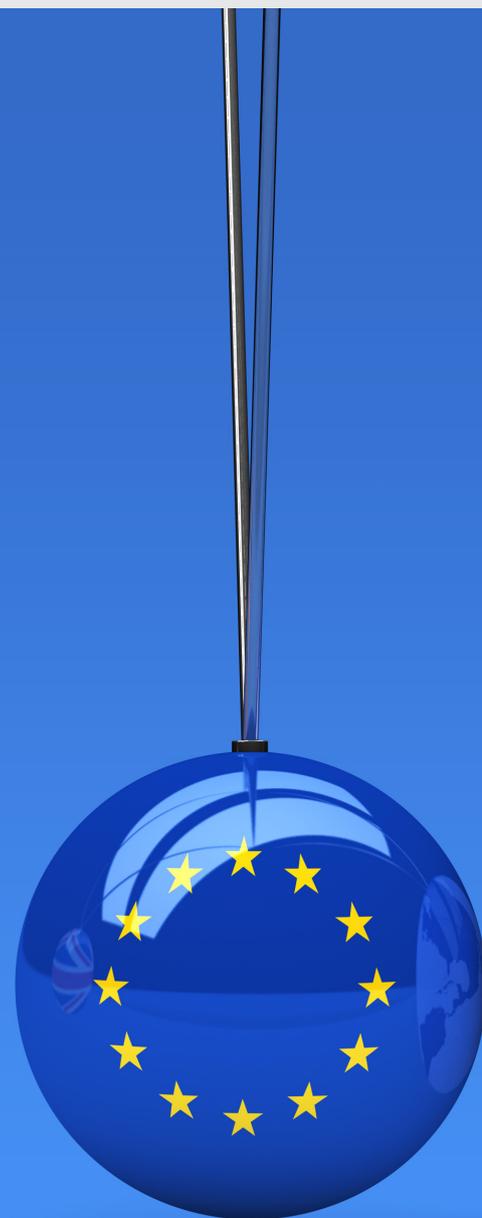


POST REFERENDUM

Impact on UK commercial property - the next leg of the journey





EXECUTIVE SUMMARY

- Opportunism may be undermining business pessimism and may explain a post-referendum 'relief rally'. Given numerous global uncertainties, including EU instability, the UK is likely to maintain its safe haven status.
- The government will not offer a Brexit plan until late Autumn and plans to present it at the European Council Summit in December. Initial perspectives may be publicised as part of the Tory Party Conference in October.
- Monetary policy remains accommodative and will assist a government pivot to fiscal stimulus by keeping government borrowing rates low. Sterling will remain weak (especially if US raises rates) and boost foreign investment into the UK in Q4 16.
- Despite monetary policy loosening, commercial property lending has tightened with LTVs slipping and lending margins increasing.
- Survey data shows that the UK may avoid recession. Hard data is not available until Q3 16 GDP is released on 27th October. Comprehensive transaction based property data is not available until the IPD Quarterly Index release on 2nd November.
- Property investment transactions were impacted substantially by the referendum. July and August volumes fell by 60% year-on-year. Capital values, based on heavily caveated valuations, are down by around 5% to the end of August.
- Devalued sterling has attracted new sets of international investors to real estate. Key buyers include Asian private investment groups (family trusts) and developers, Middle Eastern privates and opportunistic US private equity and institutions. Numerous under-bidders, including European funds, are forming a firm pricing base.
- Occupational markets are stable UK-wide, although expansionary demand is less evident, especially in London, where net stock absorption was negative in July and August. In contrast, Wells Fargo committed to a London headquarters.
- Key global risks, including the Italian referendum, elections in Spain, France, Germany and US, and the rise of trade protectionism, anti-globalisation and nationalism may overcome perceptions of Brexit risk and act to support UK markets.



