MARKET UPDATE

Q3 2022

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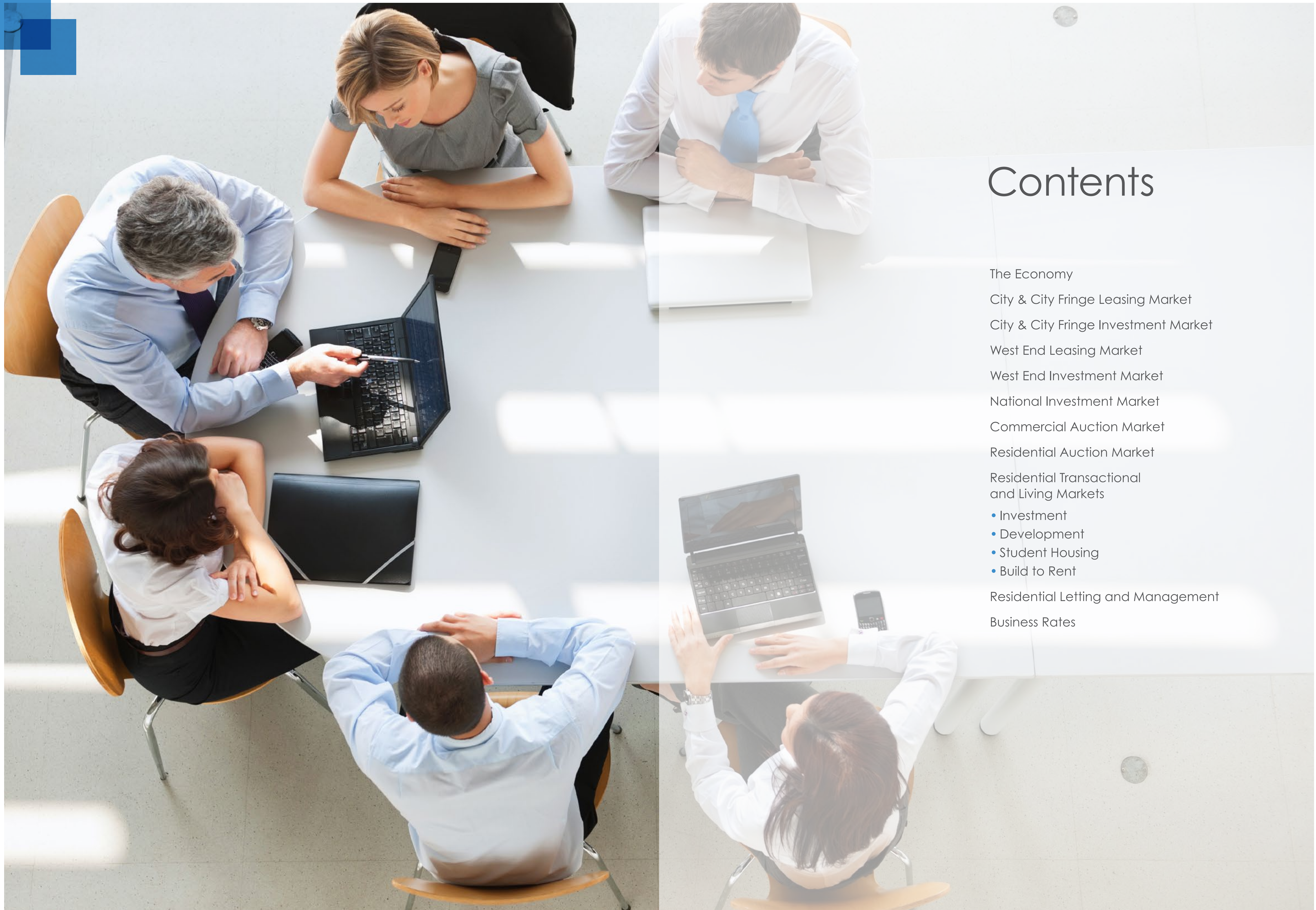

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Economic Overview

The third quarter of the year is usually relatively uneventful and framed around the summer break, Q3 2022 has been anything but. The economic landscape was becoming more challenging but the change in political leadership and the failed Truss premiership has tested us all and introduced an increased level of volatility into what was already a difficult economic period.

The UK Government and in particular the Bank of England have faced the significant challenge of reducing run-away inflation exacerbated by Russia's invasion of Ukraine. The BoE has responded with increasingly sharp interest rate rises which have progressed since December of last year: from 1.25% to 1.75% in August to 2.25% on 22 September. Following an unprecedented flurry of summer activity, there was hope for some political stability following the appointment of a new Prime Minister in Liz Truss on 8th September. However, her failed premiership and in particular the so called mini-budget which took place towards the end of the quarter, has only exacerbated the volatility in the financial markets. The ill-judged proposals centring upon unfunded tax cuts were seen as inflationary and caused the financial markets to take fright. The market reaction and the expectations for increases in interest rates have taken a step change in response.

Despite the withdrawal of the controversial mini-budget proposals and the resignation of Liz Truss the financial markets remain unsettled and the cost of government borrowing is at heightened levels. The 5 year UK Gilt (often used as a benchmark for property yields and an indicator for future interest rates) was yielding 1% at the start of the year and although it was on a steady upward trajectory it moved rapidly in September to 4.7%, it has settled more recently at 3.75% with the appointment of Rishi Sunak as Prime Minister. This has been a larger than expected increase and reflects the expectations of a big uplift in the base rate when the BoE meets again in early November and with the economy starting to shrink and recessionary times expected it reflects a realisation that the national finances are in a more troubled state than previously thought. Interest rates have increased and are unlikely to fall for some time.

The reaction of the real estate markets has been swift rebase in a market environment that continues to change daily. The cost of borrowing which for many property investors was at an all in rate of circa 3%, at the beginning of the year, has increased rapidly and is now over 7.5%, a huge change in the dynamic for investors with debt.

On the commercial side whilst occupational markets are stable and, in many areas very busy and rents in some sub sectors rising, the investment markets are weaker, particularly for debt driven investments and bond type income and downward price adjustment is evidenced across the market in varying degrees. Pricing expectation on investment assets has certainly moved outward as the cost of money has increased sharply and many commentators are describing current market conditions as a price discovery period. Many transactions are subject to price reductions or being aborted as expectations do not match reality.

As always in difficult times the auction market and lots under £1,000,000 are expected to remain liquid, driven predominantly by cash buyers although as lot sizes increase price reductions are happening as funds face redemptions and are needing to sell offering opportunities for some.

