UK Real Estate Navigator

Q3 2023	A quarterly review of the UK commercial real estate market.	knightfrank.com/research

Economic update

Global and UK economy

CONTACT: VICTORIA ORMOND, CFA

Global economy

Uncertainty continues to impact the global economic outlook.

GLOBAL OUTLOOK DOWNGRADED, BUT STILL POSITIVE

Against a backdrop of challenging economics, the global recovery is expected to be slow. While the IMF's global GDP growth forecast for 2023 remained unchanged in October at +3.0%, it downgraded its 2024 forecast by -10bps to +2.9%.

Meanwhile, economic growth expectations for the US have been upgraded for 2024. The IMF forecasts US GDP to grow by +1.5%, up by +50bps from its previous forecast in July. For the Euro Area, the IMF revised its GDP growth forecast lower for 2024, downgrading it by -30bps to +1.2%.

Despite global economic headwinds, labour markets across many geographies remain tight. In the US, employers added +336k jobs in September, almost double what markets were forecasting. In Germany, unemployment held steady at 5.7% for the third consecutive month in September, remaining below its 8.3% LTA.

GLOBAL BUSINESS ACTIVITY SLOWS

The Global Services PMI fell to a nine-month low of 50.4 in October, from 50.7 in September, however remaining in expansionary territory (figure above 50) for the tenth consecutive month.

Meanwhile, the Global Manufacturing PMI fell to 48.8 in October. This is its 14th successive month in contractionary territory (below 50).

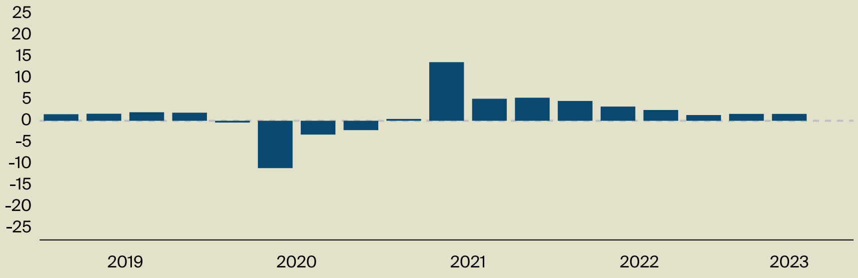
INFLATION DOWN, BUT ABOVE TARGET IN MOST LOCATIONS

Across the world, inflation figures mostly continue to fall as moderating energy prices, food prices, and weaker global demand takes effect. However, inflation remains above target in most economies, despite monetary tightening.

In the Euro Area, inflation fell for the sixth consecutive month in October to 2.9%, its lowest level since July 2021 and below expectations of 3.1%. Meanwhile, in the US, inflation remained unchanged at 3.7% in September, above expectations of a slight decline to 3.6%.

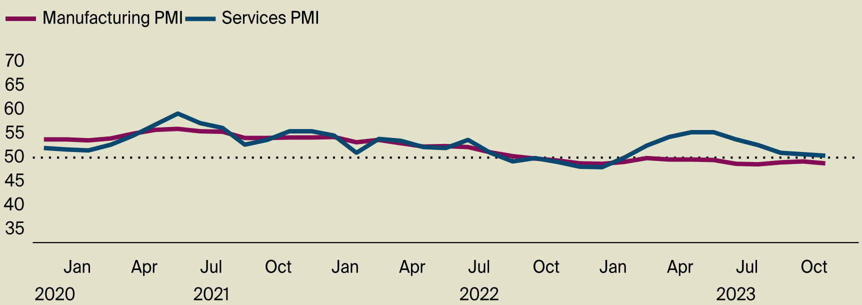
Gross Domestic Product

Quarterly OECD countries GDP growth, % change YoY, seasonally adjusted



Source: Knight Frank Research, Macrobond, OECD

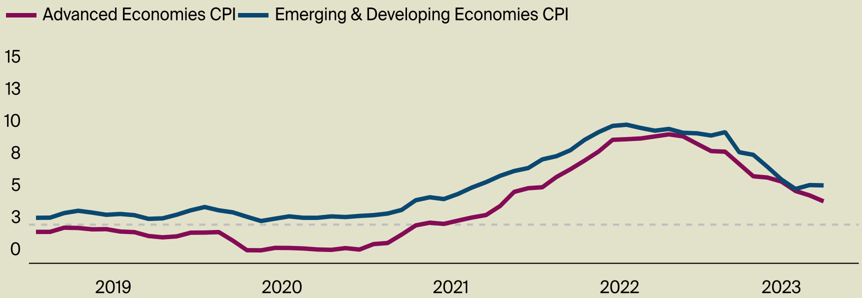
Business Activity Index



Source: Knight Frank Research, Macrobond, S&P Global /CIPS

Inflation

%



Source: Knight Frank Research, Macrobond, World Bank

UK economy

The UK economy shows signs of resilience, but the growth outlook remains soft.

UK GDP EXPANDS IN AUGUST

UK GDP expanded by +0.2% in Q2 2023, above market expectations of a flat reading and following an upwardly revised expansion of +0.3% in Q1 2023. On a monthly basis, GDP expanded by +0.2% in August 2023, up from a -0.6% contraction in July.

The Bank of England (BoE) updated its GDP forecasts in November. It now expects UK GDP growth to be flat in 2024, compared to expectations of +0.5% growth in August. For 2025 and 2026, the central bank expects the UK economy to grow by +0.25% and +0.75%, respectively.

The UK's unemployment rate lifted to 4.2% in the three months to August 2023, its highest level since October 2021 and above forecasts of 4.0%. The BoE forecasts UK unemployment to rise to 4.75% by the end of 2024.

BUSINESS ACTIVITY SUBDUED

The UK Manufacturing PMI increased to 45.2 in October, from 44.3 in the month prior, reaching a three-month high and beating market expectations of 44.7.

Meanwhile, the UK Services PMI contracted slightly to 49.2 in October, from 49.3 in September, remaining in contractionary territory (figure below 50) for the third consecutive month and reaching a nine-month low.

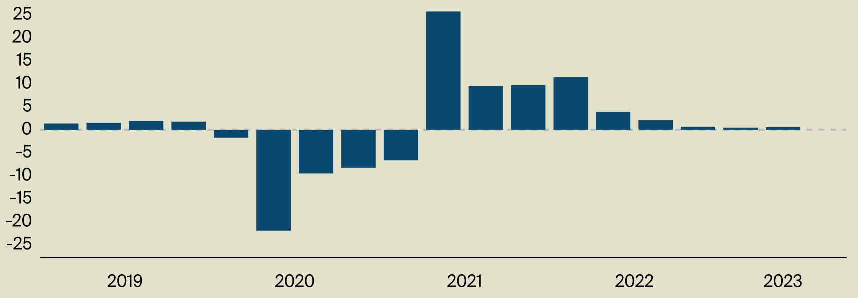
UK INFLATION: A GRADUAL DECLINE

UK inflation remained unchanged at 6.7% in September, holding at August's 18-month low but above expectations of a slight decline to 6.6%.

Overall, the central bank expects inflation to decline to 4.75% by the end of this year and reach its 2.0% target by the end of 2025.

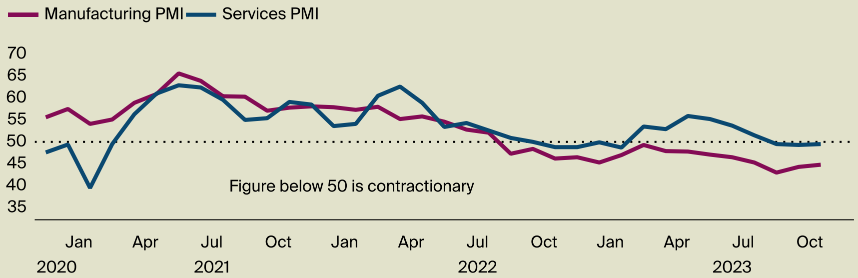
With inflation pressures starting to ease, economists widely predict that the Bank of England has ended its hiking cycle. This would suggest that the base rate peaked at 5.25% in August, with the BoE keeping rates unchanged since. Most economists expect the BoE to start cutting rates between Q2 and Q3 next year.

Gross Domestic Product
Quarterly UK GDP growth, % change YoY, constant prices, seasonally adjusted



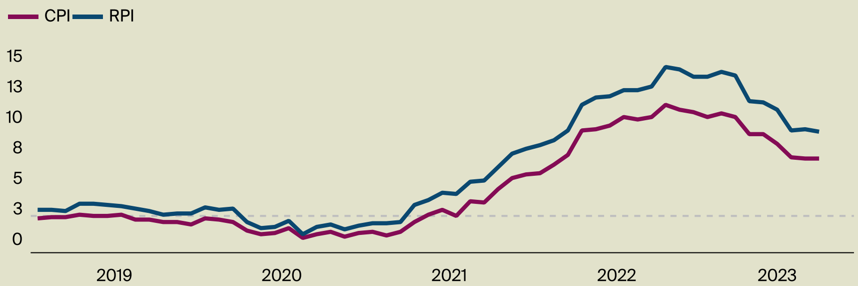
Source: Knight Frank Research, Macrobond, ONS

Business Activity Index



Source: Knight Frank Research, Macrobond, S&P Global /CIPS

Inflation
%



Source: Knight Frank Research, Macrobond, ONS

Capital markets

UK commercial real estate

CONTACT: VICTORIA ORMOND, CFA

Capital markets

UK remains the top global destination of cross border office investment this year, despite global macroeconomic headwinds.

INVESTMENT DOWN, BUT NOT OUT

UK commercial real estate (CRE) investment has shown signs of moderation this year, with preliminary numbers suggesting investment totalled £6.9bn in Q3 2023. This is a 24% decline on investment in Q2 2023 and a 46% contraction on Q3 2022.

Q1 – Q3 UK CRE investment totalled £26.4 billion in 2023, 47% below investment in the first nine months of 2022 and 36% below the Q1 – Q3 10-year long term average.

However, global CRE investment has recorded greater declines in the first three quarters of the year (-49% YoY) and the UK remained the second most invested market globally in Q3.

Offices (£2.2bn) were the most invested sector in Q3 and the only sector to record positive growth (+13% QoQ). This was followed by the Industrial (£2.0bn), Residential (£1.1bn), and Retail (£1.0bn) sectors.

Cross-border capital was also less active in the UK in Q3, with overseas investment down -61% YoY and -49% QoQ to £2.4bn. Industrial was the most invested sector for cross-border capital in Q3 2023, with £790m invested. Meanwhile, the UK was the top target for global cross border office investment in Q3.

OVERSEAS INVESTORS WITH ACCESS TO CHEAPER DOMESTIC DEBT TO REMAIN ACTIVE

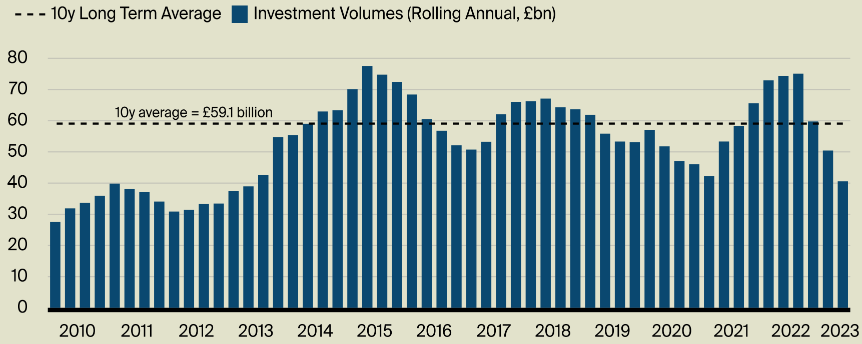
Real estate opportunities remain, despite elevated interest rates dampening investment activity.

We are now seeing a unique opportunity for buyers, such as Japanese investors, and less debt dependent investors in countries where there is relative currency strength, such as North America and Singapore, to continue to be active internationally. We're already seeing this trend in the UK, with Japanese investment up +146% YoY in the first nine months of the year.

Overall, we are likely to see an increased focus on smaller lot sizes and refinancing led activity. Liquid sectors that capture structural changes, such as data centres and living sectors, could also benefit.

UK quarterly investment volumes

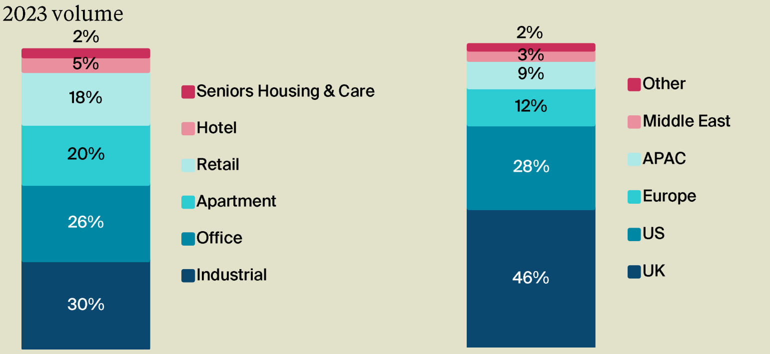
Quarterly investment volumes, rolling average



Source: Knight Frank Research, RCA

Investment volume breakdown

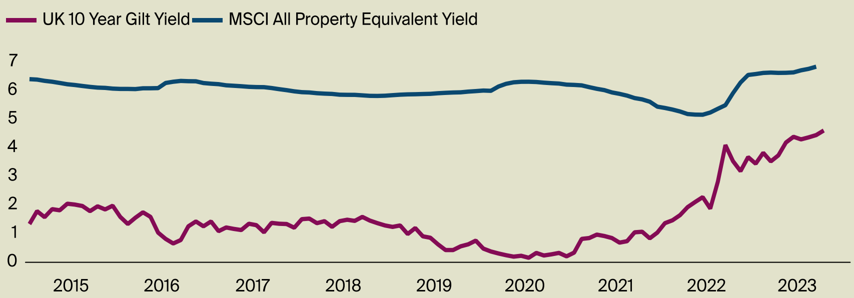
% of YTD 2023 volume



Source: Knight Frank Research, RCA

Property equivalent yield & gilt yield

%

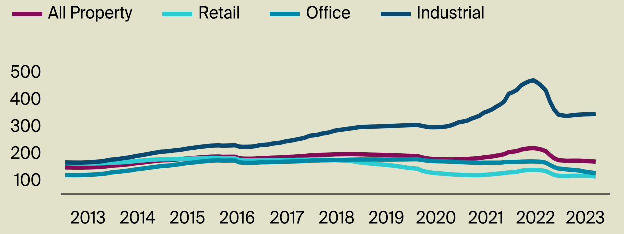


Source: Knight Frank Research, Macrobond, MSCI

Capital markets

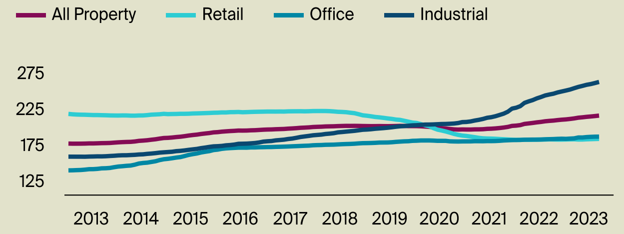
UK commercial real estate.

