OUR MARKET

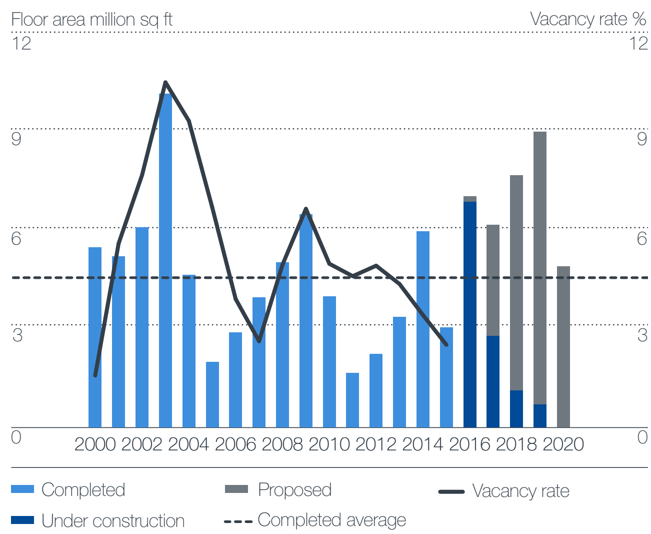
CBRE's views support our own estimates of 5-8% average ERV growth across our portfolio and for investment yields to remain firm in 2016.

Last year the Group continued to enjoy very favourable market conditions with strong occupier demand underpinned by a growing UK economy. The recent falls in public equity prices and the value of oil and other commodities demonstrate that, despite some recovery in the USA and European economies, overall economic growth remains fragile and faces a number of risks. The latest estimates see the UK economy growing at about 2% pa over the next two years, one of the faster growth rates amongst the G8 economies, and London's growth rate is expected to remain in excess of the UK average.

This level of economic activity remains conducive to employment growth and continuing low interest and inflation rates in the UK. CBRE forecasts Inner London office employment growth at 1.7% pa in the next five years. Last year 14.5m sq ft of central London office space was taken up, of which 4.4m sq ft was in the West End. Total take-up was 3% below the previous year's level, but remains well above trend. In 2015 demand from the financial sector recovered so take up was more evenly spread across sectors with business and professional services at 35.8%, banking and finance at 24.4% and TMT at 20.2%. The overall vacancy rate reduced to 2.5% in central London (one of the lowest levels recorded), and to 2.2% in the West End. Prime rental levels are now estimated at £120 per sq ft in Mayfair and St. James's, £82.50 per sq ft in Fitzrovia and £68.50 per sq ft in the City.

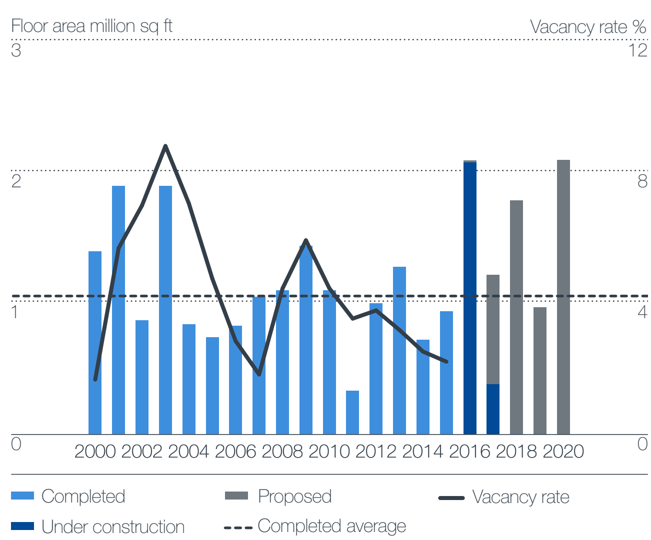
The decline in the vacancy rate has led to a supply response with estimated above average central London completions in each of the next five years. In total this adds up to a potential 35 million sq ft of space, or 16% of the current market. The net impact is likely to be lower than this as only 33%, or 11.6m sq ft, is under construction and, of this amount, 40% is pre-let or under offer. The outcome is 6.9m sq ft of speculative space currently available which represents less than half of last year's take-up. The full impact of the 23.4m sq ft yet to start may be deferred due to planning delays and the availability of finance.