The residential markets are under pressure as mortgage rates have increased to levels not seen for over a decade and although pricing has stabilised it is expected to start to be adversely impacted despite the stamp duty reductions recently announced. This of course is feeding through to the development market and with increased build costs land prices are softening.

In summary we are witnessing a rapid rebase driven by the increased cost of debt. The step change is helped by the fact that most investors and banks are well capitalised and there remains a great deal of equity in the market, underlying this the occupational markets in general are robust. Unlike previous market adjustments this one is happening at pace.

Many commentators are describing current market conditions as a price discovery period.

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City & City Fringe Leasing Market

Following a strong and buoyant first half of the year, the third quarter of 2022 was somewhat more subdued with City take up figures 30% below the 10-year average. This was partly attributable to a relatively quiet summer and the continued space audits from many companies analysing return-to-work policies prior to committing to office space.

Despite worsening macroeconomic conditions and instability in the financial markets, a growing focus on best-in-class relocations has driven significant transactions with the technology, media and law firms across Central London.

In the last 2 months, the office occupier market has continued to re-bound in the face of the pandemic with changing working patterns now emerging at true face value. More employees are returning to the office with the greatest numbers experienced since March 2020.

Office fit outs are seeing increased levels of collaboration space, wellbeing incorporation, end of trip facilities and access to outside space. Growing occupier awareness of climate change and ESG commitments has led to an increased focus on sustainability and its integration in working environments. This in turn, has now arrived at the forefront of developer's strategies with an emphasis on delivering the best working environments for their occupiers, considering dynamic working patterns and growing ESG awareness.

The Allsop weekly viewing and enquiry tracker as of week commencing 17th October is now averaging 29.1 viewings per week in 2022 compared to 18.5 in 2021. Enquires are now averaging 108.7 per week compared to 87.7 in 2021. The majority of viewings have been for sub 10,000 sqft and for fitted accommodation although there has been increased demand for the 20,000-50,000 sqft size recently. The conversion ratio from viewing to negotiating to agreeing terms has increased significantly in recent weeks although there remains concern with many developers over the instability in the economy.

Take up for the City was significantly down on Q2 at close to 900,000 sqft although on a positive note Addleshaw Goddard signed on 104,000 sqft at 41 Lothbury as a significant pre-let and Grant Thornton agreed terms for 100,000 sqft at 5 Broadgate on a sub-lease from UBS. Significant Grade A stock accounted for 65% of all transactions thus far in 2022 suggesting securing high-quality space is still a focus of the market. Many occupiers are now focussing on good transport networks particularly around Crossrail Stations such as Liverpool Street, Moorgate and Farringdon.

Under Offers remain strong with upwards of 1.6 million sqft currently under offer which should lead to a promising final Quarter. These include occupiers such as Partners Group at JJ Mack, Frontier Economics at Worship Square, Goodwin Procter taking Sancroft and Proskauer Rose reviewing 6-8 Bishopsgate.

The City supply remained relatively static for a second successive quarter at c12 million sq ft and a vacancy rate of 8.9%.

City Fringe stock has seen demand drop slightly and net deliveries increase leading to a growth in vacancy rates at c10.6%. Many of the larger schemes delivered into Q1 and Q2 2022 this year have been challenging to lease. This has been largely driven by reduced demand from the tech and media businesses for this area. Demand is however expected to increase with the opening of crossrail and the recent demand for this area as overflow from tight supply in Kings Cross and the West End. Demand remains constant for the floorplates under 10,000 sq ft.

The eastern fringe markets including Aldgate have been challenging with the recent launch of The Rowe, Whitechapel Building and 1 Portsoken all chasing the same requirements.

Strong rents continue to be achieved for 'Best in Class' stock with premium spaces hitting levels well above submarket levels and certain deals breaching £100psf in the City and City Fringe.

Rents for typical Grade A space on a mid-floor have moved up slightly to £75.00 psf.

Rent free periods remain at 2.4 months per year although these are likely to move in slightly on upper terraced floors and where there is competition for good quality Grade A space.

Grade B stock remains challenging, and Landlords will offer longer rent-free periods of 2.4 – 2.7 months plus and look to reduce rental levels where there is competition.

The increased build costs experienced in Quarter 2 and 3 seem to be showing signs of levelling off and may help developers for 2023. Costs are however extremely high and have led many developers to pause on speculative developments in fringe locations. This will lead to restrictions of good quality stock for 2025 and 2026.

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City & City Fringe Investment Market

Whilst the City and City Fringe investment markets remain relatively well capitalised, the volatility of the financial markets and the and sharp increase in the cost of debt finance has resulted in an inevitable market correction.

In spite of the obvious headwinds, the City and City Fringe investment market recorded £2.056Bn of investment transactions in Q3 2022. This is up by approximately 79% on Q2 2022 (£1.146Bn), and only 10% down on Q3 2021 (£2.293Bn).This total has been recorded across 30 transactions which is 7 more than Q2 2022 and only just below the 4 year quarterly average prior to COVID (33).

Around 40% of the total quarterly turnover was accounted for by a single transaction, Lendlease/ TCorp's purchase of 21 Moorfields, EC2 for £808.5M. 26 of the 30 transactions were deals of less than £100M, with 24 of them £50M or below, whilst the larger deals tended to be a conclusion of deals ongoing from previous quarters. The trend for smaller lot sizes trading is one we expect to continue into the final quarter of 2022 as cash buyers become more prevalent.

In spite of the obvious headwinds, the City and City Fringe investment market recorded £2.056Bn of investment transactions in Q3 2022.

Lendlease/ TCorp purchased 21 Moorfields EC2 From Landsecs for £808.5M, which reflects 4.60% and £1,442 psf for the 247 year long leasehold interest from TFL (5.00% gearing). 21 Moorfields comprises a new 568,500 sqft office development fully pre-let to Deutsche Bank AG (DB) on a 25 year lease, with annual indexation. With practical completion imminent, the property is constructed above Moorgate station and is targeting BREEAM Excellent and LEED v3 Gold ratings. This substantial transaction demonstrates the continued demand for long term secure income at buildings with outstanding ESG credentials, although we understand the price was reduced by over 10% prior to exchange of contracts, having been under offer since Q1 2022.

In the quarters second largest deal MEAG exchanged contracts to acquire 50% of the long leasehold interest in Fen Court, 120 Fenchurch Street, EC3 for circa £312m reflecting a net initial yield of 4.38% and a capital value of £1,456 psf. The property comprises 427,000 sqft of office and retail accommodation with the offices multi-let to three tenants, including M&G, Newline and WeWork, at a net passing rent of £26.7m per annum. M&G occupies 75% of the accommodation by floor area, and we understand MEAG's parent company, Munich Re, is set to occupy part of the building.

