

ARCAPITA



UK Real Estate

Focusing on the Engine Room

October 2025

Overview

The engine room has powered British society since the days of the Industrial Revolution. Once the place where great ships and early industries found their power, the engine room symbolizes steady strength, reliability, and the ability to keep everything moving forward - often unseen but always essential. A century ago, the engine room powered the physical machinery of the economy; today, it represents the dependable systems and assets that underpin modern life.

In our real estate investments, we focus on strategies with those same characteristics: resilient, robust, and a providing mission-critical role for a wide range of occupiers. In this note, we outline the latest key macro factors that we monitor, share our observations across the main UK property sectors, and highlight our focus “engine room” sub-sectors - the dependable assets that keep the economy running smoothly.



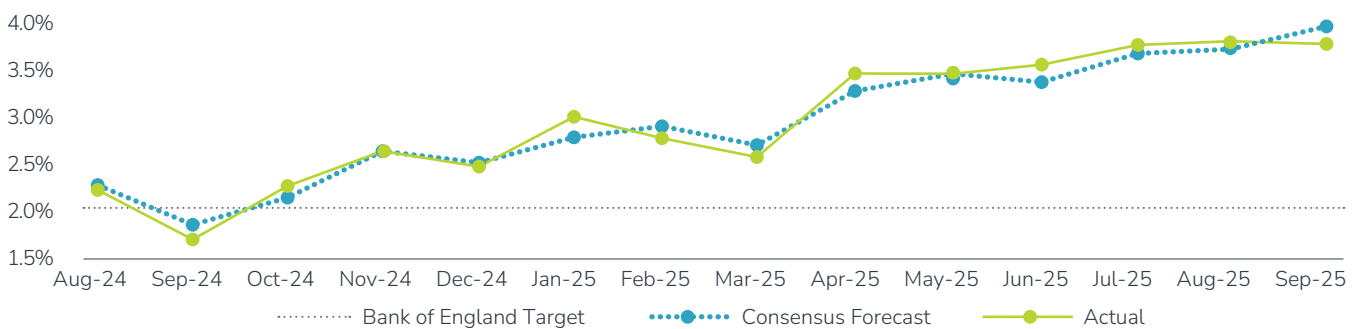
What We're Paying Attention To

Inflation

UK inflation has continued to gradually climb over 2025, from 3.0% at the outset to 3.8% in July through to September. While the reasons for this higher inflation are varied, one consistent theme is higher cost of labor, which impacts all sectors of the economy. While higher cost of labor is typically a result of wage increases, which would help offset the impact of inflation on the consumer, this round of rising labor cost has been driven primarily by the rise in National Insurance tax – a tax employers have to pay – that was passed at the start of this Labour government. In our view, higher inflation continues to be a broadly neutral environment for real estate investment: as rental income tends to provide a relative inflation hedge, this inflation outlook should provide ongoing support to income growth, particularly with shorter or inflation-linked leases.

August 2024 to September 2025 inflation prints:

Consensus vs Actual Number



Source: Reuters; The Financial Times

What this means for real estate investors

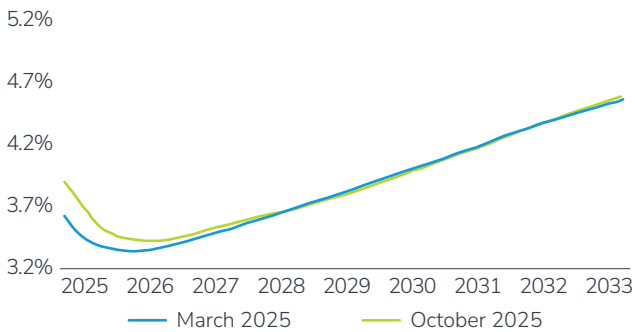
- We continue to favour explicit rent inflation linkage, or shorter unexpired lease terms, to hedge inflation exposure and capture inflation-led rental growth. While another inflation surge seems unlikely, protection in this respect remains beneficial.
- Sectors more exposed to inflation and overseas labour, such as hospitality or leisure, appear more exposed at present for income-focused investors.

