UK Real Estate Navigator

Q4 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

The global economic outlook remains soft, yet expectations of a soft landing remain.

GLOBAL OUTLOOK UPGRADED

Against a backdrop of challenging economics, the global economy has held up better than expected, demonstrating its resilience. The IMF revised its 2024 global GDP growth forecast by +20bps to 3.1% in February, compared to its October 2023 forecast.

Economic growth expectations for the US have also been upgraded for 2024. The IMF forecasts that the US GDP will grow by +2.1%, up by +60bps from its previous forecast in October. Meanwhile, the IMF revised its Euro Area GDP growth forecast lower for 2024, downgrading it by -30bps to +0.9%. For 2025, the IMF expects the US and Euro Area to grow by +1.7%.

Despite global economic headwinds, labour markets across many geographies remain tight. The US unemployment rate was unchanged at 3.7% in January 2024, below market expectations of 3.8%. In Germany, the unemployment rate was 5.7% for the fourth consecutive month in January, remaining below its 8.3% LTA.

GLOBAL BUSINESS ACTIVITY IMPROVES

The Global Services PMI rose to a six-month high of 52.3 in January, from 51.6 in December, remaining in expansionary territory (figure above 50) for the 13th successive month.

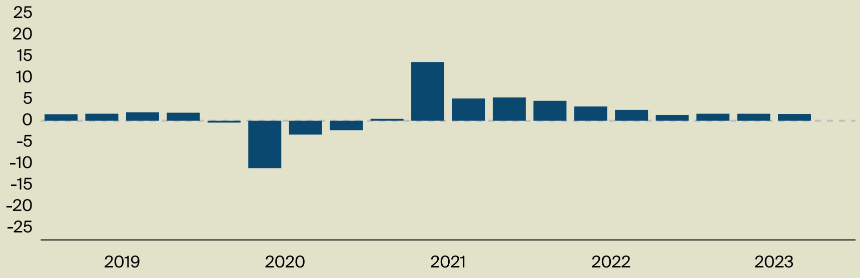
Meanwhile, the Global Manufacturing PMI increased to 50.0 in January from 49.0 in December, entering expansionary territory for the first time in 17 months.

INFLATION TO FALL BACK TO 2% TARGET IN 2024

Across the world, global headline inflation has fallen sharply due to favourable base effects and moderating energy prices. However, with noise around inflation surprises and continually evolving global geopolitics, this path is unlikely to be smooth. In the Euro Area, inflation fell to 2.8% in January 2024 from 2.9% in the month prior. Meanwhile, in the US, inflation rose to 3.4% in December, up from a five-month low of 3.1% in November.

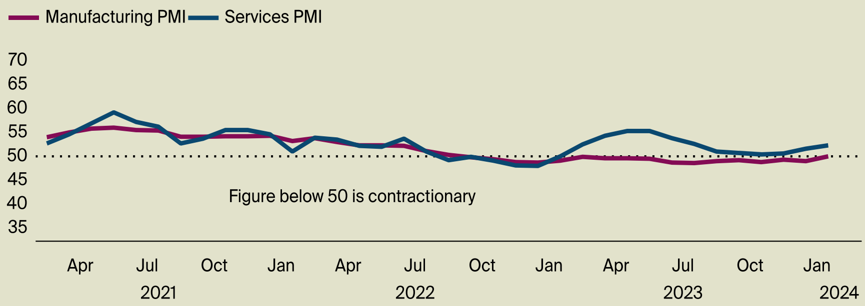
Gross Domestic Product

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



Source: Knight Frank Research, Macrobond, OECD

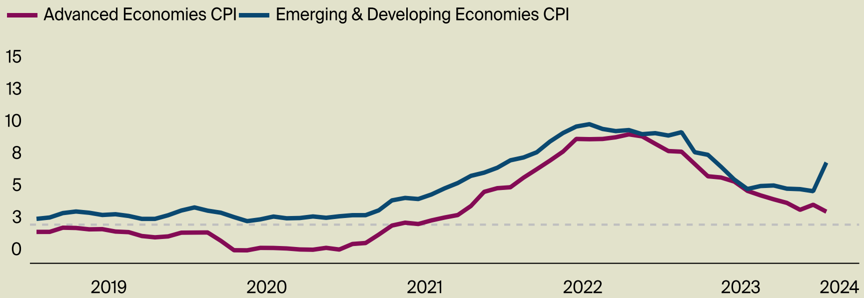
Business Activity Index



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

Inflation

%



Source: Knight Frank Research, Macrobond, World Bank

UK economy

UK inflation to moderate to the 2.0% target faster than previously expected.

UK GDP EXPANDS IN NOVEMBER

Between Q1 – Q3 2023, the UK avoided a recession, with GDP growth of +0.3% in Q1 2023 and 0.0% in Q2 2023 before recording a slight decline of -0.1% in Q3 2023. On a monthly basis, GDP expanded by +0.3% in November 2023, compared to a -0.3% contraction in October.

The Bank of England (BoE) updated its GDP forecasts in February 2024. It now expects the UK's GDP to grow by +0.25% in 2024, up from its previous 0.0% growth forecast in November. For 2025 and 2026, the central bank expects the UK economy to grow by +0.75% and +1.00%, respectively.

The UK unemployment rate contracted to 3.8% in Q4 2023, from 4.0% in the quarter prior and below expectations of it remaining unchanged. The BoE forecasts UK unemployment to rise to 4.60% by the end of 2024, however, this will remain comfortably below the long-term average of 6.7%.

BUSINESS ACTIVITY PICKS UP

The UK Services PMI rose to its highest level in eight months at 54.3 in January, up from 53.4 in December, and its third month in expansionary territory (figure above 50).

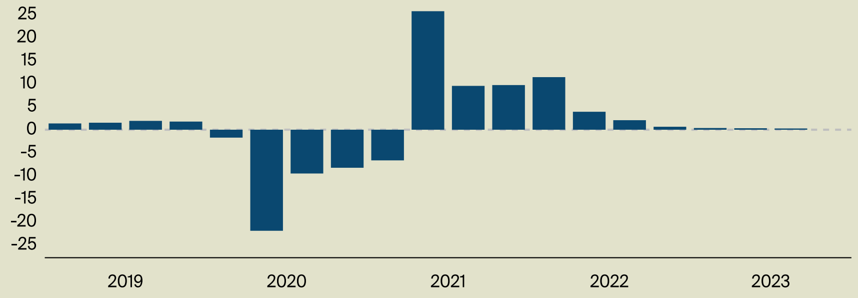
Meanwhile, the UK Manufacturing PMI increased to 47.0 in January, from 46.2 in the month prior, albeit remaining in contractionary territory (figure below 50) for the seventeenth consecutive month.

UK INFLATION: TARGET IN SIGHT

UK inflation rose for the first time in ten months in December 2023 to 4.0%, up from a near two-year low of 3.9% in November. Nonetheless, the BoE expects UK inflation to reach its 2% target by Q2 2024 (compared to Q4 2025 previously forecasted). This would bring UK inflation below the US and Euro Area for the first time in two years.

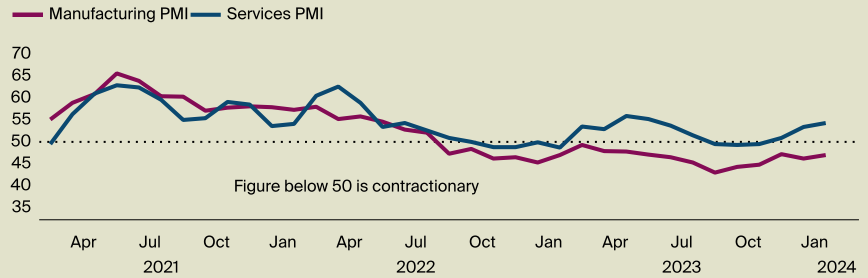
With inflation forecast to fall to target in H1 2024, most economists expect rate cuts from the BoE to start in June. Money markets are currently pricing in three quarter-point rate cuts, taking the base rate to 4.50% by the end of 2024.

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



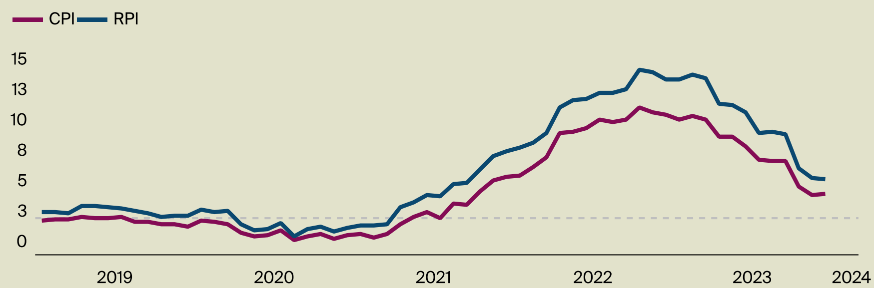
Source: Knight Frank Research, Macrobond, ONS

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

London was the top metro for overseas capital in 2023 for All Property and Offices.

POCKETS OF POSITIVITY IN Q4

UK commercial real estate (CRE) investment has shown signs of moderation in 2023, with preliminary numbers suggesting investment totalled £8.5bn in Q4 2023. This was +11% up on investment in Q3 2023, yet a -22% contraction on Q4 2022.

£32.6 billion was invested in UK CRE in 2023, which was -41% below investment in 2022 and -36% below the 10-year long-term average. The UK was not unique in seeing reduced CRE investment volumes in 2023, with the US (-51%) and Europe (-48%) recording larger proportional declines YoY.

Office (£2.4bn) and Industrial (£2.4bn) were the most invested sectors in Q4, followed by the Residential (£2.0bn) and Retail (£1.0bn) sectors. Hotel (+52%), Office (+18%) and Industrial (+15%) recorded positive investment growth QoQ in Q4.

Cross-border capital was more active in the UK in Q4, with overseas investment up +51% QoQ to £4.2bn, albeit down -49% YoY. Industrial received the most investment from cross-border sources in Q4 2023, with £1.6bn invested.

London was the top global metro for overseas investment for All Property and Offices in 2023, and the UK was the second most invested market for cross-border capital in 2023, behind the US.

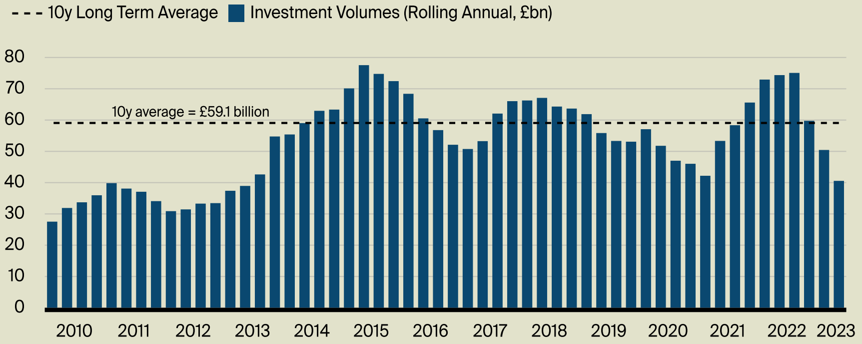
CRE INVESTMENT TO IMPROVE?

We have seen a pause in the hiking of base rates and while economists rarely agree, the narrative has shifted to when we will see rate cuts, which will also feed into swap rates. As debt costs start to come down, this will eliminate a significant barrier to transactional activity and encourage investment volumes to gradually increase this year.

With interest rates expected to remain elevated globally into H2 2024, we anticipate private capital to remain active. During previous times of dislocation, private capital has typically rotated back into commercial real estate. Private buyers are well positioned to transact in a high debt cost environment, as they are typically less reliant on upfront debt than other investors.

UK quarterly investment volumes

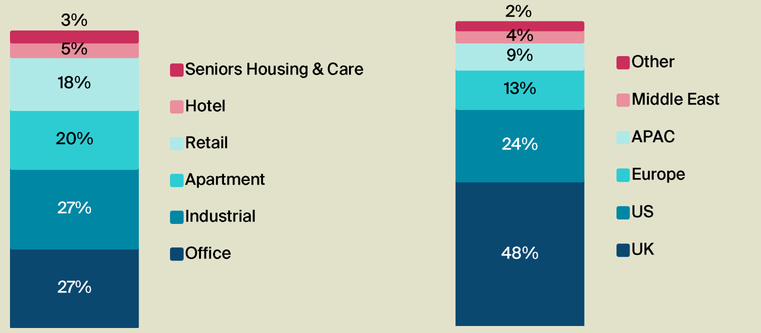
Quarterly investment volumes, rolling average



Source: Knight Frank Research, RCA

Investment volume breakdown

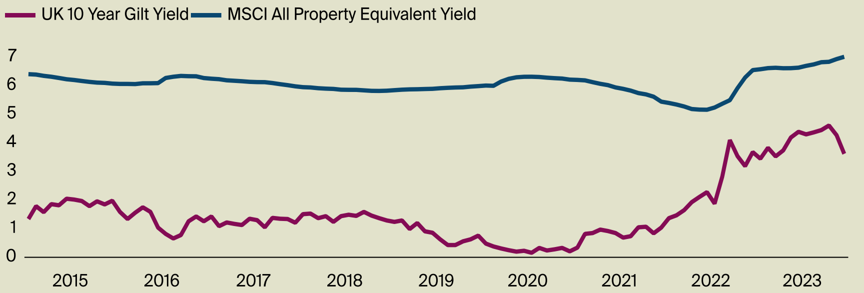
% of 2023 volume



Source: Knight Frank Research, RCA

Property equivalent yield & gilt yield

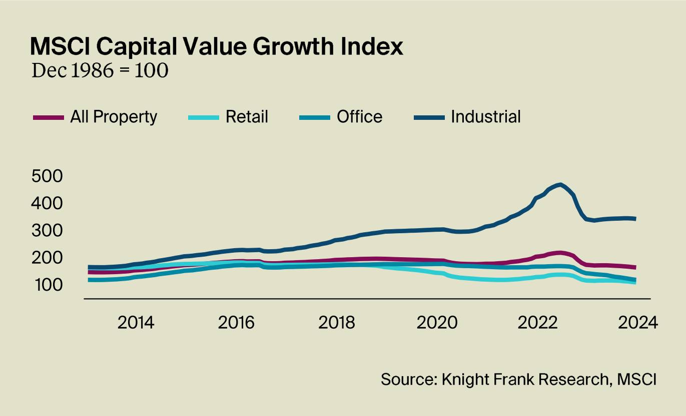
%

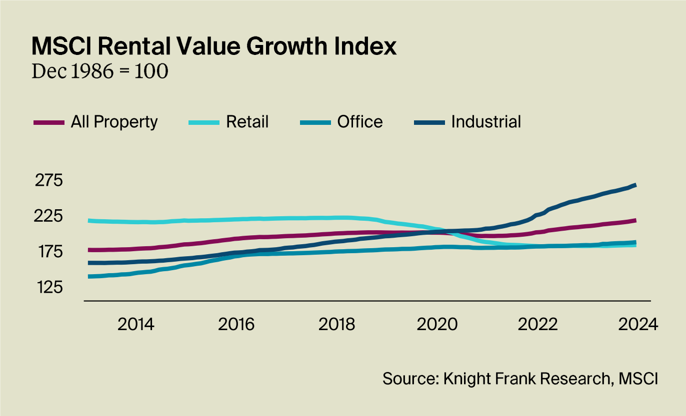


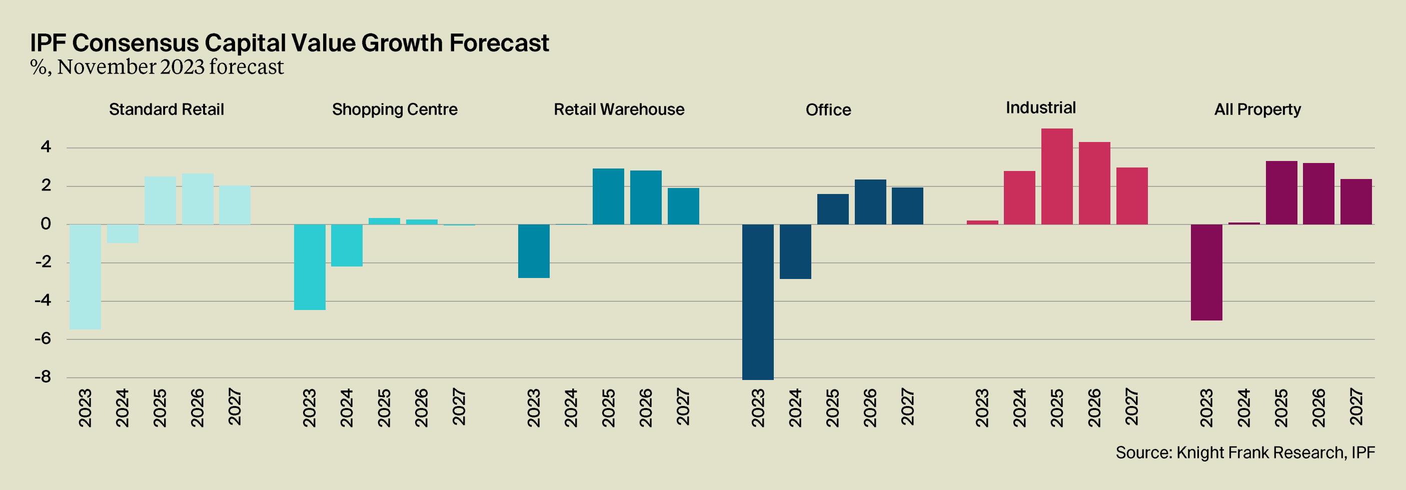
Source: Knight Frank Research, Macrobond, MSCI

Capital markets

The IPF forecasts the Industrial sector to record the highest capital value growth in 2024.







