Rapleys
PROPERTY NEWS
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Overview of the Property Market - Our Predictions for 2010

This time last year we predicted that 2009 would be a very difficult year, save for investments and that recovery would still take 2-3 years to manifest itself.

Nothing which has happened in the last 12 months has dissuaded us from this view. One massive bright spot on the horizon has been a significant improvement in prime yields, but other sectors remain extremely difficult.

2010 will of course bring about a general election and regardless of the outcome, this will bring with it, as is always the case in an election year, uncertainty, both in the period leading up to the election and for a few months following as an understanding is sought as to the implications of the result.

The other major issue of course which will affect the economy during 2010 will be central Government's approach to the massive debt burden which the UK has now incurred. There is no doubt that there will be considerable cuts in public expenditure and unemployment will continue to rise through to the Autumn. Consumer confidence will remain fragile for the majority of 2010, therefore delaying recovery in the economy.

The implications for property are obvious – continued low occupational demand, except in the competitive food sector, a further reduction in rental values and a lack of development, exacerbated by a dearth of available bank finance. Demand for prime investments is however likely to remain strong in the anticipated low interest rate environment.

Whilst many commentators are predicting a rise in base rates next year, we are of the view that the Bank of England will approach this matter very cautiously in order to avoid a "double dip" recession which would be incredibly damaging to the economy and rises, if any, are likely to be limited.

So in many ways our prediction is that there is more to come of what we experienced in 2009.

Having said that, we at Rapleys had a comparatively successful 12 months and we would like to thank all of our Clients and Friends for their continued support and we look forward to working with you all in 2010.

So to our detailed review …

Rating

Many occupiers will be faced with large increases to their rate bills this year with the introduction of the 2010 Revaluation in England, Wales and Scotland on 1st April.

In England and Wales, the draft Rating List shows an increase of 19% in the total Rateable Value. At the time of writing, the draft Rateable Values for Scotland remain a mystery although we understand the assessments will be available in January.

The Revaluation will reflect the movement in rents over the period 2003 to 2008 and as a result certain sectors will see significant increases in assessment. For example, office assessments in central London are increasing by an average of approximately 75% while the food store sector may be facing increases averaging 30%. One of the sectors to be hardest hit by the Revaluation will be petrol filling stations. One company, operating over 30 filling stations will see average increases in assessments of 85%.

As a result of the total increase in Rateable Value, the Uniform Business Rate for large properties (Rateable Value in excess of £18,000 or £25,000 in London) will fall from the current level of 48.5p to 41.4p in the pound in the rate year 2010/11. This reduction in the UBR will reduce the impact of the increase in assessments as will the Transitional Relief Scheme. However, with the Crossrail supplement (2p in the £ - although we believe this may be revisited) and various Business Improvement Districts, occupiers in certain areas could still see increases in rates of over 20% in the next financial year.

In Scotland although the draft Rateable Values have now been deposited with the Billing Authorities the figures are not yet in the public domain. We understand the new Rateable Values will be available in mid January and at the same time the UBR and Transitional Relief arrangements for Scotland will also be published. With the new rate year commencing 1st April 2010 this is a very unsatisfactory situation for Scottish occupiers.

The antecedent date (1st April 2008) for the 2010 Revaluation coincided with the changes to the empty rate legislation and the onset of the Credit Crunch. Our initial analysis of the 2010 assessments is that the Valuation Office has not fully reflected these facts in the draft assessments and as a result we anticipate a high volume of appeals, particularly in London and the South East, resulting from the Revaluation.

The April 2008 Empty rate legislation has undoubtedly caused major financial difficulties for a number of owners of vacant property. Many properties have been demolished to avoid the charges. With a likely change in Government in May 2010 we are hopeful that the new Government will take on board concerns raised by the property industry and re-visit the legislation. Unfortunately with the budgetary problems that the new Government will inherit it will be difficult to relax the current provisions in the short term but we anticipate the new Government will indicate future changes, which will hopefully assist those currently being penalised for owning vacant properties in the current economic climate.

