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UKITQ118

UK INVESTMENT TRANSACTIONS BULLETIN

Q1 VOLUME: £13.6BN

SECOND STRONGEST Q1 IN A DECADE

AVG YIELD CLIMBS 11 BPS

ZERO RETAIL DEALS ABOVE £100M

PORTFOLIO DEALS DRIVE INDUSTRIAL VOLUME

REIT VOLUME AT 7YR HIGH

OVERSEAS VOLUME 20% BELOW AVG

Ezra Nahome
CEO

2018 is starting to take shape much as we expected it to. Activity is holding up well, particularly in the regional markets, while the polarisation in demand between retail and industrial not only continues but is perhaps as extreme as I've ever seen between two of the core sectors.

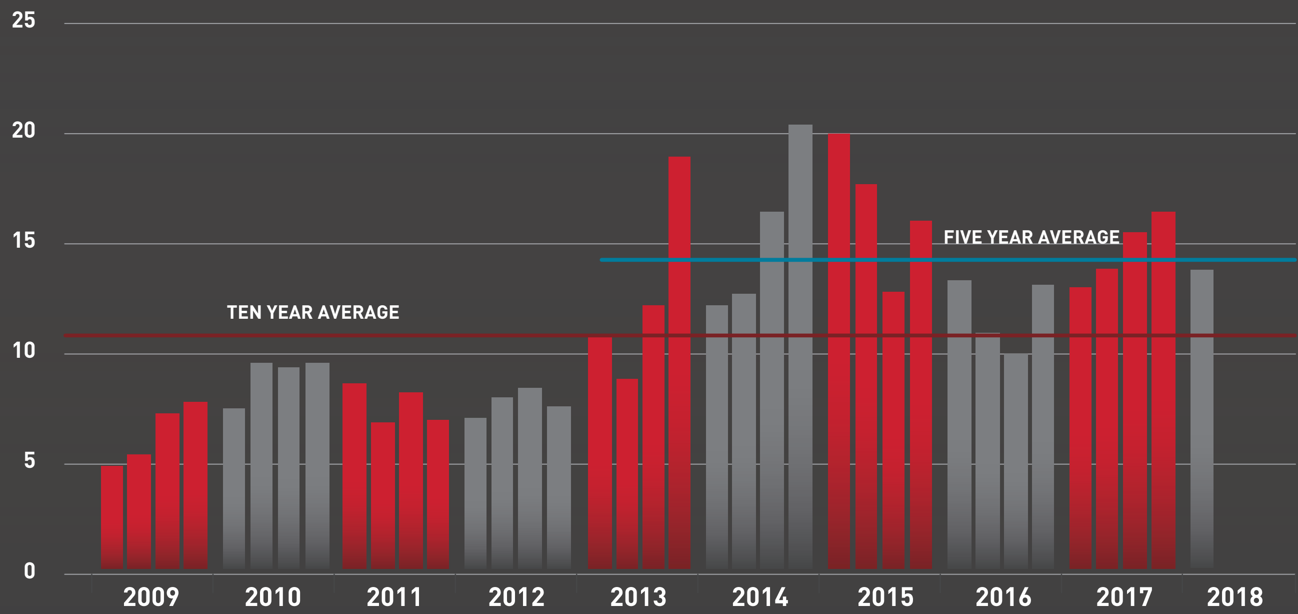
For what is usually a quiet time of the year for transactions, Q1 ranked as a very strong quarter, even if volume was admittedly a little short of the quarterly average. It was also all the more impressive given it lacked the 'super-sized' deals seen in 2017.

The healthy depth to activity in Q1 is clear testament to the attractive fundamentals around UK commercial real estate. Even if returns are moderating, our outlook is upbeat for the year ahead. Investors will be reassured by the UK's transitional deal agreed with the EU, putting pay to fears of a cliff edge scenario facing the occupier markets, while news on inflation and employment suggests the UK economy is in better shape than purported by the official figure for Q1.

However, Q1 also underscored the intensely polarised level of demand between sectors. The recent glut of bad news among retailers paints a very gloomy picture for the high street and investors are voting with their feet. However, I am convinced that this situation will present pockets of opportunity for forward-thinking investors who believe that there is a future for these assets.

Meanwhile, industrial and logistics remains the darling sector and, while value is becoming ever harder to find, the growth and increasing sophistication of e-commerce will continue to provide the foundation for investment demand over the coming year.

UK INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

SECTOR FOCUS

FLYING START TO THE YEAR

The investment market enjoyed a flying start to 2018. £13.6bn of assets changed hands in Q1, the second highest volume for a first quarter in a decade. Impressive as Q1 was, however, activity was very mixed between the sectors.

A BUSY QUARTER

Q1 was a remarkably busy for a first quarter. The number of recorded deals was 22% above the five-year quarterly average and 30% higher than the equivalent period in 2017. Indeed, arguably the only thing lacking in Q1 was an absence of the 'mega deals' that characterised 2017.

HOTEL SECTOR BOASTS Q1'S HEADLINE DEAL

Strong demand for alternative sectors continues unabated. At £1.6bn, Hotels & Leisure volume was 18% above the five-year quarterly average and was boosted by Q1's largest deal, LRC Group's £600m acquisition of Lone Star's hotel portfolio of 23 assets leased to Mercure and Hilton.

