INSIGHT

EPMR

Economic & property market review

November 2021

AVISON YOUNG

Summary

- As the UK progresses into the recovery period, the focus is beginning to shift away from Covid case numbers and more toward the composition of the future economy. Several key trends are evolving – many of which are driven by the legacy of the lockdowns and consequential changes in supply and demand relationships across sectors.
- GDP rose by 1.3% in Q3, underperforming relative to the 1.5% expected by the Bank of England (BoE). Downward revisions to the July and August growth figures (to -0.2% and 0.2% respectively) weighed on the quarterly total, although momentum picked up in the final month of Q3.
- Covid-19 vaccinations continue to be administered across the UK, with 80% of the adult population having received two full doses as of 11th November. Although case numbers are at a comparable level to that of December 2020, these are critically not translating into comparable increases in hospitalisations.
- October saw the expiry of several major government interventions, put in place in response to the pandemic. This includes the Coronavirus Job Retention Scheme (CJRS), which had provided an estimated £69 billion of support across 11.7 million employments cumulatively as of 14th September. The stamp duty land tax (SDLT) holiday has also ended following a period of tapering-off.

Economic trends

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CPI inflation increased by 3.1% in the year to September 2021, down marginally from 3.2% in August. Restaurants and hotels provided some deflationary pressure in the period but almost all other areas of the economy reported positive price growth.

CPI inflation increased by 4.2% in the year to October 2021, up on the 3.1% in September and the highest figure since 2011. The rise in the energy price cap caused 0.7 percentage points of the increases, while transport, restaurants and hotels provided additional upward momentum and most other sectors also experienced price growth. The latest figure exceeded the BoE 3.9% expectation and means that the inflation is now double the BoE's 2.0% target.

In the three months to October 2021, the employment rate increased marginally to 75.4%, with the unemployment rate continuing to decrease down to 4.3%. While the rising employment rates and declining unemployment rates are generally positive signs, there are wider factors to be considered which suggest that the labour market may be in danger of overheating.

The Markit / IHS purchasing managers indices (PMI) for October achieved a net balance of 57.8. Being in excess of the no-change 50.0 marker, and improving on last month's 54.9, this figure suggests that activity expanded for the eighth consecutive month and with additional momentum.

Central London office take-up totalled 2.4 million sq ft in Q3 2021, 1.1% above the 10-year quarterly average. This was anchored by the completion of 11 deals above the 50,000 sq ft mark – the highest quarterly volume of large lettings since the end of 2019.

Total take-up during Q3 across the Big Nine cities amounted to 2.3 million sq ft, 10% up on the 10-year average and by far the highest demand since the pandemic began. There was a particular improvement in the out-of-town markets, which accounted for 1.1 million sq ft, compared to 1.2 million sq ft in the city centres.

In the investment market, provisional transaction volumes for Q3 2021 were £13.2 billion, 7% below the 5-year quarterly average (Property Data). This is a declined from the £15.8 billion transacted in the previous quarter, with the office, retail and industrial sectors all reporting a quarter-on-quarter decline.

GDP forecasts for 2021 are continuing to grow in optimism, with the October Consensus Economics survey expecting 6.9% for the year – the highest figure anticipated thus far. Conversely, views over 2022 have become less favourable, declining to 4.7% for the year.

Economic trends

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LABOUR MARKET

In the three months to October 2021, the employment rate increased marginally to 75.4%, with the unemployment rate continuing to decrease down to 4.3%. While the rising employment rates and declining unemployment rates are generally positive signs, there are wider factors to be considered which suggest that the labour market may be in danger of overheating.

Despite a 160,000 increase in payroll employees in October, vacancies topped 1 million for the third consecutive period to achieve close to 1.2 million. Labour shortages – which have been exacerbated by the pandemic driving alterations in the composition of the economy and the turbulent exit from the EU – are seriously impacting business performance in multiple sectors. Early indicators suggest the unemployment rate is coming down rapidly, at 4.0% in September and 3.5% (or around 1.1 million individuals) in the last week of the month – lower than the pre-pandemic level – suggesting there may not be enough slack in the labour market to satisfy demand.

There is the added concern of the approaching mandate for health and adult social care workers to be vaccinated. At present, estimates suggest that around 10% of NHS staff and around 5% of adult social care workers are unvaccinated. Both of the sectors have considerable staff shortages already which are likely to become severe in response to the vaccine requirements.

Real regular pay grew by 2.2% year-on-year in the three months to September 2021, while total pay (including bonuses) grew by 3.1%, both of which represent continued decline from the June peak. These figures are relatively low considering the labour shortages, potentially reflecting the squeeze many businesses continue to feel as a result of the pandemic, and the comparatively well-off position of household savings.

The expiry of the CJRS at the end of September impacted some 1.1 million furloughed jobs. Although the full extent of the impacts are still unknown at the time of writing, initial suggestions are that the majority of these employments will be maintained with only a minority being made redundant. The government's additional funding for apprenticeships and training may curb increases chronic unemployment levels as a consequence of Covid and aid the restructuring of the post-pandemic economy. The current staff shortages require a more immediate solution or risks provoking an inflation-wage spiral as labour demands drive up pay, exacerbating the pre-existing supply-driven price rises.

