

**GVA**

# The Evolution of Long-term Income

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Traditional to Alternative



An **APLEONA** company

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# Introduction

Investor demand continues to grow for long-term stable cash flows on premises that are critical to a tenant's business. Income streams with fixed or indexed linked leases provide an excellent hedge against inflation in a low rental growth environment and their demand has noticeably increased as a result of the Brexit turmoil.

Historically the majority of long lease property was found in the more traditional property sectors and included HQ office buildings, supermarkets and distribution facilities. In recent years however, there has been a shift towards alternatives such as student housing, healthcare and budget hotels in line with an increasing weight of money targeting core assets.

Insurance companies have also been actively seeking income strips as a way of liability matching through the acquisition of inflation-linked cash flows. These are typically 30 to 50 year leases with zero reversion. To date these have predominantly been forward funding transactions.

At GVA we are experienced in advising investors and property companies on the acquisition and disposal of property, including strategic advice, securing funding, cash flow modelling, income strips and sale and leaseback creation.

We have specialist occupational teams with excellent knowledge operating in each of the sub markets and we are therefore in a unique position to provide a joined up approach and first class advice to our clients.



**Mark Beaumont**

Senior Director & National  
Head of Investment

## Key Investment Transactions

Address	Tenant	Unexpired Term	Review	Price	Yield	Date
<b>Distribution</b>						
Logistics North, Bolton	Amazon	14.75	5 yearly (CPI)	£44,500,000	4.30%	U/O
Central Park, Avonmouth	DHL	20	5 yearly (Fixed/ OMV)	£28,120,000	4.37%	Jun-17
Capacity, Dartford	TNT	20	5 yearly (RPI/ OMV)	£33,850,000	4.48%	Jun-16
Airport City, Manchester	Amazon	15	5 yearly (CPI)	£34,780,000	4.44%	Jun-16
<b>Supermarket</b>						
FiftySevenEast, Dalston, London	M&S	20	5 yearly (RPI)	£8,750,000	4.25%	Exchanged
Gorse Covert Centre, Loughbrough	Morrisons	25	5 yearly (RPI)	£32,500,000	4.25%	May-17
Southam Road, Banbury	Waitrose	20	5 yearly (Fixed)	£14,150,000	4.50%	Jul-16
Military Road, Hythe	Sainsbury's	22	Annual (RPI)	£26,400,000	4.75%	Oct-16
<b>Hotel</b>						
Travelodge Southwark, London	Travelodge	28	5 yearly (RPI)	£54,700,000	3.35%	Aug-17
Farringdon Premier Inn, London	Whitbread	25	5 yearly (CPI)	£102,860,000	3.92%	Dec-16
King's Cross HUB by Premier Inn, London	Whitbread	25	5 yearly (CPI)	£84,500,000	3.96%	Jul-16
King's Cross Travelodge, London	Travelodge	30	5 yearly (RPI)	£70,300,000	4.20%	Jun-16
<b>Leased Student Accommodation</b>						
179 High Street, Lincoln	University of Lincoln	20	Annual (RPI)	£22,100,000 (Q)	4.55% (Q)	Available
206 -214 High Street, Stratford, London	Queen Mary University (Noms)	25	Annual (RPI)	£63,000,000	4.15%	Sep-16
East Side Locks, Birmingham	Birmingham City University (Noms)	16	Annual (RPI)	£43,600,000	5.40%	Apr-15
<b>Care Homes</b>						
Moor Place, Esher	Anchor Trust	29	Annual (RPI)	£18,300,000	3.50%	Jul-17
Maternity Ward, Queen Mary's Hospital, Sidcup	Care UK	30	Annual (RPI)	£17,300,000	4.50%	Jul-17
The Lakes Care Centre, South Cerney	The Orders of St John Care Trust	40	Annual (CPI)	£11,400,000	4.50%	Nov-16
Horfield Lodge Care Home, Bristol	Methodist Homes	31	RPI	£15,300,000	4.50%	Apr-16
<b>Hospitals</b>						
Woodlands Hospital, Darlington	BMI Healthcare	17	3 yearly (RPI)	£22,100,000 (Q)	5.50% (Q)	Withdrawn
Acklam Hall, Middlesbrough	Ramsay Health Care	25	3 yearly (RPI)	£17,190,000	4.65%	Nov-16
New Hall Hospital, Salisbury	Ramsay Health Care	22	Annual (Fixed)	£49,800,000	5.32%	Apr-15
<b>Income Strip</b>						
Mount Pleasant Halls, Cambridge	St Edmund's College	47	Annual (RPI)	£71,500,000	2.30%	Jul-17
Rochdale Riverside, Rochdale	Rochdale Borough Council	35	Annual (RPI)	£100,000,000	2.60%	Jun-17
Wightlink Ferry Terminal, Portsmouth	Wightlink Limited	41	Annual (RPI)	£73,000,000	2.65%	Dec-16
Multi-Storey Car Park, Southampton	University Hospital Southampton	40	Annual (RPI)	£29,300,000	2.91%	Feb-16

