UKIT

UK INVESTMENT TRANSACTIONS BULLETIN

Q1 2017

Lambert Smith Hampton

SIZE FLATTERS

Ezra Nahome
CEO

It seems as if a month can't go by without some sort of political shock for the market to digest. Yet, surprising as it was, the prime minister's call for a snap election in June looks to be a pretty shrewd move.

On face value, Q1's volume was more than respectable given the uncertain environment the market is operating in. However, it was flattered by a flurry of major deals which masked what was actually a relatively quiet quarter.

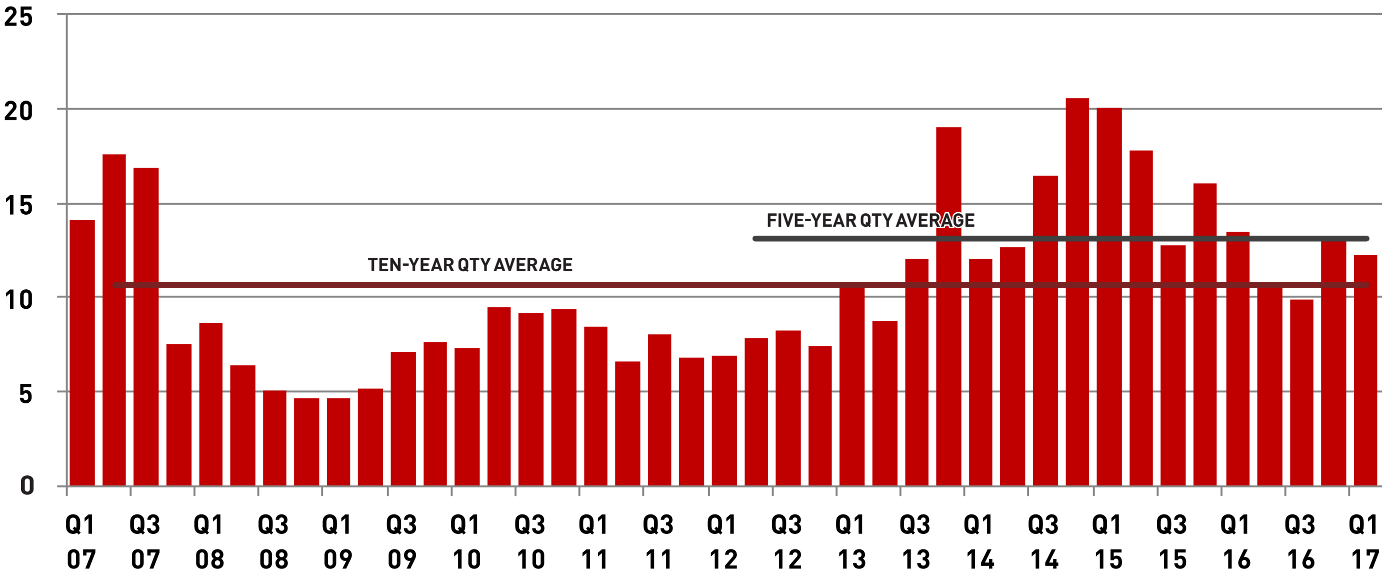
The issue boils down to stock. While there is no shortage of demand for high quality assets, not least from overseas investors, activity has been dictated by a lack of stock on the market. Meanwhile, a more sceptical view on rental growth has dampened appetite higher up the risk curve.

Investors crave certainty, and the fact that the financial markets reacted positively to the Prime Minister's announcement, just weeks after Article 50 was triggered, reflects improved confidence both in the journey toward the EU exit door and the eventual terms of Brexit.

Evidence from past elections tells us that investment activity can enter a lull in the lead up before bouncing back afterwards. On this occasion, the election outcome is widely predicted, and I expect it to have a benign effect on the market during the second quarter.

With so much of a focus on political developments, it is easy to overlook that the UK economy has quietly continued to demonstrate resilience. Moreover, should the path towards Brexit be less troublesome for the economy than many fear, those investors who are willing to take on risk may stand to benefit most of all.