Offices

City & Southbank, West End, Docklands & Stratford, South East & UK Cities

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

City & Southbank offices

Transaction volumes fall, but yields remain stable.

LOWER INVESTMENT VOLUMES

There were 15 investment transactions totalling £0.4bn in Q4, down 52.8% compared to Q3. During the quarter, investors from the United Kingdom acquired £0.2bn of offices, accounting for 51% of volumes, followed by APAC countries with £0.1bn and a 30.1% share of all transactions.

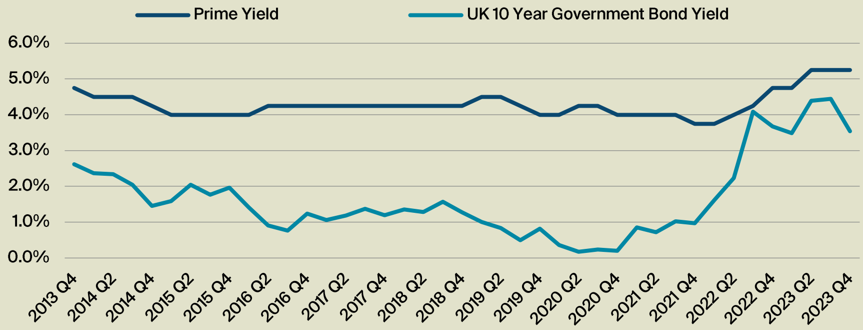
Private capital investors, less sensitive to rising interest rates, acquired £0.3bn of offices in Q4, which was 87% of all transactions. The investor group were responsible for the largest deal of the quarter at 12-14 Fetter Lane, EC4, acquired by an investor from Taiwan for £133m, reflecting a yield of 5.75%.

Managed investment funds were the next largest investor group with an 8.2% share of transaction volumes, and this was followed by private equity investors with a 5.2% share.

Current available stock is valued at £0.9bn whilst there is £0.7bn under offer. Prime yields have remained stable at 5.25% for a second consecutive quarter.

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

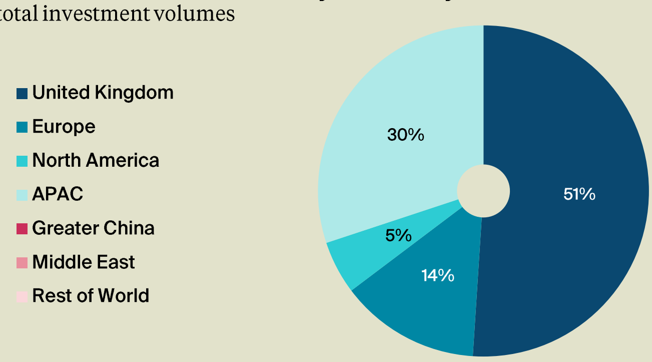
% per annum



Source: Knight Frank Research

City & Southbank: Investment volumes by nationality

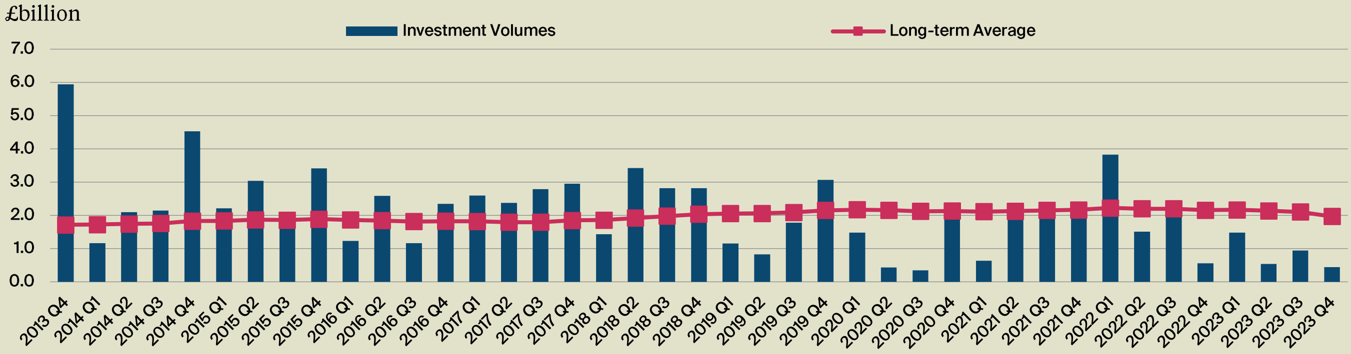
2023 Q4, % of total investment volumes



Source: Knight Frank Research

City & Southbank: Investment volumes relative to trend

£billion



Source: Knight Frank Research

City & Southbank offices

Record take-up of new and refurbished offices.

LETTINGS AT FIVE-YEAR HIGH

There was 2.4m sq ft of take-up in the City & Southbank during the quarter, an increase of 44.4% from Q3 and almost 50% above the long-term trend of 1.6m sq ft. This was the highest level of take-up since Q4 2017 and was driven by 1.8m sq ft of new and refurbished lettings – the highest level of prime take-up ever recorded and representing 73% of all lettings in the market. Take-up was above the long-term average in two submarkets of the City & Southbank - the City Core (87%) and Clerkenwell/ Farringdon (21.7%).

The largest letting in Q4 was the 520,359 sq ft pre-let signed by HSBC at Panorama St. Paul's, a year ahead of the building's completion in 2025. There has not been a transaction of this scale since Q1 2018. The second largest transaction was CFC Underwriting Ltd, which acquired 88,322 sq ft across floors 10-15 at 8 Bishopsgate. The letting takes the scheme to 63% let.

We can expect momentum to continue in the market as the City & Southbank continues to be the focus of most active requirements in London. Active demand rose to 5.1m sq ft, a 9.6% increase during the quarter and 23.6% above the long-term trend. Near-term demand continues to be led by the financial sector at 2.6m sq ft (51.5%), followed by 1.3m sq ft from professional occupiers (24.4%).

AVAILABILITY FALLS SLIGHTLY

Availability fell for a second consecutive quarter in the City & Southbank, primarily driven by the high level of leasing activity during Q4. Down 5.5% to 13.9m sq ft, this decrease has resulted in a vacancy rate of 10.1% and compares to the long-term trend of 7.0%. However, prime availability is tight and has a vacancy rate of 5.8% and is slightly below the long-term trend.

The City & Southbank development pipeline contracted to 9.9m sq ft during the quarter, following 0.8m sq ft of completions in Q4. Of the under-construction pipeline, 25% is pre-let, and there is 7.0m sq ft of speculative floorspace being delivered before the end of 2026. Compared with long-term levels of new and refurbished take-up, this level of speculative development suggests a supply shortfall of 3.4m sq ft by the end of 2026.

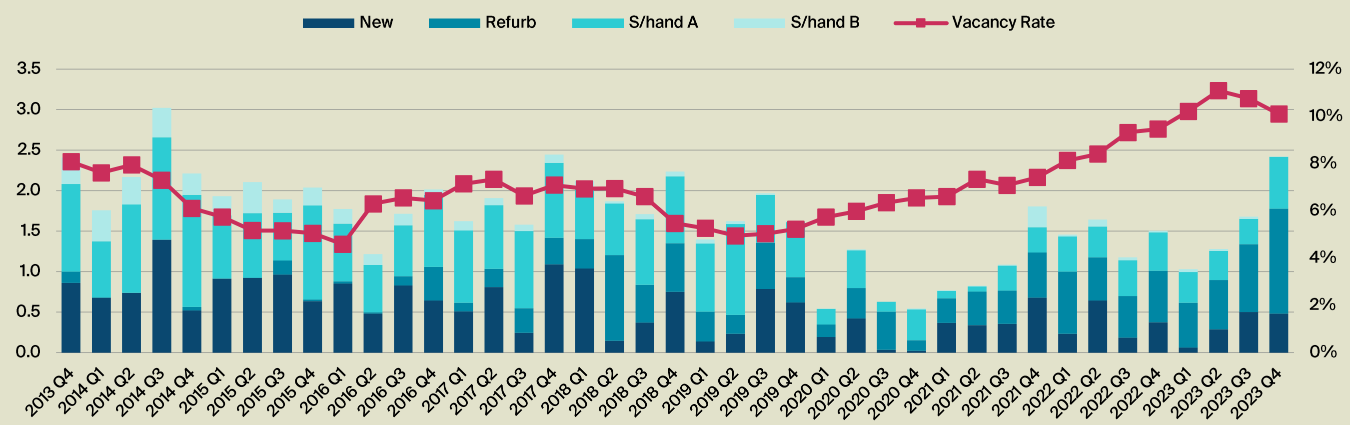
20 Ropemaker Street, EC2, was the most significant completion in Q4, comprising over half of all completed floorspace, followed by the Artesian, E1.

HIGHER PRIME RENTS

We have raised rents in the City Core from £77.50 to £87.50 per sq ft, in Clerkenwell/Farringdon from £85 to £90 per sq ft, in Midtown from £70 to £80 per sq ft and from £77.50 to £80 per sq ft in Southbank Core.

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

Million sq ft, % of stock (RHS)



Source: Knight Frank Research

West End offices

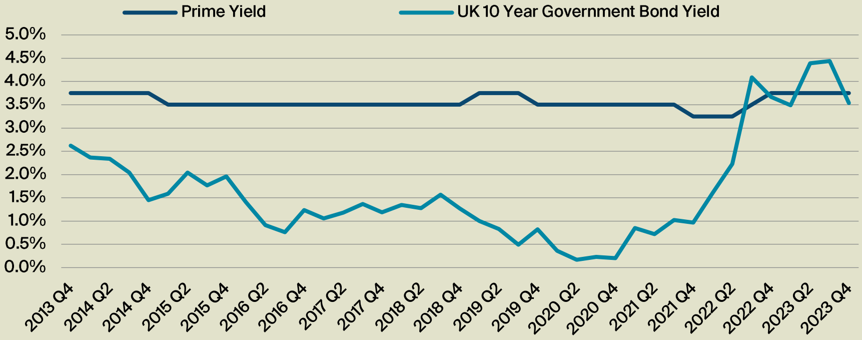
European investment drives strong transactional activity.

INVESTMENT MARKET RESILIENCE IN WEST END

Transaction volumes in Q4 totalled £1.3bn, up 173% compared to Q3 and were aligned to the long-term trend. The largest transaction in Q4 was the of sale of the Lotus Portfolio, W1, which comprised 27 freehold assets and was acquired by Oval Real Estate & Elliott Advisors for £300m, reflecting a yield of 5.64%.

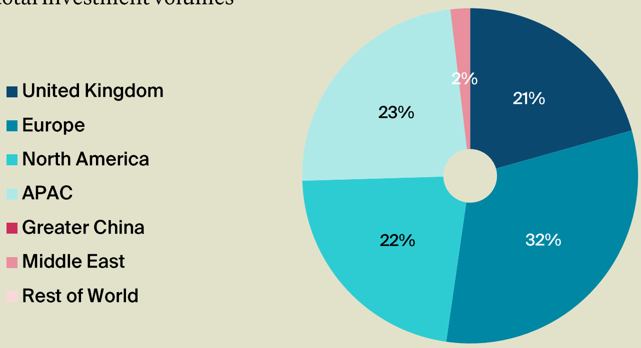
During the quarter, investors from Europe acquired £0.4bn, accounting for 31.5% of volumes, followed by APAC countries with £0.3bn and a 23.4% share of all transactions. European investors were responsible for 28% of all purchases in the West End during 2023, followed by the United Kingdom (27%) and APAC countries (23%). During 2023, private capital investors acquired £1.7bn of West End offices, 50% of total volumes. Prime yields have remained stable at 3.75% and unchanged during 2023.

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



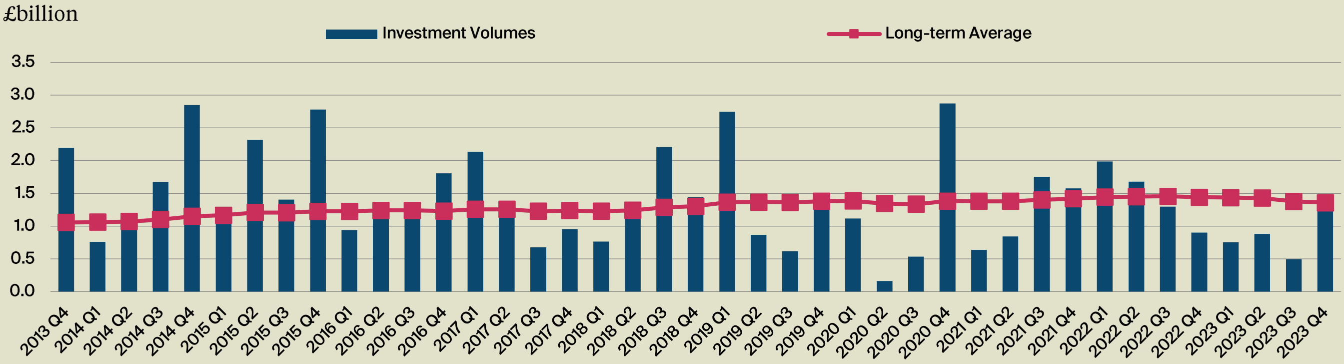
Source: Knight Frank Research

West End: Investment volumes by nationality
2023 Q4, % of total investment volumes



Source: Knight Frank Research

West End: Investment volumes relative to trend
£billion



Source: Knight Frank Research

West End offices

Above trend take-up in majority of West End submarkets.

