



INSIGHT

EPMR

Economic & property market review

August 2021

AVISON
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Summary

- The UK has emerged from the third set of national lockdowns. On 17th May, the second stage of the recovery roadmap was enacted in England, permitting indoor hospitality and leisure to resume operations once again. The postponed third stage of restriction easing in England and Wales – which dissolved the vast majority of social distancing measures – occurred on the 19th and 17th of July respectively, while Scotland maintained some restrictions including the 12pm curfew for hospitality venues until the 9th of August.
- Covid-19 vaccinations continue to be administered across the UK, with 40.8 million people having received full two doses as of 16th August. So far, it appears the vaccination effort is helping to keep hospitalisations and deaths low despite the significant resurgence in case numbers to levels comparable with December 2020.
- The ONS reported that GDP grew by 4.8% in Q2 2021. This came after a 1.6% contraction in the previous quarter as demand rebounded with the easing of restrictions. This was driven by a 7.3% increase in household consumption and a 6.1% increase in public spending, a significant increase from the 1.5% recorded in Q1.
- Government borrowing in FY2020/21 is estimated to be £300 billion. Despite being the greatest deficit since WWII, the debt interest to revenue ratio is the lowest since records began in 1947 meaning that repayments relative to revenue are the most affordable they have ever been.

Economic trends

The UK has emerged from the third set of national lockdowns. On 17th May, the second stage of the recovery roadmap was enacted in England, permitting indoor hospitality and leisure to resume operations once again. The postponed third stage of restriction easing in England and Wales – which dissolved the vast majority of social distancing measures – occurred on the 19th and 17th of July respectively, while Scotland lifted restrictions on the 9th of August but have continued to impose rules on face coverings.

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Production output was boosted by inclement weather in June, resulting in 0.8% growth. The construction sector declined by 0.8%, the second consecutive month of decrease. According to these monthly figures, UK GDP overall remains 3.1% below the pre-pandemic February 2020 level.

Government borrowing in FY2020/21 is estimated to be £298 billion. Despite being the greatest deficit since WWII, the debt interest to revenue ratio is the lowest since records began in 1947 meaning that repayments relative to revenue are the most affordable they have ever been.

This is due to the ultra-low interest rate environment, with the BoE maintaining the 0.1% record low level since March 2020. Although this reduces the fiscal impact, the immense scale of public debt – which is now estimated at £2.2 trillion – creates a significant vulnerability to even a slight increase in interest rates.

The Markit / IHS purchasing managers indices (PMI) for July achieved a weighted net balance of 59.6, continuing down from the all-time high of 63.3 observed in May and the 62.8 recorded in June. Nonetheless, July's figure remains well in excess of the no-change 50.0 marker, suggesting that activity continued to significantly expand relative to last month, just at a slightly slower pace.

All sectors remained firmly in above the critical 50.0 marker in July despite all registering a decrease in the rate of expansion. At 60.4, the manufacturing sector recorded the highest PMI of the month as strong sales figures outweighed material and staff shortages. The services sector also reported staff shortages leading to wage pressures, which in turn amounted to rising prices for consumers being charged, although robust consumer spending has helped to buoy the sector with a PMI of 59.6 in July. Construction also suffered from difficulties in sourcing materials and staff, with rising prices cited by 81% of surveyed firms. The sector achieved a PMI of 58.7 in July, compared to 66.3 in June, as new orders slowed.

GfK's consumer confidence index increased to -7 in July, up from -9 in June. This is the highest figure since the pandemic began, and the joint highest since May 2017. The improvement came from a seven point rise in the major purchase index and perceptions of the general economic situation over the past 12 months.

The BoE reported that consumers continued to borrow on net for a second consecutive month in June with consumer credit increasing by £0.3 billion. Despite continued slight declines in the interest rate on deposits down to record low levels, households increased their deposits to £9.8 billion net in June.

Despite the delay in removing restrictions, the Chancellor has said that the Coronavirus Job Retention Scheme (CRJS) will not be extended. At the end of June there were approximately 1.9 million employments furloughed on the CJRS across an estimate 28% of UK companies still using the scheme. Support from the CJRS began to taper down from 30th June, with companies required to contribute an increasing amount until the scheme ends in October. Since its inception, the CJRS has a cumulative cost of £67.4 billion as of 14th July.

Economic trends



In the three months to June 2021, the employment rate increased marginally at 75.1%, below consensus, while the unemployment rate continued to decrease down to 4.7%

LABOUR MARKET

In the three months to June 2021, the employment rate increased marginally at 75.1%, below consensus, while the unemployment rate continued to decrease down to 4.7%. These figures, taken with the 375,000 rise in HMRC PAYE employees in June and July alone, indicate a strengthening labour market.

Vacancies increased for the 14th consecutive period between April and June 2021, rising to 953,000 – the highest number of job openings on record. These figures reflect the staff shortages being experienced in many sectors of the UK economy, particularly in the hospitality industry. Combined with some inflationary impact from low-wage redundancies during the pandemic, these factors have resulted in significant real wage growth, achieving 6.6% in April-June.

While the reopening of retail and other areas of the economy will help employment across the UK, the delay in further restrictions being eased combined with the expiry of the CJRS at the end of September will likely cause an increase in joblessness during the recovery. The redundancy rate continued to decline in the April to June period to 3.6 per 1,000 employees, comparable with the pre-pandemic levels and down from the 14.2 peak between September to November. These figures show that the labour market is beginning to convalesce and regain strength, although challenges remain ahead.

INFLATION

CPI inflation increased by 2.0% in the year to July 2021, up from 2.5% in June. Rising transport costs produced the largest source of inflationary pressure while clothing, footwear and recreational goods provided some deflationary offsetting.

