

UK | Research &
Forecast Report



Accelerating success.

REAL ESTATE INVESTMENT FORECASTS

Q1 2016



All Property Forecasts	3
Economic	4
Investment Market	5
Retail	6
Standard Shops	6
Shopping Centres	7
Retail Warehouses	7
Supermarkets	7
Offices	8
Central London	8
South Eastern Offices	9
Rest of UK Offices	9
Industrial	10
Standard Industrial and Distribution Warehouses	10

All Property Forecasts

Total returns for 2015 finished the year at 13.1%, according to the IPD Quarterly Digest, consisting of 7.8% of capital growth and income returns of 5.0%. This was only 0.1% shy of our Q1 2015 forecasts, but slightly lower than our mid-year estimates, which anticipated a continuation of the strong trading seen in H1.

The overarching story for 2016 is set to be more restrained as total returns veer towards the 10-year average, but lower than the historical average since 1980. Total returns for 2016 are expected to reach 7.4% assuming an EU referendum status quo result, consisting of 2.3% capital growth and 5.0% income return. The yield shifts witnessed last year are expected to peter out as pricing steadies across geographies and sectors. Rental growth is anticipated to reach 3.6%, slightly down on the 4.0% recorded in 2015.

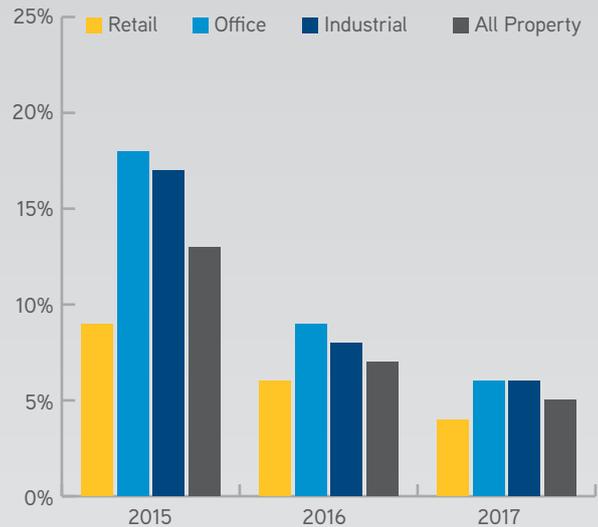
Offices will continue to outperform other sectors, with total returns of 8.8% this year, comprising 4.4% capital growth and 4.3% income returns, but with the 2016-2020 total returns annual average slowing to 6.7%. Industrial performance is expected to follow a similar trajectory, with total returns in 2016 at 8.2%, consisting of 2.6% in capital growth and 5.6% income returns, but with the 5-year total return average marginally higher at 6.8%. Retail will remain the laggard as total returns this year will reach just 6.0%, with capital growth of 0.7%.

Rental growth trends are likely to remain fragmented by geography across most sectors, with the southern part of the UK outperforming the rest of the country. This will be particularly evident for standard shops, with Central London units providing the main impetus to rental uplifts in the sector. The rental growth gap between the South and the rest of the country is however set to narrow for other sectors, with the higher costs in London – and to some extent the South East – enticing occupiers to look elsewhere. Rental growth in 2016 is expected to be strongest for Offices (6.6%), followed by Industrial (4.4%) and Retail (1.4%). The 2016-2020 annual averages are anticipated to follow a similar path with Offices (3.8%) leading, Industrial (2.5%) in second and Retail (0.9%) in third.

All Property Summary Forecasts

	DEC-15	DEC-16	DEC-17	ANNUALISED 2016 - 2020
ERV Growth (% pa)	4.0	3.6	2.7	2.2
Equivalent Yield (% eop)	5.8	5.8	5.9	6.0 (2020)
Capital Growth (% pa)	7.8	2.3	0.2	0.9
Total Return (% pa)	13.1	7.4	5.2	6.1

Total Return by Sector



Source: Colliers International, IPD

ERV Growth 2016-2020 % pa



Source: Colliers International

Total Return 2016-2020 % pa



Source: Colliers International





Economic

The UK economy continues to perform reasonably well when considered against the challenging backdrop of slower global demand and equity market volatility. Nevertheless, activity has cooled and a mid-cycle slowdown is evident, with Q4 2015 GDP growth of 0.5%. However, the much sought-after rebalancing of the economy does not appear to be taking hold as the services sector continues to provide the main driver, with output growing by 0.7% q/q in Q4 2015, compared with contractions of 0.2% and 0.1% for production and construction respectively.

Despite a good start in January, the momentum built was all but lost in February as all business sentiment surveys recorded falls. Services, the sector which accounts for more than two-thirds of all economic activity in the UK, Markit PMI fell to 52.7 from 55.6 in January as the volume of new incoming work slowed. Elsewhere, construction PMI eased back to 54.2 in February as residential building was the worst performing segment for the first time in three years. However, the manufacturing PMI index saw the largest fall as it fell to 50.8, the lowest figure since April 2013. All business surveys are still in expansionary territory and GDP growth in Q1 16 should remain positive, albeit a slight slowdown may materialise.

