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# Agenda

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- The Role of Real Estate
- Myths that drive the UK real estate market
- Potential investment strategies – risks & opportunities

# The Role of Real Estate

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## Real Estate as an investment asset class

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### Roles for Real Estate

#### EQUITY

- Return predominantly from capital growth
- Lower dividend yield

#### FIXED INCOME

- Return predominantly from income return
- Capital growth tracks inflation

#### COMMODITY

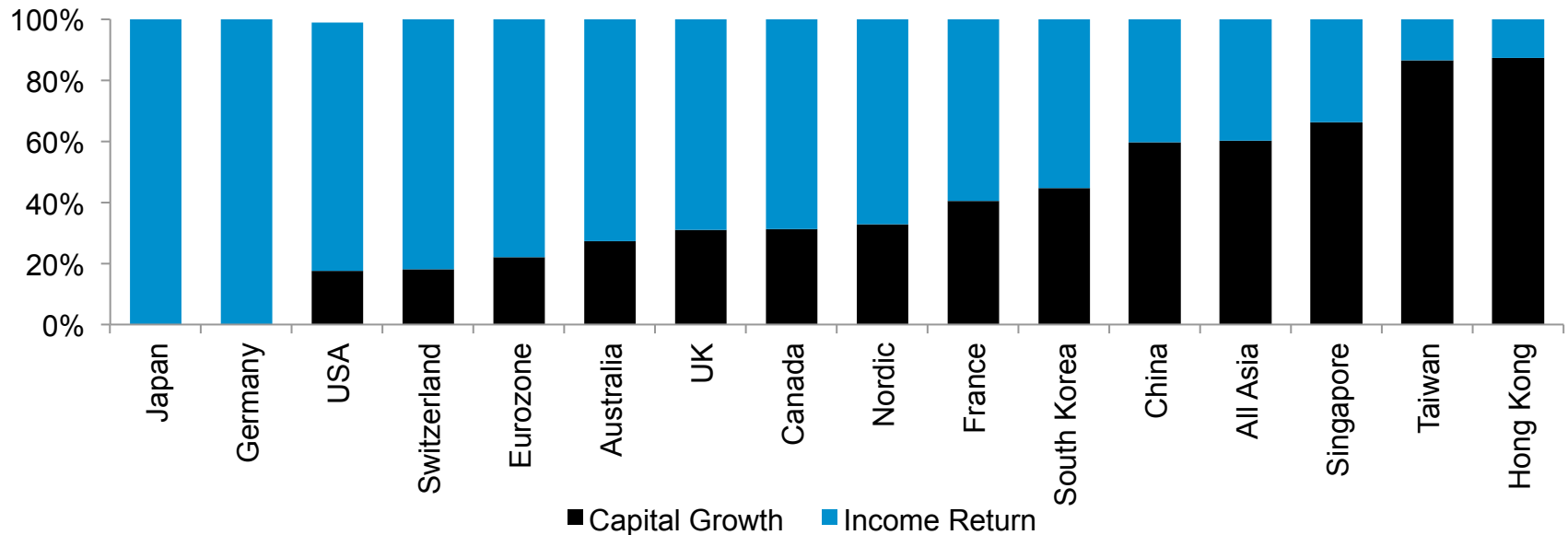
- “Real asset” (i.e. gold) with return from capital growth
- No income

- Real estate can fulfil a number of roles within a portfolio depending on the investment motives of the investor
- Real estate is not a homogenous asset class or market

