GERALD EDELMAN

INDUSTRY UPDATE
QUARTER 4
YEAR 2021

Property Services

Although the property industry has experienced volatility during the past 16 months, the sector has recovered well.

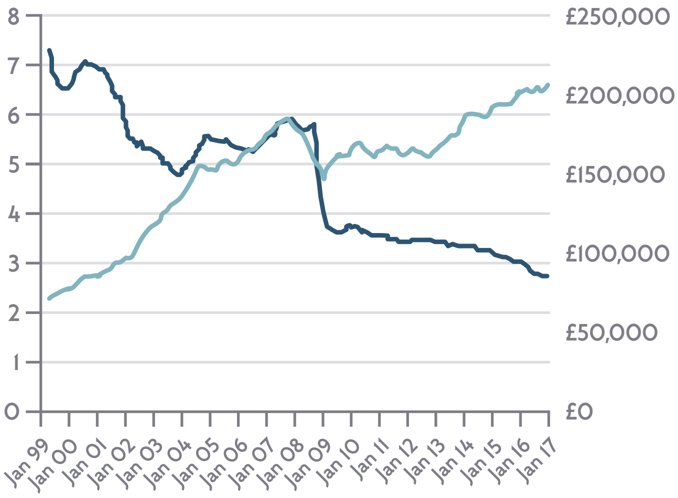
Optimism in revenue and profitability recovery are expected to continue throughout 2022 in both the commercial and residential sectors, as well as M&A activity. Despite this optimism, it may be too early to fully foresee the future of the industry as inflationary pressure threatens the rise of interest rates.

Overview

Since the opening of the UK in spring/summer 2021, the property industry continues to remain in a strong financial position with record-breaking valuations.

However, in recent weeks announcements on the UK inflation rate surging has increased speculation and anticipation of the inevitable rise of interest rates, and consequently the cost of borrowing ("cost of debt"). The extent of the impact on the industry is unknown, however history demonstrates that these two have an inverse relationship [as illustrated in the graph below]. Investors redistribute their investments away from traditional property sectors such as office spaces, and instead towards sectors with expected long-term growth, including student accommodation and warehouses.

House Prices vs Mortgage Rates



% average interest rate   Nationwide average house price

(Sources: Bank of England, Thomson Reuters Lipper, Nationwide, ONS)

The Housing Market

The housing market continues to soar with buyer demand persistently being driven through the 'race for space' as companies uphold working home arrangements for employees. Lockdown also provided consumers with the ability to accumulate record levels of savings, fuel to search for larger homes in the countryside.

House prices in the UK have hit records across all sectors and regions for the first time in almost 15 years, with buyers hustling to scoop up a home ahead of the predicted interest rate rise. According to Zoopla, the total value of Britain's homes hit £9.2 trillion this summer, with the combined value of Britain's 28.6 million residential homes increasing by £550 billion in the past year alone. The UK's property price growth slowed marginally last month as the stamp duty holiday came to an end, though October still provided the highest average UK property price on record at £267,587.

Regarding rising values over a five-year period, Zoopla stated that the South East of England had outstripped all other regions. While London maintained the position of the most valuable region, at a total of £2.4 trillion, the market was sluggish with it taking longer to sell a home in London compared to anywhere else in the UK. As we witness a return of office workers and the gradual relaxation of international travel restrictions, this has prompted overseas buyers back to London, after 18 months.

Average UK House Prices

(Sources: HM Land Registry, Registers of Scotland, Land and Property Services Northern Ireland, and Office for National Statistics - UK House Price Index)

Stamp Duty

The tapering of the stamp duty holiday from July and its expiration at the end of September in England and Northern Ireland, was forecast to hinder demand in the housing market. But the market disproved expectations, with demand for properties remaining in surplus, continuing to drive a strong property market.

Structural Factors

There are also structural factors which affect demand in the housing market, including relatively low levels of unemployment and low interest rates. But due to the increasing pressure of inflation, there is heavy anticipation of a rise of interest rates from the Bank of England – traders in money markets expecting a move from 0.1% to 0.25%, with many expecting a bigger move by the end of 2021. In foresight, we have seen several UK banks raising their mortgage rates on fixed-rate deals over the past few weeks and expect this to be a common occurrence for all lenders in the UK housing market in the near future. The record saving levels seen during the pandemic will allow buyers to lower the average loan-to-value for the houses they are buying, therefore minimising the impact on the end purchase of the rise in the cost of debt.

