Research & Forecast Report

United Kingdom | Property Snapshot
June 2018

Colliers INTERNATIONAL

Economy

Despite negative headlines, the UK economy continues to stack up reasonably well against other western advanced economies. The latest composite PMI values for May 2018 show that businesses in the UK (54.5) are expanding slightly faster than in the Eurozone (54.1) which weakened for the fourth consecutive month. CPI inflation has fallen from 3% at the beginning of 2018 to 2.4% in May creating a fledgling recovery in real wage growth (+0.1% in the three months to end April) after several months of decline in 2017. Household disposable income is likely to also show further improvement when figures are released at the end of June. Some of the headwinds to UK economic performance may be easing, although the price of oil is volatile (geopolitical uncertainty) and may act to slow further declines in inflation. Greater clarity on Brexit would, no doubt, return business investment to a stronger trend.

Colliers view: GDP headwinds may ease in H2 18, but subpar growth will define 2018 with improvement in 2019. A base rate rise this year cannot be dismissed outright.

Investment

In the year to end May, transaction volumes are down by 13% against 2017 at £18.6bn, due mostly to a very weak April. May and preliminary June figures suggest that momentum is building. The largest May deals were dominated by overseas cash. Fonciere des Regions (France) bought Starwood's hotel portfolio for £858m and Far Eastern investors bought large City assets, including 5 Broadgate for £1bn in June. UK institutions may be increasing exposure - Q2 18 net investment reached £1.2bn, so far, the highest since Q2 15. Equity continues to dominate as lending contracts, down by £615m in April. Average commercial LTVs are likely to remain near 57% when new BoE data is released at the end of June. Yields are stable with the exception of industrial yields which may compress further.

Retail: May investment volumes doubled April's total, reaching £687m, led by Motcombe's purchase of Burlington Arcade (£297m at 3.2% IY). Retail parks also sold. Orchard Street bought Slough RP for £63m at 5.4% IY. Local authorities remain active. Liverpool CC bought the Central SC from Aviva (£17m at 4.8% IY). Supermarket yields remain low as a long-income Tesco Extra in Scunthorpe might attest (sold by L&G to the Supermarket REIT for £53m at 5.1% IY).

Retail transactions	Value	Deals	May selected yields
Unit Shops	£38m	14	4.9% Bromley / 5% Reading
Retail Warehouses	£161m	7	5.4% Slough / 6% Birmingham
Shopping Centres	£349m	3	3.2% London / 4.8% Liverpool
Supermarkets	£58m	3	5.1% Scunthorpe

Source: Colliers International, Property Data Ltd.

Offices: Central London yields are stable. Mirae (Korea) bought 20 Old Bailey from Blackstone (£341m at 4.2% IY), Seaforth bought 45-9 Kingsway (£165m at 4% IY) and a European private investor bought 20 Soho Square (£117m at 4% IY) and Broadgate was sold in June (£1bn at 3.95%). Regional prime deals were struck in the mid-5% range, with a local authority buying in Bristol (£12m at 5.2% IY). Foreign appetite for regional offices is also evident.

Office transactions	Value	Deals	May selected yields
London	£1.2bn	18	3.9% to 4.2% London
Regional	£250m	27	5.8% Edinburgh / 5.2% Bristol

Source: Colliers International, Property Data Ltd.

Industrial: A wide mix of assets changed hands among a wide range of investors, including domestic funds and local authorities. Aberdeen Standard bought Capacity Dartford (£21.5m at 3.9% IY) and Portsmouth CC bought a Warrington shed (£4.9m at 4.75% IY). Multi-let parks were trading at between 4.5% (Harlow) and 8.1% (Plymouth). Pricing remains firm.

Industrial transactions	Value	Deals	May selected yields
Distribution	£232m	14	3.9% Dartford / 4.9% Warrington
Multi-let parks	£293m	19	6.4% West Bromwich

Source: Colliers International, Property Data Ltd.

Colliers view: Investment remains stable and prices well supported. Further yield compression is expected for industrial, but a shift up for secondary retail yields looks increasingly likely.

Key Indicators

	Latest[1]	End May	End Apr
UK GDP (%q/q)	0.1% (Q1 18)	0.1% (Q1 18)	0.4% (Q4 17)
UK PMI (composite)	54.5 (May)	54.5	53.2
EURO PMI (composite)	54.1 (May)	54.1	55.1
UK CPI (%)	2.4 (May)	2.4	2.4
UK RPI (%)	3.3 (May)	3.3	3.4
UK BASE RATE (%)	0.5	0.5	0.5
UK 10YR GILT (%)	1.28	1.49	1.49
GBP 3M LIBOR (% eop)	0.63	0.61	0.71
STERLING EFFECTIVE (FT)	78.7	78.7	79.5
GOLD (USD eop)	1276	1301	1316
OIL BRENT (USD eop)	74.8	77.6	75.2
FTSE 100 (eop)	7612	7678	7509
IPD All property IY	◄ 5.00 (May)	5.00	5.00
IPD All property EY	▼ 5.87 (May)	5.87	5.88

[1] June 19th (data and revisions)

Sources: FT, Haver, Markit, MSCI, ONS, Trading Economics

OCCUPIER MARKETS

Retail

Sales volume growth (ex-petrol) rebounded in May to a 4.4% y/y rate, the highest since December 2016. This reflects good weather, a royal wedding, a slowing of shop price growth, positive real wage growth and modest improvements in consumer confidence and economic sentiment. The sales deflator has fallen consistently from a high of 3.1% in October to 1.8% in May, the lowest rate since February 2017. Nevertheless, the retailer cost base remains challenging given increasing commercial rate burdens, labour cost escalation, new pension requirements, etc. This has led to retail failures as well as CVAs to rationalise costs. Company failures to mid-June reached 23, in line with 2017, but the number of stores affected this year is 1,851, already higher than all of 2017 (1,383) and almost on track to reach a level not seen since 2012 (3,951). Rents are forecast by Colliers to grow by 2% in Central London in 2018, but ex-Central London will see an outright decline of -1.8%. In 2019, further declines are forecast outside London.

