

Credit Suisse Real Estate Investment Management

# Commercial real estate market prospects after Brexit



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# Agenda

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# Brexit UK and the EU: The current situation

# Brexit UK and EU

Where are we heading to?

## Negotiation and Approval of Divorce Deal:

- Exit bill for the UK (up to 60 bn EUR)
- Great repeal bill implementing EU law into UK law
- Scottish Referendum request
- European Court of Justice authority
- Approval by the EU by a qualified majority of countries necessary

## Transition period:

- Period to implement divorce deal
- Allow for disentanglement of relations

## New deal with the EU

- Trade of goods?
- Free movement of people ?
- Passporting of financial services ?
- Irish border question ?
- Other issues?
- Unanimity required (=all EU countries need to agree to new agreement)

April  
2017

March  
2019

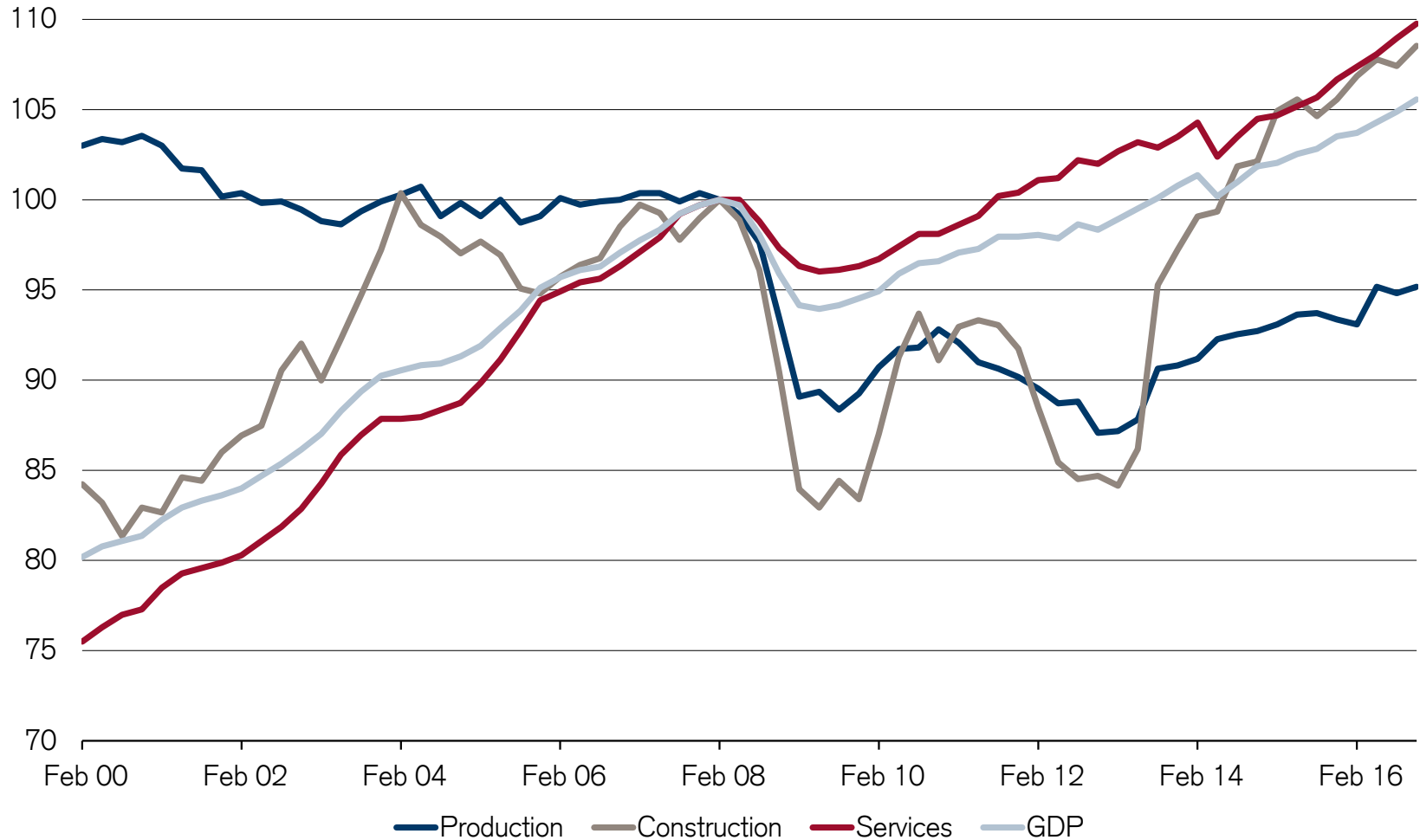
2021/  
2023  
Later?

Source: Credit Suisse

# UK is a service sector dominated economy

The industrial sector has failed to reach its pre-crisis level

Indices (Q1 2008 = 100)



