Welcome……..

Cambridge University Land Society

ALUMNI

Market Trends Seminar

Post-Brexit Prospects for Property

October 26th 2016

Your Panel……..

Cambridge University
Land Society

ALUMNI

- **Steve Mallen**
  – Principal, Steve Mallen Consulting (Geography)
- **Marcus Geddes**
  – Head of London Portfolio, Land Securities (Land Economy)
- **James Gulliford**
  – Joint Head of National Investments, Savills (Land Economy)
- **Andrew Hook**
  – Fund Manager, Aviva Investors Property Trust (Law, Real Estate Finance & Geography)
- **Dominic Smith**
  – Head of Real Estate Debt Analytics, CBRE (Geography)

Agenda……...

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Introduction

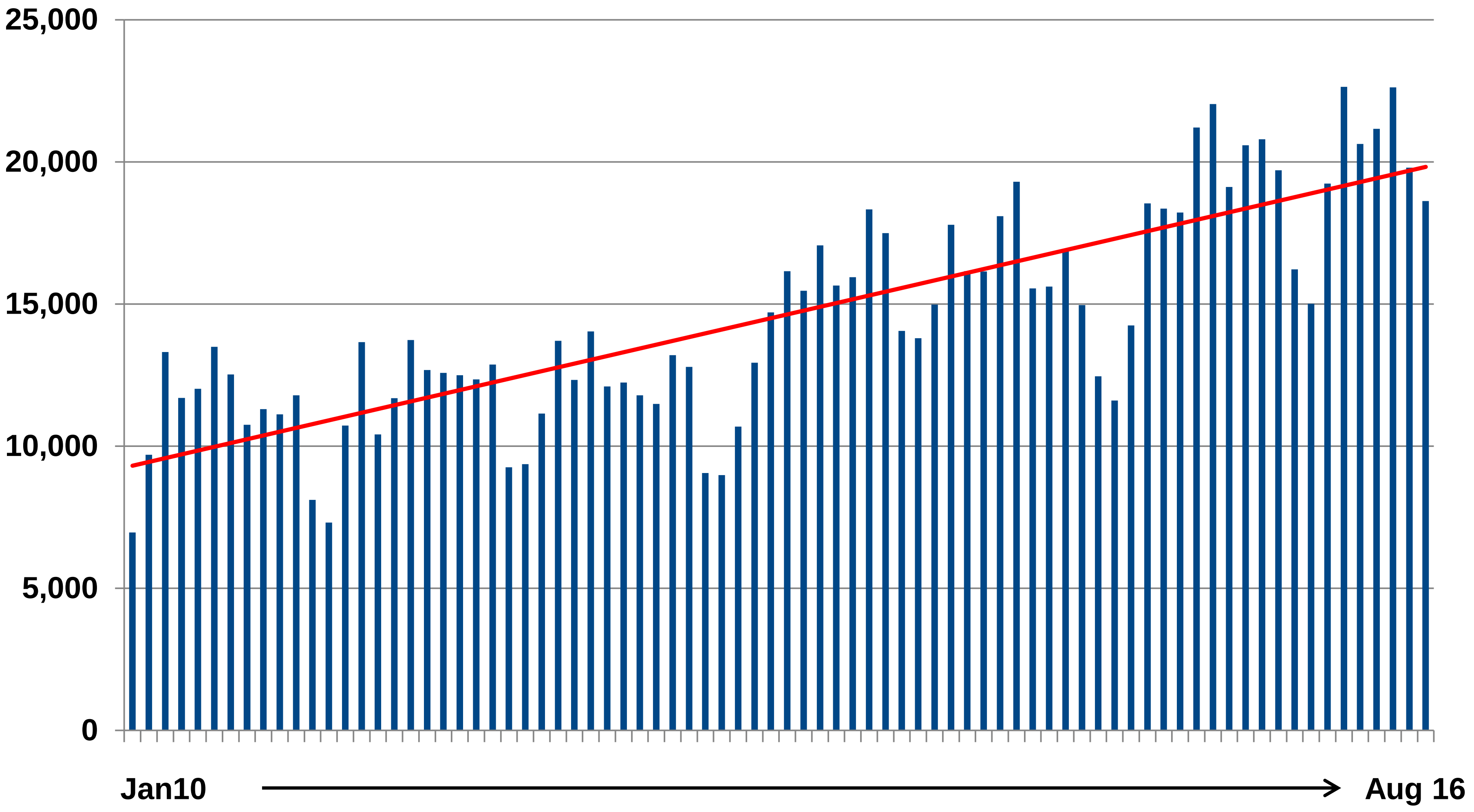
Steve Mallen

Principal, SM Consulting

Brexit – Does it matter ?

Steve Mallen

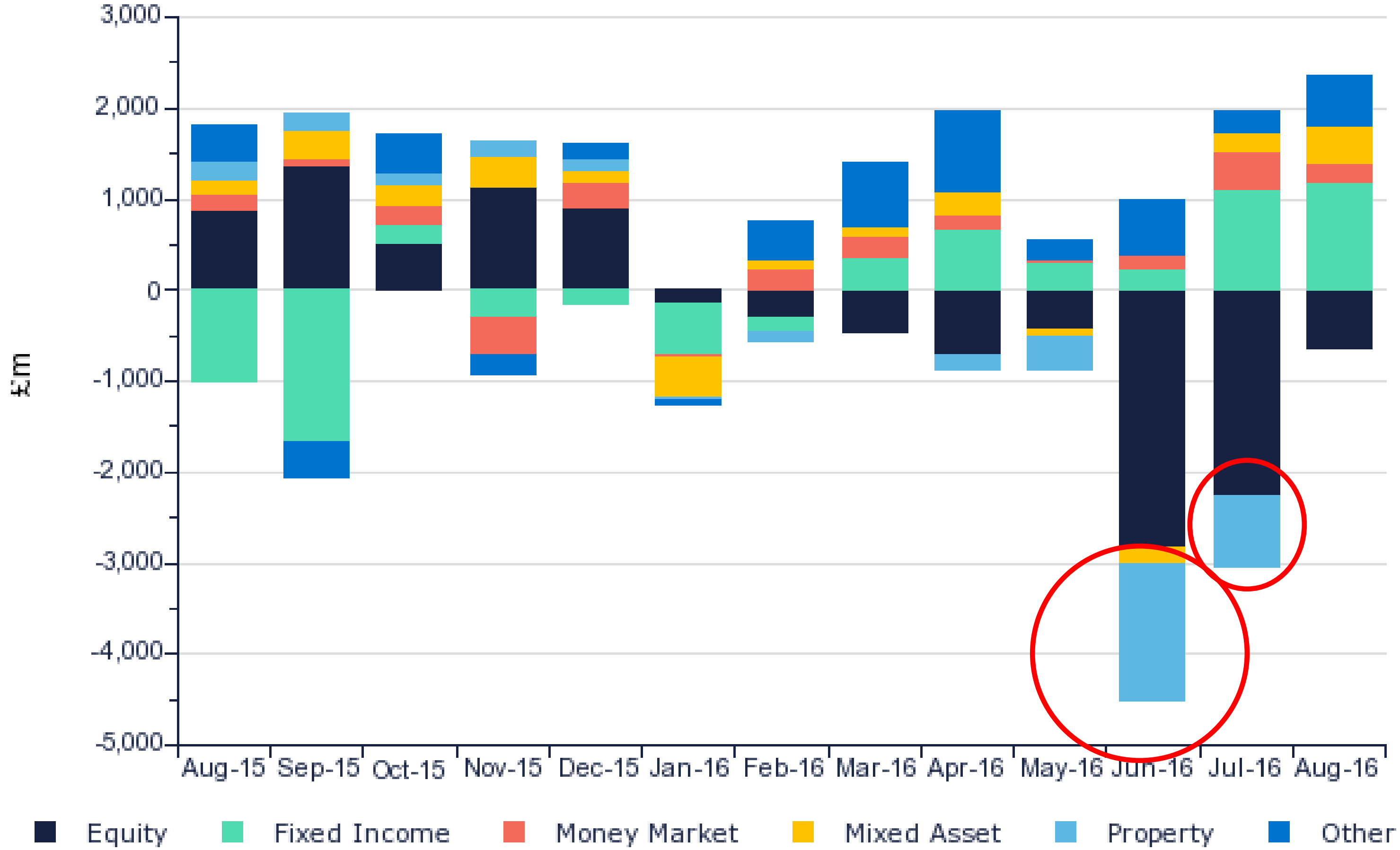
Total Value of UK Mortgage Approvals



Source: BSA

Steve Mallen

Retail sales – UK Investment Funds……..



