Our market

We operate across a diverse mix of sectors in 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 year's market dynamics on the following page. Covid-19 had an impact on our markets during the second half of March and has led to significant disruption since then.

Macroeconomic context

2019/20 was affected by significant uncertainty over the UK's departure from the EU and the outcome of the general election. Following the general election in December, there was an initial wave of optimism in early 2020 with clear signs of an improving economic outlook and real estate market but this was halted abruptly by Covid-19.

Despite the challenging market backdrop, consumer spending grew but at a much slower rate in 2019 compared with 2018. In real terms, consumer spending grew by 0.9% and disposable income by 1.3%. Excluding food spending, all retail sales declined by 1.1% (48 weeks to the end of February). Sales continued to shift online, with retail footfall declining 3.7% and online share of retail sales rising to 31.1% by February 2020 (an increase of 2 percentage points from February 2019).

Market dynamics

Notwithstanding the impacts from Covid-19, the drivers we describe on the next page will have a significant impact on our markets. Digital technology is disrupting traditional property models and enabling better products, solutions and services. Demographics are changing – there is a growing, ageing population and a larger proportion of millennials and generation Z in the workforce. Changing living, working, shopping and leisure habits will change how property companies operate, with occupiers increasingly demanding a different mix of services. And sustainability is becoming critical to our customers, from social purpose through to resource scarcity and climate change.

Market at a glance

12.7m sq ft

Take-up of office space in central London (2019: 13.6 million sq ft)

4.5%

Vacancy rate in central London offices (March 2019: 4.3%)

2.3%

Rise in prime headline office rents in the West End (2019: +2.4%)

2.8%

Rise in prime headline office rents in the City (2019: +3.6%)

-3.2%

BRC physical retail store sales[1] (2019: -2.4%)

-1.1%

BRC non-food retail sales[1] (including online) (2019: -0.2%)

-3.7%

UK footfall[1,2] (2019: -2.7%)

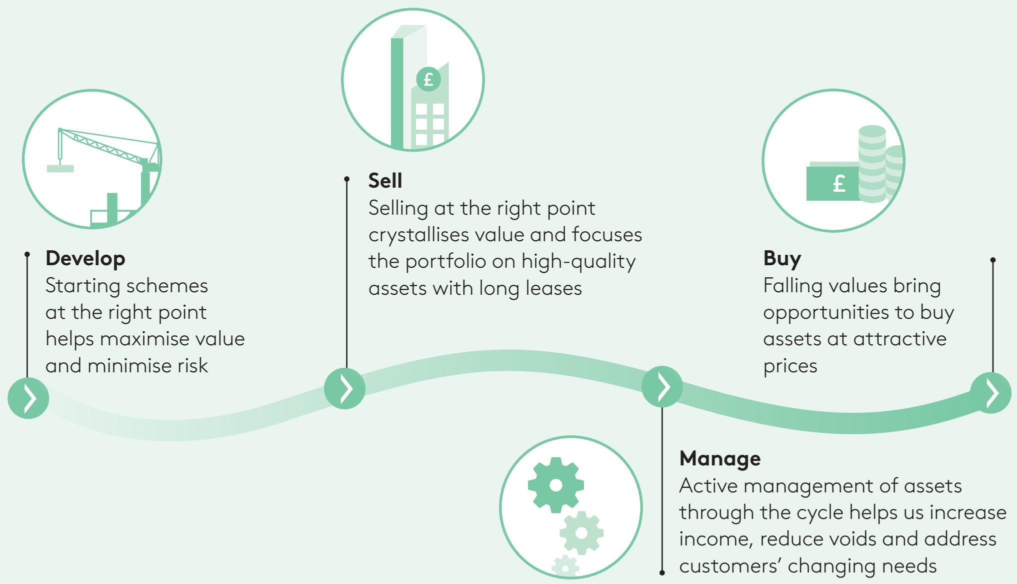
1. 48 weeks to 1 March 2020.
2. Source: ShopperTrak UK national footfall benchmark.

Market cycle

Commercial property markets are generally cyclical, with property values mainly following supply and demand, 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 healthy position through the cycle, varying the scale of our activity at different points to grow potential opportunities and mitigate risk. The nature of cycles varies as customer behaviour and needs change. Macroeconomic factors, such as low interest rates, can extend or flatten cycles. We manage our business to maximise returns from long-term trends while retaining the flexibility to respond to changing shorter-term conditions



In our biggest sector, central London offices (53% of portfolio by value), occupational demand continued to be strong, with broadly stable vacancy rates and an increase in rental values of 2.6%. Investment transactions in 2019 were down 36% compared with the previous year, as political uncertainty in the UK dampened some overseas demand. Forecasters expected the market to see modest growth in 2020, as the outlook was positive and the supply of new office space completing over the next three years was not excessive. However, Covid-19 will impact the shorter-term dynamics of the market.

