



WATLING 

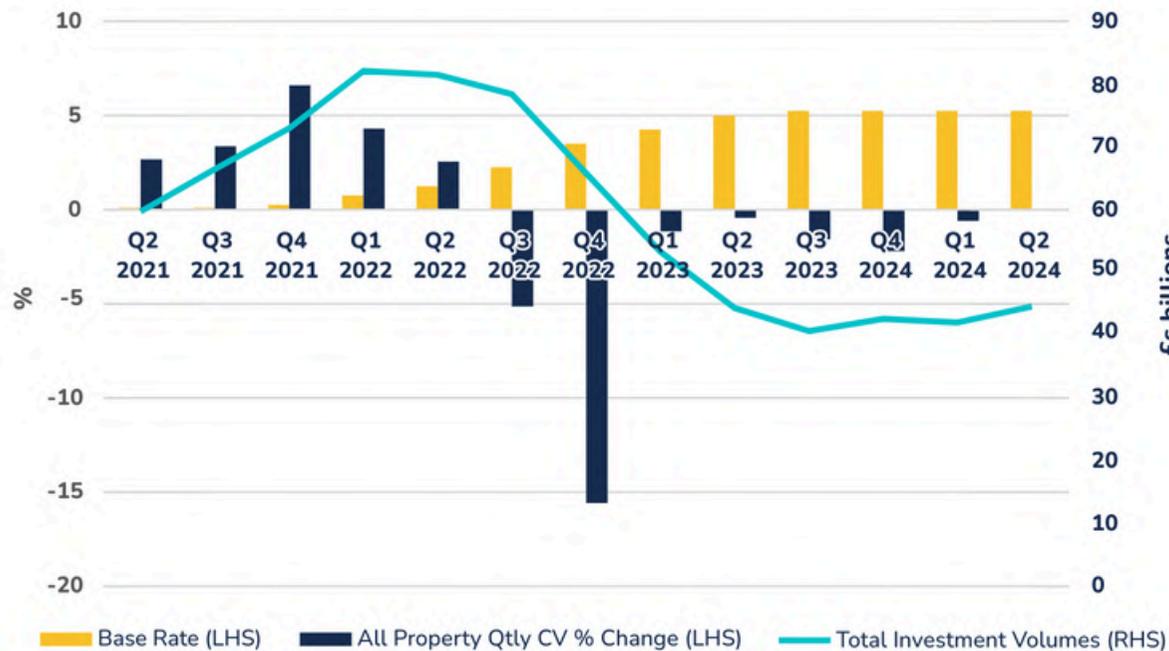
PROPERTY MARKET REVIEW

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

September 2024

MARKET OVERVIEW

Marginal recovery in investment volumes as capital values stabilise



Source: Avison Young, MSCI, Bank of England

- Even before the appointment of the new Labour government in July and the August base rate cut to 5.0%, capital values were stabilising and investment volumes showing a very modest uptick in Q2 2024
- One further base rate cut is anticipated in 2024, although inflation is still proving a headache for the Bank of England.
- There is a degree of confidence returning to the market as evidenced by the 10-year Gilt Rate having come in by 20 bps in the last six months to 3.91% and 5-year SWAP Rates having fallen by >40bps to 3.62% (Sep 5th). Further confidence should be gained from the early September £8bn government bond issue, which was ten times oversubscribed.

WATLING VIEW

With Capital Values stabilising, real estate may become a more attractive investment proposition than in recent years. Investment volumes, a bellwether for market demand, suggest greater activity is imminent.

A more stable market presents welcome news for lenders who have had uncertainty as to exit values and demand (and consequently timing) for the last two years. We are seeing particular demand for real estate with opportunities to add value (asset management, development) albeit at much reduced price points (20/25%+) than 2022.

Any increase in values will take time to evidence and is likely to be limited to prime assets that benefit from yield compression in the next two years. In most sub sectors secondary assets have a range of challenges including reduced occupational demand, emerging environmental legislation and limited (if any) rental growth. Consequently, we expect stress to continue in these markets.

