Lambert Smith Hampton

IN THE BALANCE

UKIT Q418

UK INVESTMENT TRANSACTIONS BULLETIN

Q4 VOLUME AT £16.6BN: +11% ON AVG

2018 VOLUME £61.8BN: 2ND HIGHEST IN A DECADE

NEW RECORD FOR INDUSTRIAL VOLUME...

... VS RECORD LOW VOLUME FOR SHOPPING CENTRES

AVG TRANSACTION YIELD DOWN 32BPS Q-ON-Q

FAR EAST DOMINATES OVERSEAS VOLUME

Ezra Nahome
CEO

Q4's healthy volume is clear testimony to the resilience of UK real estate, regardless of the political chaos around Brexit.

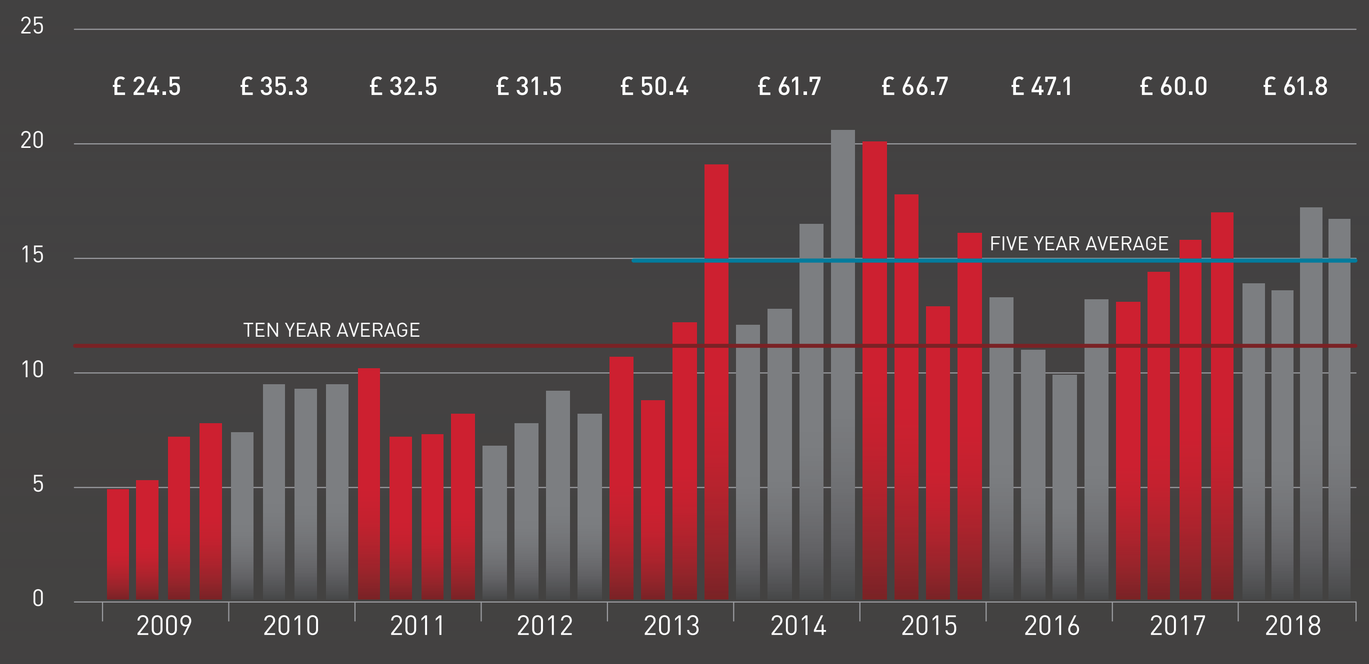
This is particularly true of investment from overseas, where the current uncertain environment could be seen by many as a buying opportunity. That said, moving into 2019, the market is likely to be relatively subdued in Q1 as domestic and smaller lot-size investors opt to sit on their hands and await greater clarity on the timing and manner of the UK's exit from the EU.

Whilst the market currently hangs in the balance, I am nonetheless upbeat about 2019 overall. Assuming a no deal Brexit scenario is avoided, I expect to see activity bouncing back strongly in the second half of the year. And, even if the worst should happen, fears of a calamitous fall in volumes and values akin to a decade ago are hard to justify.