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 market opportunities in London but also challenges.

London retains its enduring appeal for investors and occupiers, as it offers:

- an attractive mix of offices, retail and leisure, which appeals to employees
- a diverse and growing population
- the capabilities and opportunities that come with being a global financial centre
- a deep, liquid property investment market
- a relatively stable tax environment
- a strong business and transport infrastructure, and international gateway
- access to leading universities.

However, the challenges of London include:

- uncertainty over the Brexit transition period and subsequent negotiations
- the potential impact of Brexit on skills and capacity in construction
- the potential impact of immigration policy on economic growth
- an ageing infrastructure
- continued uncertainty on airport expansion
- high stamp duty
- the need to decarbonise the economy
- the need for better or faster digital connectivity.

We continue to see the 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.

2019 was another difficult year for retailers and the retail property market. Generally speaking, there is too much retail space in the UK and retailers are reviewing where they need physical stores to support their omni-channel offer. As a result, many secondary retail locations have struggled to retain retailers and customers. Dominant destinations that provide an experience remain successful and lively, but they are not immune to the structural and cyclical challenges facing the market. The capital values of shopping centres and retail parks fell significantly for the second year in a row.

The level of administrations or company voluntary arrangements (CVAs) in 2019 was slightly lower than in 2018, but remained near historically high levels, again demonstrating the challenging nature of the retail market. Despite the market environment, some retailers continued to perform well, particularly those with a compelling customer offer, great customer service and an appropriate mix of online and physical stores. Covid-19 had a rapid and significant impact on the retail and leisure market with the majority of businesses no longer trading from physical space. This, inevitably, will put further strain on those businesses already struggling in a challenging market.

In addition, the tax burden on physical retailers, compared to that of online retailers, is contributing to the decline of high streets and has affected retail parks and shopping centres. Changes to planning regulations would support more dynamic and valuable use of buildings and land.

Major longer-term drivers shaping our markets

1. Changing ways of working

The way people use office space is changing. Shifting demographics, the impact of technology and a competitive and fast-moving business environment are raising the expectations of what workspace can provide for an occupier. Employers want offices where teams and individuals can thrive. There is a growing emphasis on flexibility – of layout, capacity, leases and payment terms – together with an expectation of enhanced service from workspace providers. But it is about more than just how our customers use their space – they know their office is an extension of their brand, and sustainability and wellbeing are also both critical to retaining talent and promoting business.

2. Changing ways of shopping

While consumer spending is still rising, growth has slowed, and retailers continue to see a marked difference in the performance of online and physical retail. Online – further powered by the rise of mobile – continues to win a growing share of retail spending. Consumers increasingly use a combination of physical stores and online to complete transactions, and expect to shop seamlessly across channels. Retailers are evolving their offers to meet customers' growing demands for experience, convenience and excellent service. Often this involves adopting an omni-channel model where physical stores play a role in displaying products and offering advice, all while supporting online through managing click and collect and returns. Successful retailers enhance their brands by doing this effectively.

3. Changing ways of living

The proportion of people renting their home has more than 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. This particularly affects the young and has led to an entire segment of society becoming known as 'Generation Rent'. In the UK, the increase in flexible working, online shopping, and how people use technology to interact is changing people's behaviour in the home. This in turn is changing how we think about designing places for people to live in. The rental model, and the allure of amenity-rich city-centre living, is not restricted to younger generations. It is starting to attract the down-sizer market too.

4. Changing ways of building

To gain competitive advantage and efficiencies, and with the help of advancing technology, property professionals are finding potentially transformative ways to design, develop and build at scale. For example, design is moving from traditional architects' drawings to sophisticated digital models and simulations of operational buildings. Advances like these enable 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 construction are also emerging, including off-site modular construction.

5. Changing expectations for sustainability

The importance of sustainability is now widely recognised. Many businesses now regard it as essential to their strategy. Government, businesses and communities are working to reduce social inequality and mitigate or adapt to climate change. There is also growing scrutiny of the ways 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 in the transition to a low-carbon economy.