

The Weekly Take

New Horizons: Why Global Capital Is Eyeing U.K. Real Estate

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Spencer Levy

Recent business trends across the real estate industry in the U.S. are in many ways quite similar to what our counterparts overseas have experienced in their markets. But in a world where government and corporate policies and, indeed, investment priorities are as varied as the languages spoken across the ocean, we wanted to learn more about the state of play among European investors. On this episode, perspectives on the global flow of capital in a changing, sometimes unsettled world, including a particular view on the role of technology in investment decision making.

Nick Montgomery

There are some really exciting areas that we're working on as it relates to technology which will drive efficiencies, but most importantly for us, deliver a better investment outcome for our clients.

Spencer Levy

That's Nick Montgomery, the Global Head of Real Estate for Schroders Capital. Based in London, Nick was elevated to this post last year after more than a decade at the firm. Today, Schroders manages an overall portfolio of nearly \$100 billion in assets. That includes some 23 billion pound sterling – around 30 billion U.S. dollars that is – invested in a range of real estate strategies.

Lee Bruce

The one consistent message that I get from clients is of the importance and the value of data to them and in a fashion by which they can use it efficiently both to save them time and to give them better information on whether it's the risk to their asset or the risk of their portfolio or analysis associated with that portfolio and the risks that are in the future.

Spencer Levy

And that's Lee Bruce, a CBRE Executive Director who heads the company's U.K. valuations and advisory services business. Lee is currently in his 20th year with CBRE and his team is the largest valuations team in the country covering all sectors with specialists based in 13 cities across the U.K. and Ireland. Coming up, the global flow of capital, and an outlook on how investors in the old world see new technologies forging the future of their work. I'm Spencer Levy, and that's right now on The Weekly Take.

Spencer Levy

Welcome to The Weekly Take, and we are delighted to be here today at Schroders Capital's headquarters in London with Nick Montgomery, Global Head of Real Estate for Schroders Capital. Nick, thanks for coming out. Thanks for hosting us.

Nick Montgomery

Pleasure. Good to see you.

Spencer Levy

And then we have our friend and colleague, Lee Bruce, Head of Valuation, U.K. and Ireland CBRE. Lee, thanks for coming out today.

Lee Bruce

Thanks, Spencer.

Spencer Levy

So Nick, tell us, how's it going? The market has been clearly volatile. Just give us your sense of where the market is today for Schroders Capital.

Nick Montgomery

Yeah, OK, so we're investing globally. There's uneven pricing. But I think, at a sort of a high level, we're dealing with, obviously, significant uncertainty. And we've, I guess, become accustomed to that, really, over the course of the last 10 years. But it's accelerated from a geopolitical perspective, and not least, obviously the tariff situation. I think from a real estate perspective, whilst that has and continues to cause low investment volumes. A bit more stickiness perhaps in occupational markets. We still think actually it's an interesting point in the cycle for real estate because we have had a significant correction. So all these geopolitical uncertainties are happening when we have experienced that repricing. So, for us, it's about sticking to our long-term investment philosophy, continuing to invest in line with those long-term structural secular trends. And although, as I say, there is that uncertainty, there is cautiousness. Actually, we are optimistic about the outlook taking us from a medium to long-term view.

Spencer Levy

Staying with Schroders Capital real estate strategies, just break it down in terms of the types of vehicles you have, debt, equity, core, otherwise.

Nick Montgomery

It's 23 billion sterling of assets that we manage across our business. It's a diverse business. We've got about half of those assets – are in the U.K., and our business was born, I guess, 50 years ago with the launch of a fund that we still run today, Australia's Capital U.K. Real Estate Fund. But also the business has evolved significantly since then. So half the assets in the U.K., the balance of our portfolio is across both continental Europe where we have various key markets, boots on the ground, and also Asia. We are also increasingly investing indirectly via our solutions team, where we are investing fully globally. We're running open-ended institutional funds, we're running listed funds, where we're actually the manager of real estate investment trusts, both in the U.K., across the continent of Europe, but also we have a very successful Swiss REIT that we run. We're also, obviously, have and continue to move into more alternative real estate types where in some cases, for example, setting up our own teams to invest into hotels, but also investing indirectly into other sort of operational real estate types. Diverse business, but as I say, very clear investment philosophy. And I guess I'll just finish by saying, and I think as a wider business, we're seeking to differentiate ourselves. In being really clear how the area of sustainability and impact is integral to everything that we do, largely because we genuinely believe, and there's clear empirical evidence now for the brown discount, but for

us, more importantly, the green premium and how we can leverage our asset management capability to drive higher earnings from our assets.

