Opportunities and Outlook: The future of commercial property.

Together Commercial Property Report.

Insights into the commercial property market 2024 and beyond.

About Together.

We're Together - the market leading property finance experts with a common sense approach to lending.

We support individuals, businesses and property professionals to realise their ambitions by making finance work for them. Over the last 50 years, we've offered a range of mortgage and secured loan products to individuals and businesses who are typically underserved by mainstream lenders.

Our customers are central to everything we do. We build meaningful relationships to support our customers to turn challenges into opportunities which make their property ambitions a reality.

We're proud of our sustainability strategy which has very clear targets for how we support our planet, our communities, our customers and our colleagues. And we're determined that together, our impact is greater.

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Foreword.

After a challenging 2023 I'm greatly encouraged to see evidence of the opportunities and outlook that this report outlines for the commercial property market in 2024 and beyond. While the turbulence experienced with interest rates throughout 2023 has now begun to ease, debt and the cost of borrowing continue to be at relatively higher levels with a market having had to adjust to this interest rate environment.

But with 2024 now upon us, areas of industry may still be cautious in terms of investment decisions, it does appear there is still confidence about the opportunities that might exist. Optimism around property coming to the market and the overall appetite appears to be high, not just in the medium to longer-term, but also throughout 2024. This is made abundantly clear by the findings and data within our report.

While some developers and commercial landlords are scaling back or exiting the market, the vast majority are committed to expanding their portfolios. Many are even taking advantage of the temporary fall in prices, diversifying into new property types to capitalise on emerging growth sectors.

It's evident that property entrepreneurs are aware of the scale of the opportunity across the UK, but there are undoubtedly challenges that come with this market outlook. The funding barriers and high interest rates acting as hurdles to accessing the market need to be addressed. A key element of the process is increasing knowledge across the property sector including the diversity of funding that is available to investors.

There is a wide variety of flexible products, together with a vast selection of asset types, which when combined with the expertise and knowledge within the specialist lending industry, creates real potential value. The fact that mainstream lenders are generally losing their appetite amid tough economic conditions only heightens the importance of – and opportunities in – the world of agile finance.

Despite commercial property energy efficiency deadlines being postponed, the focus on sustainability and its growing importance in the market remains. Landlords, investors, and developers will still have to gear up for a low carbon future, so the lack of clarity on this issue needs to be urgently addressed. Government support and leadership is crucial in solving this part of the puzzle, while skills and labour shortages, cutting planning red tape and a joined-up vision for regeneration are also areas which require urgent attention. The commercial property industry must also play its part in continuing to highlight the necessary action as well as pushing for impactful solutions.

In the face of ongoing inflationary pressure, bridging loans and other commercial lending products will be crucial to maintaining activity in the sector and creating new opportunities for further investment. The purpose of bridging – one area where Together really plays to its strengths – will continue to be what it has always been about; facilitating quick acquisitions and maximising opportunities for entrepreneurial investors in the commercial market.

As a business celebrating its 50th year, we will continue over the next 12 months to open doors for property professionals concentrating on where they can create value, be that in the retail or semi-commercial space – offering speed, flexibility, and relationship-driven lending. But we also have a keen focus on creating growth in the longer term, delivering products and services that help investors seize upon the opportunities on the horizon.

What is clear is that the winners of 2024 and beyond will be those who are able to seek out growth, identify where best to create value, and use the right financing to capitalise on emerging sectors.

This report examines how the market is readying itself for 2024 and beyond and highlights how to make the most of the market opportunities. It not only makes fascinating reading, but it also gives invaluable insight into the future of commercial opportunities over the next few years.

Chris Baguley

Chris Baguley
Group Channel Development Director at Together

Expert view: Insight into the UK economic landscape by Rob Thomas.

For more than a decade, the UK benefited from historically low interest rates. The property sector was a huge beneficiary of this, driving growth and development at almost unprecedented levels. While the landscape has now shifted, the scale of the medium-term opportunity is significant.

The current environment remains challenging. The post-Covid market has proved buoyant for commercial property. However, in the past 12 months this positivity has flattened with a lot of nervousness and hesitancy now felt. For example, as indicated by UK Finance, the number of Buy-to-Let (BTL) mortgages have been falling in recent months as people either attempt to pay off loans or exit the market altogether, a trend which hasn't been seen in previous years. Indeed, the insatiable appetite that gave way to a competitive environment during the Covid years has dissipated.

Escalating inflation required substantial intervention, meaning that the Bank of England had little choice but to hike interest rates, causing the property sector to creak. Unable to make the required yields in the shorter term, against this backdrop of rate rises, some landlords have been exiting the market altogether. But with inflation coming back under control and within more manageable levels, the sector is on a more robust footing when it comes to longer term planning – even though the prospect of interest rates returning to previous lows any time soon is unlikely.

In the short-term, this creates a challenge for commercial property businesses, landlords and developers; suddenly moving to a higher interest rate environment takes some adjustment – including de-risking portfolios and diversifying into new growth sectors.

Beyond the economic clouds, we also continue to see sustainability vexing the commercial property market. The high costs required to retrofit buildings are deterring potential buyers, and traditional finance providers are equally hesitant to give the support necessary despite projects being viable.

For those looking for growth in the medium to longer term there are opportunities across the sector. And the insight on the ground is that the sector is in rude health. The survey we've undertaken shows that, while some property professionals are scaling back or exiting the market, the vast majority are committed to developing their portfolios and many are even taking advantage of the temporary reduction in property prices to expand.

The improving outlook in our macroeconomic forecast, coupled with supportive structural factors such as rising population and constrained supply due to lack of available stock, will allow for a recovery in property prices and markets from 2025, picking up momentum from 2026 onwards. This in turn supports a recovery in lending to these markets despite what has been a tougher financial environment.

All in all, total secured commercial lending is predicted to rise by 32% from an estimated £90bn in 2023 to £118bn in 2028. By any measure, that's a significant opportunity across the UK commercial property market.

Rob Thomas

Rob Thomas
Economist and Principal Researcher at the Intermediary Mortgage Lenders Association (IMLA)

2024 in numbers.

32%

the predicted rise in total secured commercial lending - from an estimated **£90bn in 2023** to **£118bn in 2028**.

69%

Just over two thirds of respondents anticipate the amount they have to borrow to support their investment strategy will rise in the next 12 months[3].

59%

A majority of landlords plan to increase rent across their portfolios in the coming year.

22%

More than one in five respondents are not confident[2] about being able to access additional finance if they wanted/needed to.

72%

Almost three quarters of property developers with a portfolio of properties surveyed feel optimistic[1] about the outlook for their business for the next 12 months.

31%

around a third of professional landlords, property investors and developers are expecting to buy more properties in the next 12 months.

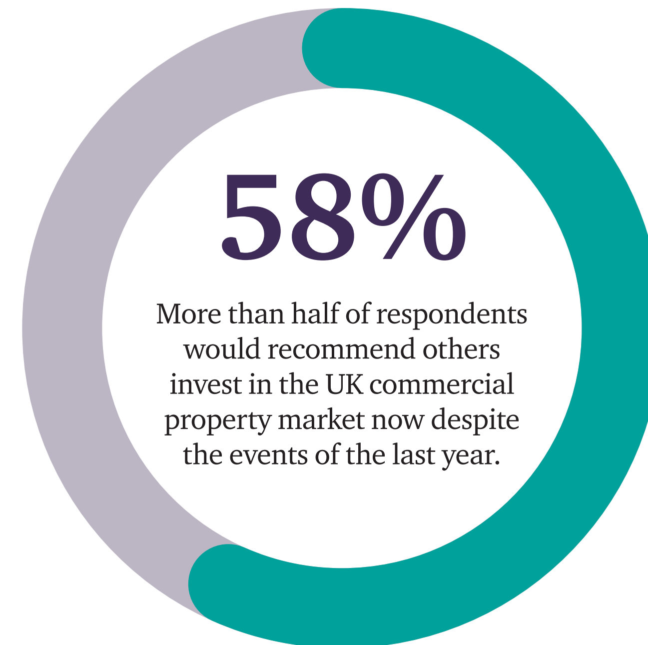
FOR RENT

24%

the average planned rental rise over the next 12 months among professional landlords.