INFLATION

CPI inflation increased by 4.2% in the year to October 2021, up on the 3.1% in September and the highest figure since 2011. The rise in the energy price cap caused 0.7 percentage points of the increases, while transport, restaurants and hotels provided additional upward momentum and most other sectors also experienced price growth. The latest figure exceeded the BoE 3.9% expectation and means that the inflation is now double the BoE's 2.0% target.

These higher than anticipated figures, combined with the labour market outlook, suggest there is a high likelihood of the BoE's Monetary Policy Committee (MPC) raising the interest rate in their December meetings – the question is more by how much. The underlying 'lower for longer' approach to interest rates – which existed pre-Covid – as well as the expiry of the latest round of bond buying, may keep the MPC to a modest hike. The sluggish growth over Q3 may also weigh on the minds, with raised rates likely to encourage consumers to hold onto their savings accrued over the past 18 months. Additionally, if the outlook remains that the current inflationary surge is transitory, then the MPC will be keen not to sacrifice long-term growth momentum at this critical stage for a temporary problem. It seems probable rates will be pushed up to 0.25% - enough to cause a reaction in the market without stifling growth.

Even if the interest rate is increased by a relatively minor amount, the scale of government debt means that any rise will likely weigh on public policies in the next Budget in March 2022. Additionally, if the inflationary pressures do not subside in the new year and the MPC deliver a second dose of base rate rises in their February meeting then spending is likely to be restricted further.

Economic trends

OUTLOOK

GDP forecasts for 2021 are continuing to grow in optimism, with the October Consensus Economics survey expecting 6.9% for the year – the highest figure anticipated thus far. Conversely, views over 2022 have become less favourable, declining to 4.7% for the year.

Covid continues to play high on the agenda for deciding the future of the UK economy. Case numbers have not receded significantly from their surge in July, although hospitalisations have remained at a manageable level so far. Booster doses of the Covid vaccine and an increased flu immunisation program are being deployment to try and keep hospitals operating over winter without becoming overwhelmed.

The inflation and labour market situations are having an increasing influence over the UK economy, through material realities and expectations. As each become more severe, there is a greater chance that the two narratives will become more entwined, producing a 'perfect storm' of labour shortages and supply side pressures driving concurrent rises in wages and prices.

LATEST CONSENSUS FORECASTS – NOVEMBER 2021

	2021	2022
Economic growth (GDP)	6.9%	4.7%
Household consumption	4.2%	6.2%
Unemployment rate	4.8%	4.8%
Bank base rate	0.3%	0.6%
CPI - Inflation	2.3%	3.3%
RPI - Inflation	3.7%	5.1%

Source: Consensus Economics

2021 ECONOMIC GROWTH FORECASTS

WORLD 5.9%

UK 6.7%

EUROZONE 5.1%

Source: IMF

KEY STATS

GDP GROWTH

▲ 5.5% Q2 2021

▲ 1.3% Q3 2021

PMI WEIGHTED AVERAGE

54.9% September ▼ 57.8% October

UNEMPLOYMENT RATE

4.3% Q3 2021

REAL EARNINGS GROWTH

3.1% (including bonuses)

2.2% (excluding bonuses)

