

## PROPERTY MARKET OVERVIEW

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**Autumn 2010**

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### Contents

- |          |                       |
|----------|-----------------------|
| <b>1</b> | Introduction          |
| <b>2</b> | Office & Industrial   |
| <b>3</b> | Retail                |
| <b>4</b> | Commercial Investment |
| <b>5</b> | Planning              |
| <b>6</b> | Residential           |
| <b>7</b> | LPA Receivership      |
| <b>8</b> | Summary               |

## Introduction

### *“is the worst all over?”*

This new edition of the Property Market Overview comes with a new look for Michael Parkes Surveyors Limited.

The year just gone has been a tumultuous one for us all. There was without doubt a lack of available funding whilst banks took stock of their loan books and, as a result, the summer of 2009 became a very bleak one indeed. The intervening months saw the lack of lending affect almost every sector of business. We have listened to probably every market analysis of what will or won't happen in future and it seems that the only certainty we have is that we don't really know what will happen next!

It is not for us to predict how the property market will perform, only to comment on how we see the UK market as a snapshot of how we perceive events at the time of writing. However, we are sure that the readers' sentiments are, at present, similar to our own in that so much is written today about what might or might not happen that it is difficult to actually judge what really is going on. Having emerged from recession already this year, now we hear that a double dip recession is a possibility. The media, of course on the look out for stories that will immediately bash the bankers cling onto the hope that disaster happens – one such newspaper admitted the reason that such doom and gloom is reported is that they too were in a recession and needed to print stories that sell!

So, where can we go from here – if we don't know where we are all heading?



Our impression, from clients and fellow businesses, is that everyone expects the coming year to be pretty similar to this last one. Most want to keep their heads down, keep costs under control and look to a break even situation. That would seem, to us, to be a sensible decision to make, and until more stability creeps into the economy we would not

expect businesses to look to make large profits or grand business decisions – and that may well be some years to come yet.

Lessons from mistakes made during more buoyant times still seem to be taken on board, and we are pleased to note that this is the case. However, it would seem to us, as a small/medium enterprise that many large corporate companies, who in the past would've utilised our services, have taken the view that their risk strategy is best mitigated by utilising only the services of equivalent large corporate companies to provide them with services in the future. How disappointing it is to note that this is the case. We ourselves have noted that this has happened and we haven't been informed that changes are to be made to panels of service providers until after the decision has been made, not even giving us a

chance to compete with the “big boys”. Surely, for business in the United Kingdom to return to normal, it is small and medium businesses, local businesses, that are the key to becoming a stable economy once more. Local businesses are vital, and to lose them in the fear that they might be able to offer less of a risk is, quite frankly, an unreal expectation. Our own work in connection with LPA Receivership cases has shown that, in actual fact, property fraud is perpetrated not by the small companies, (albeit that can happen) but has also been found in some pretty major companies too. The most determined fraudster do not seek employment with or the service of only small companies. On behalf of all those small to medium enterprises out there, we would ask larger organisations to please consider utilising local expertise and maintaining that expertise. It will benefit us all.

It seems unlikely to us that interest rates are going to rise in the immediate future but we should all keep our eyes on that, particularly for those of you with an interest in the buy to let markets. Some landlords are maintaining their portfolios by enjoying the current low rates and just a half a per cent increase may mean that some struggle to continue. However, letting agents report a sharp decrease in supply of suitable letting property, meaning that vacancy rates are low and property remains let for longer periods.

So, full recovery is a long way off yet, but there may well be light on that horizon, if we can all withstand the likely ups and downs of the year to come.

## Office & Industrial

It has been another tough year for the commercial property market. We have had two bouts of uncertainty to sustain; the change of Government at Westminster, and the subsequent Comprehensive Spending Review. However, as well as the fortunate companies who continue to win new business contracts, there are a number of new enquiries generated through companies downsizing, restructuring and re-locating to meet the financial demands within their business.

Demand for large industrial units remains sparse, although there have been one or two landmark deals due to complete across the next six months. Many of the larger requirements in the UK have been tempted to the Midlands due to cheaper rents and the superior communications network. Conversely, small freehold units in the south east are scarce, and demand is high. Small businesses with readily available deposit funds have been able to take full advantage of low interest rates and we have found that competition for such property is high. Whilst this is not driving prices up, asking prices are achievable and comparatively quick transactions usual.



