

REPORT

RICS Property Investment Forum

January 2024



Contents

Introduction	3
RICS sentiment survey update	4
Economic overview and implications for property	5
Have we dodged the normal 17-year cyclical economic recession?	5
Valuation trends and movements	6
Has the UK property sector fully repriced?	6
Property capital trends	7
Is there money waiting on the sidelines?	7
Executive summary	8

Introduction

The RICS Property Investment Forum was set up in response to the global financial crisis (GFC) and convenes up to four times a year. Its purpose is to inform RICS on the key areas in which the property investment industry seeks their leadership and support in adapting to the challenges and opportunities ahead to sustain a liquid, transparent and efficient UK property investment market.

The input to these debates is provided by a range of industry leading speakers, including the RICS chief economist, industry researchers, valuers, advisers, local and global asset allocators, developers, occupiers and accounting advisers. The debate draws on the views of senior industry participants such as capital providers – both debt and equity, local and global public and private markets – investors with risk appetites from core to opportunistic, investment advisers and occupiers.

The output of this forum regularly informs meetings with government and the wider industry. It has effected change in the marketplace – such as the recommendation to RICS' Standards and Regulations Board for an independent valuation review, which the board supported, and was chaired by Peter Pereira Gray.

The January 2024 meeting focused on the challenges presented by the perceived funding gap that has arisen between investors who can no longer extend loans without significant further equity and investors seeking a price that reflects a fundamental repricing of UK property investments as the cost of debt and inflation has increased and geopolitical risks have heightened. Many will be aware that the normal sources of capital that help recapitalise a market are sparse at present, especially in the listed markets.

A lot of detail is reviewed and debated in the forum discussion. This publication summarises the outputs of this meeting.

Phil Clark, chair

RICS sentiment survey update

The overall tone of the RICS Commercial Property Monitor for Q4 2023 is a little less negative than previously.

This is reflected in the increasing share of respondents suggesting that the real-estate market appears to be entering the early phase of an upturn (almost one-quarter), albeit the largest proportion (just over one-third) of contributors are still suggesting that it is at the bottom of the cycle.

As has been the case in recent surveys, the feedback around the occupier market continues to remain more positive – or to be more accurate, less negative – than for the investment market in the office, industrial and retail sectors.

However, it is encouraging that the RICS credit conditions metric has stabilised, which typically could be expected to lead to an improvement in the investment indicator in due course.

Some of the feedback from the latest survey highlights the ongoing impact that the lack of transaction activity has had on CRE pricing but, critically, for the time being, the level of distress remains lower than in past downturns.

Significantly, the 12-month expectation indicators for capital values and rents alike continue to point to strongly divergent trends at a sector level. Perhaps unsurprisingly, the outlook for prime space appears considerably more solid than it does for secondary buildings – and nowhere is this gap starker than when it comes to offices.

Meanwhile, the strongest returns according to respondents are likely to continue to be found in alternatives such as multi-family dwellings, life science buildings and student housing.

One other interesting feature of the results is that the polarisation in the office sector appears to be particularly pronounced in London according to respondents, even though it is visible in all parts of the country.

Simon Rubensohn, chief economist, RICS

Economic overview and implications for property

Have we dodged the normal 17-year cyclical economic recession?

Recession: has the UK dodged the normal major economic downturn that recurs every 17 years, the depth of which normally causes valuations to fall by between 25% and 45% on average?

- The UK economy appears to be achieving a soft landing, but recovery will be long and drawn out.
 - Yields are close to topping out, but significant compression should not be expected.
 - Rental growth has been surprisingly resilient but is expected to slow this year.
 - Total returns will be driven by income over the next few years.
 - The retail sector is expected to outperform expectations, while offices will struggle.
 - Investment is set for a modest recovery this year.
- Factors such as an improvement to the supply side as economies have reopened, the large number of households protected by fixed-rate mortgages and myriad other reasons could explain why the market is not experiencing the economic downturn of an investment cycle when compared with historical models, which makes it harder to predict what might happen in 2026.
- The UK market will be significantly influenced by what happens in the US presidential election and beyond.
- The supply, demand, valuation and leverage fundamentals of the UK market are in better shape relative to many other European or US markets at present, so there are reasons to be cautiously optimistic over the next two years.

Valuation trends and movements

Has the UK property sector fully repriced?

Valuation: have UK real-estate assets repriced, or will lenders force borrowers to sell assets this year in the absence of adequate equity to recapitalise their loans – leading to further valuation falls?

