

Quadrant Real Estate Advisors LLC

# U.K. Economic & Commercial Real Estate Market Commentary

2nd Quarter 2020



Atlanta, Georgia • London, England  
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### **About Quadrant Real Estate Advisors**

Quadrant Real Estate Advisors LLC ("Quadrant") is a United States SEC registered investment adviser and Australian Securities and Investments Commission ("ASIC") Foreign Registered Corporation (ABN 39 123 863 963). Quadrant has been approved by the Central Bank of Ireland to act as an Investment Manager on behalf of Investment Funds. QREA Europe LLP ("QREA") is a subsidiary of Quadrant and is authorised and regulated by the Financial Conduct Authority (registration number 610613). As of June 30<sup>th</sup>, 2020, Quadrant had approximately \$1.25 billion of commercial and multifamily real estate investments under management on behalf of institutional investors. Clients include insurance companies, pension funds and sovereign wealth management funds.

Since 1993, Quadrant's senior management has worked together as a team providing the firm's clients with access to both privately placed and publicly traded commercial real estate debt and equity investments through commingled funds and single client accounts. In addition to experience, senior management controls 100% of the firm, thereby providing true alignment of interests and accountability.

The firm's executive leadership includes Kurt Wright, Chief Executive Officer; Walter Huggins, Executive Vice President; and Jessica Eggins, Executive Vice President.

## Executive Summary

- **COVID-19**

### **General**

- The full effects of the COVID-19 lockdown were felt throughout Q2 2020, as the Government restrictions dampened economic activity across all sectors and the UK experienced its largest economic contraction on record.
- Restrictions are currently being eased on a phased basis, with retail, offices and hospitality services opening by quarter end.
- Travel restrictions will likely remain for several months, and social distancing rules continue to strain economic performance.

