Quarterly Review

Q3, 2014

Riverside CAPITAL

THE PROPERTY INVESTMENT PEOPLE

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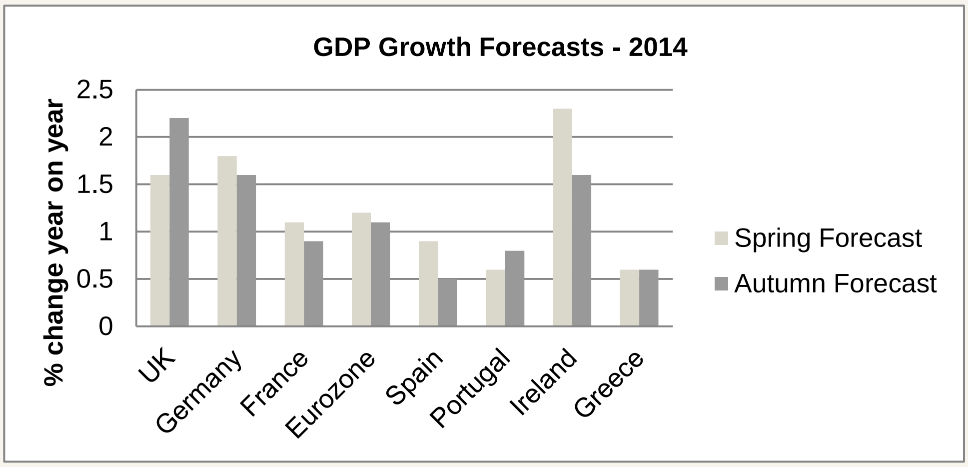
Economic Overview

After hitting all-time highs at the beginning of the third quarter, there was a period of consolidation for equity markets as investors weighed up the increasingly uneven global economic recovery. Geopolitical concerns, including conflicts in the Middle East and Ukraine were a further hindrance to risk appetite.

	Q2	Q3	% Change
FTSE 100	6743	6622	-1.80
DOW JONES	16826.6	17042	1.29
DAX	9833	9474	-3.65
CAC 40	4422	4416	-0.15
NIKKEI 225	15162	16173	6.67
USD v GBP	$1.709	$1.621	-5.19
GOLD	$112	$94	-16.02
OIL BRENT	$1,316	$1,212	-7.90

The global recovery continues but remains weak and uneven. GDP estimates were trimmed over the summer as softer data emerged in Japan, the Eurozone and some emerging - mainly Latin American - economies.



The marked divergence between the US (and UK) versus other economies remained in place over the quarter. The US economic recovery positively surprised with Q2 GDP growth upwardly revised twice in the period, most recently in September to 4.6%. Forward-looking consumer and manufacturing surveys also continued to be positive.

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Eurozone growth prospects stumbled over the summer as macroeconomic data released during the period revealed slower growth. Eurozone GDP stagnated in the second quarter following 0.2% growth in the first quarter. Leading indicators such as purchasing managers' indices (PMI) deteriorated; and the flash composite PMI for September dipped to a nine-month low of 52.3. Concerns regarding deflation also remain as inflation stayed below target with a preliminary reading of just 0.3% for September.

Germany was caught up in the turmoil due to expectations that it could be one of the worst affected by the sanctions in Russia, whilst Italy also underperformed as economic data indicated a triple dip recession and investors worried if the new government would be able to push through its reform agenda.

As a result of deteriorating data, the European Central Bank (ECB) was prompted into further policy easing. In September, the ECB took steps to try and boost the economy cutting interest rates to 0.05%, reducing the deposit rate to -0.2%, and announcing a program to buy asset backed securities. September also saw the first round of the ECB's targeted long-term refinancing operations (TLTROs) which are designed to boost bank lending to businesses.

Monetary policy easing from the ECB aside, indications that quantitative easing is more than likely to be on its way helped provide support for equity markets towards the end of the period and saw the euro weaken versus the dollar. This development should help to improve the competitiveness of Europe's exporters.

UK Economy

The spotlight was firmly on the UK due to the proposed separation of Scotland. Despite late concerns that Scotland would indeed vote 'Yes', business continued as usual, as Scotland voted 'No' in the referendum and we remained a United Kingdom.

Overall, the broad-based UK recovery continues apace, supported by the strong labour market and easy monetary policy. According to the Office for National Statistics (ONS), GDP grew by 0.8% in Q2 2014, contributing to a year-on-year increase of 3.2%, which is 0.2% above the pre-downturn peak in Q1 2008.

This is the sixth successive quarter of growth, moving the UK from having one of the slowest growth rates in the G7 since the downturn to one of the fastest, ahead of Germany (1.3%) and the US (2.5%).

