



Plight worsens for commercial property sector

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Hundreds of millions of pounds have been pulled from commercial property investments and developments in the UK in the past few weeks, exacerbating already accelerating losses in real estate values across the country.

Autumn is traditionally the time when property activity picks up from the summer recess, but the struggling sector has slowed further as the funding market almost entirely closed for new transactions.

Investors hope that after the government bail-out of the banking sector, much needed liquidity will also trickle into commercial property, with some already pointing to improvements in the interbank lending rate.

But investors seeking finance for property deals have said that the few open doors have slammed shut re-recently following problems in some of the sector's largest lenders, from Lehman Brothers and Hypo Real Estate to HBOS and Kaupthing.

The property industry has been built on cheap debt and high gearing levels, and analysts warn of a wounding period of deleveraging made worse by the billions of pounds of property and debt that banks need to sell.

Some analysts forecast a "double dip" property downturn six months ago as falling rents from struggling office and retail occupiers began to accentuate already dropping prices. This is now a reality.

According to CB Richard Ellis, the commercial real estate advisor, the capital decline in the third quarter more than doubled, rising from 3 per cent in the second quarter to 6.7 per cent.

September recorded the largest fall in capital values so far in 2008 at 2.9 per cent, according to Investment Property Databank, taking the total pricing correction to about 24 per cent in the past year.

Property Data reports that transactions levels fell to £4.3bn in the third quarter, almost a quarter of the £16.4bn sold in the same period in 2007.

James Beckham, head of City investment at agent King Sturge, said transactions had fallen to historically low levels following the collapse of a number of deals in the Square Mile in the past week. These included the £180m sale of ING Real Estate's 88 Wood Street to German fund SEB and the £150m acquisition of UBS's 200,000 sq ft Milton Gate by Signa Deutschland.

Investors report that banks are reducing lines of credit and pulling blind pools of funding where possible. Last week, HBOS Corporate cancelled a £200m facility with fund manager AAIM, effectively halting investment activity until a replacement backer can be found. The company is known to be looking for funding from the Middle East. One developer, who wished not to be named, had lined up £400m of bank debt to fund a large scheme with a consortium of banks but now reports that these have all pulled out.

Martin Allen, property analyst at Morgan Stanley, this week said the lack of new debt for investment could cause the value of institutional grade UK commercial property to fall a further 23 per cent and secondary quality property to fall an extra 29 per cent. This is worse than the bank's previous estimates.

Property entrepreneur Nick Leslau, who runs investment company Prestbury, agreed: "Without banking support there is almost no property market."

Duncan Owen, chief executive of Invista Real Estate, the fund manager that is 55 per cent owned by HBOS, said the UK market was virtually paralysed: "There isn't enough equity in the world being deployed to fund the great deleverage at current values and that means that prices will keep coming down to stimulate activity."

Mr Owen would not comment on the future of HBOS's stake in Invista.

Rob Brook, managing director of Kenmore, another HBOS-backed property company, said that it was in discussions about the future of three joint ventures with Lehman Brothers.