

Quadrant Real Estate Advisors LLC

U.K. Economic & Commercial Real Estate Market Commentary

4th Quarter 2016



www.quadrantrea.com

ATLANTA • DUBLIN • LONDON • SYDNEY

Kurt Wright, CFA
Chief Executive Officer
+1 770 752 6713
kwright@quadrantrea.com



Table of Contents

Executive Summary.....2
State of the U.K. Economy.....3
U.K. Commercial Real Estate Market Fundamentals.....5
U.K. Commercial Real Estate Debt Market.....9
Contacts.....	..10
Important Disclosures.....	..10

About Quadrant Real Estate Advisors

Quadrant Real Estate Advisors LLC (“Quadrant”) is a United States SEC registered investment adviser and Australian Securities and Investments Commission (“ASIC”) Foreign Registered Corporation (ABN 39 123 863 963). QREA Europe LLP (“QREA”) is a subsidiary of Quadrant. QREA Europe LLP (registration number 610613) is authorised and regulated by the Financial Conduct Authority. Quadrant has approximately \$8.0 billion of commercial and multifamily real estate investments under management on behalf of institutional investors. Clients include insurance companies, pension funds, sovereign wealth management funds, and high net worth investors.

Since 1993 Quadrant’s senior management has worked together as a team providing the firm’s clients with access to both privately placed and publicly traded U.S. commercial real estate debt and equity investments through commingled funds and single client accounts. In addition to experience, senior management controls 100% of the firm, thereby providing true alignment of interests and accountability.

Kurt Wright, CFA

Chief Executive Officer

+1 770 752 6713

kwright@quadrantrea.com



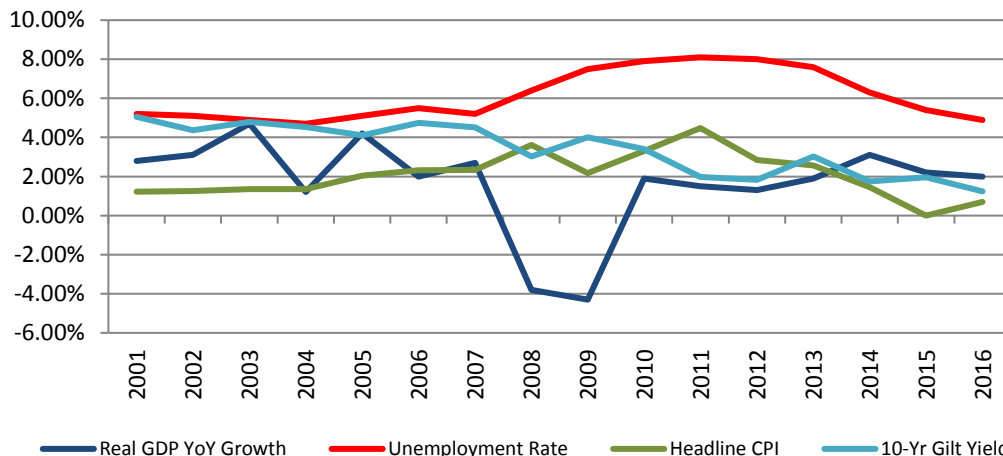
www.quadrantrea.com

ATLANTA • DUBLIN • LONDON • SYDNEY

Executive Summary

- Year-on-year Gross Domestic Product (“GDP”) growth in the U.K. was 2.2% in the fourth quarter of 2016, unchanged from the previous quarter.
- U.K. unemployment remained at 4.8% for fourth quarter, with the number of people unemployed reaching its lowest level since 2008.
- The Bank of England Bank Rate remains at 0.25% same as previous quarter.

