



UK Economy & Property

When will conditions be right for recovery?

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Professional Conferences, BAWA, Bristol, March 2024

Agenda

- 01 GDP, inflation and interest rates**
- 02 Regulatory constraint on property market**
- 03 Property metrics**
- 04 'Levelling up' update**

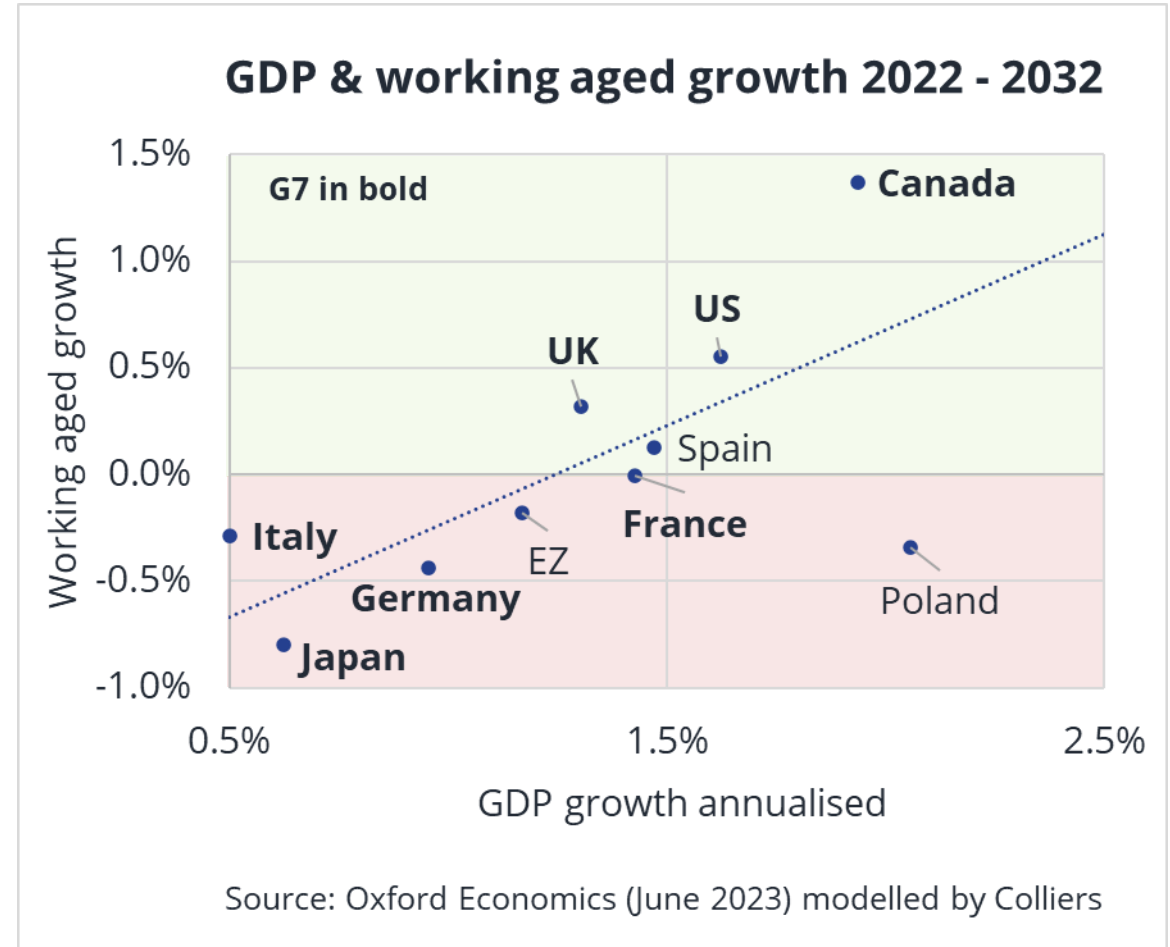
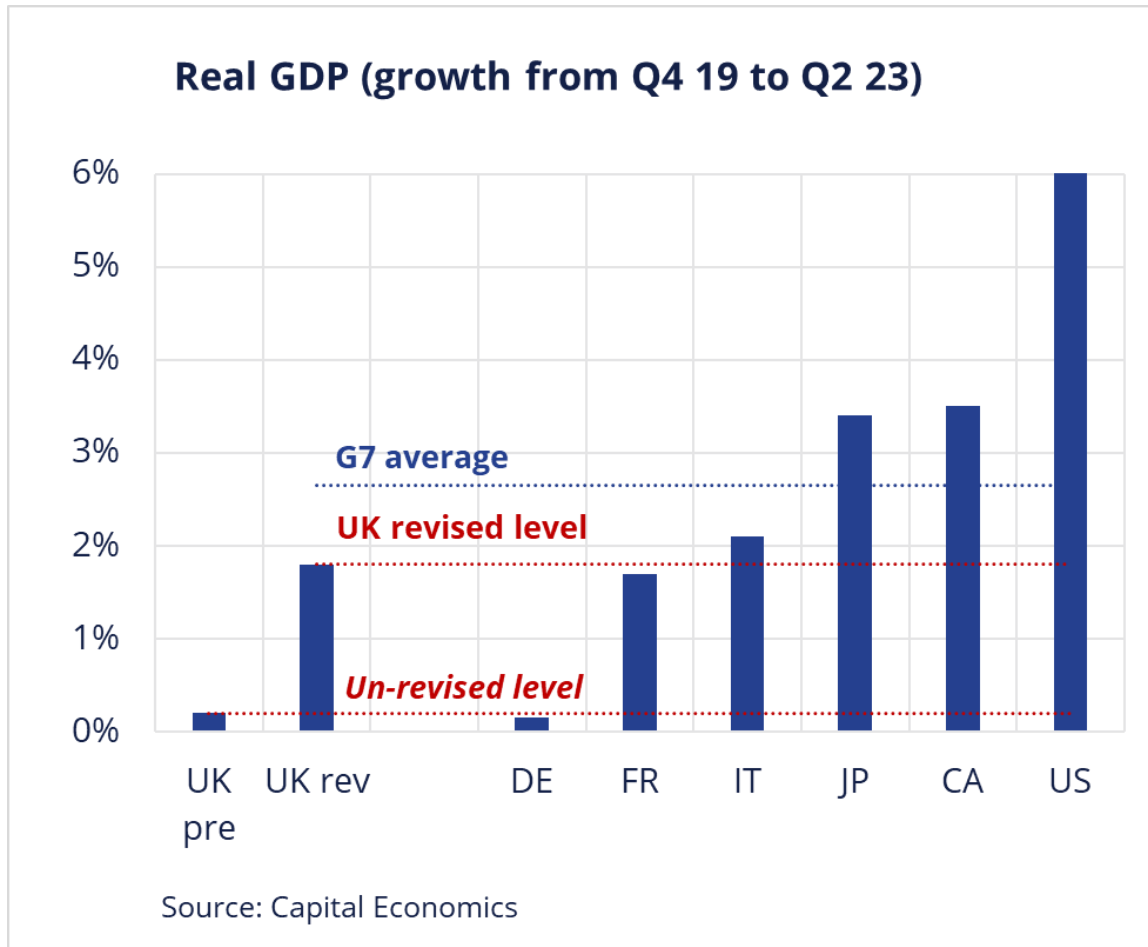
UK inflation [+ Add to myFT](#)

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

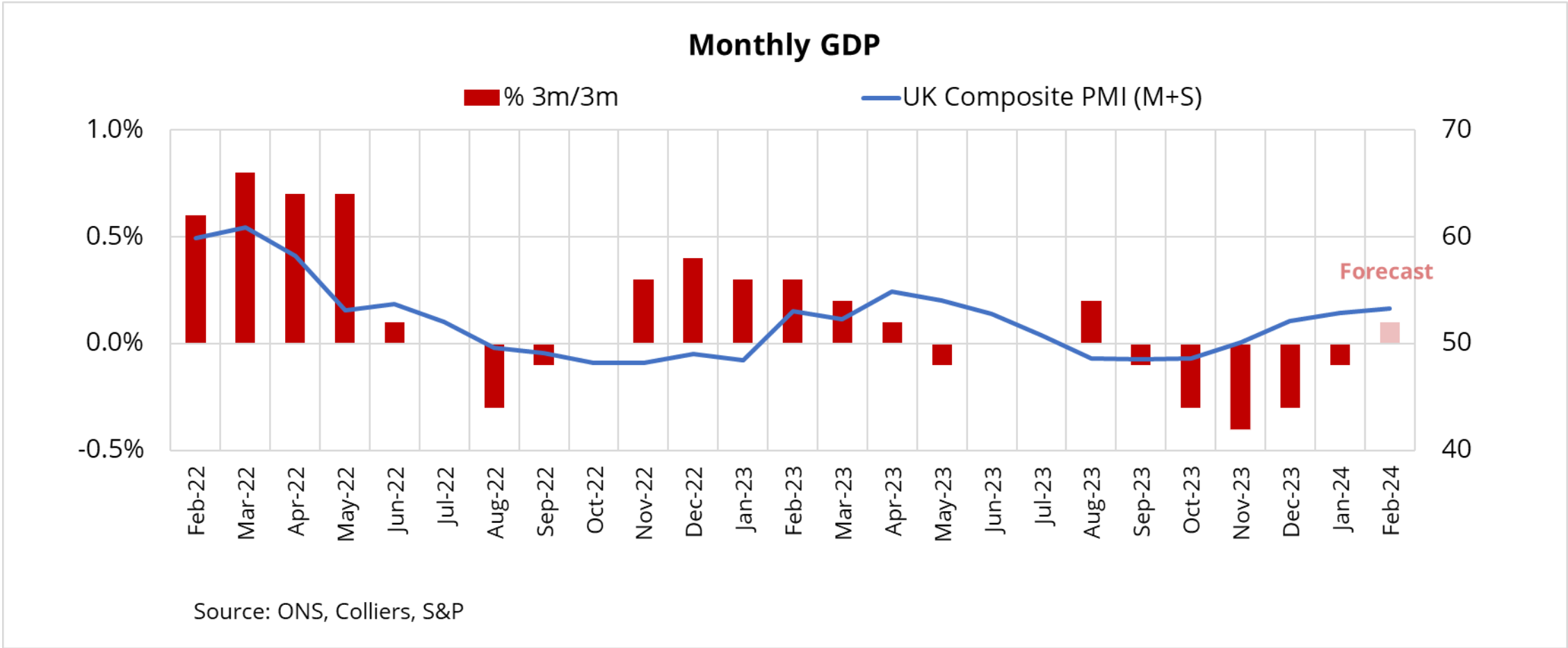


Is the UK really lagging the G7 as the media reports? Large revisions to GDP



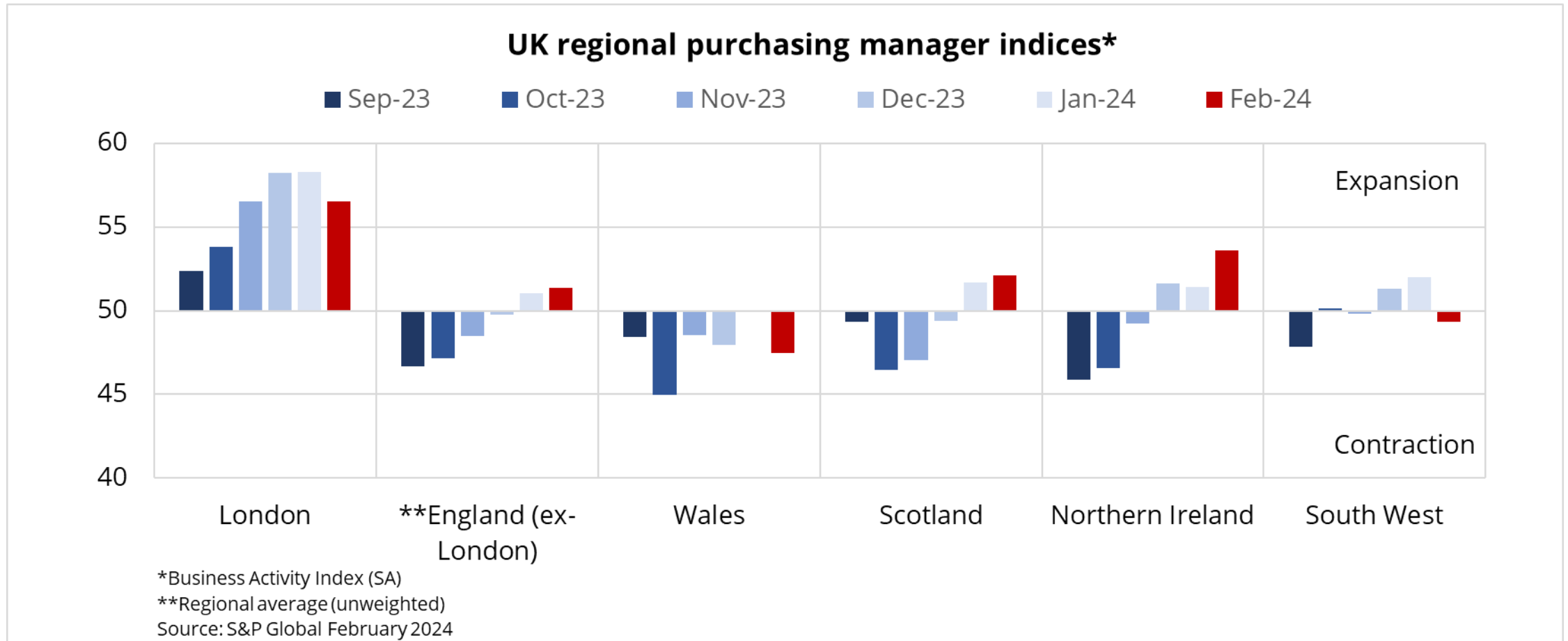
Is this the soft landing?

