



PUMP UP THE VOLUME

**VOLUME REBOUNDS
BY 58% FROM Q2**

**LIVING MAKES UP
40% OF Q3 VOLUME**

**RESURGENCE OF MAJOR
PORTFOLIO DEALS**

**INDUSTRIAL VOLUME
SURGES TO £1.9BN**

**NORTH AMERICA DRIVES
OVERSEAS VOLUME**

**AVG TRANSACTION YIELD
DOWN 31BPS**



Ezra Nahome
CEO

Q3's emphatic rebound in volume was a welcome sight after a dismal Q2, and it is pleasing to see that deals are still clearly being done in spite of the Brexit predicament.

That said, the return to form should not be taken as a revival of investor sentiment in the market. A flurry of portfolio transactions that overhung the first half of this year was integral to Q3's rebound.

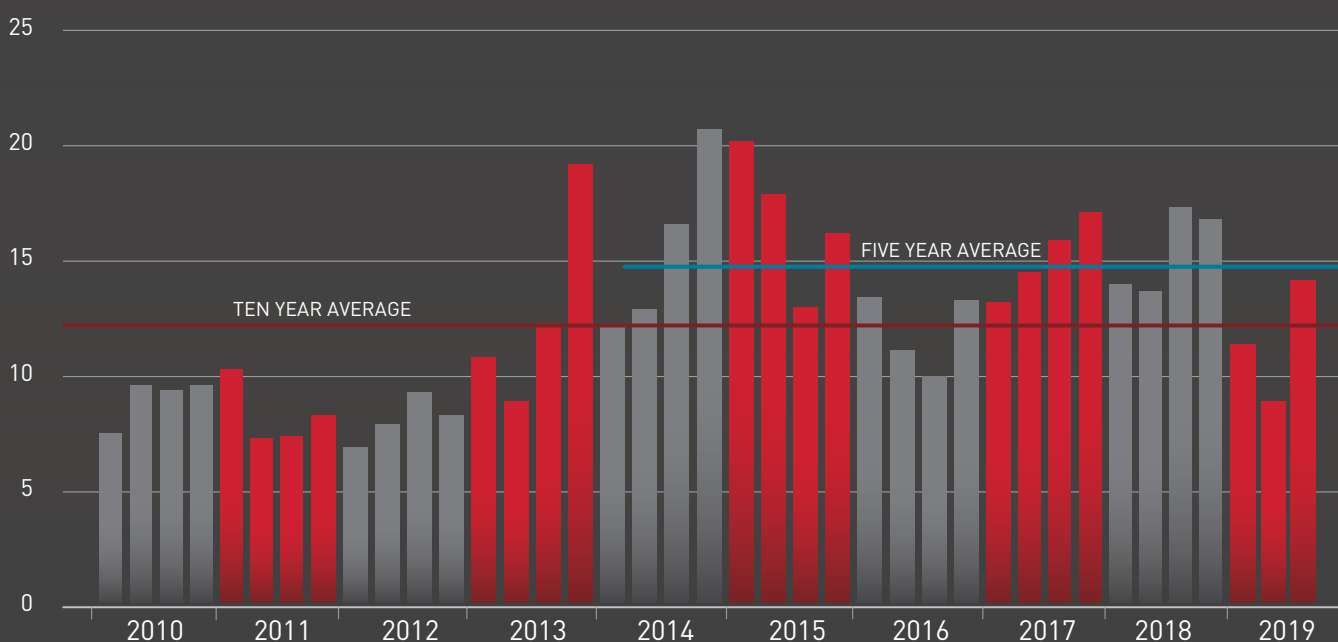
The marketplace arguably remains no less challenging than it was earlier in the year. While there is no shortage of capital out there ready to be deployed, the uncertain climate and a lack of distress has weighed on the appetite to do deals among both buyers and vendors alike.

Then, after a political whirlwind in October, the Prime Minister ultimately failed 'to get Brexit done' by the deadline. Cue further Brexit delay and continuing uncertainty in the market. The 'flexextension', a general election in December and a lack of stock will all conspire to keep volumes suppressed in the final quarter.

However, the fundamentals of investing in UK real estate remain sound. Demand for secure income product remains unwavering, while tight supply in the business space markets offers potential for growth.

If some sort of Brexit breakthrough is secured, hopefully before the end of the year, I expect confidence to be restored, translating into a substantial release of pent-up demand and a very busy start to 2020.

UK INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, PMA

SECTOR FOCUS

BACK ON TRACK BACK

While Q3's emphatic rebound in volume underlined investors' willingness to do deals, a flurry of major portfolio deals overhung the previous quarter.

A total of £13.9bn was invested in Q3, up 58% on Q2. Although the Q3 volume was still 19% down on the same quarter of last year, it was only 4% below the five-year quarterly average. The living sectors led the Q3 market recovery, but they were also backed up by improved activity in the office and industrial sectors.

REGIONS DRIVE OFFICE IMPROVEMENT

Office transactions totalled £4.9bn in Q3, up 22% on the previous quarter. However, volume was down slightly in Central London, due to a relative lack of large-scale transactions. A total of £2.7bn was invested in Central London offices in Q3, 30% below the five-year average.

The office sector saw stronger activity outside the capital, with Q3's largest deal being Goldman Sachs' purchase of Croxley Park in Watford for £400m (2.5% NIY). This transaction alone

ensured that the office park subsector had its strongest quarter in two years. Elsewhere, regional market activity was boosted by Legal & General's acquisitions of Quarry House (£243m) and 7-8 Wellington Place (£211m), both in Leeds.

