RESEARCH

EPMR

Economic & property market review

Autumn 2019

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Economic Trends

Political uncertainty continues to dominate the UK economic outlook with the direction of Brexit now dependent on the outcome of another General Election. This comes as the parliament refused to ratify the reworked withdrawal agreement ahead of 31st October. Consequently, the Brexit deadline has once again been pushed further down the road to 31st January 2020.

Growth

UK GDP returned to growth in Q3 increasing by 0.3%, up from the 0.2% contraction during Q2. GDP growth was predominantly driven by growth in the service sector, particularly in July. Growth in the construction sector also improved during this period. However, monthly data for September alone saw GDP growth decline by 0.1% with weakness across all three sectors.

Confidence Survey

The Markit / CIPS Purchasing Managers Indices average across the services, manufacturing and construction sectors reported a modest increase but remained below the crucial no-change 50 threshold. The latest manufacturing PMI index showed stockpiling recommenced in the lead up to the October Brexit deadline, although not enough to pull the manufacturing index into the expansionary territory. The outlook in the service sector improved slightly compared to September as businesses expect Brexit to be resolved early 2020, however sentiment remains weak. The construction sector remained firmly below the 50 no-change threshold.

Labour market

The unemployment rate fell back to 3.8% from July to September, down from 4.1% a year earlier. The total number of employees in employment totalled 32.8 million, up 323,000 compared to the previous year but fell by 58,000 when compared to the previous quarter. Pay growth in real terms increased by 1.8% including bonuses and 1.7% excluding bonuses compared to a year earlier. The slight slowdown in employment and pay growth are perhaps early signs of a slowing labour market.

Inflation and interest rates

CPI inflation fell to 1.5% in October, down from 1.7% in September. Inflation is expected to remain below the Bank of England's 2% target for 2019 and 2020. As widely anticipated the Bank of England held the bank rate steady in November however, on-going Brexit related uncertainty and a weaker global economic backdrop indicate looser policy going forward with two members voting for an immediate cut by 25 basis points. Several Central Banks have already cut their rates, including the Fed and European Central Bank in order to encourage growth.

Outlook for growth

GDP outlook for 2019 remains subdued at 1.2% for this year, reducing to 1% in 2020 amid persistent Brexit uncertainty and a less favourable global outlook with ongoing global trade tensions and a slowdown in the global economy potentially adding further stress to the UK economy. Whilst the forthcoming General Election will be fundamental to the direction of Brexit, the likelihood of a no-deal outcome has reduced considerably. The path Brexit takes is particularly uncertain under a hung parliament outcome, however we expect the UK to eventually leave the EU with a Brexit deal in place. Although another delay to Brexit will further deteriorate confidence in the economy in the short-term.

The Treasury consensus has now downgraded its 2019 forecast for economic growth to 1.3% and remained at 1.4% for 2020.

LATEST CONSENSUS FORECASTS, OCTOBER 2019

	2019	2020	25-year trend
Economic growth (GDP)	1.2%	1.0%	2.5% pa
Private consumption	1.4%	1.3%	
Employment growth	1.1%	0.4%	0.7% pa
Bank Base Rate (Q4)	0.76%	0.82%	
CPI – Inflation (Q4)	1.8%	2.2%	
RPI – Inflation (Q4)	2.5%	2.8%	

Source: HM Treasury (Compilation of forecasts, Avison Young)

