January 2023

The Property Round

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Richard Kleiner

GERALD EDELMAN

EDITORIAL

Welcome to the Winter 2022 edition of the Gerald Edelman Property Newsletter. This edition is very much focused on looking forward to 2023 and how the sector will perform in yet more uncertain times.

In our Property Sector Update, it is clear that the current climate – cost of living crisis, war in Ukraine, rising interest rates etc. – is taking its toll on both the residential and commercial property markets and transaction activity is beginning to slow or plateau. 2023 is expected to see a continuation of these themes, but as always in the property sector, it will prevail and what will be challenging for some, will present itself as opportunities for others.

We're delighted to bring you contributions from our guests, clients and contacts who are active in the property sector and have shared their thoughts and understandings on the year ahead. It's incredibly interesting to get their insights and to see their outlook for 2023. Spoiler alert. It's not all bad!

Following the Covid pandemic, there has been significant shifts in requirements of occupiers and tenants. In one of our articles, I have taken a closer look into this and the trend towards having flexible office space, which includes content from an article that appeared in a recent edition of Estates Gazette.

I would also like to take this opportunity to thank the whole of the Gerald Edelman team for their hard work and support during 2022. I also welcome all new additions to the team, including two new partners. Lynn Lin who joined earlier in the year and is now head of our China/Asia desk, and Grant Lee who joined us recently as an audit partner (and has also contributed to this edition).

Wishing you all a happy, healthy and prosperous 2023!

Richard Kleiner

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PROPERTY SECTOR UPDATE

2022 was quite a year – we saw the outbreak of war in Europe, the passing of Queen Elizabeth II, three prime ministers in the UK, entered into a cost of living crisis and have interest rates that now stand at their highest level in 14 years.

So, what has this meant for the property sector?

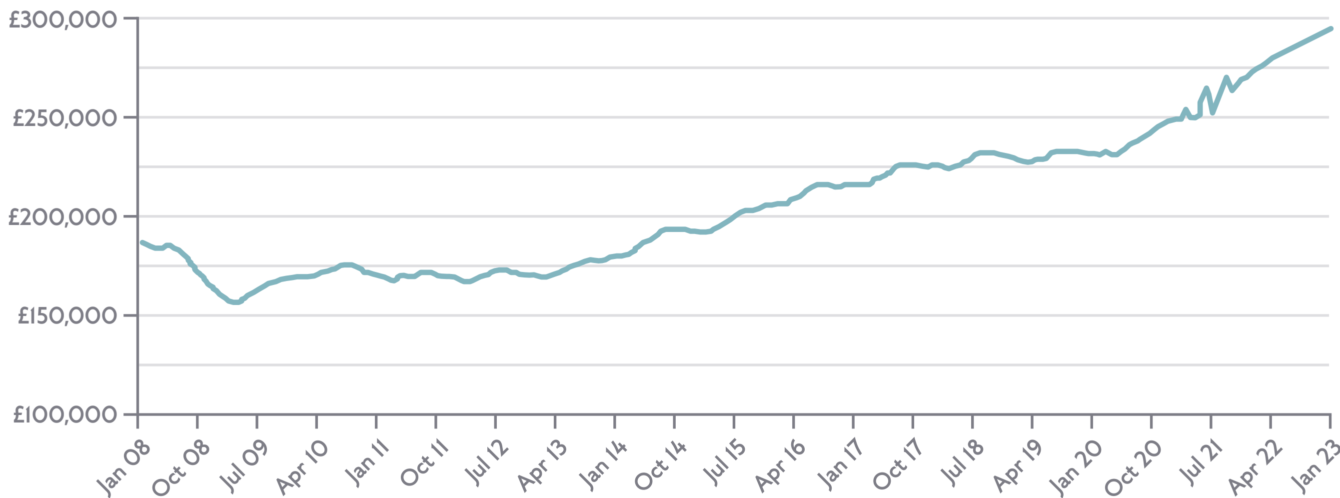
Forward indicators point to a slowing market. New sales agreed fell 12% between October and November, according to TwentyCI.

The rental sector, on the other hand, has seen a plateau with rents rising by 12.1% in the 12 months to October across the UK, according to Zoopla. The level of growth is unchanged from July. A lack of supply has supported growth, however, there is a fear that tight household finances will start to restrain growth going forward.