STUDENT PROPERTY GETS TOP MARKS

Following a subdued Q2, the living sectors (student property, PRS, hotels and healthcare) regained their status as the most active part of the market in Q3. Investment in these sectors more than trebled, quarter-on-quarter, to hit a near-record volume of £5.5bn.

Unusually, the student property sector accounted for the two largest deals across the whole of the investment market in Q3. The Unite Group acquired the 20,541-bed Liberty Living portfolio for £1.4bn, while Germany's DWS bought the 3,198-bed Vita Student portfolio for £600m.

A number of large-scale transactions also completed in the healthcare and PRS sectors, with overseas investors being particularly active. Major deals included the £347m purchase of eight private hospitals by the US REIT Medical Properties Trust; while Japan's Mitsubishi Estate made its debut in the UK build to rent sector with its acquisition of the Nine Elms Park scheme for c. £150m.

Q3 2019 INVESTMENT VOLUME (£BN)

VOLUME VS 5YR QTY AVG



| SECTOR | 2019 Q3 | 2019 Q2 | 2019 Q1 | 2018 Q4 | VS Q2 2019 (%) |
|----------------------------|--------------|-------------|--------------|--------------|----------------|
| Shops | 0.49 | 0.92 | 0.63 | 0.81 | -47% |
| Shopping Centres | 0.10 | 0.27 | 0.05 | 0.40 | -64% |
| Retail Warehouses | 0.44 | 0.31 | 0.41 | 0.24 | 44% |
| ALL RETAIL | 1.03 | 1.50 | 1.08 | 1.45 | -31% |
| Central London Offices | 2.67 | 2.79 | 1.83 | 4.27 | -4% |
| Rest of South East Offices | 0.45 | 0.34 | 0.36 | 0.46 | 31% |
| Rest of UK Offices | 0.96 | 0.65 | 0.34 | 1.51 | 47% |
| Office Parks | 0.81 | 0.20 | 0.21 | 0.26 | 299% |
| ALL OFFICE | 4.89 | 3.99 | 2.73 | 6.49 | 22% |
| South East Industrial | 0.29 | 0.11 | 0.28 | 0.39 | 156% |
| Rest of UK Industrial | 0.49 | 0.22 | 0.41 | 0.83 | 128% |
| Distribution Warehouses | 1.14 | 0.52 | 0.84 | 1.08 | 120% |
| ALL INDUSTRIAL | 1.93 | 0.85 | 1.53 | 2.29 | 143% |
| Hotels & Leisure | 0.35 | 0.46 | 2.68 | 1.00 | -23% |
| Student, Healthcare, PRS | 5.17 | 1.18 | 2.59 | 2.26 | 339% |
| ALL LIVING | 5.52 | 1.64 | 5.26 | 3.27 | 237% |
| Mixed-use & other | 0.49 | 0.80 | 0.65 | 2.83 | -39% |
| ALL PROPERTY | 13.85 | 8.78 | 11.26 | 16.33 | 58% |

Q3 2019 YIELDS

| SECTOR | TRANSACTION YIELDS | | | PRIME YIELDS | | | YIELD SENTIMENT |
|----------------------------|--------------------|------------------------|-------------------------|--------------|------------------------|-------------------------|-----------------|
| | Q3 2019 | 3 MONTH MOVEMENT (BPS) | 12 MONTH MOVEMENT (BPS) | Q3 2019 | 3 MONTH MOVEMENT (BPS) | 12 MONTH MOVEMENT (BPS) | |
| Shops | 3.24% | -15 | -66 | 5.25% | 50 | 100 | |
| Shopping Centres | N/A | N/A | N/A | 7.00% | 25 | 75 | |
| Retail Warehouses | 7.47% | -27 | 82 | 6.25%* | 25 | 150 | |
| ALL RETAIL | 6.10% | -26 | 10 | - | - | - | - |
| Central London Offices | 4.55% | 18 | 5 | 3.75% | | | |
| Rest of South East Offices | 7.04% | 114 | 78 | 4.75% | | -25 | |
| Rest of UK Offices | 5.32% | -100 | -124 | 4.75% | | | |
| Office Parks | 4.67% | -143 | -235 | 5.25% | | | |
| ALL OFFICE | 5.23% | 9 | -6 | - | - | - | - |
| South East Industrial | 4.46% | -56 | -26 | 4.00% | | | |
| Rest of UK Industrial | 6.73% | -65 | 24 | 4.75% | | | |
| Distribution Warehouses | 5.11% | -7 | -18 | 4.00% | | | |
| ALL INDUSTRIAL | 5.04% | -43 | -16 | - | - | - | - |
| Hotels & Leisure | 5.22% | 17 | -52 | 4.25% | | | |
| Student, Healthcare, PRS | 5.24% | -34 | -81 | 5.00%** | | | |
| ALL LIVING | 5.24% | -13 | -69 | - | - | - | - |
| Mixed-use & other | 6.42% | 91 | 56 | - | - | - | - |
| ALL PROPERTY | 5.38% | -31 | -28 | - | - | - | - |

* Sub regional centres

** Student accommodation (Regional, direct-let)

Source: LSH Research, Property Data, PMA

INDUSTRIAL SECTOR BACK IN VOGUE

The industrial sector received £1.9bn of investment in Q3, making it the fifth-strongest quarter in the last decade. There were nine £50m-plus deals during Q3, which represented a stark contrast with Q2 when only one asset was traded above this price level.

Noteworthy industrial transactions included the South Korean investor IGIS Asset Management's purchase of an Amazon Fulfilment Centre in Bristol, as part of a deal that also saw it acquire Amazon properties in France and Spain.