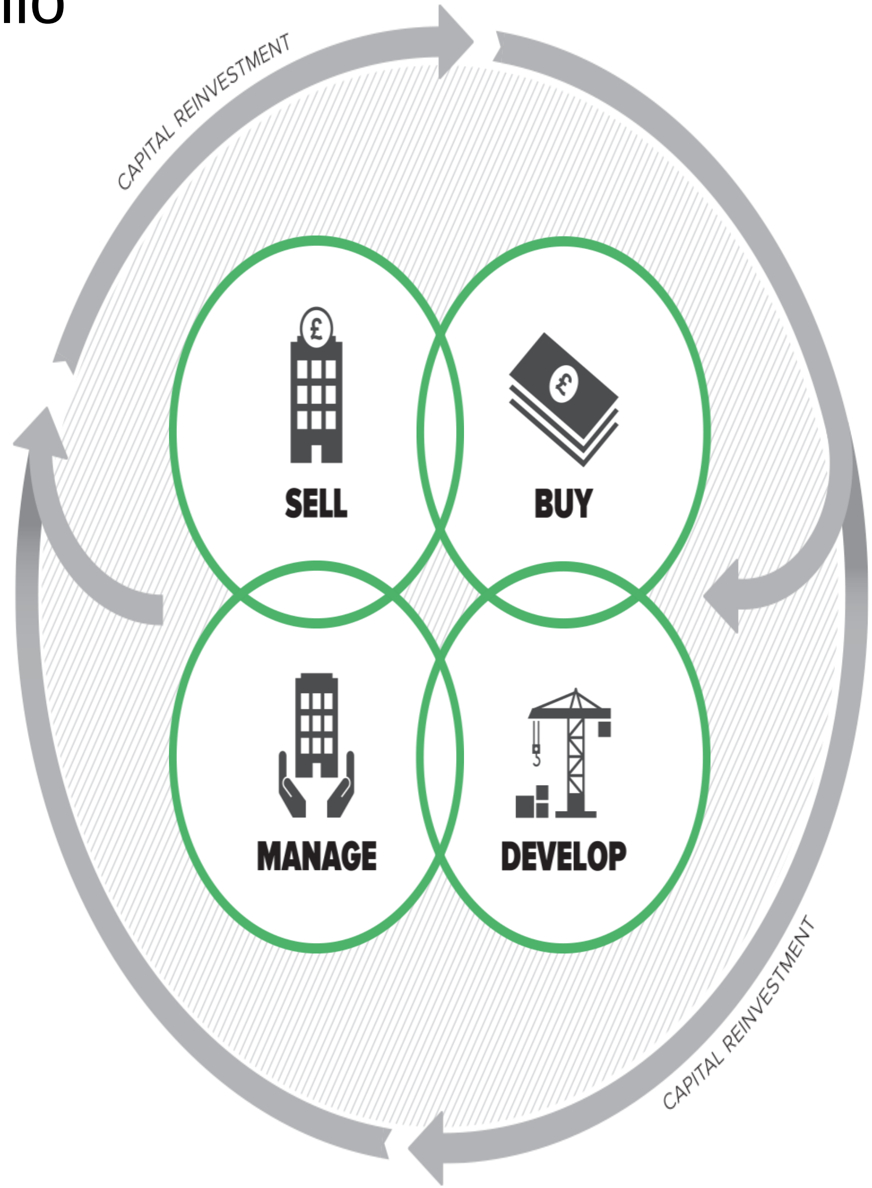
Source: Investment Association

Steve Mallen

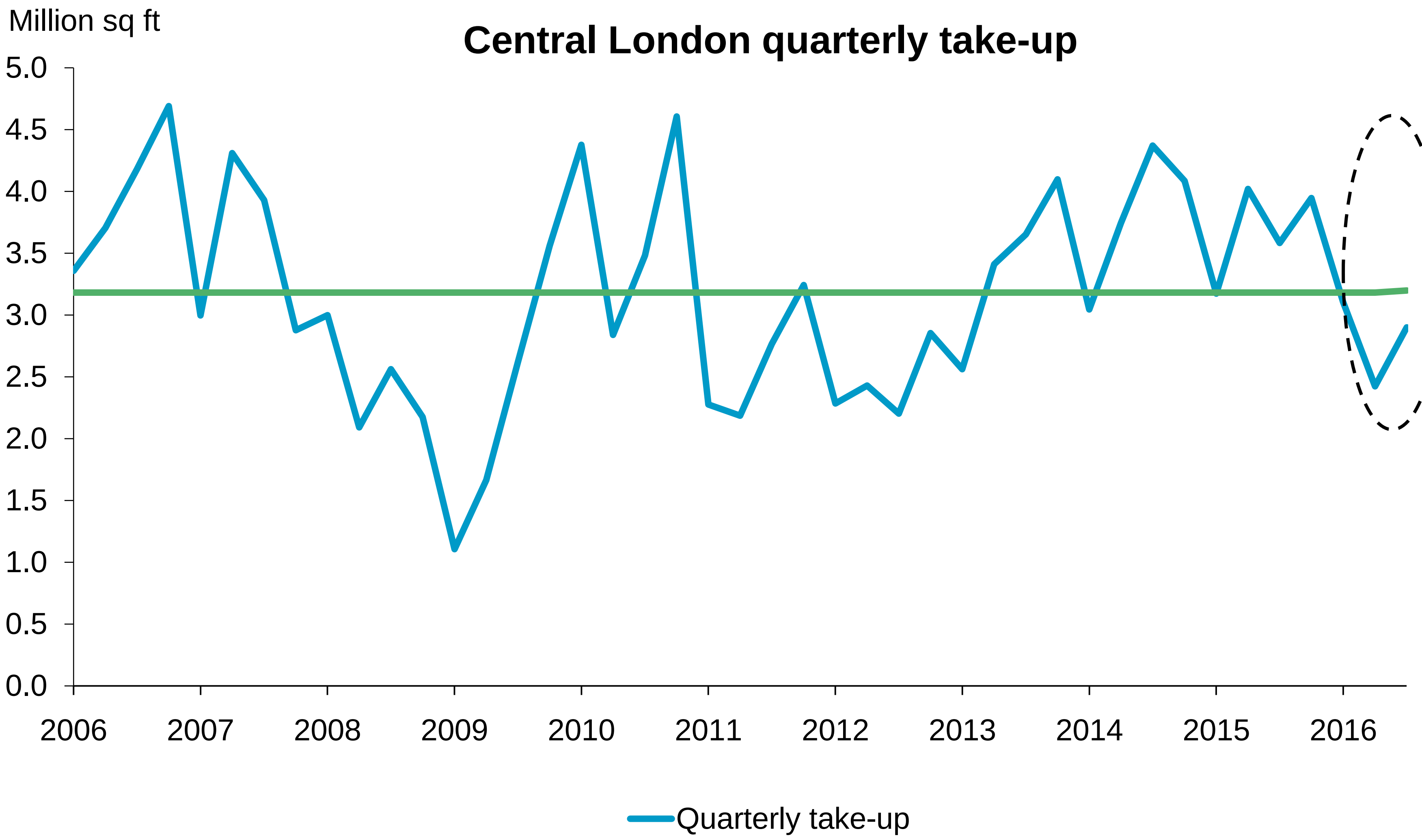
Marcus Geddes

Head of Property, London Portfolio

London Portfolio



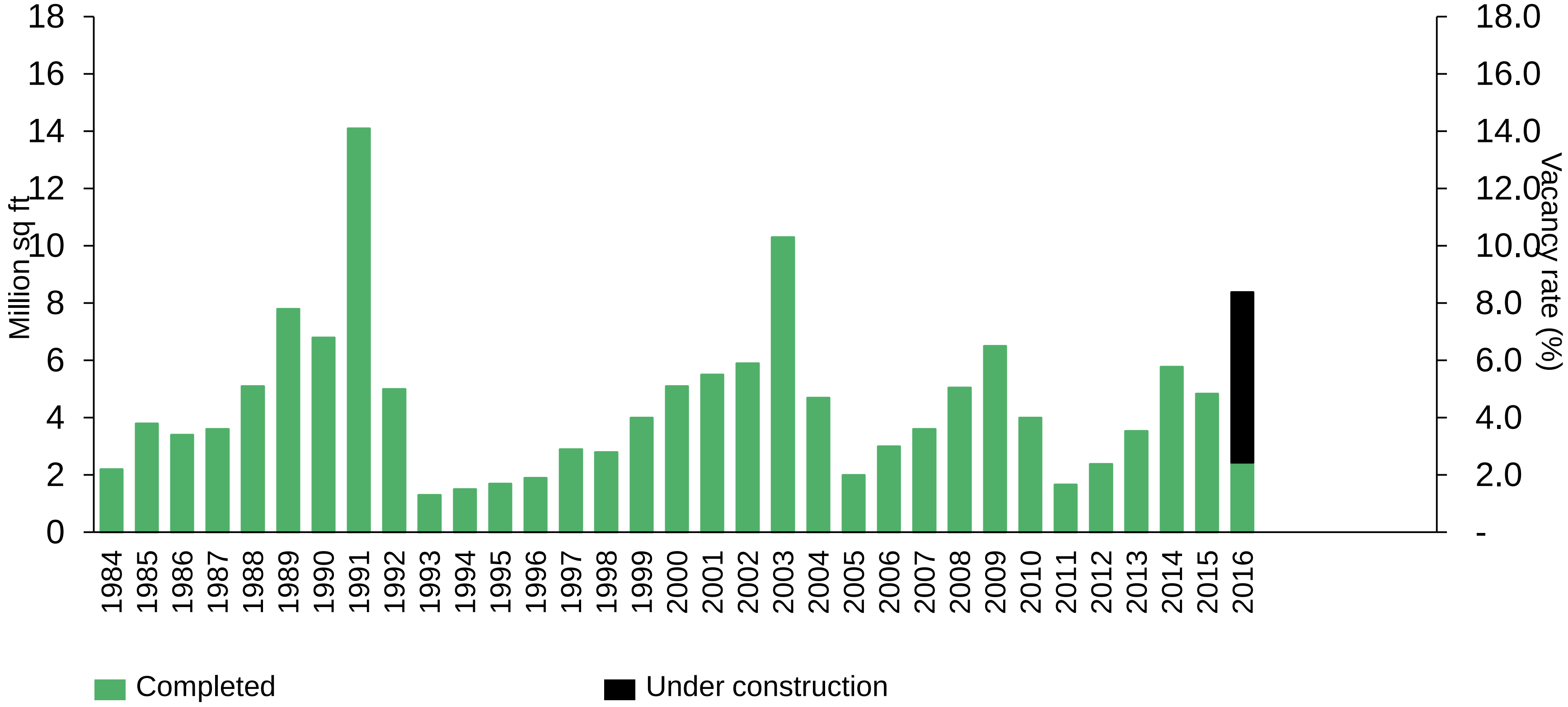
Take-up falling



Source: CBRE

Central London supply – September 2016

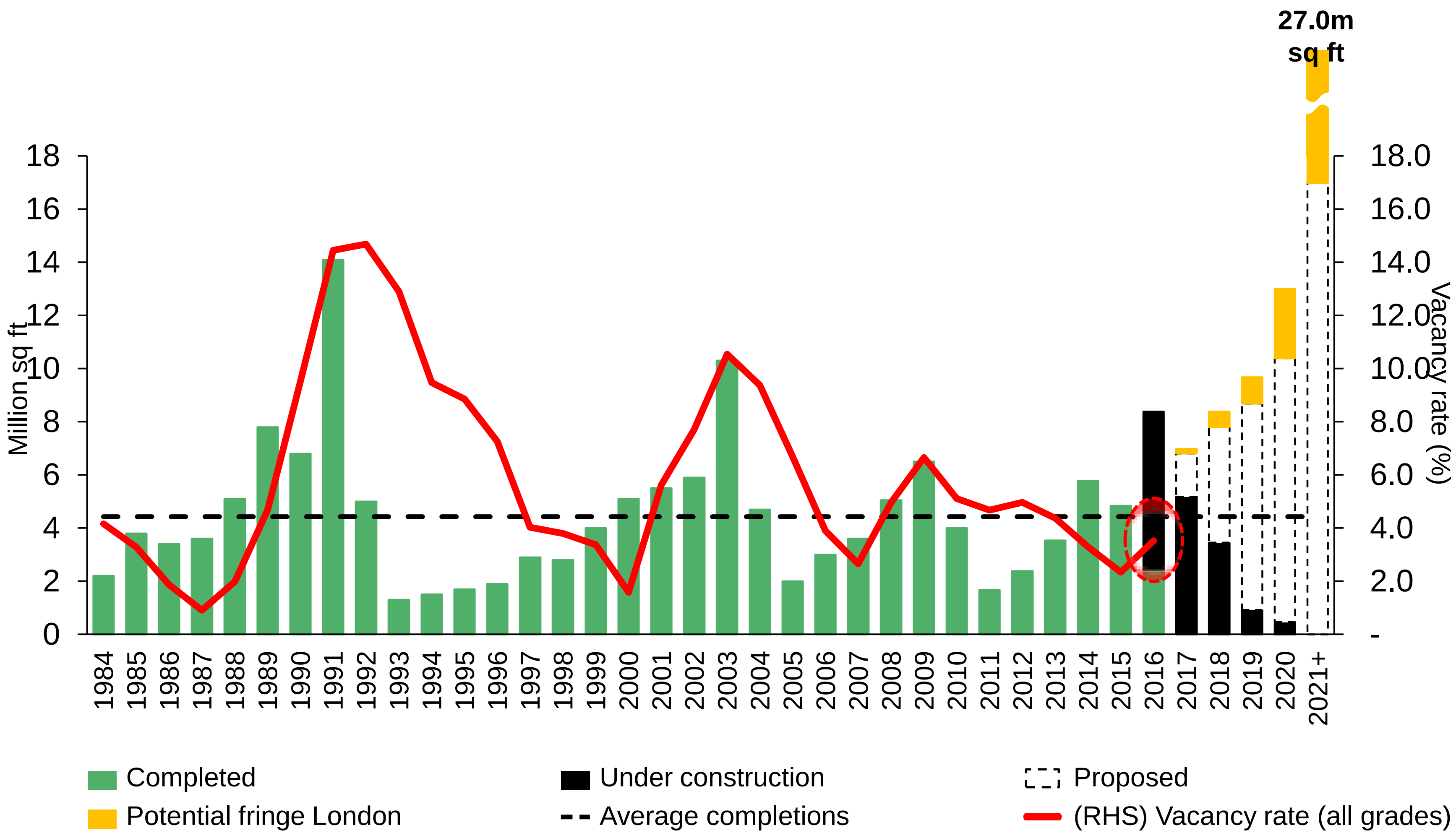
Grade A completions and vacancy



Source: CBRE, Knight Frank, Land Securities

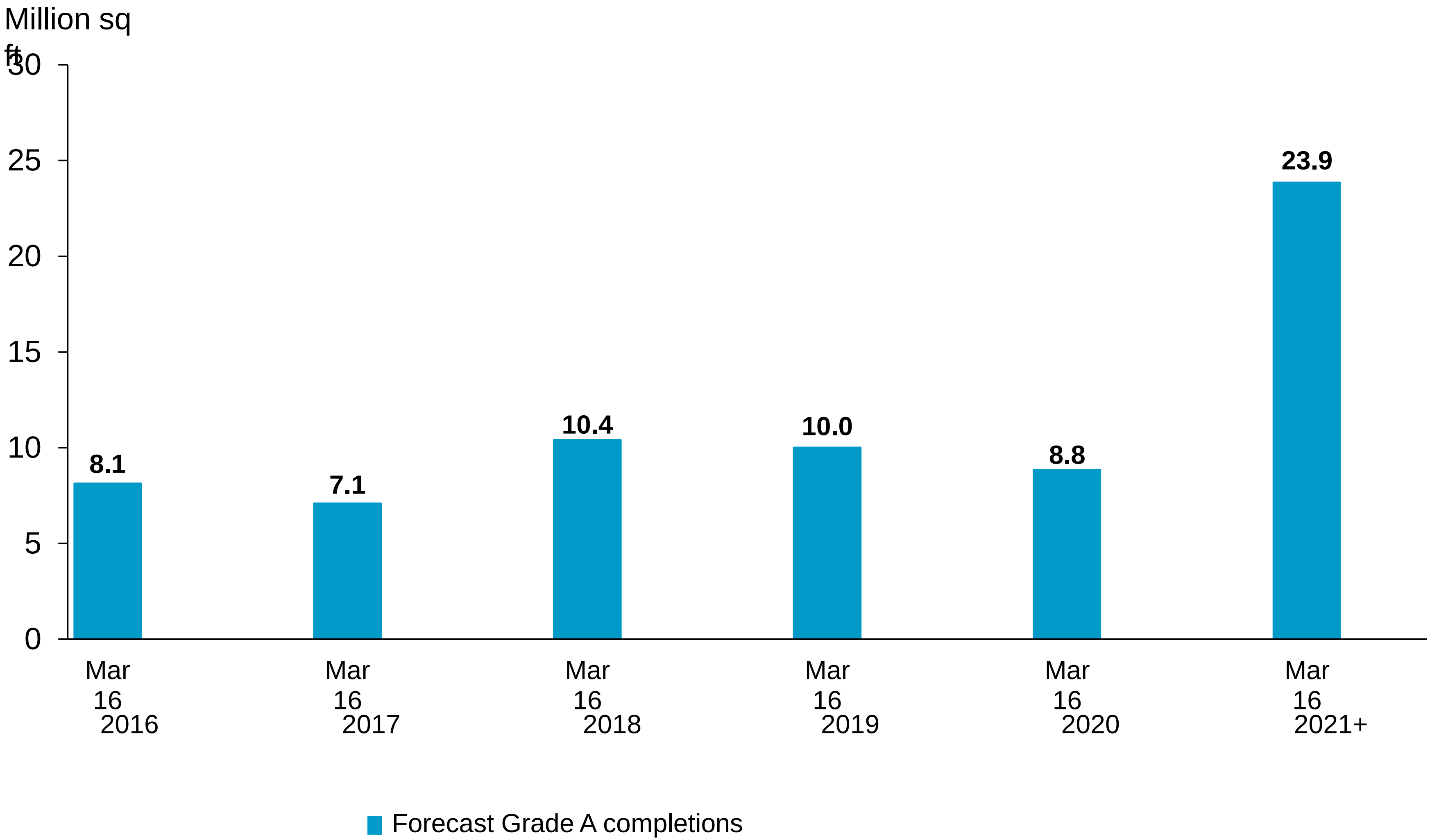
Central London supply – September 2016

Grade A completions and vacancy



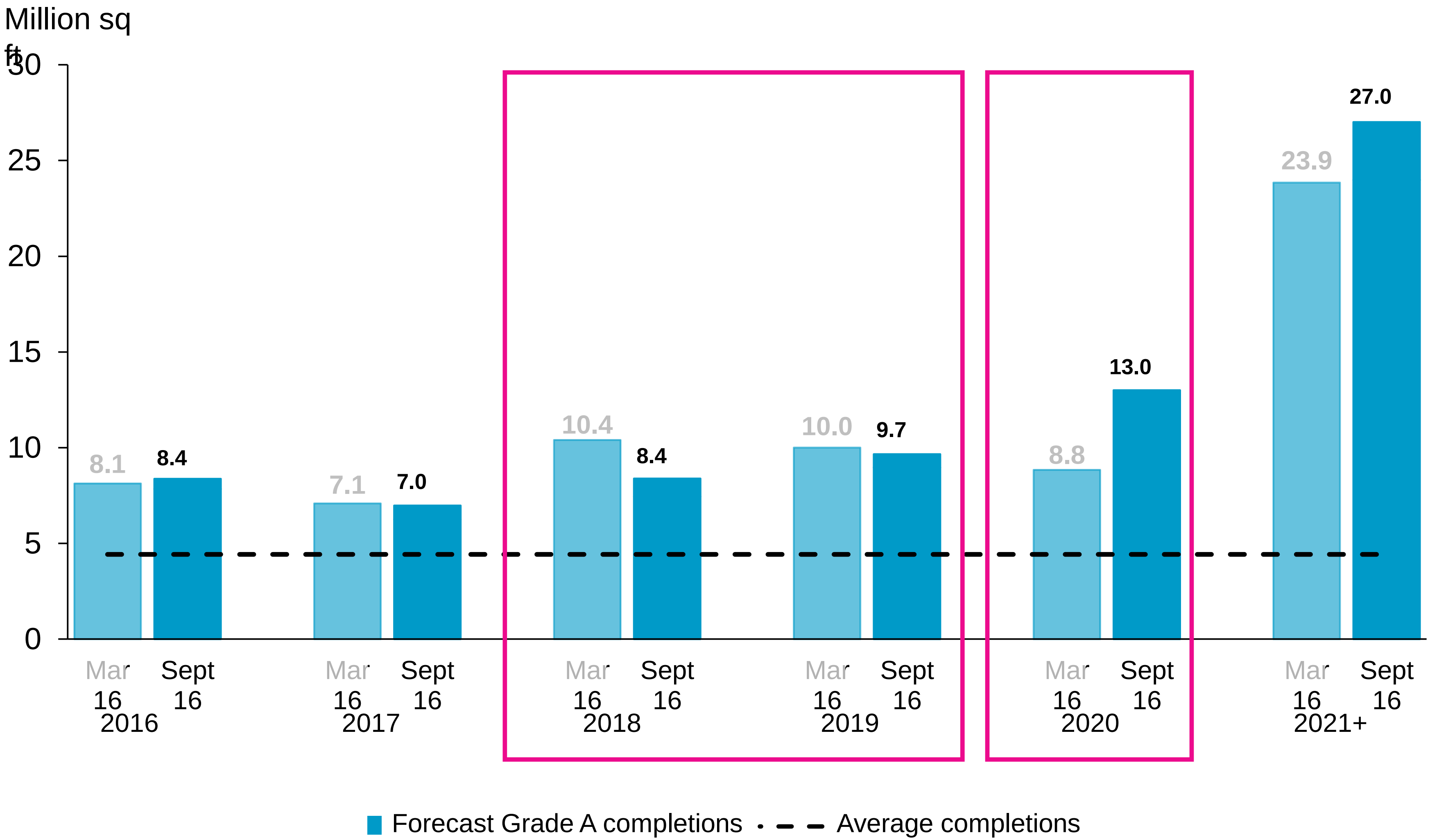
Source: CBRE, Knight Frank, Land Securities

Central London supply – March 16 and September 16 forecasts



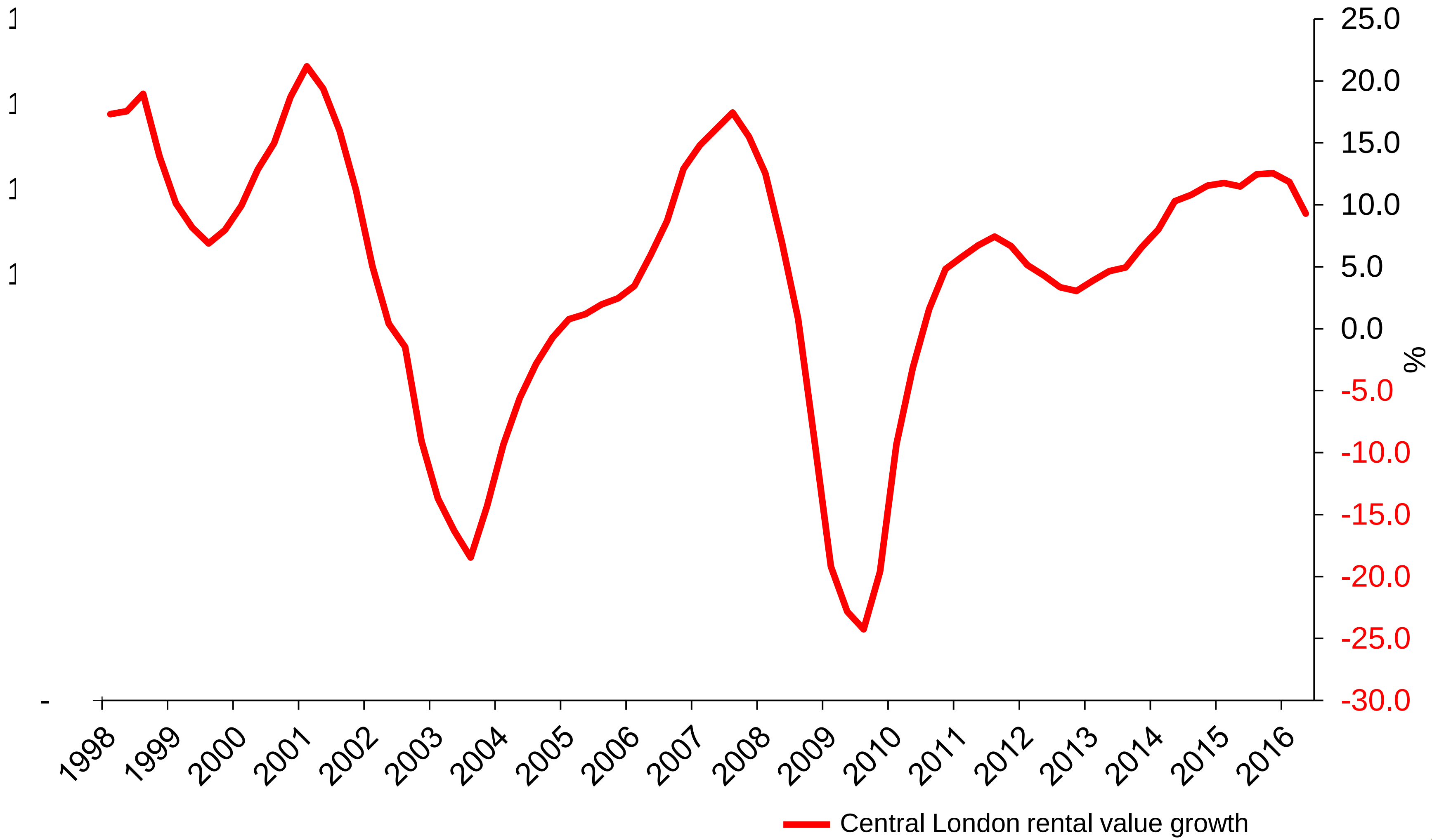
Source: CBRE, Knight Frank, Land Securities

Central London supply – March 16 and September 16 forecasts



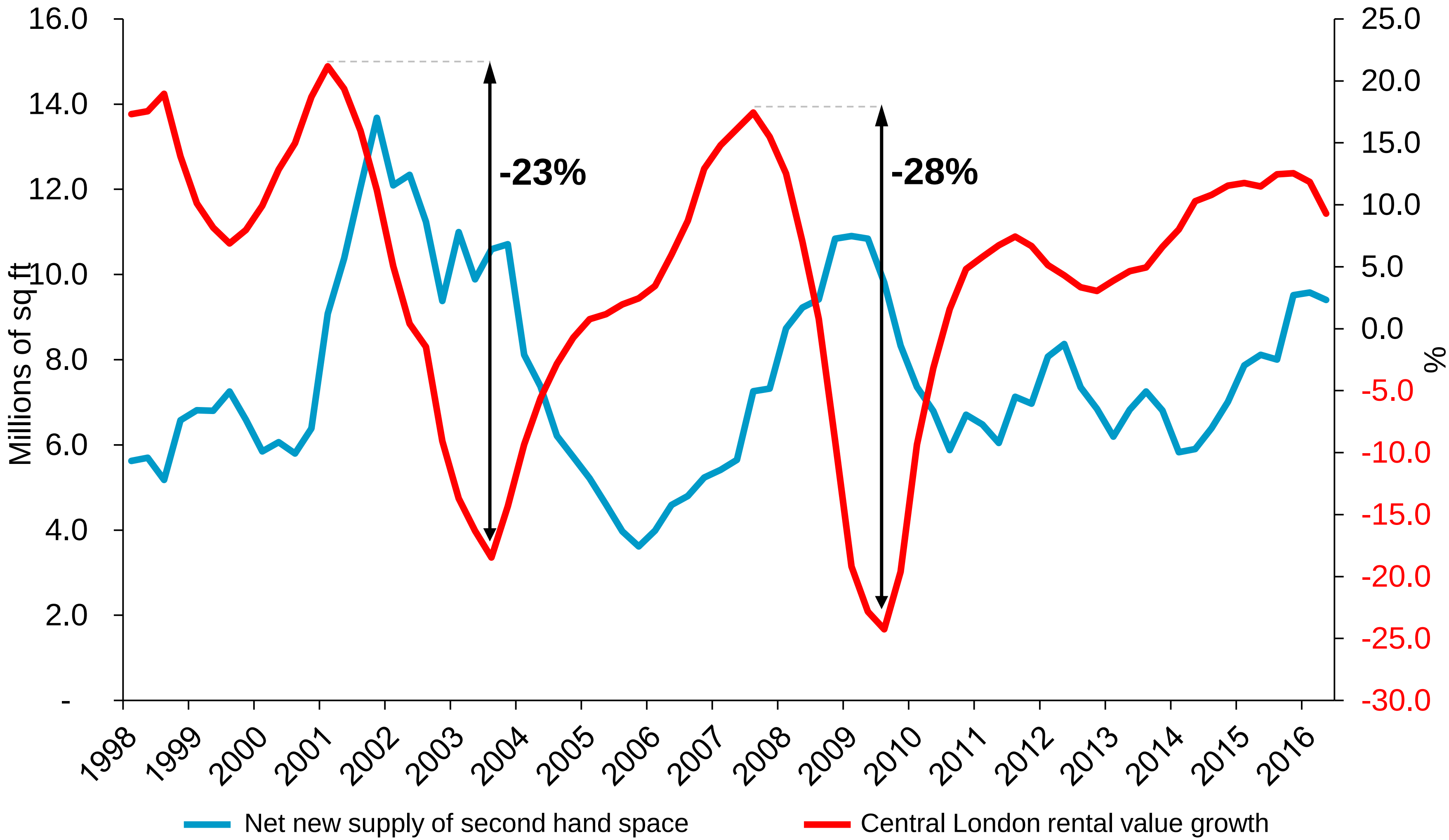
Source: CBRE, Knight Frank, Land Securities

