CLUTTONS
INVESTMENT MANAGEMENT

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Commercial property examiner

Quarter one | 2023

Contents

1. Key take aways

Forecasts for the UK economy signal that GDP will fall slightly throughout 2023 and into Q1 2024, as high energy prices and interest rates restrict consumer spending. However, this is a much shallower profile for the decline in output than forecast 3 months ago. CPI inflation is projected to fall sharply to just under 4% by the end of 2023. Continued weakness in the economy alongside a continuing reduction in energy price inflation will reduce domestic inflationary pressures and inflation will decline to below the 2% target in the medium term.

Following its February meeting, the Monetary Policy Committee (MPC) has announced a further rise in base rate to 4.0%. But the yield on the 5-15 year gilt index has hardened from 3.74% at the end of December to 3.17% as the money markets clearly believe that the long term trajectory for inflation and interest rates is now downward.

In Q4 2022, All Property total returns, as recorded by the MSCI Monthly Index, decreased to -14.5% from -4.1% in Q3. Capital growth was -15.6% in Q4 compared to -5.1% in Q3. In the 12-months to the end of December 2022, All Property total returns decreased sharply to -10.1% from +13.5% in the 12-months ending September.

We expect the weak market conditions to persist for the first half of 2023 and have therefore downgraded our forecast All Property total return for 2023 from 4% to -6%, with only income returns providing any solace. We expect All Property total returns will improve in 2024 to nearer 7%. The net effect is that the annualised average forecast for the 3years ending December 2025 will be around 3%.

2. Summary

In January's edition of its World Economic Outlook (WEO), the International Monetary Fund (IMF) warned that global economic activity is projected to fall from an estimated 3.4% in 2022 to 2.9% in 2023 but then rise to 3.1% in 2024. The rise in central bank rates to fight inflation and Russia's war in Ukraine will continue to weigh on economic activity. And, while the rapid spread of COVID-19 in China dampened growth in 2022, the recent reopening has paved the way for a faster-than-expected recovery.

UK GDP is estimated to have grown by just 0.1% in November 2022, after growth of 0.5% in October. There has been a continued slowing in the underlying 3-month economic growth rate. Output declined by 0.3% in the 3 months to November compared with a decline of 0.9% in the 3 months to August.

The MPC's latest forecasts published in February suggest that GDP will fall slightly throughout 2023 and into Q1 2024, as high energy prices and interest rates restrict consumer spending. However, this is a much shallower profile for the decline in output than in the November report.

CPI inflation increased to an annual rate of 11.1% in October 2022 from 10.1% in September but has since fallen back to 10.5%. Core inflation excluding energy, food, alcoholic drinks, and tobacco is lower but has only fallen slightly to 6.3% in December from 6.5% in September.

February's MPC forecasts suggest that headline inflation will continue to decrease. CPI inflation is projected to fall sharply to just under 4% by the end of 2023. The forecasts also signal that continued weakness in the economy alongside a continuing reduction in energy price inflation will reduce domestic inflationary pressures and inflation will decline to below the 2% target in the medium term.

The MSCI World Index lost 17.3% in 2022. All bar one of the world's major equity markets also posted losses in 2022. The sole exception was the FTSE 100, which was protected from the retreat in values seen in other markets and September's mini-budget by its large representation in oil and commodities stocks.

UK REIT share prices shrank by 7.7% in 2022 but many of the major property companies fared worse. The share price of Segro, the previously top performing logistics and warehousing specialists, fell 22.9%. Steep increases in discount rates, the cost of borrowing and sustainability of rental levels increased concerns over the record pricing of logistics assets, although the low level of yields compounded the issue.

The yield on the 5-15 year gilt index softened by 279 bps in 2022 from 0.95% to reach 3.74% by year-end, ignoring the impact of the mini-budget, as interest rates increased. Consequently, the total return performance on the FTSE Actuaries 5-15 year gilt index in Q3 was -17.6%.

Since the end of last year, the MPC, following its February meeting, has announced a further rise in the base rate to 4.0%. But the yield on the 5-15 year gilt index has hardened from 3.74% at the end of December to 3.17% as the money markets clearly believe that long term trajectory for inflation and interest rates is now downward.

The All Property initial/gilt yield gap increased by 120 bps from less than 0.25% in September to 1.4% in December. By the standards of the last 30 years, property continues to look as if it is priced above fair value.

In Q4 2022, All Property total returns, as recorded by the MSCI Monthly Index, decreased to -14.5% from -4.1% in Q3. Capital growth was -15.6% in Q4 compared to -5.1% in Q3. In the 12 months to the end of December, All Property total returns decreased sharply to -10.1% from +13.5% in the 12 months ending September.

All Property investment volumes, represented by the current value of investment transactions adjusted for capital growth, decreased by 14% in Q3 compared to Q2 and were 19% below their long run average. Preliminary estimates suggest that investment volumes fell sharply again in Q4 but as usual the numbers are likely to be revised upwards in the coming months.

We expect weak market conditions to persist for the first half of 2023 and have therefore downgraded our forecast All Property total return for 2023 from 4% to -6%.

We expect All Property total returns will improve in 2024 to nearer 7%. The net effect is that the annualised average forecast for the 3 years ending December 2025 will be around 3%.

3. The World economy

The IMF's latest forecast for global economic output at 2.9% this year is 0.2 percentage points higher than predicted in the October 2022 forecast but below the historical (2000–19) average of 3.8%. The rise in central bank rates to fight inflation and Russia's war in Ukraine will continue to weigh on economic activity. However, the recent loosening of COVID 19 restrictions in China has paved the way for a faster-than-expected recovery (see chart 1.1).