The largest development transaction of the quarter by far was AXA's £175M purchase of the 200 year long leasehold interest in 50 Fenchurch Street, EC3. The site was purchased from The Clothworkers Company and benefits from resolution to grant planning permission for a 653,843 sqft 35 storey tower. The price paid reflects £268 psf on the consented NIA and demonstrates the continuing demand for prime development sites, which can facilitate best in class buildings with strong ESG credentials.

Domestic buyers were the most active in Q3 2022, making up c 45% of total volume. Australian investor TCorp accounted for 40%, with European and North American investors each accounting for around 3%. Several domestic buyers have returned to the market after a long hiatus, seeking value with less competition. However, with Sterling at a historic low, we anticipate a number of overseas investors returning to the market once there is more stability in the financial markets.

The two large core deals of the quarter at 21 Moorfields and Fen Court, 120 Fenchurch Street suggest prime yields currently stand in the region of 4.25%. However, given the rapid increase in the SONIA rate, we anticipate outward movement in the prime city yields towards 4.50% by the end of the year.

Given the continued volatility in the financial markets, a new leadership contest and the war in Ukraine seemingly not concluding in the short term, we anticipate many investors adopting a 'wait and see' approach, as the market readjusts to a higher inflation/ higher interest rate economy. The forthcoming leadership change and the announcement of the governments medium-term fiscal plan on 31 October will likely either calm or further exacerbate volatility in the financial markets, which will determine just how sharp the next BoE interest rate rise will be on 3 November. Once the markets settle and further evidence of a pricing adjustment emerges, we anticipate a number of investors returning to the market to capitalise on historically weak Sterling and higher yields, amongst a backdrop of a relatively buoyant occupier market.

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We continue to see rental growth at the top end of the market in prime West End locations, with Mayfair & St. James's new developments continuing to set new record rents far in excess of market averages.

West End Leasing Market

Transaction levels in the West End have continued to defy wider market pressures in Q3 with take up confirmed at 35% above the long-term average for the quarter. This was achieved with only one letting over 50,000 sqft, although that one letting was the hugely significant 225,000 sqft pre-letting to Blackstone at Lansdowne House, Berkeley Square, W1.

In total there was just over 1.45M sqft let in Q3, broadly similar to the Q2 take up figure, underlining a continuing strength of occupier demand across the market despite well documented economic headwinds.

Other notable deals in the quarter included 49,000 sqft being let at Chelsfield/Olayan's new development at Hoopers Court, Basil Street, SW3 to Winton Capital and Invest Industrial; Gravity Media taking the 5th & 6th floors (29,120 sqft) on a sublease at West Works, White City and Millennium Capital taking 24,454 sqft at 62 Buckingham Gate, SW1 on a 4 year sublease.

In terms of supply, availability fell to an 18 month low reflecting a vacancy rate at 6.6% (down from 6.9% in the previous quarter) across the West End (against a 10.0% vacancy across Central London as a whole, up from 9.8%). Tenant released "grey" space availability has slowed markedly which alongside reabsorption of space previously on the market from occupiers has assisted in this reduction of availability in the West End.

The development pipeline is exceptionally constrained in the short term with 1M sqft of space due for completion before the end of the year, but with over 85% of this already pre-committed/under offer, occupiers who require new space in a short time frame have limited opportunities. Deliveries in 2023 look more substantial with more than 4 million sq ft planned to complete, albeit a significant proportion of this space is likely to be delayed into 2024 and beyond and c.30% of the space already pre-let.

We continue to see rental growth at the top end of the market in prime West End locations, with Mayfair & St. James's new developments continuing to set new record rents far in excess of market averages. For lettings at rents above £100.00 psf, the average rent level has reached its highest on record this quarter at an average rent equating to £125.50 (average was £117.50 in 2021). This is continuing to highlight the increasing disconnect with Grade B rents which are continuing to come under pressure, particularly in locations with more limited amenity and transport infrastructure.

Summing up, demand for the best office spaces in the West End continues to remain buoyant in the face of macro-economic pressures. We anticipate continuing upward pressure on rents in the short term for new Grade A space as occupiers compete for an eroding development supply pipeline. As we move into 2023 it will be important to monitor the occupational market closely for signs if wider economic concerns are impacting occupier confidence in a meaningful way that could change the current buoyant market sentiment.

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West End Investment Market

The momentum experienced during the first half of the year continued into the start of Q3 in London's West End. There was an unprecedented flurry of summer activity, both in terms of volumes of transactions taking place and number of buildings being brought to market as investors sought to capitalise on the known market conditions of the day rather than wait for the future in a market environment that continues to change daily.

We recorded a total of £1.2Bn exchanged or exchanged and completed in 25 transactions across Q3 2022, reflecting an average lot size of £48M. The largest deal of Q3 was Tabung Haji's acquisition of 33 Horseferry Road, SW1 for £247.5M, 3.25% NIY and £1,363 psf for 11-year UK Government income with annual CPI linked rent review kickers (pricing agreed at the end of 2020). This brings Q1-Q3 total to £4.4Bn (66 transactions), in line with the five-year average of £4.3Bn however c. 17% down on the pre-pandemic five-year average (£5.3Bn).

We are in a period of 'price discovery' between buyers and sellers, with long term investors hoping to be able to enter the market at below the long term average pricing.

The September 'back-to-school' season has been characterised by price renegotiation, with deals that went 'Under Offer' pre-summer experiencing price chips to reflect the continuously changing market conditions, some of which were accepted for example 43-45 Portman Square, W1 sold to WELPUT at a renegotiated c. £152.5M (c. 5.67% and c. £1,305 psf) and others were not. The sale of One Stanhope Gate, W1 by Lothbury IM to billionaire Natie Kirsh for c. £75 million (c. 3.88% NIY and £2,213 psf) is also a clear illustration of the market rebasing with prime West End office yields moving out by c. 50 bps from the record 3.25% at the start of the year.

As per the traditional trend during economic market volatility the dominant seller this quarter has been the institutional funds (10 disposals) as they off-load West End property assets to satisfy redemptions, manage liquidity and rebalance the portfolio. Domestic UK buyers dominated the buyer pool in terms of number of transactions (11) and volume (44%). Although the buyers this quarter have really come from everywhere with geographic origins being represented and accounting for the following volumes Asia (29%), Europe (12%), African (7%), Americas (7%) and the Middle East (2%).