Appeals cannot be submitted against the 2010 Revaluation assessments until 1st April 2010 and it is then likely to be some months before any serious discussions or negotiations take place with the Valuation Officer/Regional Assessor. In the meantime, occupiers will have to continue to pay rates based on the new assessment.

The opportunity however still remains to challenge existing rating assessments and if successful, reductions will be backdated to 1st April 2005 resulting in cash refunds for the previous five rate years.

Therefore, if assessments have not been challenged, occupiers should give serious consideration to submitting appeals before 31st March 2010 when the window closes on the 2005 Rating List.

Retail

Market conditions over the last 12 months have been particularly challenging as the recession maintains its firm grip on consumer spending. Many well known brands have disappeared and we expect others will follow in their footsteps early in the New Year.

Leading into Christmas there were some notes of optimism with retailers enjoying a third consecutive month of sales growth in the build up to the festive period, however, the forecast is that there will be flat sales in the New Year. A recent BDO, Stoy Hayward report suggests further bad news with the number of retail failures climbing above 5,000 in 2010 having more than doubled this year to 4,600. Effectively nearly 1 in 7 shops may soon lie empty.

These grim predictions (which we support) are contrary to some commentators' views that suggest the UK is now in the process of emerging from the recession!

The principal problem retailers are suffering from is that unemployment is still spiralling and consumer confidence remains low. It is likely that unemployment will increase. Even if output does expand in the second half of the year many businesses will still be struggling to rid themselves of the economic hangover before more prosperous times lie ahead.

Another factor which will influence household spending behaviour in 2010 will be the prospect of higher taxes as the Government attempts to address the huge budget deficit. Also lenders are going to continue to be very cautious in advancing credit to consumers.

Some good news however - in the out of town sector we have seen a recent return of activity particularly from the value led and discount operators in addition to several overseas retailers seeking to revive their acquisition programmes to capitalise on the high level of available stock in the market place.

For these acquisitive retailers, with the large number of voids in the High Street and out of town markets it does mean that operators who are experiencing improved sales will have more bargaining power over rents and incentives from landlords.

Food Retail

This sector continues to grow from strength to strength with aggressive acquisition campaigns being undertaken by the major food store operators who are seeking not only to capitalise on additional retail floor sales with site acquisitions but also targeting asset management initiatives to extend existing stores and incorporate mezzanine trading levels to provide greater sales floor area.

The Big "4" operators will continue to expand and will remain versatile and flexible in their requirements and in some cases will seek smaller store formats with decked/undercroft parking facilities to be accommodated in compromised town centre schemes and restricted site areas.

In the convenience sector Waitrose has had positive returns following trials of their small format convenience stores (5,000 - 7,500 sq ft) in 2009 and will seek to promote smaller formats (2,000 - 4,000 sq ft) in the New Year.

Sainsbury's is on track to open 100 new convenience stores and Tesco hope to double their convenience store empire by taking smaller 'corner shop' Express formats. This move will clearly conflict with the current campaign by the Association of Convenience Stores (ACS) who are presenting an action plan to the Government to preserve thousands of small shops. The Co-op having successfully acquired Somerfield in 2009 are also likely to make a number of acquisitions.

The discount food retailers will remain competitive in 2010 despite seeing their like for like sales reduced following competition from the main food group retailers who have successfully won customers back to their stores promoting 'discount' branding initiatives at their stores. In addition we believe Whole Foods Market will be seeking to expand further.

Our prediction for the food retail sector is that it will continue to be competitive in 2010 as competition remains strong but as always will be restrained by the availability of unrestricted A1 consents.

Motor Trade & Roadside

Along with many sectors of the economy, the automotive industry has experienced very challenging trading conditions throughout 2009, yet a combination of low interest rates, quantitative easing and the Government's Car Scrappage Scheme have done much to shield both manufacturers and dealers alike from the worst of the downturn.

