UKIT

UK Investment Transactions Bulletin Q1 2015

Lambert Smith Hampton

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No sign of election slowdown

- **Investor appetite has been undeterred by the upcoming General Election.** On the heels of a record year in 2014, Q1 volume reached £19.1bn, the second highest quarterly total on record after Q4 2014.

- **The All Property transaction yield dropped below 6% for the first time in seven years,** moving down by 19 basis points in Q1. Of the core sectors, Industrial saw the strongest inward movement, coming in by 23 basis points to 6.49%.

- **Specialist sectors accounted for a record 20% share of volume.** Q1's four largest deals comprised three student accommodation portfolios and the Jurys Inn hotel portfolio, all of which were purchased by overseas investors.

- **Q1 investment in the three core sectors was down on the final quarter of 2014.** Rest of UK Offices and Office Parks were the only two core subsectors to see an uplift in activity.

- **Activity in the regions continued to increase in Q1**, rising marginally on Q4 2014 and 30% above the same period last year. While volume in London was 30% above the rest of the UK combined, investment in the capital was down 19% on Q4 2014.

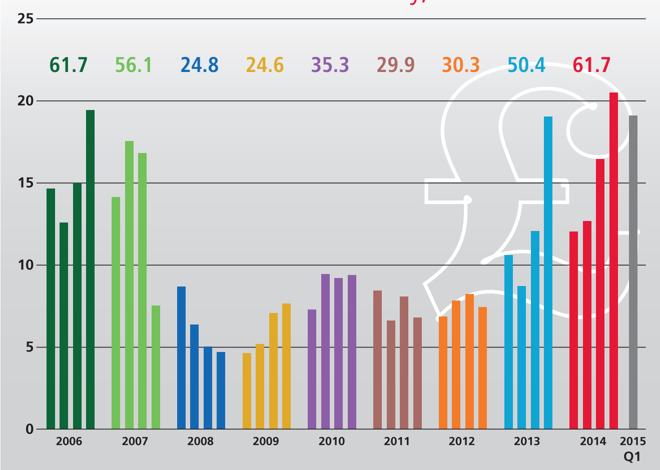
- **Overseas investors accounted for 50% of Q1 volume, despite transacting only 17% of deals.** Central London assets and portfolios remain the focus, although overseas activity in the regions increased by 41% quarter-on-quarter.

- **Overseas investors were the largest net buyers in Q1**, followed by the UK institutions. Private property companies and private investors were net sellers.

Q1 Investment volumes, £bn

Sectors	Q1 15	vs Q4 14	vs Q1 14
Shops	£1.71	-3%	79%
Shopping Centres	£1.02	-3%	-32%
Retail Warehouse	£0.66	-2%	23%
All Retail	**£3.38**	-2%	14%
Central London Offices	£4.35	-44%	61%
Rest of South East Offices	£0.51	-12%	32%
Rest of UK Offices	£1.19	20%	82%
Office Parks	£0.53	26%	-43%
All Office	**£6.58**	-33%	41%
South East Industrial	£0.19	-62%	-5%
Rest of UK Industrial	£0.52	-18%	9%
Distribution Warehouse	£0.86	-24%	81%
All Industrial	**£1.57**	-30%	36%
Hotels & Leisure	£2.62	58%	106%
Specialist	£3.73	386%	753%
Mixed-use (single assets & portfolios)	£1.24	-52%	-19%
All Property	**£19.12**	-7%	59%

UK Investment market activity, £bn



Source: LSH Research, Property Archive, Property Data

Sector focus

While Q1 investment in each of the three core asset classes was down on Q4 2014, a record quarter for investment in leisure and the specialist sectors propelled overall activity to £19.1bn in Q1 2015.

Specialist sectors lead the way

The specialist sectors are becoming an increasingly important feature of the investment market, reflected by a record £3.7bn of investment in Q1. This was dominated by several major student accommodation deals to overseas buyers, including Canada Pension Plan Investment's £1.1bn purchase of the Brandeaux Student Fund portfolio and Greystar Real Estate Partners' purchase of the Nido Portfolio.

