

## Predictions for 2007 from Estates Review

**By Editorial Staff**  
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### Property experts look into their crystal ball to give a taste of what lies in store in 2007

Arlington Securities says returns from commercial property investment will fall in 2007 from about 20 percent in 2006 to lower than 10 percent.

It says a surge in rental growth in the central London office market is compensating for a slowdown in retail rental growth. Andrew Smith, head of research, believes offices will continue to offer the highest returns over three years because of strong performance in the central London market.

But he says that although the UK will see a return to a more normal property market after the exceptional performance of the last three years, property remains an attractive proposition as part of a multi-asset portfolio, offering an attractive income return and good diversification qualities.

He believes that the launch of real estate investment trusts (Reits) will complement other forms of property investment rather than replace them and will help to underpin demand in the property market.

And he expects demand from pension funds to be sustained.

James Burchell, chief executive of Faircroft Properties, says recent interest rate rises together with the increase in office development, may lead to an increase in supply of Grade A space in several cities.

"However, there are a number of cities, such as Bristol, which are suffering from a distinct lack of supply of Grade A space and we believe these will continue to perform."

He says occupiers will continue to demand well-specified offices, whether newly built Grade A accommodation, or refurbished Grade B space.

Smaller businesses will continue to search for owner-occupier accommodation with their own front doors, together with good-quality space where sensible rents are quoted.

"We don't foresee a particular change in this as long as interest rates do not march excessively upwards," he says.

David Wells, director of Scarborough Development Group, also notes that businesses across the UK are competing for Grade A central locations, with more space and newer facilities.

"There seems to be a preference for more central locations, like The Senate in Exeter and 110 Vincent Street in Edinburgh. However, because of the increased need for office space, out-of-town venues like the Thorpe Park, in Leeds, are also receiving unprecedented levels of demand," he says.

Wells says investment in commercial property is booming and he does not see any signs of this dwindling in 2007.

"I expect the number of individuals ploughing money into this sector will increase now that Reits have been given the green light. More individuals will take the opportunity to enter the market and will use self invested personal pensions (Sipps) to purchase a Reit. These changes for individual investors and sustained demand for high quality office space will result in a healthy and prosperous office market."

Nick Cook, MD of Haywards, the workplace and corporate real estate experts, predicts the momentum towards more sustainable workplace strategies will gather pace as companies come under increasing pressure to reduce costs and seek to make themselves more attractive to a wider pool of skilled labour.

"The effect of higher costs of living, that will translate into higher staff wages, will put pressure on other areas of the business. Real estate and facilities costs are going to be obvious targets."

He says as the push to reduce the number of people processing a task continues and the confidence in off-shoring strengthens, there will be more pressure in the UK to shed jobs and real estate.

This will give rise to commercial landlords and tenants having to work harder to market their properties in an increasingly competitive marketplace.

"Looking regionally, commercial rents in the West End [London] have escalated so much in 2006 that professional service companies – such as PR and advertising agencies – are going to find it more difficult to be based there, unless they can charge higher fees.

"If the client base is resistant to this, the only other way of managing it is to move to less fashionable parts of the capital. That will have repercussions on prices in those areas."

Mr Cook predicts the managed-office and serviced-office sectors are set for a major surge of demand as smaller companies, in particular – but even large companies that are less certain about the future – start to resist taking long leases, in favour of the more virtual environments provided by these sectors.

Nabeel Chowdery, managing director of Manchester-based Property Route, which has a £75m commercial property portfolio, thinks 2007 will be similar to 2006 although the recent rise in interest rate has yet to work through the market fully.

He expects to see a more cautious approach to commercial investment stock, especially secondary and out-of-town locations.

Eleanor Richardson, partner at City of London-based legal firm KSB Law makes the following observations: The conversion of property companies to Reits will take most of the headlines as the final details of the UK scheme are published in the first quarter of 2007.

This may well see an increase in movement at the corporate end of the commercial property market as private companies seek to become, or merge with plcs in order to qualify for Reit status.

Ms Richardson also says 2007 could also see the end of forfeiture as we know it, if the current bill makes it through parliament, although it appears that this may well only change the procedure for forfeiture, rather than taking away the right for landlords to evict commercial tenants completely.

She also predicts that "with weather records being broken left right and centre in the UK, the focus is shifting more and more towards the effects our developments have on the environment, and 2007 may well see even more stringent planning conditions being imposed on both residential and commercial schemes."

She says any such developments are bound to increase the cost of developing a site; a cost that developers will want to make sure they can pass onto the purchaser or tenants.

John Ralph, head of property finance at Dickinson Dees law firm, predicts 2007 will see an increase in personal investments into niche types of property including bare land, self-build schemes and agricultural tenancies since pension companies widened the appeal of Sipp.

"Despite proposed restrictions on the transmission of Sipp property to family members, investing through Sipp in commercial property will continue to be a popular and tax-effective way of investing for retirement."

Mr Ralph says the pick up in the FTSE may ease the strangulation on rental yields in the investment sector and investors will, for the first time in five years, be able to rival property as an appreciative investment.

"This will be a gradual improvement but if the British pound continues to remain buoyant against the US dollar, the equities market is tipped to thrive.

Meanwhile, in the general commercial industry, Mr Ralph believes the introduction of Reits could have interesting consequences.

He says, for example, that if UK Reits seek to invest in overseas properties, this could have an adverse effect on the UK market.

"However, with the current strength of the UK commercial market, it is probable that we will see many foreign funds investing in UK assets."

Mat Oakley, head of Savills' commercial research, says 2007 will see the office market continue to outperform the industrial and retail markets. This will primarily be driven by rising demand, and falling vacancy rates in London and the South East, which in turn will drive rents steadily upwards.

"The big question facing the sector in 2007 is whether the weight of money targeted at commercial property will be sustained. This has been the primary driver of the rising prices and high returns seen over the last three years. "Our research into investor's plans for 2007 indicate that demand will be above average, though lower than the levels seen in 2005/6. There are further price rises to come on prime product, but they growth will not be as strong as we've seen in recent years."