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IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

May 2021

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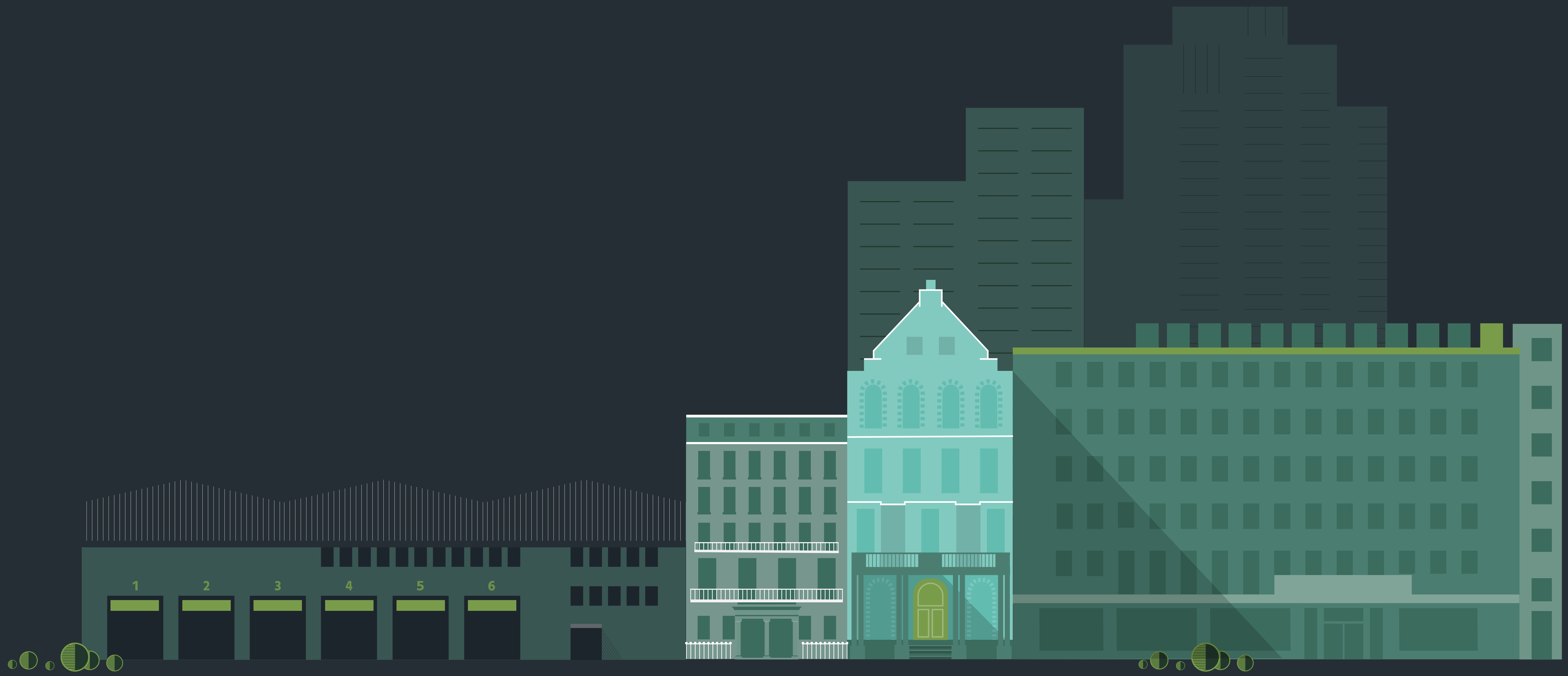

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MAY UPDATE

All Property quarterly total return continued to rally in April, driven by a surge in the industrial sector back to the heights of its 2017/18 previous peak of the market. Some of the largest recent investment deals were distribution warehouses, though investors also continue to target UK life sciences. Read more for the most recent occupier and investment updates, economics data and property forecasts.

Read more.

20.5% ▲	-52.5% ▲	7.5% ▲	1.4% ▲	1.0% ▲	5.3% ▲
London multi-let annual total return	May workplace visits, below pre-pandemic baseline	2021 GDP forecast	2021 CPI forecast	2021 10-yr bond yield forecast	2021 unemployment rate forecast

Surge in industrial returns

All Property quarterly total return continued to rally and hit 2.6% in April, which was the strongest since February 2018. At the All Property level rents have stabilised and the performance was again driven by positive yield impact on capital values.

