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UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

February 2021

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FEBRUARY UPDATE

Commercial property quarterly total return was its strongest in over two and half years in January 2021. This was, in part, driven by meaningful improvements in the beleaguered retail and leisure sectors, though the difference in performance with industrial has never been greater. Read more for the most recent occupier and investment updates, economics data and property forecasts.

Read more.

2.1% ▲	6.3% ▼	-0.1% ▲	5.5% ▲	1.5% ▲	5.9% ▲
Jan All Property quarterly return	Jan All Property equivalent yield	Jan All Property quarterly rental growth	2021 GDP forecast	2021 CPI forecast	2021 unemployment rate forecast

Strongest property return in over two and a half years

All Property quarterly total return increased again in January to 2.14%. This was the best outturn since June 2018 and, notwithstanding the strong industrial backdrop, was driven by meaningful improvements in both the retail and leisure sectors.

Retail quarterly total return was -0.11% in January and edged tantalisingly closer to zero with the least negative return since October 2018. The improvement was driven by less negative influences from both rental growth and yield impact. Equivalent yields across the retail subsectors all broadly stabilised in January, with only a small movement out for shopping centres. Retail warehouse performance continued to decouple from the wider retail measure and January marked the third month of positive quarterly total return. The latest increased to +1.27% with quarterly rental growth only slightly negative.

Leisure property performance similarly showed signs of stabilisation in January and a quarterly total return of -0.55% was the least negative since February 2020. The average equivalent yield has moved out 135 basis points over the past year, leaving capital values almost 22% cheaper. The sector is not saddled with the same longstanding structural issues that have beset retail and, with the on-target vaccine rollout promising a sustained opening up of the economy in the coming months, some assets will become of real interest to investors.

Nevertheless, commercial property return has never been so divergent across sectors, with London multi-let industrial outperforming UK shopping centres on an annual basis by an astonishing 3,485 basis points in January.

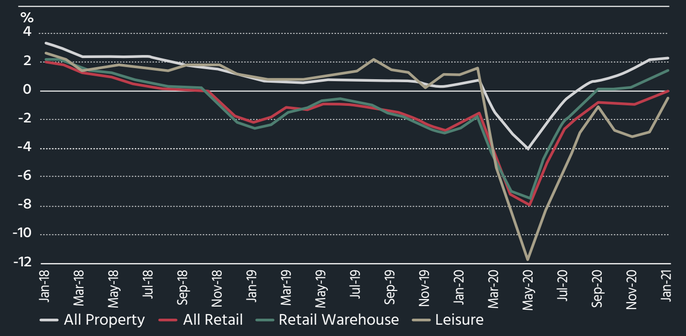
Over a more recent timeframe, industrial quarterly return in January fell to 6.04%, down from its recent peak of 6.50% in December. This was driven by lower positive yield impact, particularly in the higher performing London multi-let and national distribution warehouse subsectors. The London multi-let yield hit a new low of 4.36% and while momentum has been carried over from the end of last year it is beginning to ease as predicted. In one of the most significant deals of early 2021, Partners Group acquired the Purdey Portfolio for £253m, which contains 27 multi-let industrial sites.

UK office quarterly total return was -0.01% in January, marking a third month of effectively zero return. Rental movements have been minimal, while gradual outward yield shift has offset income return. Across subsectors, the more peripheral London and the South East office yields have moved out the most over the past three months and were 6.30% and 7.58%, respectively. Outer London rents also slipped 1.65% over the quarter. In contrast, central London yields in the more prime locations essentially held steady at 5.11%. This month's Spotlight will delve a little deeper into the themes for central London offices.

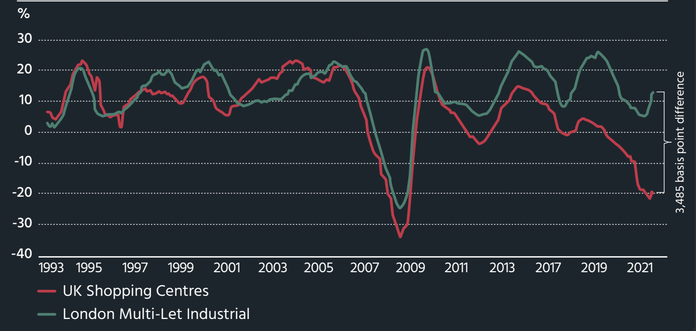
22%
Cheaper leisure capital values than a year ago

