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United Kingdom

# Real Estate Investment Forecasts

Quarter 3 | 2023











## Economic Conditions

The economy continues to show resilience to higher interest rates. UK GDP increased by 0.2% q/q in Q2 2023, following a 0.1% q/q rise in Q1. Furthermore, revisions to the national accounts show that post-pandemic performance has been upgraded significantly. More frequent data showed the economy growing by 0.5% m/m in June, which, according to the ONS, was attributed to some extent to a return to the normal number of working days after the additional May bank holiday for the King's coronation. August's PMI figures meanwhile suggest economic weakness in Q3, with the potential for a negative GDP print.

Retail sales volumes fell by 1.2% m/m in July, following a rise in June. Sales volumes remain 3.2% lower than a year ago. The GfK consumer confidence index dropped from June's 17-month high of -24 to -30 in July and remains well below the series average of -12.

There are some signs that the labour market tightness has started to ease. The official UK unemployment rate rose to a 20-month high of 4.2% in the three months to June, while the number of job vacancies continues to

fall. However, unemployment remains at a historically low level while job vacancies are still above any level seen before the pandemic. Despite these first signs of labour market tightness easing, regular pay growth reached a record high. The ONS estimates that 160,000 working days were lost because of labour market disputes in June.

CPI inflation fell to a 17-month low of 6.8% in July, in line with the Bank of England's forecast. The sharp fall in utility price inflation from 23.3% in June to 4.5% in July subtracted 0.9 percentage points from CPI inflation. However, services inflation rose from 7.2% to 7.4%.

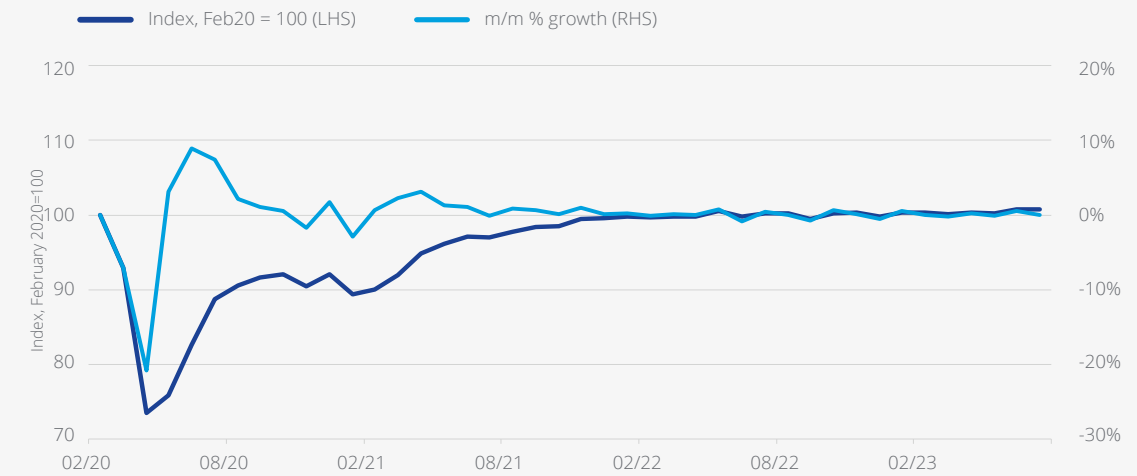
The Bank of England is expected to raise interest rates by a further 25bps on 21st of September, although this is not a forgone conclusion and will depend on updated labour market, GDP, and inflation figures. Financial markets are currently pricing in a peak in the base rate of 5.75%, but most forecasters expect rates to peak at a lower level.

## Economic Outlook

With the PMI falling to a sub-50 level, a contractionary Q3 GDP figure cannot be ruled out. That said, August HM Treasury consensus forecasts suggest the UK economy will grow by

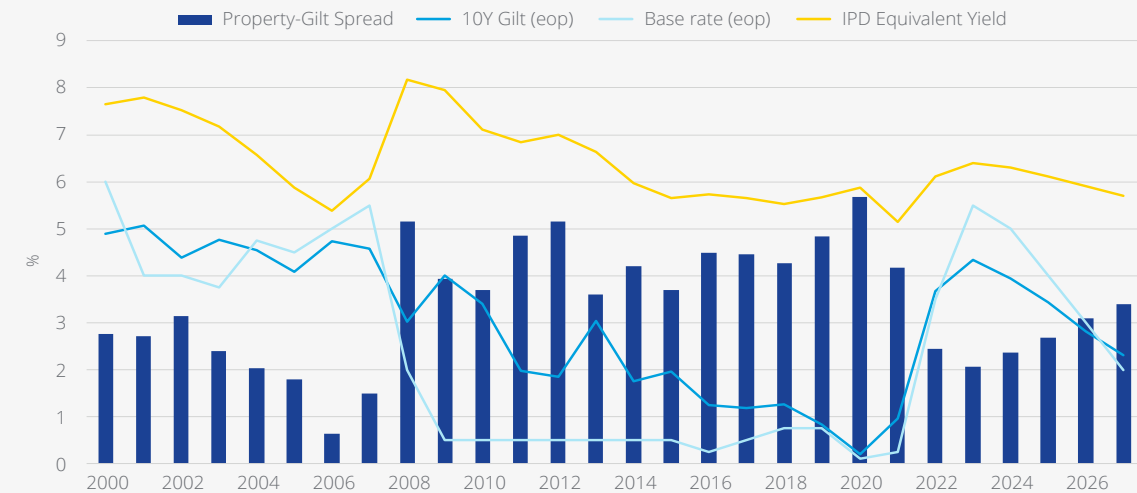
0.3% in 2023. The BoE is slightly more optimistic, predicting growth of 0.5%. GDP growth is expected to remain subdued in 2024, with the economy growing by around 0.50-0.75%.