MSCI Capital Value Growth Index
Dec 1986 = 100



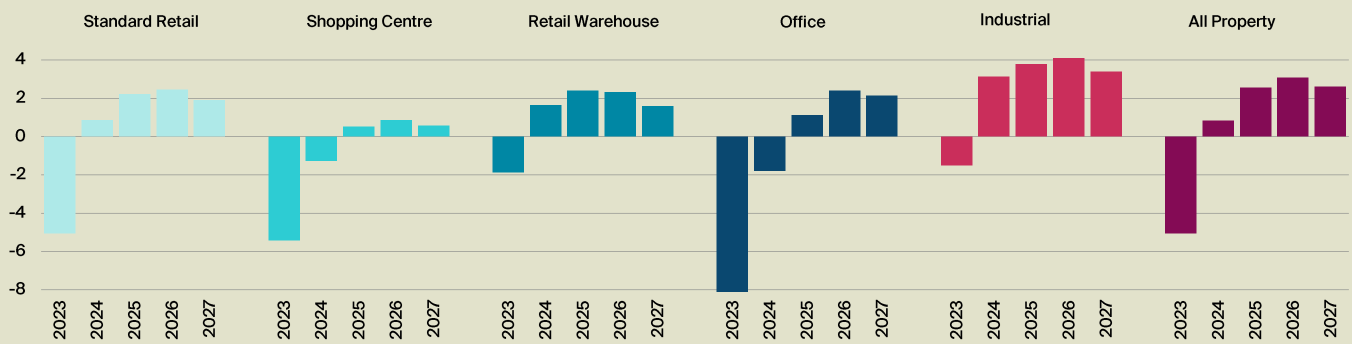
Source: Knight Frank Research, MSCI

MSCI Rental Value Growth Index
Dec 1986 = 100



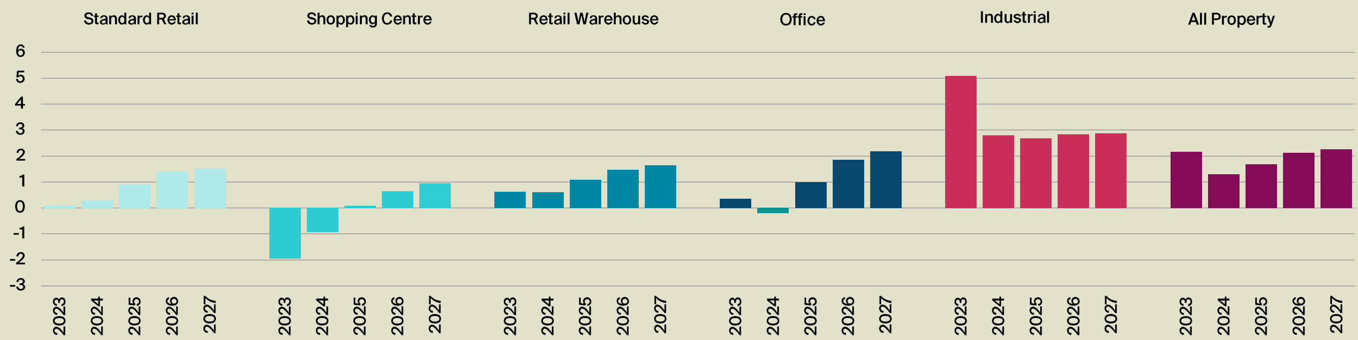
Source: Knight Frank Research, MSCI

IPF Consensus Capital Value Growth Forecast
%, August 2023 forecast



Source: Knight Frank Research, IPF

IPF Consensus Rental Value Growth Forecast
%, August 2023 forecast



Source: Knight Frank Research, IPF

Offices

The City, West End, Docklands, South East & UK Cities

CONTACT: LONDON – SHABAB QADAR, SOUTH EAST & UK CITIES – DARREN MANSFIELD

City offices

Transaction volumes rise as yields stabilise.

SENTIMENT TURNS IN INVESTMENT MARKET

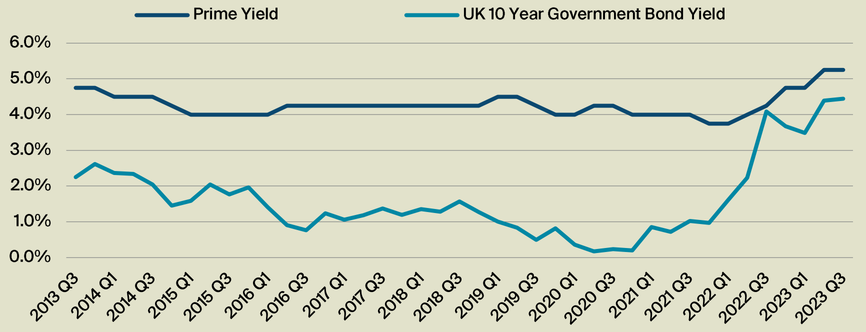
There was increased liquidity in capital markets as greater clarity emerged with regards to the peak in the interest rate tightening cycle.

Against this backdrop, transaction volumes rose by 78%, resulting in a total of £0.95bn for the quarter. The quarter's largest deal was the sale of Bloom, which was acquired by a private investor for £216m. The building is primarily let to Snapchat and located in Clerkenwell/ Farringdon, where leasing fundamentals remain relatively attractive. A further notable transaction was 8 Bleeding Heart Yard, let to the financial occupier Julius Baer, which was also purchased by a private investor. Investors from Europe and the United Kingdom were the most active buyers, with 35.1% and 29.4% of transaction volumes during the quarter, followed by APAC at 21.9%.

Private investors and private property companies represented 75% of all acquisitions, with the former representing over half (61%) of transactions for the quarter. By risk profile, there was a fall in the proportion of transactions which were for value-add opportunities (36%), whilst core (29%) and core plus (28%) accounted for larger shares of this quarter's total. Prime yields have remained stable at 5.25%.

City & Southbank - Prime yield and 10 year government bond yield

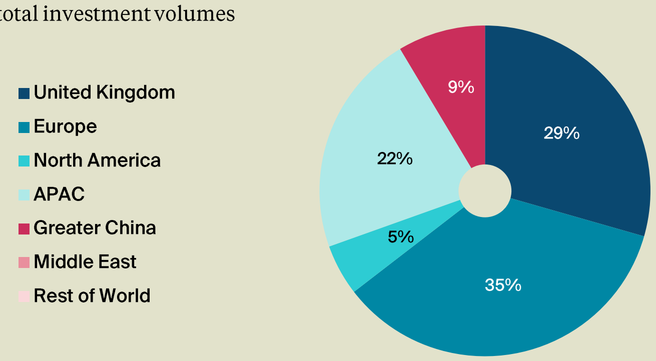
% per annum



Source: Knight Frank Research

City & Southbank: Investment volumes by nationality

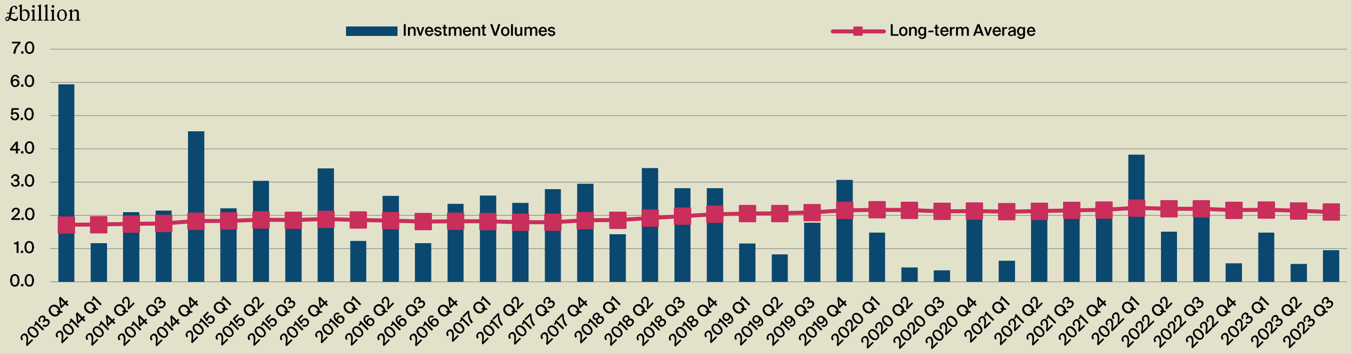
2023 Q3, % of total investment volumes



Source: Knight Frank Research

City & Southbank: Investment volumes relative to trend

£billion



Source: Knight Frank Research

City offices

Lettings transactions for new and refurbished offices drives take-up.

RISING LETTINGS MOMENTUM

During the quarter, there was 1.68m sq ft of take-up in the City & Southbank, a quarterly increase of 31.0% and a fraction above the long-term quarterly trend of 1.64m sq ft. More than 78% of lettings during the quarter were for new and refurbished space, demonstrating continued demand for best-in-class offices. The improvement in take-up is led by the City submarkets where lettings are higher in all submarkets. In contrast, take-up fell by a third, compared with the previous quarter in the Southbank market.

We expect positive momentum to be maintained, as active requirements have risen to 4.65m sq ft, a quarterly rise of 4.4%, and some 13% above the long-term trend. Moreover, space under-offer in the City & Southbank is c.2.2m sq ft.

Professional and financial occupiers persist as the largest drivers of take-up, representing 37.7% and 21.6% of the total, respectively. Last quarter saw a return of technology, media, and telecoms occupiers, with take-up rising 69% on the quarter, and accounting for 18.0% of all lettings.

During the quarter, the rental tone for prime offices in the City was buoyed by transactions at above market average rents. As a result, prime rents in the City Core have risen by £2.50 to £77.50 per sq ft. Rent free periods remain unchanged at 25-27 months in the City Core and Southbank Core submarkets for a typical 10-year institutional lease.

AVAILABILITY FALLS FOR THE FIRST TIME IN TWO YEARS

Availability has decreased by 2.4% during the quarter to 14.75m sq ft, resulting in a vacancy rate of 10.8% – or 3.9% percentage points above the long-term average. The fall in availability was driven by a healthier quarter of take-up and a number of withdrawals throughout the quarter.

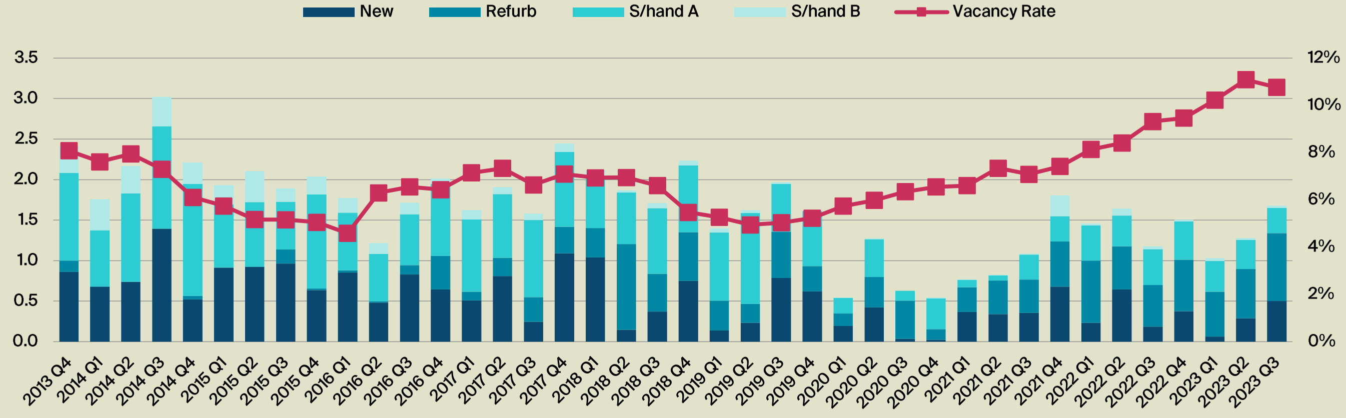
New and refurbished availability comprises 57% of the total by floorspace. However, comparing the distribution of available space by size band with current levels of active demand shows that there are only 31 new and refurbished buildings in the core City & Southbank submarkets that can suit a requirement of over 40,000 sq ft, whilst there are 40 active requirements for such space.

Completions totalled 0.73m sq ft, of which 88% has already been pre-let. Notable completions include 21 Moorfields, EC2, and Blossom Yard + Studios, which are fully pre-let to Deutsche Bank and Reed Smith LLP, respectively. Five new schemes were started during the quarter, totalling 1.3m sq ft of speculative space.

Future development completions are expected to deliver 11.0m sq ft between 2023 – 26, whilst only 25% of this floorspace has been pre-let. We expect pre-leasing activity in the City & Southbank to rise, particularly as lead-in times have been rising due to the relatively modest under-construction pipeline. Current lead-in times for pre-lets in the City & Southbank are 16.7 months, compared to 13.3 months 10 years ago.

City & Southbank: Take-up by quality and vacancy rate

Million sq ft, % of stock (RHS)



Source: Knight Frank Research

West End offices

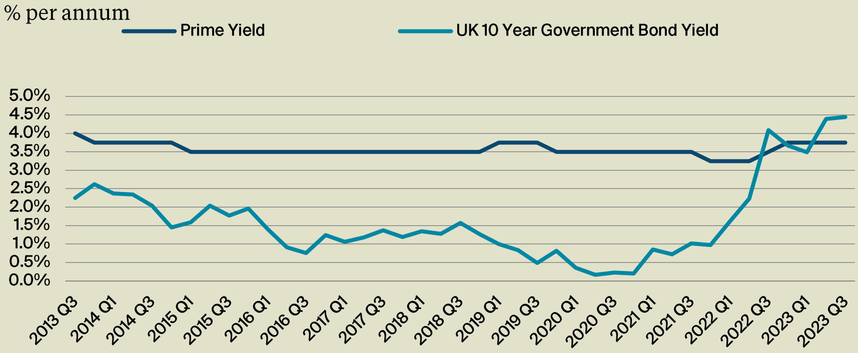
Liquidity remains low, but yields stabilise.

INVESTMENT FALLS ON THE QUARTER

There was £0.48bn of investment transactions this quarter, a 45.4% decrease on the levels seen in the previous quarter. The quarter's largest deal was Landsec acquiring The Printworks & Glasshouse, N1, for £90m. The second largest deal of the quarter was the Soho Square Estate, which was acquired by GPE for £70m.

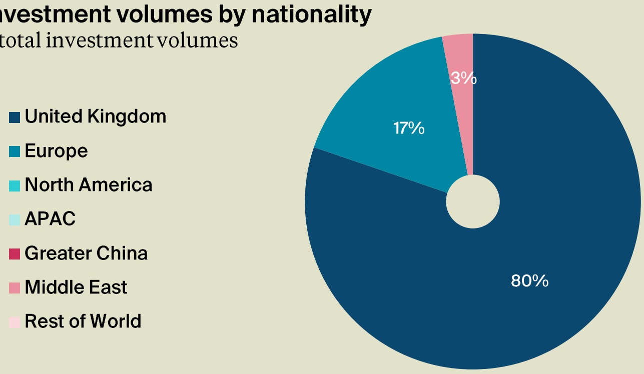
Investors from the United Kingdom have led activity in the third quarter, representing 78.4% of total volumes transacted, followed by European investors (16.4%). Quoted property companies were the main investor type, accounting for nearly half (46%) of all transactions. Over half of the quarter's acquisitions (57%) can be categorised as value-add assets. Prime yields have remained stable at 3.75%.

West End: Prime yield & 10 year government bond yield
% per annum



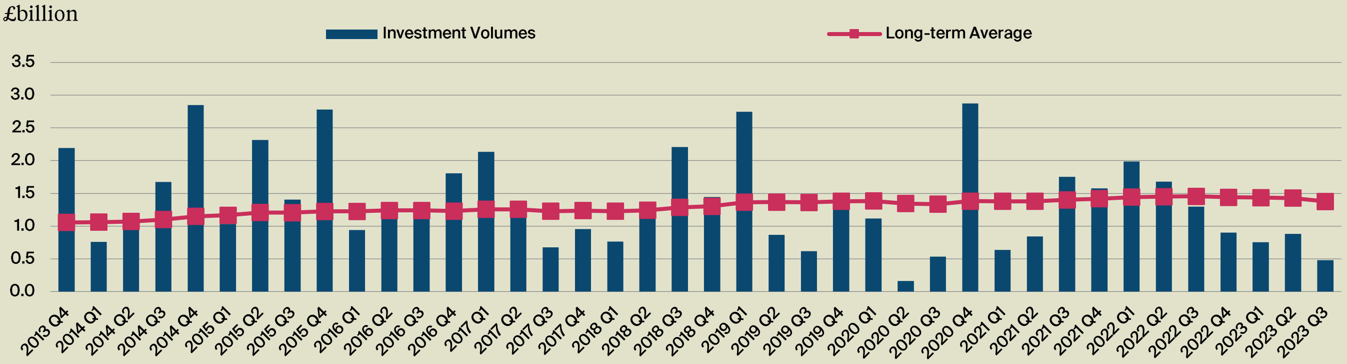
Source: Knight Frank Research

West End: Investment volumes by nationality
2023 Q3, % of total investment volumes



Source: Knight Frank Research

West End: Investment volumes relative to trend
£billion



Source: Knight Frank Research

West End offices

The shortage of prime space has driven further rental growth in the West End Core.

