UK

Investor appetite for property asset class defies downbeat view of economic woes

The commercial property sector's faith in property as an asset class outweighs its doubts over broader concerns about near-term economic activity, as investors look to increase their exposure to the sector. This is the conclusion of the latest Lloyds Bank Wholesale Banking & Markets Commercial Property Confidence Monitor, produced in association with the Investment Property Forum.

Sentiment surrounding the sector's prospects is mixed, with rising and falling levels of optimism depending on the size and location of respondents' companies. But, their investment intentions have firmed noticeably, as investors look to take advantage of lower prices and distressed sales.

Major businesses and fund managers have the greatest appetite for new investment in the next three to six months, with 65 per cent and 58 per cent respectively seeking to increase their exposure to the sector. This is in spite of half (50 per cent) of the fund managers questioned expecting the UK commercial property market to slow down over the same period and only four per cent expecting it to improve.

The double-dip recession in 2012 Q1, ongoing liquidity issues in the lending market and the recent intensification of the Euro zone debt crisis were cited as being among the drivers of negative sentiment in the current survey. This is countered by perceived positive factors including a seasonal upturn, low interest rates, affordable prices and the feel-good effect of the Jubilee celebrations and the forthcoming London 2012 Olympic and Paralympic Games.

Lynda Shillaw, Lloyds Bank Wholesale Banking & Markets' Managing Director of Corporate Real Estate, said:
"Funds are sending a clear signal that they want to increase their allocation to real estate and this is shared by most respondents. Their intention to invest is likely to be linked to perceived long term returns and shifts in their asset allocation strategies and the real estate funding market. While there is clearly pessimism surrounding immediate prospects for market activity, portfolio performance and in some cases property valuations, investors are nevertheless seeing the opportunity for longer term value growth when buying at today's prices. To take advantage of this pricing against a backdrop of generally constrained lending, investors need to work with their banks to tap into wider sources of investment funding from the debt capital markets."

According to the survey's composite index, which averages the net balance scores on prospects for the sector in the next three to six months, optimism increased most among major businesses (up 13 points to +29) and businesses in London (up 9 points to +18). This was in sharp contrast to fund managers, the most pessimistic group overall with a net balance of -17.

Property values remain muted and whilst there is a broader market expectation for further falls in value medium to large businesses in London and major organisations expect a net increase in the coming period. Conversely, investment appetite among London firms fell sharply. Only 30 per cent are looking to increase their exposure to property in the coming two quarters, while 13 per cent

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seek to divest.

Lynda Shillaw said:
"Central London remains the sweet spot for real estate, as evidenced by the recent results from companies like Shaftesbury and Great Portland Estates who have good quality stock in great central locations. There is also good momentum in prime West End retail. But, some investors will be priced out of London and may turn to prime regional assets offering better value. We are already seeing some of the large REITs selectively acquiring non-London prime.This quarter's survey also asked respondents about their appetite for the hotel & leisure and healthcare sectors.

Most groups expected to increase their exposure to the hotel & leisure sector, with the exception of major businesses. London-based companies have the highest allocation to the sector, at around seven per cent, and expect to increase this to nine per cent by the end of 2012." All groups surveyed are looking to increase their exposure to residential healthcare by the end of the year. Small businesses currently have the highest exposure to the sector at around two and a half per cent of their portfolios, while medium-to-large advisors and major businesses are planning the largest increases of exposure by the end of 2012, both doubling from less than one per cent currently, to almost two per cent.

Lynda Shillaw said:
"There is currently under-capacity in the London hotel market, which may explain the appetite for this sector among London businesses, but I would expect investment to be very selective. Healthcare represents a big opportunity in light of NHS reforms, but the market is still developing and there are reputational risks for investors given the nature of the asset. I do however think that this is a sector that will see more entrants from experienced investors and operators from other parts of the world over coming years"

Big firms and London investors expect pick-up in activity
After last quarter's improvement in sentiment, there are now mixed feelings over the outlook for the UK property market. Only London-based medium to large businesses and major companies expect a net upturn in market activity. Thirty nine per cent of London businesses and 27 per cent of major businesses expect market activity to pick up. In contrast, fund managers remain the most downbeat about the prospects of the UK property market, half (50 per cent) expect market activity to slow down in the coming three to six months.