'Inflation at 40-year high'; 'Bank of England's base rate risen for seventh consecutive time'; 'cost-of-living crisis'; 'mini-budget'; 'war in Ukraine'; 'price renegotiation'; 'attractive bond yields'. These phrases, soundbites, and ongoing events have characterised the headlines for the latter part of Q3, and momentum has been replaced largely with a 'wait-and-see' attitude from investors on both the buy and sell side. Of the 25 transactions recorded for Q3, only six happened in September. The reality of a market like this is that it tends to favour the buy side with investors able to pick up lot sizes at a discount whilst waiting for the debt market to settle and some investors are faced with the realisation that their development / refurbishment schemes are uneconomical due to ever rising construction costs combined with investor return expectations.

At the time of writing we are tracking c. 65 properties currently either on market or recently marketed, and under 10 which are in solicitors hands. The West End typically transacts around 120 buildings per annum. It is fair to say that we are in a period of 'price discovery'.

As we look forward to Q4, which is traditionally always the busiest quarter of the year, we wait for vendor pricing aspirations and what purchasers are prepared to pay to find relative parity. We are tracking approximately £1Bn of stock 'Under Offer', which suggests that the headlines domestically and internationally, politically and economically, are set to impact year-end total volumes (five year average £6.5Bn). That being said there is still a significant amount of capital wanting to invest in Central London, particularly in the Value-Add sector where 'best-in-lcass' product can be created as rental levels in the West End reach record levels, the pre-let market soars, and supply remains constrained.

We continue to track the 'Pret Index' as an indicator of the rebound of people returning to the office due to Pret's association with lunch-hour, and the clusters tracked indicate throughout London things have largely returned to normal, for example the West End is a fraction off pre-Covid levels at 97% (at the time of print) or plateaued, for example the City stands at 87% where the change in working habits of this occupier base has been much more pronounced. Pret's cafes in London's airport terminals and train stations have showed how quickly leisure, business and commuting travel rebounded. Since flight routes have reopened demand has soared and transactions climbed consistently since with sales now at 42% above pre-Covid levels at London's Heathrow, Gatwick, City and Luton airports despite the well-publicised thousands of airline routes being cancelled. Transactions at London's railway stations (Victoria, King's Cross & St Pancras) have gradually recovered as each phase of the economy reopened, with sales having now returned to pre-pandemic levels.

Ending on a positive, there is still a significant weight of capital allocated to central London, not really requiring large amounts of leverage – the streets feel 'back-to-normal' in terms of footfall, and 'best-in-class' buildings continue to be let or pre-let at record rents in a continued flight to quality. But it is fair to say that we are in a period of 'price discovery' between buyers and sellers, with long term investors hoping to be able to enter the market at below the long term average pricing.

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National Investment Market Overview

Following a period of political crisis, the 5th Prime Minister in six years – Rishi Sunak has much to attend to including war in Ukraine, rampant inflation and unsettled markets which all need urgent attention. The upset following the mini budget underlines the importance of balancing the books, communication and political leadership. The recent fiscal event widely referred to as the 'mini budget' contained the largest set of tax cuts since 1972 and an energy subsidy package which was un costed and unaccompanied by Office for Budget Responsibility forecasts. The announcements took the markets by surprise and led to a surge in GILT yields and a sharp sell off in sterling and ultimately the downfall of Liz Truss's premiership. Higher borrowing costs fed through to the investment market on the back of higher base expectations to come which has dampened buyer sentiment towards commercial real estate.

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Transaction volumes:

Full year 2021

£55.2BN
Up 26.55% on full year 2020

H1 2022

£27.17BN
Up 14.03% on H2 2021

Q3 2022

£6.95BN
Down 48.43% on Q3 2021

Retail Warehousing Overview

2022 has emerged as the year of two halves for the property market and retail warehousing is no exception. Market conditions have changed quickly with increases in interest rates and gilts, retail warehousing is having to find a new level of pricing. The occupational market is holding up well with occupiers still being acquisitive and keen to agree new terms for longer term occupation in return for rent free or a rebased rent. With vacancy levels below the 5% mark there is an element of occupiers looking to protect their store portfolio. We have again seen Home Bargains buy their store and the TK Maxx in chesterfield with the view of upsizing once they can get VP from TK Maxx. The majority of demand is still coming from food, discount and gym operators.

A lot of product came to the market in Q2 in order to seize upon pricing being achieved in Q1. Lots of this hasn't sold as pricing slipped over the summer and no longer aligned with vendors expectations. This includes the two portfolios put on the market by The Crowns and M7's which combined is over £500m and there was also Solihull Retail Park which quoted £94m and Purley Cross Retail Park at £80m. The market for the larger lot sizes has fallen away again being more reliant of debt and often too large for the institutional investors who generally cap out at £50m mark as they do not want too much exposure to one asset/location. This element of the market had only just started to recover as highlighted by the acquisition of Castlepoint in Bournemouth but is stuttering once again. Private Equity investors are still keen on the sector but waiting in the wings to see if pricing does come off and opportunities do arise.

The smaller end of the market is holding up better with private money, propcos and smaller funds still active but being selective on opportunities and requiring a discount to pricing being achieved in the first half of the year. Martins Properties completed on a portfolio of three pieces of retail warehousing in the south east for a blended 6% NIY which provides a good barometer.

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Retail Market Overview

Following the re-pricing of the retail sector following the pandemic, the asset classes now face similar prospects. This has meant some much-needed stability for the retail market in Q3, however with recent developments following the mini-budget, retail is not yet out of the water. The squeeze on domestic spending has created additional pressure for retailers who are battling the reduced footfall, which is estimated to be 20% below pre-pandemic level.

The rebased pricing of retail has attracted more opportunistic investors into the sector with several prominent shopping centres changing hands. Ireland based Martin Property Group have been one of the key players in the sector, purchasing centres in Tamworth, Bridgwater, Rochdale, Edinburgh, Mansfield, Hyde and Chester. Local authorities proactively working with investors and owners to regenerate entire town centres is also an emerging investment theme.

Whilst in the face of retail adversity, one investment product that has withstood the challenges of the pandemic and the several lockdowns was long-let supermarkets. These investments were considered bullet-proof at the beginning of 2022, however with the rising interest rates, the pricing of these assets has cooled. An investment type that is a financial derivate linked directly to borrowing rates has witnessed a softening in price with the increase of finance costs. Purchasers are no longer paying top price for these assets (unless linked to uncapped RPI reviews) and vendors therefore no longer look to sell an asset with strong fundamentals in a volatile market. This has resulted in a quiet 'long-income' market

Whilst there has been a mismatch of vendors' and purchasers' expectation earlier in the year, the market now has more 'motivated sellers'. With fund redemptions, we expect there to be a large volume of transactions in the coming months which will continue the trend of ownership shift from institutions to opportunistic property companies and private individuals.

