RESEARCH & FORECASTING UK

REAL ESTATE INVESTMENT FORECASTS Q2

Contents

"Rental growth across All Property has been stagnant since July 2010, with growth in H2 11 reversed in H1 12."

RESEARCH & FORECASTING

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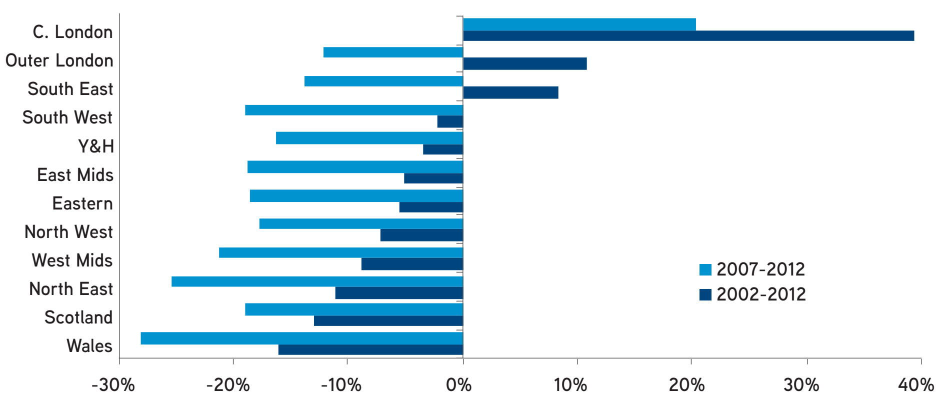
Executive Summary

- The UK economic outlook for the remainder of 2012 is mixed; External pressures continue to cast a "black cloud" on the economy, although the Olympics have the potential to provide a short-term uplift in sentiment for Q3 12.
- With low bond yields, secure income from property continues to look attractive (IPD All Property initial yields are at 6.3%). Rental growth across All Property has been stagnant since July 2010, with growth in H2 11 reversed in H1 12.
- As European banks deleverage, non-bank lenders are entering the market and/or expanding their loan books, providing alternative financing to real estate investors.
- There was £7.1bn in transactions completed in Q2 12, compared to a four quarters' average of £7.3bn. Overseas investors remain the largest investors in the UK, taking about 66% of the market share.
- In Q2 12, office investment transactions reached nearly £4.6bn, up 16% over Q2 11, of which £2.4bn was in the City. West End office investments were down from Q1 12, falling from £1.1bn to £736m.
- Office market total return has been lowered to 4.2% from 6% due to our expectation that regional yields will continue to move out, offsetting the strength of the Central London. Our forecast for 2012 has been revised down to 4.2% for the sector.
- Retail markets continue to struggle; about 37% of the total shops in administration closed in Q2 12, marginally better than the 41% recorded in Q1 12.
- Investment in the retail sector has slowed significantly with only £1.4bn transacted in Q2, down 48% from Q2 11. Our total returns forecast have been decreased to 0% for 2012.
- In the industrial sector, vacancy rates for big sheds continue to fall; availability has fallen by 28m sq ft in the past two years across the UK, highlighted by a 60% drop in availability in London.

FIGURE 1: IN-TOWN PRIME RENTS TOTAL %CHANGE



Source: Colliers International

"Despite some pull back, gilts fell to a new low of 1.48% on July 20th as regional governments in Spain move closer to requiring a bailout."

"After a stagnant first half, forecasters are unconvinced that the economy will grow at 0.8% this year suggested by the OBR in March."

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All Property Forecasts

GDP GROWTH CONSENSUS LOWERED IN JULY

The UK economy entered a mild double-dip recession in Q1 12, but this has been extended into Q2 12 with a higher than expected contraction of 0.7% q/q. With uncertainty surrounding the second Greek election, investors fled risky sovereigns in favour of "safe havens". Despite some pull back, gilts fell to a new low of 1.48% on July 20th as regional governments in Spain move closer to requiring a bailout.