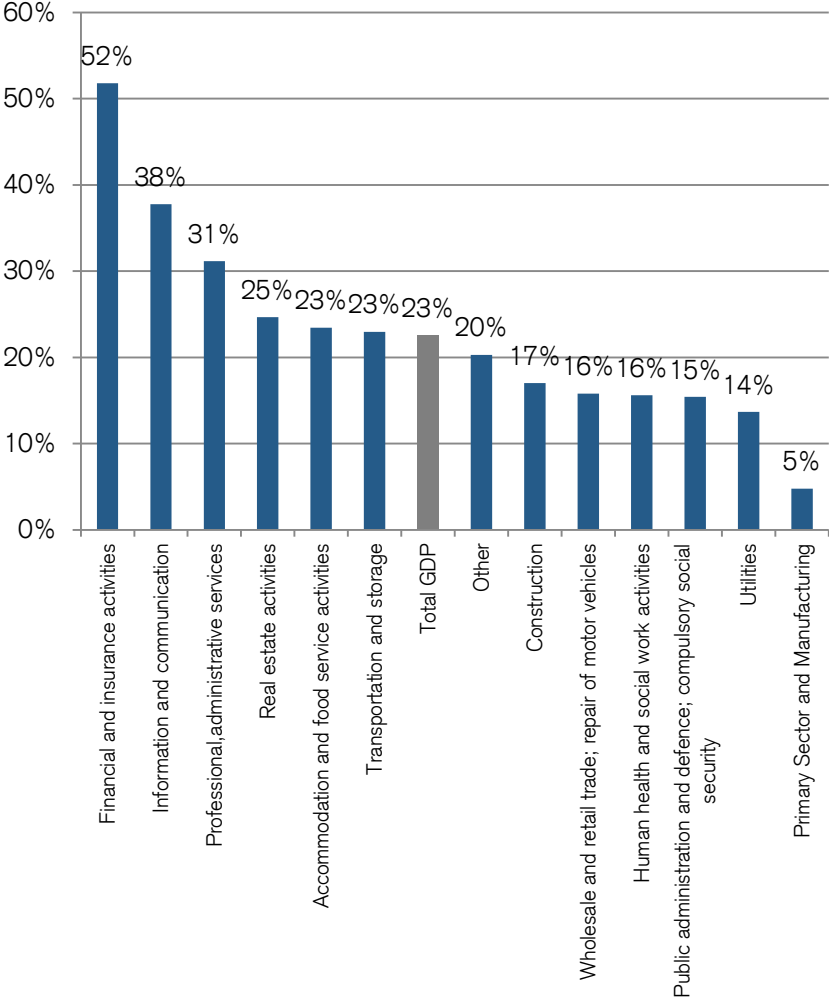
Last data point: 31.12.2016

Source: Datastream, Credit Suisse / IDC

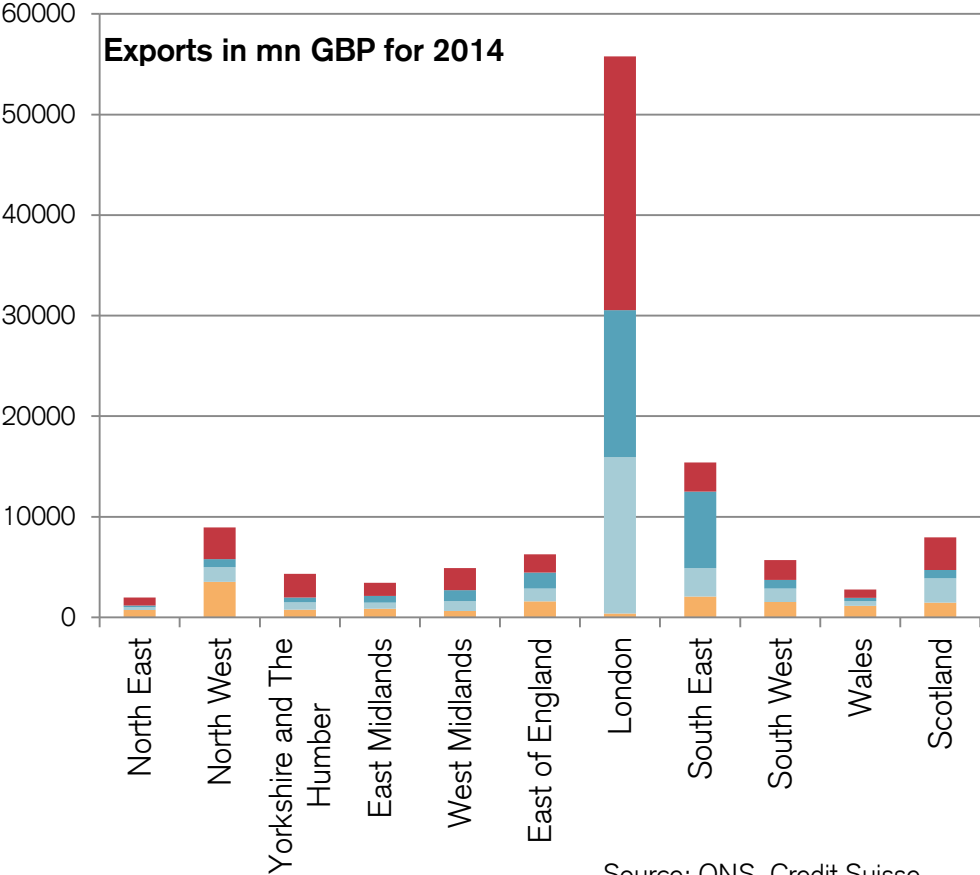
# Regional distribution of the industries in the UK

London dominates the services sector output and exports

London's share of UK's output by sector



- Value of financial service exports
- Value of service exports from the information and communications sector
- Value of travel service exports
- Value of service exports from the manufacturing sector

