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Commercial Property Investor – 2015 Outlook

• General economy continues to improve
• Employment numbers boosted still further
• Increased requirement for commercial space leading to rental growth

With the talk of a return to recession now behind us, the property market continues to flourish with increased investment levels, improved occupier demand and rental growth on the horizon. What then, does this mean for investors in 2015?

The huge levels of investment in the UK commercial property market shows no signs of slowing and continues the ripple effect outwards from central London. £15.2bn was invested in UK commercial properties in Q3 2014 which is up twenty per cent on the same period in 2013.

Fifty five per cent of total volume was invested outside of London which is the highest share since Q1 2011. CBRE reports this high volume of investment in the rest of the UK provides the potential for continuing downwards yield shift. This yield compression is more defined on secondary stock than on prime, demonstrating positive investor expectations of rental growth.

The combination of increased risk appetite and stabilisation of secondary occupier markets is largely responsible for this rapid shift in the secondary market. In addition, the sustained absence of new development in all sectors, has contributed to a shortage of prime property, forcing investors and tenants to consider secondary.

2015 therefore is expected by many to see rental growth becoming the driver for further yield shift. With a lack of available stock, occupiers are facing growing pressure to secure expansion space, thus starting to drive rents. Rental growth will of course mirror the ripple effect seen in the investment market and therefore choice of location and building quality is of paramount importance.

The latest Investment Property Databank (IPD) reinforces the point, revealing that total property returns continue to increase due to cumulative yield compression compounded by the re-emergence of rental growth. Investor sentiment is largely positive at present with the industrial sector in particular performing well and expected to see the largest net increase in rents through to the end of the decade.

Amongst the positive news there is a note of caution however, with some commentators (notably Lambert Smith Hampton) predicting the level of yield compression to slow as a result of uncertainties surrounding the 2015 General Election, timing of the anticipated interest rates rise and ongoing problems in the Eurozone.

Focus on Finance

New lenders are arriving in the market leading to increased competitiveness and flexibility. Five year fixed rate loans are available at 4% for loans of £1m or above which are the lowest rates seen for some time. Furthermore, new lenders are focusing on specific sectors of the market in contrast to the High Street banks who have continued to be the generalist ‘one-size-fits-all’ providers of finance.

However, 50 per cent of the £500bn UK commercial property market is financed by debt, the vast majority of which is still provided by the traditional lenders. As they return to healthier, more sustainable leverage ratios, banks’ appetite for real estate lending is once again on the rise, with reports of reduced spreads and more access given to smaller customers.

Also of interest is that international investment interest may now be less focussed on the UK market. DTZ report *"a lower share of future single country capital is now targeting the UK (5% of global total, compared to 9% 12 months ago), with Germany attracting an equal amount, reflecting investors' shifted focus towards the continent"*.

What they're saying (Outlook 2015)

"We are confident that property yields will remain stable as the Bank of England increases interest rates, which UBS Wealth Management forecasts it will start to do in August 2015. In fact, we believe it will take some time before interest rates reach levels that start to significantly impede returns on commercial real estate investments".

UBS Wealth Management

"The evidence suggests we are close to the peak [of the market] in terms of the rate of growth in capital values, but, in aggregate, the market is still set to perform well through to 2019".

Lambert Smith Hampton

"There are very few signs of an overheating market. For example, there is no evidence of a development boom, and the market is not excessively leveraged. Secondly, while real estate may look expensive relative to historic pricing levels, it certainly does not look expensive relative to other low risk, income-producing asset classes."

Chris Urwin, Aviva Investors

"The office sector is set to dominate [construction] industry activity in 2015, with a 23% rise in project starts anticipated following relatively steady growth of 8% this year. Office starts are expected to pick up in major metropolitan areas as the demand for more quality office space spreads beyond London. Retail and leisure project growth is also forecast to be spread widely across the UK as consumer spending picks up across the country".

Construction Prospects for 2015 Report, Glenigan

Any Questions

We hope that this has provided some food for thought and if you have any queries about the investment market or property management please:

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Around the Regions: Bristol

There is a lot of money looking for a home in Bristol but will it find one?

It's in a prosperous part of the UK with good transport links, a good educational record, a wide industrial base and strong financial services sector.

Competition for the best buildings helped Bristol office investment yields to dip below 6% for the first time earlier this year. Supply remains low – owners hang onto what they've got – although higher prices may tempt stock onto the market.

Rents could grow in the second-hand office market, too. Around 1m sq ft of office space has already been removed from the market for conversion into apartments – a further 500,000 sq ft was expected to go this year – squeezing the supply of good, second-hand office space.

Estimates suggest there is probably only 18 months' supply of grade B office space, so investors looking for triggers for rental growth should see that Bristol has more potential than most other UK locations.

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