INSIGHT

EPMR

Economic & property market review

September 2021

AVISON YOUNG

Summary

- The UK has now fully emerged from the 3rd national lockdown, with all restrictions now lifted. 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, and in Scotland restrictions were lifted on the 9th August.
- Covid-19 vaccinations continue to be administered across the UK, with 44.5 million people having received two full doses as of the 20th September. So far, it appears the vaccination effort is helping to keep hospitalisations and deaths low despite a significant resurgence in case numbers over the summer months to levels comparable with December 2020.
- In July 2021, the ONS reported that GDP grew by 0.1% month-on-month, remaining 2.1% below its pre-Covid, February 2020 level. Activity was dampened over the month by the extension of the final release of Covid restrictions across much of the UK, pushed from the third week of June to the third week of July.
- Production output increased 1.2% from June to July, boosted by reopening of an oil field previously closed for maintenance. The construction sector decreased by 1.6% over the same period, marking a third consecutive month of decline, while the services sector remained level.

Economic trends

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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.

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 August achieved a weighted net balance of 55.6, continuing to recede down from the all-time high of 63.3 observed in May and the lowest figure since March. Despite the decrease, the average remains well in excess of the no-change 50.0 marker, signalling that activity continued to expand relative to last month, just at a marginally slower pace than the previous 5 months.

The PMI for the manufacturing sector proved the most resilient over the last month, with an August figure of 60.3 only a minor step down from June's figure of 60.4, with companies overcoming continued supply chain and delivery delay difficulties to increase output and employment. Supply chain issues and rising input prices were also observed in the construction sector, where growth slowed for a fifth consecutive month, while staff shortages and the tapering of the stamp duty holiday weighed on the services sector which fell to 55.0.

Gfk's consumer confidence index decreased marginally to -8 in August, from -7 in July. While major purchase index fell by 5 points, there was a 5-point increase in the savings index to 25, suggesting that consumers are reducing their expenditure in favour of building their savings. This may be linked to the tapering of the stamp duty holiday and the strong inflation over the past few months deterring big spending.

BoE data also reflects this frugal trend, with a net repayment of £1.4 billion of mortgage debt with no additional net consumer credit expansion meaning individuals repaid more than they borrowed overall.

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.

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 July approximately 1.6 million employments were furloughed on the CJRS across an estimated 25% of UK companies still using the scheme, down from 1.9 million at the end of June. This shows the impact of the tapering of the scheme, with companies required to contribute an increasing amount toward furloughed staff's wage from 30th June until the scheme ends in October. Since its inception, the CJRS has a cumulative cost of £68.5 billion as of 16th August.

Boris Johnson aspired to drum up momentum for climate action in a speech to the UN in September, ahead of the COP26 summit in Glasgow at the end of October. The prime minister highlighted four areas which need tackling: "coal, cars, cash and trees".

Economic trends

"

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LABOUR MARKET

In the three months to July 2021, the employment rate increased to 75.2%, while the unemployment rate continued to decrease down to 4.6%. These figures, taken with the 241,000 rise in HMRC PAYE employees in August to reach 29.1 million, returning to the pre-pandemic level of February 2020, indicate the continued strengthening of the labour market particularly when considered against the backdrop of the tapering CJRS.

Vacancies increased for the 15th-consecutive period between June and August 2021, rising to 1,034,000 – exceeding 1 million for the first time on record. Firms – particularly in the construction and services sectors – are reporting staff shortages, which is fuelling wage growth. Real regular pay grew by 4.5% in the year to July 2021, while total pay (including bonuses) grew by 6.0%, both of which represent a small decline from the previous period's record growth levels. Although these factors are also influenced by other factors, such as the low growth observed in mid-2020 and the laying-off of lower-paid staff resulting in a higher average wage, they nonetheless provide depth to the positive labour market picture.

Despite this positivity, the looming expiry of the CJRS at the end of September – impacting some 1.6 million furloughed employments – will likely drive the rate of joblessness up. Capital Economics forecasts that this will push employment up to a peak of 5.0% in Q1 2022. Those who have been furloughed for a considerable period of time may need to be retrained, either within their specialty or in an area more suited to the post-Covid composition of the economy.

INFLATION

CPI inflation increased by 3.2% in the year to August 2021, up from 2.0% in July. Inflationary pressure was predominantly sourced from rising transport and holiday-associated services such as hotels and restaurants. Last year's Eat Out to Help Out scheme, active across August 2020, has caused some distortion of the current trends by exacerbating restaurant prices.

