

An aerial view of the London skyline at dusk, featuring prominent skyscrapers like The Shard, the Gherkin, and the Walkie-Talkie building. The sky is a deep blue with some clouds. The Watling logo is in the top left corner.

**WATLING** 

# PROPERTY MARKET REVIEW

Focused for Insolvency Practitioners and Business Support professionals dealing with Real Estate assets across the UK

March 2024

# MARKET OVERVIEW

Capital values indexed from market peak – the sharpest correction in the last 4 cycles



Source: Watling Real Estate, Various

- ▶ The data continues to show declining capital values albeit at a much slower rate than seen over the previous 18 months. The accelerated pace of capital value correction versus previous market corrections, and the subsequent impact this has on LTV covenants may have caught some lenders by surprise. In most cases, where LTV breaches are apparent, we are seeing lenders focus on interest rate cover as a measure for the security of their investment.
- ▶ The sharp capital value correction from the market peak in the current cycle equates to c.20% after 8 months and c.25% after 18 months, which compares with c.13% and c.35% respectively during the GFC.

# WATLING VIEW

- ▶ With the outlook for capital value growth remaining muted and transactional evidence constrained, we believe 'Valuation Lag' will continue to be experienced across the real estate marketplace in Q2/Q3 2024.
- ▶ As equity is reducing, we are seeing borrowers seeking solvent exits now to achieve neutral positions prior to the expiration of their loan.
- ▶ As the current market downturn has largely been triggered by macro-economic factors all sectors are impacted by falling values. Of the main sectors, Industrial has been the most severely hit by falling values, albeit this reflects the strong performance pre Oct 2022, and analysts are generally optimistic about the long term prospects given the underlying occupational demand and constrained supply. This positive sentiment is not mirrored in the Office and Retail markets where structural changes in Occupier requirements will limit recovery for years to come.
- ▶ Across the market there is an increasing trend towards "best and the rest" with prime real estate attracting interest from Occupiers and Investors. Secondary stock remains challenged with a pronounced yield gap depressing values.



£2.6BN – INVESTMENT VOLUMES JAN 2024, 46% BELOW 5 YR MONTHLY AVERAGE



-0.3% Q4 2023 GDP CONTRACTION

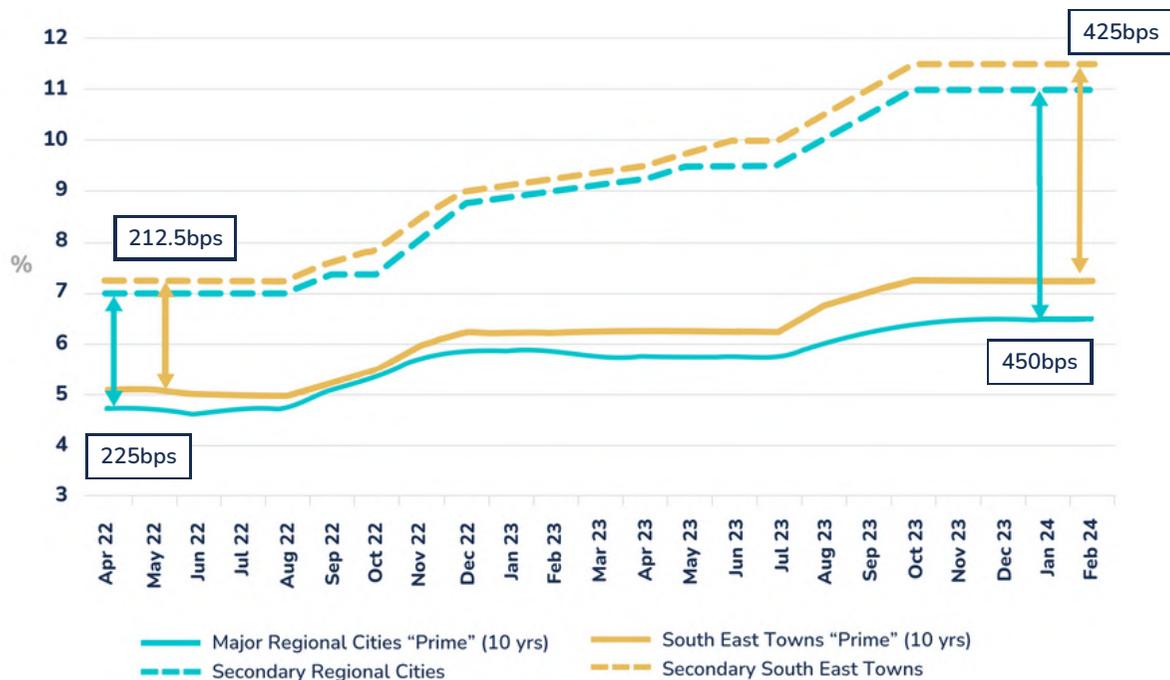


4.11% 10 YR GILT RATE, (3.54% DEC 2023)

