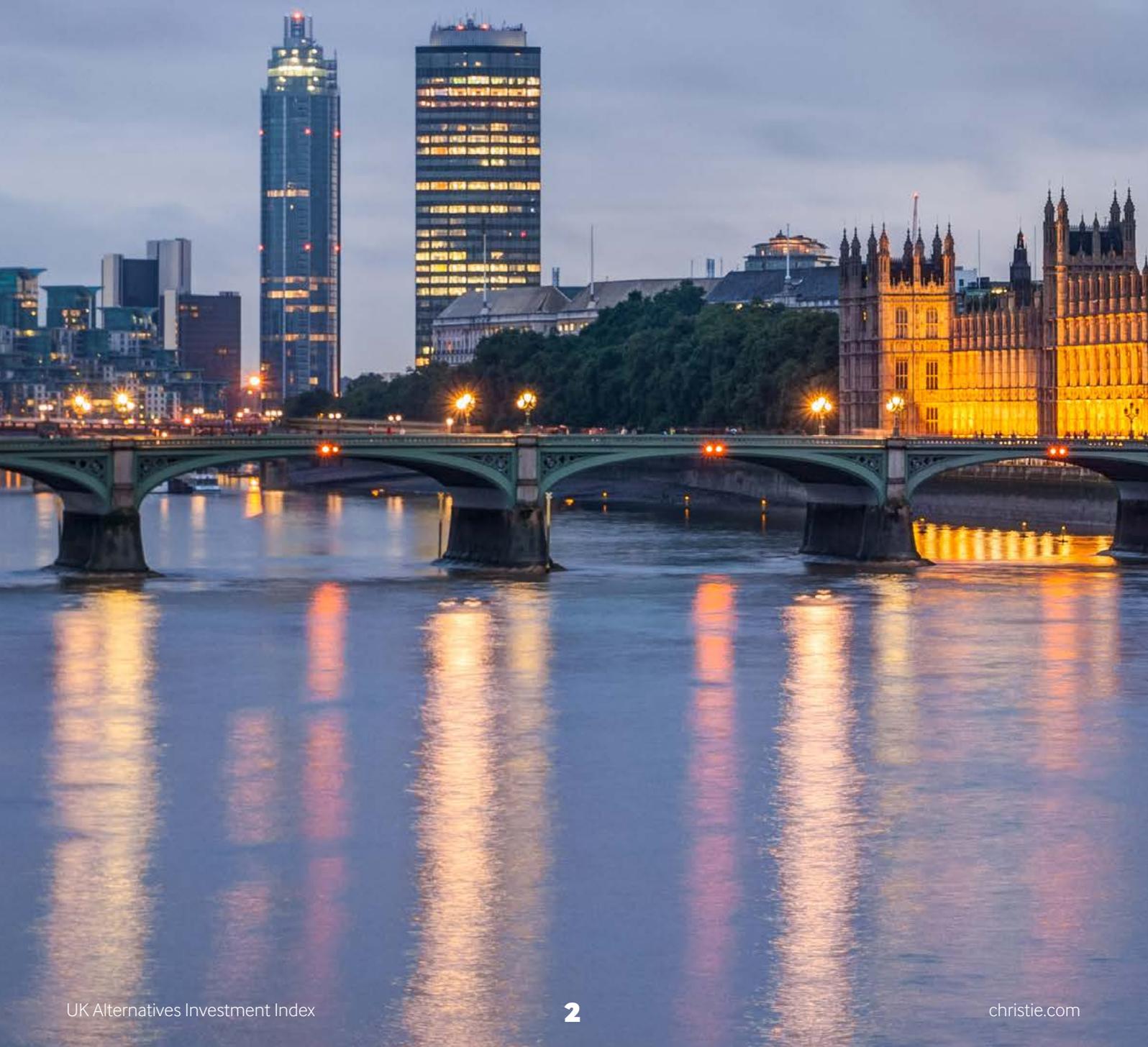




**UK ALTERNATIVES
INVESTMENT INDEX**
H1 2019

Investor appetite for UK Alternatives remains incredibly high, with investors attracted by the increased security of commercial real estate when compared to riskier equities, along with returns which remain in excess of those available from bonds and debt markets.