UK INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

Q1 ACTIVITY

Sector focus

At £12.2bn, Q1 volume was respectable, only 6% down on both the previous quarter and five-year quarterly average, but was flattered by large deals.

While Q1 volume was down 6% on the previous quarter, the number of deals was in fact down 20% quarter-on-quarter. Q1 was flattered by a number of large lot-sizes, with 30 deals over £100m transacted in Q1 compared to 22 in the previous quarter and significantly above the five-year quarterly average of 20 deals.

Central London dominates UK office volume

At £4.2bn, volume for Central London offices was its strongest since Q4 2015 and accounted for almost 80% of total office volume. While office volume as a whole was down 4% on the five-year quarterly average, Central London offices was up 9%.

However, volume in the capital was propelled by CC Land's £1.15bn acquisition of the Leadenhall Building (The Cheesegrater) from British Land and Oxford Properties. Reflecting 3.5% NIY, this was the largest deal since Q4 2014. Q1's other major deal was WestInvest and Deka Immobilien's £435m (NIY 4.25%) purchase of Facebook's UK HQ at 35/50 Rathbone Place, W1 from Great Portland Estates.

Buoyant activity in student accommodation

At £1.9bn, the specialist sectors recorded its highest quarterly volume since Q2 2015. This was driven by student accommodation deals, where volume totalled £1.1bn, including Brookfield Asset Management's £295m purchase of Unite Group's 13 asset portfolio.

Industrial volume bolstered by three deals

At £1.8bn, industrial volume was the only core sector to record above trend volume in Q1, standing 40% above average. However, several major deals masked an otherwise quiet level of activity, accounting for half of total volume in the sector.

These included SEGRO's £365m purchase of the remaining 50% stake in the Airport Property Partnership from Aviva Investors and CBRE GIP's £310m purchase of an 85% stake in UK Logistics Venture from Prologis, a portfolio comprising 16 assets.

Subdued quarter for retail

Retail saw the weakest activity relative to trend, with Q1 volume 32% below the five-year average and its lowest level since Q4 2012. This was the result of low volume in shops and shopping centres, both 40% below the five-year average.

Retail warehouses fared best among the retail sub-sectors, with Q1 volume of £650m standing closely in line with the five-year average. However, volume was boosted by Curzon Capital Partners' £245m acquisition of a nine asset portfolio from Brockton Capital.

Q1 INVESTMENT VOLUME (£BN)

SECTOR	Q1 2017	VS Q4 2016	VS Q1 2016	VS 5-YEAR AVG
Shops	£0.61	-40%	-39%	-44%
Shopping Centres	£0.56	-51%	-40%	-41%
Retail Warehouse	£0.65	-9%	29%	
ALL RETAIL	**£1.83**	**-37%**	**-25%**	**-32%**
Central London Offices	£4.25	17%	88%	9%
Rest of South East Offices	£0.30	-38%	-74%	-49%
Rest of UK Offices	£0.65	-2%	-66%	-8%
Office Parks	£0.20	15%	-3%	-58%
ALL OFFICE	**£5.40**	**9%**	**-3%**	**-4%**
South East Industrial	£0.25	-15%	36%	20%
Rest of UK Industrial	£0.38	12%	-51%	1%
Distribution Warehouse	£1.16	9%	91%	67%
ALL INDUSTRIAL	**£1.79**	**6%**	**14%**	**40%**
Hotels & Leisure	£0.85	-34%	-27%	-25%
Specialist	£1.89	57%	53%	61%
Mixed-use (single assets & portfolios)	£0.49	-51%	-67%	-57%
ALL PROPERTY	**£12.24**	**-6%**	**-9%**	**-6%**

Source: LSH Research, Property Data, Property Archive

Transaction yields remain stable

The All Property average transaction yield has remained remarkably steady over each of the past three quarters, edging out by a single basis point during Q1 to 5.66%.

