propertymark

Commercial Outlook

Q3

2023

KEY OBSERVATIONS AND HIGHLIGHTS:

Agent sentiment **continues to improve**, albeit from a low base.

Economic uncertainty continues to weigh heavily upon the commercial property sector.

Structural challenges continue to **hamper sector growth.**

67% of agents report that **interest rates are impacting property prices** and deal volumes.

Despite some challenges, **investment yield sentiment is positive.**

The Land and Yards sector continues to **set the pace**

The base rate was held in September, GDP is growing slowly, the construction materials price index is decreasing, and Propertymark Commercial agent sentiment is increasing in several key areas.

However, economic uncertainty remains and improvements in sentiment are generally from a low base. Stubbornly high inflation and interest rates continue to impact the sector causing our agents to forecast supply and demand imbalances over the coming 12 months. In short, investor appetite remains muted.

Viewed from Q3 2023, the commercial outlook is mixed. Land and yards continue to out-perform other sectors, whereas the pubs and restaurants continue to lag.

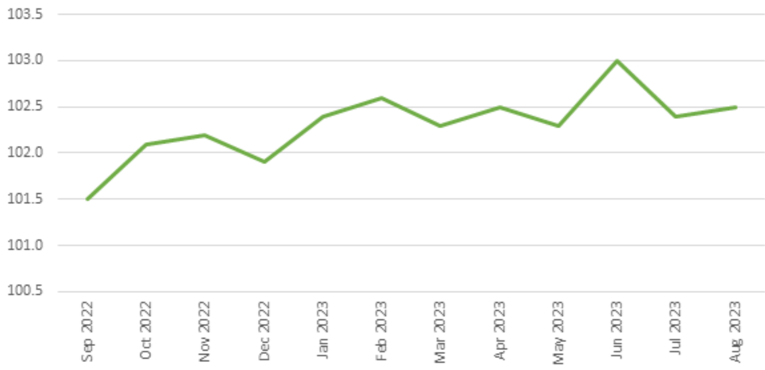
Our agents continue to be concerned about the planning process, lending restrictions, the speed of the legal process and increasing amounts of regulation and red tape. These structural issues need concerted effort by key stakeholders to realise improvements.

Nathan Emerson
Propertymark CEO

Economic **outlook**

The UK continues to face a cost-of-living crisis and the ongoing economic uncertainty is causing households and businesses to reduce consumption and investment. In addition, diverse factors including the ongoing trend for home working, legislative drivers (including net zero), stubbornly high materials prices, the availability of construction labour, continued supply chain bottlenecks and even weather patterns (floods), are among those impacting the Commercial Property Sector at large.

Figure 1: Monthly GDP Index



Source: Bank of England

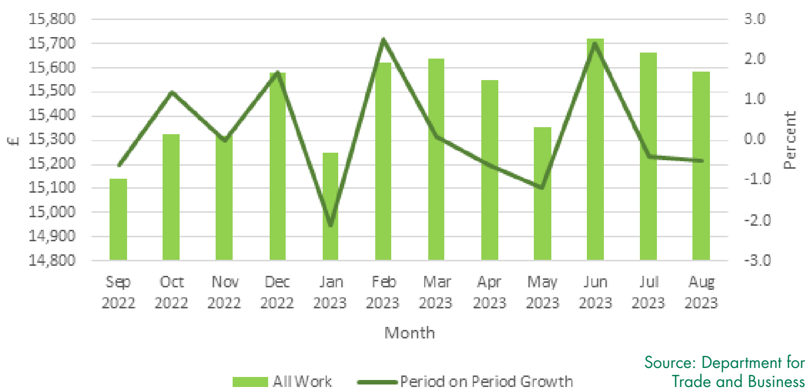
GDP GROWING SLOWLY

GDP continues its slow upward trend (Figure 1). Long-term forecasts vary, but the IMF predict 1% real GDP growth in the UK in 2024 against 1.5% for the Euro Area.

CONSTRUCTION SECTOR HOLDS BACK GDP GROWTH

The GDP growth evident in (Figure 1) has largely been driven by the service sector, with the contribution from the construction sector being negative. This can be seen in the monthly construction output price data, which shows a decrease from £15,719m in June 2023 to £15,662m in July 2023 and £15,584m in August 2023 respectively (Figure 2).