# OFFICES

# WATLING VIEW

Secondary location yields have seen a stronger correction



Source: Knight Frank

- Secondary and tertiary office stock, at risk of obsolescence due to increasingly stringent ESG requirements, has suffered significant value erosion in the last 18 months.
- Since August 2022 (18 months) yields in secondary centres in the southeast and second tier regional centres have softened by 400+ basis points. Prime offices in the strongest locations have been less impacted. City offices yields have increased by just 150bps, while prime regional city offices have risen by 175bps.
- The cost of development finance and build cost inflation prohibits speculative office development in some regional markets. At this point in the cycle development is typically only viable with a pre-let in place. In the medium term, as occupational demand recovers for prime space there may be a reduced supply which could drive rental growth.
- As highlighted below, there continues to be significant value decline from the top of the market to present day values even for trophy assets. We expect further 'forced sales' to provide points of price discovery in the market further impacting values as sponsors seek consensual exits prior to loan expiries.

5 Churchill Place, London E14 5HP Size: 401,228 sq ft NIA Construction: 2009

| Date     | Purchaser  | Price   | Change |
|----------|--|---------|--------|
| Jan 2010 | 5 Churchill Place LP, controlled by a Bermuda-based middle east investor | £208m   | -      |
| Dec 2017 | Chuang Kei Group   | £268.8m | +29%   |
| Feb 2024 | Ariomori Investment Ltd  | £110.0m | -59%   |



One Poultry, London EC2R 8EJ Size: 147,257 sq ft NIA Construction: 1996

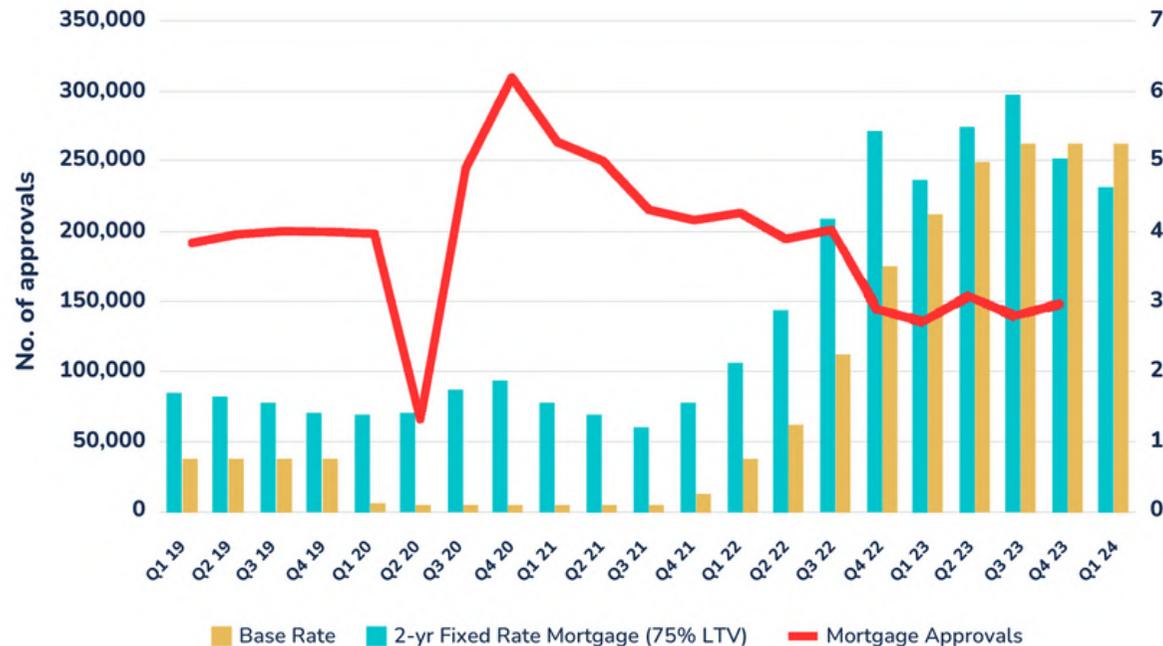
| Date           | Purchaser                                  | Price   | Change |
|----------------|--|---------|--------|
| Apr 2014       | Perella Weinberg Real Estate Fund II LP    | £110.0m | -      |
| Dec 2018       | Hana Alternative Asset Management Co., Ltd | £182.0m | +65%   |
| 2020 Valuation |  | £142.4m | -22%   |
| Nov 2023       | For Sale                                   | £125.0m | -12%   |



