For Professional Clients and/or Qualified Investors only

UK Real Estate Overview

Q1 2024

COLUMBIA THREADNEEDLE ALTERNATIVES

Contents

Risk statement

Our review and outlook is a marketing communication providing an overview of the recent economic and property market environment. It should not be considered as advice or a recommendation to buy, sell or hold investments. Nor is it investment research and has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. As with all investments, capital is at risk.

The value of investments and income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

The value of directly held property reflects the opinion of valuers and is likely to be reviewed periodically. These assets can also be illiquid and significant or persistent redemptions may require the manager to sell properties at a lower market value adversely affecting the value of your investment.

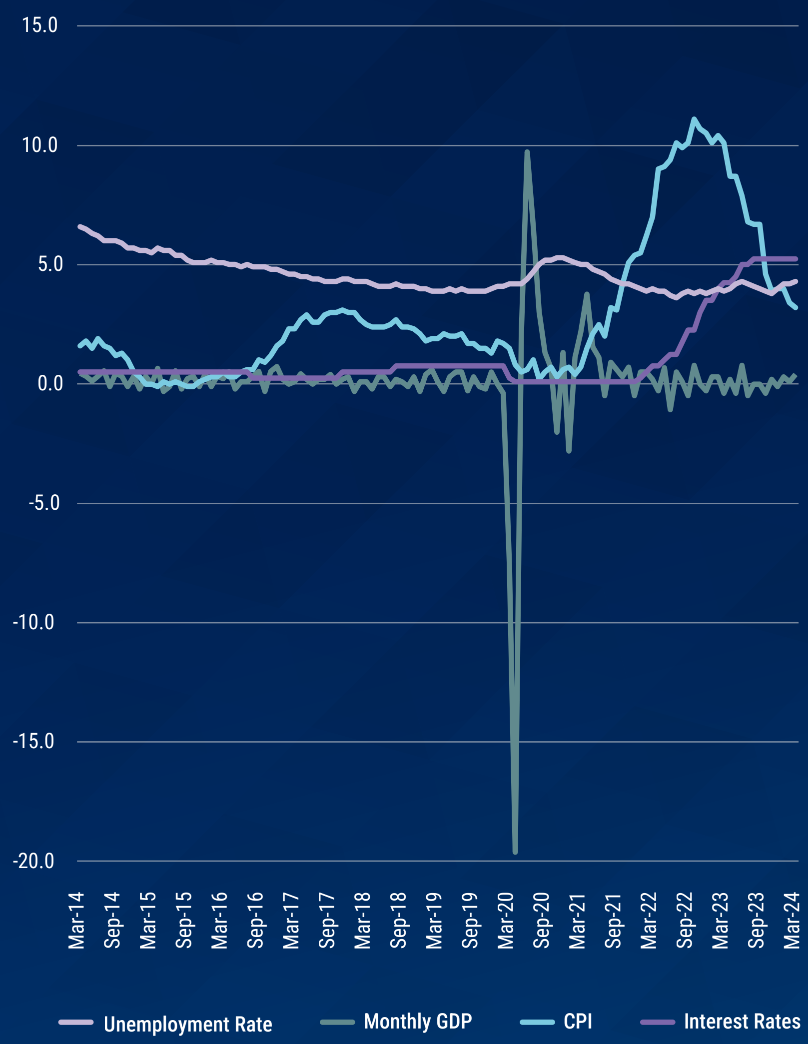
Real estate context: state of the market

