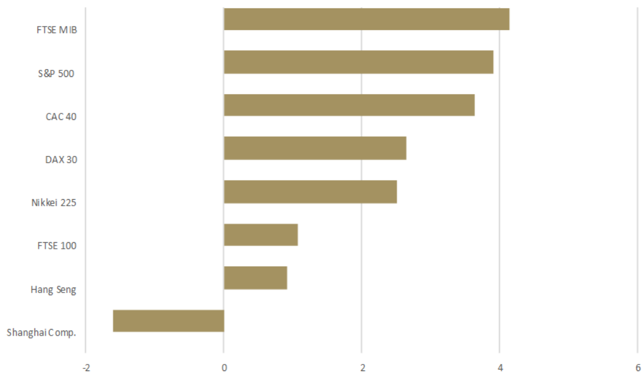
Riverside CAPITAL | THE PROPERTY INVESTMENT PEOPLE

Update - November 2019

Global Factors

With some form of trade deal between the US and China looking increasingly likely, equity markets have rallied this past month (see Chart 1). In particular, those markets more heavily exposed to trade war tensions have tended to do better, such as Taiwan's MSCI country index. But with much of the positive news about a "mini-deal" already priced into markets, there probably isn't much upside for stock markets. Meanwhile, the easing in trade war tensions alongside the Fed holding fire on interest rates have pushed up Treasury yields this month.

1.0 Change in Selected Major Equity Market Indices over 40 Trading Days to 01/12/2019 (%)



Source: Refinitiv

The latest data suggests the UK economy is sputtering. Admittedly, GDP growth edged up from minus 0.2% q/q in Q2 to plus 0.3% q/q in Q3. But growth appeared to lose momentum at the end of the third quarter, falling in both August and September. And, despite being one of the strongest parts of the economy, cracks now appear to be developing in the labour market. Indeed, employment fell in the three months to September, and surveys suggest that this trend has further to run.

Overview - November Top 5

- With the election fast approaching, economic news is overshadowed by political in the UK;
- A harder Brexit for the Conservatives and business-unfriendly policies under Labour spell limited upside for equities and the pound whatever the result;
- The property market continues to take the heat of ongoing uncertainty, with lower investment values seen across all sectors;
- A tighter supply, well below the five year average, has seen a drop in vacancy rates across the country;
- As the structural shift towards online sales for retailers continues, the logistics sector has been the beneficiary.

Meanwhile, the trickle of data released for the final quarter of 2019 were hardly reassuring. For starters, the consumer sector had a weak start to Q4 with retail sales falling by 0.1% in October, despite stores holding prices broadly unchanged. And while the IHS Markit/CIPS PMIs are probably overstating the weakness in the economy, the downturn in November's flash results was worrying.

Of course, with the election fast approaching, the big news this month is not economic, but political. With the choice of either a hardish Brexit and business-friendly policies under the Conservatives or a softer Brexit (or perhaps no Brexit at all) and business-unfriendly policies under Labour, there appears to be limited upside for equities and the pound whatever the result.

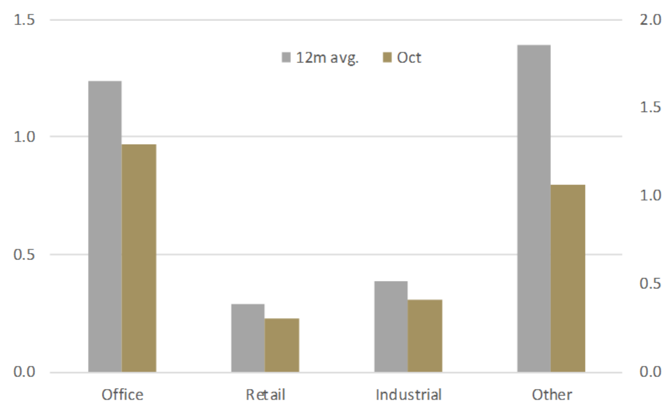
Turning to the euro-zone, while the region managed to narrowly avoid a recession in Q3, with growth a mere 0.1% on the quarter, recent economic data from the euro-zone make pretty gloomy reading. Indeed, the small decline in November's euro-zone composite PMI is consistent with growth continuing to slow. And although the euro-zone manufacturing index improved slightly, it still suggested sizeable declines in output. What's more, there are signs that the malaise is seeping into the service sector, where firms' estimates of activity over the next 12 months point to a sharp slowdown.

