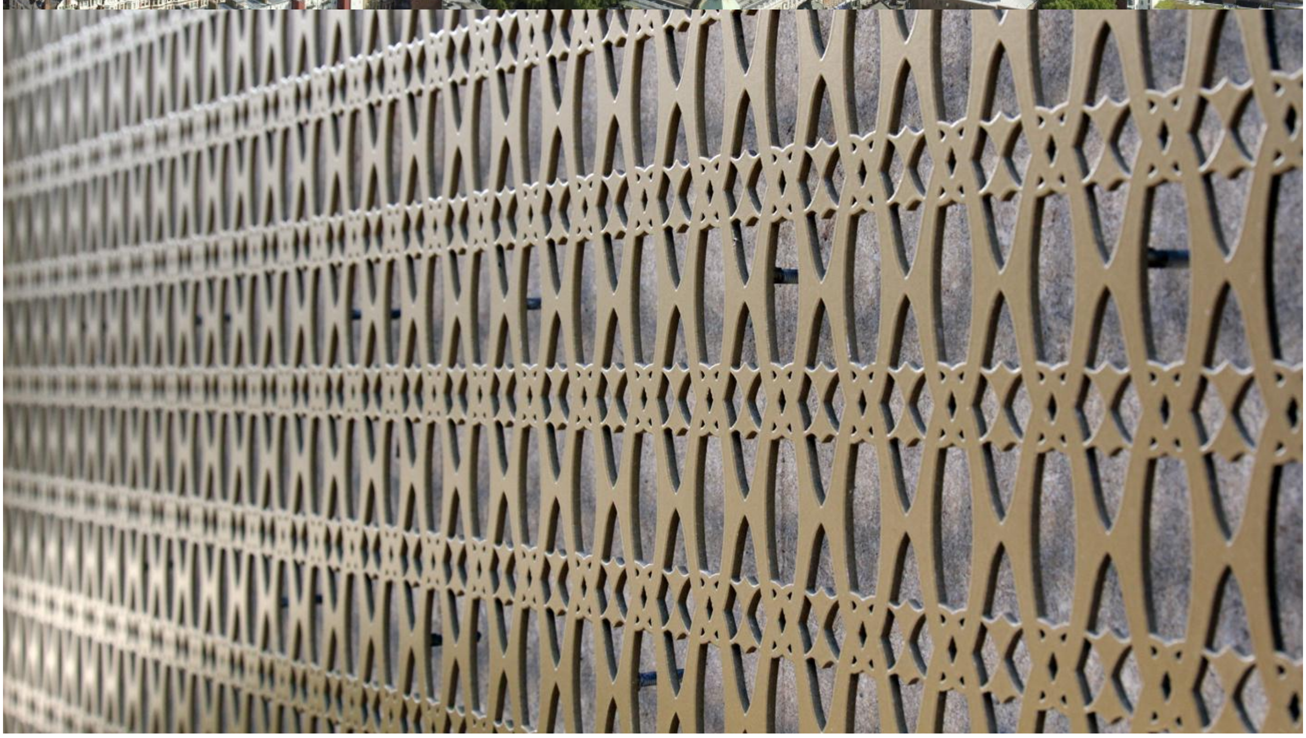
Quarterly Review

Q2 2013

Riverside CAPITAL

THE PROPERTY INVESTMENT PEOPLE



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Macro Overview

Global equity markets continued their ascent during the second quarter of 2013, with several major equity indices setting all-time highs during May, largely supported by central banks maintaining their accommodative monetary policy stance. However, in mid-May, momentum was halted after Federal Reserve (Fed) Chairman Ben Bernanke warned that stimulus efforts would be tapered if the U.S. economy continued to strengthen.

With clear signs of stress in the Chinese financial system and a warning from the Chinese Central Bank that it would not step in to prevent a liquidity shortage in the economy, the mere hint that the Fed would wind down its stimulus measures sparked a rise in bond yields and a sharp correction in global equity prices.