Figure 2: Construction output all work summary (Chained volume measure, seasonally adjusted, 2019 prices)

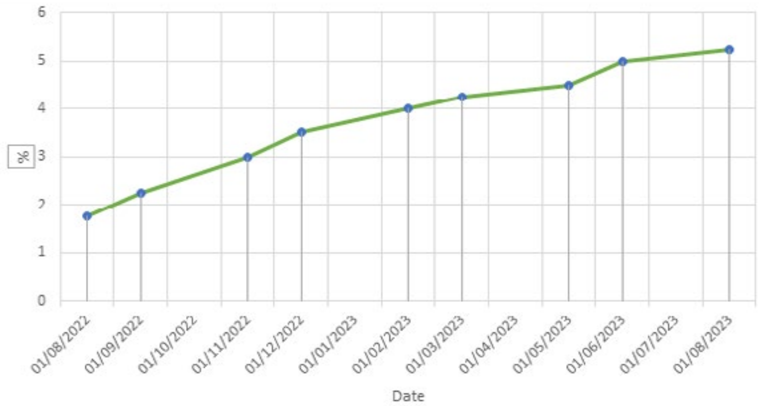


Source: Department for Trade and Business

BASE RATE REMAINS CHALLENGING

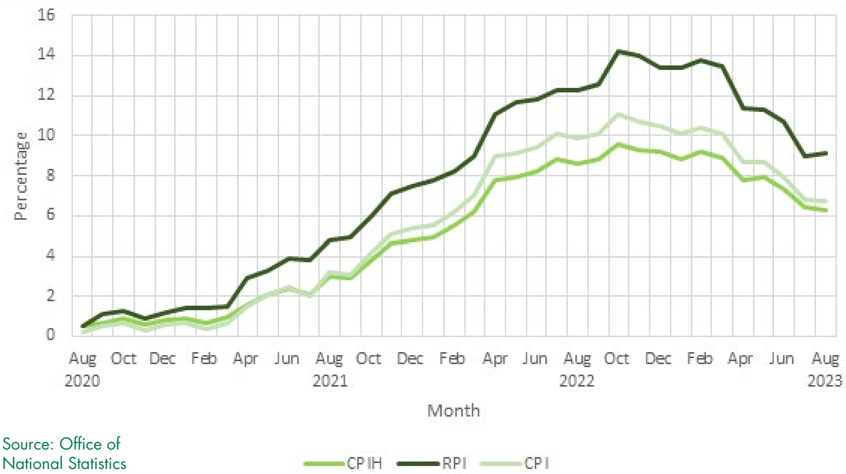
Although interest rates were held at 5.25% in September, there was little cheer for property deals. The rapid rise in the base rate over the last year is illustrated in Figure 3.

Figure 3: Bank of England base rate



Source: Bank of England

Figure 4: Inflation percentage change over 12 months



Source: Office of National Statistics

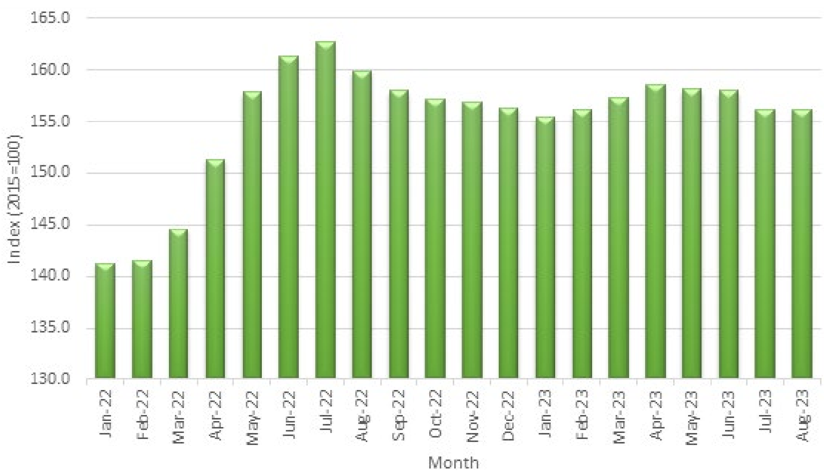
INFLATION REMAINS STUBBORNLY HIGH

Inflation remains stubbornly high despite the recent downward trend (Figure 4).

CONSTRUCTION MATERIAL PRICES REMAIN HIGH

Although the construction material price index in July and September were lower than the monthly average in the previous quarter, it remains far higher than at the start of 2022 (Figure 5).

