

Prospects for 2018



Is your glass half-empty or half-full this year?

February 2018

2017 Revisited

Bull and Bear met up at the MSCI Index release in London to discuss the year that was 2017 and to see how accurate their predictions had been. This publication records their discussion.

Bear: So here we are again. Another year, another IPD/IPF seminar to discover just how well the UK property market fared in 2017.



Bull: MSCI, Bear. It's MSCI! IPD is so 20th Century. If you want to keep in with 'cool kids', you're going to have to learn the new lingo.

Bear: Fair point. It's just so hard keeping up, particularly at our age.

Bull: Speak for yourself Bear. I am actually really enjoying the challenges of the current market and have as much of a spring in my step today as I did this time last year.

Bear: You may well still have a spring in your step, but have you got a clue in your mind? Twelve months ago, when we sat in that posh restaurant, we concluded that nobody really had that much of an idea of what lay ahead. I simply don't believe you can be any clearer a year on.

Bull: That's a bit harsh. I said it last year and I'll say it again. At least we are prepared to raise our heads above the parapet and say what we think. I'd rather be a bull than a sheep.

Bear: I've got no problem getting predictions wrong either, but we are so-called property 'experts'. I don't need to remind you just how badly wrong we got our All Property total return prediction, do I?

Bull: No you don't, but we didn't get all of our ten 2017 predictions wrong, did we? We said that the UK Government would serve the Article 50 notice by the end of March 2017. And they did.

Bear: Just.

Bull: We also said that no European Nationalist Party would win control in 2017, and no party did. Emmanuel Macron in France, Mark Rutte in the Netherlands and Angela Merkel all emerged victorious, didn't they?

Bear: Just. In case you haven't noticed, it has taken over four months for Chancellor Merkel to form her coalition. Apparently the agreement gives the basis for a "good and stable government".

Bull: Isn't that exactly what Cameron and Clegg said outside Downing Street in 2010? "We believe that together we can provide that strong and stable government that our country needs."

Bear: You're such a cynic, Bull. Anyway, you seem to have forgotten that we got our interest rate prediction wrong too.

Bull: We weren't far off. Firstly they waited until November to do it, and secondly, they only increased it by twenty-five basis points. The increase only took them back to where they were before the Brexit Referendum. Okay, we were wrong but I was really surprised by their decision. Real wages were falling at the time.

Bear: I think we just under-estimated the rate of inflation. CPI reached 3.1% in November, remember? This was the final straw. The Bank of England needed to put a lid on it, hence the rate increase.

Bull: We got our other economic forecast right though. UK GDP growth in 2017 was higher than forecast by the OBR.

Bear: But that's only because the OBR were overly pessimistic at the start of 2017. They were integral members of the 'haven't got a clue club'. They forecast GDP growth of 1.40%, remember? Yes the UK fared better than forecast, but the rate of expansion was the slowest since 2012, having fallen from 1.9% in 2016 to 1.8% last year.

Bull: We will come onto what we think is going to happen in 2018 shortly, but what we do know for sure is, we got our GDP prediction correct. That's three out of four so far. 75%. Distinction territory!

Bear: It's three out of five with our Lions rugby prediction though.

Bull: True, but I still don't know anyone who didn't expected the Lions to lose 3-0 in New Zealand.

Bear: Does three out of six predictions equate to 'bang-average'?

Bull: Why?

Bear: Because, as I mentioned earlier, our total return forecast was horribly wrong. And when I say horribly, I'm massively understating that!



Bull and Bear's Predictions for 2017 Revisited	
1	The UK will serve Article 50 by the end of March 2017 ✓
2	No European Nationalist Party will win control in 2017 ✓
3	UK GDP growth will be higher than forecast by OBR ✓
4	Interest rates will not increase by the end of 2017 ✗
5	The British and Irish Lions will lose 3-0 to The All Blacks ✗
6	Total Returns for 2017 will be 2.5% ✗
7	Prime yields will see little change over 2017 ✗
8	The Alternatives Sector will continue to increase its share of all property investment in the UK ✓
9	2017 Investment Volumes will better those of 2016 ✓
10	Industrials will be the best performing sector ✓

Source: St Bride's Managers

2017 Revisited

Bull: But we were more bullish than the IPF Consensus. It's easy to feel rather embarrassed, but what about everyone who contributed to the November 2016 forecast? The IPF Consensus total return forecast was 1.3%, with the maximum being 4.8% and the minimum being minus 5.7%. Our prediction of 2.50% looks much more respectable in that context, rather than against the year-end figure of 10.2%.

