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Insight

Real Estate Restructuring & Recovery in London

2023

The UK real estate market has witnessed an unprecedented number of socio-economic challenges in the last few years, culminating in interest rates reaching 5.25%, the highest for 15 years. With financial experts predicting that the base rate will peak at between 5.5% and 6% by the middle of 2024, it should come as no surprise that property focussed insolvency and enforcement action is on the rise. Where though is the pain being felt the most in London and the Southeast of England?





RESIDENTIAL DEVELOPMENT

Residential development is vulnerable to a number of unique challenges:



Build cost increase: -The annual rate of build costs increase, measured by the BCIS Private Housing Construction Price Index (PHCPI) peaked at 15.3% in 2Q2022 and continues to rise, although the rate of increase appears to now be slowing.



Development Finance: - Lenders have increased the cost of development finance to reflect BoE base rate increases, whilst also tightening lending criteria and decreasing the maximum available loan amounts.



Contractor failures: - According to the Insolvency Service, the construction industry experienced the highest number of insolvencies of any sector in England and Wales, with 4,143 company insolvencies reported, accounting for 19% of all insolvencies. Identifying a new contractor to complete a part-complete development is not only challenging but also has often dire cost implications.



Lower GDV's: - According to Halifax, average prices fell by 2.4% in the year to July, with Southeast England and the Home Counties suffering the largest fall at 3.9%. Most, if not all, experts are predicting house prices to fall by between 5 and 10% from their peak in September 2022, over the course of the next year.

A combination of the challenges summarised has resulted in an increase in the numbers of receiverships and administrations of part complete development projects. The squeeze on developer's profit margins has also resulted (in some cases) to attempts by developers to eke out additional value in order to mitigate losses. Whilst some developers are able to exploit legitimate ways to improve values / decrease costs, we have seen numerous examples where borrowers have breached planning or building control regulations or opted for a poorer quality finish, thereby worsening an already precarious situation.



OFFICES

The change in working practices, brought about by the covid pandemic has resulted in London office occupational levels being amongst the lowest in Europe - London West End (50%), London City (48%). How has the impacted transactional activity? –

According to JLL's most recent Q1 2023 Office report: -



Leasing activity - is 20% below the 10-year Q2 average for 2023



Investment activity - H1 2023 investment volumes were also 41% lower than the 10-year average.



Vacancy Rates - The Central London vacancy rate increased to 9.4% by the end of Q2 2023.

Empirical data on office related insolvencies remains thin, largely because offices, like other commercial investment asset classes, are traditionally let on relatively long leases with 3 or 5 year lease patterns (with upward on rent reviews), thereby delaying stress events. Nonetheless, letting and investment activity points to an inevitable increase in insolvency/enforcement activity, particularly for secondary assets and offices in locations with poor leisure/amenity offerings. Ever tightening MEES regulations look likely to put even more pressure of office investments, particularly secondary assets where significant capital investment is needed to meet current or future obligations.



RESIDENTIAL BUY TO LET

The residential buy to let sector has been buffeted by adverse legislative, tax and interest rate changes, making BTL investments increasingly unattractive. This has resulted in 70,000 buy-to-let landlords exiting the UK's rental market over the last 12 months (according to recent report prepared by UHY Hacker Young), together with an increase in the number of fixed charge receivership appointments, all despite a back-drop of strong rental growth: -

 **2 and 5 year fixed rates** – the average mortgage rates, according to Moneyfacts, are: Two-year fixed at 6.83%; Five-year fixed deals at 6.33% (Mid-August 2023), up from an average of 2.34% in December 2021 for a two year fixed mortgage

 **Legislation** - The BTL sector has been hit by a number of legislative changes, including

- the Renters (Reform) Bill, is seeking to abolish Section 21 notices, meaning that landlords can no-longer remove a tenant without due cause
- HMO licensing criteria was widened in 2018 to remove the 3 storey qualification requirement and allowing local authorities to impose additional licensing arrangements

 **Changes to tax environment** –

- CGT and SDLT costs have both increased for second homes/investment properties.
- The phasing out of mortgage interest relief and other tax-deductible costs such as arrangement fees, which began in 2015

 **Cost of living** – According to the NRLA, in Q1 2023 the number of possession claims made by private landlords totalled 7,269. This represents the highest figure in any first quarter since at least 2009. The increase in tenant defaults is clogging up the legal system, thereby making possession proceedings increasingly lengthy and BTL landlords vulnerable to longer periods with reduced or no income.

 **Cladding** – Whilst the Building Safety Fund is helping many BTL landlords remediate cladding issues, the wait times are long and buildings of 18 metres in height still do not qualify for funding. Any property sold without the benefit of an EWS1 form suitable for secured lending purposes (A1, A2 and B1) or a strong prospect of achieving one in the near term will crystallise a significant loss in value.

 BTL landlords with sizeable portfolios are subject to a subsidy threshold cap of £335,000 over 3 years. If the total amount of funding goes above this threshold, then the leaseholder will have to meet the balance themselves.

Get in touch

SW has one of the largest and most experienced property focussed Fixed Charge Receivership teams in the UK. Please get in touch should you require further information.



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