GERALDEVE

IN BRIEF

UK COMMERCIAL PROPERTY UPDATE AND OUTLOOK

March 2021

Read more.

geraldeve.com/services/research

GERALDEVE

MARCH UPDATE

Retail generated a positive quarterly return in February for the first time since October 2018 and, in turn, managed to outperform UK offices this month. This broke a run of an incredible 45 consecutive months of retail underperforming the other major property sectors. Read more for the most recent occupier and investment updates, economics data and property forecasts.

Read more.

0.35%	0.14%	5.15%	6.8% ▲	1.3% ▲	5.9% ▲
Retail quarterly total return	Office quarterly total return	Industrial quarterly total return	2021 GDP forecast	2021 CPI forecast	2021 unemployment rate forecast

Retail outperforms Office

Retail generated a positive quarterly total return in February 2021, the first since October 2018. Even more notably, it also broke the run of 45 months – almost four years – of being the worst-performing major property sector. The February return of +0.35% even pipped office into third with its 0.14%. The key driver of this improved trend was retail warehouses, where quarterly return has now been positive and progressively higher for the last four consecutive months. There have been some reports of not only yield compression in selected cases but also even gazumping in this sub-segment.

Shopping centre returns remain deeply negative but even here the trend is improving as yields start to stabilise and prices begin to bottom out. The average UK shopping centre income return was up to 10.7% in February, which will begin to start looking interesting to the right investor for the right asset. Leisure returns have followed a similar path to retail over the past 12 months for obvious reasons. However, this segment was not undergoing the same structural repricing pre-pandemic and consequently quarterly returns have improved markedly recently as the lockdown end is in sight.

At the All Property level, quarterly return eased slightly in February to 2.05%, the first month where the return had not increased since May 2020. This was on the back of a further cooling of the strong yield impact and returns from the industrial sector, which was 5.15%, down from 6.50% in December. London multi-let industrial continues to drive positive returns and the average equivalent yield fell again to a new record of 4.31%. But the rate of yield compression is slowing.

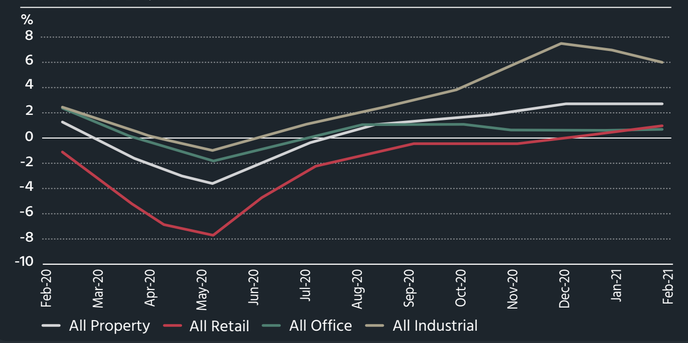
UK Office performance continues to be finely balanced between a gradual softening of yields that is eroding capital values offset by income return, which has led to four months of broadly zero quarterly total return. There is polarisation within the segment though, with the flight to prime evident in the Inner London markets where yields remain stable and quarterly returns positive. There is investor demand for core assets in London, notably still from overseas. This includes £255m for 66-73 Shoe Lane by Wing Tai Properties (Hong Kong), £110m for 45 Pall Mall by JP Morgan AM (North America), £59m for 127 Charing Cross Road by Nomura Real Estate (Japan) and, more peripherally, £50m for The Heights in Weybridge by an undisclosed Middle Eastern investor.

Other recent significant deals include BentallGreenOak's acquisition of a portfolio of seven logistics estates for £303m and Blackstone took Bedfont Logistics Park at Heathrow for £119m. The most significant retail transaction was Brent South Shopping Park bought for £55m by Brent Borough Council. There have been a number of other local authorities active recently, including Brentwood Borough Council, plus Merseyside pension fund bought offices in Clerkenwell.

