



WATLING 

# PROPERTY MARKET REVIEW

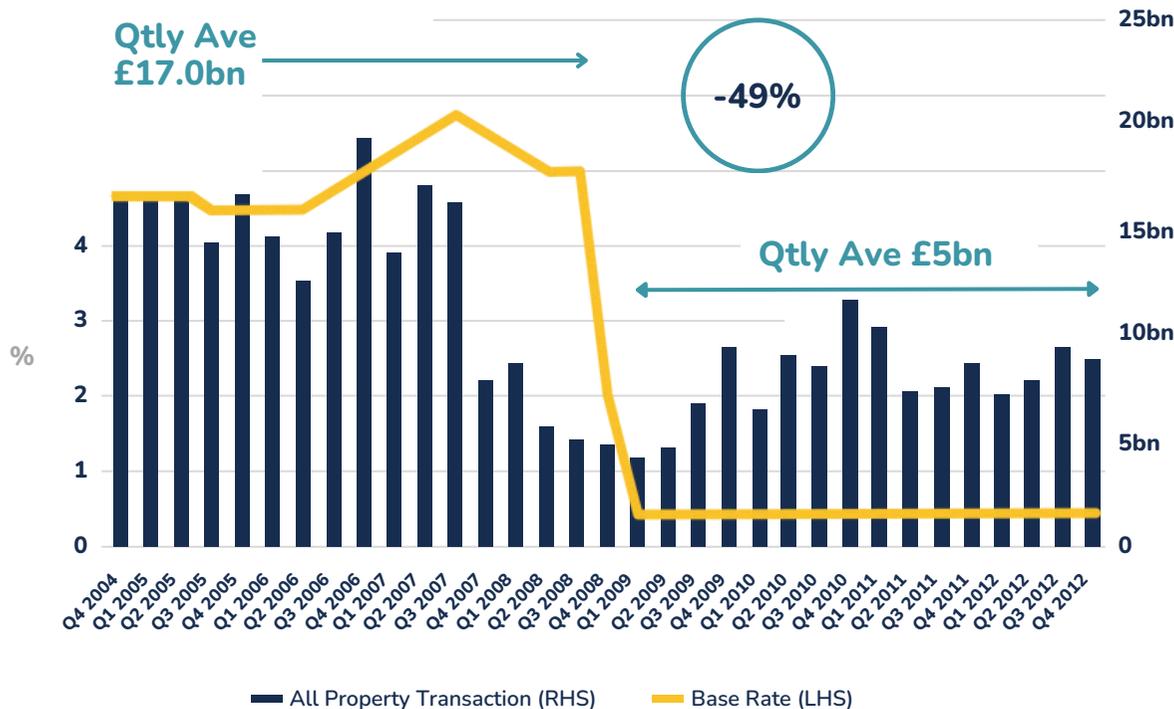
Focused for Insolvency Practitioners and Business Support professionals dealing with Real Estate assets across the UK

June 2024

# MARKET OVERVIEW

Will interest rate cuts stimulate an upturn in the Real Estate Market?

Property Transactions (GBP) vs Base Rate 2004 to 2012



Source: Bank of England, Property Data.

- Investment property sales volumes have long been a metric adopted by many real estate commentators assessing the health of UK property market. For sales volumes read transactions, increasing demand, liquidity and (in all likelihood) capital value rises. All property transactions for Q1 2024 totalled £10.2bn, versus Q1 2023 £11.9bn, a 14% fall. During the same period we have seen "All Property" capital value fall by a reported 5.3%.
- In assessing investment volume changes following previous Interest rate cuts, we have considered 2008 / 09 as interest rates were cut from 5% to 0.5% as the Global Financial Crisis (GFC) shocked the world's financial system.
- It can be seen that this dramatic cut in interest rates to stimulate the economy generated some rebound in transactional activity, however, not to the pre-GFC levels. In 2011/12, three years after interest rates were slashed, transaction volumes remained at just 57% of pre-GFC levels.

