



GERALDEVE

# IN BRIEF

## UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

May 2022







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## MAY UPDATE

All Property quarterly return ticked up to 6.2% in April despite the various economic headwinds affecting households and businesses along with inflation and monetary tightening. Industrial quarterly total return has steadied somewhat after its exceptional surge in Q4 2021 and Q1 2022, but most other weaker individual segments have recovered and posted at the very least neutral or somewhat positive returns. Retail warehouses actually outperformed industrial for the second successive month in April, with the latter segment lower-yielding and more susceptible to rising debt costs and extra scrutiny of exit yields.



<b>6.2%</b> ▲ Q1 All Property quarterly total return	<b>10.4%</b> ▲ Retail warehouse quarterly total return	<b>3.6%</b> ▼ 2022 GDP forecast	<b>7.6%</b> ▲ 2022 CPI forecast	<b>2.3%</b> ▲ 2024 10-yr bond yield forecast	<b>3.8%</b> ▼ 2022 unemployment rate forecast
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# Retail warehouses outperform industrial... again

**All Property** quarterly return ticked up to 6.2% in April, despite the various economic headwinds affecting households and businesses along with inflation and monetary tightening. Much of the return continues to be due to yield impact, and movements mirror to a large extent the performance of the industrial sector. Industrial quarterly total return has steadied somewhat after its exceptional surge in Q4 2021 and Q1 2022. Increasingly in recent months the All Property return has no longer been offset by the weaker property segments. Most individual segments posted at the very least neutral or somewhat positive returns in April.

Interestingly, **retail warehouse** has outperformed **industrial** quarterly total return for the past two months. Rental growth is considerably lower for the retail subsector, but yield impact is much more strongly positive. The average retail warehouse yield was 5.74% in April, whereas industrial was 4.16%, a full 158 basis points lower. This gives retail warehouses a significant relative cushion over the risk free rate. And while investor demand for industrial continues to be robust, rising debt costs and extra scrutiny of exit yields have entered the conversation, especially after the Bank of England's more hawkish tone at the latest MPC meeting. However, there is a divergence of opinion about the timing and depth of the cycle, which is behind much of the investor activity and pricing discussions. A significant proportion of sellers are now looking to take profits and reposition their portfolios, while developers will typically reduce their risk with forward sales.

**Office** returns continue to be unremarkable. The average yield has tightened but only of a magnitude of less than 20 basis points over the past six months. Meanwhile rental growth has been fractionally positive, leading to quarterly total return in the low single digits. Encouragingly though there was the highest number of individual central London lettings in Q1 since before the pandemic, with activity focused on the smaller size bands, which suggests a more meaningful and sustained recovery in the occupier market. Visits to the workplace appear to have stabilised at around 40% below pre-pandemic levels, consistent with the typical three-out-of-five days in the office hybrid working pattern.

In recent months the majority of investment activity in London offices has been in the City. In Q1 £2.2bn transacted, with more than half of this accounted for by the National Pension Service of Korea's acquisition of 5 Broadgate. In the West End investment was £1.1bn, driven by Google's £762m purchase of Central Saint Giles in Covent Garden. Overseas investment has been key, and more recently in April Singaporean sovereign wealth fund GIC took a 75% stake in British Land's Paddington Central office complex for £694m. The life sciences remain in high demand and Life Science REIT swooped on Oxford Technology Park in May for £183m.

