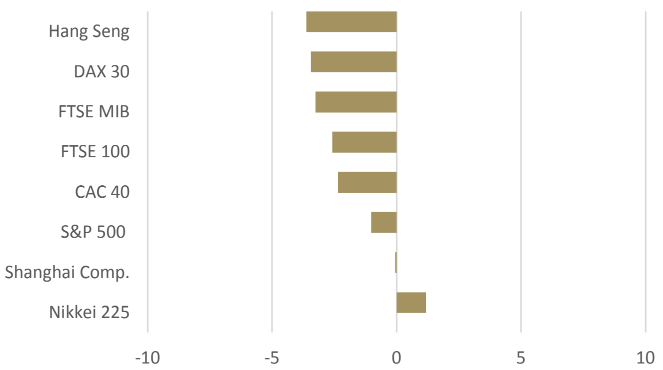
Update
October 2020

Economic Overview

An uptick in virus cases in major economies has led to more restrictive measures by governments. With these measures weighing on hopes for a recovery, most major equity markets have seen prices edge down in the past month or so (see Chart 1).

1.0 Change in Selected Major Equity Market Indices over the Last 40 Trading Days to 28/10/20 (%)



Source: Refinitiv

The increase in virus cases in the US in recent weeks, particularly in the Midwest, suggests that the country could be in the early stages of a third wave. That said, the rise in cases isn't a major concern for the economy yet. Indeed, deaths and hospitalisations remain low and, in any case, the localised restrictions imposed during the previous spike in July didn't have a major impact at the national level. But a more widespread and severe wave of infections over the winter months, which would be compounded by the impact of the regular flu season, could overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more restrictive lockdowns, which would hit the economic recovery. More encouragingly, there was a strong 1.9% m/m rise in US retail sales figures in September, which meant that on a year-on-year basis, sales were up by 5.4%. The unemployment rate also continued to fall, dropping to 7.9% from 8.4% in August.

In Europe, there has been a sharp up-tick in COVID-19 cases and as a result, more countries within the Eurozone have introduced containment measures. The latest restrictions have been more targeted than the first set and include: curfews in some major cities; the early or complete closure of restaurants, bars and nightclubs; and limits to the number of people attending theatres and sports events. But most schools and businesses remain open. Nevertheless, these restrictive measures are likely to weigh on any hopes of a recovery in the eurozone in the coming months. Meanwhile, August's retail sales rose by 4.4% m/m, meaning that sales are now 3.1% above their February level. However, a marked increase in mail order and internet sales may suggest that there is renewed anxiety from consumers about going out to the shops.

Top 5

- Equity market pricing has edged down in recent weeks following an uptick in virus cases and containment measures.

- Retail sales saw a rise, however the marked increase in internet sales suggest there is renewed anxiety about returning to the shops.

- Further restrictions by the UK government has heightened concerns in the hospitality sectors and delayed the return to the office for many office workers.

- A strong pick up in property market activity was recorded in September, up £1.3bn from the previous month. On a y/y basis however, levels remain down by 21%.

- London retailers in particular are fairing badly, with the lack of footfall from the office workers and tourists in which it has become reliant. Only 28% of retail rents have been collected, in comparison to 85% from office occupiers.

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The severity of the outbreak of the virus in the UK, which has seen the number of new confirmed COVID-19 cases reach almost 20,000 per day in the middle of October, has already prompted a tightening in measures, leaving more than 50% of England's population subject to heightened restrictions. And the drop in the composite PMI in September suggests that the recovery has already started to flatten out. The flash PMI fell from 59.1 in August to 55.7 in September. The fall in the services PMI, from 58.8 to 55.1, was probably in part due to the expiry of the government's Eat Out to Help Out restaurant discount scheme. And given that the UK survey was taken before new restrictions were imposed, the final September UK PMI reading will probably be even lower and will fall again in October. Further, the fallout in the labour market from the COVID-19 recession has been worse than previously thought as the ONS has revised its survey. Initially, the LFS measure of employment was thought to have fallen by 94,000 since February. But after adding in the 153,000 drop in the three months to August, it is now thought to have declined by 482,000, while the unemployment rate climbed from 4.0% in February to 4.5%. With the national furlough scheme closing at the end of October and the new COVID-19 restrictions likely to stall the economic recovery, there are likely to be more job losses in the coming months.