Economy

- The UK economy recorded GDP growth in Q1 2024, departing the shallow recession witnessed in the final quarter of 2023. UK GDP is estimated to have grown by 0.6% in the 3-months to March, led by a recovery in the services and production sectors recording 0.7% and 0.8% respectively. Despite this, headwinds remain as the impact of a sustained higher interest rate environment continues to unwind.
- Headline inflation rose by 3.2% year-on-year to March, down from 4.0% in the 12 months to December. The slowing trend is likely to continue as energy and food price inflation drift downwards. Inflation is expected to return closer to the Bank of England's (BoE) 2.0% target in the second half of 2024.
- The BoE voted to hold the base rate at 5.25% at its meeting in May as it continues to target lower inflation and bring the level closer to its 2.0% target. The downward trend could clear the way for a cut to the interest rate sooner than expected, with markets now anticipating a first rate reduction by the second quarter of the year, possibly as early as June.
- The labour market remains constrained by historical standards, with unemployment at 4.3% in March, although falling response rates to the Labour Force Study have made the data increasingly unreliable. Average total pay (excluding bonuses) grew at an annual rate of 6.0% to March. Retail sales were up 1.9% in Q1 2024 but were unexpectedly flat in March. However, rising real household incomes should support retail activity as the year progresses.

Source: Columbia Threadneedle Investments, MSCI UK Monthly Property Index, as at 31 March 2024. ONS data as at date stated.

UK GDP, interest rates, CPI and unemployment (monthly, %)

