propertymark

Commercial Outlook

Q4 2022

HIGHLIGHTS:

- Land/Yards sector expected to see rising capital values, rental levels and investment yields over the next year.
- Supply expected to rise in most sectors as effects off inflation and interest rates materialise.
- 84% of agents report deals agreed becoming less likely to reach completion as buyers seek to renegotiate.

SUMMARY

In November, NAEA Propertymark Commercial agents reported a worsening outlook in all sectors compared to last quarter. Recent political and economic turmoil as well as economic outlooks have dampened expectations of capital value, rental value, and investment yield growth.

The land and yards sector is seen as best placed to weather the pressures of inflation and interest rate rises with capital values, rental levels and investment yields all expected to rise over the next year by most agents caused by a continued lack of stock. For similar reasons, the industrial sector is next best placed to weather current turbulence.

The worst outlook for the next year remains in the pubs and restaurants sector. With cost-of-living concerns, energy prices and interest rate rises affecting tenants' bottom lines, combined with liquidations leading to rising supply, rental levels are expected to decline along with capital values and investment yields.

Interest rate rises are the biggest concern for agents at the moment, with many finding investors bargaining hard, even on deals already agreed. Agents are naturally seeing a rise in the proportion of cash buyers as budgets are squeezed for those highly leveraged.

It is clear from our latest report that economic uncertainty and rising interest rates have begun to affect the market for commercial property sales and lettings. Cash buyers will lead when it comes to property purchases over the next year, with members already seeing a decrease in highly financed investors purchasing property.

Our members have highlighted once again a lack of supply in the commercial sector as a whole. This is most pronounced in the industrial sector and has been caused by high demand, a lack of speculative building, and developers chasing profits in the residential sector to the detriment of commercial.

At the same time, members are expecting a rise in stock across almost all sectors in the coming year. Not all sites are likely to be re-used in line with previous planning consent as some sectors, such as pubs and restaurants, are hit harder than others. Members reported that change of use planning permission can now take over three months to obtain. Such waits are likely to leave property vacant for significant periods and put pressure on highly leveraged landlords who will struggle to pay their mortgages.

Specific concessions from landlords are likely to be necessary over the coming year to help out small businesses with rising costs and diminishing revenues. Again, pubs and restaurants and other leisure sector tenants are the most likely to need support in rent reviews. Still, securing lower rents may be difficult for some, as highly leveraged landlords are equally squeezed by rising interest rates.

Anthony Meadowcroft,
President
NAEA Commercial

LOOKING BACK

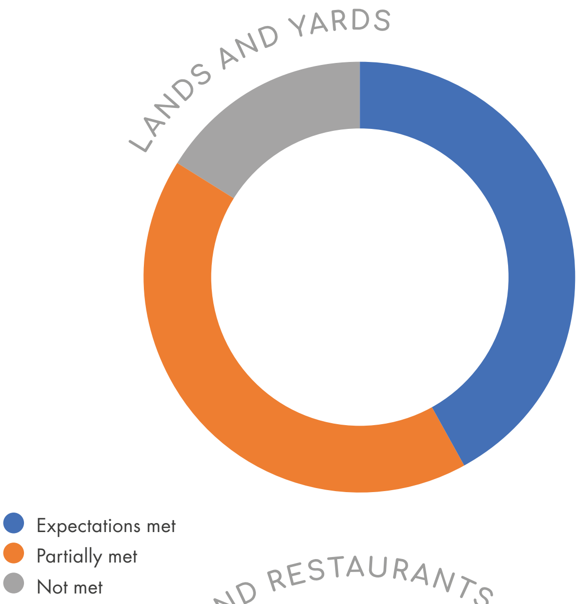
In Last quarter's Commercial Outlook, agents expected the best outlook for the land and yards sector. Capital value, rental levels and investor yields were all expected to rise over the next year by the majority of respondents.

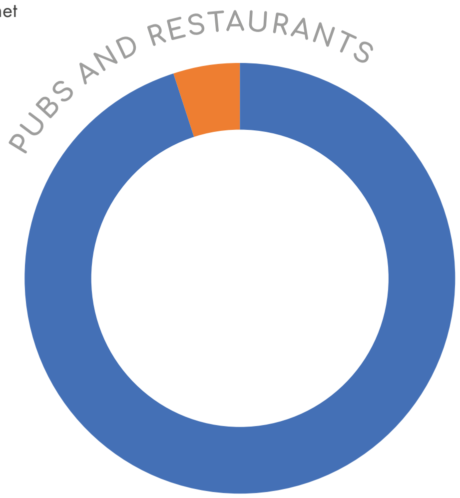
This quarter, we asked our agents whether they had seen this starting to materialise. 42 per cent reported that they had. Another 42 per cent reported that this has partially begun to materialise. 15 per cent had not seen this materialise as yet.

