Research

Investment Property Forum UK Consensus Forecasts

AUGUST 2016

SUMMARY REPORT

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This Programme supports the IPF's wider goals of enhancing the understanding and efficiency of property as an investment. The initiative provides the UK property investment market with the ability to deliver substantial, objective and high-quality analysis on a structured basis. It encourages the whole industry to engage with other financial markets, the wider business community and government on a range of complementary issues.

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Survey of Independent Forecasts for UK Commercial Property Investment August 2016

Against a backdrop of uncertainty created by the referendum result, the 24 contributors to this quarter's Consensus Forecast were faced with the task of providing projections for UK commercial property over the next five years. Forecasts were generated within a period of only eight weeks (the earliest coming just a few days after the June vote) and, unsurprisingly, short-term projections across all measures have weakened considerably compared to the May figures. However, a relatively stronger bounce back in capital values (and total returns) emerges in later years of the forecast period – albeit from a lower base than previously predicted.

Key points

Deteriorating near-term performance

- Forecasts for all measures have declined significantly over the quarter; the **All Property rental growth** forecast average for **2016** now lies at **1.3%** (from 3.1% in May). All sectors have been affected by the referendum decision, the largest movement being in the Office average, which has declined by almost 370 bps (to 1.6%). Forecasts range between 0.6% for Retail Warehouses to 2.2% for Industrials.
- Average **capital value growth** rates have fallen below zero across all sectors, resulting in an **All Property** average of **-5.3%** (from 2.2% in May). Average declines range between 614 bps and 947 bps for Standard Retail and Offices respectively.
- The **2016 All Property total return** is now predicted to be **-0.4%** (from 7.1% three months ago).

2017 to mark the bottom of the market?

- Expectations for **2017** are that further weakening in occupational markets will result in negative rental value growth of **-0.7%** for **All Property**, as only the Industrial and Retail Warehouse sectors do not drop below zero growth. **Capital values** are expected to continue to fall, producing an **All Property** growth rate of **-4.4%**. The principal driver of this further weakening is the Office sector, predicted to deliver -6.4% growth, whilst averages for remaining sectors lie between -3.0% and -4.2%.
- Despite continued negative capital value growth in **2017**, **total returns** are likely to be weakly positive for all but the Office sector, due to the contribution of income, averaging **0.6%** at the **All Property** level.

Recovery from 2018 onwards

- With the exception of Offices, following the next two years, all sectors return to positive growth for both rents and capital values. The All Property rental growth rate for 2018 is virtually zero, whilst **capital value** growth also is expected to re-emerge, to produce an **All Property** rate of **0.5%** and **total return** of **5.7%** (supported by an implied income return of 5.3%).
- Whilst rental value growth rates are not expected to match pre-referendum levels (other than in the case of Offices in 2020), **capital value growth** is predicted to pick up and exceed the May 2016 forecasts for **2019 and 2020**, resulting in **All Property** rates of **1.6% and 1.9%** in these years (from -0.1% and 0.1% three months ago).
- **Total returns** in **2019 and 2020** are projected to average **6.8% and 7.1%**, with Industrials delivering up to 7.3% and 7.5% in these final years of the survey period.

Interesting vintages!

- Analysing forecast data by age, **later** (August) **forecasts** appear to show a **more moderate** reaction to the referendum outcome, with 2016 rental growth 50 bps higher than July's average, capital growth 175 bps better and total returns over 200 bps higher. This more positive sentiment, notwithstanding current uncertainties, holds across all measures until 2019 and for each year's rental growth projections.

Economic background

The most recent official data on the economy relates to the period predating the vote to leave the European Union. The decision precipitated considerable upheaval in the financial markets and this uncertainty over the UK's post-Brexit relationship with the rest of the single market is likely to persist for a considerable period – it will take years, not months, to finalise this new order.

The second quarter preliminary estimate of gross domestic product (GDP) from the Office for National Statistics (ONS) recorded an increase of 0.6% in the period April to June 2016, compared to growth of 0.4% in the preceding quarter. Output increased in two of the main industrial groupings: services increased by 0.5% and production by 2.1%. In contrast, however, construction fell by 0.4% and agriculture by 1.0%. GDP was 2.2% higher in Quarter 2 2016, compared to the same quarter a year ago, and was estimated to be 7.7% higher than the pre-economic downturn peak of Quarter 1 2008.

The ONS reported a decrease of £3.0 billion to £23.7 billion in public sector net borrowing (excluding public sector banks) for the current financial year to date (April to July 2016), compared to the same period in 2015. In its analysis, the Office for Budgetary Responsibility (OBR) estimates that the public sector will borrow £55.5 billion during the financial year ending March 2017; a reduction of £19.8 billion against the outturn for the financial year ending March 2016.

