PATRIZIA INVESTMENT COMPASS

UNITED KINGDOM

10|2015

A REGIONAL VIEW OF THE UK

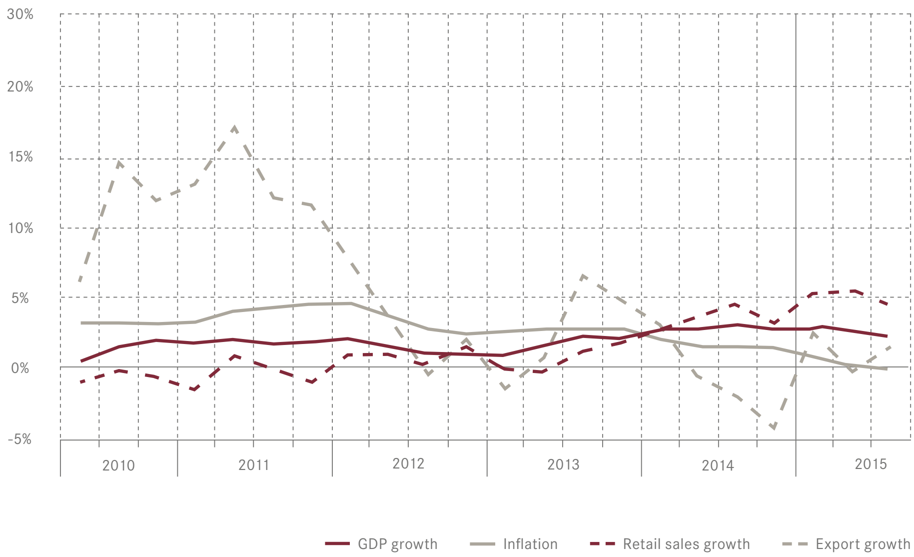
After slowing a little in the first quarter of 2015, the UK economy continued its positive development in the second quarter with GDP growth of 0.7 %.

This growth momentum is largely driven by the service and the consumer sector, as a tightening labour market results in upward pressure on wages increasing real disposable income of UK households strongly, especially given non existing inflationary pressures.

In contrast, the manufacturing sector had a challenging time so far this year, particularly the part reliant on exports, due to the appreciation of the Pound, the slowdown in emerging markets and the weak growth in the Eurozone.

Nevertheless, given the strong domestic fundamentals, growth of 2.6 % percent can be expected this year and about the same level for next year.

UK KEY ECONOMIC INDICATORS (YOY CHANGE)