Although many central banks still viewing the latest surge in inflation levels as transitionary and an essential component of a solid recovery. There is evidence of wider repricing in shipping costs and manufactured goods, likely caused by some genuine supply shortages as well as companies concurrently capitalising on the opportunity to raise prices, providing inflationary pressure globally. Further, governments who have racked up massive debt in alleviating the Covid fallout – such as the UK's – may be keen to maintain high levels of inflation (relative to the past 20 years at least) in order to help raise tax revenue without having to directly increase taxation.

However, 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. Given the scale of post-pandemic public debt, government finances are vulnerable to even a relatively minimal increase in interest rates.

Inflation has begun to subside in the US. As Europe has typically lagged the US in inflation in the recovery period, as well as the longer-term picture of recovery pressures subsiding and a stronger pound, there is a strong argument to support the view that a period of higher inflation would be temporary and unlikely to persist beyond 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 August 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 continuing to grow in optimism, with the August Consensus Economics survey expecting 6.8% for the year and 5.4% in 2022.

The critical factor remains the alleviation of Covid-19 impacts as borders reopen and normality continues to return. Efficacy of the vaccines against the known and unknown future variants of Covid continues to pose a downside risk to recovery, although current evidence suggests that efficacy remains high, as well as the possibility of a rise in the infection rate as we enter the winter months. These emphasise the rapid rollout of immunisations across the UK and the globe in order to reduce the chances of further variants mutating.

The significant surge in cases in the first weeks of July has since levelled off and may be on a downward trajectory. Despite the increase in case numbers, there has not been a comparable surge in hospitalisations or deaths, suggesting that the vaccines are working well.

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. Joe Biden signalled in September that the US was not considering a trade agreement with the UK, although there may be potential for to join the North American Free Trade Agreement (NAFTA).

International tensions remain high amongst key players, with several complex global issues continuing without resolve. Although these are generally being retained in the political sphere at present, there is a notable potential for one or more of these topics to seep into economic domains through sanctions, trade wars or state violence.

LATEST CONSENSUS FORECASTS – SEPTEMBER 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% Q1 2021

4.8% Q2 2021

PMI WEIGHTED AVERAGE

59.6% July

55.6% August

UNEMPLOYMENT RATE

4.6% August

REAL EARNINGS GROWTH

6.0% (including bonuses)

4.5% (excluding bonuses)