Recession? What recession?



Depends where you are and whom you ask.

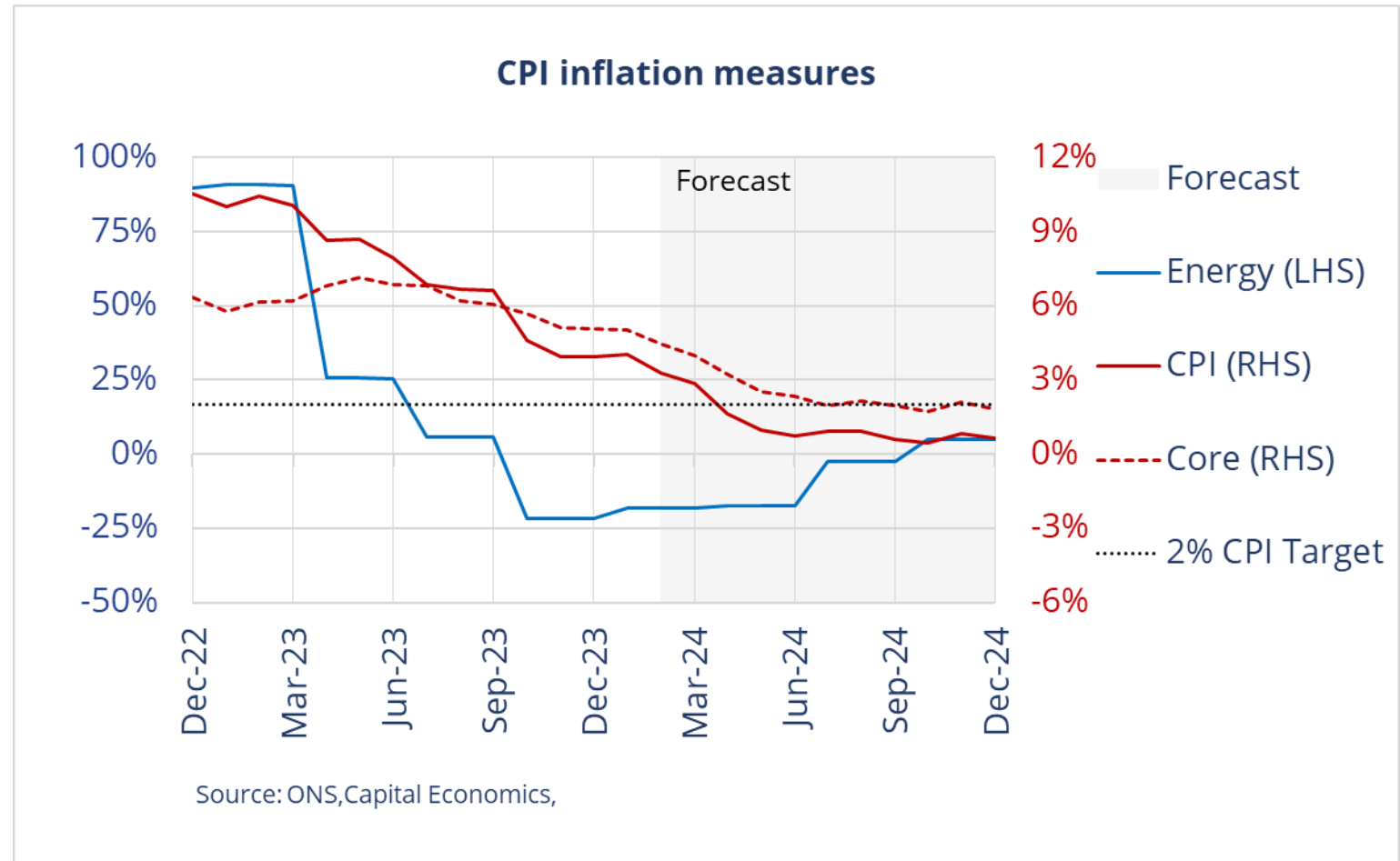
Recession? What recession?



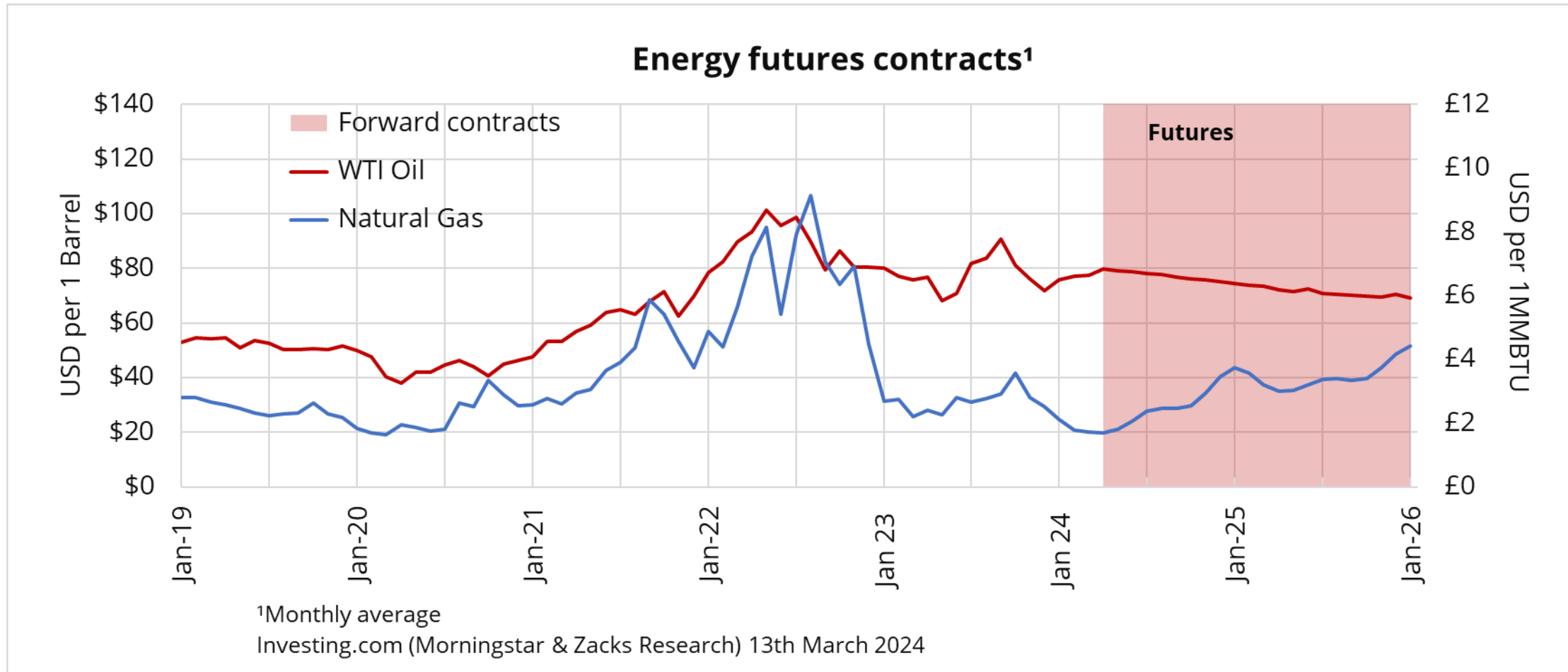
It's about energy and supply chain recovery, less about the Bank Rate Inflation gives way to 'deflationary risk'!



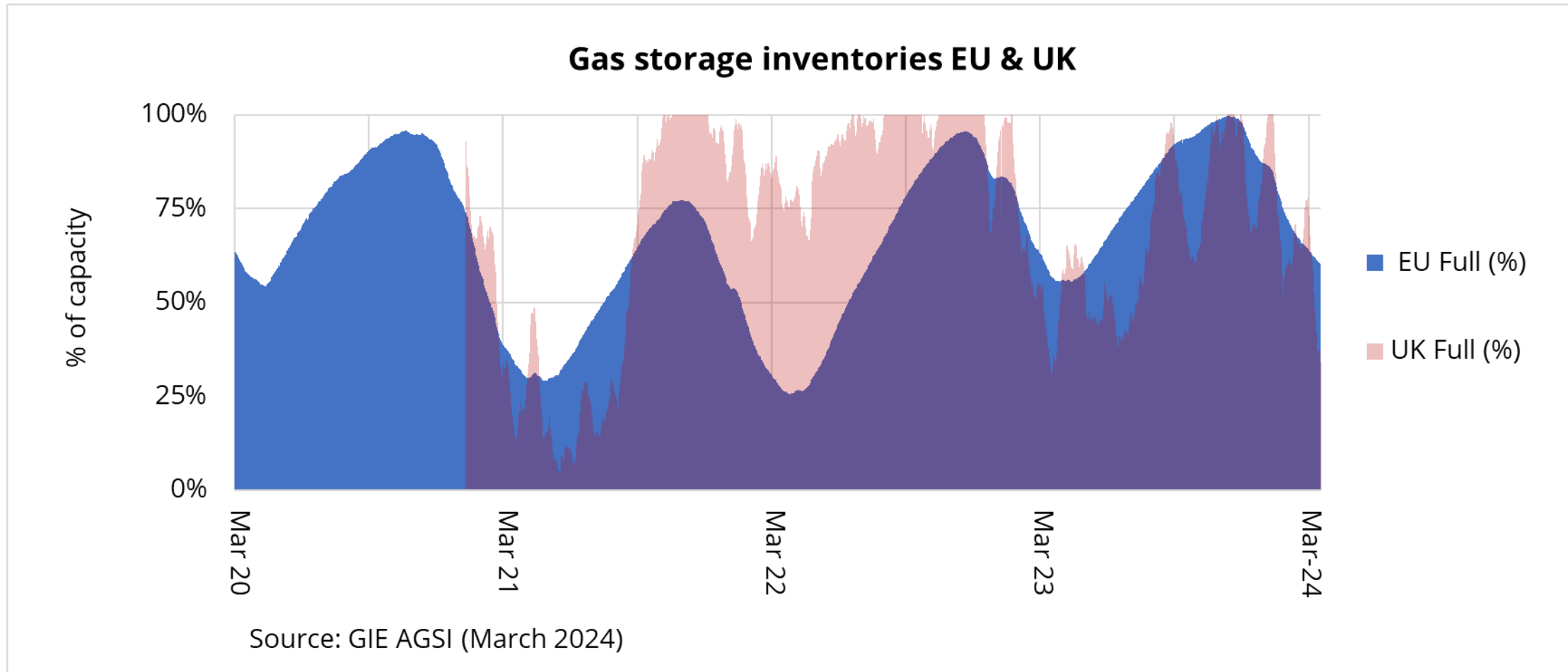
- Base effects driving inflation lower
- Bank may have overtightened
- Look for mid-year rapid rate cuts
- Prices are still high though



