Heartwood Investment Management

31 March 2017

Investment Insight

Weekly Insight

UK commercial property and Brexit

It seems inevitable that the Article 50 trigger sparked a flurry of headlines around several high profile London-based financial institutions relocating to various European cities. While some of this might be bluster as the City vies to retain its leading role in financial services, the primary concern for investors in UK commercial property remains the extent to which occupier demand will be impacted in a post-Brexit world. Risks to the UK market are further accentuated by additional supply pressures, a trend we had been anticipating even before the UK referendum result. New offices are due to come on to the market in London over the next year and this increase in supply is likely to accentuate any downward pressure on rents.

While the supply outlook keeps us cautious on UK commercial property, we are not looking to reduce exposure any further, having already taken profits in late 2015 and early 2016. In the near term, we expect investment activity to remain supported by resilient economic growth and increased interest from overseas investors - factors that have helped to drive UK commercial property's recovery since the negative shock of the UK referendum result. The sector should also find support from the following drivers:

- UK commercial property continues to offer an attractive yield relative to ten-year UK gilts and high quality corporate bonds for income-seeking investors.
- A weak sterling trend is likely to remain in place, given the UK economy has to finance a sizeable current account, and is likely to attract ongoing international investor flows into this market. Overseas investors have been committing capital to the UK market over the past six months, taking advantage of a devalued sterling.
- The transparency and security of the UK market continues to be a strong support to this market.

Notwithstanding a supportive environment in the near term, we believe that UK commercial property could be vulnerable to a slowdown going into 2018. This is when new supply comes on to the market and, as the Brexit negotiations are further along, we could see potentially weaker economic activity.

Against this backdrop, our approach remains targeted and sector-specific. We are exposed to those areas that are less vulnerable to Brexit headline risk, such as key UK regional cities, where supply and demand conditions remain supportive, as well as industrial sites and warehouses. We are also seeking out strategies with longer duration income profiles in alternative sectors. These strategies tend to benefit from long term, inflation-linked tenancy profiles and more attractive valuations than other prime sectors, which may be more sensitive to capital value returns.

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Clear Thinking

Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

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