Q2 (APRIL-JUNE) 2023

ROBERT IRVING BURNS

RIB COMMERCIAL PROPERTY REPORT

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

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ANTONY ANTONIOU

CEO, ROBERT IRVING BURNS

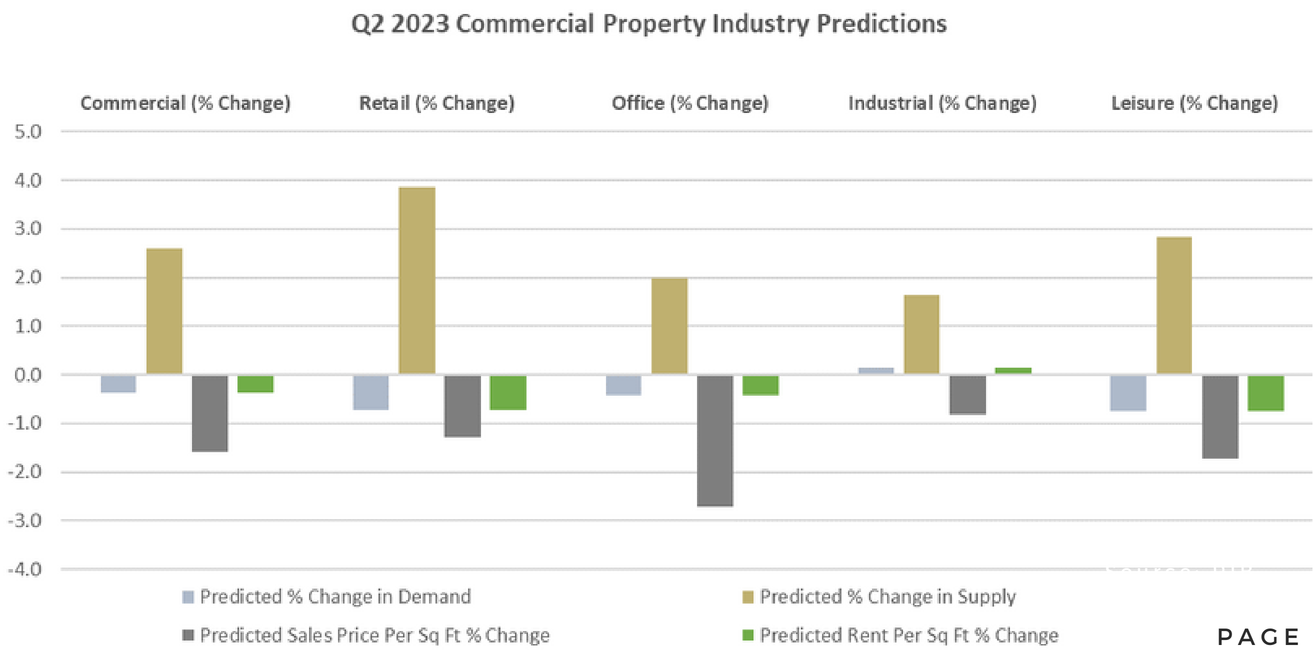
Antony Antoniou, CEO of Robert Irving Burns (RIB) the real estate agency and investment specialists, comments: "In Q2 we are expecting to see the continued depression of UK commercial real estate capital values, as both rents and sales are eroded by rising interest rates and inflation. Businesses across the UK remain focussed on paying down debt rather than investing in any large-scale capital expenditure. However, the sharp price correction we saw at the start of the year appears to be tempering in our Q2 forecast and while both sales and rental values are expected to remain on the downward trajectory, it does feel like we're nearing the floor.

