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## EPRA Insight Event 2018 UK Outlook

MORGAN STANLEY RESEARCH  
EUROPE

Morgan Stanley & Co. International plc+

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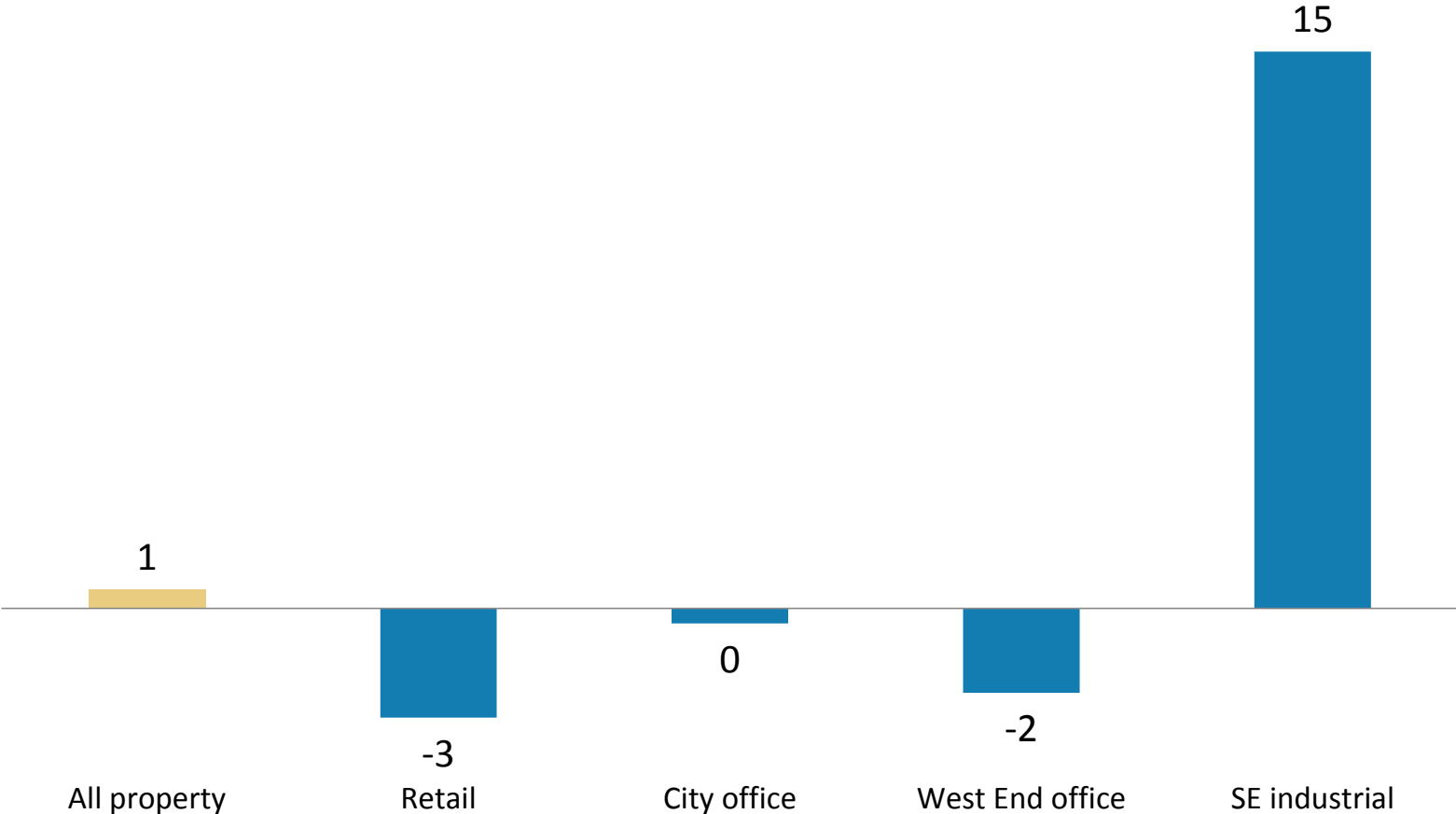
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# 1. Context

## UK commercial property values have proven resilient

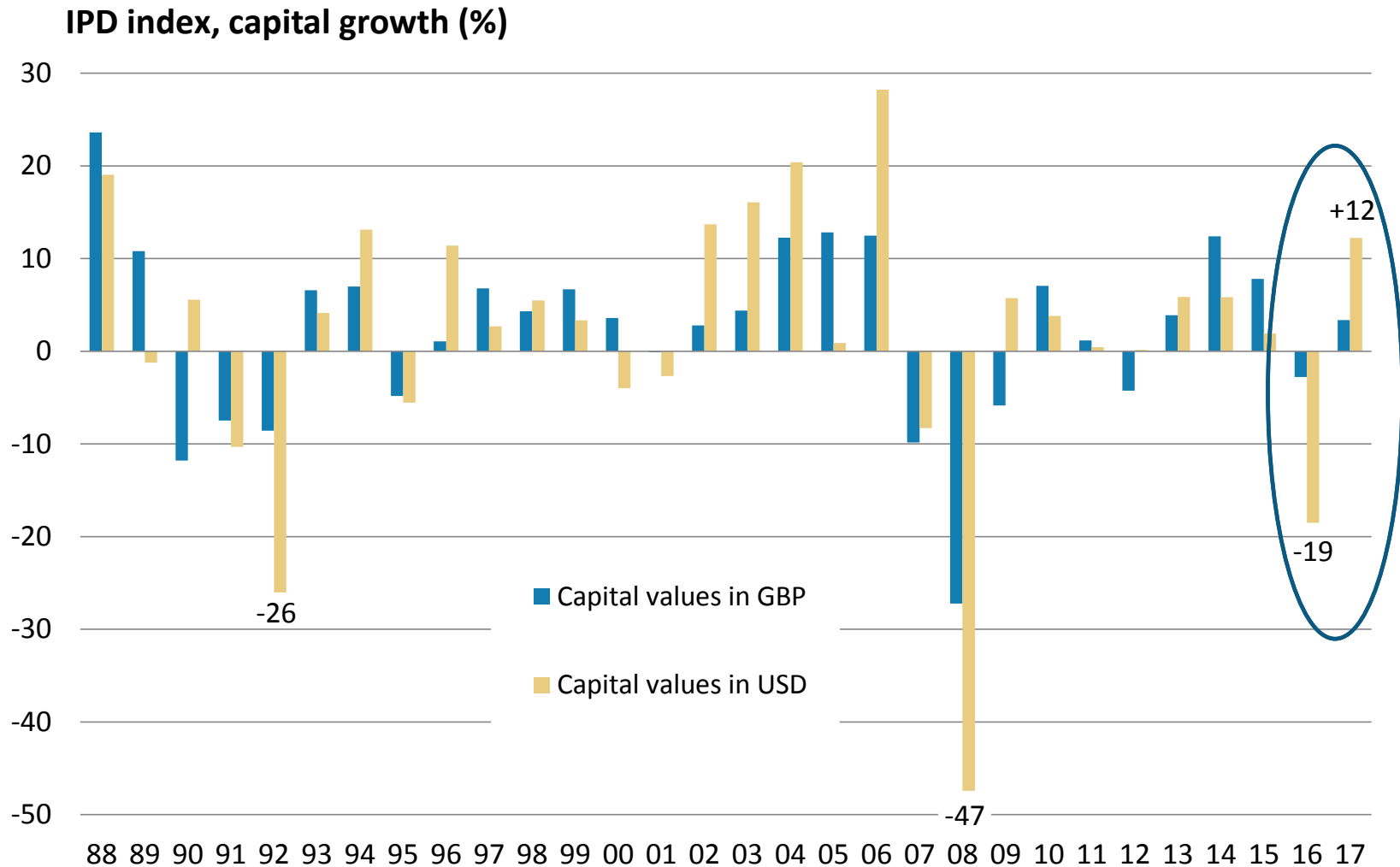
Changes in capital values since EU referendum (%), May 2016 - Nov 2017



