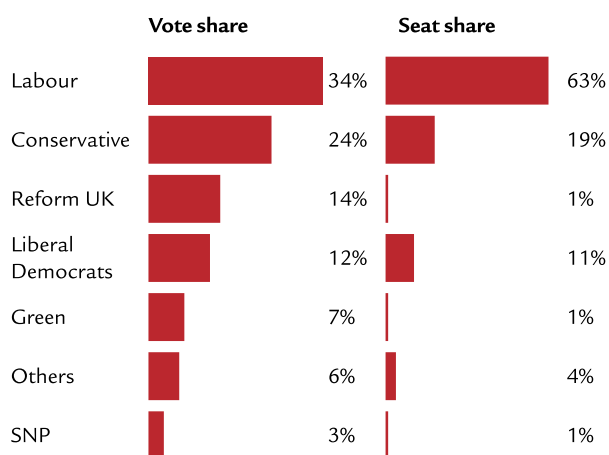


Second half-year 2024

## Key takeaways

- **The Labour party win the UK general election:** The political landscape has shifted over the first half of 2024, as the Labour party take over government from the Conservatives. This development is expected to reduce political uncertainty and provide some well-needed stability across financial markets.
- **Clear signs of positive momentum:** Month-on-month total returns have been gaining momentum throughout 2024 as real estate valuations improve and investor activity increases.
- **Sustained weakness in offices:** The sector faces significant challenges which are expected to result in structurally lower demand. London offices have displayed the greatest resilience across UK markets, although significant risks remain for non-prime assets.
- **Growth expected for UK Build-to-Rent:** Structural developments are causing a shift from homeownership to private renting. As demand strengthens for rented housing, there is a significant opportunity for institutional investors to grow the BtR sector and alleviate critical supply issues.
- **Strong demand for distribution and industrial assets:** Take-up has trended higher than last year's quarterly average, and with limited new supply under construction, we believe the sector continues to offer good prospects for performance.
- **Improving consumer sentiment will support the retail sector:** As personal finances improve over the second half of 2024, so too will the retail occupier market. Although conditions elsewhere across the retail sector remain challenging, retail warehousing offers scope for outperformance due to its high resilient income returns.

## Chart in focus



Source: BBC News.

Economic discourse shifted over the second quarter, following the announcement of an early UK general election on 4 July. Polls were largely suggestive of a landslide victory for Labour. Consequently, the announcement of a Labour win had little impact on financial markets, with sterling, equity markets, and gilt yields broadly unchanged. An overwhelming Labour majority in parliament will provide the new government the latitude to tackle key structural issues, including weak productivity growth and labour shortages. A Labour win may also support a more cooperative relationship with the EU. We expect this will reduce market uncertainty, support foreign investment, and aid prospects for growth.

The economic outlook for the UK has improved considerably in just six months. As recently as December 2023, the consensus forecast for GDP growth in 2024 was just 0.3%. According to Consensus Economics, this figure now stands at 0.8%. Over the same period, the consensus opinion also shifted to a more favourable assessment in terms of inflation. The projected average annual inflation rate is now 2.6%, a significant reduction from the previous estimate of 3.1%. This also creates an opportunity for a normalisation of monetary policy over the coming quarters. In addition to the favourable macroeconomic conditions, the outlook has been bolstered by the transition to a new government. The Labour administration has set an objective of achieving the highest sustainable growth among G7 countries. This will be achieved through a series of supply-side reforms and a focus on investment in infrastructure and the creation of new housing.

## A return to capital growth

There are clear signs of positive momentum returning to the UK real estate market. The MSCI monthly index recorded a total return of 1.7% in Q2 2024, the strongest quarterly return since Q2 2022. Although yields continued to expand at an all-property level over the period, its impact is fading and MSCI has reported that an increasing proportion of assets are recording static capital values month-on-month. There may be some scope for yield compression on the best quality assets in H2 2024 if gilt yields fall, but this is likely to be limited. Overall, yields are likely to remain flat as the spread against risk-free rates is re-established. However, alongside continued positive rental growth as the economy recovers, this implies a return to capital growth.