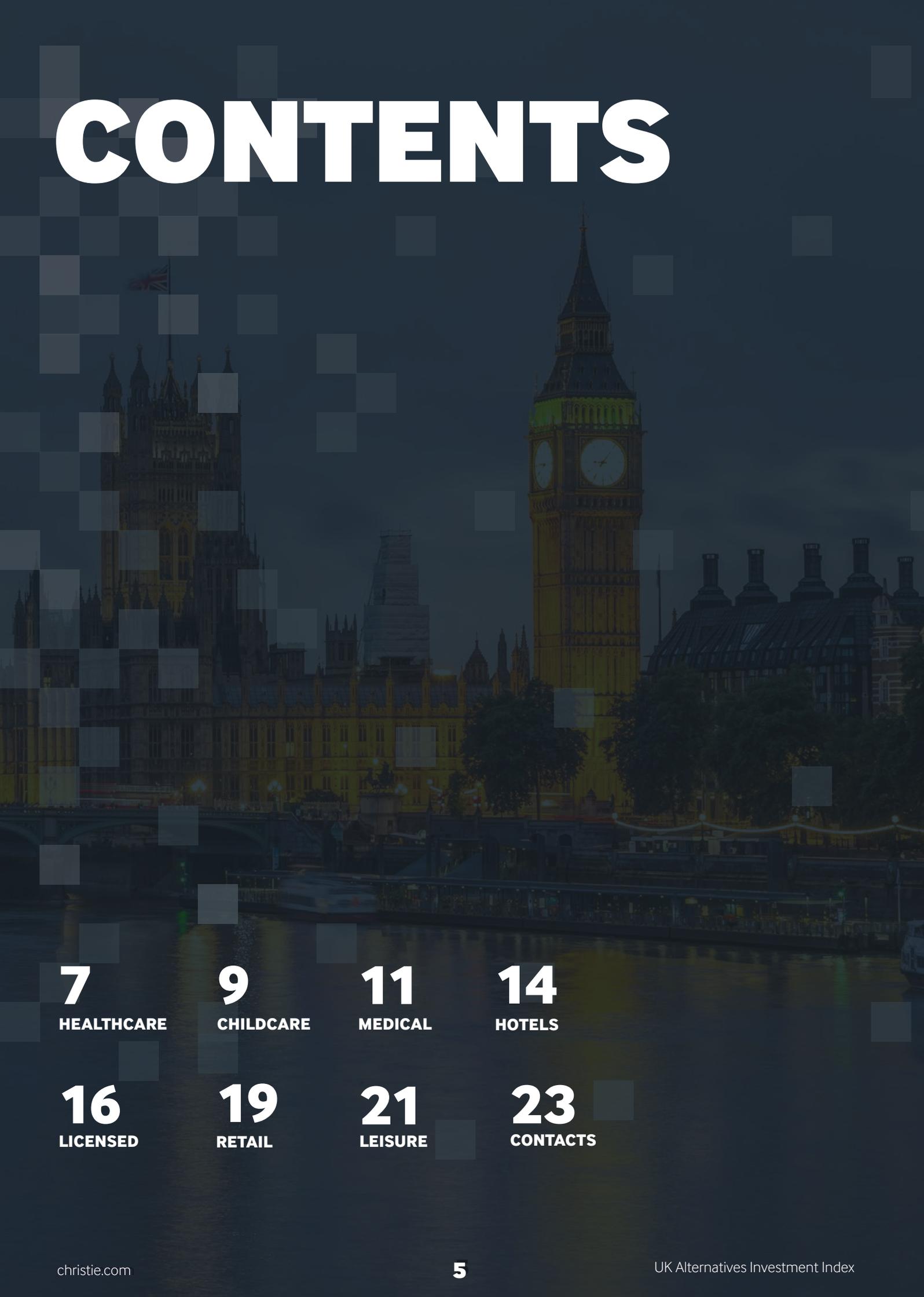
EXECUTIVE SUMMARY



Whilst Q1 2019 exhibited a reduction in M&A activity due to short-term capital market challenges (primarily currency volatility due to political turmoil over Brexit), activity returned in Q2, with investors generally optimistic about the UK in general, and confident in the opportunities that the perceived current underpricing of Alternatives represents.

With few exceptions, such as the restaurant sector, for which oversupply will remain a structural issue into the medium term, the outlook remains positive. Strong economic fundamentals in the UK, reduced vacancy periods, stable income streams and ongoing supply-side constraints, all seek to create a resounding case for both institutional and private investors considering where to deploy capital.

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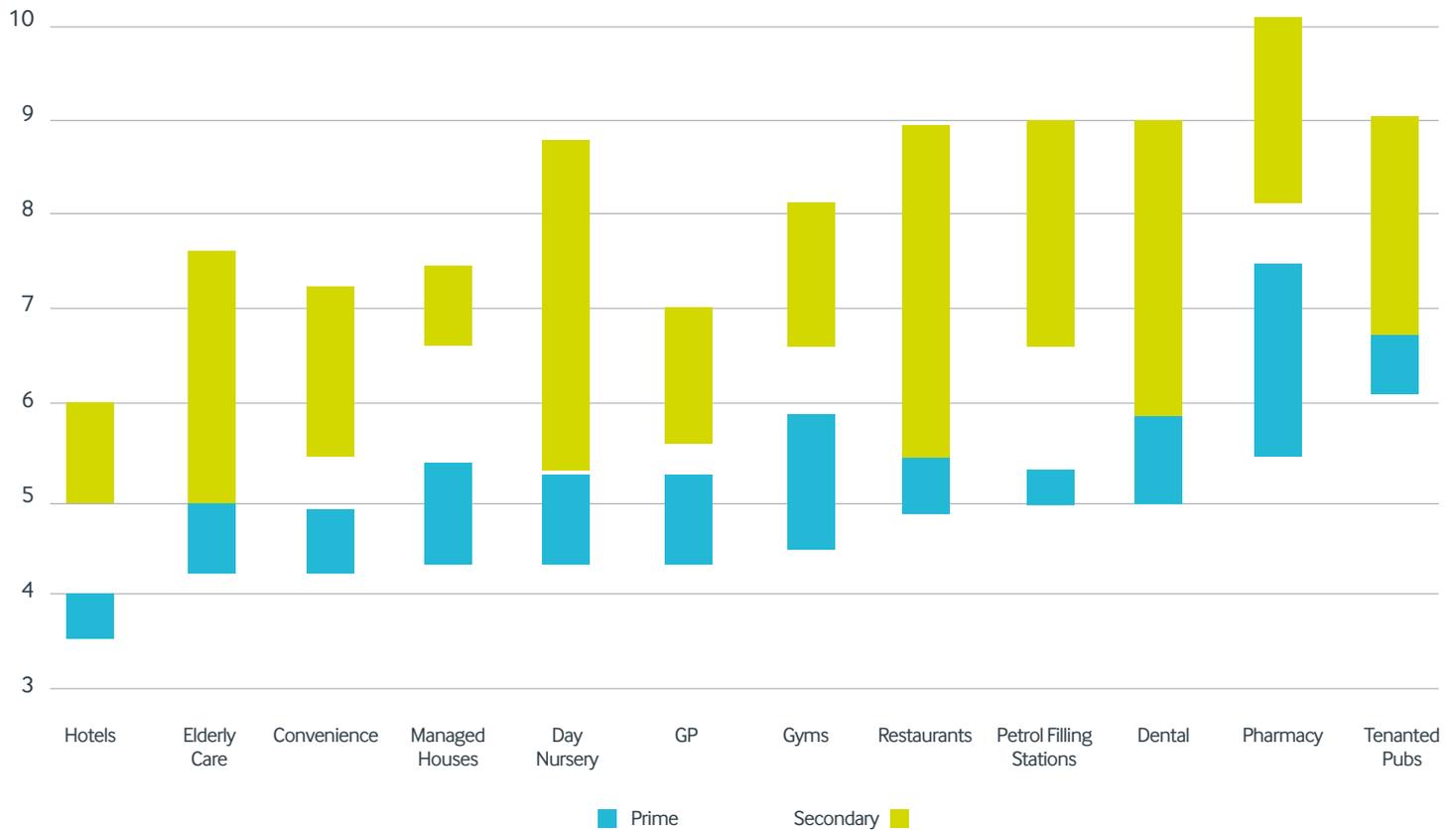
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UK ALTERNATIVES

UK ALTERNATIVES – PRIME AND SECONDARY YIELD SPREADS (%)



Yields presented are a Christie & Co assessment of the average yields currently achievable, and are based on transactional data and current market sentiment. Yields are presented to the nearest eighth of a percent.

Yield variance between sectors reflects their own liquidity, maturity, covenant strength, and a number of additional factors that can influence the attractiveness of investments in a given sector. For example, the lowest yield presented, is reflective of those achievable on London budget hotels, indicating the maturity of that sector, and the prevalence of long term RPI-linked leases to corporate operators.

The average yield spread across prime and secondary investments across all the sectors presented is 3.5%, although this ranges between 2.5% and 4.5% within the individual sectors.

Generally speaking, across the majority of sectors presented, yields have been tightening as UK alternatives continue to mature.

Furthermore, investors are increasingly willing to tolerate higher levels of operational risk in exchange for higher returns.



HEALTHCARE

HEALTHCARE

The healthcare sector consists of providers of care services across the acuity and age spectrum. The sector is subdivided into: elderly care (including both residential and nursing homes); specialist care (including hospitals, homes and supported living); and development (including extra care and retirement villages).

