UK Property Market Trends

October 2020

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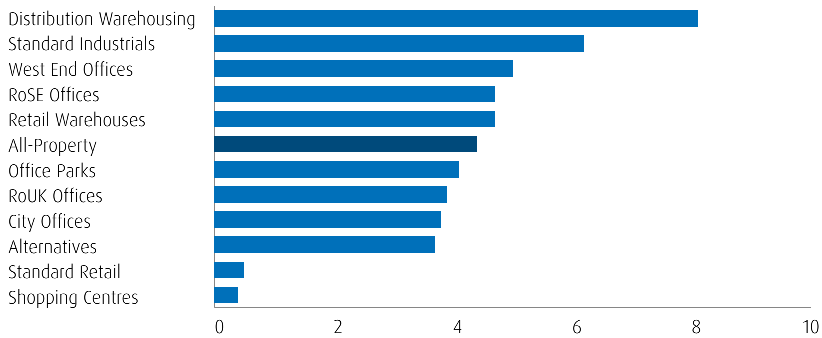
The property market has seen some signs of stabilisation but performance is expected to remain polarised.

The recovery is likely to be gradual and with downside risks. After a poor 2020, BMO REP anticipates all-property total returns to average 4.4% pa in the five years to end-2025.

BMO REP Forecast Total Returns by Segment, Five Years to end 2025 per cent per annum



Source: BMO REP Oct-20

Forecasts are provided for illustrative purposes; are not a guarantee of future performance; should not be relied upon for investment decisions; and are subject to change without notice.

Key Risks

Our review and outlook is a marketing communication providing an overview of the recent economic and property market environment. It should not be considered as advice or a recommendation to buy, sell or hold investments. Nor is it investment research and has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination.

The value of investments and income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

The value of directly held property reflects the opinion of valuers and is reviewed periodically. These assets can also be illiquid and significant or persistent redemptions may require the manager to sell properties at a lower market value adversely affecting the value of your investment.

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Economic and Property Market Overview

There was a quarter on quarter improvement in total returns across all parts of the market, with industrial/distribution delivering the best performance.

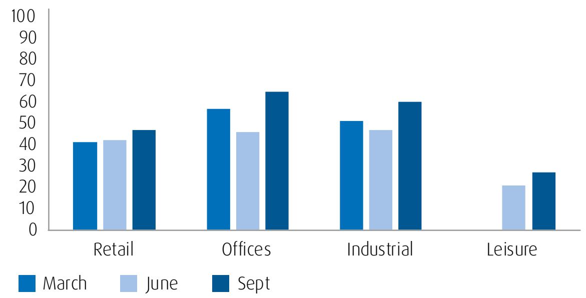
Market Snapshot three months to Sep-20	All	Retail	Offices	Industrial	Alternatives
Total Return	0.7	-0.9	0.5	2.2	-0.1
Income Return	1.4	1.8	1.2	1.2	1.3
Capital Growth	-0.7	-2.7	-0.7	1.0	-1.4
Rental Growth	-0.7	-2.1	-0.4	0.3	-1.0
Gross Rent Passing	-0.9	-3.5	0.5	0.3	-0.1
Net Initial Yield	5.1	6.6	4.6	4.5	4.9

Source: MSCI UK Monthly Property Digest Sep-20. The definition of Alternatives is the Portfolio Analysis Service definition of "other" which includes hotels, residential, leisure etc.

Past performance is not an indication of future performance.

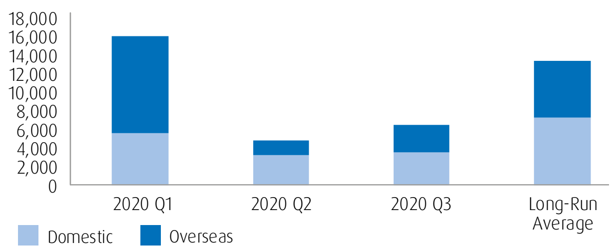
The market continues to be dominated by the pandemic and despite some relaxation in lockdown in the summer and massive fiscal and monetary support, economic recovery has been slow. The re-imposition of some restrictions has affected performance.

Rent Collection Rates – Due Date – per cent



Source: Remit Consulting Jul-20, Oct-20
* Data for Leisure not available for March 2020

Investment Activity £m



Source: Property Data Oct-20

The UK property market has seen some stabilisation following the shock of the pandemic and subsequent lockdown. All-property total returns have been improving month on month since March and turned positive in the quarter. The material uncertainty clause applied by valuers in March was gradually lifted during the quarter and some open-ended property funds announced that they would re-open.

In terms of total returns, industrials and distribution re-asserted their top ranking but shops and shopping centres continued to record negative total returns. Provincial and City offices delivered an above average quarterly performance, along with supermarkets.

There has been weakness in the occupational market and reduced rates of rent collection, particularly for retail and leisure assets. The moratorium on rent collection arrears has been extended to end-2020. Collection rates did improve in the September quarter but there has been pressure to reduce rents on a longer-term basis and to re-negotiate leases.

The investment market saw some recovery in the three months to September although activity remained well below the long-run average. Several transactions agreed before lockdown finally completed in the quarter, often involving overseas buyers. Long income, industrial/distribution and residential in particular were favoured in the period.

