

St Bride's World Cities

Delivering Discipline to Global Property Investment



May 2011

Introduction

Welcome to the St Bride's World Cities Investment Model. This model scores the risk management status of cities around the world on a consistent and objective basis to help guide investment decision making. It provides the foundation and framework for creating a balanced global investment portfolio.

We believe that international exposure to property will become a stronger theme in institutional property investment strategy and that the model will help develop this thinking. This report reviews the rationale for overseas investment in our World Cities which can be summarised as follows:-

- **Property portfolios should be rebalanced.** They are based on historic benchmarks that are not relevant today. Institutions should build up a meaningful exposure to the international property markets.
- **Current overseas weightings are too low.** For example UK Institutions invest around 10% of their portfolios overseas. This should be increased to at least 35%. In an ideal world this should come from a fresh allocation to property.
- **Global investment provides diversity.** Property markets tend to be local markets driven by local supply and demand. They are less strongly correlated with each other compared with the equity and bond markets. They also provide greater choice rather than investors chasing limited stock in an over crowded domestic market.
- **There are plenty of places to invest around the globe.** Our view is that you should remain focused on the St Bride's World Cities. This will provide diversification and discipline to the investment process.
- **Performance is projected to be good.** We should see a period of strong returns across our World Cities over the next three years. Unleveraged total returns will be in the 8-12%pa range.

- **The method of investment will depend on the market.** Direct purchases or joint ventures will work in Europe and North America. In some Asian cities the best route may be through the listed real estate markets.

These points are developed further in the following pages.

| Asia Pacific | Europe | North America |
|--------------|-----------|---------------|
| Hong Kong | Amsterdam | Boston |
| Melbourne | Berlin | Chicago |
| Seoul | Geneva | Los Angeles |
| Singapore | London | New York |
| Sydney | Munich | San Fransico |
| Tokyo | Paris | Toronto |
| | Stockholm | Washington |

The Global City Investment model is a dynamic tool for objectively assessing the relative performance and risk around the globe. The table above lists our top cities for investment. Our goal has been to create an objective and consistent method for evaluating global cities focusing on understanding city potential in the context of international property investment.



The Balanced Global Investment Portfolio

Some institutional investors already have a global exposure to property. Not many. And even fewer will have a meaningful exposure. Global mandates are common across other asset classes but not property. We believe that this will change and institutional property investment will take on more of an international flavour over the coming years, not least because having an international perspective makes it easier to assess the prospects of your domestic portfolio.

So why go global?

- Greater opportunity to diversify.** Basic investment theory suggests that the broader the diversification the more stable the returns and the more diffused the risk. Property markets tend to be local markets driven by local supply and demand factors compared with equity and bond markets which are highly integrated and strongly correlated. This is good for diversification.
- Market inefficiencies.** Some overseas markets are less efficient than our domestic markets and provide better opportunities to add value with active management. Property is closely linked to the local economy of an area so can provide well focused investment in markets which have good prospects for growth or recovery.
- Removes barriers constraining access to new stock.** The UK commercial investment market represents a small proportion of the world's investible market. Opening up the markets that you invest in allows for greater choice rather than forcing investors into an over crowded market that may – at certain points in the market cycle - offer lower quality overvalued domestic stock. Taking a global view widens the possibilities for good investment returns and opens up opportunities to profit from different economic cycles and investments that may not be available in the UK.
- The world order is changing.** Property portfolios need to be rebalanced. They are based upon historic benchmarks that are not relevant to the rapidly changing world economy.

| Population | 2007 (m) | 2030 (est) (m) | Change % | Urban Change % |
|----------------------|----------|----------------|----------|----------------|
| Middle East / Africa | 1,185 | 1,830 | 54 | 90 |
| Latin America | 572 | 712 | 24 | 34 |
| Asia | 3,800 | 4,600 | 21 | 63 |
| North America | 339 | 405 | 19 | 28 |
| Europe | 732 | 706 | -4 | 8 |

Source: UN

The table above shows projected population growth over the next 20 years. Substantial growth is projected across Africa, Latin America and Asia whilst Europe is the only region showing negative growth. The move toward urbanisation is also strongest away from Europe. These demographic changes, coupled with the growing strength of the emerging markets, will play a big role with the performance of property.

