propertymark

Commercial Outlook

Q2 2023

HIGHLIGHTS:

- 59 per cent of agents report inconsistency in planning application procedures and processes between and within local authorities.
- Pubs and restaurants the sector most adversely affected by new lending restrictions on businesses in 'high risk' industries.
- Land and yards the sector best set to see capital and rental growth over the next 12 months.

SUMMARY

In May, Propertymark Commercial agents reported an increasingly positive outlook for many sectors compared to the last two quarters. Better than anticipated performance of the UK economy has resulted in improved expectations. The land and yards sector is still considered best placed to weather the pressures of inflation and interest rate rises with capital values, rental levels and investment yields all expected to rise over the next year by our experts.

For the third quarter in a row, the pubs and restaurants sector retains the worst overall outlook for the next year. With cost-of-living concerns, energy prices and interest rate rises affecting occupants' bottom lines, combined with liquidations leading to rising supply, rental levels are expected to decline along with capital values and investment yields.

The high cost and issues in access to finance are the biggest concern for agents at the present time. In our continued look at the big issues in commercial agency, we delved further into planning, solicitor delays, and restrictions on lending.

On planning, it seems that our experts regularly struggle with inconsistency in processes, policies and what is required from applicants, both within and between local authorities. Solicitor delays have resulted in 35 per cent of our experts experiencing sales fall through because of the time it takes to arrange. Finally, our report highlights the difficult times being experienced by those in the pubs and restaurant sector seeking finance, with banks now requiring stricter terms on lending to business in this sector.

The commercial property market has seen a sluggish start to 2023. Since the Kwarteng budget of September 2022, the market has been subdued. And while we have continued to see small gains in capital values, there seems little drive in the market from investors at present. These patterns are clearly reflected in our latest Commercial Outlook.

As a result, our experts have also reported noticing an increase in conversion from pubs and restaurants and offices to residential. Though, even this market is constrained due to a lack of investor appetite at present.

Of great concern to me are the inconsistencies identified in planning processes and policies, and new lending restrictions on businesses in sectors banks now consider high risk. The UK Government needs to begin an urgent review of planning. This must include adequately resourcing these departments and ensuring consistency across the UK in planning processes and procedures. On lending restrictions, it is upon all stakeholders in the market, including Propertymark, to engage with the banks to encourage a loosening of lending restrictions that will grease the market and encourage new investment and resulting economic growth.

Nathan Emerson
Propertymark CEO

Keeping an eye on **trends**

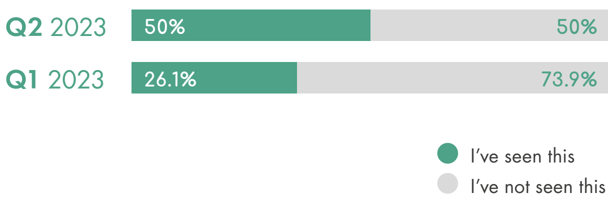
In Q4 2022, our experts highlighted several potential trends to keep an eye on over 2023. These were the repurposing of pubs and offices to residential, and higher lending costs limiting growth – hitting both price and deal volumes and resulting in an increase in cash purchases. As we move through the year, we have been keeping an eye on these trends.

This quarter, an increasing proportion of our experts have noticed a rise in the repurposing of both pubs and offices to residential.

REPURPOSING OF PUBS TO RESIDENTIAL

50 per cent of respondents to our latest survey have noticed an increase in repurposing pubs, compared to only 35 per cent last quarter.

This trend will have been exacerbated by staff costs and food prices putting pressure on businesses to stay afloat, but limited by continued strong spending on travel and eating out.[1]

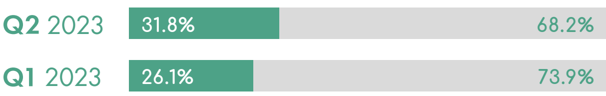


REPURPOSING OF LARGE OFFICES TO RESIDENTIAL

There has been a negligible increase in the proportion of agents reporting an increase in repurposing of large offices to residential. This is perhaps unsurprising given the lack of investment backing for housing development at present. Early signs are that the residential market may be past the worst of declining capital values,[2] which should bring renewed investment.

INCREASE IN CASH PURCHASERS

The proportion of agents reporting an increase in cash purchasers has risen very slightly. While it is true that higher interest rate costs will be impacting deal volumes as per the graph below, this does not necessarily imply that cash purchasers will flood the market. New investment has been low since the Truss/Kwarteng budget of 2022.



HIGHER LENDING COSTS HITTING BOTH PRICES AND DEAL VOLUMES

There has been a significant increase in agents reporting an increase in higher lending costs hitting both prices and deal volumes. This is supported by a sharp fall in deal volumes reported by Savills.[3]

I've seen this
I've not seen this

Other comments

Other trends our expert agents have noticed emerging over the last quarter include:

- New developments are now more likely to be commercial than residential led schemes.
- Some brands raising enquiries and looking to expand.
- A lack of supply in the industrial market driving rental growth.
- Where equipment installed on rooftops we are noticing reduced office occupancy.
- Weakening of retail demand.
- Slowdown in enquiries for larger properties - higher increase in business transfer enquiries.
- Suburban High Streets seeing increased demand and rents. Office tenants returning to work with employees requiring better working environments.
- Uncertainty due to rising costs, e.g. rents, building costs.
- Whilst there has been a fall in rental values for shops in particular, there are very few vacant shops in our locality. Offices are still very difficult to let or sell, except for redevelopment.

