

Foundations for Change



Real Estate Outlook Report 2021



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Foreword

Welcome to our Real Estate Report 2021.
As we emerge from the COVID-19 storm, it seems appropriate to take stock and look forward as to what lies ahead for the industry.

There has clearly been so much uncertainty influenced by the pandemic. However, as our survey findings show, there remains long term optimism within the sector. What is clear is that real estate businesses across all sectors have had to become far more innovative, flexible and adaptable over this time. While COVID-19 may have accelerated these changes, or in some cases, caused some of the constraints such as the rent moratorium, many of the factors affecting the market already existed before the pandemic and will continue to impact the sector in the post pandemic environment.

Our report provides a general market overview before examining some of the developments that have taken place that define space and place, and the key game changers currently impacting real estate.

The results provide a unique snapshot into the current state of the sector and some of the key factors affecting it. This is drawn from the collected opinions of those working in the industry, identifying the key challenges and opportunities they face.



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Highlights

55% respondents
optimistic about future



38% see **business
rate reforms**

as the most
important way
for government
to support the
high street



Of all the real estate sectors

**Retail
sector**
has been
most
affected



43%



have
found it
harder to
**access
finance**

Tax barriers to growth



Sustainability
is the next
big thing
for real
estate



Market overview

There is no doubt that the last 18 months have been challenging for everyone, with doors literally closed for businesses such as hotels and retailers, and landlords facing a long-term rent moratorium.

While there still remains much uncertainty in the market, with attention fluctuating between Brexit and COVID-19, we find that optimism remains amongst property investors, who are reluctant to change their investment portfolio. More than 66% of respondents to our survey felt that the economic uncertainty, concerns about consumer confidence and the fall-out from the pandemic are the most significant challenges facing business. However, at the same time, over three quarters are not actively looking to change their real estate portfolio as a result of the recent events.

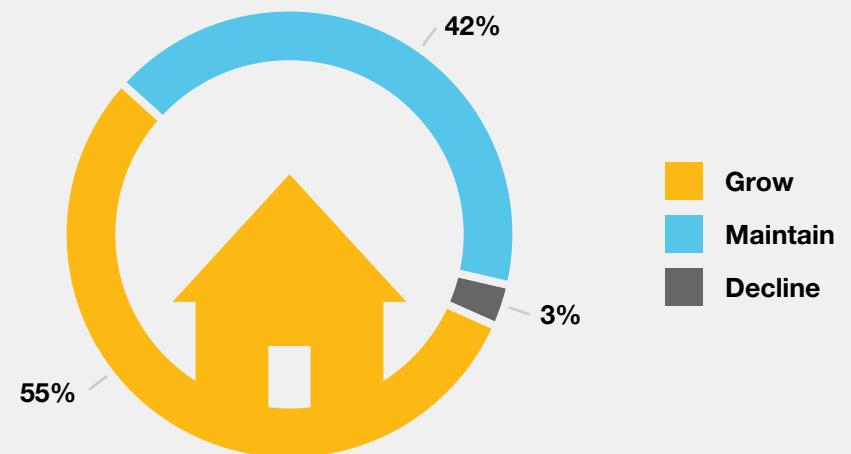
This optimism is also apparent when asking businesses about future growth, with 55% of respondents expecting their businesses to grow in the next 12 months. A further 42% expect to at least stay the same size. These results do not come as a huge shock, as we witnessed a buoyant-based response from our 2019 survey, when the uncertainties of Brexit were looming large.



75%

of respondents are not actively looking to change their real estate portfolio as a result of recent events.

In the next 12 months, respondents expect their business to





While there is opportunity for growth, businesses need to adapt quickly in order to thrive. For instance, the COVID-19 pandemic has in many ways accelerated the underlying issues already affecting high street retailers and commercial property businesses. We have seen major retailers such as Sainsbury's and John Lewis announced their own Build to Rent development projects as they look to participate in the residential sector.

With the evident housing shortage in England, the target of 300,000 homes a year not currently being met¹ and the demand for affordable housing increasing, the general demand for housing remains high with many opportunities for developers, residential landlords as well as long term investors.

With the optimism, there are also challenges that businesses face, particularly in relation to government policy, taxation, technology and people matters.

Sustainability and the use of technology is also on the forefront of respondents' agendas.

1. Tackling the under-supply of housing in England - House of Commons Library (parliament.uk)
<https://commonslibrary.parliament.uk/research-briefings/cbp-7671/>

Changing places and spaces

Commercial sectors

The impact of COVID-19 has significantly impacted all sectors, some positively and some negatively, but none more so than:

Retail



Commercial office property



As a result, it appears that areas of the retail and commercial office sectors are likely to be under serious stress. With many people having not travelled to work for over a year, office commercial property has been affected. Our results indicate this is the case, with 69% of commercial office property respondents stating London would be most impacted.

With the desire for flexibility, commercial tenants are seeking shorter leases, with research undertaken by Savills² suggesting that 2022 projections anticipate a vast majority (over 85%) of leases to be a maximum of five years. This can be compared with 2016, where the minority (under 30%) of leases were a maximum of five years. To complement this, 10-15 year leases have become nearly obsolete. As a result, there will be accounting and financing implications for landlords, with particular focus needed on the value of these shorter leases.

