Schroders

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Real Estate Flashnote

Covid-19 and its impact on UK and European commercial real estate
11 March 2020

Occupier Markets

Macro-economics

We do not know how serious the coronavirus will be. In addition to people being ill off work, the economy will also be affected by government counter-measures designed to slow the spread of the virus, so that health systems are better able to cope. The current consensus is that its impact will be modest and that with some exceptions, the hit to economic growth in the first half of 2020, will be made up in the second half. Likewise, the impact on inflation should be minor, as higher prices for imports from Asia should be offset by lower oil and commodity prices.

Office and industrial/logistics

Occupiers may adopt a wait-and-see attitude when it comes to leasing decisions, while assessing the potential impact of lower growth, or temporary operational constraints. However, many office markets are starved of quality space and corporates are likely to continue to act on their medium-term workplace strategies. Therefore, any drop off in take-up in the first half of 2020 will probably be made up in the second half.

The virus will put pressure on serviced office providers, assuming a temporary increase in people working from home.

Industrial/logistics are likely to see some disruption to supply chains in the first half of 2020, but again occupiers are unlikely to change their medium-term space plans. The virus might also boost on-line retail sales. In the long-term it is possible that the virus, in conjunction with other pressures such as growing protectionism, encourages companies to re-shore some manufacturing from Asia and hold more stock in Europe.

Retail

Grocery retail could see a short-term jump in sales as consumers stock-pile goods. However, consumers are likely to unwind their stocks once the virus has passed, leading to weaker sales in late spring/early summer. High street shops, shopping centres and retail parks are likely to see lower footfall in the short-term, especially in areas with high infection rates.

Hotels, cinemas, restaurants, airports

Hotels, leisure parks and other venues which rely on conferences, travel and leisure spending are likely to suffer a large short-term fall in income. It is uncertain whether the post-virus recovery in business will compensate for this.

Building projects

Disruption to construction works (missing material, lack of workforce) could temporarily delay projects and push up costs, depressing returns. Developer confidence might also take a short-term hit.

Investment Markets

Interest rates and monetary policy

Although many central banks, (ECB, BoJ, SNB) have limited room to lower interest rates, the recent cuts by the Fed and BofE and short-term programmes like bond-buying could see further yield compression in most types of direct real estate. With equity markets volatile, some investors could also allocate more to real estate.

Investment volumes

Investment volumes in the first half of 2020 are likely to be lower as some sellers pull potential disposals, fearing that weaker economic growth, or operational constraints on the buyer-side, or at banks/brokers/notaries might negatively impact pricing.

Many companies (including Schroders) have banned non-essential business travel. This is likely to temporarily depress cross-border transactions. In broad terms, Amsterdam, London, Madrid are more reliant on cross-border capital than the major German cities, Paris and Stockholm (see chart overleaf).

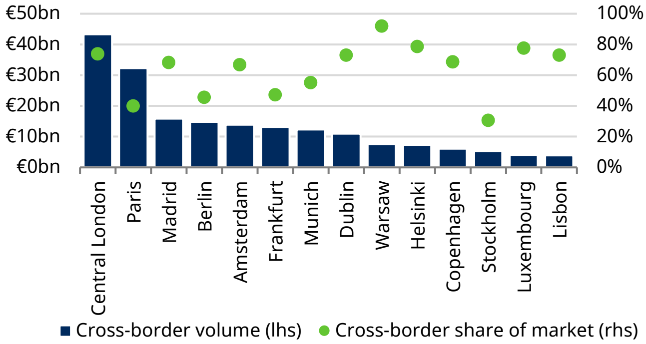
The delay of MIPIM in March and the cancellation of other events could have a mild effect on the marketing of and/or speed of completion of investment transactions. Disruption in China might force some investors there to sell their European real estate in order to plug holes in their finances.

Yet the virus is unlikely to change the fundamental attractions of real estate: high yields relative to bonds, income growth, control and the potential to add value. Accordingly, we anticipate that the second half of 2020 will see a re-bound in investment volumes.

Valuations

Schroders valuers have confirmed that they have no immediate plans to add a Material Uncertainty clause to valuations. However, this could change if the impact of the virus is more serious than expected.

Reliance on Cross-Border Capital



Source: RCA, Schroders. February 2020. Data are for all real estate types.

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