2.2%

CPI in August 2024, up from 2.0% in June

0%

All Property Capital Value growth for Q2 2024

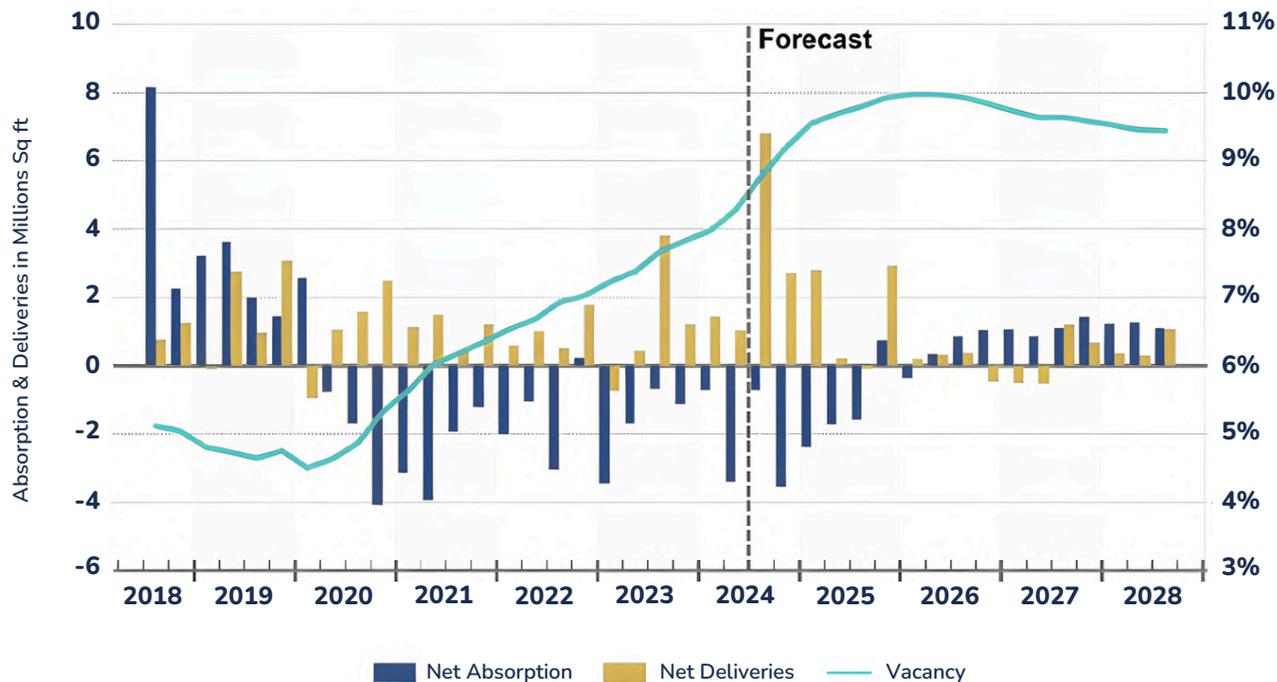
4.75%

HM Treasury interest rate forecast by the end of 2024 and to 3.75% by the end of 2025.

OFFICE SECTOR

WATLING VIEW

Vacancies continue to increase as occupiers reduce their requirements



Source: CoStar

- The ongoing structural change in the market combined with relatively weak economic growth and occupier demand has resulted in starkly negative net absorption, nationally, of -4.5m sq ft up to end of Q2 2024.
- While London saw marginally positive absorption (86,700 sq ft), some regional markets have suffered high negative absorption this last 12 months, e.g. Birmingham (-719,900 sq ft) Liverpool (-530,700 sq ft), and Glasgow (-198,500 sq ft).
- Strong leasing activity at the end of 2023 has faltered in 2024, with the exception of active pre-leasing in the London City market. Consequently, average rents are expected to fall in the near term.
- With 24.5m sq ft in the development pipeline and weak aggregate demand, the vacancy rate is expected to climb to 10% in 2026 – or 140 m sq ft.

Weak investor sentiment, higher borrowing costs and rising vacancy rates will likely continue to weigh on both activity and pricing in the coming months, with a sustained rebound unlikely until H2 2025. However, yields for prime property do appear to have stabilised in some areas.

Market conditions could soon put pressure on headline rents in all locations. Landlords' ability to offer generous concessions may have hit a ceiling due to higher construction and finance costs.

Further distress in the market, driven by pending loan maturities, could also lead to lower rents and a rebasing of values for secondary assets. With a lower cost basis buyers of distressed property could undercut the competition and still generate acceptable returns. This would make it difficult for owners of existing stock to hold asking rents as high as they have been thus far.

Forthcoming environmental legislation could result in millions of sq ft of obsolete offices being withdrawn from stock as the capital expenditure required to upgrade will be unjustifiable. This may protect rents at the lower end of the quality spectrum as tenants seeking more affordable space will have limited choice.