ELDERLY CARE

This sector has proved increasingly attractive to institutional investors in recent years, as the sector is primarily driven by need as opposed to lifestyle choice. Demand trends are also favourable, as the population lives longer with an ever-increasing range of health conditions. This is a major differentiator from other asset classes such as retail where difficulties in the High Street have been influenced by changing consumer behaviour and technological disruptors.

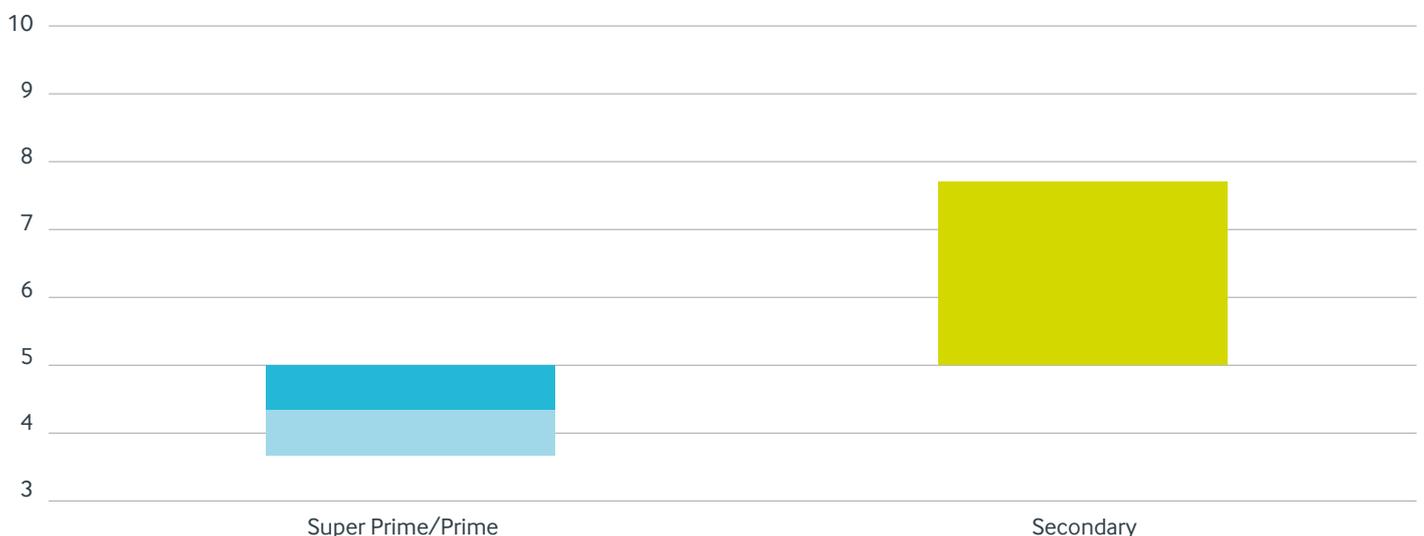
The strongest yields are typically attributed to acquisitions made by institutional investors who are seeking best-in-class stock in private-pay markets and let to prime operator covenants. Due to a scarcity of opportunities meeting these requirements, there is very strong demand for the limited supply which is brought to market. This has led to yields compressing to record levels of below 4% for super-prime assets.

Due to a combination of investor demand and increasing appetite from a wider range of operators to take leases, we are also seeing considerable activity in the prime and secondary markets. Most notably Christie & Co has negotiated several transactions involving new-build assets which are let to regional or SPV-type covenants, with yields compressing and new benchmarks being set at between 5.0%-5.5%.

A further critical ingredient is the structuring of the lease agreements with investors seeking proactive step-in rights and full visibility of trading information. Christie & Co has experienced high demand for performance monitoring services with this being an integral part of risk mitigation for a number of institutional investors.

Due to a combination of investor demand and increasing appetite from a wider range of operators to take leases, we are seeing considerable activity across the super-prime, prime and secondary markets.

ELDERLY CARE YIELDS (%)





CHILDCARE

DAY NURSERIES

The UK day nursery sector comprises some 18,000 day nurseries. Nurseries in the UK are highly regulated and the market is very fragmented, with singular, owner-operated settings accounting for circa 80% of overall provision.

DAY NURSERY

The UK day nursery sector has undergone significant growth and change during the past few decades. Over the past decade, childcare has been high on the Government's agenda, as evidenced by the introduction of different funding initiatives, such as 30hrs in England. Demographic trends have also been favourable. Post the 2008 recession we have seen a rise in households becoming reliant on dual incomes, women have increasingly established careers first, had children later in life, and now frequently choose to return to work. With nurseries increasingly being seen as essential infrastructure, and due to the high degree of fragmentation, the sector is ripe for consolidation, with this opportunity fuelling investor interest and demand from buyers.

However, the sector remains in its infancy from an institutional investor perspective, with around 80% of properties owned by independent operators. This is slowly changing although still represents a very attractive consolidation opportunity. Over the last two years, in particular, there has been growing interest from investors, both domestically and internationally. Furthermore, due to the range of lot sizes offered for sale, children's day nursery investments are popular amongst retail investors and individuals, often for incorporation within private pension plans.

At the corporate end of the market, there is excellent demand for day nurseries let on institutional leases to leading operators

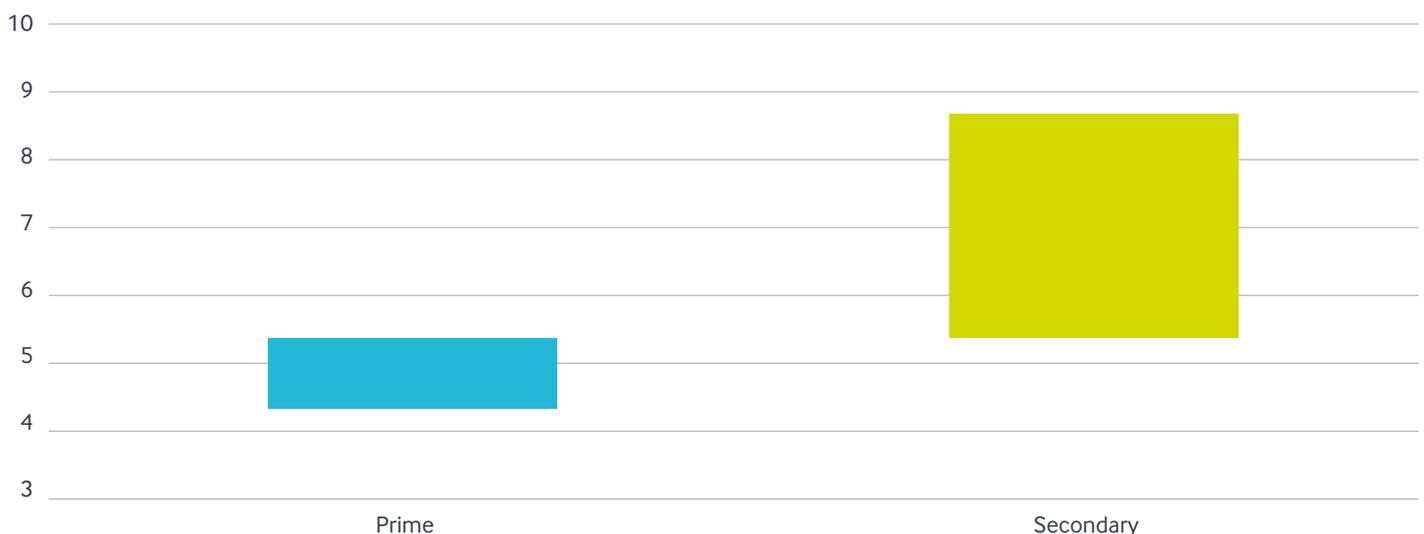
with strong covenants, such as Busy Bees and Bright Horizons. With both of these operators being strong international businesses, yields have steadily compressed with prime investments in strong locations achieving yields below 5%. The secondary market sees a wider spread depending on the nature of the asset, lease provisions and tenant covenant.