CPI INFLATION

3.2%

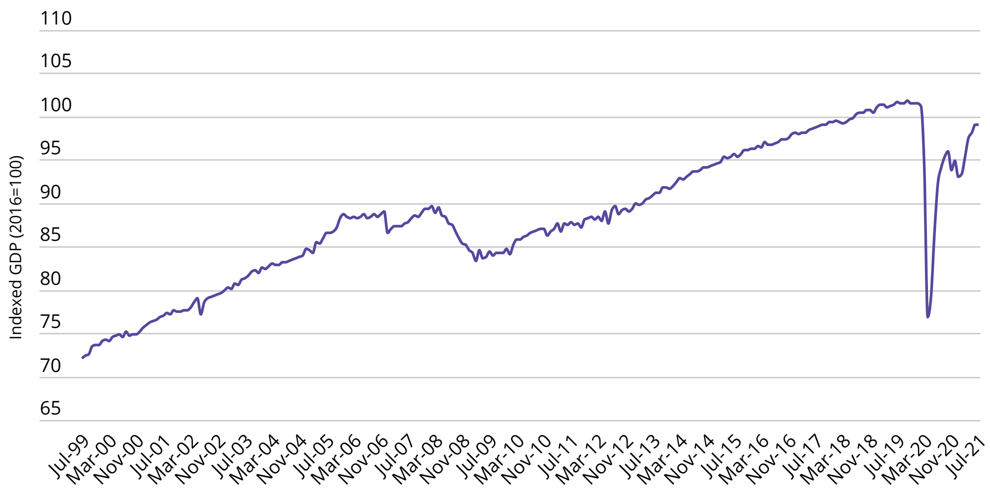
BANK RATE

0.1%

Economic data

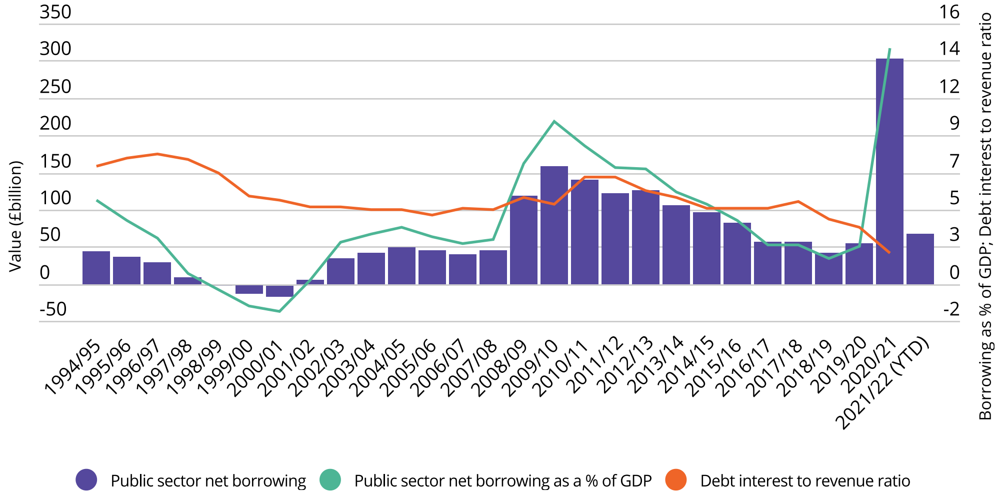
MONTHLY GDP

Source: ONS



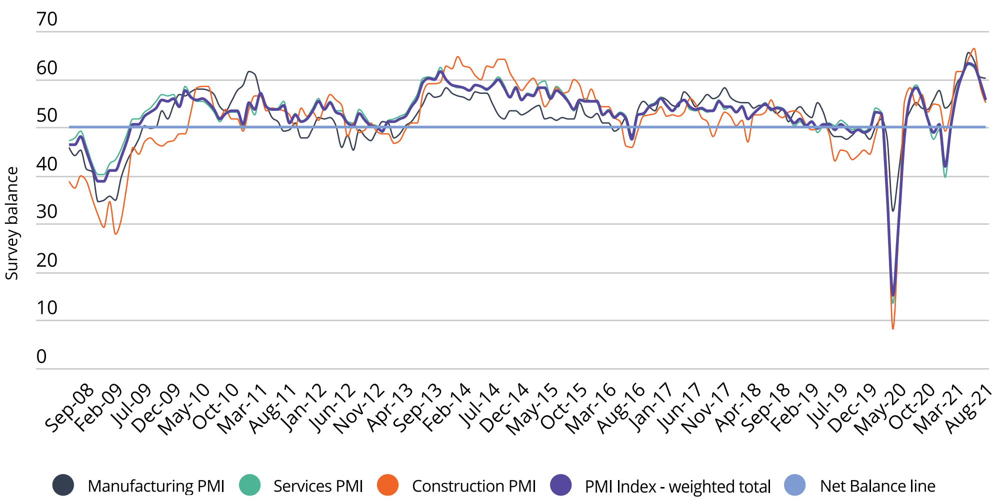
PUBLIC SECTOR NET BORROWING EXCL. PUBLIC SECTOR BANKS

