UK Economic and Property Market Update: Q3 2021

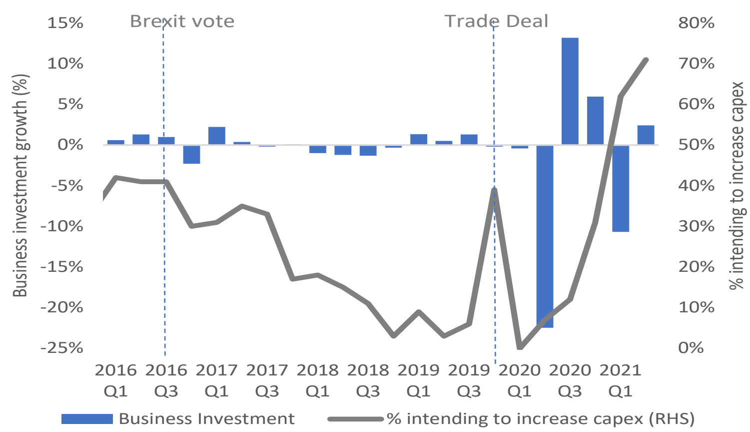
PITCH
Property Income Trust For Charities

A Fund managed by Mayfair Capital

UK Economic Overview:

The UK economy expanded 4.8% in Q2 2021, driven by consumer spending growth of 7.3% and business investment, which increased 2.4%. However, data suggests that the recovery stalled in Q3 with GDP growth of just 0.1% recorded in July. This was well below the 0.7% anticipated by consensus and attributed to a rise in covid cases impacting consumer confidence, resulting in a 2.5% decline in retail sales, and product and labour shortages constraining output in the manufacturing and constructions sectors. Shortages of steel, concrete, timber and glass contributed to a fall of 1.6% in construction.

Business investment to support UK economic recovery



Source: ONS / Macrobond / Deloitte CFO Survey (June 2021)

Consequently, we have marginally revised our GDP growth expectation for 2021 down to 6.3% with growth of 4.6% forecast next year. Growth is being driven by a rebound in consumer spending and further increases in business investment following the lessening of uncertainty related to Brexit.

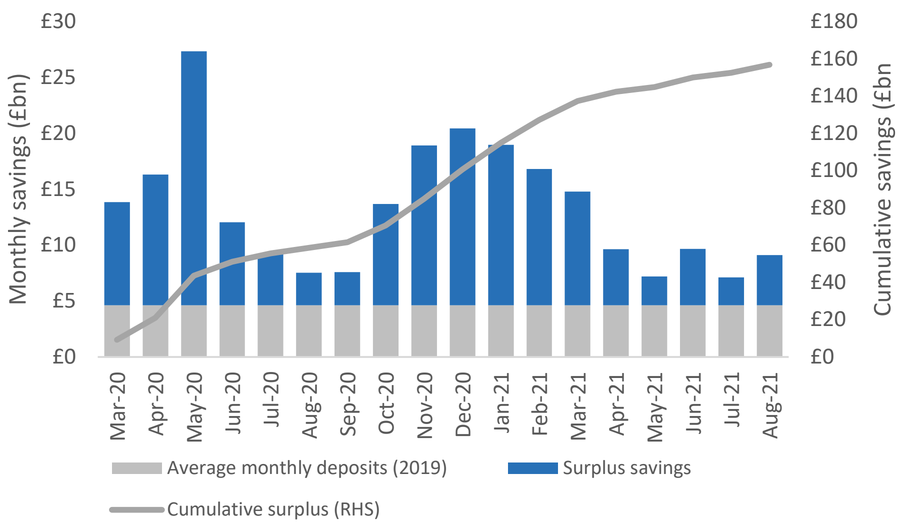
While retail sales data has disappointed in July and August, and risks to household disposable incomes are increasing, overall, household balance sheets are in good shape. Cash in households' bank accounts grew £9.1bn in August and households' have saved record amounts during the pandemic. Since March 2020, households' have saved £160bn more than would have been expected based on the average monthly saving rate pre-pandemic. This won't all be deployed by consumers but provides scope for above average spend and additional support in the event of tax increases, including the health and social care levy, and price rises.