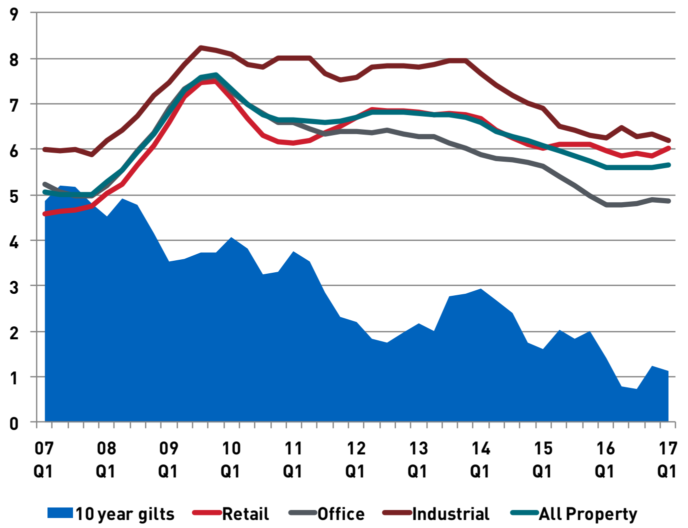
Despite initial turbulence in the market in the wake of last summer's Referendum, sentiment indicates that for a number of sectors pressure is back on pricing at the prime end of the market. In contrast, sentiment indicates that yields have softened for riskier, secondary assets.

Strongest pressure on Industrial

Sector wise, industrial has seen the most heat on pricing. The average industrial transaction yield moved in by 78bps during Q1 to stand at 5.72%, while retail moved out by 48bps to 6.80%, arguably reflecting the growing disparity between the sectors' appeal.

A similar theme is noted with regard to notional prime assets. Yields for industrial multi-lets moved in by 25bps during Q1, reflecting a strong level of demand relative to stock.

ROLLING ANNUAL TRANSACTION YIELD & 10-YEAR GILTS (%)



Source: LSH Research, FT.com

Q1 2017 YIELDS

SECTOR	Transaction yields Q1 2017	Transaction yields 3 MONTH MOVEMENT (BPS)	Transaction yields 12 MONTH MOVEMENT (BPS)	Prime yields Q1 2017	Prime yields 3 MONTH MOVEMENT (BPS)	Prime yields 12 MONTH MOVEMENT (BPS)	PRIME YIELD SENTIMENT
Shops	4.74%	-21	29	4.00%			
Shopping Centres	6.85%	106	85	5.75%		50	
Retail Warehouse	6.84%	43	76	4.75%	25	50	
ALL RETAIL	6.30%	48	67	-	-	-	-
Central London Offices	3.81%	-26	1	3.50%		25	
Rest of South East Offices	5.95%	13	-33	5.00%			
Rest of UK Offices	6.19%	-133	-37	5.00%		25	
Office Parks	7.57%	112	25	6.00%		25	
ALL OFFICE	4.72%	-21	-7	-	-	-	-
South East Industrial	5.52%	-81	-44	4.75%	-25	-25	
Rest of UK Industrial	7.22%	-32	28	5.50%	-25	-50	
Distribution Warehouse	4.58%	-121	-160	4.25%			
ALL INDUSTRIAL	5.72%	-78	-52	-	-	-	-
Hotels & Leisure	4.91%	-79	-44	4.50%	-25	-25	
Specialist	5.85%	51	36	4.50%	-25	-25	
Mixed-use (single assets & portfolios)	6.85%	61	-49	-	-	-	-
ALL PROPERTY	5.66%	1	17	-	-	-	-

Source: LSH Research, Property Data, Property Archive

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

Regional focus

Greater London fared well in Q1 as appetite from overseas investors held strong. Elsewhere, activity was suppressed by limited stock, with volume in the UK regions and portfolios below trend.

Greater London appetite robust

At £6.1bn, Greater London recorded its strongest quarter since Q4 2015 and accounted for 50% of Q1's volume. This was predominantly overseas investment focused on major Central London office assets. 12 deals over £100m changed hands, ten of which were acquired by overseas investors.