Collectively, the specialist sectors saw £2.4bn change hands in Q1, 51% above the five-year quarterly average. This included Brookfield Asset Management's £420m purchase of the SACO Portfolio of 39 assets from Oaktree Capital Management, the largest deal of its kind in the UK to date.

INDUSTRIAL JUGGERNAUT PLOUGHS ON...

Strong price increases over the past 12 months have done little to deter investors from industrial and logistics assets. Following record annual volume in 2017, volume in Q1 was £1.9bn, a record level for the first quarter and 25% above average.

Three major portfolio deals were instrumental to Q1's volume. Blackstone and M7 Real Estate purchased two of them, one consisting of 40 light industrial assets from InfraRedCapital Partners (£320m) and the other comprising a logistics portfolio from Helical (£150m).

...WHILE RETAIL STRUGGLES

In sharp contrast, malaise within the retail occupier market continues to be reflected in investor apathy, particularly for larger lot sizes. Q1 retail volume of £1.5bn was almost half its quarterly average, while there were no deals above £100m for the first time in seven years.

Q1's largest retail deal was British Land's £96m acquisition of Royal Victoria Place, Tunbridge Wells from Hermes. Despite increased corporate activity among the major landlords, shopping centre volume of £390m was 56% below its average, the weakest of each of the three subsectors.

Q1 INVESTMENT VOLUME (£BN)

SECTOR	Q1 2018	Vs Q4 2017	Vs Q1 2017	Vs 5-year avg
Shops	£0.71	-53%	-7%	-38%
Shopping Centres	£0.39	-1%	-31%	-56%
Retail Warehouse	£0.37	-58%	-44%	-48%
ALL RETAIL	£1.47	-48%	-26%	-47%
Central London Offices	£3.26	-12%	-30%	-19%
Rest of South East Offices	£0.68	-28%	118%	1%
Rest of UK Offices	£1.03	-32%	58%	28%
Office Parks	£0.35	-16%	50%	-39%
ALL OFFICE	£5.32	-19%	-9%	-12%
South East Industrial	£0.44	5%	60%	66%
Rest of UK Industrial	£0.90	69%	154%	92%
Distribution Warehouse	£0.60	-40%	-48%	-26%
ALL INDUSTRIAL	£1.95	-1%	9%	25%
Hotels & Leisure	£1.63	6%	92%	18%
Specialist	£2.35	-30%	19%	51%
Mixed-use (single assets & portfolios)	£0.88	5%	67%	-23%
ALL PROPERTY	£13.60	-20%	5%	-6%

Source: LSH Research, Property Data, Property Archive

Q1 2018 YIELDS

	TRANSACTION YIELDS			PRIME YIELDS			
SECTOR	Q1 2018	3 MONTH MOVEMENT (BPS)	12 MONTH MOVEMENT (BPS)	Q1 2018	3 MONTH MOVEMENT (BPS)	12 MONTH MOVEMENT (BPS)	YIELD SENTIMENT
Shops	4.85%	34	11	4.00%			
Shopping Centres	6.76%	-46	-10	6.00%*		25	
Retail Warehouse	6.43%	24	-41	4.50%		-25	
ALL RETAIL	6.11%	0	-18		-	-	-
Central London Offices	4.22%	9	41	3.50%			
Rest of South East Offices	6.61%	34	66	5.00%			
Rest of UK Offices	6.12%	8	-6	4.75%		-25	
Office Parks	6.46%	16	-111	5.25%			
ALL OFFICE	5.08%	16	35		-	-	-
South East Industrial	5.18%	30	-44	3.75%	-25	-75	
Rest of UK Industrial	6.67%	-60	-50	4.75%	-25	-75	
Distribution Warehouse	5.73%	41	115	3.75%	-25	-50	
ALL INDUSTRIAL	5.61%	12	-16		-	-	-
Hotels & Leisure	5.77%	74	86	4.75%		-25	
Specialist	5.79%	13	-6	5.00%**	-25	-25	
Mixed-use (single assets & portfolios)	5.13%	49	-171	-	-	-	-
ALL PROPERTY	5.67%	11	1	-	-	-	-

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

Source: LSH Research, Property Data, Property Archive

CENTRAL LONDON WEIGHS ON OFFICE VOLUME

£5.3bn of office assets changed hands in Q1, just 12% short of the trend level. Central London was the main drag on the UK total, with volume 19% below trend, while regional offices continued its strong run, with volume of £1.0bn. Major regional deals included L&G's £125m acquisition of the India Buildings, Liverpool and Aviva's £113m purchase of Two New Bailey Square, Manchester.

