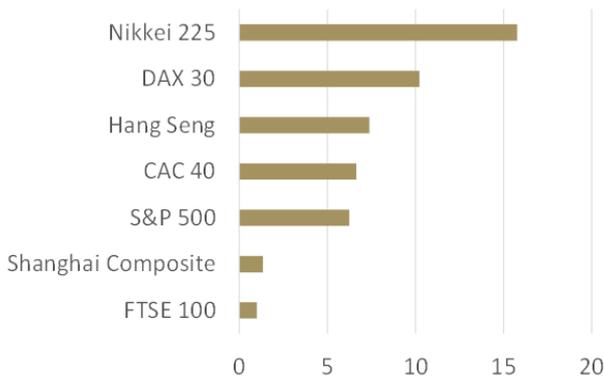


November Update

Global Factors

Major global stock markets have been on an upward trajectory over recent months. For example, the strongest European and Asian equity indices have made gains ranging between 7% and 15% over the 60 trading days to 24th November. In contrast, although still positive, the FTSE 100 has seen comparatively muted increases, of around 1% (Chart 1).

1.0 Percentage Increase of Selected Equity Market Indices (60 Trading Days to 24 November)



Source: Thomson Reuters

Currency fluctuations have been a key determinant of stock market moves. For instance, the Nikkei's 15% increase over the last three months has coincided with a 2.5% depreciation of the Yen against the Dollar. By contrast, the comparatively small gains seen by the FTSE 100 occurred during a period where sterling appreciated by 3% against the Dollar. These moves reflect the fact that a large share of the earnings of the firms traded on both the Nikkei and FTSE 100 are generated overseas. As such, depreciations boost the value of those earnings in the local currency, and vice versa.

Sterling's appreciation, in part, reflects that a few months ago markets did not expect UK interest rates to rise until 2019. But the MPC sent a clear signal in September that a rate rise was imminent, and then followed through on that signal by raising Bank Rate to 0.5% in November.

An Overview

As expected, the Chancellor Philip Hammond was constrained by the Office for Budget Responsibility's (OBR) gloom over the economic outlook. Nonetheless, recent favourable fiscal trends and some timely accounting changes allowed him to unveil a bigger giveaway than was generally anticipated. Even in the absence of stronger growth, the Chancellor's Budget measures have reduced the planned speed and scale of fiscal tightening over the coming years. Austerity is not yet over, but there is finally some light at the end of what has been a very long tunnel.

November Top 5

1. Global equity markets maintain their upward trajectory
2. UK interest rates rise for the first time in over a decade
3. Chancellor abolishes stamp duty for first time buyers on homes below £300,000
4. Hotel sector performs strongly as overseas investors take advantage of a weakening pound
5. High levels of inflation sees continued strong demand for hotels on long leases and RPI linked rent increases

That said, the recent macroeconomic data has not been particularly positive. For example, at minus 14,000 in September, job creation contracted for the first time since last October. Retail sales volumes growth also disappointed, rising by a muted 1.3%/y/y in October. And even though the unemployment rate held firm at 4.3%, signs that nominal wage growth is starting to respond to the tightness of the labour market are tentative: headline average wage growth rose modestly, from 2.1% in August to 2.2% in September. And with CPI inflation still hovering around the 3% mark, falling real household incomes are still a headwind facing consumers (Chart 2).

2.0 Average Earnings and CPI



Source: Thomson Reuters

Budget 2017: Hammond masks gloomy outlook with stamp duty cut

Philip Hammond placed a stamp duty cut for first-time buyers at the heart of his budget on Wednesday as he sought to mask Britain's deteriorating economic prospects by pledging to "revive the homeownership dream".

Faced with evidence showing that the UK will be one of the weakest growing major economies in the next five years, the chancellor announced a modest increase in funding for the NHS, and announced £15bn of measures to tackle the housing crisis.

Hammond announced a £9bn boost to borrowing in 2019-20 – expected by the Treasury to be the toughest period for the economy as Britain leaves the EU – and pushed back until the mid-2020s the date by which the government expects to eradicate its budget deficit.

In what he called a "balanced" statement, the chancellor sought to placate rebels on both wings of his party, setting aside £3bn for Whitehall departments to prepare for Brexit, and cutting waiting times for claimants of universal credit.

Property Overview

The RICS Commercial Survey for the third quarter highlighted that occupier market conditions improved.

The occupier demand balance picked up from minus 2% to plus 5%, whilst the availability balance signalled a drop in availability. With demand picking up and supply tightening, the rental expectations balance rose, from 8% to 13%. Unsurprisingly, with rental prospects brightening, the balance of respondents reporting a rise in investor enquiries doubled over the quarter from 10% to 20%.