The outlook for the UK economy for the remainder of 2012 is mixed. The external pressures from foreign shores continue to be a "black cloud" on the economy, while the Olympics have the potential to provide a short-term uplift in sentiment for Q3 12. After a stagnant first half, forecasters are unconvinced that the economy will grow at 0.8% this year suggested by the OBR in March. The HM Treasury's average of independent forecasters have lowered 2012 growth expectations to 0.1% in July, significantly lower than the 2.1% pencilled in back in June 2011.

ALL PROPERTY YIELD SPREAD OVER GILTS WIDENED IN Q2

The demand for the safety of UK gilts hit a fever pitch in Q2 12, as 10-year gilts fell to 1.5% in mid-July from 2.2% at the beginning of Q2 12. This may be beneficial to the UK government, but is detrimental to institutions requiring stable income producing assets. In comparison, the IPD All Property initial yield was 6.3% in June, with a yield spread over gilts widening by 50 bps in Q2 12 to 450 bps. Additionally, with deleveraging of the banks and exceptionally low yielding gilts, lending margins are attracting non-bank lenders to the market. Institutions are expanding their loan books, providing debt capital to investors in conjunction with direct investing in property.

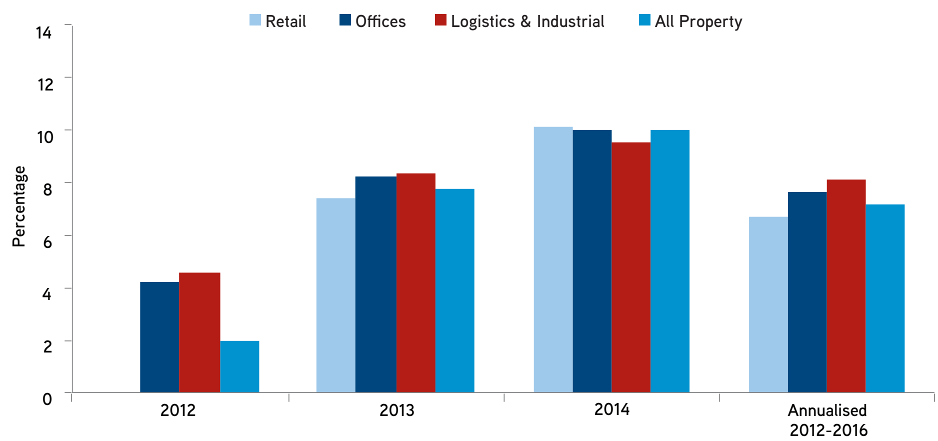
With the current outlook for the UK economy subdued, Colliers International's All Property 2012 total return forecast has been revised downwards from 2.9% in Q1 12 to 2.0% in Q2 12. Rental growth across All Property has essentially been stagnant since July 2010, with growth in H2 11 reversed in H1 12. We expect this downward trend to continue as retail administrations continue to put pressure on rents. By the end of 2012, our forecast for rental growth is a contraction of -0.9%, revised marginally from -0.7% in Q1 12.

ALL PROPERTY FORECAST SUMMARY

	2012	2013	2014	2012-2016 pa
ERV Growth (% pa)	-0.9	1.2	2.0	1.1
Equivalent Yield (% end period)	7.0	6.9	6.8	6.7
Capital Growth (% pa)	-3.6	1.8	3.6	1.8
Total Return (% pa)	2.0	7.8	10.0	7.2

Source: Colliers International/IPD

FIGURE 2: FORECAST TOTAL RETURNS BY SECTOR



Source: Colliers International/IPD

Investment Activity

For a significant amount of domestic investors, investing in UK commercial property remains reliant on availability of debt financing, which has been contracting since 2009. As a result, the downward trend of debt could be coming to a trough as healthy lending margins are attracting new entrants to the market. Across Europe, the long term refinancing operations conducted by the ECB in December and February have been instrumental in lowering Libor and keeping liquidity available for banks. But as the Eurozone crisis continues to evolve, it appears as though more ECB intervention is likely needed to keep the cost of capital down.

