APPENDIX D

Economic Commentary provided by local agents Vail Williams

Office Commentary

Receding pandemic restrictions and more employees returning to offices have helped bring about a steady rebound in office leasing in recent quarters. Office take-up reached its highest level in four years in November 2022 and then jumped again in March 2023, following a brief winter lull. Markets like London, Oxford and Cambridge have driven the rebound, while notable deals have been signed in Birmingham, Milton Keynes and Leeds in recent months. The overall demand picture remains subdued, however.

National net absorption remained negative over the past year, as firms continue to release space onto the market. While demand losses were lighter than in 2021, weak demand and rising net deliveries continue to push the national office vacancy rate upwards. It currently stands at 7.6%, its highest level in nearly a decade.

There is 30.3 million SF of new office space under construction nationally, which is a decade high. Much of this space is due to deliver over the next 12 months, which, allied to ongoing subdued demand, should cause the national office vacancy rate to increase further. London's vacancy rate will likely rise more sharply than the national average, given the capital accounts for more than half of office construction underway nationally.

Average asking rents have remained relatively resilient since the pandemic began, supported by continued rent growth at the prime end of the market and by landlords offering more generous incentive packages. Prime buildings should outperform secondary ones in the coming years as firms continue to pivot to better-quality space — to attract staff, welcome clients and meet growing environmental commitments — even as many take less space overall amid a pivot to hybrid working. This should lead to the accelerated removal of older stock. New energy performance regulations that come into force from April 2023 could do likewise.

Supply-constrained markets with a strong TMT, life science or professional services demand base and a highly educated workforce have outperformed during the pandemic and should continue to do well over the forecast. The likes of Bristol, Cambridge and Edinburgh fall into this category, with markets such as Milton Keynes, Brighton and Leeds also likely to fare relatively well.

UK office investment slumped to its lowest level in more than a decade in Q4 2022 and picked up only mildly in Q1 2023. Rising interest rates and market volatility have cooled momentum built up in the opening months of the year, when a host of blockbuster deals in London, Cambridge and the “Big Six” regional cities threatened to make 2022 a record year.

Prime yields for major regional cities (single let, 15 years) currently stand at 5.75%, a softening from May 2022 where they were between 4.50% - 5.00%. Multi-let offices with a WAULT of 5 years are attracting yields of between 6.50% - 7.00%, whereas good secondary office investments in regional cities are attracting yields of 9.50%.

Deteriorating sentiment, higher borrowing costs and weakening fundamentals are likely to continue to weigh on office prices in the coming months, although the market should be cushioned to an extent by the relative lack of debt when compared with the 2008 crisis.

Industrial Commentary

The main driver for the UK industrial and logistics property market is the rapid rise of e-commerce, which fuels demand for warehousing and distribution accommodation and for regional and local delivery centres. The Coronavirus pandemic placed an even greater focus on home shopping/home delivery and the supply chain for food and other key goods.

Despite a decline in UK manufacturing over the last 40 years, the UK manufacturing sector remains a significant and important part of the economy and a major factor in the industrial/logistics market. The UK is the ninth largest manufacturing nation in the world, employing 2.7m workers and accounting for 11% of UK GVA.

Flash UK manufacturing purchasing managers’ index (PMI) dropped to 46.9 in May 2023 from 47.8 in the previous month, and below market expectations of 48, a preliminary estimate showed. The latest reading

pointed to the steepest deterioration in the manufacturing sector for five months, as output declined for a third consecutive period due in part to subdued order books and customer destocking. New orders fell at a faster pace, with exports declining the most in four months, amid subdued global demand, Brexit-related trade headwinds, and intensifying competition for new orders in overseas markets.

The value of goods imports decreased by £1.4 billion (2.8%) in March 2023; after removing the effect of inflation, imports of goods fell by £0.8 billion (2.1%). The value of goods exports decreased by £0.7 billion (2.3%) in March 2023; after removing the effect of inflation, exports of goods fell by £0.7 billion (2.7%). The monthly falls in both imports and exports of goods were primarily because of decreases in trade with non-EU countries, while trade with the EU remained stable.

According to the latest monthly Confederation of British Industry industrial trends survey Manufacturing output volumes fell modestly in the three months to May (weighted balance of -10%, from -15% in the three months to April) and are expected to fall moderately again in the three months to August (-5%), ending four consecutive months of positive expectations. Output fell in 9 out of 17 sub-sectors in the three months to May. The decrease was driven by the motor vehicles & transport equipment, chemicals, and food, drink & tobacco sub-sectors. Total order books were reported as below "normal" in May, to a broadly similar extent as in April (-17% from -20%) and were marginally weaker than the long-run average (-13%). Export order books were also seen as below normal, but to a greater extent than last month (-26% from -9%) and were also below average (-18%).

Anna Leach, CBI Deputy Chief Economist, said: Our latest survey suggests the recent pressures on manufacturing activity have so far persisted through the second quarter. Sentiment continues to deteriorate and expectations for output growth in the coming three months have turned negative, which doesn't suggest UK manufacturing is poised to recover any significant momentum in the near-term. "With demand subdued and the outlook for costs improving, manufacturers expect growth in their selling prices to slow, which should feed through to measures of inflation over time''.

The full impact of the increase in tighter border controls as result of Brexit is still unfolding but indications so far are that there are longer delays at UK entry points. It is possible that these delays, if they become permanent will impact upon supply chains and therefore also affect the locational requirements of logistics operators.

The UK Commercial Property Market Survey published by the RICS for Q1 2023 The results of the Q1 2023 RICS UK Commercial Property Monitor remain generally subdued as the market continues to contend with higher borrowing costs and a sluggish economic growth outlook. That said, the overall tone to the latest feedback is not as downbeat as last quarter. Indeed, the industrial sector in particular has shown renewed momentum, evidenced by near-term capital value expectations turning marginally positive following the sharp downward adjustment seen at the end of last year as bond yields jumped higher. Overall, although 50% of respondents feel conditions are consistent with a downturn phase of the property cycle, respective shares of 25% and 21% now feel the market has either reached a floor or has begun to turn up (9% and 5% in Q4). The industrial sector saw a pick-up in occupier demand, registering a net balance of +16% vs +6% in Q4. During the quarter current availability dipped marginally for industrials.

Whilst there remains a good level of demand and of activity in many local industrial markets there has been an adjustment to prime yields, which will feed through to the other segments of the market. The continuing impact of external factors, in particular interest rate uncertainty, rising energy prices, cost of living and the impact of a European war, will continue to affect the market through changes in consumer demand, rises in production costs and a squeeze on profits. Commentators are predicting that the peak of the market has been passed and that there is an expectation that yields will continue to move upwards over the coming months.