Bear: I suppose so, but it does reinforce the argument that no-one in our industry seems to have a real grip on the capital markets! Even in May last year, the IPF Consensus was still forecasting a total return of only 6.7%. It's fair to say that 2017 will go down on record as a year that shocked the industry, and made a bit of a mockery of many!

November 2016's Total Return Forecasts for 2017	
	%
IPF Consensus	1.30
IPF Maximum	4.80
IPF Minimum	-5.70
St Bride's Managers	2.50
Actual	10.20

Source: IPF / MSCI and St Bride's Managers

Bull: With regards to the total return prediction, yes. But if you look at our other four property predictions, we were pretty much spot on with them all. We predicted that industrials would be the best performing sector. And boy they were!

Bear: Frightening. 19.6% for industrials as a whole, with South East Industrials recording 22.5%!! Industrials make up 22% of the total IPD, sorry, MSCI index and if industrials had been taken out, the All Property total return for 2017 would have been much nearer to 6%. That's how much industrials outperformed.



Bull: We also said that the Alternatives sector would continue to increase its share of property investment in the UK. And it has. According to LSH, Q4 2017 saw £3.3 billion of investment into the specialist sectors, taking the total for 2017 to a new annual high of £10 billion. The specialist sectors collectively accounted for a record 17% share of total volumes, surpassing both retail and industrial for the first year ever.

Bear: It's understandable though, isn't it? Why wouldn't investors want to buy assets that derive their returns from population growth, urbanisation and demographic change? It's a slam-dunk.

Bull: Just like our investment volumes prediction. We predicted that 2017 volumes would better those of 2016 and we were absolutely right. 2017's volume was £58.8bn. Not only was this 25% up on 2016 (£47bn), but it was also 38% above the ten-year annual average. A number of UK regions saw record activity and despite Q4 being the quietest quarter of 2017 for Greater London, £24.5bn was still invested, 28% above the ten-year average.

Bear: So with all this money looking for a home, it's hardly surprising that we got our final prediction wrong, is it? We predicted that prime yields would see little change over 2017, and whilst we were broadly correct for offices and retail, there was some noticeable yield compression for industrials, hotels/leisure and the specialist sectors.



Prime Investment Yields 2017		
Sector	December 2016 (% pa)	December 2017 (% pa)
High Street Shops	4.00	4.00
Shopping Centres	4.65	4.65
Retail Warehouses	4.75	4.75
West End Offices	3.75	3.75
City Offices	4.25	4.00
Regional Cities Offices	5.25	5.00
Distribution	5.00	4.50
Industrial Estates (Greater London ex Heathrow)	5.00	4.35
Industrial Estates (ex Greater London)	5.25	4.65

Source: CBRE, January 2018

Bull: 'Some noticeable yield compression'? Is sixty-five basis points your definition of 'some'? Prime Greater London industrial yields are now 4.35% for goodness sake. And there have been deals done recently that suggest further yield compression is more than possible. Take Sandown Industrial Estate in Esher. This sold for 3.67% in December. That's 3.67% Bear!! Not 6.73%. No-one would have predicted these sorts of yields at the start of 2017!

Bear: Very true. But by my calculations, that means we still got six out of our ten predictions correct.

Bull: That's not bad in these highly uncertain times, is it? And on the plus side, there's plenty of room for improvement. Let's see if we can do rather better for 2018, shall we?

Economics and Politics

Bull and Bear discuss politics and the prospects for the UK economy in 2018.

Bear: So Bull, where shall we start?

Bull: How about with an easy one? Politics.

Bear: Sorry. Did you say an easy one? Surely that's currently the hardest topic of them all?



Bull: Rubbish. No-one has any idea of what's going on. And I include the politicians in that. So from our perspective, it's easy. Prediction 1 should be UK politics will remain chaotic.

Bear: I can't disagree, but a prediction like that is hardly going to inspire or educate the loyal St Bride's Managers' readership, is it?

Bull: But would a prediction like "a new EU trade agreement will be signed by X" or "migration numbers will fall to Y" educate them either? It would be total guess work on our part. How can we make a prediction on Brexit when even the people negotiating it don't appear to know how it's going to play out?

Bear: So what are you recommending our political predictions for 2018 should be? Or are you advocating a political sabbatical?