POLITICAL

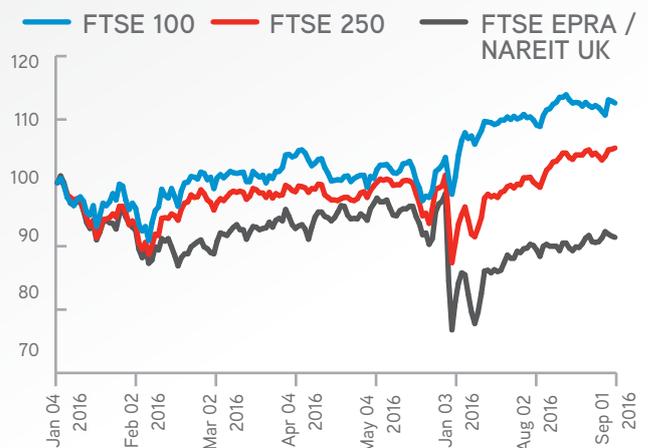
Opportunism may be undermining business pessimism and may explain in part a fragile and uneven, but discernible, post-referendum ‘relief rally’ across equity, bond and indirect property markets. A fledgling sense of greater and beneficent UK autonomy is also palpable with each new EU mis-step, as illustrated profoundly by the Apple-US-EU-Irish tax affair, the apparent unravelling of the Transatlantic Partnership (TTIP) trade deal, national populist backlashes on both sides of the Atlantic and lame duck politics as the Obama years come to a close. A lesser known Italian reform referendum and a perpetually hung Spanish parliament are also likely to begin changing the political geometry of the EU, as will next year’s elections in France and Germany. The UK may yet prove to be a beacon of stability.

Politically, the UK signs are still very hard to read. If anything, Teresa May’s G20 visit in China highlights, that while the world grows impatient, the UK government is not yet willing to pronounce on Brexit plans. The late August Chequers ‘brain dump’ offered a few clues. ‘Hard Brexit’ has received disproportionate verbiage and is supported by an FT op-ed piece by Nigel Lawson suggesting that it offered the cleanest and most efficient way to expedite an exit. He argues that the alternative would otherwise become mired in protracted negotiations as other EU nations work through their own domestic political agendas. Hence, an early Article 50 (January 2017) is being pushed by the ‘Brexiters’ and the Prime Minister has confirmed that such an early date is realistic, satisfied that a general exit strategy can be formulated in the Autumn and presented to the EU as early as the European Council Summit on 15-16 December (FT, 2nd Sep). All eyes will be on the short September parliament session and, especially, the Tory Party Conference (2-5 October) when many policy ideas may begin to be hammered out publicly.

| Key Dates | Events to Watch – Data Releases |
|-------------------------------|---|
| 5th - 15th September | Parliament in session |
| 15th September | MPC Policy Committee Announcement & Minutes |
| 15th September | IPD UK Monthly Property Index |
| 21st September | US Federal Reserve announcement |
| 2nd to 5th October | Tory Party conference |
| 10th October -- 8th November | Parliament in session |
| 17th October | IPD UK Monthly Property Index |
| 27th October | Q3 16 GDP preliminary estimate |
| 1st November | US Federal Reserve announcement |
| 2nd November | IPD UK Quarterly Property Index |
| 3rd November | MPC Policy Committee Announcement & Minutes |
| 8th November | US elections |
| 14th November – 20th December | Parliament in session |
| 14th November | IPD UK Monthly Property Index |
| 23rd November | Autumn Statement |
| 25th November | Q3 16 GDP second estimate |
| 5th December (unconfirmed) | Italian referendum |
| 14th December | US Federal Reserve announcement |
| 15th December | MPC Policy Committee Announcement & Minutes |
| 15th – 16th December | European Council Summit |
| 15th December | IPD UK Monthly Property Index |



Equity Indices and Indirect Property



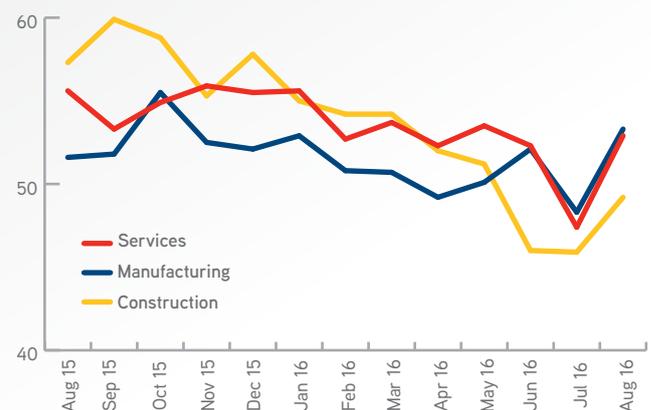
‘A fragile, but discernible, post-referendum “Brexit Bounce” is apparent across asset classes.’