Spencer Levy

When we speak to our European-based, U.K.-based clients, they put that front and center far more often than many of our American clients. And I think it's why when I have these conversations, I say, look, I'm not sure what your position is on sustainability, but if you want to have European investors in your funds, in your buildings, this has to be front and center.

Nick Montgomery

No, it is. Look, there's a regulatory dimension to that, of course, and the landscape is obviously a bit different, as you say, in Europe now, versus perhaps what's happening in the U.S. But I think from a real estate perspective, we contribute 40% of global carbon emissions as an industry. You know, whatever sort of short, medium-term government policy is, we can see that our occupiers are wanting more sustainable, high quality, more amenity in the buildings that they're occupying. And having the specialist expertise to deliver that decarbonisation but also deliver the right product for the right market is really critical. And as I say, it is coming through in returns, both in how value is appricing, the brown discount, the obsolescence risk, but again for us, more importantly, how we can drive higher earnings and rental growth by delivering those asset improvements.

Spencer Levy

So let's turn to valuations now. You certainly have had probably one of the most difficult jobs in real estate over the last three years with this rising interest rate environment. Tell us where valuations are today. Tell us a little bit about how challenging or not your business was over the past several years.

Lee Bruce

I think it's far more challenging to be a fund manager right now in real estate than it is to be of value. That's the first thing I would say. The second thing I would say is, as a valuer, as a practitioner myself, the most exciting period of any valuer is when actually you get moving to markets. So a major economic shock to the system, that's when values become popular and suddenly your clients want to see you. So, actually, although it can be very challenging economically, it's not always good for business. It is a fantastic time to be a valuer. The last few years has been challenging, I suppose, for valuation in the sense that there's been a general slowdown in transaction volumes for some time now. And, so, we all would like to have lots of evidence to justify where our valuations are and where they're moving and where they're behaving, and not rely too much just on sentiment. But there has been gaps in the parallel market over that period of time. Having said that, when I look at the U.K. compared to other geographies around the world, actually there still has been an element of transaction volumes. We're more transparent here generally in our market than many geographies around the world. So that does help values that help us.

Spencer Levy

And just for our listeners, what do you mean by transparency?

Lee Bruce

By transparency, I mean, we do share evidence, you know, we're more public, I think, in terms of where things transact at, we're not super confidential on that evidence, it's shared in an industry of valuers who look after large corporate real estate and fund managers and that information is quite widely shared across the sector and it helps us get the right

numbers. So, what that means is, I think if you look at the way the U.K. behaves compared to other markets, it sometimes is generally more dynamic. But I think that is a good thing actually on the whole. As we come into this year, we know investment volume's picked up in Q4 last year. London definitely picked up. Liquidity for larger lot sizes is actually proven. It's coming through. We think we've had five or six transactions already and London this year over 100 million. So that for me is great news. And that is international investment. There's been a lot of investment more recently from Australia, fantastic. Japan. That's just a sort of behavior we kind of want to see and observe and that shows that the U.K. – again U.K. real estate PRC is open for business and I think it's trading reasonably well under difficult circumstances at times compared to other geographies around the globe.

Spencer Levy

So let's just talk a little bit of a timeline here, and I'll use peak to trough, and where are we today? If peak was 2021, trough was 2023, we're here today. How much did it fall peak to trough, and where we are today, ballpark?

Lee Bruce

Ballpark, it came off about 25%, I think. Ballpark.

Nick Montgomery

Your dates are broadly right for most markets, aren't they? I mean, we had started to dial down risk early in 22. We were selling some of our lower-yielding assets, and where we'd completed business plans, we saw some very low-yielding industrial. The nadir of the market for me, at least from a U.K. perspective, was being asked to attend a panel in mid-2023, alongside other equity managers. It was for our Real Estate Investment Trust where the name of the panel was "The Undatables".

Spencer Levy

The Undatables?

Nick Montgomery

The Undatables, yeah, because at that point there was a lot of caution around the sector and I think particularly in the U.K., we're honest, the sector's been pretty unloved for a little while now, almost going back to Brexit, you know, whatever you thought of Brexit, it certainly had an impact on international capital flow and obviously subsequently growth. I think that is now changing and I, and I and I I think, you as I said at the start, although we have had and continue to deal with, you know, uncertain or events, as the political expression goes, we are nonetheless, I think, at an interesting point in the cycle for future vintages. We're sitting obviously in the city today, there are cranes, but actually if you look at the supply side coming through in most knowledge-based European markets offices through to you know industrials through to retail and then alternative property types we have a significant shortage right so so although the outlook for yields is, I think, uncertain and I think we're a bit more cautious about just how fast and low rates will go because because of our view about inflation more broadly actually we're pretty optimistic about about the outlook earnings growth which ultimately is why you own real estate, right. You own it for the rent.

