OakNorth's Sector Pulse

REAL ESTATE

OakNorth

Industry overview

In this month's sector pulse, we're providing an overview of several sub-sectors of real estate, including purpose-built student accommodation (PBSA), offices, build-to-rent, and retail. We look at some of the key trends from the last six months, as well as what we expect to see in the next six months.

Purpose-built student accommodation (PBSA)

PBSA I The last six months

Enrollment

The latest UCAS data shows a decline in enrolments for UK undergraduate courses in 2024/25, with 656,760 total applications, down 1.6% compared to the 2023/24 academic year, but up 2.9% compared to the 2019/20 academic year.

-1.6%
Total applications for UK undergraduate courses down compared to 2023/2024

A stable investment

PBSA continues to be considered a stable investment due to barriers to entry and its transparent, defensive nature. While high interest rates have cooled some activity over the last six months, investor sentiment remains positive, with £1.7bn invested in the sector in the first half of 2024.

£1.7bn
invested in the sector in the first half of 2024

Wage inflation

Although utility costs stabilised over the last six months, wage inflation continues to be an issue, which is limiting profit margin growth in the short term.

Stable demand for student beds

Development slowed over the last six months due to rising costs, labour shortages, and complex planning policies. Major cities such as London, Manchester, Bristol, and Nottingham, however, have significant student bed pipelines.

PBSA I Outlook for the next six months

Demand

Despite lower undergraduate applications, the outlook for demand for PBSA over the next six months remains robust, with demand continuing to exceed supply.

Multiple Dwellings Relief effect

The abolition of Multiple Dwellings Relief (MDR) in June may lead to a 4% increase in stamp duty for some properties, which could affect property pricing and transactions going forward.

4%
increase in stamp duty from MDR

Investment push towards newer buildings

Many PBSA buildings, especially those built before 2015, require upgrades to comply with newer safety standards – for example, adding extra staircases for buildings over 18 meters. This, coupled with a need to meet higher energy efficiency standards, will push investment towards newer buildings going forward.

Deal spotlight

OMNI Developments

In August, we completed a transaction for a major new PBSA development next to the University of Nottingham. The loan is to an SPV managed by OMNI Developments, an experienced developer that specialises in student accommodation and high-end residential development. The capital will be used to develop a new six-storey, 222-bedroom PBSA situated opposite the University of Nottingham's Jubilee Campus. Nottingham is home to over 63,000 students, with attendance having grown by 22% since 2015-16 and international undergraduates having increased by 34%, heightening the need for more PBSAs in the area.

Residential real estate

RESIDENTIAL REAL ESTATE I The last six months

Ongoing economic challenges

The UK residential market has shown resilience despite ongoing challenges, including higher interest rates and the cost-of-living crisis over the last two years. Dwindling supply in the Private Rented Sector (PRS) and strong rental growth have boosted the Build-to-Rent (BTR) sector, which has been the best-performing real estate subsector in terms of investments and valuations so far this year.

Mortgage rates

The sharp increase in mortgage rates in late 2022 and 2023 created significant uncertainty in the sales market, leading to a 19% year-over-year (YoY) decline in transactions and a 23% drop in new purchase mortgage approvals in 2023. However, several factors have supported prices over the last six months: strong income growth, resilience among cash buyers and first-time buyers, limited stressed sales due to stringent stress testing at mortgage origination, and staggered fixed deal maturities that avoided widespread household budget pressures.

19%

Y-o-y decline in mortgage transactions

Improving sentiment

The first half of 2024 saw an improvement in market conditions, with sentiment improving due to expectations of declining mortgage rates. While market activity has improved significantly compared to 2023, it has remained below pre-pandemic levels.

Burgeoning BTR

Over 11,000 new BTR homes were completed in the first half of 2024 alone, and with continued momentum, this year could mark a record-breaking period for BTR deliveries. BTR homes now represent a growing share of overall housing delivery, climbing from less than 1% of net additional dwellings a decade ago to 9% today (based on EPC data).

11,000

new BTR homes completed in 1H of 2024

Increased investment

Over the last six months, the BTR sector continued to be the most desired sector for investors, driven by strong rental growth and demand outlook. Total investment in the first half of 2024 climbed to over £2.6bn, surpassing the previous high of £2.3bn recorded in H1 2021.

£2.6bn

total investment in BTR in 1H of 2024

RESIDENTIAL REAL ESTATE | Outlook for the next six months

Budget expectations

The Government has promised multiple reforms to address bottlenecks in housing, including speeding up the planning process, new planned towns, and development in the grey belt and on brownfield sites – details are expected to be announced in the Budget on 30 October.

Price stability

While mortgage rates have been declining, they remain significantly higher than pre-pandemic levels and are likely to stay above those levels in the medium term, keeping affordability constrained.

Moderate growth

House prices are expected to register low to mid-single-digit growth in the near term, with, price performance being primarily driven by the pace of rate cuts by the Bank of England.

Deal spotlight

VABEL

Homes built with character

In July, we completed two transactions with London-based developer, Vabel. The first was for £48.3m to develop a major new mixed-use scheme at 28-34 Queensway in West London. In addition to 27 new homes, the development will offer a 24-hour concierge, fully landscaped residents communal gardens with outdoor seating and water features, as well as 251 sqm of retail at ground level. The second was a £30.8m co-loan with ASK Partners to acquire 114-150 Queensway and 97-113 Inverness Terrace.

