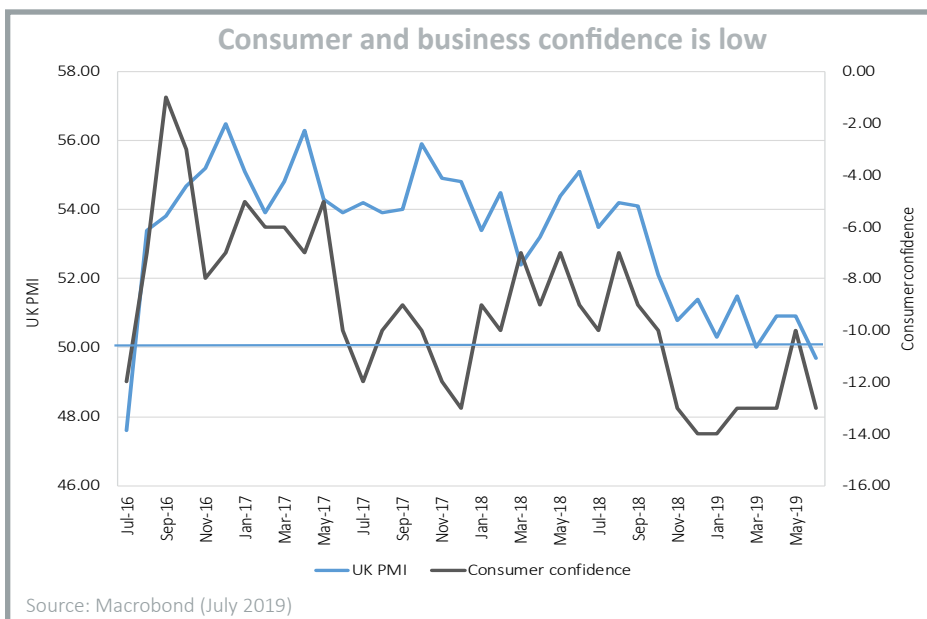


UK Economic Update

UK economic growth numbers were mixed over the first half of the year, but the overall tone is relatively weak. Business and consumer confidence fell towards the end of last year and has remained low during the first half of 2019. As a result, GDP growth of 0.5% in Q1 2019 was a surprise, although this was attributed to increased government spending and companies bringing activity forward into March in anticipation of the initial Brexit deadline.

The impact of this stockpiling combined with the planned closures of several car plants in April, had an immediate effect on early growth in Q2. Monthly GDP data revealed that the economy contracted 0.4% in April, driven by a sharp fall in manufacturing activity. This was partially reversed in May as car plant production restarted, resulting in monthly GDP growth of 0.3%. The June PMI numbers for construction and manufacturing remain below 50, indicating contraction. Furthermore, the services PMI stood at just 50.2. Consequently, the overall picture points to subdued growth in Q2.

The strength of the labour market remains one of the few positive economic news stories. Employment continues to grow as companies opt to increase hiring rather than increase capital expenditure given the uncertain backdrop. This is supporting a buoyant labour market characterised by growth in job to job



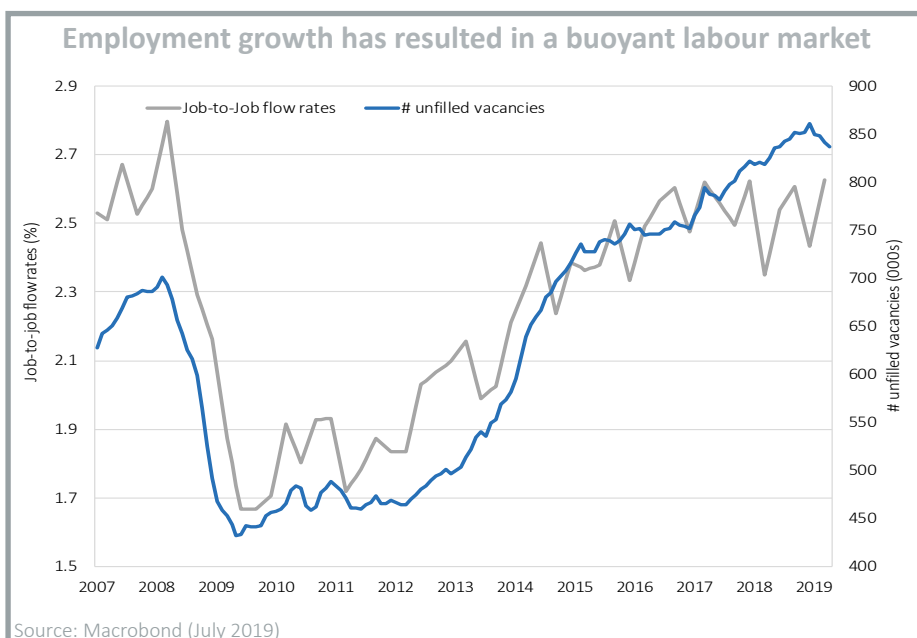
flow rates and a sharp increase in the number of unfilled vacancies. These factors are underpinning the wage growth seen over the first half of the year as companies are forced to be more competitive in order to attract and retain staff. In the short-term, as Brexit uncertainty persists, this should provide some support for the economy in the form of increased household spending. This has been evident in the retail sales figures, which despite the negative press coverage, have shown reasonably good growth this year. Retail sales volumes were up 3.4% year-on-year in Q2 2019.