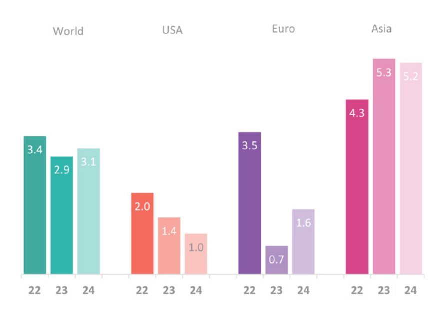
Global inflation is expected to fall from 8.8% in 2022 to 6.6% in 2023 and 4.3% in 2024, still above pre-pandemic (2017–19) levels of about 3.5%.

Growth in the United Kingdom is projected to be –0.6% in 2023, a 0.9% point downward revision from October, reflecting tighter fiscal and monetary policies and financial conditions and still-high energy retail prices weighing on household budgets (see chart 1.2).

UK GDP is estimated to have grown by just 0.1% in November 2022, after growth of 0.5% in October. There has been a continued slowing in the underlying 3-month economic growth rate. Output declined by 0.3% in the 3 months to November compared with a decline of 0.9% in the 3 months to August (see chart 1.3).

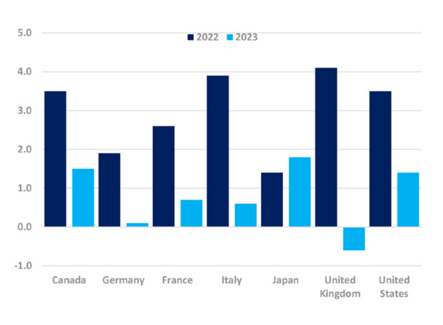
The services sector grew by 0.2% in November 2022, after growth of 0.7% in October. Output in consumer-facing services grew by 0.4% in November 2022, with the largest contribution to growth coming from food and beverage service activities as the Qatar World Cup started. Manufacturing made a negative contribution to growth in November 2022 and the construction sector was flat in November after growth of 0.4% in October (see chart 1.4).

1.1 2022 growth projections by region



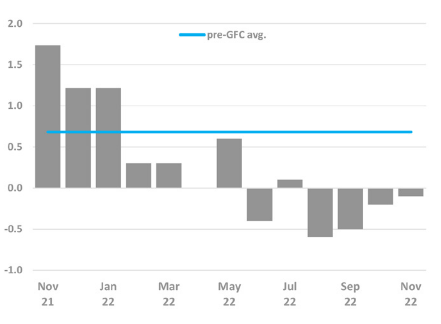
Source: IMF, Jan 2023

1.2 G7 economies forecast %'age change



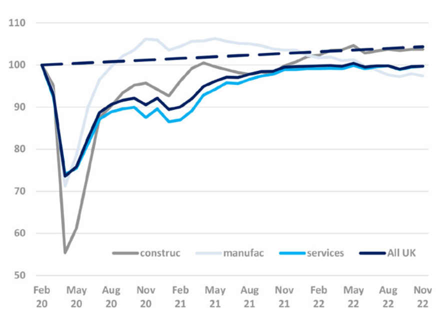
Source: IMF, Jan 2023

1.3 Rolling 3m UK economic growth



Source: ONS, January 2022

1.4 UK economic growth indices



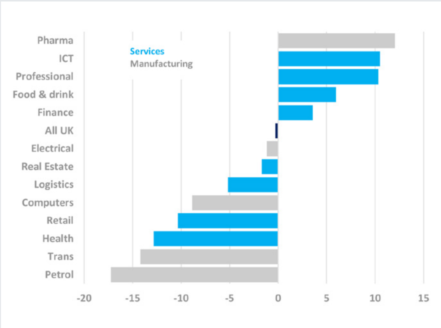
Source: ONS, Jan 2023

In the post-pandemic era, service sector industries have fared better than manufacturing. Whilst the overall economy remains 0.3% smaller than it was in February 2000, the Food and Drink sector has recovered from the threats posed by successive Covid lockdowns and is now 6.0% larger. The growth in on-line sales has not fully compensated for the decline in physical sales and the retail sector is still 10% smaller post-pandemic. The direct impact of the strikes can be seen in rail transport and postal and courier activities, but the ONS is not able to isolate the impact of these strikes from other factors across the wider economy (see chart 1.5).

The MPC's latest forecasts published in February 2023 suggest that GDP will fall slightly throughout 2023 and into Q1 2024, as high energy prices and interest rates restrict spending. However, this is a much shallower profile for the decline in output than in the November report, reflecting stronger consumption as wholesale energy prices decline and the ongoing strength of the labour market. Nevertheless, growth is expected to remain well below pre-pandemic rates (see chart 1.6).

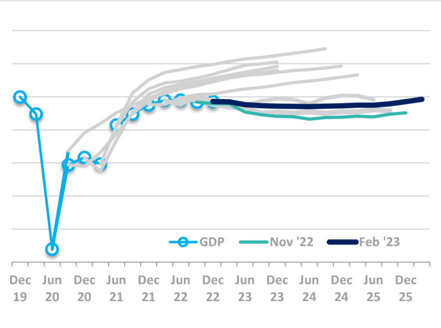
The economy has been hit by a series of significant economic shocks over recent years: the change in the UK's trading relationship with the European Union, the Covid pandemic and developments in global energy prices relating to Russia's invasion of Ukraine. These factors have held back both potential productivity and labour supply, and hence the overall supply capacity of the economy.

