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COMMERCIAL & RESIDENTIAL

Market Update

Q2 2019

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Economic Overview

With a new Prime Minister the focus inevitably returns to the challenges ahead faced by the new Boris Johnson administration and of course there will be difficulties in achieving anything with such a narrow (DUP supported) majority in parliament. There remains little clarity over the path of Brexit with the no-deal risk increasing, and we may well have a general election sooner rather than later, either planned or forced. With both of the main parties struggling with a range of issues, the political uncertainty remains.

The economy has been growing steadily but slowed markedly in the last quarter primarily due to a fall in retail sales, a drop in car production and also partly reflecting an easing of stock-building ahead of the previous Brexit deadline where businesses were preparing for a no-deal Brexit scenario as of 31st March. Growth in Q1 of 0.5% (according to the ONS) had been volatile ahead of the March deadline but growth in Q2 is expected to have been virtually flat. The expectation for Q3 and Q4 remains subdued as whilst there should be some bounce-back, the risk of a no deal Brexit has increased. The outlook for growth is therefore relatively flat.

On the positive side, elements of the economy are stronger, wage growth is at a high of 3.6% in the year to May (ONS) which continues to loosen the income squeeze and with inflation at the Bank of England MPC target rate of 2%, interest rates have remained unchanged in June and July at 0.75%.

The combination of life carrying on and a will to do business up against increasing Brexit concerns is a difficult mixture. Unsurprisingly, the real estate markets are subdued, demonstrating record low transaction volumes across the commercial markets and increasing polarisation in pricing between good quality and longer income assets, alternatives and opportunity properties, as compared to more unattractive secondary and tertiary stock.

The residential markets remain dynamic with buoyancy in the regions and the north, a relatively stable picture in central London whilst the London suburbs remain under pressure. Although as many are commenting, it does feel that we are at or near the bottom in the more difficult residential markets.

> Growth in Q1 of 0.5% (according to the ONS) had been volatile ahead of the March deadline but growth in Q2 is expected to have been virtually flat

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West End Letting Market

The second quarter of 2019 has seen the West End office leasing market continue to exhibit the strong activity of Q1 with over 2M sq ft of space being transacted over the first half of the year to date, which is circa 25% above the long term average.

Pre-Letting activity has continued to be buoyant accounting for 30% of deals of the year to date, with a further rumoured 350,000 sq ft of the development pipeline currently Under Offer.

Tech & Media continues to be the dominant tenant sector with 29% of take up, followed by Financial and Insurance (25%) and notably the Public Sector, completing on 3 transactions over 45,000 sq ft equating to 18% of the market. The appetite of the serviced office sector to increase its market share continues apace with operators securing a further 18% of the total take up in Q2.

The vacancy rate has remained broadly static at 4% since the start of the year, although there has been a notable increase in the amount of "grey" space coming to the market this quarter with a combined 70,000 sq ft placed on the market via tenants in One Carlisle Place, SW1 and UK House, W1.

In the face of resilient demand and reducing Grade A supply, rents have remained at robust levels with a handful of transactions indicating a slightly upward trend.

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There have been a number of significant deals over the last 3 months, notably the successful pre-let at One Soho Place, W1 (102,600 sq ft to G Research), the letting of the entire of 64 Victoria Street to the Parliamentary Estate on a new 15 year lease, and a new record rent achieved in Mayfair at 30 Berkeley Square, where Steadview Capital secured 2,572 sq ft at £250.00 per sq ft.

> West End office leasing market continue to exhibit the strong activity of Q1 with over 2M sq ft of space being transacted over the first half of the year to date

West End Investment Market

The West End market continues to be relatively subdued in terms of both turnover of sales and available product. Market fundamentals remain positive, however both buyers and sellers are continuing to adopt a “wait and see” approach due to Brexit.

We recorded a total of just under £1.42Bn exchanged or exchanged and completed in 21 transactions during the quarter. The average lot size was £67M. This brings the half year total to £2.42Bn in 41 transactions.

In context, this is the lowest Jan-June total since 2011, and 33% below the last 5 years’ average which stands at £3.6Bn (Q1-Q2) and £7.95Bn annually.

The reduced turnover has been caused in part by a lack of large transactions during the first half of 2019. There have been only five transactions in excess of £100m, (one of which has been concluded by Allsop). During Q2 the largest transaction was the purchase of a £280m block on Oxford Street by its tenant, Uniqlo.

Domestic investors dominated investment acquisitions, however through the team’s exposure to several high profile sales and our alliance with Millennuim Group in Asia, we have seen a recent increase in interest from overseas, notably Hong Kong - possibly caused by local political instability and also a weak Pound.

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As we move into Q3, there are a number of substantial assets either reportedly buyable or under offer, for example Nova in Victoria believed to be under offer and 23 Savile Row which has completed to Lazari Investments for around £280m.

Despite the subdued investment volumes, values remain resilient for prime Freehold stock, with best in class Grade A offices continuing to achieve record rents and investment pricing. This is driven in part by a lack of suitable stock, a strong occupational office market, and significant global capital allocations to London from both domestic and international investors.