2019 ECONOMIC GROWTH FORECASTS

Source: HM Treasury and IMF

KEY STATS

0.3% ▲
Q3 GDP growth

PMI INDEX WEIGHTED AVERAGE

SEPTEMBER **49.0** ▲ OCTOBER **49.6**

UNEMPLOYMENT RATE

3.8%

REAL EARNINGS GROWTH

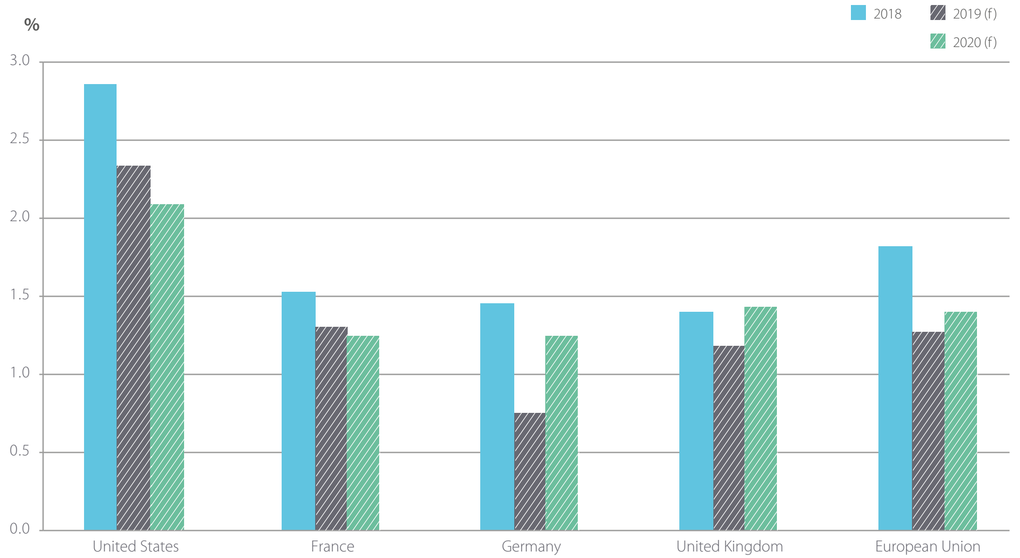
1.8% (INCLUDING BONUSES)

1.7% (EXCLUDING BONUSES)

