HANDELSBANKEN

PROPERTY INVESTOR SURVEY - VOLUME 2

Property Investor report

May 2023

Handelsbanken

Introduction
Landlords showing resilience in an uncertain world

At a time of significant macroeconomic and geopolitical uncertainty, the UK property market has continued to attract professional investors and experienced landlords. According to our research, most professional property investors indicate they are likely to increase their allocation to the sector as we look ahead.

Despite fears over the underlying strength of the UK property sector, it has held up relatively well in the face of material headwinds – including high inflation, steep interest rate rises, an ongoing conflict in Ukraine, political unrest, and a stressed UK economy. While risks and challenges remain, recent industry data underscore this relative robustness: UK house prices rose between March and April 2023, for example, ending seven consecutive months of declines.

This latest report from UK relationship bank Handelsbanken shines a light on sentiment from a highly influential and significant market segment: professional property investors who, based on our respondents, manage an average portfolio of 29 properties with a market value of £14m. Insights into this active investor base are rare, and we have taken the opportunity to ask views and opinions on key issues.

It is unsurprising, perhaps, that the vast majority (91%) of the professional property investors we spoke to for this report said they were looking to pay down debt as a priority given the current environment. However, three fifths (59%) also said they were looking to increase the size of their portfolio over the next 12 months.

Overall, as we will detail, the research points to a cautiously optimistic audience alert to opportunities but mindful of a volatile and sensitive market. Many are waiting for values to fall a little further, (a general market prospect being forecast by the Bank), particularly in the case of office and commercial assets, hoping to lock-in enhanced returns over the long term.

Methodology and respondent demographic

Handelsbanken commissioned research in March 2023 through independent research company Pure Profile among a panel of 200 professional landlords across the UK.

The sample was split equally among those owning between five and 15 properties; those owning between 15 and 25; those owning between 25 and 50; and those owning 50 or more properties. On average, each of the respondents' portfolios was comprised of 29 properties, with an estimated market value of £14m.

There were 17 respondents in each of 12 regions apart from Northern Ireland, where there were 13 respondents.

Around 62% of the sample classified their business as "real estate investment" while 22% classified their business as "landlords" (residential and commercial) and 16% classified it as "property management". Some 46% of the sample said their property holdings included commercial offices; 41% commercial retail, 41% student lettings/HMOs; 40% commercial industrial; 27% residential non-student lettings/HMOs; 23% residential static park homes; 23% commercial leisure; and 8% commercial healthcare, including hospitality and holiday parks.

Section 1

Market outlook and sentiment

Professional landlords are seeing opportunities in the current market, especially in commercial property.

Despite the tough economic environment, our research found UK real estate remains a largely favoured asset class among professional property investors. By and large, they remain laser-focused on optimising returns, disposing of assets, and releasing capital as and when necessary. There were particularly interesting findings among investors exposed to commercial property which we set out below.

Overall, almost half (45%) are bullish about the market. A sizeable number (39%) said they expect the value of their portfolio to increase significantly over the next 12 months (specifically, an increase in value by 20% or more), while more than half (53%) expect a slight increase of around 5%. Just one in 10 (10%) thought it will broadly stay the same.

Our study found that half (49%) and 40% respectively expect demand for commercial property and residential property to increase significantly over the next 12 months. These figures indicate that many investors remain on the look-out for opportunities.

Our study found that 49% and 40% respectively expect demand for commercial and residential property to increase significantly over the next 12 months.

What is the estimated current market value of your property portfolio?

£1m - £1,999,999	**2.5%**
£2m - £2,999,999	**7%**
£3m - £3,999,999	**11%**
£4m - £4,999,999	**14%**
£5m - £9,999,999	**21.5%**
£10m - £19,999,999	**25%**
£20m - £49,999,999	**14%**
£50m or more	**5%**

Source: Handelsbanken professional landlord market research, March 2023.

