Research & Forecasting Report

United Kingdom | Property Snapshot August 2018

Colliers INTERNATIONAL

Economy

UK quarterly GDP growth accelerated to 0.4% q/q in Q2 2018, with the service sector growing at the strongest rate since the end of 2016 and construction seeing a weather induced rebound in activity. However, the volatile inventory component had a large positive impact on the GDP figures and industrial production contracted with a worrying second successive quarterly decline in manufacturing. The weakening pound did little to help exporters in Q2 and trade acted as a significant drag on GDP. Latest PMI results suggest that the underlying growth pattern remains subdued at the start of Q3. Although construction continues to strengthen, both the manufacturing and service components weakened slightly, according to the surveys. CPI inflation nudged up marginally to 2.5% in July while RPI inflation slowed from 3.4% to 3.2% - the lowest it's been since March 2017. Encouragingly, retail sales had their strongest three-month period (+2.1%) in over four years.

Colliers view: Despite the expected improvement in Q2, the underlying growth trend remains subdued. GDP growth is unlikely to accelerate in Q3.

Investment

July's transaction volumes reached £3.2bn, according to preliminary data, down from a strong June when volumes stood at £7.5bn. There were only three deals above £200m, with Oxford Properties Europe's purchase of the PRS Get Living portfolio (£600m) topping the list. Assets outside the three traditional sectors made up almost half of all investment volumes. According to the latest MSCI quarterly index, all property yields hardened slightly, although retail yields softened, especially for standard shops outside of London. Industrial and office yields compressed and hotel yields reached a new record low of 4.26, according to MSCI.

Retail: South Korean investors bought the Gallagher Shopping Park in Wednesbury for £175m, representing the biggest retail warehouse deal so far this year and Noe Group purchased a portfolio of two retail parks in Bristol and Kirkcaldy for a combined £164m at 7% IY. The biggest supermarket deal was the £52m purchase of a Morrisons in Sheffield (4.9% IY). It was the second large purchase by Supermarket Income REIT this year, following the acquisition of a Tesco store in Scunthorpe in March (£53m at 4.95% IY). No shopping centre deals were reported in July.

Retail Transactions	Value	Deals	July Selected Yields
Unit Shops	£79m	22	3.99% Glasgow/ 4.5% Guildford
Retail Warehouses	£449m	8	8.3% Stoke-on-Trent
Shopping Centres	n/a	0	n/a
Supermarkets	£71m	3	4.9% Sheffield

Source: Colliers International, Property Data Ltd.

Offices: Transaction volumes were subdued in July with only limited overseas capital (£201m vs £2.7bn in June) entering the market. In the absence of +£100m deals, Railways Pension Trustees' purchase of 2 Colmore Square in Birmingham (£96m at 6.4% IY) was the largest deal in July. Israeli ZC Ronogil Investments' acquisition of 1 Commercial Street in London represents the largest overseas deal in July (£91m).

Office Transactions	Value	Deals	July Selected Yields
London	£434m	13	4.5% to 5.5% London
Regional	£373m	35	5.3% Edinburgh/ 6.4% Birmingham

Source: Colliers International, Property Data Ltd.

Industrial: By far the largest industrials deal was the purchase of a logistics portfolio by Singaporean Ascendas REIT (£205m at 5.2% IY) comprising 12 assets across the UK. Domestic investors were also active, with Tesco Pension Fund buying assets on the Beaumont Industrial Estate in Banbury (£28m at 6% IY) and BlackRock UK Property acquiring two distribution warehouses in Wolverton, Milton Keynes (£14m at 6.2% IY).

Industrial Transactions	Value	Deals	July Selected Yields
Distribution	£348m	20	5% to 6.2% Milton Keynes/ 6% Banbury
Multi-Let parks	£101m	34	4.9% Ashford

Source: Colliers International, Property Data Ltd.

Alternatives/Other: PRS accounted for almost a third of all property transaction volumes in July. Besides the Get Living portfolio, L&C Capital were active, purchasing a site for a proposed 650 PRS homes in Woolwich for £300m. A few smaller hotel deals took place and Singaporean Press Holding bought a student housing portfolio across six towns and cities (£180m).

Alternatives/Other	Value	Deals	July Selected Yields
PRS	£1bn	15	5% Newcastle
Motor Trade	£75m	4	6.4% Stafford

Source: Colliers International, Property Data Ltd.

Colliers view: Unchanged. Pricing remains firm and industrial yields are likely to compress further.

Key Indicators

	Latest[1]	End July	End June
UK GDP (%q/q)	0.4% (Q2 18)	0.2% (Q1 18)	0.1% (Q1 18)
UK PMI (composite)	53.8 (July)	53.8	55.0
EURO PMI (composite)	54.3 (July)	54.3	54.9
UK CPI (%)	2.5 (July)	2.5	2.4
UK RPI (%)	3.2 (July)	3.2	3.4
UK BASE RATE (%)	0.75	0.5	0.5
UK 10YR GILT (%)	1.38	1.43	1.38
GBP 3M LIBOR (% eop)	0.81	0.80	0.67
STERLING EFFECTIVE (FT)	77.5	77.9	78.3
GOLD (USD eop)	1186	1224	1253
OIL BRENT (USD eop)	71.3	74.3	79.4
FTSE 100 (eop)	7612	7749	7637
IPD All property IY	↓ 4.59 (Q2)	4.59	4.61 (Q1)
IPD All property EY	↓ 5.47 (Q2)	5.47	5.51 (Q1)

[1] Aug 15th (data and revisions)
Sources: FT, BoE, Haver, IHS Markit, MSCI, ONS

Occupier Markets

Retail

Retail sales volumes continued to improve in July, with trend growth[1] accelerating to the sharpest rate in over four years, driven by very strong food and online sales. However, many consumers stayed away from the high streets, according to the ONS. The latest BRC - KPMG Retail Sales Monitor (RSM) also shows a mixed performance of the sector. Food sales had their best July in five years and, unsurprisingly, fans and cooling equipment performed well, according to the report, but other areas of the sector fared worse. The report highlights that the general spending pattern remains weak by historical standards. Although there was some relief for House of Fraser employees as Sports Direct bought the department store chain, the number of retail companies going into administration this year stands at 27 (mid August) according to the Centre for Retail Research.