We are largely ruling out the prospect of further yield compression in 2019, meaning investors will be especially focused on strategies aimed at maximising income returns and capital growth. Amid all this uncertainty, one thing we can be sure of is that the weight of money targeting secure income will be unwavering in 2019. This will drive continuing demand in alternatives, most notably PRS where a multitude of investors are allocating capital.

The high street undoubtedly endured a torrid year in 2018, and there is likely to be further painful readjustment in the offing. However, quality retail assets in proven locations are now offering relative value, particularly set against industrial, and are likely to attract yield-seeking investors over the coming year.

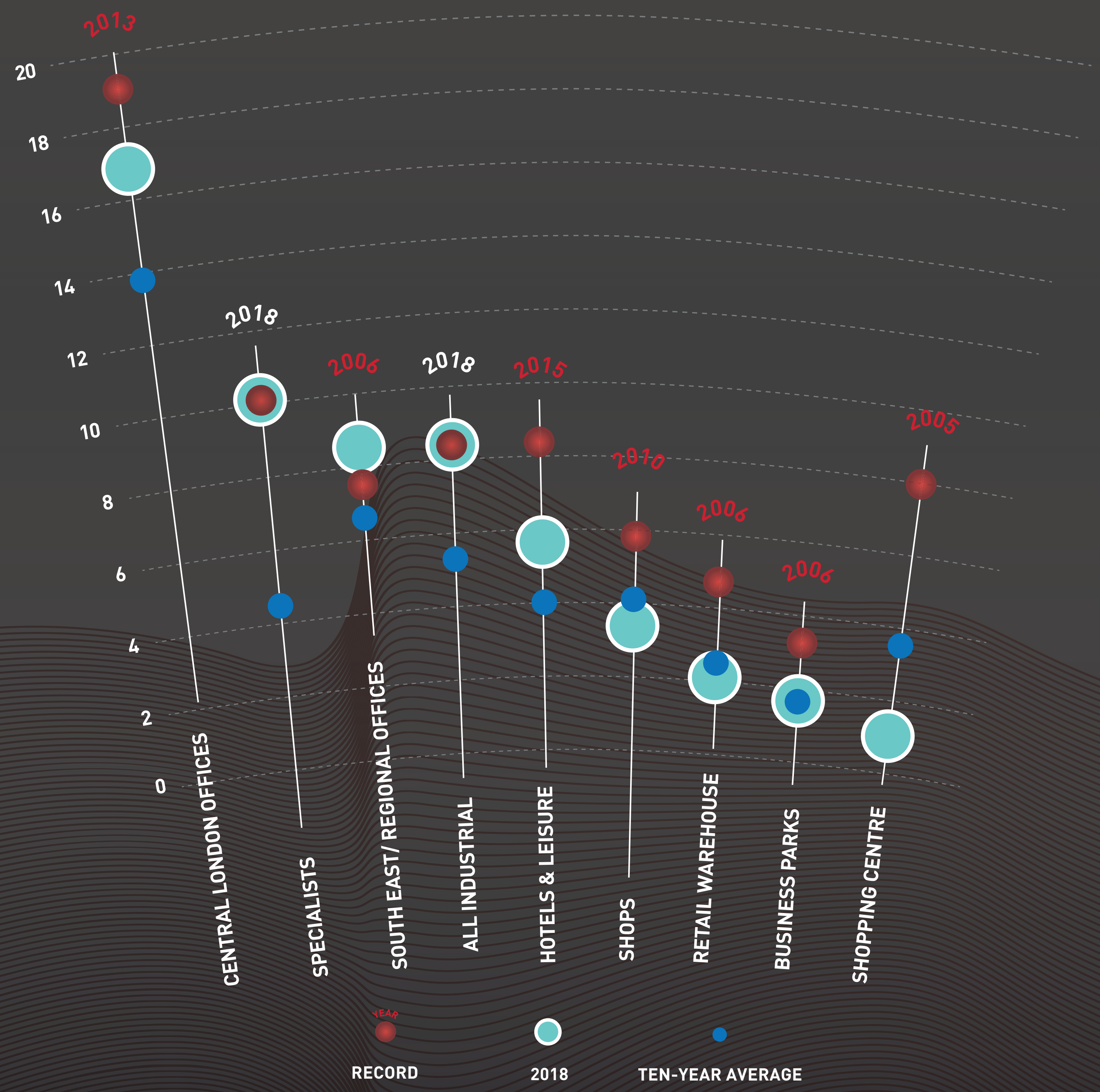
UK INVESTMENT VOLUME (£BN)