CPI INFLATION

4.2%

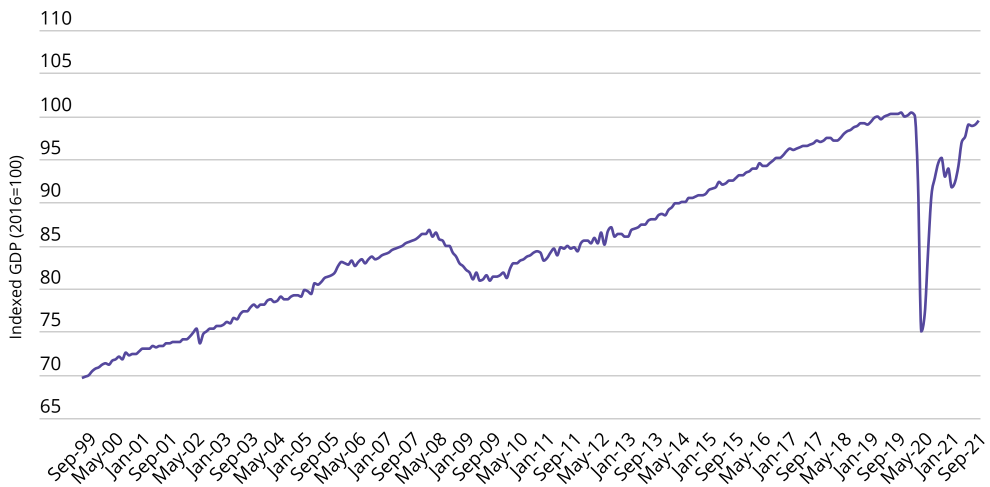
BANK RATE

0.1%

Economic data

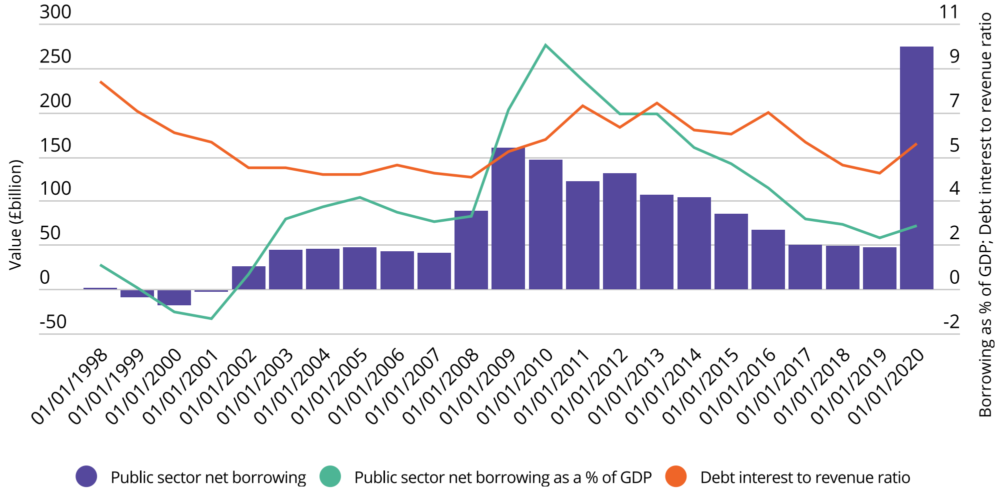
MONTHLY GDP

Source: ONS



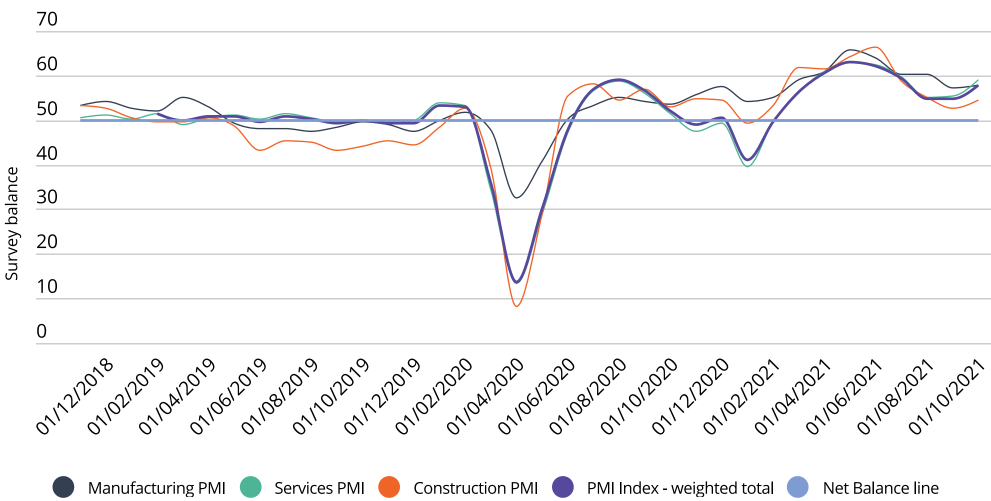
PUBLIC SECTOR NET BORROWING EXCL. PUBLIC SECTOR BANKS