Figure 5: Construction material price index: All work (2015=100)



Source: Department for Trade and Business

Supply and **demand**

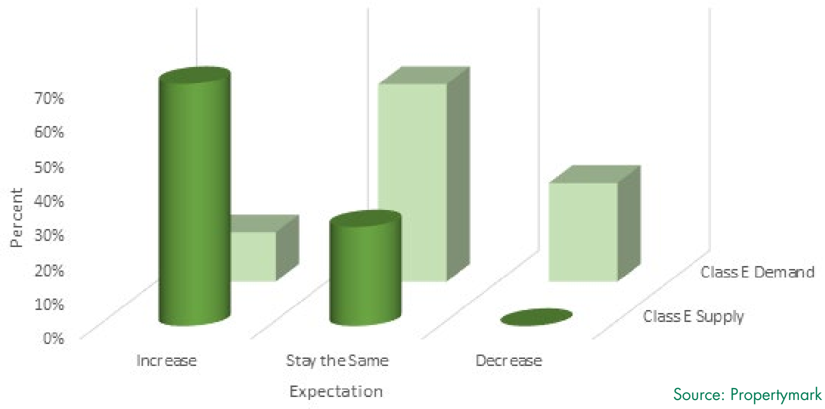
CLASS USE E SECTOR

In England, Class E incorporates a broad range of Commercial, Business and Service uses[1]. These include everything from the display and sale of goods (Class E(a)) to the provision of medical or health services (Class E(e)).

We asked our members what they expected to happen to supply and demand levels within the sector over the next 12 months (Figure 6). Over two-thirds (71%) forecast an increase in supply and the remaining 21% forecast that demand would be static.

However, almost a third of members surveyed (29%) expect demand to decrease and 57% expect it to remain the same, suggesting the emergence of a problematic supply and demand imbalance.

Figure 6: 12 Month Supply and Demand Forecast (Class E Sector)

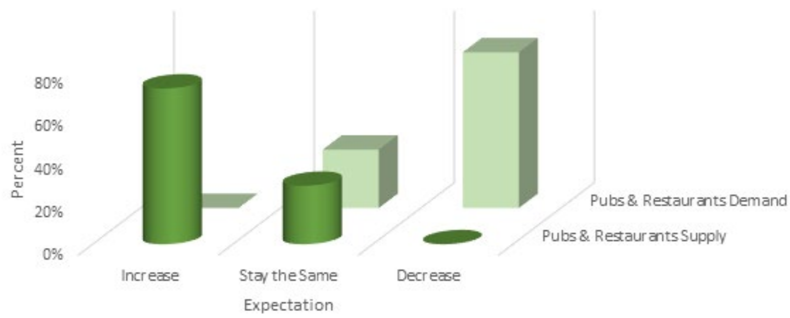


Source: Propertymark

PUBS AND RESTAURANT SECTOR

The events of the last few years have heavily impacted the Pubs and Restaurant sector, which is currently struggling to find its feet during the ongoing cost-of-living crisis. We asked our members what they expected to happen to supply and demand levels within the sector over the next 12 months (Figure 7).

Figure 7: 12 Month Supply and Demand Forecast (Pubs and Restaurants Sector)



Source: Propertymark

Reflecting challenging trading conditions, almost three-quarters (73%) of our surveyed members expect an increase of supply in the pubs and restaurants sector over the next 12 months.

The corresponding demand expectations are sobering, with the same percentage (73%) anticipating a decrease here. This supply and demand mismatch points to another challenging 12 months for the sector.

[1] Use classes differ in other parts of the UK.

OFFICE SECTOR SUPPLY AND DEMAND

The office sector has been heavily impacted by the trend of home working that commenced during lockdown. Although there are some signs of workers returning to the workplace, numbers are far below pre-pandemic levels.

