OUR MARKET

London's property market remains in good health, especially in the commercial sector where rents are steadily rising and exceptional investment demand has seen yields fall further.

London is prospering, with a population now of over 8.6 million people. This growth trend recommenced in 1990 as London once more established itself as a dominant provider of professional and financial services, not only for the domestic market but also internationally. More recently it has become a vibrant centre of the flourishing new technology and creative industries. London now receives significant inward migration not just from the UK, but from around the world. Not only is London bigger; it has also become more cosmopolitan, and is truly a global city.

These demographic trends are expected to continue with London's population forecast to grow to 10 million by 2030. London's economy has also benefited and, although it suffered in the last global financial crisis, it has made a strong recovery, in part supported by its attractions to the new industries.

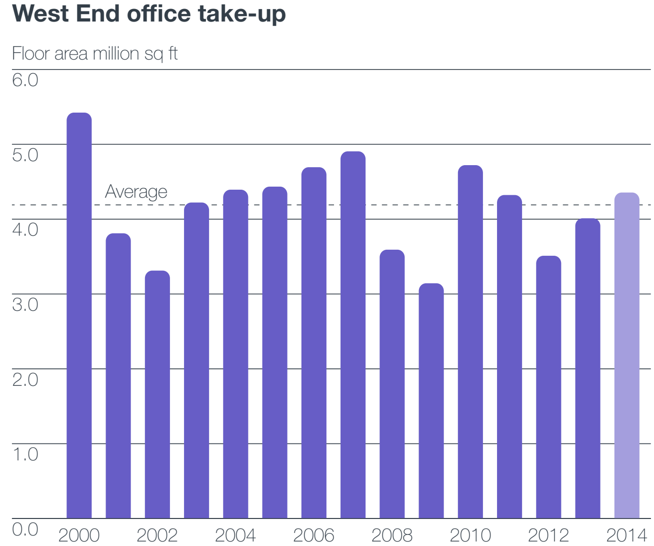
The UK economic recovery has been slower than in recent cycles and growth is expected to remain below average. This has seen base rates stay at very low levels and longer term interest rates fall significantly during the year. The UK General Election in May could dampen economic activity, as it raises uncertainty about potential changes to existing policies that might reduce London's relative appeal. Yet if economic growth quickens it remains possible that base rates might rise later in the year.

The UK economy is estimated to grow at 2-3% pa in the next two years, with London expected to lead that growth. Oxford Economics believes that 275,000 new London office jobs will be created in the next five years, which in turn, on JLL estimates, translate into extra demand for 23m sq ft of office space. This compares to central London availability of only 11m sq ft in December 2014.

West End office development pipeline

Source: CBRE

West End office take-up



Source: CBRE

OUR MARKET
CONTINUED

London's commercial property market remains in good health. Rents are steadily rising and exceptional investment demand has seen yields fall further. This cyclical recovery is supported by two structural changes. First the creative industries have developed leading to the establishment of new core office markets, and secondly the ever closer opening of Crossrail, which will significantly enhance the connectivity of a number of London locations. London's level of availability and supply remain conducive to rental growth, which we expect to continue in 2015.

Last year CBRE estimated central London prime office rents rose 11.4%, with 10.7% growth in the West End. This is the fourth year of growth, which, in line with the economy, has been at a steadier pace than in other recoveries.