Regional investment slips

At £3.8bn, volume for single-asset deals in the UK regions was down 31% on Q4 2016 and 10% below the five-year quarterly average. This was largely due to the drop in overseas investment into the regions, partly due to a lack of large lot-sizes on the market.

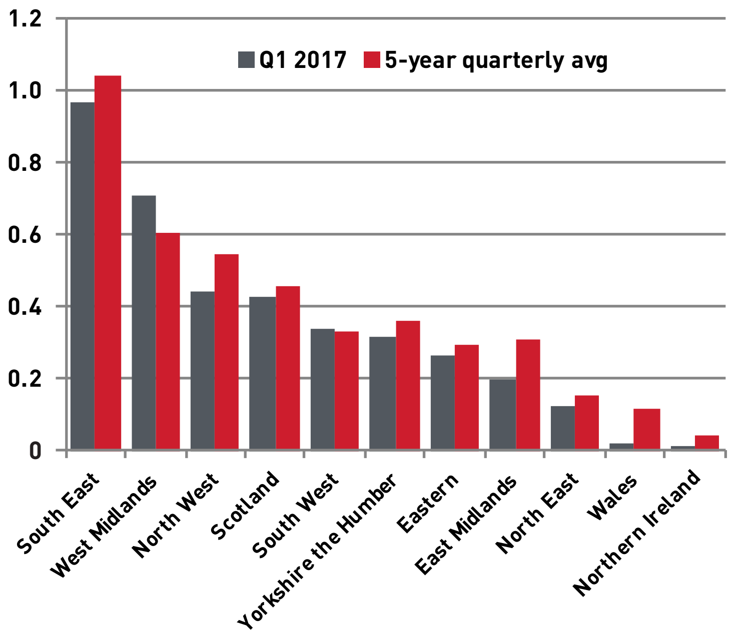
The West Midlands was the only region to see Q1 volume significantly ahead of its five-year quarterly average, by 18%. However, this was boosted by Unite Group's £227m purchase of a 50% stake in Aston Student Village student accommodation, the largest single student accommodation deal on record.

The other regions were relatively quiet in Q1. At £970m, the South East attracted the largest volume of any region in Q1 but was 7% below trend. This was largely due to Rest of South East offices, which saw the lowest volume since Q1 2013 at £303m.

Portfolio volume rebounds

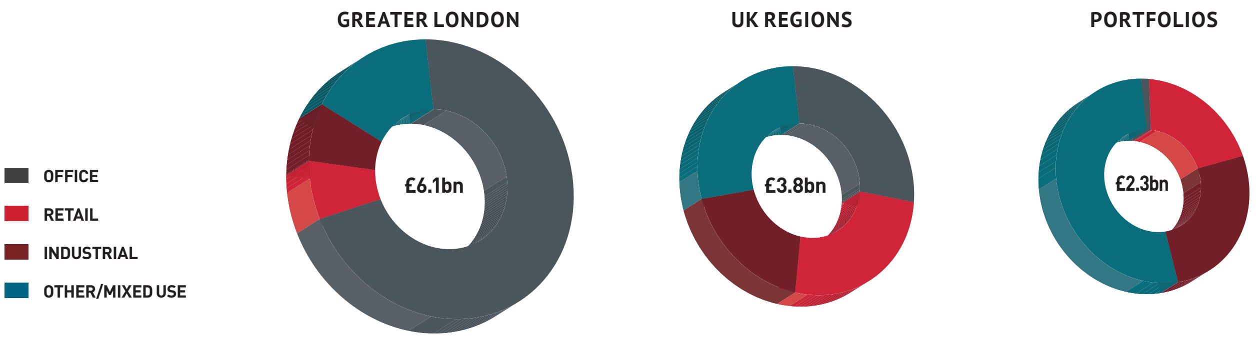
At £2.3bn, portfolio investment rebounded 42% on Q4 2016's markedly low volume, albeit 21% below the five-year quarterly average. Q1's largest portfolio deal was CBRE GIP's 85% stake in a joint venture with Prologis for £310m.

REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

LONDON AND REGIONAL BREAKDOWN (£BN)



	GREATER LONDON	UK REGIONS	PORTFOLIOS
VS Q4 2016	4%	-31%	42%
VS Q1 2016	18%	-26%	-25%
VS 5-YEAR QTY AVG	2%	-10%	-21%

Source: LSH Research, Property Data, Property Archive

Buyers and sellers

Overseas demand for UK property continued unabated in Q1, accounting for half of the total volume. This was dominated by Far Eastern investors focusing on trophy assets.

Strong appetite from the Far East

At £2.7bn, Fast Eastern buyers invested the highest quarterly volume in UK property since Q4 2013. This was boosted by the largest deal of the quarter, namely CC Land's £1.15bn acquisition of the Cheesegrater.

Investors from other origins were generally less active relative to trend, resulting in overall overseas volume down 6% quarter-on-quarter. Notably, North American buyers were quiet, acquiring £530m worth of assets, down 78% on the five-year quarterly average.

REITS sell out of London

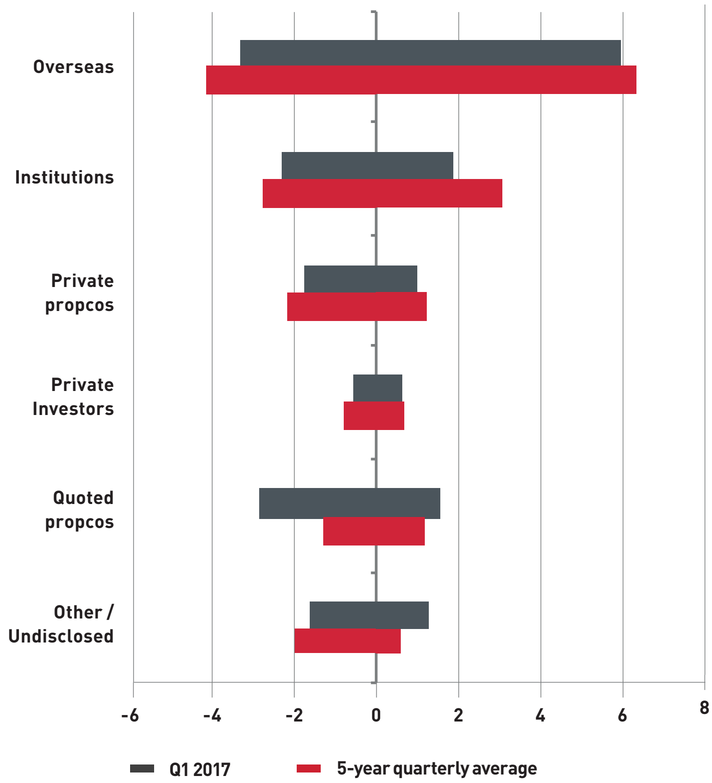
At £1.3bn, quoted property companies recorded their largest net selling since Q3 2009. However, this largely reflected major disposals of Central London offices amounting to £1.4bn, including British Land's £575m sale of its 50% stake in the Cheesegrater and Great Portland Estates' £435m sale of 35/50 Rathbone Place.

UK institutions focus on alternatives

Following three quarters of substantial net sales, UK institutions were only marginal net sellers in Q1, amounting to £0.4bn. This largely reflected lower selling activity as opposed to increased purchasing, disposing of the lowest volume of assets since Q2 2014.

