RESEARCH

EPMR

Economic & property market review

Winter 2019-2020

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Economic Trends

The UK has now entered the next phase of negotiations, following the official departure from the European Union on January 31st 2020. Whilst uncertainty around the timing of Brexit has lifted, there remains a high level of uncertainty clouding the economic outlook beyond 2020. The transition period expires in December 2020 which means the cliff-edge possibility of a 'no-deal' type scenario (reverting to World Trade Organization rules) remains a risk at the end of the year. This is likely to curb any significant improvement in business confidence.

Growth

UK GDP growth flatlined in Q4 2019, albeit preliminary figures indicate annual GDP growth for 2019 was 1.4%. Whilst post-election data has been limited, there have been early signs of a pick-up in optimism following the landslide election victory by Boris Johnson. The 'Boris Bounce' is most evident among consumers, with the GfK consumer confidence index jumping to -9 in January 2020, up 2 percentage points from December and marking the second consecutive month of improvements. Sentiment has also picked up amongst businesses.

Confidence Survey

The Markit / CIPS Purchasing Managers Indices average across the services, manufacturing and construction sectors jumped up to 53.1 in January, back into positive territory following five consecutive months below the crucial 50 no-change threshold. There was a notable recovery in the service sector and new client demand picked up as business and consumer sentiment lifted. The manufacturing sector posted a neutral 50 following improved confidence and new orders. The construction index also rebounded, however remains below the 50 mark.

Labour market

The labour market remained buoyant for much of last year with the employment rate reaching a record high of 76.3% at the end of 2019. The total number of employees in employment was a record 32.9 million, up 359,000 compared to a year earlier and the majority of the growth was driven by full-time employment.

At the same time, inflation eased to 1.3% in December resulting in 1.8% increase in real wages (excluding bonuses) for the third consecutive month. However, forward looking indicators suggest the job market is cooling.

Inflation and interest rates

Inflation weakened sharply in the second half of 2019, falling to 1.3% in December. This is the lowest level since November 2016 and the fifth consecutive month when the rate has been below 2.0%. Inflation has been minimal due to lower oil and gas prices. The Bank of England (BoE) kept interest rates on hold at 0.75% following more upbeat flash PMI and labour market data in late January 2020. We expect the Bank of England to continue to monitor post-election data closely, with a potential cut in rates in the coming months if a 'Boris bounce' does not materialise and labour market growth softens.

Outlook for growth

Politics, in particular future trade negotiations, will be a key driver for the economic outlook in 2020. Although businesses now appear to be applying less risk to Brexit, they remain wary of the potential headwinds facing the UK. Recent comments from Boris Johnson suggest the UK's strategy is to aim for a Canada style agreement, rather than a closer Norway style relationship with the EU.

Last Autumn, the government announced austerity had come to an end, with the election comprising a raft of spending pledges at the end of last year. We expect the fiscal stimulus package, to be announced on 11th March, to include increased infrastructure expenditure which will support activity over the year ahead. The latest Treasury consensus forecasts expect 1.1% economic growth for 2020.

LATEST CONSENSUS FORECASTS, JANUARY 2020

	2019	2020	25-year trend
Economic growth (GDP)	1.3%	1.1%	2.5% pa
Private consumption	1.2%	1.3%	
Employment growth	1.2%	0.5%	0.7% pa
Bank Base Rate (Q4)	0.76%	0.73%	
CPI – Inflation (Q4)	1.5%	1.8%	
RPI – Inflation (Q4)	2.2%	2.5%	