One agent commented, "there is still diminishing supply of land and yards so although demand has levelled the lack of supply is still holding prices level". The same may not be true for the whole of the UK as one agent commented, "industrial and warehousing remain strong but yields have begun to slip."

Similarly, agents expected the worst outlook was for pubs and restaurants last quarter. With a large mismatch in supply and demand, capital values were expected to fall. 95 per cent of agents reported in our latest survey that they had seen this begin to materialise over the last quarter.

Finally, agents reported in our latest survey that they found the retail sector had seen a change in fortunes over the last quarter with supply rising, and yields softening. One agent noted "demand for retail still good but not as strong as 6 months ago", and some rays of hope remain, with one agent reporting, "still extremely strong demand for secondary retail" in their experience.





The big issues

A LACK OF STOCK

In our Q3 survey, member agents reported having concerns about a lack of commercial stock. In the Q4 survey, we asked whether any sectors were particularly hard hit and the reasons for this. In line with other market observations, agents most regularly pointed to the industrial sector as that in which a lack of stock was most acute.

Causes noted:

- ECONOMIC UNCERTAINTY
- LACK OF SPECULATIVE BUILDING
- CONVERSION FROM COMMERCIAL TO RESIDENTIAL
- HIGH DEMAND
- INTEREST RATE RISES
- ISSUES WITH PLANNING CONSENT
- DEVELOPERS PREFER TO BUILD RESIDENTIAL AS MORE PROFITABLE
- MATERIAL COSTS

3 Months

With a lack of stock across the commercial sector, many prospective tenants are seeking change of use when they do find a property in the location they want. The trouble here is that our agents are reporting average waiting times for change of use planning permission to be granted is now over three months, with some experiencing delays of up to half a year. These delays inevitably put pressure on deals agreed and forces landlords into a difficult position with potential vacant property while waiting to see whether permission is granted.

ECONOMIC UNCERTAINTY

Our latest survey asked agents about the biggest issues facing commercial agents at the moment. The most common concern cited was interest rates. The rising cost of borrowing will adversely impact investors with highly leveraged portfolios. Agents are also seeing an increase in the number of buyers negotiating hard on price or attempting to renegotiate deals already agreed—when responding to our survey, 84 per cent reported deals agreed are becoming less likely to reach completion.

DEALS AGREED REACHING COMPLETION

LESS LIKELY	NO CHANGE
84.2%	15.8%

This situation has been compounded by conveyancing delays. In our latest survey, 84 per cent of respondents told us that they were experiencing issues with delayed conveyancing.

CONVEYANCING

EXPERIENCING DELAYS	NOT EXPERIENCING DELAYS
84%	16%

With economic uncertainty and interest rates affecting the market, 35 per cent of agents reported an increase in the proportion of cash buyers over the past quarter. Highly liquid investors will be best positioned to take advantage of any price reductions and fall throughs in the coming months.