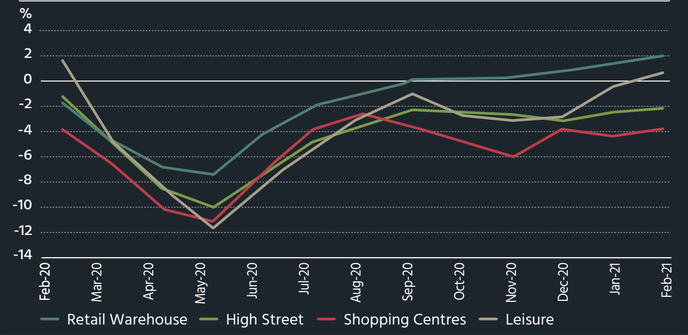
0.14%
Office quarterly total return

0.35%
Retail quarterly total return

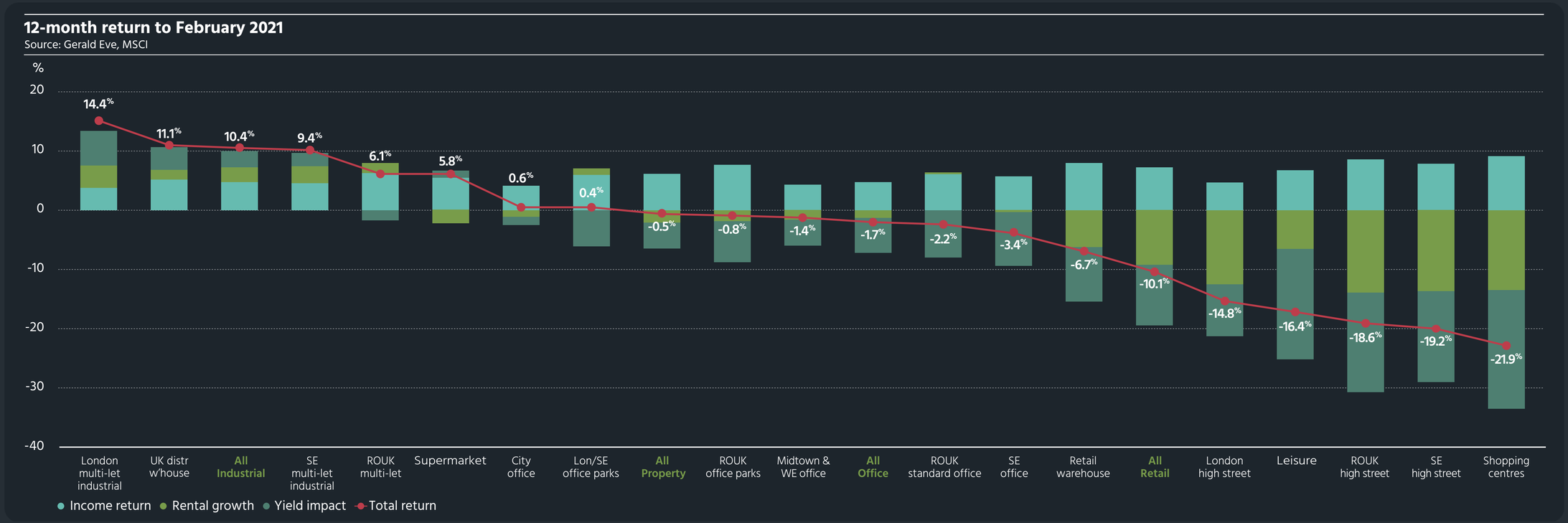
Quarterly total return by sector
Source: Gerald Eve, MSCI



