CLUTTONS
INVESTMENT MANAGEMENT

cluttonsim.com

Commercial property examiner

Q3 | 2024

Contents

CLUTTONS
INVESTMENT MANAGEMENT

1. Key take aways

In the first nine months of 2024, the economy has been growing at the annualised equivalent of 2.0% and CPI inflation has fallen back below the MPC's 2% target. A further 25 bp reduction in Bank Rate is anticipated in November. A material risk to this favourable outlook is posed by any escalation in the Middle East war that restricts the global supply of oil.

Tech stocks had mixed fortunes in Q3 and the NASDAQ index underperformed. Interest rate rises prompted a second consecutive quarterly fall in Japan's Nikkei index but other global stock markets have enjoyed a positive quarter and the MSCI World Index rose 4.0% on a hedged GBP basis, or 6.4% in USD terms. UK REITS have performed strongly over the last 12 months and this provides hope for the direct market in the underlying assets.

UK commercial real estate continued its plodding recovery in Q3 as MSCI's All Property total returns increased by a mere 10 bps to 1.8% from 1.7% in Q2. Year on year All Property capital growth improved again but remained negative. The Shopping Centre, Retail Warehouse and Industrial sectors all enjoyed superior positive growth in valuations.

As monetary policy is expected to slowly loosen, the first interest rate cut has had little impact on the performance of the commercial property market. A similar 25 bp reduction in base rate in November will have a similar muted effect. Accordingly, we have lowered our total return expectations for 2024 by a further 50 bps to 6.0%. A stronger recovery in 2025 and 2026 will require a bigger stimulus.

2. The UK economy

Although recent data suggests the pace of economic growth has slowed since the end of May, the macro-economic background to this report continues to be positive. Since the start of the year, the economy has been growing at the annualised equivalent of 2.0% and CPI inflation has fallen back below the MPC's 2% target.

In its September "Global Monthly" bulletin the World Bank noted that although global economic activity was maintaining steady growth, there is a divergence between firming services and weakening manufacturing. Similarly, the expansion of global trade is fragile with a modest improvement in services' exports alongside an ongoing contraction in manufacturing export orders. In August and early September, disinflation continued driven by falling oil and gas prices as supply remained strong and demand showed signs of weakening.

Trade in manufactured goods could meet further obstacles if confronted by the tariffs threatened by a second Trump presidency. In addition, this trend of falling oil prices is unlikely to continue as regional conflict escalates in the Middle East.

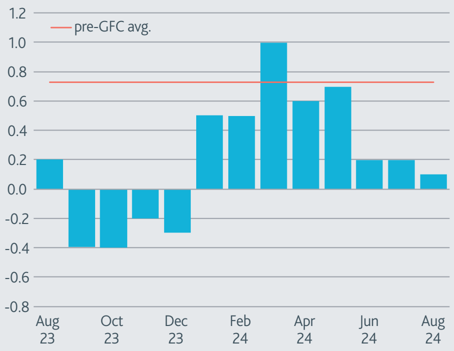
The latest data from the Office for National Statistics indicates that the UK economy has continued its recovery from a mild "technical recession" at the end of last year. Growth of 0.2% was recorded in August after no growth was recorded in June and July. The economy grew by 1.1% in the 12 months to August compared to 1.5% in the 12 months to May (see Chart 2.1).

The service sector, which represents 80% of the UK's services economy, grew by just 0.1% in the three months to August 2024, having previously grown by 1.1% in the three months to May. Professional, scientific and technical activities were the largest positive contributor to the rise in services output, growing by 0.8% in the three months to August 2024. The next largest contribution came from information and communication where output increased by 0.9%. The largest negative contribution in the three months to August 2024 was human health and social work activities, which fell by 1.1%.

Manufacturing output grew by 1.3% in the three months to August 2024 but has shrunk by -0.3% in the last 12 months. Output increased in 9 of the 13 manufacturing subsectors. The largest positive contribution came from a 2.1% growth in the manufacture of transport equipment, driven by the 3.6% rise in the manufacture of motor vehicles and trailers Construction output is estimated to have grown by 1.0% in the three months to August. New construction work increased by 1.7% driven by a 2.7% increase in new infrastructure (see Chart 2.2).

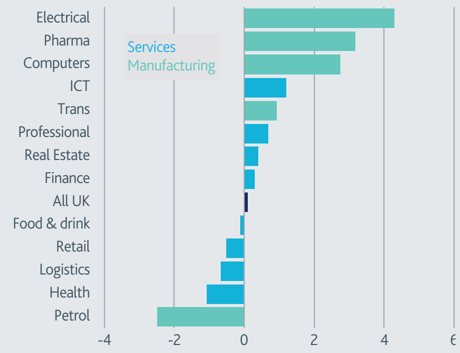
Despite the latest improvements, the UK economy continues to underperform. Although it is now 3.4% above its pre-pandemic level, it is now 5.5% below its potential level based on the assumption that output post March 2020 continued at its post-GFC trend rate. Manufacturing is -7.9% below its February 2020 level (see Chart 2.3).

2.1 Rolling 3m UK economic growth (%)



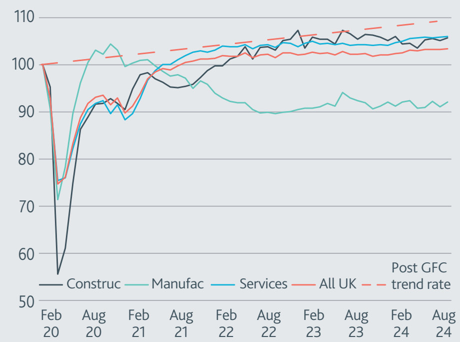
Source: ONS, Oct 2024

2.2 3m economic growth by sector (%)



Source: ONS, Oct 2024

2.3 UK economic growth indices (Feb 2020=100)



Source: ONS, Oct 2024

The MPC's economic growth forecasts have strengthened in each of the last four quarters as the negative impact on growth from past increases in Bank Rate fades, inflation returns towards its target level and further reductions in base rate are anticipated. GDP growth is forecast to reach 2.1% in 2024 and achieve an annualised average of 1.6% in the three years ending December 2026 (see Chart 2.4).