In addition, investment into Hotels & Leisure was a substantial £2.6bn in Q1. Four major deals accounted for over half of this, the largest of which was Lone Star's £676m purchase of the Jurys Inn Portfolio from the Oman Investment Fund.

More movement into regional offices

Increasing confidence in the UK's office occupier markets continues to drive activity in the regions, as largely institutional investors seek out higher yielding alternatives to London. Notably, while investment into the three core asset classes declined quarter-on-quarter, Rest of UK Offices and Office Parks recorded an uplift, increasing by 20% and 26% respectively.

A substantial weight of overseas capital continues to target Central London Offices. While Q1 volume of £4.4bn was down 44% on Q4 2014's record level, this largely reflected an absence of any 'mega deals' which characterised the last quarter. Q1's largest Central London office deal was Shimao Property's £270m purchase of Christchurch Court, Paternoster Square.

Transaction yields dip below 6%

The All Property transaction yield moved in 19 bps during Q1 to stand at 5.92%, its lowest level since Q4 2007. While West End offices was the only key sector to see a hardening of notional prime yields in Q1, the majority of sectors saw a hardening of average transaction yields, indicating that prices continued to increase for the wider market.

Of the core sectors, Industrial saw the strongest inward movement in transaction yields during Q1, falling 23 basis points to 6.49% and largely driven by activity in the distribution warehouse sector. While extremely positive fundamentals in the industrial occupier market have prompted a sharp rise in industrial capital values, reduced stock levels affected activity, with volume falling by 30% on the last quarter.

Q1 transaction yields in Central London Offices and Rest of UK Industrial stand higher than their position a year ago, despite a hardening of prime yields. This divergence suggests that investors are buying higher yielding assets in these markets, reflecting increased appetite for risk.

Yields

Sector	Transaction yields			Prime Yields		
	Q1 2015	3 month movement (b.p.)	12 month movement (b.p.)	Q1 2015	3 month movement (b.p.)	12 month movement (b.p.)
Shops	4.88%	-12	1	4.50%	◄►	-25
Shopping Centres	6.70%	-24	-84	5.50%*	◄►	-75
Retail Warehouse	6.48%	28	-26	4.50%	◄►	-75
All Retail	**6.12%**	-3	-42	–	–	–
Central London Offices	4.88%	30	27	3.50%	-25	-25
Rest of South East Offices	7.42%	98	-118	5.00%	◄►	-25
Rest of UK Offices	6.51%	-178	-11	5.25%	◄►	-25
Office Parks	8.23%	118	-159	5.25%	◄►	-75
All Office	**5.46%**	-6	-51	–	–	–
South East Industrial	6.01%	-65	-61	5.25%	◄►	-50
Rest of UK Industrial	8.61%	164	149	6.00%	◄►	-50
Distribution Warehouse	5.47%	-114	-211	4.75%	-25	-75
All Industrial	**6.49%**	-23	-49	–	–	–
Hotels & Leisure	6.26%	-11	-130	5.50%	◄►	-25
Specialist	5.42%	-68	-121	5.50%**	◄►	-100
Mixed-use (single assets & portfolios)	5.55%	-307	-190	–	–	–
All Property	**5.92%**	-19	-50	–	–	–

Source: LSH Research, Property Data, Property Archive

*Key urban centres **Student accommodation (Regional, direct-let)

Regional focus

The revival of investment in the UK regions during 2014 showed no sign of letting up in Q1. While volumes in London fell quarter-on-quarter, activity elsewhere in the UK kept pace, increasing marginally to reach £5.8bn.

Overseas buyers crowd London

London saw £7.6bn of assets change hands in Q1, making up 40% of total UK volume. While this was 19% short of Q4 2014's near-record level, it was 50% higher than Q1 2014.

