Building on trends

Laura Blows looks at how changing societal trends are affecting property use and investment opportunities

Summary
- Office demand is expected to remain, despite moves towards office and home hybrid working post-lockdown. 'Destination' offices worth travelling into are expected to grow in popularity.
- Residential investment is predicted to see significant growth, due to the supply-demand imbalance. Investor interest in student housing, co-living, private rental and senior living are all gaining traction.
- While high street retail property has been in decline for a long time, small 'convenience stores' run by major supermarkets have experienced growth. The outlook for out-of-town retail parks combining leisure and shopping and retail warehouses, is also favourable.
- The online shopping boom has accelerated the need for warehouses.

The consequences of the Covid-19 pandemic have both generated and accelerated a number of societal trends; trends that in turn have changed the ways people use property and the best areas of investment opportunity.

Offices

A much-discussed change during the pandemic has been the way people work.

"Prior to Covid-19, working from home was often more a concept rather than a true reality; Covid-19 pushed people to work 100 per cent from home in spaces that were not adapted or large enough to do so," Tikehau Capital executive director, Simon Males, says.

Therefore, Barnett Waddingham partner and senior investment consultant, Chris Binns, does not believe that demand for offices will significantly change, as people will still want to go into the office, even if not five days a week.

He also highlights the surge in start-up companies, adding demand to more flexible office space. "However, this signals a potential demise in those large 'trophy' offices, as working patterns evolve. Whether companies will still have such a desire to have central London offices remains unclear, but any shift out of London could mean greater support for office space elsewhere."

Given the uncertainty, Binns does not expect investors to make significant changes to office allocations just now, "but it will be an interesting area to watch over the coming two to five years".

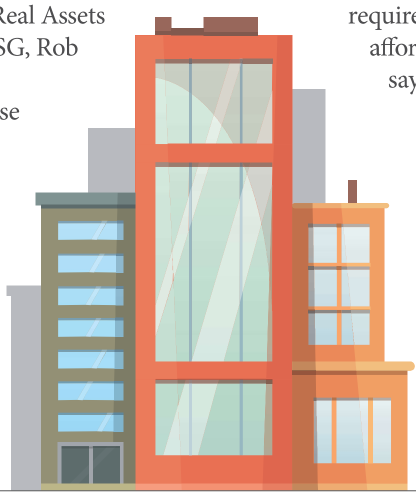
Post-Covid, Males expects that people will return to the office, but as a mix of going to the office some days and home working other days.

However, "we are still a long way from knowing exactly what the post-pandemic world of office-based work will look like. Many people are struggling with long hours, poor home working setups and difficulties in separating home from work. It's been interesting to hear a growing number of firms, particularly in financial services, reiterate their commitment to the office over the past few months", LGIM Real Assets director of strategy and ESG, Rob Martin, says.

"At the same time, those coming back to the office are finding half-empty buildings don't offer the same benefits in terms of collaboration, and the vibrancy of city centres has taken a severe knock. My take is that we will see a reduction in the total demand for office space."

Aberdeen Standard head of European research, Craig Wright, also expects lower quality office buildings in less desirable locations to bear the brunt of a drop in occupier demand, especially offices that are not easy to reach.

"Workers will question why they should sit in traffic or take a series of trains to reach an unglamorous space, far from cafes or gyms, when they could log in from home – saving time, money and critically CO_2 emissions. The positive outcome would be for these sub-standard workspaces to be re-purposed into alternative uses more suited to future commercial or residential requirements, particularly affordable housing," he says.



After Covid-19 restrictions are permanently lifted, the office that will command the highest price and greatest demand will be

the 'destination office', Wright predicts, "the type of grade-A, fit-for-the-future space that makes the commute on those two or three days of the week completely worthwhile".

This will be a creatively designed space where workers and their clients will want to spend time; an office that is sustainable and energy-efficient and designed for collaboration, training, idea generation, meetings and events, he adds.

Redington senior vice president, manager research, Jaspal Phull, agrees that the overall demand for offices will be affected by changes to workplace design with the reversal of high occupancy densities to one of lower density and a greater emphasis on collaboration spaces.

"The office will continue to play a big role, but the emphasis will be placed on health and well-being. Well located, modern offices will still be sought after, but older office space that is ill-equipped to provide the right health and safety amenities may become obsolete," he states.