RETAIL STILL OUT OF FAVOUR

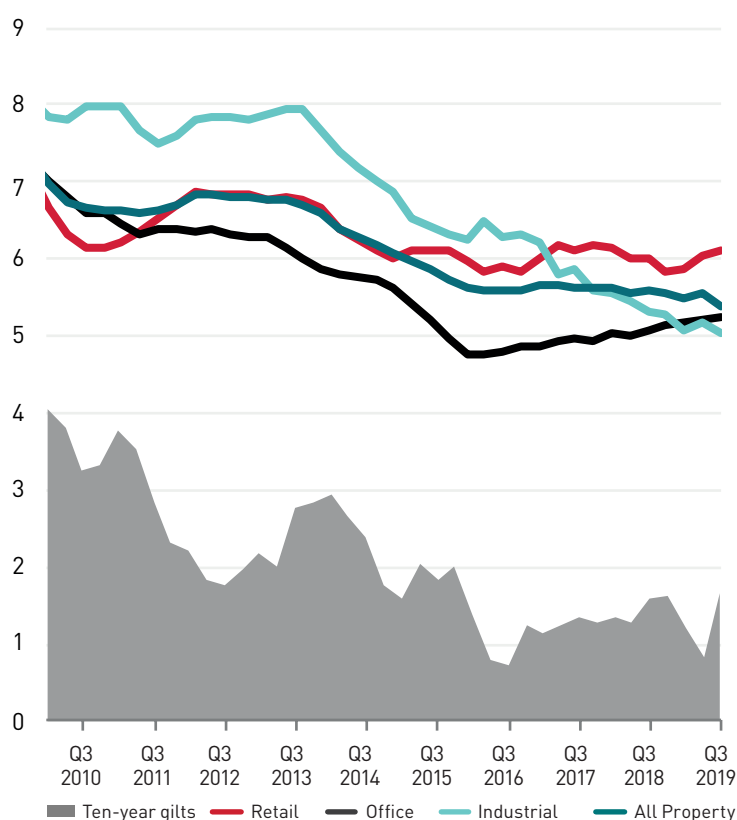
Contrasting the more positive trends in other sectors, retail property remained firmly out of favour with most investors. Retail volume only just topped £1bn in Q3, making it the weakest quarter in more than 18 years. It was a particularly dismal quarter for shopping centres, with only a handful of smaller centres being traded, adding up to less than £100m.

YIELDS MOVE BACK INWARDS

After rising in both of the previous two quarters, the All Property average transaction yield moved back inwards in Q3. It hardened by 31 basis points, to 5.38%, bringing it back close to the 11-year low of 5.34% recorded in Q4 2018. The inward yield movement reflected the increased number of better-quality larger assets being traded during the quarter.

Ongoing strong demand for secure income continues to support pricing at the prime end of the market. However, retail values continue to be driven down by weak sentiment toward the occupier markets, with notional prime yields softening across all of the retail sub-sectors in Q3. Retail warehouses have endured the largest correction over the past 12 months, with prime yields moving out by 150 basis points to 6.25%.

ROLLING ANNUAL TRANSACTION YIELDS AND 10-YEAR GILTS (%)



Source: LSH Research, Experian

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REGIONAL FOCUS

PORTFOLIOS PROLIFERATE

Investment improved across most of the UK in Q3, but a resurgence in portfolio activity was the main driver of increased volume.

MODEST UPTICK IN LONDON

Greater London played a relatively modest role in Q3's recovery. Volume rose to £4.3bn, up 8% on the previous quarter, but still 29% below the five-year average. Central London office volume dropped slightly, due mainly to an absence of 'mega deals'. There was nonetheless a steady flow of activity in the £100m-£300m range, with the largest deal being Lazari's acquisition of 23 Savile Row for £277.5m (4.14% NIY).

The living sectors made a strong contribution to Greater London investment in Q3, with four £100m-plus deals. These included Riverstone Living's forward purchase of a £300m retirement apartment scheme in Kensington alongside several significant build to rent forward funding deals.

INVESTORS LOOK EAST

Collectively, the UK regions outside London enjoyed a relatively strong Q3, with total single asset volume of £5.4bn 10% above average and exceeding London's total for only the fifth time this decade.

The strongest performing region against trend was the East of England, where Goldman Sachs' purchase of Croxley Park, Watford and Legal & General's £120m forward funding of an office development at Fletton Quays, Peterborough propelled volume to over twice the average.

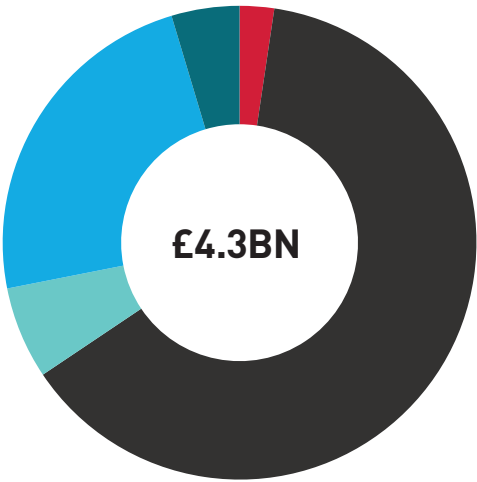
The Peterborough deal was the twelfth to be completed by L&G as part of its 'government hub' programme. Two such transactions also took place in Leeds, and together they pushed volume in Yorkshire & the Humber to £742m in Q3, more than quadruple Q2's level.

