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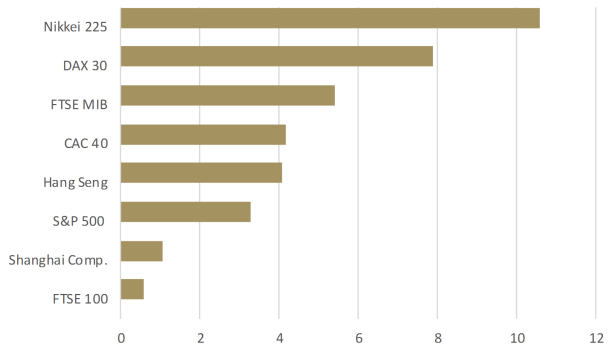
Update - October 2019

Global Factors

The mood in equity markets has generally been more positive over the past month (see Chart 1). This reflects that further moves have been made towards a trade deal between the US and China. In addition, with the UK Parliament now supporting a December election and the EU allowing a delay until the end of January next year (or earlier if a deal is secured), the risk of a no deal Brexit has reduced for now.

1.0 Change in Selected Major Equity Market Indices over 20 Trading Days to 29/10/19 (%)



Source: Refinitiv

In the US, although the progress in US/China trade talks has lowered the threat of further tariffs, economic growth has continued to slow. Admittedly, much of the 0.4% m/m fall in industrial production in September was driven by a slump in manufacturing output as a result of the strike at General Motors, which will be reversed in coming months. In turn, the Federal Reserve cut interest rates by 25bps cut in October to between 1.5% and 1.75%. However, the Fed also indicated that the current stance of policy was likely to remain appropriate. Nevertheless, markets continue to price in further easing.

Overview - October Top 5

- The risk of a "No Deal" Brexit has significantly reduced for now thanks to the agreed "flextension" and a shift of focus to the upcoming election date of December 12th.

- Brexit continues to impact the investment market. Whilst transactions are subdued, however, net lending has increased, driven by refinancing and restructuring activity.

- As the US moves closer towards a trade deal with China, equity markets have shown positive improvements over the past month.

- Industrial take-up was strong again in Q3. However, the increasing supply pipeline is expected to put downward pressure on rental value growth in parts of the country.

- For cities with softer supply pipelines, the outlook for student accommodation demand has improved in recent months and bodes well for the UK in retaining its status as the second most popular provider of international student education.

Now, the outlook for Brexit is back in Parliament's hands. Putting politics aside however, indicators suggest that the UK economy gained some momentum in Q3.

However, this is unlikely to continue. Notably, recent revisions to household consumption data show that households have been more sensitive to Brexit uncertainty than previously thought. Combined with weakness in business investment and global trade, the economy is likely to tread water until a deal is secured.

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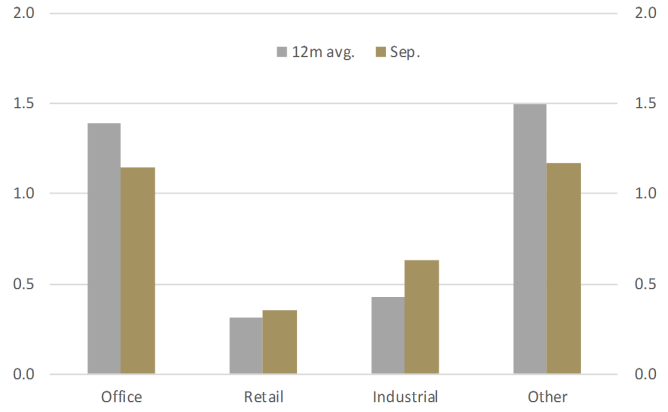
In the euro-zone, the hard data suggest that the bloc barely grew in Q3 and early indicators suggest that there has been no improvement in Q4. Indeed, the composite PMI for October was 50.2, up only marginally from 50.1 in September. This is consistent with GDP continuing to flat line. Core inflation has also remained stubbornly weak, paving the way for more monetary policy stimulus. But with a raft of policy measures already introduced at the September meeting, it was unsurprising that the ECB made no changes at its October meeting.

