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PPE - Property, Politics & Economics
A new reality in formation?

Dr Walter Boettcher, Head of Research & Economic, Colliers
Professional Conferences, Peterborough, 19th June 2024

Agenda

01 GDP, inflation and interest rates

02 Regulatory constraint on property market

03 A few property metrics

04 'Levelling up' and a dysfunctional political picnic

Business

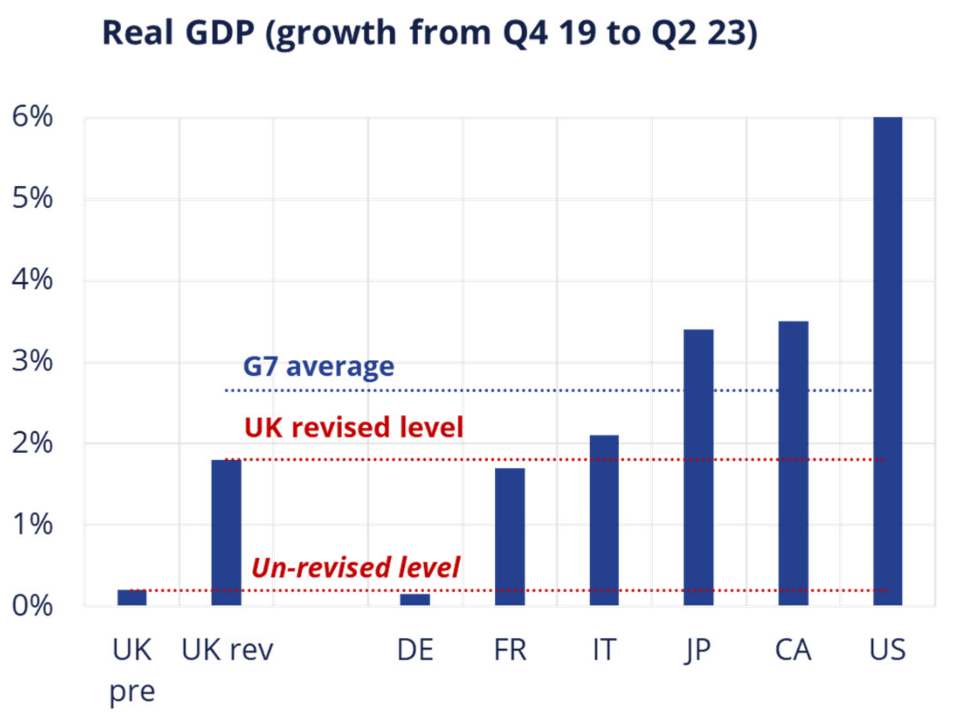
UK inflation + Add to myFT

Is the UK once again the 'sick man' of Europe?

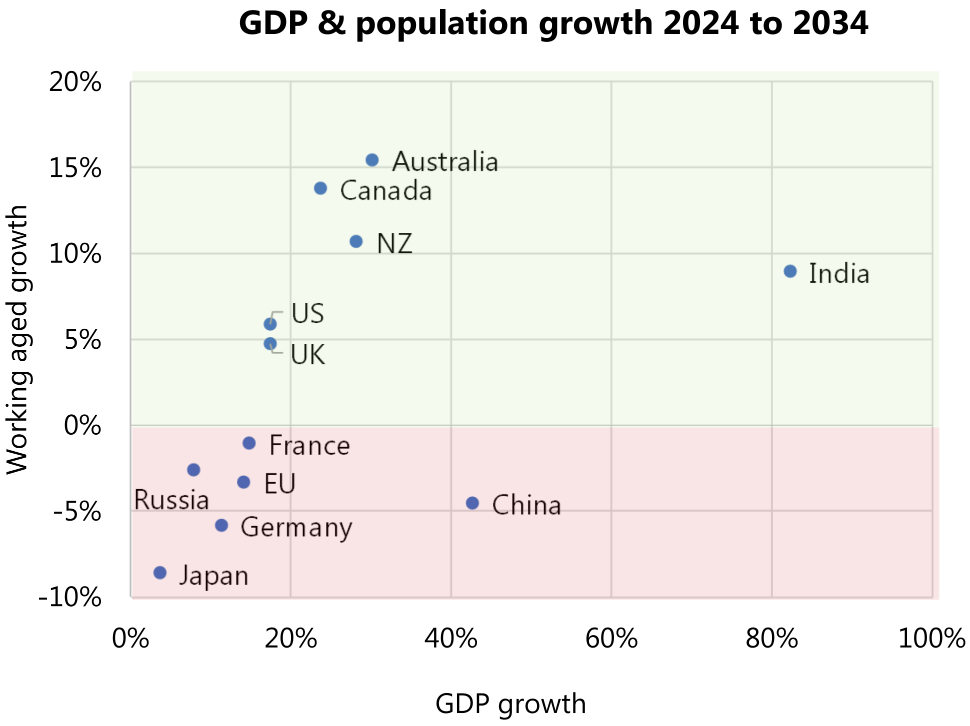
Return of high inflation and slow growth draws comparisons with the 1970s — but economists say this time it is different

Is the UK really lagging the G7 as the media reports?

Large revisions to GDP



Source: Capital Economics



Source: Oxford Economics (April 2024)

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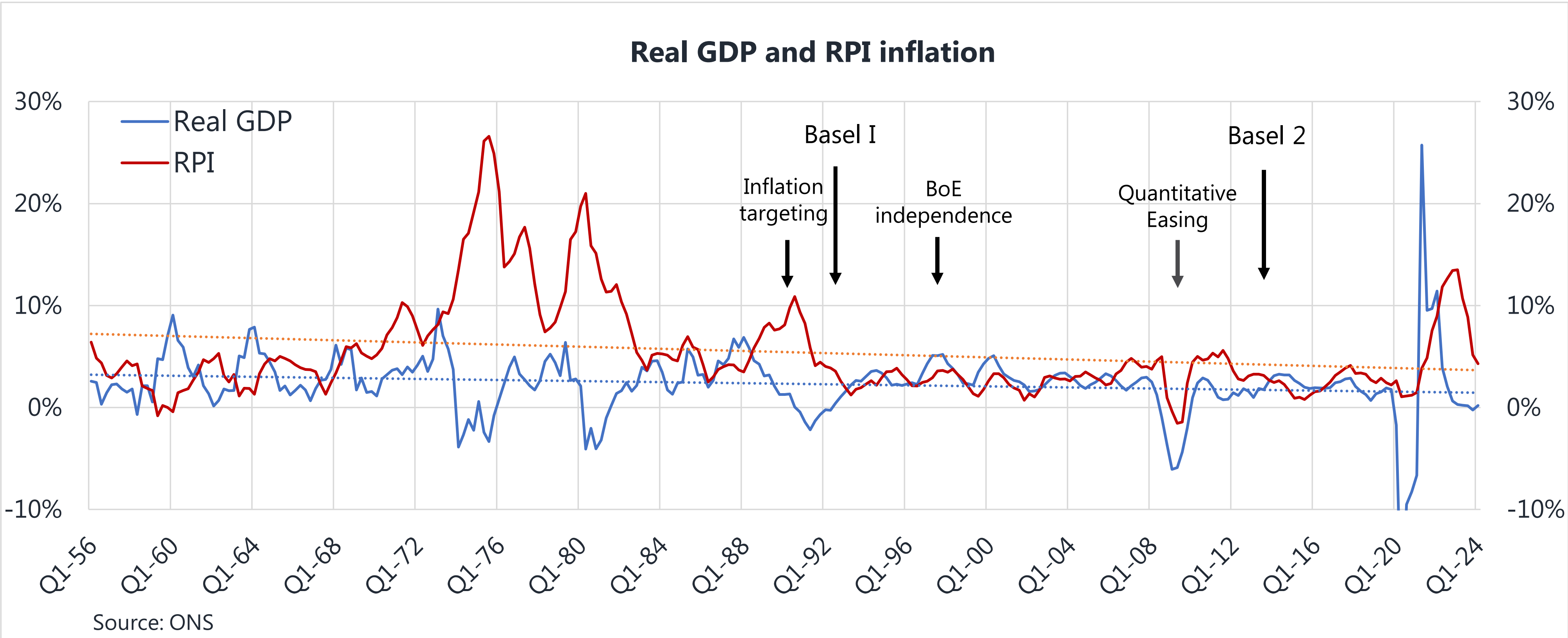
No more boom and bust?

Financial regulations stabilised economy



Business

The ‘paradox of thrift’ prevails

Animal spirits slain!

- **Paradox of thrift** – ‘greater saving’ is ‘collectively calamitous.
- Secure rather than opportunistic investment.
- An elongated sequence of shocks has left little time for risk appetites to be repaired.
- Financial regulations are impacting.
- Creative destruction remains in retreat. The reallocation rate is down by a quarter in US and Europe and by a third in the UK.
- Productivity in retreat.
- **<u>Government stimulus needed to break this logjam, not more austerity!</u>**

Why an uncertain world needs to take on more risk

Scarring from a series of shocks generates a defensive mindset that is holding back growth

ANDY HALDANE + Add to myFT

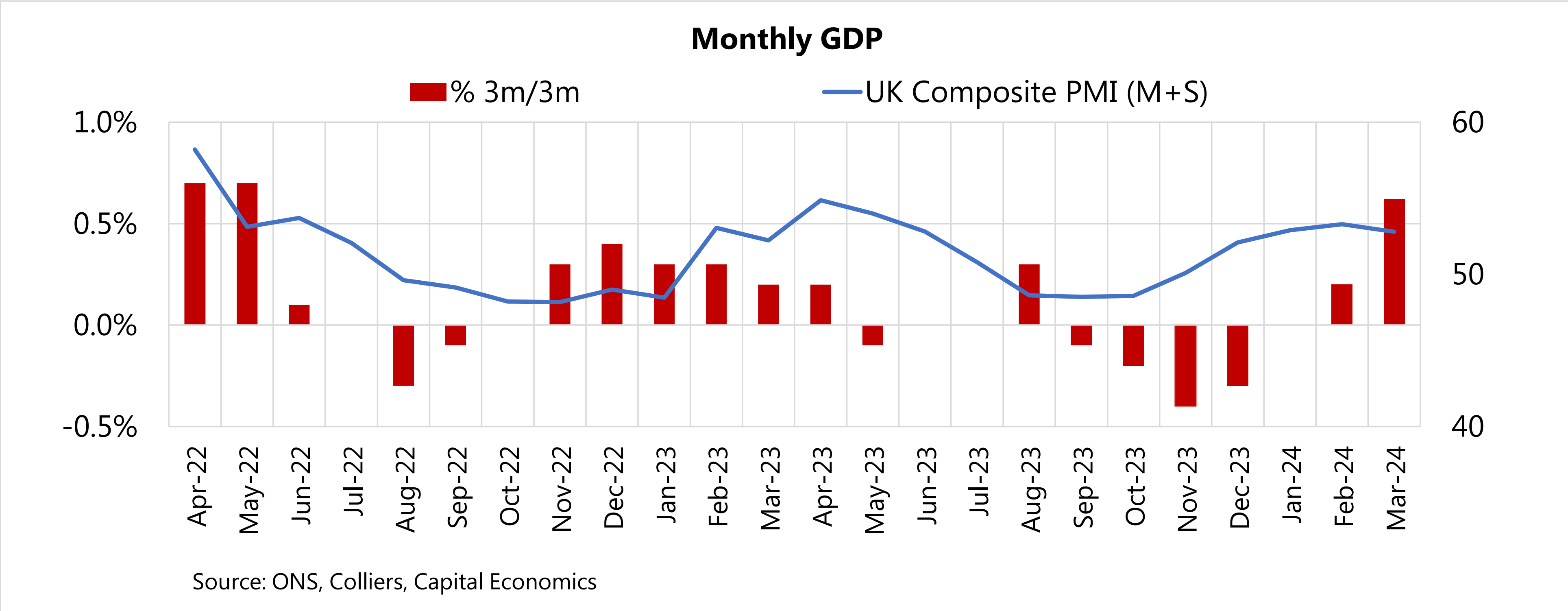
Events such as the Covid-19 pandemic have shaken the world economy, prompting a safety-first approach. But today’s risk problem is too little, not too much © AFP via Getty Images

Andy Haldane MAY 18 2024 180

Business

Is this the soft landing?