Fund managers are most downbeat on their own sector's prospects
Major businesses and London-based medium to large organisations expect an improvement in their own business sectors, with 27 per cent of major businesses and 31 per cent of London businesses predicting a pick-up over the next three to six months. Fund managers remain the most pessimistic out of all the groups with only 10 per cent expecting their own sector to pick up compared to the 36 per cent who predict a slowdown. Outside London, 21 per cent of medium to large businesses expect their sector to pick up.

Andrew Smith, Chairman of the IPF Research Steering Group and Global Head of Property at Aberdeen Asset Management commented:
"Fund managers remain pessimistic regarding shorter-term prospects in a property market faced with a cocktail of difficulties: economic woes suppressing letting markets; constrained bank

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lending activity, aggravated by the European sovereign debt crisis; and weakening capital values, particularly for secondary assets. However, some see scope to take advantage of an arbitrage opportunity afforded by depressed asset pricing in the current market. This is signalled by a majority of fund managers looking to increase fund allocations to real estate over the next six months. At the sector level, the expected performance of private residential investment remains at the forefront, followed by industrial property, which continues to generate a good running yield compared to other asset classes, despite downward pressure on income arising from the weakened occupational market."

Cool expectations on portfolio performance

Only major companies, medium to large advisors and fund managers show an improvement on the previous quarter's survey regarding their portfolio performance, although fund managers remain firmly negative. Forty two per cent of major businesses expect their portfolio performance to increase with none expecting a decrease in the next three to six months. Thirty-two percent of advisors expect an improvement compared with 27 per cent in February. Although fund managers are less pessimistic compared to the previous survey, they remain the most negative group with forty two per cent expecting their portfolio performance will decrease, as opposed to a fifth (20 per cent) that foresee an improvement. Despite being down on the previous quarter, medium to large businesses in London and the regions remain positive about their portfolio performance, with 31 per cent and 24 per cent respectively predicting an improvement.

Property value uplift expected across the board

Whilst all groups other than small businesses have a less negative view of the value of their holdings in the next three to six months, only medium to large businesses in London and major businesses currently have a net expectation of increases. However, the overall trend is more optimistic than in February. Medium to large advisors, fund managers and medium to large firms in London display the biggest positive shifts, with 19 per cent, 18 per cent and 32 per cent respectively now expecting values to improve, compared with 15 per cent, 12 per cent and 24 percent respectively in the previous quarter.

Residential lettings tipped as best performer

As has largely been the case since it was first introduced to the survey in August 2011, residential letting is tipped to be the best performing sector by all groups surveyed. For the majority of respondents, house building is predicted as the second best performer with the exception of a fifth (20 per cent) of fund managers who foresee industrial as the next best performer behind residential lettings. This quarter highlights an increasing hope for out of town retail; the average share of respondents in favour of this sector has risen from 10 per cent to 17 per cent, whilst optimism about high street retail development has fallen from seven per cent to four per cent compared to the previous survey.

Impact of the TMT sector

This quarter, respondents were asked for their views on the TMT (technology, media and telecommunications) sector and what influence they perceive this to be having on UK property market activity. All groups surveyed believe that activity in the TMT sector is having a positive impact. Fund managers are the most positive with 46 per cent, followed by medium to large advisors at 42 per cent and London businesses at 40 per cent.

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Lynda Shillaw said:
"We're certainly seeing the establishment of TMT hotspots, although their impact at this stage is not strong enough to ?move the dial' and drive significant property investment in these locations. However, TMT's influence is positive for the sector as the cluster effect creates momentum in that area and acts as a draw for other companies that can feed off their talent and innovation."

Investment intentions point to short-term buying spree

Investment intentions continue to steadily increase in most sectors, with 65 per cent of major businesses looking to increase commitment over the next three to six months, followed by fund managers, of whom 58 per cent are looking to invest more into the property market. Compared with the last quarter's survey, all groups showed greater appetite for new investment, with the exception of medium to large businesses in London and principals, whose investment intentions dipped slightly but remained positive on balance.

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