Property Overview

After £3.8bn worth of deals were completed in August, preliminary data suggest that the value of commercial property investment in September totalled £3.3bn. Notably, there was some improvement in retail and industrial activity compared with the 12-month average (see Chart 2). That said, office and alternative investment, which have accounted for the largest share of investment activity over the year, were soft.

2.0 Value of Investment Deals Completed (£bn per month)



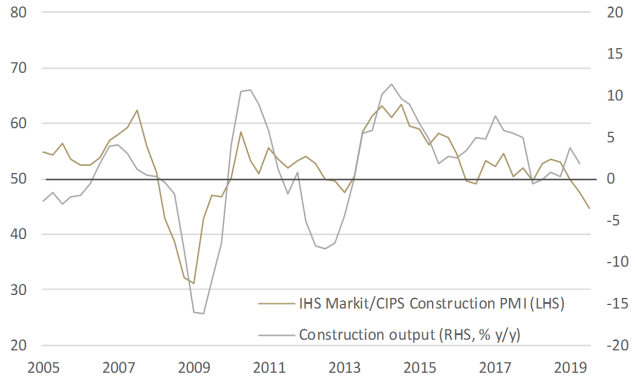
Source: Property Archive, Colliers

There have also been reports of investors pulling out of investment deals, in part reflecting Brexit uncertainties, but also because of problems with financing and the subdued outlook for property values. In turn, although some recovery in investment would be expected if a Brexit deal was secured, it is not certain that investment activity would rebound.

Despite the lack of investment transactions, Brexit uncertainty and struggles in the retail sector, the latest Cass Commercial Real Estate Lending Report showed that net lending increased over the first half of 2019. The increase was driven by refinancing and restructuring activity. This is consistent with the fall in five-year swap rates (as an indicator of the benchmark lending cost, excluding any lender margin) since the end of last year to the lowest level since the 2016 EU Referendum.

Brexit uncertainty has also contributed to weakness in commercial property construction activity. Indeed, the IHS Markit/CIPS commercial construction PMI fell to 41 in September, down from 49.1 at the start of the year. This points to a deterioration in construction output growth (see Chart 3).

3.0 IHS Markit/CIPS Construction PMI and Construction Output

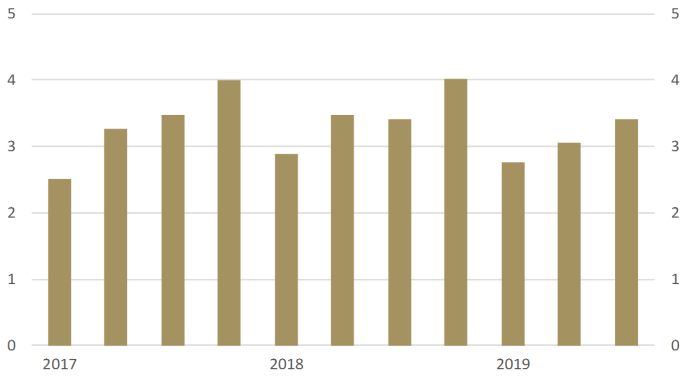


Source: IHS Markit, ONS

London Property Market

CBRE data show that Central London office take-up in Q3 held up at similar levels to a year ago, totalling 3.4m sq. ft. (see Chart 4). However, following two softer quarters, take-up so far over 2019 has been around 7% lower than over the same period of 2018. That said, take-up remains above the ten year average and under offers also increased to 4.4m sq. ft., pointing to reasonable levels of occupier demand in coming quarters.

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



Source: CBRE

The SoftBank rescue of WeWork was also positive for the Central London office occupier outlook, but perhaps not as much as some may think. The level of flexible office take-up in Central London has been reducing since around 2017. In addition, the increase in take-up has not led to a corresponding pick-up in Central London office rental value growth.