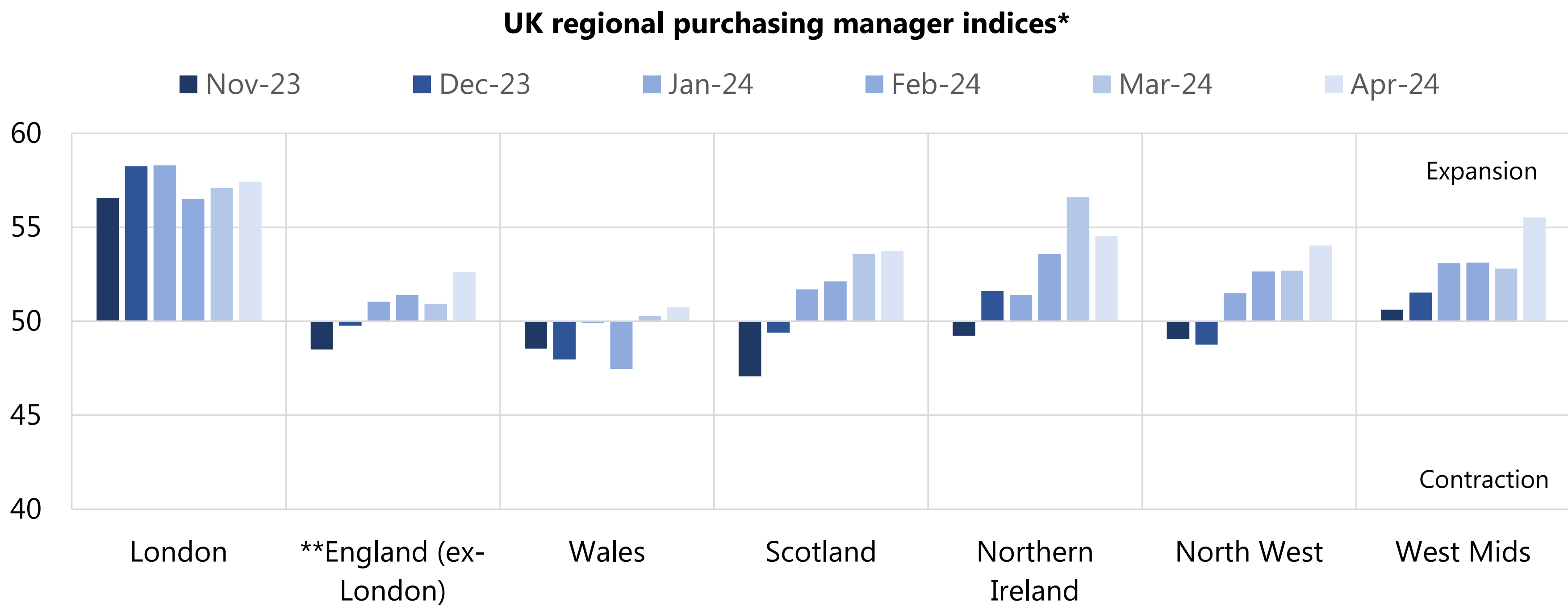
Recession? What recession?



Business

Depends where you are and whom you ask . . .

Recession? What recession?



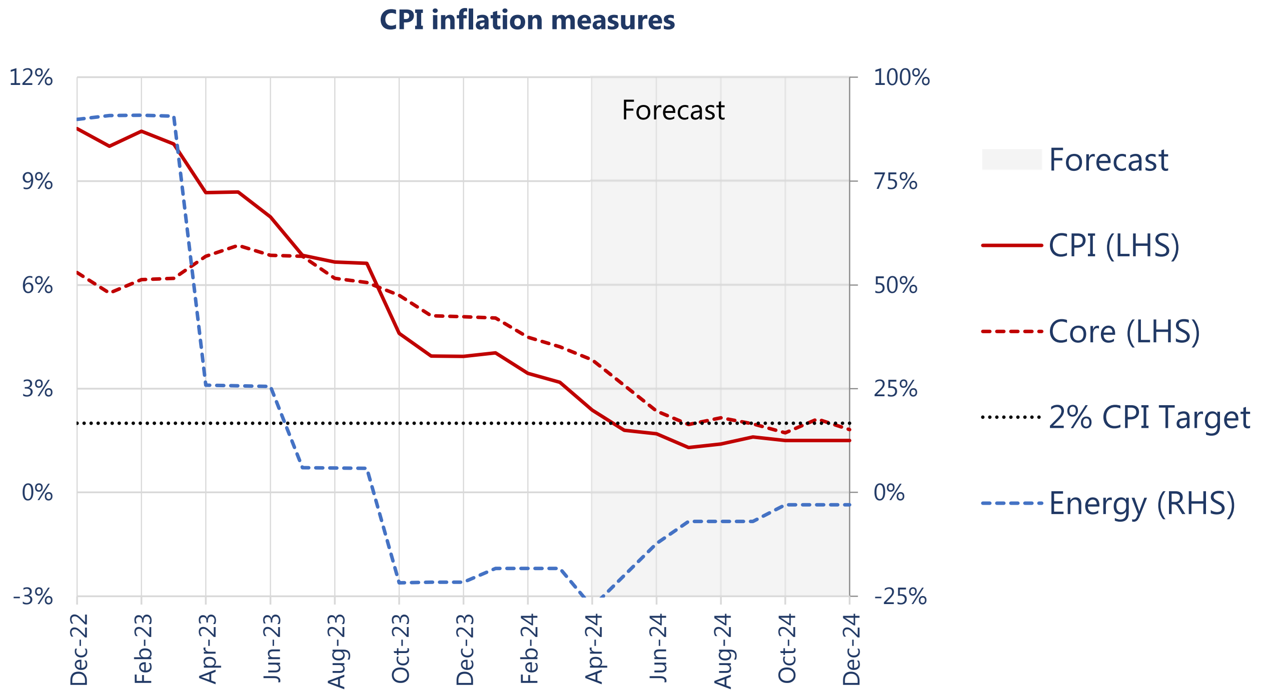
*Business Activity Index (SA)
**Regional average (unweighted)
Source: S&P Global May 2024

Business

It's about energy and supply chain recovery, less about the Bank Rate

Inflation likely to fall below target before election

- **Base effects** driving inflation lower
- Ofgem price cap fell 12% from £1,928 to £1,690 in April. Forecast to fall by 7% in July to £1,568
- Bank may have overtightened
- Look for mid-year rate cuts
- Prices still high though



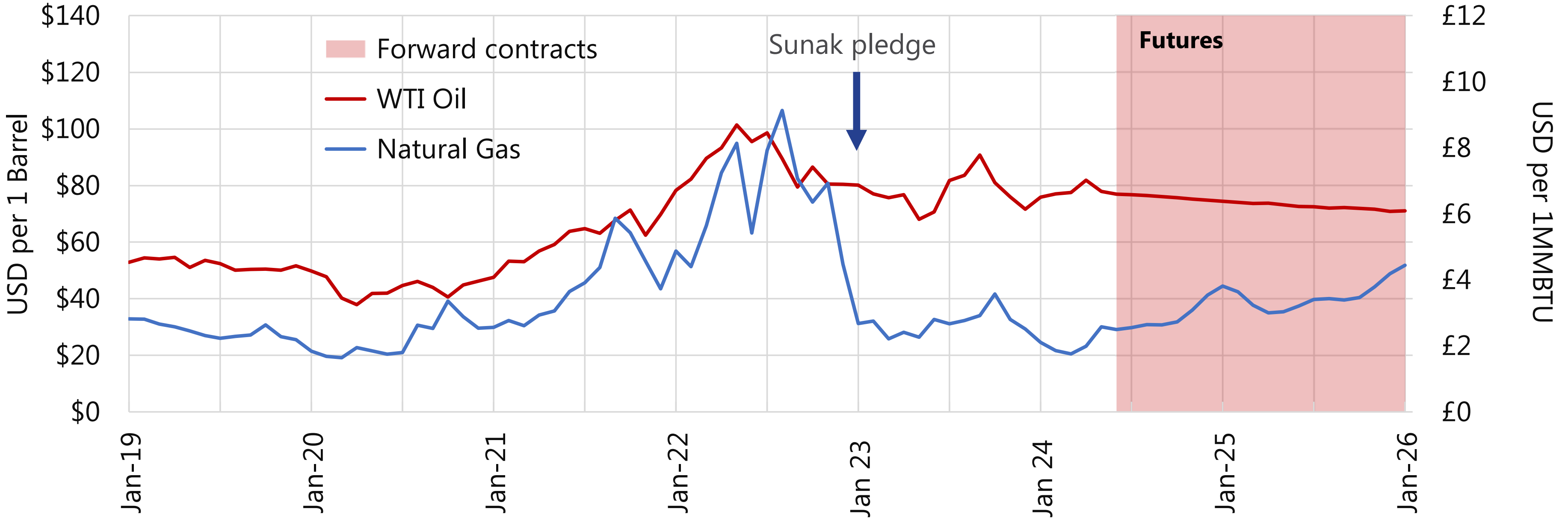
Source: ONS, Colliers (May 2024)

Business

Supply chains have shifted substantially and have greater security!

Energy supplies already deflating

Energy futures contracts[1]

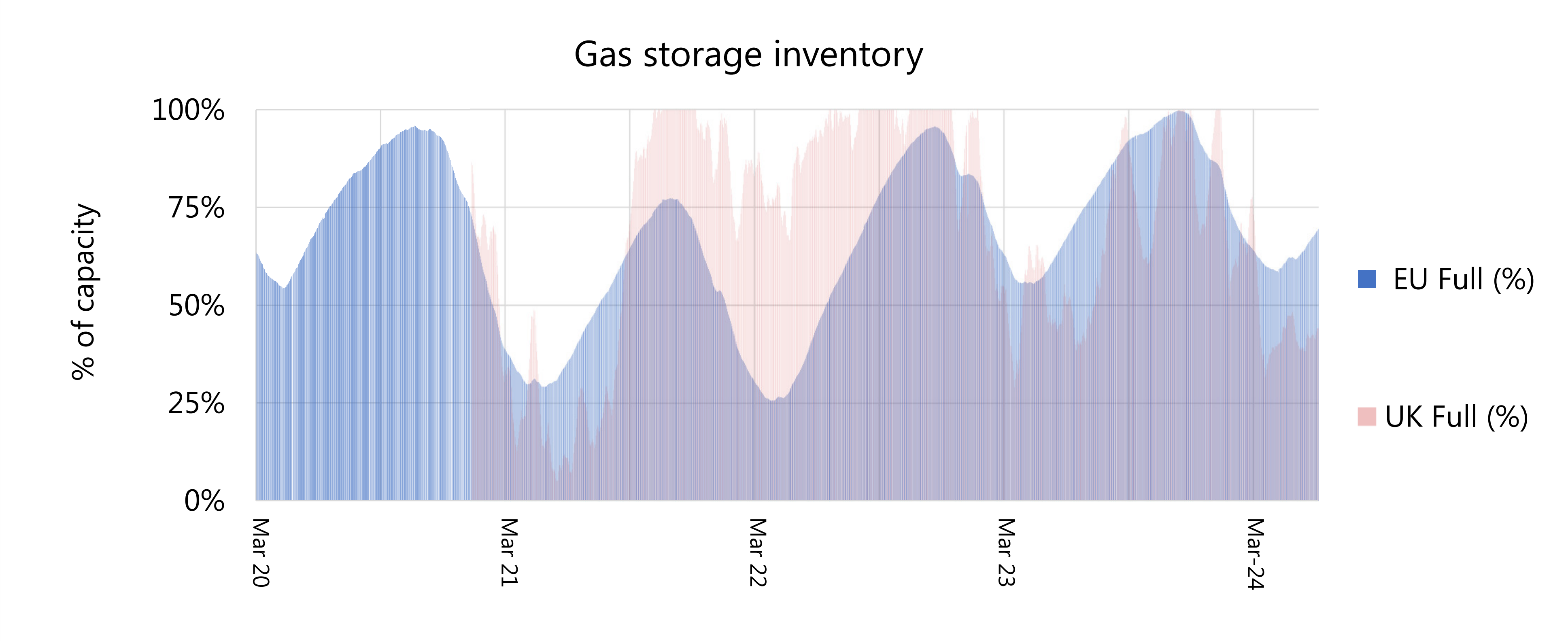


[1]Monthly average

Investing.com (Morningstar & Zacks Research) 31st May 2024

Supply chains have shifted substantially and have greater security!