Key Economic Indicators



Source: Bloomberg, Capital Economics, Office for National Statistics

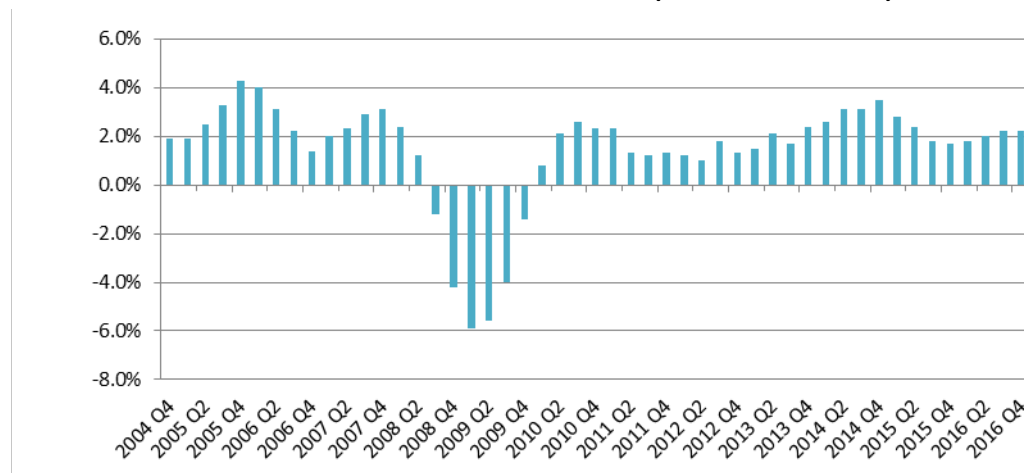
- The pound decreased 4.9% against the US dollar, falling from £1.29 at the end of the third quarter to £1.23 at the end of the fourth quarter. The pound increased 1.6% against the euro, rising from £1.15 to £1.17 during the quarter.
- Directly following the Brexit vote, mark-to-market valuations on certain properties, particularly offices located in the City of London, have fallen by as much as 10% (as evidenced by data available from publicly traded Open Ended Funds). Property funds have suspended withdrawals to their open-ended funds, citing property sales may be more difficult to execute in the current environment due to market uncertainty.
- Underlying long-term intrinsic value of many investment opportunities remains unchanged. Brexit may reduce office construction in the UK, which should have a positive impact on long term commercial real estate (“CRE”) fundamentals.
- Continued supply constraints throughout UK property subsectors are providing rental growth, especially in the Central London retail sector. Retailers are paying premium rents for the limited stock on the most desired streets.

State of the U.K. Economy

Gross Domestic Product (“GDP”)

- The preliminary estimate of 2016 year-over-year real GDP growth was 2.0%, down slightly from 2.2% in 2015.
- Services (0.6%) increased; while industrial production, construction, and agriculture contributions remained unchanged from the previous quarter.

Real Gross Domestic Product Growth (GBP-denominated)

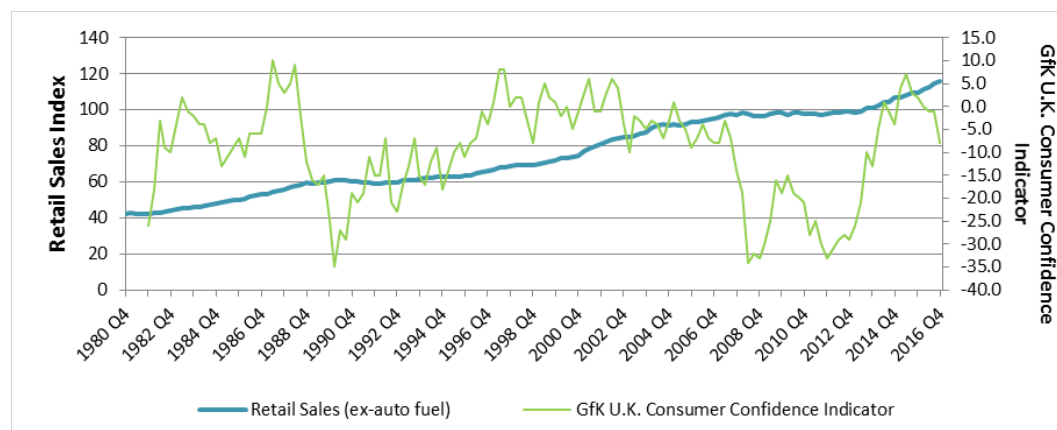


Source: Bloomberg, Office for National Statistics

Consumer Outlook

- The GfK U.K. Consumer Confidence Indicator ended the fourth quarter at -7, down from a -1 index value the previous quarter.
- Nominal retail sales (excluding automobile fuel) increased by 1.8% quarter-over-quarter and increased 4.9% year-over-year.