Encouragingly, the services sector, which accounts for about 75% of the economy, has been growing at its fastest rate in years. Despite falling slightly in September, the index is still well above historic averages and the 50-mark that separates growth from contraction. There are also signs of continued optimism amongst managers, with a recent survey of British business confidence coming in at its highest rate in 20 years.

Whilst the economic climate and data from the UK is generally positive, ongoing deflation in Europe and the strength of sterling continued to feed through, in turn weakens export demand.

The Bank of England's (BoE) August Inflation Report declared that robust, broadly based growth over the past year has taken output to above its pre-crisis peak and that unemployment has fallen sharply. However, there was an unexpected fall in the official measure of UK inflation from 1.5% to just 1.2% in the September report, this was drastically below the BOE's target of 2% and the lowest in 5 years.

For the last three years there has been a unanimous position within the BOE's Monetary Policy Committee (MPC) to keep the base rate at 0.5%. For the first time however we saw a split as 2 out of the 9 members voted for a rate rise.

The BOE continues to provide mixed signals with regard to future changes in interest rates. Despite continued economic growth, the BOE now appears to be focused on the country's "remarkably weak" wage growth and has emphasised that interest rates are expected to be raised "gradually" and by a "limited" amount. There is now a general agreement amongst economists that interest rates are likely to remain unchanged until the middle of 2015, before heading slowly towards 2.5% over the next 2-3 years.

UK Property Market

Residential

The exponential growth that we have seen over the last 12-18 months has finally shown signs of easing. The Royal Institution of Chartered Surveyors reported that during the month of August UK house prices rose at the slowest pace in a year, while official figures revealed that mortgage approvals fell in July.

The Mortgage Market Review (MMR) guidance, introduced in April, has led to a weaker outlook for mortgage approval growth, almost a 20% reduction between

January and May according to Nationwide, as eligibility criteria have become tougher.

This, high deposit requirements and concerns about future rate rises have all combined to take some steam out of the UK housing market. According to Nationwide data, Annual house price growth in London slowed from 25.8% in the second quarter to 21% in the third quarter.

In the UK as a whole, prices are about 2% above their pre-crisis peak, with the average property costing £188,000 on a non-seasonally adjusted basis. Although if London is excluded they are only 1% higher. Significant regional variations remain, with the South recording the strongest growth and the North the weakest.

Forecasts for 2015 suggest there will be a moderate adjustment in prices following a year in which they, perhaps, got ahead of themselves. In particular, fears of a future mansion tax will bring down prices at the top end of the capital's housing market.

The UK house building sector is undergoing a renaissance, growing at its fastest rate since July 2003. Despite this, there remains a critical imbalance between supply and demand . According to the Bank of England the net new supply of private housing was 110,000 in 2013, which is well below the 2000-2007 average of 180,000. Property agent Knight Frank believes that prime central London rents are continuing to rise, up 1.6% year on year in September, the highest rate of growth in two and a half years.

Average UK rents climbed by 2.4% year on year in August, as many tenants choose the end of summer to move into new accommodation.

Whilst lower than expected inflation data is likely to lead to a delay in interest rate rises, it is all but a forgone conclusion that a rise will occur sometime next year. This will directly impact homeowners on variable rate mortgages.

Commercial Property Outloook

PERFORMANCE

The continued recovery in the UK economy has been reflected in the performance of the commercial real estate market, which experienced both increasing capital values and growing rents. The UK real estate market continued to perform strongly during the third quarter of 2014, with values rising by 3.0% for all property. This rate of growth, however, was slightly down on the 3.3% for the second quarter following five successive quarters of accelerating growth.

The strong level of value growth contributed to a total return of 4.4% for the quarter, the second highest since Q1 2010, according to the IPD UK Quarterly Property Index.

It was a tough quarter for equities, driven by a rise in volatility. UK government gilts delivered solid returns at +4.3% over the third quarter, as yields ended the period significantly lower. Gilts benefited from the current low inflation environment, as well as from the general downturn in risk appetite amid growing geopolitical tensions in the Middle East and Ukraine.

Property remains a compelling investment against other asset classes and continues to maintain a healthy yield margin over bonds & equities.

Yield Compression Drives Performance

Performance in Q3 was driven largely by yield compression and the asset class was supported by high demand from investors and a persistent lack of supply, whilst development activity remained limited.

Industrials led the market over the quarter returning, 5.4% thanks to capital growth of 3.9% and strong income return of 1.5%.

Year to date, offices are the best performing sector with annualised total returns (Sep 13-Sep 14) of 25.2%, driven by capital growth of 18.4%.

Quarterly Performance (%) Q3 2014	All Property	Offices	Industrials	Retail
Capital growth	3	3.9	3.9	2.3
Income return	1.3	1.2	1.5	1.3
Initial yield	5.3	4.8	5.9	5.3
TOTAL RETURN	**4.4**	**5.1**	**5.4**	**3.7**

Capital growth showed a mixed pattern across the UK regions in Q3 2014. London retails and industrials performed very strongly, with value growth of 6.2% for West End shops being the highest for any sector-region combination. West End office growth decelerated compared to Q2, but offices on the inner London fringes and in outer London picked up.