Gas reserves at comfortable levels

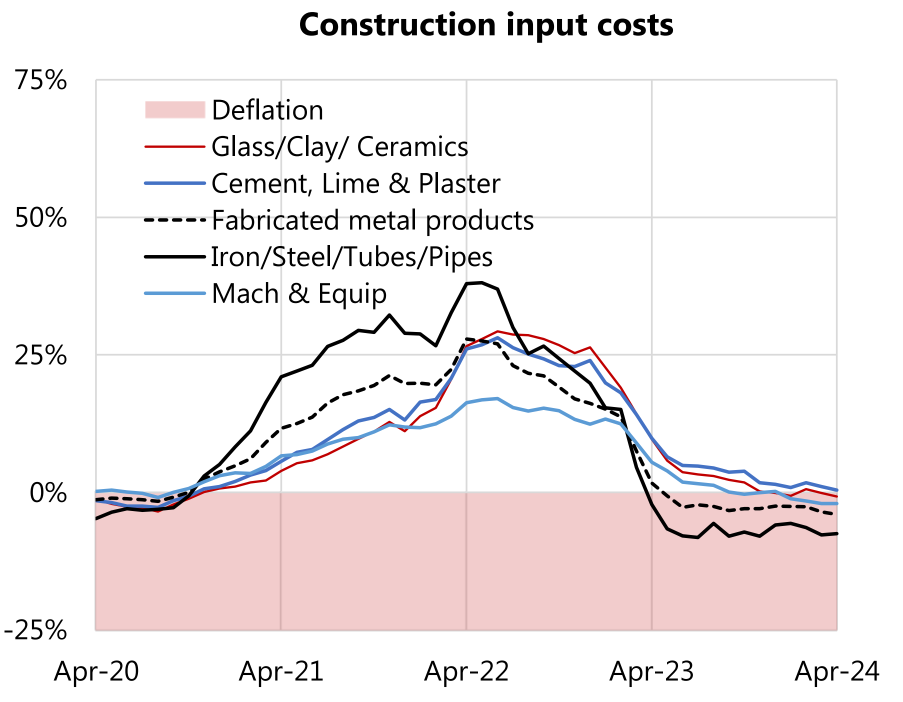


Source: GIE AGSI (May 2024)

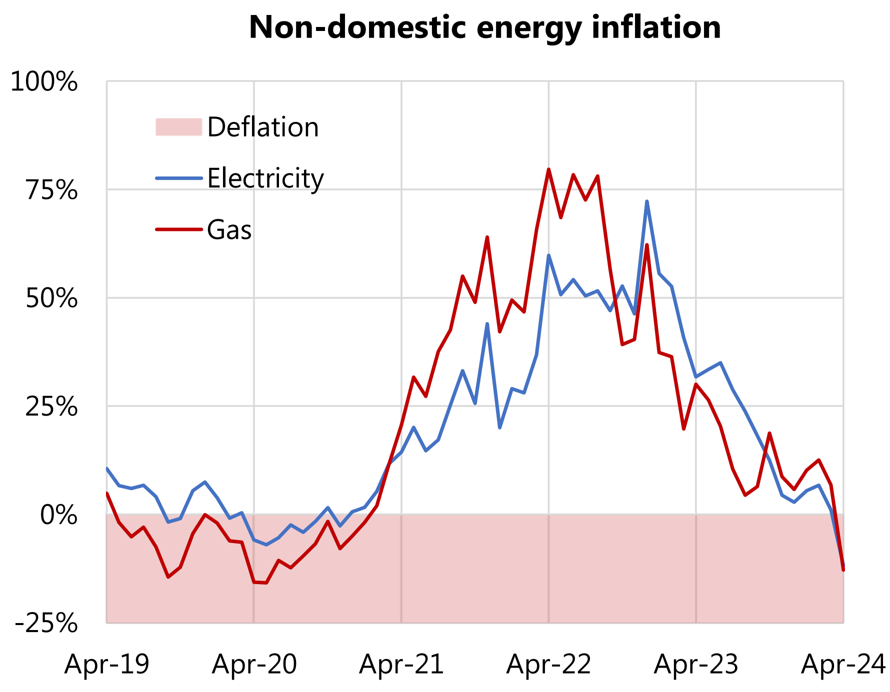
Business

Input costs deflating. Output deflation will follow!

Commodity supply chains normalising



Source: ONS PPI Input Prices



Source: PPI Materials and Fuel Purchased T1

Not a question of when cuts will come, but where they will land.

When will the Bank of England begin rate cuts?

Andrew Bailey

Depends whom you ask?

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The New York Times

Bank of England Will Overhaul Its Forecasting After Inflation Surprises

THE WALL STREET JOURNAL. · 3d

Ben Bernanke's 12-Step Guide For Fixing the Bank of England

Ben Bernanke has some thoughts on how to fix the Bank of England's much-maligned economic-forecasting models—and that ...

Frankfurter Allgemeine

F+ NACH FEHLPROGNOSEN

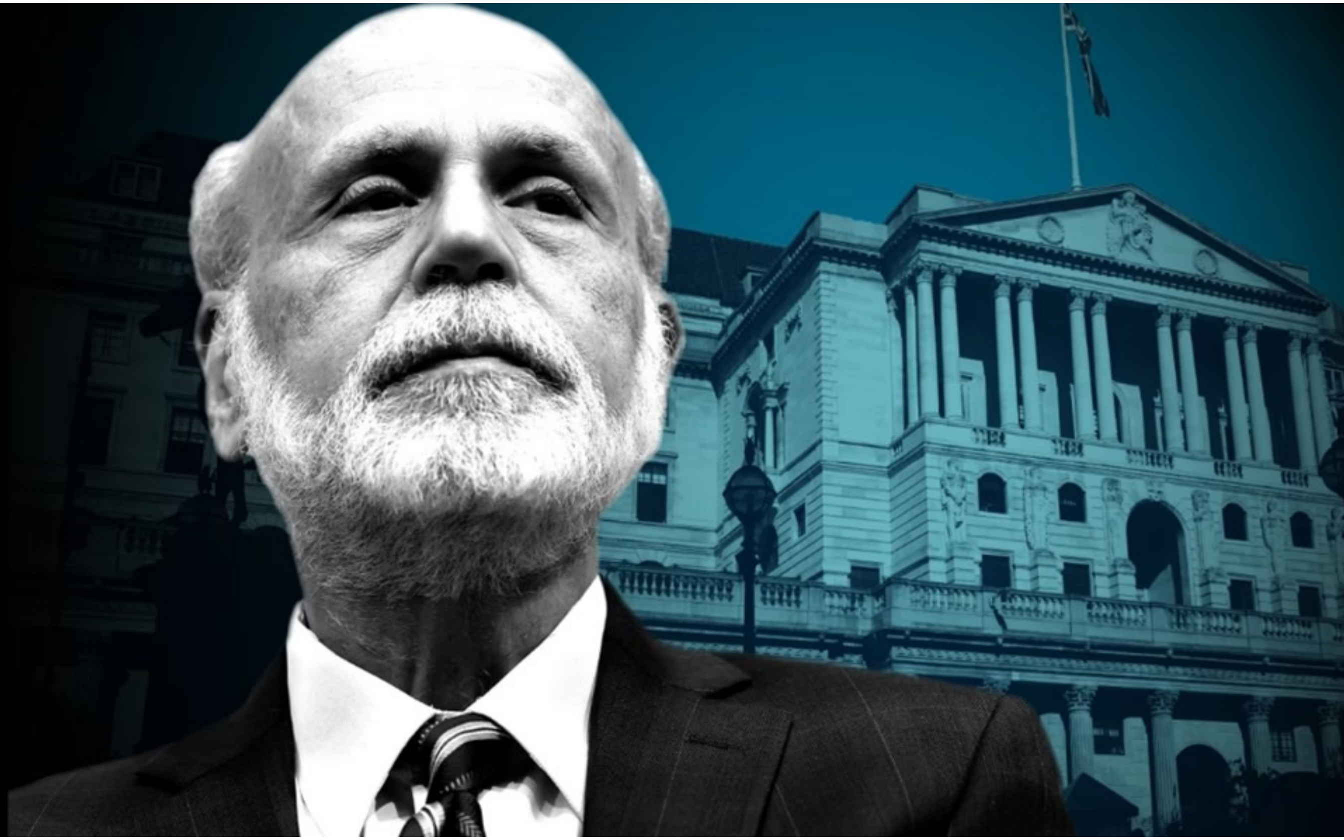
Bernanke tadelt die Bank of England

Der ehemalige amerikanische Zentralbankchef empfiehlt den britischen Kollegen eine neue Software und neue Modelle, um ihre Prognosen zu verbessern.

FINANCIAL TIMES

Ben Bernanke's brutal verdict on the Bank of England

Former Fed chair highlights shortcomings in modelling but does not call for policymakers to publish own rate projections



Not a question of when cuts will come, but where they will land.

When will the Bank of England begin rate cuts?

Huw Pill

Gag order in place until the election!

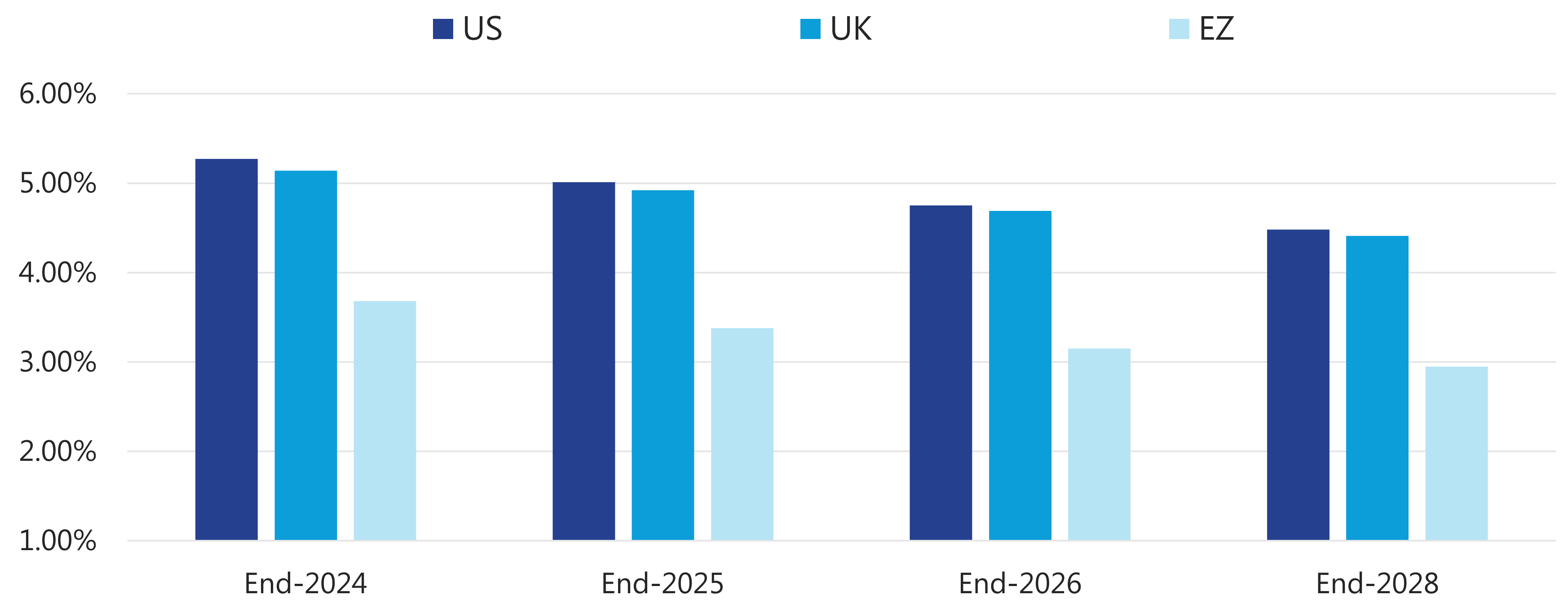
Not a question of when cuts will come, but where they will land.

When will the Bank of England begin rate cuts?

Andy Haldane

June Bank cut six months too late . . .

