Research & Forecast Report

UK | Property Snapshot
July 2016

Economy

After a few turbulent weeks across financial markets and UK politics, the post-Brexit landscape appears calmer. A new conservative party leader and PM was appointed within a few days, providing some stability and certainty. Furthermore, the FTSE 100 and FTSE 250 are now either above pre-referendum levels or within a few percentage points. Meanwhile, sterling has stabilised against the US dollar and the Euro, albeit it remains around 10% below its pre-vote level. The first PMI business surveys were released after the vote, with manufacturing PMI up to 52.1 in June, its highest reading in six months, construction PMI (46) recording its worst month in seven years and services PMI (52.3) falling slightly. However, 80-90% of the responses were received prior to the referendum, suggesting scope for a further deterioration. And, in fact, this was confirmed by a flash July estimate which points to a contraction in GDP growth, with the composite PMI index falling from 52.4 to 47.7, below the expansion threshold level of 50. Services were the most impacted, followed by manufacturing and no data yet on construction. However, most of the responses would have been collected immediately after the referendum result, and sentiment should have steadied since. Inflation (CPI) accelerated from 0.3% in May to 0.5% in June.

Colliers' view: Sterling's post-Brexit depreciation should support export growth, but inflation will rise. A base rate cut in August and more Quantitative Easing are a distinct possibility.

Investment

The lead-up to the referendum and its aftermath have subdued investment volumes in June. According to preliminary data from Property Data, a total of just £3.9bn worth of assets were traded, a fall of almost 60% compared with June 2015. All sectors and sub-sectors, recorded a decline in volumes, with the exception of shopping centres and supermarkets, which were buoyed by sizeable deals. Although overseas players remained the largest purchasers by volume (£1.4bn), quoted property companies were the largest net buyers (£409mn) in June. Equally, UK institutions were the largest disposers, shedding in excess of £1.4 billion worth of assets, which amounted to around £882mn in net sales. July to date trading volumes are around 40% compared with the same period last year, but these figures are subject to significant revisions. The largest transaction in June, by some margin, was the acquisition of a 50% share of the Merry Hill shopping centre in Dudley by Intu Properties for £410mn (IY 5.2%) from QIC. The scheme consists of 1.4mn of sq ft and is anchored by the likes of Debenhams, Marks & Spencer, Sainsbury's and Asda.

Retail Shops: A relatively lively month, with nine deals above the £10mn mark. The most significant transaction was the off-market purchase of the Royal Parade in Plymouth by British Land for £70mn (IY 6.5%) from M&G. The 600,000 sq ft asset is let to House of Fraser, Tesco and Debenhams on long leases. Shopping Centres: In addition to the Merry Hill acquisition mentioned above, Canterbury City Council bought a 50% share of the Whitefriars Quarter (600,000 sq ft) for £79mn, with the intention of buying the other half from CPPIB. **Retail Warehouses:** The largest transaction of the month was the acquisition of the Thurrock Shopping Park, consisting of 19 units and around 25,000 sq ft, for £93mn (IY 5.3%) by TH Real Estate from Hammerson. **Supermarkets:** A relatively positive month, but defined by one large deal. The Willow Brook Centre was purchased by Arax Properties from Tesco and BP Pension Fund for close to £89mn (IY 5.9%). The scheme is anchored by a Tesco Extra and is also let to Brantano, Pets at Home and Giant Cycles among others.

Central London Offices: Outside of the June transactions, Wells Fargo acquired 33 Central in the City for £300mn from HB Reavis, with the intention of relocating all of its staff into one location. This is the most significant post-EU referendum office deal thus far. In June, volumes were down 19% y/y, with £1.7bn transacted in Central London. **Regional:** The largest deals included the £50mn (IY 6.25%) purchase by BUPA of its new headquarters, The Regent in Manchester, and the acquisition of Newcastle Business School by Aviva's Lime Property Fund for £50mn.