**6.2% ▲**

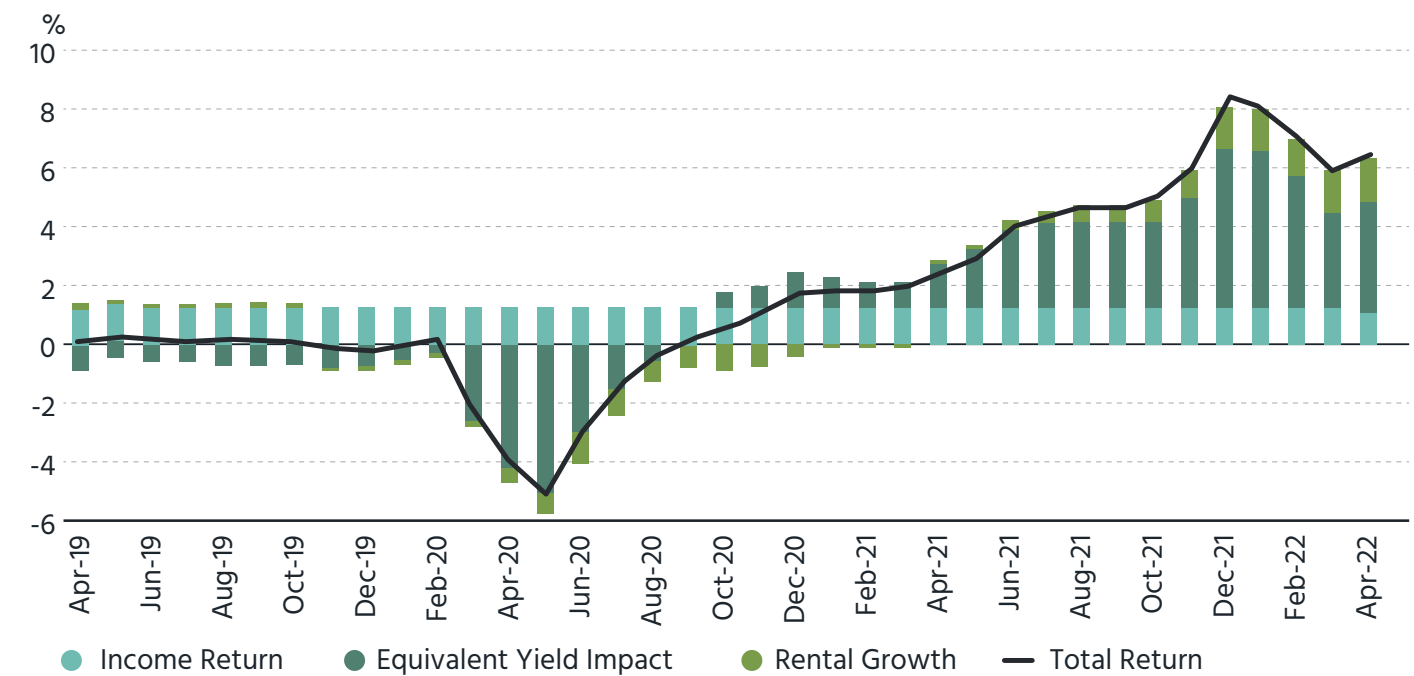
All Property quarterly total return

**10.4% ▲**

Retail warehouse quarterly total return

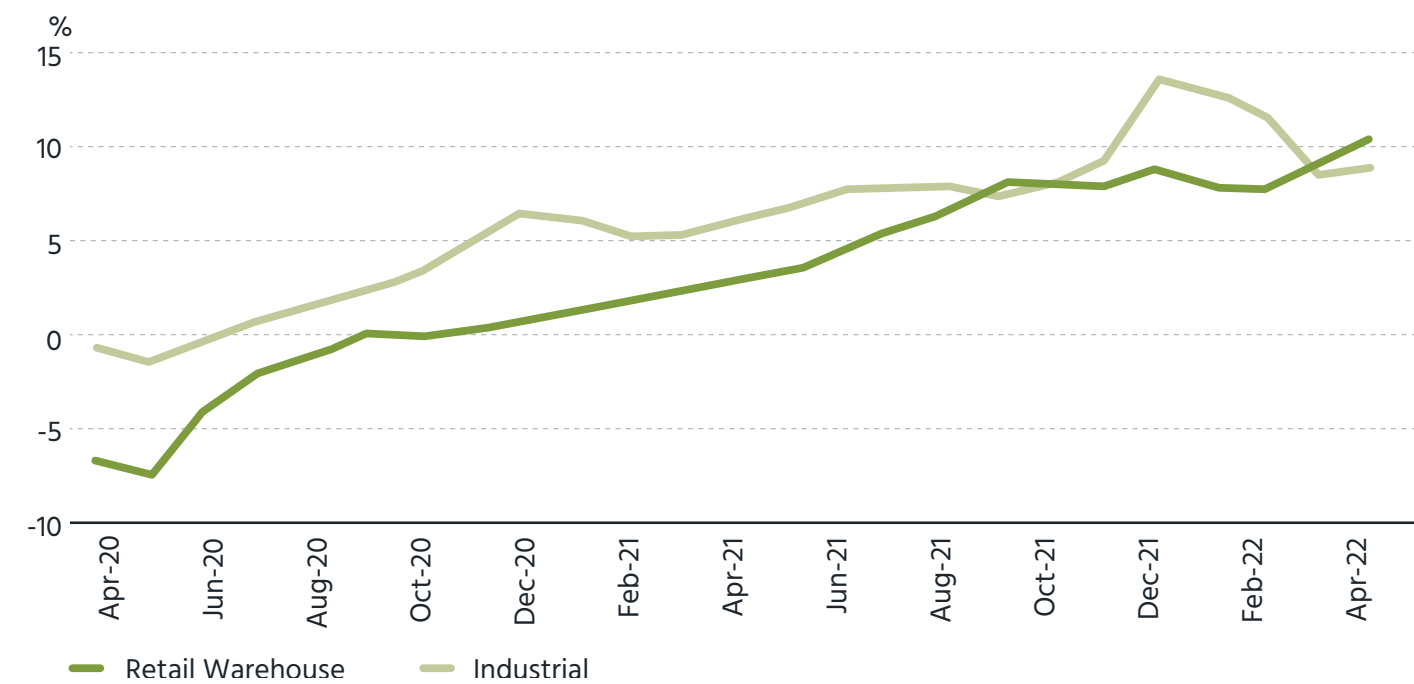
**All Property quarterly total return and components**