Spencer Levy

By the way, this is an audio-only show, but I'm now looking out the window at Schroders beautiful offices here at One London Place, and I see three cranes, one to my left, two behind me. The famous Gerken building is right behind me, for those people who know London City Real Estate, which is a sign of optimism to me.

Nick Montgomery

Well, it is, but actually compared, perhaps, to previous points in the cycle where you've got, again, from a historical perspective, in the prime parts of the London market, low vacancy, a lot of the cranes that we can see at the window are pre-lapped, right? So the building that we are looking at, I don't know, we're not being filmed here, but the building across the road there, that's the new headquarters for Clifford Chance. They've moved across from Canary Wharf. Down the road is the new HSBC building. Interestingly, I think in both cases, they've probably not got enough space. But they are creating buildings that have the highest sustainability standards, the right amenities, they're on top of the Elizabeth Line and for those sorts of assets the rental side is actually very good.

Spencer Levy

So let's talk about office for just a moment because I think what our American listeners would like to hear is the differences between the U.K. in particular and the U.S. The US is a tale of two worlds. For the best stuff and the best sub-markets, rents have never been higher right now in the U.S., but for the second tier and the third tier, very different story. What's the story here in the U.K.? How has it impacted valuations?

Lee Bruce

The headline story though isn't that different. So, there's been a flight to quality, certainly ever since COVID. So, if you don't occupy office space, you might occupy less space, but you want the best quality space, both to attract staff into the office, because we all know, anybody running a business knows the value of people having people in the office. So, as part of the sort of war for talent now in the U.K., you want to attract them to good space. So it matters. We know in CBRE in London, we're lucky. We've got a fantastic office area to house and that really matters. So, when I'm hiring staff, that counts. I show them around the office and show them around the breakout areas and it's an attractive place to work. So, there's a flight to quality. There is a big divide between the best and the worst. So we have got a performance there across that best quality space. You can see in particular the West End where rents are flying and you can see it in our best cities around the country. So, Manchester, Birmingham, Bristol, in the best offices, they achieve really high quality – high-end rents. But there is a big, there's a big rest of the market. And that's, I guess, the area in which we haven't seen any return to valuation improvement over the past period. We're not really seeing rental growth and some of those assets need to be repositioned. Some of them will not be big headquarters for banks regionally in the next 10 years. They're going to be repositioned to other uses. Clearly, in some cases, it will be forms of housing. And it's about the viability of that to make it work for investors to convert them. But that's a challenge both for private capital, and it's also a challenge for the public sector.

Nick Montgomery

I'd echo most of what Lee has said, I think, you know, we've particularly over the course of the last five years or so we've been deliberately underweight where we've got diversified strategies to the office sector and consequently overweight, particularly to multi-led industrial for example. But across Europe more broadly, where we have invested, we've invested in knowledge-based economies, great infrastructure, you know, as Lee said, so that we can attract the best talent to Schroders. I think central London is starting to show a sign to recovery. We're from an investment side as well. We've seen some quite big transactions over the course of the last few weeks where you've got U.K. sort of institutions, interestingly, buying some quite a lot of sizes. We're beginning to see a bit more interest coming out of Asia, Middle East. You know, it'll be interesting to see how

much of that capital potentially would have gone to the U.S., but now might be more focused on Europe.

Spencer Levy

So let's shift now, and I would like to talk about where we are going from a data and technology standpoint. And so from a data and technology standpoint, we've had several shows on this. So let me just ask, start with the valuation question. From a big picture standpoint, how is data technology helping the valuation business?

Lee Bruce

It's incredibly important. The one consistent message that I get from clients is of the importance and the value of data to them and in a fashion by which they can use it efficiently, both to save them time and to give them better information on whether it's the risk to their asset or the risk to their portfolio or analysis associated with that portfolio and the risks that are in the future. So as a supplier to Schrodgers real estate, what I'm thinking about is, is our data in a good place? What can we take from that data to add value to our client? And how can I do that in an efficient manner, both for myself as CBRE and for our end user? So, those are the kind of things I'm thinking about. I'm kind of thinking about, also, technology, which helps me do things faster. Everybody wants stuff faster. In a more efficient way. So we're spending a lot of time thinking about that at the moment.

