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REAL ESTATE ADVISORS

Joining the Dots...

Scottish Investment Market Quarterly Review: Q4 2024

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“The best way to spread Christmas cheer is singing loud for all to hear.”

– Buddy (from Elf)

It feels like most investment agents will be singing a little louder than this time last year but not yet belting it out from the roof tops! The market is better for sure, volumes are up, interest rates are lower, confidence is building but caution remains.

Despite the October budget doing little for wider business confidence, investor appetite for real estate remains reasonably robust. That said, it is a polarised picture with prime assets seeing a deepening buyer pool and if something looks like “real value” then there is a good level of interest. In between remains fickle.

Across the sectors, again it is a mixed landscape with industrial/ logistics, retail warehousing and living all holding up well (and in some cases appetite is improving) while offices remains the sector where there is a wider range of perceived risk and resultant view on pricing.

With this backdrop, rather than looking back over 2024, our focus in this review (in addition to our usual market analysis) will be looking forward to 2025. Will it be a year of opportunity, what sectors will fare best and what will be the key drivers for continuing the momentum that has started to build. To help form our view, we are pleased to include a guest contribution from Tom Elviss (Fund Manager at Columbia Threadneedle).

One of Buddy’s other quotes from Elf was “*I just like to smile. Smiling’s my favourite.*”

Keep smiling folks and Happy Christmas from The Lismore Team...



Market overview.

Key themes

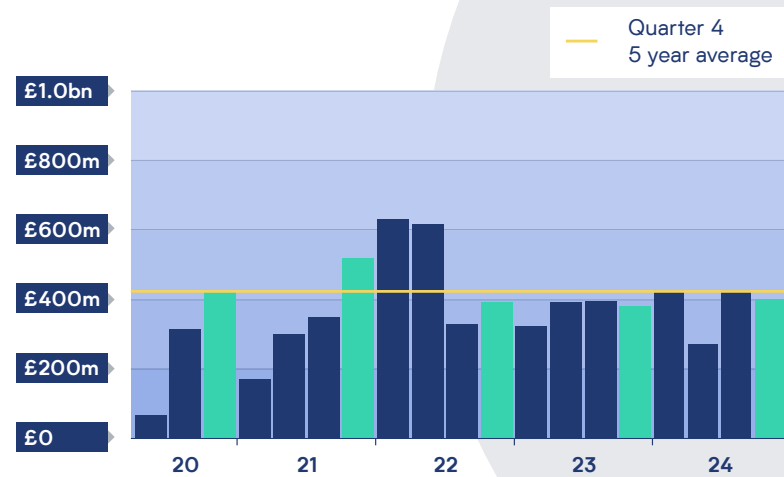
- **Interest rates easing (slowly)** — the much-anticipated cuts in base rate are happening but not as quickly as some had anticipated. The outlook for further cuts looks promising but likely to be steady rather than spectacular.
- **Rental growth driving performance** — yields across most sectors are generally stable with slight improvements in certain sub-sectors (retail warehousing, logistics and long-income), hence most investors are getting their required returns from rental growth. Again, not across all sectors, but with the development pipeline so constrained, rental growth is prevalent and helping to prop-up appraisals. Reversionary yields are back!
- **Retail buzz** — retail now looks attractive versus other asset classes, and we are starting to see this translate into more investment activity. Shopping centres and high streets in particular offer highly favourable yields. Buchanan Street in Glasgow is a good example where there are flurry of transactions completing, more than we have seen in the last 5 years.
- **French investors remain active** — having been particularly active in the office sector over the last 12 months, the French SCPIs remain acquisitive and are starting to turn their attention to other sectors (namely retail — parks and on the high street) where they can still find quality assets at yields of 7%+.
- **Long Income** — as the cost of debt is easing and gilt rates stabilise, long income (index-linked) stock is seeing renewed investor appetite. UK Funds are becoming more active in this space in addition to a range of overseas private capital. This improved weight of capital is helping to stiffen pricing.
- **Office to hotel conversion continues** — already prevalent in Edinburgh (and continuing) but now also being seen in Glasgow. The proposal by HFD to acquire 95 Bothwell Street for redevelopment as a high-end hotel (Hyatt) is a good example of how re-purposing of office buildings is helping to re-shape city centre cores.