Interest Rates & Financing Costs

The Bank of England has made three 25 basis point cuts in the interest rate in 2025, taking the base rate to 4.0% from its cyclical high at 5.25%. The market is currently pricing a further two 25 basis point cuts over the next 18 months, such that UK rates are expected to remain relatively elevated over the medium term.

SONIA Forward Curve:

March 2025 vs October 2025



Source: Chatham Financial

This compares to revised expectations of over 125 basis point cuts by the US Fed over the next 18 months (in addition to the 25 basis point cut in September 2025), and the market pricing in no further basis point cuts by the ECB, pointing to a market view of the UK base rate seeing a premium of c. 60 bps to the US and c. 160 bps to the Eurozone over the medium term.

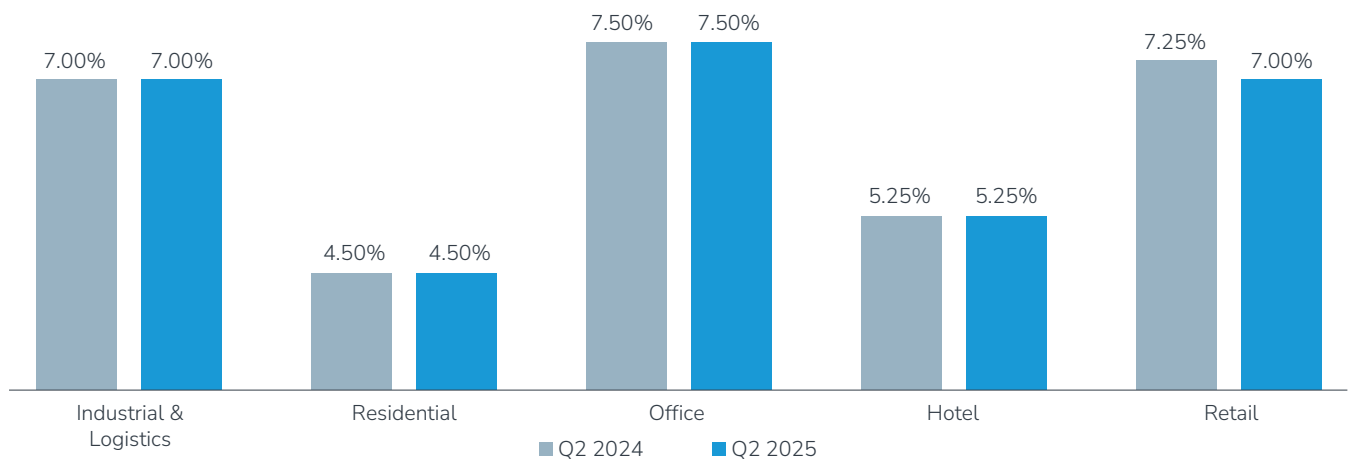
From a UK investment perspective, this means expectations are currently for a higher-for-longer interest rate environment that gives a longer runway to acquire UK real estate at attractive cap rates compared to some other geographies. In tandem, UK real estate financing costs should remain broadly stable, with healthy lender appetite and margins and available loan-to-value ratios steady. Together this means a predictable UK market environment, with the prospect of a medium term easing in interest rates that can provide added support for exits in due course.



What this means for real estate investors

- While overall financing costs are slowly decreasing, we still expect capital market conditions to remain broadly the same for the coming months.
- We also expect more lender pressure on legacy properties, whether for refinancing or potentially sales.
- We continue to favour higher cap rate sectors that can be more easily accessed in this higher-for-longer interest rate environment.
- Lenders continue to emphasise energy efficiency, whether through borrower upgrade plans or existing certifications, as they still face pressure to improve their loan book's energy profile notwithstanding new policies seen in the US.

