UK General Election: Changing of the Guard

What a new government means for the UK and for real estate investors

Election Edition 2024

Overview

After 14 years of Conservative government, it is time for a changing of the guard in UK politics. Labour has just won the UK General Election with a convincing majority and is set for a 5-year term in government. In this note we summarise the election result and resulting political dynamics, outline our thoughts on what this means for real estate investors, and reflect on the latest in the key macro factors that we are paying attention to.

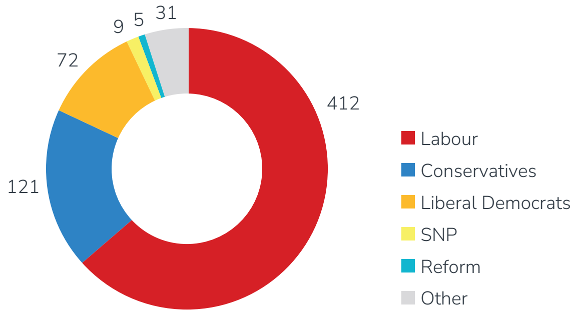
United Kingdom's 58th Prime Minister Sir Keir Starmer

UK Politics

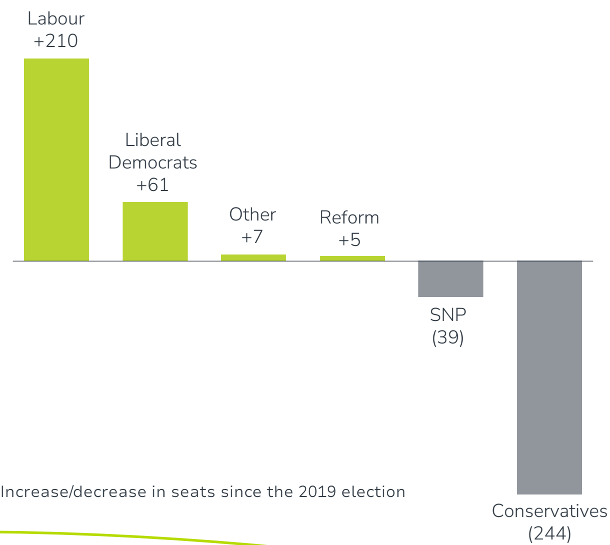
General Election Result

As expected, Labour has secured a significant majority at the UK's General Election. With a majority of 180, Sir Keir Starmer, the Labour leader, has won an election victory very similar in scale to Tony Blair's landmark win in 1997 which produced a 179-seat Labour majority.