25%

A quarter of respondents plan to refinance some of their properties to support their business objectives.



58%

More than half of respondents would recommend others invest in the UK commercial property market now despite the events of the last year.

26%

Norwich, Edinburgh, Nottingham and Birmingham areas are where over a quarter of commercial landlords are planning on investing in property this year.

The UK market in focus.

The UK interest rate environment.

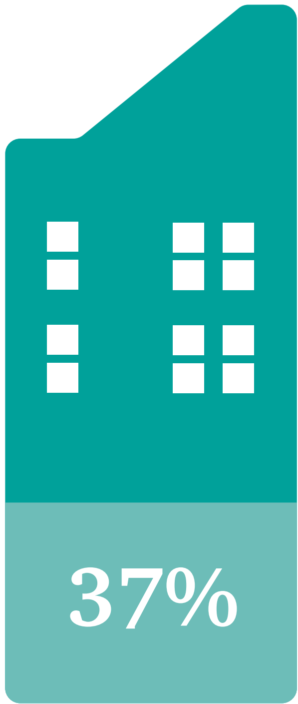
As an interest rate sensitive sector of the economy, it was inevitable that the commercial property industry would be significantly impacted by the sudden shift from an ultra-low interest environment to rates at their current levels.

The reality is that until recently, interest rates were in fact negative in real terms i.e. below the rate of inflation. And while even current levels are low by the standards of the 1970s, '80s and '90s which reached upward of 14%, when adjusted for affordability, that's roughly equivalent to 3%[4]. So, with that perspective, and because of higher house prices relative to incomes, the burden of interest payments relative to income is now high compared to recent standards.

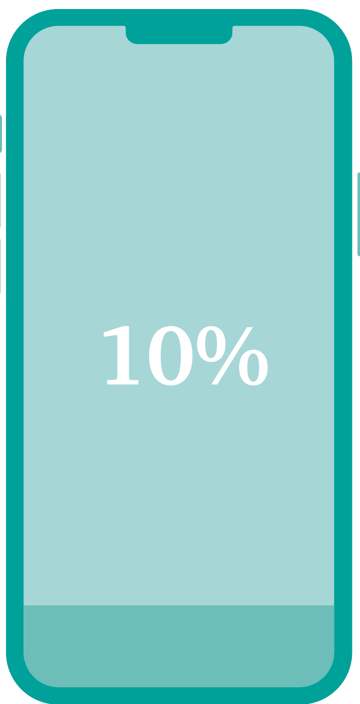
Similarly, in the commercial property market, rental yields had adjusted to lower interest rates and have subsequently risen in response to rate rise, although more through falling capital values than rents when compared to the residential market.

However, the scale of the opportunity across the market remains significant. To put it in perspective, the total secured commercial lending is predicted to rise by 32% from an estimated £90bn in 2023 to £118bn in 2028.

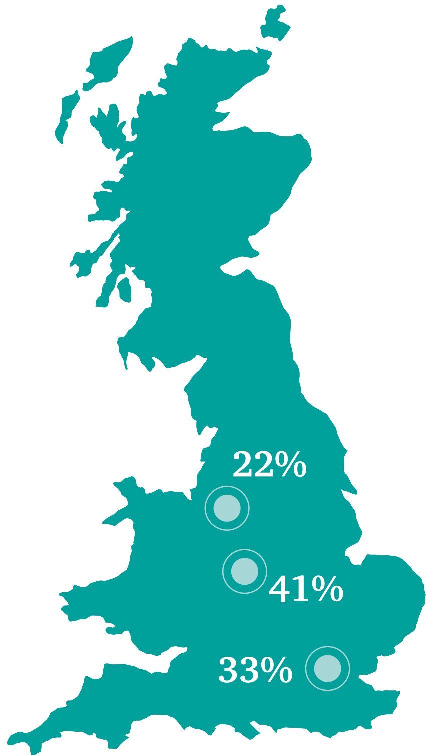
Property profiles



of those surveyed who are getting into commercial investments, do so on recommendations from others, with 16% of that number prompted by a financial adviser and 12% from peers already operating in the sector.



Social media is also becoming increasingly influential in bringing entrants to the commercial property market with 10% influenced by content that they see.

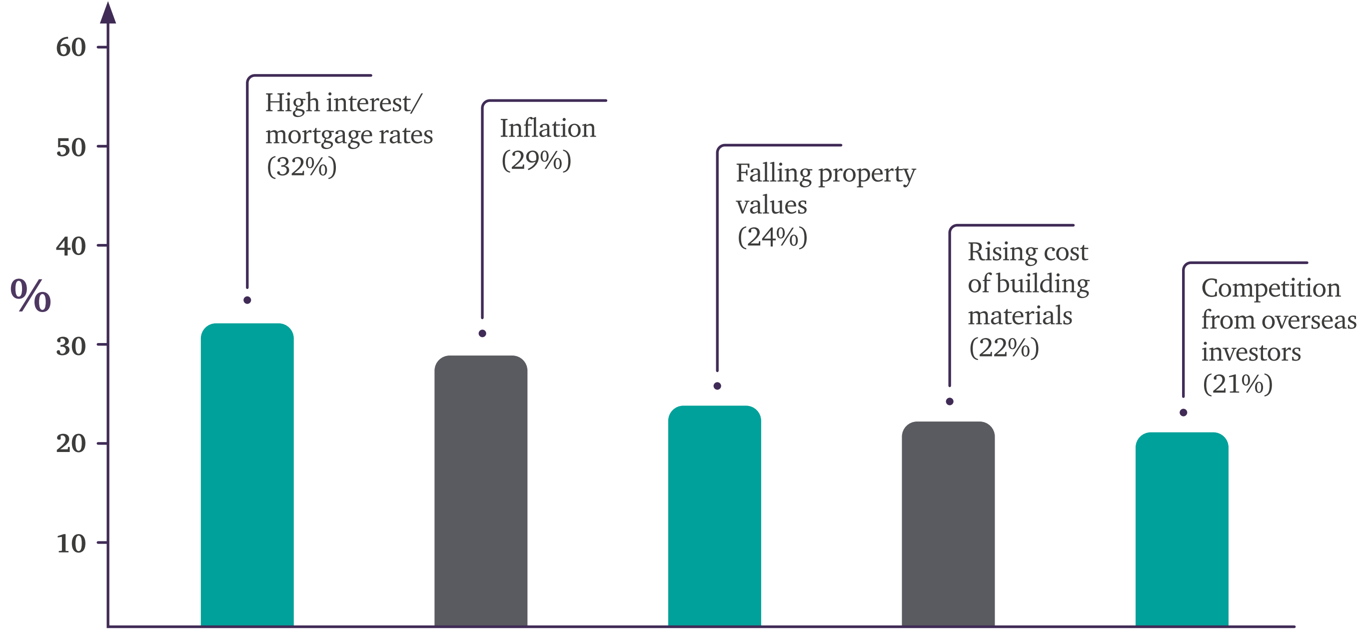


Those surveyed in the regions of West Midlands (41%), Greater London (33%), and North West England (22%) are most likely to buy more properties over the next year.

Navigating the challenges.

