



Gatehouse View

Q4 2011

Property Overview | Q4 2011



“ The second half of 2011 has seen international investors, particularly from the Middle East and Malaysia, continue to increase their presence in the UK market, with a strong focus on London and the South East.

While challenges remain, the UK's established status as a “safe haven” is expected to result in continued demand for opportunities in the UK commercial property market.

This quarter, we are pleased to announce the acquisition of the Atos data centre in Andover, England. Let to the undoubted Atos covenant, the property provides 19 years term certain income with no breaks and fixed rental uplifts. Representing an excellent portfolio investment, the long-leased, high quality property provides secure income streams to our investors.

Gatehouse will continue to source, select and structure high quality real estate opportunities, and in addition utilise its position as a regulated UK bank, to provide liquidity solutions where possible to add another dimension to its customer service offering.

We look forward to an interesting and prosperous 2012. ”

Adam Cavanagh
Executive Vice President - Head of Real Estate

Economy

- Heightened instability in the global financial markets has led the Bank of England to maintain the base rate at 0.5% in November. The European Central Bank cut rates by 25 basis points, confirming that policy makers are now moving back towards supporting growth.
- UK gilt yields remain at historic (and subinflation) lows. In the global financial markets the UK is currently seen as a safe haven, reflecting the Bank of England's supportive policies and use of Quantitative Easing. The FTSE 100 has been relatively stable, perhaps suggesting investor concern of the Euro area as priced in now.
- The UK economy recorded an improved growth figure of 0.6% between July and September, driven by strong performance in the service sector and construction.

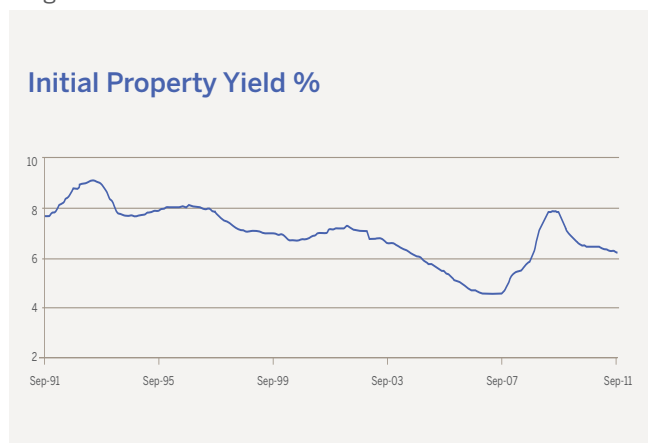
Economic Indicators	%/Value	Change
CPI	5	▼
Retail Sales (volumes)	0.6	▲
Unemployment	8.1	▲
Base Rate	0.5	▶
£ : \$	1.61	▼

Source: BoE, ONS, Bloomberg

- Since the onset of the financial crisis, the office market in London has been the subject of €72bn worth of transactions, compared to €43bn in Paris and €11bn in Frankfurt. As well as increasing their overall share of the City's office market, overseas buyers have also targeted higher value buildings since 2008.
- The IPD all-property yield fell by a mere 1bp to 6.23% in September, just about keeping yields on a gradual declining trend. Since recovery began in June 2009 yields have come in by a total of 169bps, but capital values are still 30% below their 2007 peak. Over the last three months total returns measured by IPD have been at an annualised 7.7% with steady 0.6% monthly returns. Positive overall returns rely heavily on the office sector where rental growth and capital values remain positive influences.
- There is an additional and general downside risk from a banking crisis arising from a European sovereign default. This may hasten the reduction of banks' exposure to the real estate sector putting downward pressure on capital values. But there are positive fundamentals for commercial property. The yield gap between property and the risk free rate is high and likely to remain so for the foreseeable future, with UK gilt yields at low levels.
- For prime office properties, foreign investor demand is buoyant and likely to be further boosted by the UK's "safe haven" status within Europe.
- The overall outlook is for modest, positive returns on property into next year. Total returns in 2011 should be in the 7% to 9% range.