The prospect of reduced central bank support had a significant impact on fixed income markets and led to a rise in Government bond yields across the board. The yield on 10-year U.S. Treasuries rose from approximately 1.60% to its current 2.51%, a rise that was mirrored in the UK Gilt market.

The slide in gilts came amid positive signs that the UK economy is at last beginning to recover. Market sentiment continued to show signs of improvement as news remained broadly positive over Q2. The UK all-sector Purchasing Managers Index (PMI; measuring business activity throughout the economy) indicated that growth in Britain is set to be at its highest level since March 2011.

UK employment was also much improved, however the outperformance of the London economy was once again clearly evident. Total employment in London grew by 2.2%; significantly higher than the rest of the UK at just 0.5%.

According to latest revised gross domestic product (GDP) estimates from the Office of National Statistics, the UK economy grew by 0.3% in the first quarter of 2013. In addition, an amendment to historical GDP data also means that the 2012 double-dip recession has now been revised away.

The International Monetary Fund (IMF) upgraded its 2013 growth forecast for the UK to 0.9%, highlighting a brighter outlook. The British Chambers of Commerce also upgraded its long term growth forecasts for the UK economy over the next three years.

The Council for Mortgage Lenders reported that the number of mortgages approved by banks to home buyers soared to a 17-month high at the end of May. Gross lending increased to £14.7bn, its highest level since October 2008, which represents a 16.8% rise from May 2012.

Figures from the British Bankers' Association (BBA) also revealed net borrowing by non-financial firms edged higher in June. The data fuels hopes that the Bank of England and Treasury's Funding for Lending Scheme (FLS) is starting to have a positive impact and signals progress in the wider economy, after it was extended in April and tweaked to boost small business lending.

UK Property Outlook

- Commercial property showed signs of turning a corner as improvements in the wider UK economy filtered through to property performance.

  A broader recovery in the commercial property market was evident following positive returns across all three main sectors, with shops, offices and industrials returning 1.5%, 2.3% and 2.3% respectively.

- According to the IPD UK property index UK commercial real estate rose 1.9% (Total over the three months to June 2013), representing the highest growth in the past two years.

- Capital values were positive for the first time in 18 months, up 0.4% over the quarter, halting a prolonged period of market value decline.

  Eight of the UK's second tier cities recorded capital growth this quarter, the highest level of regional growth seen in nearly two years, and all thirty cities measured showed positive returns.

- Central London continued to have a strong 2013, delivering its highest return since March 2011. Overall returns were 3%, as capital growth hit 2% for the quarter.

  Central London assets were boosted by the performance of City of London and West End office markets, which saw their strongest growth in values since March 2011. Growth was driven, chiefly, by increasing occupier demand.

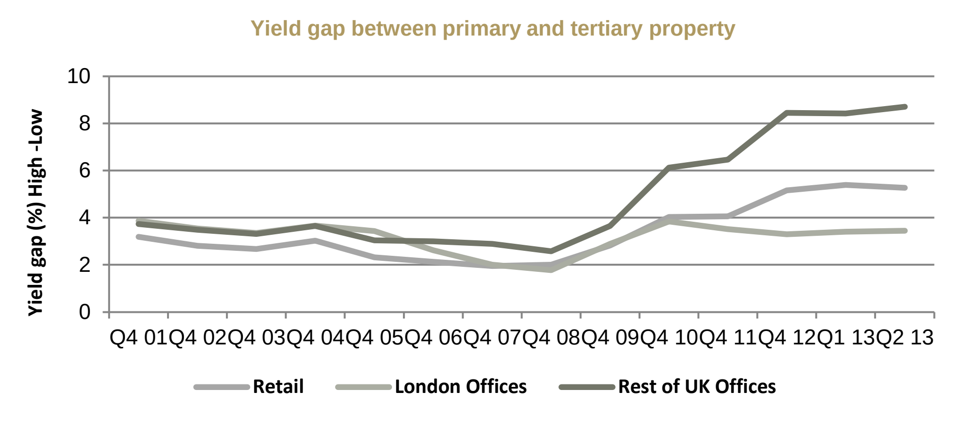
- Offices continued to show the greatest level of growth as values rose by 1% (IPD annualised total return of 6%). Industrial units were up 0.6% and the retail sector saw capital growth of 0.1.