Source: IPD, Morgan Stanley Research

# 1. Context

## Sterling weakness masking (moderating) UK capital values weakness? Not anymore!

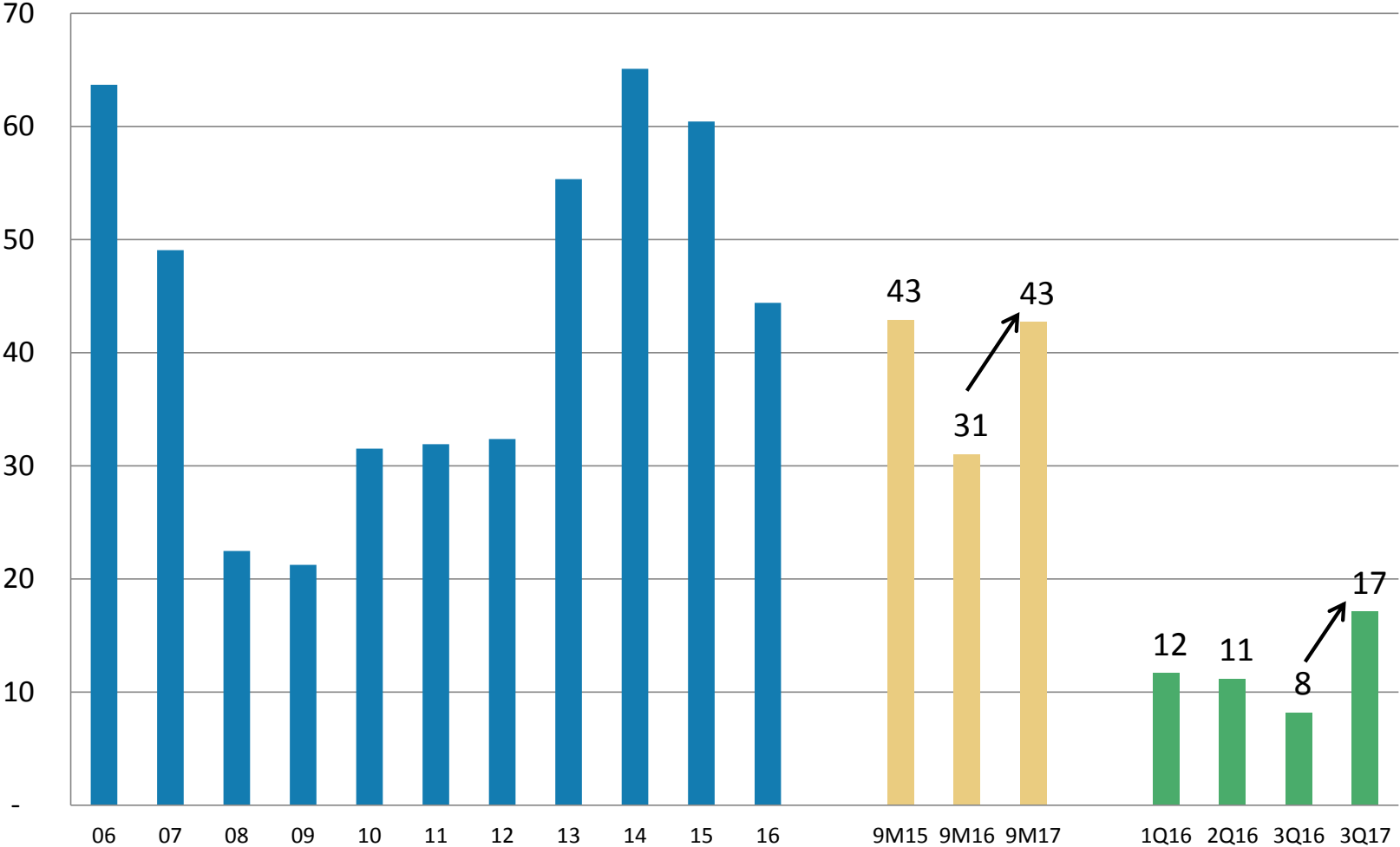


Source: IPD, Datastream, Morgan Stanley Research

# 1. Context

## Investment volumes are recovering

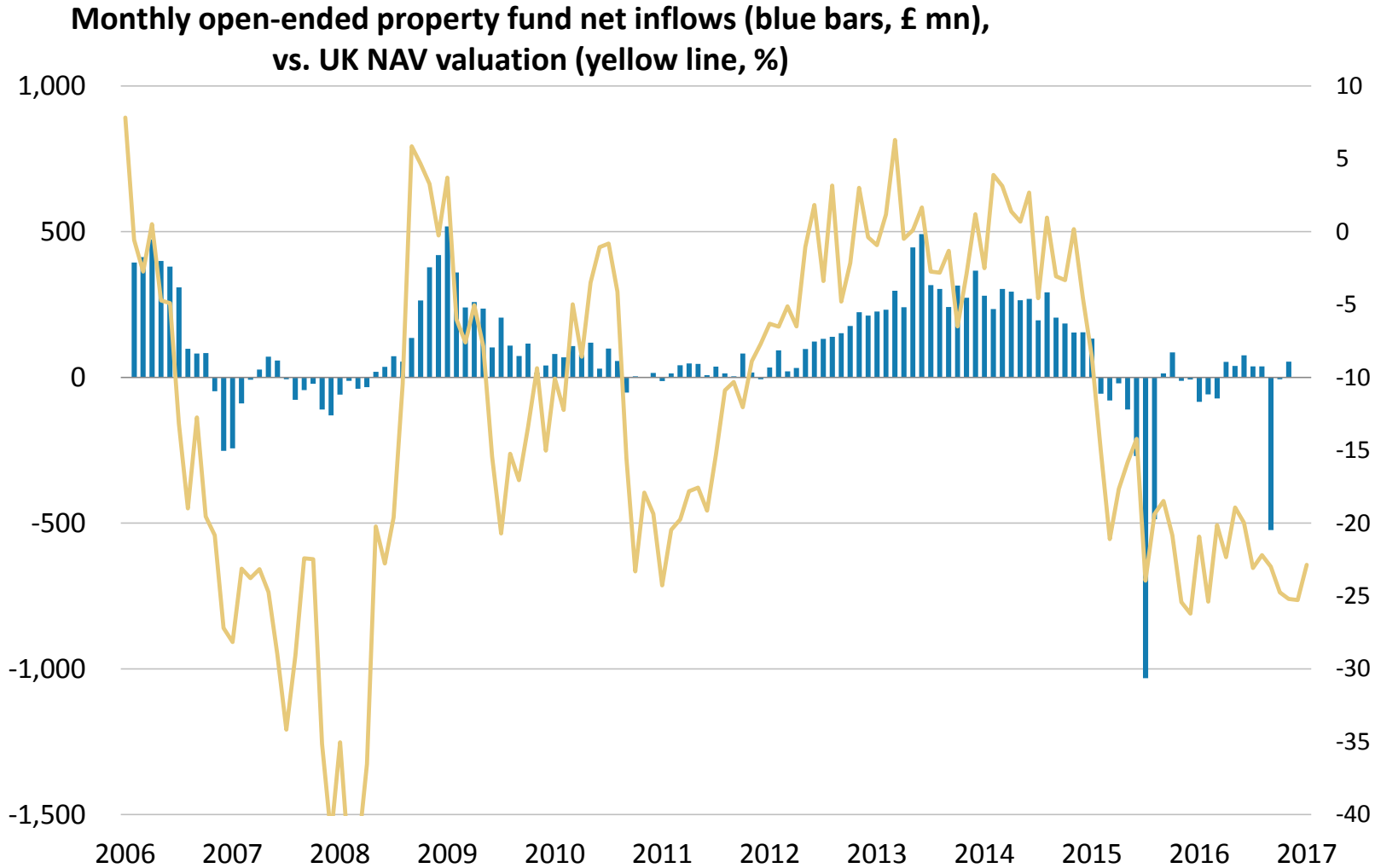
UK commercial property investment volumes (£ bn)



Source: JLL, Morgan Stanley Research

# 1. Context

## Retail investor appetite remains muted, but no longer major outflows



Source: The Investment Association, Company data, Datastream, Morgan Stanley Research

## 1. Context Why?

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Brexit negotiation progress?

Quiet period midway between initial decision and ultimate outcome?

(more than a year after the referendum, more than a year away from the March 2019 Brexit date)

Other?