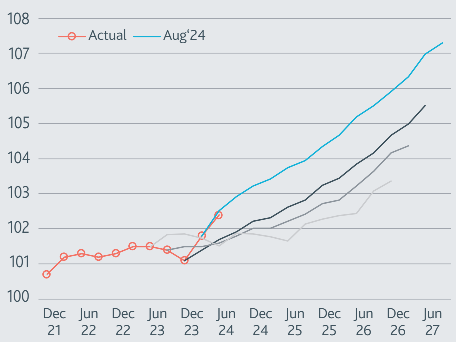
Year on year CPI inflation peaked at 11.1% in October 2022 but has now fallen to 1.7% in September. Core inflation excluding energy, food, alcohol and tobacco fell from 3.5% in June to 3.2% in September but remains above its long run average of 2.2%. Service sector CPI inflation peaked at an annual 7.5% in the middle of last year and has now fallen to 4.9% at the end of September from 5.7% in June (see Chart 2.5).

In the year to September, the largest upward effects to inflation again came from Restaurants and Hotels, and Recreation and Culture. The spike in Hotel prices has been attributed to an increase in room rates near the venues for Taylor Swift's UK tour. Similarly, the rate of inflation in the Recreation sector could be credited to the demand for tickets to see the Oasis reunion tour.

The largest downward contribution to the annual change in inflation came from the Transport sector and in particular air fares and motor fuels as petrol prices fell from above 140p per litre 12 months ago to near 130p per litre in September.

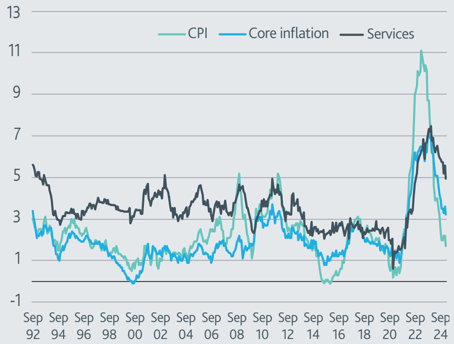
The annual rate of food price inflation is now down to 1.8% from a recent high of 19.2% in March 2023, the highest annual rate seen for over 45 years. The rise in food price inflation from 1.3% in August 2024 is the first time since March 2023 that the annual rate of food price inflation has strengthened (see Charts 2.6 & 2.7).

2.4 Actual GDP index and MPC forecasts Nov'23 - Aug'24



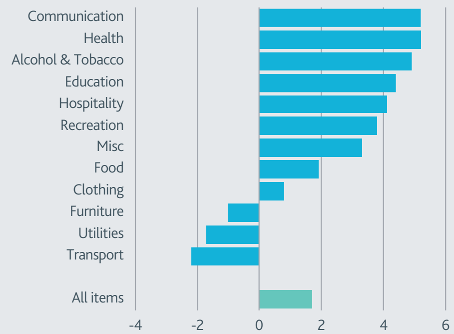
Source: ONS & Bank of England, Aug 2024

2.5 CPI inflation (%pa)



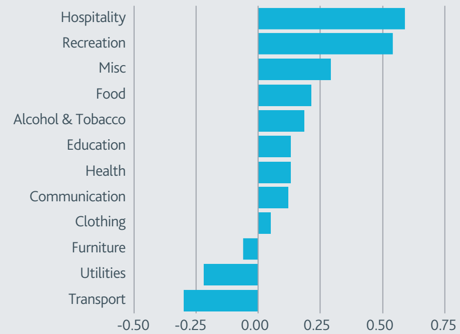
Source: ONS, Oct 2024

2.6 Inflation by sector (%) year to Sept 2024



Source: ONS, Oct 2024

2.7 Contributions to Inflation by sector (%) year to Sept 2024



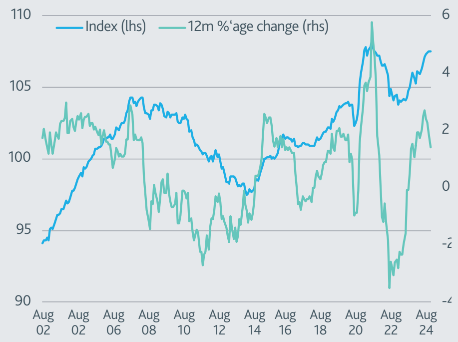
Source: ONS, Oct 2024

The growth in employee annual earnings in Great Britain has dropped below 5% for the first time in over two years, narrowing the gap between wages and inflation. Pay excluding bonuses rose by 4.9% in the three months to August compared to the previous year, down from 5.1% in the previous quarter. Including bonuses, total earnings grew by 3.8%, down from 4.1%. The MPC follows this key metric closely and may respond to these figures with more aggressive interest rate cuts (see Chart 2.8).

The projections for CPI inflation in August's Monetary Policy Report were for an increase from near to the 2% target to around 2.75% at the turn of the year reflecting the impact of the latest 25bp cut in Base rate. Inflation's lower and quicker than anticipated decline may support further cuts to Bank Rate in November. The main risk to this benign outlook come from geo-political factors (see Chart 2.9).

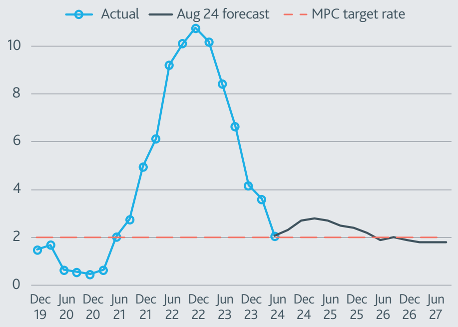
For a year since the Hamas attack on Israel on October 7th and the start of the fighting in Gaza, investment strategists have warned that a wider war could break out in the Middle East, limiting the world's oil supply and sending shock waves throughout the global economy. However, so far, the price of oil has remained largely subdued. But after the latest escalation of the conflict, oil prices have begun to rise. Israel's next move is probably critical. Attacking Iran's oil infrastructure or nuclear facilities, for example, would intensify the conflict. Analysts at Capital Economics have suggested that oil prices would need to reach $90 a barrel to become a factor for central banks. At the time of writing, the price of Brent crude had fallen from $80 a barrel in the first week of October to $74.

