Research & Forecast Report

United Kingdom | Snapshot
September 2017

Economy

The UK economy may have rebounded from the 2016 Brexit shock, but is weakening, undermined by imported inflation, falling real wages and reduced household spending power. August's composite UK purchasing manager index was expansive at 53.9, but lags the Eurozone at 55.7. August CPI reached 2.7% and will rise closer to 3%. This may explain Bank of England forward guidance that rates will rise faster than expected. Sterling and bond rates responded. The sterling index was up 5% in mid-September and bonds by +30 bps. Stronger sterling may offer respite from rising import costs, but given economic reliance on household spending, a significant rate rise seems unlikely, save for a possible return to the pre-referendum level of 0.5%. The Bank has previously announced that they intend look through a short-term spike in inflation. This is probably a more sold line to follow in forming expectations.

Colliers view: Unchanged. The economy is weaker as household spending power is undermined by inflation. Fiscal stimulus is looking increasingly likely for the Autumn Budget.

Investment

Sterling and bond rates may be increasing, but very low August levels may have contributed to a bumper investment month. Unsurprisingly, August transactions (£3.5bn) are well up on last year (£2.1bn). Chinese capital controls did not impact as one set of Chinese investors (R&F Properties/ CC Land) were substituted for another (Dalian Wanda) in the £470m purchase of the Nine Elms site. Tenacity Group (HK) also bought 70 Gracechurch Street for £271m. Far Eastern investors accounted for around half of all UK foreign investment in August. In early September, the Chinese were absent, save for a Wirefox (HK) office purchase in Glasgow for £43.5m. Instead, US and European investors have been buying a few large portfolios. A wide range of overseas investors continue to be attracted by favourable exchange rates.

Retail. August purchase volumes (£419m) were limited. Listed propcos took a 42% share, overseas investors 20% and UK institutions 15%. The only large high street asset traded was an M&S portfolio bought by Rosette Bank (Qataris) including sharia funding. Shopping centre trading remains thin. Retail warehouse transactions included three local authority purchases. The Supermarket REIT bought a large format Tesco and a Sainsbury.

Retail transactions	Value	Deals	August selected yields
Unit Shops	£63m	10	Limited evidence
Retail Warehouses	£192m	14	6.2% to 6.9% for larger assets
Shopping Centres	£20m (est)	2	Limited evidence
Supermarkets	£152m	3	4.5% to 5.4% larger assets

Source: Colliers International, Property Data Ltd.

Offices. Overseas investors bought the five top, assets by value, accounting for 65% of value across the UK. London and the South East were relatively quiet, although a wide variety of assets traded regionally. Asset management and value add plays were more visible than straight income purchases. Private property companies took the largest regional share.

Office transactions	Value	Deals	August selected yields
Central London	£0.9bn	6	3.8% Mid-Town / 4.3% WE / 4.4% City
Regional	£200m	28	5.4% (Edinburgh) to 6.3% (Reading)
Office parks	£84m	8	Limited evidence

Source: Colliers International, Property Data Ltd.

Industrial. A modest level of transactions (£231m) was led by listed propco buyers and UK institutions. Distribution remains sought after as are multi-let parks that are trading at low yields with an eye to alternative use.

Industrial transactions	Value	Deals	August selected yields
Distribution	£124m	3	6.1% (Cabot Portfolio)
Multi-let parks	£124m	17	2.9% (London), 4.9% (Ringwood)

Source: Colliers International, Property Data Ltd.

Colliers view: Activity levels are resilient, but driven by weak sterling. Ex-London activity is also strong with a wide range of buyers driven by a wide range of motives.

Key Indicators

	Latest[1]	End-Aug	End-July	End-June
UK GDP (%q/q)	0.3(2nd)	0.3(2nd)	0.3(1st)	0.2(2nd)
UK PMI (weighted average)	53.9	53.5	53.8	54.5
EURO PMI (composite)	55.7	55.7	55.7	56.3
UK CPI (%)	2.7	2.7	2.6	2.6
UK RPI (%)	3.9	3.9	3.6	3.5
UK BASE RATE (%)	0.25	0.25	0.25	0.25
UK 10YR GILT (%)	1.30	1.07	1.25	1.28
GBP 3M LIBOR (%)	0.33	0.28	0.29	0.31
STERLING EFFECTIVE (FT)	78.4	74.7	77.0	77.5
GOLD (USD)	1304	1320	1269	1241
OIL BRENT (USD)	55.7	52.7	52.6	49.0
FTSE 100	7267	7431	7372	7313
IPD All property IY	5.25	5.25	5.26	5.27
IPD All property EY	6.10	6.10	6.11	6.12

[1] Sep 19th (data and revisions)
Sources: ONS, Markit, FT, EIA, MSCI, Haver

OCCUPIER MARKETS

Retail

Sales volume growth (ex-petrol) increased by 3.1% over the first eight months of 2017 compared to 4.8% over the same period of 2016. ONS data did show a slight month-on-month strengthening in August, with sales volumes rising by 1%, the strongest since 1.2% in February. Despite record low unemployment, 4.3% in the three months to July, the retail market remains buffeted by a squeeze on disposable income, with monthly wage growth (1.4%) still lagging behind inflation (2.9% in August). Retail prices are pressured by weak sterling. The sales price deflator accelerated to 3.2% y/y in August, led by textile, clothing and footwear (4.2%) and fuel (5.0%). Occupier conditions remained generally unchanged, with the all-retail MSCI rental index still positive at 0.6% y/y. The Centre for Retail Research reports 37 retail failures in 2017, up already on the total 2016 figure of 30. Further failures are expected, although the number of shops affected will rise only marginally over 2016 levels as many retailers have already rationalised their footprints.