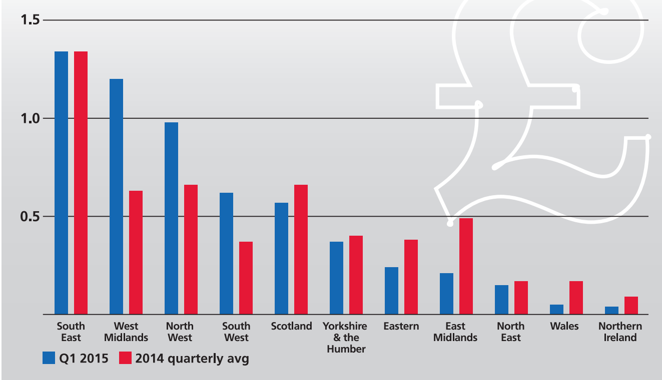
Overseas investors continue to dominate the London market, accounting for 56% of volume and nine of the ten largest deals. London's largest Q1 deal was Malaysian Employees Pension Fund's £271m acquisition of Fulham and Hammersmith Broadway Shopping Centres (5.0% NIY).

West Midlands and North West boosted by major deals

The UK's regional markets have swung firmly back into favour. As well as offering perceived better value to London, the investment case is now much more credible given the improvements in the regional economies, occupier market activity and rental growth prospects.

The West Midlands enjoyed a stellar Q1, with volume of £1.2bn, a threefold increase on the last quarter. Large transactions were key, including LDC's £307m acquisition of the NEC, Birmingham, the largest single asset deal outside London in Q1 2015.

Regional investment volumes, £bn



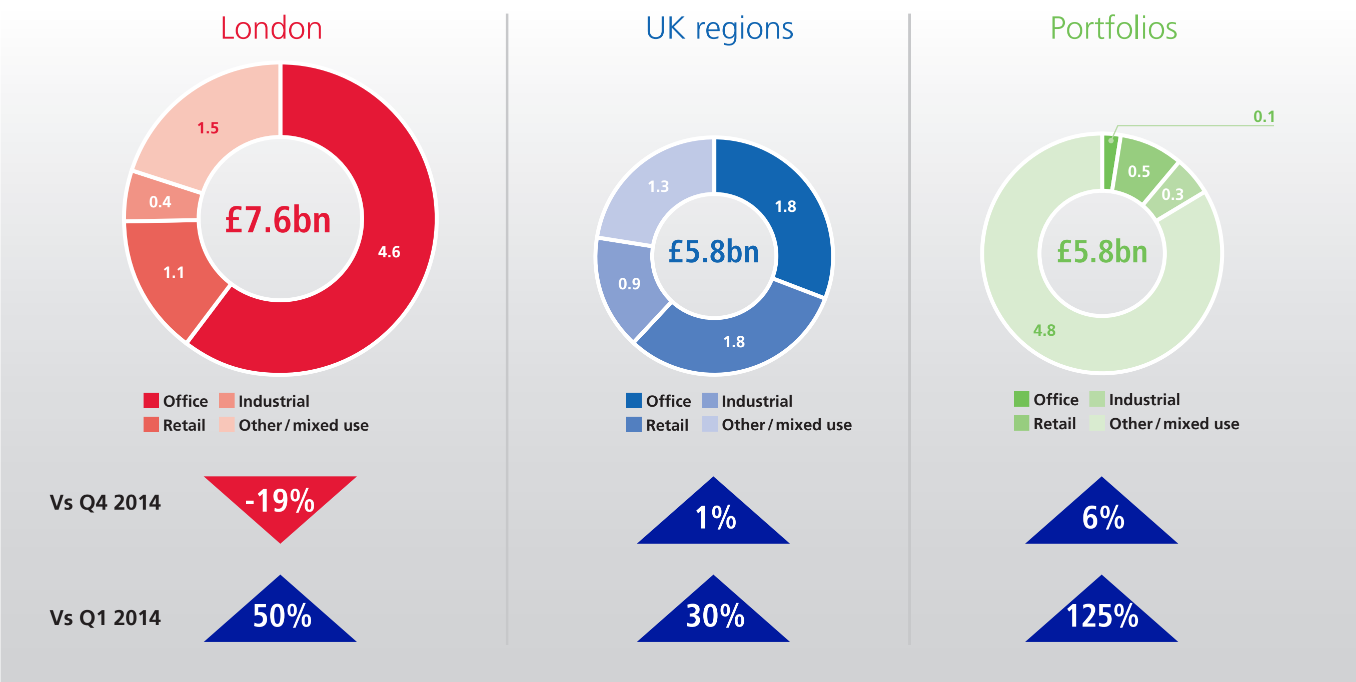
Source: LSH Research, Property Data, Property Archive