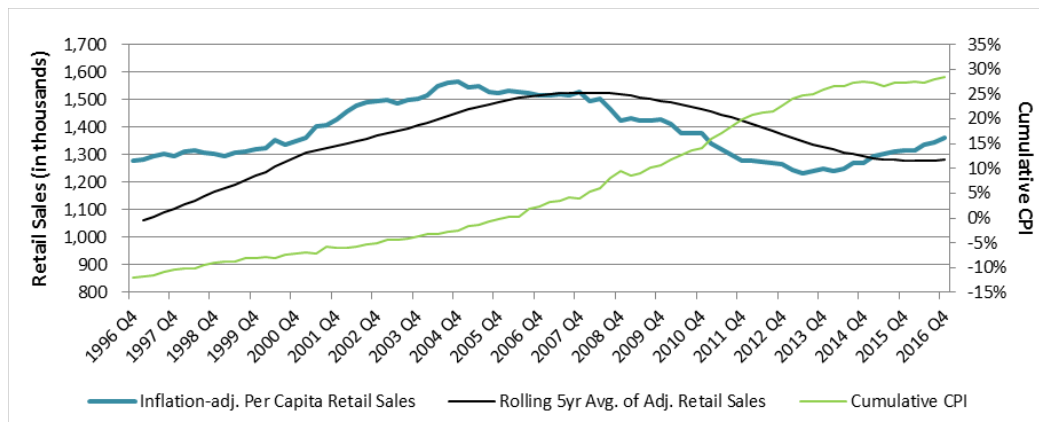
Consumer Confidence and Nominal Retail Sales



Source: GfK, Office for National Statistics

- Inflation-adjusted per capita retail sales in the fourth quarter were £1,366 compared to £1,317 in fourth quarter 2015.
- The metric remained 9.1% below the first quarter 2008 pre-recessionary amount of £1,503.

Inflation-Adjusted Per Capita Retail Sales



Source: Bloomberg, Office for National Statistics, Quadrant Real Estate Advisors

Note: Retail sales represent Retail Sales (excluding automobile fuel). Quadrant has adjusted Retail Sales to reflect per capita Retail Sales in December 1991.

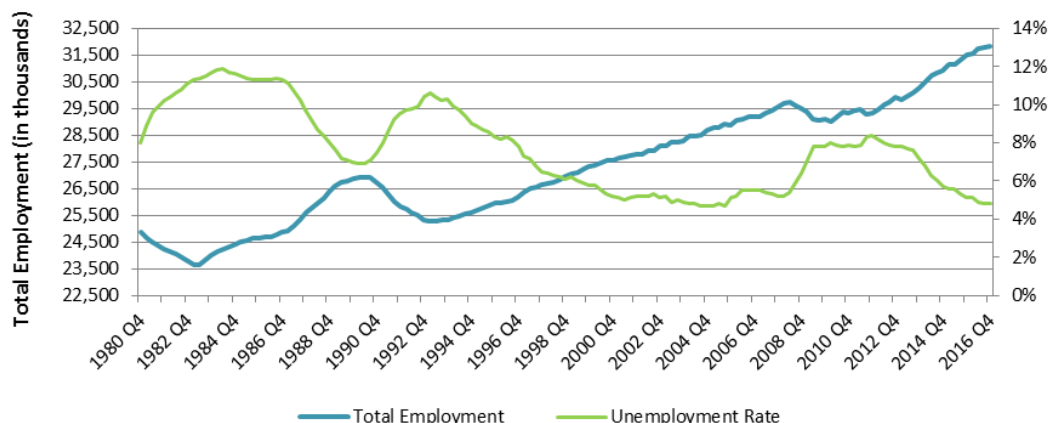
Inflation

- For the month ended December 2016, the Consumer Price Index (“CPI”) increased 1.6% year-on-year, following a 0.4% rise in the previous two months. The rate stands at its highest since July 2014.
- Primary factors for upward contributors were rising pricings for airfares, food and motor fuels.