1.5 Post pandemic economic growth by sector Nov 2022 vs Feb 2020

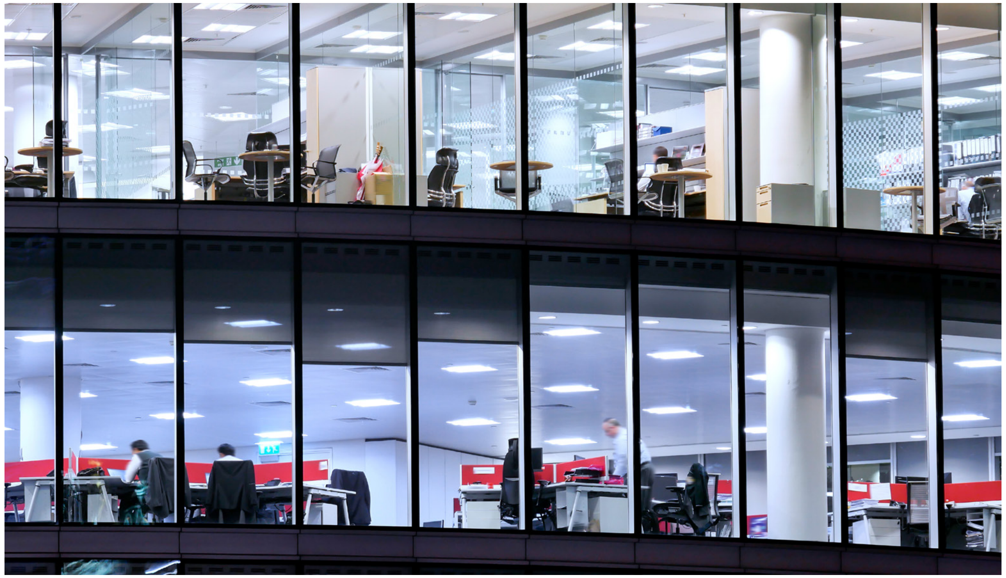


Source: ONS, Jan 2023

1.6 MPC economic projections



Source: Bank of England, February 2023



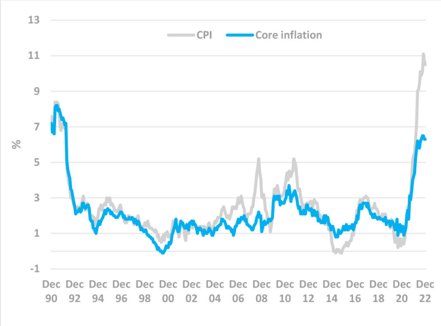
4. The UK economy

Year on year CPI inflation increased to 11.1% in October 2022 from 10.1% in September but has since fallen back to 10.5% at the end of December. Core inflation excluding energy, food, alcoholic drinks, and tobacco is lower but has only fallen slightly to 6.3% in December from 6.5% in September. But quite obviously the numbers remain extremely elevated compared to the 2% target rate (see chart 2.1).

High growth in the cost of energy and food is causing hardship and out of necessity a reduction in household spending elsewhere. ONS figures show that gas and electricity prices continue to rise rapidly compared with last year, and most adults in Great Britain are reporting using less fuel in their homes because of the rising cost of living. Electricity prices in the UK rose by 65.4% and gas prices by 128.9% in the 12 months to December 2022, and were some of the main drivers of the annual inflation rate.

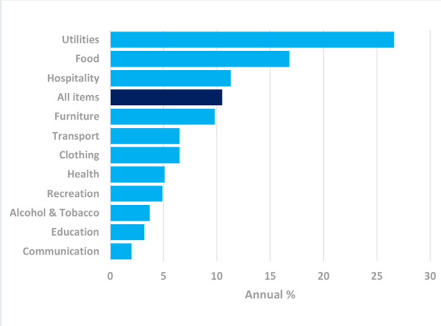
The largest downward contribution to the easing in the annual CPI rate into December 2022 came from transport. Fuel prices rose by 11.5% in the year to December 2022, down from 17.2% in November 2022. This was the sixth consecutive month when motor fuel price inflation has fallen, from a high of +43.7% in July 2022 (see chart 2.2).

2.1 CPI inflation



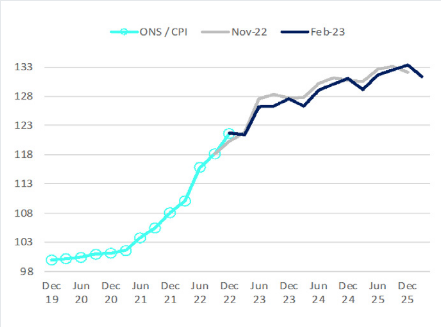
Source: ONS, January 2022

2.2 Inflation by sector



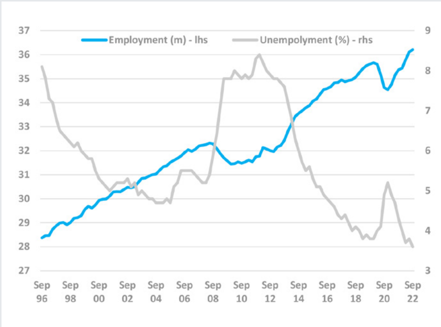
Source: ONS, January 2022

2.3 MPC inflation projections



Source: Bank of England, February 2023

2.4 UK jobs & unemployment



Source: ONS, January 2022

CPI inflation is projected by the MPC to fall sharply to just under 4% by the end of 2023. It also expects that continued weakness in the economy alongside a continuing reduction in energy price inflation will reduce domestic inflationary pressures and inflation will decline to below the 2% target in the medium term (see chart 2.3).

There has been plenty of talk in the media recently about the likely onset of recession. In the UK at least this is crudely defined as two consecutive quarters of declining output. In the USA, they take a much more holistic approach to the definition. The Business Cycle Dating Committee decides when a recession began and ended based on multiple criteria, including employment and industrial production. Looking at employment in the UK, it is far from clear that the economy is on the brink of typical recession characterised by failing businesses, job losses and mass unemployment (see chart 2.4).

