UKIT

UK Investment Transactions Bulletin Q2 2015

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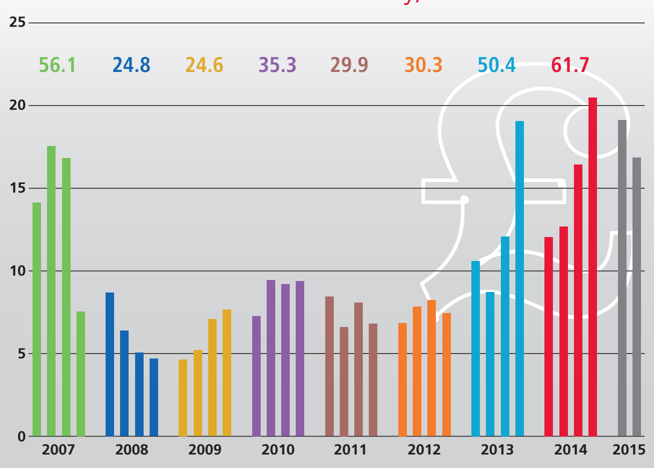
Major portfolio deals drive activity

- **Q2 investment volume totalled £16.8bn**, a 33% increase on the same period last year but 12% down on Q1's strong performance. Volume in first half of 2015 was the second strongest half-year on record after H2 2014.
- **Large portfolio deals propelled activity in Q2**, while the ten largest transactions accounted for almost a quarter of total volume. This pushed Q2's average lot-size to £35m, the highest on record and 50% above the ten-year quarterly average.
- **The All Property transaction yield moved in by 23 basis points** during Q2 to stand at 5.69%, its lowest level since Q4 2007. Of the core sectors, Offices saw the strongest downward yield movement over the quarter, while Retail yields moved up, albeit marginally.
- **H1 2015 was a record half year for the specialist sectors.** Following Q1's record volume, Q2 saw a further £2.1bn of specialist deals. Over 80% of this was invested through portfolio transactions, and included three major student accommodation deals.
- **Overseas investors were the largest buyers in Q2**, accounting for over 50% of volume, and dominated by North America. However, of the buyer types, UK institutions took the largest share of transactions, responsible for 37% of Q2's deals.
- **Greater London accounted for 43% of Q2 volume** and was 33% above its five-year average. Regional single-let investment was down 32% from Q1's strong total, but was nevertheless 7% above the five-year average.
- **South East Offices saw the strongest rise in activity quarter-on-quarter.** Volumes were up almost 60% during Q2, driven by several large deals including Legal & General's £135.5m purchase of the Compass Portfolio.

Investment volume Q2 2015, £bn

Sectors	Q2 15	vs Q2 14	vs Q1 15
Shops	£1.29	43%	-25%
Shopping Centres	£1.29	-23%	27%
Retail Warehouses	£0.70	21%	8%
All Retail	**£3.28**	4%	-3%
Central London Offices	£4.10	10%	-6%
Rest of South East Offices	£0.81	83%	58%
Rest of UK Offices	£0.82	-16%	-31%
Office Parks	£0.64	81%	21%
All Office	**£6.37**	16%	-3%
South East Industrial	£0.20	9%	6%
Rest of UK Industrial	£0.60	279%	15%
Distribution Warehouses	£0.68	-43%	-21%
All Industrial	**£1.48**	-3%	-6%
Hotels & Leisure	£2.05	186%	-22%
Specialist	£2.07	208%	-44%
Mixed-use (single assets & portfolios)	£1.58	40%	28%
All Property	**£16.84**	33%	-12%

UK Investment market activity, £bn



Source: LSH Research, Property Archive, Property Data

Sector focus

From a volume perspective, May's election apparently had no impact on the investment market. At £16.8bn, Q2 volume was up 33% on the same period last year and only 12% down on Q1, which was itself a record for a first quarter.

Large deals propelled Q2 activity

However, Q2's volume painted a slightly misleading picture over the depth of market activity. The number of transactions slipped by 25% from Q1, marginally below the long run quarterly average. Large deals were key, with the ten largest transactions together accounting for almost a quarter of total volume. This pushed the average lot-size to £35m in Q2, the highest on record and more than twice the quarterly average.