Source: ONS



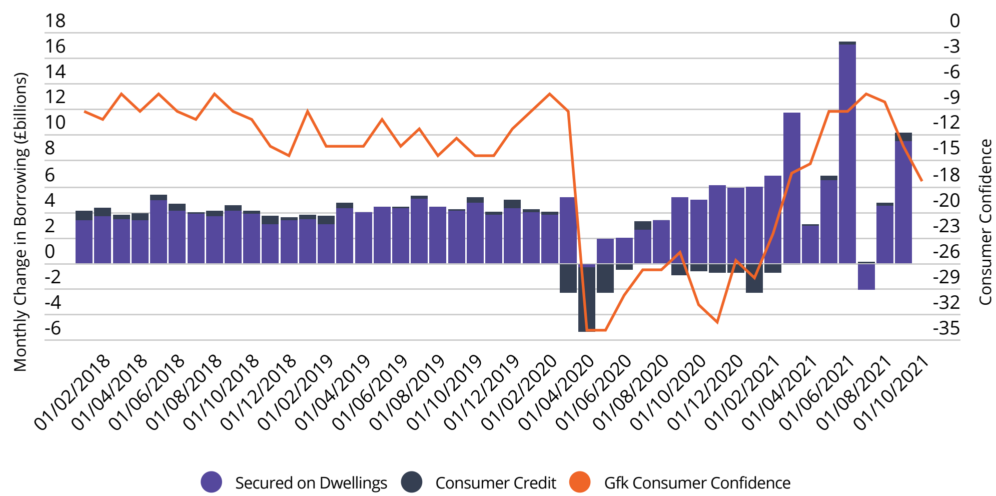
PURCHASING MANAGERS' SURVEY

Source: Markit & CIPS



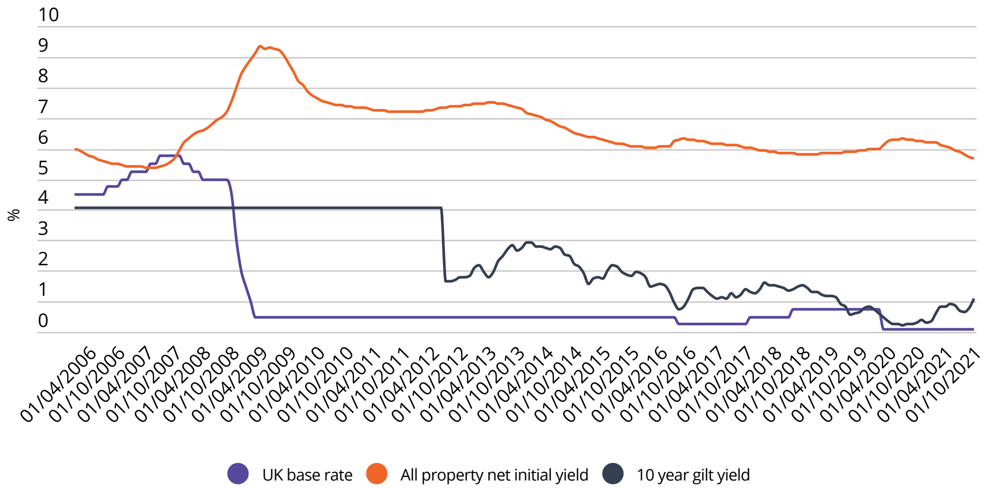
CONSUMER CREDIT AND CONFIDENCE

Source: Bank of England

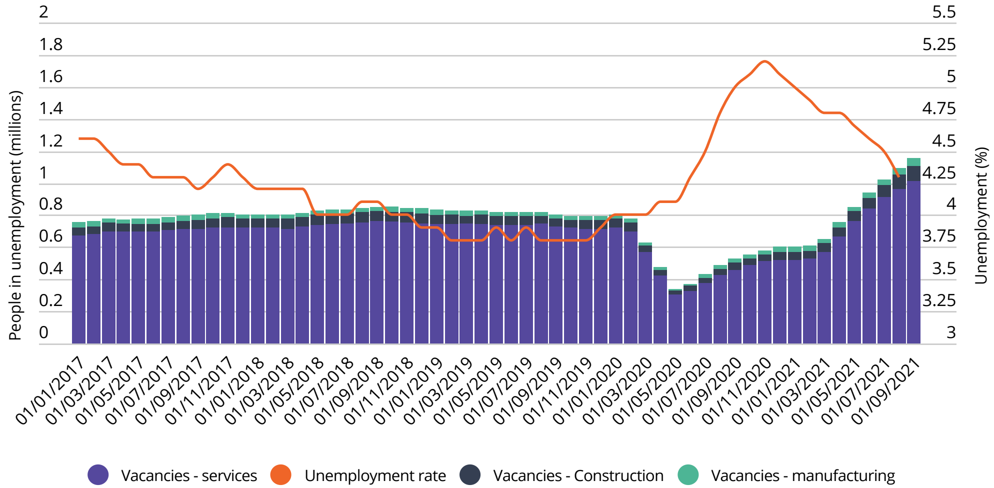


Economic data

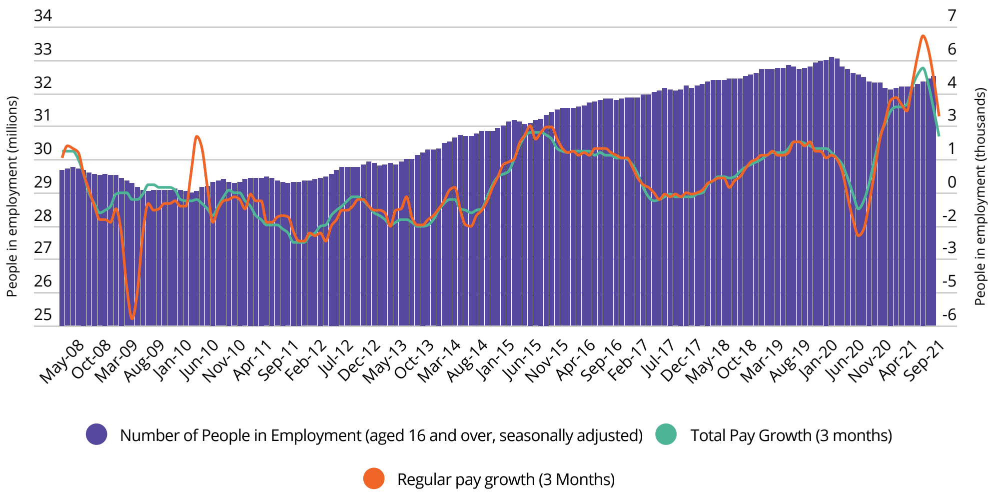
UK NET INITIAL YIELD VS GILTS VS BASE RATE Source: MSCI monthly index, Bank of England