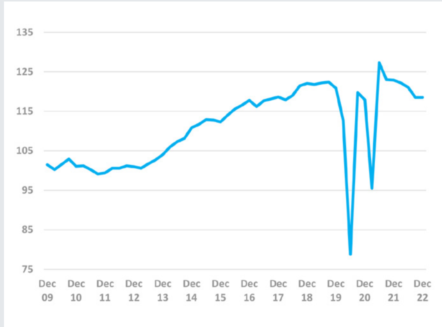
However, pay in real terms has been falling since June 2021 and remains at 2007 levels. This together with sharply higher prices for utilities, petrol and food is the cause of the cost-of-living crisis that has caused consumers to reduce their expenditure and will further slow UK economic growth (see chart 2.5).

Retail sales volumes (the amount of goods bought) fell by 1.0% in December 2022, following a fall of 0.5% in November. December's drop took sales volumes to 1.7% below the pre-COVID-19 level of February 2020. However, in terms of value spent, retail sales had risen 13.6% over the same period (see chart 2.6).

2.5 Real pay index (sa)

Source: ONS, January 2022

2.6 Retail sales volumes



Source: ONS, January 2022

5. Stock markets, interest rates & asset yields

A portfolio balanced between a mix of asset classes has been a classic investment strategy. However, 2022 was the first calendar year since 1969 when both stock and bond market indices posted a loss. Global stocks and bonds lost more than $30tn for 2022 after inflation, interest rate rises and the war in Ukraine triggered the heaviest losses in asset markets since the global financial crisis.

The MSCI World Index with large and mid-cap representation across 23 developed markets lost 17.3% in 2022. All bar one of the world's major equity markets also posted losses in 2022. The sole exception was the FTSE 100 protected from the retreat in values seen in other markets and September's mini-budget by its large representation in oil and commodities stocks (see chart 3.1).

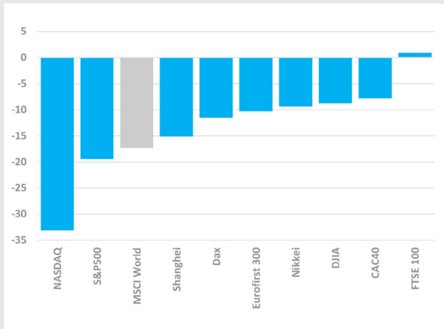
The NASDAQ which contains the listing of many of the major tech stocks, was down more than 33% in 2022. Some of these big tech stocks produced even larger losses. Shares in Meta, previously known as Facebook, fell 71.2%. Reacting to falling subscriber numbers, Netflix was marked down 57.7% last year and Nvidia, a global leader in artificial intelligence hardware and software, fell 47.2%. Prologis, the largest logistic and warehouse real estate company in the world, suffered a 23.6% fall in its share price (see chart 3.2).

UK REIT share prices under-performed the wider all share market index in 2022. The All REIT index fell 7.7% but many of the major property companies fared worse. The share price of Segro, the previously top performing logistics and warehousing specialists, fell 22.9%. Steep increases in discount rates and the cost of borrowing increased concerns over the record pricing of logistics assets. Poor prospects for the London office market and UK retail property, also weighed on the share price of Great Portland, Derwent London, British Land and Land Securities (see chart 3.3).

The pricing of UK risk free assets collapsed in Q3 as the capital markets punished the UK Government for its short lived but reckless experiment with unfunded tax cuts. The era of cheap money and historic low yields that had prevailed since the Global Financial Crisis (GFC) seems to have ended. The yield on the 5-15 year gilt index softened by 279 bps in 2022 from 0.95% to reach 3.74% by year-end.

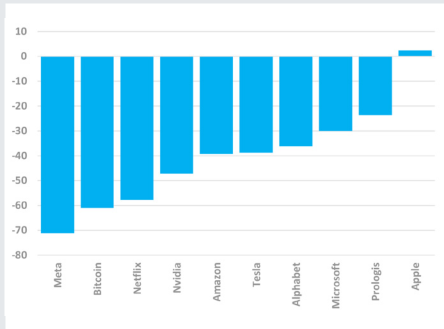
Consequently, the total return performance on the FTSE Actuaries 5-15 year gilt index in Q3 was -17.6% (see chart 3.4). Since the end of the year, the MPC following its February meeting has announced a further rise in the base rate to 4.0%. But the yield on the 5-15 year gilt index has hardened to 3.17% as the money markets clearly believe that the long term trajectory for inflation and interest rates is now downward.