Party Like It's 1997
Number of MPs by Political Party



UK Election as Easy as A-B-C:
Anything But Conservatives

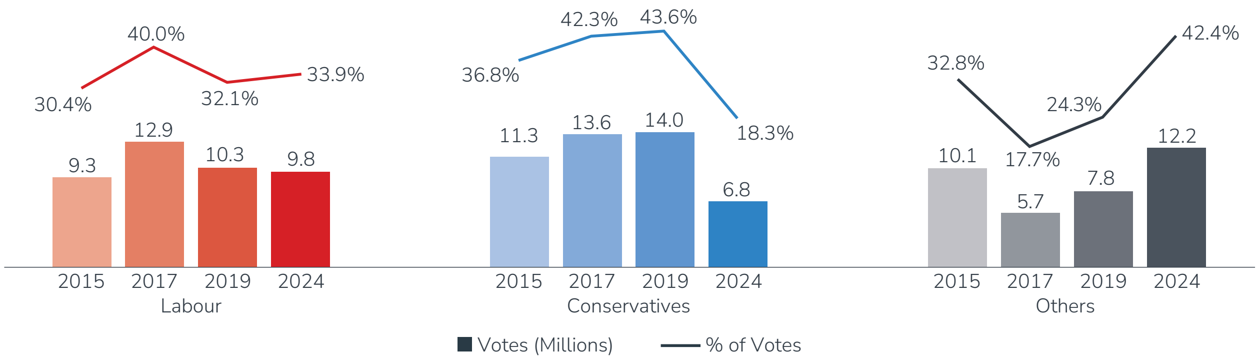


Increase/decrease in seats since the 2019 election

Sir Keir Starmer and Rishi Sunak

However, it is important to put this result into context. On the face of it, one might think that the UK population is strongly endorsing a progressive left-wing government, heading in a markedly different direction than much of the Western world. However, the voting data suggests otherwise. If we look at vote share and actual votes cast during the election compared with the 2017 election, Labour has actually declined quite significantly (see the chart below) but because the Conservatives have seen such a sharp decline themselves (with their votes halving since 2017) it has delivered a large majority to Labour.

Where's the Majority?
% of Votes and Number of Votes Since 2015

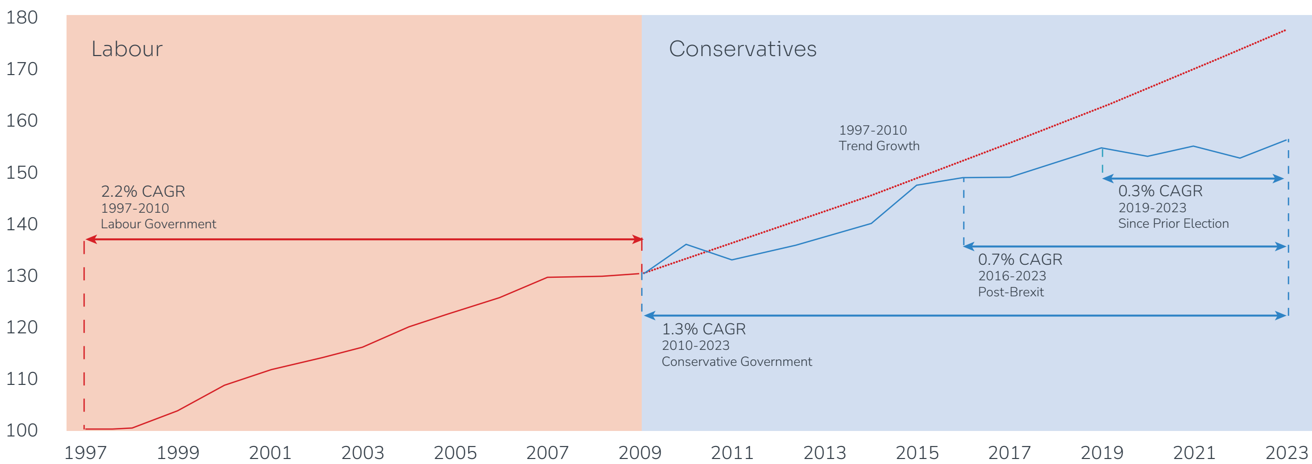


This reflects the polling data on voters' views on the two parties. In YouGov's "net favorability score" (that is percentage of favorable opinion minus percentage of unfavorable opinion), Labour and its leader Sir Keir Starmer are both negative at -3 and -12 respectively – that is, the electorate has a net negative opinion of the new government. However, in comparison, the Conservatives' and Sunak's net favorability scores are extraordinarily low at -49 and -51 respectively.

In other words, UK voters are fairly unimpressed with Labour but have decisively swung away from the Conservatives as they have seen real household disposable income growth flatten – and Labour has carefully supported this swing by leaning on policies that are often similar to the outgoing government's. So, this result could be thought of as the UK opting for establishment continuity but with a new face – in other words, this is a vote about the politics, not the economics.

At the same time, turnout of approximately 60% was the second lowest since 1885, and Labour and the Conservatives combined for less than 58% of the vote share, so equally one could view the result as reflective of a growing decentralization in UK politics, now featuring several national parties as well as regional and special interest players, rather than a US-style two party system.

Real Household Disposable Income Index (1997=100)



Political Dynamics

Due to the nature of the UK's first-past-the-post electoral system, Labour has emerged with a significant legislative majority, comparable to Tony Blair's first term in 1997. Yet counterintuitively, the scale of Labour's majority may bring its own complications.

