

strategy&

Part of the PwC network

COVID-19: UK industry focus

Where next for real estate?





“

Over the longer term,
COVID-19 may well
accelerate moves
towards greater reliance
on regional hubs and
reverse urbanisation.”

Where we are today

Early in 2020, the UK real estate sector was enjoying a cautious recovery. Transactional activity had dipped in the lead up to the December 2019 general election, primarily driven by uncertainty over Brexit, but momentum was starting to return. Investor interest remained strong. As COVID-19 began spreading, paralysing large portions of the economy, that all changed.



“

The scale of contraction means the industry tenant profile is unlikely to ever look like it did before COVID-19, especially in sectors such as retail, hospitality and leisure.”

In the context of the global crisis, real estate is particularly at risk as the pain felt by every sector using occupiable space has a knock-on effect. The damage already suffered is substantial and it is increasingly evident that demand and use requirements for property may be changing for good.

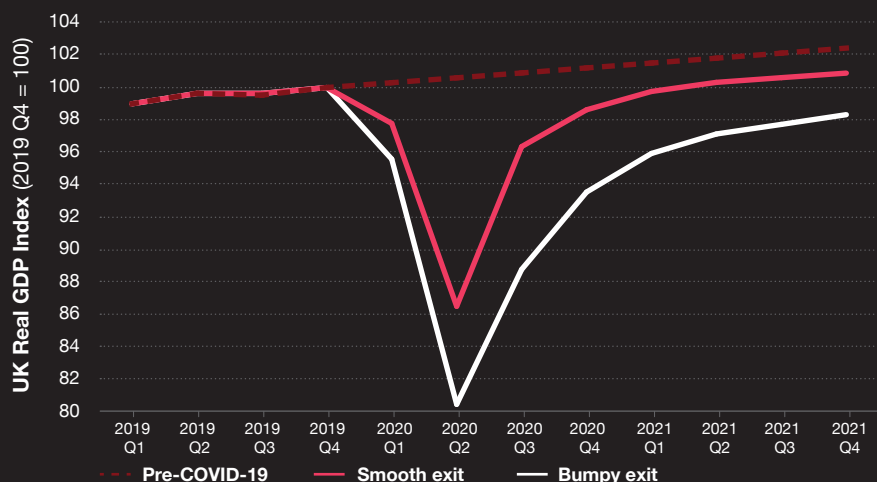
As shown (see chart on page 5), GVA impact across the UK real estate sector is more pronounced than across the broader economy, with growth contracting by 35% to 40%. This is largely a reflection of decreased rent collection and a sharp contraction among service providers in the real estate ecosystem.

35%
to 40%

contraction in
growth is expected
across the real
estate sector

The current situation is frequently compared to the 2008 global financial crisis or even the 1974 recession, but there are key differences. The collapse in economic activity combined with governmental policies to protect tenants has caused an unprecedented, steep fall in rent collections and major immediate challenges for real estate companies. With uncertainty around how many business tenants will survive the crisis and how they will view commercial space once we begin to recover, the long-term consequences of COVID-19 will be more severe than anything we've seen before.

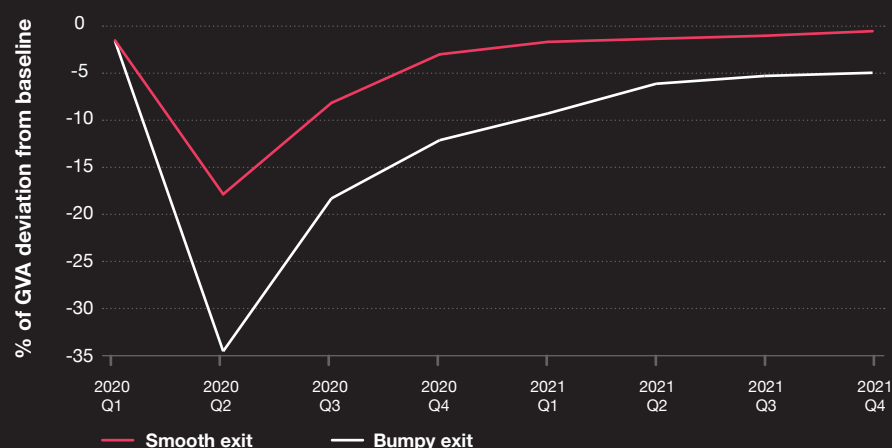
Comparison of real GDP index by scenario and pre COVID-19



*Relative to baseline projection

Source: Strategy& UK Economic Analysis April 2020

Impact of COVID-19 on Real estate against the baseline



Source: Strategy& UK Economic Analysis April 2020

397,000

Current no. of sector employees

'Total number of employees' represents the total number of employees in the Real Estate sector. These figures are deduced from ONS, specifically the Business Register and Employment Survey 2018 provisional.