As a measure of inflation, the Consumer Prices Index (CPI) rose by 0.6% in the year to July 2016, compared to a 0.5% rise in the year to June, the main drivers were rising prices for motor fuels, alcoholic beverages and accommodation services, combined with a smaller fall in food prices than a year ago. These upward pressures were partially offset by falls in social housing rent and prices for certain games and toys.

The Bank of England's Monetary Policy Committee (MPC) noted at its August meeting that, following the vote to leave the European Union, the exchange rate had fallen and the outlook for growth in the short to medium term had "weakened markedly". Consistent with a weaker medium term outlook for the real economy, which could result in a rise in unemployment, recent surveys of business activity, confidence and optimism indicate that much growth in GDP is unlikely in the second half of 2016. The MPC voted unanimously to reduce Bank Rate by 25 basis points to 0.25%, thus lowering borrowing costs for households and business, as well as to introduce a Term Funding Scheme (to provide funding for banks at interest rates close to Bank Rate), the purchase of up to £10 billion of UK corporate bonds and an expansion of the asset purchase scheme for gilts (Quantitative Easing) of £60 billion, taking the total stock of these asset purchases to £435 billion – all to be financed by the issuance of central bank reserves.

The ONS August 2016 UK labour market release reported 31.75 million people in work in the period April to June 2016 (172,000 more than for January to March and 606,000 more than for a year earlier), of whom 23.22 million were working full-time and 8.53 million working part-time (374,000 and 231,000 more respectively than a year ago). An employment rate of 74.5% is the highest since comparable records began in 1971, whilst 1.64 million, representing a rate of 4.9%, were unemployed (people not in work but seeking and available to work), 208,000 fewer than a year ago, when the unemployment rate was 5.6%. Average weekly earnings increased by 2.4% including bonuses (2.3% excluding bonuses) compared to a year earlier.

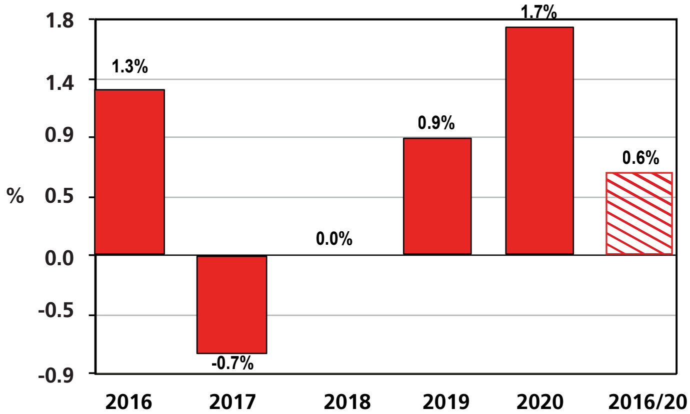
The ONS July 2016 Retail Sales in Great Britain release covered a four week period, from 3 July to 30 July 2016, and therefore includes data for the month following the EU referendum. The volume of retail sales was estimated to have increased by 5.9% compared to July 2015. An increase of 3.6% in the annual retail industry spend was reported, compared to July 2015, and a 1.6% increase compared to June 2016. The amount spent online in July 2016 increased by 16.7% compared to the same month in 2015, and represented an increase of 1.2% over June 2016.

All Property rental value growth forecasts

From a current year projection of 3.1% in May, contributors now anticipate considerably weaker rental growth, the average having fallen by more than 1.8% over the quarter. The full impact of the Brexit decision on the occupational market is registered in 2017, with negative growth now predicted (from 2.6% three months ago).

Growth prospects, whilst on an upward trend from next year's nadir, continue to be adversely affected through 2018 and 2019 (compared to previous forecasts of 1.9% and 1.5% respectively).

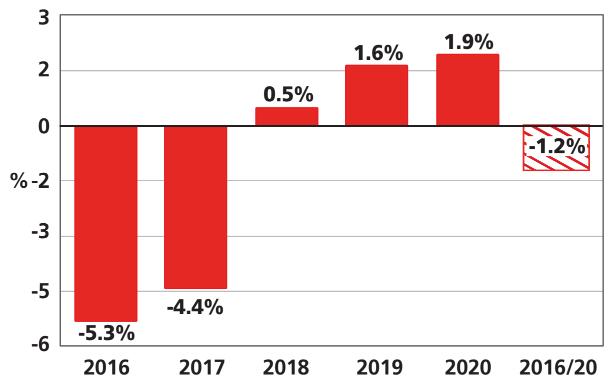
However, by 2020, with a continuing upward trajectory, growth could exceed the previous forecast by 25 bps, although too little to offset the influence of preceding years on the five-year average (down from 2.1%).



