

## ECONOMIC OUTLOOK

The UK economy grew 0.5% q/q in Q1 2019, up from the meagre 0.2% q/q recorded at the end of 2018. Stockpiling activity only had a limited impact on the growth figures, as a large proportion of stock was imported, meaning that net trade acted as a drag on GDP growth. Instead, business investment returned to growth, while household spending also continued to support the economy. However, it is likely that consumer spending growth will somewhat slow as part of the increase was attributed to temporary factors such as warmer-than-usual weather and heavy discounting at clothing and footwear stores. The Office for Budget Responsibility expects GDP growth to slow from 1.8% in 2018 to 1.2% this year, with both Capital Economics and Oxford Economics slightly more optimistic (1.5%).

CPI inflation rose above the Bank of England's target of 2.0% in April for the first time since the end of last year, largely the result of increased gas and electricity prices. Although it is likely that strong wage growth will help inflation to remain above the 2% mark as companies pass on higher costs to their clients, the BoE is in no rush to hike interest rates. After all, there remains a high degree of political uncertainty and economic growth is not expected to accelerate this year. Yes, the BoE has recently stated that there may be a need for more interest rate rises, but this is very unlikely to happen this year. The sterling/dollar exchange rate has been fairly stable over the past few months, but sterling has depreciated by around 4% since the start of May, standing at 1.26 at the time of report writing.

## ALL PROPERTY FORECASTS

Annual all-property returns are expected to turn negative this year for the first time since 2008 as rental performance and pricing concerns in the retail sector are driving increases in yields. Colliers expects negative total returns of -1.2% in 2019, but forecasts a return to positive growth thereafter. Negative capital growth of -5.8% contrasts with sustained positive income returns of 4.8% (0.2% residual). Retail assets will take the hardest hit, with all retail total returns expected to decline by -9.6% y/y this year. However, we expect the market to bottom out this year and over the five-year horizon until 2023, we predict all-property annual average returns of 5.1%.

Equivalent yields have been on a downward trajectory since 2009, but this will come to end this year. By the end of 2019, Colliers expects all-property equivalent yields to have moved out by 30bps. Yields will continue to soften slightly until 2021 before a stabilization is likely. Shopping centres and retail warehouses will see the largest shifts in yields, while supermarkets and some industrial and office sub-markets will experience very little yield movement. Brexit certainty could drive another period of modest yield compression as investor confidence improves.

Rental growth will turn negative this year, again largely driven by sharp declines in the retail sector. By the end of 2019, we expect negative rental growth of -1.3% y/y, with all retail rents down by 6.1% y/y. Rental growth will be maintained across the industrial sector, especially for assets in London and the South East. Some office markets will see sustained rental growth, while others will experience slight declines. All-property rental growth is expected to return in 2020 (+0.2% y/y) and to average 0.9% y/y over the remainder of the forecast horizon.

Investment volumes between January and May stand at £15bn, down around 30% from the

same period in 2018, following very disappointing May figures. The alternative and leisure sectors together account for over 40% of all transaction activity, while volumes in the retail sector continue to slow. Office investment has also slowed significantly, with Q1's figure of £2.4bn being the weakest since the global financial crisis. Overseas cash accounted for just under half of all investment, although Far Eastern investors seem to have chosen a more cautious approach in the first five months of the year. Middle Eastern investors have reduced their exposure to UK commercial property in Q2 2019, so far, with a net investment position of -£694m.

**Retail:** Retail sales were off to a positive start to 2019, with sales volumes up 1.6% during the first quarter. Admittedly, some of the strength in the figures may have been caused by temporary factors, e.g. the increase in food sales could have been partly driven by stockpiling activity ahead of the original Brexit deadline of 29th March and higher clothing sales were partly attributed to warmer-than-usual weather. There was some rebalancing in the April figures already, with the Office for National Statistics reporting flat sales volumes. Therefore, household spending is expected to weaken from a strong Q1, thereby limiting GDP growth in Q2.

From an occupier and investment perspective, it is currently hard to find any positive news about the retail sector. The Centre for Retail Research puts the number of companies failing so far this year at 21, affecting 727 stores. With more CVA's expected this year, there will be further downward pressure on rents. Brexit uncertainty, the rise of e-commerce, business rates and the National Living Wage are all continuing to negatively impact the sector.