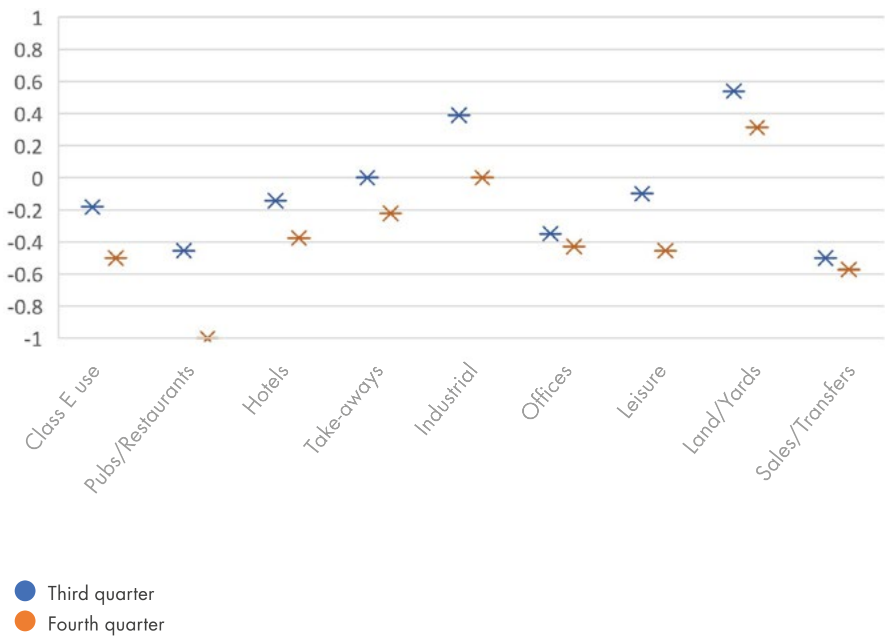
CASH BUYERS

YES	NO
34.78%	65.22%

THE NEXT TWELVE MONTHS: MARKET EXPECTATIONS

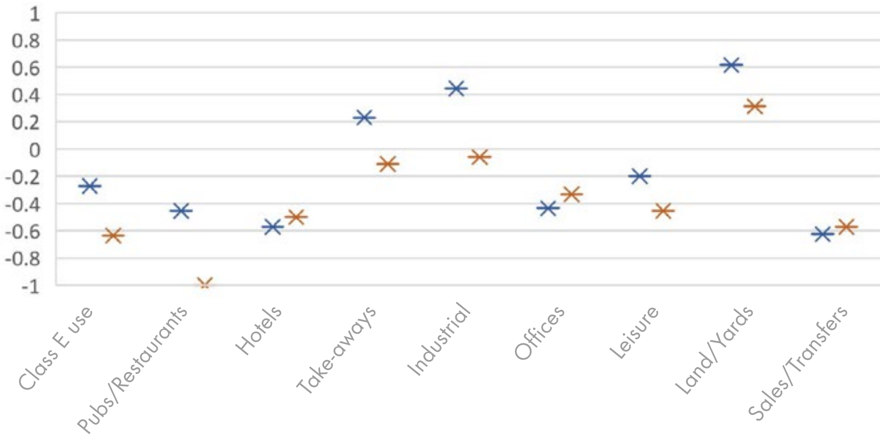
We asked our qualified agents whether they expect capital values, rental levels, investment yields, supply, and demand to increase, decrease or stay the same over the next year for all sectors in which they operate. Their responses are converted to a numeric scale bounded by 1 and -1 and reported below. Positive values indicate that the majority of respondents expected a rise in that factor over the next year. Negative values indicate that the majority of respondents expected a fall. All graphs refer to the UK.

CAPITAL VALUE



In comparison to last quarter's Outlook, expectations of future capital values are down across the board of commercial property. Nevertheless, industrial sector values are not widely expected to move much and values for land and yards are still expected to rise over the next twelve months. Commercial agents are now in complete agreement that capital values for pubs and restaurants are going to fall.

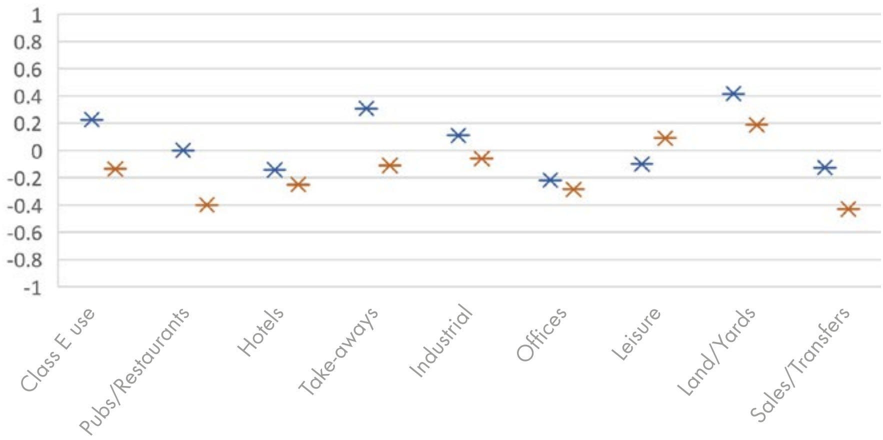
RENTAL LEVELS



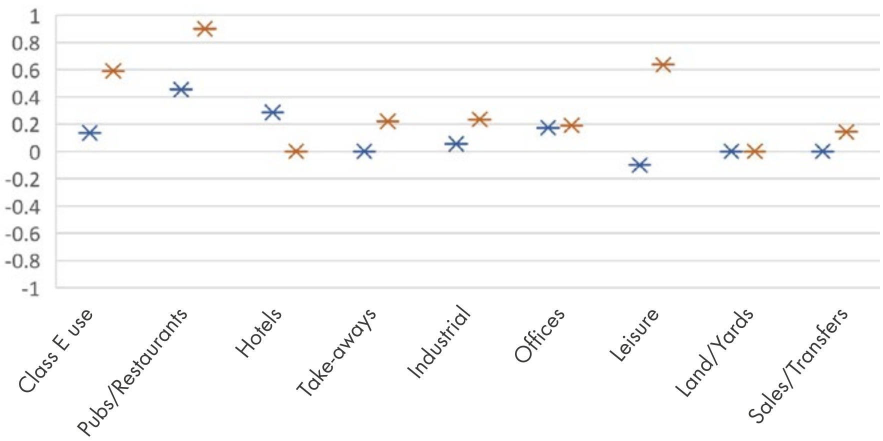
Expectations of rental level changes are broadly down from the Q3 Outlook, with land and yards being the only sector still expected to see rental value growth by the majority of responding agents.

INVESTMENT YIELDS

While expectations of yields in lands and yards has fallen, the majority of responding agents still expect these to rise over the next twelve months.