Once again this was driven by the **industrial** sector that surged in April back to the heights of its 2017/18 previous peak of the market. This reflects the "frenetic" 2021 investment activity described by agents now showing up in the valuations metrics of MSCI. The London multi-let average equivalent yield hit a new low of 4.17% in April, with the annual total return now in excess of 20%. UK-wide distribution warehouse yield tightening similarly returned over 18%, set against moderate rental growth of only 2.6%.

Some of the largest investment deals of April and early May were distribution warehouses – the roster includes £144m for the JLR site in Solihull, £110m for Next Group's distribution centre in South Elmsall, a £103m portfolio of speculative sites across the East Midlands bought by NFU Mutual and ASI's £100m purchase of the Amazon-let Hinckley 532 building.

Retail continued to make steady gains overall in April and quarterly total return increased to 1.1%. This is still a one-horse race, however, with retail warehouses quarterly total return improving every month since May 2020 to reach 2.9% in April. Meanwhile shopping centres and high street returns have remained constant at around -4% and -2.5%, respectively.

Hammerson sold seven retail parks to private equity firm Brookfield for £330m in April to pay down debt and it completes the retail landlord's disposal of its retail park portfolio. Centrica Pension Fund bought a David Lloyd centre in Northwood for £51m in one of the largest leisure deals of 2021 so far. Leisure quarterly total return continues to be increasingly positive and reached 1.4% in April, driven by yield tightening.

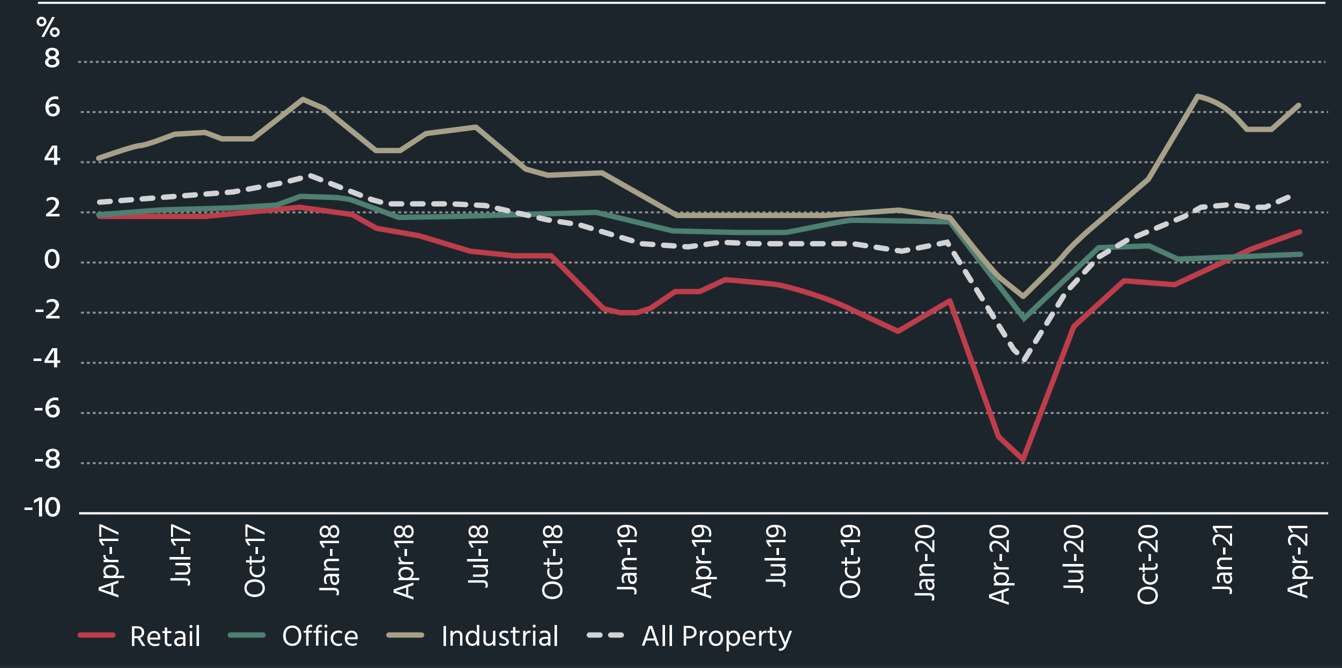
Office quarterly return continued to effectively flatline at around zero in April as it has done all year, with the sector still to reveal how it will position itself post-lockdown. However, this aggregate figure does disguise a divergence in returns over the past year, contingent on income length. Returns on London office assets with relatively longer income have held up, whereas riskier shorter income has skewed into negative territory, as shown in the chart.