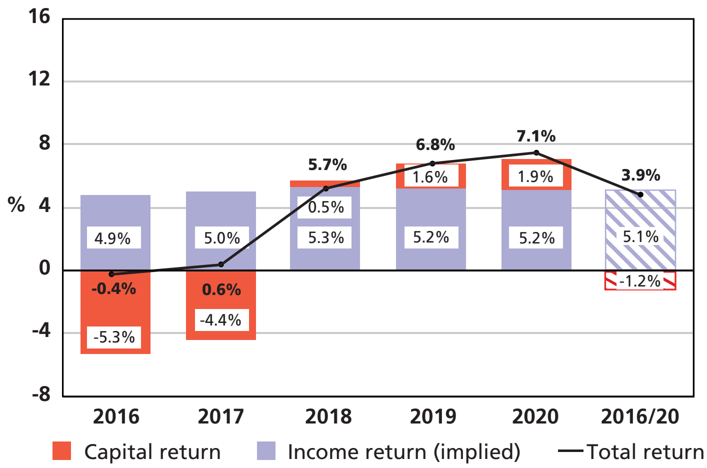
All Property average capital value growth forecasts

Capital value growth estimations have fallen considerably over the quarter, with 2016's forecast deteriorating by almost 750 bps since May's 2.2% projection. Whilst values are expected to weaken further in 2017, the rate of decline is anticipated to slow, although almost 520 bps lower than the 0.8% predicted three months ago.

By 2018, a degree of equilibrium appears to emerge amongst contributors with the growth rate matching the previous forecast for that year. In contrast to the first two years of the forecast period, by 2019 and 2020 contributors predict better average growth rates than three months ago (previously -0.1% and 0.1% respectively), albeit off a much lower base. This later improvement is insufficient, however, to counter the impact of negative growth in the first two years of the survey period.



All Property total return forecasts



The predicted reduction in capital values to negative growth has led to a precipitous fall in the total return forecast for 2016, from 7.1% three months ago to -0.4% currently. This represents the largest quarter-on-quarter downward shift in total returns forecast recorded by this survey to date. The last occasion the Consensus Forecasts recorded negative returns was in November 2009 (of -2.6% for that year), being the eighth and final consecutive quarter of sub-zero growth predictions for the then current year. (The actual IPD total return for 2009 was 3.5%, following -22.2% in 2008.)

Income will be the primary contributor to total return throughout the current survey period.

All Property survey results by contributor type

(Forecasts in brackets are May 2016 comparisons)

Property Advisors and Research Consultancies

9 (10) contributors	Rental value growth (%)						Capital value growth (%)						Total return (%)					
	2016		2017		2016/20		2016		2017		2016/20		2016		2017		2016/20	
Maximum	3.2	(3.9)	1.2	(3.7)	2.3	(3.3)	0.2	(4.7)	-0.6	(4.4)	0.7	(2.8)	5.7	(9.5)	5.3	(9.5)	6.5	(7.6)
Minimum	-1.5	(1.8)	-3.8	(1.5)	-0.6	(1.2)	-8.3	(0.3)	-8.4	(-7.6)	-2.3	(-0.8)	-3.3	(5.7)	-3.1	(-2.2)	2.8	(3.9)
Range	4.7	(2.1)	5.1	(2.2)	2.9	(2.1)	8.4	(4.3)	7.8	(12.0)	3.0	(3.6)	9.0	(3.8)	8.4	(11.7)	3.7	(3.7)
Median	1.9	(3.4)	0.0	(2.7)	0.7	(2.1)	-2.8	(2.6)	-4.7	(0.7)	-1.4	(1.3)	2.5	(7.3)	-0.1	(5.4)	3.6	(6.2)
Mean	**1.5**	**(3.3)**	**-0.4**	**(2.6)**	**0.7**	**(2.2)**	**-3.5**	**(2.7)**	**-5.0**	**(0.3)**	**-1.3**	**(1.0)**	**1.4**	**(7.6)**	**0.1**	**(5.2)**	**4.0**	**(6.0)**