Colliers view: Structural and cyclical issues persist, but performance varies. London and tourist destinations are buoyed by weak sterling, while spending elsewhere remains down.

Offices

London office take-up was robust in Q2 17, reaching its highest level since Q1 16. Activity so far in Q3 17 remains steady. Nevertheless, vacancy rates across most key London sub-markets are rising. London's average vacancy rate rose above 5% for the first time in three years in Q2 17, with the West End at 5.4% and the City at 5.2%. Despite limited new supply, the release of surplus secondary space, in conjunction with marketed tenant space, is driving up vacancy. In contrast, the City Grade A vacancy rate fell to 0.9%, a level not seen since 2011. West End Grade A availability was equally tight at 1.2%. Central London rents are stabilising. The rest of UK standard office rental growth was encouraging in recent months, edging up to 1.2% y/y in August. There are signs of accelerating growth in selected areas, with the all-office rental index rising in Eastern (3.7%), Midland & Wales (0.4%) and Rest of England (1.5%). Headline rents are stable across the main regional CBDs.

Colliers view: Occupier markets are stable across the regions, while leasing activity in Central London continues to exceed expectations. Prime rents are stable UK wide.

Industrial

Strong expansionary business survey data continues to contradict more downbeat official data, with the manufacturing PMI rising from 55.3 in July to 56.9 in August and remaining strong at 55.9 in September. Sterling's depreciation continues to support export order books, as has ongoing economic strength in the Eurozone -- the UK's largest trading partner. Nevertheless, domestic demand remains the primary source of new work. Concerns continue about increasing import and input costs as well as lower retail spending, with the latter already having some impact on requirements for large units. A supply shortage and limited development pipeline, especially for speculative projects, will continue to support rents in the medium-term. All-industrial MSCI monthly rental growth rose to 4.5% y/y in August (4.0% in July), propelled by an acceleration in the South East (6.4% y/y in August).

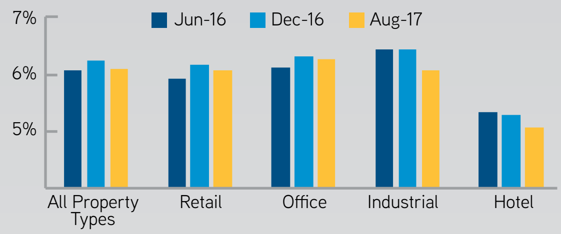
Colliers view: Colliers expects industrial rental growth to outpace other sectors over the 2017-2021 period, with London and the South East leading the way.

Residential

Annual house price growth remains firmly in lower single digits despite some differences between Halifax and Nationwide. Both have averaged around 2.7% over the last three months despite considerable volatility of the Halifax figures. Affordability levels remain stretched and are close to all-time highs, according to both providers. Average 2-year fixed 75% LTV mortgage rates hovered just above 1.4% in July and August. Recent comments by MPC members in their last meeting may lead to higher rates in September. Mortgage approvals in August also remained stable at 66,580, in line with the average of the last twelve months.

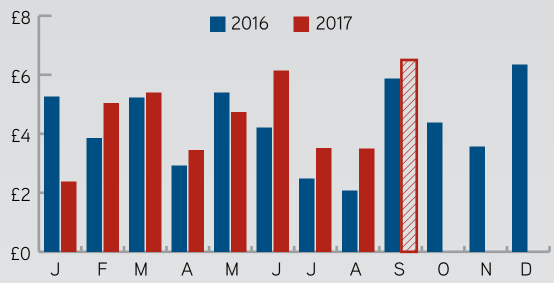
Colliers view: Despite the political sensitivity of stimulating the UK housing market, the weakness of household spending may lead to market tweaks in the Autumn Budget.

MSCI equivalent yields



Source: MSCI / IPD Monthly Index

Investment transaction volumes



Sources: Property Data Ltd., Colliers International (Sep17 forecast)

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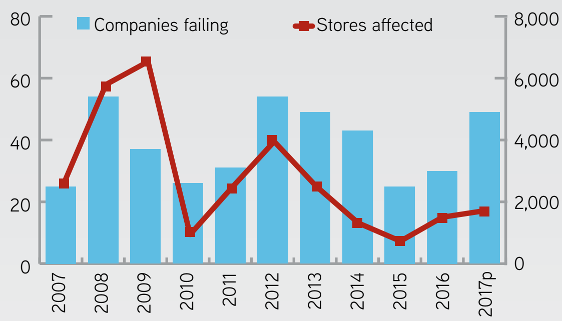
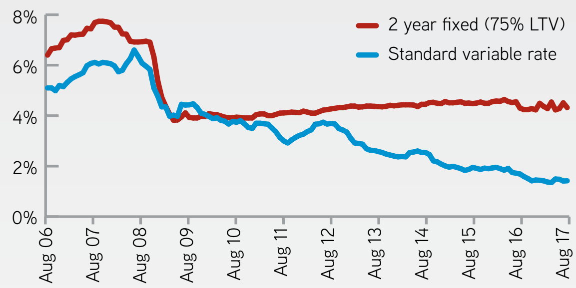


Source: Centre for Retail Research, 2017 projected by Colliers

Mortgage Rates



Source: Bank of England

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