2.1%
Jan All Property quarterly return

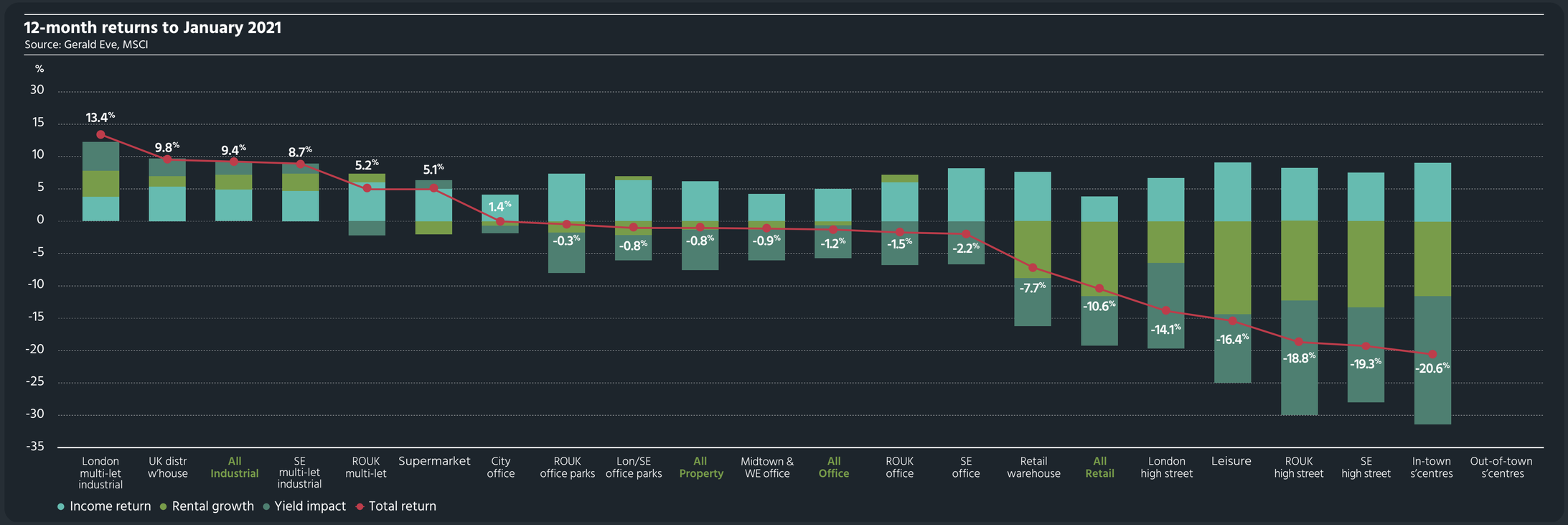
Quarterly total return by sector
Source: Gerald Eve



Annual total return by sub-sector
Source: Gerald Eve



Segments


12-month returns to January 2021
Source: Gerald Eve, MSCI
%
30
15
10
5
0
-5
-10
-15
-20
-25
-30
-35
13.4%
9.8%
9.4%
8.7%
5.2%
5.1%
1.4%
-0.3%
-0.8%
-0.8%
-0.9%
-1.2%
-1.5%
-2.2%
-7.7%
-10.6%
-14.1%
-16.4%
-18.8%
-19.3%
-20.6%
London multi-let industrial
UK distr w'house
All Industrial
SE multi-let industrial
ROUK multi-let
Supermarket
City office
ROUK office parks
Lon/SE office parks
All Property
Midtown & WE office
All Office
ROUK office
SE office
Retail warehouse
All Retail
London high street
Leisure
ROUK high street
SE high street
In-town s'centres
Out-of-town s'centres
Income return
Rental growth
Yield impact
Total return

UK economy

UK GDP rose by 1.0% quarter-on-quarter in Q4 2020. This surprised on the upside, though much was due to the recent ONS inclusion of the test, track and trace scheme into health sector output. There should be carry through to boost output in early-2021, but the impact will be mitigated by the likelihood that the lockdown will remain in place for longer than previously anticipated.

Initial evidence on the third shuttering of the UK economy indicates that activity has been hit harder than in November but the impact has been much more modest than the first lockdown in spring 2020. Oxford Economics expects GDP to fall by 4.7% quarter-on-quarter in Q1. The vaccination rollout is progressing well, meaning a substantive relaxation of social distancing restrictions is likely in Q2. This should boost confidence and lead to a strong consumer-led rebound in GDP. Consequently, annual GDP growth for 2021 has been revised upwards to 5.5%.

CPI inflation in January came in higher than expected at 0.7%. The biggest upward contributions came from the price of household goods, restaurant meals and food & drink. Strong base effects (such as the sharp rise in the depressed oil price in January) are set to continue to push up headline inflation rates from the spring to a brief period of above-target inflation in late-2021/early-2022. Low underlying inflation should still broadly be supportive for UK households, however.

