

Prospects for 2016



January 2016

A Review of 2015

Bull and Bear met up over the Christmas period to discuss the year that was 2015 and to see how accurate their predictions were. This publication records their discussion.



Bull: There's something rather hypnotic about all this, isn't there Bear?

Bear: What on earth are you on about Bull?

Bull: I am not sure whether it's the combination of the fancy-dress costumes, the fans, the crazy light shows or simply the wonderful repetition of the arrows rhythmically slamming into the board. I just find myself totally transfixed by the beauty of it all.

Bear: At long last. You've finally lost the plot Bull!

Bull: Mince pies, wrapping paper, The Pogues, the John Lewis advert, the Queen's Speech. There are a certain things that evoke images of everything that is great about Christmas and the PDC World Darts Championship is another one to add to the list.

Bear: When the team at St Bride's instructed us to review 2015 and consider our predictions for 2016, I thought your idea of meeting at an iconic sporting venue was a great one. But the Ally Pally? You could have picked the MCG in Melbourne or Newlands in Cape Town!

Bull: Lord's is the home of cricket, Twickenham the home of rugby and Wembley is the home of football, but they all pale into insignificance compared to this place for me. The Alexandra Palace is the ultimate arena. And what's more... a fat bloke can legitimately be the best in the world. What's there not to like?

Bear: I am not at all convinced. It's more like a glorified pub. But whilst we are waiting for the players, shall we have a quick canter through our 14 predictions for 2015 to see how well we did or didn't do?

Bull: Good idea. Let's start with the easy ones to get us going. We won't dwell on our Rugby World Cup Prediction shall we? I still can't believe how bad England were... it was so embarrassing.

Bear: We did get half of it right though. We predicted New Zealand to win the final. That surely merits half a mark?

Bull: Unlike our FTSE prediction.

Bear: If I remember correctly (and I do because I have last year's publication here in front of me to use as a beer mat), 'your' prediction was that the FTSE would claw back its 2014 losses but wouldn't break through 7000.

Bull: Well my beer mat quotes you as saying "it's hard to disagree with you Bull". Given that the FTSE 100 reached its highest level ever recorded in April 2015 at 7,104 and closed 2015 at 6,242, down 5%, I think we can both take equal responsibility for getting that prediction badly wrong.

St Bride's Predictions for 2015

1	The General Election will take place on 7th May 2015 ✓
2	UK GDP Growth will continue at a respectable pace but slower than 2014 ✓
3	The fortunes of the global economy hang on the US star continuing to shine brightly ✓
4	The FTSE 100 will recover the ground it lost in 2014 ✗
5	England will win their Rugby World Cup group but lose to New Zealand in the final ½
6	The market will experience a pause in the run-up and aftermath of the General Election ½
7	Investment volumes will be good but will not match 2014 levels ✗
8	Chinese investors will accelerate their UK acquisitions in 2015 ✓
9	Some overseas investors will become increasingly comfortable investing in the UK regions ✓
10	Rental growth will be strong in London and remain patchy in the regions ✓
11	There will be no further yield compression for prime London assets ✗
12	The yield gap between prime and secondary properties will close further in 2015 ✓
13	Property Total Returns will be 10.00% for 2015 ✗ (We were too low!)
14	Property will be the best performing (mainstream) asset class in 2015 ✓

Source: St Bride's Managers

Bear: Fair enough. But the fact that the index ended lower than it started caught out numerous analysts, all of whom are far brighter than you and me. Very few of them took account of the preponderance of international gas, oil and mining shares in the FTSE 100. The price of oil has now reached a 12 year low.



Bull: Let's not dwell on it Bear. On the bright side, we got our General Election forecast spot on didn't we? Not many political forecasters were brave enough to make a prediction were they? We were and hit the bullseye...well done us!



Bear: Too right, although the Conservative majority victory still amazes me. I was absolutely convinced that the second half of 2015 was going to be dominated by coalition deals and squabbles, all resulting in a stalemate. Irrespective of your political views, the fact that there was a clear winner was unequivocally good news for investor confidence and of course the UK property markets.

Bull: I assume you are referring to 'Golden Deals Day', the day after the General Election. Didn't more than £100m worth of residential property change hands in Central London that day alone?

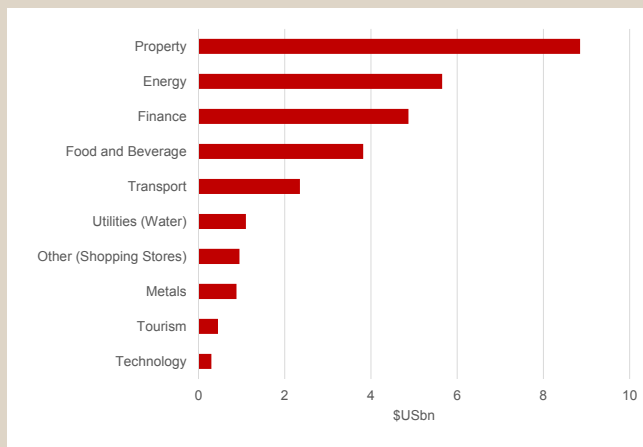
Bear: I was, sort of, but I was referring more to the fact that the unexpected Tory outright victory meant the property industry didn't feel the anticipated reverberations or slowdown we predicted.