# RESIDENTIAL DEVELOPMENT

# WATLING VIEW

Mortgage approvals impacted by increasing mortgage rates



Source: Statista, Bank of England, Nerdwallet.com

- ▶ Whilst residential values have remained largely stable, we have witnessed a significant slowdown in sales rates. Dependent on the nature of the development (e.g. houses), developers may have the option to reduce the build rate. This option does not exist for apartment blocks. With finance costs impacting Buy to Let investor appetite and first-time buyer volumes falling; secondary apartment schemes could remain challenged for some time to come.
- ▶ In some cases, developers are seeking early “Block Sale” exits as demand remains for unbroken blocks at all price points. Albeit, once under offer, we are seeing significant price adjustments on many developments as purchasers are seeking to call “the bottom of the market”.

- ▶ Demand for Permitted Development opportunities (office to residential) is declining as build quality tends to be lower and therefore less attractive to the reduced buyer pool. We are also seeing lenders undertaking a greater level of due diligence on refurbished schemes that can impact sales rates.
- ▶ Build quality is very important when seeking to exit new build apartments and achieve close to asking prices.
- ▶ Super Prime London (Belgravia / Chelsea) is witnessing significantly reduced demand, with fewer international buyers. We are currently engaged on three appointments in these areas where values are each c.20% below the most recent “Red Book” valuations.



2.6% BUILD COST INCREASE FOR YEAR TO FEB 24



1.2% NATIONWIDE REPORTED HOUSE PRICE GROWTH IN YEAR TO FEB 24



0.7% NATIONWIDE HOUSE PRICE INFLATION FOR JAN 2024

# REGIONAL ACTIVITY

## Manchester

- ▶ Headline rents continue to push forward across both office and industrial markets. Headline office rents now stand at £42.50 sq ft following two pre-lets to Pinsent Masons and Hill Dickinson at the 'under construction' St Michael's Development.
- ▶ However, most investors continue to swerve offices. One Angel Square (Co-op's hq) (330,000 sq ft offices) was brought to market in June 2022 for £210m. It was remarketed 12 months later for £165m and was eventually sold Q4 2023 for £140m.
- ▶ Margins for developers / investors are also getting tighter. Some are now looking at new local geographies, including towns such as Stockport and Warrington, where reduced amenity schemes can be delivered to help with affordability and lower costs for developers.

## Birmingham

- ▶ Despite the economic headwinds and wider property market correction, demand for good quality second-hand industrial / warehouse premises has held firm. There have been examples of previous valuations being exceeded due to a lack of supply within specific markets.
- ▶ Open storage land, once a small, subsector of the industrial marketplace, has emerged as a market in its own right over recent years. A constrained supply of good quality opportunities, growing demand, and increasing development costs have seen some rents increase by over 60 per cent within the Midlands region over the last two years.
- ▶ A high-profile illustration of the value correction experienced by high profile assets is The Mailbox, a landmark mixed-use development in the centre of Birmingham with an overall gross rent roll of c.£12m per annum. Valued at £162.5m in the first half of 2023, having fallen from £189.7m in September 2022 while listed on International Property Securities Exchange (ISPX), the asset has recently come to the market with an asking price of £120m. Initial offers have been requested with the chosen purchaser and pricing TBC.