In the labour market, the unemployment rate was unchanged at 5.1% in the November-January period, the lowest rate in over 10 years. However, when considered alongside the promising 2015 start, nominal wage growth was largely disappointing as it continued its downward trend in H2, increasing by 1.9% in December y/y, with real wage growth largely supported by the low inflationary environment. It did, however pick up slightly in January rising by 2.1% y/y.

Consumer price growth remained low, hovering around the 0% mark for most of 2015 and only edging up from November onwards. January recorded the most significant rise as the CPI index increased to 0.3%, driven by base effects, which will continue to prop up the headline figure. Moreover, oil prices have begun to rally over the past month, with the Brent crude oil price for a barrel recovering from the sub-\$30 mark in mid-January to over \$42 at the time of writing, suggesting a possible boost to inflation figures may filter through.

HM Treasury March forecasts continue to see downward revisions, with the average of the new forecasts for 2016 at 2.0%, which is markedly down from the 2.6% estimated six months ago. Next year is expected to see a similar trend, with GDP growth forecast to reach 2.1%. The most imminent potential risk to these figures is the EU referendum (and its outcome), with a 'Leave' result likely to have an adverse effect on GDP growth by a magnitude of 0.5%-1.5% over the following 18 months. Other downside risks include slower than anticipated GDP growth in the Eurozone, weak global demand and further financial market volatility.

WEEK
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Investment Market

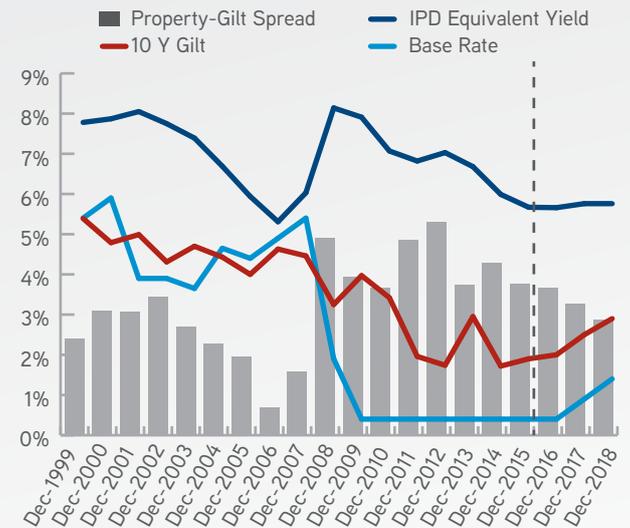
Total trading volumes in 2015 reached £70.8bn according to Property data, a 12% rise compared with the £63.2bn transacted in 2014. Office assets remained the most sought-after, but alternatives and mixed-schemes continued to increase popularity as together they accounted for approximately £28 billion worth of deals. Indeed, the three largest deals of the year, included the Centre Parcs portfolio (£2.4bn), Maybourne Hotel Group (£1.5bn), and Liberty Living portfolio (£1.1bn), highlighting the rise of the alternatives. While London remained by some distance the focal point of demand, cities such as Leeds and Birmingham saw trading volumes increased markedly in 2015, rising by 50% to £600mn in Leeds and exceeding £1bn in Birmingham. In contrast, Aberdeen was severely affected by the fall in oil prices and the subsequent job shedding and rationalisation of occupier space. Trading volumes collapsed from £783mn (ranked first in Scotland) in 2014 to just £111mn in 2015.

Overseas investors dominated acquisition activity as they comprised 50% of all investments in the commercial property market, and were also the largest net investor (£11.4bn) by some considerable margin. Although US investors (£12bn) remained the largest group in terms of acquisitions, Asian Pacific (£7.7bn) and European (£6.8bn) players closed the gap, according to Property Data.

Activity in the first two months of 2016 slowed compared to last year, with £6.3bn worth of assets traded. Although this preliminary figure will be revised upward, it is not expected to exceed the £8.4bn recorded over the same period in 2015. However, it is worth noting that Q1 2015 was the strongest first quarter since 2007, putting the recent figures in some context. Nevertheless, February has certainly seen the emergence of some restraint in the market, with the EU referendum weighing heavily on investment sentiment, pausing or delaying decisions on some acquisitions.

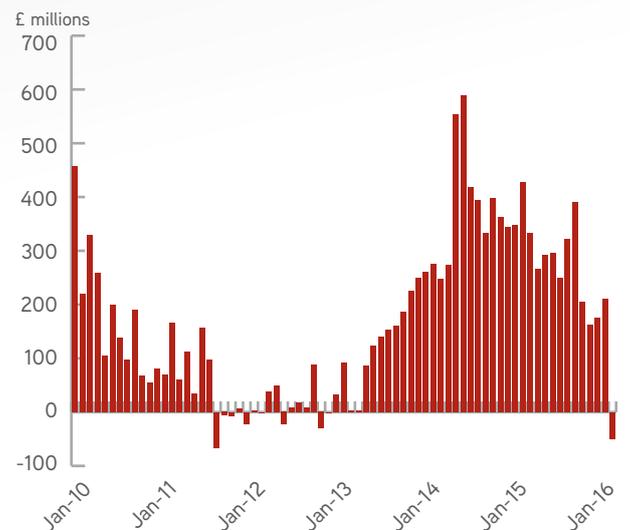
Although a cooling in the first half of the year in terms of trading volumes is expected, a status quo result in the EU referendum should give way to a relief rally in the second half of the year, which may push H2 figures transactional volumes towards 2013/2014 levels. Colliers expects All-Property yields to remain largely unchanged by the end of 2016, with a drift out only in selected sub-sectors such as supermarkets. Yields are then forecast to rise by 10 basis points in 2017 as the first interest rate hike is introduced, and will rise in tandem with the slow and gradual rate normalisation thereafter.