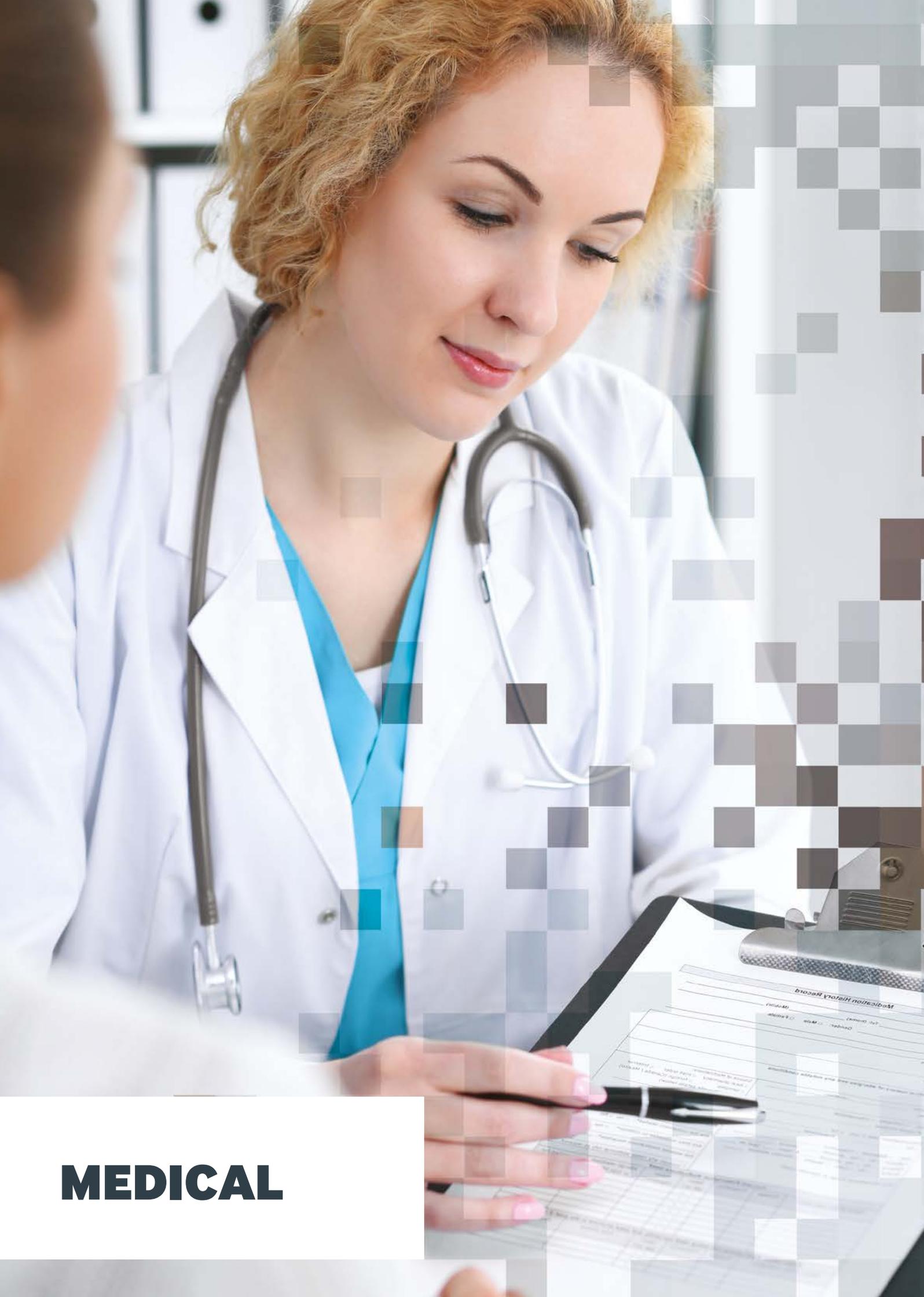


Due to the range of lot sizes offered for sale, children's day nursery investments are popular amongst retail investors and individuals, often for incorporation within private pension plans.



DAY NURSERY YIELDS (%)





MEDICAL

The medical sector consists of the providers of a wide range of “white coat” services. The sector is subdivided into a number of areas, with our focus primarily on the pharmacy, dental surgery and GP surgery subsectors.

DENTAL SURGERY

The dental investment market is dictated not by the type of dentistry being undertaken by the operator, but by the individual covenant strength of the tenant and ability to meet lease covenants and rental obligations. The sector offers a relatively stable investment platform, which should only improve as the sector becomes more corporate. However, there are limited opportunities currently as a result of the type of premises many surgeries occupy, such as converted residential dwellings.

The market is currently migrating away from individual operators and towards larger corporate groups. As the market matures and purpose-built practices come on-line in more prominent locations, and covenants improve with recognised brands, the investment yields should start to improve.

PHARMACY

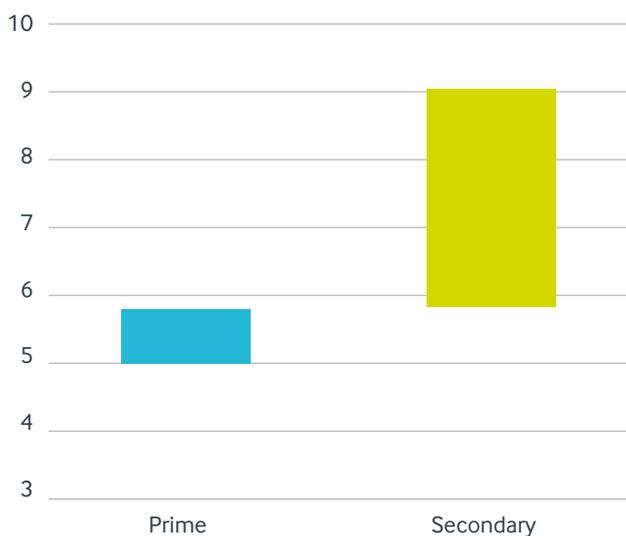
The structure of business ownership within the UK pharmacy sector is relatively disparate with over 50% controlled by independent operators ranging from individual contractors to multiple operators with up to 300 pharmacies. Beyond this, ownership is primarily confined to large corporate or supermarket operators. As a result, the investment market is relatively immature, albeit investments with corporate pharmacy tenants are frequently traded through investment auctions.