Positively, Benham & Reeves state that the new Prime Minister, Rishi Sunak, has stabilised the London housing market.

With the continuing shortages of many types of property and with mortgages stabilising it has helped to steady the sector and means that current sales prices are being underpinned by the imbalance between supply and demand in London.

AVERAGE UK HOUSE PRICES



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

THE HOUSING MARKET

The average UK property price did rise by 12.6% in the 12 months to October 2022, according to data form the office for national statistics.

However, annual house price growth fell to 4.4% in November, down from 7.2% in October according to Nationwide. The pace of falls accelerated from October when prices fell by – 0.9%. Values are likely to continue to fall until pressures on household finances start to ease.

Repricing is clearly underway too, with price reductions rising 85% in November, compared to the first nine months of the year according to TwentyCI.

The mini-budget's stamp duty cuts were also announced to be time limited until April 2025. The current lower rates will help to support the market over a challenging period and will likely result in a surge of activity before stamp duty thresholds revert to their higher levels in 2025, according to Savills' UK Housing Market Update.

Judging what this will actually mean for the market in 2023 is inevitably speculative given the uncertainty as to how high interest rates will continue to rise.

THE COMMERCIAL SECTOR

Repricing has been seen across the commercial property markets. This is reflected in the tone of the feedback gathered as part of the Q3 RICS UK Commercial Property Monitor. The Investment Enquiries metric posted a net balance reading of – 18% over the last three months compared with +12% in Q2.

RICS has also recorded that transaction activity has slipped to £10.6 billion in Q3 2022, which is more than one third down on the volumes recorded in the previous three month period. It is suggested that this decrease is due to greater caution amongst occupiers.

Knight Frank estimate the vacancy rate now stands at 9.3% for city offices which is the highest level since the start of 2012.

The sector is seeing pressures from hybrid working with business's scaling back office space. To counteract the slowing market, 85% of the respondents to RICS data indicate they are seeing an increase in the repurposing of office space.

CONSTRUCTION OUTPUT

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

PROPERTY SERVICES

According to RICS Economy and Property Market Update, the latest official data for construction output indicates that it is around 6% up on a year ago and 2.5% above pre-pandemic levels. However, the workload momentum does now appear to be slowing. New Business Enquiries are showing the least positive reading since the Q4 2020.

The cost and availability of building materials continue to be viewed as major challenges for the industry with around four-fifths of respondents to the Q3 RICS Construction Monitor identifying these issues as limiting activity. Recruitment also remains a concern, with upskilling still perceived to be the most immediate route to lifting productivity levels in the industry.

MERGERS AND ACQUISITIONS

Date Acquired	Target/Company	Acquirer/Investor	Enterprise Value (£)
17/06/2022	Hibernia REIT	Brookfield Asset Management	928,840,000
02/08/2022	Coimares	Qatar Investment Authority	299,240,000
04/07/2022	Smart Studios	Round Hill Capital	171,680,000
11/05/2022	Secure Income REIT	Lxi Reit	1,180,000,000
11/11/2022	Countryside Partnerships	Vistry Group	1,270,000,000
06/05/2022	McKay Securities	Workspace Group	265,700,000
25/05/2022	Stones Residential	Foxtons	2,190,000
22/09/2022	GL Hearn	WSP Global	60,000,000

M&A had a strong start at the beginning of FY22, seeing a year-over-year increase of 13% in M&A activity. However, activity has slowed down comparatively in H2 owing to economic uncertainty. A combination of high bank rates, an ever-fluctuating macroeconomic environment, and geopolitical issues have slowed down deal completion in the second half of FY22.

Despite the slight waning of growth, Real estate M&A generally outperforms other asset classes as it is less vulnerable to short-term fluctuations in the stock market, providing steady returns and solid capital growth. Additionally, some investors are actively seeking to complete deals before the end of the year, in the event that global macroeconomic conditions worsen.

Significant growth opportunities are predicted for property in FY23, largely associated with the continuation of the consolidation trend, offering scale to investors. Furthermore, deals on hold from the uncertainty in the economy in FY22 are set to complete in early FY23, increasing the number of Property M&A deals completed.

CONCLUSION

The increase in interest rates is taking its toll on both the residential and commercial property markets and transaction activity is beginning to slow or plateau. 2023 may be difficult for the sector, but there are signs the market is stabilising, especially in certain markets.

