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THE ART OF THE DEAL – M&A FINDING VALUE IN A FLAT MARKET

The volume of activity in the direct real estate market may remain disappointingly weak, but corporate activity over the last 18 months tells a different story. London Metric's absorption of LXi REIT and Urban Logistics REIT, the merger of Tritax Big Box and UKCM, PHP's takeover of Assura, and the acquisition by New River of Capital & Regional all suggest that some of the best management teams out there see compelling value in the market. Of course, it can be argued that it is the wider equity market's suspicion of property valuations that has been the catalyst for these deals, rather than a newfound and broad appreciation of value in the sector. Many such deals have been completed at a discount to underlying asset values, meaning that the buyers only needed to believe current valuations to deliver an immediate paper return on their investment. Nonetheless, confidence in current valuations is one of the key foundation stones to a broader-based recovery. Rental values, which are supported by a greater depth of evidence, have been trending upwards across much of the market, so a growing belief that multiples are on firmer ground would allow for capital values to move confidently in the same direction.

What is most notable about these deals is the wide range of property assets involved. It is not merely a story of one or two hot sub-sectors, rather it is a reflection that we are at a stage of the cycle where asset values in general are lot more likely to be higher in three years' time than they are to be lower. Cyclical risk was high in 2021/22, with values predicated on low interest rates, which could only really go in one direction. Rates are now in what might be considered a "normal" range in a long-term context, and asset values have adjusted by around 20-25% to reflect the journey from A to B. Rates impact therefore has been significantly reduced as a go-forward risk, even if we see little further base rate movement from here. The greater risk now relates to the impact of structural change, a risk that can be mitigated by careful stock selection and decisive asset management, which those acquisitive management teams will be confident they can deliver.

COMMERCIAL PROPERTY RETURNS

According to MSCI, average commercial property values edged up by 0.1% again in July, taking the cumulative recovery to 2.9% since last Spring. However, the rate of growth has slowed to a crawl, from a quarterly rate of 1.5% at the end of last year to just 0.3% over the last 3 months. Values on average are still almost 23% below their June '22 peak.

Capital growth remains strongest in the Industrial sector, although the quarterly growth rate has also slowed significantly, from 2.8% in Q4 to 0.8% over the last 3 months. The trend growth rate has slowed most for distribution (0.4% over 3 months) compared to standard Industrial (0.9%). Both sub-sectors continue to report robust rates of rental growth.

The office sector remains notable for the wide spread of returns even across neighbouring sub-regional locations. For example, West End values are up by 2.9% this year, whilst in the City they are marginally down (-0.1%), and in Outer London they have fallen a further 4%. In Scotland, values are up 1.3% this year but remain 40% below June '22 levels.

Capital Growth to July 2025 (%)

%	1 Month	3 Months	12 Months	From cyclical low
All Property	0.1	0.3	2.7	**2.9**
Retail	0.0	0.1	3.1	**4.3**
C London Offices	0.1	1.5	1.5	**2.1**
Regional Offices	-0.3	-1.4	-3.5	**0.0**
Industrial	0.2	0.8	5.3	**7.8**

Source: MSCI Monthly Index

Most retail formats are recording moderate levels of capital growth. Retail Parks were leading the way, with year-on-year growth of more than 6% earlier this year but have run out of steam in recent months. Value recovery for retail units and supermarkets has been slower to arrive, but recent signs are slightly more promising, with quarterly capital growth of 0.7%.

INVESTMENT MARKET ACTIVITY

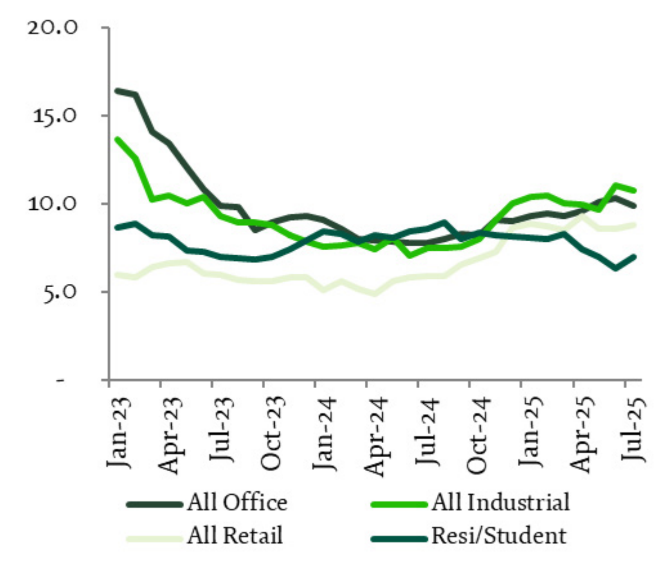
Preliminary data from Real Capital Analytics indicate that £2.4bn of transactions completed in July. This is a disappointing figure after a relatively string June, even if July is often a relatively quiet month. The YTD total of £22.6bn is around 10% lower than the same period last year, and barely half the total from the same period in 2022.