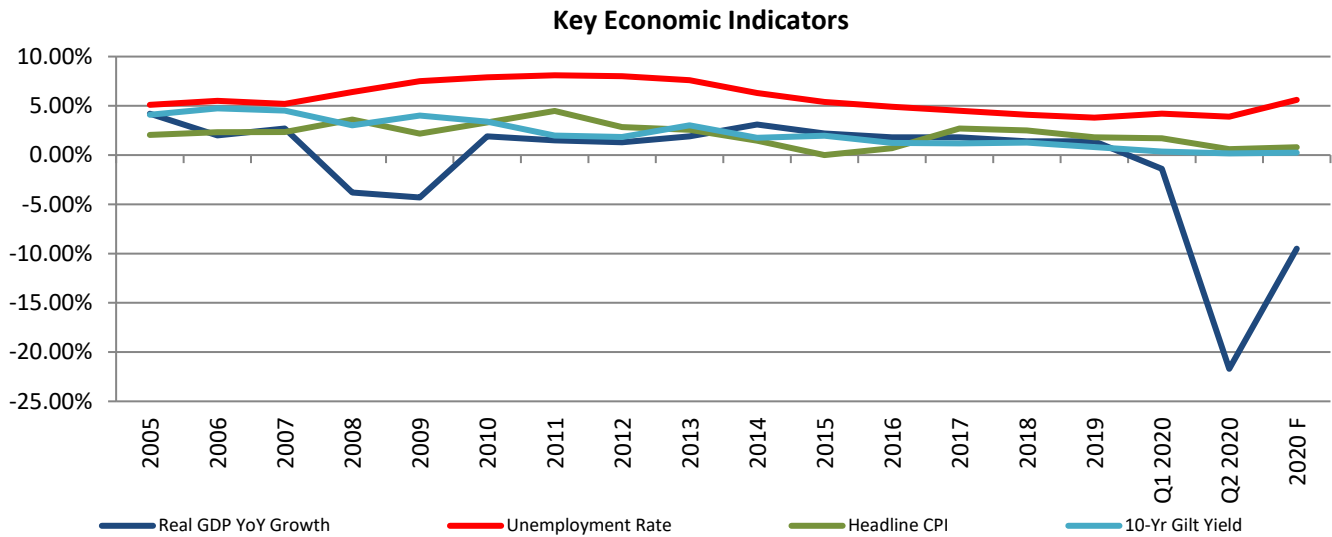
### **UK Response**

- The UK has implemented several policies to combat the COVID-19 crisis. The main programs of note are:
  - Coronavirus Job Retention Scheme
    - Furloughed workers receive 80% of their current salary. The program will end in October 2020.
  - Grant funding for small businesses and wider support for the retail, hospitality, and leisure sectors.
  - Government backed Business Continuity loans.
  - Business Rates (property tax) and VAT holiday for retail, hospitality and leisure businesses.
    - Businesses in the retail, hospitality and leisure sectors in England will not have to pay Business Rates for the 2020 to 2021 tax year.
  - Eviction holiday
    - Landlords will not be able to start proceedings to evict tenants for a six-month period starting March 25<sup>th</sup>, 2020.

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- **2020 GDP is forecast to see a -9.5% contraction.**

- Real Gross Domestic Product (“GDP”) growth in the U.K. for the quarter ending June 30, 2020 is estimated to have declined -21.7%, down from +1.3% for the same quarter in 2019.
  - This is the sharpest quarter decline in GDP on record. The UK has also entered its first recession since the 2008 financial crisis.
- According to the Office of National Statistics (ONS), 76.4% of people were employed in Q1’2020, compared with 76.6% in Q1’2020.
  - However, it is important to note that approximately 7.5 million people have claimed money through the furlough scheme. When the furlough scheme ends, unemployment is expected to increase.
- The Bank of England Bank Rate was cut during March from 0.75% to 0.1% as an emergency measure in the wake of the COVID-19 pandemic.



Source: Bloomberg, Capital Economics, Office for National Statistics

- The pound increased by 0.81% against the US dollar to \$1.24 at the end of the current quarter. The pound decreased -2.63% against the Euro to €1.11 at the end of the current quarter.

• **Brexit**

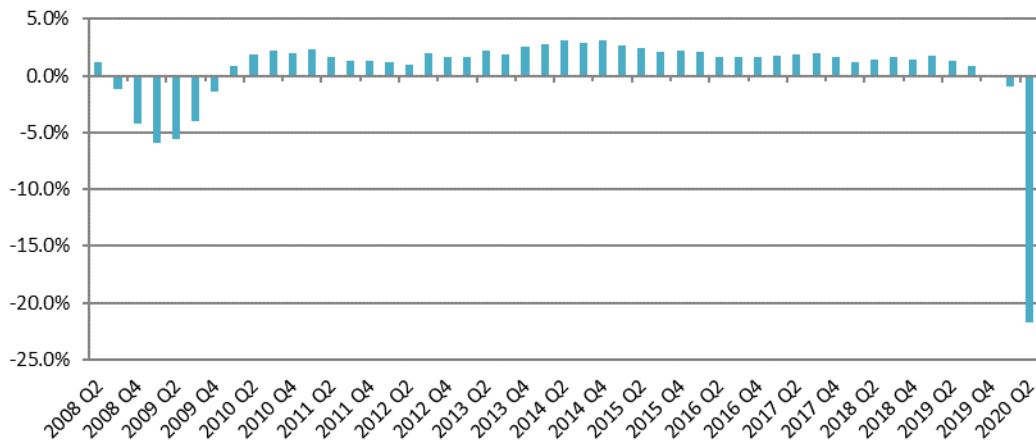
- The UK officially left the European Union on January 31st, 2020, starting an eleven-month transition period during which, the Government will seek to negotiate arrangements and trade deals.
- The current rules on trade, travel, and business will continue to apply during the transition period, ending January 1st, 2021.
- However, there is still significant uncertainty surrounding the manner in which the UK will leave the EU, specifically whether a deal can be agreed and what it will look like.
- Quadrant remains cautious on UK commercial real estate.