The St Bride's World City Model

The case for investing globally is compelling. But where do you start? The world is a big place providing plenty of opportunities to invest in real estate. Choose the level of risk you want to take and projected returns will range from single digit to 20% plus depending upon where you want to enter the risk curve.

And therein lies the problem. The big issue is knowing where you actually are on the risk curve as you venture into new, different and confusing overseas markets.

Our view is simple. You need to remain focused and understand the markets in which you are invested. To this end we have constructed the St Bride's World Cities Model. This identifies the cities – not countries – that we recommend for investment in over the coming years.

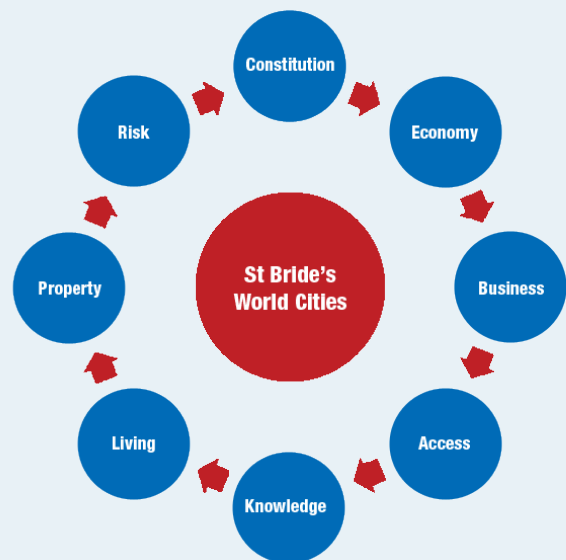
Our aim is to “de-mystify” overseas property investment and to encourage investors to focus on key cities rather than a catch-all worldwide, countrywide approach. The model is a risk management tool designed to identify the most secure destinations for long term overseas investment. It does not seek to promote the prospects for property returns, but rather to offer a clear pathway for investors to achieve a controlled exposure to overseas investment.

The results of the research produce the following cities for investment. London leads the list. The other 19 cities are spread around the 3 main investment regions.

- **Asia Pacific** – Hong Kong, Singapore, Tokyo, Sydney, Seoul and Melbourne
- **Europe** – London, Paris, Geneva, Stockholm, Amsterdam, Berlin and Munich.
- **North America** – New York, Toronto, Los Angeles, Chicago, Washington, Boston and San Francisco

Two wild cards have been added to the original list, Madrid and Shanghai, recognising their increasing importance in southern Europe and Asia. Other cities may make the list as markets emerge and economies grow. There is an expectation that cities particularly in the BRIC economies will push to be included in the index over the next 2 decades.

8 themes to assess World Cities



The model adopts eight themes weighted according to importance: Constitution, Business, Property, Economy, Knowledge, Access, and Living. Each theme has 5-6 indicators which are also weighted. Further detailed information is provided at page 6 on how the model was designed.

What will your portfolio look like?

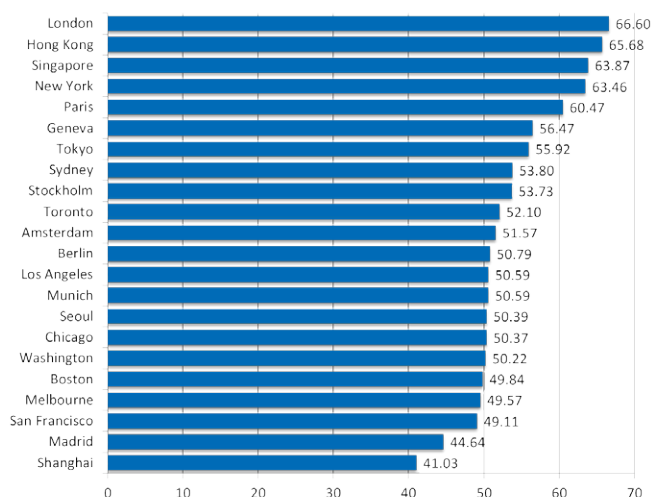
Including an allocation to The St Bride's World Cities in an investment strategy will change the structure of most institutional portfolios. A realistic target would be for the overseas weighting to be around 35% of the total allocation to property. UK assets would still dominate the make up of the portfolio albeit that London, one of our world cities, should have the major share of any domestically invested capital. The other 19 (+2 wildcard) cities are spread evenly around the 3 main investment regions, Asia, Europe and North America. This provides exposure to 15 countries, with the USA leading the way with 6 cities.

