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IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

January 2022

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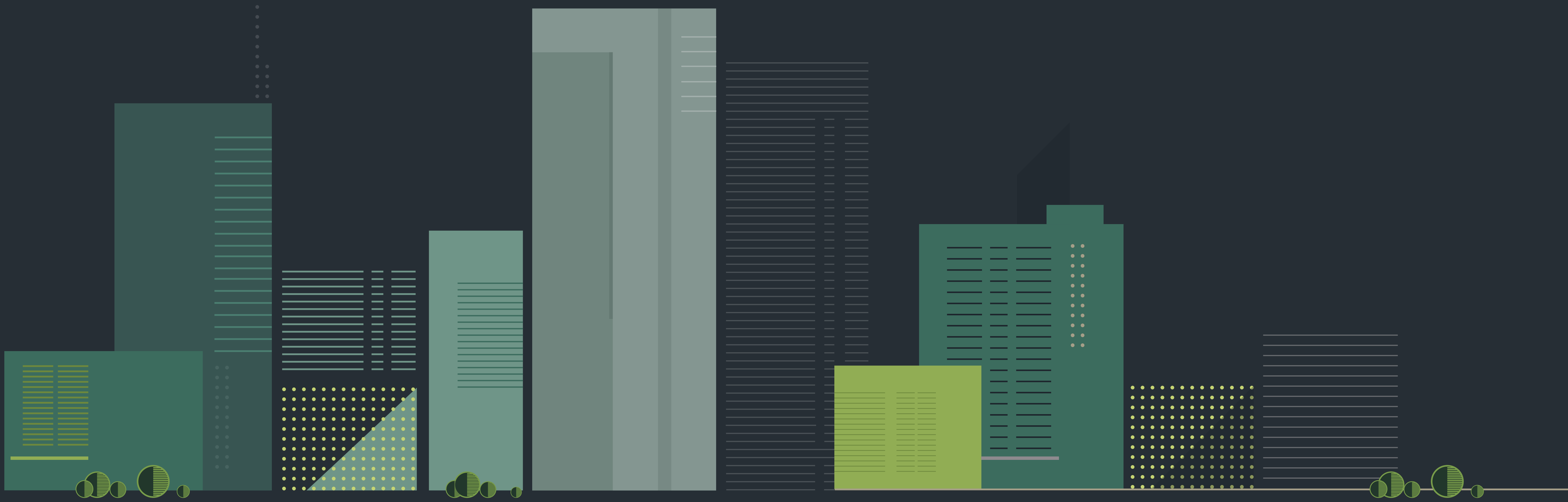

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JANUARY UPDATE

All Property annual total return finished 2021 at an incredible 19.9%. And after a decidedly rocky start to the year all three major sectors managed to generate a positive return by the end. Equally, annual commercial property investment picked up from its Q1 2021 low and finished the year at £52.4bn. This includes 16.4bn for industrial, which was by far and away the strongest year for the sector and dwarfs the previous record £11.5bn in 2017.

Read more for the most recent occupier and investment updates, economics data and property forecasts.

19.9% ▲	£52.4bn ▲	4.5% ▼	4.5% ▲	1.5% ▲	4.1% ▼
All Property annual total return	2021 All Property commercial property investment	2022 GDP forecast	2022 CPI forecast	2022 10-Yr bond yield forecast	2022 Unemployment rate forecast

An epic year of industrial investment

All Property annual total return finished 2021 at an incredible 19.9%. And after a decidedly rocky start to the year all three major sectors managed to generate a positive return in 2021. Only high street retail and shopping centres remain in negative territory and these are in the low single digits now after rallying significantly from deeply negative positions of over 20% at the start of the year. Equally, annual commercial property investment picked up from its Q1 2021 low and finished the year at £52.4bn. While this may be behind the £60bn+ years of 2017 and 2018 it is a respectable total and contains some crucial sectoral detail within it.

Industrial investment transactions hit £16.4bn in 2021. This was by far and away the strongest year for the sector and dwarfs the previous record £11.5bn in 2017. Competition for all industrial and logistics assets has been fierce and the weight of capital targeting the sector continues to drive down yields. Portfolios have been a key component of the trading volume, particularly towards the end of 2021. Most notable was Blackstone buying from Elite, Cabot and Valor in three separate deals. There has also more recently been the £1.6bn Prologis buy out of CBRE IM from their UK Logistics Venture, which is not included in this year-to-Q4 figure. The lowest yielding subsector has been London multi-let industrial, which was 3.55% for the all-grades average in December. And while all geographies performed well, London was a particular focus for investment, with a deep pool of competition and an annual return by December for multi-let units of a quite astonishing 43.5%.

