RESEARCH

UK MARKET OUTLOOK JUNE 2014

THE LIVE CAT BOUNCE

A recurring theme in this note since autumn of last year has been the resurgence of confidence in the investment market. Note the rebound in capital value expectations reported in the RICS survey in the last three calendar quarters (see figure 1). However, a concern has to be, is sentiment getting ahead of the actual market reality?

Certainly two widely reported indicators point to a market which is steadily growing, but far from surging ahead. The IPD all property capital growth index has in recent months retreated back from a strong December figure which it has not since replicated. The April figure was 0.8% month-on-month growth, compared to 1.0% in March and 1.5% for December.

Turning to investment volumes, according to Property Data the Q1 2014 figure of £10.6 bn was down 5% on the same period of last year. The quarter-on-quarter comparison is even less flattering, as volumes hit £20.7 bn in Q4, but that was undoubtedly an exceptional quarter.

Also, if we take occupier market figures – the bedrock beneath the investment market – again the numbers are encouraging but not in 'bullish' territory. The IPD all property rental value index did grow in April by a modest 0.1%, month-on-month, but that was largely thanks to Central London offices and South East industrial (as usual). Even for these bright spots, the rate of growth is less than they were recording back in December.

At this point a caveat is needed. We are not saying the recovery is fading, just that present sentiment is probably ahead of the actual situation. In our view, December probably marked the peak of a micro-boom driven by a realisation that the double-dip was over, which created a flurry of buying activity. Opportunists bought up undervalued stock and caused a sudden shift in pricing.

In contrast, 2014 is seeing a 'live cat bounce'. After leaping back to life in summer 2013, the commercial real estate moggy has landed back on its feet, but will now move forward earthbound and at a steady pace. This marks an important distinction from a 'dead cat bounce' where the sudden movement was merely gravity asserting itself on the economically inanimate.

Markets rarely move in straight lines, and sudden leaps in the statistics are usually

The market in a minute

All property capital growth index at 0.8% in April m-on-m, vs 1.0% in March*

Offices saw the highest capital growth (1.3%), and retail the lowest (0.4%)*

12 month total return reaches 14.9%, the highest since 2010*

Investment volume in Q1 was £10.6 bn, vs £11.1 bn for same period of 2013**

* IPD figures

** Based on Property Data figures

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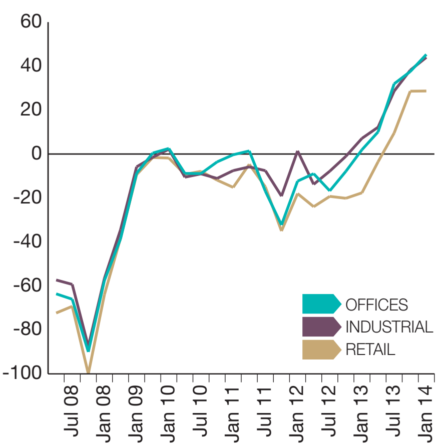
FIGURE 1

RICS survey

Capital value expectations

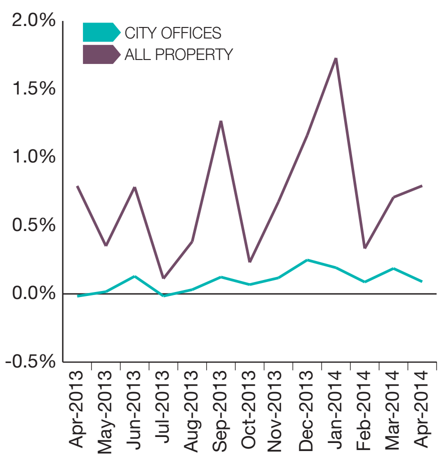


Source: Macrobond / RICS

FIGURE 2

Rental value growth m-on-m

All property vs City offices



Source: IPD

one-offs. If they do defy gravity for an extended period of time, it can be a bad sign, e.g. a bubble is inflating. In this respect, that the commercial property market has not continued to fly upwards as it did late last year is good news.

However, the robust UK economic backdrop gives us confidence that the property market will continue on its recovery path. The Bank of England in its latest policy committee meeting minutes suggested we will now see more banks acting to off-load their problematic commercial real estate exposure in order to clear the decks for new lending. The main point of dispute here is the use of the future tense by the Bank of England. One could argue that this process has been underway for some time.

Whether voluntarily or by compulsion, more stock is coming to the market at a time when the economic news is giving buyers the confidence to move up the risk curve and buy shorter income and asset management opportunities. Moreover, the unblocking of the debt log jam creates the prospects of a more active and competitive finance environment ahead, and perhaps a world where the term CMBS is associated with new capital rather than bad news.

This provides some additional upside for the property investment market, but more encouraging signs need to appear in the occupier market before sentiment strengthens further. Outside of London, rental growth is the exception to the rule. Even in London the pattern has been ‘stop-go’ for some time.

Consequently, the recent fall in unemployment and rise in employment is an encouraging sign. However, note the Bank of England says that its network of agents report that many firms still have significant spare capacity in-house to resource projects, or have room to raise productivity before needing to recruit or invest further. If correct, this could further delay a wide ranging recovery in occupier demand.

The UK commercial property market is undoubtedly in far better health than a year ago, but sentiment needs to stabilise for a while and let fundamentals catch-up.

> “The robust UK economic backdrop gives us confidence that the property market will continue on its recovery path.”

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