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

2020 ECONOMIC GROWTH FORECASTS

UK **1.1%**

WORLD **3.4%**

EUROPEAN UNION **1.6%**

Source: HM Treasury and IMF

KEY STATS

GDP GROWTH

0% ▼ Q4 2019

1.4% ▲ 2019

PMI INDEX WEIGHTED AVERAGE

JANUARY **53.1** ▲

DECEMBER **49.4**

UNEMPLOYMENT RATE

3.8%

REAL EARNINGS GROWTH

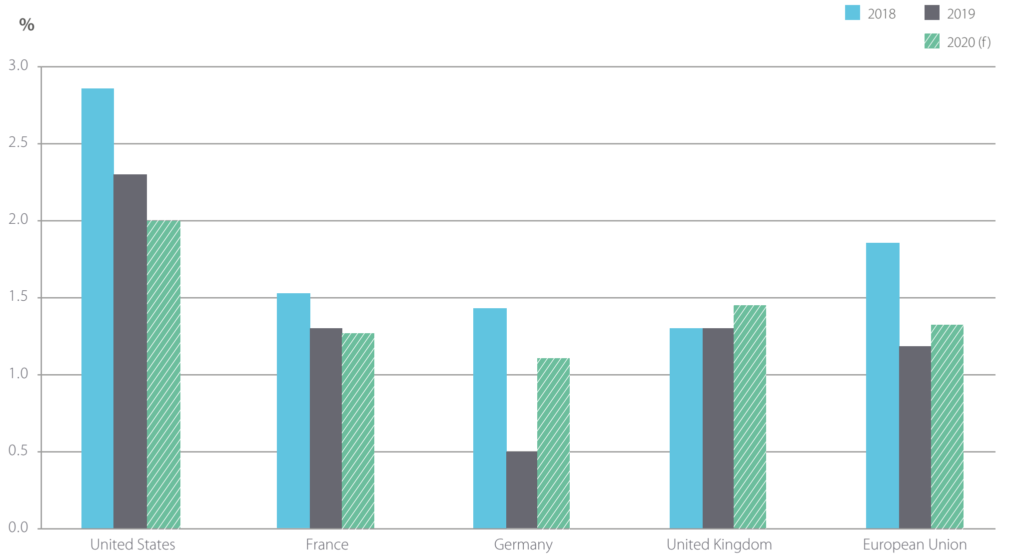
1.6% (INCLUDING BONUSES)

1.8% (EXCLUDING BONUSES)

