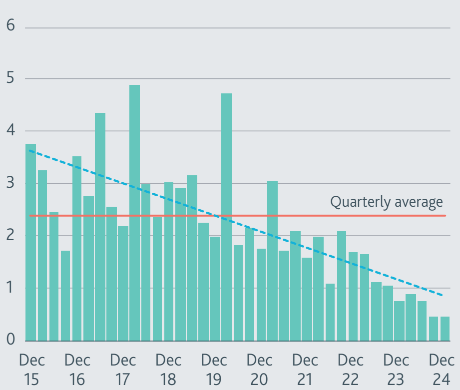
Source: CoStar, January 2025

9.9 Key centre vacancy rates



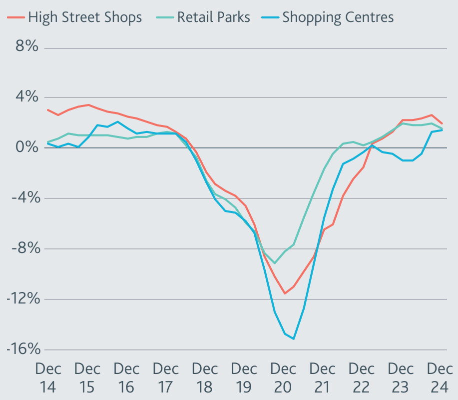
Source: CoStar, January 2025

9.10 Development completions (m sf)



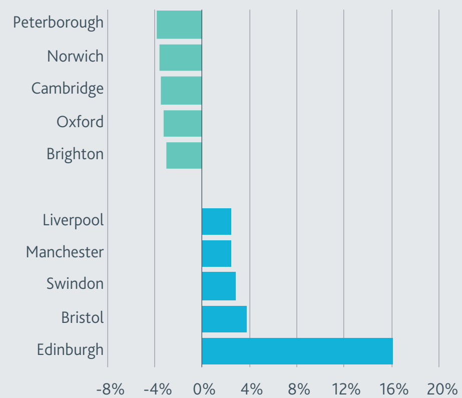
Source: CoStar, January 2025

9.11 12m MRV growth



Source: MSCI, February 2025

9.12 Key Centres MRV growth rate



Source: CoStar, January 2025

Demand and take-up of retail premises has improved in some centres, especially wealthier suburbs of Greater London, cathedral cities and affluent areas of the South East, but elsewhere vacancy rates remain elevated. This characteristic of empty shops is not uniform across the country and some of the UK's strongest retail locations have much lower vacancy levels. In some cases, this has been reflected in upward pressure on rents albeit after an average -19% decrease in High Street rental values since December 2017.

The latest market indices are showing positive rental growth in the 12 months to December 2024 across all retail segments led by Central London and Rest of UK shops. But this varies from centre to centre. Asking rents for High Street and Shopping Centre units have been falling in Brighton, Norwich and Peterborough but increasing in Liverpool, Manchester and Bristol.

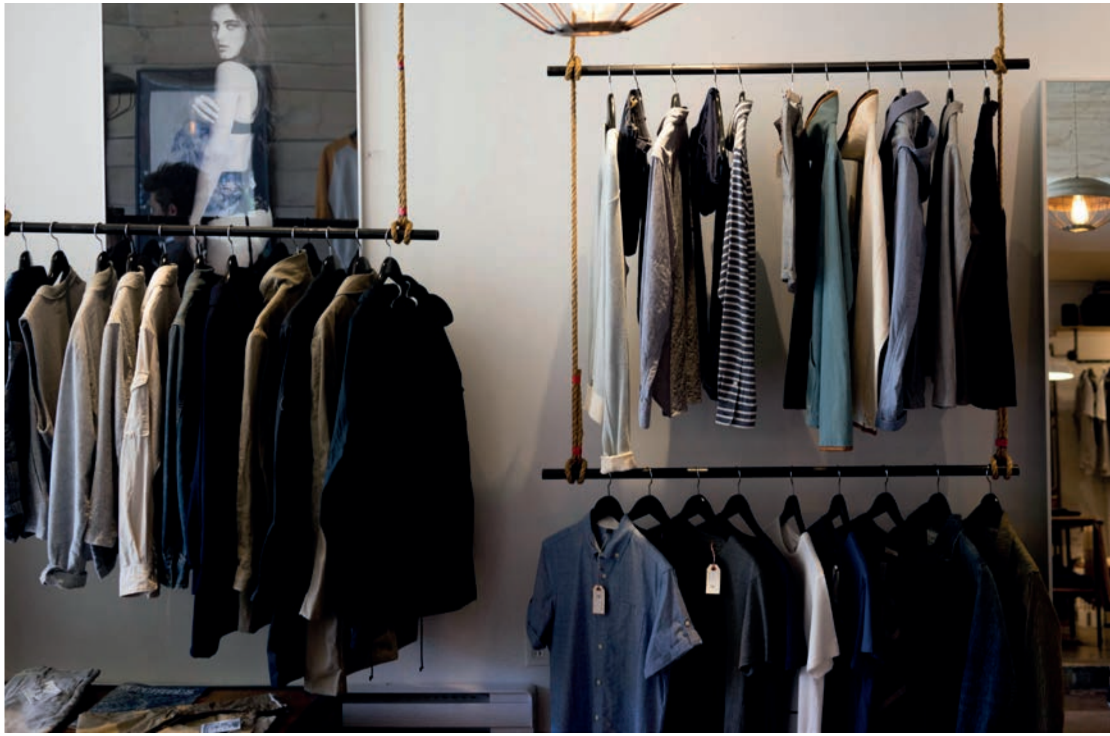
> "Demand and take-up of retail premises has improved in some centres, especially wealthier suburbs of Greater London, cathedral cities and affluent areas of the South East."