Leisure and retail subsector quarterly total return
Source: Gerald Eve, MSCI



Segments


12-month return to February 2021
Source: Gerald Eve, MSCI
%
20
10
0
-10
-20
-30
-40
14.4%
11.1%
10.4%
9.4%
6.1%
5.8%
0.6%
0.4%
-0.5%
-0.8%
-1.4%
-1.7%
-2.2%
-3.4%
-6.7%
-10.1%
-14.8%
-16.4%
-18.6%
-19.2%
-21.9%
London multi-let industrial
UK distr w'house
All Industrial
SE multi-let industrial
ROUK multi-let
Supermarket
City office
Lon/SE office parks
All Property
ROUK office parks
Midtown & WE office
All Office
ROUK standard office
SE office
Retail warehouse
All Retail
London high street
Leisure
ROUK high street
SE high street
Shopping centres
Income return
Rental growth
Yield impact
Total return

UK economy

GDP fell by 2.9% month-on-month in January, a much smaller decline than expected. This was partly due to the ONS inclusion of the test, track and trace scheme into health sector output. In addition, consumers and firms have adapted to life under lockdown and the proportion of retail sales conducted online remains high at around a third of all spending.

Oxford Economics now expects GDP to fall by only 2% quarter-on-quarter in Q1. Notwithstanding the possible disruption to vaccine supply in April and assuming the disputes with the EU do not escalate further, a substantive relaxation of social distancing restrictions remains likely in Q2. The repayment of unsecured credit and accumulated savings over lockdown has left consumers in a strong position to support the rebound in GDP when this happens. Consequently, annual GDP growth for 2021 has been revised upwards again to 6.8%.

The Budget on the 3rd March offered more near term support than was anticipated and extended existing Covid support programmes until the autumn. There was also the introduction of a two-year 'super deduction' capital allowance, designed to encourage cash-rich firms to bring forward investment. However, GDP forecasts have been lowered for the medium term after plans to freeze most tax allowances for four years and raise the main rate of corporation tax from 19% to 25% from 2023.

The 10-year bond yield moved out again in February and sterling rose again against the euro and US dollar. The price of oil increased further in February to $62 a barrel and, while still historically relatively moderate, is now over 2.5 times its value in April 2020. This will feed through to a brief period of above-target inflation in late-2021/early-2022. Low underlying inflation should still broadly be supportive for UK households over the medium term, however.

Unemployment remains a key risk to the outlook, but with the Coronavirus Job Retention Scheme now extended the official ILO unemployment rate is forecast to peak at below 6% in 2021. Meanwhile, the fallout from the extra trade frictions due to Brexit will continue to weigh on export viability and competitiveness.