## U.K. Economy

### Gross Domestic Product (“GDP”)

- Real Gross Domestic Product (“GDP”) growth in the UK year-on-year for the quarter ending June 30, 2020 is estimated to be -21.7%, down from 1.3% in the same period ending June 30, 2019 (2300 BPS decline).
- This is the largest quarterly GDP decline the UK has ever experienced and was attributed to the COVID-19 pandemic.
- The true economic impact of the pandemic will only become clear when central government support is rolled back and Q3 & Q4 2020 growth figures are available. The current forecasted GDP growth for Q3 and Q4 2020 are -10.2% and -6.6% respectively.

**Real Gross Domestic Product Growth (GBP-denominated)**

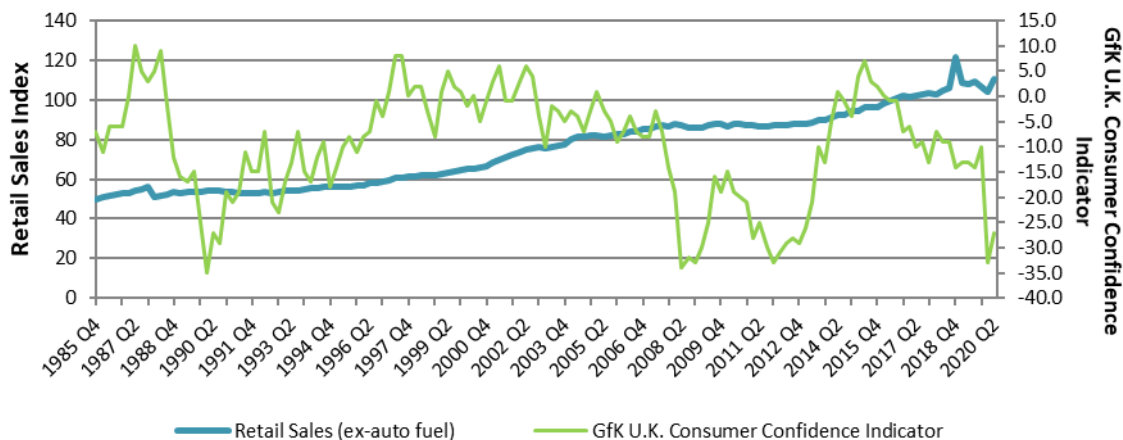


Source: Bloomberg, Office for National Statistics

### Consumer Outlook

- The GfK U.K. Consumer Confidence Indicator for Q2’2020 rose to -27 from -33 in Q1’2020.
- Nominal retail sales (excluding automobile fuel) increased by 6.1% quarter-over-quarter, and 2.3% year-over-year.