Rents fall as occupiers release space



Source: CBRE and IPD

Rents fall as occupiers release space



Source: CBRE and IPD

Investment Market

- Volumes down 36% compared to Q3 2015*, slowing ahead to 23 June
- Well let, high quality assets most resilient
- Limited transactional evidence on higher risk properties

* Rolling 4 quarters year-on-year

Nova South, SW1

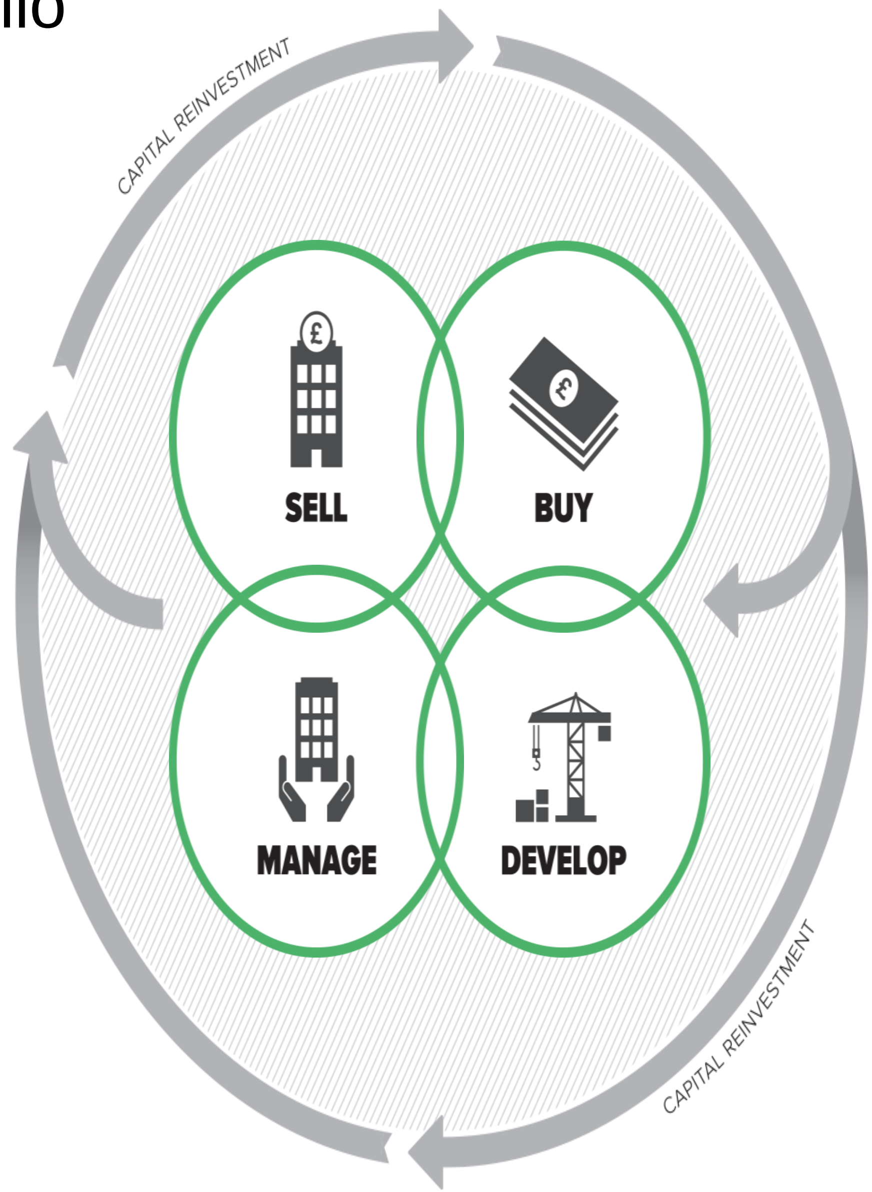
Investment Market - Land Pricing

- Re-pricing of risk
- Marginal movement of assumptions
- Significant impact on land value

	SCN1	SCN2	DIFF
HEADLINE+	£70	£68	-3%
BLENDED RENT	£60	£58	
INCENTIVE (M)	21	23	-10%
YIELD	4.00%	4.25%	-6%
P. COSTS	6.75%	6.75%	
GDV	£1,307	£1,174	-10%
HARD COST	£350	£350	
ON COSTS / FIN	£500	£500	
PROFIT	17.5%	20.0%	14%
LAND	£308	£154	-50%

Cushman Wakefield

London Portfolio

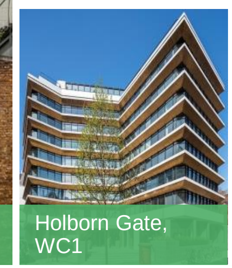


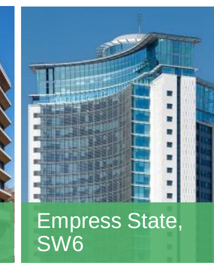
Sales – crystallising value

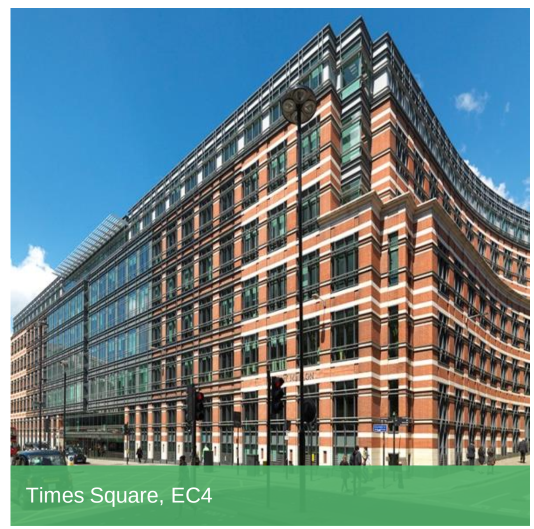
- £3bn of disposals in London over the last six years
- Crystallising early profit on developments
- Disposal of non-core assets with limited look ahead returns after adding value


Thomas More Square, E1


Arundel Great Court, WC2

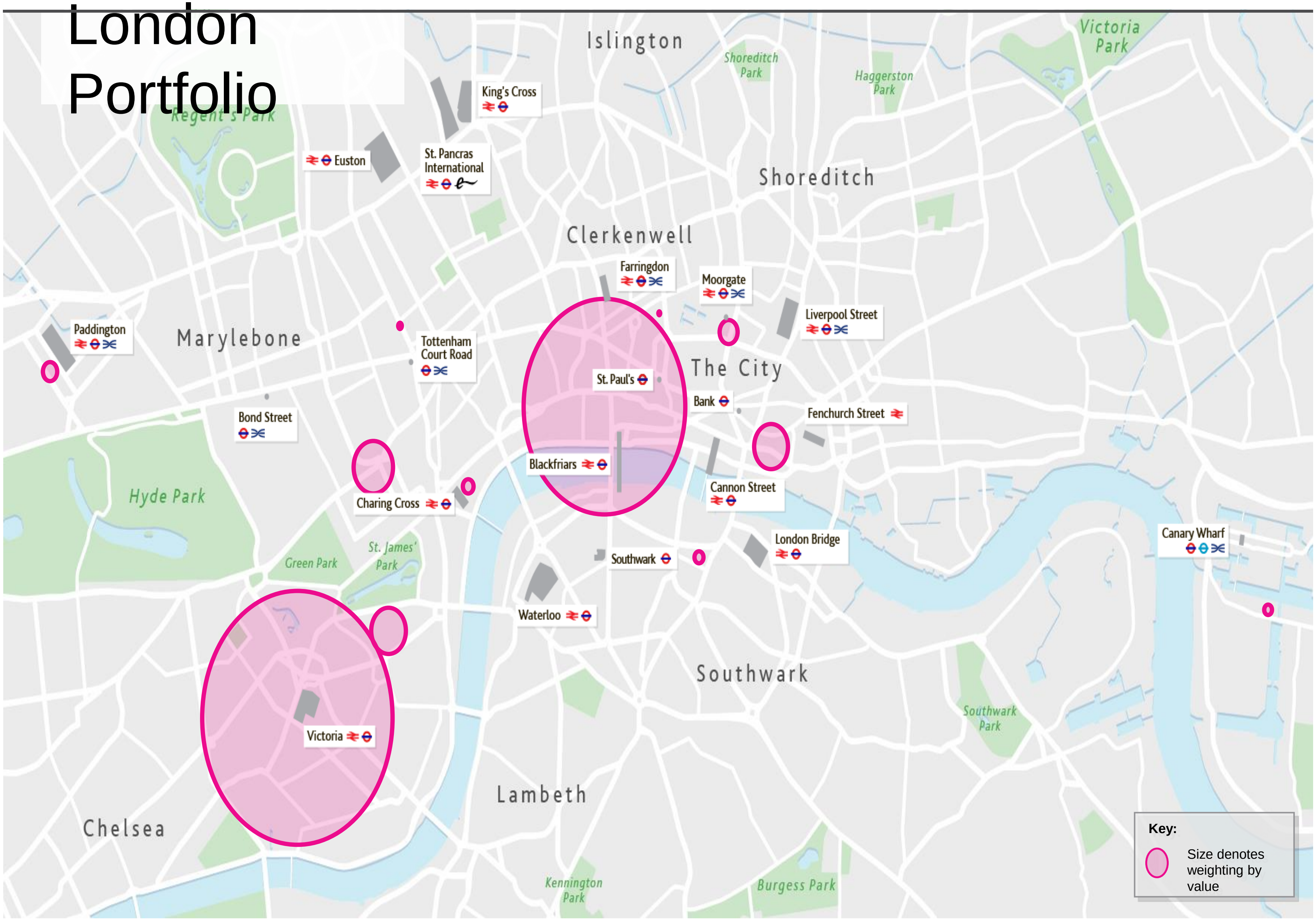

Holborn Gate, WC1


Empress State, SW6


Times Square, EC4

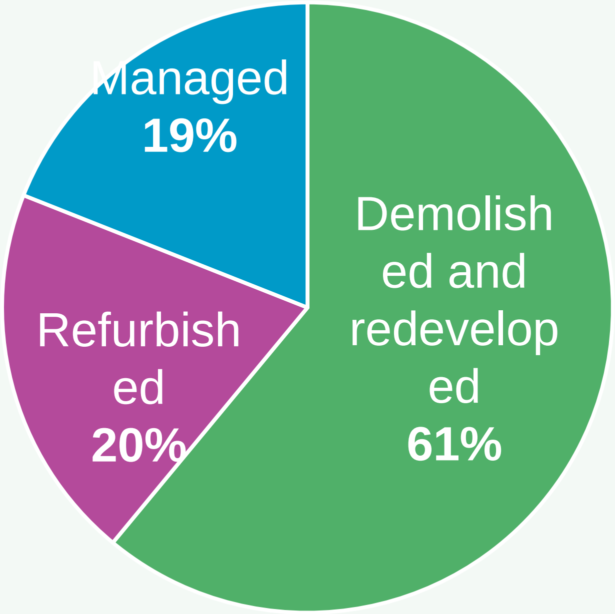

110 Cannon Street, EC4

London Portfolio



A modern relevant office portfolio

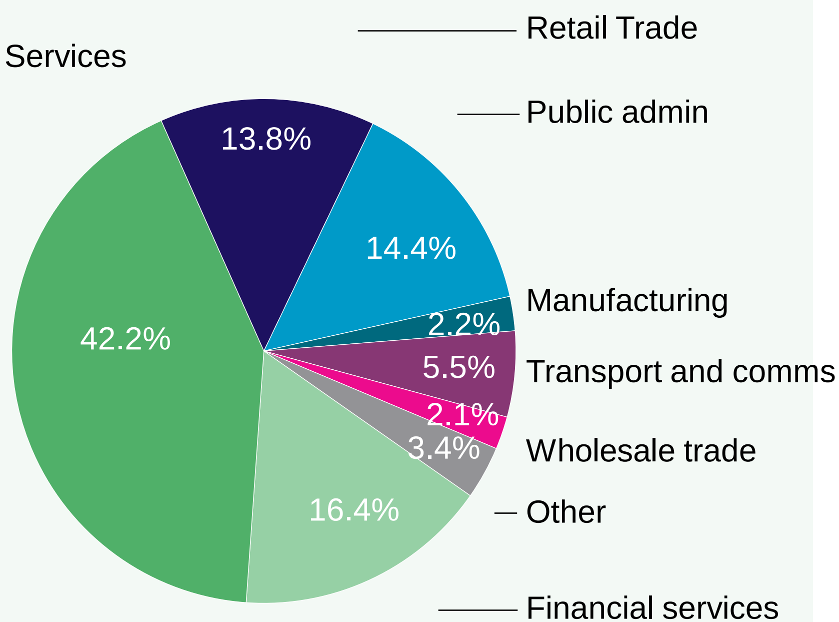
Portion of London Portfolio refurbished or developed since 2006



81% of the portfolio is less than 10 years old

Diverse customer base

Rental income by business sector



Standard Industrial Classification

Selected key occupiers

Rolls Royce
Deloitte.
John Lewis
Jimmy Choo
K&L Gates
Mizuho
TaylorWessing
M&S
Jupiter
Royal & SunAlliance
Redbus Interhouse
Bain & Company
Experian
Schlumberger

Source: Land Securities and IPD

Development

- 3.5m sq ft development programme
- 11.5 acres of new public realm
- 20,000 employed on construction sites
- Community Employment Programme: trained 1,100 over last 5 years securing 826 jobs

Nova, SW1

Development letting – maintaining momentum

20 Eastbourne Terrace, W2

- Three lettings secured in August totalling 24,000 sq ft
- 10 year leases
- 90% let with two floors remaining

1 & 2 New Ludgate, EC4

- 5,160 sq ft let since March
- 96% let with one floor remaining

20 Eastbourne Terrace, W2

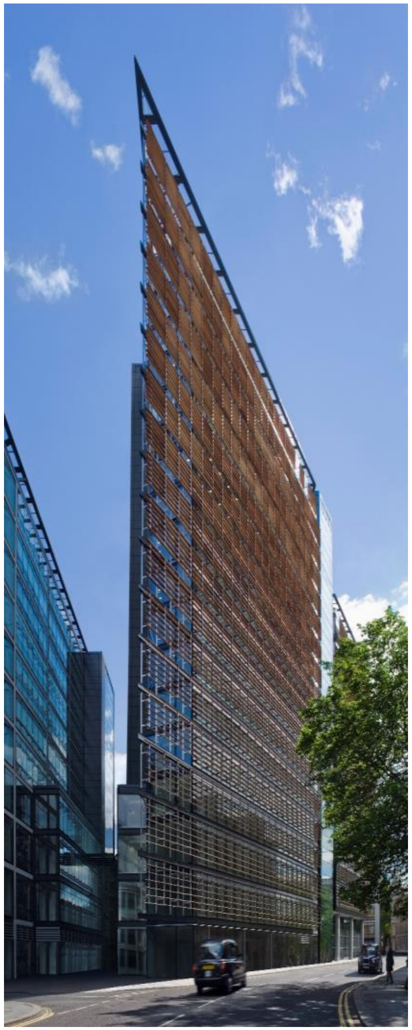
New Ludgate, EC4

Nova – good interest as we approach completion

- 83,000 sq ft let since March 2016 on 15 year leases
- Now 35% pre-let
- 360,000 sq ft to let
- Retailers and office occupiers fitting out

Nova North, SW1

Rigorous asset management



7 Soho Square – growing customer, lengthening income

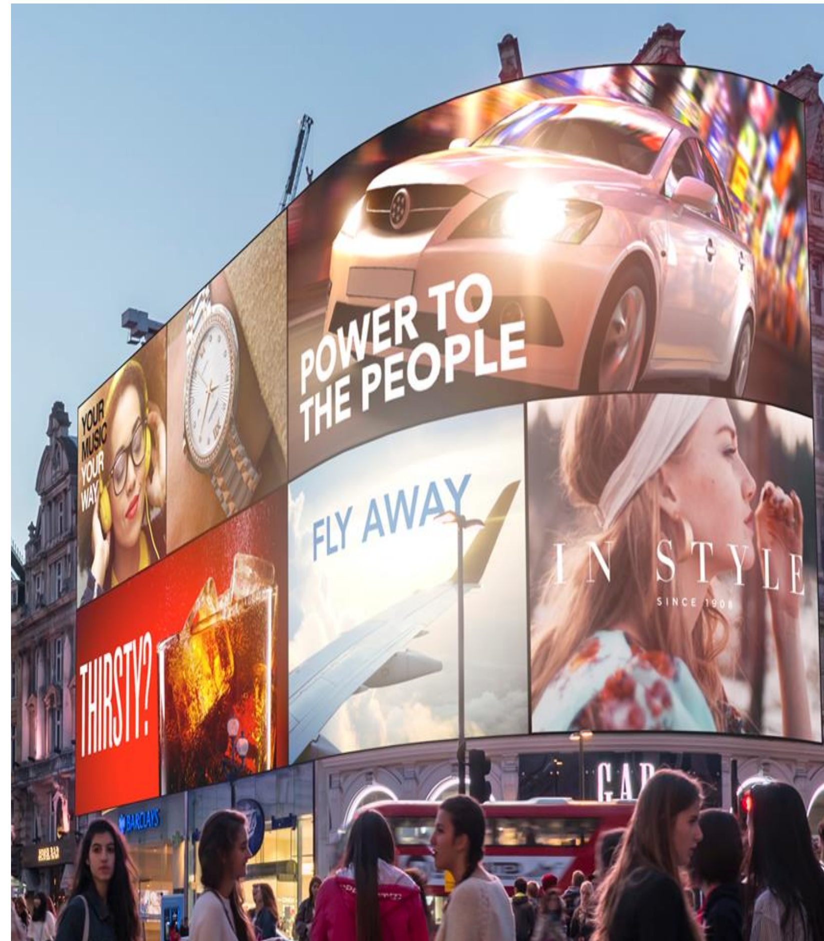
- Located next to Tottenham Court Road Crossrail station
- Trip Advisor has taken an additional 8,500 sq ft of space
- Leases extended to 2023
- Pre-agreed 2018 rent reviews
- Rent increased by 38%