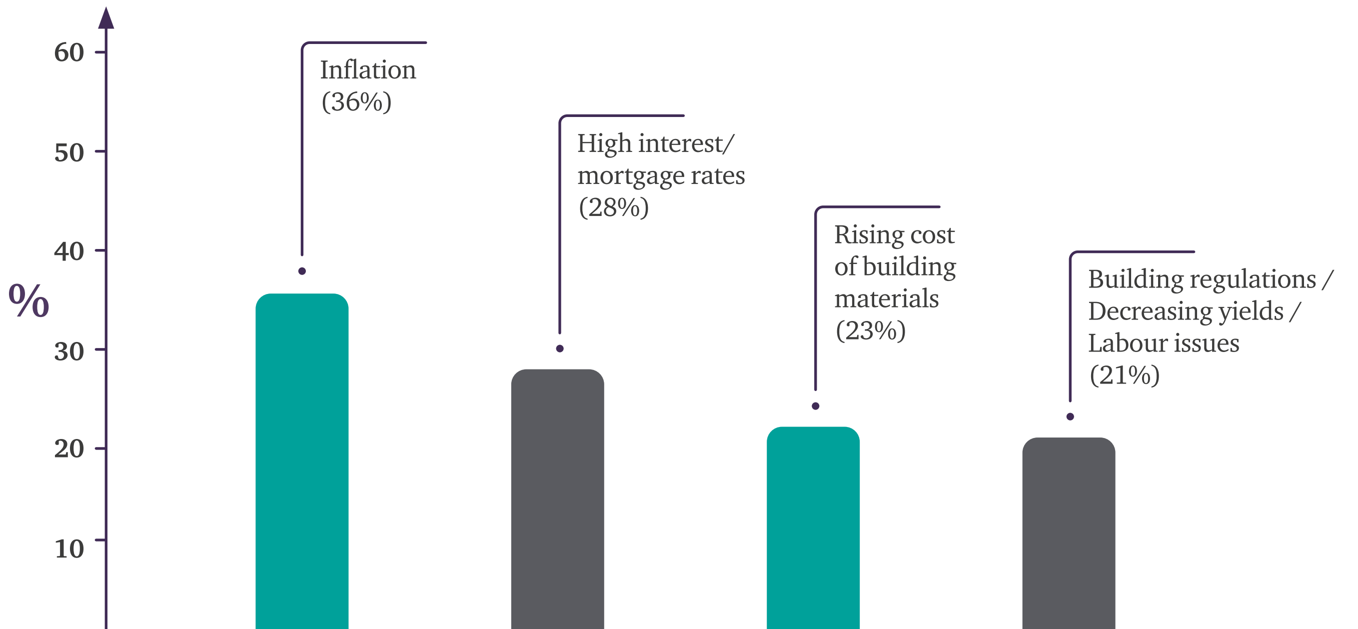
Developers remain ambitious. But it's clear that they are facing headwinds when it comes to their investment goals – the top two being high interest/ mortgage rates (32%) and inflation (29%). The research also found that they were concerned about falling property values (24%) as well as the rising cost of building materials (22%).

Developers' top challenges to property investment ambitions:



Landlords express similar views, though more than one in five also cited decreasing yields (21%) as a top challenge to their investment ambitions.

Landlords' top challenges to property investment ambitions:



Mitigating the challenges.

These challenges continue to affect the bottom line. Our research found that on average, revenue is down 9% among commercial mortgage holders surveyed, with a further 5% fall anticipated over the next 12 months.

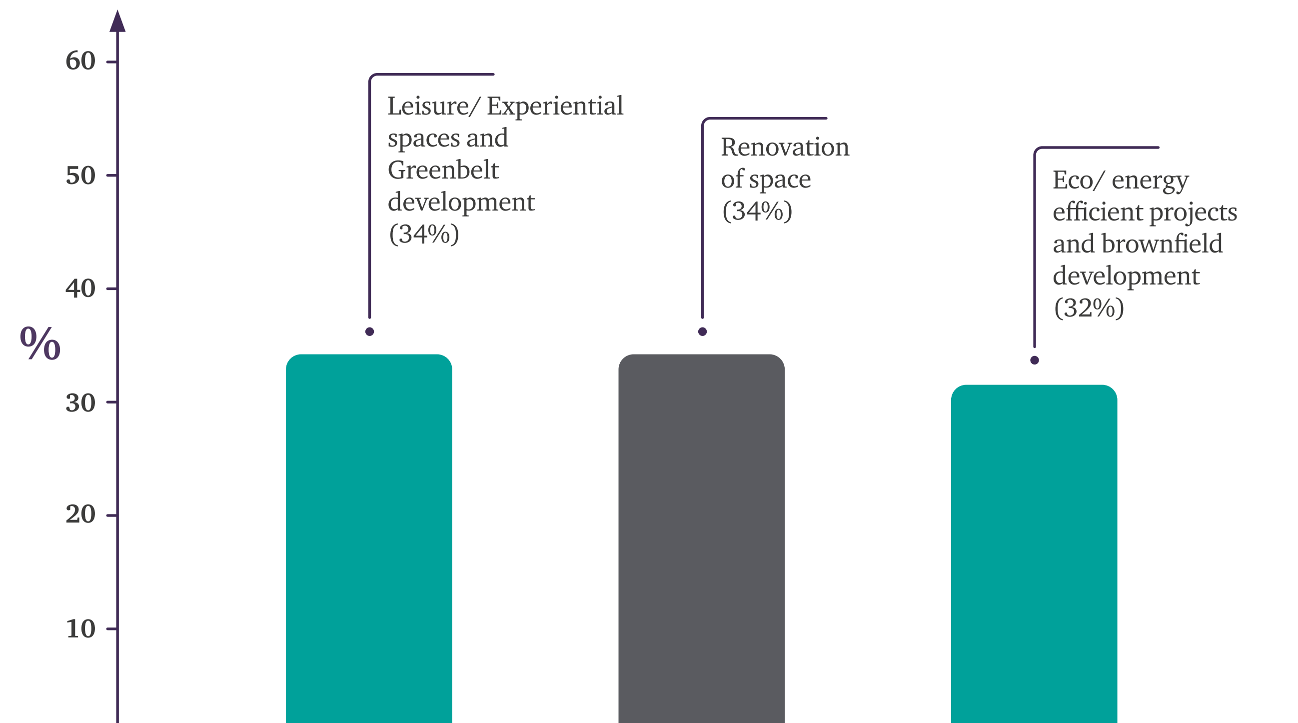
This poses a significant challenge. In reaction, a quarter (25%) plan to refinance some of their properties to support their business objectives. A similar amount (23%) say that they plan to diversify into other property types to mitigate the situation.

A snapshot on de-risking

- More than two in five (44%) of respondents are planning to de-risk and shrink their property portfolio over the next 12 months.
- Around half of those who are planning this (48%) will do it in the next three to six months, with about a quarter (23%) planning on doing it sooner. On average, among those looking to de-risk and shrink portfolios, a 33% reduction in portfolio size is expected.

The majority of landlords (59%) plan to increase rent across their portfolios in the coming year, with an average planned rise of 24%. When examining the data by portfolio focus[5], it's those who prioritise greenbelt development and renovation of space where the biggest investment increases are planned (both 34%).

Top three planned investment increase by sector focus



> It's evident that property entrepreneurs are aware of the scale of the opportunity across the UK, but there are undoubtedly challenges that come with this market outlook.
>
> **Chris Baguley**
> Group Channel Development Director, Together.

Laser focus on longer term opportunities.

Most property professionals are still committed to their long term investment plans. While 14% said that they plan to exit the property market completely and a further 17% will dispose of some investments, nearly a third (31%) are expecting to buy more properties in the next 12 months.

