



GERALDEVE

# IN BRIEF

## UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

September 2021

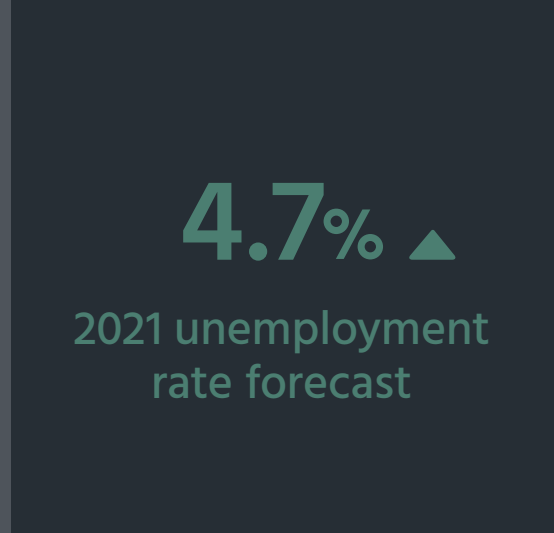
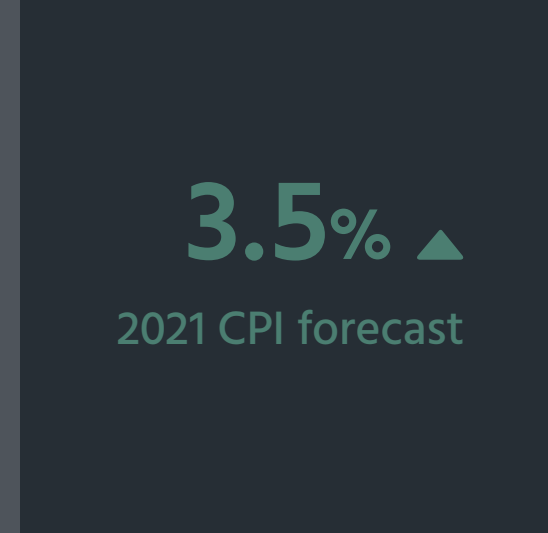




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## SEPTEMBER UPDATE

All Property annual rental growth was effectively zero in August, which was the first non-negative figure since before the pandemic in January 2020. Retail rents edged ever closer to a floor while exceptional industrial returns pushed All Property annual total return to almost 12%. Read more for the most recent occupier and investment updates, economics data and property forecasts.



# First non-negative rental growth since the pandemic

**All Property** annual total return continued its upward march and hit 11.6% in August. The driving factor is yield impact but rental growth is no longer a drag. All Property annual rental growth was effectively zero in August, which was the first non-negative figure since before the pandemic in January 2020.

The improved rental trend was driven by strength in industrial and further signs of stabilisation in retail. Retail rental growth was running at an annual rate of -5.2% in August and this should continue to come closer to zero quite quickly over the next few months as higher frequency indicators suggest minimal declines in retail rents in recent months. In the three months to August, high street rents fell 1.1%, shopping centres 0.3% and retail warehouses only 0.1%.

**Retail** continues to be the least traded sector, with effectively only retail warehouses and supermarkets featuring in investment transactions in recent months. In August Invesco acquired the Fort Shopping Park in Birmingham for £84m in a joint venture with George Capital. The Railways Pension fund also sold their 'Railpen' retail warehouse portfolio to iSec for £68m, with assets across Cardiff, Scunthorpe and York.

**Industrial** continues to perform robustly, with annual total return at over 27% in August. Strong positive rental growth and yield impact have worked together to generate some of the highest returns on record in recent months. London multi-let and national distribution warehouses continue to be the strongest performers, both at around 30% annual total return in August.

Large distribution warehouse rents took a sharp step up in most locations in Q3, particularly in the south and west London prime markets where competing segments of occupier demand are set against very low vacancy. Data from the multi-let segment also show a sharp acceleration in rents at the midpoint of 2021 as new entrants such as the last mile food delivery specialists seek coverage of urban centres, set against effectively a fixed supply.

It's not all logistics though – Blackstone recently spent £130m on a 91 acre site in Broxbourne, Hertfordshire for a proposed new £700m expansion of Sunset Studios. In more traditional fashion, EQT Exeter took Primark's 785,000 sq ft Huntington Road distribution warehouse in Thrapston, Northamptonshire for £102m.