3.1 World stock markets in 2022



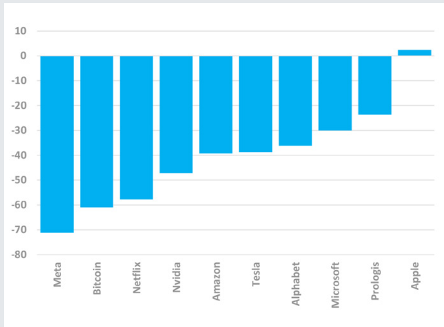
Source: Yahoo Finance, Jan 2023

3.2 Tech & other selected stocks 2022



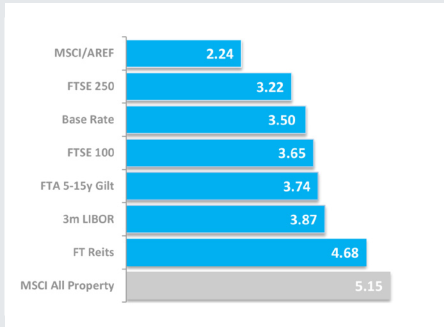
Source: Yahoo Finance, Jan 2023

3.3 UK Reit price movement in 2022



Source: Yahoo Finance, Jan 2023

3.4 UK asset yields 2022

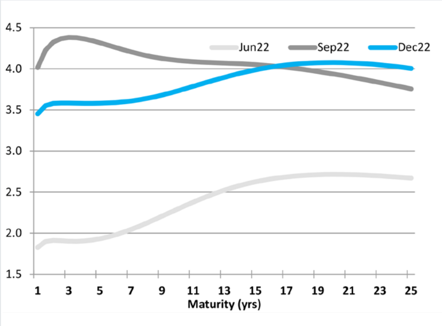


Source: Yahoo Finance & MSCI, Jan 2023

Following Chancellor Kwarteng's Mini-Budget Market last September, expectations of future interest rates increased by 250 bps at the shorter end of the yield curve and by 150 bps for longer maturities. His successor Jeremy Hunt and Prime Minister Rishi Sunak have since restored a degree of order. By the end of December 2022, shorter term forward rates had fallen back by 75 bps but longer-term rates remained elevated. Based on the conditioning path for Bank Rate published by the Bank of England, markets which 3 months ago expected rates to rise to almost 5.25%, now expect them to peak at 4.5% by the end of Q3 this year (see chart 3.5).

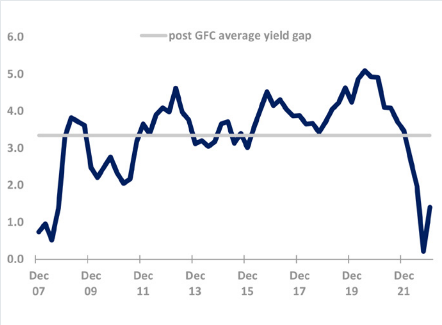
As risk free rates fell back and property yields rose, the property initial/gilt yield gap increased by 120 bps from less than 0.25% in September to 1.4% in December. By the standards prevailing post-GFC, property continues to look as if it is priced above fair value. The last time the asset class was valued at this level was on the eve of the GFC when a banking crisis triggered a decline in All Property capital values of 40% (see chart 3.6).

3.5 Gilt yield curve (%)



Source: Bank of England, Nov 2023

3.6 Property IY – Gilt yield gap



Source: MSCI & Bank of England, Jan 2023

6. Commercial property market performance

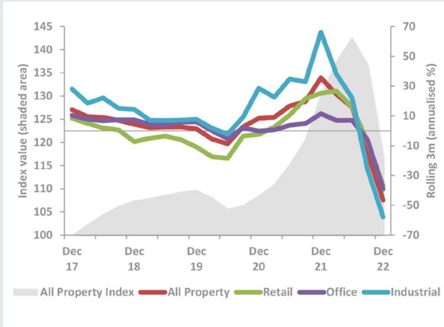
In Q4 2022, All Property total returns, as recorded by the MSCI Monthly Index, decreased to -14.5% from -4.1% in Q3. Capital growth was -15.6% in Q4 compared to -5.1% in Q3. Property equivalent yields softened by 108 bps and contributed a -17.5% fall in valuations. All Property rental value growth decreased to 0.7% in Q4 from 1.0% in Q3. Q4 income returns amounted to 1.3% (see Charts 4.1 & 4.4).

Over the course of the fourth quarter, office rental value growth decreased to 0.3% from 0.4% in Q3, while industrial rental value growth decreased to 1.6% from 2.2% in Q3. All Retail rental value growth remained broadly flat in Q4. However, market rental values for Retail Warehousing, Shopping Centres and Rest of the UK and South East shops continued to fall back, whilst central London retail rental values increased by 2.6% (see Charts 4.2 & 4.5).

In the 12 months to the end of December 2022, All Property total returns decreased sharply to -10.1% from +13.5% in the 12 months ending September. Year-on-year capital growth decreased to -14.2% in December from +8.4% in September. Property equivalent yields have softened by 111 bps in the 12 months to December and contributed to an 18.3% drop in valuations. All Property rental values increased year-on-year by 4.2% and income return amounted to 4.7%. Even without any further movements in the market, these year-on-year numbers will weaken further next quarter as strong returns in Q1 2022 fall out of the calculation.

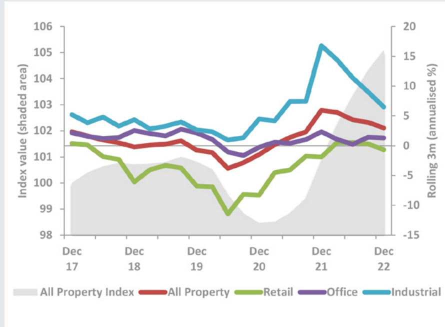
Strong investment and occupier demand for industrials has driven yields down to 3.3% and approaching 2.5% for last mile logistics in London at the top of the market. The sharp increase in the benchmark risk free rate, borrowing costs and sustainability of rental levels has led to a re-appraisal of value in this sector of the market in particular (see Charts 4.3 & 4.6).