PORTFOLIO DEALS COME TO LIFE

Portfolio transactions totalled £4.2bn in Q3, more than the combined total of the previous two quarters. Portfolios represented 30% of all investment during Q3, their highest market share since Q2 2015.

The living sectors dominated portfolio activity in Q3, accounting for 83% of the total volume. There were nine portfolios of £100m-plus transacted during the quarter, of which seven were in the living sectors. The remaining two were both industrial transactions, which helped to push the industrial portfolio volume to £484m.

Q3 2019 LONDON AND REGIONAL BREAKDOWN (£BN)



GREATER LONDON

VS Q2 2019

8%

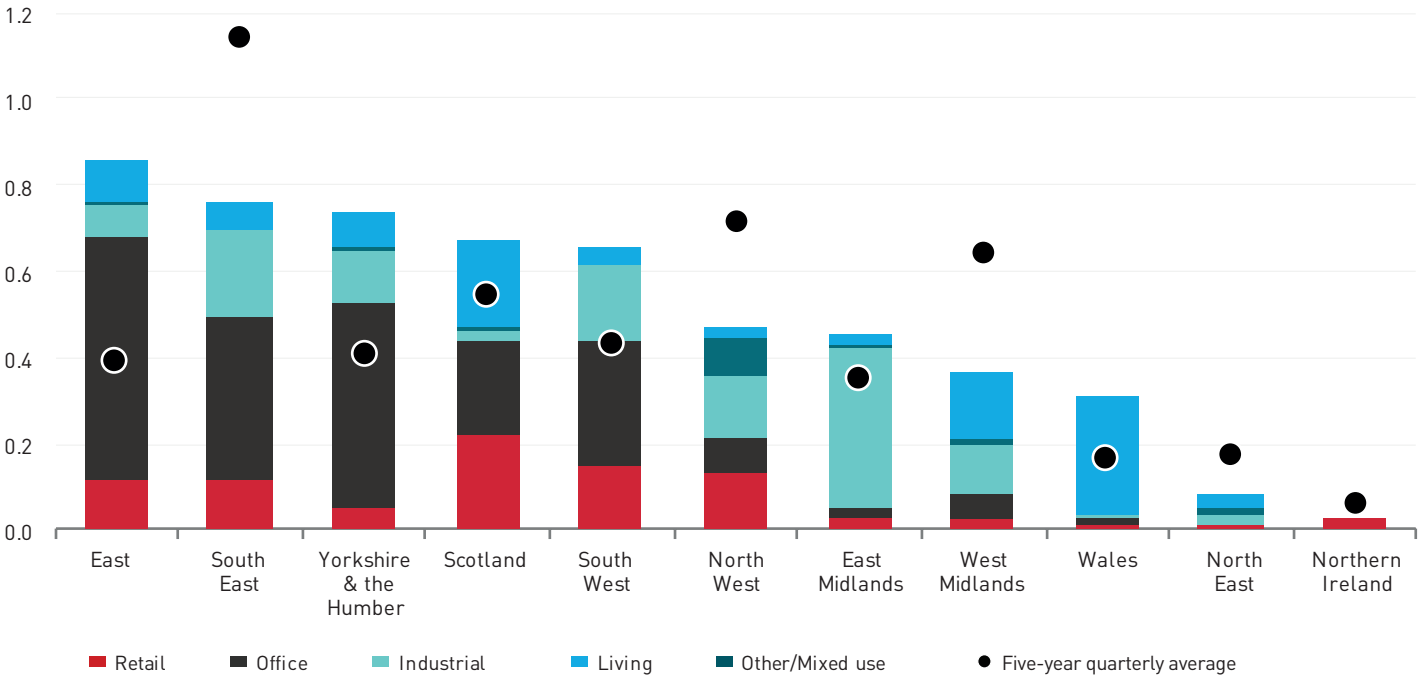
VS Q3 2018

-40%

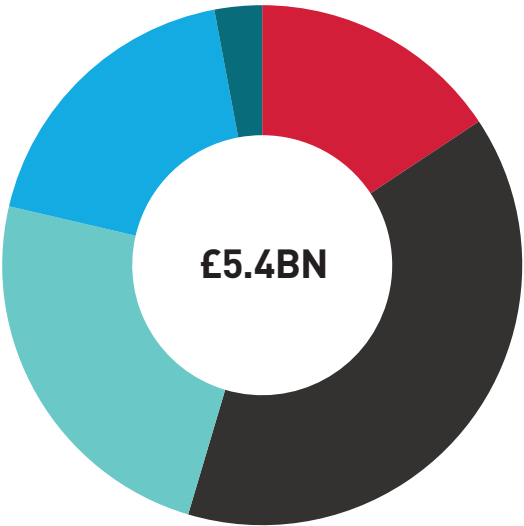
VS FIVE-YEAR QUARTERLY AVERAGE

-29%

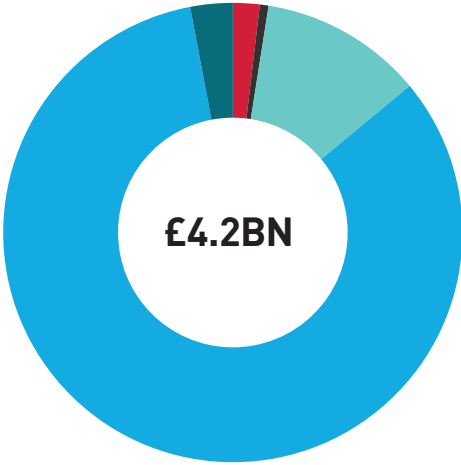
Q3 REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, PMA



UK REGIONS



PORTFOLIOS

47%

273%

4%

-9%

10%

19%

Source: LSH Research, Property Data, PMA

BUYERS & SELLERS

AMERICAN LIVING

Investment recovered from the lows of Q2 across all buyer types. Capital inflows from the US ensured that overseas investors were the largest net purchasers of UK property in Q3.