Major retailers such as M&S, Aldi, Next, and Primark are maintaining their commitment to bricks-and-mortar stores and have expanded their portfolios and invested in store upgrades and modernization. However, M&S and Next, in particular, are growing their out-of-town portfolios at the expense of the more traditional High Street. Retail Parks provide more efficient and larger space that can house their entire product range, serviced by ample car parking space and supported by independent on-site cafes, restaurants and other leisure occupiers.

Changes to fiscal and employment policy announced in the budget are likely to increase the overheads of many retailers. Higher National Insurance contributions will add around £250 million to Tesco's annual costs. A letter to Chancellor Rachel Reeves, co-ordinated by the British Retail Consortium and signed by Boots, Next and M&S amongst others, warns that the increase in NIC contributions as well as the national living wage could trigger both job losses and higher prices. Although the same retailers could also gain from an increase in net disposable income amongst a section of the UK's consumers.

The increase in employment costs will also be borne by landlords responsible for the repair and maintenance of shopping centres. They will surely seek to recover this through charging their occupiers higher levels of service charge. Any preliminary indication of increasing market rental value growth will be squeezed out by higher management costs as occupiers remain focused on their total occupancy costs. However, those centres where the service charge has been capped may benefit from an uplift in headline rents.

High Street and Shopping Centre occupiers have long complained about the unfair burden of high business rates. Finally, a 75% discount for retail, hospitality and leisure (RHL) occupiers was introduced for 2023/24 and extended to 2024/25. The new Labour Government has further extended the relief to 2025/26 but reduced the discount to 40%. A permanent lower multiplier for RHL occupiers funded by a higher multiplier on larger distribution warehouses occupied by "online giants", will follow a consultation exercise but delayed until 2026/27.



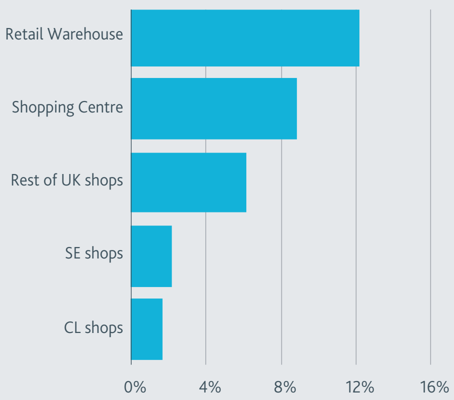
8.2 Investment view

High income returns and a slight re-rating in yields have produced some strong performance numbers from Shopping Centres and Retail Warehouses, relative to 2024's All Property average. Two of the investment transactions highlighted in one of the tables opposite are illustrative. Fremlin Walk in Maidstone was anchored by House of Fraser which finally entered administration in 2018 and was acquired by Mike Ashley's Sports Direct (now Frasers Group). Last year the Fremlin Walk store was refurbished and rebranded as Fraser, with the centre being sold in September by M&G Real Estate to Frasers Group for £25 million (NIY 10.3%).

In 2013 AustralianSuper, a not-for-profit pension fund based in Melbourne, acquired a 50% stake in Centre:mk, Milton Keynes 1.3 million sf regional shopping mall occupied by M&S, John Lewis, Harrods Boots, Next and others, for £269.66 million reflecting a net initial yield of 5.34%. In November 2024, AustralianSuper sold its interest to Royal London Asset Management for £140 million – a 9.00% net initial yield.

