propertymark

# Commercial Outlook

# Q4 2023

## KEY OBSERVATIONS AND HIGHLIGHTS:

**Rental sentiment** remains low in key sectors.

Members forecast **muted performance** in 2024.

**EPCs** continue to have a bearing on **rent reviews** and renewals.

**86%** of agents report that **high lending costs** continue to impact prices and deal volumes.

**38%** of members forecast a decrease in demand in **the Class E sector**.

**29%** of members report **rents staying the same** following review.

Nathan Emerson
**Propertymark CEO**

**Economic performance continues to be a challenge, with inflation, interest rates and construction material prices remaining stubbornly high.**

It is clear from member sentiment, that economic uncertainty, and interest rates in particular, are continuing to weigh on the commercial property market. Supply and demand imbalances continue in key sectors, suggesting that there will be a challenging start to 2024.

# Economic **outlook**

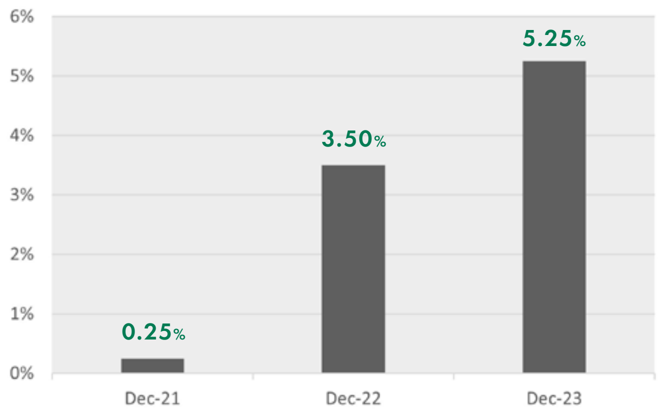
**Despite the interest rate being held in December 2023, uncertainty continues to pervade the UK economy. GDP growth is anaemic and there has been little change in inflation.**

## BASE RATE REMAINS UNCHANGED

The Bank of England Monetary Policy Committee voted (6 to 3) to hold the base rate at 5.25% in December 2023. Three members voted to increase the rate to 5.5%.

This relative stability is welcome although the rate remains high in comparison to December 2021 (0.25%) and December 2022 (3.5%) *(Figure 1).*