[1] ONS Statistics: www.ons.gov.uk/economy/economicoutputandproductivity/output/bulletins/economicactivityandsocialchangeintheukrealtimeindicators/latest (18 May 2023)
[2] Rightmove: www.rightmove.co.uk/news/house-price-index (May 2023)
[3] Savills: www.savills.co.uk/research_articles/229130/347456-0 (19 May 2023)

The BIG issues

Our expert agents reported this quarter that the biggest issue remains the countrywide economic situation, and specifically, the cost and availability of finance.

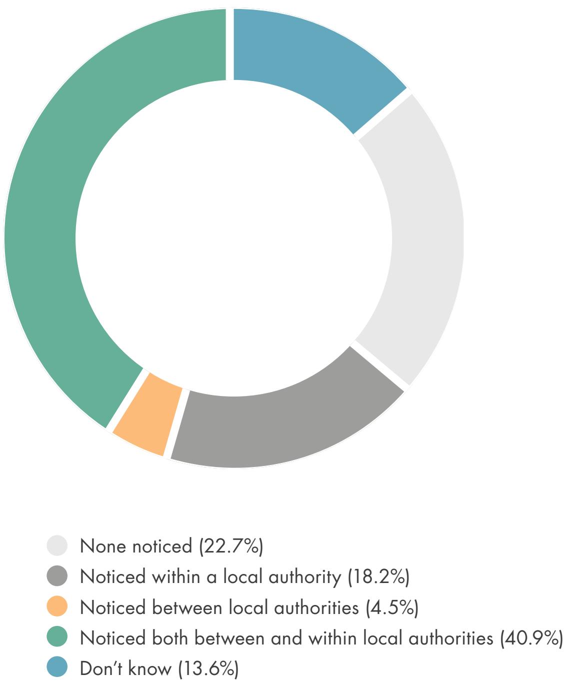
Following last quarter's report, we delved further into three key issues – planning, solicitor delays, and restrictions on lending – which our experts have identified as being particularly problematic at this time.

PLANNING

Over the past three quarters Propertymark has been gathering insight from its experts regarding issues around planning. In previous Commercial Outlooks, we reported on the average waiting times for change of use planning permission to be granted and highlighted that a lack of planning staff in local authorities and the backlogs this has caused are at the centre of the troubles commercial property agents face in planning.

Further to this, several agents have noted their frustration with an apparent lack of consistency in planning decisions. Propertymark is aware that there may be inconsistency in planning outcomes as each application should be treated as unique and consideration given to all contextual factors. However, processes, policies and what is required from applicants should be standardised as far as possible. For instance, building safety standards or ecological ratings for new homes should not vary between areas, but spatial planning and placemaking concerns might.

In our latest survey, we asked our expert agents whether they had noticed inconsistency in the application of planning processes, policies or application requirements within and between local authorities. 59 per cent of respondents reported inconsistency either within, between, or both within and between local authorities.



Additional comments

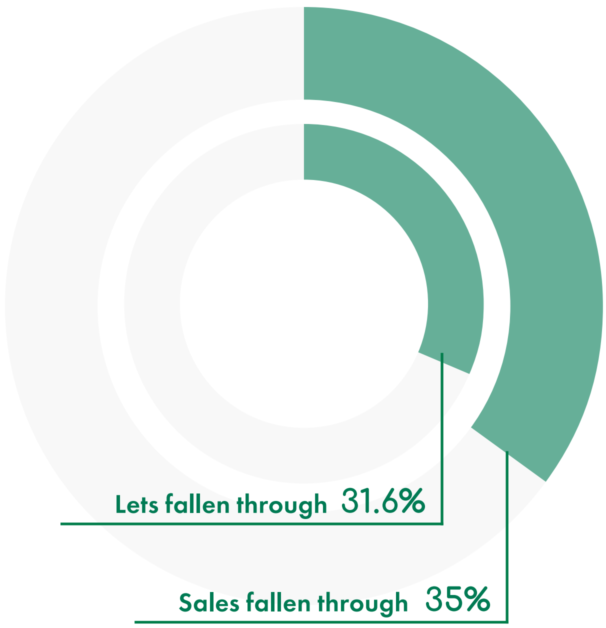
After questioning our agents about inconsistencies in planning, we asked how troubles with planning could be resolved. Suggested solutions included:

- Create targets for growth for each local authority.
- Easier access to planners.
- Greater resources within local planning authorities.
- Stricter requirements for determination timelines and reintroducing pre-app meetings.
- Speed, availability to speak to someone and communication between departments need urgent attention.
- Make it easier to speak with a planning officer.
- Local authorities should take guidance on how their decisions affect the financial viability of certain schemes.
- Apply more rules that would cover permitted development. Make planning councillors liable financially if they go against planning officers advice and subsequently lose an appeal.

SOLICITOR DELAYS

Solicitor delays are not unique to the residential sector. Our commercial agents have also been experiencing delays in their work. To monitor the extreme end of these delays, we asked our experts whether they had sales or lettings deals fall through because of solicitor delays.

35 per cent of respondents had experienced sales falling through and 32 per cent had experienced lets falling through. These figures highlight a growing issue with solicitor delays and Propertymark will continue to monitor the situation and impact positive change where possible.



Finally, Propertymark is aware that some lenders have placed greater restrictions on lending to certain types of business that they consider high-risk in the current economic environment.