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GERALD EDELMAN

SPECIALIST PROPERTY ADVISERS

Our team has over 50 years of experience working with individuals and businesses in the property and construction sector.

60% of our client base comprises of entities and individuals operating within this industry, which means our team has the knowledge and experience to help you overcome challenges, capitalise on opportunities and ultimately, achieve your aspirations.

We support all those working in the sector, from property developers and landlords to professionals, such as surveyors, architects and letting and estate agents.

We offer a one stop shop for our clients, delivering compliance (audit, business strategy and direct tax advice) and beyond compliance (M&A and Deal Advisory, International Tax, Asset finance and specialist tax advice) support. You can expect to work with a dedicated team that is committed to your success.

Contact us and see how we can support you.

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WHERE IS THE PROPERTY MARKET HEADING IN 2023?

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The next 12 months will be difficult for many with real estate holdings, but with difficulties for some there come opportunities for others. As a business we always do better in recessionary times than in boom times.

Over the past 10 years we have seen record low interest rates, which have allowed people to buy property and make money without thinking. For the next few years property investors and speculators are going to have to give thought to their asset management and in some cases look for a plan B.

The last three months have seen some tumultuous times in UK politics, and this has destabilised the capital markets. We feel the Bank of England had been too slow in increasing interest rates and quantitative easing (QE) had continued for too long, which has made the interest rate increases sharper than necessary.

Without the Russian invasion of Ukraine, which has had its own effect on the world's economies, the central bank's use of QE was inevitably going to cause inflation and the only method of controlling inflation open to the central banks is to dramatically increase bank rates.

Rising interest rates, energy costs and a general cost of living increase, has created the perfect storm for property owners, whether it is your home, business premises or as an investor. We spoke with a major bank last week and they were stress testing lending based upon interest rates of 9%. We are not saying this is normal but if that is the case across the lenders, there will be some serious casualties.

In the home buyer market, talk of 20% to 30% falls in prices is widely reported. Whilst we can see this in the new home sector, where there will be short-term over supply as demand falls, we suspect this will be in isolated pockets of the Southeast and some of the UK's cities. There may well be some pain for homeowners with high loan to value where affordability is a problem, but we suspect the banks will offer assistance rather than risk a market crash.

Price falls may also be advantageous for those in help to buy situations where the value of the lenders portion will diminish, possibly presenting opportunity for buying larger proportions or the whole property for less than the entry price.

For those with more equity and a steady income, whilst belt tightening may be necessary, if there is no pressure to sell then why take a lower price unless you are up sizing.

The buy-to-let market could be an area where there is stress. While landlords can try to increase rents to cover loan repayments, with tenants' resources stretched with other spiralling costs, there is a risk tenants will not be able to pay. This could result in forced sales, but again banks have been more careful with loan to value since 2009 and this may not happen.

In commercial property, there are many head winds; from WFH affecting demand for offices, declining footfall in town centres, to energy cost rises making business space unviable. There will be price corrections. A yield of 4.5% looks fine when you can borrow at 3.5%. It doesn't look so good when the cost of borrowing hits 6%. We don't expect bargains, just opportunities.

If you are a property developer, there are also problems ahead. Not only have building costs risen rapidly, but with finance costs also rising, the land or residual property value must be diminishing if a profit is to be realised.

For Central London developers, the saving grace is there remains good demand for the best quality space offering great ESG. This has kept prime City rents rising and we expect to see £100 per sq.ft. achieved regularly in the next two years and the West End well over £125 per sq.ft.

That leaves the retail and leisure sectors. Hotel occupancy in London is reaching pre-pandemic levels, with a combination of domestic tourism and world travellers. We think the removal of the VAT recovery scheme for overseas visitors is short-sighted and could mean Chinese and Middle Eastern customers shopping in Paris and Milan rather than London. Perhaps the unintended consequence of Liz Truss's failed economics causing the collapse of the value of Sterling has counteracted some of these concerns.

For retail, despite COVID driving us to buy online, there is still a place for the High Street. Rent and business rates need correcting, which will reduce overheads and then the High Street will return. City centres do need the workers to return to the office five days a week. Cafés and shops cannot operate not knowing when their customer base will be there or indeed opening just three or four days per week. Many cafés and bars across the City centres have already gone, more will follow as a result of the energy cost crisis, but new operators will emerge. Britain remains a land of entrepreneurs and we will find a way through these turbulent times.