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Office Market Overview

After a strong H1 enjoying yield compression and robust investor demand, the national office market calmed down in Q3 as investors wrestled with the soaring cost of debt and lower supply overall.

Q2 was dominated by several larger transactions, however, Q3 only saw a handful of deals in excess of £25m whilst a number of disposals were put on hold. First Street North in Manchester traded for £105m on a forward funding basis to Pension Insurance Corp whilst the Bower in Stockley Park traded for £73.75m reflecting a NIY of 7.2%, a 120 bps discount against quoting yield.

The deployment of capital remains weighted towards assets offering high quality accommodation, income security and strong ESG credentials, however this type of stock is heavily under-supplied. Despite the clear lack of supply, we have seen prime yields move out by 50-75 bps in the last 3 months for longer income stock with a WAULT of 10 years+ as a result of debt levels rising.

Encouragingly, logged demand has risen rapidly in 2022 as occupiers are beginning to see the advantage of office occupation, increasingly encouraging staff to return on a full-time basis. More than ever, occupier requirements are focused on 'new' or speculative' accommodation, as take-up for this type of space is at the highest level on record due to the essential requirement of better-quality offices with strong sustainability credentials to lure occupiers back to the office permanently.

As we move in to Q4, there is an expectation that we will continue to see lower than expected supply, however we could see several opportunities resurface having been repriced to reflect the changing market conditions.

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Industrial Market Overview

The industrial sector has not been immune to all the market movement mentioned above.

Prime yields were always at an unsustainable level in the 2%s & 3%s and once it became clear that interest rates were going to rise, these yields were always going to move out. It is the prime end of the market which has suffered the most with yields moving out 150 to 200 basis points.

Good secondary industrial has proved more robust – market sentiment has all been negative however it is too early to gauge where multi-let industrial estates are at. We believe that yields may have moved out by 100 basis points although on the flip side we are hearing from our clients that industrial rents are still rising – whether this rental growth is sustainable in a weakening economy remains to be seen. With all the variables listed above, we are of the opinion that now may be a good time to consider industrial as a "buy opportunity".

Despite all the fall in values mentioned above, we have been busy in the sector over the past 3 months. We have sold a well let unit in Launceston for £3.3m (NIY 5.1%) and then followed up with the sale of a small estate in Tamworth where we achieved a yield of 6.75% against a quoting yield of 6%. In addition, earlier this month we acquired a development site in Dartford for a UK developer backed by US equity in the sum of £26m and at present we are under offer on the sale of a portfolio of industrial estates in the North East on behalf of a UK institution (£20m).

Not the brightest of pictures but if Allsop are anything to go by the market is still very active in this sector…

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Portfolio Market Overview

Unlike the two previous quarters, Q3 has seen a bounce back in portfolios emerging to the market. Pricing corrections and motivated sellers have supported this trend with several big-ticket transactions completed in Q3, alongside the launching of several new opportunities. The standout deal this quarter was the £425 million purchase of Project George, a 3.3 million sq.ft industrial portfolio that included a 700,000 sq ft delivery pipeline across 50 acres, purchased by the Singaporean sovereign wealth fund, GIC.

Despite increased market activity, investment volumes fell to £1.7 billion as rising interest rates and negative macroeconomic indicators have caused a slowdown in investor confidence. However, the £20-£60m market has seen a return compared to the previous quarter where transactions totalled £253.1 million, reflecting a 25% increase against Q2 volumes.

The portfolio market continues to be propped up by industrial transactions with 4 out of the 5 £100m transactions being institutional industrial disposals. This trend is set to continue with the a number of industrial sales entering the market having come off the back of open ended funds battling rising redemptions and the prospect of raising liquidity.

As we enter Q4 we expect to see more portfolios emerge across all sectors, as evidenced with Shell's disposal of its UK funds assets. Allsop are marketing the Chamber portfolio which offers a rare opportunity to acquire six hotels with 17.5 years unexpired to Travelodge with uncapped RPI indexed reviews in 2025 and 2030.

Looking forward to 2023, those with dry power and appetite for risk will use this time as a window of opportunity to invest accordingly.

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We could see several opportunities resurface having been repriced to reflect the changing market conditions.

Commercial Auction Market

Since the announcement of the infamous mini-Budget on 23 September, much of which has been subject to a U-turn by the hastily appointed new chancellor Jeremy Hunt, the mood among many property investors has been sombre.

That sentiment is completely understandable: a sharp increase in borrowing costs has made it difficult to price property, which has consequently made lending a more complicated affair, leading to a degree of pricing readjustment across the sector. According to some, prices could fall by 20% by the end of 2024, and some maintain that no asset classes will be immune to the doomsday scenario, which will see offices, shops, warehouses and residential property affected. The U-turn is complete, but the damage is done.

Many property funds have been shifting assets as investors seek to exit to meet their own obligations. As a result, some have delayed or suspended redemptions from their institutional real estate funds as they try to free up cash by selling existing property assets in this highly tense market environment.

Insulated from the turmoil

What some don't realise is that property auctions are well insulated from the overall market turmoil, and based on what Allsop has been witnessing for the past couple of months, liquidity has not been an issue. At this point, many of you may have raised your eyebrows in disbelief, and I understand why – convention dictates that buyers will always want a return that exceeds the cost of finance on their investment, and we have been selling assets at 5% or less when borrowing costs have risen to 5% or more.

The figures simply don't seem to stack up, and it doesn't take an investment guru to see that. However, things will make more sense when you look at our buyer base: the majority of them buy in cash, which removes the financing hurdle altogether.

But why would someone want to invest in property now, amid the doom and gloom that we're constantly being reminded of? Simply because a physical asset with income-producing potential provides a degree of certainty in these tumultuous times, and if you're not relying on external borrowing then you're still in for a comfortable return on your investment.

Those who are prepared to hold on to their assets and ride out the wave of instability are not particularly worried about short-term price fluctuations. Needless to say, our buyers appreciate quality assets in good locations and with well-capitalised tenants, and as long as these factors are accounted for, most are happy to continue investing despite the barrage of depressing headlines.

Different rules

Our auctions are a market within a market, and conventional rules don't always apply. Because of the sheer volume of transactions we handle, we have a good understanding of where values are at any point in time, and that makes the auction route an attractive one to a variety of sellers willing to part with their assets on fair terms.