2. https://www.savills.co.uk/research_articles/229130/303584-0

Figure1: Within your property portfolio, which sector has been most impacted?





The effects of COVID-19 are numerous across the real estate sector for landlords, as they have faced a number of challenges including the continued extension of the rent moratorium, now due to last until at least March 2022, alongside tenants seeking additional concessions on new and existing arrangements often requiring additional incentives as well as shorter or more flexible arrangements. All of which have put pressure on valuations, particularly within the retail and hospitality sectors. Access to funding has become more difficult for almost half of our participants since the pandemic, as banks continuing to be the main source financing it is likely they have been more reluctant to fund assets with more COVID-19 challenges, this is likely to continue while uncertainty remains with banks expected to require more robust financial modelling on perceived riskier assets.

It is perhaps not surprising given how the different property types have been affected, that a number of our respondents are looking to change their portfolio balance across different real estate asset classes. It is worth highlighting that where there is a change of intention or use of a property there can be potential accounting implications which could impacts the results and presentation within the financial statements and could affect existing lending covenants as well as resulting in unforeseen compliance costs, such as external valuation requirements, and should therefore be investigated prior to the change being made.



Peter Gilligan, Partner, Crowe



Whereas in the commercial office sector, London was highlighted as the most immediately affected by the pandemic, the impact on the retail sector isn't as confined to the bigger cities, with our results suggesting a more even split between London (45%) and Regional (55%). This no doubt reflects the national trend towards online retail.

Major retailers and high street landlords will have to consider redeveloping their existing stores for their businesses to remain commercially viable. We can expect to see more Build to Rent schemes being put forward as well developments with a more blended mix of asset classes including flexible office space, retail and leisure, alongside residential. The pandemic has also allowed people to appreciate outside space more, as well as their local community, so we expect to see developments being altered to reflect these underlying needs. Developers should consider the impact of their developments on the local community already in place, and how they can bring a community together in order to improve residents' wellbeing and their living experience. Typical amenities for the benefit of the community can include parks, community centres and parking. This again links to the idea of adapting space and place.

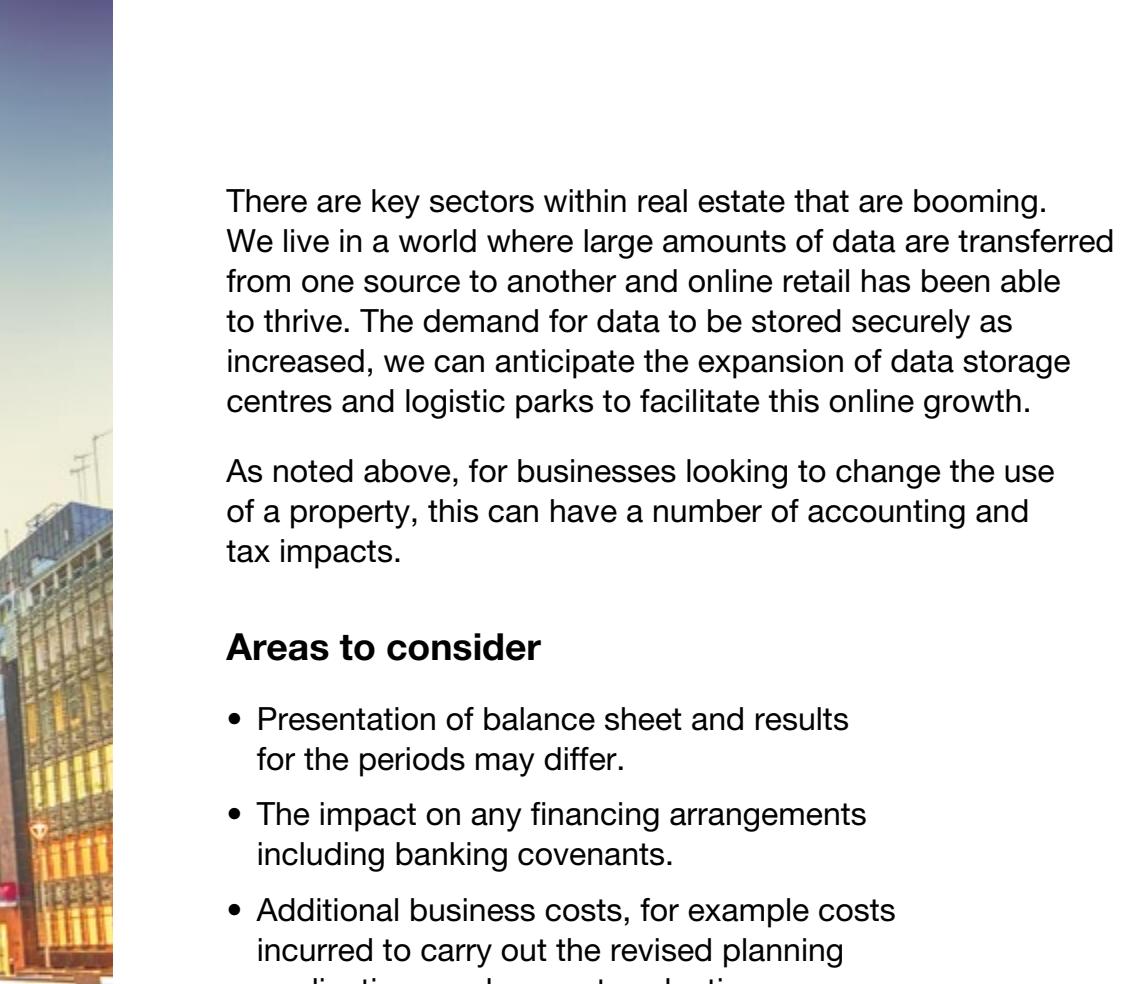
Businesses operating in the hospitality sector have also had to examine how best to adapt their assets to changing demands in the market. Across the main commercial asset classes there is a clear movement beyond simply paying for space, rather a space with additional services.



