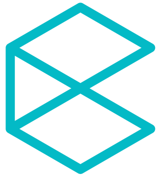

CARPENTER BOX

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South East Property Newsletter

Issue 3: Autumn 2023

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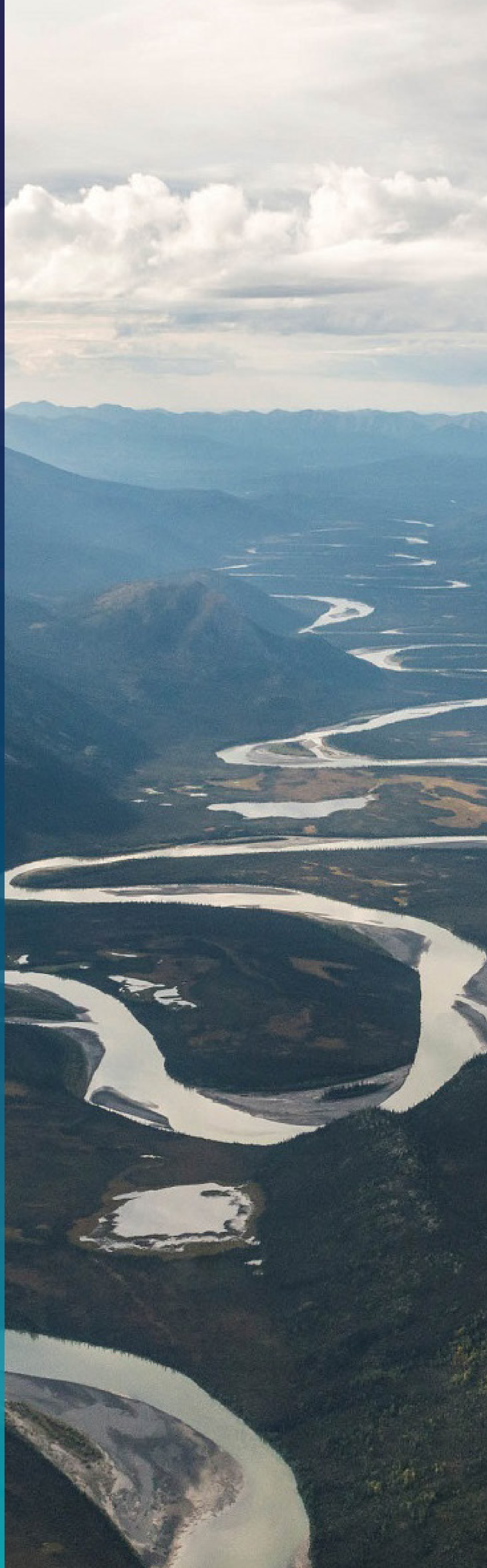


Welcome to issue 3 of our South East Property newsletter!

This latest edition from the Construction & Real Estate team at Carpenter Box seeks to cover the latest news, trends, challenges and opportunities facing the sector.

This edition looks carbon reduction in the built environment and provides some insight into how you can assess and reduce the carbon in your business. We also include articles on how the recent interest rate increases are currently impacting the property sector as well as some important considerations if you are thinking of incorporating your property portfolio.

As usual this issue also covers the latest house and building materials prices, as well as construction output figures from the Office of National Statistics.

We hope you find the read informative. If you have any questions about the topics discussed, we're here and happy to help, so please don't hesitate to get in touch.

Robert Dowling
Head of Construction and Real Estate
Carpenter Box

Carbon reduction in the Built Environment

This article was written by Ian Hopping of Auditel

The built environment is responsible for about 42% of annual global CO2 emissions.

According to the United Nations, between 2020 and 2060, the world is expected to add about 241 billion m2 of new floor area to the global building stock. This is the equivalent of adding an entire New York City to the world, every month, for 40 years. UN Secretary-General, António Guterres, said in his message on World Habitat Day in 2021 that *"Three-quarters of the infrastructure that will exist in 2050 has yet to be built."*

In the UK, infrastructure is associated with half of all Greenhouse Gas emissions of which 30% are directly attributed to the construction, operation and maintenance of infrastructure assets.