Creating opportunities

Piccadilly Lights

Creating opportunities – harnessing new technology

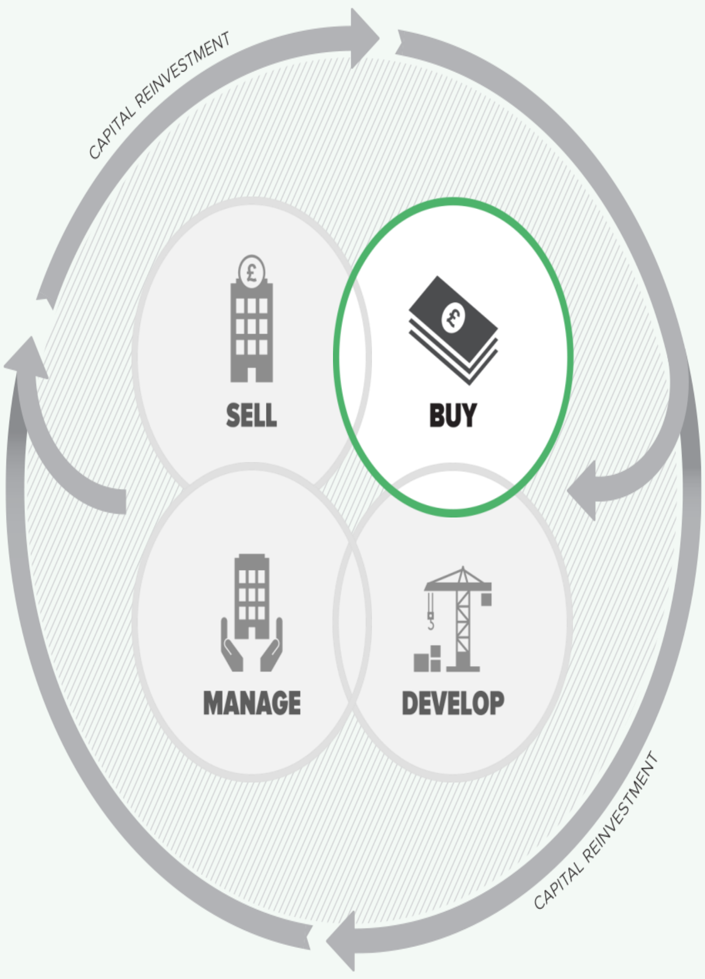
- Obtained planning consent to replace existing 6 screens with a single state of the art screen
- Flexibility over how space is used
- Interactive screen technology responding to public, environment and social media



Piccadilly Lights, consented screen

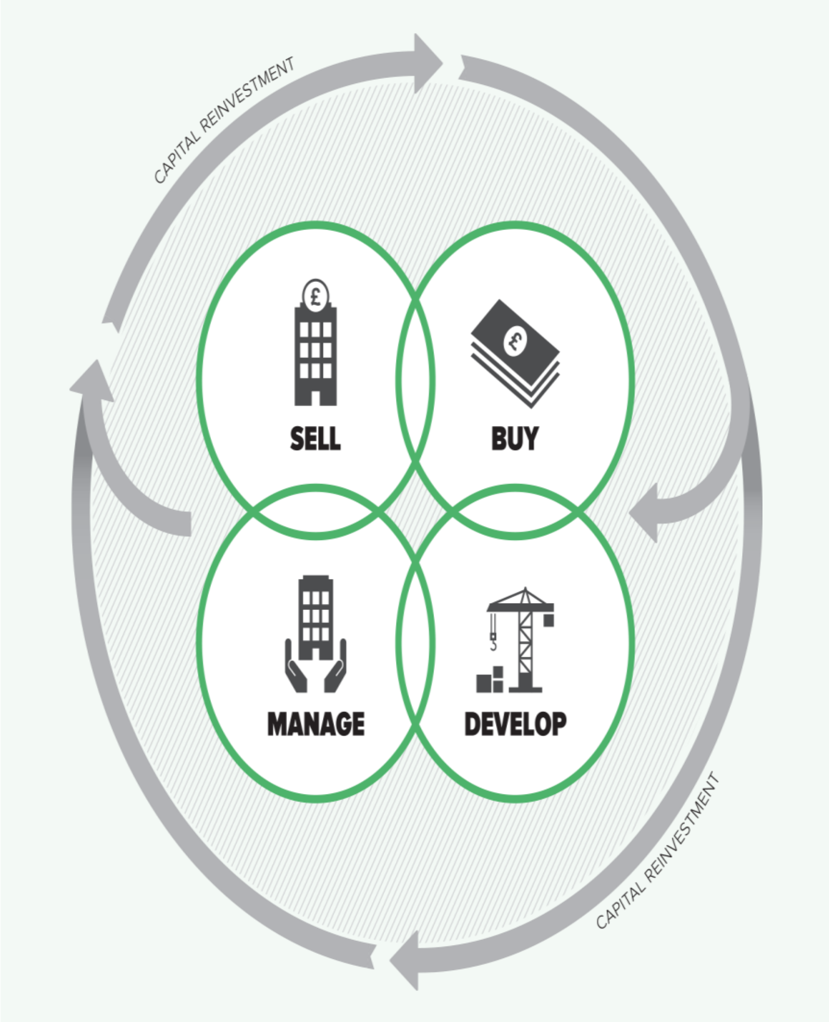
Restocking the portfolio

- Geography – well-connected locations across the whole of London
- Capitalise on development and refurbishment skills
- Pure yield / asset management opportunities to capture rental and capital value growth



Replacing risk with resilience

- Development programme funded by judicious sales
- Created building and income resilience
- Creating and seizing opportunities to drive value
- Ready to restock…but patient



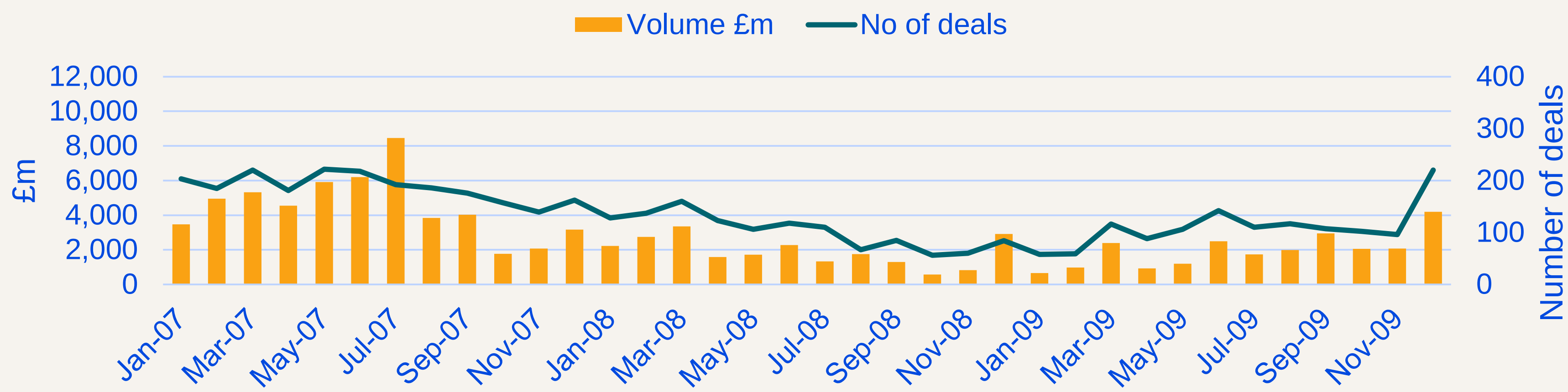
“Post Brexit Prospects for Property”

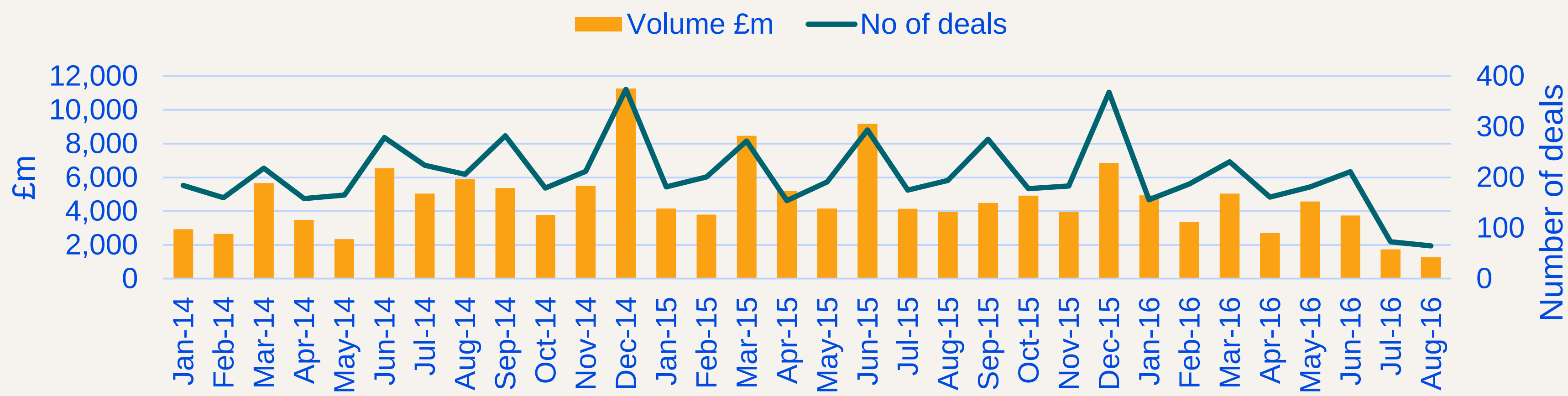
26th October 2016

Where were we before the Brexit?

- Comparatively strong economic outlook, with some concerns about austerity
- Investment cycle slowing both in terms of volume and pricing (“depth” in bidding evaporated in Summer 15)
- Occupational markets robust:
  - Lower vacancies than previous cycles
  - Some questions about expanding development pipeline particularly in C London
  - Slowing investment volumes and prime yields not being met for 12 months +
  - Weakening (but positive) rental growth prospects
- Bank lending restrained and at low LTVs
- Property firmly in the “least worst asset” box

The sentiment-based investment market has slowed to similar levels that we saw in 2008 and 2009





UK RE market performance since the vote

- Initial turmoil created a perception of deep discounting (mainly from open ended daily dealt funds), but this was not supported two weeks later
- Over the last month clear signs have emerged from buyers that while secondary or short term income assets have seen declines, long term income and annuity type investments with fixed uplifts are maintaining their value
- The devaluation of sterling and some price discounts mean that entry prices are nearly 20% cheaper than prior to the referendum for some investors

Biggest questions for 2016 and beyond are around the occupational markets

Retail

- Stable 2H 2016, then all eyes on consumer confidence, saving ratios and Christmas
- Weak pound, and minimum wage will drag on retailer profitability

Logistics

- Consumer caution may result in an uptick in online sales and support logistics demand
- Stable occupational outlook

Offices

- Needs-based occupational demand to be unaffected, though a rise in lease extensions likely as businesses evaluate the new world. Leasing volumes lower than original forecast of reversion to trend levels in 2017
- Regional office markets and outer London supported by lower supply and comparative cost savings for occupiers

Conclusions and outlook

- Remember we started 2016, 6 years into an "upcycle", with capital values up 35%, commercial RE having outperformed all other asset classes and some yields were back to 2007 levels
- We are in a property boom and historically they have ended badly
- Investors don't have confidence in the valuation system hence the discounts to NAV in public markets
- Declining lease lengths increase income and pricing volatility (question relevance of risk premium to gilt rate)
- Bull case revolved around low rates, the need for income plus increased allocations to RE
- IPD benchmarking is stifling creativity and dictating strategy
- Remember income makes up the vast majority of property's long term performance and rental growth always underwhelms

CULS – MARKET TRENDS 2016

The Post Brexit Prospects for Property

26th October 2016

AVIVA INVESTORS

AGENDA

ECONOMIC OVERVIEW

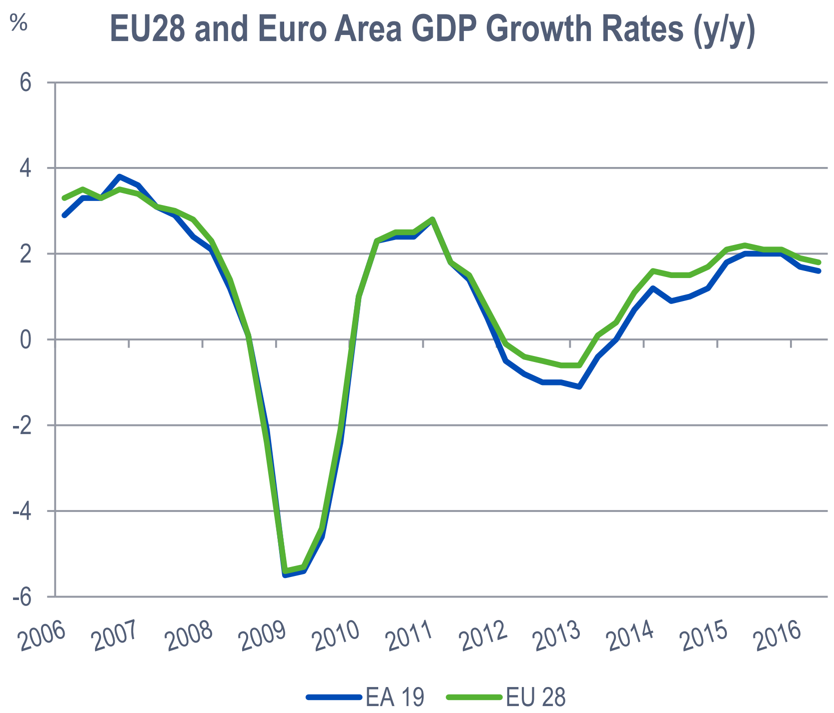
OCCUPIER MARKET BACKGROUND

CAPITAL MARKET PERSPECTIVE

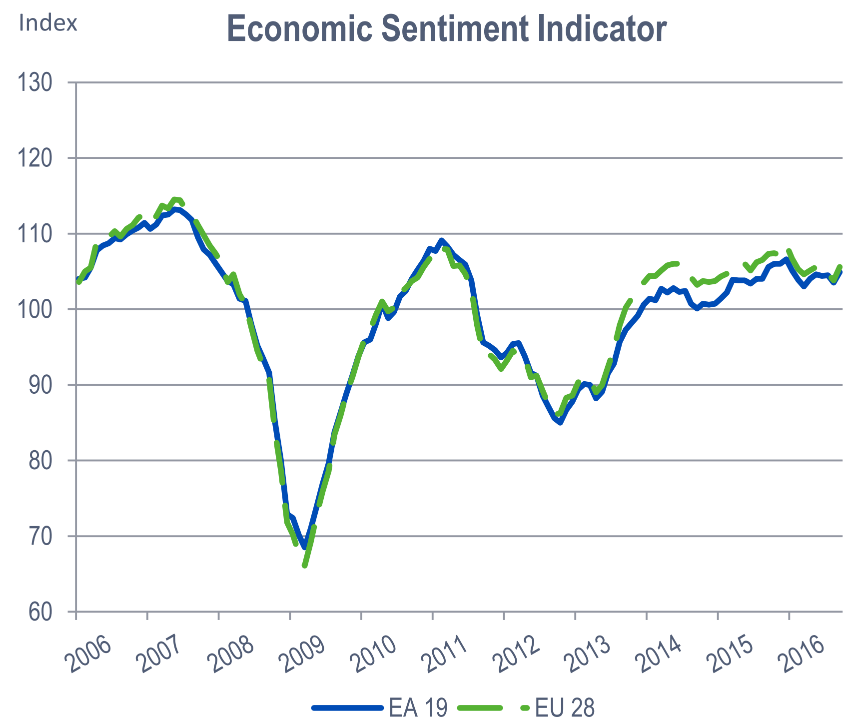
OUTLOOK

European Economic Outlook

Eurozone economic sentiment recovers after the initial dip post Brexit vote



Source: Thomson Reuters Datastream

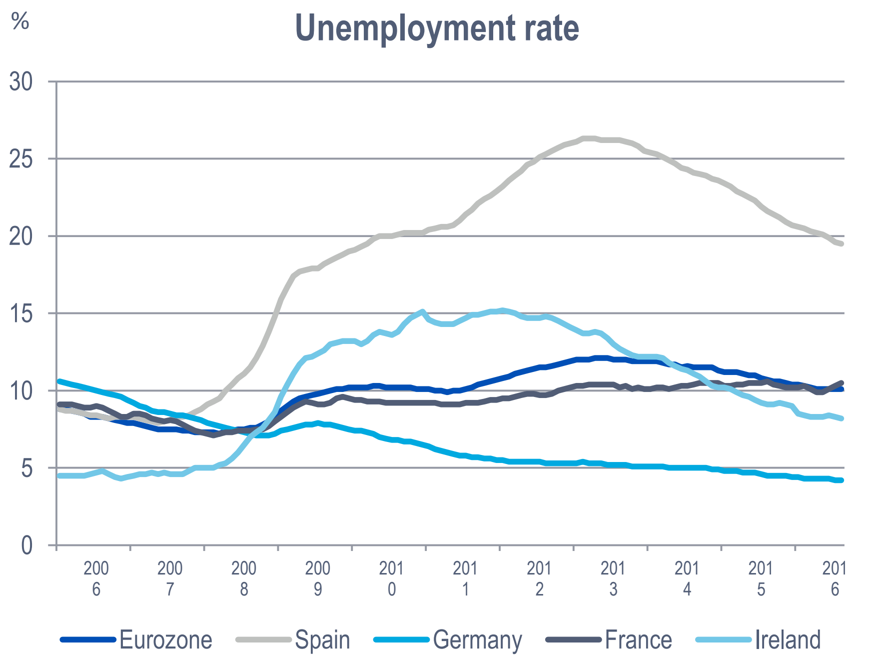


Source: Thomson Reuters Datastream

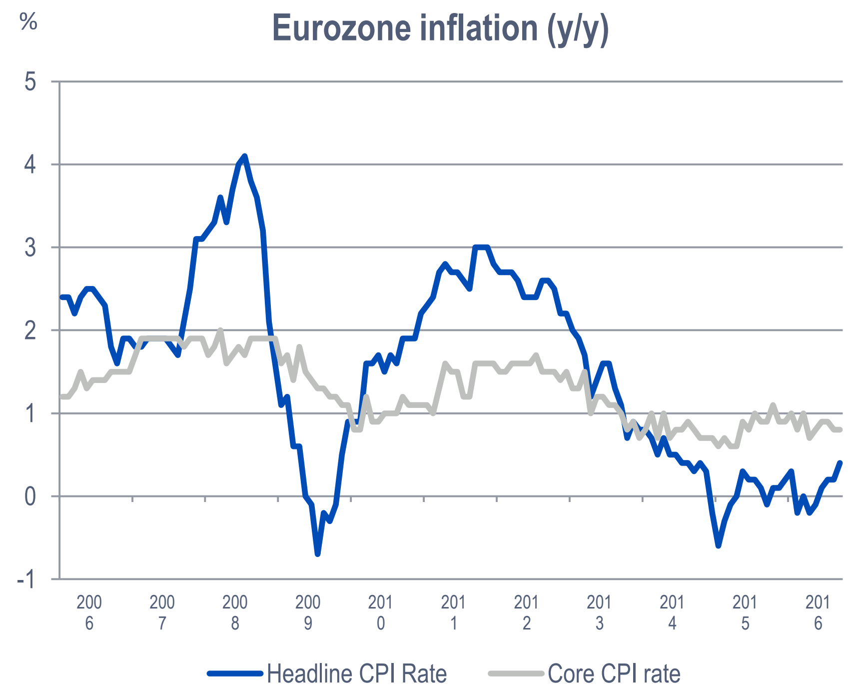
– GDP in the Eurozone is likely to continue to grow at a modest pace
– Economic confidence in the Eurozone and EU overall recovered in September from a dip seen after the UK's EU referendum. For the Eurozone, it is now above the May 2016 levels.