COST OF BORROWING IS LIKELY TO INCREASE

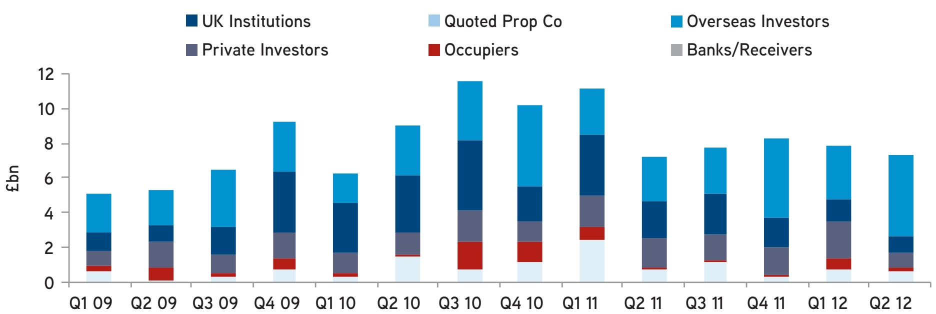
New ECB intervention is expected to come in the form of resuming large-scale purchases of sovereign debt, either directly or via the European Stability Mechanism (the permanent bailout fund). Spanish 10-year bond yields have oscillated near unsustainable levels, peaking at 7.63% on July 25th. Italy may need to bailout the Sicily regional government, thus putting more strain on the central government. The eurozone debt crisis is now much closer to the core than at the beginning of the year. Germany and The Netherlands were recently placed on negative outlook by Moody's. If they are downgraded, the cost of borrowing across Europe will likely rise, limiting the availability of bank lending further.

AMERICANS SEEK HIGHER YIELDS THAN EUROPEANS

In H1 2012, Americans have been the largest foreign investors in UK property, spending £2.3bn at an average yield of 6.6%, while Europeans have taken £1.7bn at an average yield of 5.3%. Americans have been seeking opportunities in regional offices, industrial portfolios and a few retail units, while Europeans are investing in Central London offices. By value, in H1 12, about 45% of American investment has been outside of London, while Europeans have put 9% of their investments outside of the capital.

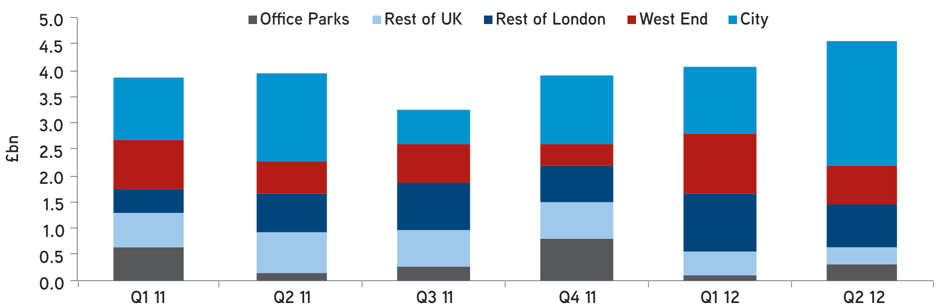
According to Property Data, there was £7.1bn in transactions completed in Q2 12, slightly below the four quarters' average of £7.3bn. For the fifth consecutive quarter, overseas investors were the largest investors in the UK, taking about 66% of the market share. Overseas investors purchased £4.6bn and disposed of £2bn this quarter; UK institutions and private propcos were net sellers £670m and £1.1bn respectively.

FIGURE 3: QUARTERLY PURCHASES BY INVESTOR TYPE



Source: Colliers International/Property Data Ltd

FIGURE 4: QUARTERLY OFFICE INVESTMENT BY SUBSECTOR



Source: Colliers International/Property Data Ltd

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Retail

MARGINS UNDER PRESSURE AS RETAIL SALES FALL Q/Q

With the third consecutive quarter of contraction in GDP, consumer confidence remains subdued (GfK at -29 in June). Real disposable income dropped 0.9% q/q in Q1 12 and the saving ratio (6.4%) remains above the average for the past decade (4.3%). The troubles facing the retail sector continued in Q2 12; retail sales by volume and by value contracted 0.2% and 1% q/q respectively, indicating that margins remain under pressure. The tough trading environment saw the list of multi-store retailers falling into administration grow in Q2 12. About 37% of the total shops of failing companies closed in Q2 12, a marginally better result than the 41% recorded in Q1 12.