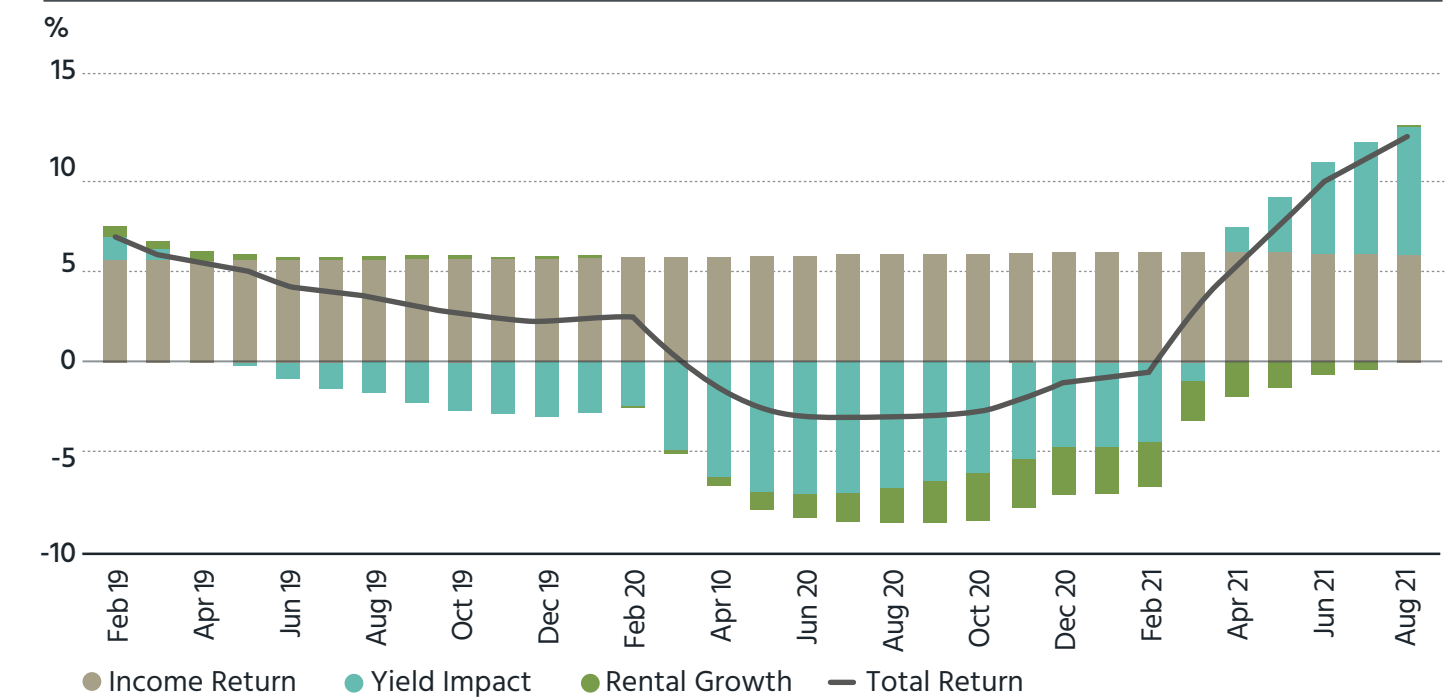
**Office** investment performance still appears relatively unremarkable. Quarterly rental growth remains lacklustre while the market is awash with sublet available space. Meanwhile take-up is ticking over broadly in line with lease events while occupiers still deliberate over their requirements. The investment market has been more active, especially at the prime end. Typically activity has been focussed on London but Regional REIT's recent purchase of the UK-wide 31 asset Squarestone Portfolio for £236m reflects confidence in the regional office market.

**0%** ▲  
All Property annual rental growth

**27.2%** ▲  
Industrial annual total return

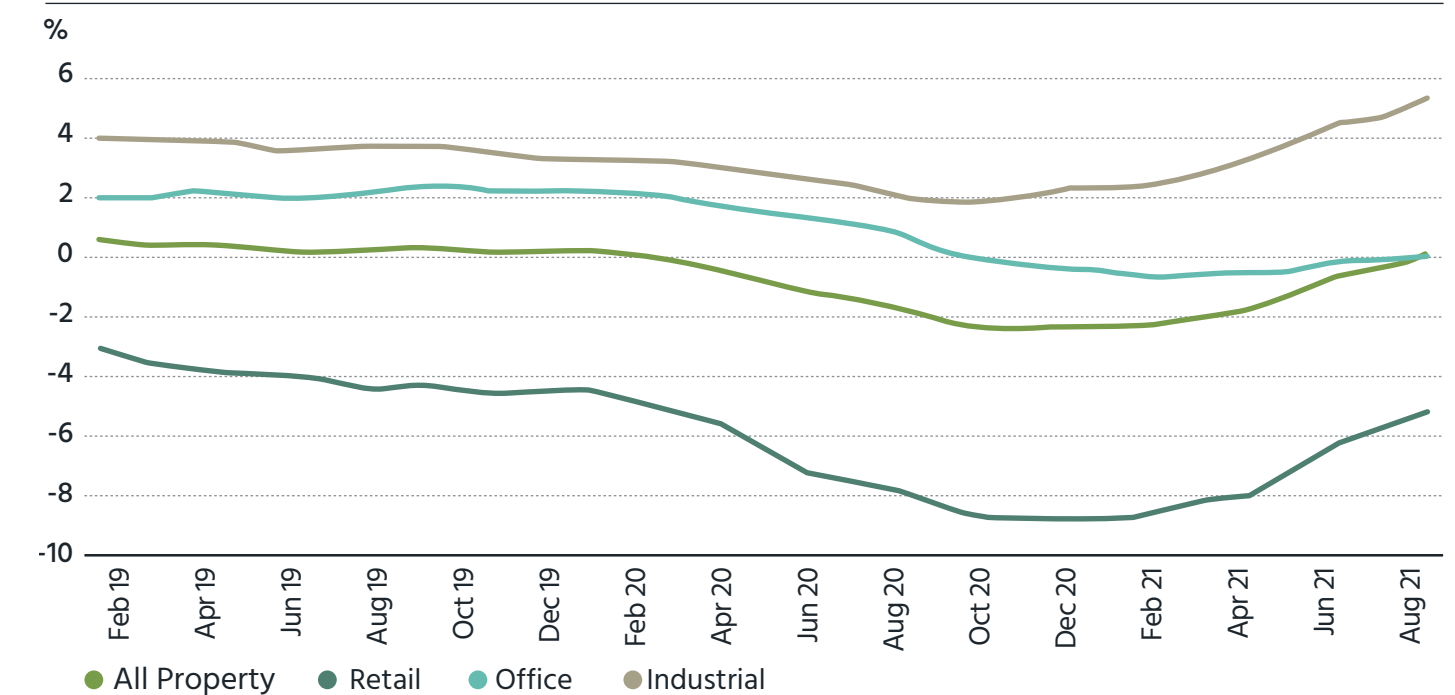
**All Property annual total return and components**