The beds sectors dominated the largest deals in July, most notably the acquisition by QuadReal of a PBSA portfolio from Apollo for £500m. The portfolio, comprising 3,450 beds across 8 assets, was previously reported by React News to be under offer at £560m in May. Elsewhere, Goldman Sachs and Generation Estates acquired a 435 bed PBSA block in Southampton from Vita Student Housing for £86m.

Single-family (rental houses) has been taking an increasingly large share of Build-to-Rent investment this year. This trend is exemplified by a £100m commitment from the JV between Kennedy Wilson and CPPIB to acquire 275 new homes in Milton Keynes, Derby and Cheltenham.

One of the most iconic office buildings in the country has traded for only the second time in its history as the Royal Liver Building in Liverpool was sold for £57m. The building, which was put up for sale in March 2022 for £90m, was acquired by Princes Foods, one of the occupiers.

Investment Market Trends (12m rolling, £bn)



Source: Real Capital Analytics

Supermarket Income REIT continued to target the largest format stores, acquiring a 93,000 sq ft Tesco in Ashford for £54m. The 7% initial yield reflects a relatively short 9-year unexpired term. Elsewhere, US REIT WP Carey acquired two mid-sized Morrisons in the East Midlands for £51m.

MARKET YIELDS

The benchmark ten-year Gilt yield has gone through a period of volatility in recent months as economic data has painted a picture of tepid growth and sticky inflation. At almost 4.75% at the time of writing, the widely referenced risk-free rate is circa 80bp higher than it was this time last year.

JLL only made one change to their benchmark yields in the last month, with the prime benchmark for Solus Retail Warehouses brought in by 25bp to 6.0%. One example of a retail warehouse trading even keener than that was the sale by Tritax Big Box of a B&Q in Romford to CBRE IM for £33m, representing a net initial yield of 5.5%.

With the supermarket benchmark remaining at 5.25%, the differential between a prime supermarket and a prime retail warehouse is now just 75bp. Given that the former benchmark reflects a longer index-linked lease, that premium looks narrow, perhaps reflecting the high levels of stock being brought to market by Asda and Morrisons.

Benchmark prime yields (%)

%	July 25	-3m	-12m
High Street Shop	6.50	6.75	7.00
Retail Park	5.50	5.50	5.50
Regional City Office	6.75	6.75	6.50
Regional Multi-let Ind	5.25	5.25	5.25
Regional Cities BTR	4.50+	4.50+	4.50-
Regional Student (Direct)	5.50	5.50	5.25

Source: JLL

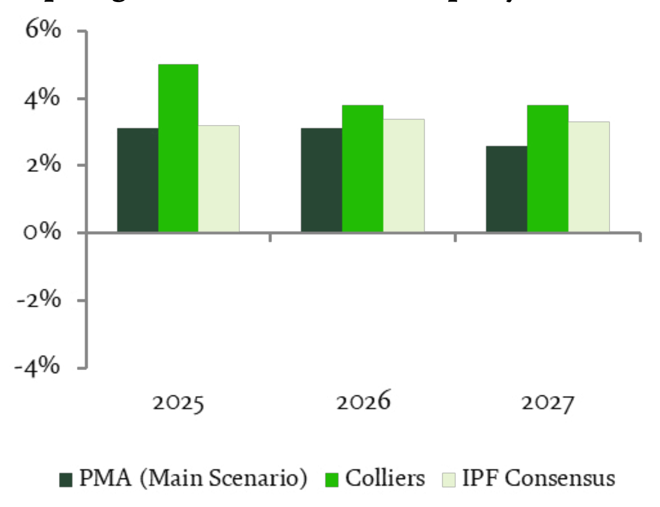
The cut to base rate in August was widely predicted, but the narrow split in the vote has cast some doubt on the extent of further reductions. The five-year swap rate was little changed on the month, at 4.2% at the time of writing. The forward curve implies a terminal rate of 4.5% or 4.75%, with the next (and perhaps final) cut expected around the end of the year.

AUCTIONS

A notable feature of Allsop's commercial auctions this year has been the significance of post auction sales. The July auction illustrates this trend, with moderate sales proceeds by the end of the auction boosted 25% by post auction sales. The May and June auctions saw similar levels post auction, perhaps reflecting the difficulty of setting guide prices in a thin market.

