fieldfisher

Real estate
'State of the market'
survey 2021

Introduction

In **January 2021**, Fieldfisher's real estate group conducted a survey of more than 500 clients and industry contacts.

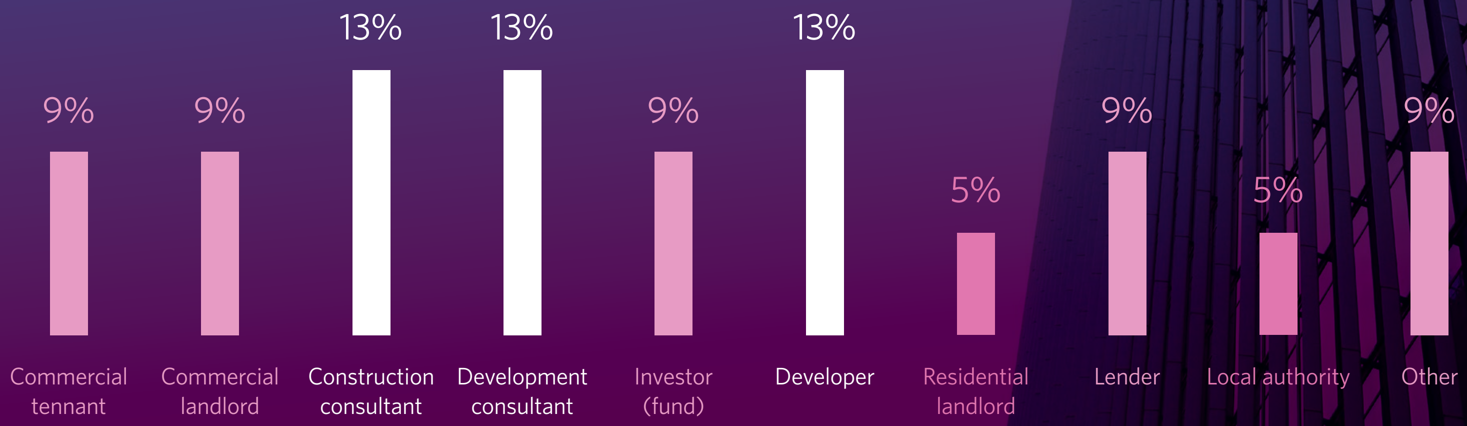
We asked them to share their views on the UK real estate market in 2021 – at the start of the third national lockdown, before the government had set out its 'roadmap' to easing Covid-19 restrictions.

The survey received an overwhelming response from industry participants keen to voice their views on a sector that has fundamentally changed as a result of seismic shifts in the way people work, shop, eat and live – as a result of Covid-19 but also broader societal trends.

We requested both quantitative and qualitative responses to a variety of questions, ranging from 'Covid clauses' to financing.

Our real estate team analysed the feedback and collated the data into the following report.

Our respondents



Headline findings

Demand for office space expected to change in line with working patterns

Neutral (50/50) outlook on UK real estate sector as a whole

More flexible leasing arrangements predicted to become a feature of the market

Mixed support for monthly rent payments

Raising finance likely to be challenging over the next 12 months

Lack of confidence in leisure sector growth

Confidence

Factors other than Covid-19 have negatively affected confidence

“We will proceed with cautious optimism; there will be further setbacks and delays and timing cannot be certain.“

Survey respondent

We asked respondents how they would characterise their organisation's outlook on the next 12 months out of 10, where 1 is extremely cautious and 10 is extremely optimistic.

The average score was 5.2, suggesting a 'glass half full' (but only just) attitude towards the UK real estate market over the coming 12 months.

Of those who scored 4 or less, only around a quarter (26%) said their extreme caution was caused by the Covid-19 pandemic.