High

Jobs at risk RAG rating

'Jobs at risk' rating reflects the analysis conducted by the International Labour Organisation. They assessed the global impacts of COVID-19 on different sectors, assessing those most likely to lay off workers due to lower cash flow.

22%

of workers normally come into physically close contact with >20 fellow workers

Physically close contact is defined as a distance of 2m. Source: PwC Research QuantiBus April 2020.

42%

of workers can work from home

The Work From Home index is based on a survey carried out by PwC Research, and is the equivalent to the % of respondents saying they can work from home.

What are we learning?

Sector impact will be widespread and recovery will be challenging

Not being able to collect rents has already led to cash flow implications for real estate companies struggling to meet their operating costs and honour financial commitments to banks and investors. This will worsen as lockdowns and social distancing continue. Conversations with our clients suggest just 60% of commercial real estate rents were collected in March. We'll likely see more detail on this – and its impact – at the end of the second financial quarter, in June.

Payment deferrals will provide some recovery of unpaid rents. Government support schemes, the availability of reserves and new investment capital will save some tenants. But the scale of contraction means the industry tenant profile is unlikely to ever look like it did before COVID-19, especially in sectors such as retail, hospitality and leisure. As the lockdown begins to ease, real estate companies may need to think about what roles they play in any tenant's "back to work" agenda, for example temporarily reconfiguring floor space.

Other parts of the broader real estate ecosystem will also be vulnerable. Developers are dealing with significant pauses on construction sites and delays in recovering outlay costs, which is restricting cash flow. Elsewhere, social distancing and lockdown measures have brought the real estate agency sector to a complete halt, with agents furloughing up to 80% of their workforces. As buildings stand empty, an extensive network of outsourced service providers (cleaning, maintenance, security etc.) is suffering too.

60%

conversations
with our clients
suggest just 60%
of commercial real
estate rents were
collected in March

“

The scale of contraction means the industry tenant profile is unlikely to ever look like it did before COVID-19, especially in sectors such as retail, hospitality and leisure.”

Prepare for years of uncertainty as core assumptions are challenged

COVID-19 poses questions that will take years – even decades – to answer. Real estate companies will have to adjust to this period of uncertainty in whatever way they can.

We are seeing a variety of long-held assumptions being challenged. For example, how much floor space will retailers need if current levels of online shopping become embedded or existing trends accelerate? With the ease of remote working becoming apparent, will people need to be in the office for work as often? With the instability of many supply chains now exposed, how will the logistics industry respond?

Existing trends such as repurposing of single-use real estate (mentioned in our latest [Emerging Trends in Real Estate Europe 2020 report](#)) and enhanced ‘partnerships’ between real estate companies and tenants may be accelerated to ensure, in part, that the current stock of built commercial real estate remains fit for purpose.

Over the longer term, COVID-19 may well accelerate moves towards greater reliance on regional hubs and “reverse urbanisation”. This could lead to uncertainty about the current availability of suitable real estate assets and infrastructure within these areas to satisfy increased and diversified demand.

In the worst-case scenario, real estate companies would be left with expensive, significantly devalued assets on their balance sheets for which there is no demand. At the same time, we might see a surge in demand for real estate that currently doesn’t exist in regional hubs, as well as a reduction in funds to invest and develop required space.

Right now, it is impossible to determine what will happen to real estate investments. We don’t know where long-term valuations will settle post-crisis; however, with reduced and volatile values across all asset classes, investors might look to rebalance their current exposure to real estate. The “wall of capital” that has supported gateway city asset valuations for the past 10 years may be reduced; although with low interest rates set to continue, demand for yield will remain.



“

Investors and managers, that haven't already, need to reposition themselves as soon as possible to ensure they are prepared for new trends.”

How do we respond?