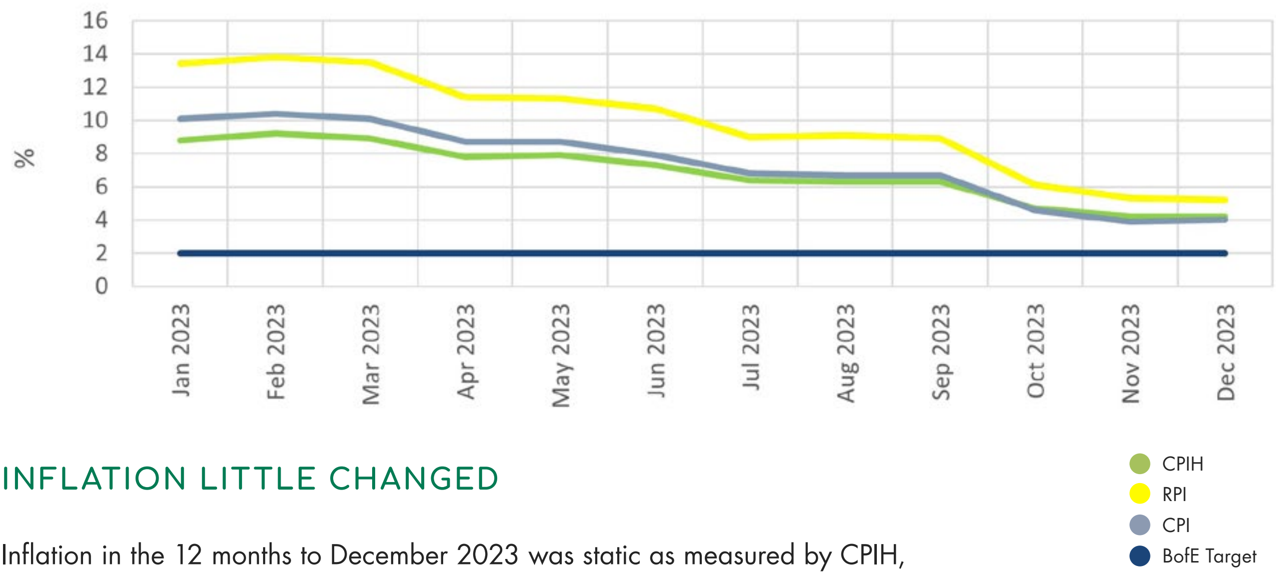
Figure 1: Bank of England base rate




Source: Bank of England

Figure 2: Inflation percentage change over 12-month period

Source: Office of National Statistics



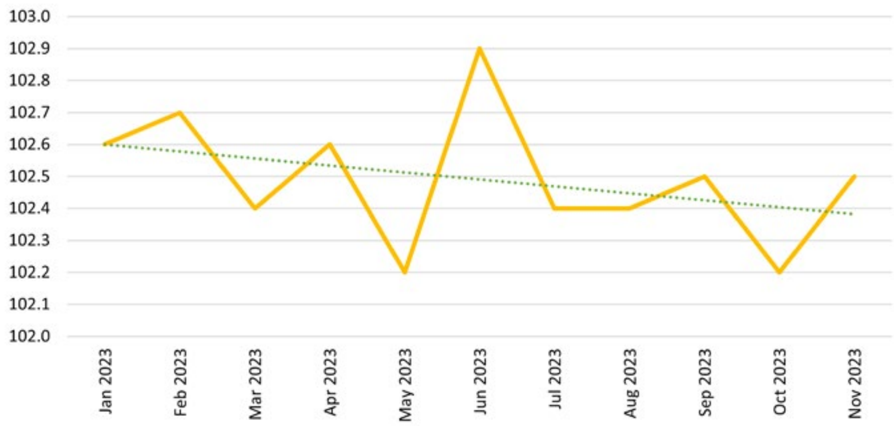

## INFLATION LITTLE CHANGED

Inflation in the 12 months to December 2023 was static as measured by CPIH, marginally up as measured by CPI and marginally down as measured by RPI *(Figure 2).* Whilst headline inflation has come down from highs earlier in the year, it remains somewhat off the Bank of England's 2% target.

## GDP GROWTH ANAEMIC

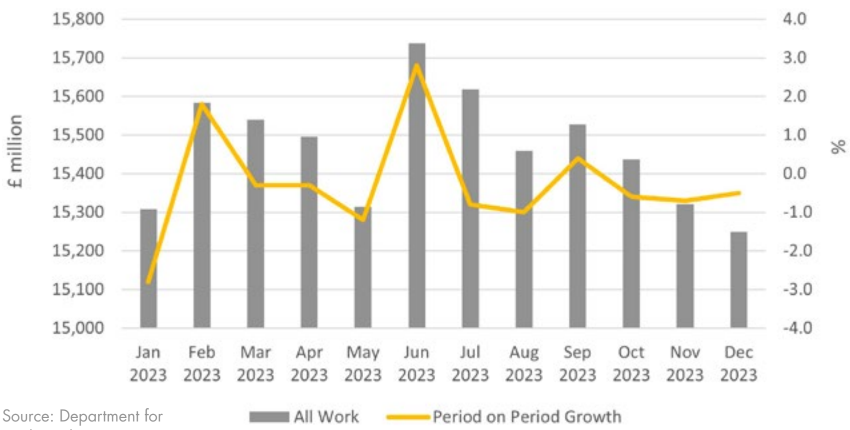
2023 has been a lackluster year for UK GDP performance *(Figure 3).*