Colliers view: A welcome improvement in retail sales. Online sales will continue growing in importance while high street shops may struggle.

Offices

Central London : The trend of above average demand and insufficient supply continues. London offices vacancy rates fell to their lowest levels in a year (5.3%), despite take-up of new build and refurbished space falling to a two-year low. This development highlights a lack of available top quality assets rather than declining demand. **Regional CBDs:** Take-up figures across the CBDs are healthy, with Manchester enjoying a particularly strong first half of 2018. A lack of available grade A space is likely to exert further upward pressure on rents going forward.

Colliers view: Upward pressure on headline rents in London and regional CBDs is set to continue in the second half of the year.

Industrial

The ONS reported a 0.8% fall in industrial production in Q2 2018, with manufacturing and energy supply both declining when compared to the previous quarter. While higher than average temperatures explain the drop in energy supply, falling manufacturing output is more of a puzzle, especially given the weakness of the pound which should, in theory, support exports. A weak trade performance was characterized by the sharpest decline in the value of car exports in over a decade.[2] On a more positive note, the ONS data also showed manufacturing production expanding by 0.4% m/m in June and the latest PMI and CBI survey data point to growth in the sector at the start of Q3. Industrial rents continued to rise in Q2 according to the MSCI quarterly index, reaching 8.0% y/y in London (7.4% in Q1) and 6.8% y/y in the South East (6.6% in Q1).

Colliers view: Unchanged. The manufacturing sector struggled in H1 but improvements are expected in H2. Rental growth is set to strengthen further as supply shortages persist.

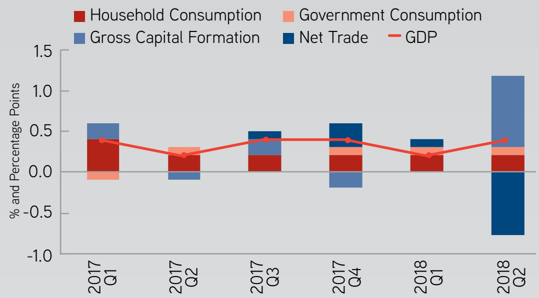
Residential

There was a modest rebound in house price growth in July according to both the Halifax and Nationwide measures. That said, house price growth remains in a very narrow range and well below levels seen throughout 2015 and 2016. Housing transaction numbers are stagnant at best, with the latest HMRC figures showing a 5.7% decline in transaction completions between June 2017 and June 2018. A lack of supply, the cost of stamp duty and high property prices are barriers to moving, further subduing activity. The 2 year fixed (75% LTV) continues to move sideways and stands at 1.76%.

Colliers view: House price growth will remain muted this year. Nonetheless, first-time buyers will continue to struggle to step onto the housing ladder.

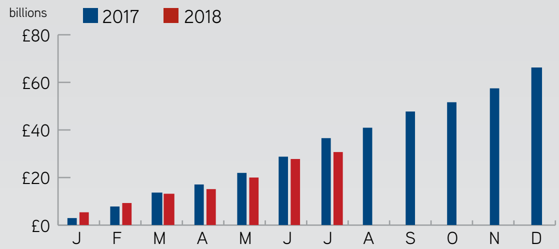
[1] Three-month on three-month growth
[2] Cars account for roughly 10% of all UK goods exports. Source: ONS

Contributions to GDP Growth



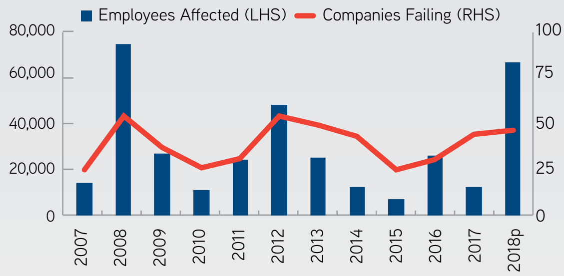
Sources: ONS

Investment Transaction Volumes (Cumulative)



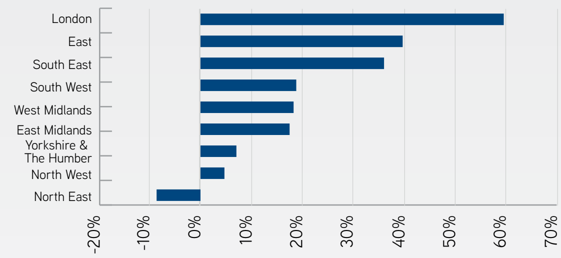
Sources: Property Data Ltd., Colliers International, July 2018.

Retail Failures



2018 figures through mid August 2018. Forecast for 2018 simple exptrapolation. Source: Centre for Retail Research

Change in Average House Prices Since Pre-Crisis Peak



Source: HM Land Registry, ONS

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