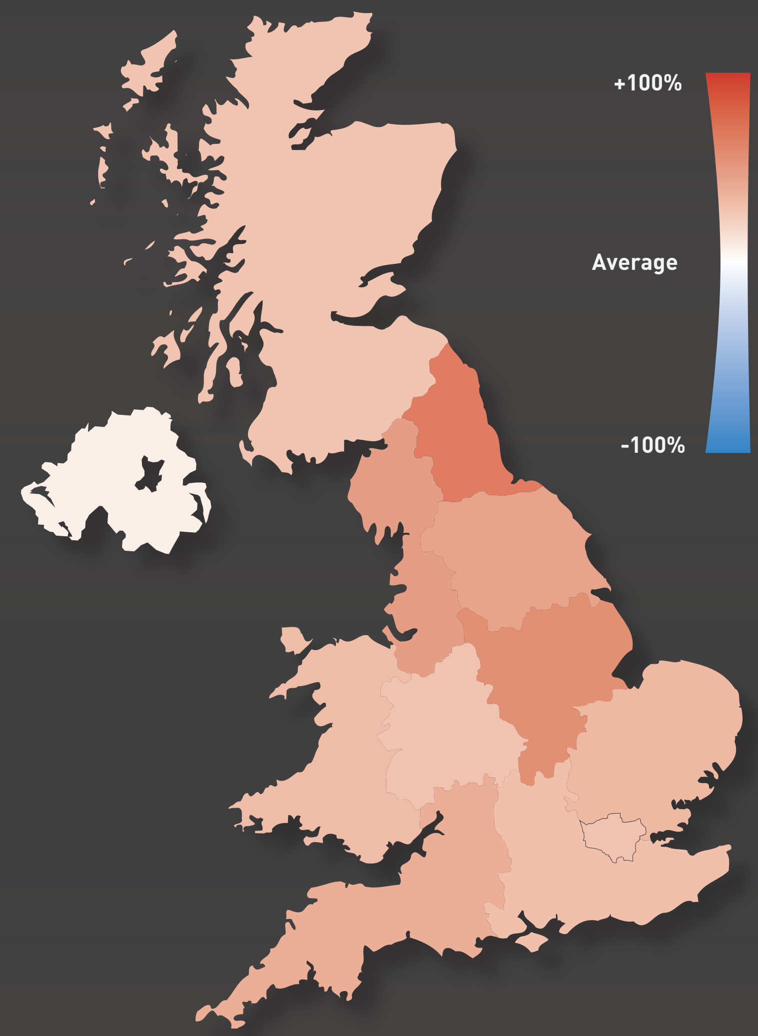
Source: LSH Research, Property Data, Property Archive

2018 HIGHLIGHTS

VOLUME BY SECTOR (BN)