RETAIL INVESTMENT DOWN SIGNIFICANTLY

Investment in the retail sector has slowed significantly, with only £1.4bn transacted in Q2 12, down 48% from Q2 11. The largest asset to trade hands was 133 Oxford Street bought by Zara founder Amancio Ortega for £155m at 4% IY from Deka. Outside of London, Capital & Regional and Oaktree teamed up to purchase the Kingfisher Centre in Redditch for £130m at 8% IY, with an LTV of 60%. After several months of negotiation, Norway's sovereign wealth fund is under offer for 75% ownership of Meadowhall Centre in Sheffield, valuing the shopping centre at £1.2bn at 5% IY, and will likely complete in Q3 12. Movement of non-prime shopping centres remains very limited.

GREAT BRITAIN PRIME RENTS FALL FOR FOURTH CONSECUTIVE YEAR

In-town prime rents in Central London grew by 9.4% for the 12 months to June 2012, while elsewhere they have been contracting. Great Britain prime rents fell 1.2% the 12 months to June 2012, the fourth consecutive year of contraction. Foreign retailers are setting up shop predominantly in Central London, while domestic retailers are targeting regional prime locations and online channels. This combination is proving difficult for secondary and tertiary properties across smaller UK centres.

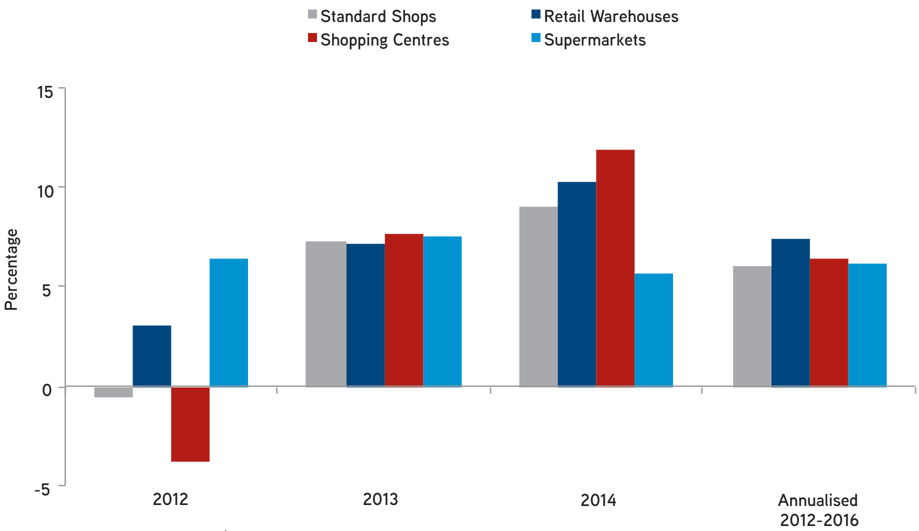
Colliers' outlook for total return in the retail sector in 2012 has been downgraded to 0.0% in Q2 12 from an already low expectation of 0.2% in Q1 12. Capital values are being impacted by yields moving out across most of the sector. Standard shop yields are expected to move out 30 bp in 2012, while secondary shopping centre yields continue to rise due to lack of investor appetite. Supermarkets continue to hold their value as yields remain at about 5% this year.

RETAIL FORECAST SUMMARY

	2012	2013	2014	2012-2016 pa
ERV Growth (% pa)	-1.6	1.1	1.9	1.1
Equivalent Yield (% end period)	6.7	6.6	6.4	6.3
Capital Growth (% pa)	-5.6	1.3	3.9	0.7
Total Return (% pa)	0.0	7.4	10.2	6.7

Source: Colliers International/IPD

FIGURE 5: FORECAST TOTAL RETURNS BY SUBSECTOR



Source: Colliers International/IPD

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"The shortage of quality space in the West End is seeing yields harden further as investors compete for stock."

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Offices

BROOKFIELD EXPANDS CITY HOLDINGS WITH HAMMERSON PORTFOLIO DEAL

In Q2 12, office investment transactions reached nearly £4.6bn, up 16% over Q2 11, of which £2.4bn was in the City. Brookfield completed the purchase of Hammerson's London office portfolio (£518m), while a Brazilian billionaire bought Plantation Place for £470m. There were some noteworthy deals that fell apart this quarter, such as Woolgate Exchange (£270m to a Malaysian fund), Triton Court (£43m to Jack Petchey) and Drapers Garden (£285m to Boston Properties). Nevertheless, two of the three properties were sold to other investors shortly thereafter.