European Economic Outlook

Unemployment and low inflation point to continued weakness in the European economy



Source: Thomson Reuters Datastream

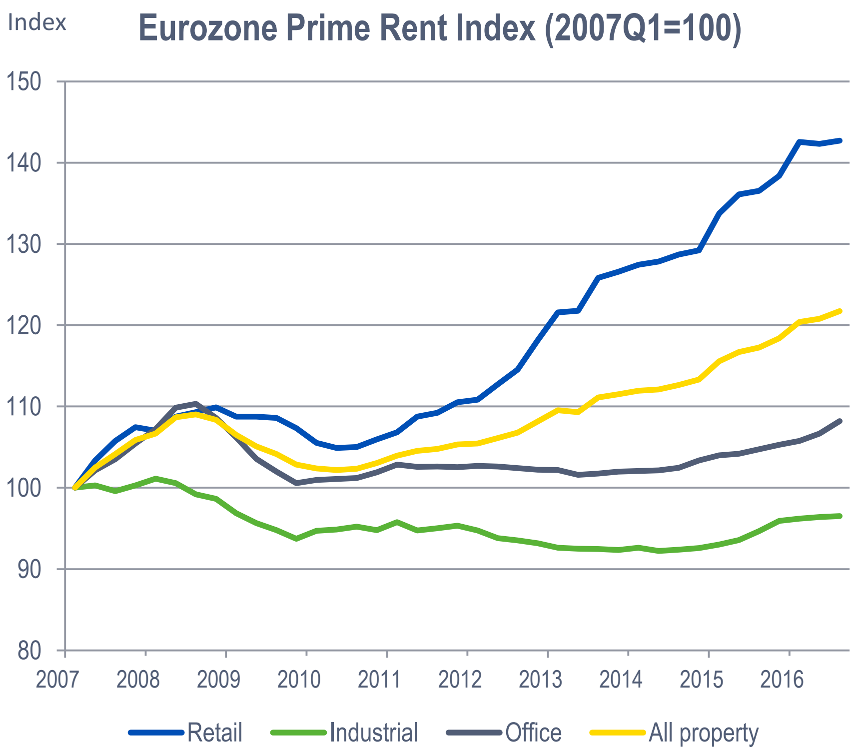


Source: Thomson Reuters Datastream

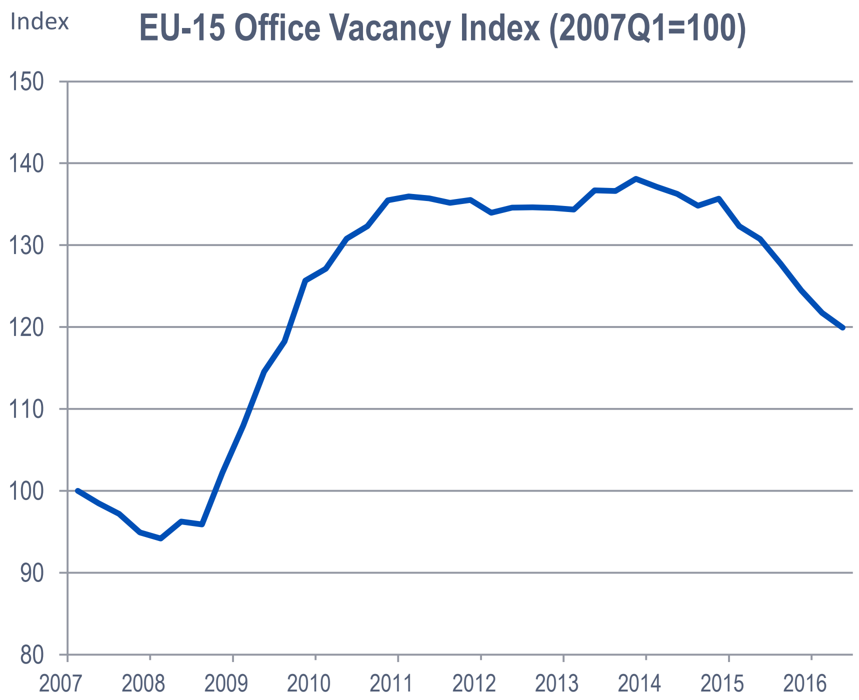
- Unemployment in the Eurozone remained stable at 10.1% in August 2016 - the lowest point since mid-2011.
- Eurozone consumer prices rose 0.4% in August (y/y) – the fastest rate since mid-2014. Inflation is still uncomfortably low, well below the ECB's inflation target close to 2%.

Improving occupier market fundamentals

Positive indicators for European property markets



Source: CBRE

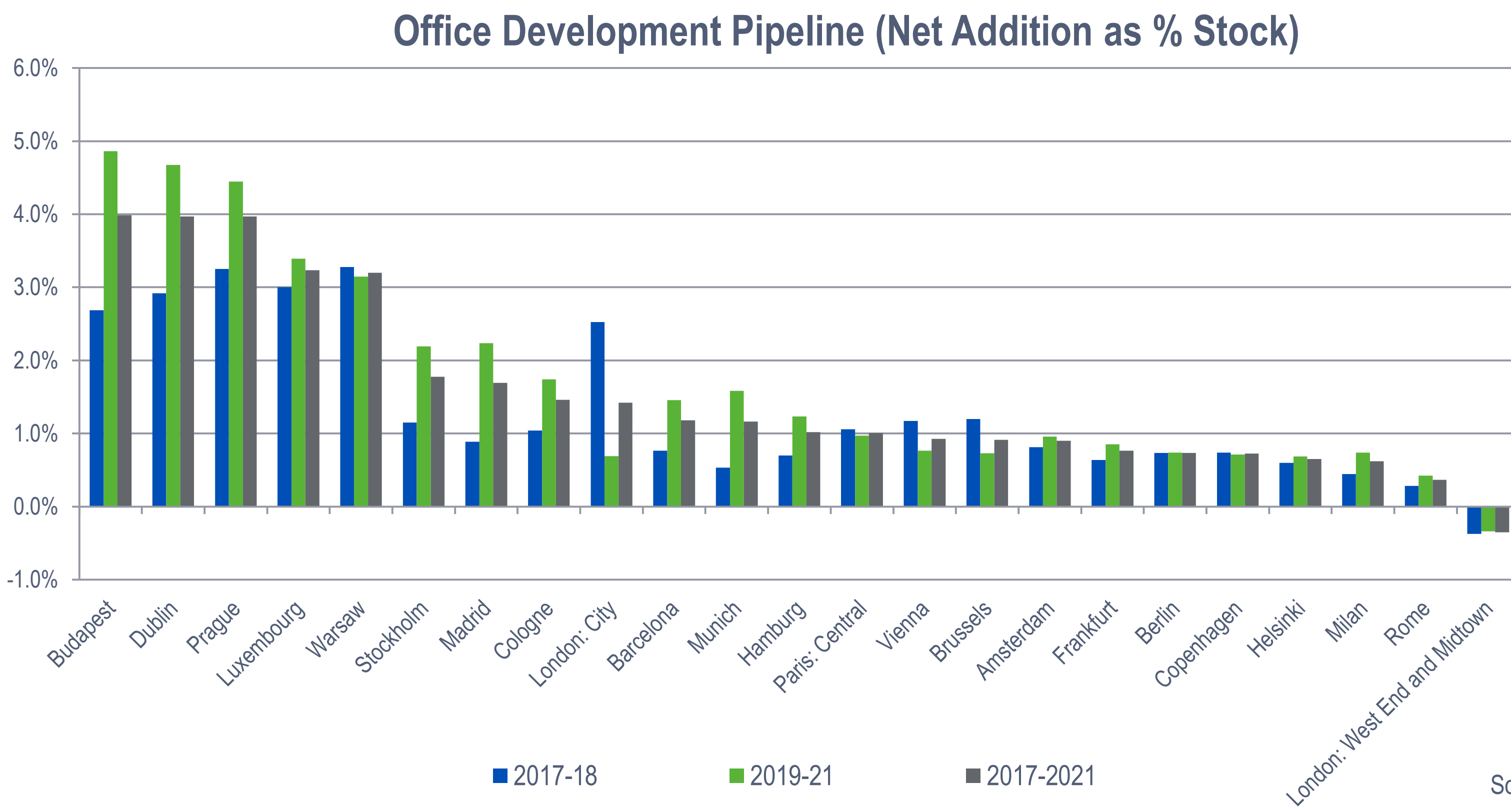


Source: CBRE

Prime rents increased by 3.8% y/y in Q3 following a 3.5% rise in H1 2016. Retail continues to outperform.

Supply response remains modest

New supply remains limited in most markets

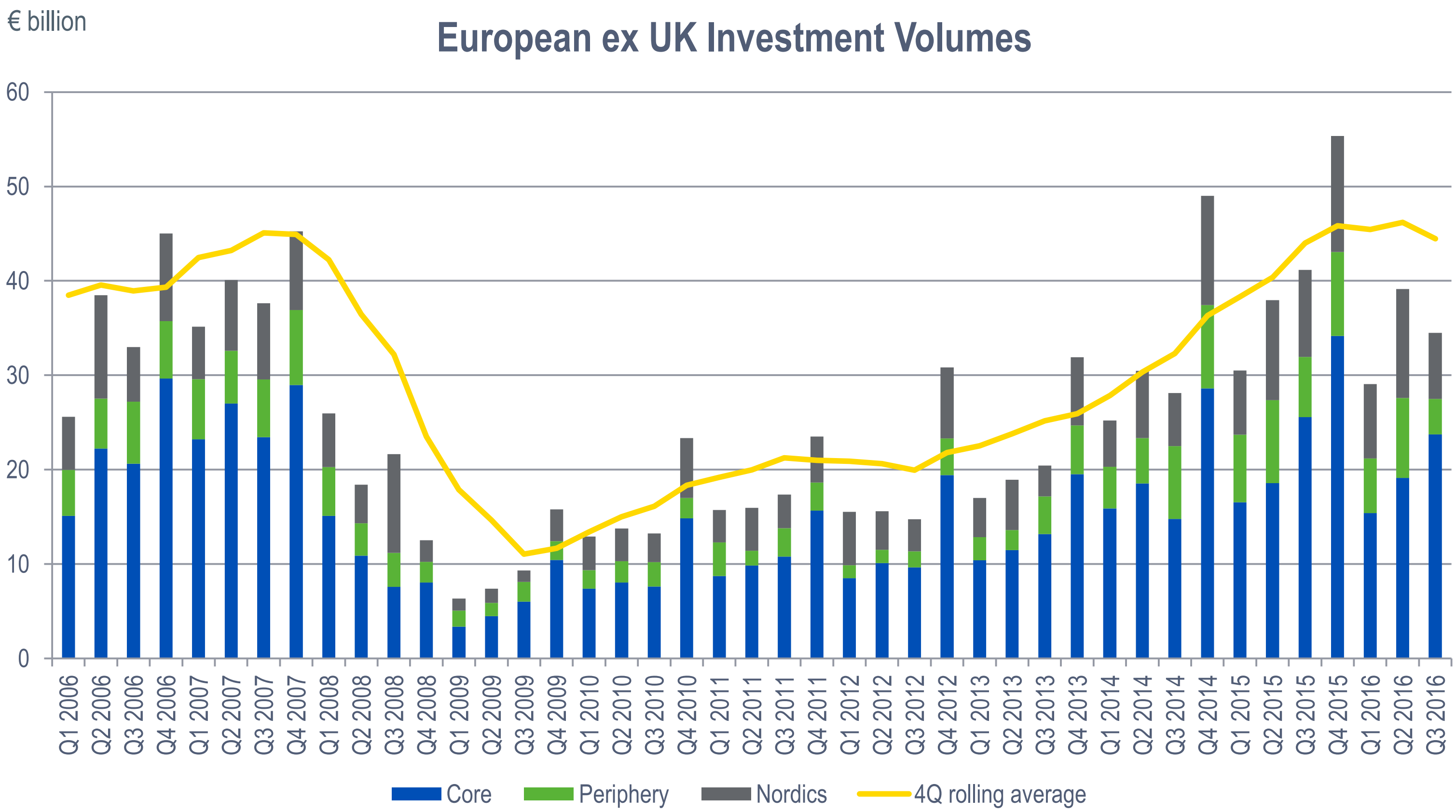


Source: PMA

Significant levels of development in CEE markets, Dublin and Luxembourg.

Investment demand remains high

Investment volumes lower than in 2015 due to supply shortages, still above average



Source: CBRE

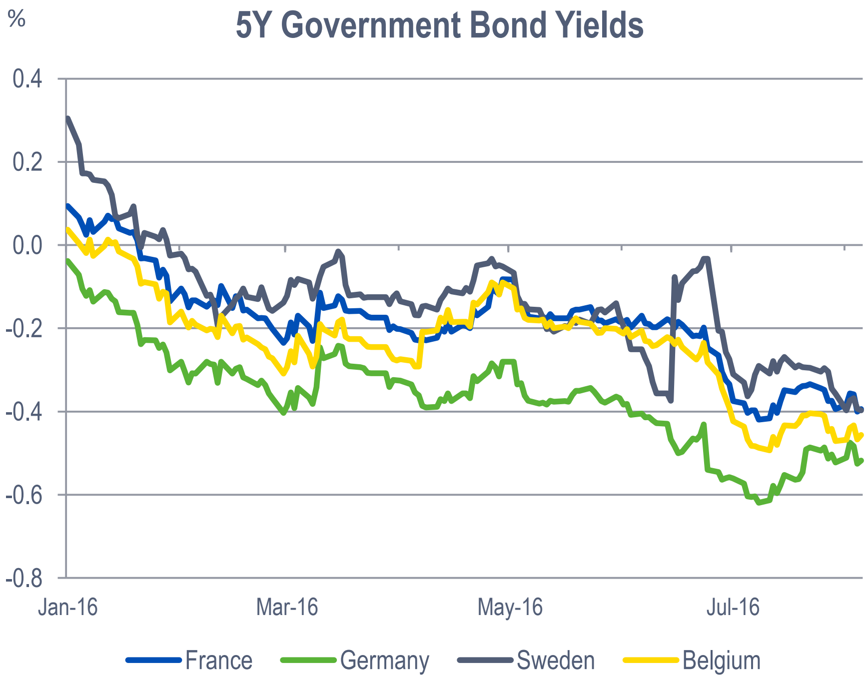
* France, Germany, Benelux
** Austria, Ireland, Portugal, Spain, Czech Republic, Hungary, Poland, Romania, Slovakia

Sweden, CEE, Denmark, Finland and Netherlands recorded double-digit y/y increases in investment volumes in Q1-Q3 2016