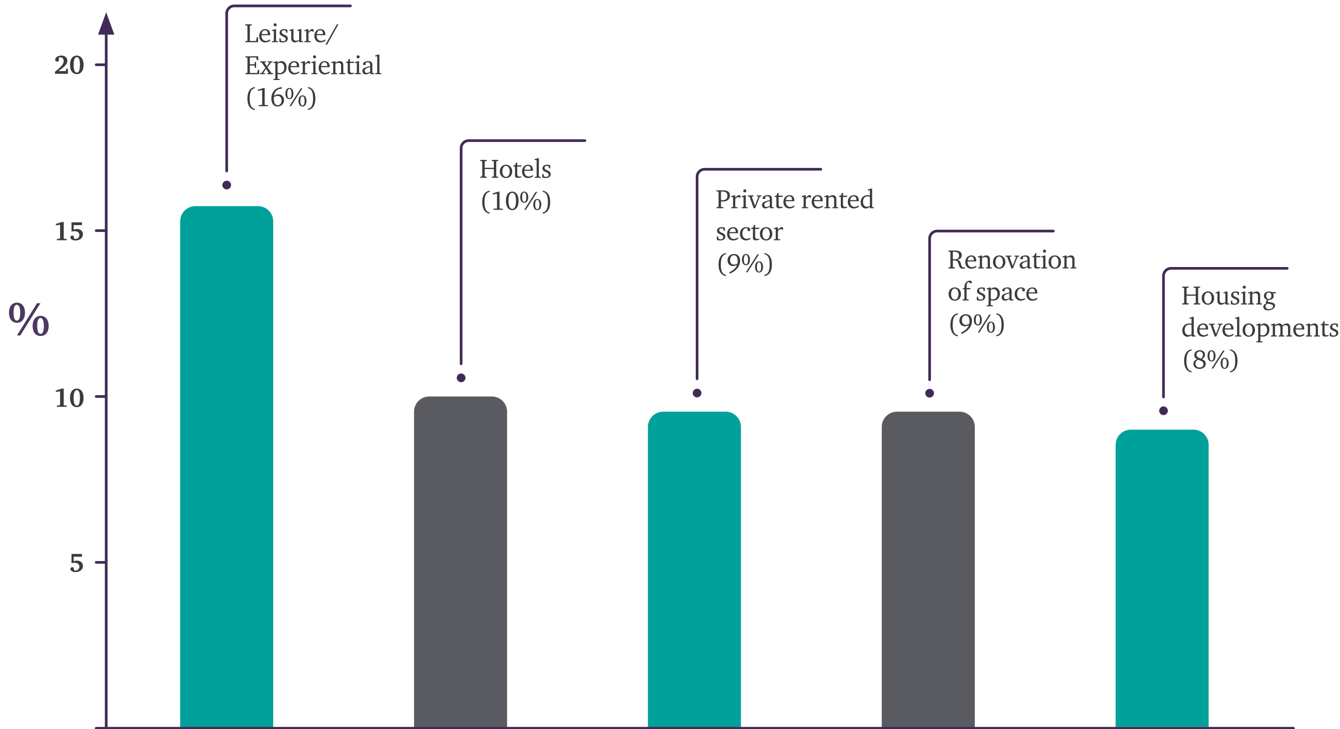
When looking at the year ahead, the market is bullish. Almost three quarters (72%) of developers with a portfolio of properties feel optimistic about the outlook for their business in 2024.

More than two thirds (67%) of professional landlords feel the same, and 70% of real estate portfolio investors agree[6].

Over the shorter term, the areas offering the most attractive investment opportunities are:

And, in several key areas, investors are anticipating revenue increases in the next 12 months.

Anticipated revenue growth in the next 12 months



Crucially, 58% of all respondents would recommend others invest in the UK commercial property market now despite the events of the last year.

The Together expert view

“The fact that property investors are most positive about the outlook for student housing no doubt reflects supply shortages driven by record student numbers which has created severe shortages of accommodation in some locations, putting upward pressure on rents.

Along with a huge undersupply of student accommodation, we are seeing a similar story in the social housing sector, particularly in quality care accommodation because of a growing elderly population. We see huge opportunities for investors in these two areas.

The retail space also offers real upside potential. Changing shopping habits has put real pressure on the sector, but a change of use to residential units, for example, would often meet a hugely pressing local need whilst occupying vacant lots.

This variation of use would in turn stimulate smaller retail opportunities.”

Elliot Vure
Director of Corporate Sales at Together

Meeting the funding challenge.

While there’s optimism in the market, there are real concerns about access to the right kind of finance. As banks look to limit their involvement in more complex commercial transactions, there is a risk that investment opportunities will be missed or will see a period of cessation.

According to our findings, more than one in five (22%) respondents are ‘not confident’[7] about being able to access additional finance if they wanted or needed to. Furthermore, more than two thirds of those surveyed (69%) anticipate the amount they have to borrow to support their investment strategy will rise in the next 12 months[8] – likely to be exacerbated by the cost of servicing debt.

The question for the industry is how it’s going to meet this challenge – while taking advantage of the available opportunities.

As debt servicing becomes harder, it does also offer those willing to engage the chance to snap up a good deal. For this, bridging finance will prove key.

Crucially, when looking for additional funding, 39% of prospective borrowers are seeking lenders prepared to provide a higher degree of flexibility. But speed (29%), level of service (29%) and reliability (28%) are key considerations cited by respondents too.

Our Partner view

“A lot of our SME clients may have been waiting to see what happens in the property market during a year of upheaval in the global economy. We’ve have seen unrest in Ukraine and the Middle East, which, among other factors such as Covid, have all added to the instability seen in the UK economy over the past few years.

However, we’re now finding that our clients can’t afford to simply wait and see any longer and need to press ahead with their business plans. Rates have gone up but are expected to reduce and energy bills should also start coming down, so they are seeing this as a period of normalisation and re-building.

There is also a likely General Election on the horizon. Any incoming Government needs to make sure they do nothing to destabilise an already delicate economy. They need to take common sense decisions which allow SMEs to flourish, because they are vital to the future of the UK economy.”

Philip Gray
Managing Director at Watts Commercial

There’s certainly a real opportunity for growth in demand, specifically for properties that play a key role in the digital economy, whether it be food supplies, restaurants servicing the growing demand for deliveries through ‘dark kitchens, or clothing warehouses and distribution centres.

Consumers are increasingly prioritising experiences, so areas that support hospitality and leisure innovation are also likely to drive growth and revenue. Though office space has faced a challenging time, significant deals can be found during times of distress and those buildings offer real opportunity for a conversion of and innovative use of space.

Ryan Etchells
Chief Commercial Officer at Together

Our Partner view

"Before any political election, the market can slow. However, the SME lending market has been so buoyant recently I do not think it will slow dramatically as demand continues'.

Whichever party succeeds in the next election, they have to back housebuilding, new developments and regeneration of brownfield sites.

On a regional level, they need to fulfil their promise of investing in infrastructure in the North, especially given their U-turn on HS2 which has been terribly managed and their 'levelling up campaign' which never happened and has been little spoken of since! Value creation and opportunities come out of investment in infrastructure. There is no better example than the new Elizabeth line in London and the positivity it brought to surrounding areas. Investment and planning reform is needed!

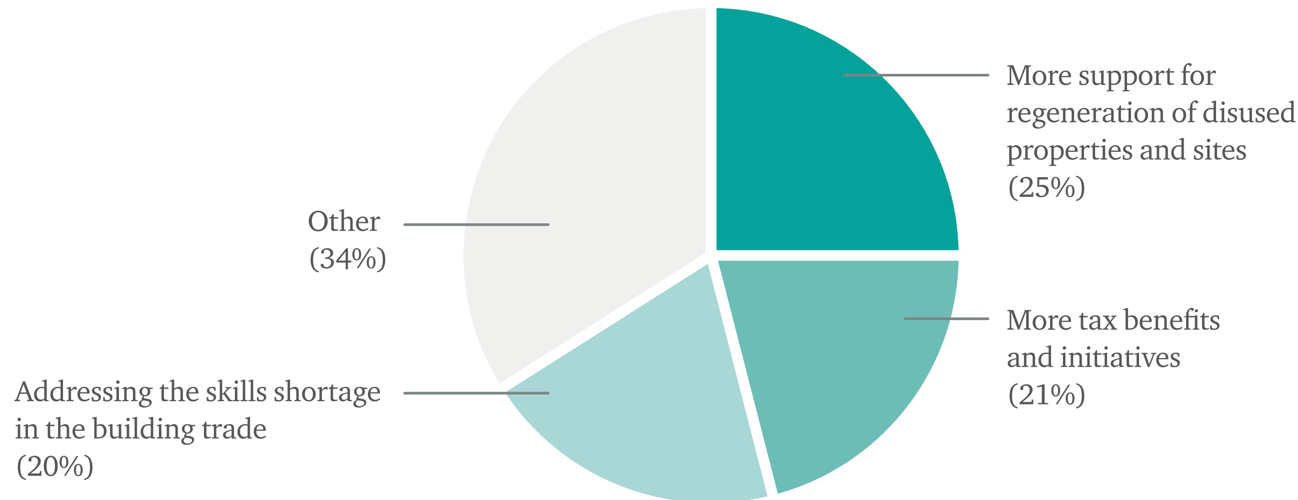
Second homeowners are being hit by additional stamp duty and increased council tax in some regions. Buy-to-Let landlords face extra stamp duty too when purchasing. The Government should do more to support investors. They introduced rules to allow first time buyers to get on the market and reduce the amount of investors buying those properties, when they should have focussed on first time buyers, regional infrastructure and planning reform to allow for overall growth.

