Market Insight

UK REAL ESTATE

EXPLORING INVESTMENT OPPORTUNITIES

These are the key takeaways from a forum hosted in November 2023, to discuss real estate investment trends . Expert speakers shared their views on the current shape of the market and its growth potential, with specialists commenting on certain sectors.

THE MACRO-ECONOMIC PICTURE

Globally

- The US' record levels of borrowing to subsidise its businesses and protect them from importers has decoupled the global supply chain. Tariffs have reduced trade and foreign investment. As the world's reserve currency they can get away with it but it has a major impact globally.
- Whilst we expect interest rates to fall, unprecedented borrowing will create upward pressure.

In the UK

- Low productivity is compounding growth.
- As proven by the mini budget in October 2022, the markets will not tolerate high levels of borrowing to fuel growth.
- A change of government might create an uptick in behaviour and activity.
- Labour's aggressive plans for affordable housing would in turn mean more market housing. Labour would also not suffer the conflict of interest regarding contentious development land in the Tory heartlands of the south east.

Growth could be stimulated in three ways

1. Fix the labour market at the lower skilled end, allowing workers into the country for jobs in hotels and restaurants.
2. Fix the relationship with the EU, negotiating access to UK services in return for allowing EU workers access to the UK.
3. Get Britain building again, by fixing the broken planning system.

"Fixing the broken planning system is key to economic growth"

SECTOR TRENDS

Impacts on real estate

- Traditionally the UK has built its way out of recession, but the current short-term approach of government has created a reluctance to start major infrastructure projects and think innovatively about plans to build for growth and attract foreign investment.
- We have a significant shortage of affordable homes at the mid-market level which means businesses unable to attract staff into areas.
- The planning system will not hold for much longer. Decisions should be made independently to avoid the conflict with trying to get re-elected.
- We need to stimulate SME housebuilding. Local authorities could allocate a percentage of land in smaller plot sizes to help create a supply-side push.
- Construction costs will not go down. To raise productivity, we need to get more work done off-site in factories which would attract more women and young people into the sector.

"Location and the right offering is key"

ASK financed the replanning of a site in Southwark into a PBSA-led mixed-use scheme with 444-beds

Student living

- The sector has proven resilient but location is key.
- Yields have widened by 0.25% - 0.50%, perhaps more in central London with inflation at between 5 and 20%. The student sector picks up inflation annually and 5% inflation roughly covers a 0.25% widening of yields - this has saved the sector.
- It is an anti-cyclical, defensive and small market. A lot of money is tied up in funds which needs to be spent. It is considered safer than offices and retail and there is more historical data on PBSA than on BTR and co-living.
- Councils have put pressure on planning to move away from HMOs and into PBSA. HMOs are also hindered by regulations.
- The growth trajectory is for 2-3%pa and there are not the beds to sustain that.
- Rents keep rising. Parents pay and plan for that which helps, and 24% of the market is made up of overseas students who are less sensitive to rent rises.

Life sciences

- The sector benefits from ageing demographics and increased healthcare spending.
- An R&D revolution is seeing smaller companies take on research, increasing lab-space demand.
- AI and robotics are shortening timelines, increasing the chances of success and bringing more investment into the sector.
- The clustering theory has been proven in success stories of San Diego, San Francisco and areas of London. Investors should consider the maturity of locations and demand for areas.
- Working with start ups in a fast moving sector means it's imperative to understand the needs of the market so that space can be re-let easily.
- There is currently no government stimulus but packages such as the Mansion House Compact should unlock more capital for maturer life sciences businesses.

A mixed-use scheme at King's Cross, funded by ASK, will have 14,000 sqm of lab-enabled office space.

Offices

- During the pandemic occupancy in the flexible office market went down to around 50%.
- Occupancy levels are now back to around 80%.
- Post-pandemic the employee is driving the direction of travel.
- A flight to quality means that outdated buildings are not letting but the most desirable spaces are full and rents are higher than ever.
- Flexible office owners have become more like operators than landlords.
- There is a real demand for amenities which companies are using to attract staff back to the office.
- Flexible space used to be inconsistent and have no longevity but license fees are now up and length of stay is up from around 18 months to 36 months.
- The number of desks per company has also increased by around four times in the last 20 years. This has been caused by increased interest from the larger enterprise market, where we are seeing some whole buildings let to one tenant for 3-5 years.
- Consistency in the flexible space is driving investment. Operators who can take long leases or management agreements similar to hotels for 20-30 years, can build consistency of operational income, giving a greater multiple. Owning the freehold is even better.
- At the moment flexible office space is doing much better than conventional, because flexible operators are offering what the customer wants. However, 25% of the flexible market is currently let to enterprise clients who cannot find suitable space elsewhere. But, they will go back to conventional space once the rest of the market refurbishes in line with customer demand and catches up.

"Consistency of operational income in the flexible office space is driving up multiples"

An 11,016 sq ft freehold Grade A office building located at King's Cross refinanced by ASK

The super-prime London residential market

- This market requires patience. No one needs to buy in this sector. It has got to be perfect or it won't sell, whatever the price.
- It's a growing market, with 1800 new billionaires globally every year.
- Finding good contractors is very difficult; many now work in small teams which is harder to manage.
- Westminster planning restrictions are currently buoying the sales market but ultimately it will restrict future supply.

INVESTMENT STRATEGIES

Capital alignment

- Real estate investment is all about alignment of capital, risk management and understanding the end product.
- Those that are well capitalised will never have a distressed asset and can invest in the troughs, which have come every 18 years since the second world war. The next trough is due in 2025.
- In the last 20 years the UK has moved away from long-term capital. Open-ended and closed-ended property funds all require quick exits, not in line the maturity of the asset. This has forced the market.
- The low interest rate environment encouraged property investment purely for a yield on cash. It is now more important to invest in the purpose of the real estate, which is making quality and location more important than yield on debt or cost.
- There is still a lot of money to be made from well-located, quality real estate assets backed by strong sponsors.

"Quality and location have become more important than yield on debt or cost"

What is the best sector?

- There isn't one. Invest in the best management teams who have enough long term capital to see through planning and market cycles.
- It is key to know your market. A well-backed scheme done well, in the right location with the right team will always be a success. The same formula applies for real estate debt too.

ASK financed the acquisition of this site in Woolwich with planning permission for a 298-bed PBSA scheme.

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