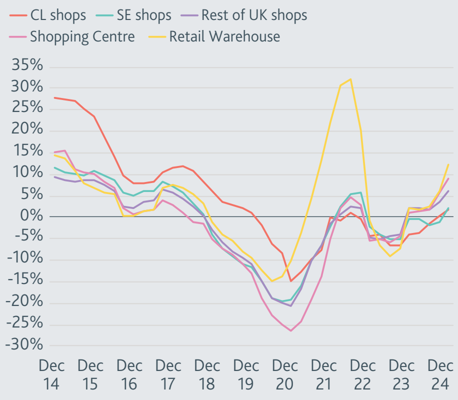
Further evidence of activity in the shopping centre space is provided by Landsec's acquisition of a 92% stake in Liverpool ONE for £490m from the Abu Dhabi Investment Authority (69%) and Grosvenor (23%). A £35m payment to ADIA has been deferred for two years and Landsec's initial £455m investment is expected to yield a 7.5% return.

9.13 2024 total returns



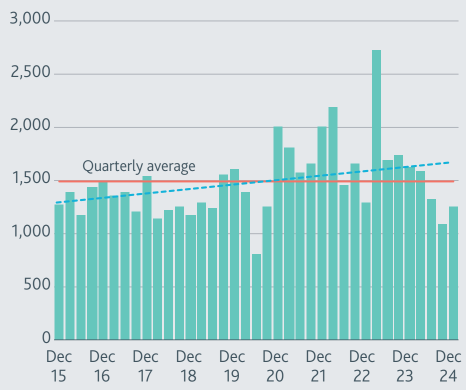
Source: MSCI, February 2025

9.14 Rolling 12m total returns



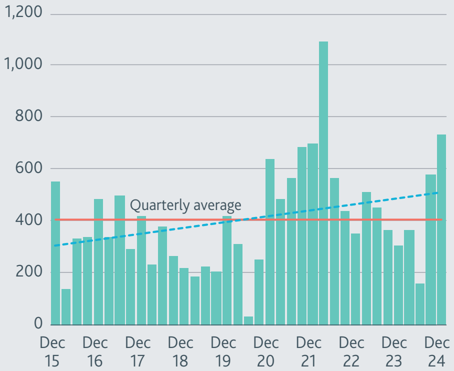
Source: MSCI, February 2025

9.15 Shop investment volumes and trend (£m)



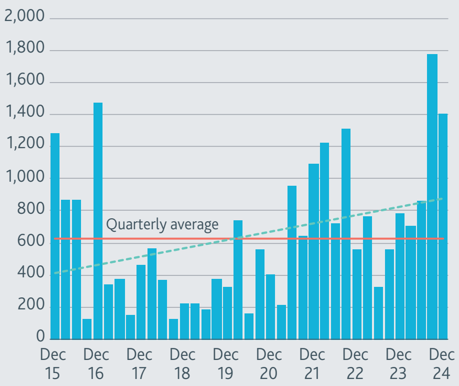
Source: CoStar, January 2025

9.16 Retail Park investment volumes and trend (£m)



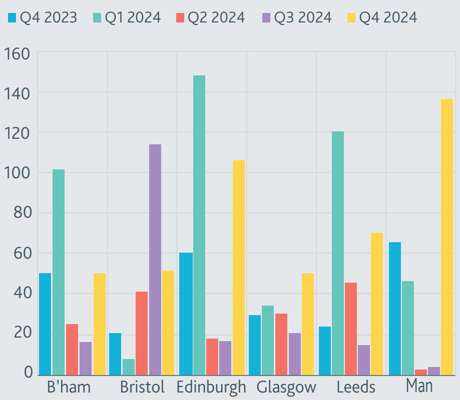
Source: CoStar, January 2025

9.17 Shopping Centre investment volumes and trend (£m)



Source: CoStar, January 2025

9.18 Key centre investment (£m)



Source: CoStar, January 2025

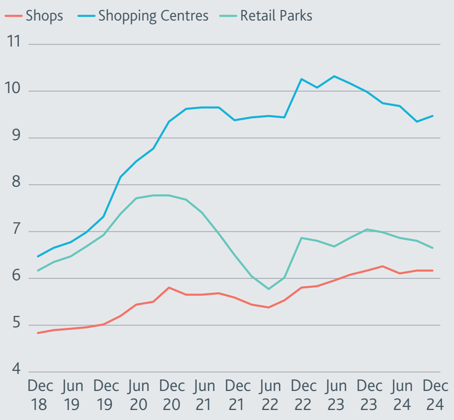
Landsec's strategy is to boost its investment in major retail destinations, using proceeds from £464m of non-core sales earlier this year. Landsec now owns and manages seven of the UK's 30 top shopping centres.

