march 2014

investment bulletin

Fletcher King
CHARTERED SURVEYORS

Institutional Investment in Property

Recovery finally seems to be established. April's Preliminary Estimate of GDP indicates that the economy followed up its increase of 0.7% in Q4 2013 by posting a further 0.8% of growth in Q1. Economic growth in the 4 quarters to the end of March amounted to 3.1% compared to growth of 2.7% in the 4 quarters to the end of December.

Rising consumer confidence has been a key factor supporting the growth in the economy. In March GfK's UK Consumer Confidence Index pointed to continuing improvement in sentiment. GfK commented that the current long term trend is very strongly positive.

In February, for the first time since the start of the Great Recession in 2008, wages grew faster than prices measured by the CPI although not the RPI. However, there is a long way to go before wages regain their 2008 value.

During the recession, the economy shrank by 7.2% but at the end of the first quarter GDP was estimated to be just 0.6% lower than the pre-financial crisis peak in Q1 2008. But the economy remains some 13.7% below its potential level. The MPC has said it, "intends to maintain the present highly stimulative monetary policy until the economic slack has been substantially reduced." The output gap leaves scope for interest rates to remain low for some time yet.

Taking a lead from the broader economy, the commercial property market enjoyed its fourth consecutive quarter of increasing prices in the first quarter. The pace of growth moderated slightly from the end of 2013 and capital values as measured by the IPD Monthly index rose by 2.3% in Q1 2014 compared to 3.0% in Q4 2013. Total returns decreased to 3.9% in Q1 from 4.7% in Q4 but total returns in the 12 months to March increased to 14.0% from 10.9% in the 12-months to December.

As optimism about the outlook for the economy improved, institutional investors strengthened their appetite for commercial property in Q4 acquiring property assets worth £3.0 billion and recording sales of £1.4 billion. Net investment in Q4 of £1.6 billion compared to net investment of £722 million in Q3. Since the start of the market recovery in Q4 2009 institutions have been net purchasers of commercial property in 15 out of 17 quarters. In the 12 months to December, net investment by institutions amounted to £2.0 billion compared with net investment of £800 million in the 12 months to September.

In the fourth quarter, pension funds invested a further £517 million and have been net investors for the last twenty seven quarters. Total investment by pension funds in the 12 months to December amounted to £871 million compared to £643 million in the 12 months to September and £1.4 billion in the year to December 2012. Life companies returned to acquiring property in Q4. Net investment in Q4 amounted to £766 million compared to net sales of £70 million in Q3. Total disinvestment in the 12 months to the end of December amounted to £357 million compared to disinvestment of £1.2 billion in the 12 months ending September and a net disinvestment of £790 million in the year to December 2012. Property Unit Trusts were net investors for the seventeenth consecutive quarter and invested £245 million in Q4. Net investment in the 12 months to the end of December amounted to £1.0 billion compared with net investment of £874 million in the 12 months ending September and £347 million in the year to December 2012.

There are early indications that the predominance of overseas money focused on Central London assets may be diminishing.

Central London offices made up 23% of all transactions in Q1 as investment decreased by 78% to £1.9 billion from £8.8 billion in Q4 when investment turnover was heightened by the purchase of a 50% stake in Broadgate for £1.7 billion by Singapore's sovereign wealth fund and the acquisition by Kuwaiti owned St Martins Property Corporation of More London on the Southbank also for a further £1.7 billion. Long run average quarterly investment in Central London offices is £2.9 billion.

Investment by UK institutions in Q1 decreased by 44% to £2.7 billion from £4.9 billion in Q4. Money into commercial property from overseas investors fell 75% to £2.7 billion from a record £10.8 billion as overseas investors share of the UK investment market decreased from 51% in Q4 2013 to 32% in Q1 2014.