4.1 Total returns by sector



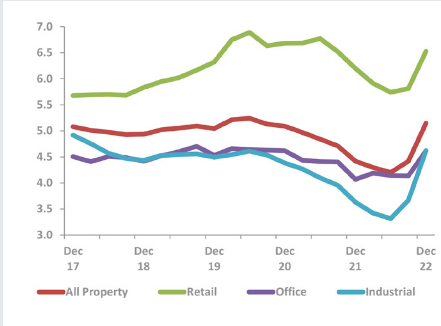
Source: MSCI, Jan 2023

4.2 MRV growth by sector



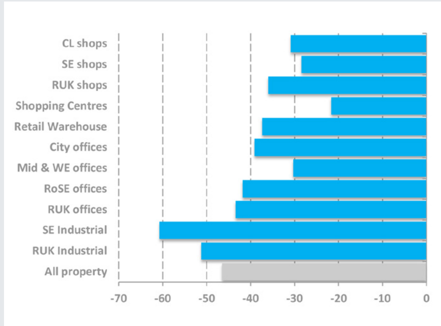
Source: MSCI, Jan 2023

4.3 Initial yield by sector



Source: MSCI, Jan 2023

4.4 Total returns by segment (Q4 annualised)

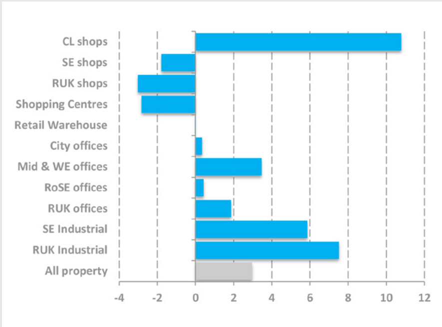


Source: MSCI, Jan 2023

Tables 5.1 – 5.5 contain further performance data for UK commercial real estate in Q4 2022.

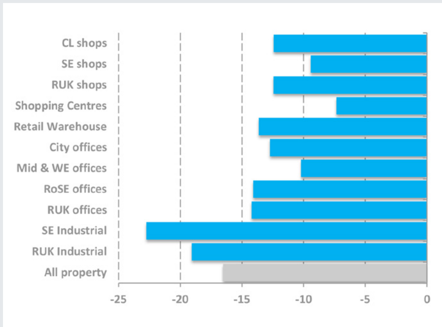
In Table 5.6, we have adopted the factor approach to real estate by segmenting the market firstly by use and secondly by a key characteristic i.e. yield, rent or lease length. The numbers presented are the 3 month total return relative to the MSCI All Property average for Q3 2022. A heat map has been used as a visual aid to pick out the under-performing segments in red and out-performing segments in green.
The third quarter saw a complete reversal of the trends that have prevailed for most of the last 5 years. All industrial segments underperformed while parts of the office, shop and shopping centre segments outperformed. We expect this picture to only be reinforced once detailed Q4 data is published.

4.5 MRV growth by segment (Q4 annualised)



Source: MSCI, Jan 2023

4.6 Yield impact (Q4)



Source: MSCI, Jan 2023

5.1 Total returns

	Dec	3m	6m	12m
All Property	-3.3	-14.5	-18.0	-10.1
Retail	-2.1	-10.8	-12.5	-3.7
Office	-2.9	-11.7	-13.2	-10.1
Industrial	-4.6	-19.4	-25.3	-14.9
Annualised				
All Property	-32.9	-46.5	-32.7	-10.1
Retail	-22.1	-36.8	-23.5	-3.7
Office	-30.0	-39.1	-24.4	-10.1
Industrial	-43.0	-57.8	-44.1	-14.9

Source: MSCI

5.2 Capital growth

	Dec	3m	6m	12m
All Property	-3.7	-15.6	-19.9	-14.2
Retail	-2.6	-12.3	-15.2	-9.4
Office	-3.4	-12.7	-15.1	-14.1
Industrial	-5.0	-20.3	-26.7	-18.0
Annualised				
All Property	-36.4	-49.2	-35.9	-14.2
Retail	-27.1	-40.8	-28.1	-9.4
Office	-33.6	-42.0	-27.9	-14.1
Industrial	-45.6	-59.6	-46.3	-18.0

Source: MSCI

5.3 Income return

	Dec	3m	6m	12m
All Property	0.4	1.3	2.4	4.7
Retail	0.5	1.6	3.1	6.3
Office	0.4	1.2	2.3	4.7
Industrial	0.4	1.0	1.9	3.8
Annualised				
All Property	5.4	5.1	4.8	4.7
Retail	6.7	6.5	6.3	6.3
Office	5.1	4.9	4.7	4.7
Industrial	4.5	4.2	3.9	3.8

Source: MSCI

5.4 ERV growth

	Dec	3m	6m	12m
All Property	0.3	0.7	1.7	4.2
Retail	-0.0	-0.2	-0.1	0.2
Office	0.1	0.3	0.7	1.0
Industrial	0.5	1.6	3.8	10.3
Annualised				
All Property	3.2	3.0	3.4	4.2
Retail	-0.1	-0.7	-0.2	0.2
Office	1.1	1.3	1.4	1.0
Industrial	6.7	6.5	7.7	10.3

Source: MSCI

5.5 Net initial yield

	Dec	3m	6m	12m
All Property	5.1	4.4	4.2	4.4
Retail	6.5	5.8.	5.7	6.2
Office	4.6	4.1	4.1	4.1
Industrial	4.6	3.7	3.3	3.6

Source: MSCI

5.6 Performance by strategy relative to All Property average Q3 2022

	Low yield	High yield	High rent	Low rent	Long lease	Short lease
Shops	0.1	3.7	2.5	0.1	-0.4	2.9
Shopping Centres	1.7	3.0	3.7	1.7	1.7	0.9
Retail Warehouses	0.8	2.8	1.3	0.8	1.2	2.1
Central London offices	1.5	0.1	2.7	1.5	0.6	1.2
RoSe offices	2.5	1.8	1.7	2.5	1.6	2.6
RUK offices	0.2	0.6	2.4	0.2	-1.0	0.9
Industrials	-4.7	0.3	-3.7	-4.7	-4.0	-2.6

Source: MSCI, Oct & January 2023

7. Investment in property

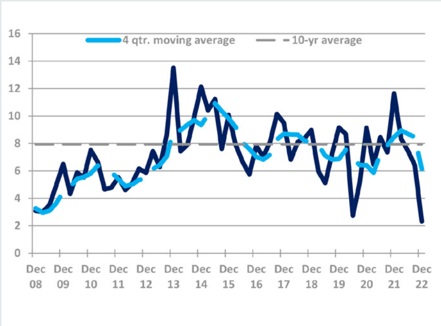
All Property investment volumes, represented by the current value of investment transactions adjusted for capital growth, decreased by 14% in Q3 2022 compared to Q2 and were 19% below their long run average. Preliminary estimates suggest that investment volumes fell sharply again in Q4 but as usual the numbers are likely to be revised upwards in the coming months (see chart 6.1).

