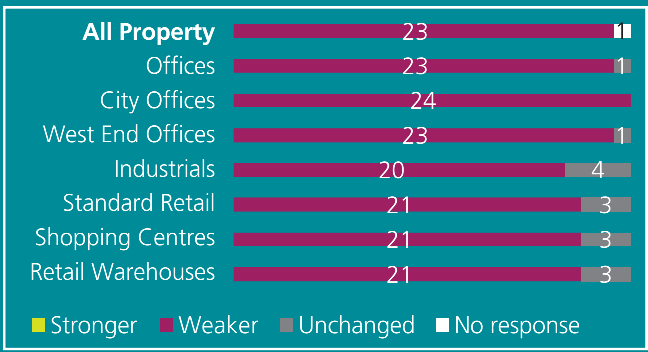
Research Programme
2015-2018

Post-Brexit Forecaster Sentiment Survey July 2016

Following the 23 June referendum result for the UK to leave the European Union, the IPF invited its regular Consensus Forecasts contributors to participate in a sentiment survey. Based on responses from 24 organisations, this note compares current opinion to pre-Brexit projections of rental and capital value growth over the near, medium and longer term (i.e. 2016/2017, 2018/2019 and 2020 and beyond) with comments from individual contributors.

RENTAL VALUE GROWTH

2016/2017



"While all sectors are weaker, Central London offices have been marked down more heavily than the rest, industrials the least. Central London is the only retail sub sector where rents are expected to rise over the period."

"The market was slowing anyway pre Brexit, but the decision is likely to affect corporate profitability and consumer confidence and spending power."

"Lower economic growth and the risk of a recession [will] lead occupiers across all sectors to lay off staff, cut costs and defer investment. [As a consequence] demand for commercial property space decreases and rental growth falls back from current levels."

"Consensus economic forecasts are already down for the UK, but it remains difficult to assess if this entails slower growth (best case), a shallow technical [recession] (possible) or series of them or prolonged depression (less likely). But even on the better case, continued but slower positive economic growth, still implies more sluggish occupational demand and thus rents."

"Offices are more susceptible to the short-term implication, due to the uncertainty that the results will create for the business environment. Retail and industrial are more impacted in the medium to long term depending on the outcome of the negotiations."

"We see the impact as greatest in those parts of the retail sector that were already struggling pre-Brexit. Some of the nervousness surrounding City offices is overdone – tech has been a large and growing share of demand for some time, and it remains to be seen that the UK will lose financial passporting."

"We are now assuming a reduction in GVA growth in the remainder of 2016 and 2017 to 1.3% y/y, with flat Financial & Business Service employment growth and pedestrian Household Spending growth. On the upside, the fall in the pound is expected to increase spending by overseas visitors."

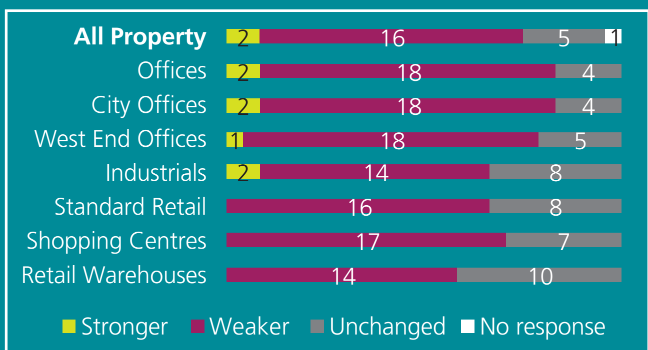
2018/2019

"Essentially, only those areas of the market where there are structural drivers of demand [are] broadly unchanged. The remainder factor in a weaker demand environment for a considerable period of time, … the uncertainty caused by Brexit will be long-lasting and likely have knock-on effects across the more macro picture."

"Brexit will damage the long run potential rate of economic growth in the UK. The uncertainties created will last for at least 5 years as the UK firstly leaves and then seeks to re-negotiate its terms of access to the single market."

"While some have cited 2 years for trade to be sorted out, issues such as passporting of UK services could take even longer."

"… this is dependant on the outcome of the negotiations. It is perfectly possible that the retail and logistic sectors may not be affected if a deal for the status quo on UK access to the single market is agreed."



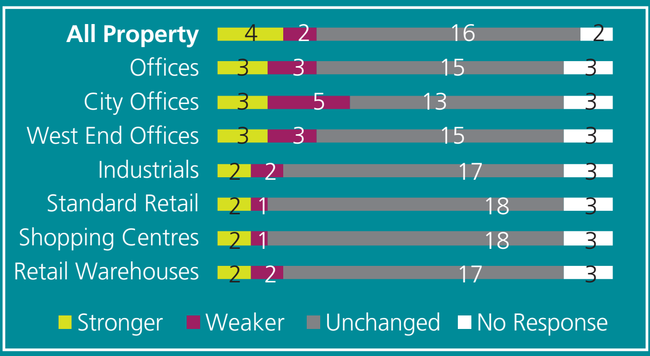
"Although weaker in 2018/19, [rents] are more weak for some segments that others; i.e. the hit to the rental outlook … is not uniform."

