2021 Forecast

South East

AVISON YOUNG

AVISON YOUNG

2021 Forecast

South East

Executive Summary

- The South East has a heavy concentration of internationally significant engineering businesses, with a large number of aerospace and defence companies.
- A potential source of new office space requirements may be seen in the 'hub and spoke' office model, with businesses keeping central headquarters but also occupying several smaller 'work near home' locations.
- Industrial property will remain in high demand from occupiers and investors across the region, supported by an enduring supply/ demand imbalance.
- Looking forward, we expect landlords and retailers will need to find innovative ways to draw the consumer in and away from online shopping, particularly in the fashion category.
- The South East's housing market will see a strong start before slowing but the region will see more suburban Build to Rent activity over the course of the year.
- Retail faces another difficult period, although some asset types, such as retail parks, fare better than others.

The South East of England is the largest regional economy outside of London and its fundamental strengths leave its real estate markets relatively well positioned for a robust recovery in 2021. Supported by the strength in life sciences, tech and engineering we expect to see Oxford and Cambridge's office markets continue to perform well, markets like Slough and Reading will take time to recover.

The South East's economy is expected to emerge from 2020 the least scathed of all the regions (Oxford Economics). In general, less urban areas have performed better than city regions and the South East combines this with a high proportion of people employed in sectors that were able to adapt well to home working. Despite this, the economic damage from 2020 has still been significant.

The South East's economic fundamentals will stand it in good stead for a strong rebound in 2021, ahead of the national average. It is a large prosperous and fast growing region with the second largest regional economy in the UK (after London). It has a low unemployment rate, does well at attracting investment and has been excellent at creating new businesses. In 2019 its increase in businesses was more than double the national level.

It has a more varied economy than many other regions and this diversity helped its resilience in 2020 and will continue to do so 2021. Its dominant sectors are ICT, pharmaceuticals, biotech, healthcare, high tech engineering and broadly these are placed to come out of the crisis relatively well and in some cases will benefit from it.

The South East has a heavy concentration of internationally-significant engineering businesses, with a large number of aerospace and defence companies. Its businesses have a high propensity to export and this does leave it exposed to fall out from Brexit. The good news from our Brexit deal is the absence of any tariffs but there will be disruption, particularly in the first half of the year, from non-tariff barriers to trade.

Supported by the strength in life sciences, tech and engineering we expect to see Oxford and Cambridge's office markets continue to perform well.

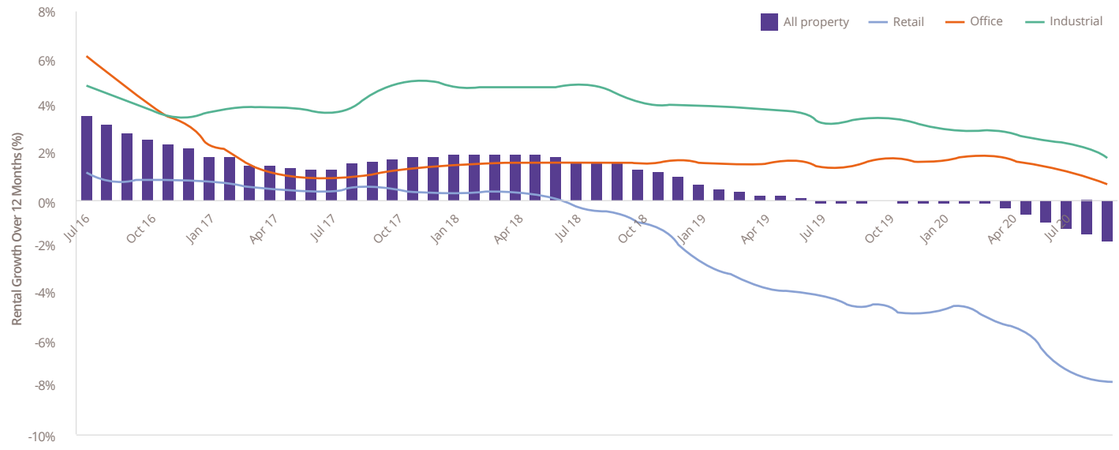
Trend watch

Portfolio Metamorphosis
We expect to see occupiers evaluate their portfolio's and look into the benefits of a hub and spoke model.

Love thy neighbourhood
With more acceptance of homworking, local neighbourhoods will see a revitalisation.

Average annual rental growth

MSCI Monthly Index



The office market in the South East has been visibly impacted by Covid-19 across 2020. The anticipated recovery in office occupancy in Q4 failed to materialise prior to renewed government restrictions coming into effect. This low occupancy and continued medium-term uncertainty has had a direct impact on the office leasing market in the South East. Take up in the region totalled 1.4 million in 2020 a 40% decline on 2019. Activity in key urban centres was particularly hard-hit, with previously robust areas such as Slough, Reading and Maidenhead experiencing a demand drought. Cambridge and Oxford appear to have bucked this trend however, with both areas increasing headline rents over 2020, along with multiple leases being taken in the Farnborough Aerospace Centre as high-tech innovation hotspots continue to attract tenants.