For, to misquote Spiderman, with great power comes great expectations – and the power given by the size of Labour's majority brings sky high expectations, across all policy areas and from many overlapping stakeholders. And, as the maxim also goes, happiness equals reality minus expectations. So, sky high expectations demand rapid, concrete action to satisfy the electorate and these stakeholders, and probably within the first 18-24 months of the 5-year term. Otherwise, Labour risks growing discontent from voters, frustrated by a lack of positive change despite the favourable conditions (what might be termed the 'Obama effect', or what seems to happen with the England men's football team at most major tournaments).

However, at the same time, the scale of Labour's majority means that the Government's greatest opposition may arguably come from the Labour backbenchers (that is, Labour MPs who are not given a ministerial role on the front benches of the House of Commons, and who therefore occupy the back benches). A majority of this size means many incoming Labour MPs without a government role, but who are keen to push for change and are also arguably freer to rebel against government policy given that the size of Labour's majority means that not every vote is crucial.

This therefore sets up an interesting tension. Can the Government navigate its many stakeholders to rapidly deliver policies that satisfy both voters and its stakeholders? How long does the Government have before its honeymoon period starts to turn into simmering frustration? Or… does it opt for a similar flightpath to the Conservative government, incremental change as opposed to a new broom, and delivering establishment continuity? The next year should bring some initial answers.

Labour Policies

On the face of it, Labour's election manifesto suggests that there may be more continuity than one might expect. Labour caution leading up to and during the election campaign means that it is often hard to see much clear water between them and the Conservatives in terms of economic or fiscal policy, and Labour's stated top priority is to provide economic stability. One key example of continuity is in Labour strengthening the role of the Office of Budget Responsibility (OBR, the Government's budget watchdog) in analysing Government budget proposals – the OBR was set up by the Conservatives in 2010 and strengthening its role means maintaining a similar policy approach to the past 14 years. Equally Labour has committed to capping corporation tax at its current level of 25% for this parliamentary term. This again supports the trend of steady but unspectacular predictability for businesses in the UK.

Elsewhere, Labour priorities include traditional emphasis on investing in the NHS, in education and in law and order, plus a determination to update workers' rights in light of the changes to working practices over the past years (such as the rise of the gig economy). In addition, one thing that both Labour and the Conservatives agree on is the desire to speed up the planning system to encourage more new construction and development, particularly housing, and Labour's manifesto has a focus on planning reform and increasing housing construction. However, a slow and complicated planning system is only one reason for a slow construction and development pipeline – build cost growth has eased but build costs remain elevated, development finance is expensive, labour availability is constrained and exit pricing is subdued, so many projects are finding it difficult to make the numbers stack up. In addition, there is an emerging planning debate over 'embodied carbon'– that is, the relative impact of refurbishing older buildings and retaining the carbon that is embodied within their steel, concrete etc., versus demolishing them to build a modern, highly efficient building. In some areas, this could lead to a presumption in favour of refurbishment over new build and could well slow further rather than speed up planning, which could potentially have a significant impact on the amount, and type of, space that can be delivered.

Elsewhere in UK Politics

Former Prime Minister Rishi Sunak

Conservatives

This was a bad result for the Conservative Party. It was its worst ever election result, nine Cabinet ministers lost their seats including former PM Liz Truss, and the party was wiped out in Wales. On the other hand, the party won significantly more MPs than some of the more excitable predictions had suggested and was only approximately 10 points behind Labour compared to polling that was consistently around 15-20 points behind. All eyes will be on Sunak and an upcoming leadership change in the coming weeks and months, while there will be a desire to see the party provide an effective opposition to Labour to ensure appropriate legislative scrutiny.

Liberal Democrats

Conversely the Liberal Democrats enjoyed their best-ever election result, with 72 MPs a significant increase from their previous high of 62. This came after a highly targeted campaign focused on their traditional heartlands in south and southwest England, as well as parts of Scotland, and largely through winning previously Conservative seats.

