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Colliers International forecasts total commercial property returns to slow to a cyclical low of 1.2% in 2019. Income return (4.8%) becomes the only source of growth, as capital growth turns negative (-3.5%, 0.1% residual). This is down from 6.0% in 2018 and 10.2% in 2017. However, we expect total returns growth to recover in 2020 and to remain in mid-single digits over the forecast horizon. The trend of softening yields that has emerged towards the end of 2018 will continue and we expect all property equivalent yields to move out by 19bps this year. They will continue to soften until 2022, although by 2020, stabilisation may begin in several sectors.

The retail sector will continue to struggle in 2019 and we anticipate total returns to fall from negative 0.5% in 2018 to negative 4.0% in 2019. Positive income returns contrast with negative capital growth, with values expected to decline by 9.2%. This is stronger than the 5.2% drop in capital values in 2018. Standard Retail in Rest of UK and Shopping Centres will perform particularly poorly, with negative total returns of 7.4% and 6.3% respectively. Supermarkets are holding up better with predicted total returns growth of 3.6% (-1.6% capital growth, 5.3% income return and 0.1% residual). Brexit uncertainty, the rise of e-commerce, business rates and the National Living Wage are all negatively impacting the sector. We expect a substantial softening of yields across all retail segments.

Despite remaining the standout performer, the main downward pressure on total returns growth comes from the cooling industrial sector. We believe that the double-digit growth we’ve seen over the past few years will come to an end in 2019, with total returns forecast to increase by 7.3%, comprising 2.6% capital growth and 4.5% income returns (0.2% residual). Over the five-year forecast horizon, Colliers predict annual growth of all-industrial total returns to average 6.4%, as demand for ‘last mile’ delivery units and larger distribution centres as well as increasing interest from retailers will continue to drive growth. Equivalent yields will move out only slightly, with some parts of the market, such as London standard industrial seeing very little yield movement.

Offices will also record positive total returns growth of 2.0% in 2019, comprising -2.0% capital growth and 4.1% income return (0.1% residual), down from 6.0% in 2018. Rest of UK and City of London will see the strongest returns (5.3% and 4.1%, respectively) while a number of markets will experience negative returns. Midtown and West End are predicted to see negative returns of 0.5% in 2019, before returning to positive growth in 2020. Equivalent yields in City of London will see very little if any yield movement this year as demand for trophy and other prime assets remains strong, while supply remains limited. Over the five-year period until 2023, all office total returns will grow at 4.7% per annum.

### ALL PROPERTY FORECASTS

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Source: Colliers International, MSCI / IPD
TOTAL RETURN BY SECTOR

TOTAL RETURN 2019 - 2023 %pa

Source: Colliers International

ERV GROWTH 2019 - 2023 %pa

Source: Colliers International
ECONOMIC OUTLOOK

It was not much of a surprise when the Office for National Statistics reported that economic growth slowed in 2018. GDP expanded by 1.4% y/y, down from 1.8% y/y in 2017, but broadly consistent with independent forecasts. The rate of growth was the lowest since 2012. By sector, services remained the driving force, with the sector experiencing growth of 1.7% y/y. The industrial sector performed relatively poorly, with output rising just 0.7% y/y, down from 1.8% y/y in the previous year and construction activity saw the most significant slowdown, with growth slowing from 7.1% y/y in 2017 to 0.7% y/y. The outlook for 2019 and beyond remains uncertain, but the Bank of England recently lowered their growth estimate for this year from 1.7% to 1.2% which would represent the weakest expansion since the global financial crisis. Capital Economics are slightly more optimistic and predict growth of 1.5% for 2019, before accelerating to 2.2% in 2020.

There are now clear signs that Brexit is having an impact on the UK economy. Business investment has fallen for four consecutive quarters, the longest spell of continuous decline since the global financial crisis, although the scale of the drop is much smaller than it was in 2008/09. Moreover, the ONS reported that there was a slight increase in inventories being held by UK companies which anecdotal evidence from business surveys links to stockpiling.