Transaction volumes

- Q4 saw £406m traded up 6% on Q4 2023.
- Q4 volumes were 4% below the 5 year average.
- Whilst volumes in Q4 are slightly lower than average, a number of deals are due to complete in early Q1 2025, including a couple of significant transactions, which should provide a bounce to start 2025 positively.



Sale volumes



Pricing

- The improvement in prime pricing (across certain sectors) that we reported last quarter has been consolidated. Retail Parks, High Street and Long Income have seen some improvement. Worth noting that this improvement is quite stock specific and very focused on the better assets. A deeper buyer pool (with the welcome return of some UK Funds) and their lower cost of capital is helping the positive trend.
- Demand for Logistics and Multi-Let Industrials remains strong in terms of depth of the buyer pool. Prime yields at sub 6% have been established and several recent deals in Eurocentral are helping to consolidate this level. Again, quite specific in terms of quality of asset and with rental growth to come.
- Offices continue to cause the widest range of views on pricing. While prime Edinburgh may have found its level, outside of that, the buyer pool is shallow and investors active in this space are still looking for good value.
- Retail continues to see renewed interest. A range of buyers including UK Funds, the French SCPIs, Realty Income and various UK REITs is holding pricing firm. 6.5-7% for the better parks and sub 6% for the best supermarkets with rental indexation. The High Street is also interesting but only in the strongest city centre pitches where rents have been properly rebased. Initial yields in the low 6's with reversion to come is making sense.
- In the Living sector, appetite remains robust for up and built stock, with development funding more challenging. The on-going sale of Mayfield Residences (direct-let scheme) in Edinburgh at c5.5% (LGIM acquiring) in the face of strong bidding is a good benchmark for the sector. The sale of Solasta in Glasgow (a 324 bed BTR development) is ongoing which will set a good benchmark for this sector and should be reported next quarter.

Investor Activity

- In terms of overseas buyers, the French SCPIs continue to be one of the most active buyers, along with buyers from Israel and the GCC who are still focused on higher yielding stock (10%+) in Aberdeen. Scotland continues to be on the radar for new entrants and we expect this trend to continue with recent activity in the office, industrial and retail warehousing sectors. We have also seen Austrian and North American equity completing transactions.
- Within the UK - high profile corporate mergers & acquisitions is resulting in some of the REITs being net sellers of non-core assets, with the biggest (positive) change being the re-emergence of Fund acquisition activity. Property companies are starting to benefit from the improving debt landscape but the real effect of this has yet to be seen in completed deals.
- Private equity is becoming more active, with several large portfolio acquisitions (including assets in Scotland) recently completed, which is likely to lead to more asset sales of noncore assets or sales once value-add business plans are complete.

Key recent transactions.

Q4 saw some interesting themes and significant transactions which we have highlighted below:



Prime Four Business Park, Aberdeen

“Trio of prime out of town office buildings trade”

- Vendor: BMO
- Purchaser: EEH Ventures Limited
- Let to: CNOOC, Apache and Transocean Buildings
- Price/Yield: £45m/17.88%
- Date: December 2024



30 Coddington Crescent, Eurocentral

“Prime industrial snapped up”

- Vendor: Ahli United Bank
- Purchaser: AFH
- Let to: SiG Trading Limited
- Price/Yield: £9.4m/5.80%
- Date: December 2024



Maldron Hotel, Glasgow

“Long leased hotel snapped up”

- Vendor: abrdn
- Purchaser: Swiss Life
- Let to: Dalata Cardiff Limited
- Price/Yield: £31.5m/5.50%
- Date: November 2024



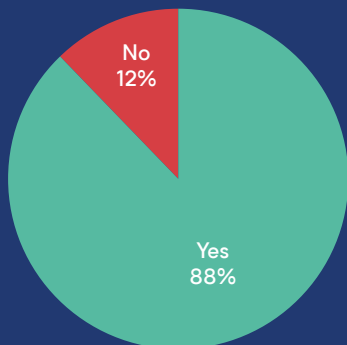
Barrhead Retail Park, Glasgow

“SCPI acquires new build food anchored retail park”

- Vendor: London and Scottish
- Purchaser: Iroko Zen
- Let to: Lidl, B&M, Burger King, Starbucks, Indigo Sun, etc.
- Price/Yield: £14.60m/7.00%
- Date: November 2024

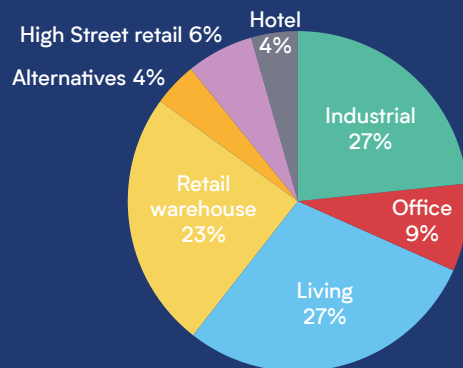
The Investor View on the year ahead...