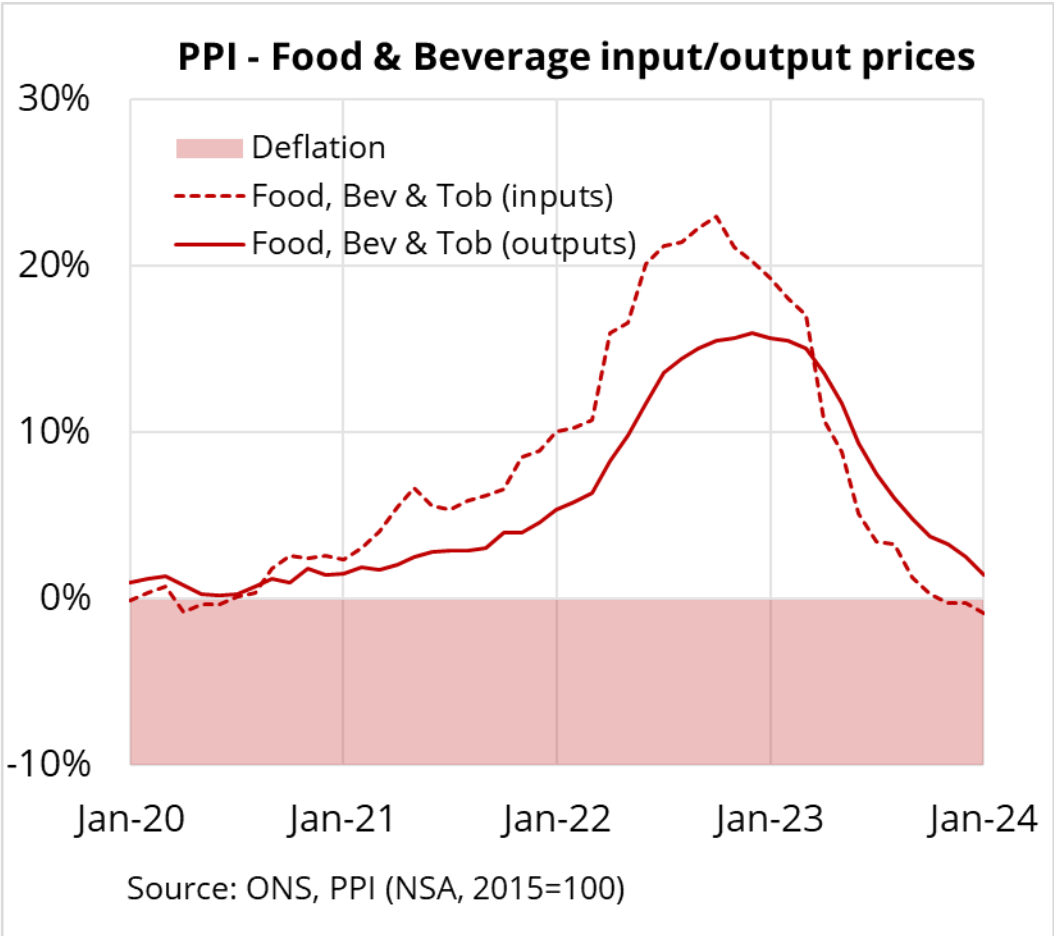
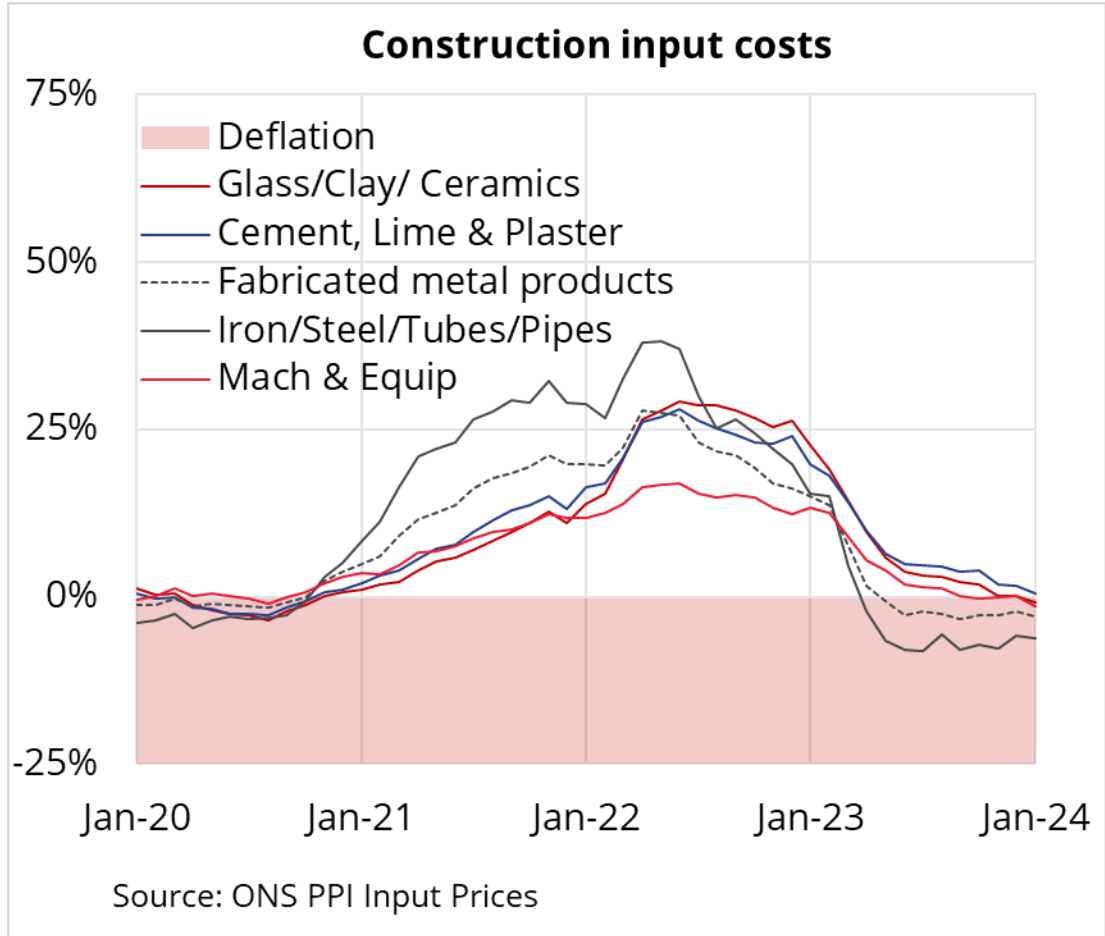
Supply chains have shifted substantially and have greater security! Energy supplies already deflating



Supply chains have shifted substantially and have greater security! Gas reserves at comfortable levels



Commodity input costs deflating. Output inflation will follow! Inflation gives way to a 'deflationary risk'!



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?

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

When will the Bank of England begin rate cuts?

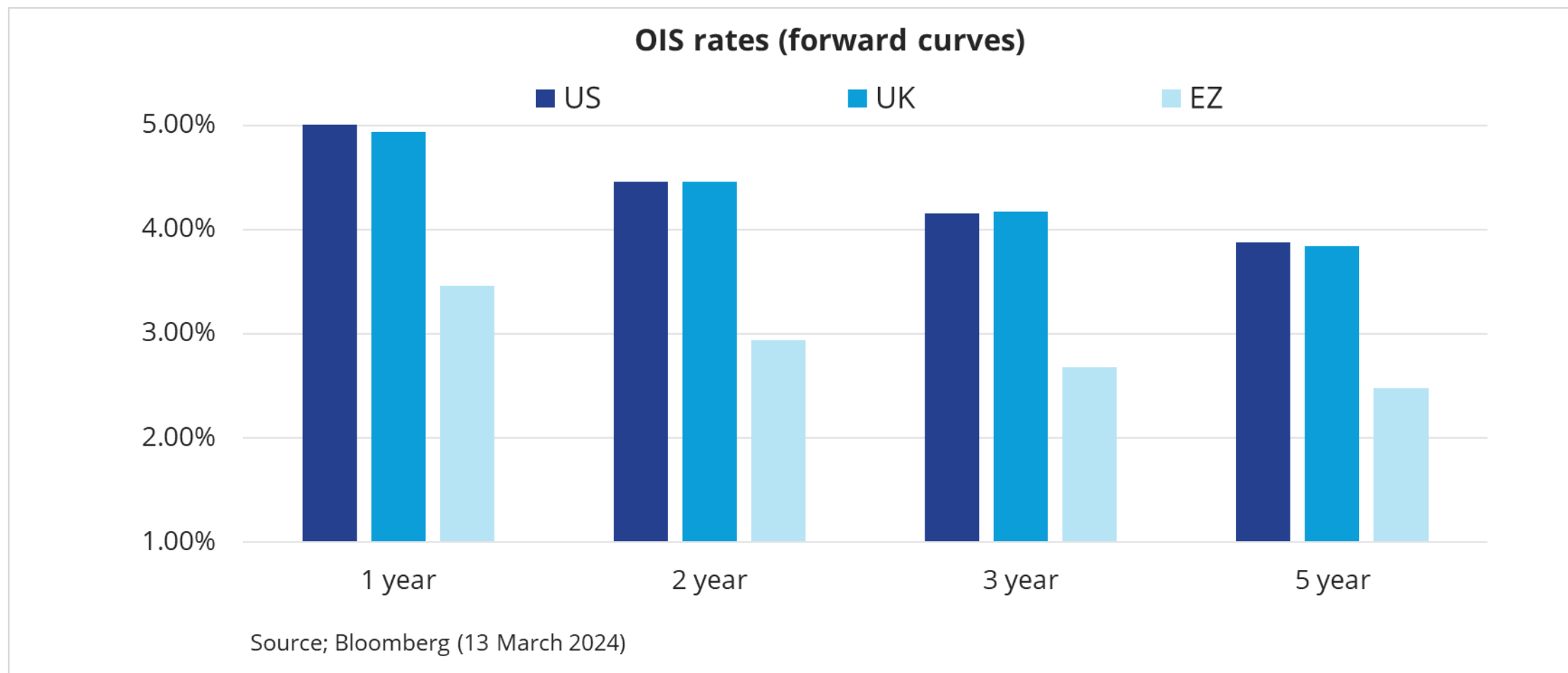


Huw Pill

Depends whom you ask?

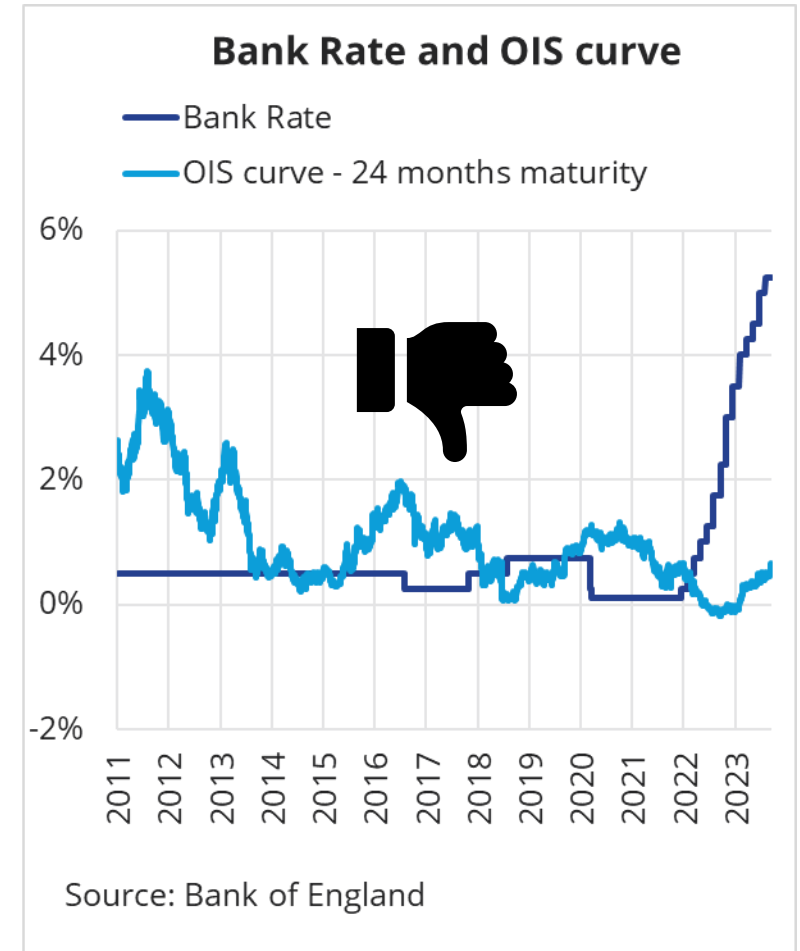
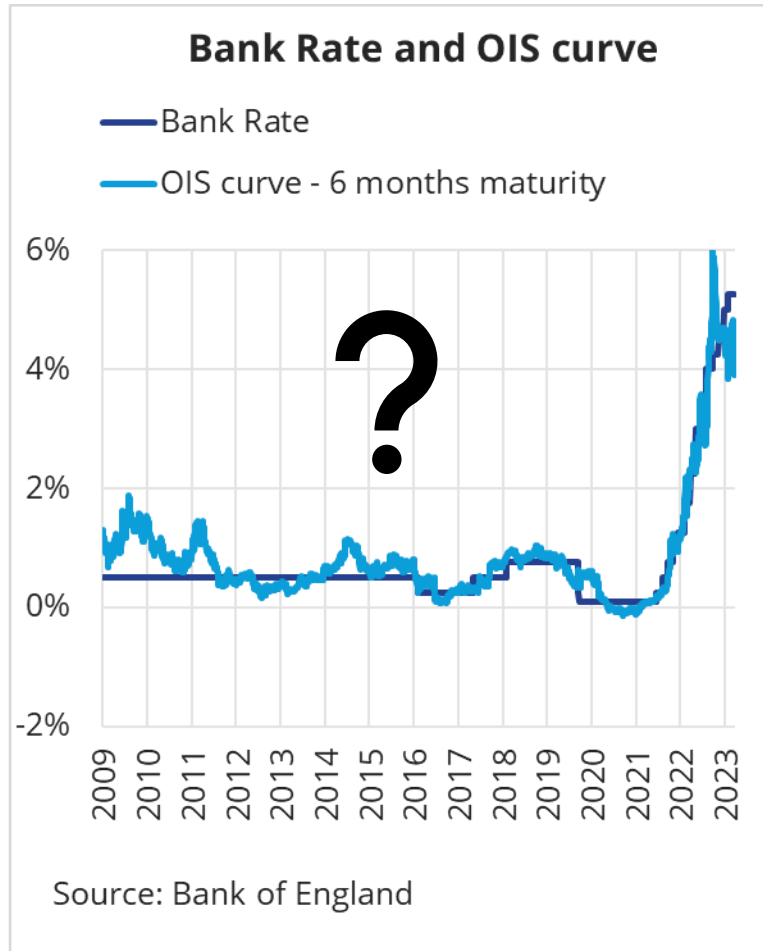
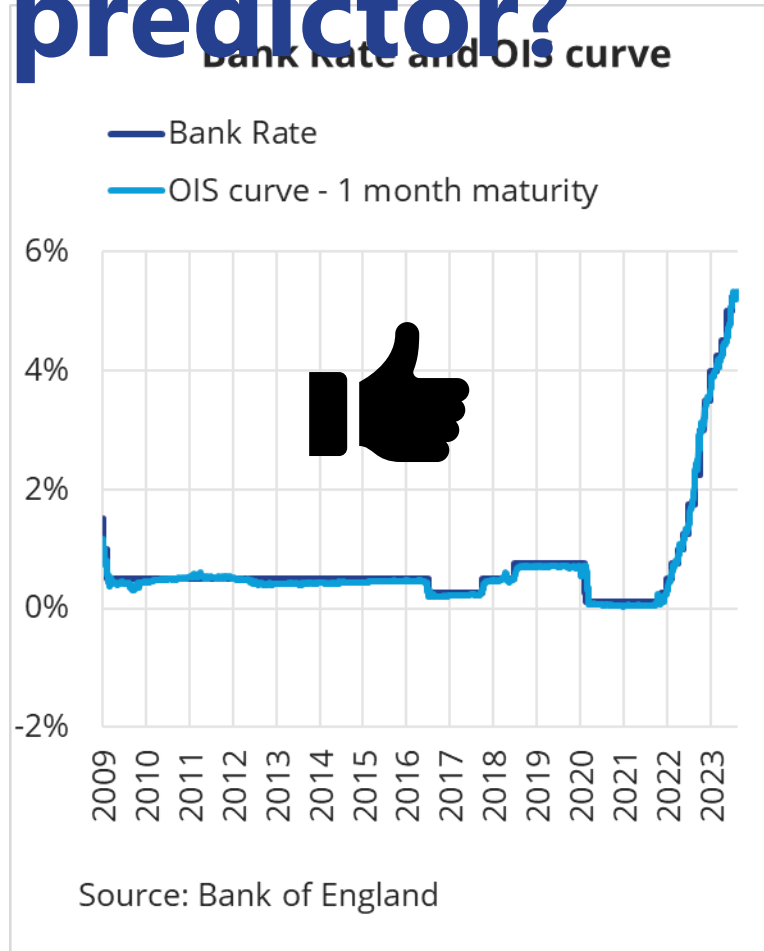
Not a strong indicator of base rates beyond 6 months

