MoneyWeek

Is commercial property in terminal decline?

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A growing trend in society suggests that we might already have enough shops and offices for our future needs.

Ever since the dotcom boom, people have been predicting the end of 'bricks and mortar' businesses. We got slightly ahead of ourselves by a decade or two, but things are changing rapidly now. This inevitably raises the question: how many more shops and offices do we really need?

According to the British Council of Shopping Centres, one in five shopping centres in the UK is at risk of defaulting on loans. That suggests demand for new retail space is weak, whilst supply is still growing.

There was a huge amount of new retail space built during the consumer boom. By mid-2008, just as the downturn hit home, the rate of retail space development was at its highest for 40 years. Some developments have been postponed since then, and some projects have been cancelled due to a lack of financing, but there is also a drop in demand from retailers experiencing a downturn in consumer spending.

The huge expansion in credit leading up to the start of the financial crisis created what could turn out to be unnaturally high levels of consumer spending, especially in the UK.

But we are now seeing an increase in the savings rate as households attempt to unwind their high debt levels. This will have a negative impact on retail spending; it might fluctuate in the short term, but for the next few years it could decline as consumers come to grips with weak pay increases, persistently high unemployment, reduced government spending, higher interest rates, higher inflation and higher taxes.

A decline in spending power hits retailers directly and they may be forced to continue cutting costs and streamlining their operations. They will close underperforming stores and focus on improving sales from better-performing locations, whilst trying to boost online sales as much as possible. The net effect could well be less need for new shops.

Technology is also having a significant impact on consumer shopping habits. According to Retail Decisions, a card payment business, online sales in the UK increased by 21% between 2008 and 2009, with up to 33 million people making a purchase online.

The role of shops is changing too. They are often used to view items before buying them online at a better price. The rise of smart phones and netbooks is only making this easier: shoppers can compare an item's price online whilst standing in a store looking at it.

Online retailers often have a price advantage because they don’t pay high rents for prime retail sites. The extrapolation of this trend, as 24-hour online access and the prevalence of browser-enabled portable devices make accessing the internet much easier, suggests that online competition will continue to intensify for bricks and mortar-only businesses.

• Demand for office space is another sector under threat. Outside London, rents are expected to fall during 2010 due to oversupply and the public sector cutting back on workspace requirements.

The need to be physically close to other people is diminishing rapidly as telecommunications improve. Video-conferencing is expanding - it saves time and money whilst still enabling participants to read expressions and body language. Only the physical handshake is missing from the meeting.

The concept of working at a distance has been around for some time, but there are certain catalysts that might cause a significant step-up in the evolution of the process. The financial crisis could be one such catalyst, especially if we see the economy drop back into recession. Another could be a change in government policy, such as tax breaks for those who are prepared to change their habits. But change will probably come more gradually.

Advances in technology are making remote working easier and cheaper. As companies have sought to cut costs during the recession they have reduced spending on business travel (high and rising fuel prices haven’t helped) and have looked at ways to reduce fixed overhead costs such as office space. The financial crisis has made ‘streamlining’ a priority for businesses that only needed to focus on managing expansion during the boom years and a drawn out period of weak growth could see this continuing for longer than usual.

One particular theme that is rapidly gaining prominence is the misery of the daily commute. The sheer numbers of people moving around the country, especially at rush hours, makes the idea of working from home increasingly appealing.

The threat of transport strikes as unions fight with employers and the government about pay rises only highlights how pointless so much commuting really is. Home working saves wasted time (some people spend three hours a day or more going to and from work), whereas commuting costs money, can be stressful and adds greatly to pollution. Whilst there will always be a need for certain jobs to be located in one single office. It is unlikely that we will need a growing number of centralised workplaces over the longer-term when the alternative is becoming more feasible and more attractive.

I’m not suggesting that the construction industry will disappear, there will always be a need for new buildings, even as technology brings changes to requirements. The adoption of the desktop computer helped automate offices, but businesses also required new building designs to accommodate all the cabling under floors and through ceilings. In turn it is likely that changes in technology and their effects on our lives will create new ‘machines’ for living and working (as Le Corbusier described them).

Online businesses require warehouses to store goods and an expansion in distance working could see more residential development being adapted to suit the requirement for work space in the home, but the net overall effect is that the migration of services into the online world could change the physical landscape of the country and this would have massive repercussions for the commercial property sector as it stands today.

• *This article was written by Richard McCreery, founder of RM Wealth Management, an independent investment advisory service.*