The London Office market also offers investors more favourable yields than most other key global gateway cities.

Whilst the challenges in the retail occupational markets have also appeared in the West End, Prime Bond Street continues to prove attractive, with a Hong Kong investor paying 1.6% for 172 New Bond Street c £74m. Bond Street has been the star performer over the last 20 years - The same unit had traded in 2011 for £25m and in 2002 for £7m, and passing rent has risen by 500%.

We anticipate a continuation of this reduced activity during Q3, particularly given the possible re-emergence of a no-deal Brexit. However prime office and retail will remain liquid and achieve record pricing, driven by demand for both domestic and overseas investors who believe in London’s long term status as a top global gateway city.

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City and City Fringe Letting Market

The continued uncertainty over the economy in the shadow of Brexit and the leadership campaign is likely to create further delayed decision making to City Business' moving into the next quarter.

Whilst there have been signs of a slowing economy and recent redundancies both nationally and within the City financial sector, in particular Deutsche Bank, we have witnessed higher levels of demand from the finance and insurance sectors over the tech and media sector this quarter. Further demand is expected from the challenger banks such as Monzo Bank (who are actively seeking 80,000 sq ft in the marketplace) amongst other new FinTech market entrants.

The largest City deals taking place this quarter were Quilter taking 100,000 sq ft at Senator, 85 Queen Victoria Street (L&G advised by Allsop) at £65.00 per sq ft on a 15 year term, Brewin Dolphin acquiring the whole of 25 Cannon Street (114,000 sq ft) at £68.00 per sq ft from Pembroke Real Estate and Smith & Williamson acquiring 85,000 sq ft at Gresham St Paul's, 40 Gresham Street at a rent of £68.00 per sq ft.

The Serviced Office Sector has continued to thrive, accounting for 18% of market take-up. Recent lettings include Spaces (Regus) at 100 Bishopsgate taking 40,000 sq ft on levels 18 and 19 at a rent of £77.50 per sq ft and 25,000 sq ft at 15 St Helen's Place. CBRE's flexible workspace provider Hana has also taken approximately 40,000 sq ft at 70 St Mary Axe, with its first UK location launch. WeWork continues to expand with one of the largest acquisitions taking place this year at 30 Churchill Place with 284,000 sq ft acquired on a sublease from the European Medical Agency. WeWork is also negotiating on numerous self-contained smaller buildings to roll out its new HQ by WeWork concept, enabling growing businesses to take self-contained floors in unbranded WeWork centres.

Total take-up for Q2 remains robust and was recorded at 880,576 sq ft, only marginally down on the previous quarter and the long term 10 year average. There is further positive news for the City with the expected relocation of BT to 320,000 sq ft at 1 Braham Street, which is due to sign in Q3 2019.

Supply in the City currently stands at 6.1M sq ft with a very low vacancy rate of 4.4%, with Grade A available stock remaining very low at 2.1%.

The continued demand for space twin-tracked with the low vacancy rate across the City has resulted in rents remaining stable, with rental increases recorded in City fringe sub-markets.

Significant development completions will increase the supply pipeline for Q3 and Q4 2019 and include 70 St Mary Axe – 159,000 sq ft, The Scalpel – 133,000 sq ft, Wenlock Works – 128,000 sq ft, Devon House – 93,000 sq ft and 30 St Mary Axe – 107,000 sq ft.

> Further positive news for the City with the expected relocation of BT to 320,000 sq ft at 1 Braham Street, which is due to sign in Q3 2019

The City Fringe supply remains tight with a lack of larger (10,000 sq ft+) floorplates available in the marketplace. The Aldgate, Whitechapel and Eastern Fringe is becoming an increasingly active location with a number of major refurbishment/development completions being placed under offer close to or on completion. These include Dept W, Mile End Road (55,000 sq ft) and Wool + Tailor, Alie Street (25,000 sq ft). All of these deals achieved premium rents for their local sub-markets.

Other notable fringe market transactions include the letting of the upper floors at Chapter House, Corsham Street to Ebiquity (13,122 sq ft) at an average rent of £70.00 per sq ft and the letting of 38,565 sq ft at Arnold to Fora at a rent of £63.00 per sq ft overall on a 15 year term.

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City and City Fringe Investment

The relatively slow start to 2019 has continued into Q2 with limited product on the market and transactions taking much longer than usual to reach exchange and completion. The complicated political backdrop and the inevitability of a new Prime Minister; one who will likely want the UK to 'BREXIT' in October 2019, has caused hesitation from not only domestic buyers and sellers but also overseas investors which has resulted in a very slow and protracted first half of the year.

As a result our City Investment Team has recorded a total of only £1.050Bn over 29 transactions during Q2 2019, which is 56% down on Q1 2019 in terms of investment volume and 72% down on Q2 2018 volumes. It is almost half of the long term average. The largest deal of this quarter however, was the sale of Greycoat's development at 8 Salisbury Square, EC4 to Hong Kong based Wing Tai which traded for £221M - 4.6% NIY and £1,337 per sq ft, significantly smaller than the 25 Canada Square deal (£1.1Bn) which skewed the Q1 2019 figures.