# WATLING VIEW

- Whilst the GFC was an exceptional event, it is evident that despite significant economic stimulus and slashing interest rates, the real estate investment market was slow to recover. In 2024 and 2025 we will see interest rate cuts from the current high of 5.25%, with expectations of two 25bps cuts to 4.75% by the year end.
- While these rate cuts will help generate economic growth, the forecast rates will not be at the exceptionally low levels of recent years as the economy moves towards a new normal. While the costs of finance will fall, it will be a gradual process and may not come quickly enough, or be of sufficient scale, to offer relief to many highly leveraged investors. A recovery in real estate investment volumes will likely be slow and restrained, with activity and volumes unlikely to build meaningful momentum until at least H2 2025. An increase in both levels of stress and distress are likely as values crystallise and lenders are required to take action.
- As transactional activity does start to increase (not necessarily at increased values), we may see a crystallisation of valuation points, providing additional comparable evidence for valuers. This "valuation lag" and more pertinently value crystallisation may again present issues for both owners and lenders alike.



10 YEAR GILT RATE - 4.11% AS OF 18/06/24



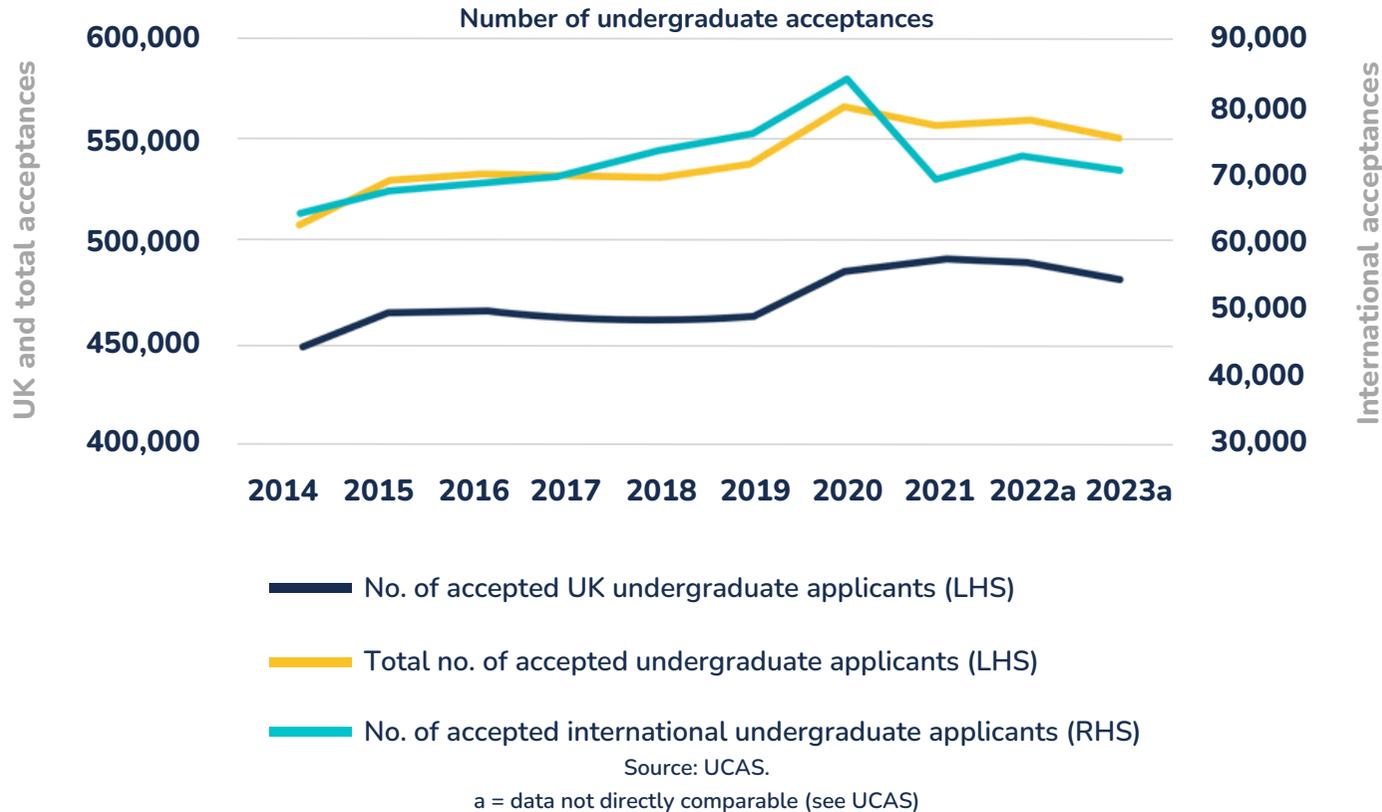
5-YEAR SWAP RATE 3.95% AS OF 18/06/24



2.0% - CPI JUNE 2024

# PURPOSE BUILT STUDENT ACCOMMODATION

Can the boom continue?