Commercial Property Market

- Overseas institutions dominate foreign ownership of the Central London market, with investors from Germany, the US, the Middle East and Malaysia reportedly owning over 52 per cent of total floor space during the height of the downturn.
- The pound continues to remain resilient against the Euro, and continues to offer good the value particularly with the technical support provided against dollar value at 1.54. Based on figures reported last year the pound has made several bounces from this level. Lack of a European resolution will however strengthen the dollar in the short term.
- Looking ahead, 2012 should be a good year for investment into the UK, with the London Olympics and Queen Elizabeth's diamond jubilee giving a strong boost to tourism and potentially growth.



Source: IPD

£ to US\$ Exchange Rate (Historic and Projected)



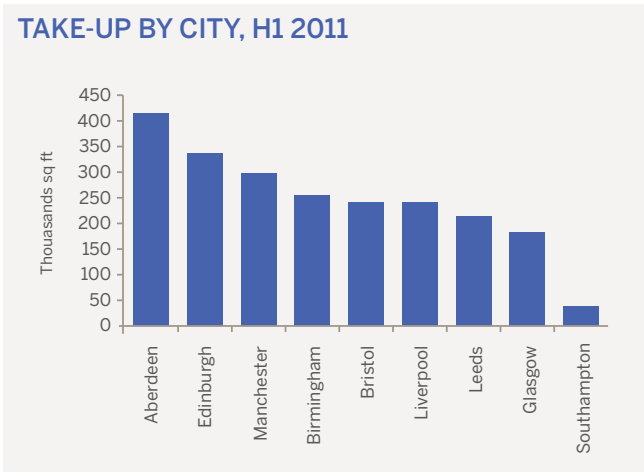
Source: Bloomberg, ONS

Office Market

Regional Occupational Market

The broad trends we saw in 2010 have been maintained: the largest cities have been the most active and the Scottish cities have maintained demand levels. Encouragingly most cities have a number of active requirements, some for significantly large amounts of space. Even so, many of these occupiers are taking their time to commit to specific acquisitions, reflecting the mood in the wider economy.

TAKE-UP BY CITY, H1 2011



Source : CB Richard Ellis/Regional Market

- A point to note this year has been the emergence of requirements from the professional services firms with some large active requirements. The financial (eg Morgan Stanley, JP Morgan, Tesco Bank), legal (eg Allen and Overy, Herbert Smith, Weightmans, The Law Society) and accountancy (eg KPMG) sectors have all been active. Some of this activity can be explained by back office functions being set up in lower cost locations away from London and the South East.

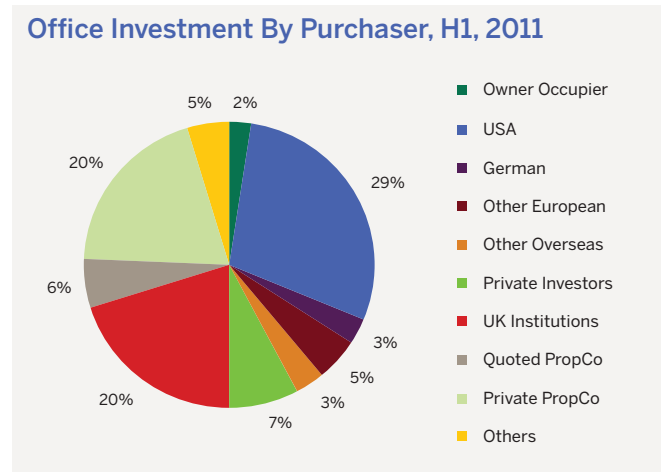
Key town prime rents and forecasts

Town	Q3 prime rents (psf)	Movement
Basingstoke	£ 17.50	=
Bracknell	£ 20.00	=
Brentwood	£ 21.00	=
Chiswick	£ 40.00	+
Croydon	£ 17.50	+
Gatwick	£ 21.50	=
Guildford	£ 27.50	+
Hammersmith	£ 37.50	+
Heathrow	£ 27.50	+
Maidenhead	£ 30.00	+
Reading	£ 30.50	=
Slough	£ 25.00	=
Staines	£ 28.50	+
St Albans	£ 22.50	+
Uxbridge	£ 28.00	+
Watford	£ 22.00	=
West Malling	£ 20.50	=

Investment Markets

- In the offices markets outside Central London, a total of £2.09 billion of stock has been purchased, a total boosted by the sale of Chiswick Park, a business park in West London, for £480m to Blackstone, the US investment company.