Selected Rates



Source: IPD, Haver Analytics and Oxford Economics

Net Investment into Funds by Asset Class: Property



Source: IMA (UK domiciled unit trust / OEIC net sales)



Retail

Standard Shops

High street occupier demand remained heavily focused on London, as evidenced by the double-digit growth witnessed in the main thoroughfares of the capital. According to IPD, Central London and Rest of London rental growth in Q4 2015 was 10.3% and 3.4% respectively, in contrast to the 1.4% rise in the South East & Eastern and the 0.1% decline in the Rest of UK. The rate in Central London did however slow towards the year end, peaking at 11.2% in Q3, suggesting a moderation in 2016. Nevertheless, strong demand from international and UK brands for Central London pitches will continue to drive rents to new record levels, partly supported by the newly-approved and more relaxed Chinese visa system, which should draw tourist spend from other major international cities.

Despite the more restrained growth pace seen outside of the capital, there has been a distinct improvement in occupier demand elsewhere, particularly in the top 20-30 south eastern towns, which pushed the regions rental average up and incentives down. Although occupier demand remains relatively thin in the northern regions and rental growth was flat in Q4 2015, market activity is at its highest level since the economic crisis, with discounters leading the way. Banks have also been expanding but due to the high supply on offer this has not led to active competition for floor space. A3 occupiers are also increasing their footprint at a solid pace, and where A3 consent can be secured this is leading rental growth as there is stiff competition from the sector. However, this is generally in leisure destinations or secondary pitches and is not visibly impacting on prime retail rental values. The A3 market is nonetheless instilling vitality and improving the viability of some high streets. Significant developments such as Victoria Gate in Leeds, expected to open this autumn, will undoubtedly change the retail regional landscape and rental growth is expected to edge up this year.

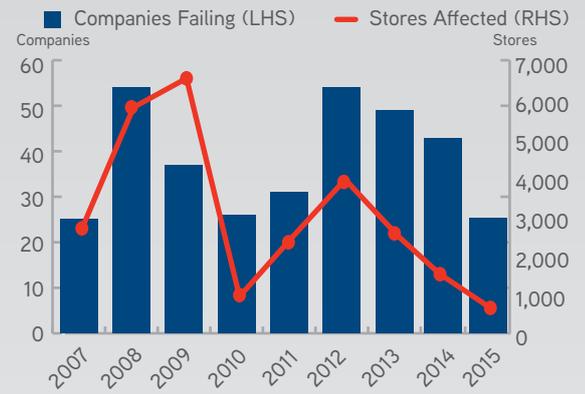
The overall retail turnover remains positive with sales continuing their persistent upward trajectory, growing by 5.3% y/y in January, with non-store and shop sales up by 11.5% and 4.4% respectively. Retail deflation was yet again a feature of the market, with non-store operators discounting at a faster pace than store retailers, but with margins under pressure across the board.

Nevertheless, constant retail sales growth translated into fewer insolvencies last year. There were only 25 companies and 728 shops affected in 2015, the lowest figure recorded by the Centre for Retail Research during a 9-year period, and significantly down from the 6,536 total in 2012. GfK's headline consumer confidence index was positive every month in 2015, a first in its 41-years old time series. However, it did record a cooling in February as it fell to its threshold level of 0, weighed down by negative economic sentiment for the next 12 months and lower savings sentiment. The Major Purchases index remained buoyant at 12.

Colliers forecasts high street IPD rental growth of 3.7% this year, slightly up on 2015, with an annual average of 2.3% over the five years to 2020. The rental growth gap between London and the rest of the country is expected to narrow, but the capital will continue to drive occupier demand and the overall rate. Colliers forecasts rental uplifts of 7.1% in Central London, 4.0% in Rest of London, 2.0% in Rest of South East & Eastern and 0.4% for Rest of UK.

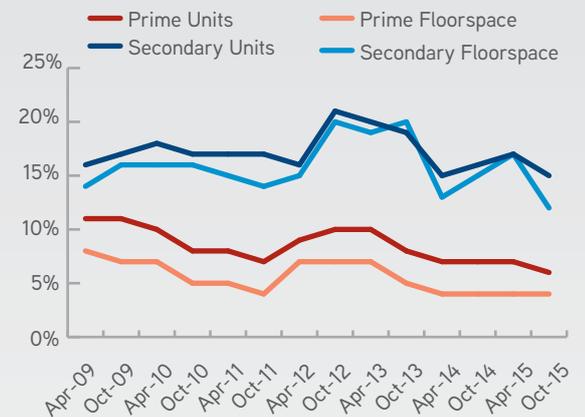
Retail Summary Forecasts				
	DEC-15	DEC-16	DEC-17	ANNUALISED 2016 - 2020
ERV Growth (% pa)	1.1	1.4	1.2	0.9
Equivalent Yield (% eop)	5.5	5.5	5.6	5.7 (2020)
Capital Growth (% pa)	3.7	0.7	-0.8	0.0
Total Return (% pa)	9.0	6.0	4.4	5.2

