

Real Estate Strategic Outlook: United Kingdom

Short-term challenges, longer-term opportunity

Economy remains volatile, but early signs of recovery

The Bank of England increased interest rates a further 25 basis points in August to 5.25%, the highest level since 2008. Despite remaining elevated, the recent fall in inflation has provided some relief and interest rates are now expected to peak by the end of the year at 5.75%.¹ However, the outlook remains volatile and while inflation should continue to soften, it is unlikely to reach the 2% target until late 2024.² As such, UK interest rates are likely to remain higher for longer compared to the Eurozone.

Looking further forward, however, 10-year government bond yields are expected to fall steadily from 2025 and GDP growth is forecast to comfortably outpace the Eurozone over a 10-year horizon. We expect London will continue to be a driver of growth, supported by positive demographic and employment fundamentals.²

UK real estate outperforms over the medium-term

Greater repricing presents mid-term opportunities

Earlier in 2023, sentiment towards UK real estate was improving and there were early signs of yield stabilisation and, in the case of logistics, recovery. However, aforementioned rate hikes have since stalled market recovery and risks around pricing are on the downside in the short-term, albeit any further price correction should be far more modest in comparison to that already seen.

Investors remain cautious at present, but a significant weight of capital is waiting to target UK real estate. We anticipate prime yields will stabilize by the end of the year, before gradually compressing from 2025 as finance costs move in and liquidity returns. A higher entry yield and an expectation of prime rent growth suggest a robust medium-term outlook for UK property, with returns forecast to outperform the European average.

Logistics: Significant price correction and positive fundamentals

Structural tailwinds continue to support UK logistics. Despite slowing from pandemic highs, demand should be supported by

further e-commerce growth and a shift to 'just-in-case' supply chains. A reduced development pipeline should drive continued, albeit more moderate, rent growth and a recovery in pricing over the medium term should drive healthy returns. Redeveloping ageing light-industrial assets to energy-efficient last-hour logistics near urban centres, such as London and Manchester, would likely capture strong rental uplift.

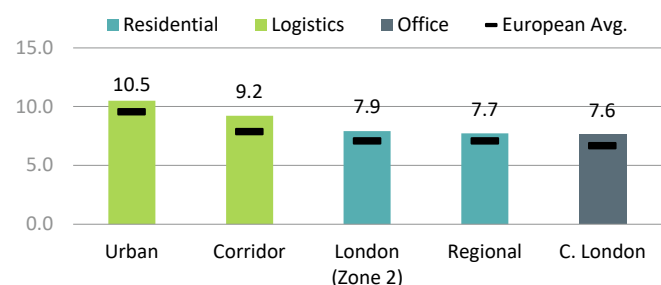
Residential: living sectors supported by a notable undersupply

There is a strong case for student housing in the UK, with growing demand from both domestic and international students and a significant undersupply of beds in many of the UK's largest cities. The build-to-rent sector is also supported by positive fundamentals and the UK remains one of Europe's few housing markets with limited regulation, allowing stronger rental uplifts.

Office: Medium-term supply pipeline supports redevelopment

Central London's office market continues to be supported by solid long-term fundamentals, including healthy employment growth prospects. Falling development activity alongside an existing undersupply of best-in-class office stock supports the refurbishments of well-located Grade B assets into highly sustainable Next Generation offices.

Prime Total Return Forecast, 2023-2032f (% p.a.)



Source: DWS, July 2023

¹ Oxford Economics, August 2023

² DWS, July 2023

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