Source: ONS



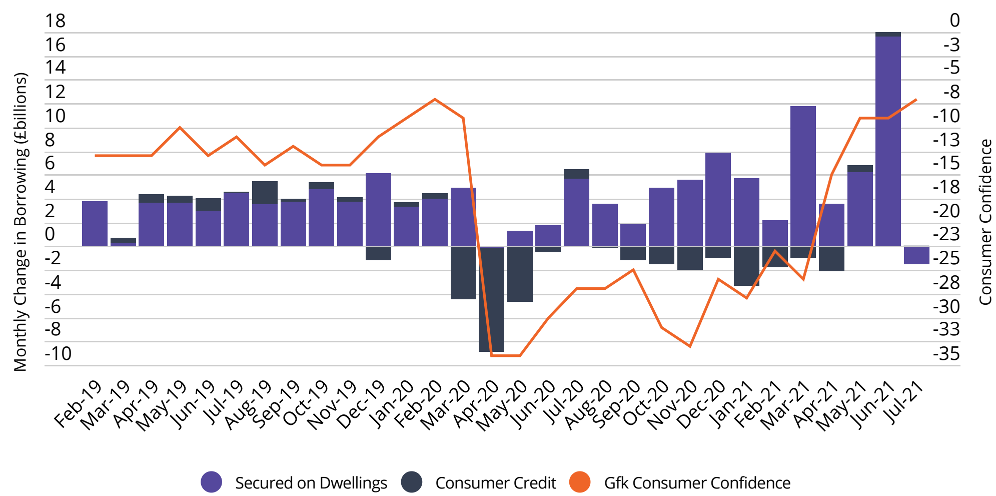
PURCHASING MANAGERS' SURVEY

Source: Markit & CIPS



CONSUMER CREDIT AND CONFIDENCE

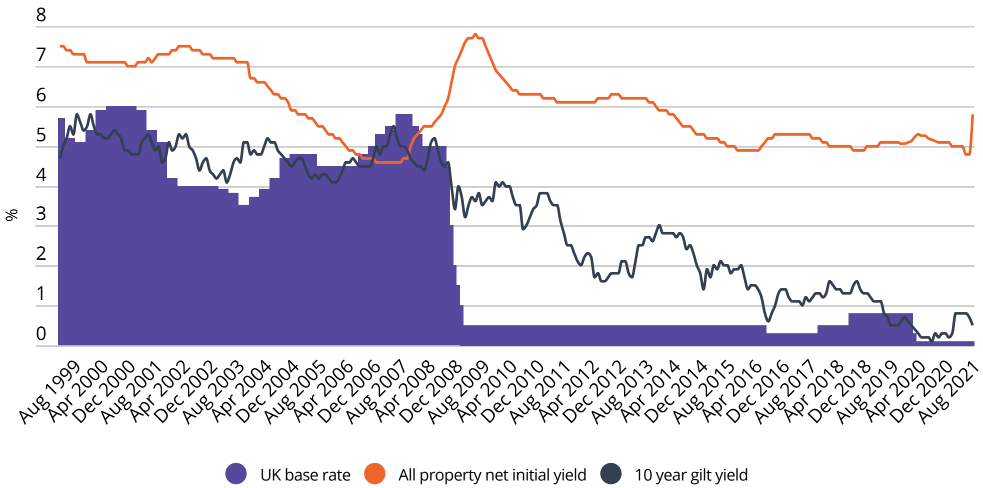
Source: Bank of England



Economic data

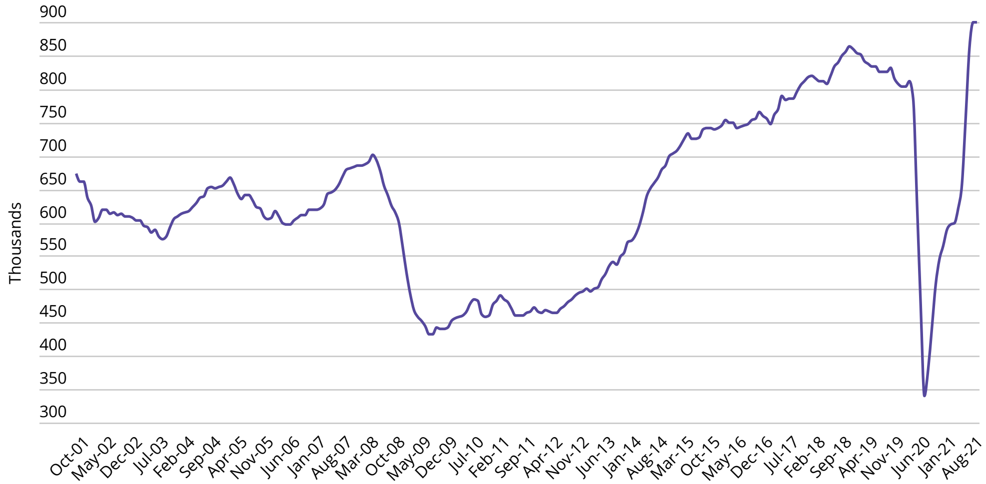
UK NET INITIAL YIELD VS GILTS VS BASE RATE