Other Parties

The Reform party gathered over 14% of the vote but only 5 seats, while the Green party had nearly 7% of the vote but only 4 seats – for comparison the Liberal Democrats secured 72 seats on 12% of the vote. Such are the vagaries and distortions of the first-past-the-post electoral system, where concentrated support is arguably more valuable than widespread votes.

In Scotland, the SNP had won 48 out of 57 MPs in 2019 and campaigned on the basis that a majority of Scottish MPs this election would be treated as a mandate to negotiate a second independence referendum. They won only nine seats and their number of votes almost halved. A renewed push for Scottish independence looks highly unlikely for a long time.

Sir Ed Davey, Leader of the Liberal Democrats

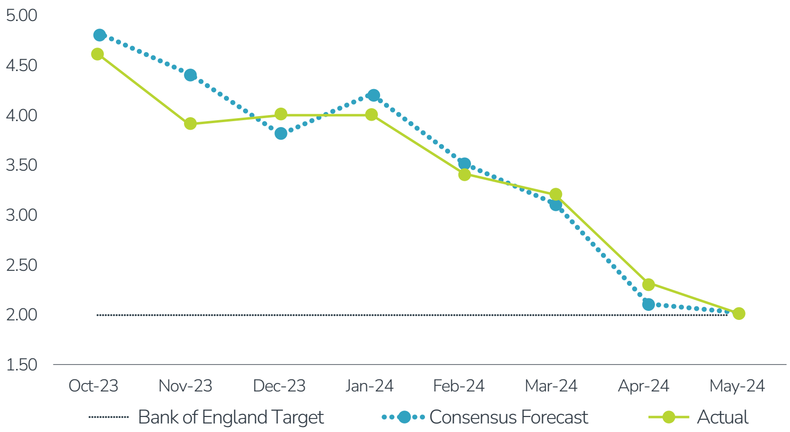
Economic Indicators

Inflation

Outside of politics, UK inflation has been on a downward trend, falling over 50% from its level of 4.5% in October 2023, and already within the tolerated band around the 2% target. Our expectations are that it could end up largely in a 2%-4% band, but it is equally possible that it could undershoot the 2% target and hit 1.5% or thereabouts before correcting.

In line with these expectations and with consensus, the May inflation print came in at the 2% target. We could see inflation fall below 2% in June, although downwards pressure from lower energy is receding so that inflation could tick up to around 2.5% in Q4 2024.

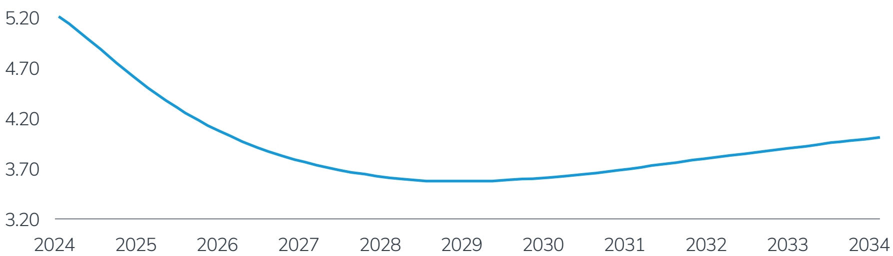
Inflation:
A Summer Slowdown



Interest Rates & Financing Costs

As expected, the Bank of England has maintained interest rates at 5.25%, where they have been since August 2023. The market is currently pricing in one 25 basis point cut in the autumn and a second 25 basis point cut at the start of 2025, so we expect capital market conditions to stay broadly the same until the year end.

Interest Rate Expectations:
SONIA 3m Forward Curve

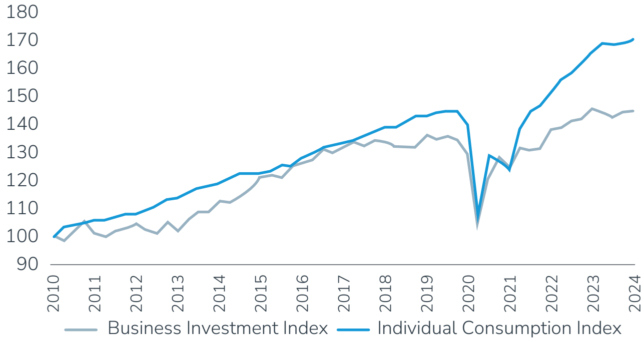


This has meant that UK real estate financing costs remain stable, albeit at the new, higher, level. Lender appetite, risk premiums, and available loan-to-value ratios are also steady. This continues to provide stability and predictability for investors, but does not ease refinancing pressure for existing borrowers, who may be nearing the end of extension options with their current debt facilities.