CPI INFLATION **1.5%**

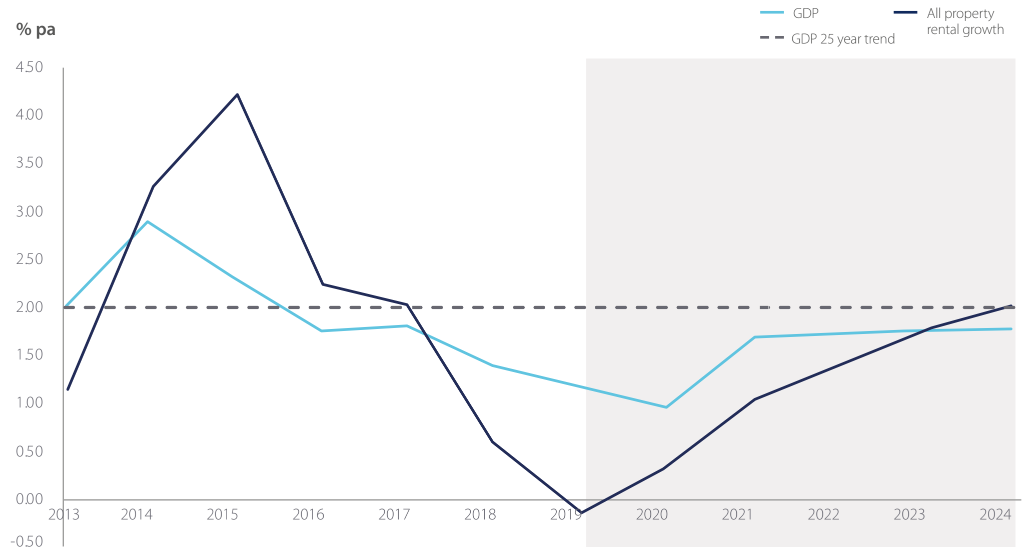
BANK RATE **0.75%**

GLOBAL ECONOMIC GROWTH



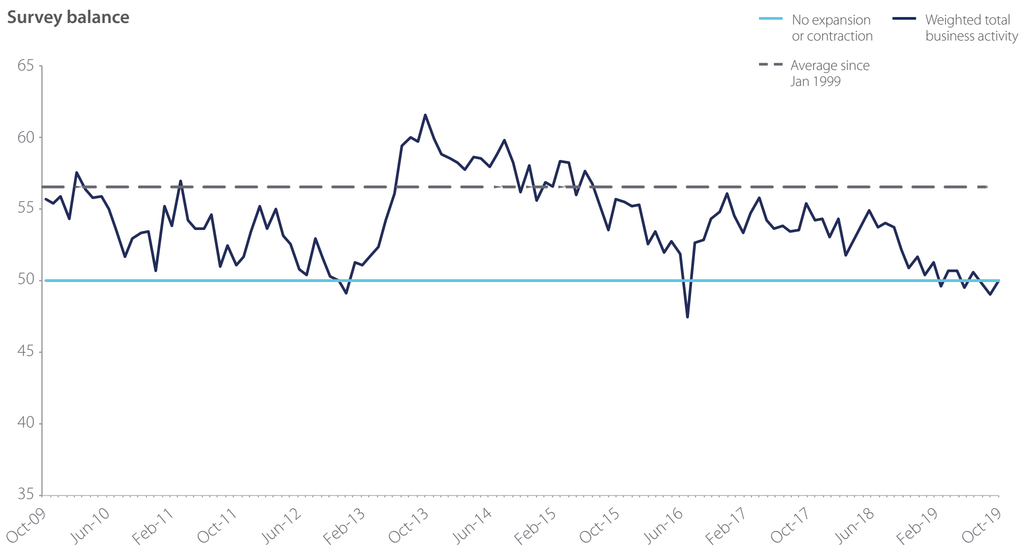
Source: IMF

GDP AND ALL-PROPERTY RENTAL GROWTH FORECAST



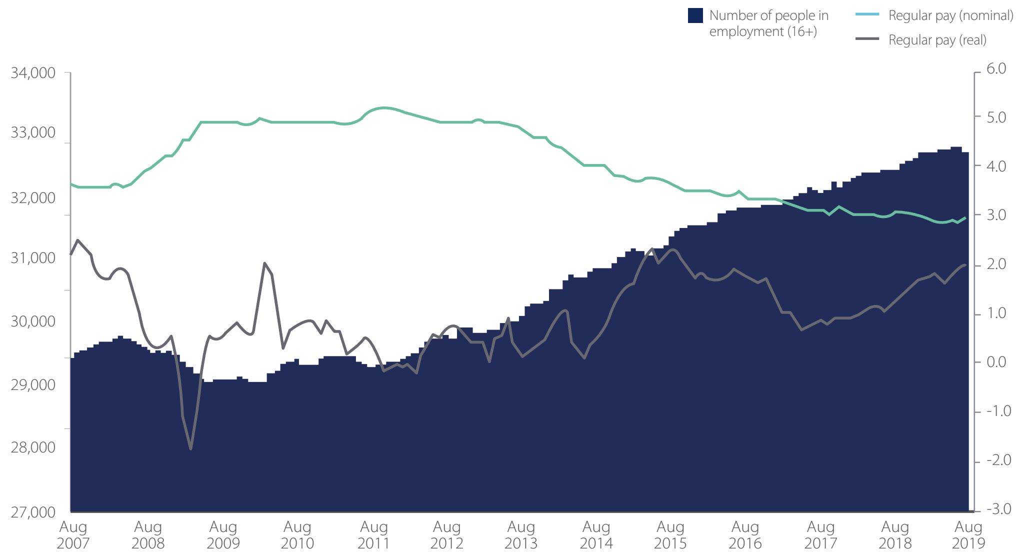
Source: Experian, HM treasury consensus, MSCI, REF and Avison Young

PURCHASING MANAGERS' SURVEY



Source: Markit & CIPS

EMPLOYMENT AND AVERAGE WEEKLY EARNINGS ANNUAL GROWTH RATES



Source: Experian, HM treasury consensus

Occupier market

Supply

The annual level of new construction orders across the retail, office and industrial sectors improved by almost 8% year-on-year but remains well below the 20-year trend. In the office sector and industrial sector constrained supply remains a common theme whilst availability in the retail sector has risen sharply.

Demand

Take up in the **Central London office market** totalled 3.3 million sq ft in Q3 2019, up 29% on the 10-year average despite uncertainty during the run-up to Brexit. Strong activity in the 50,000 sq ft + size bands has largely driven the market and demonstrates commitment from high profile occupiers. The serviced offices sector accounted for the highest proportion of take-up across Central London at 31%. This represented a large increase in serviced office take-up on previous quarters, significantly above the 15% recorded for Q2 2019 and equating to just over 1 million sq ft. WeWork were the largest acquirer of space in Q3 with 11 deals, although this will clearly drop off for year-end following their announcement of a hold on leasing activity.

