

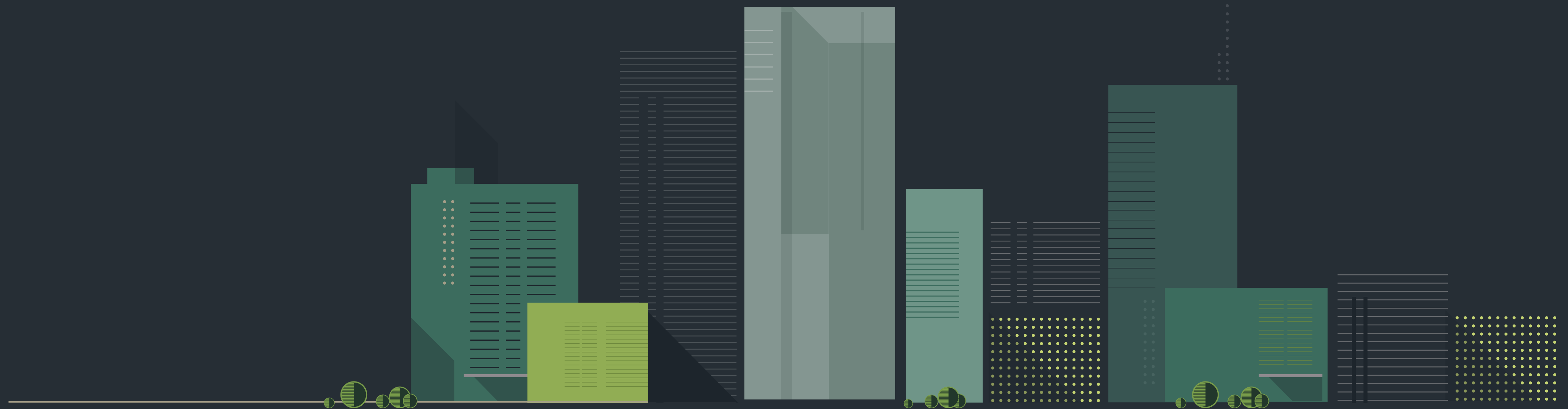


GERALDEVE

IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

December 2021





GERALDEVE

DECEMBER UPDATE

All Property annual total return continued its steadfast 2021 rise from negative territory in February to reach almost 17% in November. Industrial yield impact is the driving force, though there has been significant yield tightening for retail warehouses and supermarkets also. Key for industrial has been the step change in rental growth this year, which is featured in the Spotlight. Read more for the most recent occupier and investment updates, economics data and property forecasts.



32% ▲

Industrial annual total return

21% ▲

Retail warehouse annual total return

4.9% ▼

2022 GDP forecast

2.3% ▼

2022 CPI forecast

1.5% ▲

2022 10-yr bond yield forecast

4.2% ▼

2022 unemployment rate forecast



2021: From sub-zero to hero

All Property annual total return continued its steadfast 2021 rise from negative territory in February to reach almost 17% in November. Clearly yield impact is the driving force and it is interesting to note that while industrial dominates of course, there are other sectors that have contributed meaningfully to this. **Retail warehouse** annual yield impact was over 16% in November and the main difference for returns here versus the stellar performance of **industrial** is rental growth. The step change in industrial rents this year has been a result of the perfect storm of void rates bumping along at critical low levels, limited new development and the enormous amount of pent-up occupier demand given a further sustained boost by the pandemic. This is covered in more detail in this month's Spotlight section.

In an uncertain world, investment demand has been focussed on high quality defensive stock and inflation-linked long income. Investor competition is strong for these assets although stock remains limited, mainly supported by tenant sale-and-leasebacks and industrial development activity. Key industrial investment deals in December include CBRE GI's purchase of the John Lewis distribution centre in Milton Keynes for an estimated £140m with a view to making substantive ESG improvements. **Supermarkets** have also performed well over the pandemic and the yield impact in the year to November of almost 10% is testament to this. Many of the factors above are captured in LXi REIT's £59m purchase of retail warehouse units anchored by a Sainsburys in Middlesbrough on long income for a net initial yield of 4.9%.

Shopping centres, along with high street units, are seeing not only further signs of stabilisation in pricing, but also an increasing number of actual deals taking place. The flagship Silverburn shopping centre in Glasgow was bought by Henderson Park for £140m from Hammerson and Canada Place Pension Plan Investment Board in December, albeit for less than half of the £297m paid in December 2009. The centre includes the largest Tesco in Scotland on a long leasehold.