Bull: I think this is another half-marker though Bear. I agree that there wasn't much of a slowdown after the General Election. Interest in property remained high, supported by rising occupational demand, a positive trend of rental growth, a significant yield gap and strong inflows of capital. But against that, there was definitely evidence of a pre-election slowdown. Mortgage approvals dipped notably between April and May, whilst according to Lambert Smith Hampton, the number of commercial property deals fell by a quarter in the second quarter as investors took a pause.

Bear: So how did we fare with our property predictions?

Bull: Not too bad. For example, we forecast that Chinese investors would continue to be acquisitive during 2015. The UK still remains one of their favourite places to invest and they still see UK commercial property as a good bet despite the apparent problems with their own economy. That said, the last couple of months did see increased noises that Chinese capital was starting to seek refuge elsewhere, the US in particular.

Chinese Investment in the UK by Sector 2005 - 2015



Source: The American Enterprise Institute and The Heritage Foundation

Bear: That sounds rather worrying.

Bull: No need to worry Bear. Overseas investors are still very fond of the UK, especially London.

Bear: Okay, fair enough. But we got our investment volumes and total return predictions wrong didn't we?

Bull: We did but not wildly, and remember the 2015 year-end figures have not yet been finalised. Forecasts suggest that investment volumes will reach £70bn, a record yearly total, whilst total returns look set to reach around 13% pa.



We did correctly predict that overseas investors would become increasingly comfortable investing outside London, and they have... 32% of transactions by value outside London attracted foreign buyers from 31 different countries.

Last Year's Total Return Forecasts for 2015

IPF Consensus	10.80%
St Bride's Managers	10.00%
IPF Minimum	6.30%
Actual	13.00% (tbc)

Source: IPF / IPD

Bear: And we also correctly predicted that the yield gap between prime and secondary properties would close further, and that property would be the best performing mainstream asset class.

Bull: That's the spirit Bear...I knew one day you'd start looking at things more positively.

Bear: And talking of positive things, the first match of the evening is set to start. I can see both players waiting for their walk up to the oche.

Bull: If my darting knowledge is right, it's the Spaniard, Antonio Alcinas, aka 'El Dartador', against Mark Frost, aka 'Frosty the Throw Man'. I can't wait!

Bear: Get the beers in Bull...by the time you are back that song that everyone chants and does that wavey-arm dance to will have started, you know the one...Chase the Sun by Planet Funk Da Da Da Da Da Da Da Da Da Da Da Da Da Da... Oi Oi Oi.

UK Economy and Politics

Bull and Bear discuss the prospects for the UK economy and the looming EU Referendum.

Bull: So then Bear, whilst Sky are debating the merits of Peter 'Snakebite' Wright's new hairstyle, shall we have a crack at our predictions for the UK economy and politics for 2016?

Bear: Why not? We followed this order last year so why change a winning format?

Bull: Well I'll kick off then with the economy. I know 2015 wasn't as good as 2014, but we predicted that didn't we? And I recognise that some of the economic data that was released just before Christmas might have had George choking on his Brussel sprouts, but I really can't foresee anything lurking out there that is likely to act as a genuine game-changer. 'Steady as she goes' I say for the UK economy in 2016.



Bear: I have to disagree with you Bull. You brushed over those recent negative results so quickly but they merit far greater attention if you ask me. The official figures show a stuttering UK economy. The recovery remains fragile and unbalanced. What did Mr Osborne warn us about? A 'dangerous cocktail of threats'.

Bull: Talk about a huge overreaction Bear. I accept that the borrowing figures were much worse than expected, but the ONS revision of Q3 2015 growth was only down from 0.50% to 0.40%. The UK economy is still expected to have grown by 2.2% in 2015.

Bear: But you've failed to mention that growth in the second quarter of 2015 was also revised down and that our manufacturing output is still lower than before the Crash. Add in the fact that Mr Osborne has very little chance of being able to meet his deficit-reduction target for 2015-2016, I think there are genuine reasons for real concern.

Bull: But the UK's recent economic performance has been strong. Remember the UK was one of the fastest growing economies in the G7 last year. And we have a record high employment rate. So what do you think 2016 has in store for the UK and global economies?

Bear: Almost certain growth.

Bull: Sorry? Can you repeat that Bear? For a moment there I thought you said something positive.

Bear: The world economy is almost certain to grow. According to Consensus Forecasts, global growth is expected to be 2.8% in 2016, up from 2.6% in 2015. This looks quite tolerable to me but remember, there are still important downside risks lurking around the corner.

