The British Real Estate Market in the Light of Brexit

The Brexit referendum predicted difficult times for the British real estate market. But what has actually happened since the landmark decision? While the market for office real estate has held up surprisingly well since the referendum, the residential market has lost much of its attractiveness in recent years.

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Wüest Partner, April 2019

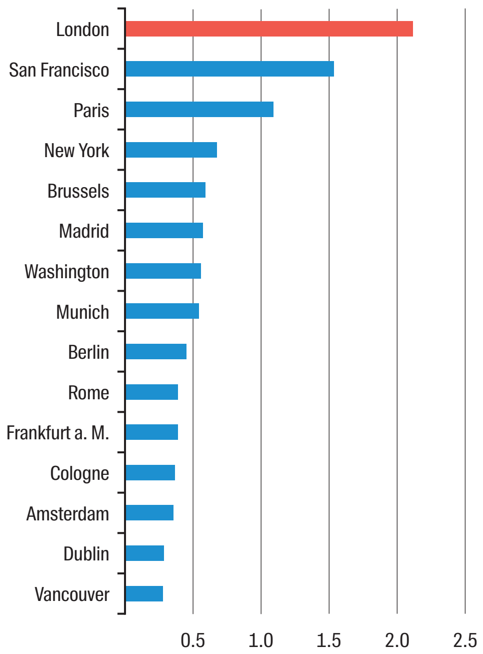
In view of the turmoil surrounding Britain›s withdrawal from the European Union, it is surprising that London remains a particularly sought-after market for Swiss real estate investors. In no other city have they generated a higher cross-border transaction volume in recent years (figure 1). The volume even doubled in 2018 compared with 2017.

However, Swiss investors are not the only ones showing interest. The share of foreign investors in the London office market has increased significantly since the Brexit decision, as most of them have benefited from a generous discount, resulting from the favourable pound. Investors will also appreciate the size and liquidity of the British real estate market and the high degree of market transparency.

«EU passport» as a key question

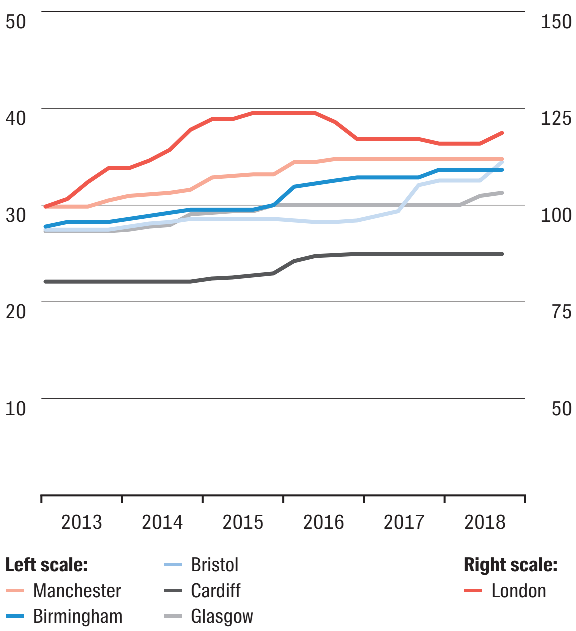
For the UK real estate market in general and London in particular, how the distribution of British services within the EU is regulated in the event of a UK withdrawal is of particular relevance. Multinational companies especially would be affected by the abolition of the so-called EU passport. This passport now allows companies registered in one EU country to conduct cross-border business in another EU country without having to obtain a further licence. The loss of this passport would be considerable for London as a global financial centre. Smaller, regionally oriented centres such as Birmingham or Manchester would be less severely affected, as they are dependent on the cross-border internal market through exports

1 **Real estate purchases by Swiss investors abroad**
(in billion EUR, transactions from 2.5 million EUR, 2016–2018)



Sources: RCA; Wüest Partner

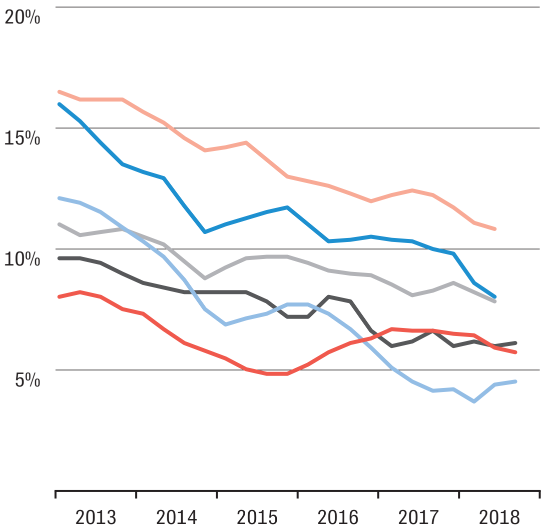
2 **Office spaces: prime rents**
(in GBP per square foot and year)



