

RESEARCH &amp; FORECASTING UK

## PROPERTY PRICING SURVEY



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## Executive Summary

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“The gap between prime and secondary yields increased to 259 bps across all subsectors from the 224 bps in July.”

“In terms of what is going to boost the UK economy, 60% of the respondents felt that there would be no boost and that the UK economy would rumble on slowly.”

- Property continued to be a buy with Central London and the South East as the most favoured regions across all sectors. Selling remained very selective with some focus on Wales, the North East, the North West and Yorkshire & The Humber.
- For investing, South East offices are favoured by 80% of the respondents, followed by Central London offices and retail each by 70% and South East retail by 60%.
- On the sell side, Welsh offices and retail, North East offices, North West offices and retail and Yorkshire & The Humber offices were selected by 40% of the respondents, up slightly from 36% on July’s pricing survey.
- The total return for 2011 saw a revision upwards to 7.0% pa from 6.2% pa in July.
- The total return for 2012 has been revised downwards to 6.1% pa from 7.0% pa in July.
- The total return for 2013 is forecast to be 7.9% pa.
- Prime and secondary yield movements have been varied. Prime yield compression was selective with offices, office parks and shopping centres seeing on average 23 bps change.
- Secondary yields generally moved outwards by 26 bps, on average; however, office parks and retail shops did see some yield compression.
- Prime property remains overpriced with the exception of offices, probably due to the Central London effect, and retail warehouses that are fairly priced.
- Secondary property is generally under priced with the exception of shops and shopping centres, which are overpriced.
- Rental growth for 2011 continued to be downgraded across most subsectors, the exceptions being retail shops and office parks. 2012 rental growth saw downward adjustment across all sectors, while 2013 saw all sectors turn positive.
- Capital growth for 2011 saw an upward adjustment; however, 2012 had a more aggressive downgrading across all subsectors. By 2013, capital growth is expected to turn positive across most sectors, with office parks as the exception.
- When answering “Why invest in property now?”, 80% felt that the income premium to gilts was an important factor.
- In terms of what was going to boost the UK economy, 60% of the respondents felt that there would be no boost and that the UK economy would rumble on slowly.
- As to what effect the eurozone sovereign debt and banking crisis was having on property investment strategies, 40% felt that they would watch and wait, whereas 20% thought it would be good for UK property.
- The respondents said the government should rejuvenate town centres that have high retail vacancy rates by implementing change of use of commercial property to residential, no business rates, flexible planning, strategies to reposition centres, incentive packages to occupiers and restrictions on the size and location of supermarkets.

# Investment Intentions

According to November's pricing survey, property continued to be a "buy" with focus mainly on the South East and Central London. South East offices are favoured by 80% of the respondents, followed by Central London offices and retail each by 70% and South East retail by 60%. The respondents are showing stronger interest in these segments than in the July survey, while the South East industrial sector is less favoured than in the previous survey.

On the sell side, Welsh offices and retail, North East offices, North West offices and retail and Yorkshire & The Humber offices were each favoured by 40% of the respondents. Regions saw no significant difference from the July 2011 survey as these areas are feeling the most from public sector job cuts.

The UK is divided into two regions, the south as "purchases" and the north as "sales". This reflects the different levels of economic activity, as well as the relative reliance on public sector jobs in the northern economies.

There continued to be muted interest in residential as a buy for Central London and the South East.

distribution warehouses yields moving out on average by 93 bps. Office parks and retail shops yields compressed by 50 bps on average and retail warehouses and shopping centres saw no change since July.

The all property secondary yield across all subsectors grew to 8.7%, up 30 bps from July's 8.4%. At the top end of the secondary yield range is distribution warehouses at 10.2%, up significantly from 9.0%. Older distribution warehouses are increasingly obsolete as investment in new, modern space comes to market. Standard shops continue to be at the low range of secondary yields at 6.6%, down from 7.4%.

The gap between prime and secondary yields increased to 259 bps across all subsectors from the 224 bps in July. The offices sector prime/secondary yield gap increased to 149 bps, the widest of all subsectors, followed by 110 bps for distribution warehouses. Shops and retail warehouses have seen a narrowing of the prime/secondary yield gap since July.

There was a continued polarisation in the market with prime attracting safe haven capital and secondary yields moving out due to poor expectations. Prime is generally overpriced, except offices, due to the strength of Central London. Prime retail warehouses are fair value. There continues to be selective opportunities for secondary space, although overall, secondary pricing is moving outwards. With the exception of shops and shopping centres, secondary property is underpriced.