Similarly, investment in the North West region doubled to reach £1.0bn in Q1, a quarter of which was accounted for by Legal & General's purchase of a 50% stake in MediaCityUK, Salford for £252m.

Another record quarter for portfolio deals

Q4 2014's record quarter for portfolio volume was surpassed again in Q1 2015, rising by 6% to reach £5.8bn. The four largest portfolio deals involved leisure and alternative assets, and together they accounted for 50% of portfolio investment volumes. Investment from North America, in particular US banks and private equity, has provided the key source of demand for UK portfolios.

Q1 2015 London and regional breakdown, £bn



Source: LSH Research, Property Archive, Property Data

Buyers and sellers

With intense competition for London assets, one of our top predictions for 2015 was for overseas activity to diversify and spread into the regions. Evidence from Q1 would appear to bear this out.

Overseas investors compete for regional stock

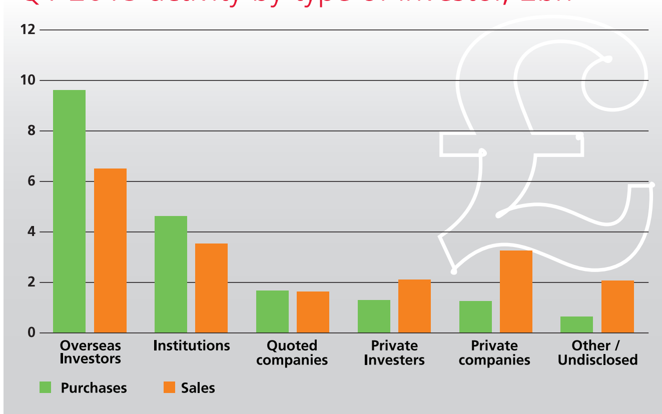
While overseas investors' share of total Q1 activity was closely in line with Q4 2014, at half of total volume, the underlying destination of capital inflows between London and the regions shifted. Overseas investment for single assets in the regions increased 41% quarter-on-quarter to £1.3bn, while in London it dropped by a third to £4.3bn.

Despite the undisputed dominance of overseas investors in the capital, institutional investment in London reached £1.7bn, its highest quarterly total since Q3 2006. However, evidence suggests a degree of profit taking in core Central London markets, with net selling in London's West End set against strong net purchasing elsewhere in London, in areas such as Southwark and Hammersmith.

North American buyers dominate overseas volumes

Reflecting strong appetite for major UK portfolios, North American buyers continue to dominate overseas investment volume, accounting for half of the total in Q1 2015. North American buyers were also behind the three largest deals in the quarter, including Canada Pension Plan Investment's £1.1bn purchase of Brandeaux Student Fund portfolio.