Bull: No, no. I am happy to front up but why don't we tackle the questions that the men and women on the street are interested in.

Bear: Like what?

Bull: How about 'when will Theresa May find a personality and a clear vision for the UK?' 'What weapon will Boris Johnson use to oust Mrs May?' 'Will Jeremy Corbyn buy a new suit in 2018?' 'Will Donald Trump become the new face of Advance Hair Studio?' 'Will Kim Jong-un get trigger happy?'

Bear: Grow up Bull. You're being childish.

Bull: Maybe, but I can't make any sense of what's currently going on. I am trying to keep up, but it's all just a bit manic, isn't it?

Bear: It is, but whether we like it or not, 2018 is going to play a pivotal role in determining the future of the UK. I am not just talking about how the Brexit negotiators get on in Brussels, but the UK Government has got a real job on its hands in terms of convincing the public that they can lead us through these choppy waters.

Bull: Mrs May has an enormous task in front of her, that's for sure. She doesn't even appear to be in control of her own party, does she? But then again, the Conservatives are not going to want to call a General Election with Jezza lurking in the wings. It's hardly surprising that the bookies reckon the next UK General Election won't be until 2022 or later. The odds are 2/1, apparently.

Bear: I can't disagree with those odds, but what do we reckon the chances are of Mrs May still being our Prime Minister when the UK finally leaves the EU?

Prediction 1 - Theresa May will still be Prime Minister at the end of 2018

The year Theresa May is replaced as Prime Minister

Year	Odds
2018	5/4
2019	2/1
2020 or later	5/2

Source: Ladbrokes, 13 February 2018

Bull: I reckon she'll hang on by her finger nails. Not least because there is no obvious replacement, is there? Ladbrokes don't agree with me though. The last time I checked, it was 5/4 for her to be replaced in 2018.

Bear: Do you have something to tell me Bull? Your betting knowledge is mightily impressive, if not rather disconcerting!

Bull: Hmmh! And did you know that the odds that no Brexit deal is reached before 1st April 2019 are 7/4, or the odds that the UK will apply to rejoin the EU by 2027 are 4/1, or even the odds that Michael Gove will be the next PM are 11/1?

Bear: And?

Bull: The odds that Donald Trump will be impeached in his first term are evens, or the odds on Trump and Putin receiving the joint Noble Peace Prize are 25/1, and the odds of Kim Jong-un launching a bid for a Premier League club this season are 66/1.

Bear: Stop it! I've got the message. But what about the UK economy? How do you think it's going to perform in 2018?



Bull: Again I think we are going to have to guess somewhat, but I'm pretty confident. The Brexit negotiations are bound to have a bearing on how the economy performs. A smooth(ish) process which leans towards a soft Brexit will probably reassure the financial markets and encourage business activity. Progress on EU trade talks is bound to buoy confidence and sterling.

Bear: It's unlike you to be so bullish!

Bull: But I have good reason, I reckon. There is finally some positive wage growth, plus falling inflation, and this is widely expected to support a rebound in household spending. Despite over eighteen months of Brexit gloom and political uncertainty, unemployment is also still at an historic low (4.3%), remember?

Bear: So are you expecting UK GDP growth to be higher in 2018 than was recorded in 2017?

Economics and Politics

Prediction 2 - UK GDP growth in 2018 will again be higher than forecast by the OBR

GDP Growth and CPI Forecasts 2018-2022		
	GDP	CPI
2018	1.4%	2.4%
2019	1.3%	1.9%
2020	1.3%	2.0%
2021	1.5%	2.0%
2022	1.6%	2.0%

Source: OBR, November 2017

Bull: I am, yes. The OBR is forecasting growth of 1.4% in 2018. But personally, I think the UK may actually fare rather better than that.

Bear: But what we are both forgetting is that whilst the UK economy is growing, it's trailing behind the US, France and Germany. The IMF is forecasting a growth rate of 2.7% for the US and 2.2% for the Eurozone in 2018. I think the chief economist at World First summed it up perfectly when he said, "the UK economy is in a chronic crawl at the moment whilst the rest of the world is enjoying a significant skip higher in growth." We mustn't forget that UK GDP growth was the weakest of any G7 nation in 2017.

Bull: But the UK economy and global economy are going to "recouple" later this year according to Mark Carney, assuming of course we gain greater clarity over our future trading relationship with Europe.



Bear: So what's your current thinking on interest rates? Will The Bank stick or twist this year?