Source: Gerald Eve, MSCI



**Quarterly total return by sector**

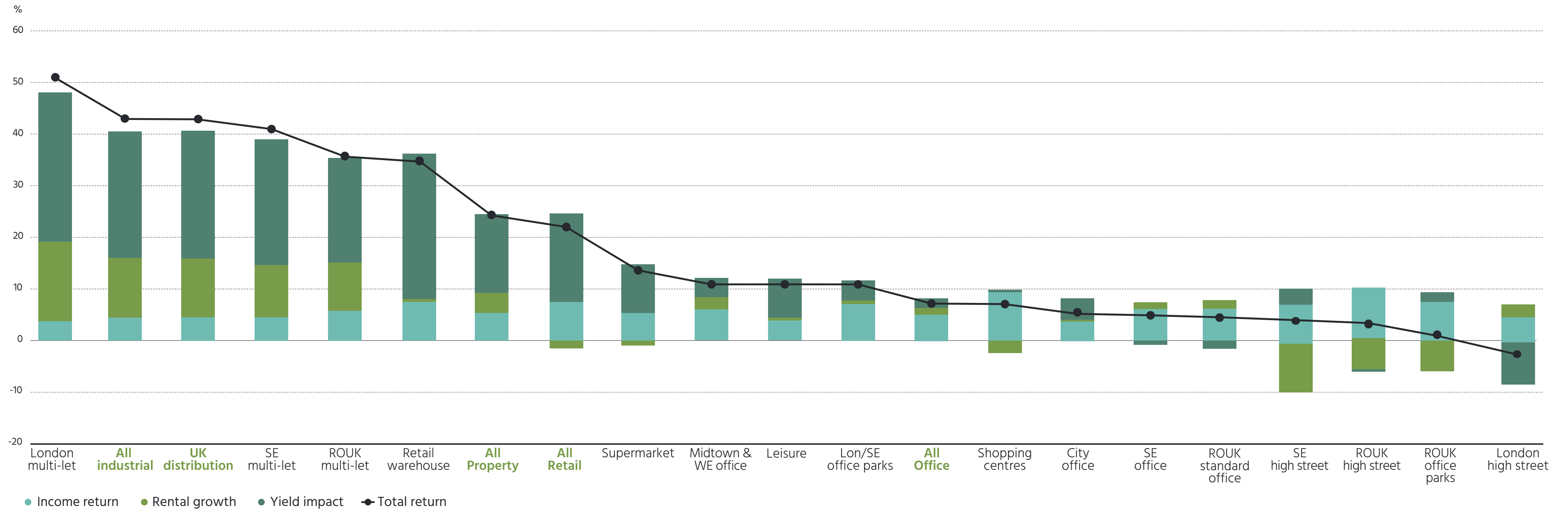
Source: Gerald Eve, MSCI



# Data Monitor

## 12-month return to April 2022

Source: MSCI



# UK economy

The UK economy contracted 0.1% month-on-month in March as the current various problematic headwinds impact this lagging indicator. CPI inflation hit a 40-year high of 9% in April, driven by elevated global goods prices such as steel and concrete, and exacerbated by supply chain disruptions from lockdowns in China. The availability and price of various foodstuffs have been impacted amongst other things by the conflict in Ukraine. The large recent rise in the energy price cap is likely to be followed by another in the autumn, thus the expected fallback in inflation over the second half of 2022 is likely to be only gradual. Sharply rising input costs are of key concern to businesses and high frequency sentiment indicators suggest there will be a record rise in output prices to try to offset this. The Bank of England has responded with quantitative tightening and increased the base interest rate for the fourth successive meeting in early May to 1.00%. Oxford Economics expects a further two 25bps increases over the remainder of 2022.

Income tax thresholds have been frozen and national insurance contributions were increased in April. All in this is set to cause the largest drop in real household incomes for over 80 years. Retail sales growth has been erratic and GfK consumer confidence in May was the lowest since its inception in 1972. The increase and expected further increases in interest rates will feed through to business loans that will particularly affect SMEs, which took on significantly more debt over the pandemic through various government support schemes. Meanwhile corporation tax is due to increase from 19% to 25% in 2023. This combined with the generally less attractive UK business environment post-Brexit will have a dampening effect on business investment over the medium term.

There are nevertheless labour shortages across multiple sectors, though the level of total employment is lower than it was pre-pandemic, indicating a sharp fall in participation since 2019. The continued upward trend in job vacancies and potential wage inflation will be of key concern to the monetary authorities, and the interest rate rises are likely to help push the consumer sector into recession this year.