MIXED TRENDS ACROSS UK BUYER TYPES

Investment from UK institutions recovered from a weak Q2, to reach £2.6bn, close to the 5-year average. However, they remained net sellers, making disposals of £2.9bn, partly reflecting their need to maintain cash reserves in case of redemptions from their property funds.

Among other investor types, quoted propcos stood out with volume of £2.2bn, their highest total on record. This was primarily due to the Unite Group's purchase of the Liberty Living portfolio, and was also boosted by numerous REITs focused on a variety of living subsectors.

Private propcos invested £1.7bn in Q3, up 72% on the previous quarter. However, with sales of £3.5bn, they were the biggest net sellers during Q3. Contrasting the vogue for the living sectors among other buyer types, private propcos primarily focused on office assets, which represented 59% of their Q3 purchases.

US CAPITAL TARGETS LIVING SECTORS






Investment from overseas buyers came to £5.6bn in Q3. While this was an improvement on the previous two quarters, it was still 19% down on the five-year average. North American investors appeared most willing to accept Brexit risks and take advantage of the buying window created by the weakness of the pound. However, investment from other parts of the world generally remained down on recent years.

North American investors made £2.0bn of purchases in Q3, their highest total since Q4 2015. More than half of this was targeted at the living sectors, with PRS, senior living, healthcare and student property assets all being acquired by US capital.

FAR EASTERN INVESTMENT REMAINS DOWN

Far Eastern buyers invested just £0.7bn in Q3, down 64% on the five-year average. This partly reflected the limited availability of prime Central London stock, which remains a major focus for their demand. However, Q3 did also provide signs that Far Eastern investors are becoming more willing to explore opportunities in the living sectors.

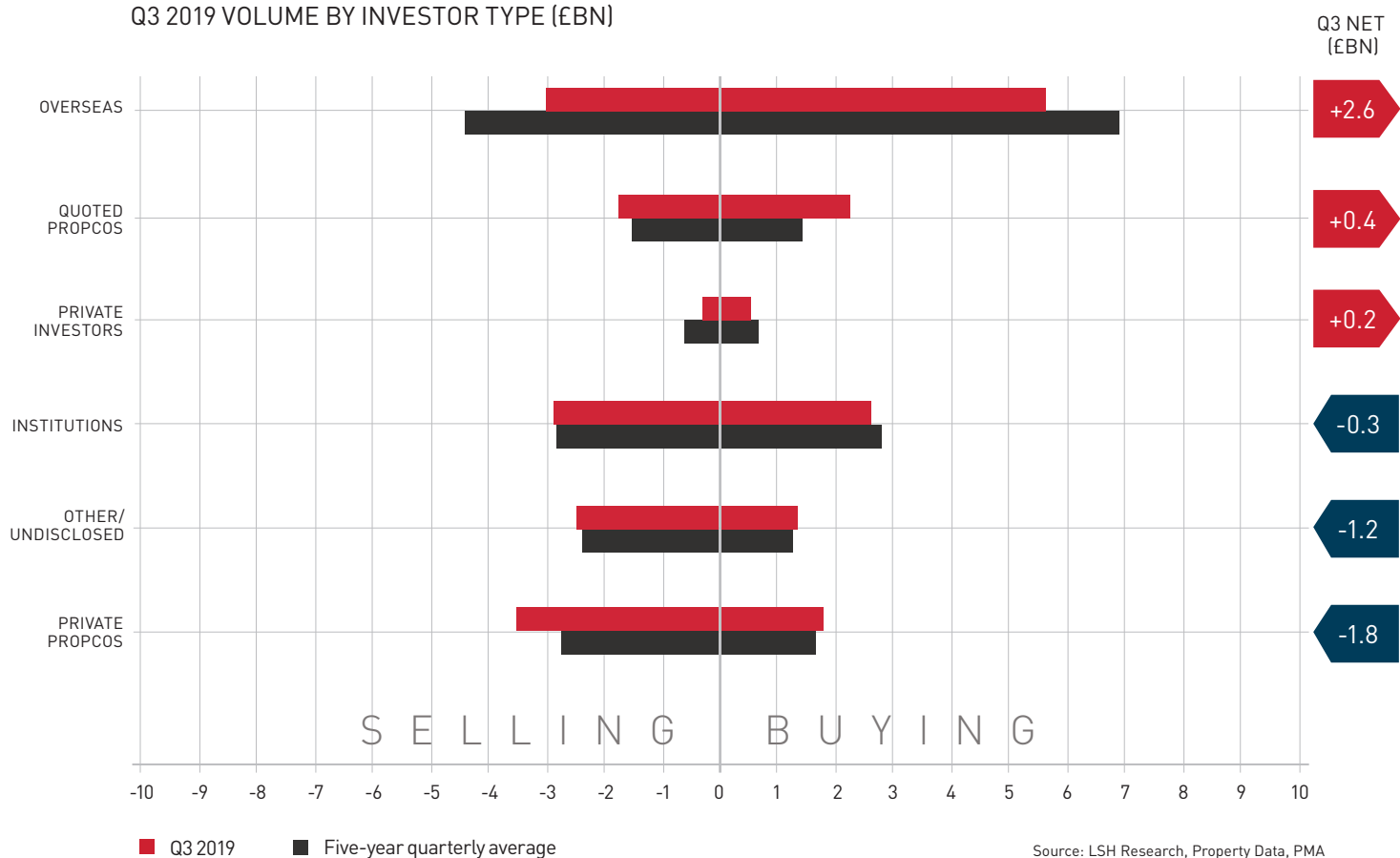
Q3 2019: GLOBAL INVESTMENT FLOWS INTO UK (£BN)

| ORIGIN | £BN | NET £BN |
|--|-----|---------|
|  NORTH AMERICA | 2.0 | 1.4 |
|  FAR EAST | 0.7 | 0.5 |
|  MIDDLE EAST | 0.5 | 0.4 |
|  EUROPE | 0.7 | 0.5 |
|  OTHER/UNKNOWN | 1.7 | -0.3 |