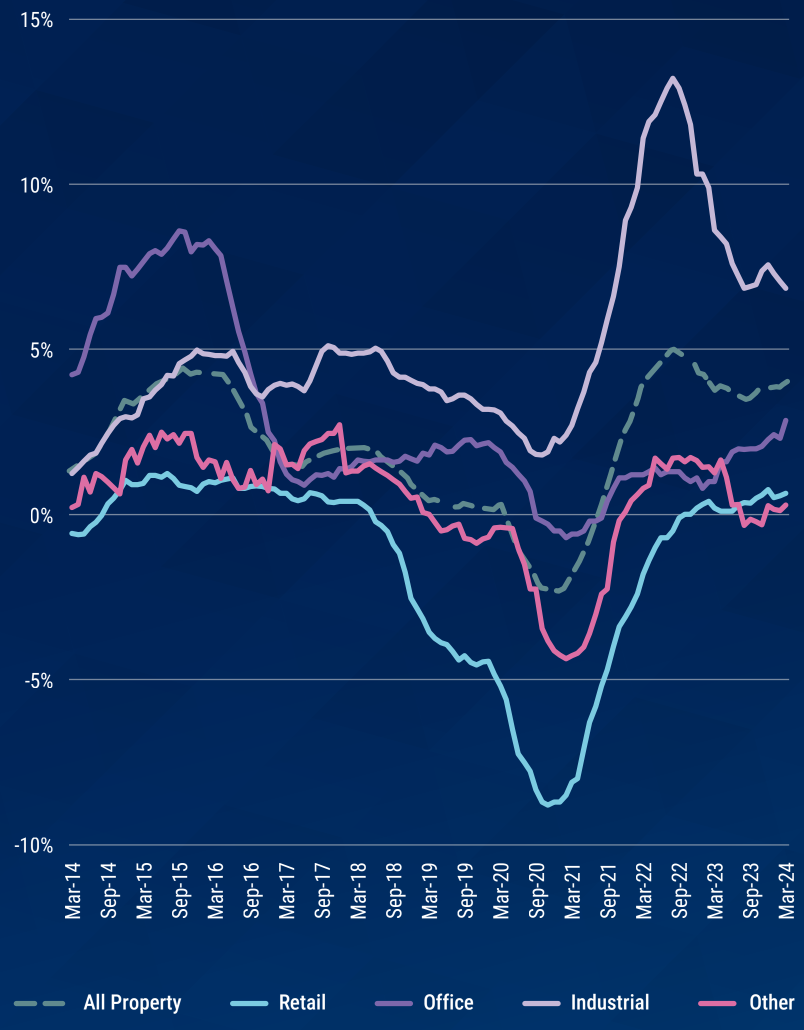


Real estate context: state of the market

Occupier market

- The retail warehouse sector continues to attract strong investor interest. Vacancy rates are markedly lower compared with shopping centres or high street shops. Footfall has also proven to be more resilient than other areas of the retail sector, particularly for schemes with a more discount-oriented line-up. Appetite for the sector is not expected to change for the foreseeable future.
- Positive rental growth is still being recorded in some low vacancy logistics locations across the country. However, this is at more moderate levels compared with the record-breaking growth seen in the post-Covid years. Weaker overall occupational demand, which will feed a slower upswing in rents, will be offset by the slowing development pipeline. Newly delivered stock will contribute to an increasingly polarised rental market and a widening gap between prime and secondary rents as occupiers chase the best-quality space – both new-build and refurbished secondary units and stock with ESG credentials.
- Sentiment towards the office sector remains very weak as it grapples with new working habits and a weaker economic backdrop. The vacancy rate in London and key regional cities has been rising over the past 12 months, but the rate of increase is beginning to slow. This is partly due to developers scaling back on schemes, especially speculative schemes where financing is much harder to obtain. Construction costs are still elevated and the situation will hold back the much-needed high-quality supply in 2024 and 2025. Landlords are scrutinising their portfolios to identify schemes that have sufficient existing EPC ratings and those projects that could be easy wins in terms of upgrading and/or refurbishment. There is less appetite for taking on offices that require substantial upgrades given the high cost of capital expenditure.

UK property market rental value growth (year-on-year, %)



Source: Columbia Threadneedle Investments, MSCI UK Monthly Property Index, as at 31 March 2024.

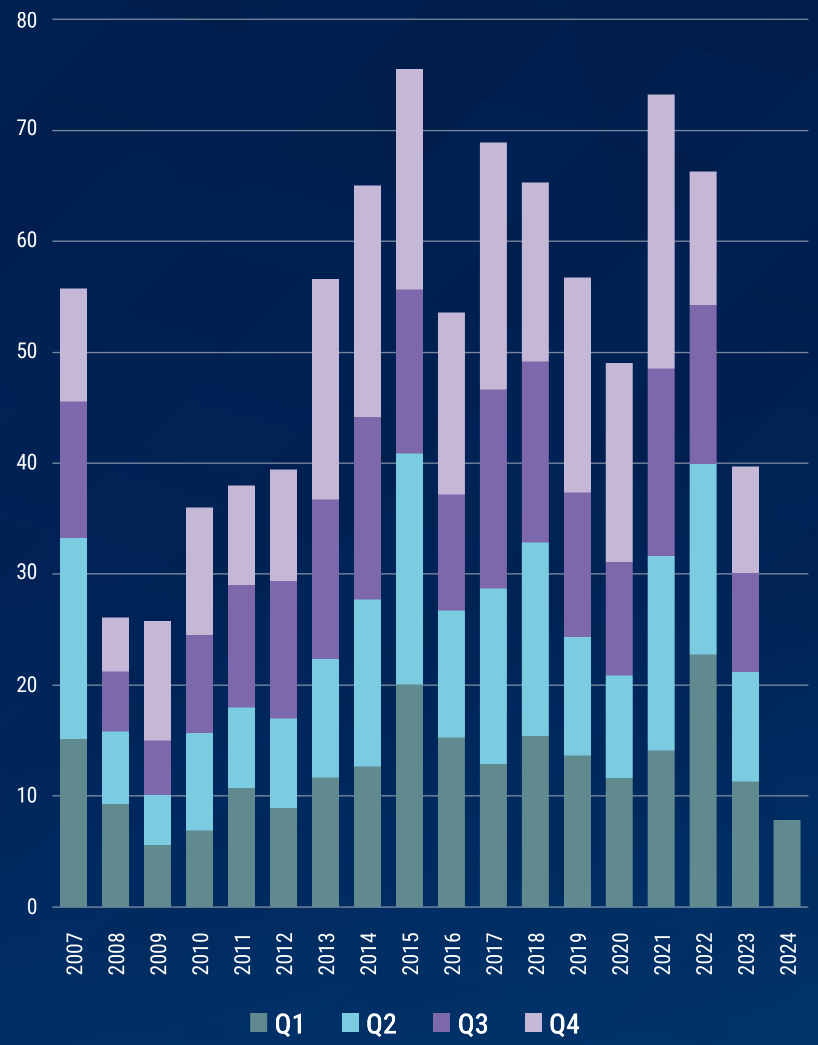
Real estate context: state of the market