Q1 2015 activity by type of investor, £bn



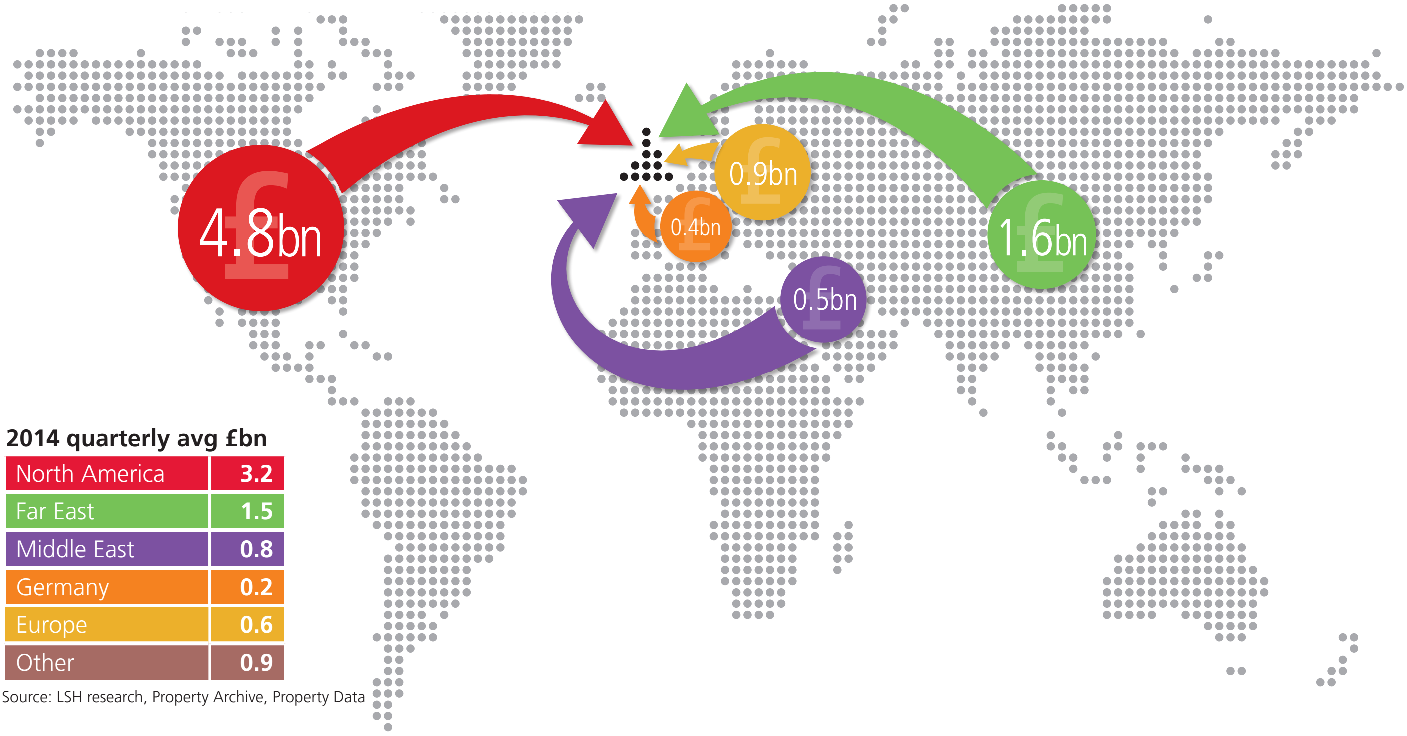
Source: LSH Research, Property Archive, Property Data

Despite the relative weakness of the Euro against Sterling, German buyers more than doubled their investment into the UK quarter-on-quarter. The £431m of activity comprised five deals, the largest of which was VGV's acquisition of 1-5 Howick Place, Victoria, for £210m (NIY 4.26%).

Legal & General is the most active institutional buyer

UK institutions were the second largest net buyer of UK property after overseas buyers, investing £4.6bn in Q1 2015. By volume, Legal & General was the largest institutional buyer with £1.1bn of investment in Q1, which included its £370m purchase of the Bishopsgate Unit Trust portfolio (6.0% NIY). However, Aviva was the most active institution, buying 12 assets in Q1.