Total institutional investment shrank by 51% to £15 billion in Q4 from £31 billion in Q3. Institutions made net investments in Q4 of £7.7 billion in overseas equities, £3.2 billion in UK gilts, but were net sellers of £418 million in UK equities and £431 million in cash and other short term instruments

Investment in UK commercial property

The value of UK commercial investment transactions in 2013 rose 60% to £53.6 billion from £33.5 billion in 2012. 2013's total was the highest since 2007 as investment in Q4 reached the highest quarterly level since at least March 2000. Central London was the focus of 45% of all investment transactions in 2013 with the Rest of London and the South East accounting for a further 20%.

For a four year period ending in 2007 investment transactions averaged £54.6 billion a year as the commercial market bubble inflated. Average investment in every other year between 2000 and 2012 totaled no more than £35.8 billion and averaged £30.8 billion.

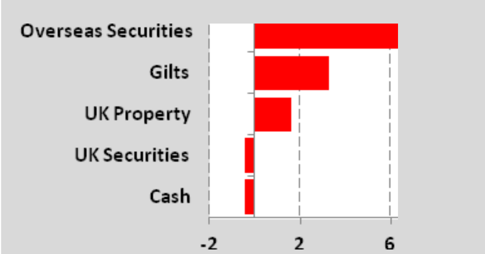
Perhaps then it is no bad thing that the value of UK commercial investment transactions in Q1 shrank

Investment in UK Property
Q4 2013 (£m)

	Pension Funds	Insurance Companies	Unit Trusts	Total
Buy	1,020	1,525	444	2,989
Sell	503	697	199	1,399
Net	**517**	**828**	**245**	**1,590**

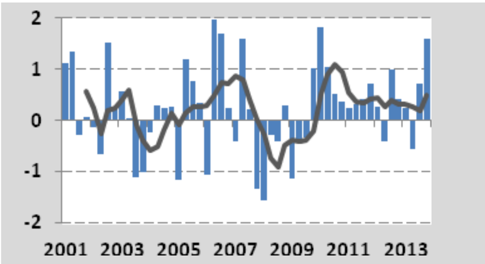
Source: National Statistics

Net Institutional Investment (£billion) Q4 2013
By asset type



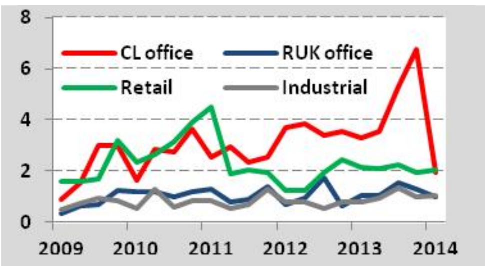
Source: National Statistics

Net Institutional Investment in Property (£billion)



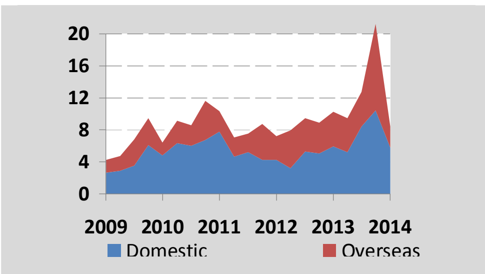
Source: National Statistics

Investment by sector (£bn)



Source: Property Data

Property investors by type (£bn)



Source: Property Data

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60% to £8.4 billion from £21.20 billion in Q4. In the light of this, Q1's performance at least bears more favourable comparison to long run average quarterly investment of £9.4 billion.

Across the regions the most popular destinations for capital in the last five years have been the North West, Scotland and West Midlands. Indicating perhaps that investors in commercial property are less daunted by the prospects for an independent Scotland than the rest of the business community. The least popular destinations were the North East, Wales and East Midlands; which is not surprising as these are the three smallest regional economies.

In the five years to 2013 overseas investors accounted for 18% of all purchases in the regions outside London and the South East; whereas 61% of Central London purchases originated overseas.

Over the last five years, investor's most popular cities were Manchester, Birmingham and Glasgow. Manchester and Birmingham have the two largest city economies outside London and the South East and Glasgow remains the UK's biggest regional office market.