That said, a large proportion of the quarter's improvement was concentrated in the industrial sector. For example, taking the rental expectations balance as a bellwether suggests that industrial rents look set to rise, whilst office and retail rents are expected to plateau (Chart 3).

3.0 Net Balance of RICS Surveyors Reporting Rising Rental Expectations (%)



Source: RICS

Generally speaking, investment activity was fairly muted in October. At £3.8bn, the total value of deals agreed was slightly lower than the £3.9bn recorded in September. Nevertheless, there were some signs of improving liquidity. For instance, reflecting a sharp rise in the number of deals signed, the implied average lot size fell by a third, to £24m.

Meanwhile, in this month's budget, the Chancellor announced that after 2018, increases in business rates will be calculated using the CPI measure of inflation, rather than RPI. Moreover, after the next revaluation, the time between revaluations is set to fall from five years currently, to three years. But perhaps the most important announcement was of the launch of a consultation around the payment of capital gains tax on the disposal of real estate assets by foreign investors. This would bring the UK in line with most other developed economies.

On residential property, although the Chancellor abolished stamp duty for first time buyers on homes below £300,000, this measure is fairly inexpensive, at around £0.6bn per annum. Outside of London, the majority of first homes are bought for less than £250,000, which attracts stamp duty of just £2,500, with many first homes below the £125,000 threshold for the tax altogether.

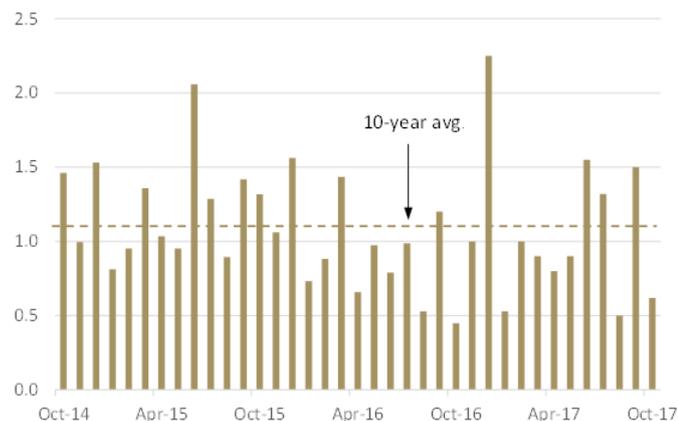
On the supply side, Hammond set aside £1bn-£1.5bn for facilitating and encouraging housebuilding from 2019-20, along with a review on whether developers are holding on to land banks speculatively, rather than for technical reasons, with an aim of boosting supply for development.

London Property Market

September was a subdued month for central London offices.

For one thing, at 0.6m sq.ft., office take-up in the capital fell by 58% m/m (Chart 4). Despite that, the most recent figures do not alter the bigger picture that leasing activity has been healthy since last year's referendum. Taking the twelve months to September together, office take-up stood at 12.9m sq.ft., a figure that was 6% higher than the 10-year average.

4.0 Central London Office Take-Up (M Sq.Ft. per Month)



Source: CBRE

Office availability in central London has risen over the last two months. In fact, the volume of space available increased by 2% for a second consecutive month in September. Standing at 14.5m sq.ft., office availability reached its highest point since April. Even then, at the current rate of take-up, the available stock would only take about a year to let.

Investment activity in the capital picked up slightly during October. Totalling just over £1.2bn, that was 18% higher than in September. That helped London's share of activity to rise from 26% to 31% over the same period.

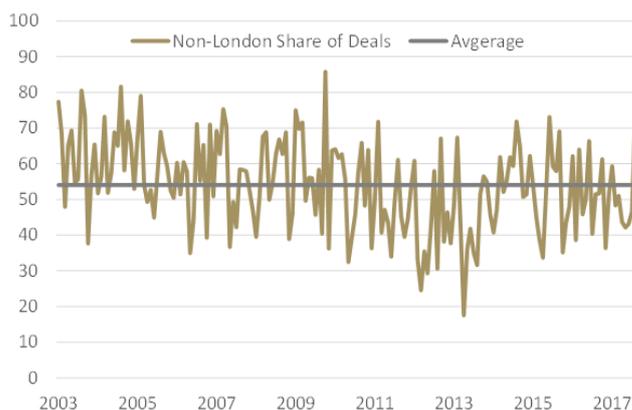
Regional Property Market

The RICS Commercial Survey was more upbeat about the prospects for non-London property markets. Indeed, the occupier demand net balances rose in all regions bar the capital, driven primarily by the industrial sector. Meanwhile, rental expectations were unchanged or improved in all regions outside of London.