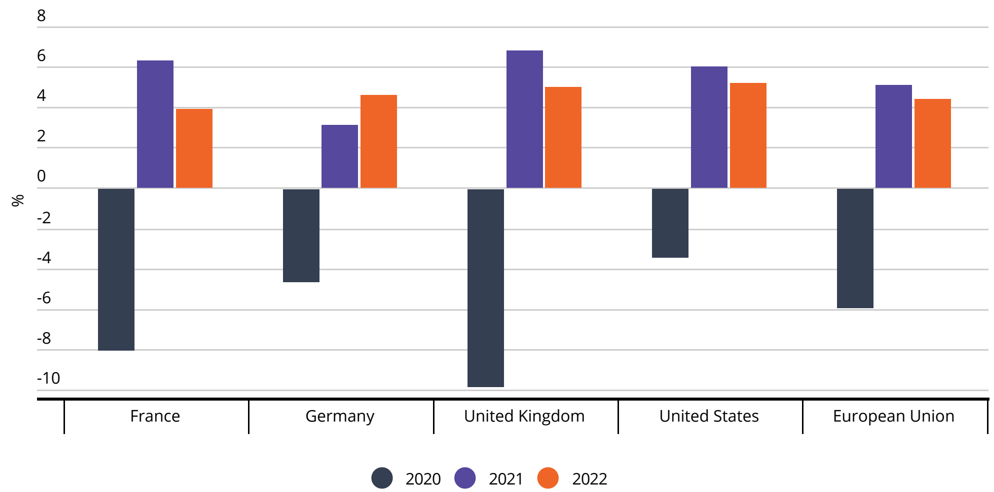
VACANCIES Source: ONS



EMPLOYMENT AND AVERAGE WEEKLY EARNINGS Source: ONS



GLOBAL ECONOMIC GROWTH Source: IMF



Summary

- Central London office take-up totalled 2.4 million sq ft in Q3 2021, 1.1% above the 10-year quarterly average. This was anchored by the completion of 11 deals above the 50,000 sq ft mark – the highest quarterly volume of large lettings since the end of 2019. Facebook's 310,000 sq ft deal at 1 Triton Square, NW1, was the largest of the quarter, while Travers Smith committed to a 158,000 sq ft pre-let at Stonecutter Court, EC4.
- Total take-up during Q3 across the Big Nine cities amounted to 2.3 million sq ft, 10% up on the 10-year average and by far the highest demand since the pandemic began. There was a particular improvement in the out-of-town markets, which accounted for 1.1 million sq ft, compared to 1.2 million sq ft in the city centres.
- Retail sales in September recorded a 0.2% decline in volume – the fifth consecutive monthly decrease despite a strong return to pre-pandemic levels in the period following the 12th April relaxation in restrictions. Households goods experienced a 9.3% contraction in sales volumes, contributing to a 1.4% decline across non-food store retailing overall, while food stores and automotive fuel sales reported monthly rises of 0.6% and 2.9% respectively. Online retailing increased month-on-month to 25.9% from 25.7% - the first monthly increase since the all-time high in January 2021. Although only marginal, this figure suggests that the market share now held by e-commerce is likely to persist.

Occupier market

Central London office take-up totalled 2.4 million sq ft in Q3 2021, 1.1% above the 10-year quarterly average. This was anchored by the completion of 11 deals above the 50,000 sq ft mark – the highest quarterly volume of large lettings since the end of 2019. Facebook's 310,000 sq ft deal at 1 Triton Square, NW1, was the largest of the quarter, while Travers Smith committed to a 158,000 sq ft pre-let at Stonecutter Court, EC4.

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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 24,755 retail job losses from 13 major retailers collapsing, affecting circa 1,687 stores. It is worth noting that these figures do not include smaller businesses, which have also been hit hard.

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 2021, 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 October 2021, MSCI data reflects a similar story with the industrial sector delivering 6.6% rental value growth compared to 0.8% and -4.0% for office and retail respectively. Industrial remains the only sector to record positive annualised capital value growth at a staggering 25.3%, the strongest figure on record, compared to -2.4% and 2.4% for office and retail. Subsequently, industrial yields hardened to 4.7% in October, while offices and retail also declined marginally to 6.4% and 6.8% respectively.

Occupier market

OUTLOOK

Office occupancy numbers have been steadily rising up through Q3 and into Q4. Combined with the positive figures observed in both the London and Big Nine markets, these trends support the view that the office leasing market is returning to serious levels of activity in H2 2021. However, rising case numbers pose a threat to gradually improving office occupancy statistics, with government and private work-from-home advise a possibility should the trend continue to progress. While such policies would compound the effects, there will be a sustained increase in the level of home working relative to before the pandemic regardless. This may result in further grey sub-let space coming to market as occupiers look to reduce their footprints.

Although many were hopeful that the savings accrued by consumers during the pandemic would be deployed to boost the recovery through consumer spending, the latest retail sales data suggests this is unlikely to materialise, at least in the short-term outlook. The performance of our UK Cities Recovery Index has also been largely flat in over the autumnal months, suggesting that activity is unlikely to have increased substantially following the slower August growth.

