



POST-BREXIT

Reassessing risk and opportunity following
Britain's decision to leave the EU

SUMMARY

► Risk & World markets:

Uncertainty in the wake of Britain's EU referendum has changed the balance and perception of world risk, affecting all global markets to varying degrees. This has changed the prospects for real estate markets asymmetrically. Real Estate has characteristics which may be increasingly sought-after in uncertain times so caution on REITs and funds may be tempered by increased appetite for direct property ownership in particular sectors and jurisdictions.

► Real Estate characteristics:

Negative short bond yields in

some countries and very low income returns in many means that income-producing real estate should be increasingly sought after.

Real estate in stable jurisdictions with good title still offer investors a way to store their wealth amidst turbulent markets.

► Safe havens and income

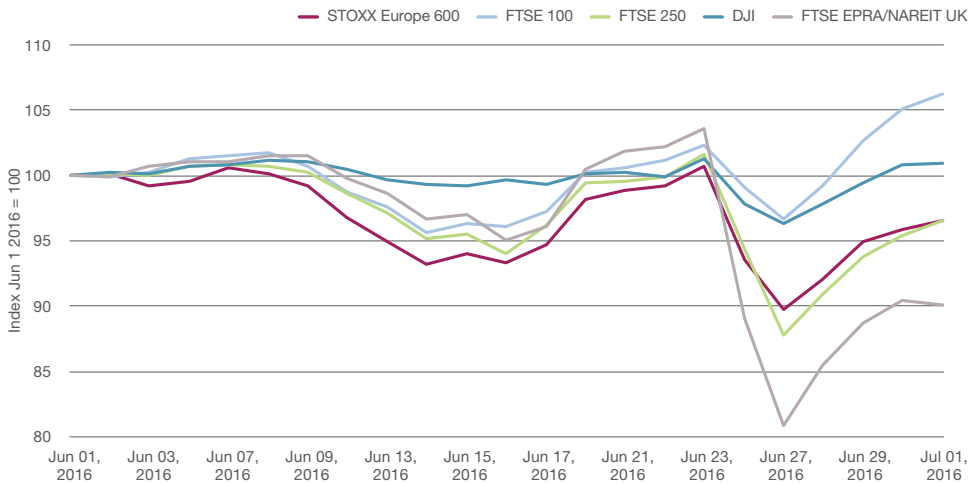
streams: Real estate in stable jurisdictions with good title still offer investors a way to store their wealth amidst

turbulent markets. Rental premiums over gilt yields may be viewed as a bonus by some over and above this safe haven status so temporary fluctuations in capital values have little ► relevance to these longer-term-income investors.

Global appetite for real estate:

While short to medium term worries on economic performance may keep the Sterling low, this will present buying opportunities, especially where debt availability is not an issue. Underlying fundamentals of supply, demand and rental growth will become key determinants of success.

FIGURE 1
Post EU referendum stock market volatility



Source: Investing.com

11% off
UK properties for USD(\$) investors since vote



Britain's vote to leave the EU on 23rd June 2016 and the subsequent political and constitutional turmoil that followed in its wake, introduced a very large dose of uncertainty into investment markets not only in the UK and the EU, but globally and so changed both the sum total and distribution of risk dramatically.

While some markets have realised that this perception of risk was overdone in certain sectors, and have recovered markedly, others remain subdued or have rallied only moderately. Some markets such as gold, the Yen and US while Sterling, Euros and UK stocks, particularly REITs and construction, are still down (see Figure 1).

Unlike these assets, there is no real-time trading data in directly owned real estate so it will not be possible to precisely assess the impact of Brexit in either pricing or turnover terms for at least a few months but it is possible to look at the characteristics of property against other assets to begin to understand its potential positioning.

The key themes that emerge are:

- ▶ Globally, UK real estate will increasingly be sought after as an income-producing investment, with emphasis on capital growth, particularly where bond yields are low or have even turned negative.
- ▶ The role of property in providing a safe store of wealth in 'safe haven', secure title, jurisdictions will come to the fore although this will be tempered by currency risk in places where the Sterling may move down further against the investor currency.
- ▶ A focus on real estate occupier fundamentals, and their impact on rental returns and prospects for rental growth, is inevitable and may present investment opportunities over coming months.

