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Bank of London & The Middle East

Strong Foundations

Why Gulf investment in UK property is about to ramp up

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Foreword

The past twelve months have been some of the most challenging for the UK real estate market. Political uncertainty, high interest rates and high inflation have taken a toll on investor appetite, especially among high net worth international investors who have access to opportunities around the world. But our most recent research suggests we are now heading towards a period of growth and opportunity, particularly for Gulf Corporation Council (GCC) investors.

Based on research conducted for this paper, we now expect that Gulf investment in UK real estate could reach £2.5 billion in 2024. Leading voices in the sector support the view that activity is about to ramp up again - when we asked partners of BLME if they expect to see an increase in GCC investment in the UK real estate sector over the next 12 months, 43% said yes, 36% said they are unsure, and only 21% said no. This growth could create exciting opportunities and provide a cash injection for many UK regions.

This report explores the reasons behind this predicted increase, including:

1. The strength of the Gulf economies and the need for diversification. Gulf Cooperation Council (GCC) economies have grown rapidly over the last 18 months – the UAE's, for example, grew by twice as much in 2022 as it did in 2021, and is aiming to double in size by 2031.[1]

   Individuals from the Gulf have capital to deploy, and they are particularly attuned to the benefits of geographically diversifying their investments. 36% of the average Middle Eastern Ultra High Net Worth Individual's (UHNWI's) property portfolio is held overseas – for those from every other region in the globe, the proportion is lower.[2]

2. The favoured asset classes of GCC investors and the reasons behind these preferences. GCC investor appetite is particularly strong for Purpose Built Student Accommodation, given the social ties which investors often have with the UK's leading universities. Investors are also likely to increasingly invest in warehouses and logistics assets, which experienced a COVID boom, and prime office space, particularly with strong ESG credentials, is bouncing back as businesses solidify their future office needs.

3. The appetite for regional assets. GCC investors will always be interested in London assets, but are increasingly looking at regional options where there are opportunities for higher yields. The growing number of sports clubs which are owned by GCC countries, and the recent partnership between LIV Golf and the PGA Tour is leading to an increased familiarity with the UK's big six cities and beyond.

These key factors combined mean that for GCC investors, the UK remains an attractive prospect, despite geopolitical and economic uncertainties. This will likely ensure that GCC appetite for UK real estate continues to boom over the coming years.

Andy Thomson, Head of Real Estate

[1] UAE's GDP grew 7.6% in 2022, econ minister says | Reuters
[2] Knight Frank, The Wealth Report, 2023

Right price, right time: What's the impact of the wider economic picture?

Falling UK property prices, favourable exchange rates, and fast growth in the GCC are creating opportunities for the UK's real estate market to attract Gulf investment.

Across the globe, interest rates remain high. This puts downward pressure on values, including for assets located in the UK. Between May 2022 and May 2023, house prices in the UK fell at their fastest annual rate for 14 years.[3]

The value of the country's commercial properties, meanwhile, fell dramatically in the second half of last year, down by 18% on average.[4]

> "Pricing has moved, there's absolutely no question about that. If you compare to 12, or even nine months ago, there's clearly been a drop in price across the board. However, whether we have hit the bottom or not is still a question in investors' minds."
>
> Raney Aburdene, Investor Relations & Business Development, Capital Trust Limited

This decline in property values creates opportunities for Gulf buyers to capitalise, before prices start to go back up. Opportunistic GCC nationals will consider entering the market now, while valuations are low, and will potentially look to refinance when interest rates start falling, with greater affordability the key factor affecting appetite for UK real estate right now.

What are the key factors affecting appetite for UK real estate right now?