Overnight indexed swaps suggest slow decline



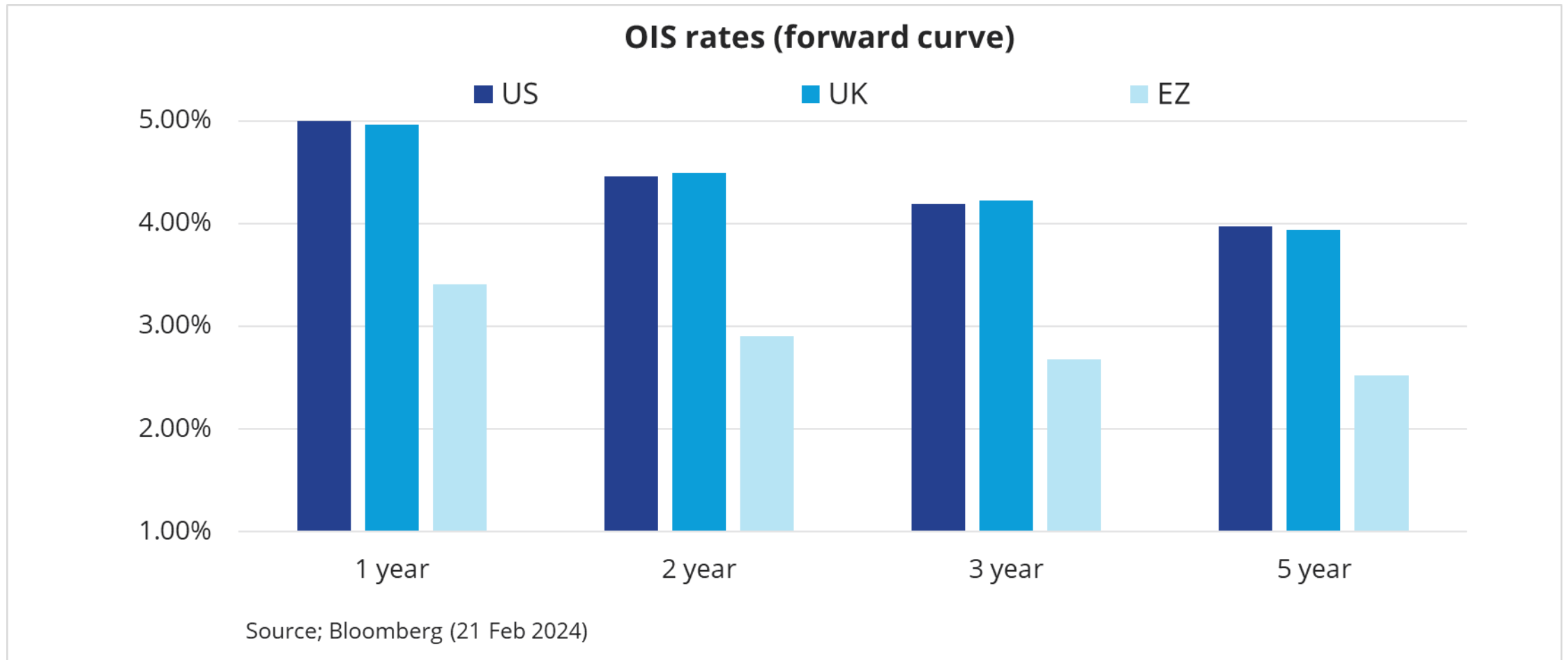
Depends on time frame

Is the OIS forward curve a good predictor?



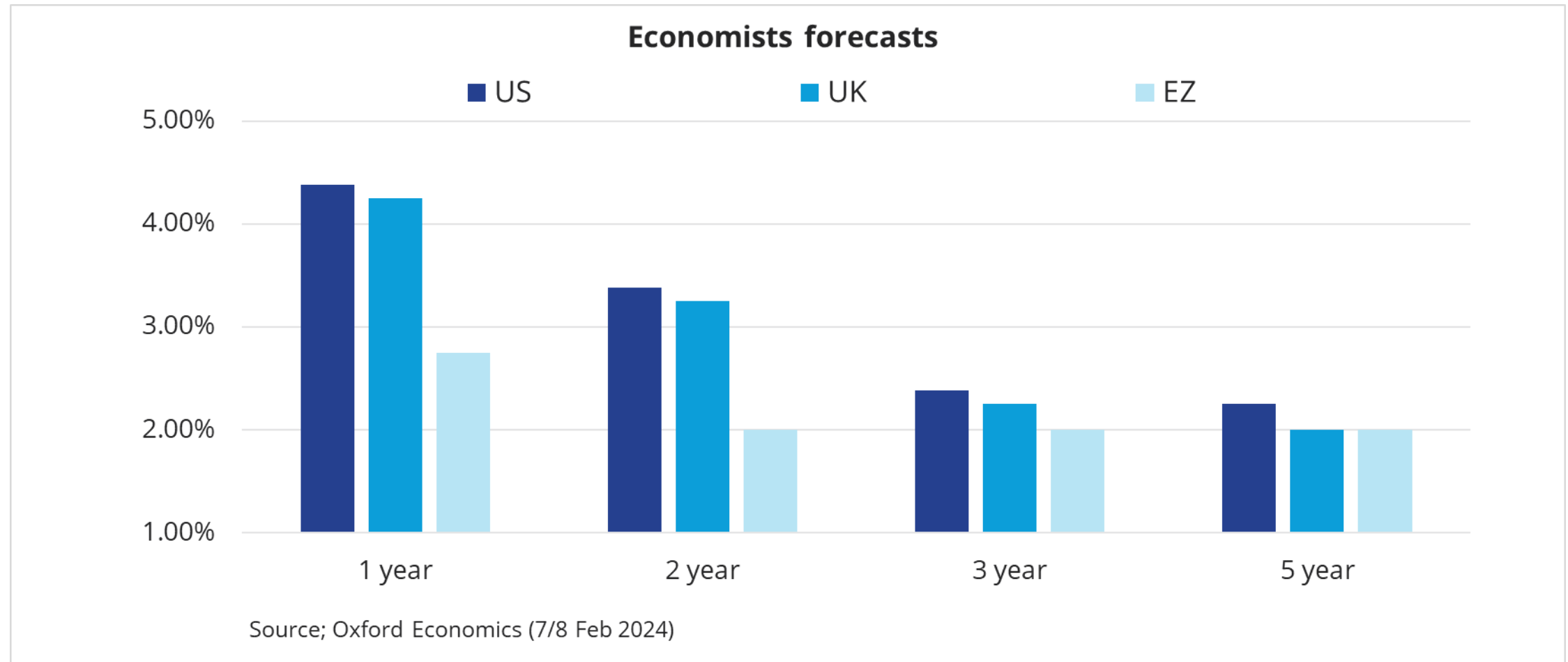
... but that is about all they show

Overnight indexed swaps suggest bank rate peak

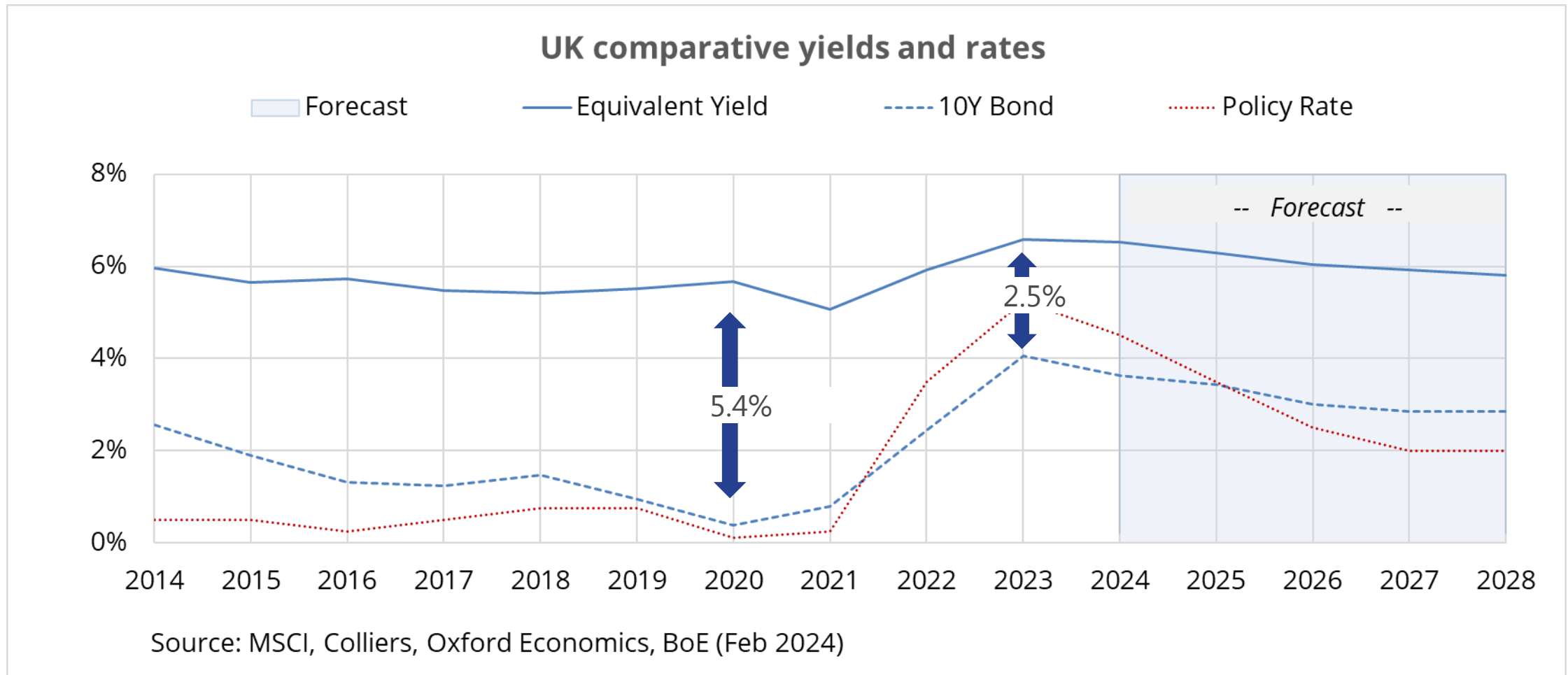


The real question for real estate is where rates will land (R^*)

Economists forecast suggest a more rapid decline



Scope for returns based on yield compression is much reduced! Importance to commercial real estate?



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!