Source: MSCI



**Annual rental growth by sector**

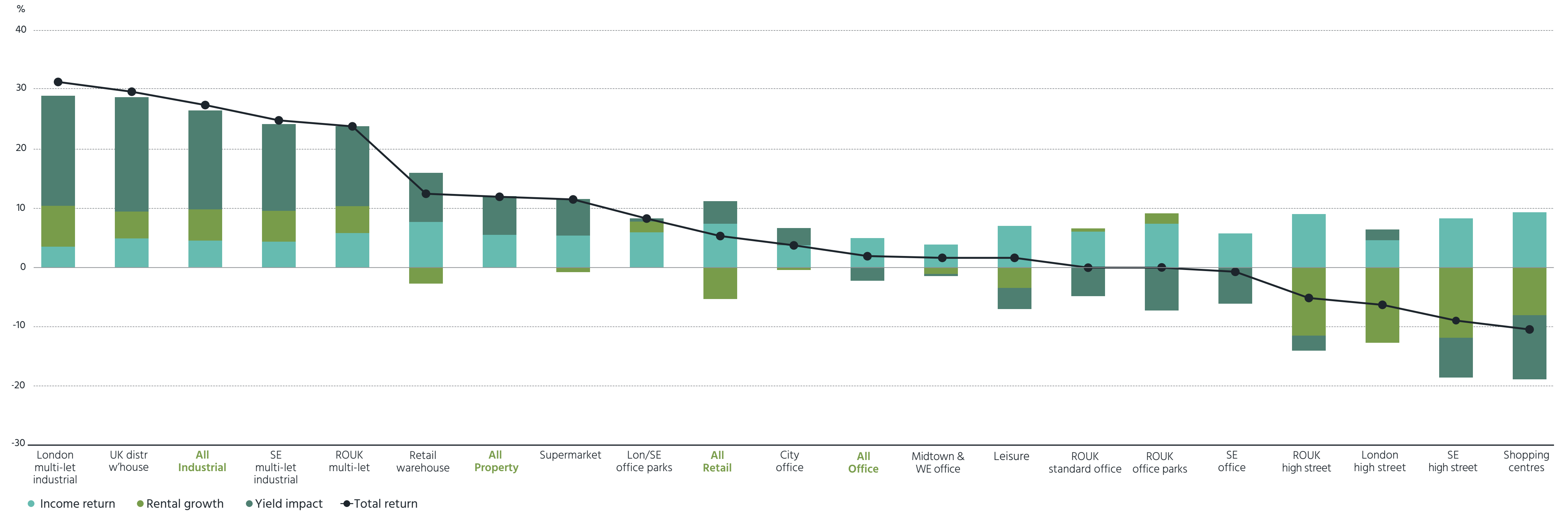
Source: MSCI



# Segments

## 12-month return to August 2021

Source: MSCI



# UK economy

UK GDP increased by a disappointing 0.1% between June and July. This has been put down in part to rising covid cases and the surge in the amount of people asked to self-isolate. This stopped large numbers of people from going to work and curbed footfall in shops and restaurants.

Retail spending was again down 1% between July and August, and 5% below the recent peak in April. The most significant cooling in recent months has been spending on homewares, which was almost 14% lower in August than in May. This volatility reflects the continued normalisation of spending patterns, set against the ongoing unpredictability of covid. Online spending accounted for around a quarter of the retail total, which is a sustained increase above the pre-pandemic level of less than 20%. Consumer confidence edged downwards again in August but remained comparable to figures at the end of 2019.

Economic commentators remain relatively bullish and predict a pickup in short term activity from the lingering impacts of lifting social restrictions and less stringent rules on self-isolation – though the major economic gains are now in the past. More recent high-frequency data support this and excess cumulative household savings will be an enabling factor. Fiscal policy remains highly stimulatory, with most government support schemes to run until the autumn and some even into March next year. The weaker-than-expected outturn for July and escalating transportation and goods costs and shortages means Oxford Economics has revised its 2021 GDP growth forecast to 6.9%, down from 7.3% last month.