Finally, in the US, growth will probably slow in Q4. Indeed, there appears to be a much larger drag from inventories in the final quarter and the survey data suggest growth is set to slow. But this may be the trough. Most of the downside risks appear to be fading, or at the very least don't seem to be deteriorating any further. Indeed, inventories are set to run down in a few months, a partial truce with China looks likely and global data are stabilising. And while the latest easing cycle appears to have paused, there are signs that the Fed's previous rate cuts are feeding through to stronger demand in the housing sector.

Property Overview

The value of commercial property investment totalled £2.3bn in October, below its 12-month average of £3.3bn and also the £3.4bn total in September. Lower investment values were seen across all sectors compared with the 12-month average (see Chart 2). Investment values are unlikely to recover much this year given ongoing uncertainty about the General Election and Brexit.

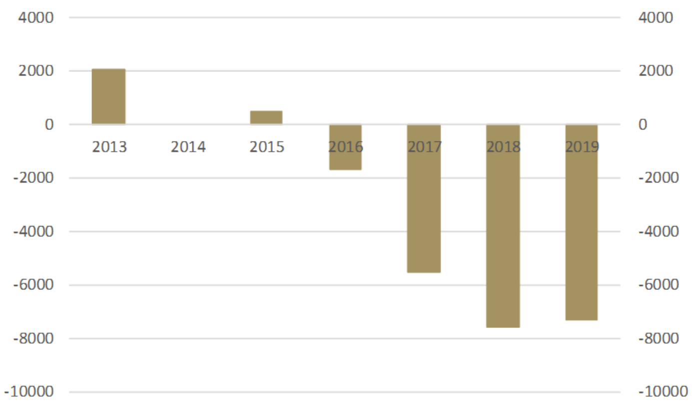
3.0 Value of Investment Deals Completed (£bn per month)



Source: Property Archive, Colliers

In the listed sector, British Land and LandSec suffered from exposure to the retail sector in their first half results. They reported losses of 5.4% and 3.2% in the net asset value of their portfolio respectively due to declining values in their retail assets after numerous tenant insolvencies. (See Chart 3.)

3.0 Retail Closures and Openings



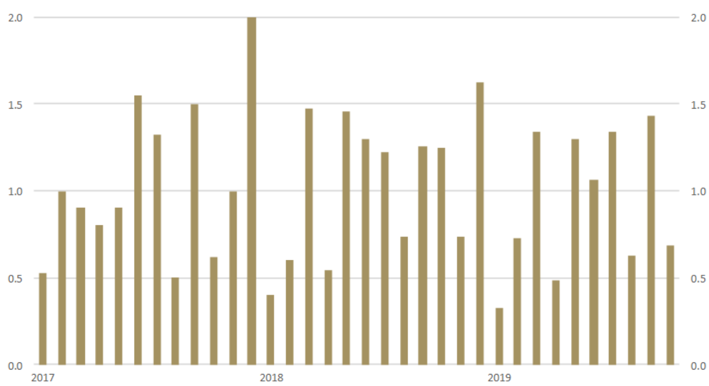
Source: Local Data Company

London Property Market

According to CBRE, take-up was subdued in the Central London office market at 0.7m sq. ft in October, which was below the 10-year average (see Chart 4). As the supply of Central London offices increased by 4% m/m to 13.2m sq. ft. in October, this pushed the vacancy rate up to 4.2% from 4% in September.

The Winter London Office Crane Survey by Deloitte Real Estate confirmed construction has weakened in 2019. Just 1.8 million sq. ft. of new construction started in the six months to September and this was a little below the long-term average. The IHS Markit/CIPS commercial construction PMI, which was just 44.2 in October, down from 50.6 at the start of the year, suggests that construction starts will remain weak which should help prevent rents falling in Central London.