1) Will 2025 be a year of opportunity?



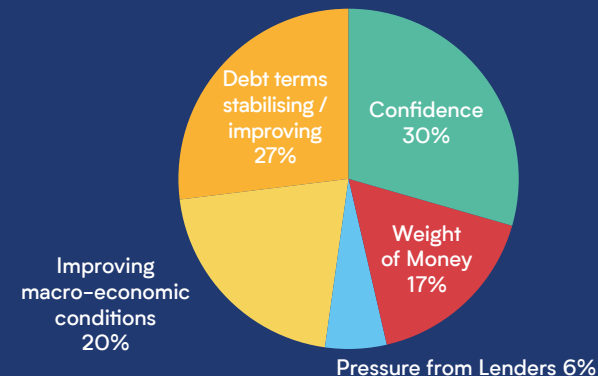
- A strong majority of respondents (88%) believe 2025 will be a year of opportunity, slightly down from 96% last year but still reflecting significant optimism. Among fund managers and investment managers, the sentiment was even stronger, with 100% and 91% respectively sharing a positive outlook.
- However, concerns were raised about the broader economic context. Measures introduced in the recent UK Budget are expected to have notable impacts, including reduced profit margins for retailers, restrained recruitment across industries, and tightened consumer spending. These factors are likely to affect the occupational market as businesses adjust their supply chain needs.
- While sentiment was slightly more positive earlier in the year, the announcement that the UK economy contracted in October by 0.1% (for the second month in a row) has tempered expectations. This disappointing figure suggests a slower momentum than initially anticipated.
- Nonetheless, prospects for 2025 remain cautiously optimistic. With cross sector pricing beginning to stabilise, the prospects for strong rental growth in certain sectors — particularly prime industrial, the very best high street retail and selective office markets — is expected to drive activity in the coming year, with any notable yield compression more likely towards the end of 2025, contingent on interest rates continuing to head towards 3.5% by early 2026, as currently forecast.

2) What will the top three performing sectors be in 2025?



- The Industrial, Living, and Retail Warehousing sectors are expected to dominate in 2025, with 77% of respondents identifying these as the top-performing categories. These preferences closely mirror the results from 12 months ago, highlighting the continued liquidity and resilience of the sectors.
- In contrast, the office and high street retail sectors garnered significantly less attention, accounting for just 8% and 6% of votes respectively. While the office sector did not rank highly overall, several respondents noted that prime office assets in major UK cities are likely to perform well, driven by occupational demand for best in class space and subsequent rental growth. High street retail, in the very best locations, is generating traction, particularly where there is strong rental growth off rebased rents.
- The sectors receiving the fewest votes were Alternatives (4%), and Hotels (4%). Within Alternatives, data centers and life sciences were specifically mentioned as areas of interest, reflecting the growing demand for assets tied to technology and healthcare advancements.
- These results underscore the continued focus on sectors offering attractive rental growth performance and liquidity.

3) What three factors do you see as creating a more liquid market in 2025?



- Confidence has been identified as the most significant factor influencing the market, with 30% of respondents selecting it as a key driver. This marks a significant rise from 21% in Q4 2023, highlighting a shift in sentiment among stakeholders. The increased focus on confidence suggests growing optimism, underpinned by a perception of greater stability or resilience in the sector as it navigates ongoing challenges.
- Following confidence, improving macro-economic conditions (21%) and the stabilisation or improvement of debt terms (27%) were highlighted as important factors. These results underscore the critical role that broader economic recovery and debt market trends play in shaping expectations for 2025. Anticipated interest rate cuts and market repricing may further bolster activity and create opportunities for growth.
- While weight of money and pressure from lenders received fewer votes, they were still noted by respondents, both in this survey and in Q4 2024. This suggests these factors remain secondary but relevant, particularly in shaping financing conditions and capital strategies.
- Overall, the findings point to cautious optimism for the UK commercial real estate market in 2025. Confidence, supported by improving macro-economic conditions and favourable debt trends, could drive increased activity and investment in the sector.