Despite the lower volumes we are tracking in excess of £1.3Bn of deals which are currently under offer including some large lot sizes. The BT Headquarters at 81 Newgate Street, EC4 is under offer for a second time, having been rumoured to have been under offer previously to both GPE. The property comprises a c.£200M vacant building requiring redevelopment near St Paul's. In Southwark a similar situation arose for the ITV Headquarters, SE1 which was launched in February 2019 and is onto its third prospective purchaser, guiding £150M and above, for a substantial mixed use site with impressive river frontage and views. Both these large scale development opportunities experienced highly competitive bidding primarily due to one of the strongest pre-let markets on record, but ultimately passed through a couple of parties, which is reflective of a backdrop of political uncertainty.

The average lot size in Q2 was £36M, substantially smaller than in Q1 and the majority of sales were lot sizes between £20M-£50M. The genetic make-up of these buyers remains very diverse and interestingly a number of UK Funds have made purchases within this quarter including CCLA who acquired Palace House, 3 Cathedral Street, SE1 in Southwark from Schroders. Palace House comprises a freehold building which is single let to Kaplan for a further 8 years term certain and sold for £48.80M, 5% NIY and £1,070 per sq ft. Allsop advised Schroders on this deal.

Another UK Institution, Nuveen Real Estate was the buyer of another Allsop sale, One Clink Street, SE1 a freehold, multi-let, mixed-use building recently developed by Palmer Capital, for £18.825M, 5.69% NIY and £819 per sq ft. We suspect this is a reaction to a shift in Fund weightings as the majority of UK Institutions have been net sellers of Central London buildings since the EU Referendum; a trend we expect to continue, especially in the fringe markets of Southwark, Shoreditch and Farringdon.

more risky 'value add' opportunities which offer the potential for refurbishment and redevelopment and the ability to re-let within the next 2 years have attracted the most attention from buyers

We have witnessed a softening of income generating assets with prime yields coming under increased pressure and certain scenarios suggesting that they have moved out - for example, 8 Salisbury Square trading at 4.6% net initial yield for a newly developed, prime freehold multi-let building with a WAULT in excess of 10 years. This would have perhaps traded at closer to 4.25% in the first half of 2018. However, it will be interesting to monitor the situation regarding 8 Finsbury Circus which is currently on the market guiding £260M / 4.0% for 11 years of multi-let income. If this asking price is met, this would suggest demand remains for the very best assets in the very best locations.

Interestingly, more risky 'value add' opportunities which offer the potential for refurbishment and redevelopment and the ability to re-let within the next 2 years have attracted the most attention from buyers. Allsop's acquisition of 222 Bishopsgate, EC2 on behalf of a Private Chinese client of Goldstone for £21.1M, £915 per sq ft with 1 year of income, and Paxton House, Artillery Lane, E1 for £11.1M, £889 per sq ft, attracted over 10 bids and over 25 bids respectively, with pricing well exceeding aspirations. Again, this is reflective of a strong occupational market.

As we draw nearer to 31 October and a potential exit from the European Union without a deal, we expect the relatively subdued investment market to continue into Q3 2019. However, we believe this is primarily due to a lack of product on the market rather a lack of demand, as there are still a number of investors undeterred by Brexit. For example, Q2 has experienced renewed interest from Asian investors due to the Hong Kong political protests, which could mean a willingness to move their money out of the country in the short to medium term. Exchange rates remain favourable and if prime yields were to move out to 4.25% - 4.5%, we expect interest to rekindle from other parts of the world too, resulting in a more positive second half to the year.

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National Investment Market

With the ongoing political turmoil, Q2 2019 proved a difficult quarter for UK commercial property transaction volumes. For the full year 2018 and Q2 2019, transaction volumes for the entire UK market were down overall as follows:

Full Year

£56.75 Bn:- down 9.8% on 2017. London accounted for £20.7 Bn.

H1 2019

£16.86 Bn:- down 39.2% on H2 2018.

Q2 2019:

£6.46 Bn:- down 55.5% on Q2 2018.

With a new Prime Minister in Boris Johnson and the next Brexit deadline (31 October) looming, the challenge for the new administration is considerable. In our judgement, the odds of a hard Brexit have increased which will weigh on investor sentiment and lead to a further fall in transaction volumes over the coming quarter.

Industrial

Q2 has followed the trend of the previous two quarters and seen transactional volume fall to £952M over 55 recorded transactions. This represents a 41% reduction on the previous quarter and a substantial 81% on Q4 2018. Over the past 2 years, it has been a lack of opportunities restricting transactional volumes. However, during Q2 we have experienced buyers becoming more selective and with individual investment considerations driving volume and pricing within the sector.

The key driver in the industrial market is income duration. This provides security over the inevitable disruption Brexit will bring but also provides assurance to the more cynical investor concerned that the market has peaked, or is close to doing so. The industrial sector has reacted to this demand for income with the average new lease length increasing 40% since 2011. Although this is mainly the result of technological advances in the industrial/logistics sector encouraging occupiers to take longer leases, it has also been influenced by landlords pushing for longer lease lengths to capitalise on investor demand.

