RESEARCH

UK MARKET OUTLOOK AUGUST 2014

Knight Frank

A RECOVERY GATHERING PACE

The latest IPD figures point to a market where the upswing is accelerating, particular when benchmarked against the 1990s recovery. June saw the IPD all property capital growth index rise by 1.6%, its strongest performance this year. All three sectors saw expansion, and once again offices led the way.

The market in a minute

All property capital growth index at 1.6% in June m-on-m, vs 1.1% in May*

Offices saw the highest capital growth (2.1%), and retail the lowest (1.1%)*

12 month total return reaches 17.6%, the highest since 2010*

Investment volume in H1 was £23.5 bn, vs £20.6 bn for same period of 2013**

* Based on IPD figures
** Based on Property Data figures

During the recession it became popular among analysts to benchmark the 2007-2009 index figures against those for the early 1990s by having the respective peaks as zero on a graph, and then running the downturns side-by-side. Unsurprisingly it confirmed that the last downturn saw values fall much harder compared to the early 90s.

What happens if we apply the same approach to the subsequent recovery?

For this analysis we have taken May 1993 and July 2009 as the respective starting points, being the lowest points for the IPD index – so the study is inclusive of the double dip periods that characterised both recoveries.

As figure 1 shows, the present recovery has proved comparatively robust. This time around the market took longer to succumb to a double-dip, which in turn was short-lived compared to that seen in the 1990s. Particularly encouraging has been the last few months with capital growth accelerating.

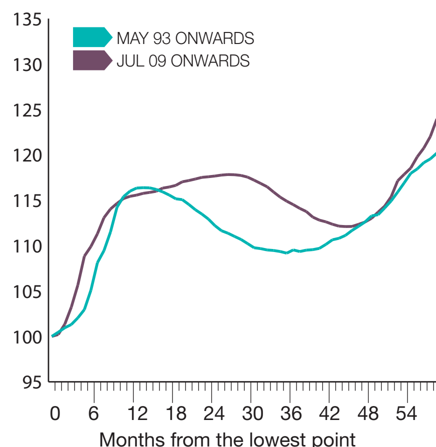
The impending rise in interest rates will probably take some of the heat out of the market, but clearly there is confidence among investors and capital is being deployed.

Also, commercial property is benefiting from the upbeat economic news we have seen this year. Last month the IMF raised its forecast for UK GDP growth this year to the highest it is predicting for the G7 nations.

Figures from the ONS showed the British economy rising above its pre-recession peak for output. The significance of this is that while the economy is below its last peak firms can probably service new business through picking up slack within their own organisations. Rising above the peak suggests they will need to add staff and resources, and for real estate that suggests rising demand for expansion space, or firms relocating to larger premises.

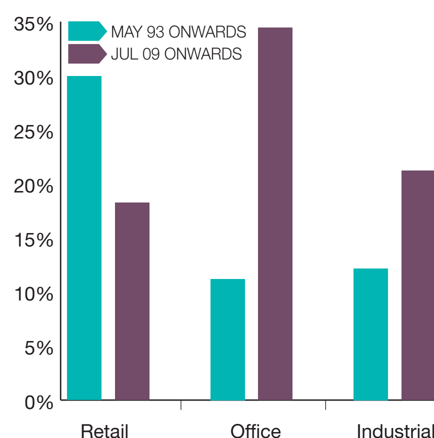
Given developers in many regions have been reluctant to build without at least a

FIGURE 1
IPD Capital growth index
1990s recovery vs now



Source: IPD

FIGURE 2
Sector performance
Growth from the lowest point



Source: IPD

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partial (if not total) pre-let in recent years, this means we could soon see vacancy rates falling and rental growth returning.

So far so positive, but it is necessary to match this with a caveat. The upbeat UK GDP figures owe much to the consumer, which in turn reflects rising house prices. This raises the concern that we are in the midst of a pre-election consumer boom, with the danger of a post-election slowdown.

There is also the risk that the Bank of England has let the economy get a little too warm, and finds itself playing catch-up and raising interest rates faster than it has been guiding the markets up to now. Certainly, the UK is doing surprisingly well at a time when the economic news on an international level is decidedly mixed. This beckons the question, what happens when the UK gets an additional boost from a rising global economy, and would this cause the economy to overheat?

Nevertheless, it would be wrong to end this month's Market Outlook on a gloomy note; after all the economic and property market indicators released since the previous edition have been broadly positive.

Therefore final word should be in reference to what is statistically the star performer of this new market cycle – offices.

Coming out of the early 90s downturn, there was a lot of pessimism surrounding the future of offices. The steady rise of the internet encouraged futurists to predict long-term decline for offices in favour of work from home; a forecast that sections of the IT industry that stood to benefit understandably talked up. Also, many companies were squeezing workstation sizes, and some were experimenting with hot desking.

However, today there is a new optimism surrounding the office sector. Many employers want their staff to come into the office, so they interact with colleagues and generate ideas. Space lost at the desk is now being replaced elsewhere, whether is it team space or locker rooms, or cafes. Today often the head of HR and the CEO will be involved in selecting the size and layout of a firm's new office. This has reduced pressure to cut workstations, and moved staff satisfaction up the agenda.

Moreover, if the UK economy is going to reduce its worrying dependence on consumerism, the industries we would expect to bring about the rebalancing will be hi-tech, bio-tech, business services, and finance. The property sector best placed to benefit from expansion in these industries is offices.

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