Current Average Yield Levels %		
Sector	Prime Rack Rented % pa	Secondary % pa
Offices	5.8 (5.9)	9.6 (8.2)
Office Parks	6.9 (7.4)	9.5 (9.7)
Retail Shops	5.1 (5.1)	6.6 (7.4)
Retail Warehouses	5.8 (5.5)	7.5 (7.5)
Shopping Centres	5.9 (6.0)	8.0 (8.0)
Standard Industrials	6.6 (6.6)	9.5 (8.9)
Distribution Warehouses	6.6 (6.5)	10.2 (9.0)

(July 2011 responses in brackets)

# Yield Levels

Prime yield compression on offices, office parks and shopping centres has seen an average of 23 bps change for these subsectors. However, across all sectors, average prime yields decreased by only 4 bps since the previous survey. Meanwhile, secondary yields overall have moved outwards by 26 bps, on average; however, office parks and retail shops yields did compress slightly.

Office parks saw the largest compression in prime yields since July at 50 bps. For prime offices and shopping centres, yields came in 10 bps, while prime retail warehouses and distribution warehouses saw yields move out by 30 bps and 10 bps respectively. Prime retail shops and standard industrial yields remained constant at 5.5% and 6.6% respectively.

The all property prime yield remained unchanged at 6.1%. Prime yields on office parks fell from 7.4% to 6.9%, but remain the highest subsector yield. Conversely, the lowest prime yield was 5.1% for retail shops, which remained stable since the July survey.

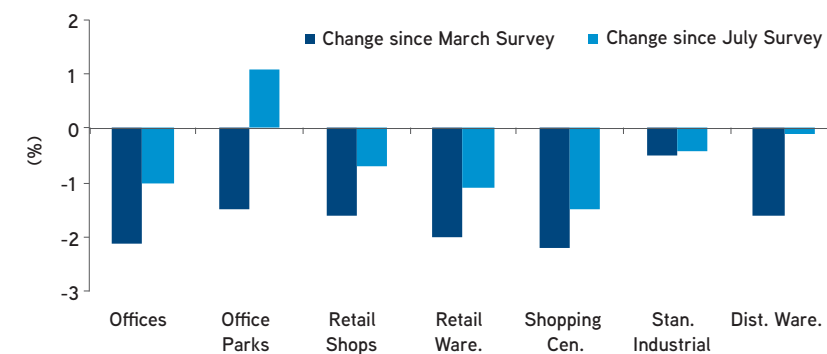
The movement in secondary yields was also varied with office, standard industrial and

FIGURE 1: PRIME SECONDARY YIELD GAP



Source: Colliers International/REC

FIGURE 2: NOVEMBER SURVEY: CHANGE IN 2012 RENTAL GROWTH PA EXPECTATIONS



Source: Colliers International/REC

## Rental Growth

The November respondents downgraded their expectations for 2011 rental growth from the previous survey across most subsectors, leaving only office parks and retail shops with improvements. The November survey saw all property rental growth expectations drop by 24 bps. Overall, most subsectors continued to see negative rental growth in 2011, with offices showing growth at 1.9% this year. Nevertheless, offices had the largest adjustment at 90 bps lower, followed by shopping centres at 50 bps lower.

Office parks saw the largest positive adjustment at 80 bps higher, followed by retail shops up 30 bps. All sectors are expected to see negative rental growth in 2011, except for offices which is positive at 1.9% pa. Shopping centres are expected to see the worst rental growth of minus 1.6% pa for 2011.

For 2012 there has been aggressive downgrading of rental growth expectations, seeing a fall of 110 bps. Offices at 1.4% pa and retail warehouses at 0.2% pa are the only subsectors to see rental growth next year.

Expectations for rental growth in 2013 are positive for all property at 0.6% pa. Offices continue to see the best rental growth of 1.4% pa, followed by retail shops at 1.3% pa.

Rental growth expectations for 2012 see retail shops, shopping centres and standard industrial with the best improvement of 60 bps over 2011 figures. Conversely, office parks saw rental growth expectations drop 120 bps, while distribution warehouses fell 70 bps. Analysing the expectations of rental growth change from 2012 to 2013, shopping centres saw the most rental growth change with an increase of 170 bps, followed by office parks and retail shops of 150 bps.

## Capital Growth

According to the pricing survey, 2011 capital growth forecasts for most subsectors continue to remain in negative territory, only offices and retail warehouses are positive. For 2012, expectations of a slowdown in economic activity have been reflected in the survey as respondents gave negative adjustments to capital growth for all subsectors. The survey suggests that 2013 should see capital growth turn positive across all subsectors.