8.2%

Current vacancy rates, an 85% increase on pre-pandemic levels

£7.7bn

Annual investment to 30 June 2024, one third of the long-term average

11%

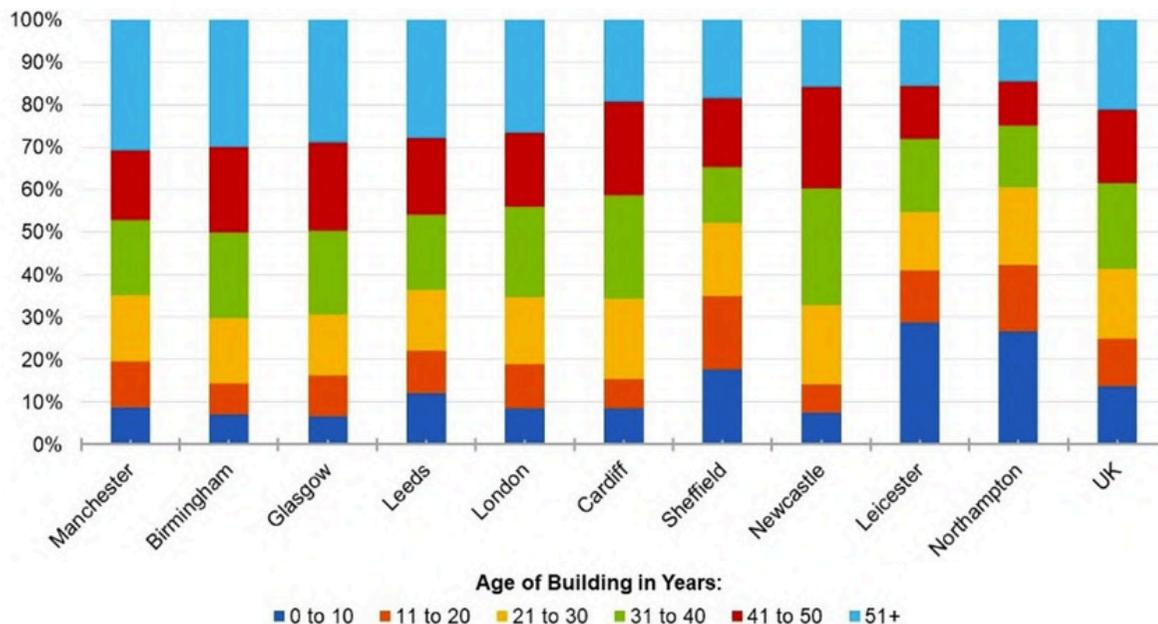
Secondary Yield in regional cities. (9.5% Sept 2023)

INDUSTRIAL SECTOR

WATLING VIEW

Developing environmental legislation threatens capital values in secondary markets

Share of Stock in Age Bracket



Source: CoStar, March 2024

- Ageing real estate stock and the requirement to meet new building regulations and environmental standards brought in to help meet the government's 2050 net zero target is a major, and costly, challenge for landlords.
- Under the Minimum Energy Efficiency Standards (MEES), in order for a property to be let the current minimum EPC rating is "E", which is due to move to "C" in 2027 and "B" in 2030 – although further consultation and evolution of the framework is expected, which creates a degree of uncertainty.
- The chart illustrates that several regional cities have c. 40% of industrial stock more than 40 years old. It is anticipated that most of this will fall below the proposed 2027 MEES requirements.

Wider market forces are dictating that the energy performance of property assets is a key factor in transactional decision making and we expect the trend will continue to gather momentum.

Consequently, we may see a widening "two-tier" market develop as older stock becomes far less attractive to investors, occupiers and lenders. The data left supports the view that this trend could be particularly pronounced in the industrial sector given the age profile of accommodation.

In respect of Capital Values increases, the industrial sector has been the best performing sub-sector of the real estate market over the last five years. However, values for secondary located sheds and older manufacturing units have been swept along by general yield compression within the sector. Concerns exist about whether these values can be sustained given the likely requirement for capital expenditure caused by developing MEES legislation, thus presenting a medium term risk for lenders active in this market.

The costs associated with upgrading older buildings may prove prohibitive and many landlords will be staring at environmental obsolescence, implying the removal of swathes of older stock from the market.