The largest transaction of the year in the South East office market was the 329,000 sq ft pre-let of Building 2 Ruskin Square, Croydon, by the Ministry of Housing, Communities and Local Government from Schroders and Stanhope. Followed by the co-working provider Fora taking a 15-year lease of 65,000 sq ft at Station Road, Cambridge at a new headline rent record of £48.50.

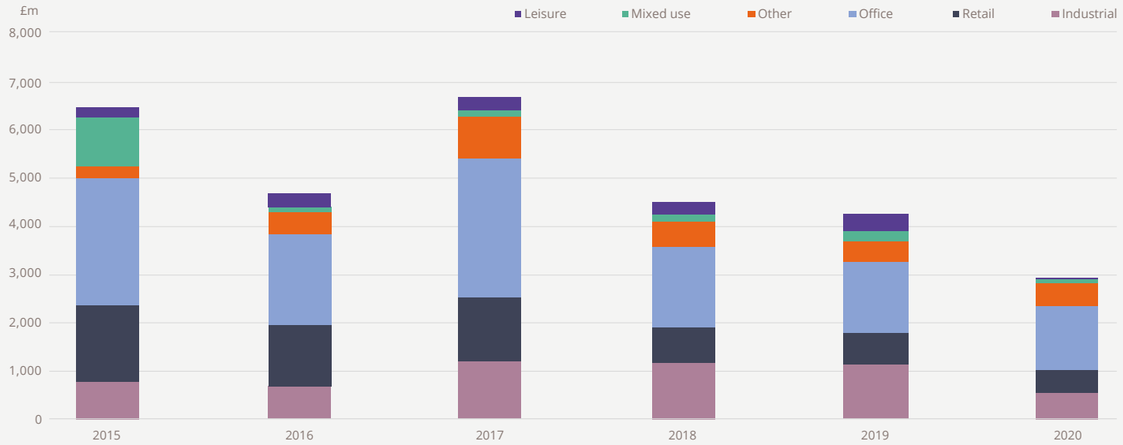
Moving into 2021, it is unlikely that activity will recover immediately in the South East. Potential occupiers are likely to delay requirements where possible until a majority of the population are vaccinated and occupancy levels subsequently pickup.

A potential source of new requirements may be seen in the 'hub and spoke' office model, with businesses keeping central headquarters but also occupying several smaller 'work near home' locations for staff. Although this is yet to come into the South East market in a meaningful way, we expect this model will come into serious consideration in the latter half of 2021.

On the investment side, there remains a gap between vendor and purchaser expectations. Many investors have adopted a 'wait and see' approach, fuelled by the prolonged uncertainty in the economic outlook. This has withheld some assets coming to market earlier in the year, made up for by a £1.4 billion flood of stock put up for sale in October and November. While enquiries recovered to some extent in H2 2020, the conversion rate remains low – a trend likely to continue until the gap between purchaser and vendor expectations narrows, or we see more distress in the market.

The South East industrial market has seen another strong year in 2020, with growth in both rental and capital values forecast to persist over 2021 and beyond. This growth has been underpinned by the ripple effect of London property values increasing, driving occupiers and investors out into the South East. This has been compounded by a chronic undersupply of quality industrial stock in the region, due to the erosion of industrial land over many years for alternative use such as residential and the lack of development opportunities that this has created generally. Meanwhile, demand has increased significantly as a result of Covid accelerating the existing upward trend in e-commerce logistics space in particular.

Investment in the South East



Last mile logistics centres, too, are seeing increased interest as a result of the expansion of e-commerce, E-fulfilment / parcel companies looking to expand their network offerings in a number of locations. Given the mismatch in supply and demand in this area – and in the wider logistics market – we expect significant upward pressure on rental values in 2021.

Data centres are also emerging as another significant occupier of industrial space in the South East. Innovation in the Cambridge-Oxford corridor is delivering the technology – as well as some of the demand – for these new hubs, which are likely to become substantially more prominent in the market over the next five years.

Investors have continued to seek out industrial assets in the undersupplied South East. Single let assets will in many cases have longer lease terms with stronger covenants whilst multi let assets offer opportunities for management and rental growth in an under supplied market. The considerable cash-backing of many of the major market players, including Warehouse REIT, Blackstone, Amazon and UK institutions, has helped to support capital value growth in the South East even as yields continue to harden to record lows. The expectation of rental growth in the South East industrial market is appearing to outweigh the capital outlay requirements. This growth comes despite the turbulence of 2020 and is expected to continue at least through 2021.