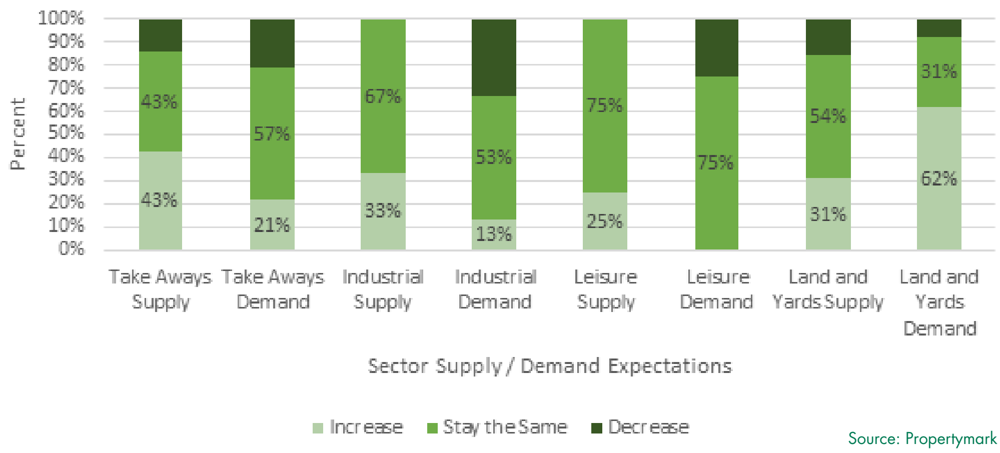
We asked our members what they expected to happen to supply and demand levels within the sector over the next 12 months (Figure 8). Whilst there will be significant fluctuations between markets, the majority of our agents (58%) predict that supply will increase in the coming 12 months.

Figure 8: 12 Month Supply and Demand Forecast (Office Sector)

Source: Propertymark

Unfortunately for landlords, many of our agents (47%) also forecast a significant downturn in demand.

Figure 9: 12 Month Supply and Demand Forecast (Other Sectors)



Source: Propertymark

OTHER SECTORS

Supply and demand expectations fluctuate over the remaining sectors (Figure 9). For example, in the Take Aways Sector, a supply imbalance is predicted with a slightly higher forecast increase in supply (43%) than in demand (21%). A similar picture emerges in the Industrial Sector (33% and 13% respectively).

With regard to the Leisure Sector, the majority of members forecast that both supply and demand will remain the same. However, whilst 25% forecast an increase in supply, there is no corresponding increase forecast in demand, in fact, a 25% decrease in demand is forecast.

In the Land and Yard Sector, 85% of agents forecast that supply will remain the same or increase and 93% suggest the same for demand.

Capital values

ALL SECTORS

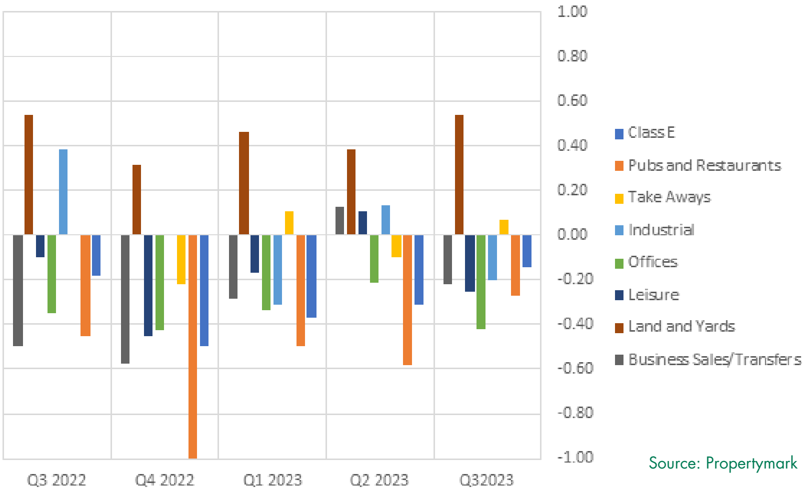
CAPITAL VALUES TO REMAIN SUPPRESSED IN MOST SECTORS

We asked our expert agents whether they expect capital values to increase, decrease or stay the same over the next year within each of the sectors in which they operate (Figure 10). Their responses are converted to a numeric scale bounded by 1 and -1 and reported below. Positive values indicate that most respondents expect capital values to rise or remain the same over the next year. Negative values indicate that most respondents expect capital values to fall or remain the same[2].

In comparison to previous quarters, we can see that sentiment towards the Land and Yards Sector remains positive. And in a change from last quarter, sentiment towards the Takeaway Sector has improved. However, in the Business Sales/Transfers, Leisure, Industrial and Hotels Sectors, sentiment has become negative.