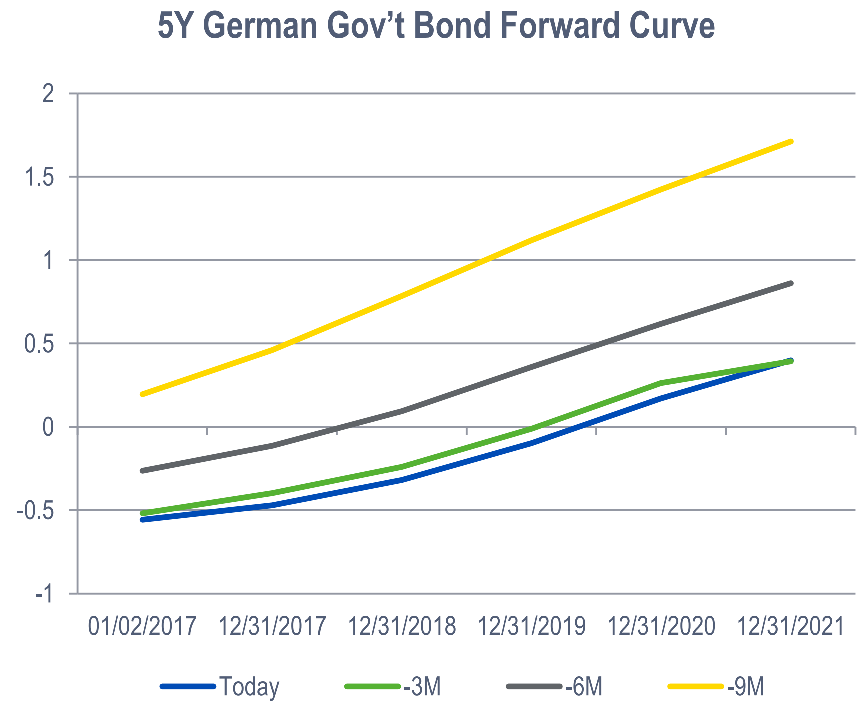
Government bond yield movements

Higher uncertainty to drive government bond yields lower for longer

AVIVA INVESTORS



Source: Thomson Reuters Datastream

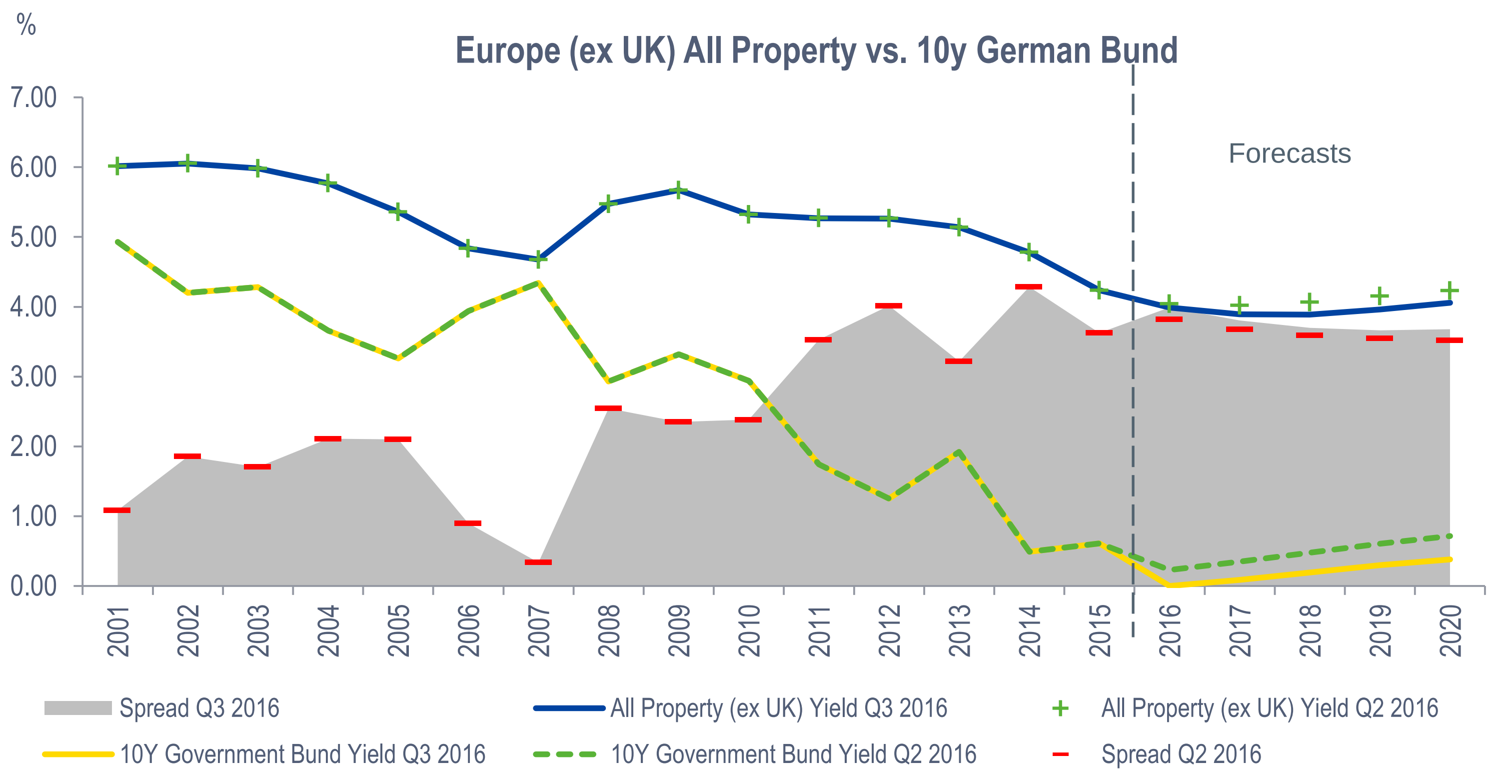


Source: Bloomberg, as at 20/10/2016

Market pricing suggests that bond yields will remain in negative territory until 2019.

Property risk premium over bonds to remain substantial

Lower bond yields for longer will drive the spread in next 5 years



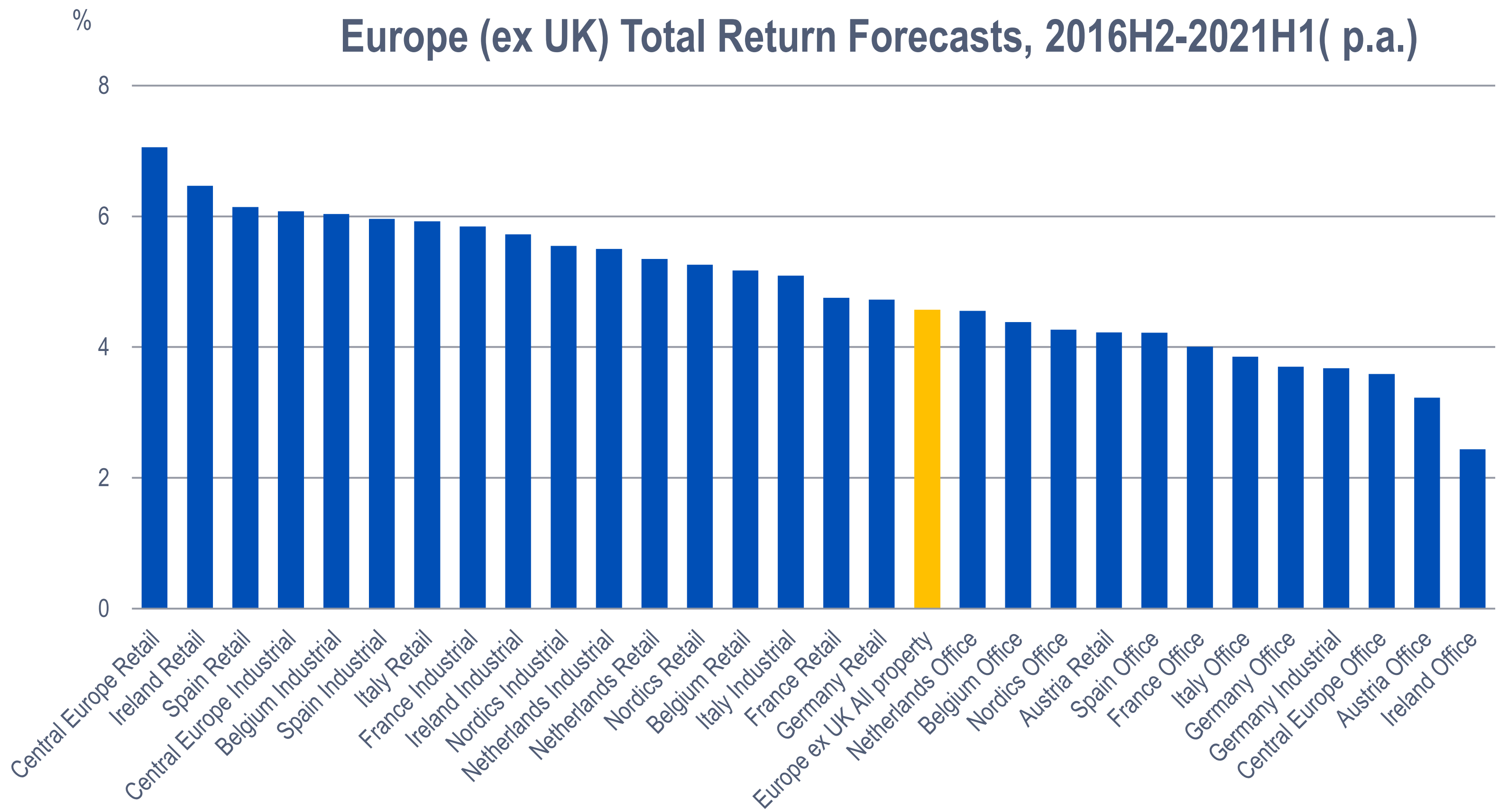
Source: Bloomberg, Aviva Investors.

A higher spread between property and bond yields is expected in 2016 and 2017 as government bond yields remain close to zero.

OUTLOOK FOR EUROPEAN REAL ESTATE

European prime total return forecasts – 2016H2-2021H1

Retail markets in CEE, Ireland and Spain expected to deliver the highest returns



Source: Aviva Investors.

Office markets, more advanced in the rental and yield cycles, will underperform.

Political Risk remains elevated

Plenty of political hurdles to jump

DATE	COUNTRY	POLITICAL EVENT
23rd November 2016	USA	US presidential election
4th December 2016	Italy	Constitutional referendum
4th December 2016	Austria	Presidential election (re-run)
15th March 2017	Netherlands	Dutch parliamentary election
end-March 2017	UK / Wider EU	Article 50 likely to be triggered
April / May 2017	France	French presidential election
May 2017	Germany	German regional elections
September 2017	Germany	German parliamentary elections

Potential for contagion remains high

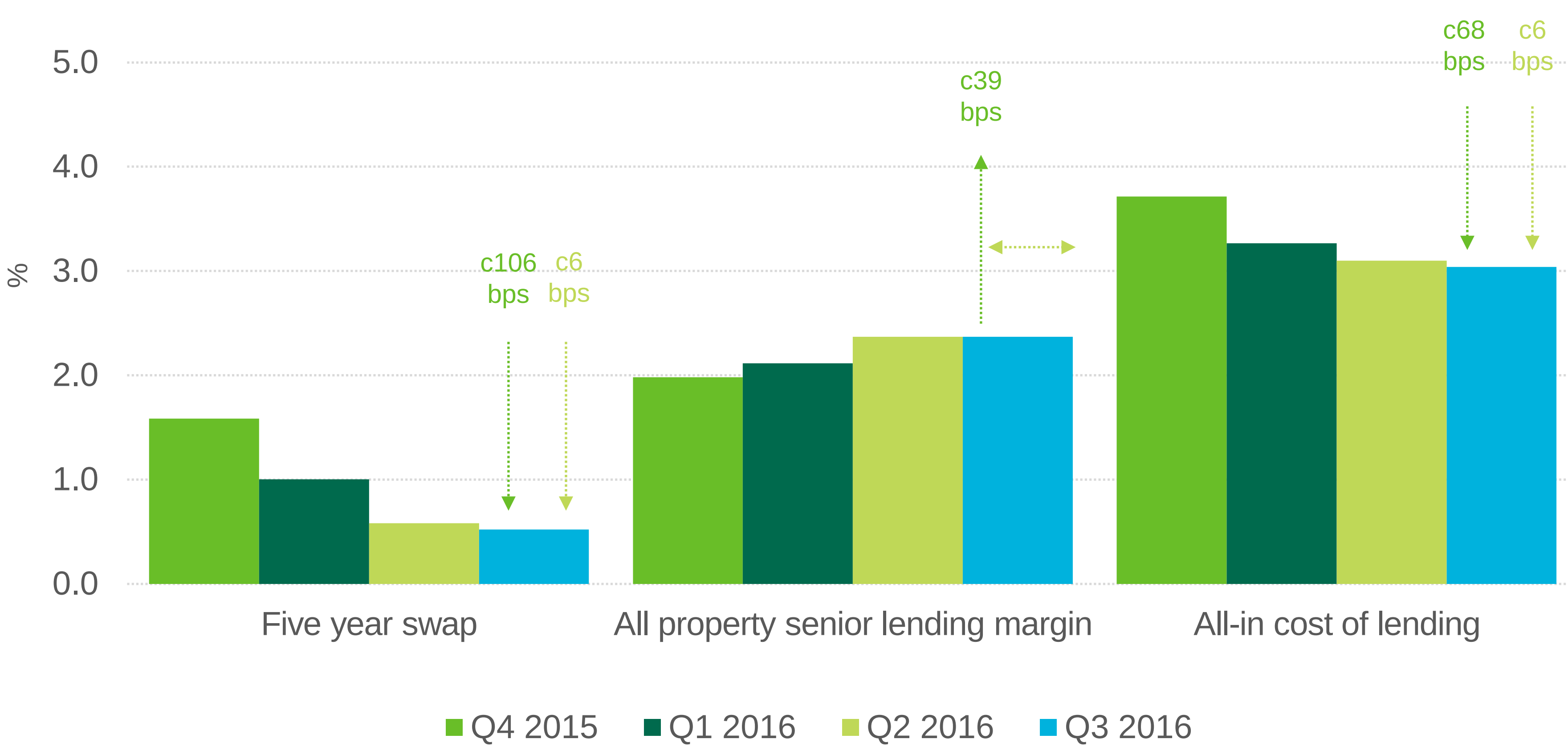
CBRE DEBT ANALYTICS

DEBT OUTLOOK AFTER THE VOTE

OCTOBER 2016

CHANGING LENDING TERMS OVER THE LAST NINE MONTHS

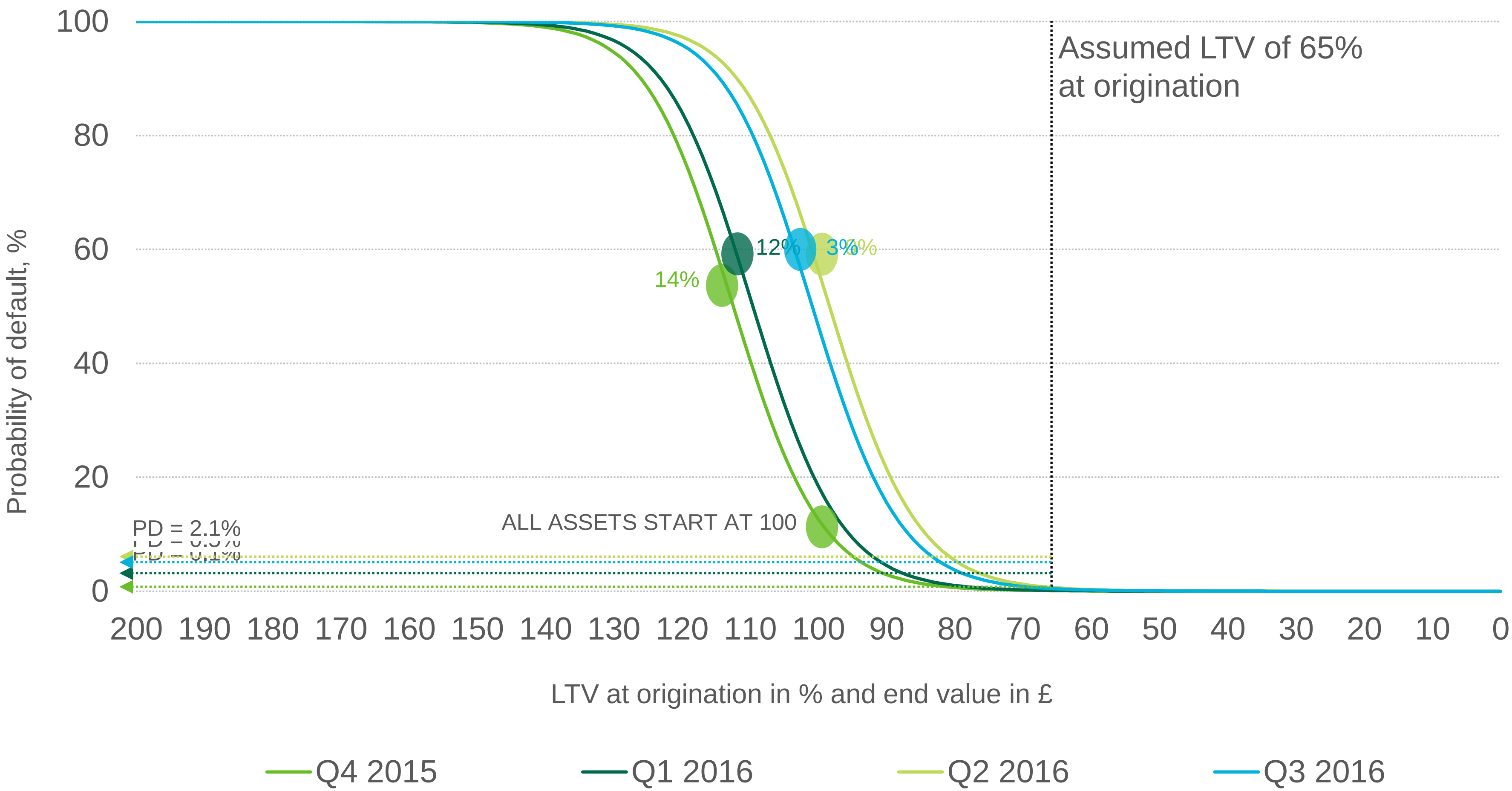
KEY COMPONENTS OF LENDING PRICING FOR Q4 2015 TO Q3 2016 SENIOR LENDING



Source: CBRE, Macrobond.
Note: Assumes 65% LTV.

CHANGING DEFAULT RISK OVER THE LAST NINE MONTHS

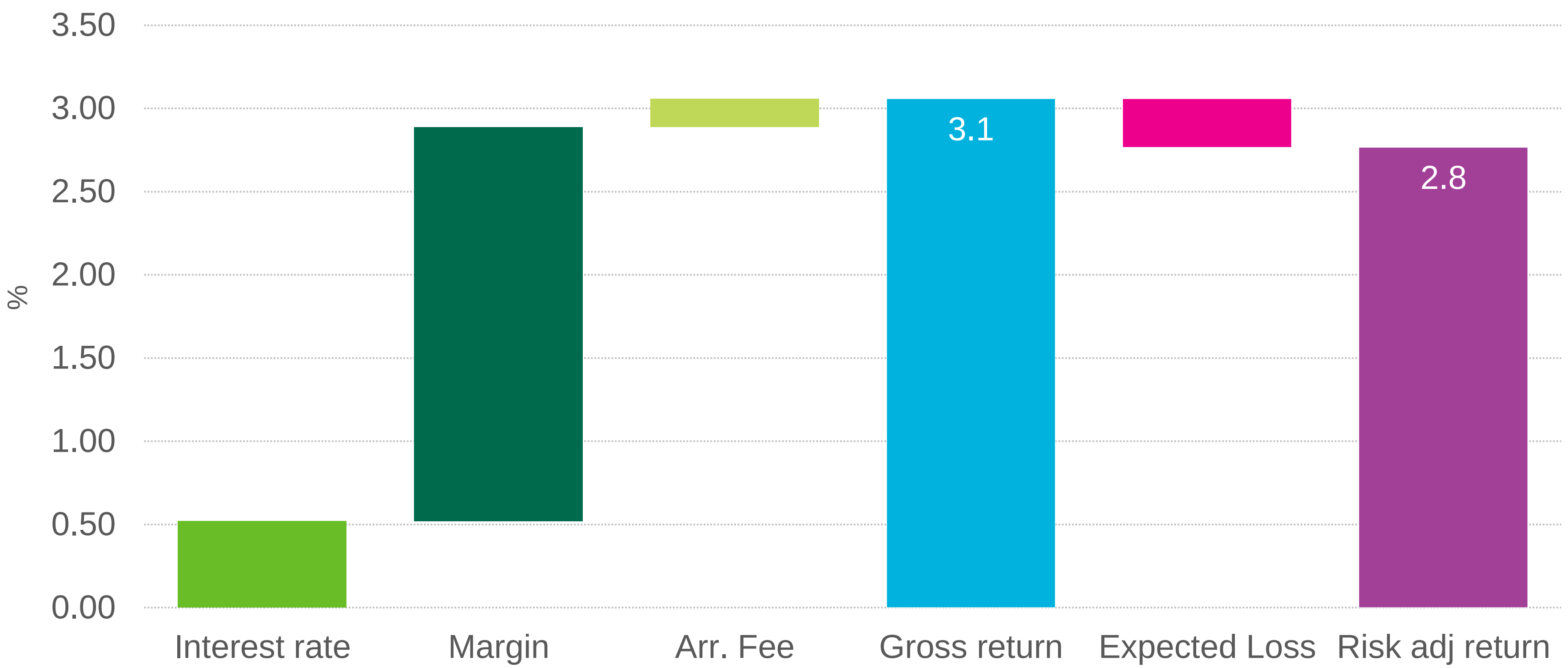
PROBABILITY DISTRIBUTIONS FOR Q4 2015 TO Q3 2016 SENIOR LENDING



Source: CBRE.

