Economic Research

**Brexit**
The impact on UK commercial real estate

Despite initial common concerns after the Brexit referendum in June 2016, the market has remained resilient with transaction volumes, demand and take-up remaining solid so far. Although the negotiations are still on-going we see good reasons to invest in commercial real estate in the UK.

### Opportunities
- The UK offers a liquid and transparent real estate market; ease of doing business; a flexible, skilled and diverse labour market; and a history of innovation and reinvention
- Sterling devaluation has supported manufacturers, helping to diversify sources of economic growth
- Infrastructure investment such as Crossrail, HS2 and Heathrow expansion will aid UK economic competitiveness
- UK government bond yields remain well below historical averages. The large yield gap compared to UK real estate is attractive
- Rental growth in parts of the real estate market is expected to continue

### Risks
- The UK economy is largely driven by consumer spending. It is exposed to higher inflation and lower real earnings
- Elements of the service sector and financial services may need to relocate to mainland Europe in the event of a “hard” Brexit
- Reduced labour mobility could impact all sectors and real estate markets
- Continued political uncertainty over the nature of the UK/EU negotiation outcome and domestic political disruption could dampen UK occupier and investor activity in real estate market

### The UK real estate market since the referendum
- Occupier demand and take-up has remained solid since the referendum. Large corporate occupiers have undertaken contingency planning to mitigate risks from the UK/EU negotiations but there are no examples of major relocations yet
- Rental growth in Central London core office markets has stalled with evidence of increasing occupier incentives. The development pipeline beyond 2019 is low and occupiers continue a flight to A-grade space in order to secure the quality offices they need to attract and retain the best talent. This will support medium term prospects
- Tech occupiers have been particularly active in Central London with Google, Apple and Amazon confirming or expanding their pre-letting requirements since the referendum; reflecting a diversification of the occupier base
- The UK, especially London, has been a financial centre for centuries. Its legacy, skilled labour, language, cultural and time zone relative to other financial hubs will support the sector’s long-term health

- Non-core Central London and UK regional locations have seen stable or positive rental growth since the referendum due to on-going occupier demand and a shortage of quality stock in many markets
- The UK Government tax authority is driving regional office demand through a program of decentralisation and consolidation. The regions are also absorbing back-office functions from occupiers optimising business functions whilst older office buildings are being converted to residential, reducing supply further
- Like elsewhere, retail is most exposed to economic headwinds. E-commerce continues to gain traction with successful retailers embracing omni-channel retail through “click and collect” and other real estate strategies
- The industrial sector has outperformed with high investor interest and occupier demand. Stock is undersupplied and it is benefiting from the structural shift towards e-commerce and responsive supply chains
- There is a growing alternative sector covering a variety of submarkets and assets. These have offered strong diversification and performance helping match investors cash flow requirements or liabilities
The UK economy since the referendum

- Prior to the referendum it was predicted that a vote to leave the EU would trigger a severe economic downturn. Whilst a slowdown has occurred, the economic impact has been more subdued than expected.
- GDP growth has slowed but remains positive. As the UK economy benefits from the first synchronised global upswing since 2009, purchasing managers indices (PMI) suggest output remains in expansion territory.
- In contrast to business sentiment, consumer sentiment has dropped off. As higher import prices weigh on real wages, consumer spending growth is predicted to slow within the next 12 months.
- The devaluation of Sterling has attracted overseas investors to the UK, and benefited exporters and tourism.
- Given the uncertain outcome of EU negotiations, UK services have seen the greatest decline in business confidence.
- Interest rates are anticipated to remain low for an extended period of time due to financial repression elsewhere (e.g. the Eurozone and Japan).
- Uncertainty persists over the outcome of the negotiations and the type of deal sought by the UK and whether a transitional period will be acceptable for both parties.

### Real GDP Growth

- Source: Macrobond

### Inflation

- Source: Macrobond

### MSCI All property

- Source: MSCI

### Investment volumes

- Source: Property Archive