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

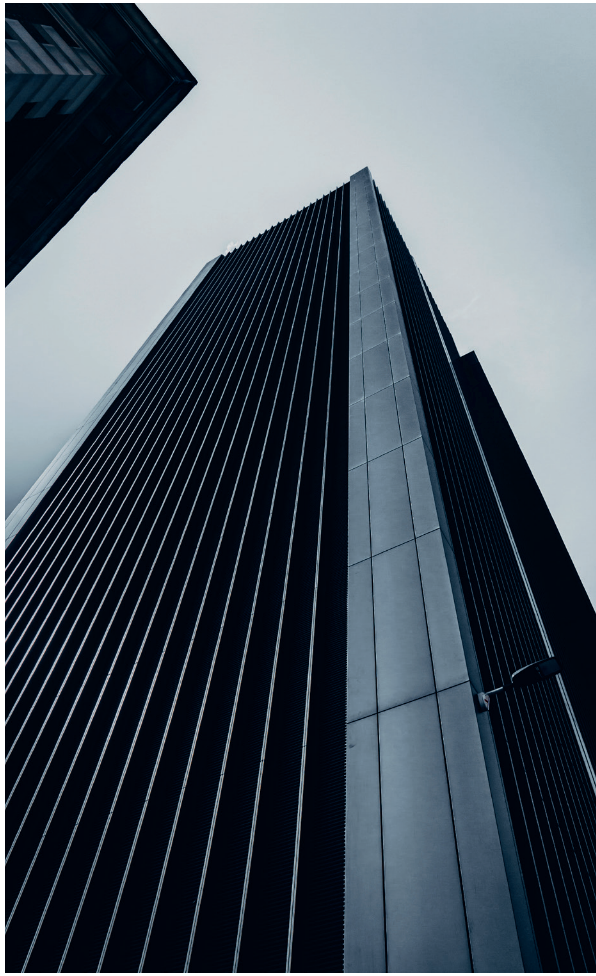


Source: ONS, Oct 2024

2.9 Annual CPI and MPC forecasts



Source: ONS & Bank of England, Aug 2024



3. Stock markets, interest rates & asset yields

The MSCI World Index, with large and mid-cap representation across 23 developed markets, improved from gains of 2.8% in Q2 to 4.0% in Q3, on a hedged GBP basis, or 6.4% in USD terms. Performance was once again driven by the information technology, healthcare, and consumer discretionary sectors, as energy and financials underperformed due to global economic uncertainties and continued high interest rates.

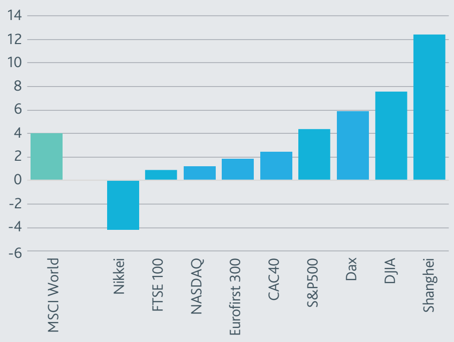
The FTSE 100 had a positive quarter, supported by improving economic conditions, though its gains of 0.9% were more modest compared to US and European markets. The US economy continued to suggest that the Fed would successfully manage a soft landing and was supported by a 50 bp cut in rates. The Dow Jones Industrial increased by 7.6% in Q3 but the NASDAQ underperformed and rose by just 1.2% as doubts that the high expectations for AI may not be realised proliferated.

European markets were supported by an easing in monetary policy as the ECB reduced its deposit facility rate from 4.0% to 3.5% with 25 bp cuts in June and September. The Eurofirst 300 rose 1.9% in Q3 supported by a 2.4% increase in France's CAC 40 and a 5.9% rise in Germany's DAX, despite concerns over the strength of the economy. In Asia, Japan's Nikkei fell for the second consecutive quarter as interest rates rose and the yen strengthened, damaging demand from export markets. China's financial markets benefitted from an aggressive government stimulus package, prompting the biggest weekly stock market rally the country has witnessed in more than 15 years (see Chart 3.1).

Tech stocks suffered from mixed results in the third quarter. Alphabet, Microsoft, Amazon and Nvidia share prices, all fell back. In August, the US Justice Department won its antitrust lawsuit against Google (Alphabet) and is now considering ways to stop Google from using some of its products including the "Chrome" web browser, "Play" app store and the "Android" operating system to "illegally" bolster its dominant search business.

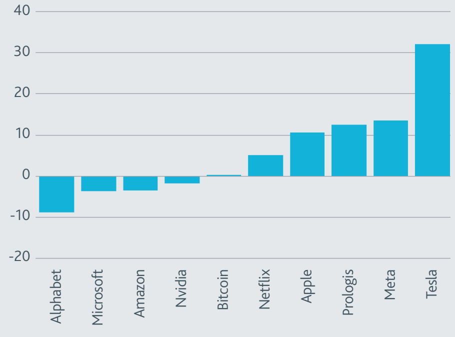
However, Apple, Meta and Tesla, the world's top electric vehicle manufacturer, all rose strongly. Investors in Prologis enjoyed a better quarter as its share price rose 12.4% having fallen -13.8% three months earlier. The largest logistic and warehouse real estate company in the world published a research note in August arguing that: (i) leasing activity is poised to increase as its logistic sector occupiers expand their footprint to meet increasing demand from consumers; (ii) the end of the pandemic building boom is approaching, and development completions are set to fall sharply in the second half of 2024; and (iii) the vacancy rate will peak in the next three to six months (see Chart 3.2).