ECONOMIC – FINANCIAL

HM Treasury and the Bank of England are still flying blind, save for a few survey based indicators that suggest that the Monetary Policy Committee may have acted too early and ineffectively. The MPC, on the other hand, might argue that their actions restored confidence. August purchasing manager indices have bounced back to pre-referendum levels and are consistent with economic expansion. While it may be argued that the bounce-back is merely a response to an over-reaction and that it is too soon to declare the bounce-back as definitive, given that business risks are primarily political, a general sense prevails that the modest base rate reduction and further targeted quantitative easing will do little to stimulate business confidence and investment, especially when the MPC actions were accompanied by forecasts showing that a technical recession is possible. Liquidity is certainly not an issue, as it was at the time of earlier QE interventions. The impact on commercial property debt has been minimal. Counterintuitively, lending margins have risen slightly from 2% to around 2.5% at the same time that LTVs have fallen as banks have become more cautious. Senior debt leverage remains in a range of between 50% to 60%. Useful by-products of the new stimulus, though, include entrenching sterling's devaluation. Export orders are up and imports, especially from the EU, are down. For UK property, residential and commercial buy opportunities, offered by weak sterling, are not lost on cross border investors who are all too apparent in the market. Should sterling fall further in response to a US Fed decision to raise rates at their September 21st meeting, the market will receive a substantial boost as foreign investors see even greater value going into the final quarter. A floor for sterling is hard to call, but given that traders are less willing to 'short' sterling, it is hard to see sterling below a \$1.25-\$1.30 range.

The Bank's latest policies have also ensured that government borrowing costs will remain very low for quite a while, hence a pivot to fiscal stimulus is increasingly likely given that the Chancellor has already said that the timing of fiscal targets will be allowed to slip. The Chancellor has a reputation as an austerity hawk, so the idea floated by some of a temporary VAT reduction may be premature. Banks, though, have not yet passed on August's base rate cut to borrowers, so if spending needs to be supported, the VAT reduction could begin to look plausible. If the Chancellor is to be believed and fiscal policies will be addressed in the 'normal course of government business', then the Autumn Statement seems like the likely time for clarity. Falling close to December's European Council Summit suggests that surprises in both content and timing may be in store. It will depend, no doubt, on the hard data as it becomes available in late October with the release of Q3 16 GDP.

