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## Quarterly UK property market update



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Over 2011 as a whole the IPD Monthly Index produced a healthy return of 8.1%, ahead of equities but behind gilts. However, returns were stronger earlier on, falling away as the year progressed, and by the fourth quarter overall capital growth disappeared. The retail and industrial sectors experienced declines in capital values in December and only the office sector showed an increase in value. Investors remain concerned over the economic climate in the UK and problems in the Eurozone, in particular downgrades to GDP growth forecasts, which will have a knock-on effect for property occupiers and rental growth.

UK investors continued to concentrate on prime stock in prime locations. Within the office sector, Central London remained the preferred option due to the perception of continuing rental growth. Long income deals such as supermarket sale & leasebacks and distribution warehouses were also popular as investors sought a secure and ongoing income stream. However, supply of this quality of stock was limited and therefore attracted considerable interest. Foreign buyers mainly restricted their purchases to Central London, both retail and offices, with an increasing trend towards Asian investors snapping up the larger stock.

During the quarter the retail sector experienced mixed fortunes. Outside the prime locations rents came under pressure and yields consequently moved out. Retailers with significant levels of debt suffered disproportionately as retail spending was more focused, with some operators, for example Barratts, going into administration. The investment market in Central London retail remained strong, buoyed by overseas investors, with yields in Bond Street falling well below 4%. There were a few deals in the retail warehouse sector and prime stock, such as Brighton, attracting a number of bids; Brighton eventually sold for an initial yield of 5.1%.

The office market in Central London continues to show rental growth, with prime rents in Mayfair exceeding £90 per square foot and those in the City around £55 per square foot. This growth came despite take-up generally being down as occupiers were more cautious on the economy. Supply remained restricted, with development completions at a 20 year low. Outside Central London the picture was not so rosy; take-up in the major regional centres was down in the quarter and rents fell, albeit marginally.

The major transactions in the industrial sector were large portfolio deals. Segro acquired the Hermes Logistics fund for £315 million, whilst Blackstone bought a £215 million portfolio from Prologis. Occupiers were highly selective in their strategy and the North South divide remains very much in evidence with regard to take-up and rental growth.

The outlook for 2012 is not particularly promising as the economic turmoil unfolds. Towards the end of 2011 yields on secondary property came under pressure and we expect this to continue this year. Investors are seeing retailers in trouble and are concerned about falling rental values and increased vacancies, a situation that is unlikely to ameliorate during 2012.

The performance of prime stock and Central London offices meant the market produced reasonable capital growth overall in 2011. Rents in the City are showing signs of remaining static as those occupiers previously considering a move put their plans on hold. This is unlikely to change until there is evidence that the wider economic issues are being tackled. Prime yields have little room for manoeuvre and with poorer rental growth prospects and weakening secondary yields, capital values overall are likely to fall in 2012. This could present opportunities for cash-rich investors who may be able to pick up good quality stock at reduced prices. We also expect the attraction of long income deals to continue, particularly those with RPI or CPI minimum uplifts.

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Good thinking. Well applied.