Q1 (JAN-MAR) 2023

ROBERT IRVING BURNS

RIB COMMERCIAL PROPERTY REPORT

A new comprehensive Commercial Property Report from Robert Irving Burns (RIB), the real estate investment professionals.

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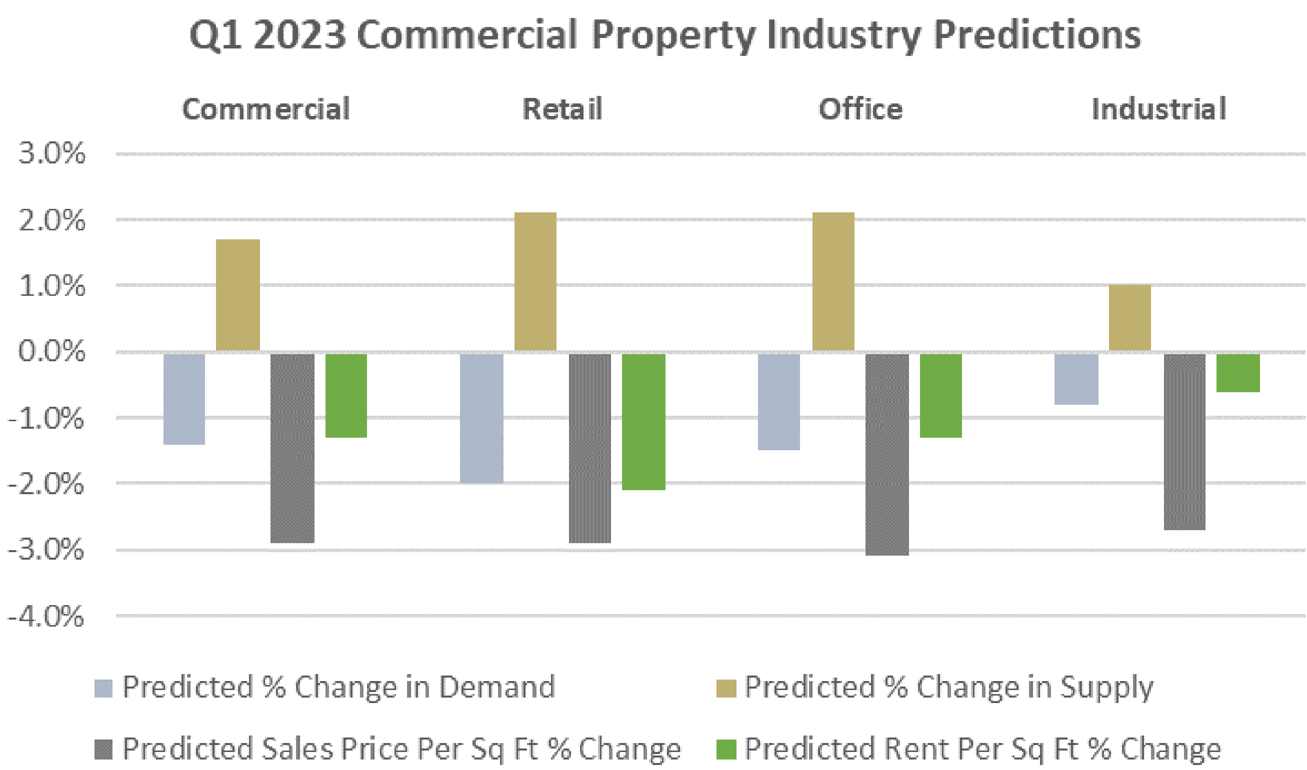
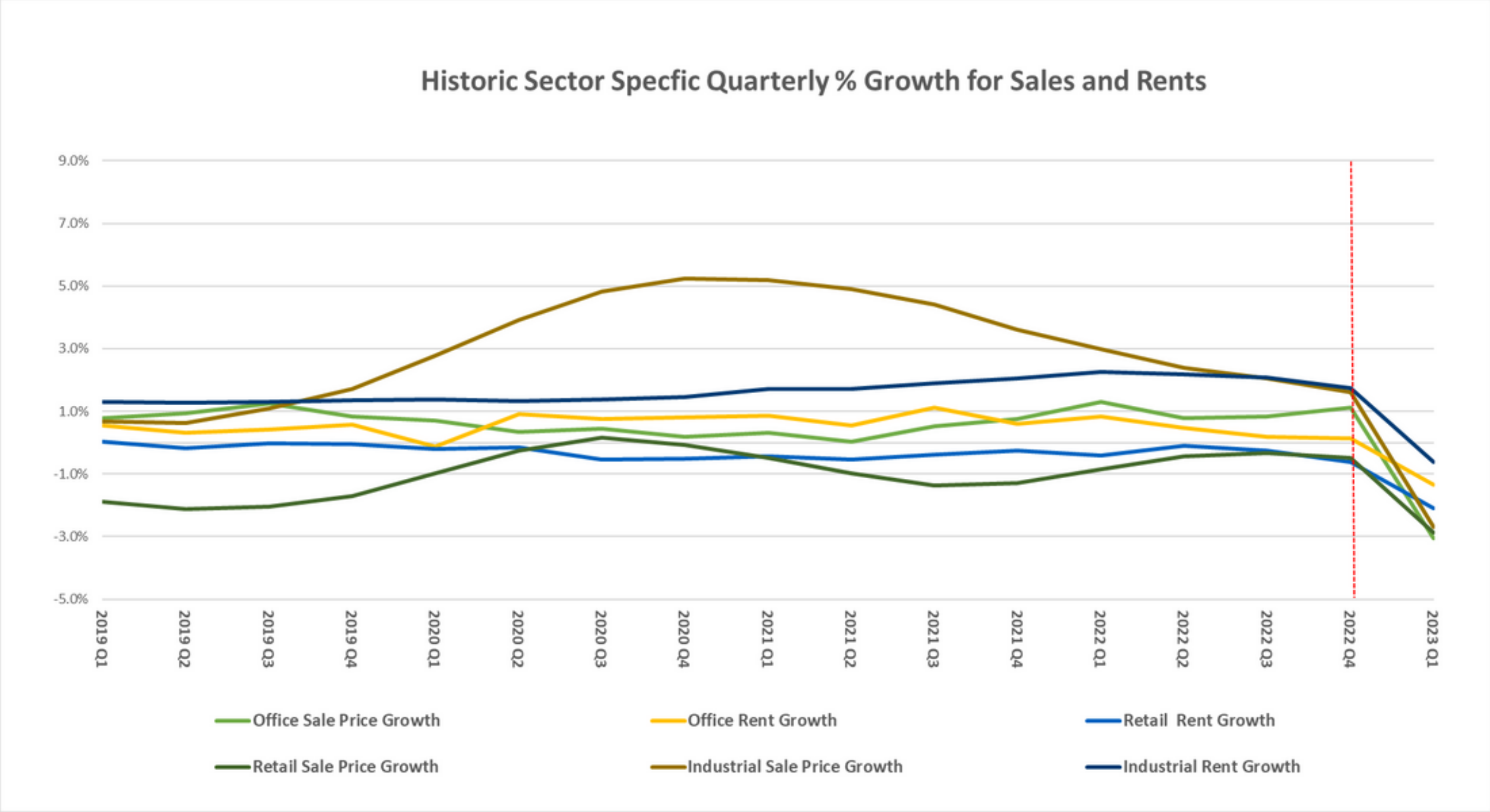
While this is not, yet, the winter of discontent that some had predicted, we're a far cry from the growth we were promised earlier this year. Predictions for Q1 2023 are decidedly negative according to property experts across the UK – and the sample represents close to 10% of the total Commercial Real Estate Agents in the UK.

