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Savills unveils 2024 cross-sector UK forecasts

2 years ago

Savills forecasts 8 asset classes set to see annualised returns in excess of 8%

- Buy-to-let in the North West, London industrial and retail warehouses to be the top performing sub-sectors next year
- 2024 will be an opportunity to buy at the very bottom of the cycle for commercial investors – with retail, industrial and office space looking comparatively cheap
- Struggles in the private rented sector are also expected to spur institutional landlords to consider both Built to Rent and Purpose Build Student Accommodation
- Farmland remains a key solution to a multitude of challenges facing society and will play a key role in net zero initiatives
- Prime arable land with the main purpose of food production will continue to appeal, heightened through the impact of global shocks such as conflict or extreme weather

Residential buy-to-let in the North West, London industrial property and retail warehouses are set to be the UK property market's top performers from next year according to Savills, all experiencing annualised investment returns of between 8.5% and 9.2% between 2024-2028, with eight types of asset class in total anticipated of seeing returns in excess of 8%.

Savills annual cross-sector forecasts suggest a stronger outlook and opportunity for UK property investment in 2024 as interest rates steady. But returns will continue to be driven by income potential instead of capital growth.

Commercial: Opportunity to take advantage of market bottoming out

Savills says that opportunistic investors will be attracted to parts of the retail market by rebased rents and rates, and higher yields, as well as the medium-term capital growth upside that could come from change of use. Occupier demand for prime high-quality and highly rated warehouses, meanwhile, is also set to keep prices rising in 2024, especially in London, according to the international real estate advisor.

After an uneven year for the UK office market, cooling inflation, falling borrowing costs, and good rental growth prospects will bring some development schemes back into viability territory in 2024, as investors look to capitalise on the undersupply of prime and green office space.

Residential: Mortgage market turbulence to cool in 2024

Turbulence in the mortgage markets, an uncertain planning environment, increased build cost inflation and regulatory changes in the private rented sector, suppressed transactions and growth in the residential sector in 2023. But with inflation heading back towards the Bank of England target of 2.0% and more stability in the mortgage markets, Savills expects to see the primary sources of financial disturbance ease back over the course of next year.

Despite tougher conditions for landlords, with Savills forecasting rents to grow by a further 18.1% by 2028 there is still significant opportunity for those less reliant on debt, particularly for those with a portfolio furthest from London, with Savills forecasting 9.2% returns for the North West.

But struggles in the private rented sector are also expected to spur on institutional landlords, and both Built to Rent and Purpose Built Student Accommodation are expected to play an increasingly important role looking forward, says Savills.

Rural: UK farmland remains a key solution to challenges faced by society

Farmland remains a solution to many of the challenges being faced by society and certainly is being looked at as the saviour for meeting many of the environmental targets the government has set. It continues to provide long-term capital growth, and in 2023, global conflicts reinforced the importance of UK land producing food, fuel and fibre.

Prime arable land with the main purpose of food production will continue to be in demand, especially land with access to a resilient water supply. Food security remains on the political stage and the issue is heightened through the impact of global shocks be that conflict or intense weather extremes. Savills has forecast capital growth of 3.0% for prime arable land.

While the UK forestry market slowed over 2023 from its peak in 2021, the investment opportunity that land offers as the UK continues to work towards net zero emissions by 2050 (2045 for Scotland) is still significant. Savills forecasts that Grade 3 arable land could provide the optimum balance of risk due to its flexibility – appealing to agricultural buyers as well as those motivated by nature-based solutions and natural capital.

Richard Merryweather, Savills joint head of UK investment, comments: “The factors that drove falls in UK property values and transaction levels over the last two years are expected to improve in 2024. There will be significant opportunity – especially in the commercial and residential spaces – for investors to buy at the bottom of the market, with a focus on opportunities where capital values have either over-corrected, or where rental growth prospects might be accelerating.

"The UK is one of 40 counties that is expected to have an election in 2024 which often causes investor uncertainty. However, our analysis suggests that although transactional activity is generally lower than normal in the three months prior to the election date, it recovers over the following six months."

"The rationale for investing in land and property remains good, particularly for investors who are looking for infrastructure-type investments that deliver comparatively predictable income streams over the long term. A rising interest in food security and carbon reduction is likely to boost investor interest in these segments. We are seldom able to see the bottom of any cycle this clearly, but we are confident that 2024 and 2025 will be the years in which normal service will be resumed."