Although the considerable weight of quantitative easing over the last year may have been offset in terms of inflation by the massive economic fallout from the pandemic, a rapid recovery presents an inflationary risk. Strong consumer demand combined with a rebounding labour market (including significant wage growth) and the considerable household savings accrued over the past year could drive price growth beyond the BoE's 2.0% target – as observed in May and June 2021.

A surge in inflation represents the largest risk in terms of pushing interest rates up, with the BoE likely to wield a base rate hike against excessive price growth. The scale of the post-pandemic government debt means that public finances would be vulnerable to even a relatively minimal increase in interest rates. However, inflation was allowed to rise to 5.0% in the aftermath of the global financial crisis, and BoE has suggested that levels would need to consistently exceed their target for a lengthy period before they consider tightening fiscal policy.

The longer-term picture sees recovery pressures subside and a stronger pound. This means that high levels of inflation are probably transitional and are unlikely to persist into 2022, with the 2.0% target not being consistently met until 2023. Hence the 'lower for longer' approach to interest rates adopted by the UK and other central banks internationally are expected to continue for a number of years rather than months, with the BoE Monetary Policy Committee (MPC) voting to maintain the record 0.1% interest rate in May 2021 once again. The MPC also decided to maintain the rate of asset purchases and the total program remains at £895 billion.

Economic trends

OUTLOOK

GDP forecasts for 2021 are cautiously optimistic, with the July Consensus Economics survey expecting an average of 7.1% for the year and 5.4% in 2022.

The critical factor remains the alleviation of Covid-19 impacts, particularly as the Delta variant fuels a surge in case numbers and restrictions are removed across the UK. Efficacy of the vaccines against the known and unknown future variants of Covid pose a downside risk to recovery as well as the possibility of a rise in the infection rate as restrictions are eased. These emphasise the rapid rollout of immunisations across the UK and the globe in order to reduce the chances of further variants mutating.

Dissolving social distancing in England and Wales on the 19th and 17th July respectively resulted in a significant surge in cases in the first weeks of July. However these did not feed through into a comparable increase in hospitalisations or deaths.

With the Brexit deal signed, a considerable downside risk to the UK economy has been significantly reduced. There remain, however, gaps and questions around the specifics of the agreement and impacts of the deal (positive or negative) are likely to take time to materialise, along with the UK's post-Brexit trade relationships.

LATEST CONSENSUS FORECASTS – AUGUST 2021

	2021	2022
Economic growth (GDP)	6.8%	5.4%
Household consumption	3.9%	6.8%
Unemployment rate	5.1%	5.1%
Bank base rate	0.1%	0.3%
CPI - Inflation	2.2%	2.7%
RPI - Inflation	3.4%	4.0%

Source: Consensus Economics

2021 ECONOMIC GROWTH FORECASTS



WORLD
6.0%



UK
5.3%



EUROZONE
4.4%

Source: IMF

KEY STATS

GDP GROWTH

▼ 1.5% ▲ 4.8%
Q1 2021 Q2 2021

PMI WEIGHTED AVERAGE

62.8% ▼ 59.6%
June July

UNEMPLOYMENT RATE



4.8%
May

REAL EARNINGS GROWTH



5.6% 4.9%
(including bonuses) (excluding bonuses)