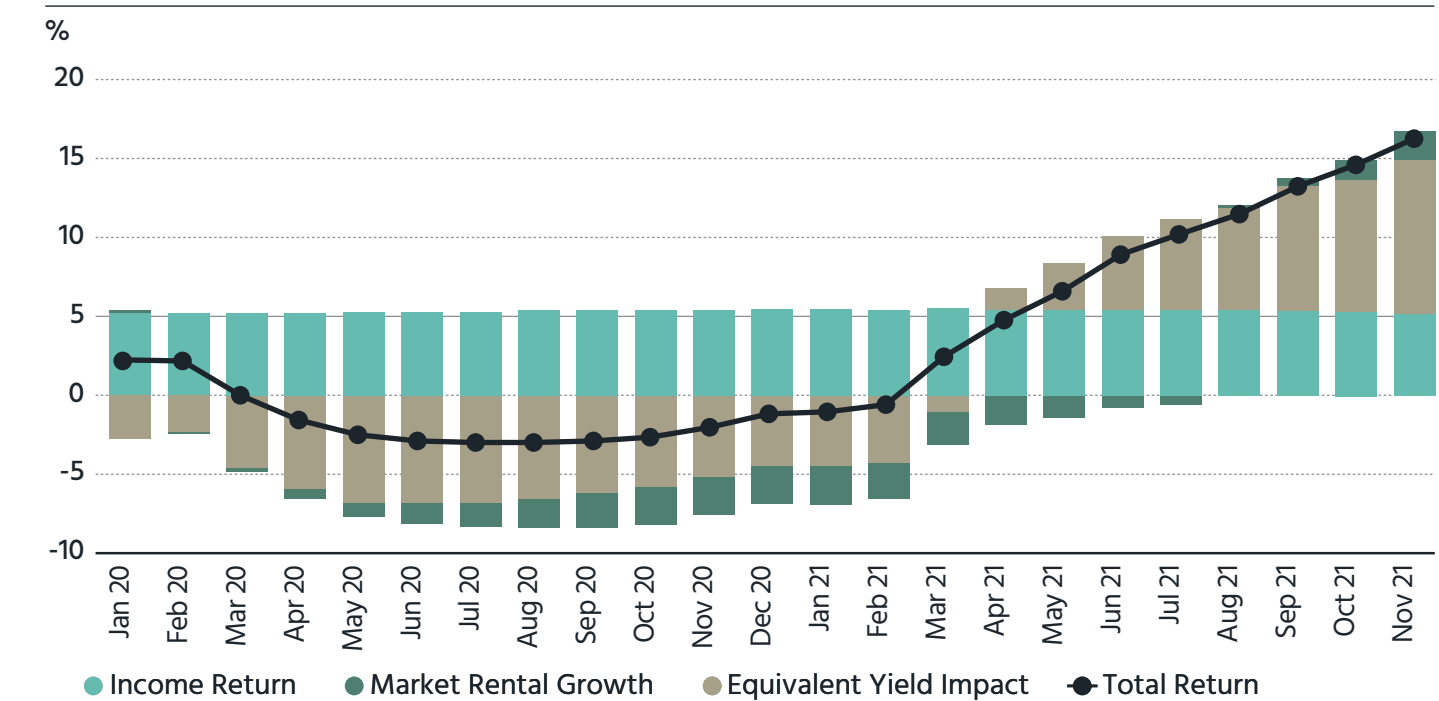
The UK **office** sector is still dominated by overseas investment with a clear preference for best-in-class assets and, again, long leases and diversified tenants. Returns have been unremarkable over 2021, but the key factor for geographical differences is the negative yield impact for assets outside of the South East where pricing has slipped. In contrast, the City and particularly the West End have seen some yield compression. In one of the largest deals in December, ARA Dunedin (on behalf of ARA Korea-managed funds) purchased the mixed-use office-led Marble Arch Place in London for £280m. The recently completed scheme is rated BREAAAM Excellent and has a WAULT of 15 years.

