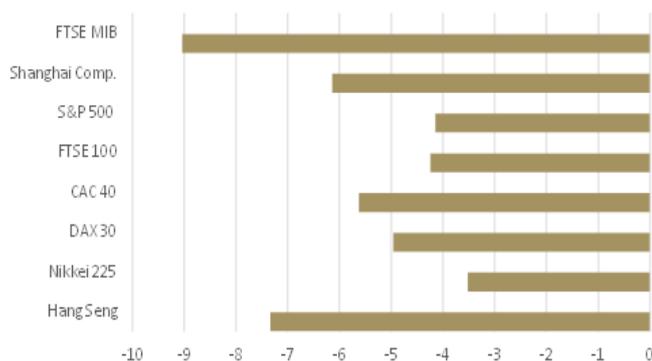


Update - October 2018

Global Factors

In recent weeks, sentiment has weighed on global equity markets (see Chart 1). Investors appear concerned about the level of stock market valuations given the prospect of further monetary policy tightening in the US and the potential for slower economic growth in response. Political concerns have weighed on the FTSE MIB, and the Shanghai Composite has fallen to a two-year low on the back of a weakening domestic growth outlook and a continuation of the US-China trade dispute. Nevertheless, weak market sentiment is in contrast to mostly positive economic data outturns.

1.0 Change in selected major market indices over the last 20 trading days from 23/10/2018



Source: Thomson Reuters

Indeed, data out of the US presents a picture of a strong economy. Strengthening manufacturing output drove a pick-up in industrial production to 5.2% y/y in September, from 4.9% y/y in August. This is possibly a sign that trade tariffs are providing support for domestic firms, at least temporarily. Granted September's employment data was weak, but it was undoubtedly dented by the temporary effect of Hurricane Harvey.

An Overview

Brexit negotiations between the UK and the EU are reaching an inflection point, but the likelihood of a deal continues to ebb and flow almost with each meeting between UK and EU negotiators. Even if an agreement is reached over the coming weeks, there is a significant risk that it will not gain sufficient support in parliament. In spite of this uncertainty, London's appeal as a major hub for overseas investors continued to be underlined this week as data showed that the proportion of foreign money being injected into the capital's commercial property market has hit an all-time high.

October Top 5

- Investors are growing increasingly worried about a cocktail of risks that could act as a significant drag on the world economy;
- Economic indicators suggest that UK growth has picked up over the 3rd quarter;
- Outlook for take-up in the central London office market appears solid, with under offers above their 10-year average, and are stronger than the average take-up rates of the past 10 years;
- Increasing numbers of full time students and an undersupply of rooms continues to support the demand for student accommodation;
- Demand for more affordable rooms in shared student accommodation remains high, providing support for rental growth.

Even so, the unemployment rate declined to 3.7%, the lowest rate since 1969. Further, for now at least, real consumption growth has only slowed gradually as the boost from tax cuts begins to wane. Real consumption growth in the third quarter, of 3.5% annualised, was only slightly slower than the 3.8% recorded in Q2. In turn, the hawkish tone of the Federal Reserve's September minutes, emphasising that interest rates could increase to above neutral levels, was unsurprising.

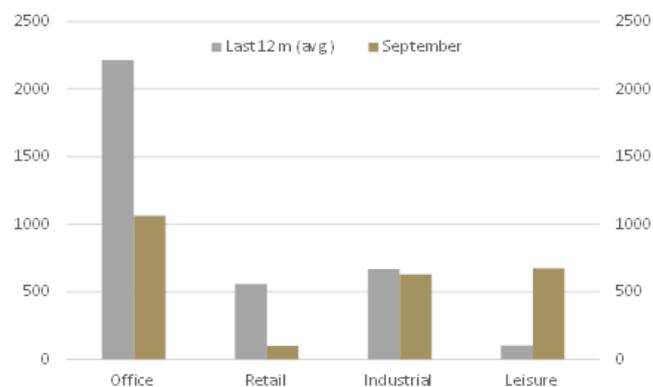
In the UK, economic indicators suggest that growth in the third quarter was at least as strong, if not stronger, than Q2. In the three months to August, employment growth picked up to 0.9% y/y, from 0.8% y/y in July. With unfilled job vacancies at near record levels, and the unemployment rate at 4%, tightness in the labour market is clear. In turn, the pace of headline wage growth has increased, reaching 3.1% y/y in August. Nevertheless, as yet, there are no clear signs that positive real wage growth has boosted the pace of consumer spending growth. Although retail sales increased by a solid 1.2% q/q in Q3, non-retail sales have been softer and are dragging down overall consumer spending.