Co-living

CO-LIVING | The last six months

Strong demand

With co-living rents being on average 10%-20% lower than other private rented sector (PRS) accommodations, demand for co-living remained strong over the last six months

10-20%

Co-living rents lower than other PRS accommodations but demand remained strong

Demand exceeds supply

This demand is exasperated by limited supply – there are currently approximately 30,000 co-living beds in the UK, of which half are in London, but a target market of over 725,000 people.

30,000

total co-living beds but a demand for 720,000

Repurposing resurgence

Just like the rest of real estate, co-living development faces significant challenges including high construction costs, long planning processes, and stricter energy and fire safety regulations. Converting existing office buildings and hotels is emerging as a viable solution to overcome these challenges, and one that is less suited for other more traditional PRS accommodations which are less able to offer hybrid models of long and short stays.

CO-LIVING | Outlook for the next six months

Investor interest

Over the next six months, investor interest is likely to focus on sites with planning potential for co-living, where funds for the initial development can transition into long-term investments.

An attractive alternative

Easing inflation and lower interest rates will likely boost investment activity over the next six months, as high capital costs have been the primary obstacle to deals. Strong rental performance, quick lease-ups, and growing cash flows in urban areas like London will continue to make co-living an attractive option for investors.

CRE - Office, industrial, retail

CRE I The last six months

Lower-sized investment deals

When it comes to offices, investment volumes have remained weak over the last six months due to ongoing structural changes and challenging economic conditions. Deals are mainly concentrated in the lower size spectrum, with 87% of deals completed under £20m in the first half of 2024 compared to the 5-year annual average of 71%.

87%
of deals completed under £20m in the first half of 2024

Flexibility is key

High-specification buildings in well-connected locations continued to attract strong demand however, as occupiers seek to bring employees back into the office. The demand for life sciences has also been robust, with strong take-up in Oxford and Cambridge. The Flex office market also continued to see strong interest over the last six months, with Serviced/Flex office providers accounting for 10% of total office space take-up in H1. Occupiers are willing to pay a premium for high-spec, amenity-rich, and well-connected space, with key demand factors including: short-term flexibility to increase productivity, short-form leases rather than a license agreement, customization, and security (both physical and IT).

Retail in recovery

When it comes to retail, we have seen certain sub-sectors perform well over the last six months, especially retail parks where strong take-up has reduced vacancy to a decade low. Prime shopping centers and key high streets in central London have also been in recovery mode after several challenging years.

CRE I Outlook for the next six months

Refinancing driving debt

Credit conditions are improving, indicating a positive shift in CRE debt availability in the near future. We anticipate that refinancing will be the primary driver of increased CRE debt in the short term, rather than new investments. As the rate cut cycle progresses, we expect this to gradually support more transaction activity toward the end of 2024 and into 2025.

Anticipated declines in interest rates

Investments in the industrial sector have fallen significantly from their record highs in 2021, but recovery in the occupier market during the first half of 2024, combined with the start of the Bank of England's rate cut cycle, suggests that sentiment will improve over the next six months. Anticipated declines in interest rates are also expected to gradually increase transaction volumes, rising prices, and tightening yields.

Repurposing

A major concern for the office sector is the surplus of secondhand supply due to significant negative net absorption over the last four years. However, with the expected decline in interest rates over the next few years, coupled with lower construction costs inflation, repurposing activity is expected to pick up in the future. Recent relaxations in conversion under Permitted Development Rights (PDR) rules are also expected to accelerate this.

More yield compression

The investment market for retail remained subdued over the last six months, but signs of revival are beginning to emerge. Growing expectations of interest rate cuts, improving occupational dynamics, and anticipated price increases have encouraged many owners to retain their assets. This has led to less available stock, which intensified competitive bidding over the last six months, and means we are likely to see more yield compression in the months ahead.

Deal spotlight

Bedford Park

£6m loan to fund development

In August, we provided a £6m loan to Gatehouse Hub Ltd to fund the development of 19 industrial logistics units spread over 43,487 sq.ft., and a wellness centre comprising of 6,458 sq.ft. on the outskirts of Burgess Hill in West Sussex. The project is being led by Bedford Park Developments which has experience in all aspects of planning, land promotion and development.

mamas &papas

Provided bespoke funding package

In August, we provided a bespoke funding package to the UK's leading premium nursery brand, Mamas & Papas, to support its continued growth. Founded in 1981 and headquartered in Huddersfield, West Yorkshire, Mamas & Papas is a designer, wholesaler, and retailer of nursery and baby products including travel systems, nursery furniture and children's clothing..

CAÏSSA | HOLDINGS

£1.3m loan to support acquisition

In April, we completed a £1.3m loan to Caissa Holdings, a private property investment and development group, to support the acquisition of a five-storey retail property in central Glasgow. Located on Sauchiehall Street, the building is currently let to Waterstones and Flying Tiger and houses Scotland's largest bookstore, which also contains event space, and two cafes located in the basement and second floors respectively.