Strong investor appetite for UK life sciences continued into Q2. Harrison Street and Trinity Investment Management's joint venture to buy BioCity Group for £120m included a portfolio of 12 science park properties totalling almost half a million sq ft in Nottingham, Cardiff and Glasgow. AXA IM also recently purchased the Sherard Building on Oxford Science Park for a rumoured £23m.

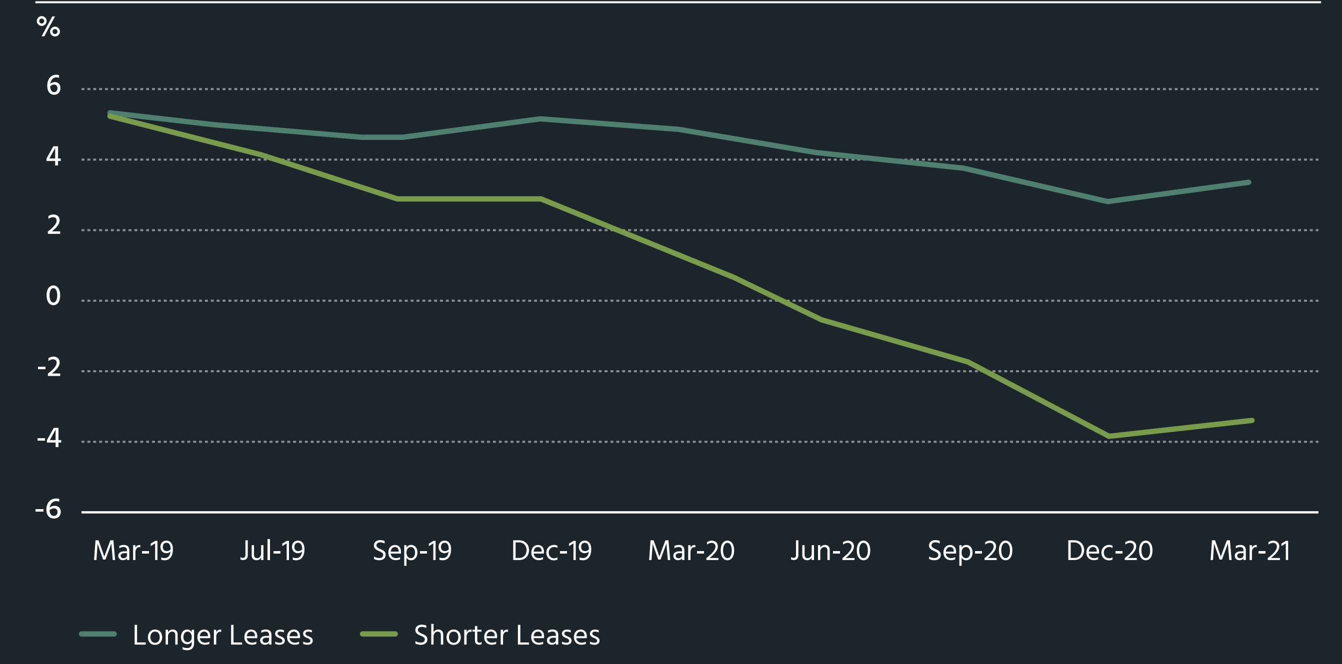
20.5% ▲
London multi-let annual total return

£330m
Largest April deal, Retail Portfolio

Quarterly total return by sector
Source: MSCI



London office annual total return by remaining lease term
Source: MSCI



Segments

12-month return to April 2021
Source: MSCI

UK economy

UK GDP surprised on the upside and increased by 2.1% month-on-month in March, which limited the Q1 lockdown quarterly economic contraction to just -1.5%. The reopening of schools on 8th March was linked with higher scores on mobility indicators and an upward trend of spending on credit and store cards. Q1 2021 sits in stark contrast to the -19.5% contraction in Q2 2020 under the first lockdown. It also means that GDP in March was 'only' 5.9% below its pre-pandemic level.