Supported by resilient broad-based domestic demand, the UK's mid-market hotel sector is likely to recover ahead of upper upscale and luxury hotels which are more dependent on international arrivals.

From the developer's perspective, construction and operating efficiencies of the more basic offering reduce exposure to anticipated material and labour cost inflation while allowing flexibility to target alternative market segments, such as long-stay, in due course.

Malcolm Kerr,
Managing Director,
Horwath HTL UK



There are key sectors within real estate that are booming. We live in a world where large amounts of data are transferred from one source to another and online retail has been able to thrive. The demand for data to be stored securely as increased, we can anticipate the expansion of data storage centres and logistic parks to facilitate this online growth.

As noted above, for businesses looking to change the use of a property, this can have a number of accounting and tax impacts.

Areas to consider

- Presentation of balance sheet and results for the periods may differ.
- The impact on any financing arrangements including banking covenants.
- Additional business costs, for example costs incurred to carry out the revised planning applications and property valuations.
- Associated tax implications including possibility of a dry tax charge where an intention to develop and sell changes to develop and hold.

Residential sector

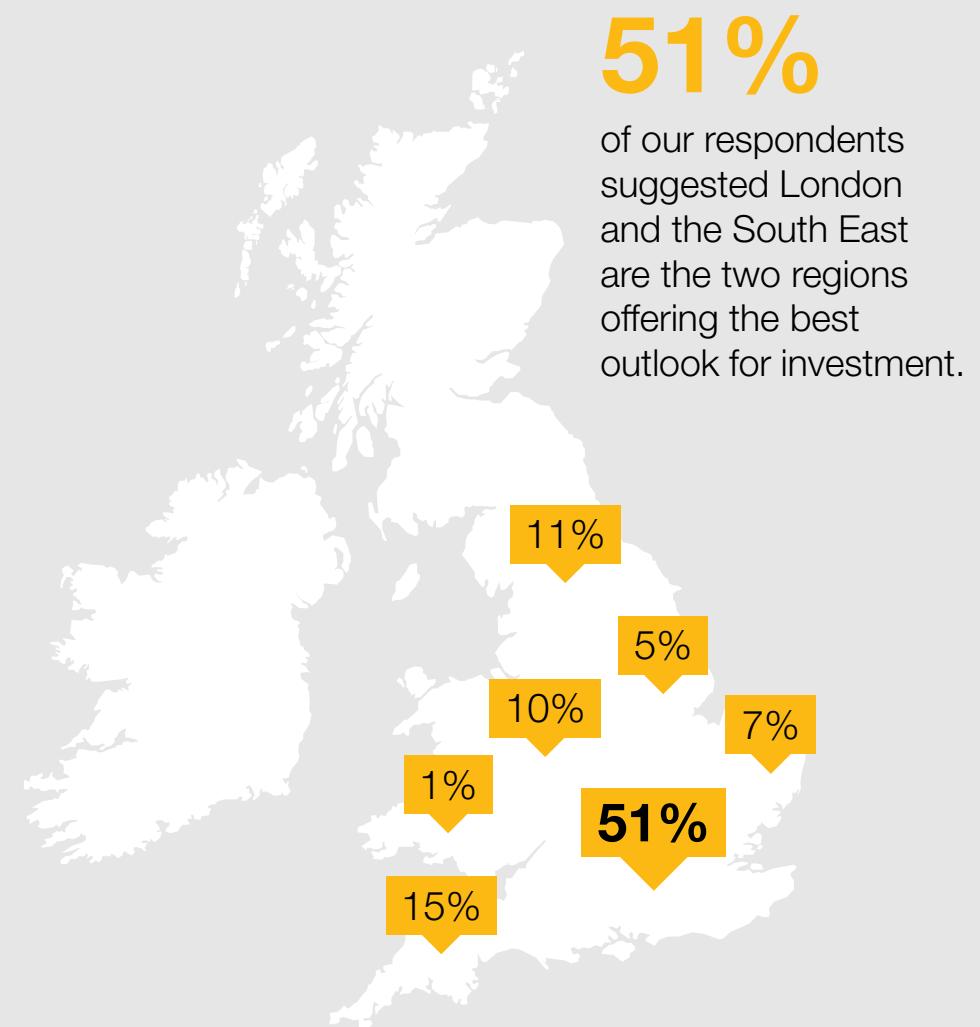
There is a current housing shortage in the UK which presents an opportunity for all involved in the residential market.

There are an estimated 345,000 homes needed per year³, considering new households and an accumulation of existing needs for suitable housing. Over the next 12 months, 51% of our respondents suggested London and the South East are the two regions offering the best outlook for investment.