Data available for 2019 paint a mixed picture of the health of the UK economy. The PMI surveys suggest that the economy came to a standstill in January, with the all-sector PMI dropping to 50.3. With the exception of July 2016 (the month after the EU referendum), the January figure was the lowest since 2012. The business sentiment component of the data remained subdued and at one of the lowest levels since its inception in 2012. The Q1 2019 ICAEW Business Confidence Monitor painted a similar picture, with the headline figure falling to its lowest level for nearly a decade.

The Bank of England raised the Bank Rate from 0.5% to 0.75% at the beginning of August, but has stayed on hold since. The rate rise did little to boost sterling and the GBP/USD exchange rate has been relatively stable in recent months, moving between 1.25 and 1.33. That said, Oxford Economics expect sterling to strengthen to 1.39 per USD by the end of 2019 and to 1.47 per USD by the end of 2020. Annual CPI has slowed from 3.0% in January 2018 to 1.8% in January 2019, falling below the Bank of England’s 2% target for the first time in two years. Over the same period, RPI inflation slowed from 4.0% to 2.5%. With low unemployment finally feeding through to nominal earnings growth, real wages continue to increase, which in theory, should support consumer spending. Yields on UK 10-year gilts stood at 1.31 at the time of report writing. This is down from 1.33 at the end of 2018 and well below the 2018 high of 1.70 (achieved on 10 October 2018).

Latest public borrowing figures show that the government ran a surplus of £14.9bn in January, the best January figure since records began in 1993. In the April 2018 – January 2019 period, borrowing was £21.2bn, a staggering £18.5bn less than in the previous year. The better than expected borrowing figures should give Chancellor Philip Hammond some headroom for fiscal stimulus to support economic growth, should he need to.
INVESTMENT MARKET

Investment volumes broke through the £60bn mark for the fourth time in the past five years in 2018, highlighting ongoing appetite for UK commercial real estate. At £62.1bn, transaction activity was down only slightly from 2017’s £65.6bn and was well above the 10-year average of £49.8bn. This was helped by revised December figures showing the strongest end to a year since 2014, with investment volumes reaching £8.5bn. Offices remained in high demand in 2018, with overall investment volumes of £23.5bn making it the most sought after sector. Meanwhile, transaction activity in the alternatives/mixed use sector reached a record high of £17.9bn, up almost 10% from 2017 levels and demand for industrial assets also remained healthy. However, retail investment volumes slowed to just £5.8bn in 2018, down more than 30% from 2017 and the lowest annual figure since 2000.

The two largest deals of 2018 were mixed use schemes, led by the Battersea Power Station deal in which two Malaysian investors finalised a delayed deal worth £1.58bn. The asset includes Apple’s new London Campus as well as around 100 retail/food units. The second-largest deal of the year was Blackstone Real Estate and Telereal Trillium’s £1.46bn purchase of the Arches Portfolio which includes around 5,200 properties. A number of large trophy asset deals took place in the office sector, namely NPS of Korea’s £1.2bn purchase of Plumtree Court, EC4 at 4.1% IY and CK Asset Holdings Ltd bought 5 Broadgate for £1bn at 3.95% IY. Other notable large deals outside the traditional sectors include Oxford Properties Europe’s acquisition of a 39% stake in 2,000 PRS-units + 4,400 PRS pipeline across London, Glasgow and Leeds for £600m and Brookfield Asset Management’s £520m purchase of the Enigma portfolio, comprising 5,407-student beds across 15 buildings. A total of 2,840 deals was recorded by PropertyData (2,961 in 2017), with the top 10 transactions accounting for around 15% of all investment.

Overseas buyers continued to invest in UK commercial property and accounted for 44% of all transaction activity. Cross border investment topped the £20bn mark for the sixth consecutive year, with particular strong interest from Far Eastern investors (£10.7bn). That said, European capital accounted for transaction volumes of £6.0bn, in line with the 2017 figure and above the 10-year average of £4.7bn. US investors continued to reduce their exposure to UK commercial property and were the main net sellers in 2018 (-£5.9bn) while Far Eastern investors remained a main net buyer (£6.2bn). UK institutions increased their exposure to UK commercial real estate, with a net investment position of +£2.3bn, following two years of net investment declines. Private property companies were also main net sellers in 2018.