The least popular of the UK's larger centres were Edinburgh, Bristol and surprisingly, Reading. Reading is the largest office centre in the South East, the seventh largest in the UK outside London and has the third largest local economy. Its office vacancy rate, however, remains high at 17% whilst total availability is even higher at 21% of stock. The industrial vacancy rate is 13% and total availability is 16%. In both office and industrial markets the absorption rates over the last twelve months are negative; that is to say that more space is still coming onto the market than is being let.

As Central London assets become more expensive and the economic recovery spreads to the regions, investors should feel more comfortable moving up the risk curve and buying into the regions and cities beyond London and the South East. There is anecdotal evidence of this activity. Aviva Investors launched the UK Real Estate Recovery II Fund, an ungeared fund that will invest in UK commercial real estate with a focus on secondary assets, in the second half of last year. St. Modwen, a Midlands based Property Company and developer said at the end of 2013 that it was starting to see an increase in occupier demand outside the South East. At about the same time RBS sold its first portfolio of distressed UK commercial property assets. The 28 industrial distribution units in the 2m sq ft "Sapphire" portfolio had a guide price of £63m and were sold to a hedge fund. Other hedge funds have also announced plans to buy property in northern England and the Midlands.

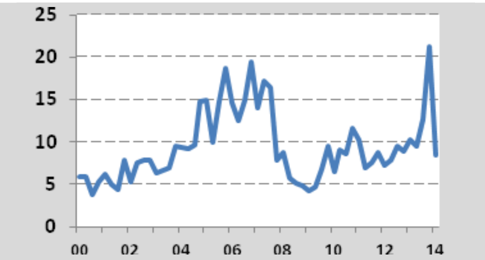
The decrease in investment levels in the first quarter was a nationwide feature. Investment across London and the South East, however, fell 73% while investment in the Rest of the UK was down 41%.

In Q1 2014 rolling 12m investment in industrials increased by 7% to £4.2 billion; 75% of this total was invested in the Rest of the UK regions. Rolling 12m investment in Rest of UK offices increased by 12% in Q1 to £2.3 billion.

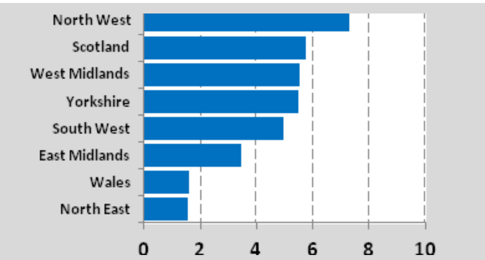
Investment in the West Midlands, North East and Wales grew quarter on quarter. The biggest transactions in Q1 being Intu Properties purchase of Merry Hill Shopping Centre; Aberdeen Asset Management's purchase of Cardiff's Capital Shopping Park; and the BBC Pension Fund's purchase of Time Central, Gallowgate, Newcastle upon Tyne.

Overseas cash flows may slow from hereon but it is highly unlikely that they will be reversed. After factoring in currency movements, overseas investors in Central London assets under-performed domestic investors in the same asset class for all of the last five years bar the last nine months because of the weakness of sterling. As sterling hardened against world currencies from the middle of last year, this situation has now been reversed and existing overseas investors are now out performing domestic investors. Whilst the recovery in the value of sterling benefits existing overseas investors, it does, however, mean that overseas investors face higher price barriers to entering the UK market.

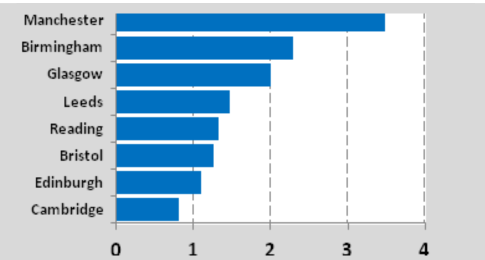
UK Commercial investment transactions (£bn)



Investment in UK regions 2009-13 (£bn)



Investment in UK cities 2009-13 (£bn)



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