2018/2019 cont'd

"There may be pockets of opportunity. e.g. if Scotland were to remain and [rest of the] UK leave there may be relocations to Edinburgh and Glasgow from London. … NOT a forecast … but just one of many scenarios which may unfold over the coming years."

"Many of the worst case scenarios for the City office market will probably fail to materialise. Also, many people are overlooking the fact that Brexit will put the brakes on an already thin development pipeline."

2020 & Beyond



"It is far too soon to judge whether long-term assumptions should be altered as a result of Brexit. Arguably, any long-term changes would be down to major structural shifts, such as automation of jobs, the influence of technology, demographic shifts etc. But decisions regarding long-term growth are not taken lightly or as a result of short-term demand shocks like we expect to see now."

"Brexit will damage the long-run potential rate of economic growth in the UK. The uncertainties created will last for at least 5 years as the UK firstly leaves and then seeks to re-negotiate its terms of access to the single market."

"We can see a risk to long-term structural growth rates if the UK becomes more closed to immigration and thus subject to declining population."

"Offices are stronger in growth terms due to development being shelved in the later years that had previous pushed rents lower; retail is mixed – [with the] housing market and big ticket items hitting retail warehousing – supermarkets are doing better and helping push growth in standard retail. Although growth unchanged in the year the level is not back to previous level[s]."

"Perhaps stronger, if EU renegotiation can be completed within 5 years and the UK's economic outlook is more stable, thus allowing real estate markets to 'catch up' some of the rental growth lost over 2016/20."

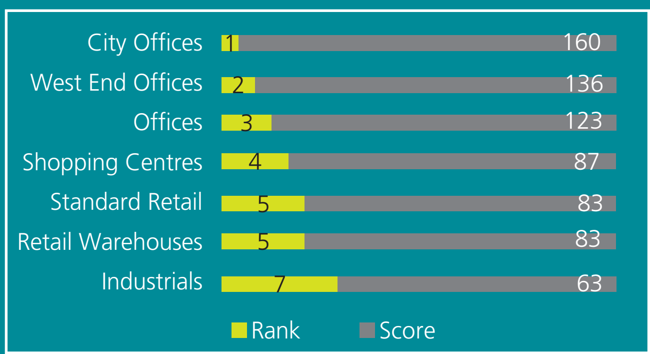
"Whilst it is too early to know which of the many potential outcomes of Brexit will come to pass, assuming that the very worst case scenarios can be avoided, we do not see any reason to reduce long-term rental growth prospects across UK real estate."

"One benefit of the result should be a reduction in new construction, particularly in London. This reduced supply will offset any long-term reduction in occupier demand. So whilst the short-term outcome of the referendum is adverse, real estate is likely to be better value for investors at some point in the coming months/years than it was before the referendum. The question of course is when?"

Sectors most likely to be affected

"City office and their financial services occupiers have most to lose. Major concerns are loss of passporting rights, moves to force all euro transactions to be cleared/settled within the Eurozone & aggressive competition from France/ Paris, Germany/Frankfurt and other EU cities."

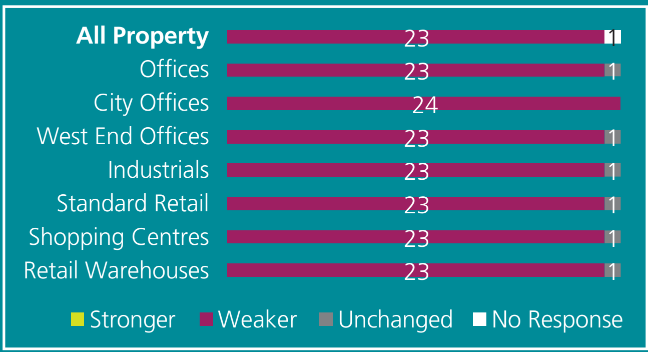
"Offices will take biggest hit short term but likely to come back as development is curtailed and so a demand/supply imbalance at the back end of the forecasts will boost rents. Many markets are not over-supplied at the moment and so the down shift won't be as great as at points when there has been high vacancy in place."



"Industrial will be supported by the tenant range . Retail warehouses [will be] exposed to drops in consumer confidence and reduced housing activity. Shopping centres will be supported by prime centres."

CAPITAL VALUE GROWTH

2016/2017



" Driven by rental decline and rising yields across the board. Very long, secure income with inflation-linked uplifts and 5A1* covenants may escape this but it will be asset specific in our view."

" Possibly weaker although my forecasts already priced in Brexit."

" A correction in prices is perfectly rational: not because the long-term growth prospects of the UK economy are now necessarily any lower, but because the range of possible outcomes is now so much wider (as they also are in the EU) and some very negative."