“Expert view” on 2025...



Tom Elviss

Fund Manager
Columbia Threadneedle

2025 — a year of opportunity?

Q3 2024 was arguably the start of the new cycle for the real estate sector in the UK with capital growth at a market level and an upturn in investor confidence. In September there was definitely a mood of increased optimism and the gap between vendors pricing aspiration and buyer narrowed with an uptick in transactional activity. We also saw UK inflation fall to a 3 year low in September and the Bank of England commenced a rate cutting cycle. However the dual impact of The new Labour Governments first budget and the US elections have slowed down market activity and it has been a quiet end to the year.

Going into 2025 there are a number of factors that should support the UK Real Estate market particularly the expectation of further cuts to the base rate and lower borrowing costs for real estate investors. With pricing having rebased from the highs of 2022 there is an expectation of capital growth and higher total returns from the sector. With the traditional UK Institutions less active in the market following the impact of the September 2022 mini budget, the major market participants are likely to be US domiciled private equity vehicles who have been particularly active in the Industrial and residential space and are likely to be buoyed by the new US Government.

There are therefore tailwinds for the Real Estate investment market that should support pricing and create opportunities. However the occupational markets face some significant headwinds from anaemic economic growth and government policies around national insurance and the minimum wage increasing the cost of labour. We have already seen a number of retailers putting their expansion plans on hold and we are closely monitoring our multi-let industrial holdings for greater frequencies of company failures or extended voids.

What sectors will be in favour in 2025?

We expect to see a further divergence in returns and investor appetite for those sectors benefitting from demographic and digital factors that will underpin performance in the industrial, retail warehouse and residential sectors and the more challenged office and in town retail sectors.

We continue to see constrained supply of high quality modern warehousing stock in a number of core markets in the UK which will continue to sustain low vacancy rates and drive rental growth. Deglobalisation and the impact of Covid and the war in Ukraine has highlighted supply chain fragilities and driven further tenant demand with occupiers such as Nike taking a UK warehouse footprint for the 1st time. The volume of capital targeted at the sector particularly from overseas will continue to drive investor demand and maintain or sharpen pricing. The sustainability credentials of industrial assets are likely to become increasingly important to both occupiers and investors as we move towards future sustainability targets and goals.

As a major investor in the sector over the last 5 years, we continue to see compelling fundamentals in the out-of-town retail market. With an effective vacancy rate excluding long term voids of c.2%, a minimus development pipeline and a retailer preference to trade from out-of-town units the sector has strong occupational support. We are also seeing more retailers utilising their retail warehouse units for omni channel retailing with the single unit allowing physical sales, click and collect and in some cases last mile distribution from the store. Despite the high-profile failures of Wilkos, Carpetright and Homebase in the last 12 months we are witnessing significant rental growth. Following the Carpetright CVA, Columbia Threadneedle Investments have re let units at an average rent c.15% above the previous ERV. There is an active pool of buyers in the sector driving pricing with Realty and British Land undertaking a high volume of transactions across the year and new entrants such as Redevco acquiring a £500m+ portfolio in December. With more rental growth forecast and high levels of demand we expect to see initial yields hardening in 2025.

Within the residential sector the demographic factors driving senior living are compelling as the number of over 65's is forecast to almost double from 11MM in 2016 to 20MM in 2046. The UK market is in a nascent stage with just 0.7% of over 65's living in senior housing compared to over 5% in the USA, Australia and New Zealand. The PBSA market is also set to benefit from a growing cohort of university aged domestic students over the next 5 years. Although we have seen over supply in some markets and pressure on the higher price point schemes as overseas number have waned, the cost of debt and tax changes in the buy to let market is likely to reduce supply of privately owned stock forcing students to look at purpose built stock.

What factors do you see as creating a more liquid market in 2025?

I think in Q3 we saw an uptick in investor demand and a more liquid market. In 2025 it will be the appetite of global players looking to deploy capital driving demand and pricing.