- During 2014 CBRE estimated 6.0m sq ft of office space was completed in central London, which was a 72% increase on the previous year. West End new supply was actually lower at just 0.8m sq ft, which was 35% below the expected level at the start of the year as a number of schemes are completing late.
- CBRE expect central London completions to fall to 3.6m sq ft in 2015 before picking up to 8.0m sq ft in 2016 and 6.1m sq ft in 2017. The outlook for the West End follows a different pattern with rising supply of 1.2m sq ft in 2015, and then also peaking at a potential 2.2m sq ft in 2016. The largest concentrations of new supply in the West End over the next five years are expected to be in Victoria (1.4m sq ft), Fitzrovia (1.0m sq ft) and Mayfair (0.9m sq ft).
- Last year's central London take-up of 15.0m sq ft exceeded 2013's total by 9%. Of this 22% was pre-let, which was a similar ratio to 2013. Demand from creative industries and business services remained high at 26% and 20% of total take-up, respectively, and demand from financial services recovered to represent 24% of 2014 take-up.
- Total West End lettings were 4.4m sq ft, also a rise of 9%. Business services led here, representing 28% of total demand and CBRE highlighted the importance of service and managed office providers. Creatives had a smaller share at 19%.
- Strong take-up levels saw the central London vacancy rate fall from 4.7% to 3.7% in 2014. This is the lowest level since mid-2008, and 26% below the ten-year average. In the West End, where 60% of our portfolio is located, it is even lower at 2.7% down from 3.4% in the year. CBRE expects central London take-up to be lower this year, but availability will still fall.

The conditions are well set to secure continuing rental growth. CBRE estimates that Fitzrovia will see the highest West End rental growth in the next five years following the delivery of new buildings.

"Fitzrovia prime rents are forecast to show the strongest rental growth in the West End averaging 4.3% per annum over the next five years."

CBRE
JANUARY 2015

6.0m sq ft
of central London completions (West End: 0.8m sq ft)

15.0m sq ft
central London take-up (West End: 4.4m sq ft)

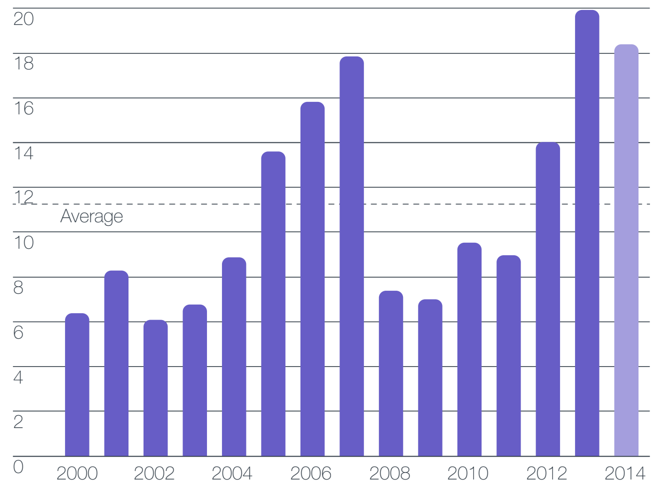
2.7%
West End vacancy rate, down from 3.4%

The investment market remained very firm in 2014. London activity was buoyed by a positive outlook and falling gilt and corporate bond yields. In the year £18.4bn was invested in central London commercial property, which almost matched 2013's record level of £19.9bn.

London assets continue to attract international investors with a number of headline deals involving new entrants. This sheer appetite deepens the pool of demand and liquidity, which has seen a wider definition of core London. Domestic institutional direct property weightings have risen both tactically to benefit from the improving markets, and structurally as real estate has raised its status as an alternative asset class with a relatively high yield.

The impact has pushed London investment yields to new lows yet investors seem more comfortable at the start of 2015 than at the beginning of 2014. The change in sentiment reflects the slowing economic outlook, which has meant that expectations of the timing of any interest rate rises have been extended, and bond yields have fallen. However, as the Bank of England warns, businesses should assume interest rates will rise in the next two years. We remain of the view that, providing such changes are modest and rental growth continues, property yields will stay firm. If, and when, property yields start to rise in the future, we currently expect neither a sharp correction nor a spate of forced property sales, given the higher levels of equity purchases so far this cycle.

Central London office investment transactions £bn



Source: CBRE

"The tech entrepreneurial spirit in London is thriving. Today, there are more great ideas, investors and working spaces across the city. It's a great time to showcase the capital's successes and opportunities to the global tech sector and demonstrate what London has to offer."

SIR RICHARD BRANSON
PIONEER-AT-LARGE, VIRGIN MEDIA PIONEERS AND VIRGIN START UP
JUNE 2014