IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

March 2022

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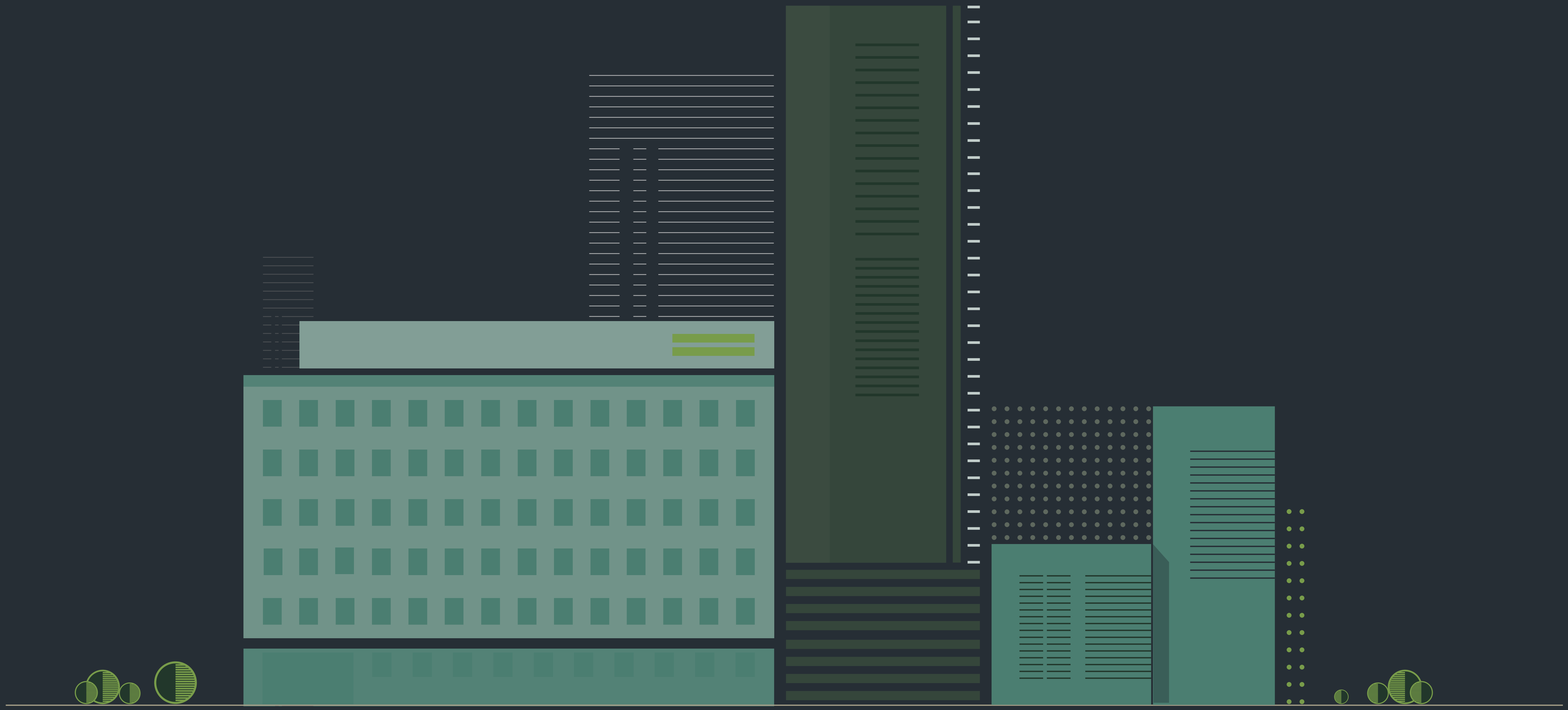

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MARCH UPDATE

Commercial property returns continue to be exceptional but eased back slightly in January and again in February this year. This comes as investors eye the inflationary environment and expectations of higher interest rates set against a highly uncertain economic backdrop littered with various downside risks. Nevertheless, the continued weight of global capital is under pressure to be invested before yields dip that final bit further and debt financing becomes more expensive. This calls for some aggressive assumptions on performance but in this market anything seems possible.

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

126% ▲	London multi-let 5yr total capital value change
-51% ▼	Shopping centres 5yr total capital value change
3.7% ▼	2022 GDP forecast
6.5% ▲	2022 CPI forecast
2.2% ▲	2024 10-yr bond yield forecast
3.8% ▼	2022 unemployment rate forecast

A turning point for UK commercial property?