Office Investment By Purchaser, H1, 2011



Source Property Data

- Overseas investors have dominated activity accounting for almost half of all offices transacted by value. Overseas funds, in particular German funds, have been attracted to the prime yields on offer in the regional office markets eg Commerzreal's purchase of 1 Snowhill in Birmingham.
- UK institutions made up 20% of total investment volume and are selectively seeking higher yielding, multi-let opportunities with asset management potential. The only other significant net purchasers were UK property companies who accounted for 26% of total transactions and for example included the purchase of The Mailbox in Birmingham by Brockton Capital for £127m.
- Prime yields have been relatively stable during the year to date. The highest yields are to be found in Liverpool and Southampton at 7.0%, which are a 100 basis points higher than many of the larger cities (Birmingham, Bristol, Edinburgh and Glasgow). Manchester boasted the lowest yield of the regional cities at 5.8%.

M25 / South East

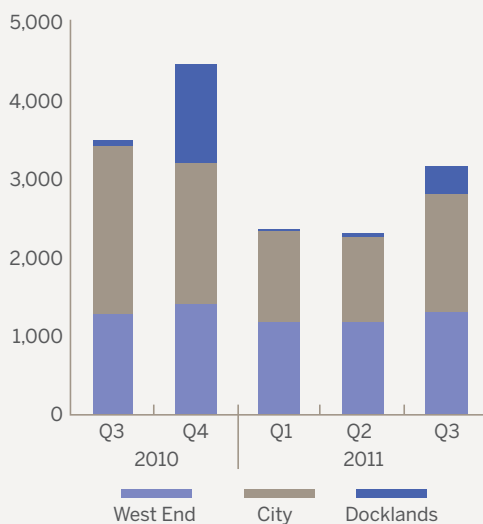
- Total take-up in the M25 was 708,659 sq ft in Q3, more than double the Q2 total and 7% above the 10-year quarterly average. The Thames Valley markets dominated activity in Q3, accounting for 35 of the 40 recorded transactions. In the M4, Q3 takeup rebounded from Q2, with take-up of 421,000 sq ft across 27 transactions, the highest seen in a single quarter since Q3 2008. Reading was particularly active, with nine transactions totalling 108,611 sq ft.
- The M4's West London markets, including Hammersmith, Chiswick and Heathrow, also saw a flurry of transactions, with the most notable being International SOS' acquisition of 41,000 sq ft at Building 4, Chiswick Park, at an agreed rent of £39.00 per sq ft. In the M3, several large deals pushed Q3 take-up to 343,792 sq ft – over four times the Q2 level and 47% above the 10-year quarterly average. Active named demand is broadly stable, rising by 4% during Q3 to stand at 5.70m sq ft.
- New and Grade A space in the M25 as a proportion of total availability continues to decline, falling from a peak of 71% in Q2 2010 to its current level of 63%. The M4 vacancy rate saw a notable fall in Q3, reducing from 11.6% in Q2 to 11.1%, its lowest level since Q2 2009
- Given the uncertain economic outlook, a key strength of the South East market is the diversity of its occupier profile, including global brands, manufacturing and service-related companies. The strong presence of Information, Communication, Technology ("ICT") related occupiers in the South East means the region is well-placed to capture the anticipated growth associated with the development of new technologies, such as cloud computing (a key feature of the Atos Data Centre) and advanced telecommunications.