CPI INFLATION



2.5%

BANK RATE

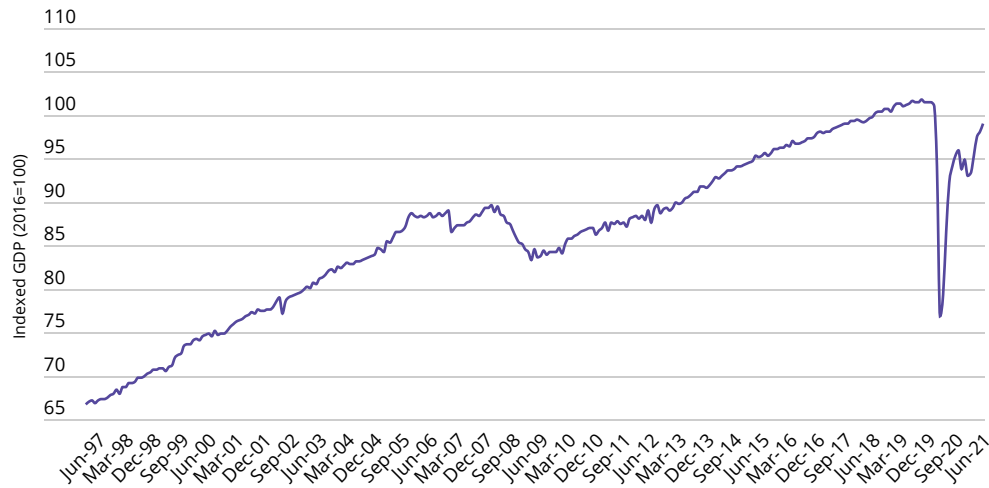


0.1%

Economic data

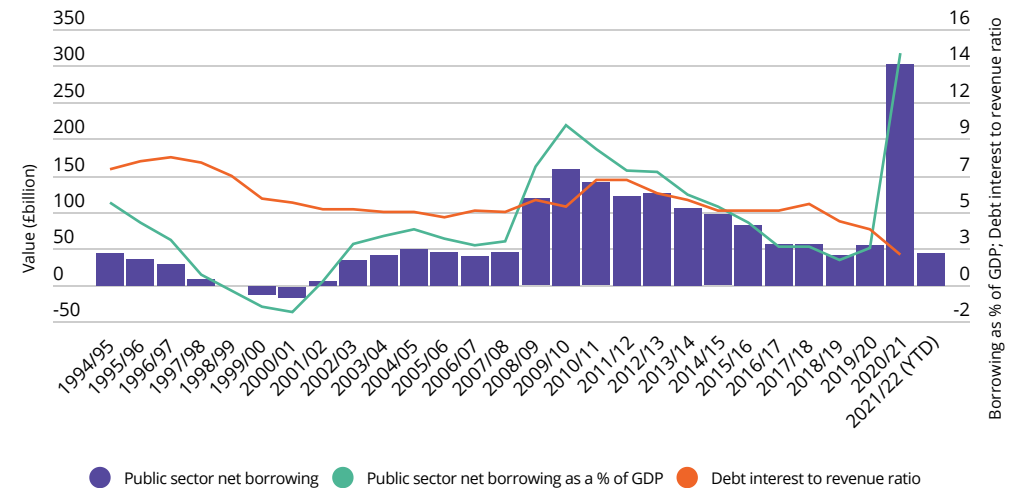
MONTHLY GDP

Source: ONS



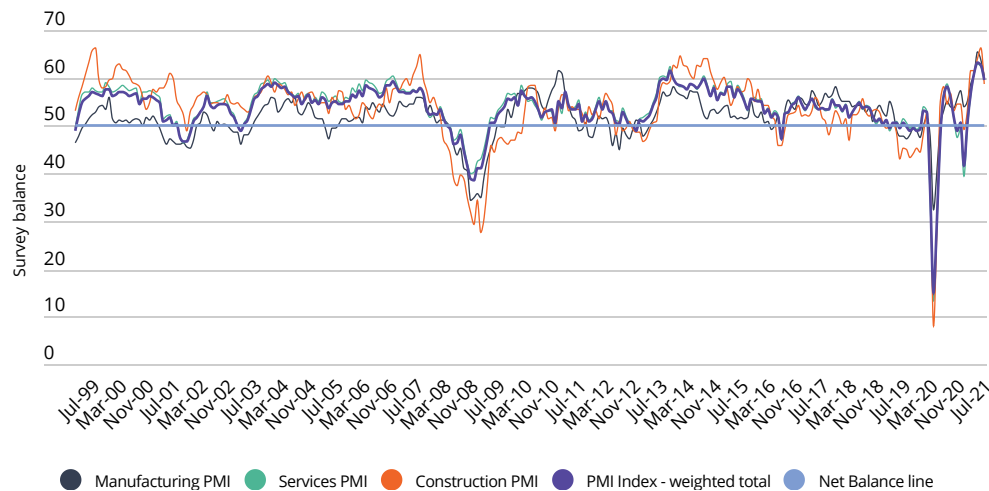
PUBLIC SECTOR NET BORROWING EXCL. PUBLIC SECTOR BANKS