3.0 Central London Office Take-Up (M Sq. Ft.)



Source: Local Data Company

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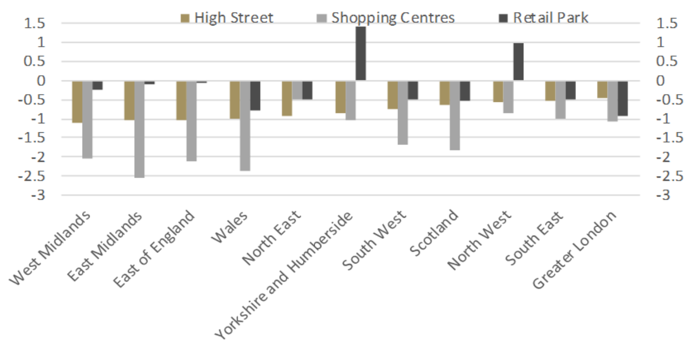
Regional Property Market

Cushman & Wakefield reported regional office take-up totalled 1.1m sq. ft. in Q3, which was well below the five-year quarterly average. However, as the supply of regional offices was 7.5m sq. ft. in Q3, also well below the five-year average, vacancy reduced from 7.3% at the start of the year to 7% at the end of Q3.

Industrial prime yields were 5.1% on average in the UK in Q3, down around 25bps from a year earlier according to Cushman & Wakefield. However, some prime assets in the regions such as Panattoni Park, Northampton and Super-G, Castleford sold at yields of 4.65% and 4.6% respectively in Q3. Further, Barwood Capital acquired seven multi-let industrial assets, which totalled £38m for its, predominantly industrial, Regional Property Fund in Q3 and committed £48m for a new Barwood Regional Property Growth Fund IV.

The retail sector has suffered from rising vacancy rates and in turn, declining rental values. On balance, there have been store closures in all regions, particularly on high streets and in shopping centres, according to Local Data Company. By contrast, retail parks had the lowest decline in the retail sector across the regions, even seeing rises in some regions in H1 (see Chart 5).

5.0 Net Change by Region (%)(Incl. Extensions, M



Source: Local Data Company

Sector Spotlight - Logistics

As the structural shift towards online sales for retailers continues, the logistics sector has been a beneficiary. Indeed, ONS data showed that online sales as a percentage of total retail sales were 19% in October, up from 18.1% last year. Consistent with this, JLL reports that retailers were the most active source of logistics take-up in the first half of this year.

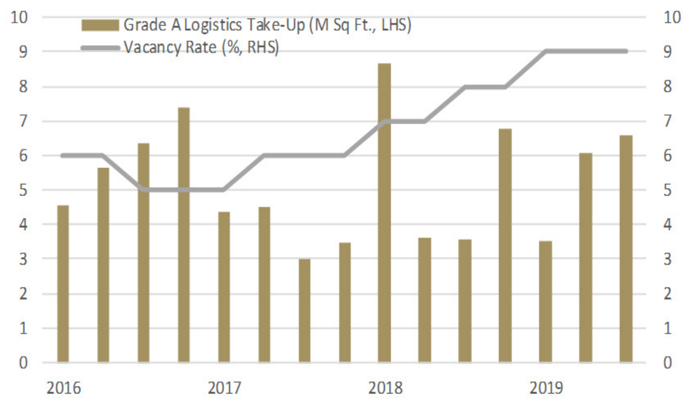
The occupier market was robust in Q3, with take-up broadly unchanged from the same period last year, which was also a strong quarter. A few notable deals drove demand. In particular Jaguar Land Rover's acquisition of space at Appleby Magna accounted for 2.9m sq. ft. of the 6.6m sq. ft. taken up in Q3 (see Chart 6).

That said, supply has increased since 2016 as industrial developers such as Panattoni and Gazeley speculatively build more and larger units. According to JLL, supply increased from 12.6m at the end of 2016 to 25.8m sq. ft. at Q3 2019. Although this has meant the vacancy rate has increased from 6% to 9% during this period, supply is still below 2008 levels and the 10-year average. We expect rental growth to slow in part due to the rising vacancy in the industrial sector.

Admittedly, industrial investment volumes in Q1-Q3 2019 were down on the same period last year but were in line with the five-year average. Investors continued to show strong appetite for industrial units in London and South East in Q3, as some transactions sold at yields below 4%. Notably, Prologis purchased Royal Mail, Greenford for 3.56% and Royal London bought Tower Thurrock at 3.9%.

In turn, investors continue to be attracted to the higher industrial returns in comparison with the other traditional sectors. However, with rents slowing and yields marginally rising, capital value growth is expected to slow. Nevertheless, total returns for industrial are expected to continue to outperform the office and retail sector over the next two years.

6.0 Grade A Take Up and Vacancy Rate (£m, %)



Source: JLL

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