Our team at James Andrew International are here to give sensible real estate advice if required.

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CHAIRMAN

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"INTERESTING TIMES"? AN EYE TO THE FUTURE IN COMMERCIAL REAL ESTATE INVESTMENT

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That old cliché, 'interesting times', is getting a good airing again. The phrase has been around for my whole career (which spans to date some 35 years!) and it always rises to the surface when things look somewhat uncertain.

The real estate 'added value' investment market revels in uncertainty. We investors/developers are the eternal optimist and we always believe that we can find that special deal.

Right now, both globally and in the UK, we are in a period of change and turmoil, in the eye of a 'perfect storm'...

- War in the Ukraine
- Covid aftermath and continuum
- Brexit effect and continued confusion
- Public sector borrowing at all time high
- Interest rate rises
- Refinancing/mortgage cost combined with lenders' tightening criteria
- Double digit inflation
- Utility costs spiralling
- Occupational requirement uncertainty for corporates
- Return to the workplace? Rise of hybrid models
- ESG and sustainability considerations
- Retail/online digital landscape

Based on my 'interesting times' theory, is all the above a signpost to a 2023 full of opportunity in the UK commercial real estate arena? Cautiously and to a degree (yes, I'm sitting uncomfortably on the fence), I believe so.

My prediction is that we will begin to see opportunities from the beginning of 2023, but pricing will not start to shift in a meaningful way until the second/third quarter onwards (one of the major catalysts being owners' financing obligations).

Global real estate manager, AEW, forecasts that the UK will be the *most* attractive market for investors for the second consecutive year in 2023.

Whilst this may be encouraging on a macro level, our business is based on the micro market.

WHAT SHOULD YOU LOOK FOR WHEN BUYING THAT PERFECT DEAL?

All deals require consideration on their own merits, but here are a few pointers:

- Stock selection is key in whatever sector piques your interest; location – established or improving?
- Entry/purchase price – values are all over the place as we speak and even our esteemed valuation experts are struggling with both yields and rental values. Perhaps sit tight for the time being unless you have a special reason to venture in...or be bold and go for it?!
- Hold period – what is your investment rationale? Long term hold or three to five year business plan? A longer-term hold could allow you to take a view on entry price and be more competitive with your bid.
- Asset refurbishment/development or straightforward dry investment?
- Control your own destiny. Does your business plan rely on the cooperation of a third party (neighbour or the council perhaps)? Be aware of this potential pitfall and try to always be in control of your own destiny.
- What do you know about the vendor? What is their motivation for the sale?
- If financing the asset, manage the funder's expectations to ensure they are comfortable with the strategy at an early stage and that they appreciate your expertise and ability to deliver.
- Surround yourself with good professionals in a multitude of disciplines; surveyors/project managers for construction knowledge, occupational specialists to assess demand and deliver occupiers etc.
- Asset Management expertise. This is fundamental to being able to deliver on your business plan. It's more than likely that you will have to amend the plan on a number of occasions throughout the process. It's all well and good buying the asset but the key is working it to extract its value and, most importantly, to ensure that if things don't go according to plan, you are able to protect your investment.

We look forward to what 2023 will bring, but hope you find these pointers useful for your next investment.

FLEXIBLE OFFICE SPACE – THE CURRENT TRENDS

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Following the Covid pandemic and the move, in large part, to hybrid working, there seems to be a major shift to more and more companies having a need for flexible office space.

There have been many commentators expressing views on whether the trends are sustainable over the medium to long term, and an article that recently appeared in Estates Gazette goes into more detail.

Within Estates Gazette's report it considered whether the demand for flexible office space is expected to increase in the foreseeable future and, if so, whether the supply can keep up.

THE KEY FINDINGS

The key findings were as follows:

- The flexible workspace in England and Wales would need to grow by 40% to deliver the required supply if just 10% of leased office tenants moved to a flexible arrangement.
- Businesses would need to grow by less than 20% on average whereas secondary markets would be significantly under-supplied.
- London's flexible office market is more mature, putting it in a better position to absorb additional demand from traditional office occupiers, although this is not expected to be sustainable.
- The amount of vacant traditional office space in the market could provide the solution to the flexible supply growth and would inevitably transform the flexible workspace landscape across the UK.