CPI INFLATION **1.3%**

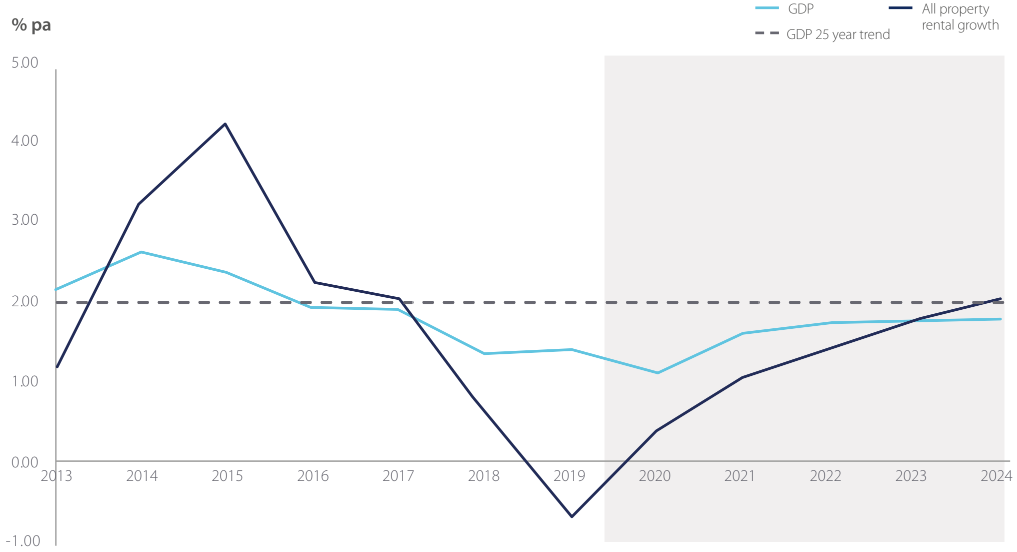
BANK RATE **0.75%**

GLOBAL ECONOMIC GROWTH



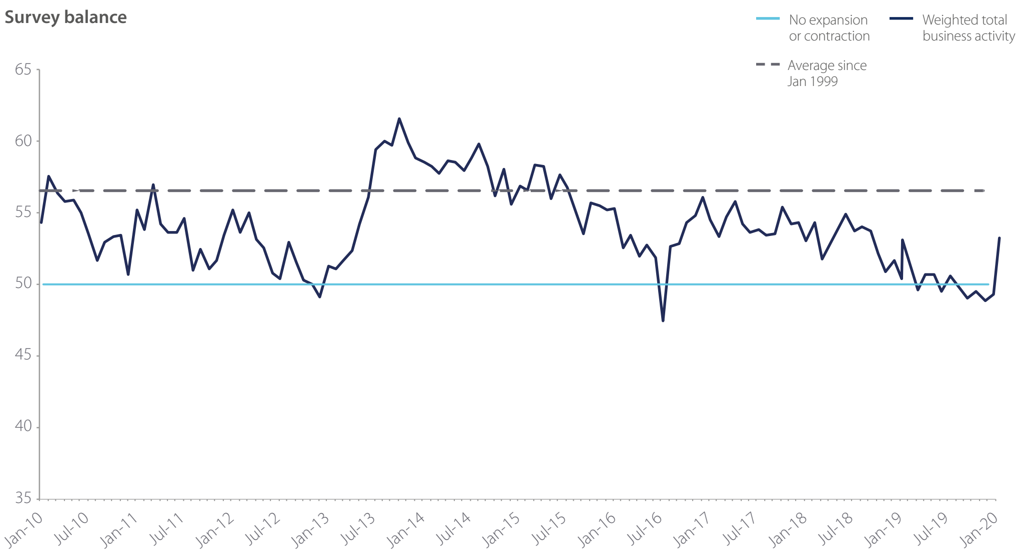
Source: IMF

GDP AND ALL-PROPERTY RENTAL GROWTH FORECAST



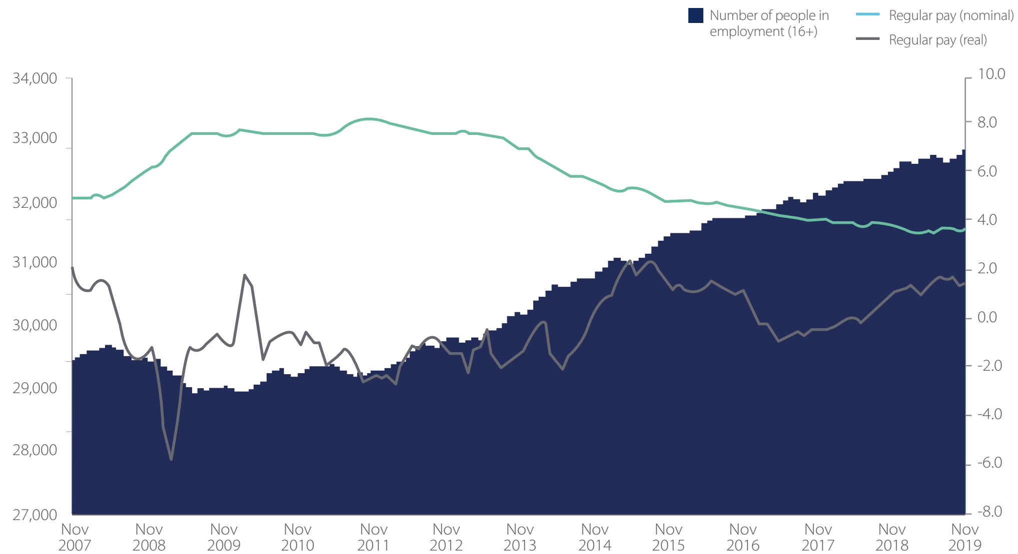
Source: Experian, HM treasury consensus, MSCI, REF and Avison Young

PURCHASING MANAGERS' SURVEY



Source: Markit & CIPS

EMPLOYMENT AND AVERAGE WEEKLY EARNINGS ANNUAL GROWTH RATES



Source: Experian, HM treasury consensus

Occupier market

Supply

New construction orders across the retail, office and industrial sectors fell for the second quarter in Q3 2019, albeit were up 4% year on year. More recently, the Markit / CIPS construction activity survey, covering all construction activity, jumped up to 48.4 in January. Whilst the index remains below the crucial 50 no-change threshold, the pace of contraction has softened. Residential activity led the recovery however, survey respondents expect commercial projects to pick up as political uncertainty dissipates somewhat.