# Global Commercial Real Estate: income vs. capital return

## Long Term\* All Property Returns – Components of Performance

% of Total Return from Income Return & Capital Growth



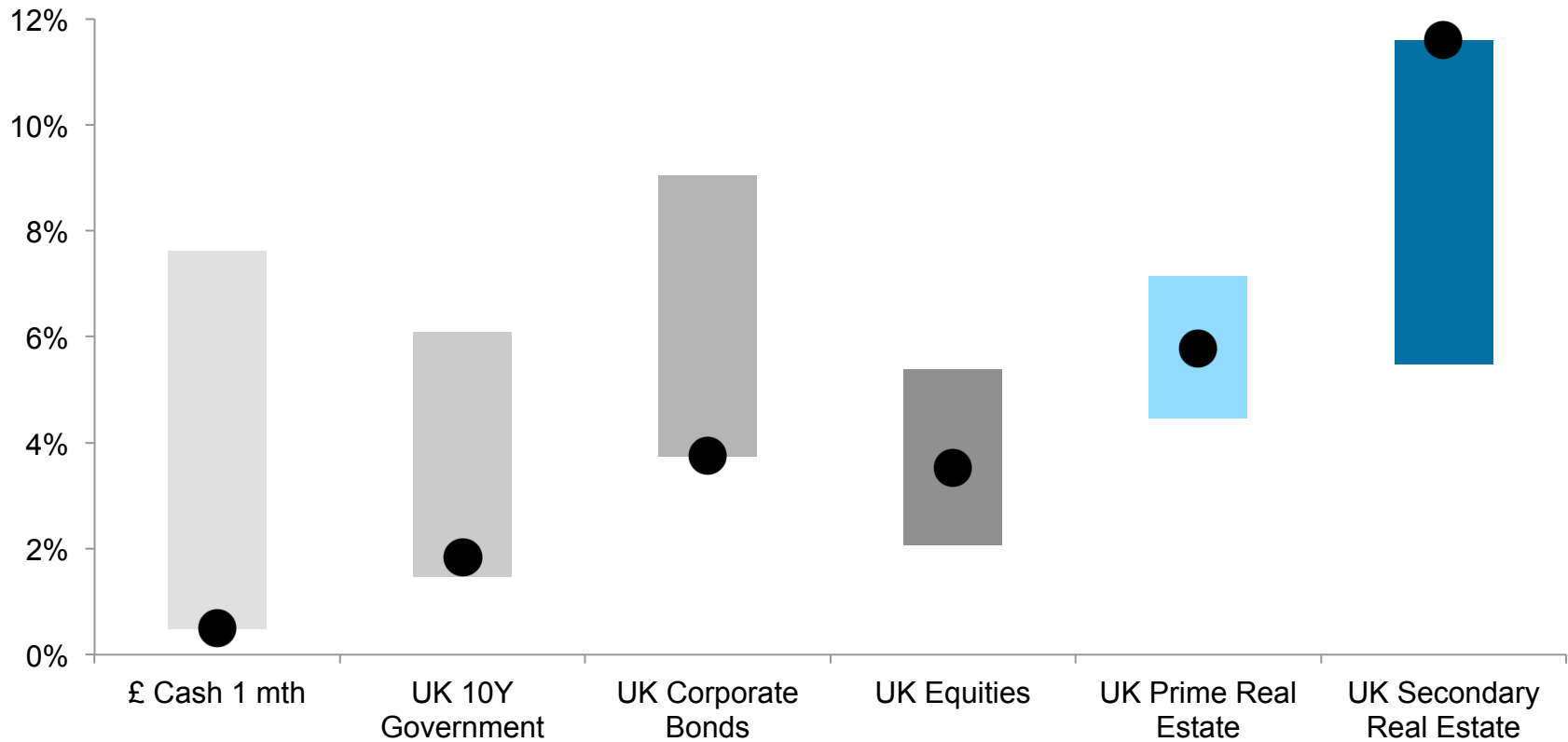
- Western Europe + Anglo markets = bond style investment returns
- Asia Pacific + Emerging markets = equity style investment returns

Source: NACREIF 1978 to 2011, IPD Multinational Index 2011, JLL/FIL Pan European Index 1981 to 2011, HK Rating & Valuation Dept 1988 to 2011, CBRE 2001-2011, CBRE/FIL Pan Asian All Prime Property Index 2001 to 2011

# Myths that Drive the UK Real Estate Market

# Current yields versus long term ranges\*

## Current yield vs. long term range



Source: FIL Limited, DataStream, Bloomberg, CBRE, December 2012.