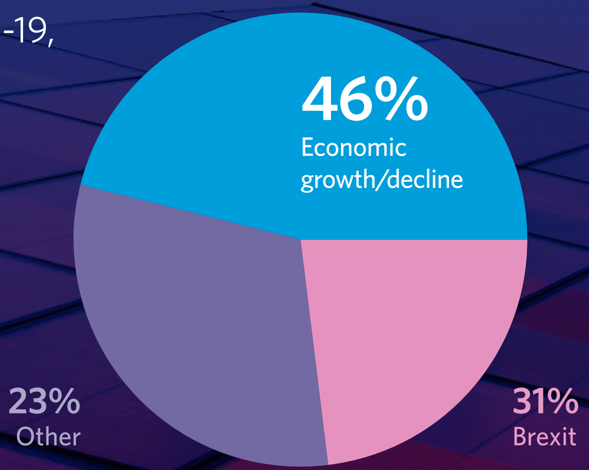
By far the most pressing concern for respondents was the strength of the UK economy. A number of respondents cited the stage of the economic cycle the UK was at pre-pandemic, suggesting that the UK property market – both commercial and residential – could tip into decline over the next year.

Brexit was the other standout issue worrying survey respondents, suggesting that even though the UK signed the Trade and Cooperation Agreement (TCA) as a baseline for its future relationship with the EU, many are still anxious that the shift in the UK's position on free trade and movement poses risks for the domestic real estate market.

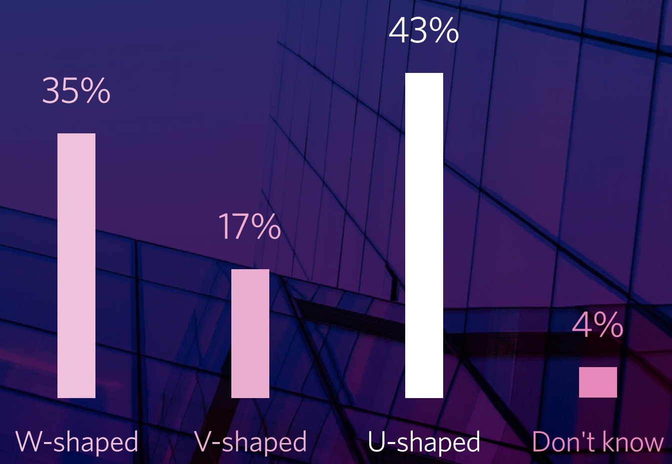
Other concerns included: inflation risk; a permanent reduction in demand for office space; changes in the retail industry; and possible public funding restrictions.

43% of survey respondents said they expected the UK real estate market would undergo a U-shaped recovery, benefitting from a relatively strong but not unhindered rebound in activity (as opposed to 17% who thought the recovery would be V-shaped), while the next largest group (35%) thought the recovery would be a bumpier W-shaped recovery.

Q: If not Covid-19, what other factors have caused your caution?



Q: What shape do you anticipate the recovery of the real estate market to follow?



Hopes for a strong economic bounce and post-pandemic recovery

Among those who scored 7 or higher out of 10 on their outlook for the sector, their optimism was chiefly (37%) driven by the vaccine roll-out and belief that a successful immunisation programme will help the UK return to social and economic normality before the end of the year.

Just over a quarter (27%) of respondents were confident that low interest rates will embolden businesses to move on transactions while borrowing remains competitive.

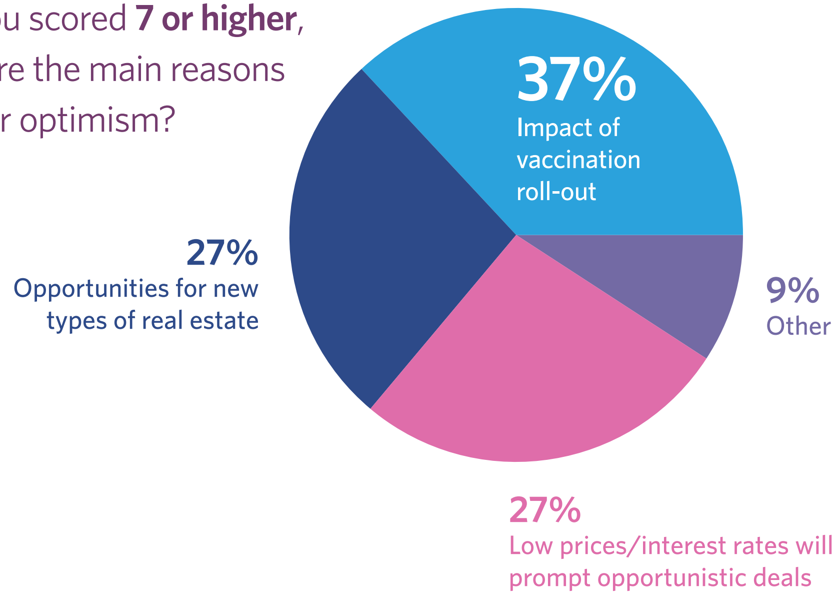
An equal number (27%) said they were buoyed by opportunities for new types of real estate as people's working and social habits shift permanently as a consequence on the pandemic.