Source: PATRIZIA, Reuters

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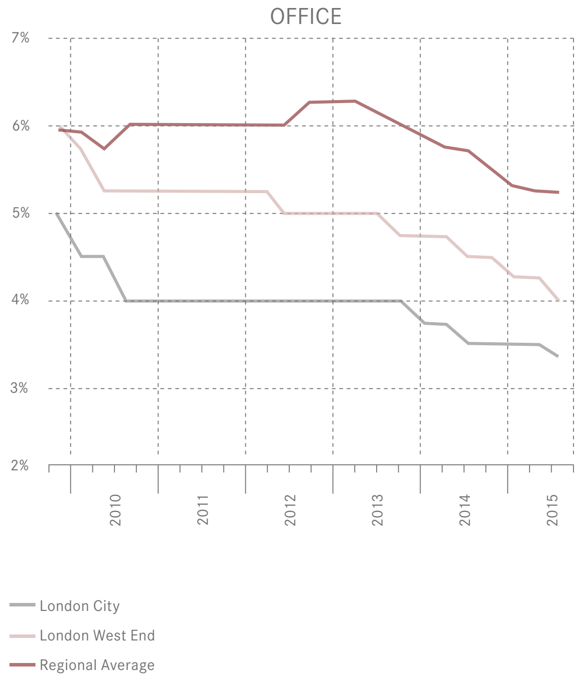
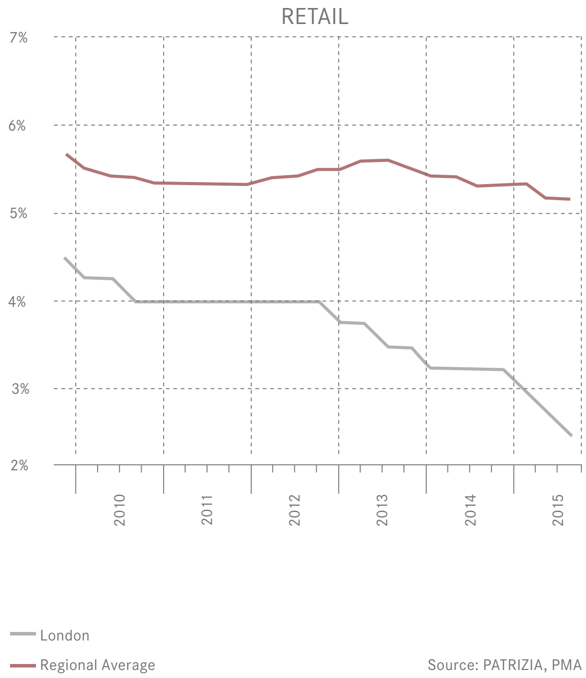
Against the backdrop of this solid economic development and the continuing low rate environment interest in UK property from domestic and international investors remains high. With London being one of two global cities in Europe, the financial centre in Europe and globally as well as the most liquid property market in Europe, international investors especially from outside Europe have a very strong bias towards the UK capital. However, with the supply of high quality assets in London on the decline and competition on the rise due to the arrival of new international players in the last months, investors are increasingly looking to the regions to deploy their capital. As a consequence, nearly 60 % of the investment activity in 2014 took place in the regional markets, the highest level seen since 2006 and it can be expected that this year will see a similar regional share. Although historically UK investors have been the main player in the regional markets, the search for value increasingly leads international players to look at the regional property markets, especially in the six biggest cities outside London (Manchester, Edinburgh, Birmingham, Leeds, Glasgow and Bristol), increasing the competition for assets in these markets.

PRIME NET YIELDS LONDON VS. BIG REGIONAL MARKETS FOR OFFICE AND RETAIL





Source: PATRIZIA, PMA

As a result, prime yields in the big six cities have been moving in and currently range between 5 and 5.75 % for prime office assets and between 4.75 and 5.75 % for prime retail assets.

This is a clear downward shift from the levels seen at the peak of the crisis, but relative pricing in comparison with the prime yield levels seen in London still offers a lot of room for further yield compression. With yields compressing in the big six cities, as competition for assets is heating up and product availability is limited, investors, especially from the UK, start to look for valuable investment opportunities further out. With most of these tertiary cities being less transparent in comparison with London or the big six, investors have to ask themselves, which markets they should look at and what sectors to target.