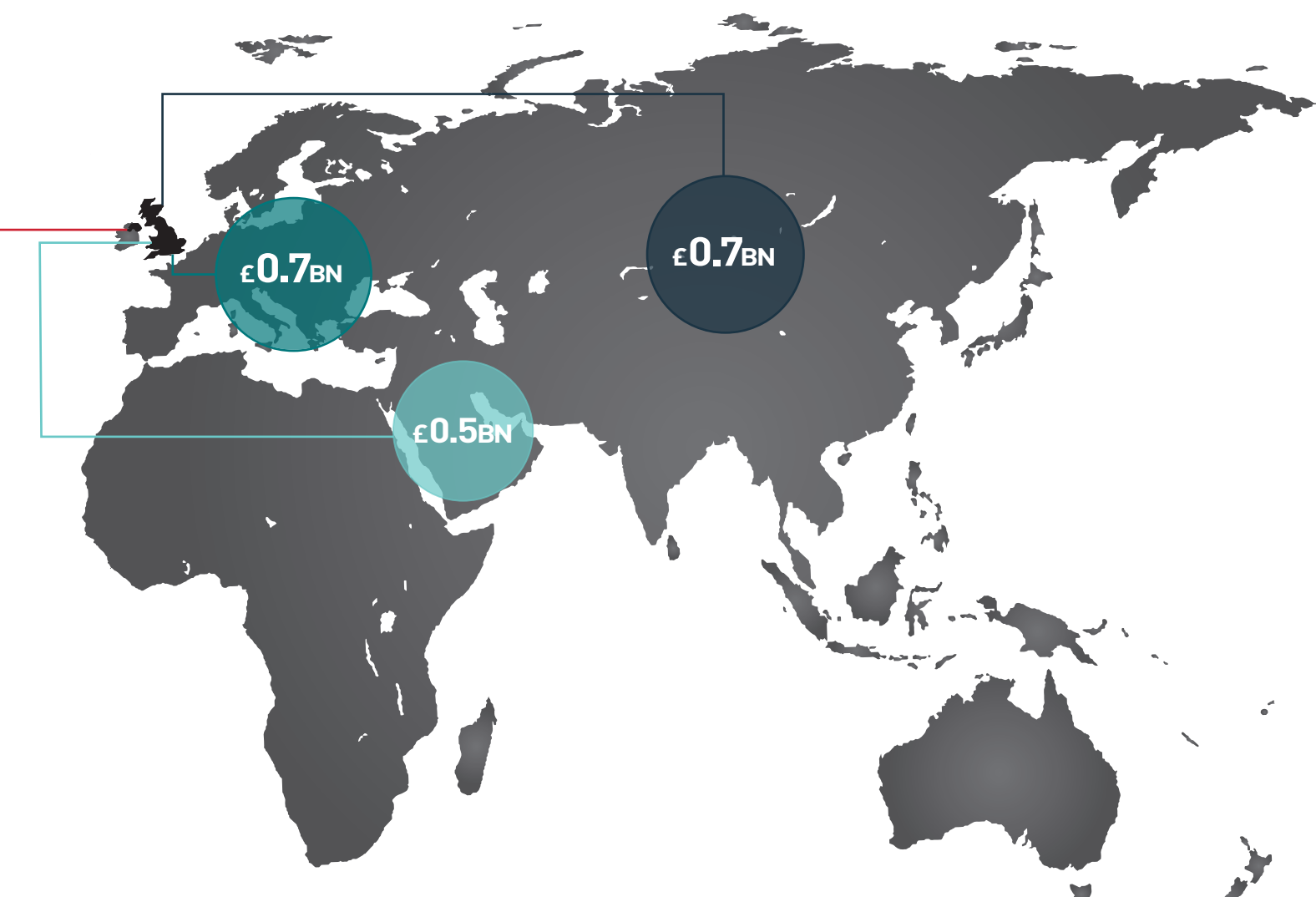


£2.0BN

Q3 2019 VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, PMA



OUTLOOK

LIMBO LAND

The UK economy avoided recession, but decision-making will remain challenging for occupiers and investors alike until some form of resolution to Brexit is achieved. Get set for another election.

RECESSION AVERTED

Despite a fresh bout of Brexit-induced political clamour, mounting evidence indicates growth returned to the UK economy in Q3 following Q2's 0.2% contraction. As well as avoiding a slip into a technical recession, some forecasting houses are expecting respectable growth of around 0.4% in Q3, twice that of the Bank of England's initial view.

Positive momentum in the services sector partly explains Q3's rebound, reflecting growth in household incomes and resilient consumer sentiment. However, firms' contingency measures around Brexit largely explain 2019's bumpy growth. For example, a recent spike in UK car production directly fuelled growth in August, but it reflected manufacturers' moves to minimise the impact of a no-deal Brexit last March.