### Monthly GDP estimate



Source: ONS

### Selected Rates



Source: Colliers, Oxford Economics, MSCI

### UK instantaneous OIS Forward Curve



Source: Bank of England





## High Level Investment Market Trends

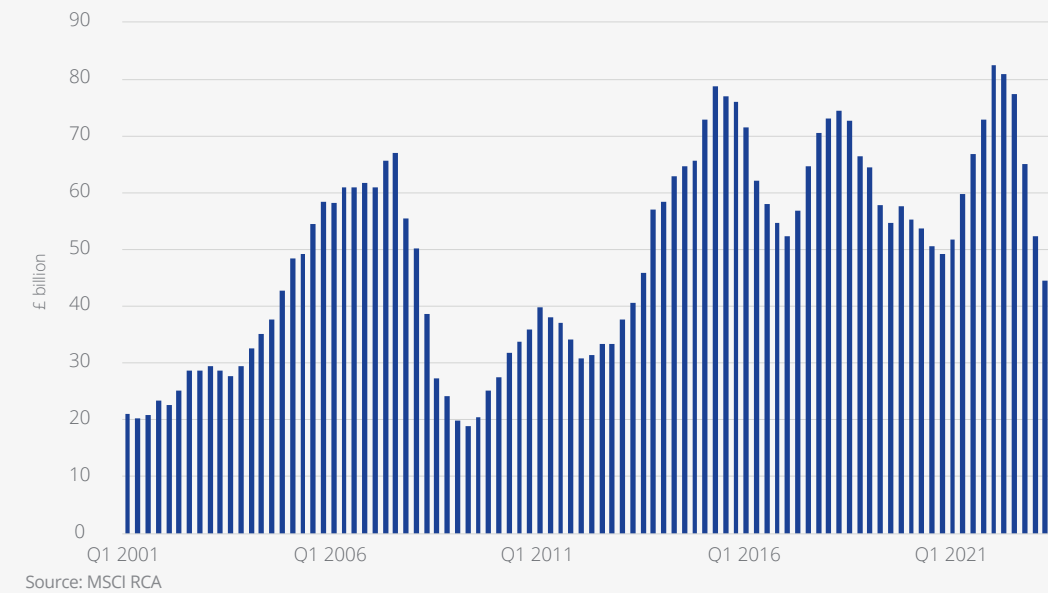
Quarterly investment volumes slowed for a sixth consecutive quarter in Q2. The £8bn invested during the quarter was the weakest figure since 2011 and well below the five-year quarterly average of £15.3bn as high debt costs and a challenging economic environment continue to impact decision making. Industrial investment volumes in Q2 were 23% below the five-year quarterly average, retail recorded a shortfall of 41%, and offices was 66% below average. The largest Q2 deals include the £465m sale of an industrial portfolio to Blackrock and Mitsui Fudosan's £315m acquisition of Sancroft at St Pauls. Preliminary data for July and August suggests no pick-up in investment sales activity in Q3 so far. The year-to-date (up to August) figure of just over £22bn is over 50% below the corresponding 2022 level.

The sharp outward movement in yields experienced in the second half of 2022 has come to an end. The MSCI All Property equivalent yield rose by 9bps in Q1, followed by a further 9bps rise in Q2, having increased by over 100bps in H2 2022. We expect further modest outward shifts over the coming months.