- An advantage linked to falling Grade A supply is rental growth. We have already seen some indication of a supply-led recovery to headline rents in key Thames Valley markets, such as Chiswick, Uxbridge and Hammersmith. As Grade A supply is eroded, we expect a host of other markets in the Thames Valley area to witness a degree of rental growth 12 months from now.
- Despite the uncertainty, a number of significant active requirements were launched towards the end of Q3 2011, which may help support activity.

Central London

- Take-up rose in the third quarter to 3.2 m sq ft, 40% higher than the previous quarter and back above the long-term average level. The increase was fuelled by a significant rise in activity involving larger units – there were six deals greater than 50,000 sq ft in Q3 compared to just three in the previous two quarters. Activity for sub-50,000 sq ft units also increased, suggesting the market is gaining momentum.

Central London take-up by quarter & sub & sub-market Q3 2010 - Q3 2011 (000's sqft)



Source: Knight Frank

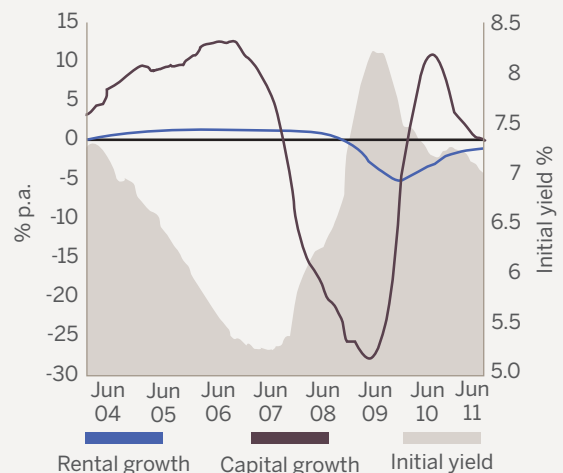
- Availability fell for the eighth consecutive quarter and is now 15.9 m sq ft, reflecting a vacancy rate of 6.9%. This fall was particularly encouraging considering more than 300,000 sq ft of take-up was in pre-lets and did not remove any up-and-ready supply from the market. There is now almost 10.0 m sq ft less office space available to rent in Central London than was the case 2 years ago.
- Transaction volumes were constrained by a marked lack of stock in both markets although late in the quarter availability levels rose considerably as the City-based KanAm portfolio was brought to the market.
- Central London offices are continuing to attract investors seeking a 'safe haven', particularly against the backdrop of historically low gilt yields. While overseas investors continue to account for a large share of turnover, there has been increased demand from domestic investors, with the overall weight of money chasing Central London assets ensuring prime yields remain at their current levels.

Logistics

- The rapid growth of online retailing will remain a key driver of occupational demand in the logistics market over the next 12 months. In the absence of speculative development, design and build pre-lets will increasingly be undertaken by those occupiers willing to commit to long leases.

- Headline rents are likely to remain broadly stable over the coming 12 months. However, as supply diminishes, the pendulum is starting to swing gradually back towards the landlord, with the hardening of incentives seen at certain locations expected to become more widespread. The investment market will continue to see a polarisation in pricing between prime and secondary stock. However, with prime opportunities in short supply, good quality, well-located secondary stock could see increased investment demand.
- Changing patterns of consumption continue to fuel logistics demand. According to IMRG (Interactive Media in Retail Group - the recognised authoritative voice of e-retail), internet spending grew by 18% in 2010, to £58.8bn, and is forecast to grow by a further 17% in 2011 alone. Changing consumer spending patterns, aided by technological advances, are steadily bringing about fundamental structural change to the logistics network.
- The supply of large-scale, speculatively developed distribution units has now been largely absorbed, with just a few units remaining in most regions. Consequently, in order to expand or optimise their distribution networks, retailers, particularly e-retailers and the major supermarkets, are increasingly seeking design and build (D&B) opportunities.