At the beginning of the year, the uncertainties as to the future of General Motors' businesses in Europe, coupled with the collapse of Saab and the short term working initiatives at Honda and Nissan in the UK, gave cause for a considerable amount of uncertainty in the sector, as a consequence of which both corporate and property activity in the sector has remained very subdued. That having been said, sentiment has improved as the year has gone on, particularly as dealers have enjoyed healthy margins on improved residual prices for used vehicle stocks, while service departments have also remained busy as customers have held on to their vehicles for longer.

Overall, there have been very few corporate collapses, or distressed sales in the sector. The larger publicly quoted groups have re-financed and elsewhere, banks have been largely supportive.

From a property prospective, the year has yet been one of further consolidation as dealers have shed unprofitable outlets. We estimate at the year end there are at least 250 motor showroom properties vacant and on the market with little demand from within the trade. As a consequence, both price expectations and rents have fallen commensurately with values typically 30 - 40% below where they were at the height of the market.

Looking forward into 2010, there are few signs of upturn. Indeed, tightening of fiscal markets post election, the imminent expiry of the Scrappage Scheme and the re-introduction of 17.5% VAT will dampen the market for new vehicles while dealers fear that the reduced volumes of cars sold over the past couple of years will ultimately see through to lower demand for vehicle servicing and after sales products.

In conclusion, we anticipate 2010 will remain extremely challenging for those operating in the sector and we see yet further consolidation occurring through a combination of distressed and corporate insolvencies and the closure of smaller, more peripheral trading outlets. From a corporate perspective there are now several well funded dealer groups actively seeking to pick up opportunities and its likely that we will see one major group purchase during the course of 2010.

Aside from the automotive sector, the petrol forecourt and roadside markets are showing much more promising signs of recovery. Having fallen back slightly over 2009, the forecourt market remains robust with a number of well funded, independent and convenience store groups seeking new opportunities across the UK. The market has been constrained by a lack of supply and this has ensured that prices have held up well. We see this persisting into 2010 and if capital markets ease, then we expect to see some renewed development activity, particularly on "new to industry" sites and for the redevelopment of existing forecourts capable of supporting a strong convenience retail business.

Elsewhere in the roadside sector a number of retailers and operators drawn to out of town locations which provide both roadside presence and parking provision continue to feed back into the market. In recent months, operators such as Kwik-Fit, McDonalds, Sainsbury's and others have all announced ambitious expansion targets for 2010. This bodes well for activity going forward and we are optimistic that there will be a modest strengthening of prices and rents for well located sites holding potential for this type of use.

Business Space

In common with most property sectors in 2009, Business Space has been characterised by low transaction levels as the market "bumps along the bottom". There have been various bursts of activity but this is mainly as a result of occupiers, who may have been delaying decisions on real estate, coming to the stage when they have no option other than to make a move.

Undoubtedly vacancy rates remain at historically high levels and the majority of occupiers are still maintaining a "do nothing" strategy, unmoved by landlords' and vendors' attempts to attract interest through increasingly competitive asking terms. The latter is particular so with landlords and head tenants who are facing voids where empty rates have added to the burden.

In the warehouse/distribution sector there has been much less activity from the retailers who were significant in driving the market in previous years. As a consequence, in all the key distribution hubs throughout the UK motorway network, there are vacant speculatively built warehouses in the 100,000+ size bracket that still await first occupation. There have been some signs of requirements in recent months and it is hoped that this will materialise into firm activity in 2010. It is clear however that although there maybe some take up in the larger prime distribution sheds, vacancy rates will remain high across secondary stock.

As a consequence of the weak pound, exporting manufacturers are experiencing improved trading conditions and it may well be that during the course of 2010 some of these who need to increase production capacity will be looking to acquire more space. However as a generality, secondary industrial property will continue to experience high vacancy/low demand. Many owners may seek to mitigate their holding costs through demolition.