There was an expectation that there might be more motivated vendors needing to sell due to loan maturities and the increased cost of debt but this has not really materialised yet as it seems lenders are happy to extend loans rather than force a sale.

There are a number of UK pension funds looking to sell down and shrinking DB schemes will provide some stock but with such a polarisation of demand towards the winning sectors and vendors unwilling to sell their best holdings we may continue to see transaction levels consistent with the last 12-18 months.

How do you see the outlook for Operational Real Estate, will strong underlying dynamics continue to drive the sector?

I think there is increased interest within the investment markets to get access to operational real estate. In the last few years with elevated levels of inflation the ability to flex pricing on a regular basis helps to insulate against the impact on real returns when compared with a typical 5 year rent review pattern. The attractive income profile will continue to drive interest with return generally showing a premium to that of leased stock.

As leases continue to shorten we will see more real estate being operational in nature with a typical sub 5 year term certain making durable repeatable income streams as valuable as a long term lease.

“Our view” on 2025...



Simon Cusiter

Director
Lismore Real Estate Advisors

2025 — a year of opportunity?

2025 should see a more solid foundation becoming evident in the recovery phase of the market, with investors focusing on the locations and sectors of the market which can support income growth.

With interest rates set to reduce slower rather than faster, gilt yields having risen recently and, following the Budget, most commentators expecting inflation to run slightly hotter for longer, significant yield compression feels unlikely. Investors underwriting deals, at least for the first half of the year, will be more focused on the income component and opportunity for that to grow, rather than assuming much yield movement.

Although recovery looks like it may be slower than previously anticipated, we do anticipate this gathering momentum as 2025 progresses.

What sectors will be in favour in 2025?

Tied to the comments above, we believe the sectors in Scotland which offer opportunity are diverse, but the sub-markets are much more precise. Rents in Scotland in the logistics and multi-let industrial market are still well-discounted to elsewhere in the UK and, with low supply of quality stock, we see the potential for growth along the M8/M74 corridors and urban estates.

CBD Edinburgh offices we are also convinced in, with a clear focus on the absolute core city centre where the demand is, and the supply isn't. If more certainty comes through on rent control, then the residential BTR sector remains relatively untapped and offers huge potential not only for generation of robust income, but for the regeneration of our city centres such as has been seen in Leeds and Manchester especially. There have been some early signs of BTR liquidity returning with transactions in Glasgow recently which is encouraging.

We also like the opportunity that long-let, inflation-linked, leases provide if the location and tenant credit can support pricing. Some of these assets (hotels and leisure-led particularly) are trading much closer to VP values than they have for a long time which is an additional attraction for investors.

What factors do you see as creating a more liquid market in 2025?

At an economic level, business confidence needs to continue to improve. In terms of growth, the OBR and Bank of England have recently raised their forecast for GDP growth in 2025, up from 1.2% to 1.7%, which is encouraging. Consumer confidence was knocked immediately post-Budget in October but has begun to recover in November and December.

If these key economic signals continue to show improvement, all of which impact on occupier demand and confidence, this will flow through into investor confidence.

As mentioned previously, the market is stabilising. This, coupled with gradually reducing interest rates should enhance investor confidence and increase market depth further — property already offers good relative value based on current interest rates, bond yields and a (globally) highly valued stock market. However, given the anticipated lag on stronger economic progression there is potentially a longer window for sensibly valued deals, which will benefit investors with a longer time horizon.

Interestingly, the of lack of new development (where viability remains challenged through higher construction costs, finance appetite and uncertain exit pricing), has a positive impact on good quality existing assets which benefit from rental growth as a result.

Which buyer and seller pools are likely to be active during 2025?

2024 showed increasing market depth, especially during H2 with buy-side demand from the institutional market, prop co's, HNWI's and French SCPI's. Private Equity funds have been active on a corporate basis through M&A, particularly in the REIT space. Non-core asset sales and wholesale break up have led to trading activity and we expect this to continue into 2025.

Lack of meaningful new development has meant that best in class assets have been hard to come by which has led to core investors beginning to consider development fundings again in order to gain access to the best quality assets in growth-led sectors. With the level of cost uncertainty on development projects beginning to abate and yields in the prime segment of the market stabilising, we anticipate this trend continuing.

Overall, we see H1 2025 as “more of the same” in terms of buyer/seller dynamics, with an improvement in sentiment and more activity likely in H2 2025.

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