Market direction: Part Z

Part Z is a proposed amendment to the building regulations and is supported by major contractors, developers and architects as well as industry bodies RIBA, ICE and the CIOB.

If enacted, Part Z would ensure that embodied carbon is assessed on all projects, as part of a comprehensive whole life carbon assessment. It would also ensure that the embodied carbon emissions are then capped on all major construction projects - initially through limits on upfront embodied carbon, but over time expanding to cover all aspects of embodied carbon.

The journey to Net Zero: what is driving change?

- **Consumer pressure:** Western consumers are making more environmentally aware buying choices
- **ESG for investors:** ESG agenda for investors and fund management has become a top priority.
- **Reporting legislation:** Gradual introduction of emission reporting in company accounts and reports such as TCFD, SECR, ESOS, European Taxonomy and CBAM.

Terminology

» **Carbon Neutral – short term:** Means balancing your GHG emissions by "offsetting" an equivalent amount of carbon for the amount produced.

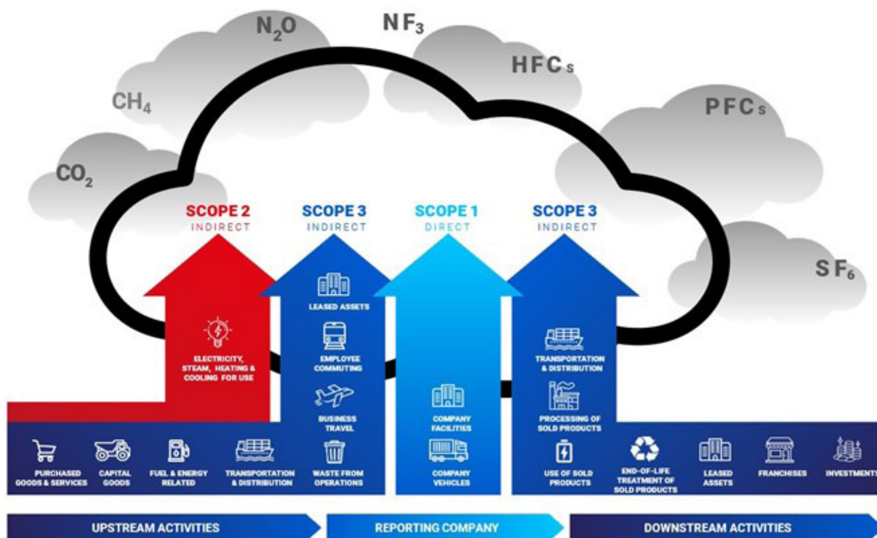
» **Net Zero – long term:** This is reached when the amount of residual CO2e emitted is matched by the quantity of CO2e removed or captured. You cannot achieve net–zero by offsetting.

» **Operational/Organisational Carbon:** Means the GHG (greenhouse gas) emissions associated within the operational boundaries of the subject and within the organisational control.

» **Embodied Carbon:** Means the carbon associated with a building project, throughout the lifetime of the project, including raw materials, site preparation, construction, usage and demolition.

GHG Emissions Scopes for Carbon Accounting

Greenhouse gas emissions are grouped into 3 scopes as seen from the diagram below.



With many organisations citing that over 60% of their GHG emissions are in Scope 3 activities, businesses cannot ignore the link between procurement and carbon management. Effective procurement reviews will help gather emissions data and generate savings to fund further carbon reduction work. Equally, effective carbon inventories will require procurement reviews of all key areas of expenditure.

Organisations across the world are weighting carbon emissions as the new 'fifth element' in any buying decision alongside price, quality, service, and delivery.

Reducing Carbon in your business

Measuring your emission is important, but the real goal for us all must be to reduce our absolute emissions. Often organisations rush to implement reduction ideas with no real understanding of their impact on overall emissions. Equally, others spend far too much money offsetting emissions with carbon credits, without any real consideration towards carbon reduction.

A genuine journey to Net Zero must have real and meaningful carbon reduction ideas in consideration at executive level. Often these reduction ideas can be defined as short, medium or long term. They can also be targeted as procurement based, capital investment based, or behavioural change based.