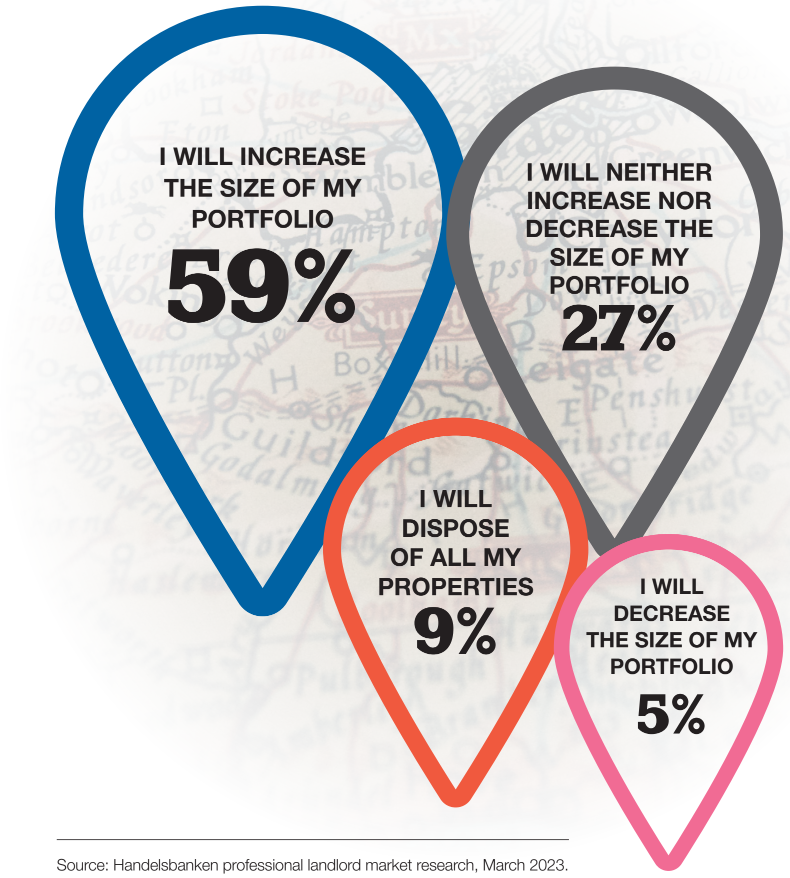
How do you expect demand for the following property types to change over the next 12 months?

	Residential	Commercial
It will increase significantly	40%	49%
It will increase slightly	50%	38%
It will remain the same	10%	14%
It will decrease	1%	0%

Source: Handelsbanken professional landlord market research, March 2023. Figures subject to rounding

Given this sentiment, some 59% of our respondents said they will grow their portfolio over the next year. This represents a strong and continued interest in UK property as an asset class from serious investors. Just a quarter (27%) said the size of their portfolio will likely stay the same while only 5% said they expect it to shrink.

How do you plan to shape your portfolio over the next 12 months?



Source: Handelsbanken professional landlord market research, March 2023.

> The bottoming out of commercial property prices in Q1 2023 corresponds with reasonably positive sentiment in this survey."

James Sproule
UK Chief Economist

Geographic and sector diversification

London continues to be a strong market target for property investors, and professional landlords are seeing opportunities in commercial property.

