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Property Market Overview

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CONTENTS




- 1 INTRODUCTION**
- 2 OFFICES**
- 3 RETAIL**
- 4 INVESTMENT**
- 5 PLANNING**
- 6 RESIDENTIAL**
- 7 INDUSTRIAL**
- 8 SUMMARY**






Introduction


Brave New World



In the last edition of this *Overview*, we considered the effect of the possibility of sovereign default by Greece and the need to restore stability and confidence to Europe's financial institutions in order that a recovery in the property market can be underpinned. Times remain uncertain, as the ongoing negotiations with Greece's private sector creditors are testament. However, there is always a knock-on effect in such times and this is being most clearly felt in capital flight, and the UK, being outside the Eurozone, is one of the main beneficiaries of Greek capital from Greeks panicked about the prospect of Greece leaving the Eurozone, returning to the drachma and their life savings being wiped out by such a shift. Bank deposits in Greece have fallen 21% since January 2010, according to Greek central bank data.



Big cross-border money from large investors has been used to buy very visible assets, at the top end mainly in the commercial property market. But nearly all of this money is going to one place – London. Since 2008, this counter-cyclical trend has led London to be the most traded real estate market in the world, according to Jones Lang LaSalle (JLL). JLL data indicated the number of transactions in London rose 25% in both 2009 and 2010 and is likely to increase by a further 10% this year.



If proof were needed, 52% of offices in the City of London are now owned by foreign investors, up from just 10% in 1980. During the 2008-2011 period, some 42% of sales were from UK owners to foreign investors, with just 6% being traded the other way, according to Development Securities data, and these investors typically paid about three times the average £27m purchase price paid by a UK buyer. It also emphasises a recurrent theme in these pages over recent months – quality. Whilst UK buyers in the London property market are still the biggest group, holding 48% of all property here, followed by German investors which own 16%, there has also been a growing trend towards the super-rich seeking quality property, officially owning some 6% of the office space, but, with a culture of secrecy and much property in trusts. The long-term future of the London market seems relatively assured for now and makes an appropriate focus for this issue.

Offices

Leases to be pivotal in 2012

Apart from a focus on London in these pages, with the aid of a raft of end-of-year data and analysis from the larger research teams, we have gazed into our crystal ball at what the market may hold for a number of property sectors in 2012, offices included.

The supply shortages of quality (Grade A) office property are likely to continue and hence prime rental levels will see support. This polarisation in rents means that it is possible a parallel market in quality office property could develop post-2013 as development expenditure on secondary quality property becomes a necessity. Office jobs across the UK, according to Oxford Economics, are expected to remain broadly flat on aggregate, with financial and business services (allowing for the reductions in the public sector in 2011) increasing modestly by 0.4% at year end.

Within Central London (here we go again) faster growth in GDP in 2012 is expected of 1.1% compared with 0.4% for the UK. This has also been reflected in employment expectations in the financial and business services sector, which in LONDON show a slightly better 1.17% growth rate next year. However, the CEBR forecasts a stagnant 2012 and with businesses exercising caution in decision making in the first half of 2012, and expansionary requirements rare, this may be the more likely scenario.

The really important elements of 2012 will be lease breaks and expiries. We alluded last quarter to a number of long office leases coming up for review and JLL's research indicates that only 18% of the occupants of the 575,000m² of London office space and 750,000m² of regional office space known to be up for review between 2012 and 2016 have agreed to take new space already. With a directionless market, the results of negotiations to extend and restructure (probably on shorter maturities) may drive the majority of market activity.

Certain trends in the marketplace will continue: the dominance of hi-tech occupiers and the trend of smaller space requirements, driven by cost pressures and enabled by more advanced workplace solutions. Current Grade A supply in the context of a much-reduced development pipeline is likely to run out in 9-24 months, making lease negotiations all the more interesting in 2013-14.

