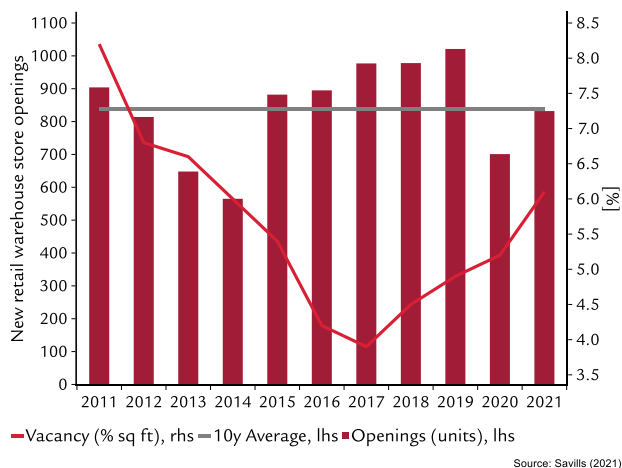


First half of 2022

Key takeaways

- **UK All Property returns improve in H2:** Total returns in H2 2021 amounted to 12.9% compared to -6.2% in H1 2021 based on the MSCI UK Monthly Index. All main sectors, including retail, saw a positive return; however, performance polarisation between segments remains a pervasive theme.
- **Investment activity recovers despite Covid variants:** H2 investment volumes improved on H1 as pandemic-induced structural changes are understood. We expect liquidity to continue into H1 2022, as development pipelines materialise, and more high-quality stock becomes available.
- **Logistics performance remains exceptional:** Logistics is the standout performer having seen significant yield compression and rental growth in H2. The sector registered its strongest take-up levels ever in 2021 with vacancy levels at an all-time low. Elevated levels of online retail spending have stabilised, indicating demand should remain robust.
- **Office winners and losers:** Offices have been relatively resilient although performance in the sector has been divided between locations and specification. As office leases expire, we anticipate new occupational preferences emerging as a result of continued hybrid-working practices. This will cause performance divergence depending on the degree to which offices are aligned to structural change.
- **Retail warehouses continue to drive performance:** Retail warehousing has contributed a 17.1% total return to the retail sector, which now outperforms offices for the first time since 2016. However, as the volume of online sales stabilise at an elevated level, shopping centres and high street shops continue to suffer.

Chart in focus



Retail warehouse capital values grew 7.0% in Q4 2021 alone, roughly eight times the rate of other retail segments. This statistic helps illustrate the divergence in performance between different retail segments. By analysing occupational market activity, it becomes clearer as to what is driving this out-performance. New retail warehouse store openings in 2021 are in line with the 10-year average. Operators with a value-oriented focus dominated market activity, especially food-based operators, accounting for a third of all new openings over the year. In this time, Lidl has been most active, opening 53 new stores equating to 908,400 sq ft, which should help drive new openings over the 10-year average for the first time since 2019.

Given the progress of its vaccination campaign and the recent spread of the Omicron variant, the UK economy is likely to be the first major economy to enter the endemic stage of COVID-19. Under this scenario a return to mostly normal activity seems possible by around the third quarter of 2022. This comparative advantage of the UK economy relative to its continental peers may be offset by tighter financial conditions as the Bank of England has already embarked on monetary policy normalisation. While the pandemic is likely to become a less dominant factor to assess medium-term economic activity, questions related to Brexit remain. In the short-term, lower net migration and a tight labour market are likely to weigh on potential growth.

Investor appetite increases

The recovery in transaction activity continued across H2 2021, with data from RCA indicating that total volumes amounted to £33.8 bn, representing a 28% increase compared to the same period last year. Recovery has strengthened across all sectors with industrial investment volumes for the year-to-date reaching £17 bn, nearly double that of last year. All-property yields declined steadily in H2 2021, although the magnitude of the decline varies between sectors; the contraction in capital values seen during 2020 was followed by a 10% rise across 2021, surpassing forecasts by double.