Source: MSCI monthly index, Bank of England



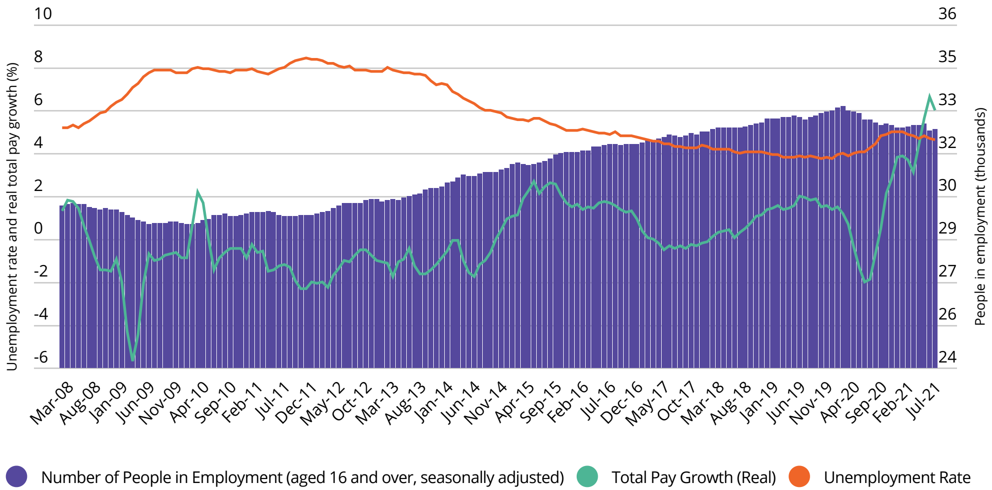
VACANCIES

Source: ONS



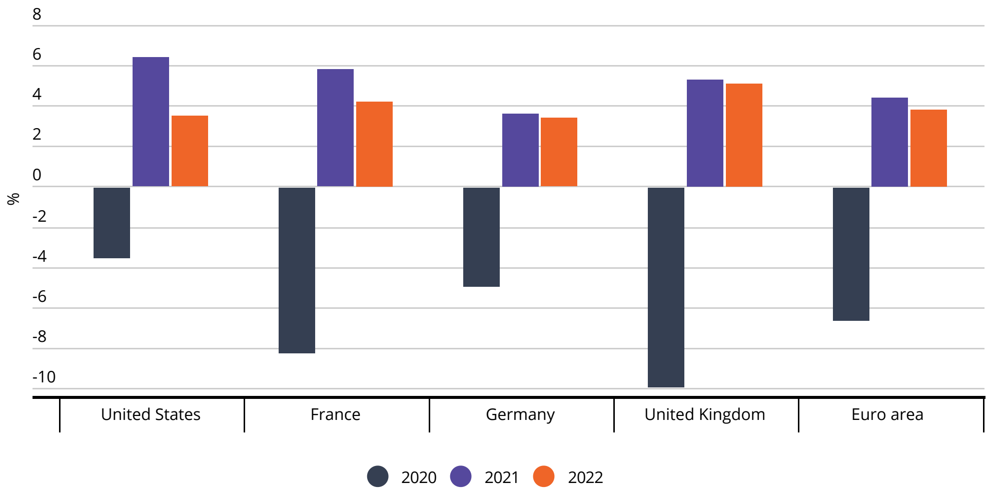
EMPLOYMENT AND AVERAGE WEEKLY EARNINGS

Source: ONS



GLOBAL ECONOMIC GROWTH

Source: IMF



Summary

- Central London office take-up totalled 2.0 million sq ft in Q2 2021, the highest figure since Q1 2020, but still 17% below the 10-year quarterly average.
- otal 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.

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 deal. 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.

Retail sales in August recorded a 0.9% decline in volume – the fourth consecutive monthly decrease despite a strong return to pre-pandemic levels in the period following the 12th April relaxation in restrictions. Food, non-food and non-store retailing all saw month-on-month declines in August, suggesting that the economy didn't regain much momentum following the stagnant July growth figures.

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.

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 subsiding down to plateau at 25.5% in July and August – 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.

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 August 2021, MSCI data reflects a similar story with the industrial sector delivering 5.2% rental value growth compared to -0.2% and -5.2% for office and retail respectively. Industrial remains the only sector to record positive annualised capital value growth at a staggering 21.6%, the strongest figure on record, compared to -3.1% and -2.0% for office and retail. Subsequently, industrial yields hardened to 4.8% in August, while offices and retail declined marginally to 6.4% and 7.0% respectively.

Occupier market

OUTLOOK

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.