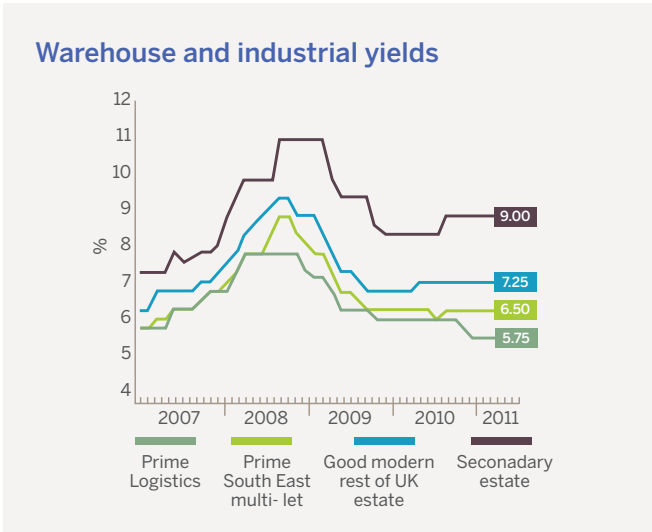
Industrial sector performance



Source: Knight Frank

- As existing stock becomes more scarce, falling supply is tilting the balance of power ever so slightly back towards the landlord. While it remains predominantly a tenants' market, headline rents are stable and incentives are hardening in many regions.
- Prime distribution / logistics yields remained static during H1 2011. Single-let prime logistics deals are generating yields as low as 5.75%, where assets carry 20 year+ income and fixed rental uplifts. More typically, prime logistics yields range from 6.00% to 6.50% depending on location. For multi-let estates, a clear distinction can be drawn between the South East and the rest of the UK. Prime yields for this kind of product stand at 6.50% in the South East compared with 7.25% elsewhere in the UK. Yields for secondary and tertiary assets remain under outward pressure.
- Well-let logistics units which provide secure income streams continue to attract significant interest from both UK Funds and private investors, particularly where rents are subject to fixed uplifts or linked to RPI. Notably, having traditionally focused on Central London offices, overseas buyers from Asia and the Middle East are starting to become more active in this sector, attracted by covenant quality and lease length.

- UK institutions and well-financed property companies continue to target multi-let industrial estates. Their requirements are predominantly for either prime or good quality secondary product, with a strong preference for the South East region, where the occupational markets appear relatively robust in comparison with UK's other main regional centres.

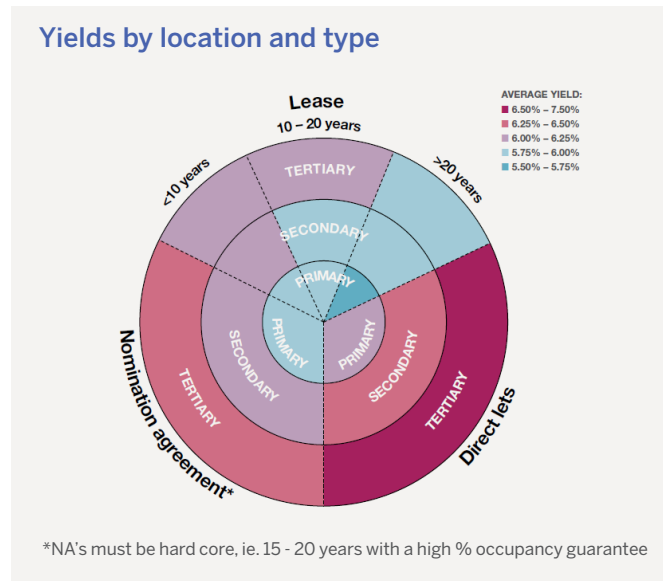


Source: IPD

Student Accomodation

- The student sector continues to deliver strong returns compared to other mainstream asset classes in the UK. Despite current economic and property market conditions, the volume of deals in the student sector recently has perhaps been surprisingly high. There have been circa 85 major deals in the 18 months to July 2011 with a total value of £1.3 billion. Of the deals that involved direct let schemes in 2010, the average net yield was between 6.25% and 6.35%. Yields on the whole have moved in since this time last year, mainly because of higher volumes of investment.