Supply and Demand

Supply and demand has and will always be the primary pricing model in the housing market. The under supply of houses in the housing market continues to cause an imbalance within the industry. Of recent, industry leaders are expecting the upwards momentum of prices to continue, despite the increased cost of debt, as a result of the limited supply of available housing where in September 2021, Knight Frank reported that there were 13 buyers for every new property listed in the UK.

This imbalance is not a 'normal' occurrence in the market, with the only time demand ever surpassing supply in the past five years, was in January 2020. This excess of demand is likely to keep upwards pressure on prices in the coming months until supply and demand meet at 'golden' equilibrium.

The Commercial Sector

In the past 18 months, there has been a shuffle in commercial property as investors looked to move within the property industry to relatively well performing alternative sectors.

The pandemic has haunted a number of commercial property sectors, specifically retail and office spaces. This has promoted landlords to concentrate into alternative sectors in the property industry which have fared better throughout the pandemic, including warehouses and student accommodation. Repositioned investor portfolios are following structural trends of ecommerce and the growth in student populations. There has been an 18% increase in the number of deals recorded from January to July 2021, in which commercial property investment volumes reached £31.4 billion in July, a 32% increase from the previous year.

Warehouses and Student Accommodation

Warehouses are being probed by the aggressive rise of ecommerce businesses during the pandemic, where the lockdown and restrictions on physical shopping acted as a catalyst for strong technological advancement within the ecommerce industry.

Equally, with rising levels of student populations and a surge in investment to research and development through academic institutions, there is growing demand and investment within student housing and campuses. This repositioning of portfolios is evidenced by two moves from Blackstone, in the sale of BNY Mellon's London Office (St. Pauls) and the approach to student housing operator GCP Student living.

Office Sector

The use of office spaces has remained relatively volatile during the pandemic. Though many individuals are now making their way back to offices, despite employers extending their work from home position. This recovery is exacerbated by the relaxation of travel restrictions as overseas investors and companies look at their geographical position of their portfolios and are able to visit the site before completing their purchases. It is expected that office buildings in London, Sydney and Melbourne will bring record levels of cross-border capital in 2022. Research by Knight Frank's, states the United Kingdom to see $15.7 billion investment outwards and $38 billion inwards, providing a net position of $22.3 billion overseas investment to the UK property market. More specifically, the office sector is expected to attract over half of all cross-border investment.

Change in commercial real estate investment

(Sources: Y-o-y change in commercial property investment in the UK Q1 Statista)

Property Services

The COVID-19 pandemic initially led to severe disruption in on-site construction activity and impacted both supply chains and new sales activity, which naturally reduced revenue opportunities. Lower output and fewer enquiries from the pandemic reduced industry revenue by 23%. The construction industry performance is contingent on movement in property prices, government schemes intended to boost housing supply, and the underlying sentiment of the property market which included property investment and mortgage activity.

As previously discussed, property prices are in a recorded level position, with a strong sentiment in the market and the continuation of demand despite the end of stamp duty holiday in September. In the October budget it was announced by the chancellor of the exchequer, Rishi Sunak, that the government were providing a £11.5 billion fund to boost construction of new homes, as part of the affordable housing programme.

Additionally, a £1.8 billion fund will see 1,500 hectares of brownfield sites and derelict homes turn into new homes. Between Government stimulus, high property prices and strong sentiment, it should be expected that the recovery of the buildings construction industry should see strong recovery this year, potentially above expectations. Moreover, government schemes like Help to Buy have been vital to stimulating housing demand and encouraging construction.

As mentioned in our previous report, property and real estate service industries have experienced substantial M&A activity over the past number of years. There is no surprise that the COVID-19 pandemic initially caused a slump in deals completed. Though as the property market experience recorded breaking levels, a number of players looked to consolidate their position in the real estate market. The retail industry suffered the most from store closures causing distressed retail properties to be acquired by large institutional investors and private equity firms. Notably, Ingka Investments snapped up Acadia Group's Topshop store in central London.