Quarterly Performance	Q1 2013			Q2 2013		
	All Property	Offices	Inner London offices	All Property	Offices	Inner London offices
Rental Value growth	0	0.5	1.6	0.2	0.8	1.4
Capital growth	-0.4	0	1.3	0.4	1	1.9
Income return	1.5	1.4	1.3	1.5	1.3	1.1
Equivalent yield	7.1	7.3	7.2	7.1	7.3	7.2
TOTAL RETURN	1.1	1.4	2.6	1.9	2.3	3.1

Source: IPD UK Quarterly Q2 2013

- Secondary market pricing for retail & rest of UK offices continued to fall, thus widening the yield gap between prime, good quality secondary and tertiary (or poor secondary) asset classes.

  The gap in capital values between London and the rest of the UK has grown to over 35% since 2009.



Source: IPD UK Quarterly Q2 2013

- The first half of 2013 saw inflows of £19.33bn into the UK market, an increase of 9.5% from the same period last year (£17.66bn), with the majority of the inflows coming from overseas investors and UK institutions, according to the property archive.

- Overseas investors accounted for £10.32bn (over 50%) of total investment activity, this was almost 2.5times that of UK institutions. This is the 18th consecutive quarter that they have been net investors.

- Overseas investor demand for Central London property remained as strong as ever with £3.89bn invested over Q2 2013. The lack of supply (Central London) that was evident in Q1 carried through into Q2, however, was somewhat mitigated by the increase in the number of off market deals.

  In 2012 international investors accounted for 72% of all transactions into London. In 2013, so far, this has increased to 76%.

- Offices remained the most sought after sector (amongst all investors) with £7.77bn of inward investment.

- There was a marked increase in demand for prime retail sites, Investment volumes in Q2 were up over 80% (£404m) on Q1, amid strong demand from institutions and overseas investors.

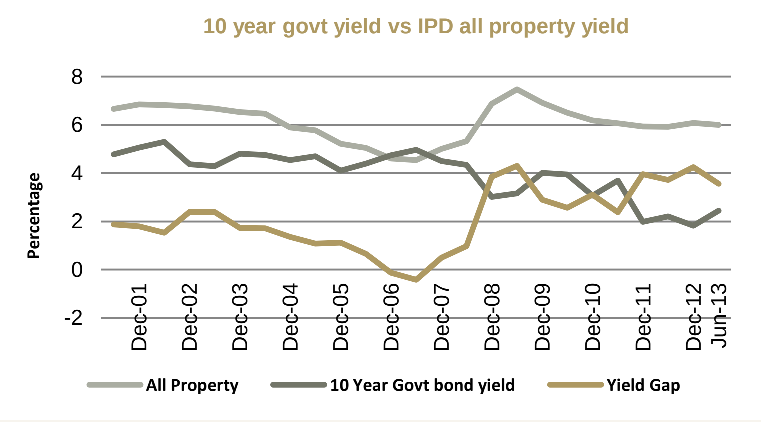
  With significant levels of cash chasing a limited supply, valuations for certain ‘trophy assets’ and, in particular, retail assets have been over inflated.

  A prime example of demand chasing limited supply was the purchase of Old Spitafield Market by a new US entrant. Amid stiff competition from investors from as far afield as China and Brazil as well as strong domestic bidders, Ashkenazy paid £105 million, £15 million ahead of the £90 million asking price, exchanging the deal in 3 working days.

- Demand for flagship space is particularly strong, as evidenced by the recent acquisition by Hackett of the Ferrari lease on Regent Street. Q2 also saw a record breaking pre-let of £1300 psf being achieved on Bond Street.
- Sentiment with respect to secondary locations remains cautious, though demand has shown encouraging signs of picking up.
- According to the latest research from Savills, a further 2,000 vacant shops appeared during the first six months of 2013 however, retail capital values actually increased in the second quarter.
- International inflows continue to place downward pressure on yields. London is still the destination of choice and with no signs of a slowdown in overseas demand, the sheer weight of money chasing a limited supply of stock will likely cause further yield compression.
- Prime West End rents remained stable at £97.50, however Q2 did see a significant number of core deals achieving rents in excess of £100 psf.