TAKE-UP RISES

In 2023 Q3, take-up totalled 0.87m sq ft, an increase on the previous quarter, although 21.8% below the quarterly long-term trend. Transactions for new and refurbished space totalled 0.35m sq ft, 19% below the long-term trend (0.45m sq ft) and representing 42% of all lettings. Accordingly, there was a significant rise in take-up of good quality second hand space, rising by almost 77% during the quarter, and accounting for 52% of leasing volumes.

The largest letting of the quarter was John Lewis PLC's leasing of 108,527 sq ft at 1 Drummond Gate, SW1. The transaction is understood to be a temporary move while their Victoria headquarters undergoes refurbishment. It was the only West End transaction above 50,000 sq ft during the quarter and resulted in the average deal size rising to 5,706 sq ft from the 5,215 in 2023 Q2. The second largest transaction was Moelis & Company, pre-letting 49,175 at 25 Baker Street, W1. The deal takes 25 Baker Street 79% pre-let. The financial services company will join Pimco in the building when it completes in 2024.

Corporate occupiers represent the dominant occupier group in the West End during the quarter, accounting for 33% of the total, primarily due to the John Lewis deal. Financial occupiers follow with 19.6% of total take-up.

Active requirements have increased to 2.66m sq ft, up more than a third on the quarter and nearly 40% above the long-term trend. Financials continue to drive demand with 44.9% of the total, followed by corporate occupiers (20.9%) and professionals (19.5%).

MARGINAL RISE IN AVAILABILITY

Availability rose for a third consecutive quarter by 2.3% to 6.7m sq ft. This minor change has resulted in no change to the vacancy rate of 7.1%. New and refurbished space accounts for 67% of availability at 4.47m sq ft. However, the availability of new and refurbished buildings is lower at 41%, and a lack of available buildings is evident above 60,000 sq ft.

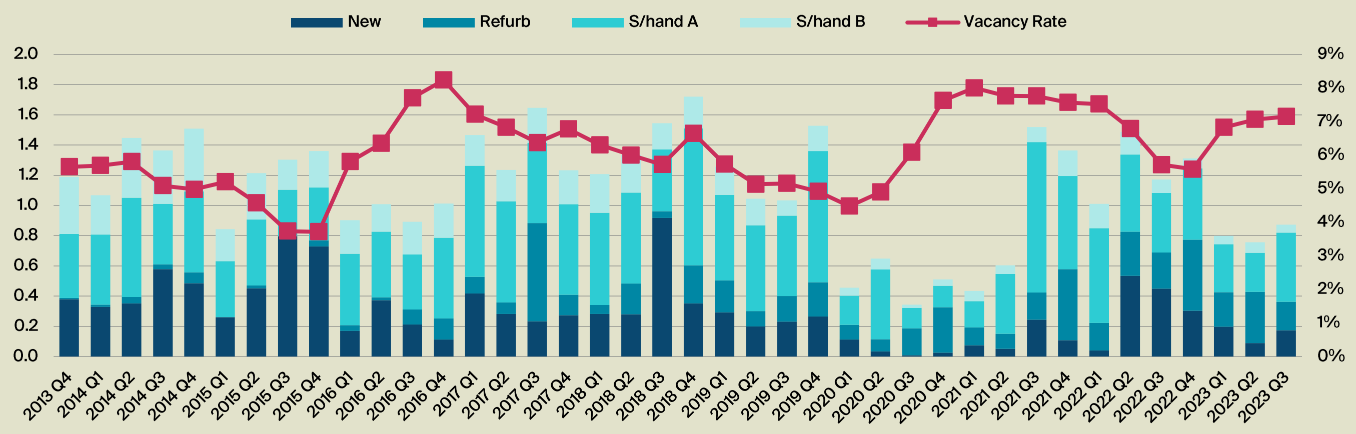
There were 0.95m sq ft of completions in 2023 Q3, of which 55% was pre-let. Notable completions include the Earnshaw, WC1, and 31 St James Square, SW1, both of which had healthy lease-ups before completion with GlaxoSmithKline PLC making the Earnshaw their new London headquarters, and an array of niche financial occupiers taking 31 St James Square to 60% pre-let on completion.

The under-construction pipeline has decreased during the quarter to 5.05m sq ft, 3.78m sq ft of which is being built speculatively. Four buildings started in 2023 Q3 and will deliver 0.3m sq ft of speculative space by 2027.

RENTAL TENISON IN WEST END

Prime rents have risen in two West End submarkets. The underlying acuteness of supply in the West End Core and Marylebone has driven rental growth, with rents rising by £5 to £140.00 per sq ft and by £3 to £100.00 per sq ft, respectively. Rent-free periods are unchanged at 24 months on a typical 10-year lease.

West End: Take-up by quality and vacancy rate
Million sq ft, % of stock (RHS)



Source: Knight Frank Research

Dockland offices

Take-up has doubled over the quarter as occupier base further diversifies.

TAKE-UP INCREASES ON THE QUARTER

There were seven lettings in Docklands & Stratford, totalling 156,041 sq ft. This is double the activity seen in the previous quarter but is 28.5% below the long-term trend. The largest transaction occurred in Stratford, with Liverpool Media Academy acquiring an additional 52,300 sq ft at Here East, E20, taking their total footprint in Stratford to 151,325 sq ft. The subsequent two largest transactions were in Canary Wharf, with hVIVO PLC letting 39,049 sq ft at 40 Bank Street, E14, and McLaren Group letting 22,573 sq ft at 20 Churchill Place, E14. Take-up of new and refurbished space increased marginally during the quarter to 52.5% of total lettings.

Miscellaneous occupiers, mainly educational institutions, accounted for 33.5% of take-up, followed by corporates at 25% and professionals at 23.1%.

Active requirements have increased marginally to 230,000 sq ft, with financial occupiers (47%) and the public sector (40%) being the most active.

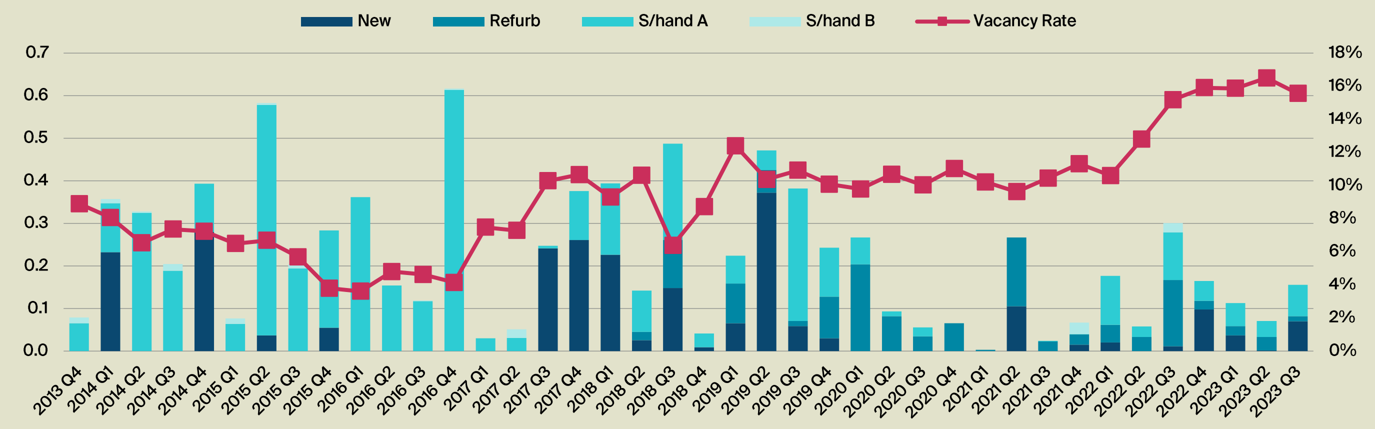
Prime rents are unchanged at £55.00 per sq ft in Canary Wharf and £48.50 in Stratford. Rent free periods remain stable at 27 – 30 months in the former and 27 months in the latter for a typical 10-year lease.

DECREASING AVAILABILITY

Availability decreased by 4.9% over the quarter to 3.91m sq ft. This has caused the vacancy rate to fall to 15.6% for the quarter. The decrease is due to the limited pipeline of new stock and a healthier quarter of leasing transactions.

There were 214,333 sq ft of speculative completions during the third quarter, with the completion of three parts of Vastint's Sugar House Island scheme. Colour Works, Ink House, and the Type building form the canal-side Chimney Walk office development. With these completions, the development pipeline shrinks to one under construction scheme, the Turing Building, which is set to deliver 350,735 sq ft of space in 2024 Q3.

Docklands & Stratford: Take-up by quality and vacancy rate
Million sq ft, % of stock (RHS)



Source: Knight Frank Research

South East offices

Investment volumes in Q3 were low, with the high cost of debt and continuing economic turbulence undermining investor confidence.

INVESTORS PAUSE IN Q3

Investment transactions in the third quarter totalled £111.3 million across 15 deals, with smaller-sized acquisitions dominating activity due to the current debt financing environment. Deal sizes in Q3 reflected the year so far, with all but two transactions during 2023 having been completed at a price under £50 million. However, positively, over £500 million of stock was under offer or had recently been exchanged at quarter end, suggesting a busier final quarter of the year.

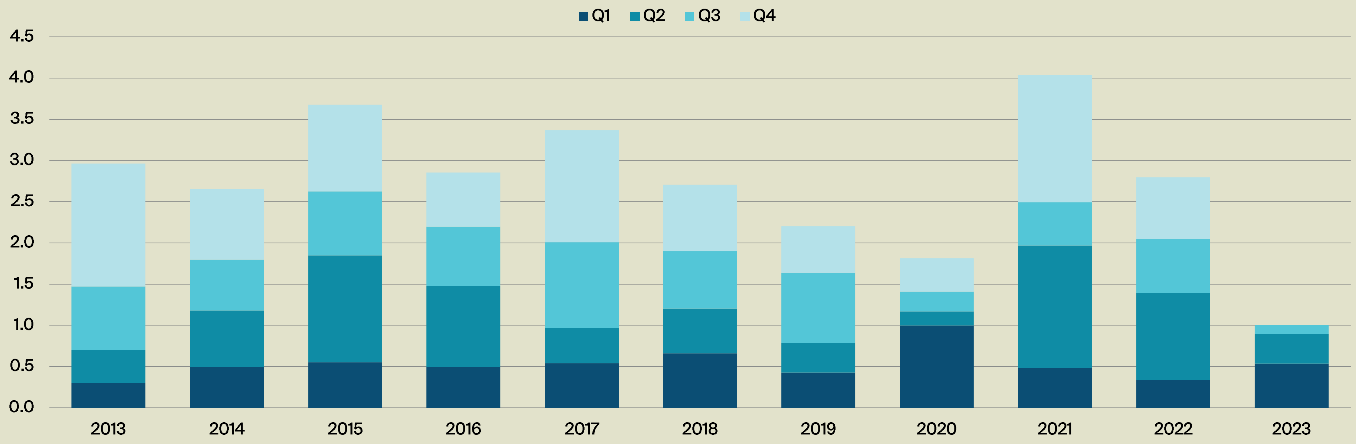
PRICE SHIFT IN Q3

Prime office yields in the South East softened by a further 25bps to 6.75% in Q3, albeit the potential for additional outward shifts is reducing. The Bank of England's recent decision to hold base rates and the recent dip in the 5-year SONIA swap rate add some weight to the prospect of a slightly more favourable investor environment moving forward. Even so, the cost of debt remains a hurdle to activity, with most investors continuing to take a cautious stance.

BUYER POOL REMAINS THIN

Anticipation of pricing movement, high cost of debt, and economic disruption for overseas buyers in their domestic markets has thinned the buyer landscape for South East offices in 2023. Institutional capital remains largely absent, albeit this primarily reflects the lack of opportunities to buy prime stock. US Private Equity interest has also retreated as US markets and the US economy has deteriorated. Analysis of 2023 transactions indicates that property companies account for most acquisitions at 37%, with private investors the next at 23%. Both have sought low-value buildings with long income or asset management opportunities.

South East: Investment volumes
£billion



Source: Knight Frank Research

South East offices

Leasing volumes and active demand improved in Q3. Supply levels remain static, with the development pipeline challenged by rising costs.

TAKE-UP RISES AS THE HIGH DEAL COUNT CONTINUES

Total take-up for the region as a whole proved respectable but not exceptional. Just over 870,831 sq ft was let or acquired by occupiers, marginally above the long-term quarterly average and the highest total in 2023. A higher-than-average deal count was again evident during the quarter, demonstrating a general escalation of organisations reacting earlier to upcoming lease events. In Q3, 90 occupier transactions were completed, ahead of the long-term quarterly average of 60. Notably, Cambridge and Oxford continued to register the highest interest, with the two cities accounting for 26% of take-up in Q3 and 31% when considered over the year-to-date.

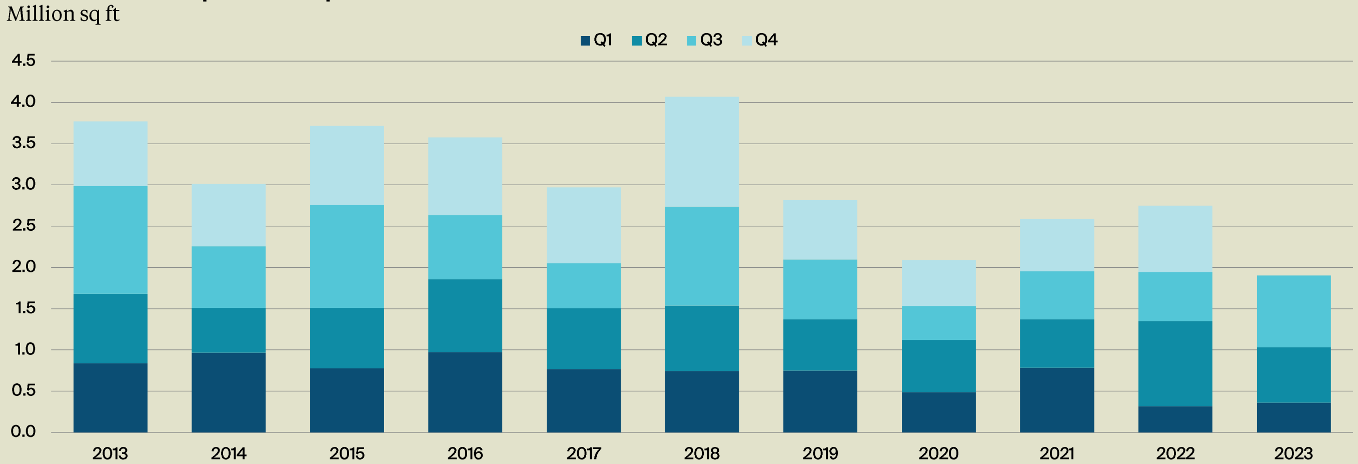
A FURTHER UPTICK IN THE FOURTH QUARTER?

As year-end approaches, leasing volumes for 2023 have reached 2.0m sq ft, 15% less than recorded at the equivalent juncture in 2022. Notably, however, close to 1.3m sq ft of space was under offer at quarter end. Of this total, 20% was for Cambridge and Oxford, with the remaining 1m sq ft targeting the broader South East market. Furthermore, named demand also had exceeded the 5m sq ft mark by quarter end, finalising at 5.4m sq ft headed by firms from the technology sector that account for 39%. This total is the highest for two years.

VACANCY RISING, BUT BEST QUALITY SUPPLY REMAINS STABLE

Overall vacancy nudged higher during Q3 to finish the quarter at 7.9%, just above the long-term trend of 7.3%. Notably, the availability of New & Grade A space remained stable. At quarter end, the vacancy rate relating to New and Grade A space was 5.8%, unchanged from the previous quarter and demonstrating the short void periods of well-located, good-quality space in the current marketplace. The development pipeline offers little for those targeting new space in the core South East markets. At quarter end, 1.7m sq ft of speculative space was under construction and due for delivery before the end of 2025. Beyond the next 24 months, though, construction starts will likely be scarce, with yield shifts, rising debt, and construction costs impacting developer appetite. Outside of the South East Core, developer activity is higher. In Cambridge and Oxford, 1.35m sq ft is under construction with a delivery date before the end of 2025.

South East: Occupier take-up
Million sq ft



Source: Knight Frank Research

UK Cities offices

Investment volumes rise over the quarter, but liquidity remains focused on smaller lot sizes.

