REAL ESTATE

UK Real Estate Market
2022 key trends and insights

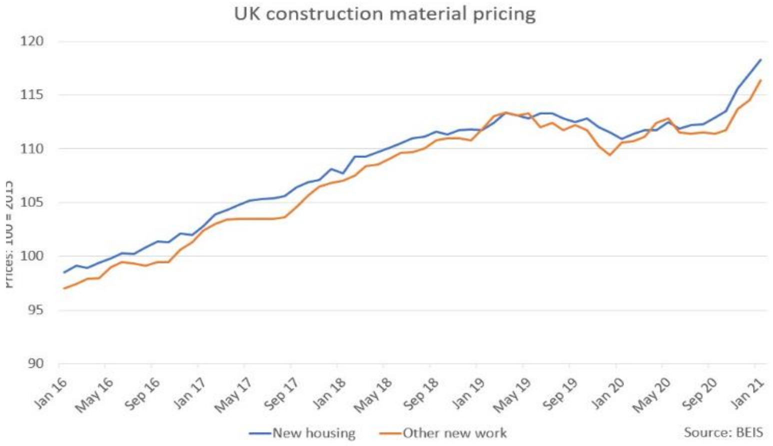
Changes in macro-environment factors can have a direct impact on UK Real Estate. Our experts take a look at some key trends and insights currently impacting our Real Estate customers.

UK rising costs

Inflation has risen to its highest level in almost 30 years, due to a number of macro-environmental factors including supply chain disruption, labour and skills shortages and a global recession ensuing from the Covid-19 pandemic. Inflationary pressures on materials and labour have continued to increase costs throughout the post pandemic period, which causes significant industry issues and has an impact on claims inflation. Price increases and inflation are inextricably linked to indexation or 'index linking' which is used by the insurance industry to help customers avoid the risk of underinsurance.

The economy is now reopening with consumers spending the money they couldn't during the lockdown restrictions, resulting in demand outstripping supply across many areas. The rising cost of materials and stock coupled with global supply chain challenges has further compounded the issue.

Index linking is applied by insurers to ensure that an asset's insured value is adjusted in line with changes in inflation, deflation and the cost of living. Index linking is undertaken to protect against the risk of underinsurance, where a policyholder may find they are responsible for a percentage of the total loss due to their asset not being insured for its full value. By applying index linking, the sum insured is automatically updated (usually increased) in line with economic changes when the policy renews. However, Allianz reviews showed that almost 50% of policies had a buildings sum insured that was less than 80% of the rebuilding estimate.



For more information on macro-environmental factors and what you can do to protect yourselves, please read our article: [Why is index linking so important to customers?]

Climate change and increasing flood risk

Flooding is the greatest natural disaster risk in the UK, with an estimated 1 in 6 properties in England and Wales, 1 in 11 properties in Scotland and 1 in 34 properties in Northern Ireland now at risk of flooding. Six of the ten wettest years on record have occurred since 1998. (Source: FloodRe)

Flooding can occur during any time of the year (not just the Winter period), and from various sources including river, coastal and surface water run-off from flash flooding. In London, flash floods caused chaos and left a trail of destruction across in July, 2021. Flood waters poured through the streets and seeped into homes, shops and restaurants in various parts of the capital as it was hit by extreme storms, with properties having basements being worst affected. London relies on a Victorian drainage system that was not designed to cope with the city's current and predicted future populations - for example 48.5mm of rain fell on Shepherd's Bush in an hour on 12 July, while its average rainfall for that month is 46.8mm. "A basement bar in Portobello Road in Notting Hill, watched in disbelief on Monday evening as the flood water rose from 2 inches to 1.5 feet in just five minutes". (Source: The Guardian)

Groundwater flooding, flash flooding, poor drainage, malfunctioning sump pumps and internal plumbing faults are all common causes of flooded basements, which is why buildings with basements are usually designed with a sump pit underneath.