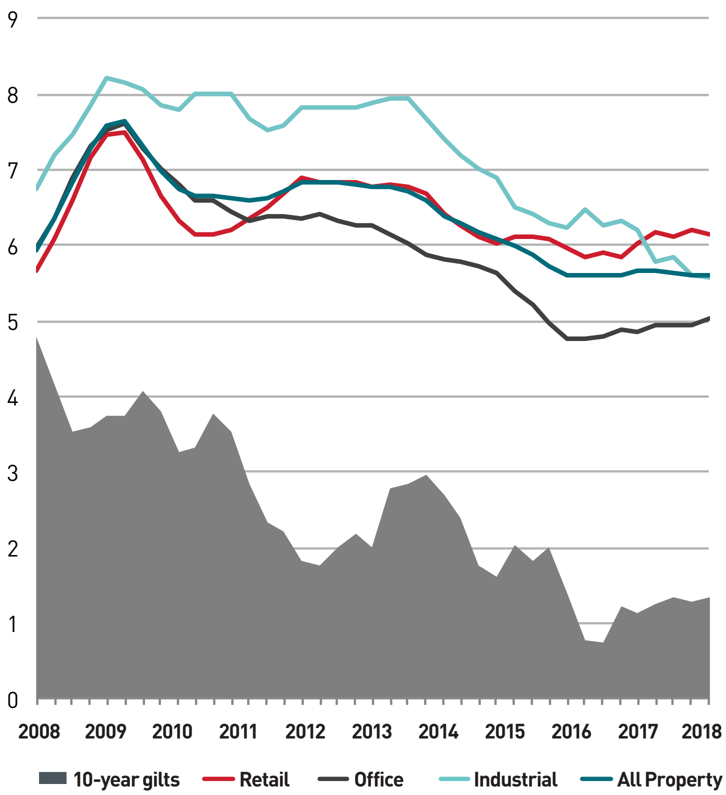
STOCK DRIVES UPWARD YIELD MOVEMENT

The All Property average transaction yield edged up by 11 basis points in Q1 to stand at 5.67%, effectively reversing the downward movement seen in Q3 2017 and moving back into line with the level seen over much of the past two years.

Average yield movements at the sector level indicate that Q1's All Property movement was linked to the nature of stock as opposed to a softening in prices; while average retail yields remained stable at 6.11%, industrial yields moved up by 12bps to 5.61%.

This is supported by notional pricing and transactional evidence across the various sectors. Prime yields remained broadly stable across the sectors during Q1, the clear exception being industrial where each of the subsectors hardened by 25bps to new all-time lows.

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



Source: LSH Research, Experian

REGIONAL FOCUS

REACHING TO THE REGIONS

The revival of activity across the UK continues, characterised in Q1 by a surge of institutional investor appetite for offices in the UK's core regional cities.

NORTH WEST STARS AMONG UK REGIONS

Portfolios aside, the UK regions collectively recorded £5.7bn of investment in Q1, 16% above the five-year quarterly average and up 46% on the same period in 2017. With the exception of the West Midlands and Northern Ireland, the majority of regions saw above average volume.

The North West had a fine first quarter, with volume of £975m more than double the same period last year. Major deals included the aforementioned purchases of the India Buildings, Liverpool and New bailey Square Manchester, alongside Secure Income REIT's £102m acquisition of Manchester Arena from Mansford LLP.

SUBDUED START TO THE YEAR FOR THE CAPITAL

Meanwhile, at £5.3bn, Greater London investment was down 15% on the five-year quarterly average. Q1's headline deals in the capital included Zeno Capital's £400m (NIY 3.9%) purchase of Riverbank House, EC4 from Evans Randall; and Samsung SRA Asset Management's £315m (NIY 4.7%) acquisition of 200 Aldersgate, EC1 from Ashby Capital.

INDUSTRIAL AND HOTELS DRIVE PORTFOLIO VOLUME

£2.6bn of portfolios transacted during Q1, down 21% on the five-year quarterly average. The under par performance was largely down to a virtual absence of portfolio deals in the office and retail sector, while industrial and hotels dominated portfolio volume.

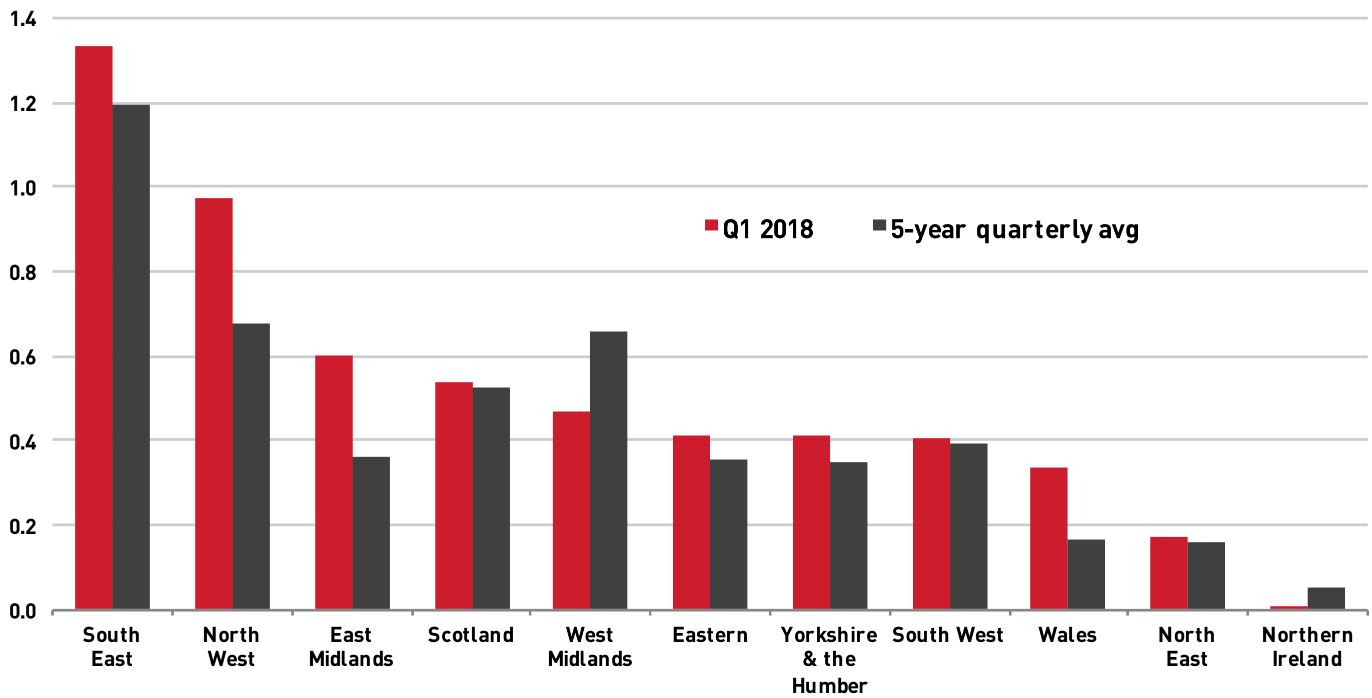
£753m worth of industrial portfolios changed hands across seven deals in Q1, 50% above the five-year quarterly average. Meanwhile, £1.0bn of Hotels & Leisure portfolios transacted, up 59% on the five-year average, and dominated by LRC Group's £600m acquisition of Lone Star's hotel portfolio.