Non-core assets featured strongly

Following Q1's record quarter, strong demand for non-core assets has continued and accounted for almost 25% of total volume in Q2.

The specialist sectors saw £2.1bn of transactions in Q2, the majority of which comprised several major student accommodation deals. Of these, the largest was Goldman Sachs and Greystar's £500m purchase of the Westbourne portfolio for £500m.

Hotels & Leisure saw a significant £2.1bn of investment in Q2. The quarter also saw Blackstone sell Center Parcs to Brookfield for £2.4bn, although, as a corporate acquisition, the figures are not included in Q2's investment volume.

South East Offices sees largest increase quarter-on-quarter

Of all the sectors, South East Offices saw the highest increase in volumes quarter-on-quarter, rising 60% to £810m. This was boosted by Legal & General's £135.5m purchase of the Compass Portfolio and Hermes' £131m purchase of Hammersmith Grove, which together accounted for over 30% of sector volume.

Renewed acceleration in price growth

The All Property transaction yield hardened once again during Q2. The average yield moved in by 23 basis points quarter-on-quarter to stand at 5.69%, its lowest level since Q4 2007. Of the core sectors, Offices saw the strongest inward movement during Q2 to stand at 4.84%, while the average Retail yield moved marginally upwards to 6.18%.

At the prime end of the market, yields were broadly stable during Q2, arguably reflecting a growing appetite for higher yielding secondary assets. The clearest exception was Distribution Warehouses, with transactional evidence indicating that prime yields hardened by 50bps during Q2 to 4.25%.

Yields

Sector	Transaction yields Q2 2015	Transaction yields 3 month movement (b.p.)	Transaction yields 12 month movement (b.p.)	Prime yields Q2 2015	Prime yields 3 month movement (b.p.)	Prime yields 12 month movement (b.p.)
Shops	4.61%	-27	-14	4.25%	-25	-25
Shopping Centres	7.59%	89	198	5.50%*	◄►	◄►
Retail Warehouses	5.92%	-55	-68	4.25%	-25	-50
All Retail	**6.18%**	6	42	–	–	–
Central London Offices	4.11%	-77	-76	3.25%	-25	-50
Rest of South East Offices	5.91%	-152	-191	5.00%	◄►	◄►
Rest of UK Offices	6.36%	-15	16	5.00%	◄►	-25
Office Parks	6.93%	-130	-77	5.25%	◄►	-25
All Office	**4.84%**	-62	-93	–	–	–
South East Industrial	5.89%	-13	-204	5.25%	◄►	-25
Rest of UK Industrial	6.70%	-191	-116	6.00%	◄►	-25
Distribution Warehouses	5.98%	51	-71	4.25%	-50	-75
All Industrial	**6.10%**	-39	-151			
Hotels & Leisure	5.42%	-83	-72	5.50%	◄►	-25
Specialist	5.22%	-20	-82	5.50%**	◄►	-75
Mixed-use (single assets & portfolios)	5.92%	37	101	–	–	–
All Property	**5.69%**	-23	-37	–	–	–

Source: LSH Research, Property Data, Property Archive

*Sub regional centres **Student accommodation (Regional, direct-let)

Regional focus

Although volume for single-let regional assets slipped notably from Q1's level, record activity for UK portfolios confirms that investor appetite for regionally located stock remains very strong.

Record half year for portfolio deals

Portfolio volumes reached £5.7bn in Q2, falling narrowly short of Q1's record of £5.8bn. Portfolio deals also accounted for a third of overall volume, the highest proportion since 2003. Non-core assets were the main component of Q2 activity, with hotels and student accommodation each commanding 20% of portfolio volume.

