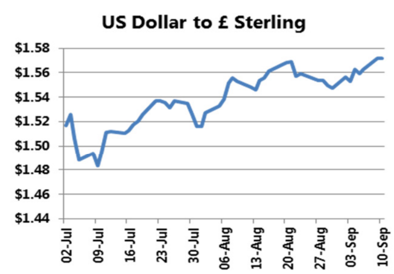
RESEARCH

SEPTEMBER 2013
UK MARKET OUTLOOK

Commercial property review

Knight Frank

Financial indicators



Source: Bank of England

- Financial markets have become increasingly sceptical of the Bank of England's policy guidance that base rates will remain at 0.5% until 2016. Ten year Gilt yields stood at just over 3.00% at the time of writing, up from 1.75% a year ago.
- Nevertheless, the Governor Mark Carney seems to be sticking to his guns, as the Bank of England announced that September bond maturity coupons from the QE programme would be reinvested. This is in effect what is called 'QE-lite' by some commentators.
- Thanks to a run of better economic news, Sterling has strengthened against a range of global currencies. This has coincided with a flight of money from a number of emerging markets, such as India and Indonesia, where investors have become increasingly bearish on the economic outlook with fiscal monetary tightening expected.

Economic outlook

- The second reading for Q2 UK GDP saw a surprise increase from 0.6% to 0.7%, and is part of the reason why investors are sceptical of the Bank of England's forward guidance. The GDP figures point to broad-based growth.
- The latest PMI indices for the UK also made for encouraging reading. The manufacturing index rose to 57.2 in August, up from 54.8 in July – a reading of over 50 suggests growth. The services index read at 60.5, up from 60.2 the previous month.
- However, Britain's trade deficit widened in July to £3.1 bn, compared to £1.3 bn in June and £1.0 bn in July 2012. This was due to weaker exports of manufactured goods to countries outside the EU, which may in part reflect the economic slowdown in some emerging markets.

Key economic indicators

	% / Value	Change
CPI *	28	↓
Retail sales (volumes) *	3.0	↑
Unemployment *	7.7	↓
Base Rate	0.5	→
£ : $	1.57	↑
£ : €	1.19	↑
FTSE 100	6,584.0	↓

Source: NS, FT, BoE.
All figures as at 10th Septmeber, except * end July.
Currencies are the spot rate. FTSE is the index value.

Property performance

Key performance indicators

Borrowing yield gap*		476 bps ↓
Risk yield gap**		457 bps ↑
Investment purchases (2013)		£25.16 bn
All Property void rate		9.7% ↑
	Initial yield	**20yr average**
Retail	6.2%	6.2%
Office	5.9%	7.0%
Industrial	7.3%	7.7%

Source: IPD, FT, Property Data, Knight Frank Research
*5 yr Swap rates to All Property initial yield
**Gilt redemption yield to All Property equivalent yield
IPD and matching data as at end July 2013

- The IPD all property capital growth index recorded a third consecutive month of growth in July, rising 0.23% month-on-month, compared to the June figure of 0.21%.
- Turning to the main sectors, the office and industrial indices were both in the black, at 0.50% and 0.41% growth respectively. Interestingly, retail at minus 0.02% was only just in the red, and could turn positive again in August. This would be a welcome sign of improvement for what has been the most embattled property sector in recent years.
- Over £25.2 bn of commercial property stock was purchased in the year to the end of August, compared to £20.9 bn in the same period of 2012. The increase is partly due to high volumes for shopping centres and leisure property.

Commercial Research
James Roberts, Head of Commercial Research
+44 (0)20 7861 1239
james.roberts@knightfrank.com

www.knightfrank.com
Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members' names

SEPTEMBER 2013
UK MARKET OUTLOOK
Commercial property review

Industrial gains momentum

- A recurring theme in this note in the last two years has been that good news for property has mostly come from the office sector. However, in recent months signs have emerged that industrial property is moving into a new cycle.

- Starting with the IPD measures, the all industrial capital growth index recorded its third consecutive month of growth in July. The rental value index has increased for a second month in a row. Given the positive news highlighted below, we expect both indices to continue to grow.
- In the occupier market, Prologis recently signed a pre-let of 165,000 sq ft at its Ryton Park, near Coventry, to Hi Logistics. They also plan to speculatively develop a new 225,000 sq ft warehouse at the same park, and another 310,000 sq ft shed at Dunstable.
- Retailer Poundland is taking a new 350,000 sq ft distribution centre in Essex. This follows Marks & Spencer committing to a 1 million sq ft shed at DP World's London Gateway scheme in June. Also, July saw DHL sign on a 62,000 sq ft warehouse at Park Royal in West London, and Bunzl pre-let 168,000 sq ft at Birch Coppice Park in the Midlands.
- Turning to manufacturers, JCB has acquired 385,000 sq ft at G Park Blue Planet in Staffordshire. Moreover, areas associated with the automotive sector are also seeing increased demand for warehouse space, reflecting growth for the UK car industry.
- Consequently, availability of larger units is under pressure. According to Knight Frank's Logic report, there was 6.6 m sq ft of new build sheds of over 100,000 sq ft available at the end of June – down from 9.1 m sq ft a year earlier. Developers have responded by seeking planning and preparing sites so they can quickly respond to a pre-let.
- Similarly in the investment market we are seeing increased interest in industrial property. According to Property Data, the first eight months of this year saw the transaction volume reach £2.3 bn, up from £1.9 bn for the same period of 2012.
- Recent deals show UK unit funds active in the market, possibly attracted to the relatively higher yields compared to some other commercial property sub-sectors. Also, some of the better economic news lately on consumer spending and factory output will also have encouraged investors to look at industrial property.
- Moreover, there are the future opportunities for warehouses resulting from the rise of internet shopping, as shown by Amazon's UK growth plans. The internet's share of UK retail sales has doubled in the last five years.
- Five years on from the financial shock of 2008, the economy appears more globalised than ever, while the internet's role in shopping and commerce has expanded. In this world where we spend ever more on goods made abroad and expect them delivered to our doorsteps, sheds are essential economic infrastructure. For investors they offer exposure to a global recovery.

Knight Frank Comments

2013 is proving to be a watershed year for UK commercial property, as the economic recovery draws more investors off the side lines. As well as demand picking up, we are also seeing a change in what is stock in demand – regional offices and industrial are back on investors' shopping lists. There are also encouraging signs in parts of the retail sector; although this remains an area of commercial property that is still working through structural changes.

UK commercial property investors are rediscovering the world outside of London, but they must avoid pitfalls. The recovery will not be evenly spread, as the new cycle (like others before) will be shaped by the new technologies, changing consumer habits and the rising industries of the coming era. This note spent time on warehouses, which will benefit from our growing enthusiasm for shopping online. Investors need to ask the question, which industries will gain from the new trends, and what are their property needs?