UK RE Capitalization Rates by Sector



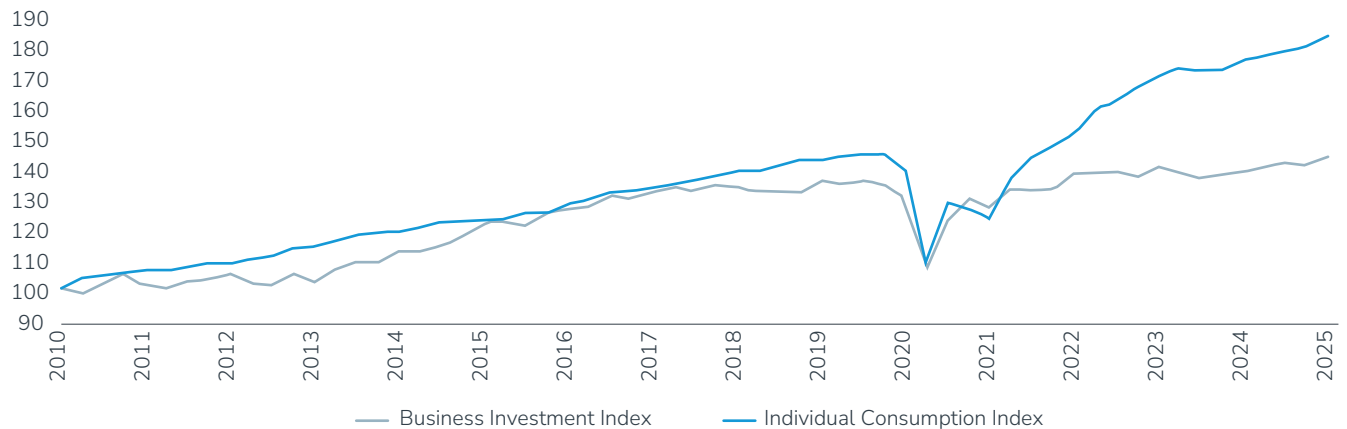
Source: Knight Frank Investment Yield Guide; Knight Frank UK Living Sectors Yield Guide



UK Economy

From being essentially flat in late 2024, UK GDP has been surprisingly robust over 2025 given all the noise around media headlines, global headwinds and speculation about future tax changes. Partly this seems due to underlying resilience in the UK services sector, partly to positive momentum from a more promising outcome to US trade negotiations compared to other countries, and partly due to structural features whereby initial GDP estimates have been later revised upwards as more fulsome data becomes available. The UK government remains focused on productivity and growth, although it now realises that this may be a slower road given the complexities of streamlining regulations and bottlenecks to growth. Over the rest of 2025, we anticipate that the UK-GCC free trade agreement will be finalised, although the impact of the November Budget may temper optimism if some of the speculated tax increases materialise.

UK Consumption & Investment Index



Source: ONS

What this means for real estate investors

- We continue to prefer income diversification and sectors making up the backbone of the UK economy (those workhorse sectors that we focus on later in this report), while being cautious on subsectors highly dependent on international capital flows.
- We favour real estate with affordable rents and offering value-for-money.

UK Property Sectors

Summary

Arcapita currently focuses on the industrial sector, particularly multi-let industrial, where higher capitalization rates, diversified and sustainable income profiles, and multiple avenues to create value through active asset management combine to create an attractive investment opportunity. We continue to monitor additional opportunities and highlight our thoughts on the various sectors within the UK Real Estate market below.

Central London Offices



What are we seeing:

- “Return to the Office”: A number of high-profile companies have mandated employees back to the office at least 3 days a week and others are continuing to increase these mandates further. Despite the impacts of Covid and Working From Home, the world of work is much closer to what it looked like in 2019 than what was predicted during the pandemic. New TFL Underground data reveals that Central London journeys (Mon-Fri) are at 75% of pre-Covid levels.
- As such demand has increased with big office tenants focusing on best-quality space in new or refurbished buildings, as they try to lure employees back to in-person work. This has led to rents increasing to their highest levels (9.2% rental growth YoY) and a shortage of new properties as development / refurbishment dwindled throughout the pandemic (with a 5.5% Grade A vacancy rate for Central London, and particularly a 2.3% Grade A vacancy rate for Mayfair).¹
- This trend has not only been seen with high-profile office occupiers, but for SMEs as well who want high quality space with the addition of lease flexibility. Demand for serviced offices has increased 173% in the past 5 years and enquiries are up by 12% year on year.²

Regional Offices

What are we seeing:

- Office take-up is still subdued across all regions with a vacancy rate of 11.2%. Cushman and Wakefield report that take up in Q2 2025 was 18% below the 5-year quarterly average. Within that though, Grade A offices have performed relatively well: Grade A take up has dominated activity (77%), with occupiers looking for well-located space close to transport hubs with strong amenity provision and sustainability credentials.
- Investor activity is cautious with large lot sizes (£50m+) often struggling, and a focus has been more towards smaller value-add lot sizes for assets in prime locations where the margin for error is seen as smaller and leasing risk profile more manageable.