Central London office development pipeline



Source: CBRE

West End office development pipeline



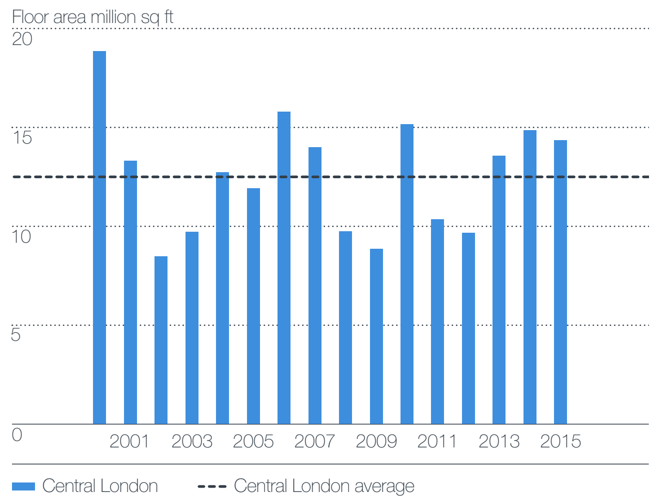
Source: CBRE

Another feature of the potential supply is that only 24%, or 8.2m sq ft, is in the West End and the amount of new supply to be delivered in the West End is expected to fall between 2016 and 2019. Of this potential supply 2.5m sq ft is under construction of which 30% is pre-let. This leaves 1.7m sq ft under speculative construction representing 40% of last year's take-up. After the completion of White Collar Factory and the refurbishment of The White Chapel Building E1 later this year, our subsequent committed major projects are all located in the West End.

Last year saw £16.2bn of central London investment transactions (£8.2bn in H1), which was £2.3bn below 2014 levels with a smaller volume of deals above £100m. Overseas investors continued to dominate, but the UK buyers' share of the total increased to 42% from 31%. CBRE reports that demand weakened in Q3 before picking up again in Q4, and there was £4.5bn of office stock under offer at year end. However, it expects to see more stock on the market as some investors seek to take profits. CBRE expects yields to be unchanged in 2016 given the background of continuing low interest rates and central London's growth prospects. It estimates rental growth in the City and West End markets for 2016 to be over 6%. Our own portfolio has a more significant West End and Tech Belt weighting than the central London average, but CBRE's views support our own estimates of 5-8% average ERV growth across our portfolio and investment yields to remain firm in 2016.

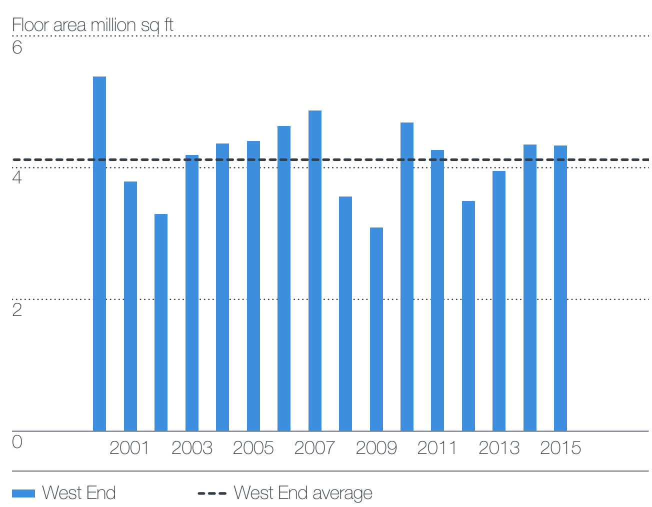
In the near term the London property market continues to face a number of specific opportunities and challenges. Crossrail is on track to open in 2018. This will improve London's east-west connectivity and, in central London, the new service is expected to particularly benefit Tottenham Court Road and Farringdon. Approximately half our portfolio is located near these two stations. With London's population growth expected to continue, attention has begun to focus on central London's next major rail project, Crossrail 2, but this is still uncommitted and the project is unlikely to complete before 2030 at the earliest. If it goes ahead it will improve north-south connectivity, again running through Tottenham Court Road and with new stations in our Islington and Victoria villages.