The rate of annual CPI inflation jumped to 3.2% in August from 2% in July. This is still considered temporary by most commentators and includes various fuel cost increases (which will include a jump in the energy price cap in October), the hospitality VAT cut reversal and spike in the price of global goods. Oxford Economics predicts that CPI inflation will finish 2021 at 3.5% and fall back in 2022. We are more concerned that price rises could become more entrenched, but in either case the Bank of England is likely to tolerate this and not increase the base rate until 2023 at the very earliest.

**6.9%▲**  
2021 GDP forecast

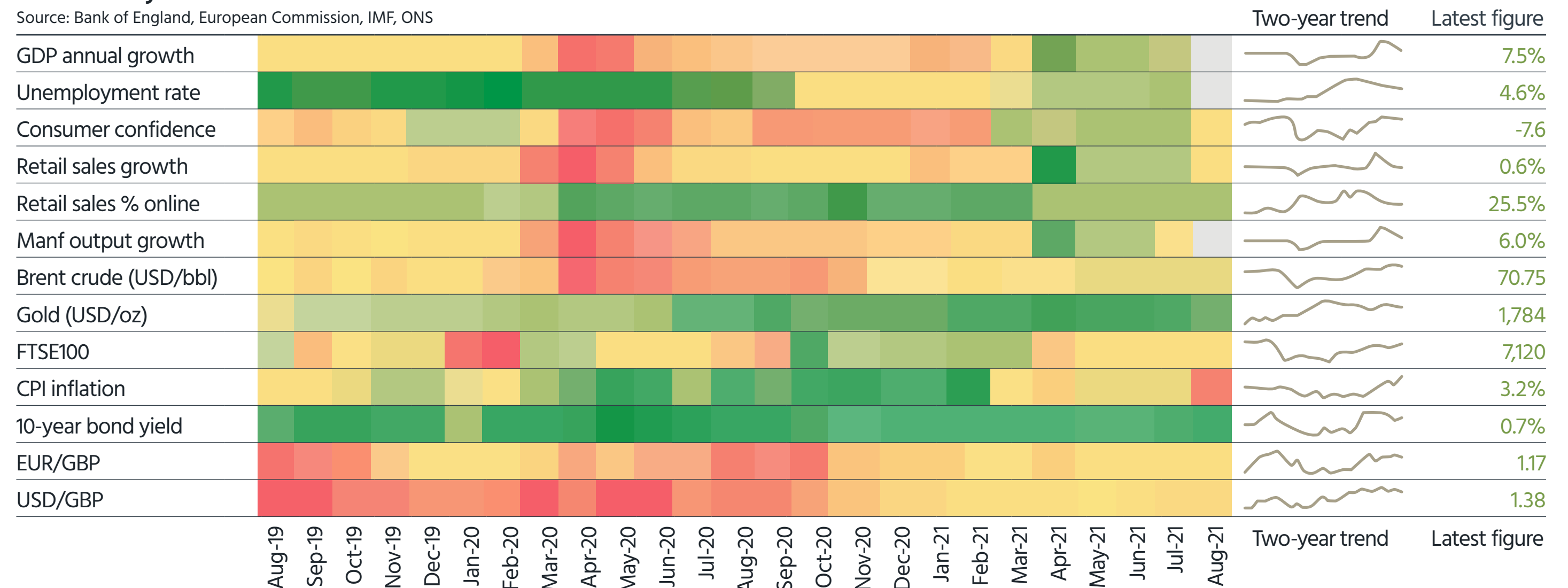
**3.5%▲**  
2021 CPI forecast

**0.9%▲**  
2021 10-yr bond yield forecast

**4.7%▲**  
2021 unemployment rate forecast

## The monthly monitor

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



## Spotlight on... Multi-let industrial

Multi-let is the smaller end of the industrial market, with units characterised in Gerald Eve’s unique and detailed syndicated study as being between 500 – 50,000 sq ft. Much like their big box logistics brethren, multi-let market rents have accelerated again so far in 2021 after a strong finish to 2020. London and the South East rental growth has been particularly bullish, and incentives and underrentedness here have also continued to trend downwards, which means the passing rents tenants pay have accelerated even faster than headline market rents.

