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THE PROPERTY INVESTMENT PEOPLE

11/15

UK Property Market Snapshot

November 2015

Global Macro Overview

September rounded off a tumultuous quarter for global equity markets, having experienced sharp falls on the back of fears about slowing growth in China and uncertainty surrounding the timing of interest rate rises in the US.

The prospect of the first Federal Reserve interest rate hike in nearly a decade has been one of the most debated and discussed topics this year. It was widely anticipated that the U.S. central bank would finally start to raise interest rates from zero, but instead they opted to hold steady for at least one more month.

It was the cautious tone from the Fed's chairwoman, Janet Yellen, that took markets by surprise as she described the decision as a close call. Having refered to "recent global economic and financial developments" that are expected to put "downward pressure on US growth and inflation", it appears that the Fed are sufficiently concerned about events in China and the impact a slowdown will have on the US.

Although Ms Yellen insisted that it would be appropriate to raise rates later this year, market expectations are now set for a rate rise in 2016. Further, the speed at which rates rise could be slower than previously expected.

The Fed's revised projection for the level of longer-term interest rates remains relatively low at just 3.5%. Markets expect the terminal interest rate to be even lower: closer to 2%.

On a cautionary note, the International Monetary Fund (IMF) cut global growth forecasts, stating that an emerging markets slowdown may entrench low inflation and promote stagnation in the west.

The IMF's world economic outlook predicted the US would have the strongest growth of the leading G7 industrial nations in both 2015 and 2016, at 2.6% and 2.8% respectively. Britain is expected to be the second fastest growing G7 nation.

Economic news out of the US was positive as second quarter US GDP forecasts were revised upwards and record job vacancies hinted at wage inflation ahead.

In Europe, whilst economic indicators have generally been positive, headline inflation has remained stubbornly low. The European Central Bank (ECB) has flagged this and has also held out the prospect of additional monetary stimulus, should inflation and employment remain subdued.

Revised projections for longer-term interest rates remain low at just 3.5%; markets expect the terminal interest rate to be even lower.

Sovereign bonds continued to benefit from the flight to safe haven assets during September with yields on US treasuries, UK gilts and German bunds all falling to the lower end of their recent ranges.

UK Economy

On the whole, September provided a positive outlook for the UK economy. The IMF raised its forecast for UK growth in 2015, amid downgrades "across the board" for advanced and emerging economies. It said China's slowdown, falling commodity prices and an expected increase in US interest rates would all weigh on output.

The UK's recent GDP history was also upgraded by the Office of National Statistics. This is due to upward revisions to GDP growth between 2011 and 2013. The UK is now 5.8% above its pre-recession peak, up from an earlier estimate of 5.2%.

There was further positive news on the UK's current account deficit, which narrowed much faster then expected in the second quarter of the year. The deficit went from £24bn, or 5.2% of national income, in the first quarter of 2015, to £16.8bn, or 3.6% of GDP, in the second. (The current account figure from the Office for National Statistics measures the difference between imports and exports of trade and investment).

The outlook for retail has also started to look a lot brighter as retail sales grew at a much stronger rate than expected. The robust growth is expected to continue into the Christmas period, according to the Confederation of British Industry's (CBI) latest monthly Distributive Trades Survey.

Of the 119 firms polled by the Confederation of British Industry (CBI), 55% expect sales volumes to increase in the year to September, with only 4% expecting a decrease, giving a balance of 51%, its highest since June.

The only cloud on the horizon was data that showed that, whilst consumer confidence dipped due to reduced optimism over the current global economic outlook, it is still at a historically high level, which should remain supportive to consumer spending.

The Bank of England remains committed to normalising interest rates, having repeatedly flagged the end of 2015 as their expected time-frame for a first rate hike. However, given that inflation continues to hover around 0%, interest rates seem set to remain at the current record low for a while yet.

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UK Residential Property

The number of UK house sales rose at the fastest pace in September, according to the Royal Institution of Chartered Surveyors (RICS). It is the fifth month in a row that sales have increased.

Asking prices in England and Wales increased by 1% in September, led by the East of England, according to the latest index figures, while in Scotland they increased by 0.8%.

Prices increased the most in the East of the country, up 2.3% month on month, but the South East continues to be the UK's fastest moving regional market with prices up 7% over the last six months.

Price rises are being fuelled by the lack of supply in many parts, which is likely to push up prices further. Across the UK, the average stock per surveyor remains at 47, the smallest number recorded (RICS).

UK Commercial Property

Commercial property returns continue to outpace other asset classes

- UK real estate returned 1.3% in September: the second highest level of returns so far this year, according to the IPD UK Monthly Property Index.
- The split between capital growth and income return was 0.8% and 0.4% respectively.
- The best performing sector over the period was offices, with returns of 1.7%, followed by industrial which was up 1.5%. Returns for retail investments, whilst positive, continued to lag at 0.8%.
- Despite a significant rise in volatility over the last six months, commercial property has continued to maintain strong returns. The index is up 7.2% overall, led by offices and industrial, up 9.7% and 9.1% respectively.
- Over the same period, equities are down 9.2% and bonds marginaly positive up 0.3%.

Despite a rise in volatility over the last 6 months, commercial property continues to have strong returns, with the index up 7.2% overall.