Source: ONS



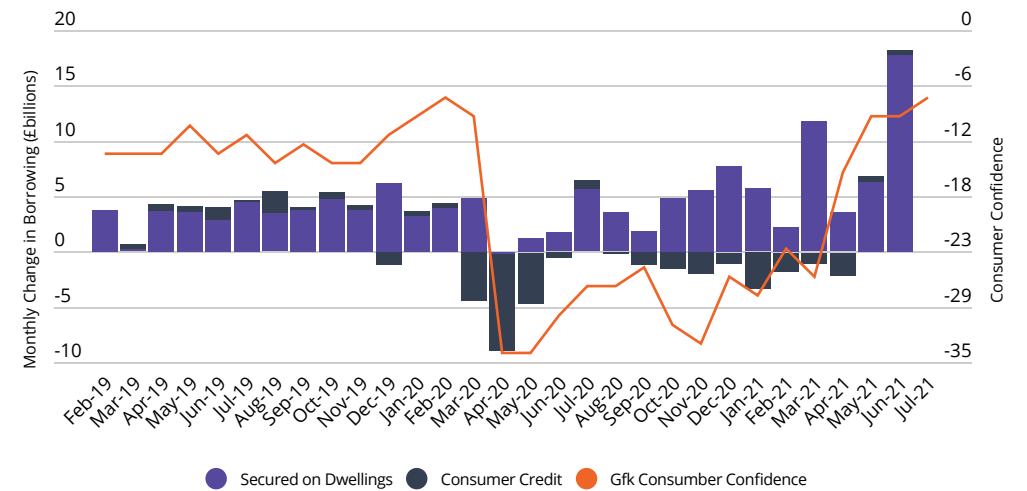
PURCHASING MANAGERS' SURVEY

Source: Markit & CIPS



CONSUMER CREDIT AND CONFIDENCE

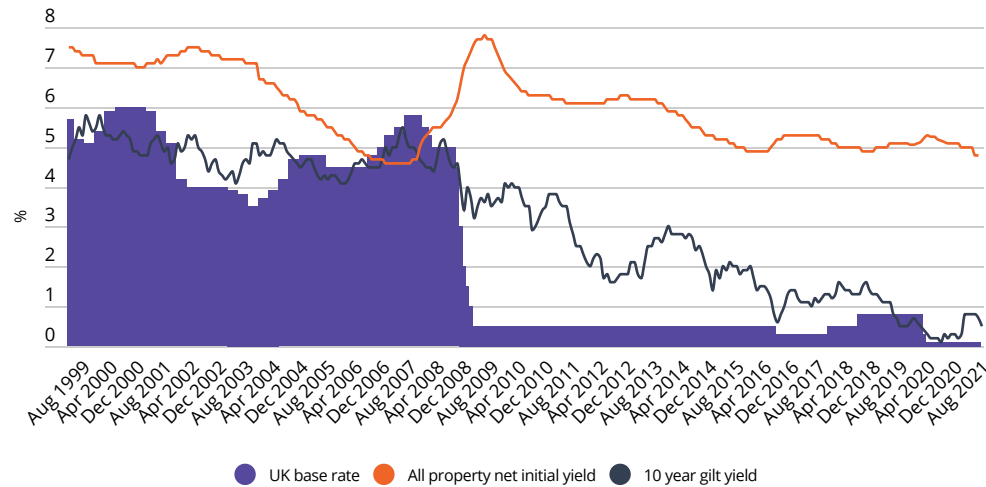
Source: Bank of England



Economic data

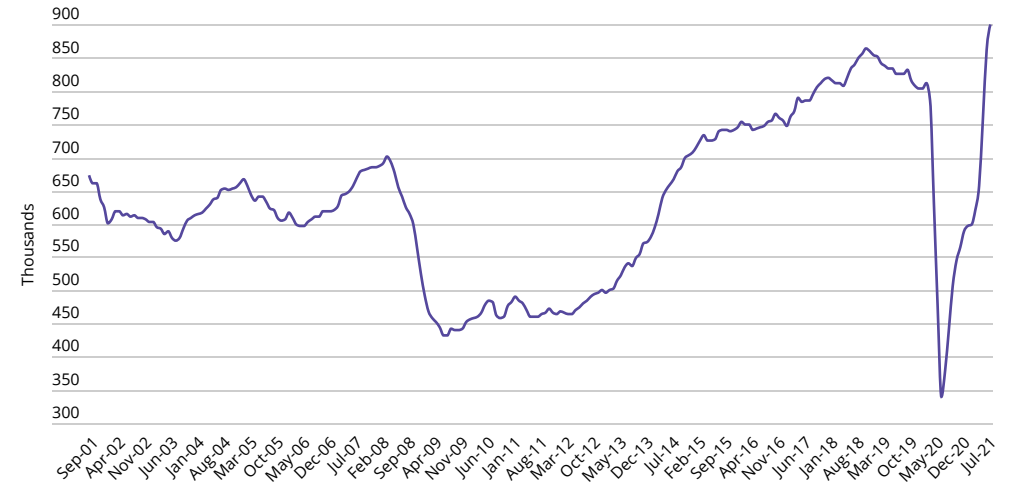
UK NET INITIAL YIELD VS GILTS VS BASE RATE

Source: MSCI monthly index, Bank of England



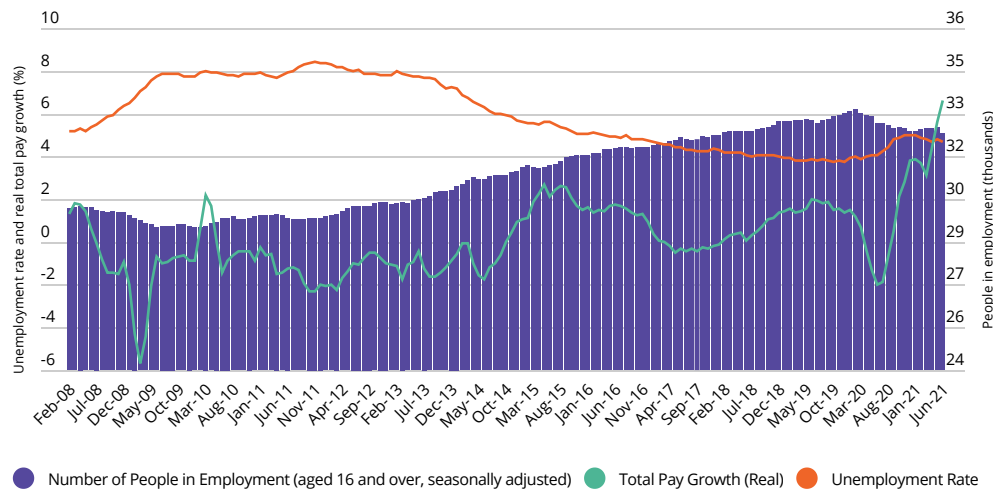
VACANCIES

Source: ONS



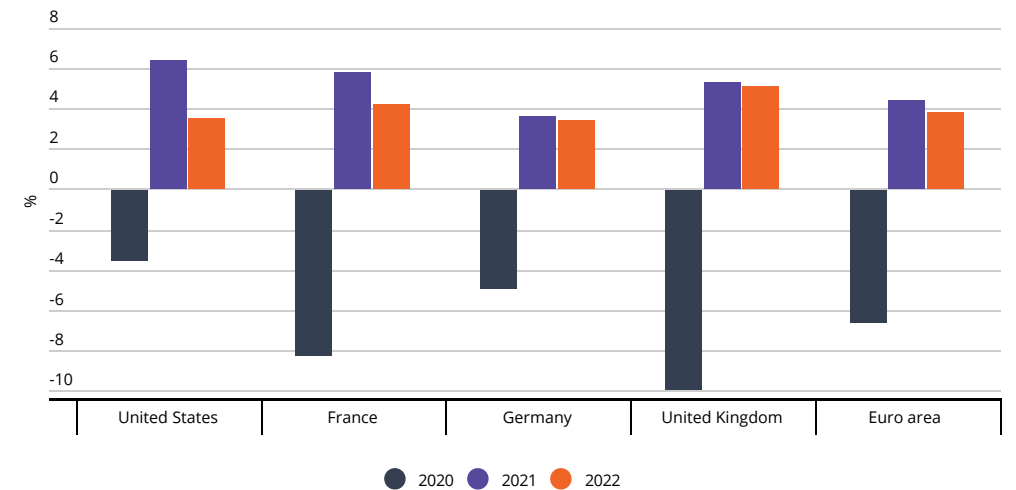
EMPLOYMENT AND AVERAGE WEEKLY EARNINGS

Source: ONS



GLOBAL ECONOMIC GROWTH

Source: IMF



Summary

- Central London office take-up totalled 2.0 million sq ft in Q2 2021, the highest figure since Q1 2020, but still 17% below the 10-year quarterly average.
- Total take-up during Q2 across the Big Nine cities amounted to 1.57 million sq ft during Q2, 25% down on the ten-year average. Activity was strongest in the city centres, which accounted for the highest level since Q1 2020 and 66% of all activity at 1.02 million sq ft, with 542,000 sq ft out-of-town.