Bull: Twist, but probably not until the second half of the year. I know there is a lot of chat currently about May being the month when the next interest rate increase is made, but I don't think enough progress will have been made on Brexit by then to justify it.

Bear: It's a tough one to call. It does look like the rate of inflation has peaked (3.1% in November and 3% in December and January). The Bank of England has also stated that it expects CPI to fall back to 2.4% by the end of 2018 but this will still be above their target rate of 2%. Inflation will justify a rate rise later this year.

Bull: So, what's your prediction then?

Bear: Well, on the one hand, the likes of EY ITEM Club reckon there will be two hikes, one in May and the other in November. And on the other hand...

Prediction 3 - Interest rates will be 0.75% in December 2018

Interest rates are on an upward path	
Year (End of)	Interest Rate
2018	0.75%
2019	1.00%
2020	1.25%
2021	1.50%

Source: ING

Bull: Come on. Get off the fence. For me I'd much rather go along with ING's prediction of 0.75%. The Bank needs to be careful not to go too far, but it's hard to see them doing nothing.

Bear: Ok, but I'm itching to discuss 2018's sporting calendar, but we can't *not* briefly discuss the stock markets. What's going on there?

Bull: As far as I can make out, it has just been a good old-fashioned market-driven change in valuations, after a lengthy bull run. If you recall, the sell-off was sparked by good economic news in the US, as it emerged that wages for the average American worker had grown by 2.9% during the year to January.

Bear: But why would good economic news cause such a large sell-off?

Bull: Think about it. If your average worker is being paid more, then there's the prospect of inflation rising, and higher interest rates to counter it. That pushes up bond yields, which makes equities less attractive while raising general borrowing costs. Et voila!

Bear: Fair enough. It won't hurt with the relative attraction of property as an asset class either, will it? I know equities were the best performing asset class in 2017, delivering 11.8%, but we shouldn't forget that property has outperformed equities over both five and ten years. In an environment where income remains paramount, property still looks well placed to benefit.

Bull: It was hardly surprising to see that the 2018 Global Investment Intentions Survey states that 56% of global investors plan to increase their exposure to property over the next twenty-four months, targeting an average 10.2% of total capital allocations.

Bear: They'll be joining the back of a long queue! Before we dive into the prospects for the UK property market, let's have a go at some sporting predictions.



Sport

Bull and Bear discuss their predictions for the 2018 Sporting Calendar.

Bull: Well, as far as I am concerned, the big three sporting events this year are the Football World Cup, the Ryder Cup and the Commonwealth Games in Brisbane. I know there's the Winter Olympics in South Korea going on at present, but Team GB is hardly great at winter sports, is it? Plus a lot of it is taking place during the middle of the night.

Bear: That's going to be the same for the Commonwealth Games in April then, isn't it? I can't see myself getting up at 3am to watch the long jump heats, can you?



Bull: Nope. Especially with no Greg Rutherford competing. But I am also struggling to get too excited by the Football World Cup in Russia. What's the point of building up the England team when we all know they have every chance of being knocked out at the group stage at the hands of Panama or Tunisia?

Bear: Because we've got Harry Kane. He's one of our own!

Bull: He'll be exhausted come June though. He's been carrying Tottenham for the last three years. I'm afraid I have little hope of anything better than an England exit in the last sixteen. On penalties of course.

Bear: Quarter-finals for England, with Brazil winning it, even though they are only third favourites, apparently.

Prediction 4 - Brazil will win the World Cup in Russia

Latest World Cup Winners Betting Odds

Country	Odds
Germany	9/2
France	6/1
Brazil	9/2
Spain	15/2
England	16/1

Source: Bet365, 13 February 2018

Bull: Fine. Let's go with it. So what about the Ryder Cup? Will Europe reclaim the trophy at Le Golf National near Paris at the end of September?

Bear: Home advantage is so important in the Ryder Cup, even if France isn't necessarily regarded as a hot-bed for fanatical golf fans. Eight out of the last ten matches have been won by the home team. On that basis, I'm going for Europe to win, but it'll be really close.

Bull: I can't argue with that prediction either.

Prediction 5 - Europe will win the Ryder Cup in France

Ryder Cup Winners 1997-2016

Year	Venue	Winner
2016	USA	USA
2014	Europe	Europe
2012	USA	Europe
2010	Europe	Europe
2008	USA	USA
2006	Europe	Europe
2004	USA	Europe
2002	Europe	Europe
1999	USA	USA
1997	Europe	Europe

Source: BBC

Bear: There must be some sporting events in 2018 that we disagree on, although I suspect the Premier League Champions is not one of them.