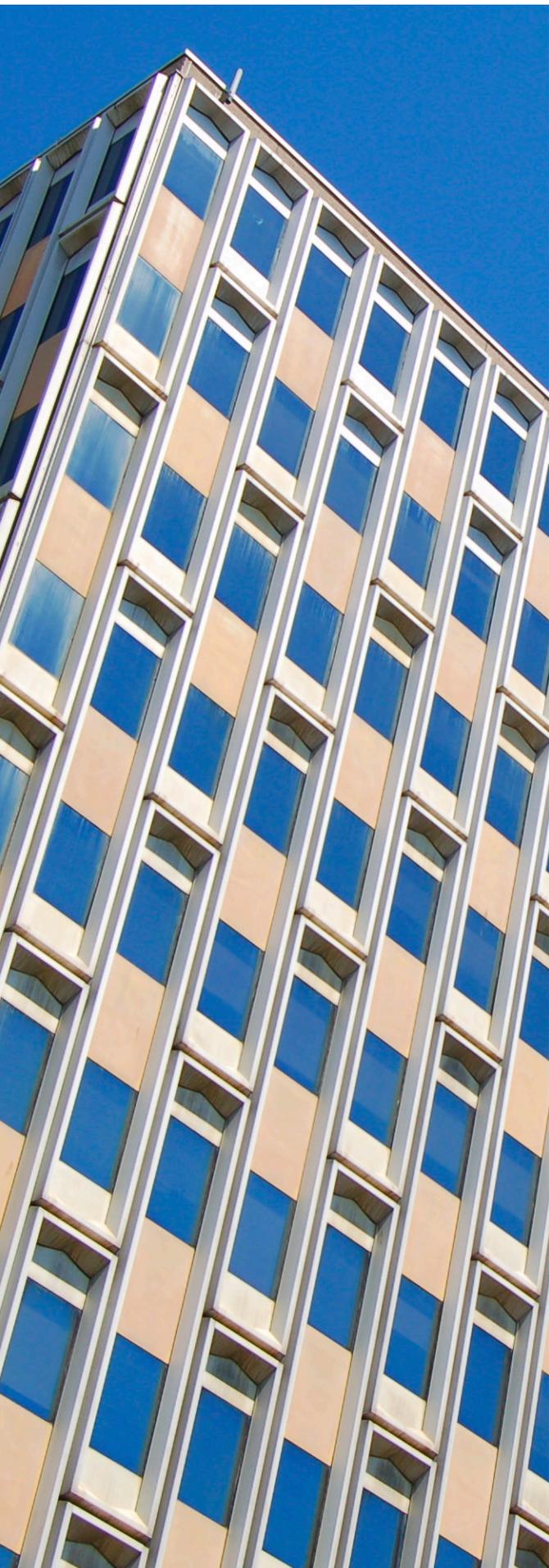
Purchasing Manager Indices



Source: CPI/Markit

'August purchasing manager indices have bounced back to pre-referendum levels and are consistent with economic expansion.'



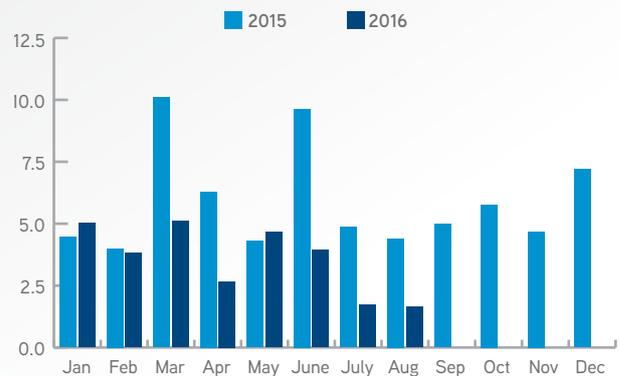


PROPERTY INVESTMENT

Separating the referendum impact on UK commercial property referendum from the impact of a widely anticipated late cycle cooling of prices and activity is difficult. Yields across many market segments had already stalled and a few 'fully priced' prime market segments were already showing signs of yield softening prior to the vote, with capital values showing modest falls as early as March. London prime residential peaked at the end of 2014 and prime commercial peaked in mid-2015. In the absence of post-referendum transactional evidence, valuation sentiment suggests that prices have fallen by around 5% to the end of August, with MSCI/IPD reporting that capital values fell by 2.8% in July.

Retail fund redemption driven sales were instrumental in pushing yields out immediately after the referendum. The funds sought to actively devalue portfolios so as to avoid overpaying investors seeking to exit. As widely reported, several funds soon closed temporarily to redemptions. Some £788m is reported to have been withdrawn by investors from UK funds in July. Whatever opportunistic window that may have existed for redemption sales looks to have been slammed shut about two weeks after the referendum. Since then a few funds are reported to have seen fresh net inflows. This may have been driven, in part, by a modest recovery in REIT pricing, which is in line with March 2016 values, but also by limited alternative positive yield bearing investment options. Income remains king for the risk averse – a theme that recurs across the UK property markets.

UK Investment Volumes (£ billions)



Source: Property Data Ltd

'The vote impacted transaction volumes, which fell precipitously in July . . .'

The vote impacted transaction volumes, which fell precipitously in July to £1.7bn, down from £4.1bn in July 2015 and in line with £1.7bn in July 2009 recorded during the 'Great Recession'. Preliminary data suggests that August volumes will struggle to reach July's subdued level. Deal numbers have fallen and there has been an absence of large deals, although Asian investors are understood to be looking at WeWorks for £290m and US private equity is looking at an M&S portfolio valued at near £500m. Any suggestion that the market resembles that of the Great Recession is unfounded. A moderate cyclical cooling was already underway in the UK and it is truly remarkable that the referendum has not had a greater impact so far.