OIS forward curves show slow rate decline

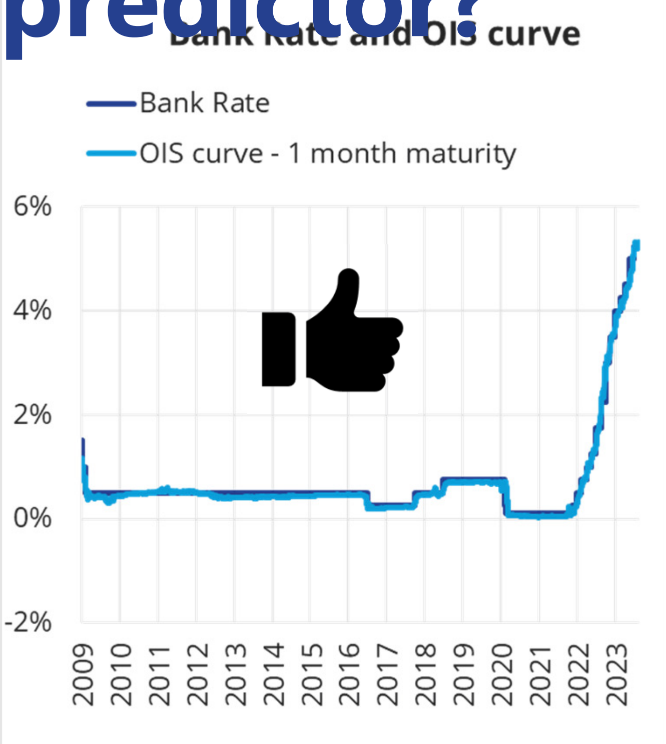


Source: Bloomberg (31 May 2024)

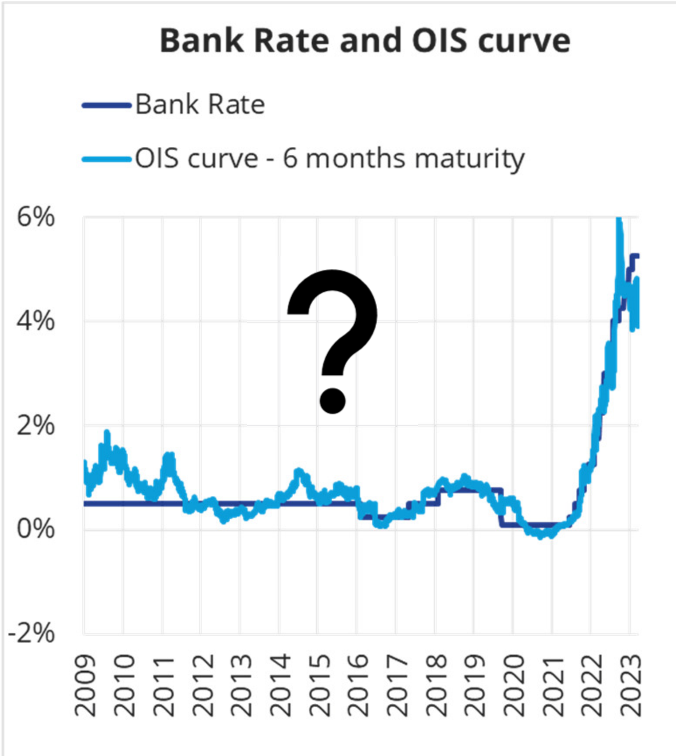
Business

Depends on time frame

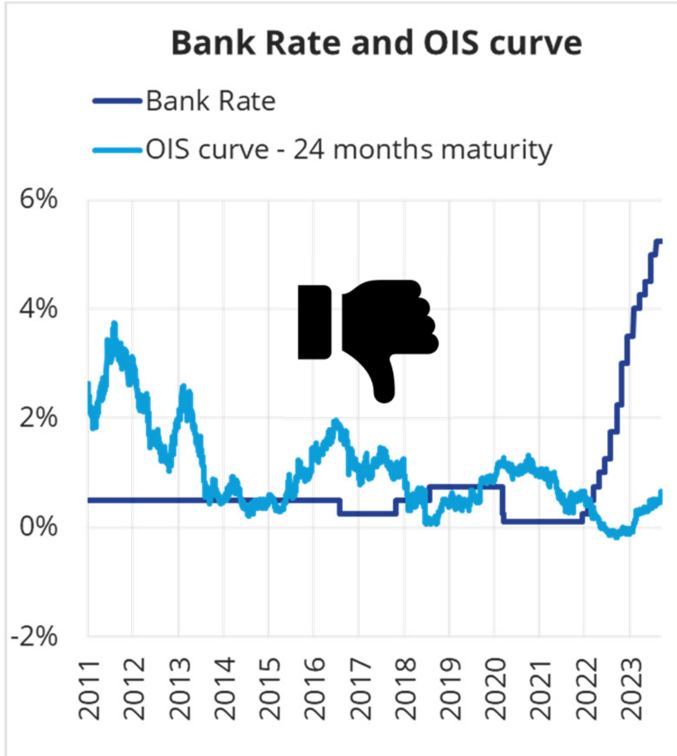
Is the OIS forward curve a good predictor?



Source: Bank of England

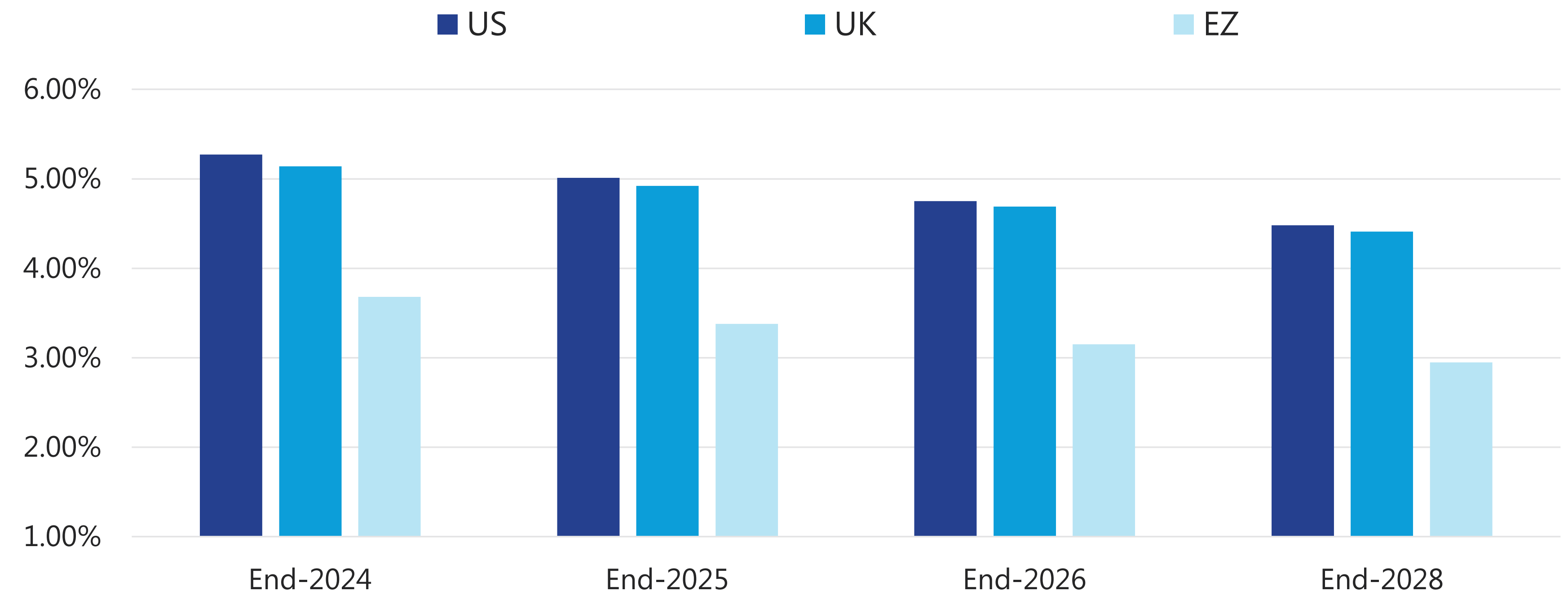


Source: Bank of England



Source: Bank of England

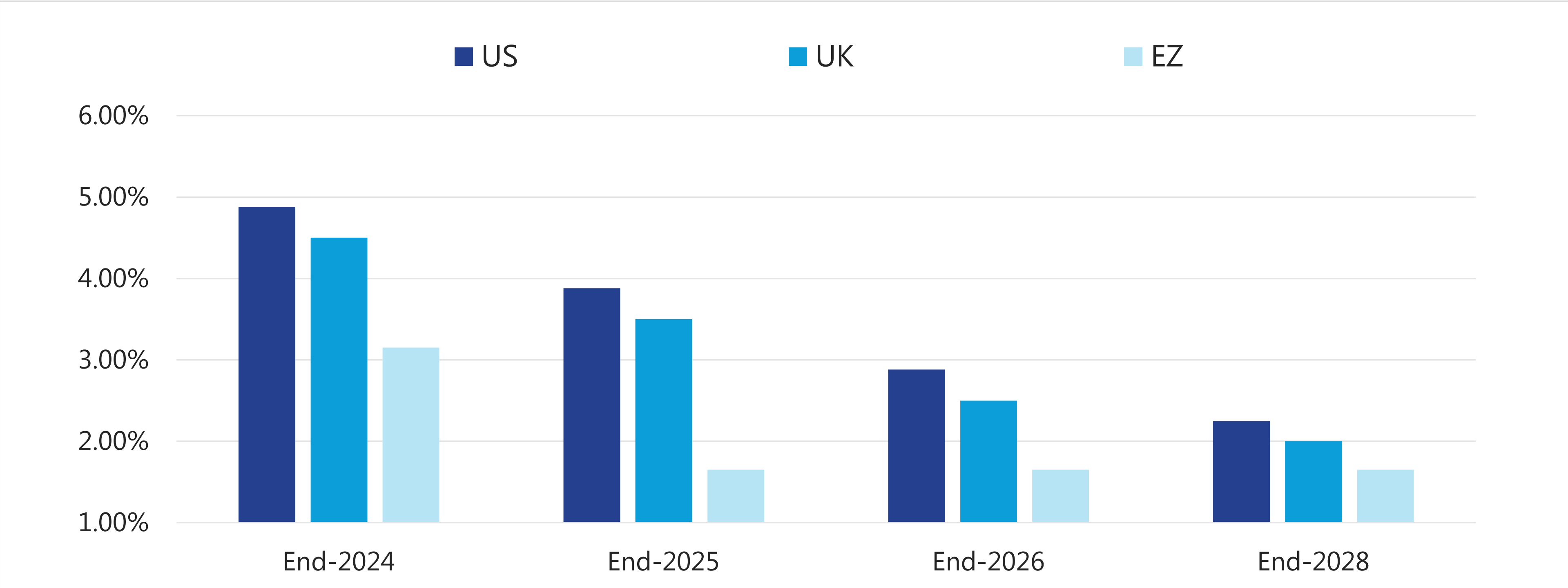
OIS forward curves show slow rate decline



Source: Bloomberg (31 May 2024)

Business

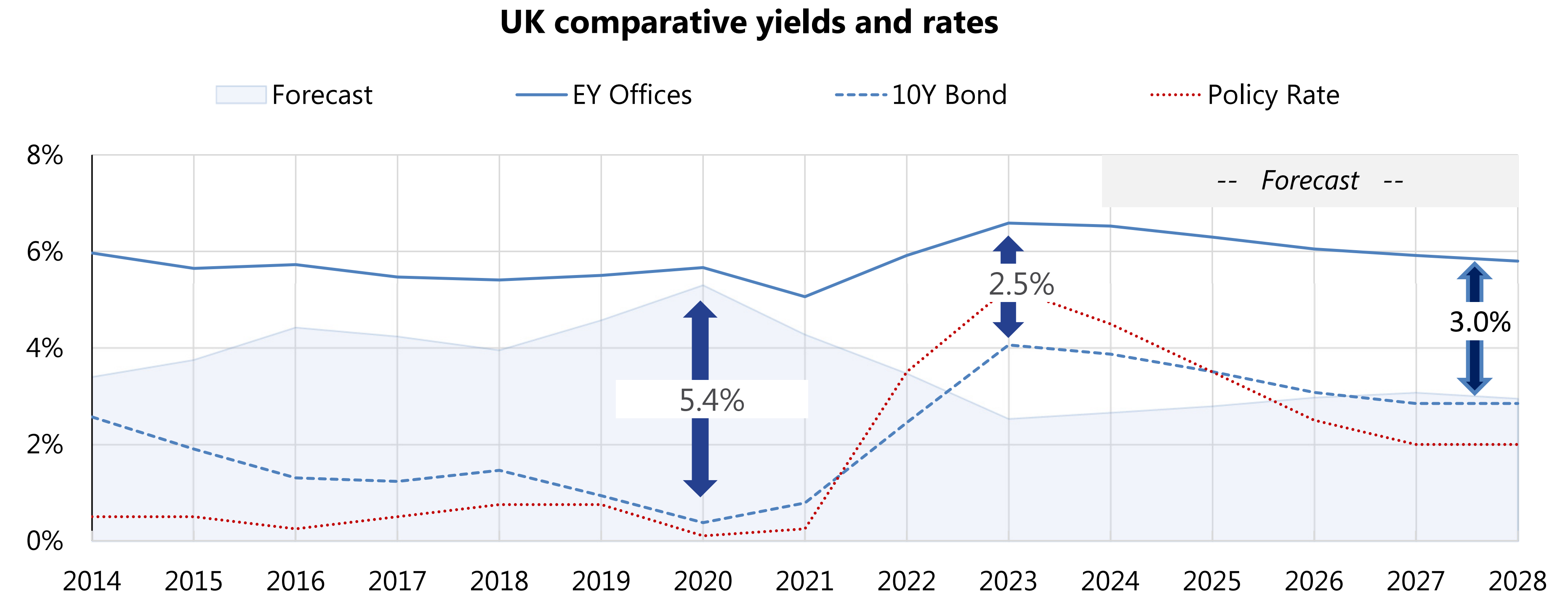
Economists see a faster decline



Source: Bloomberg (31 May 2024)

Scope for returns based on yield compression is much reduced!