The 10-year bond yield moved out to the highest it has been since February 2020 and sterling rose again against the euro and US dollar in January. The chance of negative interest rates previously mooted as a possibility by the Bank of England now appear extremely unlikely.

Unemployment is a key risk to the UK outlook. Official data are likely to understate the magnitude of the fall in employment given problems in accurately measuring the scale of outward migration during the pandemic. With the Coronavirus Job Retention Scheme due to close at the end of April, the official ILO unemployment rate is forecast to peak at around 6% in mid-2021. Meanwhile, the fallout from the extra trade frictions due to Brexit will continue to weigh on export viability and competitiveness.

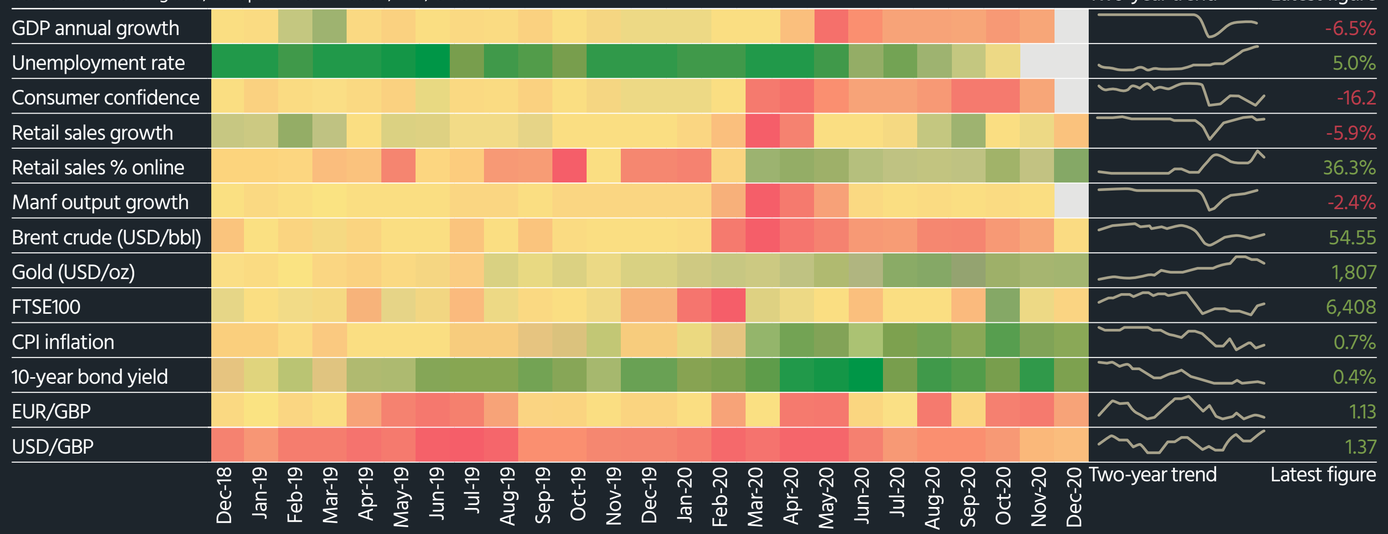
5.5% ▲
2021 GDP forecast

1.5% ▲
2021 CPI forecast

0.4% ▲
% 2021 10-yr bond yield forecast

5.9% ▲
2021 unemployment rate forecast

The monthly monitor
Source: Bank of England, European Commission, IMF, ONS



Spotlight on...
Central London offices

Muted lettings activity in 2020

Annual take-up was just under 7m sq ft in 2020, less than half of the 2019 total. Lockdown and ongoing social restrictions mean that occupiers have effectively pushed the pause button when approaching lease decisions. Subdued demand continued into Q1, but activity is anticipated to pick up by the summer when occupiers consider a more realistic wholesale return to the office and delayed plans are implemented. Occupier priorities are expected to centre around ESG, encouraging workplace flexibility through technology and enhanced collaborative space.

A large release of space caused peaks in availability

Availability in London increased by 0.7%-pts from 6.4% in Q3 to 7.1% in Q4 2020. With occupier demand dampened, many submarkets have shifted to near historical peaks in availability, notably the City, Shoreditch, and Southbank. The volume of tenant-controlled space increased over 2020 and reached 3m sq ft at year-end, which is the highest figure since Q1 2018. Over 800,000 sq ft was released by tenants just H2 2020 alone. In Shoreditch, Soho, Southbank, and Victoria sub-let space accounts for over 20% of all availability.