Prime Yields	2012	2013	
	Q4	Q1	Q2
West End Offices	4.00%	4.00%	4.00%
City Offices	5.00%	4.75%	4.75%
Non London Offices	6.25%	6.50%	6.50%
High street retail	4.75%	4.75%	4.75%
Good secondary retail	6.85%	7.00%	7.00%

- The yield on the benchmark 10-year UK Gilt soared from 2.01% at the beginning of June to 2.56%, before ending the month at 2.44%. The sharp rise has seen the spread fall to 07-08 levels, despite this; property yields continue to maintain a substantial margin over UK gilts.



Source: IPD UK Quarterly Q2 2013

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Riverside Capital View

The last three months has seen a significant improvement in the UK economic outlook, following on from growth exceeding expectations in Q1. Consumer spending growth has underpinned much of the recent gains in economic momentum, in spite of the continued decline of real consumer wages.

In the short term, any sign of improvement is more than welcomed. However, in order to allow for a sustained recovery, a reliance on consumer spending must be supported by further investment spend and an improvement in the current account deficit (through exports).

The outlook for the occupier market is improving and remains dependent upon the performance of the economy. Over the last two years, London has led the recovery and the gap with rest of the UK has continued to increase. Allied with a lack of suitable supply, the demand for London property appears to be increasing, and we envisage that this will intensify as corporate confidence improves and business plans that were on the back-burner during the recession are put back in place.

Having seen the first signs that economic recovery is spreading to rest of the UK, it is also evident that the recovery in the property market is extending beyond London. As yields remain under pressure in the capital we are starting to see investors broadening their search for higher returns. This change in attitudes to risk has resulted in a general expansion in market activity.

In light of the Government's announcements concerning a relaxation of planning rules governing office to residential conversions, a number of transactions in Q2 were driven by the possibility to convert from offices to a more profitable use. We see this as a possible trend that could accelerate over the next 18 months.

Headline Transactions, Q1 2013

Property	Sale price	Yield (%)	Size (sq. ft.)	Purchaser
Lloyds Building, Lime Street, EC3	£260 million	6.25	362,500	Ping An
London Stock Exchange, EC4	£235 million	5.33	246,100	Oxford Properties
90 Long Acre, WC2	£163 million	5.25	193,986	Northwood
Old Spitalfields Market	£105 million	4.3		Ashkenazy Acquisition

Robert Hannington, Non-Executive Director at Riverside Capital, discusses the influence of international investment in London.

“There was a time, as an extrapolist, that one could reasonably predict occupier supply and demand together with investment demand in the London markets. The cycle durations were endlessly debated and classically the ‘green shoots’ of chancellor Lamont which followed the over exuberance of office development in response to de-regulation in the 1990 crash took until 1996 to flower, following a number of apparent false starts to economic recovery.

“1990 was of course a massive oversupply and high interest rate issue, and today we face the hangover from a huge over borrowing issue which at least is not exacerbated by accompanying high interest rates.

“In the ‘down time’ of 2009 to today the London market has been completely underpinned by incoming investment capital which has not been deterred by the weakness of the UK economy; in fact perversely, the weakness of sterling has probably encouraged it.

“It is worth noting what London property markets offer investors, much of which we take for granted. In no particular order the list of advantages is probably not replicated in any other single country. A world economic centre, central time zone, stability, lack of corruption, a tight planning system, transparency, depth of market, relatively stable currency, security and finally a place where people simply want to be.