The Central London office development pipeline continues to be starved of Grade A supply and under construction space remains in very high demand. Throughout 2019, 3.3 million sq ft of stock was pre-let in 47 separate transactions. There is also substantial pre-letting activity in the Big Nine office markets, where the supply position has remained relatively constant over the past two years. There is 5.8 million sq ft of space under construction across the Big Nine, 56% of which is already pre-let.

Demand

Central London office take-up totalled 12.3 million sq ft in 2019, following a strong performance in Q4. This is one of the strongest years on record and only just surpassed by 2018's 12.5 million sq ft. The limited supply and high demand has placed considerable pressure on rental levels throughout Central London. Rents for the most sought after spaces in the City continue to surpass previous benchmarks and in some instances achieve levels comparable to the West End.

Total take-up across the **Big Nine office** markets amounted to 8.8 million sq ft in 2019, 3% above the ten year average albeit below the 10 million sq ft achieved in the previous two years. The heightened uncertainty surrounding Brexit and false deadlines resulted in the total being down on the previous two years but comparable to 2016.

The **serviced office sector** has entered its next stage of maturity and settled as a more manageable feature of the London office market following WeWork's failed IPO launch. The movement away from quantity of locations towards quality of provision follows from similar trends in the conventional office market a year ago. In the Big Nine flexible office market, 2019 was a record year of activity, accounting for 14% of take-up and the third year of strong demand in succession. Much of this activity however was in the first half of the year, with the largest deals to WeWork, Spaces and Instant Offices Group. Evidence from the second half of the year suggests activity has begun to plateau in this sector.

The **retail** market is unlikely to benefit from the improvement in sentiment witnessed elsewhere in the economy. Its problems remain structural, with the Centre for Retail Research estimating over 143,000 jobs losses in 2019 as a result of more than 16,000 stores closing. Unfortunately 2020 is unlikely to be much different as job losses and closures are expected to rise by 20% and 9% respectively in the year ahead. Consequently, average retail rental values fell by 5% in 2019, down from -2.2% in 2018 (MSCI Quarterly Index).

Demand for **industrial** space remains resilient, albeit there has been a notable slowdown compared to the previous two years. The latest RICS Commercial Property Market Survey reported a modest reduction in availability of industrial space, which continues to place pressure on rents particularly in prime locations. However, average rental value growth slowed to 2.8% in 2019, compared to 4.6% in the year prior. Across the industrial sector, we expect rents to rise by almost 3% in 2020, with those in prime locations achieving growth closer to 4%.

Outlook

Clarity on the timing of Brexit, and the looser fiscal policy stance has resulted in a modest improvement on the outlook for 2020. According to the RICS commercial property survey, the alleviation of political uncertainty is likely to release some pent-up activity which was awaiting outcome of the general election. In 2019, all-property average rental values fell by 0.7% (MSCI Quarterly Index) which is set to improve to 0.4% in 2020.

ALL PROPERTY RENTAL VALUE GROWTH FORECASTS

	2019	2020
IPF Quarterly Consensus (November 2019)		
Maximum	0.9%	1.0%
Minimum	-2.1%	-3.8%
Average	-0.2%	-0.2%
Avison Young (February 2020)	-0.1%	0.4%

Source: IPF, REFL, Avison Young)