ABOVE TREND TAKE-UP

There was 1.40m sq ft of take-up in the West End during the quarter, an increase of 60.8% from Q3 and 25% above the long-term trend of 1.12m sq ft. This was the highest level of take-up since 2022 Q2. Transactions of the best quality offices represented 56.7% of lettings in the market. Take-up was above the long-term average in two-thirds of the submarkets in the West End and was highest in the West End Core (77.7%), Soho (153%), and Strand/Covent Garden (59%).

The largest letting in Q4 was the 172,405 sq ft pre-let signed by Millenium Capital Management at 50 Berkeley Street, W1J, at a rent of £135.00 per sq ft. The move will be a return to the Berkeley Street premises, Millenium Capital Management's home from 2004 to 2022, once refurbishment works are completed in 2025. The second largest transaction was law firm Paul, Weiss, Rifkind, Wharton & Garrison LLP, who acquired 81,433 sq ft of space across three floors at Air, W1.

Following a quarter of strong leasing momentum, active demand in the West End has fallen to 1.88m sq ft. There is however, 0.8m sq ft of space under-offer in the West End, predominantly in the West End Core and Fitzrovia submarkets. Near-term demand is driven by the financial sector at 0.6m sq ft (34%) followed by 0.4m sq ft from manufacturing and corporate occupiers (23%).

SLIGHT RISE IN AVAILABILITY BUT FUTURE PIPELINE IS MODEST

West End availability has risen by 2.1% to 6.8m sq ft. The rise has been primarily driven by upcoming development completions in 2024 Q2 and constitutes a vacancy rate of 7.3%. Prime availability remains constrained and has a vacancy rate of 4.9%. Just under half of the West End's submarkets have total vacancy rates below long-term trends.

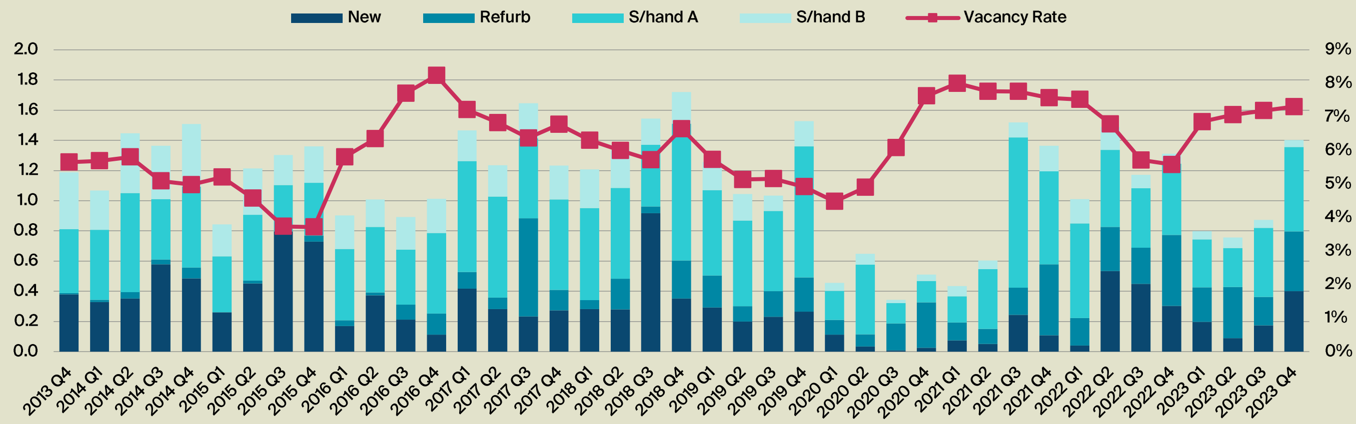
The under-construction development pipeline has increased to 5.17m sq ft. However, the volume of speculative space is down 4% to 3.69m sq ft. The West End pipeline is 29% pre-let. This volume of under-construction speculative activity is anticipated to result in a shortfall of 1.7m sq ft of prime space by the end of 2026.

151 Buckingham Palace Road, SW1, was the largest completion in Q4 and delivered 202,916 sq ft of which 27,215 sq ft was under offer. Pre-let lead-in times over the last five years for the West End are, on average, 12.6 months ahead of a scheme's completion.

FURTHER RISES TO PRIME RENTS

As a result of our change to the assessment of prime rents we have raised rents in all but two submarkets – Bloomsbury and White City. The most significant rises have been in the West End Core from £140 to £150 per sq ft, in King's Cross/Euston from £82.50 to £90 per sq ft and in Strand/Covent Garden from £80 to £87.50 per sq ft.

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



Source: Knight Frank Research

Docklands & Stratford offices

Take-up has fallen over the quarter, and availability remains high.

TAKE-UP FALLS IN Q4

During the quarter, there was 0.09m sq ft of take-up in Docklands & Stratford, a decrease of 37% from Q3 and 55% below the long-term trend. Transactions of the best quality offices represented 12.2% of lettings in the market as availability is predominantly second-hand, resulting in lower levels of new and refurbished take-up compared to other London markets.

The largest letting in Q4 was the 84,999 sq ft lease signed by the National Crime Agency across floors 12-14 at 1 Westfield Avenue (S5), E20. The sub-lease was signed at the rental rate of £40.00 per sq ft. As such, this one deal means that public sector take-up was 86.4% in Q4. The second largest deal was AviadoBio, letting 11,000 sq ft at 20 Water Street, E14, at £57.70 per sq ft.

Throughout 2023, manufacturing and corporate occupiers represented 29% of take-up in Docklands and Stratford, followed by miscellaneous occupiers at 28%. There is currently 0.2m sq ft floorspace under offer in the market; over half of this is in Canary Wharf and of a new and refurbished quality. Active demand has reduced to 0.14m sq ft, down 37.8% from the previous quarter. Financial occupiers drive demand with 85% of all named demand in the market.

TOTAL AVAILABILITY REMAINS HIGH

Availability has risen 7% on the quarter to 4.19m sq ft, resulting in a vacancy rate of 16.8%, almost double the long-term trend of 9.7%. However, vacant new and refurbished space is much lower at 7.8% of all stock.

Only one scheme is under construction, the 350,779 sq ft Turing building in Stratford which completes later this year.

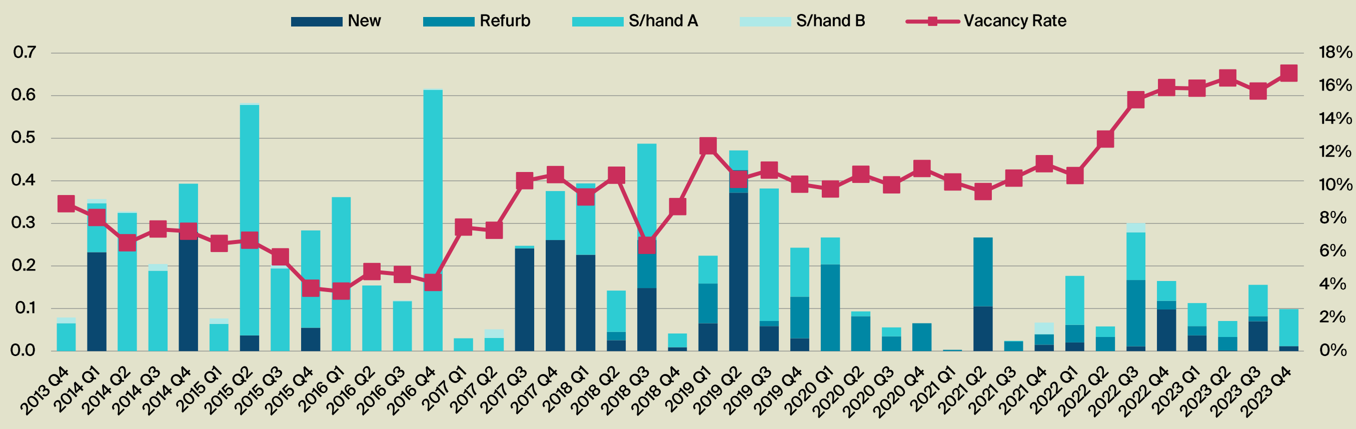
We have raised rents in Canary Wharf from £55 to £57.50 as available prime space remains limited. Rent frees are unchanged at 28.5 months on a typical 10-year lease.

HIGHER YIELDS

There was no investment activity during Q4. Investment availability has risen 88% to £0.52bn, and a further £0.02bn is under offer. Prime yields have moved out to 7.25%, reflecting the challenging investment landscape of the market.

Docklands & Stratford: Take-up by quality and vacancy rate

Million sq ft, % of stock (RHS)



Source: Knight Frank Research

South East offices

Investment activity remained subdued in Q4, however falling interest rates in 2024 are expected to encourage investors back to the UK office markets.

WIDER TURMOIL HINDERS OFFICE INVESTMENT

Investment activity remained subdued in Q4, with £218m of office stock traded, a 57% increase compared with Q3 2023 but 69% below the 10-year quarterly average. Consequently, investment volumes for 2023 finalised the year at £1.3bn, 55% less than in 2022 and 54% below the 10-year annual average.

The absence of international buyers partly contributed to the subdued level of market activity in 2023. Although responsible for two of the three transactions over £50m, the number of deals completed by foreign buyers represented 26% of the market, down from 37% in 2022.

LIQUIDITY THIN FOR HIGHER VALUE ASSETS

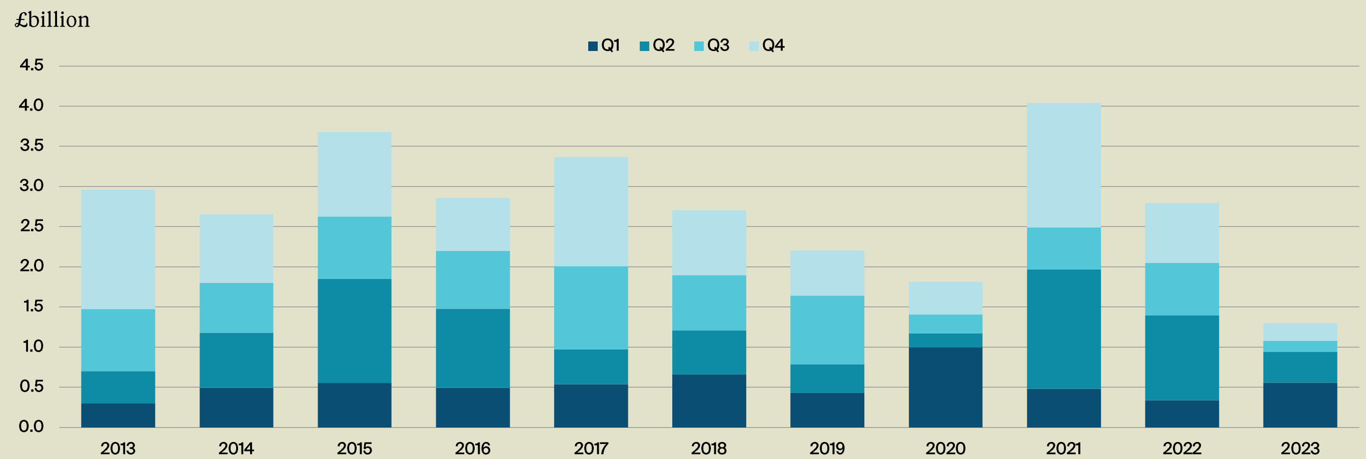
Despite market challenges, 2023 registered a relatively high number of investment deals. During the year, 88 investment transactions were completed, just ahead of the 5-year annual average of 86. However, liquidity at the higher-value section of the market proved tight in 2023, with only three transactions above £50m completed. This compares with an annual average of 16. Notably, Life Sciences assets accounted for two of the three transactions above £50m.

PRICING TO SETTLE IN 2024?

The continued turbulence within domestic and global capital markets led to rapid market repricing in 2023. Prime office yields for the South East offices increased by 100bps to 7.00% over the year, a level not recorded since the Global Financial Crisis.

Moving forward, inflationary pressure and capital markets have stabilised, with forecasts indicating a fall in interest rates can be expected in 2024. Price discovery will remain a firm market characteristic, at least for the short term, with the shift in capital values offering opportunities for some investment groups. Equity-backed opportunistic buyers are active, and as markets continue to stabilise, we anticipate that core and core-plus investors will grow in number.

South East: Investment volumes



Source: Knight Frank Research

South East offices

A comparatively strong Q4, in which several large occupier deals completed, pushed take-up above the 5-year annual average.

OCCUPIER ACTIVITY PROVES RESILIENT DESPITE SIGNIFICANT HEADWINDS

The expectation of a tight future supply landscape set the tone for solid occupier activity in the final quarter of 2023. During Q4, take-up increased by 64% quarter-on-quarter to reach 1.4m sq ft, the highest quarterly total since 2018. Consequently, take-up across the South East for the year increased to 3.45m sq ft, almost identical to the total of 2022 and 3% above the 5-year annual average. A high deal count supported the level of take-up. In 2023, 333 occupier transactions were completed, the highest number of deals in our records.

BEST AND THE REST

A continuing occupier trend observed in 2023 was a distinct focus on acquiring the best quality. This has meant that firms have acted earlier to secure spaces. In 2023, 13 leases were agreed prior to the completion of development, the highest total since 2001. New and grade A space accounted for 84%, well above the long-term average of 66%. In contrast, take-up of grade B space was low, accounting for just 16% of the total.

QUALITY OVER QUANTITY

The final annual results demonstrated a broader trend of reducing requirement sizes. During the year, 74% of deals were for 10,000 sq ft or less, albeit the number of deals completed at the size range was the highest in our records. Overall, the average deal size in 2023 was 10,400 sq ft. This is the smallest in our records, dating back to 1992.

DEMAND CONCENTRATION CREATES UPWARD RENTAL PRESSURE

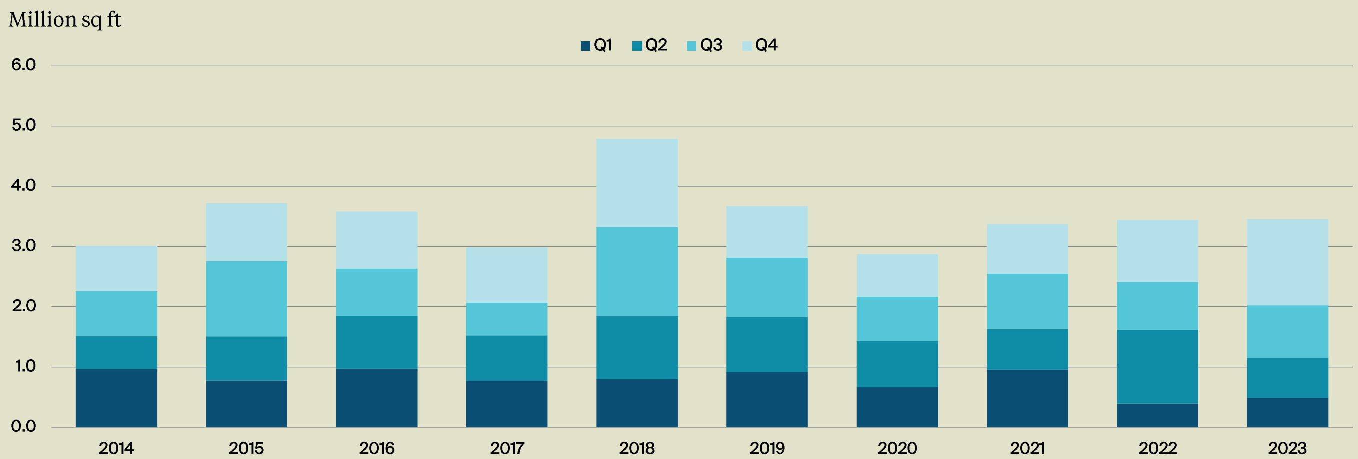
Activity levels varied considerably across the markets. In 2023, 6 markets accounted for 50% of total take-up. Consequently, due to this pressure on high quality and the polarisation of markets, 17 of 54 markets recorded an increase in prime rent during 2023, and 17 of 54 recorded a decrease. The remainder stayed the same as year-end 2022.