Importance to commercial real estate?



Source: MSCI, BoE (Feb 2024)

Business

A key message for real estate

Over the next five years, **scope for returns through yield compression will be limited.**

Outsized returns will require debt leverage to maximise returns from **developing, repositioning and asset managing** to create ‘fit-for-purpose’ real estate.

Investors may have to get their hands dirty!

Business

And . . . by the way . . .

If Government hopes to drive economic growth through business investment in innovation and technology, they will need to encourage development of flexible high-quality ESG compliant space to accommodate new equipment and new hybrid working formats.

Government may need to revisit policies!

Tenth anniversary of the ‘supervisory slotting criteria’ (1st January 2014)

Legislative reforms arising from the GFC

Prudential Regulatory Agency introduced ‘slotting’ in January 2014

- *Requirement that banks risk-weight individual real estate loans to determine how much capital they must hold to cover the loans*
- *Each loan must be ‘slotted’ into a risk category*
- *More risk requires more capital to be held*
- *Less risk means less capital to be held*

Maturity	Cat I Strong	Cat II Good	Cat III Satisfactory	Cat IV Weak	Cat 5 Default
< 2.5 years	50%	70%	115%	250%	Write off 50%
=> 2.5 years	70%	90%	115%	250%	Write off 50%

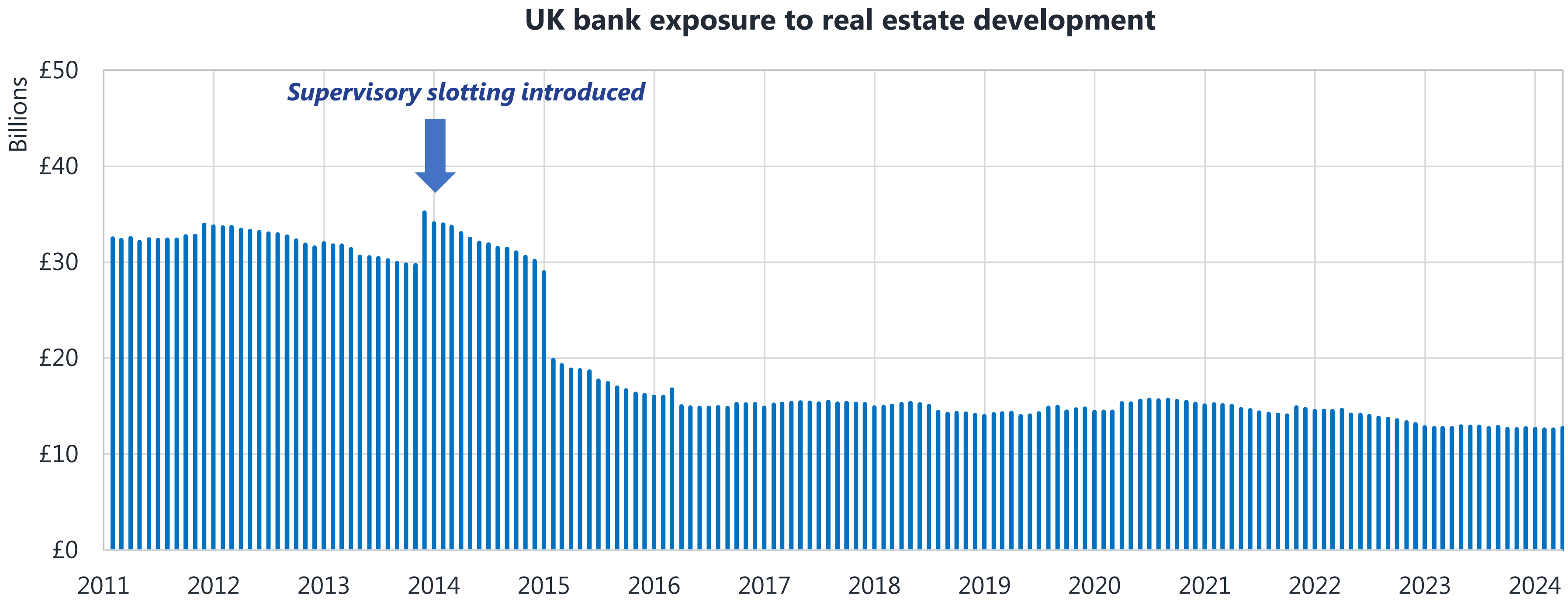
Impact on UK commercial real estate

- *Real estate debt and speculative development cycles eradicated*
- *Shortages of high-quality Grade A space across sectors*
- *Limited investible standing assets*

Business

Exposure to development fell as risk aversion rose

Impact of 2014 GFC reforms

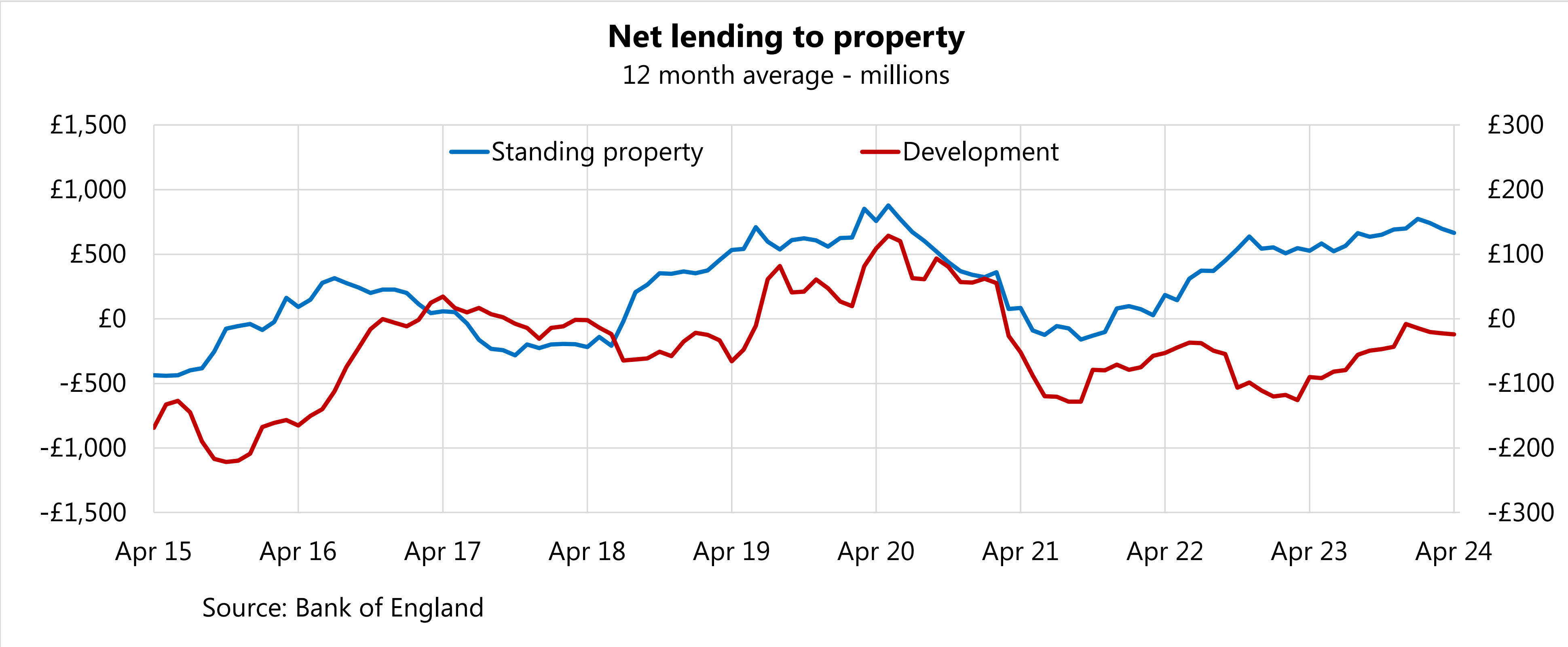


Source: Bank of England (April 2024)

Business

Exposure to development fell

Impact of 2014 GFC reforms



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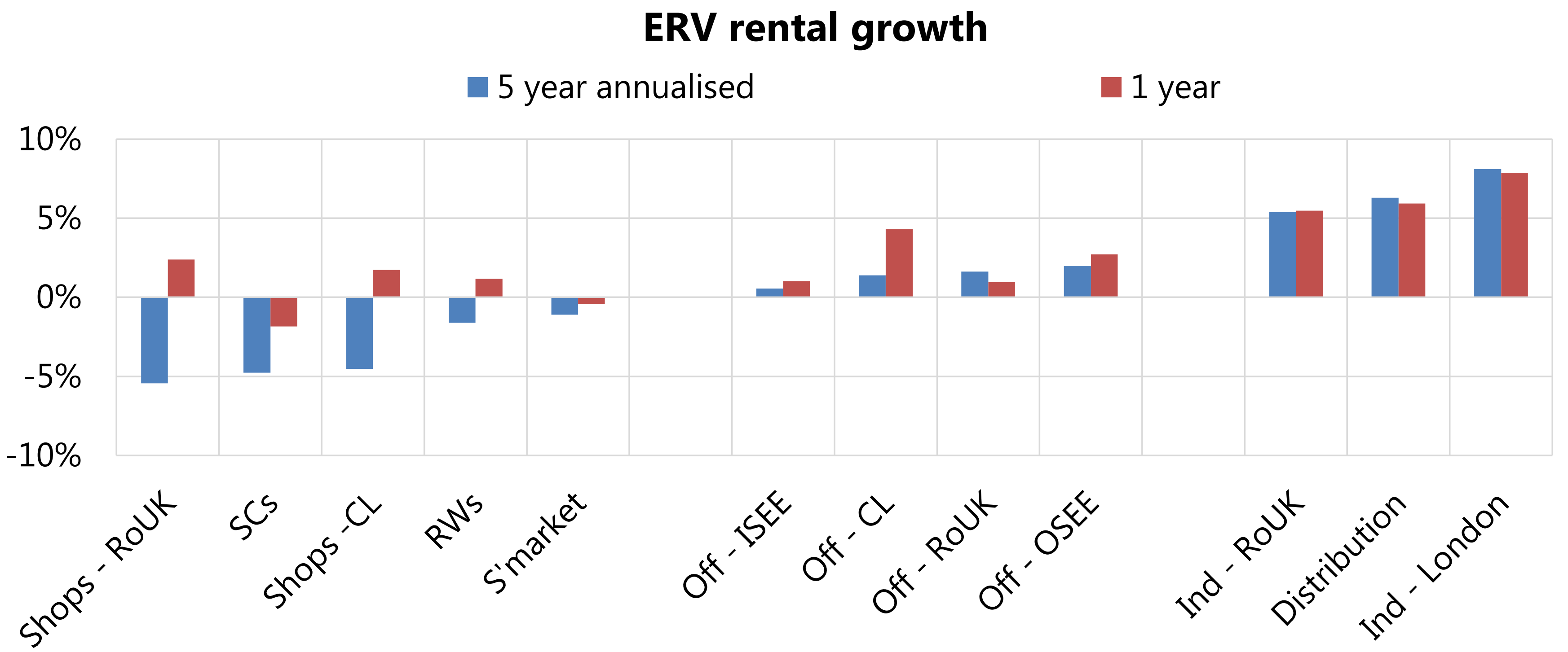
. . . in the absence of quality rental stock