Although many were hopeful that the savings accrued by consumers during the pandemic would be deployed to boost the recovery through consumer spending, but 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 over August and into September, suggesting that activity is unlikely to have bounced after the third and final relaxation in restrictions in July compared to that observed in April and May.

E-commerce appears to have retained a 25.5% share of retail sales now, 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.

The inflation outlook remains clouded. Shortages in materials and components are certainly feeding through into prices, while high vacancies are boosting wage growth which can, in turn, drive inflation further. To a certain degree, these factors are to be expected as the economy and society decide what the post-Covid composition looks like. Running the economy this hot for too long risks an inflationary spiral – like that observed in the 1970s. Central banks are keenly assessing this risk and, although it is probably low at the moment, will be willing to step in with interest rate hikes and slashes in money supply if necessary.

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

House prices continued to report strong growth in August, with the annual figure rising to 11.0% from 10.5% in July. The month-on-month change was measured at 2.1% – the second highest figure on record, behind only the 2.3% observed in April 2021. Despite tapering down, the stamp duty holiday may still be providing impetus to prices as property valued between £125,000 and £250,000 can still save a maximum of £2,500 until the scheme expires at the end of September.

Transactional activity has also been remarkably high in the first half of the year. The provisional seasonally adjusted estimate of 433,420 UK residential transactions during Q2 was only a small step down from the record 449,440 in Q1 which was the highest since statistics started being recorded in their current format in 2005. Provisional estimates suggest that transactional activity peaked at 198,900 in July before falling off substantially to 98,300 in August.

According to the RICS Residential Market Survey in August, buyer demand has cooled over the summer months which is reflected in the slowing transaction levels. New listings are also reportedly continuing to decrease, helping to maintain strong growth figures even as sales figures start to slip.

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 interest rates are likely to remain low despite the boisterous inflation figures, hence capital should remain relatively cheap.

The economic backdrop combined with a continuation of demand resulting from reassessment of housing needs are expected to 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.

> "There has been a record level of occupational activity for big box warehousing during the first half of the year