INVESTMENT VOLUMES RISE IN Q3

Office investment across the UK cities in Q3 reached £292.75m, reflecting a 20% increase when compared to the previous quarter. Even so, the third quarter total was 42% below the 5-year quarterly average, demonstrating the current challenged marketplace. The sale of Brindleyplace in Birmingham to Praxis and Veld Capital for £125m underpinned the quarterly rise. This transaction is the largest office acquisition outside of London to complete this year.

YIELDS SOFTEN FURTHER

In Q3, prime yields softened in nine of the ten regional cities studied, with pricing under pressure in response to elevated swap rates and the erosion of the gap between UK gilts and office yields. As of Q3, prime yields ranged from 6.00% to 8.25% across the UK cities. These reflect an outward shift of +25bps to +75bps, albeit there has been little transactional evidence at present. With the Bank of England holding interest rates, expectations are that pricing will begin to stabilise, at least for prime. Secondary assets and shorter income may see further drift as price discovery continues.

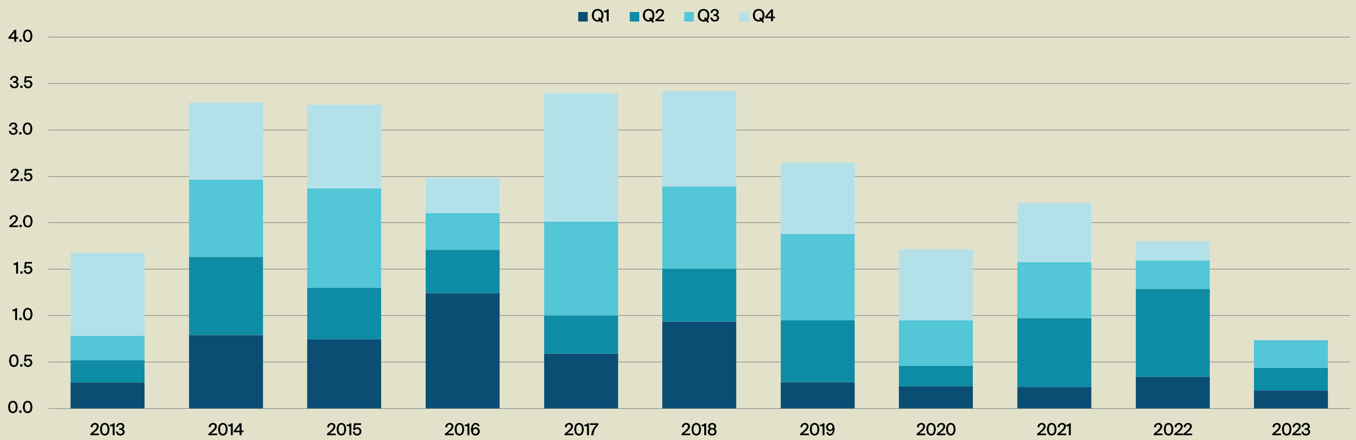
PROPERTY COMPANIES DOMINATE

In Q3 2023, property companies accounted for 75% of total office investment deals across the regional cities. Of 16 investment deals in the quarter, 12 involved property companies as the purchaser. Considered across the year so far, property companies have been responsible for 35 of 56 acquisitions, representing 65% of total investment volumes in 2023.

SIZE MATTERS

An interesting statistic of 2023 was that only two deals have completed above £50m and only five above £30m. This is the lowest number at this stage of a year since 2013 and demonstrates the principal area of focus for investors. Transactions below £10m account for 65% of all deals, the highest share of the market for nine years.

UK Cities: Investment volumes
£billion



Source: Knight Frank Research

UK Cities offices

Occupier take-up rises in Q3, whilst Grade A supply slips to an 18-month low.

OCCUPIER ACTIVITY INCREASING

Total take-up across the UK cities reached 1.3m sq ft in Q3. This figure is in line with the 10-year average and represents a 27% increase when compared to Q2 2023. Even so, year-to-date, leasing volumes sit at 3.4m sq ft. This total is 9% lower than recorded at the same juncture in 2022.

DEMAND FOCUSED ON BEST QUALITY

Occupiers continued to target best quality space in the third quarter, with New or grade A space accounting for 57% of the combined UK Cities take-up in Q3. In some cities, this percentage was above 80%. Significant lettings for grade A space included BT taking 65,000 sq ft at Endeavour in Sheffield, Lloyds Bank leasing nearly 60,000 sq ft at 6 Brindleyplace in Birmingham, and Arden University taking 43,000 sq ft at Two Hardman Street in Manchester.

DEVELOPMENT PIPELINE REMAINS SHALLOW

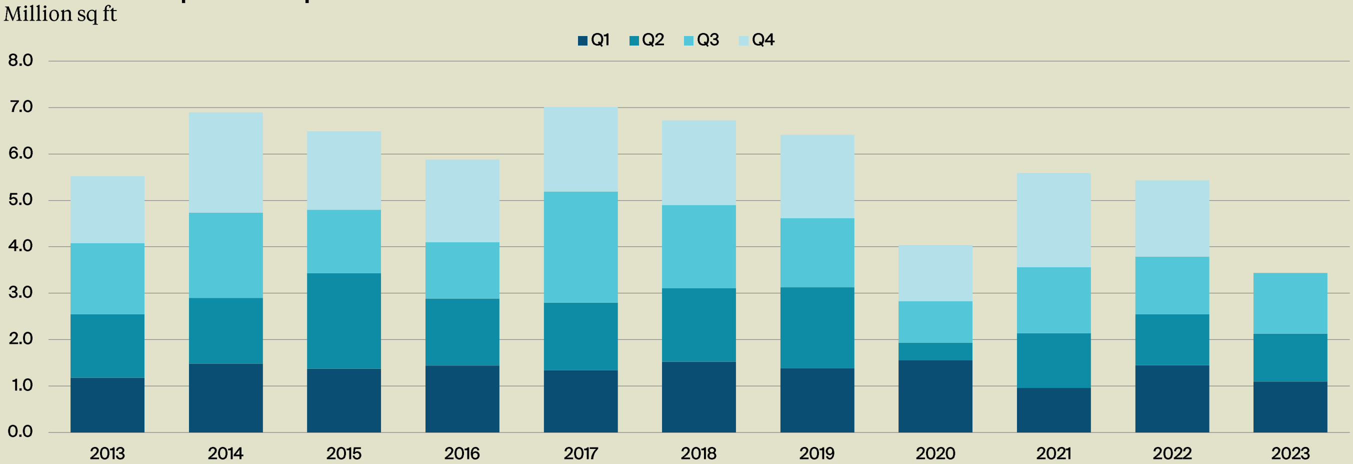
The total amount of speculative office space under construction rose by 400,000 in Q3 to just under 4.4m sq ft in Q3. Close to 50% of this total is due to reach practical completion by the end of the year. This could mean a short-term increase in the new and grade A vacancy rate. Beyond this, 2.1m sq ft due to complete of the following 48 months to the end of 2025. With construction and debt costs elevated and market rates moving out, additional development project starts will be selective and primarily back by a significant pre-let.

SUPPLY CONSTRAINTS INITIATING EARLY OCCUPIER ACTION

A lack of supply for best-in-class space across the UK office market means that occupiers are increasingly looking to agree lease terms further ahead of their lease breaks and expiries, to ensure they secure the type of space they require. Early action is most acute for larger space requirements, where availability is particularly tight. Although the overall market vacancy rate has risen above 10%, the rate for new and grade A rate remains below 5% and, in some examples, 1-2% of total stock.

This narrowing of supply has led to rental growth for Prime. During 2023, seven of the ten UK Cites markets have recorded an uplift in prime rent.

UK Cities: Occupier take-up
Million sq ft

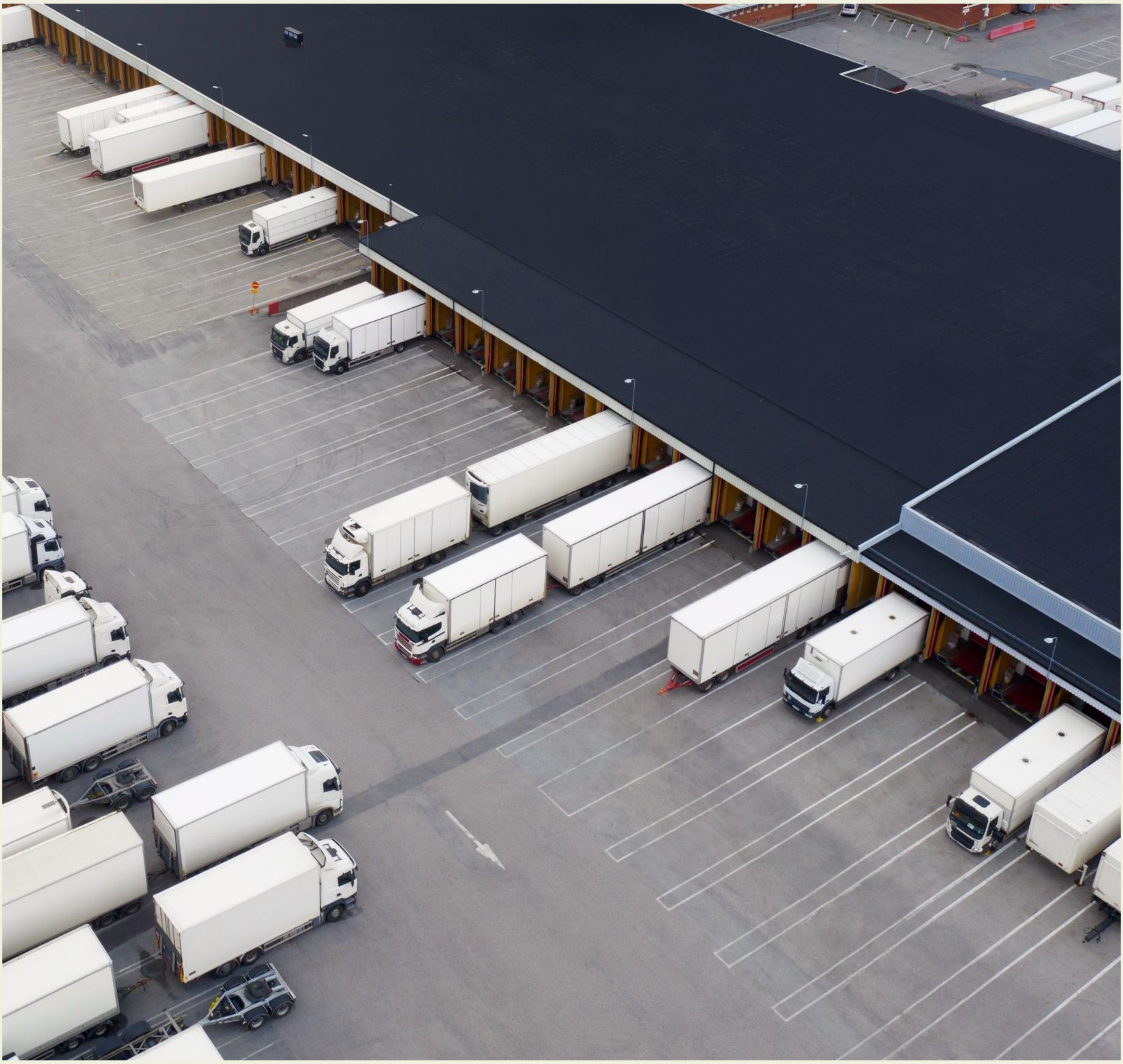


Source: Knight Frank Research

Industrial & distribution

Investment and occupational markets

CONTACT: DEIRDRE O'REILLY



Industrial & distribution

Prime yields stabilise but remain under pressure.

INVESTMENT VOLUMES THIN BUT AHEAD OF PRE-PANDEMIC AVERAGES

Industrial investment figures for Q3 2023 show a total of £2 billion invested. This brings the total for Jan-Sept 2023 (YTD) to £7.2 billion, and while 48% lower compared with the £14 billion transacted over the same period in 2022, it is 51% ahead of the ten-year YTD pre-pandemic average (2010-2019), of £4.8 billion. YTD 2023 investment has also exceeded the ten-year pre-pandemic annual average of £7.1 billion (+2.4%).

Investment activity remains challenged by the cost of finance, the gap between purchaser and vendor expectations, and yield repricing. There remains a weight of capital targeting the sector with well-capitalised buyers seeking out a pricing advantage, but as vendors continue to see value in industrial property over other asset classes, a leaner pool of sellers has also slowed deal activity. Cross-border investors continue to contribute the largest share of capital, accounting for 61.7% YTD. Private capital accounts for a further 16.5%, while institutional investors and REITs have been less acquisitive so far this year.

GROWTH IN ANNUAL INCOME RETURNS

Capital values in the UK industrial sector have returned to positive growth territory, up +0.2% in September. Annualised capital values declined by -19.7% in September, but this is an improvement from -22.8% in August and -26.7% in June (MSCI).

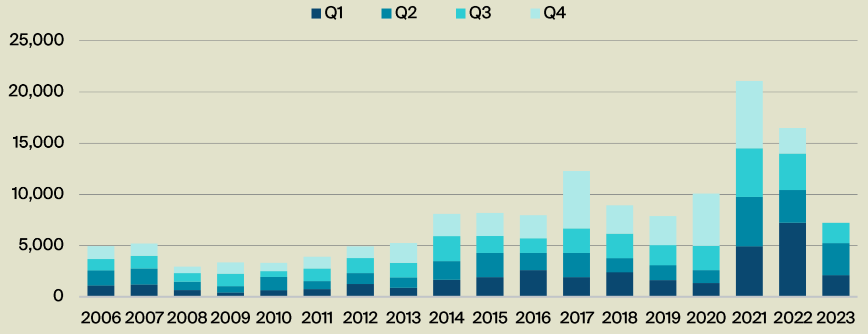
Monthly total returns also remain positive, with +0.6% growth in September. Annual total returns were -15.8% lower in September, but up from -19.2% in August and -23.4% in June.

Monthly income return remained unchanged at +0.4% in September, equating to +4.7% over the past year.

STABILISATION IN PRIME YIELDS

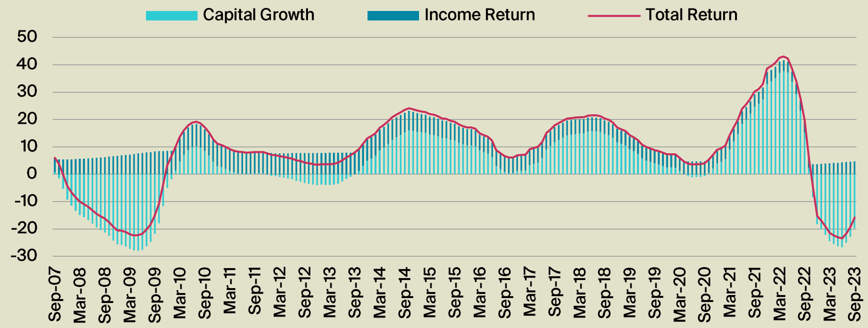
Prime Distribution / Warehousing with 15-year income on open market rent reviews remained stable in Q3, at 5.25%, though they remain under pressure given elevated government bond yields. Since their turning point in June 2022, prime yields have softened by 175bps.

Investment volumes
£million



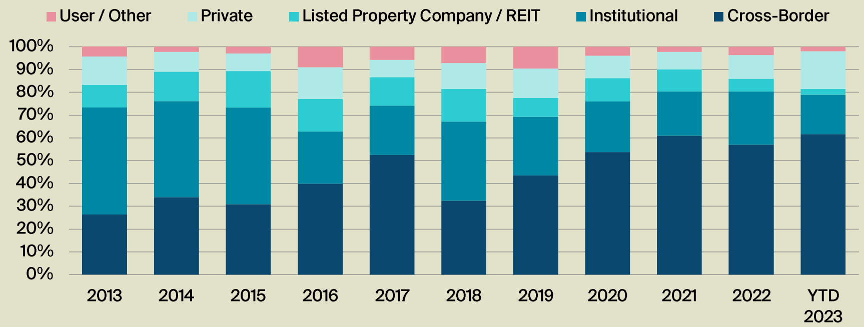
Source: Knight Frank Research, RCA

Total return (annualised)
%



Source: Knight Frank Research, MSCI

Capital composition
%



Source: Knight Frank Research, RCA

Industrial & distribution

Average rents continue to grow despite moderation in take-up.