SUPPLY LANDSCAPE SHIFTING

The overall vacancy for the South East increased marginally in 2023, finishing the year above the long-term average at 7.8%. Interestingly, Grade B space accounted for 24% of South East availability at year-end. This is the lowest representation since mid-2021 and demonstrates new stock coming to market and a greater prevalence of lower-quality stock being taken out of the market.

In 2023, over 1.4m sq ft of speculative development was completed, the highest total since 2017. However, Oxford and Cambridge accounted for 44% of this total as these markets respond to demand for Life Sciences companies. At year-end, 3m sq ft of speculative space was under construction and due to be completed before the end of 2025. Of this, Oxford and Cambridge account for 28%.

South East: Occupier take-up



Source: Knight Frank Research

UK Cities offices

Investment volumes continue to rise quarter-on-quarter, albeit liquidity for large lot sizes stays low.

A SUSTAINED RISE IN INVESTMENT VOLUMES THROUGHOUT 2023

Investment across the regional offices rose each quarter in 2023, reaching £395.98m in Q4, more than double that in Q1. Despite this, annual office investment finished 37% below the previous year, and 41% below the 5-year annual average, at £1.13bn. In a challenging investor market, the largest transaction across the regional cities in 2023 was the sale of One Angel Square in Manchester to Menomadin Group for £137.5m.

IS THIS THE END OF THE CURRENT REPRICING?

Prime office yields continued to soften in Q4 and increased by up to 200bps across the regional cities in 2023. However, interest rates will be a key driver of the office market in 2024. With further interest rate hikes now unlikely, debt costs will remain steady, providing a pricing benchmark for buyers and sellers. Prime office yields will stabilise, encouraging more investment activity as investors take advantage of pricing that offers discounts compared to the long-term average.

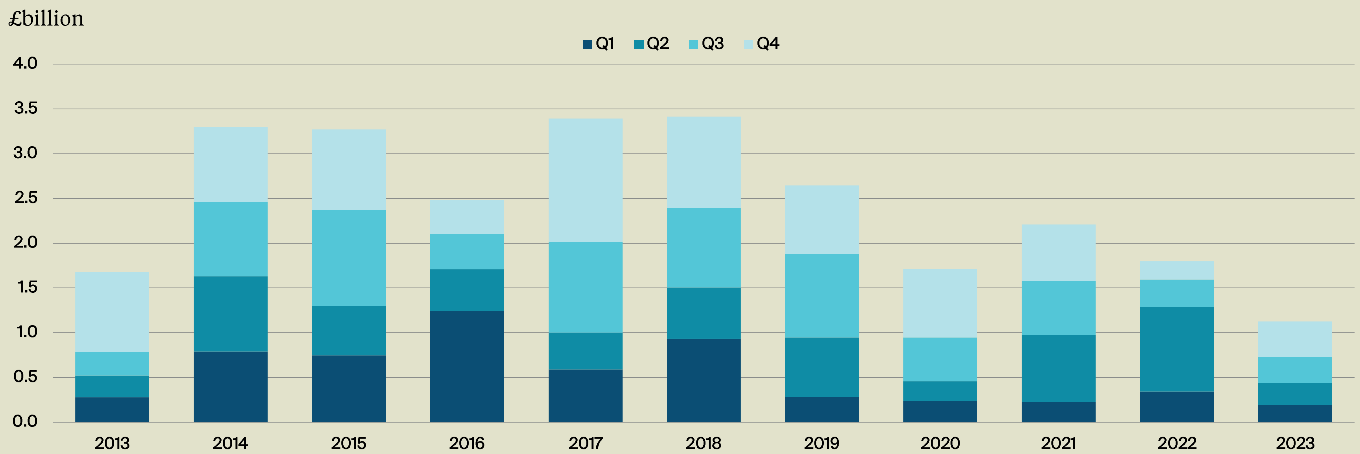
OVERSEAS INVESTORS TAKE THE TOP SPOT FOR INWARD CAPITAL FLOWS IN Q4

In the final quarter of 2023, overseas investors accounted for close to 40% of investment turnover. However, this is largely attributed to the acquisition of One Angel Square by a Middle Eastern investor. In terms of deal number, property companies continued to dominate in Q4, accounting for half of transactions. Considered for all of 2023, property companies also dominated, accounting for 40 out of 71 transactions (56% of all completed deals).

SMALLER LOT SIZES DOMINATE

Alongside falling investment volumes, the average deal size has fallen incrementally over the past five years, and is currently £15.4m, 20% below the long-term annual average. Notably, just three deals above £50m completed in 2023, 76% below the 10-year annual average of circa. 13 deals in this size band.

UK Cities: Investment volumes



Source: Knight Frank Research

UK Cities offices

Occupier take-up in Q4 reaches the long-term average, whilst a lack of best-quality supply is supporting pre-letting and rental growth.

OCCUPIER ACTIVITY INCREASING

Take-up in Q4 reached 1.3m sq ft across the UK cities, a level on par with both the previous quarter and the 5-year quarterly average. Despite this, annual leasing volumes finished below the total of the previous year at 4.7m sq ft, 10% below the long-term average. Deal numbers however reached 1,087, 7% above the 5-year annual average, albeit the average deal size was low at 4,347 sq ft.

SUPPLY SQUEEZE FOR THE BEST

A shortage of supply for best-in-class space is evident across the UK cities. The percentage of take-up accounted for by new or grade A space fell to 43% from 57% the previous quarter. Despite this, 5 out of 10 cities recorded take-up for new and grade A space of above 50% of overall take-up, reaching as high as 81%.

Notable occupier deals for best-quality space include the letting of circa. 32,000 sq ft of BREEAM ‘Excellent’ and SMART-enabled space at One Centenary Way in Birmingham to legal firm Mills & Reeve. Meanwhile, the global consultancy BDO took circa. 23,000 sq ft of space at Eden in Manchester, a building designed to be net zero in operation and WiredScore ‘Platinum’ and BREEAM ‘Outstanding’ certified.

THE RISE OF THE PRE-LET

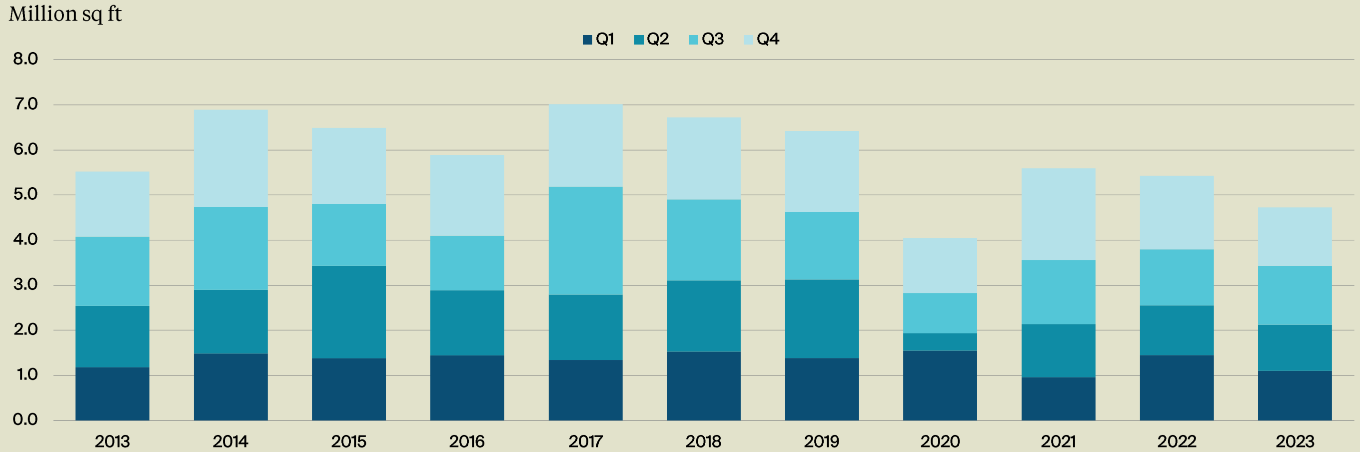
The scarcity of prime space is forcing tenants to secure spaces well ahead of forthcoming lease events. While overall vacancy rates have risen, high-quality space has remained limited, with a vacancy rate of below 3% for new and grade A space. The supply squeeze is most acute for those requiring large floorplates. With high construction costs, lower market rates and a switch to alternative use further restricting future supply, competition for space will continue in the coming year. Consequently, prime rents are forecasted to increase by 3% on average. Pre-letting activity and leases agreed during the construction period will be a significant factor in the market in 2024.

SERVICED OFFICES FOOTPRINT GROWS IN 2023

In 2023, serviced office providers including Cubo, Orega, Re-defined, Regus, and Wizu expanded their presence in many UK regional cities, with this subsector taking 259,000 sq ft across 15 deals. Occupiers are exploring flex space as part of their real estate strategies, especially when an interim solution is required whilst longer-term space is secured. More are seeking higher levels of flexibility than afforded by conventional leased space. Flex space is especially important to the growth of the technology, creative and digital sectors, to which traditional leases are not suited. Further expansion is expected in 2024.

UK Cities: Occupier take-up

Million sq ft

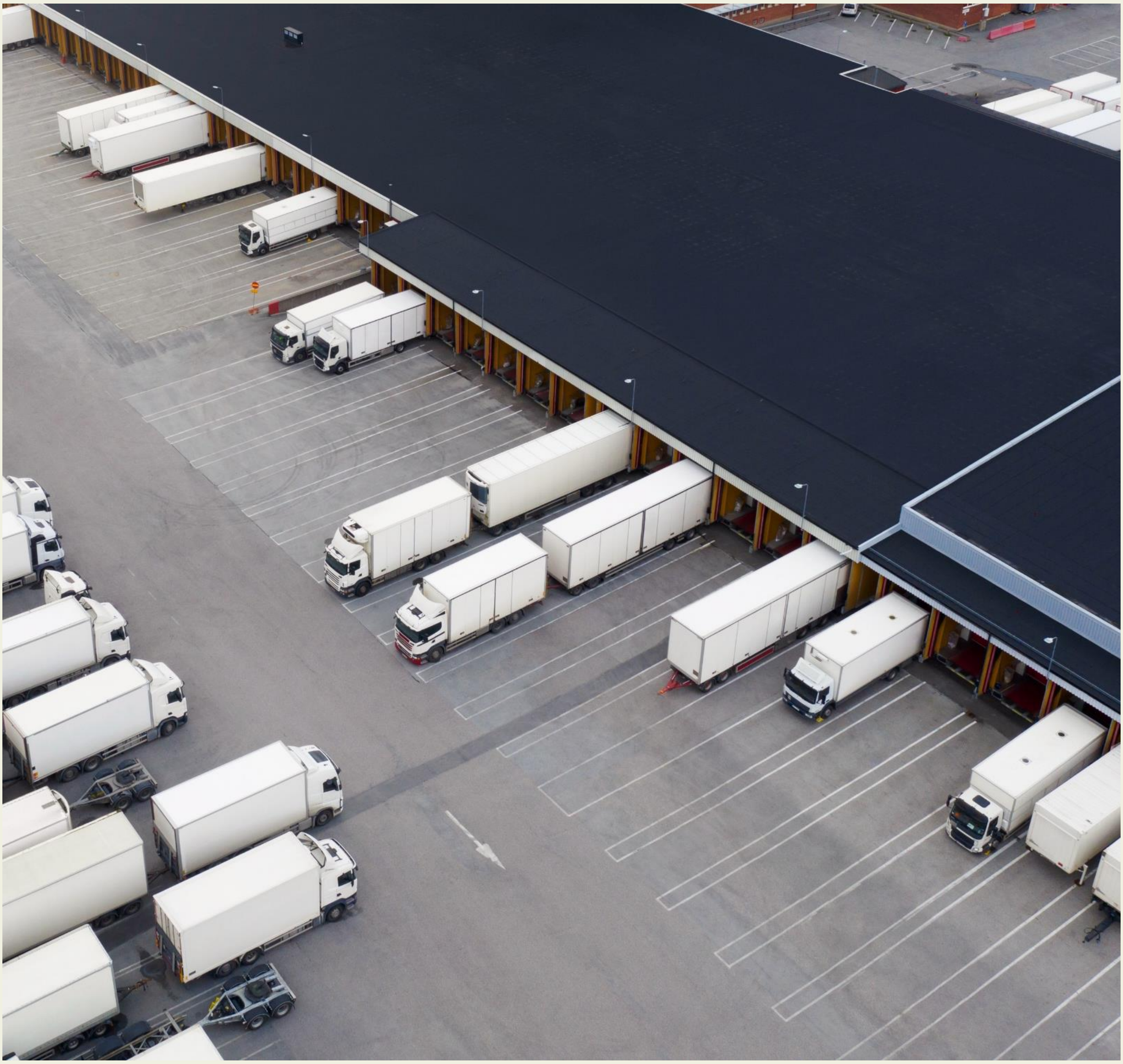


Source: Knight Frank Research

Industrial & distribution

Investment and occupational markets

CONTACT: DEIRDRE O'REILLY



Industrial & distribution

2023 investment was challenged by less unanimity among buyers and sellers on where properties should be priced, but sentiment remains in the sector's favour.

INVESTMENT AHEAD OF LONG-TERM AVERAGE, DESPITE CHALLENGES

Investment figures for Q4 2023 show £2.4 billion invested in the UK industrial sector, +16% higher than a slow Q3. This brings the total for 2023 to £9.8 billion, and although reflecting a -41% annual decline, 2023 volumes stood +38% above the ten-year pre-pandemic annual average of £7.8 billion. 2023 deal activity was challenged by high financing costs, softened yields, and less unanimity among buyers and sellers on where properties should be priced. Sentiment continues to favour the sector as an asset class in which to maintain exposure, but a lack of willing sellers during the year has kept volumes relatively thin.

Both cross-border and UK private capital grew their share of the market, comprising 62.1% and 13.7% of 2023 investment, respectively. While institutional investors and REITs were less acquisitive, the buyer pool showed signs of strengthening as the year ended, with UK institutions returning to the market and new interest seeking to capitalise on favourable pricing.

PRIME YIELDS STABILISE

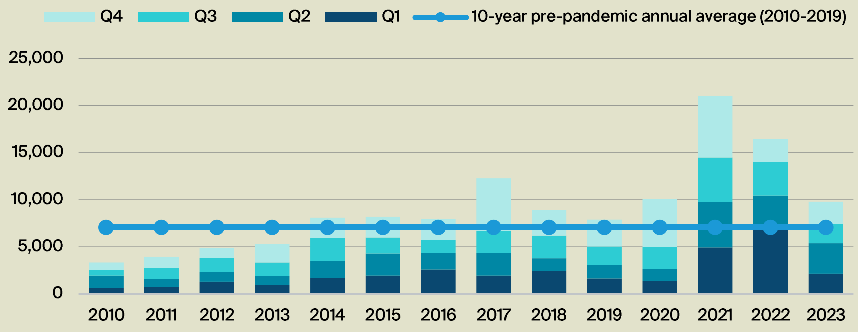
Prime distribution/warehousing with 15-year income on open market rent reviews settled at 5.25% during 2023. Although prime pricing has stabilised, the performance gap between prime and secondary assets may widen further. The UK industrial equivalent yield softened to 6.2% in December, from 6.1% in November and 6.0% in September 2023 (MSCI).

A RETURN TO GROWTH IN RETURNS

Annual total returns turned positive, recording +5.2% in December, from -15.8% in September, though monthly total returns were stable in December. Monthly income returns remained unchanged at +0.4% growth, equating to +4.9% for the year (MSCI).