The new leasehold reform, which is contentious, will impact the purchase of flats within blocks, as the quality of their management will now become harder without a professional freeholder. The list of challenges for property investors goes on and on."

Stephen Todd
Chief Commercial Officer, VAS Valuation Group

How can the government help?

When asked about which Government priorities would help create a better environment for commercial landlords and UK SMEs, respondents cited three key areas;



> Value creation and opportunities come out of investment in infrastructure. There is no better example than the new Elizabeth line in London and the positivity it brought to surrounding areas. Investment and planning reform is needed!
>
> **Stephen Todd**
> Chief Commercial Officer, VAS Valuation Group

Under the spotlight: Bridging finance.

The Bridging sector comes of age.

Over the coming months and years, bridging finance is uniquely positioned to establish itself as the backbone of the commercial lending market. Short term bridging facilities are a great specialist product to support debt, pending a future sale and fill the funding gap where mainstream lenders don't have the same appetite.

No longer perceived as a 'distress' product, it's an effective funding vehicle that helps corporate, commercial customers and portfolio landlords acquire advantageously priced projects quickly. The bridging market was worth about £2.5bn 10 years ago, this is now well over £5bn[9].

As traditional lenders look to scale back from funding real estate opportunities, there is a potential void that if not filled, will see acquisitions and transactions unable to proceed. If the market is going to be able to lock in the longer-term opportunities that are undoubtedly there, both in residential and commercial property, bridging will be critical.

The five-year forecast

Bridging finance is expected to grow by 19%, reflecting the somewhat counter-cyclical nature of this lending, as it is in demand when the property market is slow and other lending criteria are tight. Nonetheless, bridging finance has been experiencing a structural increase as its speed of execution and its flexibility, has seen it become more widely appreciated.

Rob Thomas
Economist and Principal Researcher, IMLA

The supply outlook.

Funding conditions, which have been undoubtedly challenging over the past year, are expected to ease in 2024 and beyond. This is welcome news for the sector. We anticipate economic conditions that are far more benign than those that would imply a risk of serious credit losses in a market where average LTVs rarely reach 60%[10].

Resilience is also baked into a banking system that is well capitalised with strong levels of liquidity. There was far greater debt in both the financial system and amongst client borrowers in the lead up to global financial crisis of 2008-9.

We are now also in a position where there's a much healthier range of lenders able to operate within the bridging sector. This increased competition provides borrowers with more choice, with some lenders heightening scrutiny on asset quality and loan performance. We expect this trend to continue but as conditions allow support of continued profitable lending, an exodus of lenders is unlikely.

The demand outlook.

Greater hesitancy from mainstream lenders has been a direct result of an uncertain economic landscape, making it more challenging for potential investors to secure funding. These mainstream sources of funds are going to be squeezed even more in 2024, offering the bridging market an opportunity to step in to support property professionals with entrepreneurial ambitions. The anticipated economic uplift in 2026 and beyond should improve accessibility of other forms of secured finance.

The sustainability drive across the property sector has seen energy efficiency standards tightened for commercial buildings. Combined with shifting commercial and workplace patterns post-Covid, there is a vast swathe of repurposing on the cards. With many lenders scaling back their exposure, smaller ticket projects in particular will struggle to get the debt funding they require from other sources, leaving bridging finance well positioned to unlock investment opportunities.

Key factors at a glance

- Widespread opportunities for repurposing properties will also drive appetite for bridging products especially with the sustainability drive across the commercial property sector.
- The uncertain economic outlook will see greater caution on the part of lenders.

Our Partner view

"Buy-to-Let has historically been the stellar investment class, with reasonable returns and relatively low risk / volatility, then you have HMOs, semi-commercial properties, commercial properties, heavy refurbishment and development to choose from. These have generally brought higher returns as you move along the different sectors, but also higher risk and complexities. Investors are moving up this risk curve and are looking at different asset classes to access higher returns, to counteract increases in things like interest rates and tax changes, so they can hit their desired returns. Lenders need to support these investors.

The country needs over 300,000 new homes to be built a year to meet the governments targets so there will need to be changes to the planning system and overall infrastructure investment to allow this to happen. The price of materials has reduced to more sensible levels, making building from the ground up more viable.

I think it is really important that lenders, like Together, support customers in building their portfolios and can lend across the different asset classes as investors requirements change due to reasons out of their control."

Stephen Todd
Chief Commercial Officer, VAS Valuation Group

Under the spotlight: Buy to Let.

Prime opportunity for residential landlords in 2024.

Constriction of housing supply combined with a lack of residential mortgage affordability makes the Buy-to-Let investment sector an attractive proposition for professional landlords who are equity balanced.

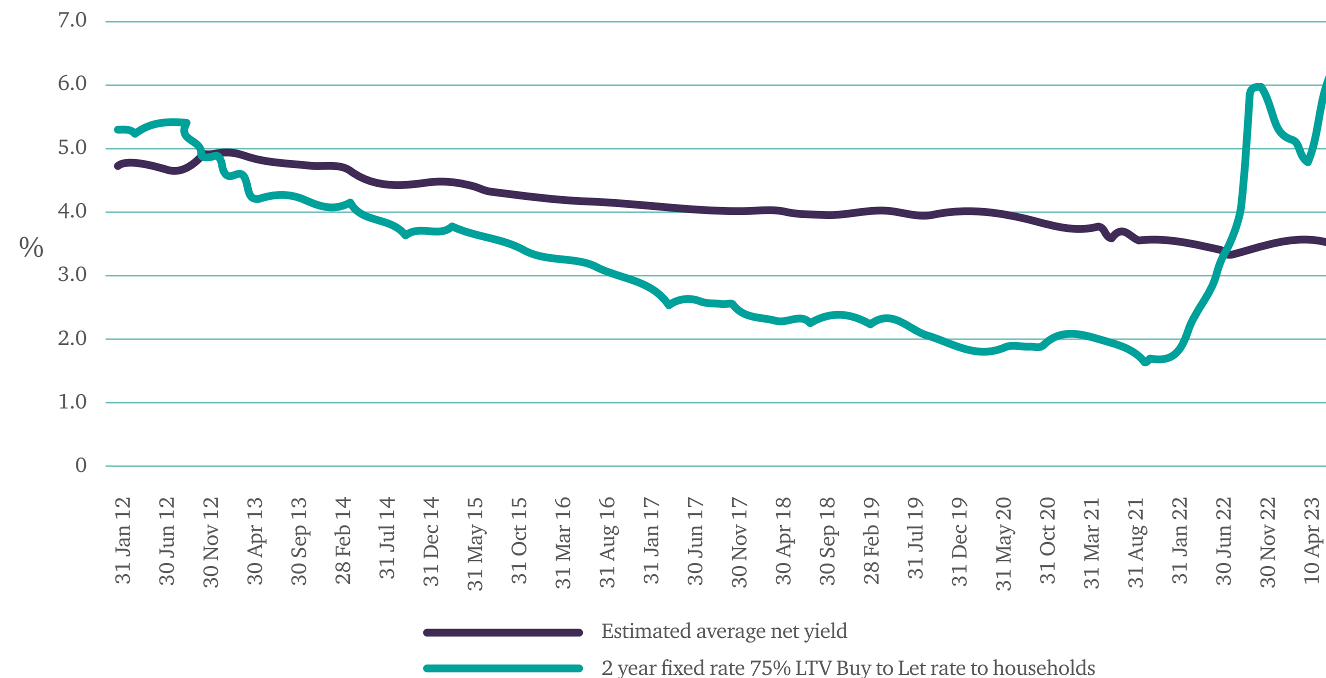
The Buy-to-Let (BTL) lending market has been more severely affected by rising mortgage rates than mainstream mortgages. Higher than previously observed fixed interest rates have made it more difficult for the more highly geared landlords to refinance any loans coming to the end of their fixed periods because lenders are required to assess Buy to Let borrower affordability using a minimum income cover ratio (ICR).