The **Big Nine office markets** continue to attract large inward investment and relocation deals, boosting take-up during the third quarter. Take-up totalled 2.1 million sq ft during Q3, just above the ten year quarterly average. Although this is significantly short of the record levels of the last two years it is at a similar level to the referendum year 2016, the last time the market was so affected by political uncertainty. The second half of the year tends to show stronger activity but Brexit has impacted on occupier decisions this quarter, particularly for small to medium sized deals.

The on-going challenges in the **retail** market remain a prominent theme, with Mothercare UK the latest casualty to the structural shift towards online shopping. The retailer also faced increased competition from supermarkets and failed to create an experiential retail offer which has become essential for success on the high street. The decline in tenant demand has led to a fall in average all-retail rental values by -4.7% in the 12 months to October, down from 1.1% a year earlier (MSCI Monthly Index).

Demand for the **industrial** sector on the contrary continued to rise, albeit at a slower pace. The sector continues to be underpinned by the growth in e-commerce. However, the slowdown in the global economy as well as Brexit uncertainty has weighed in. Average rental growth increased by 3.4% in the 12 months to October (MSCI Monthly Index), whilst robust it's a slowdown from the circa 4% pa growth seen in the previous three years.

Outlook

Any continuation of the delay to Brexit is likely to exacerbate the caution seen in some occupier markets during Q3. A positive decision will likely see an improvement in business sentiment, decision making and a reawakening of pent-up demand.

Supply remains constrained in many markets with the exception of retail. As a result, we expect rental growth to remain robust in the industrial sector albeit a slowdown from the circa 4% pa growth over in the previous few years. Offices on average are also expected to see healthy rental growth in line with inflation, particularly in prime locations. Overall, we expect all property rental growth to decline by 0.1% this year before returning to positive growth of 0.4% in 2020. This is largely due to the poor performance in the retail sector which remains a structural one.

ALL PROPERTY RENTAL VALUE GROWTH FORECASTS

	2019	2020
IPF Quarterly Consensus (September 2019)		
Maximum	1.0%	1.0%
Minimum	-1.9%	-3.8%
Average	-0.2%	-0.1%
Avison Young (November 2019)	-0.1%	0.4%

Source: IPF, REFL, Avison Young)