Occupier market

Central London office take-up totalled 2.0 million sq ft in Q2 2021, the highest figure since Q1 2020, but still 17% below the 10-year quarterly average. IBM's acquisition 157,120 sq ft of sub-let space at Southbank Place was the largest dealt. There were two other deals in excess of 100,000 sq ft during the quarter – JLL taking 134,000 sq ft 1-2 Broadgate, EC2, and ITV committing to 120,000 sq ft at BBC Broadcasting Centre in Wood Lane, W12.

Total take-up during Q2 across the Big Nine cities amounted to 1.57 million sq ft during Q2, 25% down on the ten-year average. Activity was strongest in the city centres, which accounted for the highest level since Q1 2020 and 66% of all activity at 1.02 million sq ft, with 542,000 sq ft out-of-town.

'Freedom day' on 19th July – when all social distancing restrictions were lifted in England – was not met with such enthusiastic increases in mobility and spending as observed subsequently from the two previous restriction easing dates in 2021. However there has been a more gradual uptick since then, with aggregate spending fluctuating around the pre-pandemic baseline level according to high frequency CHAPS payment data in the week to 5th August. Mobility too increased slightly, reaching 80% of pre-pandemic levels on 7th August.

While reopening will undoubtedly help to ease some of the pain currently being felt in the retail sector in particular, the significant structural adjustment occurring across the sector is still ongoing as consumers spend more online and less in store. So far in 2021, there have been an estimated 24,775 retail job losses from 13 major retailers collapsing, affecting circa 1,687 stores. These figures do not include smaller businesses, which have also been hit hard.

Lockdown-induced physical store closures and the need for vulnerable groups to shelter accelerated the uptake of online retailing, even in previously hard to reach demographics and markets, such as grocery shopping. Internet sales achieved a new peak in January, accounting for 36.4% of all retailing during the third national lockdown before steadily subsiding down to 27.3% in May – still well in excess of the 19.1% in pre-pandemic February 2020. The considerable progress made in advancing the supporting infrastructure and in improving public attitude toward online retailing will persist even once physical stores can reopen; hence the outlook is positive for the e-commerce market.

The recent expansion of online retailing has been largely at the expense of physical stores. This trend is demonstrated by the recent spending spree of several pure-play online retailers purchasing insolvent high street brands without purchasing their physical sites. The failed Arcadia Group's Topshop, Topman, H&M and Miss Selfridge have been purchased by online retailer Asos for £330 million, while Burton, Dorothy Perkins and Wallis have been acquired by Boohoo who also recently bought the Debenhams chain. All of these deals have been for the brands and websites only, excluding the 408 physical stores and cutting approximately 24,000 jobs.

Increasing demand for warehousing and logistical space in light of the e-commerce boom has provided considerable momentum in the industrial market across 2020 and into 2021. There has been a record level of occupational activity for big box warehousing during the first half of the year, continuing the momentum gathered in the second half of 2020. Take-up of large grade A warehouses (> 100,000 sq ft) amounted to 25.4 million sq ft during H1, 71% up on the five-year, six-monthly average and a staggering 46.1 million sq ft of take-up over the past 12 months.

In the year to June 2021, MSCI data reflects a similar story with the industrial sector delivering 4.3% rental value growth compared to -0.2% and -6.2% for office and retail respectively. Industrial was also the only sector to record positive annualised capital value growth at 17.9%, the strongest figure since January 1990, compared to -3.4% and -5.4% for office and retail. Subsequently, industrial yields hardened to 4.9% in June, while office and retail remained flat at 6.5% and 7.2% respectively.

OUTLOOK

We are hopeful consumer spending will help drive economic recovery in the short term. The government are also hoping to increase corporate expenditure to fuel growth through the 130% tax super-deduction on business investments.

Occupier market

Client feedback tells us that several notable office occupiers have set provisional return to office dates in Q3 2021, some of which may now be pushed back in line with the latest government guidance. Broadly, we expect to see a serious return of activity in the office leasing market in H2 2021. Although the return to office is anticipated to be strong once public health concerns are sufficiently reduced, there will be a sustained increase in the level of home working relative to before the pandemic. This trend, as well as companies looking to cut costs, will likely result in further grey sub-let space coming to market as occupiers look to reduce their footprints.

The restart grants, limited rates relief and most significantly the extension of the CJRS, alongside potential consumer expenditure increases from savings accrued during the past year, mean that retail may finally experience some positivity having reopened on 12th April with strong retail sales reported. However, it is anticipated that e-commerce will retain a sizeable share of activity post-Covid and it seems likely that physical store retailing will continue to bear the brunt of the structural shift in the economy and consumer behaviour over the medium-term.

Retail's loss is industrial's gain, however, with Capital Economics estimating that the e-commerce boom could increase industrial demand by around 15% over the next decade. Combined with restricted supply across the UK, this means that both capital values and rents are likely to continue to rise in the industrial market.