Quality of carbon inventories

To safeguard your brand against the danger of any false environmental claims, you need to ensure the quality of your first carbon inventory is robust.

Quality carbon inventory check list:

- Include clear definition of organisational and operational emission boundaries
- Examine the full value chain of your organisation
- Comply with GHG Protocols or ISO 14064-1
- Avoid spend based analysis
- Document any excluded emissions, with reasoning
- Clear and verifiable calculation methods
- Clear evidence file for all activity data
- Ideally, 3rd party verifier's opinion statement

Offsetting your Carbon Footprint and Emission

Offsetting your carbon means essentially funding and investing in carbon offsetting projects and schemes around the world that remove carbon emissions from the atmosphere. For your business to be Carbon Neutral, you must purchase offsets that match the same volume removed as you or your business is producing. In simple terms, offsetting one tonne of carbon means there will be one tonne less of carbon in the atmosphere than there would have been previously. Examples of such projects include the creation of clean energy technologies; developing carbon capture technology or planting trees to remove CO2 from the atmosphere.

Some organisations offset their entire carbon footprint, while others often aim to neutralise the impact of a specific carbon creating activity, such as taking a flight. This is done by calculating the emissions of the specific trip and investing in offset schemes and projects that reduce those emissions, making the flight 'carbon neutral'.

Offsetting carbon emissions is a continuous exercise and we have outlined our process:

- Firstly we define and measure your current and future carbon footprint.
- We then reduce it by implementing a tailored carbon reduction plan and help you buy carbon offsets to offset your emissions.
- Finally, we document and validate this process with a verification body (e.g. BSI and NQA).

Carbon Management in Infrastructure: PAS 2080

PAS 2080 is the leading standard for carbon management solutions in buildings and infrastructure development and is for all value chain members in the built environment. PAS 2080:2022 is intended to:

- align the built environment with the transition to a net-zero carbon economy by 2050;
- encourage wider uptake of carbon management across the built environment to include buildings;
- ensure close collaboration between all members of the value chain;
- reinforce the importance of the carbon reduction hierarchy for whole-life carbon reduction.

Auditel can help your business provide clarity about your journey to net zero and achieve your carbon goals, whether that is producing carbon footprint reports that comply with GHG Protocols and ISO:14064-1 or verified carbon neutrality to BSI PAS 2060.

For further information please contact Ian Hopping, Senior Energy and Carbon Consultant at ian.hopping@auditel.co.uk or 07976 244456

Ian Hopping
Senior Energy and Carbon Consultant

Interest rate increases: how does it impact you and why?

We asked Rob Starr Cert CII, Cert (MP), CEO of Seico Group for an expert viewpoint on the current interest rate increases and how they are currently impacting specific areas within the property sector.

Well this is certainly an interesting time to be working in the property market; calling it character building is perhaps not strong enough. The impact of interest rate increases and increased inflation clearly has a negative financial effect on everyone, but I think it's fair to say that for those involved in the property market as a source of income the impact is far more than just financial, it also brings an element of uncertainty to our lives.

So who did the latest interest rate increase really impact from a borrowing perspective? We always tend to concentrate on just homeowners, the standard residential market, as that of course is where the volume is. But I think that perhaps there are another three areas where the impact is now really starting to bite – these are Later Life borrowers, Property Developers and Construction Businesses.

Later life lending

Later Life lending, usually known as equity release, is for older borrowers seeking retirement and needing to repay their interest-only mortgages to keep their home or to use some of their equity to create a better retirement – all the while being able to stay in the home they love. This is a really important facility and needs to be available! But these type of loans have been hit really hard by the rate hikes and Lenders have pulled many products and increased their rates so dramatically for over 55s that the numbers are now starting to not fit.

It has made it more difficult for older borrowers to release equity from their homes and the ones who can borrow are finding that the amounts are much lower than they need. Equity release may even no longer be viable for some.

There is no real solution to this at present, as high interest rates have a dramatic effect when interest is rolled up into the capital over a number of years. So, for this to be viable at the moment it will mean borrowing less or else maybe having to move house after all.