- There is significant uncertainty over the continued success of the UK University sector as we move into 2024/25.
- The sector has a heavy reliance on international students who pay an average tuition fee of £17,000 p.a. compared to domestic students who pay £9,250 p.a. Data from the Higher Education Statistics Agency advises that the number of international student enrolments grew from 469,160 in the 2017-18 academic year to 679,970 in 2021-22. Rental growth within the PBSA sector has followed as demand has increased. However, recent data from Enrolly admissions management service shows that international student visas were lower in 2023 than 2022, with their figures showing postgraduate acceptances down by 37% this year. Brexit, migration policies and higher visa costs, following legislative changes reflective from January 2024, are creating further challenges.

## WATLING VIEW

- Whilst overall student numbers have fallen, based on student numbers to beds ratio many university cities still fall a long way short on PBSA. Moreover, as some private landlords exit the sector in the face of increased costs, environmental legislation and higher taxation, student accommodation supply may remain constrained in most locations.
- Repurposing of previously prime retail units, such as the M&S in Glasgow (619 student beds) and House of Fraser in Leeds (369 beds), will continue to provide attractive returns to developers. Generally, Local Authorities are often supportive of new PBSA development as a means of protecting existing PRS stock and, in some cases, repurposing surplus commercial stock.
- There are however examples of less established Universities that are witnessing declining student applications and also have a heavy reliance (25%+) on International Students. These include the Universities of Leicester, Surrey and Southampton. Should student applications continue to fall, and the visa changes reduce International Student admissions, we suspect that this may trigger challenges for developers as occupational demand may not materialise for marginal schemes in secondary locations.



