Santander Asset Management

50 years creating value

ABOUT INVESTING

Supporting clients through the changing property investment lanscape

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The property sector has suffered as a result of the COVID-19 pandemic. However, there are also new opportunities and funds that have proved resilient. Property remains an important consideration for a balanced, diversified portfolio.

Government actions to control the spread of COVID-19 have had a harsh effect on shops and offices, dramatically accelerating a shift to digital that was already underway.

The pandemic effect

With all but essential shops shut for months on end, consumers had little choice but to move online. While online outlets were quick to step up, high street retailers have been left counting the cost. The temporary closures of shops and retail centres left a big dent in tenant revenues, weakened cash reserves and further undermined the market in the face of growing competition from online retail.

With everyone who could do so required to work at home, offices were also abandoned. It comes as no surprise then that the final quarter of 2020 saw a two-decade high in vacant shops in the UK, with the biggest increase in empty offices since the Global Financial Crisis, according to the Royal Institution of Chartered Surveyors.[1]

Even as restrictions ease we are at a crossroads in terms of working practices. While some employers are insisting staff return to the office others have introduced permanent work from home or hybrid working practices. The UK Government is also planning to give all employees the right to request flexible working from their first day, although employers do not have to agree to these requests.[2] It remains to be seen how many workers will return to the office and the extent to which companies may need to review their space requirements.

The shift to digital brings new investment potential

There are positives in the acceleration of digital shopping and working. For example, the growth in online sales has also driven up demand for logistics space, such as warehouses. It's estimated that the UK will need an additional 60 million square feet (14% of existing capacity).[3] Greater digitisation requires more and larger data centres with investments across Australia, Japan and throughout Asia.[4] Some industrial property sectors also stand to benefit from any ongoing trend towards onshoring as multinationals look to make their supply chains more resilient.

The role of residential property

While commercial property is the primary focus of most funds, residential real estate does feature. Demand for private rented sector properties remains strong, and the sector offers relatively low correlation with commercial real estate as well as other asset classes.

Institutional investors in particular are partnering with developers and housebuilders in the private rental market, although there are still few retail fund offerings with significant exposure to that market. Those available tend to involve good quality flats in sought after areas. The market suffered a sharp slowdown during the pandemic - not least because construction was on hold for several months - and has more recently been hit by a shortage of building materials.

The pandemic has also created opportunities, for example the potential for developers to invest in and repurpose empty or underused commercial real estate for the residential market, particularly in city centres.

Evergrande: the world's most heavily indebted property company

One of the big property stories just recently relates to real estate developer Evergrande in China. Once the world's most valuable property stock, it is now paying a heavy price for its role in the vast oversupply of properties in China, with crippling liquidity issues following new government restrictions on the amount that large real estate developers can owe.[5]

Navigating a changing landscape

For property fund managers, there's been little choice but to adapt. Many of those with significant exposure to the hardest hit sectors, such as offices and retail, have worked with tenants to renegotiate rents, amend lease terms and in some cases agree write-offs in order to maintain occupancy.

Open-ended funds have also had to close their doors to redemptions in order to protect investors from the effects of large-scale withdrawals. The FCA is looking at introducing statutory notice periods of up to 180 days for withdrawals.[6] This measure is already in place in markets including Germany,[7] but clashes with ISA rules requiring investors to be allowed to access their funds or transfer them to another ISA within 30 days of a request being made.

Building a case for property

Despite the challenges faced, property fund performance has proved relatively resilient. The average fund in the Investment Association's UK Direct Property sector was up by just over 4% in the year to early October 2021,[8] while the average trust in the Association of Investment Companies (AIC) UK Commercial Property sector was up by just over 30% in the same period, recovering strongly from a sharp dip in 2020.[9]

Property can have a role to play as part of a diversified portfolio, particularly when a steady income can be hard to find elsewhere and with inflation predicted to rise. The range of strategies and approaches available can help advisers manage exposure to property, as well as guiding their clients through what continues to be an uncertain period.

Learn more

Stay up-to-date with our latest **Markets and Insights** at **santanderassetmanagement.co.uk**.

[1] Reuters - UK sees surge in empty shops and offices amid pandemic – RICS, 28/1/21

[2] Gov.UK – Millions to be empowered by government plans to strengthen day one employment rights and increase productivity of businesses, 23/9/21

[3] FT.com – Online shopping boom in pandemic drives demand for warehouse space, 22/6/21

[4] Cision PR Newswire – Digitalisation to Fuel the Growth of Data Centres in the APC Region – Arizton, 4/10/21

[5] FT.com – Evergrande and the end of China's 'build, build, build' model, 22/9/21

[6] FCA – CP21/12: A new authorised fund regime for investing in long term assets, 7/5/21

[7] Funds Europe – UK could learn from Germany's property fund redemption rule, 4/8/20

[8] Trustnet.com – Sector analysis, accessed 7/10/21

[9] Trustnet.com – Sector analysis, accessed 7/10/21

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