As for Q2, non-essential retail and outdoor hospitality reopened on 12th April, boosting retail sales to an incredible 42% up on a year earlier. Spending on clothing and footwear was triple the figure of April 2020. Consumer confidence increased to its highest in over a year and the recent 17th May further relaxation of lockdown to include indoor hospitality will drive further gains. Oxford Economics forecasts UK GDP to grow by an increased 5.7% quarter-on-quarter in Q2 and has again revised its forecast for GDP growth in 2021 to 7.5%, up from 7.2% last month.

Continued fiscal support will be a key influence, with most of the highly stimulatory Covid-related support schemes due to remain in place until the autumn. Demand for labour should be recovering by the time that the Job Retention Scheme is withdrawn in September. The latest ILO unemployment figure showed another tick downwards to 4.8% and the expectation is that it will still rise but to a downward-revised forecast of 5.3% by the year-end. This is only 1.5 percentage points above its pre-pandemic rate at end-2019.

As expected, base effects from energy prices and unusual seasonal pricing patterns in the clothing sector shifted the annual CPI inflation rate to 1.5% in April, up from 0.7% in March. This temporary increase is set to continue for the next couple of months. Broadly though disinflationary pressures should prevail and household spending power will be further supported by low inflation, with CPI forecast to stay below the 2% target over the next few years.