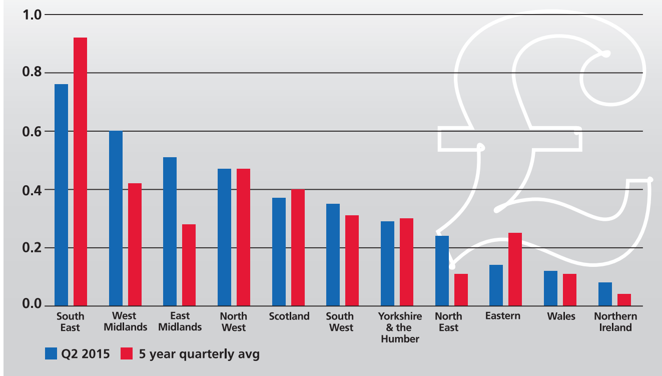
Demand for London continues

London saw £7.2bn of assets change hands in Q2 and, while 5% below Q1, was 24% above the same period last year. Over half of London's volume was made up of Central London Offices, although the largest deal in the capital was a retail asset, where Ponte Gadea purchased a substantial holding on Oxford Street for £435m from Oriana GP.

The regions remain attractive

The UK's regional markets remain in favour, reflecting the renewed confidence in the economy beyond the capital and the search for higher yield. While regional, single-let volume fell by 32% quarter-on-quarter, it was nevertheless 7% above the five-year quarterly average.

Quarterly regional investment volumes, £bn

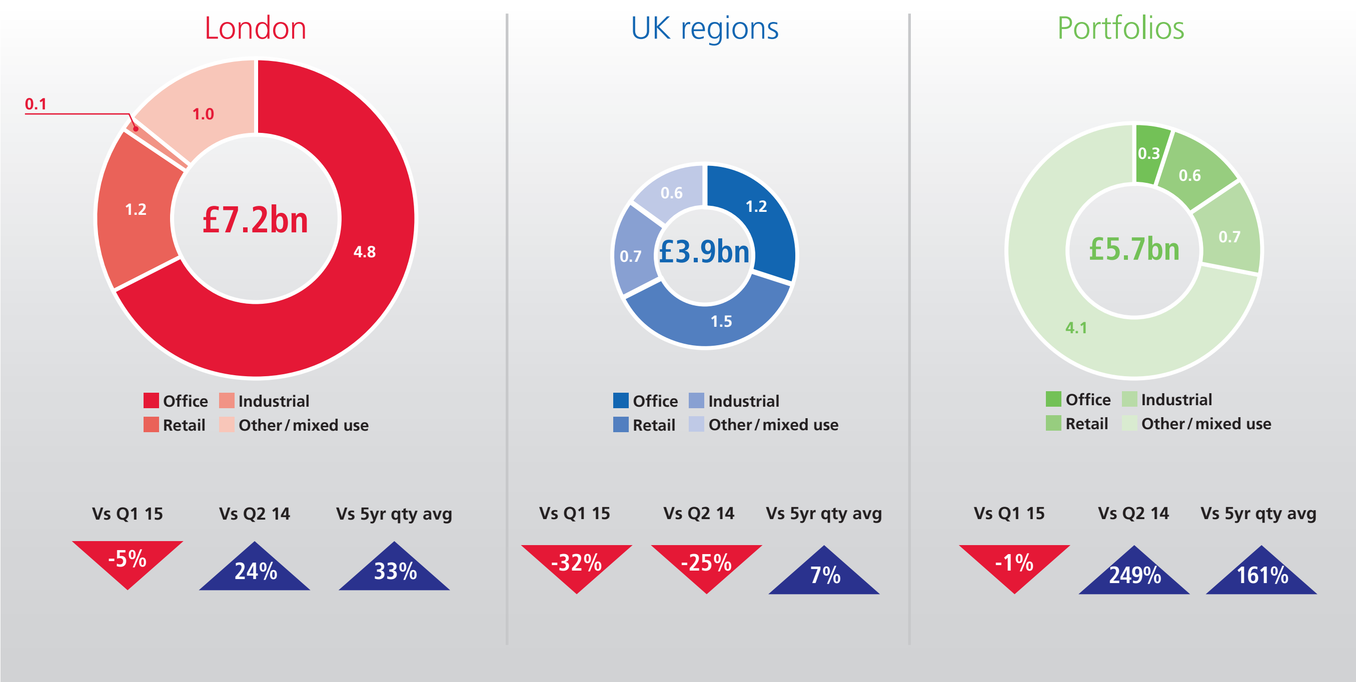


Source: LSH Research, Property Data, Property Archive

Outside of the South East, the West Midlands attracted the most investment in Q2 at £603m, over 40% above the five-year average. The largest deal was New Frontier Properties' purchase of Coopers Square shopping centre in Burton-upon-Trent for £94m from F&C REIT. With turnover of £243m, the North East region performed the strongest against its five-year average, with the majority of volume comprising retail assets.