Strong demand for UK assets is coming from a wide range of cross-border investors spurred on by a 10% devaluation of sterling, an increasingly desperate search for yield and the promise of stable income. For prime assets, a 10% depreciation of sterling equates to an outward yield movement of at least 50 bps of yield. Ironically, despite a vote to 'Leave the EU', EU buyers are a strong part of the demand equation. A handful of EU based funds have successfully acquired, especially in the UK regions, but this belies the true depth of EU interest as numerous EU funds have more often been among the top under-bidders. Waverley Gate in Edinburgh is being purchased by TRIUVA (Germany) at a 5% discount following collapse of a previous deal when a BREXIT clause was invoked.

Asian demand also remains very strong, although the actors have changed as Asian insurance funds have been replaced by private investment groups (family trusts) and developers who continue to find Asian markets expensive. Chinese companies continue to dominate the post referendum London market, but property companies from Singapore and Thailand are also active. Prices may have slipped, but not far -- numerous under-bidders are providing a strong pricing base. In addition to European and Asian-based investors, US private equity and institutions continue to look for value as illustrated, above all, by Brockton Capital's purchase of 10 Hammersmith Grove for £85m – a substantial discount

to £105m asking price and coming on the back of immediate post-referendum redemption pressure. Fortress Investment Group is also reported to be seeking to negotiate £50m off the price of the M&S portfolio.

No individual asset class looks to be a key target, although prime industrial logistics ticks a lot of boxes for investors of all types and origins. The sector is hindered by lack of supply as existing landlords (UK funds) are hesitant to bring difficult to replace long income to the market. Alternative asset classes, especially those offering long income, including hotels, leisure, student accommodation, healthcare and others, account for almost one-quarter of all investment since the referendum. Hotels has attracted considerable domestics and cross border demand.

Given a strengthening economic data profile in the UK, heightened uncertainty in Europe, expectations of a US rate hike, weaker sterling, not to mention the US election, the UK commercial property market is likely to continue to see strong cross-border demand. US private equity, in particular, is likely to remain solid. Prime yields are likely to stabilise further, with forecasts suggesting that total returns to UK property may avoid an outright contraction in 2016. A key question, though, is where will the sales stock come from. Given that the UK retail fund flows are stabilising and there are no signs of any significant forced sales by banks, it may be up to developers and REITs to provide the fodder. In 2017, numerous closed funds expire which will prompt sales, but in large measure, stable income producing assets are likely to be held by existing landlords as they were back in 2009. Not surprisingly, landlords and potential investors alike are focussing increasingly on occupier market performance as income growth will be key to value over the next few years. Although total investment volumes have fallen post referendum, early evidence suggests that a reasonable year-end is in the making. Total volumes have already reached £30bn, with a fair wind, total volumes are likely to approach £50bn, although this will be down by over a quarter on 2015's remarkable £71bn.

| Post-referendum transactions – sample of foreign buyers | Price | Yield | Buyer | Seller |
|---|-------|-------|-----------------------------|----------------|
| M&S portfolio (pending) | £450m | 6.50% | Fortress (US) | Topland |
| Debenhams, Oxford Street | £400m | 2.75% | Ramsbury (Sweden) | British Land |
| 1 St Peter's Square, Manchester | £164m | 5.25% | Deka (Germany) | Argent |
| Boots, Oxford Street | £124m | 3.25% | NORGES (Norway) | Aberdeen AM |
| 23 King Street London | £120m | 3.97% | Wheelock (HK) | Standard Life |
| Ryder Court, St James, London | £115m | 4.35% | Vanke (China) | TH Real Estate |
| Sony HQ, Gt Marlborough St | £104m | 4.50% | Alduwaliya AM (Qatar) | Blackrock |
| 5 King William Street | £88m | 3.72% | Private (Middle East) | Allegra |
| Student accommodation portfolio | £86m | n/a | Arlington (Middle East) | Rockspring |
| 10 Hammersmith Grove | £86m | 6.10% | Brockton Capital | Aberdeen AM |
| 33 Gracechurch St, London | £75m | 5.00% | U City Public (Thailand) | Confidential |
| Waverley Gate, Edinburgh (tbc) | £62m | 5.5% | TRIUVA (Germany) | M&G |
| No. 1 Leeds | £34m | tbc | Credit Suisse (Switzerland) | TRIUVA |
| 63 Queen Victoria Street | £34m | 5.00% | Hoi Hup (Singapore) | Standard Life |
| 12 Moorgate, London | £33m | 4.35% | Minsheng (China) | AIK |
| Vulcan House, Sheffield | £30m | tbc | Trinova (Spain) | Government |