7.5% ▲
2021 GDP forecast

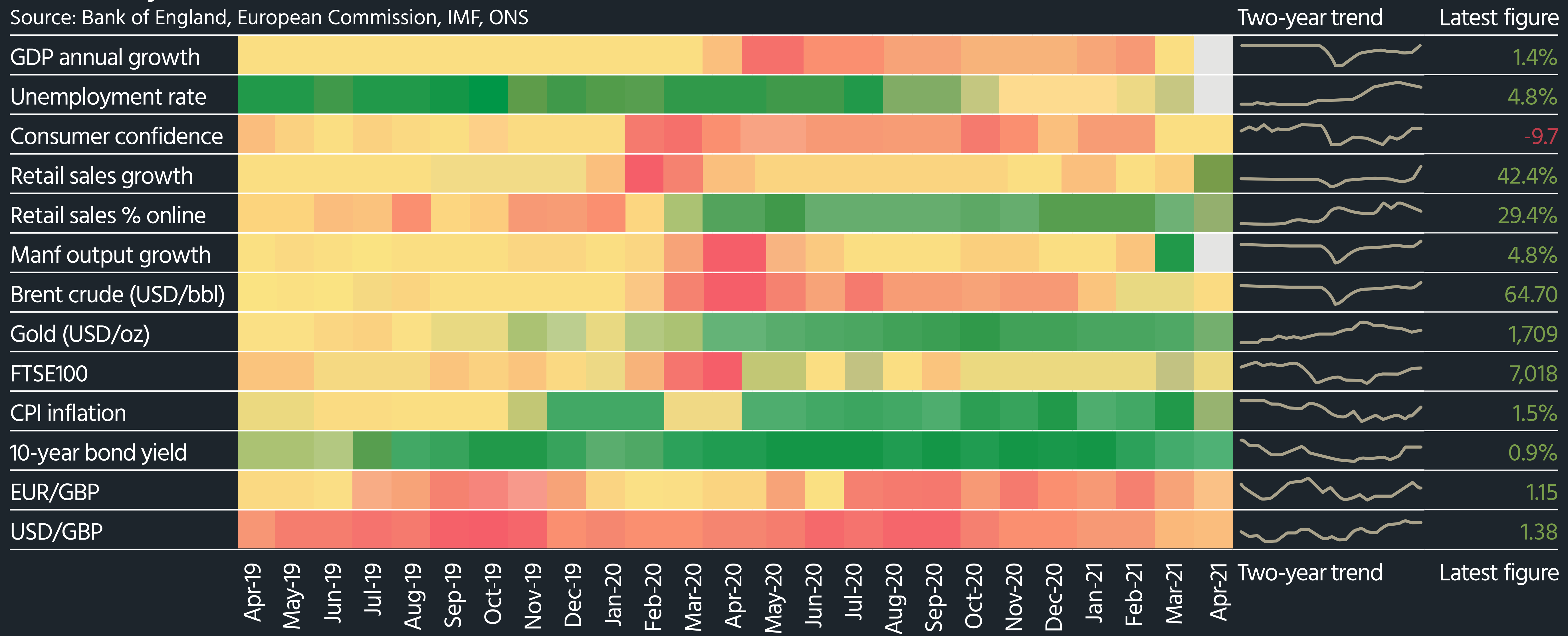
1.0% ▲
2021 10-yr bond yield forecast

1.4% ▲
2021 CPI forecast

5.3% ▲
2021 unemployment rate forecast

The monthly monitor

Source: Bank of England, European Commission, IMF, ONS



Spotlight on... London office recovery

Occupier activity still hesitant and erratic

Office take-up increased 25% in Q1 2021 to 1.4m sq ft but this was still less than half the 5-year average of 3.1m sq ft. Monthly take-up data in Q2 has so far given no further indication of a meaningful recovery in the lettings market. The 562,000 sq ft taken-up in April was a positive sign and the strongest figure in nine months. However, activity to 18th May has been limited with only 119,000 sq ft signed, requiring an additional 683,000 sq ft to be let in the remainder of Q2 to reach even the Q1 activity level.

Workplace visits still very muted but now above December 2020 (pre-third lockdown) peak

Mobility data show that visits to workplaces in Inner London during May were still less than half of their pre-lockdown baseline level. The trend over 2021 has been an increasing one, however, in line with the lifting of certain lockdown measures on 8th March and 12th April, and as larger proportions of the population have been vaccinated. Given these factors, the proportion that have returned is still extremely muted and it appears that most are waiting until after 21st June, when it will become clearer how occupiers intend to position themselves once all restrictions are lifted.

Law firms continue to drive occupier activity

The professional services sector has been the most active occupier group so far in 2021, accounting for 32% of all market activity. Law firms have been key with a 200,000 sq ft pre-let commitment from Latham & Watkins at 1 Leadenhall, and Sullivan and Cromwell's renewal of 67,000 sq ft at 1 New Fetter Lane. As a subsector, law firms have made up 61% of all professional services take-up and accounted for just under a fifth of all central London office occupier activity in 2021 so far. Law firms have been active during previous downturns to take advantage of property market conditions, but this time around the case is even stronger, given concerns over the potential operational security implications of long-term home working.