All Property quarterly total return peaked at a near 12-year high of 7.9% in December last year before easing back slightly in January and again in February to 6.7%. Property returns continue to be exceptional, running at around 22% annually, but this softening reflected somewhat less aggressive positive yield impact across several segments, notably retail warehouses and industrial. The inflationary environment and expectations of higher interest rates set against a highly uncertain economic backdrop littered with various downside risks has likely given investors some small pause for thought. Nevertheless, the **industrial** market, certainly, is strong. Prime rents across multi-let and larger logistics formats surged forward again in Q1 and void rates dwindled to new historic lows, which continues to underpin investor confidence.

The continued weight of global capital is under pressure to be invested before yields dip that final bit further and debt financing becomes more expensive. This calls for some aggressive assumptions on performance but in this market anything seems possible. Along the risk curve investor demand is a little lighter for the most prime product since the yields are now so low a straight income buy is less appealing, even though ERVs continue to rise assertively. The hottest money is seeking an element of asset management to help push passing rents on even higher. This is advantageous for smaller multi-let units over their larger format counterparts as lease events tend to come around sooner. London multi-let annual total return was a quite staggering 48% in February and over the past five years capital values have more than doubled, while shopping centre and high street values have halved.

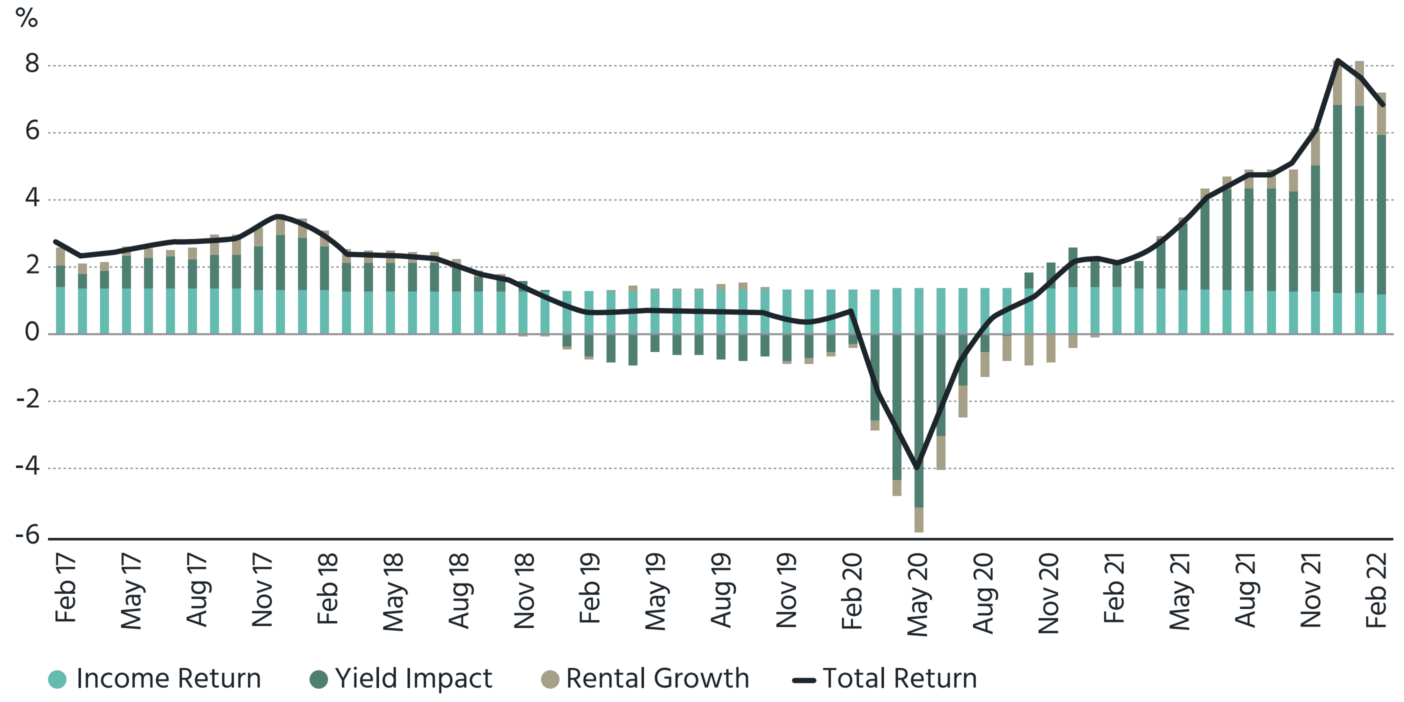
Nevertheless, values for these retail segments have effectively bottomed out and there has been a flurry of **shopping centre** investment transactions in recent months. After LaSalle Investment Management parted with £600m for Cheshire Oaks in Ellesmere Port and Swindon Designer Outlet in January, Redical Holdings swooped on the landmark Victoria Gate and Victoria Quarter shopping centres Leeds for £120m. Hammerson’s sale of the assets which total over 600,000 sq ft will provide much-needed cash to reduce their net debt position.