Investment market

- Total UK commercial property investment volumes recorded £9.9 billion in Q1 2024 which is approximately 9% lower than Q4 2023 volumes. Capital value declines have moderated for favoured sectors, as pricing is expected to bottom-out through mid-2024 with retail warehousing perhaps the lead indicator of nascent pricing recovery. Some further asset repricing is anticipated in non-favoured sectors, for example offices where vacancies continue to rise. Attractive buying opportunities exist for investors brave enough to transact in an environment that does not yet offer full transparency.
- Challenges remain as the market adapts to investing and financing in a higher interest rate environment. The days of ultra-low rates seen over the past 15 years or so are behind us and rate-setters have indicated that markets should expect a period of 'higher for longer'.
- Nonetheless, the uptick in investment volumes in the final quarter of 2023 is hopefully the beginning of a healthier appetite and positive outlook for real estate across 2024, although momentum is expected to gather pace slowly. Some of the opportunity will come from landlords needing to refinance due to much higher debt costs, thus bringing more good product to the market.
- The underlying investor base continues to evolve as UK pension funds, estimated to account for around £70 billion of assets, gradually disinvest some of this from real estate. Meanwhile, the allocation of private equity into closed-ended real estate funds is expected to replace some of this with an estimated global aggregate of dry powder amounting to about $400 billion.

Source: Columbia Threadneedle Investments, MSCI UK Monthly Property Index, as at 31 March 2024, MSCI Real Capital Analytics Q1 2024.

UK investment volumes (GBP bn)