57%	Greater affordability (exchange rate/ fall in prices)
50%	UK legal system
42%	Accessibility to the UK

> "There is an expectation that in the second half of this year, there will be more investment activity, provided a greater confidence around peak interest rates. The key factors affecting appetite for UK real estate right now include price correction and the availability of finance."
>
> Hassan Farran, Head of Middle East Capital Markets, Cushman Wakefield

[3] Nationwide, House Price Index, 2023
[4] The Telegraph, How the great home working experiment fell apart, 2023

This greater affordability is boosted by the rapid and continuing growth of Gulf economies, which puts many local citizens in a strong position to purchase real estate. The UAE's economy, for instance, grew by 7.6% in 2022, partly due to a dramatic rise in the price of its largest export - oil - following Russia's invasion of Ukraine.[5]

The OPEC+ alliance of oil producing countries, which includes three Gulf nations, recently said it would reduce oil output to prop up the commodity's value. This will likely cause oil prices to rise again, putting Gulf nationals in an even stronger position to invest capital.

> "There is surplus capital once again in the GCC, allowing diversification through international investment … I expect GCC investors to see this as a window of opportunity, particularly those with greater cash resources who will be able to transact with less competition."
>
> Nick Green, Partner, Trowers & Hamlins

And when they're looking at where to invest this capital, it's likely that they will look at opportunities outside of the GCC. As GCC countries have regularly experienced political and economic uncertainty, investors have a particularly strong appetite for ensuring their portfolio is geographically diverse.

41% of Middle Eastern UHNWIs' residential property assets are located outside their country of residence – higher than UHNWIs from any other region. And when they purchase a new home, the UK is a favoured destination.[6]

> "When Gulf investors choose the UK, their decision is being driven by diversification - it's not always about having the highest yield. They want access to a different currency and a different market, as GCC nationals and family offices want overseas exposure."
>
> Henry Faun, Partner, Private Office Middle East, Knight Frank

Over a third of the experts we spoke to noted that, because of high global interest rates, some Gulf nationals are currently choosing local savings accounts instead of international investments. However, high savings rates look likely to be short term, and investors wanting longer term returns will continue to look for the right real estate opportunities. When they do so, our survey found that Gulf nationals are predominantly opting for either a mixed investment approach or for finished and tenanted schemes – looking for different opportunities to generate wealth.

Are Gulf nationals investing in Britain more inclined to purchase finished and tenanted schemes providing long-term, stable income; or asset management opportunities to secure a potential greater risk return?

42%	A mixed investment approach
42%	Finished and tenanted schemes that provide long term stable income
14%	Asset management opportunities to secure a potential greater risk return

[5] UAE's GDP grew 7.6% in 2022, econ minister says | Reuters
[6] Knight Frank, The Wealth Report, 2023

Different class: Which asset types attract Gulf investors?

According to our GCC experts, the asset type which will see the biggest investment growth in 2023 will be Purpose Built Student Accommodation. Investors from the Gulf region have a particular affinity with UK-based student accommodation. The UK is known for its prestigious universities, and many GCC investors attended them or have children who are currently studying there. This was a trend identified in our previous report, Built to Last, which continues to have a strong influence on GCC investor decisions.

Which asset types will see the biggest investment growth in 2023?

- 57% Purpose Built Student Accommodation (PBSA)
- 35% Offices
- 35% Warehouse/ Logistics

Recent data showed that the number of students at British universities from the Gulf region is growing. In 2022, both Saudi Arabia and the UAE made the list of the top ten countries outside the EU for students coming to study in the UK: 8,750 students came from Saudi Arabia and 8,085 came from the UAE.[7]

With the proportion of school-leavers who choose university increasing every year for the last decade in the UK, it's likely that there will be even more PBSA investment opportunities in the future. Over 679,970 international students are already studying in the UK, an increase of 12.3% on last year's figure. If an investor's children are studying in the UK, this creates a strong social tie.

These social ties are one reason behind this growing interest in PBSA. But, there are also commercial reasons why GCC investors view it as especially promising. Firstly, PBSA is an asset class with high occupancy rates, which have recovered strongly following a pandemic-induced drop when universities moved lectures and seminars online. PBSA occupancy rates averaged 98% in 2022 in the UK, up from 90% in the previous year.[8]

Student accommodation also has low rates of tenant failure, particularly important at a time of high energy prices – which have caused widespread tenant failure in more energy-intensive asset classes such as hospitality.