32%▲
Industrial annual total return

21%▲
Retail warehouse annual total return

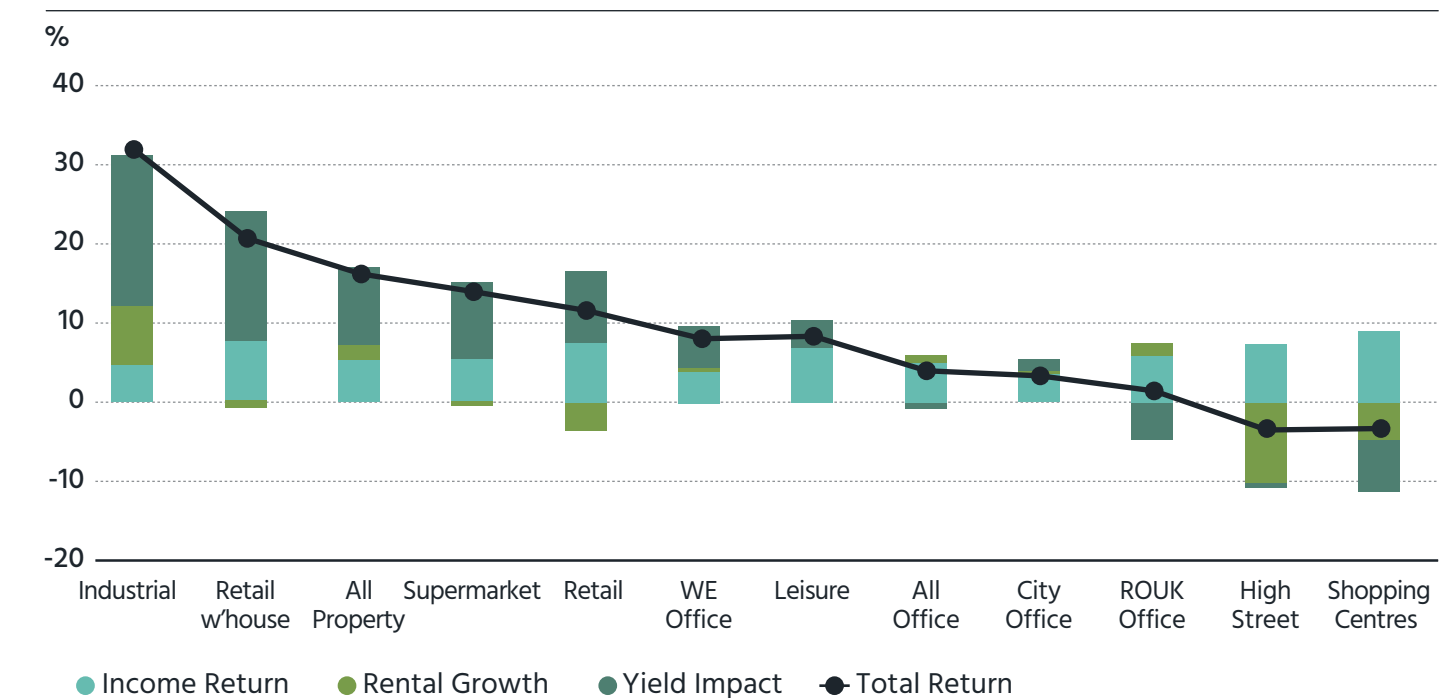
All Property annual total return and components

Sources: MSCI



Selected segments, annual total return and components

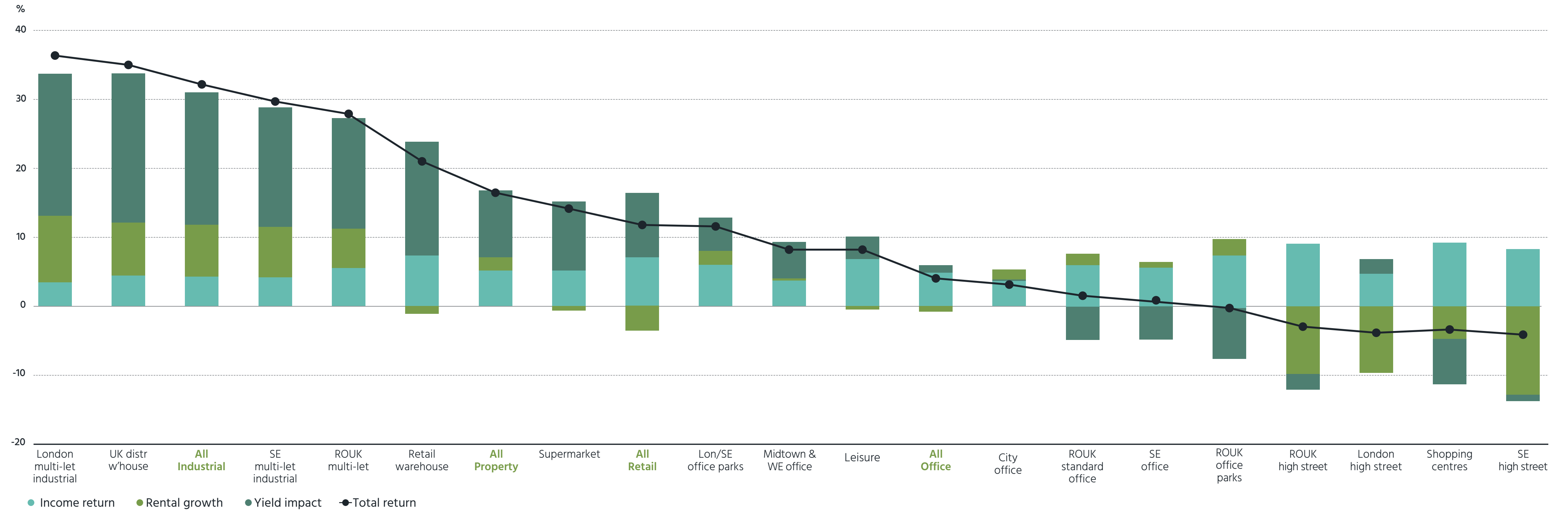
Source: MSCI



Segments

12-month return to November 2021

Source: MSCI



UK economy

The economy grew by only 0.1% in the month to October in keeping with the predicted autumn slowdown. Moreover, growth has been supported by increases in health output, partly due to high levels of Covid testing. With the troubling uncertainties for social consumption caused by the new Omicron Covid variant, Oxford Economics has revised down its forecast of GDP growth for 2022 to 4.9% from 5.5% last month.