Changing demands for what people want from their buildings could present a headache for landlords of existing premises, who may be facing expensive retrofit jobs.

But for developers and architects, the chance to design innovative new types of building with more flexible facilities, larger amounts of outdoor space and natural ventilation, potentially in new locations under 'hub and spoke' approaches to workforce deployment, is an exciting prospect.

Others were optimistic about growing demand in sectors such as student accommodation while others hoped for high street rejuvenation with new types of retail outlets and consumer amenities.

Q: If you scored **7 or higher**, what are the main reasons for your optimism?



Changes in the built environment

"The pandemic has forced businesses to pause and consider how they use space. The office is not dead, but it will be different and flexible working will be more common. If anything, the pandemic has put a question mark over high-density housing with little outside space."

Survey respondent

Certain key forces to shape the sector

Unsurprisingly after more than a year of largely home-based working, survey participants believed that remote working would be the most significant issue facing the real estate market over the next 12-18 months, with 32% of respondents citing this as a major factor shaping future property decisions.

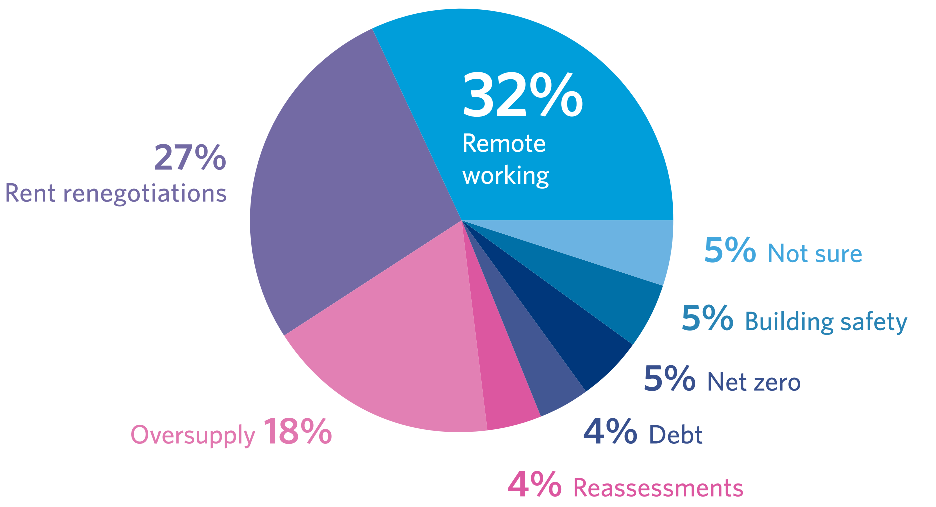
Close behind and related to remote working is the prospect of rent renegotiations, cited by 27% of respondents.

This is likely to be driven in part by a wave of CVAs among commercial tenants in the retail and hospitality sectors, while government measures to protect residential and commercial tenants from eviction for non-payment of rent have given landlords and tenants opportunities to discuss payment terms.

Oversupply in the (primarily commercial) real estate market was a concern for 18% of survey participants, most likely tied to potentially reduced demand for office and retail space.

Issues that may have been more pressing for the sector pre-pandemic, including building safety and 'Net Zero' emissions obligations (both of which were cited by 5% of survey respondents), appear to have retreated in the face of more immediate concerns.

Q: Which of the following issues do you anticipate will be of greatest significance in the real estate market in the next 12-18 months?



Demand for office space expected to fall

An overwhelming 78% of respondents said they expected demand for office leasing to be less than it was before the Covid-19 pandemic.

This prediction is in line with anecdotal evidence indicating that some large office tenants have withdrawn from future tenancy agreements or surrendered leases early since the start of the pandemic, or have sought to sub-let some of their floor space in the medium-to-long term.