Tenants are increasingly choosing flexible workspaces, not only because of the lower-risk commitment but also due to a wider range of products on offer, including hospitality and leisure facilities.

As identified in the Key Findings (above), impact on flexible workspace supply will be uneven if the various scenarios are played out across the UK. Whilst major cities are reasonably mature, with the market share for flexible workspace increasing significantly over the past few years, secondary cities are not as well positioned.

London is considered one of the most flexible workspace markets in Europe and, as workers have returned to the office in the capital, occupancy rates within flexible workspaces are expected to remain above those of traditional offices.

The pandemic has also created a shift in the attitudes of landlords to the flexible office sector. Prior to Covid, landlords had only experimented with flexible space, but many are now under pressure to incorporate flexible space into their portfolios to remain competitive.

In terms of what this means for the future, the perception of work has most definitely shifted, which although interesting, is concerning for many landlords and the office market must move to meet the changes in demand.

Watch this space!

Prior to Covid, landlords had only experimented with flexible space, but many are now under pressure to incorporate flexible space into their portfolios to remain competitive.

TRUST STRUCTURES HOLDING UK REAL ESTATE

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An update on the Register of Overseas Entities (ROE) and reporting requirements.

The Register of Overseas Entities is now fully operational with the registration process via Companies House effective from 1 August 2022.

Whilst applicable to overseas companies/ partnerships owning UK land, other entities may be affected.

Here we take a look at trust structures holding UK real estate to examine the different scenarios when overseas entities may need to register with Companies House.

These include:

- Direct ownership by a non-UK trust
- Ownership via an underlying company held by a non-UK trust
- Ownership via a nominee company on behalf of a non-UK trust

DIRECT OWNERSHIP BY A NON-UK TRUST

If the UK land is directly held by a trust whose trustees are all individuals, the ROE won't be applicable as it is only legal entities governed by foreign law that are potentially caught by the registration requirement.

There will generally be a requirement to register on the ROE where non-UK incorporated corporate trustees directly hold the land. If registerable, information about the corporate trustee will need to be given, together with details on any persons who qualify as registrable beneficial owners of the company.

Information on the trust (which include details of the trustee(s), settlor(s) and beneficiaries), is not required where the overseas entity holding the qualifying land is the trustee. Further consideration is needed for private trust companies, where the trustee holding the property is a widely-held overseas company or where the trustee holding the property is an overseas subsidiary of a widely-held overseas company.

OWNERSHIP VIA AN UNDERLYING COMPANY HELD BY A NON-UK TRUST

If an underlying non-UK company owns UK land, there will usually be a requirement for the company to be registered on the ROE. Where the trustee holds more than 25% of the shares in the company, it will be a registrable beneficial owner.

OWNERSHIP VIA A NOMINEE COMPANY ON BEHALF OF A NON-UK TRUST

The final structure is one where the legal title is held by a company as nominee for the trust.
If the nominee company is registerable, it would need to provide details of its registrable beneficial owners.

If the trustee is not a registrable beneficial owner, there is no requirement to include details of the trust.

It is highly likely that a nominee arrangement will be considered an express trust for the purposes of the TRS.

As a result, where the trust is a non-UK trust, and the trust has a UK tax liability or the trust acquired an interest in UK land on or after 6 October 2020, it will need to be registered on the TRS.

The deadline for registration is 31 January 2023. The overseas entity must also file an annual update one year after it was registered, and every year after that.

Given the complexity of the legislation and the many elements which need to be considered when reviewing the requirement to register, it is anticipated that there will be a grace period where prosecution and penalties will not apply for late registration. Having said that, we encourage everyone to take reasonable steps to ensure registration where applicable, is done in good time.

GE can advise as to whether a trust structure falls within the scope of ROE and/or TRS regime, contact Sonal Shah if you need any support.

ORDER OUT OF CHAOS

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Coming into 2022, it felt as though we had all survived the most challenging effects of Covid in terms of its impact on our beloved sector (and businesses).

Yet, despite the sunnier climes predicted, we were sent back down to earth with a bump when the seemingly unimaginable prospect of war in Europe became a reality following Russia's invasion of Ukraine.

The impact was immediate, from the tragic loss of life to the rapidly rising inflation that has pushed up the price of everything in our professional and personal lives. Combined with the persistent rail strikes, whose predictable unpredictability makes it almost impossible for restaurants to operate with confidence and consumers to plan with certainty, and we are in time of consolidation, rather than growth. This has inevitably put the brakes on many property acquisition programmes.