54% of respondents suggested the same in our 2019 survey. The continued development and roll-out of Crossrail over the next few years may be an important factor in these results as London and the South East will be more connected than ever.

To reduce the housing shortfall, it may be necessary to see a relaxation of rules regarding Green Belt areas, allowing for more developments. The easing of rules would be well-received as only 45% of respondents believe the current Green Belt policies are conducive to solving the housing crisis. This is an increase of 15% from the results of our 2019 survey, and the Green Belt was only approximately 32km² larger at the time⁴.

With COVID-19 extending the possibility of home working for more people and an expectation that this will continue to a certain degree post-pandemic, it will be interesting to see what impact this will have on the demand for residential properties near key transport links. This is an area to keep an eye on. It would seem likely that some workers will sacrifice easier commutes for larger properties further outside the main cities, on the basis that going to the office becomes less frequent.



3. Tackling the under-supply of housing in England - House of Commons Library.
<https://commonslibrary.parliament.uk/research-briefings/cbp-7671/>

4. Green Belt - House of Commons Library.
<https://commonslibrary.parliament.uk/research-briefings/sn00934/>

Game changers

Government and funding

During the pandemic, the UK government has provided support in many ways, notably the furlough scheme, Coronavirus Business Interruption Loans (CBILS) and business rates reliefs. With funding being gradually tapered off, property businesses and their tenants will need to consider how they will cover their costs, and whether their business models require change.

Property investors were not able to evict tenants during the pandemic due to a rent moratorium being introduced. This has led to either a significant loss or deferral of income.

Coupled with this, over 43% of our respondents stated that it has become more difficult to obtain finance in the last 12 months, with that finance predominantly still being provided by bank finance (46%). We would expect that the challenges of raising finance will continue for at least a further year as lenders re-adjust to the post-pandemic world. It is clear that finance and funding is available but probably at a higher net cost. Over 45% of our respondents felt that low interest rates have been around for so long that any increase would significantly impact the market.

Figure 2: Sources of finance

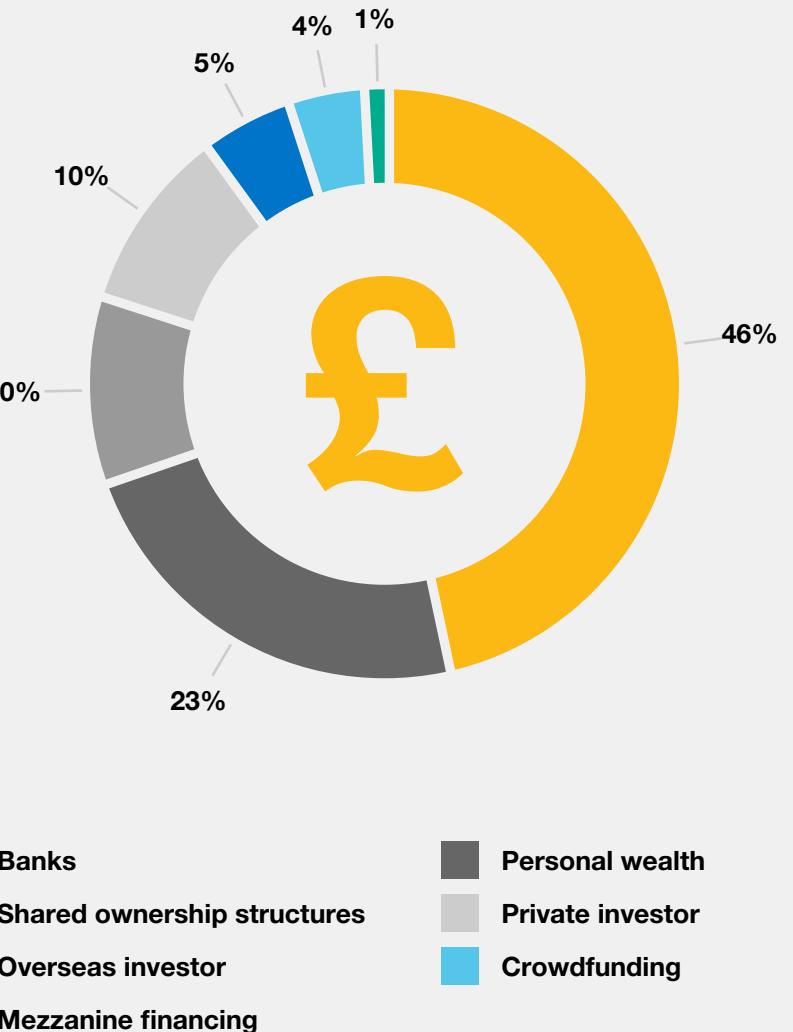
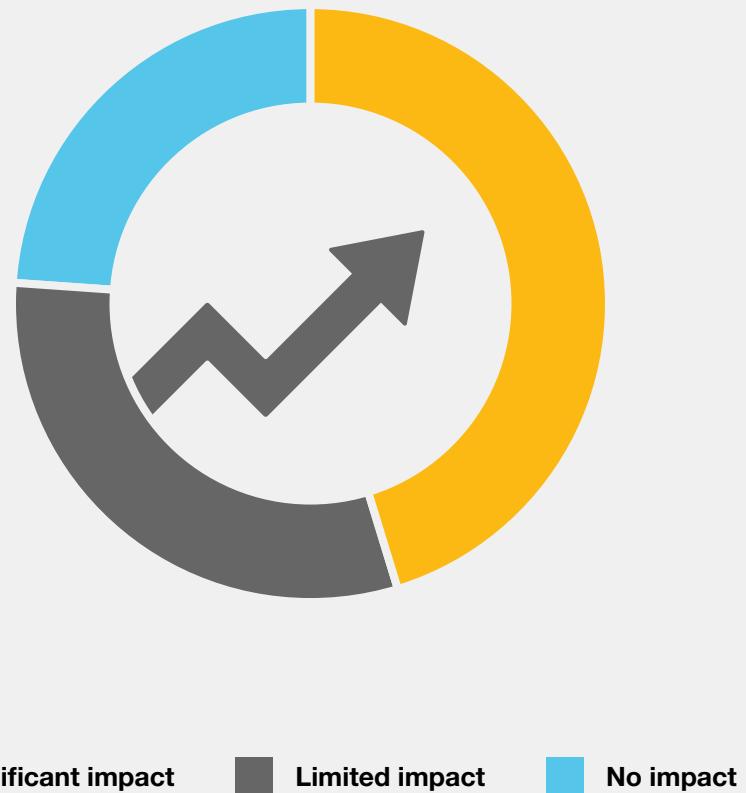