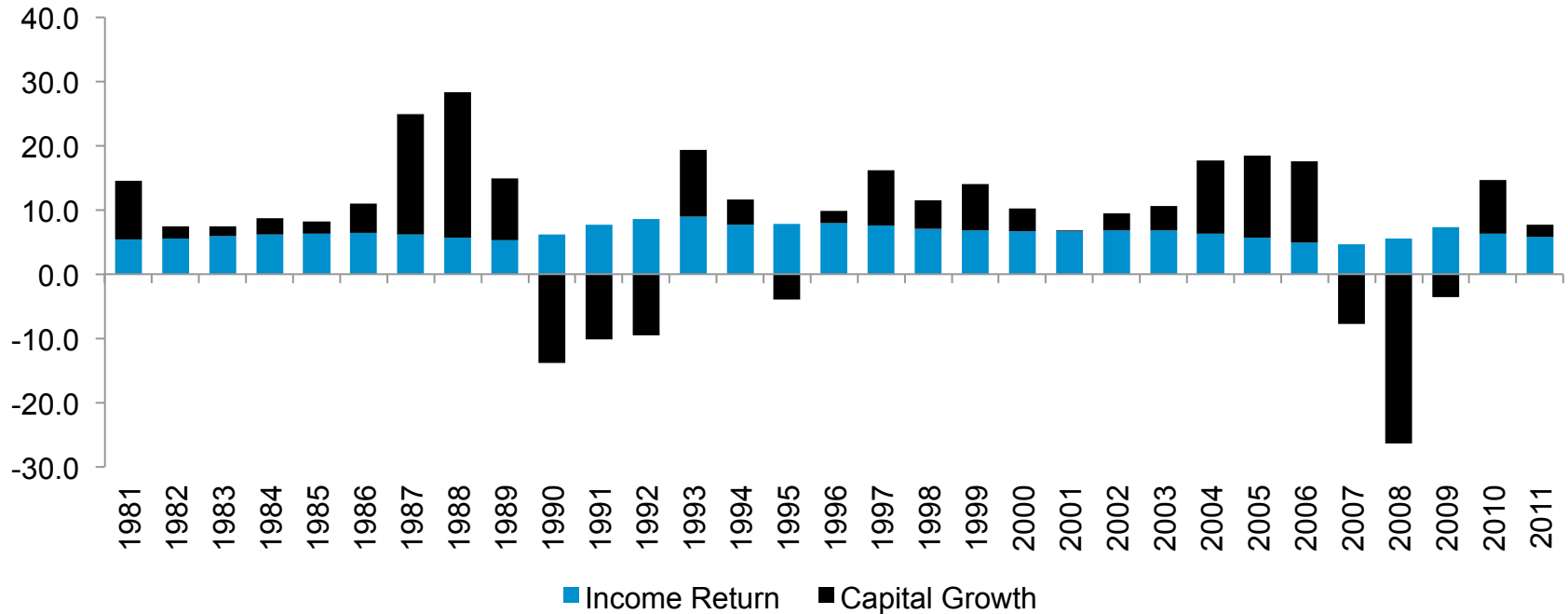
\* Longest time period selected for each data series, based on availability of data, so 'long term' covers varying time periods. Shortest time period relates to secondary UK real estate (13 years). Other data covers 15 year periods or longer.

# Myth 1

## Capital return is the primary driver of UK real estate performance

### IPD UK Annual Index – Components of Performance

All Property Total Return 1981 to 2011 - % pa



- Income return = approximately two-thirds of total return

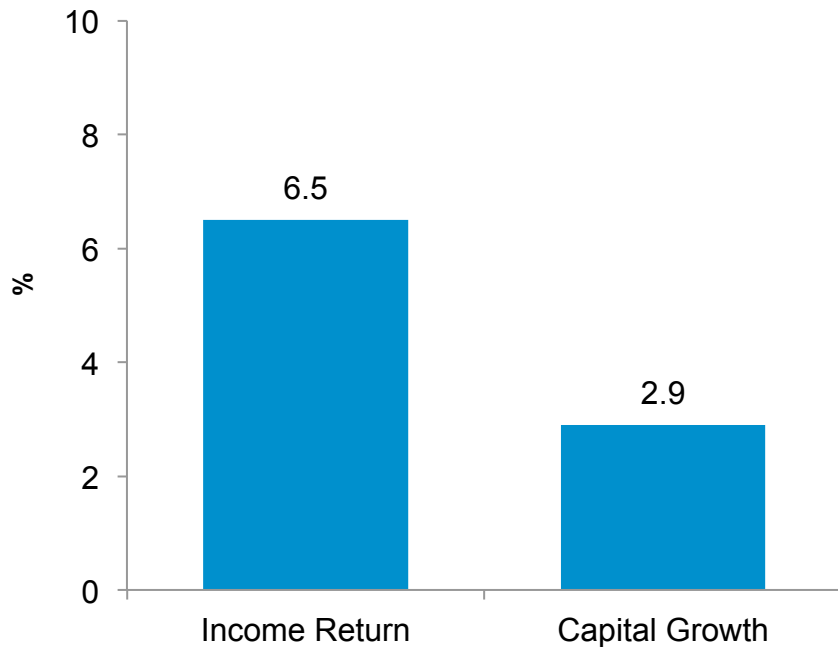
Source: FIL Limited, IPD. Data series to end December 2011.