Institutional demand for retail warehousing investments also remains strong. In October last year, British Land acquired a retail warehouse portfolio of seven assets from Brookfield, a global real estate investment manager, in Didcot, Rugby, Falkirk, Waterlooville, St Helens, Middlesborough, Telford and Nottingham, for £600 million with a blended 7.20% net initial yield.

Investors are also beginning to re-invest in the High Street. The expectation of further reductions in base rates and a perception that Shops are "cheap" after a 43% fall in capital values since their peak in early 2018, is likely to boost further investment interest in the High Street, particularly where assets are available with residential upper floors.

> "High income returns and a slight re-rating in yields have produced some strong performance numbers from Shopping Centres and Retail Warehouses."

9.19 Equivalent yields



Source: MSCI, February 2025

9.20 Featured investment transactions

Building	Price (£m)	Yield (%)	Buyer
Retail Parks			
Trafford Retail Park	37.00	5.65% (NIY)	Knight Frank IM
Arnison Retail Park, Durham	105.94	6.94% (NIY)	Realty Income Corporation
Longwell Green Retail Park, Bristol	22.59	5.6% (NIY)	
Shopping Centres			
Fremlin Walk, Maidstone	25.00	10.3% (NIY)	Frasers Group
Centre:mk	140.00	9.0% (NIY)	Royal London AM

Source: Cluttons, January 2025

9.21 Investment yields

Yields	Q4 2024	Q3 2024
Prime Shops	6.75%	6.75%
Secondary Shops	8.00%-10.00%	8.00%-10.00%
Shopping Centres		
Prime – Dominant Regional	8.00%	8.25%
Retail Warehouse		
Prime Parks (Open A1/Food Store)	5.50%	5.75%
Prime – Solus (15Yrs/10Yrs)	6.00%-6.50%	6.00%-6.50%

Source: Cluttons, January 2025

Retail focus

Summary tables

9.22 Availability (m sf.)

	Q4 2024	Q3 2024	5y avg.	Trending
London	6.15	5.98	5.72	▼
South East	4.55	4.55	4.80	◀▶
Rest of UK	26.15	26.20	26.71	▼
Shopping Centres	9.81	9.71	10.37	▲
Retail Parks	4.77	3.85	4.71	▲

Source: CoStar, January 2025

9.23 Take-up (m sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	0.630	0.729	0.632	▼
South East	0.375	0.698	0.580	▼
Rest of UK	1.704	2.486	2.420	▼
Shopping Centres	1.170	1.240	0.901	▼
Retail Parks	0.383	0.576	0.542	▼

Source: CoStar, January 2025

9.24 Vacancy rates

	Q4 2024	Q3 2024	5y avg.	Trending
London	3%	3%	3%	◀▶
South East	2%	2%	3%	◀▶
Rest of UK	3%	3%	3%	◀▶
Shopping Centres	5%	5%	5%	◀▶
Retail Parks	3%	3%	3%	◀▶

Source: CoStar, January 2025

9.26 Completions ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	37.04	144.29	310.43	▼
South East	44.93	33.01	221.17	▲
Rest of UK	379.17	289.69	1,000.18	▲
Shopping Cen.	0	0	60.87	
Retail Parks	0	7.12	76.55	▼

Source: CoStar, January 2025

9.27 Construction ('000 sf)

	Q4 2024	Q3 2024	5y avg.	Trending
London	1,123	1,012	1,813	▲
South East	490	535	962	▼
Rest of UK	2,616	2,763	3,345	▼
Shopping Cen.	0	0	322	
Retail Parks	0	0	291	

Source: CoStar, January 2025

9.28 12m MRV growth

	Q4 2024	Q3 2024	5y avg.	Trending
London	2.5%	3.6%	-2.1%	▼
South East	1.2%	1.4%	-3.6%	▼
Rest of UK	2.2%	2.5%	-4.0%	▼
Shopping Centres	1.6%	2.0%	-1.3%	▼
Retail Parks	1.5%	1.3%	-4.1%	▲