Property development finance

I think it is no surprise that developers are struggling at the moment as rates on refurbishment and development loans have hit 6-7%. Mezzanine finance has also almost disappeared.

The other thing is that in some areas property prices have fallen, which means developers have less headroom on loans. Furthermore, site valuations are starting to come in lower, which also reduces viable loan amounts. It really feels like the Banks are concerned about a housing market slowdown. New players are definitely going to find it extremely difficult too, however I think that most experienced developers, with strong track records, have seen this all before and can secure the finance they need by taking expert advice.

Perhaps for these it means that there are better deals to be done as the competition is less and the pendulum can start at last to swing in their favour. That would be a nice change for sure.

Construction business finance

The UK economy is almost entirely reliant on property. Builders need to able able to build! And Builders need funding for materials, wages and equipment. But because of rising inflation and interest rate volatility, lenders are wary of funding construction projects. This is once again an area where the more experienced and proven Construction companies have the advantage over the newcomers, as they can demonstrate resilience in previous times and perhaps they can cash flow some of their costs more than new players can.

The alternative to construction finance is of course Bridging Loans. These always seem to be available no matter the market conditions, but they do take advantage with high rates being offered over standard lending and as such they are more expensive now than they have ever been and have much tighter terms. The same is true of Asset Finance deals for equipment, they too are still available by they also have higher rates and need larger deposits. It does seem that Lender appetite for new construction is very limited – and that means only the best projects are getting funded. In fact, most builders we speak to are having to self-fund or pause projects until the outlook improves. Survival is probably now the priority for construction firms rather than growth.

Banks' lending policies

The instability in the world market, the ongoing conflict in Russia and the crazy politics around the world have made the High Street banks more risk-averse and more selective with their lending. Affordability stress tests now factor in the increased rates, and as such maximum loan amounts are lower. Self-employed borrowers are facing greater scrutiny of their incomes and need higher deposits. The Banks are generally favouring borrowers with larger deposits and excellent credit. Overall, lending criteria is tighter across the board.

Current trends on residential and buy to lets

Fixed rate demand is very high right now as borrowers are looking for payment security. However, product choice is shrinking amid rising swap rates. The 2-year fixes remain the most competitive, and 5-year deals are disappearing as lenders are finding it hard to predict what is going to happen in the medium term. This also means that now traditional bank lenders are filling the gaps left by the risk-averse banks, but of course at higher rates. Remortgaging early is a popular approach now – planning 6 months in advance can offer peace of mind.

My conclusion

I do hate to not end on a positive note as by my nature I am a positive person, but a reality check is too important to ignore.

In summary, we had it good for a decade, but the era of cheap, easy credit is over. Borrowers across the board need to adjust expectations as lenders are being more selective and rates stay at their current level for the foreseeable future.

Understanding the new lending realities and seeking expert advice is more essential than it has ever been. Yes there are deals to be done available, there always are, and those with experience and proven track records will be the winners, they always are. Perhaps this is the way it should be in business?

Property remains the main staple of the UK economy and probably always will be. So if property is your business and you are good at it, then find a way and crack on.

Rob Starr
CEO, Seico Group

For expert advice on residential or commercial finance, you can contact our Finance Partner, SEICO Group on 01273 778888 or email:

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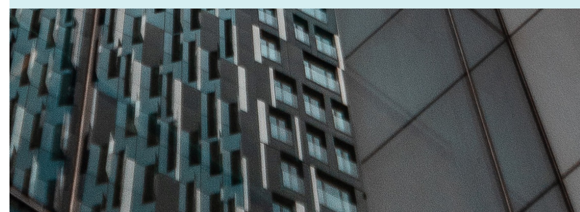

Incorporation of a property business

Incorporation is the transfer of a business owned and run by an individual or a partnership to a company.

Considerations

There are many reasons to consider incorporating a property business but there are tax and commercial implications arising from incorporation. This route is not suitable for all property businesses and individual circumstances should be taken into account.

The incorporation itself may give rise to taxes including Capital Gains Tax and Stamp Duty Land Tax. Each is considered briefly below.