Increasing inflation pressures represent the greatest risk to our growth expectations. CPI leapt to a nine-year high of 3.2% in August from 2.0% in July, although around 0.9 percentage points (ppts) was due to base effects linked to a fall in prices in August 2020, primarily due to the Eat Out to Help Out restaurant discount scheme.

However, cost pressures are building elsewhere. August recorded further rises in producer input price inflation and output price inflation, and although UK consumers are protected by the regulation of household energy prices, the scheduled 12% increase in utility prices in October is expected to boost CPI by 0.7 ppts.

Data from the labour market, also remains inflationary. A surge in vacancies to more than 27% above pre-pandemic levels has driven wage growth to over 8%. However, with the winding down of Government support over the coming months, the employment outlook remains uncertain.

Households have saved record amounts during the pandemic



Source: Bank of England (September 2021)

Many of the inflationary pressures will drop out of inflation next year and so we still expect inflation to begin to trend down. However, it is expected to drop more slowly than previously forecast. Given the surge in natural gas prices, Ofgem is anticipated to opt for a further hike in prices in April that could add 0.5 ppts to CPI. Inflation may even fall more slowly than our revised forecasts, particularly if labour shortages persist.

Current conditions increase the risk that inflation expectation become unanchored from the 2% target. The latest MPC statement suggests that a policy response to inflation should be expected, which has led markets to anticipate an increase in interest rates next year. Comments from the MPC indicate that how conditions in the labour market evolve over the next six months will be a key determinant to monetary policy.

Political risks to growth continue to linger. Trade remains the main drag on GDP growth, with the UK lagging other countries, indicating that this is in part due to continued uncertainty around trade relations. A situation that is not helped by the ongoing dispute around the precise implementation of the Northern Ireland Protocol. Alongside this, the spectre of a second Scottish referendum is also looming, raising broader questions about the outlook of the union.

In conclusion, while the prospects for a continued UK recovery are good, we remain cognisant of a rising number of risks. The final quarter of the year looks set to be volatile.

UK Economic and Property Market Update: Q3 2021

A Fund managed by Mayfair Capital

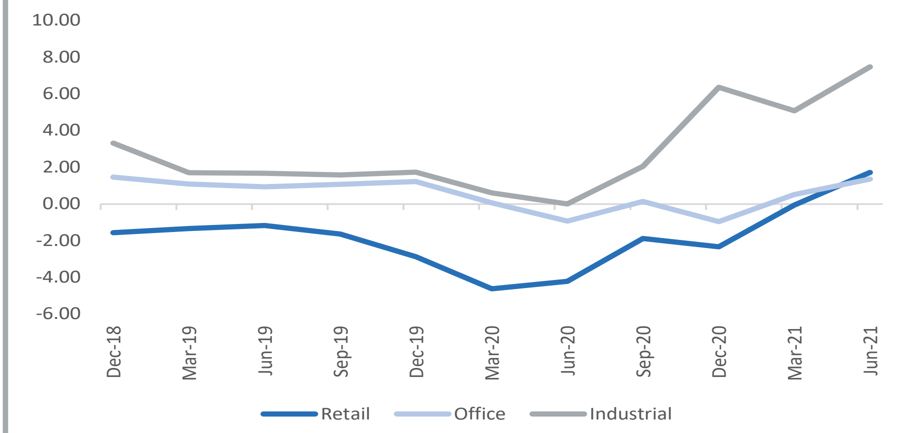
PITCH
Property Income Trust For Charities

UK Property Market:

The investment market recovery seen in Q2 was sustained throughout this quarter as real estate transaction volumes continued to increase. In total, £15bn transacted across the UK, compared with £14bn in Q2. Although investment activity across the year to date is up 45% over the same period in 2020, activity in the final quarter is likely to be more aligned with activity seen last year.