Property ownership is also highly fragmented with pharmacy premises in retail parades generally owned by institutions or the local authority, so unable to be detached and sold individually. Likewise, pharmacies integrated into health centres are held on a leasehold basis. The balance, which are standalone businesses in freehold properties, are owned either by the business owner or a third-party landlord. There is a ready market for these investments but their value generally dictates that they are sold to independent investors only.

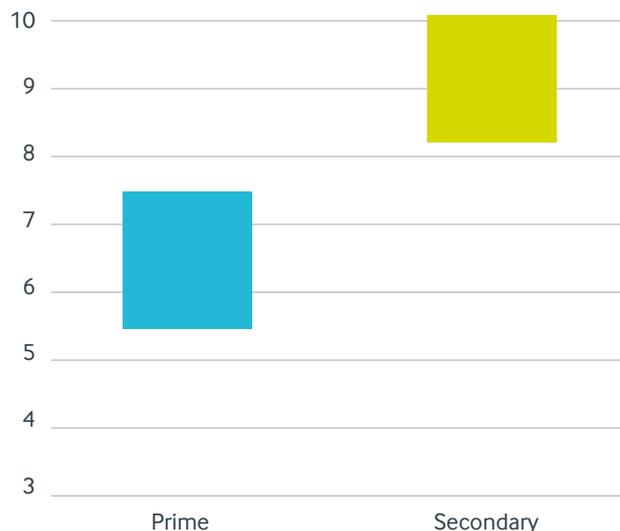
The principle income driver within the pharmacy sector is that of NHS dispensing thereby providing a relatively secure income base. As a result, covenant strength, albeit dependent on the size of operator, will invariably sit ahead of other high-street retail covenants. It should be noted that whilst the retail environment is a contributory factor affecting investment value, operator covenant strength is a more dominant driver of yield choice for pharmacy investments.

Many independent operators, in disposing of their going concern businesses, will retain freehold investments which may give rise to smaller investment opportunities being traded in the market place.

DENTAL SURGERY YIELDS (%)



PHARMACY YIELDS (%)



GENERAL PRACTICE SURGERIES

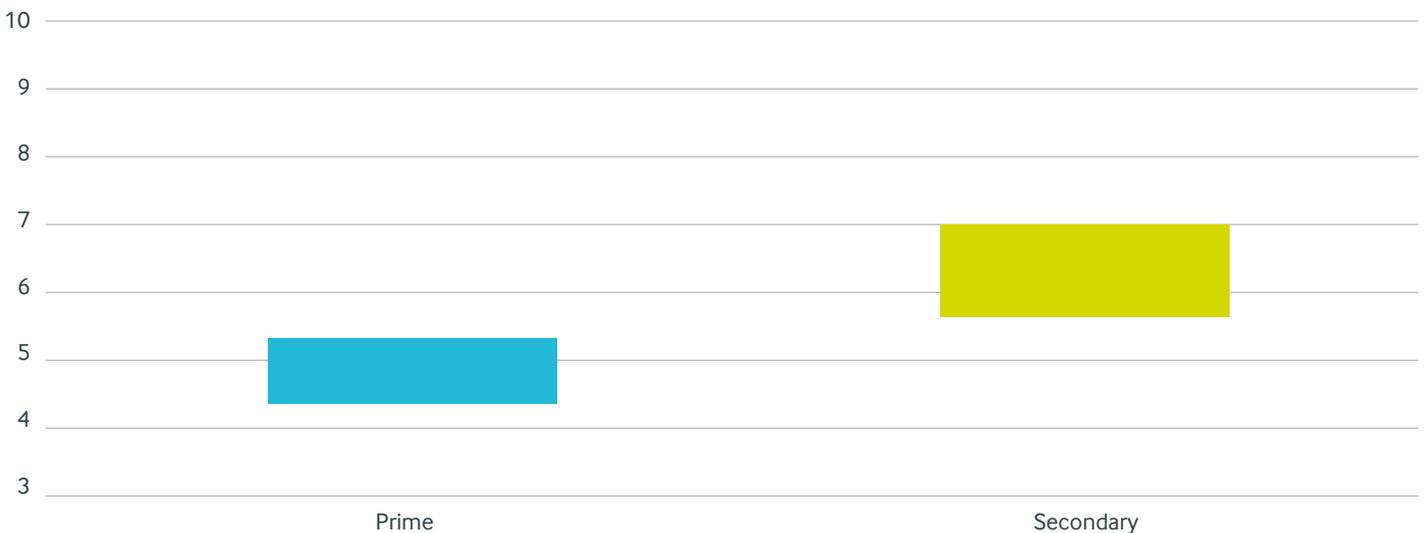
The GP sector has been extremely attractive to investors for many years. Due to the increased security offered by its NHS-backed rental scheme, it is seen as a relatively safe haven for investors, as there will be a consistent level of rental income from a reliable covenant. The need for GP surgeries will continue into the future, and is likely to only increase due to demographic trends.

Competition for prime investment grade opportunities remains exceptionally competitive, whilst tenants have also looked to future-proof their surgery space, thus increasing the desirability of such investments going forward.

“ The need for GP surgeries will continue into the future, and likely only increase due to demographic trends. ”



GENERAL PRACTICE SURGERY YIELDS (%)





HOTELS

The UK hotel market is an attractive investment proposition that appeals to a wide range of buyers. Fixed-income investments in leased hotels have tended to be in the budget and midscale segments, where there are operators and brands with sufficient covenant strength to take FRI leases and bear the operating risk.

HOTELS

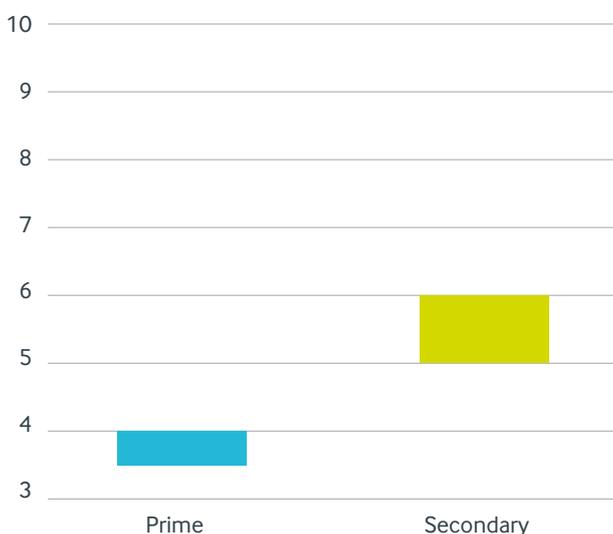
Owner-operated (or going-concern) structures remain the dominant ownership model in the UK hotel sector, operated either as independent businesses or as part of a chain under a franchise or management agreement. These operational structures allow owners to benefit from performance improvements, although are not directly comparable to traditional investments due to the increased risk profile.