" All sectors [are] equally exposed and similar to other market corrections the spread in value falls converge."

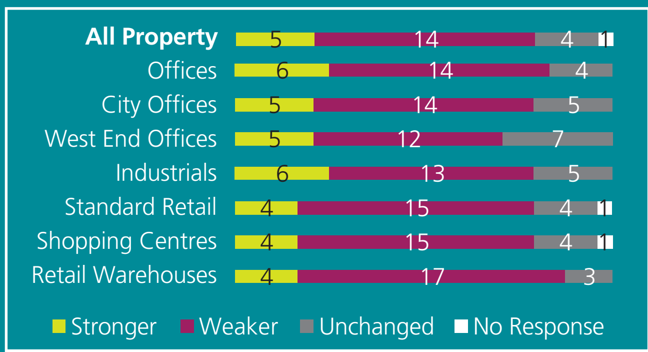
" Weaker growth, even if still positive suggests rising yields. Monetary policy response is likely to be less effective than last time around in this respect – but [the] degree of upward yield pressure also depends on rates. The third driver of value – debt finance availability – has seen pricing (margins) widen already from 150bps to over 200bps in the first week alone ..."

2018/2019

" While our expectations wouldn't be for a markedly different outcome at the back end, weaker occupational markets do imply weaker capital performance. Much will depend on the speed of decline in the shorter term as to whether a modest recovery later in the forecast period will mean the numbers are improved. At present we do not expect much recovery in 2018/19. Our expectation for the next 5 years in aggregate is more negative than before."

" Growth in 2019 driven by a rebound – again in levels terms we see a permanent hit to values in many cases but the growth in values from 18 to 19 is higher."

" At some point there will be ambulance chaser money re-entering the market, it will be majority foreign in our view, and typically such money favours London. Also we see Brexit accelerating the trend of retailers shifting their focus from shops to multi-channel, which will draw more investors towards industrial."



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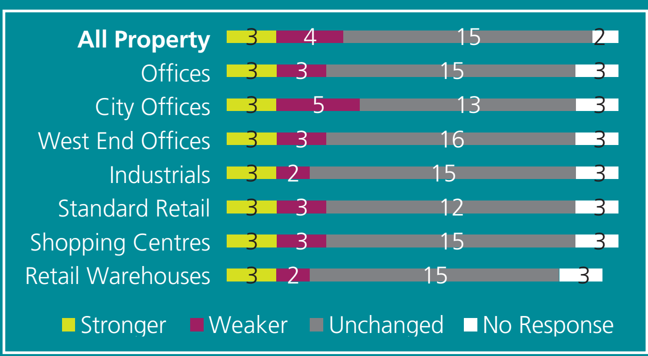
2020 & Beyond



" Possibly weaker although my forecasts already priced in Brexit."

" Over the long term, yields play no part in capital growth – all growth is derived from income growth through rising rental values. Yields, in our view, fluctuate around a level that reflects the risk premium of the asset. As we have not changed our view on long-term rental growth, there is likewise no change in capital growth."

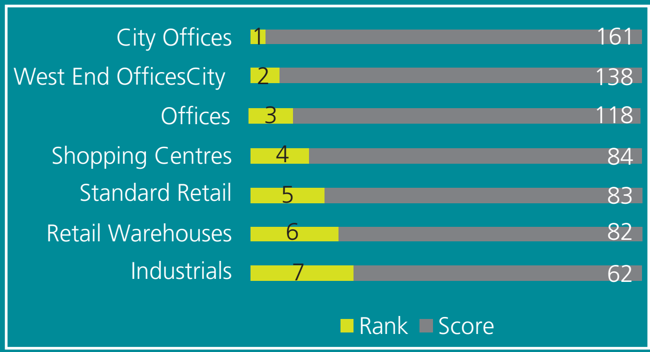
" … in our previous forecasts we were seeing 2018 as the peak of the cycle and so 2019 and 2020 would have been where values were rea djusted in those conditions."

*Dun & Bradstreet (D&B) Ratings of Financial Strength Indicator (5A = Tangible Net Worth of £35m and above) and Risk Indicator (1 = Minimum Risk of Probability of Failure).

Sectors most likely to be affected

" No difference in the hierarchy, except for standard retails holding up better in yield terms than retail warehouses due to the prevalence of smaller, private buyers seeking income."

" Some of the prime end retail will be supported by foreign visitors and so may seem safe – also domestically people need to shop so again relative safety – the dominance of London in the weightings and the globalised nature of services occupying these will make them seem more risky – plus they were near their cyclical high – Industrial should fare OK as dependent on many factors and many have long leases etc. – so security of income will again see them as being safer longer term with the risk premium reducing more quickly than for offices."



" In addition to threats to financial sector jobs in London, capital volatility is greater ..."

The 2015-2018 Research Programme is sponsored by:

Acknowledgement

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CBRE
CBRE Global Investors
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