UK Commercial Market in Minutes
Lack of liquidity remains

May 2013

New sources of overseas investment

■ The downward pressure on yields seen last month picked up pace in April with three more sectors added to the list - M25 offices, provincial offices and industrial multi-lets.

■ The lack of liquidity, particularly for prime, is the main culprit as institutional demand increases and new overseas investors start to eye the UK such as the Chinese Life Funds.

■ The Chinese Government's deregulation of the insurance sector, allowing life funds to invest in real estate across a limited number of markets outside China for the first time, could see £10bn focused on UK property. Once you add the Taiwanese Life Insurance funds to the list and the fact that only 5% of China's population has life assurance, this figure is set to expand enormously.

■ The conditions attached to the deregulation means that the focus will be on prime London. As a result the competition for assets and the pressure on yields is set to intensify.

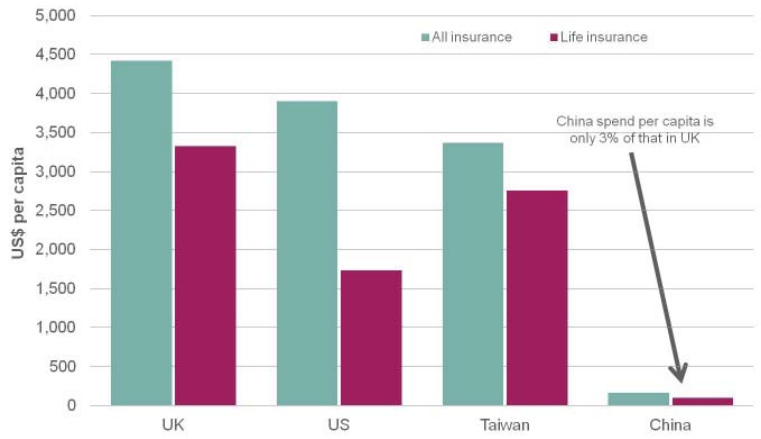
■ Competition for prime has already displaced UK institutions attention to prime product in key regional cities. But again liquidity remains an issue.

■ Values in the regions are still, on average, 48% off their peak meaning that for some there is reluctance to sell preferring to hold property until values improve. While there are secondary assets available, the institutions remain cautious to move up the risk curve.

■ With the UK escaping a triple dip recession in Q1 this cautiousness may fade. Seeing as the institutions are in the business of investing we may see an improvement in activity later in the year subject to more sellers coming to the market.

GRAPH 1

China insurance premiums per capita only 3% of UK



Graph source: SwisRe sigma

TABLE 1

Prime equivalent yields

	Apr 12	Mar 13	Apr 13
West End Offices	3.75%	3.50%	3.50%
City Offices	5.25%	4.75%	4.75%
Offices M25	6.25%	6.25%	6.25%↓
Provincial Offices	6.00%	6.25%	6.25%↓
High Street Retail	4.75%	4.75%	4.75%
Shopping Centres	5.50%	5.00%	5.00%
Retail Warehouse (open A1)	5.25%	5.25%↓	5.25%↓
Retail Warehouse (restricted)	5.75%	6.00%↓	6.00%↓
Foodstores	4.50%	4.50%	4.50%
Industrial Distribution	6.25%	6.00%	6.00%
Industrial Multi-lets	6.00%	6.00%	6.00%↓
Leisure Parks	6.25%	6.25%	6.25%
Regional Hotels	7.00%	7.00%	7.00%

Table source: Savills

Is this the 'true' start of the recovery?

■ To the relief of George Osborne the UK avoided triple dip with Q1 GDP up 0.3%. Year-on-year this was the biggest annual rise since Q411 at 0.6%.

■ Service industries were the principal drivers with a 0.6% quarterly increase, with Transport, Storage & Communications reporting the greatest growth of 1.4%. Business services & finances grew by a modest 0.2%. Construction continues to be the biggest drag on output with a 2.5% fall this quarter, with a year-on-year decline of 5.9%.

■ The hope is that this avoidance of a triple dip will foster a return in consumer spending. Without it growth will remain relatively lack lustre with forecasts suggesting 0.9% growth in GDP this year increasing to 2.0% in 2014.

■ As seen previously, consumer confidence tends to track economic performance (graph 2). GfK NOP's confidence indicator held at -26 in March for the third consecutive month, however, dipped to -27 in April. Our belief is that this dip was probably due to the negative press surrounding a potential triple dip. Its unexpected avoidance and news flow suggesting that the UK economy is finally recovering should help confidence tick back up over the next few months.

Offices, still the ideal

■ The deepening shortage of grade A office space, particularly in the regions, has seen a number of investors acquire assets for refurbishment. Hines and Moorfield's purchase and subsequent refurbishment of Five Brindleyplace in Birmingham is a prime example. Considering that Savills refurbishment PMI has averaged 7.5 points since January 2012, exceeding the 2.5 average seen across total activity, this is likely to continue for some time.

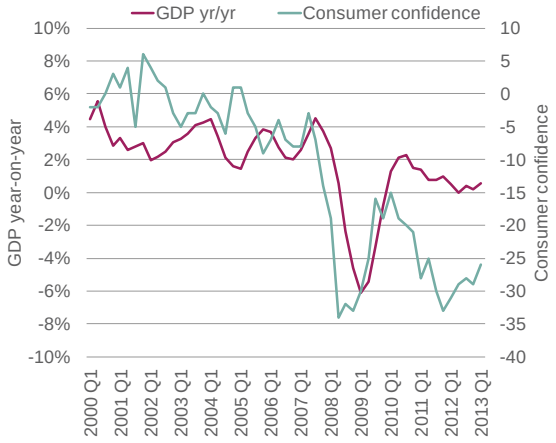
■ But how can you make refurbished space attractive? Based on our recent survey with the BCO (British Council for Offices), it would appear that it is getting the basics right that are key.

■ The survey of over 1,000 office workers in the UK into their workplace preferences found that beyond location, comfort, temperature and lighting were top rated features in the ideal office with external building design rated as important by only 14%.

■ The percieved decline in corporates need for offices due to alternative ways of working looks unlikely if responses from our survey are anything to go by. Despite increased homeworking there remains strong appetite from employees to be in the office particularly from younger staff. For example, for 18-34 year olds, a dedicated office workstation was the top rated place to work from. With occupier property decisions increasingly being determined by the preferences of their staff, it appears the office is far from dead.

GRAPH 2

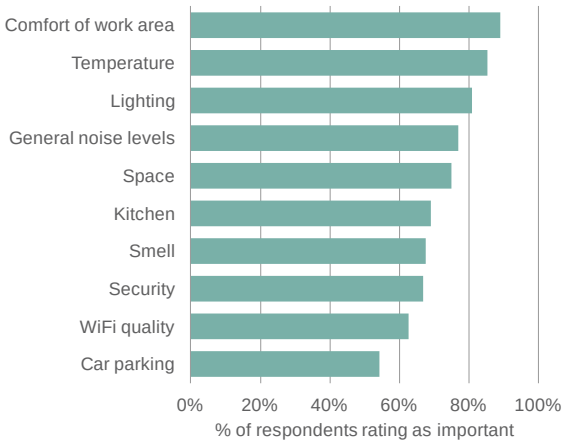
Triple dip avoidance could see a return in consumer confidence



Graph source: ONS; GfK NOP

GRAPH 3

The top 10 office features



Graph source: Savills; BCO; YouGov

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