However, 2019 was off to a subdued start. At the time of report writing, preliminary January and February transaction volumes stood at just £4bn. Although this is likely to rise to around £5bn as more data comes in, the figure is down significantly from £8.1bn in January/February 2018. Should an EU withdrawal agreement be concluded in the first half of 2019, then we expect a noticeable improvement.

All property equivalent yields hardened during the first half of 2018, but have levelled off at 5.45% as per Q4 2018. Nonetheless, they were 12bps lower than in Q4 2017. Industrial recorded the steepest drops in yields (39bps), followed by offices (19bps). However, retail equivalent yields have started to soften, reaching 5.66% at the end of 2018. This is an increase of 13bps since the end of 2017. The only exception to this were standard shops in London, where yields hardened slightly by 6bps between Q4 2017 and Q4 2018.
INVESTMENT VOLUMES (£ BILLIONS)

Source: Property Data Ltd

SELECTED RATES

Source: Colliers International, IPD, Haver Analytics and Oxford Economics

TOTAL TRADING VOLUMES IN 2018 (£BN)

Source: Property Data
RETAIL

STANDARD SHOPS

With structural changes and subdued consumer confidence denting interest in the retail sector, it was no surprise that unit shops investment volumes slowed from £3.6bn in 2017 to £2.5bn in 2018, a 32% decline and the lowest annual figure in 15 years. Most of the drop was attributed to weaker interest in shops outside of London as the capital attracted £759m, up 11% since 2017, but below the 10-year average of just over £1bn. Four of the five largest 2018 deals were traded in London, led by the £180m purchase of 135-137 Bond Street by a Singaporean investor (3% IY). Outside the capital, Sports Direct bought Glasgow’s House of Fraser building on Buchanan Street for £95m at 4.2% IY, vowing to create the “Harrods of the North” and also acquired a 90,000 sq ft building in Newcastle for £32m.

Retail sales performed surprisingly well at the start of 2019, with the ONS reporting a 4.2% y/y increase in January – the largest annual rise since December 2016. It was particularly encouraging for the high street that clothing sales increased 5.5% y/y, although much of this was attributed to discounting, as prices fell 0.9% y/y. While this helped retailers to boost sales, it means that profit margins continued to be squeezed and it is therefore unlikely that this solid growth will be maintained. The KPMG retail sales monitor also pointed to a positive start to 2019, but, similar to the ONS, noted that the colder weather and continual discounting drove up fashion sales. Nonetheless, it looks as if consumers are more resilient to Brexit uncertainty than many had feared. A healthy labour market, sustained wage growth and slowing inflation should support household spending, and there is scope for growth to gather momentum once there is more clarity on the Brexit negotiations.

Rents are falling across the board, with the exception of Central London, where marginal growth of 0.2% y/y was maintained in Q4 2018. However, this is down from 2.8% y/y in Q3 and the weakest performance since 2010. Standard shops in “Rest of UK” recorded a particularly steep decline in rents (-3.5% y/y), according to the latest MSCI quarterly index.

Rents are predicted to decline across all segments in 2019, with Rest of UK predicted to see the steepest drop (-7.0%), followed by Rest of South East (-4.0%). Although Central London will hold up somewhat better, it is almost certain that rents will fall here too. The decline is forecast to be of a much smaller magnitude though (-1.0%). With consumer confidence remaining muted, landlords becoming more flexible on rents and continued Brexit uncertainty, the occupier outlook for 2019 remains very cautious and it is generally believed that the market will continue to become more challenging. According to the Centre for Retail Research, 43 retailers have gone bust in 2018, affecting over 2,500 stores and more CVAs are expected in 2019 which is likely to negatively impact rental growth.