**Consumer Confidence and Nominal Retail Sales**

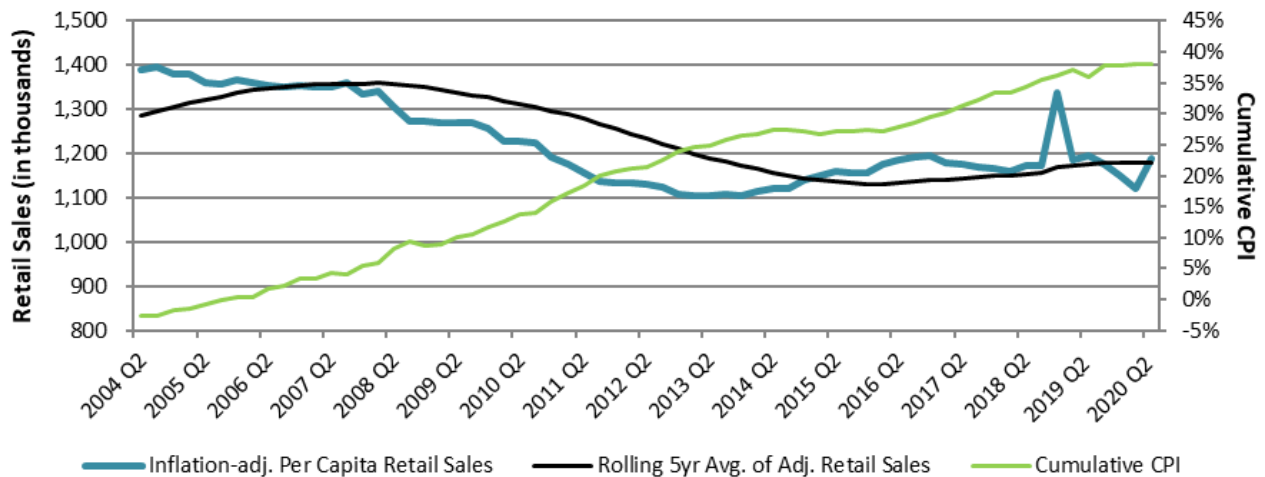


Source: GfK, Office for National Statistics

### Consumer Spending & Inflation

- Inflation-adjusted per capita retail sales in Q2'2020 remained stable at £1,188.
  - The metric remained 12.96% below the first quarter 2008 pre-recessionary amount of £1,342.

**Inflation-Adjusted Per Capita Retail Sales**



Source: Bloomberg, Office for National Statistics, Quadrant Real Estate Advisors

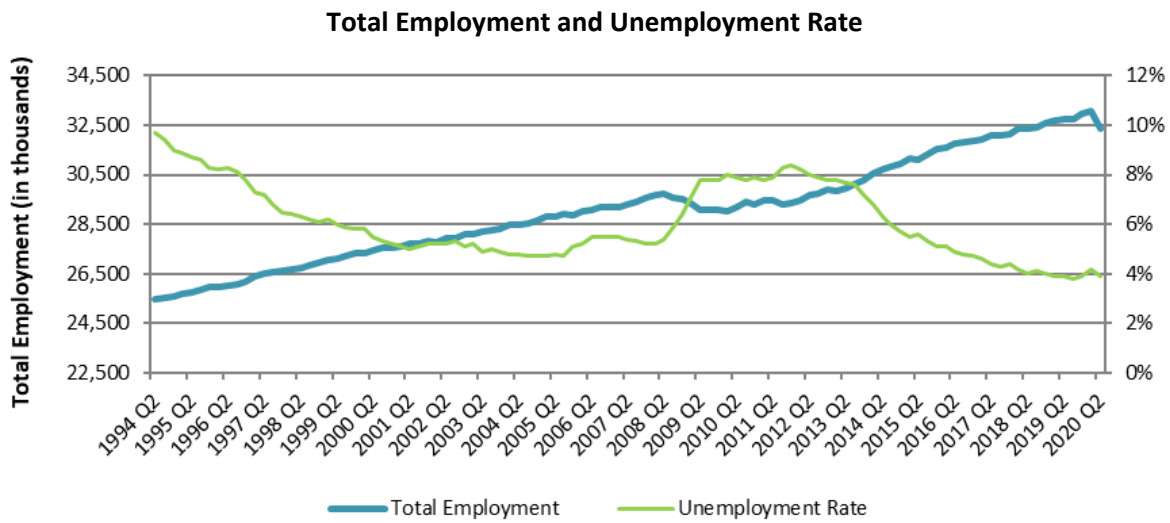
Note: Retail sales represent Retail Sales (excluding automobile fuel). Quadrant has adjusted Retail Sales to reflect per capita Retail Sales in December 1991.

- The Bank of England has maintained its inflation target of 2% per annum.
- The Consumer Price Index ("CPI") remained stable at 1.5% year-on-year.

### Labor Market

**Note:** The COVID-19 Pandemic has led to a spike in furloughed workers, and when the furlough scheme ends in October an unemployment spike is expected.