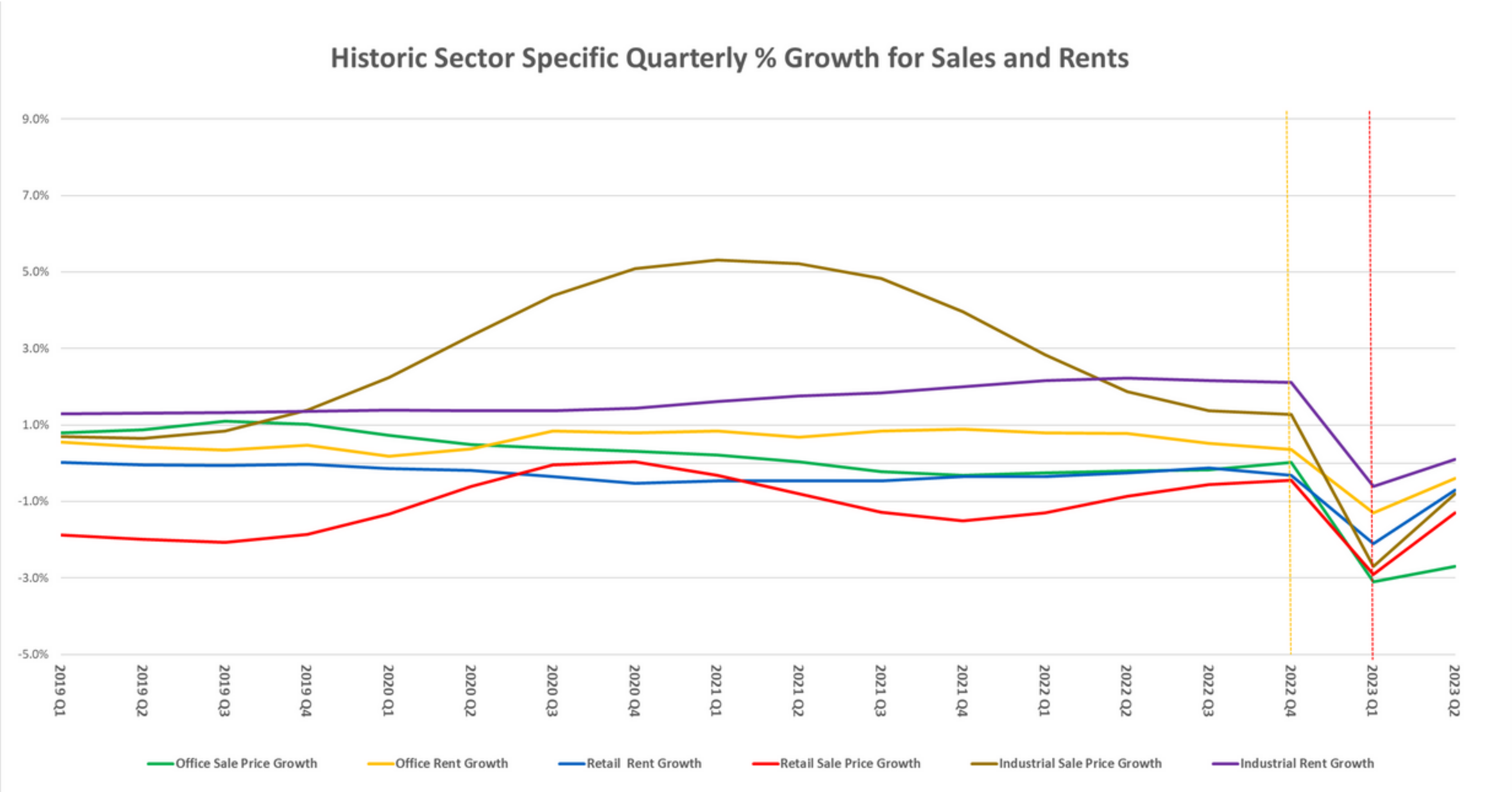
"While it is far from plain sailing ahead, the outlook is decidedly more positive that the previous quarter forecast. There is consensus among economists that inflation will halve to around 5% by the end of 2023, which will help to ease both the cost of living crisis and business appetite for certain capital investments. To achieve that, it's likely that the Bank of England will not only raise base rates (up to 4.5% according to one-yr swap expectations) but keep rates higher for longer, which will create a cap to any potential growth and easing of capital expenditure.