Office performance appears relatively much less remarkable but in central London take-up for Q1 is estimated to have held up fairly well after a post-lockdowns resurgence in occupier market activity in H2 last year. The market continues to be highly polarised, with prime assets that can boast the best sustainability credentials and help occupiers achieve their net zero targets being the main show in town. In a joint venture, Allianz and Aviva will upgrade 1 Liverpool Street and 101 Moorgate to such a standard. Adding value in this way is an effective means of boosting returns in the current market. Overseas investment has been strong so far in 2022 and the City hosted two deals in March that combined to almost £2bn. NPS of Korea and Ho Bee Land Ltd paid £1.21bn and £718m, respectively, for 5 Broadgate and 52-54 Lime Street.

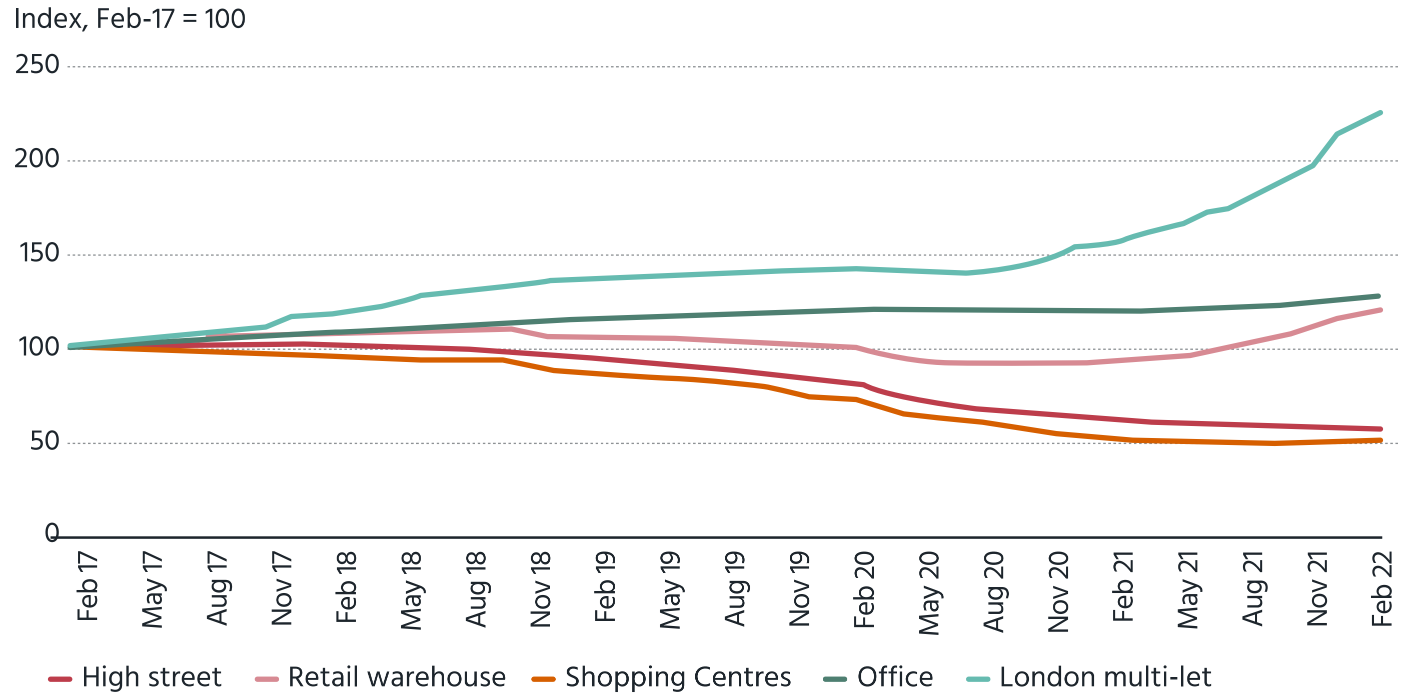
126% ▲
London multi-let 5yr total capital value change