Figure 3: Impact of rising interest rates on property sector



Planning laws

Obtaining planning for a property development can be difficult and time consuming, and as expected, when asked what the government could do to help real estate, 14% of our respondents suggest planning reforms should be on top of the government's agenda. Under the current system it can take a number of years for a standard housing development to go through the planning system – the pandemic will have undoubtedly increased the time scales for obtaining planning permission even further. This may well provide some in the market with further opportunities as developers work out their land banks with planning permissions in place. These delays put further pressure on the government to elaborate further on their *Planning for the future*⁵ paper that they published back in August 2020. The paper suggested that a new planning system with a traffic light system is to be implemented shortly. The planning paper also suggested different zones for categorising land:

- 'growth', which would be for substantial development
- 'renewal', with a presumption for development as long as it is suitable
- 'protected', which would continue to be restricted.

With the recent appointment of Michael Gove, as the Housing Minister, the government has announced that it will be reconsidering these proposals in light of political opposition. This inevitably will mean that there are further delays in any substantive planning reforms which is likely to lead to a short term land supply issue and further pressure to deliver on the government's housing objectives.

5. <https://www.gov.uk/government/consultations/planning-for-the-future>

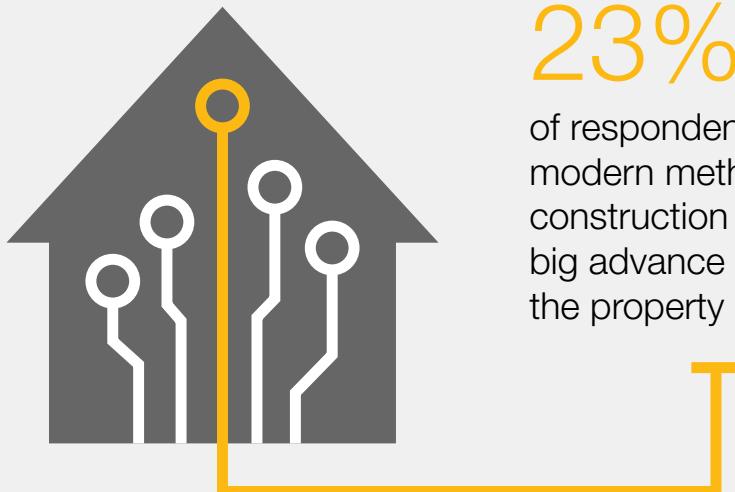
Technology

The Fourth Industrial Revolution is of a scale, speed and complexity that is unprecedented. It is characterised by a fusion of technologies, such as artificial intelligence and advanced robotics, that is blurring the lines between the physical and digital worlds. The property sector is trailing slightly behind other sectors but change is on the horizon. Just behind the sustainability agenda, modern methods of construction are believed to be the next big advance to impact the property sector, stated by 23% of our respondents.



37%

of respondents said that they believed that offices are the most likely property to be affected by technological trends.



23%

of respondents believe modern methods of construction is the next big advance to impact the property sector.

We are already seeing smart buildings being built using modern technology to optimise the environment for working conditions. The construction of these buildings could also allow for the integration of any future technological trends and developments. Smart buildings can specifically be constructed for offices in order to increase productivity, reduce energy consumption and therefore reduce operating costs.

Figure 4: Types of property that are most likely to be affected by technological trends



The closure of stores through the UK lockdowns has forced consumers towards the online retail sector, which saw incredible growth in their share of the UK retail sales, now accounting for 27.9% of all retail in the UK (*). Given this, it is no surprise that 29% of respondents expect retail to be affected by technological trends.