## 2. What about 2018?

### What assumptions are we using

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#### **London offices**

Market rents -4% on average for REITs

Capital values -3% on average

#### **Retail**

Flattish reported like for like rents for REITs

Capital values -2% on average for REITs

#### **Industrial/logistics**

Rents +4%

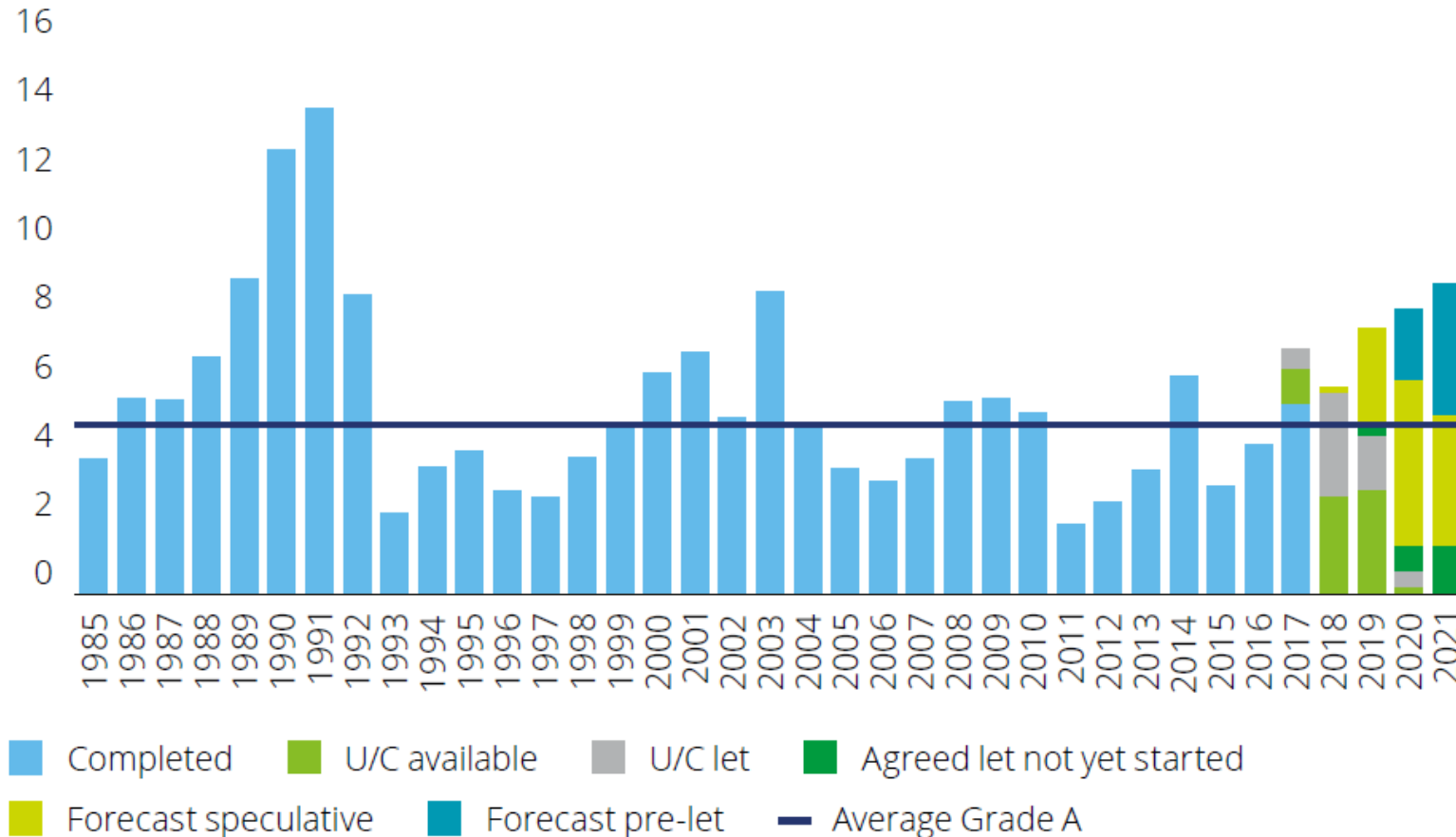