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%

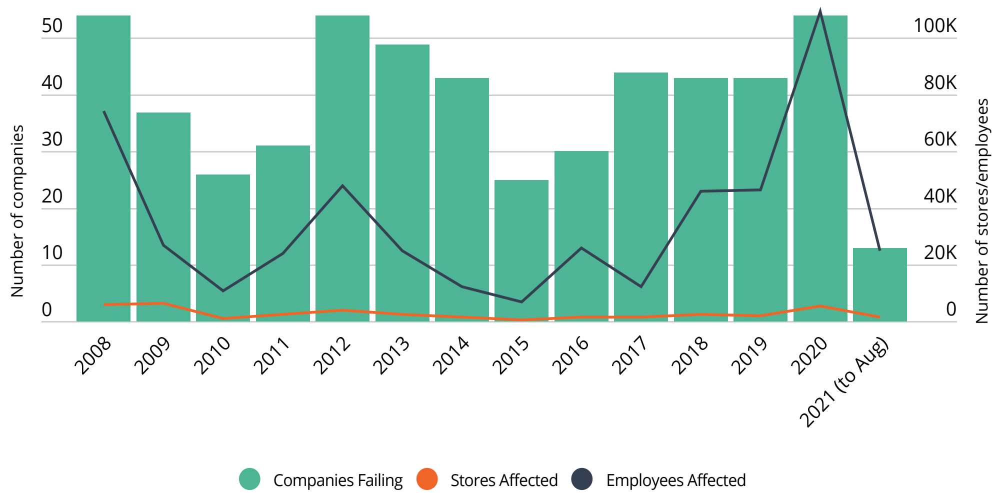
Occupier market data

BIG NINE & CENTRAL LONDON TAKE-UP

Source: Avison Young

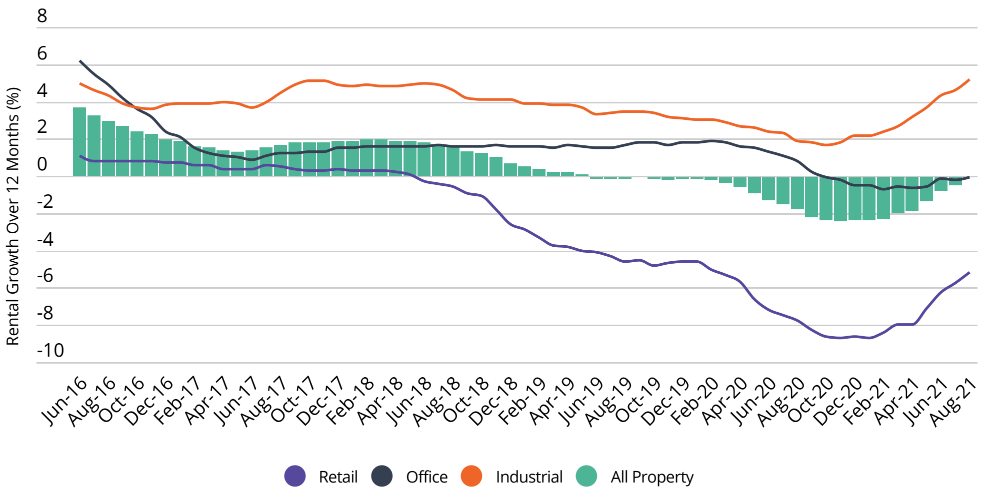
FAILING RETAIL COMPANIES

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.
- 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

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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 volumes are holding up well across the Big Nine office markets. 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 levewwl with the ten-year average.

Annual all property capital value growth achieved 5.9% in the year to August 2021, driven by the continued surge in industrial values. All property equivalent yields hardened in August to 5.8%, 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 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 continues to not equate to hospitalisations, prompting another lockdown.

However, the looming deadlines of government-sourced economic defences provided to individuals and businesses add 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 – those who feel they understand the changes in socioeconomic composition that are occuring may look to deploy capital in line with their expectations.

> **"In the near-term, there could be considerable scope for investments for those with the capital and appetite for the increased risk.**

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

5.8%

ANNUAL ALL PROP TOTAL RETURN

11.6%

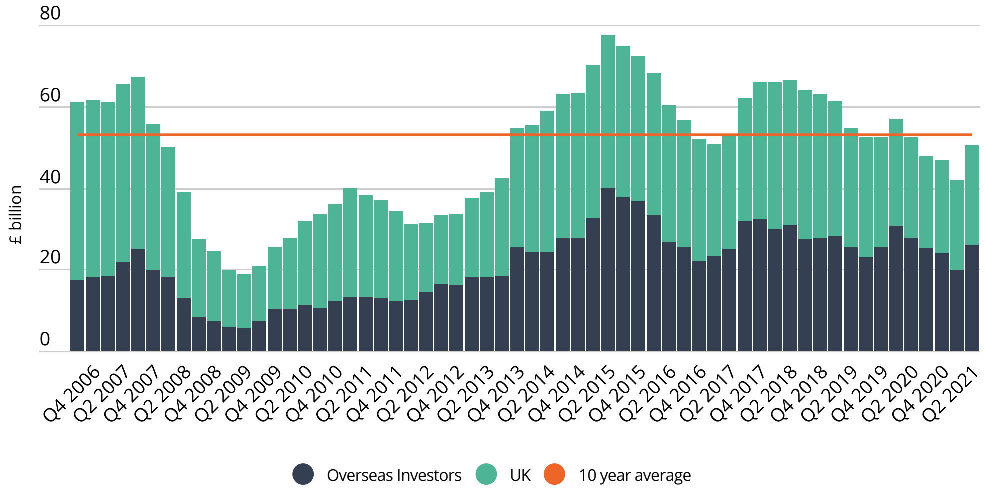
ANNUAL ALL PROP CAPITAL GROWTH

5.9%

Investment market data

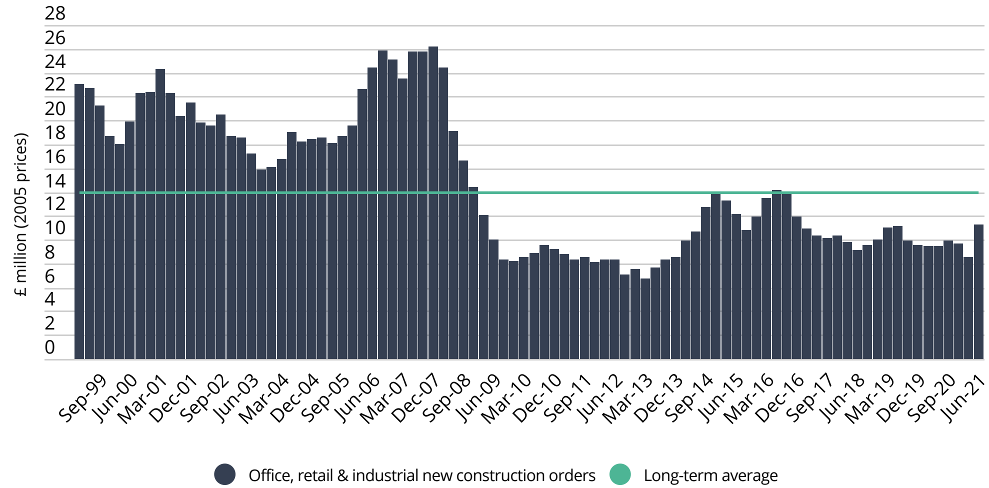
ROLLING ANNUAL INVESTMENT TRANSACTION VOLUMES