Industrials made up 24% (by value) of investment transactions in 2022; Central London offices represented a further 19% and Alternatives including Medical Facilities, Car Showrooms, Residential and Student Accommodation made up another 26%. Across all sectors of the market, investment volumes were lower in 2022 than in 2021 (see chart 6.2).

Central London offices traditionally dominate UK real estate investment representing 27% of the UK's real estate investment market over the last 22 years. Investment volumes have been on a declining trend since December 2013. Signs of improvement that were evident since March 2021 have now been firmly reversed (see chart 6.3).

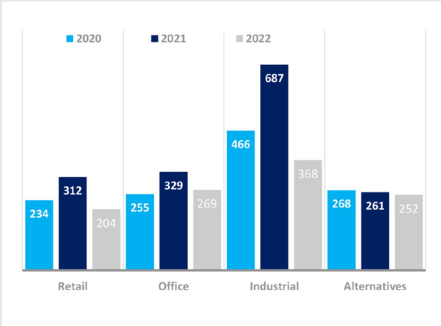
Transaction numbers in the City of London and West End and Midtown markets decreased in 2022 and the City Fringe, Docklands and Southbank markets were again thinly traded. In 2022, the City of London accounted for 47% of all Central London office transactions while the West End represented a further 24% of such transactions (see chart 6.4).

6.1 All property investment volumes (£bn)



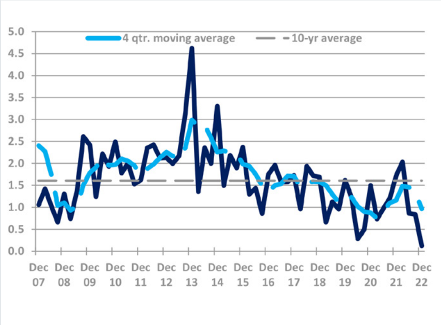
Source: Property Data, MSCI & APR, Jan 2023

6.2 Investment transaction nos. by year



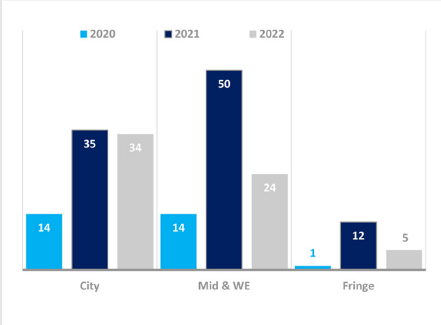
Source: Property Data, Jan 2023

6.3 Central London office investment volumes (£bn)



Source: Property Data, MSCI & APR, Jan 2023

6.4 Central London office Investment transaction nos. by year

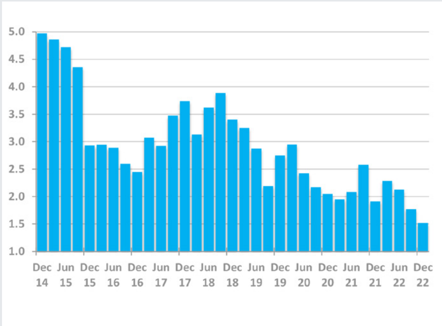


Source: Property Data, Jan 2023

Overseas' Central London investment volumes have been declining for the last five quarters. The surge in activity in 2021 can be put down to the release of pent-up demand after pandemic lockdown restrictions were lifted. Optimists or sell side brokers are now saying that the sudden fall in value of the pound triggered by "Trussonomics" will usher in a wall of overseas' capital targeting Central London offices. There is no sign of this so far (see chart 6.5).

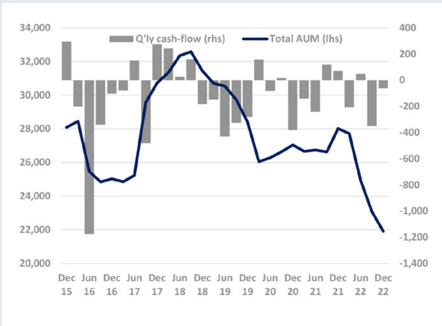
In the last six years, property funds have regularly faced demands for redemptions from retail investors. Data to the end of November 2022 indicates that the sector has suffered from quarter-on-quarter net redemption demands since mid-2018. Retail investment vehicles have been overwhelmed by calls for redemptions and have been forced to suspend trading in their units, but also to sell some assets in Q4 2022 to meet some repayments. Redemption demand also spread to the institutional open diversified core market in September as falling gilt prices forced pension funds to increase liquidity levels (see chart 6.6).

6.5 Overseas investment in Central London offices (£bn)



Source: Property Data, Jan 2023

6.6 Property funds AUM & cash-flow (£m)



Source: Investment Association, Jan 2023

8. Outlook & house view

Increasing risk free rates and the weak economic outlook are reflected in November's IPF consensus forecasts. Its total return forecasts for 2023 have been decreased to -0.1% from 4.1% in August and more than 6% at the start of the year. The outlook for 2024 has strengthened very slightly to 6.1% from 5.8% (see chart 7.1).