BUSINESS INVESTMENT STAGNATES

Behind the volatility is more troubling evidence of stagnating business investment, a key bellwether of confidence and certainty in the private sector. UK business investment has fallen in five of

the last six quarters, and Brexit uncertainty is a major factor. Prior to the referendum, business investment was in line with other G7 countries but, since then, it has risen by less than 1%, compared with an average of 12% in the rest of the G7. Clearly, further delay to a Brexit resolution will not help matters.

EMPLOYMENT OFF THE BOIL

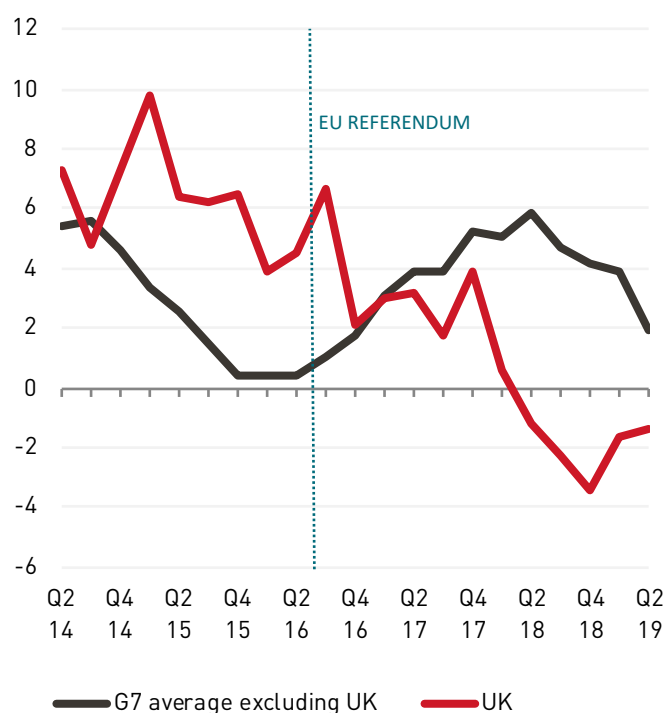
Brexit's impact on business confidence now appears to be affecting the labour market. Following a sustained period of expansion, UK employment fell by 56,000 in the three months to August, the first drop in two years. Forward-looking indicators also point to further slight contraction, with UK job vacancies falling by 5.6% over the past year.

The labour market nonetheless remains extremely tight - unemployment stands close to 44-year low of only 3.9%. Limited slack continues to fuel sharp increases in average wages, rising 3.8% over the 12 months to August and only a fraction down from July's 10-year high of 3.9%. With wage growth running at twice the rate of inflation, consumers are in a relatively good place amid all the Brexit noise.

MPC KEEPS ITS POWDER DRY

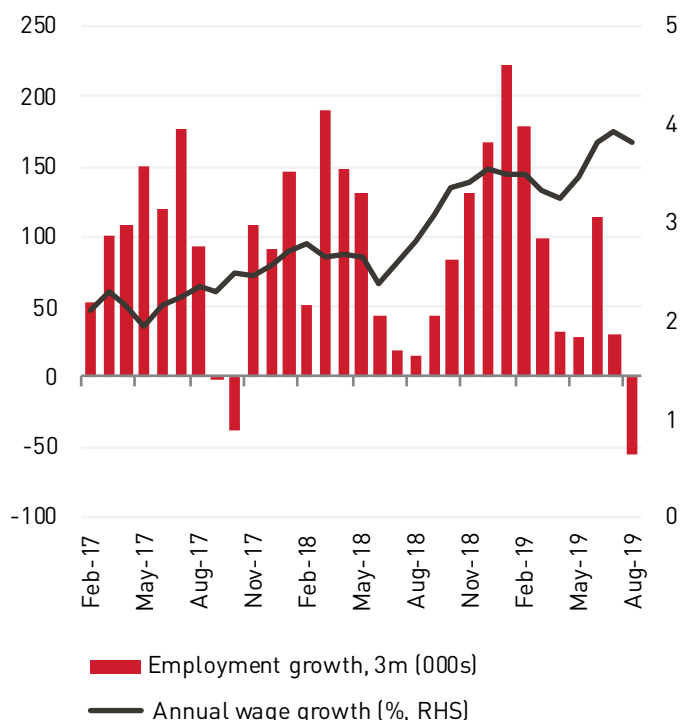
The Bank of England is faced with needing to balance the upside risks to inflation against the downside risks to growth posed by Brexit. With CPI inflation currently standing at a below target rate of 1.7% and widely expected to remain so over the remainder of the year, the MPC is under little pressure to renew stimulus in the form of an interest rate cut.

BUSINESS INVESTMENT (% PA)



Source: ONS, Pantheon Economics

UK WAGE AND EMPLOYMENT GROWTH



Source: ONS

That said, economic risks posed by Brexit, and indeed the wider tone of caution around the global economy from other central banks, are also interfering with the MPC's longer-term aspiration to take bank rate closer to 'normal' levels.

RATIONALE REMAINS

Regardless of Brexit, the persistence of low interest rates and global weight of money will continue to support pricing at the prime end of the UK property market. Even though prime yields stand at or close to historic lows, they continue to offer attractive returns relative to low risk alternatives. By way of example, prime regional office yields of 4.75% currently command a substantial 400bps risk premium over 10-year gilts.

The one glaring exception is retail, as occupiers grapple with profound structural change in our shopping habits. With the exception of central London, the deterioration in prime retail values seen over the past 18 months is almost comparable with the global financial crisis a decade ago. While further adjustment in values is in store, opportunities increasingly abound for asset repositioning.