Over the past few months, we have sold numerous properties on behalf of an array of sellers, including listed funds, REITs, family offices, private equity firms and propcos, with no signs of panic-selling in sight, if prices were anything to go by. Some sellers did better than they thought they would given the overall economic sentiment, and more than 50% of the total sales were achieved at auction on the day itself, as sellers stuck to their pricing and buyers had to compete.

Of the £125m raised at our September auction, we sold a variety of asset types, including a £3.4m gym in Leeds (NIY 7.6%), an industrial portfolio totalling £18.4m (NIY 6.5%), a £2.4m mixed-use scheme in London (NIY 6%), a £9.6m portfolio of veterinary practices (NIY 4.9%) and a £4.7m Boots portfolio (NIY 6.7%), which clearly shows that the rules of the private treaty market, inextricably linked to the cost of borrowing, do not apply in the auction environment. Interestingly, the assets from our latest auction were sold at an average of 119% of the guide price for the £1m+ lots, which, again, shows that not everything we read about the state of the property market in the weeks following the mini-Budget (with a maxi-impact) should be taken at face value.

As Allsop approaches its November commercial auction, we're bracing ourselves for non-stop calls as buyers and sellers try to gain first-hand insights into the market. Luckily, the data-rich auctions market can help with that.

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The rules of the private treaty market, inextricably linked to the cost of borrowing, do not apply in the auction environment.

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Residential Auction Market

> The first auction of Q3 was held on 4 August. Although interest rates had not entered their current trajectory, they were on the rise. Despite this, the sale generated £34M from the sale of 115 lots

The third quarter of 2022 has seen some of the most serious economic shifts for many years. In addition to rising costs of living, a falling pound and disturbing escalations in the Ukraine war, the Bank of England increased interest rates to 2.25% for the seventh consecutive time since December 2021 in an effort to tame runaway inflation – the highest level for 14 years. The move increased the mortgage costs of around two million homeowners almost immediately. As the UK enters recession, the future of house prices looks increasingly uncertain.

The first auction of Q3 was held on 4 August. Although interest rates had not entered their current trajectory, they were on the rise. Despite this, the sale generated £34M from the sale of 115 lots, with a number of high value lots selling prior. A total of 2,156 bids were placed on the day, with 600 individuals having registered to participate. The success rate was 80% and the total raised exceeded the August 2021 total.

The highest value lot to sell under the hammer was a garage and workshop in South Wimbledon with planning permission for seven flats, which sold for £1.52M. A freehold house in Folkestone was the most popular lot of the day. It sold for £297,000 having attracted a total of 140 bids. A freehold house in Kennington guided at £800,000 was sold for £870,000. And a freehold building arranged as three flats in Ruislip sold for £865,000 from a guide price of £780,000.

The second sale of Q3 was held on 22 September. By this time, the UK had a new prime minister. The mini budget had been announced for the following day. In total 126 lots were sold raising £46.5M.

One of the largest lots to sell on the day was a freehold semi-detached building in Hackney. Internally arranged as five self-contained flats, the building was let on a rent guaranteed lease which expired in February 2023. It was producing £75,000pa (equivalent). It was knocked down for £2.42M reflecting a yield of 3.75%. A freehold building arranged as eight self-contained flats in Exeter Road, West Hampstead, London was offered subject to assured shorthold tenancies. Producing £116,592pa, it sold for £1.905m or 6.66%. The garden land of this house, which had a generous frontage to the parallel street, was then offered as a separate lot. It extended to around 3,300 sqft and had potential for development as a single house (subject to consents). Guided at £100,000+, it sold after much competition for £394,000.

Owner occupier lots went well. A freehold detached house in Tunbridge Wells sold for £581,000. And a detached four bedroom house in 0.68 acres in Yeovil was knocked down for £402,000.

Our next residential online sale will be held on 15 December.

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Residential Transactional and Living Markets

Investment

I ended my Q2 comments with the following "The sentiment for Q3 indicates an understandable note of caution thanks to high inflation and the threat of interest rate hikes…"

An awful lot has happened in the three months of Q3 which I don't need to spell out now, but in terms of residential investment we brought to market a number of excellent opportunities across London and the UK, each with their own unique selling points. To name a few, they included a prime freehold block of fourteen apartments in Pimlico, an entire cul-de-sac of 18 houses in Canada Water and a portfolio of 500 units in the North East. As always, accurate pricing is key and in each instance the interest levels were very good despite the time of year and notably cautionary outlook. The market was quick to recognise the uniqueness of these opportunities and with the benefit of hindsight perhaps it comes as no surprise that the ultimate buyer in each instance was based abroad taking full advantage of the weakening pound. The deployment of foreign capital is a trend we expect to continue for the time being.

> Looking forward, bearing in mind the increased cost of debt there will have to be adjustments to property pricing in this sector.

Looking forward, bearing in mind the increased cost of debt there will have to be adjustments to property pricing in this sector. The days of cheap borrowing are behind us for the foreseeable future thus we anticipate that the drivers for investment will change. Asset management and value add angles will be even more important than they were previously and more specifically where capital values are higher and yields lower, investors will factor in a larger discount to the vacant possession value. Where more borrowing is required higher yields will be the driver and investors will once again look to the regions where capital values are lower.

What is important to remember are the very basic fundamentals of this sector. People always need somewhere to live, there is a fundamental shortage of housing and, as we learnt from the COVID pandemic, paying rent or a mortgage remains at the very top of people's priorities, making residential rental returns a much safer bet than perhaps other property sectors.

Albeit the dust has yet to settle as quickly as we'd like it to, it has quickly become a buyers market and cash is undoubtedly king for the time being.

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Residential Development

Q3 generally suffers from a certain slowdown over the summer months followed by a spate of activity as the summer ends and September arrives. This year this appears to have been exaggerated more than most as people waited to see what the impact of the Boris Johnsons resignation meant. There was subsequently a flurry of activity in early September as the market saw more opportunities launched, however this was quickly followed by a pause following the uncertainty brought on by Truss's mini-budget. The later part of the quarter was therefore also slow with the majority of transactions happening being those that had been agreed prior to the summer.

The housebuilders are in a much better position than they were in the last economic crisis in 2008 from a cash position, however the economic uncertainty, combined with rising interest rates and the challenging mortgage market has seen their share prices fall over recent months. This has led to a degree of caution on their part and therefore it is clear that while they are still in the market for opportunities and need to keep their pipeline going, they are generally not aggressively bidding on sites and are being more selective in their opportunities. With the funding market becoming increasingly expensive the smaller SME developers are also focusing more on their existing assets than on new opportunities and are struggling to be as competitive in terms of price.