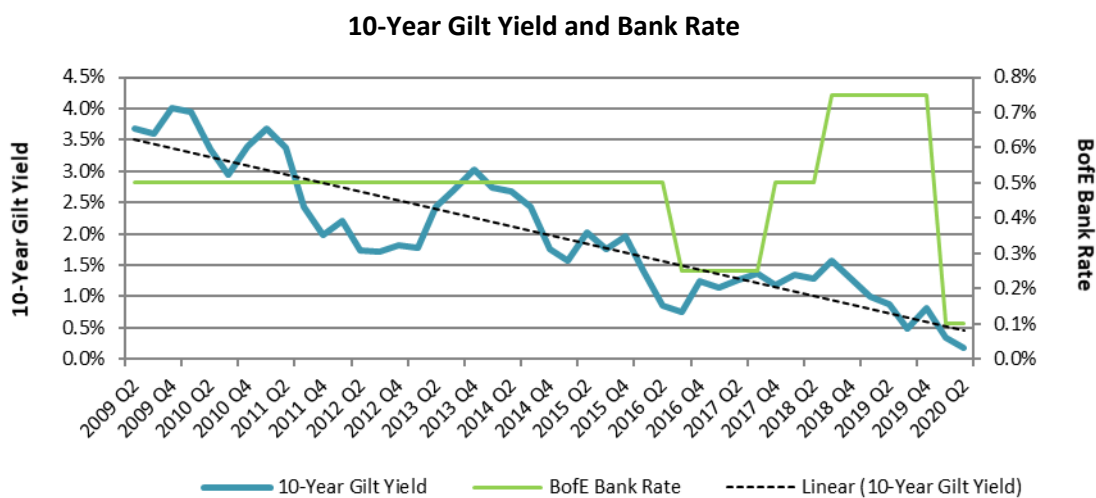
- Total employment decreased to 32,343,000 as at end June 2020 which is 730,000 less than last quarter.
- Employment among people aged between 16 and 64 remained stable 76.4%.
- The unemployment rate decreased by 0.1% to 3.9% for Q2'2020 equating to roughly 1.35 million people.
  - If the coronavirus crisis is factored in, it is estimated that the unemployment rate at end of Q2 2020 was between 8%-10%, sharply up from 4.00% in March 2020. This figure excludes workers placed on furlough under the Coronavirus Job Retention Scheme, which is estimated to support a further 7.5 million employees.



Source: Bloomberg, Office for National Statistics

### Interest Rates

- The Bank of England Bank Rate was cut during March from 0.75% to 0.1% as an emergency measure in the wake of the COVID-19 pandemic.
  - The rate was originally cut to 0.25% on 11 March 2020 and was cut again a week later to 0.1% in response to the worsening COVID-19 conditions.
- It is expected that any increases in the bank rate after the crisis will be implemented at a gradual and slow pace, depending on the length and severity of the economic downturn.
- 10-Year Gilt yields decreased quarter-over-quarter from 0.350% to 0.170%.



Source: Bloomberg

**Interest Rate Benchmarks**

Benchmark	March 2020	June 2020
3-month LIBOR	0.59%	0.14%
3-year LIBOR	0.49%	0.19%
10-year EUR Swap	0.59%	0.37%

Source: Bloomberg.

**U.K. Commercial Real Estate Market Fundamentals****Property Investment Yields (Cap Rates)**

Property Sector	Market Sentiment	Jun-20	Mar-20	Jun-19
<b>Office</b>				
London – West End (Core)	Negative	3.50% - 3.75%	3.50% - 3.75%	3.50% - 3.75%
London – City (Prime)	Negative	4.00% - 4.25%	4.00% - 4.25%	4.25% - 4.50%
SE Towns	Negative	5.25%	5.00%+	5.00%
Major Regional Cities	Negative	5.00%	4.75%	4.75%
<b>Retail</b>				
High Street Retail – Prime	Negative	6.25% - 6.50%	5.50%	5.25%
High Street Retail – Good Secondary	Negative	8.25%+	7.50%	6.50%++
High Street Retail – Sec./Tertiary	Negative	10.00%++	10.00%++	10.00%++
<b>Shopping Centres</b>				
Shopping Centres – Regional Scheme	Negative	7.00%+	6.00%	5.25%
Shopping Centres – Local Scheme (successful)	Negative	9.50%+	8.75%	8.50%
Shopping Centres – Local Scheme (Challenged)	Negative	12.50%+	11.50%	10.00%
<b>Industrial</b>				
Bulky Goods Parks – Prime	Negative	7.00%	6.50%	6.00%+
Bulky Goods Parks – Secondary	Negative	8.50%+	8.00%	7.50%+
Distribution – Prime	Stable	4.00%-	4.00%-	4.00%
Distribution – Secondary	Negative	5.50%	5.00%	5.00%
SE London Estate – Prime	Negative	4.25%+	4.00%	4.00%
Estate – Secondary	Negative	6.25%+	6.00%+	6.00%