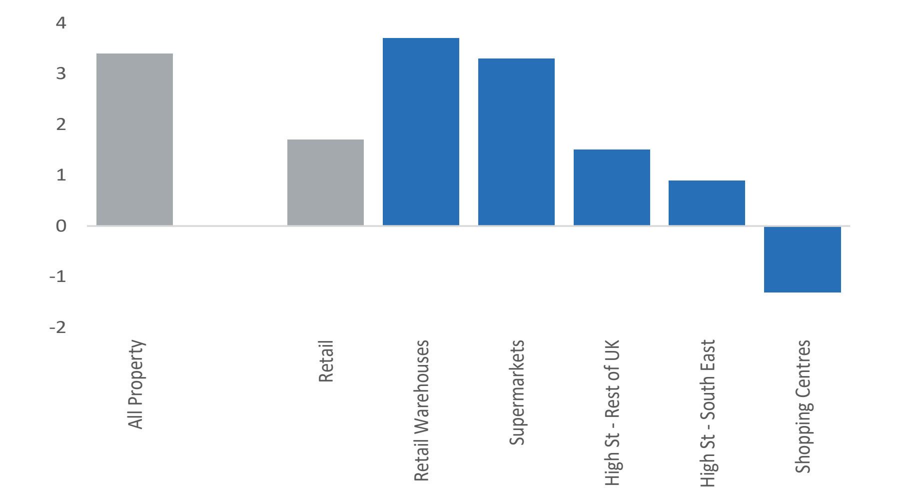
MSCI UK All Property has returned 8.3% over the year to September, with capital values up 5.0%. Quarterly capital growth of 3.3% has largely been driven by the industrial sector, which continues to out-perform. Forecasts suggest that, other than industrial, yields will remain flat throughout H2, and experience only minor declines thereafter. Rising build cost inflation is expected to constrain development pipelines across all sectors. Consequently, shortages of good quality, thematically aligned stock will remain, suggesting prime assets will be resilient over the next 24 months with potential for rental growth.

Despite continued economic recovery following the reduction in social distancing measures, the office sector has seen slow improvements whilst occupiers consider new requirements for flexible working. Office investments returned 1.3% in Q3 with marginal capital growth of 0.1%. The modest increase in rents seen in Q2 continued, rising 0.3% over the quarter although this was predominantly driven by regional and South Eastern markets. Although rental growth has been subdued, lack of supply across regional cities such as Leeds, Liverpool and Cardiff should help lift rents in these locations. Though flexible working may impact space requirements, occupational demand will continue to target Grade A space across all segments; the London market is also expected to remain resilient, benefitting from its inherent business clusters and connectivity attributes.



Source: MSCI Quarterly Property Digest (Q2 2021)

The industrial sector continues to drive performance at an all-property level with total returns at 7.9% over the quarter. The increased occupational demand for industrial space has predominantly been driven by two factors: Firstly, due to elevated e-commerce throughout the pandemic, and secondly supply-chain reconfigurations to accommodate higher levels of stock to mitigate the risk of shortages. This is illustrated as the vacancy rate of UK 'Big Box' market has fallen to little over 2%, a record low. Developers are responding with approximately 17 million sq ft of industrial units under construction across the UK, albeit smaller units which are cheaper and quicker to construct, causing an imbalance between available supply and occupier needs. Increasing build costs mean that we do not anticipate an acceleration in development or oversupply. However, Capital Economics predict the increased supply will slow rental growth from 2.6% year-on-year between 2021-25, to 1.9% year-on year between 2022-25. Despite this slightly weaker growth, the industrial sector outperforms the all-property rental growth forecasts which sit at 0.8% year-on-year between 2021-25.



Source: MSCI Quarterly Property Digest (Q2 2021)

Retail returned 4.2% over Q3 marking the third consecutive quarter of positive growth. Although comparable with all-property returns (4.6%), total returns within the retail sector were driven almost entirely by retail warehousing which returned 6.6% over the quarter. Retail warehousing also saw the highest investment activity, attracting £274m capital, 42% above the five-year average. August was the thirteenth consecutive quarter that saw all-property equivalent yields decline, with the retail yields contracting the sharpest. This was mainly driven by shopping centres which declined 23bps and this, although surprising, may reflect opportunistic investment activity whilst capital values are significantly lower than other sub-sectors. Despite the re-opening of physical retail, sales continued to fall as spending shifted from goods to services; this was felt as retail was the only sector not to achieve any rental growth.

Increased investment activity and further growth in capital values indicate that the property market has continued its recovery in the third quarter. Rental growth prospects at a headline level remain fairly subdued dut there will be growing polarisation between winning and losing assets.

Mayfair Capital Investment Management Limited, 55 Wells Street, London, W1T 3PT