BCLP. Client Intelligent

Insights

REAL ESTATE OUTLOOK 2023

Sep 25, 2023

SUMMARY

At the beginning of 2023, our real estate subsector leaders shared their insights on what headwinds and tailwinds they expected for the industry in the coming year. As a follow-up retrospective, we asked the subsector leaders to take another look at what challenges or wins the real estate industry underwent over the last nine months, and what they expect from the rest of the year. These insights help us to determine impacts on our industry, practice, and most importantly, our clients.

BUILD TO RENT AND MULTIFAMILY

HEADWINDS:

- France: the non-renewal of tax incentives to encourage private investment in rental property (Pinel law) has led to a fall in housing construction (c. -30%).
- Germany: rising building costs due to higher supply and energy costs. Increasing levels of regulation, in particular ESG and adjustments of residential rent levels. Real Estate developers are currently facing difficulties and we have seen and will continue to see an increasing number of insolvencies.
- UK: anticipated and recently enacted regulatory reforms in respect of assured shorthold tenancies, building safety and district / communal heating and cooling present additional challenges to the development and operation of Build to Rent assets in addition to the macroeconomic trends also affecting other sectors.
- US: acquiring suitable land for Build to Rent developments can be expensive, especially in desirable urban or suburban areas.

TAILWINDS:

- France: the government is planning to introduce tax incentives for private real estate investment trusts (SCPIs) whose assets are made up of affordable rental housing.
- Germany: in prime urban areas, there is a high level of demand outperforming apartments/houses on the market. This will continue given the dropping numbers for new building applications as a result of the increased building costs and interest rates (see headwind above).
- UK: increasing demand for rental homes as a result of private landlords leaving the sector due to pressure from rising interest rates and increased regulation and a slowdown of sales by house builders.
- US: many Americans are shifting away from traditional homeownership in favour of renting, driven by factors like flexibility, convenience, and the rising cost of buying a home.

DATA CENTRES AND DIGITAL INFRASTRUCTURE

HEADWINDS:

- Data center developers are being challenged by investors to accommodate ESG concerns and facing resistance to new development from governmental authorities for similar reasons, with particular concern regarding power and water consumption.
- While demand for new data centers is high, developers are facing constraints with respect to power availability and materials shortages and delays.

TAILWINDS:

- AI innovation and investment and continued move to cloud-based services (steaming, work from home, enterprise) continues to drive demand.
- Data center investors have been realizing steady returns, while more traditional asset classes (including office and retail) continue to lag.

INFRASTRUCTURE

HEADWINDS:

- Long term effects of increased borrowing costs dampening investor sentiment across all infrastructure classes (e.g. Thames Water, Southern Water), although infrastructure remains an attractive asset class in a high interest environment.
- In relation to energy transition, critical upgrades to transmission infrastructure are hampered by twin issues of slow permitting processes and challenges around social license issues.

- Uncertainty around protectionist and security driven trade restrictions on Chinese exports. For example, Cleantech manufacturing remains dominated by China despite US and European policy action.

TAILWINDS:

- Net zero policies should continue to drive decarbonisation across transport and power infrastructure, particularly infrastructure required for electrification and / or green hydrogen.
- US Inflation Reduction Act and US Infrastructure Investment and Jobs Act seem to be resulting in infrastructure and supply chain (e.g. advanced manufacturing facilities) coming online, with the flow on effect that investors see the incentives as creating a favorable environment for investment. We expect to see continued interest from foreign investors particularly from geo-politically aligned jurisdictions favoring US as a destination for infrastructure capital allocation.
- Supply chain issues seem to be resolving themselves (albeit slowly), and key material costs are on a downward trajectory fall in the medium term driven by slow Chinese recovery. However potential for long term headwinds resulting from sustained slowdown in China.

HOTELS & HOSPITALITY

HEADWINDS:

- Interest rates, inflation and slowed financing have suppressed US and European markets for the last 12 months causing signs of stress.
- In APAC, Vietnam and Thailand are facing challenges from oversupply but this is also leading to some portfolio investment opportunities.

TAILWINDS

- US hotel owners and operators remain optimistic. The economy has remained resilient and wage growth is keeping up with inflation.
- UK hotels are performing strongly, with luxury hotels proving to be a successful inflation hedge.
- France is performing well, with the Rugby World Cup and Olympics around the corner.

PRIVATE EQUITY

HEADWINDS

- Higher debt costs and rate unpredictability make desired returns uncertain and difficult to achieve.
- “Flight to quality” invites oversized competition between potential investors/buyers for Class A product.
- Mismatch in pricing expectations remains as buyers wait for distress/re-financings and sellers keep their powder dry.