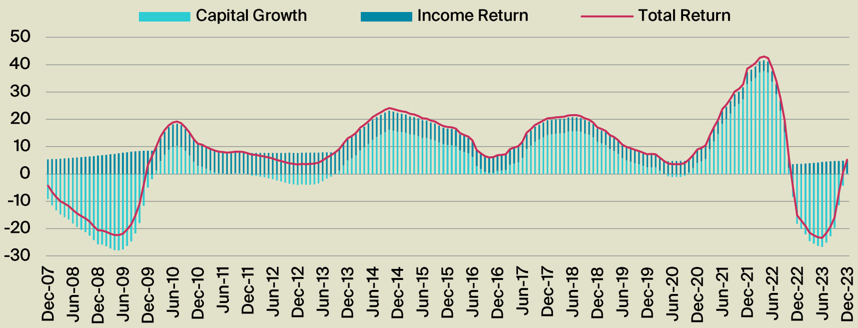
Capital values remain volatile; following 13 consecutive declines, annualised capital values returned to growth of +0.2% in December, up from the -19.7% in September, though monthly capital values edged down by -0.4% in December.

Investment volumes
£million



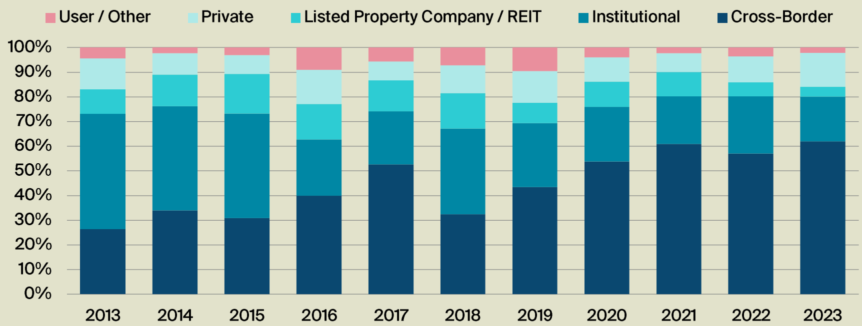
Source: Knight Frank Research, RCA

Total return (annualised)
%



Source: Knight Frank Research, MSCI

Capital composition
%



Source: Knight Frank Research, RCA

Industrial & distribution

Return to pre-pandemic take-up levels amid economic challenges, but continued growth in both prime and average rents.

PRE-PANDEMIC TAKE-UP LEVELS

UK industrial take-up volumes in 2023 moderated to levels seen before the pandemic, following three years of record-breaking activity in 2020-2022. Take-up figures for Q4 2023 show 8.1 million sq ft of space committed, bringing the annual total to 29.9 million sq ft (units over 50,000 sq ft). While this marks a 35% decline on 2022 volumes, it aligns more closely with the ten-year pre-pandemic annual average of 34 million sq ft.

Albeit with a more cautious approach amid challenging economic conditions, occupiers continue to be active. Enhanced e-commerce capabilities, supply chain resilience, and a preference for modern facilities with strong ESG credentials remain at the forefront of occupier focus.

FOCUS SHIFTS TO EXISTING BUILDINGS

2023 saw a decline in pre-let and build-to-suit activity and a shift in focus towards existing buildings, including speculatively completed space and buildings undergoing high-quality refurbishment. Notably, the share of take-up that is second-hand space rose to 47% in 2023, from 32% in 2022.

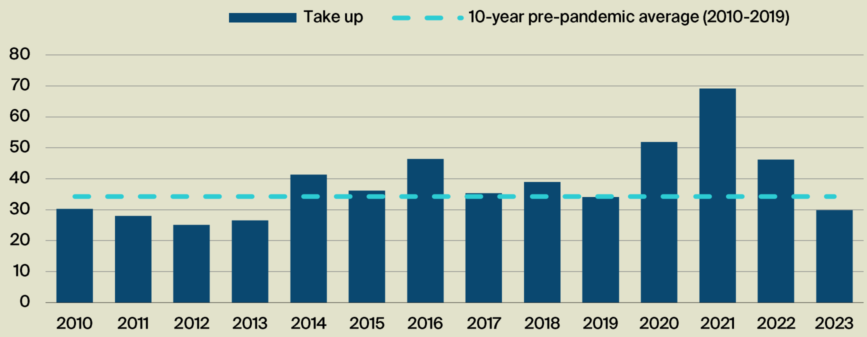
...AS DEVELOPMENT PIPELINE SLOWS

Supply levels of units over 50,000 sq ft trended upwards during 2023, driven by development completions and the return of second-hand space. However, the volume of speculative space under construction was -28% lower YoY in Q4, at 15.3 million sq ft (units 50,000 sq ft+). A slowdown in the development pipeline will mean that vacancy rates in some markets are likely to gradually fall again in 2024. The vacancy rate stood at 5.5% in Q4, up from 3.3% in Q4 2022, but below the 8.3% pre-pandemic average.

ONGOING, ALBEIT MODERATED, ASCENT IN RENTS

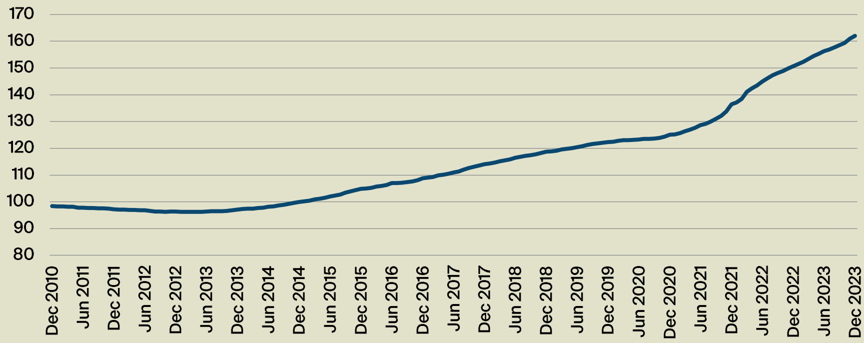
Annual market rental value growth in the year to December 2023 was +7.6%, down from +10.5% in the same period in 2022. Month-on-month growth decelerated in December to +0.72%, from +0.95% in November, but up from +0.57% in September (MSCI).

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



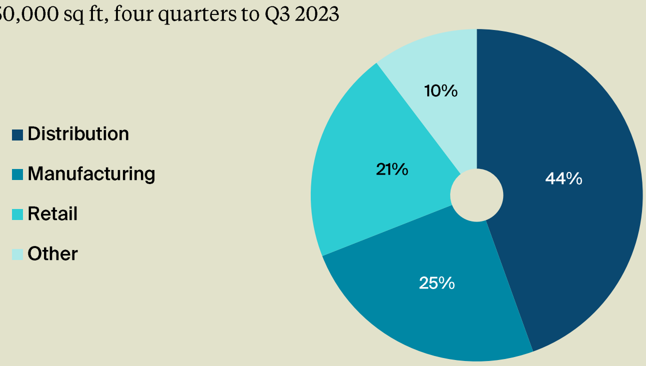
Source: Knight Frank Research

Average market rental growth
Jan 2010 = 100



Source: Knight Frank Research, MSCI

Take-up by occupier type
Units over 50,000 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

Most metrics showed improvement in Q4, with 2023 proving stronger for the sector than anticipated. 2024 will prove stronger still, albeit anything but plain sailing.

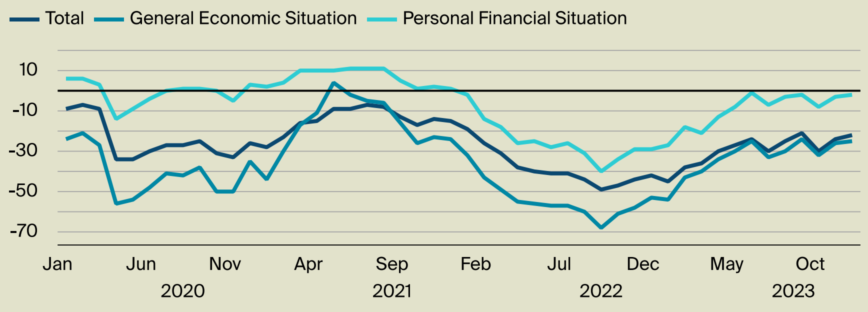
CONSUMERS CLOSE TO OPTIMISM
Consumer markets made positive progress, with householders' mood near optimism regarding personal financial outlooks (Dec -2pts vs Dec 22 – 29pts). Labour market stability played a major role, with wage growth strong (+6.5%) in the three months to November. Q4 retail sales values grew steadily (+3.9%) but decelerated versus Q3 (+5.3%). Encouragingly, volume declines (-1.4%) improved as inflation receded (Shop Price inflation: 5.3%). Overall, 2023 annual sales grew an impressive +5.1%, surpassing the 10-year average (+3.5%), illustrating the consumer meltdown widely feared failed to materialise.

RECORD LOW OCCUPIER FALLOUT
The strength of the occupier pool continued to surprise on the upside. News flow from retailers during the festive period was generally positive. The majority reported robust store trading, and a handful increased profit guidance expectations. However, the tone and mood of the outlook rightly remain only cautiously optimistic. In total, only 971 stores in 2023 were listed as affected by CVA/administration – the lowest figure since 2015. Accordingly, overall vacancy rates improved by -10bps to hit 15.3%, underlining the stability of the occupier landscape.

INVESTMENT DEALS STEADY
Investment markets were largely out of sync with occupier markets, but investor confidence did grow. Although not spectacular, All Retail delivered a positive total return of +1.0% in 2023, considerably better than other CRE use classes (e.g. Offices -11.9%). High-income returns (7.0%) relative to Industrial (4.9%) and Offices (5.6%) also contributed to improved sentiment.

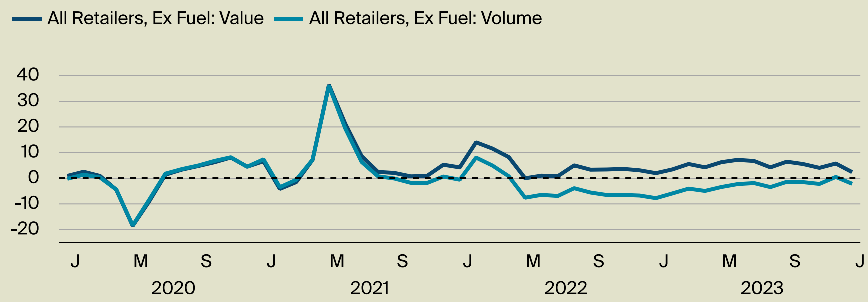
Ultimately, Q4 transactions (£1.3bn) marked a QoQ slowdown but a YoY increase of +37%. Overall, 2023 transaction volumes (£6.1bn) were down versus long-term averages (10-year £7.3bn) but showed modest improvement on 2022 levels, marking a move in the right direction.

Consumer confidence
Confidence over the next 12 months



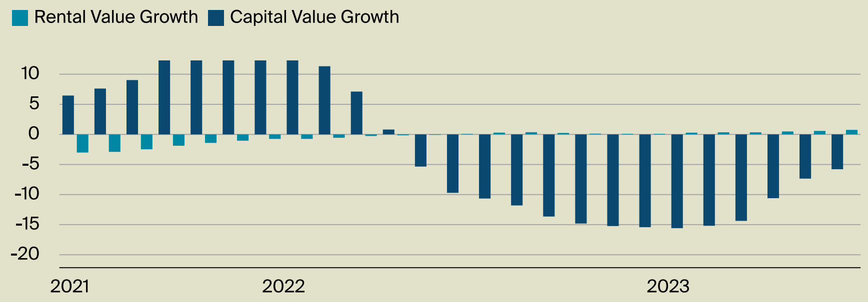
Source: Gfk

ONS retail sales
Monthly YoY change, %



Source: ONS

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



Source: MSCI

High street retail

Unsettled weather held back shopper visits, but robust trading and an improved macro-economic backdrop buoyed retailers' optimism for the year ahead.

STORMS IMPACTED VISITOR NUMBERS

An unsettled, rainy but mild Autumn resulted in sluggish footfall levels (Oct -4.6% YoY / Nov -1.7% / Dec -4.2%) thanks to six storms: Babet, Ciaran, Debi, Elin, Fergus, and Gerrit. November was the most resilient month for footfall thanks to Black Friday promotions. However, the discounting event wreaked havoc on spend data. ONS headlines purported weak festive trading (Dec vals +2.3% / vols -2.1% vs Nov +5.6% / +0.5%), which ran counter to operators' positive trading updates, and consumer spend data which was up +£7.46bn in December in cash terms.

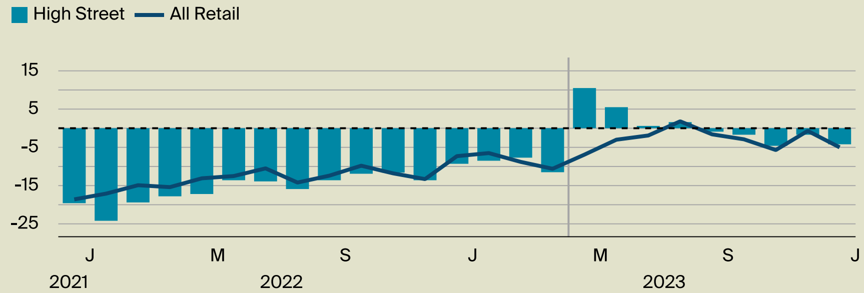
CAUTIOUS OPTIMISM EMERGING

Operators across a variety of categories reported better-than-anticipated trading (e.g. Card Factory +7.8%; Boots +9.8%; H&M +6.0%; M&S +8.1%; Pandora +12%, Primark +7.9%). Many tentatively expressed cautious optimism for the year ahead, but with an eye firmly on fresh geo-political disruptions in the Red Sea. Vacancy rates were steady at 14.0%, while new store investments boosted confidence further. M&S announced a £30m investment in Scottish locations, and Poundland plans to revamp 850 stores. Wilko's comeback also picked up pace with new store openings in Plymouth, Exeter and Luton.

ROBUST COVENANTS COVETED

In line with wider Retail, High Street investment volumes slowed QoQ to £77m, taking the 2023 total to £628m. Liquidity was highest for smaller lot sizes, with average transactions at ca. £5.3m. Units let to robust covenants attracted the strongest interest, especially those in the top tier 'Cathedral Cities' and London villages. Key deals included the sale of 18-20 Church Street, Liverpool for £7.8m on behalf of Redevco (let to Decathlon); the sale of 37 – 44 Stall Street & 9-18 Bath Street, Bath for £15.2m on behalf of M&G (let to Primark, Mountain Warehouse, Costa, Itsu); and 77 Princes St & 1 Hanover St, Edinburgh for £14m to Hunter Fund Management (let to Dr Marten, O2).