CURRENT LENDING RETURNS

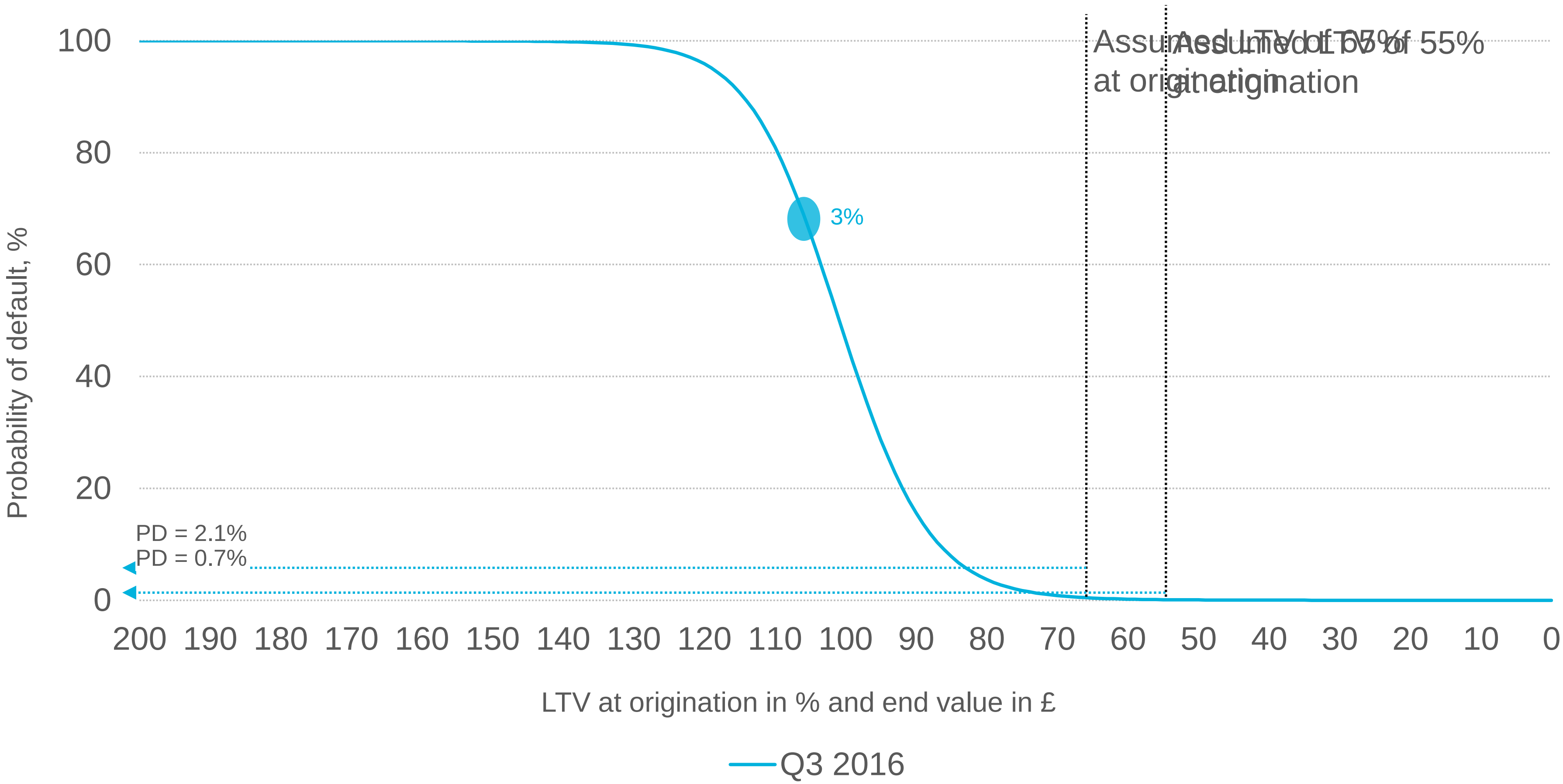
GROSS AND RISK-ADJUSTED RETURN FOR Q3 2016 SENIOR LENDING



Source: CBRE, Macrobond.
Note: Assumes 65% LTV.

MITIGATING DEFAULT RISK THROUGH LOWER LTV

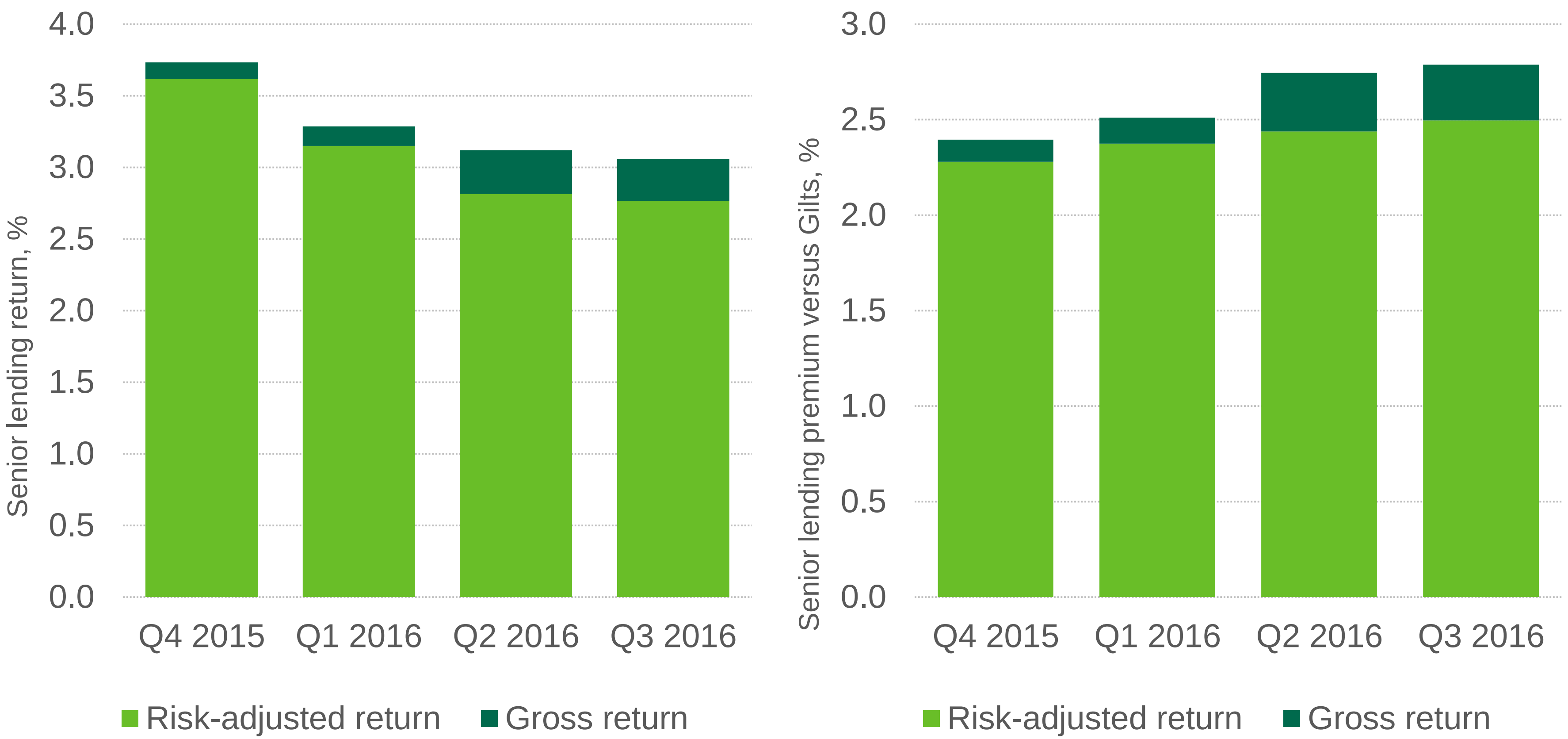
PROBABILITY DISTRIBUTIONS FOR Q3 2016 SENIOR LENDING



Source: CBRE.

ABSOLUTE AND RELATIVE RETURNS

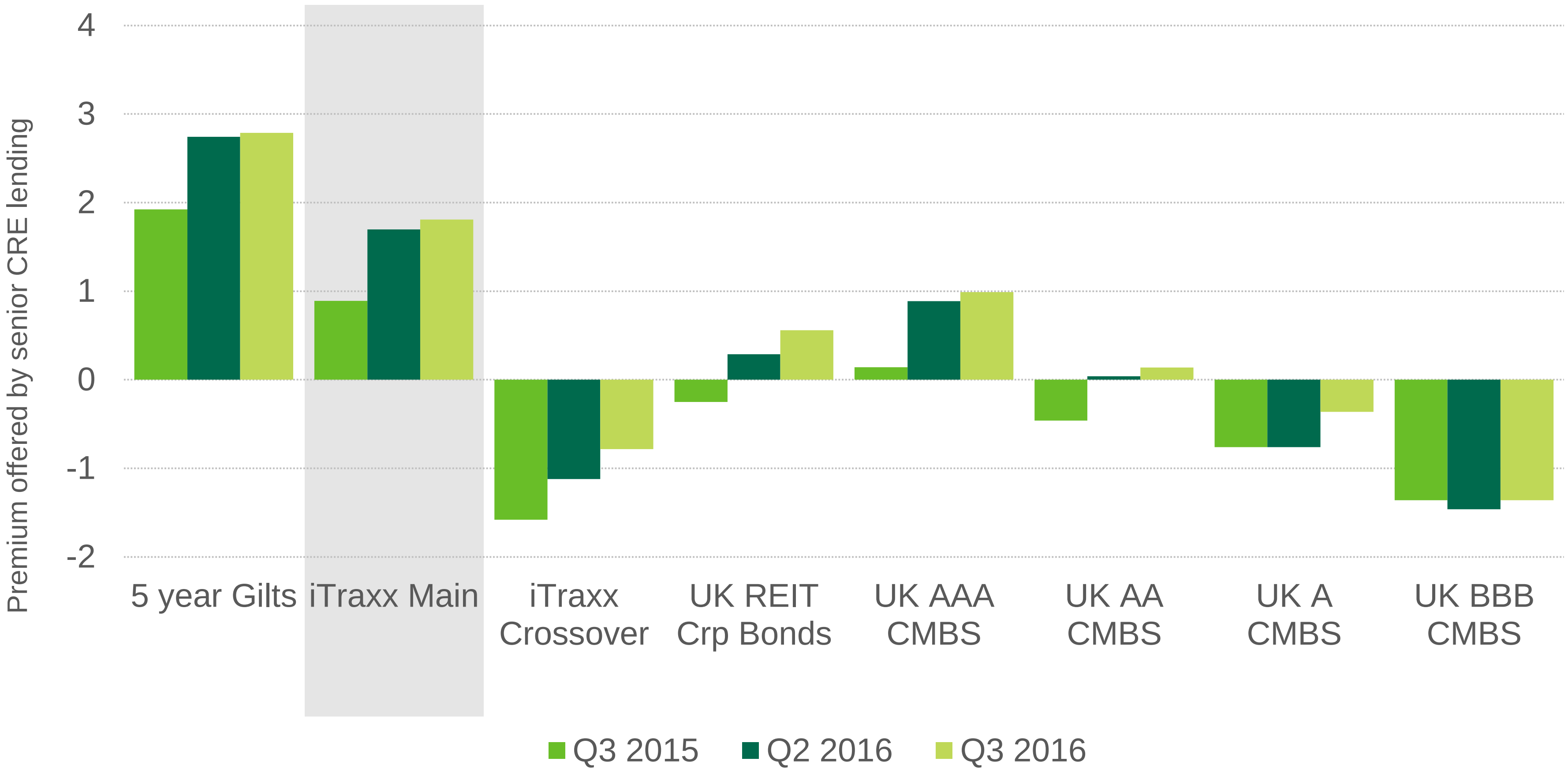
GROSS AND RISK-ADJUSTED RETURN FOR Q4 2015 TO Q3 2016 SENIOR LENDING



Source: CBRE.
Note: Assumes 65% LTV.

CRE DEBT IN A MULTI-ASSET CONTEXT

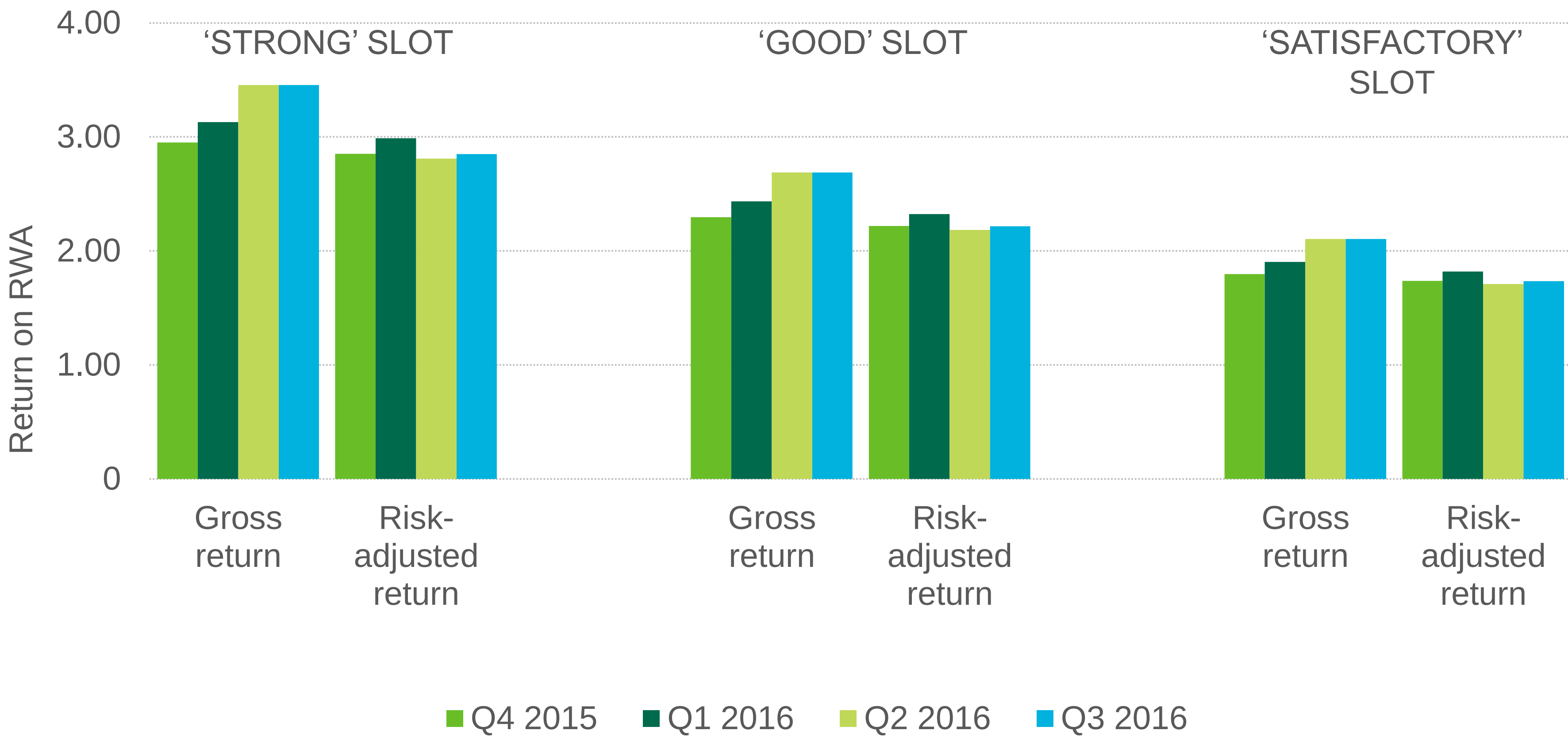
PREMIUM ON CRE DEBT VERSUS OTHER FORMS OF FIXED INCOME, Q3 2015 TO Q3 2016



Source: CBRE, Macrobond.

CHANGING LENDING RETURNS OVER THE LAST NINE MONTHS

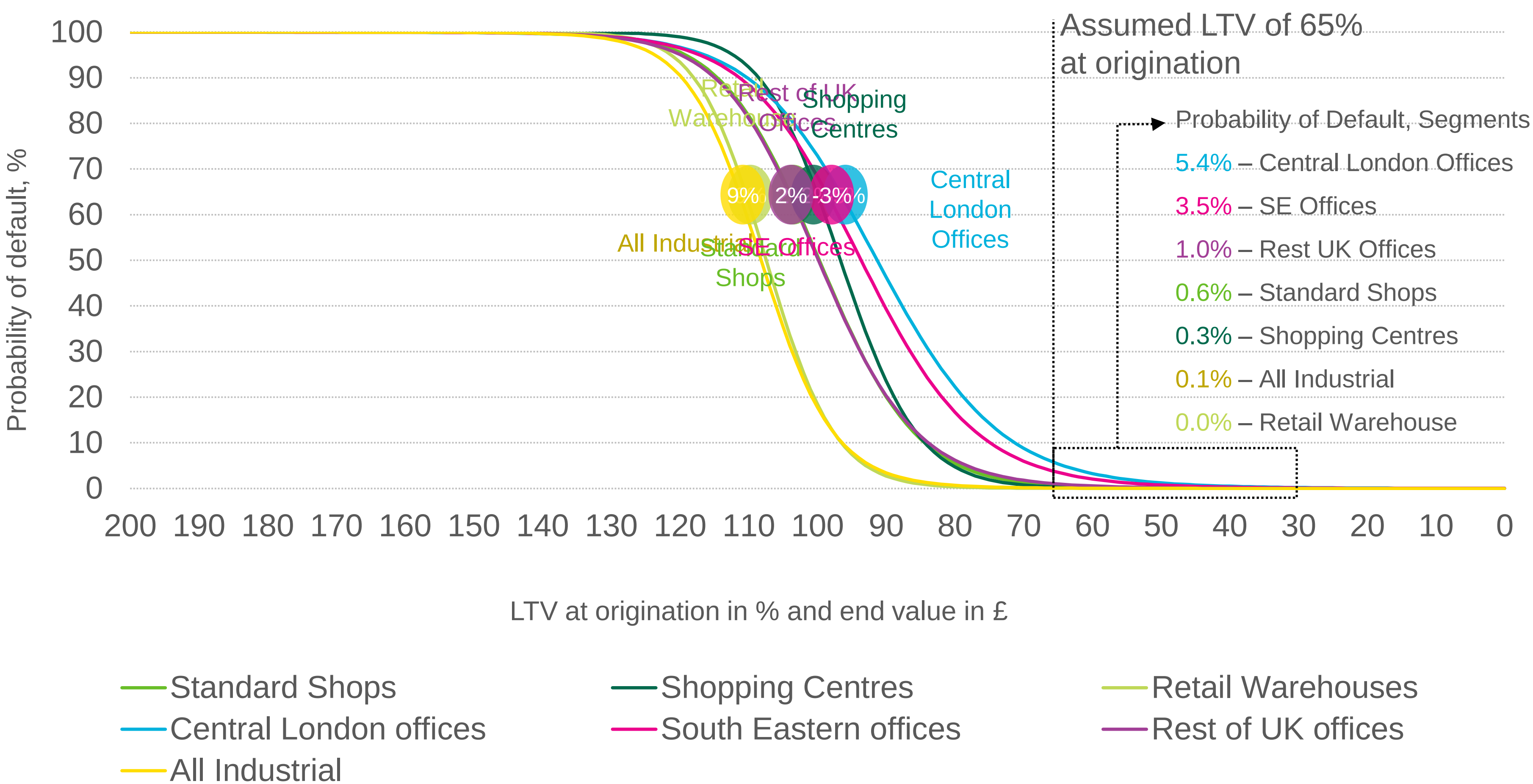
GROSS AND RISK-ADJUSTED RETURN ON RWA FOR Q4 2015 TO Q3 2016 SENIOR LENDING



Source: CBRE, Macrobond.
Note: Assumes 65% LTV.