Save what can be saved, one step at a time

With such widespread economic upheaval, the pressure on real estate companies to proactively manage their tenant portfolio has intensified. Assessing each tenant's financial position and swiftly identifying those who are most likely to survive and prosper will be key in selecting which to invest in and creating a strategy for moving forward. How that investment is shaped (rent deferrals, discounts, lease extensions etc.) will also need close consideration.

A renewed focus on cost and operational efficiency will be important. Rebasing outsourced contracts with facilities management suppliers is proving an effective way of trimming costs in the immediate term. However, where possible, real estate companies need to preserve the quality of certain facilities management services, particularly repairs & maintenance and security – a collapse of that ecosystem would do significant harm.

Real estate companies should consider old and new funding options to shore up cash in the short term. Existing lenders are a good start, as are government-backed lending schemes. They will also need to consider new sources of capital and debt.

Longer-term, pressures from investors looking to reshape their profile may see some look to realise existing investments. This is particularly likely for managers of open-ended real estate funds. How this is handled will have significant consequences for investors and managers.

Accept and adapt for the long run

This crisis is likely to permanently change the use of commercial real estate. Investors and managers, that haven't already, need to reposition themselves as soon as possible to ensure they are prepared for new trends, such as reverse urbanisation, reduced office working, the growing popularity of online and local community shopping, and a long-term decline in business travel. Health and wellbeing is also likely to become a greater driver of value across all forms of real estate.

Consider the factors beyond the current crisis

COVID-19 has the potential to be a significant driver of change for the real estate sector, but real estate companies need to remember the factors that were shaping the market long before the pandemic.

The pre-existing climate crisis, will continue to heap stakeholder pressure on real estate companies to commit to sustainability goals. Businesses must not lose sight of environmental, social and governance (ESG) issues, even as they grapple with their financial survival.

Real estate will increasingly be shaped by the parameters of socially and environmentally responsible investing, and companies should consider ESG policies to be long-term investments in their financial resilience.

Societal shifts in response to COVID-19 can help accelerate progress towards a greener future across a whole variety of industry sectors.

“

COVID-19 has the potential to be a significant driver of change for the real estate sector, but real estate companies need to remember the factors that were shaping the market long before the pandemic.”

Stay focused under pressure and act strategically

The real estate sector undoubtedly faces some substantial short – and long-term challenges from COVID-19, simply because of its exposure to almost every other industry that has proved vulnerable to the pandemic.

Decision-makers must remain rational and strategically minded. Cost-saving measures should be a constant priority as a means of staying liquid, and executives must consider every option for shoring up capital.

In the longer term, the sector should be acutely attuned to broader demographic trends, many of which may take time to become apparent.

The most successful players will be those who can tolerate uncertainty, who can be discerning under pressure and who can make painful short-term decisions for the long-term good.

Who to talk to

Angus Johnston

Partner, UK and EMEA
Real Estate industry lead, PwC
+44 (0) 7710 344040
angus.i.johnston@pwc.com

Craig Hughes

Partner, Global Real Estate
industry lead, PwC
+44 (0) 7715 607043
craig.o.hughes@pwc.com

Chris Mutch

Partner, UK Real Estate
Deals lead, PwC
+44 (0) 7753 928161
chris.mutch@pwc.com

Simon Hampton

Partner, UK Real Assets lead, PwC
+44 (0) 7990 506355
simon.hampton@pwc.com

Andrew Kail

Partner, UK Leader for Financial
Services, PwC
+44 (0) 7703 459443
andrew.kail@pwc.com



Part of the PwC network

This insight is brought to you using the capability of Strategy&, PwC's global strategy house, alongside our PwC industry experts. Together, we transform organisations by developing actionable strategies that deliver results.

We are uniquely placed to combine strategy with technical, industry and execution expertise. We embed our strategy capabilities with expert teams across our PwC network, to show you where you need to go, the choices you'll need to make to get there, and how to get it right.

The result is an authentic strategy process powerful enough to capture possibility, while pragmatic enough to ensure effective delivery. It's the strategy that turns vision into reality. It's strategy, made real.

www.strategyand.pwc.com

@2020 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details. Mentions of Strategy& refer to the global team of practical strategists that is integrated within the PwC network of firms. For more about Strategy&, see www.strategyand.pwc.com. No reproduction is permitted in whole or part without written permission of PwC. Disclaimer: This content is for general purposes only, and should not be used as a substitute for consultation with professional advisors.