“There have been many arguments expounded regarding the ‘bubble’ nature of prime London residential. Bubbles tend to occur when a small number of investors have specific reasons to invest and where there is a danger of those reasons ceasing causing the market to collapse. In London, for a variety of reasons, we have seen investors from Greece, Portugal, Spain, France, following the US, India, Middle East and most recently

Australia, Malaysia and Canada, with China and South Korea about to join the party. With this depth of investment demand coupled with a finite supply controlled by tight planning it seems unlikely that the definition of 'bubble' will be met any time soon. Bubble conditions have been seen in evidence in certain parts of the commercial cycle in the past and examples were the Swedish Pension Funds being allowed to invest outside their Country for the first time following deregulation in 1985. The huge Japanese inflows of 1989/90 followed by the German influx using a strong Deutschmark to buy at depressed prices from 1991to1995 are also examples, however you can see that they were small numbers of buyers meeting an oversupplied market.

"In the commercial markets, such has been the size of the incoming capital flows from diversified buyers that UK institutions have been pushed to consider the potential advantages of fringe locations and active management propositions which I will return to. There is no doubt that the London markets have been stabilised by this influx and it should be noted that London and so an extent the South East has become an entirely different economy from the UK, which is still suffering from the overall malaise of the depressed economy as a whole. The earlier recovery of 1996 only occurred when it was clear that companies were expanding through an obvious recovery in the UK economy and tenants were met with a rapidly reducing supply. Current data is patchy depending on specific locations but as stated above much tighter in the South East Corner of the UK.

"The opportunity has arisen with our new investing visitors in that they need to address active management. They may not appreciate that so much more can be done to improve the performance of their investments than just collecting the quarterly rents. The issues of distance and time zones can also be fundamental.

"I return to the extrapolation referred to above. We falteringly look set to return to some sort of economic recovery, which in the end will be the driver to property investment growth as occupier demand and supply return to equilibrium. Although West End office rents budge towards their highest ever, there is plenty of scope elsewhere and yields can only be driven down so far. Future rental growth will ultimately be the key to overall success.

"At least the green shoots seem to have propagated. However, today there are so many 'noises off' that can change the course of our graph. 9/11 would be a good historic example but looking forward there are many things outside the influence of the UK. They include, the Euro which is by no means fixed, US debt is eye-watering, North and South Korea continue to sabre rattle and Iran remains ominous. Any of these could cause a wobble to shake the world."

Ashley Wilcox, Investment Director at Riverside Capital, discusses the significance of Riverside Capital's recent purchase, Pure Gym, 202 Wandsworth Road, London SE8.

"Spotting an opportunity for sound income returns within one of London's most up and coming fringe markets was a key driver for our investors in the recent acquisition of Pure Gym on Wandsworth Road.

"Nine Elms has recently been described as the greatest transformational story at the heart of the world's greatest City. The regeneration project will provide 16,000 new homes and create 25,000 jobs.

"The proposed redevelopment of Battersea Power Station, revitalisation of New Covent Garden and the new US Embassy will all be completed by 2017. In addition, infrastructure improvements may be completed by as early as 2019 with two new stations at Nine Elms and Battersea Power Station forming part of the Northern Line Extension.

"The £2.55m acquisition represents a net initial yield of 7.78% and was undertaken with equity from Connection Capital's clients together with debt from RBS on a 50:50 basis. The property comprises 19,508 sq. ft. of accommodation and forms part of the ground floor and basement of Cantilever House which was redeveloped by Mount Anvil in 2010.

"In addition to the regeneration of Nine Elms, Pure Gyms' predicted brand growth in the short-term following a £50m private equity buyout by CCMP Capital Advisors was a major positive for the investors. Their desire to operate 15 new gyms in London and a further 25 nationwide by the end of 2013 will undoubtedly enhance Pure Gyms' covenant strength.

"The potential to exit at any point within the five year business plan provides liquidity and the opportunity to roll with the market. At such time the Pure Gym lease will hold a minimum of 10 years unexpired term and will remain an attractive market proposition.

"Our investors' belief in the micro environment coupled with sensible property investment fundamentals means they will no doubt benefit in terms of return on investment at exit. In the meantime they will reap the benefits of a sound income return throughout the hold period.

"To date the Riverside Capital team have undertaken almost £500m of transactions. Despite the small lot size of £2.55m in this instance, we believed the opportunity to invest in this exciting fringe market was too good to miss."

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