Benefits:

- Companies pay tax at rates between 19% and 25% on their profits vs individuals paying at 20%/40%/45%.
- No restrictions on deduction of finance costs.
- Possible lower rate for Corporation Tax on capital gains – 19% to 25% vs 20% to 28%.
- Flexibility over changes in ownership – shares in a company can easily be transferred to family members.
- Potential additional one-off tax savings on the incorporation.

Tax on incorporation

In principle the incorporation of a property portfolio can give rise to both Capital Gains Tax (CGT) and Stamp Duty Land Tax (SDLT) liabilities.

In some circumstances however and when certain conditions are satisfied, neither CGT nor SDLT are payable.

Other important considerations

In the case of mortgaged property portfolios, it is important to discuss plans with lenders early on.

In our view a sound and sensible form of incorporation is one that includes express consent of lenders and can in some cases involve a change in lender to facilitate the transaction.

Note that the terms of any existing mortgages must be understood in order to avoid inadvertently triggering early repayment charges, which can be cost prohibitive.

How we can help

- Advising on whether incorporation of a property portfolio is appropriate to your circumstances.
- The structure of the transaction and availability of reliefs to mitigate taxes that might otherwise arise
- Other tax planning opportunities that arise as a result of an incorporation such as pension planning and inheritance tax planning.
- Calculating the tax benefits of incorporation.
- Liaising with lawyers and lenders in respect of the practicalities of implementing a new structure.

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House price growth

The Office for National Statistics has recently released the House Price data for August 2023, with average UK house prices increasing slighty in the last 12 months.

Monthly house prices changes across the UK: August 2023

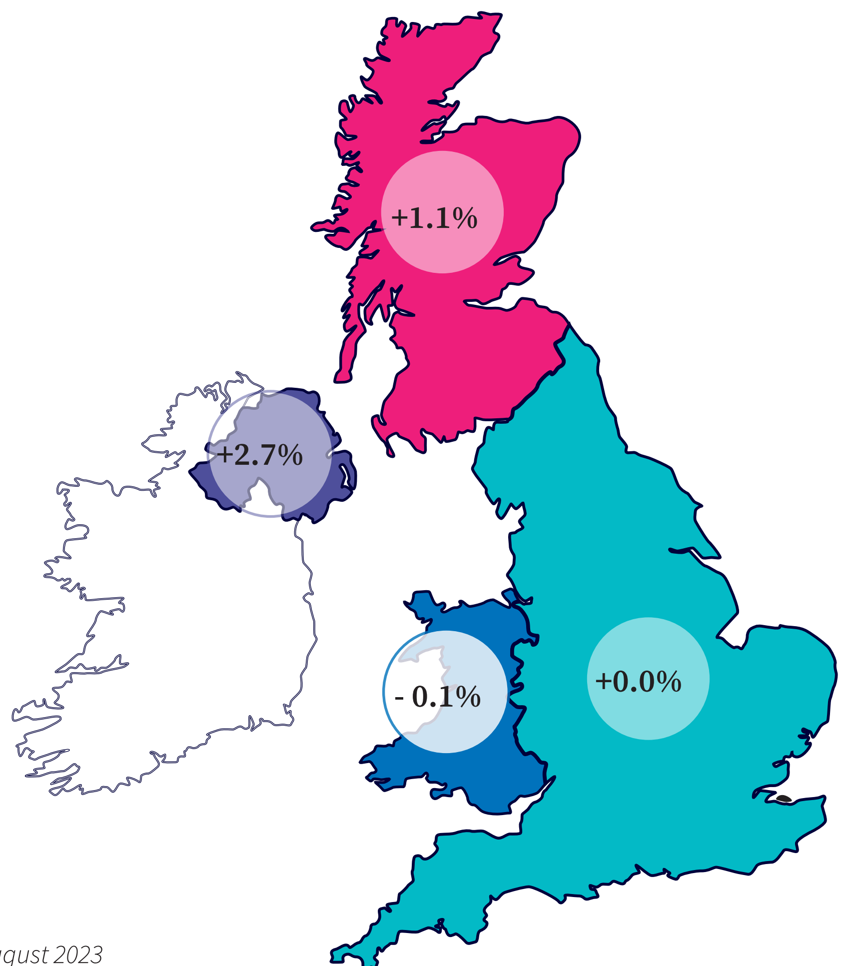
UK average house prices increased by 0.2% over the year to August 2023 but down 0.7% from July 2023. The average UK house price was £291,000 in August 2023, £9,000 above the recent low point in March 2023.