Source: Property Data



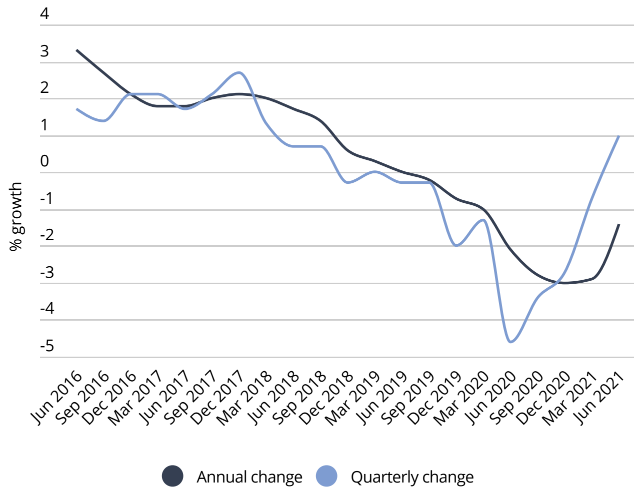
NEW CONSTRUCTION ORDERS RETAIL, OFFICE AND INDUSTRIAL

Source: ONS



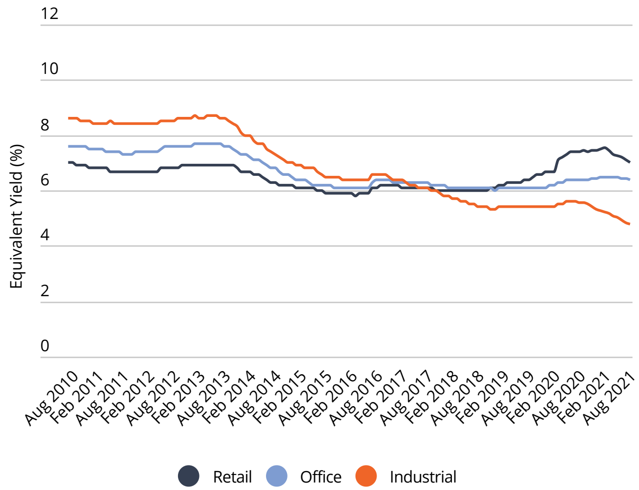
ALL PROP AVERAGE CAPITAL VALUE GROWTH

Source: MSCI



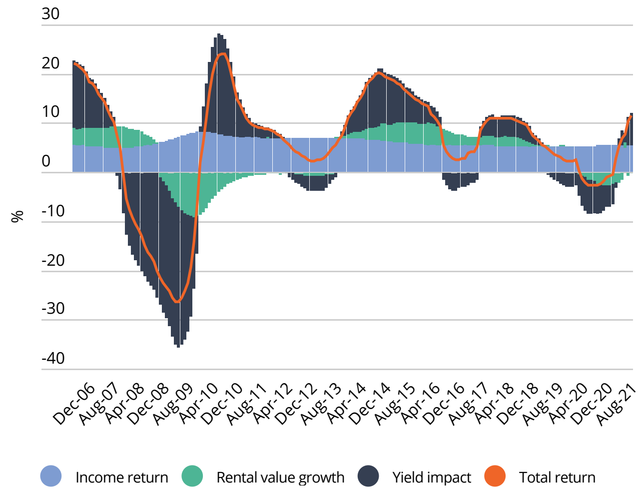
AVERAGE EQUIVALENT YIELDS

Source: MSCI Monthly



ALL PROPERTY ANNUAL TOTAL RETURN

Source: MSCI Monthly



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