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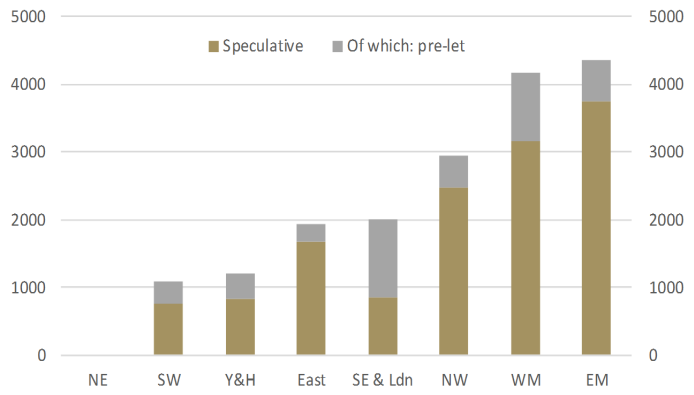
Regional Property Market

In the South East office market, Colliers data show that take-up was soft at just 0.6m sq. ft. in Q3, as might be expected for the summer months. However, over the year to date, take-up levels remain strong. In turn, the vacancy rate has reduced to 7.9%, compared with 8.8% a year ago.

Meanwhile, Colliers data show that industrial take-up was strong in Q3, at just below 9m sq. ft.. However, the increasing supply pipeline is expected to put downward pressure on rental value growth in parts of the country. In particular, a large amount of speculative industrial development is expected to come to market this year in the West and East Midlands (see Chart 5.) In contrast, tightness in the market is evident in London and the South East, where 57% of the pipeline for this year is already pre-let.

5.0 Speculative Industrial Development (000s Sq. Ft.)



Source: Colliers

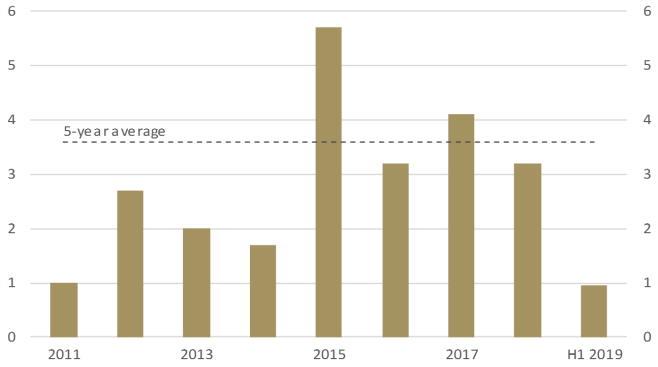
In the retail sector, regional rental value growth has continued to underperform Central London. Consistent with this picture, the scale of rental reductions as a result of Company Voluntary Administrations (CVAs) has also generally been larger in regional cities than in London. However, CBRE data show that the exceptions to this have been Cambridge and Aberdeen, where rental reductions as a result of CVAs have been 15% or less.

Sector Spotlight

Student Accommodation

Over the first half of 2019, student accommodation investment was soft (see Chart 6). But there have been signs of an improvement in Q3. Notably, student accommodation investment was boosted by Unite Group's agreement to purchase the Liberty Living Portfolio for £1.4bn. And, according to Knight Frank, prime direct-let student accommodation yields held steady at 4% and 5.25% in London and the regions respectively in October. That said, investor appetite has not been broad-based across the country. In some cases, this has reflected a lack of stock and, in others, less positive supply and demand dynamics.

6.0 Student accommodation investment volumes (£bn)



Source: JLL

In particular, the development of private purpose-built student accommodation (PBSA) has been particularly strong. For now, houses in multiple occupation (HMOs) still account for the majority (just under 60%) of student-occupied beds. However, a recent report by the student accommodation search platform, StuRents, suggested that the volume of PBSA is set to surpass that of university-provided accommodation for the first time by the end of next year. This has raised concerns about an oversupply of PBSA in some markets.

However, for those cities with softer supply pipelines, the outlook for student demand has improved in recent months and bodes well for the UK in retaining its status as the second most popular provider of international student education. For one, with it looking more likely that a Brexit deal will be secured, albeit after yet another delay, there is more certainty over the rights of EU students, at least up until the 2020-21 academic year. What's more, the recent softening of rules around the length of time international students can remain in the UK in search of work should support demand.

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The details of the policy are currently limited, but the length of time is expected to be extended from six months to two years and to apply to students enrolling in the 2020-2021 academic year.

On balance, against a challenging backdrop, there remain promising opportunities in the student accommodation market, particularly for those searching for higher yields compared to traditional markets. That said, high levels of development have meant that certain types of student accommodation in some cities has probably reached a saturation point.

For further information please contact:

Sarah White
Marketing, Riverside Capital
+44 (0)20 7297 4480

sw@rivercap.co.uk