As of: 3rd quarter 2018

Source: Wüest Partner

3 **Office spaces: vacant spaces** (as a percentage of the stock)

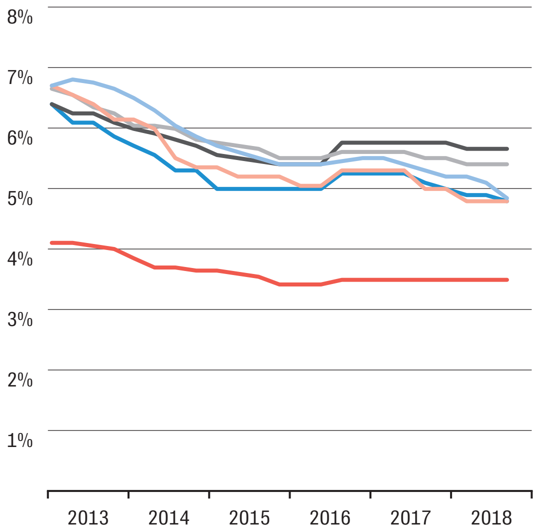


London
Birmingham
Cardiff
Manchester
Bristol
Glasgow

As of: 2nd or 3rd quarter 2018

Source: Wüest Partner

4 **Offices spaces: prime yields**



London
Birmingham
Cardiff
Manchester
Bristol
Glasgow

As of: 3rd quarter 2018

Source: Wüest Partner

to the EU or through workers and financial subsidies from the EU, but to a much lesser extent than London.

Substantial demand for office space

After a decline in rental activity both in London and in the major regional centres in 2016, demand for office space increased significantly again in the following two years. After years of rising (prime) rents, the Brexit vote led to stagnating rents and even falling rents in London. After some initial hesitation, many companies took advantage of the opportunity to secure attractive offers, so that the rental market showed itself to be surprisingly resilient to the ongoing political frenzy. In some cities, higher prime rents have even recently been recorded again, for example in Bristol, Glasgow and London (figure 2).

The declining supply also supported the increase in rents. While there is already a shortage of supply in the regional centres, many building contractors in London have been irresolute since the referendum, with the result that building activity has declined ever since. In Bristol, vacancy rates have temporarily fallen to a local low, and in Glasgow the decline in vacant properties has recently accelerated sharply. In London, the only British city that can be said to have experienced a Brexit-induced increase in vacancy in 2016, the rate fell noticeably again in 2018 (figure 3).

The shock following the adoption of the referendum not only had a negative impact on the British pound, but also on office real estate yields: over the course of 2016, prime yields in virtually all cities rose by around 10 to 40 basis points. This was followed by a brief period of stagnation, with sustained sound fundamentals – at least outside London – leading to lower yields from 2017 onwards (figure 4).

Price declines in home ownership

In contrast to the resilient office market, the market for owner-occupied homes has cooled down significantly since the summer of 2016 in the United Kingdom. With the exception of a temporary recovery in 2017, the sales volume has declined steadily and is now even showing a significant decline in London. This development had already begun in 2014, but has accelerated massively since the summer of 2016 (figure 5). The continuing uncertainty surrounding Brexit cannot be dismissed as a cause, and as long as there is no more clarity about the further course of events, many potential buyers will adopt a wait-and-see attitude. In the wake of dwindling demand, average annual house price growth slowed from 8.2 percent in June 2016 to 2.5 percent most recently, and in London even from 11.6 percent to minus 0.6 percent.

When interpreting the latest developments, it should be borne in mind that home ownership prices rose, in some cases sharply, in the years preceding the referendum, making owner-occupied homes increasingly unaffordable despite solid wage growth. Prices remain inaccessible in many places (figure 6). In London, for example, the average house price at the end of 2018 was around 474 500 pounds – twelve times the average annual income and still more than twice as high as in the rest of the UK.