In the UK Climate Change Risk Assessment 2022 presented to Parliament pursuant to Section 56 of the Climate Change Act 2008, it notes "Climate change is happening now. It is one of the biggest challenges of our generation and has already begun to cause irreversible damage to our planet and way of life. We have clear evidence demonstrating the pace of warming in recent decades and the impacts we will face should this continue". (Source: ABI)

Allianz

Whilst still with limitation, there is more information and a growing awareness of climate risk, but yet there remains a lack of clarity on ownership of risks and responses, and the complexity of adapting for a future which contains innate uncertainty.

The scale of the challenge brought about by flash flooding in the UK is brought to light in the article written for The Guardian in January 2022 - [UK towns and cities hit by flash flooding 51 times since 2007].

There have also been life safety concerns raised for residents living in basement flats. (Source: [The Independent])

One of the conclusions that can be drawn is that customers need to become more resilient to flooding, and some useful tips for those with basements would be to consider if you are likely to be affected, and if relevant, implement the following risk management actions:

- Sign up for [flood] and [extreme weather] event warnings, so that you can set into motion the emergency actions you have planned at the earliest possible moment
- Consider if your basement can be tanked (a form of waterproofing) to help keep water out
- Periodic inspection, maintenance and cleaning out of drains, gullies, gutters and sump pumps
- Install non-return valves to toilets, sinks, showers, baths, drains etc
- Seal any gaps or holes where utilities enter the building using a proprietary flood protection sealant
- Raise equipment, installations and other expensive vulnerable items by at least 100mm or above the expected flood level, whichever is greater. For example, electric intake panels and sockets, boilers, computer servers etc.

For more information on how you can protect your property against flooding please visit our [Risk Management website - Flooding preparations].

Modern methods of construction

Construction and carbon management

According to the UK Green Building Council, the UK's built environment (buildings and infrastructure) is currently responsible for 25% of total greenhouse gas emissions. With the government's arguably challenging plan to build 300,000 new homes per year, the pressure is on to find ways to accommodate construction projects using sustainable methods, safely. There's an opportunity for the insurance industry to add real value, by providing relevant solutions and risk management advice to satisfy both safety and sustainability requirements.

This drive towards eco-friendly options has seen an increased use of timber in construction; after all it's a naturally occurring material, a good insulator, and has the potential to reduce the amount of a building's embodied carbon emissions. However timber can present its own risks, not least through its susceptibility to ignition, burning and water damage. Insurers recognise these risks but also appreciate their customers' appetite for using 'greener' construction methods and materials. Herein lies an opportunity for the insurance industry to add real value, by providing relevant solutions and risk management advice to satisfy both safety and sustainability requirements. Communication between the insurer and customer is essential, to achieve the right balance of risk mitigation and responsible construction.

A recent paper from the RISCAuthority, includes input from a number of insurers including Allianz. This details resilience requirements, design features that can influence insurance cover, and proposes various ways forward for timber construction, including a combination of traditional and newer materials, with safety as the top priority.

An update on the building Safety Bill

The Building Safety Bill (first published on 20 July 2020) which is currently in the final stages of review in the House of Lords, with Royal Assent expected to be given this summer, is designed to give residents more power to hold builders and developers to account and toughen sanctions against those who threaten their safety. A Building Safety Regulator will oversee the new regime and be responsible for ensuring that any building safety risks in new and existing high rise residential buildings of 18m and above (or of seven storeys or more) are effectively managed and resolved, providing a 'Golden Thread' of information throughout a buildings life.

What will the building regulator do?

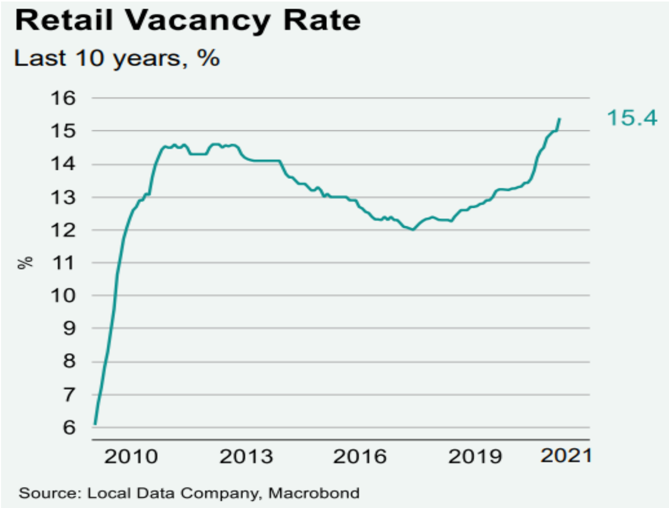
The new Building Safety Regulator will be at the heart of the reforms. Part of the Health and Safety Executive (HSE), it will be responsible for overseeing the "safety and performance of all buildings". The three broad functions of the Building Safety Regulator will be to:

1. "Implement the new, more stringent regulatory regime for higher-risk buildings"
2. "Oversee the safety and performance of all buildings"
3. "Assist and encourage competence among the built environment industry, and registered building inspectors".

Sector Trends

Retail

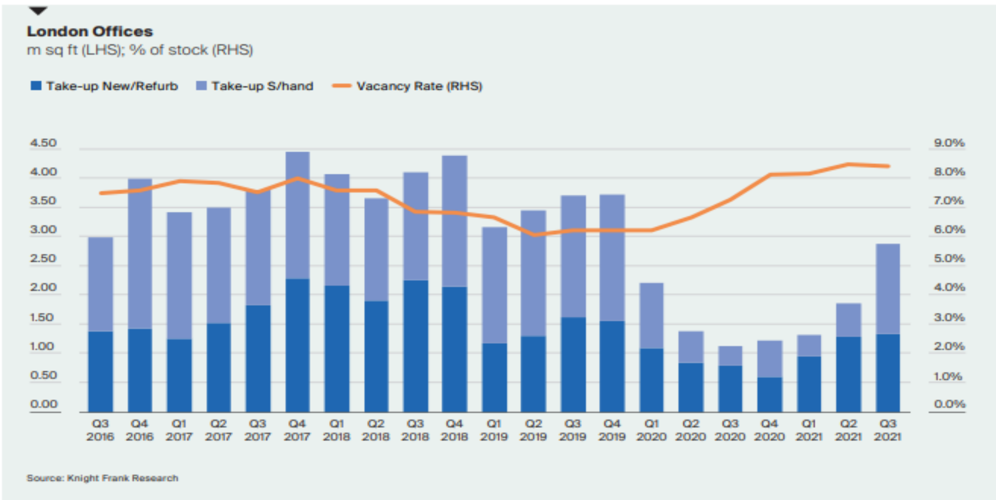
In the wake of further store closures; notably all the Arcadia Group fascia's, property vacancies are at a new record high. There are an estimated 5,000 fewer stores since the pandemic hit; equating to 1 in 7 being vacant.



Central London has seen a slower rate of retail recovery than elsewhere. According to Knight Frank Oxford Street's vacancy rate is around 13.5%, a very sharp increase on the previous year when the rate stood at 5.3%. And compare these two figures with a 15 year average of 2.6%. It's not hard to understand why: any retail market is dependent on people and those people simply haven't been there. More than any other location, the capital is far more dependent on tourist and worker traffic. CACI data show that ordinarily, tourists make up ca. 46% of retail spend in the West End.

Office

Office recovery strengthens, demand is broadening and there is a fall in vacancy. There was a marginal fall in availability across London to 18.71m sq ft - the first quarterly fall in availability since Q4 2019. The vacancy rate in London is 7.7% and is 1.1% above the long-run average.



The largest decrease in availability at a submarket level occurred in the City Core, where availability decreased by 9.4% to 5.34m sq ft. Across London, 16.7% of available stock is comprised of new buildings while refurbished and second hand space accounts for 83.3%.The overall vacancy rate decreased for the second consecutive quarter to 7.6%; with supply levels falling in all London markets. New build vacancy rate remained stable at 1.6%, slightly above the 10-year average of 1.1%. (Source: CBRE - UK Office Market Figures Q4 2021, JLL - Central London Office Market Report Q4 2021, Savills - City office Market Watch Jan 22)