# Myth 1

## Capital return is the primary driver of UK real estate performance (cont'd)

### Components of Long Term Performance

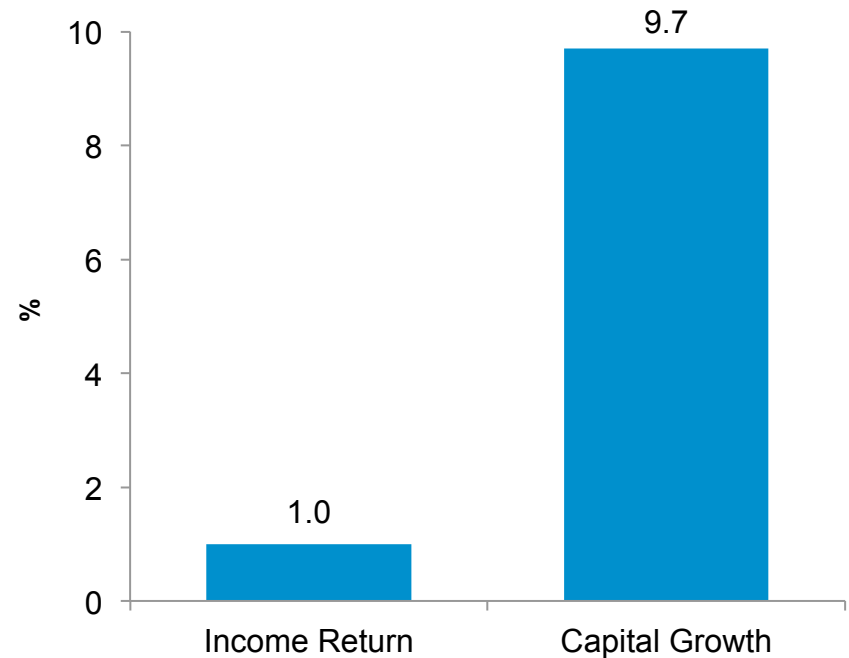
Income Return v Capital Growth - % pa 1981 to 2011



- More ability to control income than capital

### Volatility of Long Term Performance

Income Return v Capital Growth - % pa 1981 to 2011



- Volatility of income exceptionally low

Source: FIL Limited, UK IPD All Property Index. Data series to end December 2011.



## Myth 2

### London is the least volatile market

- London offices amongst the most volatile sub-markets in the UK
- Industrials, 'standard retail' and some regional office markets amongst the least volatile