Whilst the London office market has recently enjoyed a small surge of successful lettings, the rest of the region has continued to struggle, as this sector remains in decline. At the

other end of the scale there have been a small number of start-up business requirements which have provided some much needed respite. Seemingly, the main tactic from Landlords is to try and retain the same quoting rents as last year whilst offering extended Tenant incentives, predominantly rent free periods, for those who are willing and able to sign up for a reasonable term. Landlords with small premises available now appreciate that demand is low and that they must be flexible in order to make their investments work for them. Many Landlords have entertained short term tenancy solutions, with occupiers covering the legal costs but paying little or no rent; the concept being that it is better to have a tenant in the property paying business rates than a vacant office attracting expense via non-domestic rates. Rate relief - or lack thereof - continues to cause havoc in this rather bleak sector. All of this has had a negative impact on values, which have dropped considerably – assuming that there is a purchaser for such property – sales remain virtually unheard of. Understandably, we have not seen any new office development for some considerable time.

The lack of readily available funding in the commercial property sector continues to cause frustration for businesses, investors and developers alike. Their attitude has not changed since last year, in that; without assistance from the financial institutions the market will not recover. The banks, it seems, are more cautious than ever. Sadly, with the general outlook for the coming months, there aren't many professionals in the market who can blame them, the overall view is that the real force of the government cuts are yet to be experienced.

## **Retail**

### ***“three themes”***

A colleague's wife, who you will rapidly realise is not a Chartered Surveyor, does not believe that commercial property extends beyond Bluewater. Her best friend believes that you have to go into a shop for the same reason that George Mallory tried to climb Everest: “because it's there”. If, as economists are prone to do, you extrapolate this behaviour to the marketplace, we would have no concerns whatsoever about value of retail property because we would live in a bubble insulated from reality.

However, the reality of “high street” retailing in the last quarter of 2010 is likely to be dominated by three themes: the potential impact of increasing VAT to 20% in January 2011; the outcomes of the government's October Spending Review; and multi-channel competition from on-line retailers. This is most clearly seen by surveyors in one recurring area - vacancy rates.

Research by the Local Data Company<sup>1</sup> on town centres showed the continuing impact of the recession. Its main findings for the south-east were:

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<sup>1</sup> A Gathering Storm? Shop Vacancy Report - Mid Year 2010, published September 2010

- The number of empty shops continues to increase in most centres but that the rate of increase is slowing;
- With exception of the far south-east, most centres in the south -east have performed reasonably well in the first half of 2010;
- Margate sees the highest vacancy rate amongst the large and medium sized centres at over 27% significantly higher than Eastbourne (13%) and Brighton (11.2%);
- At 6.6% Tunbridge Wells sees the lowest rate of the larger centres in the region.

So what are we actually seeing in the market on a day-to-day basis? Footfall and disposable income are key. With the range of on-line retailing options available and the reported increase in obesity (oh dear, are we becoming controversial here) shoppers are increasingly reluctant to move away from prime retailing areas. The sustainability of disposable income is going to become an increasingly important factor with the tax rises in the pipeline – Woolworths in Sheerness which closed in December 2008, is still vacant, as are up to half a dozen other units in Sheerness High Street. On the other hand, centres like Tunbridge Wells (see above) and Whitstable are holding up much better. So much so in Whitstable’s case that it has been found to have the highest proportion of independent retailers in the country<sup>2</sup>, let alone the region. And yes, if you walk through Whitstable town centre, there is hardly a vacant shop to be seen.



So why? It seems to be a combination of community spirit and opposing the expansion of the “big four” retailers – Tesco, Sainsbury’s, Asda and Morrison’s and the, albeit tempting, local investment through section 106 agreements. Whitstable has seen an influx of second-home owners, which could distort the local economy although only time will tell. Which brings us neatly to the wider subject of property investment.