Average house prices remained steady across all four countries over the past 12 months:

- England increased 0.0% to £310,000
- Wales decreased -0.1% to £217,000
- Scotland increased 1.1% to £194,000
- Northern Ireland increased 2.7% to £174,000

House prices by region

The North East had the highest annual high price growth at 3.6%. The lowest annual growth was in in the East of England where average prices decreased by 1.6% over the year to August 2023. However, London average price houses remain the most expensive in the UK, with an average price of £536,000in August 2023.



Source: Office for National Statistics – Price Index: August 2023

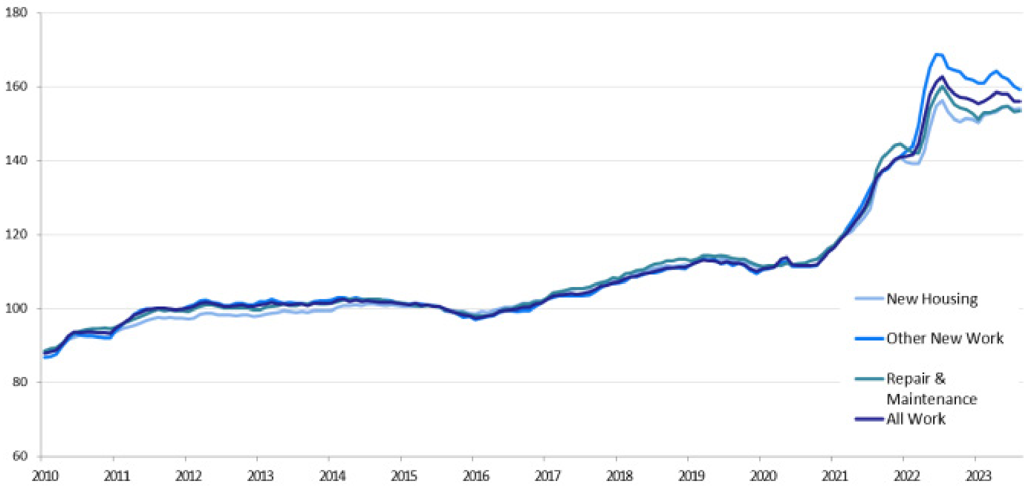
Building Materials and Construction Output

The Department for Business, Energy & Industrial Strategy recently released their monthly statistics of building materials and components for September 2023. This is coupled with the ONS data on Construction Output for August 2023.

Construction Material Price Indices August 2023

The material price index for 'All Work' **decreased by 2.3%** in August 2023 compared to August 2022.

Chart 1: Construction Material Price Indices, UK
Index, 2015 = 100



Source: Monthly Statistics of Building Materials and Components Table 1.

Year-on-year and month-on-month changes to construction material prices

	Year-on-year change (August 2022 to August 2023)	Month-on-month change (July 2023 to August 2023)
New Housing	0.5%	0.1%
Other New Work	-3.7%	-0.6%
Repair & Maintenance	-2.8%	0.2%
All work	-2.3%	0.0%

Source: Monthly Statistics of Building Materials and Components Table 1.

Construction Output: August 2023

Monthly construction output **is estimated to have decreased by 0.5%** in August 2023 with the monthly value in level terms at £15,584 million. The decrease in monthly output came solely from a 1.5% decrease in new work, partially offset by a 1% increase in repair and maintenance. At a sector level, the main contributors to the monthly decrease was from private commercial and private new housing, which decreased 4.1% and 1.4% respectively.

However on a quarterly basis, construction output saw an increase of 0.9% in the three months to August 2023, mainly contributed by increases to new work and repair and maintenance which both saw increases of 0.9%.

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CARPENTER BOX *BUILDING A BRIGHTER FUTURE*

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