Residential



What are we seeing:

- UK Build To Rent (BTR) now accounts for more than 132,000 homes across the country with regional cities accounting for 57% of total supply, and there are an additional 104,000 homes currently under construction or in the planning pipeline. Cities such as Manchester, Birmingham and Leeds have been the major target areas for investors and developers where purpose-built BTR is set to meet nearly half of local housing requirements.³
- Single Family Housing continues to be a highlight of the investment market with £1.9bn deployed in H1 2025 (according to Cushman & Wakefield). Forward fundings for development are still the dominant route into the market but we are now seeing first generation stock trading. In a landmark transaction, Morgan Stanley is reportedly under offer to acquire L&Q's PRS business for £1.1bn. The portfolio consists of 3,143 homes across 53 schemes in Greater London, the majority of which were built in the last 10 years.

¹Cushman & Wakefield

²BE Offices

³Cushman & Wakefield

Retail



What are we seeing:

- The retail market has continued to be resilient despite navigating a challenging cost environment, with April's policy changes around tax and a rise in the national minimum wage impacting retailers' bottom lines.
- Prime shopping centers and regional high streets are seeing strong occupier demand and vacancy rates continuing to fall, which is driving rental growth across these markets. Cushman & Wakefield report an increase in rents of 4% YoY for Shopping Centers and 4.2% for regional high streets.
- Central London Retail vacancy rates continue to fall below 5% across Covent Garden, Regent Street and Bond Street with rental growth increasing 3.3% in Q2 2025 (Cushman data) as a consequence of continued investment into local public realms which have improved the shopper experience.
- Retail Warehousing continues to demonstrate strong performance, underpinned by value-led consumer behavior. Vacancy rates remain low (4%) and continue to fall with demand from existing and new occupiers remaining robust.⁵
- In terms of investment, Retail Warehousing continues to have the highest transaction volumes, reaching £1.48bn in H1 2025, a 78% increase year on year and the highest H1 total since 2022 according to Allsops. However, activity is increasingly constrained by limited stock availability.

Industrial



What are we seeing:

- Occupier fundamentals for multi-let remain robust, supported by a resilient mix of demand across services, manufacturing and SMEs. Indeed, multi-let rental growth continues to outperform other sectors, though the pace has moderated. After London's rapid gains in 2021-22 the cycle has become more regionally balanced, with regional UK outperforming London & the South East for a second consecutive year.
- Demand for logistics space has improved in 2025, driven by activity from Chinese internet retailers, 3PLs and Amazon. This has lifted take-up back to the 10-year average after a period of weaker demand. Availability has continued to rise from a low of 3.6% in Q4 2022 to 8.6% in Q2 2025 (Newmark data), due to an increase in second-hand stock returning to the market (accounting for 60% of total availability), as occupiers have upgraded to more efficient and sustainable buildings.
- Speculative development remains constrained by the relatively narrow gap between build costs and capital values. Speculative development starts for Q2 2025 totaled 2.75m sq ft which is significantly below the 5-year quarterly average of 4m sq ft.⁴
- On the investment side, portfolio transactions have led the way in terms of activity as they have offered sufficient scale to match the weight of capital and debt looking to be deployed. In contrast, single-asset deals have faced a more subdued market, with less depth of demand and perhaps more value on offer compared to portfolios.

⁴Newmark

⁵Cushman & Wakefield

Engine Room Sectors and Properties

In our real estate investments, we focus on properties with the same characteristics as the engine room: steady, dependable, and reliable while providing an essential function and powering the economy forwards. But where can these powerhouse sectors and properties be found?

Our approach is to focus on the following:

✓ Does it suit occupiers:

The eternal real estate slogan of 'location, location, location' still holds. Is the property conveniently located for businesses and people, and do they want to be there?