Some commentators wondered if this move to online would stick once physical stores reopened but it is clear that to a large extent it has. While we have seen a small drop in online following the most recent reopening, online retail sales remain much higher than their pre-pandemic levels, with volumes in July 2021 being 40.4% higher than in February 2020(*)

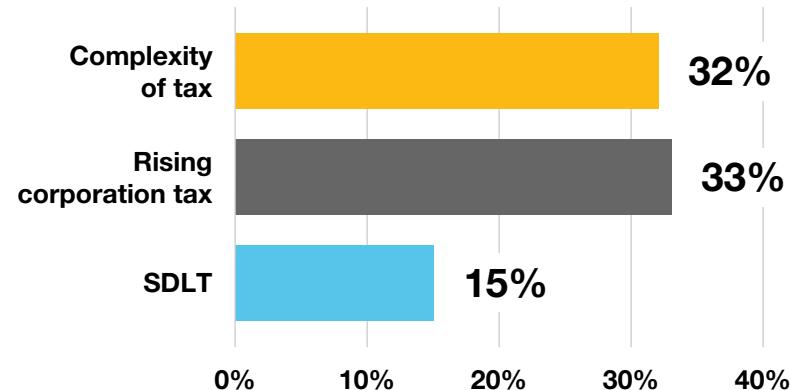
* Office of National Statistics: Retail sales, Great Britain: July 2021

Jeremy Cooper,
National Head of
Retail, Crowe

Taxation

The government announced that the corporation tax rate will increase to at least 25% from April 2023, as well as the potential introduction of a property development tax for larger housing developers. The proposed increased headline rate of corporation tax is a significant increase and the last time the main rate was this high was in 2011 at a rate of 26%. This, an increasing complexity of the tax system, and Stamp Duty Land Tax (SDLT) are what businesses believe to be the biggest tax barriers to growth.

Figure 5: Biggest tax barriers to growth



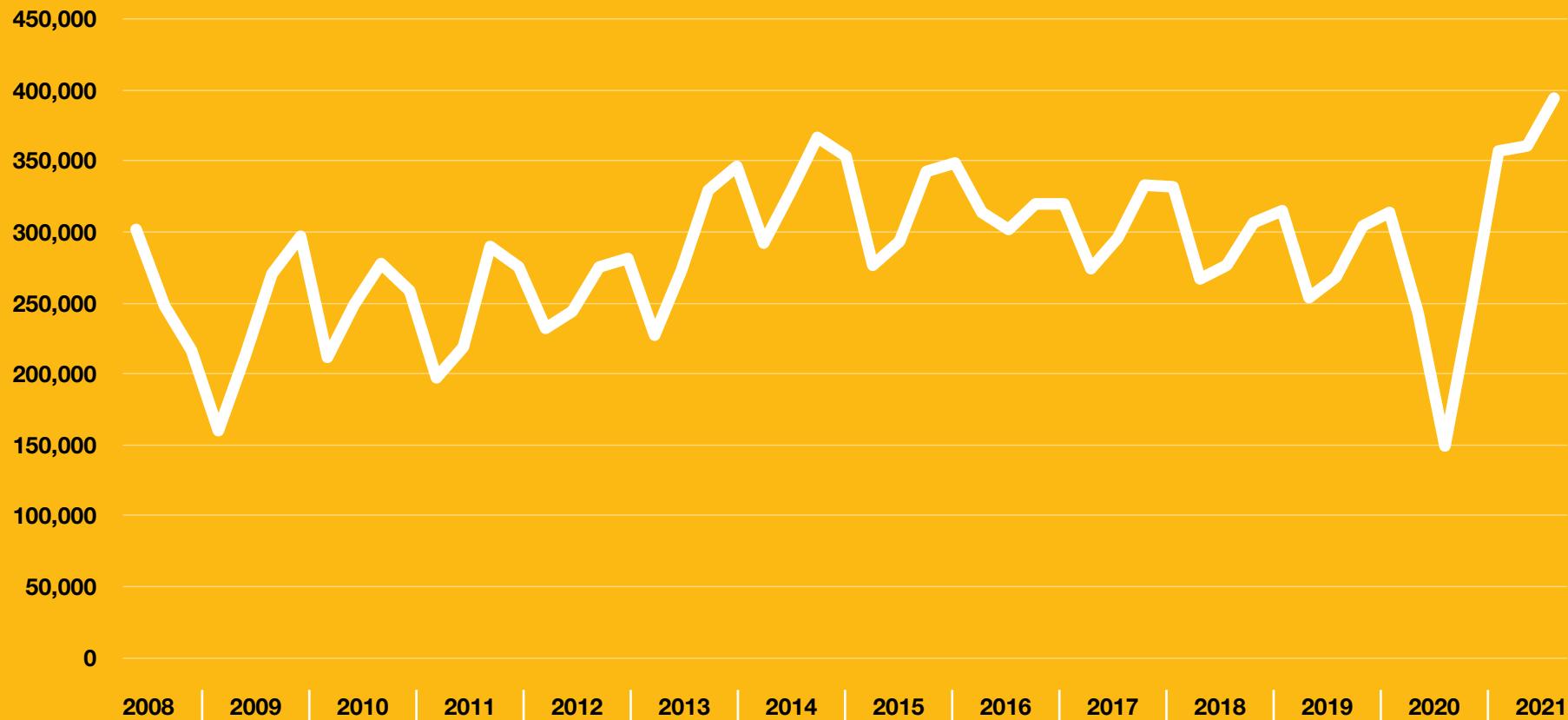
At the same time as announcing the corporation tax increases, the government announced the introduction of the new 130% super deduction and 50% first year allowance on capital expenditure incurred from 1 April 2021 to 31 March 2023. This was to stimulate business investment and capital expenditure. The super deduction will allow companies to receive a tax deduction of up to 25p for every £1 spent on new qualifying plant and machinery assets. Commercial property owners may qualify for these reliefs in respect of fit outs or refurbishments. As a result, the UK's capital allowance regime is now ranked first in the Organisation for Economic Co-operation and Development (OECD) in terms of competitiveness.