Prime logistics yields have remained in the region of 4.00% - 4.50% with income duration and fixed/index linked reviews driving pricing and keeping institutional investors in the market. Prime multi-let yields remain in region of 4.50% - 5.00% with location and reversionary potential driving pricing. Secondary yields have plateaued and remain in the region of 6.50 -7.00%. Although we have witnessed secondary yields move-out in some instances and we are experiencing reduced demand as investors focus on income.

Notable industrial transactions during Q2 include the sale and leaseback of Sports Direct's headquarters in Shirebrook, Mansfield for £120M and the £100M sale of the R32 Portfolio comprising 32 multi and single let industrial assets predominantly located in the West Midlands.

High Street Retail

The High Street retail investment market remained subdued in Q2 2019. Investor confidence in the sector remains low; this continues to be amplified with the news of more retailers suffering, with Monsoon the latest major High Street name to enter into CVA.

Preliminary numbers from Property Data show investment volumes to be close to £160M for Q2 which is down 70% on the same period last year. This is dominated by a Chinese private investor's purchase of 172 New Bond Street, London for £74M. The largest recorded regional deal was Metro Bank's purchase of 58/64 Fargate, Sheffield for £9.5M reflecting a net initial yield of 4.9%.

The depth of interest for High Street investments has remained thin across the sector with prime yields consolidating at close to 5%.

It is clear that any demand within this sector is for assets within London and top tier retail locations alongside investments offering secure income. Investors are also focusing closely on rents – buyers are unwilling to invest in assets they perceive as being over-rented, unless the price paid enables them to consider taking a rent cut at the next tenant negotiation.

Secondary and tertiary retail remains less resilient with yields continuing to move further out, increasing the gulf been prime and secondary. Tertiary yields in this sector are currently 10%+.

Allsop advised on several transactions through the last quarter including the disposals of 67-69 High Street, Guildford achieving £2.5M – 5.46% NIY, 11 Haymarket, Norwich achieving £2.4M – 6.40% and 10 Market Place, Cirencester achieving £1.52M reflecting 6.00% NIY.

Allsop has also advised on the sale of the College Walk Shopping Centre, Rotherham achieving £3.55M – 14.00% NIY.

Retail Warehousing

Activity totalling £204M across eleven transactions averaging 8% NIY down over 50% on Q2 2018 (source: Property Data). Current yields remain at 6.00% for prime open A1 schemes and 6.25% for restricted A1 consent, whilst secondary schemes range between 8.00% - 10% NIY.

There continues to be downward pressures on rents with bricks and mortar occupiers under stress from online retail competition. Recent research (source: EGi Radius) has shown that more than 50% of retail park leases have lease breaks or expires between now and 2025; the legacy of long leases being signed during the 1990's. Given the pressure on rents and oversupply in the sector this will likely lead to a rebasing of a large percentage of retail warehouse rents, particularly in the fashion sector and in secondary schemes within a town.

Positively, private equity and overseas investors are now identifying value in the sector with a view to alternative uses. This is evidenced by the private equity purchase of Dallow Road Retail Park in Luton for £24M - 7.60% NIY, which is let to B&Q and LIDL for 10 years, and East Kilbride Retail Park which was purchased by Corum Real Estate for £12.25M - 10.50% NIY. In addition Newriver purchased four retail parks in Aberdeen, Inverness, Dundee and the Isle of Wright for £60M at 9.8% NIY with equity from a fund operated by Pimco.

National Offices

Q2 2019 has been dominated by further political uncertainty and this has had a significant impact on national office investment volumes. While volumes remain down on 2018, pricing has remained stable due to the weight of money chasing regional office stock.

This is not surprising given the fundamentals of the national office markets remaining robust. The south east and 'Big 6' cities are generally all at record low levels of Grade A supply at sub 6%, take up has remained high and development pipelines remain constrained. This has resulted in a general expectation of short to medium term rental growth in these sub-markets.

In terms of buyers, local councils have been one of the largest investor pools over the last 2 years. Councils have begun to take a more cautious approach to investing into direct real estate exacerbated by the spotlight cast onto them by central government and the press.

We expect this pool of buyers to be replaced by overseas capital due to competition for Central London assets forcing investors to look further afield.

Portfolio

A vast influx of institutional and private capital has entered UK real estate markets in recent years, as Quantitative Easing continues to bloat markets and narrow bond yields, forcing investors to look elsewhere for income. This influx of capital has also led to a desperation to deploy it in large quantities and this sustained pressure to invest continues to drive the UK Portfolio Market.

Off-market and selectively marketed portfolios continue to increasingly dominate transactional volume, limiting the veracity of statistical analysis of the sector. Market volume totalled approximately £6Bn in the first half of 2019, a similar level to the same period in 2018. Whilst the number of "recorded" transactions are declining, we expect the true total to be significantly higher and are witnessing a return of larger portfolio lot sizes, in particular within industrial/logistics and alternative sectors.

