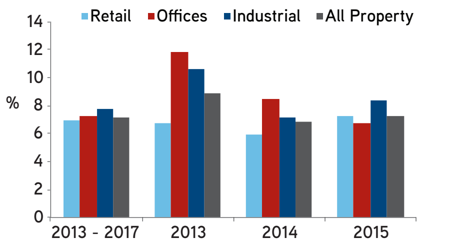
RESEARCH & FORECASTING UK

REIF IN BRIEF Q2 2013

REAL ESTATE INVESTMENT FORECASTS

FIGURE 1: FORECAST TOTAL RETURN BY SECTOR



Source: Colliers International, IPD

FIGURE 2: TOTAL RETURN 2013-2017 % PA

Source: Colliers International, IPD

FIGURE 3: ERV GROWTH BY SUBSECTOR 2013-2017 % PA

Source: Colliers International, IPD

Forecast Assumption

- Positive economic news continues, the economy shows signs of a weak but sustained recovery. Weak fundamentals and on-going austerity will keep tighter monetary policy firmly off the MPC agenda. Mark Carney has initiated forward guidance to keep rates low and accommodate growth.
- Although economic fundamentals remain weak, improved sentiment will enhance risk appetite across all property asset classes. Private investors (domestic and foreign) and property companies will continue to acquire higher yielding properties at a measured pace, capitalising on the yield differential between London and the regions, prime and secondary.
- Overseas investors will continue to drive the Central London market, pushing down yields and driving overall volumes. UK institutions will remain largely “priced-out” of the capital and will continue to look to the regions, predominately the South East, for core and core+ opportunities.
- As the economic recovery gains traction, shareholder pressure may initiate a new phase of corporate investment. As a result occupier markets will strengthen, and lack of supply will create rental pressure. This will persist until lending markets improve and development increases.

FORECASTS

All Property Forecast Summary	2013	2014	2015	Annualised 2013-2017
ERV Growth (% pa)	0.5	1.0	1.8	1.7
Equivalent Yield (% eop)	6.9	6.9	6.8	6.8 (2017)
Capital Growth (% pa)	3.4	1.8	1.8	1.7
Total Return (% pa)	8.8	6.9	7.3	7.2

Retail Forecast Summary	2013	2014	2015	Annualised 2013-2017
ERV Growth (% pa)	-0.3	0.3	1.8	1.8
Equivalent Yield (% eop)	6.4	6.4	6.4	6.4 (2017)
Capital Growth (% pa)	1.4	0.9	1.9	1.7
Total Return (% pa)	6.7	5.9	7.2	7.0

Offices Forecast Summary	2013	2014	2015	Annualised 2013-2017
ERV Growth (% pa)	2.2	2.1	1.7	1.8
Equivalent Yield (% eop)	6.9	6.9	6.9	6.9 (2017)
Capital Growth (% pa)	6.7	3.9	1.7	2.1
Total Return (% pa)	11.9	8.5	6.8	7.2

Industrial Forecast Summary	2013	2014	2015	Annualised 2013-2017
ERV Growth (% pa)	0.0	1.0	1.8	1.4
Equivalent Yield (% eop)	8.2	8.3	8.2	8.3 (2017)
Capital Growth (% pa)	3.8	1.0	1.5	1.0
Total Return (% pa)	10.6	7.2	8.4	7.8

Source: Colliers International, IPD

All Property Forecasts

The 2012 IPD total return of 3.4% exceeded expectations as capital values held up better than expected. Colliers International's updated forecast for the 2013 IPD total return is 8.8%, based on steady income returns as well as 0.5% rental growth and 3.4% capital value growth. In 2012, all property yields fell to 7%; we expect yields to harden further to 6.9% by year-end as investors look increasingly at higher yielding assets in search of returns. An increased appetite for regional stock is already apparent, notably from experienced foreign purchasers, who are venturing beyond London to the regions in search of yield. Near universal yield compression is expected to drive capital growth of 3.4% in 2013, in contrast to last year's declines. Rental growth will remain elusive, up 0.5% in 2013 after a similar modest rise last year. Economic confidence returned in H1 13, if this positivity can mature into a sustained recovery then occupier markets will improve dramatically and rental growth will begin to contribute substantially. Our forecasts show modest yield compression and accelerating rental growth in 2014-16, with total returns reaching 7.5% by the end of the period.

Retail

The Centre for Retail Research claims 36 companies have failed so far in 2013 (to the end of June) affecting 2,142 stores and 20,945 employees. Concerns that 2013 will be record year for failures are beginning to subside as the rate of failures slows. However, trading conditions remain tough; retail sales volumes are rising, but this is partly due to retailers "buying" volume with lower prices, adding more pressure to already thin margins. A positive headline sales deflator is driven by food store increases, non-food stores and non-store retailers continue to discount. Employment is unlikely to rise in the near term as firms attempt to regain lost productivity, while labour market slack will restrict nominal wage growth and persistent above target inflation will continue to erode real incomes. Falls in the savings ratio, as economic confidence improves could provide a welcome boost to domestic consumption. Overall we expect retail rents to fall by a further 0.3% in 2013, dragged down by ex-London standard shops (-1.2%) and shopping centres (-0.8%). A medium-term recovery is expected once the immediate headwinds have dissipated; we expect rental growth to average 1.8% pa over the next 5 years. Yields are expected to harden 10bps in 2013 as investor demand for Central London shops and supermarkets remains strong. Retail total returns are forecast to rise from 2.4% in 2012 to 6.7% in 2013, driven by capital growth in the supermarket sector.

Offices

Banking sector demand will remain muted as job loss announcements continue and the sector itself is redefined with a steady flow of new regulations. In its absence, TMT growth has supported the Central London market and will continue to be a key source of demand going forward, although TMT companies may not be willing to pay the top rents that financial companies once paid. Prime Mayfair and St James demand is still driven by hedge funds, investment managers, but increasingly by natural resource companies who are agreeing to rents in excess of £110 psf. Central London sub-markets will also continue to see substantial rental uplifts as demand continues to widen in scope. In regional centres, rents are supported by rapidly diminishing availability of prime stock; Grade-A space in Leeds is severely limited and increasingly this is becoming indicative of other regional centres. Total returns of 11.9% makes offices our strongest performing sector in 2013, driven by capital growth of 6.7% as demand for Central London office assets remains insatiable and regional stock is increasingly targeted. Rental growth is strong, again driven by Central London, but our outlook for the regions outside of Central London has improved significantly as supply conditions tighten.

Industrial and Logistics

The manufacturing outlook improved recently as rising demand has increased output growth and pushed the PMI survey to a 25-month high of 52.5 in June. Exports are relatively flat, but weaker sterling and relative calm in the Eurozone should provide a platform for growth with positive knock-on effects for UK industrial occupier markets. Re-shoring of production is another theme that is in its infancy, but provides considerable upside potential should this trend take root. Non-store retail sales growth increased 18% y/y in May and internet-based demand will continue to drive activity throughout the forecast horizon. Limited Grade-A availability is restricting occupier options severely and lack of developer finance for speculative schemes means this shortage is unlikely to be alleviated until funding conditions improve. Despite the first hints of a resurgence of the 'design and build' market, we expect this supply-demand mismatch to bring rental falls to an end by the end of the year and for modest growth to resume thereafter, averaging 1.4% over the next five years. As in the recent past, London and the South East will continue to outperform and attract occupiers and investors alike. Weight of money will push yields down this year driving total returns of 10.6%. Total returns will average 7.8% over the next five years as yields stabilise and modest rental growth begins to contribute.

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