Bull: Tottenham, right?

Bear: Dream on. Manchester City have got that sown up already. Predicting The Masters, Wimbledon, the Women's World Twenty20 and the Six Nations is much more interesting. Write yours down and we can revisit them next year.



Bear: That's enough sport chat. Let's consider the year ahead for the UK property market.

Bull and Bear's 2018 Other Sporting Predictions

Competition	Bull	Bear
Six Nations	England	Ireland
The Premier League	Manchester City	Manchester City
Cricket Test Series vs India	England	England
Women's World Twenty20	England	Australia
The Masters	Jon Rahm	Jason Day
Wimbledon	Roger Federer	Rafael Nadal

Source: St Bride's Managers

UK Property Market

Bull and Bear discuss their predictions for the UK Property Market.

Bear: So how are we going to tackle this, Bull? There's just so much to cover and just so little time to do it.

Bull: Well, why don't we just concentrate on the issues that everyone wants the answers to?

Bear: Like what?



Bull: Whether the current appetite for anything industrial is going to remain? Can anything be done to resuscitate the retail sector? Will the local councils continue spending, sorry investing? What will be the impact of the removal of the capital gains tax exemption for overseas investors?

Bear: They're all valid, but how about how will London fare as we make our way towards Brexit? Is the flexible office sector here to stay this time? Will the Alternatives sector still offer opportunities for out-performance? Will the Grenfell Tower tragedy have an impact on the construction industry? Is there any value to be had, anywhere?

Bull: As you said Bear. So much to cover. But let's give them all a go.

Bear: Well, I'll kick off by saying I just can't see investor demand for industrials remaining as insatiable as it is at present. Investment in industrials exceeded £10 billion in 2017! Yes industrials were the star performer, but yields are just so low at present.

Bull: As strange as it might sound, I think another year of healthy out-performance from industrials lies ahead. The occupational market story looks sound, if not defensive, what with the structural shift towards e-commerce. There appears no let-up in the variety of capital either. US, Asian as well as domestic investors are all keen on the sector. £800 million was traded in December alone.

Bear: Remember just how low the yields are though. They are being underwritten by some rather ambitious rental growth assumptions.

Bull: Long-term may be, but UK prime rents for multi-lets increased on average by 5.4% last year, led by London (+7%), South East (+6%) and South West (5%). Over the next five years, Colliers are predicting average rental growth of 3.0% per annum.

Bear: But that's way too generic. It's far patchier out there than that. Rental growth outside the South East and East grew at only 1.8% last year.



Bull: The retail sector would give an arm and both legs for that level of rental growth though, wouldn't it?

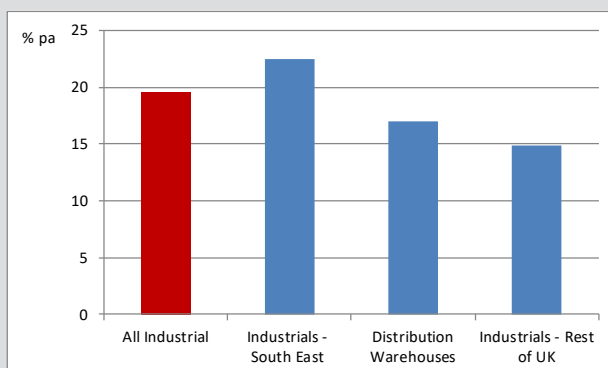
Bear: Normally I would agree but did you not see that prime retail rents increased 2.7% over 2017? Suburban London led the way (7%), but Eastern (3.9%), Central London (3.6%) and Scotland (3.6%) all performed well too. This really shocked me because all I've been hearing about is retail's operational challenges, the continued rise of online sales and tenants issuing profit warnings.

Bull: I think the major retail centres will fare okay actually, as they will continue to benefit from a combination of strong domestic and tourist spend. It's also been interesting to see the apparent slowing pace of online growth, down from 14.4% in 2012 to 7.9% in 2016.

Bear: That may well be the case but further retail casualties are inevitable, along with the continued rationalisation of stores. Only recently we have seen Homebase, New Look, Marks & Spencer and Eat announce possible shop closures this year. As much as I don't want to say it, it's hard to see anything but yet another subdued year for retail in terms of investment volumes and rental growth. The only exception to this may be retail warehouses which continues to show resilience.