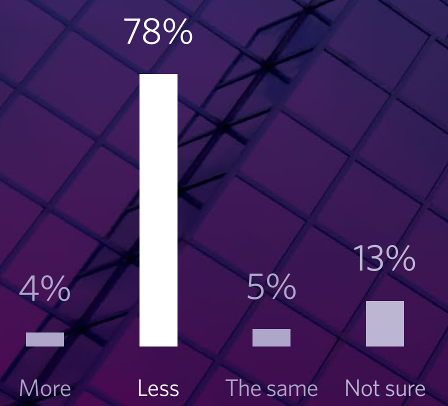
This view is however moderated by 65% of respondents indicating they expected to see increased demand for serviced and/or flexible workspace, while responses to earlier survey questions highlighted the potential for 'hub and spoke' office-working arrangements which could decentralise office demand from large cities.

This trend, if it materialises, will have consequences for infrastructure development, if hitherto solid demand for capacity to transport commuters to and from large urban centres on a daily basis changes.

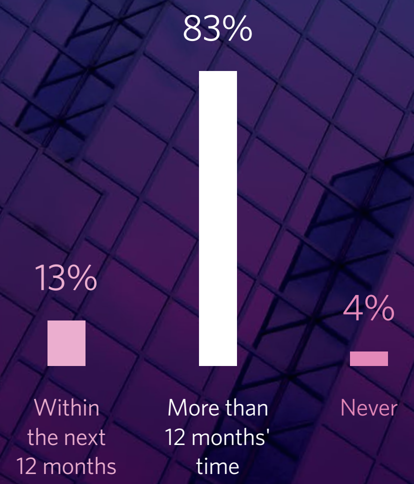
However, there have also been arguments against the sustainability of long-term home-working and pointing out the inefficiency of decentralised work forces, and some survey participants expect that office leasing will return to pre-pandemic levels – but not for at least 12 months.

A decisive majority (56%) of respondents said that they did not intend/were not aware of plans to reduce the amount of office space occupied by their business in the next 12 months.

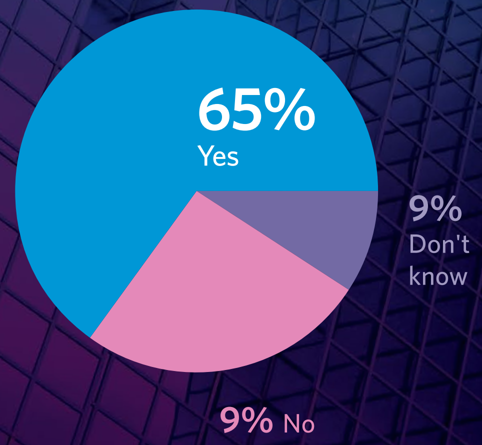
Q: Do you anticipate that demand for office leasing in the next 12 months will be more, less or the same as before Covid-19?



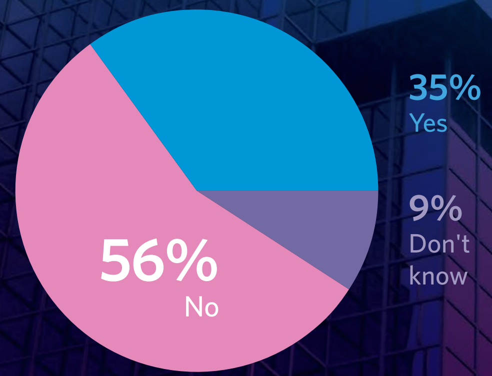
Q: When, if at all, do you anticipate office leasing to return to pre pandemic levels?



Q: Do you think the pandemic will result in an increased demand for serviced offices/ flexible workspace?



Q: Is your business/the business you work for, planning to reduce the amount of space it occupies over the next 24 months?



Changes in leasing models

Industry divided over monthly rent payments

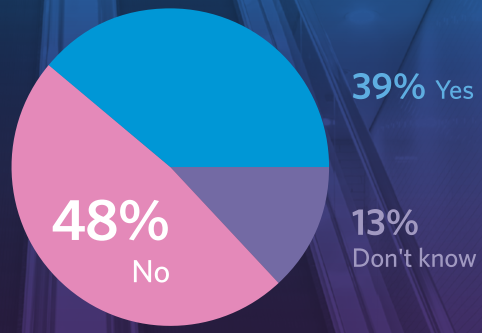
The majority (48%) of survey respondents did not believe that monthly rent payments, the trend towards which emerged as traditional quarter days became unrealistic during Covid-19 lockdowns, are here to stay.