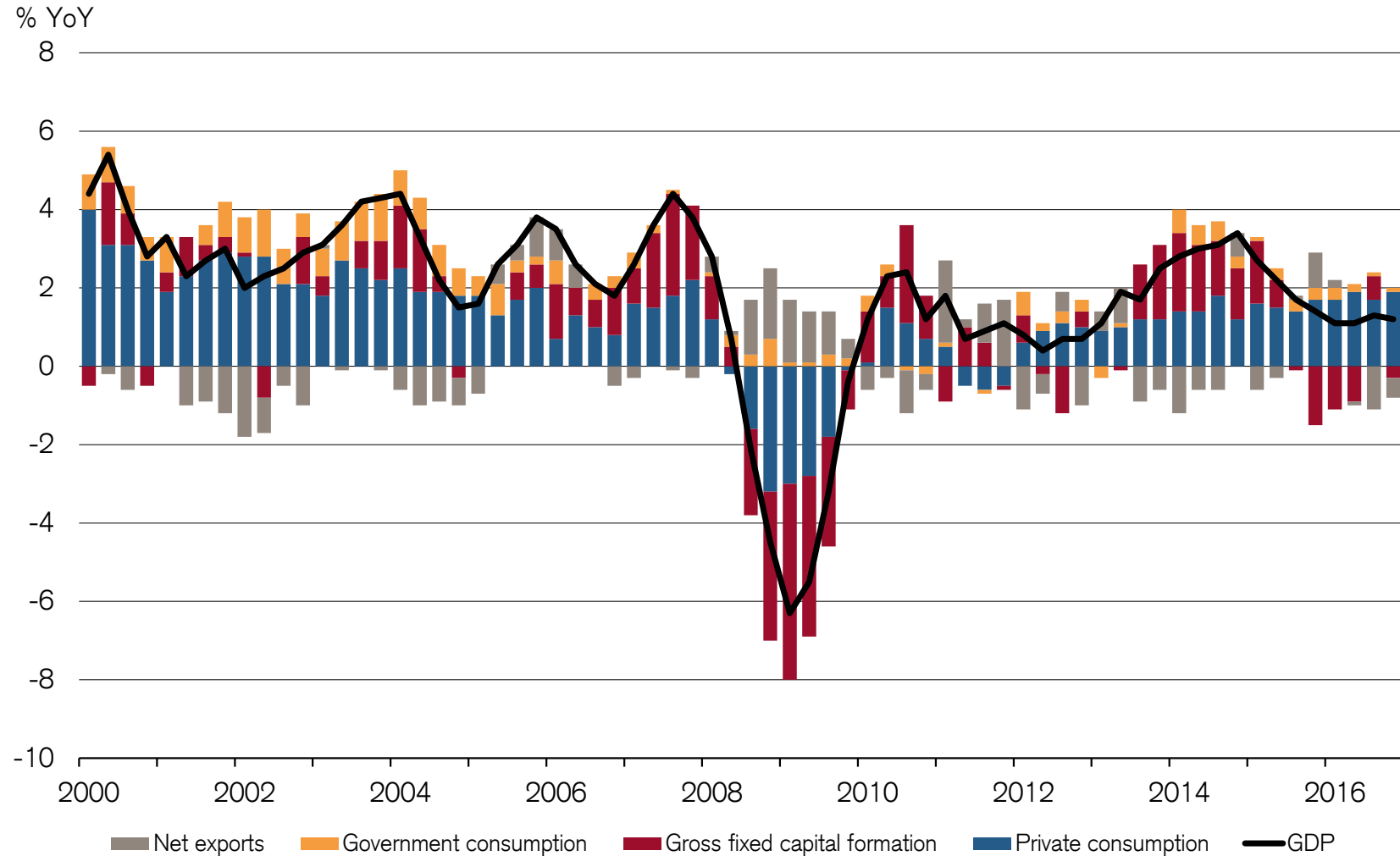


Source: ONS, Credit Suisse  
Last data point: December 2014

**What has happened in the UK and EU  
commercial markets so far**

# UK GDP growth has only slowed down somewhat

Domestic demand so far the largest driver



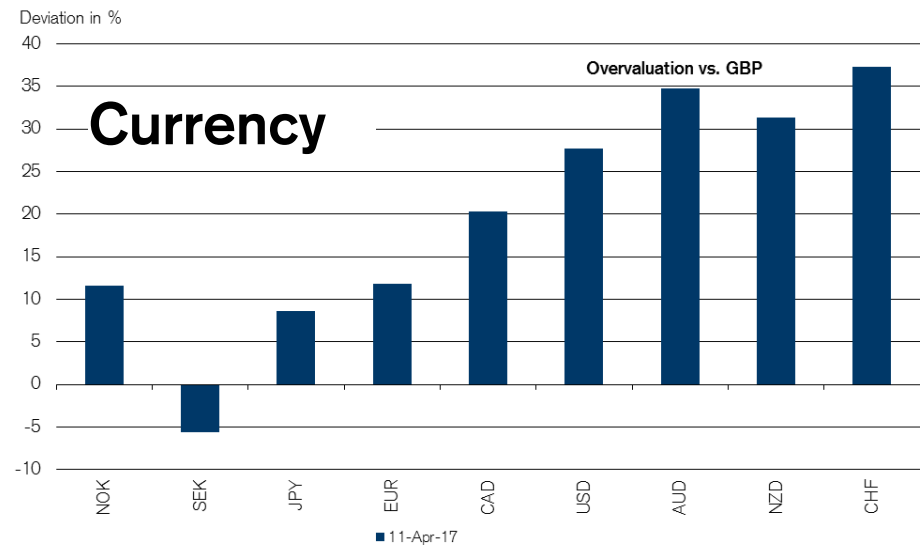
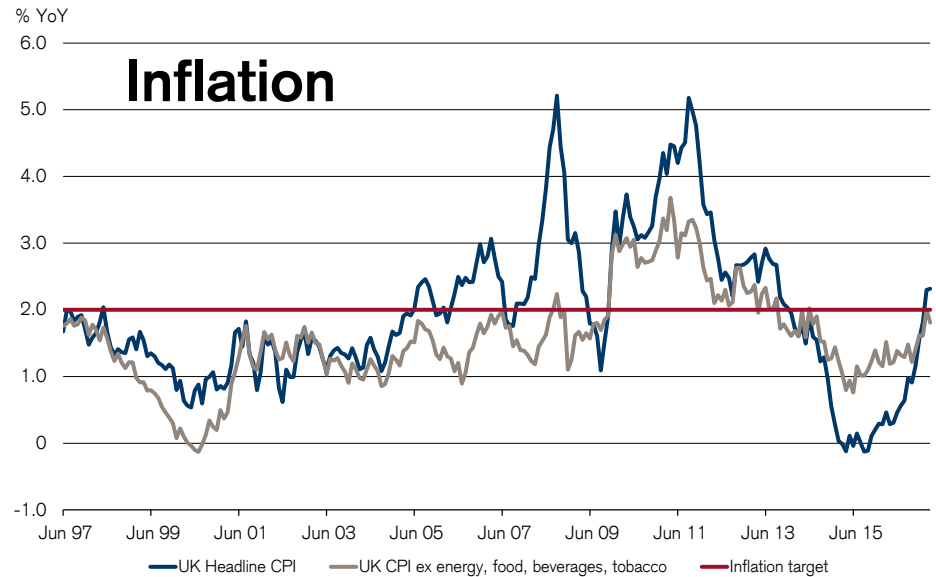
Last data point: 31.12.2016

Source: Datastream, Credit Suisse / IDC



# Other important macro trends

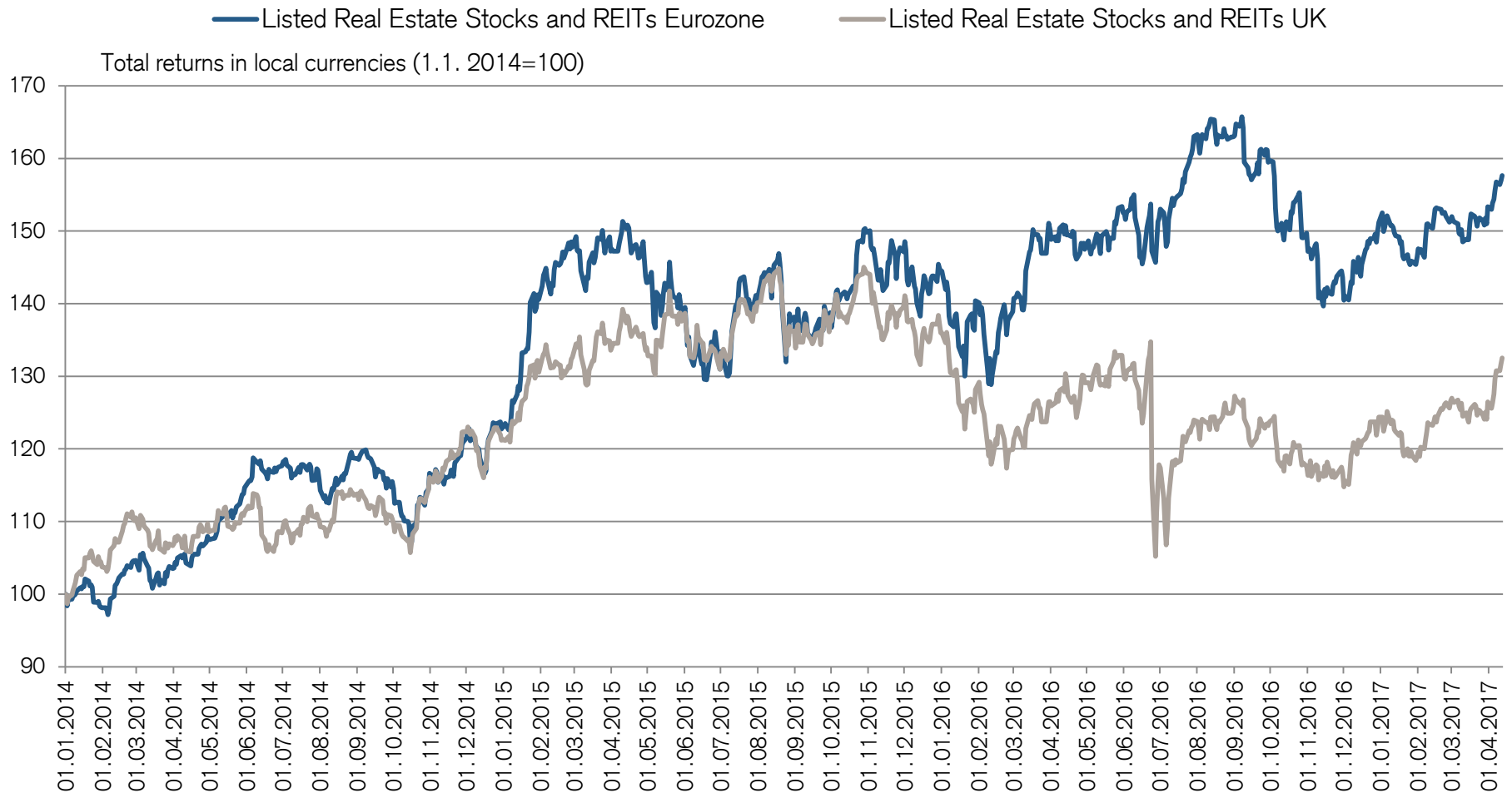
- Substantial depreciation of GBP vs all major currencies
- Asset purchases and interest rate cut by the BoE eased negative macro impact
- Rising inflation in the UK due to higher commodity and import prices
- Solid growth in the Eurozone in H2 2016
- An reacceleration of global economic momentum and end of deflationary worries