[7] International Student Statistics in UK 2023 - Study in UK (studying-in-uk.org)
[8] Student Travel Network, Student accommodation rents increase as PBSA sector posts strong 2022, 2023

This sector is likely to become more popular, particularly if the Kingdom of Bahrain's Sovereign Wealth Fund opts to push forward with its plans to invest in student accommodation in the UK, via a partnership with Investec.[9]

> GCC investors like PBSA and Multi-Let Industrial assets because they are viewed as a safer option from a tenant security and occupancy perspective, with the income secured to many different tenants. In challenging economic periods, the occupancy will drop, but you're never going to have zero occupancy, and it's likely to average in the 90s on good quality assets."
>
> Michael Ferris, Director and Head of Investment, JR Capital

However, Gulf investor interest in UK real estate is certainly not limited to the student accommodation market.

How changing shopping and working habits shape Gulf investor demand

Our previous report, Built to Last, found that the popularity of sectors which grew rapidly during COVID-19 lockdowns, including industrial assets like warehouses, continued to endure post pandemic. These are still strong asset classes today, owing to changing shopping habits: As of June 2023, almost 12% of UK grocery spending is online, more than double pre-COVID rates, when it accounted for just 8%[10]. This shift makes the property assets which online shopping depends on, including logistical assets such as warehouses, more attractive to investors.

> "Industrial assets like warehouses are seen as very resilient, because during the pandemic they continued to grow and function as usual - you generally can't work from home if you work in an industrial warehouse. That area has grown significantly – it's seen as one of the safer asset classes in real estate, and continues to attract a lot of attention now."
>
> Raney Aburdene, Investor Relations & Business Development, Capital Trust Limited

This view is also supported by **Khaled Alanani, Senior Director, GFH UK** who comments: *"The sectors with the strongest long-term fundamentals and structural demand drivers are the logistics and living sectors. Logistics in particular will continue to benefit from the rise of e-commerce and manufacturing demand, which should lead to continued rental growth."*

Turning to the office sector, many investors adopted a wait and see approach in the post-pandemic period, unsure of the long term impact of new ways of working. While there have been some changes to the way we work, there are signs that more employees are returning to the office.

The number of UK tech jobs advertised as fully remote fell from 39% in April 2022 to 27% in March 2023. Tech job adverts offering hybrid working, on the other hand, increased by nearly 10%[11] in the same period. This shift highlights the opportunity for Gulf investors to capitalise on the changing working habits that continue to shape Britain's office market.

With a shift to more hybrid working, employers may look to downsize their office space, but maintain a high quality work environment to encourage employees into the office.

[9] Bahraini wealth fund mulls UK student housing venture with Investcorp | News | Real Assets (ipe.com)
[10] Kantar, 'Massive shift' in food shopping habits as prices soar, 2023
[11] The Telegraph, How the great home working experiment fell apart, 2023

Sophisticated investors will seek out smaller prime offices, with modern technology and stronger sustainability credentials, as these command higher rents and are more likely to align with what employers are looking for. given BLME's extensive on-the-ground presence in the Gulf region, the Bank is in a uniquely strong position to identify and support these investors.

> "Many businesses post COVID are saying we don't need a bigger space. Previously, if you had 10,000 staff, you had 10,000 seats. Businesses are now thinking they can make it work with five and then have people rotating or coming in three days a week. So they're downsizing into very high spec offices, with great facilities, often in cooler locations outside London."
>
> Henry Faun, Partner, Private Office Middle East, Knight Frank

Environmental performance – a new indicator of quality

An emerging concern when determining the quality of assets is their ability to comply with recent environmental legislation. As **Alastair Glover, Partner, Trowers & Hamlins** comments: *"Of the three ESG factors, environmental is definitely the most important for GCC investors. Although it's not quite as important as it is for UK / US investors, it's becoming an increasing concern in the GCC."*

International investors will need to pay close attention to the regulations in the UK. UK environmental regulations known as Energy Performance Certificates (EPC) recently became more stringent. In April 2023, it became an offence to continue to let or rent out a property if it does not have a rating of at least E – and a Government white paper has suggested that this could be made even stricter by 2030.