Is London's supremacy crumbling?

The dwindling sales volume of home ownership is not only due to weakened demand, but also to a shortage of supply. The devaluation of the British currency led to an increase in inflation and thus to higher costs for building contractors. The number of construction starts increased steadily until mid-2017, but has been declining ever since. The number of completed projects has also barely increased recently (figure 7). This has exacerbated the shortage of supply, especially of new buildings, in recent months, which is reflected in a price premium over existing properties that has been rising steadily since the Brexit vote.

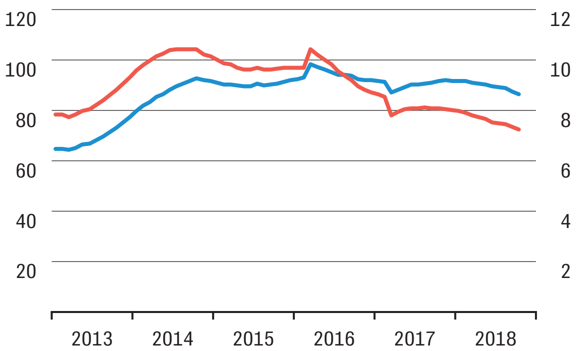
Lack of absorption capacity

As unclear as the implementation of the Brexit is, as unclear are the effects on the British real estate market. In general, however, the fear of a large-scale «Brexodus» on the part of many companies seems exaggerated for two reasons: on the one hand, the alternatives to the London office space market within the EU are limited. Frankfurt, Paris, Dublin and Amsterdam are cited as the strongest profiteers of the Brexit. However, while Frankfurt and Paris lack large contiguous and representative spaces, Amsterdam and Dublin are too small to overtake London.

On the other hand – and this without downplaying the future challenges for the British economy – London has been able to hold its own in the past. Finally, the British capital benefits not least from a large pool of qualified workers, but also from liquid capital markets, linguistic circumstances (English as the «world language»), high clustering effects, particularly in the finance and insurance sectors, and an already relatively low degree of regulation.

Since only a fraction of London›s financial industry exceeds the absorption capacity of most European office markets, any relocations from London will not be concentrated in one European city, but will take place in a dispersed fashion across Europe. Given this dispersion, it will take years for another European city to shatter London›s supremacy. Accordingly, London will continue to function as a global financial centre, and other cities in Europe will (continue to) only take on passport functions.

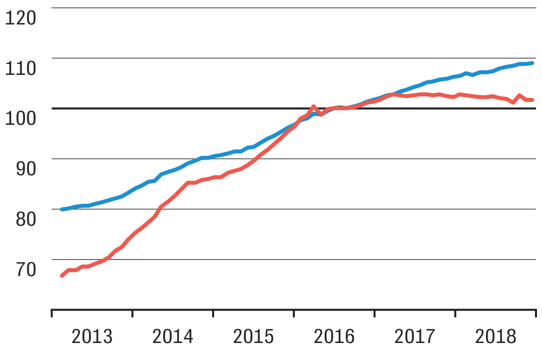
5 **Home ownership: sales volume**
(in 1000 properties, moving annual total)



Left scale: United Kingdom
Right scale: London

Sources: ONS; Wüest Partner

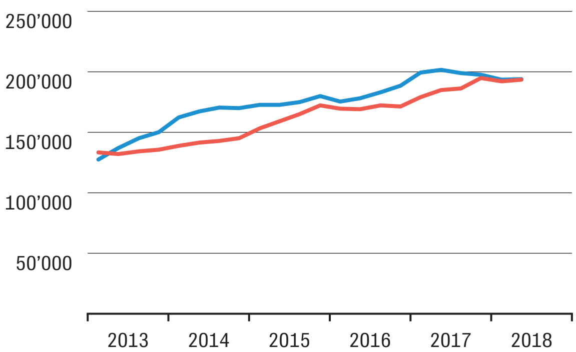
6 **Home ownership: price development**
(index 1 June 2016 = 100)