Values +6%

## 2. What about 2018?

### London offices: Are we overstating supply?

#### Central London: office development pipeline forecast

Million sq ft

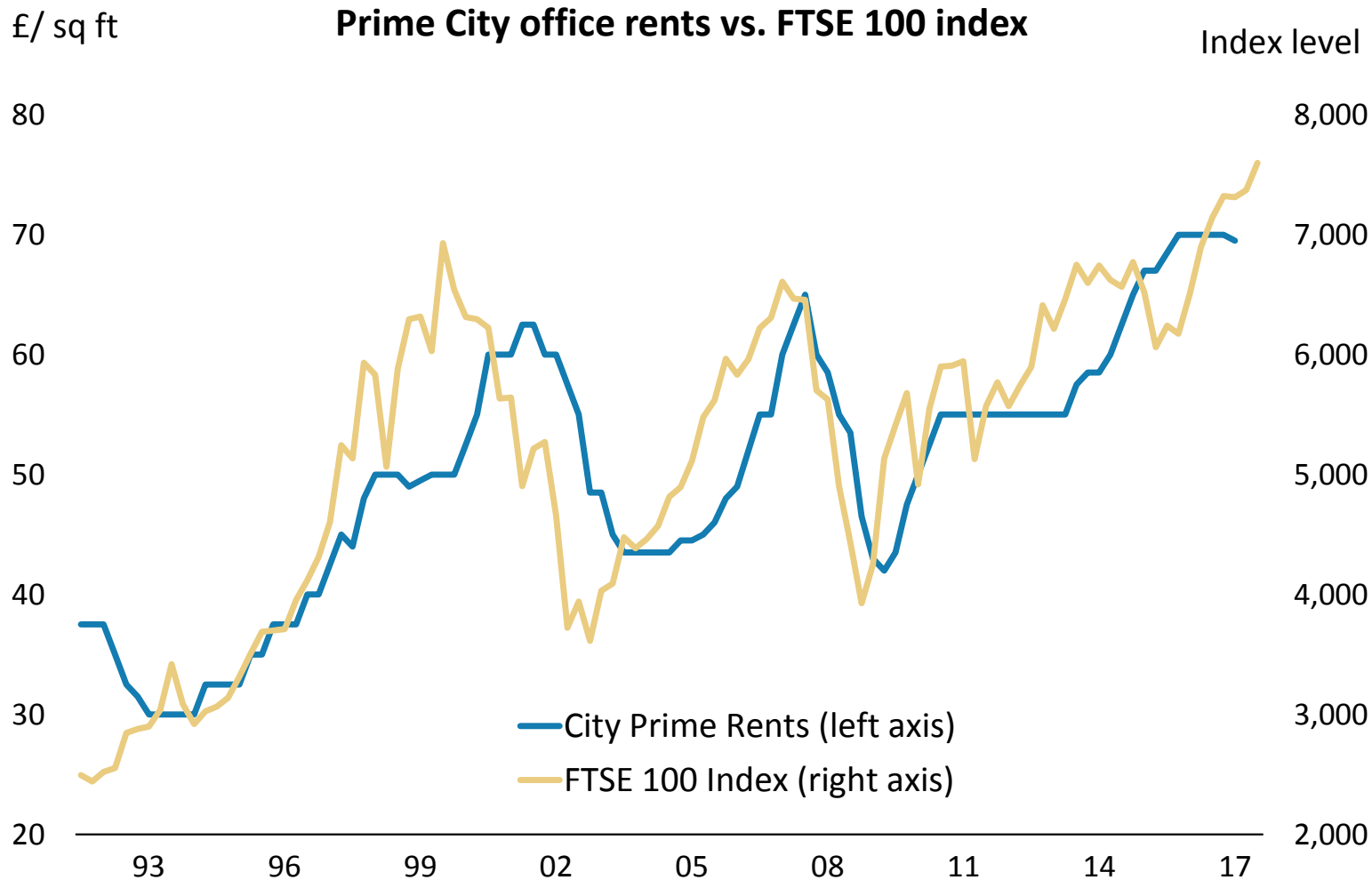


Source: Deloitte Real Estate, Morgan Stanley Research



## 2. What about 2018?

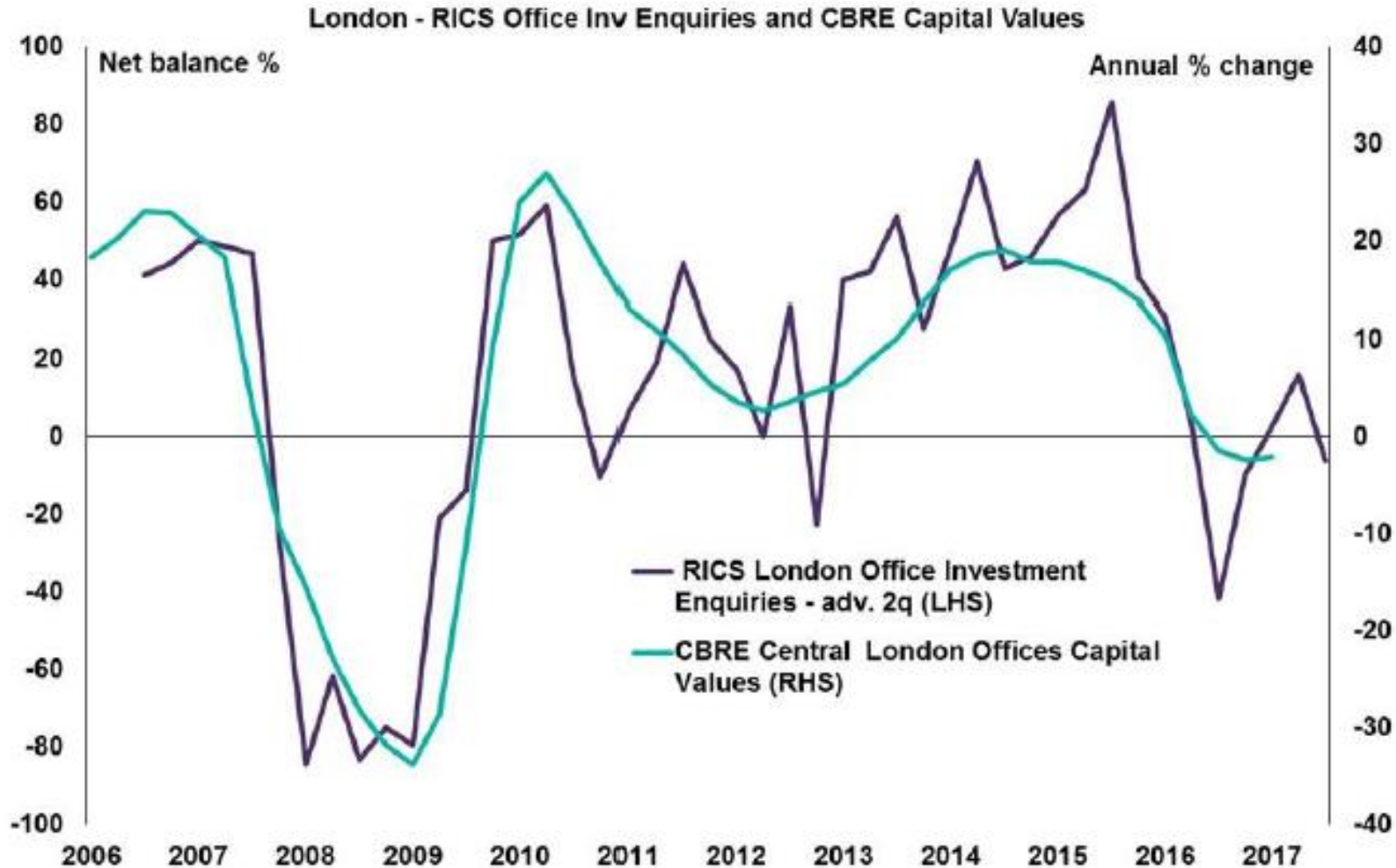
### London offices: How to gauge demand?