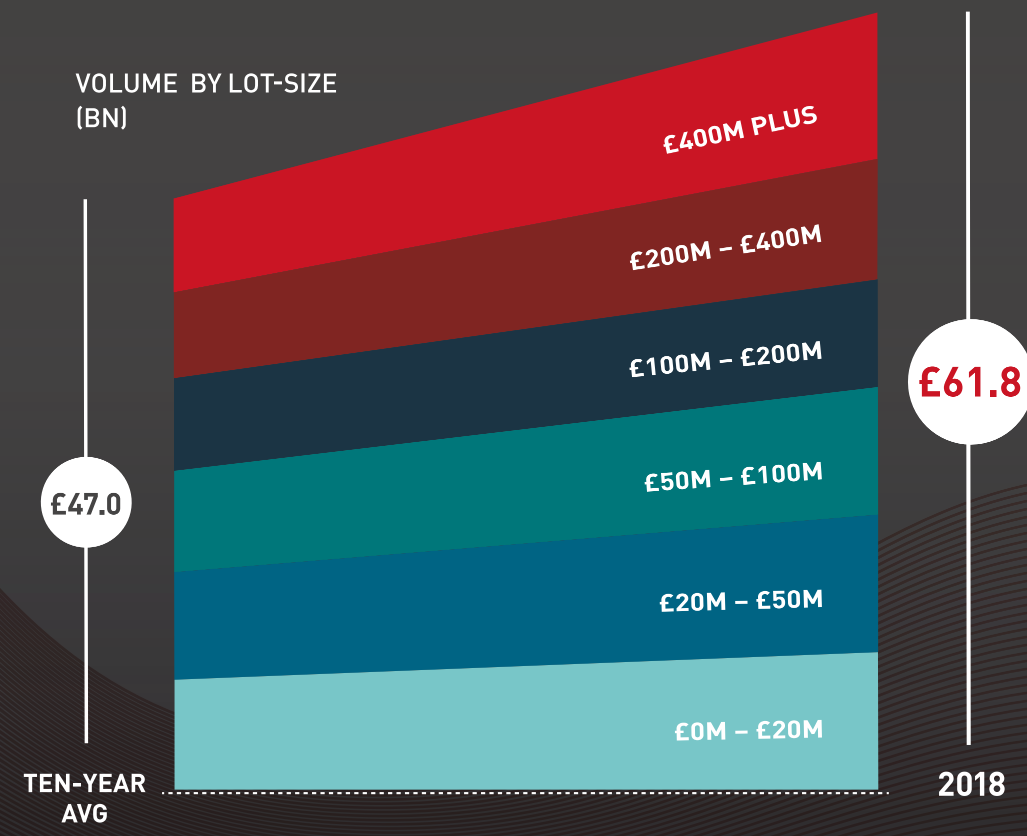


REGIONAL VOLUME VS TEN-YEAR AVERAGE



VOLUME BY INVESTOR TYPE (£BN)

VOLUME BY LOT-SIZE (BN)



SECTOR FOCUS

ENDING ON A HIGH

2018 finished on a high. Q4 volume of £16.6bn pushed the annual total to £61.8bn, up 3% on 2017 and the second strongest year in a decade, after 2015.

Q4's volume was underpinned by a flurry of major transactions, including Permodalan Nasional Berhad and the Employees Provident Fund of Malaysia's massive £1.58bn acquisition of Battersea Power Station - the UK's largest property deal since Q4 2013. The number of deals in Q4 was in fact 14% down on Q3 and only on par with the average for the final quarter, normally the busiest period of the year.

DOUBLE RECORD INDUSTRIAL & LOGISTICS

Despite value being ever harder to find, unwavering demand for industrial and logistics continues unabated across all the subsectors. Records tumbled once again; Q4 volume of £2.3bn was a new quarterly high, and also took 2018 volume to a new annual record of £8.4bn.

Q4's largest industrial deal was Ascendas REIT's £257.5m (5.39% NIY) purchase of a 26 asset portfolio from Griffin UK Logistics. This was the second largest industrial deal in 2018 behind Blackstone's £320m (6.30% NIY) acquisition of the Powerhouse Portfolio from InfraRed Capital Partners in Q1 2018.

DITTO FOR THE SPECIALIST SECTORS

Momentum behind specialist sector investment continues to build. Q4 volume of £2.8bn of took the total for 2018 to £10.6bn, eclipsing 2017's previous high by 5% and making up a significant 17% of total 2018 volume.

2018 was also characterised by growing traction in PRS. Following a record Q3 volume of £1.8bn, Q4 saw one of the largest ever PRS deals, Grainger Plc's £396m acquisition of the GRIP Portfolio comprising 35 assets.

WEAKEST RETAIL VOLUME IN SIX YEARS

In stark contrast, a poor Christmas for the high street was mirrored in yet another weak quarter of volume. At £1.4bn, retail volume in Q4 was the lowest since Q2 2012. All subsectors were significantly below trend, most notably retail warehouses, where volume was 64% below average.

However, the quarter saw the second largest retail deal of 2018, namely Norinchukin Bank's £236m (5.50% NIY) acquisition of a 50% stake in Highcross Shopping Centre, Leicester from Hammerson. This took the annual retail volume in 2018 to £6.4bn, its lowest since 2012 and 28% down on the ten-year average.

