Market Insight

ECONOMIC TURMOIL

THE IMPACT ON REAL ESTATE

Daniel Austin, ASK's CEO and Co-founder shares his views on the impact of the current economic situation on the real estate market in the UK, where the opportunities lie and the outlook for the medium term

A DRAMATIC SHIFT

Disruption challenging real estate fundamentals requires a fresh approach

Since 2020 we have seen a number of factors influence the global real estate market. A dramatic shift in the way buildings are used, the fastest surge in interest rates we have seen in more than 40 years, bank failures in the U.S. and Europe, and now a recession on the horizon. This disruption is challenging real estate fundamentals as we know them and requires a fresh approach to underwriting. It is certainly a daunting time for equity investors in real estate but with unprecedented opportunities forecast it does also have the potential to be a very good time to deploy capital in real estate debt.

The debt funding gap in Europe has been estimated at 51 billion euros

Opportunities in real estate debt

Reuters recently reported that around 20% of loans backing commercial real estate in Britain, France and Germany that fall due between now and 2025 are likely to face refinancing challenges given higher interest rates. This debt funding gap has been estimated at €51bn. At ASK we have already seen refinancing challenges amongst our clients and in response we launched a product to meet the needs of developers requiring finance on completed developments.

The surge in rates and falling property valuations has meant that developers and investors are struggling to sell assets at the right price and at the wrong time in the cycle to realise profit targets. Refinancing with a traditional lender is not an option because of interest coverage ratio requirements. ASK's flexible underwriting approach allows us offer bridge-to-exit finance over a longer time period than traditional bridge finance, and secured against built and often income-producing assets, this is a strong investment strategy.

THE LIVING SECTOR

Our target for this product is the living sector, including residential, student accommodation, build to rent, co-living and hotels where we are seeing counter cyclical trends and, in many cases significant undersupply.

Build to sell

The build to sell market has been heavily impacted by the rising cost of mortgages, with approval rates significantly down. However, many mortgage rates have now fallen below 6% and it is widely expected that prices will bottom out now that the consecutive rate rises have stalled and inflation has reached its peak. Therefore, in the medium term we expect the residential for sale market to start recovering, based on the huge shortfall in supply, build costs coming down and the expected introduction of government stimulus for buyers. As base rates start to fall again, investor confidence will return and unlock new schemes.

The Hampton by Hilton Hotel at Bristol Airport - ASK lent £24.6m to fund an extension supported by approved airport expansion plans

Build to rent and student accommodation

Build to rent and student accommodation however, have shown exceptional resilience, and performed well in the last 6-9 months. Student accommodation is said to be the strongest living sector, with a peak wave expected to hit by 2030. Post-Covid, the demand has been very strong for purpose-built accommodation for the benefits of a managed community, all-inclusive bills and because of the lack of stock in the private rental sector (CBRE estimates that 400,000 rental properties have been sold in the last seven years). This has also in turn driven 13% rental growth in London and 10% nationally, with rents outperforming inflation (Allsop). The difficulty for PBSA and BTR schemes has been land prices and planning difficulties. Land prices have fallen in London and in peripheral areas but are currently still too high to make schemes viable. Ultimately, there is a shortage of land, particularly in London, but global investment means that land and assets will continue to trade.

Annual rental price inflation is running at 13% in London and 10% nationally

Hotels

Hotels are also performing well, benefiting from the post-Covid return to travel. We have lent against two hotels in this last quarter, operated by Z Hotels and the Hampton brand of the Hilton group. Both hotels have been operating at year-round occupancy levels above 90%. Research recently published by Knight Frank showed London hotels achieved an occupancy rate of 82% in June 2023, a rise of 3.2% year on year. Hotels outside the capital recorded growth of 4% to almost 81% occupancy compared with 2022.

A LONG-TERM PERSPECTIVE

Creative strategies and patience

Overall, we're in a challenging macroeconomic environment that requires versatility, patience, and a long-term perspective. We believe strategies focused on assets that will benefit from secular trends such as population increases, and post-Covid changes in behaviour, will ultimately drive value creation. Developers will likely continue to seek out assets which will benefit from being re-positioned to take advantage of the shift in occupier demand.

With banks side-lined, we expect to see compelling refinancing opportunities to lend against completed developments, and value-add projects to present opportunities for alternative lenders with flexible underwriting strategies.

At ASK we are committed to seeking out opportunities with well-capitalised borrowers who have the holding power to trade through the cycle and which can achieve strong risk-adjusted returns. This will form a key part of our underwriting strategy over the short-to-medium term.

With banks side-lined, we see attractive opportunities to lend against completed developments

ASK provided a bridge to sell loan secured against 133 completed BTR apartments at Canary Wharf