Retail Insolvencies



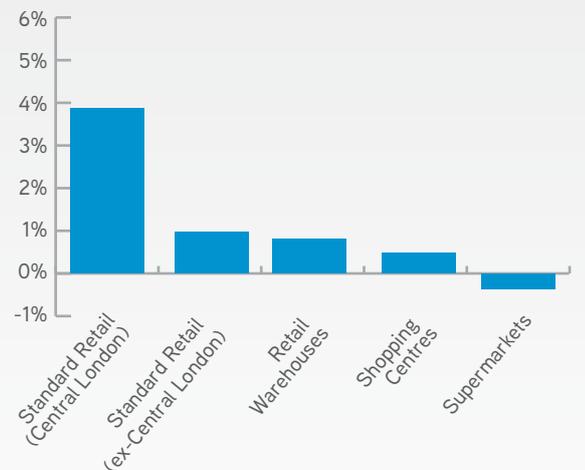
Source: Centre for Retail Research

High Street Vacancy Rates (Excl. London)



Source: Colliers International

Retail Annual Rental Growth Forecasts (2016-20)



Source: Colliers International

Shopping Centres

The polarised shopping centre landscape remains intact, with dominant regional shopping centres the most sought-after, while poor secondary and tertiary schemes continued to suffer from excess space. Indeed, IPD rental growth data for shopping centres in the low-yield (prime proxy) quartile reached 1.4% y/y in Q4 2015, in contrast to the 1.0% fall for the mid-yield (secondary proxy) quartile. As a result, IPD rental growth, while present in selected shopping centres, has generally bumped along the bottom for the past 18 months, culminating in an uplift of 0.2% in Q4 15. What is more, according to LDC's latest report, shopping centres continued to see the highest vacancy rate (14.1%) among retail sub-sectors in H2 2015, compared to town centres (11.5%) and retail warehouses (6.2%). However, there are some nascent signs of stabilisation and potential improvements which bode well for 2016. Shopping centres recorded the largest decline (0.7%) in LDC's H2 survey and this trend was confirmed by IPD's income and occupancy analysis, with 13.7% of all shopping tenancies void in Q4 2015, compared with the 15.2% recorded six months before, and the ERV in income voids also fell to just 6.7%. Colliers forecasts rental growth to accelerate slightly to 0.5% this year and average 0.4% in 2016-2020, but with a potential upside to these figures.

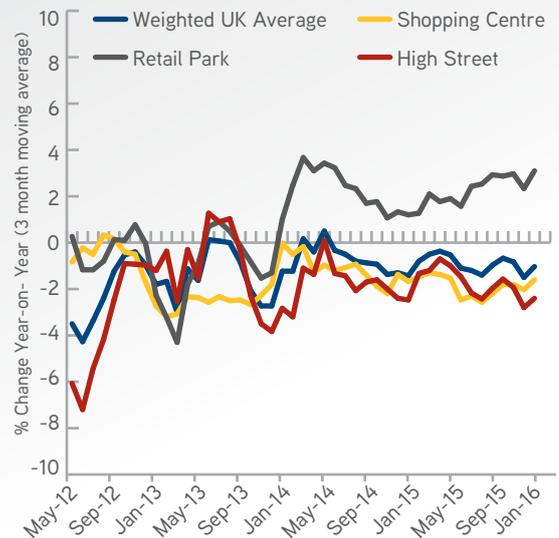
Retail Warehouses

Taking Central London shops out of the equation, retail warehouses were the best performing retail sub-sector last year in terms of IPD rental growth (0.9%), although performance remained below the 15-year average (1.5%). Overall, the North/South and prime/secondary polarisation was also evident in the retail warehouse sector, with prime schemes and those situated in the South of the country performing better, exemplified by South East vacancy rates of around 2.0%. The environment was generally conducive to attracting consumers and occupiers out of town, with petrol prices at their lowest since the recession, click and collect's continuing popularity, a buoyant residential market, and competitive retail warehouse occupational costs. Household goods volume sales have been on a positive trajectory for 26 consecutive months, growing by 6.8% in 2014, 8.4% last year, and 2016 has begun on a good note as sales rose by 3.0% y/y in January. Much of this was driven by vibrant activity in the housing market which pushed house price growth into double-digits in some regions. Although this trend is expected to continue this year, it is set to slow, particularly in prime Central London, where tighter regulations are already having an impact and may even see prices fall. Colliers forecasts another measured acceleration this year, with rental growth expected to reach 1.2% in 2016 and average 0.8% in 2016-2020.