Prediction 6 - Industrials will continue to out-perform

Industrial Total Returns 2017



Source: MSCI

Prediction 7 - Retail investment volumes will remain subdued

Q4 2017 Investment Volumes

Sector	Q4 2017 (£bn)	vs Q4 2016	vs 5-year average
Retail	£2.60	-10%	-7%
Office	£6.39	29%	7%
Industrial	£1.96	16%	31%
Hotels / Leisure	£1.51	17%	15%
Specialist	£3.30	173%	132%
All Property	£16.49	27%	16%

Source: LSH

UK Property Market

Bull: I think the local authorities will play quite a significant role in determining whether you are right. They were very active in the shopping sector market in 2017, making up 12% of total volumes.

Bear: Crikey. I knew they had been busy but I hadn't realised quite to such an extent.



Bull: According to LSH, local authorities invested a record £1.8 billion into UK property in 2017. While they accounted for only 3% of UK volumes, they were very active in certain sectors, not just shopping centres, but also South East offices where they made up 16% of total volumes.

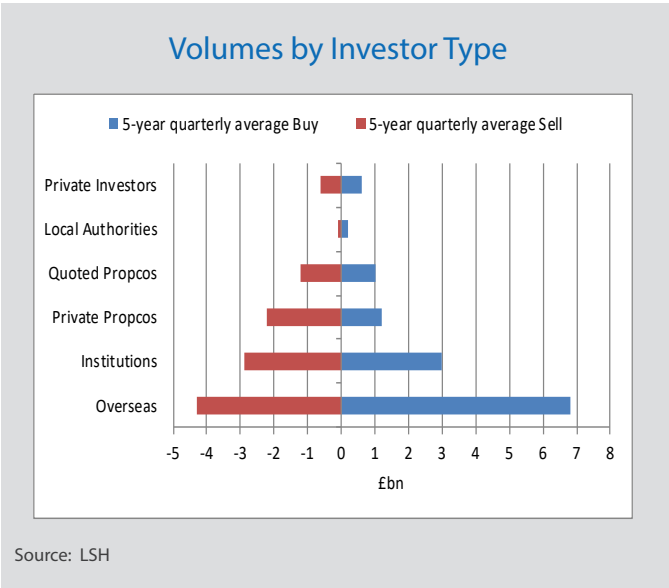
Bear: But this won't continue, will it? Concerns about council commercialisation strategies have already been raised in Parliament. A consultation was issued late last year on changes on the prudential framework of capital finance.

Bull: I can't see the problem myself. All they are doing is improving their financial position and offsetting declining Central Government funding. The key, of course, is to make sure they go into the market with their eyes open.

Bear: That's why it has been suggested that they need to be better at explaining 'why' and not just 'what' they are doing with their investment activity. They've also been reminded of their principal duty...to deliver statutory services. There's also a strong possibility that they will be prevented from investing out of their own boroughs, although there are definite pros and cons to that.

Bull: Investing locally makes a lot of sense, not least from a knowledge, regeneration and control perspective. But the argument against is, of course, one of diversification. Whatever the merits, given the recent hysteria in the media, I just can't see local authorities continuing to play such an active role in 2018.

Prediction 8 - Local authorities will play less of an active role in the investment market in 2018



Bear: I agree. That'll leave less competition for the UK institutions and overseas investors, won't it?

Bull: It looks that way. And neither of those investor groups are going anywhere. For example, Q4 2017 was very much about the return of the UK institutions. They acquired £3.9 billion worth of assets in the quarter, the highest since Q2 2015. Their annual total for 2017 was £10 billion, only 2% below the ten-year average.

Bear: So was this at the expense of the overseas investors?

Bull: Sort of, but the two groups have been looking for assets in different parts of the country. The institutions have predominantly been targeting the regions whilst overseas investors have been making hay in London. There has of course been some cross-over, but gone are the days of branding overseas investors simply London office trophy hunters.

Bear: Why do you say that? Overseas capital drove 85% of Central London volumes last year.

Bull: Because they invested a record £1.8 billion into industrials in 2017. I'm still to see any hard evidence of Brexit impacting overseas investor demand. Overseas volumes in 2017 was £28.1 billion. That's 49% above the ten-year average.

Bear: Of course it has. It's just that there is so much money looking, that those investors who have been put off are not being missed too much.