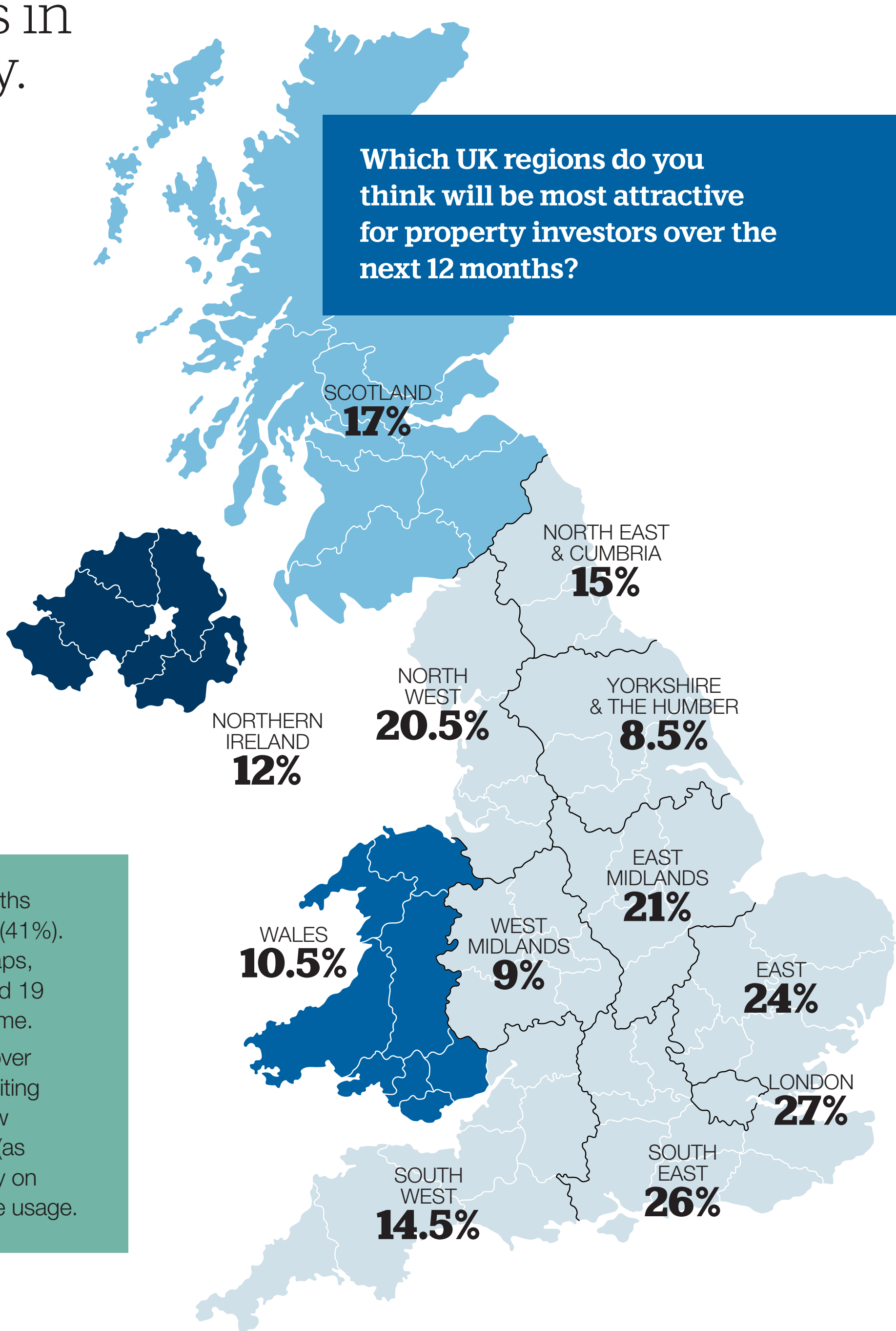
Among those looking to increase their portfolio, three fifths reported they are looking to diversify geographically, with a similar number (57%) saying they were looking to do so sectorally.

London, historically often the most dominant market in terms of investor allocation and sentiment, is still seen as the most attractive region over the next 12 months (cited by 27% of our respondents) followed by the South East (26%). Areas seen as less attractive for property investment are Yorkshire and the Humber and the West Midlands (both attracting interest from only 9% of our sample).

The most attractive sectors over the next 12 months are commercial offices (43%) and residential flats (41%). The strong interest in commercial offices is, perhaps, surprising given the uncertainty around post-Covid 19 office occupancy and the rise of working from home.

However, as values have undergone a correction over the past few years, many investors will likely be waiting for opportunities to buy at reduced cost with a view to longer term value creation, re purposing assets (as Handelsbanken is seeing) and / or capitalising early on shifts in working patterns back towards more office usage.

Which UK regions do you think will be most attractive for property investors over the next 12 months?