- There has been much press coverage about the impact of changes to tuition fees and the impact of funding cuts in the wake of the Browne Review of the Higher Education system. The increased cost of Higher Education tuition fees is suspected to see reduced applications for English students for the 2012 academic year, with the application process open from early September 2011.
- It is expected that some universities will experience a negative impact with declining student numbers, whilst others will see more positive effects from students searching for a "flight to quality". The ability of individual universities to respond by attracting alternative sources of funding, foreign students and postgraduate students differs greatly. This will evidently make a difference to student numbers in a particular town or city. It is argued therefore, that the prospects for student housing as an asset class are diverging between primary locations and tertiary ones.



Source: Savills Research

Real Estate Team

Gatehouse have established an experienced Real Estate Team



Adam Cavanagh
Head of Real Estate

Adam is Head of Real Estate at Gatehouse Bank plc. Since joining Gatehouse in April 2009, Adam has established an innovative and market leading real estate team and led over £300,000,000 of transactions in the office, student accommodation and industrial sectors. During his career Adam has completed over £2 billion of acquisitions across the UK, Europe, the United States and Asia. Adam has experience structuring joint ventures, providing senior leverage, mezzanine and equity into a wide range of real estate transactions which has contributed greatly to the Gatehouse success in identifying, securing and closing market leading transactions. Adam has a BA (Hons) in History, Economic History and Politics.



Will Lowndes
Vice President - Real Estate

Will has previously worked on behalf of Prudential's Real Estate investment arm, PRUPIM, for 6 years where he completed £1.5 billion of acquisitions across all UK commercial property sectors. In this role Will also provided advice for a wide range of funds, primarily for Prudential's and M&G's long income funds. Will has also gained extensive UK real estate experience during his time at Savills, as a member of their Central London Investment Team where he acted on behalf of a number of institutional & private investors and REIT's. Will holds an MSc in Real Estate from Reading University and a BA (Hons) in History from Leicester University.



Jamie Munday
Vice President, Asset Manager - Real Estate

New to Gatehouse Bank, Jamie joined the team in August 2011 as a dedicated Asset Manager. Jamie joins Gatehouse from ING Real Estate Investment Management where he was Asset Manager for General Motor's £100,000,000 pension fund, and Fund Manager for ING Real Estate £170,000,000 Value Add Fund and £75,000,000 Focus Fund. Jamie has a MSc in Real Estate from The University of Reading and is also the holder of BA (Hons) in Politics.



Stuart Jarvis
Associate Vice President - Real Estate

Stuart joined Gatehouse Bank having previously worked for over three years in Kuwait. During this time he worked on establishing Shariah compliant equity funds and ran a conventional IPO portfolio. Upon joining Gatehouse, Stuart first worked on establishing Milestone Capital PCC, a flexible sukuk issuance platform and arranged the first issuance through the platform. Having worked on a number of cross border Capital Market transactions, Stuart joined the real estate team in early 2009, and has been specialising in student property opportunities. Stuart has a BA (Hons) in Arabic with Anthropology, MA in Islamic Political Economy and is a holder of the Chartered Institute for Securities and Investments Islamic Finance Qualification.



Abdulla Alghanim
Analyst – Real Estate

Abdulla Alghanim has previously interned at Mar-Gulf Management, Los Angeles, CA, USA. He has also gained experience in Real Estate investments working at Al Aman Investment Company, Kuwait. He holds a BS in Real Estate Finance at California State University, Northridge, CA, USA.



Tim Tollast
Analyst – Real Estate

Tim Tollast has joined Gatehouse Bank from DTZ where he has previously spent 3 years specialising in commercial property valuation. He has a BSc (Hons) in Economics and Urban Planning from the University of Birmingham, a Postgraduate diploma in Real Estate from London South Bank University and is a member of the Royal Institution of Chartered Surveyors.

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