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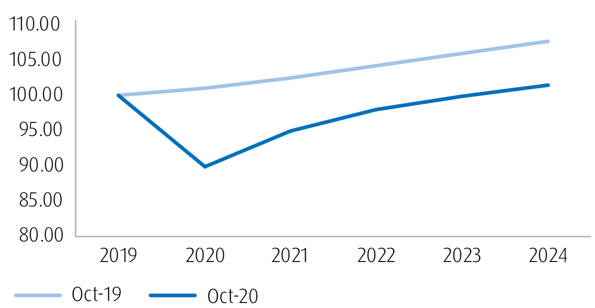
The Economic and Property Market Outlook

After a very difficult 2020 and a highly uncertain 2021, we are predicting, at the all-property level, a period of recovery, helped by continued low interest rates.

The pandemic has led to a sharp downgrading of economic forecasts both in the UK and globally. The resurgence of the virus has increased concern about the length of the crisis and the possibility of a second recession. Surveys indicate that in the UK, respondents believe that the "new normal" may not occur until the latter part of 2021. Consensus forecasts indicate that although 2020 represents a trough, recovery will be protracted, with GDP not regaining 2019 levels until at least 2023, and with a permanent loss of predicted output in prospect. Attention is increasingly being focused on the timing of the introduction of an effective vaccine to give some respite from repeated and disruptive lockdowns and to provide the degree of certainty to enable investor confidence to be restored.

Real GDP Consensus Forecasts 2019=100



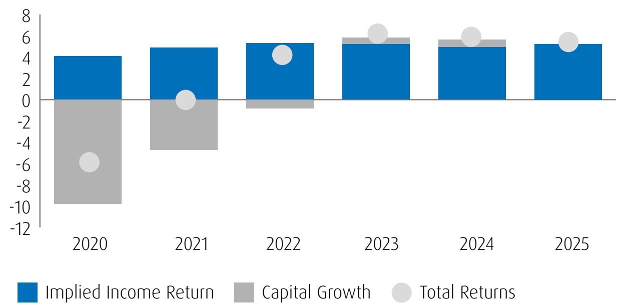
Source: Consensus Economics Oct-19, Oct-20

Although additional government support has been announced, there is concern about the level of business failures and the impact on employment and income, as both the restrictions continue and once aid is reduced and as rent/mortgage relief ends.

There is also Brexit. Negotiations have seen little progress ahead of the year-end deadline and some disruption is probable as the UK transitions to the post-Brexit world.

The consensus property forecasts from the Investment Property Forum (IPF) have seen the estimate for 2020 all-property total returns revised favourably as the market steadied. BMO REP has similarly revised its 2020 estimate to minus 5.7% versus the minus 7.4% consensus. The forecasts see the income return continuing to underpin property performance.

Components of BMO REP Forecast All-Property Total Returns – per cent



Source: BMO REP Oct-20

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However, both BMO REP and IPF Consensus forecasts have been downgraded for 2021. Although industrial/distribution is predicted to be relatively resilient, building on its positive performance in the latest quarter, we expect continued weakness particularly in the retail market to give a barely positive total return for the year. The property forecasts are based broadly on the consensus economic outlook and with a continued supportive fiscal and monetary policy, including low gilt and other interest rates. The outlook for 2021 is exceptionally uncertain and there are risks to the downside should the economic recovery falter or move into reverse, and if Brexit poses unexpected challenges.

Rental growth is expected to be muted given the economic backdrop and the need to rebuild balance sheets. BMO REP forecasts point to sustained rental declines in retail rents throughout the forecast period but positive rental growth in prospect for industrials and distribution. The pandemic is expected

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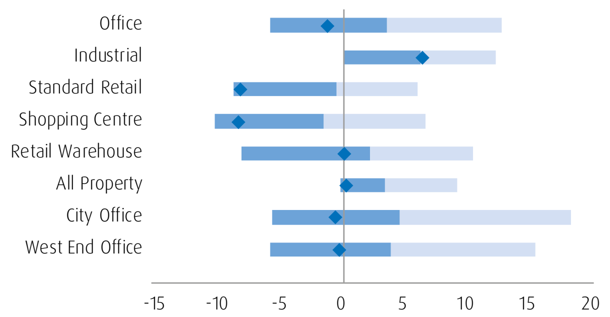
BMO REP Forecasts versus IPF Consensus Forecast Range. Total Returns 2021 – per cent



Sources: BMO REP Oct-20 (marked as diamonds), Investment Property Forum (IPF) Consensus Forecasts Sep-20.

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to have a significant and lasting effect on lease structures and income streams. The town centre retail market is expected to experience a severe fall in income in 2020 and further declines in subsequent years, but most other sectors are expected to see greater resilience.

The investment market may take time to recover fully from the pandemic. Survey evidence points to a sharp deterioration in Q3 2020. Sentiment was positive for residential, warehousing and to a lesser degree standard industrials, but is extremely negative for town centre retail. There has also been some capital raising to fund acquisitions, and greater interest in sale and leasebacks by office occupiers, as well as retailers. The banks may be moving to a less supportive stance though, which could limit the upturn.