Encouragingly retail spending increased in November, as it did in October after five previous months of declines. The current figures show growth of 4.1% over the past year but spending is still 2.8% below where it was in April. Growth has been driven by in-store spending on textiles and footwear, which was up an incredible 50% in the year to November. This reflects the pent up bounce back from the massive drop-off in the earlier stages of the pandemic. Conversely, spending on household goods in-store remains 11% lower than a year ago. The proportion of online retail spending increased seasonally as expected in November to 30% of the total. This is likely to persist in December, given flash PMI activity indicators of relatively more restricted in-person socialising and shopping.

Manufacturing output fell another 0.1% in October, as supply chain disruptions and shortages across the sector persist. Meanwhile the unemployment rate edged down again to 4.2% in October and initial evidence suggests that workers mostly returned to their jobs post-furlough. However, there is great uncertainty now as the consequences of Omicron play out and while any further potential government support is unknown.

CPI annual inflation surprised on the upside and hit 4.8% in November. Moreover the imminent likelihood of more social restrictions will delay the rotation of spending back from goods to services, which may exacerbate price pressures. After a spike early in 2022, Oxford Economics optimistically expects inflation to drop out of the figures later in the year and into 2023. Nevertheless, the Bank of England saw sufficient danger to begin raising base rates, to 0.25%, in December. There will likely be two further increases in 2022, ending the year at 0.75%.

4.9% ▼
2022 GDP forecast

1.5% ▲
2022 10-yr bond yield forecast

2.3% ▼
2022 CPI forecast

4.2% ▼
2022 unemployment rate forecast

The monthly monitor

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

	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Two-year trend	Latest figure
GDP annual growth	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	4.6%
Unemployment rate	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	4.2%
Consumer confidence	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	-11.5
Retail sales growth	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	4.6%
Retail sales % online	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Line chart	30.1%
Manf output growth	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	1.2%
Brent crude (USD/bbl)	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	81.05
Gold (USD/oz)	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Line chart	1,820
FTSE100	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	7,060
CPI inflation	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	4.8%
10-year bond yield	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Line chart	0.8%
EUR/GBP	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	1.18
USD/GBP	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Yellow	Line chart	1.32

Spotlight on... Multi-let industrial rents

Multi-let rents have accelerated in recent years, reflective of the structural shift in societal spending patterns and the gentrifying occupier base. However, a perfect storm has seen a step change over 2021. Void rates are bumping along at critical low levels and limited new development has been met with enormous pent-up occupier demand given a further sustained boost by the pandemic. In the three quarters to Q3 2021 best-in-class Inner London multi-let rents have increased by as much as 36%. Even for regions outside of the South East prime headline rents have increased over 20% on average.

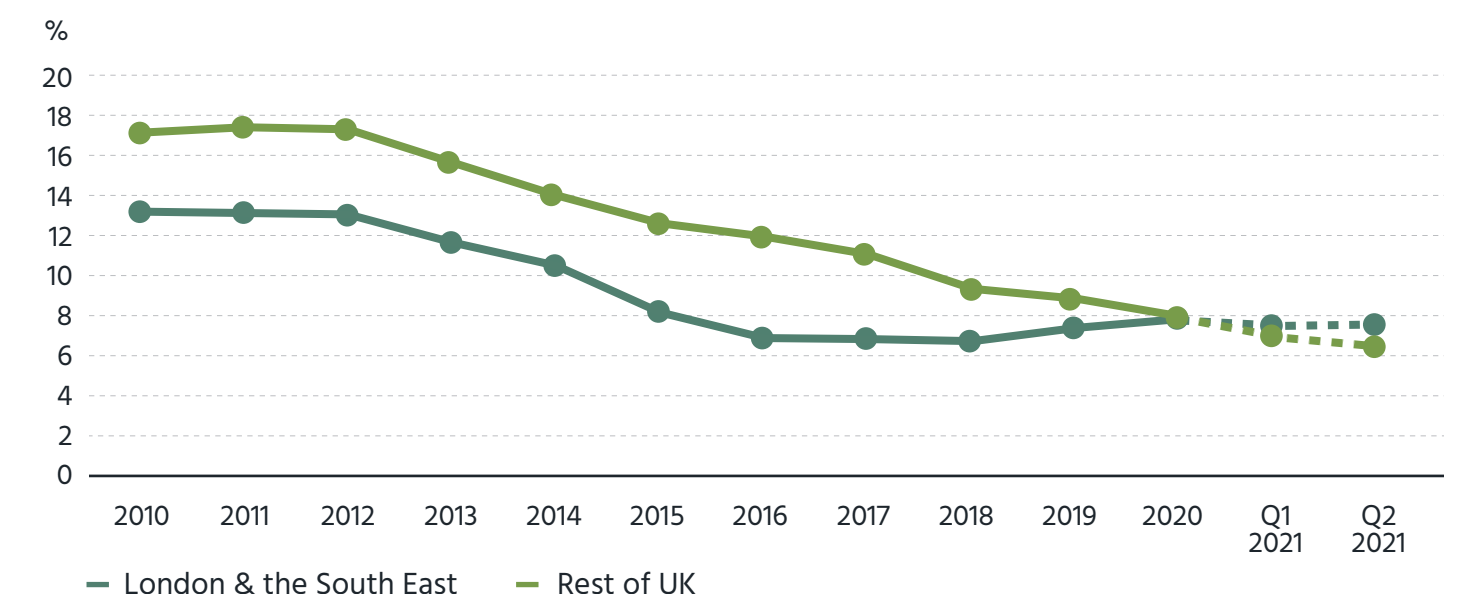
Trade counters feature prominently across all classes and sizes of multi-let space, typically holding around a quarter of occupied space. There are many requirements in the market, partly due to residential repurposing of previously held units. Amid the scarcity of suitable accommodation, some trade counters have been forced to make small sub-5k sq ft units work by really 'sweating the space' so they can maintain essential access to the densely populated household catchments. The issue is compounded with the larger national occupiers that increasingly need to be selective when it comes to the environmental credentials of buildings, which is further limiting choice.