SUPPLY

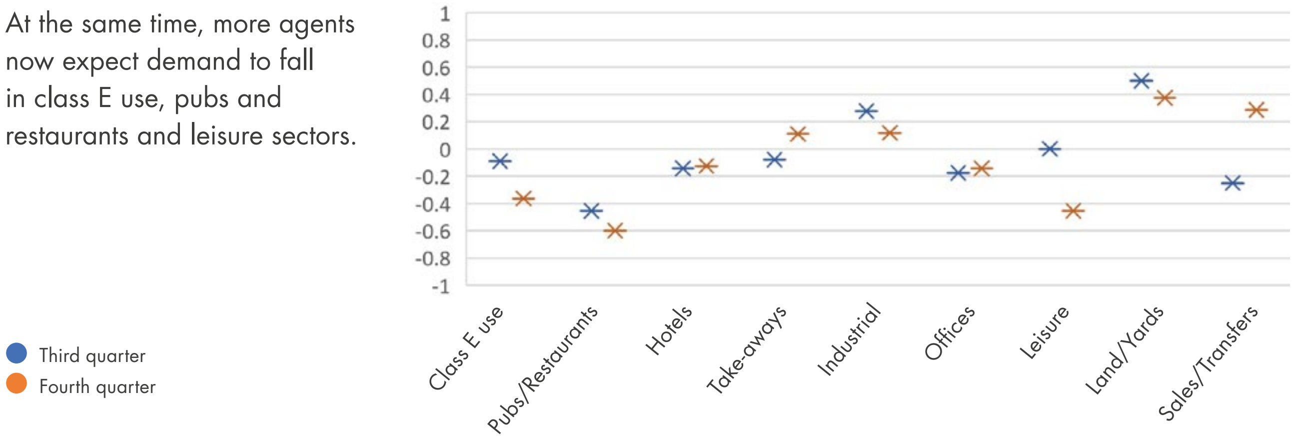


Since last quarter, more and more agents expect supply to increase in class E use, pubs and restaurants and the leisure sectors. Supply in other sectors is widely expected to remain steady, with some marginal increases.

Third quarter
Fourth quarter

DEMAND

At the same time, more agents now expect demand to fall in class E use, pubs and restaurants and leisure sectors.



Aside from capital value, rental levels, investor yields, supply and demand, our agents reported several other expected market trends to emerge over the next year.

REPURPOSING OF MANY PUBS TO RESIDENTIAL

REPURPOSING OF LARGE OFFICES TO RESIDENTIAL

INCREASE IN CASH PURCHASERS

HIGHER LENDING COST EXPECTED TO HIT BOTH PRICES AND DEAL VOLUMES

MORE SHOPS CLOSING

COST OF BORROWING PREVENTING GROWTH IN SECTOR

ANY TAX RISES AFFECTING CONFIDENCE

MORE OFF-MARKET SALES

THE UK ECONOMIC OUTLOOK

The following section is based on data provided by external sources. Latest expectations are that high inflation will persist into the new year before falling back to normal levels at the beginning of 2024. GDP growth is expected to enter negative territory and not re-emerge until mid-2024. Bank of England interest rates are expected to rise further, peaking between 4 and 5 per cent in 2023.

Sustained staff vacancy rates in key industries and no anticipated change in material prices suggest construction and refurbishment costs will remain high. On the other hand, an expected plateauing of prices will help investors to plan development and refurbishment projects with a greater degree of certainty regarding cost. Furthermore, evidence suggests that property remains a superior investment to primary alternatives.

INFLATION (CPI)

The Bank of England (BoE) expects inflation to peak by the beginning of 2023 before falling off sharply. With prices continuing to rise strongly over the next year, household and company budgets will be squeezed.

The recent energy price caps for domestic properties and businesses have helped somewhat in this regard but there will inevitably be less money for consumer spending and investments over the coming months. As previously discussed, the hospitality and leisure industries are likely to be the hardest hit by constrained consumer spending.