TAKE-UP LEVELS MODERATE

Amidst the challenging economic backdrop, occupier take-up volumes have fallen this year, with approx. 21.5 million sq ft occupied over Jan-Sep (YTD), representing a significant 43% fall year-on-year (units over 50,000 sq ft). Although Q3 2023 take-up volumes were reasonably robust at 8.6 million sq ft, exceeding Q2 by 53%, the quarterly total was 24% lower than Q3 2022 levels.

The latest occupier data demonstrates continued resilience from distribution firms and a growing share of take-up by manufacturers, but a decline in demand from retailers. Distribution firms accounted for 48% of all floorspace taken in the four quarters to Q3 2023, up from 41% in the comparable period last year. Manufacturing firms represented 27% of the annual take-up to end-Sept, up from 21% in the same period last year. The share of take-up by retailers has declined to 18% this year, from 26% last year.

CONTINUED RENTAL GROWTH

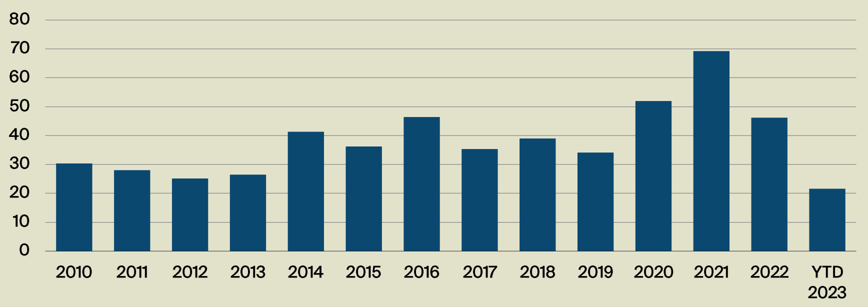
Average rents for UK industrial are still rising, albeit at a more modest pace. Annual market rental value growth in the year to September 2023 was +7.1%, down from +13.0% in the year to September 2022 (MSCI). Month-on-month growth showed a slight acceleration in September, with +0.57% growth, up from +0.54% in August.

VACANCY RATE RISES, WHILE SPECULATIVE DEVELOPMENT DECLINES

The latest Q3 2023 figures show the vacancy rate increasing from 4.6% in Q2 2023 to 5.2% in Q3. The rise in vacancy is largely driven by development completions, as well as the return of second-hand space to the market.

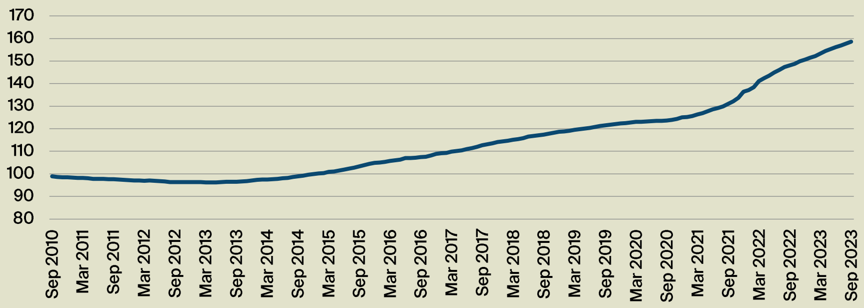
While we may see further rises to the vacancy rate, it remains well below the long-term, pre-pandemic average, of 8.3%. A decline in development activity this year will also mean a slowdown in the delivery of new space to the market next year. Approx. 15.4 million sq ft of space was under construction speculatively at end-Q3, 28% lower on the previous quarter and -30% year-on-year (units 50,000 sq ft+).

Take-up (units over 50,000 sq ft)
Million sq ft



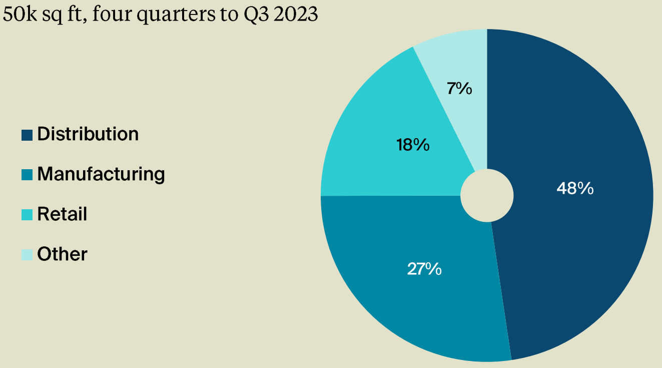
Source: Knight Frank Research

Average market rental growth
Jan 2010 = 100



Source: Knight Frank Research, MSCI

Take-up by occupier type
Units over 50k sq ft, four quarters to Q3 2023



Source: Knight Frank Research

Retail & leisure

Retail, high street, shopping centres, out-of-town, leisure, foodstores and Central London

CONTACT: EMMA BARNSTABLE

Retail

The sector proved its resilience again in Q3 despite tough market conditions.

CONSUMER CONFIDENCE REBUILDS

The mood of the nation has improved substantially over the last year (-21 pts in September 2023 vs. -49 pts in 2022), driven by improvements in inflation, stabilisation of interest rates, strong wage growth, and job security. Confidence ultimately still tracks negatively – but has not been positive since 2016.

Notably, consumers feel more confident in their personal financial outlooks (-8 pts) than the wider economy (-32 pts). Accordingly, Q3 retail sales were solid, growing +5.6% YoY, although inflation still impacted volumes (-2.0%).

RETAILERS HOLD STRONG DESPITE WILKO FALLOUT

Distress amongst occupiers has been limited, despite the demise of Wilko sparking fresh fears of wider malaise.

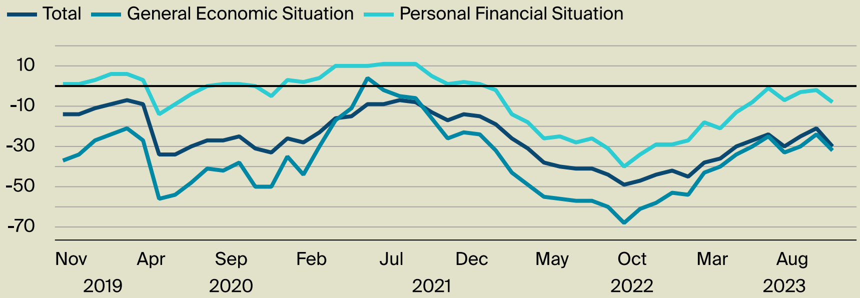
In 2023 YTD figures, just 41 retail business failures affecting 970 stores have been tracked by CRR. This compares to 49 retailers and 2,318 stores in 2022. The fact substantially fewer bricks and mortar locations have been affected indicates distress has been concentrated among online retailers. August arguably marked the first 'major' bricks and mortar retail casualty of the year – Wilko.

INVESTMENT VOLUMES IMPROVE

Retail investment volumes totalled £1.7bn in Q3. This was -6% down on the corresponding quarter in 2022, but up +82% QoQ against a particularly lacklustre Q2. The QoQ increase was largely driven by Shopping Centres (where deals, by their nature, are lumpy) and a general resurgence in Foodstores.

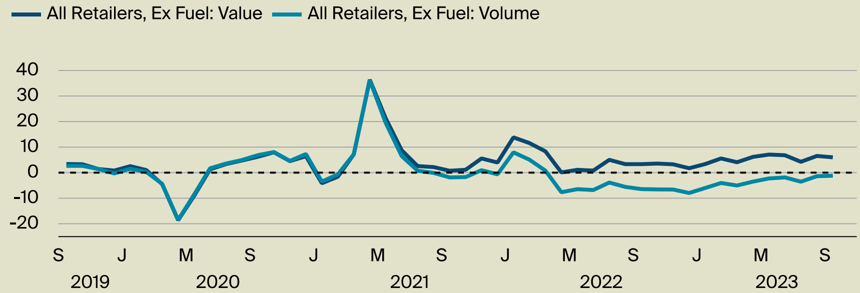
Total returns across capital markets are still registering in negative territory. However, Retail is proving the most resilient of the major sub-sectors. In the 12 months to September, Retail total returns (-8.3%) were higher than All Property (-13.7%), Offices (-18.9%), and Industrial (-15.8%). Retail also delivered the highest income return at 6.8% over the same period.

Consumer confidence
Confidence over the next 12 months



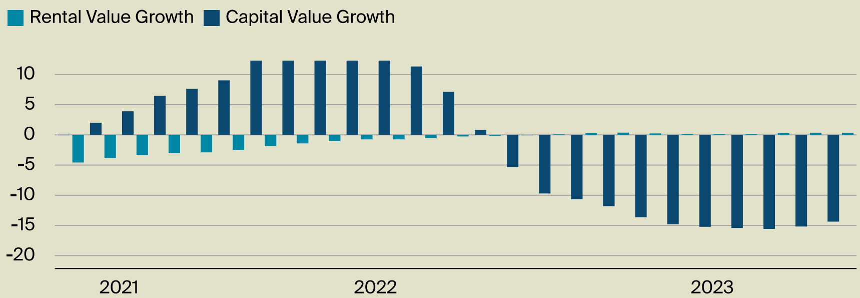
Source: Gfk

ONS retail sales
Monthly YoY change, %



Source: ONS

All retail – rental/capital value growth
Rolling 12 month % change



Source: MSCI

High street retail

Vacancy rates stabilised below pandemic peak as occupiers gradually re-absorbed & repurposed units.

VISITS RESILIENT VERSUS WIDER RETAIL

High Street footfall fluctuated under mixed summer weather (July: +1.6% YoY / August -0.9% / September -1.7%) but has generally compared favourably to All Retail averages (July: +1.8% / August -1.6% / September -2.9%). Unseasonably warm weather in September benefited High Streets to a degree, witnessing the smallest YoY decline (-1.7%) of all the sub-sectors (RP -2.4% / SC -4.0%).

City Centre destinations also fared relatively well (-1.6%), with Edinburgh (+7.5%) and Liverpool (+3.4%) seeing a major uplift in footfall numbers.

VACANT SPACE REOCCUPIED

Operators saw Wilko's demise as an opportunity to selectively acquire prime, high-footfall locations in major towns and cities across the UK. Portions of its physical estate have quickly been re-absorbed: B&M acquired 51 stores for £31m, and 75 stores are reopening under the Poundland fascia. In October, Wilko announced its return to high streets, with five locations due to open.

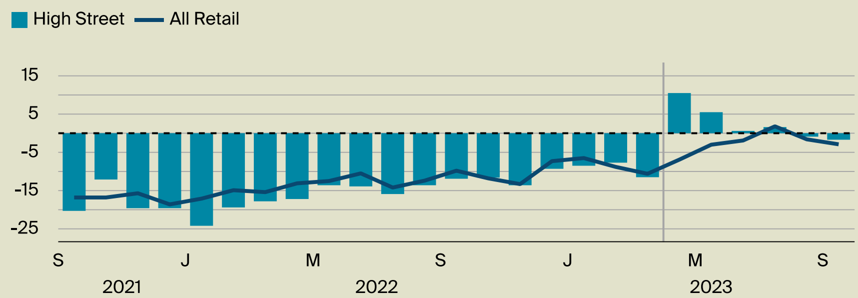
Reoccupation of space has helped stabilise vacancy rates in Q3 2023 (14.0%) which are now below the pandemic peak (14.5%). According to LDC, 50% of former Arcadia stores have now been reoccupied or repurposed to other uses, alongside 59% of ex-Debenhams and 91% of ex-BHS stores.

FLURRY OF INVESTMENT ACTIVITY

Pent-up sales brought more stock to market, creating a flurry of activity and accelerating transaction volumes by +16% QoQ. Activity was concentrated in prime and regional towns and cities, with liquidity greatest for smaller lot sizes, with cash buyers less impacted by elevated debt costs.

Prime Yields remained stable at 6.75%, although Good Secondary witnessed a +25bps softening. Key deals included Dickens Yard, Ealing – a retail, leisure, and residential quarter including 28 retail units, and the sale of the Lush flagship at 38 – 46 Church Street, Liverpool for £8.8m.

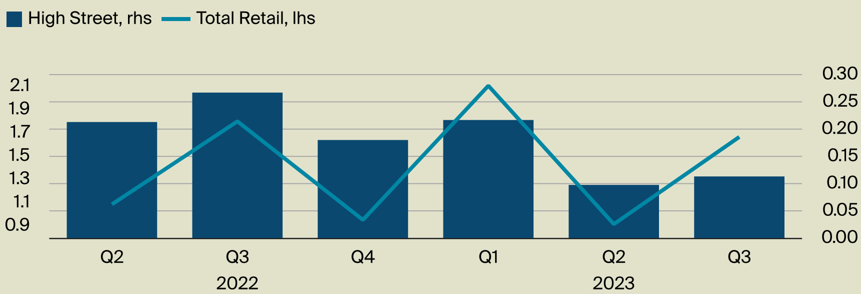
High street footfall
Monthly YoY change, %, vs. 2019 levels



*March 2021 – March 2023 figures are compared to 2019 levels

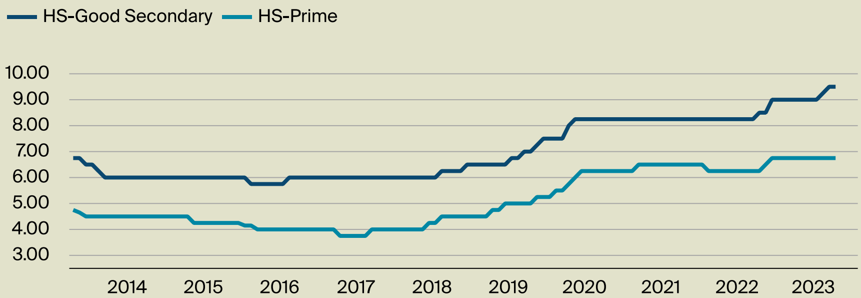
Source: BRC / Springboard

High street investment volumes
£million



Source: Knight Frank

High street yields
%



Source: Knight Frank

Shopping centres

Strong occupational activity in prime locations buoyed by robust consumer demand for clothing, footwear, and cosmetics.

DISCRETIONARY GOODS DEMAND HOLDING UP

Q3 retail sales (values) grew by a robust +5.6% YoY, with Non-Food increasing +3.7%. Demand for discretionary categories was mixed, but standout categories witnessed value and volume growth: Footwear (+20.9% / +15.3%), and Cosmetics (+11.2% / +3.2%).

Visits to SCs have been slow overall, with recent monthly footfall displaying fluctuating year-on-year declines (July +0.2% / August -3.8% / September -4.0%). The deterioration of footfall has generally been more severe in Shopping Centres than wider Retail (July +1.8% / August -1.6% / September -2.9%).

STRONG OCCUPATIONAL PERFORMANCE IN PRIME LOCATIONS

Leasing activity has been strongest in prime locations with expansion and upsizing of key players (e.g. Frasers Group 120,000 sq ft deal in Sheffield's Meadowhall / Boots 11,200 sq ft beauty flagship in Battersea Power Station). Leading operator URW reported strong rental performance (+2.1% LfL) in the first nine months of 2023, with tenant sales (+7.9%) and footfall (+6.3%) both up YoY.

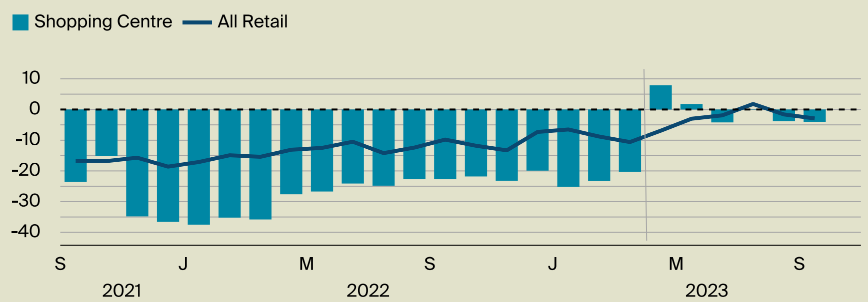
The collapse of Wilko did affect many Shopping Centres in the mid-secondary markets. Overall, vacancy rates inched up marginally by +10bps, ending a nine-quarter streak of improvements (Q3: 17.9%).