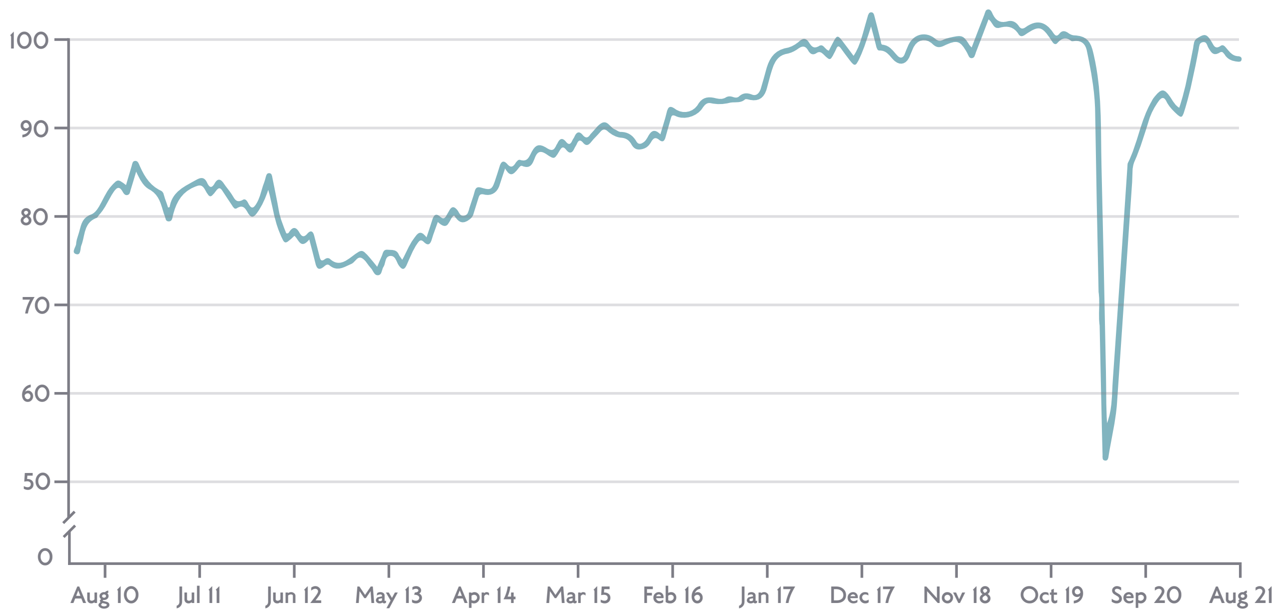
M&A

Some deal highlights from the last property update:

Date	Company	Investor	Deal Type
26-Oct-21	Arcadia Group (Topshop Store in Central London)	Ingka Investments	Buyout/LBO
25-Oct-21	Urban & Civic (700 Homes Portfolio)	The Goldman Sachs Group	Buyout/LBO
28-Sep-21	Helix Property Advisors	Hines Interest Limited	Merger/ Acquisition
16-Sep-21	Cactus Property Management	LDC	Buyout/LBO
6-Aug-21	St Modwen Properties	The Blackstone Group	Buyout/LBO

The movement of shifting portfolios away from traditional assets, such as leased offices and retail spaces, towards warehouses and student housing, was already noticeable during the lead up to the pandemic, but COVID-19 has exacerbated this trend. This is evidenced though Blackstone's buyout of St. Modwen Properties, after approaching the logistics

Construction Output



(Sources: Office for National Statistics - Construction Output and Employment)

(warehousing) and housing developer for a £1.2 billion deal. In a move to increase their exposure to sectors that have boomed during the pandemic, with a strong strategy towards logistics as one of their 'long-term investment themes'.

Taking a slightly longer term view, the focus on ESG and sustainability will have a significant impact on the future landscape of deals in the property industry. As sustainability considerations are factored into investment decisions in every stage of the assets lifecycle; through the construction and design, building management, acquisition and disposal.

Conclusion

The property market should be optimistic for revenue and profitability recovery throughout 2022, as market sentiment and government stimulus will continue to support their post-pandemic positioning. It is expected that the housing market will continue to remain in a strong position for months to come, though it is too early to fully expect the true effect of the anticipated increase in interest rates. The soar in ecommerce and growth in student populations will continue to affect investors portfolios as they look to gain exposure to long-term investment themes.

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