Labour Market

- Total employment increased by 37,000 jobs during the quarter.
- Employment among people aged 16 to 64 increased to 74.6%, an increase of 302,000 over the previous year. The employment rate is the highest in the U.K. since comparable records in 1971.
- The unemployment rate remained the same quarter over quarter at 4.8%.

Total Employment and Unemployment Rate

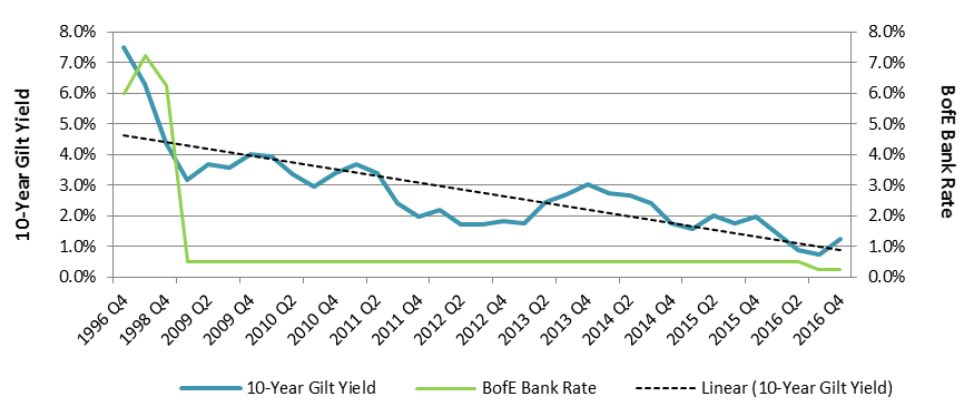


Source: Bloomberg, Office for National Statistics

Interest Rates

- The Bank of England Rate remained unchanged at 0.25% during the fourth quarter.
- The Monetary Policy Committee voted to implement a stimulus package in August 2016. The decision was made to meet inflation targets of 2.0% to sustain growth and employment. The inflation rate as of December 2016 was 1.6%.
- The Bank Rate remains unchanged from Q3 2016.
- Government bond yields increased quarter-over-quarter from 0.75% to 1.24%.

10-Year Gilt Yield and Bank Rate (20 Years)



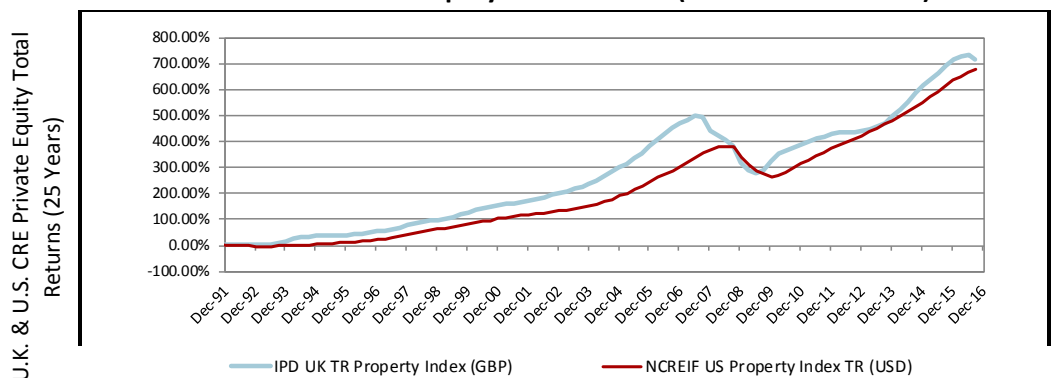
Source: Bloomberg

U.K. Commercial Real Estate Market Fundamentals

Private Equity Performance & Pricing

- The following chart shows CRE private equity performance in the U.S. and the U.K. over the past 25 years. The light blue line shows GBP-denominated U.K. performance and the red line highlights U.S. performance.
- During the fourth quarter, the IPD Total Return Property Index exceeded its previous high from Q2 2016 by 0.26%.