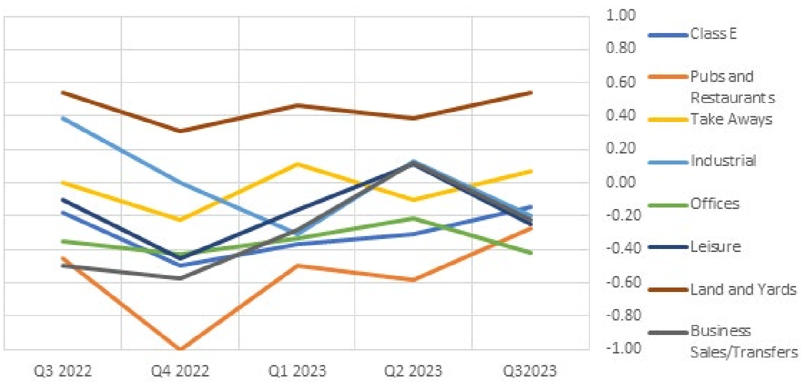
If we look at the data in a different format, we can see market sentiment trends more clearly (Fig 11). Though still negative overall, the outlook for Class E value has been trending upward over the last three quarters. Similarly, the outlook for Pubs and Restaurants remains challenging, but the situation has improved since Q4 2022.

Figure 10: Capital value expectations over the next 12 months (all sectors)



Source: Propertymark

Figure 11: Trends in capital value sentiment (all sectors)



Source: Propertymark

[2] The same methodology is adopted for our insights into rent levels and net yields.

Rent levels

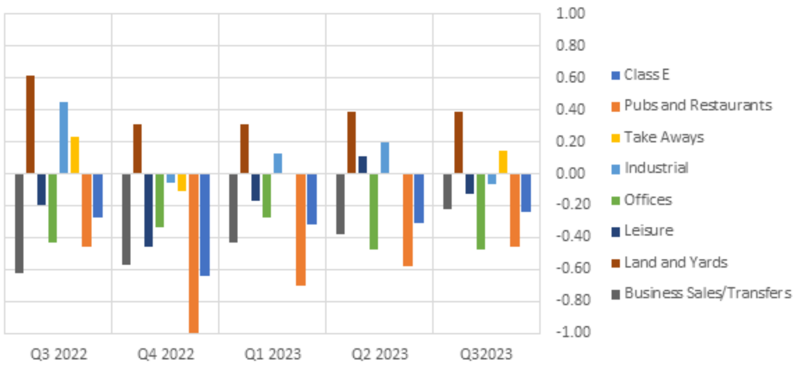
ALL SECTORS

We asked our members about their expectations for rent levels[3] in the coming twelve months. Reflecting the strong sentiment identified in the previous section, the majority of agents report that rents in the Land and Yards Sector would increase or stay the same (Figure 12).

However, with the further exception of the Take Aways Sector, rental sentiment amongst agents is largely negative. This is not surprising given some of the supply and demand imbalances that were identified earlier and the uncertainty that remains within the UK economy.

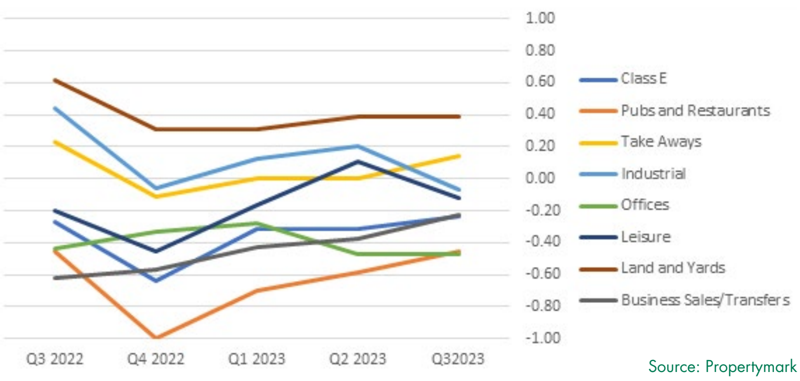
Again, the trends are interesting (Figure 13). There are quarter-on-quarter increases in sentiment in several key areas, but these are generally from a low base.