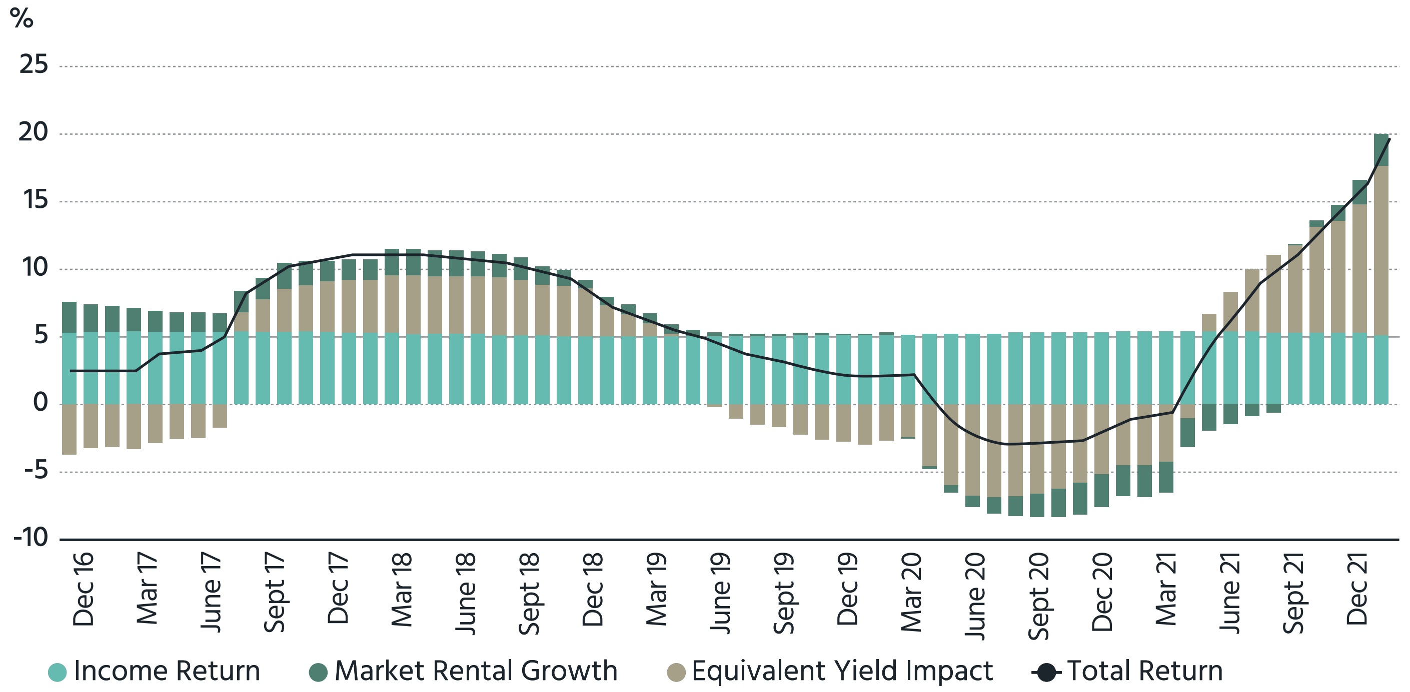
It is important to note that **offices**, while far from breaking any records in 2021 nevertheless achieved a total investment volume of £18.8bn, which was the largest major sector. Central London capital values held up over the pandemic and there has in fact been some yield compression since the middle of 2021. The flight to quality persists, with most investment activity focussed in the West End. More recently in January Google purchased 41 Central St Giles for £762.5m with the intention to refurbish and consolidate their employees in this best-in-class space. These kinds of transactions are set to become more common over 2022 as occupiers tailor office space to incentivise daily occupancy and facilitate hybrid working.