However, 39% of respondents thought a shift to monthly payments would last, indicating that the market is split on the resilience of this trend (although this could reflect the division between landlord preferences for a return to quarter days and tenants wishing to retain the flexibility afforded by monthly payments).

The flexible rent model is also being advocated by new market entrants. Even before the pandemic, proptech companies were springing up to provide more flexibility for tenants and landlords via payment apps and related services.

These applications promise to take the cost and effort out of rent collection for landlords by paying rent upfront, while giving tenants the option of monthly or even weekly payments.

Q: Do you think the trend towards monthly rent payments is here to stay?



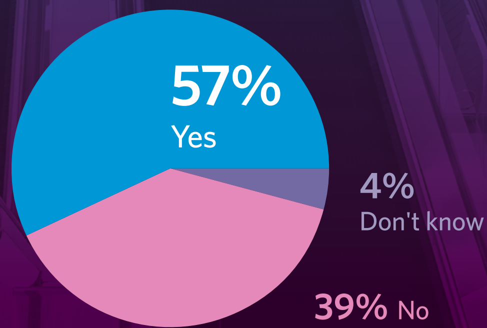
'Covid clauses' likely to become a feature of contracts

Like many industries, 2020 witnessed the advent of 'Covid clauses' – setting out the rights and obligations of parties in the event of disruption caused by a pandemic or similarly seismic event – in contracts.

57% of Fieldfisher's survey respondents said they thought Covid clauses would become a permanent feature of leases, while 39% thought such additions would eventually disappear.

Such clauses cannot cover every possibility, however, and it seems likely that any grounds to suspend rent or discuss amending payment terms will remain a highly contentious issue.

Q: Do you think 'Covid clauses' (i.e. clauses to provide for a rent suspension or at least discussion) will be drafted into all new leases going forward?



Real estate sector will see post-pandemic wish lists

Most actors in the UK real estate sector are preparing to negotiate over their future property requirements as a result of the Covid-19 lockdowns.

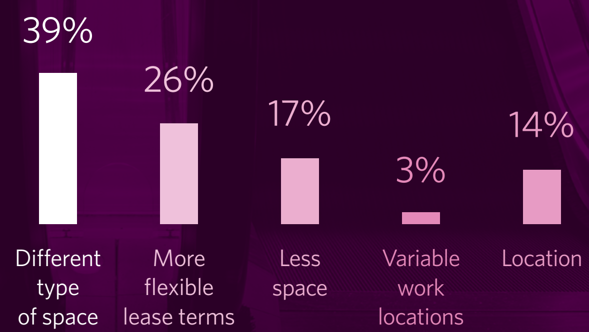
Fieldfisher's survey results show that these requirements are varied, although the leading priority for respondents (at 39%) was for different types of space, as traditional working and living space models proved difficult to adapt to pandemic conditions.

17% expected less space would be needed altogether.

26% of respondents wanted more flexible lease terms (see above), while a further 17% said that either businesses would relocate entirely, or consider variable locations from which to operate.

These requirements are likely to impact the content of leases in future.

Q: What do you consider to be the biggest impact the pandemic will have on your future property requirements or approach to property?



Assets for the future

Little change in asset popularity

Despite general uncertainty about the future of UK office space, offices remained the most popular asset class among Fieldfisher's survey respondents, with 43% saying this was one of the areas they were most interested in.

PRS and logistics were the next most popular asset classes (each being selected by 26% of respondents), while build to sell and hotels ranked as the joint third most popular asset classes (for 21% of respondents).

The popularity of these asset classes is broadly in line with pre-pandemic favourites, as were some of the least popular choices such as senior living (at 4%) and bricks and mortar retail (at 8%).