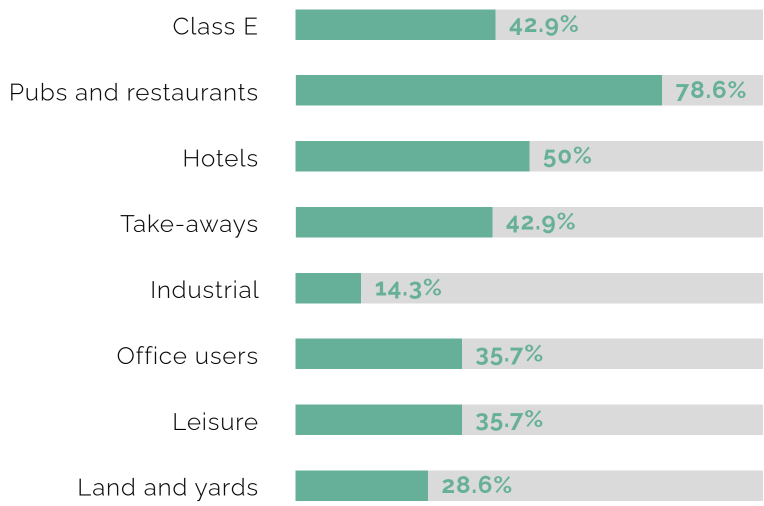
Initially, we thought this might be limited to organisations in the leisure, and pubs and restaurants industries. However, our experts told us that they have seen this across all sectors of commercial property to some extent during the current economic turmoil.

67 per cent of respondents reported noticing that some lenders have placed greater restrictions on lending to certain types of business.

As can be seen below, pubs and restaurants have been particularly hard hit by new restrictions on lending to business areas considered high risk, with 79 per cent of experts, who have seen increased restrictions, reporting that they have noticed this issue in the pubs and restaurants sector.

However, hotels, take-aways and class E sectors are not far behind. This new trend is concerning as new restrictions will prohibit investment in the UK economy and dampen the commercial market.

PERCENTAGE OF AGENTS WHO HAVE NOTICED INCREASE LENDING RESTRICTIONS ON THIS TYPE OF PROPERTY



The next twelve months: **market expectations**

We asked our expert agents whether they expect capital values, rental levels, investment yields, supply, and demand to increase, decrease or stay the same over the next year for all sectors in which they operate.

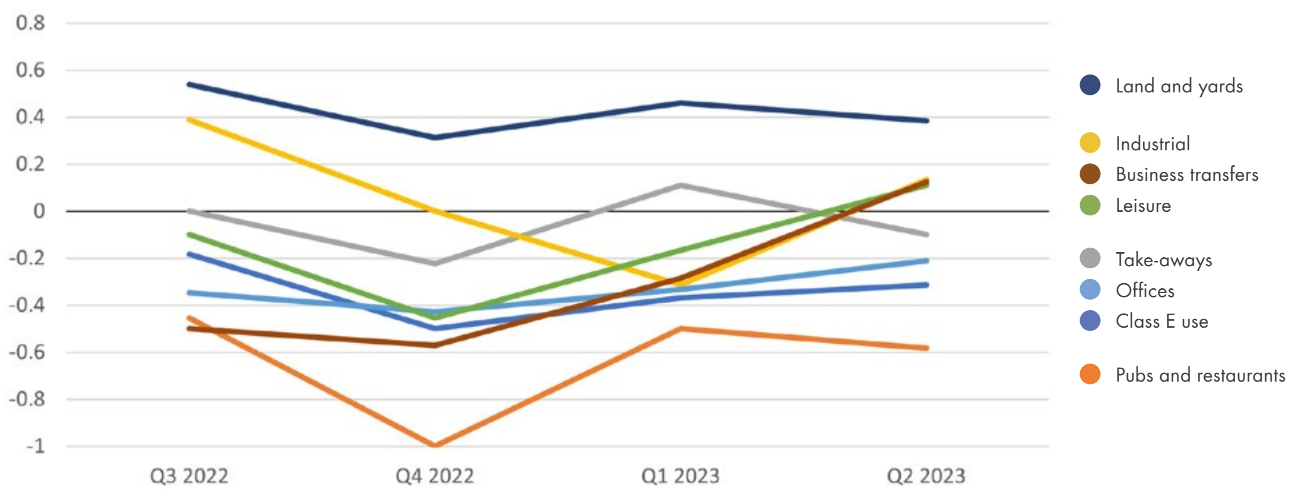
Their responses are converted to a numeric scale bounded by 1 and -1 and reported below. Positive values indicate that the majority of respondents expected a rise in that factor over the next year. Negative values indicate that the majority of respondents expected a fall.

In comparison to last quarter's Outlook, sentiment among agents is broadly up across the sectors covered. A most notable outlier is the pubs and restaurants sector, which is expected to continue to struggle during the current economic turbulence.

CAPITAL VALUE

Land and yards remains the sector with the broadest agreement on capital value growth expectations over the next 12 months among our experts. Pubs and restaurants remain the sector most widely expected to see a fall. Offices and class E assets retain a negative expectation on capital value growth, as they have in the previous three quarters.