Retail

Keeping the administrators at bay

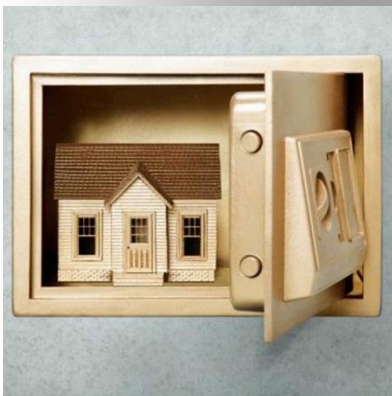
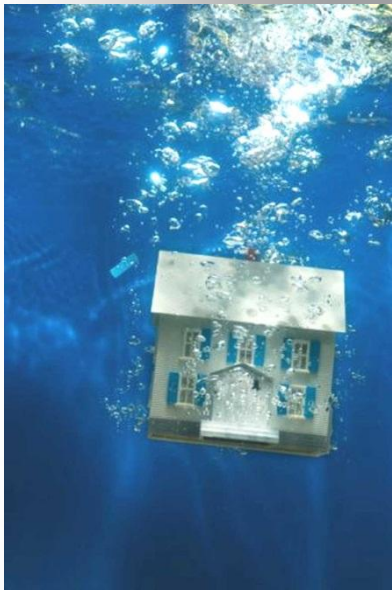
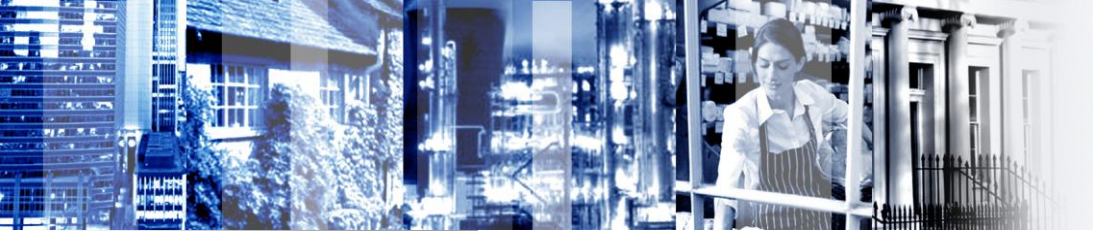
Eleven major retail administrations were recorded in the last quarter. We mention this very subtly, as, even though it doesn't have a separate page in this *Overview* now, Michael Parkes Surveyors Ltd maintains an active LPA receivership portfolio. We are not seeking the demise of the retail sector (far from it) but we are there to help, if needed. In case you wondered about the identity of the administrations, they were: Bonmarche (rescued by Sun European Partners), Peacocks, La Senza (Alshaya UK acquired majority of stores), Pumpkin Patch (UK subsidiary), Blacks Leisure Group (acquired by JD Sports), Hawkin's Bazaar (rescued by former parent Primary Capital), Past Times, d2, Fashion Rocks, Jewel Nation and Half Price Jewellers. The number of retailers going into administration has been the highest since 2008-9.

Hard work and creativity over Christmas 2011 paid off for Debenhams, Select, Edinburgh Woollen Mill, B&M, Cash Converters, Costa Coffee and others as they reported plans to increase their store portfolio but some including Fresh & Easy, Little Chef, New Look and Homeplus announced plans to close stores. Another notable innovation likely to grow in 2012 is the introduction of contactless payment by Superdrug in its 50 stores and similar technology is being piloted by Waitrose in three of its stores.

There was a 16.5-18.5% increase in online sales, and a total of £7.9bn was spent in December, depending on whether you believe the IMRG Cap Gemini Index or the British Retail Consortium. Mobile sales accounted for 15.9% of all online sales on Boxing Day, and these are trends we can only see increasing in 2012, with their consequent impact on the balance of retail and warehouse property space.

Finally, McDonalds. The fast food chain is now going to be the UK's biggest retailer of children's books as it has decided to replace the plastic toy in a Happy Meal with a book. OK, most readers of this won't be buying a Happy Meal any time soon, but McDonalds apparently has plans to capitalise on the depressed commercial property market and purchase more of the land and buildings where it operates. Watch this space.





Investment

Looking East

In an edition concentrating on a major global property centre, London, and indirectly the flow of global capital to perceived safe havens, it would be remiss to ignore, in investment terms, possibly the world's biggest property market, but one which may not be as strong in 2012 as the rest of the world would like: China.

Construction has been key to China's boom and property prices have risen in tandem with the height of the buildings. They have increased at least fivefold in the last decade in cities across China, according to state media. However, there are clear signs of overheating and property developers are slashing prices by as much as a third in some new schemes. JP Morgan believes the property market could drop by as much as 20% in the country's major cities within the next 12 to 18 months. Investors are moving out of the private property sector to the commercial sector or overseas property market, with much investment coming to London.