UNCERTAINTY BREEDS INERTIA

While Brexit's prolongation is a source of frustration to many, the vanishing likelihood of a no deal departure from the EU means the market is less exposed to a demand shock than it was. Latest odds from one bookmaker put the risk of a no deal Brexit in 2019 at only 3%, tumbling from 43% in August.

Yet, ongoing uncertainty and a general election in December do not bode well for a fuller restoration of investment activity in Q4. Even if volume hits £10bn in Q4, volume for the year as a

whole would amount to a seven year low of circa £45bn. On the plus side, if clarity over Brexit emerges before the year-end, we anticipate a substantial release of pent-up demand and a resurgence of activity in Q1 2020.

ALL ABOUT THE INCOME

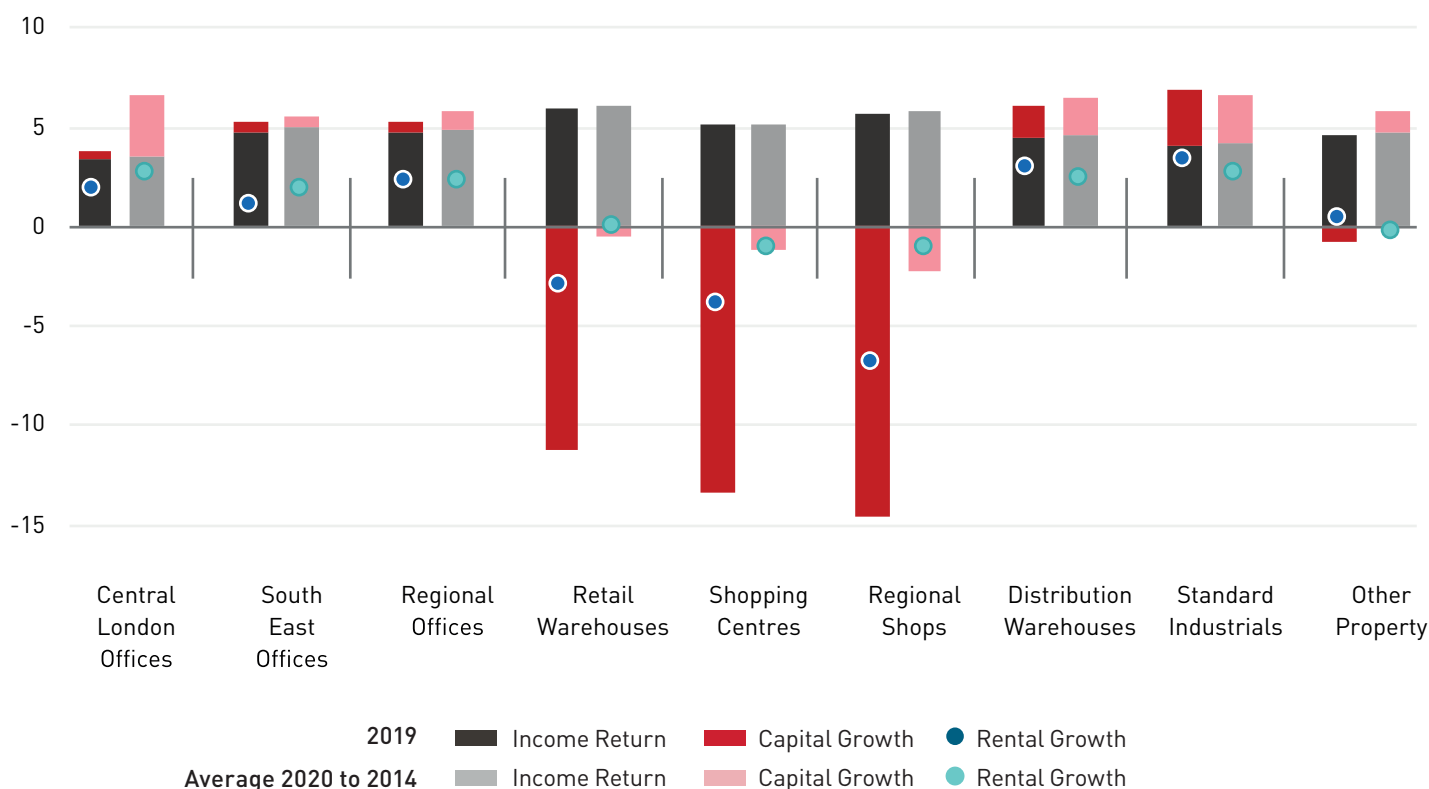
According to MSCI, All Property values have fallen throughout 2019, albeit driven by ongoing value falls in the retail sectors. LSH's All Property total return forecast has weakened again for 2019, down to 0.8% and reflecting a 3.6% fall in capital values. Even though returns are easing down across the market, industrial is set to outperform once again in 2019, albeit to a far lesser degree than previous years.

The shape forecast over the next five years partly depends on how Brexit plays out. Our baseline forecast, which assumes an orderly exit from the EU, points to an improvement of returns which are largely dependent upon income.

POCKETS OF GROWTH

Despite current uncertainty, tight levels of supply in the business space markets continue to support rental growth prospects. While industrial remains marginally the lead performing sector in our forecast, value-add strategies in the UK's regional office markets arguably provide among the strongest prospects for outperformance. As ever, a deep understanding of the micro location will be key, while confidence to invest in such opportunities will benefit from improved certainty.

FORECAST COMPONENTS OF RETURN (% PA)



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