As a result, 2023 saw a sharp drop in BTL lending, with total borrowing down 46% year-to-date, with a 51% drop for house purchases, albeit coming off a record year in 2022. With funding costs now firmly above average net rental yields, more equity is required to keep typical net rental income above mortgage interest costs.

The five-year forecast

Our forecast sees the strongest growth in Buy to Let lending - up 50% over the five years to 2028. This partly reflects a very weak number in 2023, as affordability pressures impact some borrowers' ability to refinance or transact but investors with low loan to value portfolios will continue to be in the strongest position.

Rob Thomas
Economist and Principal Researcher, IMLA



The supply outlook.

Although most are likely to find reasonably priced product transfer options from their existing lenders some will move onto high reversionary rates, putting pressure on cash flows. For less geared landlords, however, this does offer an opportunity to expand as some highly geared landlords will exit the sector.

With the growing role of professional landlords, who are more likely to use a corporate structure, another key factor is the removal of the tax deduction of mortgage interest for property held in personal names — 74% of new purchases[11] - rather than through a corporate entity. This has been amplified by the rise in mortgage rates and the continued freezing of the higher rate threshold, dragging more people into the higher band.

Other potential regulatory changes, such as the Renters Reform Bill as well as possibly tighter EPC requirements, will increase costs for landlords in the coming years due to the additional requirements expected under the new legislation. Moreover, the threat of even more tightened legislation, such as statutory rent controls, which have been imposed in Scotland, raises risks for landlords.

Both will likely also encourage the more inexperienced landlord to exit the market.

However, lenders remain well capitalised, and we anticipate only modest credit losses during the current property cycle as most landlords have both ample equity and strong ICRs. For those wishing to exit the market, there should be opportunities to sell with tenants in situ, as less highly geared professional landlords look to step in. This means that there should be limited contraction of supply.

In fact, with the outlook bullish for rental yields over the forecast horizon, especially once mortgage rates start to fall, the market remains highly attractive for expansion as well as new entrants.

Key factors at a glance

- Buy to Let borrowers coming to the end of fixed periods at lower interest rates in 2024 will exacerbate pressures on affordability.
- Tax disadvantages for landlords.
- Regulatory changes.
- Adequate supply of Buy to Let credit will be maintained.
- Higher rental yields.

The real change that is needed is in planning. Processes need to be easier and quicker, with skilled resource in place to make sensible decisions.

Tanya Elmaz
Director of Intermediary Sales, Together

The demand outlook.

Population growth, particularly in key urban areas, is being driven primarily by high net migration, which is estimated to have reached a record 606,000 in 2022 according to the ONS[12].

Affordability barriers have increased with mortgage rates, excluding a larger proportion of prospective first-time buyers, a sizeable amount of whom will be living in private rented sector accommodation.

The uncertain outlook for house prices will hold back some prospective first-time buyers, leaving people renting for longer.

Key factors at a glance

- Difficulties facing first-time buyers caused by higher mortgage rates.
- Continued rapid population growth.
- Weaker house prices reduce the incentive to purchase now.

The Together expert view

"A boost to the commercial property market has so many positive ramifications for the economy. These include building homes for those that need them, creating jobs constructing and renovating buildings, and creating workplaces to provide services that are needed in communities.

The real change that is needed is in planning. Processes need to be easier and quicker, with skilled resource in place to make sensible decisions. Subsidised taxes and grants to encourage the adoption of regulations will support building and the refurbishment of existing stock. Currently, the task can just be too onerous for developers and property investors to contemplate so more streamline, accessible processes need to be put in place.

A renewed focus on improving transport links is also needed, helping to make travel into our towns and city centres easier. In turn, these improvements would be a boost to urban based office, leisure and retail businesses and local economies.

We'd expect to see more workers returning to the office in 2024, although the type of accommodation in demand will have changed. I think smaller, sustainable commercial properties, built to a high specification, or existing offices refurbished to a high standard, could prove to be the most attractive asset types in the coming years."

Tanya Elmaz
Director of Intermediary Sales, Together

The Auction experts view.

The Together expert view

“There was a lot of pessimism over the past year with volatility in the property market and it has been challenging, but our own figures haven’t reflected this.

We’ve seen records in terms of volume with nearly 2,000 auction finance cases funded in 2023, worth nearly £200million. The number of residential property lots has seen an increase, which may be because of some landlords exiting the market but that’s not the main driver. We’ve also seen commercial property in the £1m+ bracket tending to sell at auction, with buyers evidently looking for higher quality asset classes.

We will definitely see more property coming on the market this year as landlords roll off their lower fixed rate mortgages and decide to sell. However, there will be greater stability, with more benign mortgage rates on the horizon, so there will be more auction buyers, including a growing number of online bidders, investing in competitively-priced property.”

Scott Hendry
Director of Auction Relationships, Together

Our Partner view

“In the world of commercial property auctions, the majority of lots are commercial properties that have the benefit of a tenant in situ. A buyer will be looking for two avenues of value: the first is an uplift in the capital value of the asset over time, and the second is a secure income stream from the rent paid to the landlord. With base rates currently around 5%, and 5% being a typical yield, fewer investors are in the market buying, hence the fall in volumes.

Rates started rising from 0.25% at the beginning of 2022, and ended the year at 3.5%, and that year, 2022, saw a far more modest rise in the number of commercial auction sales of 2.5% and a revenue rise of 5.6%. In 2023, the Bank Rate rose to 5.25%. This rapid rise will have had a large bearing on the appetite for commercial investments, and this is evidenced by the 15% fall, by value, in sales revenue. In addition, given the transactional costs of buying and selling a commercial property, investors may well prefer to hold onto a good quality income producing property rather than selling.

As a result of, and in addition to the above headwinds, the market has softened and vendor expectation of value exceeded market reality. The result has been that vendors and auctioneers could not agree on value and where the reserves should be set, leading to reduced listing for auctions and fewer sales happening.”

David Sandeman
Managing Director of auction specialists Essential Information Group (EIG)

Under the spotlight: Commercial property lending.

Investment lags despite brighter outlook.

With the supply of new property affected by low levels of new development and regulatory changes potentially triggering reduced stock levels, the supply of commercial property is likely to be relatively constrained. This problem will become more apparent when the economy starts to pick up from 2025 onwards.

The five-year forecast

It is expected that commercial property lending will see a very healthy gross lending increase of 22% by 2028.

Rob Thomas
Economist and Principal Researcher, IMLA

The supply outlook.

New energy efficiency requirements for offices and retail units have already impacted supply with some secondary office space being withdrawn or repurposed, mainly through conversion into flats. Further proposed upgrades for 2027 and 2030 are likely to accelerate this shift, leading to a contraction in secondary stock and ultimately a shortage of office accommodation as the economy recovers.