Retail investment volumes stand at just £1.8bn so far this year, down from £2.3bn during the same period last year, and on course to reach the

### ALL PROPERTY FORECAST SUMMARY

	DEC-19	DEC-20	DEC-21	2019 - 2023
ERV Growth (% pa)	-1.3	0.2	1.5	0.9
Equivalent Yield (% eop)	5.8	5.9	5.9	5.9 (2023)
Capital Growth (% pa)	-5.8	-0.4	1.0	0.0
Total Return (% pa)	-1.2	4.6	6.2	5.1

Source: Colliers International, MSCI

### RETAIL FORECAST SUMMARY

	DEC-19	DEC-20	DEC-21	2019 - 2023
ERV Growth (% pa)	-6.1	-3.1	-0.3	-1.7
Equivalent Yield (% eop)	6.3	6.4	6.4	6.4 (2023)
Capital Growth (% pa)	-14.6	-3.2	0.7	-3.0
Total Return (% pa)	-9.6	3.0	7.2	3.1

Source: Colliers International, MSCI

### OFFICE FORECAST SUMMARY

	DEC-19	DEC-20	DEC-21	2019 - 2023
ERV Growth (% pa)	0.4	1.1	2.0	1.7
Equivalent Yield (% eop)	5.8	5.8	5.9	5.0 (2023)
Capital Growth (% pa)	-2.3	0.9	1.0	1.1
Total Return (% pa)	1.6	5.1	5.2	5.3

Source: Colliers International, MSCI

### LOGISTICS & INDUSTRIAL FORECAST SUMMARY

	DEC-19	DEC-20	DEC-21	2019 - 2023
ERV Growth (% pa)	3.0	3.1	2.9	3.1
Equivalent Yield (% eop)	5.3	5.4	5.4	5.4 (2023)
Capital Growth (% pa)	2.3	1.4	1.3	2.6
Total Return (% pa)	6.9	6.0	6.0	7.3

Source: Colliers International, MSCI

lowest annual level since 2000. Shopping centres and retail warehouses are trading particularly poorly, while some prime unit shops continue to attract investors. Only seven shopping centre deals have been reported between January and May, some of which had reported yields of close to 10%. For example, the Killingworth Centre in Newcastle was sold at 9.4% IY while the Chantry Centre in Andover changed hands at 9.5% IY.

Rents fell across all main retail segments in Q1, according to the latest MSCI index, with the only exception being Standard Shops - Central London, where rents showed a marginal increase of 0.1% q/q. Standard Shop - SE& Eastern recorded the sharpest decline in market rental value growth (-1.8% q/q), followed by Standard Shop - Rest of UK (-1.6% q/q) and Shopping Centres (-1.2% q/q).

Our latest forecasts suggest that rents will fall across all retail segments in 2019. Shopping Centres (-10% y/y) and Retail Warehouses (-7.0% y/y) will see by far the largest declines. Standard Shops in Central London and Supermarkets will hold up somewhat better, but rents in these segments are also forecast to fall (-2.0% y/y in both cases). All retail rents will return to growth in 2022, but will nonetheless average -1.7% over the 2019-2023 forecast horizon.

All-retail total returns are expected to show a decline of -9.6% y/y in 2019, following a 0.5% y/y decline in 2018, with income returns of 5.6% not sufficient to offset negative capital growth of -14.6% (0.6% residual). Capital growth will remain in negative territory in 2020, but stabilize thereafter. Over the five-year forecast horizon, all-retail total returns are expected to average 3.1% pa.

**Offices:** Supply of new development space in Central London is almost at a standstill. While 2020 will see new product delivered, the intervening shortage will continue to provide occupier motivation for securing pre-lets. Although construction starts are up, the proportion of pre-lets is rising too and the limited development pipeline will ensure that vacancy rates remain stable or slightly fall.

Despite slowing from 0.8% y/y in 2018 to 0.4% y/y, all-office MSCI rental growth is predicted to remain in positive territory by the end of 2019. That said, a number of segments will see rents fall, led by City of London and Midtown (both -1.0% y/y). Meanwhile, West End, Rest of UK, Rest of London and South East will sustain positive rental growth over the 2019-2023 period.