Industrial: A quiet June for the sector, with only £420mn worth of assets traded, a fall of 44% compared with the same month in 2015. The most significant deal was the ESN portfolio acquisition by ARGO for £46.6mn (IY 5.7%).

Colliers' view: Investors are waiting for more post EU referendum evidence to emerge. However, the depreciation of sterling, combined with a likely fall in capital values, should provide an attractive proposition for foreign investors.

Key Indicators

	Latest[1]	End-June	End-May	End-April
UK GDP (%q/q)	0.4	0.4(3rd est)	0.4(2nd est)	0.4(1st est)
UK PMI (weighted average)	51.9	51.9	53.0	51.9
EURO PMI (composite)	53.1	53.1	53.1	53.0
UK CPI (%)	0.5	0.5	0.3	0.3
UK RPI (%)	1.6	1.6	1.4	1.3
UK BASE RATE (%)	0.5	0.5	0.5	0.5
UK 10YR GILT (%)	1.00	1.00	1.55	1.68
GBP 3M LIBOR (%)	0.59	0.56	0.57	0.57
STERLING EFFECTIVE (FT)	79.6	80.4	86.2	86.5
GOLD (USD)	1317	1324	1215	1286
OIL BRENT (USD)	47.3	49.2	49.7	45.9
FTSE 100	6729	6360	6225	6242
IPD All property IY	4.96	4.96	4.92	4.92
IPD All property EY	6.09	6.09	6.06	6.07

[1] July 20th (data and revisions)
Sources: ONS, Markit, FT, EIA, IPD, Haver

OCCUPIER MARKETS

Retail

The main downside risks from leaving the EU are linked to sterling's depreciation, increased import costs and its resulting inflation, but also a reduction in spending as consumers tighten their belts anticipating an economic slowdown. Sterling has certainly fallen in value, but for now it remains within the range of expectations. Retail sales volume growth in June was positive as it rose by 4.3%, the 38th consecutive monthly increase on an annual basis. However, it was tempered by recent standards and clothing sales posted a decline of 6.1%, with bad weather blamed. Deflationary pressures continued to persist as average store prices in June fell by 2.5% y/y. Prime rental growth is, however, emerging across the country, albeit it remains timid. Central London and its surrounding areas continue to drive the overall rate, growing by 9.1% and 5.2% respectively in April y/y, but moderate uplifts were also observed in the North East (2.0%) and York & Humber (1.9%). Wales and Scotland were the only two regions to record declines in rental values, albeit they were marginal at 0.4% and 0.2% respectively.

Colliers' view: Evidence of Brexit's impact on retail spending is currently limited and somewhat mixed. July retail sales figures should provide more clarity.

Offices

Central London: Notwithstanding the current economic and political climate, unique and premium product in the City of London will benefit from insulation against downward rental pressures, with examples of landlords remaining bullish on rents and incentives for the best quality units. Given the low vacancy environment and anticipated constraints on new supply, new Grade A is set to perform well. Average net effective rents in the West End are set to fall over the next 6-12 months, but with new supply already below trend and potential speculative schemes being delayed, downward pressure may be short-lived. Retaining 'passporting' rights to the single market will be an important issue for the City during Brexit negotiations. **Regional:** Occupier demand and take-up pre-EU referendum generally expanded at a steady pace in the first half of the year, particularly in the Southern regions. Prime headline rents in Manchester edged up again to £35 psf in Q2. On an annual basis, Harrow and Watford recorded the largest uplifts, growing by 39% and 38% respectively.

Colliers' view: Occupier demand may cool as a result of Brexit vote, with recruitment and expansion slowing, particularly in central London. However, no concrete evidence yet.

Industrial

Although Markit's manufacturing PMI bounced back in June after flirting with contraction in previous months, the flash July estimate (49.1) points to a contraction, with the weaker pound improving export orders, but not enough to offset higher import costs. Sterling depreciated immediately following the EU referendum result and, if it remains at the same levels or falls further, in theory, the survey and activity should benefit from stronger new orders from abroad. In the meantime, the demand/supply imbalance continues to be felt across the market. Prime headline rents for big sheds (over 100,00 sq ft) rose across most regions, led by Outer London, West London, the North West and Yorks & Humber, all recording double-digit growth in the year to June 2016. Rental performance for secondary sheds was more muted, but with strong growth in London and good uplifts across the South West, Wales and Yorks & Humber.