Our analysis has focused exclusively on the budget segment, where there is a greater proportion of leases, but the movement in yields can still be considered a relatively useful indicator of the overall trend in hotel investment yields more broadly.

The main branded operators in the UK's budget segment all have strong covenants, and are generally desirable investments. Compression of yields has driven an increase in investor risk appetite, particularly towards structures that give greater exposure to the underlying operational business, and the inherent risks and rewards that this allows.

Prime investments are defined as those within the London area, and secondary investments are those in other key UK cities. Yields presented assume fixed income, strong covenant FRI leases and exclude super-prime investments and development deals.

HOTEL YIELDS (%)



GOING CONCERNS AND DEVELOPMENT

The growth of third-party operators has given investors the opportunity to invest in the operating business without having to run it themselves. Typically, yields for comparable assets but with vacant possession would be expected to sit approximately 150 bps above the fixed income yields, with the range narrowing in London and widening in the Regional UK. Additionally, yield spreads are much wider in the going-concern investment space, reflecting the risks involved in operating different categories of hotel from low-cost, less volatile budget hotels, to luxury hotels with more extensive facilities, services and staff costs or from highly-seasonal leisure-driven properties to city-centre hotels with the ability to capture year-round corporate business.

Development and forward-commitment investments also remain attractive, typically softening yields by 50-75 bps. In recent years, we have seen a greater prevalence of forward funding, whereby investors take an even greater risk in funding the development.

NEW CONCEPTS AND ALTERNATIVE ACCOMMODATION TYPES

Due to the rising operational costs in business rates and staffing, investors are increasingly keen to seek out lean operating models, including "affordable luxury", lifestyle and limited-service models as well as hostels and serviced apartments.

The lower capital intensity, higher occupancy, and the higher operating margins make hostels attractive. Although quality of assets varies widely and there is limited evidence of investment-grade properties transacting, there is growing interest from private and institutional investors.

Serviced apartments and aparthotels also have leaner operations, yet good brand presence. Yields currently range above those of hotels (by 100bps or more), but are expected to sharpen further as investment-grade supply in the sector continues to grow and the investment class becomes more widely known.



LICENSED

The licensed sector consists of a wide range of establishments, from pubs, to restaurants, cafés, nightclubs and others. We have focused primarily on the subsectors that are seeing the most interest currently: pubs (managed, tenanted and leased), as well as restaurants and coffee shops.

MANAGED HOUSES

Managed houses tend to be the best quality pub stock in the UK, often with a mixed offer that includes food, and sometimes even accommodation. These properties tend to include large car parks, and be more family friendly.

Transactional activity included British Land disposing of 45 investments let to Spirit Pub Company (which was itself acquired by listed operator Greene King plc in 2015) to Aprirose for £130m.

Yields of around 5% are achievable for the most attractive assets (long-term RPI-linked leases let to listed operators) although access to supply is challenging given that very few new pubs are being developed, and the sector is largely freehold, with the best stock already in the hands of operators (many of whom are multi-generational families) or investors. We have seen operators pursue sale and leaseback agreements on a general ground rent basis (a percentage of sustainable EBITDAR), attracted by very compressed yields as low as 2.5% either to finance new builds or recapitalise their business.

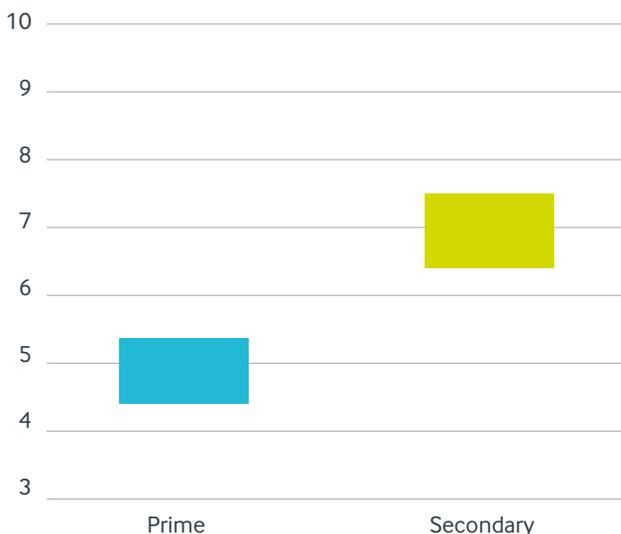
TENANTED AND LEASED PUBS

Tenanted and leased pubs are proving incredibly popular with investors currently, with Private Equity, REITs and real estate funds eager to expand their portfolios within the sector. Interest can be seen at both ends of the market, with strong covenants achieving good yields, and yet more challenging assets earning yields well into double digits.

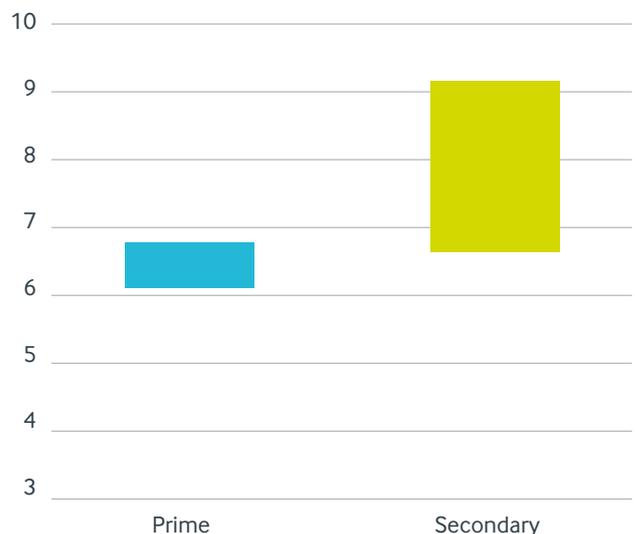
Transactional activity in the first half of the year began with the material acquisition of 370 leasehold investments from ei Group's commercial property division by investment management firm Davidson Kempner in a £348m deal, which Christie & Co advised on, further evidencing the desire of many to enter the sector. This was followed in July 2019 with Stonegate announcing an acquisition of listed pub company ei Group.

Additional churn is expected from established operators seeking to pay down debt or rationalise portfolios (including packages of MRO leases that have arisen over time following the implementation of the Pubs Code), creating opportunities to deploy capital.