**3.6%▼**  
2022 GDP forecast

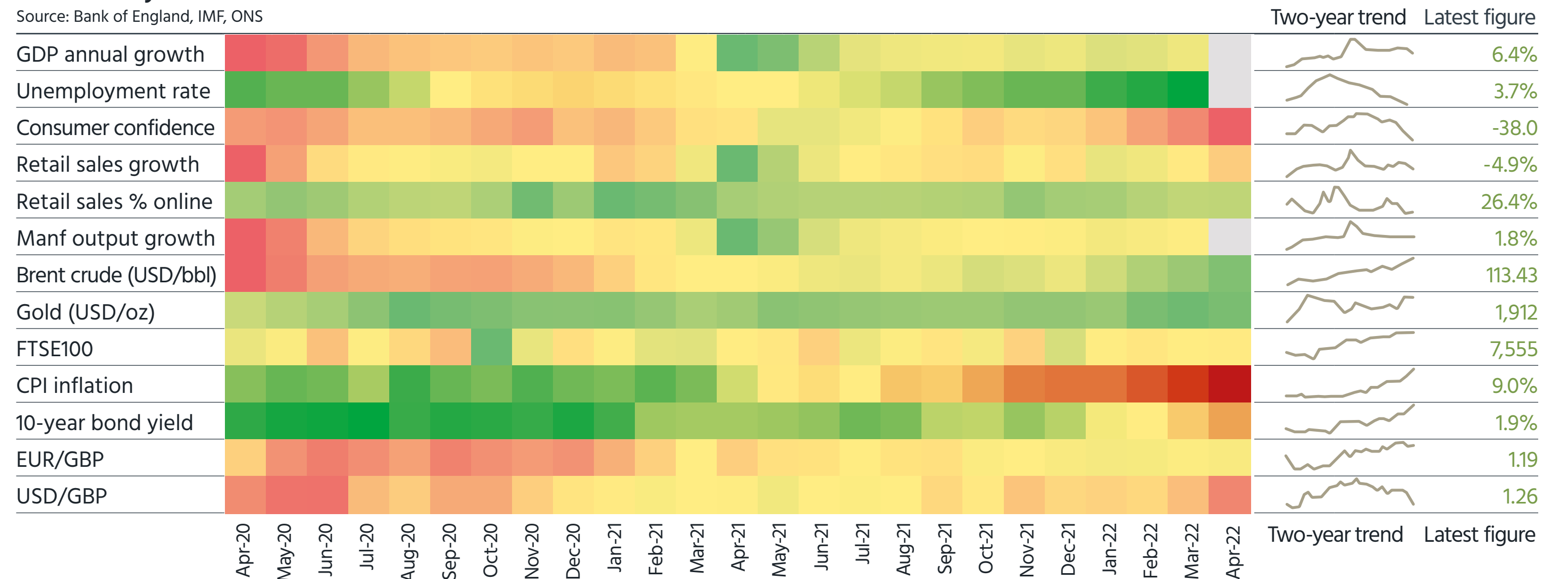
**2.3%▲**  
2024 10-yr bond yield forecast

**7.6%▲**  
2022 CPI forecast

**3.8%▼**  
2022 unemployment rate forecast

## The monthly monitor

Source: Bank of England, IMF, ONS



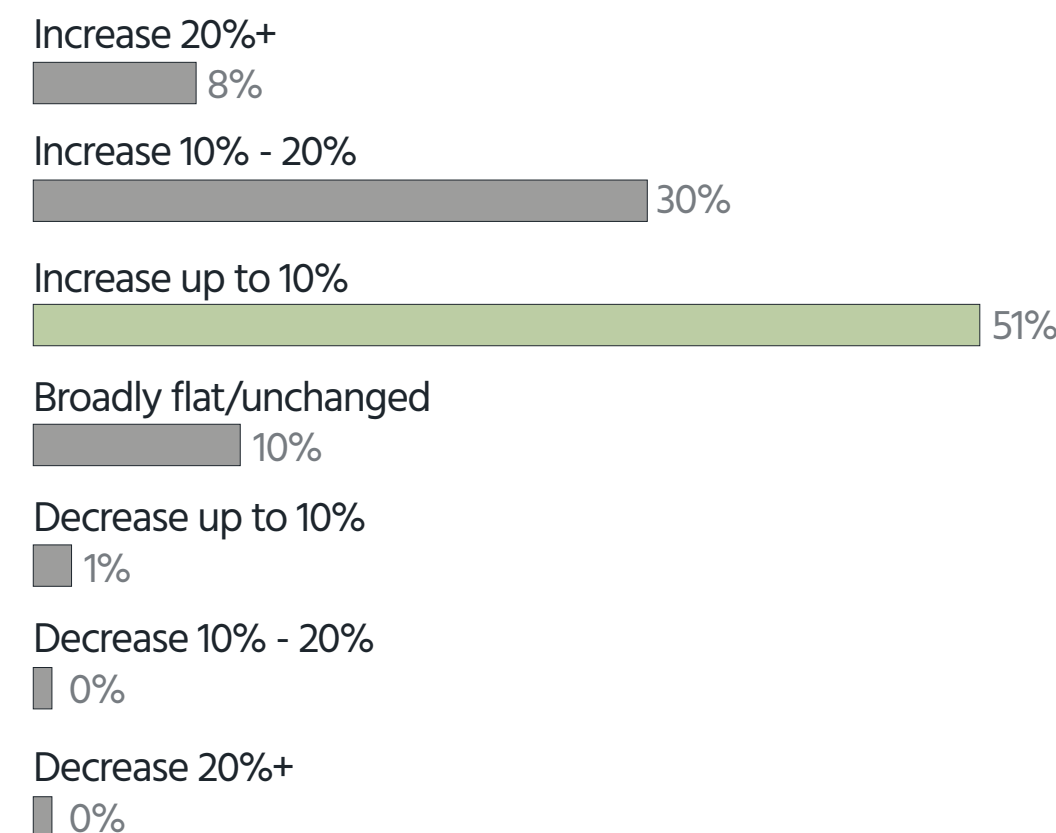
# Spotlight on... Gerald Eve's Industrial and Logistics breakfast briefing