Figure 3: UK GDP (Index, 2019 = 100)




Source: Office for National Statistics

Figure 4: Inflation percentage change over 12 months




Source: Department for Trade and Business

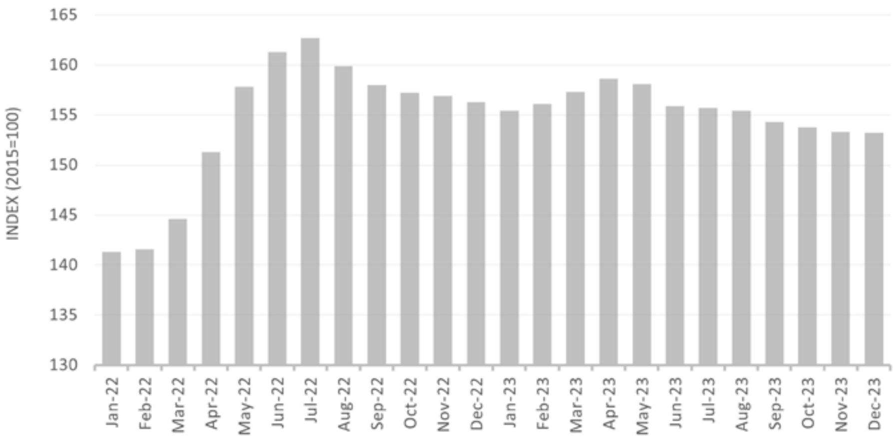
## CONSTRUCTION SECTOR HOLDS BACK GDP GROWTH

The GDP growth evident in Figure 3 has largely been driven by the service sector. As can be seen in Figure 4, the monthly construction output price data, reveals month-on-month decreases in Q4 2023.

## CONSTRUCTION MATERIAL PRICES INDEX TRENDS DOWNWARDS

The construction material price index trended downwards in Q4, although 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

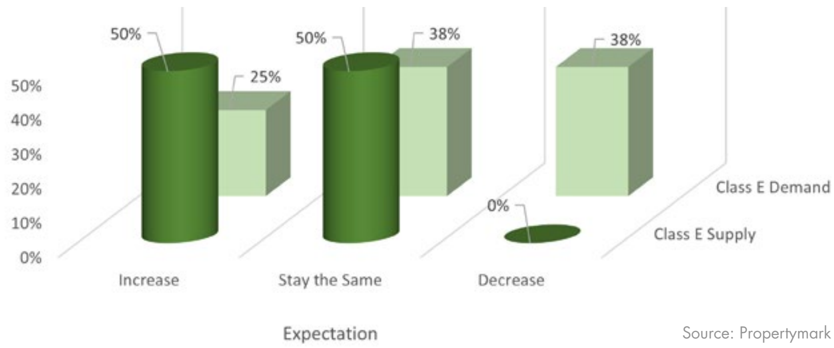
# Supply and **demand**

## 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. In total, 50% forecast an increase in supply compared with 71% in Q3. In addition, more members forecast a reduction in demand in Q4 (38%) than in Q3 (29%). As such, supply and demand remain imbalanced (Figure 6).

Figure 6: 12-month supply and demand forecast (Class E Sector)