Property Overview

On the back of the rise in COVID-19 cases, the UK government has imposed further restrictive measures across the country. This is likely to heighten concerns around the retail and hospitality sectors in particular and delay the return to the office for many workers.

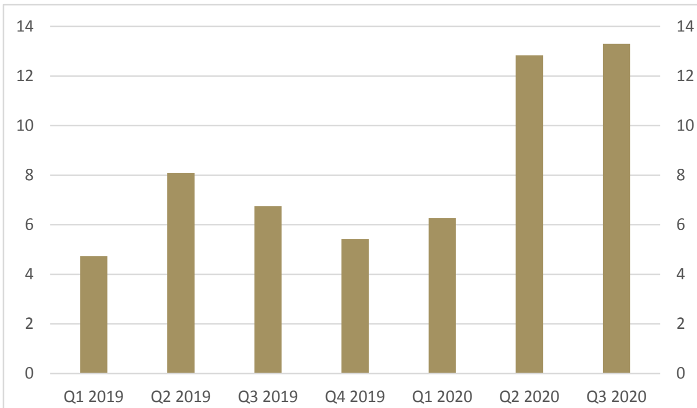
According to Springboard, the year-on-year reduction in high street footfall has fallen from minus 34% at the start of the September to minus 39% in the second half of the month. This was likely driven by the introduction of a 10pm closure for pubs, bars and restaurants which has disproportionately hit high streets that have greater exposure to the hospitality sector. Meanwhile, shopping centre and retail park footfall was down 32% and 11% respectively.

With virus fears and government restrictions hurting footfall and accelerating a shift to ecommerce, a record number of stores have closed in the UK in H1. Indeed, PwC and the Local Data Company report that there was a record high net closure of 6,000 stores in the UK in H1 2020, which was almost double the minus 3,500 net change in H1 2019. And the survey does not include temporarily closed sites, so there could be further closures if there is not more government support in the near term.

On the one hand, store openings have been driven by changing consumer behaviours and preferences, which has led to the success of many value retailers and supermarkets, as well as takeaways and coffee shops. By contrast, many net closures have been dominated by the effect of structural changes on specific retail sectors. For instance, many banks have closed physical branches in favour of online services and fashion retailers have increased their online presence, while cutting back on physical sites.

The rise in ecommerce has benefited the industrial market, which has seen occupier demand strengthen further in Q3 and reach its second consecutive quarterly record. Indeed, CBRE report that take-up increased from 12.8m. sq. ft. in Q2 to 13.3m. sq. ft. in Q3 (see Chart 2). At the same time, availability edged down slightly from 26.3m. sq. ft. to 25.3m. sq. ft. and speculative construction remains low. This is likely to provide support to industrial rents this year.

2.0 Industrial Take-Up (M. Sq. Ft.)

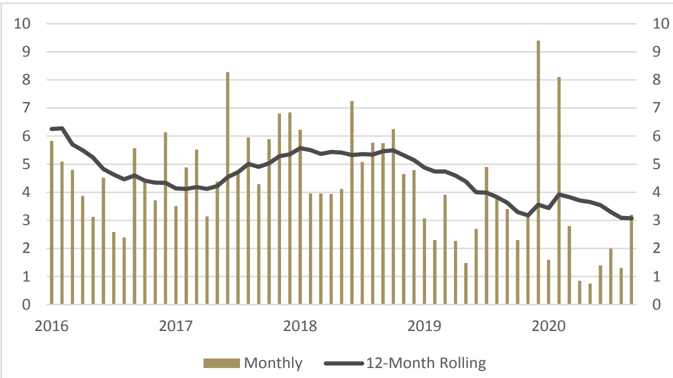


Source: CBRE

For the office market, the number of workers returning to the office was gathering pace before government advice reverted back to working from home. Morgan Stanley report that 45% of office staff were back in the offices in September, compared with 37% in August. This is likely to have fallen back with the government advising people to work from home if they can again. Nevertheless, even at 45%, the return to the office in the UK lagged behind major economies in Europe such as France, Italy, Spain and Germany, which all saw over 75% of workers return.