The office market has also seen increasing vacancy rates throughout 2009. Asking rents on vacant properties have been cut in many instances in the second part of 2009 in an attempt to generate lettings. Whilst there are some requirements, it is as yet unclear whether these will materialise in the form of lettings in the early part of 2010. However, even with a small increase in take up at the prime end of the market, we will begin to see major space occupiers finding themselves with a limited choice of Grade A space to consider and this may persuade well funded developers to commence new projects in anticipation of a better letting market in 12 to 24 months.

Secondary office space will continue to show high vacancy rates and rents will remain under pressure. Limited opportunities for disposal for conversion/redevelopment will exist given low activity in the flatted residential sector but one bright spot will be demand from budget hotel operators as they continue to push for representation in central urban areas.

Investment

The last two quarters of 2009 saw an unprecedented movement in pricing to pre-recession levels in many sectors. The reported 50% reduction in values from peak to trough for many properties has been reversed and certainly the prime end of the commercial investment market has seen significant equity invested back into the markets with more to be spent in Q1 of 2010.

Institutional investors have returned with vigour helping to push the IPD UK Monthly Index at the end of 2009 to its largest monthly increase in the past 15 years. It is now a question of sustainability.

Whilst the Government's quantative easing programme was implemented to contribute to a return of the bank lending market, little evidence has been seen to suggest that this has occurred. Whilst banks are repairing their balance sheets, there seems little evidence that the debt market is returning. With occupational markets in all sectors indicating further levels of decline, combined with falling rental values, it is unlikely that 2010 will see a resurgence of bank lending.

We are anticipating that certainly for the first quarter of 2010, demand for limited opportunities will continue to drive the pricing of prime property assets, however, we are expecting this activity to tail off as the potential for a "double dip" may become reality. Furthermore, we expect the disparity between prime and secondary investment stock to widen.

With the likelihood for further business failures increasing in 2010 it is likely that those banks holding significant property loan books may well start selling and we are expecting more opportunities for purchasers as a result.

All in all, the significant recovery in values on prime stock is likely to continue in 2010, however, its sustainability is questionable. We do however anticipate more activity from overseas investors as sterling continues to struggle.

Town Planning

The Government's encouragement to local planning authorities to be less stringent and demanding in terms of financial s.106 contributions and affordable housing requirements is a welcome response to the economic climate. Conversely, the long-awaited Community Infrastructure Levy (CIL) has been further deferred, probably also in response to economic considerations, with the latest estimated date of April 2010. It seems likely that this will be close to a General Election and that the CIL proposals might not re-emerge for some time, if at all.

The forthcoming election could also affect the embryonic Infrastructure Planning Commission (IPC), which is due to start receiving applications on 1st March. The outcome of the election is likely to significantly affect whether the IPC is given an opportunity to function for long enough for us to judge its performance. It will be interesting to see whether the pre-election party campaigns generate any new ideas for the wider planning system but all party consensus indicates that sustainability/climate change and promoting better design will be central to any changes.

The most significant recent change to the planning system, insofar as it affects development and property investment, is the recent publication of PPS4, setting out the Government's new planning policies on Town Centre uses and wider forms of economic development. Our initial view is that the changes are not as radical as previously proposed, although some changes will have significant effects.

No change has been made in response to the Competition Commission's recommendations relating to its investigation of the grocery sector, with the Government promising to respond to that "shortly". It will be surprising if PPS4 is to be revised in the short-term, so it seems likely that the Government's response will be through measures applied through other legislation.

Otherwise, PPS4 retains and possibly strengthens the 'town centre first' approach of PPS6, retaining in particular the emphasis on the sequential approach and retail impact issues. Applicants for planning permission are no longer required to demonstrate need for their proposals, but need remains central to the planning system, though only through the preparation of Local Development Frameworks. We doubt that the LDF system is sufficiently responsive to adequately cope with the need issue. The implication for developers and retailers is that where there is an up-to-date development plan and a proposal does not accord with it, it will be necessary to challenge the LDF and its evidence base on need – a seemingly more difficult task for applicants than under the previous system.