Q4 2018 INVESTMENT VOLUME (£BN)

VOLUME VS 5YR QTY AVG: -50% | -25% | AVERAGE | +25% | +50%

SECTOR	Q4 2018	Q3 2018	Q2 2018	Q1 2018	VS Q3 2018 (%)
Shops	**0.81**	0.67	1.10	0.73	21%
Shopping Centres	**0.40**	0.04	0.22	0.39	951%
Retail Warehouse	**0.24**	0.77	0.63	0.37	-68%
ALL RETAIL	**1.45**	1.47	1.95	1.49	-2%
Central London Offices	**4.27**	4.50	4.67	3.46	-5%
Rest of South East Offices	**0.56**	0.91	0.75	0.85	-39%
Rest of UK Offices	**1.64**	0.97	0.71	1.10	70%
Office Parks	**0.26**	0.40	0.34	0.35	-35%
ALL OFFICE	**6.73**	6.77	6.48	5.76	-1%
South East Industrial	**0.39**	0.31	0.31	0.44	25%
Rest of UK Industrial	**0.83**	0.96	0.64	0.90	-13%
Distribution Warehouse	**1.08**	0.92	1.00	0.60	17%
ALL INDUSTRIAL	**2.29**	2.19	1.94	1.95	5%
Hotels & Leisure	**1.30**	1.24	1.33	1.69	5%
Specialist	**2.76**	3.51	2.02	2.35	-21%
Mixed-use (single assets & portfolios)	**2.04**	1.85	0.37	0.88	10%
ALL PROPERTY	**16.57**	17.04	14.07	14.13	-3%

Source: LSH Research, Property Data, Property Archive

Q4 2018 YIELDS

SECTOR	TRANSACTION YIELDS Q4 2018	TRANSACTION YIELDS 3 MONTH MOVEMENT (BPS)	TRANSACTION YIELDS 12 MONTH MOVEMENT (BPS)	PRIME YIELDS Q4 2018	PRIME YIELDS 3 MONTH MOVEMENT (BPS)	PRIME YIELDS 12 MONTH MOVEMENT (BPS)	YIELD SENTIMENT
Shops	3.94%	5	-57	4.25%		25	
Shopping Centres	6.63%	-57	-59	6.50%*	25	50	
Retail Warehouse	5.65%	-100	-54	5.25%	50	75	
ALL RETAIL	5.54%	-46	-57				-
Central London Offices	4.47%	-3	35	3.50%			
Rest of South East Offices	6.04%	-21	-23	5.00%			
Rest of UK Offices	6.32%	-24	27	4.75%		-25	
Office Parks	6.92%	-10	62	5.25%			
ALL OFFICE	5.19%	-10	28				-
South East Industrial	4.71%	-1	-18	3.75%		-25	
Rest of UK Industrial	5.75%	-74	-152	4.75%		-25	
Distribution Warehouse	5.27%	-2	-5	3.75%		-25	
ALL INDUSTRIAL	5.06%	-14	-42				-
Hotels & Leisure	4.97%	-80	-7	5.50%	50	75	
Specialist	5.88%	-2	21	5.00%**		-25	
Mixed-use (single assets & portfolios)	5.25%	-154	61	-	-	-	-
ALL PROPERTY	5.34%	-32	-22	-	-	-	-

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

Source: LSH Research, Property Data, Property Archive

STRONG FINISH TO YEAR FOR REGIONAL OFFICES

2018 ended strongly for office volume, with £6.7bn of assets changing hands in Q4. At £1.6bn, Rest of UK office volume was particularly strong in Q4, its highest since Q1 2016 and 83% above the quarterly average. This included Legal & General's £360m acquisition of a 50% stake in the Bruntwood SciTech joint venture, comprising science and technology assets and developments.

The office sector fared well in 2018 as whole, with total volume across the subsectors amounting to £25.7bn, up 5% on 2017 and 29% above the ten-year average. At £16.9bn, Central London office volume surpassed each the previous two years and was 26% above the ten-year average.