Spencer Levy

People are talking about the disruption from data technology, specifically at the valuation sector. How much is it going to disrupt the valuation business or does it make the valuation business go to a higher level, meaning that the more complicated deal.

Lee Bruce

So I say it's just improvement. It's this development and improvement. It's us being, it'll make us more sophisticated in the years to come. You'll still need valuers to interpret that information to make sure it also corresponds to what you're actually seeing, so to validate it. But to my point about speed, it'll let us do things faster, quicker, and more dynamically.

Spencer Levy

So Nick, from your perspective, data technology, how is it impacting your business?

Nick Montgomery

I think for us, it's allowing us to deliver efficiencies in the way that we run the business, I guess more generally. We have co-pilot now on everything that we're doing and it makes report writing a bit easier and delivering synopses of things that allows us to, I guess in that respect, to run faster. I think it will have a big impact, if you like, on the more commoditised parts of a real estate market and as you say, that could impact valuation. I think equally, I think areas of property management are already seeing huge improvements and efficiencies by using some of these new AI systems. I think it will also help us make better investment decisions. We've got technology here in the building where we have AI systems preparing first drafts of investment reports using all manner of different data sources, even thinking about what should we have? Sort of AI investment committee members, for example.

Spencer Levy

Let's stop there for a second, and I'm going to rewind that tape for 15 seconds. You've got six humans sitting around a table and two AI investment committee members. What does that mean?

Nick Montgomery

Well, we're not doing it yet, but it means you've got the ability to essentially put that proposal within a system and getting a really interesting perspective from AI on that transaction based on data sources, which we wouldn't have even contemplated five years ago. So, that's – I think that's down the road. I think what we are doing already, which is really interesting, is how we are now using, and I gave the example earlier of our U.K. impact strategy, our ability to at the touch of a button, provide an incredible level of geospatial analysis to allow us – to underwrite assets in a way that would have taken us weeks previously. So we have a system we've developed for our U.K. Impact Strategy, which we're rolling out, which takes a myriad of data sources, government data sources around things like housing, health, distance from a doctor's surgery, distance from a dentist, distance on the bus stop and many many many more and then through AI essentially driving a rating that looks all those areas and importantly using that system to identify need and where there's a potential for our capital to deliver a positive outcome in line with that social impact strategy. So I think there are some really exciting areas that we're working on as it relates to technology which will drive efficiencies but most importantly for us deliver a better investment outcome for our clients.

Spencer Levy

So let's just put this in practical terms. And, now, I'm like being a movie script writer here. We have the investment committee today, which is six or eight human beings sitting around the table using traditional metrics. Two years from now maybe we have the AI bot there that has a vote or at least input into what you're saying. And, so, we're here at One London Place and do you own this building?

Nick Montgomery

No, we don't.

Spencer Levy

Okay, so whoever owns this building has a choice of am I going to build this building and the six or eight committee members are – this is great Schroders got investment grade credit but the metro stop is one block too far away and because it's one block too far away we think that people will return to office three and a half days a week versus four and because of that we think that your building while it looks great on day one won't look as great on day three. Is that the kind of thing that's going to happen?

Nick Montgomery

I think, yes, insofar as that data will be there, but then there's sort of the lived experience as well, isn't it? And what's the immediate environment like around that building? How much tree cover is there? Is there a decent restaurant or coffee shop? I think what's great about our ability to use those data now is how you then combine it with that human lived experience and those specialist expertise that we've got, right. And actually for our asset management teams, it will allow us to spend more time on those tenant interactions, stakeholder interactions, because that can't be replaced by AI. The more commoditized property management, you know, the optimization of building management systems, for example, there are these areas which are fantastic and which we're already implementing. When we're marketing, selling buildings, virtual fly-throughs, the ability to space plan within a second. Those things are fantastically enabling in terms of allowing us to run faster, but the great thing about the real estate industry, as we're sitting here, is there is still that really critical people dimension, relationships, occupier relationships, stakeholder relationships, which should be very complementary.

Spencer Levy

And I think this is the key takeaway from this segment of the conversation because people say it's going to disrupt valuations. It's going to disrupt building operations. The answer is it's gonna take all of us or potentially take all us to spend more time on high value add activities. The analysis of the output, the relationship building which in the commercial real estate business is maybe the number one most important component because you're not getting a loan from a bank on a computer. You're not getting a lease with a major tenant on a computer. You're going to be able to get an investor on a computer. It has – it is physical, you're there and it takes years and things that are unquantifiable from relationship to trust and other factors.