MANAGED HOUSE YIELDS (%)



TENANTED AND LEASED PUB YIELDS (%)



RESTAURANTS

Investors benefited post recession from the explosion of casual dining, with rents rising rapidly as brands sought out sites for expansion, and yields compressed. However, the sector has experienced a challenging period over the past two to three years, with a number of high-profile CVAs and administrations. Even household names were not immune, as evidenced with the collapse of the Jamie’s Italian chain in May 2019, which Christie & Co advised on. M&A activity included The Restaurant Group’s acquisition of Wagamama.

Uncertainty has pulled back yields against their peak, and CVA-led rental reductions of up to 30% also impacted the value of investments. Despite this, there remains a number of highly-competent operators with strong brands and good covenant strength eager to take leases in the strongest trading locations. The primary challenge will remain one of oversupply, which may put the brakes on rental increases, although super-prime sites with high footfall should continue to perform.

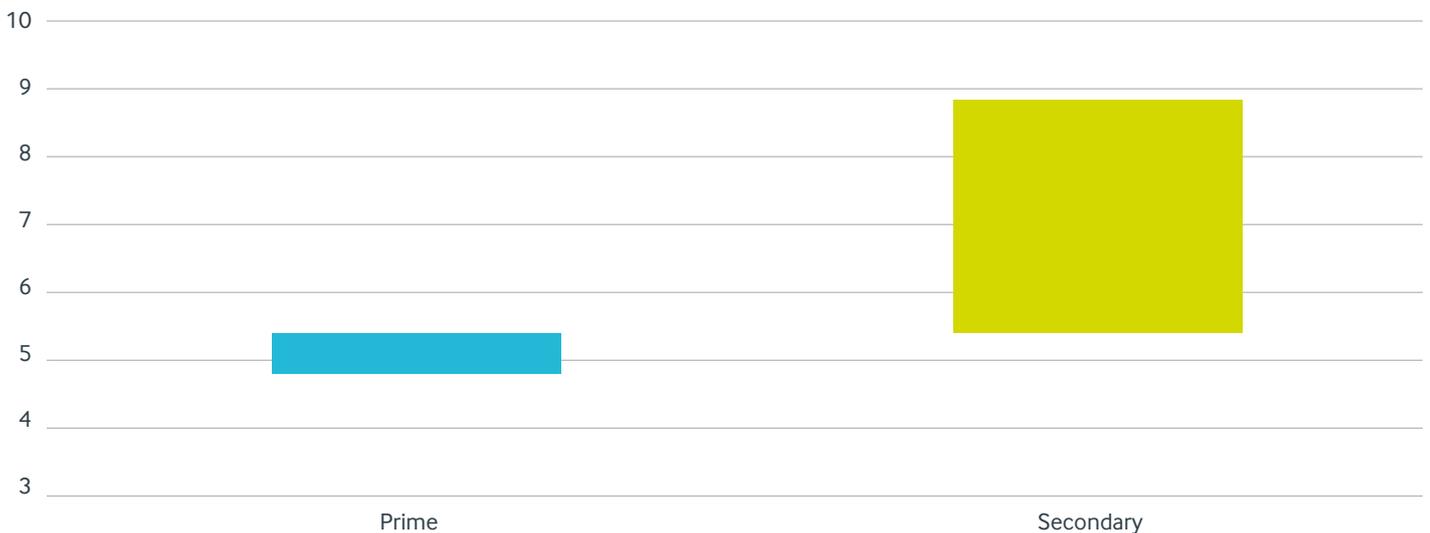
Note that many investment properties with restaurants are mixed-use, with office or residential components on upper floors, which can result in blended yields.

COFFEE SHOPS

The operational side of the UK coffee scene was very much in focus during the first half of the year, with Whitbread disposing of Costa Coffee to Coca Cola for £3.9bn in December 2018, and S.A. Brain disposing of a majority stake in Coffee #1 to Caffè Nero in January 2019. Demand trends are positive and total revenues from coffee sales are forecast to grow at an average 6.8% per annum over the next six years; behind the predicted growth in supply. As such, we are anticipating a proportion of surplus high-street restaurant space across the UK being converted into café use, which should increase the number of investments available.

Behind the sharp yields commanded by Starbucks (and key franchisees), Costa Coffee and Caffè Nero (now incl. Coffee #1), there are a limited number of scale coffee shop operators with strong covenants, primarily just Coffeesmiths. All of these brands are fast growing, and there are significant opportunities for investors, new entrants, and consolidators alike.

RESTAURANT YIELDS (%)





RETAIL

The retail sector consists of a wide range of subsectors in different stages of maturity from an investment perspective. We have focussed on convenience stores and petrol filling stations, which are relatively mature investment sectors, as well as garden centres, which are still maturing.

PETROL FILLING STATIONS

Petrol filling stations remain a relatively specialist investment sector, characterised by a broad pool of private investors with an appetite for long lease investments with strong tenant covenants.

The highest quality modern petrol filling station investments, let to institutional grade tenants on 20-25 year leases, are in relatively short supply, and prime locations can command yields as low as 5.0%. Given the availability of debt finance on historically competitive terms, we expect prime yields to remain stable in the short term.

Older petrol filling stations, as well as those in weaker locations, with unexpired lease terms of less than 10 years, or lower quality tenants, are in less demand. Yields for these investments quickly move beyond 6.5% to as high as 9.0%, particularly where rents are fixed at unsustainably high levels.

CONVENIENCE STORES

Significant changes in consumer behaviour has shifted some investor focus away from traditional high street retail towards more resilient sectors such as food retail. Convenience retail leases often have the added attraction of rents that are index-linked to RPI or CPI, with caps and collars or fixed annual increases.

Convenience store and smaller format supermarket investments therefore remain popular with smaller funds, private investors and family offices, who can acquire income secured against national covenants in lot sizes below £1.5m. Prime yields of 4.5% are achievable in the most affluent and densely populated areas.

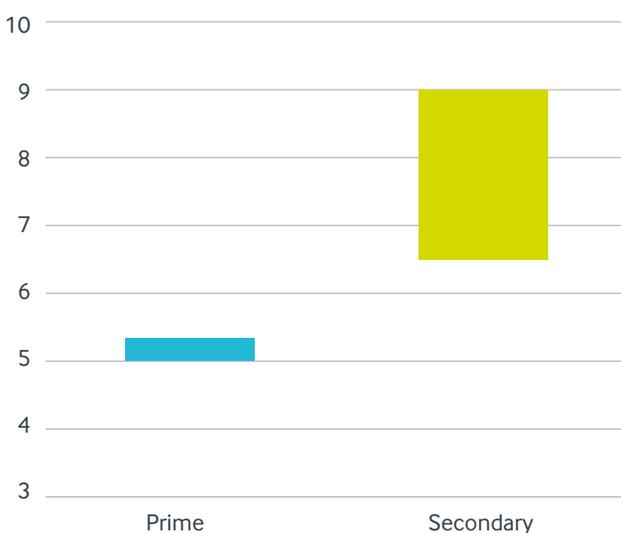
Notwithstanding weak market rental growth, and whilst interest rates remain at relatively low levels historically, we expect long dated (indexed linked) income from convenience store investments to remain attractive to investors during the second half of 2019.