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



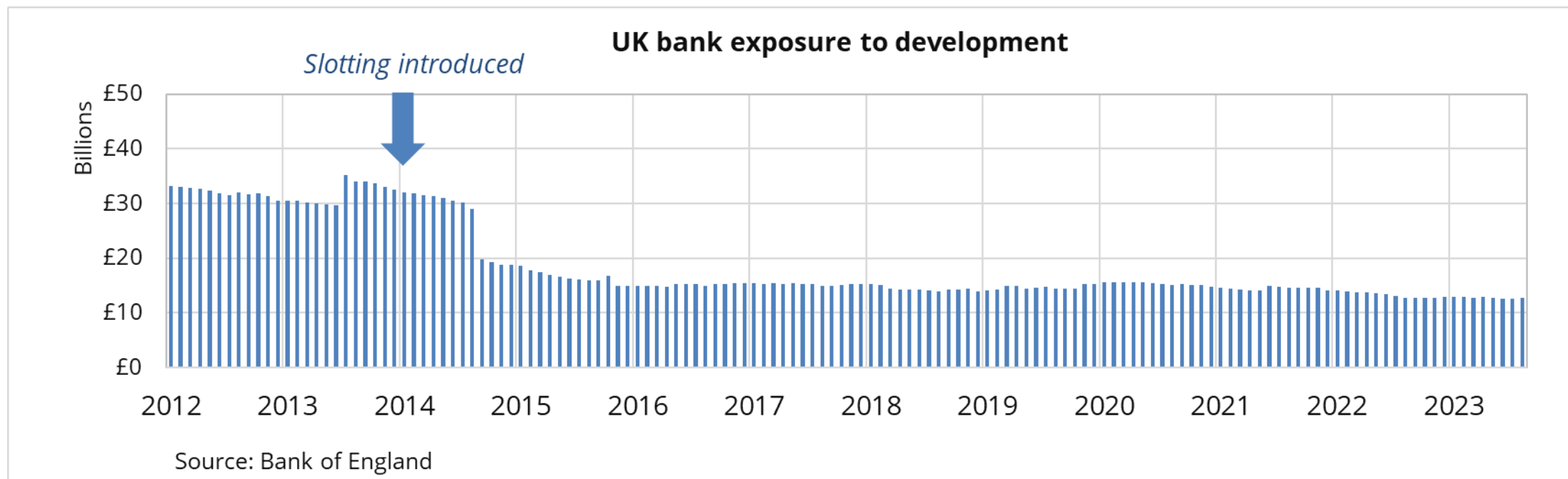
Maturity	Cat I Strong	Cat II Good	Cat III Satisfactory	Cat IV Weak	Cat 5 Default
< 2.5 years	50%	70%	115%	250%	Write off 50%
=> 2.5 years	70%	90%	115%	250%	Write off 50%

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

Exposure to development fell

Impact of 2014 GFC reforms

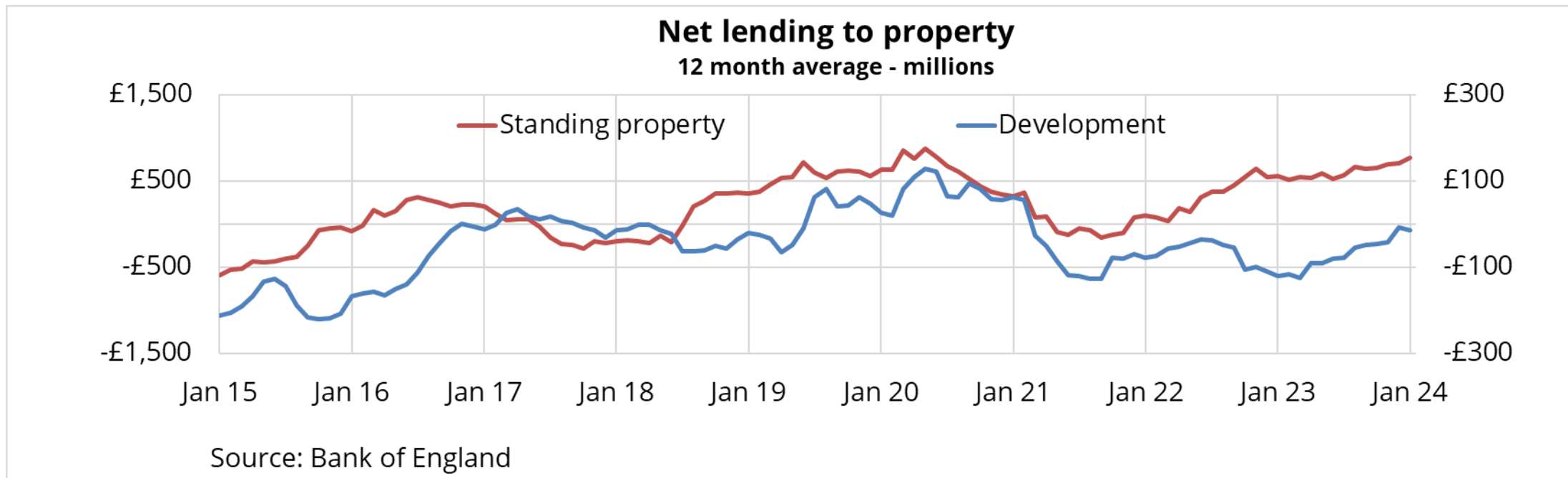


- Bank LTVs fell from 65% to <55% (2023)
- Institutional lenders followed in risk-off mode
- Spec development driven by equity only
- Debt and development cycle greatly curtailed

UK Banks	CRE Development Exposure	Net lending per annum
2011-13	£33bn	-£1.4bn
2014 - 23	£17bn	-£2.1 bn

Exposure to development fell

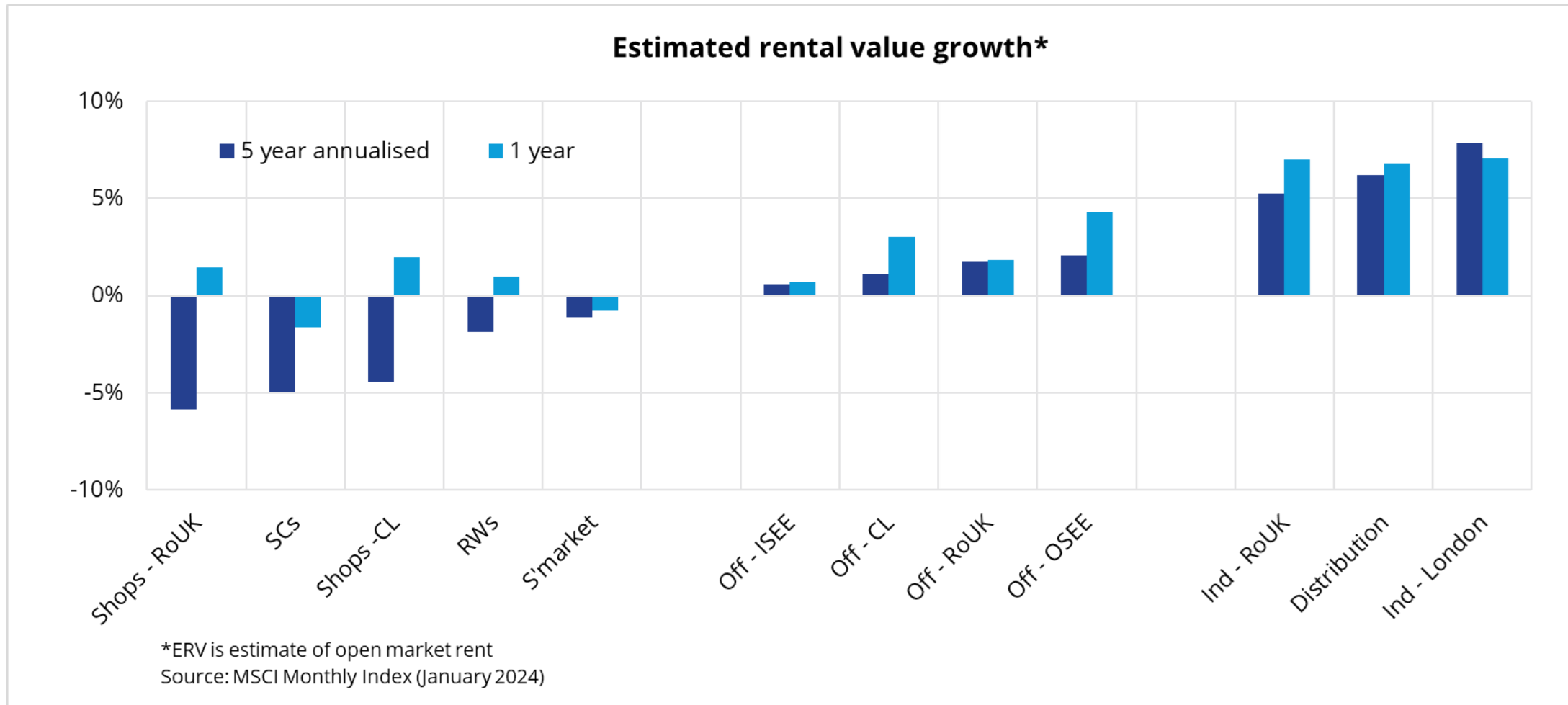
Impact of 2014 GFC reforms



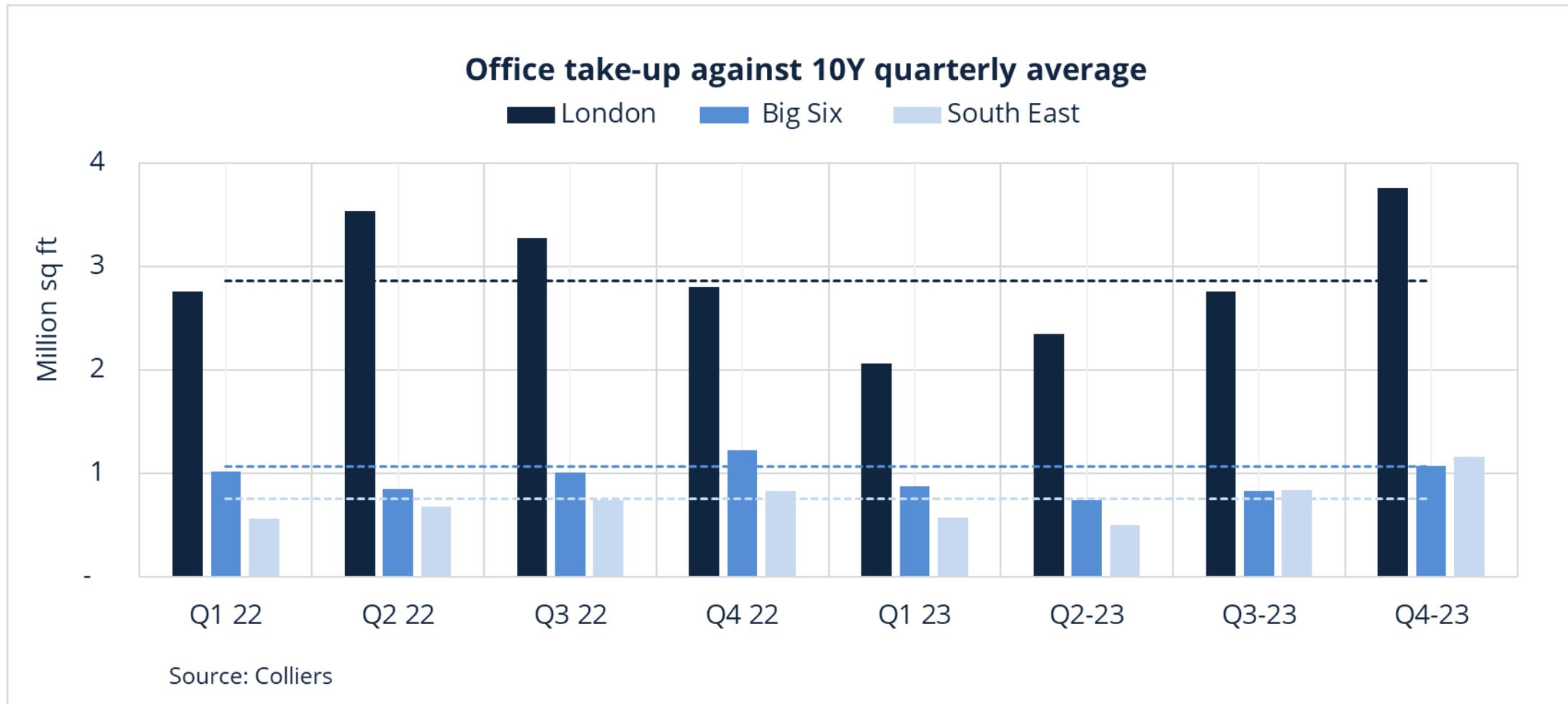
- Latest data shows little change
- Debt advisory specialists remain busy matching equity with debt opportunities including senior debt positions

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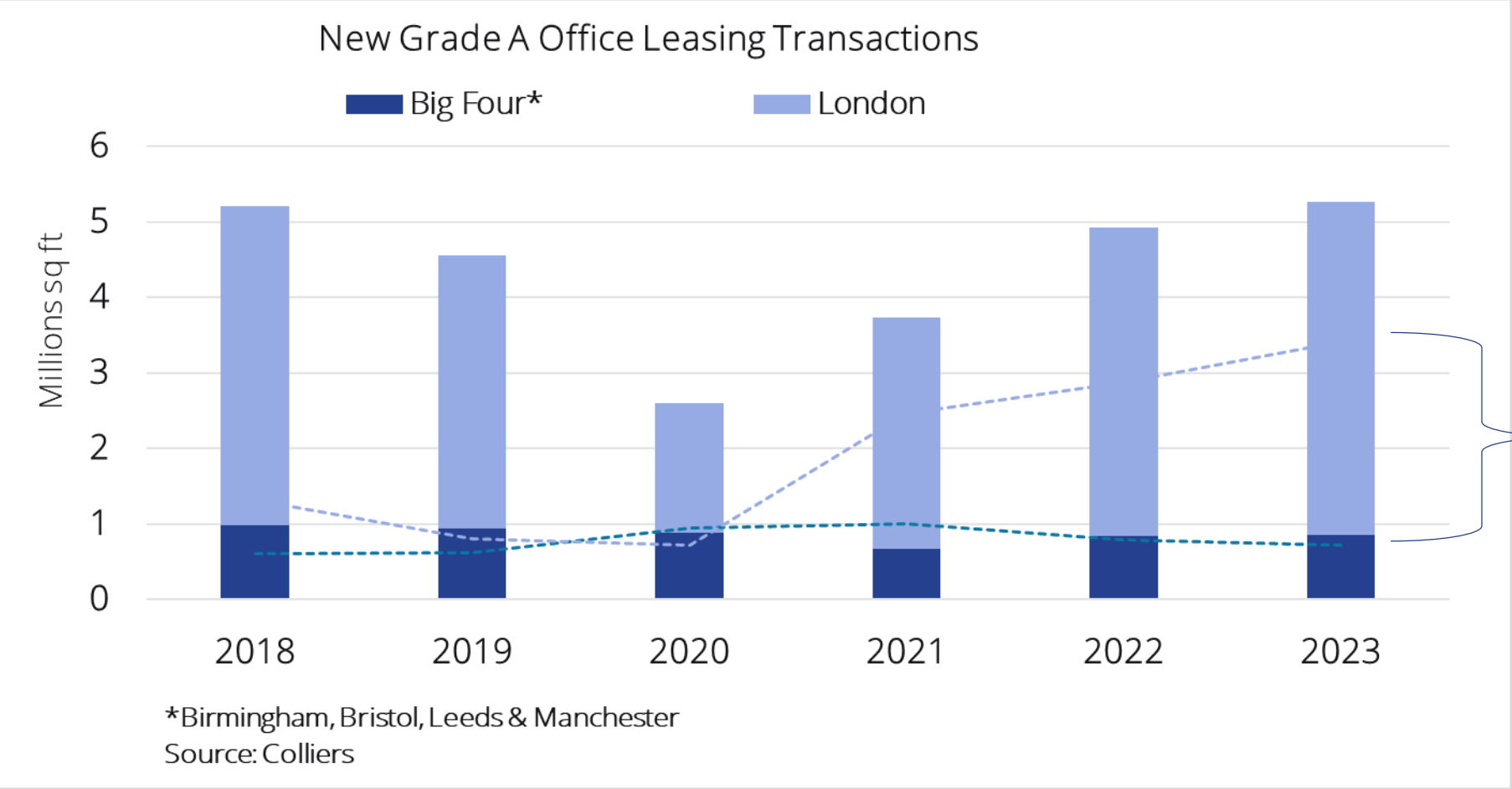
... in the absence of quality rental stock
Rental values continue to show strength