Working from home has and will continue to have a direct impact on the residential market as well, Phull adds, as households reassess their needs. "The value of having access to a private outside space has increased, this in turn will increase the demand for out-of-town suburbs."

In order to mix home office with working in the 'physical' office, some homeowners will seek to move away from city centres and suburbs to secure a larger home and better proximity to the outdoors, Males predicts. "They will have to stay in reasonable distance in order to be able to commute so in our view, 'commuter belt' areas that are in the immediate vicinity of large cities could well be the winner in years to come," he says.

Residential

Generally, a move towards residential property is the area Binns thinks will see most growth in coming years. "There is a supply-demand imbalance, with the government and local authorities not building enough stock, which is driving up prices," he explains.

Martin highlights how the government estimates that 300,000 new homes are required to meet housing need but, over the past 10 years, only around 199,000 new homes on average have been built each year.

The continued decrease in the provision of 'Buy to Let' accommodation, means Aberdeen Standard head of UK residential investment, Ed Crockett, expects the market to remain undersupplied relative to demand.

According to Binns, the majority of investment opportunities for pension schemes lie in the new-build sector, which should, in theory, benefit from increased prices. "However, we urge some caution here as raw material prices have increased significantly over the same period, meaning that developers may not see such an immediate benefit," he warns.

Prior to the pandemic, there was a view that people could not afford to buy homes and many were pushed to rent, which led a lot of people to get excited about the private rental sector (PRS) as there was significant demand and little supply, Patron Capital, managing director, Keith Breslauer, says.

However, a lot of families have accrued savings during lockdown, he adds, while banks have actually increased their lending.

"This doesn't mean everyone has to jump out of PRS, but the general housing market has been enhanced and you're in a good position regardless of whether you're developing assets for rental or for the private sales market," Breslauer says.

Indeed, institutional investment into residential asset classes continues to grow, with interest in student housing, co-living, PRS and senior living is gaining traction "as investors look to cover the full demographic spectrum", Phull says.

Co-living is probably the first residential step for the younger generation who are likely to go on to rent larger-sized accommodation when they co-habit with someone else. This does not mean that eventually some of them will not buy in the residential market, but if rental market 'products' are adapted to their needs it is probable that the younger generation will stay longer as a tenant through their lifetime, Males predicts.

'Generation rent' refers to the generation of young adults who, because of high house prices, live in rented accommodation and are regarded as having little chance of becoming homeowners. "The term, however, doesn't differentiate between those that have no choice and those that simply chose to do so, given that they place less

value on the ownership of hard assets than other generations," Phull warns.

He highlights how some build-to-rent apartments are designed to facilitate those needs, with hotel-like living consisting of a community-led approach to renting a home, such as the inclusion of shared social spaces, bars, lounges and co-working spaces.

According to Phull, the case for investing in social/affordable housing is also getting stronger.

"The sector provides stable, predictable income and index-tracking rental growth. Not only does it offer a compelling investment case, but it also makes an important contribution to society. The pandemic will inevitably increase poverty and inequality and given the long-term property supply/demand imbalance, this will inevitably make ownership and renting even more unaffordable for a generation," he explains.

There are also property investment opportunities for those in later-life looking for new homes.

"By 2069, it's estimated that there will be a further 7.5 million UK residents aged 65 and over. With such a rapidly ageing society, the types of property that society needs is going to change drastically. This is particularly true in two crucial areas: retirement communities and care homes," Octopus Real Estate CEO, Benjamin Davis, says.

"Recent research we conducted found that 27 per cent of over-65s would consider moving into a retirement community – but currently only 1 per cent of UK retirees live in such facilities. Changing tastes and the desire to lead independent lives in later life are also driving demand for high-quality facilities with communal elements, such as swimming pools and gyms," he adds.

"The UK still has a severe shortage of care homes and a high proportion of those in existence aren't fit for purpose. There's an urgent need for high-quality facilities where residents can feel at home and be properly cared for, particularly as an ever-higher proportion of the population faces the need for later-life care."

Purpose-built retirement communities are well established in Australia and the USA, but are relatively unknown in the UK, so Schroders head of real estate research, Mark Callender, expects that demand will grow as the population ages and people see the opportunity to live in a community, but still own their own home.