The government provided partial and full business rates relief to many businesses during the pandemic. Business rates are currently payable by retail and commercial properties, based on a property's rateable value. Presently, these values are reviewed every five years. This can lead to values becoming outdated as the market changes, which could mean increased costs for businesses. Currently, the government has announced a 'Fundamental Review of Business Rates', with the results published later this autumn. One of the proposals is to ensure revaluations take place every three years, instead of five. This is an area to watch, with 38% of our respondents telling us that a reform of business rates is important to supporting the high street.

The government also temporarily increased the nil rate band for SDLT for residential properties to stimulate demand in the housing market. The nil rate band is the rate before you start paying SDLT on the purchase of a residential property. New legislation, in response to the pandemic, stated that from 8 July 2020 to 30 June 2021, up to £500,000 of the purchase price was free from SDLT. The latest quarterly results for SDLT up to 30 June 2021, demonstrate how responsive the housing market is to SDLT changes. Despite no SDLT arising on transactions under £500,000, total SDLT receipts in Q2 2021 were 12% higher than in Q1 2021, and 92% higher than in Q2 2020. With the end of the SDLT holiday on 30 June 2021, there was frantic activity to complete residential sales in advance of this deadline, adding additional heat to the market. This was evidenced by the fact that residential property transactions in Q2 2021 were a staggering 175% higher than in Q2 2020 (the quarter before the SDLT holiday was introduced).

It will be interesting to see the government's approach to SDLT post pandemic, as 15% of our survey respondents regard SDLT as a high cost and therefore a barrier to growth.

Figure 5: Total SDLT transactions over 13-year period



Source: gov.uk

Mitigating the impact of change

Sustainability

Sustainability is about meeting the needs of the present without compromising the ability of future generations to meet their needs. The three pillars of sustainability typically referred to are economic, environmental and social. Balance between the three needs to be considered. Just under half of our respondents (46%) indicate that sustainability will be the next big thing to impact the real estate sector.

As discussed earlier in the report, the construction of smart buildings is a step in the right direction, but we also need to look at the development itself in addition to the end product. The construction industry contributes a large amount to the UK's total carbon footprint. Trying to reduce this will take effort but in an ever more sustainability conscious society, it seems as the only direction to follow. As developers, there is an incentive to improve the bottom line, but what if there was an improvement to the top line with added value instead, and this then used as a selling point? On-site renewal energy generation, use of energy efficient materials and reusing materials (where possible) are just examples of a long list of changes that could be made. Building regulations already include stringent energy requirements, but more regulations can be expected in the future given the importance of sustainability.

The introduction of the 'super deduction' of capital allowances will accelerate the timing of intended capital expenditure by property owners, but it is only available for a short time up until April 2023. It is likely to make fit-out contributions to tenants as a lease incentive, as opposed to a rent-free period, more attractive to landlords. However, what is missing now from our capital allowance regime is any tax incentive for property owners to use environmental or sustainable methods or products.

Previously there were such regimes which promote the use of energy and water efficient capital expenditure, but these have been phased out. As well as the 'stick' of more regulation for buildings to be more sustainable, the government should consider reintroducing some eco-friendly capital allowance 'carrots' in the longer term.

Richard Robinson,
Senior Manager,
Capital allowance
expert, Crowe

Workforce

Attracting staff and retaining talent is a key concern for the real estate industry. Being in a post-Brexit UK, a large number of valuable EU workers, particularly in the construction sector, have either left or are likely to find it more difficult to enter the UK due to post-Brexit immigration rules. As a result, the industry's long-standing problem of skill shortages is likely to get worse, which may result in delays to construction projects.

With diversity now firmly on many people's agenda, there is a large consensus (75% of our respondents) who believe there will be more diversity in the construction industry. To effect this change, there must be education and training provided at all levels, starting at primary schools, and actively supported by the government.

“

As an organisation, Women in Property has been working hard to improve diversity and inclusion for over thirty years, but it is only in the last few that we have seen a real impact, particularly on gender diversity. So, it is very encouraging that 75% of respondents to this survey are so positive about the future.

However, if we are to continue to see an increase, there is no room for complacency. Diversity cannot happen without inclusion first, therefore inclusion must be at the heart of everything we do. Education is critical; encouraging young people to think differently about careers in the built environment sector and showing them that there are tremendous opportunities for all of us, irrespective of gender, ethnicity, disability or social background.

”

Rachel Bell,
National Chair of
Women in Property



Linking into the sustainability and environment debate, and with the digital age now here to stay, the question arises as to whether travel will be required as often for corporate travellers. We have seen video meetings work for many businesses while COVID-19 put a halt on international business travel. Corporate travellers tend to have larger carbon footprints due to business class allocation using more space per person. If travelling is truly necessary, business class travel could be reduced, but going beyond that, by changing the mode of travel could help reduce carbon emissions significantly. Reports have estimated a 90% reduction in greenhouse emissions when switching from air to rail⁶. In April 2021, France introduced a law banning short-haul internal flights where rail alternatives exist. Changes to travel for work will also result in changes on whether people wish to live, spend their leisure time and work.