Source: CBRE, Datastream, Morgan Stanley Research

## 2. What about 2018?

### London offices: RICS sentiment index turned negative again

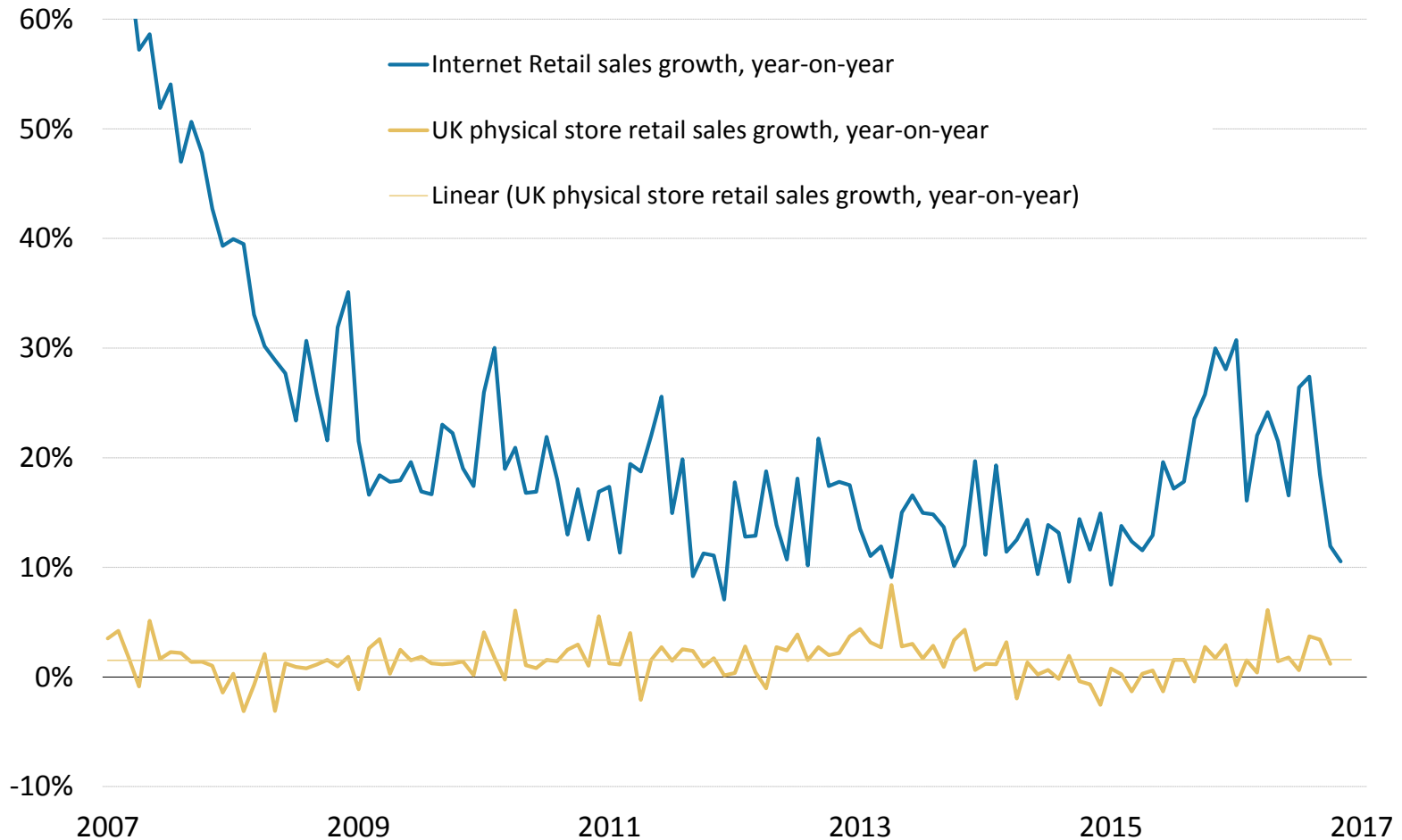


Source: RICS, Morgan Stanley Research

## 2. What about 2018?

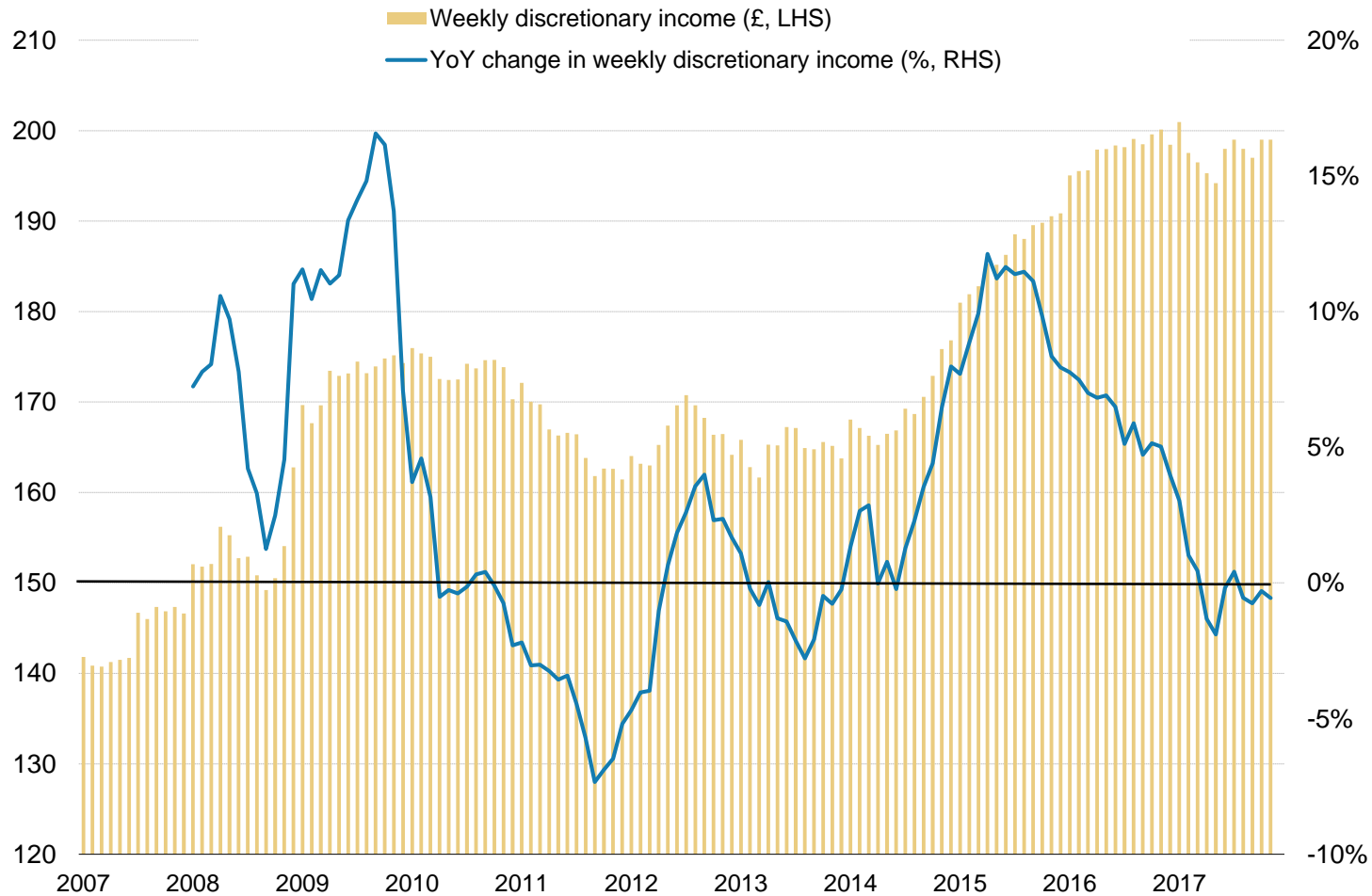
