Research & Forecast Report

United Kingdom | Snapshot
October 2016

Colliers INTERNATIONAL

Accelerating success.

Economy

The post-EU referendum recovery in business sentiment continued in September as manufacturing and construction recorded an uptick in their headline PMI figures. The most important sector to the UK economy, services, eased back marginally. Albeit still in positive territory, it fell from 52.9 in August to 52.6 in September, above the expansionary threshold of 50, but below its long-run average of 55.1. Manufacturing PMI rose to 55.4, its highest level in over two years, while the construction index recorded its first positive reading since May as it reached 52.3. These numbers were good news for occupational demand, but conversely, lingering concerns about the UK government's stance in their future EU exit negotiations and a perceived rising likelihood of a "hard Brexit" scenario have significantly dented sterling, which fell below £1/€1.1 for the first time since 2010. The pound did, nonetheless, receive a boost in recent days as a result of higher than expected inflation figures and surprisingly robust labour market data. Inflation (CPI) rose to 1.0% in September, up from 0.6% in August and above forecasts, while the unemployment rate was unchanged at 4.9% and wage growth remained upbeat.

Colliers view: Although the BoE appears comfortable with an inflation target overshoot, which may tip the scales towards another rate cut, expectations for such a move may be overstated.

Investment

Following two subdued months in July and August, held back by the EU referendum result and the ensuing impact on investor sentiment, activity rose markedly in September, buoyed in particular by strong demand for alternatives and mixed schemes. A total of £5.3bn worth of commercial properties were traded according to Property Data, up 5.5% on the same month last year. This was, however, not enough to close the quarterly difference, with £9.5bn transacted in Q3 16 versus the £14.3bn recorded in Q3 15. Nevertheless, confidence in the market has firmed over the past two months, with a number of significant deals finalised. In addition to the NCP and Marks & Spencer portfolio deals mentioned in the previous snapshot, a JV between GSA and GIC acquired the Threesixty portfolio from Oaktree for £430mn, the largest student housing transaction of the year. Foreign investors continued to dictate purchasing activity as they represented 55% of all acquisitions in the September to mid-October period, investing £3.6bn. They were also, yet again, the largest net investors in the UK market, with a surplus of £1.3bn, followed by occupiers (£299mn).

Retail Shops: The Mark & Spencer portfolio deal (£410mn, IY 6.6%) buoyed what was an otherwise subdued period, comprised almost entirely of sub-£10mn deals. Pricing remained keen as 6-8 Maddox St. in the West End was bought by the Crown Estate for £8.4mn (IY 3.35%) **Shopping Centres:** A virtual standstill, with no schemes exchanged between September to mid-October, in contrast to the £339mn traded in 2015 over the same period.

Retail Warehouses: Bucking the overall subdued retail trend, strong investor demand and activity was evident, with £523mn worth of assets transacted. The largest deal was the Jura portfolio, acquired by BMO from British Land for £191mn (IY 6.25%). **Supermarkets:** A tick-up in volumes as £109mn, consisting of three transactions, was traded. The most significant was Sainsbury's purchase of a 50% stake in one of its own units in Chiswick for £71.4mn.

Central London Offices: Demand for office assets recovered in September from an extremely subdued August as total trading volumes reached £820mn, but still down 22% on annual basis. There were a number of mixed-used properties, with predominantly office space, exchanged in September to mid-October. The largest of these was the purchase of 120 Holborn (340,000 sq ft) for £230mn by a Singaporean JV between UOL Group and UIC Overseas Investment. **Regional:** One £100mn+ deal finalised in the regions; the acquisition of the BP business park in Sunbury-on-Thames by Spelthorne Borough Council for £360mn, with the council aiming to lease the space back to BP.

Industrial: Interest for industrial assets remains keen, however, trading volumes in September to mid-October were down compared with the same period last year. Tritax Big Box was particularly busy as it acquired the three largest assets by value, led by Birch Coppice Business Park in Tamworth (£80mn, IY 5.04%).

Colliers view: The decline in capital values appears to be fizzling out and occupier markets are holding firm, however, the real "Brexit" test may be yet to come in 2017.

Key Indicators

	Latest[1]	End-Sep	End-Aug	End-Jul
UK GDP (%q/q)	0.7(3rd est)	0.7(3rd est)	0.6(2nd est)	0.6(1st est)
UK PMI (weighted average)	52.9	52.9	52.7	47.4
EURO PMI (composite)	52.6	52.6	52.9	52.9
UK CPI (%)	1.0	1.0	0.6	0.6
UK RPI (%)	2.0	2.0	1.8	1.9
UK BASE RATE (%)	0.25	0.25	0.25	0.5
UK 10YR GILT (% eop)	1.07	0.82	0.67	0.86
GBP 3M LIBOR (%)	0.41	0.36	0.39	0.54
STERLING EFFECTIVE (FT)	74.5	77.5	77.8	79.6
GOLD (USD)	1272	1323	1318	1342
OIL BRENT (USD)	51.4	49.9	48.8	43.2
FTSE 100	7027	6899	6782	6721
IPD All property IY	5.23	5.23	5.19	5.14
IPD All property EY	6.32	6.32	6.30	6.25

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

OCCUPIER MARKETS

Retail

Retail sales growth showed no sign of turning negative in third quarter, although September did highlight a slowdown. Retail sales (excl. fuel) volume growth rose by 4.0% y/y, down on the 6.2% recorded in August as all segments, apart from clothing, witnessed an increase. Textile, clothing and footwear, together with petrol stations, were also the only stores to see price increases in September, suggesting shoppers may have been put off by the higher price tags. However, the heavy discounting observed over the past two years appears to be petering out and sterling's devaluation is expected to exert upward pressure on retailers' overheads and, consequently, lead to further increases. Nevertheless, although inflation is generally expected to materialise in the retail sector, a loose monetary policy, tight labour market, encouraging wage growth and recovering consumer sentiment (GFK index at -1 in September) should provide ample support. After the small blip in July, rental growth in the following two months remained positive (0.1%), with standard shops and retail warehouses leading the way in September (0.2%).

