DISRUPTIVE CHANGE LEADS TO OPPORTUNITY

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How has political uncertainty impacted UK real estate?

Any form of uncertainty is disruptive. The hung parliament result of the June general election, with no party obtaining a majority, created renewed doubt at a time when the electorate needed strong leadership and direction to navigate the complicated process of Brexit. However, the economy's resilience immediately following the vote calls into question the link between political uncertainty and economic activity. More importantly perhaps, it is the ongoing negotiations with the EU which many occupiers and investors are keeping a close eye on, before making real estate decisions.

It is currently difficult for many UK based businesses to make long-term strategic decisions about expansion, growth and investment due to the unknown outcome of the exit process. As a result, we envisage occupier demand for space in some sectors to ease moderately over the next two years. However, there remains relative stability in demand across most occupational markets and significant supply restrictions versus their long term averages.

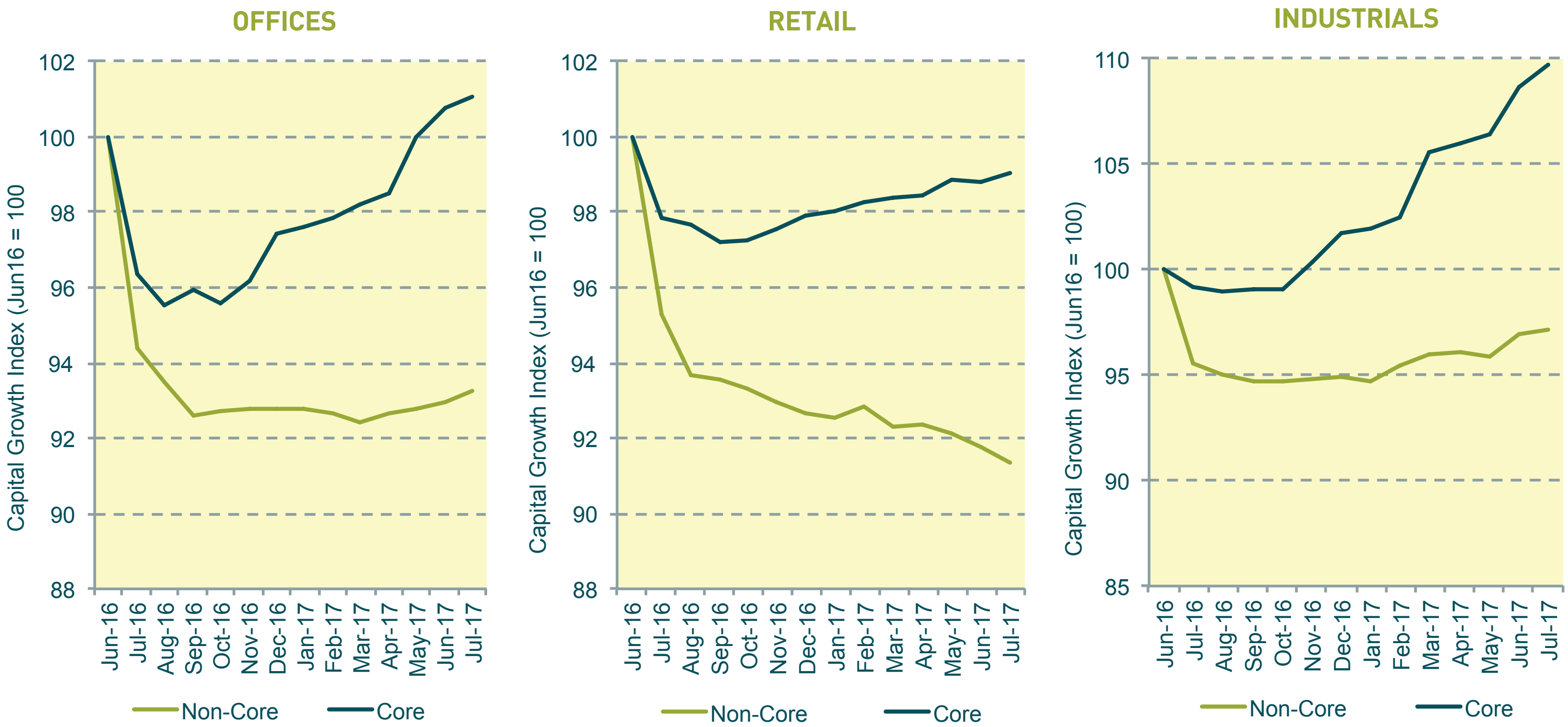
Domestic investors are focusing on 'safe haven' assets that demonstrate defensive income or have the potential for further growth, which has underpinned the pricing of core assets. As they are shying away from perceived risk, there is a divergence of pricing for non-core assets, which has fallen some 7% since the EU referendum result last year; we expect to see further weakness in these assets. Yields for core assets continue to be driven downwards by overseas buyers, partly attracted by the relative weakness of sterling.