### Retail: online vs. in-store sales growth

UK in-store and online retail sales growth (%)



Source: Savills, Datastream, Morgan Stanley Research

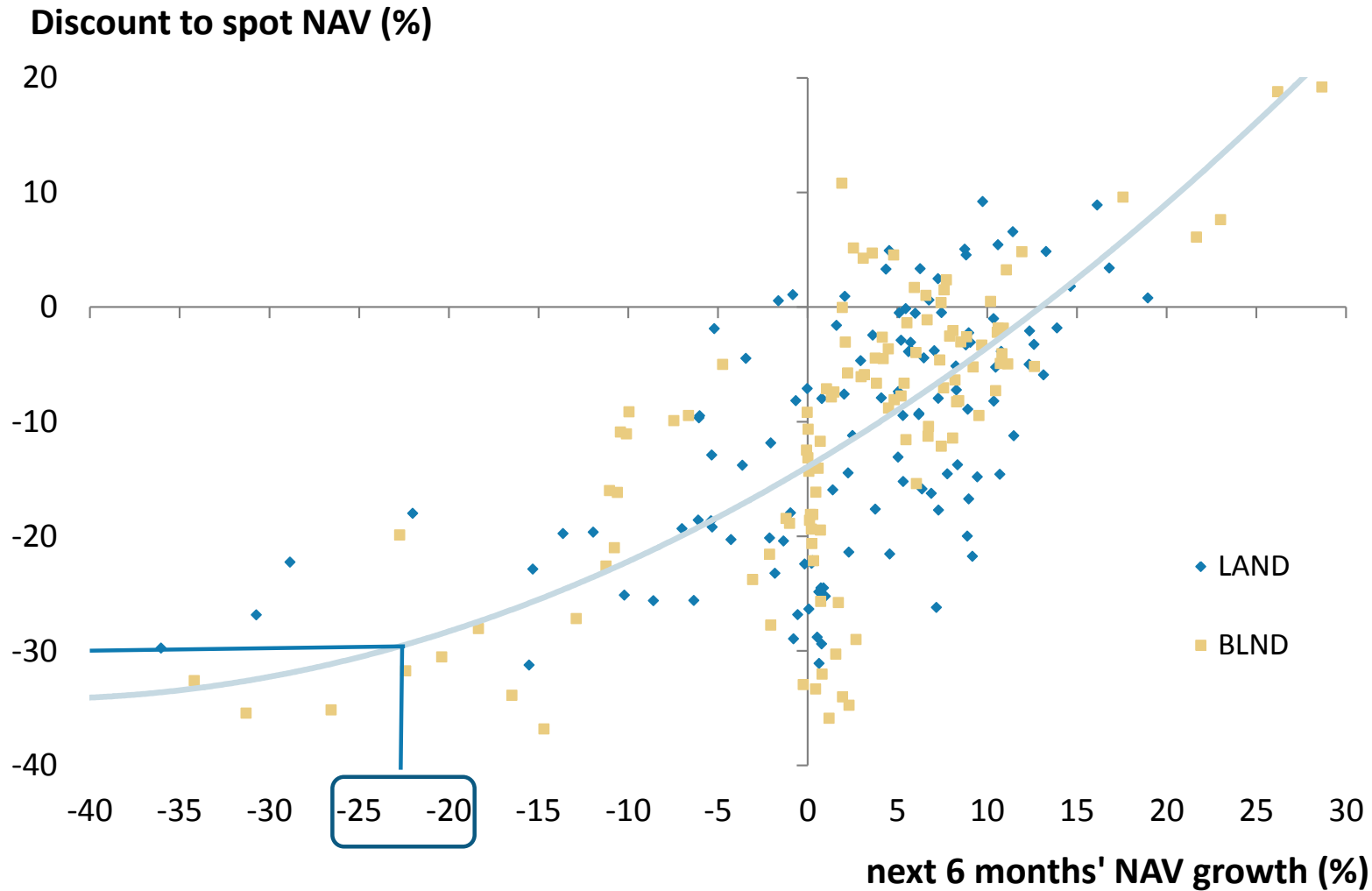
## 2. What about 2018? Retail: Household discretionary income