> "Lenders may not be able to finance a building with an EPC rating of lower than B by 2030, so it affects how much you can borrow. And consequently, lenders' appetite for buildings with a poor EPC rating is declining – they are not prepared to lend against buildings which cannot be refinanced in seven years' time. Therefore, assets must have a suitable environmental rating today."
>
> Scott McKinnon, Property Finance Director, Mutual Finance

Where a building does not meet the required standards, there is a commercial opportunity for investors whose advisers have the right expertise. If values decrease for assets which do not meet the EPC requirements, there's an opportunity to buy, invest and create value.

How significant a consideration are the changes to Energy Performance Certificate (EPC) ratings for your clients' investment and property management decisions?

57% Very significant

35% Significant

7% Neither significant nor insignificant

City centred: Do Gulf investors look beyond London?

GCC investor appetite for cities outside London is strong, but investors continue to look to London for properties where they are the end user, or for trophy assets. When asked which locations in the UK Gulf nationals prefer to invest in, the most common answer provided by our panel of GCC investment experts was London, followed by Manchester in second place, then Birmingham in third. But what is it about Britain's capital that GCC investors are drawn to?

When investing in the UK, do your clients have preferred locations to invest in? (Respondents could select up to three options)

57.1% Manchester

28.6% Birmingham

28.6% Bristol

7.1% Glasgow

0% Liverpool

28.6% Other 3 respondents said Edinburgh and 1 said The South]

> "There are two distinct investor types: those who seek income and those seeking wealth preservation and long-term growth. London remains attractive to the more long-term capital, whereas the gateway cities appeal to syndication platforms and income driven investors."
>
> Naseer Aka, Managing Partner at Lanesbrook Real Estate Ltd

Historically, the popularity of the London market has meant that it offers lower yields, but greater stability, suited to investors focused on long-term growth. Now, house prices are falling faster in London and the South-East than the rest of the country[12], and between June 2022 and June 2023, the value of houses in Britain's capital fell year-on-year for the first time since 2012[13].

With residential valuations in London dropping at a particularly fast rate, the city now offers more promising long-term income growth opportunities for investors. In order to capitalise, though, they need advisors with the on-the-ground presence and expertise required to spot the discounted opportunities.

> "In London and the South East, you cannot achieve the cash-on-cash returns that some investors look for. So the families that are purchasing there are mainly buying for wealth preservation or development."
>
> Tareq Hisham Hawasli, Co-Founder, Darin Partners

Gulf investors' location preferences, however, are not shaped by commercial factors alone. London, for example, also has the advantage of familiarity with GCC investors, who are particularly fond of the city's walkability and temperate climate, in comparison with Gulf countries, where average temperatures are high, and cars are the default mode of transport.

> "London is still the preferred location among GCC investors. GCC citizens are frequent visitors to the UK capital and are therefore familiar with the city. Manchester is also a popular choice and its familiarity has increased due to Manchester City's Abu Dhabi-linked ownership. Newcastle is also starting to garner more attention due to the Saudi PIF acquisition of Newcastle United."
>
> Raney Aburdene, Investor Relations & Business Development, Capital Trust Limited

GCC investors continue to look at opportunities on a case-by-case basis based on the individual merit of the asset, rather than specific locations. For example, BLME's investment in the NCA's office in Warrington: Warrington is not a typically strong office investment location, but the strong tenant and length of lease made it an attractive proposition.