TRANSACTIONS CASH LED

Investment markets continue to be characterised by elevated financing costs, with most transactions taking place on a cash basis, drastically reducing average lot sizes, with very few transactions above >£20m taking place.

A handful of owners did acquire minority shares in assets they already own, boosting volumes (e.g. Aviva, Bentalls Centre). Deal volumes did accelerate in Q3 but remain below 10-year averages (£2.5bn). Landsec's progression of negotiations to acquire a 69% stake in Liverpool One could boost year-end totals: however, full recovery in transaction volumes is unlikely to take hold for another 12-months.

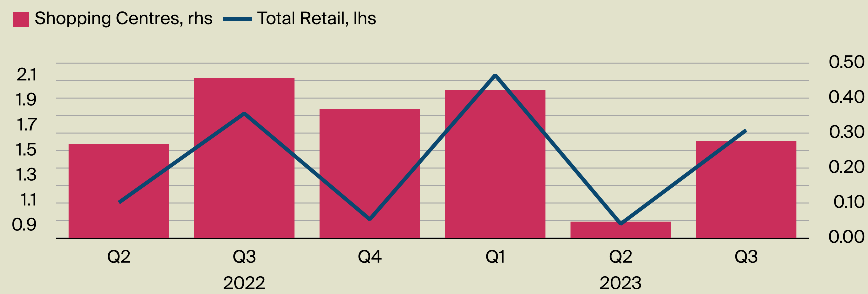
Shopping centre footfall
Monthly YoY change, %, vs. 2019 levels



*March 2021 – March 2023 figures are compared to 2019 levels

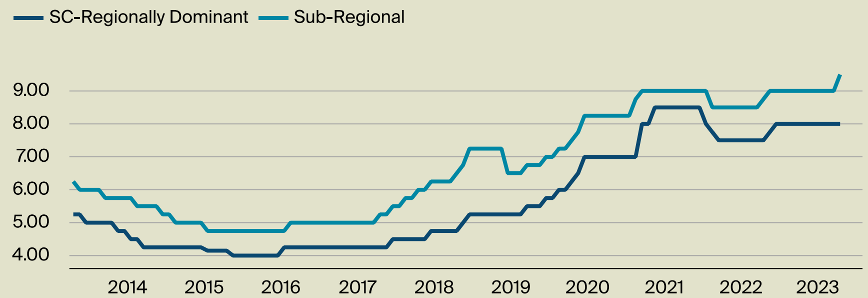
Source: BRC / Springboard

Shopping centre investment volumes
£million



Source: Knight Frank

Shopping centre yields
%



Source: Knight Frank

Out-of-town

Retail Parks / Retail Warehousing remain one of the retail sector's bright spots, favoured by consumers, operators, and investors alike.

MIXED DEMAND FOR BULKY GOODS

The popularity of the retail park format amongst consumers holds strong. Footfall has fluctuated (July +1.4% YoY / August 0.0% / September -2.4%) but continues to show greater resilience than All Retail (July -1.8% / August -1.6% / September -2.9%).

In terms of retail sales, performance amongst Out-of-Town (OOT) categories was mixed. There was evidence of softening demand for select 'big-ticket' items: Computers & Telecomms (-11.5%) Household Electricals (-2.2%), DIY (-0.4%). But equally positive sales growth amongst Sports Equipment (+1.4%), Furniture (+7.2%), and Floor Coverings (+8.0%).

A WINNING OPERATIONAL FORMAT

Occupiers continue to favour OOT locations, attracted to affordable rents and omni-channel capabilities.

According to LDC, Retail Parks were the only asset class to record a net increase in units occupied in H1 2023 (i.e. more openings than closures), with grocers, health clubs, and food-to-go operators driving take-up. Additionally, it was the only format to record an improvement in its vacancy rate to 8.1%; a rapid recovery from its pandemic peak of 11.5% (H1 2021).

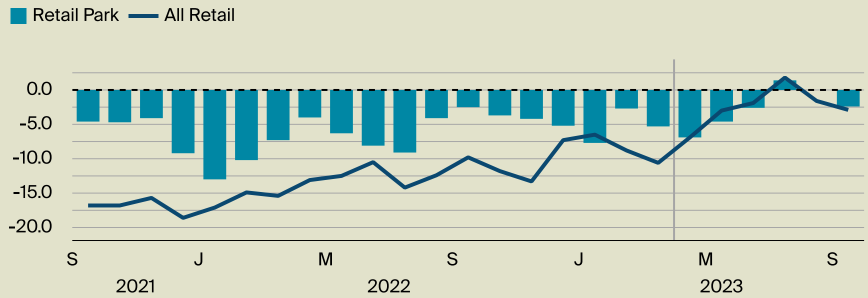
There is now positive rental pressure building in select locations - British Land increasing its rental growth outlook by a third, to between 3% - 5%.

INVESTMENT KPIS OUTPERFORMING WIDER CRE SECTORS

The sub-sector has been well-insulated to events of the last year compared to wider capital markets. Total returns in the 12 months to September 2023 registered at -7.6%, the second-least worst performance (behind Shopping Centres (-1.7%)) - and substantially ahead of negative returns across Industrial (-15.8%) and Offices (-18.9%).

Debt costs continue to restrict the market to cash buyers, holding back deal volumes. In YTD figures, transactions totalled £1.5bn, compared to £2.2bn in the equivalent period in 2022.

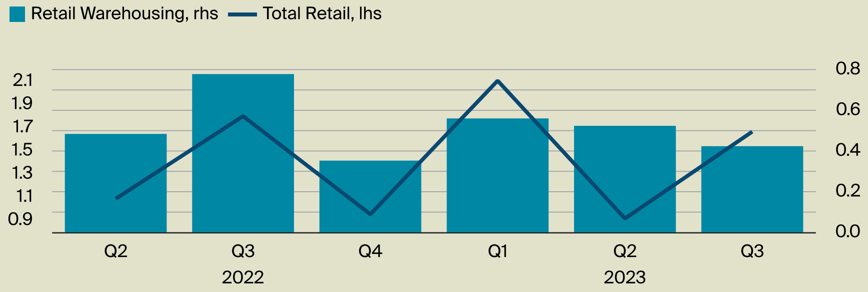
Retail park footfall
Monthly YoY change, %, vs. 2019 levels



*March 2021 – March 2023 figures are compared to 2019 levels

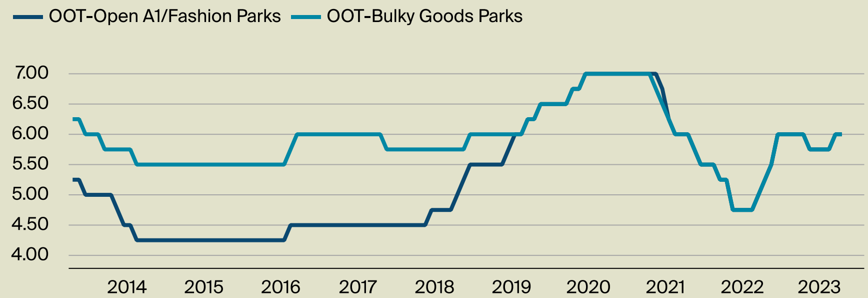
Source: BRC / Springboard

Retail warehousing investment volumes
£million



Source: Knight Frank

Retail warehouse yields
%



Source: Knight Frank

Leisure

Strong consumer demand proved insufficient to counterbalance prevailing operational headwinds.

BRITONS EAGER TO SOCIALISE

Demand was robust during the summer months, as consumer confidence improved during the holiday season.

According to Coffer CGA, hospitality outlets recorded their tenth successive month of YoY sales growth in July (+10.2%). Poor weather dampened August sales (+7.7%), but September's heatwave (+8.1%) secured 12 months of sales growth for the sector.

Barclaycard data provided further evidence of consumers' desire to socialise and spend. In September, Hospitality and Leisure (+8.5%) and Eating and Drinking (+6.4%) spend saw positive YoY growth, buoyed by social events such as the Rugby World Cup.

OPERATORS FACE HEADWINDS

Operating conditions were still challenging despite robust consumer demand. Staff shortages, rising wages, and elevated energy costs collectively constituted significant pressures on profit margins. Opening rates across restaurants, bars, pubs, and clubs slowed, as closures accelerated, driving a decline in overall net units in H1 2023 to -446 (versus an increase of +654 in H1 2022), according to LDC.

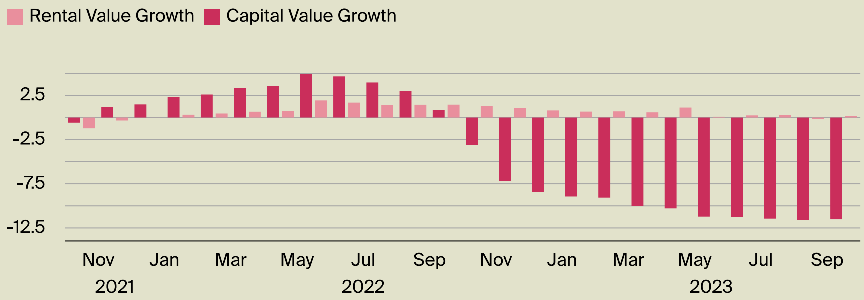
Some leisure operators (e.g. Gravity, Boom Battle Bar) have become an effective space filler for those repurposing large vacant spaces. This has helped stabilise the leisure vacancy rate at 10.7%, marking a substantial improvement on its pandemic peak (11.3% H1 2021).

INVESTMENT VOLUMES DOWN

Transactions registered a relatively subdued £19.3m in Q3, according to RCA, taking total investment for 2023 YTD to £103m. Leisure deals are characteristically infrequent, but even so, investment volumes for the full year are expected to be substantially below 2022 (£280m) and 2021 (£377m) totals.

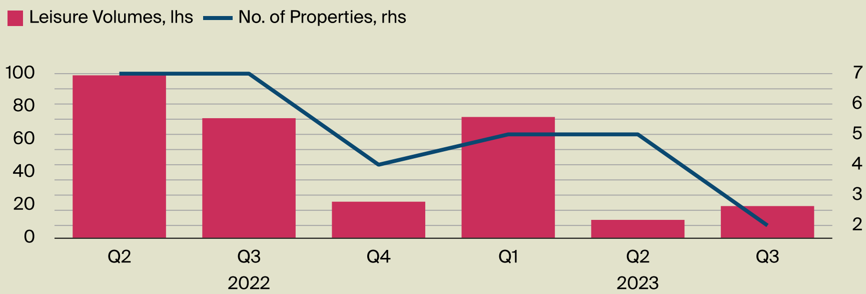
David Lloyd's sale and leaseback of its recently constructed gym and wellness club in Rugby to South Yorkshire Pension Authority (SYPA) marked a key deal: the transaction providing 30-year-long indexed income growth.

Leisure – rental / capital value growth
Rolling 12 month % change



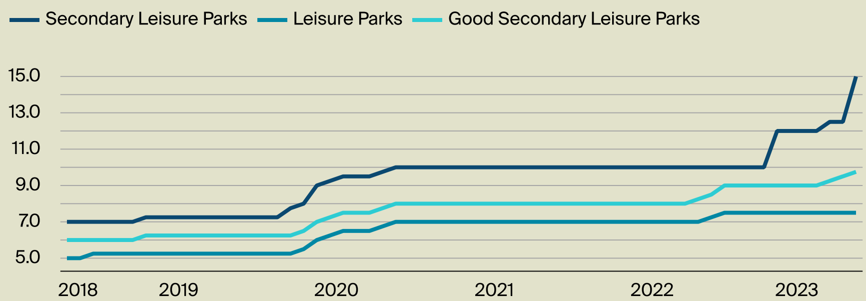
Source: MSCI

Leisure investment volumes
£million



Source: RCA

Leisure yields
%



Source: Knight Frank

Foodstores

Back in vogue, with investors seeking secure income as deal volumes increase on 2022 levels.

LOWER INFLATION WELCOMED

Grocery sales in Q3 were strong (+7.5%), outpacing wider retail sales growth of +5.6%. Volumes were still impacted (-3.3%) despite easing rates: October marking the first time grocery inflation fell into single digit growth. Consumers are starting to see the prices of some staples edge down. But 95% remain worried about grocery inflation – with lower prices taking time to trickle through.

Shoppers are still trading down to cheaper, own-label products to minimise costs, with Kantar tracking a £3bn shift away from brands.

DISCOUNTERS GROW MARKET SHARE

Since January, the discount and convenience operators have made the most gains in terms of market share. Lidl has grown its market share by +50bps to 7.6%, and Aldi +70bps to 9.9%. Co-Op is the only other grocer to have grown its market share during the period, by +60bps, to 6.1%.

Operators are still seeking to attract customers by providing the best value. Focus has shifted from everyday low prices to promotions and deals. According to Kantar, branded-promotion sales hit their highest rate, growing +7.3%, however still lagging own-label lines (+10.1%).

HIGHLY COVETED BY INVESTORS

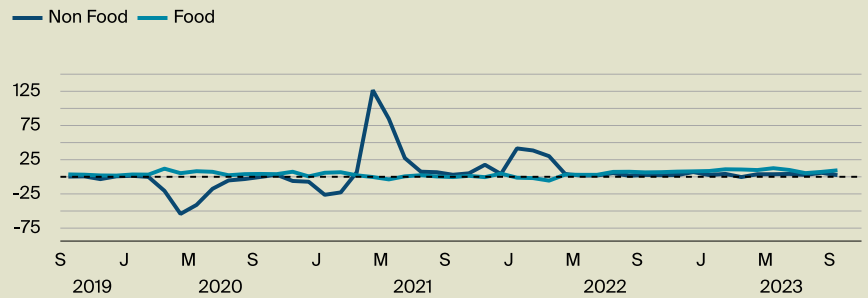
Investor demand has witnessed a resurgence due to the sector's ability to provide secure income during times of economic downturn.

Investment volumes did suffer in 2022 due to a lack of stock, but have since revived over the course of 2023. In YTD figures, Foodstore volumes totalled £2bn, buoyed by major deals including the £175m Morrison's Portfolio sale and leaseback and Sainsbury's Reversionary Portfolio. A busy Q4 could bring this year into line with longer-term averages.

In terms of outlook, forecasts now predict a positive income return of 5.1% p.a. during 2024 – 2027, outpacing Industrial (4.5%).

Food vs. non-food retail sales

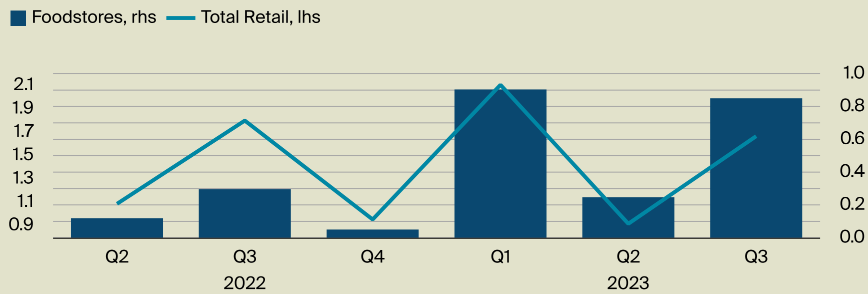
Monthly YoY change, %



Source: ONS, Macrobond

Foodstore investment volumes

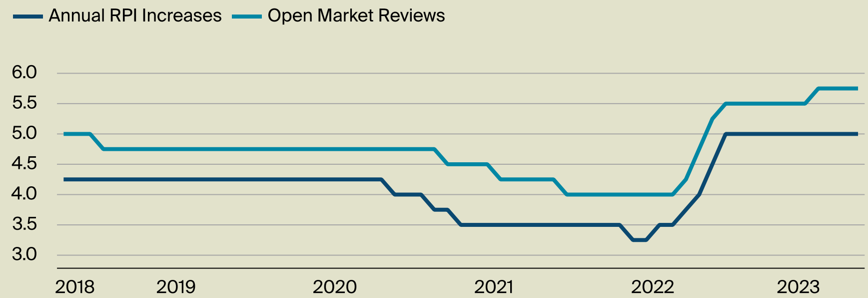
£million



Source: Knight Frank

Foodstore yields

%



Source: Knight Frank

Central London

Thriving - not just surviving - under the return of its core customer base this summer: the high spending international tourist.

HIGH SPENDING TOURISTS RETURN

Visits to the West End have been tracking positively, with footfall and spend both up +6% YoY in the nine months to September. Retail and leisure sales are now anticipated to reach £8.9bn for the year as a whole, approximately +11% higher than 2022 levels.