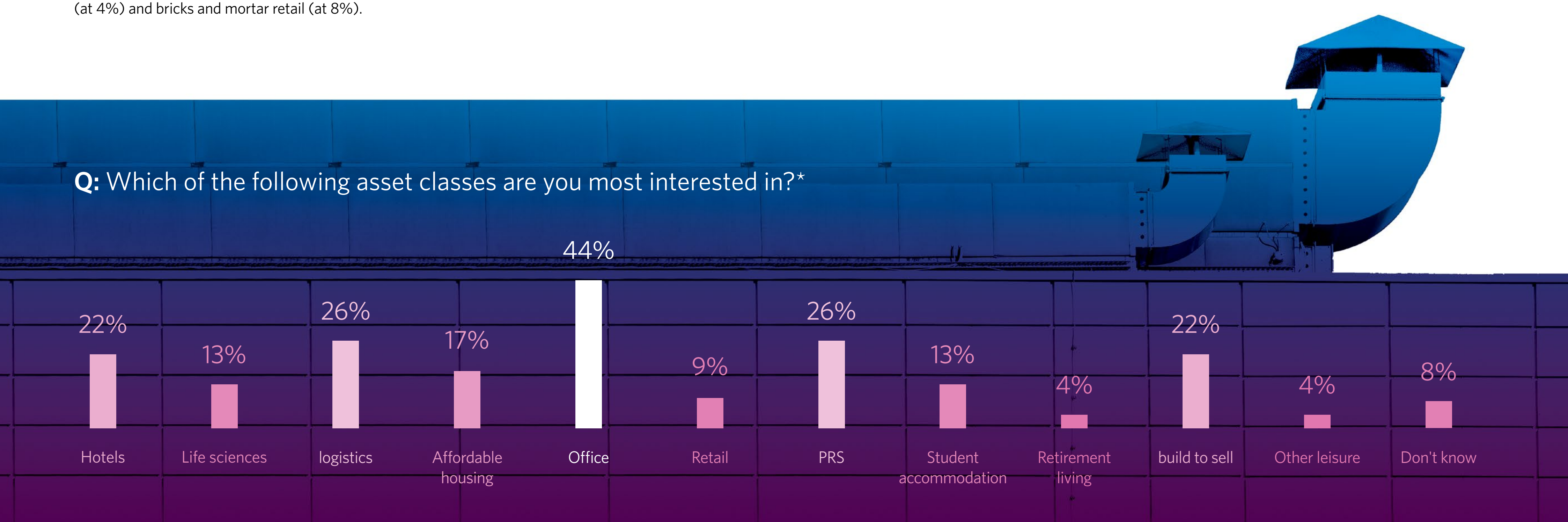
A perhaps surprising loser was the leisure sector (restaurants, cinemas, gyms etc.), which was attractive to just 4% of respondents. This industry is partly tied to the performance of office space as many leisure amenities are provided for the use of office workers, but respondents' confidence in the recovery of the office market did not extend to leisure facilities.

Although the pandemic has had a distorting impact on the leisure and hospitality sector, the response to Fieldfisher's survey suggests participants felt the sector was approaching saturation point prior to the pandemic.

"There are naturally sectors that have severe challenges and re-basing to go through but it is not accurate to describe the whole market as so. There are many areas that are moving well and a huge desire to return to regular economic activity."

Survey respondent

Q: Which of the following asset classes are you most interested in?*



*Respondents were allowed to select multiple options

Finance

Challenges ahead for financing real estate projects

A slim majority (43%) of survey respondents expected to find it more difficult to raise acquisition finance in the next 12 months than during the previous year.

39% said they expected no change, while a minority (9%) said they thought it would be easier to secure funds.

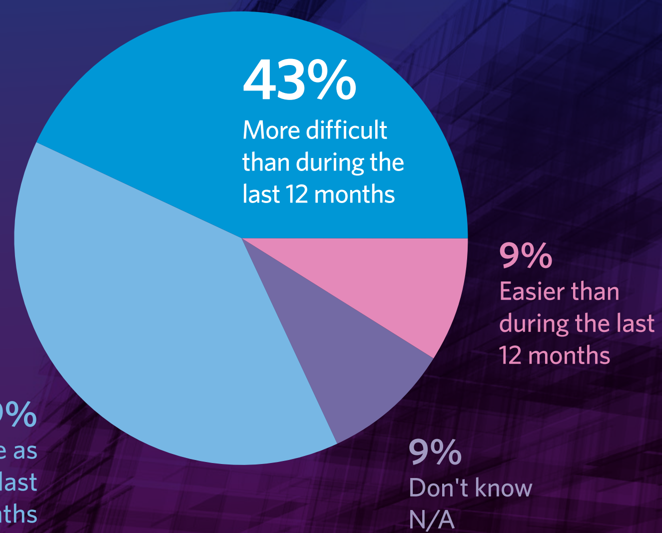
Similarly, 52% of respondents said they thought it would be more difficult to raise development finance over the next year, with 22% anticipating no change and 9% expecting a more favourable financing environment.