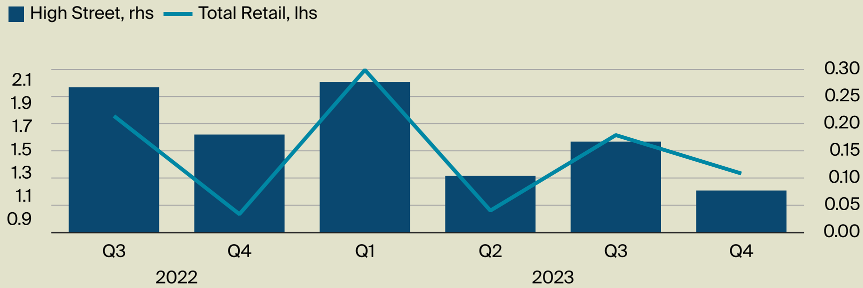
High street footfall
Monthly YoY change, %, vs 2019 levels



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

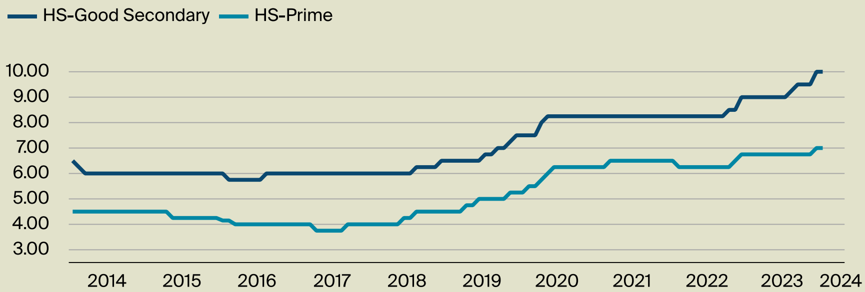
Source: BRC / Springboard

High street investment volumes
£million



Source: Knight Frank

High street yields
%



Source: Knight Frank

Shopping centres

Vacancy rates improved as polarisation between destination locations/'right-sized' convenience and centres no longer fit-for-purpose intensified.

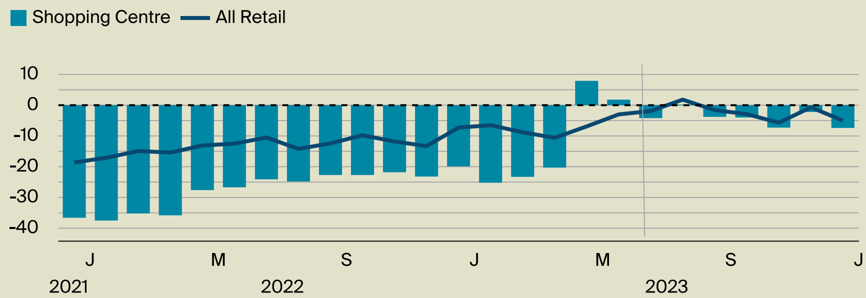
STRONG APPEAL FOR 'DESTINATIONS'
Q4 retail sales growth did decelerate to +3.9%, with Non-Food much weaker at +0.9%. Clothing demand was disappointingly subdued in Q4 (+0.9%), despite stellar performance earlier in the year. However, Cosmetics (vals 11.3%/ vols 6.6%) and Footwear (8.6%/4.5%) maintained and continued a strong run of value and volume growth.

Footfall levels across the UK (Oct: -7.3% YoY/Nov: -2.2% / Dec: -7.4%) masked good performance in select destination locations, with major city schemes outperforming (e.g. Edinburgh: Nov +5.7%/Dec +6.4% & Leeds: Nov +3.1%/Dec +0.5%). Overall average footfall trends reveal SCs continue to lag All Retail (Oct: -5.7%/Nov: -0.7%/Dec: -5.0%).

VACANCY RATE IMPROVEMENTS
The sale of larger schemes during 2023 led new asset managers to revitalise leasing strategies, spurring strong letting activity, resizing of spaces, and diversifying use mix (e.g. Sovereign Centros – Basingstoke / Ellandi – Highcross). New store openings and relocations, such as by the likes of M&S in Birmingham Bullring, Leeds White Rose and Manchester Trafford Centre, contributed to a further -20bps improvement in vacancy to reach 17.7%. Vacancy rates are now approximately -50bps lower than 2022 levels. But more work is required to tackle persistent vacancy (9.9%) which remains elevated versus HS (7.0%) and RP (4.4%).

LARGER LOTS TEST MARKET
Deal volumes accelerated in Q4 to £437m, marking the strongest quarter of 2023, as vendors began to test the market with larger sales. Churchill Square, Brighton, served as a bellwether - acquired by Ingka Centres for £143m. Three other deals transacted with a lot size above £40m: Livingston Designer Outlet (£57m), Junction 32 Outlet (£46m), and The Centre, Livingston, for £46m. 2023 volumes (£1.17bn) were ultimately below 2022 levels (£2.1bn) and are expected to remain subdued for the foreseeable future as financing costs remain prohibitively high.

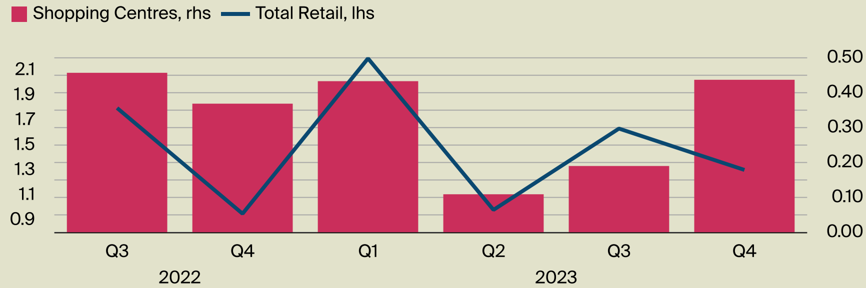
Shopping centre footfall
Monthly YoY change, %, vs 2019 levels



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

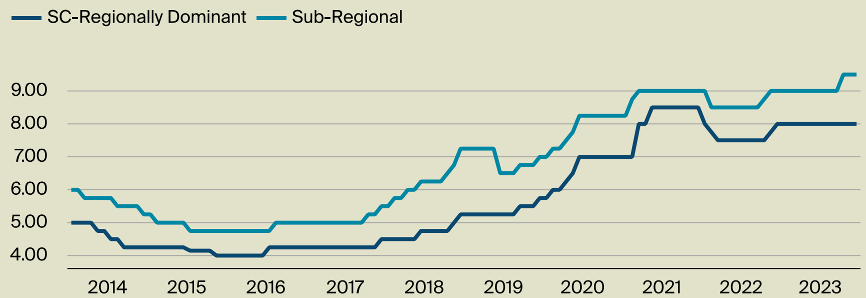
Source: BRC / Springboard

Shopping centre investment volumes
£million



Source: Knight Frank

Shopping centre yields
%



Source: Knight Frank

Out-of-town

Retail Parks & Warehousing won favour from consumers, operators and investors alike - but scarcity of supply is failing to satisfy investor appetite.

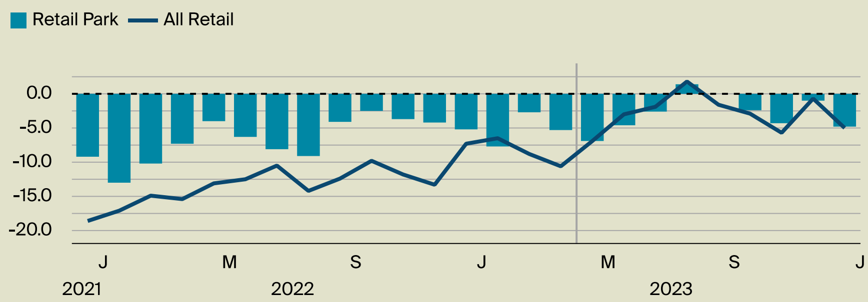
FOOD ANCHORS MOST POPULAR
Consumer appeal for the retail park format held strong, with grocery and quick-service F&B anchored sites proving most popular. Q4 Food sales (+6.4%) significantly outpaced Non-Food (+0.9%), with bulky goods demand waning against a backdrop of weak housing market activity and depressed appetite for major purchases (-23pts). Carpets (-0.4%), Furniture (-0.9%) and DIY (-3.9%) all witnessed declines in sale values YoY in Q4. However, Computers (+18.3), Specialist Food (+14.2%) and Cosmetics (+14.2%) all saw double-digit growth.

OCCUPIERS FIGHT FOR SPACE
A fresh wave of high street retailers, including Lush and Mango, migrated to out-of-town locations for the first time, under the allure of affordable rents, favourable rates and substantial foot traffic. Consequently, unit vacancy rates improved by a further -20bps to 7.6%, marking the lowest quarterly rate since Q2 2019. Vacancy rates now stand well below their pandemic peak (Q2 2021: 11.5%). With record low voids, available stock has become scarce, intensifying competition amongst occupiers seeking new and expansion space. A variety of contenders continue to vie for units e.g. Greggs, Taco Bell, JD Sports Gyms, Popeyes, driving positive rental growth trends.

STOCK SHORTAGES HEADACHE
Despite a strong occupier base, capital markets remained largely disconnected and constrained by debt markets. Q4 transaction volumes were subdued at £355m, taking 2023 totals to £1.84bn.

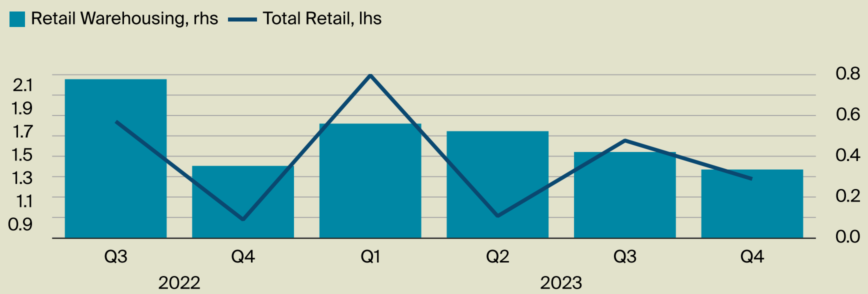
Investor demand for the sector is there in spades but volumes remain frustrated by a shortage of available stock, with an ongoing standoff between vendor valuations and market pricing. Core buyers continue to be PropCos, who were responsible for 51% of deal volumes in 2023, followed by Institutions (33%) many of whom hold local authority mandates. 2024 volumes are now projected to match 2023's, assuming interest rates stabilise, aiding a recovery in debt markets.

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



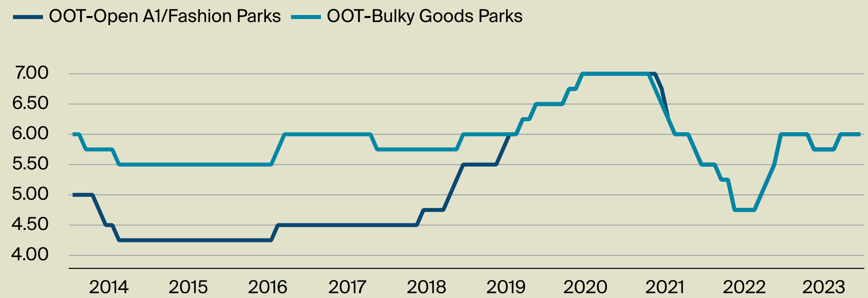
*March 2021 – March 2023 figures are compared to 2019 levels
Source: BRC / Springboard

Retail warehousing investment volumes
£million



Source: Knight Frank

Retail warehouse yields
%



Source: Knight Frank

Leisure

Operational challenges persisted but slowing closures and twelve months of solid trading performance boosted the outlook for 2024.

SEASONAL SOCIALISING STRONG

The desire to socialise and spend on leisure pursuits was strong in Q4 as seasonal celebrations got underway. Barclaycard data showed strong YoY spending growth across both the 'Hospitality and Leisure' (Oct: +7.1%/ Nov: +8.5%/Dec: +8.9%) and 'Eating and Drinking' markets (Oct: +6.1%/Nov: +5.1%/Dec: +5.7%). Overall, sales across the top hospitality groups was better than expected, with managed pubs, bars, and restaurants achieving robust like-for-like growth during every month in 2023, according to CGA.

SITE CLOSURES SLOWING

Conditions for occupiers were tough, with most still fire-fighting cost and labour issues, but robust data on trading and closures buoyed optimism for the year ahead. Q4 Site closure rates slowed substantially, with the hospitality sector losing 803 sites in total. This equates to nine closures per day – far below the COVID peak of 24 per day. There are now 3,000 fewer hospitality premises than at the end of 2022. However, the downward trajectory has flattened out in many segments, including Community Pubs (-0.2% QoQ) and Large Venues (-0.2%), with some even witnessing stability/ growth (Bar Restaurants 0.0%/Hotels +0.2%).

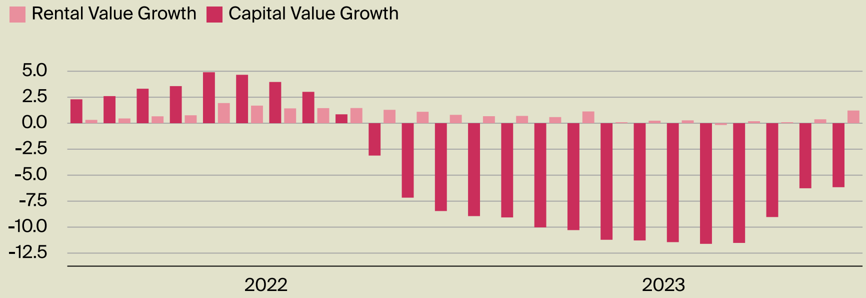
COMPELLING INCOME RETURNS

Investor sentiment has yet to substantially return following the devastation wreaked by COVID, despite income returns (7.6%) in the 12 months to December appearing more compelling vs Retail (7.1%) and All Property (5.5%).

As expected, 2023 annual leisure investment registered down: £132m vs £280m in 2022. Key deals involved assets let to strong covenants such as S&L of Everyman cinema in Salisbury at 7.30% and Virgin Active gym in Streatham at 9.80%. With more transactional evidence trickling through, yields adjusted: the gap between prime and secondary narrowed (Leisure Parks +25bps to 7.75% /Good Secondary Leisure Parks -75bps to 9.00%).

Leisure: rental/capital value growth

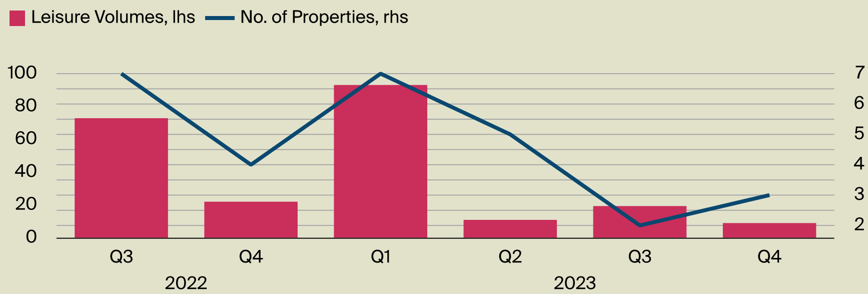
Rolling 12 month % change



Source: MSCI

Leisure investment volumes

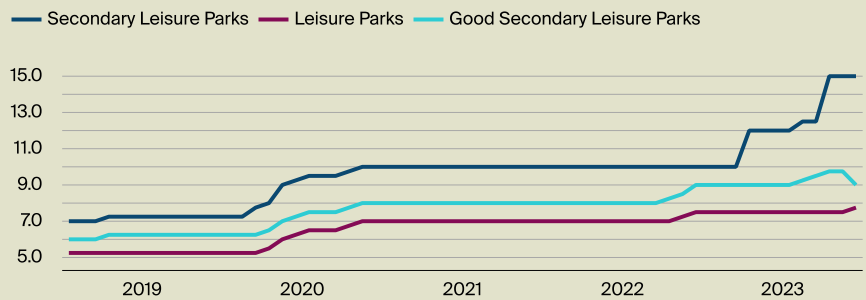
£million



Source: RCA

Leisure yields

%



Source: Knight Frank

Foodstores

A stellar quarter for foodstores, with solid results across consumer, occupier and investor markets, capping off an excellent year.