Figure 12: Rent level expectations over the next 12 months (all sectors)



Source: Propertymark

Figure 13: Trends in rent levels sentiment (all sectors)



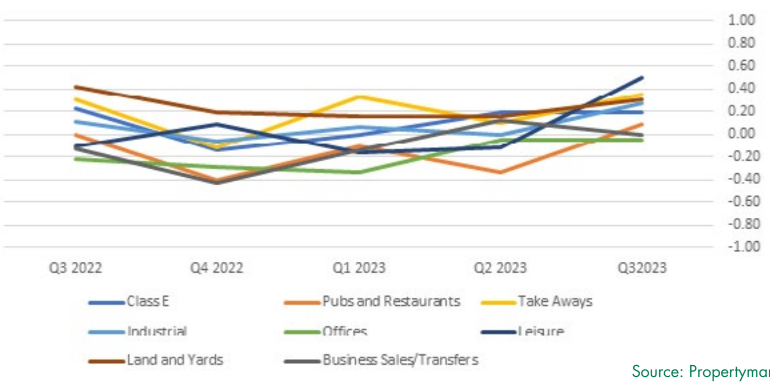
Source: Propertymark

Investment yields

ALL SECTORS

Despite the challenging environment, when we asked our agents about their expectations for investment yields in the coming twelve months, they forecast growth in most sectors (Figure 14).

Figure 14: Trends in investment yield sentiment (all sectors)

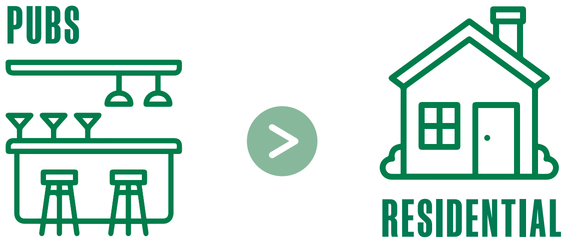


Source: Propertymark

[3] ITZA levels in the case of the Class E sector.

Key trends

We continue to monitor key trends in the commercial property sector and this quarter focuses on repurposing, lending costs, cash purchasers and EPCs.



PUBS CONTINUE TO BE REPURPOSED FOR RESIDENTIAL ACCOMMODATION

We asked our agents to identify key repurposing trends and 19% reported a repurposing of pubs to residential accommodation and in particular HMO-type accommodation. This is not unexpected given the negative sentiment expressed toward the Pubs and Restaurant Sector earlier.

REPURPOSING

When asked about repurposing, 38% of agents report that retail space continues to be lost to alternative uses. However, two other trends remained strong, namely the repurposing of former pubs and banks.

BANKS REPURPOSED TO RESIDENTIAL ACCOMMODATION AND CLASS E USES

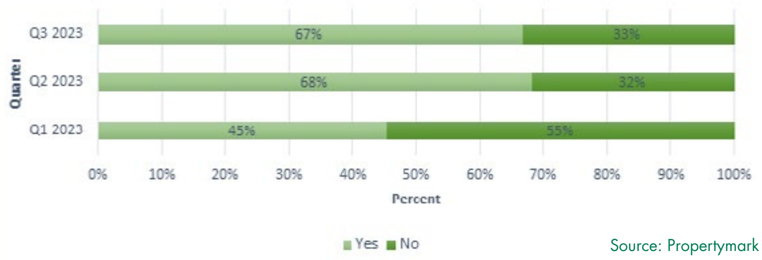
We specifically asked agents how defunct bank branches were being repurposed. Although several alternative uses were highlighted, many reported Health, Beauty, and Medical uses as well as Coffee Shop and Niche Retail uses. In many cases, banks were being repurposed to provide a mix of residential and retail space.

LENDING COSTS

INTEREST RATES CONTINUE TO IMPACT PRICES AND DEAL VOLUMES

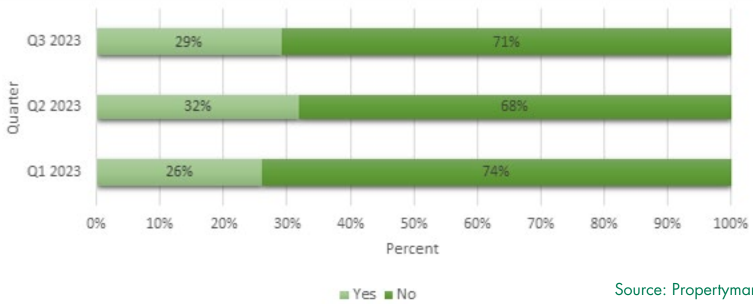
Although interest rates were held in September 2023, they have risen rapidly over the last year (Figure 3). We asked our agents if higher lending costs are hitting both prices and deal volumes. The responses were broadly the same as last quarter with 67% saying yes and 33% saying no (Figure 15). Interest rates will likely continue to subdue the market for the foreseeable future.