An important outcome from the Brexit deal will be the ongoing negotiations around the equivalency of financial service operations. If the UK does not achieve a favourable outcome – i.e. UK firms do not gain EU equivalency – then UK locations will be less appealing for companies looking to do business with the EU.

HOUSING MARKET

The first half of 2021 has seen the strongest year-on-year house price growth since 2004, with June's 0.7% growth (Nationwide) bringing the total so far this year to 13.4%.

Transactional activity has also been remarkably high in the first half of the year. The provisional (non-seasonally adjusted) estimate of 449,030 UK residential transactions during Q1 was the highest since statistics started being recorded in their current format in 2005.

Since peaking in March at 183,670, transactions levels have been falling back with 119,540 provisionally reported for April and 114,940 for May. However, despite the slowing, these levels are still well ahead of the 2013-19 average.

According to the RICS Residential Market Survey, buyer demand has cooled over the last few months which is reflected in the slowing transaction levels. New buyer enquiries remains still firmly positive though, which will help to underpin continued strength in the market in the coming months.

Another factor which will help support price growth is declining supply. The RICS survey in June reported that the majority of surveyors saw a decline in the level of new instructions.

With the unwinding of the SDLT holiday, we expect wider macro-economic factors to return as the key drivers of the housing market. Our near-term economic outlook is broadly positive, and our view is that the inflation we are seeing is transitory and will not impact interest rates.

The economic backdrop combined with a continuation of demand resulting from reassessment of housing needs will support continued house price growth and transaction levels through the year. Although this will be at much more moderate levels than we have seen so far.



Total take-up during Q2 across the Big Nine cities amounted to 1.57 million sq ft during Q2, 25% down on the ten-year average.

KEY STATS

ANNUAL ROLLING VALUE OF NEW CONSTRUCTION ORDERS

£11.3 billion

Q2 TAKE-UP LEVELS

CENTRAL LONDON OFFICES



2.0m sq ft

'BIG NINE' REGIONAL OFFICES



1.6m sq ft

ANNUALISED AVERAGE RENTAL GROWTH

ALL PROPERTY

-0.4%

INDUSTRIAL

RETAIL

OFFICES



4.6%



-5.8%



-0.2%

Occupier market data

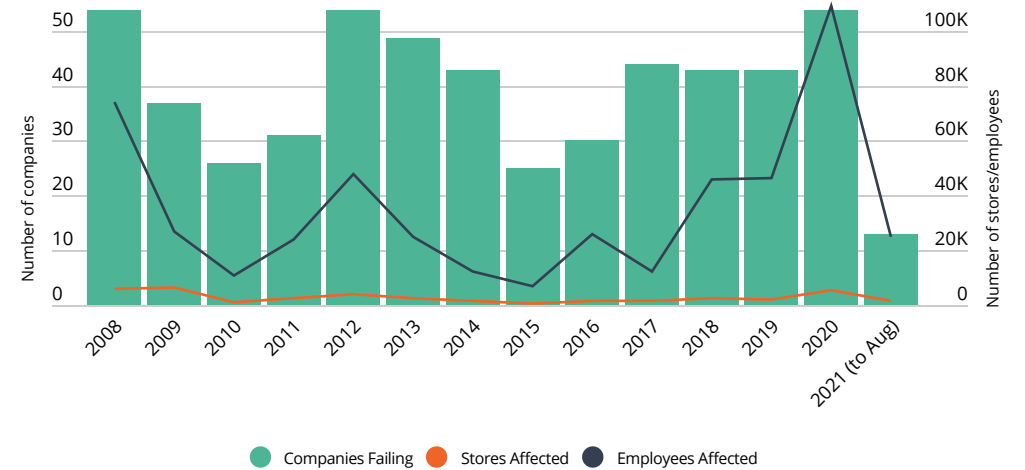
BIG NINE & CENTRAL LONDON TAKE-UP

Source: Avison Young



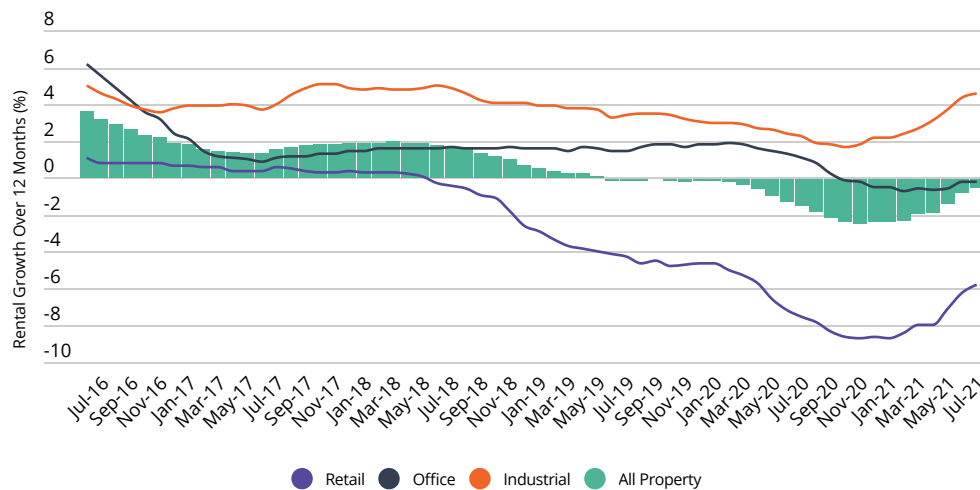
FAILING RETAIL COMPANIES

Source: Centre for Retail Research



AVERAGE ANNUAL RENTAL GROWTH

Source: MSCI Monthly Index



Summary

- In the investment market, provisional transaction volumes for Q2 2021 were £13.7 billion, 1% below the 5-year quarterly average (Property Data). This is a considerable improve on the Q1 figure which was the lowest volume reported for the period since 2012 at £11.4 million.
- Government announced a further extension to the moratorium on commercial evictions for an additional nine months to now end in March 2022. Commercial tenants are currently facing rental arrears of £6 billion. The extension was welcomed by occupiers at the distain of landlords as tensions between the two heated up ahead of the previous end date of 30th June 2021.
- Effective vaccine rollout across the UK and will be the key driver of economic performance in the near term. Our progress so far, and the boost in consumer activity seen in our Cities Recovery Index following the 12th April and 17th May lockdown easing, gives hope for further economic recovery in Q3.