Third party **Logistics** firms typically occupy the larger, mid-box end of multi-let and this is particularly the case in Greater London. Parcel & post occupiers are still very active in multi-let to create ever greater numbers of last-touch depots and they are now also competing for space with the grocery delivery firms. Multi-let occupancy related to food is key in London, with 23% of all tenant activity in the sub-5k sq ft units. Grocery logistics (including new entrant last minute delivery services) account for around a third of this and continue to be very active in Inner London and have stretched out into the Greater London boroughs and selectively into the South East near urban centres.

The **quasi-office** footprint is over 22% in Inner London. Post-Covid there has been increased demand, notably from retailers, for multi-let back offices to consolidate with logistics operations and free up expensive and underutilised traditional offices in the capital. Meanwhile in Greater London multi-let space is increasingly being used to service the TV and film industry for computing and design, which also extends to housing lighting, props and sets. Data centres are a growing segment too, given high demand for public cloud services.

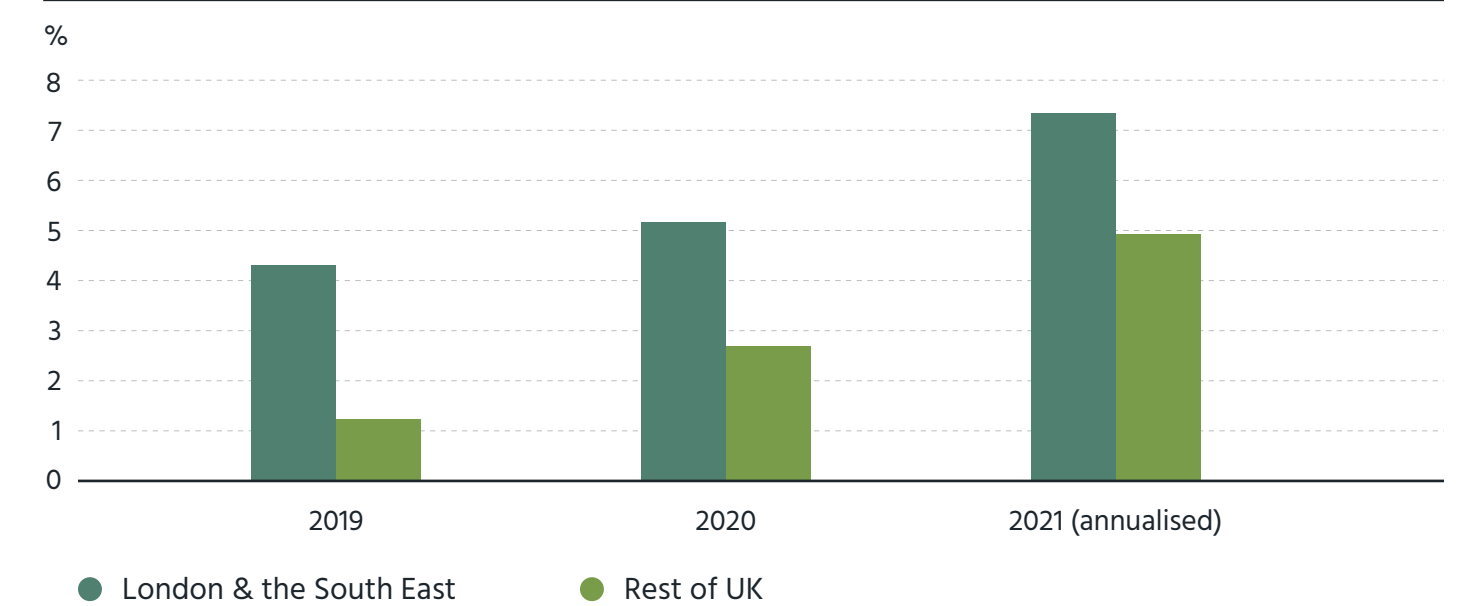
Multi-let void rates by geography

Source: Gerald Eve, MSCI



Annual all-grades ERV growth by geography

Source: Gerald Eve, MSCI



Outlook

All Property total return is forecast to exceed 19% in 2021 and slip back to around 10% in 2022. Nevertheless, industrial is set to continue its dominance. Underperforming retail subsectors should switch from negative to positive return in 2022 and the sector overall is likely to continue to outperform UK offices.