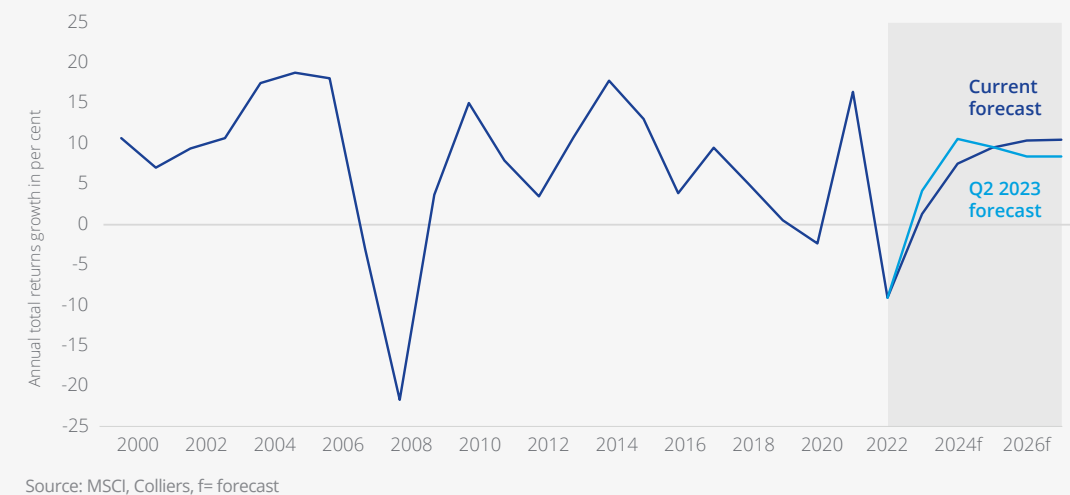
## Regional Investment Market Trends

Quarterly investment activity across the "Big-Six" rose from £1.4bn in Q1 to a one-year high of £2.3bn in Q2. Manchester led the way with £920m invested, marking the city's strongest quarter since Q4 2021. The figure was 28% above the five-year quarterly average. Birmingham recorded a decline in investment volumes from £480m in Q1 to £410m, while volumes improved in Bristol from £130m to £340m, Glasgow (£50m to £230m), Edinburgh, (£80m to £210m). Quarterly investment volumes in Leeds were stable at £200m.

## Investment Volumes, 12-months Moving Sum



## Total Return (%pa)



## All Property Forecast Summary

### Q3 2023

	Dec-23	Dec-24	Dec-25	5 years to 2027
ERV Growth (% pa)	2.5	2.3	2.4	2.5
Equivalent Yield (% eop)	6.4	6.3	6.1	-41 bps
Capital Growth (% pa)	-3.2	3.0	5.0	3.3
Total Return (% pa)	1.3	7.6	9.6	7.8

Source: Colliers, MSCI





## Investor Trends

Overseas capital has made up 50% of all investment into UK commercial real estate so far in 2023. US investors continued to be dominant, having invested a total of £5.1bn so far in 2023, followed by Singapore (£1bn), Germany (£650m), and Japan (£600m). Domestic institutional investors account for only 16% of investment activity in the year to date, down from 19% in 2022 and amongst the lowest shares on record.

## Forecasts

All Property returns showed marginal growth of 0.4% q/q in Q2, following a stable Q1 and declines throughout H2 2022. Offices (-2.8% q/q) was the only sector to record a further drop in total returns in Q2 as yields continued to move out.

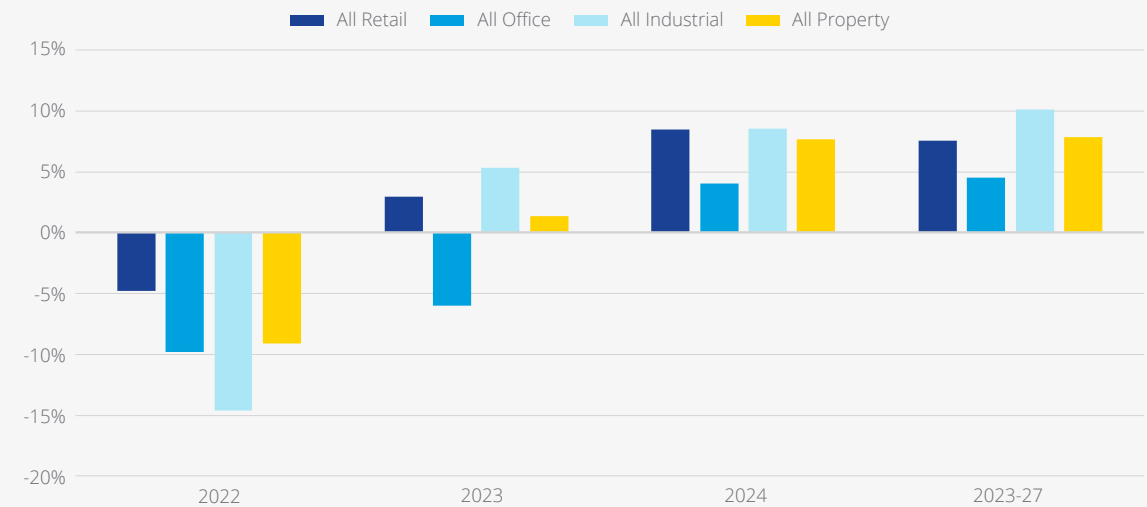
Economic uncertainty, the sustained risk of a mild recession and high interest rates continue to weigh on investor confidence and decision making. With interest rates now expected to stay higher for longer compared to our Q2 2023 REIF forecasts, the scarcity of accessible

financing options will continue to hinder transaction volumes for bigger ticket assets. We adjusted our yield forecasts accordingly and now predict the All Property equivalent yield to rise from its current level of 6.24% to 6.40% by the end of the year, 18bps higher than we predicted in Q2. The further rise in yields will result in All Property total returns rising by only 1.3% this year (previously 4.2%) before picking up to 7.6% (previously 10.6%) in 2024.

With yields then expected to compress gradually over the remainder of the forecast period, capital growth will turn positive again in 2024, following a 3.2% decline in 2023. Over the 2023-2027 forecast period, All Property total returns will average 7.8% pa. Industrial (10.1% pa) and Retail Warehouses (8.4% pa) will outperform the other sectors.