Economic growth in the euro-zone in Q3 also appears to have been similar to Q2, at around 0.4% q/q. Indeed, the final September composite PMI, at 54.1, points to only modest growth in the bloc. Further, industrial production grew by a surprisingly strong 1% m/m in August. That was despite production of motor vehicles falling as a result of temporary hold-ups in car production, due to testing ahead of the introduction of new emissions regulations in September. But the bigger picture is that economic growth in the euro-zone has slowed from the start of the year, with exports, in particular, being affected by weaker global growth.

Property Overview

September's Property Archive data show that a lack of liquidity is still the defining feature of the UK commercial property investment market. The total value of deals completed in September, at £4.7bn, was 9% higher than a year earlier. However, similar to August, investment was boosted by one large deal - the £1.46bn purchase of the Network Rail Portfolio by Telereal Trillium/Blackstone. Excluding this deal, investment would have been 24% lower than a year ago. Across sectors, there was some positive news, with investment strengthening in the leisure sector and holding up in the industrial sector (see Chart 2). Office investment continues to dominate activity, but at just over £1bn in September, it was around half of its 12 month average value.

2.0 Value of investment deals by sector



Source: Property Archive

In general, the outlook for occupier demand appears healthy while the supply pipeline is limited. Granted, employment fell by 5,000 jobs in the three months to August. And on past form, the current rate of employment growth, at 0.9% y/y, is consistent with all-property rental value growth moderating a bit further over the next two or three quarters. Nevertheless, the Q2 RICS Construction Market survey suggests that the UK commercial property development pipeline is not expected to increase materially (see Chart 3). On balance, there is little obvious risk of a rental correction in the foreseeable future.

3.0 Past and Expected Workloads (% Net Balance)



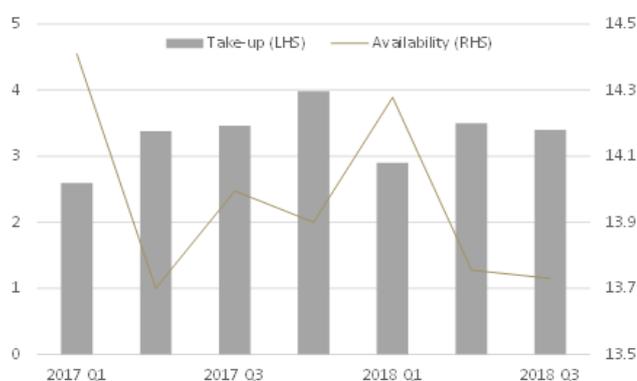
Source: RICS Construction and Infrastructure Survey

Nevertheless, concerns about pricing are building. This is most noticeable in the retail and South East office sectors, where Savills note that the greatest upward pressure on yields is being felt. Indeed, it is hard to envisage property yields falling much further. After all, if Brexit is smooth, Bank Rate will continue to rise as the economy gathers momentum. If it is not, investors may take a step back, keeping yields stable or perhaps pushing them higher, at least temporarily.

London Property Market

In central London, data from CBRE show that office-take up in Q3, at 3.4m sq. ft, was just 3% lower than the strong second quarter (see Chart 4). In turn, take-up so far over 2018 has been greater than the total level of take up for the same period in 2016 and 2017. Indeed, healthy levels of occupier demand and limited supply meant that availability fell to 13.7m sq. ft. in Q3.

4.0 Central London Office Take-Up and Availability (M Sq. Ft.)



Source: CBRE

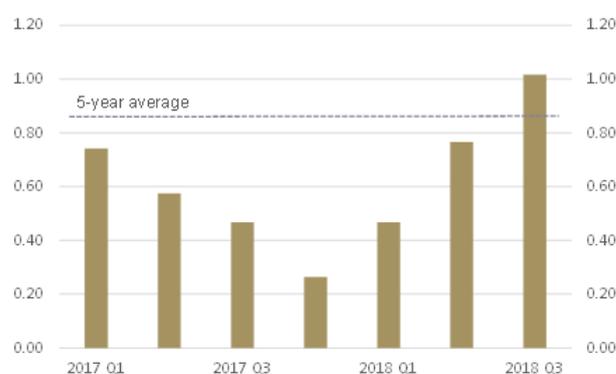
Despite the completion of a number of large deals in Q3, the outlook for take-up in the central London office market appears solid. Under offers, at 3.9m sq. ft., are 1m sq. ft. above their 10-year average and are stronger than the average take-up rates of the past 10 years.

Nevertheless, there are differences between central London markets. Carter Jonas note that there is further upside for Grade A office rents in areas with low vacancy and good transportation links such as Paddington, Farringdon and Victoria. Meanwhile, secondary locations where vacancy is higher, such as Shoreditch, Spitafields and Docklands, are more likely to have to lower rents to compete for tenants.

Regional Property Market

Looking at the regional office markets, data from Colliers show that occupier demand in the third quarter in the South East was also strong, exceeding the five-year average of just over 0.8m sq. ft. (see Chart 5). Take-up was bolstered by transactions for larger-sized properties, including the letting of 120,000 sq. ft. at Leavesdon Park by ASOS and the letting of 110,000 sq. ft. at 25 Windsor Road by the Slough Borough Council.