-51% ▼
Shopping centres 5yr total capital value change

Quarterly All Property total return and components
Source: MSCI



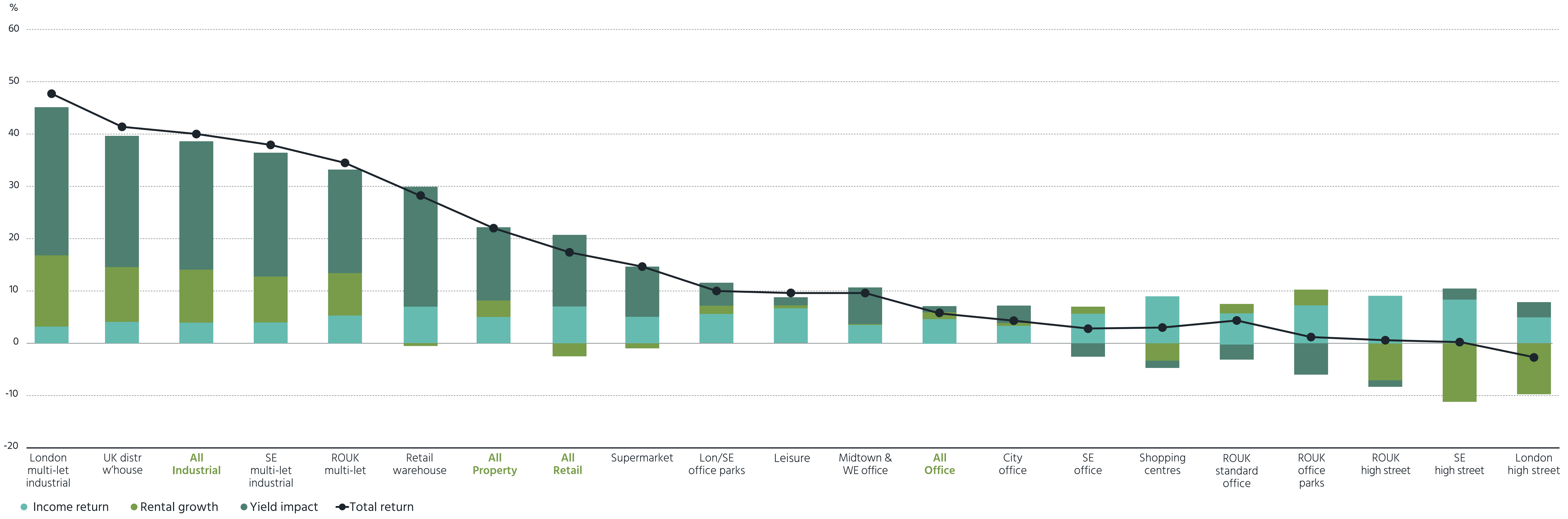
Capital values by sector
Source: MSCI



Segments

12-month return to February 2022

Source: MSCI



UK economy

UK economic activity picked up 0.8% in January due to a briefer Omicron disruption than initially feared. National output was 10% higher than the doldrums of early 2021, with services activity and construction strongly up but agriculture and production at low single digit growth. National output was 10% higher than the doldrums of early 2021, with services activity and construction strongly up, with agriculture and production at low single digit growth. Nevertheless, the UK economy is in a difficult position, with fiscal and monetary tightening jostling with the surging cost of living. The war in Ukraine has added to global food and energy price pressures and domestic CPI inflation was 6.1% in February, with RPI at an incredible 8.2%. The oil price has been volatile and flirted with up to $120 a barrel earlier in the month.

Income tax thresholds and allowances have been frozen and national insurance contributions will rise from April. Meanwhile the energy cap is due to rise by 54%. Oxford Economics expect this to help push CPI inflation up to 8.5% over the next couple of months. The Bank of England has responded with quantitative tightening and increased the base interest rate again in March to its pre-pandemic rate of 0.75%, which will feed through to mortgage repayments and business loans. However, Oxford Economics now expect only one more 25bp increase this year in May as priorities flit between inflation and downside risks to growth.

Wage growth is well below inflation, which will cause a significant drop in in real household incomes. GfK Consumer Confidence index fell to its lowest level in 16 months in March. Expectations for personal finances, the economic view for the year ahead and plans for major purchases components were all negative factors.

Corporation tax will increase from 19% to 25% in 2023. This and more spending on debt repayments and a less attractive UK business environment post-Brexit will have a dampening effect on business investment over the medium term. Meanwhile the increased customs and regulatory hurdles will continue to impact the UK's export competitiveness. On a more positive note CPI inflation should drop in 2023 as various base effects fall out of the figures. The furlough scheme successfully avoided a surge in unemployment, which is back to its pre-pandemic level with labour shortages across multiple sectors.

