EXECUTIVE SUMMARY

> Encouraging amount of investment activity in Q1 2021;
> Limited supply due to lack of international travel is holding back the market;
> Momentum is building and strong recovery is anticipated over the summer months if lockdown restrictions are removed;
> Industrial property and strong income-producing assets remain the standout performers. Retail, hospitality and leisure continue to struggle;
> Structural risk to UK office sector overstated;
> UK house prices experiencing strong growth due to low interest rates, supportive policy and fiscal stimulus;
> Confidence and activity returning to the Prime Central London market after a difficult 2020.

COMMERCIAL PROPERTY

LOCKDOWN HOLDS BACK INVESTMENT ACTIVITY

Following a busy end to 2020, there has been an encouraging start to the year with GBP 11.1bn\(^1\) of investment transactions in the first quarter. Although this is 20% below the 5-year average for equivalent periods, this is positive in the context of ongoing travel and business restrictions, demonstrating that there is still robust demand for UK commercial property.

One key issue which continues to concern market participants is the lack of available stock. This can be primarily attributed to the absence of international travel as overseas investors have been a key segment of the UK market for a number of years. Although many overseas institutions maintain a presence in the UK and have been largely unaffected, the main bulk of the international buyers have stayed at home. A significant number of vendors have therefore either delayed or cancelled planned sales until they return, thus restricting available stock. If travel restrictions are eased in the summer, as per current UK government guidance, then stock levels and transactional activity are anticipated to rebound strongly.

UK CRE Quarterly Investment Volumes

UK CRE Net Investment 2016 - 2021

\(^1\) Source: PropertyData, 2021
# Top 10 Largest UK Commercial Property Transactions Last 12-Months

<table>
<thead>
<tr>
<th>Building / Transaction Name</th>
<th>Location</th>
<th>Sector</th>
<th>Price GBP</th>
<th>Date</th>
<th>Vendor (Nationality)</th>
<th>Purchaser (Nationality)</th>
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<tbody>
<tr>
<td>Dolphin Square Sw1</td>
<td>Central London Residential 850.0 20-Sep Westbrook Partners (USA) AXA REIM (France)</td>
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<td>Project Harmony</td>
<td>UK-Wide Portfolio Residential / Student 580.0 20-Dec Realstar (Canada) Quadreal (Canada)</td>
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<tr>
<td>1 &amp; 2 New Ludgate Ec4</td>
<td>Central London Office 552.0 20-Dec Land Securities (UK) Sun Venture (Singapore)</td>
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<td>Platform Portfolio</td>
<td>UK Wide Portfolio Industrial 473.0 20-Oct ProLogis (USA) Blackstone Real Estate (USA)</td>
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<tr>
<td>1 London Wall Place Ec2</td>
<td>Central London Office 472.0 20-Oct Brookfield (Canada) AGC Equity Partners (UK)</td>
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<td>Nova Estate</td>
<td>Central London Mixed 430.6 20-Oct CPPIB (Canada) Suntec REIT (Singapore)</td>
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<td>Marylebone Portfolio</td>
<td>Central London Office 401.0 20-Dec British Land (UK) Allianz RE (Germany)</td>
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<tr>
<td>25 Cabot Square E14</td>
<td>Central London Office 380.0 20-Jul Hines Global REIT (USA) Link REIT (HK)</td>
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<tr>
<td>Epic Industrial Portfolio</td>
<td>UK Wide Portfolio Industrial 335.0 20-Dec EPIC (UK) Blackstone Real Estate (USA)</td>
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<tr>
<td>Retail Park Portfolio</td>
<td>UK Wide Portfolio Retail Warehouse 330.0 21-Apr Hammerson plc (UK) Brookfield AM (Canada)</td>
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Data to 01 May. Source: PropertyData, 2021
Both REITs and wider UK Equities have recovered strongly since late October due to the expectations of an economic recovery based on the rollout of the UK’s COVID vaccination programme. Together, they were the best performing asset classes, both in Q1 2021 and over the last 12-months, although the UK REIT index is still -8% below its level at the start of last year. This recovery continues to be uneven, with income-focused investors concentrating on Companies with high quality portfolios in the right sectors and a diversified, robust tenant base.

The private market has also recovered strongly over the same period and momentum is building in commercial property returns, having struggled over the course of the past 2 years. Since bottoming in October 2020, average UK commercial property values have risen by 1.6%\(^2\) after five consecutive months of positive capital growth – albeit unevenly. Whether this will continue for the remainder of 2021 will largely depend on the timing of removal of travel and business restrictions. At present, it is anticipated that there will be strong returns in Q3 2021 in line with the rebound in investment activity.

\(^2\)Source: MSCI, 2021
COVID continues to have a variable impact on UK commercial property, with sector positioning and income profiles the key differentiator. Industrial/logistics property remains the biggest ‘winner’ as online sales have remained at elevated levels during the various lockdown periods. In turn, this has fuelled both occupier and investor demand and supported rental and capital values for the industrial sector throughout the pandemic. Despite the short term COVID effects, this is a long-term structural change to consumer habits and will continue for the foreseeable future. The most attractive segment within industrial remains urban warehouses due to the critical need to fulfil the ‘last mile’ of product delivery combined with supply constraints and competition from the residential sector.