### 3 Most and Least Volatile Parts of the UK Property Market Over 25 years (1987-2012)



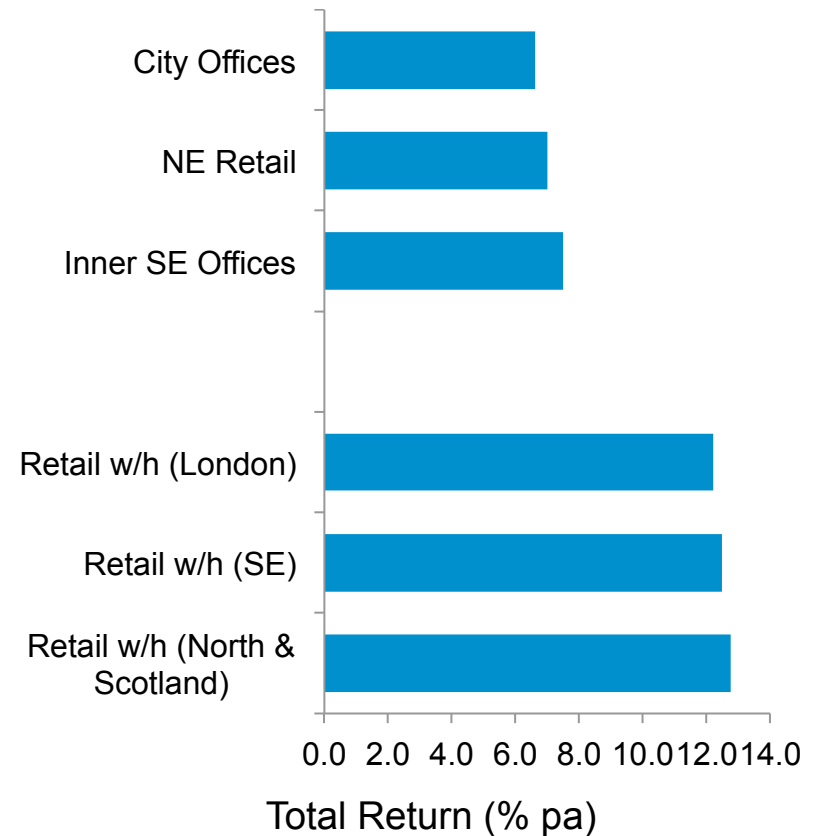
Source: IPD Monthly Index August 2012

## Myth 3

### London is one of the best performing markets

- City offices worst performing sub-market in the UK over the long term
- Retail warehousing has dominated the league tables - a one-off long term secular trend
- All industrial markets appeared in the top half of the performance table