Q1 2018
LONDON AND REGIONAL BREAKDOWN (£BN)

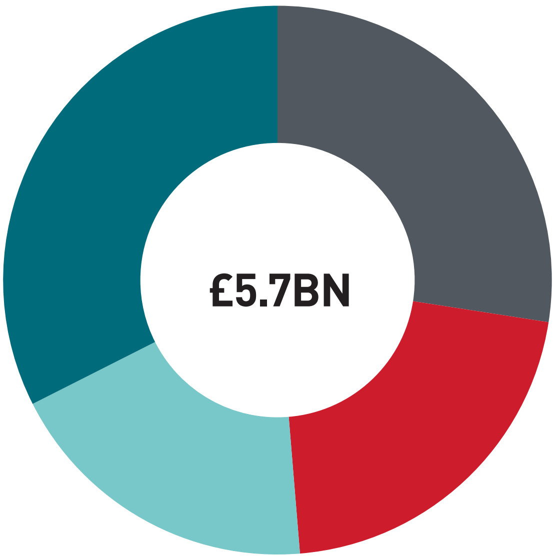
GREATER LONDON

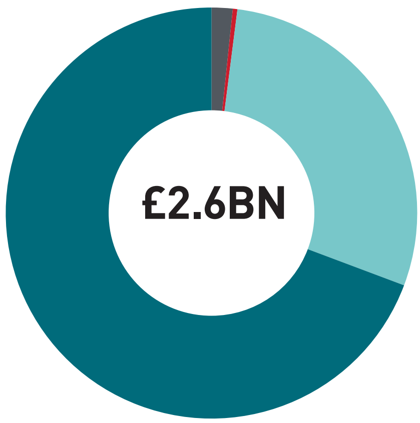
	GREATER LONDON
VS Q4 2017	-2%
VS Q1 2017	-21%
VS 5-YEAR QTY AVG	-15%

Q1 REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive





UK REGIONS	PORTFOLIOS
-21%	-41%
46%	11%
16%	-21%

Source: LSH Research, Property Data, Property Archive

BUYERS & SELLERS

REIT REVIVAL

Q1 activity saw mixed levels of activity among buyer types. Overseas volume was quiet by recent standards, while quoted property companies invested near record levels of capital.

FAR EAST KEY TO OVERSEAS VOLUME

At £5.5bn, total overseas investment was relatively subdued, marking its weakest quarterly volume in 18 months and 20% below trend level. The under par activity was reflected in below average investment in London and a lack of major lot-size deals in Q1.

At £2.1bn, Far Eastern investors continue to command the leading share of overseas volume, accounting for a substantial 39% in Q1. Meanwhile, investment was down among the other key sources of capital, notably Germany, where inflows were their lowest since Q2 2014.

RESURGENCE OF THE REITS

Having suffered a chastening experience from 2016's Brexit vote, quoted property companies are now very active in the market. The REITS invested £2.0bn in Q1, the highest quarterly total in seven years, and were net buyers for the first quarter post the vote, to the tune of £847m.