Bull: Arh... there it is. The Bear caveat to any optimism expressed! Well it won't come as a surprise to you that I am fairly bullish. The UK is forecast by the OBR to grow by 2.3%, the US by 2.3% too, whilst even the Eurozone is forecast to grow by 1.7%.

Bear: It's hardly jaw dropping growth though is it? It all feels a bit 'so-so'. Where's the big economic growth going to come from?

Bull: Well Asia, excluding Japan, is forecast to lead the world economy. India is expected to be the fastest growing large economy at 7.8% in 2016, with China expected to follow at 6.5%.

Bear: If you believe their data!

Bull: You old cynic Bear. So what's our prediction going to be? How about that the pace of UK economic growth is likely to be marginally lower than 2015 and lower than forecast by the OBR. This accounts for your pessimism and my optimism.



Bear: I am happy with that and I am happy to add an extra prediction - that headline inflation will also be lower than forecast.

Prediction 1- UK GDP growth and inflation will be lower than forecast by the OBR

GDP Growth and CPI Forecasts 2016-2020

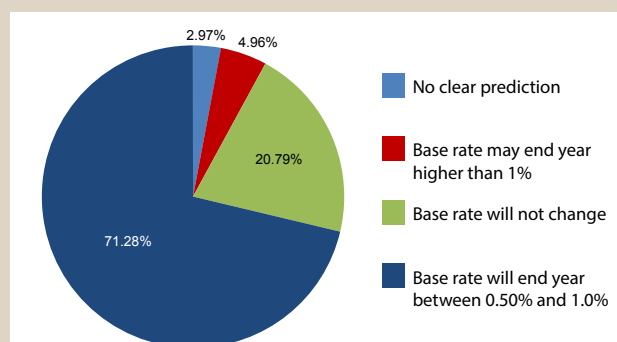
	GDP	CPI
2016	2.3%	1.0%
2017	2.5%	1.8%
2018	2.4%	1.9%
2019	2.3%	2.0%
2020	2.3%	2.0%

Source: OBR, November 2015

Bull: Given continued low rates of money and credit growth combined with the strength of the pound, I can't disagree with you Bear. But where do you stand on a possible interest rate rise this year?

Prediction 2 - Interest rates will not increase before Quarter 4 2016

Predicted UK Monetary Policy 2016



Source: FT Survey

Bear: I am not convinced that the UK economy is quite robust enough yet to sustain a rise. I can't see the Bank of England following the Fed in raising rates for a little while. In fact, I am not convinced that a rise will come this year at all. Q4 2016 at the earliest if you ask me.

Bull: I think, surprisingly, I agree with you. The current CPI inflation rate is so much lower than the 2% target whilst raising the rate would strengthen the pound. That won't help.

Bull: I suppose all that we have just discussed has assumed the small matter of an EU Referendum has been shelved until 2017?

Bear: Absolutely. The one major concern I have for the next 12-15 months is the EU Referendum. A drawn-out process will cast a shadow over the UK's economy. The best we can hope for is that the Referendum is brought forward to sometime this year.

Bull: Here, here. I couldn't agree more. This is massive and I think that the Great British public is only now starting to recognise its importance. Newspaper columns are increasingly focusing on it, there are more and more polls predicting the likely outcome, and all this despite us all still not having a definitive date!



Bear: If the General Election polls are anything to go by, I think we should give the EU Referendum polls a miss. The ones I have seen recently are already giving very mixed signals.

Bull: The last three polls that I have seen certainly show that everything is still to play for. I don't believe it though. I just can't see the UK exiting the EU when push comes to shove.

Prediction 3 - The UK will not vote to leave Europe

Latest Brexit Polls

	ORB International (Jan 2016)	Ipsos Mori and ICM (Dec 2015)	Lord Ashcroft (Jan 2016)
Leave	43	41	47
Stay	36	43	38
Undecided	21	16	15

Source: FT

Bear: But business support for membership of the EU has narrowed from 74% six months ago to 62% today. Furthermore, the backdrop of a continued weak recovery in Europe, the migration crisis and continued uncertainties over the structure of the monetary union has meant that public opinion has also become more negative.

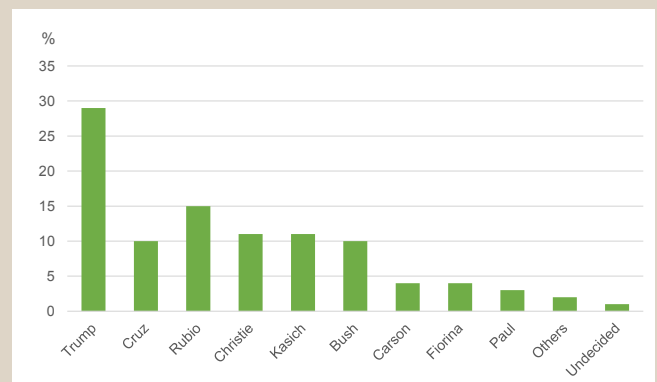
Bull: As I said back in July, whilst the prospect of a 'Brexit' will result in a period of uncertainty, the UK would do just fine if we decided to ditch Brussels.