► Buying opportunities will be most apparent for those with large war-chests and in dollar-denominated or UAE Dirhams/ Saudi Riyal currencies who were already waiting for cyclical buying opportunities in some fully valued markets. This activity will be tempered by fear of economic downturns but, again, the longer- term nature of real estate investment will come to the fore.

► Leveraged investors will be less prominent and opportunistic and unconventional investors with cash will be the most active. This may mean a larger proportion of private investors once again active in the market.

Interest rates and yields

In the face of rising global risk (and in the expectation of Bank of England base rate cuts), there appears to have been a flight to safety in the form of government bonds. At the end of June, the UK joined Japan and Germany in experiencing short- term negative bond rates.

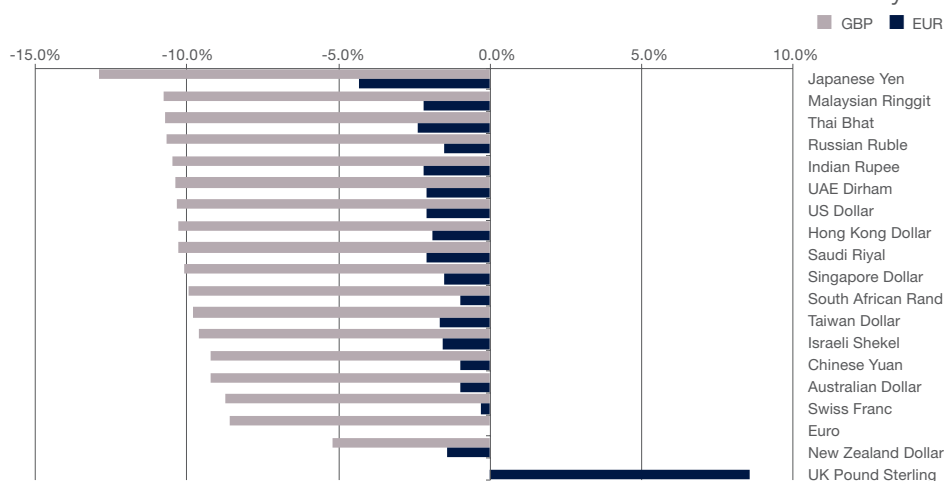
Expectations before the referendum were that UK and US base rates would start to move out in the near future. Fears in some fully valued markets were that rental growth would not keep pace. With expectations once again that base rates will stay lower for longer, or even drop, property yields have longer to move out and are more likely to do so through rental growth rather than capital contraction.

When the opportunity cost of money turns negative, any income-producing asset must start to have particular attractions. This potentially puts real estate into a new and different class for as long as the majority of tenants continue to pay rent. Under these circumstances, we expect fully let properties of all use types and classes with low void rates in deep markets to remain an essential part of any well-balanced investment portfolio.

However, we expect this also means that the fundamentals and



FIGURE 2 **GBP and EUR vs world currencies** Movements 23rd June vs 1st July



Source: Bank of England

the future prospects of both the market and the property will be carefully scrutinised by investors before purchase.

When the world is searching for income, investors are likely to be looking for both quality and value.

Exchange rates

The credit rating of the UK was instantly downgraded on the 24th June when the referendum results were known and sterling plummeted against most other currencies, even the euro which also suffered devaluation against the US dollar.

Currency volatility has added to the risks of placing investments in Euros or sterling for the moment but also offers opportunities for those holding US dollars, other dollar- pegged currencies and

Yen to buy assets more cheaply. Figure 3 shows how currencies have moved since the eve of the referendum.

UK property has become significantly cheaper for US dollar and related currencies and especially for holders of Japanese Yen. We do not think these currency changes will give every dollar buyer a desire to buy UK real estate but it does mean that investment buyers will become increasingly focused on the fundamentals of yield levels and rental growth prospects. Real estate will look good value where these are present, particularly as expectations of more global volatility rise. The world is faced with further US and European political change and elections, to cite just one element of risk, for example.

Geopolitical and cyclical risk

Long before the Brexit vote, some degree of geopolitical risk related to the Eurozone seems to have already been priced into European real estate markets. Real estate investors at the end of last year, for example, were buying London on the same level of net effective yield, adjusted for bond rates, as other major world cities like New York and Hong Kong while Eurozone cities such as Paris, Frankfurt and Brussels had not seen the same degree of yield compression and some were being priced on the same risk-adjusted net effective yields as Chengdu and Manila (see Figure 3).