Figure 15: The proportion of agents reporting that higher lending costs are hitting both prices and deal volumes



Source: Propertymark

Figure 16: The proportion of agents reporting an increase in cash purchases



Source: Propertymark

CASH PURCHASERS

CASH CONTINUES TO BE KING

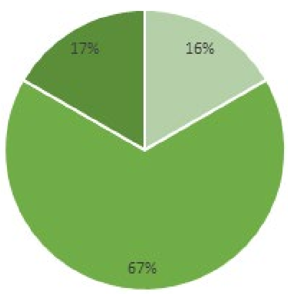
In Q4 2022, our agents pointed to an increase in the number of cash purchasers. We have continued to monitor this trend. This quarter, the proportion of agents reporting an increase in cash purchases has fallen slightly from 32% to 29% (Figure 16). With interest rates currently sitting at 5.25%, it is not clear how long this trend will continue.

EPCs

EPCS BEGINNING TO BITE

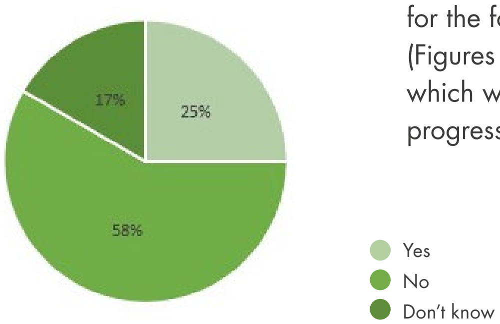
Given the increasing focus on Net Zero targets, we asked our agents if the EPC ratings were becoming an increasing material consideration during rent reviews and renewal negotiations. 16% said yes for the former and 25% for the latter (Figures 17 and 18). This is an area in which we expect further change as we progress towards 2050.

Figure 17: are EPCs materially affecting rent review negotiations?



Source: Propertymark

Figure 18: are epcs materially affecting lease renewal negotiations?



Source: Propertymark

Agent insights

We asked our agents to provide some general market insights and to identify the key challenges currently facing the sector. These are summarised below.

GENERAL MARKET INSIGHTS

There has been a **general slow-down in retail**, office, and light industrial enquiries.

There is strong demand in workshops and storage, coupled with **good rent reviews**.

Lender valuers appear to be taking a **more cautious approach to valuation.**

KEY CHALLENGES

Ever increasing amounts of regulation and red tape.

Reluctance of banks and building societies to lend.

High interest rates.

Lack of confidence in the economy

The legal process is getting slower and slower.

Deals are being delayed, frustrated, and derailed by planning delays.

HOW CAN WE HELP?

Should you need further information or potential comment contact: mediaenquiries@propertymark.co.uk

Our media team can connect you with expert property professionals, data, and insight to create media content that better engages with audiences. Our unique position enables us to deliver focused insight based on market conditions, government policies/ambitions, mortgage/interest rates, sales, lettings, property auctioneering, and cost of living issues related to property.

TAKE THE NEXT STEP

The views and figures in this Propertymark Commercial Outlook refer to the UK as a whole. Specific geographic locations and markets (city centre/suburban/etc.) will vary.

We strongly recommend that you contact a Propertymark commercial agent in your area to discuss opportunities that suit you. You can find your local agent at propertymark.co.uk/find-an-expert

There are several reasons why you should use an Propertymark commercial agent over any other:

INTEGRITY

As members of Propertymark, our agents have a proven dedication to professionalism within the commercial property sector.

CUSTOMER PROTECTION

Propertymark member agents are regulated by Propertymark, which is a nationally recognised regulatory brand, and provide high standards of service.

COMPLIANCE

Our members have access to the latest legal and best practice guidance.

ENDS

ABOUT THE PROPERTYMARK COMMERCIAL OUTLOOK

This report is based on a survey of Propertymark commercial agents conducted during the third quarter of 2023. It is further addended with an analysis conducted by Propertymark of key statistics relevant to the commercial property market.

ABOUT PROPERTYMARK

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Propertymark is a leading professional body of commercial and other agents. We are member-led with a Board which is made up of practicing agents and we work closely with our members to set professional standards through regulation, accredited and recognised qualifications, an industry leading training programme and mandatory Continuing Professional Development.

The Commercial division of Propertymark represents members who practice from over 650 offices and aim to reassure the public that by appointing a Propertymark Protected agent to represent them, they will be safeguarded and receive the highest level of integrity and service for all property matters.

EDITOR NOTES

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