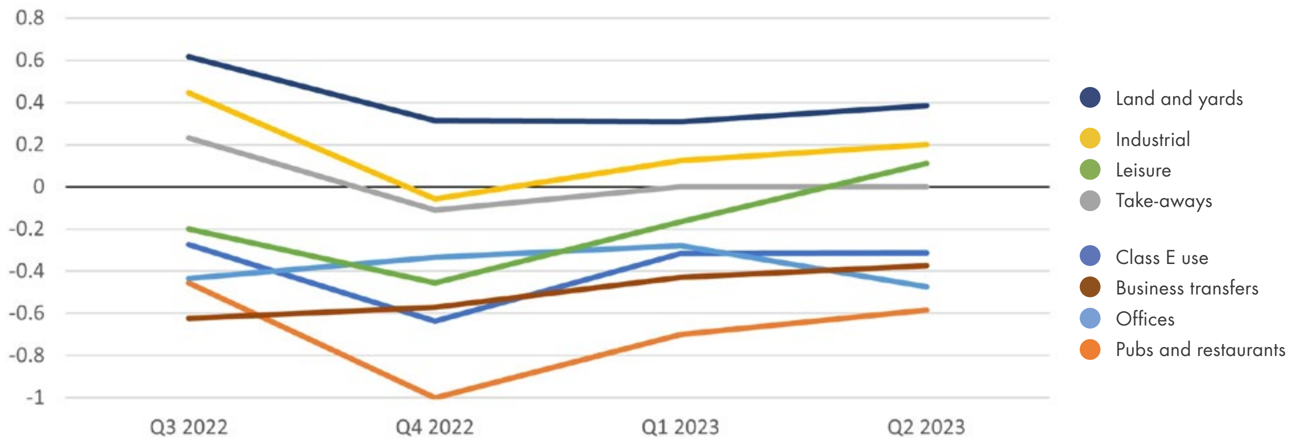
Changes in the way that people work (remote working, hybrid working, etc.) has been one key element of change brought about by the pandemic which has continued, causing difficulties for office and class E sectors.



RENTAL LEVELS

The leadership of land and yards in capital value growth expectations is mirrored in rental growth forecasts by our experts. Again, the pubs and restaurants sector is most widely expected to see a decline in rental levels.

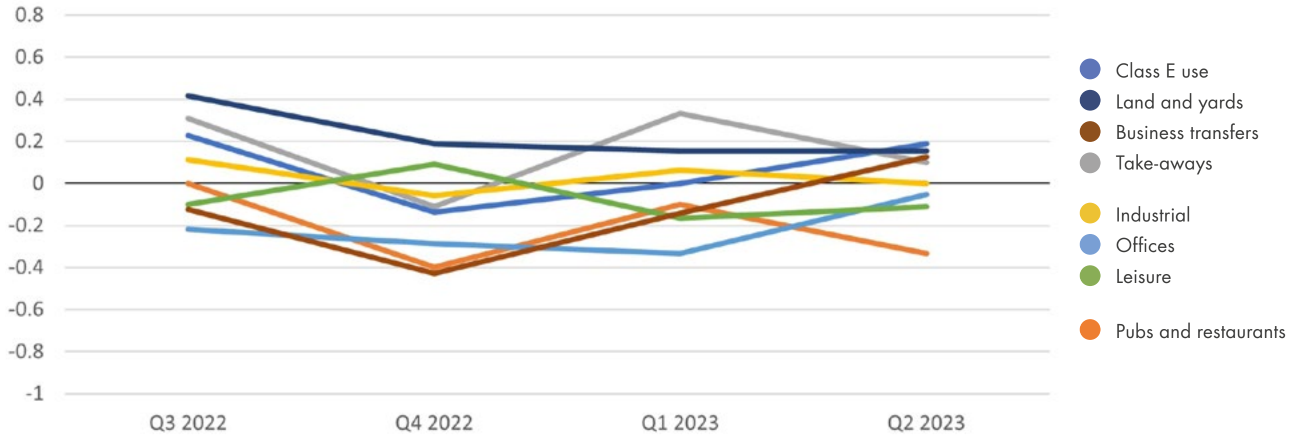
Interestingly, leisure has seen a resurgence in confidence among our experts, who no-longer broadly expect declining capital value and rental levels in this sector.



INVESTMENT YIELDS

Consequently, investment yields are broadly expected to fall in the pubs and restaurant sector in line with capital and rental level decline.

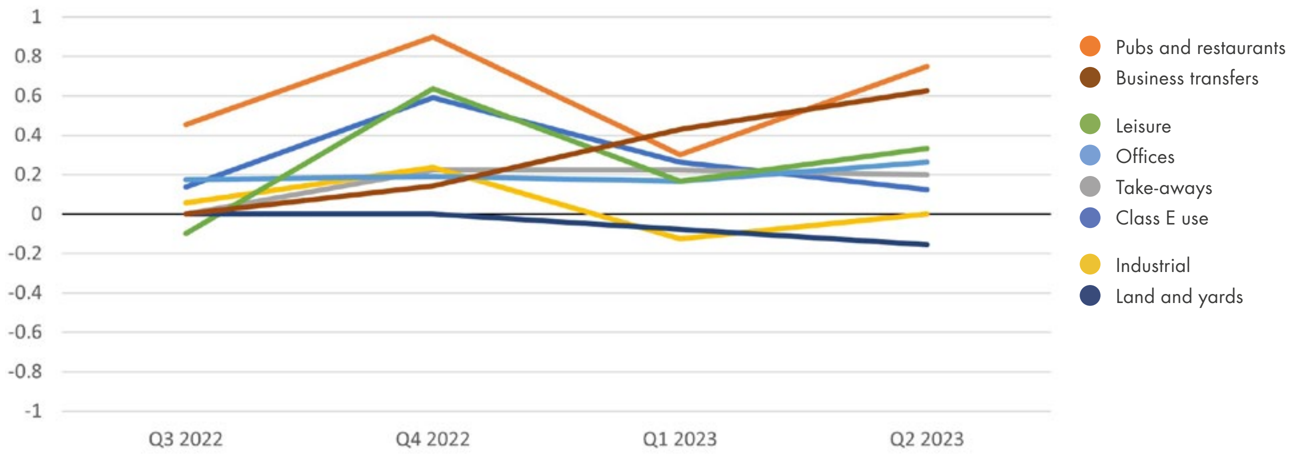
Note that investment yield predictions are much closer to zero than capital or rental value expectations, which reflects anticipated relative movements in capital and rental levels seen above.