## ***Investment***

### ***“investment has been a dirty word”***

Since the early part of 2008, investment has been a dirty word mainly because it has tended to have the word “banker” attached to the end of it causing apoplectic readers of the Daily Mail to demand a return to the economics of the 1950’s. Ironically, 1951 saw the end of a 12-year unchanged bank rate of 2% and by November 1957 it had reached 7% and borrowed money in the meantime had fuelled a residential property price boom, which required cooling. Sound familiar?

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<sup>2</sup> Clone Town report, New Economics Foundation, September 2010

In the investment world, accurate information that you can rely on for any length of time is about as rare as an MP with an expense account. This is very much indicative of the past decade where returns on asset classes have varied markedly, with two stock-market crises, a property price bubble and commodity prices exhibiting marked peaks and troughs. Looking for trends in the commercial property investment market is reliant on transactions that have taken place in the widest possible area. However much of the information that is published relates to London and is therefore not universally applicable.

If you look at the period 2000-9, then the average accumulated return on UK commercial property was 75% and on residential property equities) was 187%<sup>3</sup> (compared to 18% for interpreting raw statistics where in the property cycle location. London was a good commercial property in 2009. at roughly half the boom-took advantage; Nomura new City office at Watermark gave them six years rent-free.



residential property equities). However, depends very much on you are and your place to rent Contracts were signed time level. Tenants signed a lease on a Place which in effect We have never seen

anything like this provincially, so six years rent-free in Maidstone is likely to be a pipe dream.

To demonstrate just how cyclical the market is, the three-month development outlook, an index compiled by Savills, has turned negative for the first time in a year. On its own, this is not a great indicator for the whole market as the prices for acquiring existing properties now make financial sense. During the property boom, many investment funds were willing to accept a negative initial cash flow on buildings in the hope of greater gains from new construction, improving neighbourhoods or just a rising market. The UK average acquisition yield is now 5.8%, up from 5.7% two months ago. With borrowing costs remaining low probably until the second quarter of 2011, property is cash flow positive for the highest quality investors.

As the Financial Times noted on 9 August, even if longer-term construction looks relatively more risky, commercial property overall appears unlikely to revisit its 2009 lows. This is also a cautionary tale for those who think that indirect investment in property companies, even heavyweights like British Land and Land Securities is mitigating risk. Britain's output growth this year is barely expected to break 1%, before the full impact of the spending review in October is known; a stark reminder that a full commercial property recovery can only co-exist with an economic one.

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<sup>3</sup> Lloyds Banking Group, March 2010

## Planning

### *“localism”*

So what is different with the change of Government?

Perhaps surprisingly the new Government has quite quickly targeted planning for some change as part of its “localism” agenda. So what do the alterations to the planning system made to date mean for its day to day operation?

### The Changes

- Abolition of Regional Plans

On the 6<sup>th</sup> of July the Secretary of State (SoS) announced outside London the abolition of all Regional Plans with immediate effect. Individual planning authorities in future will need to identify a strategic context for themselves by setting their own



housing and employment/economic development targets. The Government has stated that it still expects individual councils to maintain a 5 year housing supply of deliverable (readily available) sites and also set out their housing ambitions over 15 year periods.

The Government has confirmed that material policy, particularly in the context of determining planning applications, within individual authority areas will for the meantime comprise: national policy (PPSs and PPGs); any adopted new style Development Plan Documents (LDF documents); SoS saved “old style” Local Plan policies; and any old style plans that have not lapsed.

Local authorities are being encouraged to continue to produce LDF documents and to review already adopted new style documents at the earliest opportunity.

It is anticipated that amendments to the plan making regime will be incorporated in the Government’s Decentralisation and Localism Bill, which is due to be published by the end of November, becoming law in Autumn 2011.

- The Abolition of Minimum Housing Densities

On the 9<sup>th</sup> of June the SoS announced the abolition of the indicative minimum residential density requirement of the 30 dwellings per hectare (12 dwellings per acre) that had been set out in PPS3 – Housing. This change was implemented by issuing a new version of PPS3 (June 2010) within which the old density guidance was simply deleted.

- Exclusion of Garden Land from the definition of Previously Developed land (PDL)

In reissuing PPS3 the Government also made an amendment to the definition of PDL to exclude “garden land”, to end what it has termed “garden grabbing”.