Despite the pressures, however, there have been some successes in the sector. Value propositions have gone from strength to strength and this has led to a growth in requirements for drive throughs, which have traditionally only been dominated by a few players.

There has also been the rise of the drive-in, fuelled (pardon the pun), by the uptake in EV ownership. We predict that 2023 will see much more variety for when you are recharging roadside.

We have also seen strong operators in big cities outside London performing, and expanding in some instances, as well as the London suburbs holding up well. This has been driven in part by hybrid working, with many consumers seeking their familiar workplace brands in their own neighbourhoods. Destination and theatrical dining has also prospered, both in London and the rest of the country.

Stepping back to make sense of this suggests that the larger, more able landlords have been participating in deals in a more meaningful way. They are seeking a more collaborative relationship with their tenants, with Grosvenor's CEO, James Raynor, even going so far as to announce a move away from using the term 'landlord' as reflection of its desire to work together.

In addition, new developments that had been slow to gain traction have now seen more movement as the year is closing and with a new year ahead. Markers have been laid down in numerous sites we have been dealing with, sprouting either London debuts or independents again either debuting or indeed growing. And the opening of Battersea Power Station, an absolute triumph of transformation, has no doubt given the market a shot of confidence.

Our feeling is as larger businesses dispose of their marginal or non-profitable sites during the course of 2023, those markers will become a stronger force, offering opportunities for the smaller guys to grow on more favourable terms than seen for many years or possibly ever.

Larger business will also get more opportunities to purchase smaller businesses, offering new brand growth to portfolios with lagging brands.

Moves have also been made for international growth and this will continue. Franchising a brand to a new territory such as UAE can be a profitable route for growth with much of the risk negated, and we are also seeing brands searching for landmark locations in certain US cities too.

In summary, growth is beginning to be back on the agenda and will continue in a considered manner throughout 2023. Who knows, we may yet see some order emerging out of the chaos of the last few years. Here's hoping so...

We have also seen strong operators in big cities outside London performing, and expanding in some instances, as well as the London suburbs holding up well.

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COMMERCIAL INVESTMENT OPPORTUNITIES – FIND THE OPPORTUNITY IN DIFFICULT TIMES

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In this current market, there has been an increase in the number of business owners opting to own their operating premises, rather than leasing – allowing them to benefit from the potential profitable growth of the asset.

REALISING POTENTIAL

In these more challenging financial times, we have helped several clients to accomplish this – some with as little as 12 months of trading history. This is achieved by evidencing the financial projections of the business/asset, enabling lenders to offer up to 75% loan-to-value – allowing the client to channel funds into equity instead of rent.

For land and property owners, many are also realising the profitable potential of separating a parchment of their land to develop a separate dwelling, creating an asset that could provide a yield, if held. This can be achieved by raising funds against existing assets and attaining planning to develop ground-up dwellings.

It is also possible to utilise the land independently as leverage for the funding of such development, often with some lenders not requiring former experience of such ventures.

FIND THE RIGHT SOLUTION

Managing expectations from the outset is key, particularly when navigating the current environment of increased rates and uncertainty, as consumers and lenders are forced to be more flexible and adapt.

The previous standard of five-year fixed rates at 2.5% is no longer the norm – resulting in more conversations surrounding flexible, variable rates over a two-year term. That being said, advice given in today's market can quickly become outdated.

Therefore, any commitments made should take into consideration the potential for market recovery within the next 18-24 months. Decisions that seem prudent now could prove to be more costly as the market fluctuates and adjusts.

Understanding the options that are available is crucial for positive/more profitable outcomes. For example, landlords are having to look for alternative methods for maintaining profitable buy-to-let portfolios – incorporating a property portfolio into a special purpose vehicle (SPV) from personal ownership is one such method and is becoming an increasingly popular choice for landlords.

The knowledge and experience of an adviser are also vital to navigate the market and economic uncertainty, to ensure clients secure the most suitable solution. Landlords can increase overall yields by raising additional capital against existing properties to make additional purchases, which is something that is very much keeping lending in the buy-to-let market open for business.

Henry Dannell recently completed on a case where the client had been told by another brokerage that no further debt could be raised against the existing portfolio. However, we were able to submit one remortgage application, which raised sufficient funds to purchase an additional two buy-to-let properties, all within 72 hours from receipt of the enquiry.