Fund Managers*

14 (17) contributors	Rental value growth (%)						Capital value growth (%)						Total return (%)					
	2016		2017		2016/20		2016		2017		2016/20		2016		2017		2016/20	
Maximum	3.0	(4.4)	2.0	(4.0)	2.2	(3.0)	-1.2	(5.2)	0.0	(5.3)	0.8	(2.2)	3.0	(10.1)	4.0	(10.4)	5.4	(8.0)
Minimum	-0.6	(2.0)	-5.0	(1.0)	-0.1	(1.1)	-10.0	(0.0)	-10.7	(-1.5)	-3.5	(-1.6)	-5.9	(5.0)	-5.4	(3.1)	2.2	(3.3)
Range	3.6	(2.4)	7.0	(3.0)	2.3	(1.9)	8.8	(5.2)	10.7	(6.8)	4.3	(3.8)	8.9	(5.1)	9.4	(7.3)	3.2	(4.7)
Median	1.4	(2.8)	-1.1	(2.5)	0.5	(2.1)	-6.5	(1.9)	-3.2	(0.4)	-1.2	(0.2)	-1.7	(6.7)	1.8	(5.3)	3.8	(5.3)
Mean	**1.1**	**(3.0)**	**-1.0**	**(2.6)**	**0.6**	**(2.1)**	**-6.6**	**(1.9)**	**-4.2**	**(1.1)**	**-1.2**	**(0.4)**	**-1.8**	**(6.8)**	**0.7**	**(6.0)**	**3.7**	**(5.4)**

All Forecasters*

24 (28) contributors	Rental value growth (%)						Capital value growth (%)						Total return (%)					
	2016		2017		2016/20		2016		2017		2016/20		2016		2017		2016/20	
Maximum	3.2	(4.4)	2.0	(4.0)	2.3	(3.3)	0.2	(5.2)	0.0	(5.3)	0.8	(2.8)	5.7	(10.1)	5.3	(10.4)	6.5	(8.0)
Minimum	-1.5	(1.8)	-5.0	(1.0)	-0.6	(1.1)	-10.0	(0.0)	-10.7	(-7.6)	-3.5	(-1.6)	-5.9	(5.0)	-5.4	(-2.2)	2.2	(3.3)
Range	4.7	(2.6)	7.0	(3.0)	2.9	(2.2)	10.2	(5.2)	10.7	(12.9)	4.3	(4.4)	11.6	(5.1)	10.7	(12.6)	4.3	(4.7)
Std. Dev.	1.1	(0.6)	1.6	(0.7)	0.6	(0.5)	2.8	(1.3)	2.8	(2.4)	1.1	(1.1)	3.0	(1.3)	2.8	(2.4)	1.1	(1.2)
Median	1.5	(3.1)	-0.3	(2.6)	0.6	(2.1)	-6.0	(2.3)	-4.5	(0.4)	-1.4	(0.9)	-0.9	(7.0)	0.1	(5.2)	3.6	(5.8)
Mean	**1.3**	**(3.1)**	**-0.7**	**(2.6)**	**0.6**	**(2.1)**	**-5.3**	**(2.2)**	**-4.4**	**(0.8)**	**-1.2**	**(0.6)**	**-0.4**	**(7.1)**	**0.6**	**(5.7)**	**3.9**	**(5.6)**

*Includes one Fund Manager who provided rental growth forecasts only at the All Property and each sector level (including central London offices).

Notes:

1. Figures are subject to rounding and are forecasts of All Property or relevant segment Annual Index measures published by the Investment Property Databank (IPD). These measures relate to standing investments only, meaning that the effects of transaction activity, developments and certain active management initiatives are specifically excluded.
2. To qualify, all forecasts were produced no more than 12 weeks prior to the survey date.
3. Maximum: The strongest growth or return forecast in the survey under each heading.
4. Minimum: The weakest growth or return forecast in the survey under each heading.
5. Range: The difference between the maximum and minimum figures in the survey.
6. Median: The middle forecast when all observations are ranked in order. The average of the middle two forecasts is taken where there is an even number of observations.
7. Mean: The arithmetic mean of all forecasts in the survey under each heading. All views carry equal weight.
8. Standard deviation: A statistical measure of the spread of forecasts around the mean. Calculated at the 'All forecaster' level only.
9. The sector figures are not analysed by contributor type; all figures are shown at the 'All forecaster' level.
10. In the charts and tables, 'All Property' figures were contributed by 24 participants for each performance measure (other than one Fund Manager who provided rental growth forecasts only). Full sector forecasts were received from reduced samples of 21/18 contributors.

Acknowledgements

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Note

Consensus forecasts further the objective of the IPF to enhance the efficiency of the real estate investment market. The IPF is extremely grateful for the continuing support of the contributors as noted above. This publication is only possible thanks to the provision of these individual forecasts.

If your organisation wishes to contribute to future surveys, please contact the IPF Research Director at pcraddock@ipf.org.uk.

Disclaimer

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