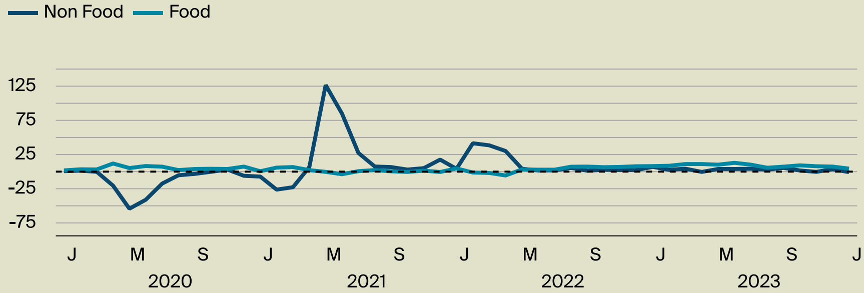
RECORD SHOPPER NUMBERS
Grocery retail sales were strong across Q4, with Barclaycard data showing positive YoY spend and transaction growth (Oct: +5.3%/+5.0%; Nov: +5.0%/+3.8%; Dec: +3.1%/+4.0%). This was underscored by excellent trading updates from the major grocers, who highlighted a significant return to volume growth in December, as grocery price inflation (6.7%) fell to its lowest level since April 2022. Supermarkets witnessed their busiest Christmas since 2019, according to Kantar, with +12m additional trips made versus 2022. A record £13.7bn transacted during the period, with the average household spending at an all-time high of £477 across the month, an increase of +£28.

RACE TO PROVIDE BEST VALUE
As the rate of inflation fell at its fastest pace ever recorded, operators worked hard to offer best value to win over shoppers. Sainsbury's reached its highest market share since December 2022 at 15.8%, whilst Tesco gained a 0.1 percentage point of share to hold 27.6% of the market. Lidl and Aldi continued to be the fastest-growing grocers year-on-year, hitting their highest-ever market shares at 7.7% and 9.3%, respectively.

PORTFOLIOS DRIVE RECORD RESULTS
Foodstore volumes hit a record £2.48bn in 2023, with Q4 volumes totalling £453m. Two sizeable portfolio deals buoyed figures: Morrison's sale & leaseback to Realty (£175m), and a £132m portfolio of Waitrose stores to M&G. Beyond the big-ticket sales, investor interest was concentrated among a range of institutional and specialist investors, but rising debt costs constrained volumes with yields of 6.00%+ typically required. Open Market Review yields did soften +25bps to 6.00%, whilst Annual RPI Increases remained steady at 5.00%.

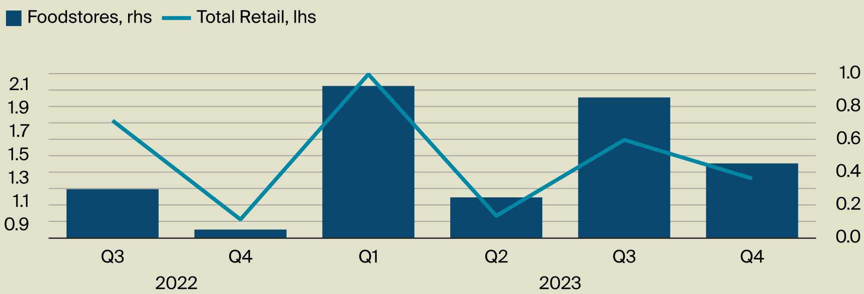
Investor demand is expected to be solid in 2024 given the finite number of successful UK operators and largely inelastic consumer demand.

Food vs non-food retail sales
Monthly YoY change, %



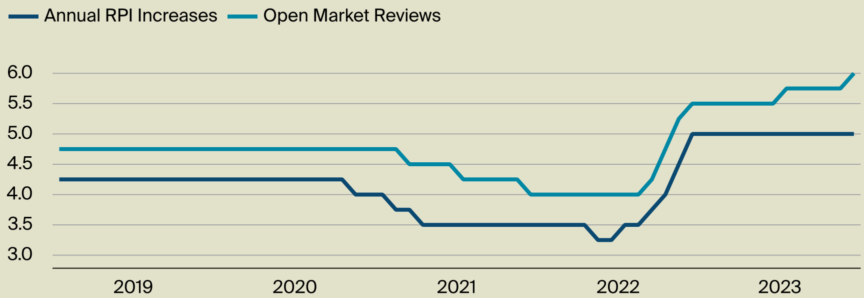
Source: ONS, Macrobond

Foodstore investment volumes
£million



Source: Knight Frank

Foodstore yields
%



Source: Knight Frank

Central London

2023 confirmed London's magnetic appeal as a top global retail and leisure destination for both shoppers and private investors.

SPEND UP VERSUS 2022 LEVELS

Retail & leisure visits to the capital were more resilient than the wider UK according to the BRC (London/UK: Oct -2.9%/-5.7% YoY, Nov -0.4%/-0.7%, Dec -1.4%/-5.0%). 2023 West End sales are now estimated to be £9bn, marking a +12% increase on 2022 levels. This is still -1% below 2019 levels, but this shortfall is expected to be redressed in 2024. International shoppers did return in good numbers, but the balance towards its core customer is yet to tip. Domestic spend still had the edge, accounting for 52.1% of sales, suggesting room for improvement from international tourists. NWEC estimates sales could have been boosted by an additional +£400m if tax-free shopping was available to international visitors.

POSITIVE LEASING ACTIVITY

A flurry of new occupiers opened their doors in the West End during Q4. Oxford St welcomed key brands including The Fragrance Store, Dr Martens and Krispy Kreme. HMV returned following a four-year absence and Miniso cemented its rapid UK expansion with its 23rd store and flagship. Bimba Y Lola, Paul & Shark, and Hoff also opened flagships on Regent St, with Ugg upsizing from Glasshouse St. This sustained positive momentum in leasing activity helped vacancy rates across the capital fall to their lowest rate (10.6%) since Q4 2020. Retail Park vacancies improved a massive 120bps to 8.4%, whilst High Streets improved to 10.3%. Shopping Centres vacancy rose to 14.5%, however.

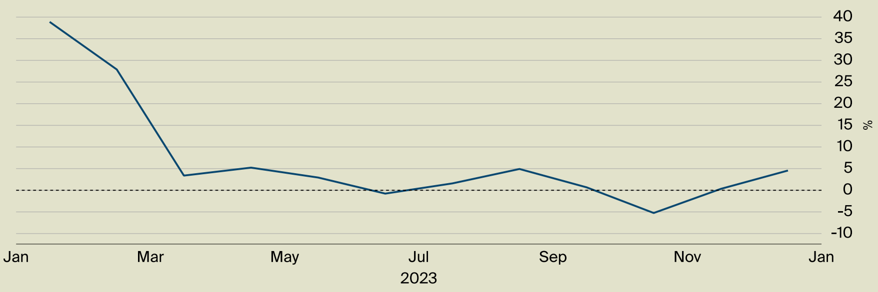
PRIVATE CAPITAL DOMINATES

Deals in Q4 were few and far between, with volumes totalling just £18.7m, according to RCA. Key deals included 3-5 Wardour St (£9.8m), The Barts Square Collection (£7.0m) and 18 Great Suffolk St (£1.8m).

Overall annual volumes amounted to £879.7m, comfortably above the 5-year average, and higher than 2022 levels. 2023 was undoubtedly the year for private capital to acquire trophy assets in the capital: comprising the top buyer category by some margin (74% of purchases, versus just 4.4% in 2022).

West End footfall

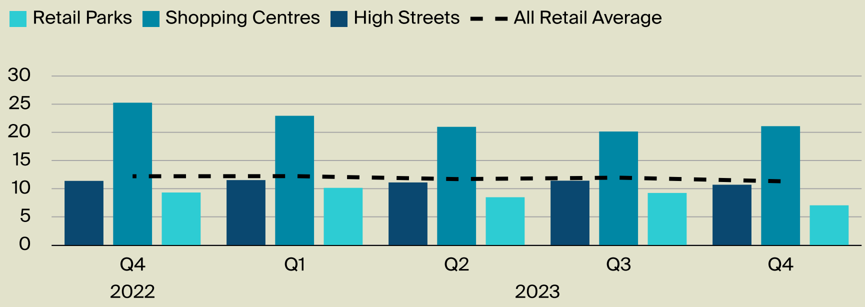
Like-for-like change %, vs 2019



Source: New West End Company

Vacancy rates

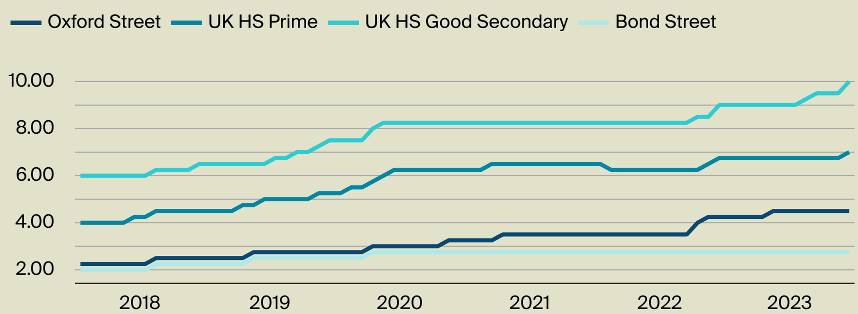
% units



Source: Local Data Company

Yields

%

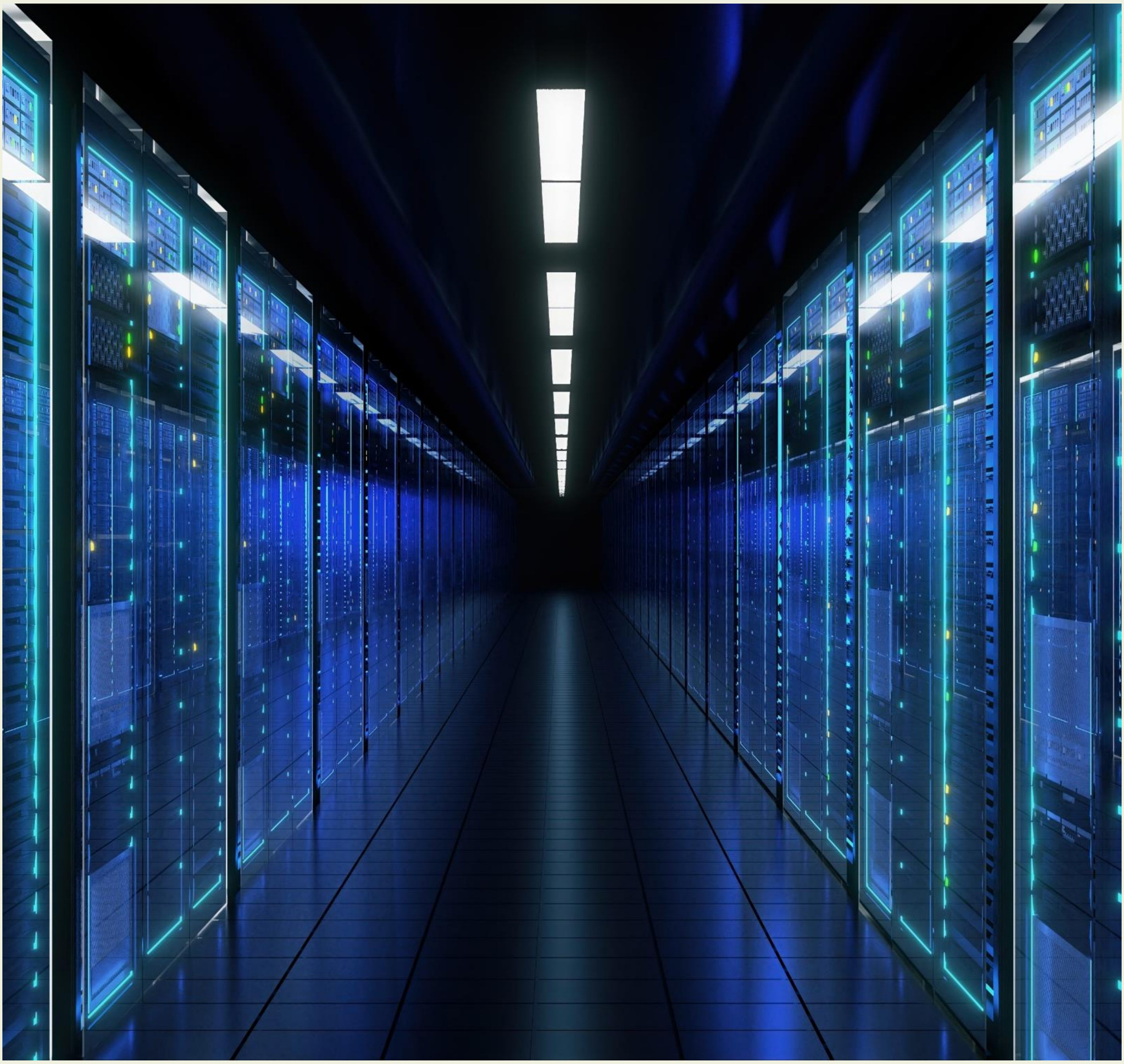


Source: Knight Frank

Specialist sectors

Data centres, healthcare & life sciences

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



Data centres

Take-up remains limited by a lack of new supply. Investment activity is improving, aided by stabilising yields and positive market sentiment.

INVESTMENT VOLUMES PICKING UP
Q4 2023 investment volumes totalled £1.3bn, the highest quarterly total in our records. Supporting the rise was the completion of an investment partnership between Vantage Data Centres and DigitalBridge and a consortium of investors led by MEAG and Infranity. The investment partnership initially consists of six stabilised data centres across Europe and has a total value of approximately €2.5 billion ($2.7bn). Consequently, transaction volumes in the UK in 2023 were £1.7bn.

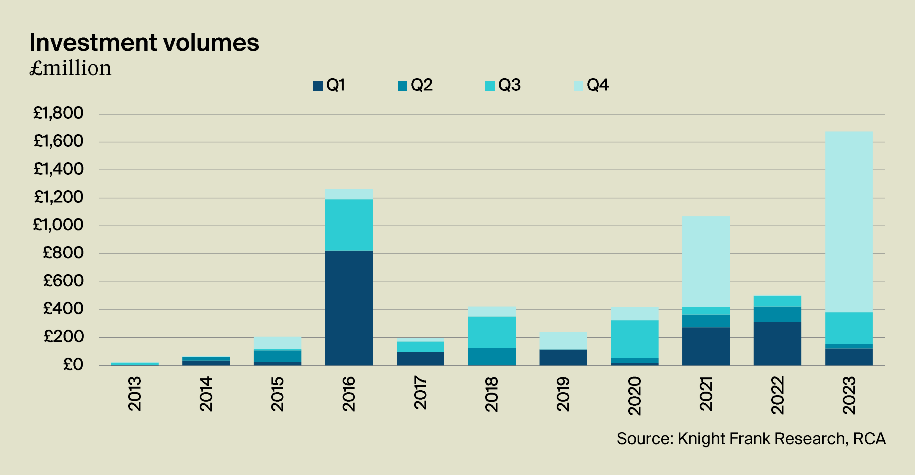
YIELDS STABILISED
Following a period of market negativity and subsequent yield softening, the market has since stabilised. Having risen by 100bps between October 2022 and July 2023, the market for annually indexed 15-year leases settled at 5%.

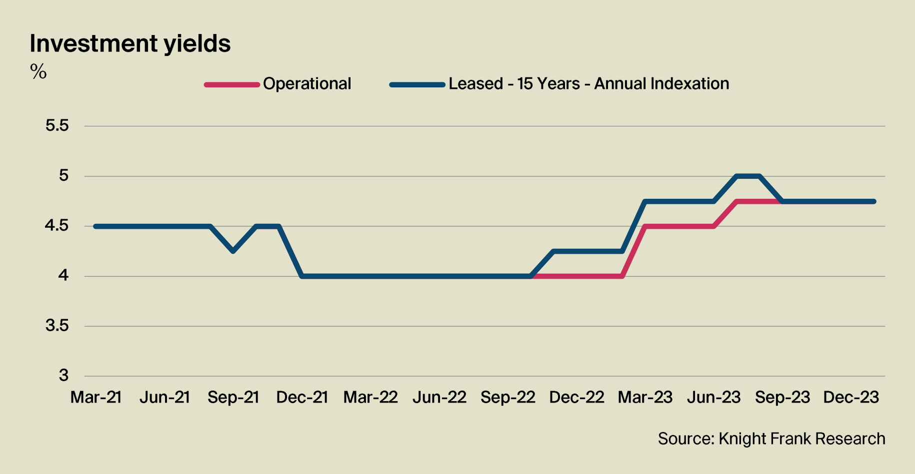
Improved market sentiment in Q4, following stabilised interest rates and tempered inflation, has resulted in pricing and closing yields of 4.75%.