£17K - INTERNATIONAL STUDENT AVERAGE TUITION FEE



1.5 - ACCEPTED BALANCED RATIO OF STUDENT NUMBERS TO BEDS

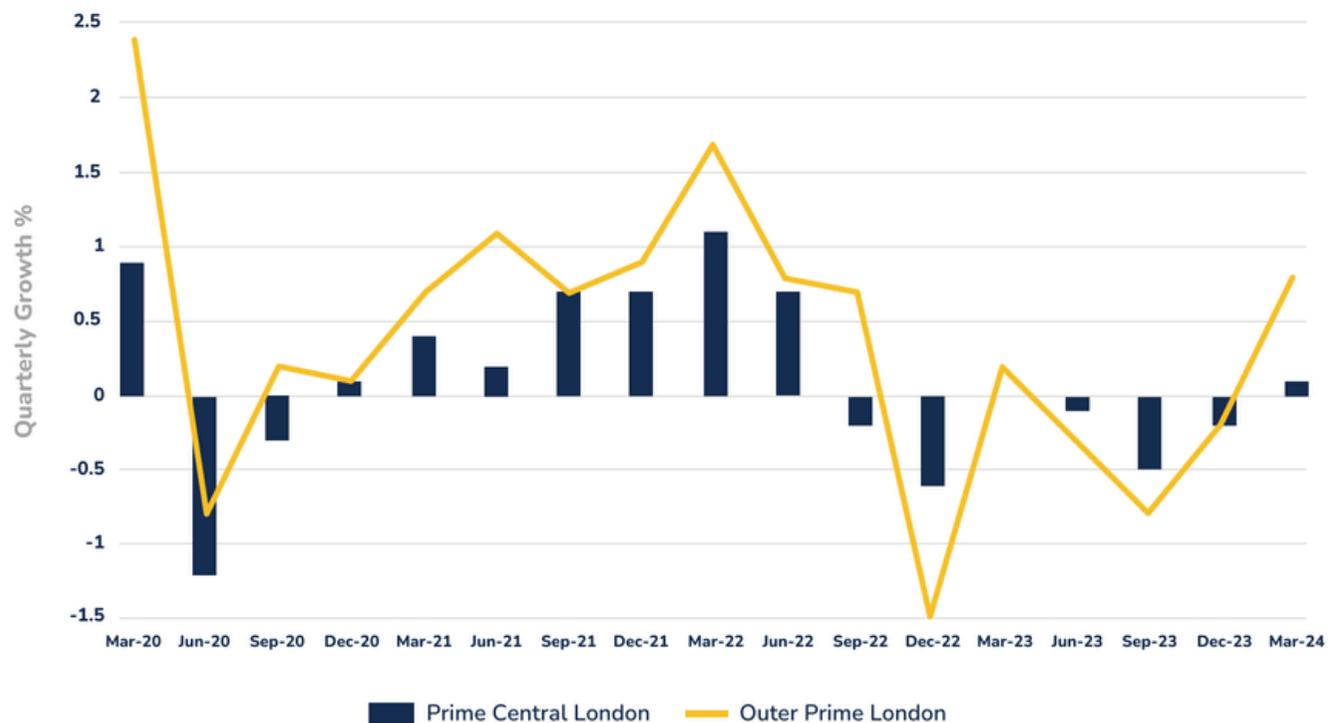


-37% - REDUCTION IN INTERNATIONAL POSTGRADUATE ACCEPTANCES

# CENTRAL LONDON RESIDENTIAL

Will the market improve in 2024/25?

Quarterly Prime London Price Changes



Source: Savills.

- ▶ The Prime Central London market (PCL), comprising Mayfair, Belgravia, Knightsbridge, Chelsea, and Kensington, continues to struggle following six quarters of negative or zero growth through to the end of 2023. In terms of pricing, both Savills (0%) and Knight Frank (-1.0%) are forecasting a flat PCL market for the remainder of 2024.
- ▶ The PCL market is more susceptible to international investment movements and was particularly impacted following the Brexit vote and the invasion of Ukraine. Probably more surprising is the continued fragility of the market.
- ▶ Traditional areas, such as Notting Hill, that are popular with UK based owner occupiers / families are still active. However, parts of London, such as Knightsbridge and The Hyde Park Estate, where there has been little in the way of new developments, are struggling to compete with up-and-coming areas like Bayswater and Whitehall.

## WATLING VIEW

- ▶ Transaction time has moved out significantly, with the time on market approaching 300 days and with many transactions at a standstill. This is partly explained by the impact of interest rates changes, but in our view it is mostly explained by asking prices that are significantly higher than realistic market levels. There are many properties that have been on the market for several years at inflated prices which are elongating the "time on market" figures due to unrealistic vendor price expectations.
- ▶ Investors are being more cautious following the decision in *Duval v 11 – 13 Randolph Crescent Limited*. This has impacted landlords' freedom in managing some blocks with long leases and the power wielded by long leasehold tenants has increased exponentially with potentially historic financial / nuisance implications.
- ▶ Purchasers are concerned over the potential impact of changes to the non-dom rules whereby non-doms only pay UK tax on UK earnings, but do not need to pay UK tax on overseas income. This has caused a degree of hesitation in prime markets since the proposed changes were announced in March. It is an increasingly politicised issue and many potential purchasers / vendors will have a keen eye on the forthcoming general election.



-0.6% - PCL ANNUAL PRICE FALL TO Q1 2024



1.5% - ANNUAL NATIONAL HOUSE PRICE CHANGE (HALIFAX)