Over 150 clients were in attendance at the Royal Society of Medicine for our Industrial and Logistics breakfast briefing on Wednesday, 18th May. There were presentations with key findings from our Prime Logistics and Multi-let research along with a capital markets outlook at this crucial juncture for the sector. As part of proceedings we polled our audience to get a large-sample steer from the great and the good of industrial on the future directions for the sector.

There is a large majority that predicts nominal prime logistics rents will increase as much as 20% over the next two years, with virtually no expectation of a decline. Meanwhile, inflation and interest rates are seen as the most significant issues facing multi-let income over the short term. And industrial yields are expected to soften by around 25bps, with a sizeable minority predicting a more significant outward shift of up to 75bps over the next two years.

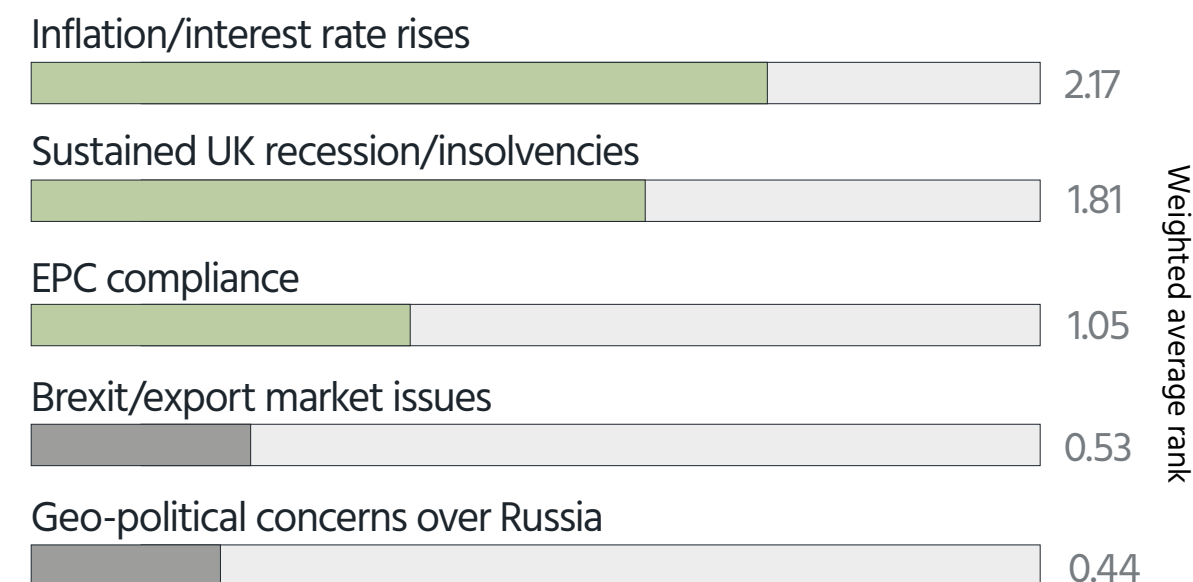
## PRIME LOGISTICS NOMINAL RENTS INCREASED OVER 25% OVER THE PAST TWO YEARS. WHERE DO YOU SEE THEM GOING OVER THE NEXT TWO YEARS?