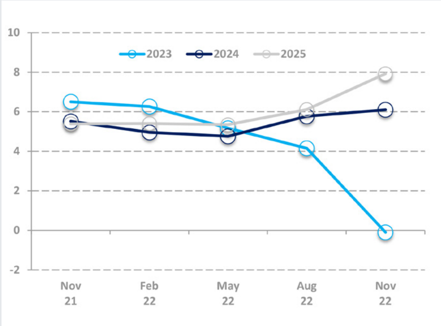
The IPF consensus view remains that values will continue to drift down in 2023 although clearly the pace of decline will be slower than recent levels. This year will, however, mark the bottom of the cycle with year-on-year total return forecasts increasing to 6% in 2024 and 8% in the years thereafter. The annualised average over the next 4years ending 2026 will be 5.4% (see chart 7.2).

Respondents to the IPF Consensus forecasts now expect to see every segment, apart from regional offices, provide negative performance in 2023. There has been a complete reversal in the outlook for Industrials and Retail Warehouses. But sentiment is weakest for City of London and West End offices (see chart 7.3).

As interest rates continue to rise and uncertainty surrounding the economy grows, the range of forecasts has widened, reflecting an increase in risk. Total return forecasts for 2023 range between +7.4% and -18.7%. In comparison the forecast range for 2024 is a relatively small at 11.8%, with a maximum of 13.0% and a minimum of 1.4% (see chart 7.4).

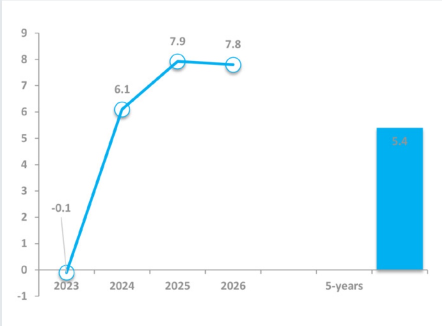
Although we downgraded our All-Property total return forecasts for 2022 last quarter to between 1% and -1%, we did not anticipate the strength of the downturn in Q4 as the rate of decline in capital growth accelerated to -15.6% from -5.1% in Q3. We had assumed that the partial recovery in the gilt market after the promotion of Rishi Sunak to No.10 would be reflected by a slowing in the de-rating of commercial real estate. This proved to be far from the case.

7.1 IPF forecast evolution (November 22)



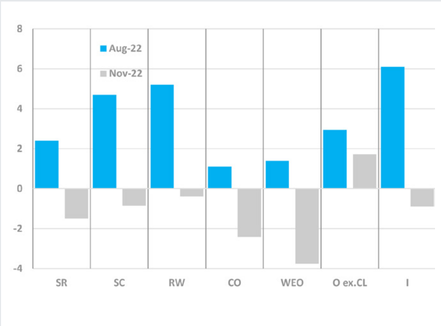
Source: IPF, Nov 2022

7.2 IPF All Property forecasts y-by-y (November 22)



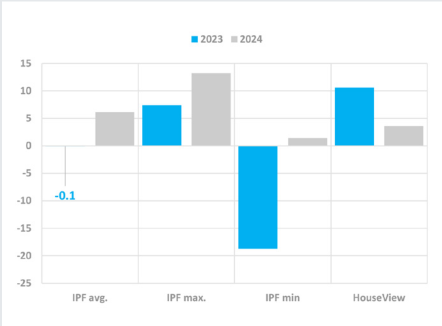
Source: IPF, Nov 2022

7.3 IPF 2023 forecasts by sector Nov 22 v Aug 22



Source: IPF, Nov 2022

7.4 UK commercial total return forecast range

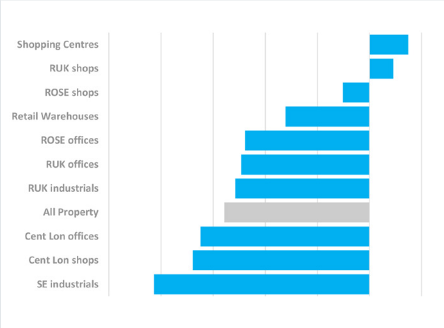


Source: IPF, Nov 2022

The central forecast from the House View model is revised on a quarterly basis to reflect the changing macro-economic outlook and the current performance of commercial real estate. We now expect weak market conditions to persist at least for the first half of 2023. We have therefore downgraded our forecast All Property total return for 2023 from 4% to -6% (see chart 7.5).

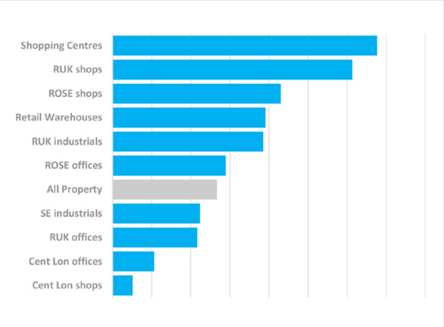
We expect All Property total returns to improve in 2024 to nearer 7%. The net effect is that the annualised average forecast for the 3 years ending December 2025 could be around 3%. After years of under-performance, Shopping Centres and Rest of UK Shops are providing an 8% income return, which provides some resilience in the face of a general de-rate of the asset class (see chart 7.6), albeit these returns reflect the underlying uncertainty across these occupier markets. The usual caveats regarding uncertainty surrounding our central forecast remain including a more benign outlook for the economy, inflation and interest rates and an improvement in liquidity as investors believe that the sudden downward adjustment in pricing now presents a buying opportunity.

7.5 Cluttons House View - 2023 relative total returns (%)



Source: IPF, APR & Cluttons, Feb 2023

7.6 Cluttons House View - 2023-2025 relative total returns (%)



Source: IPF, APR & Cluttons, Feb 2023

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