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London Market Snapshot

October 2015

Global Macro Overview

Global equities experienced their sharpest falls since 2011, with most major markets moving into "correction" territory (a fall of more than 10%) from highs achieved in the spring.

Markets started the month on a nervous note with investor concern about the negative impact of a potential Chinese slowdown on growth in Europe, Asia and America leading to a significant rise in volatility.

Equity markets around the word plumeted as China's failed attempts to halt the slide in the local Shanghai stock market culminated with the central bank devaluing the renminbi mid-month for three days in a row.

The currency devaluation was widely interpreted as an attempt to stimulate the world's second largest economy and concerns quickly spread that growth expectations in China would not be met. This was later confirmed by poor PMI data.

The FTSE 100 ended the month down 448 points (-6%) and the S&P 500 lost 132 points (-6%). The Nikkei 225 fared worse, falling over 8% in local currency terms.

The sell-off in equities saw both UK gilts and US treasuries fall to values last seen in May, as investors sought the percieved safety offered by higher-quality assets. Yields largely recovered from these mid-month lows to be flat or higher by the end of August. The 10-year gilt rate rose from 1.88% to 1.96% and the 10-year Treasury yield rose from 2.18% to 2.22%.

The retreat in global commodity prices also continued in August, as concerns over Chinese growth intensified. Oil was extremely volatile; after a month of decline prices surged 10% on the 28th August: the largest one-day gain in seven years.

As we approach the final few months of the year, investor focus has turned to the US and the timing of the first increase in interest rates for nearly a decade. Whilst the US economy is now in full employment and macro data looks increasingly more positive, the dilemma the Fed now faces is whether or not they should start to raise rates at a time when disinflationary clouds are gathering over many emerging economies, and equity markets are suffering from extreme levels of volatility.

Until recent months, many investors were confident that the central bank would lift rates in September. Yet comments recently made by Fed officials suggest they are divided over whether to increase rates this year.

The direct impact of a Fed increase may appear small, but the indirect consequences, including on the BoE's thinking and the stock market, could be significant.

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UK Economy

It is becoming increasingly clear that the world economy has lost momentum. Following on from the Greek debt crisis, we are now facing the bigger problem of a notable slowdown in China. However, despite this, the UK continues to experiance a positive economic outlook.

The latest estimate from the Office for National Statistics is that the economy grew by 0.7% in the second quarter of the year, after an identical expansion in the first three months. The ONS estimates that the economy grew by 3% last year, the strongest full year of growth since 2006.

The CBI has upgraded its GDP growth forecast for this year to 2.6%, pointing to a stronger uplift in productivity and decent business investment prospects. In addition, rising earnings growth and very low inflation are continuing to boost household spending power.

Rates to remain on hold

As with the Federal Reserve, there has been considerable focus on the Bank of England and the likely timing of their first interest rate increase. In their last meeting, the MPC voted by a margin of eight to one to leave Bank Rate at 0.5% and unanimously to leave its stock of Quantitative Easing assets at £375 billion. The minutes show growing concern about the deterioration in China and other emerging markets during the last month, which is likely to be a drag on UK growth and inflation.

Strong economic data had initially brought forward expectations of the likely timing of UK interest rate rises, however, given the current market turmoil the likelihood of this happening before the year-end are now very remote.

The UK faced another month of "noflation". With the fall in energy prices and the current strength of Sterling, it is difficult to picture when inflation will return to the MPC's 2% target.

Inflation first fell to zero in February and has hovered at this level ever since. With no catalyst on the horizon, CPI is likely to hover around 0% over the next few months.

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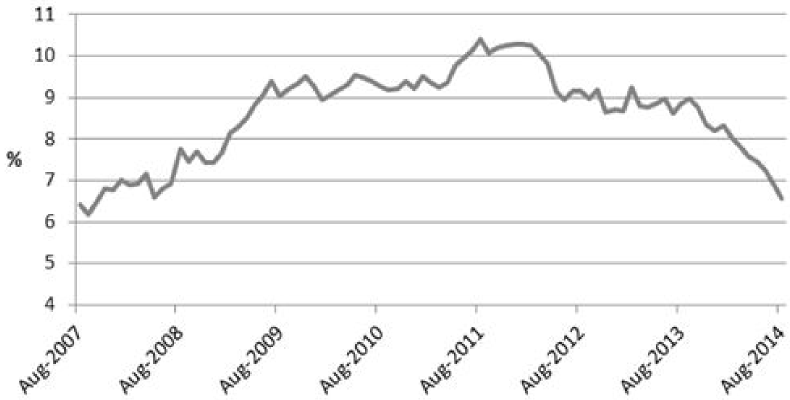
London Market

Employment drives occupational demand across the capital

- The latest employment figures from the Office for National Statistics (ONS) show the jobs market in London is back to where it was in 2007.
- The unemployment rate in the capital fell to 6.6% in August: its lowest level since the onset of the financial crisis back in 2007.