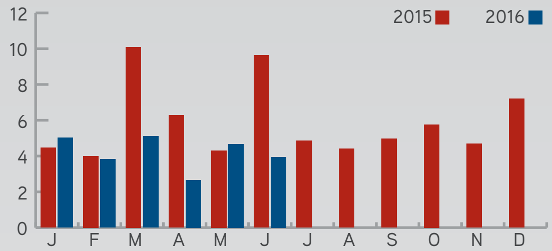
Colliers' view: Manufacturing may be one of the few sectors to benefit from the EU referendum result, although a deferment of purchases could act as a drag on domestic orders.

Residential

House price growth trends were a mixed bag in June, depending on the data provider. Halifax annual house price growth slowed in the three months to June to 8.4%, compared with the 9.2% rate recorded in May. According to Nationwide, growth edged up to 5.1% in June from 4.7% in the previous month. Most of this data concerns the period leading up to the EU referendum and the result itself is likely to have a detrimental effect on growth in the near term. Given the unsustainable affordability levels reached, especially in the capital, a slowing trend was already underway and 'Brexit' will only accelerate this correction. In the meantime, however, mortgage rates fell to their lowest figure on record in June, with the fixed 2-year fixed rate for a 75% LTV mortgage at just 1.74%.

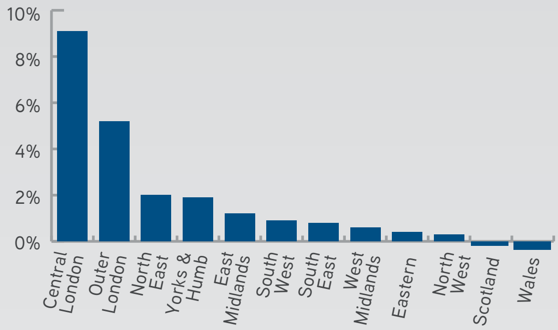
Colliers' view: House price growth is set to slow in some areas and turn negative in others, but a cut to the base rate and record low mortgage rates should, to some extent, soften the blow.

Investment Volumes (£ billions)



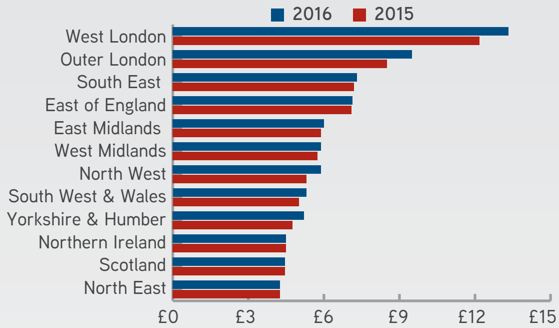
Source: Property Data

Prime Retail Rental Growth (Apr-16 y/y)



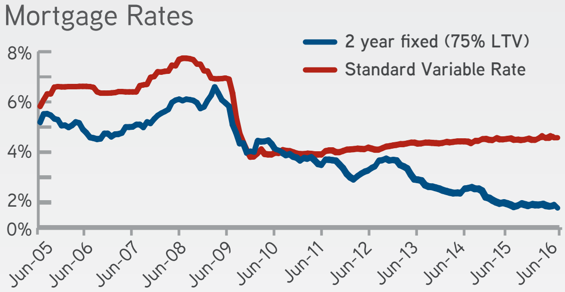
Source: Colliers International

Prime Industrial Headline Rents (Jun-16, sq ft/year)



Source: Colliers International

Mortgage Rates



Source: Bank of England

For more information, please contact:

Martin Mahmuti
+44 20 7487 1927
martin.mahmuti@colliers.com

Colliers International
50 George Street
London W1U 7GA