SUPPLY

Supply is expected to increase in almost all sectors – land and yards being the notable exception.

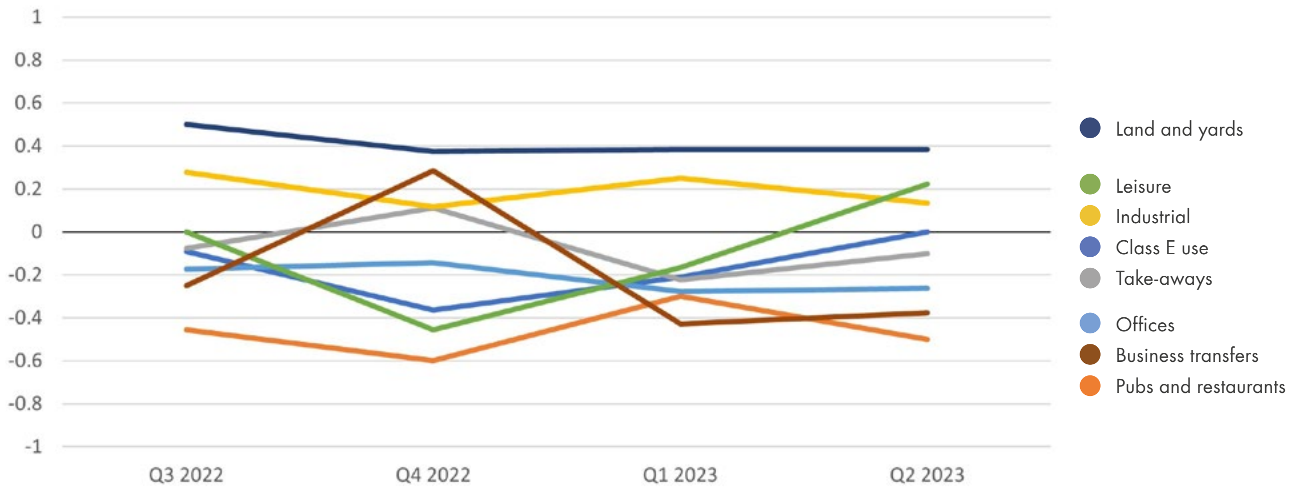
Still, it is in the pubs and restaurants sector that supply is most widely projected to rise over the next 12 months; with business transfers not far behind.



DEMAND

Our experts continue to widely expect increasing demand for land and yards, even beyond its current high level.

Pubs and restaurants and the business transfers sectors are most broadly expected to see a reduction in demand over the next twelve months as economic woes continue.



The UK **economic outlook**

The following section is based on data provided by external sources. Latest expectations are that high inflation will fall away more slowly over the next two years before returning to target levels at the beginning of 2025.

GDP growth is expected to remain close to zero for the next three years at least. Following the release of April's inflation figures, financial markets now expect Bank of England interest rates to rise further this year, possibly peaking closer to 5.5 per cent by the end of the year, before beginning to fall back very slightly next year. Reducing staff vacancy rates in key industries and steady material prices suggest construction and refurbishment costs are levelling out.