# Distribution

Take-up of modern distribution units over 100,000 sq ft was 25% above the five year average in 2016 with continued confidence in the sector ensuring occupiers remain committed to signing long leases.

### Market Drivers

- Continued growth of e-commerce with large scale distribution hubs and last mile delivery
- High occupier take-up
- Retailers' increasing desire to improve supply chains
- Shortage of land, particularly in the South East
- Strong rental growth prospects across the UK
- Relatively low obsolescence

### Challenges/ Investor Considerations

- Supply chains will be affected by fluctuations in the exchange rate
- Potential tariffs imposed on EU sourced materials
- Improved racking heights leading to demand for super high bay warehousing

Once dominated by UK institutional investors, the sector has attracted a variety of other buyers including high net worth individuals from both the UK and overseas, local authorities and bespoke distribution investment funds, all of whom are looking to benefit from the strong market fundamentals.

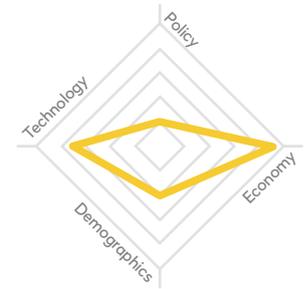
## E-Commerce



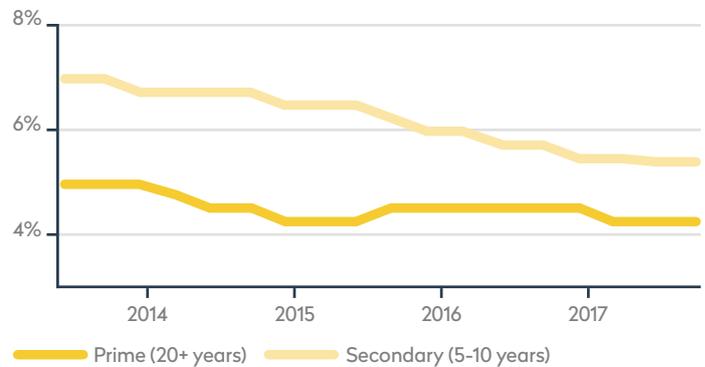
2030  
**40%**  
of all UK retail sales

## Drivers of Future Growth

The sector has benefitted significantly from the structural changes in the retail market, which has created demand for distribution networks. Technology has been a catalyst in this process as witnessed by the growth in e-commerce and supply chain improvements.



## Distribution Yields



Source: GVA



Hachette UK, Didcot. Acquisition for £29,240,000 on behalf of Tritax Big Box REIT

# Supermarkets

The sector continues to undergo significant change with consumers benefitting from an increased choice in the way they can shop, ranging from large format out-of-town stores to smaller local convenience formats, click and collect and home delivery.

### Market Drivers

- Improved performance and operating margins of 'The Big 4'
- Rationalisation of space with concessionary stores
- Discount retailers expanding through large store format development
- Continued investment in refurbishment programmes

### Challenges/ Investor Considerations

- Major operators focus store expansion on convenience shopping
- Retailer buy in options
- Rental growth vs inflation outside affluent South East locations
- Obsolescence of superstores

A lack of sale and leasebacks and new large foodstore development will limit future investment product, however, expectations are for institutions acquisition activity to return given improving market sentiment with yields still above historic lows.