More than a year on since the EU Referendum, what is the latest outlook for the UK economy?

The UK is settling into a period of slower growth owing to inflationary pressure eroding real wages and limiting consumer spending. Current

Non-core asset values diverge from core across all sectors

CBRE PROPERTY VALUATION CAPITAL GROWTH, INDEX JUNE 16 = 100



Source: CBRE (data to July 2017)

consensus forecasts show the UK economy expanding by 1.6% this year with further softening projected in the short term and growth of 1.4% for 2018.

What are the key macro trends impacting the shape of demand for property in the UK?

Firstly, a growing population. The UK population exceeded 65 million last year and is projected to grow beyond 70 million in the next twenty years. Secondly, urban densification. Limited available land and the preference of the younger generation to live, work and spend leisure time within the same area is driving growth in cities. Urbanisation and the over-arching need for more residential units is putting upward pressure on commercial land, exacerbating the current lack of quality supply in both logistics and offices. This provides an opportunity for asset managers to either create core product through new build development, or to upgrade the quality of existing buildings situated in the right location, through active refurbishment. Any form of reconfiguration is likely to intensify the building's use, improve efficiency and, where appropriate, include a combination of different uses.

The Government will continue to try to rebalance the economy beyond London and the South East and has earmarked £26 billion of investment by 2020 for transport and infrastructure to boost the connectivity of the Midlands and Northern regions of Britain. Together with the devolution of Government powers to key regional cities, we expect to see certain cities unlocking sites for urban regeneration.

Another key trend is technological innovation. We have already seen, and continue to feel the impact of the rise of e-commerce. Retailers are being forced to adapt in order to attract customers to their stores, while the need for logistics space to deliver goods 'anywhere anytime' is boosting demand for urban logistics and hub and spoke schemes. These technological advances will continue to shape both occupational and investment decisions, whether it be through automation, reducing the amount of floor space businesses require, the advent of driverless vehicles unlocking new logistics hub locations, or through higher quality and better availability of broadband across the country. It is important for us to be mindful of such innovations and incorporate them into our investment thinking and strategy.

Where are the opportunities for property investors in the UK?

It is about unlocking the value in supply constrained submarkets. By targeting well-located, non-core real estate, requiring active asset management and/or refurbishment, there is the potential to improve the income profile of the property. For example, a centrally located, but older office building could benefit from the application of capital expenditure to refurbish and modernise the asset, which would ultimately make the property more competitive and appealing to occupiers.

In retail, assets which either offer convenience or an experience should succeed despite weaker consumer confidence. This is likely to lead to greater polarisation between better performing retail, including dominant shopping centres with a diverse offering incorporating leisure, and poor retail, such as high street shops in oversupplied second tier towns. We can take advantage of this in the right location where there is risk aversion and pricing arbitrage on good schemes with short weighted average unexpired lease term and capex requirements.

The strongest prospects for growth in logistics are at locations serving London and the South East, but the weight of capital chasing this market is pushing values to levels that are difficult to justify from an investment perspective. Speculative development in these locations is an option. The large regional centres of Manchester, Leeds, Birmingham and Bristol are appealing, particularly for urban logistics, as occupiers look to serve these major conurbations.

In a market environment like this, what does it take for investors to succeed?

An in-depth understanding of the underlying occupational market is crucial to identifying the best opportunities. Knowing how to price risk is essential and comes from extensive research and experience in evaluating a particular submarket's fundamentals. Finally, timing entry into a particular sub-sector and always having sight of an exit will ultimately determine strong returns.

ACTIVE MANAGEMENT IN ACTION: 56-70 PUTNEY HIGH STREET, LONDON

This 38,584 sq ft retail scheme is located in a prime high street location on the south bank of the river Thames in an affluent suburb of London. It is served by excellent transport links and is a highly desirable location to live, work and play. There is significant latent growth in local retail market compared to local competing centres. The retail block of four units is let to TK Maxx, Halfords, Barclays and Superdrug. Planning permission has been granted for 97 residential units on five floors above the retail, providing a clear opportunity to unlock significant development potential. We agreed deals in principle with all tenants prior to completing on the acquisition to ensure delivery of vacant possession. Our collective established skills at M&G Real Estate in planning, development management, leasing and residential sales combine together to aim to achieve optimal value enhancement on the asset.

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