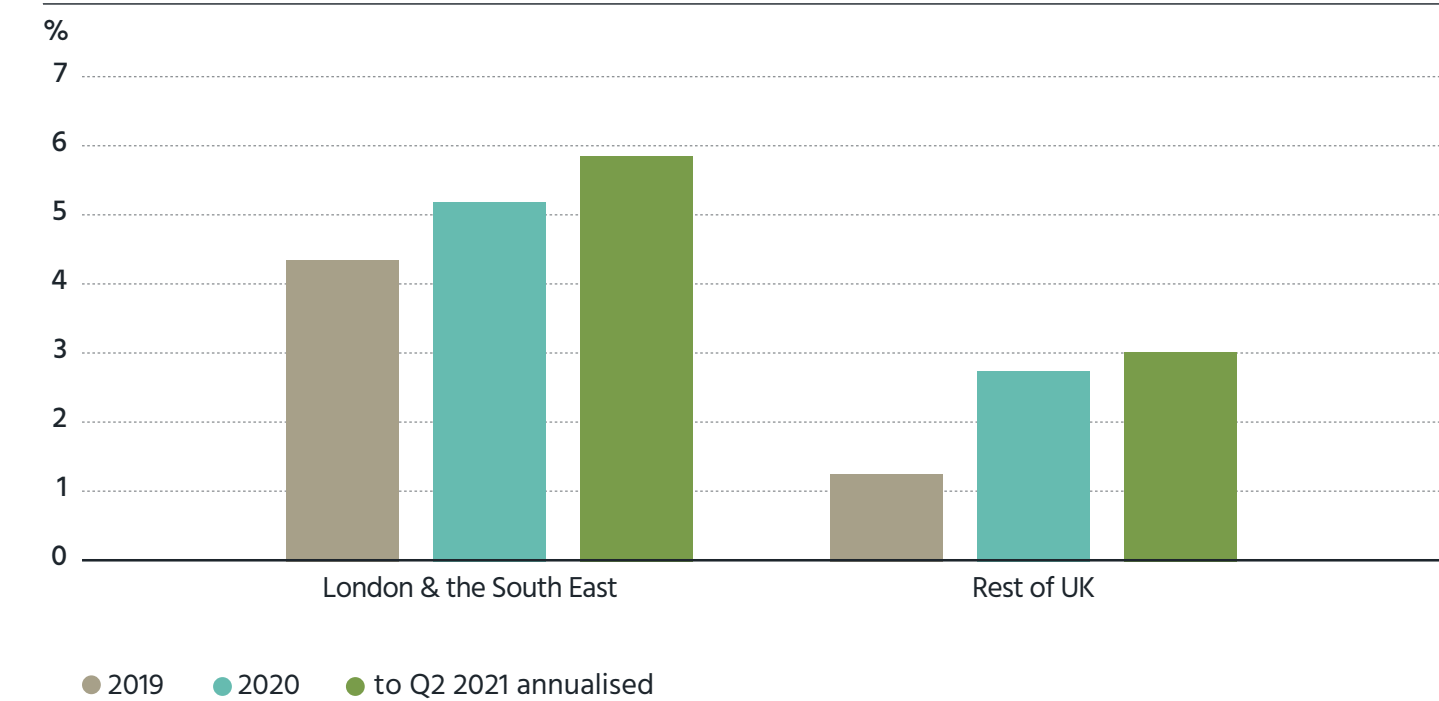
The footprint of logistics occupiers continues to grow strongly, particularly in the larger multi-let units in Greater London where this accounts for around a third of all space. In Inner London the major sector is food-related occupier activity, which takes up around a quarter of all multi-let floorspace. Increasingly this has been accounted for by the rapid expansion of last mile food delivery specialists. Having the right network of locations for these operators is key and, since supply of multi-let units is essentially fixed, rents have pushed up. Tenancy lengths have continued to trend downwards, which is great both for these types of tenants seeking flexibility and for landlords to capture the rent reversion.

Somewhat surprisingly then, the Q2 data suggest that the multi-let void rate in London & the South East moved above that of the regions outside of the South East for the first time on record. The driver appears to be the larger mid box multi-let units in Inner London. This could reflect affordability and substitutability factors. While tenants in the smaller space that operate on very short notice delivery functions need to be in this geography, larger generalised storage and distribution functions could potentially be operated from a less central location at much-reduced cost. In the current market, landlords will be more comfortable to take a void and hold out for the right tenant and/or the highest headline rent, or indeed an angle to repurpose to residential.

Broader risk measures for multi-let, such as retention after expiry, propensity to exercise breaks and the default rate have all improved recently or were ostensibly not negatively impacted by covid. Government interventions have been impactful of course, but the conditions of the pandemic have arguably been as beneficial for many of the smaller industrial occupiers as their larger counterparts. This combined with the flexibility and entrepreneurship of many of these smaller tenants has led them to flourish for now. Looking forward however, almost a third of all UK multi-let floorspace has a lease event over 2021/22. This represents a key risk as the economy heads towards a difficult period of intensified inflation mixed with the impacts of Brexit and as supportive government policies are taken away.