6. For the sake of the planet, it's time to rethink business travel, [fastcompany.com](https://www.fastcompany.com/90632762/its-time-to-reassess-the-role-of-business-travel-in-global-warming).
<https://www.fastcompany.com/90632762/its-time-to-reassess-the-role-of-business-travel-in-global-warming>

Conclusion

While many businesses have weathered the storm of the pandemic and taken advantage of the government support available, there is now a steep hill to climb for those in real estate, particularly for those in the retail and commercial property sectors. There is opportunity for growth, but businesses will need to adapt quickly in order to thrive.

Areas to consider to encourage growth in a hard-hit industry are:



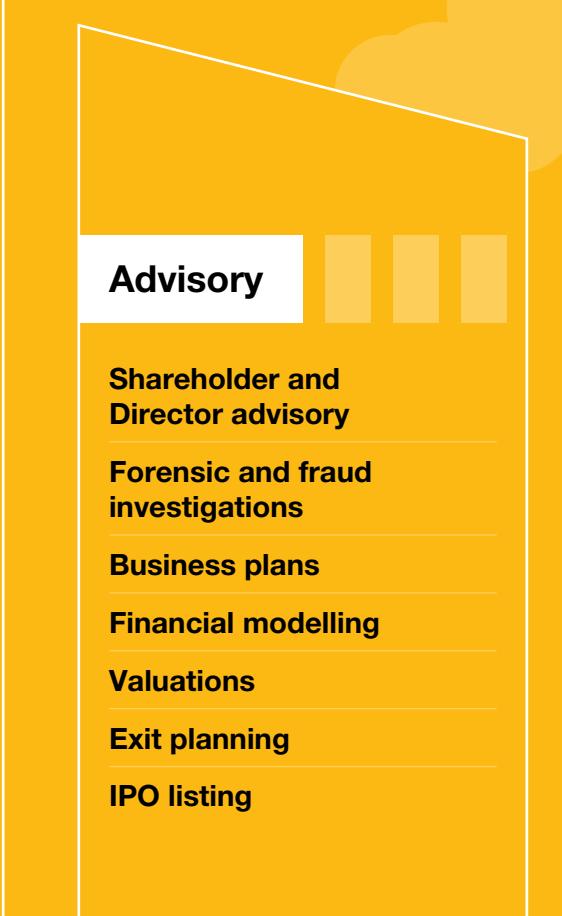
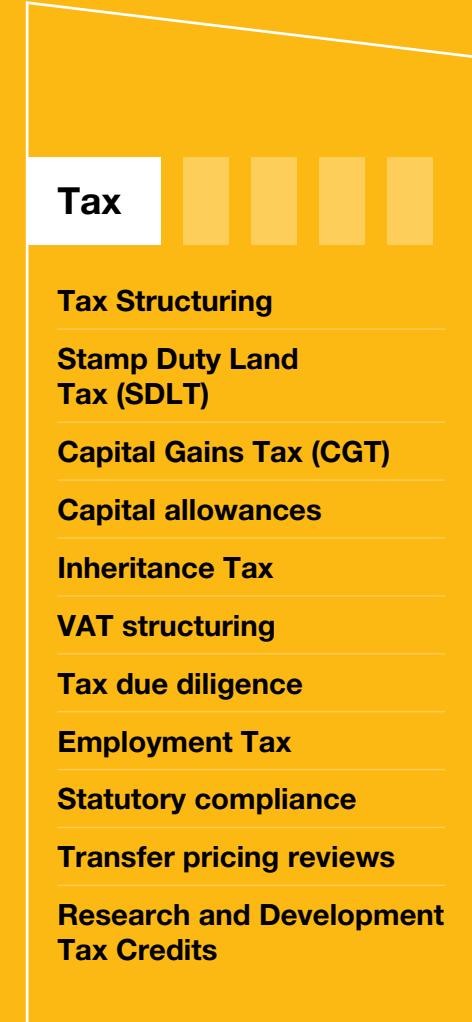
- 1 Government policy on taxation, planning rules, and incentives for sustainability.
- 2 Education and training to encourage people into the property sector given the wide skills shortage post-Brexit, with a focus on retaining existing talent.
- 3 Availability of finance
- 4 Openness to change including construction of mixed used developments (flexible office space, retail and leisure alongside residential).
- 5 Adoption of technology, not just in production, but also for post-fabrication of new buildings.
- 6 Integration of sustainability, both materials and practices, with the view of improving the top line.

Methodology

There was a total of 99 respondents to the survey across all levels and all types of businesses related to the real estate industry.



How Crowe can help you



Start the conversation

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We are trusted by thousands of clients for our specialist advice, our ability to make smart decisions and our readiness to provide lasting value. Our broad technical expertise and deep market knowledge means we are well placed to offer insight and pragmatic advice to businesses of all sizes, professional practices, social purpose and non profit organisations, pension funds and private clients.

We work with our clients to build something valuable, substantial and enduring. Our aim is to become trusted advisors to all the organisations and individuals with whom we work. Close working relationships are at the heart of our effective service delivery.

