LONG INCOME VALUATION DASHBOARD

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MARKET UPDATE

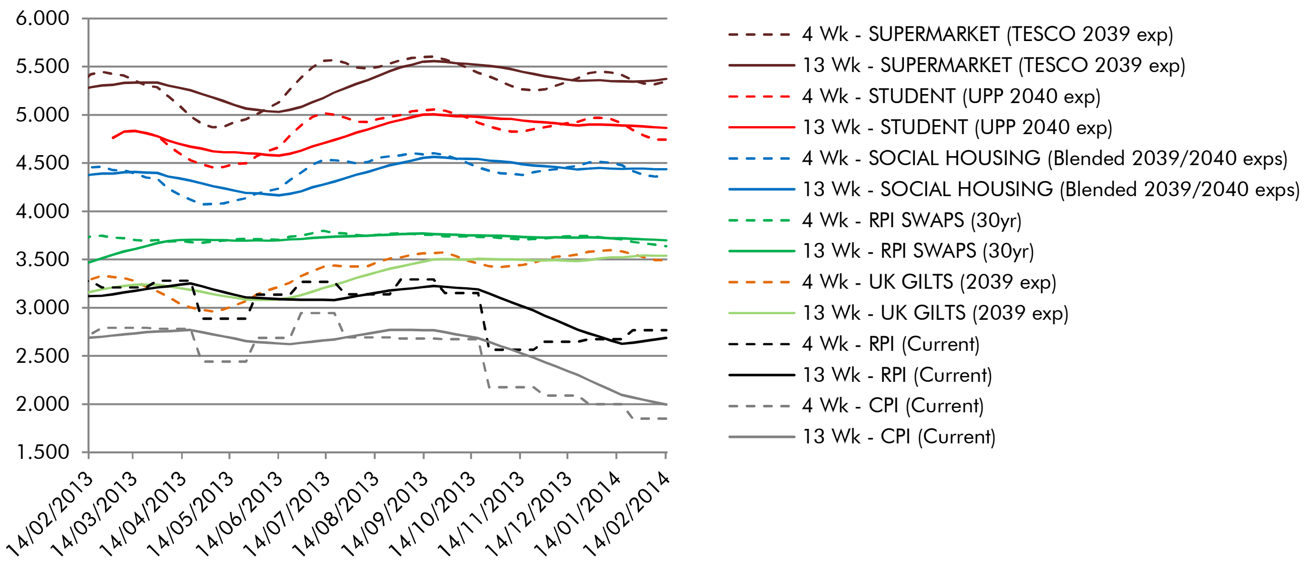
- The IPD Long Income Index reported a quarterly return of 2.8% for Q4 2013 and 10.3% annualised total return. This compares to the Quarterly All Property Fund Index which reported 4.1% for Q4 2013 and 9% annualised total return.
- Gilts have remain broadly stable over the quarter but 50bps up on the 52 week low.
- RPI Swaps are falling gradually (blended rate down 0.09%). Current actual RPI for the 12 months to February 2014 stands at 2.8%.
- The opportunities for investors and operators in Commercial Ground Rents has continued to develop. We have been involved in a major Central London leisure investment over the quarter and recently advised on M&G's acquisition of the Bannatyne Ground Rent portfolio. This was a £92m deal for the sale and leaseback of 39 Bannatyne Health Clubs at a rent that was attractive to the operator and mitigated risk for the investor. The transaction has enabled the business to be virtually debt free.
- The Long Income market continues to expand in to less frequently traded and emerging sectors. The strength of the underlying business and long term affordability of rent is key in determining the risks associated with the investment. If we can help you please contact any member of the team listed overleaf.

- RPI Swaps (blended) are the average of 30, 40 and 50 year RPI SWAPS. They are the 4 week average as at 14 February 2014.
- Gilts (blended) are the average of Treasury Gilts with 2039, 2042, 2049 and 2060 expiries.
- Supermarket Bond (blended) are TSCOLN 5.125% (47 expiry), TSCOLN 7.622% (39 expiry), TSCOLN 6.15% (37 expiry).
- Social Housing Bond (blended) are Notting Hill Housing Trust (42), Hyde HA (40), L&Q HT (40), Sovereign HC Plc (39), Affinity Sutton Capital Markets (38), Sanctuary (39), Genfinance (39), Circle Angular (38).