## Bristol

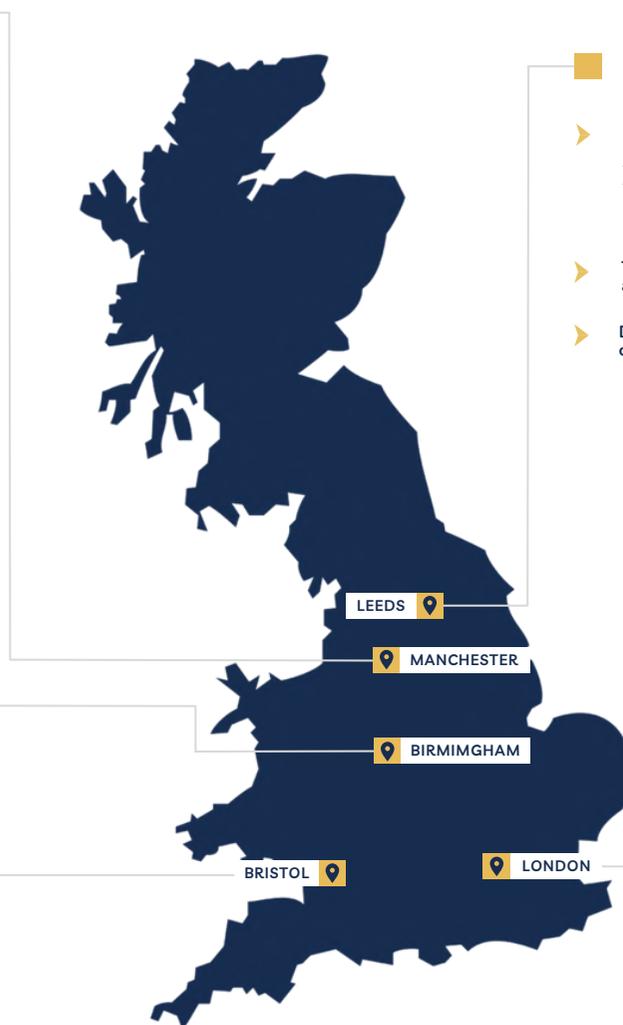
- ▶ Office take-up totalled c270,000 sq ft in Q4 2023, reflecting a 38% increase on Q3 but still 11% down on the 10 year average.
- ▶ Grade A office accommodation remains undersupplied. Prime rents remain unchanged at £42.50 sq ft, having been at this level for c.21 months now. With an anticipated 700,000+ sq ft of additional office accommodation due to complete during 2024 the polarisation of an increasingly two-tiered market between prime and everything else is likely to continue.
- ▶ In terms of the industrial market, vacancy rates for the South West and Wales stood at c9% during 2023, with this reducing to c3.5% once Wales is stripped out. The South West is still experiencing an undersupply of industrial accommodation, however, Wales is seeing supply increase against a backdrop of higher insolvencies and relocation of established manufacturing businesses.

## Leeds

- ▶ Q4 2023 office take up was 23% below the 10-year quarterly average, albeit prime rental growth increased by 5% in 2023. This supports the view that, whilst typically most occupiers are taking less space, there is a "flight to quality" which threatens to leave secondary stock and locations stressed. Investor sentiment remains subdued, to say the least, with office investment in Q4 2023 totalling £2.7m, significantly below the 10-year average of £40m.
- ▶ There is continued evidence of secondary offices being refurbished for student accommodation and private residential.
- ▶ Development bubble? - 2024 will see c.440,000 sq ft of newly built office space complete, 70% of which is not pre-let.

## London & South East

- ▶ The volume of investment transactions in the central London office market fell significantly in 2023, to c£7bn vs c£13.5bn in 2022. The yield gap between prime and secondary sits at over 400 bps reflective of the high construction costs required to upgrade dated stock.
- ▶ In the occupier market there is increasing divergence between the best and the rest with over 90 per cent of 2023 take-up being for Grade A stock, and 50 per cent of that being within BREAM excellent buildings. High demand for the best space and a limited development pipeline is driving up rents, with prime levels in the City approaching £90 psf.
- ▶ Shopping Centre transactions continue to evidence huge swings in value as illustrated by the recent sale by British Land of the Royal Victoria Place Shopping Centre, Tunbridge Well. Bought in Q2 2018 for £92.5m, and after incurring Capital Expenditure of £120m, the asset was sold to Tunbridge Wells Borough Council in Q4 2023 for a reported £8.15m – a 91% drop in value, excluding cap ex. Source: Estates Gazette





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