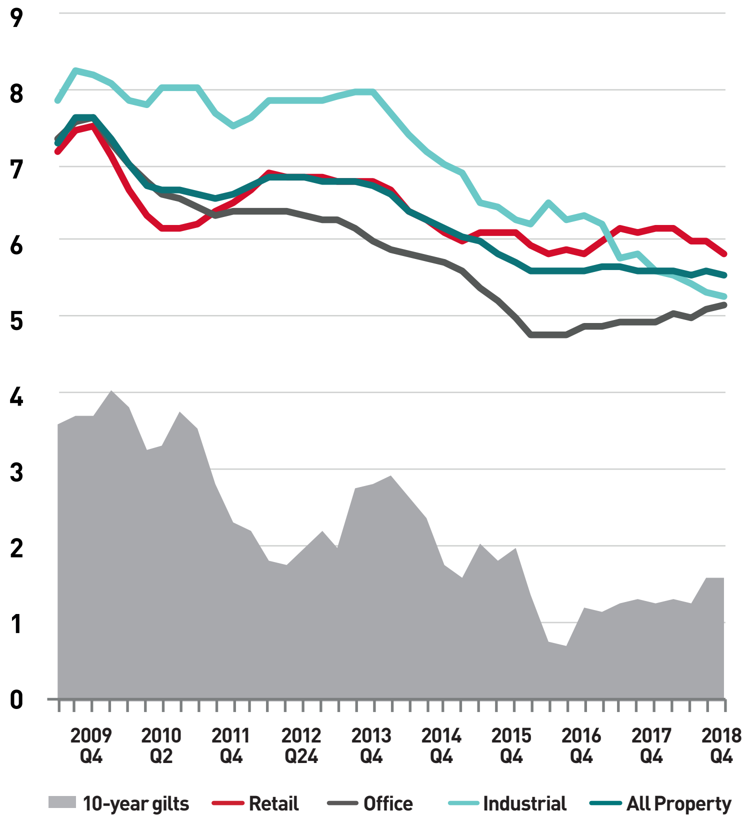
TRANSACTION YIELDS AT DECADE LOW

The All Property average transaction yield moved in by a notable 32 bps during Q4 to an 11-year low 5.34%. The majority of subsectors saw inward movement, reflecting an investor focus on secure, quality assets amid elevated levels of uncertainty over the near term outlook.

Retail saw the largest movement, with average yields moving in by 46 bps to 5.54%, the lowest since Q4 2007. With investors clearly wary of occupational risks throughout the sector, this reflects the focus on prime assets.

Meanwhile, notional prime yields in retail continue to soften. Mirroring deteriorating sentiment, prime retail warehouse yields moved out by a further 50 bps alone in Q4. Elsewhere, prime yields remained broadly stable across the industrial and office sectors during the quarter.

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



Source: LSH Research, Experian

REGIONAL FOCUS

REGIONS REJOICE

Q4 saw healthy volume in both the capital and across the rest of the UK, with every region recording above average volume in 2018.

BATTERSEA FLATTERS LONDON

While Q4 Greater London volume of £7.0bn was down 3% on Q3, it was nonetheless 12% above the five-year quarterly average. However, Q4 was somewhat flattered by the £1.58bn Battersea Power Station deal, which alone accounted for almost a quarter of volume in the capital.

Nonetheless, over 2018 as a whole, Greater London volume of £26.5bn was 5% up on 2017 and 27% above the ten-year average. Despite uncertainty in the market, overseas investors appear confident in the capital, investing £16.3bn in 2018.

REGIONS REJOICE

Excluding portfolios, investment volume in the regions outside London was £5.6bn in Q4, up 8% on the previous quarter and 13% above average. This brought the annual total for 2018 to £21.3bn, its best year since 2006.

It was a healthy picture across the regions, all of which recorded above average volume in 2018. A strong finish to the year saw the North East and the East Midlands among the standout performers, with volume 61% and 52% above average respectively in 2018, while Yorkshire & the Humber enjoyed record annual volume of £1.9bn.