FIGURE 1: INFLATION PROJECTION TO Q3 2025

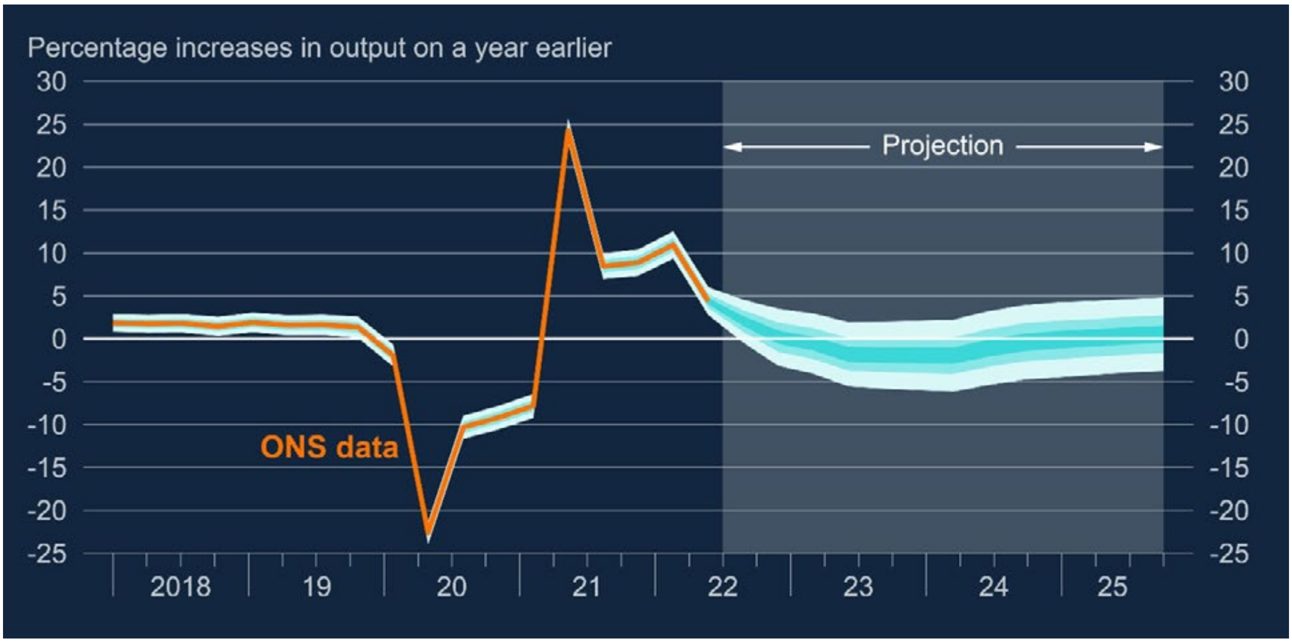
Source: Bank of England, *Monetary Policy Report—November 2022* (released 3 November 2022)

GDP AND GDP GROWTH PROJECTION

Current projections of GDP growth by the BoE show the potential for an elongated period of recession finishing in the first half of 2024. However, these projections take into account market expectations of BoE base rates which impact lending, including mortgage rates. The report itself states "further increases in Bank Rate may be required for a sustainable return of inflation to target, albeit to a peak lower than priced into financial markets". [1]

If this announcement has any impact on market expectations of its own Rate, recession may not last for as long as currently forecast.

FIGURE 2: GDP GROWTH PROJECTION TO Q3 2025



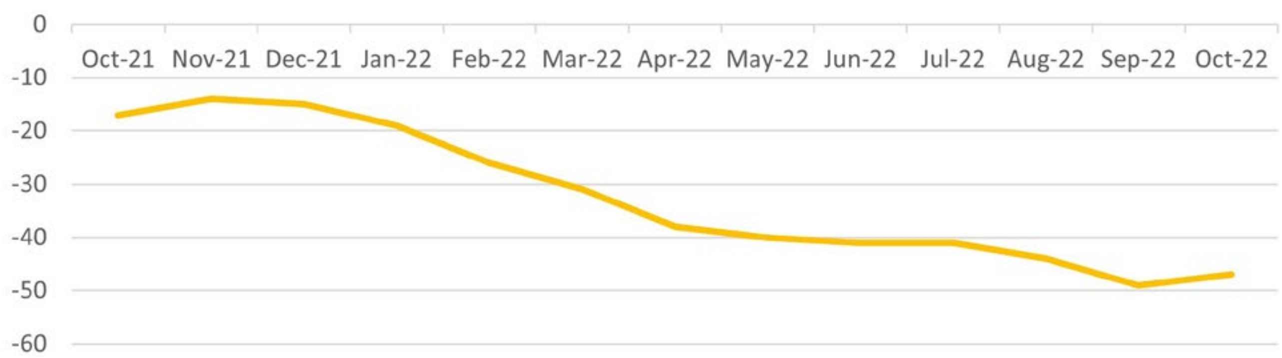
Source: Bank of England, *Monetary Policy Report—November 2022* (released 3 November 2022)

[1] *Monetary Policy Report—November 2022* (p6): bankofengland.co.uk/monetary-policy-report/2022/november-2022

CONSUMER CONFIDENCE

The GfK Consumer Confidence Barometer has taken a tumble over the last year hitting a low of -49 in September. Consumer confidence picked up slightly in October, possibly reflecting reassurance by energy price cap announcements. [2]

FIGURE 3: CONSUMER CONFIDENCE



Source: *GfK Consumer Confidence Barometer* (released 21 October 2022)

INTEREST RATES

Having analysed market conditions and wider expectations following the recent Truss-Kwarteng budget and BoE reporting, Trading Economics forecast UK interest rates to rise to 3.5 per cent by the end of the year. They further expect rates to slowly rise over 2023 to five per cent, although the BoE has itself suggested this is not likely to be the case. We could see interest rates levelling out closer to four per cent.