Colliers view: Despite modest improvements to the trading environment, operators will continue to struggle with costs and margins. Property performance will weaken further this year and next.

Offices

Central London: The focus is on sub-5,000 sq ft space (especially sub-2,500 sq ft) as demand growth from SMEs and new start-ups is approaching an all-time high. Leases are also increasingly flexible with only 3% of leases in excess of 10 years. Fringe locations are popular given the possibility of cost savings. The City headline rent is stable at £68.50 psf. In the West End, the headline is £120 psf, but may increase given numerous imminent high end deals likely to complete in St James and Mayfair. **Regional CBDs:** Unchanged. Demand conditions remain strong across the main UK CBDs. Take-up in Q1 18 was very strong in Manchester, but also very robust in Birmingham and Leeds. Bristol demand was in line with its 5-year average, but further rental increases are expected with Bristol likely to reach £34 psf this year after breeching £30 psf for the first time in 2017.

Colliers view: London continues to see new positive market dynamics. UK regional CBDs are also experiencing strong demand in a setting of limited space. Further rental growth is likely.

Industrial

Manufacturing PMI indices in May 54.4 suggest improvement, but this was achieved by 'the steepest build-up of finished goods inventories in the 26-year survey history' (IHS Markit, June 2018). Supply chain constraints and input price inflation are cited as inhibiting business expansion. Nevertheless, non-store retail sales were increasing at a 16.3% y/y rate in May, suggesting that internet retailers and associated fulfilment centres are doing a brisk business. Demand for distribution space continues to outstrip supply, hence rental growth remains steady with Colliers forecasting 2.5% growth in 2018. Standard industrial unit rents will increase by 4.5%, with London seeing 6% growth. The five-year forecast horizon remains strong.

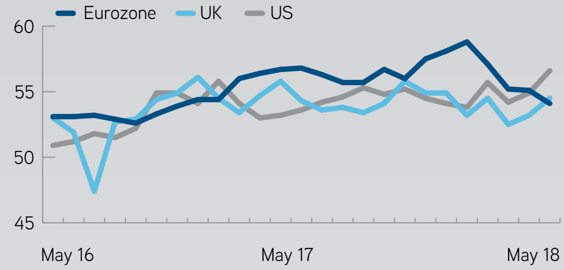
Colliers view: Unchanged. Stable demand and lack of Grade A space will support further rental growth. Limited spec development will also support values.

Residential

UK house price growth remains subdued at 2.4% y/y according to Nationwide and in line with general CPI inflation. The more volatile Halifax figures rebounded from 0.3% y/y growth in April to 1.6% y/y in May. Mortgage approval data suggests that the market has slowed modestly with house purchase mortgage approvals at 62,455. The 2 year fixed (75% LTV) is 1.72% equal to the level of July 2016 and 32 bps higher than the record low of 1.4% in September 2017. The market remains generally stalled, with many potential sellers choosing not to move due to what is perceived as punitive levels of stamp duty. Prime Central London is also stalled as there is a wide gap between buyer's and seller's perceptions of value and some foreign buyers are still trying to understand what the latest reforms mean for international ownership and taxation.

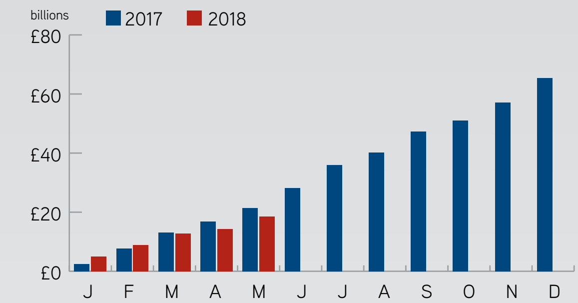
Colliers view: Low mortgage rates continues to support the mass market, although stamp duty tweaks has stalled the top end. Prime London assets are also buffeted by confusing regulations impacting foreign investors.

Composite PMI Index



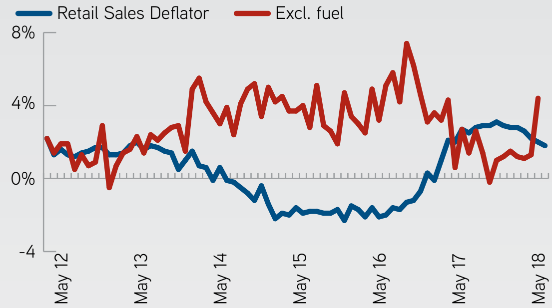
Source: Markit, Trading Economics

Investment transaction volumes (cumulative)



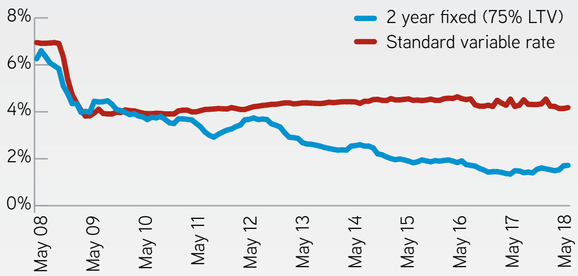
Source: Property Data Ltd., Colliers International, June 2018.

Retail Sales Growth %y/y



Source: ONS

Mortgage Rates



Source: Bank of England

For more information, please contact:

Walter Boettcher
+44 20 7344 6581
walter.boettcher@colliers.com

Colliers International
50 George Street
London W1U 7GA