EXECUTIVE SUMMARY

> Rebound in investment activity in Q2 2021;
> Strong performance from UK REITs and direct commercial property over the period;
> Competition and low rates driving aggressive yield compression;
> Scope for further yield compression due to ongoing premium over other asset classes;
> Strong period for industrial property;
> Pressure easing on retail, hospitality and leisure assets but debt problems looming;
> UK house prices expected to cool in H2 2021;
> Limited movements in Prime Central London market due to lack of international travel.

COMMERCIAL PROPERTY

REBOUND IN INVESTMENT ACTIVITY

After an encouraging start to the year, the UK market continued to display its resilience with GBP 15.2bn of commercial property transactions in Q2 2021, with a particular surge of deals in June. This was almost 15% ahead of the 10-year average for equivalent periods due to a number of large portfolio deals concluding over the period and demonstrates that the UK market is firmly on the road to recovery following the challenges of 2020.

Although supply continues to be comparatively tight, there is no shortage of demand for UK commercial assets and yields continue to move inwards. International travel remains restricted though and the anticipated breakout for the market has yet to fully materialise. However, the progress of the UK’s vaccination programme and the reopening up of the economy following the Government’s much anticipated ‘Freedom Day’ on 19 July gives optimism that there will be more progress throughout the remainder of H2 2021.

Source: PropertyData, 2021
### TOP 10 LARGEST UK COMMERCIAL PROPERTY TRANSACTIONS YTD 2021

<table>
<thead>
<tr>
<th>Building / Transaction Name</th>
<th>Location</th>
<th>Sector</th>
<th>Price GBPm</th>
<th>Date</th>
<th>Vendor (nationality)</th>
<th>Purchaser (nationality)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student Portfolio</td>
<td>UK Wide Portfolio</td>
<td>Student Accom.</td>
<td>969.0</td>
<td>Jul-21</td>
<td>GCP Student Living (UK)</td>
<td>iQ Student (USA) / Scape Student (UK)</td>
</tr>
<tr>
<td>Arlington Portfolio</td>
<td>UK Wide Portfolio</td>
<td>Business Park</td>
<td>714.0</td>
<td>Jun-21</td>
<td>TPG Real Estate (USA)</td>
<td>Brookfield Asset Mgt (Canada)</td>
</tr>
<tr>
<td>30 Fenchurch St, EC3</td>
<td>City of London</td>
<td>Office</td>
<td>635.0</td>
<td>Jun-21</td>
<td>Trustees of Moise Safra (Lebanon)</td>
<td>Brookfield Asset Mgt (Canada)</td>
</tr>
<tr>
<td>1 Braham Street E1</td>
<td>Central London</td>
<td>Office</td>
<td>468.0</td>
<td>May-21</td>
<td>Aldgate Developments (UK)</td>
<td>Union Investment RE (Germany)</td>
</tr>
<tr>
<td>3 Minster Court, EC3</td>
<td>City of London</td>
<td>Office</td>
<td>353.0</td>
<td>Jun-21</td>
<td>Ivanhoe Cambridge (Canada)</td>
<td>Suntec REIT (Singapore)</td>
</tr>
<tr>
<td>Wembley / Whitechapel</td>
<td>Central London</td>
<td>Student Accom.</td>
<td>342.0</td>
<td>Jun-21</td>
<td>Unite Group PLC (UK)</td>
<td>GIC Real Estate (Singapore)</td>
</tr>
<tr>
<td>Retail Park Portfolio</td>
<td>UK Wide Portfolio</td>
<td>Retail Warehouse</td>
<td>330.0</td>
<td>Apr-21</td>
<td>Hammerson PLC (UK)</td>
<td>Brookfield AM (Canada)</td>
</tr>
<tr>
<td>Quintain Portfolio</td>
<td>UK Wide Portfolio</td>
<td>Student Accom.</td>
<td>315.0</td>
<td>Apr-21</td>
<td>Fusion Students (UK)</td>
<td>Lone Star (USA)</td>
</tr>
<tr>
<td>Logistics Portfolio</td>
<td>UK Wide Portfolio</td>
<td>Industrial</td>
<td>303.0</td>
<td>Feb-21</td>
<td>Morgan Stanley RE (USA) / Thor Equities (USA)</td>
<td>BentallGreenOak (USA)</td>
</tr>
<tr>
<td>Nido Portfolio</td>
<td>UK Wide Portfolio</td>
<td>Student Accom.</td>
<td>291.0</td>
<td>Feb-21</td>
<td>KKR (USA)</td>
<td>Greystar (USA)</td>
</tr>
</tbody>
</table>

Data to 01 August. Source: PropertyData, 2021
UK REITs, along with the wider UK equities market, continued their run of strong performance over Q2 on expectations of an economic recovery and improved occupier conditions due to the advanced progress of the UK’s COVID vaccination programme and the gradual easing of lockdown restrictions.