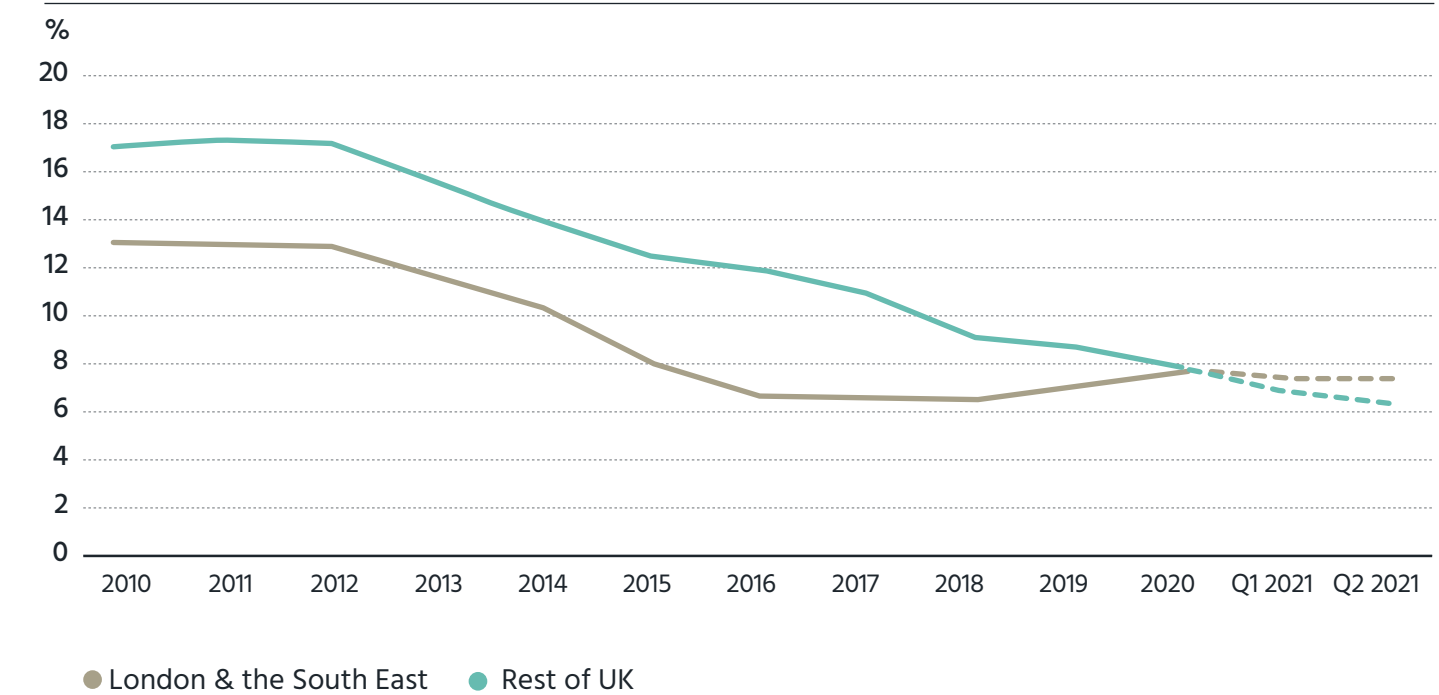
### ERV annual growth rates

Source: MSCI, Gerald Eve



### Void rates by major region

Source: MSCI, Gerald Eve



# Outlook

All Property total return is forecast to hit 12.0% in 2021, before slipping back to 8.8% in 2022. This will be driven in the short term by the surge in industrial rents and yield tightening, and as retail and leisure pricing stabilise and contribute positively again in some cases by the end of 2021 and into 2022.

There will be sustained underlying strength in the **industrial** market, not only in London and South East multi-let, but also wider UK distribution warehouses. The current late cycle surge in investment activity and pricing will boost total return in 2021. However, this very keen pricing going into more uncertain economic conditions in 2022 suggest this exceptional rate of return will not be maintained.

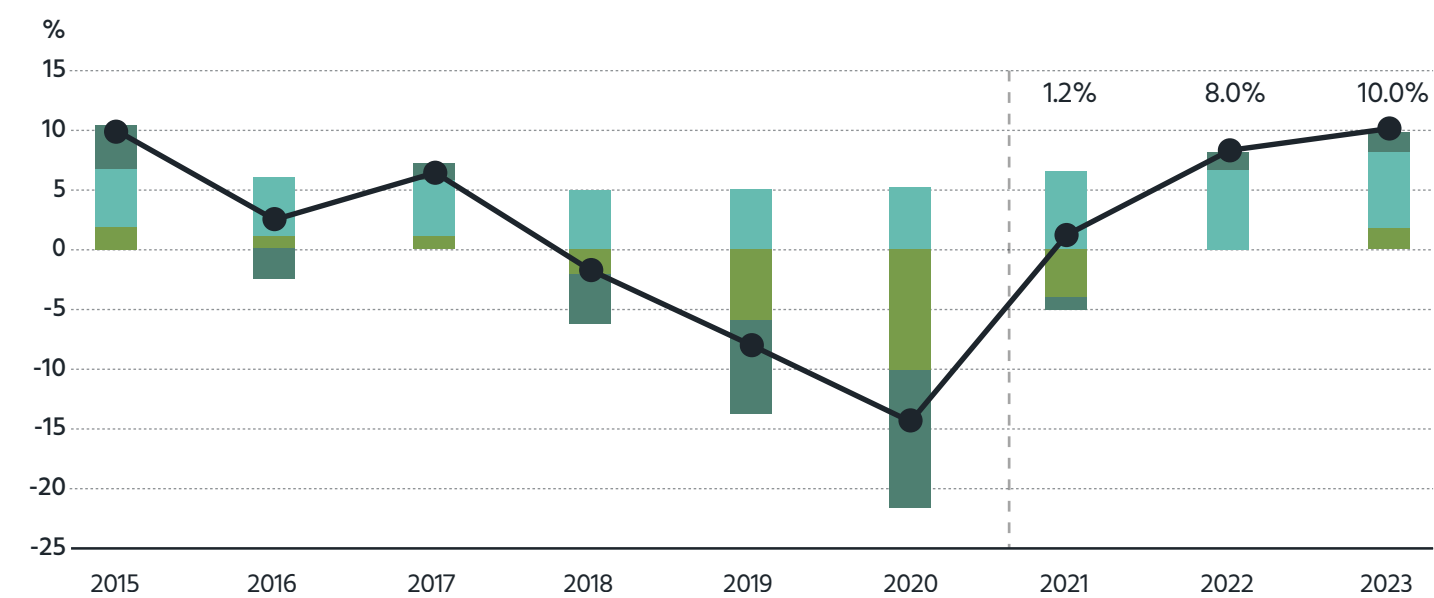
Headline **office** rents in the regions are expected to erode over 2021 as tenant-controlled space continues to increase. Thus some further yield softening in the short term is expected – particularly for secondary assets with short income that pose greater operational and ESG challenges.