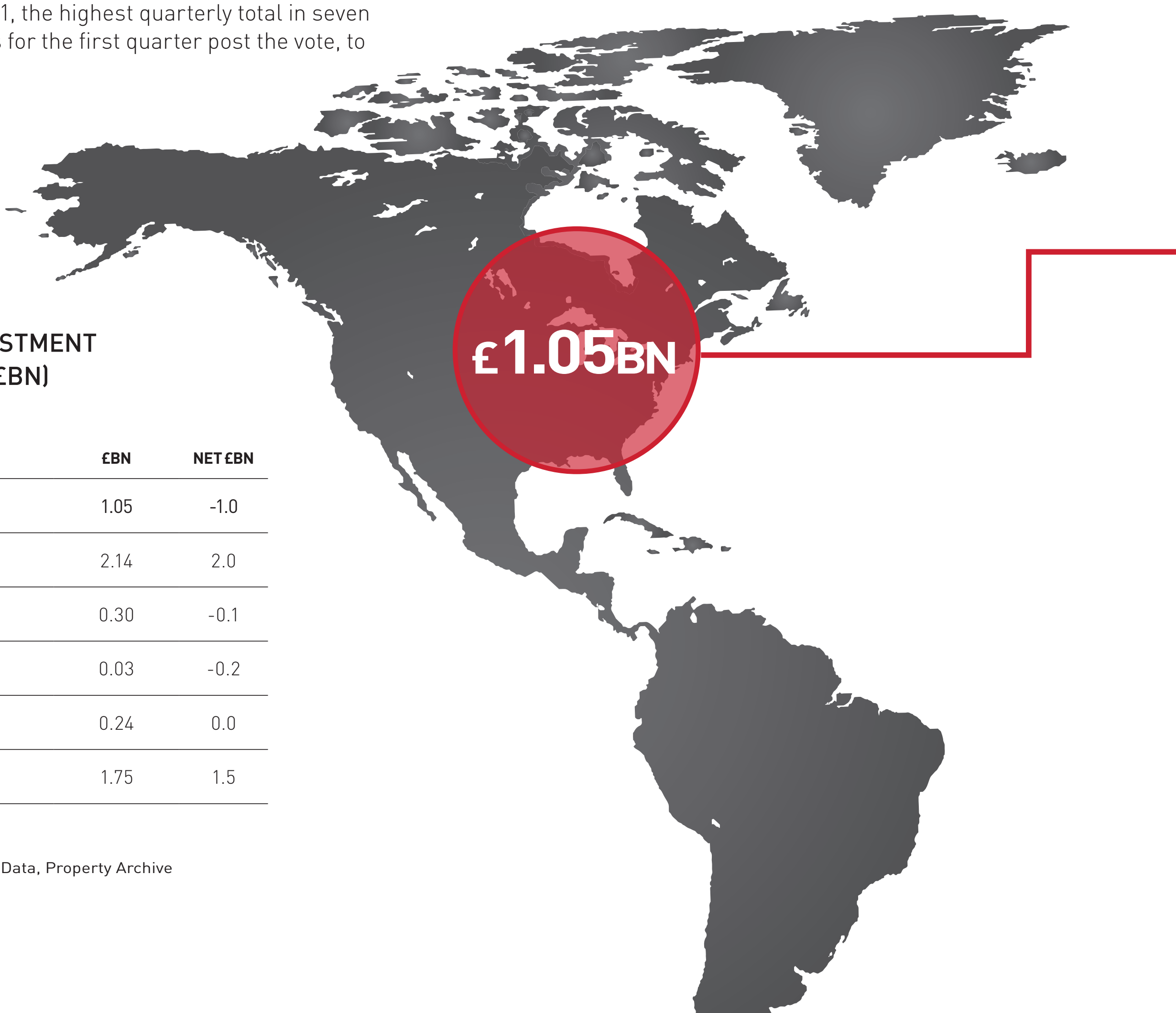
The focus of quoted buyers was on the alternative sectors in Q1, with Hotels & Leisure purchasing amounting to £449m. Secure Income REIT was the most active quoted buyer with five purchases, the largest comprising a £212m (NIY 6.1%) portfolio of 59 Travelodges from GoldenTree Asset Management.

INSTITUTIONS REVERT TO SELLING

Having briefly resurfaced to net buying in Q4 2017, institutions reverted to being net sellers in Q1, by £573m. As ever Central London offices provided the focus of disposals, while the largest acquisition was L&G's £182.4m (NIY 5.02%) purchase of Woodside Industrial Estate from Harbert European.

LOCAL AUTHORITIES CONTINUE TO INVEST

Local authorities invested £553m into UK property in Q1, up 14% on the previous quarter. Spelthorne Borough Council cemented its position as the UK's largest local authority buyer, boosted by the £170m acquisition of 12 Hammersmith Grove, London W6.