SECTOR DISPARITIES

Property with ‘long and strong’ income (i.e. long-term leases to high quality tenants) has also escaped the pandemic relatively unscathed due to the persistent low rate environment and prolonged periods of economic uncertainty. Investor demand has remained robust for these assets, regardless of sector e.g. well-let supermarkets despite the problems in the wider retail sector. Income is a key investment rationale for commercial property and pricing will remain elevated whilst interest rates remain at historical lows. Properties with non-discretionary demand drivers (such as healthcare) would also be in the ‘long and strong’ income category.
The future of the office sector has been of intense debate over the last 15 months. The main concern is that, in future, more people working from home will lead to lower demand for office space thus depressing rents and values. The equation is not so simple in our view and we believe that the risk of a structural decline in the UK office sector is fairly low. COVID has been an unprecedented event, but it is unlikely that it will lead to a permanent, wholesale shift to home working rather than in the office. This has been supported by statements made earlier in the year by several CEOs of FTSE 100 companies. A flexible arrangement is most likely for a portion of staff, with some days at home and some days in work. However, this will still require the same amount of space for the one or two days that will actually be spent in the office. The new working environment, whatever that may be, could even have a positive effect on office demand – shifting it away from crowded urban areas or spurring the need for additional sites to avoid concentrating vital staff in one central location.

Retail, hospitality and leisure assets have suffered the most from the pandemic and continue to do so. Retail in particular is locked in a ‘zero sum game’ with e-commerce and the industrial sector, although this is the continuation of a structural trend which began well before 2020. Any recovery in these sectors will largely depend on the full easing of lockdown restrictions and occupier impairment will continue to weigh on performance for a number of years.
The current UK Government has been consistently supportive of home ownership with a succession of high-profile initiatives introduced since 2013 such as stamp duty cuts and loan guarantee schemes designed to help first-time buyers in particular.

Although the COVID pandemic did severely curtail market activity for a large part of 2020, the easing of lockdowns over the summer months unleashed a wave of pent up demand with buyers keen to escape city centres for suburban locations with more rooms and outdoor space to provide a better environment for working from home.

In his Summer statement, the Chancellor of the Exchequer Rishi Sunak added further impetus by introducing a stamp duty holiday for any properties up to GBP 500,000. People buying property up to this amount would therefore pay no stamp duty at all. Although originally due to run until March 2021, it has since been extended to June 2021.

Over this whole period, interest rates – and therefore borrowing costs – have remained exceptionally low. Combined with high household savings rates, it is therefore unsurprising that the UK housing market has performed so well, despite the economic impact of a global pandemic.

RESIDENTIAL PROPERTY

The UK residential market has experienced strong growth despite the significant challenges posed by the ongoing COVID-19 pandemic. Average UK house prices are 8.2% higher than they were at the start of the lockdown, driven by a combination of supportive government policy, an accommodative macro environment and short-term stimulus measures introduced by the Chancellor of the Exchequer.
As the UK entered a third national lockdown at the beginning of the year, it was unclear how this would affect the Prime Central London property market. Since the ‘Boris Bounce’ at the beginning of 2020, caused by a decisive Conservative election win and the conclusion of Brexit, there was a period of growth in Prime Central London (PCL) for the first time in over five years. However, sales prices subsequently decreased over the course of 2020 and were down 2.5% annually by the end of December.

During Q1 2021 though, PCL values grew by 0.4% due to the announcement of a planned roadmap out of lockdown, the rollout of the UK vaccination programme, pent-up buyer demand, and the stamp duty holiday. This would suggest that the PCL market has passed the bottom, and that confidence and activity have now resumed.

Although the stamp duty holiday has now been extended, it was originally due to expire at the end March 2021. Combined with the introduction of a 2% surcharge for overseas buyers from 1st April, this caused a surge of activity to beat both deadlines. As a result, there was the highest number of transactions recorded in the PCL market since March 2016, as well as the highest numbers of offers accepted and new prospective buyers registered in London for almost 10 years.

Rental activity remains subdued though. Residential rents in Zone 1 are currently around 20% below pre-pandemic levels, and leasing activity is 23% lower compared to Q4 2020. However, agents have reported that tenants have now begun to take advantage of the lower rental levels and reduced competition, with a particular focus on the main office districts in the City and Canary Wharf for commuting convenience in preparation for a return to work.

4 Source: Cluttons, 2021 | 5 Source: Savills, 2021 | 6 Source: Knight Frank, 2021 | 7 Source: Cluttons, 2021
OUTLOOK

After spending the majority of 2020 in lockdown, both the commercial and residential property markets suffered from a lack of investment activity. However, with a gradual easing of travel and business restrictions there has been a steady resumption of transactions and both markets are set to recover strongly should the environment return to some sort of normality over the Summer period.

Industrial and ‘long and strong’ income will continue to be the leaders in the commercial property space. Despite widespread concern from many commentators, we believe that there is a low probability of a long-term structural decline in the office sector, as there has been for retail.

The wider UK residential market will also continue its run of strong returns whilst fiscal stimulus and low rates persist. There have been some encouraging signs in the PCL market over the first months of the year and the return of international travel and therefore buyers should have a galvanising effect on prices.

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