Our market

We are active across a diverse mix of sectors within the UK commercial property market.

Our markets

We have a broad base of premium assets across central London offices, London shopping centres, regional shopping centres, retail parks, retail outlets, leisure space and hotels. We're also in the early phases of developing plans for significant residential-led, mixed use schemes at sites we own. The dynamics in each of these market sectors vary, and there are also variations between specific locations and assets. You can read our commentary on the market dynamics this year on the following page.

Macro-economic context

2018/19 saw positive economic growth but continued uncertainty over the nature of the UK's departure terms and future relationship with the EU. Businesses and consumers have continued to spend and progress plans, but both groups appear to be deferring some decisions. For example, surveys show reduced corporate risk appetite and lower business activity.

In real terms, consumer spending and disposable income both grew by c. 2% but total retail sales grew by only 0.9%. Excluding food spend, retail sales were flat. Spend continued to shift online with retail footfall declining 2.8% and online share of retail sales rising to 19% by March 2019 (an increase of 1.1 percentage points versus March 2018).

Big drivers shaping our markets

1. Changing ways of working

Workspace is evolving at speed – a reflection of a competitive and fast-moving business environment, shifting demographics and the impact of technology. Teams and individuals are adopting new ways of collaborating with colleagues and external partners. And new generations of employees are bringing fresh expectations and aspirations to the workplace. In response, occupiers are placing growing importance on flexibility of layout, capacity, leases and payment terms, together with enhanced service levels from space providers. Customers want efficient, superbly designed environments that express their brand and promote collaboration, productivity, wellbeing and a dynamic culture.

2. Changing ways of shopping

Online – further powered by the rise of mobile – continues to win an ever-higher share of retail spend. More and more consumers expect to engage with retailers seamlessly across channels. Experience and convenience remain critical drivers of brand preference. Many retailers are grappling with the new retail models, systems and approaches required to succeed, including adopting an omni-channel model where physical stores play a role beyond selling. For example, stores can provide a powerful platform for customer engagement, presenting new products, enhancing customer service and expressing the brand.

3. Changing ways of living

The proportion of people renting their home has doubled since the turn of the century. An undersupply of new homes has contributed to house price growth exceeding earnings growth over a sustained period, particularly impacting the young and leading to an entire segment of society becoming known as 'Generation Rent'. The UK is a fast-moving society, and an increase in flexible working, shopping online and how people use technology to interact is impacting behaviour and changing how we think about designing the places people will live in the future. The rental model and allure of city centre living is not restricted to younger generations. The opportunity to access well located, amenity-rich city centre living is starting to attract the down-sizer market too.

4. Changing ways of building

Driven by competition, technology and economic necessity, new and potentially transformative ways are being found to design, develop and build at scale. For example, there are opportunities for design to move from traditional architectural drawings to sophisticated digital models and digital simulations of operational buildings. Advances like these enable space providers to reduce cost, time and risk at the construction stage, and to test and optimise buildings for long-term operational performance. More efficient methods of standardised construction are also emerging, including offsite modular construction.

5. Changing expectations around sustainability

Businesses, government and the public now recognise the need for long-term thinking on social and environmental issues. We are seeing the impact of climate change and social inequality. And there is growing scrutiny of the ways in which companies treat their partners and supply chain. How businesses respond to these issues will determine their resilience and competitiveness over the long term. Smart, progressive thinking can help support the relationships and resources companies rely on to prosper and grow and transition into a low carbon economy.

Myo – our flexible office offering

Market dynamics

In our biggest sector, central London offices (48% of portfolio by value), occupational and investor demand remained healthy during the year. The vacancy rate fell contributing to a modest increase in rental values, reversing the decline seen last year. As a result, capital values have risen slightly. Forecasters expect the market to enter a modest down-cycle through to 2020, then return to long-term growth. The retail market in central London has not been immune to challenging conditions for occupiers but it continued to benefit from stronger fundamentals, including tourism, wealthy catchments and flagship locations.

London has retained enduring appeal for investors and occupiers. It offers:

- Attractive mix of offices, retail and leisure, which appeals to employees
- A growing population
- Capabilities and opportunities of a global financial centre
- Deep, liquid property investment market
- International gateway
- Relatively stable tax framework
- Strong business and transport infrastructure
- Diverse community and English-speaking population
- Access to top universities.