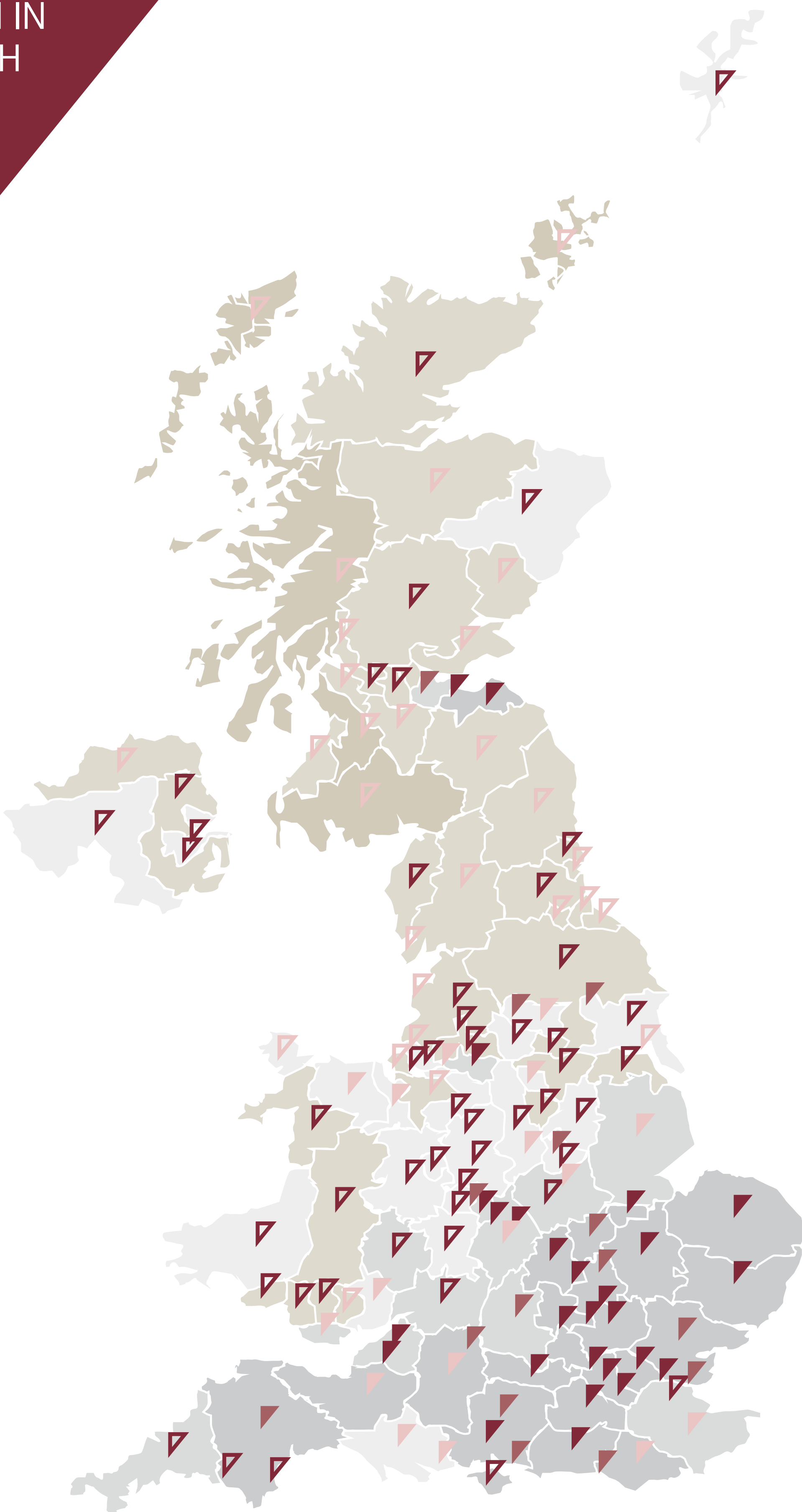
Despite the fact that the UK as a whole has a positive demographic outlook, a strong regional analysis has to be carried out to identify sustainable long-term investment locations. In addition, the already high urbanization observed in the UK is still further increasing, resulting in individual opportunities and challenges in the different regional urban centres that have to be evaluated.

Given the already stretched infrastructure in many UK urban centres, the general investment story is more about value-add type investments, e. g. redevelopments, repositionings or conversions, despite all the additional demand in the residential and commercial sector created by the growing population. They offer the necessary locational and accessibility advantages tenants are looking for and which many green field and city fringe developments can not offer as many local governments lack the money for the necessary infrastructure developments.

Starting with the demographic perspectives for the UK regions in the coming 15 years, a strong regional variation can be observed when looking at the change in the overall population figures and the growth of the working age population. First of all, there is a strong overall bias in population growth towards the South and the South East in particular, with these regions expecting double digit population growth. The only region outside the South with double digit population growth is the City of Edinburgh. Nevertheless, population growth in general is positive, only very few regions, especially in the North East, like the Lochaber, Skye & Lochalsh, Arran & Cumbrae and Argyll & Bute NUTS-3 region are expecting negative population growth. As the aging of the population is a general trend all across Europe, it is necessary to combine these general demographic figures with forecasts for the growth in the working age population.

Looking at the UK, a strong spatial correlation between the two figures can be observed, but the expected growth in the working age population shows a larger variability, as the growth figures for the UK NUTS-3 regions vary between 13.4 % and -9.7 %, whereas the population forecasts only vary between 13.7 % and -2.7 %.