The largest single asset deal outside of the capital was Deutsche Asset & Wealth Management's office purchase of No.2 St Peter's Square, Manchester for £100m from Mosley Street Ventures Limited. As a whole, Manchester attracted almost a quarter of Rest of UK Offices investment in Q2, followed by Glasgow, which made up 18%.

Q2 2015 London and regional breakdown, £bn



Source: LSH Research, Property Archive, Property Data

Buyers and sellers

Overseas investors maintained their dominant position as the largest net investor into UK property in Q2, and purchased seven of the ten largest lot-sizes in the quarter. While UK institutions followed a close second, this buyer type saw the strongest quarter-on-quarter increase in net investment, rising by 41% from Q1.

Overseas money targets large portfolios

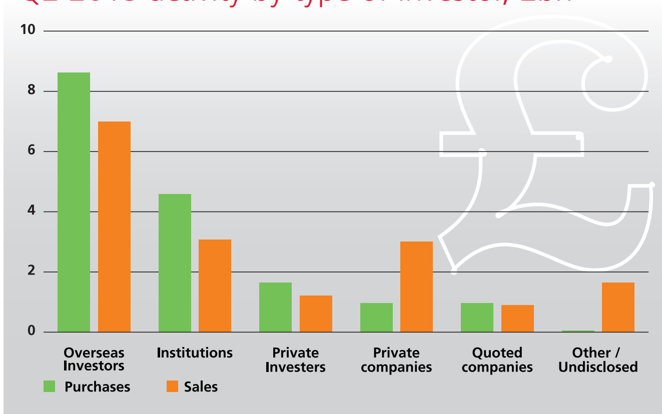
North American buyers continue to dominate the overseas buyer profile, investing £4.7bn into the market in Q2 and accounting for 55% of total overseas investment. Portfolios were a key focus for North American buyers, making up 65% of total portfolio volume. This included the largest deal of the quarter, TPG Capital's purchase of a portfolio of 48 hotels for £595m from Atlas Hotels.

Despite the continued economic uncertainty on the continent, European investment increased by 10% quarter-on-quarter to £1.5bn, its highest since Q4 2013 and 26% above average. German buyers have increased their investment into UK property consistently over each of the last three quarters, rising by 18% in Q2 to £500m. However, half of this comprised Union Investment's £250m purchase of 90-94 Watermark Place, EC4, London.

The Far East was the largest overseas net buyer

Although North America was the main overseas buyer into the UK market in absolute terms, the Far East was the largest overseas net investor. While North America poured significant capital into UK property, it also sold a large volume of assets, equating to a net investment of £0.3bn into the market, compared to the Far East's £1.2bn.