Source: ASDA, Morgan Stanley Research

### 3. Property stocks

## UK NAV valuations consistent with a steep near-term drop in NAVs/capital values

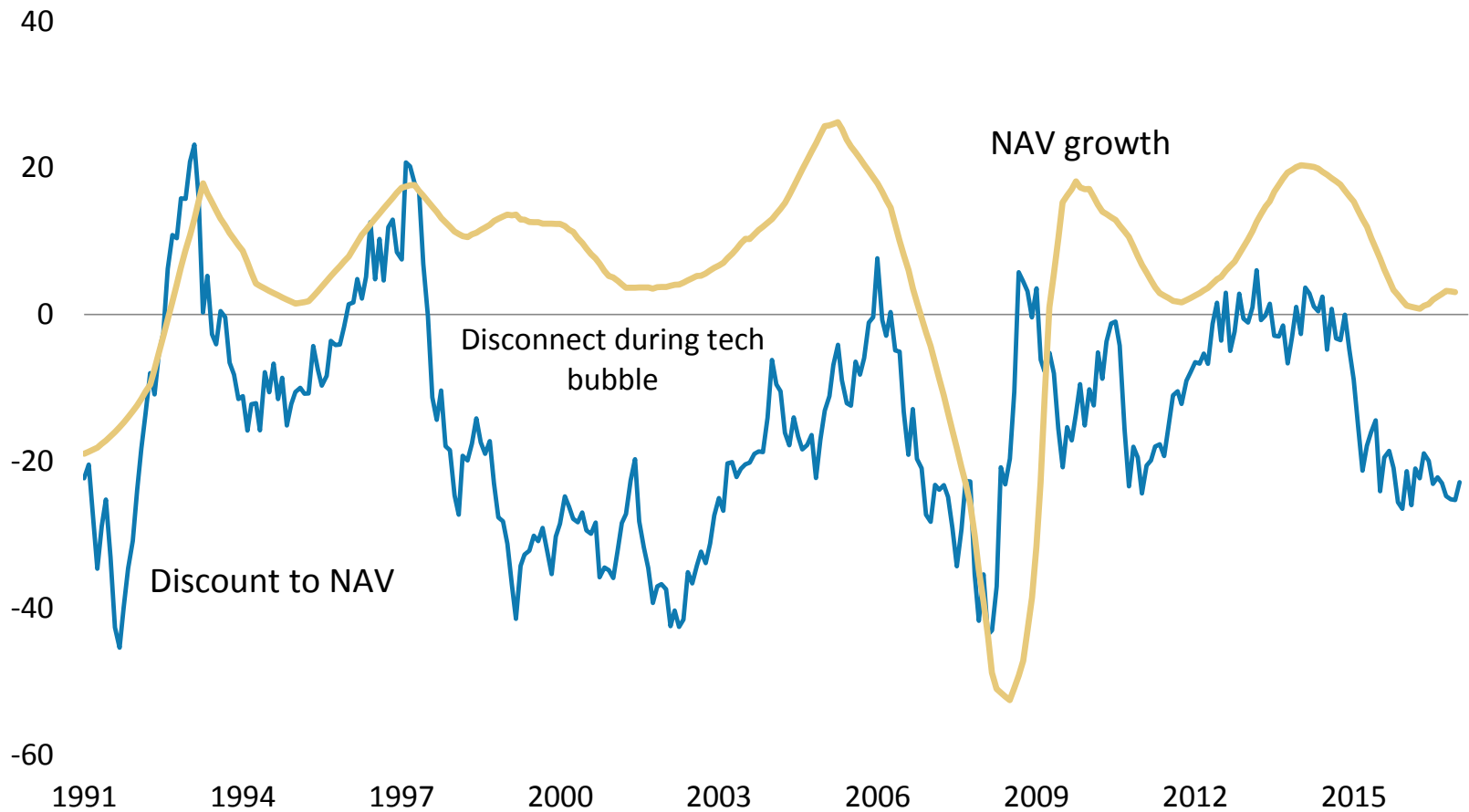


Source: Company Data, Datastream, IPD, Morgan Stanley Research

### 3. Property stocks

## Flattish NAV growth at best does not bode well

### NAV valuation and NAV growth (%), UK

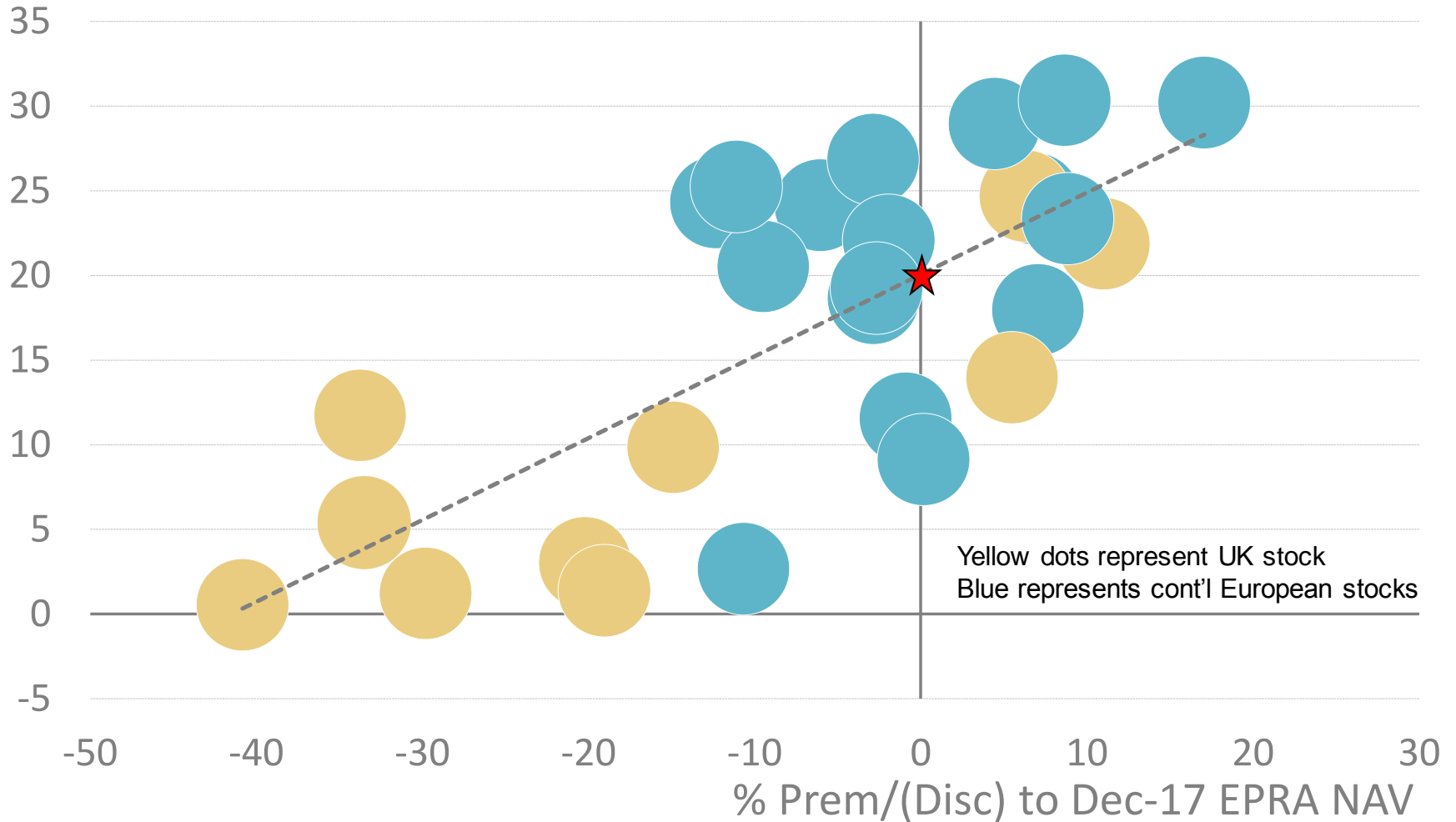


Source: Company Data, Datastream, IPD, Morgan Stanley Research

### 3. Property stocks

## Flattish NAV growth at best does not bode well from an ROE perspective

Total return (NAV growth+divi return,%) +2Y at Dec-17



Source: Company Data, Datastream, Morgan Stanley Research

## 4. So how are we positioned for 2018?

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For quite a while now, most of our Overweights have been away from the UK, with a focus on

- German residential
- Spain
- Logistics

In the UK our preference goes out to Segro, yet again



## Panel discussion

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Brian Bickell, Shaftesbury

Chris Grigg, British Land

Helen Gordon, Grainger

James Wilkinson, BlackRock

Toby Courtauld, Great Portland Estates

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MSC)	
	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MSC
Overweight/Buy	1142	36%	320	40%	28%	560	38%
Equal-weight/Hold	1424	44%	371	47%	26%	674	46%
Not-Rated/Hold	55	2%	6	1%	11%	9	1%
Underweight/Sell	583	18%	95	12%	16%	237	16%