- There has been a significant correction in market values – although not as deep as the GFC, there are reasons for that, particularly the lower leverage in the market. The initial decline in capital values was rapid. The peak of the market was June 2022, with the pace of value decline accelerating in the final quarter of the year during the ill-fated period of Trussonomics before levelling out in early 2023 but continuing to fall at a gentler pace for the remainder of the year.
- In absolute terms, there has been a mid-20s decline in broad capital values in 2022–23, compared with a mid-40s peak to trough during the 2007 GFC. However, when adjusted for inflation, the delta between these two periods narrows.
- The spread of property yields over gilts observed in the past 15 years has not re-emerged yet, but a question remains as to whether that is an indicator of further valuation falls when trends before 2009 are examined. If we look further back in history and treat the era of so-called ‘free money’ after the GFC as an anomaly, it is clear that the level of spread between property yields and the ten-year gilt rate that became commonplace after 2009 was not always evident.
- Property sectors are behaving differently, so the bottom for one sector may not be the bottom for another. Over the past decade, in particular, we have seen performance between sectors diverge as a result of structural and behavioural changes, notably the rise of e-commerce and increased obsolescence in the office sector. How far values have left to fall will vary by sector, but there is consensus that values in the office sector are expected to weaken further. It is too simplistic to talk about this at an aggregate property level.
- As a result of higher interest rates, a significant funding gap has emerged and investors face difficulty at upcoming refinancing events. Valuers expect some more price discoveries as properties that cannot be economically refinanced are sold. It is worth noting though that if values improve then the funding gap will be eroded.

Property capital trends

Is there money waiting on the sidelines?

Capital: now that base and inflation rates are trending downwards, do public, private, debt and equity investors have the confidence to price risk and invest in UK real estate?

- While 2024 has started as 2023 finished, confidence in investment should grow over the next 12 months. There is a lot of capital that is expected to return to the market as confidence grows through 2024.
- Whether a property is fit for purpose is one of the main factors influencing the UK property market, and notably:
 - it has been easier in the residential and logistics sectors to make properties fit for purpose as there is a much greater supply need
 - the investment appetite has shifted, with alternatives being favoured over traditional sectors
 - the high cost of ESG in making properties fit for purpose needs to be considered.
- Some £10bn of private assets are expected to come out of defined benefits schemes over the next decade, of which 50% are expected to be from real estate. However, the quality of stock released is not expected to be high, which will affect values. It is unclear who will buy such assets.
- At some point a monitor of what constitutes zombie property will be required in the UK as there is a lot of stock that has no potential for alternative uses and that is worth nothing or less than nothing.
- Similar to what has happened in the residential sector, the government may choose to weaken ESG requirements in the commercial sector because, fundamentally, there is no funding to invest in the UK regions and existing ESG requirements cannot work without such investment.
- The public markets were up 30% on average in the last two months of 2023. The UK real-estate market typically enters a trough a quarter before real GDP, so the question remains of how much further downside awaits in terms of real GDP.
- European equity markets are not open to the same extent as the UK's is. From a listed market perspective, the UK has benefitted from the fact that many companies were well positioned and reduced risk and development exposure in 2016.

- UK debt markets are open, but lending is specific, asset based and depends on the business plan as well as the sponsor. The last thing a bank wants to do is lend at the end of a cycle, and notably there has not been the same spike in debt lending as was seen at the end of the GFC.
- Parties that have been disciplined in their hedging have break costs and can repay their loans. Moreover, numerous well-run companies have built up liquidity buffers in a low-interest-rate market and can choose to repay when they see value.
- The leverage that the UK market started with was low and slotting caused pain, but it meant that UK banks' average LTVs were in the 40s. LTVs are now much higher and, although there is congestion, there is real liquidity in the mezzanine space. While 2023 was a year of the banks getting their ducks in a row, 2024 will see a steady increase in the number of assets being sold.
- The bid-offer spread between buyers and sellers remains but is generally narrowing where valuations remain below the range of bids subsequently received, especially when a distressed bank is involved. The market is not matching valuations, and this difference still needs to be financed.
- The year ahead will be different in this regard, as there will be a gradual and steady increase in confidence in terms of what a lender can achieve when taking an asset to market.

Executive summary

- The UK appears to have achieved a soft landing, but the recovery is quite likely to be long and drawn out. The country still remains exposed to global economic shocks outside its control.
- This is also largely reflected in feedback to the RICS UK Commercial Property Market Survey.
- There appears to be a healthy supply of market capital in the listed sector.
- The debt markets are open, and in a better place than they were during the GFC for well-constructed plans with a sensible borrower.
- This year is expected to be seen as one when investors felt far more confident to price risk now that central bank and inflation rates are demonstrably falling.

Delivering confidence

We are RICS. As a member-led chartered professional body working in the public interest, we uphold the highest technical and ethical standards.

We inspire professionalism, advance knowledge and support our members across global markets to make an effective contribution for the benefit of society. We independently regulate our members in the management of land, real estate, construction and infrastructure. Our work with others supports their professional practice and pioneers a natural and built environment that is sustainable, resilient and inclusive for all.

General enquiries
contactrics@rics.org

Candidate support
candidatesupport@rics.org