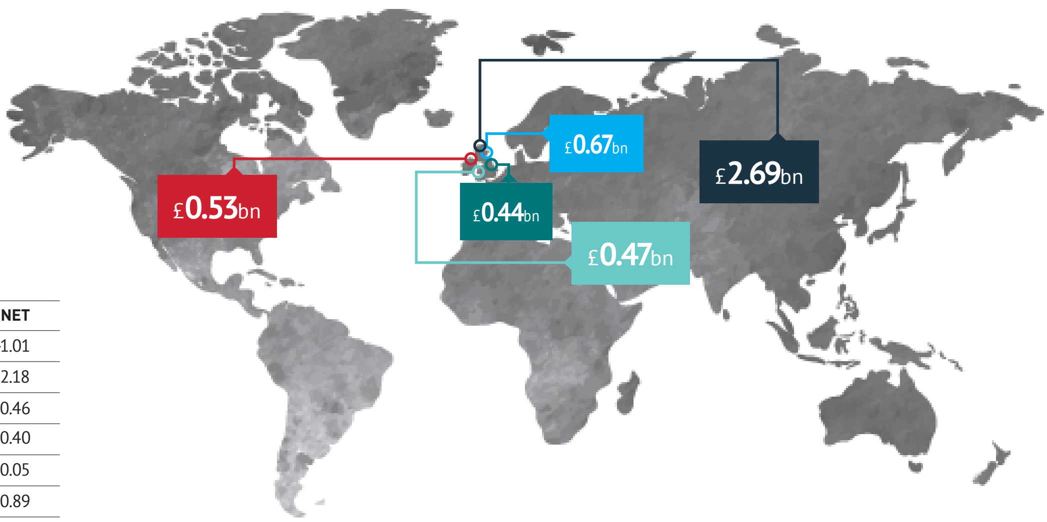
With an apparently growing movement into alternatives, the largest proportion of institutions' investment was in hotel and leisure, at 30%, compared to offices at 10%. This included DTZ Investors' £108m (NIY 5.90%) purchase of The Printworks, Manchester from Land Securities.

VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive

Q1 2017: GLOBAL INVESTMENT FLOWS INTO UK (£BN)



ORIGIN	£BN	NET
North America	0.53	-1.01
Far East	2.69	2.18
Middle East	0.47	0.46
Germany	0.44	0.40
Europe	0.67	-0.05
Other	1.12	0.89

Source: LSH Research, Property Data, Property Archive

OUTLOOK

Amidst all the political furore both domestically and abroad, the UK economy continues to display considerable resilience. While the decision to hold a snap election does increase short-term uncertainty, prospects of a 'better Brexit' may just be the tonic to encourage investors to look back up the risk curve.

UK economy motors on

Almost a year on since the vote for Brexit, reasonable momentum remains in the UK economy. Recent key forecasts have been revised upwards with, notably, the IMF upgrading its outlook for UK GDP growth for 2017 twice in three months, to a respectable 2.0%.

The services sector, the dominant source of UK economic output and employment, is at the heart of this resilience. The UK jobs market continues to go from strength to strength - the number of people in work is up 300,000 year-on-year, while unemployment is now only 4.7%, its lowest level since 1975.

Feeling the pinch

The consumer outlook is the main blot on the economy's copybook. After a lengthy period of low inflation and rising real wages, consumer spending power is now being eroded by a 'double wammy' of sterling's depreciation and rising commodity prices. This is arguably already being reflected in retail sales, which in Q1 fell for the first time since 2013.

However, other typically less sanguine parts of the UK economy are expected to benefit. The lower pound, alongside at least two more years of full access to the EU single market, has boosted the competitiveness of UK producers. Consequently, in contrast with previous years, net trade with the UK will contribute to rather than act as a drag on growth.

Clouds lift in the global economy

The positive outlook for UK trade is also partly down to improving sentiment in the global economy. China's rate of economic growth is picking up once again; the new US administration is committed to public spending over austerity; while there are encouraging signs that activity is picking up in the Eurozone. The latter is good news for both UK exporters, and potentially Brexit negotiators.

Election to have benign impact

Turning to the commercial property market, discussions abound over the potential impact of the snap election on near-term activity. However, with the outcome widely regarded as predictable, June's election is not, in our view, expected to have a material effect on investment or occupier decisions during Q2. Indeed, activity was very strong in the lead-up to the last election in 2015, despite its outcome being far less predictable.