The prediction in short? It will be a buyers' market within the commercial property space, with the potential for commercial asset sale prices softening by -3.0% and supply of property rising by +1.7%. Over the last few years certain parts of the sector have undoubtedly been hit harder than others, primarily the retail and office spaces, but even the Industrial sector, which has previously been immune to market volatility is now succumbing.

The supply of commercial property across the Retail, Office and Industrial sectors is the only thing which will be going up next year, so we will expect to see those long term investors, REITS and funds, who have been keeping their powder dry, returning to the market and taking advantage of this window of opportunity.



UK COMMERCIAL PROPERTY MARKET Q1 2023



Source: RIB, plus combined other sources

When viewed over a four year period (pre and post pandemic) it's clear to see the resilience and growth of the industrial market, as consumers turned to online retail.

While the party, which saw strong sales price growth through the last year, does appear to be winding down, the big question for 2023 is, which sector will we see that type of growth and resilience in the coming year?

"I can only see Offices getting trickier. Retail offers more yield and, in a market where borrowing is high, Retail may offer some good value where rents are rebased and they have survived the pandemic.

Industrial rents will stabilise but unlikely to grow like they have. Supply will still be a fundamental issue with industrial which in the long run should keep yields buoyant."

Commercial Real Estate Specialist

Q1 2023 Predictions	Commercial	Retail	Office	Industrial
Predicted Sales Price Per Sq. Ft % Change	-2.9%	-2.9%	-3.1%	-2.7%
Predicted Rent Per Sq. Ft % Change	-1.3%	-2.1%	-1.3%	-0.6%
Predicted % Change in Demand	-1.4%	-2.0%	-1.5%	-0.8%
Predicted % Change in Supply	1.7%	2.1%	2.1%	1.0%

OFFICES

Sales: In spite of the resurgence and innovation we have seen within the urban office market post the pandemic, sales prices per square foot are predicted to plummet by -3.0% on average in Q1 2023. Close to a third of respondents (31%) believe that office sales prices could come down by over 5% in the period.

But it will be a tale of two markets, with prices expected to be protected in the luxury and highly sustainable segment within the market, and those with lower quality specification and energy efficiency suffering the brunt of this downturn.

Rents: While rents are forecast to drop by -1.4% in Q1 2023, close to a third of respondents (31%) felt that rents would remain flat over the period. Again, the devil is in the detail here, and it is the CAT A +, high quality flexible spaces which will see the most resilience in terms of their rental value.

Demand vs. Supply: Demand in Q1 2023 is forecast to reduce by -1.5%, with any growth in demand focused on flexible, serviced, Grade A offices. Supply is anticipated to increase by +2.1%, with 19% of respondents predicting that supply will increase by over +5%.

Lease length: The majority (47%) believe the average lease length will be between 30-40 months, with 23% expecting the average lease length to be less than 30 months and 30% expecting leases to be 40+ months.

31%

*of respondents forecast that Office **sales prices per square foot** could come down by over -5% in Q1 2023*

-1.4%

*Office **rents per square foot** price reduction in Q1 2023*

RETAIL

Sales: Retail continues to drag its feet, and while the weather, cost of living crisis and industrial action will have taken some of the shine off the 'Golden Quarter', it is Q1 2023 which will do the most damage to property values, with sales prices per square foot expected to drop by an average of -2.9% in the period and over 30% of respondents citing that prices would fall by more than -5%.

It is the much suffering high street and hospitality sector which is expected to feel the brunt here, with many comments that suburban prime retail will continue to be in high demand as hybrid working becomes more prevalent. Change of use is also making small retail increasingly attractive to investors - it's the multiples who have fled the market.

However, the change in Business Rates next year might look to offset this, with bricks and mortar retailers paying significantly lower business rates, while operators of large warehouse and logistics facilities will see their bills jump.

Rents: Rents are forecast to drop by -2.1% in Q1 2023, the sharpest decline among all the sectors, with a third (33.1%) of respondents indicating that rents could drop by over -5%. However, there is certainly potential rental growth for high street retail in line with inflation over the year. Respondents were also hopeful that Business Rate revaluation would offset rent reductions, allowing tenants to pay higher rents.

Demand vs. Supply: Demand in Q1 2023 is forecast to reduce by -2.03%, the most significant reduction out of the three sectors analysed, and a reflection of the challenging recovery across the sector post-pandemic. The reverse is expected on the supply side, with forecasts anticipating a 2.1% increase.

Lease length: The majority (40%) believe the average lease length will be between 23-40 months. However, over a third (35%) believe leases will be 55+ months.

33%

*forecast that Retail **rents per square foo**t could come down by over -5% in Q1 2023*

"RATES REVALUATION WILL LARGELY OFFSET FURTHER RENTAL REDUCTIONS IN CERTAIN AREAS."

RETAIL REAL ESTATE SPECIALIST

INDUSTRIAL

Sales: The industrial honeymoon has come to an end it seems, and after years of successive growth sales prices per square foot are forecast to drop 2.7% on average, with a quarter of respondents (25%) predicting that prices will fall by more than 5%, which is an unprecedented drop. The industrial and logistics market remains strong from an occupational point of view, due to ongoing demand and growth from the online retail sector and a lack of supply, especially in areas of strong transport communications.

It is clear to see the boil coming off the market when looking at the share price and value of the REITs in this space, with the majority seeing double digit share price losses this year (Prologis -25% (YTD) Segro -41% (YTD) and Tritax Big Box REIT -39% (YTD)).

Rents: Rents are forecast to decrease, but only by 0.6% on average, with 39.1% of respondents forecasting they will remain flat in Q1 2023.

Supply vs Demand: Supply of stock for the industrial sector has seen the lowest projected growth of the three sectors, at just under 1% (0.95%). This has been attributed to rising build costs hampering new development and a lack of well-connected existing stock. Demand is projected to fall in Q1 2023, but only by -0.8%, with a third of respondents predicting demand will be flat.