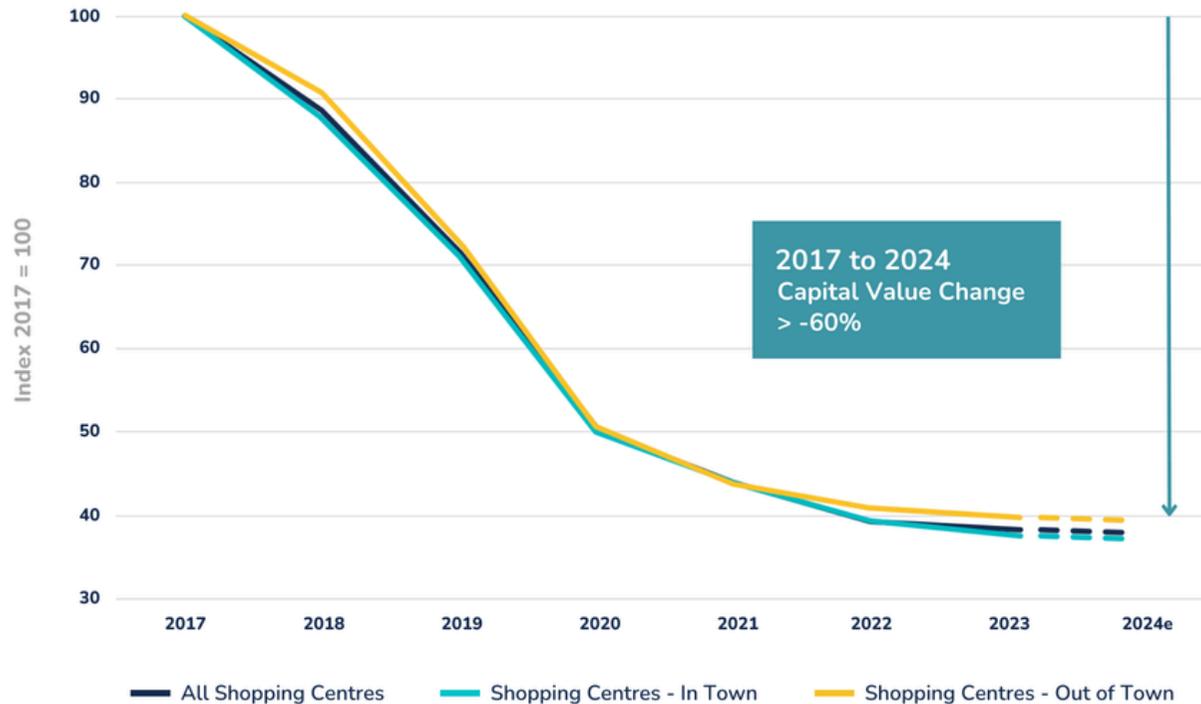
61K - MORTGAGE APPROVALS STEADY IN MARCH AND APRIL

# PUBLIC SECTOR FINANCE

With a squeeze on public sector finance is worse still to come for shopping centres?

# WATLING VIEW

Shopping Centre Capital Value Index



Source: MSCI, Watling Real Estate.

- Regardless of the election outcome public sector finance is likely to be squeezed further. With most Local Authorities proactively supporting the sector in recent years what will happen to these failing assets in 2024 onwards? For some, there is no recovery. Crossways shopping centre in Paignton was bulldozed in 2023, with sheltered housing being considered as a replacement. Stockton-on-Tees Borough Council bought both the Castlegate Centre and Wellington Square. Following demolition, work is now underway on an urban park linking the High Street to the River Tees. Whilst examples of changes of use vary it is evident that, outside of the main centres, repurposing is only financially viable with public sector investment.
- Within the last three years Watling have dealt with several stressed shopping centres that have been sold to local councils as, in many cases, they were the only credible purchaser. Whilst lenders often crystallised a debt shortfall, losses were mitigated. If Councils no longer have the capital to invest in shopping centres and repurpose, we may see more secondary centres simply close as holding costs (such as void service charge) do not cover income. The impact on value could be catastrophic.

- The latest sector “trends” are now the new normal as the structural changes within the sector impact all landlords and their investors / lenders. When faced with the growth in online competition, stubbornly high vacancy rates, loss of an anchor store, high business rates, selective tenant demand, and ESG targets requiring capital investment, a simple re-basing of rents is not going to generate the turnaround needed. With excess retail capacity and changing shopper habits, alternative use may be the only viable option for many secondary centres.
- In some cases, the mantle has been taken on by local authorities, who were able to borrow cheaply from the Public Works Loan Board to invest in commercial property. Facing a substantial funding reduction from central government these authorities were seeking to plug that gap through investing in income producing property assets. In buying shopping centres within their own jurisdiction the ambition was also to asset manage, reduce vacancy rates and reposition struggling shopping centres as thriving assets. However, with falling income and values, the investments have proved, at the very least, challenging and sometimes damaging to already stretched local authority finances.



-60% - SHOPPING CENTRE CAPITAL VALUE FALL 2017 TO 2024



17.7% - SHOPPING CENTRE VACANCY RATES END 2023 (LDC)



318 - STORE CLOSURES TO DATE IN 2024 DUE TO RETAIL FAILURES



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