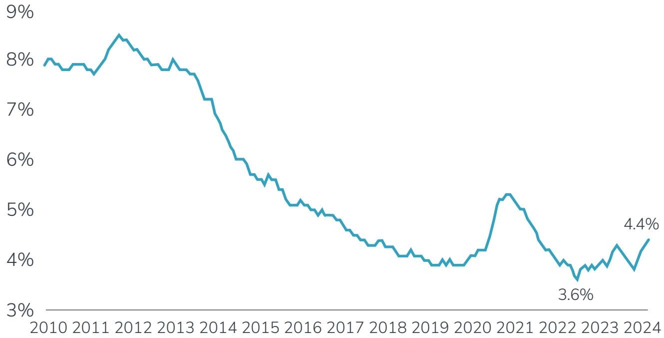
UK Economy

The latest data shows that UK GDP grew by 0.7% in Q1 2024, the fastest growth since 2021 and ahead of consensus at 0.4%, providing a resilient economic backdrop for the incoming government. At the same time, unemployment has remained near cyclical lows, consumer spending is still resilient and gross capital formation has continued a steady acceleration after a long period of subdued investment following Brexit and the COVID pandemic.

The Task Ahead:
Stimulating Business Investment



Steady as She Goes:
UK Unemployment Rate



What This Means for Investment into the UK

We expect the UK to continue on its steady economic path over the coming months, with inflation around the 2% target and with a likely Bank of England rate cut, while Labour's economic policy should broadly follow the existing policy flightpath.

With a Labour election victory having been expected for months, this result has been largely priced into financial markets. Nevertheless, the reality of a sizeable parliamentary majority and a Labour party prioritising economic stability and growth, plus the slow but steady progress in the key economic indicators of inflation, interest rates and GDP growth, all point towards the UK's increasing attractiveness to global investors. Indeed, the UK's politically stable outlook compares favourably with events elsewhere, reinforcing the country's positioning as a safe haven for investment.

We expect investor interest to be particularly evident in real estate and fixed income markets as interest rates being to fall, while this economic backdrop should also provide a tailwind to the UK private equity market, particularly around defensive strategies such as business services. In this environment, attractive investment returns are available but need to be earned – in our view this favours active management and a targeted approach.

What This Means for Real Estate Investors

Investment Strategies

- Capital market conditions are likely to stay broadly the same until the year end, before a gradual easing in financing costs. This provides predictability for new borrowers but puts added pressure on existing borrowers
- We continue to favour higher cap rate sectors that mitigate the impact of higher interest rates, and those where rental performance remains resilient
- We still favour explicit rent inflation linkage, or shorter unexpired lease terms, to hedge inflation exposure and capture inflation-led rental growth

Within UK real estate, we continue to favour an active investment strategy focused on properties with shorter, staggered lease terms, a diverse income stream, and affordable rents that can be grown through active management. Within this strategy, our preferred sector is UK multi-let industrial, offering an attractive combination of cyclically high cap rates, sustainable income return, and capital growth through focused asset management.

We also continue to favour strategies focused on upgrading buildings' energy efficiency, as we have confidence that by increasing their appeal to occupiers, lenders and investors will deliver additional return over the medium term, while there is scope for Labour to strengthen the regulatory approach in this area.

Conversely, we would maintain a watching brief on residential and infrastructure markets while Labour outline their policies on planning and regulation, as the opportunities for international investors in this sector may evolve accordingly.

