January 2023

UK property market: Outlook 2022-2026.

The Bank of England cautions that an unusually long recession may already be underway. In this environment, we believe the UK property market will generate weak performance for 2023 before rebounding in 2024 and beyond.

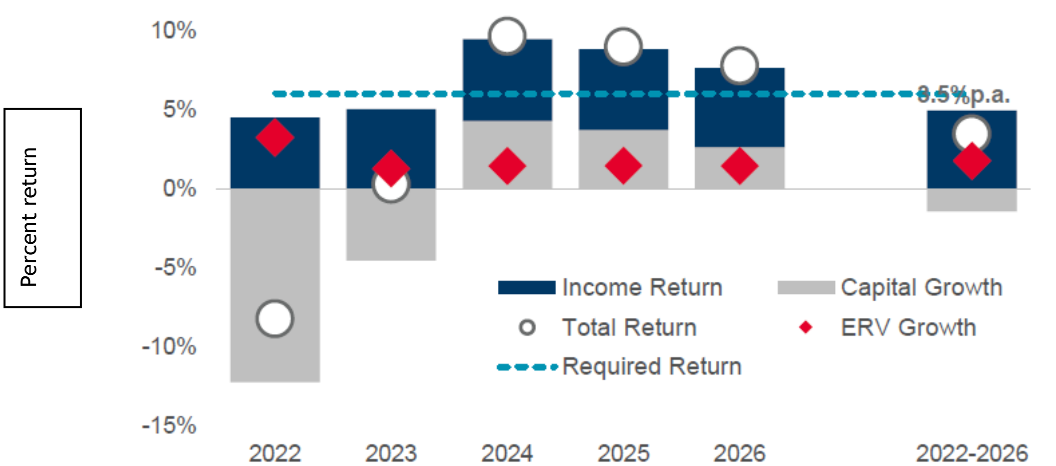
Rising rates, high inflation, weak currency=weak property market

The UK economy has been posting troubling economic warning signs. Historically high inflation, a weakening pound relative to the dollar, and strong wage growth led the Bank of England's Monetary Policy Committee (MPC) to raise rates interest rates by 50 basis points in September and then another 75 a little over a month later (its largest rate hike in over 30 years as shown by [www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp)](www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp). While these moves may be have been necessary to combat inflation, they put increased pressure on an already struggling economy. As the country's broader economy faces the prospect of a prolonged recession lasting through 2023, we believe that the UK property market will fare similarly. We expect the UK property market to deliver weak returns through the end of 2023. As economic conditions improve in 2024 and beyond the property market should rebound for the remainder of the forecast period (2024-2026).

"Very challenging" economic conditions hit real estate prices

In early November, the Bank of England warned that the UK was on the brink of a recession that could potentially extend into 2024. Facing an economic downturn that could be the nation's longest on record, the central bank described the outlook as "very challenging". Meanwhile, increasing fuel and food prices pushed the annual rate of Consumer Price Index inflation to multiple 40-year highs on multiple occasions in 2022 as per the Office for National Statistics. It is within the context of these extreme and adverse market conditions that we believe that the UK property market is experiencing a broad repricing and we believe the aforementioned recession and inflation will likely cause weak performance through 2023. Estimated rental value growth (ERV) is projected to remain low through 2026.

All property direct market return forecasts (2022-2026)



Source: DTZ Investors (October 2022)

Data refers to predicted future performance. Predicted future performance is no guarantee of future results. Investment may lead to a financial loss if no guarantee on the capital is in place.

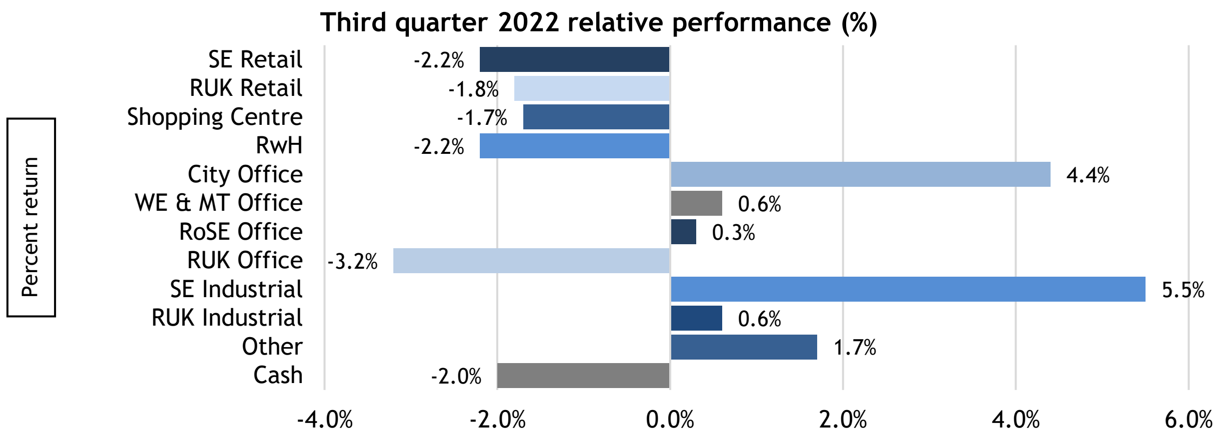
The challenges to the property market

The UK economy contracted in the third quarter of 2022 based on estimates from the Bank of England. While policymakers raised rates to combat persistent inflation, this had an adverse impact on the real estate investment market. Higher rates can translate into higher costs for borrowers, pushing purchases further out of reach for potential home buyers. In relative terms, an increase in bond yields can also make real estate investments less attractive; why lock up one's capital in an illiquid property when a more liquid vehicle offers a competitive return? Furthermore, the persistent rises in inflation serve to push up operational costs, potentially reducing the profit margins for real estate investments. Finally, a combination of higher cost of living and low consumer confidence has the potential to drag consumer-led property segments lower.

Bright spots

While we expect poor performance for the broad UK property market in the short term, not all segments of the market are created equal. Retail, for example, was down in the third quarter, as the first three bars in Exhibit 1 show. Retail warehouse was as well, as highlighted by the fourth bar. Office space was mixed. Industrial properties were positive to varying degrees. On the bright side, we believe that alternative real estate segments (ex. student housing) have the potential to behave differently than the rest of the market, with positive near-term prospects for rent growth and returns. Conversely, we expect to see a sharp near-term reversal in the industrial sector, which had outperformed in the second quarter. We don't expect this trend to be long lived however, believing that positive supply/demand metrics and limited development activity in this segment should lead to a quicker recovery than in others in 2023.

Exhibit 1: Not all market segments move in lockstep



Source: MSCI/underlying fund managers (unlisted data)/Panmure Gordon (listed data); DTZ investors (Portfolio calculations). "Cash" relates to the cash held within the underlying funds. Past performance does not predict future returns.

Our Fund

The SEI UK Property Fund remains overweight to South East Industrial. The supply/demand dynamics in this market remain favorable, and looking beyond the near-term capital market re-pricing, the prospects for rental growth look positive.

We anticipate a reduction in the long position in City offices, as the sector has a negative outlook given the long- term headwinds.

The portfolio's overweight exposure to alternative real estate segments, categorized by MSCI as "Other", is considered favorable in the current market context because these segments have strong fundamentals that are less tied to UK gross domestic product and are likely to prove more resilient in the near-term. Values are expected to hold up relatively well in the residential, student housing and healthcare segments where the portfolio is overweight. The overweight to real estate debt should also be helpful.

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