London's strengths attract a large, varied mix of property investors, many from overseas. This helps us when selling assets but increases competition when buying. We see excellent market opportunities in London but also challenges, including:

- Uncertainty over the outcome of Brexit negotiations
- Potential impact of Brexit on skills and capacity in construction
- Impact of immigration limits on economic growth
- Pressure on ageing infrastructure
- Continued lack of clarity around airport expansion
- High levels of stamp duty
- Political uncertainty within the UK
- Need for better/faster digital connectivity.

We continue to see lack of housing at affordable or attractive prices as a challenge, but the potential for residential-led densification means this also represents an opportunity for us.

In general, it was a challenging year for retailers and the retail property market. Dominant destinations that provide an experience remain successful and vibrant, but there are structural and cyclical challenges. In shopping centres and retail parks, capital values have fallen significantly, with the market in a pronounced down-cycle. The continued growth of online retail and cost pressures are leading to store closures and lease restructures. This process is not yet at an end.

The challenging nature of retail has been reflected in the level of administrations and company voluntary arrangements (CVAs) in the market. Since the start of 2018, more than 80 retail and food & beverage chains have gone into administration or CVA.

The unequal tax burden on physical retailers compared with online retailers is contributing to the decline of high streets and impacted retail parks and shopping centres. Changes to planning may be required to support more dynamic and valuable use of buildings and land.

Market at a glance

13.6m sq ft

Take-up of office space in central London (2018: 13.6 million sq ft)

4.3%

Vacancy rate in central London offices (March 2018: 4.8%)

+2.4%

Rise in prime headline office rents in the West End (2018: -4.5%)

+3.6%

Rise in prime headline office rents in the City (2018: -2.1%)

-2.1%

BRC physical retail store sales (2018: -2.2%)

0.0%

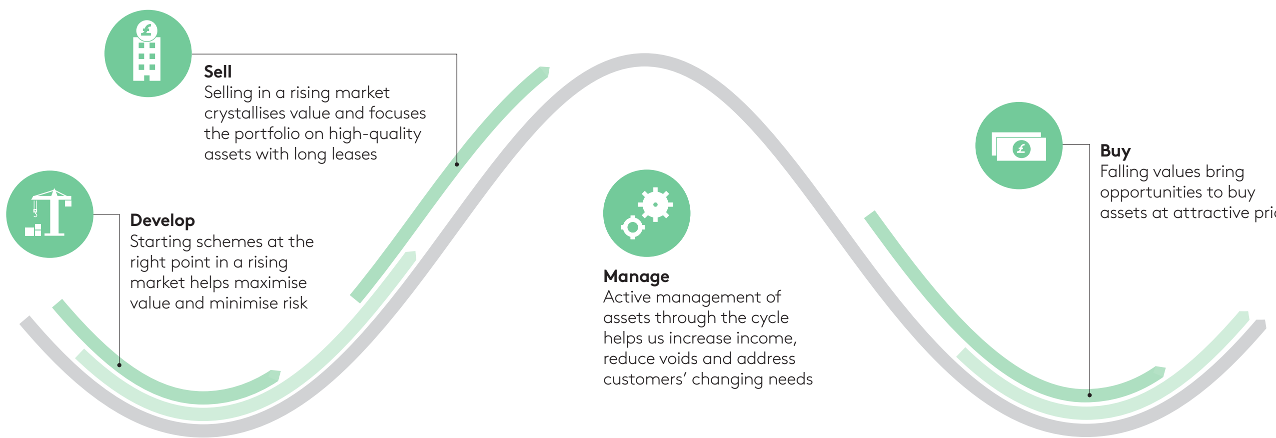
BRC non-food retail sales (including online) (2018: -0.1%)

-2.8%

UK footfall[1] (2018: -2.5%)

1. Source: ShopperTrak UK national footfall benchmark.

Market cycle



Commercial property markets are generally cyclical, with property values mainly driven by the supply and demand of space, together with market participants' cost of capital.

The larger UK property sectors have many participants and a deep pool of investors. This creates a liquid market for individual properties.

We aim to maintain a robust position through the cycle, varying the scale of our activity at different points to grow potential opportunities and mitigate risk.