Quarterly Performance (%) Q3 2014	All Property	Offices	Industrials	Retail
Rental Value growth	0.8	1.6	0.7	0.2

Despite the continued strong growth, capital values overall are still c. 28% off the peak levels of 2007 according to IPD.

Offices in the capital continued to see by far the strongest rental value growth in the UK, reflecting buoyant occupier conditions and offices remain the outperformers. However, we are now starting to see the retail sector catch up.

As we approach the end of the year it now looks likely that total returns from property in 2014 will reach the highest levels seen for about eight years, ahead of both equity and fixed interest markets in the UK. While the pace of returns may slow in the coming years, the background remains favourable for property investment.

Yield Hardening Continues

Increased competition from buyers against a backdrop of falling stock levels is helping to force down yields.

According to Cushman & Wakefield's latest UK report, commercial property yields have continued to fall across prime and secondary markets since mid-summer, with prime down 7 basis points (bps) since June to an average of 5.1% while secondary yields are down 17bps to average 7.8%.

Average prime yields are now within 22bps of early 2007 levels.

Three sectors are at, or below where they were in mid-2007 (WE offices, shopping centres, and distribution).

With Gilt yields also falling over the last quarter the property yield gap has edged up once more.

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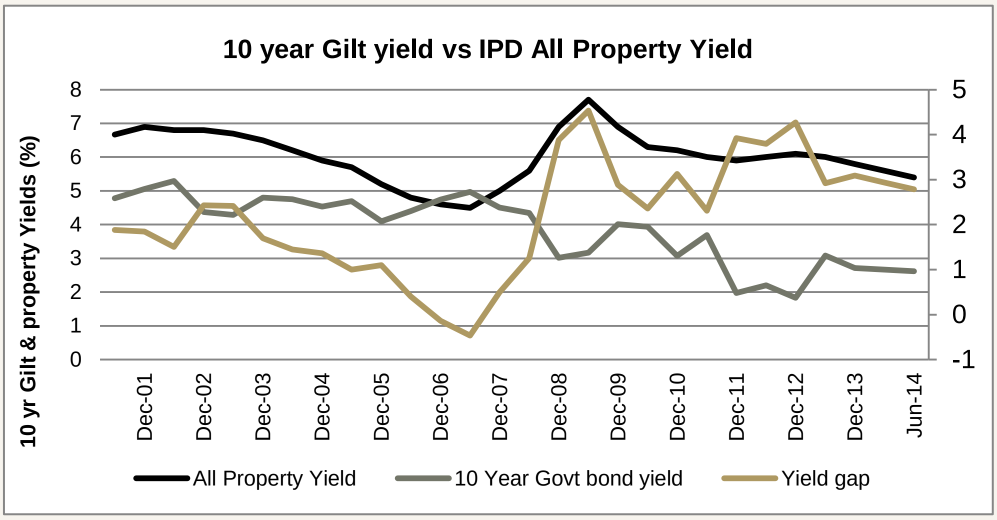
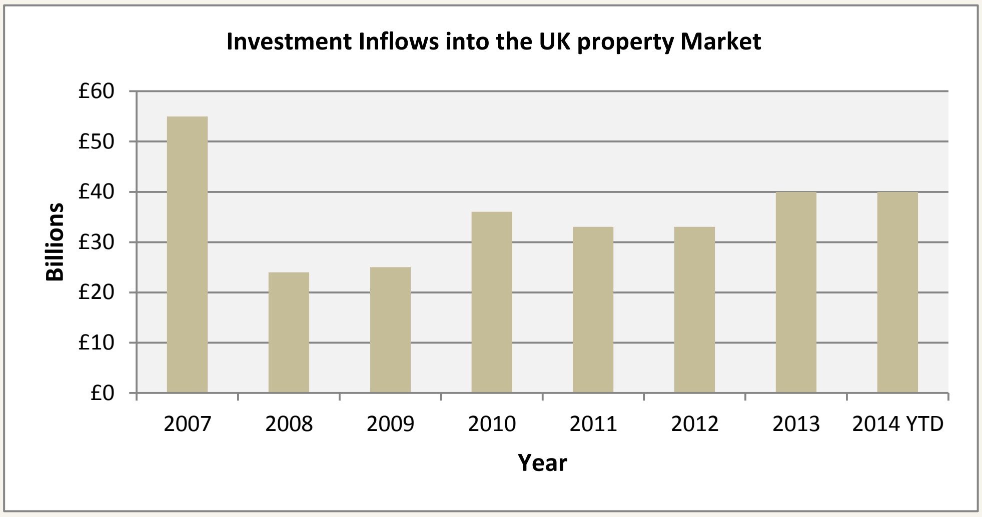


The inevitable rise in interest rates in 2015 will likely see a rise in Gilt yields, however, even if gilts were to rise in line with Base Rate forecasts there would remain a very attractive premium between property and bonds.