A divided performance in offices

Offices returned 4.0% in H2 2021. Capital values increased 1.6% due to positive rental growth of 0.8% and declining yields. As in H1, there was a divided performance across the sector with yields hardening in the West End of London and the largest regional cities, whilst remaining flat elsewhere. Improving performance in the West End continued into H2 2021, returning 7.8%; City of London offices on the other hand saw comparatively weaker returns of 1.3% despite a strong performance at the start of the year. In regional cities, occupier demand has surpassed the 10-year average, demonstrating resilience to homeworking. This is likely due to a combination of cheaper space, shorter commuting times, and typically less adaptable occupiers. Across the sector, however, office assets that offer a modern, flexible, and amenity-rich space are expected to prove resilient to changing working practices and it is for these buildings that the highest rents will be paid.

Strong year for industrials

The industrial sector continues to significantly outperform, returning 21.9% in H2 2021. Over this period, capital values have risen 19.4%, as rental values grew 5.8% and yields continued to compress; MSCI reported that industrial yields have fallen by 60bps. Occupational activity has contributed to a record low vacancy rate of 3.7%, as take-up of “big box” units (> 100,000 sq ft) has been very strong. The growth of e-commerce over the pandemic has been the key driver of demand. Although the development pipeline has increased, many projects are facing delays due to supply chain issues and rising construction costs. It is anticipated that a lack of available space will support rental growth, but as institutional demand becomes less discerning, there is a risk of mispricing.

Retail warehouses outperform

Performance for the retail sector continued to rebound in Q4, returning 5.8% over the quarter, resulting in a total return of 11.1% in H2 2021. This recovery has been driven by the retail warehousing segment which returned 17.1% in H2 2021 as capital values increased by 13.2%. In contrast, values across the wider sector remained mostly flat. Yield movements have been divergent across the segments: over Q4 alone, high street shop yields rose by 4bps, whilst falling in shopping centres (25-bps), supermarkets (14-bps) and retail warehousing (46-bps). High street retail has seen little growth since restrictions eased as the level of online sales remain elevated at 27%, suggesting the structural shift to online retail will continue despite the re-opening of physical stores.

Recovery likely to slow in 2022

The all-property performance rebound seen in H1 2021 continued into the second half of the year, however this remains polarised across the sectors. Despite recovering occupational and investment activity, the outlook for capital growth in the medium term is moderate as rental growth remains flat overall and yield compression begins to ease. Emerging headwinds due to the Omicron variant present an economic risk, however, the national effort to administer vaccination boosters should support recovery in the medium term.

Chart 1: All Property returns (Q4 2021)

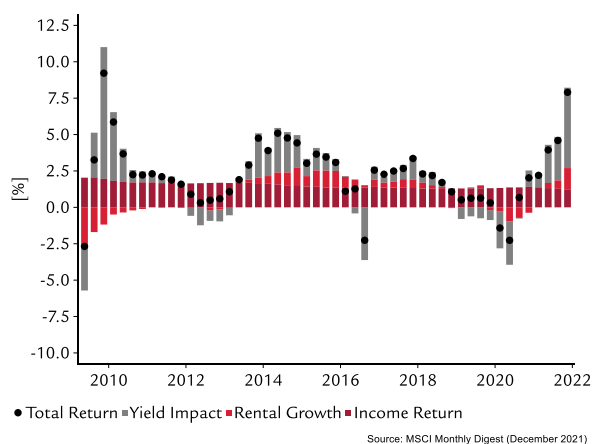
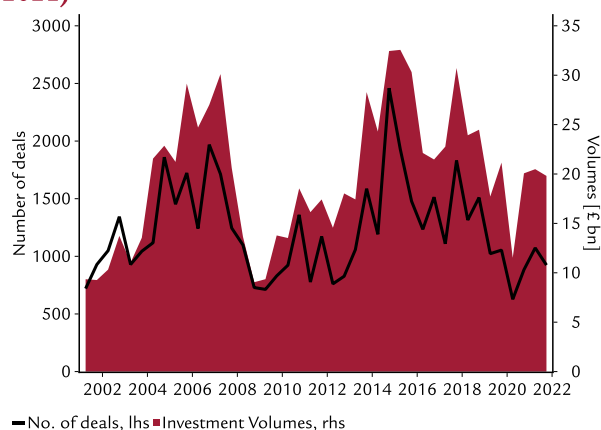


Chart 2: UK property investment volumes (to Q4 2021)



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Released and approved by the Economics Department, Swiss Life Asset Management Ltd, Zurich

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