Crucially, international visitors - the lifeblood of the market accounting for ca. 50% of spend – have returned. In September, the influx of high-spending Chinese shoppers spiked +151% vs. 2022 levels, now just -3% below 2019 levels.

The positive effects of the Elizabeth Line are also being felt, bringing 68 million passengers into the West End in 2023 so far.

REGENERATION PLANS REINVIGORATE OCCUPIER ACTIVITY

Plans to regenerate Oxford St by 2026 sparked renewed interest from international and premium brands. New openings registered by LDC included Whistles, Sweaty Betty, Pandora, ME+EM, Kurt Geiger, and French Connection. A further 23 new brands are set to enter across Q4 and 2024, according to the NWEC.

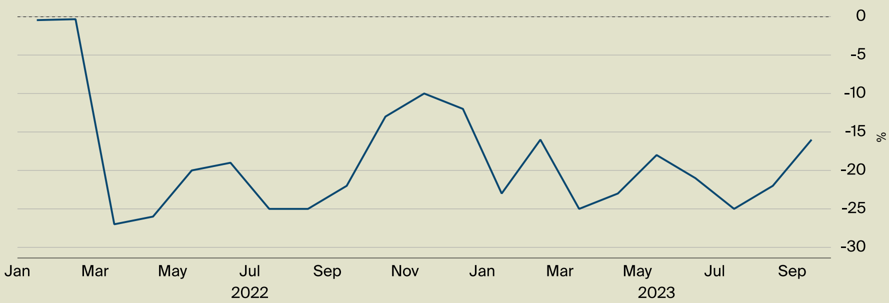
With activity concentrated on prime pitches, vacancy rates across the capital's high streets rose only marginally, by +10bps, to reach 10.7%. Rates have lingered around the 10.6% mark since 2021, indicating stabilisation.

INVESTORS TARGET LUXURY FLAGSHIPS

Investment has flowed into Central London retail with transactions totalling £798m across Q1 – Q3 2023 according to RCA, marking a substantial uplift on the equivalent period in 2022 (£221m).

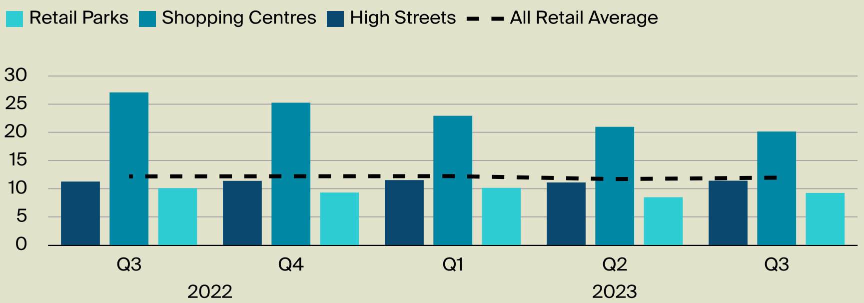
Volumes have been driven by luxury brands acquiring their flagship premises to hedge against rising rents: Swiss watch company Richard Mille acquired Stanbrook House (2-5 Old Bond St) for ca. £170m. Demand is not limited to luxury locations, with premium and mass-market locations now coming to the fore (GPEs sale of 288-300 Regent St / Langham Estates portfolio of 27-West End assets).

West End footfall
Like-for-like change %, vs. 2019



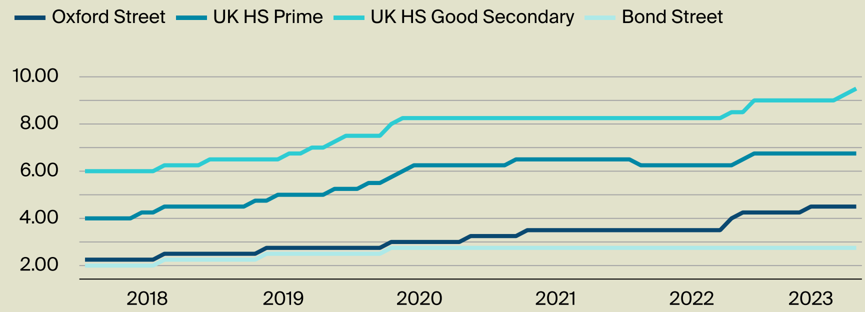
Source: New West End Company

Vacancy rates
% units



Source: Local Data Company

Yields
%



Source: Knight Frank

Specialist sectors

Data centres, healthcare, hotels & life sciences

CONTACT: DATA CENTRES – DARREN MANSFIELD, HEALTHCARE – RYAN RICHARDS, HOTELS – PHILIPPA GOLDSTEIN, LIFE SCIENCES – JENNIFER TOWNSEND

Data centres

Despite take-up being limited by a lack of new supply, investment volumes have begun to show signs of recovery, aided by stabilising yields and positive market sentiment.

INVESTMENT VOLUMES PICKING UP

Q3 2023 investment volumes totalled £227 million, bringing total investment for the year to a little over £241 million. This is the largest quarterly investment volume since Q1 2021 and represents the biggest Q3 volume since 2016.

Though transaction volumes are around a third less when compared to the Q1 – Q3 period in 2022 and 2021, 2023 has already surpassed the 10-year pre-pandemic average of £228 million.

Growing influence from Institutional buyers is driving 2023 investment, accounting for over 50% of transaction volumes, up from 23% in 2022.

YIELDS STABILISED

Following a period of market negativity and subsequent yield softening, the market has since stabilised. Having risen by 100bps between Oct-22 and Jul-23, the market for annually indexed 15-year leases settled at 5%.

Improved market sentiment in Q3, following stabilised interest rates and tempered inflation, has resulted in pricing and closing yields of 4.75%. The £125m London data centre portfolio purchase reflected a 4.6% net initial yield.

TAKE-UP LIMITED BY MUTED SUPPLY

Colocation supply in Q3 remained at 1,100MW. In Q4, between 13-20MW is forecast to go live.

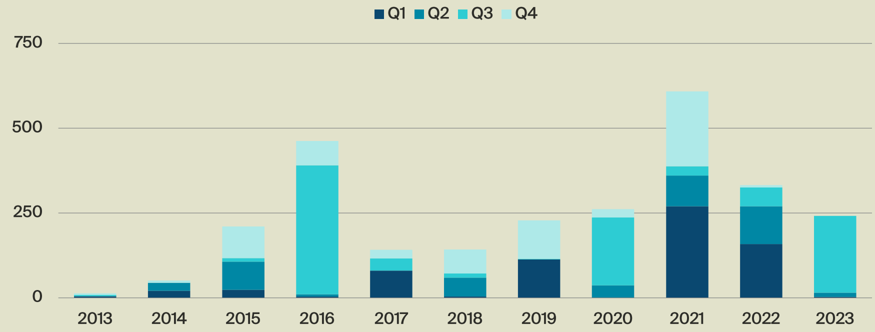
Take-up has been slow in 2023, with three consecutive quarters performing below the 4-year (16-quarter) average.

Space under construction is entirely pre-let, with the next phase of new availability not arriving until Q4 2024.

The development pipeline is healthy, with under construction or permitted capacity having the potential to expand existing space by 50% come the end of 2026.

Investment volumes

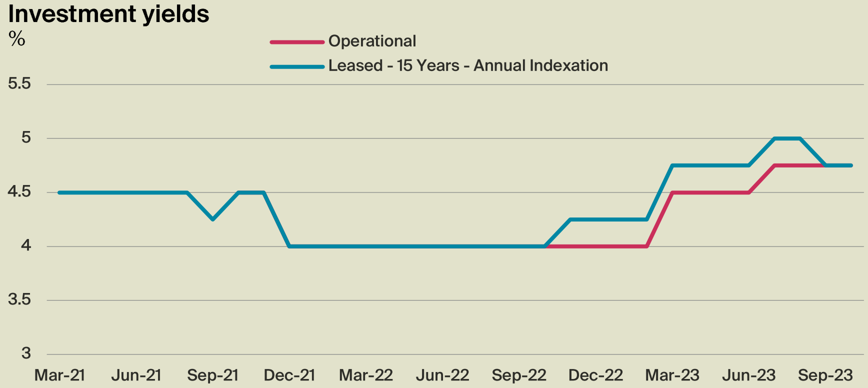
£million



Source: Knight Frank Research, RCA

Investment yields

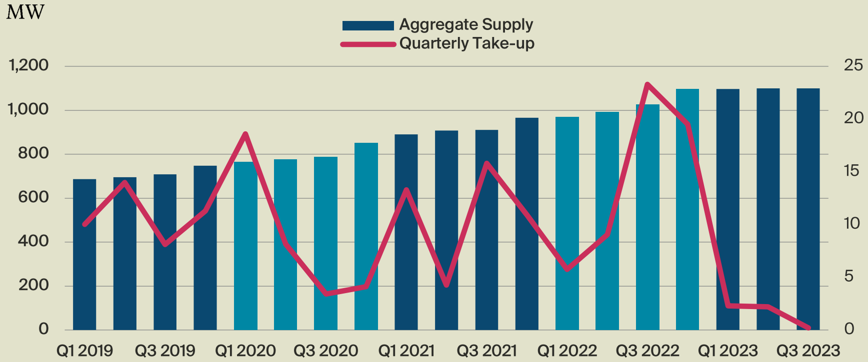
%



Source: Knight Frank Research

Supply & take-up

MW



Source: Knight Frank Research, DC Byte

Healthcare

Transactions down on the year as key participants 'hold back'.

INVESTORS MAINTAIN 'MARKET GAUGING' POSITION

Generally, the sector has maintained its positive sentiment based on the fundamental drivers in line with significant dry powder amongst investors.

However, reported transactions year-to-date have remained low as investors seemingly pace themselves to assess market pricing correctly. Many investors have advised that they are using this time to explore asset management/value-add opportunities across their portfolios. However, they are still willing to consider the right opportunities for new acquisitions.

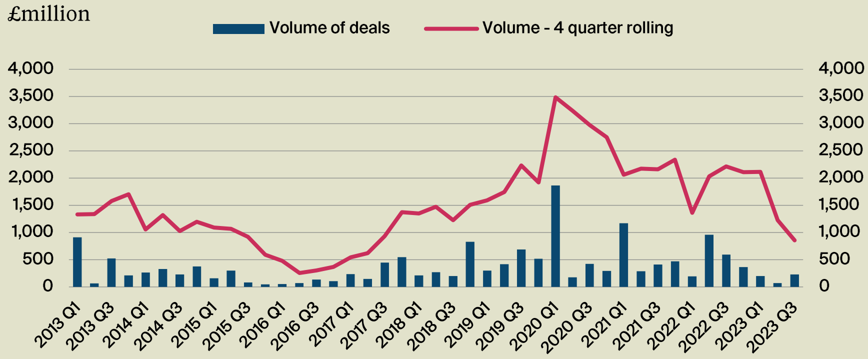
Prime care home yields have softened by c.75bps.

DOMESTIC CAPITAL REMAINS MOST ACTIVE IN A MUTED ENVIRONMENT

Domestic capital accounts for c. 90% of 2023 transactions, compared to the five-year average of 44%. This statistic suggests that the issues or concerns around the cost of capital may be more prominent amongst overseas investors, who have been somewhat non-existent year-to-date. However, this is not to say it is too late to complete a significant portfolio transaction. This would pull this back in line with the composition averages we have become used to seeing, especially at these lower transaction volumes.

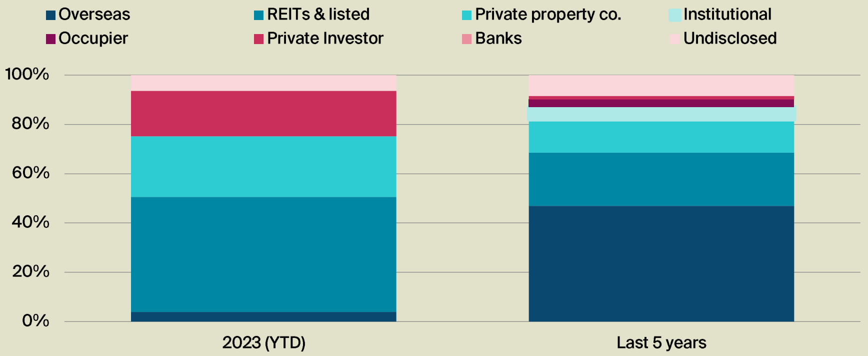
While domestic REITs have taken the vast share of market volume, it is worth noting that private capital has been most active from Q1 onwards in terms of volume of deals as opposed to value of deals.

Recorded healthcare property transactions
£million



Source: Knight Frank Research

Healthcare property transactions by buyer type



Source: Knight Frank Research

Healthcare

Strong operator trading provides support to positive sector sentiment.

OCCUPANCY LEVELS CONTINUE ON THEIR PATH TO NORMALISATION

Following our annual trading data collection, operator occupancies have, quite promisingly, increased by three percent on the year. While this is slightly below the pre-pandemic levels in the high eighties, around 40% of operators now report occupancies that are considered back to normal.

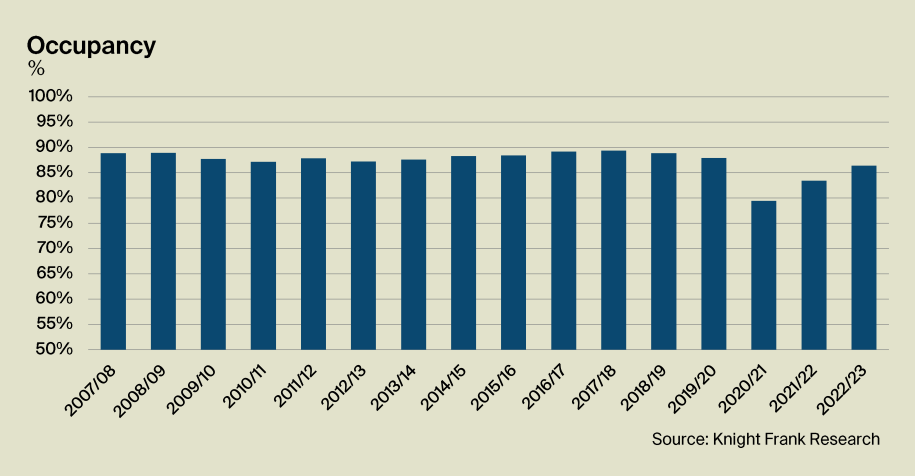
In the case of nursing care, agency staff usage has averaged above the 10% level, whereas residential homes remain at the sub-10% mark.

Utility costs and staffing have emerged as the sector's most significant concerns, with operator accounts for the last financial year highlighting significant jumps in utility costs (approx. 3x in some cases).

NEW HOME SUPPLY BACK TO REASONABLE LEVELS, BUT STILL SOME WAY TO GO

Year-to-date 2023 has seen the completion of circa. 5,700 new care beds in the UK, the highest number we have seen in a given year. Again, we are aware of the potential inflation due to the overspill in completions from 2022. The more significant issue is the number of home closures offsetting this and, therefore, hindering overall bed growth.

The current development pipeline will be achieved via refurbishment or extension to existing stock instead of new builds. Build costs, coupled with finance costs, are leaving several industry players with points to consider regarding the place for new build opportunities amongst their current strategy.



Hotels

Strong (and improving) trading performance in both London and the Regions.

REVPAR AND GOPPAR BOTH POSITIVE
The strong trading performance of H1 2023 continued into Q3, with both London and Regional UK recording a respectable uplift in RevPAR vs. the same period in 2022. Growth rates have slowed QoQ throughout the year, due to strong comparatives in 2022.

In London, Q3 YoY occupancy increased by more than five percentage points to 82%, whilst ADR was up marginally to £245. This resulted in RevPAR growth of 7.9%.