This positive picture sits comfortably with the picture of regional office take-up too. According to GVA, with a combined value of 3.4m sq.ft., office leasing activity in the nine cities that they cover rose by 50% q/q. It was also encouraging that quarterly take-up was higher than the five-year average in six of these nine markets. Within the total, the strongest showings were in Manchester and Leeds where quarterly take-up surpassed 0.5m sq.ft.

That said, regional markets share of investment activity fell in October. Indeed, having hovered around 75% in the two previous months, non-London markets' share of activity stood closet to 65% at the latest reading. **But the big picture is that regional markets have made up a larger share of activity than the average seen over the last fourteen years or so (Chart 5).**

5.0 Non-London Share of Commercial Property Investment Deals (%)



Source: Property Archive

Sector Spotlight - Hotels

Despite the uncertain political outlook following the UK general election and the ongoing Brexit negotiations, the UK Hotel market remains attractive to a wide range of investors from the UK and overseas.

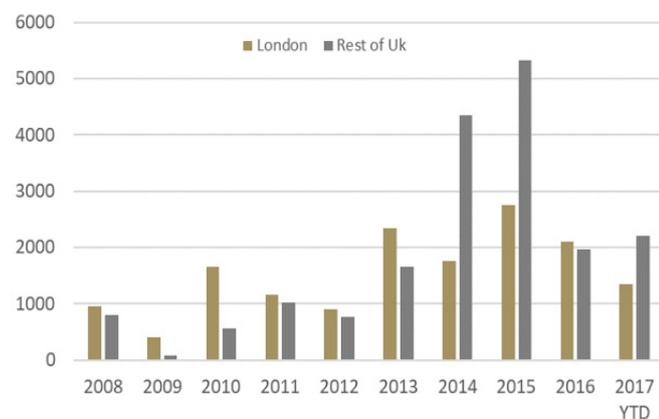
Over the last 24 months, we have continued to see a robust recovery in the hotel sector with increased investment activity and valuations which has encompassed most regions across the UK.

With inflation on the rise we are also seeing strong demand for hotels on long leases and RPI linked rent increases, which bodes well for our Travelodge holdings.

Hotel investment activity has held up well. For example, according to Property Archive, monthly hotel transactions have averaged more than seven nationally over the twelve months to October. That figure is 11% higher than the equivalent figure for 2016. Meanwhile, in value terms, hotel investment activity has averaged £336m per month in the year to October, up from £255m last October.

Savills data provides a geographic breakdown of hotel investment activity. It reveals that by the third quarter of 2017, rest of UK hotel investment activity had already exceeded 2016's total. By contrast, hotel investment in the capital is slightly behind last year's pace. The £1.3bn transacted so far this year in London represents two-thirds of 2016's total of £2.1bn (Chart 6).

6.0 Value of Hotel Investment (£m per Year)



Source: Savills

This has largely been supported by demand from overseas investors. Data from Savills suggests that roughly half of all hotel transactions involved foreign buyers. Previous peaks in overseas buyer activity in the regions, such as in 2014 and 2015, were largely driven by US private equity portfolio acquisitions. This time there

has been a wider pool of investors, with Far Eastern investors dominating transactions this year. Indeed, Savills data shows that 40% of all hotel purchases were made by investors from the Asia Pacific region.

The post-referendum fall in the pound has been widely credited for the resilience of investor demand for UK hotel assets. While this is slightly at odds with the experience of the last decade or so, where hotel investment has been largely uncorrelated with movements in the exchange rate, it is entirely possible that a weaker exchange rate has encouraged nervous investors to take the plunge.

That said, the supportive impact of the weaker exchange rate may have come by encouraging higher demand for tourism-related services. The data provides some support for this idea. Granted, tourist spend during the three months to July stood just 0.5% higher than a year earlier. However, tourist arrivals – arguably a better measure for hotel demand – stood some 5% higher than a year prior.

The outlook for the hotel sector remains bright. London has long been a focus for hotel investment, but now regional markets are witnessing the benefit from overseas investors following the weakening of the pound. The prospects for a sterling appreciation going forward seem fairly limited. Provided that the low exchange rate continues to encourage tourist arrivals, or at the very least that investors still believe that a weaker exchange rate makes the sector more attractive, both investor and occupier demand are likely to hold up well.

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