Although the probability of a no deal Brexit is rising, our base case still assumes some form of deal will be struck

with the EU. Under this scenario, we forecast modest GDP growth of 1.1% this year and 1.3% next. While Brexit is having an impact, this relatively low level of growth also reflects external headwinds, such as increasing trade tensions and a broader cyclical slowdown globally. As a result, while these growth rates may look disappointing, UK performance is broadly expected to be in line with other major economies in Europe as a global slowdown becomes increasingly evident.

Given the modest growth outlook, the relatively benign inflation environment is expected to be maintained, keeping interest rates unchanged. While it is widely anticipated that a no deal Brexit will be accompanied by rate cuts, in our view, there is also scope for more fiscal stimulus in the medium term under our base case. Recent statements from the MPC support this view, as the Committee takes a more dovish tone given its assessment that downside risks to growth have increased. This is partly due to global factors, including growing trade disputes and weaker global growth, but also the ongoing subdued levels of business investment and growing concerns about the possibility of no deal Brexit.

Despite relatively low economic growth forecasts, we believe that the resultant prolonging of the low interest rate environment will be supportive of real estate in the medium term.



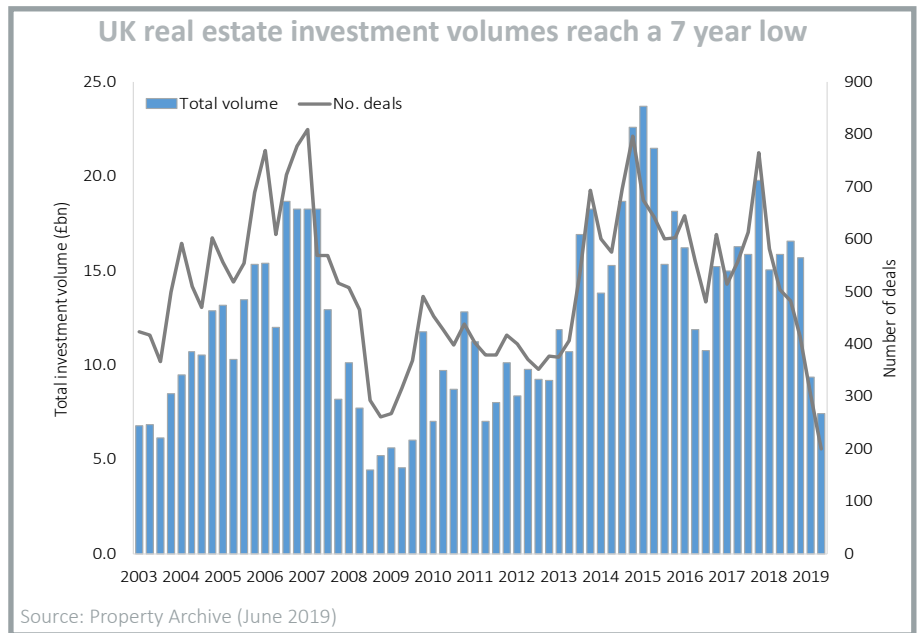
UK Property Market Update

Provisional Q2 2019 figures show that £7.5bn was invested into UK real estate in 200 transactions. This number may be revised upwards but as it stands this is one of the lowest quarterly volumes in a decade and the limited number of transactions points to increased market illiquidity. At £37.2m, the average deal size was the second greatest on record and reflects a number of large portfolio deals, such as the £1.4bn acquisition of the Liberty Living portfolio by Unite.

The macro investment picture is thus one of suppressed activity. Fewer deals are being brought to market and a clear two-tier market has emerged. On one side is quality, non-retail, well-let stock secured to good covenants for which bidding remains competitive. On the other side is more secondary stock, including retail assets, which is shorter-let or exposed to higher void or capex risk for which demand is much thinner. The market is risk-averse and a high degree of polarisation between and within sectors prevails.

The MSCI All Property UK (monthly) total return was 0.6% over the three months to June 2019, compared to 2.2% for the same period last year. On a rolling annual basis, capital values have declined every month since January 2018. Income is now the primary return driver.

Offices returned 0.9% in Q2 with all segments recording negative capital growth. This was driven by pricing movements.



The impact of yields softening on capital growth was -0.5%, but 0.4% rental value growth provided a counterbalance. Rest of UK was the strongest returning sector at 1.3%, whilst London – West End registered the strongest rental growth at 0.9%. The MCIM Fair Value model indicates that London and regional offices currently offer the best value of any UK segments, due largely to the level of rental value growth forecast over the next decade and low vacancy rates.

Industrial recorded a total return of 1.7% in Q2 2019. Yields softened marginally but this was more than outweighed by 0.8% rental growth. Industrial is expected to carry on benefiting from the structural shift towards online retail and rising consumer expectation of responsive, fast

supply chains. Half-year take-up (of big-box units) was strong at 28% above the long-term average, according to Savills and occupational demand endures. The development pipeline is responding and there is a risk of floorspace over-supply in some markets.

Retail returned -0.9% in Q2 due to yield increases (-1.5% impact on capital growth) and rental value decline (-0.8% impact). All retail segments recorded negative returns on a quarterly and annual basis. As outlined above, retail sales volumes are rising. However, an increasing share is being captured online, which is challenging high streets. Retail total returns are expected to deteriorate further over the next six months due to the size of legacy portfolios, the speed of structural change and an overall floor-space oversupply. We foresee further capital decline across the retail sector as the market recalibrates.

We believe that the UK will experience an elongated property cycle because gilt yields remain low, the sector is not over-leveraged and new supply is constrained. In this context, UK real estate should remain attractive to investors seeking income. Given the strength of occupational fundamentals in the Office and Industrial sectors, there are selected opportunities to capture future rental value growth in supply constrained markets. Prudent stock selection is critical.