## London offices perform well

While the office sector certainly lacks the more positive momentum witnessed elsewhere, valuation falls are becoming less negative. In addition, there is increasing disparity between segments. Capital values in the West End were relatively stable in Q2 (-0.2%) but fell 1.2% in the City, while values declined 2.1% and 2.8% in the South-East and Rest of UK, respectively. The variance is being driven by the strength of rental growth recorded in the West End as yields have moved out across all office segments.

## Growth of UK Build-to-Rent

As homeownership becomes increasingly unaffordable given elevated mortgage rates and house prices, demand in the private rented sector (PRS) has been mounting. Meanwhile, PRS supply has been shrinking. Since peaking in 2016 when nearly 240,000 buy-to-let mortgages were approved, private landlords have been selling more homes than they have been buying, removing critical rented stock. Consequently, an increasing weight of capital is targeting opportunities to address this undersupply. As the build-to-rent sector gains momentum, the opportunity for institutional investors is significant; Savills estimate a further £300bn of investment needed to meet required demand.

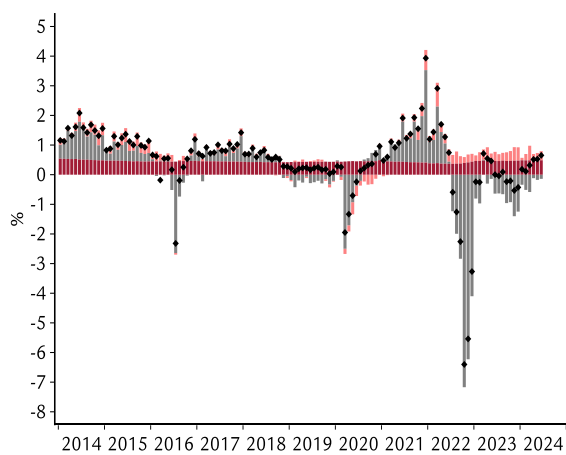
## Lack of industrial supply

The industrial sector has continued to perform well over the first half of 2024. Rental values increased 2.5% according to MSCI, which after residential, represented the strongest rental growth across the market. This reflects the robustness of occupational demand and continued constrained supply environment. Yields edged out only modestly in H1 2024, however this was not sufficient to outweigh the positive change in rental values, resulting in capital growth of 0.5% over the first half of the year. Performance has been relatively homogenous across the country, but take-up has been particularly strong for multi-let mid-box schemes (units < 50,000 sq ft), with a clear lack of supply.

## Focus on retail warehousing

Sentiment tracking indices are beginning to pick up, while consumers and businesses eagerly await an improvement in financial conditions. This will have a positive impact on the sector, though all segments are not considered equal. While conditions on the high street continue to worsen, retail warehousing is the clear outperformer, delivering robust capital value growth as well as the opportunity to enhance income returns through asset management. Looking ahead, we expect households' spending power to improve in the coming months as the drag from higher mortgage payments reaches its peak. This should support retail sales and rental growth, particularly where there has been a substantial correction in rental values.

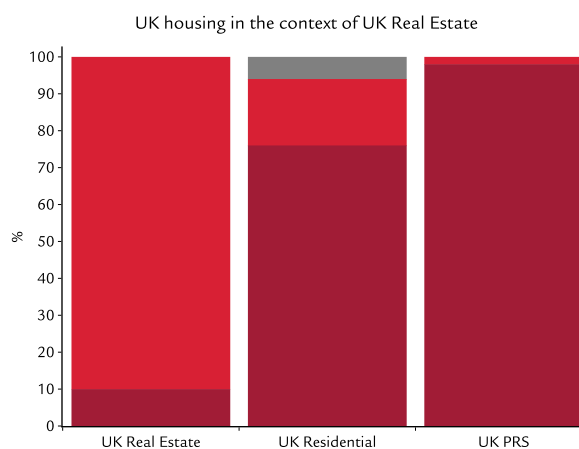
**Chart 1: All property returns (Q2 2024)**



◆ Total Return ■ Rental Growth ▲ Yield Impact ■ Income Return

Source: MSCI Monthly Index (June 2024)

**Chart 2: Opportunity to institutionalise the private rented sector**



Source: Savills Research using British Property Federation, HM Land Registry, 2021 Census, Registers of Scotland, English Housing Survey, NISRA, ONS, DLLHC.

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