The record-breaking late cycle surge in **industrial** investment activity and pricing will boost total return in 2021 to almost 34%. The overwhelming occupier demand set against insufficient supply will continue to drive rental growth in 2022. Equally there should be some carry over of yield impact but at a much more moderate rate given the current keenness of investment pricing set against the rising interest rate environment.

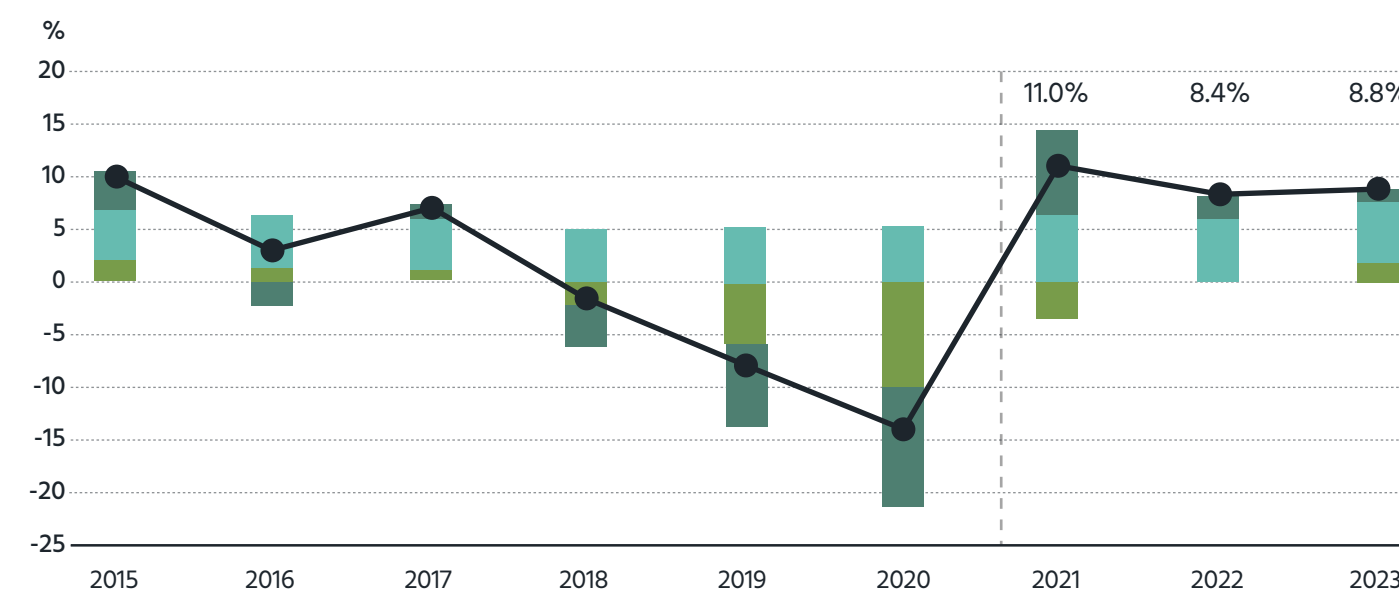
Office rents have stabilised in Q4 after slipping back earlier in 2021 with the influx of tenant-controlled space. The polarisation of the best-in-class assets is set to intensify, and prime yields have consequently tightened in London. Landlords and developers are reportedly marketing buildings which will deliver in the next 6-12 months above current market rents as they know competition for new space will be high.

Retail will outperform offices in 2021, driven by an incredible 24% return for retail warehouses. This will be the first non-negative return since 2017. In 2022 retail warehouse return should ease but overall retail return is set to outperform offices again as high street and shopping centre pricing stabilise and contribute positively.