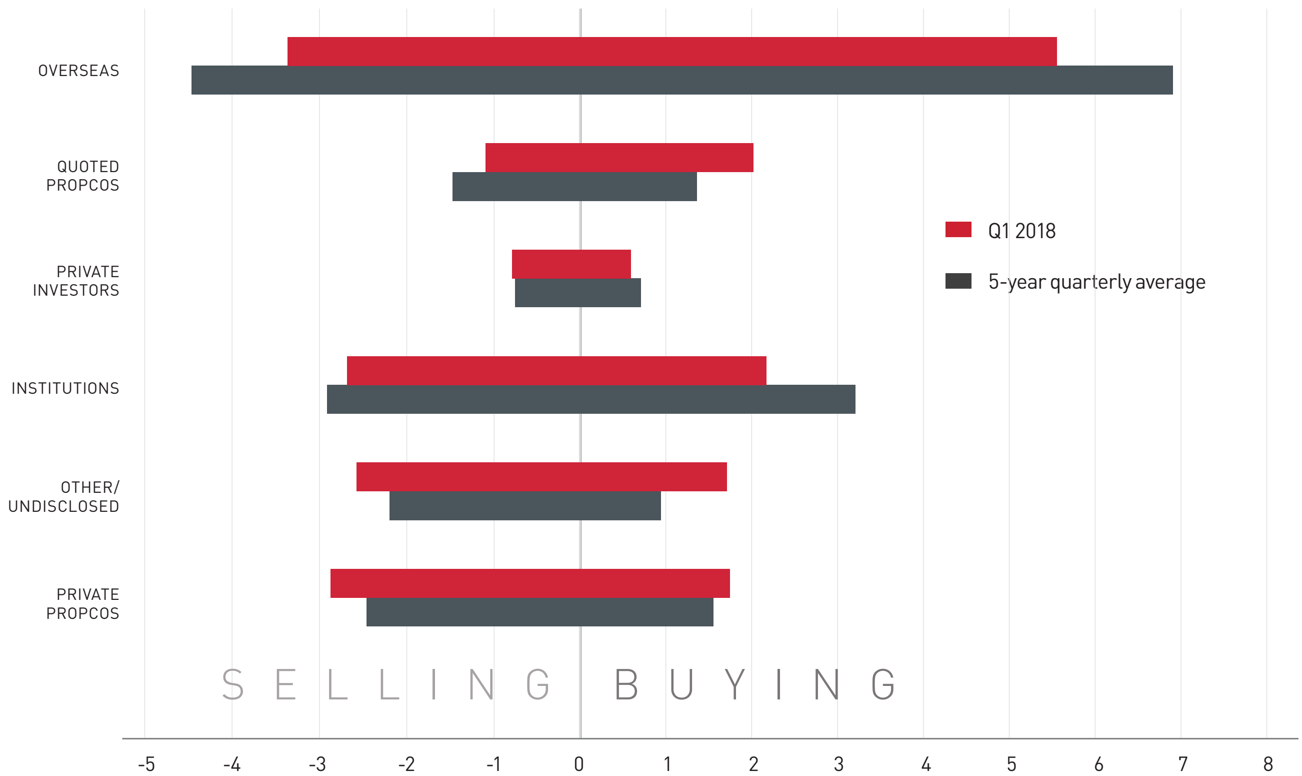


Q1 2018: GLOBAL INVESTMENT FLOWS INTO UK CRE (£BN)

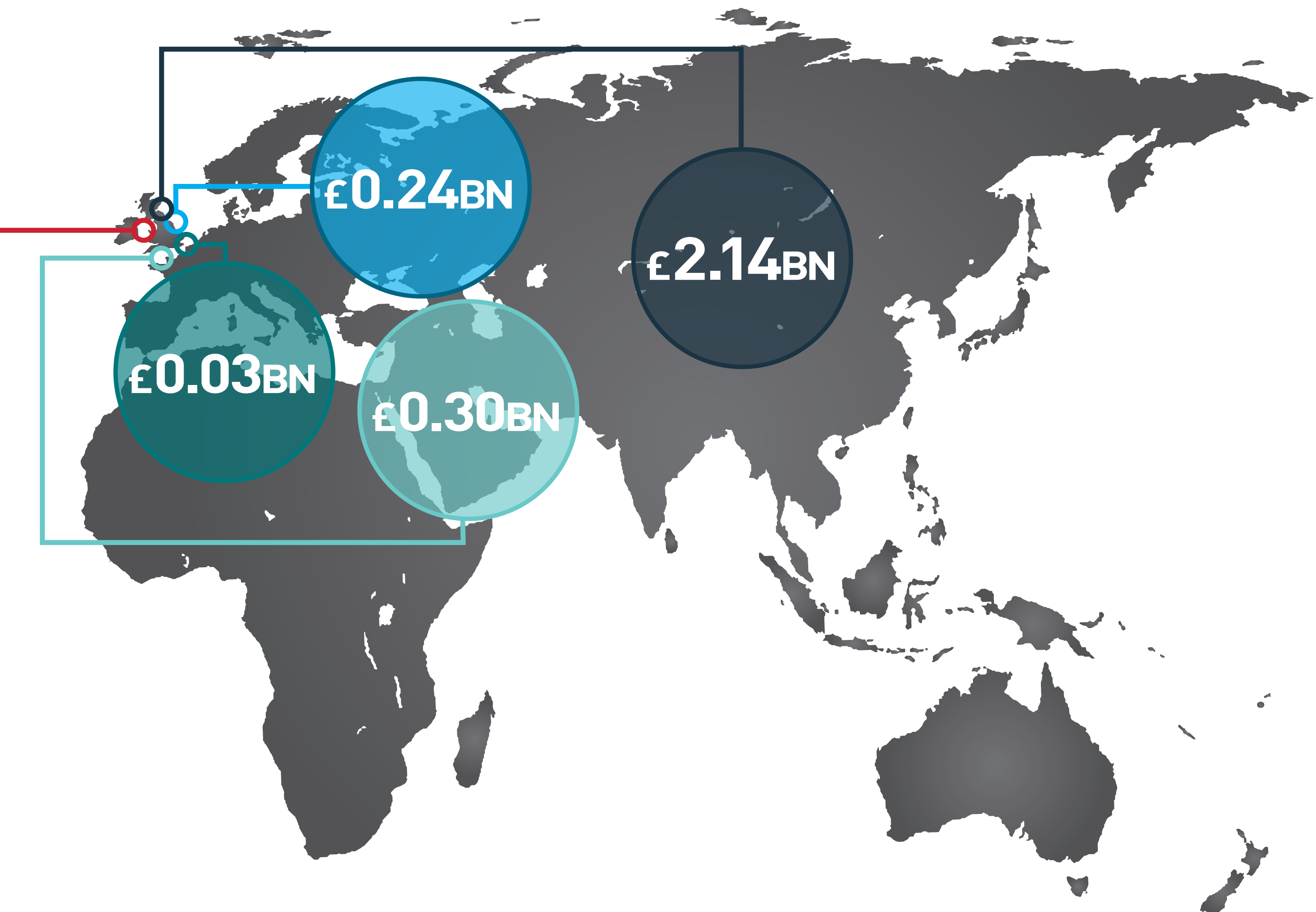
ORIGIN	£BN	NET £BN
NORTH AMERICA	1.05	-1.0
FAR EAST	2.14	2.0
MIDDLE EAST	0.30	-0.1
GERMANY	0.03	-0.2
EUROPE	0.24	0.0
OTHER	1.75	1.5