TAILWINDS

- Providing alternative debt opportunities
- Pivoting to less traditional asset classes and more creative deal structures
- Being able to move capital quickly during a bear market by acquiring product at relatively low prices

LOGISTICS

HEADWINDS

- A transition to more environmentally friendly buildings will be costly and make many existing buildings quickly obsolete.
- Interest rates and terms continue to impact the availability of finance.
- Competing sectors may attract a larger percentage of available investment.

TAILWINDS

- Supply remains strong but there’s a shortage of good grade logistics and industrial stock.
- Vacancy levels remain low and demand is holding up.
- The nearshoring trend benefits this sector as geopolitical uncertainty and supply chain issues drive demand for logistics space.
- Architects and developers are finding creative ways to use AI and automation technologies when designing industrial buildings closer to city centers.

LIFE SCIENCES

TAILWINDS

- Remains strong as an investment destination and is a robust growth area short to medium term.
- The UK has a thriving life sciences economic environment with government launching a £650m incentive growth package.
- A record number of new businesses are springing up meaning occupier demand and rents remain high.

HEADWINDS

- Decrease in deal volume caused by supply shortage of high quality sites and lack of speed and flexibility in the planning process.
- Healthy development pipeline as space becomes available - valuations and returns may start to soften.
- Debt finance is typically available however current interest rates will dissuade certain investors.

HEALTHCARE

TAILWINDS

Retirement Living

- Existing living investors expected to diversify into or increase their exposure.
- Overseas operators and developers expanding to the UK and seeking long term funding partners.
- Launch of the Older People's Task Force and expectation of legislative / regulatory reform.

Care Homes

- Opportunities for European consolidation opening up.

HEADWINDS

Retirement Living

- Government has not committed to a deadline for response to the NPPF Consultation, risking insufficient time to implement meaningful change.

- Concerns that the requirements of biodiversity net gain are a level of complexity that Local Planning Authorities are not geared-up to handle.

Care Homes

- Risk of further closures as mortgage rate increases compound existing headwinds.
- Impact of Minimum Energy Efficiency Standards Regulations.

RETAIL

HEADWINDS

- Macro -Economic factors
  - higher borrowing costs for retailers for new debt and refinancing of old debt;
  - constraints on capex for retailer and investment decisions on hold; and
  - impact on consumer confidence causing a change in consumer habits.

- High inflation and rising interest rates has resulted in:
- Retailers also grappling with exchange rate volatility and supply chain constraints.
- Retail Insolvencies – on the increase for non-essential retailing as post Covid leisure activities and home improvements decline and consumer habits change. "Helpless" landlords are feeling the impact of CVAs and restructuring plans.
- Planning constraints – redevelopment and repurposing of retail assets being affected by political intervention and environmental concerns.

TAILWINDS

- Footfall and vacancy rates – remain relatively stable as younger people have more disposable income.
- Rates – recent rates reforms have been welcomed but impact varies depending on retail category, sector and geography. Larger stores generally seeing greater benefits.
- Supermarket investment - Grocery retailing (including a strong convenience market) remains resilient and desirable investment with increased sale and leaseback activity.
- Retail warehousing/retail parks – with traditionally greater focus on essential products continue to trade well, drive greater footfall and remain attractive to investors.

- Discounter and Athleisure retailers – still in acquisition mode, but query when discounters will reach saturation point.
- Drive-Thrus – competitive market for new sites from both traditional operators and new competition.
- Experiential retail - retailers and landlords investing in augmented reality and improving experiential offering.
- Luxury retail –investment in West End luxury shopping destinations such as Bond Street continue and luxury retailers are expanding in such areas.

FILM AND TV STUDIOS

HEADWINDS

- Business rates – the rateable value of studios is being re-assessed, which is leading to significant increases in business rates.
- Macro forces – inflation, an increase in the cost of debt and political uncertainty (locally and nationally) are generating hesitancy around the sector (as with other sectors).
- Has the occupational market gone full circle? The big players (Apple TV, Netflix, Disney+ etc.) have taken a lot of space on long term arrangements, but they are curbing costs and are expected to be more selective and cautious about longer term arrangements in the future. Will the sector therefore revert back to shorter term and ad hoc arrangements, which may not be as institutionally desirable.

TAILWINDS

- The likely end of ongoing strike action and the release of the resulting backlog, together with projected increases in film and TV production spending in the UK to meet ongoing changes in viewing habits and ever increasing demand for new content.
- Numerous market commentators project the need for more purpose built studio space in the UK to meet this demand. There are also ESG opportunities in this sector, which from an environmental and sustainability perspective has struggled to grapple with high energy consumption and waste generation.
- The UK’s reputation for excellence in TV and Film production and its attractiveness to the entertainment sector, including as a result of tax incentives, government subsidies and its skilled workforce.

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