Source: Colliers International

PROPERTY OCCUPATION

UK occupier markets are stable post-referendum with lease expiries, company consolidations and back office relocations moving ahead at a steady pace. Expansionary demand may have cooled, although examples of new market entrants and existing tenant expansions can be found in most markets, especially those supported by new transport infrastructure and development enhancements. Given the ongoing shortage of quality space across asset classes, headline rents are also stable, although the immediate post referendum uncertainty has led some landlords to offer increased incentives. The retail and industrial sectors continue to receive steady support from consumer spending, which has remained relatively robust post referendum. Industrial occupation will continue to be hampered by lack of space that is adaptable to the needs of the new retail economy.

London. Despite its distinction as the epicentre of Brexit risk and despite negative rhetoric and business media posturing, London has received a few recent votes of confidence. An early expression of support arose with Wells Fargo's July confirmation of forward funding of 33 Central (227,000 sq ft) in the City for its own occupation as European headquarters. Likewise, despite the referendum vote, there is no evidence that Apple will walk away from its iconic Battersea project (450,000 sq ft). Given the recent EU-Apple-US tax spat, a signed UK lease may well arrive sooner than expected. Other high profile London deals remain on track. Elsewhere in London, PA Consulting has taken

58,846 sq ft at the Verde Building in Bressenden Place as a new UK headquarters. The UK government has leased 45,000 sq ft in Land Securities Nova South in Victoria for its new National Cyber Security Centre. McKinsey is looking likely to sign a deal for a new 120,000 sq ft London headquarters in Holborn and another 20,000 sq ft has been let in the Shard by a few new tenants. In short, the deal flow suggests that London commercial leasing looks to be business as usual. The deal flow also suggests that domestic operators are not postponing decisions; for internationals, it may still be too soon to say.

Data. In contrast, the latest hard leasing data is ambiguous, at least at first glance. Preliminary Central London net stock absorption figures for July and August suggest that expansionary demand has slowed. Like the investment market, though, it is hard to separate referendum effects from the traditional summer lull. However, given the 2.2m sq ft of pre-let space scheduled to complete before year-end, London looks likely to finish 2016 showing another year of strong expansion.

Vacancy rates across the main submarkets have risen slightly over the summer, but remain very low, ranging from 2.2% in Canary Wharf and Southbank to 3.2% in the City and West End. These are levels that are usually associated with strong rental growth. Mallow Street, a social media pensions network, is reported to have just agreed a lease at 125 Old Broad Street in the City for £120 psf. While it is a small space (1,000 sq ft), it suggests that expectations of rental declines may be premature. Given retrenchment in the development projects beyond 2016, as AXA's on-going review of 22 Bishopsgate suggests, lack of space will continue to support rents, with the latest IPF Consensus forecast showing stability for 2016 and only modest rental declines in 2017.

Central London Net Stock Absorption

| Net Stock Absorption | City | Canary Wharf | Docklands | Southbank | West End | London Total |
|----------------------|-----------|--------------|-----------|-----------|----------|--------------|
| 2015 H1 | 980,533 | 295,173 | 239,860 | -10,758 | 192,815 | 1,402,450 |
| 2015 H2 | 2,321,907 | 297,892 | 271,432 | 290,232 | 595,240 | 3,478,811 |
| 2016 H1 | 205,667 | -37,022 | 96,602 | 66,017 | -314,721 | 53,565 |
| 2016 (H2 to end-Aug) | -514,693 | -89,499 | -117,019 | -71,855 | 129,000 | -569,032 |