United Kingdom — London

Sources: ONS; Wüest Partner

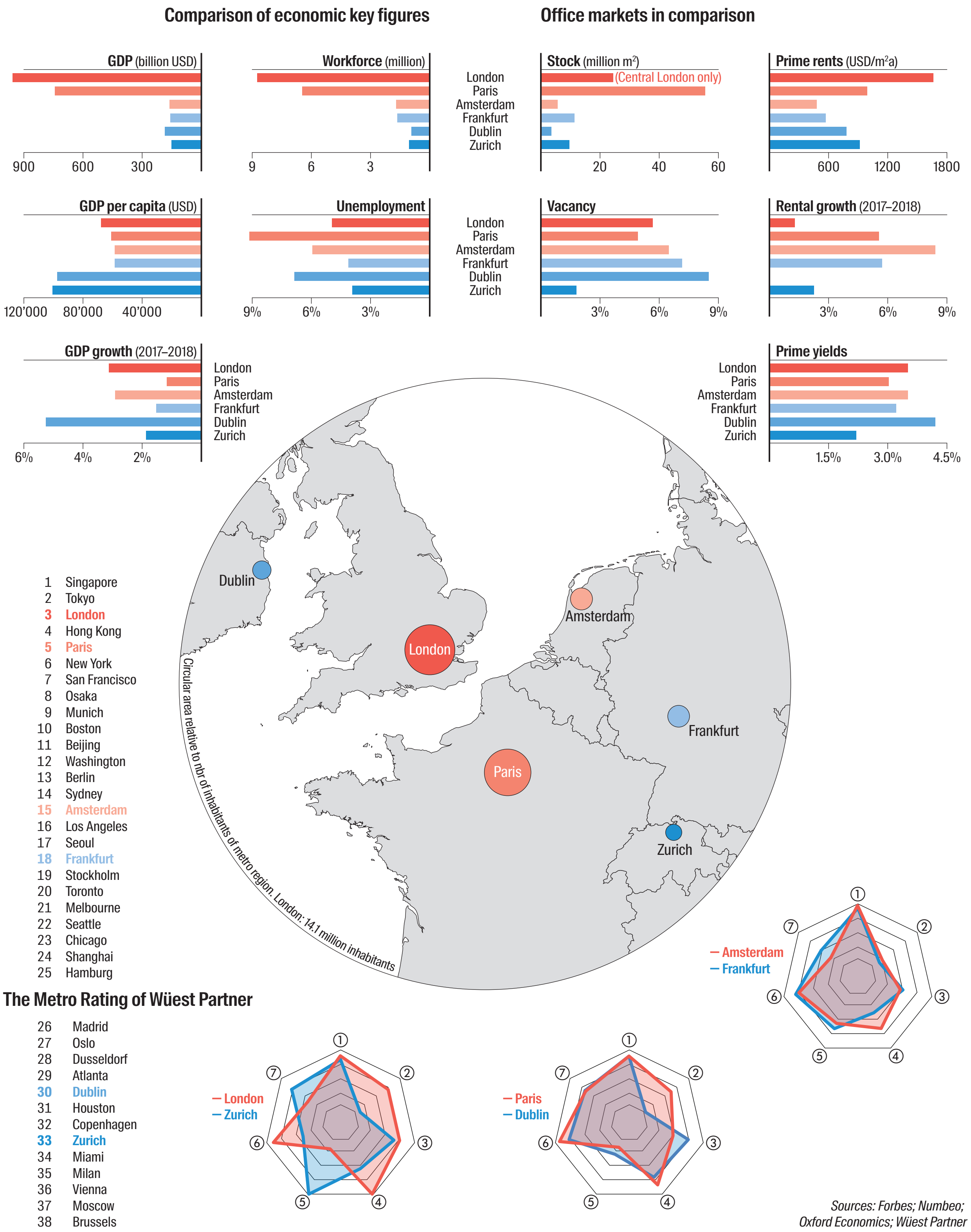
7 **Home ownership: construction starts and completions**
(number of properties, moving annual total)



Construction starts — Completions

Sources: gov.uk; Wüest Partner

8 **London in comparison with other European metropolises** (latest status)



Sources: Forbes; Numbeo; Oxford Economics; Wüest Partner

About Wüest Partner

We have been advising professional real estate companies and investors since 1985. While initially developing business exclusively in Switzerland, we have been expanding our in-depth expertise to international real estate markets for more than ten years. As independent and leading experts, we create the foundation for first-class decision-making. With a wide range of services consisting of data, consulting, valuation, applications and publications, we support our customers domestically and abroad. Our knowledge creates transparency and paves the way for your development in the global real estate industry.

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Have we piqued your interest?

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