» REGIONAL VARIATION IN POPULATION GROWTH LEAD TO INDIVIDUAL OPPORTUNITIES AND CHALLENGES.



Source: PATRIZIA Regiograph,
Oxford Economics

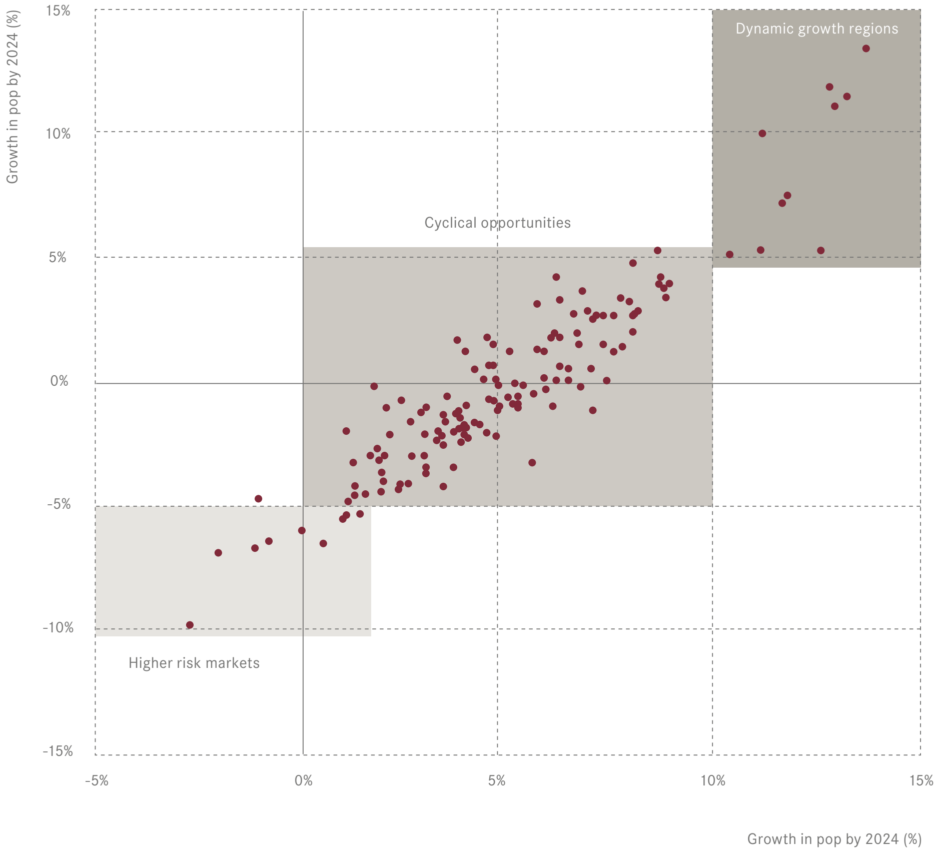
POPULATION AND WORKING AGE POPULATION GROWTH UNTIL 2024 IN THE UK REGIONS

REGIONAL CLUSTERS IN THE UK FROM AN INVESTMENT PERSPECTIVE

Clustering the UK NUTS-3 regions based on expected population growth and the growth of the working age population results in three clear cut investment clusters. On the one end are the dynamic growth regions with strong population and working age population growth consisting mainly of London, its surrounding regions and Edinburgh.

On the other end are the high risk markets, showing negative growth in the working age population and most of the time also in the overall population. The third group in the middle consists of markets with generally positive population growth and a slightly growing or shrinking working age population. The middle group offers investors a multitude of investment opportunities, depending of course on the position of the individual market within the property cycle, as the general demographic demand picture is solid.

Given the above mentioned infrastructure challenges for many UK cities, especially mixed-use assets offer investors valuable investment opportunities as long as accessibility by private and crucially public transport is given. If investors take these factors into account, locations outside London and the big six can offer rewarding investments with very competitive returns.



● Points represent the NUTS3-regions

Source: PATRIZIA, Oxford Economics