3.7% ▼
2022 GDP forecast

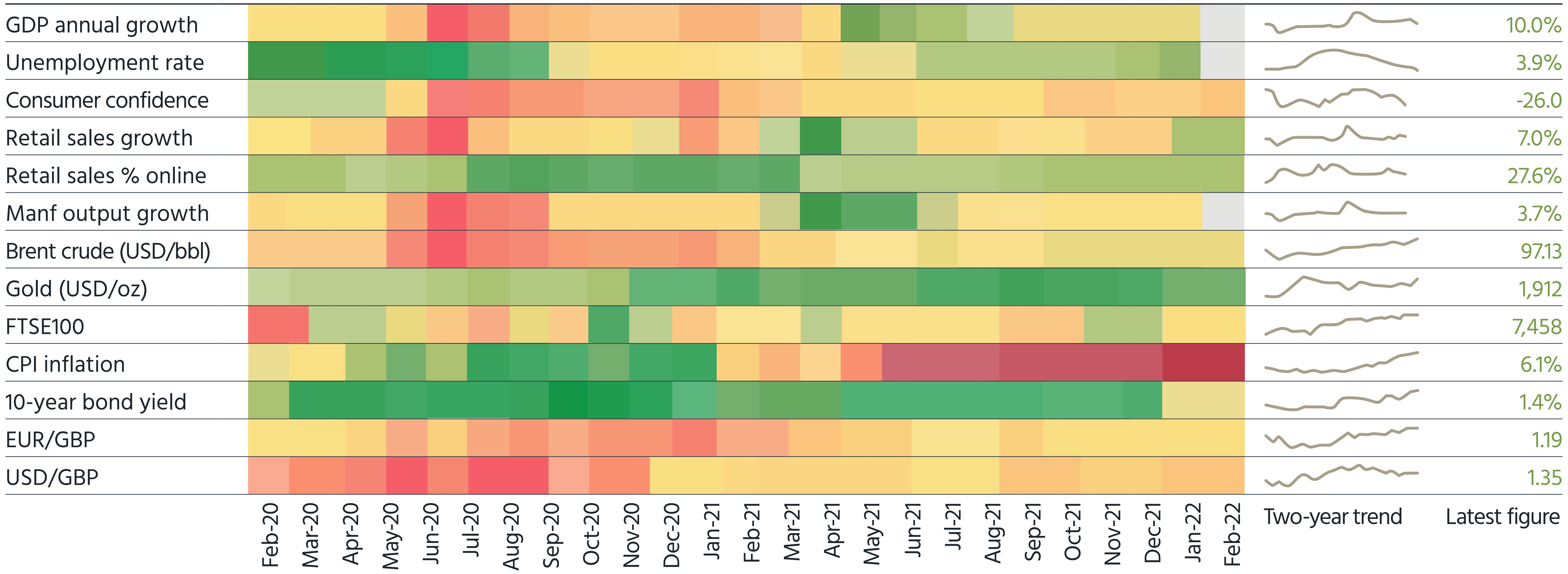
2.2% ▲
2024 10-yr bond yield forecast

6.5% ▲
2022 CPI forecast

3.8% ▼
2022 unemployment rate forecast

The monthly monitor

Source: Bank of England, IMF, ONS



Spotlight on...
the South East office investment market

TOTAL TRANSACTIONS IN Q1 DOWN 18% ON YEAR EARLIER BUT SET TO RISE

The total South East office transaction volume was £486m across 29 deals in Q1, 18% lower than the £573m traded in Q1 2021. Property companies were the most active investors, accounting for 28% of total acquisitions. Looking forward, there is a staggering pipeline of an estimated £687m of assets currently under offer. Market sentiment has improved markedly following the lifting of the various covid-related restrictions and the amount traded is likely to increase dramatically in Q2 and remain elevated over the course of the year. This is set to be further boosted by M&A activity, including Workspace's acquisition of McKay Securities, which is expected to complete in May 2022.

SELLERS EXPECTED TO BRING INVESTMENT PRODUCT IN GREATER NUMBERS

The year got off to a traditionally slow start on the sales side, with a limited amount of new investment stock launched. Just £266m (excluding off-market transactions) was brought to the market in Q1. Property companies and institutions accounted for the majority of this, with 41% and 30%, respectively, of the total. Activity was backloaded to the end of the quarter, with around half of the assets put up for sale in March. More than 50% of the product made available in January and February is now under offer or completed and this has given greater impetus to vendors to get their product into market, which we expect to continue over subsequent quarters.