- The New Homes Bonus

As part of the October 2010 Comprehensive Spending Review announcement the Government indicated that it proposes to introduce “The New Homes Bonus”.



The New Homes Bonus is designed to increase economic development and housing development by incentivising Councils and communities to accept new house building in their areas. Under the bonus system for each home built, the Government will pay the Council in question a sum equivalent to the additional Council Tax that the new home will generate and to in effect match fund the Council Tax for a period of 6 years, commencing in April 2011.

The abolition of regional plans is a significant change to land use planning and is likely to reduce certainty amongst landowners, developers, local authorities and communities for some time to come, despite the Government’s view that more certainty should be provided.

In the aftermath of the abolition of the regional guidance, some authorities are seeking to have the Government’s decision judicially reviewed and this might lead to further confusion while the issue wends its way through the courts.

The Government is encouraging authorities to progress their LDFs and review adopted LDF documents based upon the targets set out in the now defunct plans. However not surprisingly some authorities are reluctant to progress their LDFs until the outcome of any legal action is known. Others can be expected to wait to see how the new legislation evolves as the Localism Bill progresses through its parliamentary stages.

Early indications are that there will be no formal role for regional or sub-regional planning under the new regime. While both Regional Plans and Structure Plans were by no means perfect, their existence provided some higher level direction to district and borough councils in terms of the level of employment and housing development to be accommodated and the infrastructure provision required to support that development. The evolving new system by placing the emphasis upon local decision making has the potential to leave local authorities acting inconsistently having to weight up competing interests. The absence of any regional or sub-regional targets will also potentially create major issues for the delivery of infrastructure to support new development. Highway and health authorities for example will have less certainty about the scale of what they need to provide and when, because it will not be until all authorities in a particular area have been through their individual planning making process that requirements on a sub-regional or regional basis will become apparent. There is a danger that more strategic scale infrastructure delivery will continue to fail to match the rate of new development.



It must also be questionable whether the New Homes Bonus will have the desired effect, because the incentive might encourage some authorities, in financially challenging times for them, to be swayed by the availability of additional funding rather than planning their areas in the most appropriate way. There is also a risk that a “dog eat dog” situation may develop among authorities. Supply and demand distortions may also arise because developers are more likely to direct their attention to areas where they expect to encounter less resistance, which will not necessarily match demand.

It is likely that for the foreseeable future plan making will become even slower than it has been, with development targets being argued over even more intensely at the local level. For landowners and developers it will however be important to keep abreast with what individual authorities are doing, because windows of opportunity to bring sites forward for development may be lost if authorities start reigning in the scale of development they will accept. Equally new opportunities may arise amongst authorities that take on a more pro development stance.

The revisions made to PPS3, particularly the scrapping of minimum density targets, should ensure that there is a better fit between new residential development and the areas in which it is to be sited. Developers should therefore have more freedom to bring schemes forward that reflect market demand, which in turn should be compatible with maximising land values and developer returns.

## Residential

### *“this softer trend will continue”*

Nothing fuels obsessive after-dinner conversation, or, for that matter conversation generally it seems, as the peaks and troughs of residential property prices. This piece does not promise you information on when you should put your house on the market (if you want to) and less still, what you might get for it, but it might encourage you to put down your copy of the Daily Express and take a more sanguine, longer-term view of the market.

House prices began to fall for the first time in a year in July. If we were writing this in April and May, we would have started on a much more positive note, but that is because markets are driven by sentiment, and sentiment is a very fickle thing. Sentiment can change so abruptly that it creates its own momentum and previously sane people have been known to lose their grip on reality temporarily and get swept along on waves of euphoria or depression, depending on which direction they think the cycle is heading. The problem for us surveyors trying to predict where these turns of sentiment are going to occur is that a herd mentality doesn't follow the rules of conventional economics.