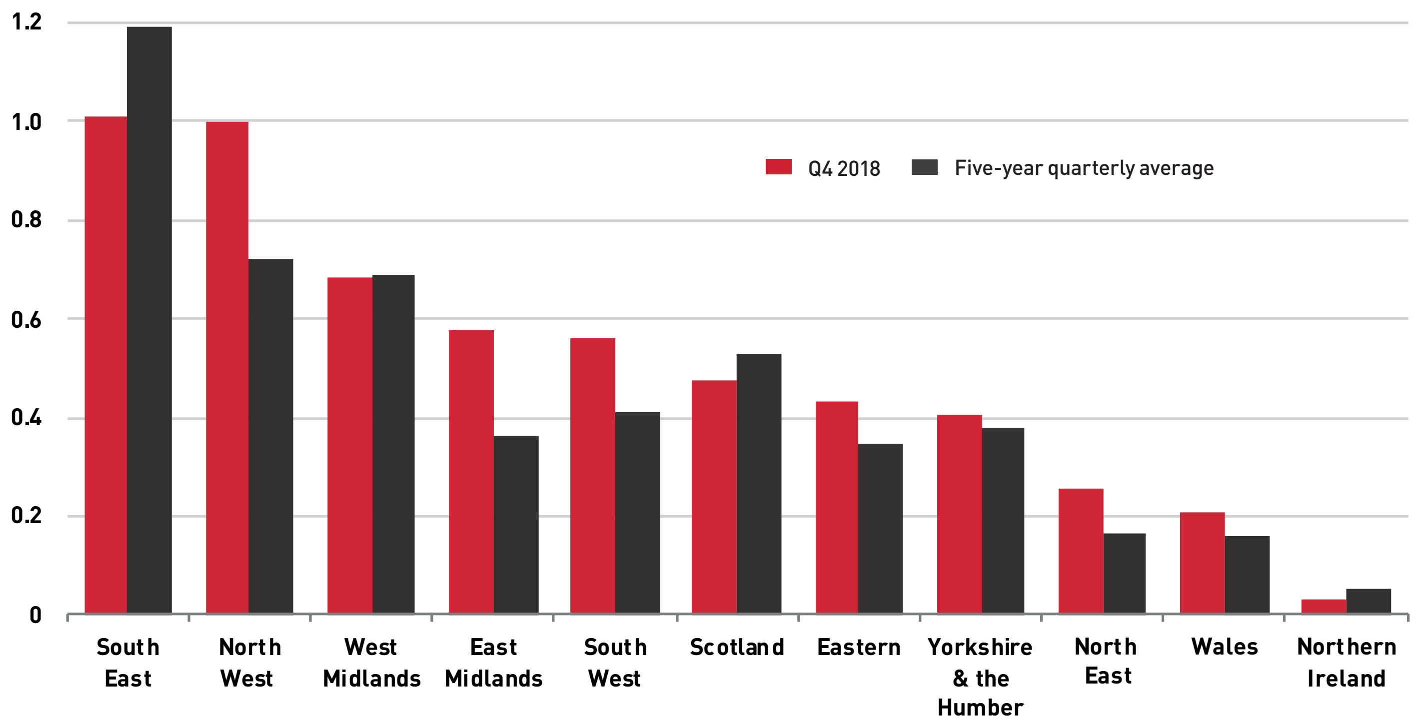
Q4 saw 2018's largest deal in the regions, Aviva's £300m acquisition of a 50% stake in the Enterprise City development, Manchester. This propelled volume for the North West region to £3.3bn in 2018, its strongest year since 2006.

ANOTHER STRONG YEAR FOR PORTFOLIOS

At £4.0bn, portfolio activity in Q4 was 10% above the five year quarterly average. This brought the annual total for 2018 to £14.0bn, up 3% on 2017, boosted by the largest ever portfolio deal, Telereal Trillium and Blackstone's £1.46bn Network Rail Arches portfolio in Q3 2018.

The largest portfolio deal in Q4 was Celvam Management's £475m acquisition of London Executive Offices from Queensgate Investments, including 11 Central London office assets.

Q4 REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

Q4 LONDON AND REGIONAL BREAKDOWN (£BN)

	GREATER LONDON	UK REGIONS	PORTFOLIOS
VS Q3 2018	-3%	8%	-14%
VS Q4 2017	29%	-20%	-11%
VS FIVE-YEAR QTY AVG	12%	13%	10%

Source: LSH Research, Property Data, Property Archive

BUYERS & SELLERS

BEAST FROM THE FAR EAST

Far Eastern investors' insatiable appetite for UK real estate continued in Q4, while activity among other overseas origins appeared more restrained.

FAR EAST DOMINATES INFLOWS

Despite ongoing uncertainty over the UK's future relationship with the EU, overseas investors continue to show faith in UK real estate and take advantage of favourable exchange rates. At £8.1bn, Q4 overseas investment was 16% above the five-year quarterly average.

Once again, overseas volume was dominated by Far Eastern investors, who continue to command the leading share of capital inflows on the back of exceptionally large deals. Far Eastern volume climbed to £4.8bn in Q4, underpinned by the Battersea Power Station deal, taking the 2018 total to a record £12.6bn.

However, investment from the other overseas origin groups was subdued in 2018. North America and the Middle East recorded their lowest annual volumes in six years. Nonetheless, the total overseas volume reached £27.9bn in 2018, 33% above the ten-year annual average.

MAJOR DEALS FLATTER INSTITUTIONAL ACTIVITY

While institutions were net purchasers in Q4, a number of major deals masked relativity quiet activity. This included Legal & General's £360m acquisition of a 50% stake in Bruntwood SciTech portfolio and Aviva Investors' £300m acquisition of a 50% stake in Enterprise City, Manchester.