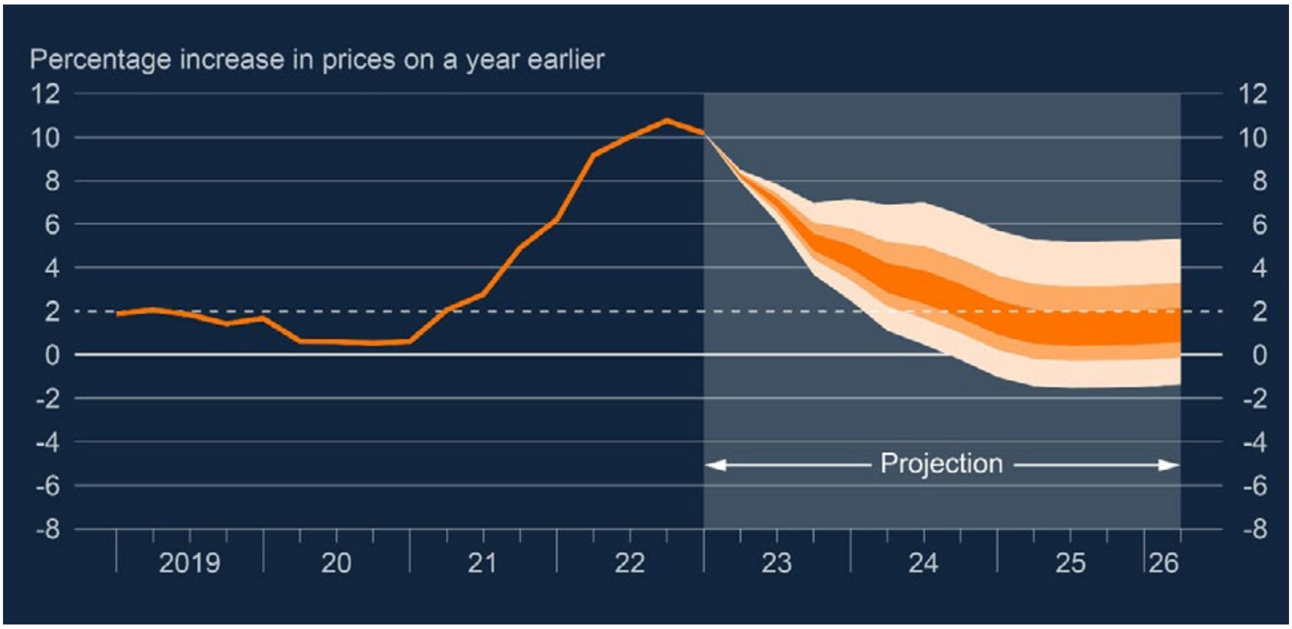
INFLATION (CPI)

The Bank of England (BoE) has adjusted its inflation expectations in recent months, but it still expects that inflation has now peaked. In contrast to last quarter's forecast, the BoE expects inflation to fall more slowly over 2023, not returning to the target rate of two per cent until Q4 2024.

As a result, the BoE increased interest rates on 11 May to 4.5 per cent. Since then, the Bank has further increased rates to five per cent, following the emergence of stubbornly high core inflation.

Core inflation rose to 6.8 per cent in April, up from 6.2 per cent in March. It has since fallen back to 6.5 per cent in May, but the UK is experiencing the third highest core inflation in the world after Argentina, which is experiencing hyperinflation, and South Sudan. Market expectations are still that rates will have to rise further to bring core inflation down.

FIGURE 1: INFLATION PROJECTION TO Q1 2026

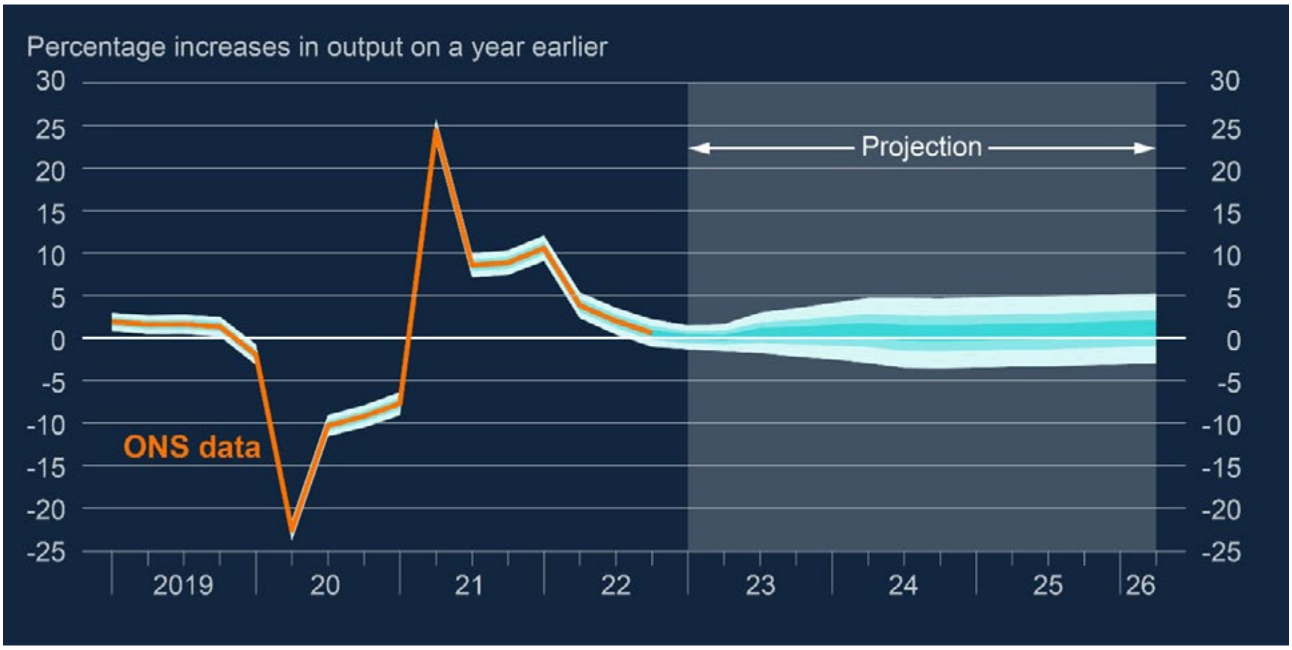


Source: Bank of England, *Monetary Policy Report—May 2023* (released 11 May 2023)

GDP GROWTH

In it's last report, the Bank anticipated that the UK would avoid a recession in 2023 and is likely to report very minimal growth. Indeed, extremely slow growth is the full projection into Q1 2026.