Source: Slido, Gerald Eve



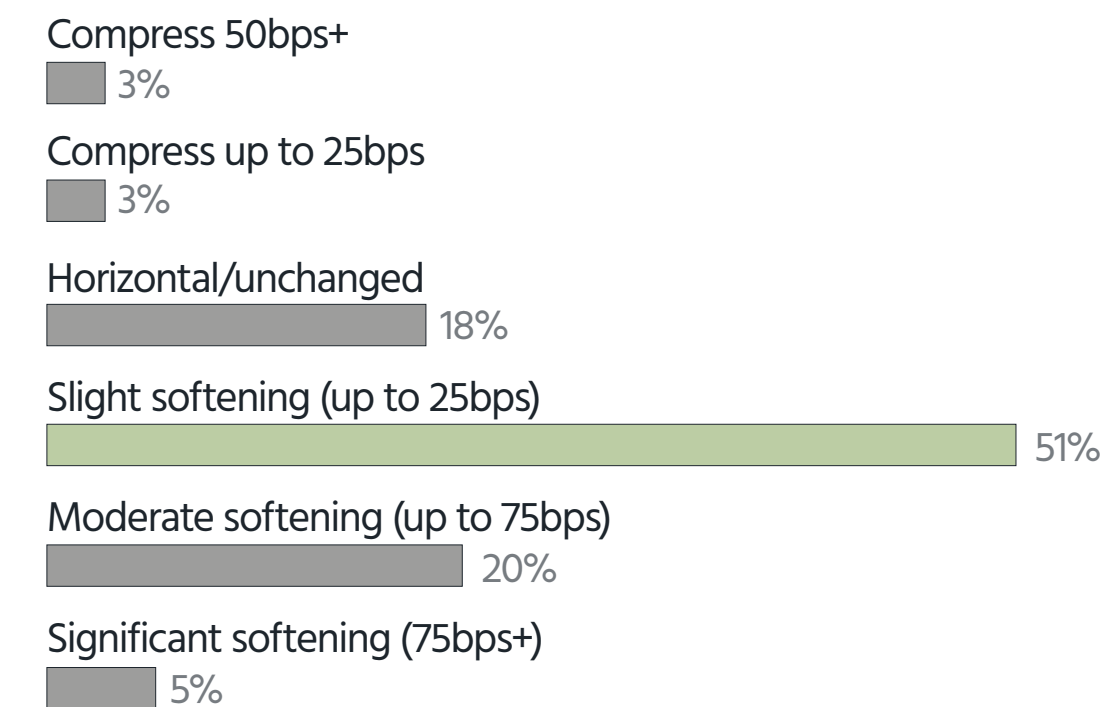
## WHAT DO YOU SEE AS THE MAIN RISK TO MULTI-LET INDUSTRIAL INCOME OVER THE NEXT TWO YEARS? RANKING 1 TO 3

Source: Slido, Gerald Eve



## INDUSTRIAL YIELDS HAVE COMPRESSED AN INCREDIBLE AVERAGE 127BPS OVER THE PAST TWO YEARS, GENERATING OVER 32% OF CAPITAL GROWTH. WHERE DO YOU SEE INDUSTRIAL YIELDS GOING OVER THE NEXT TWO YEARS?

Source: Slido, Gerald Eve





# Outlook

All Property annual 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 their high yields guarantee a positive total 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.

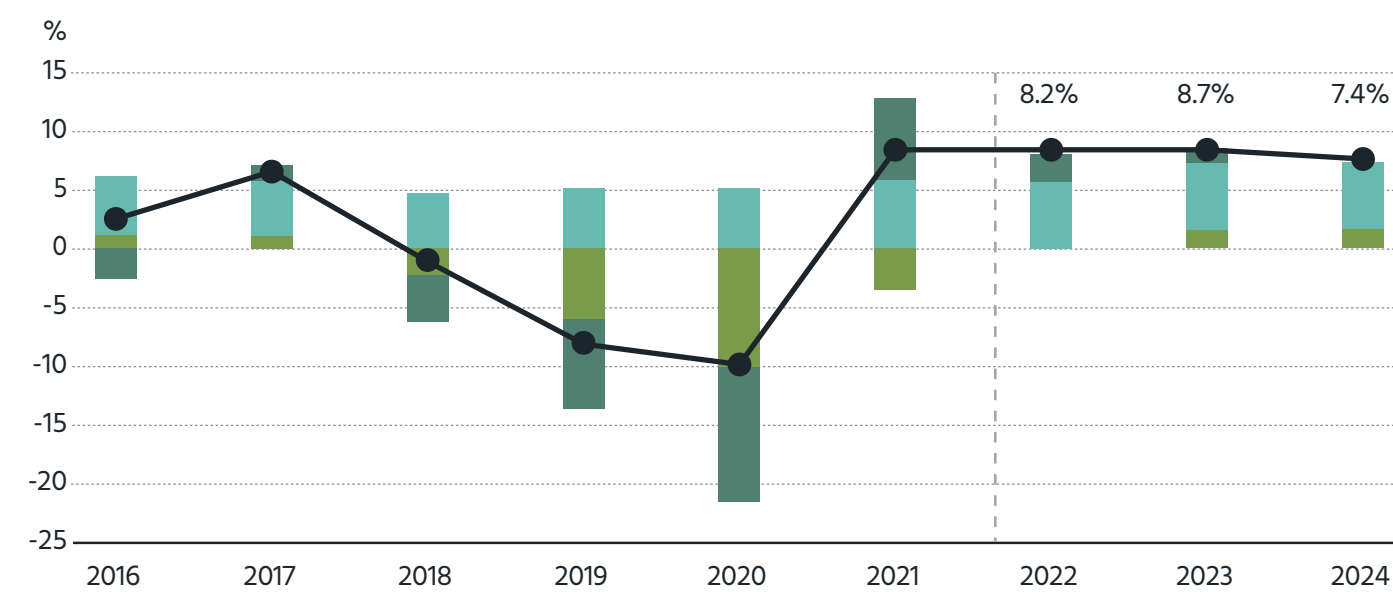
**Office** rents have stabilised now that occupier activity has improved post-lockdowns. The polarisation of the best-in-class assets is set to intensify, and prime yields have consequently tightened in London. Availability has narrowed and landlords and developers are reportedly marketing buildings which will deliver in the next 6-12 months above current market rents as they know competition for new space of the right specification 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.

