UK Monthly *Commentary*

UK Valuation Advisory – January 2016

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UK Monthly Commentary

Finance

- US federal reserve rate at 0.5% The US central bank has raised interest rates by a quarter percentage point and pledged a gradual pace of increases
- UK base rate unchanged at 0.5%
- 5-Year swap rate 1.59% (Beginning December 1.35%). 10-Year Rate 1.99% (Beginning December 1.79%)
- Margin of LIBOR above base rate circa nine basis points (LIBOR at 0.59)
- Bank lending, 65% LTV maximum, margins range from 150 basis points plus, depending on asset, borrower and LTV, expanding group of lenders and range of loan terms including development finance. Some mezzanine funding now available
- European banking market slowly improving, still banks using ECB unlimited short term lending. The ECB injecting €60bn per month 'QE' considering increasing amount. Current Greek government close to meeting initial bail out conditions, and transfer of 'new' bailout funds. IMF consensus that €100bn plus debt 'write down' needed to enable Greek economy to survive and grow

Economic view

- The FTSE 100 index at 6,242 down from 6,396 at the beginning of December. This compares to 6,566 this time last year
- Inflation RPIX (excluding mortgage interest payments) at 1.1% as of November 2015. CPI rose by 0.1% in the year to November 2015, compared with a 0.1% fall in the year to October 2015. Movements in transport costs and alcohol and tobacco prices were the main contributors to the rise in the rate. Falling clothing prices partially offset the rise
- Comparing August to October 2015 with a year earlier, pay for employees in Great Britain increased by 2.4% including bonuses and by 2.0% excluding bonuses
- Retail sales volumes increased by 5.0% in November 2015 compared to November 2014
- Business services (78.6% of GDP) is estimated to have increased by 2.1% in October 2015 compared with October 2014. The largest contribution growth from: distribution, hotels and restaurants, (0.9 percentage points). The UK's deficit on trade in goods and services was estimated to have been £4.1m in October 2015, a widening of £3.1bn from September 2015
- Slower manufacturing export growth, UK manufacturing activity positive, but PMI for December fell to a three-month low 51.9
- Unemployment rate was 5.2%, lower than for a year earlier (6.0%). It has not been lower since the three months to January 2006. There were 1.71m unemployed people, 110,000 fewer than for May to July 2015
- Annual house price growth increased to 4.5% in December. London house price growth increased to 12.2% in Q4
- GDP for 2015 at 2.2% and 2016 forecast at 2.4%

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Property view

- IPD total returns for all property in the 12 months to November 2015 14.29% (October 2015 14.73%)
- IPD total returns for the sectors in the 12 months to November 2015 were: Offices 19.13% (October 2015 19.87%), industrial 18.11% (October 2015 18.77%), retail 9.01% (October 2015 9.14%)
- Rental index (monthly rates) up 0.32% (Offices up 0.51%, Industrial up 0.54% and retail up 0.06%)
- Investment volumes £60,520m year to date December 2015. (Compared to £63,280m in 2014)

Sentiment

- Prices moving up with more buyers for sound investments. Demand very competitive for quality assets across UK especially in South East London, attracting 'safe haven' and of trophy investment. Buyers from Sovereign Wealth Funds, Asia Pacific, Germany, US, Middle East also UK private/'opportunity' fund/investors property companies, UK institutions. Yield compression starting to slow, still moving inwards for the time being. IPD all property equivalent yield at the end of November 2015 is 6.12%

International

- Economic activity in the U.S. manufacturing sector contracted in December for the second consecutive month, while the overall economy grew for the 79th consecutive month. The December PMI registered 48.2%, a decrease of 0.4 percentage point from the November reading of 48.6%. GDP 2015 forecast at 2.5% and 2016 forecast at 2.6%. The US Economy grew 2.2% (y-o-y) in Q3 2015
- Brent Crude at $35.7 a barrel. (Since testing $30 and below)
- Across the EU, GDP expanded by 1.8% in 2015 and 2.1% forecast in 2016. In the Eurozone, GDP growth for 2015 at 1.5% and 2016 forecast at 1.8%
- Unemployment in the Eurozone at 10.5% in November 2015 (16.924m people). 24.6% in Greece (youth 49.5%), 21.4% in Spain (youth 47.5%). Eurozone youth unemployment was 22.5% in November 2015. Germany unemployment 4.5%
- Asia GDP growth forecast for 2015 at 4.4%
- Malaysia: GDP 2015 at 4.7%; Vietnam: 2015 forecast at 6.2%; Japan GDP growth at 0.5% in 2015; Singapore: GDP growth at 1.8% in 2015; South Korea: GDP growth at 2.5% in 2015; Hong Kong, China: GDP growth at 2.5% in 2015
- China: GDP growth forecast for 2015 around 6.3%. Increased private sector consumption taking up slack as management of economy continues with overall success. Some equity market volatility inevitable during this phase, stabilised as much as possible, by market control instructions