#### 3 Best & Worst Performing Parts of the UK Property Market Over 25 years (1987-2012)

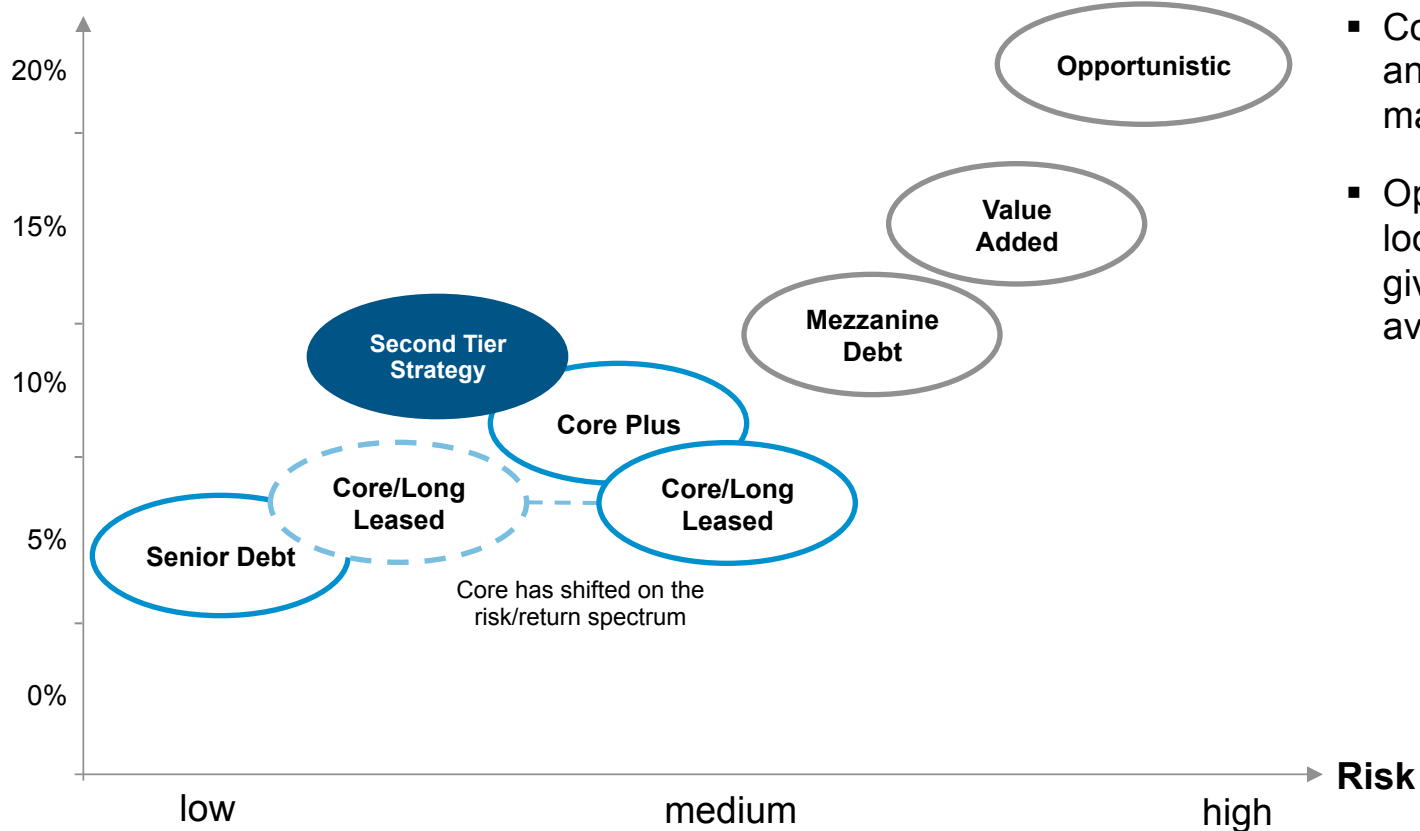


Source: IPD Monthly Index August 2012

# Potential investment strategies - risks and opportunities

# Real Estate Strategies

## Return

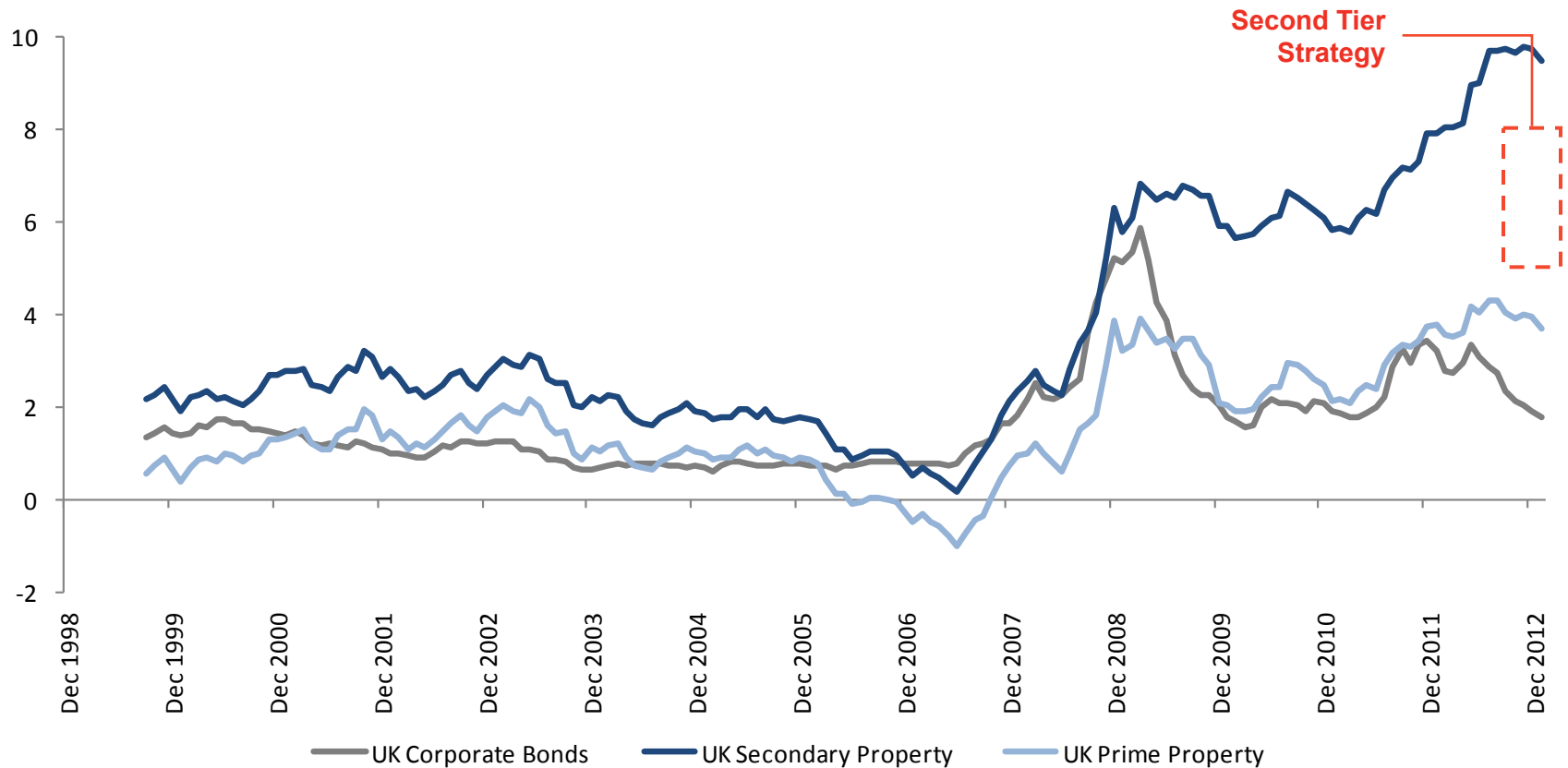


- Core is expensive and exposed to bond market re-pricing
- Opportunistic returns look challenging given limited debt availability

Source: FIL Limited, internal opinion




# Pricing driven by lack of investor appetite rather than fundamentals

As with the corporate credit market in 2008/09, the property market is failing to distinguish the range of asset quality within secondary



Source: FIL Limited, CBRE, IPD UK Monthly Index, Bloomberg – February 2013.