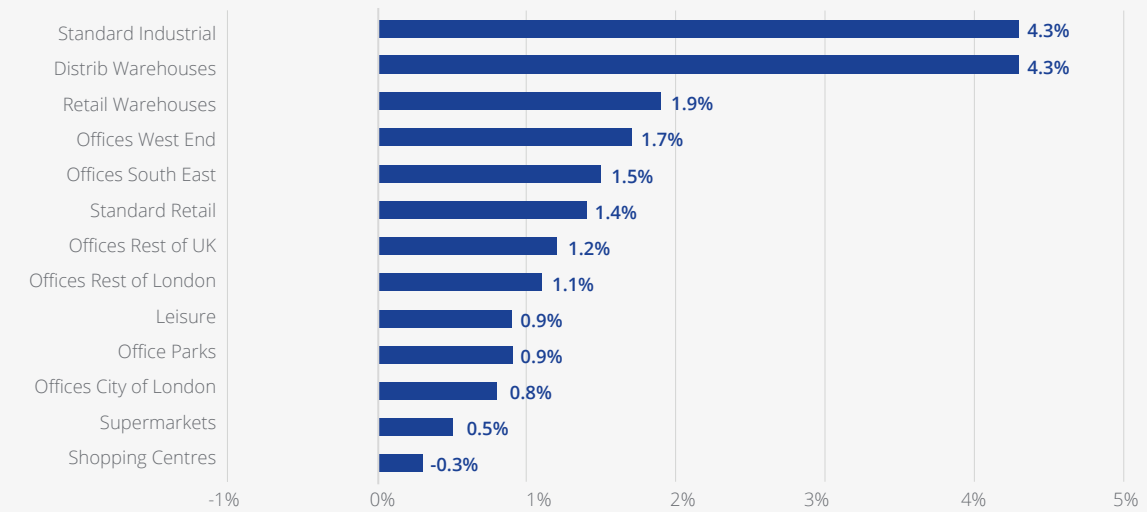
The property yield/gilt spread narrowed to a 15-year low of 244bps and will fall to just over 200bps by the end of the year. However, with gilt rates then expected to fall, the gap will widen to 339bps by the end of the forecast horizon in 2027.

## Total Return by Sector



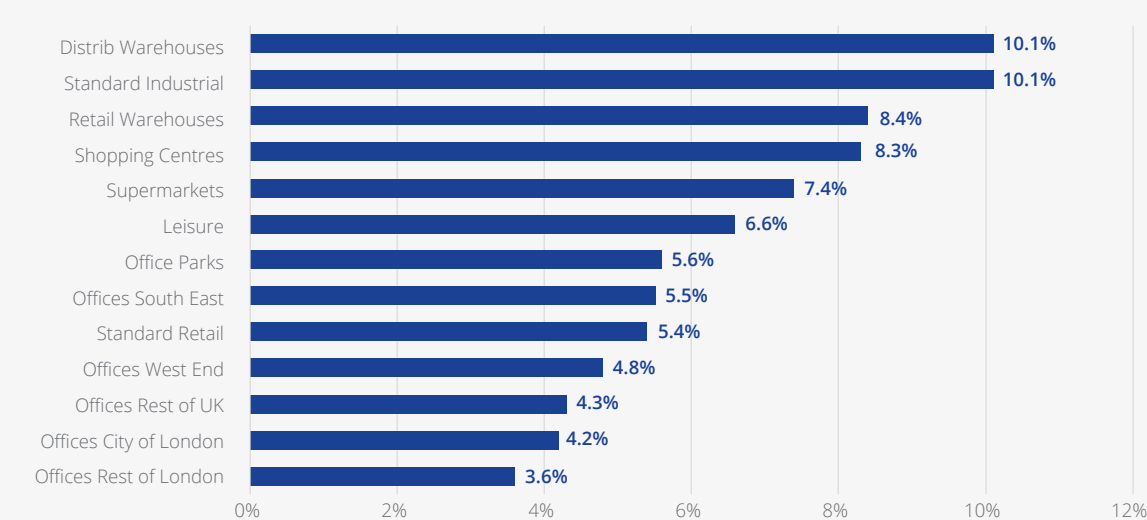
Source: Colliers

## ERV Growth %pa (2023-2027)



Source: Colliers

## Total Return %pa (2023-2027)



Source: Colliers





## Retail

### Capital Market

Quarterly investment volumes across the retail sector slowed from £2.6bn in Q1 to £1.3bn in Q2, which is 37% below the five-year quarterly average of £2.1bn. Realty Income Corporation made the two largest purchases during Q2, acquiring a two-asset retail park portfolio with sites in Bristol and Fife for a combined £175m and a three-asset retail park portfolio with sites in Aberdeen and Inverness for a combined £63m. Outside the retail park segment, Federated Hermes bought a Sainsbury's in Glasgow for £48m, and Supermarket Income REIT acquired a Tesco Superstore in Worcester for £38m. Equivalent yields compressed across Standard Shops outside of London and Retail Warehouses in Q2, but rose to a nine-year high for Central London Shops (4.37%) and to a new record-high for Shopping Centres (10.25%).