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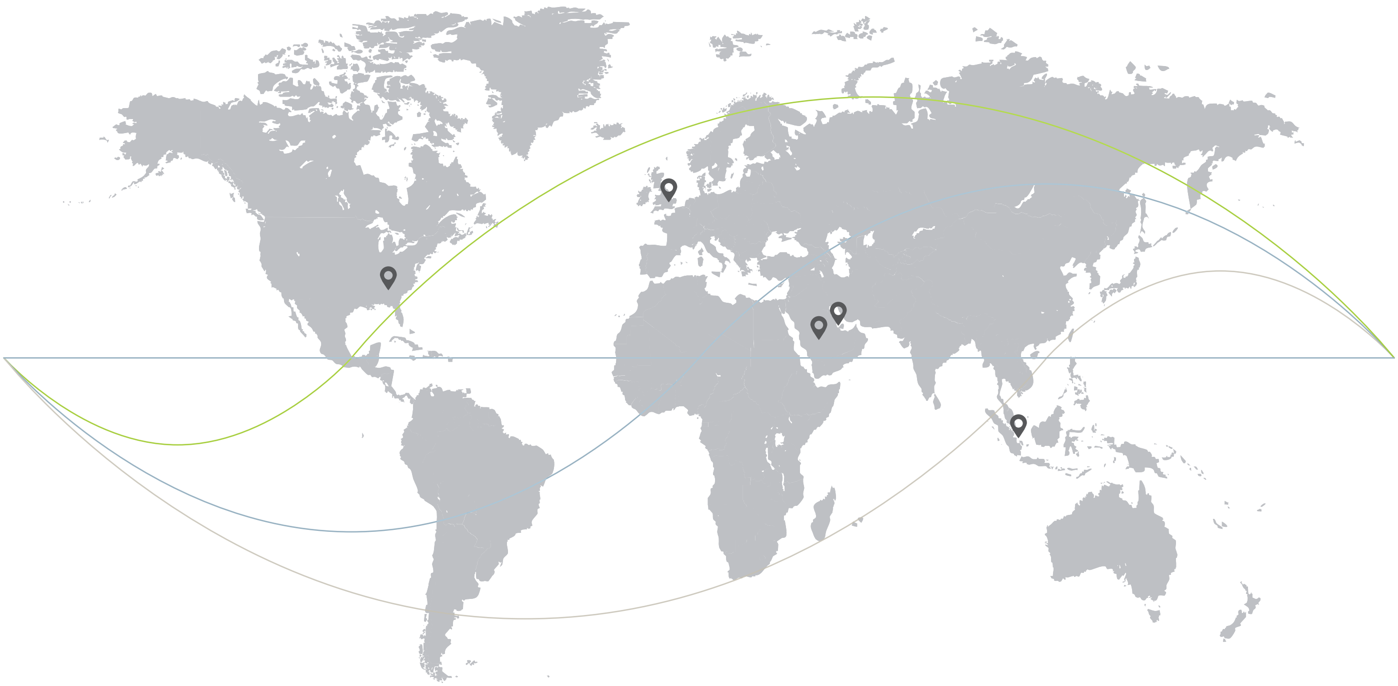
ARCAPITA

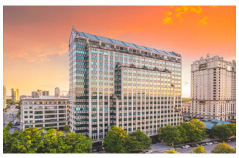
Overview

Arcapita is a premier asset manager offering diverse investment opportunities, focusing on private equity and real estate. At the center of one of the fastest growing wealth markets in the world, Arcapita's management has been serving an exclusive group of investors in the GCC region over the past two decades. With offices in Bahrain, US, UK, Saudi Arabia, and Singapore, Arcapita's management team has completed transactions worth a total value of approximately $30 billion and possesses a footprint to invest on a global scale. Arcapita focuses on defensive and counter-cyclical sectors supported by long-term macroeconomic and demographic trends.

With two decades of experience, Arcapita's management has built a global investment platform to access the opportunities that exist in our core markets of the US, Europe, Middle East and Asia.



United States



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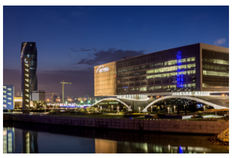

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