✓ Ability to house a wide variety of occupiers:

In part this is a question of planning (how wide a range of occupiers are legally able to be in the property?) and in part a question of the building fabric (is it highly bespoke, or can it physically accommodate many different occupiers?)

✓ Affordability:

Simply put, an affordable unit can attract a wider range of occupiers

✓ Uncomplicated:

Linking into affordability, a building doesn't always need to have the latest technology and complicated equipment. Many people would prefer a sturdy product that is reliable and works well, plus from an investor's perspective there are likely lower operating costs and lower obsolescence risk



In addition to these building-specific characteristics, we also focus on markets where occupiers face pressures: perhaps through a simple lack of spaces to house them, or because of high pricing impacting affordability. This doesn't change the appeal of the building characteristics we look for, but we find that in a market where occupiers are pressured, these characteristics tend to be more valued.

In this approach, it is worth highlighting that real estate sectors are not excluded *per se*: for example, retail has not been the most popular sector in recent years, but there are certainly retail assets that are in this powerhouse typology. At the same time, this approach does reflect a preference for domestically focused properties, given the larger customer audience – so for example, student housing assets that target UK students at affordable prices, rather than top pricing tier assets that rely on a narrow segment of international students to deliver their returns.

Finally, overlaying this approach is a consideration of capital markets: different sectors' engine room assets may offer significantly different pricing and income returns, so we would naturally gravitate towards those where strong occupational dynamics blend with higher cap rates and income returns.

Engine Room Sectors and Properties

So what does this approach lead to in practice? Well, since the interest rate driven repricing in 2022/23, our preference has been UK multi-let industrial. Here we find an attractive combination of engine room asset characteristics:

-  Broad planning use, relatively standard units and affordable rents house a wide range of businesses – from international firms to SMEs, and across business sectors – providing consistent occupier demand
-  Many industrial estates are well located to serve towns and cities, with good transport links – and supply has often been eroded over the years as such areas have been converted into residential or other uses, leading to lower vacancy rates and good occupational dynamics
-  Industrial assets are often uncomplicated, certainly compared to latest generation residential or office buildings, keeping operating costs and obsolescence risk lower
-  Compared to domestically focused living sector assets, industrial properties have seen a greater repricing and higher cap rates

Taken together, these features underpin a combination of higher cap rates, sustainable income returns, and the potential for capital growth through focused asset management – in our view, forming one of the most attractive investment opportunities in the current global real estate markets.



Arcapita's Focus

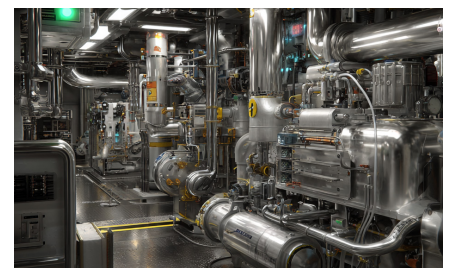
Our focus stays on UK multi-let industrial real estate

Over 2025, there has continued to be a lot of noise both politically and geo-politically, yet the UK economy continues to surprise with its resilience – although given all the various challenges it has overcome for the past several years, perhaps this resilience, and the relatively stable investment climate that produces, should be a bit less of a surprise.

With this continuing stability, it is understandable that the investment environment remains broadly unchanged, and in this we still see the most attractive investment returns in higher income assets,

active management strategies and a disciplined, targeted approach that can capitalize on these dynamics.

Within UK real estate, we maintain our highest conviction on the engine room sectors we have discussed: domestically focused properties featuring affordable rents, diverse rent rolls and a value for money proposition. In particular, our preferred sector continues to be UK multi-let industrial, with its attractive combination of higher cap rates, sustainable income return, and capital growth through focused asset management.



Residential assets remain on our radar, although we wait to see how taxation and regulatory changes evolve over the coming months, as these may materially affect their investment prospects.

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, UAE, 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.

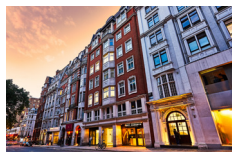


United States



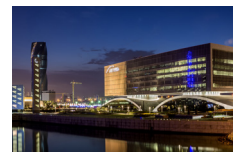
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