Central London office take-up



Source: CBRE

West End office take-up



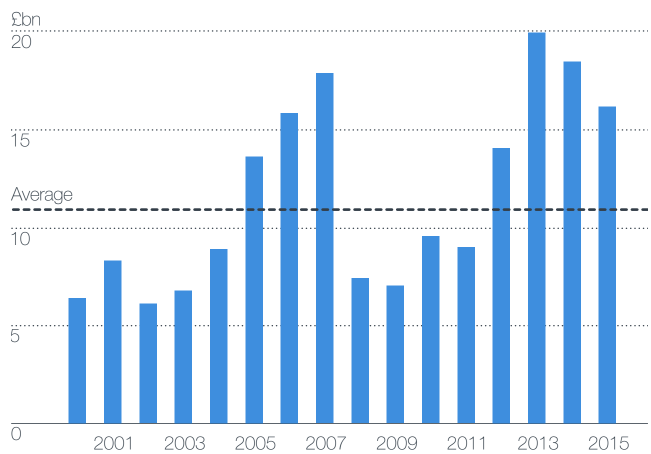
Source: CBRE

OUR MARKET
CONTINUED

It is expected that business rates (local taxes) will increase in 2017, and this is likely to raise occupation costs in London. The new rates will be set on April 2015 rental levels, whereas the current rates are set on April 2008 levels. As most London commercial property has experienced good rental growth in that period, business rates are likely to rise, although a transitional period, if adopted, could defer the full impact. Although these costs are borne by our tenants, the rise in overall occupation costs may affect future rental growth while these additional expenses are absorbed. CBRE has recently estimated the impact across 19 central London locations. On an unweighted basis the average increase in rates on prime offices is 40%, which translates into an average increase of occupational costs (rates and rents) of 11%. Given that we have seen strong rental growth on our properties we would expect to be affected and CBRE estimates that occupational costs in our largest village, Fitzrovia, will increase by 4%. Based on their numbers, the successful Shoreditch and Farringdon locations could experience some of the higher increases of our villages, with increases of 13% and 9% respectively. These numbers remain a matter of conjecture at this stage, but they suggest Tech Belt total occupancy costs will still remain substantially below most of the traditional core office locations.

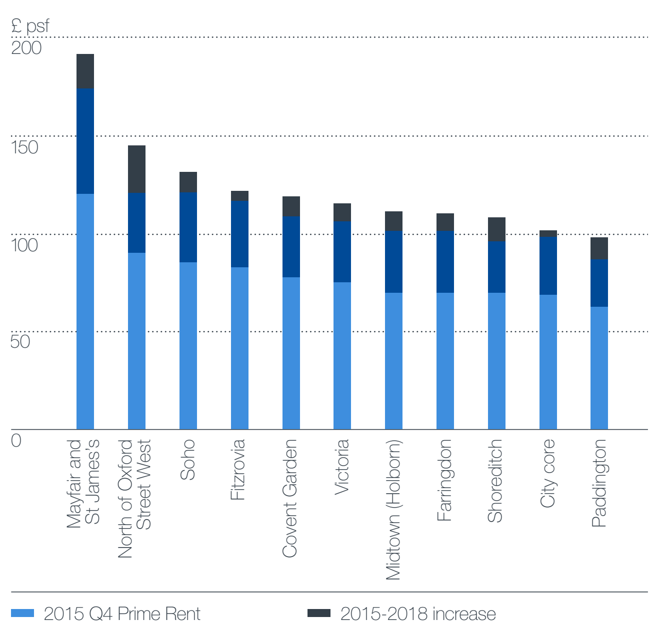
As well as these two specific catalysts there are two uncertainties based on upcoming votes. On 5 May Londoners will choose a new Mayor, and, whatever the outcome, there are likely to be some policy changes. In addition, a national referendum on whether the UK should remain in the European Union is to be held on 23 June. We have previously discussed the additional property market uncertainty that we would expect to see if the result was for the UK to leave the EU. CBRE warns that the central London office market would be the most affected given the sensitivity of the financial services industry. Our own portfolio would not be immune to any potential fall out, but it has no exposure to the City core market and financial tenants accounted for just 2% of our rental income in December 2015.

Central London office investment transactions



Source: CBRE

Estimated business rates



Source: CBRE