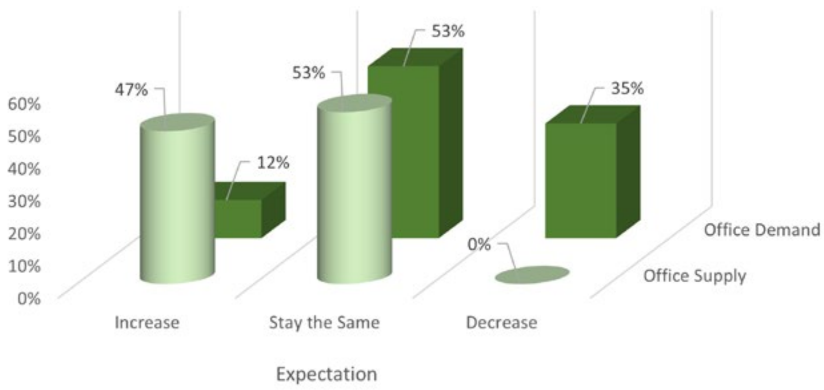



Source: Propertymark

## OFFICE SECTOR

We also asked our members what they expected to happen to supply and demand levels within the office sector over the next 12 months. Just over one-third predicted a decrease in demand (35%), while around half (47%) predicted an increase in supply (Figure 7). Again, supply and demand are out of kilter.

Figure 7: 12-month supply and demand forecast (office sector)




Source: Propertymark

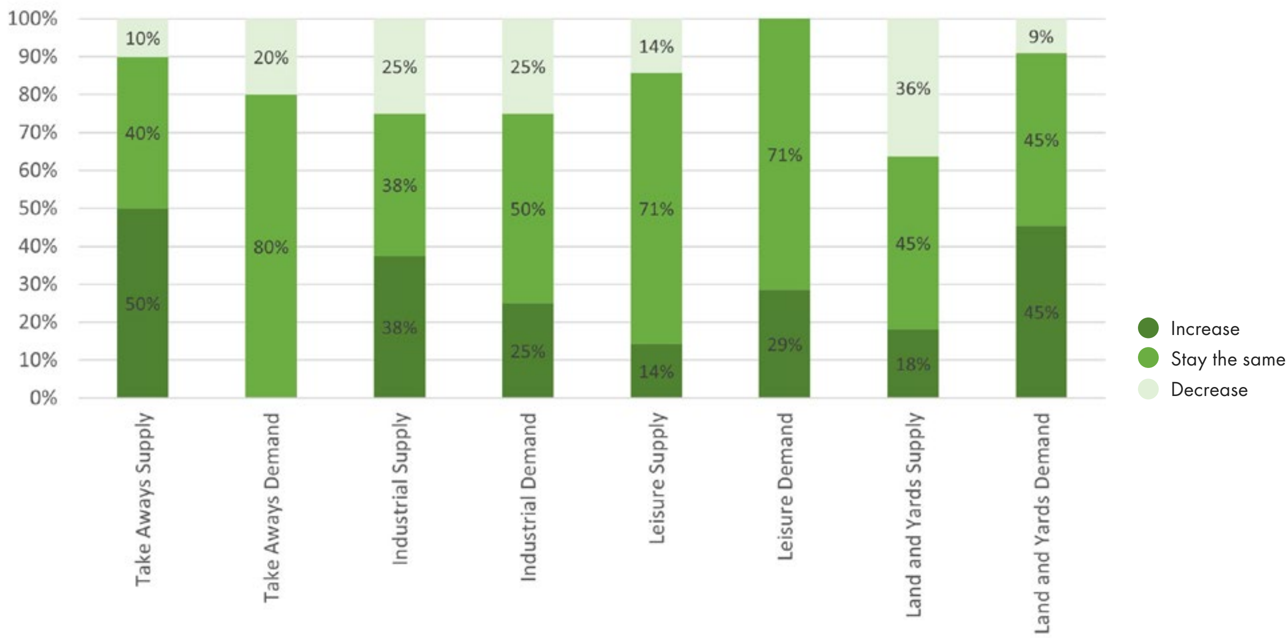
[1] Use classes differ in other parts of the UK.

## OTHER SECTORS

Supply and demand expectations fluctuate in the other sectors our members operate within (Figure 8). For example, in the takeaway sector, 50% of members forecast that supply will increase, whilst the majority (80%) suggest that demand will remain the same.

Furthermore, in the land and yards sector, 45% of members forecast an increase in demand, whereas just 18% forecast an increase in supply.