Given the last 12 months were fundamentally disrupted by the Covid-19 pandemic, which had a knock-on effect on financing activity, it seems that generally Fieldfisher's survey participants expect the ramifications of this to continue or worsen over the year ahead.

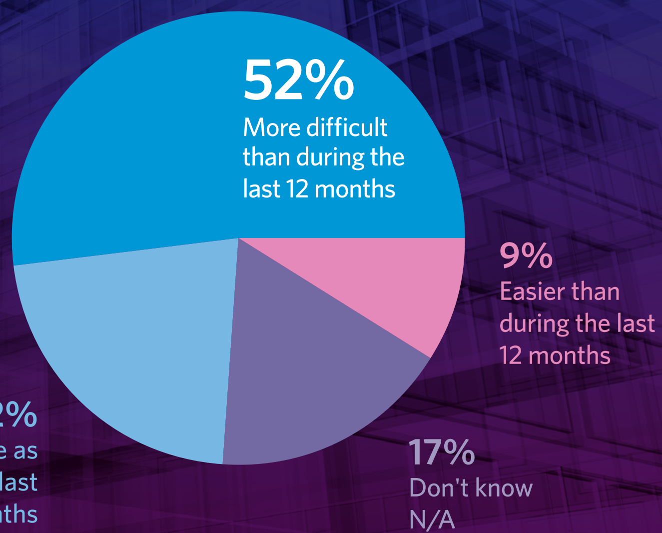
The survey was however conducted before Prime Minister Boris Johnson set out the government's 'road map' for lifting Covid-19 restrictions in line with the nationwide vaccine roll-out, which may have influenced sentiment.

Anecdotal evidence from Fieldfisher clients and contacts is inconclusive, with some banks and funds indicating they intend to be hyper-cautious about lending on property ventures for the foreseeable future, while others that have amassed large cash piles are eager to deploy capital quickly.

Q: What are your expectations for raising finance in the next 12 months for acquisition?



Q: What are your expectations for raising finance in the next 12 months for development?



Conclusion

Uncertainty is, unsurprisingly, the overriding sentiment among Fieldfisher survey respondents.

Had this survey been conducted following the announcement of the government's post-Covid 'road map', the responses might have been different. However, many of the underlying trends that appear to have informed the responses pre-date the pandemic and represent long-term structural issues for the real estate industry.

Brexit is a background factor that has implications for construction and the residential property sectors in particular.

The fate of the UK office leasing market is likely to become clearer towards the summer as Covid-19 restrictions ease, while prospects for the hospitality and leisure asset classes will depend partly on the relaxation of travel restrictions and wider economic factors such as unemployment and wage levels.

Much of the change hinted at in these survey responses will be reflected in real estate and construction sector contracts – including through the introduction of 'Covid clauses', more flexible lease agreements and the performance of buildings following the pandemic, the Grenfell fire of 2017 and the introduction of Net Zero obligations.

For more information on how to prepare for these changes, please contact a member of the Fieldfisher real estate team.

About Fieldfisher Real Estate

Fieldfisher's Europe-wide Real Estate specialists advise developers, financiers, pension funds, private equity funds and REITS through to corporate occupiers, retailers, borrowers and lenders.

As well as working with companies domiciled in Europe, we are experts at assisting with international investment in European markets and general cross-border, work focusing on everything from luxury hotels to major infrastructure projects.

Our Construction and Projects team helps clients deliver construction, engineering and infrastructure projects on time and within budget. Benefiting from in-house experience (over 75% of our team have undertaken client secondments), our specialists understand the commercial as well as legal pressures facing the industry and provide practical solutions whatever your project.

The team acts for developers, asset managers, funders, contractors, sub-contractors and public authorities, advising across a variety of sectors including building, energy, infrastructure, marine engineering and shipbuilding, mining, hospitality and leisure, healthcare, PRS and transport.

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