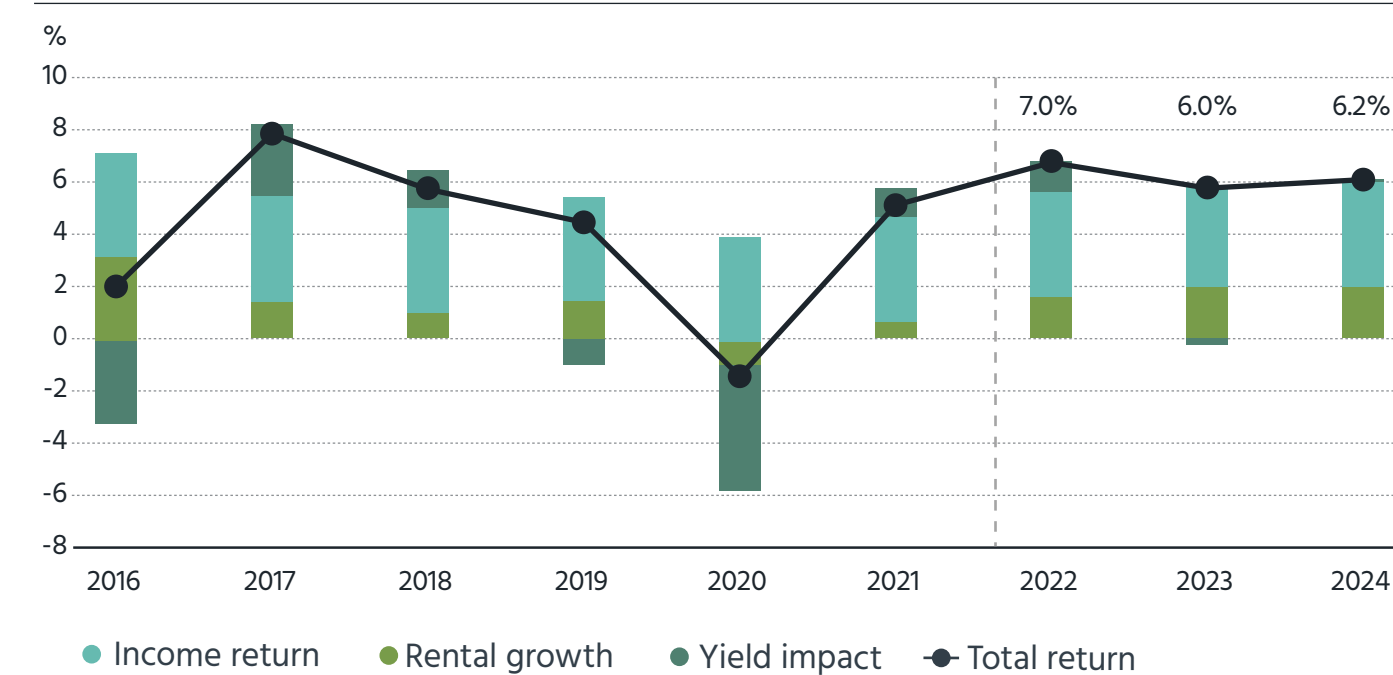
## Total return and components by sector