E-commerce appears to have retained around a 25% to 26% share of retail sales, considerably up on the pre-Covid level. While this will continue to push painful restructuring in the retail sector, the industrial market is sweeping up the spoils. Capital Economics estimates 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. Rising shipping costs and supply chain difficulties may also encourage reshoring of processing and production, providing a potential further boost to the industrial sector over the medium-term.

While there are questions around the direct relationship between inflation and property, there are several of indirect impacts that may materialise should the CPI continue to track upward at a considerable rate, particularly when combined with the current labour market picture.

The most prominent of these is likely to be felt in the retail sector. An interest rate rise due to high inflation levels, combined with higher prices and slower wage growth would weigh on consumer spending. Taken with the supply chain and distribution difficulties resulting in stock shortage, this could amount to greater pressure on physical retailing by pushing consumers online to more well-stocked alternatives at cheaper prices. An additional knock-on effect would be felt in the industrial sector, further fuelling the rapid growth observed in the sector over the past two years.

HOUSING MARKET

House price growth in the UK remained strong in Q3 despite the initial tapering of the Stamp Duty Land Tax (SDLT) holiday at the end of June. Nationwide reported 10.3% year on year growth in the quarter, the same as in Q2. This puts the average UK house price at £247,535, compared to £224,337 at the same time last year.

Transactional activity has also remained strong, despite a dip in July following the tapering of the SDLT holiday. The most recent figures for August show 98,300 transactions, 20.8% higher than the same time last year and a 32% rebound from July's figures. Over the past 12 months, transaction levels have been the highest we have seen since the Global Financial Crisis and 25% above the 2019 total.

Although we expect the market to cool somewhat in the final quarter of the year, the latest RICS Residential Market Survey and internet searches suggest buyer demand ticked up in September having receded over the previous two months.

Zoopla have also reported higher than typical demand for the time of year.

Another factor which will help support price growth is very limited supply. According to the RICS survey, the number of homes per surveyor at its lowest level on record except for the housing market shutdown in Q2 2020.

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 although supply chain pressures and inflation are posing an increasing risk.

The economic backdrop, low mortgage rates and a continuation of demand resulting from reassessment of housing needs will support continued house price growth and transaction levels. Although this will be at more moderate levels than we have seen so far.