Stronger sentiment and/or forced decision-making? Take-up on a strengthening trend UK-wide



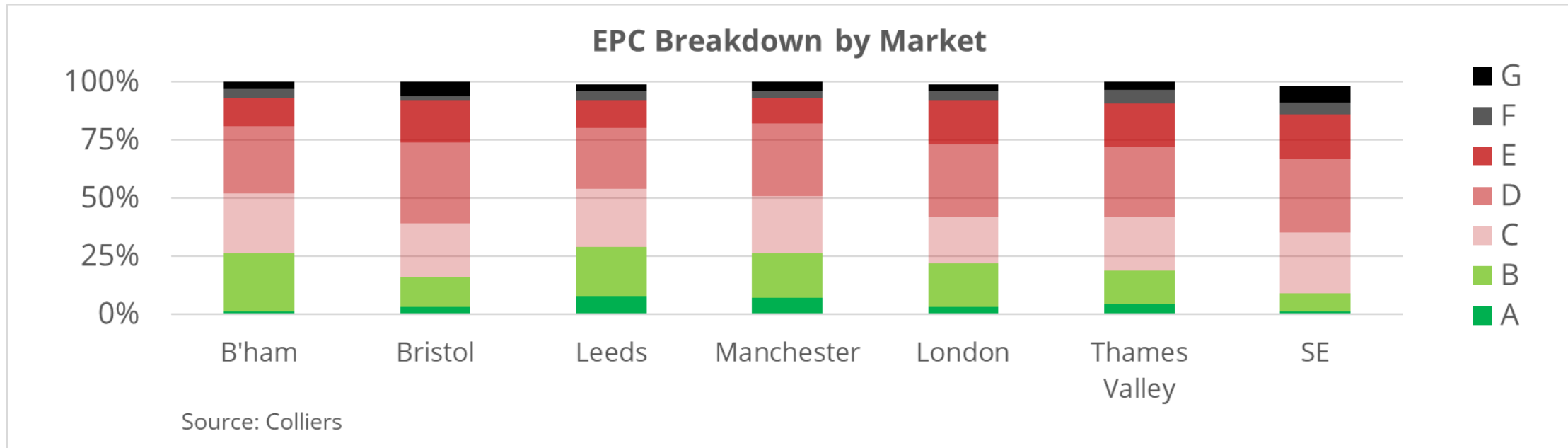
Regional take-up inhibited by lack of available Grade A product Demand recovering after pandemic hiatus



If you fund it, they will come!

Growing risk of stranded assets (not easily upgraded/ resurrected for alternative use)

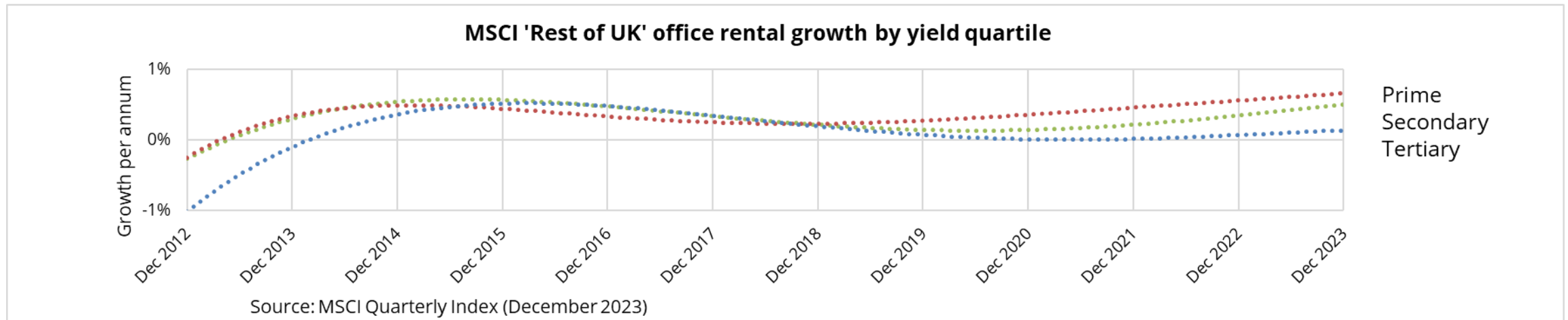
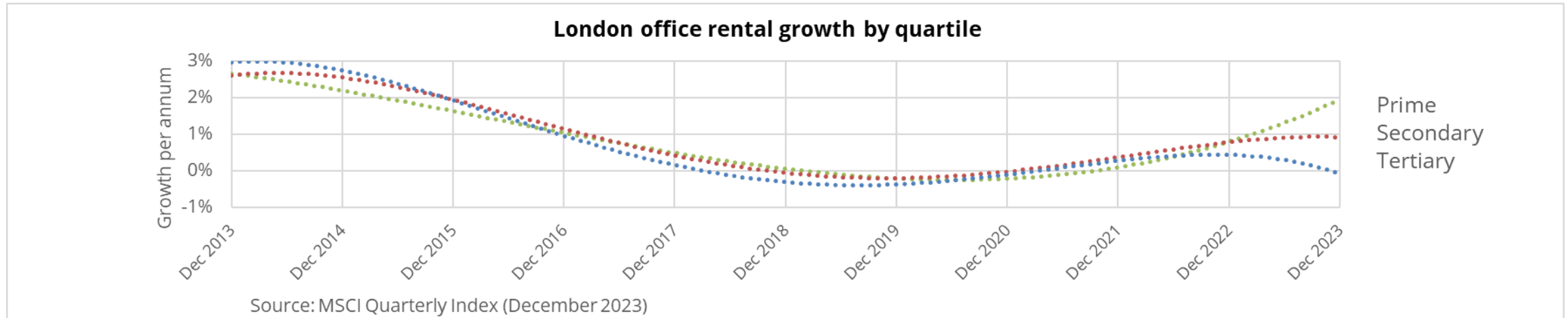
The quality gap – EPC clock is ticking



- **EPC Clock is ticking**
- Pending legislation (2023) to be introduced requiring ALL tenancies to have EPC rating of Grade A or B
- Only 25% of office 'Big Four' office space is of Grade A or B standard.
- Knock-on effects on existing premium space given steady occupier demand include a potential for localised rental spikes.

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

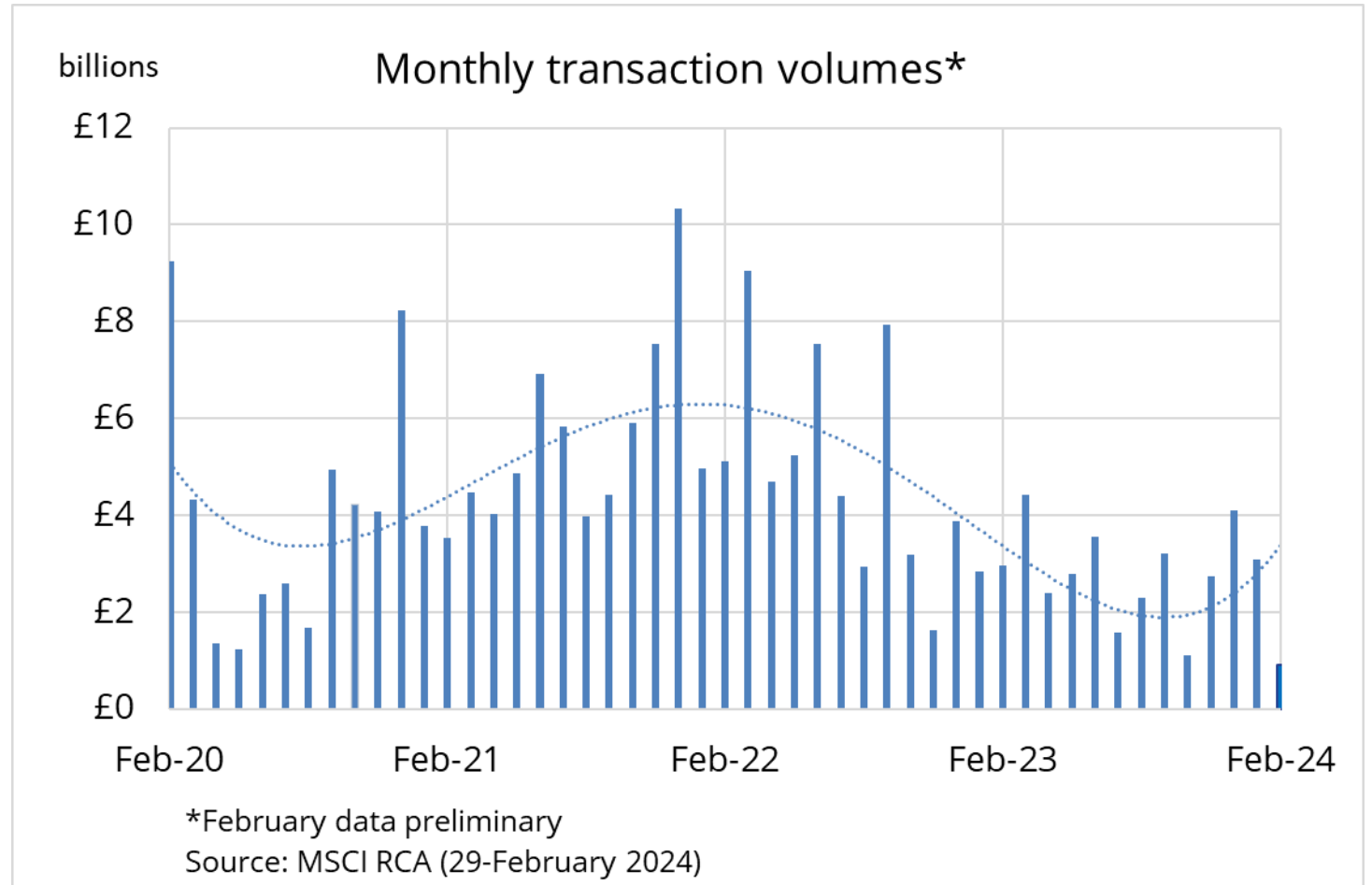
Quartiles show office sector schism?