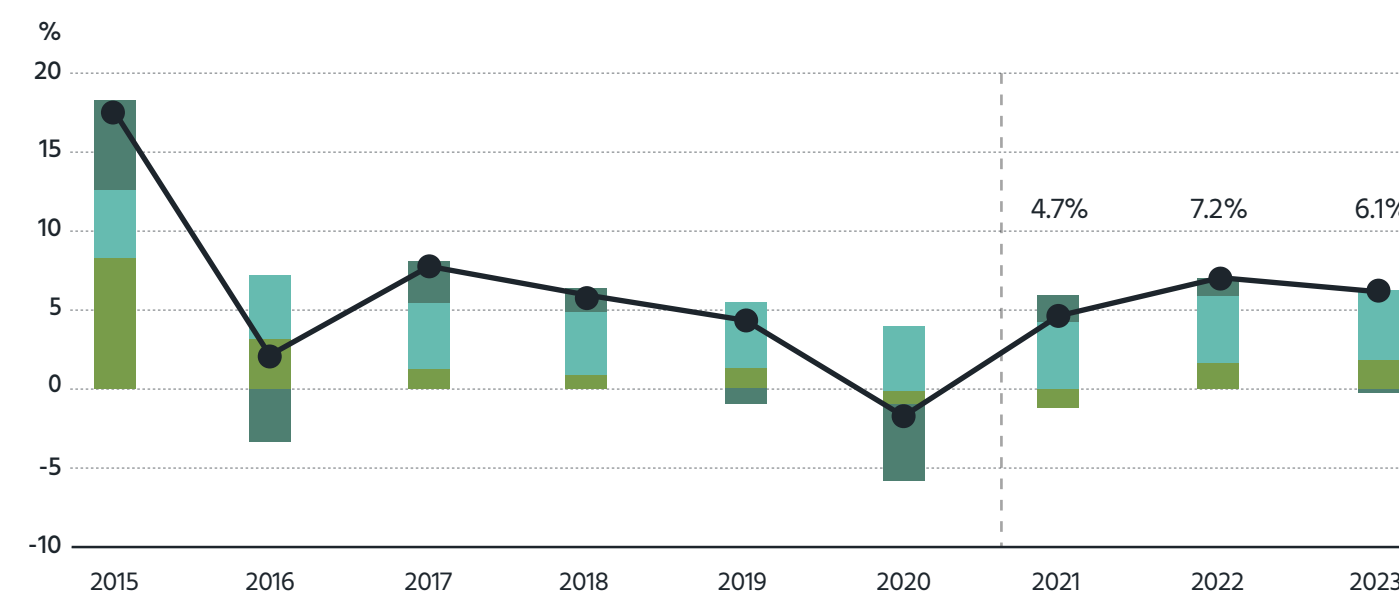
Total return and components by sector

Source: Gerald Eve, MSCI

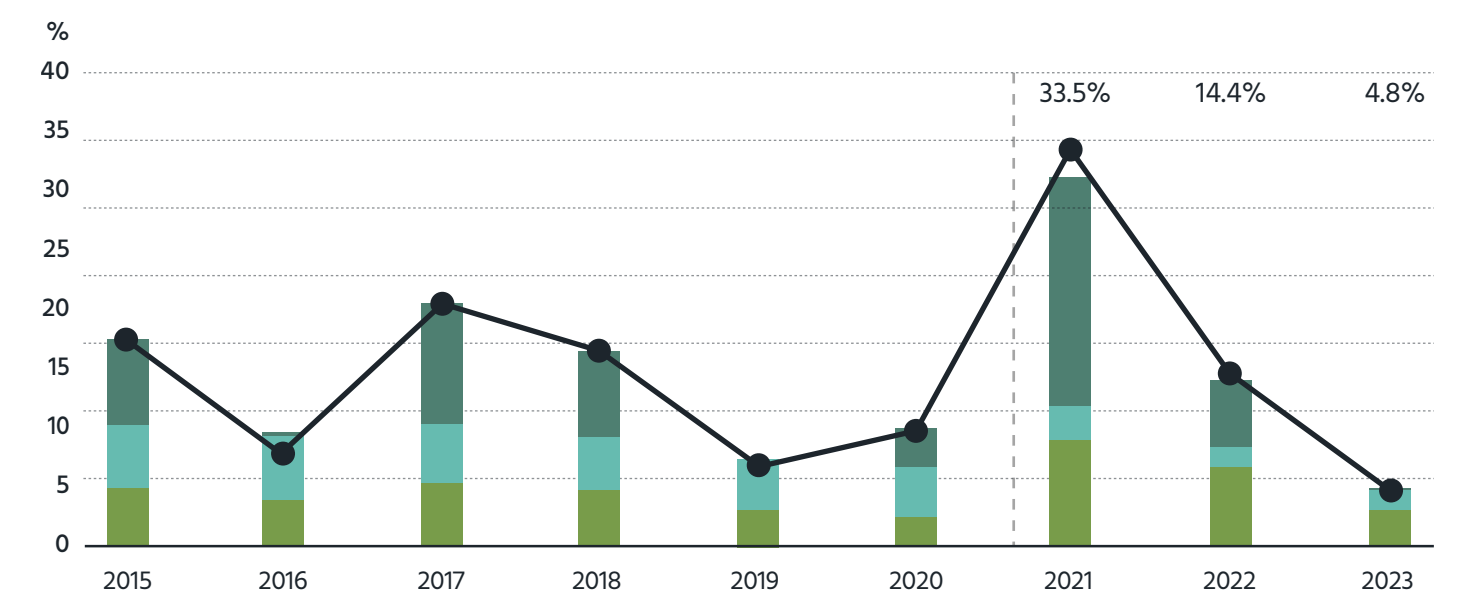
Retail



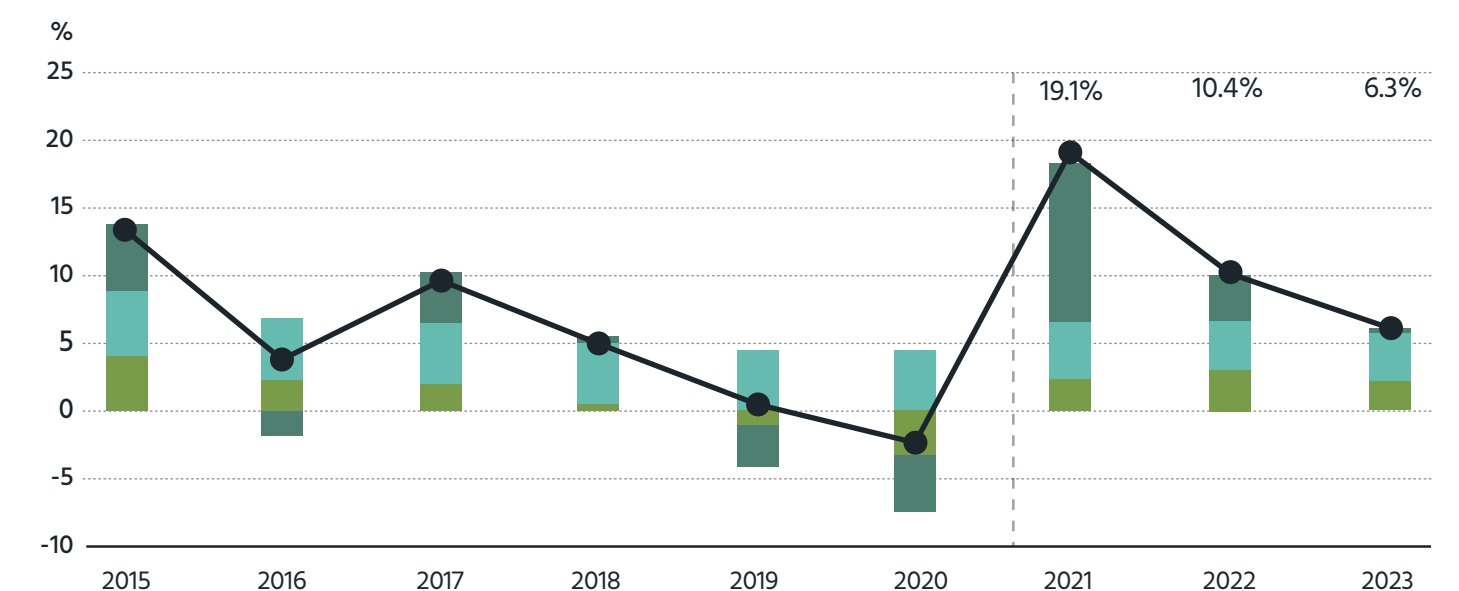
Office



Industrial



All Property



Income return Rental growth Yield impact Total return

Contact

Research

STEVE SHARMAN

Partner

ssharman@geraldeve.com

Tel. +44 (0)20 7333 6271

BEN CLARKE

Partner

bclarke@geraldeve.com

Tel. +44 (0)20 7333 6288

OLIVER AL-REHANI

Senior Research Analyst

oal-rehani@geraldeve.com

Tel. +44 (0)20 7518 7255

Capital Markets

JOHN RODGERS

Partner

jrodgers@geraldeve.com

Tel. +44 (0)20 3486 3467

MARK TROWELL

Partner

mtrowell@geraldeve.com

Tel. +44 (0)20 7333 6323

RICHARD MOIR

Partner

rmoir@geraldeve.com

Tel. +44 (0)20 7333 6281

Further Insight

Multi-Let
Q3 2021

Planning Budget
Briefing Note
November 2021

Business Rates Review
November 2021

Prime Logistics
Q3 2021

Manchester BTR
2021

Euro Logistics
Summer 2021

London Markets
Q3 2021

Sustainable Retrofit
June 2021

South East Office
Investment
Q3 2021

Multi-Let
Q2 2021

Life Sciences
Q1 2021

Our advice and recommendations are underpinned by the in-depth analysis of our award-winning research team. With a particular focus on investment, London offices and industrial, our researchers work closely with the agency teams to produce market-leading reports recognised for their detail and practical insight.

Disclaimer & copyright

In Brief is a short summary of market conditions and is not intended as advice. No responsibility can be accepted for loss or damage caused by reliance on it © All rights reserved. The reproduction of the whole or part of this publication is strictly prohibited without permission from Gerald Eve LLP. 12/21