3.1 World stock markets in Q3 2024 (%'age growth)

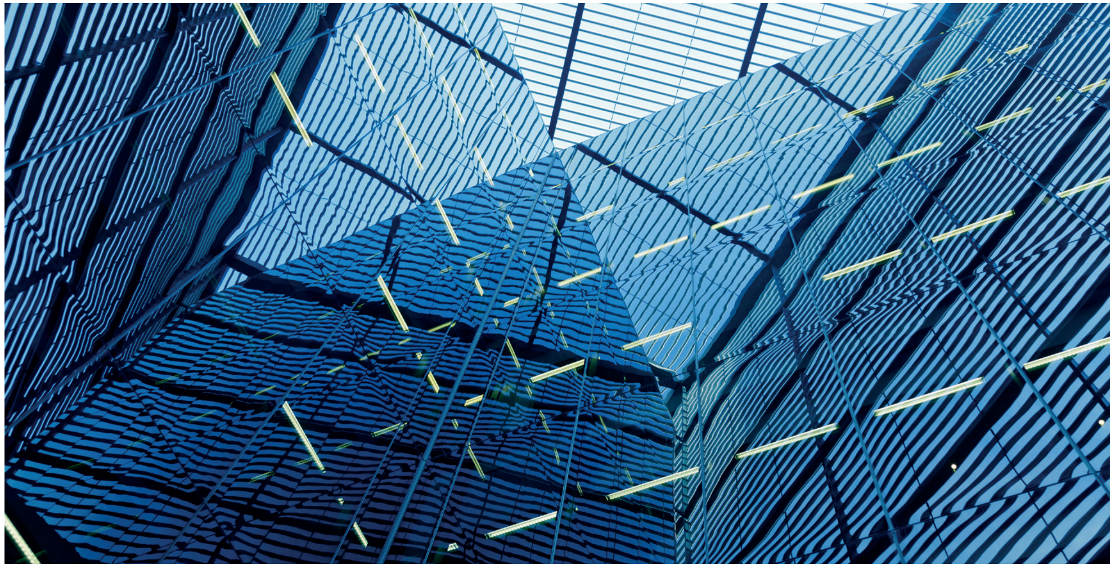


Source: Yahoo Finance, Oct 2024

3.2 Tech & other selected stocks in Q3 2024 (%'age growth)



Source: Yahoo Finance, Oct 2024



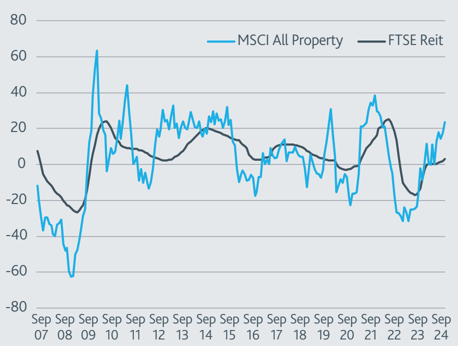
The performance of the FTSE REIT index in the last 12 months hints at a possible improvement in the outlook for the underlying assets (see Chart 3.3). The Reit index outperformed the wider all share market in Q3 by an impressive 3.5 percentage points. The performance was largely driven by expected improvements in market conditions as the first interest rate cut was finally delivered in August. The sector hopes this will be the first of many, lowering financing costs and stimulating rental demand.

Valuation improvements were achieved across the whole sector with the surprising exception of Segro, a logistic warehouse and industrial specialist and the UK's largest REIT. Segro's share price fell by 2.7% in the quarter. Perhaps more surprising was the 14.8% improvement in Hammerson's share price following the sale of its stake in Value Retail, owner of Bicester Village luxury retail outlet to an LVMH-backed private equity firm for £600mn (see Chart 3.4).

Property companies are now starting to position themselves for the next upswing in the cycle and capitalise on the demand for logistics assets driven by the rise of ecommerce. Starwood, a private equity group, announced a recommended cash offer for Balanced Commercial Property Trust, managed by Columbia Threadneedle, which includes a central London estate around St Christopher's Place near Bond Street as well as warehousing and other assets across the country. In September, Brookfield, a Canadian investment manager, put the CityPoint office asset in the City of London on the market, and in the same month outbid Segro's previously agreed deal to take over Tritax EuroBox, offering a reported £557m for the European logistic and distribution investor.

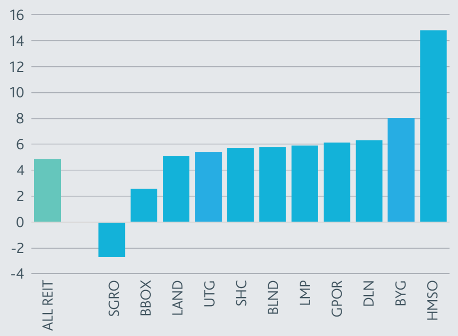
A recovering economy and stubborn core and service sector inflation put pressure on the pricing of UK risk-free assets in the first half of the year. Gilt yields peaked in April and the pressure eased throughout the third quarter. (see Charts 3.5 & 3.6). The yield on the 5-15 year gilt index hardened by 19 bps in the third quarter and now stands at 4.00%. This is reflected in the total return performance on the FTSE Actuaries 5-15 year gilt index in Q3 of 2.6%. Over the last 12 months, the gilt index has provided total returns of 9.3% and Q3's yield is 55 bps lower than it was in September 2023.