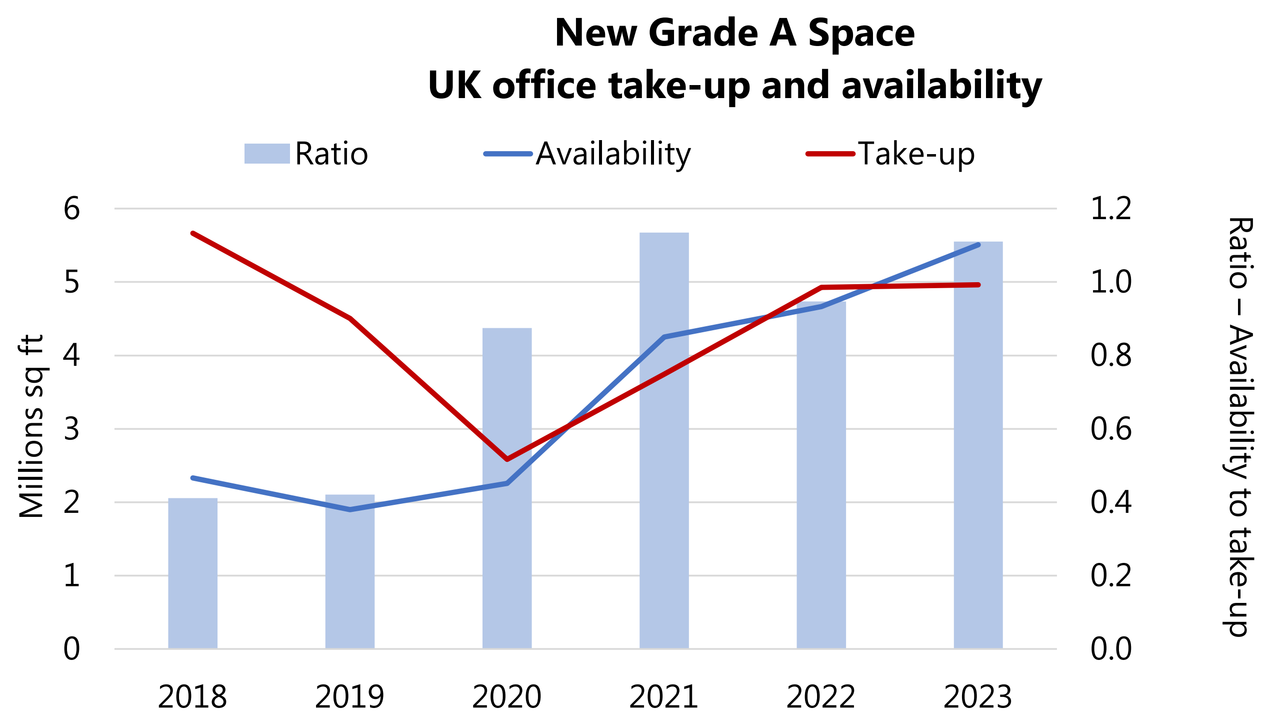
Rental values continue to show strength



Source: MSCI Monthly Index (April 2024)

Take-up inhibited by lack of available Grade A product

Demand recovering after pandemic hiatus



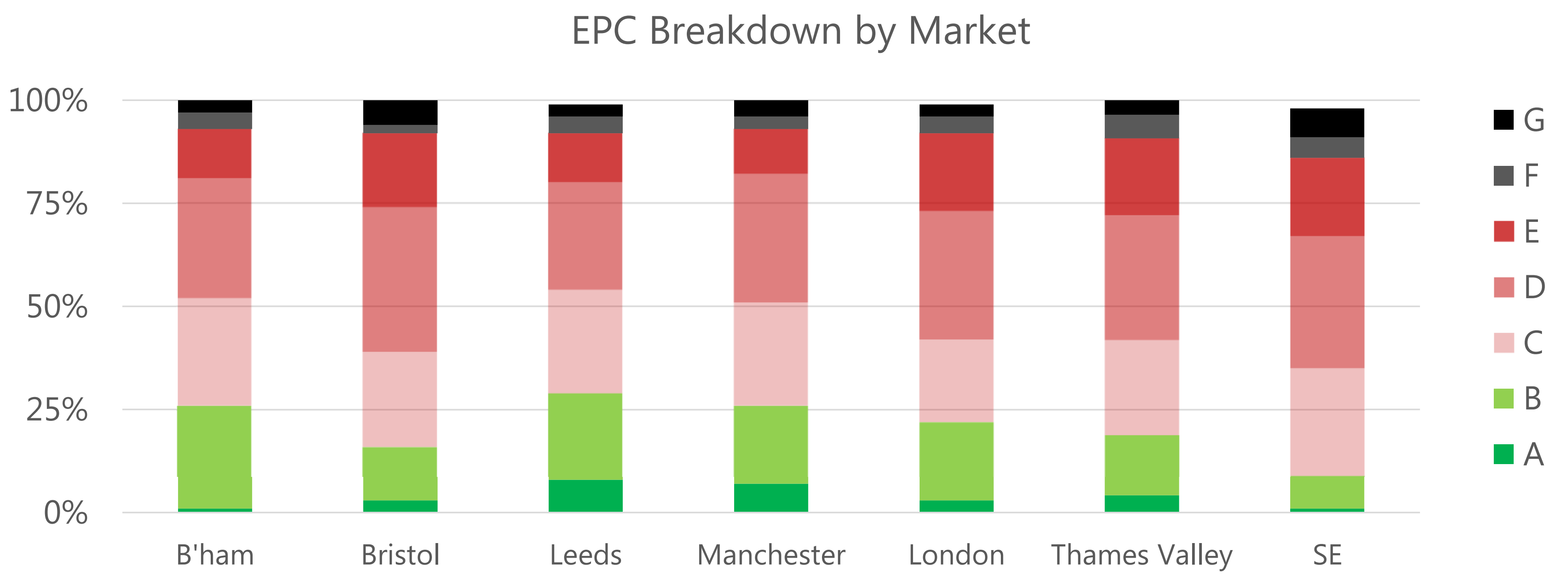
Source: Colliers

New Grade A Vacancy	
Birmingham	1.6%
Bristol	1.9%
Leeds	0.7%
Manchester	1.6%
London	1.5%
City	1.4%
West End	1.1%
Source: Colliers	

Business

Growing risk of stranded assets – tax incentives to come?

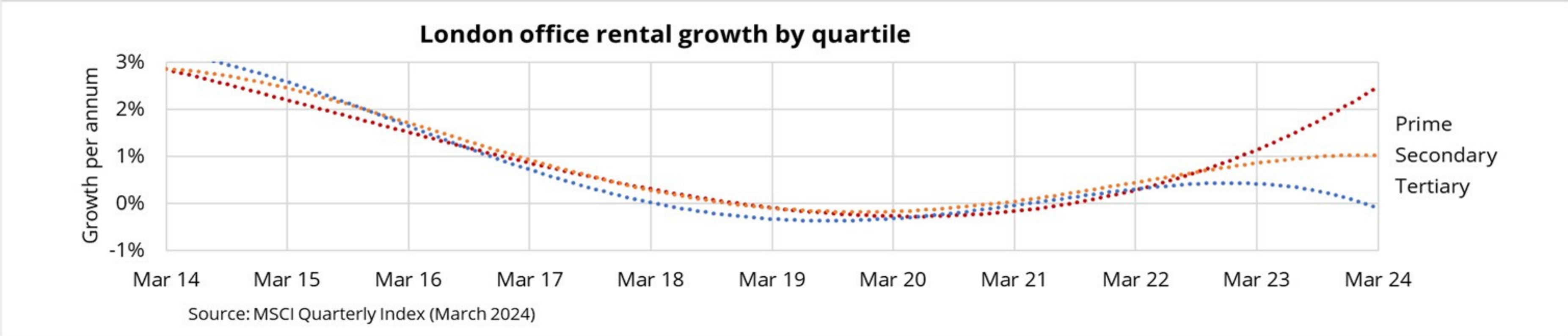
The office quality challenge

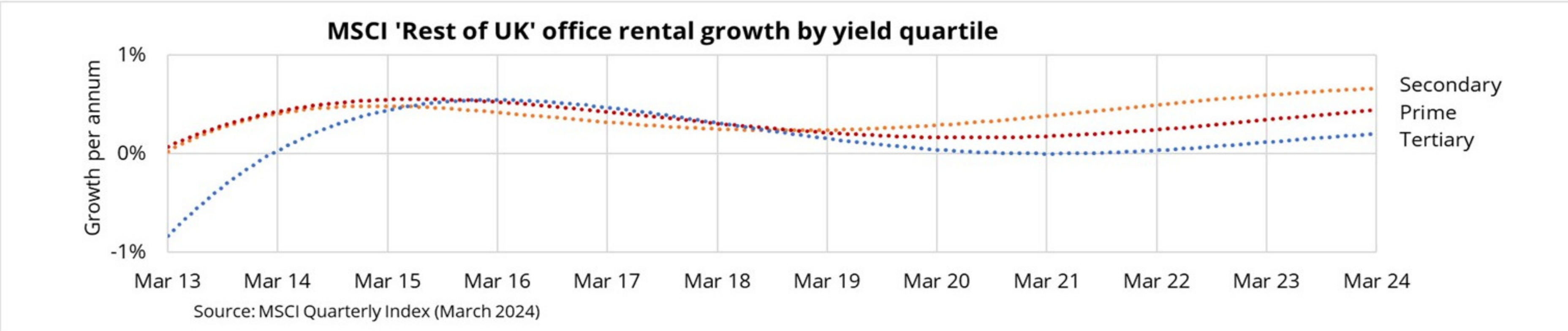


Source: Colliers (UK)

Not especially compelling, but could reflect lack of new Grade A supply

Quartiles show office sector schism?



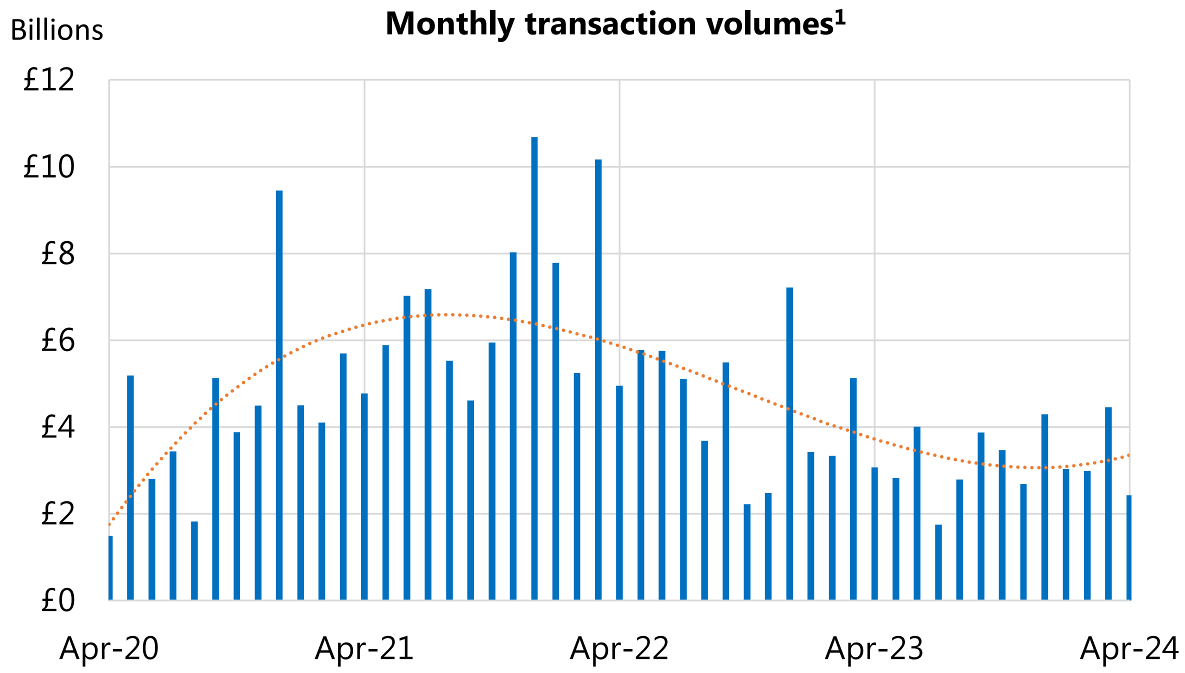


Business

Hope springs eternal!

