

UK real estate: have we reached the bottom yet?

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The UK was the first European real estate market to experience asset price falls and is showing some signs of stabilising.

The real estate market in the UK was ahead of the rest of Europe heading into crisis. Will it be ahead in recovering? In recent weeks, a number of commentators have speculated that the UK property market might be close to reaching the bottom. There is certainly increased interest, and even in some cases activity, from overseas investors.

The UK, whose real estate market has traditionally relied heavily on debt financing, has experienced one of the most marked downturns amongst European countries. The latest issue of our UK Real Estate Insights publication notes that capital values have fallen almost 40% since the peak of the market in June 2007. When combined with the fall in the value of sterling, commercial property in the UK is now over 50% cheaper, priced in Euro, than at the peak of the market.

Changing dynamics

It is important to note, however, that the nature of the real estate crisis is changing. What started out as a real estate capital markets crisis is turning with recession into a potential occupier crisis. The focus of attention for real estate investors is, therefore, much more on what is happening in the broader economy. The UK economy officially entered recession in the final quarter of 2008 as it posted its second consecutive quarter of contraction. The pace of decline became much quicker as the economy contracted by 1.6% on top of a 0.5% decline in Q3 2008. The situation has deteriorated further since then and we now expect negative GDP growth of 3.5% in 2009. This is not unique to the UK and the crisis in property and the broader economy is afflicting the rest of Europe too.

Despite the economic gloom, there may be opportunities to get through the current difficulties with high-quality assets let on long occupational leases to financially sound tenants.

As well as activity by direct investors in property, we have also seen new equity being invested in the listed sector. Following the significant decline in commercial property values in the fourth quarter of 2008 and with many analysts predicting further significant declines in 2009, it became clear to many of the UK listed real estate companies that they would need to deal with the dramatic erosion of their equity. These companies realised that they would need to address their capital structure, and replace the equity that was being diminished by falling valuations with equity either from asset sales or from shareholders by way of a rights issue or placing of new shares.

Have prices reached the bottom?

Does this mean that we have reached the bottom? Unfortunately, like the ocean, the bottom appears to be a very murky place, and there is not much clarity as to what is lurking down there or what lies ahead. There is uncertainty as to how close we are to valuation lows and we have certainly not reached the bottom of the occupier crisis. For the rest of Europe, the question must be whether the signs of increasing activity in the UK are an indicator that the transactions may start again elsewhere too and, perhaps even more crucially, if recovery is possible without the savage re-pricing that has occurred in the UK.

To obtain a copy of UK Real Estate Insights, please e-mail:
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