Property can also be utilised as a platform to raise additional funds for a wide variety of other purposes, such as covering tax bills, funding property refurbishment or development, and for cashflow purposes for trading businesses.

Connecting with an adviser is the best way to find the most suitable solution for any set of circumstances.

Decisions that seem prudent now could prove to be more costly as the market fluctuates and adjusts.

PROPERTY 2023 THEMES – A FEW FINANCIAL REPORTING POINTS TO CONSIDER

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As the pain of rent concessions and empty properties during the pandemic receded during 2022, a sense of normality coupled with new ways of working started to feel conventional.

Transactional volume for UK commercial property deals held up well but finished with a slide in values in the last quarter of 2022. UK businesses may suffer a tightening of cash as the cost of doing business continues to rise during 2023.

Expected reductions in consumer discretionary spend reduced by high cost of goods, services, fuel, energy, and increased borrowing costs will have knock on impacts onto retail and leisure. Whilst the reversal of yield compression and weakening estimated rental values driven by high inflation and financing costs will affect the sector negatively, there are a few bright spots in the market.

Consistent with strong letting activity through 2022, there is expected to be high demand for prime assets in highly sought-after locations. For example, centrally located London office space may remain favoured as tenants with strong historical performance seek prime office and mixed-use assets. While values are assumed to decrease across all sectors, assets with attractive investment prospects are expected to be broadly the same as 2022. This may favour property assets such as: data centres (especially newer offerings), retirement complexes, health, student housing, housing available for rent, industrial, and logistics. The latter is envisaged to cool slightly due to the knock-on effect of a decrease in on-line consumer spending.

A widening of yields between prime, secondary and tertiary assets is expected to play out. This may be especially prevalent in secondary UK cities and suburbs. As opportunities start to present themselves, property investors may start to position themselves as net buyers in the market. Private Equity Real Estate funds in their investment period with dry powder could have a head start in securing acquisitions.

Real estate investors may have to work a little hader in 2023 to enhance their portfolios through capital improvements. Such enhancements may

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include refurbishments, fit outs or other asset improvement initiatives aimed at enhancing the tenant's experience and well-being, including the use of sustainability capabilities, or 'proptech', to name a few. However, those institutional investors may also have less cash to spend on property due to decreases in the value of their investment portfolios driven by capital falls across their equity and bond portfolios.

Consequently, it is thought that less equity and debt will be available for investment in real estate, whilst borrowing costs become more expensive, and financiers more selective about their collateral.

Conversely, a cooling of property valuations might help the attractiveness of the asset class as the yields of fully let long leased properties become more competitive in comparison to fixed income. As might the strong dollar against historical levels. These market forces may impact the financial statements of property owners in several ways. Some of the more significant themes are briefly outlined below.

	Possible 2023 Outlooks	Potential Impacts
Asset Valuations	▸ Reversal of yield compression and weakening sector lease income in some asset classes.	▸ Increase in the subjectivity of estimates and judgements as transactional volume decreases (although liquidity is not expected to disappear from the market, nor are Valuer's uncertainty clauses expected to appear). ▸ Specialised and niche assets – greater judgement and estimates as more adjustments for differences are made to comparable transactions. Expect a greater number of Auditor queries. ▸ Rental income – greater concessions may be needed to attract higher quality tenants (e.g. with longer rent-free incentives or higher fit out costs) – spread over the lease term and decrease rental income.
Debt Covenants	▸ Loan to Value ("LTV") – following the financial crisis, the LTV debt covenants may be in the range of 50% – 60% or below. These have the potential to edge up to 80% on some asset classes due to the reversal of yield compression. ▸ Interest cover – may decrease to the extent property rental income weakens.	▸ Property managers may be entering into early dialogue with the lenders to the extent breaches are foreseen on forecasts and sensitivity analysis. All debt breaches need to be disclosed in the financial statements. ▸ Over-rented properties may contribute to an overall drop in rental income portfolios as leases come up for renewal or break clauses exercised. ▸ Managing financing cash flows – floating to fixed interest rate derivatives may be accounted for as a cash flow hedge where the effective portion of the cash flow hedge is recognised in other comprehensive income, any ineffective portions recognised in the income statement. If not, then changes to the fair value are posted to the income statement. ▸ For unhedged investors under IFRS, cash flows will have to be re-estimated periodically in order to update the effective interest rate calculations on floating rate debt ▸ Listed property investors or operators may undertake equity raisings to inject into property portfolios or take advantage of market opportunities.