JLL prime yields

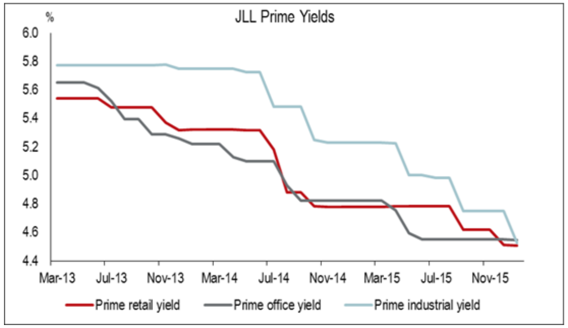
Sector	Yield	Movement since last month	Movement over last 12 months
RETAIL			
Prime High Street	4.00%	↔	↓
Regional High Street	4.50%	↔	↓
Food stores – supermarkets	4.50%	↔	↑
Shopping Centre (regional dominant)	4.25%	↔	↓
Shopping Centre (secondary)	7.00%	↔	↓
Shopping Centre (tertiary)	9.00%	↔	↔
Retail Warehouse, solus unit – bulky	5.75%	↔	↔
Retail Warehouse (Open A1/Fashion parks)	4.25%	↔	↔
OFFICES			
City (lot size up to £40 million)	4.00%	↔	↓
West End (£10 million to £80 million)	3.75%	↔	↓
Fringe City / Inner London	5.25%	↔	↓
Regional City Centre	5.00%	↔	↓
Business Parks – South East	5.50%	↔	↓
INDUSTRIALS			
South East single let	4.75%	↔	↓
Regional single let	5.00%	↔	↓
South East multi let	4.50%	↓	↓
Regional multi let	5.50%	↔	↓
LEISURE			
City Centre	5.25%	↔	↓
Out of Town	5.25%	↔	↓
JLL Prime Yield	**4.54%**	↓	↓
MONEY MARKETS			
Swap (five year)	1.59%	↑	↓

Note: Yields are generated by JLL based on the latest evidence of deals by JLL and other agents. The prime yield series is a weighted yield (derived from capital values) based on individual prime yields.

Prime yield relates to well-specified, well configured grade A stock let at a rack rent on a 10-15 year lease in a prime location to a strong covenant.

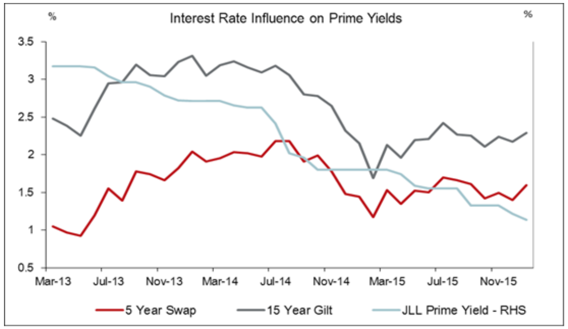
Interest rate influence on prime yields

Source: JLL; Thomson Reuters Datastream



JLL prime yields

Source: JLL



JLL prime yields

The JLL prime yield ended the year moving in from 4.58% to 4.54%. The headline prime yield compressed by 35 basis points in 2015. The industrial prime yield came in the most during the year, by 70 basis points followed by the office and retail sectors both declining by 35 basis points.

- Starting with investment in the City & Docklands, December recorded £1.9bn across 24 deals, representing over 16% of the total turnover for 2015. 2015 was another robust year, with £11.4bn transacted across 165 deals, although this was below the 2014 figure of £12.4bn. Key deals included (i) 262 High Holborn, WC1 – sold by Standard Life to Lazari for £34m reflecting a capital value of £1,111 per sq ft (ii) Bloomberg Place, WC1 – M&G paid £92.5m for the freehold, reflecting a NIY of 2.89% (iii) Thames Court, EC4 – bought by a private European investor for £195m reflecting a NIY of 4.99%

- In the West End investment market, December recorded £1.2bn, nearly £450m ahead of the equivalent figure last year. This brought the total investment volumes for 2015 to £7.1bn, traded across 120 transactions. Key deals included (i) Almack House, St James – sold by the Grosvenor Fund for £230m, reflecting a NIY of sub 3.5%. (ii) Canadian pension fund PSP entered into a joint venture with Aviva to buy 14 prime assets worth £1bn, the largest Central London transaction of 2015 (iii) 40 Dover St – acquired by a Hong Kong investor for £90m, reflecting a NIY of 3.05%

- In the national office sector, the second half of last year saw a continued weight of money but not in the same quantum as it was in Q1/Q2 which was largely driven by the retail funds. Although the inflows improved over the back end of the year, we saw a cautious approach to investment adopted by a number of the UK funds. Transaction wise, it was a strong end to the year which supports forecasts that Western Corridor investment volumes for 2015 will be close to £3bn. This will eclipse the total volumes achieved in 2014 of £1.1bn. Key deals include (i) Brockton sold two buildings to Standard Life, Urban Building, Slough (£27.5m) and One Valpy, Reading (£29.4m) (ii) AEW acquired SEGRO's Bath Road development for £325m, reflecting a NIY of 6.3%

- Turning to retail, 2015's investment volumes were over £3bn, above 2014's level. Key deals include (i) McArthur Glen Outlet Centre, Bridgend – sold by Henderson to M & G to £115m reflecting a NIY of 5.75% (ii) Borehamwood Shopping Centre – sold by Aviva to Henderson for £105m reflecting a NIY of 5.03%

- There were 155 recorded transactions in 2015 within the out of town investment market, with a total value of £4bn, significantly higher than 2014's total of £1.9bn. The biggest individual deal was Parkgate retail park in Rotherham sold in August for £175m, reflecting a NIY of 5.7%

- Finally, in the debt markets, debt origination will end up in the region of the £52-57bn range for the full year 2015, comparing with £45bn in 2014. This would represent the best single year of origination since 2007. This all points to a debt market that has now reached a point of stabilisation and that should mean a year of continued good debt availability across the UK market. There were a few notable deals closed in December including the huge, reportedly up to £900m, loan from AIG to finance the redevelopment of Camden Lock by Israeli entrepreneur Teddy Sagi. Lone Star also agreed £130m of debt to fund their mixed used development in Elephant and Castle from Lloyds and Wells Fargo. On the investment side, Value Retail refinanced Bicester Village with a group of five banks, increasing their leverage to £425m from £320m just two and a half years ago

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