KEY STATS

ANNUAL ROLLING VALUE OF NEW CONSTRUCTION ORDERS

£9.7 billion

Q4 TAKE-UP LEVELS

CENTRAL LONDON OFFICES

3.3m sq ft

'BIG NINE' REGIONAL OFFICES

2.2m sq ft

ANNUALISED AVERAGE RENTAL GROWTH

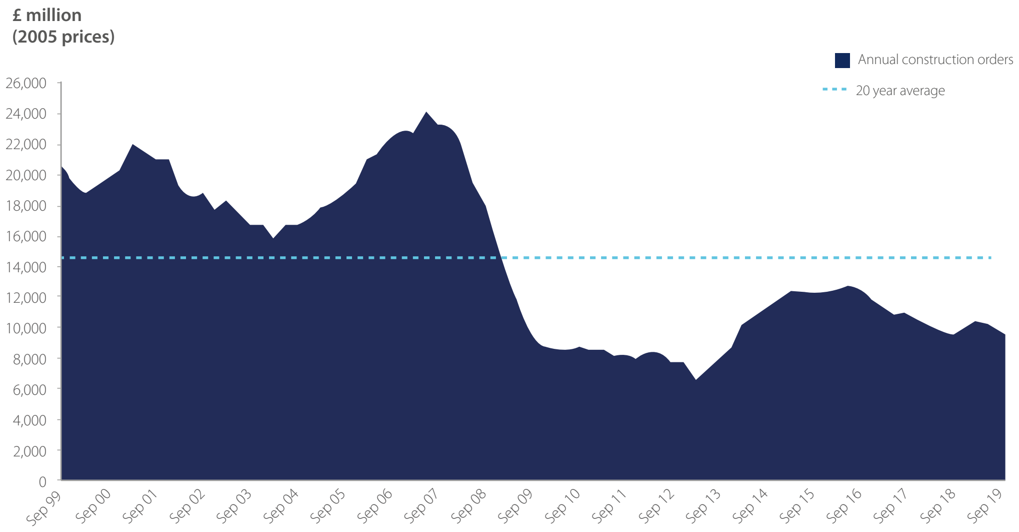
ALL-PROPERTY **-0.7%**

OFFICES **1.4%**

RETAIL **-5%**

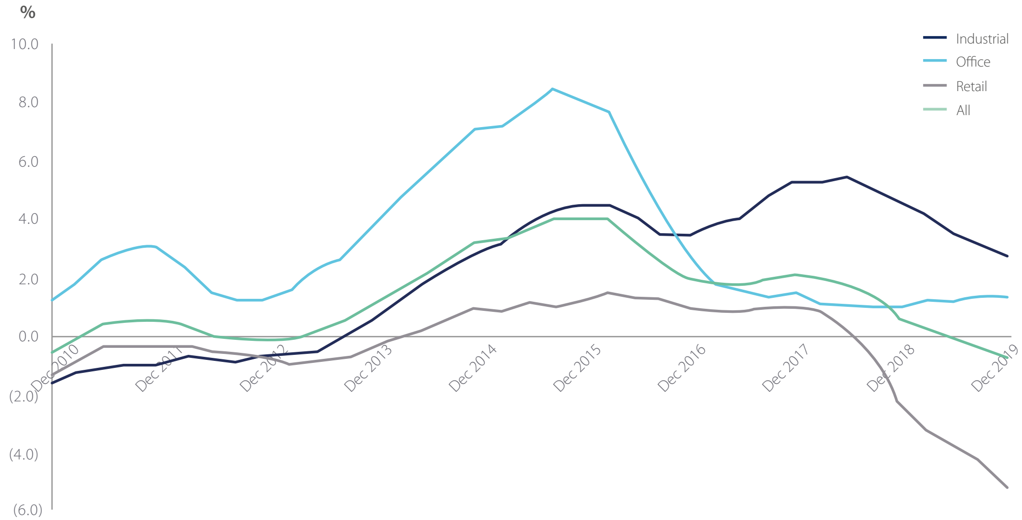
INDUSTRIAL **2.8%**

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



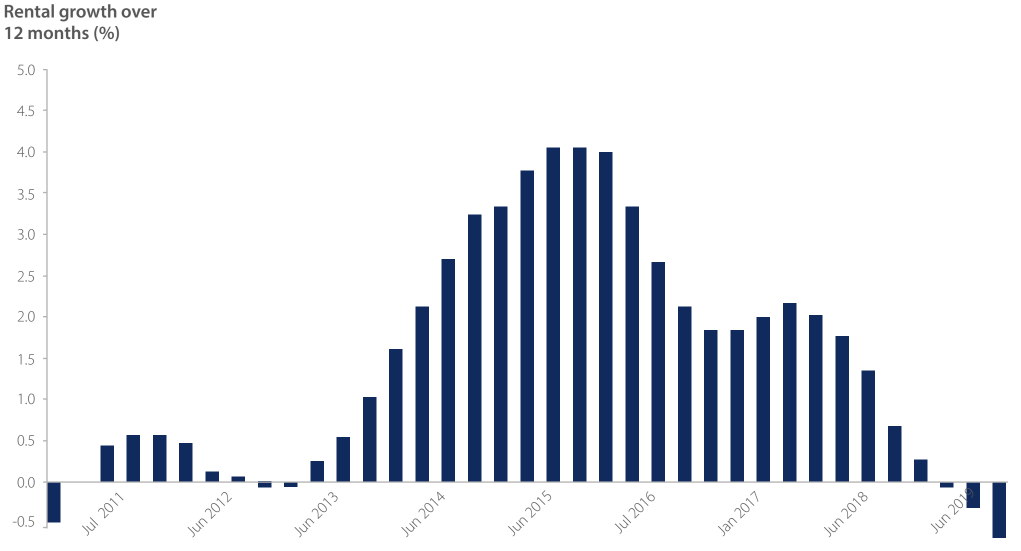
Source: ONS

AVERAGE ANNUAL RENTAL GROWTH



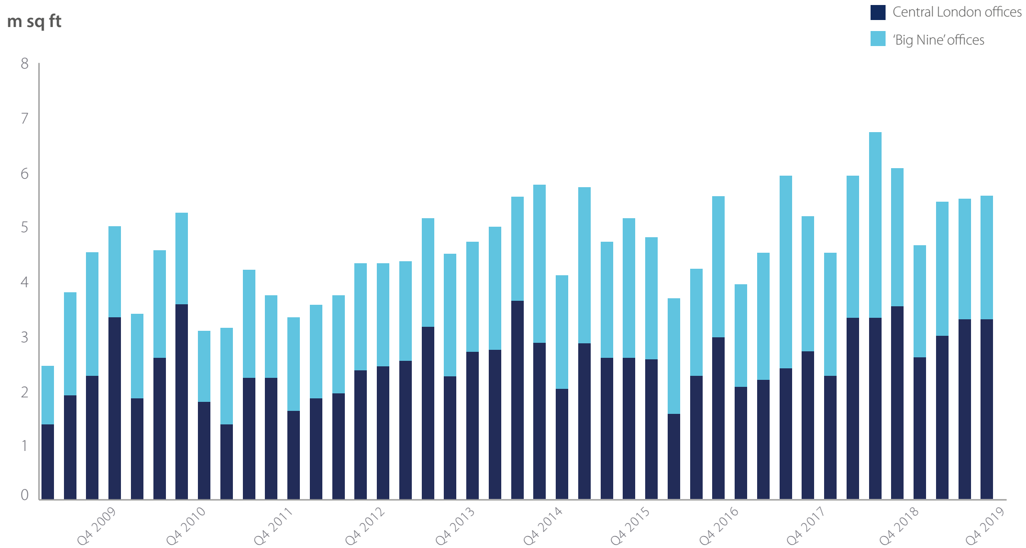
Source: MSCI Quarterly Index

AVERAGE ALL-PROPERTY ANNUAL RENTAL GROWTH



Source: MSCI Quarterly Index

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



Source: Avison Young

Investment

Investor demand

The official Brexit day is now finally behind us. Whilst nothing has changed fundamentally we expect some pent-up demand to be released early 2020 following an improvement in sentiment post-election. However, the latter half of the year may start to see activity slow depending on the progress of the future trade relationship with the EU.

Circa £18 billion of UK commercial property was transacted in Q4 2019, very similar to Q4 2018 and up 30% on Q3. This brought the total to £52.5 billion in 2019. Whilst this is clearly well below the market peak of nearly £80 billion pa in mid-2015, it represents a more stabilised level and is in line with the ten year average. Defensive stock remains highly sought after including industrial, offices and residential but the supply of such opportunities continues to diminish.

Overseas investors dominated activity in Q4, accounting for almost 60% of all activity. US investors were the most active investing circa £3.8 billion in Q4 alone, (equating to 37% of all overseas investment in Q4) which was the strongest performance since mid-2015. Far eastern and European investors also increased their exposure in the UK, accounting for 28% and 21% of overseas investment respectively. There remains a huge weight of global money looking to invest in commercial property in 2020. The latest INREV report suggested circa €98 billion of new capital is expected to be invested in real estate globally during 2020. The UK continues to be featured in the top three European destinations for investment, alongside Germany and France.