Bull: Exactly. We are seeing ongoing demand from China and Hong Kong, plus other sources from Japan, Korea and the Middle East. Appetite for prime London remains pretty buoyant. I can see absolutely no reason why this will change in 2018.

Bear: Surely the Chancellor's announcement in his November Budget that he will be removing the capital gains tax exemption for overseas investors from April next year will have an impact?



Bull: You would have thought so. There are bound to be some investors who are dissuaded by the changes. But we have to remember that the change only aligns the UK with most other developed countries. The major reasons for investing here in the UK will remain, like liquidity, transparency, range of lot sizes. And the UK still looks relatively 'cheap' in comparison with other European and global cities, even without the currency play.

Bear: But shouldn't investors be worried about the London office occupational market? Prime rental values decreased for the fifth consecutive quarter, according to CBRE.

Bull: The current market conditions are much more positive than expected though. The full year take-up was 13.2 million sq. ft. Availability, which includes space which is not ready-to-occupy but will become so within twelve months, fell by 5% over the year.

UK Property Market

Prediction 9 - Overall, overseas investors will not be deterred from investing in UK property

Prime UK Office Yields vs European Cities

City	% pa
Manchester	5.00
London (City)	4.00
Amsterdam	3.75
London (West End)	3.50
Madrid	3.25
Berlin	3.25
Munich	3.00
Paris	3.00
Geneva	3.00

Source: Savills

Bear: But there's been a large increase in second-hand availability which has seen the vacancy rate rise from 4.4% to 4.7%. Prime rents fell marginally in the City too, down 2% compared to 2016.

Bull: Rents remain stable in the West End though at £118 psf. I reckon the Brexit sentiment is pretty mixed. Spanish Bank, Alanatra Partners, has announced plans they will move their HQ to London. Sumito Mitsui Banking Corporation has just signed a twenty-year pre-let on 161,000 sq. ft. at 100 Liverpool Street. There's hardly been a mass exodus, although I accept that performance will continue to vary by micro-location.

Bear: And we also can't ignore the impact of the serviced-office sector, can we? That accounted for 18% of take-up in the City of London. It was the sector's greatest quantum of space on record.

Bull: I totally agree, because it's not just in London where the flexible office sector has grown. WeWork, for example, acquired their first two regional sites in Manchester in 2017 and further flexible office acquisitions in other regional markets are expected this year. According to GVA, 2017 was the year that serviced office/co-working deals soared in the regional markets, totalling 635,000 sq. ft. This accounted for 9% of all activity over 5,000 sq. ft. and compares to an average over the previous five years of 87,000 sq. ft.

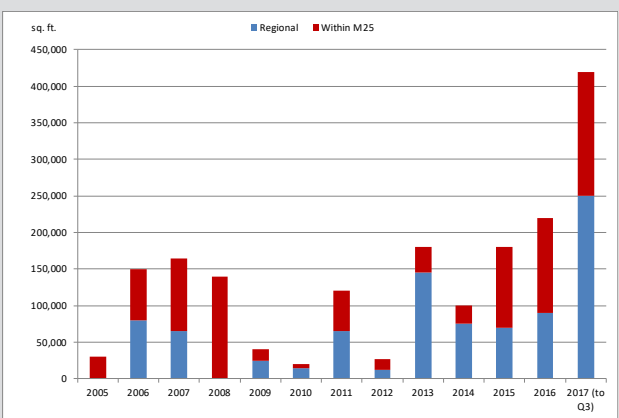
Bear: So I assume we are both agreed that the flexible office sector will continue to expand in 2018?



Bull: Absolutely. Investors need to take note. They need to recognise that what worked in the past won't necessarily work in the future. They need to be more willing to accommodate flexible space in their buildings and provide more amenities. If they don't, they will be left behind.

Prediction 10 - The UK Serviced Office Market will continue to expand

Serviced Office Take-Up 2006-2017



Source: Savills

Bear: The fact that the institutions have embraced the Alternatives sector suggests that at long last they are recognising that traditional investment strategies have to evolve. This sector is now a key component.