In contrast to the alternative sectors, investment volumes within the supermarket sector have steadily fallen due to structural changes, with half of all transactions since 2016 being purchased by the occupational retailer.

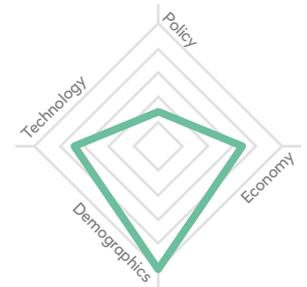
### Growing UK Population



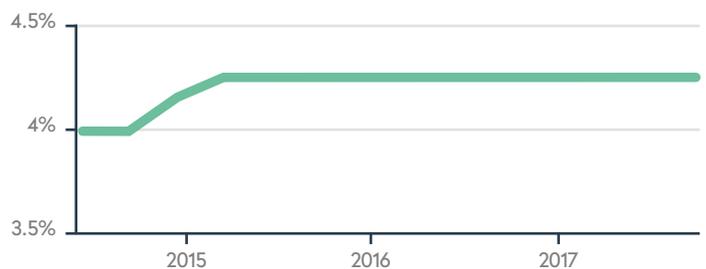
2017 **66** MILLION > 2030 **75** MILLION

### Drivers of Future Growth

Population growth is the greatest driver for the sector, however improved marketing channels and economic turmoil has had a significant influence on consumers decisions. Technology is continuing to impact on the sector as retailers are required to provide a greater choice of shopping channels.



### Prime Supermarket Yields



Source: GVA



ASDA, Barking. Funding disposal for £38,150,000 on behalf of Bouygues Developments

# Hotels

The hotel sector has seen considerable consolidation in recent years with the budget operators now accounting for a quarter of all beds in the UK.

## Market Drivers

- Largest and most established alternative sector
- Record number of tourists visiting London and the regions
- Continued international appeal of the UK given the weak pound
- Greater domestic tourism due to unattractive foreign exchange rates
- Infrastructure developments including Crossrail and HS2

## Challenges/ Investor Considerations

- Increasing supplier costs following Brexit
- Introduction of the national minimum wage
- Growing threat from terrorism requires continued alertness
- Market disrupters generating greater competition (e.g. Airbnb)

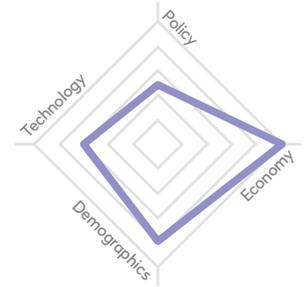
Overseas investors, who continue to seek trophy assets predominately in London, have re-emerged as the largest buyer in the sector. UK funds continue to target the budget hotel market given the strong covenants and inflationary linked income, which has resulted in record yields paid for Premier Inn and Travelodge investment opportunities.

## UK Tourism

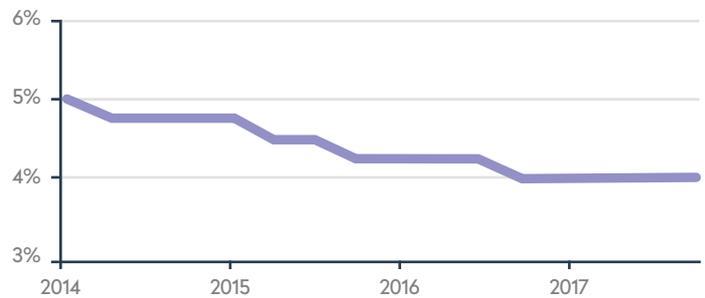


## Drivers of Future Growth

The economy continues to have the greatest impact on the sector with the strength of the pound significantly influencing overseas and domestic tourism. Policy, such as the national minimum wage, is a challenge facing hotel operators, whilst technology is having a growing impact as a result of evolving consumer expectations.



## Prime Budget Hotel Yields



Source: GVA



Finzels Reach, Bristol. Funding disposal for £17,800,000 on behalf of Palmer Capital.

# Student Accommodation

The growth of the UK student housing sector has been driven by full-time student numbers returning to levels seen prior to the tuition fee hike in 2011/12. Increasing demand from returning students and significant refurbishment programmes being undertaken by universities are further impacting on the supply demand imbalance.

