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UPDATE

AREF Vision Event 2024 – The outlook for the year ahead

Update prepared by Ben Robins and Michaela Hamilton (Jersey)

On 26 November 2024, the Association of Real Estate Funds (**AREF**) held its annual Vision Event in Jersey for the first time. Mourant was proud to sponsor this highly anticipated event, which explored the economic outlook and key market trends for real estate funds for the coming year.

The UK real estate outlook - keynote presentation

The keynote presentation by Mark Clacy-Jones, Head of Real Estate Strategy at abrdn, provided an insightful market analysis and predictions for the year ahead.

Economic backdrop:

- Policy rates are still set to fall across much of the world through 2025.
- The UK budget saw a large increase in tax, spend, and borrowing but after a short-term boost to growth, the Office for Budget Responsibility forecasts the budget to be relatively neutral for growth over the medium term.

UK real estate cycle:

- The capital cycle is turning positive.
- Industrial and retail warehouse values have increased every quarter in 2024 and there has been positive rental growth.
- After a sharp correction, real estate valuations are beginning to stabilise, although sector and regional differences remain.

What's coming next?

- The UK Q4 2024 economic fundamentals are looking more attractive alongside a clearer macroeconomic path and there is a window of opportunity now in the real estate cycle.
- Although investment activity remains relatively muted, Q1 2025 will be a turning point. Investors continue to wait for further cuts before selling/buying, but capital is there ready to be deployed.
- Financing costs, whilst still high, are no longer as much of a headwind for the real estate sector.
- The UK REIT sector has staged a strong recovery in 2024.

abrdn UK real estate forecasts:

- *Office sector* - the fundamentals for the Big 6 regional office markets (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester) are improving but remain comparatively weak. Vacancy rates are trending in the right direction generally, although there is a greater downside risk in London given the pipeline of towers and a vacancy rate that remains high.
- *Industrial and logistics* - yields are showing stability after a sharp correction. Despite a slight uptick in construction activity, there has been a noticeable slowdown.
- *Private rented sector* - rental value growth remains positive.

- *Retail parks* - abrdn maintains a positive outlook for retail parks with the correct tenant line-up.
- For funds with capital to invest, now is the time. 2025 and 2026 are predicted to be strong years.

The challenges and opportunities within the real estate sector - panel session

Mourant partner, Ben Robins, moderated the panel session which, in addition to Mark Clacy-Jones, featured Alex Notay – Housing, Placemaking and Impact Investment Expert, Paul Richards – CEO of AREF, and Simon Vardon – a Jersey-based Real Assets specialist and non-executive director.

What is AREF's view, and on which areas are you lobbying, post change of the UK Government?

- Paul said that for AREF, in common with many other industry participants and investors, the stability of the new Government and the policy focus is welcome. The new ministers have come into office understanding their portfolios and knowing what they want to do which provides certainty. There are three areas of particular focus for AREF:
    - ESG (environmental, social, and governance) - with a particular focus on advocating for regulations and incentives to support carbon-reduction strategies within the built environment;
    - Pension system - addressing the challenges arising from the shift from Defined Benefit to Defined Contribution schemes, which has resulted in reduced investment flowing into the sector; and
    - Housing - AREF is carrying out work related to the Government's target of building 1.5 million new homes in the UK and speeding up processes to attract more money into the sector.

Are there any conflicts in the new UK Government's policies?

- Paul and Alex agreed that certain polices on new affordable housing and ESG (eg energy efficiency transformation) can conflict in practice. Natural capital and biodiversity will restrict building on the green belt, and there is a potential disconnect between policies on net zero, eg minimum energy efficiency standards, and delivering affordable housing. Government will need to find solutions.

How do you define 'impact investing' as it seems to be a very broad concept?

- The Global Impact Investing Network has a formally agreed definition, but Alex explained that an impact investment is essentially one which makes a positive impact that would not otherwise have occurred. There are two key elements:
    - *Intentionality*: a deliberate intention to deliver a positive impact; and
    - *Additionality*: it must be a material and measurable impact over and above what would otherwise have been delivered.

  Impact investing is an area that is growing and increased ten-fold in a decade.

What about 'stranded assets'?

- Alex explained that a stranded asset is an asset on a balance sheet which would cost more to refurbish or retrofit than its value. AREF's ESG & Impact Investing Committee has been looking at ways to repurpose/refit stranded assets and a paper on this will be published shortly.

Where is the market currently in terms of appetite for impact and ESG?