Source: MSCI, January 2025

9.29 Average rents (£ psf)

	Q4 2024	Q3 2024	Trending
London	43.60	43.90	▼
South East	25.50	25.70	▼
Rest of UK	19.00	19.00	◀▶
Shopping Centres	34.00	33.90	▲
Retail Parks	21.00	21.10	▼

Source: CoStar, January 2025

9.30 Investment volumes (£ bn)

	Q4 2024	Q3 2024	5y avg.	Trending
London	367.61	244.03	541.64	▲
South East	165.27	207.42	277.24	▼
Rest of UK	515.88	461.33	744.04	▲
Shopping Cen.	552.49	694.22	343.06	▼
Retail Parks	725.24	560.91	478.18	▲

Source: CoStar, January 2025

9.31 Prime yields

	Q4 2024	Q3 2024	Trending
Prime Shops	6.75%	6.75%	◀▶
Secondary Shops	8.00%-10.00%	8.00%-10.00%	◀▶
Shopping Centres			
Prime - Dominant Regional	8.00%	8.25%	▼
Retail Warehouse			
Prime Parks (Open A1/Food Store)	5.50%	5.75%	▼
Prime - Solus (15Yrs/10Yrs)	6.00% - 6.50%	6.00% - 6.50%	◀▶

Source: Cluttons, Jan 2025

10. Outlook & House view

Forecasters remain confident that they will see a gradual recovery in the UK's commercial property market over the medium term. Consequently, November's Investment Property Forum (IPF) consensus forecasts for 2025 were increased to 8.8% from 8.4% in August. The outlook for 2026 has also strengthened (see Chart 7.1).

The strength of the recovery in Q4 surprised the majority of contributors to November's IPF consensus view. The median forecast of 5.4% underestimated 2024's eventual year-end All Property performance of 7.0%. Average capital values had been slowly improving since May, but the pace of capital growth surprised on the upside in November and December especially. Stronger yet performance is anticipated in the next three years. The annualised total return average forecast over the three years to 2027 is 8.5 % and 8.2% for the four years to 2028 (see Chart 7.2).

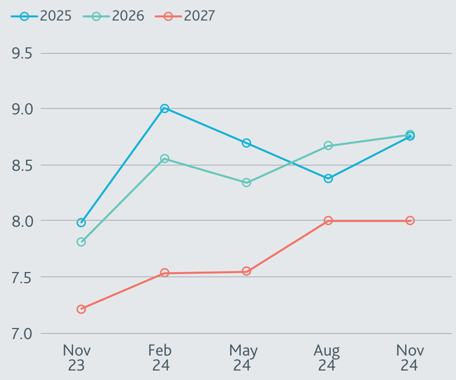
Respondents to the IPF Consensus Forecast Survey expect positive total returns in 2025 across all segments. Standard Retail, City, West End and Rest of UK offices are expected to improve after a disappointing 2024. The outlook for Shopping Centres, Retail Warehouses and Industrials is stronger although in the view of the forecast panel they are unlikely to better 2024's performance (see Chart 7.3).

The maximum total return forecast for 2025 has increased from +10.9% in August to +11.2% in November's consensus report whilst the minimum forecast remained 6.4%. The forecast range for 2026 is 4.2%, with a maximum of +10.3% and a minimum of +6.1% (see Chart 7.4).

This property market cycle continues to be driven by movements in the risk-free rate and the cost of borrowing. The first cut to UK base rate was delayed until August but only had a marginal impact on the performance of commercial property in the third quarter. A further 25 bp reduction in Bank Rate to 4.75% in November resulted in stronger performance in Q4 and a better than expected outcome for 2024.

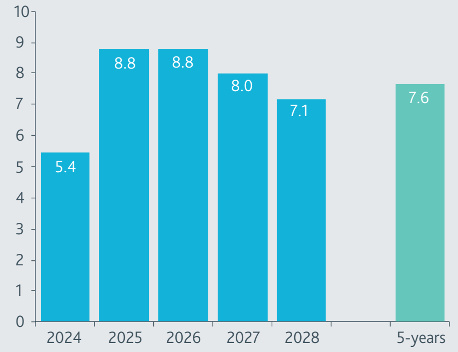
The interest rate outlook for 2025 is unclear. Some are expecting two cuts this year, while others are forecasting four or more cuts in the next 12 months. Markets may have been confidently expecting a further cut in February as annual cpi inflation fell below the 2.0% target and economic growth remained weak. Although the economy remains weak, inflation has since risen back above target. Moreover, in the US, the Fed's response to the strategic ambiguity of the Trump Whitehouse remains highly uncertain. At present we expect the UK's elevated risk-free rates to adjust back to previous levels within a