**Retail** should experience some further but smaller falls 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.

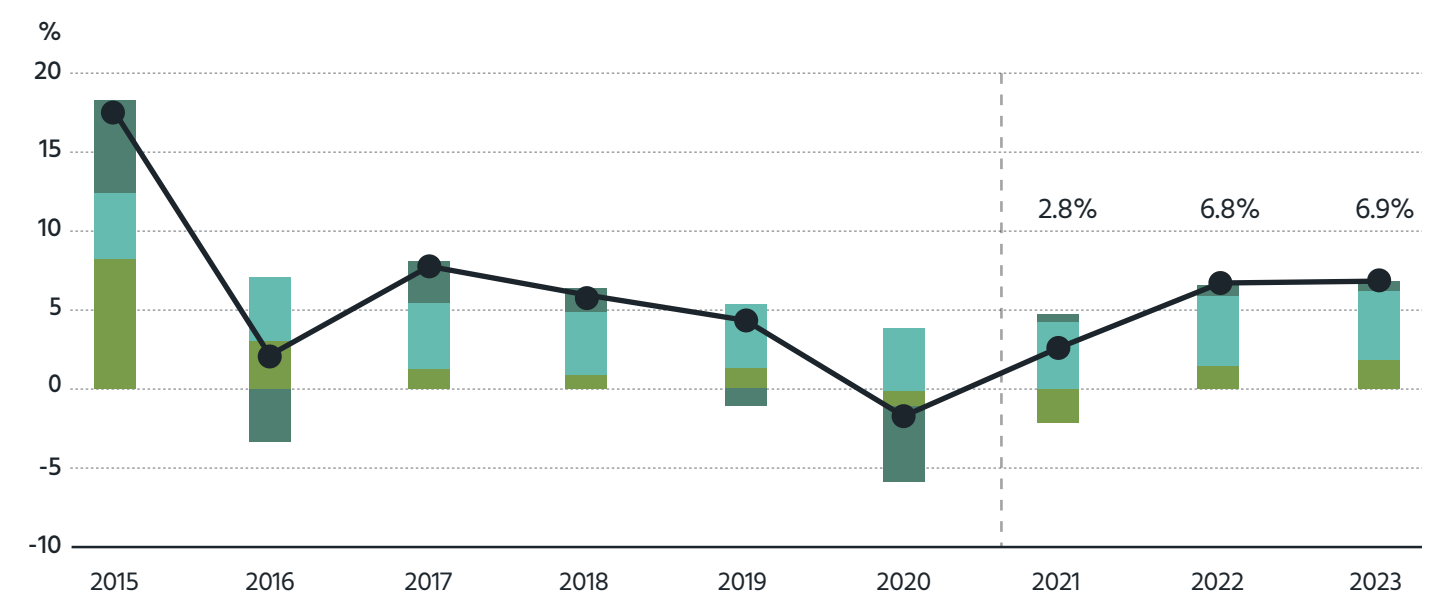
## Total return and components by sector