"This burgeoning positivity is down to a number of geo-political and economic factors; with the Windsor Framework easing concerns around the ongoing fiscal and employment impacts of Brexit, the removal of China's zero-Covid policy expected to smooth out supply chains and the growth of UK GDP in January ahead of OBR expectations (up 0.3% ahead of the expected 0.1%).

"As a result, our forecast has seen rent expectations in Industrial move into the black (up 0.1%) and rents overall across commercial expected to be down just 0.4%. Sales values will take longer to recover and are expected to reduce further by 1.6% in Q2, with Offices seeing the sharpest fall, down 2.7%.

"With the supply of property coming onto the market expected to remain high, up 2.6% in Q2, rents are recovering and sales values remain low, it continues to be a buyers' market for those with access to capital. This is particularly pertinent across the Retail and Leisure sectors, where high yields means they are less affected by spiking interest rates in relative terms."





Source: Sourced from Valuation Office Agency and HM Land Registry data © Crown copyright and database right 2021 and RIB private databases.
NB:The above data from Q1 2023 is forecast; at the time of writing no actual data was available & Leisure industry is omitted from this graph due to a lack of comparable back data.

While all sectors are primarily expected to continue to see negative growth across sales and rental values, the Industrial sector is bucking the trend. Rental values are expected to nudge up 0.1% and sales values are down just 0.8%. It's clear to see the continued resilience of the market.

The big question remains how will the business rate revaluation impact the sector - indeed over 80% of respondents believe the sector will be negatively impacted. See further anaylsis on pages 7 and 11.

"The cost of money makes real estate untenable without property yields declining or the cost of money reducing. Inflationary pressures are hitting hard across all sectors, causing restraint in macro economy."

COMMERCIAL PROPERTY SPECIALIST IN THE SOUTH EAST

Q2 2023 Predictions	Commercial (% Change)	Retail (% Change)	Office (% Change)	Industrial (% Change)	Leisure (% Change)
Predicted Sales Price Per Sq Ft % Change	-1.6	-1.3	-2.7	-0.8	-1.7
Predicted Rent Per Sq Ft % Change	-0.4	-0.7	-0.4	0.1	-0.7
Predicted % Change in Supply	2.5	2.7	2.2	2.6	2.8
Predicted % Change in Demand	-0.4	-0.7	-0.4	0.1	-0.7

OFFICE SECTOR

Sales: The office market is forecast to see the greatest fall in sales values over the next quarter, with prices per square foot predicted to fall by 2.7% (marginally less than the -3.0% predicted in Q1 2023).

This is the sharpest fall across all four sectors analysed, with the next closest 1% improved (Leisure -1.7% sales value growth). Close to a quarter of respondents (24%) believe that office sales prices could come down by over 5% over the period.

Rents: Rents, on the other hand, are expected to see some growth, and while they are forecast to drop by 0.4%, this is a 1% recovery on the previous quarter (-1.4% in Q1 2023). The reasons behind this, according to the respondents, is strong demand for high quality (CAT A), flexible and collaborative spaces, which are more limited in supply and could push rents up.

Demand vs. Supply: As mentioned, demand for good quality offices is rising, as employers and employees alike realise the benefits of in-person office interactions. As such, demand in Q2 2023 is forecast to reduce by just 0.4%, compared to the forecast of -1.5% in Q1 2023. Supply is anticipated to continue to increase on a similar trajectory to Q1, up by +2.6% (+2.1% in Q1 23).

Lease length: The length of lease isn't expected to change dramatically, with the majority (48%) believing the average lease length will be between 30-40 months, which is in line with Q1 projections.

Respondents commented that as yields move out, covenants and lease terms are becoming more important and are being carefully reviewed.