Investment Volumes

UK Commercial property investment topped £16.3bn in the third quarter of 2014, 41% up on the same period in 2013. Overall investment for 2014 is now expected to break the £50bn mark for the first time since 2007.



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£6bn was invested in the regions over Q3, the highest level since 2006 and the first time it has overtaken the flow of investment into London since Q1 2011.

While Asian and Middle Eastern investors remain a key source of capital for the UK, North American investors have dominated H1 2014, contributing over half of the inbound global capital in the first six months of the year.

Central London's appeal to overseas investors remains as strong as ever with £4.4 billion of assets sold over the quarter, well above the long-term average of £3.1 billion. Overseas investors continued to dominate transaction volumes, specifically the larger lot sizes, accounting for 74% of turnover.

The London office sector remains in high demand. Whilst competition for assets is keeping yields low, investors keep on buying, initiating the next phase of the property cycle whereby we start to see the benefits of positive rental growth coming through.

Transactional yields for the industrial sector are well above their five year average. Going forward, inflows into the country are set to get even larger. The Japanese Government recently announced that the government pension scheme had £43bn to invest in global real estate. Given that the operations are to be based here in London, there is a high probability that a lot of the cash will find a home here.

Regional Outlook

The increase in capital inflow over the last 12 months has continued to force yields to harden within London. This has led to investors moving up the risk curve and looking, increasingly, outside of the capital for opportunities.

Rising business confidence and strengthening occupational demand has increased the prospect of rental growth and is helping to push values up in the regions. Forecasted returns for the year have risen as a result.

Prime offices within the strongest regional markets (Bristol, Manchester, Leeds and Birmingham) are seeing a lot of interest, which raises a new concern of a looming grade A supply shortage. Manchester is seeing yields approaching 5% and retail sub-5%, with landlords now looking to cash in on investor appetite.

Unlike transactions in London, which have been driven by money from overseas, transactions in the regions are currently being driven by UK institutions, accounting for close to 50% of total investment volumes year to date.

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Occupational Demand and Rental Growth

Employment is a key driver of occupational demand, particularly for the office sector. Whilst employment levels took a big hit in 2008/9, levels have grown strongly across the UK since 2011.

During the second quarter of this year the unemployment rate fell to 6.5%, the lowest since December 2008 and equalling the highest level of employment since records began in 1971. The outlook looks brightest in London where jobs lost in the financial crisis have now been recovered, confirming that the capital has bounced back from the credit crunch.

On the offices front, rising take-up and falling vacancy is driving record rental growth of 9.2% across central London offices this year. Regional offices have pockets of supply-shortages and little development scheduled. Accordingly, rental growth is expected to accelerate over the next three years, according to a report by Colliers International.

Demand for space is now outpacing supply. According to the latest report by property investment agents, DTZ, office take-up in central London reached 1.6m sq ft in September, bringing the year-to-date total to 10.4m sq ft, 15% up on the same period last year.

This has meant that the availability of Grade B Central London Office space has hit a 13 year low.

Further, JLL warned that occupiers will face a 13m sq ft shortfall of office space in central London by 2018, as 23m sq ft will be required but only 10m is set to come to market.

Outlook

The outlook for the rest of 2014 and beyond looks to be in very good shape. There is strong, and rising, investor demand that is well supported by debt markets, where increasing competition is driving financing costs down.

This demand is also no longer concentrated on London and the weight of money is spreading to the regions as well as the sub sectors.

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Looking into 2015 we expect yield compression to start moderating due to an inevitable rise in interest rates. Capital growth, however, will remain positive driven by positive rental growth.

Investors will continue to look for asset management opportunities where a successful refurbishment will lead to rental growth and significant increase in values.

The last 12 - 18 months has represented a positive change for the regional office markets. Office rents are now returning to growth

The outlook for regional commercial property remains positive with demand increasing across the majority of key markets, representing a significant growth in take-up and falling supply.

Regional volumes only made up 16% of total volumes in 2013 and to date they make up 27%. We expect this rising trend to continue as we go through the rest of the year.

Regional office rents are also now returning to growth.

Due to the high levels of demand, there is a severe shortage of available stock, particularly Grade A. This will lead to a pick-up in demand for high quality secondary assets in good locations.

For further information please contact:

Sarah White
Head of Marketing
Tel: +44 (0)20 7297 4480
Email: sw@rivercap.co.uk

Jaspal Phull
Head of Research
Tel: +44 (0)20 7297 4480
Email: jp@rivercap.co.uk

www.rivercap.co.uk