RESEARCH

PROPONOMICS – MACRO VIEW

MAY 2016

THE EU REFERENDUM: STANDBY FOR A REMAIN RALLY?

According to Ladbrokes the odds are moving in favour of a remain vote at the forthcoming referendum. Over 90% of the bets received in the last month have been for a remain vote. The currency market appears to agree with the bookies (see figure 1), as the pound recovers.

EU referendum

Signs are emerging that remain **is gaining ground in the referendum**

The experience of the Scottish referendum was a market rally followed a vote for the status quo

Signs of improvement in the global economy **could also support a remain rally**

Nevertheless, there are still **three weeks for leave to stage a comeback**

JAMES ROBERTS
Chief Economist

"Ladbrokes report that over 90% of the referendum bets it has received in the last month are for a remain vote."

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Certainly, there is more shaping sterling's value than just the Brexit debate. However, in the UK bookmakers have a better track record on calling political votes than the opinion polls, with last year's General Election a good example. The pollsters concede there is disparity between the results they receive in surveys conducted via the internet compared to telephone polling. Moreover, a poll last week for The Daily Telegraph estimated remain's share of the vote at 55%.

While, the bookmakers and their customers could be wrong, recent events merit further analysis of what a remain vote will mean for the commercial property market.

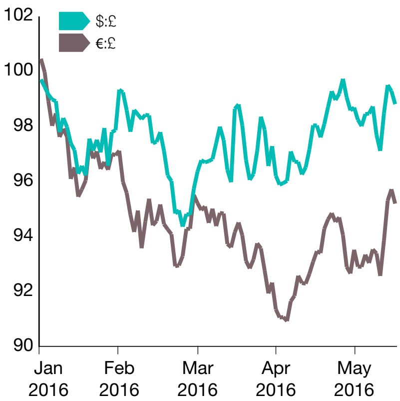
The Remain Rally

Pursuing the logic that "investors hate uncertainty", by restoring the status quo a remain vote could bring investors back into the market. That is the lesson of history, as shown by the market bounce for Scottish property after the 2014 referendum on independence (see figure 2).

Critically, demand did not collapse during the first quarter of 2016. Total commercial investment sales in Q1 2016, according to Property Data, stood at £13.8 bn, down from £18.5 bn in Q1 2015. To set this in context, during 2012 (at the height of the Euro Crisis) quarterly sales ranged from £7.2 bn to £9.4 bn. This shows investors have been less concerned by the referendum than the Euro Crisis, suggesting on-going confidence in the property market.

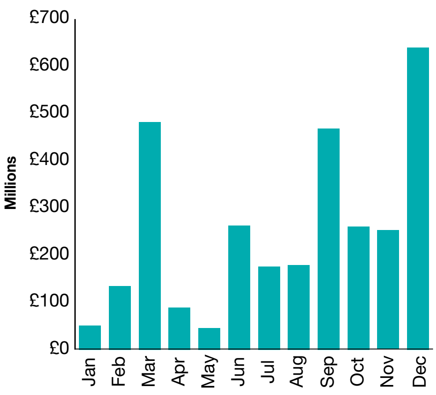
Moreover, the fall in sales in Q1 was concentrated in retail, leisure and mixed-use property. For offices and industrial there were actually small increases in volume – from £5.1 bn in Q1 15 to £5.2 bn in Q1 16 for offices, and from £1.2 bn in Q1 15 to £1.7 bn in Q1 16 for industrial. In fact those parts of the market that have seen falling sales were actually in a slowdown in the latter part of 2015, reflecting a wider restructuring for the secondary retail market.

FIGURE 1
Euro: Pound and Dollar: Pound exchange rate indices



Source: Bank of England

FIGURE 2
Investment in Scottish Commercial Property in 2014 (referendum was in September)



Source: Property Data

Demand on the side lines

If we look at Central London offices, buying activity has held up better for the small lot sizes popular with private investors, than for large assets, as institutional buyers have been awaiting the referendum result. Moreover, unit funds have been building up cash in the event of a leave vote. These funds would become available for acquisitions if there is a remain vote. This suggests a logjam of demand related to the poll, which may lead to a rise in sales after the referendum.

Also, Britain is not alone in the world in having an upcoming poll with a possible radical outcome. The US has elections in the November, with Donald Trump heading the Republican ticket, and Germany has Federal elections next year, with immigration as a hot potato. After the referendum, the UK could enjoy safe haven status over these rival G7 nations by settling the political uncertainty earlier.

Moreover, there are tentative signs of recovery in the global economy, which should address concerns that the property market has been slowing for wider reasons than just the referendum. Japan's GDP for Q1 beat expectations, the Fed in the US is back to discussing a rate rise (a sign of confidence in the outlook), and oil has rallied. Consequently UK property could be in a position to ride a general rising tide for the global economy in the second half of the year.

Remain timeline

Given the poll is in late June, the pattern of a remain rally will be shaped by the traditional July and August holiday slowdown. It should become easier to complete deals in September and October, so much of the effect would be felt in the latter part of Q3, and into Q4. London, being an international market, we believe will feel the effect soonest. Beyond London, a reversal of the recent outflows of money from property unit funds may need to occur, pushing the rally for regional markets towards the end of the year.

Yields could go lower in certain sub-markets, as property still offers a very large risk premium over Gilts, although there is probably little room for significant hardening at this point in the cycle. For some parts of the property market, like secondary retail warehouses and shopping centres, it will require more than an end to the Brexit issue to draw buyers back in. Moreover, we also need to add the caveat that there are still just over three weeks of campaigning left for leave to stage a comeback.

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James Roberts
Chief Economist
+44 20 7861 1239
james.roberts@knightfrank.com

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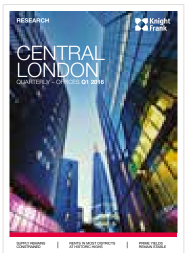

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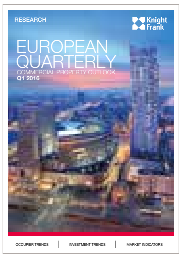

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