Landlords and occupiers continue to experience immense pressure in the UK. This is not only driven by the Covid pandemic and the challenges that has brought but also from changing consumer behaviour and online competition prior to the pandemic which has subsequently been accelerated. Consumers have become far more accustomed to shopping online and this, coupled with the forced closure of non-essential retail during the pandemic meant many retail, occupiers and assets have struggled. This has resulted in closures and administrations and subsequently gaps in our high streets and shopping centres.

Whilst retail on the whole has suffered greatly, some asset types have fared better than others[1]. Retail Parks have seen less disruption than their city centre counterparts due to their mix of players (heavily focused on supermarket and "essential" category retailers) but also due to their large floor plates and accessibility by car. Similarly, local high streets have seen a welcome boost in footfall as they capture activity and spend from consumers who are forced to spend time closer to home.

Looking forward, we expect landlords and retailers will need to find innovative ways to draw the consumer in and away from online shopping, particularly in the fashion category. Retail Parks will continue to attract consumers, due to their mix of occupiers in categories that have performed well recently such as food, discount, DIY and home goods. Shopping centres and High Streets which can create a sense of destination or place for the consumer will thrive, elsewhere we expect repurposing and adaption of centres.

[1] Focus On Retail In UK Cities Recovery Index

New requirements may be seen in the 'hub and spoke' office model, with businesses keeping central headquarters but also occupying several smaller 'work near home' locations for staff.

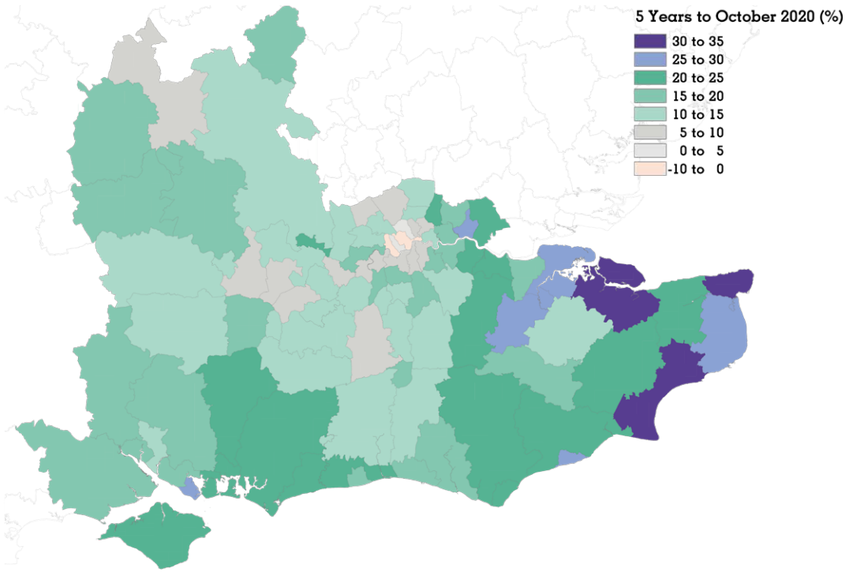
In the five years to October 2020 average house prices in the South East have risen 19%, in line with the national average. This slower growth over the last five years reflects the regions later position in the housing cycle and the region's faster recovery after the global financial crisis than the wider country. Its strong growth over that period means house prices are well above the national average. The average house price in the South East is £336, 074 compared to £262,000 for the English average. The house price to earnings ratio is 9.9, compared to 13.3 for London and 6.9 for England. The ratio is high but remains significantly more affordable than London which continues to attract people relocating from the capital.

Demand in the South East's housing market has benefitted from the shift toward flexible working practices that we have seen during 2020. Houses with attractive local environments, outdoor space and more room to work than more dense urban housing will continue to be popular in 2021. People will increasingly consider living further away from city centres as they place their living environment above proximity, or at least accessibility, to their workplace.

Build to Rent is emerging into the mainstream in the UK and the next stage of its evolution will see increased activity in the South East. Suburban Build to Rent developments are geared towards families and tend to operate with lower turnover because these households move less frequently. Nearly two thirds of suburban renters are aged over 40, which government data shows is the fastest-growing segment of the rental market. The high house prices in the South East are an increasing obstacle to homeownership and more families will remain in the rented sector longer. This makes it an ideal area for Suburban Build to Rent and this is a trend we expect to see gather momentum in 2021.

The high house prices in the South East are an increasing obstacle to homeownership and more families will remain in the rented sector longer. This makes it an ideal area for Suburban Build to Rent and this is a trend we expect to see gather momentum in 2021.

House Price Growth
HM Land Registry



Get more market information

Ros Goode
Managing Director, London
ros.goode@avisonyoung.com
+44 (0)20 7911 2840

Daryl Perry
Director, Head of UK Research
daryl.perry@avisonyoung.com
+44 (0)20 7911 2340

Visit us online

avisonyoung.com/2021-forecast

AVISON YOUNG