Source: Credit Suisse, Datastream  
Last datapoint: April 2017

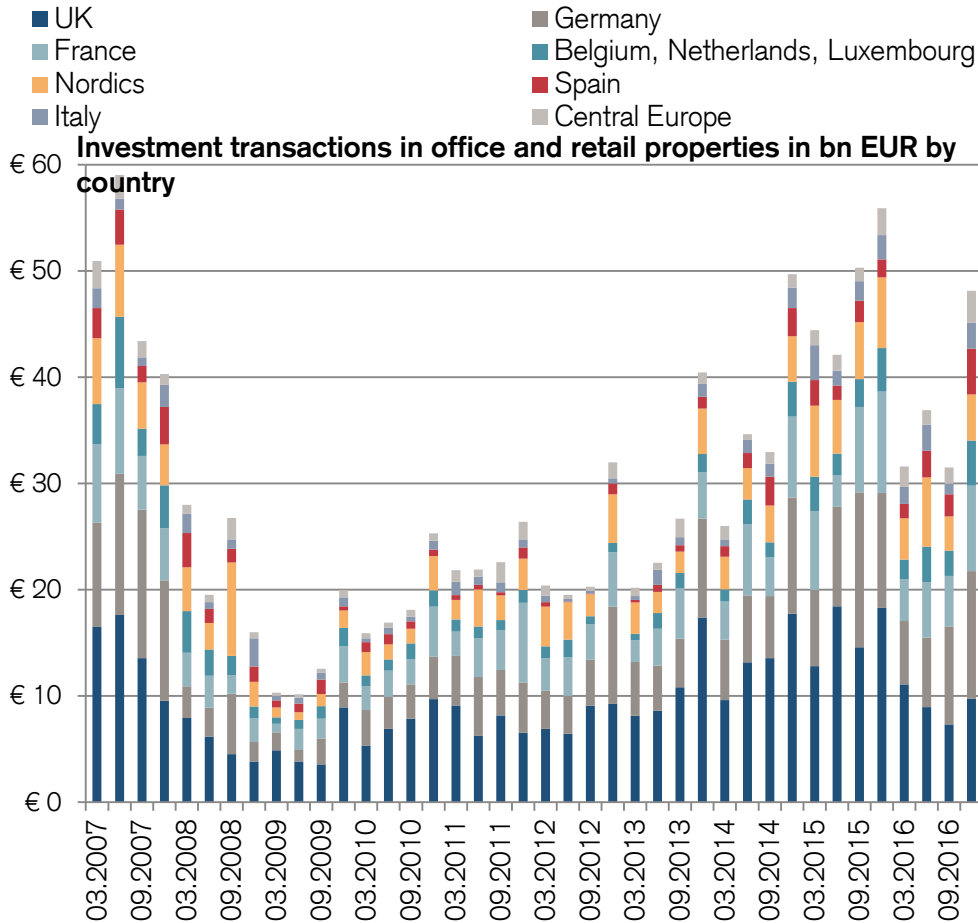
# What did listed real estate markets do?

UK REITs have fully recovered their post June 23 losses...



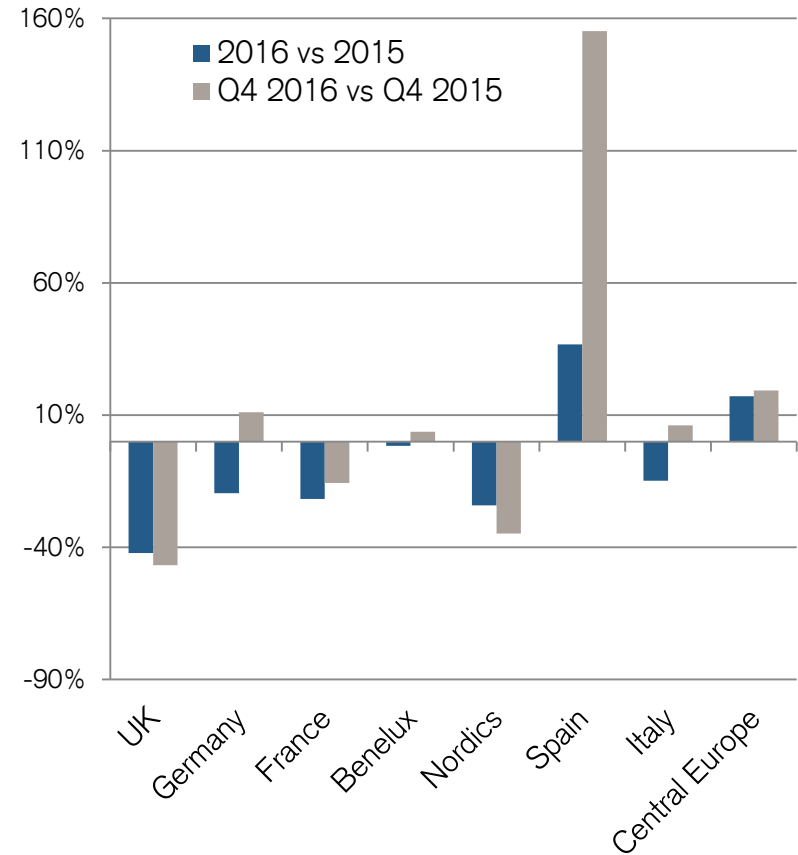
# Commercial real estate transaction volumes

## Lower UK volumes in 2016



Source: RCA, Credit Suisse  
Last data point: December 2016.

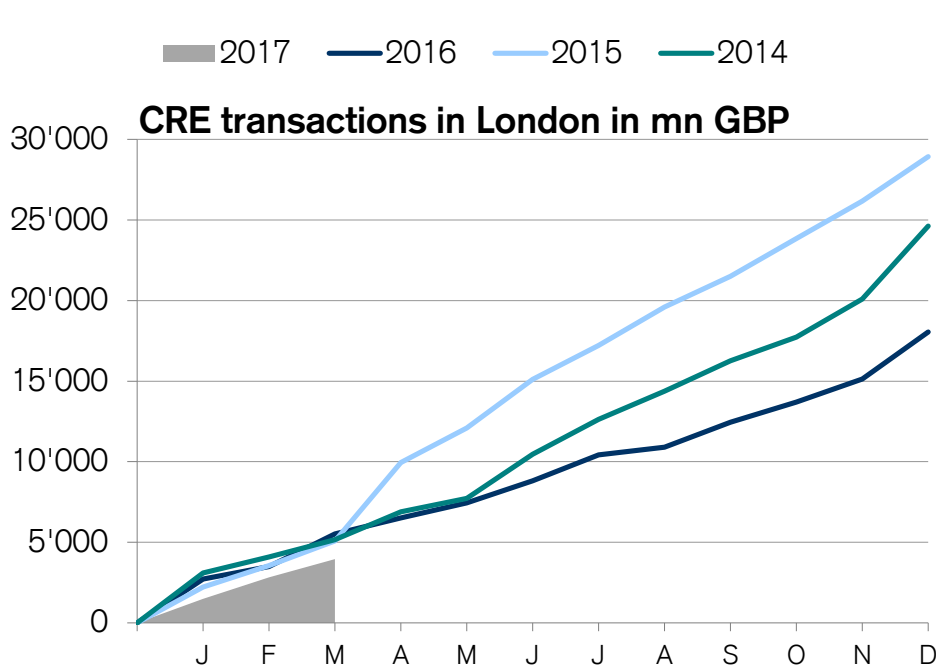
### Change in transaction volumes for office and retail