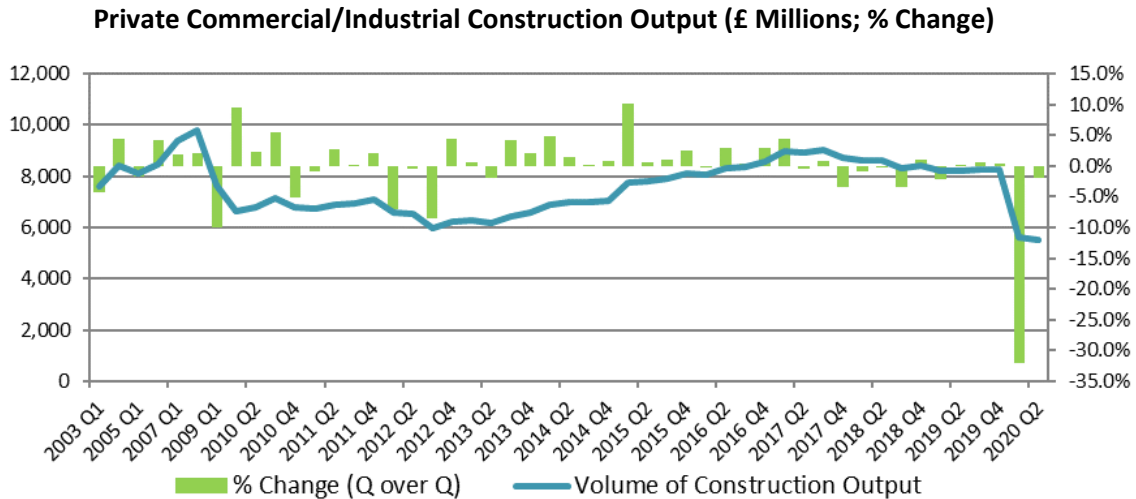
Source: Knight Frank &amp; Savills – Yield guide is for indicative purposes only.

Note: "Secondary" refers to outlying markets.



**Spatial Supply**

- Construction output fell by -2.0% in the three months to June 2020, compared with the previous three-month period.
- The following chart shows private construction output volume (left axis) and quarterly percentage change (right axis).



Source: Office for National Statistics, Quadrant Real Estate Advisors, Bloomberg

- The Royal Institute of British Architects’ have reported a 6-point drop to -17 in their Future Trends Workload Index. The index fell to -82 in April, the steepest fall in confidence on record.
  - The ‘RIBA Future Workload Index’ graph shows the difference between those expecting more work in the next three months, and those expecting less.
  - Future projects still face significant challenges, as the COVID-19 restrictions hinder supply chains and jeopardize the construction timeline.

**Rental Rate Growth**

**U.K. CRE Rental Rate Growth by Property Sector**

Property Sector	Rental Growth					
	2016	2017	2018	2019	2020 Q1	2020 Q2
Office	2.9%	0.7%	1.5%	0.6%	0.5%	0.0%
Retail	1.0%	1.4%	1.2%	-1.1%	-1.0%	-12.9%
Industrial/Warehouse	3.5%	10.4%	8.0%	1.5%	1.9%	2.0%

Source: RICS: UK Commercial Property Market Survey, RIBA: Future Trends Survey, Capital Economics/CBRE

## Sources

- *Bloomberg*, [www.bloomberg.com](http://www.bloomberg.com);
- *Office for National Statistics (ONS)*, [www.ons.gov.uk](http://www.ons.gov.uk);
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- *Bannon*;
- *Cogent*;;
- *PWC*;
- *HOTSTATS*;
- *Daft.ie*;
- *IDA*;
- *RICS*;
- *RIDA*;
- *Quadrant Market Discussions*.

## Important Disclosures

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