Entry into new markets can be done in a number of ways:

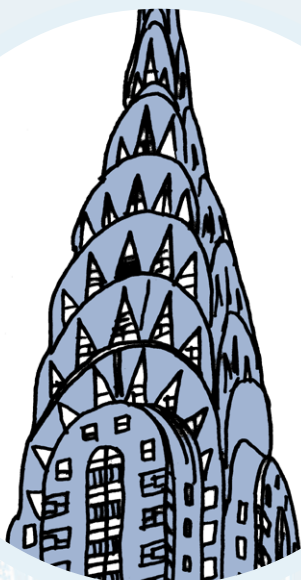
- **Investing directly.** Control is maintained but can be management intensive and require strong local knowledge. In some cities on our list this may be impractical.
- **Investing via pooled funds or joint ventures.** This route requires less capital but balanced against this is the loss of direct control.
- **Investing via the listed real estate market.** This option provides liquidity and is good for rebalancing a portfolio. It can deliver returns relatively fast by capturing market movements quickly. However increased volatility and a tendency to track equity rather than property markets may not appeal to some investors.

Our view is that it depends on the market. Certainly North America and Europe will provide opportunities to access the markets by way of direct purchases or pooled funds. Our preference is for JV's or small clubs which provide more control than the larger pooled funds. In some Asian cities access may be best via the public quoted market.

St Bride's World Cities



The Chart shows our World Cities ranked according to their risk profile generated by the St Bride's World City Index. As a first step into international markets it may be appropriate to invest in the higher ranked cities. Hong Kong, Singapore, New York, Paris, Geneva and London will provide the foundation of a strong international portfolio as well as maintaining a relatively low risk profile.



St Bride's World City Investment Model

The St Bride's World City Investment Model scores the risk management of cities around the world, on a consistent and objective basis, to help guide investment decision-making. We have used a variety of secondary sources to produce a composite model based on reputable data that is likely to be updated in the future, allowing periodic updating of the model.

It has not been our goal here, as with many published indicators, to establish the "top city" or even the "top ten cities". Rather our goal has been to establish an objective and consistent method for evaluating investment prospects around the world.

The model is based around a series of seven themes.

1. Constitution: a reflection of the quality of governance; openness to international engagement, and of human well-being.

2. Economy: a series of indicators to summarise economic stability and vitality, labour markets and growth.

3. Business: measures reflecting a city's global role, including areas such as protection on investors, availability of credit and access to capital.

4. Access: including both "softer" indicators such as tourism and cultural exchange, as well as "harder" indicators, such as goods markets and transport and infrastructure.