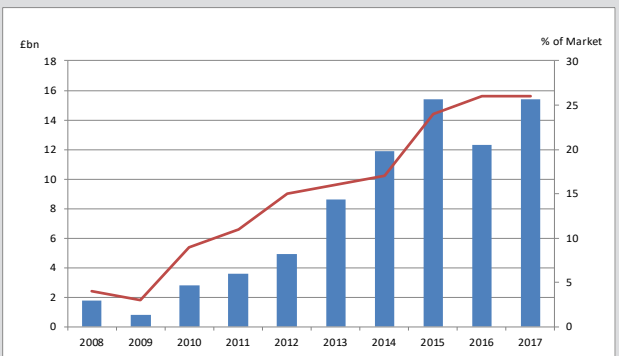


Bull: And it will only continue to grow. The appetite is not just being driven by exposure to strong demographic trends and those sectors which are suffering from a structural supply and demand balance. The attraction is heightened by the long-income many of these assets offer, plus, in many cases, their inflation-linking.

Bear: On average, UK funds hold a 17% weighting in specialist property. It seems a no brainer to predict this will increase steadily over 2018.

Prediction 11 - The Alternative Sector will continue to increase its share of property investment

Alternatives Investment Volumes



Source: JLL

UK Property Market

Bull: It's hardly inspiring, but I suspect 2018 will be like that. Steady Eddy. What investors do need to be wary of though is their corporate and social responsibility. The awful Grenfell Tower tragedy last year may well see new building standards needing to be implemented.

Bear: And of course there are the minimum efficiency energy standards that kick in, in April. There are reports that nearly one in six properties are still at risk of being non-compliant.

Bull: Not in St Bride's portfolio though of course!

Bear: It feels like we are nearing the end of our discussions. The only thing we haven't really touched on is the million-dollar question about value. Where can investors find value and what's property going to deliver this year?

Bull: Not as much as 2017. If we look at the most recent IPF Consensus forecast in November, we should expect a total return of 4.0%. That seems much too light to me. I can see some further yield compressions across a few of the sub-sectors, industrials included, and of course property will always deliver a pretty healthy income return.

Bear: I tend to agree with you. Okay, we were all proved horribly wrong last year, but I think we can safely assume that capital values won't increase by the same extent. But then again, I don't see anything that is likely to cause a panic either. I'd be comfortable at predicting an All Property total return of something like 6%.



Bull: I think we would all settle for that. If our industry can deliver those sorts of returns in such uncertain times, there must be something going for it. Shall we finish on this positive note?

Prediction 12 - Total Returns will be 6.0%

Total Return Forecasts for 2018

	Capital Value Growth (% pa)	Total Return (% pa)
IPF Consensus	-0.7	4.0
IPF Maximum	2.1	7.8
IPF Minimum	-4.9	-0.1
St Bride's Managers	1.2	6.0

Source: IPF Forecast (November 2017) / St Bride's Managers

Bear: But we haven't discussed where and what investors should be doing to achieve these returns? Do you have a view?

Bull: It's hard not to think there must be some value in the big REITS at present. The share price discounts to NAVs look juicy to me.

Bear: They do but if history is anything to go by, the discounts would be indicating that values are coming down.

Bull: Indeed, but I just don't see the really best assets falling in value this year. If that's the case, why would an investor pay a sub 4% yield for a prime office in London when they could buy stocks in British Land or Landsec. Both companies are yielding in excess of 4%, plus investors would be buying in at a 20-30% discount for quality assets with proven management teams. I am struggling to see the downside.

Bear: Fair enough. But what about the more direct approach to property investment? Where should investors be looking to deploy their money? If you ask me, everything still feels very expensive.



Bull: We're living in a world where there are few unambiguously cheap assets. I can't see the search ending for sustainable, inflation-proofed returns. Money will continue to target industrials, plus the Alternatives sector.

Bear: But other than through inflation-linking, where's the growth coming from? Yields are already at historic lows. Would you not be advocating a closer look at secondary assets, especially if there are genuine asset management angles?

Bull: You know me. I'll look at anything if there's value. But investors do need to be careful. They must stick to their investment principles. They must not settle for second best. They must not chase the market. We have to remember the investment rationales for each investor type vary hugely. What might seem expensive to one investor may in fact seem cheap to another. If they do that, they should be okay.

Bear: And if they don't?

Bull: They will only have themselves to blame. Right, I am done. We can revisit our predictions at St Bride's Annual Seminar in June.

Bear: What are the details again?

Bull: I thought you'd never ask...

Save the date - Thursday 7th June 2018



St Bride's Managers Annual Seminar

The Royal Society of Medicine at
1 Wimpole Street, London, W1

8.30am	Registration
9.00am	Start
11.00am	End



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