Historical performance indications and financial market scenarios are no reliable indicators of future performance

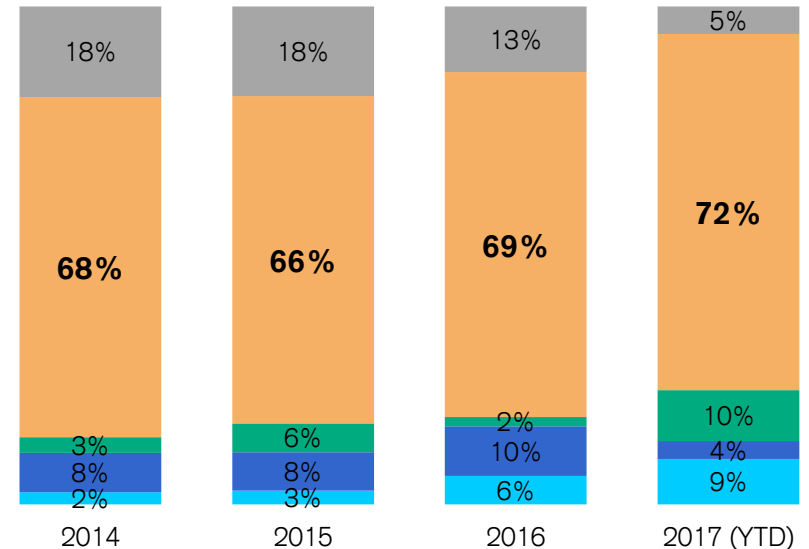
# Analysis of office transactions in Central London

Less transactions but strong Chinese bid for prime London



■ Institutional ■ Cross-Border ■ Public Listed/REITs ■ Private ■ User/Other

## Breakdown of London purchases by buyer group

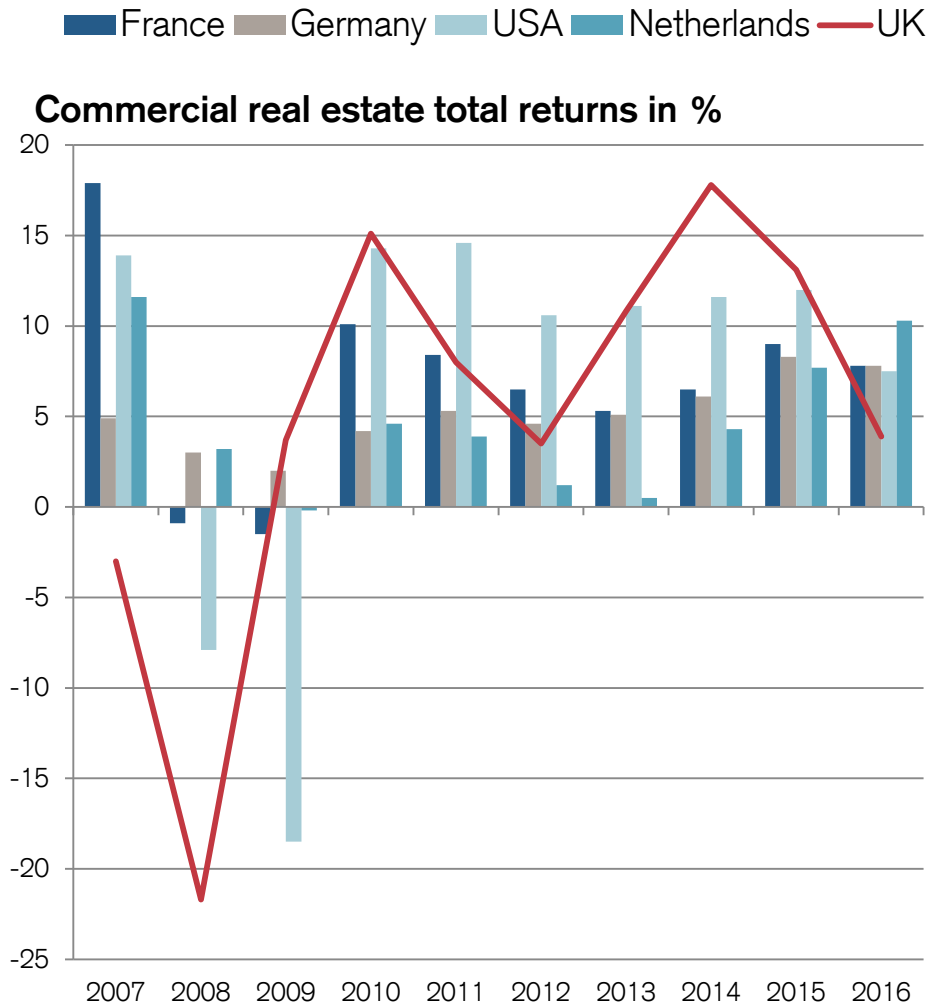


- **Keynote transactions in central London beating record yields early 2017**
- **Foreign UHNWI investors looking for assets with long leases and strong tenants**
- **Less demand for assets with shorter leases**
- **UK and European buyers still in wait and see mode for the UK**
- **UK investors are net sellers**
- **Little focus on regional markets by most foreign investors**

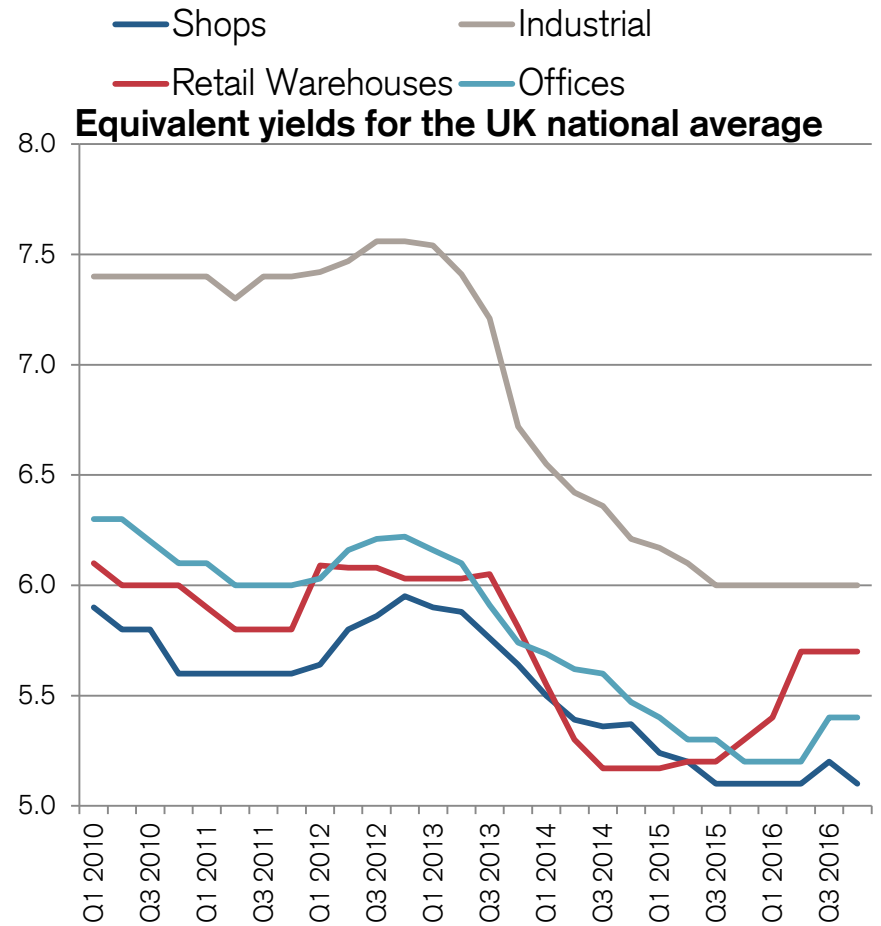
Source: RCA, Credit Suisse  
Last data point: April 2017