RETAIL FORECAST SUMMARY

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SHOPPING CENTRES

Shopping centre transactions weakened significantly in 2018. At £1.3bn, annual investment into the sector was at its lowest level on record, down by a third from 2017 and 60% below the 10-year average. Only 11 shopping centre deals were recorded in the H2 2018, down from 23 in an already weak first half of the year. Overseas investors continued to reduce their exposure to shopping centres, with net investment volumes standing at -£76m. Meanwhile, private property companies (+£125m) and occupiers (+£177m) were net buyers in 2018. Three +£100m deals were recorded in 2018, led by Motocomb Estates’ £297m purchase of Burlington Arcade SC (3.2% IY) and Norinchukin Bank and M&G Real Estate’s purchase of Leicester’s Highcross Shopping Centre for £236m at 5.5% IY. Moreover, DTZ Investors’ acquired Shopstop SC at Clapham Junction (£130m at 3.25% IY).

Shopping centres are currently seeing the steepest decline in rents since the aftermath of the global financial crisis. Rents were down by 2.6% y/y in Q4 2018, according to MSCI, and there is little hope that this trend will reverse in the near future. Capital value growth is firmly in negative territory, falling some 9.5% y/y in Q4 2018. Shopping centres have lost around 30% in value over the past two years and changing consumer behaviour, rising cost pressures and increased online sales will continue to change the retail landscape. In its annual report, shopping centre landlord Intu reported a £1.4bn (equal to 13.3%) write down on the value of its properties in 2018.

Shopping centre rents will continue to fall in 2019, and Colliers predict the rate of decline to accelerate from -2.6% in 2018 to -6.0%. The average rate until 2023 is negative at -2.4% pa. Equivalent yields are predicted to soften by 53bps this year as a general repricing occurs.

Source: Colliers International, MSCI / IPD
RETAIL WAREHOUSES
Investment volumes in the retail warehouse sector also weakened in 2018, but held up somewhat better than standard shops and shopping centres. Transaction activity reached £2bn, down from £2.7bn in 2017, but above the £2bn mark for the sixth year running. Much of the weaker 2018 figure can be attributed to a very slow end to the year, as volumes fell to just £283m in Q4, versus an average of £577m over the first three quarters. South Korean investors bought the Gallagher Shopping Park in Wednesbury for £175m, representing the biggest retail warehouse deal of the year and M&G Real Estate purchased two sites in Birmingham and Edinburgh at a combined value of £261m (5.0% IY and 5.38% IY, respectively). With convenience being one of the main points of competition for online retailers and internet services such as ‘next day delivery’ there will likely be greater demand for smaller urban warehouses which are an integral part of the ‘last mile’ delivery process.

Yields for warehouses were generally in the 5%-7% range, although some sub-5% deals for smaller schemes were also recorded, such as Knight Frank’s acquisitions of an £11m asset in Tunbridge Wells and a £9.5m property in Watford. Both assets were traded at 4.7% IY. Network Rail bought a standalone retail warehouse unit in Clapham Junction for £12m at 3.5% IY.

Retail warehouses, in line with the trend in the wider retail sector, will see rents decline over the next few years. Colliers expect negative growth of -5.0% and -3.0% in 2019 and 2020, respectively, before easing slightly. Capital growth will remain negative until 2021, at which point a slight recovery is expected.

SUPERMARKETS
Annual supermarket investment volumes failed to reach £1bn in 2018 for the first time since 2006. At £833m, transaction activity was down by 27% from the £1bn recorded in 2017 and almost 50% below the 10-year annual average. Tesco bought a total of four supermarkets last year, amounting to a combined investment value of £146. The largest supermarket deal of 2018 was take place in Cirencester in September, when Tesco bought a £57m asset at 5.2% IY. Other notable deals include Supermarket REIT’s purchases of a Tesco Extra in Scunthorpe for £53m at 5.1% IY and a Morrisons in Sheffield for £52m at 4.9% IY.