# Defining mispriced high quality 'second tier' property

	Prime/ Long Leased	Second tier Opportunity	Secondary
			
	<b>City of London</b>	<b>Glasgow</b>	<b>Stevenage</b>
Location	Established Markets	Established Markets	Secondary Centres
Building Quality	High/Medium	High/Medium	Medium/Low
Tenant Quality <sup>(1)</sup>	> Baa2	> Baa2	Sub investment grade
Lease Length to Expiry	10 years +	5 years +	1 year + / Vacant
<b>Acquisition Yield</b>	<b>4 – 5.5%</b>	<b>6.5 – 12%</b>	<b>10% +</b>

<sup>1</sup> Equivalent bond rating from Moodys.  
Source: FIL Limited, 31 December 2012.

# Irrational Risk Aversion?

Same Government, Same Cash, 6.7% Yield Gap

**Building let to UK Government  
Tax Office for 9 years**



**Rental Yield 8.2%**

**UK 10 Year Government Bonds**



**Current Yield 1.5 %**

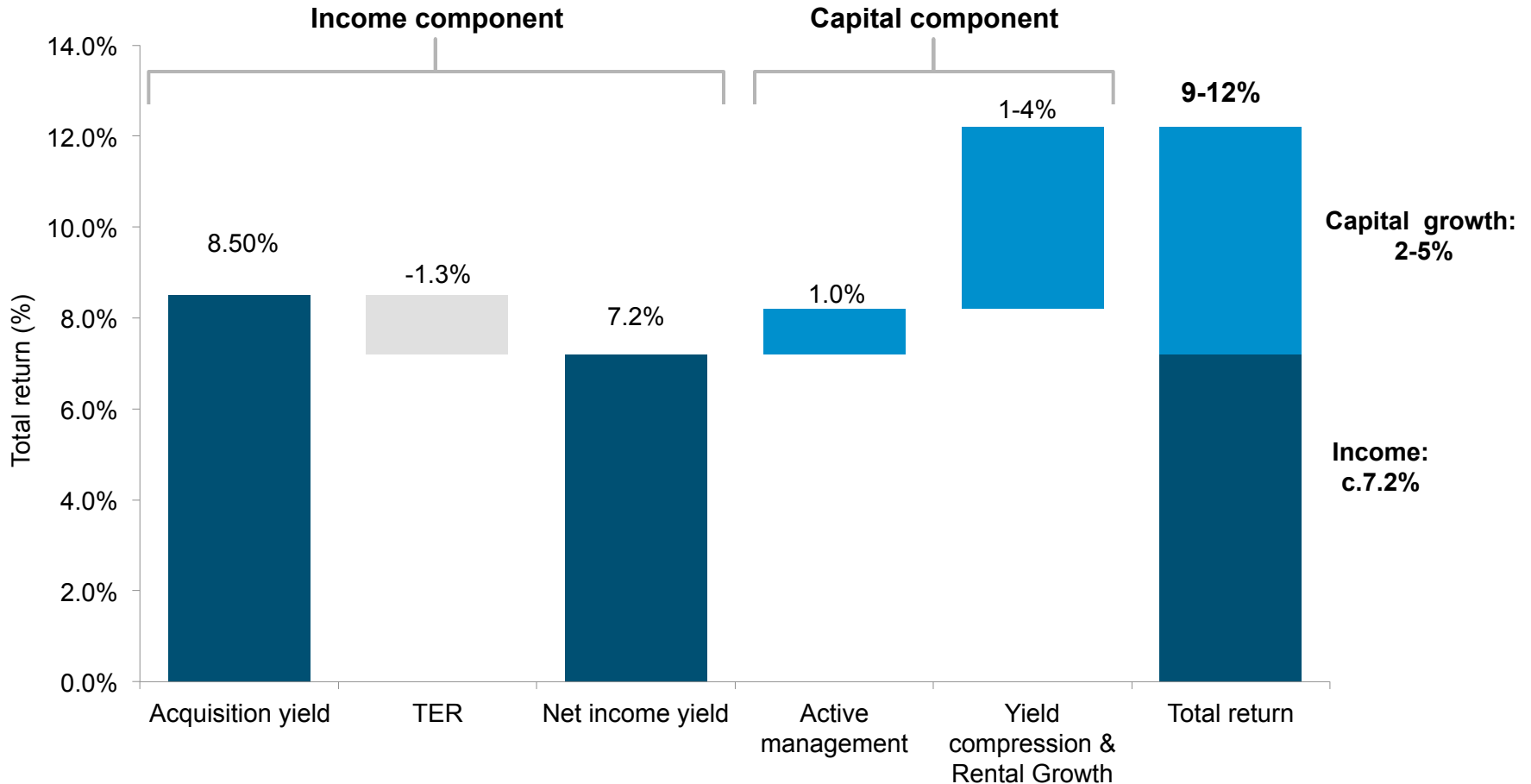
Source: FIL Limited, Financial Times, 31.12.12.