The expectations for all property capital growth for 2011 is minus 0.2% pa. Offices are expected to see a rise of 2.6% pa, followed by retail warehouses at 0.7% pa. Respondents are

### Latest Rental Growth Expectations - Average % pa

Sector	2011 % pa	2012 % pa	2013 % pa
Offices	1.9 (2.8)	1.4 (3.0)	1.4
Office Parks	-0.1 (-0.9)	-1.3 (0.3)	0.2
Retail Shops	-0.8 (-1.0)	-0.2 (0.4)	1.3
Retail Warehouses	-0.2 (0.1)	0.2 (0.8)	0.9
Shopping Centres	-1.6 (-1.1)	-1.0 (0.2)	0.7
Standard Industrial	-0.6 (-0.4)	0.0 (0.7)	0.9
Distribution Warehouses	-0.3 (-0.2)	-1.0 (0.9)	0.1

(July 2011 responses in brackets)

### Latest Capital Growth Expectations - Average % pa

Sector	2011 % pa	2012 % pa	2013 % pa
Offices	2.6 (1.5)	0.2 (1.6)	1.0
Office Parks	-0.6 (-2.9)	-3.0 (-1.0)	-0.7
Retail Shops	-0.4 (-1.4)	-0.9 (-0.2)	1.7
Retail Warehouses	0.7 (0.3)	-2.2 (0.2)	1.1
Shopping Centres	-1.8 (-1.2)	-2.4 (-0.3)	1.4
Standard Industrial	-0.7 (-1.1)	-2.3 (0.3)	0.4
Distribution Warehouses	-1.3 (-1.5)	-3.1 (0.0)	0.2

(July 2011 responses in brackets)

saying the worst subsector for capital growth will be shopping centres at minus 1.8% pa, followed by distribution warehouses at minus 1.3% pa. Meanwhile, office parks expectations for 2011 capital growth jumped from -2.9% in July to -0.6% in November. Bucking the trend, shopping centres was the only subsector to see a downgrade of expectations, from -1.2% to -1.8%.

The 2012 capital growth forecasts have been aggressively downgraded by 228 bps. The industrial sector saw the largest adjustment from 0.3% to -2.3% for capital growth next year. Offices fared the best, although still downgraded, with an adjustment from 1.6% pa in the July survey to 0.2% pa.

The respondents are more bullish for capital growth in 2013, as most subsectors moved into positive territory. All property capital growth is expected to be 0.7% in 2013. Retail shops will lead the way in capital growth with 1.7%, followed by shopping centres at 1.4%. Office parks are expected to fall by 0.7%, while distribution warehouses will fall slightly at 0.2%.

## Total Returns

2011 total returns have been revised upwards to 7.0% from 6.2% in July and 5.4% pa in March of this year.

Conversely, total returns for 2012 have been revised downwards to 6.1% from 7.0% in July and 8.2% in March. 50% of the respondents felt that the main factor contributing to 2012 total return was income. Other factors affecting total returns are outward yield shift, rental growth stagnation and a lack of bank finance.

Respondents are more positive on total returns for 2013 with a forecast of 7.9%. The main factors contributing to total returns in 2013 are rental growth improvement (50% of the respondents), economic growth (40% of the respondents) and yield stabilisation (30% of the respondents).

With regard to the question "Why invest in property now?", 80% felt that the income premium to gilts was an important factor in driving decisions. Diversification and less volatility than the other asset classes were also mentioned by 30% of the respondents. Other reasons given were long term liability matching and capital protection.

Furthermore, 60% of the respondents said they would invest in property through other vehicles, mainly in jvs, while 30% of the respondents had no opinion and 10% said they wouldn't invest in property right now.

## Topical Questions

In terms of what is going to boost the UK economy, 60% of the respondents felt that there would be no boost and that the UK economy would rumble on slowly. 30% felt that it could take between one and three years for a recovery, which was based on increased confidence encouraging cash rich corporates to invest, improvement of net trade or government spending on infrastructure. Global political stability and resolution of the euro crisis were also mentioned.

As to the effect that the eurozone sovereign debt and banking crisis is having on property investment strategies, 40% felt that they would watch and wait, whereas 20% thought it would be good for UK property. As to the impact of the crisis, there were different views including: it was a positive that the UK was not part of the euro, the UK still had high levels of debt, bank margins would increase and if there was any default it would cause big problems.

There were varied answers as to what the government should do to rejuvenate town centres that have high retail vacancy rates. The main suggestions were: change of use of commercial property to residential, no business rates, flexible planning, strategies to reposition centres, incentive packages to occupiers and restrictions on the size and location of supermarkets.

*The Colliers International and Real Estate Capital Pricing Survey is in its 18th year of operation, analysing different property sectors for both prime and secondary product. Analysis is undertaken on yield levels, breaking down the capital and rental growth expectations and their relationship to total returns. Views on property investment compared to the other asset classes are obtained, as well as on various topical property related issues.*

*This survey is unique as it analyses the views across the entire property investment community to provide a short term detailed market analysis of the industry's expectations for capital and rental growth. These results play an indispensable role due to the changing nature of the timing and pricing of property investment activity.*

## 512 offices in 61 countries on 6 continents

United States: 125  
Canada: 38  
Latin America: 18  
Asia Pacific: 32  
ANZ: 182  
EMEA: 117

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