KEY STATS

ANNUAL ROLLING VALUE OF NEW CONSTRUCTION ORDERS

£10.3 billion

Q3 TAKE-UP LEVELS

CENTRAL LONDON OFFICES

3.3m sq ft

'BIG NINE' REGIONAL OFFICES

2.1m sq ft

ANNUALISED AVERAGE RENTAL GROWTH

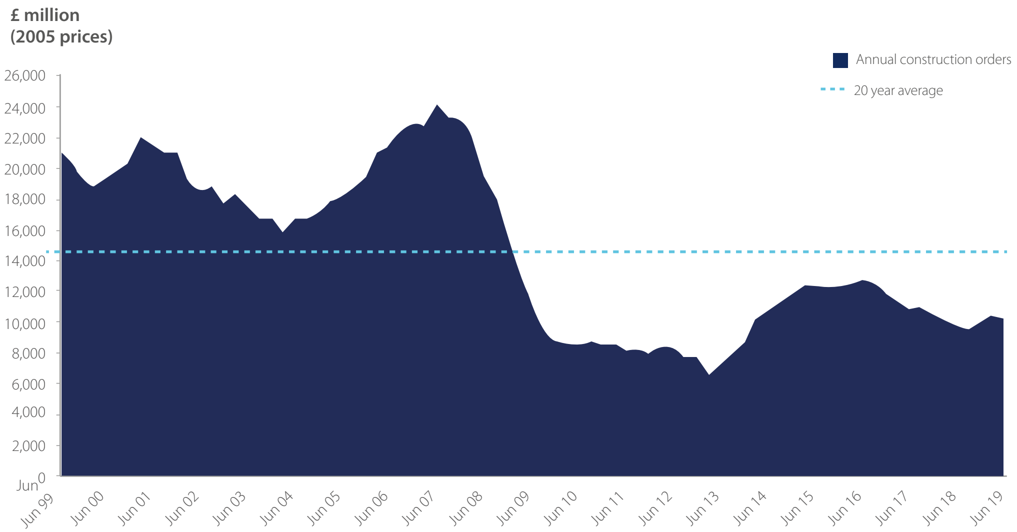
ALL-PROPERTY **-0.1%**

OFFICES **1.8%**

RETAIL **-4.7%**

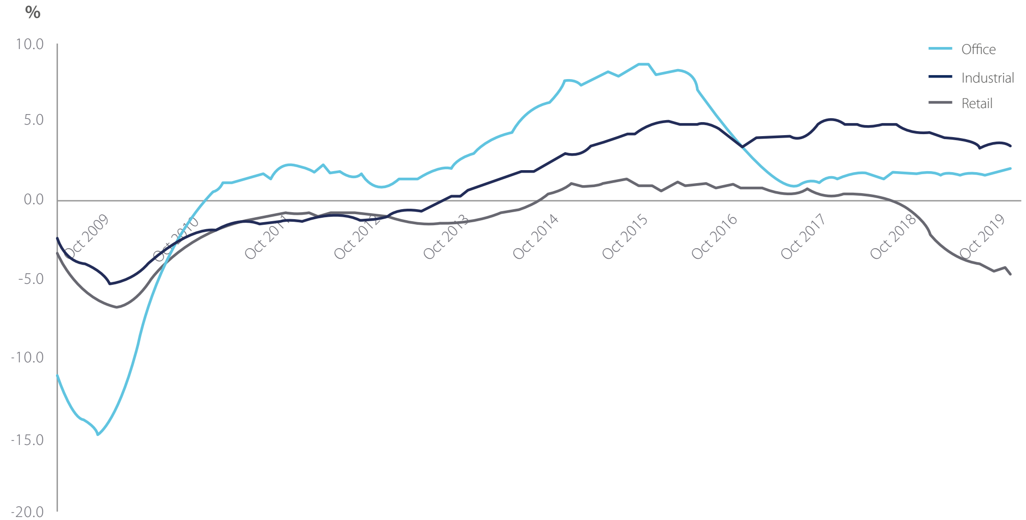
INDUSTRIAL **3.4%**

NEW CONSTRUCTION ORDERS (DEVELOPMENT ACTIVITY) RETAIL, OFFICE AND INDUSTRIAL



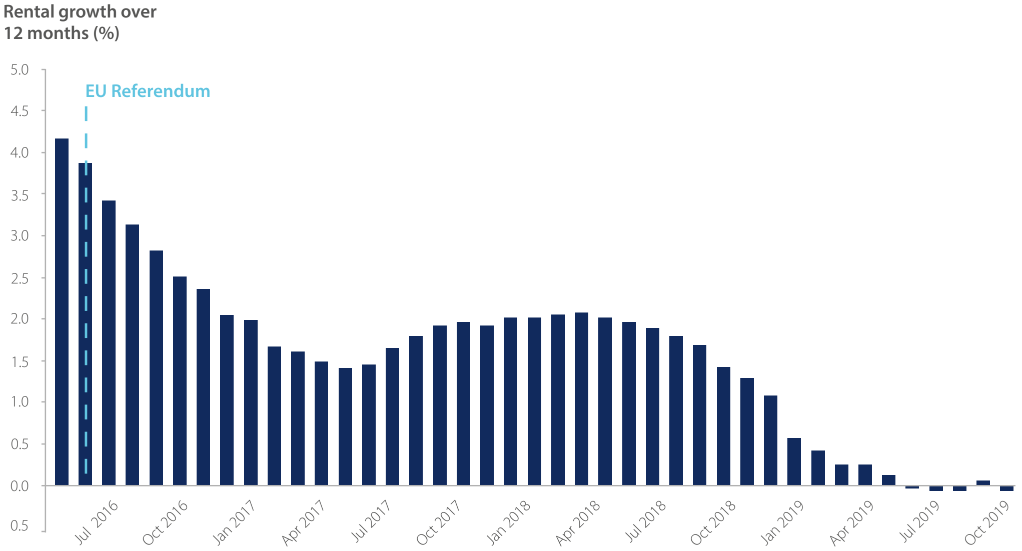
Source: ONS

AVERAGE ANNUAL RENTAL GROWTH



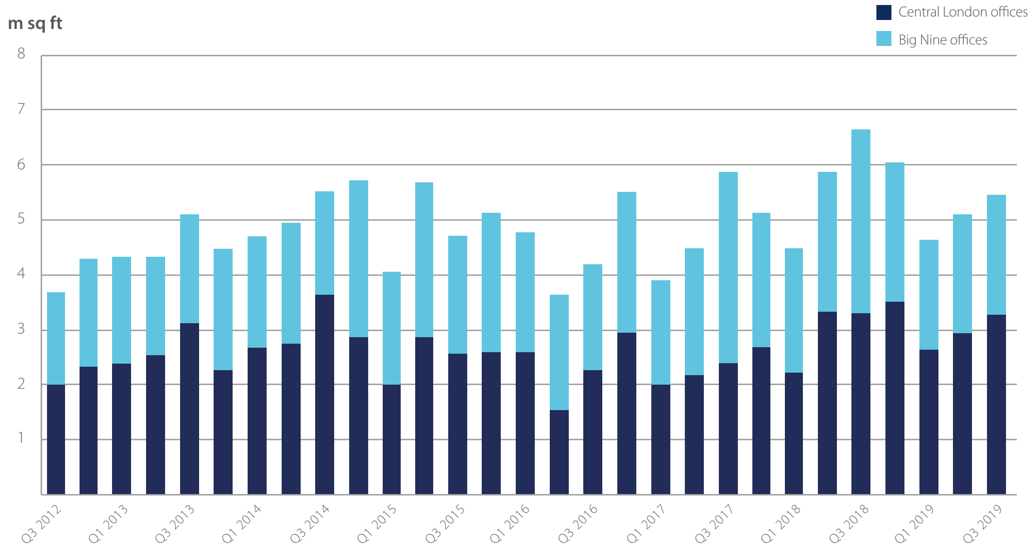
Source: MSCI Monthly Index

AVERAGE ALL-PROPERTY ANNUAL RENTAL GROWTH



Source: MSCI Monthly Index

QUARTERLY OFFICE TAKE-UP IN CENTRAL LONDON AND THE 'BIG NINE'



Source: Avison Young

Investment

Investor demand

Investment activity in the UK commercial market picked up by 42% during Q3 2019, compared to the Q2 2019. However, on a 12 month rolling basis activity dropped by 20% but remains in line with the 10-year average. Brexit uncertainty picked up ahead of the October Brexit date and investors have been more cautious.

Whilst overseas investors remain dominant purchasers in the UK commercial real estate market their activity decline by a third during Q3 2019 when compared to a year earlier.

However, there has been a noticeable increase from US investors during Q2 and Q3, above the 10-year quarterly average. European investment activity was fairly subdued during the first half of the year but picked up during Q3, 22% above the 10-year quarterly average.

Recent performance