The **Retail** investment total for 2021 was £5.9bn – a shadow of its glory years of course but there are several positives to note. Firstly retail warehouses stand apart within the sector and finished 2021 with an excellent 25% annual total return. Moreover, **shopping centres** are now seeing not only further signs of stabilisation in pricing, but also a market where actual deals can take place. These include Silverburn in Glasgow and Bluewater in Dartford going for £140m and £172m respectively in December. But in what will be one of the largest deals of 2022, LaSalle Investment Management parted with £600m in January for Cheshire Oaks in Ellesmere Port and Swindon Designer Outlet, bought from Nuveen Real Estate.

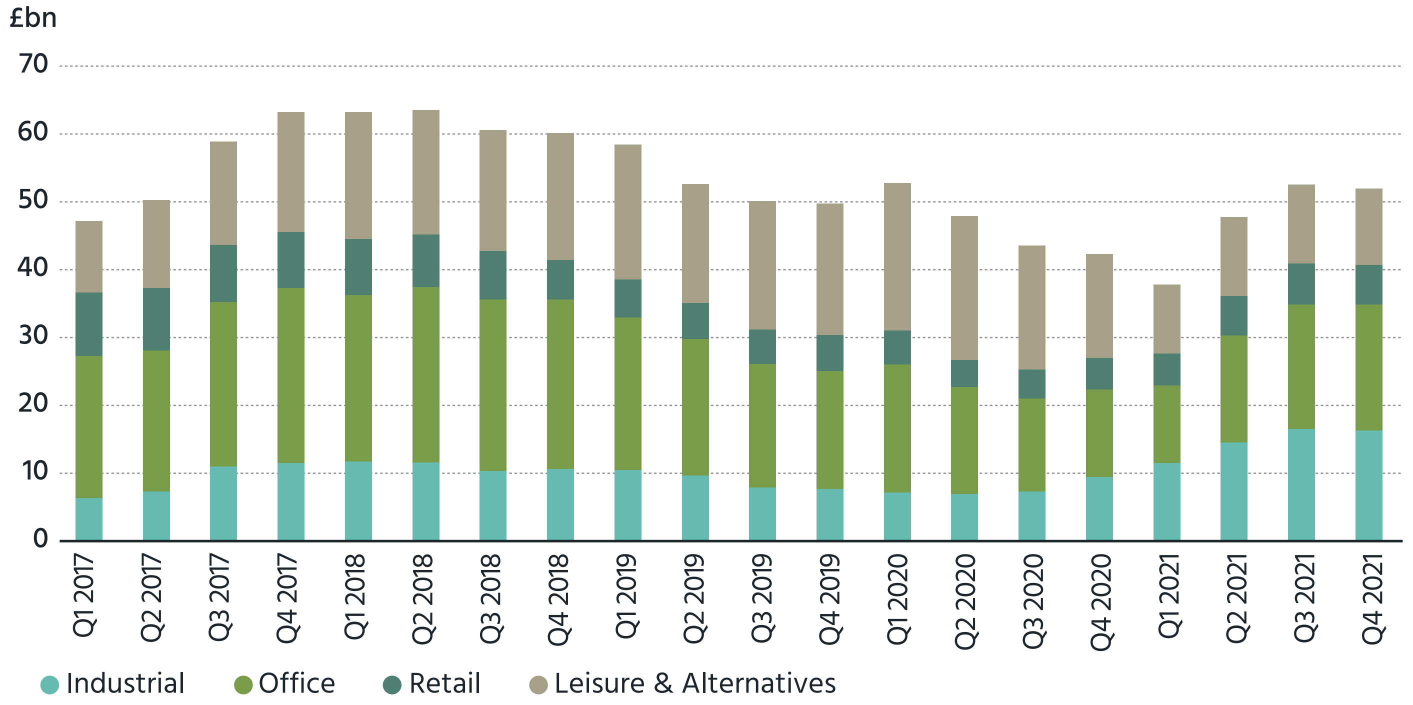
19.9% ▲
All Property annual total return