Respondents commented that the growth of the sector will vary dramatically depending on the location and size of the units. London is expected to stay positive, but will see a much slower growth trajectory. However, big box logistics and sheds nationwide will see lower demand, alongside lower supply, so rents will at least hold. In contrast, smaller sheds and poorer locations could see demand drop and rents follow.

Lease length: The majority (58%) of respondents believe the average lease length will be over 55 months, with less than one in ten (9%) seeing lease lengths below 35 months.

25%

forecast that Industrial ***sales price per square foot*** *could come down by over -5% in Q1 2023*

"YIELD DECOMPRESSION FOR FORWARD FUNDING NEW WAREHOUSE DEVELOPMENTS IS CREATING STALEMATES FOR DEVELOPERS - OCCUPIERS MAY HAVE TO BUY RATHER THAN LEASE - RENTALS ON SECONDHANDED STOCK LIKELY TO RISE AS A CONSEQUENCE."

INDUSTRIAL REAL ESTATE SPECIALIST

SPECIALIST COMMENTARY

COMMERCIAL

“"The funds are tanking values which should facilitate an early recovery in capital values.”

“Yield Play versus Occupier Demand.”

“The pandemic proved that all businesses need to be flexible in order to survive.”

“Increased build costs will see a number of developments unprofitable given the large numbers paid for sites!”

“Investor appetite and rising construction costs are putting off developers desire to spec units - longer lead times for build to suit units means business planning more important than ever.”

“The effect of fiercer EPC regulations on the commercial property world.”

“Grade A stock will continue to see rents rise, whilst Grade B will likely have longer voids and falling rents.”

“Although generally I believe retail and industrial may remain stable, I would expect (prime) retail and (prime/local) office markets to continue to fall (both rental and investment).”

arrangements especially in the office and retail sectors.”

“We are in for a tough time. Interest rates to rocket and companies decreasing occupancy levels and going tits up.”

“Local authorities/ govt should consider rates reductions for vacant commercial units for new leases occupier demand is still strong, but supply has reduced which will help rents remain constant.”

“I expect different submarkets to perform better than others rather than Central London as a whole.”

“In Central London and the stronger locations demand is resilient and supply is low. We are still seeing plenty of demand in Central London and the strong local villages and for flagship locations.”

“A lot of the market will depend on the length of the recession we are currently experiencing
Lack of Grade A supply still significant.”

“ESG; Affordability (total occupancy cost)”

“Build costs associated to new development schemes are currently rising roughly 6% - 7% per quarter. This must decrease significantly in order for new developments to be feasible.”

“Occupier demand remains strong - landlords seem nervous.”

"Increase in rent frees / incentives are likely.”

“Uncertainty about interest rates will affect investment decisions.”

“Market polarisation, retail bottoming out, industrial has peaked, offices stable.”

““Debt will be key.”

Retail spending will reduce. Offices - people may want to go back to the office to avoid paying energy costs at home, but this will be part time, controlled by the employer, who will reduce the size of the office. Industrial sector - supply will continue to increase with new build, but the Planning system will prolong the timescales. Rents may continue to increase whilst build costs are high, but if the build costs reduce, then the rents may level off.”

“Strong occupational market in SE Yields will stabilise in Q1/2 22 cost of capital will be biggest variable. The next 6 months will be a bumpy ride - tricky to predict.”

“Lending platforms should be more transparent over requirements to encourage new entrants.”

“Quality and location will win the day, price will determine sales.”

“I believe we will see an increase in side-by-side leasing
Key headwinds are build cost inflation, rising debt costs and macroeconomic turbulence.”

“Yields are suffering landlords will seek to initially increase looking to combat the yields, only to discover they aren’t being competitive, in which case they will drop the asking rent.”

“Investment demand has dropped too.”

“We will continue to see more varied occupiers in the market.”

METHODOLOGY

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The survey was sent to a bespoke database, cultivated over 10 years, of over 8,000 senior commercial estate agents. The survey ran between 15th November – 24th November 2022.

The UK geographic breakdown of respondents in order of representation was: London, South East, Midlands, South West, North West, East of England, Yorkshire, North East, Scotland, Wales, and Northern Ireland.

Over a third (37%) of respondents operate in the Office sector, and the same number (37%) operate in multiple sectors, with 14% working specifically in Industrial and 13% in Retail.

Additional historic data was sourced from Valuation Office Agency and HM Land Registry data © Crown copyright and database right 2021.