FIGURE 4: INTEREST RATE EXPECTATIONS

Source: Trading Economics | Bank of England (retrieved 9 November 2022)

[2] *GfK derive their monthly consumer confidence figures from questions about the present and future. Thus, it can also be seen as confidence in the UK economy over the next year by consumers.*

MATERIALS AND CONSTRUCTION

Data provided by the global consultancy firm, Linesight, shows construction material prices holding steady into the first half of 2023. A more static price level in construction costs will allow developers to be more confident when calculating the cost of build from residual valuations on developments.

Retrofitting costs, especially for environmental efficiency upgrades, can also be more accurately forecast in the run up to new minimum energy efficiency standards (MEES) requirements for letting commercial property coming into force on 1 April 2023. After this date, landlords cannot continue to let or sub-let property below an EPC E.

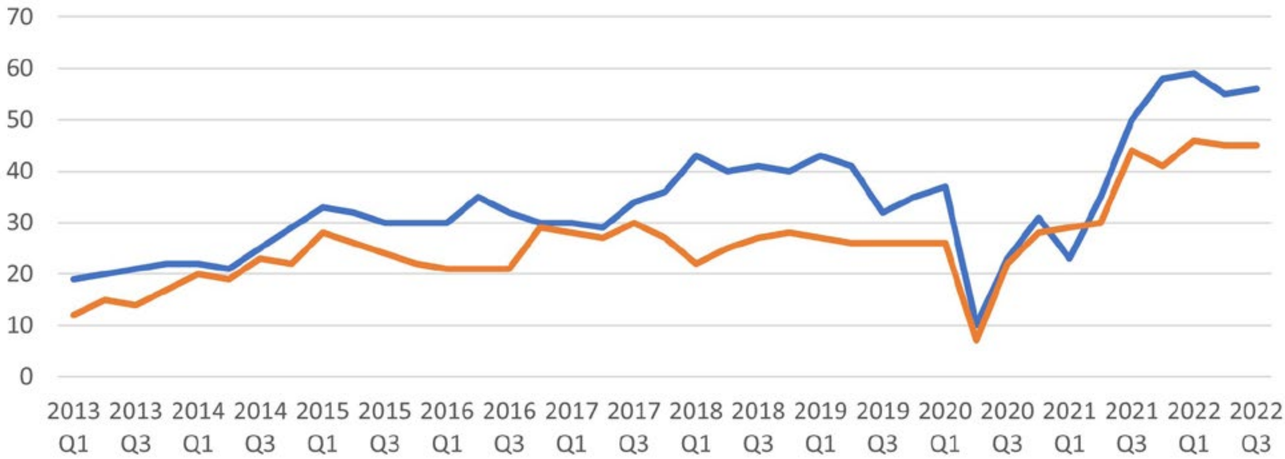
FIGURE 5: PROJECTED CONSTRUCTION MATERIAL PRICES

UK construction materials pricing (2021–22)

Source: *Linesight Global Country Commodity Reports* (released 27 October 2022)

Vacancies in the construction and transport and storage sectors rose sharply in 2021 and have remained high. With no immediate easing of a lack of staff, high costs of labour and delays in construction are likely to continue well into 2023. With a likely round of refurbishments needed ahead of MEES requirements coming into force, demand for labour and materials is likely to rise further.

