Things could easily get worse before they get better

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There is more pain to come as a result of higher debt costs and the weakening economy

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I recently wrote that we'd entered the third seismic structural market correction of my 37 years in the industry, following dramatic shifts in 1989 and 2008 – but this time around, the variance of factors impacting activity and pricing as we emerge, will be very different. So, how is it going to play out market activity and pricing wise?

Well, if I knew the answer to that, I wouldn't be writing this piece. And we are reminded in uncertain times like these, experts may know stuff, but that doesn't mean they've got a clue what's going to happen next. So, with that credence ringing in your ears, here's my view.

New lenders

There are two striking differences between now and the global financial crisis in 2008. Firstly, in 2008 about 75% of the debt was held by a handful of clearing banks and building societies – they didn't have the patience, balance sheets and granular expertise or resource for a slow work out. They foreclosed on billions of pounds of loans, there was an avalanche of assets disposed of individually and in large NPL portfolios which were broken up over time as pricing was established against the backdrop of swiftly diminishing borrowing costs – activity snowballed over the proceeding years – happy investors and service providers everywhere!

This time around however, those large lenders only hold about 35% of the debt with the balance now held by challenger banks, debt funds or private lenders who are, in the main unregulated. These lenders will be far more canny and prescriptive – yes receivers and insolvency practitioners are much busier and that uptick will continue, but rather than just pulling the rug, lenders will seek capital calls and increased margins where tolerable.

We'll see a gradual shift of "value" from borrowers to lenders and in addition, lenders will be creative by selling debt or considering JVs or overage agreements where suitable with fresh capital and expertise. And they won't be in a rush, that is, assuming their interest payments are being serviced which they can generally expect presuming continued tenant solvency – which I'll come back to!

Cost burden

And the second fundamental and colossal difference is, in and from 2008 the cost of borrowing dropped like a stone whereas this time around in percentage terms, it's shot up like a rocket and critically, whilst it will drift back a little in time, it won't get anywhere near the low levels we've enjoyed for the last decade, for at least another decade, if ever at all.

So, whilst there will be sector and asset specific exceptions, the bottom line is one's all in borrowing costs are at least 200%-300% greater. That has to have a structural impact on values which we've already partially witnessed – but we simply don't yet know how this increase in borrowing costs is going to translate to values. For sure we have further pricing discovery to explore because as we stand, we have a market where in the main, vendors numerically or emotionally want more than purchasers are willing to pay given debt dynamics and alternative options such as gilts and high interest bearing accounts where the risk premium makes much more sense.

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There are of course the sheds, beds and meds sectors that have stronger fundamentals and investor appetite however they aren't immune, especially for the latter two where existing supply is limited and for new product there are viability challenges.

I saw a recent headline stating volumes are 30% down – my instinct says double that if not more, certainly in number of transactions terms. So it's going to be a rough ride for those that rely on trading activity. And whilst there is a shed load of capital waiting to buy, in addition to pricing there is also a mismatch as to the profile of assets more likely to surface versus where that real depth of that capital wants to deploy.

So, through this prism, I see a continuing steady trickle of trades and gradual attrition as investor demand meets supply, or not, over at least the next 24 months journeying to where values may settle. This will partially be predicated due to borrowers approaching fixed dates of refinancing, which is a certainty, combined with lenders retaining the luxury of their debt payments being serviced and thereby being able to take their time to extract value and unwind positions in an orderly manner – but how certain is that? I'd be looking over my shoulder hard.

Economic pressure

Albeit still relatively low in actual numbers, corporate insolvencies in England and Wales are 27% up year on year. The PMI index, a strong indicator of recession is now consistently averaging below the critical 50 level. And consumer spending wise, I'm wondering if we've been naively surfing a wave of positive sentiment and therefore residual consumer spend as a result of left over Covid savings coupled with today's saving rates, but that the reality of the cost of living crisis is about to bite us on the proverbials. I know what goes through my mind cost wise when I pop out for a meal nowadays or am looking to get away for a few days.

And all this before you factor the known unknowns of an election next year where clinging onto power for the incumbent appears to trump well… anything, and tectonic geo-political tension that could easily affect supply chains and energy costs again. Full of the joys of spring I know, but no value in burying our heads in the sand to what I see as only downside risk. If all this "lag" does lead to meaningful tenant default, then the lenders will lose their luxury as outlined above. It may even result in some of those smaller lenders looking over their shoulders, especially as at least some have borrowed capital against their loan

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book from the large banks who for slotting of capital reasons, are restricted as to their sponsors.

So if you think you may want or need to sell for whatever reason over the next couple of years I'd advise you to get on and do it. Of course if everyone's does the same, pricing will drop even further, but that's the market and there's always an element of luck when it comes to timing. Or do you hold tight and ride it out if you can stomach capital calls, increased debt servicing and possible tenant default?

Never has the need trusted advisors with access to smart capital been so important as opportunities and nuance will be woven into what unfolds. My expert view is I see a shit storm coming and if we do get meaningful tenant default, expect blood on the streets. But then we know how good experts are in knowing what happens next.

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