Source: Handelsbanken professional landlord market research, March 2023. Respondents could click more than one region

Section 2
Challenges and risks

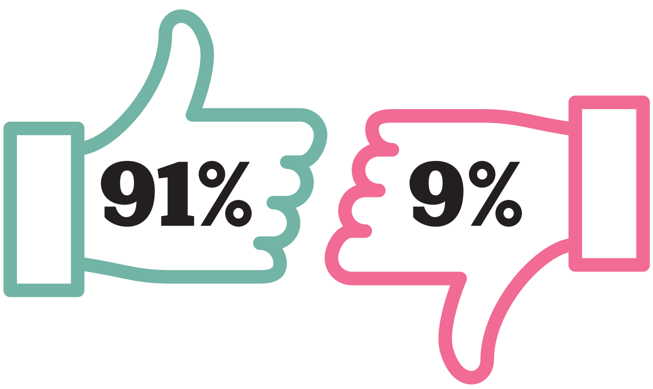
Tenant stress is affecting the majority of landlords but investors are managing issues judiciously

As one would expect, professional property investors are acutely aware of the risks and challenges facing the market.

Among those disposing of assets over the coming period, two thirds (66%) said they were bearish about the market, while a quarter (24%) said they cannot afford to upgrade in line with new regulations such as Energy Performance Certificate (EPC) ratings (see next chapter for more detailed views on EPC demands).

Three fifths (59%) said they need to liquidate some or all of their properties because of financial pressures, while the same number (59%) cited the need to liquidate to invest elsewhere. Some 7% plan to dispose of properties in line with their investment strategy.

In the current high interest rate environment, are you looking to pay down the debt on your portfolio?



Source: Handelsbanken professional landlord market research, March 2023

In our conversations with established and experienced property investors, the sharp rise in interest rates seen over the course of 2022 and 2023 in the face of high inflation has been a challenging reminder that capital is not as cheap as it once was, and portfolios need to be truly optimised in terms of yields and risk/return profiles.

We were not surprised to see that a high percentage of respondents (91%) said they were looking to pay down debt given high interest rates.

Likewise, tenant stress was also a key consideration, and a risk flashing on many investors' radars. Three fifths (60%) of respondents said that they were seeing requests for rental deferments/contract renegotiation while more than half (54%) have seen the number of void months increase over the past 12 months. In contrast, research we commissioned last year with a slightly different base of property investors found 41% had seen void periods increase.

In addition, 41% reported they were contending with overdue/late payments. Only 6% reported "no issues" at all in terms of tenants.

6% NOT experiencing any issues

	All respondents
Request for rental deferments / contract re-negotiations	60%
Increased voids compared to previous years	54%
Overdue / late payments	41%
N/A - I am not experiencing any stresses	6%

Are you experiencing any of the following tenant stresses within your portfolio?

Source: Handelsbanken professional landlord market research, March 2023. Respondents could click more than one answer

Investors with larger portfolios are likely to be holding back from making significant investments in 2023, waiting for the market to fall before making strategic acquisitions. To turn a willingness to acquire into reality, yields will likely need to improve to tempt them into action, but that comes with a reduction in capital values, which will have an impact on their current assets.

It is a sign of the current market that many are taking this approach, particularly given the rate environment and demand for many to invest capital in existing assets to bring them up to new environmental criteria and legal requirements.

"The findings highlight why it's important to know the area where you are planning to invest."

Danielle Coe
Branch Manager, Leamington Spa

Section 3
EPC ratings and energy efficiency

Landlords are prepared to invest in improving energy efficiency in anticipation of rule changes

One of the most significant challenges for investors and professional landlords is the drive to upgrade their portfolio's energy efficiency.

In common with most developed markets, the UK is committed to improving the environmental profile of its real estate stock. Improving Energy Performance Certificate (EPC) ratings is a core element of the UK government's drive to a 'net-zero' economy. EPC standards illustrate a building's energy efficiency and range from a top rating of A down to G. Additionally, as a bank, Handelsbanken has committed to reaching net-zero by 2040, so this question helps us to understand the challenges landlords might be facing to reduce their portfolio's carbon footprint.

Minimum Energy Efficiency Standards (MEES) were first implemented in April 2018. From 1 April this year, the regulations tightened further, with rules introduced in England and Wales around letting properties which don't meet the minimum legal requirement. In short, it became unlawful for a landlord to continue to let a commercial property with an EPC rating of below E.