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KEY STATS

ANNUAL ROLLING VALUE OF NEW CONSTRUCTION ORDERS

£11.3 billion

Q2 TAKE-UP LEVELS

CENTRAL LONDON OFFICES

2.4m sq ft

'BIG NINE' REGIONAL OFFICES

2.3m sq ft

ANNUALISED AVERAGE RENTAL GROWTH

ALL PROPERTY

1.2%

INDUSTRIAL	RETAIL	OFFICES
6.6%	-4.0%	0.8%

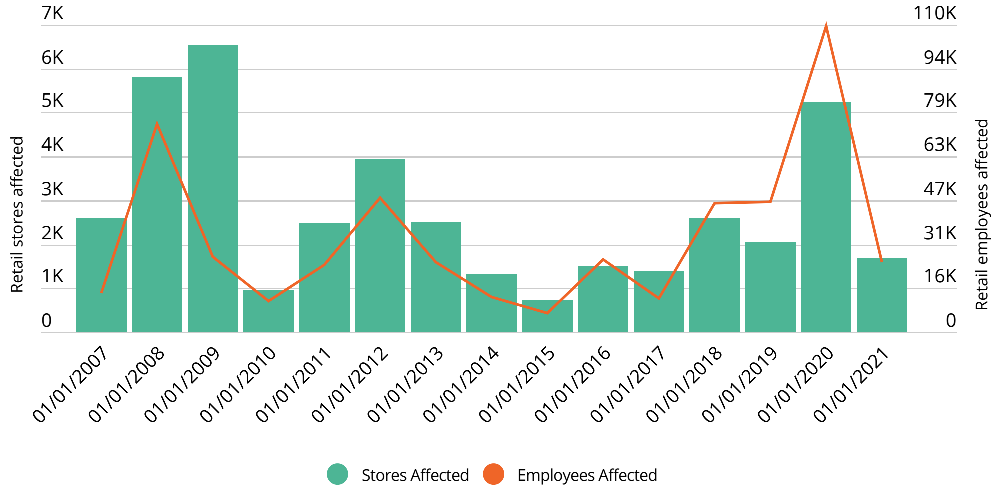
Occupier market data

BIG NINE & CENTRAL LONDON TAKE-UP

Source: Avison Young

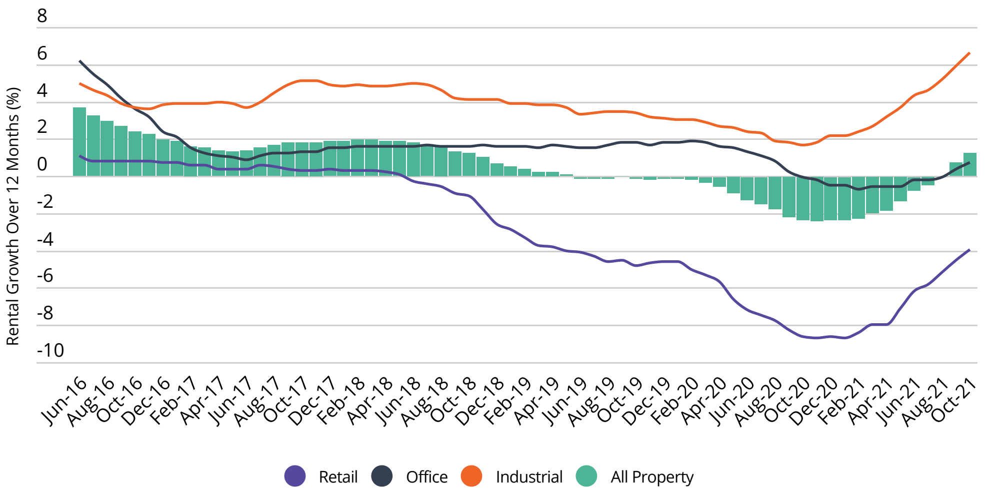
FAILING RETAIL COMPANIES

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.
- 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 office 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 market

In the investment market, provisional transaction volumes for Q3 2021 were £13.2 billion, 7% below the 5-year quarterly average (Property Data). This is a declined from the £15.8 billion transacted in the previous quarter, with the office, retail and industrial sectors all reporting a quarter-on-quarter decline. Despite this, industrial volumes remained 62% above the quarterly average, further demonstrating the strength of the current market. In the year to Q3 2021, the majority of investment came from overseas investors, accounting for 52% of the total.

Central London investment volumes in Q3 2021 totalled £3.1 billion. This is almost three times the overall investment compared to this point last year, boosting the 12-month rolling average office investment in London to nearly £12 billion – the highest figure since mid-2019. Among the largest transactions of the quarter were Times Square, EC4, purchased by Generali for upwards of £450 million and Deka's acquisition of 8 St James' Square, SW1, for £220 million.

Confidence in the regional office investment market remains robust with activity over the past 15 months performing above the long-term average - a strong performance given the recent conditions. Total investment volumes during Q3 amounted to £753 million, 26% up on the ten-year average of £599 million.

Annual all property capital value growth achieved 8.8% in the year to October 2021, driven primarily by the continued surge in industrial values. All property equivalent yields hardened in October to 5.7%, primarily due to the industrial sector again although declines were observed across the sectors as the property market edges closer to pre-Covid levels of risk.

Investment market

OUTLOOK

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.

Industrial stock is expected to continue to drive returns on the all property level for the UK, while restructuring in the office and retail sectors weigh on capital growth for the remainder of 2021 at least.

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Q3 2021 VOLUMES BY REGIONS

- London **£4.6 billion**
- South East **£1.2 billion**
- East of England **£938 million**
- North West **£758 million**
- East Midlands **£579 million**
- York & Humber **£438 million**
- West Midlands **£438 million**
- Scotland **£420 million**
- South West **£385 million**
- Wales **£103 million**
- North East **£62 million**
- Northern Ireland **No data**