"Loneliness is a major problem among the elderly. Retirement villages also help to free-up the supply of large family homes in their locality. We believe that they should deliver an ungeared gross internal rate of return of circa 3 per cent over a five-year holding period, which is commensurate with the development risk," he adds.

Historically, senior housing has been among the more-resilient sectors in downturns and has shown a lack of correlation to the major property sectors, Phull adds.

Retail

Just as the types of properties people live in is changing, so too are the places in which they shop.

The past decade has seen the rapid growth of convenience stores run by major supermarkets, due to the shift away from the 'big' weekly shop at the supermarket and cooking with raw ingredients to last minute shopping and eating ready meals, Callender states.

The sector has been relatively defensive and generates an attractive yield of 5 per cent, he states, adding that convenience gained market share during Covid-19 as people shopped locally and both Amazon and Iceland are now entering the segment, creating strong competition for sites.

Meanwhile, high street retail properties have been struggling for some time, due to technological advances and a shift towards online retail, accelerated by the pandemic, Binns says.

He expects that the high street retail sector will continue to struggle, but the outlook for the wider retail sector, such as out-of-town retail parks combining leisure and shopping and retail warehouses, to be more favourable.

"These typically large, single-level stores tend to be occupied by home improvement, gardening, furniture and electrical goods retailers, many of whom have benefitted from the post-lockdown surge in home renovation. These areas haven't seen a significant shift to online, either due to the bulky nature of the goods sold or a change in general shopping habits."

Industrial

Warehouses generally, not just retail warehouses, are also expected to be a

good investment opportunity.

"Investors are increasingly turning their focus towards the industrial market; a sector that had already proved its buoyancy prior to the pandemic," Martin says.

Since then, thousands of new warehouses are needed across UK and Europe with the online shopping boom having been further accelerated by Covid-19," Males explains.

"Online spending as a proportion of total UK retail sales reached a record high of over 36 per cent in January this year, almost two times higher than pre-pandemic levels. In the UK alone, the additional space required in this sector is estimated to be 14 per cent of existing stock, which creates a significant supply/demand imbalance," he explains.

Phull predicts 'last mile logistics' to be the biggest beneficiary and that the demand for smaller units located in proximity to urban town centres will continue to intensify.

"The biggest hindrance, however, is the availability of suitable stock. The supply of suitable/available warehouses in the UK remains constrained as is the availability of development land," he adds.

"There will also be growing demand for green warehouses as major corporations make commitments on net-zero carbon emissions. Buildings with solar panelling and energy monitoring will be highly sought after."

Martin also notes that there is a scarcity of high-quality, well located industrial assets, meaning the supply-demand imbalance is significant.

"This presents a compelling investment proposition, particularly in multi-lets, and we see good prospects for rental growth, particularly in the south-east where substantial holdings of quality industrial stock are rare," he explains.

"Within the industrial sector, urban logistics increasingly presents a solid investment proposition, whilst we are also seeing self-storage offering a very interesting growth opportunity, at yields that compare very strongly to the wider market."

Callender also notes that the popularity for self-storage has expanded significantly over the past decade for a variety of reasons.

"Partly it is down to materialism and people owning too much stuff; partly it is because new houses are getting smaller; partly because the high absolute level of house prices makes it more difficult for people with young families to move up the housing ladder and partly because of people starting online businesses and then outgrowing their spare bedroom, or garage," he says.

"The sector continued to grow in 2020, as more people worked from home and needed to de-clutter. Revenue has increased by 3-4 per cent per annum on a like-for-like basis since 2010 and we think that the sector will continue to grow as people become more familiar with the concept," he explains.

Males says that the secure, contractual income offered makes warehouses an attractive sector for the better-funded asset owners to match cashflows to their pension scheme liability profile.

However, investors need to take heed of the massive flow of capital to invest in this asset class and that fierce competition has significantly reduced the returns investors could expect, Males says.

As Breslauer warns, "we all know about the powerful story supporting logistics assets, but that value has already been captured and the maths just won't add up for many people entering this market now".

Long-term focus

While the above sectors have seen an acceleration of growth recently, it is important to look beyond short-term trends and challenges when it comes to property investment. As Aberdeen Standard Property long lease property fund manager, Les Ross, says: "Long-income real estate funds, which invest in property with leases often over 20 years in length, have enjoyed strong performance during the pandemic."

Written by Laura Blows