January 2023

The Property Round

In This Issue

This Issue's Contributors

Richard Kleiner
CEO

Sonal Shah
INTERNATIONAL TAX PARTNER

Grant Lee
PARTNER

Plus articles from Ted Schama at Shelley Sandzer, Martyn Green at Landstones, Harvey Soning and Jeremy Grey at James Andrew International, Matt Karagul at Henry Dannell, and Leigh Perl at Haymarket Properties.

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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

Contact Us
73 Cornhill, London, EC3V 3QQ +44 (0)20 7299 1400 hello@geraldedelman.com

XLNC FOUNDING MEMBER

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?

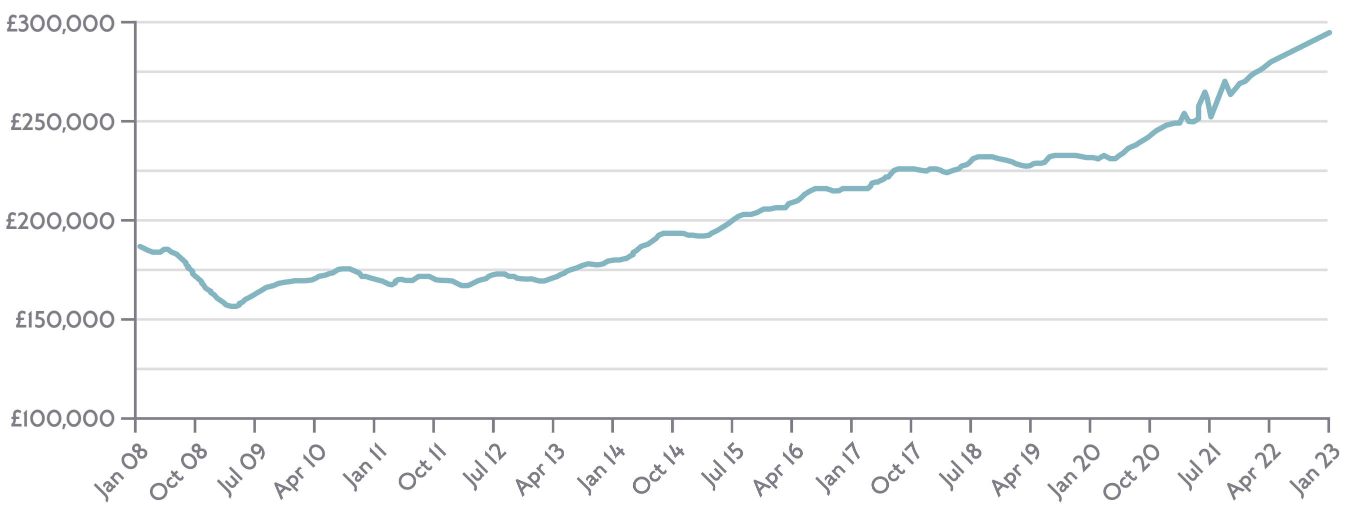
Forward indicators point to a slowing market. New sales agreed fell 12% between October and November, according to TwentyCI.

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

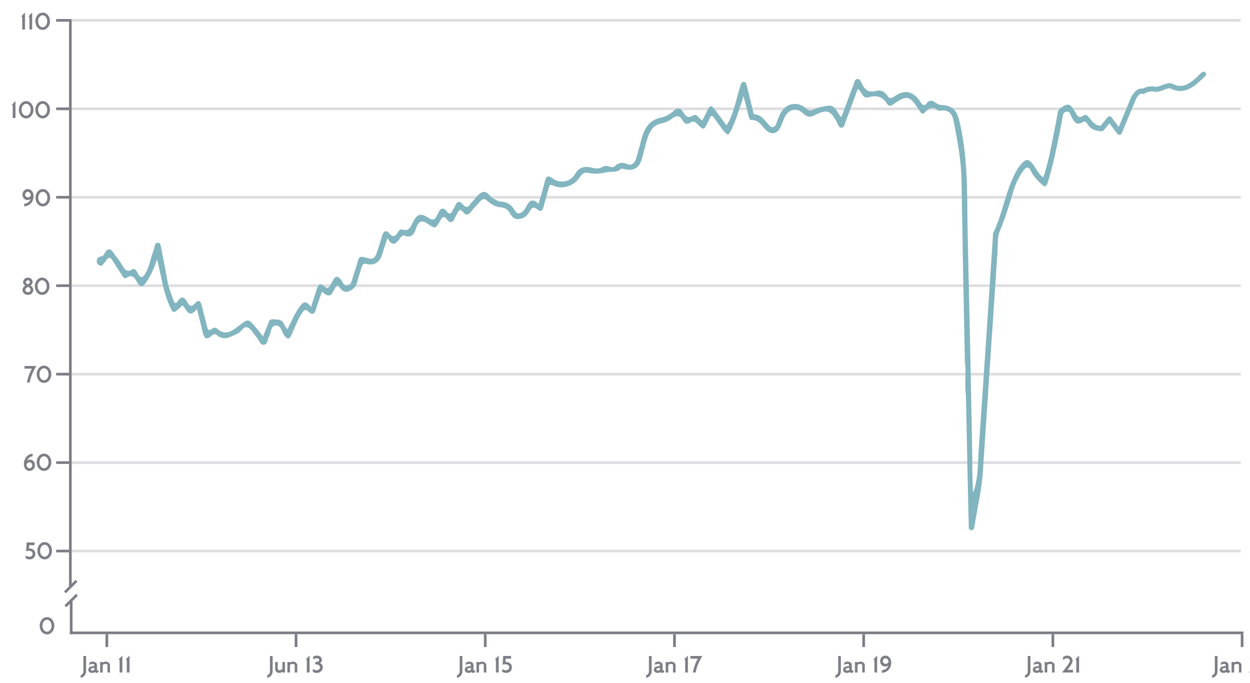
Repricing has been seen across the commercial property markets. This is reflected in the tone of the feedback gathered as part of the Q3 RICS UK Commercial Property Monitor. The Investment Enquiries metric posted a net balance reading of – 18% over the last three months compared with +12% in Q2.