Supermarkets

Conditions in the supermarket sector remain challenging, with structural changes currently underway as the weekly trolley shop is being reduced and pressured by a three-pronged "attack" from discounters, convenience and online shopping. Large store expansions are mostly on hold, apart from exceptional circumstances. Conversely, M&S Simply Food are targeting 90 new stores this year, Coop have an ambitious 120 store opening programme, while the discounters, Aldi, Lidl and Netto, are also looking to expand their portfolio, underlining the attractiveness and strength of the smaller segment (stores of up to 25,000 sq.ft). This shift in food store dynamics has resulted in a supermarket rental growth decline of 1.0% y/y in Q4 2015. Deflationary pressures persist as the major operators continue to vie for market share and try to fend off the challenge of the discounters. The food-store implied deflator in December 2015 reached its highest negative figure since May 1997, falling by 2.8% y/y, before easing back in January. While the pace of food deflation may lessen slightly this year as "base effects" come into play, it will not be enough to reverse the rental growth negative tide. Colliers forecasts IPD supermarket rental index to fall again this year (-1.5%), averaging -0.6% in the 2016-2020 period.

Footfall



Source: Springboard



Offices

Central London

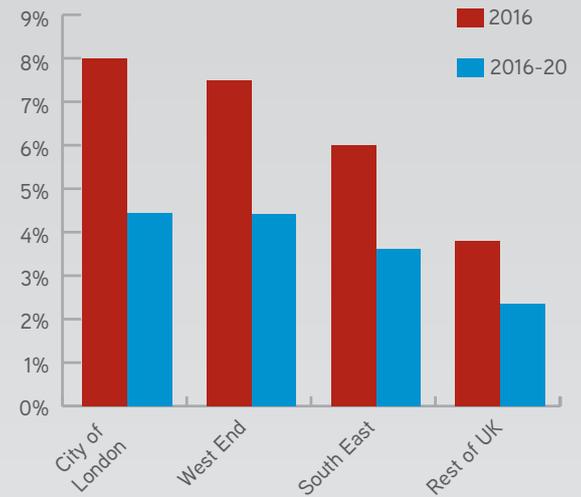
Occupier demand in the City of London remained buoyant, with prime rents across all wider submarkets experiencing upward pressure. Farringdon, Clerkenwell, Shoreditch and Aldgate all saw double-digit increases (20%+) in rents during the course of 2015. City headline rents ended the year at £70 psf and are expected to breach the £75 barrier by the end of 2016. Over 1 million sq ft of space was completed in Q4 2015, but just 74,000 sq ft of this total was delivered speculatively. The largest deal was the 250,000 sq ft pre-let to Royal Bank of Canada at the 100 Bishopsgate scheme which is due to be completed in Q4 2018. Although 4.4 million sq ft are set to be completed in 2016, more than double the figure in 2015, over 50% of this is either under offer or let. The composition of City take-up in 2015 was in line with more traditional occupier profiling, with Business, Financial and Professional Services accounting for close to 70% of total take-up, although Fintech is expected to play a more important role in 2016.

Prime West End rents reached £125 psf in 2015, however, demand for premium product in core West End locations has been noticeably thinner during the first quarter of 2016. Nevertheless, despite this slowdown, absorption of office space continues to be steady and 2015 was the highest annual total since 2010. Non-core locations such as Victoria, Bloomsbury, and Paddington, where occupiers are seeking more competitively priced Grade A stock, continue to experience strong interest. Media and Tech occupiers dominated demand last year as they accounted for almost half of all deals concluded in the West End, and they will continue to drive demand with pre-lets being signed earlier in the construction cycle. 2016 will see the announcement of major new occupational requirements from blue chip corporates who are keen to secure space ahead of expiries and breaks over the next 2-3 years.

Grade A availability continued to decline across both City and West End markets in Q4 2015, falling by 42% y/y. Despite the falls in transaction levels, occupiers continue to absorb space as fast as it can be delivered. Central London is expected to remain the engine behind the rental growth story this year, albeit the pace is expected to moderate after two years of sustained double-digit increases. Colliers forecasts growth of 8.0% in the City, 8.5% in Mid Town and 7.5% in the West End, averaging 4.4%-4.6% annually in 2016-2020.

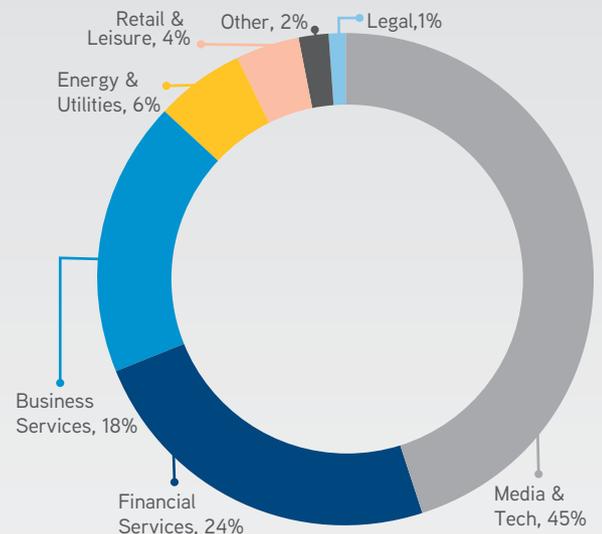
Office Summary Forecasts				
SUMMARY	DEC-15	DEC-16	DEC-17	ANNUALISED 2016 - 2020
ERV Growth (% pa)	8.2	6.6	4.3	3.8
Equivalent Yield (% eop)	5.7	5.7	5.8	5.9 (2020)
Capital Growth (% pa)	12.9	4.4	1.2	2.1
Total Return (% pa)	17.6	8.8	5.6	6.7