Bear: Rubbish Bull. Many major international companies would no longer choose Britain as the base for their European operations should we exit. In addition to a loss of trade, there will be a loss of foreign investment and less inward migration of highly talented Europeans who have aided growth. An exit would spark uncertainty, which stops companies investing and households spending, all harming growth.

Bull: Before we move on, we really should touch on the US and in particular the Presidential Election in November. I am concerned that the US economy will be hampered by the election process, especially if Donald Duck, sorry Donald Trump gets in.

Prediction 4 - Donald Trump will not be the 45th US President

Latest Poll for The Republican Nomination for US President



Source: Public Policy Polling, 6 January 2016

Bear: He won't. He can't. Can he?

Bull: The latest polls have him holding onto a sizeable lead for the Republican Party nomination. Stranger things have happened.

Bull: People get more pragmatic the closer they get to the actual vote. Even Americans! Donald Trump won't be the next President of USA. It will make the election run-up much more fun but ultimately come November he will have just wasted a reported \$US1bn on campaigning!



Bear: He can afford it though. Let's change topics. Time for a bit of sport.

Sport

Bull and Bear discuss the 2016 sporting calendar.

Bear: So then Bull. What does 2016 have in store for us on the sporting front?

Bull: Other than the Olympics, Paralympics, European Football Championship, Ryder Cup, Cricket World Twenty20, not a great deal!



Bear: That does have the making of a terrific sporting calendar doesn't it? It's just such a shame that the two biggest international sporting events of the year, Euro 2016 in France and the Olympic Games in Rio, will both begin with clouds hanging over them, albeit for very different reasons.

Bull: I thought you had snapped out of your negative thinking Bear?

Bear: I am trying, honestly, but I reckon that Euro 2016 could well become an exercise in defiance following the horrific events in Paris in November. The predicted celebration of football across 10 French cities is now bound to be cloaked in heavy security. UEFA expanded the qualifying to 24 teams and this certainly enlivened the qualification process, but the new format (plus the expected heavy security presence) will delay most of the excitement until the latter stages.

Bull: But at least the new format gives England, Wales, Northern Ireland and The Republic of Ireland all a decent chance of progressing.

Bear: But England, despite an impressive qualifying campaign, will go into the tournament without any genuine star players. Then again, if they don't get out of their group there will be something very, very wrong. Hodgson would have to be sacked.

Bull: The England vs Wales game should be a cracker shouldn't it? I can see both teams beating Russia and Slovakia and thereby both getting out of Group B, especially given that as well as the top two, the best four third-placed teams also go through. How far they will both progress after that is anyone's guess but I am pretty sure a penalty shoot-out defeat for England will feature somewhere!

Bear: What I do know is that employers should brace themselves for a lot of holiday requests on Thursday 16th June. The England versus Wales game kicks off at 2pm. The pubs will be rammed. I can't see any of the home nations making the final on 10 July but I can, strangely enough, see England squeaking into a semi-final.

Prediction 5 - England will win Group B but lose on penalties in the semi-finals of Euro 2016

Predicted Final Group B Standings

1.	England
2.	Wales
3.	Russia
4.	Slovakia

Source: St Bride's Managers

Bull: So why are you down on the Olympics? Don't you remember how amazing the summer of 2012 was?

Bear: Of course I do. How can anyone forget? But the build-up to the first Olympics in South America has encountered problem after problem. When, in 2009, Rio won the Olympics, it was supposed to signal Brazil's coming of age as an economic superpower on the international stage. It just hasn't worked out that way has it?

Bull: I know that Brazil's ongoing economic slump has forced budget cuts but I don't think ticket sales have been poor. I also assume that the traditional panic over whether the venues will be ready will prove unfounded come the 5th August.

Bear: But you've forgotten to mention there is a mix of corruption probes, worries over human rights issues and concerns about the pollution in the bay where the sailing will take place. This has left the feel-good buzz that the organisers were hoping for a long way off.



Bull: I am sure everything will be fine. Rio's natural beauty and the welcoming nature of the hosts will carry the event. I just hope that for Team GB the heroics of the Games in Beijing in 2008 and London in 2012 aren't seen as high-water marks in terms of performance.

Bear: That's going to be a huge ask! Even UK Sport agree, having recently said that improving on the record haul of 65 medals in 2012 is 'within scope'. That's hardly nailing their sails to the mast is it?

Prediction 6 - Team GB will not better its London 2012 medal tally

Team GB Medal Success

	Beijing 2008	London 2012	Rio 2016
Gold	19	29	10
Silver	13	17	17
Bronze	15	19	21
Total	47	65	48
Medal Table Ranking	4th	3rd	7th

Source: BBC / St Bride's Managers

Bull: If they do win more medals, and I tend to agree with you that it's going to be a tough ask, they would become the first nation to win more medals after hosting the Olympics. No host country since 1896 has increased its medal tally at the next summer Games.