Transactional recovery not yet evident

- Transactions hindered by lack of price discovery
- Lack of quality investment stock
- Lack of accretive debt
- Risk perceptions heightened
- Risk-free bond yields more attractive than real estate
- Regulatory controls impacting
- ‘Animal spirits’ missing



[1]April data preliminary
Source: MSCI RCA (30-May-2024)

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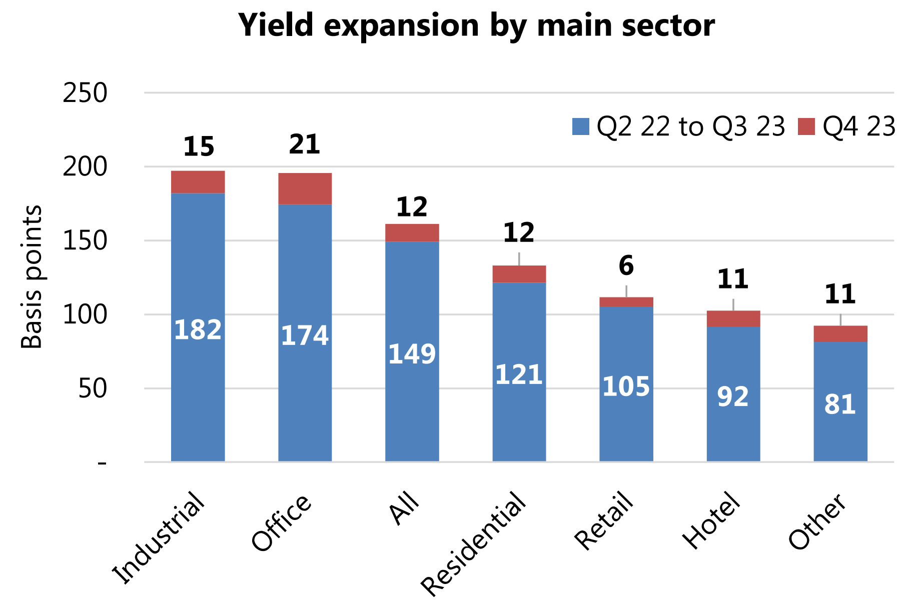
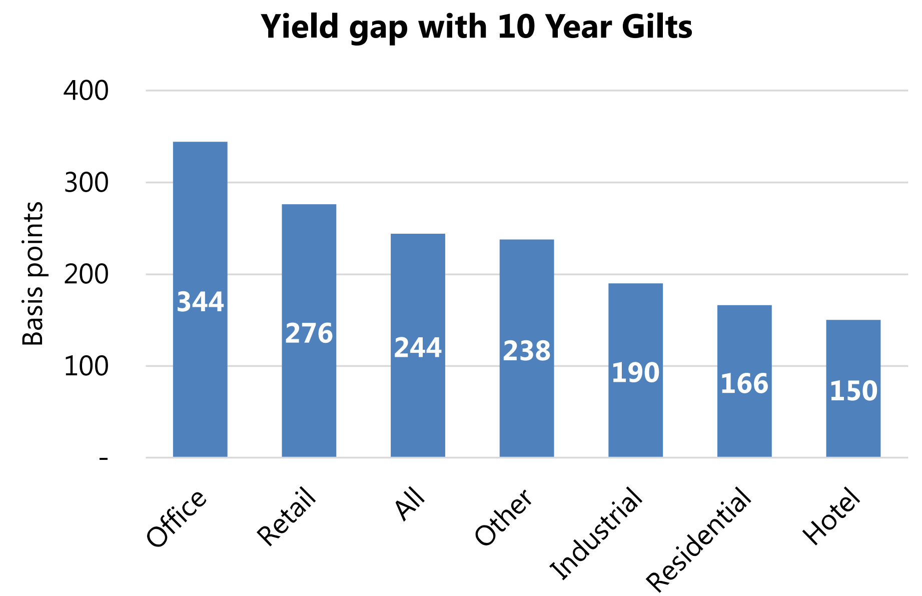
. . . but further expansion expected in specific sectors

Yield expansion may be slowing



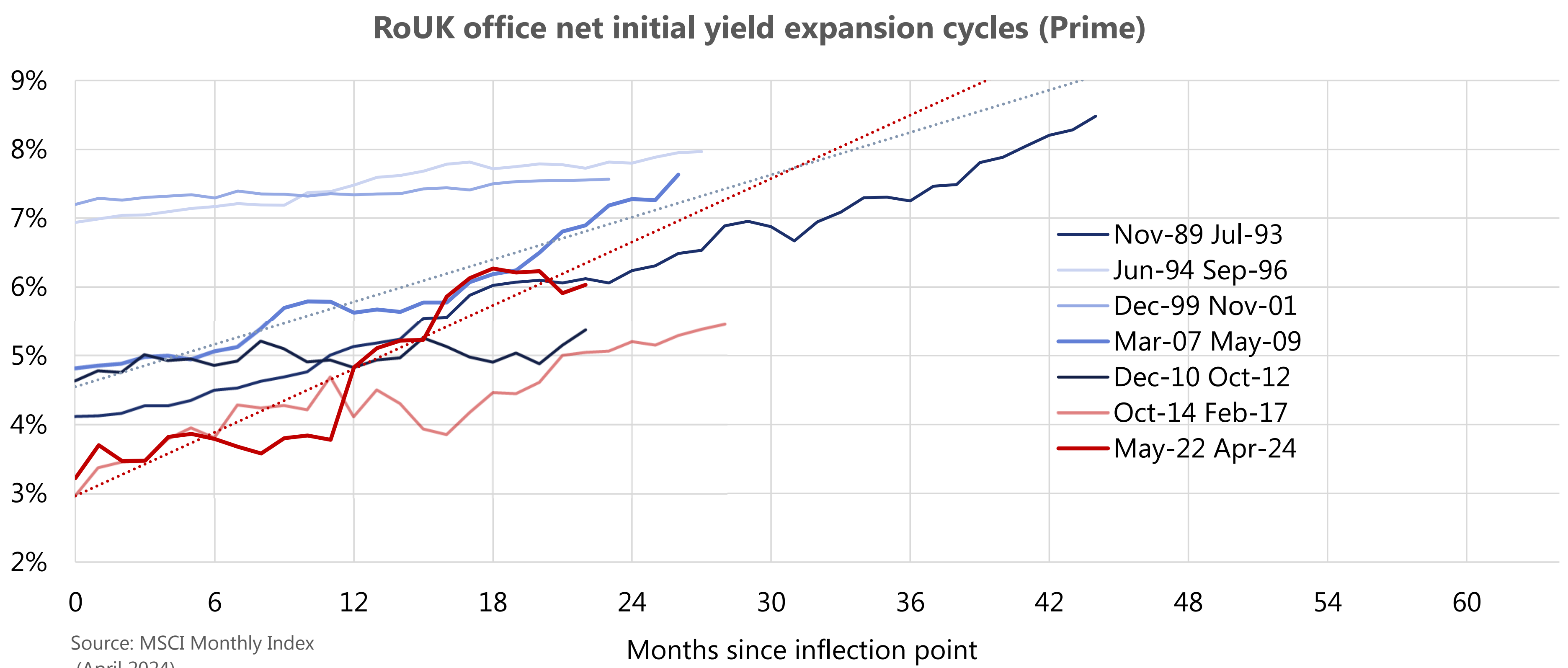
Source: MSCI Quarterly (December 2023)



Source: MSCI Quarterly (December 2023)

Further expansion likely despite recent signs of stability

Yield expansion for RoUK offices



Source: MSCI Monthly Index (April 2024)

Levelling up?

Alive and kicking?

What will Labour bring to the dysfunctional picnic?

Government policy in transition?

45%

24%

9%%

11%

6%

3%

- Commercial property is a perennial victim of **<u>'The Law of Unintended Consequences.'</u>**
- Banking reform eradicated of the debt and development cycle.
- Government restricted finance costs for private BTL investors. Result, severe shortage of rental stock and record levels of rent.
- Housing (especially social housing) likely to receive more attention. Tenant protection? Rent caps?
- Planning reform? Commercial rate reform? Good luck!
- Tax avoidance? Private equity loopholes (carried interest)? Easy targets? Leading to capital flight?
- Net zero. Green tax initiatives? Regulatory slippage?
- Reserved Investor Fund?
- Levelling up?

'The reports of my death are greatly exaggerated.'

Is 'levelling up' alive and well?

Former UK prime ministers back cross-party approach to regional mayors

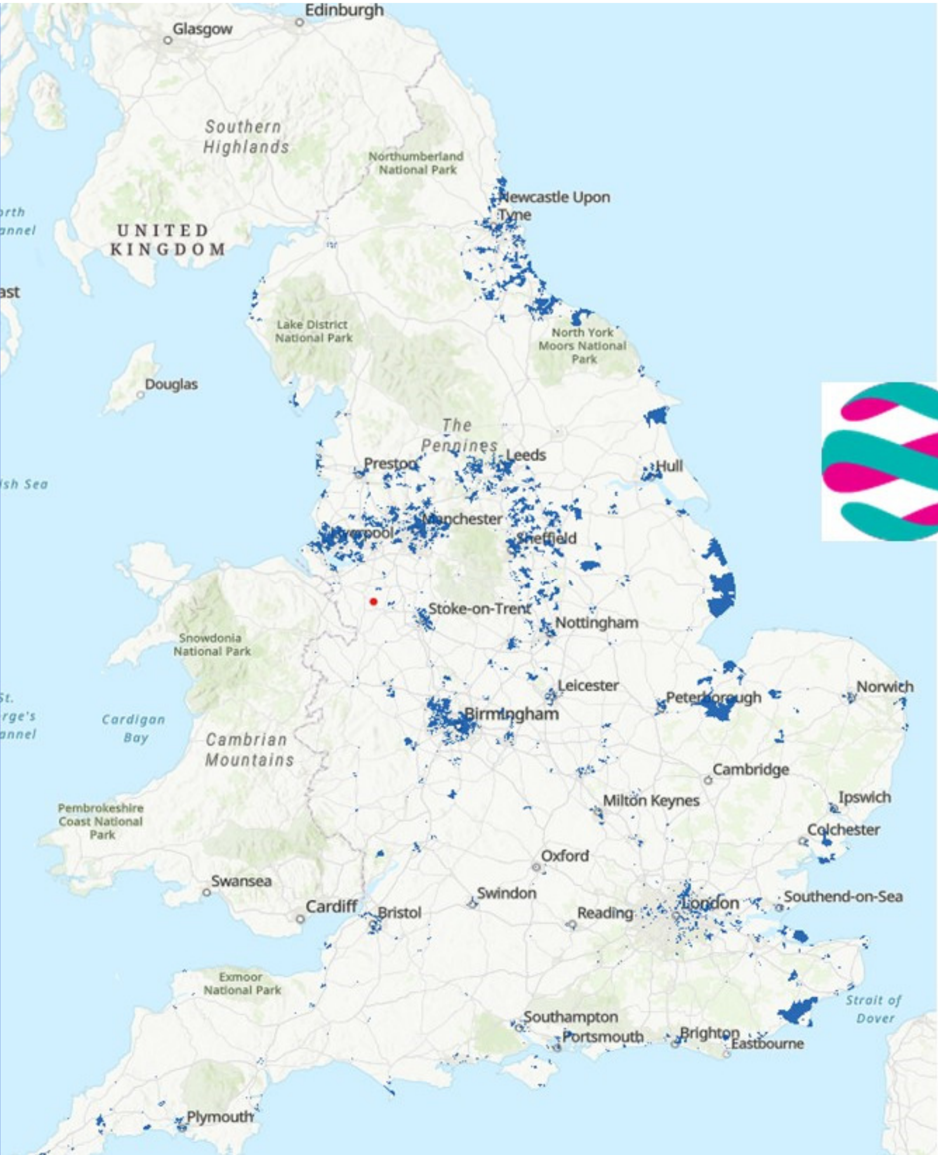
John Major, Tony Blair and Gordon Brown call for end to 'chopping and changing' over devolution, according to Ed Balls review