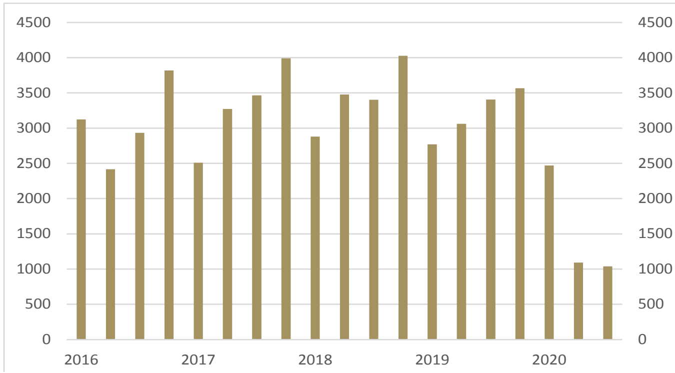
Meanwhile, there was a strong pick-up in investment activity in September. Indeed, data from Colliers show that transactions totalled £3.2bn, up from £1.3bn in the previous month (see Chart 3). This was only 6% down compared to September 2019, but on a year-to-date basis, activity is still down by 21%.

3.0 Monthly Investment (£bn)



Source:Colliers

4.0 Central London Take Up (000s Sq. Ft.)



Source:CBRE

The improvement in investment activity in September was driven by with a marked rise in all sectors. Given the elevated proportion of ecommerce, it is unsurprising that industrial investment continued to grow. More surprisingly, retail totalled £550m, up from just £150m in the previous month and almost double its 12-month average. In particular, investors bought retail warehouses and supermarkets, which have been the least affected retail sub-sectors. On the other hand, while office investment recovered somewhat from its low levels in August, September's total was still around 20% down on its 12-month average. This may highlight concerns that investors have regarding long-term remote work trends. Moreover, with the consensus view that capital values will continue to fall next year, there is still likely to be a degree of mis-match between buyer and seller price expectations, which will prevent a strong recovery in the final months of the year.

London Property Market

Although investment in London offices improved in Q3, it remains low compared to its historic trend. CBRE report that investment activity totalled £900m in Q3, up slightly from the £780m seen in the previous quarter. In part, this still-low level of activity reflects challenges around viewings and completing deals as well as a mismatch between buyer and seller price expectations.

In the occupier market, after falling sharply in Q2, Central London office take-up fell again in Q3. According to CBRE, take-up totalled 1m. sq. ft. in Q3, down 10% on the previous quarter. As a result, this was the lowest quarter on record (see Chart 4).

At the same time, availability continued to rise sharply. In fact, the 23% q/q rise meant that availability reached 19.9m sq. ft., the highest level since 2009. This was largely due to a rise in second-hand space and pushed the vacancy rate to 6.5% from 5.3%.

There was 13.9m sq. ft. under construction at the end of September, of which just over half was either let or under offer. However, this will simply shift tenants from old buildings to new, meaning that older space will see the majority of the rise in vacancy. Somewhat more positively, delays caused by COVID-19 to completions and new starts could help to limit the rise in vacancy and ease some of the downward pressure on rents.

Further ahead, while it is uncertain how much of a demand shift that working from home will have in the long-term, most surveys point to workers indicating that they want more flexible working practices. As a result, the City of London Corporation plans to diversify its occupiers away from its reliance on professional services. Within the next five years, they have set out a plan to have a fifth of office tenants as new businesses to the City and largely transform vacant retail spaces into affordable hubs for more start-ups. The City is aiming for more affordable workplaces for smaller businesses, buildings better adapted for remote working and introducing a flexible working season tickets for rail travel to incentivise tenants.

Regional Property Market

Regional office investment rose in September. According to Colliers, transactions were up from £165m in August to £290m, the highest monthly total so far this year. Nevertheless, Knight Frank note that sentiment towards regional office assets remains negative. Prime regional office yields were steady in September, at 5%.