£52.4bn ▲
2021 All Property commercial property investment

All Property annual total return and components
Sources: MSCI



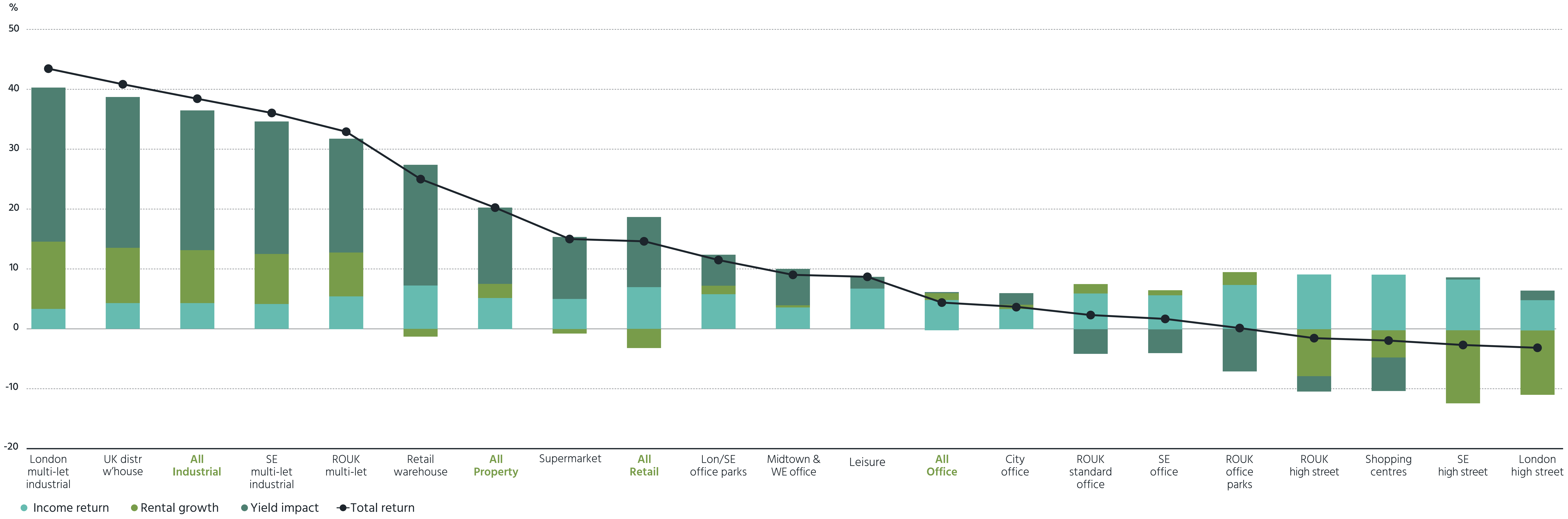
Rolling annual commercial property investment
Source: Gerald Eve, Property Data



Segments

12-month return to December 2021

Source: MSCI



UK economy

The UK economy grew by 0.9% in the month to November to its highest ever value, exceeding the previous peak back in October 2019. Ostensibly the covid arrears have been erased but drilling down into the sectoral detail shows that spending on health (including covid testing and vaccinations) is up 12% compared with pre-pandemic February 2020. Meanwhile supply chain disruptions and shortages mean that the manufacturing sector is still more than 4% smaller than pre-pandemic. Moreover, the impact of the Omicron variant is likely to feature negatively in the data from December. High frequency indicators suggest social spending took a hit from the government's Plan B along with generally more cautious consumers that had to self-isolate in greater numbers.

The disruption continued into the start of the year and consequently Oxford Economics has reduced its 2022 GDP forecast down to 4.5% from 4.9% last month. The other key factor on the minds of consumers, businesses and policy makers is of course the rate of inflation, which increased again to 5.4% on the CPI measure in December, the highest rate for decades. Supply squeezes and elevated global goods prices combined with continued rising petrol prices, the large rise in the energy price cap and the restoration of the domestic hospitality VAT rate are set to push UK inflation to over 6% in early 2022. Oxford Economics now forecasts average inflation in 2022 of 4.5%, up from 3.8% last month. A further two base interest rate rises are expected this year to reach 0.75%.

Retail spending is volatile and dropped 3.6% in December compared with November. This occurred as expected in tandem with the reduction of in-person shopping, notably on clothing and footwear. Oxford Economics still expects wealthier households this year to spend around 5% of excess savings accumulated over the pandemic and support the ongoing economic recovery. We are relatively more cautious, however, given the negative consumer sentiment and uncertainty surrounding the various cost of living rises that will now increasingly include higher mortgage repayments.