> Off-market and selectively marketed portfolios continue to increasingly dominate transactional volume

The inexorable rise of major global economies, in particular within Asia, has driven sovereign wealth funds, pension funds and private investors from China, Singapore and elsewhere to target the UK. Additionally, we have seen particular activity within the £20M-£60M lot size range from a wide range of institutional and non-institutional capital alike.

Correct asset selection continues to remain one of the most hotly debated topics. Premium pricing for portfolios remains achievable but excellent attention to detail and correct presentation is vital to achieving competitive bidding situations.

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Commercial Auction Market

The commercial auction sector, overall, has seen turnover down, year on year, with a fall of 18% in volumes sold.

The Allsop Commercial team has been more resilient than the wider market with a 10% reduction in revenues maintaining a success rate well above the national average of about 75%. We are now averaging 82% for the last six months. We have held four auctions in 2019 and raised £294.1M.

Q2 saw our May and July sales.

The May auction was held off the back of two very strong auctions to start the year and found a more hesitant market. Nevertheless, we saw a total of £67.5M sold with a success rate of 73.5% to date. There was a slight uptick in yields with Grade A increasing to 6.3% from 5.9% in March and a greater spread of more secondary assets pushing the Grade B yields out to 9.1% from 7.5% in March. With a smaller auction the data set is more limited which will have had an undue impact, and we will examine this in greater detail in our Summer Review which will be published in early September.

One interesting statistic for the May sale was the margin over reserve on the day which held steady at 16%, in line with our long term average. The largest lot of the day reflected buyers' continuing appetite for regional yield, with a multi-let office building in Wolverhampton achieving £3.4M - 9.1% NIY.

At the lower yielding end of the spectrum, demand remained as keen as ever for well let banks, which continued into the July auction. In May, one example was a small bank investment in Rushey Green, Catford with 15 years unexpired achieved 4.6% NIY.

You might recall that the May auction was held at the time of Theresa May's resignation, and despite, or perhaps in spite of, the uncertainty resonating from Westminster there remained an abundance of cash rich buyers with a healthy desire to invest, with a weight of money pursuing the better quality assets. Mixed use and development opportunities are the next most favoured sectors but buyers were exercising more discretion than ever in the retail sector.

Buyers seemed more confident in our July auction, with a stronger than anticipated sale, totalling over £72M and a success rate of 79%.

Despite the negative headlines, including the announcement of Monsoon's CVA and William Hill proposed closure of 700 stores, retail investments were among the best-performing assets on the day, with 22 lots, including shopping centres and high street shops, selling for more than £1M, of these, 5 lots exceeded £3M.

One of the highlights was a bank building on Camden High Street, let to Lloyds Bank until 2022 with four self-contained flats, which sold prior to auction for more than the £5.5M guide and 4.5% NIY.

> A slight uptick in yields with Grade A increasing to 6.3% from 5.9% in March and a greater spread of more secondary assets pushing the Grade B yields out to 9.1% from 7.5% in March

The retail investment market continues to challenge landlords, investors and market pundits, but with real attention to pricing we are seeing good liquidity, from unit shops to shopping centres.

The largest lot sold on the day was Lot 11 - Berkhamsted, a substantial Boots the Chemist let at £169,950 pa until 2022 with future residential potential which achieved £3.2M – 5% NIY.

We sold two shopping centres in the July sale, one of which; College Walk Shopping Centre in Rotherham, sold prior to auction in excess of the £3.5M guide.

The shopping centre comprises 18 units with tenants that include JD Sports, Subway and Warren James. It currently generates a gross income of £528,250 pa.

The Deiniol Shopping Centre in Bangor also sold, at £1,000,000 ahead of the guide price, at £1,370,000 and it is one of seven multi-let centres that Allsop has sold in the last 12 months.

Buyers were also competing for alternative assets, with nine out of the ten Kwik Fit roadside assets selling for a fund. All let on leases expiring in 2031, they achieved an average of 8.8%.

The margin over reserve on the day for the overall auction was 19% which was an increase from 16% in May, whilst Grade A yields remained firm at 6.3% and Grade B improved to 8.4%.

This strong result shows that there is tremendous liquidity in the market but buyers do have a great deal of choice and they are as informed as ever which puts an emphasis on correct pricing. The bidding was frenetic for the best-let investments, particularly in the South East or for those with added value opportunities.

Looking ahead, the political position is likely to remain unclear at least for the next quarter, but interest rates will be at their current levels for a good while yet. It is clear that Private Investors are cash rich and will bid competitively where assets appeal, the key as ever is pricing.

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Business Rates

Business rates are currently high on the political agenda.

In England the Government's Treasury Committee is in the middle of an inquiry into Business Rates. The Committee is examining how Business Rates policy has changed, alternatives to property-based taxes such as the proposed digital services tax and how changes to Business Rates could impact businesses. Commenting on the inquiry, Nicky Morgan MP, Chair of the Treasury Committee, stated *"Many high street businesses are struggling to remain competitive. It has been estimated that 10,000 shops will close this year. Unless action is taken, closures could continue and job losses may soar"*.

