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UK Real Estate Market Commentary – June 2021

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Uncertainty has weighed on the UK since the EU referendum in 2016, compounded by a poor response to COVID-19 in 2020, creating conditions where the UK not only had a health crisis but also where GDP contracted by 9.9% – the deepest slump since 1709.

The pandemic gave protection to occupiers from rental payments, created restrictions on buying or selling assets, and saw debt providers temporarily pause from enforcing sales on defaulting loans and making new loans. With the UK largely having been off the map of global investors for the last few years, real estate values have lagged many other parts of the world.

Notwithstanding these challenges, the pandemic and the UK's departure from the EU hasn't changed the trends in real estate, it has just accelerated them.

Trends such as the growth of ecommerce, falling interest rates and a growing UK population were here a decade ago, but in the last year they have created a market where industrial warehousing take-up has reached an unprecedented level, where the UK's population is at a record high and where interest rates are at record lows.

As the UK reopens, we are seeing a broad investor consensus on the attraction of residential and logistics, and it is easy to see why. As the government pursues its strategy of 'building back better', its focus is on the delivery of 300,000 residential homes annually and £600bn of infrastructure investment over the next five years.

Multi-family and suburban single-family rental accommodation will help close the current affordability chasm, with investors accepting a lower return from predictable, inflation linked rental income streams in a £7trn UK residential market.

The private sector will drive demand for logistics space to meet e-commerce growth and newly created post Brexit supply chains. This is space that does not currently exist, and the development of buildings with high transport connectivity, which are located near populous and wealthy catchment areas and are able to meet ever higher environmental standards will be essential.

Higher UK property yields will continue to look attractive, with a 500bps spread between the all-property yield and 10-year UK gilts. Owners or creators of commercial real estate or high quality residential real estate will continue to find high demand for assets from yield starved investors.

Focus will increasingly grow upon how we prepare to mitigate the effects of climate change, with a target of Net Zero carbon emissions by 2050.

The UK should be relatively well placed to meet these challenges in terms of its economy, infrastructure, and geography. However, many commercial real estate assets will become obsolete in the years ahead due to the cost of improving a building's poor performance or changing its location.

Whilst delivering sufficient affordable housing is possible if the UK Government and institutional investors commit in scale, delivering a more environmentally sustainable and resilient Britain will be much harder.

With £1trn commercial property, the potential for value destruction is huge. So too, however, is the opportunity for investors who own and manage assets which are prepared for 2050. In the meantime, the slower property owners are to adapt, either by improving development standards or upgrading the assets they own, the sharper and more painful the value destruction they will experience.

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