FIGURE 6: VACANCIES

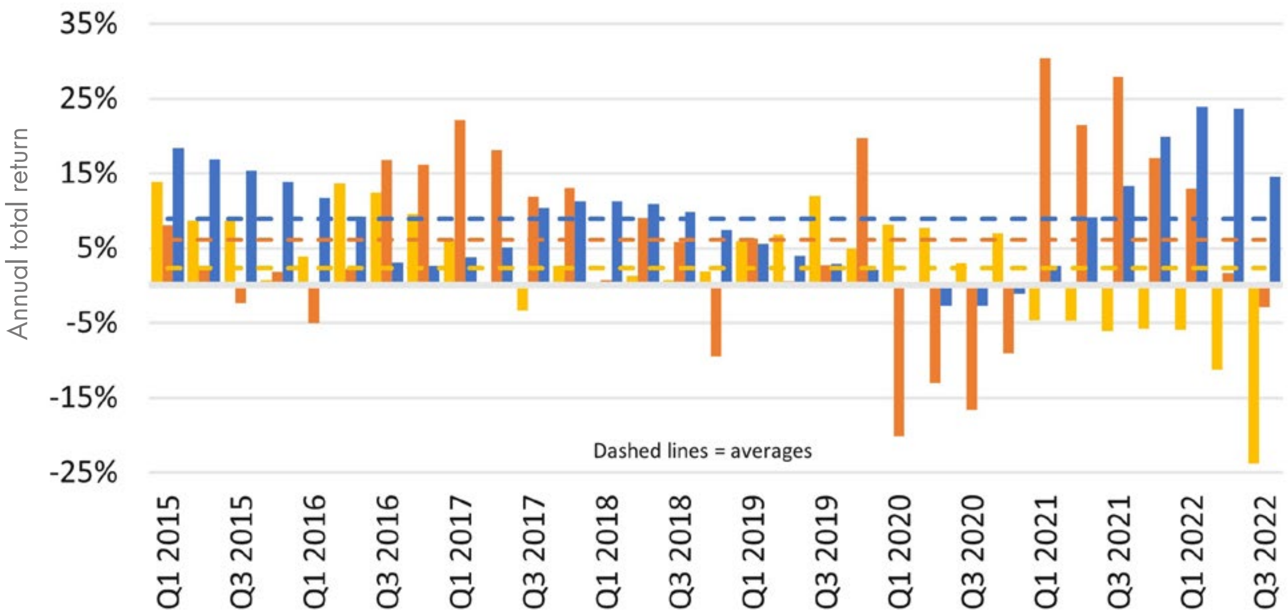


Transport and storage
Construction

Source: ONS

Despite the challenges the commercial property sector faces, recent analysis by Savills shows UK property has historically been a better investment than primary alternatives in terms of annual total returns.

FIGURE 7: TOTAL INVESTMENT RETURNS



Source: Savills, MSCI, FTSE, DMO

Ten year UK Government Bonds
FTSE All Share
All UK 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 NAEA 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 NAEA 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.

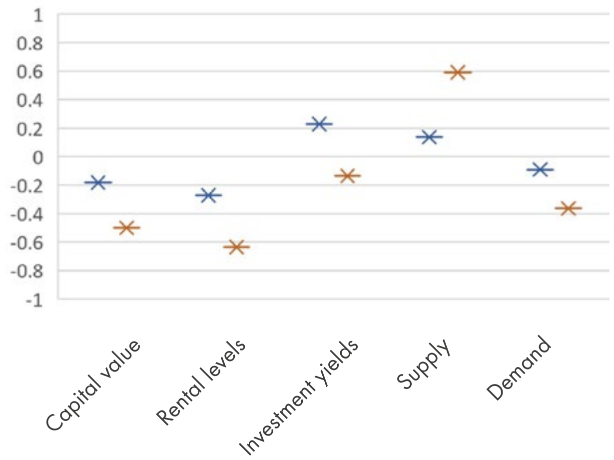
COMPLIANCE

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

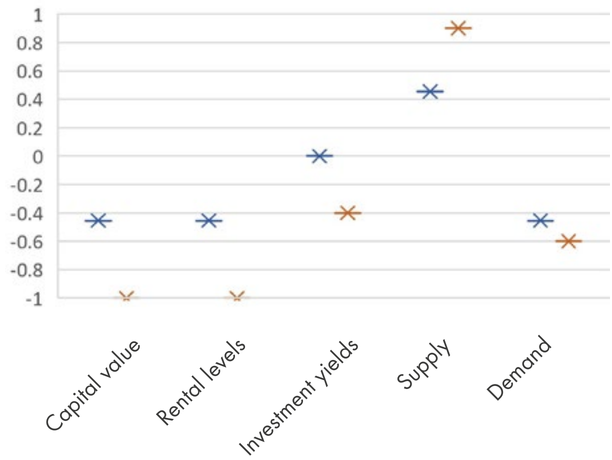
MARKET EXPECTATIONS BY SECTOR

The below graphs display the same expectations as those presented in the Outlook section above, but are grouped by sector for readers interested in specific divisions.

