RESEARCH & FORECASTING UK

PROPERTY PRICING SURVEY

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Executive Summary

- Property continued to be a selective buy across all sectors in Central London and the South East, ranging from a 36% preference for Central London industrials to 86% for South East industrials.
- Other geographic locations remained mainly sale targets across all sectors.
- The north/south divide has continued from the March 2012 survey, with the south a buy and the north a sale.
- The 2012 total return was again revised down quite sharply, by 260 bps (250 bps March survey) to 1.0% pa from 3.6% pa in the March survey (6.1% pa November 2011).
- Total return for 2013 was also revised downwards to 6.1% pa, a 100 bps drop from the March survey of 7.1% pa (7.9% pa November 2011 survey).
- Yield movement for prime saw an average 29 bps increase, greater than the 16 bps seen in the March survey.
- Secondary yield outward movement was greater, with an average of 56 bps across all sectors. Secondary property is bearing the brunt of negative sentiment.
- Prime continued to be overpriced except for offices and distribution, unchanged from the March 2012 survey.
- Secondary was underpriced except for secondary retail units and shopping centres.
- Rental growth for 2012 was again downgraded, on average by minus 60 bps, with all sectors forecasting negative growth at minus 1.6% pa on average. Rental growth for 2013 improved over 2012, although remaining negative at minus 0.3% pa. Office, retail warehouse, industrial and distribution rental growth moves into positive territory for 2013.
- Capital growth for 2012 was more aggressively reduced than rental growth, by an average of 280 bps. For 2013, only two sectors remained in negative territory – business parks and retail shop units.
- For reasons to invest in property now, 43% of respondents said income; 43% said property provided a beneficial yield level compared to the other asset classes, especially when compared to government bonds, and 36% said property benefited from low volatility.
- Asked what effect the eurozone uncertainty was having on the UK property market, most responses were negative: 43% of respondents said it was contributing to a lack of confidence for both the economy and business and 36% said it was delaying formative decision making.
- Asked what proportion of property lending will be non-bank in a year's time, only 43% of respondents provided a figure - which was in the range of 10% to 40% of new lending to UK property.
- 50% of respondents said that they would invest in infrastructure, but there were words of caution.

"The north/south divide, has continued, with the south a buy and the north a sell."

"The 2012 total return was again revised down quite sharply, to 1.0%."

"50% of respondents said that they would invest in infrastructure."

Investment Intentions

Property was very much a selective buy across all sectors in Central London and the South East: offices – Central London preferred by 79% of respondents, South East by 64%; retail – Central London by 57%, South East by 79%; and industrial – Central London by 36%, South East by 86%.

Other geographic locations were mainly a sell across all commercial sectors. This survey showed a more pronounced north/south divide, with the south a buy and the north a sell. For the offices sector, the sell side was diverse, with 43% of respondents looking to reduce exposure in the East Midlands, South West, North East and Yorkshire and Humberside.

The focus of investment activity tracks perceived economic growth and favourable employment prospects. Investors continued to be risk averse, with interest concentrated on Central London and the South East as the more positive locations.

Yield Levels

The average outward movement for prime yields was 29 bps across all sectors. All prime yields moved out except for business parks which saw a 10 bps reduction. The highest prime yield was for business parks at 7.5%, followed by industrials at 7.1%. The lowest prime yield continued to be retail shop units at 5.6%, followed by shopping centres at 6.1%. The average prime yield across all sectors was 6.5%, an increase of 20 bps from the March 2012 survey.

The outward movement in secondary yields was, again, greater across the sectors than it was for prime. The average outward movement across sectors for all secondary yields was 56 bps. The largest movement was 100 bps for secondary distribution from 8.9% to 9.9%. The lowest outward adjustment was seen in secondary business park yields, up 20 bps to 10.1%.