### Market Drivers

- Strong UK higher education system
- Removal of cap that previously limited student acceptances
- Excellent performance during previous recessions
- Rental growth has outperformed inflation in recent years
- Mature market with increasing institutional interest

### Challenges/ Investor Considerations

- Severe lack of long lease/ nomination product
- Increasing build costs impacting on development viability
- Brexit and effect on overseas students
- Saturation reached in some markets
- Local market dynamics

The UK student housing sector continues to evolve with new investors seeking market exposure. Last year saw a strong trend for portfolio acquisitions with overseas buyers accounting for the largest share of the market (64%) and this theme has carried through in to 2017. There remains significant appetite from specialist funds and REITs who continue to search for prime assets in strong university towns.

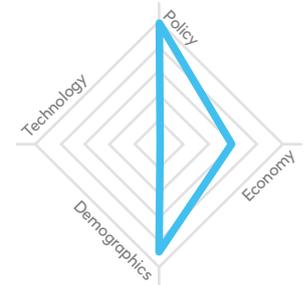
### Global Middle Class



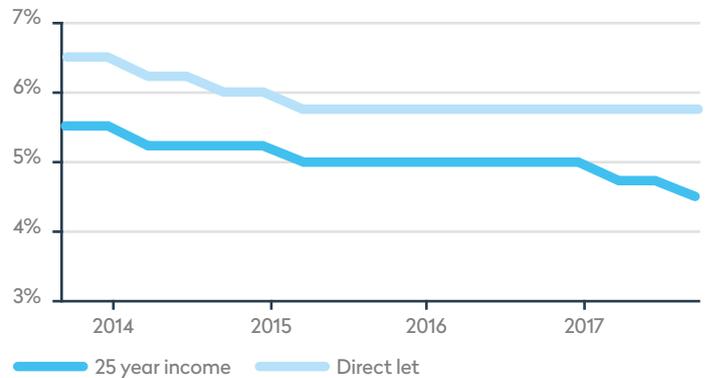
2009 2020 2030  
**1.8 > 3.2 > 4.9**  
 BILLION BILLION BILLION

### Drivers of Future Growth

The sector is driven primarily by policy including planning, tuition fees and immigration. Demographics are also key, particularly given the growing middle class population. The strength of the economy can impact on the accessibility of development finance, whilst student demand has proven to be counter cyclical in recent times.



### Prime Regional Student Accommodation Yields



Source: GVA



DH1, Durham. Funding disposal on behalf of Jansons Property Group

# Healthcare

The strong underlying fundamentals of the healthcare sector has attracted a significant weight of capital over the past 24 months. The UK has a growing elderly population, predominantly driven by increasing life expectancies, with a rapidly burgeoning demand for services from both a medical treatment and social care perspective.

### Market Drivers

- Longer life expectancies
- Technological medical advancements
- Considerable housing wealth of those aged over 65
- Increasing number of stable operators
- Structural undersupply of beds
- Rising fee income from both private and local authority markets

### Challenges/ Investor Considerations

- Tenant covenant and operating margins
- Introduction of the national minimum wage
- High construction and fit out costs restricts new market entrants
- Brexit impact on labour pool
- Policy regarding state funding
- Implications of CQC ratings
- Increased need for transitional care and retirement communities

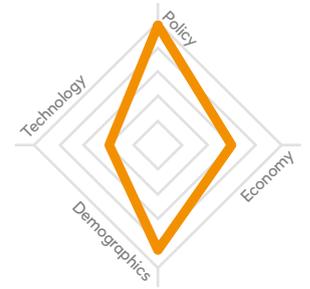
The UK healthcare sector has become an increasingly popular target for capital as investors search for more attractive returns. This has resulted in new market entrants, improved sector understanding, increased market competition and significant yield compression.