The property is owned by Fidelity's institutional UK property fund and is let to the First Secretary of State on a lease expiring in 2021. The yield quoted is the 'equivalent yield' at end December 2012, based on valuation by the Independent Valuer to the fund.

The UK government bond yield is the gross redemption yield on the March 2022 issued bond, as at 31.12.12.

# Future Return Potential

## Enhanced yield with potential for capital appreciation



Source: FIL Limited, 31/12/2012.

Note: Based on FIL forecasts. This projection is not an indicator of future performance. Calculated over 5 years, based on forecasts from FIL Limited. Yield compression element of capital component based on potential for reversion to long term average yields.



# Real Estate Investment Solutions

	1. Pooled Funds i. UK ii. Eurozone	2. Joint Venture Deals	3. Segregated account
<b>Strategy</b>	<ul style="list-style-type: none"> <li>Balanced core plus</li> </ul>	<ul style="list-style-type: none"> <li>Impaired core strategy</li> </ul>	<ul style="list-style-type: none"> <li>Bespoke strategy for Client</li> </ul>
<b>Geographic remit</b>	<ul style="list-style-type: none"> <li>UK or Core Eurozone markets</li> </ul>	<ul style="list-style-type: none"> <li>UK</li> <li>Germany</li> <li>France</li> </ul>	<ul style="list-style-type: none"> <li>Determined by Client</li> </ul>
<b>Net expected return</b>	<ul style="list-style-type: none"> <li>8-10% per annum</li> </ul>	<ul style="list-style-type: none"> <li>10%+ per annum</li> </ul>	<ul style="list-style-type: none"> <li>Dependent upon strategy</li> </ul>
<b>Distribution yield</b>	<ul style="list-style-type: none"> <li>UK c.7%</li> <li>Eurozone c.5%</li> </ul>	<ul style="list-style-type: none"> <li>c.4-6%</li> </ul>	<ul style="list-style-type: none"> <li>Dependent upon strategy</li> </ul>
<b>Equity commitment</b>	<ul style="list-style-type: none"> <li>£1.5-75m</li> </ul>	<ul style="list-style-type: none"> <li>£100m+</li> </ul>	<ul style="list-style-type: none"> <li>£150m+</li> </ul>



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## Summary

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- More than two-thirds of UK real estate total return comes from income
- Prime or long leased real estate ≠ strong and stable performance
- Mispricing opportunities in mispriced second tier real estate
  - c. 2% to 5% above long term average

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# Regulatory Risk Warning

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