7.1 IPF Consensus forecast evolution (%)



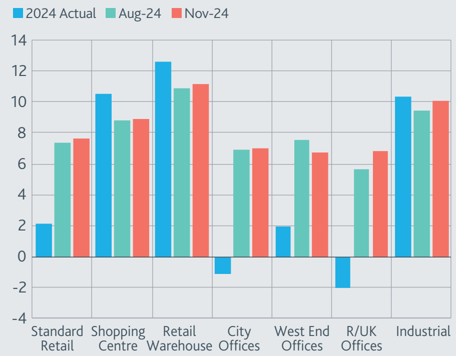
Source: IPF, Nov 2024

7.2 IPF All Property consensus forecasts y-by-y (%)



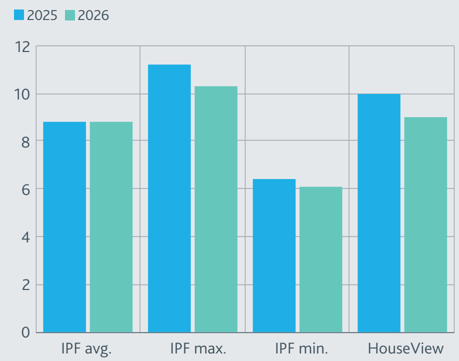
Source: IPF, Nov 2024

7.3 IPF 2025 total return forecasts by sector Nov 24 v Aug 24 (%)



Source: IPF & MSCI, Nov 2024

7.4 UK commercial total return forecast range (%)

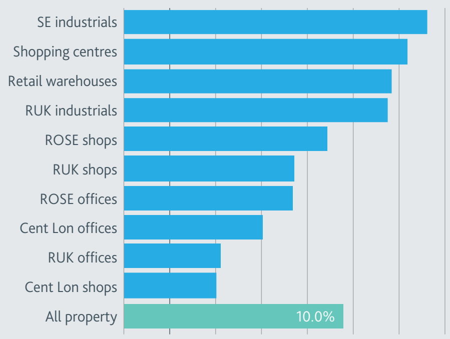


Source: IPF, APR & Cluttons, Nov 2024 & Jan 2025 relatively short space of time and on this basis, we expect that the performance of UK CRE will strengthen in the second half of 2025 and 2026 driven by Industrials (especially logistics) and Retail Warehousing, with Shopping Centres benefitting from coming off a very low base (see charts 7.5 & 7.6).

We are very far from a "goldilocks" scenario that benefits all segments of the market. Within the model Industrials benefit from continuing elevated levels of rental growth and Shopping Centre performance is boosted by high income returns of 8%. Post Covid, investor demand for Retail Warehouses is supported by large footprints with asset management and alternative use potential. Offices are penalised by reduced occupier demand as hybrid working patterns now seem to be established and the cost of upgrading buildings to meet energy and emissions requirements.

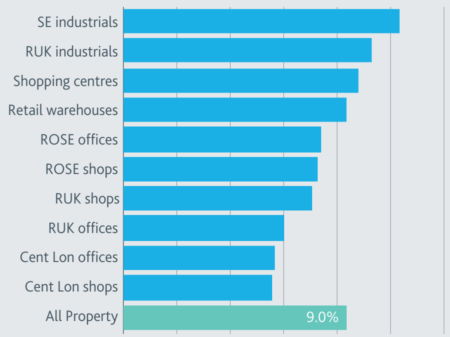
The central forecast from the House View model, which shows 10% total return this year and 9% next year, is revised on a quarterly basis to reflect the changing macro-economic outlook and the current performance of commercial real estate. The uncertainties are larger now than they have been for some time. Upside risks involve a more favourable outlook for the economy, inflation, and interest rates, along with improved liquidity as investors continue to build on the nascent recovery in activity. Downside risks include geopolitical instability in Ukraine and the Middle East. Although ceasefires have been negotiated in Gaza and Lebanon, peace there remains fragile. An end to Russia's war on Ukraine has been promised by the US's new administration but care needs to be taken that the future of other states lying on Russia's western border are not destabilised in the process. Of more immediate concern to UK real estate is the outlook for inflation and interest rates both domestic and international.

7.5 Cluttons House View – 2025 relative total returns (%)



Source: IPF, APR & Cluttons, Jan 2025

7.6 Cluttons House View – 2025-2028 relative total returns (%)



Source: IPF, APR & Cluttons, Jan 2025

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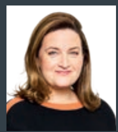

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