Investors returned to the market later in the year

Investment volume in 2020 totalled £8.3bn but activity was weighted towards the second half of the year when £5bn transacted. This was heavily skewed by £3.8bn of acquisitions made in Q4. The anticipated lifting of international travel bans, sale campaigns now coming online, and pent-up demand should act as a boost for investment in 2021. This will be underpinned by investors' ability to capture discounts while sterling is still historically cheap, compounded by relatively attractive yields in London compared to other major global office markets.

Overseas investors dominated Q4 activity

The breakdown of London office capital flows show that overseas investors were the most active buyer type in Q4, with £3.3bn of acquisitions and accounting for 87% of all activity. In contrast, UK Property Companies were the most active seller type and disposed of £1.5bn of assets, which reduced their net position by £1.3bn. By investor domicile, Far East investors were the most active and acquired £1.6bn of London offices. This may in part be a geopolitical play as Hong Kong investors were particularly active on prime stock in the West End. The focus on investment quality is key here, with strong leasing credentials paramount.

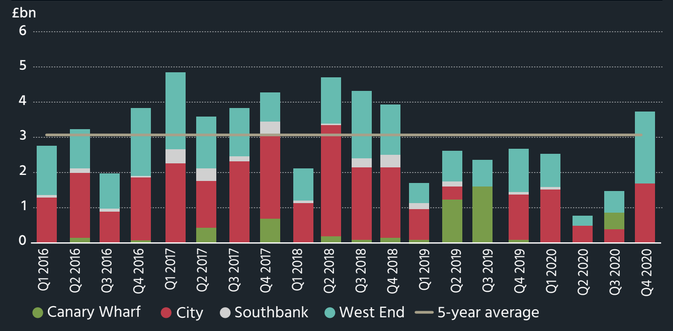
7.0m sq ft ▼
2020 annual take-up

£3.8bn ▲
Q4 2020 investment

7.1% ▲
Q4 2020 availability rate

87.2% ▲
Q4 2020 proportional overseas investment

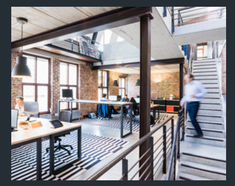
Quarterly office investment by submarket
Source: Gerald Eve



Outlook

All Property total return is forecast to return to a positive and be 6.0% in 2021, improving to 7.2% in 2022, as retail and leisure pricing stabilise and contribute positively. Equivalent yields will be offset by different sector forces and remain around 5.7% in 2021 and 22.

There will be sustained underlying strength in the industrial market, especially in London and the South East. However, yields are arguably near their floor in prime markets and an uncertain outlook for consumers and businesses following the unwinding of lockdown government support will inevitably lead to at least some small increase in voids. Consequently, inward yield momentum is forecast to slow over 2021.



Headline office rents are expected to deteriorate more rapidly in 2021 as the return to work better evidences the occupier fallout from the lockdowns. Thus some further yield softening in the short term is expected – particularly for secondary that pose greater ESG issues.

Retail should experience some further but smaller fall in rents and more moderate outward yield shift in 2021. Stabilisation in the sector by 2022 points to some relatively competitive returns, boosted by a large income return component.

Equivalent yield

	OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
2017	5.7%	5.4%	5.6%	5.5%
2018	5.6%	5.6%	5.2%	5.4%
2019	5.5%	6.0%	5.2%	5.5%
2020	5.7%	6.7%	5.1%	5.7%
2021	5.7%	7.0%	4.9%	5.6%
2022	5.6%	6.9%	4.9%	5.6%

Annual rental growth

	OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
2017	1.5%	1.0%	5.3%	2.0%
2018	1.1%	-2.1%	4.6%	0.6%
2019	1.4%	-5.0%	2.8%	-0.7%
2020	-0.8%	-9.4%	2.3%	-3.1%
2021	-2.0%	-3.8%	2.4%	-0.5%
2022	1.6%	0.0%	3.1%	1.7%

Annual capital growth

	OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
2018	1.8%	-6.2%	11.5%	0.6%
2019	0.3%	-11.6%	2.4%	-3.3%
2020	-5.5%	17.1%	4.6%	-6.6%
2021	-1.5%	-6.2%	5.7%	1.3%
2022	2.2%	1.4%	3.2%	2.5%

Source: Gerald Eve, MSCI

Annual total return

	OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
2017	5.8%	-1.7%	16.4%	5.1%
2018	4.4%	-6.8%	6.9%	1.2%
2019	-1.7%	-12.4%	9.2%	-2.3%
2020	2.8%	-0.1%	9.5%	6.0%
2021	6.7%	8.2%	6.6%	7.2%
2022	6.7%	8.2%	6.6%	7.2%

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