Office Rental Growth Forecasts



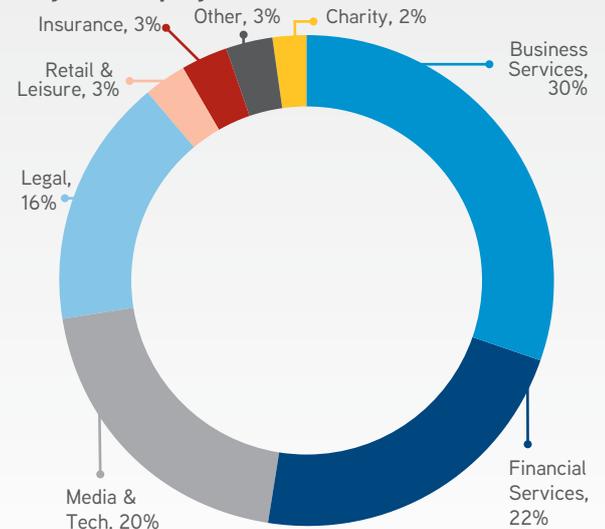
Source: Colliers International

West End Take-up by Business Sector 2015



Source: Colliers International

City Take-up by Business Sector 2015



Source: Colliers International

South Eastern Offices

Occupier conditions in South Eastern office markets remain benign and IPD rental growth for standard offices of 4.4% in Q4 2015 continued to support this story. The market had a strong start to the year, underlined by two major lettings in Reading amounting to 195,000 sq ft. There is a distinct trend for occupiers securing Grade A or “best in class” products, which are promoting further speculative developments in key South Eastern towns. There are several speculative developments in West London and the Thames Valley in excess of 100,000 sq ft due to reach completion this year, with another healthy pipeline due to be delivered in 2017.

Nevertheless, vacancy rates are generally continuing to fall and prime rents have seen further uplifts in West and South West London, as well as key South Eastern centres such as Maidenhead, Reading and Staines. Prime headline rents rose by 5.8% across the South East, with the strongest growth recorded in Leatherhead (29.5%), followed by Wembley (26.7%), Bromley (23.5%) and Slough (22.7%). Financial and Business employment growth forecasts for this year anticipate a 2.0% expansion according to Oxford Economics, and will average 1.6% in the 2016-2020 period, suggesting scope for good occupier demand and rental growth. Colliers forecasts rental growth to accelerate to 6.0% in South East & Eastern, before slowing thereafter to an annual average of 3.6% in 2016-2020.

Rest of UK Offices

Regional offices witnessed increased occupier demand last year, with all regions recording prime rental uplifts and improvements on the 2014 figures, albeit annual growth lagged behind London and the South East. The South West was the highlight as cities such as Gloucester (19.4% y/y), Bournemouth (7.7%), Plymouth (6.7%) and Swindon (6.7%) drove the overall rate. There were a number of UK cities showing an acceleration in prime rents in Q4 2015 on an annual basis, including Liverpool (£21 psf, 13.5%), Edinburgh (£30 psf, 5.3%), Manchester (£34 psf, 4.6%), Glasgow (£30 psf, 3.4%), Belfast (£15.5 psf, 19.2%) and Newcastle (£23 psf, 7.0%), among others.

Vacancy rates saw further erosions in the second half of the year and they were either at their lowest level since before the recession or at their lowest on record. Grade A vacancy in cities such as Birmingham, Leeds and Manchester reached 3.9%, 5.0% and 5.9% respectively at the end of 2015. Take-up generally remained above the historical average, while net stock absorption was positive across the board. Oxford Economics forecasts another year of FBS employment growth (2.1%) in 2016 and a five-year average of 1.6%, suggesting regional requirements will remain active. Colliers forecasts average rental growth to accelerate from the 3.4% recorded in 2015, to 3.8% this year, and should average 2.3% in the 2016-2020 period.



Industrial

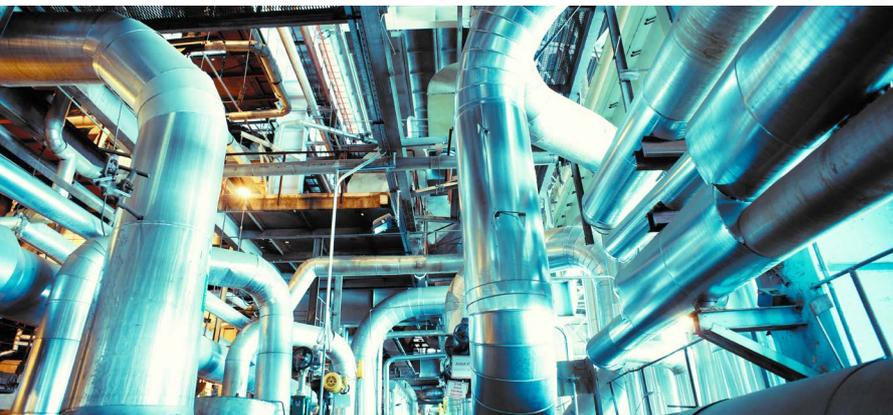
Standard Industrial and Distribution Warehouses

The Markit Manufacturing PMI index fell in February to its lowest level in almost three years to 50.8, slightly above the stagnation threshold level of 50 but flirting with a contraction. Weaker global demand from UK's trading partners and China, coupled with the relative strength of sterling, despite trading lower in February/March, have had an impact on the demand for UK exports and their competitiveness. The latest survey shows that domestic demand, the main driver of manufacturing output, also cooled in February, but it is too early to say whether this is the start of a new trend.