3.3 Long term 12m total returns



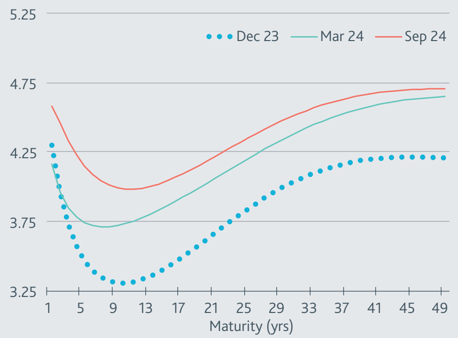
Source: Yahoo Finance & MSCI, Oct 2024

3.4 Reit price movement in Q3 2024 (%'age growth)



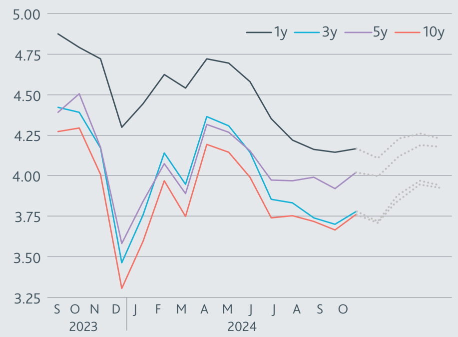
Source: Yahoo Finance, Oct 2024

3.5 Gilt yield curve (%)



Source: Bank of England, Oct 2024

3.6 UK gilt yields & implied forecasts



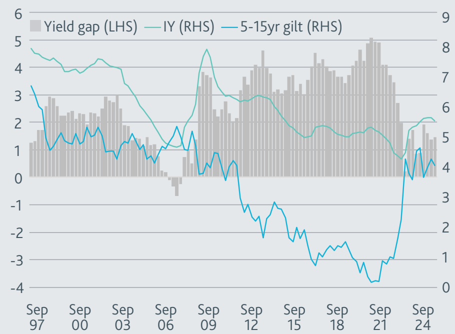
Source: Bank of England, Oct 2024

As risk free rates compressed in Q3, the All Property initial yield itself hardened by 10 bps. Consequently, the property initial / gilt yield gap increased by 9 bps to 1.45% (see Chart 3.7). By the standards of the last 16 years, when base rates were less than 1% for much of the time, property continues to look as if it is priced above fair value. However, it is unlikely that Bank Rate will quickly return to such a low level. The MPC's forecasts imply a gradual easing to 3.5% by the end of the forecast period at the end of 2027.

In the current environment a property yield gap of nearer 200 bps may be more realistic. Further reductions in risk free rates and the cost of borrowing should strengthen a recovery which has so far been weak by comparison with past events. In the meantime, direct property continues to offer a competitive income return compared to other UK asset classes (see Chart 3.8).

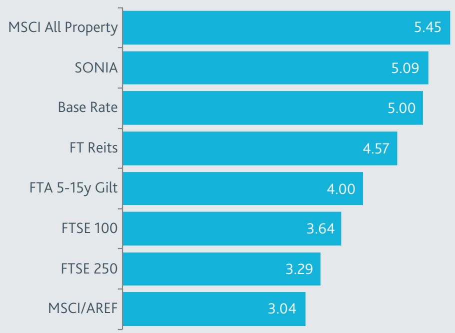
In a recent interview, the Governor of the Bank of England, Andrew Bailey, said he was encouraged that inflationary pressures had not been as persistent as feared and held out the prospect of the MPC becoming a "bit more aggressive" in cutting interest rates, provided the news on inflation continued to be good. Analysts now expect the MPC to initiate a quarter-point cut to 4.75% in November barring any more escalation in the fighting in the Middle East.

3.7 Property IY - Gilt yield gap (%)



Source: MSCI & Bank of England, Oct 2024

3.8 UK asset yields Q3 2024 (%)



Source: Yahoo Finance & MSCI, Oct 2024

4. Commercial property market performance

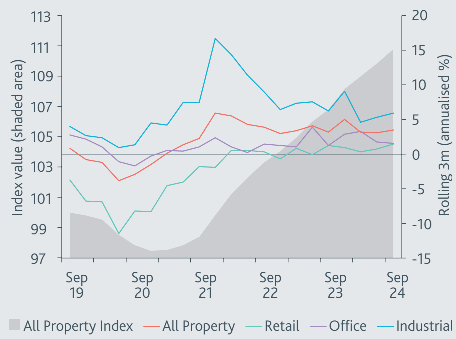
In Q3, All Property total returns, as recorded by the MSCI Monthly Index, increased by 10 bps to 1.8% from 1.7% in Q2. Capital values rose by 0.3% compared to a rise of 0.2% three months earlier. Property equivalent yields softened by 4 bp and contributed to a -0.2% fall in valuations. All Property market rental value growth increased to 0.9% from 0.8% in Q2. Third quarter income returns amounted to 1.4% (see Charts 4.1 & 4.4).

Over the course of the third quarter, office rental value growth remained stable at 0.4% and retail rental value growth was also stable at 0.2%, while industrial rental value growth increased to 1.4% from 1.3% a quarter earlier. Market rental values for shopping centres and retail warehouses remain positive but rental values for the traditional high street shop segments continue to deteriorate (see Charts 4.2 & 4.5).

In the 12 months to the end of September, All Property total returns increased to 2.9% from 1.0% in the 12 months ending June. Year to date total returns amount to 4.2% reflecting an annualised year end performance of 5.6%.

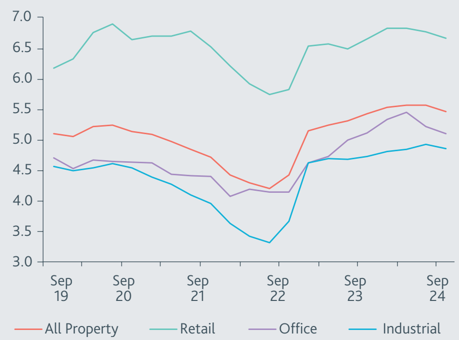
Year-on-year capital growth also improved to -2.8% in September from -4.7% in June but still remained negative. Property equivalent yields have softened by 28 bps in the 12 months to September and contributed to a 5.6% drop in valuations over the course of the last 12 months. All Property rental values increased year-on-year by 3.7% and income return amounted to 5.9%.