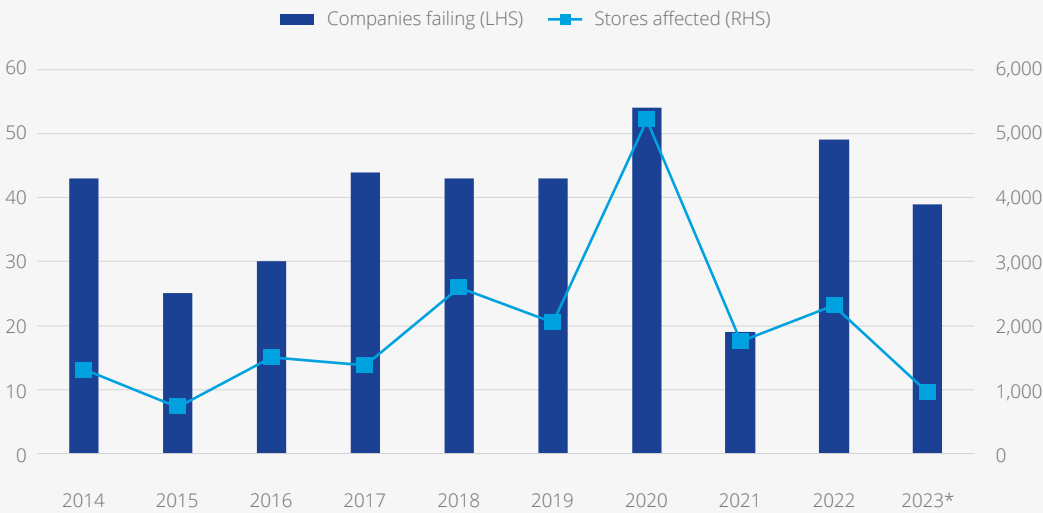
### Occupier Market

Retail sales volumes fell by 1.2% m/m in July, following growth between April and June. However, sales volumes remain lower than a year ago. The GfK consumer confidence index improved to a 17-month high in June but suffered a renewed drop in July. At -30, the index remains well below its long-term average of -12. Annual retail price inflation stood at 9% in July down from 12.3% a year ago, and the lowest since March 2022. Internet sales market penetration reached lockdown high of 37.8% in January 2021 but has settled in a range of 25-26% in recent months.

Although vacancy rates as measured by MSCI have started to come down, they remain well above five-year averages across most retail segments and locations. The exception are Retail Warehouses, where vacancy rates have fallen to a near four-year low of 4.4%.

The Centre for Retail Research reports that 39 retailers went into administration between January and mid-August, affecting 962 stores. If the rate of store closures continues at this level, then the 2023 total could be the lowest since 2017. This may act to support rents despite poor trading and the cost-of-living crisis. In Central London, rents rose by 0.5% q/q in Q1, with Rest of UK recording an even larger rise (+0.8% q/q). Shopping Centres recorded a second consecutive quarterly increase in rents (+0.3% q/q), Retail Warehouses recorded the strongest increase in over five years (+0.4% q/q) and Supermarket rents increased marginally (+0.1% q/q). Despite increasing signs of stability, further weakness is expected as consumer spending is expected to remain subdued in the short term.

### Retail Failures



Source: Centre for Retail Research  
\*Simple extrapolation of data up to August

### Outlook

Despite the challenging economic environment reducing consumer spending, retail rents will continue to increase over the forecast horizon, according to our latest forecasts. Some retail rents have already come down to levels at which landlords no longer accept any further rental reductions, while falling business rates give occupiers some more scope to afford slightly higher rents. We therefore predict All Retail rents to rise by 0.9% y/y in 2023, driven by Standard Retail – Central London and Retail Warehouses (both at +1.5%).

Over the 2023-2027 forecast horizon we predict positive average rental growth across all retail segments, led by Retail Warehouses (1.9% pa) and Standard retail – Central London (+1.8% pa). Shopping Centres will only experience marginal rental growth (+0.3% pa).

Investors are re-evaluating their perceptions of the retail industry which has been through years of structural change and repricing which now provide investors with the potential for income growth and value add opportunities. Although retail equivalent yields appeared to have stabilised, we believe that there is scope for some further outward shift and we therefore forecast All Retail yields to end 2023 at 6.77%, from 6.64% at the end of 2022. Yields will then start to move in slightly to 6.66% by the end of 2024 before falling further over the following years. Retail Warehouses (-52 bps) will see the sharpest fall in yields over the forecast horizon.

Total returns fell by 4.8% in 2022 but will return to growth of 2.9% this year, driven by income returns, as capital values continue to fall (-2.8% y/y) this year. Over the 2023-2027 period, total returns growth will average 7.5% pa, driven by Retail Warehouses at 8.4% pa.

### Retail Forecast Summary

	Dec-23	Dec-24	Dec-25	5 years to 2027
ERV Growth (% pa)	0.9	1.3	1.4	1.3
Equivalent Yield (% eop)	6.8	6.7	6.4	-43 bps
Capital Growth (% pa)	-2.8	2.4	4.3	1.9
Total Return (% pa)	2.9	8.3	10.1	7.5

Source: Colliers, MSCI





## Offices

### Capital Market - London

Investment volumes in London reached £1.9 billion in Q2 with 38 individual assets changing hands. The quarterly total reflects a fall of 24% compared to Q1. The number of deals completed fell by the same percentage, reflecting a fall in the average price achieved from £79 million (Q1) to £51 million (Q2). Key London sales in Q2 included Mitsui’s purchase of Sancroft for £315 million from Shimao and Greycoat and the sale of Winchester House, 75 London Wall to Castleforge and Gamuda for £257 million from Invesco. Outside of London, investment activity picked up slightly from £460m in Q1 to £610m. Prime yields in the West End appear stable at 4% but in the City, where Q2 activity was limited (sub £1bn), yields continued to soften, now standing at 5.25%.