Food store sales returned to the strong growth experienced in the summer months, rising 3.2% in January 2019. This is attributed to price discounting. Indeed, food price inflation has slowed recently and stood at just 0.5% y/y in January. This is down significantly from 4.0% y/y in January 2018. While lower prices generally result in higher sales, it may also mean shrinking margins.

Supermarket rental growth remained negative in Q4 2018. Rents have now fallen for 15 consecutive quarters and, at -1.7% y/y, the rate of decline was the strongest in a year-and-a-half. Physical stores face increasing competition from online supermarkets such as Ocado and, despite plateauing in recent months, online sales now account for 5.4% of all food sales in the UK, up from 3.5% five years, according to the ONS.

A recent YouGov study, co-ordinated by Colliers, indicated a clear preference for online grocery shopping amongst the under 35’s – in particular with Amazon. The study found that over 50% of 18-34 year olds found the idea of grocery shopping with their Amazon Prime account an attractive proposition, outlining the pressing need at the major grocers to improve profitability in this channel.

2019 will be an interesting year for supermarkets, with Sainsbury’s takeover of Asda currently facing some headwinds, after the Competition and Markets Authority raised concerns.

Supermarket rents are forecast to remain under pressure in 2019, having already suffered a decline of -1.7% in 2018. By year end, rents will have fallen by 2.0% and over the 2019-2023 period, Colliers expect rental growth to average -1.2% pa. Yields will remain stable at 4.85%, while capital values will move into negative territory in 2019. Total supermarket returns will reach 4.5% per annum through 2022, modest by historical standards, but better than any other retail segment.
RETAIL INSOLVENCIES

HIGH STREET VACANCY RATES (NATIONAL VS LONDON)

UK RETAIL SALES, 3M/3M CHANGE

AVERAGE RETAIL RENTAL GROWTH (2019-23)
OFFICES

CENTRAL LONDON

Strong interest in the Central London office market was sustained in 2018, with investment volumes breaking through the £14bn mark for the second year running. Although down slightly from 2017’s £14.6bn, transaction activity was comfortably above the 10-year average of £12.5bn. The number of transactions went up marginally with a total of 168 deals recorded in 2018 (versus 160 in 2017). Overseas capital accounted for around three quarters of all transaction volumes, with particular strong interest from Far Eastern investors, who accounted for the top three deals last year. The largest transaction was NPS’s (Korea) purchase of an 840,000 sq ft building at 40 Shoe Lane for £1.2bn. The building is currently under development and will be taken by Goldman Sachs on a 25-year lease with a break option after 20 years. The only other £1bn+ deal was CK Asset Holdings Ltd acquisition of 5 Broadgate (£1.0bn at 3.95% IY), with Ho Bee Land Limited’s purchase of Ropemaker Place for £650m at 4.62% IY completing the top three.

Despite the spectre of Brexit uncertainty, the London office market confounded expectations in 2018 with transaction levels rising 10% y-on-y. The key trend has been a surge in second-hand take-up, influenced by a now unprecedented shortage of new/refurbished accommodation. While all offices availability continued to fall, the incidence of flexible offices product is on the rise. Annual take-up by flexible providers reached 1.9 million sq ft, although this is down on the 2017 total of 2.3 million sq ft.

Of course, there may be some negative effects on the UK, London and London’s office market in the event of a no-deal Brexit, but the government has said that it would reduce the tax and regulatory burden on businesses in order to attract investment. Moreover, the number of people in work in London rose to a new record high in 2018 and the capital added over 200,000 jobs since the EU referendum. The information & communication sector was one of the most active sectors, hiring some 70,000 people between June 2016 and September 2018 (latest available data). The figures highlight how London’s economy is diversifying, with sectors outside of finance growing in importance. Attracting and retaining the best staff remains a main challenge for businesses and this may explain growing importance of offering a high quality work environment.

Anecdotal evidence suggests that investors remain cautious in anticipation of Brexit and that they are prepared to be patient, focusing on well let assets with minimal capital expenditure. Although there is still appetite in the Central London office market and any Brexit bounce could support the sector, a combination of cyclical and Brexit related effects will push Central London rents into negative territory in 2019 (-1.0%) and 2020 (-0.4%). Positive Central London office rental growth is then forecast to return in 2021 and to average 0.6% pa over the forecast horizon.
## CENTRAL LONDON VACANCY RATES

![Graph showing vacancy rates for different types of office spaces in Central London from Q4 2013 to Q4 2018.]