Q2 2015 activity by type of investor, £bn



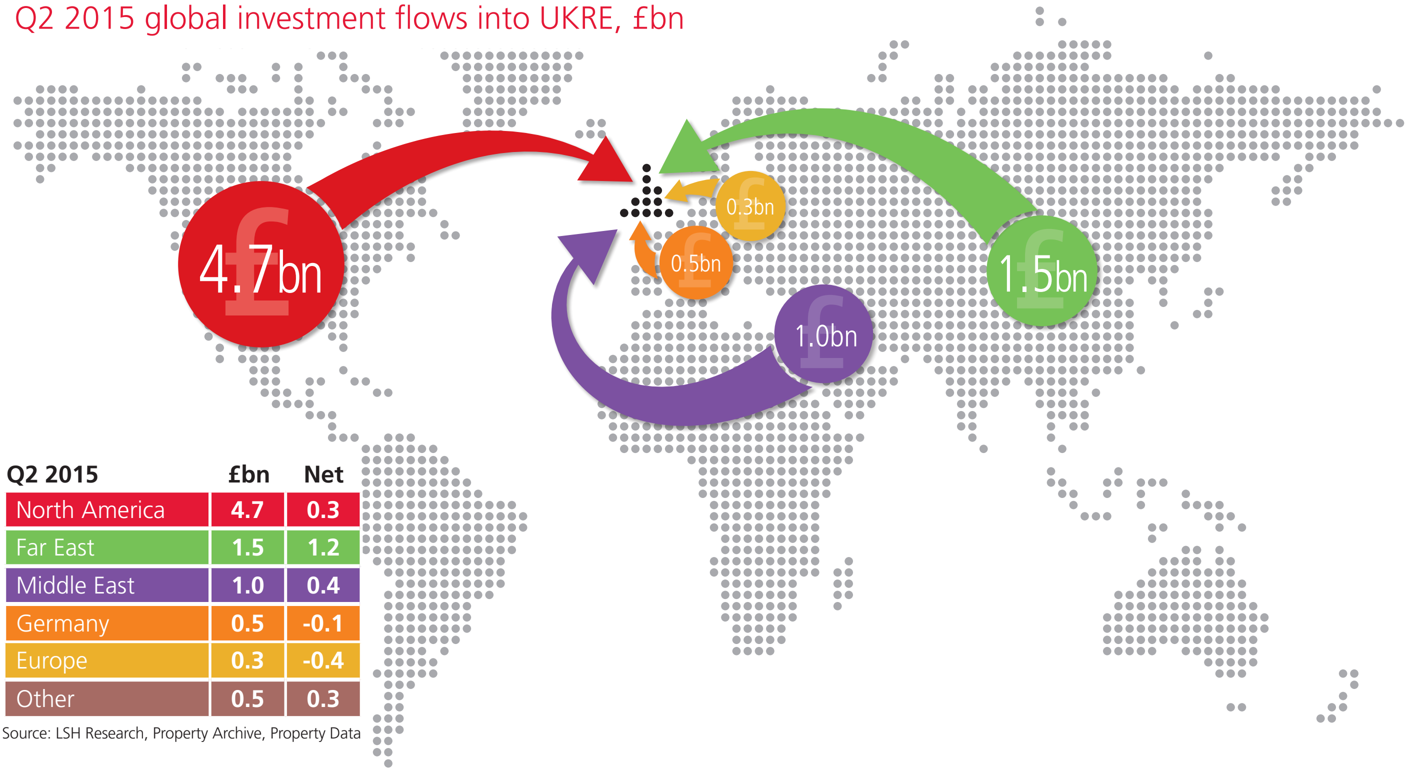
Source: LSH Research, Property Archive, Property Data

Legal & General retains status as most active institution

UK institutions were the second largest net buyer after overseas investors, investing a net £1.5bn into the UK property market during Q2. For the second quarter running, Legal & General was the largest institutional buyer with £434m of investment in Q2. The vast majority of this money was invested in offices, making up over 90% of their spending.

M&G was the second largest institutional buyer of UK commercial property, acquiring £360m worth of assets in Q2. Their largest acquisition was its £167m purchase of Bedfont Lakes Office Park, Heathrow, from Aberdeen Asset Management (5.44% NIY).

Q2 2015 global investment flows into UKRE, £bn



Q2 2015	£bn	Net
North America	4.7	0.3
Far East	1.5	1.2
Middle East	1.0	0.4
Germany	0.5	-0.1
Europe	0.3	-0.4
Other	0.5	0.3

Source: LSH Research, Property Archive, Property Data

Outlook

2015: Another record year for volumes?

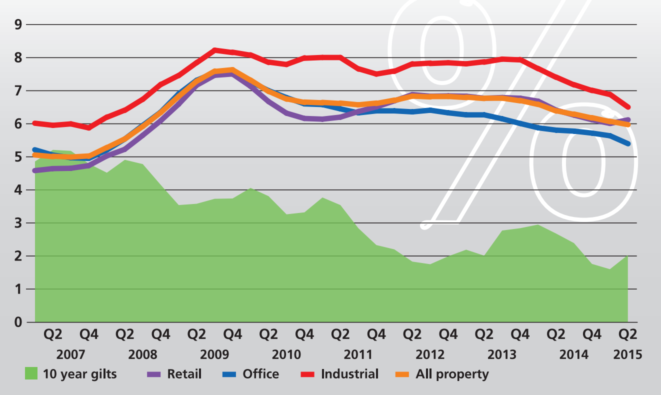
Given the scale of investment volume in H1, the odds of 2015 surpassing 2014's record annual total have shortened significantly from six months ago. That said, major portfolio deals propelled Q2's figures, with the number of deals falling below the ten-year average for the second quarter.