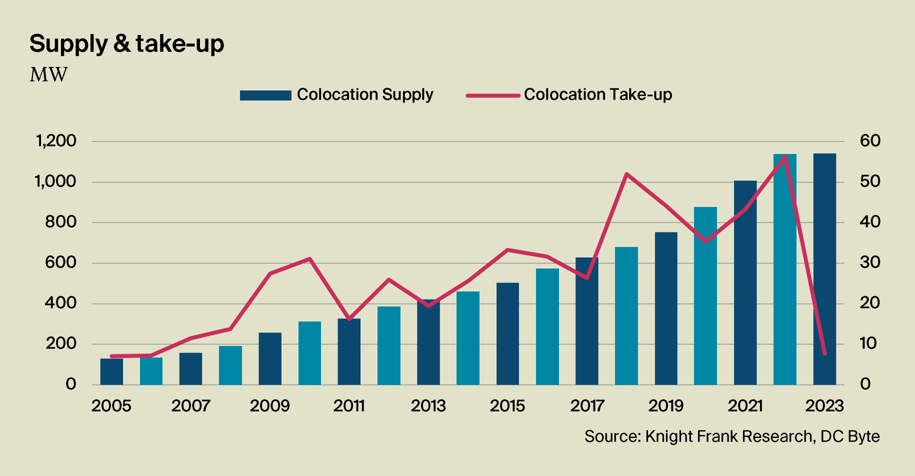
TAKE-UP LIMITED BY MUTED SUPPLY
Colocation supply in Q4 remained at 1,100MW. Take-up has been slow in 2023, with each quarter performing below the 4-year (16-quarter) average.

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% by the end of 2026.







Healthcare

Transactions volumes finish approximately 50% below previous year.

TRANSACTION VOLUMES DIP SIGNIFICANTLY

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

Although reported transactions for 2023 were lower than usual at £977m, more than 50% below the previous year, it is noteworthy that this generally represents real estate as a whole and not purely healthcare as a sector.

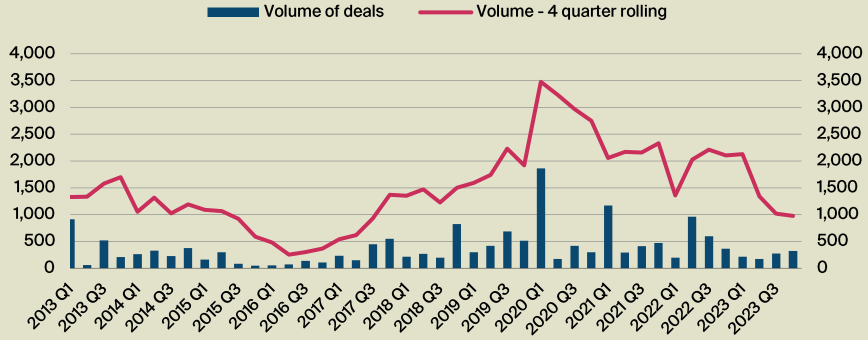
We will likely see volumes pick up again in 2024, with some European geographies still presenting as attractive propositions in terms of real estate returns vs gilts.

In the short term, strategic portfolio management will play a huge role in generating returns for investors. As of the end of 2023, UK prime healthcare yields sat just above 30-year gilts at 4.5% vs 4.14%, respectively.

DOMESTIC CAPITAL REMAINS MOST ACTIVE IN A MUTED ENVIRONMENT

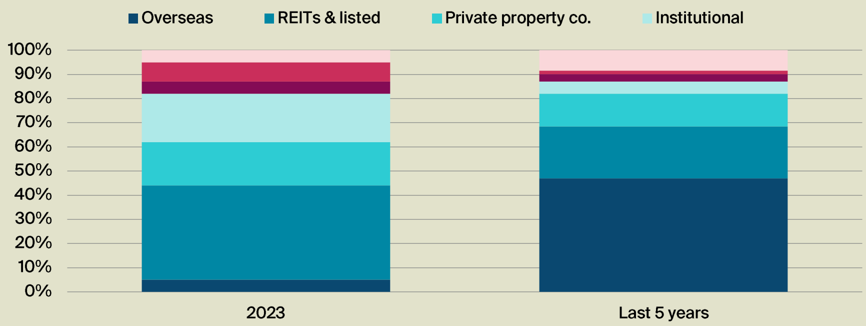
UK domestic capital finished the year accounting for the majority of transactions, compared to the 5-year averages, whereby we are used to seeing overseas capital play a more substantial role (44% domestic and 47% overseas). While private capital was a standout in terms of investor type in 2023, several institutional investors and REITs were active in the latter stages of the year. Civitas and Newcore were active in acquisition as a part of broader social infrastructure strategies.

Recorded healthcare property transactions
£million



Source: Knight Frank Research

Healthcare property transactions by buyer type



Source: Knight Frank Research

Healthcare

The sector remains reliant on larger, modern purpose-built care homes to support supply.

AVERAGE OCCUPANCIES AND WEEKLY FEES SUPPORT TRADING AMIDST HIGHER OPERATIONAL COSTS

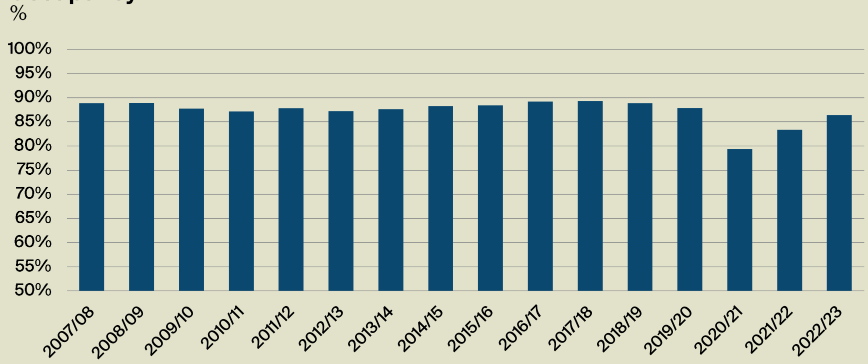
Average occupancies have continued their recovery, with most major operators trading at pre-pandemic levels, instilling further confidence in the sector.

Our most recent trading performance survey shows that average occupancy levels sat at 86.4%. Beyond this, we have also seen a vast increase in weekly fees achieved by homes, up by 9.6% on average across all care and funding types. Operator profitability remains a concern due to greater costs, which are heavily impacted by utility, staff and finance costs.

SECTOR EXPERIENCING NET HOME CLOSURES, WHILST LARGER, FUTURE-PROOFED HOMES HELP TO MAINTAIN BED SUPPLY

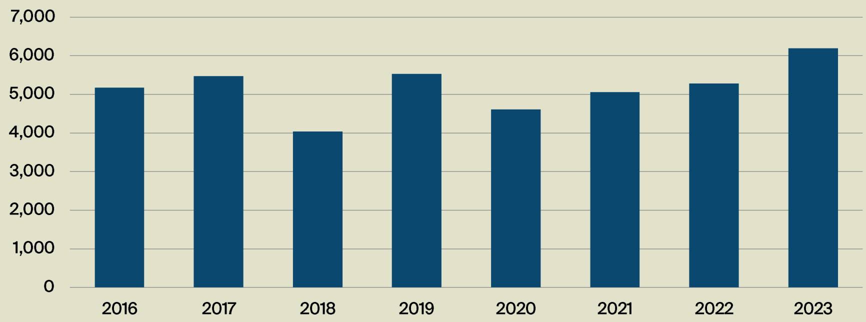
Regarding supply, we saw 115 new homes opening in 2023. This represents homes providing purely new and not rebranded bed supply. The year once again saw a trend of more home closures than openings. However, the closures were smaller compared to the opening of larger fit-for-purpose stock, allowing the sector to maintain bed supply levels.

Occupancy



Source: Knight Frank Research

New UK care home beds completed



Source: Knight Frank Research

Life sciences

UK life sciences sector sees record company formations in 2023 despite a more cautious funding environment.

NEW LIFE SCIENCES FIRMS ROCKET AHEAD AS INVESTORS TAKE A MORE MEASURED APPROACH TO CAPITAL ALLOCATION

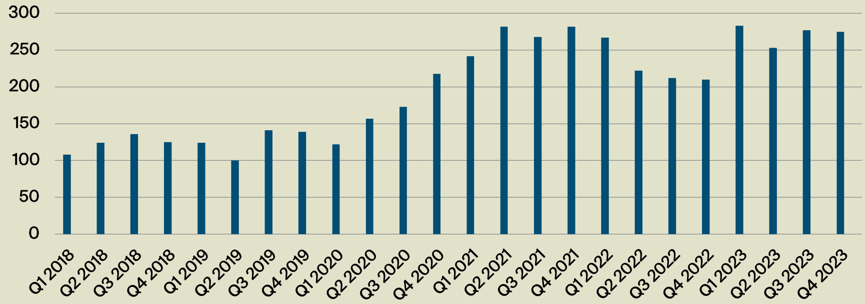
The formation of new life sciences companies in the UK continues to accelerate, with 275 incorporated in Q4. This was broadly in line with Q3 and a 31% jump compared to the same period in 2022. In 2023, 1,088 life sciences companies have launched in the UK - the highest annual total in the past decade. This impressive rate of early-stage company building evidences the UK's strengths in translating research into fledgling businesses and spinning out good scientific ideas. However, the UK must overcome challenges in scaling up and retaining these companies through late-stage commercialisation.

In 2023, UK life sciences companies raised £3.3 billion in venture capital financing, the third-highest amount over the past ten years. On a year-on-year basis, funding to the sector declined 7%. However, the life sciences sector performed better than the broader UK venture capital landscape, which saw investment drop by 44% to £16.1 billion in 2023. Deal count fell to its lowest point since 2014 and declined 44% compared to 2022. In 2023, investors focused on fewer but more significant deals.

Looking ahead, 2024 should bring improved venture capital investment, given the significant unused capital, a more optimistic focus on funding transformative life sciences companies, and stabilisation and potential reduction of interest rates.

Vacancies for scientific and quality assurance roles were down 22% since the beginning of October. This compares to a 24% fall across all industries over the same period.

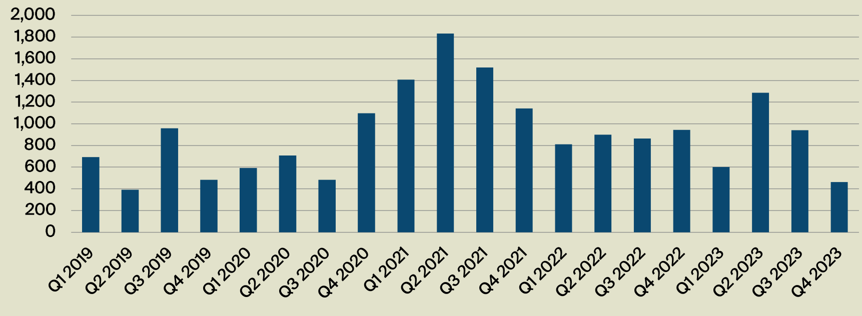
UK life sciences company incorporations
Company incorporations



Data includes active companies only. BVD sector: Biotech and life sciences. Location analysis is based on registered address only. Submarket analysis is available upon request

Source: Knight Frank Research, Fame

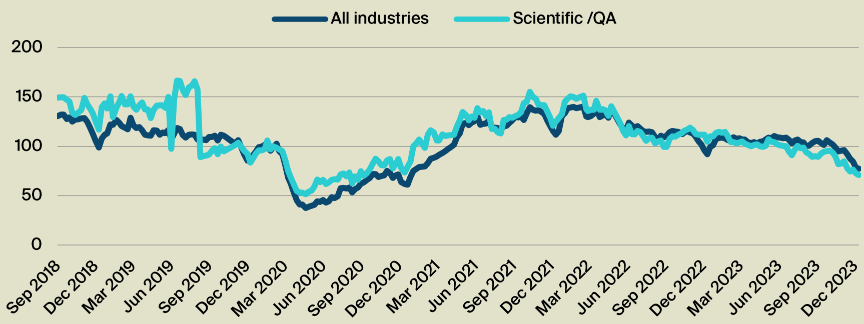
UK life sciences venture capital funding
VC funding into UK life sciences companies, £million



HQ only. Completed deals and full transactions only. Covers: Biopharma, MedTech and Digital health. Data as at 06/01/2024. The data in PitchBook is continuously updated to reflect the most current information. As a result, historical data may change over time.

Source: Knight Frank Research, PitchBook

Vacancies for scientific and QA roles UK
Scientific & QA weekly job adverts, index 100: average February 2020



Source: Knight Frank, Adzuna

Life sciences

Oxford and Cambridge life sciences take-up increases 175% year-on-year.

LIFE SCIENCES REAL ESTATE INVESTMENT STALLS

Investment in life sciences commercial real estate across the Golden Triangle declined 57% in 2023 compared to the previous year. Multiple factors dampened activity, including tight inventory, investor wariness of development risk, and more stringent financing conditions. The investor landscape has also condensed – whereas a diverse range of acquirers entered the market during the pandemic's boom, the current roster of prospective investors is narrower and more specialist.

In 2023, real estate investment volumes in the Golden Triangle's life sciences sector totalled £0.62bn distributed across 13 transactions. London deals constituted 66% of that total investment by value.

Following a subdued Q3, investment activity in the Golden Triangle picked up in Q4, with three transactions completed totalling £56.65m. Additionally, the London Borough of Sutton disposed of a new long leasehold interest in 11.9 acres of land at the London Cancer Hub to Aviva Capital Partners and Socius. Together with the campus partners, they will advance the development of a world-leading oncology-focused R&D and treatment cluster.

TAKE-UP SURGES IN 2023, WITH NEW LAB SPACE COMING FORWARD

Life sciences take-up in Oxford in 2023 increased by 250% year-on-year, and in Cambridge rose by 130%.

Take-up of life sciences space in Oxford totalled 280,540 sq ft, 64% above the 5-year average, with lab-enabled office space accounting for 76% of leasing. In Cambridge, a total of 305,772 sq ft was leased, 46% above the 5-year average. Q4 take-up in Cambridge was the highest in the past five years at c.145,000 sq ft.

The Golden Triangle as a whole, which encompasses Cambridge, Oxford and London, saw a 14% year-on-year increase in life sciences take-up, totalling 938,724 sq ft, despite leasing in London for the year dropping 42% versus 2022's figures (though still 29% above the long-term average). In London, take-up was hampered by a lack of available supply and a reduction in deals over 100,000 sq ft.

Despite available lab space in the Golden Triangle increasing from 238,221 sq ft at the end of Q3 to c.418,209 sq ft by the end of the year, the supply of lab space remains considerably below named demand, which stands at 1.87 million sq ft. The supply-side squeeze is, however, likely to ease over the next year, with the planned addition of c.1.1m sq ft of new lab and office space, including major schemes such as the c.110,000 sq ft Apex at Tribeca in King's Cross, developed by Reef Group, and the first phase of Pioneer Group and Oxford Properties' Victoria House in Bloomsbury.

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