U.K. and U.S. CRE Private Equity Total Returns (25 Year Cumulative)



Source: IPD, NCREIF, Bloomberg, Quadrant Real Estate Advisors

- As the table below shows, a material spread between cap rates for prime and secondary property remains.
- Cap rates for property sectors remained flat for the quarter.

Property Investment Yields (Cap Rates)

Property Sector	September 2016	December 2016
OFFICE		
London – West End	3.50%-3.75%	3.50%
London – City	4.25%+	4.25%+
M25 / South East	5.25%+	5.25%
Major Regional Cities	5.00%	5.00%
RETAIL		
High Street Retail – Prime	4.00%	4.00%
High Street Retail – Strong Secondary	6.00%-6.25%	6.00%-6.25%
High Street Retail – Secondary	10.00%++	10.00%++
Shopping Centres – Prime	5.00%	5.00%
Shopping Centres – Strong Secondary	6.50%	6.50%
Shopping Centres – Secondary	9.00%	9.00%
Bulky Goods Parks – Prime	6.00%	6.00%
Bulky Goods Parks – Secondary	7.00%	7.00%
INDUSTRIAL / WAREHOUSE		
Distribution – Prime	4.25%-4.50%	4.25%-4.50%
Distribution – Secondary	6.50%	6.50%
Estate – Prime	4.75%-5.00%	4.75%-5.00%
Estate – Secondary	7.00%	7.00%

Source: Knight Frank & Savills

Note: "Strong Secondary" refers to metro areas of major regional cities, and "Secondary" refers to outlying markets.

Private Equity Transaction Volume

- The following table shows approximate U.K. commercial property private equity transaction volume (limited to properties >5,000 sf in size).

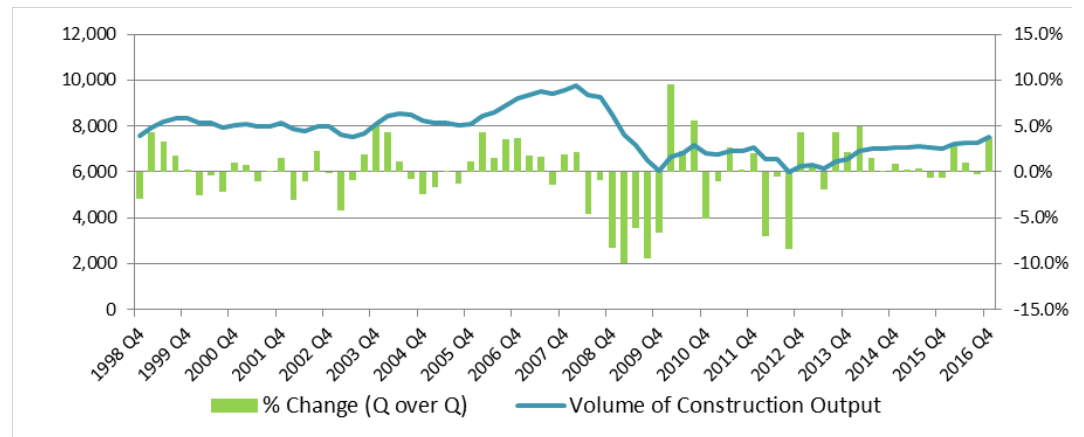
Private Equity Transaction Volume

Property Sector	Total Volume (£ millions)		Total Square Footage (millions)	
	Q4 2016	Q3 2016	Q4 2016	Q3 2016
OFFICE	3,656.6	2,372.4	7.0	8.2
RETAIL	2,974.1	1,590.3	8.4	6.8
INDUSTRIAL / WAREHOUSE	606.8	576.6	15.7	12.0

Source: Egi, Quadrant Real Estate Advisors

Spatial Supply

- Seasonally-adjusted private commercial/industrial production output volume contracted 0.1% in the fourth quarter of 2016.
- Construction volume decreased by 0.1% from the previous quarter (revised) and increased 4.6% from the previous year.
- The following chart shows private construction output volume (left axis) and quarterly percentage change (right axis).