24%

of respondents forecast that Office ***sales prices per square foot*** *will come down by over -5% in Q2 2023*

-0.4%

forecast Office ***rents per square foot*** *price reduction in Q2 2023*

RETAIL SECTOR

Sales: The retail sector continues to be challenging, with sales prices per square foot expected to drop by an average of 1.3%, however this is an improvement on the previous quarterly forecast (-2.9%). There does appear to be some divide in terms of market expectations between the larger retailers and SMEs, with demand supporting price growth across centrally located, boutique properties, and large out-of-town properties underperforming.

Some parts of the sector have had a 'brutal start to the year' according to the Centre for Retail Research, with a number of high profile insolvencies in Q1, including Paperchase, with its 106 stores. This has resulted in nearly 15,000 British retail jobs being cut since January, with most of the jobs losses at large retail chains, including the big supermarkets, and were due to store closures and restructuring.

Rents: Rents are forecast to drop by -0.7%, which is an improvement on the forecast 2.1% rental decrease in Q1 2023. It is the sharpest decline among all the sectors, however, there remains potential rental growth in high street retail in line with inflation over the year.

Demand vs. Supply: Demand in Q2 2023 is forecast to reduce by 0.7%, which again is up on the Q1 forecast of -2.03%. While there are still challenges post-pandemic, it is encouraging that high street premises remain in demand, according to respondents. Given the number of store closures and out-of-town downsizing, it is unsurprising that supply forecast to rise by 2.7%, up from the Q1 forecast (2.1%).

Lease length: The average lease length within retail is rising. The majority of respondents (43%) now believe the average lease length in Q2 will be over 55 months, this is up from between 23-40 months (40% forecast this was the average lease length in Q1).

Business Rates: When asked about the upcoming changes in Business Rates, our respondents felt that they will have a positive impact on Independent SME retailers (44%) and the High Street (47%). A third of respondents (33%) expect rates rises to have a negative impact on nationwide retailers, and 46% anticipate out of town retail to be negatively impacted. Given the forecasts, it begs the question, will Q2 2023 begin the boom of the boutique retailer?

43%

*of respondents believe the average **lease length** in will be over 55 months in Q2 2023.*

Rising by a minimum of 15 months on the previous forecast

INDUSTRIAL SECTOR

Sales: The industrial sales price per square foot is forecast to drop by just 0.8% in Q2, making it the best performing sector in terms of sales price and significantly improved from the previous forecast (a predicted drop of 2.7% in Q1). Indeed the respondents were divided, with 36% of respondents forecasting that prices would rise and 20% believing prices could rise by over 2% with the main variations being due to location and size of property.

Strong occupational demand and a lack of supply in the <50,000 sq. ft properties has led the recovery. Respondents believe the 'big box' end of the market will continue to struggle in the next quarter and beyond, and that is reflected in the continued share price volatility of the listed REITs in this space.

Rents: Rents in this sector are forecast to increase by 0.1% on average, an improvement on the -0.6% forecast from last quarter. It is the first rental value among the four sectors forecast to move into the black this year, which will further impact yields within the sector.

Supply vs Demand: The forecast supply of stock for the Industrial sector in Q2 is set to increase, rising to 2.6% (Q1 was expected to drop 0.95%). This is also the only sector forecast to see a rise in demand as well (up 0.1%) which had been forecast to drop 0.8% in the previous quarter.

When commenting on the supply/demand dynamic, respondents commented that demand had been strong through 2022 and 2023 and while some felt that occupier take-up was beginning to ease off, especially around London, demand remains above the 5 year average.

Lease length: The majority (47%) of respondents believe the average lease length will be over 55 months, but that majority is reduced on the previous quarterly forecast (58%) and there is a rise in the number of respondents (42%) seeing lease lengths below 35 months.

36%

forecast that Industrial ***sales price per square foot*** *will rise in Q2 2023*

"THE SMALLER END OF THE WAREHOUSE MARKET (LESS THAN 50,000 SQ. FT) WILL CONTINUE TO THRIVE. THE MARKET ABOVE THAT WILL CONTINUE TO STRUGGLE FOR THE NEXT 3 YEARS."