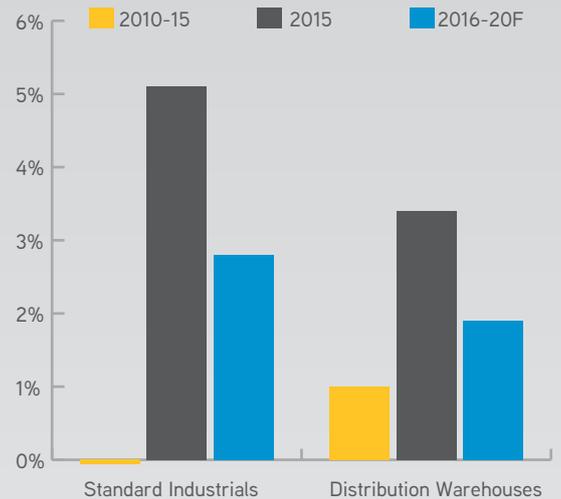
Online retail fuelled industrial leasing activity in 2015, with 35% of all industrial leasing deals involving a retail & food operator, and 29% concerning the logistics & distribution segment. Amazon was by some distance the main occupier last year, taking over 2.4 million sq ft, which included a 1 million sq ft fulfilment centre in Bardonia/Coalville. Industrial take-up in 2015 rose by 16% to 93 million sq ft, while falls in industrial supply and big shed availability, 26% and 36% respectively, constrained the provision of space on offer. The acute shortage of quality grade A space in the industrial sector has become something of a mantra, but when combined with good demand it has clearly been supporting rental levels. However, phenomenal industrial rental growth may be peaking as leasing demand cools in a supply constrained market.

Pre-lettings will remain preferable to speculative development, with the latter heavily reliant on debt support. However, a case can be made for spec projects being preferred by some developers as the buildings will likely attract a premium due to the current extreme shortage of supply. As e-commerce continues to dominate, the 'reverse logistics' trend of goods returned, which need to be checked, cleaned, packaged and processed, often within a separate building, will further add to the demand cycle. Colliers forecast a slight rental growth cooling to 4.4% this year, converging with the long-term trend rate of 2% in the following years as it averages 2.5% in 2016-2020.

Industrial Summary Forecasts				
	DEC-15	DEC-16	DEC-17	ANNUALISED 2016 - 2020
ERV Growth (% pa)	4.6	4.4	3.6	2.5
Equivalent Yield (% eop)	6.4	6.4	6.5	6.6 (2020)
Capital Growth (% pa)	10.6	2.6	0.8	1.2
Total Return (% pa)	16.5	8.2	6.4	6.9

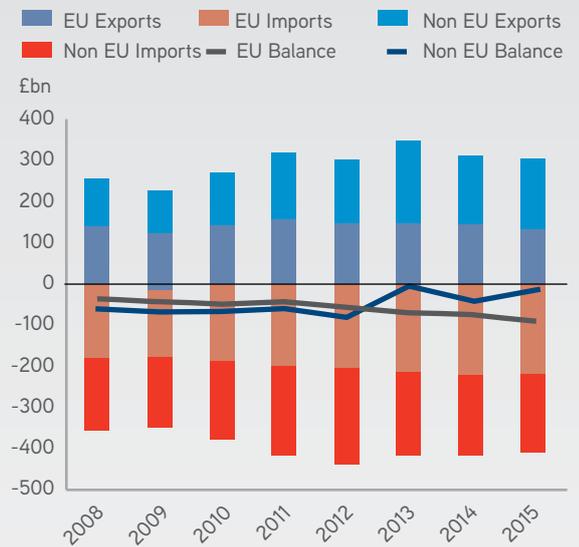


Industrial Annual Rental Growth Forecasts



Source: Colliers International, IPD

UK Trade (2015)



Source: HMRC, Overseas Trade Statistics

Purchasing Manager Indices



Source: Markit PMI

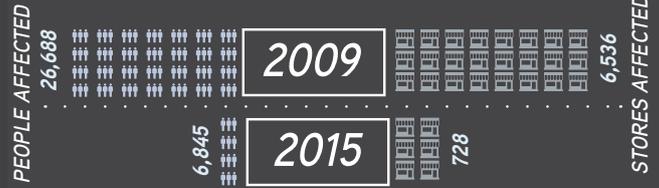
REIF AT A GLANCE

FOOTFALL (3m to Jan, y/y%)