Private Commercial/Industrial Construction Output (£ Millions; % Change)

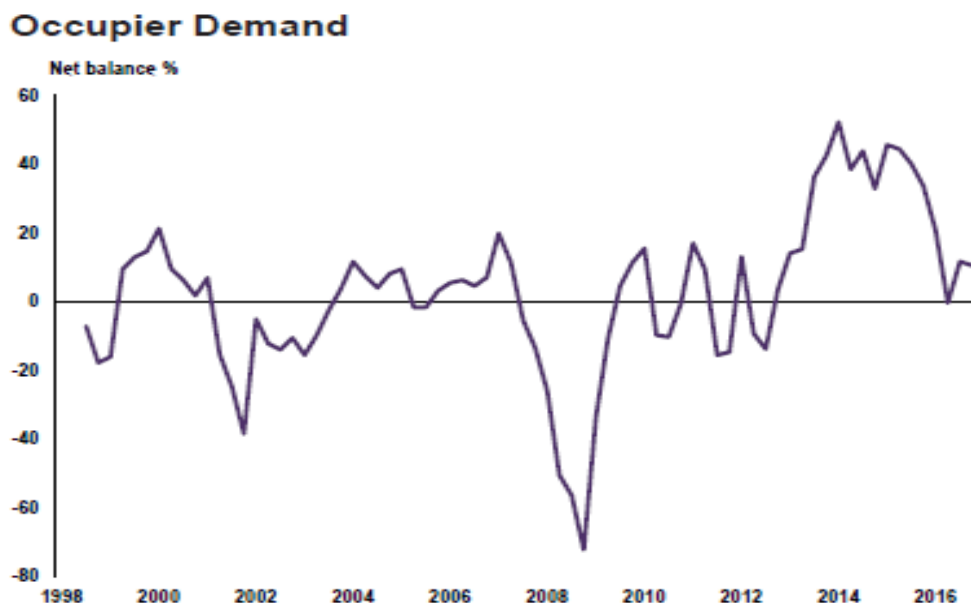
Source: Office for National Statistics, Quadrant Real Estate Advisors

- The Royal Institute of British Architects' December 2016 Future Trends Survey saw signs of stability in workload confidence and no expectation of a decrease in the near future.
- The December workload index was +17, which represents confidence has stabilised and is in a positive territory for all sectors (excluding public sector) as a whole with private housing being the strongest.
- The commercial sector is forecasted to be modest which is consistent with the prior quarter of +1.

Spatial Demand

- Occupier demand showed signs of slight recovery after the sharp deterioration seen at the end of Q2 due to the EU vote (Royal Institution of Chartered Surveyors (“RICS”) Commercial Property Market Survey). Occupiers in the office and retail sectors remain flat compared to the previous quarter, while demand in the industrial sector was the only area that increased.

RICS Commercial Property Market Survey – Occupier Demand



Source: RICS

- Overall, expectations improved slightly across most parts of the UK, while feedback remains cautious in London.

Rental Rate Growth

- Rental rates for prime commercial property grew by 0.4% during the fourth quarter and 3.7% for 2016.
- RICS survey respondents reported expected rental rates to increase modestly in the short term.