15%

Sector Capital Value increase over the last five years

70%

Industrial units in Birmingham are over 30 years old

43%

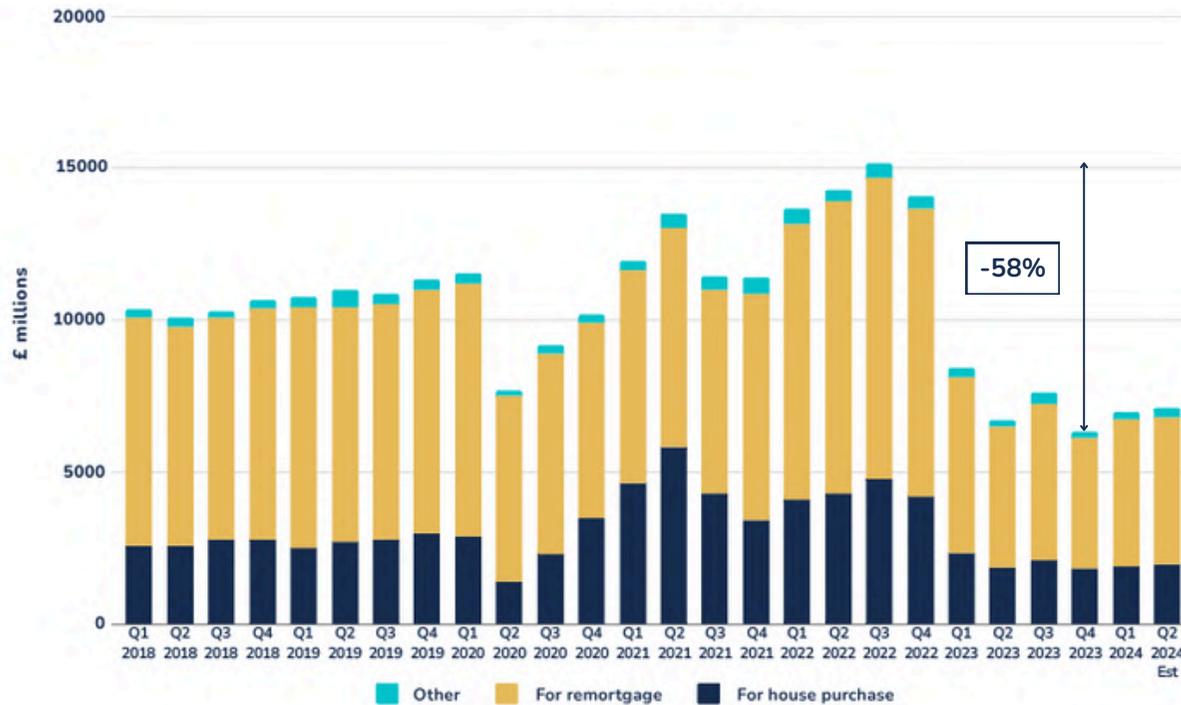
UK industrial stock dates from the 1980s and 1990s

RESIDENTIAL INVESTMENT

WATLING VIEW

Are private Buy To Let investors exiting an over heated market?

Value of new BTL lending



Source: UK Finance

- ▶ The value of buy-to-let (BTL) loans peaked in Q3 2022 at £15.2bn, with £4.8bn lent on new home purchases and £9.9bn advanced on remortgages.
- ▶ Increased interest rates, regulatory responsibilities and administrative burdens have dampened the sector's appeal which has resulted in a much smaller market as investors have exited. Total lending fell from £15.8bn to £6.3bn (-58%) between Q3 2022 and Q4 2023, with lending on new BTL properties falling by 61% and remortgaging down by 52% as investors deserted the sector.
- ▶ Whilst lending is showing signs of recovering from the Q4 2023 low point, it remains well below the median term (Q1 2018 to Q4 2022) lending figure of £11.5bn.

Once highly sought after for its potential to yield high profits within a relatively short time frame, the BTL sector is not the attractive investment it once was, with repercussions for developers targeting private landlords who have been hit by much reduced sales rates.

The sector's attractiveness to investors has taken a battering in recent years following government intervention and wider economic impacts, including changes to tax regulations, stricter lending criteria, and environmental legislation as part of the government's net-zero strategy.

High-interest rates, which have had a significant impact on landlords' cash profits, are down from 23% of rental income between 2014 and 2021 to less than 4% more recently according to Savills. The Labour government's Renters' Rights Bill, which will ban Section 21 "no-fault" evictions, which could receive Royal assent by the end of 2024/ early 2025 presents a future threat.

With little positivity in the sector the market will remain subdued and values curtailed for the short / medium term. Rumours of the introduction of rent controls do nothing to entice investors back into the sector. Such rent controls can generate unintended consequences, including the stifling of housing supply, reducing labour mobility and driving up rents in unregulated dwellings.

6.74%

Average rental yield for a BTL in the UK in Q4 2023

£424

April 2024 Landlord average monthly returns per unit (£776 April 2020)

4.35%

Lowest product fee free BTL mortgage rate (75% LTV) September 2024

LONDON

60 Cannon Street, London, EC4N 6NP

BIRMINGHAM

75/77 Colmore Row, Birmingham, B3 2AP

LEEDS

One, The Embankment, Neville Street, Leeds, LS1 4DW

MANCHESTER

125 Deansgate, Manchester, M3 2BY

BRISTOL

17-19 Berkeley Square, Bristol, BS8 1HB

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