Investment market

In the investment market, provisional transaction volumes for Q2 2021 were £13.7 billion, 1% below the 5-year quarterly average (Property Data). This is a considerable improvement on the Q1 figure which was the lowest volume reported for the period since 2012 at £11.4 million.

All three of the industrial, office and retail sectors saw an increase in investment volumes in Q2 2021 compared to Q1. Against the 5 year quarterly average, Q2 volumes for industrial were up 54%, while office and retail both down by 1%.

Central London investment volumes in Q2 2021 totalled £1.7 billion, 58% below the 10-year quarterly average and a decline from the strong end to 2020. The largest transactions of the quarter were One Braham, purchased by Union Investment for £468 million and Suntec's acquisition of The Minster Building for £353 million.

Investment volumes are holding up well across the Big Nine cities. Total investment volumes during Q2 2021 amounted to £669 million, 14% up on the ten-year average of £585 million. This brings volumes for the past 12 months to £2.29 billion, which is level with the ten-year average.

Annual all property capital value growth achieved 3.4% in the year to June 2021, driven by the continued surge in industrial capital value growth. All property equivalent yields declined marginally in June to 6.0%, primarily due to the industrial sector again.

Investment market

OUTLOOK

The continuation of fiscal support measures announced in the Budget, policy support for investment, the progressing vaccine rollout and the roadmap for easing restrictions suggest that economic recovery will continue to gather momentum across Q2 2021 – so long as the recent surge in case numbers does not translate into increased hospitalisations, prompting another lockdown.

However, the looming deadlines of government-sourced economic defences provided to individuals and businesses provide a degree of downside risk for the recovery. The end of the moratorium on domestic evictions, the tapering-off of the CJRS and the delay in the relaxation of restrictions are likely to cause some who are already struggling to boil over. The hope is the wider economy has already reached some stability – or possibly even growth – by this point so as to be able to absorb this turbulence.

The majority of respondents of the annual INREV investor survey suggested they had not significantly changed their investment plans for 2021 as a result of Covid-19. Capital Economics also forecast positive total returns for UK commercial property in 2021, albeit at a modest level.

In the near-term, there could be considerable scope for investments for those with the capital and appetite for the increased risk. There may be further opportunities in from structural shifts that have occurred or been accelerated in the last year.

Effective vaccine rollout across the UK and will be the key driver of economic performance in the near term. Our progress so far, and the boost in consumer activity seen in our Cities Recovery Index following the 12th April and 17th May lockdown easing, gives hope for further economic recovery over Q3.

Annual all property capital value growth achieved 3.4% in the year to June 2021, driven by the continued surge in industrial capital value growth.



Q2 2021 VOLUMES BY REGIONS

London £4.7 billion	East Midlands £1.2 billion
South East £1 billion	East of England £506 million
North West £597 million	Scotland £317 million
South West £475 million	Northern Ireland £9 million
Yorks & Humber £433 million	Wales £87 million
West Midlands £1.1 billion	North East £109 million