Q1 2015 global investment flows into UKRE, £bn



2014 quarterly avg £bn

North America	3.2
Far East	1.5
Middle East	0.8
Germany	0.2
Europe	0.6
Other	0.9

Source: LSH research, Property Archive, Property Data

Outlook

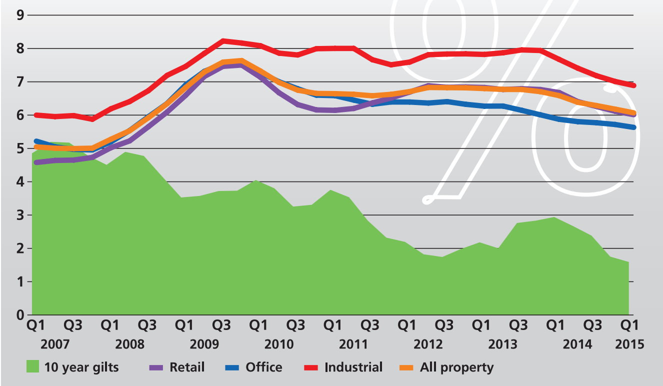
Political uncertainty vs the bigger picture

The likelihood of a hung parliament has evidently done little thus far to deter investors from the market. Clearly, political uncertainty is being offset by a host of other, positive, factors influencing the market.

- Firstly, current consensus indicates that the base rate will remain at 0.5% until at least Spring 2016, while any increases thereafter will be gradual. Unattractive returns from low risk assets continue to fuel demand for commercial property, with figures from the Investment Management Association revealing a continuing influx of capital into retail property funds during the first few months of 2015.

- Property markets are inextricably linked to the performance of the economy. UK economic growth for 2014 was recently revised up to 2.8%, the strongest of any G7 nation, while official forecasts point to similar growth in 2015. The consumer is set to play a key role, with EY forecasting the present 'noflation' environment to support the real wage growth of 3.7%, its strongest in 20 years.

Rolling annual transactional yields & 10 year government bonds, %



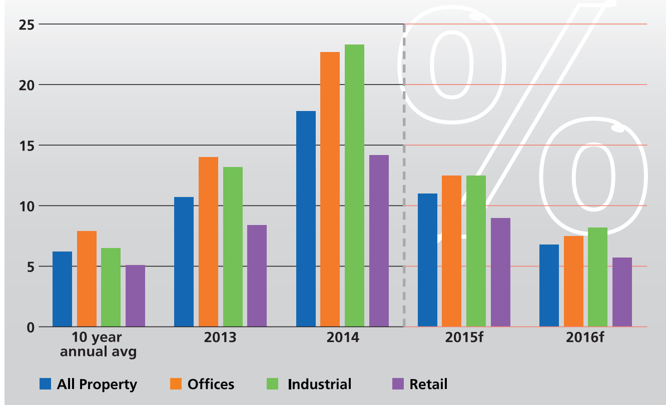
Source: LSH Research, FT.com

- Finally, overseas appetite for UK commercial property remains unwaveringly strong. The unstable geopolitical environment and the enduring transparency of UK property markets continue to attract flows of global capital. The Dollar's current strength relative to Sterling will also continue to fuel demand from North American investors.

From yield compression to rental growth

The prevailing low interest rate environment and increasingly competitive lending appetite suggests there is more scope for yield compression than was widely thought six months ago. Based on the IPD measure, our forecast for All Property returns stands at a healthy 12% in 2015, with capital growth taking the lion's share of total returns.

Total return forecasts, % pa



Source: LSH Research, IPD

However, total returns have already peaked, with the rate of yield compression easing down from the unsustainable levels of 2014. In its place, rental growth will play an increasingly important part in driving performance, reflecting the strength of demand and supply pressures in the occupier markets. This is particularly true of the office and industrial sectors, which recorded strong activity in 2014.

Investment performance is steadily reverting to occupier market fundamentals. Therefore, in 2016, our forecast is for on trend All Property returns of circa 8%, with income generation and rental growth underpinning investment performance.

Time to rethink retail?

Returns from the retail sector have underperformed those of offices and industrial over recent years, and our forecast for the next two years indicates a continuation of this trend. However, this is an aggregate figure for the sector as a whole and masks pockets of potential growth.

Firstly, the latest figures around retailing are encouraging; retail sales volumes increased to 4.2% in the 12 months to March, while GFK's Consumer Confidence Index recently moved to a 13-year high. Furthermore, the rapid adoption of 'click and collect' demonstrates that many retailers have become adept at combining ecommerce with bricks and mortar platforms while there continues to be new entrants to the market.