Source: LSH Research, Property Data, Property Archive

Q1 2018 VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive

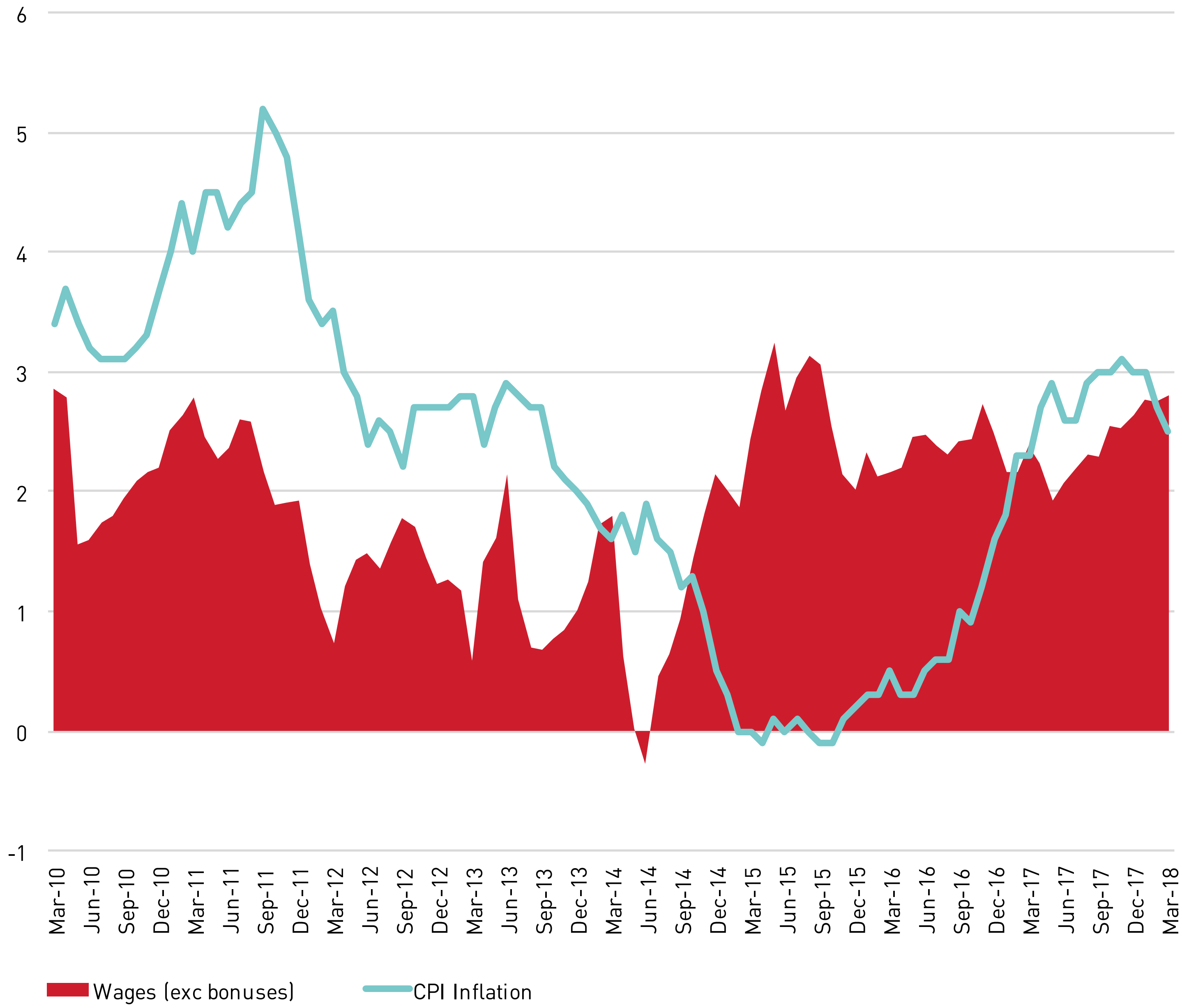


OUTLOOK

SPRING HAS SPRUNG

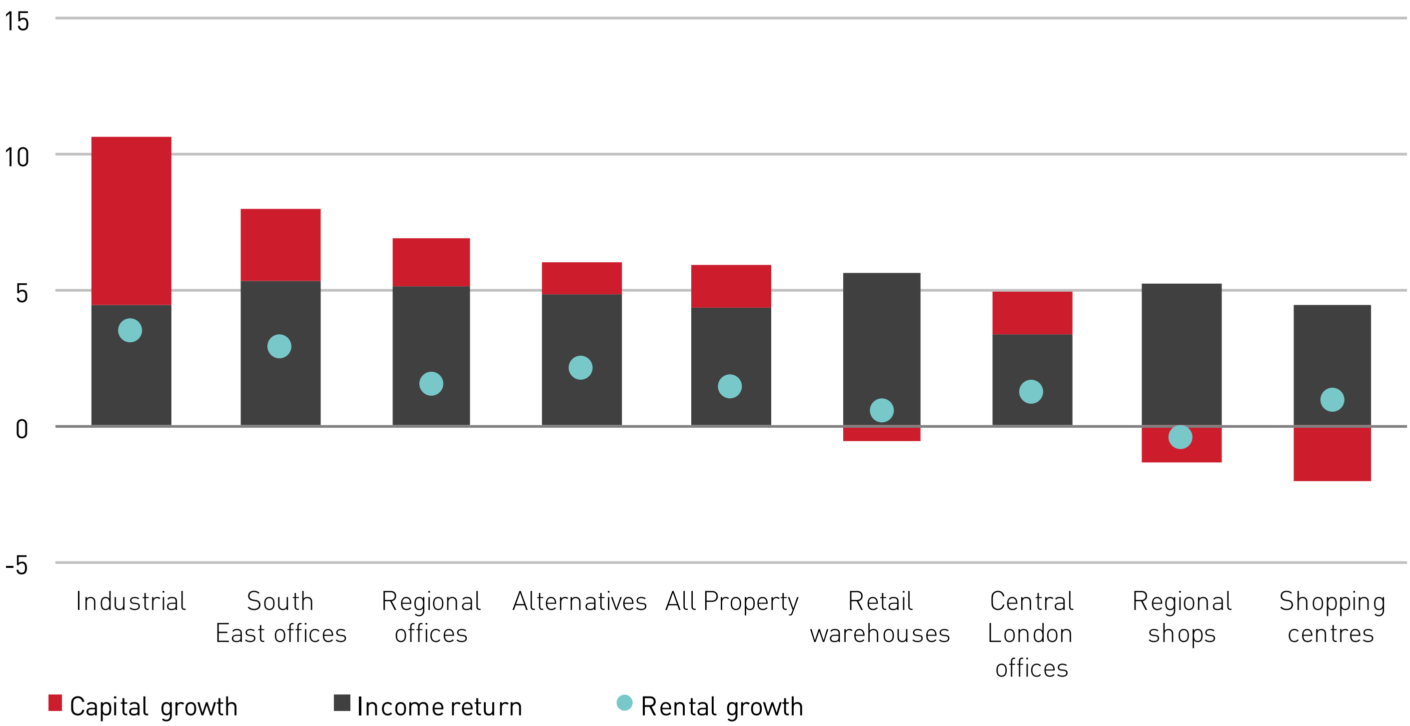
After a depressingly weather-affected start to the year, Spring has finally sprung, bringing with it far more promising news around the state of the UK economy. Meanwhile, the polarised nature of market activity in 2017 has, if anything, become even more entrenched.

WAGE GROWTH VS INFLATION (% ANNUAL)



Source: ONS

COMPONENTS OF 2018 TOTAL RETURN FORECAST (%)



Source: LSH, RealFOR

LABOUR MARKET IN RUDE HEALTH

Disappointing GDP growth of only 0.1% in Q1 stands in stark contrast with much better news on the labour market. Unemployment has edged down once again, standing at just 4.2% and its lowest level since 1975, while the number of UK employees expanded by over 100,000 over the three months to February. What's more, a number of the key surveys relating to the jobs market reveals that UK job vacancies have reached a record high, as employers seek to expand headcount.

RISING WAGES A TONIC TO CONSUMERS

Little slack in the labour market is finally starting to feed through into rising wages. At 2.8% year-on-year, wage growth stands at its highest level since August 2015. Moreover, March's surprise fall of CPI inflation, down from 2.7% to 2.5%, means real wages are firmly back into growth territory, a trend which is expected to continue throughout 2018.

While consumers and retailers are hardly out of the woods, with sentiment remaining weak and worries over the level of personal indebtedness, it does at least provide a degree of respite. This, alongside ongoing growth in business investment, may well translate into stronger UK growth than the modest 1.5% currently forecast for 2018.

PREPARE FOR INTEREST RATE RISES