In Scotland, new regulations and statutory instruments came into effect in August 2009, implementing the Planning etc (Scotland) Act 2006. All applications will now be determined under the new development hierarchy, which defines development within three categories – national, major and local. These changes are in their infancy, but we anticipate that in 2010 the impacts will be more noticeable as the new regime takes over.

The changes to the planning system have also brought about the requirement to replace Structure and Local Plans with (in some cases) City Region Strategic Development Plans and Local Development Plans. Generally, these appear to be progressing quickly and as such there is a pressing need to ensure the plans are monitored closely this year, to ensure that development sites are effectively promoted.

The Scottish Government will publish in 2010 the consolidated Scottish Planning Policy (SPP), which will replace the current series of SPPs and NPPGs to provide a shorter, clearer and more focused statement of national policy.

Commercial Development

Development activity will continue to decline into 2010, echoing the past 12 months down turn in the UK market.

Occupier demand will remain weak in 2010, the cost of empty rates and voids will add further pressure to the feasibility of commercial development into 2010, with occupiers reluctant to commit to schemes, and those doing so expecting significant rental inducements.

The recent hardening of prime yields will assist the viability of schemes, however, secondary markets will continue to flat line into 2010, impacting on speculative development, as has been seen over the past 12 months.

As a consequence of the occupational and investment markets, many schemes will continue to be mothballed into 2010, until market conditions improve.

Despite the record low level base rate held by the Bank Of England, which will carry on into 2010, the availability of finance, not the cost, will be a major hindrance to development, fuelled by lower loan to value ratios applied by the banks. Furthermore, rolled over debt carried into 2010, combined with the cautious lending criteria of banks, will lead to further receivership of development sites, something that has not been as prevalent in 2009, as predicted. As a consequence of this, distressed asset sales are likely to be a feature of the next 12 months.

Developer uncertainty will continue to force pressure on costs; however, the rise of sustainability issues will become increasingly prevalent, impacting on the viability of development plans going forward. Developers will, where possible, continue to renegotiate their planning obligations, otherwise little private sector development will materialise, until development viability can be achieved.

Residential Development

The prime feature of the beginning of 2009 was the steep reduction in house prices with values settling some 14% below the heights of 2007 primarily as a result of continued restrictions on mortgage availability and a 'wait and see' attitude of buyers. However, improvements in the economy in Spring and the impact of cuts in interest rates cushioned the potential threat of defaults and repossessions, which may have engulfed the market.

Towards the latter part of 2009 prices have in some areas increased where properties are in short supply and those with equity enter the market. The outlook for 2010 is uncertain with an election looming, severe cuts in spending announced, higher taxation and predicted rise in unemployment. These factors will all contribute to a downward pressure on prices particularly if the availability of mortgages remains restrictive.

Residential developers have had a year of consolidation, write downs and restructuring. Activity in land buying has increased, particularly in the South East, with small to medium size sites benefiting from existing planning consents proving popular as developers have an eye to the fact that future permissions will be burdened with Community Infrastructure and sustainability costs. However, the increase in activity and availability of new build houses will ease supply and put further pressure on prices.

Corporate Property Services

The pressures on corporate occupiers to minimise their overheads are certain to continue throughout 2010. All rechargeable costs from landlords such as service charges will inevitably continue to face detailed scrutiny and challenge and there will be further dialogue regarding moving from quarterly to monthly rent payments. Landlords who take seriously the need to interact with their tenants and show reasonable flexibility will reap the rewards in the longer term.

Surplus accommodation will need close pro active and hands on management to drive down overheads. Innovative solutions will need to be sought where leases on non operational properties are inflexible and particular care will be required in the management of sub tenancies to maintain income, achieve protection from vacant rates charges and the inevitable difficulties of supervising a vacant building.

The comments contained in this newsletter are for information purposes only. Professional advice should be sought prior to taking any action and Rapleys LLP will not accept any responsibility for decisions taken solely on the basis of information contained in this newsletter.

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