Recent performance

All-property yields began to drift outwards in 2019 to 5.6% in December, up from 5.5% a year earlier. This is largely a result from the big increase in average retail yields, whilst average industrial and office yields have broadly stabilised. Consequently average all-property capital values have declined by 3.3% in December 2019, down from 1.4% growth in 2018. Again, figures are heavily weighed down by the contraction in the retail sector albeit rate of capital growth also slowed for offices and industrial assets.

Outlook for returns

The latest annual total return increased by 1.2% in 2019, down from 6.1% in 2018. We expect this to improve in 2020 as average rental value growth picks up and average capital value declines moderately.

We expect activity to improve in early 2020, as some political uncertainty reduced when Boris Johnson won an unexpectedly large majority in the general election. Looking further ahead into the second half of 2020, there are a range of uncertainties including a potential cut in interest rates, the clarification of the UK's future relationship with the EU and the impact on business and consumer confidence. These will all be key in shaping the direction of the investment market.

However, the weight of money and relative scarcity of supply will continue to be supportive of yield levels, particularly for quality defensive stock. The UK will remain a relatively stable "safe haven" global property market and UK commercial property will continue to provide an attractive income return in a low growth, low interest rate environment.

Q4 2019 VOLUMES BY REGIONS

- London **£7 billion**
- East of England **£477 million**
- East Midlands **£473 million**
- North East **£162 million**
- North West **£588 million**
- Scotland **£415 million**
- South East **£1.7 billion**
- South West **£718 million**
- Wales **£237 million**
- West Midlands **£1 billion**
- Yorks & Humber **£504 million**
- Northern Ireland **£88 million**

KEY STATS

ANNUAL ROLLING INVESTMENT TRANSACTIONS VALUE

£52.5 billion

Q4 VOLUMES BY INVESTOR TYPE

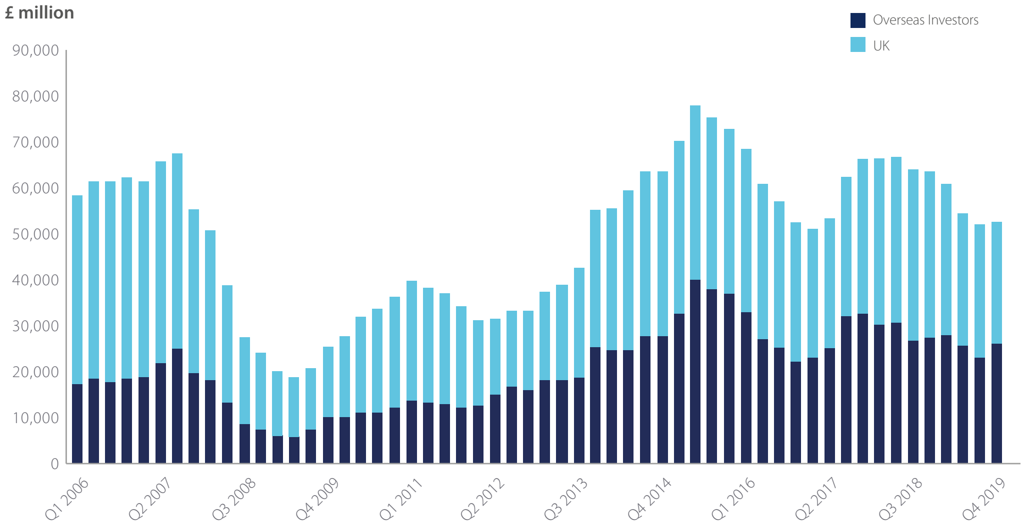
OVERSEAS INVESTOR	UK INSTITUTION	UK PROPERTY COMPANY
58%	13%	18%