West End office investments are down from Q1 12, falling from £1.1bn to £736m. The shortage of quality space in the West End is seeing yields harden further as investors compete for stock. LIM has beaten out several suitors for 23 Savile Row, offering to pay £210m at 3.7% IY, above the £200m asking price in March. WELPUT received £166m for Stratton House from Sirosa Liberty, representing a 4.2% IY. WELPUT then bought 3 St. James's Square for £66.4m to convert into luxury residential properties after leases expire in 2014.

INSURANCE FIRMS TAKE SPACE IN THE WALKIE TALKIE

Insurance firms are stepping up their search in the City this quarter. With completion expected at the beginning of 2014, the Walkie Talkie has prelet to insurer Markel International (51,000 sq ft at £65 psf) and Kiln Group is under offer (60,000 sq ft at about £60 psf). JLT Group is taking 281,000 sq ft at St Botolph's Building, which will now be fully let, paying around £45 psf on a 15-year lease. Furthermore, Prudential (60,000 sq ft), Amlin (100,000 sq ft), Ascot (30,000 sq ft) and Royal & Sun Alliance (130,000 sq ft) are looking for new space.

REGIONAL TAKE UP STILL BELOW AVERAGE

Weak UK economic sentiment continues to hamper regional office investment deals, with only £324m completing in Q2 12 compared to £531m average over the past four quarters. The largest regional transaction was Granta Park in Cambridge, with BioMed Realty Trust paying £127m at 7.9% IY. Likewise, regional take up will fall below average for 2012. Nevertheless, leading foreign companies have taken space this quarter: BlackRock's 87,000 sq ft in Edinburgh, GDF Suez's 40,000 sq ft in Aberdeen, and Huawei is expected to take 165,000 sq ft at Green Park in Reading. Additionally, Sony is looking for 80,000 sq ft in the North West, BUPA for 160,000 sq ft and Jacobs Engineering for 100,000 sq ft in Manchester, while Standard Chartered is considering taking space in Liverpool.

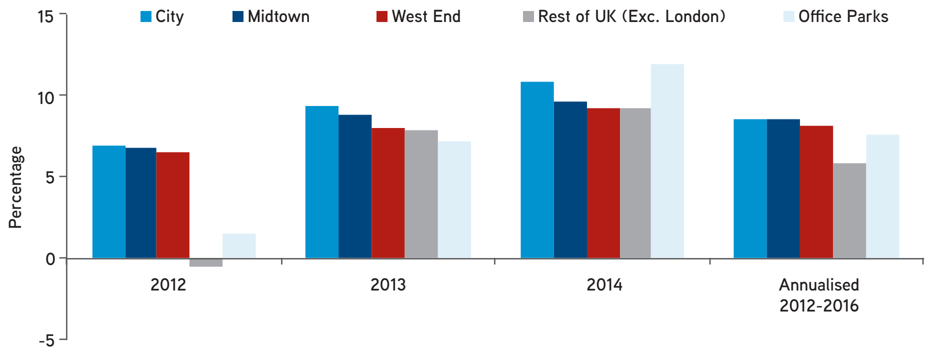
Offices total return has been lowered to 4.2% from 6% due to our expectation that regional yields will continue to move out, outweighing the strength of the Central London market. Rental growth for this year has been downgraded across the office sector from 0.5% to 0.2%, yet we still believe Central London is likely to see rents grow by 2-3% this year.