4.2 MRV growth (%) by sector



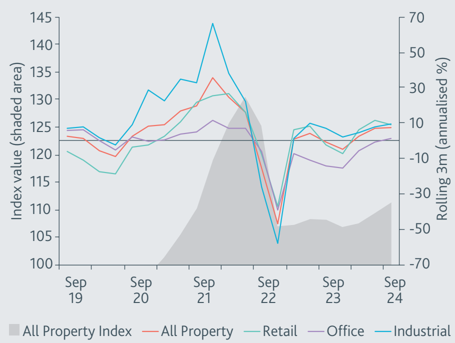
Source: MSCI, Oct 2024

4.3 Initial yield (%) by sector



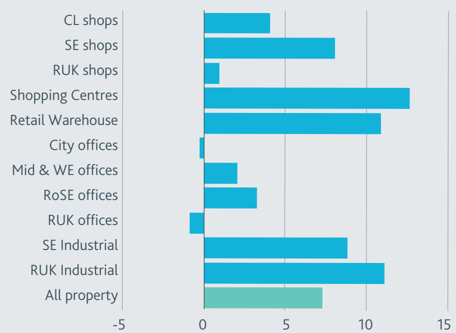
Source: MSCI, Oct 2024

4.1 Total returns (%) by sector



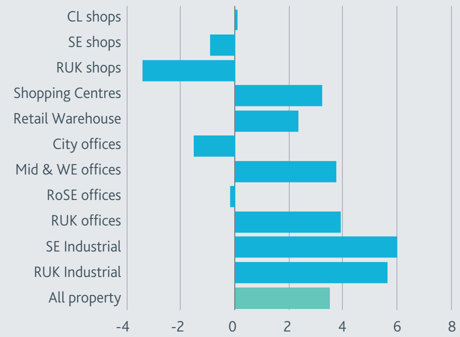
Source: MSCI, Oct 2024

4.4 Total returns (%) by segment – Q3 2024 annualised



Source: MSCI, Oct 2024

4.5 MRV growth (%) by segment – Q3 2024 annualised



Source: MSCI, Oct 2024

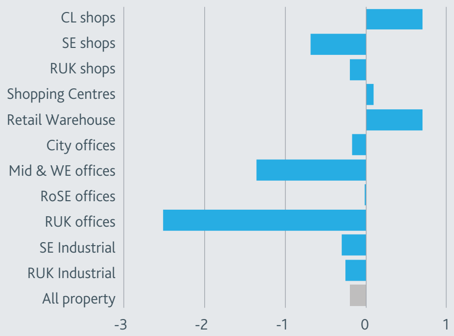
CLUTTONS
INVESTMENT MANAGEMENT

In the last three months, equivalent yields have continued to harden. Any downward adjustment movement has been limited for industrials, but the office sector suffered from a strong de-rate of 30 bps in September. Office values have decreased by 33% since the downturn started in June 2022 and the latest data seems to suggest that they have further to fall (see Charts 4.3 & 4.6).

The pace of recovery has so far disappointed. Clearly investors are looking for more stimulus than the 25 bp cut to interest rates so far implemented. In both the early 1990's and the GFC of 2008-2009, the MPC reduced Bank Rate by five percentage points to stimulate growth. The UK's commercial property market responded by producing capital growth of 13% between 1993 and 1995 and 17% between 2009 and 2011 (see Chart 4.7).

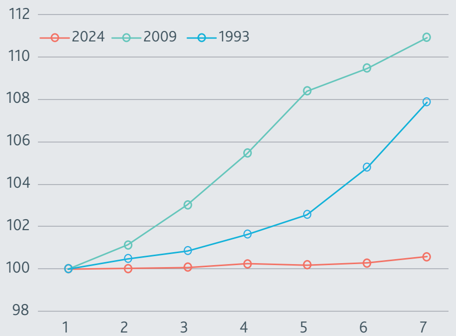
Tables 4.8 – 4.12 contain further performance data for UK commercial real estate in Q3 2024.

4.6 Yield impact (%) - Q3 2024



Source: MSCI, Oct 2024

4.7 The pace of recovery from market downturn by month



Source: MSCI & APR, Oct 2024

4.8 Total returns (%)

	Oct	3m	6m	12m
All Property	0.8	1.8	3.5	2.9
Retail	1.0	2.2	5.1	4.7
Office	0.0	0.4	0.2	-5.3
Industrial	1.0	2.3	4.2	5.9
Annualised				
All Property	9.5	7.3	7.2	2.9
Retail	12.6	9.2	10.4	4.7
Office	-0.1	1.4	0.3	-5.3
Industrial	13.0	9.6	8.7	5.9

Source: MSCI, Oct 2024

4.9 Capital growth (%)

	Oct	3m	6m	12m
All Property	0.3	0.3	0.6	-2.8
Retail	0.4	0.5	1.5	-2.3
Office	-0.4	-1.0	-2.6	-10.5
Industrial	0.6	1.1	1.7	0.8
Annualised				
All Property	3.5	1.4	1.2	-2.8
Retail	5.2	1.9	3.0	-2.3
Office	-5.3	-3.9	-5.1	-10.5
Industrial	7.6	4.3	3.4	0.8

Source: MSCI, Oct 2024

4.10 Income return (%)

	Oct	3m	6m	12m
All Property	0.5	1.4	2.9	5.9
Retail	0.6	1.8	3.6	7.2
Office	0.4	1.4	2.8	5.8
Industrial	0.4	1.2	2.5	5.1
Annualised				
All Property	5.8	5.9	5.9	5.9
Retail	7.1	7.2	7.3	7.2
Office	5.4	5.5	5.7	5.8
Industrial	5.1	5.1	5.1	5.1

4.11 ERV growth (%)

	Oct	3m	6m	12m
All Property	0.4	0.9	1.6	3.7
Retail	0.2	0.4	0.5	0.9
Office	0.0	0.4	0.8	2.4
Industrial	0.7	1.4	2.8	6.2
Annualised				
All Property	4.7	3.5	3.3	3.7
Retail	2.2	1.5	1.1	0.9
Office	-0.2	1.6	1.7	2.4
Industrial	8.9	5.9	5.6	6.2

Source: MSCI, Oct 2024

4.12 Net initial yield (%)

	Oct	3m	6m	12m
All Property	5.5	5.6	5.6	5.4
Retail	6.7	6.8	6.8	6.6
Office	5.1	5.2	5.5	5.1
Industrial	4.9	4.9	4.8	4.7

Source: MSCI, Oct 2024

5. Investment in property

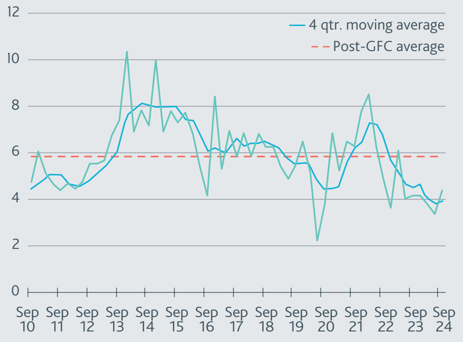
All Property investment volumes, represented by the current value of investment transactions adjusted for capital growth, decreased by -10% in Q2 compared to Q1. Second quarter transaction volumes were -42% below their long run average. Reflecting a possible improvement in market conditions, preliminary estimates suggest that investment volumes in Q3 increased by 30% but were 25% below the long run average. As usual the latest numbers for Q3 are likely to be revised in the coming months (see Chart 5.1).

