

# Commercial Property Market Commentary



The comments below reflect our views as at 30 September 2004 and underlie our approach to the valuation of the portfolio. They reflect conditions up to the valuation date only.

The commentary focuses on the prime commercial property markets where the Company has significant holdings.

## General

Commercial property continues to prove a popular investment class. Properties across all sectors have risen in value due to yields being bid lower. Buyers, attracted by the combination of income security, growth potential, and the opportunities for active asset enhancement, far outnumber potential sellers.

This imbalance looks set to continue. Cash rich funds seeking property investments have been joined by a number of new vehicles aimed at the private investor. The situation is only likely to be exacerbated with the expected introduction of new tax transparent property investment vehicles.

Although occupier markets do not all share the same buoyancy, rental growth remains strong in many retail markets and is anticipated elsewhere by many investors and developers.

Meanwhile, conditions in the bond and equity markets remain subdued. We therefore see little prospect of demand for property subsiding in the short term.

## Central London Offices

Investor demand, as for all sectors, is strong. Whilst long let, well secured buildings such as those at Broadgate, remain popular, the price differential obtainable on shorter income streams has narrowed. This is because many purchasers anticipate that rents will increase in the medium term.

Indeed recent months have seen increased City occupier take-up; a good proportion of it at buildings held by British Land.

In general, occupational demand has mostly been from 'support' functions such as legal and insurance companies. Investors and developers are therefore looking for signs of a structural shift in demand from the City's traditional tenant base, in order to generate positive rental growth.

The West End has a more diverse occupational base. Leasing transactions at prime buildings at figures close to previous 'highs' have encouraged those who anticipate that this will have a corresponding effect upon the rest of the market. The vacancy rate is relatively low and there is very little good quality stock either available or in the immediate development pipeline.

Investors therefore anticipate earlier rental growth here, which has in turn increased the prices paid during the past six months for virtually all buildings irrespective of income quality and lease length.

## Out of Town Retail

Supply remains finite from both the occupiers' and the investors' points of view. The planning environment is becoming even more restrictive including the proposal to bring the construction of mezzanine floors under planning control.

Meanwhile, occupational demand continues to grow. As a result rents have shown strong growth and are forecast to continue to do so. These factors have all combined to produce a very competitive investment market.

A notable trend has been the increased demand from investors for older schemes benefiting from relatively open A1 planning consents. These can be refurbished, established tenants relocated, and new fashion or other high street tenants substituted, often producing dramatic uplift in rents.

Out of town food stores have also continued to see good rental growth; particularly from favourable rent review settlements. Accordingly, investors are prepared to accept low initial yields, even for shorter income streams, as there is ample evidence that traders are willing to renew or extend leases in good trading locations.

## Shopping Centres and High Street Retail

Retailers continue to experience mixed fortunes. Although there are few signs of consumers reducing their expenditure, retailer margins remain under pressure.

However yields have sharpened, reflecting the strength of demand for property and, in the case of centres, the scope for enhancing returns through asset management.

As with all sectors, yield compression has occurred such that the difference between prime and secondary or even tertiary schemes has narrowed. Consequently, some investors who purchased one or two years ago are now realising profits.

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