# Slowdown in returns in the UK despite stability elsewhere

Uptick of yields post Brexit of 10-30 bps



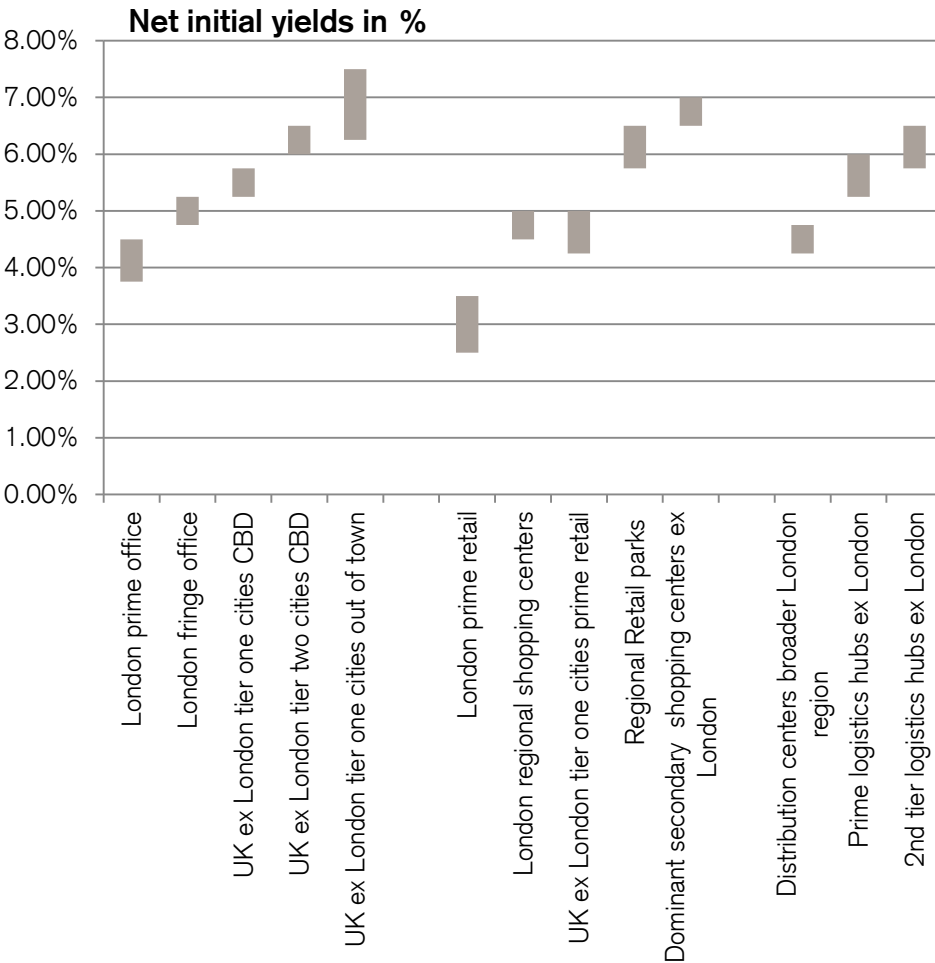
Source: MSCI IPD, Datatstream  
Last datapoint: December 2016



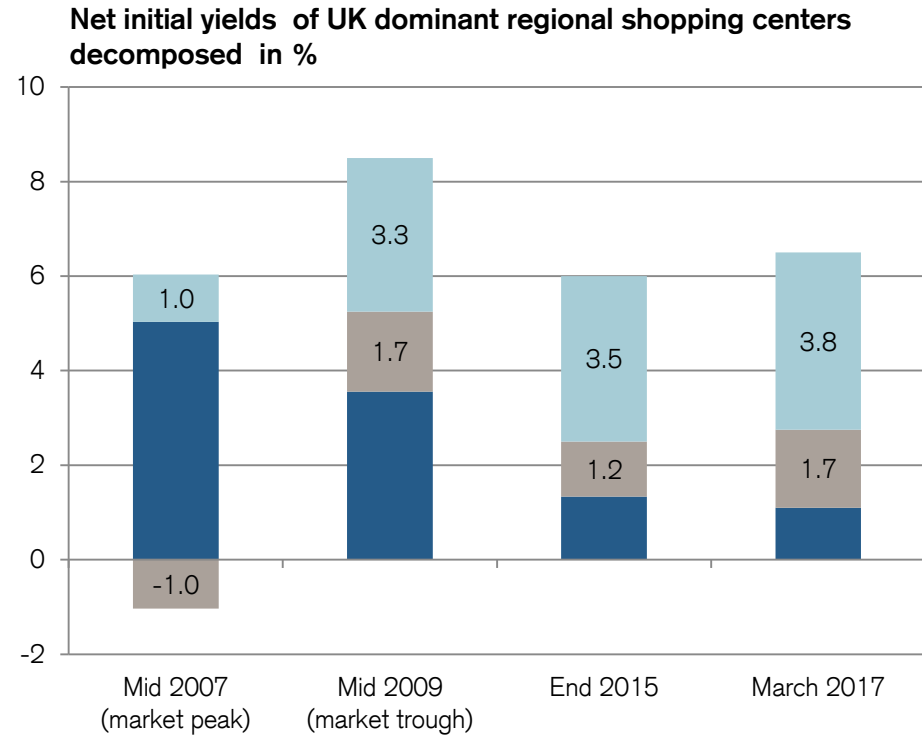
Historical performance indications and financial market scenarios are no reliable indicators of future performance

# Differentiation in pricing between segments and locations

Secondary UK assets offer higher yields



- Risk premium add-on between London prime to secondary regional shopping center
- Risk premium prime London retail
- 10y UK bond yield



Source: Cushman Wakefield, Savills, Datastream  
Last datapoint: December 2016

Historical performance indications and financial market scenarios are no reliable indicators of future performance

# Rental market trends

## Slowdown in London offices, momentum in logistics

### Retail real estate



- Booming prime London rental market supported by tourism
- Prime spots also outside of London with good momentum
- Online retailing creating challenges for secondary retail