The top 20 cities scorecard

| City | Constitution | Economy | Business | Access | Knowledge | Living | Property | Risk | Overall |
|---------------|--------------|---------|----------|--------|-----------|--------|----------|------|---------|
| London | 16.12 | 7.17 | 16.07 | 7.96 | 8.58 | 7.64 | 10.86 | 7.82 | 66.60 |
| Hong Kong | 17.03 | 7.01 | 15.11 | 5.23 | 5.81 | 7.46 | 13.95 | 5.93 | 65.68 |
| Singapore | 17.72 | 6.96 | 14.62 | 8.58 | 6.19 | 7.92 | 10.70 | 6.82 | 63.87 |
| New York | 15.96 | 10.10 | 16.25 | 6.46 | 7.35 | 7.39 | 9.13 | 9.17 | 63.46 |
| Paris | 15.66 | 6.65 | 12.84 | 6.73 | 7.62 | 7.34 | 10.83 | 7.21 | 60.47 |
| Geneva | 16.82 | 5.72 | 10.80 | 4.27 | 6.43 | 8.04 | 9.45 | 5.05 | 56.47 |
| Tokyo | 15.44 | 9.58 | 14.12 | 4.47 | 6.92 | 7.66 | 7.12 | 9.41 | 55.92 |
| Sydney | 16.80 | 5.85 | 12.77 | 4.10 | 5.79 | 7.77 | 9.43 | 8.71 | 53.80 |
| Stockholm | 16.75 | 5.49 | 11.54 | 3.16 | 5.91 | 7.61 | 7.96 | 4.70 | 53.73 |
| Toronto | 16.60 | 6.05 | 13.37 | 4.34 | 6.03 | 7.82 | 5.37 | 7.47 | 52.10 |
| Amsterdam | 16.13 | 5.37 | 10.83 | 4.99 | 6.47 | 7.88 | 6.76 | 6.86 | 51.57 |
| Berlin | 16.43 | 5.23 | 11.21 | 4.54 | 6.76 | 7.77 | 6.93 | 8.07 | 50.79 |
| Los Angeles | 15.96 | 7.49 | 13.67 | 4.59 | 6.47 | 7.54 | 4.19 | 9.32 | 50.59 |
| Munich | 16.43 | 5.06 | 11.00 | 4.66 | 6.12 | 7.73 | 7.65 | 8.07 | 50.59 |
| Seoul | 14.91 | 6.59 | 12.04 | 4.24 | 7.07 | 6.78 | 6.73 | 7.97 | 50.39 |
| Chicago | 15.96 | 7.04 | 14.29 | 4.02 | 6.97 | 7.35 | 3.92 | 9.17 | 50.37 |
| Washington | 15.96 | 6.38 | 13.68 | 4.03 | 6.70 | 7.46 | 5.18 | 9.17 | 50.22 |
| Boston | 15.96 | 6.27 | 13.41 | 4.43 | 6.80 | 7.43 | 4.72 | 9.17 | 49.84 |
| Melbourne | 16.80 | 5.62 | 10.67 | 4.56 | 5.36 | 7.75 | 7.51 | 8.71 | 49.57 |
| San Francisco | 15.96 | 6.15 | 13.71 | 4.15 | 6.27 | 7.56 | 4.63 | 9.32 | 49.11 |

The table above shows the ranking of our World Cities with the scores on each of the eight indicators. Overall London appears at the top of the list followed by Hong Kong, Singapore and New York. At the bottom Melbourne and San Francisco complete the list. As a point of reference our 2 wild cards Madrid and Shanghai had overall scores of 44.64 and 41.03 respectively.



5. Knowledge: intended to reflect investment in the knowledge economy, including innovation, medical schools, technological development and information flow.

6. Living: indicators of quality of life, including health and education levels, environmental quality, personal safety and the rule of law.

7. Property: a final theme to reflect the maturity of the property market, with indicators including occupancy costs, vacancy levels and transparency.

We believe that this selection of themes provides a rounded picture of the issues that will be of concern to an international investor considering opportunities in “competing” cities. Each of the themes is weighted in order to reflect the fact that some issues are more important to investors than others. The weightings can be altered to reflect the specific priorities of a group of investors or, indeed, a changing social, political, economic landscape.

Within each of the themes, we have generated five or six specific indicators. By way of an example, we have shown below the indicators contained within the Constitution theme. This theme covers the quality of governance; openness to international business and human well-being.

The sources of this theme are mainly world governing bodies: the Heritage Foundation, World Bank, World Economic Forum and UN all produce reputable and comparable data, which are used here.

Once each indicator is scored, then the city’s theme scores are totalled, complete with weightings as indicated earlier. Thus with either five or six indicators, each theme has a maximum score of five hundred or six hundred. Once the theme scoring is completed, the scores are aggregated to produce an overall performance score for each city.

In order to ensure that we are sufficiently forward-looking, we have also scored each city against a risk profile – a further series of criteria that look at issues that might form a threat to a city’s attractiveness. Issues such as pollution, corruption and CO2 emissions are included.

Overall, the City Investment Model provides an objective and robust method for evaluating the risks relating to the investment prospects of cities around the world.

Indicator Example: Constitution

| Indicator | Definition | Reference |
|-------------------------|--|---|
| a Openness | A measure of openness of countries according to ten criteria of freedom, by country | Heritage Foundation, 2011 Index of Economic Freedom |
| b Opacity | Measures five components of negative social capital: corruption; legal system inadequacies; economic enforcement policies; accounting standards and regulation, by country | Milken Institute, 2009 Opacity Index |
| c Governance | Measure of government effectiveness, by country | World Bank, Worldwide Governance Indicators, 2009 |
| d Infrastructure | Provision of transport, energy and telephony, by country | World Economic Forum, Global Competitiveness Report 2010 - 2011 |

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