As the economy picks up again from 2025 onwards, we could see a return of shortages both of industrial buildings and primary offices in many locations, putting upward pressure on rents.

With lenders having been cautious in recent years, credit losses should peak at much lower levels during this downswing. As a result, we expect lenders to continue to have the confidence to offer finance on a diverse range of commercial property.

We do not anticipate much of a further tightening of lending criteria or maximum LTVs despite the expected rise in interest rates. This reflects the fact that higher interest rates are largely a response to a more robust economy, which supports tenant demand and rent levels. It also reflects the fact that earlier uncertainty about how severe the downturn in the commercial property cycle might have dissipated, leaving lenders feeling sufficiently confident to maintain the flow of credit to the sector.

However, banks need to deploy and lend and are currently sat on substantial levels of liquidity.

Therefore, we would hope to see more attractive rates return to the market.

Key factors at a glance

- Enhanced minimum energy efficiency standards and environmental considerations continue to influence visibility of current stock.
- Caution remains on the part of developers.
- There are limited further lending options as criteria is tightening.
- Banks and other lenders are well capitalised with strong liquidity.

The Together expert view

“Despite a growing tech and digital involvement, the commercial property sector remains a people business. Expertise and relationships remain utterly central to deals and yields. At Together, we’ve always prided ourselves on being relationships driven, ensuring we are fostering strong connections with our clients of old as well as readying ourselves for all new business opportunities that come through our doors.

This really marks us out as a differentiator in the space as during times when mainstream lenders may be less able to consider lending to certain commercial sectors. We will always take the time to get to know the people behind the business before finalising our decision.

It’s key to us to understand what their motivations and ambitions are and how we might be able to best support them. Our flexibility in product offering as well as having our client relationship and credit underwriting teams work in proximity maintains our competitive speed of response.

Feedback from our team suggests a very positive outlook for the commercial market as traditional banks are becoming more restrictive and there is a real need for specialist lenders to help provide funding solutions for opportunities.”

Joanne Fletcher
Director of Banking Programme, Together

The demand outlook.

As we expect 2024 may see higher interest rates and weaker growth, the current property downswing can be expected to continue. We predict things to brighten slightly in 2025 and improve more rapidly after that.

Surveys suggest that firms are expecting staff to return to the office, including a study by Hays[13] , the recruitment consultant, reporting a higher proportion of workers now based in the office full time, and that 57% of employees would accept a job without hybrid working. This could increase demand for office space over the forecast period.

The shift to online retail is set to continue as consumers become increasingly accustomed to shopping this way. Some secondary retail space can be repurposed as residential accommodation, but it will require local authorities to take a more active role in re-zoning to prevent haphazard conversion of space leading to a disjointed mix of retail and residential in many locations. Shopping centres will need to innovate to ensure they remain desirable destinations. However, rising real wages from late 2023[14] are set to continue over the forecast horizon, and should provide consumers with extra disposable income for eating out and other leisure activities.

Amazon, which dominates online retail, had been aggressively adding warehouse space to meet surging demand but in 2023 it announced it was closing some capacity in the face of weaker than expected sales.[15]

The Together expert view

"Our aim is to help build the commercial properties of the future while helping customers convert the profits that they are working for. But for smaller and larger schemes alike, there's a real issue with the treatment on repurposing versus rebuilding.

Under the current regulations, each is held to the same standards with requirements vastly inflating repurposing costs. This too often incentivises demolition and rebuild, or simply undercuts the financial viability of projects altogether. Properly addressing this situation would provide a substantial boost not just to the sector, but to the UK's climate targets too."

Ryan Etchells
Chief Commercial Officer, Together

Key factors at a glance

- The state of the economy is the most significant factor shaping demand for commercial property.
- Online retail's share of the market is expected to continue to expand.
- Some retreat from hybrid working is to be expected.
- The surge in demand for new warehouse space from ecommerce may have largely run its course.

Our Partner view

"We are seeing a surge in demand from occupiers looking to enhance their ESG credentials through their real estate interests. Rental growth has been strong in prime new build assets but the real estate industry needs to find it's way in supporting a viable ESG pathway for existing assets to be refurbished in a sustainable fashion. There needs to be a better understanding of the advantages an existing building provides from an embodied carbon perspective.

Due to the challenging development economics associated with new build development, repurposing existing assets will play a key role in our future supply pipeline."

Will Lewis
Director, OBI Property

Under the spotlight: Development finance.

Changes to how we live and work.

Across the UK, there is significant appetite for investment into infrastructure, delivering improvements to quality of life and attractive returns for investors. Development finance is key to unlocking those opportunities and delivering on the ambitions of individuals, businesses, and government.

The five-year forecast

As the most pro-cyclical area of commercial property lending, development finance is expected to benefit significantly from the strong economic recovery anticipated in 2025 and beyond. The forecast predicts robust growth in lending of plus 28% in the five years to 2028.

Rob Thomas
Economist and Principal Researcher, IMLA

The supply outlook.

Development is the most cyclically geared segment of property investment and is hugely sensitive to interest rates. This means that a potential for continued higher interest rates in 2024 can be expected to hit development activity and lending, but as they settle at a lower level, development finance lenders will provide support for a brighter economic picture into 2025 and beyond.

It's important to recognise how quickly the price of land adjusts to the economic environment. This can play a key role in helping to support development output. But this is reliant on land sellers being willing to accept lower sale prices rather than holding out for improved conditions.

Material costs rose sharply after the pandemic, impacting developers' profit margins but supply chains are now returning to more normal levels. And, should construction levels soften, the pricing of materials may ease, reducing construction costs.

The political landscape will also be key. Both main parties are looking to set out an agenda to capture the public's imagination, with a new Government likely to be in place by January 2025 at the latest. Longer-term, the election of a Labour Government would be expected to lead to more permissive planning regulations. However, it is unclear how quickly such a shift would occur.

There are headwinds and hurdles that need to be to be mitigated. For example, high interest rates also add to developers' costs, impacting the viability of some projects. And while labour costs would normally fall during a downturn and relieve some cost pressures, this cannot be taken for granted. The longstanding structural shortage of skilled labour in the construction industry greatly reduces the elasticity of wages.

Key factors at a glance

- Development is the most cyclically geared segment of property investment.
- Changes in planning regulations are required.
- Land prices adjust rapidly.
- High interest rates reflect an uncertain outlook but also provide an incentive to lenders.
- Material cost pressures should ease.
- Typical reduction in labour cost cannot be relied upon.

The demand outlook.

Aggregate demand has held up well, requiring higher interest rates to squeeze inflationary pressures out of the system. In the short term, this will inevitably reduce demand for commercial space.

The challenge of higher interest costs, combined with a more uncertain outlook for capital values of completed projects will also likely hold back investors in 2024. But once again, with an improving position beyond, the impact is expected to be short-term.

It is also expected that the higher mortgage rates will hit affordability in the residential sales market across the UK. This will reduce demand from potential buyers, who may hold off purchasing through fear of falling house prices. This is, however, partially mitigated by rising household real incomes as wage growth outstrips inflation from late 2023 onwards. By 2025, when interest rates are expected to have reduced from current levels, buyer demand is likely to pick up.

We also continue to see shifting and new patterns of demand for floor space, creating numerous repurposing opportunities. The demand for finance to support the transformation of buildings is likely to run at a high rate over the forecast horizon. In particular, many towns and cities have secondary office space with high vacancy rates that can be profitably converted into flats.

Key factors at a glance

- Fears of contracting demand across the economy could limit developers' appetite to spend on new property in the near term.
- Developers will be cautious in the face of higher rates.
- Higher mortgage rates will worsen affordability pressures in the residential sales market.
- Shifting patterns of demand for floor space, accelerated by the legacy of Covid lockdowns, have created numerous repurposing opportunities.

The Together expert view

"It's been exacerbated in recent years, but the skills shortage in the building sector is fundamentally structural. And it's undoubtedly holding back the UK property market. This is a challenge for the industry as well as Government. Over the next few years, it's critical that substantive, joined-up policy and investment is focused on solving the issue of labour shortages in the construction industry, once and for all."

