Autumn 2015

NEWS

News & Views From Rougemont Estates

Welcome to the Rougemont Estates Newsletter

In this latest issue we provide an update on the commercial property market and share our insights for the coming months.

The New Look Jersey Syndicates Retail investment purchase.

The underlying fundamentals for UK property continue to strengthen.

In 2014, UK GDP growth reached 3.0%, the strongest annual increase recorded since 2007. The optimistic news has continued into 2015, with positive growth in Q1 and further improvement in Q2, marking the tenth consecutive quarter of growth.

A positive set of economic factors are underpinning the current growth trajectory. The economy is enjoying a period of low inflation, historically low interest rates, low unemployment and political stability. Companies are positive about their prospects for growth, helped by healthy order books and improved business and consumer confidence.

Powered by a solid UK economic outlook, the last 12 months have seen a marked shift in the UK property market. With increasing business confidence comes a growing appetite for commercial property and we are seeing the fastest rising occupier demand in 17 years. Unsurprisingly, these positive dynamics are resulting in upward pressure on rents. We are now seeing the highest rental growth value since 2007; offices are up 6% year on year, industrial rents up 3.9% and retail up 3.2%. Yields on the highest quality buildings stand at record lows. The Cushman & Wakefield All Property headline average prime yield hardened by 9bps to 4.92% in Q1 2015, with the largest compression seen in the office sector (13bps), followed by retail (8bps), while industrial yields were stable.

The weight of money targeting property is now at its highest level in over 8 years. £65bn was invested in UK property in 2014, the highest level of investment on record and 27% above the ten-year annual average. The trend has continued into 2015, with direct real estate investment in the UK for H1 totalling £30.7bn, 10% above the previous peak in 2006 (JLL Research). The Institutional funds and private equity investors have confidently returned, with these big players increasing their commercial property spend by over 30% year on year. Property funds have seen huge capital inflows from retail investors, attracted to property over other asset classes and, with low Gilt and Bond yields, institutional pension funds are seeking long dated secure income to match liabilities.

Overseas capital also continues to flock to the UK. The first 4 months of 2015 saw £5.4bn of non-domestic purchases of commercial real-estate investments outside London, nearly half the total volume that was seen in 2014 (which was itself a record year for non-domestic investment outside London).

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Where do opportunities lie?

Cushman and Wakefield's most recent report states that the Northern regions are better placed for delivering rental growth than any other region in the UK. The North, North West and Yorkshire & the Humber, are expected to see average rental growth of 5% in Retail, 5.4% in the Office market and 4.2% in Industrial over the next 10 years. With fierce competition for what are, arguably, overpriced long-term investments, we are having to adapt our property search criteria in order to match the income and total returns generated over the last 5 years.

Whilst our focus remains on identifying, wherever possible, long-term leased assets with a strong covenant, a minimum of 10 year income and the opportunity of future enhanced capital value, we also expect to see strong performance from shorter leased assets with 4-5 years unexpired, particularly when in a strong location and where they are set to benefit from rental growth, or, lease renewal/ extension. With confidence returning to the occupier market and positive rental growth mitigating against the shorter number of unexpired years, investors may well wish to consider such opportunities and in so doing accept a slightly higher level of potential risk in order to crystallise best value over the medium to long-term.

Prime Property Investment Yields

	Aug 14	July 15	Aug 15
West End Offices	3.25%	3.00%	3.00%
City Offices	4.50%	4.00%	4.00%
Offices M25	5.25% ↓	5.00%↓	5.00%↓
Provincial Offices	5.25%↓	5.00%↓	4.75%
High Street Retail	4.50%↓	4.25%↓	4.25%↓
Shopping Centres	4.50%	4.25%	4.25%
Foodstores	4.50%	5.15%	5.15%
Industrial Distribution	5.00%	4.75%↓	4.50%
Industrial Multi-lets	5.00%	5.00%↓	4.75%
Regional Hotels	6.50%	5.50%	5.50%

Table Source: Savills

cont. from cover. Investor groups are looking to deploy capital immediately and are turning to the UK regions and secondary stock as they hunt for higher returns in an environment of increasing demand and limited supply. Research from JLL shows investment activity in the "Big Six" regions in 2014 was up 80% on the previous year. For property investors, the sheer weight of money in the market means growing competition for quality office and industrial space. This is helping to fuel growth in the secondary market where there is still room for further rental growth and yield compression.