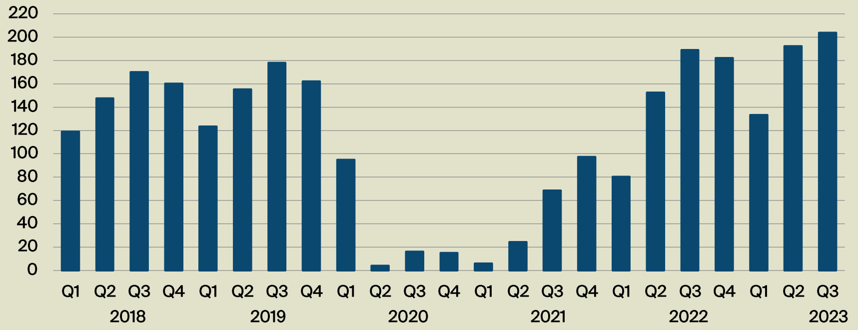
Across Regional UK, a similar rise in RevPAR (+7.5% to £91) was achieved, but this was driven more through ADR growth than by a rise in occupancy. As inflationary pressures continue, combined with robust levels of transient demand and improving demand for conferences and events, this is facilitating strong growth in rooms and ancillary revenue streams.

High inflation has also meant continued cost pressures throughout 2023, with total costs rising by 23% YoY in London and by 14% in Regional UK, as at September YTD. Yet, the sector continues to deliver a resilient and strong profit recovery. GOPPAR YTD in London and Regional UK is up 23% and 11%, respectively. Both London (+2%) and Regional UK (+5%) have now made a full recovery in GOPPAR versus YTD 2019, but Regional UK's leading city centres markets still have further to climb (-5%).

RETURN OF INTERNATIONAL TRAVEL
Maintaining revenue growth strong enough to counter the continued steep rise in costs remains one of the key challenges that lie ahead.

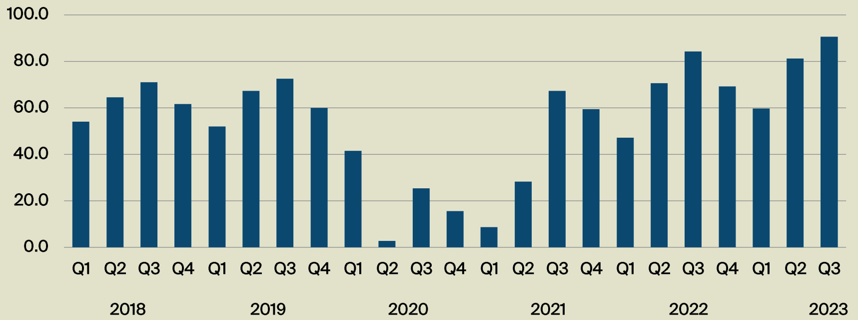
Structural changes that have taken place since the pandemic are favourable to hospitality, with spending on experiences and a desire to travel positively impacting both rooms and ancillary spend. International travel is set to return even stronger in 2024, and changes in the working week, with increased hybrid working and the extension of the weekend, are further propellors of growth.

RevPAR in London
Quarterly, £



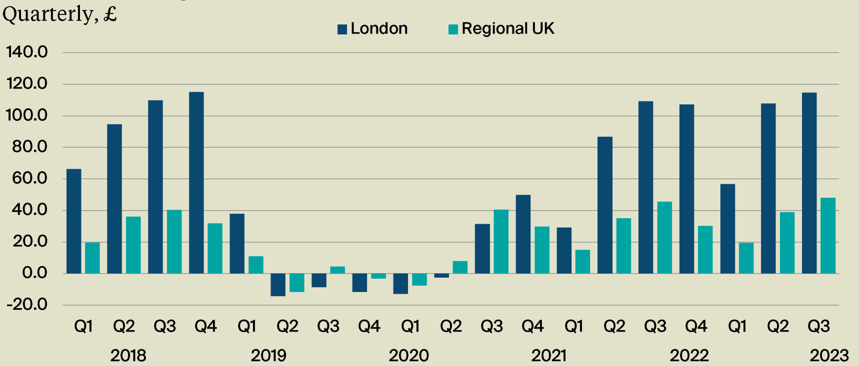
Source: HotStats

RevPAR in regional UK
Quarterly, £



Source: HotStats

Gross Operating Profit PAR
Quarterly, £



Source: HotStats

Hotels

Patchy transactional activity, but some green shots amidst greater economic stability.

DEPRESSED VOLUMES BUT RESILIENT PRICING

Hotel transaction volumes totalled £1.35 billion for the nine months to September, 53% below YoY investment volumes in 2022. This reinforces just how challenging it is to successfully execute and complete deals.

Investment to date into the London hotel market totalled ca. £700m, also down 50% YoY, but where hotels have transacted, pricing has remained resilient, averaging ca. £350,000 per key.

Active capital is currently being deployed from specific pockets of investors. Throughout 2023, we have seen an uptick in the number of enquiries made by high-net-worth individuals (HNWIs), family offices, and overseas corporate clients. Not dependent on the sourcing of debt financing, their motivation to purchase is often specific and personal. Whilst some are new entrants, others seek to enhance their collection of UK-owned hotel assets which align with their vision and long-term strategy for investment.

We are also now seeing investment activity coming from private equity firms, but those which already have a holding in the market. Targeting specific assets with significant repositioning potential reaffirms the confidence that these investors have; to grow and enhance their existing portfolios, as well as in the future growth prospects of the sector.

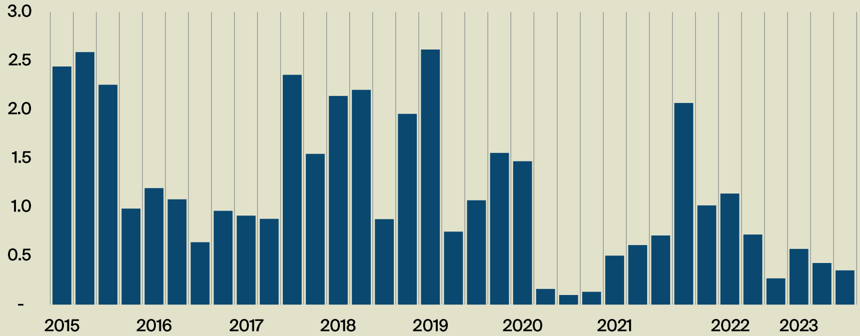
AWAITING ECONOMIC STABILITY

Market conditions have made potential buyers more discerning in their asset selection and heightened their intent to only make an attractive offer for the right asset.

We expect that investor confidence and sentiment in the UK hotel market will be further strengthened by a period of greater economic stability. Transactional activity remains patchy, but there are green shoots as the tide is beginning to turn, as deals move forward, and both enquiries and activity begin to pick up.

Investment volumes

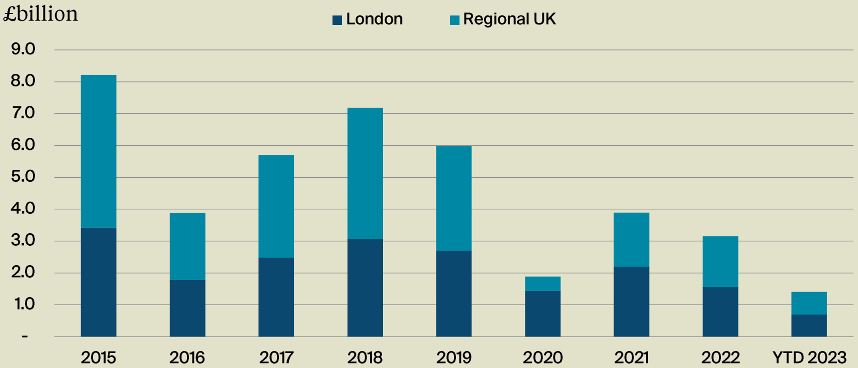
£billion



Source: CoStar Group, Real Capital Analytics, MSCI, Knight Frank Research

Investment volumes

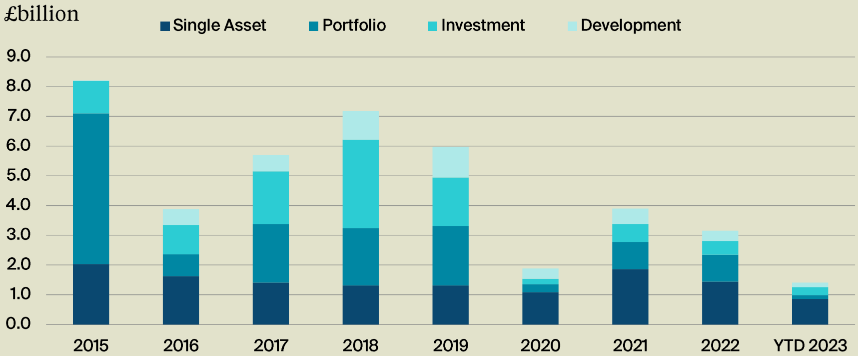
£billion



Source: CoStar Group, Real Capital Analytics, MSCI, Knight Frank Research

Investment volume breakdown

£billion



Source: STR, a CoStar Group Company; Real Capital Analytics, MSCI, Knight Frank Research

Life sciences

Key metrics emphasise the robust condition of the UK life sciences sector in the third quarter of 2023.

COMPANY FORMATION ACCELERATES

The formation of new life sciences companies in the UK continues to accelerate, with 277 incorporated in the third quarter of 2023. This represents a 9% increase from the previous quarter and a 31% jump compared to the same period in 2022. So far this year, 813 life sciences companies have launched in the UK - the highest number for the first three quarters in the past decade.

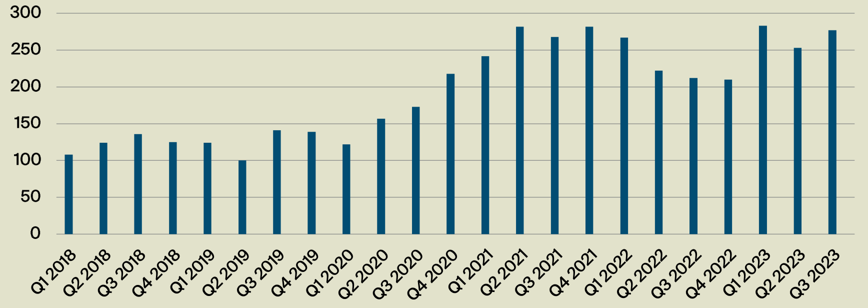
Venture capital (VC) funding for UK life sciences companies totalled £883m in the third quarter of 2023, representing a 32% decrease from the previous quarter, but a 5% increase compared to the same period last year. The exceptionally high £602m raised by YgEia3 in Q2 contributed to the quarter-over-quarter decline. Excluding the Q2 outlier, VC funding actually increased by 26% quarter-over-quarter. So far this year, UK life sciences companies have attracted £2.7bn in VC backing, marking the second highest level over the past decade for the first three quarters.

The number of VC deals completed has declined for three consecutive quarters. This suggests investors are being more selective and cautious when evaluating opportunities. However, substantial capital continues to flow into the highest value companies. In Q3 2023, nearly half of the total £883m in VC funding was concentrated in just three deals above £100m for CMR Surgical, Apollo Therapeutics, and Ellipses Pharma. Despite the downward trend in deal volume, these sizable transactions demonstrate that well-positioned, high-potential companies can still attract major backing.

Job openings in science and quality assurance (QA) fields decreased in Q3, according to the Adzuna/ONS index of online job advertisements. Vacancies for scientific and QA roles fell 11% quarter-over-quarter, a larger decline than the 3% drop seen across all industries.

UK life sciences company incorporations

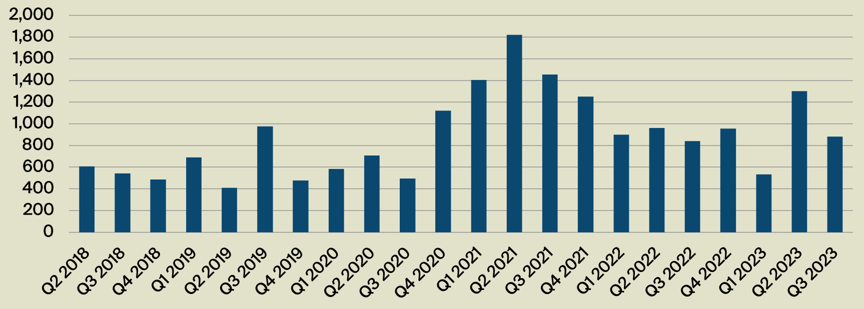
Company incorporations



Source: Fame and Knight Frank research. Data includes active companies only. BVD sector: Biotech and life sciences. Location analysis is based on registered address only. Sub market analysis is available upon request

UK life sciences venture capital funding

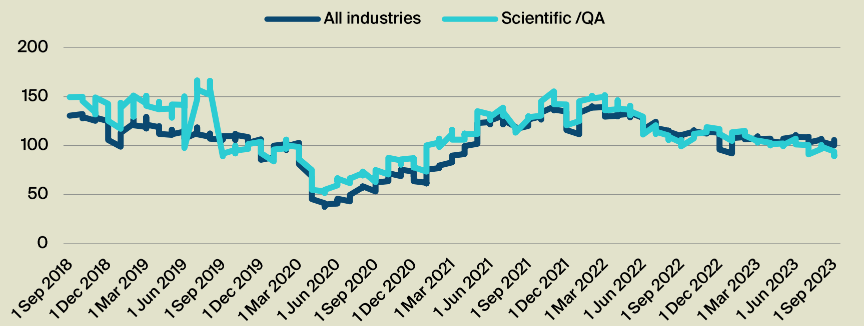
VC funding into UK life sciences companies, £million



Source: PitchBook and Knight Frank research. HQ location UK, Completed deals only. Covers: Biopharma, MedTech and Digital health. Data as at 17/07/2023. Sub market analysis is available upon request.

Vacancies for scientific and QA roles UK

Scientific & QA weekly job adverts, index 100: average February 2020



Source: Knight Frank, Adzuna

Life sciences

Commercial real estate investments in life sciences assets moderated, but investor appetite persists for top-tier opportunities. Take-up remains constrained by a lack of supply.

THE UK REMAINS AN ATTRACTIVE HUB FOR LIFE SCIENCES

While the sector isn’t without its challenges, the high rate of new incorporations underscores the UK's position as an attractive hub for launching life sciences ventures. The robust levels of VC funding indicate ongoing investor interest in a sector that has underlying growth fundamentals that transcend the economic environment.

LIFE SCIENCES REAL ESTATE INVESTMENT FALLS IN Q3

After an active start to the year, investments into commercial real estate for the UK’s life sciences sector in the Golden Triangle cooled in the third quarter of 2023. No investment deals were recorded, a slowdown attributed to constrained inventory, investor wariness of development risk, and tighter financing conditions. Additionally, investors that have already bought into the life sciences market are working through their current investments. However, investor interest remains robust for high-quality opportunities in the sector, according to a 2023 Knight Frank poll ranking life sciences a top four priority for capital allocation over the next 18 months. While the third quarter was quiet, year-to-date investment volumes in the Golden Triangle reached £568.27m across nine transactions and £601.3m across the UK.

TAKE-UP DECLINES QUARTER-ON-QUARTER

In Q3, total life sciences leasing activity across the Golden Triangle, encompassing both office and lab space, amounted to 148,304 sq ft. This represents a 53% decrease from last quarter, though Q2 was skewed upward by Moderna's 145,000 sq ft deal at Harwell Campus. Q3 take-up was broadly in line with the five-year quarterly average.

London accounted for 50% of take-up across the Golden Triangle in Q3. A major Q3 deal was hVIVO, a contract research organisation, signing for 39,049 sq ft at 40 Bank Street, E14. The company stated this expanded space will include cutting-edge quarantine rooms, labs, outpatient facilities and corporate offices.

The supply of new space remains severely constrained. In Cambridge alone, over 1 million sq ft of lab demand contrasts with a mere 24,700 sq ft of available space as developers grapple with planning constraints and faltering access to critical infrastructure required for new labs. Region-wide, c.2.25 million sq ft of live requirements contrast with just 417,000 sq ft of available space. Over the longer term, 56% of the Golden Triangle’s 30 million sq ft development pipeline remains in the pre-planning phase, with these obstacles hindering the prospect of the full pipeline coming to fruition.

Key contacts

Click on the relevant button below to meet the team

Offices

Retail

Logistics & Industrial

Hotels

Healthcare

Life Sciences

Data Centres

Student Property

Automotive

Capital Markets

Valuation & Advisory

Debt Advisory

Restructuring & Recovery

William Matthews
Partner, Department Head
Commercial Research
william.matthews@knightfrank.com
+44 20 3909 6842

Antonia Haralambous
Associate
Commercial Research
antonia.haralambous@knightfrank.com
+44 20 3866 8033

Knight Frank Research Reports are available at knightfrank.com/research

Knight Frank