- Alex confirmed we are in a phase where the anti-ESG backlash is firmly in progress, particularly in the US. ESG is not, however, going away. It is broadly understood by most people in the market that the ESG factors that are being considered are important. On that point, Mark explained how abrdn fund managers always look at the ESG implications at the outset when considering an acquisition.
- ESG needs to be embedded in good practice rather than being a tick box exercise. Alex described the remarkable progress made, given over 200 jurisdictions have now adopted the framework of the Task Force on Climate-Related Financial Disclosure into their regulations (the EU has the Sustainable Finance Disclosure Regulation, and the UK has the Sustainable Disclosure Regulation).
- Ben noted that it will be challenging for international businesses to set a unified global policy and strategy on ESG given certain views in the US on ESG. On that point, Paul mentioned the impact of 'greenhushing' (a company's refusal to publicise ESG information), particularly in relation to information disclosed to US investors.

What are you seeing in terms of managing ESG requirements on real estate fund management boards?

- Simon explained how he now observes that an ESG section (typically comprising environmental metrics and a description of community and social activities) is now included as standard practice within Fund/Asset Manager presentations to Boards. Consistency in the type of information provided will come in time. On occasion, where Boards wish to discuss ESG in greater detail, then arranging a meeting with the Head of Sustainability (or similar) at the Fund/Asset Manager has proven very useful and can also lead to additional reporting being shared. Boards need to remain mindful that even if the property is only held for a relatively short time, that they ensure the required journey to net zero is enabled, and on track whilst under their ownership. Simon also reported that he is increasingly seeing ESG incorporated into investment decisions and in some cases being the driving factor for an investment decision.

With an improving market, we can hope to see new funds and investment structures being established. How well placed is Jersey these days to feature in those structuring solutions and what type of entities should we expect to see being used for real estate investment?

- In response, Simon listed the following:
  - Real Estate Investment Trust (REIT): Refinements have been made to the REIT regime making it more accessible and cost effective, so we have seen the rise of the private REIT. There has also been increased interest in the REIT regime as a consequence of rising Corporation Tax rates. In the past REITs have been structured using Jersey companies with a UK Board to be UK tax resident, which is often considered optimal operationally owing to the ease of making distributions and absence of stamp duty on transfer and he would expect to see more of this type of activity going forward.
  - Qualifying Asset Holding Company (QAHC): Proving very popular for some other alternative asset classes, this relatively new UK regime is not designed for use where the underlying asset is UK real estate, however, the regime can be beneficial if the company's underlying asset is overseas real estate. A QAHC company needs to be UK tax resident, and once again a Jersey company can be used when structuring.
  - Jersey Property Unit Trust (JPUT): This is still a very popular vehicle to use for structuring investment into UK real estate. Some of the motivations for using JPUTs in the past have dissipated, but JPUTs remain relevant today. The new HMRC transparency and exemption elections have kept JPUTs competitive, but also investor preference (particularly institutional investors of an exempt tax profile) is a factor for the continued use of JPUTs. It is also worth noting that a UK regime like the REIT regime does carry certain rules and restrictions and thus may not be suitable for every asset or every strategy. There are no such regime restrictions for a JPUT.
  - Reserved Investor Fund (RIF): The expected arrival of this new UK fund product is Easter 2025 and we keenly await the secondary legislation which will allow the industry to compare the RIF with other fund products.
- In summary, there is a lot of choice which can only be good for investors. Ben noted that the Jersey products are still working very well. This year Mourant has been working on a number of REITs structured with Jersey companies and JPUTs and there has also been interest in establishing 'Jersey QAHCs'. There is often a need for interaction of fund products with feeder or holding vehicles in different jurisdictions (whether UK, Channel Islands or Luxembourg, for example) to satisfy structuring needs, which ideally requires service providers with locations in those different jurisdictions to manage any complexity.

Other Q&A observations:

- At this stage, without a centrally agreed index or base line, the best way to measure impact investing is for firms to internally set their own measures and pick some external benchmarks to work against. Firms needs to be realistic about impact, as it takes time. Any impact strategy and measure of that strategy must, therefore, include the time factor.
- Two significant UK bills are coming through next year in the UK: the Devolution Bill (removing the two-tier level of governance to increase efficiency at a local level) and the Planning and Infrastructure Bill (making planning an enabler rather than a blocker).

AI in the real estate industry is still in the early stages but is likely to help with reporting, drafting and analysing documents, preparing valuations and writing reports, improving ESG metrics and interrogating data in deal data rooms. AI will, therefore, ultimately drive down costs.

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