THE OUTLOOK FOR DIFFERENT SECTORS

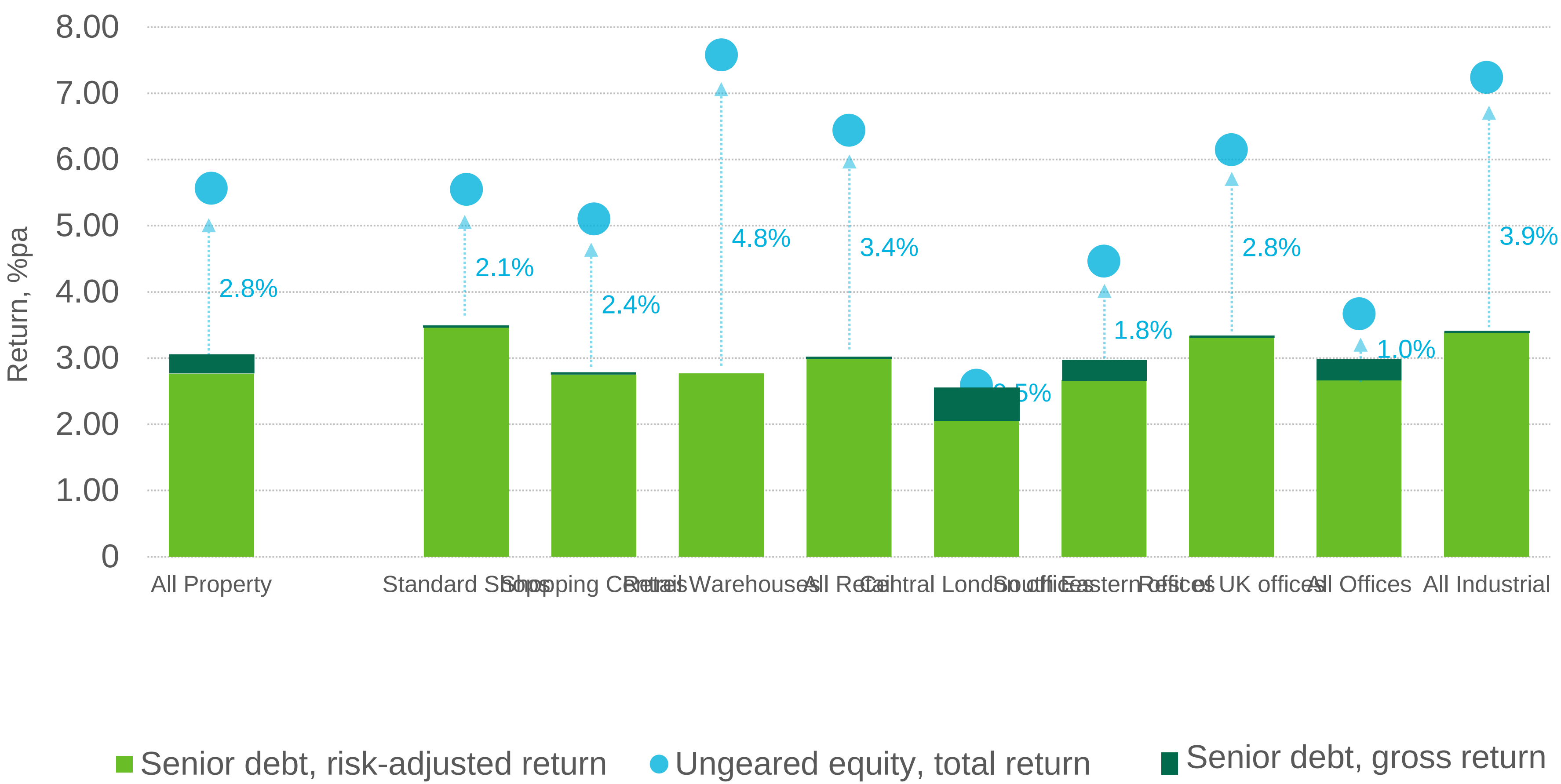
PROBABILITY DISTRIBUTIONS FOR Q3 2016 SENIOR LENDING



Source: CBRE.

RETURNS TO EQUITY AND DEBT

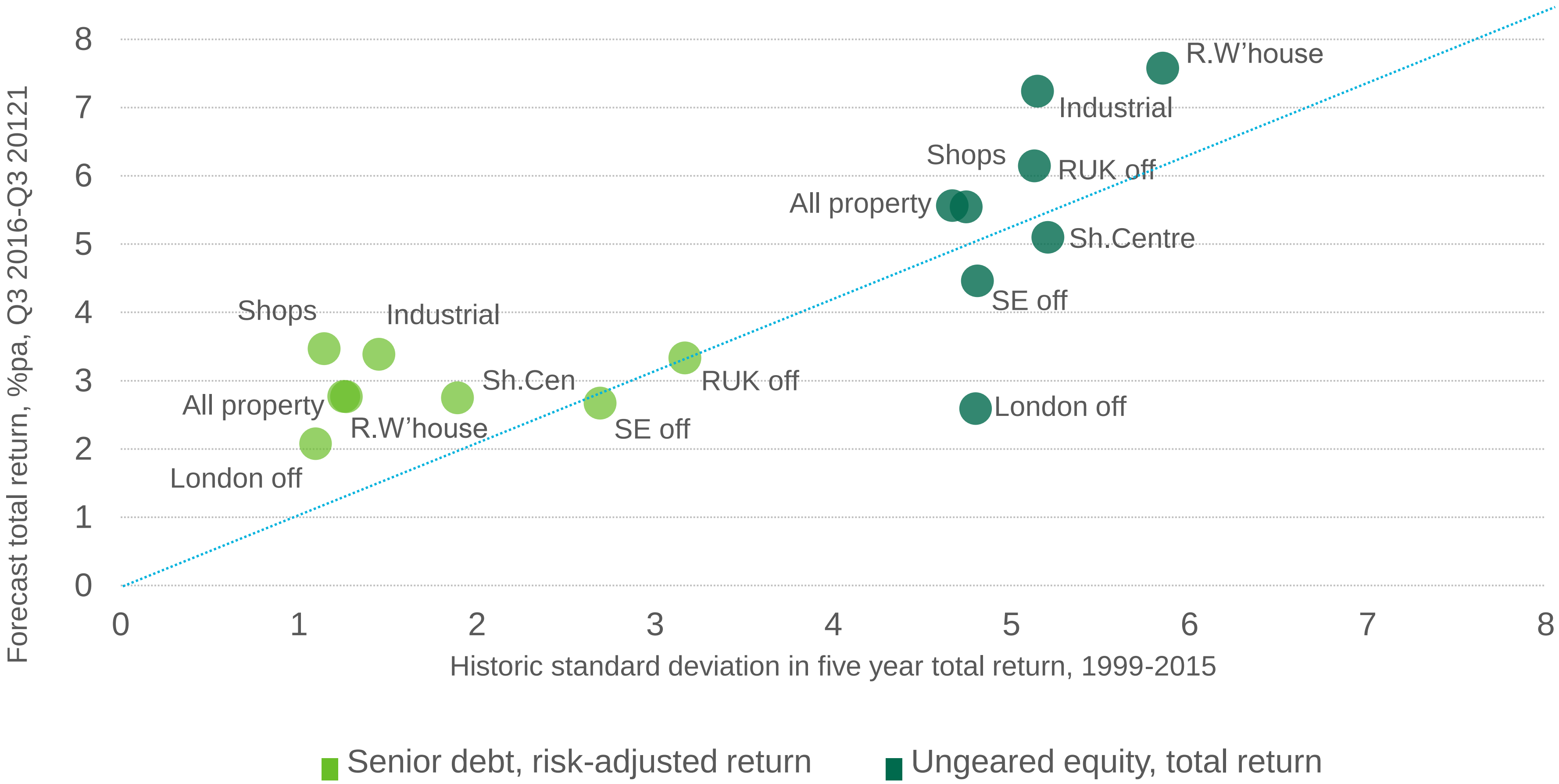
COMPARISON OF RETURNS, EQUITY INVESTMENT AND Q3 2016 SENIOR LENDING



Source: CBRE.

COMPARISON OF RISK AND RETURN

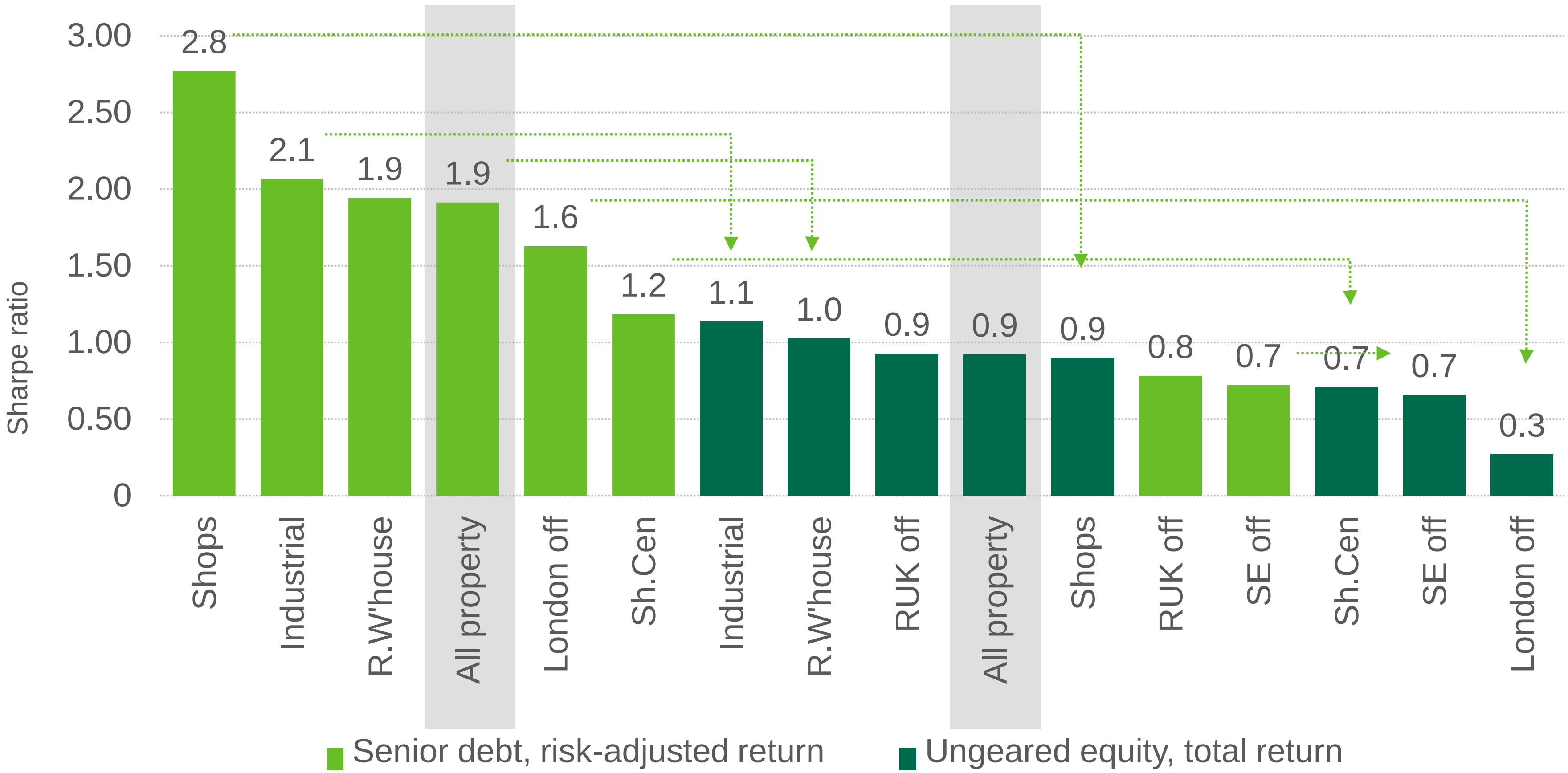
EXPECTED RETURN VERSUS HISTORIC STANDARD DEVIATION IN RETURN



Source: CBRE.

SHARPE RATIO

SHARPE RATIO FOR CRE DEBT AND CRE EQUITY



Source: CBRE.

CONCLUSIONS

SENIOR LENDING RETURNS c.3%

LOW CAPITAL GROWTH OUTLOOK DRIVES PD UP TO 2% AT 65% LTV – STILL MODEST, AND SUB-1% AT 55% LTV

PREMIUM TO GILTS 2.5-2.8% AND RISING

MARGINS UP 25BPS POST-BREXIT VOTE

PREMIUM TO CORPORATE DEBT 1.8% AND RISING

EQUITY PREMIUM FAIR, BUT NO MORE

LOW VOLATILITY OF CRE DEBT MAKES IT A CLEAR RISK-ADJUSTED WINNER

FOR FURTHER INFORMATION

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VISIT OUR MICROSITE FOR QUARTERLY PUBLICATIONS AND TOPICAL THOUGHT LEADERSHIP ITEMS – www.valuedinsights.cbre.co.uk/debt-analytics

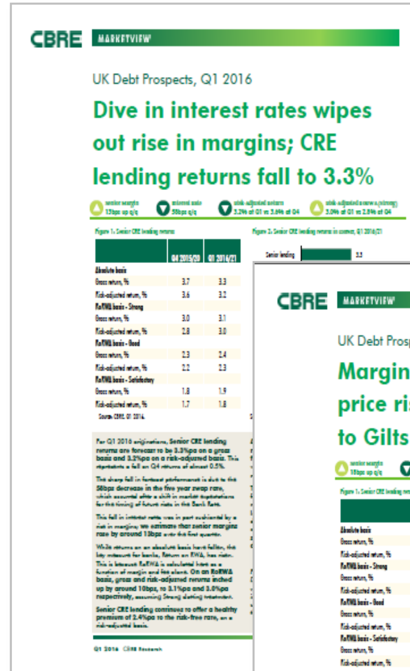

CBRE VIEWPOINT UNITED KINGDOM BREXIT BRIEFING 2016

Valuation & Advisory July 2016

Brexit: The Banking Response

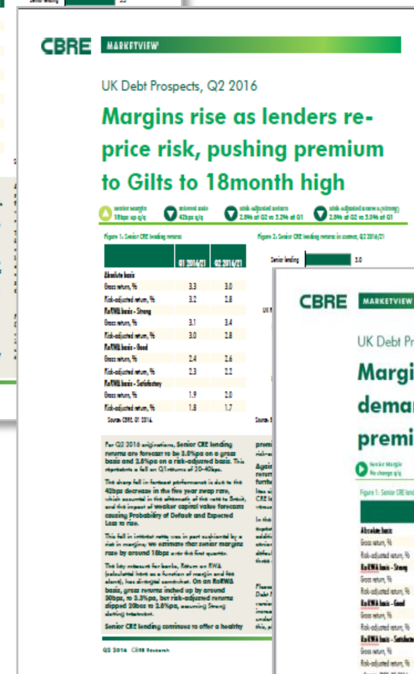
Dominic Smith
Head of Real Estate Debt Analytics
London Valuation Advisory – Investment Valuation

Among the many financial market considerations being speculated upon in the wake of Brexit is the appetite for bank lending to commercial real estate. A fall in capital values and consequent rise in LTVs on existing lending could push up capital requirements, making historic lending less profitable and diminishing the availability of funds for future lending. However, in analysing some of the more adverse anticipated market scenarios, we find that any capital shortfall is likely to be minimal – a minute fraction of that facing the industry in the 2008/09 crisis. So, Bank lending to commercial real estate will not be significantly curtailed by capital constraints brought on by post-vote market jitters. Furthermore, recent action by the Bank of England to reduce the counter-cyclical capital requirement will in effect act to dampen the impact of rising RWAs on balance sheets. Of course, other factors may influence lending behaviour on the part of the banks, but restructuring in the UK lending market means that borrowers are far less exposed to one type of lender than was the case a decade ago.


CBRE MARKETVIEW

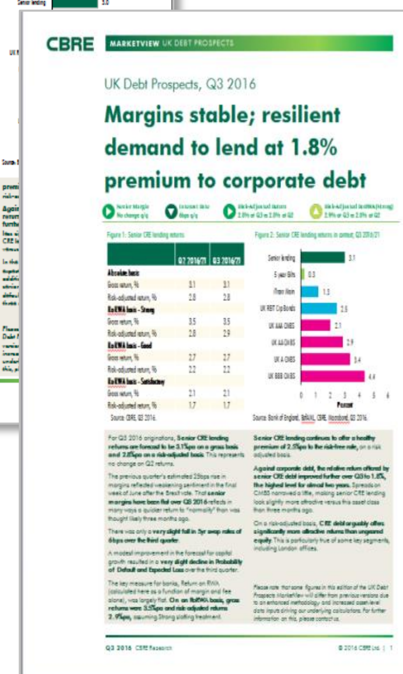
UK Debt Prospects, Q1 2016

Dive in interest rates wipes out rise in margins; CRE lending returns fall to 3.3%


CBRE MARKETVIEW

UK Debt Prospects, Q2 2016

Margins rise as lenders re-price risk, pushing premium to Gilts to 18month high


CBRE MARKETVIEW UK DEBT PROSPECTS

UK Debt Prospects, Q3 2016

Margins stable; resilient demand to lend at 1.8% premium to corporate debt

Questions……..?

ALUMNI

Cambridge University
Land Society

Thank you…...

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