Source: Springboard

RETAIL INSOLVENCIES

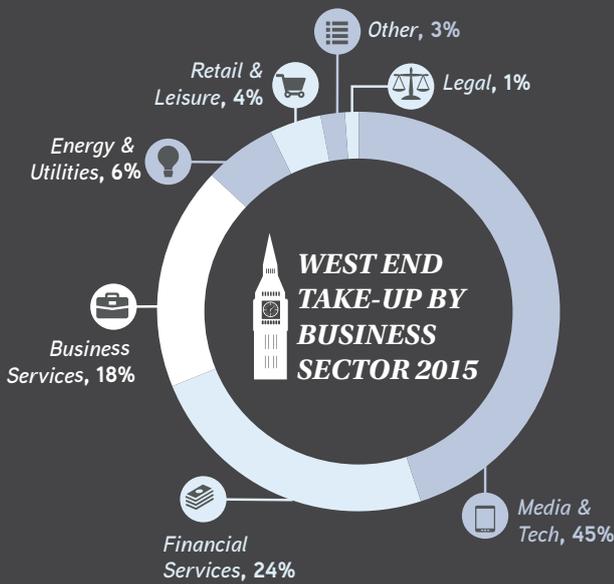


Source: Centre for Retail Research

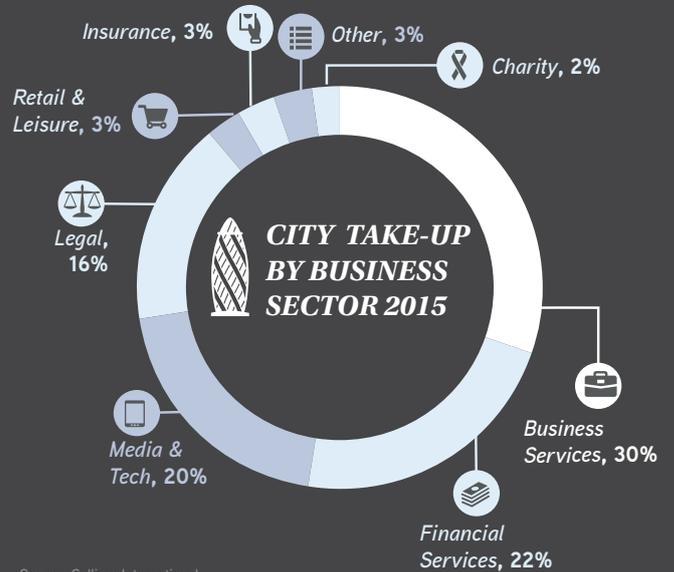
TOTAL TRADING VOLUMES IN THE INVESTMENT MARKET



Source: Property Data

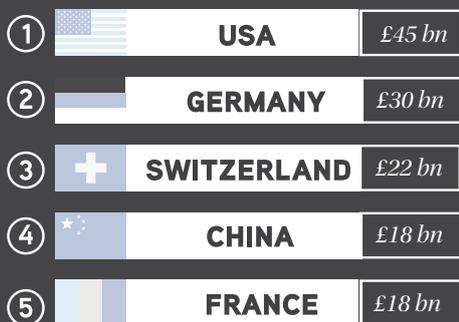


Source: Colliers International



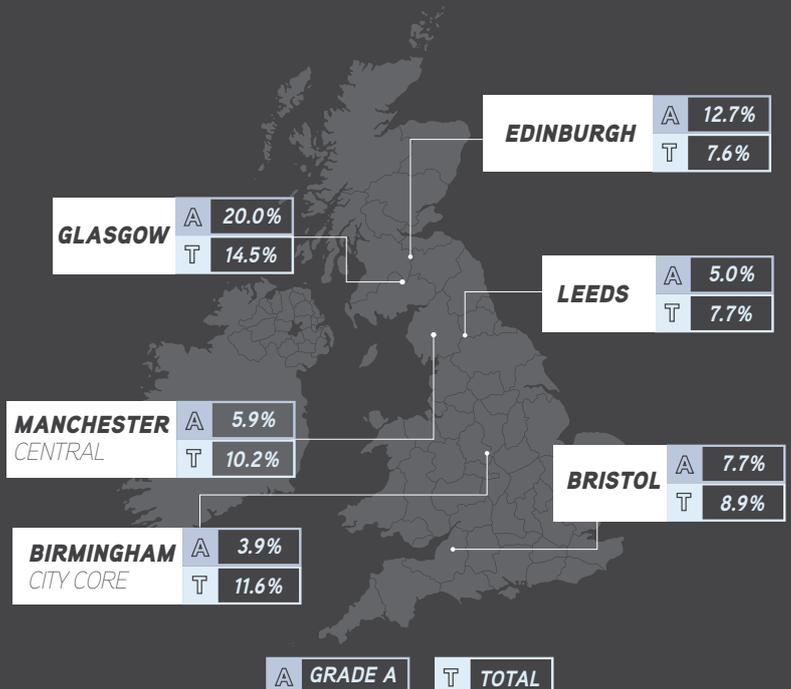
Source: Colliers International

TOP 5 EXPORT DESTINATIONS



Source: HMRC, Overseas Trade Statistics

OFFICE VACANCY RATES IN SELECTED CITIES (H2 2015)



A GRADE A T TOTAL

Source: Colliers International

RETAIL WAREHOUSE VACANCY RATES



Source: Trevor Wood, Colliers International

554 offices in
66 countries on
6 continents

\$2.5

billion in
annual revenue

2.0

billion square feet
under management

16,000

professionals
and staff

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