This is good news for investors who can be more confident in secondary rental growth. The right property will still attract solid tenants and be worth any increased risk. With prime yields now stabilising across most markets, income growth is replacing yield compression as the primary driver of future returns.

However optimistic it may all seem, there are still risks to consider. Whilst the Conservatives securing a majority at the General Election was widely welcomed by the market, uncertainty beckons in the shape of the UK's looming EU referendum. It's also possible that the ultra-low interest rate environment, coupled with the weight of money in the market and the lack of stock, could over-inflate prices and be counter-productive.

Looking ahead, the outlook for UK property is positive. We anticipate that capital will continue to migrate to the regions over the coming year and expect the office sector to be the top performer, primarily driven by rental growth fuelled by lack of stock. A lack of space will be the dominant theme across all sectors, in particular in the industrial sector, with internet retailers driving strong demand and sheds continuing to close the gap on offices.

Rougemont is proud to have sponsored the 1moreChild charity once again, supporting children in Uganda with education and mentoring. Having already cycled from London to Milan over the last three years, Rougemont Managing Director James Craven, recently completed the next four day leg from Milan to Rome co-ordinated by the Ride25 round-the-world cycling challenge. The leg saw James and the Ride25 team climb a gruelling 30,000ft, pedal 450 miles through the Tuscan Hills and raise over £100,000 for 1moreChild.

A tactical approach to investing

Investing in syndicated property continues to be popular. The cornerstone of Rougemont's success to date has been its skill in locating the right type of properties that offer long term secure income returns with the potential for enhanced capital value through either yield shift, an alternative change of use, or an extension to the existing lease terms. In addition, ensuring that our properties have the correct rental value, or are index linked, we continue to ensure that our investors benefit from rental growth, without a lengthy wait.

Our primary objective is to generate a good secure rate of return for investors. We continue to focus on properties that are dependent on the core fundamentals of use, covenant and lease length, and we will only ever present to our investors appropriately researched opportunities that fulfil these important criteria.

Having completed our sixth year in business Rougemont now has over £60m of commercial investment property under management and has recently completed the purchase of its first residential development site having raised funding for the construction of 21 three bedroom houses in the popular North Yorkshire Moors market town of Helmsley. We are extremely grateful to all those clients and professional partners who promote our products and services and we look forward to you sharing in our continued success over the next year.

The following are some of our acquisitions over the last 18 months:

Purchase of a whisky maturation warehouse next to the M8 and Edinburgh airport. A new 15 year lease, incorporating fixed rental increases, to the North British Distillery (a D&B 5A1 rated tenant and a Diageo plc subsidiary). Investor income return 8.70% per annum, paid quarterly, plus capital growth on sale. **Investment value £6,320,000.**

Purchase of a York city centre office let to Lupton Fawcett Denison Till who has been in occupation for 25 years. Investor return 10.00% per annum, paid quarterly, plus the potential of capital growth on sale. **Investment value £1,500,000.**

Purchase of the New Look retail store, in St Helier Jersey, a 13 year unexpired lease, incorporating fixed rental increases, to New Look (a D&B 5A1 rated tenant). Investor income return 8.40% per annum, paid quarterly, plus the potential of capital growth on sale. **Investment value £6,600,000.**

Purchase of a York city centre commercial office let to Siemen plc, subject to a 7 years unexpired lease. Investor return 8.60% per annum, paid quarterly, plus the potential of capital growth on sale. **Investment value £3,520,000.**

Development funding and the purchase of Helmsley residential site with planning permission for 21 three bedroom houses. Investor return 12.50% per annum on investor funding, which is secured by way of first fixed charge. Project timescale 18 - 24 months.

The Rougemont Estates blog, available on the website, provides regular news and insights from the Rougemont team. The blog can be delivered directly to your inbox by subscribing online. You can also follow Rougemont on Twitter - @RougemontEstate

For further information or details of Rougemont Estates investment opportunities please contact the office:
Tel: **01423 877910** or email: **info@rougemontestates.co.uk** **www.rougemontestates.com**
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