Source: Gerald Eve, MSCI

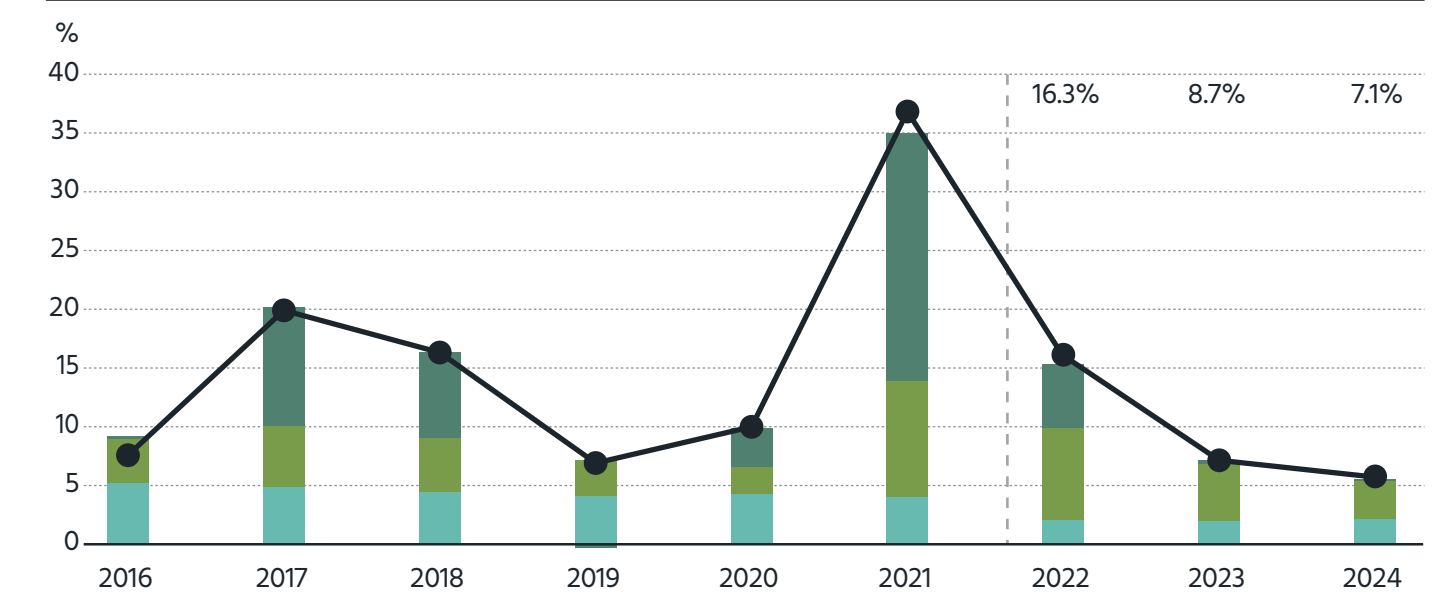
### Retail



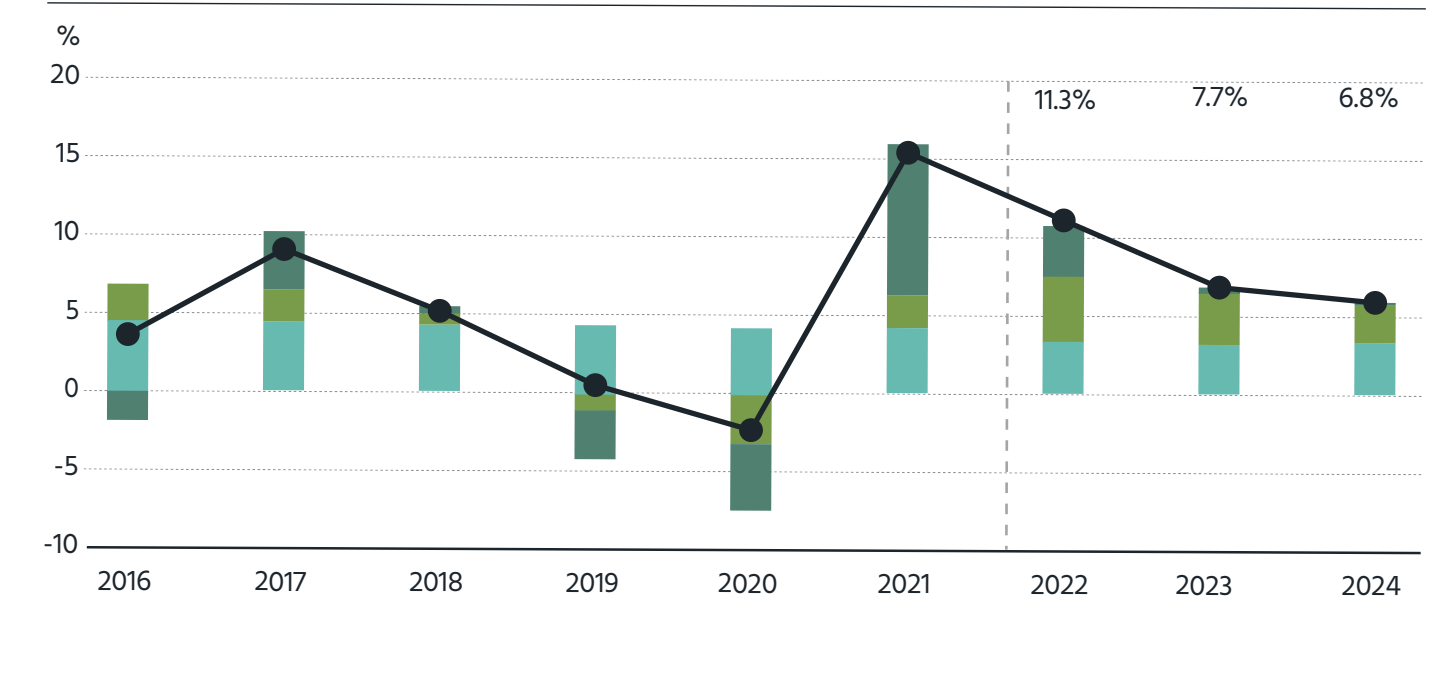
### Office



### Industrial



### All Property



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## Agency

## Valuation

## Further Insight

**South East offices**  
Q1 2022

**Prime Logistics**  
Q1 2022

**Valuing Sustainability**  
April 2022

**A life science lease of life:  
Adaptive repurposing**  
March 2022

**Euro Logistics**  
March 2022

**Retail Repurposing  
and Repositioning**  
February 2022

**Office Certification  
Explained**  
February 2022

**Industrial Logistics**  
January 2022

**Multi-Let**  
Q4 2021

**London Markets**  
Q1 2022

**Manchester BTR**  
September 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.

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