Former Labour minister Ed Balls: 'Without cross-party political leadership and a commitment to agree a plan and then to stick to it, things aren't going to get better' © Mark Lear/Alamy

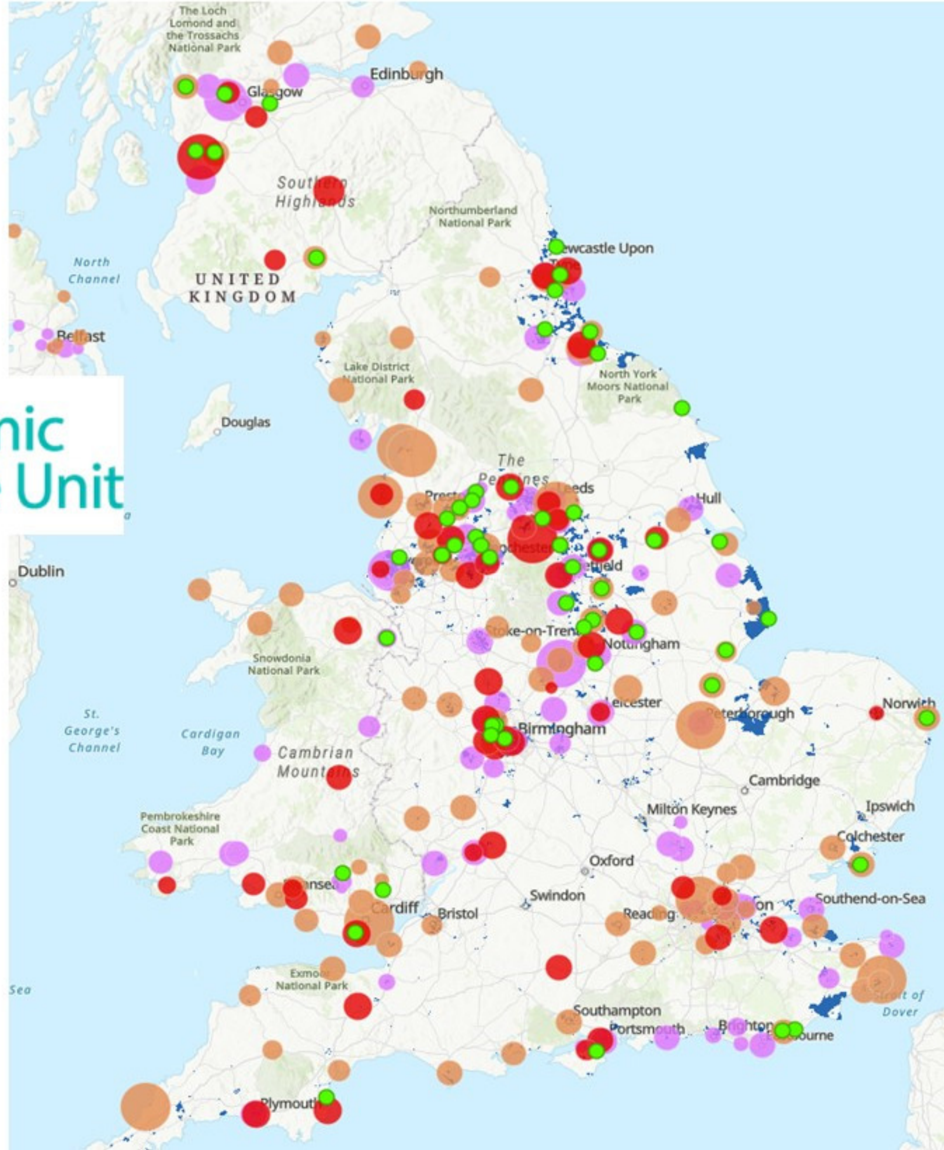
George Parker in London YESTERDAY 88

- Tony Blair, Gordon Brown, John Major, George Osborne call for cross-party approach that will last for two decades

Strange Brew

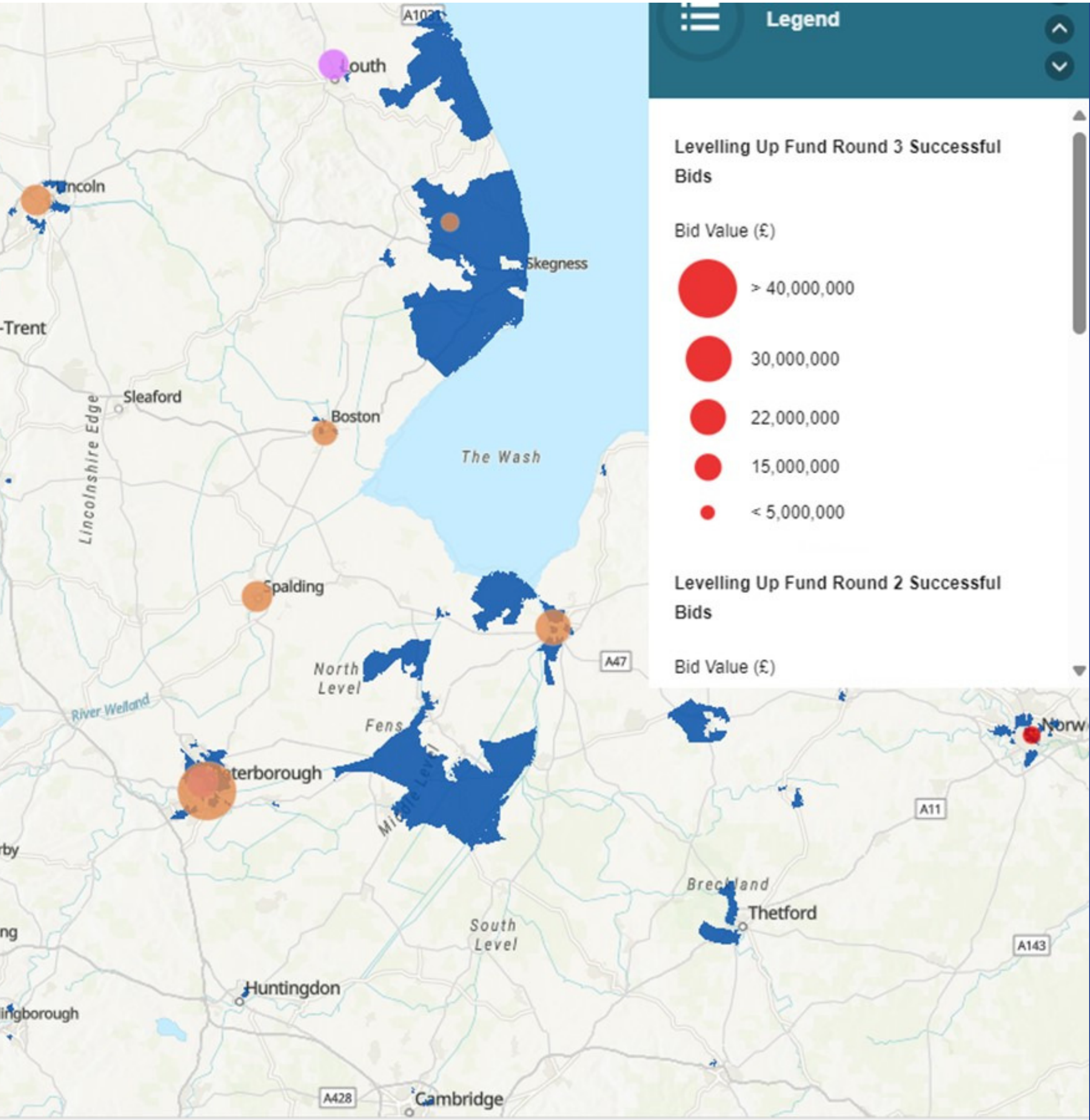


The Economic Intelligence Unit



Areas of deprivation

Areas of levelling up funding



Levelling Up

Round I

- Peterborough Living Lab (£20m)

Round 2

- Cambridge & Peterborough CA Peterborough Station enhancements and connectivity (£47.9m)
- Norfolk CC Southgate transport & travel links (£24m)
- Spalding Castle Sports Complex/ Community Centre refurb (£20m
- Boston BC Rosegarth Square Masterplan (£14.8m)
- Lincoln Western Growth Corridor – transport (£20m)

Round 3

- Norwich – Miles Cross Health, Wellbeing & Economic Activity (£7.6m)

£20 million for Healthcare Training Facility (+£20 million from partners)

Bolton – Institute of Medical Science

Partnership University of Bolton, Bolton Council, Bolton NHS Foundation Trust and Bolton College

£20m Levelling up funds for IMS
£20m Levelling up funds for town centre regeneration
£23m from Towns Fund
£12m revamp of the Octagon Theatre

Business

Remediation and regeneration is key

Levelling up? ✓

- *Funding: Levelling up fund grant of £48 million in 5 installments. Additional funding: £17 million from Peterborough CC, Network Rail, LNER. Improved pedestrian/cycle access and linkages to other targeted regeneration areas. C&P CA is in charge of project delivery. Planning/construction to begin in 2024 with further development through 2028.*
- *PSQ is a central piece in a wider £600 million city regeneration. Designed to enable private investment in commercial and residential development.*
- *Fletton Quays government hub (1,000 staff from Home Office, DEFRA et al. Part of £120 million Fletton Quays regeneration project. Peterborough Investment Partnership Council and JV parnters developed GPA's first new build hub. Forward funded by landowner L&G. Peterborough CC leases their new offices and are now borrowing £50 million to buy the building from L&G.*
- **Update: government approval of outline business plan (March 2024)**
- **Full business case submission Autumn 2024**

POWERED BY LEVELLING UP

Nick Sandford
Mayor PCC

Nik Johnson
Mayor C&P CA

Peterborough Station Quarter (PSQ)
(Gateway to the East of England)

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Remediation and regeneration is key

Levelling up? ✓

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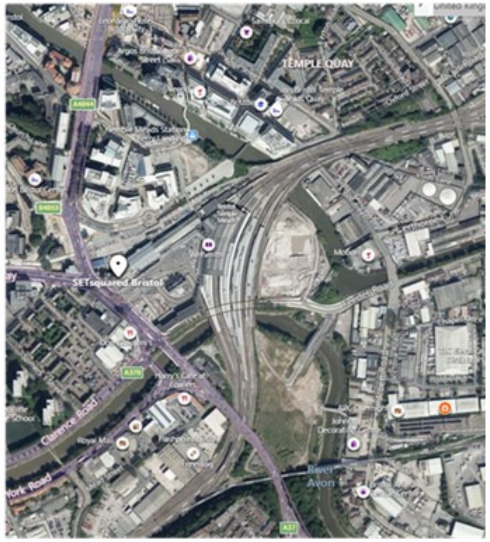
LEVELLING UP

NOMA Manchester

Paradise Birmingham

Bristol Temple Quarter



Leeds South Bank

Peterborough Station Quarter

If by 'levelling up' you mean regeneration, then evidence is abundant of projects across the UK enabled by local combined authorities, central government seed funding, and private investment.

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Business

Enables authorised investors to access unauthorised funds

Reserved Investor Fund (Contractual Scheme)

- **Authorised investors include:**
  - ***i.*** ***<u>Institutional investors</u>***
  - *ii.* *Professional clients with financial knowledge*
  - *iii.* *High net worth individuals (family trusts)*

- **Unauthorised funds offers advantages:**
  - *i.* *Less regulation & oversight – cost savings*
  - *ii.* *Higher returns due to flexible strategies*
  - ***iii.*** ***<u>Diversification into unique assets/niche markets</u>***

- **Advantages for Real Estate**
  - ***i.*** ***<u>Investment in less liquid long-term regeneration</u>***
  - *ii.* *Flexible approaches to property holdings*
  - *iii.* *AREF supported*

- **Disadvantages**
  - ***i.*** ***<u>Greater risk and lack of oversight</u>***
  - *ii.* *Opaque disclosures*
  - *iii.* *Less investor protection*
  - *iv.* *Liquidity*

Business

Volatility and instability the new normal

Outlook for 2024 and beyond

- US economic and foreign policies under a Trump White House is likely to increase uncertainty:
  - US Fed independence may be challenged
  - Risk premia may be added to US treasuries
  - Capital flight possible due to *'dollar weaponisation'*
  - Protectionism will destabilise world trade
  - Isolationism likely to encourage autocrats threatening world rules-based order (sovereign equality, national self-determination, business regulation, etc.)
  - Fiscal and trade policies likely to prove inflationary

Business

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Accelerating success.

Business