4.5% ▼
2022 GDP forecast

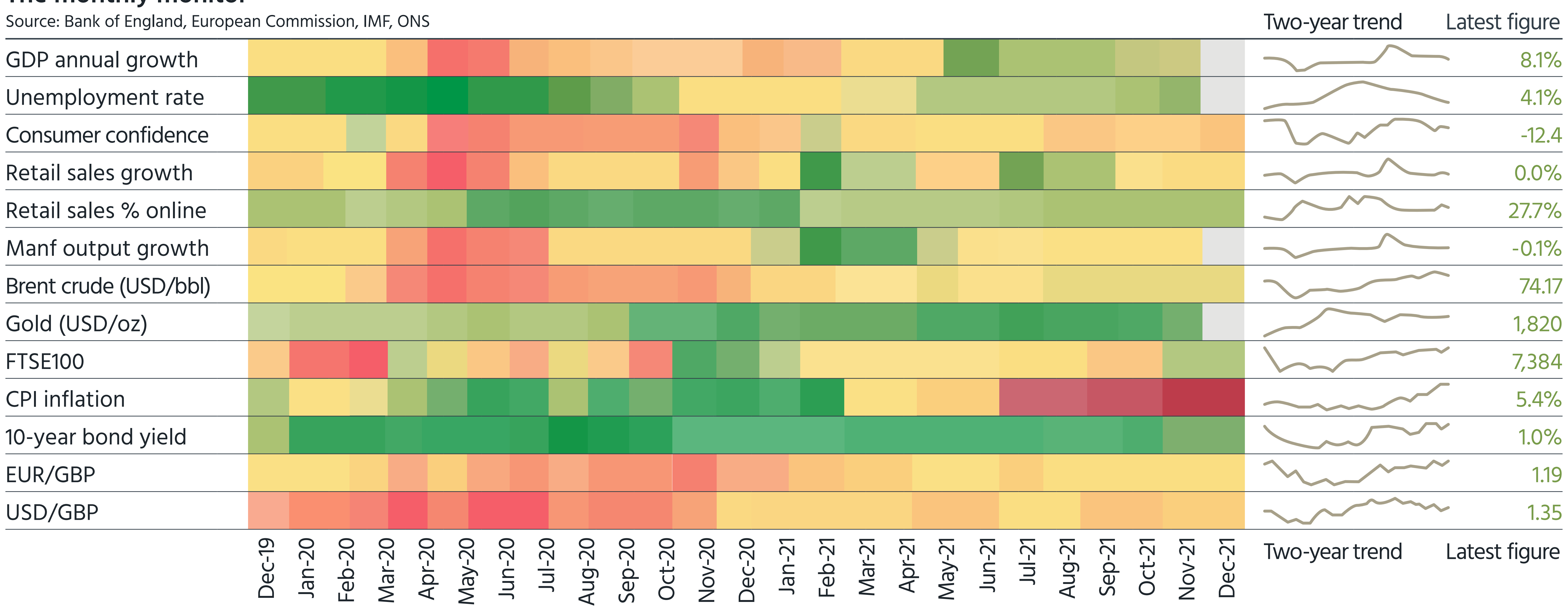
1.5% ▲
2022 10-yr bond yield forecast

4.5% ▲
2022 CPI forecast

4.1% ▼
2022 unemployment rate forecast

The monthly monitor

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



Spotlight on...
The 2022 real estate debt market

Here we outline some of the key themes for each of the main property sectors. Generally, there is downward pressure on loan-to-value ratios across most asset classes, with 60% considered fundable for most. Lenders are likely to continue to focus strongly on the tenant or operator's covenant and performance. Meanwhile ESG will only increase in prominence so loans to improve a building's rating or efficiency will be well regarded. Green Loans may offer small margin reductions for hitting certain building efficiency levels.

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Industrial & logistics

Continued appetite expected, especially on developments. The note of caution here is that yields have continued to compress while debt costs have been slowly rising on both the margin and the Base/Libor/Sonia rates. Consequently debt costs and yield are close to one another and gearing doesn't give the leveraged returns property investors have been used to.

Offices

Lenders will continue to support the office sector, but there will be an ongoing flight to quality buildings more popular with occupiers. Speculative development in the sector will be challenging and lenders will continue to struggle with shorter income assets. Margins will be stable for long let, higher value assets. But they will be higher for more challenging locations or lower quality stock.