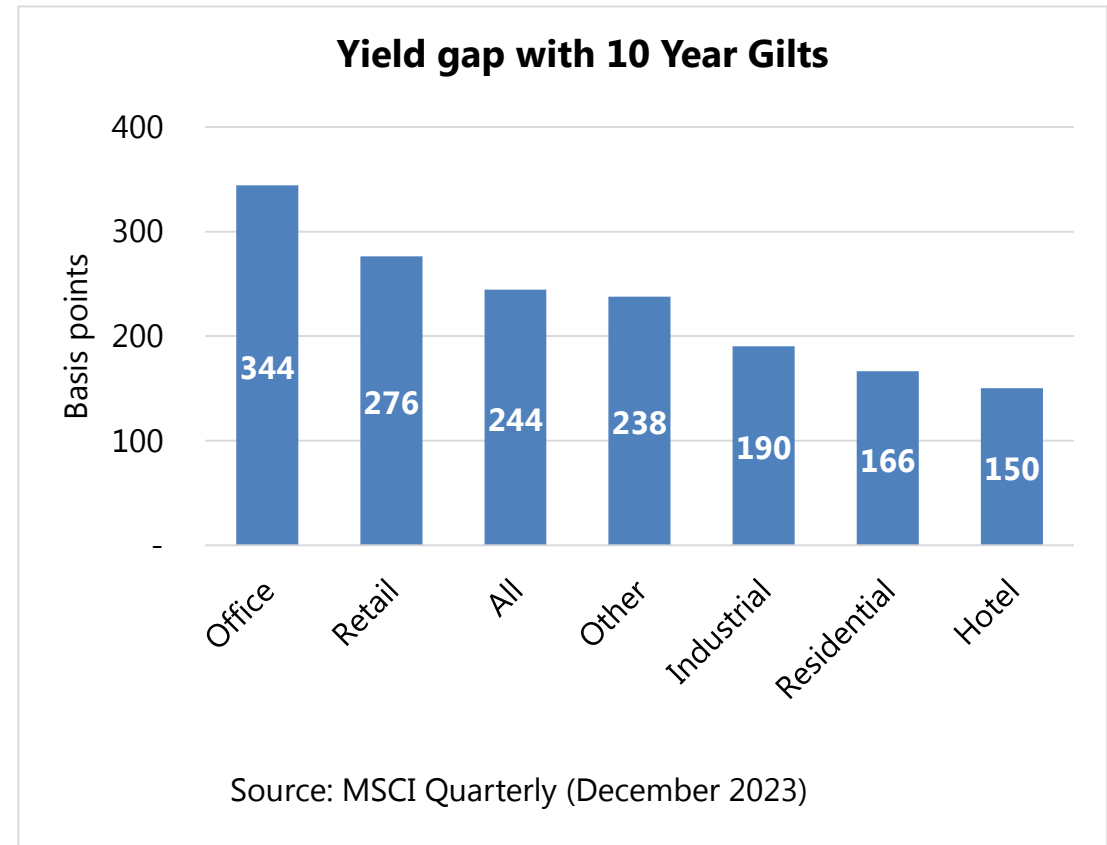
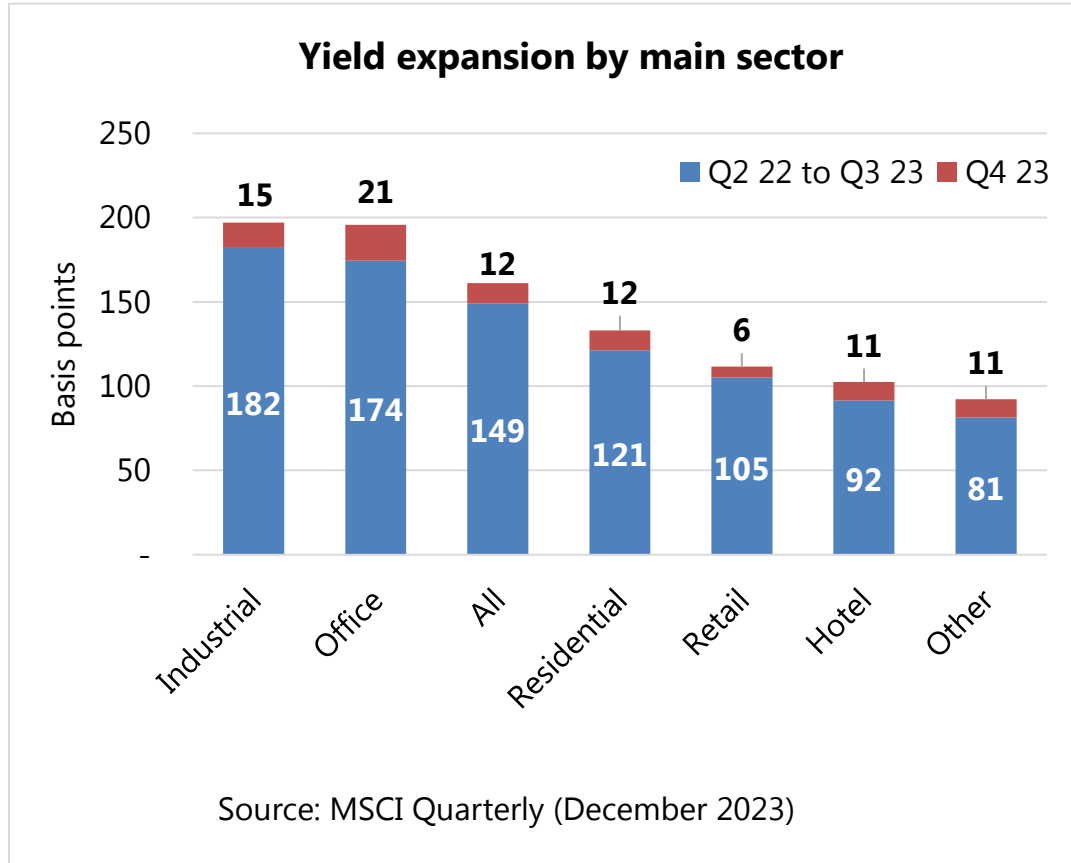
... but hope springs eternal

Transactional recovery not yet evident

- Transactions hindered by lack of price discovery
- Rebasing of prices due to new bond yield levels
- Lack of debt financing
- Lack of suitable stock
- Risk perceptions
- Asset allocation metrics
- 'Animal spirits' missing

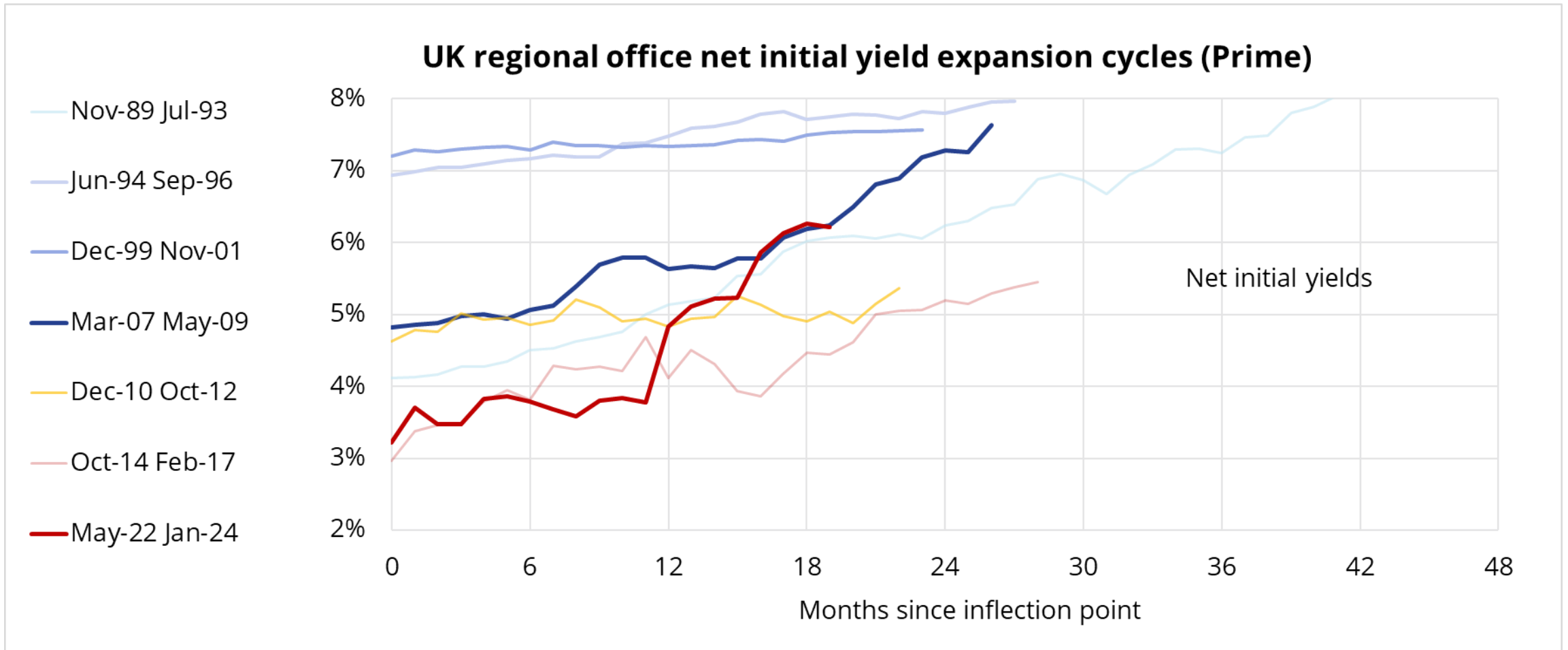


... but further expansion expected in specific sectors
Yield expansion may be slowing

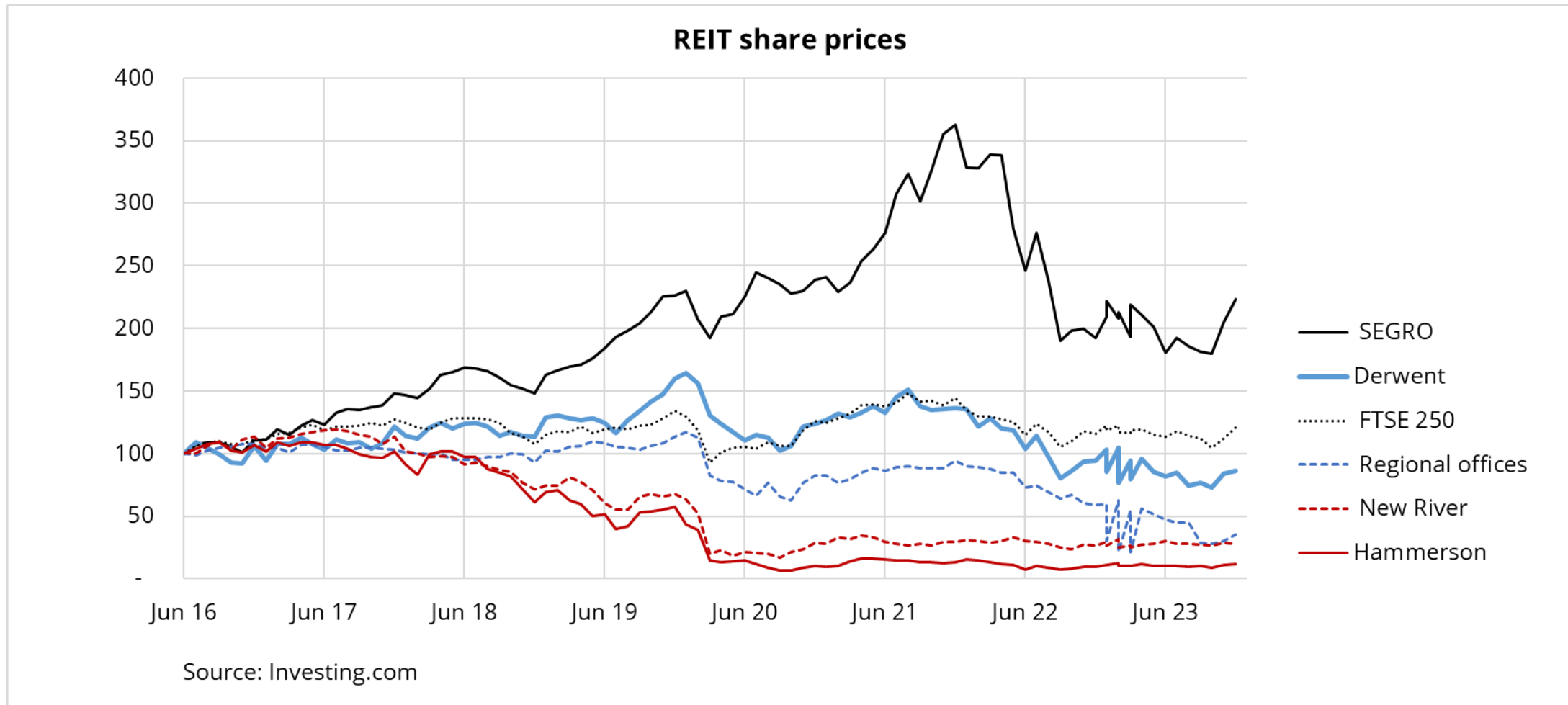


Further expansion likely despite recent signs of stability

Yield expansion for RoUK offices



Structural changes becoming more evident in the pricing REIT pricing suggests we may be bottoming out





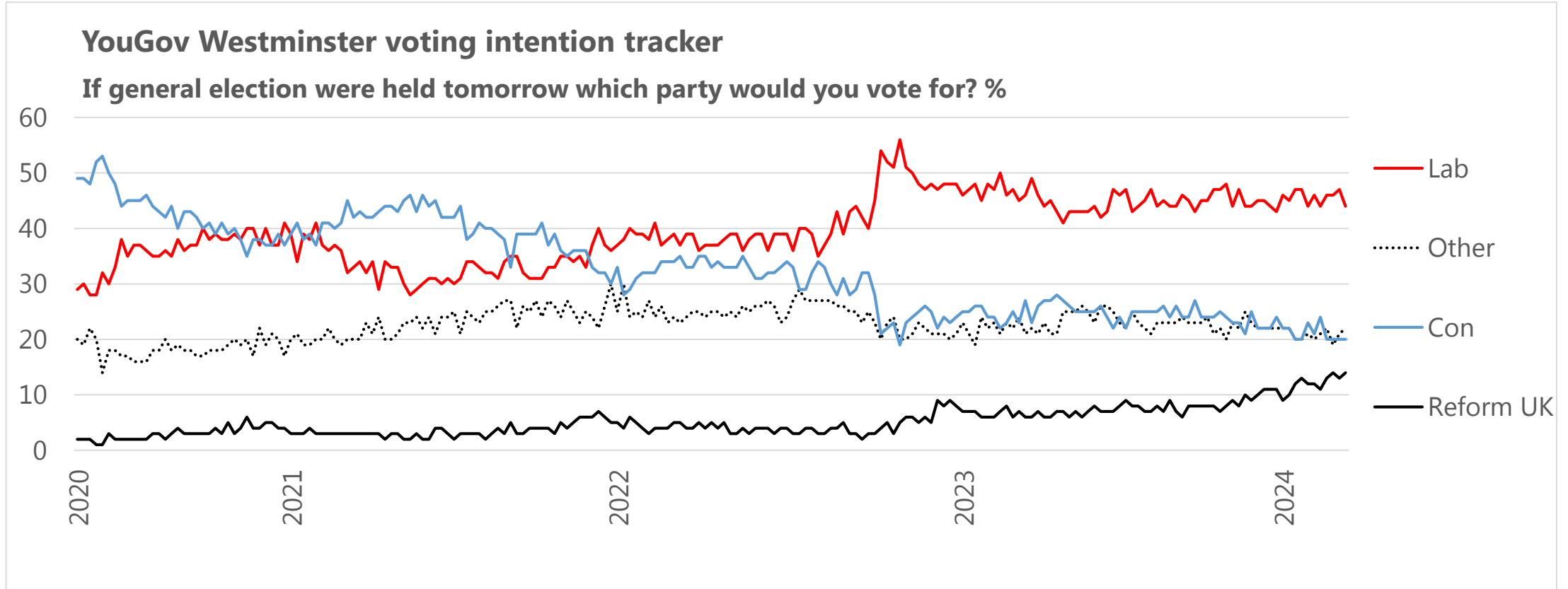
Levelling up?



