

UK COMMERCIAL PROPERTY UPDATE

13th Nov. 2009



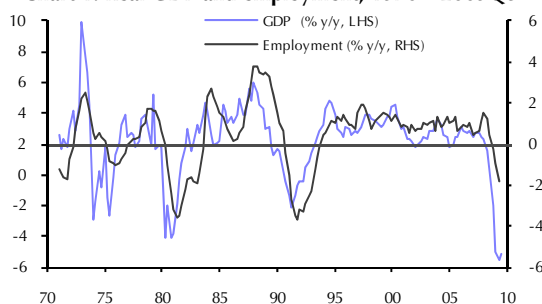
Has the shift to part-time working limited the fall in property demand?

- Part-time working has become more common during this recession, and may have helped commercial property demand to hold up better than it would have done in a scenario where firms were simply laying-off staff. However, we think that overall employment still has considerably further to fall, and this means that property rental values will continue to decline until at least late 2010.
- As Chart 1 shows, during this recession to date, employment has fallen by much less than its pretty close historical relationship with GDP would have suggested. One reason for this is that some firms have chosen to cut working hours and/or wages rather than headcounts.
- Yesterday's data showed that full-time employment fell from 22.1m at its peak in May 2008 to 21.3m in September 2009, a drop of 3.7%. **By contrast, as Chart 2 shows, part-time employment has continued to rise, up from 7.5m in May 2008 to 7.7m in September.** Part-time employment now accounts for a record 26.5% of employee jobs, up a full percentage point over the past 18 months.
- In terms of the demand for commercial property, part-time working creates *scope* for space-saving arrangements such as hot-desking. But firms are unlikely to go down that route if greater part-time working is seen as a temporary measure. In other words, **relative to a scenario in which firms were simply cutting staff levels, we suspect that, on balance, the recent rise in part-time employment that has been observed will have supported property requirements.**
- Even so, that may have had little positive effect on rents to date, as heightened uncertainty caused take-up to plunge in late 2008 and early 2009. To date, IPD rental values are down by 9% from their peak, compared to 7% at the same stage of the early 1990s downturn. But won't labour market resilience help support rental values over the *next* year or two? Perhaps, but we remain cautious about occupier market prospects.
- **For a start, firms' cuts in hours and wages have not stopped labour costs from rising and we anticipate that, after a drop of around 1.5% this year, employment will fall by a further 2.5% or so in 2010, and perhaps by another 0.5% in 2011.** So, regardless of what happens to the full-time/part-time split, lower headcounts are likely to continue to undermine rental values for at least another 12 months.
- **But even if we are wrong about that view, the lack of job cuts in the downturn could also imply a slower pace of hiring when the economy eventually does pick-up – i.e. a so-called jobless recovery.** That outcome might mean less scope for rental values to fall over the next 1-2 years, but, equally, a greater likelihood that any rental recovery in 2011 onwards proves to be pretty weak.
- Either way, the medium-term outlook for occupier demand remains fairly soft, which may undermine hopes that the low supply pipeline will kick-start a strong recovery in rental values from 2011 onwards. **Needless to say, this poses concerns over the sustainability of the current investment market-driven recovery in commercial property prices and returns.**

Kelvin Davidson

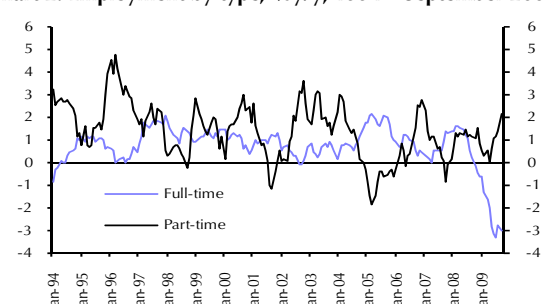
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Chart 1: Real GDP and employment, 1970 – 2009Q3



Source – Thomson Datastream

Chart 2: Employment by type, %y/y, 1994 – September 2009



Source – Thomson Datastream