The average all-property equivalent yield has drifted upwards throughout 2019 standing at 5.9% in October 2019 (MSCI Monthly Index). At sector level, the retail sector saw the sharpest increase in average equivalent yields, rising to 6.6% in October 2019 compared to 6% a year earlier. Whereas, average equivalent yields in the industrial and office sector hardened marginally over the same period.

Average all-property capital continued to decline this year, contracting by 2.6% in the year to October. This is mainly due to sharp falls in the retail sector however growth has also slowed across the office and industrial sectors albeit capital growth for prime assets remains robust. Consequently, total returns have slowed to circa 2.5% over the year.

Outlook

Investment activity has waned amid the Brexit impasse. Despite this, a host of buyers remain in the market with considerable amounts of capital to invest. A reduction in the Brexit-related uncertainty early next year could see demand pick up, primarily in the industrial and office sectors. Challenges in the retail sector are likely to remain in the year ahead and we thereby expect capital values to deteriorate further.

We expect average all-property equivalent yields to continue to drift upwards given the stress from the retail sector. However, the softer stance by Bank of England suggests there's a possibility of an interest rate cut next year, particularly if the economy remains engulfed in Brexit-related uncertainty or global slowdown persists. The immediate effect of prolonged uncertainty from the Brexit extension will add further pressure on the yields in the near term although, lower interest rates may moderate the pace of property yields rise over the medium term.