LIFE SCIENCE SECTOR CONTINUES TO BE A MAJOR FOCUS FOR GLOBAL CAPITAL

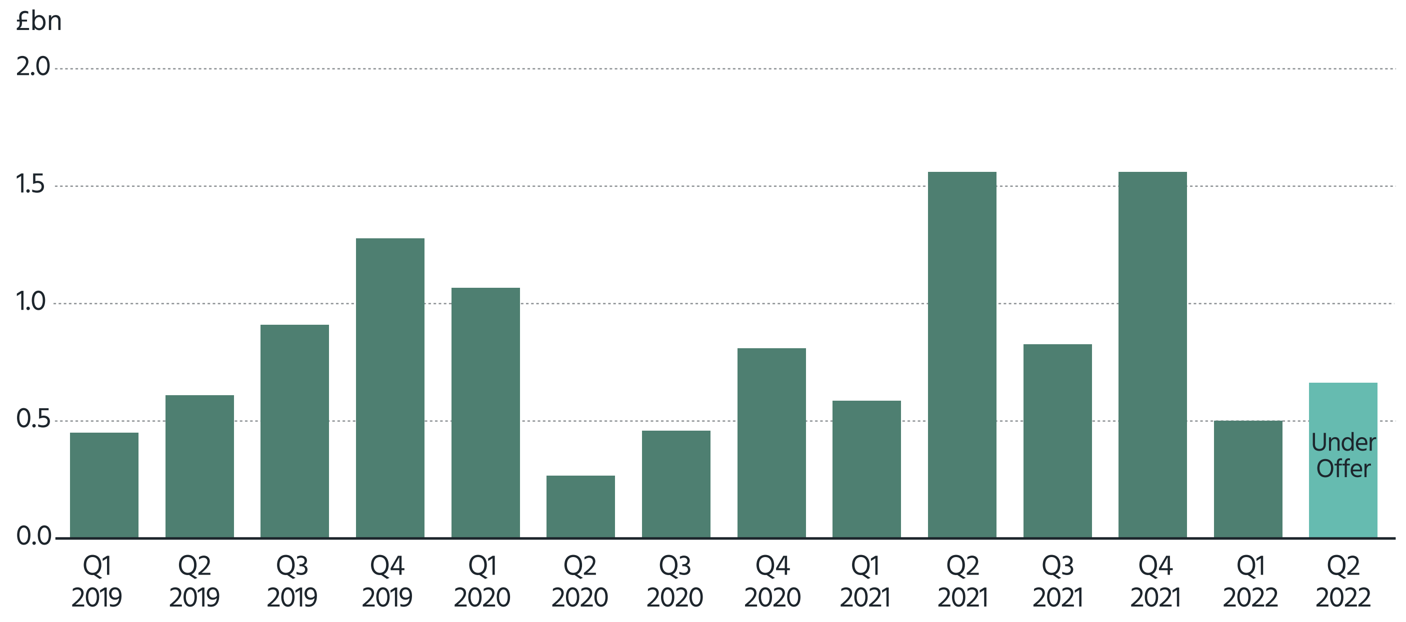
There is strong global investor interest for UK life sciences assets and investment supply in Q1 was insufficient to satisfy demand. One of the key transactions included Breakthrough Properties and Tishman's joint venture purchase of Trinity House for £41m. This is a large-scale redevelopment opportunity in Oxford Science Park and the price paid reflects approximately £25m per acre.

INCREASED INVESTMENT FOR REPURPOSING TO ALTERNATIVE USES

As shown in the chart, the surge in capital value for some property segments (notably industrial) over the last two years has made the purchase of offices in the South East for repurposing increasingly viable. Approximately £264m of office space was acquired for alternative uses in Q1, including industrial, data centres, life sciences and residential. This included Bridge Industrial's £55m purchase of Weybridge Business Park which will be repurposed to industrial, and Keppel DC REIT's purchase of Waterside House, Bracknell, which Vodafone currently uses as a data centre, for £57 million, reflecting a yield of sub-4%. Residential conversion sales have proved popular too, with a lack of stock due to tighter regulations on permitted development creating competitive tension and putting upward pressure on pricing.

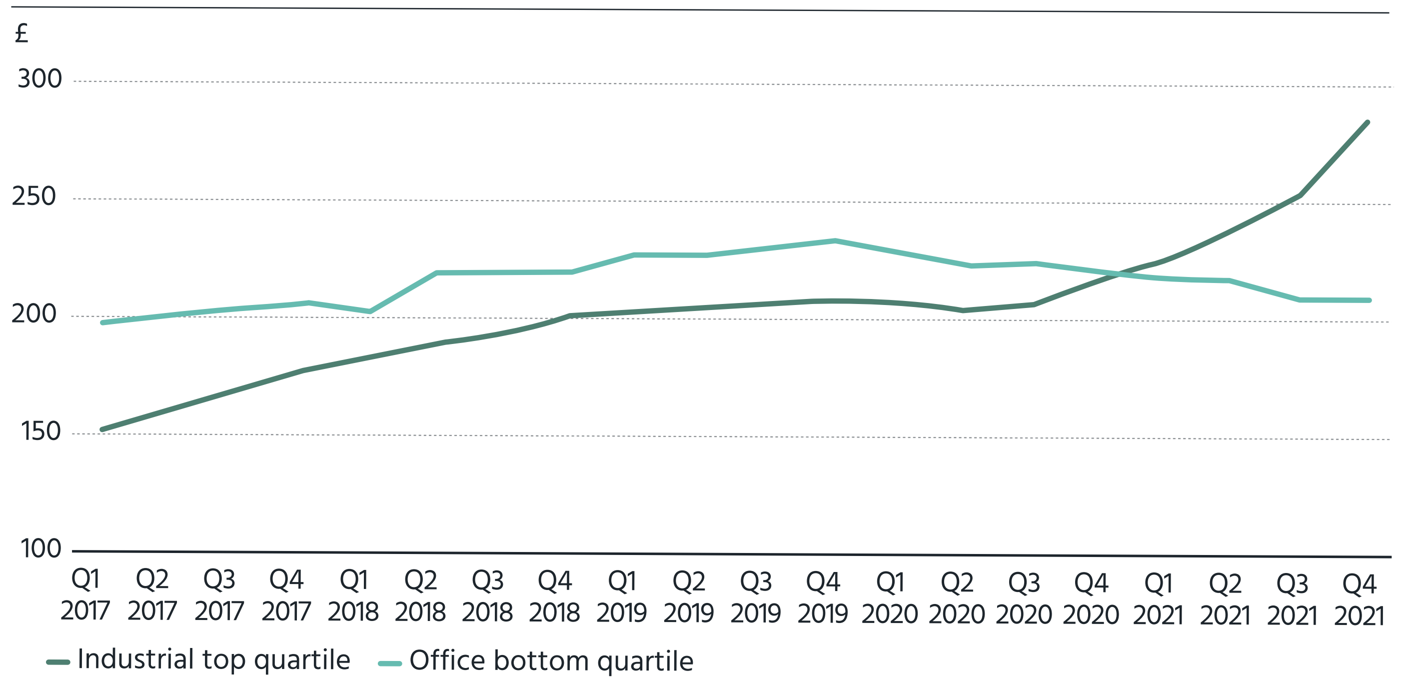
Quarterly South East office investment volumes