### Occupier Market - London

Take-up for Q2 2023 shows a surprising improvement compared to Q1, with the total coming in at 2.35 million sq ft compared to 2.03 million in Q1. London wide take-up rose by 16% q/q, driven by a 44% increase in the City. Southbank also recorded a healthy (+33%) improvement. Demand for quality space is accelerating at the expense of non-prime stock. Grade A space accounted for 77% of take-up in Q2 with over 68% of that derived from the City.

No 100,000 sq ft+ transactions were recorded in Q2, the first time since Q3 2020 at the height of the pandemic. The legal sector remained a key taker of space with Goodwin Procter and Dentons committing to new offices. In addition, Kirkland & Ellis and Latham & Watkins exercised clauses to take option space at 40 Leadenhall and 1 Leadenhall respectively.

Due to subdued demand in selected submarkets, vacancy rose to its highest level since Q4 2009, although at 10.1% it reflects only a modest rise on the 12-month figure. Availability of new/refurbished space fell by 10% q/q but second-hand accommodation rose to north of 20 million sq ft a new record level for London as a whole.

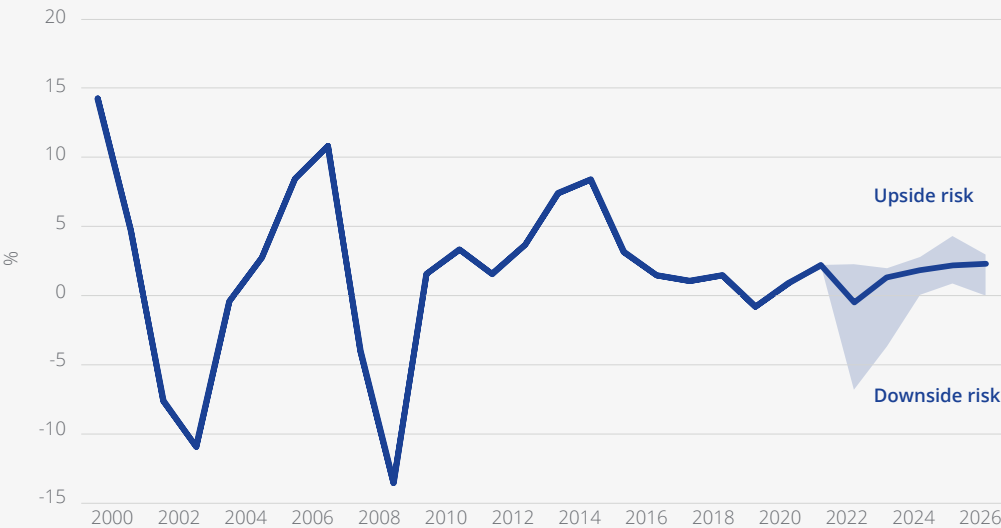
Occupiers continue to push the rental envelope with appetite for quality continuing to drive top rents. The average rental level for transactions over £100 psf rose sharply in Q2, reaching £145 psf compared to £128 psf in Q1. At the same time, average rent achieved for non-Grade A space rose in Q2 from £56 psf to £60 psf. Occupier demand for flexibility of ‘value’ space on short term leases is set to remain a feature of the market in H2 2023.

### Offices Forecast Summary

	Dec-23	Dec-24	Dec-25	5 years to 2027
ERV Growth (% pa)	1.2	0.7	1.1	1.2
Equivalent Yield (% eop)	7.2	7.3	7.1	27 bps
Capital Growth (% pa)	-9.7	0.1	3.8	0.5
Total Return (% pa)	-6.0	4.0	7.9	4.5

Source: Colliers, MSCI

### “All Office” Rental Growth y/y % Change



Source: Colliers, IPF, MSCI

### Occupier Market - Regional CBDs

**Birmingham's** office take-up bounced back in Q2 after a decline in Q1. At 177,665 sq ft take-up was up by 16% on Q1 levels and 5% above the five-year quarterly average. H1 2023 take-up was up by 13% on the H1 2022 figure. Prime rents in the city centre remain steady at £40.00 psf with 103 Colmore Row remaining the benchmark, where 43,000 sq ft is still to be leased. We anticipate further uplift in H2 2023 with expectation of year-end rents reaching £42.50 psf.

**Bristol's** city centre saw a further dip in take-up in Q2, reaching just 66,050 sq ft, which is 20% below Q1. The level represents the lowest quarterly total since Q2 2020, which was pandemic influenced. Further constrained demand has meant an additional upward movement in vacancy in line with Q1. At 7.8%, overall vacancy is at its highest level since Q1 2016. Although prime rents have remained unchanged at £42.50 psf, there is still potential for further uplift given anticipated activity in Q3. With some new schemes quoting £45 psf it is expected that rents will continue to grow.

Take-up in **Edinburgh** improved slightly in Q2, but the H1 figure of 184,900 sq ft is 18% below the H1 2022 total. Availability of new Grade A space is very limited with a vacancy rate of sub-1%. Prime rents rose from £38.00 psf to £39.50 psf.

**Glasgow** lacked any significant larger lettings in Q2, with the total H1 take-up figure of 143,300 sq ft, around 25% down on H1 2022. However, the availability of new Grade A space in Glasgow is still below trend with a vacancy rate of sub-3%. Prime rents stand at £36.00 psf.