OFFICES FORECAST SUMMARY

	2012	2013	2014	2012-2016 pa
ERV Growth (% pa)	0.2	1.8	2.4	1.8
Equivalent Yield (% end period)	7.0	6.9	6.8	6.7
Capital Growth (% pa)	-0.9	2.8	3.8	2.0
Total Return (% pa)	4.2	8.3	10.0	7.7

Source: Colliers International/IPD

FIGURE 6: FORECAST TOTAL RETURNS BY SUBSECTOR



Source: Colliers International/IPD

Logistics & Industrial

Logistics & industrial investment transactions for Q2 12 totalled £779m, at a weighted average yield of 7.8%, much higher than the £490m recorded in Q2 11. The biggest deal of Q2 12 was Harbert Management's purchase of a four estate multi-let portfolio for £204.5m at 6.7% IY from SEGRO, followed by Berkeley Group purchasing News Corp's old printing works in Wapping for £150m. Blackstone continued its acquisition programme by investing in three separate distribution warehouses totalling £89m at a weighted average yield of 8.6%. Although funding remains difficult, firms that are looking to expand are contemplating large new builds with specific use, especially export-oriented manufacturers.

FORMER PRINTWORKS SET FOR REDEVELOPMENT

This quarter saw three former newspapers' printing works in London bought for redevelopment, with News Corp's Wapping location going for the highest valuation. The Daily Mirror's former printing works at 6 Back Hill near Farringdon is likely to be redeveloped into offices after it was purchased by Allied London and Aerium from NAMA for £26.1m. The Daily Mail's former Canada Water print works leasehold is being sought by British Land and Southwark Council, whom have labelled the location of "strategic importance", for about £12m for the remaining 73 years; Southwark is the freeholder of the site.

SUPPLY OF AVAILABLE BIG SHEDS FALLING

Vacancy rates for big sheds continue to fall as new supply is slow to come to market while demand is modest. Big sheds availability has fallen by 28m sq ft in the past two years across the UK, highlighted by a 60% drop in availability in London. A new record rent for a shed surrounding Heathrow was set in July as Emirates' cargo division, Dnata, has taken a 141,500 sq ft prelet at about £16 psf for 10-years at SWIP's Airport Industrial Property Unit Trust.

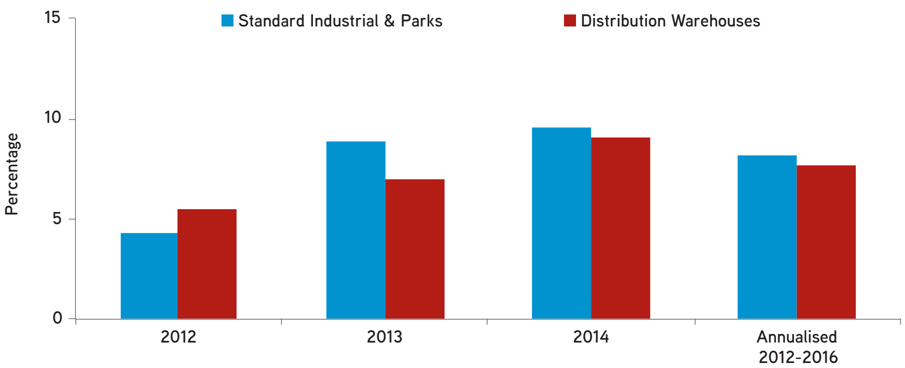
The industrial rental growth forecast has remained the same as Q1 12, at -1.0% for 2012, but should turn positive in 2013 and have growth of 1.0% pa over the five year forecast horizon. The logistics & industrial sector will not escape the effects of a slowing economy. Our total return forecast has been downgraded to 4.6% from 6.5% in Q1 12. Good income producing properties remain in demand, especially diversified multi-lets with good covenants. Next year, total return is forecasted to be 8.4%, down slightly from 8.7% in our previous forecast.

LOGISTICS & INDUSTRIAL FORECAST SUMMARY

	2012	2013	2014	2012-2016 pa
ERV Growth (% pa)	-1.0	0.8	1.5	1.0
Equivalent Yield (% end period)	8.4	8.3	8.2	8.0
Capital Growth (% pa)	-2.2	1.4	1.9	0.9
Total Return (% pa)	4.6	8.4	9.5	8.1

Source: Colliers International/IPD

FIGURE 7: FORECAST TOTAL RETURNS FOR INDUSTRIAL SUBSECTORS



Source: Colliers International/IPD

520+ offices in 62 countries on 6 continents

United States: 147
Canada: 37
Latin America: 19
Asia Pacific: 201
EMEA: 118

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