Colliers view: Retail spending may come under some pressure over the next year as inflation picks up, but the benign forces mentioned above should absorb some of this pressure.

Offices

Central London: Despite sub-trend take-up, West End headline rents were unchanged in Q3 and are set to end the year at similar levels. While incentive packages have moved out marginally, the shortage of prime stock is insulating prime rents to a degree. The true test will come with the release of new space over the next six months, especially if grey space begins to come onto the market. In the City, although rents on sub 10,000 sq ft units appear to holding firm, headline rents have already come in to £72.50 psf after a brief peak at £75 psf. Premium space is likely to be resistant to downward pressure, but fringe locations, with prospects of double-digit percentage uplifts in business rates, are set to become even less affordable for emerging tech occupiers. **Regional:** Take-up was generally resilient in Q3 across key regional cities. There were several significant deals recorded, most notably Swinton Insurance agreeing to take up 165,000 sq ft of Grade A space at 101 Embankment in Manchester, one of the largest deals finalised in the city in recent years.

Colliers view: Central London is expected be the epicentre of any "Brexit" fallout in 2017 and an average 10% increase to business rates bills is unlikely to help.

Industrial

Another strong uplift to business sentiment in September, with the PMI manufacturing index reaching its strongest level in over two years, fuelled primarily by the consumer goods sector. Occupier conditions in the industrial sector remain buoyant as a result of continued online retail sales growth propping up demand for space amid the tight supply available. The retail sector now accounts for almost 40% of all demand for industrial space and this trend is expected to be even more prevalent in the years ahead. Signs of speculative development returning, but "Brexit" may be impacting on future appetite. Availability remains extremely tight in London, the South East and other urban regional centres. Big shed prime rental growth was positive in H1 y/y, led by a double-digit rise (13.6%) in Manchester and a strong uplift (9.5%) in Leeds.

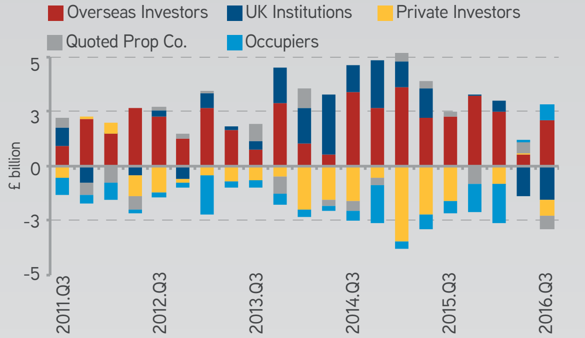
Colliers view: 11mn sq ft of spec space is set to be completed this year, the highest since 2008, however, demand will continue to outstrip the supply on offer.

Residential

The main house price data providers have converged, with Halifax growth easing to 5.8% y/y in the three months to September and Nationwide slowing to 5.3% y/y in September. Activity levels are also softening. Mortgage approvals fell to 60,058 in August, the lowest figure since November 2014. Nevertheless, mortgage rates continued their downward trajectory unabated as they touched another record low in September, with the 2-year fixed rate for a 75% LTV falling to just 1.59%. Together with a robust labour market, which at the moment appears unperturbed by the EU referendum result, ultra-low mortgage rates are likely to keep interest in residential properties keen.

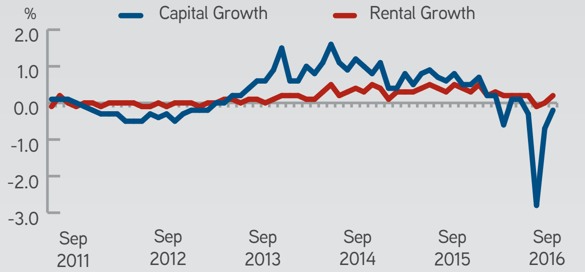
Colliers view: Despite recent cooler growth, house price forecasts should remain in positive territory in the short-term, but with isolated cases of falling prices e.g. Central London, impacted by affordability being stretched to record levels and changes to the stamp duty system.

Net Value of Investment



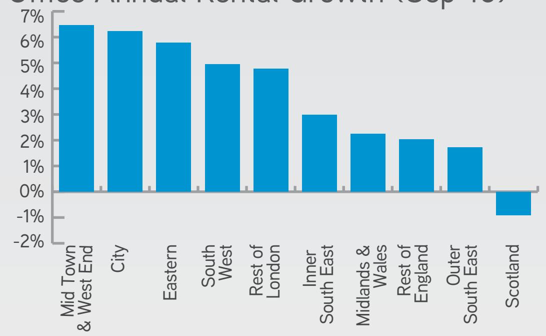
Source: Property Data Ltd

UK IPD All-Property Performance (m-o-m)



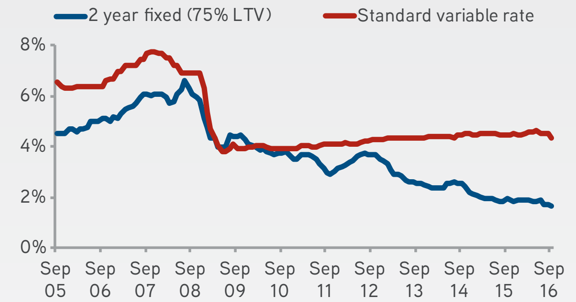
Source: IPD Monthly

Office Annual Rental Growth (Sep-16)



Source: IPD Monthly

Mortgage Rates



Source: Bank of England

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