Market in Minutes

September 2011

Rental growth is beginning to emerge outside London

Prime yields have been stable for a year

- August is generally the hardest month of the year in which to take the temperature of the investment market. Is the lack of activity and continued stability of pricing down to everyone being on holiday, or a harbinger of a weak third quarter?

- The stability in the property market in August can generally be attributed to the holiday season. However, with massive equity market volatility, worsening global economic conditions, Libya and domestic civil disorder this August has probably been the least quiet summer for a long time. So what does this mean for the remainder of 2011?

- Equity market and economic uncertainty generally result in a rise in the use of the term “safe haven” in the context of UK (and specifically London) property, and the last month has been no exception to this rule. This supports steady yield levels and rising investment volumes for London offices in particular. Elsewhere in the UK investment market we are seeing rising investor caution, with concerns being raised about the strength of the UK economic recovery, particularly in relation to consumer confidence and spending. As a result of this, while prime yields are broadly supportable, we expect secondary and tertiary yields to continue to soften over the remainder of this year.

Prime equivalent yields

	August-10	July-11	August-11
West End Offices	3.75%	3.75%	3.75%
City Offices	5.25%	5.25%	5.25%
Offices M25	6.50%	6.50%-	6.50%-
Provincial Offices	6.00%	6.00%-	6.00%
High Street Retail	4.75%	4.75%	4.75%
Shopping Centres	6.00%	5.50%	5.50%
Retail Warehouse (open A1)	5.25%	5.25%-	5.25%
Retail Warehouse (restricted)	6.25%	5.75%	5.75%
Foodstores	4.50%	4.25%	4.25%
Industrial Distribution	6.50%	6.25%	6.25%
Industrial Multi-lets	6.25%	6.25%-	6.25%-
Leisure Parks	6.75%	6.25%	6.25%
Regional Hotels	7.00%	6.75%	6.75%

Source: Savills

Note: In some sectors initial yield pricing is becoming more relevant than equivalent yields. This particularly applies to retail warehousing and hotels where the figures indicated above are net initial yields. The +/- against the figures in the table above reflects the expected direction of movement in yields over the next 3 months.

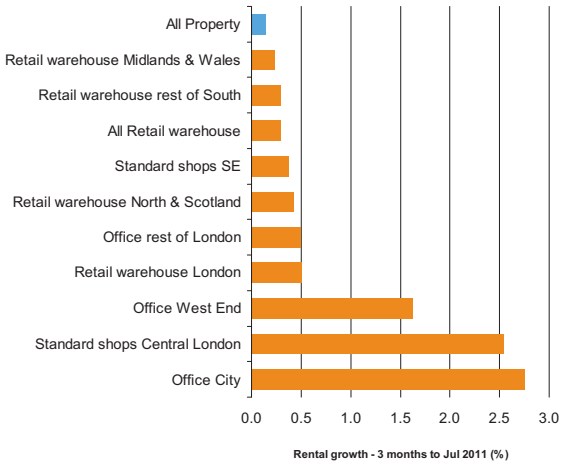
Rental growth - still just a phrase associated with London offices?

- According to IPD, All Property rental growth is gradually improving, but at 0.15% for the three months to end-July 2011 it isn't exactly stellar.

- The received wisdom is that the only sectors delivering rental growth are central London offices and retails, but as this chart shows, various parts of the retail market are beginning to see rises in average rents - most notably the retail warehouse market across the country.

- This might seem counter-intuitive, particularly given the slide in consumer confidence in August. However, our data on retail warehouse vacancy rates is now showing that some regions of the UK now have a vacancy rate of below 6%, and this is beginning to result in rising rents on the most in-demand schemes. The same is also true in strong town centre retail markets across the UK.

IPD subsectors where rents have risen over the last three months



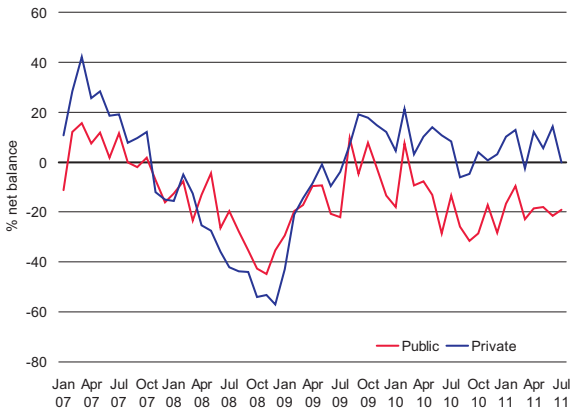
Source: IPD, Savills

Market in Minutes

Development and construction activity still being held back by lender's caution

- The latest data on new construction orders from the ONS showed that the volume of new orders in Q2 2011 fell to its lowest level since the third quarter of 1980, a 23% fall on the level a year ago.
- Our own monthly survey of the activity and intentions of 200 commercial property developers supports this muted trend, with the most common explanation cited for the low level of new starts being "ongoing restricted bank lending".
- The existing and planned further requirements for banks to hold more capital, will undoubtedly result in continuing difficulties for property developers in raising senior debt for speculative development. We are firmly of the belief that the ICB's proposal for ring-fencing retail and investment banking operations would raise the cost of borrowing for developers, as well as limit their ability to borrow for development purposes.

Commercial Development Activity index remains muted



Source: Savills, Markit

2012: Reasons to be cheerful?

- With consumer confidence weakening, GDP growth flat, and claimant counts rising are there any macro-economic reasons to be anything other than pessimistic about 2012?
- Surprisingly enough, there are a few quite persuasive reasons why a proper recovery may not be far away. Retail sales volumes continued to rise in July (albeit only by 0.2%), but given that many expected a fall in July following the early beginning to the sales in June this indicates that consumer confidence may not be as bad as surveys are showing.
- Inflation continues to rise, and the price rises announced by domestic gas and electricity providers will drive both CPI and RPI higher over the next few months. However, much of this high level is due to temporary factors which will recede. For example, CPIY (which excludes the impact of changes to indirect taxes such as VAT) is only 2.7%. This points to a significant fall in inflation in January 2012 when the last VAT rise drops out of the headline inflation number. This will be very good news for real earnings growth.
- Finally, there has been a sharp improvement in the state of public finances. Given that the growth prospects for the whole of the remainder of this parliament are going to be closely linked to the government's desire to pay down debts, any positive news on public borrowing levels is very important. The latest data on Public Sector Net Borrowing showed that it was just £0.02bn in July, down from £3.5bn a year ago. Growth in revenues also accelerated - chiefly due to the pick up in retail sales and higher corporation tax receipts. While there is still some way to go to hit the OBR's target for public borrowing in 2011/12, it is clear that the austerity programme is finally beginning to deliver.

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