**Figure 8: 12-month supply and demand forecast (other sectors)**




Source: Propertymark

# Capital values

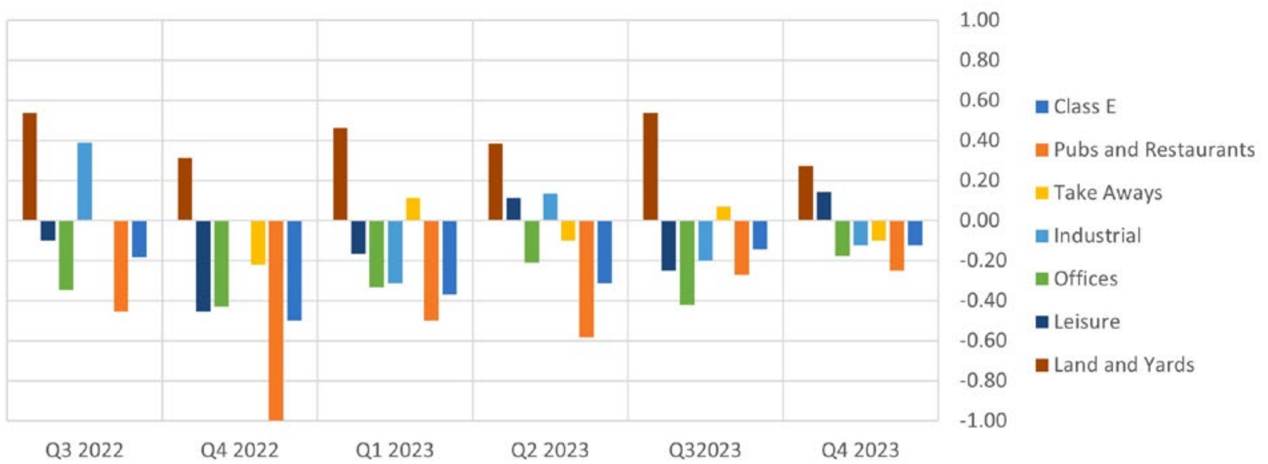
ALL SECTORS

We asked our members 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.

Their responses are converted to a numeric scale bounded by 1 and -1 and reported below. Positive values indicate that most respondents expected 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 the previous quarters, we can see that sentiment towards the land and yards sector remains positive but is cooling. The Leisure sector has seen a positive swing, and the takeaways sector has a negative swing. In general, sentiment is moving toward the middle ground but remains negative in key sectors (Figure 9).

Figure 9: Capital value expectations over the next 12 months (all sectors)




Source: Propertymark

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

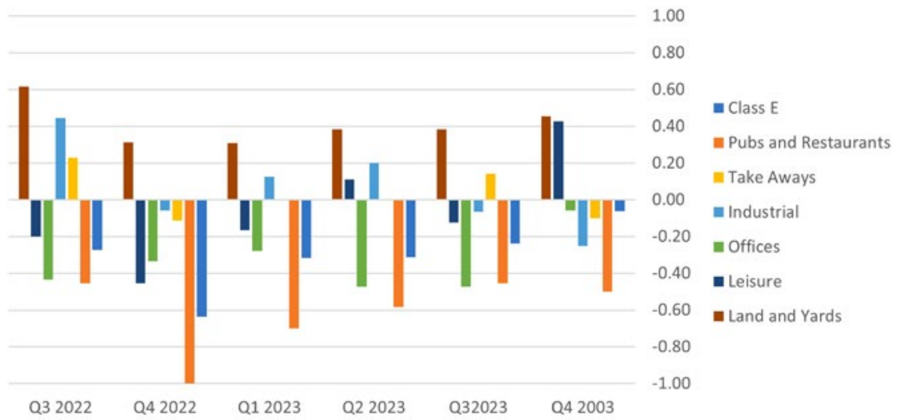
# Rent levels

ALL SECTORS

We also asked our members about their expectations for rent levels [3] in the coming twelve months.