Despite the fall in inflation and weather affected growth in Q1, the Bank of England is still widely expected to trigger an upward movement on interest rates at some point in the year. Such a move will be in step with efforts to 're-normalise' rates globally, and the fact that real wages are rising implies that UK consumers and mortgagees will be better-placed to cope.

MARKETS WELCOME BREXIT TRANSITION DEAL

The transition deal agreed in March over the UK's departure from the EU will have reassured the market, putting pay to any fears of a cliff edge scenario for occupiers and investors alike. That said, we can expect plenty more twists and turns over the coming year as negotiations turn to the eventual trade deal.

For would be investors, the prospect of at least two rate rises alongside a commensurate rise in gilt yields arguably poses the main challenge over the year ahead. In our view, an interest rate of, say, 1% is more likely to work against further yield compression as opposed to pushing yields out. That said, pricing for smaller, secondary assets, which tend to be more reliant on private investors and debt, could be at risk.

GULF IN SENTIMENT TO ENDURE IN 2018

2017 saw the widest differential in total return performance at the IPD segment level since 1992, with shopping centres returning 4% compared with 23% for South East industrials. Though limited scope for yield compression means this will not be repeated in 2018, the gulf in investor sentiment towards retail and industrial will endure.

However, with alternatives and industrial yields abnormally low by historic standards, income seeking investors will be increasingly drawn to higher yielding assets, particularly where there is scope for growth. Given tight supply, this already applies to regional offices, but may increasingly extend to good quality, well-let retail assets where clear value can now be found.

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