KEY STATS

ANNUAL ROLLING INVESTMENT TRANSACTIONS VALUE

£52.1 billion

Q1 VOLUMES BY INVESTOR TYPE

OVERSEAS INVESTORS

52%

UK PROPERTY COMPANY

29%

UK INSTITUTIONS

9%

ALL PROPERTY EQUIVALENT YIELDS

5.7%

ANNUAL ALL PROP TOTAL RETURN

14.7%

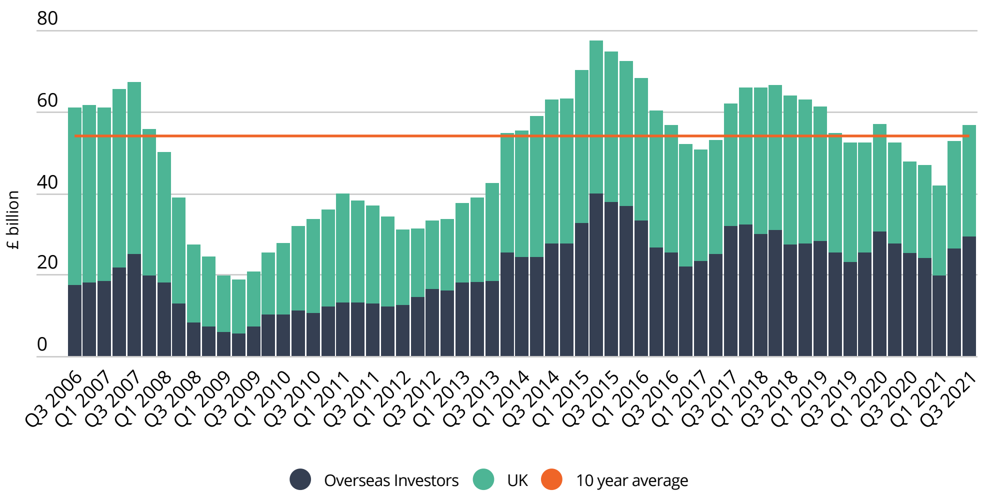
ANNUAL ALL PROP CAPITAL GROWTH

8.8%

Investment market data

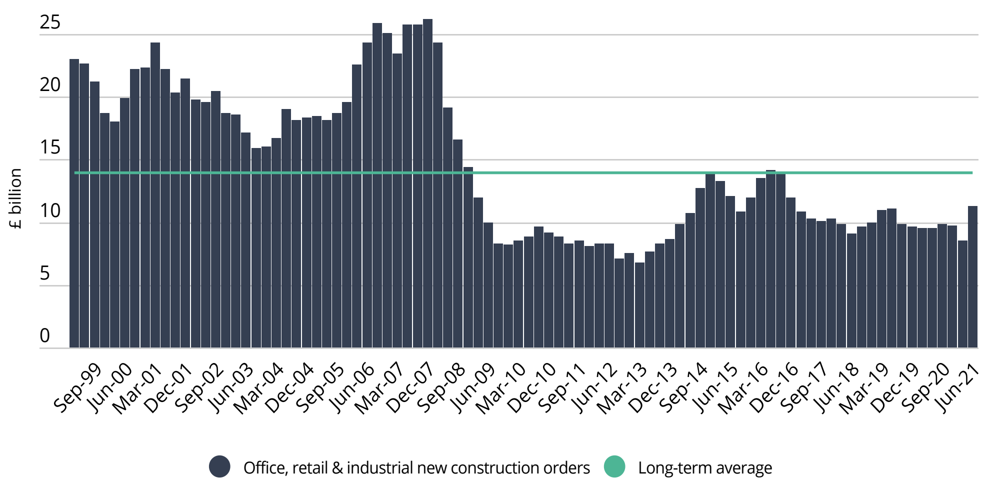
ROLLING ANNUAL INVESTMENT TRANSACTION VOLUMES

Source: Property Data



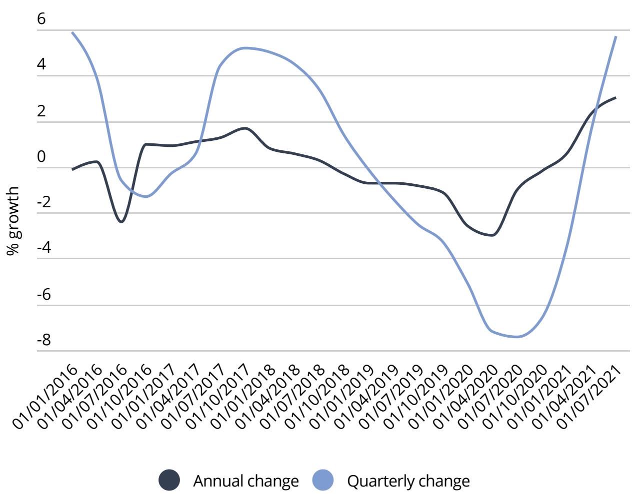
NEW CONSTRUCTION ORDERS RETAIL, OFFICE AND INDUSTRIAL

Source: ONS



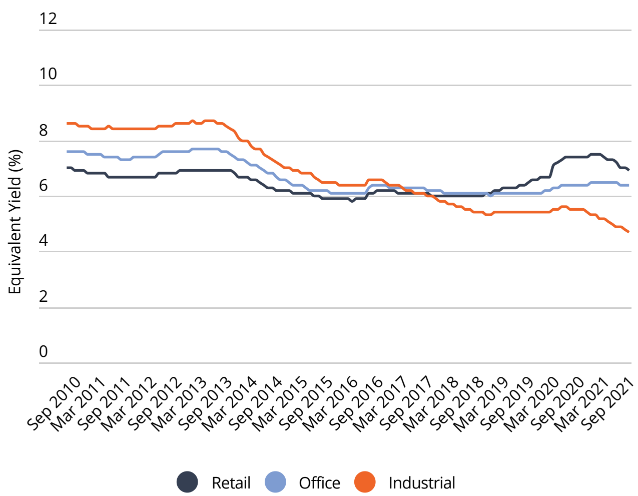
ALL PROP AVERAGE CAPITAL VALUE GROWTH

Source: MSCI



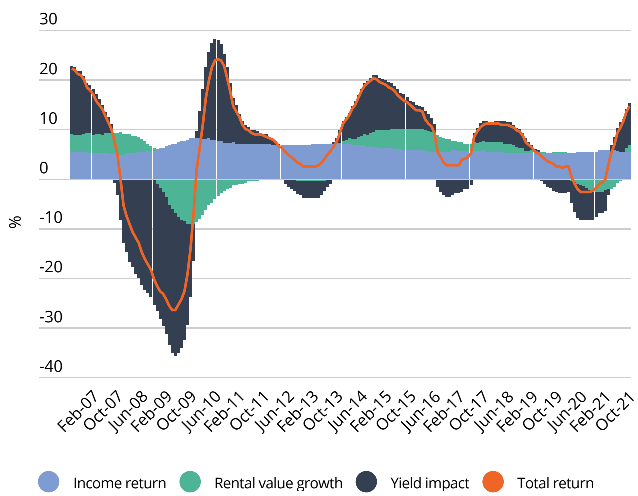
AVERAGE EQUIVALENT YIELDS

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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