Yields have since moved in significantly in many European cities but some global investors' appetite for Euro denominated assets in a region of political uncertainty may have been somewhat impaired compared to other world regions. Global markets appear to think that the EU is not out of the woods yet making London property comparatively more attractive.

Conclusion

In the very early days of global post Brexit reaction, and indeed in the days preceding it, stock market volatility has increased dramatically. Meanwhile, yields on lower-risk government bonds – even UK ones, have moved in, not out since the referendum. The search for safety is still on and the prospects for negative interest rates seems to have increased. There is still appetite from global investors to put their money somewhere. It is becoming increasingly difficult to find asset classes and sectors which offer stable incomes and stability or safe haven status. The price of gold, for example, rose by 6.4%, from US\$1,253/ounce to US\$1,333 over the four days to June 27th. Some other real assets, particularly real estate, may look only slightly less

attractive to certain investors, particularly those seeking income as well as diversification.

There is a point, especially in countries with negative interest rates, like Japan, when the yield available from real estate in the UK with secure tenure and a socially safe environment and transparent markets looks compelling, despite increased risk and volatility. This is especially the case for cash investors seeking mid and long-term income streams. Recent currency strength, especially if it is expected to be temporary, makes the purchase of a sound

Sterling income producing asset look cheap.

Performance will be found, as always, in real estate locations where there is steady demand from growing populations, security of title, market transparency, limited supply plus long-term economic and growth prospects (cities like London, Manchester and Birmingham). Investors are likely to be looking for all these quality factors but looking for value too in the form of higher yields. Returns will be further enhanced in places as the Sterling strengthens over time so that income returns to foreign currency investors are improved.

FIGURE 3
Grade A Properties December 2015

Net effective yield less local 10yr bond rate (NOBEY)	
New York Midtown	0.5%
London West End	0.7%
London City	0.8%
Hong Kong	0.8%
Sydney	1.0%
LA West	1.0%
Shanghai	1.3%
Chicago	1.3%
San Francisco	1.5%
Beijing	1.7%
Singapore	1.8%
Miami	1.8%
Warsaw	1.9%
Madrid	2.0%
Paris	2.3%
Tokyo	3.0%
Frankfurt	3.3%
Berlin	3.4%
Copenhagen	3.6%
Cologne	3.7%
Dublin	3.7%
Brussels	4.5%

Recommended post Brexit U.K. real estate opportunities.



One Nine Elms

Soaring over 56 storeys into the sky, One Nine Elms will offer its residents unrivalled views of London's most famous landmarks, from The Shard and the London Eye, to Westminster Abbey and the Houses of Parliament. All of the apartments for sale are linked to a 5-star hotel with luxury amenities. Residents will enjoy access to a 24 hour concierge, a spacious gym, pool, spa and the 50th floor residents' sky lounge and terrace, a truly unique space to entertain with London's skyline as your backdrop.

Right next door to Vauxhall Underground station, with speedy transport links into London's West End and the City, it is also walking distance to the transforming 3km of London's riverside into an ultra-desirable residential quarter, international business district, and outstanding cultural and leisure destination.



Television Centre

Television Centre is at the heart of the largest redevelopment in West London.

Slated as the most iconic redevelopment in London, Television Centre's apartments and penthouses are at the centre of an enriching place. With all-day cafés and restaurants, television recordings and cinema screenings, health club, pool and spa, hotel, private gardens, and landscaped terraces with a programme of cultural events.

Part of the multi-billion pound regeneration in White City. It is a milestone in the transformation of 145-acre White City, with £8 billion of investment bringing more than 5,000 homes, a Harvard-style campus of academic excellence, a media village, an expanded Westfield shopping mall and the largest-ever John Lewis department store. Facilities include the Soho House, screening rooms, BBC live show studios, gym, spa, pool and concierge service.



The Buckingham

Situated directly opposite the Buckingham Palace, residents will enjoy a centrality of location that few others possess.

Located in St James's Park and directly opposite Buckingham Palace, The Buckingham apartments enjoy a centrality of location that few others possess. They sit at the nexus of London, surrounded by the best of British history, power and culture. The open space surrounding The Buckingham also frames some of Europe's most elegant and beloved architectural landmarks, broadest avenues and grandest Royal Parks.

The development offers 1 bedroom to 3 bedroom options with all modern living amenities as well as private access apartments.

Get in touch with the Elysian team to find out more:



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