- **City Second Hand**
- **West End Second Hand**
- **City Grade A**
- **West End Grade A**

### INVESTOR TYPES’ SHARE OF ALL CENTRAL LONDON OFFICE INVESTMENT

- **2018**
- **10 year average**

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**Source:** Property Data

## OFFICE FORECAST SUMMARY

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**Source:** Colliers International, MSCI / IPD
OFFICES

SOUTH EASTERN OFFICES

Investment volumes in the South East office sector slowed from a record £2.8bn in 2017 to £1.6bn in 2018, but above the 10-year average of £1.5bn, according to PropertyData. By far the largest deal in 2018 was Spelthorne Borough Council’s £285m purchase of a portfolio across Reading, Uxbridge and Slough, including tenants such as HSBC, Orange and the Make-A-Wish Foundation. Elsewhere, a JV led by Valesco Group acquired a three-building campus in Reading’s Thames Valley Park for £100m at 6.6% IY and Runnymede Borough Council bought a business park in Staines for £81m. Councils and other occupiers accounted for almost half of all transaction activity in 2018, while the overseas share fell from 57% in 2017 to just 13% last year – the lowest figure in eight years.

Last year was off to a slow start in terms of leasing demand, but the year ended on an unexpected high, with annual take-up 37% higher than in 2017 and 10% above the five-year annual average. Despite some occupiers moving from business parks into town centres, business park take-up across the South East was greater than in-town take-up in 2018 at 1.9 million sq ft. The key attraction for occupiers to business parks is the parking and privacy that they provide. Growth in flexible office take-up continued to strengthen during 2018, totalling 570,000 sq ft for the year. Supply dynamics will keep rents strong in the South East. Key centres that have seen strong rental growth include Windsor with 22% annual growth, as well as Ealing and Brighton both seeing 14% annual growth. With only a limited development and supply pipeline, rents will remain under pressure and therefore, Colliers expect rental growth of 1.0% in 2019 and 1.5% in 2020. The five-year annualised growth rate is anticipated to reach 1.7% in 2019-2023. Coupled with steady investment demand, yields will drift out only slowly, hence total returns will average 5.4% per annum over the forecast period, placing South East offices in the stronger tier of performance.

REST OF UK OFFICES

Notable deals outside London and the South East include Legal & General’s £125m purchase of Liverpool’s India Buildings. The grade II-listed landmark is currently undergoing significant redevelopment and HMRC have announced that they will move around 3,500 staff into 270,000 sq ft of pre-let space. Elsewhere, Lime Property Fund acquired New Bailey Square in Salford for £113m. The building is pre-let to Salford City Council on a 25-year lease. Occupier demand will remain strong, especially in the CBD’s. Amazon, for example, announced last October the opening of a new office (90,000 sq ft) in Manchester’s Hanover Building, which will accommodate at least 600 staff. Also in Manchester, Booking.com took 232,000 sq ft in the new St John’s Quarter. Elsewhere, Barclays is planning to create up to 2,500 new jobs at Glasgow’s Buchanan Wharf campus and Channel 4 has chosen Leeds for its regional headquarters. A limited development pipeline and sustained demand for Grade A offices continue to exert upward pressure on rents. Colliers predict Rest of UK office rents to increase by 1.5% in 2019 and by 2.0% 2020 before accelerating slightly. Like South East offices, the Rest of the UK will be among the stronger tier of performance with total returns forecast to average 5.4% per annum through 2023.
### ANNUAL OFFICE RENTAL GROWTH FORECASTS