The average secondary yield across all sectors was 9.3% up from 8.7% in the March survey. The highest secondary yield was business parks at 10.1%, followed by distribution at 9.8%. The lowest secondary yield was retail warehouses at 8.4%, followed by retail shop units at 8.5%.

The gap between prime and secondary yields increased by 30 bps to 275 bps on average. There was a range in movement across the sectors, with retail warehouses seeing a reduction of 20 bps and distribution seeing an increase of 75 bps.

The biggest prime/secondary yield gap was in shopping centres with secondary 317 bps, followed by distribution with 305 bps. The smallest prime/secondary yield gap was in the retail warehouse sector – 201 bps, followed by business parks with 269 bps (see **Figure 1**).

Current Average Yield Levels %

Sector	Prime Rack Rented % pa	Secondary % pa
Offices	6.2 (5.8)	9.0 (8.6)
Business Parks	7.4 (7.5)	10.1 (9.9)
Retail Shop Units	5.6 (5.2)	8.5 (7.9)
Retail Warehouses	6.4 (5.9)	8.4 (8.1)
Shopping Centres	6.2 (6.1)	9.4 (8.8)
Industrials	7.1 (6.7)	9.8 (9.0)
Distribution	6.9 (6.6)	9.9 (8.9)

(March 2012 responses in brackets)

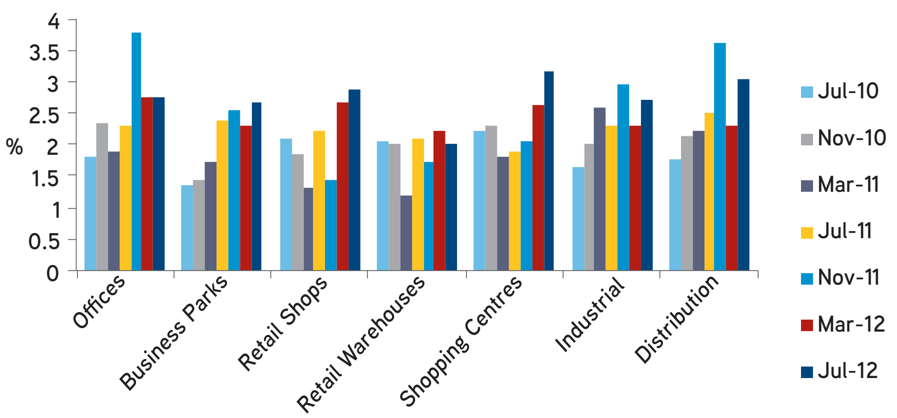
Overall, prime continued to be overpriced across the sectors except for office and distribution, as was the case in the March 2012 survey. Secondary was underpriced except for retail units and shopping centres. Secondary yields moved out more than prime, as secondary continues to bear the brunt of negative sentiment in the uncertain economic environment.

Rental Growth

Rental growth for 2012 continued to be downgraded, on average, by a further 60 bps from the March 2012 survey. All sectors were forecast to see negative rental growth. The biggest change was in the office sector – minus 110 bps, followed by business parks with minus 80 bps.

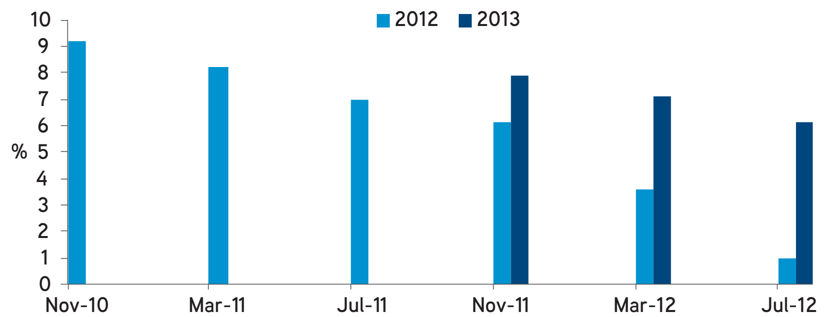
The average forecast rental growth for 2012 across all the sectors was minus 1.6% pa. Shopping centres were forecast to see the worst rental growth of minus 2.8% pa, followed by business parks at minus 2.6% pa. Although still negative, offices were forecast to see the best (or least poor) rental growth of minus 0.5% pa, followed by distribution at minus 0.9% pa.