Bear: 2012 saw Team GB win 29 golds, 17 silvers and 19 bronzes. I am struggling to think of many 'medal bankers' this time around.

Bull: Jess Ennis-Hill, Mo, Greg Rutherford are all decent bets. The cyclists and rowers are always good for a hatful of medals too. The Brownlee brothers are still top of their games at triathlon, whilst don't rule out medal successes in the new Olympic sports such as golf and rugby sevens.



Bear: I do think Team GB Paralympians have got a decent chance of improving on their tally of 120 medals they won in 2012 though. Both Greece and China won more medals after hosting the Paralympics.

Bull: You know I could talk sport all day, but there is a danger that the readers will start to think we are more passionate about sport than property! To round this section off shall we make some quick-fire predictions for the other major sporting events that are taking place this year?

Bear: Good idea. Where shall we start?

Bull: Well here's a bold one for starters - the USA to win the Ryder Cup in Minnesota in October.

Bear: Are you mad? Europe has been so dominant recently. They have triumphed five times out of the last six occasions.

Bull: True. But I reckon the Americans are starting to understand how much the team ethic means in this competition. And anyway they would have won three of the last four on home soil but for Europe's miracle of Medina comeback in 2012. I can see the USA winning, as much as I don't want them to. What about The Masters?

Bear: Rory McIlroy to take his first Masters and complete the career Grand Slam.

Bull: I can't disagree with you and talking of Grand Slams, I reckon Novak Djokovic will win the French Open on his way to the Grand Slam. And not to be outdone, I can see Serena Williams surpassing Steffi Graf for career Grand Slam titles and win the Golden Slam — the four Grand Slam events and Olympic gold.

Bear: Dare we predict the Six Nations after our World Cup disaster?

Bull: As long as we don't bet on England! But that won't be a problem. I can see Ireland winning the Six Nations.

Bear: I agree. This is getting stupid. We should be disagreeing with each other on everything, not agreeing!



Bull: Well I bet you won't agree with all of these. Germany to win Euro 2016, Manchester City to win The Premier League and India to win the World Twenty20.

Bear: They are all solid predictions Bull. My only difference is the Premier League where I quite like Tottenham's chances!

Bull: You are nothing if not predictable Bear. I need to visit the little boy's room but once I am back shall we consider the year ahead for the UK property market?

Bear: Good idea. I'll get another round of drinks in whilst I am waiting for you.

Bull and Bear's Other Sporting Predictions

Competition	Winner
Ryder Cup	America
World Twenty20	India
Six Nations	Ireland
The Premier League	Manchester City
The Masters	Rory McIlroy
Euro 2016	Germany

Source: St Bride's Managers

The UK Property Market

Bull and Bear discuss their predictions for the UK commercial property market.

Bull: I reckon I could be a professional darts player. All you have to do is stand still, aim and throw something a few feet. It is one of the few activities where practice surely makes perfect. How hard can it be?



Bear: Behave Bull. Have you ever tried it? It's seriously hard. Now stop procrastinating and let's get on with our property market predictions. I'll kick-off by saying that 2016 won't be as good as 2015.

Bull: What makes you say that? The economy is in decent shape and the other major asset classes hardly offer better value. The outlook for the next 12 months looks positive if you ask me.

Bear: But if you judge the market simply on levels of return, then 2016 won't be in the same ballpark as 2014 or 2015.

Bull: What do we expect the All Property Total Return for 2015 to have been? Around 13% isn't it? This is a strong level of performance, especially considering the current 'noflation' environment and compared with the returns generated by equities and gilts.

Bear: Yes but that was for 2015. We are now talking about 2016. I have not seen anyone predict that 2016 property returns will be anywhere near as high. In fact, we won't see double digit returns this year. The IPF All Property 2016 Consensus Forecast is 9.3% pa, with their 5 year average forecast (2015-2019) only 7.7% pa.

Bull: Whilst I expect returns will be down on the last couple of years, you'll struggle to find many investors complaining at those sort of levels though.

Bear: But I don't think that property will deliver the IPD Consensus forecast. I reckon total returns will be lucky to break 8.0%. I know St Bride's believe that. Capital growth is expected to fall away and returns will become almost wholly reliant upon the income element.

Prediction 7 - Total Returns for 2016 will be 8.00%

All Property Total Return Forecasts for 2016

IPF Maximum	IPF Minimum	IPF Consensus	St Bride's Managers
13.0%	6.7%	9.3%	8.0%

Source: IPF / St Bride's Managers

Bull: Well I am far from convinced that we have seen the end of yield compression. According to IPD, the All Property Equivalent Yield moved down by 30 basis points during the first 10 months of 2015.

Bear: Yes Bull but the pace of the downward yield shift is definitely easing. The figures prove it. All Property Annual Capital Value growth peaked at 13% in October 2014 and it is now around 8% (October 2015).

Bull: So are you saying that the UK property market has peaked?