### Office real estate



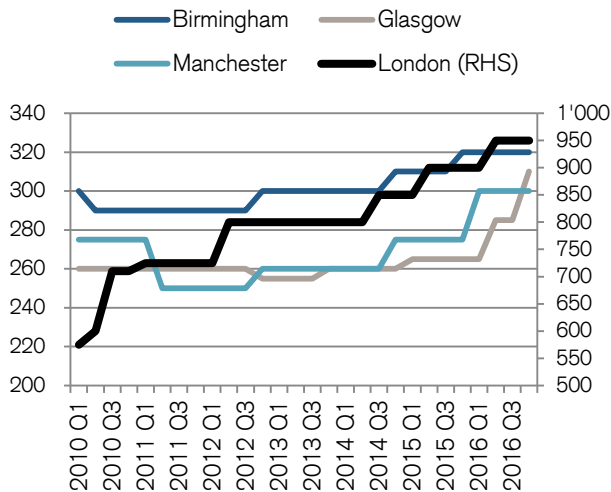
- Higher vacancy rates in London due to higher construction activity, rents started to drop
- No major shifts away from international occupiers but take-up was down by 20%
- Stable office markets with rents rising in regional office markets

### Logistics real estate

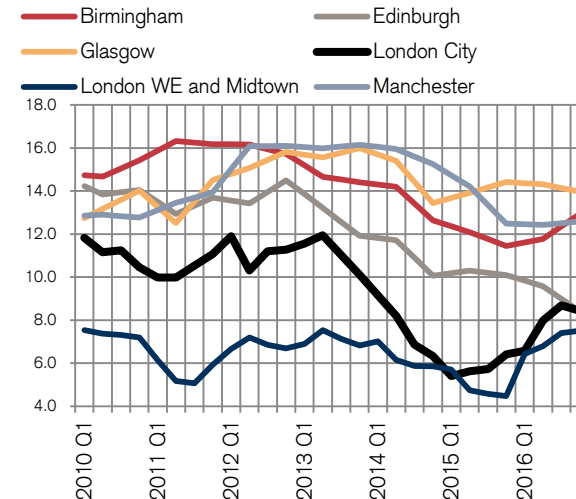


- 2016 record year of space take up for logistics with almost 30 mn sf
- Ecommerce strongest segment with over 30% of take up.
- Supply – Demand remains in equilibrium Rent continue to rise

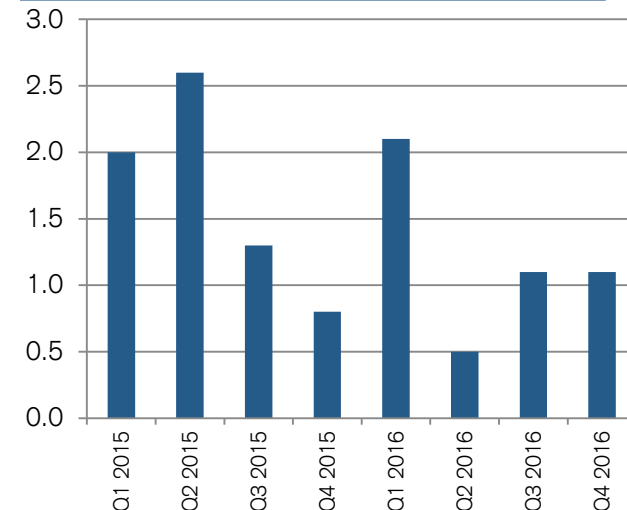
#### Prime retail pitches (rent psf in GBP)



#### Rising vacancies in London



#### QoQ growth of rents for UK industrial space in %

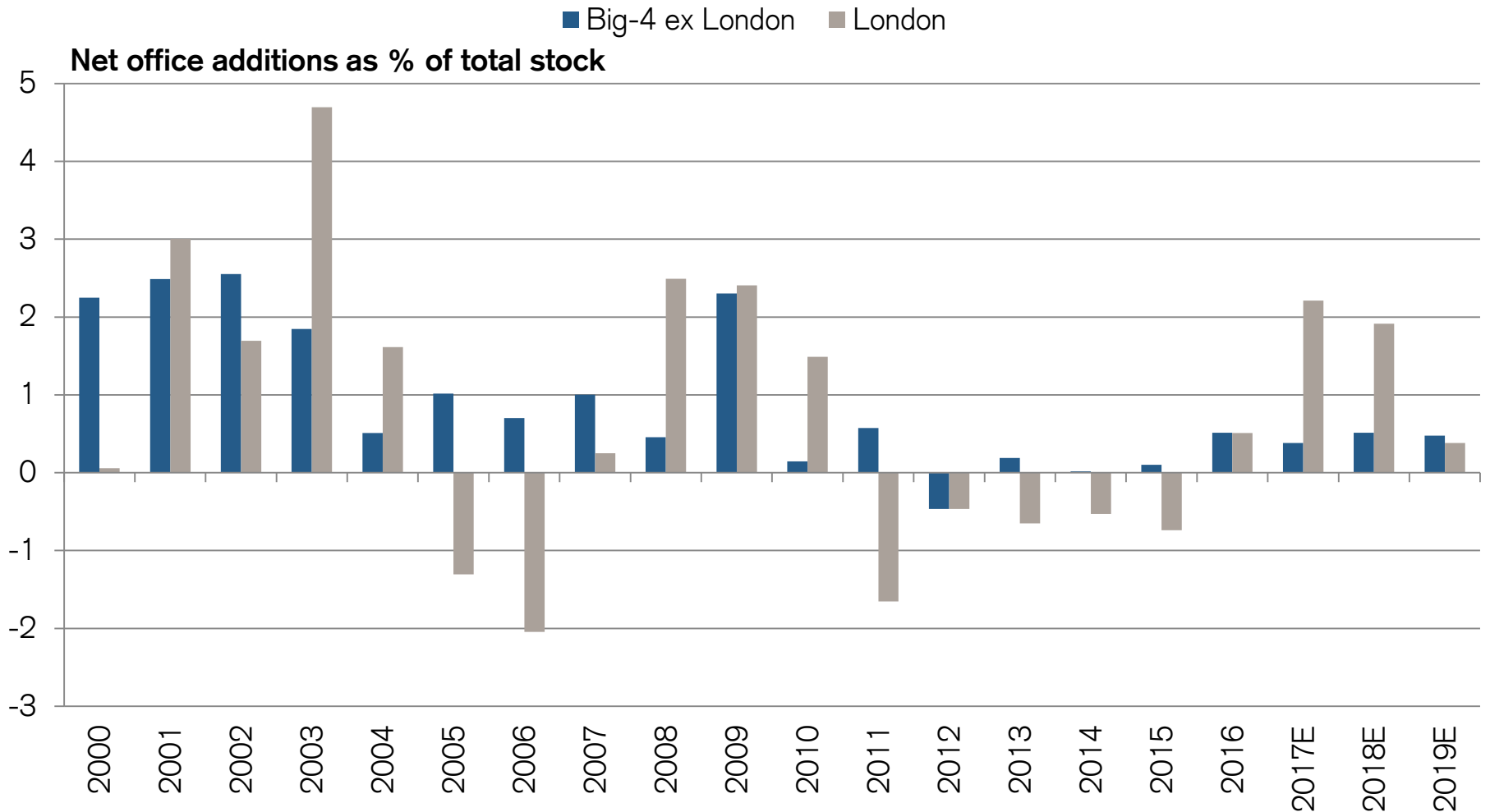


**Our views, strategies and scenarios  
for UK real estate**



# Supply trends matter

Higher construction to hit London, but low supply in the regions



Historical performance indications and financial market scenarios are no reliable indicators of future performance