Exceptionally strong Q1 take-up in **Leeds** meant Q2 numbers were always likely to be lower. Regardless, the H1 2023 total was 16% up on H2 2022 and evidence remains of healthy underlying demand despite challenging wider market conditions. Availability edged up in Q2 and while still above 10-year and five-year quarterly averages, Grade A vacancy remains below 2.5%. Prime rents have risen, highlighted by the £37.00 psf paid by Reward Finance.

H1 2023 take-up in **Manchester** reached 392,329 sq ft, of which 46% was reported for Q2. The largest letting was to Arup, who acquired 16,218 sq ft at Longmead's 3 Piccadilly Place. New build Grade A office availability currently stands at 400,591 sq ft, which includes the recently completed Net Zero Carbon 4 Angel Square. Rental growth continues to be achieved in the city centre with a new headline city centre office rent set at £43.00 per sq ft at St Michael's following the pre-let agreements with Pinsent Masons & Hill Dickinson.





## Outlook

Colliers latest forecasts show that average MSCI rents across all offices will increase by 1.2% y/y in 2023, before the current demand slowdown will result in weaker rental growth of 0.7% y/y in 2024.

As the MSCI data only provides information about average rental increases and not prime rents it is important to acknowledge the vast differences between different quality stock. A shortage of prime and premium stock, an oversupply of non-future-proofed office space, and landlord reluctance or lack of capacity to upgrade 'tired' and no longer fit-for-purpose stock, is leading to steady rise in rental levels for Grade A and A+ quality stock. Prime rents will therefore see further uplift as occupiers compete for limited availability of high-quality space.

With yields expected to see further outward shifts this year and possibly into early-2024, capital values will decline this year before stabilising in 2024 and then rising again from 2025. All Office total returns will therefore fall by 6.0% in 2023 but grow again in 2024 (+4.0%). Over the 2023-2027 forecast period, All Office total returns will average 4.5% pa.

## Industrial & Logistics

### Capital Market

Industrial investment volumes reached £4 billion over the first six months of the year, down 62% y/y but relatively in line with the five-year pre-Covid H1 average of £4.2bn. Investor appetite has been restrained by volatile financial markets and increasing borrowing costs. Yields have remained largely stable over the past few months, following significant outward movement in the second half of 2022. Although sentiment on the long-term performance of the industrial sector remains positive, there continues to be a substantial gap between sellers' aspirations and buyers' expectations.

### Occupier Demand and Supply

Occupational demand has been experiencing a slight slowdown over the past nine months because occupiers are exercising greater caution. Third party logistics providers (3PLs) and retailers are looking carefully at their property requirements due to slowing retail sales and increasing costs.

However, the market has remained resilient and there is still a good level of demand when compared to historical pre-Covid trends. Some of the latest deals in Q3 2023 so far include: Butternut Box signing a 20-year lease at the speculatively developed SP3 Symmetry Park Doncaster (132,750 sq ft); XPO Logistics taking the secondary unit Voltaic Wakefield 41 (211,000 sq ft); Mod Pods agreeing a 15-year lease for a 311,261 sq ft warehouse at Walsgrave Triangle, Coventry; and Lloyds Frasers letting 163,423 sq ft at XDCK163 Magna Park, Lutterworth to mention a few.

From a supply perspective, our record shows that there is 11.5m sq ft of speculative supply under construction. However, looking ahead in 2024, we expect development activity to contract significantly, thus there is likely to be a pinch point around Q3/4 2024. This will sustain rental growth and result in more demand for build to suit warehouses.

Annual rental growth rates continue to slow across most regions. According to MSCI, Q2 rental growth was the strongest in East of England (+9.8% y/y), West Midlands (+9.2% y/y), and North West (+9.1% y/y) while rental growth in London slowed from 18.1% y/y in Q2 2022 to 7.4% y/y.

### Industrial & Logistics Forecast Summary

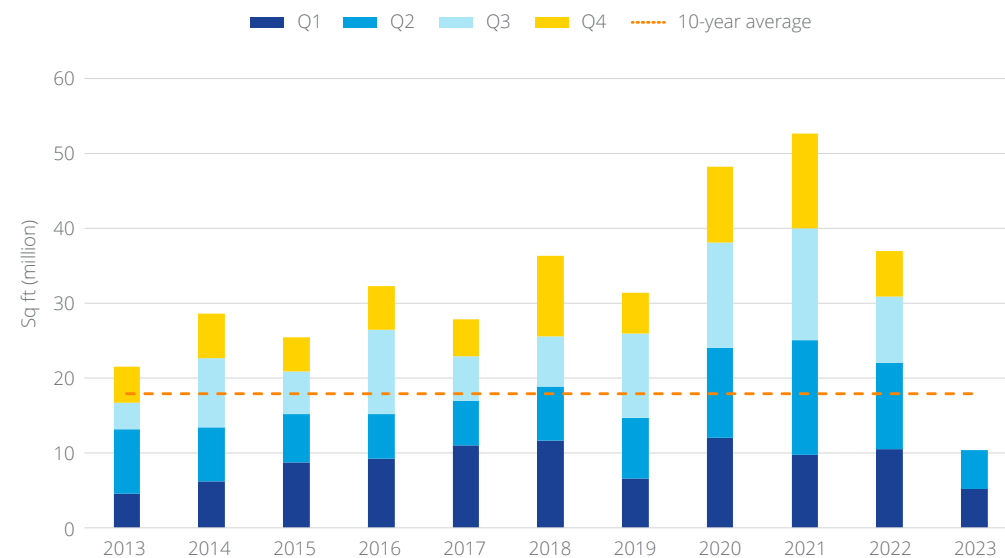
	Dec-23	Dec-24	Dec-25	5 years to 2027
ERV Growth (% pa)	4.8	3.7	4.1	4.3
Equivalent Yield (% eop)	5.8	5.7	5.5	-63 bps
Capital Growth (% pa)	1.0	4.2	5.7	5.8
Total Return (% pa)	5.2	8.4	10.0	10.1