Alive and kicking?

No overall majority is likely, hence policy mitigation

Voter intention



Prime minister ratings (favourability net balance) Starmer (-25), Sunak (-46)

'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

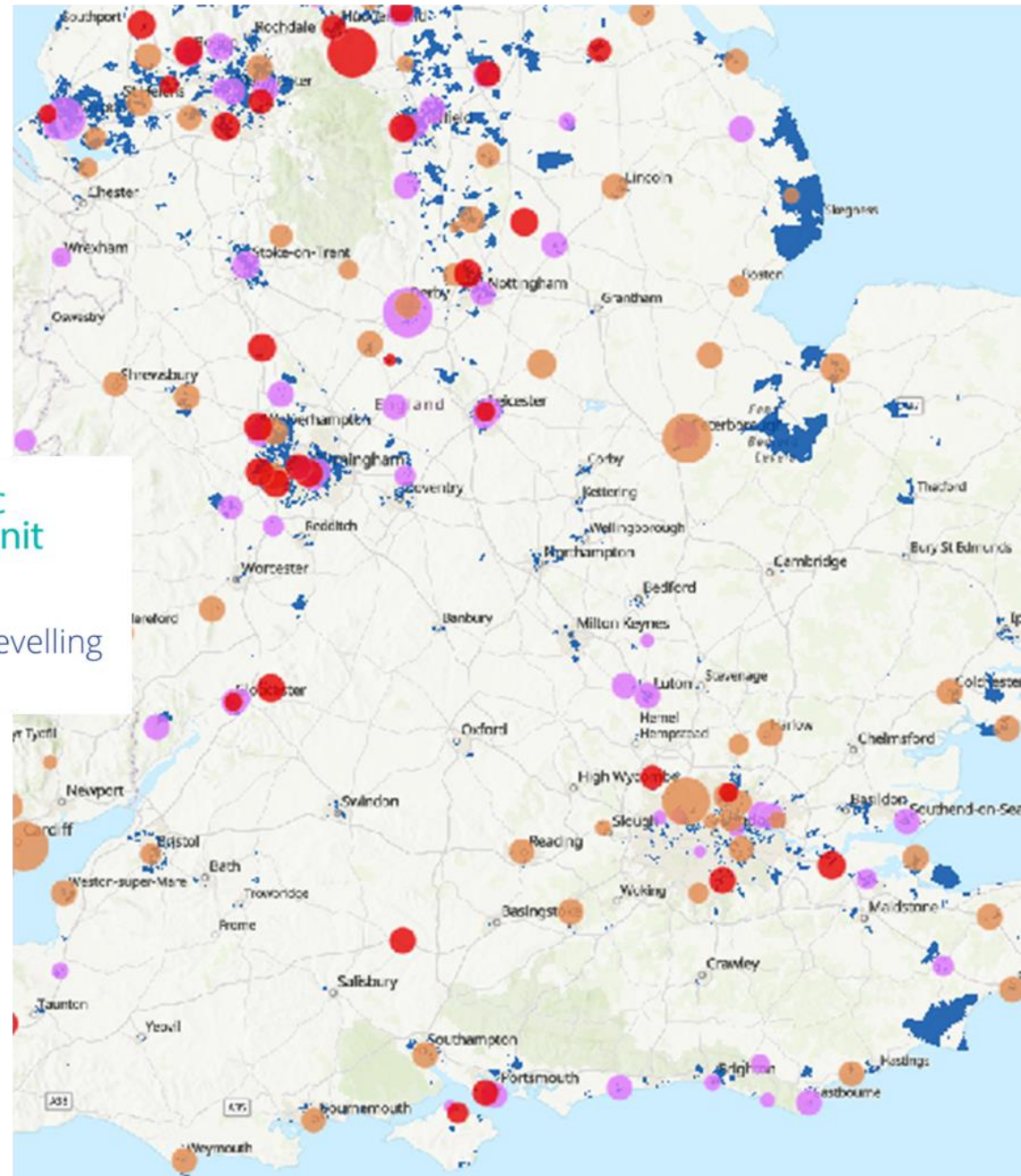
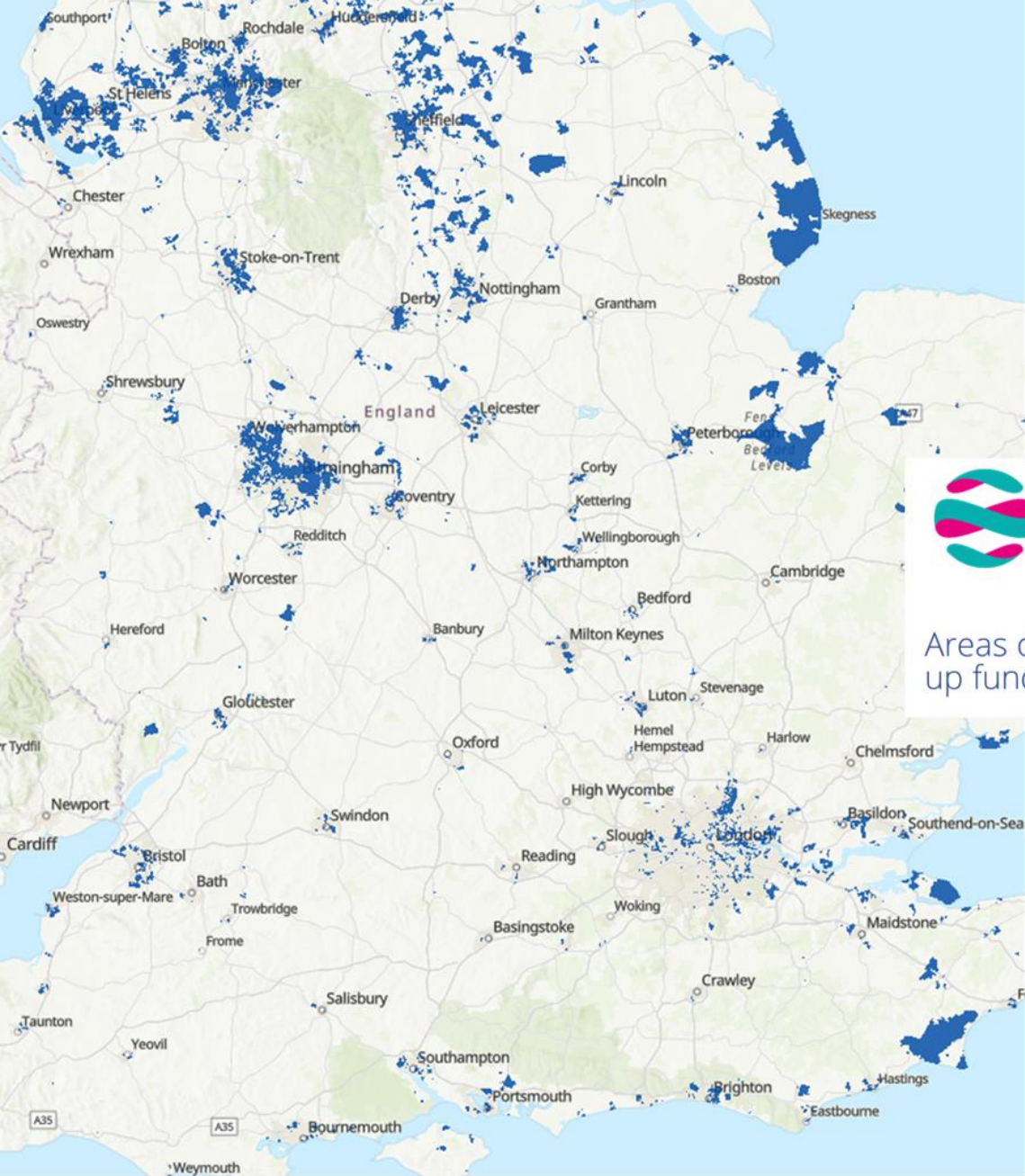
George Parker in London YESTERDAY



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



Strange Brew



Areas of deprivation & levelling up funding

Remediation and regeneration is key Levelling up? ✓

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UP**

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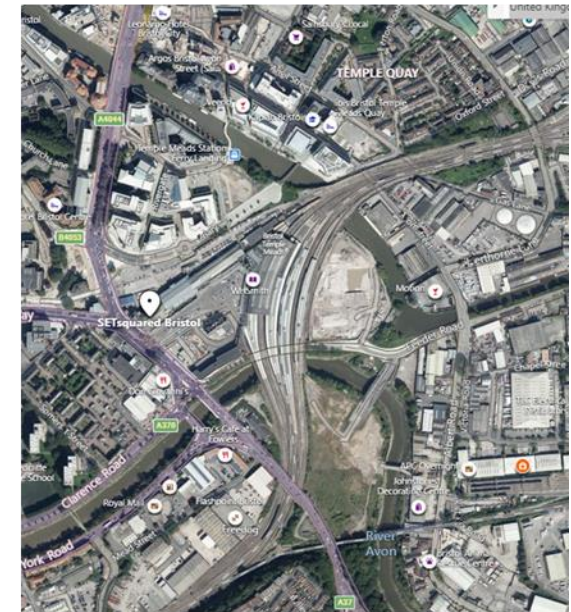
NOMA Manchester



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.

Progress?

Temple Meads Quarter

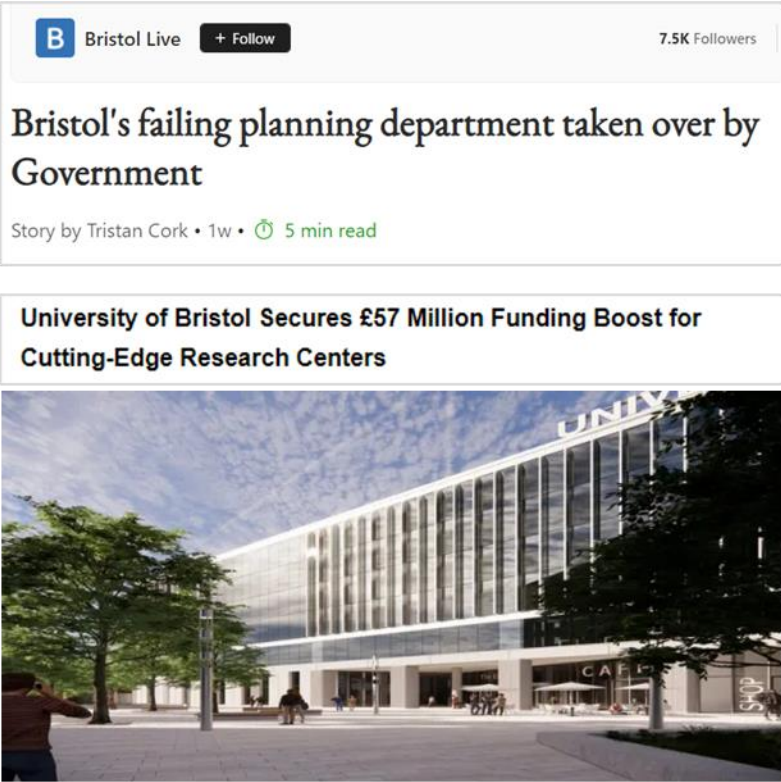
2021



2024

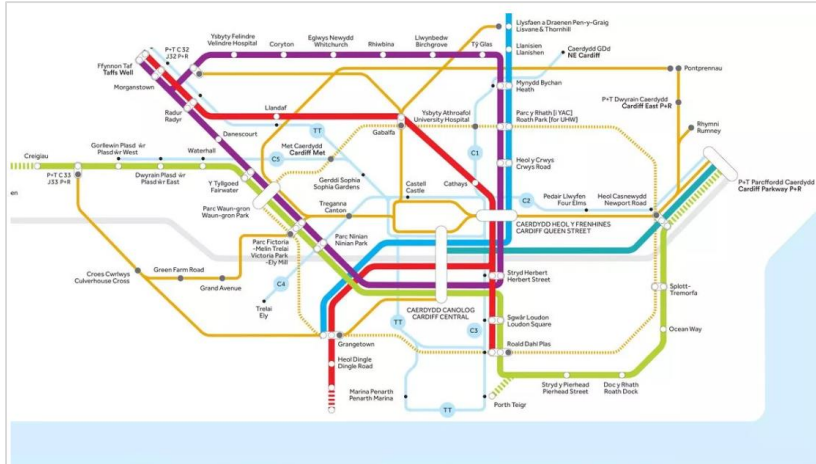


Last week



Wales - 11 projects with £208 million allocated

Cardiff Crossrail



Cardiff Bay Development Corporation regeneration (1,100 hectares of derelict docklands)

- £50 million awarded for Cardiff Crossrail (Cardiff Bay and Cardiff Central Station) LSO providing better access for western suburbs

Share of £15m funding to Cheltenham CC for Master Planning Golden Valley Development



- **Very early stages** of planning. GCHQ will act as an anchor for tech incubators to support global cyber-security research and development

Enables authorised investors to access unauthorised funds

Reserved Investor Fund (Contractual Scheme)



- **Authorised investors include:**
 - i. **Institutional investors**
 - 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. **Diversification into unique assets/niche markets**

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

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



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