Source: PMA, Credit Suisse  
Last data point: December 2016

# Views and Strategy

## Our baseline scenario for the UK

**UK real GDP growth average at 1.6%** expected for 2017 and 2018

**Inflation at 2.4% p.a. on average** expected for 2017 and 2018

**Limited parts of service** sector move out from London to other EU cities

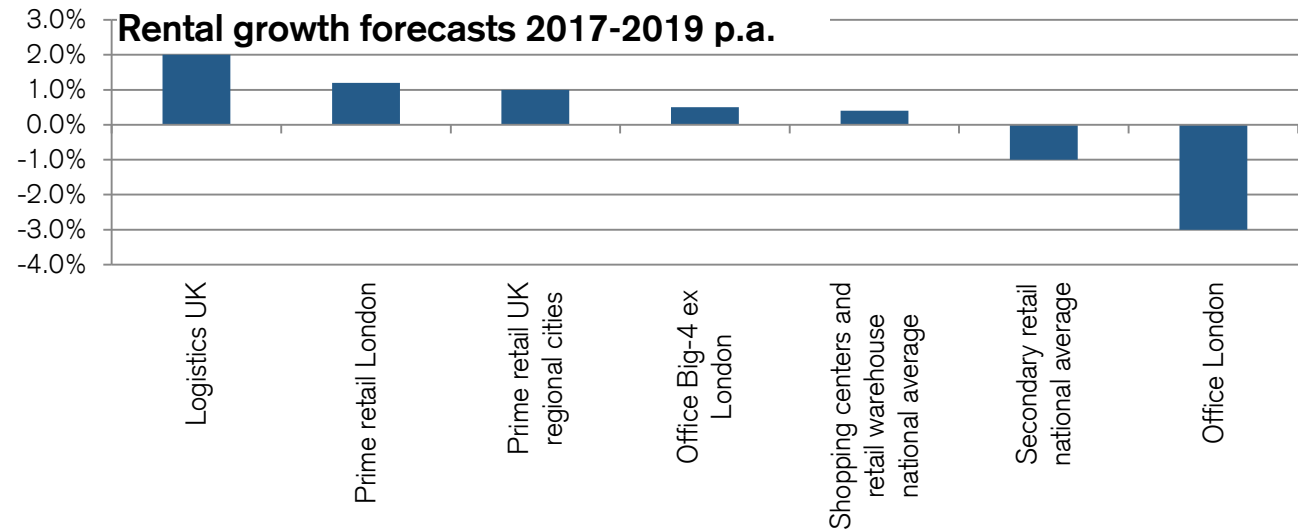
**Slightly higher bond** yields, interest rate to remain on hold 2017 in Europe

European and global economic **recovery to continue**

### Outlook: short versus the long term

- **Higher vacancy and slightly higher cap rates for London office over the next two years; Downside pressure on office rents, especially in the financial exposed submarkets.**
- **Downside in London offices over the next quarters as chance for long term oriented investors, as we are confident mid to long term. Focus on tenant quality and yields**
- **Stable vacancy rates outside of London but regional differences; Post June 2016 we have and continue to look to put money at work in regional centers**
- **UK regional markets also key story for our new European value added fund**

### Rental growth forecasts 2017-2019 p.a.



Historical performance indications and financial market scenarios are no reliable indicators of future performance

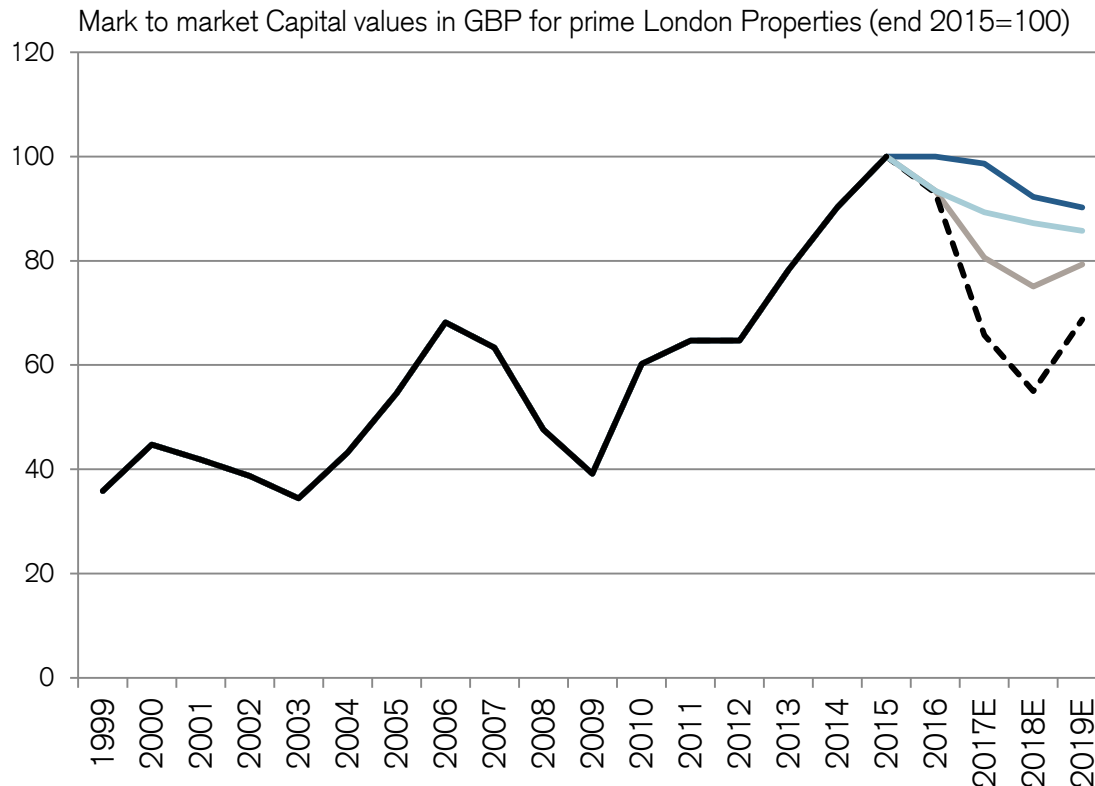
Source: PMA, Datastream, Credit Suisse  
Last data point: December 2016

Source: Credit Suisse

# Thinking in scenarios

## Synthetic transaction price evolution for London

- Pre-Brexit Scenario
- Post Brexit "CS REIM Base Case" Scenario
- - - Financial Crisis Scenario
- Only rental adjustment with stable yields
- Price evolution 1999-2015



### Other factors to consider

- Deal analysis with lease lengths and over/under-rents necessary
- FX view for foreign investors can also play into the decision
- Higher inflation to benefit cash flows with upward rent reviews
- Strategy matters: Income return or capital appreciation?
- High uncertainties impact forecasts and calculation of expected IRRs

Source: PMA, Credit Suisse  
Last data point: December 2016

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