Savills commercial themes and top picks for 2024:

- Savills believes that 2024 will be the year when investors stop making sector-wide pronouncements and start to focus on the traditional asset-specific basics.
- Undersupply of prime and green office space across the UK's major office markets remains a fact, and will continue to be a driver of better than average rental growth over the short to medium term. Value-add investor demand will deepen in 2024 to capitalise on this, though larger projects will remain challenged by institutional caution.
- Opportunistic investors will continue to be attracted to parts of the retail market by the high yields on offer, as well as the medium term capital growth upside that could come from change of use. Savills does not expect to see a surge in retail investment volumes in 2024, but some prime yield hardening in some sectors and locations is baked into our forecasts for both 2024 and 2025.
- Logistics and life-sciences will both be on investors' shopping lists in 2024. Both sectors offer an attractive mix of structural change driven demand, restrained supply, and strong rental growth prospects, so it is easy to see why income-focused investors in particular continue to be enthused by them. With annual rental growth prospects in the high single digits, for some supply constrained markets per annum, the rationale for buying while these sectors are comparatively cheap remains a good one.

Top picks:

1. Strategic sheds: Well-let logistics projects in good locations where the value over-corrected in 2021-2023. Buy in 2024 and sell into a hot market in 2026?
2. Core offices that are priced as value-add: High yields and strong rental growth prospects mean that value-add returns will be briefly achievable on Core offices.
3. Essential retail: Foodstores and neighbourhood-focused retail look cheap. Population growth, omni-channel retail and constrained stock all support entering these segments now for an income-focused strategy.

Savills residential themes and top picks for 2024:

- Even though costs of debt are expected to stay "higher for longer", progressive cuts in the cost of mortgage debt over the next five years should open up capacity for a return to house price growth and an increase activity levels. Savills has forecast mainstream house prices to return to growth by 2025.
- Prices remain 19% below their 2014 peak in prime central London and is overdue a recovery. But such recovery will have to take place in a much tighter tax and regulatory environment than before,

at a time when the current parliamentary opposition has non-doms tax status and overseas buyers stamp duty firmly on its radar.

- The prospect of a more widespread recovery in market conditions will come as welcome news to a housebuilding industry, which has been at the sharp end of the housing market downturn of the past year. Coinciding with the cessation of Help to Buy, substantial increase in build costs and a substantial shift in planning policy this has been a bruising experience.
- Buoyed by a burst of strong rental growth, larger equity-rich landlords have been much better placed to weather the storm, being able to take a more sanguine view on the impact of the end of the Assured Shorthold across a portfolio which diversifies tenant specific risks.
- But the benefits to developers of selling built-to-order units off-plan (post Help to Buy), looks more conducive to the process of assembling portfolios of energy-efficient, new-build residential homes than ever.

Top picks:

1. Best in Class: Whenever a market is in the late stages of a downturn or the early stages of a recovery, it's the properties that are Best in Class that perform most strongly. It's a combination of location, situation, aesthetics and quality of accommodation. Difficult to describe but you know it when you see it.
2. Retirement for rent: The emergence of new players and new models in the retirement housing sector, backed up by a structural imbalance in demand and supply underpins this year's residential investment pick
3. Partnerships with an affordable twist: While delivering a new generation of new towns is a laudable aspiration, the timescales, trials and tribulations involving in bringing these into being suggests it remains one for the evangelists. With a shift in focus to the delivery of affordable homes in the event of a change in government, we expect to see more partnerships between developers an affordable housing providers, especially the new generation of "for profits".

Savills rural themes and top picks for 2024:

- GB farmland supply is at its highest level (155,000 acres), since Brexit and the start of the agricultural transition. Savills has forecast the three year upward trend to continue to reach around 180,000 acres per year by 2028.
- As we move into 2024 and the impact of the agricultural transition continues to be felt, there will be more decisions to be made. These may include reviewing the opportunities and markets that farmland presents from food production, development, energy and renewables and the emerging nature markets or, the more final decisions of retirement or exiting the sector.
- Whether funded through private investment or the public purse, farmland values will be sustained due to the multiple demands from it. The UK has set targets to achieve net zero emissions by 2050 and for 30% of land and sea to be protected by 2030. A key solution will be the sequencing, bundling and stacking of opportunities in the nature markets. This will provide the profitability required to secure farmland values and, will provide the outcomes needed to meet the ever increasing demands on land.
- The UK forestry market slowed over 2023 from its peak in 2021, however Savills considers this to be a temporary response to a number of external pressures in late 2022 and the future forecast is a return to steady capital growth for 2024 of 2.5%.

- Augmenting the UK’s renewable capacity will requires the right mix of policy, investment and suitable sites. Strong return on investment will provide adequate incentive to investors (the average return on investment for a solar farm in the UK is between 10 and 20%). But, policy certainty around developing renewables on certain grades of land is needed and the liberalisation of onshore wind in England has also been widely called for.

Top picks:

1. Grade 3 arable land: Savills forecasts that Grade 3 arable land will be in demand due to its versatility in providing solutions for the emerging nature markets as well as being a key part of a productive food producing system.
2. Prime arable land: with the main purpose of food production will continue to appeal, especially land with water accessibility, resilience and sustainability. Food security continues to be on the political stage and heightened through the impact of global shocks be that conflict or intense weather extremes. Our five year forecast is growth of 2.5%.

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