Retail made up 45% (by number) of investment transactions in Q2; offices represented a further 22% and industrials made up the remaining 33%. Retail and office investment volumes so far recorded in Q3 are lower than in Q2 but industrial investment volumes are seeing a recovery from the lows of Q2 (see Chart 5.2).

Last year investment volumes disappointed by only matching the volumes achieved in 2020, the year of Covid Lockdowns and working from home. So far this year investment volumes are again disappointing in comparison with recent years (see Chart 5.3).

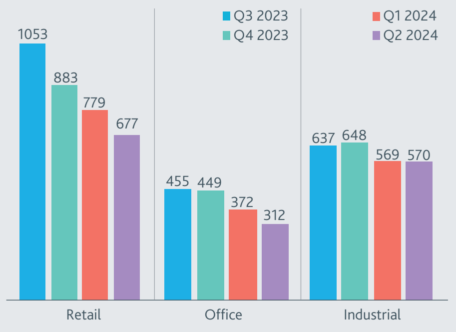
Investment volumes in the UK's key Central London office market decreased by 15% in Q2 compared to Q1. Second quarter transaction volumes were -69% below their long run average. In a reflection of the upturn in the broader All Property investment volumes, preliminary estimates for Q3 indicate that Central London office transaction volumes improved by 34% but were still 58% below the long run average (see Chart 5.4).

5.1 All property investment volumes (£bn)



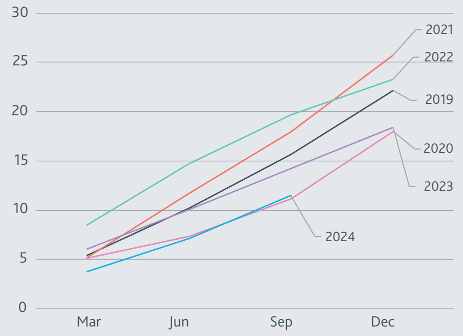
Source: CoStar, MSCI & APR, Oct 2024

5.2 UK investment transaction nos. by quarter



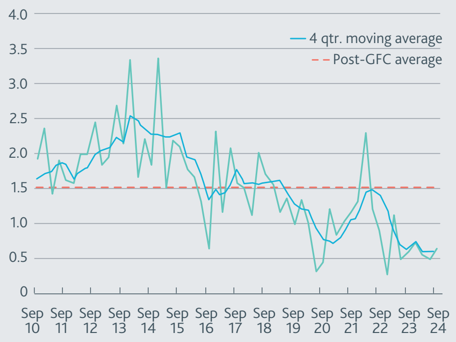
Source: CoStar, MSCI & APR, Oct 2024

5.3 Cumulative investment transactions by year (£bn)



Source: CoStar, MSCI & APR, Oct 2024

5.4 Central London office investment volumes (£bn)

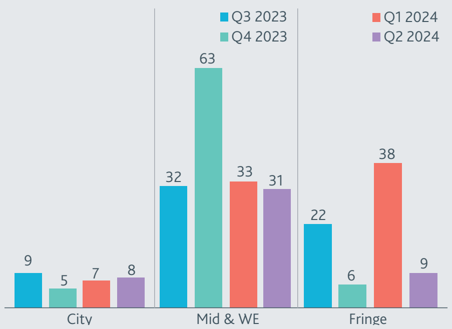


Source: CoStar, MSCI & APR, Oct 2024

Midtown and West End made up 42% (by number) of Central London office investment transactions in Q2; Fringe offices represented a surprising 49% and City offices made another 9%. Fringe office investment volumes so far recorded in Q3 have decreased whilst interest in City, Midtown and West End offices appears to be holding up (see Chart 5.5).

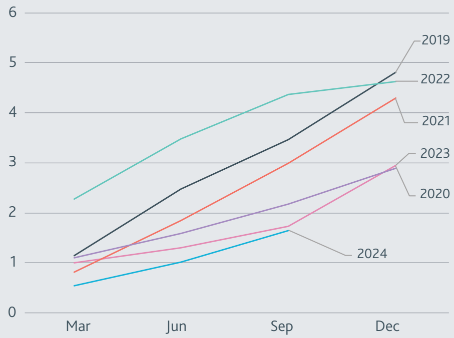
Reflecting the trend in the wider investment market, Central London office investment volumes disappointed in 2023 and the cumulative total for the current year suggests that 2024 may struggle to even match last year (see Chart 5.6).

5.5 Central London Office transaction nos. by quarter



Source: CoStar, MSCI & APR, Oct 2024

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



Source: CoStar, MSCI & APR, Oct 2024

6. Outlook & house view

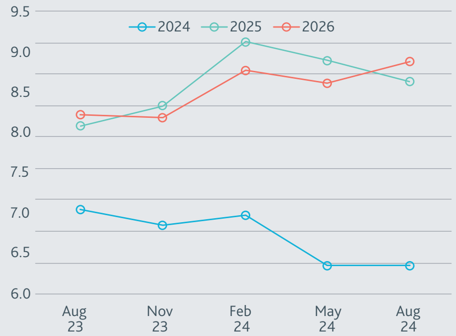
The recovery in the UK's commercial property market during the first nine months of the year has been much weaker than expected. Consequently, May's Investment Property Forum (IPF) consensus forecasts for 2024 were cut to 5.5% from 6.25% at the start of the year. The latest survey in September has reinforced this view. The outlook for 2025 has also weakened although expectations are stronger for the last three years of the forecast period (see Chart 6.1).

September's IPF consensus view continues to characterise 2024 as a year of stabilisation rather than recovery. With UK commercial real estate currently offering a net initial yield of 5.6%, the 2024 outlook remains neutral for All Property average capital values although negative for offices in both Central London and the Rest of the UK. However, a return to more robust levels of capital growth in the years thereafter seems likely. The annualised total return average forecast over the three years to 2026 is 7.5% and 7.6% for the five years to 2028 (see Chart 6.2).

Respondents to the IPF Consensus Forecast Survey continue to expect positive total returns in 2024 for all segments but the numbers imply that near negative total returns will continue for offices outside Central London. The outlook for City and West End offices has strengthened but nevertheless imply capital value reductions over the course of the year. A surprise outcome from the survey is that Shopping Centres and Retail Warehouses are now tipped to outperform industrials (see Chart 6.3).