The Michael Parkes website (if you're reading the paper copy of this, do look at [www.michaelparkes.co.uk](http://www.michaelparkes.co.uk)) mentions the Royal Institution of Chartered Surveyors in more than one context, but its property research is worth reporting here. RICS look at the balance of chartered surveyors reporting rises in prices versus falls in prices. This tends to be a good “leader” of the market as it is more representative of sentiment rather than actual prices, which take a quarter or so to be recorded formally. In July, 25% of surveyors reported falling house prices over the previous three months, compared with 11% saying prices rose in October. On a seasonally adjusted basis, the negative balance of -8 was the first time the RICS headline measure had indicated falling prices for a year, and was caused by an excessive number of sellers. The forward-looking price expectations numbers suggest this softer trend will continue through the second half.



In the medium term, the main issue is the ability of borrowers to raise mortgage finance. In many ways, the loan-to-value ratios that banks are now prepared to finance are totally realistic. It's just that over the period 2003-7, what were, on all rational measures wholly unrealistic ratios were taken, by property professionals as well as the general public, as being the norm. The impact of wholesale funding on banks' balance sheets, an esoteric subject at the best of times, was not properly understood and a controlled descent from

100% mortgages to 70% mortgages, which should have occurred, did not happen until it was too late.

Lloyds Banking Group has said it expects “static” house prices in 2010 and a 3% rise in 2011. This prognosis is a reflection of the uncertainties that plague a fragile market with minimal direction. There are opportunities to be had, but you’ll have to wait for our next overview and the update of website blog to find out where they are.

## LPA Receivership

### *“increase in activity”*

This specialist sector of the market is one that few surveyors get to become involved in and remains a niche area for many. The last year, during which our Managing Director had the honour of being Chairman of NARA, The Association of Property & Fixed Charge Receivers, has seen much debate about Receivership, as it moved further and further forward as a key to managing bad debt.

At the start of the recession, much speculation could be heard within the “industry” about how there would be a rush to place lender’s property debt into LPA Receivership, and certainly the new entrants wishing to train in Receivership would seem to show that many major practices thought that this would be the case. Whilst an increase was seen, the lenders were cautious about revealing much about their debt, and the flood didn’t happen.



Our own experience is that many cases that have been brought to the fore are, unfortunately, fraud related. However, this does show that lenders are taking the financial crisis, and the cause of it, very seriously indeed. The complexity of some of the cases has shown that little could have been done to prevent much of it, with borrowers able to present very professional looking documentation to back up their forecasts and values. At present, the situation looks to be evolving a little, with most lenders now posting profits, and having less fear of publishing

debt, finding the confidence not to continue to attempt to manage bad debt themselves but instead to appoint LPA Receivers to remedy the situation.

There is little doubt the next few years are going to see an increase in activity in this sector. Interest rates remain low and, whilst they do, many, landlords particularly, are able to sustain their mortgage repayments. If, as predicted, interest rates begin to rise over the

next year, then many may well fall behind on payments and be unable to maintain the mortgage. In a market where predictions of a double dip recession are still regularly spoken about, it isn't a good time to sell, with estate agents now reporting that there are many more vendors than there are purchasers in the marketplace. In addition, demand for bank finance is most definitely down, and until there is impetus in the market to buy once more, or more importantly, the perception by the public that high street lenders are indeed willing to lend, it is difficult to predict, if not impossible, when a good time to sell will actually be.

## Summary

In the current market, there appears little to be cheerful about. However, our experience seems to show that there is indeed movement in the marketplace and, with bank lending available, this can only improve. The fear of a double dip is still a concern, but it cannot and should not prevent businesses from moving forward. There is little doubt that the coming year is likely not to see increases in profit in many sectors and indeed hardship throughout many others, with spending cuts and job losses expected.

As long as growth, no matter how slow or frustrating it is during 2011, is managed in a steady manner, the outlook looks – in our opinion – good. We must be careful to manage supply and demand, to ensure that particularly within the residential sector, prices do not reach unmanageable levels once more, but confidence needs to return to the market before we are likely to see any substantial movement in any marketplace at present.

As yet we have not the property industry who they are in a position to welcome in huge profit all appear to be looking to sustainable manner and the icing on the cake, if it



spoken to anyone within is prepared to shout that expand dramatically or to margins but instead, we manage growth in a look at possible profit as arrives.

We would like to think that many lessons have been learned from this recession and that we can look forward to a property cycle that will bring stability, prosperity and profitability back to all. We wait with bated breath.

**NOTE**

The views expressed in this Overview 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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