Investment Inflows

Lowest quarterly volume since Q2 2013

- September followed on from a relatively quiet summer for investment inflows, with £3.12bn invested across the UK.
- Q3 inflows totalled £12.1bn, which was significantly down on the £20bn+ volumes we saw in Q1 and Q2 2015. This was also the lowest quarterly volume recorded since Q2 2013 according to data by property archive.
- There are currently a significant number of properties under offer and a number of large portfolios poised to go on the market. So, whilst the summer may have been quiet, we appear to be set for an active final quarter.

Source: Property Archive – September 2015 investment bulletin

- As in the South East, demand in regional markets has been very strong, particularly for prime assets, both from domestic investors and private equity. Prime investment stock is in limited supply and subject to continued inward yield compression.
- Investment in commercial property in the regions exceeded that in London for the first time in 12 months during the third quarter, according to research by Lambert Smith Hampton (LSH).
- Overseas investors continue to make net inflows, having acquired £4.55bn worth of commercial property in Q3 2015. This was the lowest net investment since Q4 of 2012.
- Close to 59% of investment activity last year took place in the regions: its highest level since 2006, with a similar volume share expected this year.

Prime regional investment stock is in limited supply and subject to continued inward yeild compression.

Rental growth in prime headline office rents continues across the UK's regional markets

- Rental growth is now starting to exert more of an influence, especially for offices and industrials, and it is broadening beyond the capital. Whilst rents for offices in UK cities outside of London were falling two years ago, there has been a sharp reversal of the trend this year with positive year–on-year growth.

Rent per square foot

Rental growth rate (year in year)

Source: Riverside Capital research

- The industrial market returned to growth in 2013 with all regions having recorded positive rental growth for three consecutive quarters to June 2015. The strongest rental growth has come from the West Midlands, East Midlands and South West. Take up is higher, development is low and the market is now dominated by pre-lets. Rental growth is therefore likely to continue for the foreseeable future.

- Quality commercial property continues to yield in excess of other comparable assets available to UK and international investors.

- LSH research found that yields continued to harden from 5.69% to 5.55% as the search for value led an increasing number of investors to look beyond London for opportunities.

Rental growth is now starting to exert more of an influenece, especially for offices and industrials.

Prime Yields	Offices	Industrial	Retail
Bristol	5.75%	5.75%	5.75%
Manchester	5.00%	5.75%	5.00%
Leeds	5.50%	6.25%	5.00%
Birmingham	5.25%	5.75%	5.50%
Glasgow	5.75%	6.75%	4.75%
Edinburgh	5.50%	6.75%	4.75%

Source: Riverside Capital research

- Occupier fundamentals are very positive. The low levels of development activity over the past five years mean that shortages of quality space have become increasingly apparent as the economic recovery gathers pace.

- Demand remains strong, driven by both local businesses and national businesses looking to move outside of London.

- Birmingham accounted for 945,000 sq. ft. out of 4.4m sq. ft. of office space enquiries across ten regional cities. The other cities were: Aberdeen, Bristol, Cardiff, Edinburgh, Glasgow, Leeds, Manchester, Newcastle and Sheffield.

- With a wall of money hitting the UK and a historic lack of development during the economic downturn, we are now seeing the same problem of a diminishing supply of Grade A across the regional office sector.

- Birmingham now has the lowest levels of Grade A stock outside London with currently just one year's supply. Half of this still under construction. According to data from Savills, by 2017 grade-A office space in the city centre will have reached an all-time low if current active requirements are absorbed by existing stock. This limits opportunities not just for potential inward investors but also local companies.

- Manchester boasted the second highest take-up outside London, recording just shy of 400,000 sq. ft. of office premises removed from the market.

With a historic lack of development, we are now seeing a dimishing supply of Grade A across the regional office sector.

Summary

- The UK remains one of the fastest growing developed economies, with GDP-per-head finally back to pre-recession levels.
- UK inflation is forecast to be just 0.2% in 2015. However it is expected to start climbing towards the Bank of England's 2% target by the end of 2016, assuming there are no further major falls in global food and energy prices.
- The regional market remians strong. Office, hotels and industrial sectors are seeing record demand, with investors buoyed by strengthening business confidence and the positive performance of occupational markets.
- While swap rates have been gradually drifting up in recent months, the all in cost of debt finance remains near historic lows. Lenders are also starting to show a greater appetite for regional opportunities.
- There may be scope for further uplift in values due to yield shifts, but momentum is shifting towards rental growth as the driver behind capital value growth.
- When viewed against current bond rates, property yields still offer good value and, with rental growth coming through, there is still a significant incentive to invest in UK commercial property.

Recent Key Deals

Address	Sector	Area (sqft)	Price (£m)	Vendor	Purchaser
Kew Green Hotels Portfolio	Hotel	n/a	£400	n/a	HK CTS Metropark Hotels
Portfolio	Mixed Use	23,000	£160	Alhambra Properties	
Jupiter Hotels Portfolio	Hotel	n/a	£160	n/a	Tiesco (Thailand)
Colmore Plaza, Birmingham	Office	28,799	£140	Carlyle EREP	Ashby Capital
St Peters Sqare, Manchester	Office	15,421	£100	Mosley Street Ventures	Deutsche Asset & Wealth
Portfolio	Shopping Centre	35,881	£54.85	Reciever	Catalyst Capital

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