Bear: I think the levels of investment have peaked yes, but I still think there is room for further capital growth in the regional markets.

Bull: So does that mean you are calling the top of the London property market?

Bear: Well we sort of did that last January didn't we because we predicted that we wouldn't see any further yield compression. Twelve months on though and I definitely can't see London yields compressing further. The current yields are eye-watering. A Russell & Bromley shop on Oxford Street recently sold for 2.3% initial yield!

Bull: I am not so sure. There's a wall of capital that still wants to be invested in London property.

Bear: That may be true Bull but I just don't see any further yield compression in London. How many times do you want me to say it?

Bull: Okay, okay. I don't want a fight Bear. So does that mean we are going to retain our prediction of January 2015, that being there will be no further yield compression in London?

Bear: Well if we retain it that is one less prediction we have to come up with. And we are bound to get it right one year!

Prediction 8 - There will be no further yield compression in London

London Investment Yields - December 2015

Prime Offices: West End	3.25% - 3.50%
Prime Offices: City	4.00%
High Street Retail: Bond Street	2.25%
High Street Retail: Oxford Street	2.50%
Prime Industrial Estate	4.75%
Student Accommodation: Direct Let	4.50%
Hotel: Prime London Lease	4.25%

Source: Knight Frank

Bull: Fair enough but I am still not totally convinced you are right Bear. Have you not seen the investment volumes for 2015? There is still a huge amount of money looking for a property home.

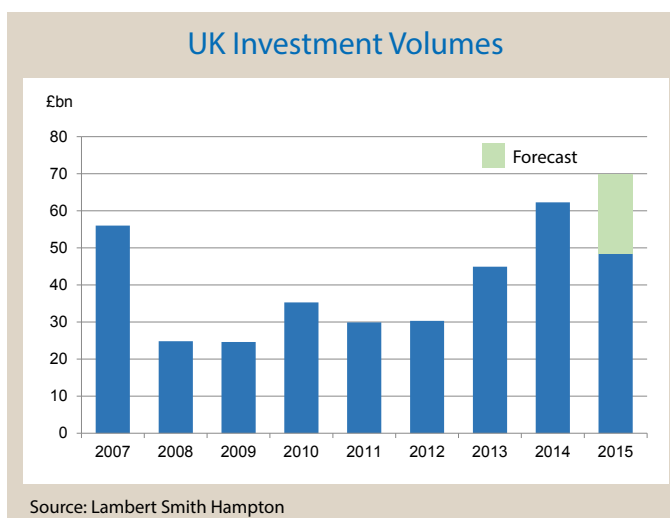


Bear: I've not seen the most recent numbers. What do they show?

Bull: The forecast for total investment volumes for 2015 is £70bn! 2014 recorded £62bn to put this figure in context. 2015 will be a record breaking year for UK commercial property investment.

Bear: Well on that basis I am very, very comfortable predicting that investment volumes will be well down in 2016. The Q3 2015 investment total was £12.8bn, a fall of 23% on Q2 2015. That was the third successive quarterly decline. In addition, and perhaps as telling, net inflows into property funds for retail investors have also started to ease.

Prediction 9 - 2016 investment volumes will not match 2014 or 2015



Bull: Where did you read that?



Bear: Property Week. Q1 2015 saw a net inflow of £896m into property funds, but inflows moderated big time as the year went on. The third quarter fell to £674m – the lowest quarterly level since the fourth quarter of 2013.

Bull: That may be the case but these numbers still show significant net inflows. Most investors I have spoken to appreciate that high capital returns can't go on forever, but with interest rates remaining low (and look set to remain low for a while yet), property still looks attractive. The issue is more about lack of product to buy rather than a drop in investor demand.

Bear: I don't entirely disagree with you but are investors being driven by property's attractiveness or by their nervousness of the other asset classes? Where's the value in the bond market? And we've already seen that there is plenty of turbulence in the equity market at present.



Bull: Probably a bit of both. But I did read recently that according to Collier's Global Investor Outlook, more than half of global investors plan to increase their real estate allocations within multi-asset portfolios. Real estate holdings of up to 20% could soon become commonplace for global pension funds.

Bear: I'll believe it when I see it. But if this huge wall of capital is really looking for a home in UK property, where should it be invested? London is still so expensive whilst the regional markets have also seen significant yield compression over the last 12 months. Is there any value left anywhere?

Bull: London remains strong and will perform okay in 2016. Investors will need to focus increasingly on finding value through asset management or development given yields are now at or approaching historic levels. Strong rental growth will drive returns in London.