They reported that rents in the pubs and restaurants sector will remain subdued (Figure 10). Members are more pessimistic this quarter regarding rents in the industrial, takeaways, and pubs and restaurants sectors. Sentiment has dramatically increased in the leisure sector, although it remains to be seen if this will be sustained.

Figure 10: Rent level expectations over the next 12 months (all sectors)



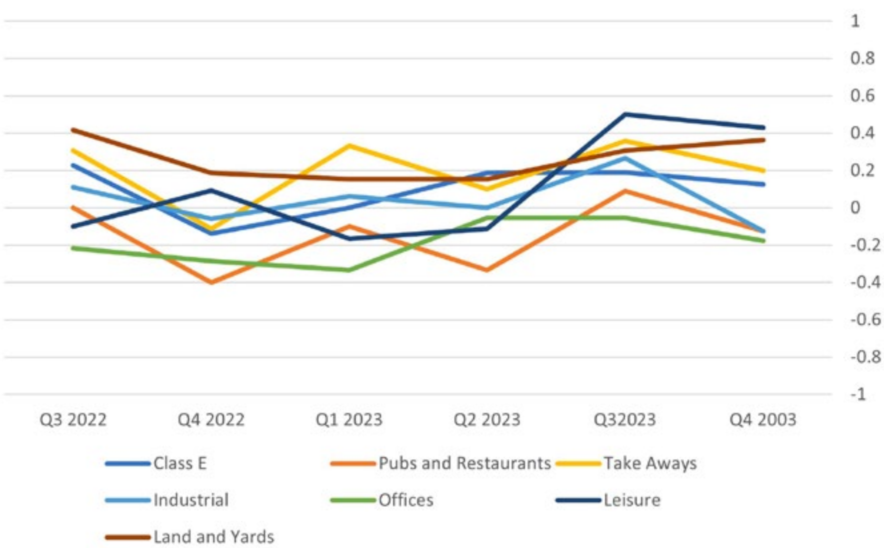

Source: Propertymark

# Investment yields

ALL SECTORS

Expectations for investment yields in the coming twelve months vary by sector with the largest changes in sentiment visible within the industrial and pubs and restaurants sectors (Figure 11).

Figure 11: Trends in investment yield sentiment (all sectors)




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

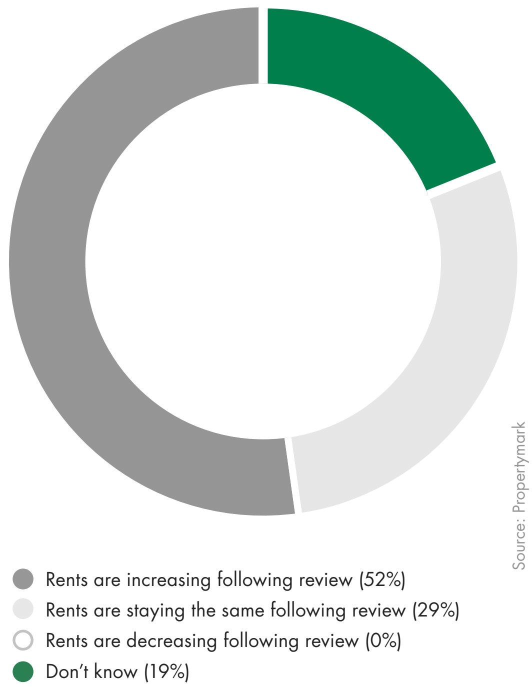
# Rent reviews

We asked our members what the outcome of rent reviews undertaken in Q4 was. Over half (52%) reported that rents were increasing. However, over a quarter (29%) reported that rents were staying the same following review (Figure 12).

**Furthermore, one member highlighted:**

> Some rents are being negotiated informally in some sectors due to the modest growth not justifying the costs of undertaking a formal full process.