Nick Montgomery

No, that's right, exactly right. We are managing largely, because obviously we're investing indirectly as well, but most of what we're doing is investing directly and creating the time for our teams to get out and look at assets, understand locations. That's the real value piece.

Spencer Levy

So one little, just a career tip for folks. One of the things that I've been doing for 30 years is every time I get a hotel, I try to pick my restaurant a mile or two away. Why? Because I like to walk cities. I walk cities, I've walked every city. I'll be walking London for three hours this afternoon because that is the only way to understand it. And that is one of the beauties of our business, notwithstanding how much can be quantified, so much can't.

Nick Montgomery

Yeah, my children know more about the U.K. industrial market than most other teenagers, because as you say, you're driving something, you pull off a motorway, you look at the estate, and that's what it's all about, isn't it? I know you've got to, because locations change as well, and you've gotta see it.

Spencer Levy

Absolutely. So, we're just about out of time but tell us your outlook of where the market is going over the next couple years. Any structural shifts, anything being overestimated, underestimated? Starting with you, Lee, how do you see the future of real estate here in the U.K.?

Lee Bruce

Well, the first thing I'd say is, I'd reiterate what I said at the start. I think we're in a good place in the U.K. I think the market is now gradually recovering. It's having some bumps along the way from macro global changes. And that will probably, I imagine, continue for some time. But I quite like the way we're positioned. I quite know where we are politically here. And I'm genuinely quite optimistic about the outlook. I mentioned one big change. So, we've um – final salary pension schemes in the U.K. are beginning to wind down. But the good news is we've got a whole big growth of the pension industry from DC mandatory pension contributions in the U.K. That will grow, I think, not unlike the Australian model. So, for me, that is the next decade, next 15, 20 years.

Nick Montgomery

I'd say there are three key points. I think looking at it not just U.K. but more broadly across the markets we're operating, we have seen a significant repricing. Not on the scale of the global financial crisis because balance sheets are in much better shape but nonetheless it

has been a significant pricing. It's been an uneven pricing as well, repricing, so I think we see opportunities over the next few years to get into interesting sectors as they reprice both by sector and the geographies in which we're operating. So we are excited about the opportunity that will come about through that repricing. The second point I'll say is, I think the underlying fundamentals are supportive. In most gateway cities, most sectors around those gateway cities there is an undersupply. There is a shortage, and as I mentioned, although the uncertainty means occupational markets could be a bit stickier, perhaps, than we thought going back six months, there is still a shortage of the best quality space. We've got cost-push inflation, and we think that will drive continued rental growth with inflation also remaining elevated. But again, I think real estate will do what it should do, which is provide that inflation hedging, which you can then enhance through the active management and getting the stock and the sector selections right. So, I guess, I'll just finish by saying, I think, although as I say, the outlook is uncertain, I think for investors who are looking to deploy today, we think this could be a really interesting entry point and therefore the vintage is coming from now across the different parts of the market, which we think have the most structural support. I think it's a really good time to be looking at the sector.

Spencer Levy

On behalf of The Weekly Take, great conversation with Nick Montgomery, Global Head of Real Estate, Schrodgers Capital. Nick, thank you for coming out today.

Nick Montgomery

Pleasure.

Spencer Levy

And hosting us in your beautiful space. And Lee Bruce, Head of Valuation, U.K. and Ireland, CBRE. Lee, I'll see you back at Henry Etterhouse in a few hours.

Lee Bruce

Thanks, Spencer.

Spencer Levy

If you caught my farewell just then, you'll note that we'll have more to come from our trip to the U.K. as we return to the CBRE office at Henrietta House to dig into development and construction. And something of a compliment to the investment-focused conversation you just heard, we hosted a roundtable featuring one of the top workplace builders in Europe. A show with lots of global insights and tactical takeaways. Before we go there, however, we've got a show from Boston with a big dig into investing ideas that are brewing at another firm that's deploying capital all over the world. For now, remember to share this episode and look for related content on our website, [CBRE.com/TheWeeklyTake](https://www.cbre.com/TheWeeklyTake). And if you like what we do, please also subscribe, rate and review us wherever you listen. Thanks for joining us, I'm Spencer Levy. Be smart. Be safe. Be well.