**2019**
- Rest of UK: 1.50%
- South East: 1.00%
- West End: 1.00%
- City of London: 0.50%

**2019-23**
- Rest of UK: 2.20%
- South East: 1.70%
- West End: -0.50%
- City of London: -1.00%

Source: Colliers International

### INCREASE IN £ PER SQ FT BETWEEN 2012 AND 2018

- Bristol: 30%
- Manchester: 25%
- Birmingham: 20%
- Edinburgh: 15%
- Leeds: 10%
- Glasgow: 5%

Source: Colliers International

### PRIME RENTS ACROSS ‘BIG SIX’ IN £PSF

- Manchester
- Birmingham
- Edinburgh
- Bristol
- Glasgow
- Leeds
INDUSTRIAL

STANDARD INDUSTRIAL AND DISTRIBUTION WAREHOUSES

UK manufacturers faced the strongest quarterly decline in output in six years at the end of 2018, dragged down by slowing demand for new cars and the resulting reduction in activity at car factories. The ONS release highlighted a widespread weakness across the manufacturing sector, with ten of the 13 sub-sectors recording lower output. PMI data meanwhile suggest that the worst may not yet be over. The PMI dropped from December’s 54.2 to 52.8 in January, with the survey’s output component suggesting that manufacturing production fell further at the start of 2019. Business optimism measures also took a hit and were, with the exception of the drop in sentiment after the EU referendum, the lowest since 2012. Meanwhile, the data highlighted that companies are stockpiling at a record pace, as they sought to safeguard against potential disruptions caused by Brexit.

Despite the ongoing political and economic uncertainty generated by Brexit, occupational demand in 2018 surprised on the upside with take-up for larger and better quality units driving activity nationally. Following on from the above-average performance witnessed in 2017 and strong 2018 figures, latest data shows that circa 8.7 million sq ft of speculatively developed space (100,000+ sq ft) was under construction by end-January 2019. This indicates that 2019’s total completed warehouse space could potentially surpass this cycle’s previous record of circa 9.0 million sq ft witnessed in 2016.

The vacancy rate for distribution warehouses stood at 3.8% in Q4 2018 (down from 5.3% in Q4 2017), which according to the MSCI/IPD quarterly index, is among the lowest recorded in three years and further highlights an imbalance of supply and demand. This imbalance, paired with alternative use redevelopment pressures has caused upward pressure on rents and Colliers believes that this trend will continue throughout 2019 and thereby support rental growth.

Despite these strong supports, rental growth is forecast to moderate in 2019 to a 3.2% pa rate by year end and to slow further over the forecast horizon. In the five years to 2023, annualised rental growth will average 2.9%. London is expected to be the standout performer once again, driven by strong demand for ‘last mile’ delivery units, with annualised rental growth of 3.8% pa over the forecast horizon, followed by Rest of South East at 3.1%, Distribution Warehouses at 2.7% and the Rest of the UK at 2.1%.

Given these rental projections, it is not surprising that investment demand for industrial remains very strong. Yields hardened across all regions in 2018 and Colliers predict very little movement in yields this year, before drifting out slightly over the forecast horizon. Total returns for 2019 are forecast at 7.3%, down from a very strong 17.8% in 2018. Industrial remains the standout performer by most measures. Total returns annualised through 2023 will average 6.4%.
INDUSTRIAL ANNUAL RENTAL GROWTH FORECASTS

Source: Colliers International, MSCI, IPD

PURCHASING MANAGER INDICES

Source: IHS Markit

INDUSTRIAL & LOGISTICS FORECAST SUMMARY

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<tr>
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<th>DEC 2019</th>
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<th>DEC 2021</th>
<th>2019 - 2023</th>
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<tbody>
<tr>
<td>ERV Growth (% p.a.)</td>
<td>3.2</td>
<td>3.2</td>
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<td>Equivalent Yield (% eop)</td>
<td>5.3</td>
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<td>5.3 (2023)</td>
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<td>Capital Growth (% p.a.)</td>
<td>2.6</td>
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<td>Total Return (% p.a.)</td>
<td>7.3</td>
<td>6.8</td>
<td>5.1</td>
<td>6.4</td>
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Source: Colliers International, MSCI
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