The private market has also had a strong quarter with a total return of 3.9%, bringing year to date performance to 6.2%\(^1\). Momentum has returned and average UK commercial property values have risen by 3.5% so far this year, driven primarily by exceptional returns from the industrial sector. Competition for deals remains intense in this low rate environment and yields have declined aggressively over the course of the year as a result. There remains scope for additional yield compression and it is anticipated that there will be robust growth in the second half of the year, in line with the forecast recovery in investment activity.

\(^1\) Source: MSCI, 2021
Industrial/logistics property has had an extremely strong Q2, with average values rising by 6.6% and average rents by 1.8%. The sector remains the beneficiary of the structural shift to online shopping and supply chain reform as well as experiencing a short-term demand boost due to COVID-enforced lockdowns. We continue to favour urban warehouses section due to the critical need to fulfil the ‘last mile’ of product delivery combined with supply constraints and competition for sites from the UK housing market.

Investor demand for yielding assets also continues to be strong in this low rate environment. The comparative lack of deals during the lockdown period has led to high competition and an aggressive drop in yields as a result. Average UK commercial property yields had fallen to 4.86% as at the end of June, having started the year at 5.18%. There remains scope for additional compression as the spread over other yielding asset classes, such as corporate and government bonds, remains wide. This is one of the key factors supporting the UK and Central London office markets as investors struggle to find equivalent yields elsewhere. A point that is made even clearer when comparing the UK and London to other major markets/cities and by evaluation versus real yield levels (i.e. net of inflation).

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Retail, hospitality and leisure assets remain under pressure, although the pace of decline has slowed as the UK economy gradually re-opened and customer footfall recovered. These sectors have built up deep problems with rental and loan arrears accumulating over the course of the pandemic and look vulnerable to further declines in coming periods. A tight credit environment and a potential wave of loan defaults are also a looming risk. There is almost certainly further downside until these sectors reach their bottom.
The UK residential market continued to experience strong growth over the period, particularly houses in suburban locations in response to the various lockdowns imposed over the pandemic. Average UK house prices are now 8.8% higher than they were in June 2020, driven by a combination of supportive government policy, low interest rates, elevated household savings and the Stamp Duty Holiday introduced by the Chancellor of the Exchequer mid-way through last year.

Although originally due to run until March 2021, the Stamp Duty Holiday was subsequently extended and will now be phased out between 01 July and 30 September.

**UK House Prices, Annual % Change SA**

Data as at end Jun-21. Source: Halifax/Lloyds Banking Group, 2021

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PRIME CENTRAL LONDON RESIDENTIAL

Although the London market has benefited from same the factors affecting the wider UK residential market, the Prime Central London (PCL) market has been subdued due to the ongoing lack of international travel. Even so, the market has remained resilient with a good level of activity from mainly domestic purchasers, leading to a rise of 0.5% in values over the quarter.

With the continued successful rollout of the COVID-19 vaccine and staff beginning to return to the office, Prime Central London values should continue their upward trend, with the easing of international travel restrictions adding further impetus in due course.

Source: Knight Frank, Lloyds Banking Group, 2021
OUTLOOK

There has been a strong rebound in activity and performance in Q2 2021 as COVID-related restrictions have eased and markets return to some level of normality. Despite good numbers, the post-lockdown breakthrough has yet to fully materialise but we envisage ‘more of the same’ in coming months resulting in a strong year for UK commercial property. Investors should be prepared for tighter yields and heavy competition for the right assets.

Industrial and income-focused properties will continue to be the leaders for the foreseeable future as the structural drivers for these areas remain unaffected by current events. Despite some improvement in key data, retail, hospitality and leisure assets will remain under pressure over the same time period.

After a strong run, the wider UK residential market will cool over the course of H2 2021 with the gradual removal of stimulus measures. Meanwhile, the PCL market has remained subdued but is on an upward trend and will recover swiftly on resumption of international travel.

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