U.K. CRE Rental Rate Growth by Property Sector

Property Sector	Rental Growth (forecasts in gray)				
	2015	2016	2017	2018	2019
Office	8.2%	2.9%	1.1%	1.1%	0.9%
Retail	1.3%	1.0%	0.1%	0.5%	1.4%
Industrial/Warehouse	4.5%	3.5%	2.0%	1.8%	1.6%

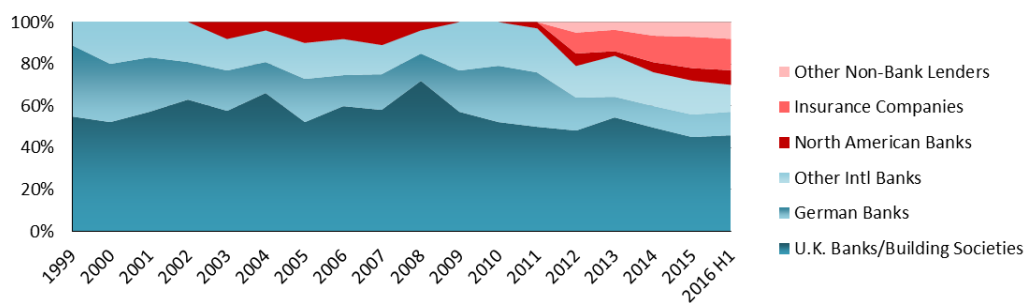
Source: Capital Economics

U.K. Commercial Real Estate Debt Market

Private Debt Market Overview

- The capital availability gap that resulted from banks and building societies limiting new CRE debt originations has attracted non-bank portfolio lenders. During the first half of 2016, the Other Non-bank Lenders grew 22% while the property loan exposure of UK Banks/Building Societies grew by 5%.
- The migration of the lender base over time is exhibited in the chart below (data through mid-year 2016 due to availability of non-bank lender data).

U.K. Commercial Real Estate Debt Outstanding by Lender Type



Source: De Montfort University mid-year 2016

- For the first half of 2016, the banks and building societies were the primary suppliers of development funding and completed £2bn of development lending of which £3.3bn was funded in total during H1 2016.
- CRE debt (including development lending) as a percentage of outstanding bank debt remains unchanged quarter-over-quarter at 7.3%.
- Other Non-bank Lenders grew by 22% while the UK Banks & Building Societies grew by 5% in the first six months of 2016.
- 89% of outstanding debt held by banks, building societies, insurance companies and Other Non-bank-Lenders exhibit 70% or less loan-to-value ratios and 4.0% have interest coverage ratios below 1.0x (as of H1 2016).
- The market continues to gain stability based on the decline in legacy loans and loan exposures with higher LTV ratios of about 100%. The bulk of the loan books are now composed of loans up to 70% LTV by all lender groups.

Private Debt Market Pricing Summary

The following table presents a summary of current bank market lending rates across debt types based on a generic Grade A office asset with reasonable tenant, rent roll, and sponsorship characteristics.

Benchmark	September 2016	December 2016
3-month LIBOR	0.38%	0.37%
3-year GBP Gilt Swap	0.44%	0.69%
5-year GBP Gilt Swap	0.51%	0.86%
7-year GBP Gilt Swap	0.62%	1.03%
10-year GBP Gilt Swap	0.76%	1.23%

Source: Bloomberg & Mortgages for Business

Contacts

U.K. & Europe:

Linda Nel

Senior Vice President

+1 (1) 770 752 6726

lnel@quadrantrea.com

United States:

Thomas Mattinson

Executive Vice President

+1 (1) 770 752 6714

tmattinson@quadrantrea.com

Australia:

Evan Goldszak

Senior Analyst

+61 (0) 2 9917 8303

egoldszak@quadrantrea.com

Important Disclosures

This report is for informational purposes only and does not constitute, form, nor should be construed as an offer to sell or a solicitation of an offer to buy investments or any fund and does not constitute any commitment or recommendation on the part of Quadrant Real Estate Advisors. An investment offering will be made only through a confidential private offering memorandum subject at all time to revision and completion.

The information contained herein is derived from various sources which Quadrant believes but does not guarantee to be accurate as of the date hereof. Neither Quadrant nor any of its affiliates nor any other person makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this newsletter and nothing contained herein shall be relied upon or construed as a promise or reorientation of past or future performance.