There is still limited evidence of land values seeing significant reductions, however the planning process has been getting increasingly challenging and build costs have been rising for some time and continue to be at an all time high. This now combined with the economic uncertainty and the impact that rising interest rates has had on mortgage availability and affordability has meant that developers are increasingly struggling to meet landowners historical aspirations and the transactions that are happening are either in good locations with strong fundamentals or with landowners who understand the impact recent events has had and still wish to sell.

With less competition from the commercial market, which has seen a significant shift in yields, this will arguably open up more opportunities for developers who may have previously been priced out of the opportunity in favour of existing use value. Fundamentally there continues to be a shortage of homes and the PRS and BTR markets have seen leasing numbers significantly increase in recent months with rents dramatically increasing. With the institutional investors appetite in residential having grown and rents increasing this is an exit that an increasing number of build to sell developers have been looking at in order to de-risk their developments with over 40% of the new homes sales in London in Q3 2022 being to PRS or BTR investors (according to Molior London). This started as people saw Help to Buy coming to an end, however it should be noted that 22% of new homes sales this quarter were still absorbed by Help to Buy which will be coming to an end next year.

There is no doubt that the number of buyers in the market is thinner, however there is still strong appetite for good opportunities and multiple offers being made, however it is those that are cash rich in this climate which will be most successful as vendors increasingly focus on a party's deliverability. With Rishi Sunak now potentially offering a sense of stability, hopefully there is a degree of optimism in the air over the coming months. Undoubtedly, we will see some softening of land values due to the on-going build cost increases and the new interest rate environment, albeit with the land market being so diverse, we expect it to be more marked in certain typologies and price points.

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> There is still limited evidence of land values seeing significant reductions, however the planning process has been getting increasingly challenging and build costs have been rising for some time and continue to be at an all time high.

Student Housing

It feels sensible to approach the Q3 update on the student housing market by separating into pre and post 'mini-budget' because the quarter has been defined by this.

Pre 'mini-budget'

The general sentiment was strong on both the operational side and within the transactional markets. This was underpinned by good market fundamentals demonstrated in the most recent data from UCAS. Although total acceptances were down by 1% from the previous year, mainly driven by the decline in EU and mature students, the total numbers were 1.4% higher than 2019, prior to the pandemic. Crucially, the number of acceptances from 18-year-olds continued to increase by 1.4% year-on-year and is expected to continue.

StuRents reported that during the pandemic, higher tariff universities over-recruited due to higher grades being achieved. This year however, there was a 7.7% drop in acceptances at these higher tariff universities with more students receiving lower grades. Consequently, medium and lower tariff providers have performed better growing their number of acceptances by 2.3% and 2.9% respectively. It will be interesting to see if this continues to play out in the longer term or whether this is simply a rebalancing of numbers following a cohort of students with high grades.

Q3 saw the start of the new 2022/23 academic year with operators also dealing with higher energy costs impacting stabilised returns. This impact was softened by a combination of tightening up management efficiencies and increasing rents where possible.

- Unite Students sold a portfolio of six student properties totalling 1,050 beds in Aberdeen to Clearbell for £33m reflecting a 6% net yield.
- The University of London sold Lillian Penson Hall comprising 313 vacant student bedrooms to Union Property Services for over £75m, substantially higher than the £55m guide price.
- Tristan Capital Partners and Bricks Group purchased the Aura Investors PBSA scheme in Liverpool, previously in administration. The purchase price of £110m reflecting ~£110,000 per bedroom.

The HMO market was buoyant despite potential challenges with the Renters' Reform Bill proposals. Although PBSA is exempt, it is not clear whether the Bill excludes student HMOs. The main challenges relate to the abolition of Section 21 'no fault' evictions and a ban on fixed term tenancies, instead transitioning all tenancies to one system of periodic tenancies. Investors were also trying to grapple with increased running costs mainly relating to utilities.

Post 'mini budget'

The result of the mini budget causing immediate rises in inflation and a sense of uncertainty has caused some unexpected market turbulence. Across the sector, transactions under offer have generally slowed and there has been some evidence of price adjustments on agreed deals to take into consideration the increased cost of borrowing with some, particularly larger transactions, falling out of bed. This is less a reflection of student accommodation as an asset class and more a case of trying to ascertain what changes (if any) to values is occurring.

It feels as though investors are currently in three categories; some investors are on pause, some are taking stock but adjusting pricing, and some are almost continuing as before.

We have definitely seen a softening of yields for HMOs which is a product of two factors; utility costs and the cost of debt. Almost all the national HMO landlords are UK-based and therefore exposed to the UK debt markets and rents are mostly all inclusive. Whether this is short term or not remains to be seen but good quality opportunities of scale are in limited supply therefore vendors will likely hold out for a recovery.

With PBSA, value-add and higher yielding opportunities might be sheltered to some extent, but stabilised pure income stock is different – there is likely a shift in yields here. That said, some overseas investors seem to be continuing as before which might be the benefit of a currency play. It will be interesting to see how these – very significant – market players dictate the tone of the market (and values) in the coming months.

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The Build to Rent Market

Whilst macro-economic factors have inevitably had an impact on the BTR investment market, there has been less of an impact when compared against other asset classes. This is largely due to the counter cyclical dynamics of residential rental investments and the strong drivers that remain; high occupancy, rental growth and restricted supply. It is likely that the higher cost of borrowing for mortgages and continued build cost challenges is only going to exacerbate the imbalance of supply / demand.

The regions remain particularly attractive, aided by operating assets in those areas showing strong occupation and rental levels, whilst London and the south east has become increasingly desirable as occupation and rental levels now returning to pre-pandemic levels – as evidence by Eco World's Barking Wharf letting 595 flats within 14 months.

Occupational demand on operating BTR schemes remains extremely high which is generally driven from 23 – 35-year-olds, who want to live in good quality rental accommodation, in central locations, with cohesive communities where residents can feel secure with longer term tenancies. The success of BTR schemes which have opened over the past three to 12 months is prove of this demand, with the vast majority of schemes in main centres such as Bristol, Birmingham, Manchester and Leeds being over 95% let and ahead of forecasted lease up rates.

The British Property Federation's (BPF) latest figures show a total number of units either complete, under construction or with planning standing at 237,362. Numbers in the regions continue to grow at a faster rate than London, accounting for approximately 140,777 with 96,585 in the capital.

> Funding yields remain resilient for well-designed multi-family BTR stock in prime, practical locations, underpinned by the strong performance of operating schemes.