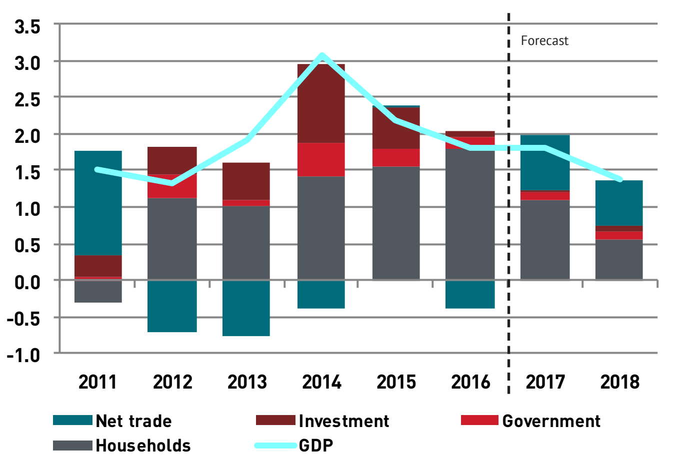
An increasingly two-tier market

At the prime end of the market, a combination of low interest rate expectations, ongoing weight of money and limited stock has continued to exert downward pressure on yields. In contrast, a stronger degree of risk aversion towards secondary assets has already prompted yields to soften over the past 12 months.

The one clear exception to the rule is industrial & logistics, where tight supply and structural change continue to drive expectations of further rental growth. While prospective vendors in this sector have the potential to crystallise substantial gains, the difficulty surrounds where to re-invest.

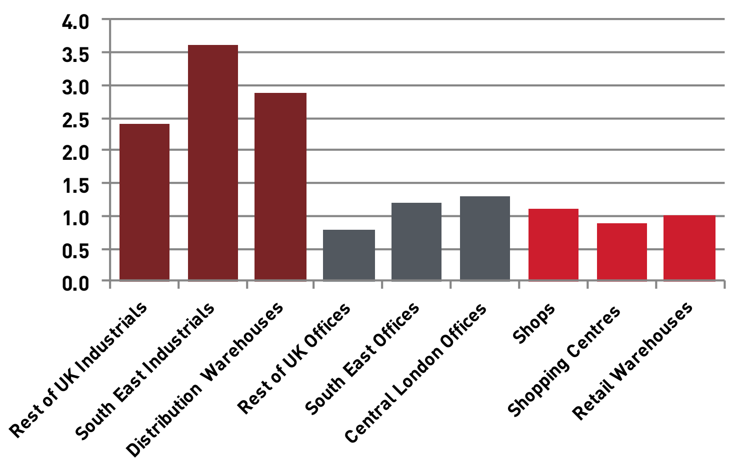
Ultimately, sentiment will dictate how much more softening secondary yields see in the latter half of 2017. Just as the financial markets reacted positively to the news of a snap election, the perception of a 'better Brexit' may prompt some investors to reconsider their appetite for risk.

CONTRIBUTIONS TO UK GDP GROWTH (%)



Source: ONS, Experian

RENTAL GROWTH FORECAST 2017 TO 2021 (% P.A.)



Source: LSH, Real Estate Forecasting

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

Nick Lloyd
Head of Capital Markets
+44 (0)20 7198 2221
nlloyd@lsh.co.uk

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

Isabel Watterson
Senior Analyst
+44 (0)20 7198 2258
iwatterson@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

Bill Lynn
Director – Newcastle
+44 (0)191 338 8294
blynn@lsh.co.uk

Paddy Brennan
Director – Belfast
+44 (0)28 9026 9206
pbrennan@lsh.co.uk

Ben Roberts
Director – Manchester
+44 (0)161 242 8002
broberts@lsh.co.uk

Ewen White
Director – Glasgow
+44 (0)141 266 6777
ewhite@lsh.co.uk

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

lsh.co.uk
lshinvestmentsales.co.uk

Lambert Smith Hampton