The structural problems affecting retail will take time to resolve and could be compounded by a weak domestic economy and the loss of income from tourism. Retail warehouse values could see greater support from easier social distancing and more re-purposing options. We expect a permanent shift to greater spending online.

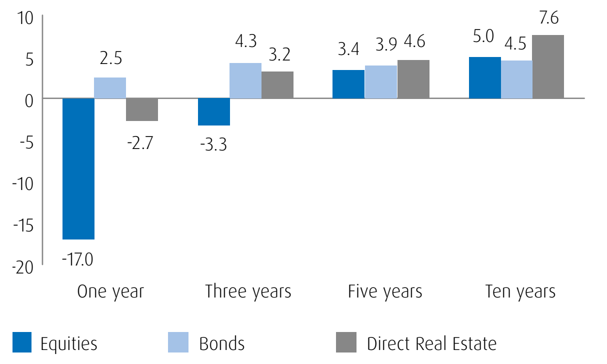
The office market outlook is helped by low new supply but is clouded, especially in London, by Brexit concerns and the likely impact of increased working from home and lower occupational density on rental growth prospects. There is a reluctance to commit to new space and 2021 could be a transition year. Changing occupier requirements, including more lease flexibility and improved specification, will affect the market. The sector is facing headwinds which could slow the pace of recovery, but we believe that the market will adapt and offices are here to stay.

The industrials market is likely to benefit from the continued growth of online retailing but it could also be hit by weakness in manufacturing and retail administrations. It remains in favour with a wide range of investors which is likely to support its relative performance.

The alternatives market is diverse and performance within the sector is expected to reflect this. There are concerns about some covenants in the hotel and care homes sectors in particular but the student accommodation market has to date been resilient. Demographics and government policy may work in the sector's favour over time, especially for residential property.

Direct property out-performed both gilts and equities in the quarter and over five and ten years. After a very difficult 2020 and a highly uncertain 2021, we are predicting, at the all-property level, a period of recovery, helped by continued low interest rates.

UK Multi-Asset Class Performance – Total Returns – to September 2020 (% pa)



Source: Lipper, FTSE 350, JP Morgan United Kingdom GBI 7-10 Years, MSCI UK Monthly Property Index, Sep-20

Key Investment Transactions Data

30 Lombard St, London

Bank of Scotland, Tollcross, Edinburgh

Tesco, Newmarket bought by Supermarket Income REIT

Large pre COVID deals are completing

30 Lombard Street was sold to RE-Invest for £76m at a topped-up 4.16% initial yield.

55 Colmore Row, Birmingham was sold to Union Investments by Nuveen at an estimated £105m.

Singapore's Suntec REIT has bought CPPIB's stake in the Nova scheme in Victoria at circa £435m.

Some price cutting and aborted deals

The Bank of Scotland building at Tollcross, Edinburgh is being re-marketed after a deal with Korean buyers collapsed.

The Core office building in Manchester was sold at £21.5m to CBRE GI at c.£3.5m less than the asking price.

Cola has abandoned plans to sell a hotel and retail scheme in London marketed at £1bn in March 2020.

Long income assets remain in favour

The Supermarket Income REIT has bought eight supermarket assets and is fund raising for more acquisitions.

Target Healthcare, Impact Healthcare and Aedifica of Belgium are buying long lease care homes.

LXi has bought a Travelodge in Workington on a 25 year lease.

Industrials/logistics are still in demand

Panattoni sold the Amazon unit in Swindon to L&G for £202m (4.3% initial yield) in the UK's largest ever single asset distribution deal.

Exeter Property Group has bought a portfolio of 9 logistics assets from the BAPF for £150m at a 5% yield.

In October, Blackstone completed its purchase of the Prologis Platform portfolio for £483m.

Interest in development opportunities emerging

Five bids were received for 50 Fenchurch Street in London.

Schroders UK Real Estate Fund is to forward fund the £45m One Cambridge Square office development.

Oxford Properties has bought a 15-acre logistics site at Heathrow for redevelopment.

Growing interest from overseas buyers

Buyers from North America, Europe, the Middle East and Asia have all completed £80m deals from July 2020.

Link REIT of Hong Kong bought 25 Cabot Square from Hines for £380m at a 4.7% yield.

As a special purchaser, Chanel bought its premises in Bond St for £310m at well above the asking price.

Sale and leasebacks are being pursued by some companies

McClaren is proposing a sale and leaseback of its Woking HQ for £200m.

BAT is said to be considering a sale and leaseback of its London HQ for £250m.

Sources: BMO REP Oct 20, Property Data Oct 20

Retail investment activity still subdued

Aberdeen Standard has sold a retail park in Tunbridge Wells to M7 for £46m at a 7.5% yield in an off-market deal.

BlackRock has received permission to repurpose Colosseum Retail Park, Enfield for primarily residential use.

Continued interest in residential

In London, Get Living is forward funding a £252m Build to Rent (BTR) scheme and Long Harbour a £156m BTR project.

PIC and L&G have each forward funded BTR schemes in Manchester and Glasgow respectively.

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