FIGURE 2: GDP GROWTH PROJECTION TO Q1 2026



Source: Bank of England, *Monetary Policy Report—May 2023* (released 11 May 2023)

In positive news, energy bills have fallen slightly as gas prices have reduced in recent months. Nevertheless, prices are likely to rise again over the winter and the BoEs latest projection still sees prices remaining higher than they were before 2021 well into 2026.

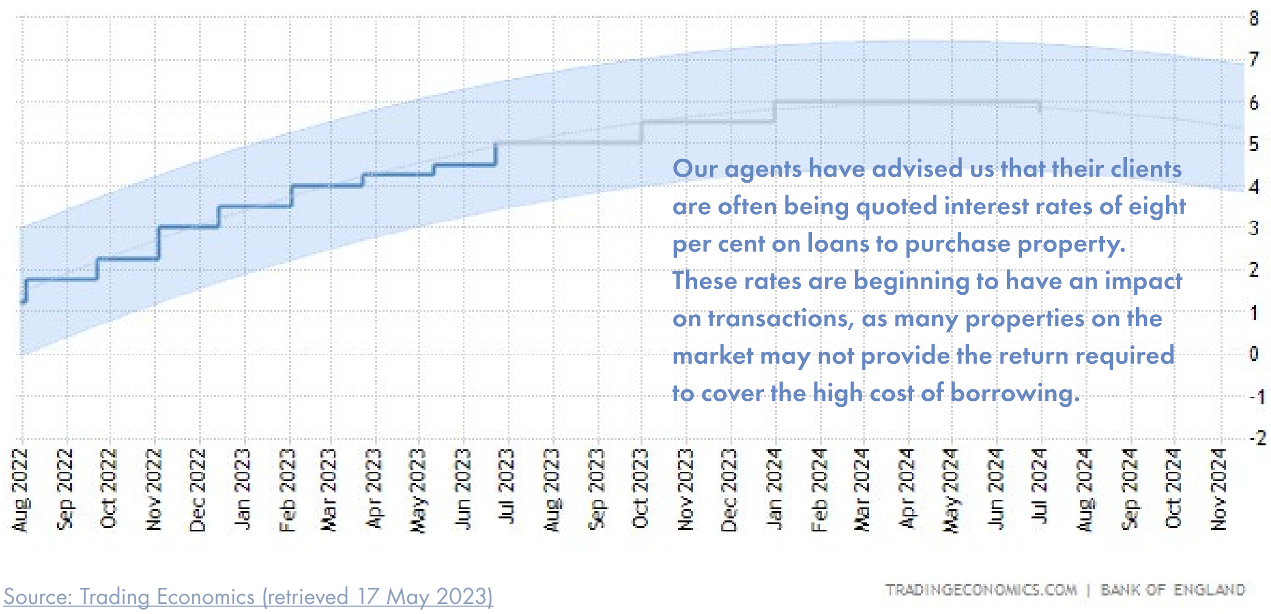
FIGURE 3: WHOLESALE GAS SPOT PRICE AND FORECAST CONDITIONING ASSUMPTIONS FOR WHOLESALE GAS PRICES

Source: Bank of England, *Monetary Policy Report—May 2023* (released 11 May 2023)

INTEREST RATES

As previously discussed, the Bank raised its base rate to five per cent on 22 June. Following core inflation figures for April, financial markets now expect that interest rates rise further over 2023, peaking at around 5.5 per cent.

FIGURE 4: INTEREST RATE EXPECTATIONS



Source: Trading Economics (retrieved 17 May 2023)

CONSUMER CONFIDENCE

The GfK Consumer Confidence Barometer picked up again in May, and now stands 13 points higher than a year past. It appears consumers are increasingly confident about their personal finances and spending power, despite lingering inflation and rising interest rates seen in recent months. If this continues, the Bank will find it even harder to get a grip on inflation.[4]