	Possible 2023 Outlooks	Potential Impacts
Asset Acquisitions	▸ As potential property acquisitions start to appear, more purchases may be undertaken as the valuations decrease and become more competitive. ▸ It is common practice in the UK to purchase properties within property wrappers.	▸ Acquisitions range in complexity and may vary on the spectrum as to whether they are asset acquisitions (recognise the property in the balance sheet with any associated liabilities) or whether the transaction is a business combination. The significance of the inputs, processes and outputs will determine whether it's a business. ▸ Asset acquisitions have the purchase price allocated to them based on their relative fair values – transaction costs form part of the cost of the asset. Under IFRS the initial recognition exemption is available for deferred tax. In business combinations, the assets and liabilities will be recognised and measured at their acquisition date fair values, with any positive or negative goodwill, and transaction costs being expensed. Under UK GAAP, goodwill will have a finite life and be amortised, deferred tax will be recognised on fair value adjustments and directly attributable costs are included in the purchase consideration.

The above table only highlights a few of the accounting treatments to be aware of given the market trends. There are numerous others that have not been expanded upon, for example leases, deferred tax, rental income, service charges, business rates, foreign exchange and capital or maintenance spend.

Please do get in touch should you have any audit or accounting advice requirements.

On Wednesday 16 November, Gerald Edelman hosted a wine tasting and networking evening for professionals within the property sector.

From developers to investors, architects and interior designers, the evening gave those in the property sector a platform to meet and network with likeminded individuals.

Want to join our property network?

If you work in the property sector or are looking to expand your connections amongst like-minded entrepreneurs, email Lauren Kelly at lkelly@geraldedelman.com about joining our network.

GERALD EDELMAN

LOOKING FORWARD TO 2023

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You'd be forgiven for thinking 2022 was a disaster after disaster. We emerged from a global pandemic, saw Ukraine enter into a war, witnessed our shortest ever-serving prime minister in Liz Truss, the passing of Queen Elizabeth II, our longest-serving monarch, and finally, the inevitable conservative leadership race to select a new prime minister, the third in as many years.

Despite this, there are plenty of positives to take into 2023.

We have a progressive government and a business-friendly prime minister who's stated getting Britain back on its feet and providing a platform for businesses to thrive is a priority. We're also hopeful to see a positive conclusion to the war in Ukraine. The knock-on effect of this is the falling of energy prices, helping to control fuel-based price inflation. As well as lowering interest rates and stability returning to the mortgage market long term. Buyers were reluctant to purchase at the end of 2022 due to uncertainty around mortgage products, hobbling the sales market for several months while banks repriced their offerings.

2023 will be positive but there will remain headwinds in the marketplace. Interest rates will take their time falling as the Bank of England wrestles with inflation, and mortgage products could take even longer.

The UK economy may fall into a recessionary cycle as business and output growth slows. Inflation will still be a factor for households as higher prices erode savings and wage inflation doesn't keep up with the real cost of living. For the property market, the effect of inflation could be upward pressure on prices. As the incentive to save is diminished, many people will look to transfer their savings into tangible assets.

We expect 2023 to start as 2022 left off with regard to prices and stock levels. We've seen historically low levels of stock for the last six months, prices in the lettings market are close to 40% up on the lows of the pandemic and sales prices remain strong on the back of a lack of available property.

Our advice for 2023 is as always quality, quality, quality.

If you're thinking of investing in a buy-to-let property, always purchase the *best* property your budget allows.

This may seem obvious, however, many fall into the trap of buying a compromised property for the extra space thinking bigger is better. This isn't the case. When it comes to void periods and property liquidity, a premium one-bedroom apartment on a good floor will always outperform a compromised two-bedroom property on a poor road or lower ground floor, for example.

If you buy premium, you will always do well.

We've seen a period of a weaker currency, making London a good value investment for overseas inventors. London continues to be a world financial capital bringing companies and employees to the capital each year. The English capital also boasts five of the world's top educational establishments, this brings thousands of students from the far east and across the world into the city's rental market.

At Landstones, we're bullish on the long-term outlook for property in prime central London.

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