The BTR single-family housing (SFH) market has remained extremely dynamic, activity of note includes: Apache Capital gained planning consent to deliver 373 sustainable homes in Eddington, Cambridge; Leaf Living announced two deals with Countryside to build 106 homes in Heybridge and Milton Keynes; Aviva Investors and Packaged Living completed a deal to purchase 195 homes in Telford;

Activity of note within the BTR multi-family market this quarter includes: DWS have partnered with Watkin Jones to deliver 316 units in Bath; Round Hill Capital have agreed a £165M forward fund with developer Olympian Homes for their 488 unit scheme in Manchester; AIMCo and Ridgeback Group have acquired a portfolio of UK BTRE assets from Angelo Gordon for £283M in Cardiff, Birmingham, Sheffield and Greater London, taking their portfolio to 3,102 units; Long Harbour, together with Cadillac Fairview and PSP Investments, have agreed to forward purchase 204 units within Leaside Lock, Bromley-by-Bow for £110M; Court Collaboration entered into a funding partnership with PGIM to support the acquisition and development of their BTR scheme in Digbeth, Birmingham; Moda have acquired a site with planning permission for 410 homes in Sheffield city centre; Get Living have agreed to fund Watkin Jones' Leatherhead scheme for £71M.

Funding yields remain resilient for well-designed multi-family BTR stock in prime, practical locations, underpinned by the strong performance of operating schemes. This is aiding to help reduce the impact of increasing delivery costs, a result of in part, labour and material shortages and rising utility costs. In London and strong south east locations, NIYs range from 3.50% to 4.00%, with major regional centres at 3.75% to 4.50%. Secondary locations are in the region of 4.50% to 5.00% NIY.

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Residential Letting and Management

The BtR and Single Family market has continued its upward trajectory amid broader global challenges. Political upheaval, the war in Ukraine and rising interest rates failed to dampen rising rental levels. Our own multi-family portfolio has enjoyed rental growth in excess of 6% across all assets year to date. Indeed Office for National Statistics' (ONS) rental index outlines rental increases across the market, for both movers and non-movers at 3.7%.

Whilst the fundamentals of this asset class is clearly underpinned by a chronic undersupply of quality housing the correlation between rental growth and salary growth is important if we are to continue to see rental growth. Our residents' cost of living exposure is becoming more acute and so initiatives are underway to insulate our residents (and create a comparative advantage for Allsop's clients). Such initiatives have included PV panel installation on our single family assets and a new district water source heat pump installation at our BtR asset The Keel.

The appeal of energy efficient new-build homes has moved further up the agenda for our customer-base with 76% of respondents to our recent Homeviews survey stating they are interested in their home's energy efficiency rating and in energy efficiency initiatives in general.

We believe this is likely more prevalent now than ever due to the energy cost issues the populous faces but also because the demographic we (and the sector) attracts are more interested in their environmental impact. Indeed this is an area our clients and their customers are aligned as often forward funders and potential purchasers of stabilised assets have their own ESG criteria which must be met.

These well-documented rising costs of living are not dampening the demand for rental property in either single family or BtR all assets with our portfolios currently operating in excess of 98% occupancy. Indeed the ONS's most recent survey shows the average rental value at £795.00 – the highest since records began.

Allsop continue to see a strong appetite for investment targeting Build to Rent (BtR) and whilst recent budget and economic impacts have undoubtedly caused some pause for thought with leveraged funders the strong performance we continue to see in terms of rental growth, occupancy and collection rates as well as the lack of supply in the market more generally means we are confident the investment fundamentals remain.

We continue to monitor whether a cooling period may emerge further into 2023 whether that be because an affordability ceiling is hit for certain schemes or because central fiscal and monetary action manages to curb inflation more generally. Our own data suggests our BtR customer-base is better protected from inflationary shocks whilst our single family residents tend to spend less as a proportion of their take-home salary on rent and therefore there is likely more headroom from an affordability basis to accommodate any shift in the average rents within the rental market.

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Well-documented rising costs of living are not dampening the demand for rental property in either single family or BtR all assets with our portfolios currently operating in excess of 98% occupancy

One survey undertaken has predicted an average fall of 25% in Rateable Values in the retail sector. I suspect there will be wide variations in falls and it wouldn't surprise me to see some retail down by over 50%.

Business Rates

2023 Revaluation – publication of draft figures imminent

It is understood that the publication of the draft 2023 Rateable Values is potentially being brought forward. Originally the draft figures were due to be released on 31st December. We have been advised that publication of the figures will now possibly be in late November.

The actual impact of the 2023 Revaluation on Rates Bills however will also depend on the following:

- 2023/24 Uniform Business Rate (UBR) – At a revaluation the UBR is reset in order to bring in the same tax income in real terms to the Government. For example if the total Rateable Value of the county following the revaluation was reduced by 10% then the UBR would increase by 10% to bring in the same income. This UBR figure is then increased by CPI to bring in the same tax income in real terms.
- Rates Phasing – Following a new revaluation the rates liability on some properties can increase substantially. The Government are required by law however to introduce a rate phasing scheme in order to provide some protection to those businesses facing large overnight increases. The cost of this scheme however has previously been financed by also placing caps on the level of reductions ratepayers can receive. Following a consultation held in the summer the Government are considering whether to permit those ratepayers seeing a significant reduction in their rates bills to receive the reduction immediately rather than it being phased in over a number of years.

UBR and Phasing announcements

For previous Rating Revaluations by the time the draft Rateable Values have been released the Government have also confirmed the level of the UBR for the following year and the rate phasing regulations relating to large rate increases and reductions. It is therefore anticipated that the Government will be likely to announce the UBR and phasing details in late November.

Wales and Scotland – 30th November –
The draft 2023 Rateable Values for properties in Wales are likely to be released at the same time as those in England. In Scotland the draft 2023 Rateable Values are due to be published on 30th November.

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Major swings in rates liability likely

From what we understand the VOA have taken on board the fall in rental values in the retail sector. This should lead to rates liabilities on retail premises significantly falling from next April onwards. One survey undertaken has predicted an average fall of 25% in Rateable Values in the retail sector. I suspect there will be wide variations in falls and it wouldn't surprise me to see some retail down by over 50%.This will be long overdue but welcome news for retailers as well as landlords with empty properties who are having to pay rates on properties which they are unable to let.

- Asset Management
- Auctions
- Build to Rent
- Business Rates
- Development Agency & Advisory
- Investment Sales & Acquisition
- Lease Advisory
- Letting & Management
- Office Leasing (Central London)
- Receivership
- Student Housing
- Valuation

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