In Scotland the Non-Domestic Rates (Scotland) Bill has been introduced to implement many of the recommendations of the Barclay Review of Business Rates. In Northern Ireland the Department of Finance on 9 May announced its own review stating that *"in recent years significant changes have taken place in our high streets and town centres. It is critical from a business perspective, as well as a government funding perspective, that our rating system is capable of responding to this wider process of change."* In Wales there is an ongoing review of measures to Tackle Avoidance of Non-Domestic Rates as well as reform to the rates appeal system.

It is no coincidence that the current high level of political intervention on Business Rates coincides with both the dissatisfaction with business rates and the level of the charge also being at an all time high. In all the regions of the UK the UBR/ rate poundage is now above 50p in the pound. In parts of Northern Ireland such as Belfast it is now over 60p in the pound.

The modern Business Rates system which commenced in 1990 saw the Government take control of Business Rates away from local Councils and the establishment of a national Uniform Business Rate (UBR) of 34.8p. Unlike other taxes though where the tax rate is largely fixed the UBR changes every year and has been permitted to increase from roughly one third of a property's rental value in 1990 to one half today. Had the level of the UBR remained at its original level then it is unlikely that rates would have become such an issue for so many businesses.

> Many high street businesses are struggling to remain competitive. It has been estimated that 10,000 shops will close this year

A further criticism of Business Rates is how slow the system is to respond to changes in rental values. With Rateable Values currently based on rental levels prevailing over 4 years ago in many locations there is a disconnect between current rents and the level of Business Rates. The Government has, however, just introduced the Non-Domestic Rating (Lists) Bill 2017-19 which will bring forward the next Rating Revaluation in England to 1 April 2021 and to move the cycle of Revaluations thereafter from 5 yearly to 3 yearly.

The Government failed, however, to take the opportunity to adjust the actual valuation date for the Revaluation which is still to be two years before the Revaluation i.e. in April 2019. It could have adopted a valuation date just one year before the Revaluation which is exactly what is planned in Scotland for the 2025 Revaluation.

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Residential Development Market

As we enter Q3 2019, while the sun has come out, the challenges around Brexit are becoming increasingly present in people's minds with Boris Johnson's new Government promising a no deal Brexit if necessary. The impending deadline for leaving the EU has arguably driven up operating costs within the construction sector, impacting material and labour prices and this, combined with a negative impact on market sentiment within the housing market, has increased the general challenges in the residential development market.

It is therefore unsurprising that data suggests a continued fall in construction starting this quarter, with Construction PMI data suggesting that every subsector of construction, housebuilding, commercial and civil engineering has reported sharp falls in activity in June. New orders have reportedly dropped at the sharpest rate for 10 years for the third month in a row. While this may suggest an air of negativity, the pressure on new housing delivery has never been as high, irrelevant of a cooling market and Brexit uncertainty.

The key constraint on housing delivery, market conditions aside, is the availability of land, of which there is a fundamental shortage and therefore a strong demand. The sector has become increasingly crowded over recent years and, with cheap debt still readily available and increased competition, developers are still bidding competitively and looking at alternative ways to reduce costs in order to provide a competitive edge. A notable strategy in light of increased labour and construction costs has been increased investment in more modern methods of construction, such as Modular. This enables developers to reduce both their construction costs and timelines, therefore significantly improving their cash flow and often enabling them to bid more competitively as opposed to increasing their profit margins.

We have seen a greater increase in demand for sites with sub 100 units as the larger developers venture into the territory typically occupied by the smaller SME developers. This increased competition, from those that benefit from greater economies of scale and a need to keep construction teams busy, has meant that strong land values in this area of the market are continuing to be achieved, with a notable increase in demand for sites with the capability of delivering 50–100 units.

On larger schemes, partnerships between landowners and developers continue to play an important role, often providing opportunities to unlock sites that otherwise would not have come forward and providing set time parameters, thereby accelerating delivery and often spreading the risk for the developers while increasing value for the landowner. However, the planning regime is still hindered significantly by a shortage of staff and political posturing and, in March 2019, the Government pledged to publish additional planning guidance on housing diversification on large sites in response to the Letwin review of build-out rates.

> The key constraint on housing delivery, market conditions aside, is the availability of land, of which there is a fundamental shortage and therefore a strong demand

In summary, in the shadow of Brexit, increased construction costs and low market sentiment, there is still a strong demand for land, but it is the quality of the purchaser and the level of due diligence carried out that you are seeking as a vendor in this market.

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Residential Investment Market

`Cautious' and `resilient' are the most apt words to describe the UK wide residential investment market over the last few months.

The northern markets in particular remain buoyant and are attracting interest from a variety of investors. Significant cash resources are available from a variety of property funds, whilst wealthy regional and local investors keep them honest by creating additional competition for piecemeal block sales.

Although we have seen capital growth and yield compression over the last 6 months, investors remain interested in the regions because opportunities tend to offer much greater returns than London and the south east. The main issue for investors remains the availability of good quality, unbroken, Freehold stock, which remains the most sought after product in today's residential market.