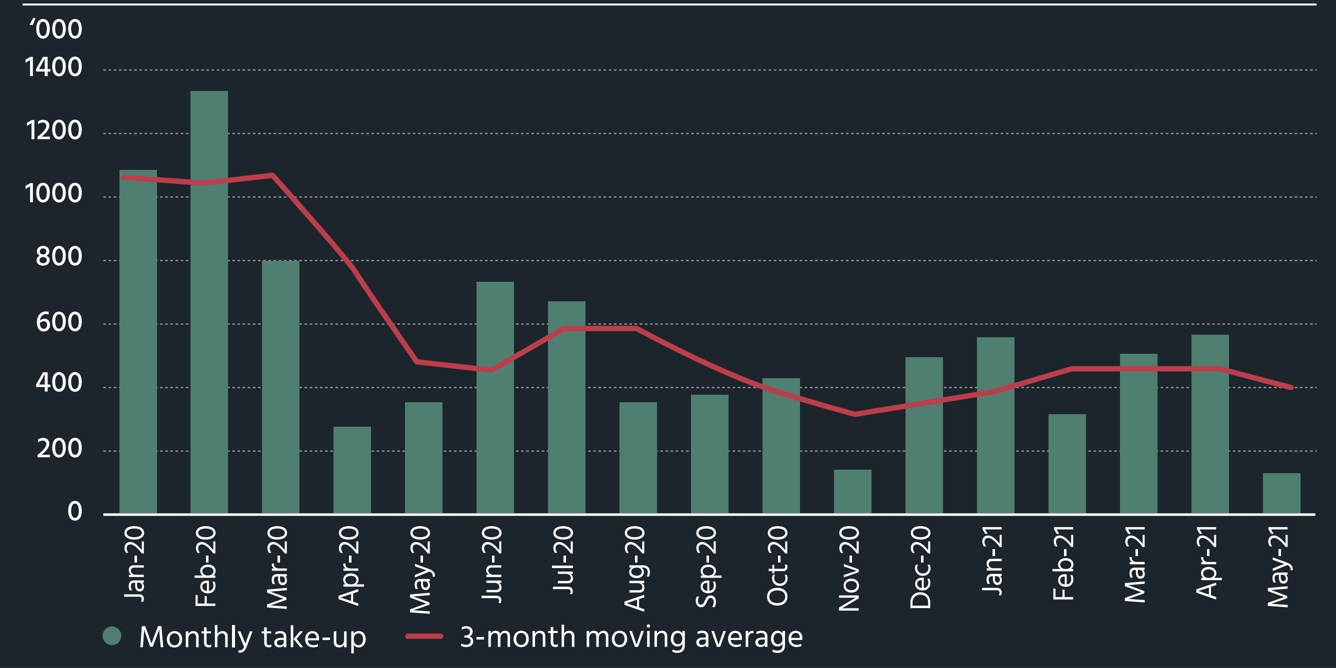
32%
Professional services take-up

19%
Legal sector take-up

2m sq ft
Central London office take-up YTD

-52.5%
May workplace visits, below baseline

London Office, monthly take-up
Source: Gerald Eve



London workplace visits, below pre-pandemic baseline
Source: Google mobility data

Outlook

All Property total return is forecast to return to a positive and be 9.4% in 2021, slipping back to 6.9% in 2022. This will be driven in the short term by industrial as yields tighten further in H1 2021, and as retail and leisure pricing stabilise and contribute positively again in some cases in H2 2021.

There will be sustained underlying strength in the industrial market, especially in London and the South East. The current late cycle surge in investment activity and pricing will boost total return in 2021. An uncertain outlook for consumers and businesses following the unwinding of lockdown government support late in 2021 will inevitably lead to at least some small increase in voids, meaning total return is forecast to slip back in 2022.

Headline office rents are expected to deteriorate more rapidly in 2021 as the return to the office better evidences the occupier fallout from the lockdowns. Thus some further yield softening in the short term is expected – particularly for secondary assets that pose greater operational and ESG issues.

Retail should experience some further but smaller fall in rents and more moderate outward yield shift in 2021. A non-negative annual total return in 2021 driven by retail warehouses will be the first since 2017. By 2022 total return should increase to be relatively competitive against other sectors, boosted by a large income return component.

Total return and components by sector
Source: Gerald Eve, MSCI

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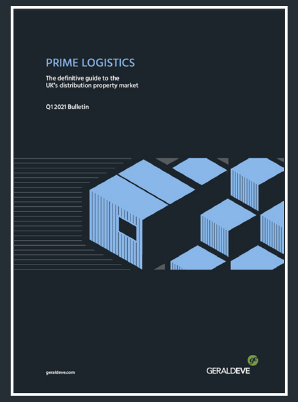
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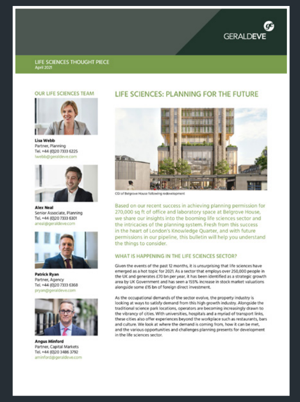
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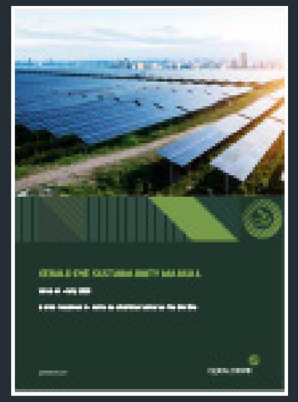
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