Paradoxically, much of the price rise was driven by increased bank lending after the collapse and rescue of major banks in developed economies in 2008, with limited controls. If you think the moribund state of the UK residential housing market was caused by an asset price bubble, consider that, according to Chinese state media, there were only 1,000 sales of second-hand homes in Beijing in 2000. In contrast, there were over 200,000 sales last year. A dampening of the market is therefore inevitable but the ramifications of a housing market rising and falling extends far beyond construction and that proportion of the economy as mortgage lending underpins other sectors of the Chinese economy, and crucially, confidence.

There is not outright panic yet but there is concern. China's economic growth slowed to 8.9% in fourth quarter of 2011, down from 9.1% in the previous quarter. Gently slowing growth to more sustainable levels includes a curb on lending to prevent overheating in the property and investment markets, and tightened monetary supply. Real estate investment in China rose 27.9% in 2011, down from an annual growth rate of 29.9% between January and November, the National Bureau of Statistics said. This sustainable development path is likely to move away from investment to more focus on domestic markets. That, of course, could result in greater foreign direct investment with the UK as a beneficiary.

Planning

Post-Localism

Last year saw the roll-out of the government's localism agenda, culminating in the Localism Act, which will have significant implications for cities and their suburbs. Headline announcements came in the form of enterprise zones, the Local Government Resources Review, the introduction of a new minister for cities, Greg Clark, and Nick Clegg's announcement of deals for eight core cities. In 2012 the following are a few resolutions for what to consider in a planning and legislative context for cities in the coming year:

- Pay close attention to the Local Government Finance Bill announced before Christmas and whether the government's interpretation of business rate reform will provide enough incentives for councils to grow their business base. While the proposed system will reward authorities for expanding this base it is also complicated and creates uncertainty over local government revenues;
- The speed of progress and development of local enterprise partnerships (LEPs), the government's main vehicle for driving forward many of the changes in the Localism Act. LEPs have the potential to be effective if they can set strategic plans and take forward their new responsibilities. Likewise, it will be important for the government to engage with LEPs according to their need and ensure they have enough support to maintain momentum.
- Watch the results of the mayoral elections scheduled to take place in 11 of 12 of England's largest cities on 6 May. It will be interesting to see at which geographical level the Government thinks mayors could best operate, whilst giving cities the choice to hold a referendum for a metropolitan - or city-regional - mayor, or a local authority mayor depending on political appetite.

From a London perspective (back there again), the viability of future schemes being affected by the proposed introduction of a Mayoral Community Infrastructure Levy (CIL), and CIL charges from the London boroughs. There has been a 40% increase in construction activity since this time last year, with 7,300 new residential units started in 2011. More than 11,000 units are under construction in east London alone, a result of another London-centric phenomenon known as the Olympic Games.



Residential

On life support again

Just as we “went to press” last November, the Government announced a mortgage indemnity scheme for new-builds, as part of the Coalition’s housing strategy, in a bid to kick-start (yet again) the residential housing market. The lenders are Barclays, HSBC, Lloyds Banking Group, Nationwide, Royal Bank of Scotland, Santander, and Yorkshire and Clydesdale Banks, who between them have 80% of the mortgage market and the 25 developers who have agreed to participate in the scheme include the UK’s biggest house builders, Barratt, Persimmon and Taylor Wimpey, who between them, build some 60% of all new homes in the country. Under the scheme, lenders will advance up to 95% LTV on new-build property for first-time and first-move buyers, but will also pay 3.5% of the value of the property into an indemnity fund, which will pay out to the lender if a property financed under the scheme is repossessed and there is a shortfall (we taxpayers pay out if the loss is 3.5%-9%).

Criticism centres on the scheme being an ill-thought-out interference in the market, which may mean taxpayers’ money being used to support developers’ sale prices. If it all goes wrong, the first-time buyer would lose their deposit, the developer and taxpayer would lose their stakes, and the bank would get the house. RICS spokesperson Michael Newey said: “The focus on new-build will not free up chains and may reduce demand for second-hand property.” Many think a stamp duty holiday for all home buyers up to £250,000 would have been a better boost to the resale market.

As if more evidence was needed of a lifeless residential market, UK house sales fell 1% last year to 869,000, one of the lowest totals on record, HM Revenue & Customs has said. Sales levels over the past three years (848,000 in 2009, 878,000 in 2010) are roughly half the levels recorded in the run up to the banking crisis in 2007.