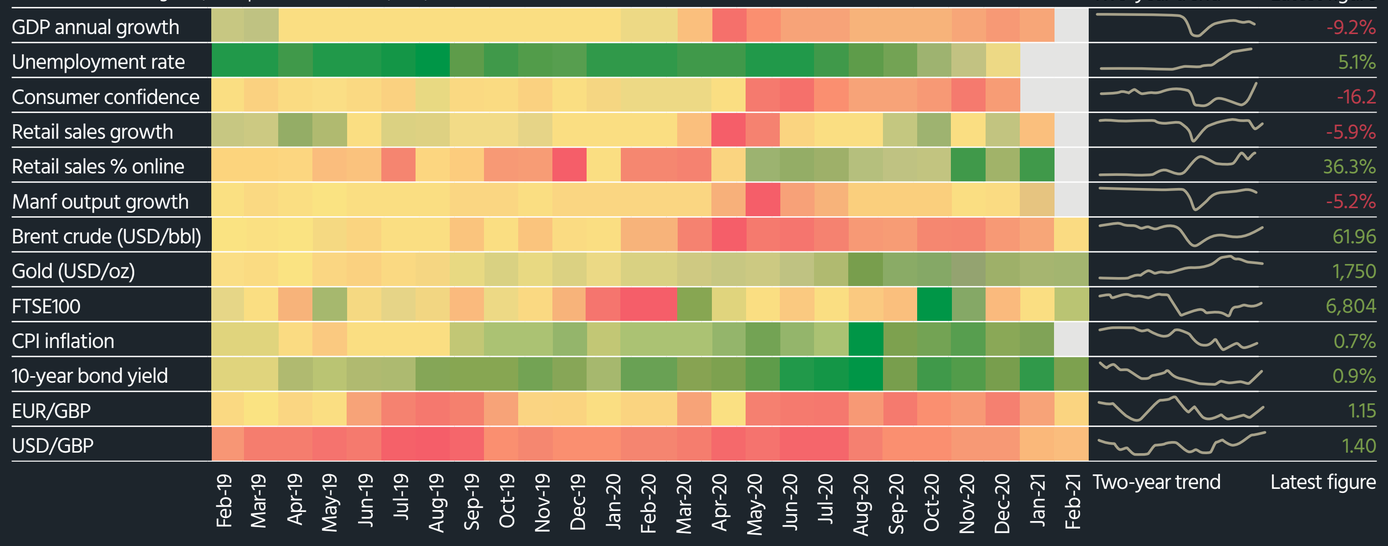
6.8% ▲
2021 GDP forecast

0.9% ▲
2021 10-yr bond yield forecast

1.3% ▲
2021 CPI forecast

5.9% ▲
2021 unemployment rate forecast

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



Spotlight on...
Build-to-rent residential

Investment resilient over the pandemic

In a year marred by uncertainty, Build-to-rent (BtR) bucked the trend with strong investment activity totalling £4.2bn in 2020, an increase of more than 40% compared with 2019. Investors looking to safeguard income over the longer term and provide diversity in portfolio compositions sought out opportunities in residential. Some investors, such as German based ECE, made their first foray into the BtR market in 2020. ECE purchased a trio of assets in UK regional cities, while other more experienced institutions increased their allocation – for example, Legal & General RE made another seven investments into the sector, which totalled £609m across UK regional cities.

North American investors apply multi-family expertise

Overseas investors were more active than domestic in 2020, accounting for 55% of investment and allocated £2.3bn to the sector. North American investors that could apply their existing knowledge of multi-family investment were the largest sub-type within this group. Canadian and US-based funds invested £911m and £458m, respectively. Notable acquisitions were QuadReal's purchase of the £580m Project Harmony portfolio, comprising of six BtR assets spread across London and Manchester, with two purpose-built student accommodation assets.

£4.2bn
2020 investment volume

£2.3bn
Overseas investment

65%
Forward-funding

4.32%
Average weighted yield

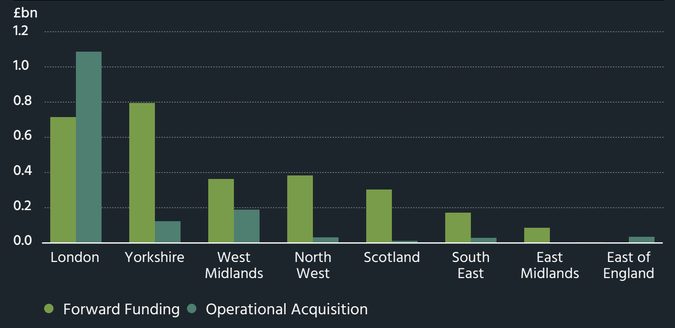
Keen investor appetite for new developments

Of the £4.2bn invested in 2020, 65% (£2.7bn) was on a forward-funding basis. By region, Yorkshire had the largest amount of forward-funding, totalling £783m, with Leeds receiving the largest inflows. This was followed closely by London with £700m. As the maturity of BtR is more advanced in the capital, London was still clearly the favoured destination for operational acquisitions with £1.1bn invested in 2020. Available yield data shows a clear differential between investor strategies - UK institutions transacted exclusively at yields of 4.5% and below, whereas the appetite from propcos was for higher yielding products, 5.5% and above.