With marked price rises seen for offices and industrial, the relative value in the market for retail assets may prompt investors to reconsider the sector, in spite of the structural headwinds. Investors will have to move with caution, but now might just be time to steal a march.

About us

We are a commercial property consultancy working with investors, developers and occupiers in both the public and private sectors across the UK and Ireland.

Amazon to Zurich: we have partnerships with the complete A to Z of the best organisations in Britain and Ireland.

Transport to telecoms: we have experience of an extremely wide range of sectors.

Capital markets to construction consultancy: we serve an incredibly diverse range of commercial property disciplines.

We value lateral thinking and celebrate enterprise, with a focus on delivering more for our clients. By looking beyond the obvious, we consistently generate impressive results.

For further information please contact:

Ezra Nahome
CEO
+44 (0)20 7198 2222
enahome@lsh.co.uk

Paddy Brennan
Head of Capital Markets
+44 (0)28 9026 9206
pbrennan@lsh.co.uk

Nick Lloyd
Director – London
+44 (0)20 7198 2221
nlloyd@lsh.co.uk

Oliver du Sautoy
Head of Research
+44 (0)20 7198 2193
odusautoy@lsh.co.uk

Darren Sheward
Director – Bristol
+44 (0)117 914 2041
dsheward@lsh.co.uk

Adam Ramshaw
Director – Birmingham
+44 (0)121 237 2395
aramshaw@lsh.co.uk

Donall McCann
Director – Belfast
+44 (0)28 9026 9220
dmccann@lsh.co.uk

Abid Jaffry
Director – Manchester
+44 (0)161 242 7099
ajaffry@lsh.co.uk

Ewen White
Director – Glasgow
+44 (0)141 226 6777
ewhite@lsh.co.uk

Andrew Shiells
Director – Edinburgh
+44 (0)131 226 0333
asheills@lsh.co.uk

www.lshinvestmentsales.co.uk

Our national office network

Belfast
Tel: +44 (0)28 9032 7954

Birmingham
Tel: +44 (0)121 236 2066
Tel: +44 (0)121 200 7620

Bristol
Tel: +44 (0)117 926 6666
Tel: +44 (0)117 927 3454

Cambridge
Tel: +44 (0)1223 276336

Cardiff
Tel: +44 (0)29 2049 0499

Chelmsford
Tel: +44 (0)1245 215521

Dublin
Tel: +353 (0)1 676 0331

Edinburgh
Tel: +44 (0)131 226 0333

Exeter
Tel: +44 (0)1392 880 180

Fareham
Tel: +44 (0)1489 579579

Glasgow
Tel: +44 (0)141 226 6777

Guildford
Tel: +44 (0)1483 538181

Leeds
Tel: +44 (0)113 245 9393
Tel: +44 (0)113 245 8454

Leicester
Tel: +44 (0)116 255 2694

Liverpool
Tel: +44 (0)151 236 8454

London
Tel: +44 (0)20 7198 2000
Tel: +44 (0)20 7955 8454

Luton
Tel: +44 (0)1582 450444

Maidenhead
Tel: +44 (0)1628 676001

Manchester
Tel: +44 (0)161 228 6411
Tel: +44 (0)161 216 9197
Tel: +44 (0)161 833 1197

Milton Keynes
Tel: +44 (0)1908 604630

Newcastle upon Tyne
Tel: +44 (0)191 232 6291

Northampton
Tel: +44 (0)1604 664366

Nottingham
Tel: +44 (0)115 950 1414
Tel: +44 (0)115 988 6170

Oxford
Tel: +44 (0)1865 200244

Reading
Tel: +44 (0)118 959 8855

St Albans
Tel: +44 (0)1727 834234

Sheffield
Tel: +44 (0)114 275 3752

Solent
Tel: +44 (0)2380 461 630

Southampton
Tel: +44 (0)23 8033 0041

Swansea
Tel: +44 (0)1792 702800

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Due to space constraints within the report, it has not been possible to include both imperial and metric measurements.

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