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UK Commercial Market in Minutes
Overseas investor confidence driven by attractive returns

February 2018

Yields remain flat

■ There was no movement of the UK yield average during January, but it does remain around 30 basis points lower than a year earlier.

■ There is, however, downward pressure on these yields, with a couple of sectors (Industrial Distribution & M25 Offices) still having a downward trend arrow applied to latest figures.

■ For 2017, the outcome for the UK investment volume was approximately £65.4bn and this represents a 26% increase on the 2016 total. The office and industrial sectors led the way to meet investors' appetite for UK commercial real estate.

■ Of the 2017 total investment volume, nearly half was accounted for by the overseas investor and a fifth of all investment was Far East, by origin. These investors are looking beyond Brexit and happy to secure prime property with secure income characteristics.

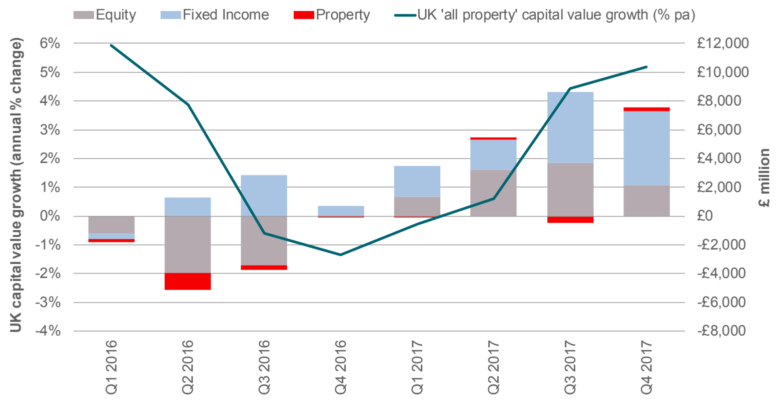
■ The industrial sector saw nearly £11bn of property change hands, which was 80% higher than the previous year. For all sectors, the initial data for January 2018 shows a 66% increase on the total level recorded for the same month last year. This will include deals falling in to 2018, but again illustrates the strength of investors' appetite this year.

■ Graph 1 shows data from The Investment Association. The net retail sales for property funds went in to positive territory in Q4 2017 driven by a more positive capital growth outlook.

■ As this edition marks the 10-year anniversary of this publication, it is worth looking back to February 2008 and reflect on how different the market was then. Average UK prime yields had risen by over 120 basis points during the year, development activity indicators had slumped and GDP expectations were slashed. Compared to risks highlighted in the first edition, the Brexit impact is currently relatively mild!

GRAPH 1

Net retail funds sales for property moved slightly positive in the final quarter of 2017



Graph source: The Investment Association, MSCI

TABLE 1

Prime yields

	Jan 17	Nov/Dec 17	Jan 18
West End Offices	3.25%	3.25%	3.25%
City Offices	4.25%	4.00%	4.00%
Offices M25	5.25%↓	5.00%↓	5.00%↓
Provincial Offices	5.25%↓	4.75%	4.75%
High Street Retail	4.00%	4.00%	4.00%
Shopping Centres	4.50%	4.75%	4.75%
Retail Warehouse (open A1)	5.25%	5.00%	5.00%
Retail Warehouse (restricted)	5.75%	5.25%	5.25%
Foodstores	5.00%	4.50%	4.50%
Industrial Distribution	5.00%	4.50%↓	4.50%↓
Industrial Multi-lets	4.75%↓	4.25%	4.25%
Leisure Parks	5.00%	5.00%	5.00%
Regional Hotels	5.25%	4.50%	4.50%

Table source: Savills

Returns likely to be higher than expected

■ Graph 2 illustrates the growth in capital values for 'all property' in the UK and helps to highlight short-term trends. The two lines show either the change over the year or the month to end-2017. Both remain positive.

■ Independent UK property forecasts, including those from the Investment Property Forum, suggest total returns between 4% and 5% in 2018. Based upon our current projection, we think this looks too low. Annual rolling UK total returns are just above 11% as at the end of January 2018.

■ We expect total returns to be around 7% this year. This will be driven by slightly better than expected rental growth in most sectors, particularly industrial, but primarily a continued downward shift in equivalent yields, which have been on a downward trend since autumn 2016. The latest monthly data from MSCI supports this, with average 'all property' yields now below 6% for the first time since end-2007.

■ The outlook, just for 2018, shows that the industrial sector continues to lead the way in terms of total return expectations. This is followed by the broad retail sectors and then offices. The markets closer or within the South East have a higher total return outlook.

Corporate transactions will drive UK economic growth

■ Despite an improving level of consumer confidence in the UK, the corporate sector is still slightly less sanguine. A recent Deloitte survey of Chief Financial Officers, across 19 European countries, show that 38% of the UK respondents expect fewer employees in the next 12 months - the lowest of all the countries. This will impact on the perceived need for additional commercial floorspace.

■ However, much more positively, is the fact that the UK still accounts for a significant proportion of corporate investment transactions, which includes venture capital, private equity and M&A activity. These types of transactions drive corporate growth and ultimately some form of commercial property event, for example, from the headcount growth.

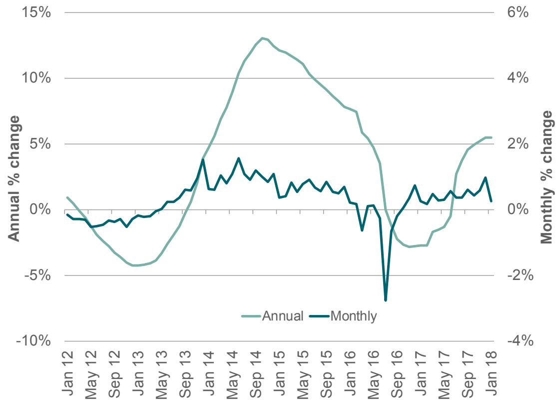
■ There are two key points from Graph 3. Firstly, the level of investment has increased substantially in the past five years, despite Brexit. The rise in the overall volume of corporate investment, has amounted to £6.4 trillion in this last 5-year period. Secondly, the share for the UK, at around 30% on average, is substantial and will drive UK growth.

■ It is worth picking up the second point. The confidence in the UK as a centre for investment, whether it is corporate M&A or investment into the start-up community, illustrates the inherent strength of the UK.

■ What does this data tell us about the UK commercial property market? In fact, a lot, as this is the 'oil' in the UK economy. The corporate investment data is completed deals only and the scale of these transactions will result in some form of real estate activity as the companies grow and expand as a result of raising new capital.

GRAPH 2

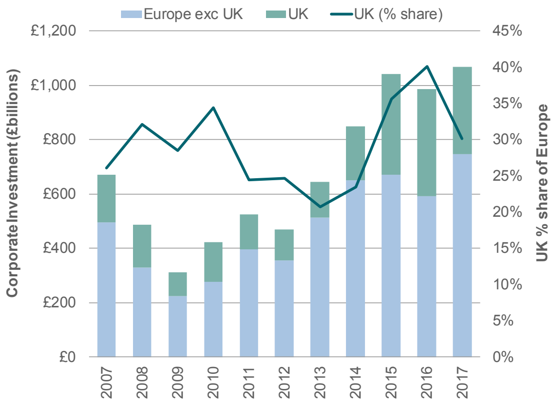
Monthly capital growth remains positive, but annual growth is levelling



Graph source: MSCI

GRAPH 3

Corporate investment is the latent driver of occupier floorspace demand



Graph source: Savills, Company data

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