According to our study, which was conducted just before the new rules came into force, meeting EPC ratings and refurbishing assets is a top priority for professional investors. Well over half (57%) were hopeful that all of their commercial properties would meet new standards on EPCs requiring a rating of E or above to be fit for letting by the deadline.

How much are you planning to invest across your property portfolio over the next 12 months specifically to improve your EPC ratings?

	All respondents
£1,001 - £2,000	2.5%
£2,001 - £5,000	2.5%
£5,001 - £10,000	2.5%
£10,001 - £20,000	2.5%
£20,001 - £50,000	11%
£50,001 - £70,000	12.5%
£70,001 - £100,000	12%
£100,001 - £200,000	19%
£200,001 - £500,000	16.5%
£500,001 - £750,000	11.5%
£750,001 - £1,000,000	6.5%
£1,000,001 - £2,000,000	1%

Source: Handelsbanken professional landlord market research, March 2023.

Half (52%) of respondents said they were very familiar with government plans to increase minimum EPC standards to B by 2030. Around 44% admitted to only being moderately familiar, with 4% slightly familiar.

In terms of how much the landlords we surveyed are willing to spend to bring their portfolios up to a higher energy efficiency, more than half (55%) are planning to invest £100,000 or more over the next 12 months across their portfolio. Nearly one in five (19%) is planning to invest £500,000 or more. All property business owners surveyed plan to invest at least £1,000.

To put this into context, £500,000 equates to approximately 3.5% of the average sample portfolio value. Given that the vast majority (92%) believe the value of their portfolios will increase by 5% or more, many are likely to see that rise absorb these investment costs.

It's worth bearing in mind that in 2020, as part of its consultation into improving energy efficiency of privately rented homes, in England and Wales, the government proposed increasing the energy efficiency performance standard for privately rented homes to EPC C for new tenancies from 2025 for a landlord in England and Wales, and all tenancies from 2028. It also suggested lifting the cap on landlords' maximum spend from £3,500 to £10,000, based on its assumption that landlords will spend £4,700 per property to reach a C rating. These are not insignificant amounts, and for many investors represents a major step-up in capital expenditure. The government has promised a response to the consultation by the end of the year.

From April 2023, it became unlawful in England and Wales for a landlord to continue to let a commercial property with an EPC rating of less than E. How confident are you that your commercial properties will meet or exceed the required standard?

	All respondents
Very confident - I know all of my properties will have an E or above rating	39%
Confident – I am hopeful that – all of my properties will have an E or above rating	57%
Not very confident – I expect some of my properties will miss the deadline	3%
N/A - I am unaware of this legislation	1%

Complying with EPC regulations and upgrading energy efficiency have been front of mind among many of our customers, who are acutely aware of the associated challenges and requirements. In many cases, we are seeing customers looking to preserve cash and only invest in necessary improvements – or projects that will significantly enhance income streams.

Source: Handelsbanken professional landlord market research, March 2023.

Section 4
Conclusion

This study highlights that professional property investors remain bullish about the sector's prospects in the long term. However, risks and challenges remain firmly in place, and the need for effective portfolio and capital management has taken centre stage.

Despite the myriad challenges feeding into a difficult economic backdrop, large portfolio investors are on the whole skilfully navigating the current market conditions. It is interesting to note that all property sectors are forecast to see a net increase in exposure as we look ahead, revealing that investors' entrepreneurial approach and commitment to active management remains undimmed.

As a bank and long-term partner to a growing number of professional property investors, we have deep expertise in the sector. Through our nationwide branch network, we also have a presence in many areas of the UK which means we have extensive local market knowledge. We are committed to providing customers with a best in class, tailored personal service.

We look forward to keeping a finger on the pulse of this core demographic so that we can continue to adapt and enhance our solutions according to their evolving needs.

"In our experience of the market, investors will require significant investment to meet current tenant demands for greater amenities to achieve meaningful returns."

Simon Bradley
Chief Credit Officer

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