FIGURE 1: PRIME VS SECONDARY YIELD SPREAD



Source: Colliers International/REC

FIGURE 2: CHANGE IN TOTAL RETURN EXPECTATIONS



Source: Colliers International/REC

Compared with the March 2012 survey, anticipated rental growth for 2013 deteriorated in all sectors except for shopping centres, which remained at minus 0.2% pa. The average downward adjustment was minus 90 bps. The average rental growth across all sectors was minus 0.3% pa.

For 2013, the picture was mixed across the sectors, with business parks, retail shop units and shopping centres remaining in negative territory, but offices, retail warehouses, industrials and distribution moving into positive growth.

The strongest rental growth forecast for 2013 was for offices at 1.0% pa, followed by both retail warehouses and distribution at 0.2% pa. The weakest rental growth forecast for 2013 was for retail shop units at minus 1.9% pa, followed by business parks at minus 1.2% pa.

2013 rental growth was forecast to be, on average, 130 bps better than 2012. The biggest beneficiary was shopping centres which saw a 260 bps improvement, followed by business parks at 140 bps. The smallest relative change was for retail shop units at 10 bps. Worries about the high street persist and the survey suggests that any sustained recovery will be post 2013. Only offices are expected to recoup their 2012 rental growth loss in 2013.

Latest Rental Growth Expectations – Average % pa

Sector	2012 % pa		2013 % pa	
Offices	-0.5	(0.6)	1.0	(2.3)
Business Parks	-2.6	(-1.8)	-1.2	(-0.1)
Retail Shop Units	-2.0	(-1.6)	-1.9	(0.2)
Retail Warehouses	-1.1	(-0.7)	0.2	(1.3)
Shopping Centres	-2.8	(-2.6)	-0.2	(-0.2)
Industrials	-1.2	(-0.6)	0.1	(0.4)
Distribution	-0.9	(-0.3)	0.2	(0.8)

(March 2012 responses in brackets)

Latest Capital Growth Expectations – Average % pa

Sector	2012 % pa		2013 % pa	
Offices	-3.3	(-1.2)	0.3	(1.3)
Business Parks	-7.1	(-3.2)	-0.6	(-0.7)
Retail Shop Units	-7.0	(-3.1)	-0.7	(0.1)
Retail Warehouses	-5.0	(-3.6)	1.0	(1.4)
Shopping Centres	-8.7	(-5.0)	0.1	(0.4)
Industrials	-5.1	(-2.8)	0.0	(0.0)
Distribution	-3.9	(-1.9)	0.1	(-0.2)

(March 2012 responses in brackets)

Capital Growth

Capital growth forecasts for 2012 were further downgraded from the March 2012 survey by another 280 bps on average. The biggest change was for business parks and retail units, which saw a negative adjustment of minus 390 bps, followed by shopping centres with minus 370 bps. The least affected sector was retail warehouses with minus 140 bps.

The forecast average capital growth across all sectors for 2012 was minus 5.7% pa (minus 3.0% pa March 2012). Shopping centres were forecast to see the worst capital growth in 2012 of minus 8.7% pa, followed by business parks at minus 7.1% pa and retail shop units with minus 7.0% pa. While still negative, the best sector was offices at minus 3.0% pa capital growth, followed by distribution at minus 3.9% pa.

The 2013 forecasts for capital growth saw further reductions from the March 2012 survey across all sectors except for distribution, which saw a slight improvement of 30 bps and business parks at 10 bps.