Allsop's noted the wide range in initial yields in Retail lots, reflecting the extreme differences in reversionary potential. Stronger high street locations are starting to see meaningful reversion, whilst in contrast, weaker assets at the tail end of long leases are still exposed to significant over-rentedness.

Capital growth forecasts (All Property, %)



Source: PMA Jun '25, Colliers Q2 '25, IPF Consensus Forecasts (Spring '25)

MARKET FORECASTS

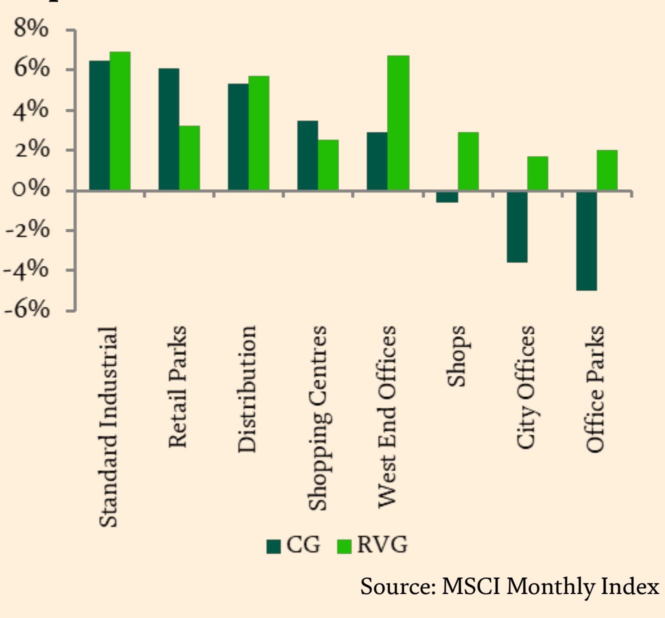
Property agency Colliers released their latest forecast outlook in June, slightly upgrading their previous predictions. They anticipate 5% capital growth this calendar year, implying a significant acceleration on the 1% recorded over the first seven months. Their 5-year outlook is for a very healthy 3.4% per annum, which they expect to be supported by 2.7% p.a. rental growth.

Colliers predict that the Industrial sector will continue to outperform, with robust capital growth of 5.8% this year contributing to 3.8% per annum over a five-year horizon. Their forecast does not rely on material yield compression, with value appreciation expected to be fully underwritten by rental value growth.

Colliers do see some potential for yield compression in the office sector, with equivalent yields expected to come in by 60bp. Supported by moderate rental growth of 2.2% per annum, they anticipate capital growth of 3.1% p.a. through to 2029. They note however, that rental growth will be driven by prime assets, with little if any growth for secondary/tertiary assets.

The Retail sector is forecast to deliver slightly weaker capital growth (2.8% p.a.), but this is expected to be almost entirely underwritten by rental growth, which would mark a material improvement from the last decade. Notably, Retail is predicted to outperform on a total return basis, at 8.8% p.a. through to 2029.

Capital and Rental Growth since March '24



Source: MSCI Monthly Index

LOOKING FORWARD

It is hard to deny that 2025 has been disappointing so far from an investment market perspective, with underlying trends no better than in 2023 or 2024. The optimism that many felt towards the end of last year was quickly undermined by the tariffs saga, which seems no closer to resolution today than it was on March 1st when President Trump declared that "Trade wars are good and easy to win".

Domestically, inflation has proven to be stickier than many had hoped, ticking up again in July to further reduce expectations for rate cuts. Yet paradoxically this may prove to be the catalyst for the market to finally emerge from its slumber and return to the kind of investment levels we would expect to see as part of a broad-based cyclical recovery.

Many seem to have been waiting for the best part of three years for some sort of sign. Waiting for elections, waiting for budgets, most of all waiting for lower interest rates. However, markets are now implying that we are close to the bottom of the interest rate cycle, with only one or two further quarter point cuts expected. The benchmark five-year SONIA swap rate is 3.8% at the time of writing, not far below the current base rate, but also not far above the lower end of a range it's occupied since late-2022. At these rates, moderate leverage can be accretive again, and competition amongst lenders means that debt availability is likely to be a tailwind rather than a constraint for the next phase of the cycle. Occupiers are also doing their bit, despite the flat economy, with healthy levels of take-up squeezing availability and encouraging rental values upwards across a large cross-section of the market. Conditions then seem set fair for a recovery. The last missing ingredient is the re-emergence of the "animal spirits" identified by John Maynard Keynes – In his words "a spontaneous urge to action rather than inaction" that will finally spark the market back to life.

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IMPORTANT INFORMATION