### Ageing UK Population

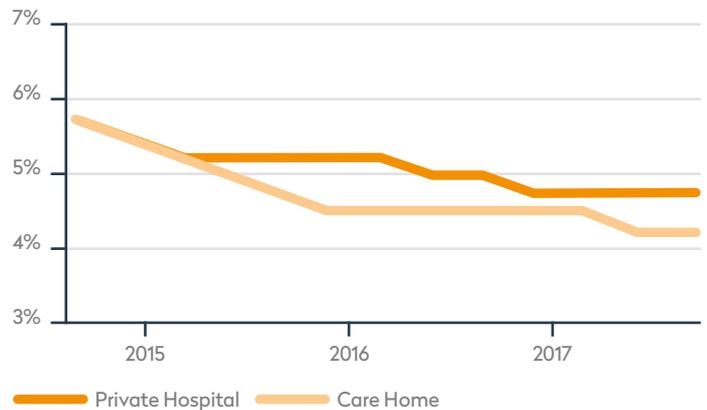


### Drivers of Future Growth

Policy has a significant impact on the sector with the national minimum wage and local authority funding being major factors. Strong house price growth has created substantial equity amongst the older generations that can be used to cover costs, however there are rising concerns over funding care for the millennials.



### Prime Healthcare Yields



Source: GVA



New Hall Hospital, Salisbury. Acquired for £49,800,000 on behalf of LaSalle Investment Management.

# Income Strips

Income strip transactions have predominantly involved forward-funding arrangements creating an inflation linked cash flow in return for development funding. These have typically been 25 to 50 year leases, zero reversion and no residual property risk.

### Market Drivers

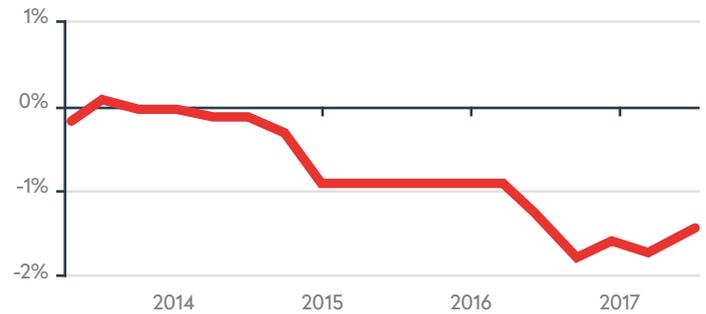
- Record low bond market with negative real returns
- Strong demand for risk free product
- Improved sector understanding
- Vendors looking to unlock major development schemes
- Long term tenant/vendor security

### Challenges/ Investor Considerations

- Rent affordability for covenant underwrite and sufficient headroom to insure against inflationary uplifts
- Term and covenant are vital to recover and earn a return on initial investment
- Gilt market
- Current pricing 'window' may only last in the short/ medium term

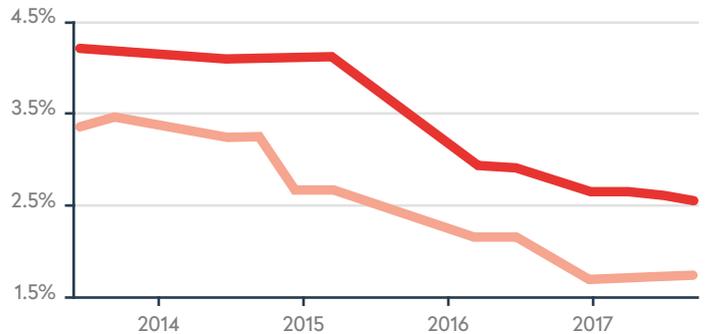
As income strips have become more understood, the weight of money in the sector has grown considerably. The market continues to be dominated by annuity and fixed income buyers given their reputation and trusted ability to perform, however competition has arrived from other investors who are bidding aggressively to secure stock. Yields are at record lows and demand is predicted to remain strong whilst the bond market remains at historic lows.

## 40 Year Index Linked Gilt - Yield



Source: Fixed Income Investor

## Investment Grade Income Strips versus Gilt Rate



Income Strip NIY 40 year Gilt

Source: GVA



Wightlink Ferry Terminal, Portsmouth. Disposal for £73,150,000 on behalf of Portsmouth City Council

If you'd like to talk to one of our Alternative Investment team to discuss property services or any market leading research, please get in touch.

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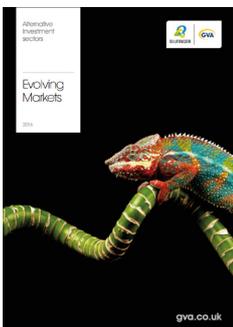
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