Anecdotally, however, an uptick in transactions has been noted in the early stages of Q3. With depth returning to the market and plenty of overseas and institutional capital continuing to source product, the availability of stock may ultimately determine whether 2015 marks a new record.

A little more scope for yield compression

On face value, property yields at the prime end of the market look unnervingly like those of the boom period of 2007. However, the prevailing economic backdrop is fundamentally different to then. The current spread between average property yields and low risk bond assets remains substantial by historic standards, standing at over 350bps at the time of writing.

Rolling annual transaction yields, %



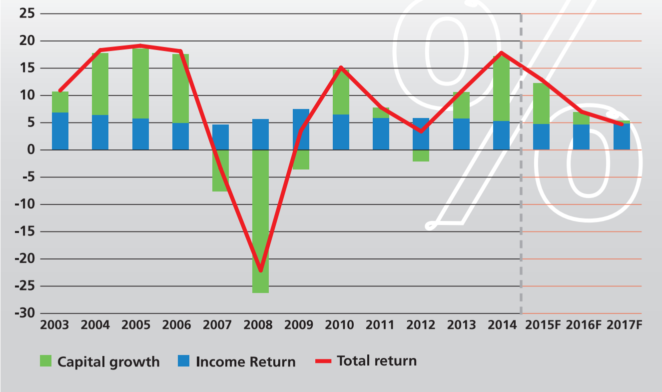
Source: LSH Research, FT

In the near term, this should support pricing at the prime end of the market and provide scope for further yield compression for secondary stock, albeit focused within undersupplied regional markets where pricing remains substantially down on pre-recession levels.

Back to fundamentals

Judging by H1 2015's performance, capital growth is forecast to again provide the main component of returns for the year as a whole. Our forecast for capital growth of 8% in 2015 will support total returns of c.13% for 2015. However, the market is reverting back to core fundamentals and, from 2016, income is forecast to return as the main driver of performance, with returns moderating to trend levels of c.7%.

All Property performance and forecast, %



Source: LSH Research, RES

The real positive is that the occupier markets across the UK are now in the throes of a new rental cycle. According to IPD, All Property rental growth has climbed to an eight-year high of 3.7% and, of the key property sectors, only regional retail continues to endure falling rents, partly on the back of structural changes affecting the sector.

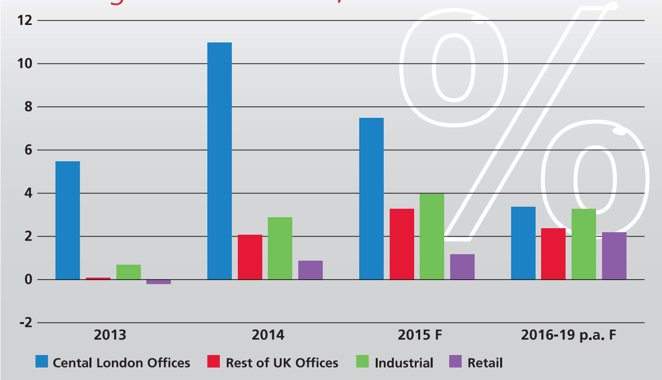
2016: Three potential risks to the outlook

- **The timing and extent of interest rate rises** is key to the outlook for property into 2016 and beyond. While recent noises from the Bank of England suggest that a rise may be possible before year-end, an emphasis that rises will be slow, gradual and probably sit below trend level for several years should reassure the market.

- **The latest Greek bailout** has alleviated risks of a fresh, full blown Eurozone crisis, at least in the short term. As the principle destination for UK exports, key sectors of the UK economy and its occupier markets will benefit from a sustained period of stability and growth in Europe, which is by no means certain.

- **The EU referendum**, once pencilled in, is likely to be a nervy period for both UK and overseas investors. Even if the chance of a 'Brexit' vote is seen as relatively slim, the run-up may stymie investment activity and possibly cause prices to soften, just as Scotland's referendum on its split with the UK demonstrated in 2014.

Rental growth forecasts, %



Source: LSH Research, RES

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.

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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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