<b>Total</b>	<b>3204</b>		<b>792</b>			<b>1480</b>	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding of f of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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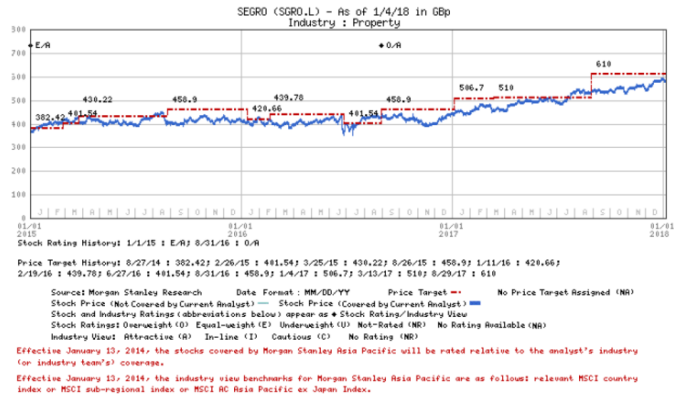
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## Disclosure Section

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### Valuation methodology and risks

**SGRO.L / Share price at last close (4/1/2018): 579p**

Valuation methodology for our Segro PT of 610p. We set our price target based on a NAV valuation. We start from an average or 'base discount' level, which is the level we think REITs trade on across the cycle. While we do not have a long-term data series for UK REITs (this tax structure was only introduced in 2007), we use Dutch REITs as a proxy. Over the last 20 years Dutch REITs have on average traded at around a 5% NAV discount. We narrow this by 5pp to reflect the fact the fundamentals for the logistic property market are strong. On a stock-specific basis, we adjust the base discount up by 4pp for Segro's development exposure. As such, we set our price target at a 4% premium to our estimated 2018 NAV, which gives us our 610p (rounded) target.

Risks to achieving price target. We think a key upside risk is a further squeeze in logistics rents as a significantly greater than expected demand more than offsets supply levels, driving returns that are materially better than consensus assumes. Demand for logistics and industrial space is very much linked to economic growth; any major macro shock could undermine this and would therefore impact the shares' performance.



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