In the south, outside London, demand is good for the right stock, correctly priced in the right locations and there is a clear flight to quality.

London is still proving challenging and although it is widely perceived that Central London may have hit the bottom, this is not the case in the outer London zones and there is a clear disconnect between vendors' prices (undoubtedly due to historic valuations) and buyers' aspirations.

New build flats priced in excess of £700 per sq ft are a particular challenge for investors unless discounted heavily.

Traditional investment stock such as regulated tenancies remain popular as the supply dwindles and houses priced below £400,000, as highlighted by our recent sales of The Capital Portfolio and two small regulated portfolios.

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The same positive long term investment fundamentals for residential property in all its forms continue to underpin the market in that people still need places to live whether to rent or to buy.

Demand remains strong for good income producing assets all across the UK albeit buyers are increasingly more discerning, thus careful and considered pricing is key. It is undoubtedly a buyer's market.

Unfortunately the hoped for `Brexit bounce' mentioned previously has stalled for obvious reasons and no doubt the same furore around the dreaded `B' word will kick off in earnest in the run up to October.

On a more positive note, it was evident to us that the residential market quickly grew tired of Brexit discussions and it was business as usual in Q1 and Q2 hence we see no reason for this not to happen again in Q3 and Q4.

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Student Housing

Student Housing continues to demonstrate its resilience to wider economic disturbances. Unite's £1.9Bn acquisition of Liberty Living will grab the headlines as the most significant transaction of Q2 and most likely of the year and beyond. The market was not necessarily in need of a confidence boost but if nothing else, this statement underlines the continued belief in the sector amongst investors.

2019 transaction volumes for PBSA are on track to move ahead of the £3.2Bn transacted in 2018 as the market experiences strong investor demand and good availability of stock. The widely forgotten HMO and secondary markets are equally resilient with investor appetite and curiosity having notably gathered momentum throughout the course of the year. Both sectors are benefitting from new investor appetite as opportunities can offer cheaper alternative accommodation in a market where affordability is quickly becoming a key issue.

At today's date, national student platform StuRents estimates there to be 116,000 beds with approved consent and a further 38,000 pending determination. Whether or not all these are delivered is questionable but the very depth of opportunity will continue to drive the market as traders recycle operating stock in order to fund new developments. This will continue to add value to an asset class reportedly worth a total of £65Bn (current) and provide the scale required in order to capitalise on the recent influx of Asian Capital.

Q2 brought the release of the eagerly awaited UCAS data providing the official 2018/19 student intake numbers. The report confirmed that international student applications have risen again, (up 6% year on year) despite concerns in respect of BREXIT. Overall applications fell -0.6% from year to date with acceptances similarly falling albeit a marginal -0.1%. What does this mean for student housing? On the face of it not a lot but a closer analysis of the data reveals significant trends. From a high level perspective, the Russell Group universities are experiencing growing student intakes well ahead of the national averages, whereas less established, poorer quality institutions are suffering year on year decline.

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This analysis supports the continued investor demand for stock in Russell Group towns and cities and increased scepticism for opportunities beyond. Notwithstanding, each destination requires its own micro analysis and there are sound investment opportunities to acquire well located high performing assets in secondary towns and cities underpinned by successful former polytechnic institutions offering vocational degree courses.

May 30th saw the delayed release of The Augar Review. Commissioned by Theresa May, this is a review of post 18 education in England with a focus on higher education and, more specifically, funding and tuition fees. If the panel's recommendations are implemented fully, the higher education sector should receive the same total amount of funding, but it will be distributed differently. The suggested cap on tuition fees (£7,250 from £9,250) will leave a funding deficit of c.£2Bn supposedly topped up by the government in the form of 'grants'.

However, the additional funding would be handled on a discretionary basis and is most likely to be allocated towards higher quality degree courses where teaching provides a higher value to the student and the UK wider economy. The Augar review recommendations will therefore deplete lesser university courses offering poor value for money experiences. Likely then that the better universities will prosper, offering yet further support for investment in stronger academic centres.

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The Build to Rent Market

There are now an increasing number of authentic BTR developments which have completed or are nearing completion. Moda's 'Angel Gardens' development in Manchester and L&G's 'Spring Wharf' in Bath have both launched within the last two to three months. The British Property Federation's (BPF) latest figures demonstrate this shift into the construction phase, estimating an impressive 30,357 units completed and 37,549 under construction. London has maintained the majority gain of BTR homes this quarter with approximately 73,974 and 66,116 in the regions; schemes in the regions outnumbered London this time last year.

Recent BTR announcements worthy of mention include: Telford Homes has agreed terms on a £280M design and build contract with Henderson Park and Greystar to build 894 BTR homes in Nine Elms, Battersea; L&G has agreed to forward fund Skyliner; S1's 338 BTR development in Edinburgh; Goldman Sachs has entered the UK BTR market by providing a four and a half year £118M debt facility to Apache Capital Partners and Moda Living's The Mercian, a 42-storey tower on Broad Street, Birmingham; Platform_ has acquired a site two miles north of Edinburgh city centre for a BTR development and will be submitting a new application on the site to increase the density from the current planning of 220 apartments; Apache and Moda have also partnered with North Star Investment Management to develop a £200M residential scheme of a former gasworks site in York. 450 of the 710 homes will be BTR dwellings, owned and operated by Moda alongside 20,000 sq ft of amenity space.

