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Investors lose interest in UK commercial property as occupier demand falls

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The Royal Institution of Chartered Surveyors (RICS) UK Commercial Property Monitor Q4 2022 demonstrated a further deterioration in overall market conditions during the quarter. At the national level, 83% of respondents believe the market is in the downturn phase of the cycle, up slightly from 81% taking this view in Q3. 49% still consider this downturn to be in its early stages.

In the occupier market, the all-sector net balance for tenant demand slipped to -20% in Q4 2022. This is down from -10% in Q3 and marks the weakest reading since the end of 2020. In terms of the specific sectors, there was a noteworthy fall in occupier demand across offices (net balance -29%) and retail premises (-45%). Meanwhile, tenant demand remained marginally positive for the industrial sector (net balance +6%).

With respect to rental growth projections, on a twelve-month view, expectations remain modestly positive for prime office and industrial space. Focussing on prime offices, at the headline level, a net balance of +10% foresee an increase in rents for the 12 months ahead. Regional differences can be seen in this picture however, with London posting a net balance of +19 and the North +13%.

While the rental outlook appears more resilient in some market segments for 12 months ahead, the recent increase in interest rates is having a more widespread negative impact on investor sentiment. Investor enquiries reportedly fell at the headline level in Q4 2022, evidenced by a net balance of -30%. This decline was seen across all sectors covered for the first time since the early stages of the pandemic. Likewise, overseas investment demand was also down within each sector compared with the previous quarter.

Recent interest rate rises are also having a significant impact on capital values, with near-term expectations falling sharply across all sectors. Looking out over the next twelve months, capital value projections are now in negative territory across all three mainstream sectors in both prime and secondary markets. All parts of the UK now display negative all-property average capital value expectations for the year to come.

Playing a significant part in the pull-back across many investment market indicators during Q4, credit conditions were reported to have worsened by a net balance of -73% of contributors (down from -68% last time). As such, this is a fresh record low for the series (first introduced in 2014), with higher interest rates singled out by many contributors as ushering in a period of adjustment in market valuations.

Tarrant Parsons, Senior Economist at RICS said: “The investment side of the UK commercial real estate market has been significantly affected by tighter monetary policy of late, with higher borrowing costs weighing on investor demand and prompting an adjustment in valuation levels. Indeed, linked to the rise in government bond yields over the past six months, capital values have pulled back noticeably of late, while expectations point to this downward trend continuing over the near term.

“That said, for now at least, pockets of resilience are visible on the occupier side of the market, with tenant demand still edging higher across the industrial sector, while the outlook for prime office rents also remains in positive territory (perhaps supported by more sustainable features). Going forward, the broader economic landscape will be crucial in determining how trends across the occupier market unfold from here.