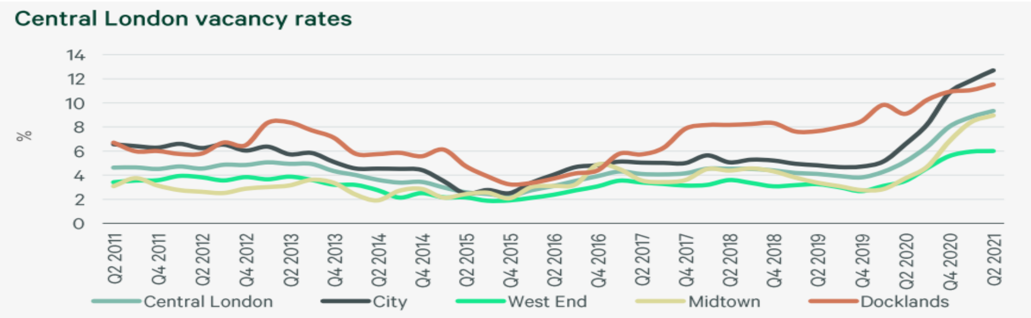
Logistics

Overall the logistics property market has proved able to rise to the challenge that Covid-19 has presented over the last two years, but with a backdrop of the lowest vacancy rate ever recorded (2.91%) and rising construction costs, it remains to be seen how the expected demand of 2022 can be satisfied.

New work models

Firms expect the proportion of employees working from home to be almost three times larger from 2022 onwards than in 2019. In 2022 ESG will take centre stage, with 25% of survey respondents from a Bank of England Monetary policy report stating that sustainability goals are the most important factor in decision making; leading to higher demand for new, efficient buildings.

Almost half (46%) of these homeworkers said they spent less as a result of homeworking because of the Covid-19 pandemic. Along with flexibility and reduced commuting, this is an incentive for homeworking. Research indicates that the majority of large companies desire an equal mix of time in and out of the office and employees also have a preference to work between two to three days a week in the office.



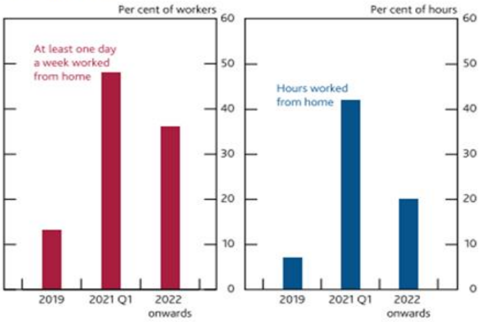
(Source: CBRE, UK Office Market Figures, Q3 2021)

There is no one-size-fits-all approach to cater for hybrid working. By far the most popular approach involves setting guidance. This 'hybrid work with guardrails', is being pursued by 78% of large companies with 10,000 or more employees. However, facilitating this approach is complex. Many companies are seeing the need to focus on experience as a way to 'magnetise the office' and attract employees back.

Higher occupancy costs for more sophisticated, hybrid workplaces will be offset by smaller footprint requirements.

Chart 3.6: Firms expect people to work from home more often in the future

Past prevalence of working from home and firms' expectations for 2022 onwards(a)

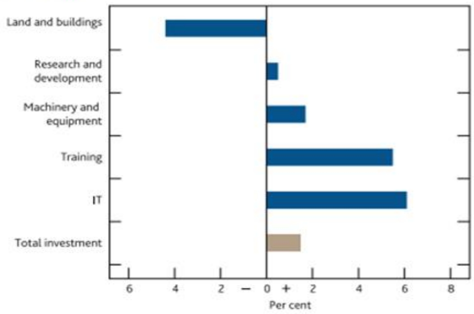


Sources: DMP Survey and Bank calculations.

(a) Question: 'How often did your full-time employees work from home/how often do you expect them to work from home in the following periods: (a) 2019; (b) 2021 Q1; (c) 2022+?'. Responses were collected February-April 2021.

Chart 3.7: Firms intend to pivot investment away from land and buildings towards training and IT

Firms' expectations for the impact of Covid on investment from 2022 onwards(a)



Sources: DMP Survey and Bank calculations.

(a) Question: 'In 2022+, how do you expect the Covid-19 pandemic to affect the following types of expenditure made by your business, relative to what would have otherwise happened?'. Responses were collected July-September 2021.

(Source: CBRE, UK Real Estate Market Outlook 2022, Dec 2021)