ALL-PROPERTY EQUIVALENT YIELDS

5.6%

ANNUALISED ALL-PROPERTY TOTAL RETURN	ANNUALISED ALL-PROPERTY CAPITAL GROWTH
1.2%	-3.3%

ROLLING ANNUAL INVESTMENT TRANSACTION VOLUMES

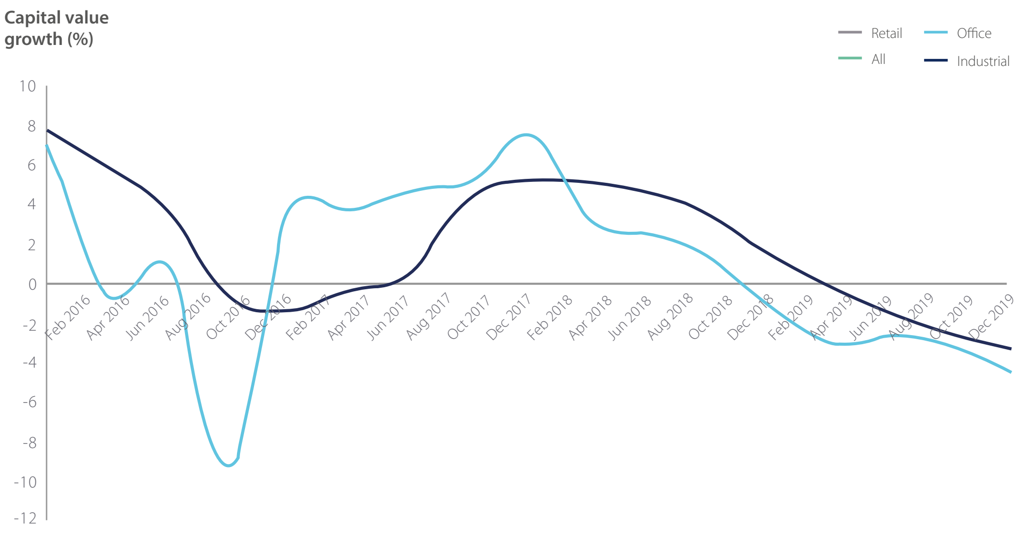


Source: Property Data

ALL PROPERTY ANNUAL TOTAL RETURN

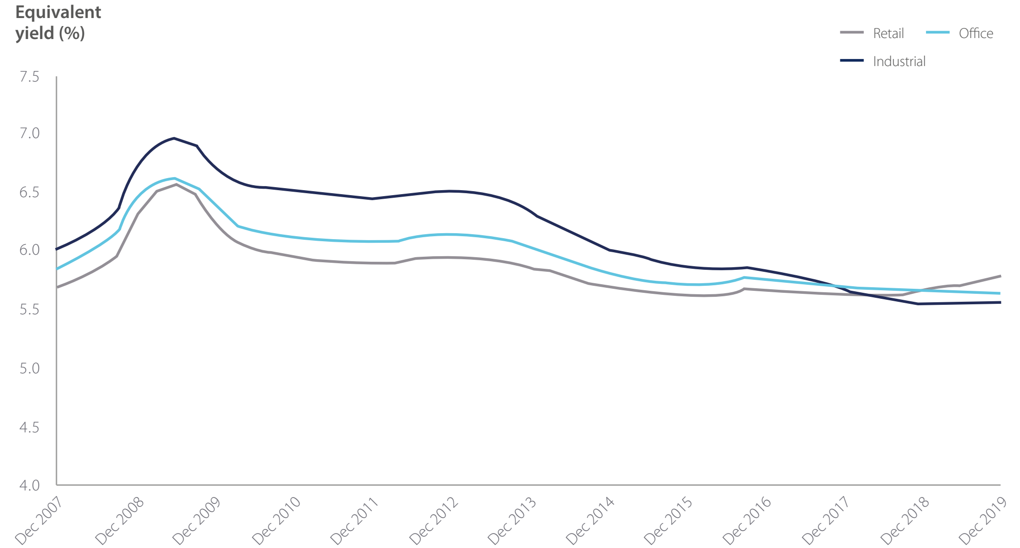
Source: MSCI Quarterly Index

ANNUALISED CAPITAL VALUE GROWTH



Source: MSCI Quarterly Index

AVERAGE EQUIVALENT YIELDS



Source: MSCI Quarterly Index

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

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