Source: Colliers, MSCI





### Industrial Take-Up, Units Sized 100,00+ sq ft



Source: Colliers

### Outlook

Looking ahead into 2024, with the currently suppressed attitude to speculative funding, there will be a significantly lower level of new space coming online which will stabilise future supply levels, while also sustaining this continuing rental growth. Colliers is forecasting an average annual rental growth for UK assets of 4.2% to 2027.

We expect rental growth to slow from the strong rates recorded throughout most of 2021 and 2022, with All Industrial rents to increase by 5.1% in 2023, before slowing to 3.8% in 2024. Rental growth is then expected to strengthen slightly. We predict a further rise in yields in Q3 before stabilising and potentially re-compressing towards the end of 2023. All Industrial yields will end 2023 at 5.73%, up from 5.62% at the end of 2022.

All Industrial total returns fell by 14.6% in 2022, but we predict a return to growth in 2023 (+6%). Total returns growth will then accelerate to 13.4% in 2024 and remain close to double digits until the end of the five-year forecast horizon.

## Other Sectors

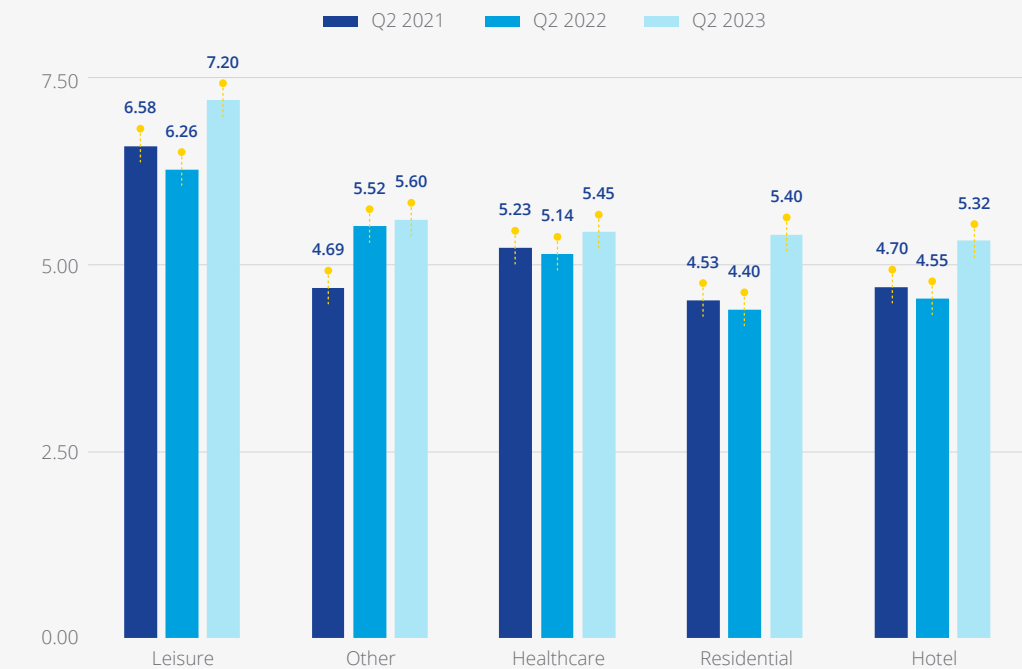
Investment into the PBSA (purpose-built student accommodation) sector reached a record-high of £8.6bn in 2022 but slowed considerably in 2023, totalling only £590m so far this year (January-August). The largest transactions were recorded in Warwick (1,209 units /£160m) and Bristol (819 units/£103m).

Residential investment volumes were stable at £1.5bn in Q2, but preliminary figures for Q3 suggest a sharp slowdown, with only £150m invested so far. The largest 2023 transactions to date include 722 units in Birmingham (£302m), 768 units across three London sites (£300m), and 865 units across 11 sites UK-wide (£205m).

MSCI data suggests that yields rose by over 100 bps between Q1 2022 and Q2 2023, although the pace of outward movement has slowed.

Hotel investment slowed slightly from £520m in Q1 to £450m in Q2. The year-to-date (January-August) figure of £1.1bn is around 56% below the corresponding 2022 figure. The largest transactions so far this year include The Caledonian in Edinburgh (241 beds, £85m), The Grand Hotel Brighton (201 beds, £60m), and Covent Garden Hotel (58 beds, £55m). MSCI data suggests that hotel yields rose by 5 bps in Q2, having moved out by 11 bps in Q1.

### Equivalent Yield - Selected Sectors



Source: MSCI Digest Q2 2023



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