Manchester case study in upcoming new Gerald Eve research

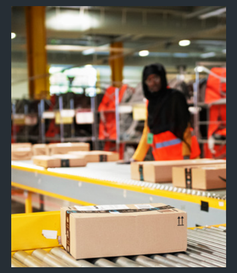
Last year Manchester ranked 4th out of 22 UK cities for BtR investment, with £403m invested over six transactions. Five out of six of these transactions provided forward funding for a total of 1,881 units, signalling a confidence to develop large-scale housing schemes in Manchester. Positive underlying characteristics of the city reinforce these investments since Manchester has one of the largest creative clusters in the UK after London. Demographics show working age population growth has been faster than any other age group in the city, which has in turn created a squeeze on housing supply.

Build-to-rent activity by region and investment type, 2020
Source: Gerald Eve, Propertydata

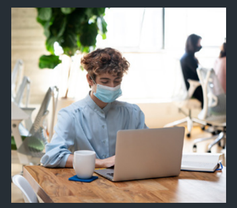


Outlook

All Property total return is forecast to return to a positive and be 7.9% in 2021, slipping back to 7.0% in 2022. This is as retail and leisure pricing stabilise and contribute positively again in some cases, while some of the heat comes out of the industrial market.



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 the office better evidences the occupier fallout from the lockdowns. Thus some further yield softening in the short term is expected – particularly for secondary assets that pose greater operational and ESG issues.

Retail should experience some further but smaller fall in rents and more moderate outward yield shift in 2021. A non-negative annual total return in 2021 will be the first since 2017 and by 2022 this should increase to be relatively competitive, boosted by a large income return component.

Equivalent yield

	OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
2018	5.6%	5.6%	5.2%	5.4%
2019	5.4%	6.0%	5.2%	5.5%
2020	5.7%	6.7%	5.0%	5.7%
2021	**5.6%**	**6.8%**	**4.9%**	**5.5%**
2022	**5.6%**	**6.7%**	**4.9%**	**5.4%**
2023	**5.6%**	**6.6%**	**4.9%**	**5.4%**

Annual rental growth

OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
1.1%	-2.1%	4.6%	0.6%
1.5%	-5.9%	2.9%	-1.0%
-1.0%	-10.1%	2.3%	-3.2%
-2.0%	**-3.6%**	**2.4%**	**-0.3%**
1.6%	**0.0%**	**2.8%**	**1.7%**
2.0%	**1.8%**	**2.8%**	**2.1%**

Annual capital growth

	OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
2018	1.8%	-6.2%	11.5%	0.6%
2019	0.4%	-12.5%	2.4%	-3.8%
2020	-5.4%	-18.5%	5.2%	-6.5%
2021	**-1.5%**	**-5.4%**	**5.7%**	**3.2%**
2022	**2.2%**	**1.4%**	**2.9%**	**2.4%**
2023	**2.5%**	**3.9%**	**2.9%**	**2.9%**

Source: Gerald Eve, MSCI

Annual total return

OFFICE	RETAIL	INDUSTRIAL	ALL PROPERTY
5.8%	-1.7%	16.4%	5.1%
4.4%	-8.0%	6.8%	0.6%
-1.6%	-14.2%	9.7%	-2.4%
2.8%	**0.6%**	**9.4%**	**7.9%**
6.8%	**8.0%**	**6.3%**	**7.0%**
6.9%	**10.5%**	**6.3%**	**7.5%**

Contact

Research

STEVE SHARMAN
Partner
ssharman@geraldeve.com
Tel. +44 (0)20 7333 6271

BEN CLARKE
Senior Associate
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

Agency

MARK TROWELL
Partner
mtrowell@geraldeve.com
Tel. +44 (0)20 7333 6323

Valuation

RICHARD MOIR
Partner
rmoir@geraldeve.com
Tel. +44 (0)20 7333 6281

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.

Other research publications

Euro Logistics
Winter 2020

Listed Markets
September 2020

Gerald Eve Sustainability
July 2020

London Markets
Q4 2020

Prime Logistics Bulletin
Q4 2020

Sout East Office Bulletin
Q4 2020

Industrial Revolution
July 2020

SUBSCRIBE HERE