CLASS E USE

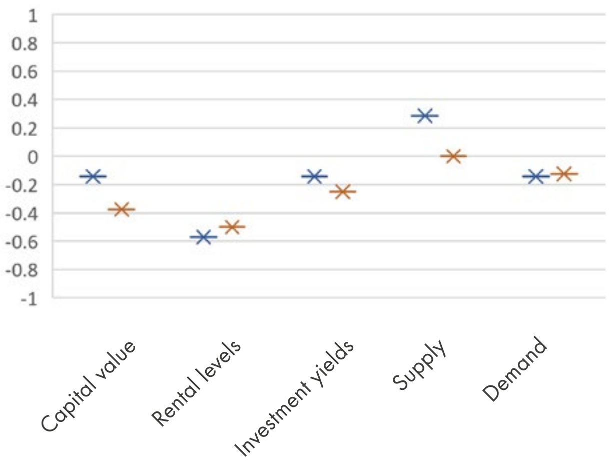


PUBS AND RESTAURANTS

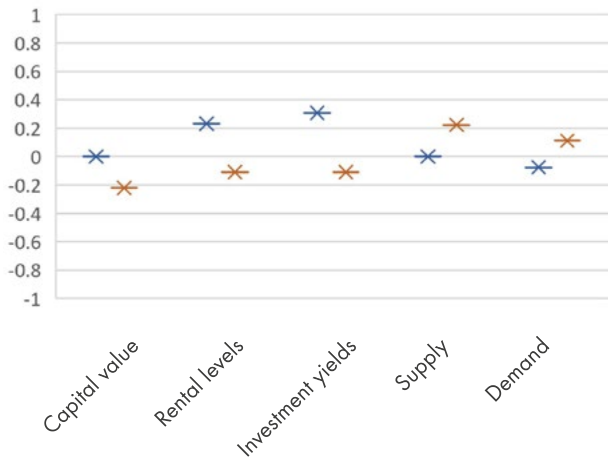


Third quarter
Fourth quarter

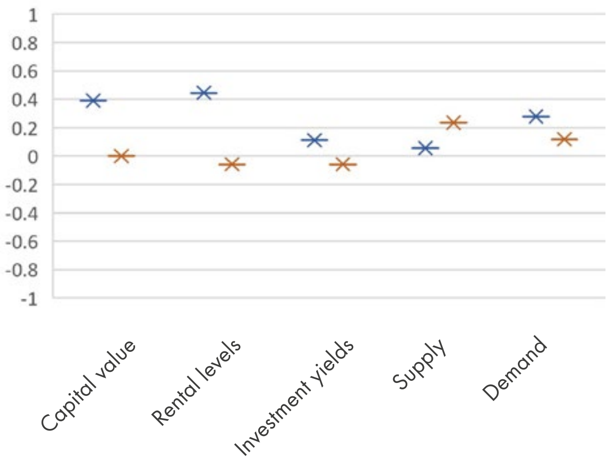
HOTELS



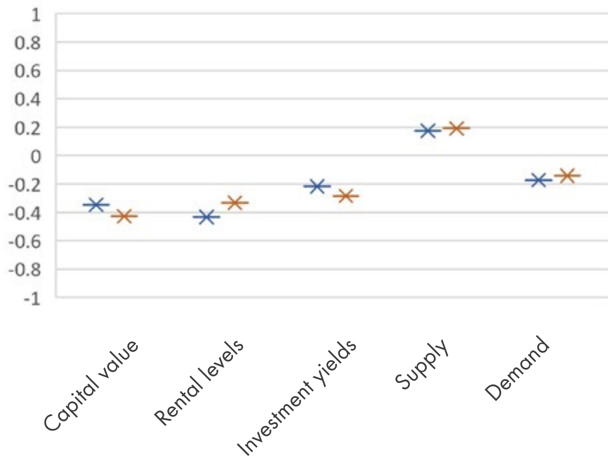
TAKE-AWAYS



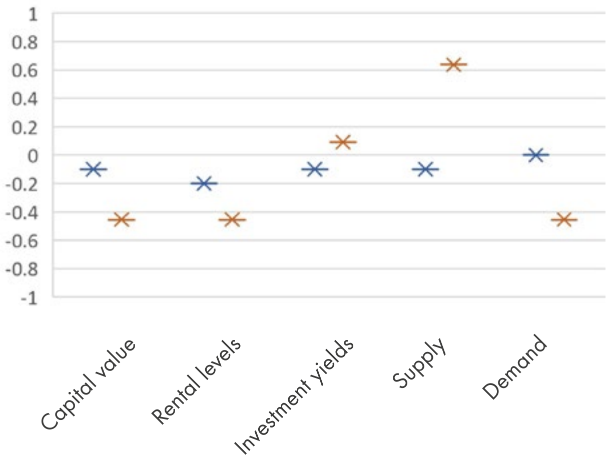
INDUSTRIAL



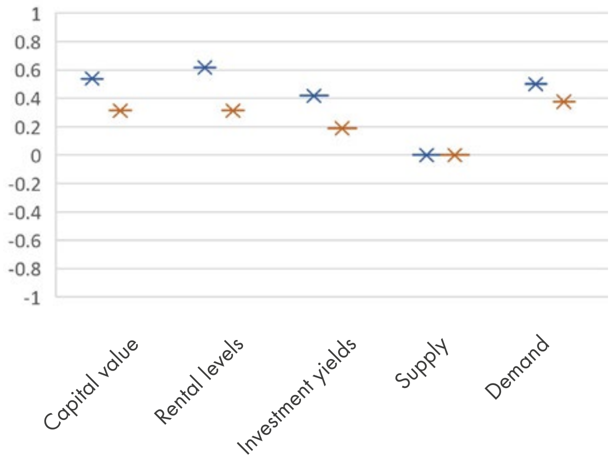
OFFICES



LEISURE



LAND/YARDS



Third quarter
Fourth quarter

ENDS

ABOUT THE PROPERTYMARK COMMERCIAL OUTLOOK

This report is based on a survey of Propertymark Commercial agents conducted between 27 October and 9 November 2022. It is further addended with an analysis conducted by Propertymark of key statistics relevant to the commercial property market.

ABOUT PROPERTYMARK

Propertymark is the leading professional body for commercial agents, estate and letting agents, auctioneers, valuers and inventory providers comprising nearly 18,000 members. 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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