Figure 12: Outcome of rent reviews undertaken in Q4 2023




# **Key** trends

We continue to monitor key trends in the commercial property sector with a focus on lending costs, cash purchasers and EPCs.

## LENDING COSTS

We continue to ask our members if higher lending costs are hitting both prices and deal volumes. In Q4, 86% responded that this was the case, up from 67% in the previous quarter. Interest rates will likely continue to subdue the market in the interim (Figure 13).

Figure 13: Outcome of rent reviews undertaken in Q4 2023

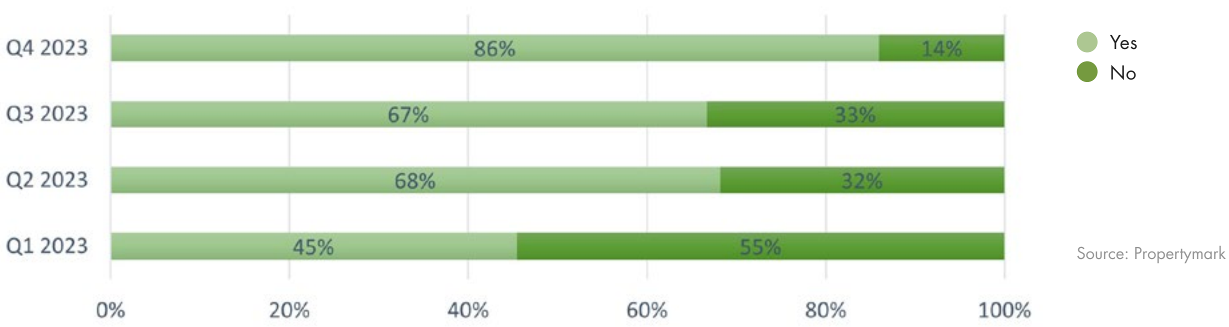
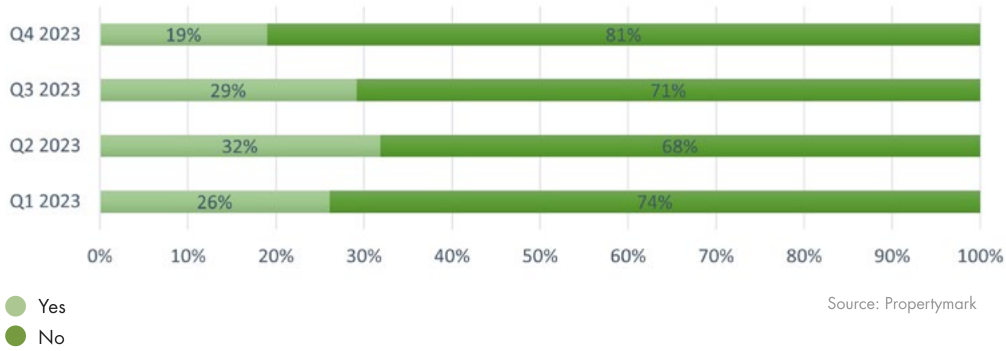


Figure 14: Proportion of agents reporting an increase in cash purchases




Source: Propertymark

## CASH PURCHASERS

Fewer members reported an increase in cash purchases in Q4 over Q3 (Figure 14).

## EPCS

Some members reported that EPCs are now a material consideration during rent review and renewal negotiations (Figure 15 and Figure 16). One member reported that EPCs were 'definitely being looked at before commitment' by tenants.

**However, as another suggested, the impact has been tempered by the government's shifting stance on EPC targets:**

> The impact on EPCs is in fact less than we expected as the government have slowed the introduction of the new regime, so the impact is only on old and very poorly performing premises as opposed to mainstream stock.