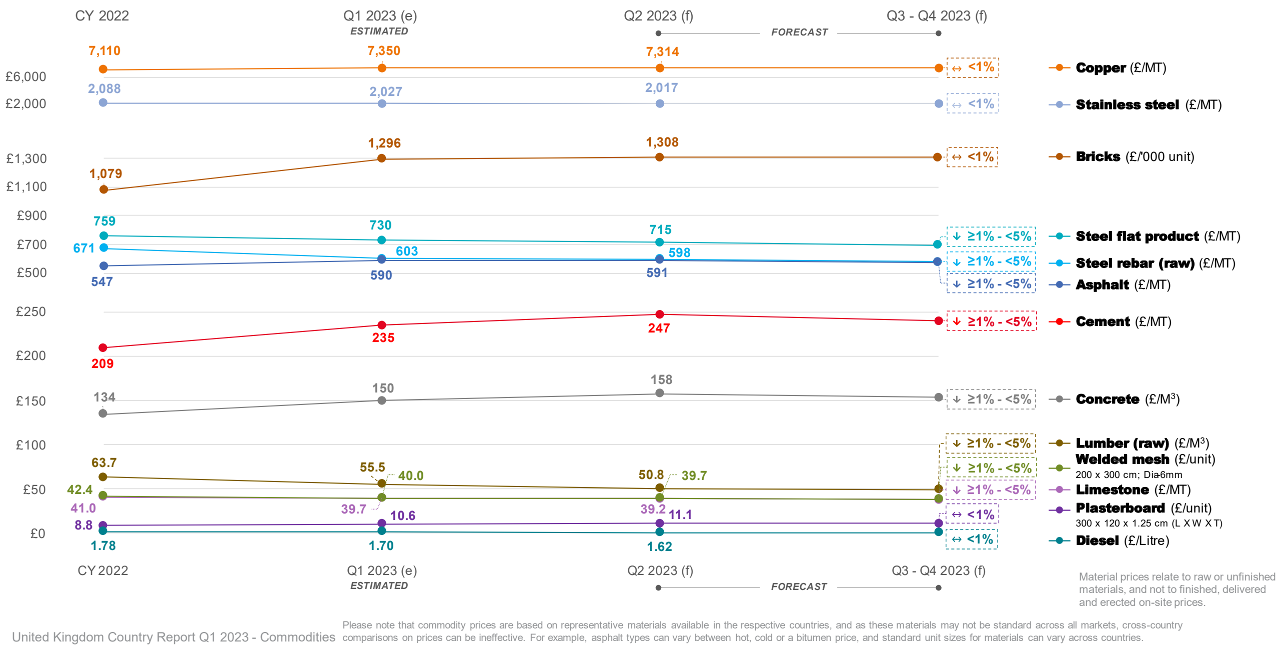
FIGURE 5: CONSUMER CONFIDENCE

Source: *GfK Consumer Confidence Barometer* (released 19 May 2023)

Data provided by the global consultancy firm, Linesight, shows construction material prices holding steady into the fourth quarter of 2023. A more static price level in construction materials, with some items coming down in price, will provide some relief for developers.

FIGURE 6: PROJECTED CONSTRUCTION MATERIAL PRICES

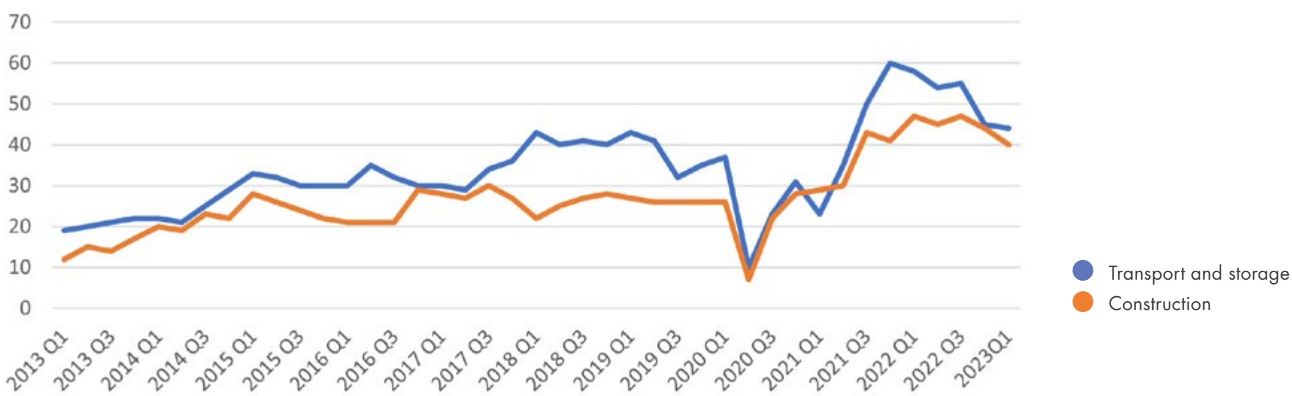
UK construction materials pricing (2022–2023)



Source: *Linesight Global Country Commodity Reports* (released 23 May 2023)

Vacancies in the construction and transport and storage sectors have continued to fall, if slowly in Q1 2023. This reduction reflects a fall in demand for labour in these industries following the recent economic turmoil. While vacancy rates remain high, so will wages.

FIGURE 7: VACANCIES



Source: ONS

[4] *GfK derive their monthly consumer confidence figures from questions about the present and future. Thus, it can also be seen as confidence in the UK economy over the next year by consumers.*

TAKE THE NEXT STEP

The views and figures in this Propertymark Commercial Outlook refer to the UK as a whole. Specific geographic locations and markets (city centre/suburban/etc.) will vary.

We strongly recommend that you contact a Propertymark commercial agent in your area to discuss opportunities that suit you. You can find your local agent at propertymark.co.uk/find-an-expert

There are several reasons why you should use an Propertymark commercial agent over any other:

INTEGRITY

As members of Propertymark, our agents have a proven dedication to professionalism within the commercial property sector.

CUSTOMER PROTECTION

Propertymark member agents are regulated by Propertymark, which is a nationally recognised regulatory brand, and provide high standards of service.

COMPLIANCE

Our members have access to the latest legal and best practice guidance.

ENDS

ABOUT THE PROPERTYMARK COMMERCIAL OUTLOOK

This report is based on a survey of Propertymark commercial agents conducted between 25 April and 23 May 2023. It is further addended with an analysis conducted by Propertymark of key statistics relevant to the commercial property market.

ABOUT PROPERTYMARK

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Propertymark is a leading professional body of commercial and other agents. We are member-led with a Board which is made up of practicing agents and we work closely with our members to set professional standards through regulation, accredited and recognised qualifications, an industry leading training programme and mandatory Continuing Professional Development.

The Commercial division of Propertymark represents members who practice from over 650 offices and aim to reassure the public that by appointing a Propertymark Protected agent to represent them, they will be safeguarded and receive the highest level of integrity and service for all property matters.

EDITOR NOTES

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