GARDEN CENTRES

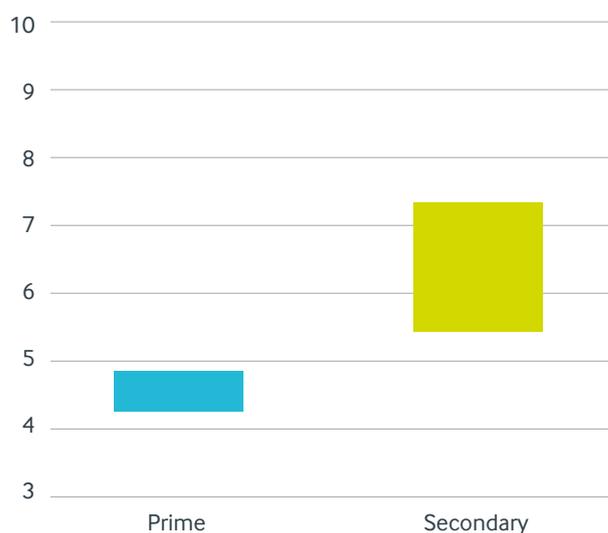
The garden centre investment market is small, with limited transactional evidence. Recent single asset investment deals include the sale of Wimborne Garden Centre, let to Wyevale Garden Centres for a further 11 years, which transacted at a net initial yield of 6.6%. Investment portfolio deals are even less frequent, with little activity other than Blackrock's 2015

acquisition of a portfolio of 8 garden centre investments (5 of which were leased to Wyevale as part of a sale and leaseback) for a price of £112.5m, representing a yield of 5.25%; and their 2018 acquisition of a further three garden centres in a sale and leaseback transaction from Blue Diamond at a price of £26m.

PETROL FILLING STATION YIELDS (%)



CONVENIENCE STORE YIELDS (%)





LEISURE

LEISURE

The leisure sector can be subdivided into many sub-sectors, including golf clubs, cinemas, gyms, bowling alleys, and more. We have focused primarily on the health & fitness sector due to the scale and growth of the market and its attractiveness to investors.

GYMS

The UK's health & fitness industry has continued to grow strongly as the nation's health & wellbeing remains consistently in the public eye, whether via the media or the ever-increasing concern of the government and other public bodies.

The industry has weathered the economic downturns better than a number of so-called "discretionary" leisure segments and is today seen by its millions of participants as a necessary part of their lives.

Since 2010, the number of gyms in both public and private ownership has grown to around 7,250 (+23%), whilst the number of members is currently around 10.5m (+42%). The market valuation of the industry, now estimated to be worth some £5.1bn, has seen a 34% increase over the same period.

The private market remains highly fragmented with the top ten operators accounting for approximately 25% of clubs, offering great potential for further consolidation. Key growth has been driven by the budget operators, spearheaded by Pure Gym and the Gym Group, as well as the growth in the franchise market from the likes of Anytime Fitness and energie. Premium operators such as David Lloyd Leisure have continued to grow organically both in the UK and Europe as have those upper mid-market players such as Bannatyne Fitness and Nuffield,

with all making selective acquisitions and investing significantly in their portfolios.

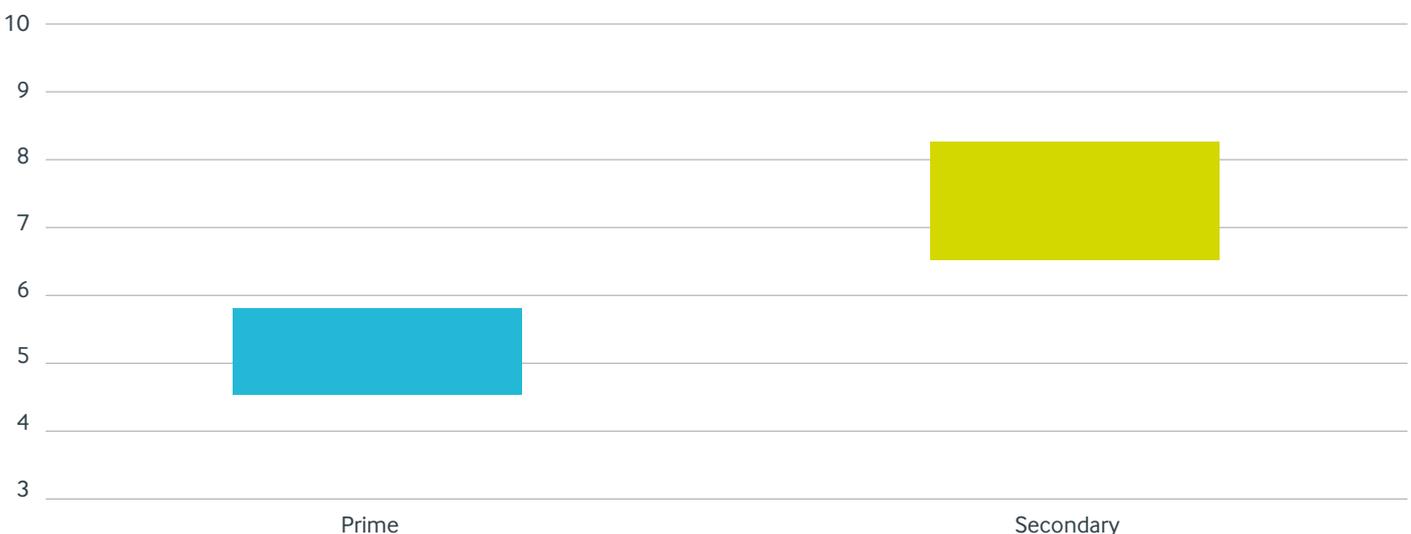
From a property perspective, the industry is essentially a leasehold one, with the likes of David Lloyd Leisure and Bannatyne pursuing a long leasehold strategy for their core estates. Most other operators take FRI leases of 15-25 year duration. As most locations have reached saturation, there has been a greater focus on in-fill development and smaller-format clubs.

Key factors for investors include the quality of real estate with purpose-built facilities in demand, particular those in high-profile locations close to major population centres with dedicated on-site parking.

Comparatively low barriers to entry for the low-cost sector have driven up competition for sites and by definition rents, and investors should take specialist advice to ensure businesses have the ability at unit level to cover property outgoings, which account for a significant percentage of income.

Recent Christie & Co transactions include David Lloyd, Harrogate, to CBREGi (3.4%) and Better Gym, Sheffield, to a local authority pension fund (6%).

GYM YIELDS (%)



CONTACTS

Christie & Co is a leading specialist advisor in buying and selling businesses and investments across the alternative sectors, including hotels, pubs, restaurants, childcare, healthcare, convenience retail, leisure and medical. Our network of 29 office locations is well placed to ensure that we are easily accessible to our clients across the UK, Europe and beyond.

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