Source: Propertymark

Figure 15: Are EPCs materially affecting rent review negotiations

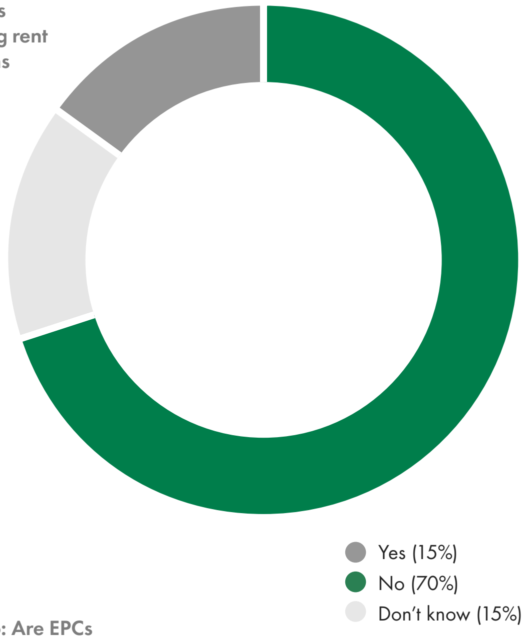
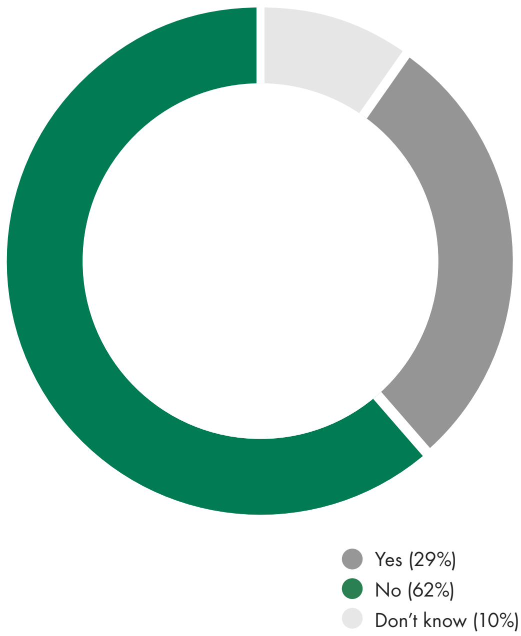



Figure 16: Are EPCs materially affecting lease renewal negotiations



# Agent **insights**

**To provide a qualitative overview of developments in the commercial property sector, we asked our members to provide some general market insights, to identify the key challenges they face and to provide some predictions for 2024.**

## GENERAL MARKET INSIGHTS:

"Very strong demand for small/medium sized workshops, storage units and compounds."

"Demand is increasing and the rent is getting better, which should certainly motivate investors."

"Pricing expectations are not in line with the current market."

"In terms of business transfers, these are mainly being driven by retirement sales. Little has changed overall since the last quarter however confidence does seem to be returning and the outlook is better. What impact that will have on pricing and deal volumes is uncertain."

## KEY CHALLENGES:

"How to save costs for client acquisitions, in particular on three-year leases and ensuring to obtain the best standard of EPC to minimise exposure to dilapidations."

"Political and economic uncertainty makes planning difficult."

"Lack of certainty, risk of war etc., curtailing operators' confidence and in turn their willingness to fund or borrow."

"Shortness of units, lack of new builds, lack of land."

"Interest rates still affecting supply."

"Lending barriers on commercial sale funding."

**Continued...**

KEY CHALLENGES:

"Business rates are putting off commercial lenders and buyers."

"The high interest rates and failure of businesses."

# Agent predictions for **2024**

"I would see the first three months being very flat with a slight up swing. However, it will be difficult to predict whether the momentum will continue to the end of the year due to factors including the political situation (i.e., elections) and corporate employment strategies (e.g., Meta closing its West End HQ)."

"The economic issues across the UK and beyond are preventing businesses from expanding and committing to new ventures. Franchise companies are holding off and not growing their units as they feel they have another year to wait before rates drop allowing borrowing to reduce. It will be another few years until bigger outlets look to expand."

## 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 a 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 fourth 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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