Unemployment rate in London



Source: ONS

- These strong employment numbers have helped to provide a significant boost to occupational demand for the London office market over the first half of the year.
- Take-up in Central London for August 2015 was 814,000 sq. ft., 34% lower than the previous month according to the latest CBRE Monthly Index. This was mainly due to limited availability rather than a decline in occupier demand.
- Vacancy remains low by historical levels, falling to a 14-year low in the West End, the first time it has declined below the 3% mark since 2001, and 4.3% in the City.
- The Media Tech sector continues to drive West End demand, together with the Banking & Finance sector, accounting for a quarter of take-up so far this year up from 22% in Q1 2015, and to just under a third of all take-up in the West End, up from 22% in Q1.
- The largest transaction of the month saw Candy Crush creator King.com acquire The enire Amprsand building, 180 Wardour Street in Soho, a deal totalling 66,400sq. ft.
- Further to the Candy Crush maker's commitment to the West End, Media tech giant, Facebook are under offer on 200,000 sq. ft. at Great Portland Estate's 1 Rathbone Square scheme.
- The largest deal in the City saw serviced office operator, One Avenue Group acquire 48,600 sq. ft. at Dawson House, EC3.

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Investment Volumes

High demand vs limited supply continues to push up rents

- Rents for offices in London have been rising steadily in the first half of this year (+5.2%, according to IPD Central London Office Index) and are on course to surpass full-year 2015 forecasts of 8%.
- The polarisation in rental growth fortunes between London, the South East and the rest of the country is expected to persist, with some office locations in the capital already on course to reach double-digit uplifts in 2015.
- The average quoting rent for City of London office space has moved up a price band in the first half of the year as strong occupier demand and constrained supply continues to buoy the market, new research from Savills has shown. Data showed that over the first half of 2015 the most common deal in the City was for a floorplate of 10,000 sq. ft. at a quoting rent of £50-£59.99/sq. ft.
- Based on the persisting undersupply of vacant office space, office development completion and assumptions on demand for office space across all of London's office sub-markets, it is predicted that office rents will continue to rise until at least mid-2017. When office developments that are currently under construction/refurbishment begin to reach completion, tenants will be provided with more choice which should ease the upward pressure on rents.

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Further yield compression to come

- The weight of money, particularly from overseas investors, continued to drive down IPD All-Property yields which hardened by 15 bps in the first half of the year.
- The inward shift has been stronger for offices, South East offices in particular, and weaker for retail. The current spread between prime and secondary yields (350bp) is still well above the 2007 low (205bp).
- Year-on-year, yields across London have compressed considerably and are now at record lows. However, even at these levels, quality commercial property continues to yield in excess of other comparable assets available to UK and international investors.

Prime Yields	August 14	August 15	Sentiment
City Offices	4.50%	4.00%	Positive
West End	3.50%	3 - 3.25%	Positive
Bond Street (retail)	2.25%	2.25%	Positive
Oxford St (retail)	3.25%	2.75%	Positive

Summary

- The UK economy continues to perform strongly, although the pace of growth has marginally slowed amid concerns around China.
- Driven by a sharp increase in leasing activity in the second quarter, office take-up in 2015 reached the highest total recorded at mid-year since 2007.
- Commercial property and office rents have reached all-time highs across the West End, midtown and the City. Headlines have recently been dominated by a spate of high-profile tech firms making a home for themselves in the capital.
- While swap rates have been gradually drifting up in recent months, the all-in cost of debt finance remains near historic lows.
- Rising rental growth will become increasingly more important in an environment of low inflation and low interest rates, especially where investors are broadening their search for income.

Key deals in August

Address	Sector	Area (m2)	Price (£m)	Yield (%)	Purchaser
London, N1	Shopping Centre	14,028	171	4.1	CBRE Global Investors
London, W2	Office	7,605	110	4.7	GWM Group
Bartholomew Close, London, EC1	Office	19,602	102.4	-	Ashby Capital LLP
5 Cheapside, London, EC2	Office	3,728	80	-	Easa Saleh Al Gurg Group
Atrium, Uxbridge	Office	12,820	55.9	5.7	Blackrock UK
7 Bishopsgate, London, EC2	Office	15,421	100	-	WELPUT

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