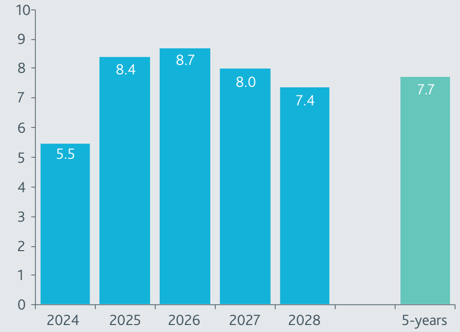
The maximum total return forecast for 2024 has decreased from +10.2% to +9.3% whist the minimum forecast has improved to +3.1% from +1.6% in May. The forecast range for 2025 has decreased to 4.5%, with a maximum of +10.9% and a minimum of +6.4% (see Chart 6.4).

6.1 IPF Consensus forecast evolution (%)



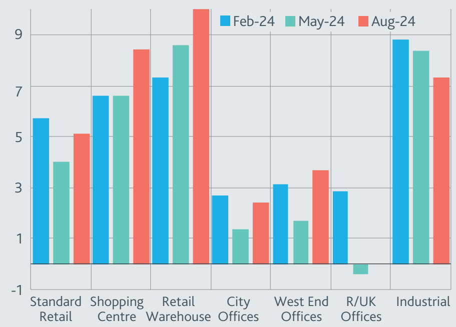
Source: IPF, Sep 2024

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



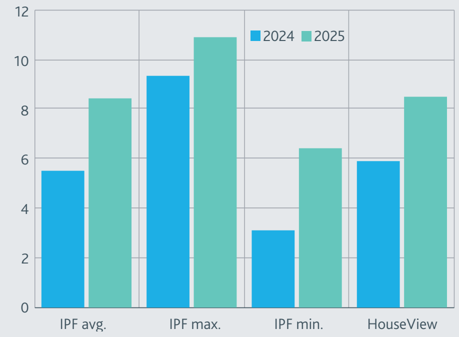
Source: IPF, Sep 2024

6.3 IPF 2024 total return forecasts by sector Aug 24 v May 24 (%)



Source: IPF, Sep 2024

6.4 UK commercial total return forecast range (%)



Source: IPF, APR & Cluttons, Oct 2024

This property market cycle continues to be driven by movements in the risk-free rate and the cost of borrowing. The first cut to base rate was delayed until August but only had a marginal impact on the performance of commercial property in the third quarter. Currently, there is no reason to think that a further 25 bp reduction in base rate in November will be greeted differently. Consequently, although we expect the market to continue its gradual improvement in the last quarter of the year, we have again reduced our target for 2024 by a further 50 bps to 6.0%. Next year and 2026 should provide a stronger recovery led by industrials, Retail Warehousing and Shopping Centres. (see Charts 7.5 & 7.6).

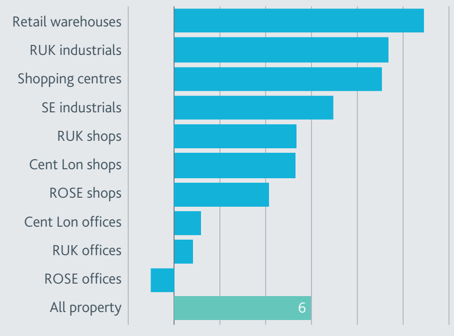
The central forecast from the House View model is revised on a quarterly basis to reflect the changing macro-economic outlook and the current performance of commercial real estate. The uncertainties listed in our report last quarter remain much the same. Upside risks involve a more favourable outlook for the economy, inflation, and interest rates, along with improved liquidity as investors see the recent price drops as an immediate buying opportunity. Downside risks include geo-political instability in Ukraine and the Middle East, a potential resurgence in inflation and a global trade war should former President Donald Trump return to the White House.

Taking a more long run perspective, the commercial real estate market has endured a period of structural change in the last few years through the growth of online retailing and the development of remote and hybrid working models. Online shopping has hollowed out the UK's high streets and forced the closure of many department stores. In October the former governor of the Bank of England, Mark Carney issued a reminder of another threat to values. Namely, that a governmental push towards net zero could lead to "significant" stranded assets as the cost of upgrading buildings to meet energy and emissions specifications would not prove financially viable.

The new UK government could resurrect proposals, shelved by its predecessors, requiring commercial buildings to have an "energy performance certificate" rating of least B by 2030. Although, it currently seems likely that the energy efficiency ambitions for 2030 will be scaled back to C.

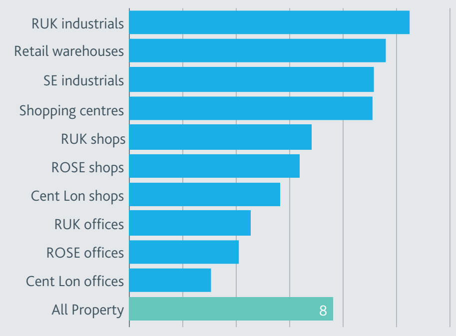
It has been estimated that 70% of floor space in England and Wales currently has an EPC rating of C or below. Fortunately, most institutional grade assets and the portfolios of listed property companies are of better quality. British Land said in its annual report it would cost £100 million to improve the 42% of its portfolio that did not already have an EPC rating of A or B by 2030. Two-thirds of that could be recovered through service charges. Land Securities has a £135 million net zero transition plan.

7.5 Cluttons House View - 2024 relative total returns (%)



Source: APR & Cluttons, Oct 2024

7.6 Cluttons House View - 2024-2027 relative total returns (%)



Source: APR & Cluttons, Oct 2024

CLUTTONS
INVESTMENT MANAGEMENT

cluttonsim.com

For further details contact:

Jamie McCombe
Head of investment management
+44 (0) 20 7647 7234
jamie.mccombe@cluttonsim.com

Grainne Gilmore
Director of research and insight
+44 (0) 20 7647 7142
grainne.gilmore@cluttons.com

Researched on behalf of Cluttons Investment Management by Alexander Property Research.

RICS