Source: Colliers International



Ex-London. Outside of London, it also looks like business as usual. Demand across key regional CBDs remains steady. The Midlands Engine appears to be firing as JLR have taken 468,955 sq ft at a Pro Logis business park. In Greater Manchester, on-going demand, straddling both sides of the referendum, is just under 1.25m sq ft spread across a wide range of professional and finance services. Recent completions include Freshfield's lease for 80,000 sq ft at One New Bailey and Swinton Covea's (French) new lease at 101 Embankment (165,000 sq ft). An American international engineering firm also completed on 10,000 sq ft at Manchester Airport. In Bristol, lack of space has driven demand to out of town sites, where government demand is strong along with construction

firms and housebuilders. Final approval of Hinckley Point is set to create an additional squeeze on space. In the Thames Valley, lease expiries and on-going company consolidations are stable and accompanied by some expansionary demand, as illustrated by an American firm Cognizant's search for additional space outside of London to take advantage of Crossrail opportunities. In Leeds, Lowell Group (debt servicing) is expanding and has leased an additional 60,000 sq ft to add to its existing 80,000 sq ft. In Scotland, where the EU referendum result is layered on residual Scottish referendum uncertainty, only three deals >5,000 sq ft have been concluded, suggesting that the EU referendum may be having a disproportionate impact.

Central London Vacancy Rate

| Vacancy | City | Canary Wharf | Docklands | Southbank | West End | London Total |
|----------------------|------|--------------|-----------|-----------|----------|--------------|
| 2015 H1 | 3.9% | 3.3% | 4.3% | 2.8% | 2.9% | 3.4% |
| 2015 H2 | 2.7% | 1.4% | 2.9% | 2.4% | 2.6% | 2.6% |
| 2016 H1 | 2.6% | 1.6% | 2.4% | 1.9% | 3.1% | 2.7% |
| 2016 (H2 to end-Aug) | 3.2% | 2.2% | 3.0% | 2.2% | 3.2% | 3.1% |

Source: Colliers International

Regional Office Leases – Post Referendum

| Regional office leases – post referendum | Size sq ft | Tenant | Sector |
|--|------------|--------------------------|-----------------------|
| Ryton – Pro Logis Park | 468,955 | JLR (Tata - India) | Automotive |
| Manchester – 101 Embankment | 165,000 | Swinton Covea (French) | Insurance |
| Salford – 4 Exchange Quay | 94,036 | AJ Bell Ltd | Investment management |
| Manchester – One New Bailey | 80,000 | Freshfields (UK) | Professional services |
| Bristol – 10 Templeback | 23,207 | Ovo Energy (UK) | Energy supplier |
| Birmingham – Quay Place | 17,271 | Bouyges UK (France) | Construction |
| Redditch – Paper Mill Drive | 11,952 | MWH Global (US) | Engineering |
| Edinburgh – 81-85 George Street | 10,000 | Intergen (China, Canada) | Energy infrastructure |

Source: Colliers International

MARKET RISKS

- Given the surprising degree of market stability in the wake of the EU referendum, there is a substantial amount of uncertainty that is not likely to be dispelled until a clear Brexit Plan is unveiled later this Autumn. The property market outlook for 2017 is linked to the question of whether a clear strategic plan will be enough to support business confidence or whether uncertainty will remain until the tactical details and chances of eventual success are apparent. The UK faces several challenges in extricating itself from the EU. Whether it is the timing of Article 50, the extent of EU market access, the degree of 'passporting' rights, autonomy in financial and professional services regulation or the contentious degree of free movement of labour.
- On the other hand, numerous international political and geopolitical risks may act to mitigate Brexit concerns. The EU and the Eurozone in particular have the capacity to unsettle European business confidence. The Italian reform referendum is one key bellwether of the ability of individual countries to make political reforms deemed necessary to bring their economies more closely in line with Eurozone requirements. Failure of the referendum is likely to unseat the existing government and raises the possibility of new Eurosceptic parties forming a government. The proposed reforms are less to do with banking and finance as they are with labour market flexibility. Spain is also struggling with government stability and reform. Elections in France and Germany in 2017 will also showcase internal domestic stresses, especially in relation to free movement within the EU.
- In the US, the possibility of electing a president who promotes trade protectionism suggests that TTIP and TPP trade deals will be shelved. Reversing globalisation is likely to have a major impact on global perceptions of the US as an investment target and is likely to generate new and unpredictable flows of international capital. As a free trade proponent, the UK may well see a substantial benefit. As suggested at the outset, given the international context, and despite recent sovereign downgrades by international rating agencies, the UK may find its traditional safe haven status fully intact.





554 offices in
66 countries on
6 continents

\$2.5

billion in
annual revenue

2.0

billion square feet
under management

16,000

professionals
and staff

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