Q2 VOLUMES BY REGIONS

- London **£4.1 billion**
- East of England **£873 million**
- East Midlands **£352 million**
- North East **£95 million**
- North West **£534 million**
- Scotland **£717 million**
- South East **£721 million**
- South West **£531 million**
- Wales **£311 million**
- West Midlands **£874 million**
- Yorks & Humber **£781 million**
- Northern Ireland **£15 million**

KEY STATS

ANNUAL ROLLING INVESTMENT TRANSACTIONS VALUE

£50.7 billion

Q2 VOLUMES BY INVESTOR TYPE

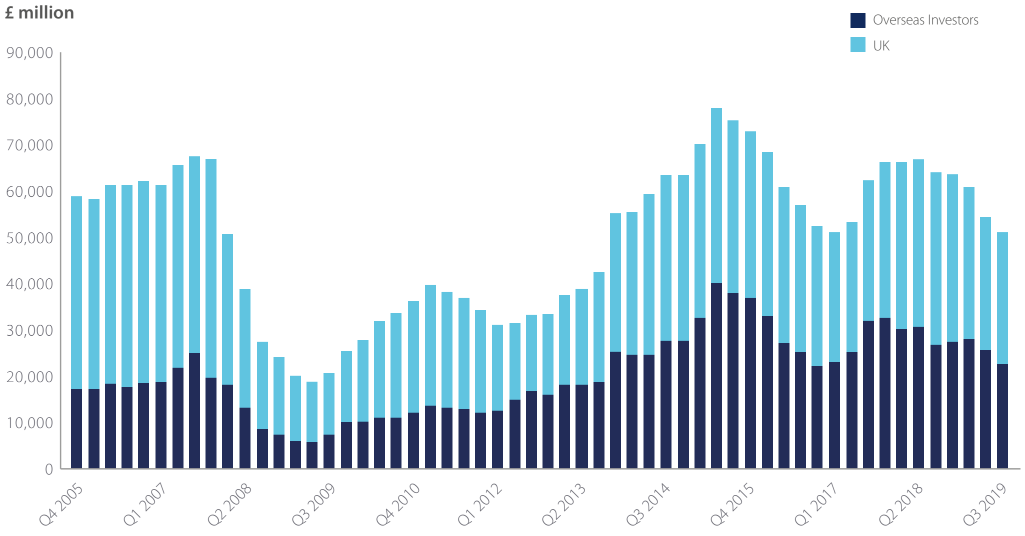
OVERSEAS INVESTOR	UK INSTITUTION	UK PROPERTY COMPANY
39%	16%	33%

ALL-PROPERTY EQUIVALENT YIELDS

5.9%

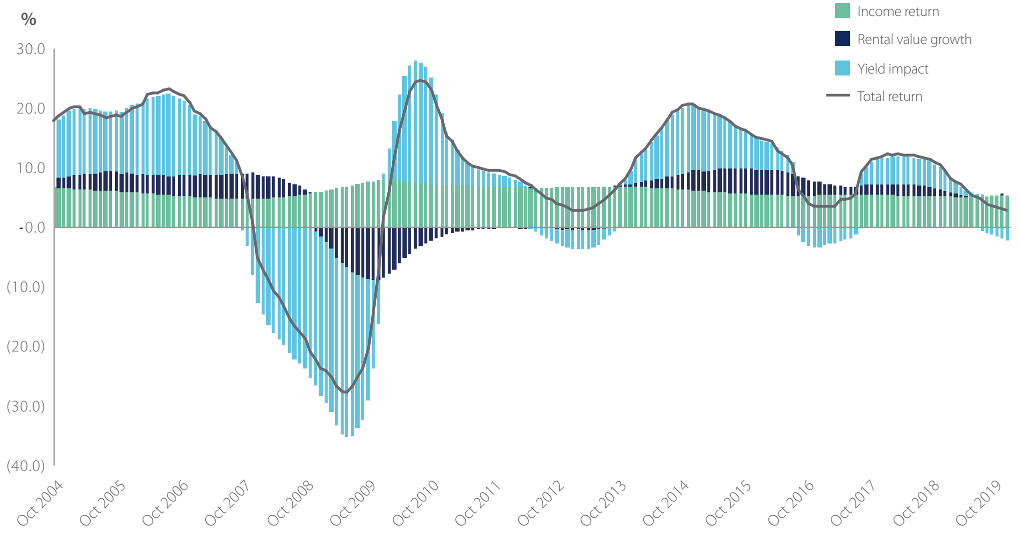
ANNUALISED ALL-PROPERTY TOTAL RETURN	ANNUALISED ALL-PROPERTY CAPITAL GROWTH
2.5%	-2.6%