KEY STATS

ANNUAL ROLLING INVESTMENT
TRANSACTIONS VALUE

£50.5 billion

Q1 VOLUMES BY INVESTOR TYPE

OVERSEAS INVESTORS

 **56%**

UK PROPERTY COMPANY

 **21%**

UK INSTITUTIONS

 **12%**

ALL PROPERTY EQUIVALENT YIELDS

6.1%

ANNUAL ALL PROP TOTAL RETURN

5.2%

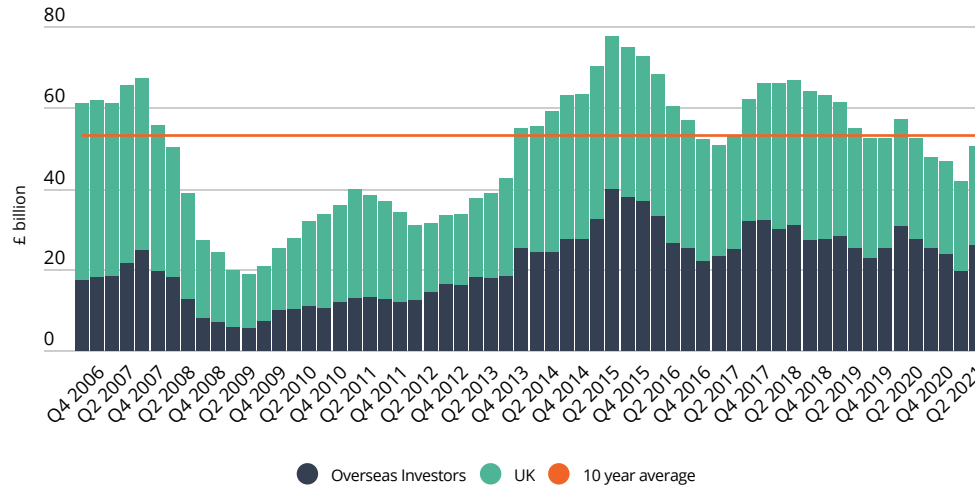
ANNUAL ALL PROP CAPITAL GROWTH

-0.6%

Investment market data

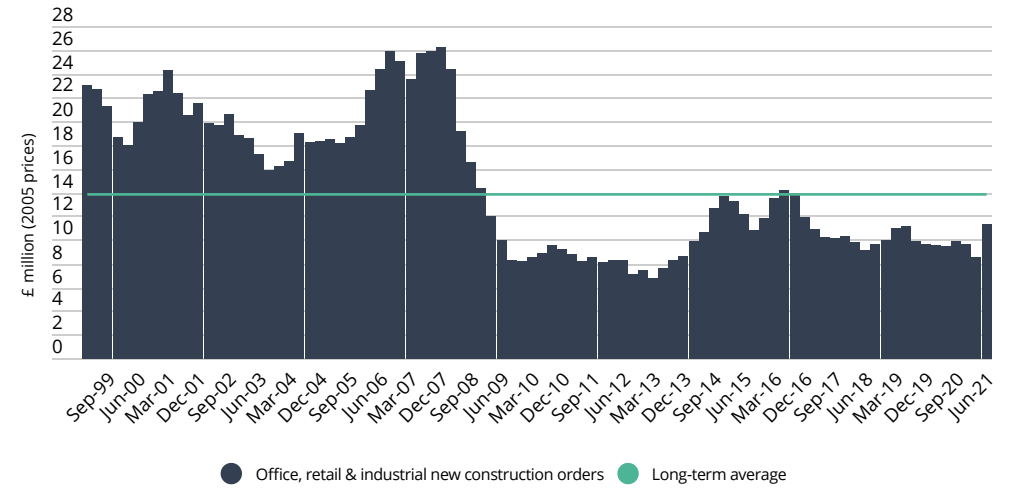
ROLLING ANNUAL INVESTMENT TRANSACTION VOLUMES

Source: Property Data



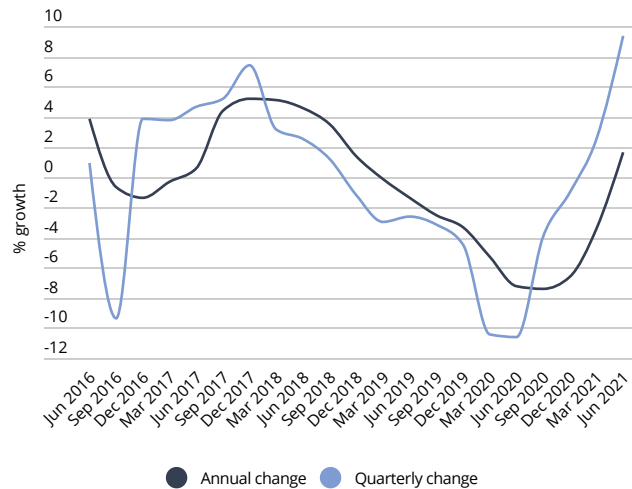
NEW CONSTRUCTION ORDERS RETAIL, OFFICE AND INDUSTRIAL

Source: ONS



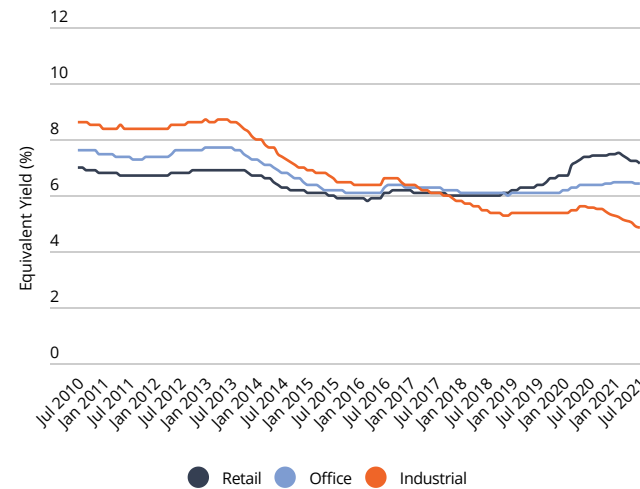
ALL PROP AVERAGE CAPITAL VALUE GROWTH

Source: MSCI



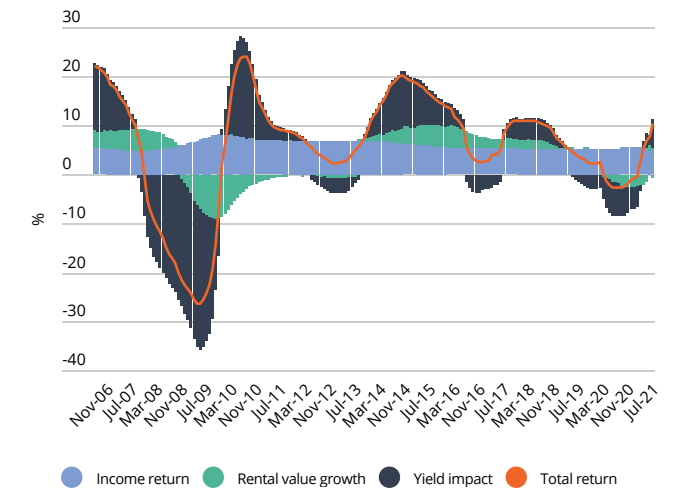
AVERAGE EQUIVALENT YIELDS

Source: MSCI Monthly



ALL PROPERTY ANNUAL TOTAL RETURN

Source: MSCI Monthly



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

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