

# Introduction

An extract from UK real estate insights - Issue 13, July 2009

## Introduction

### Reasons to be cheerful, part 3

Welcome to the latest edition of UK real estate insights. In the previous two editions we have commented on the changing nature of the real estate crisis as the situation has moved beyond one of falling values into a market with deteriorating real estate fundamentals. In the April issue, we speculated as to whether we might be reaching the bottom of the market, and what the bottom might look like. Since then, divining the future has not become any easier – the augurs prodding at the entrails are receiving very mixed messages.

There are increasing signs of buyers from overseas returning to the UK, particularly from Germany and the Middle East and also some home-grown recovery funds. Generally, they are looking for properties with long leases and strong covenant strength tenants, although there are some examples of buyers being slightly less demanding (in the words of Mike Prew from Nomura, not insisting on 'marmalade on their toast'). However, for those looking for reasons not to be cheerful, there are also plenty of signs of distress. In June, administrators from PricewaterhouseCoopers<sup>1</sup> were appointed at Rock Investments, although in that instance the very extensive media coverage probably had more to do with Paul Kemsley's role as one of Sir Alan Sugar's interviewees on *The Apprentice* than the importance of Rock to the UK economy. Other administrations and receiverships of property companies have also been hitting the press. Even on this, there is a debate as to how it should be interpreted. Is the increasingly interventionist activity by the banks a sign that the situation is continuing to deteriorate or that they believe that we have reached the bottom?

The equity raisings by property companies and funds also sends mixed messages. The debt covenant breaches that they are remedying are a clear indicator of the continuing fall in values.



There is also clearly an opportunistic element. Ian Coull of SEGRO, after speaking at our annual real estate client conference on 21 May, hot-footed it back to his office to announce a bid for Brixton...

The key issue now is the state of the occupier market and we have included

our latest economic forecasts in this edition of UK real estate insights. As might be expected, the messages here to are mixed. A number of economic indicators suggest that although things are not yet getting better, at least the rate of decline is moderating. However,

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<sup>1</sup> "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom).

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as our UK economic outlook points out, “the extent of the good news should not be exaggerated and to a significant extent just reflects the normal operation of the stock cycle”. “Destocking made a major contribution to the very sharp fall in GDP in Q4 2008 and Q1 2009. While the reversal of this stock adjustment could lead to quarterly GDP growth becoming positive again before the end of 2009, there is a risk of a relapse into recession in early 2010 (allowing also for the effect of VAT rising back to 17.5% from 1 January 2010).” The prospect of unemployment continuing to rise is also of direct concern to the real estate industry. Fewer people occupying desks will add to the issue of grey space in offices as well as reducing their capacity to spend in the shops.

The current issue of UK economic outlook includes a detailed assessment of the potential adverse impact of the downturn on different age groups, a subject likely to be of particular interest to retailers and their landlords. “We find that the youngest age group is the most exposed to rising unemployment, but that older workers nearing retirement will also be severely hit as they are not only at relatively high risk of losing their jobs in downsizing exercises, but will also have seen their prospective pensions and their housing wealth fall very significantly over the past two years.” On the positive side, the report does

come with a less dramatic health warning on downside risk than the previous edition.

So for both the broader economy and the real estate markets the outlook is still unclear. However this is at least an improvement on unremitting gloom. Reasons to be cheerful? The jury is still out.

Finally, as already mentioned above, we held our annual real estate client conference on 21 May. More details are included elsewhere in this edition of UK real estate insights, but I would like to take the opportunity in particular to thank our experts from the industry for the lively panel discussion: Ian Coull, Chief Executive, SEGRO; Nick Jacobson, Managing Director, Head of European Real Estate & Lodging, Citigroup; Michael Kenney, Senior Director, Hypo Real Estate; and Andrew Wood, Chief Investment Officer, MGPA.

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