AEW UK

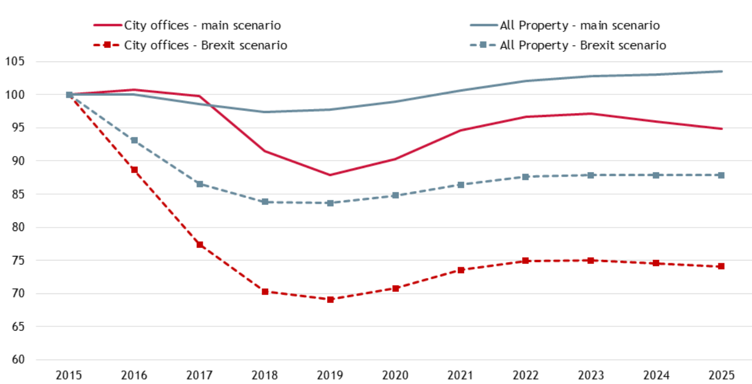
Brexit - We live in interesting times - Friday June 24th

Whilst political commentary suggested the European Referendum result would be close, pricing in the financial markets indicated that the Remain Camp would ultimately prevail. The initial volatility seen in the financial markets' reaction to the unforecast Brexit vote is therefore unsurprising. Investors have looked for safe havens like gold or UK gilts, with Sterling and the FTSE being hit.

Whilst the direct real estate market will take time to react, valuers will be caveating end of June valuations and all eyes will be on the faster moving quoted real estate sector for guidance. Broadly speaking, amongst the biggest real estate stocks, those with the greatest exposure to London have fallen most heavily, particularly in early trading and those in other sectors, less so. The impact on the generally smaller, externally managed REITs, has been much less pronounced, with trading mostly still around NAV. Trading volumes are up on average; perhaps a sign of buyers seeking to exploit short term opportunities to capitalise on uncertainty.

London offices forecast to suffer most

PMA view for Brexit impact: capital values (base = 100)



"We disagree with the PMA Brexit scenario forecasts for prime central London office capital values falling 30-35%. These capital value drawdowns are significantly predicated on property yield expansion, which is in turn driven by forecasts that longer-dated gilt yields will move out. We believe that, under Brexit, gilts will continue to be a perceived safe haven asset, and thus gilt yields will either remain low or compress. Moreover, these PMA capital value forecasts are also predicated on serious falls in rental values. We also don't believe this to be as serious a downside risk as PMA do. While the central London office market is undoubtedly most exposed to the downside risks of Brexit, it's those sectors less reliant on financial services occupiers and those geographies away from central London that are likely to be least affected by Brexit." - Sam Martin, Head of Research & Strategy - AEW Europe

Whilst quoted markets will find their own level relatively quickly, the slower moving direct market and the uncertainty the Brexit vote causes around valuations is a potential short term issue for investors and managers in open ended funds. Our investors may recall that considerable research and development around valuation and pricing best practice for open ended funds was drafted into the legal documents constituting the AEW UK open ended funds. Over the coming dealing days our Governance committee, via its pricing subcommittee (on the AEW UK Core Property Fund) will be considering whether to make any recommendations to the manager regarding the fair price for investors' capital wishing to enter or leave the funds.

Both of our open ended funds are experiencing positive cash flow at the current time and our REIT has, on relatively high volume, continued to trade around NAV post the vote. Our pooled funds are not exposed to Central London offices, the sector which seems to give quoted investors most concern, and provide a relatively high income return which must be increasingly in demand.

The uncertainty around what happens next with the UK's negotiation to exit its EU Membership is likely to prolong caution from investors and tenants alike. That said the absence of property supply in many of our markets is a positive, and our tenants continue to negotiate to take leases on our buildings, even on Day One after the unexpected referendum result.

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