Source: Gerald Eve, MSCI

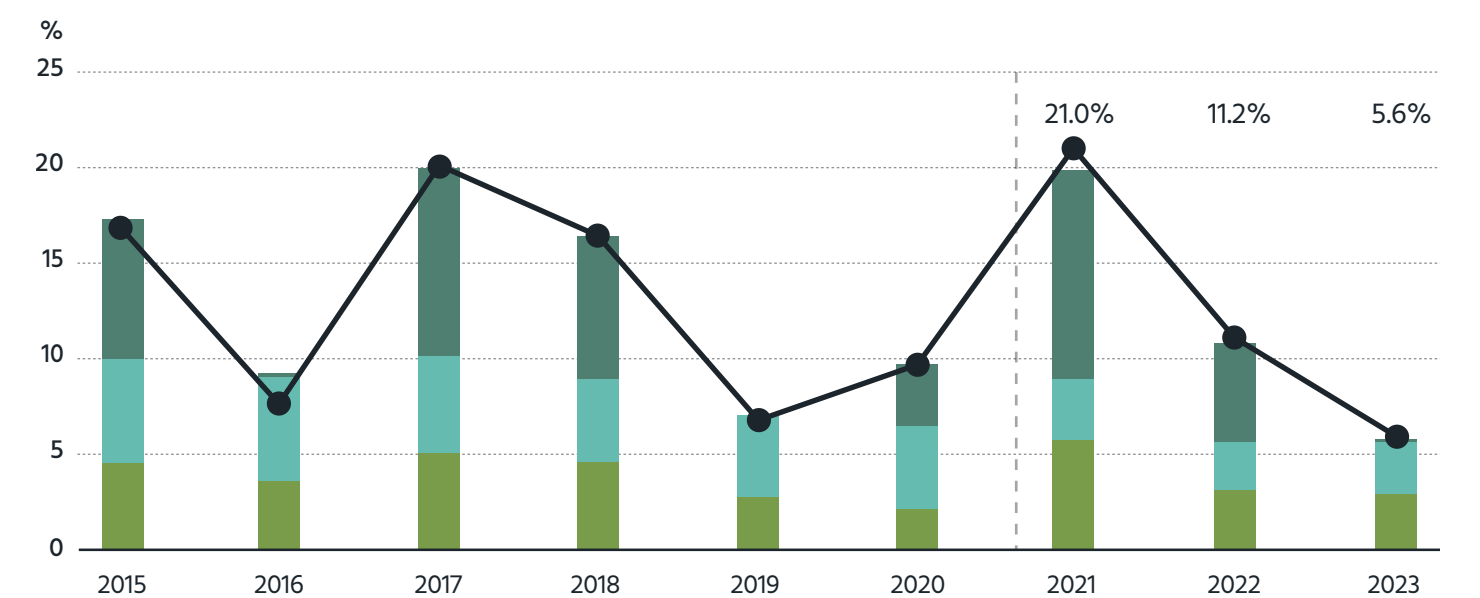
### Retail



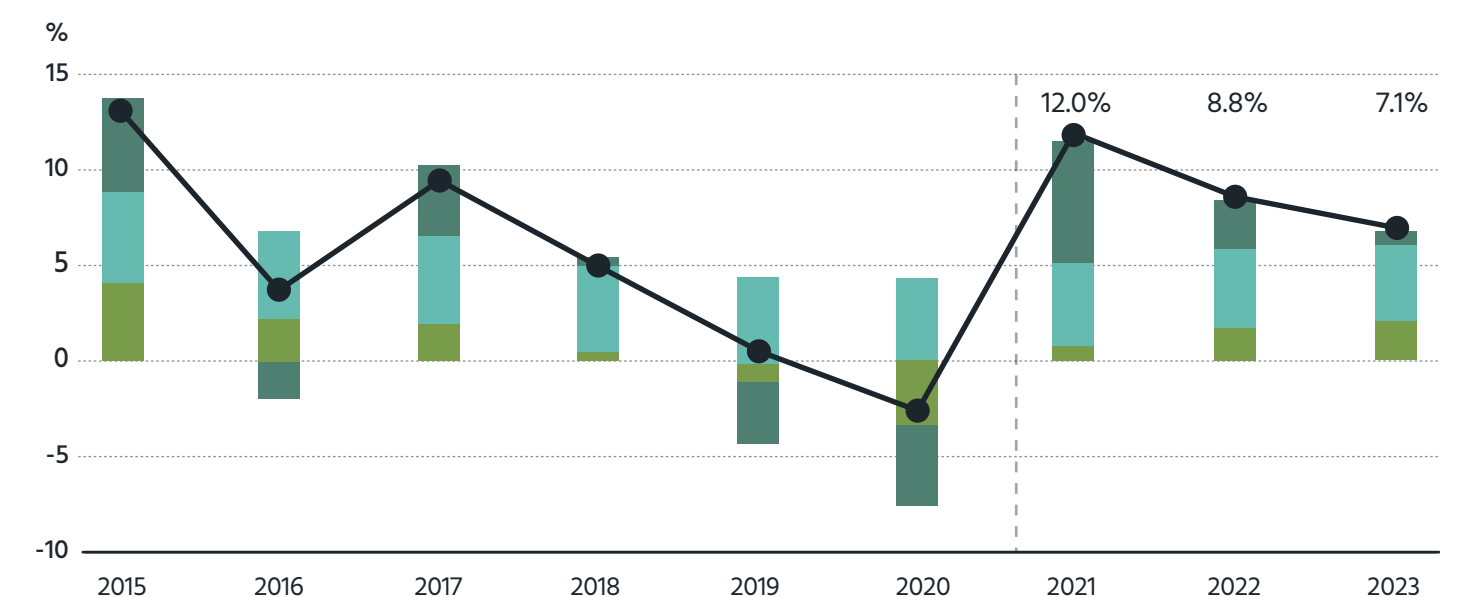
### Office



### Industrial



### All Property



Income return Rental growth Yield impact Total return

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## Agency

## Valuation

## Further Insight

**Manchester BTR**  
2021

**Multi-Let**  
Q2 2021

**Euro Logistics**  
Summer 2021

**Prime Logistics**  
Q2 2021

**London Markets**  
Q2 2021

**Sustainable Retrofit**  
June 2021

**Westminster SDP**  
June 2021

**Prime Logistics Report**  
Q1 2021

**Life Sciences**  
Q1 2021

**Industrial Revolution**  
July 2020

**Multi-let Insight Series**  
Summer 2020

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