This is a combination of very poor levels of credit availability and very low levels of new construction activity and shows no sign of ending. The Council of Mortgage Lenders has predicted that total lending, to both buyers and people remortgaging, will fall again this year, which suggests that sales may also fall further. In 2013, the FSA will ban mortgages where the loan is greater than the value of the property, and will also stop loans to people who cannot prove they have sufficiently large incomes to repay their home loans, likely dampening demand still further.



Industrial

“Boris Island”



Another bit of crystal-ball gazing at the industrial and warehouse sector. Retailers, we reckon, will lead demand for logistics space over 2012 and the trade sector will lead demand for standard industrial warehouse units. As with offices, the availability of good quality stock will diminish further, tenant inducements will fall and headline rents will increase in certain prime locations. According to Jones Lang LaSalle, development will be mainly demand-led, but property companies with existing landholdings will increase small scale speculative development in key areas. As in the residential market, funding issues are still a concern and are currently holding back development. In the south-east (Essex actually), DP World is constructing a new container port at London Gateway (due to open in the last quarter of 2013) and marketing some 850,000m² of logistics space on the adjacent park with rail connectivity.

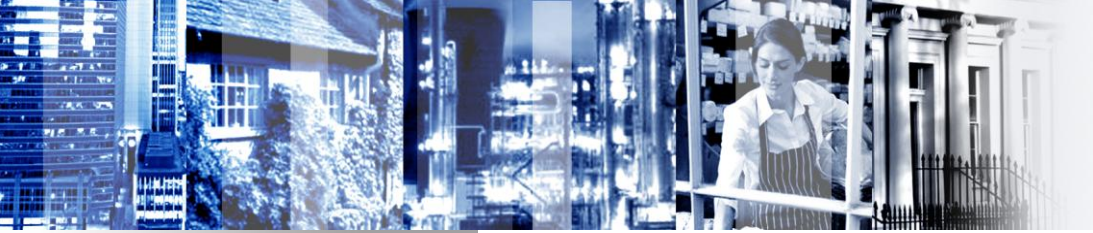


Another area to watch in 2012 will be the Government’s approach to meeting the demand for future airport capacity in London and the South East. A draft policy framework for public consultation is due to be published in March 2012 and formally adopted by March 2013. In its National Infrastructure Plan (November 2011), the Government says the draft framework “will explore all options for maintaining the UK’s aviation hub status, with the exception of a third runway at Heathrow.” There are currently three main proposals, all local to us:-

- A new airport on an artificial island in the Thames Estuary, which is being promoted by Boris Johnson the Mayor of London – often referred to as “Boris Island”;
- A new airport on the Isle of Grain, proposed by Foster and Partners (it makes you wonder about the amount of piling that would be needed);
- A high-speed train line linking Heathrow and Gatwick airports to create a combined hub, known as “Heathwick”.



Whilst these projects are clearly longer-term than 2012 alone, it is likely that 2012 will see one of these proposals emerge as more likely over the longer-term, which could have significant implications for economic growth and industrial property demand longer-term.



Summary

The problem with New Year resolutions is that they are never kept – you have probably broken yours already by the time you read this. It's the same with trying to predict market movements; the base from which you work has to be so generalised that the chances of accurate, and especially monetary, predictions remaining valid for any length of time is wishful thinking. What the last three years have taught us is, if you are trying to predict anything, start from a very modest base and if it really radically improves, great, otherwise predicting more of the same in a very flat trend is the most prudent course.

We were going to have had a look at radical solutions to fire up the property market in this issue but we are going to defer this to the summer because at the moment there is little appetite for the increased risk that this implies, either from lenders, investors or Government. Change over the next six months is likely to be in very small increments, more through structural changes in the wider economy about doing business, rather than the initiative being seized by certain participants to take the market to the next level of development.

Overall, in the past three years, the market has moved ahead in value terms by about 10% and commercial property prices are around where they were at the end of 2006. The whole philosophy of investing in property for the long term may be about to change.

NOTE

The views expressed in this Overview, unless they quote external research, relate to the south-east of England. They are general views, which should not be applied to individual properties without professional advice.

Edited by Denise Ford MRICS who would be pleased to respond to any comments.

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