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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FLEXIBLE OFFICE SPACE – THE CURRENT TRENDS

RICHARD KLEINER

CEO, GERALD EDELMAN

+44(0)20 7299 1405 +44 (0)7768 920 220 rkleiner@geraldedelman.com

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!

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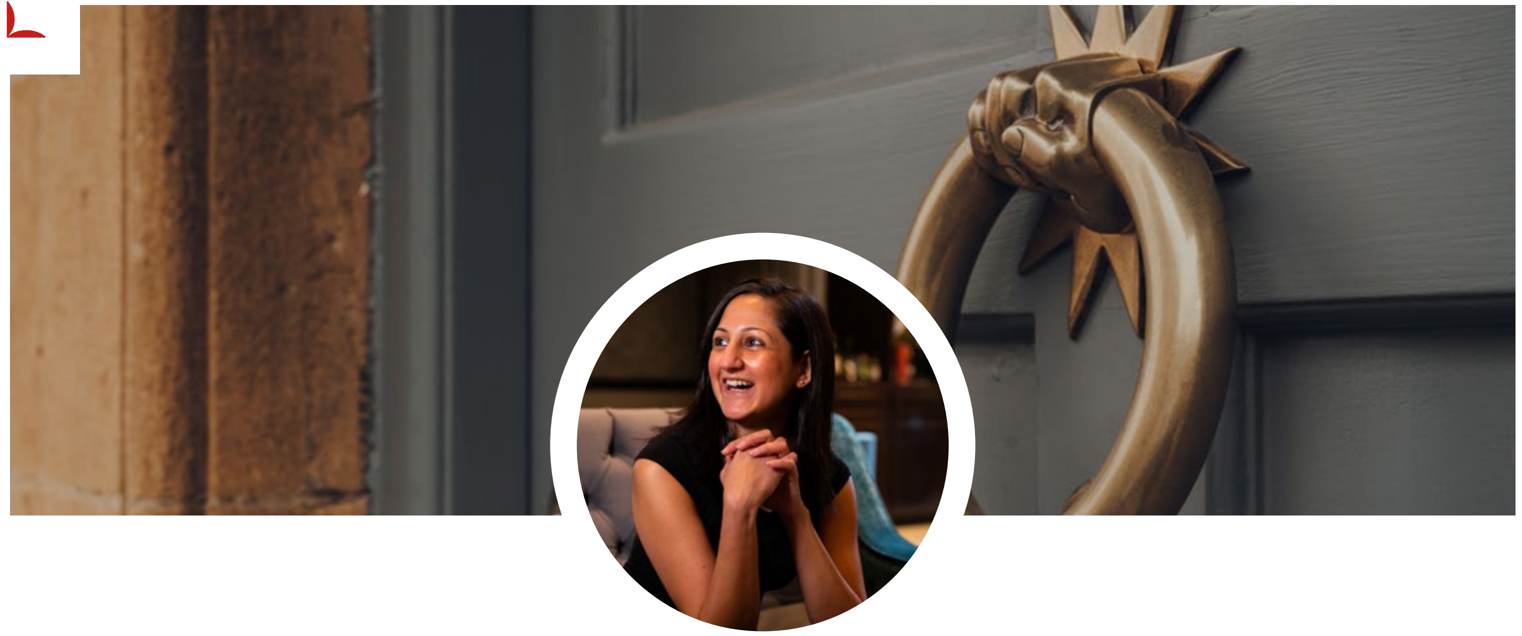

TRUST STRUCTURES HOLDING UK REAL ESTATE

SONAL SHAH
INTERNATIONAL TAX PARTNER, GERALD EDELMAN
+44(0)20 7299 1409 +44 (0)7775 703 015 scshah@geraldedelman.com

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.

	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.

PROPERTY ENTREPRENEURS WINE TASTING

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

MARTYN GREEN

MANAGING DIRECTOR, LANDSTONES

+44(0)20 7096 9476 contact@landstones.co.uk www.landstones.co.uk

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.

GET IN TOUCH

Landstones Estate Agents
297 Westbourne Grove
London
W11 2QA

020 7096 9476
contact@landstones.co.uk
www.landstones.co.uk

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GERALD EDELMAN

Contact us

73 Cornhill, London, EC3V 3QQ +44 (0)20 7299 1400 hello@geraldedelman.com

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