INDUSTRIAL REAL ESTATE SPECIALIST, THE MIDLANDS

LEISURE INDUSTRY

Following feedback from respondents, we have included Leisure in this latest forecast, with just under a quarter of respondents (24%) operating in this sector.

Sales: Sales price per square foot is forecast to drop by 1.7% in Q2, which is higher than Retail (-1.3%) but not as significant a drop as the Office sector (estimated drop 2.7%). While the sector had rebounded in early 2022, the outlook for the first half of 2023 remains challenging, with rising interest rates impacting debt costs and therefore the expectation of lower investment.

Rents: Rents in this sector are forecast to decrease by 0.7% on average, which is in line with the Retail forecast (-0.7%). Tenants have been through a challenging period, due to the well-publicised cost of living crisis reducing consumer spending and staffing challenging as a result of the Pandemic and Brexit implications.

Supply vs Demand: In Q2 our respondents are expecting supply to increase at the highest rate of all the sectors, rising 2.8% in the quarter. While overall demand is not expected to rise (it is forecast to fall 0.4%), respondents are expecting to see continued high demand for premium quality, and real estate that does not meet investor and occupiers' specification or environmental goals will be marginalised.

Lease length: The majority (48%) of respondents believe the average lease length will be over 55 months, which is similar to both Retail and Industrial.

Business Rates: When asked about the upcoming changes in Business Rates, the majority of our respondents (52%) felt that the Hospitality and Leisure sectors would be negatively impacted, which might well be reflected in the expected negative values across both sales, rents and demand.

52%

of respondents forecast the Leisure and Hospitality Sector will be negatively affected by the Business Rate Revaluation

"WE HAVE A GOOD GAMING SECTOR PUSHING MARKET DEMAND AND HENCE RENTS, WITH VERY LITTLE AVAILABILITY."

LEISURE REAL ESTATE SPECIALIST, THE MIDLANDS

SPECIALIST COMMENTARY

A SELECTION OF COMMENTARY

Commercial General

"Yields moving out, covenant and lease terms more important and carefully reviewed."

"The is a price dislocation. Lack of transaction evidence to support actual value . Cost of money makes real estate untenable without property yields declining or cost of money reducing. Inflationary pressures hitting hard across all sectors causing restraint in macro economy."

Office

"Fitted office becoming an expectation for occupiers."

"Lack of Good Quality Grade A Stock in the North."

"Looking at offices in the Liverpool City Region in particular, demand levels are fairly stagnant - but there is a large issue with the supply of high-quality office space."

"Fit out, there's little to no market for tertiary space. Fully fitted, refurbished space is key."

"Office supply will diminish but it's a long way down to meet office demand."

"High demand for flexible office space."

"The smaller end of the warehouse market (Less than 50,000 sq. ft) will continue to thrive. The market above that will struggle for 3 years."

"Drive for better quality collaborative space."

“Work from home is causing tenants to consider reducing space."

Retail

“Potential rental growth for high street retail in line with inflation.”

Industrial

”Floor space requirements tend to be increasing - moving towards 20,000 sqft rather than 10,000 sqft on the ground (Industrial)."

"There is a distinct lack of Industrial stock."

"Shortage of high quality industrial supply."

"Demand has been strong through 2022, however occupier take up has begun to decline over the past quarter. Despite this, take up remains above the 5 year average."

Leisure

"Expansion of ULEZ will likely see more suburban London demand."

"We have a good gaming sector pushing market demand and hence rents with very little availability."

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, which has on average of 250 responses, ran between the 16th and 24th February 2023.

The 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.

There is a great deal of cross sector experience among respondents, which is distributed:

- Office sector (67%)
- Industrial (46%)
- Retail (38%)
- Leisure (24%)

Additional data was sourced from Valuation Office Agency and HM Land Registry data © Crown copyright and database right 2021, as well as other private RIB sources.