The average capital growth forecast across all sectors for 2013 was 0.0% pa, indicating that there was some stabilisation of the softening yields seen in 2012. Retail warehouses were forecast to see the best capital growth of 1.0% pa, followed by offices at 0.3% pa. The worst sectors were retail shop units at minus 0.7% pa and business parks at minus 0.6% pa. None of the sectors would recoup the forecast 2012 capital loss in 2013.

In looking at the relative change of the 2012 capital growth forecasts versus those of 2013, there was an average improvement of 570 bps. Shopping centres were forecast to see the best improvement - 880 bps, followed by business parks with 650 bps. There could be some mileage in investing in these two sectors if the anticipated bounce back proves correct. The smallest relative change was in the office sector at 300 bps, followed by distribution of 400 bps.

Total Returns

In the July 2012 survey, the 2012 total return was again revised downwards, quite sharply, by 260 bps (250 bps March survey) to 1.0% pa from 3.6% pa in the March 2012 survey (6.1% pa November 2011, 8.2% pa March 2011) – see **Figure 2**. 57% of respondents felt that this was due to softening yields and 43% felt that it was because of the issues in Europe combined with the global slowdown, creating much uncertainty.

Total return for 2013 was also revised downwards to 6.1% pa, a 100 bps drop from the March survey . It was, however, an improvement from the forecast 2012 total return figure. The main drivers for this performance were: gradual yield stabilisation and improvement in the occupier market (50% of respondents) and some improvement in capital growth, by 36% of participants.

Asked why invest in property now, 43% of respondents said income; 43% said property had a beneficial yield level compared to other asset classes, especially when compared to government bonds, and 36% said property was less volatile than other asset classes. Other reasons given were: real asset, active management opportunities, UK is a liquid market with landlord friendly leases and the perception of property as a hedge against inflation.

43% of the respondents said they would invest in other vehicles, mainly in joint ventures. Limited partnerships, property derivatives, property unit trusts and pooled funds were also mentioned. 21% of respondents said they would not invest in other vehicles and 36% had no opinion.

Topical Questions

As to the effect that eurozone uncertainty was having on the UK property market, most responses were negative: 43% of respondents said it was contributing to a lack of confidence for both the economy and business and 36% said it was delaying formative decision making. Other comments were: certain properties had become untradeable; it was the main driver of yield decompression; falling values were a direct consequence of this and there was the need for EU leadership. 21% of respondents felt that there was some benefit in that the UK was seen as a safe haven, but this was concentrated on London, exacerbating the poorer prospects for the rest of the UK. Also, it was mentioned that Southern European investors were entering the UK market for lot sizes of up to £50m and these investors did not care about yield levels.

As to what proportion of property lending would be non-bank in a year's time, only 43% of respondents provided a figure, which was in the range of 10% to 40% of new lending to UK property. 64% of respondents said most new lending would be from insurance companies. 36% felt that debt funds and opportunity funds would also play a part.

50% of respondents said they would invest in infrastructure, but there were several words of caution: as a specialist class there was a requirement for a distinctive skill set; the need for the correct debt/equity structure plus a clear exit route; the associated risk of the underlying infrastructure; better awareness of the downside; improved transparency and the potential regulatory uncertainty. On the more positive side, it was seen as a diversifier, providing stable, quality income flows. The provision of debt for infrastructure was also seen as an opportunity.

The Colliers International and Real Estate Capital Property Pricing Survey is in its 19th year. The survey analyses the pricing of the different property sectors for both prime and secondary product. Analysis is undertaken on yield levels, breaking down the capital and rental growth expectations and their relationship to total returns. Views on property investment compared to the other asset classes are obtained as well as responses to various topical property related issues.

This survey is unique. It analyses the views across the entire property investment community to provide a short term detailed market analysis of the industry's expectations for capital and rental growth. These results play an indispensable role due to the changing nature of the timing and pricing of property investment activity. There was a 19.4% response rate to the questionnaire, which is above average.

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