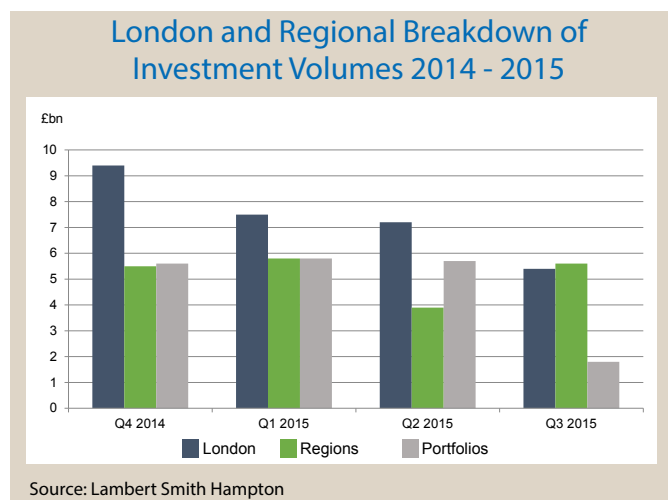
Bear: In other words investors are going to have to work harder, be far more forensic on the assets they are looking to acquire or invest in assets higher up the risk curve.

Bull: Exactly.

Bear: So what about the regional markets?

Bull: I think the UK regions could be in for a busy year in terms of investment. Whilst London will continue to be a focus of intense competition, pricing levels there will drive more and more investors to diversify into the regions.

Prediction 10 - Investment volumes in the regions will exceed those in London



Bear: That may well happen but is there any value left anywhere?

Bull: There are still areas where St Bride's believe value can be extracted. Smaller lot sizes, those too big for private investors and too small for the larger institutions / overseas buyers.

Bear: What the £3m-£7m range they have talked about previously?

Bull: Exactly. According to Savills, typically the average yield on lots of £5m to £15m is still 100-200 basis points higher than it was in 2000 and 2007. St Bride's belief is that this is a reflection of a perception that smaller assets are higher risk or offer lower returns. They expect that margin to close in 2016.

Bear: So where are these areas or is that one of their top secrets?

St Bride's Key Cities

Offices	Retail	Industrial
Bristol	Bristol	Bristol
Leeds	Leeds	Leeds
Manchester	Manchester	Manchester
Edinburgh	Edinburgh	Cardiff
Cambridge	Guildford	Milton Keynes

Source: St Bride's Managers

Bull: No I don't think so. The focus for their newly closed fund is on key regional cities, those which they believe will see growth not just in the short-term but also importantly in the long-term.

Bear: But isn't rental growth expected to remain muted in this low-growth environment we are in?

Bull: To the contrary Bear. Yes it will still remain patchy and some regional locations are still undoubtedly suffering, but the rental growth story looks pretty compelling and not just in London. Take industrials for example. IPD All Industrial Rental Growth reached 4.9% year-on-year in November 2015, the strongest figure since October 2000. Industrials continues to go from strength to strength.



Bear: Yes but you have focused on the best performing sector. Take a look at retail. Retail rental growth continues to lag behind, with the annual rate for All Retail posting a 0.50% year-on-year increase in November. Shops outside of London and the South East fell by 0.3% year-on-year over the same period.

Bull: But you have focused on the worst performing sector! Take offices. Occupier fundamentals continue to strengthen, with demand across the UK regions holding up, supporting decent rental growth.

Bear: UK-wide? I seriously doubt that.

Bull: The UK's regional markets have experienced some pretty dramatic levels of take-up recently. Prime headline rents across the big nine cities that GVA monitor increased by 4% over the twelve months to Q3 2015. However with rent free periods also falling, net effective rents increased by 10% over the same period.

Bear: But there still remains such a significant variation by sector and location. I can believe the rental growth story in London, despite the high rents being paid and the large amount of space under construction. However I just don't believe the story in the majority of the UK's towns and cities. I don't even think 'patchy' is the right word to describe it.

Bull: The London occupational market is phenomenal isn't it? The amount of vacant office space currently stands at 4.28% according to BNP Paribas Real Estate. This is a 14 year low. Lettings in 2015 also set new rental level benchmarks. And the pre-letting figures are remarkable.

Bear: What do you mean by that?

Bull: Pre-letting agreements in London are being signed far earlier in the construction cycle than they previously were. In 2015 pre-lets to West End occupiers were signed 16 months prior to completion of a scheme. In 2013 it was just five months.



Bear: You make a strong case Bull but I am concerned, I am afraid, about the increased threat of terrorism and the impact that this might have for the London occupational markets.

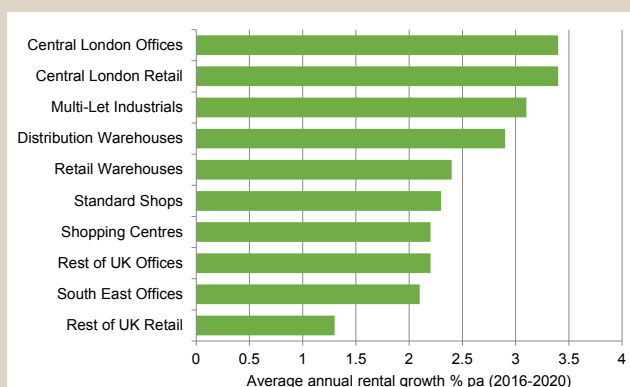
Bull: That's understandable Bear. It's hard not to after the atrocities in Paris. Security has been stepped up though given the threat level is classified as 'severe'. I just don't think Londoners will allow the threat to affect them on a day-to-day basis.