The appetite for Scotland has increased throughout 2019, buoyed by the acquisitions from Platform_ and L&G mentioned above. Investors are now looking to deploy capital in Scotland alongside well-connected large towns, seen as growing locations outside of the core major cities. Experience from other stabilised schemes is providing the confidence that security of income can be achieved in some secondary areas, stronger yields are helping to improve viability, as well as research showing an average premium of over 9% when compared to BTL market rents. Investors are becoming more comfortable with investment pricing being closer to hypothetical sales values which is an important factor in making it possible for BTR to work in towns and cities with sales values of less than £300 psf.

The BTR housing market continues to grow; we are starting to see a small number of contiguous schemes alongside the opportunity to acquire a portion of units from larger developments, usually delivered by a housebuilder. Hearthstone has recently acquired 100 BTR homes having committed £31M across three transactions in Manchester, Nottinghamshire, the Midlands and Southern England.

> Pricing remains difficult in these areas and although we are now seeing some incremental stabilised asset transactions, factors such as design, layout, management, and amenity space can only be considered on a case

Yields remain strong for well-designed BTR stock in prime, practical locations; in London and strong south east locations, NIYs range from 3.25% to 4.00%, with a number of major regional centres at 4% to 4.5%. Secondary locations are seeing closer to 4.75% to 5.25% NIY. Pricing remains difficult in these areas and although we are now seeing some incremental stabilised asset transactions, factors such as design, layout, management, and amenity space can only be considered on a case by case basis, which makes comparisons challenging.

Allsop Lettings and Management has launched Moorfield's second BTR development: The Trilogy, Manchester. 64% of the 232 units have now been let, with 32% having been pre-let. The Forge in Newcastle, Moorfield's first BTR development, continues to perform well with 53% let over three phases, the third phase having just been released. The Duet, Moorfield's third BTR development, located in Salford is due for completion in October and will be released to the market in mid-July.

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Residential Auction Market

In Q1, Allsop Residential Auctions sold 406 lots for a total value of £113m (success rate 76%).

Since then Allsop has raised £66m from the sale of 228 lots (76%) from its 30 May residential catalogue and £38m from the sale of 133 lots (71%) from its 18 July residential catalogue. This has brought the total raised in 2019 from the sale of residential lots to over £217m.

May auction highlights

Of the total raised in May, approximately £57.3m was generated from properties located in the South-East. Of these, 111 lots with a combined value of £45.5m, were situated within the M25.

The most valuable lot to sell under the hammer in May was lot 33, an unbroken freehold building in Eton Avenue, Hampstead, London. Offered to the market for the first time in 20 years, this valuable investment was arranged as seven self-contained, six non-self-contained flats. Mainly let and producing over £181,000 pa it sold at £4.66m. Also in London, lot 196, a vacant freehold terrace comprising of three, two-bedroom flats in sought-after Chiswick sold at £1.7m

The largest sale of the catalogue achieved prior to auction was lot 66 a half acre site in South West London's Colliers Wood. Currently occupied by eight, fully-let industrial units generating £101,650 pa, the site has the potential for redevelopment, subject to planning consent. Lot 185, a well-located block of flats with a house and planning permission to convert into three apartments and one, two-bedroom house on Long Acre, in the heart of Covent Garden, also sold prior to auction.

Indeed, investments with potential for redevelopment remain in demand. Lot 28, a freehold office building with an application for permitted development submitted to convert the site into 15 flats in Wembley, sold at £1.38m.

July auction highlights

The largest lot of the catalogue was lot 54 a former office building in Slough. Phoenix Building was offered with permitted development rights for conversion to 31 self-contained apartments with a total area of 12,370 sq ft. It was sold prior to auction from a guide of £3.25-3.5m.

The highest price achieved under the hammer was lot 114, 8 Inglewood Road, West Hampstead, London NW6. This freehold mid terraced building is arranged as five self-contained flats. Four flats are let on assured shorthold tenancies and one is let on a regulated tenancy. It is producing £80,312 per annum. It was knocked down for £1.555m reflecting a gross yield of 6.69%.

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Market comment

The ongoing political chaos and the paralysis at Westminster caused by Brexit and the Conservative leadership contest became the new normal in the light of Boris's appointment. Although there is still an air of caution in the room, buyers and sellers are continuing to trade.

Attractive reserves and appropriate guide pricing is still producing healthy competition and strong results. In room activity has become an effective combination of sales under the hammer and a race between bidders to sweep up lots that didn't quite meet their reserves. In some cases unsold lots are achieving above reserve immediately after having been offered. It seems that initial timidity is giving way to a post-sale clamber for available stock.

The next residential auction will take place on September 19th at The InterContinental London Park Lane, W1J 7QY.

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