FINANCIAL/YIELD INDICATORS

Rate	Trend	December 2013	March 2014	52-week high	52-week low
UK RPI 30-Year Swaps	↓	3.71%	**3.64%**	3.76%	3.13%
RPI Swaps (blended)	↓	3.71%	**3.62%**	3.80%	3.18%
UK Gilt, 2042 Expiry	↔	3.46%	**3.50%**	3.52%	2.89%
Gilts (blended)	↔	3.46%	**3.49%**	3.52%	2.94%
Supermarket Bond (blended)	↔	5.01%	**4.88%**	5.05%	4.32%
Social Housing Bond (blended)	↔	4.36%	**4.35%**	4.75%	4.00%
Prime Supermarkets	↔	4.25%	**4.25%**	4.50%	4.25%
Prime Commercial Ground Rent	↔	4.25%	**4.00%**	4.25%	4.00%
Prime Budget Hotel (excl. London)	↓	5.00%	**5.00%**	5.50%	5.00%
Prime Budget Hotel (London)	↓	4.50%	**4.50%**	5.00%	4.50%

GOVERNMENT GILT AND CORPORATE BOND LONG-TERM TRACKER



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Long Income Ground Rent Investment

Over the last 12 months the ground rent market has continued to perform strongly. Pricing has increased sharply and demand for portfolios is at an all-time high. We estimate that there is currently over £400 million of equity chasing new ground rent investment supply of approximately £150 million. Below we summarise a number of key issues facing the market:

Ground Rents, Counter-Cyclical?

The popularity of the sector over the last few years has often been attributed to ground rents 'triple-A rated' status. Against the backdrop of the economic downturn, ground rents' heavy collaterisation and index linked income stream, have presented a compelling investment case for institutions seeking to match long term liabilities. The argument has followed that economic recovery would signal a dampening in the sector with investors moving to higher yielding asset classes which offer greater returns. This has so far not been the case. In spite of the improving economy, buoyant property market, weakening UK Gilt yields and lower levels of inflation the market for the ground rent sector strengthened considerably in 2013 and into the early part of 2014.

Forward Purchase Agreements

The market is experiencing the growing proliferation of forward purchase agreements. These can be structured in a number of ways but a common iteration is full consideration paid at exchange. At this point in time often the development is either under construction, with a large proportion of units remaining unsold or even development works having not commenced. The developer will often pay a coupon to the investor during the intervening period until all of the individual unit leases are executed and fully income producing. Given the strong demand in the market forward purchase agreements are providing a useful means of securing assets. These agreements have mostly been utilised with large PLC developers but, given current market conditions, investors are seeking to move up the risk curve and execute these agreements with small to mid-sized developers.

Opportunities

Notwithstanding the escalation in pricing there are still institutions, insurance companies and fund managers wishing to enter the sector. Given the current market dynamics we consider it would be difficult for any new major investor to enter the sector on a meaningful basis. The majority of the aforementioned would not be prepared to grow a portfolio gradually over a number of years through piecemeal acquisitions. We envisage consolidation within the sector as existing investors, both small and large, seek to capitalise on current pricing points and exit, or partially exit, the market.

Pricing

We summarise below our opinion of current pricing on lots sizes in excess of £500,000 in comparison with previous multipliers reported in our 2013 paper 'The Evolving Residential Ground Rent Paper':

	Q1 2013		Q1 2014	
Review Mechanism	**Multiplier (YP)**	**Gross Yield**	**Multiplier (YP)**	**Gross Yield**
5 yearly RPI	26	3.8%	31	3.2%
10 yearly RPI	23	4.3%	27	3.7%
25 yearly RPI	19	5.3%	22.5	4.4%
25 year Fixed Multiple (Doubling)	18	5.6%	20	5%

Given the escalation of pricing in 2013 growth appears to have slowed and we envisage a period of pricing stabilisation in 2014. As benchmark gross yields now represent some of the strongest in the wider property sector, and existing funds in the market are nearing their benchmark pricing maximum thresholds, we do not envisage major pricing increases in the foreseeable future.

*The snapshot of pricing is based on our high level opinion of multipliers in the current market as at Q1 2014. The multipliers assume freehold, good quality well located town centre schemes with a lot size of over £500,000 but under £10 million, new leases with 125 plus year terms, ground rent per unit of £250 per annum, landlord retains insurance rights with management obligations falling to a management company, 'normalised' notice fee provisions, no rental or service charge arrears.

FOR MORE INFORMATION, PLEASE CONTACT:

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