Retail

Lenders will have several distressed retail positions and as such their appetite in this sector may wane. The exceptions are typically food-led or DIY units let on longer leases to good covenants. Covenant strength will be key for lenders and where margins will remain stable. Margins will increase significantly for more challenging locations or lower quality stock.

Build-to-rent

There are several lenders willing to consider this sector as it becomes a more popular and traded asset class. Schemes with micro units will continue to be a challenge following changes in planning rules but forward funding will remain active. Development margins will remain higher but well-occupied sites in strong locations should be lower.

Hotels and leisure

This sector has had a challenging time over the pandemic but there are signs of lenders coming back for both development and investment. There will be a flight to quality and a real focus on the operator (or tenant) with a preference to city centre and family/leisure hotels and a good trading history. Hotels with poor trading (especially if its non-branded) will be a challenge.

Education

There has been a growth in interest in the education and early years sectors with a few notable larger transactions. Previously a preserve of the clearing banks, several challenger banks have now entered the market and are competing for market share. Margins are likely to be stable for established newer properties in desirable locations with a good trading history.

Outlook

All Property total return is estimated to have exceeded 19% in 2021 and is forecast to 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 return for **industrial** in 2021 will not be repeated in 2022 but the sector is expected to continue to dominate with a return in excess of 14%. The overwhelming occupier demand set against insufficient supply will continue to drive rental growth in 2022. Equally there should be some carry-over of positive 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 outperformed offices in 2021, driven by retail warehouses. This was 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

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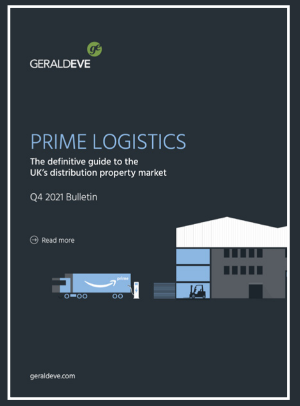
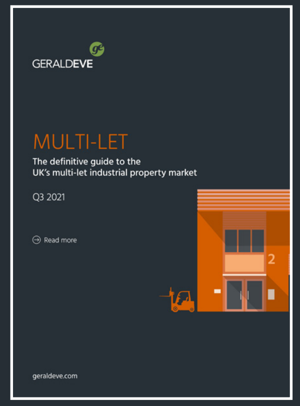
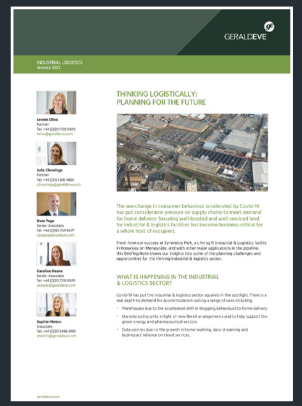
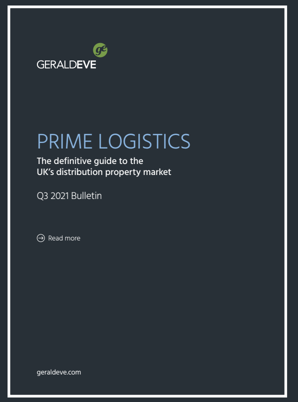
Further Insight


Prime Logistics
Q4 2021

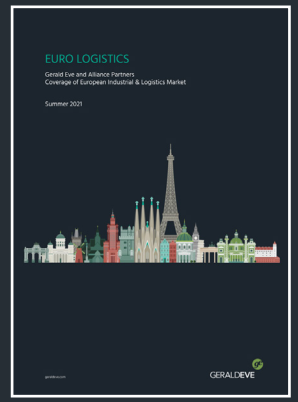

Multi-Let
Q3 2021


Industrial Logistics
January 2022


Business Rates Review
November 2021

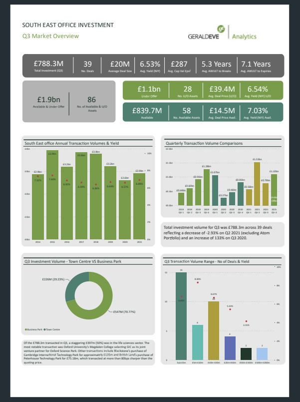

Prime Logistics
Q3 2021


Manchester BTR
2021


Euro Logistics
Summer 2021


London Markets
Q3 2021


Sustainable Retrofit
June 2021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Multi-Let
Q2 2021

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