Office investment volumes in the first five months of 2019 amount to £4.6bn, down by over a third from the £7.2bn transacted over the same period a year ago. It appears that overseas investors have so far this year taken a more cautious approach, accounting for only around 38% of all office investment in Central London, down from 72% in 2018. Moreover, overseas investors (alongside UK institutions) are a main net seller of office assets in 2019 so far, meaning they are reducing their exposure to the sector. However, the figures are heavily influenced by Citigroup's purchase of Canada Square for £1.1bn at 4.23% IY. Citigroup leases the whole tower and sublets most parts of

it to other tenants and the transaction is therefore treated as an occupier deal.

All-office total returns are expected to slow to 1.6% by the end of 2019, comprised of -2.3% capital growth and 4.0% income return (0.1% residual), down from 6.2% in 2018. Rest of UK and London City offices are set to outperform with total returns of 4.0% and 3.3%, respectively. With yields moving out modestly and capital growth turning negative, income return will be the only source of total return growth in 2019. With most of the repricing occurring this year, yields will begin to stabilize in 2020, resulting in a re-acceleration of total returns growth. All-office annual total returns are predicted to average 5.3% between 2019 and 2023.

**Logistics & Industrial:** Data from the Office for National Statistics shows that manufacturing output increased 2.2% q/q in Q1 2019, the strongest rise in over 30 years. The solid performance was due primarily to the volatile pharmaceutical products subsector (+9.4%) and food products, beverages and tobacco (2.7%), both of which can be linked to stockpiling activity ahead of the UK's initial departure date from the EU.

However, there are clear signs of a negative Brexit impact. The Society of Motor Manufacturers and Traders (SMMT) reported a 45% decline in car production in April. The SMMT expects car production volumes in 2019 to be down by around 10% from 2018 figures. Meanwhile, latest PMI results point to a deterioration in the manufacturing sector, with the headline figure dropping below the 50.0 no-change mark for the first time since July 2016 (the month after the EU referendum). The report highlights that stockpiling activity, which had boosted the headline PMI figure in recent months, came to a halt in May.

At 1.1% q/q, South East and Wales saw the strongest growth in industrial market rents, according to the Q1 MSCI/IPD index, followed by London at 1.0% q/q and Eastern England at 0.9 q/q. Rental growth was much weaker in Scotland (0.3% q/q) and North West (0.1% q/q). Wales recorded the strongest acceleration with rents increasing at 1.1% q/q, up from 0.3% q/q in Q4 2018.

At 6.9% y/y total returns growth, the industrial sector remains the standout performer across the commercial property universe in 2019. Despite slowing to 6.0% y/y in 2020, total returns will average 7.3% over the five-year forecast horizon. In contrast to the other sectors, positive capital growth of 2.3% will be maintained this year.

As is the case with the other sectors, the outlook heavily depends on the future relationship between the EU and the UK and our forecasts are based on the assumption that there will be some form of agreement by the end of October. A deal would bring greater certainty and potentially unlock requirements that are currently on hold. A 'no deal' could on the one hand lead to further opportunities linked to stockpiling, but on the other hand, adversely affect the sector through the impact of downsizing, business relocations and supply chain shifts.

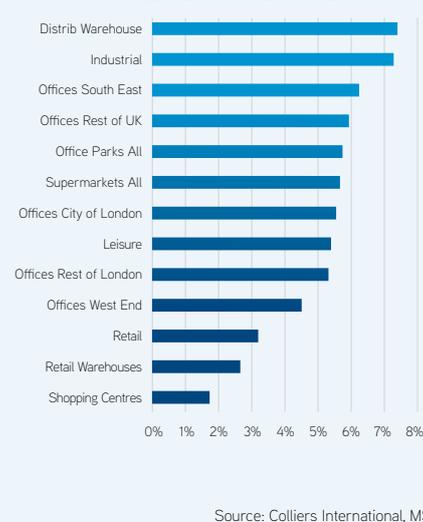
CHART 1: TOTAL RETURN



CHART 2: ERV GROWTH 2019-2023



CHART 3: TOTAL RETURN 2019-23



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