Bear: I hope not. So, are we also going to retain our January 2015 prediction that rental growth will be strong in London and remain patchy in the regions too?

Bear: I think we have to. The IPF Consensus All Property Rental Growth forecast for 2016 is 3.4% and 2.8% for the next 5 years. I think we'll be lucky to see that.

Prediction 11 - Rental growth will remain strong in London and patchy in the Regions

Outlook for Average Commercial Rental Growth 2016 - 2020



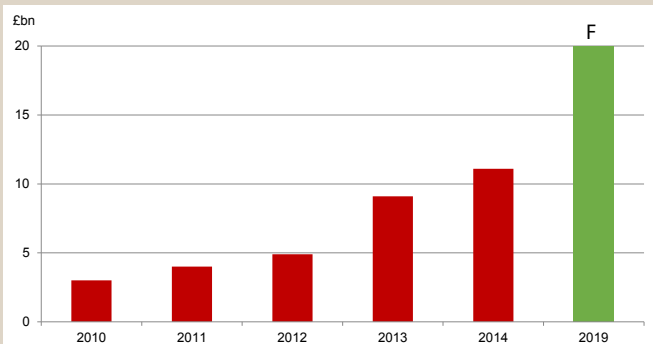
Source: Savills Research

Bull: Are there any important topics that we haven't covered Bear? According to my notes we have only come up with 11 predictions so far and we really need two more. How about a prediction on the alternative sector and residential?

Bear: I can see the alternative sector continuing to make up a growing share of total property investment volumes. Over the last 2 years investment into that sector exceeded £10 billion each year! In 2014 a fifth of all commercial deals were in alternative assets. In the next five years JLL are forecasting that capital flows will double and by 2020 alternatives will make up 29% of all property investment in the UK.

Prediction 12 - The alternative sector will increase its share of all property investment in the UK

Alternative Commercial Property Investment



Source: JLL

Bull: It's not surprising though given that many of the sub-sectors are underpinned by strong demographic stories. The same applies for residential.

Bear: Not that old chestnut again. There has been so much noise about PRS but is it going to ever really take-off as an asset class? It's getting a bit dull isn't it?

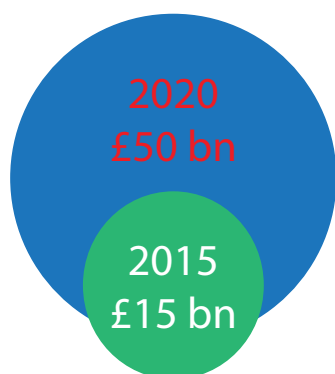
Bull: Knight Frank reckon it will. They believe a modern, professionally managed UK Private Rented Sector has finally arrived and is poised for lift-off.

Bear: What makes them so convinced this time around?

Bull: Well they recently interviewed sixteen large-scale investors in the Build-to-Rent market to ascertain their views on the sector. The survey respondents indicated that investment in the sector is set to triple by 2020. Knight Frank estimate that the sector will be worth £50 billion by 2020.

Prediction 13 - The Private Rented Sector will start to see significant institutional investment

Current and expected investment in the private rented sector by large scale investors



Source: Knight Frank Research

Bear: About time if you ask me. But I think I actually agree with them. The private rented sector is continuing to grow in size. The last I heard was that around 5.4 million, or 20% of households are now being let out to private tenants. That's up from 10% only 12 years ago!



Bull: See Bear, you can end things on an optimistic note... a new asset class, continued demand from investors, rental growth, a robust and growing economy. It all looks pretty good doesn't it?

Bear: I am happy to concede that things could be worse so long as you recognise that dangers do still lurk out there and the possible impact of the EU Referendum could be significant for the UK.

Bull: Well if it shuts you up, then fine, I am happy to concede that. Let's head off. I want to get home to watch the cricket highlights from South Africa. The chat at the bar was that Ben Stokes has been whacking it to all parts again.



We would be delighted to share our further thoughts on the UK property market with you. In the meantime we trust that 2016 will be a happy, healthy and prosperous year for you all.

St Bride's January Predictions for 2016

1	UK GDP growth and inflation will be lower than forecast by the OBR
2	Interest rates will not increase before Quarter 4 2016
3	The UK will not vote to leave Europe
4	Donald Trump will not be the 45th US President
5	England will win Group B but lose on penalties in the semi-finals of Euro 2016
6	Team GB will not better its London 2012 medal tally
7	Total Returns for 2016 will be 8.00%
8	There will be no further yield compression in London
9	2016 investment volumes will not match 2014 or 2015
10	Investment volumes in the regions will exceed those in London
11	Rental growth will remain strong in London and patchy in the regions
12	The alternative sector will increase its share of all property investment in the UK
13	The Private Rented Sector will start to see significant institutional investment

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