5.0 South East Office Take-Up (M Sq. Ft.)



Source: Colliers

However, with space under offer standing at just 350,000 sq. ft., take-up is likely to be less buoyant over the rest of the year. This is unsurprising given that office-based employment growth in the South East has slowed to a greater extent than in London and the rest of the UK. Indeed, the latest available data suggest that, on average over the past year, office-based employment growth in the South East was just 0.3% y/y, compared to 1.7% y/y and 1% in London and the rest of the UK respectively.

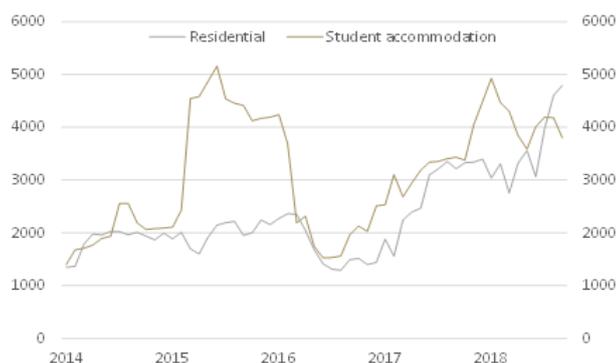
Elsewhere, Bristol city centre has seen some of the strongest office rental growth in any UK market, fuelled by solid demand and tight supply, according to research by Lambert Smith Hampton. The lack of space is the main theme in the Bristol city centre market and availability continues to tighten, standing at just 621,000 sq. ft. at the end of H1 2018. Put into context with average take-up, this is equivalent to only 1.2 years of supply – which is substantially below the UK regional average of 2.8.

Sector Spotlight

Student Accommodation

2017 was very strong for investment in student accommodation, with some large purchases by the likes of iQ Student Accommodation and Liberty Living. However, in contrast to the continual strength of residential investment activity, investment in student accommodation has weakened in 2018 (see Chart 6). Nevertheless, Savills predicts that the final figure for student assets traded in 2018 will be around £5bn.

6.0 Value of Student Accommodation and Residential Investment



Source: Property Archive

Knight Frank estimate that rental growth slowed slightly in the 2018/19 academic year, from 2.6% y/y to 2.3% y/y. But, there are differences in performance across cities. Cities that have a growing student population and limited supply pipeline, such as Cardiff, are doing better than cities with stronger development pipelines, such as Plymouth. According to JLL, in 2018 Q2, yields for prime London student accommodation were 4.25%, compared to 4.75% for inner London property and 5.25%-5.5% for prime regional property.

The outlook for the Student “HMO” (houses of multiple occupation) sector remains strong and prospects for tenant demand are solid, supported by the fact that UK universities are well regarded internationally, and to some extent, by the lower pound. According to data from HESA (Higher Education Statistics Agency), in the 2016/17 academic year there were 1.8 million full-time students. Of this total 490,000 students were living in Purpose Built Student Accommodation (PBSA) whilst 536,000 were living in “other” rented accommodation. Given the overall undersupply of suitable properties, the potential market for student accommodation remains large.

Knight Frank note that around 11,000 student rooms are in the pipeline to be built over the next two years. Indeed, Unite Students have a 1,000 bed development in London due for completion in the 2020/21 academic year. And the Watkin Jones’ Project Colorado is expected to provide almost 2,600 beds in Wembley, Waltham, Bristol, Glasgow, Coventry and Chester. But this is unlikely to be able to address the current undersupply; since 2007, the number of full-time students has risen 11.3% (HESA, 2017), meaning an additional 26,448 full-time students every year, the vast majority of whom require accommodation.

Going forward a number of uncertainties exist, however, these are likely to hit the PBSA (Purpose Built Student Accommodation) market proportionately more than the HMO market. In particular, with international students accounting for 41% of student accommodation occupancy, there are concerns over whether EU students will continue to study in the UK in coming years. EU students make up around 70% of non-UK students. Further, affordability issues have been a constraint on demand. The draft London Plan has outlined that 35% of student accommodation must be ‘affordable’. In 2017/18, this was equivalent to an annual rent of just over £6,000. It is possible that this could make some PBSA development opportunities unprofitable.

HMOs remain popular amongst students despite the constant growth of the purpose-built sector and the amenities they offer. Demand for more affordable rooms in shared accommodation is particularly high vs self-contained studios in impersonal blocks. The upshot is that rents have continued to grow and will do into the future as a result of continued demand by students.

Riverside Capital's Student Housing Portfolio will soon be available for investment to Riverside Capital clients.

To register your interest, please click [here](#).

For further information please contact:

Sarah White
Head of Marketing
+44 (0)20 7297 4480

sw@rivercap.co.uk