> "Generally, Gulf investors are often opportunity-led, rather than location-led, so they will look at anything with a solid location and a compelling business case – which could be found anywhere in the UK."
>
> Nick Green, Partner, Trowers & Hamlins

Rather than investing only in specific locations, Gulf investor preferences are shaped by the affinity they feel for British cultural assets like the Premier League. In April 2023, for example, Manchester City Football Club – owned by UAE Deputy Prime Minister Sheikh Mansour - submitted a planning application for a £300 million expansion of Etihad Stadium. The partnership between LIV Golf and the PGA may also prompt more GCC clients to familiarise themselves with other areas of the UK, and further diversify into the regions.

> "I think more sophisticated GCC investors appreciate that there are good returns to be achieved outside of London. For these investors, they'll consider the big six regional centres and other major population centres. Many have invested here and have had positive experiences."
>
> Rupert Sheldon, Head of UK Core REIM, Fiera Real Estate UK

[12] City AM, House prices: London and south east falling faster than rest of the country, 2023
[13] Halifax, London house prices fall year-on-year for first time since 2012 as interest rates continue to rise, 2023

Building on success

Rapidly growing Gulf economies mean that many GCC nationals have fresh capital to deploy. Investors from that region have a particularly strong preference for geographic diversity – and an emotional attraction to Britain's cultural offering from the Premier League to Russel Group Universities.

Based on the in-depth research conducted for this report, as well as experience in the market, our recommendations for UK real estate investment are as follows:

- Investors should look closely for opportunities to purchase undervalued assets. 78% of our expert panel said that the disruption will prompt their clients to 'wait and see' before purchasing properties in the UK, but opportunistic buyers are purchasing now while property prices are low, with the option to refinance when interest rates fall.

- GCC nationals looking to invest in UK property should make use of advisers and intermediaries with the extensive on-the-ground presence needed to identify where asset management opportunities exist to buy, invest and create value. For example, assets with an EPC rating lower than 'B' are likely to become void when the UK Government reduces the minimum required rating – so there is a strong opportunity to drive up the value of such an asset by increasing its EPC rating in the interim.

- Investors and their advisers should look closely at the opportunities in the UK regions. While London will continue to be popular, there's PBSA, warehouse and prime office space opportunities available in many of the UK's big cities. UK-based advisers will be able to provide crucial insights on the quality of the tenant, and familiarity with the region or city.

Interviewees and respondents

We would like to extend our thanks to the following individuals, who contributed to this report:

- **Alastair Glover**, Partner, Trowers & Hamlins
- **Bassam Kameshki**, Adviser to the Board, Middle East, Cordatus
- **Claudio Sgobba**, Senior Director, Debt and Structured Finance, International Capital Markets, EMEA, JLL
- **Hassan Farran**, Head of Middle East Capital Markets, Cushman Wakefield
- **Henry Faun**, Partner, Private Office Middle East, Knight Frank
- **Johan Eriksson**, Managing Partner, Oryx Real Estate Partners
- **Khaled Alanani**, Senior Director, GFH UK
- **Michael Ferris**, Director and Head of Investment, JR Capital
- **Naseer Aka**, Managing Partner, Lanesbrook Real Estate
- **Nick Green**, Partner, Trowers & Hamlins
- **Raney Aburdene**, Head of Investor Relations and Business Development, Capital Trust
- **Rupert Sheldon**, Head of UK Core REIM, Fiera Real Estate UK
- **Scott McKinnon**, Property Finance Director, Mutual Finance
- **Tareq Hisham Hawasli**, Co-Founder, Darin Partners

Methodology

Between 6th April and 11th May 2023, we conducted an online survey among a panel of 14 GCC investment experts working in commercial and residential real estate, who are BLME contacts.

We also conducted in-depth virtual interviews with 11 of those contacts between 18th April and 11th May.

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If you're keen to explore the opportunities in UK real estate investment, then please email the team at BLME:

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