Ian Pickering
Director of Development Finance at Together

View from Stuart Heslop, Commercial Finance Expert.

A generation of property owners and developers have known nothing but a near zero interest rate environment and therefore the last 24 months have seen mindsets adjusting back to a time that feels like a lifetime ago. Building a new cost of funds into appraisals is of course only one consequence of the current base rate. The move in rates has also seen an adjustment in exit yield expectations for developers as institutional and family office buyers have many more investment options to consider that will deliver a risk-free return. Feed in the inflation we have seen in construction costs, and you have had almost the perfect storm.

We are now of course seeing inflation begin to temper back from where we have seen it for the last year and construction markets do feel a bit more palatable for developers, but we are not going to see costs reduce back to lower levels with the new world now baked in to the market pricing. At least they might stop rising and that will hopefully provide some certainty for one element of the appraisal.

Watching the Bank of England in recent times has provided commentators with plenty of decisions to debate. Did rates move early enough or quickly enough and once they were on the move did the Bank give time for their actions to take hold before moving rates again? Arguably rates should have moved higher much earlier with the 10-bps Base Rate persisting for 18 months and a base rate lower than 1% for an incredible 13 years. When we look back at this period in the future, I think we will all point at a missed opportunity to correct rates sooner. That might have avoided the rapid rate rises that we witnessed last year.

Whatever your opinion, it did feel rather settling when rates were held at 5.25% at the recent MPC meetings. We have gradually seen short to medium term interest rate markets settling with interest rate swap markets beginning to find a bit of predictability. Two-year money reduced to around 4% and five-year money to around 3.5% by the end of 2023 following a period of relative stability. They have come off of highs above 6% and 5% respectively. These are not, of course, forecasts but simply where the market is pricing interest rate risk but at least it seems to be a bit less volatile compared to what we have witnessed over the last year.

The big question is whether this relative stability will begin to give investors the confidence to get back into the market. There are some signs of that, with assets now finding their way to the market in more volume than we have seen and we are about to find out if we do indeed have a functioning market. And, if there are buyers out there, where are we going to see pricing? Just finding an answer to that question will be helpful, almost no matter where we see the level. Being able to appraise a site, plug in an exit yield that you buy in to and make an offer that you believe in will breed confidence.

So, what is the new normal? I've lost count of the number of times I have been asked "when will it get back to normal?" The last decade or so hasn't been normal in an historic context with multiple global events impacting markets. The uncertainty has been crippling and the exit from an artificially low interest rate environment has been painful. And it is uncertainty that unsettles the decision makers in this market.

I am hoping that the early part of the new year will give us a real sense of the direction of travel for the market. Inflation will hopefully have settled. Interest rates look like they have peaked with the next move being downwards. And we are hopefully about to see a bit more volume hit the market to allow us to find a level. Everyone craves certainty and the next six months should be able to provide that.

Stuart Heslop

Stuart Heslop
Commercial Finance Expert

Seizing the opportunities.

Diversification and creating opportunities throughout 2024 is certainly what comes across from this latest report.

Despite a really challenging economic environment, the property professionals we have engaged appear to be bullish about the future in the commercial real estate market into 2024.

They value the right kind of partnership and relationship to harness opportunities as they seek to expand their portfolios and enter new growth sectors.

The period of sustained low interest rates is clearly a thing of the past; however, the industry is encouragingly pragmatic about the issues they face and how they should best be navigated – whether that be political, economic or technological. It is clear from the findings that with this change comes opportunity.

As we look at the UK commercial property landscape, the scope and diversity of the opportunities is impressive. Whether it's student housing, retrofitting office space to support the sustainability-driven landscape, or investing in hotels and leisure, the next few years are going to provide significant growth for the UK commercial property market. The optimism of the sector, combined with economic recovery, means investors will ultimately be in a strong position to capitalise on these opportunities.

What is essential is having the relationships and experience across the market to ensure that these opportunities can be maximised throughout 2024. Forging strong bonds and pragmatic decision making with our commercial clients is crucial for us to provide the right type of facility to suit their ultimate ambitions.

Establishing specialist agile support along with a reliable partnership will ensure that when those opportunities are identified, they can be seized and actioned expertly and without delay.

For Together as a business, it's hugely exciting – a chance to be at the heart of the recovery by helping to open doors for our customers and partners, as we have done for 50 years.

Marc Goldberg

Marc Goldberg
CEO Sales & Distribution

What is clear is that the winners of 2024 and beyond will be those who are able to seek out growth, identify where best to create value and use the right financing to capitalise on emerging sectors.

Chris Baguley
Group Channel Development Director, Together.

Key takeaways.

Property investors

Have a business plan – this will ensure that lenders can understand what is trying to be achieved in that time scale – location and credible debt repayment will be key.

Embrace the breadth of UK opportunities and diversify across the range of commercial property markets.

Don't sit on the sidelines – unlike equity investing, it's as much about timing the market as time in the market. Those investors that delay getting into the market will unlikely reap the rewards.

Brokers

Take the opportunity to widen horizons on markets, move into unregulated lending and learn about the broad range of business loans available.

Recognise and adjust to the regional differences across the UK – yield will continue to drive growth in more regional investments.

Learn and understand how to access products to assist in maximizing customers' profits - provide solutions for their needs and continue to be diverse in your offering.

Policy makers

Planning needs to be easier, quicker, and better resourced. Local councils are vastly under resourced and hard to recruit into when compared to private sector jobs.

The structural skills gap needs to be tackled once and for all – it's been allowed to fester for far too long and it's inhibiting growth.

If climate goals are going to be achieved, substantial changes need to be made to subsidise and incentivise climate-positive development.

Methodology.

The research was conducted by Censuswide, among a sample of 500 UK respondents (aged 18+) who have taken out a commercial mortgage product in the past - with at least 4 properties in their portfolio. The data was collected between 04.10.2023 – 13.10.2023. Censuswide abides by and employs members of the Market Research Society and follows the MRS code of conduct which is based on the ESOMAR principles.

Notes to Editors

[1] 'Very optimistic' and 'Somewhat optimistic' answers combined.

[2] 'Not very confident' and 'Not confident at all' answers combined.

[3] 'Yes, significantly' and 'Yes, somewhat' answers combined.

[4] https://www.edmundconway.com/rising-interest-rates-are-a-bigger-deal-than-you-might-think/

[5] Findings on portfolio/sector focus have been combined, with mean scores provided.

[6] 'Very optimistic' and 'Somewhat optimistic' answers combined

[7] 'Not very confident' and 'Not confident at all' answers combined.

[8] 'Yes, significantly' and 'Yes, somewhat' answers combined.

[9] https://clients.mintel.com/content/report/bridging-loans-uk-2023.

[10] https://clients.mintel.com/content/report/bridging-loans-uk-2023.

[11] https://www.hamptons.co.uk/articles/the-unstoppable-rise-of-corporate-ownership#/.

[12] International migration hits new high in 2022 but there are signs of change | National Statistical (ons.gov.uk)

[13] https://www.hays.co.uk/media-centre/press-releases/content/employers-missing-a-trick-by-not-including-flexible-working#:~:text=The%20research%20uncovered%20that%20over,a%20hybrid%20approach%20to%20working.

[14] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/averageweeklyearningsingreatbritain/december2023#:~:text=changes%20for%20users.-,In%20real%20terms%20(adjusted%20for%20inflation%20using%20the%20Consumer%20Prices,by%201.5%25%20on%20the%20year.

[15] https://www.retail-insight-network.com/news/amazon-uk-warehouses-closure/.

Any property used as security, including your home, may be repossessed if you don't repay your mortgage.

Together is a trading style of each of the undernoted companies, which have their registered office address at Lake View, Lakeside, Cheadle, Cheshire, SK8 3GW.

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