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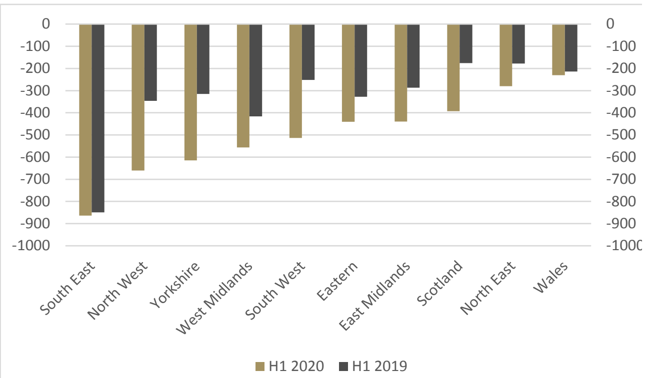
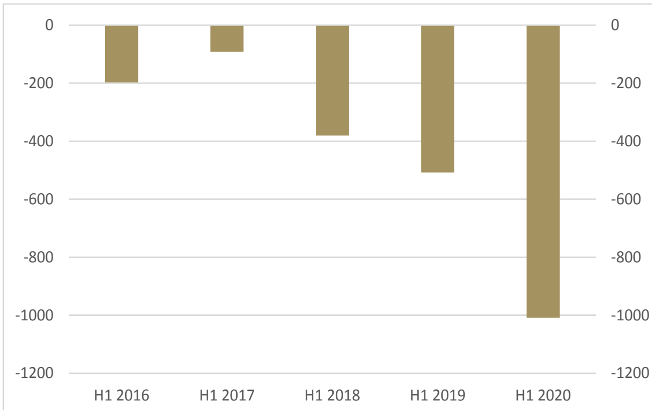
Meanwhile, government restrictions and virus fears have accelerated a decline in retail stores in the regions. Indeed, PwC and the Local Data Company note that there were almost 5,000 net closures of stores in the regions in H1, up from 3,400 closures in the year before. While the South East was the region that saw the most net closures, it was in line with the decline a year ago (see Chart 5). By contrast, regions such as Scotland, the South West, Yorkshire and the North West saw net closures increase by over 90% y/y in H1 2020.

5.0 Store Net Closure by Regions



Source: PwC and Local Data Company

6.0 London Store Net Closure Returns (%, p.a.)



Source: PwC and Local Data Company

With stores often based in dense commuter areas within London and many workers still working from home and fewer tourists, chains such as Upper Crust, Wasabi and Itsu have been forced to launch CVAs. And concerns around more working from home in the future have led to similar companies assessing their locations in the long-term.

With many retail tenants seeing a sharp fall in business, many have not paid rents and London landlords have taken a hit to their incomes. For instance, Great Portland Estates, which owns properties in just Central London, has only received 28% of its rents due for the end of September from retail, hospitality & leisure tenants. By comparison, 85% of rent has been collected for other sectors, mainly offices.

With virus numbers rising, a surge in tourism flows and a return to the office is unlikely in the near-term. As a result, without further government support, the New West End company, which represents retailers across Oxford Street, Bond Street, Regent Street and Mayfair, estimates that more than 50,000 retail jobs could be at risk and £5bn could be lost in sales.

Sector Spotlight

London Retail

With footfall still weak, London retailers are faring badly. According to Springboard, London footfall was down 56% y/y in September, compared to minus 36% y/y in regional cities. Further, with workers being advised to work from home if they can towards the end of the month and London in tier two lockdown – high alert – the outlook for retailers over the coming months is likely to deteriorate further. With retail rents in London already high and footfall so low, it is unsurprising that store openings are stalling and closures are accelerating rapidly. In fact, PwC and the Local Data Company report that there was a net decline of 1,000 stores in London in the first half of this year, double the fall seen a year ago (see Chart 6). This also meant that the decline in London was worse than the average for Great Britain for the first time. One sector that has been hit particularly hard is the food-to-go market.

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