Source: Gerald Eve



South East capital value per sq ft by sector and quality

Source: Gerald Eve, MSCI



Outlook

All Property total return is forecast to fall back to 11.4% in 2022. Returns will be weighted to the front of this year rather than backloaded as they were in 2021. Industrial is set to continue its dominance. Meanwhile underperforming retail subsectors have stabilised, and a high income return guarantees positive return in 2022. The retail sector overall is likely to continue to outperform UK offices.

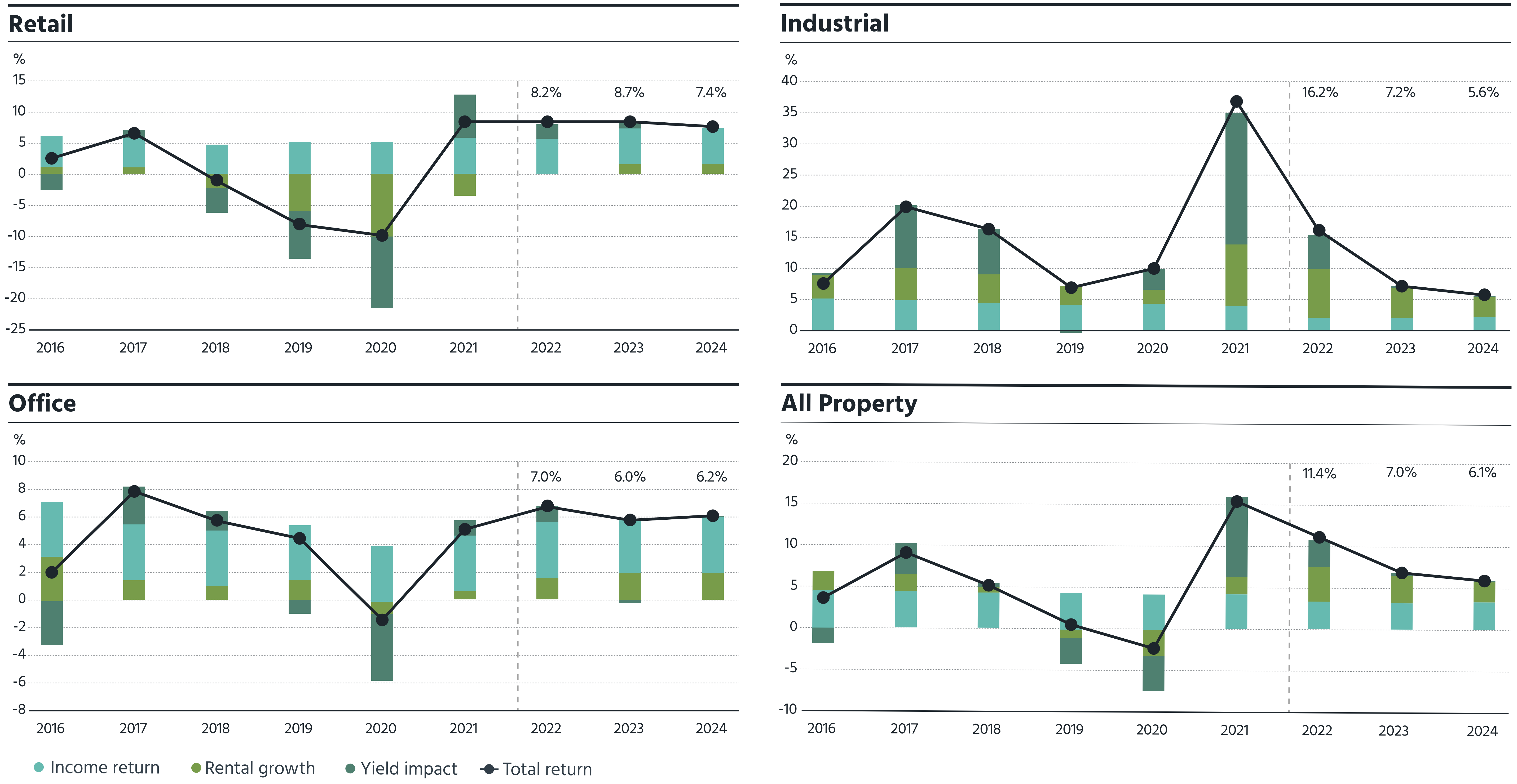
The record-breaking return for **industrial** in 2021 will not be repeated in 2022 but the sector is expected to continue to dominate with a return of over 16%. The overwhelming occupier demand set against insufficient supply will continue to drive rental growth in 2022. Equally there should be some carry-over of positive yield impact but at an ultimately more moderate rate given the current keenness of investment pricing set against the rising interest rate environment.