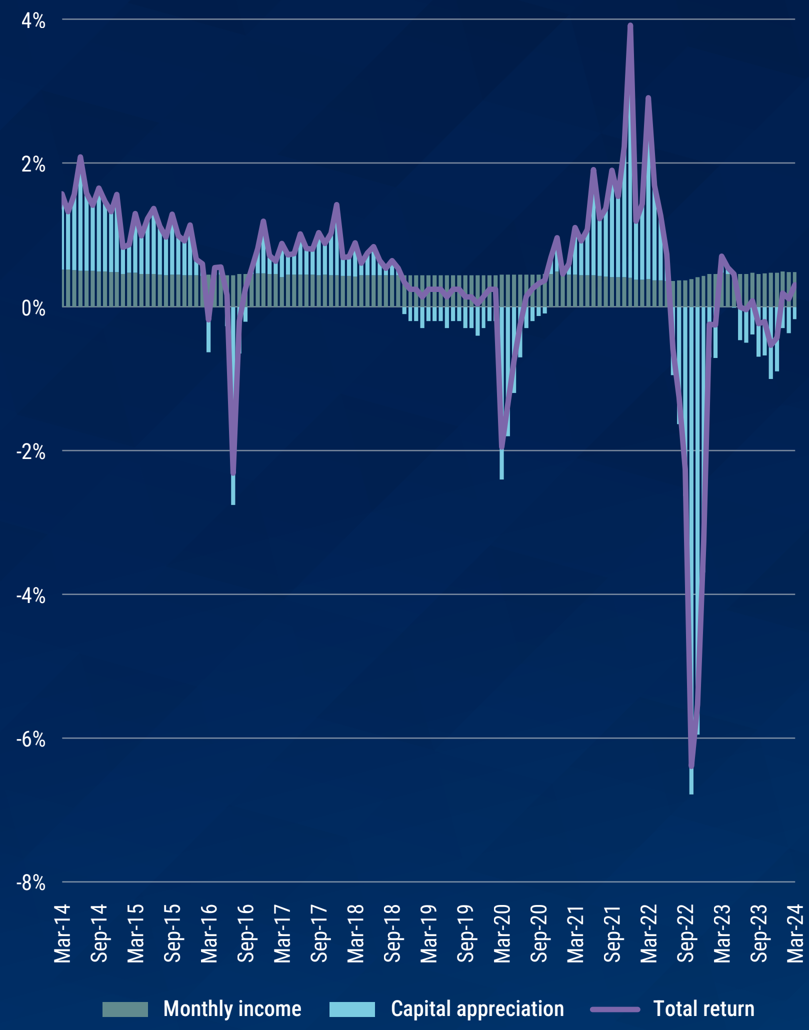


Real estate context: state of the market

Returns and outlook

- Total returns for the UK commercial property market turned positive in Q1 2024 with the MSCI UK monthly index recording a return of 0.6% (0.3% on a 12-month basis to March). Retail was the best-performing sector with a total return in the three months to March of 1.5%. Offices continued to struggle and were the only sector to register negative total returns in the first quarter, coming in at -1.4%.
- All-property capital values declined by 0.8% in the quarter and by 5.3% on a 12-month basis. Despite ongoing economic headwinds, income returns remained positive in Q1 2024 at 1.5% (5.8% on a 12-month basis), demonstrating the resilient income credentials that underpin the UK commercial property market.
- Income returns will underpin the expected improvement in total returns while yield-driven capital growth is likely to be limited, at least in the short to medium term. This will drive the continued divergence in performance across property types. Over time the benefits of looser monetary policy will increase activity, but the impact is unlikely to be seen fully until 2025. 2024 will continue to see the impact of the 515bps of tightening seen since late-2021 feeding through to the real economy.
- The all-property net initial yield at the end of March 2024 was 5.6%, up marginally from 5.5% in Q4 2023. With the era of ultra-low interest rates behind us there is further value correction to come, although it is expected to bottom-out by the middle of the year. This, alongside more conservative loan to value ratios, increased margin costs and potentially elevated rates of under- and non-performing loans, could see more instances of bank-forced sales creating further opportunity for market dislocation.

UK commercial property monthly total returns



Source: Columbia Threadneedle Investments, MSCI UK Monthly Property Index, as at 31 March 2024.

Global perspectives into practice

Key sector metrics as at end of March 2024

Trending key

Trending key
Strengthening
Stable
Weakening

	Industrials	Offices	Retail	Alternatives
Headlines	Development pipeline slows further, exacerbating the lack of quality supply	Sentiment remains weak but vacancy is beginning to plateau – albeit at elevated levels	Strong investor and occupier demand for out-of-town schemes but options limited	Structural and demographic changes favour 'Beds' and 'Meds'
Vacancy* (By Market Rent)	6.90%	22.80%	6.20%	2.30%
Rental Growth* (Annualised)	6.90%	2.80%	0.60%	4.10%
Prime Yield Pricing** (Net Initial Yield, rack rented)	Distribution 5.25%	London (City) 5.75%	Warehouse 6.00%	Student 5.00%
	Multi-let 5.25%	Regions 6.50%	High Street 7.00%	Leisure 8.00%
Allocation	Favour multi-let and mid-box logistics. Neutral big-box distribution	Highly selective: favour urban centres with good amenities and accessibility	Favour out-of-town warehouses/parks. Underweight in-town	Favour, strategic land, 'meds' and residential including student housing

Finance:
5-year Gilt: 3.8%
5-year Swap: 3.8%

Real estate*:
NIY: 5.6%
EQV: 7.1%

Spread:
3.3%
(5-year Gilt to EQV)

Source: Columbia Threadneedle Investments, *MSCI UK Monthly Property Index and **CBRE Prime Yields, all as at 31 March 2024 unless stated otherwise. MSCI UK Monthly Property Index Vacancy rate and Market Value Rental Growth (Alternatives data is unweighted average Hotels, Residential, Other), as at 31 March 2024. Trends against average of prior 6-months (+/- <0.25% denotes stable). Opinions, estimates, forecasts, projections and statements of financial market trends are based on market conditions at the date of the publication, constitute our judgment and are subject to change without notice. There can be no guarantee they will be met. Provided for information only, not to be construed as investment recommendation or advice. Past performance is not a guide to future returns. Capital is at risk and investors may not get back the original amount invested. Not all investment ideas are suitable for all investors. NYI = net initial yield, EQV = equivalent value.

To find out more, visit **columbiathreadneedle.com**

6595760.1 | WF2062948 (Issued 05/24 - Valid 11/24)