ROLLING ANNUAL INVESTMENT TRANSACTION VOLUMES



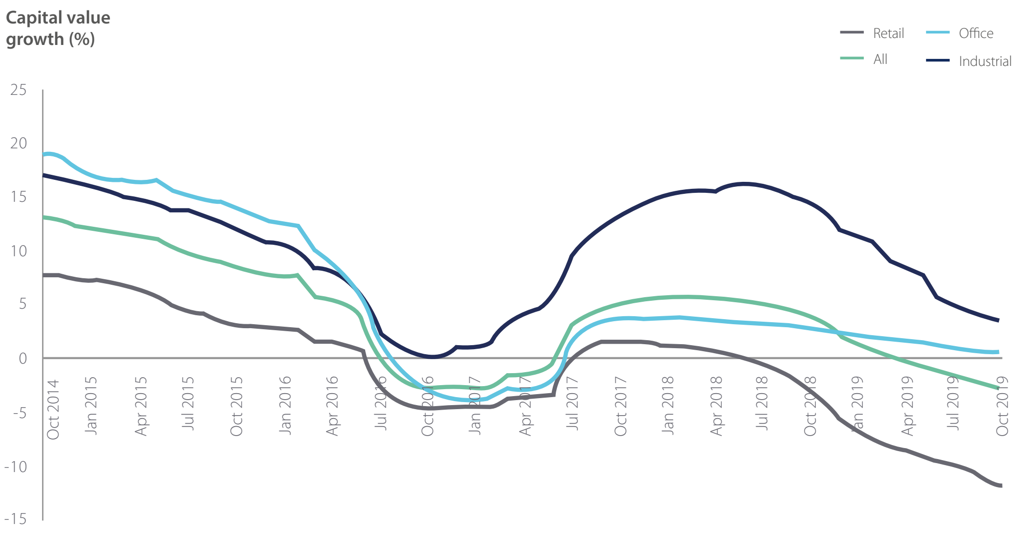
Source: Property Data

ALL PROPERTY ANNUAL TOTAL RETURN



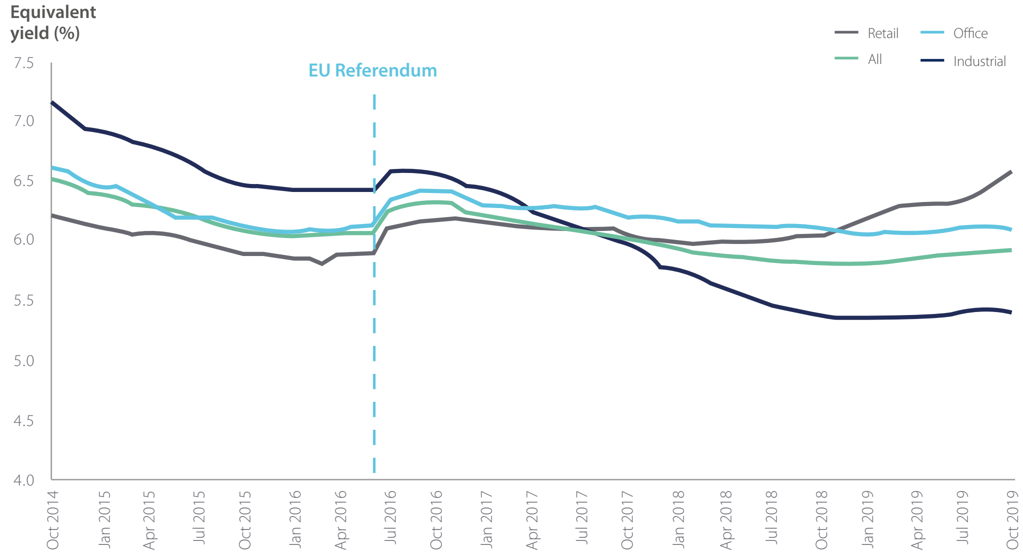
Source: MSCI Monthly Index

ANNUALISED CAPITAL VALUE GROWTH



Source: MSCI Monthly Index

AVERAGE EQUIVALENT YIELDS



Source: MSCI Monthly Index

Should you wish to discuss any details within this update please get in touch.

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