Office rents have stabilised now that occupier activity has improved post-lockdowns. 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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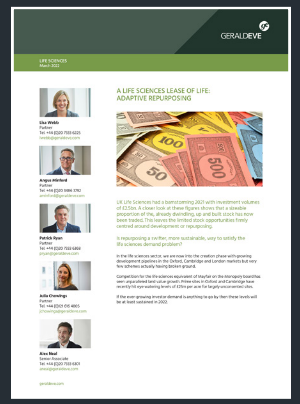
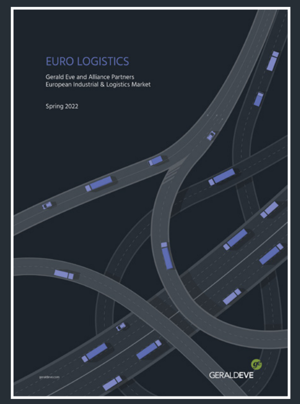
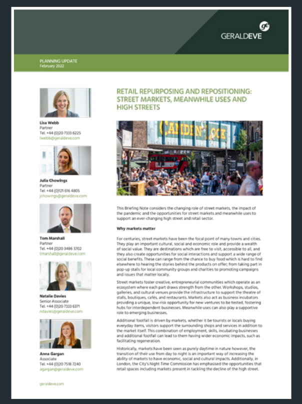
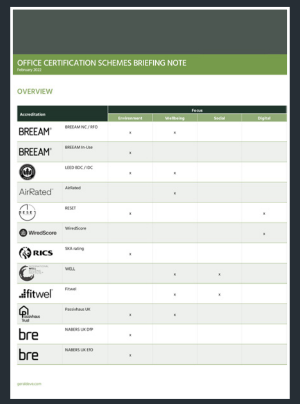

A life science lease of life: Adaptive repurposing
March 2022


Euro Logistics
March 2022


Retail Repurposing and Repositioning
February 2022


Office Certification Explained
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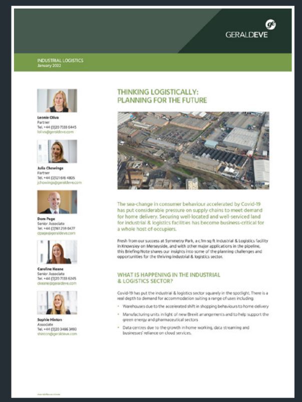
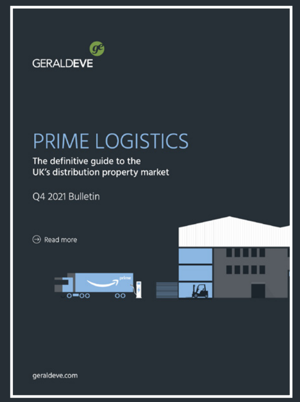
Multi-Let
Q4

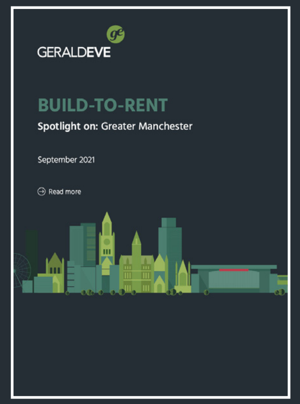
London Markets
Q4 2021


Industrial Logistics
January 2022



Prime Logistics
Q4 2021

Business Rates Review
November 2021



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