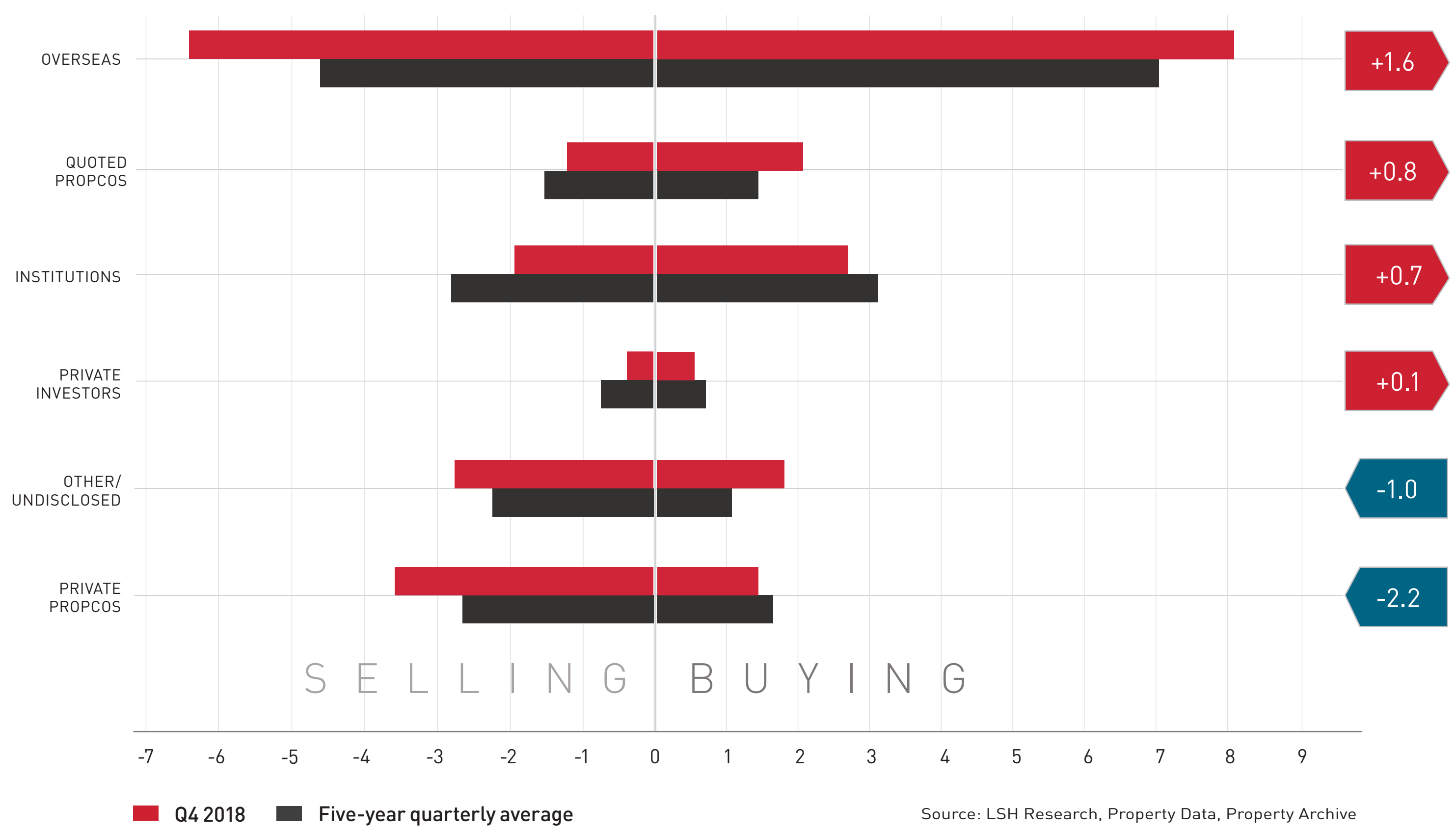
REITS REBOUND

At £2.0bn, quoted companies invested their second highest quarterly volume in a decade in Q4. This was underpinned by activity in the specialist sectors, and included Grainger Plc's £396m acquisition of the GRIP PRS Portfolio. They were also notably active in the industrial sector, including Tritax Big Box REIT's £147m (5.25% NIY) purchase of Integra 61, Durham from Citrus Group.

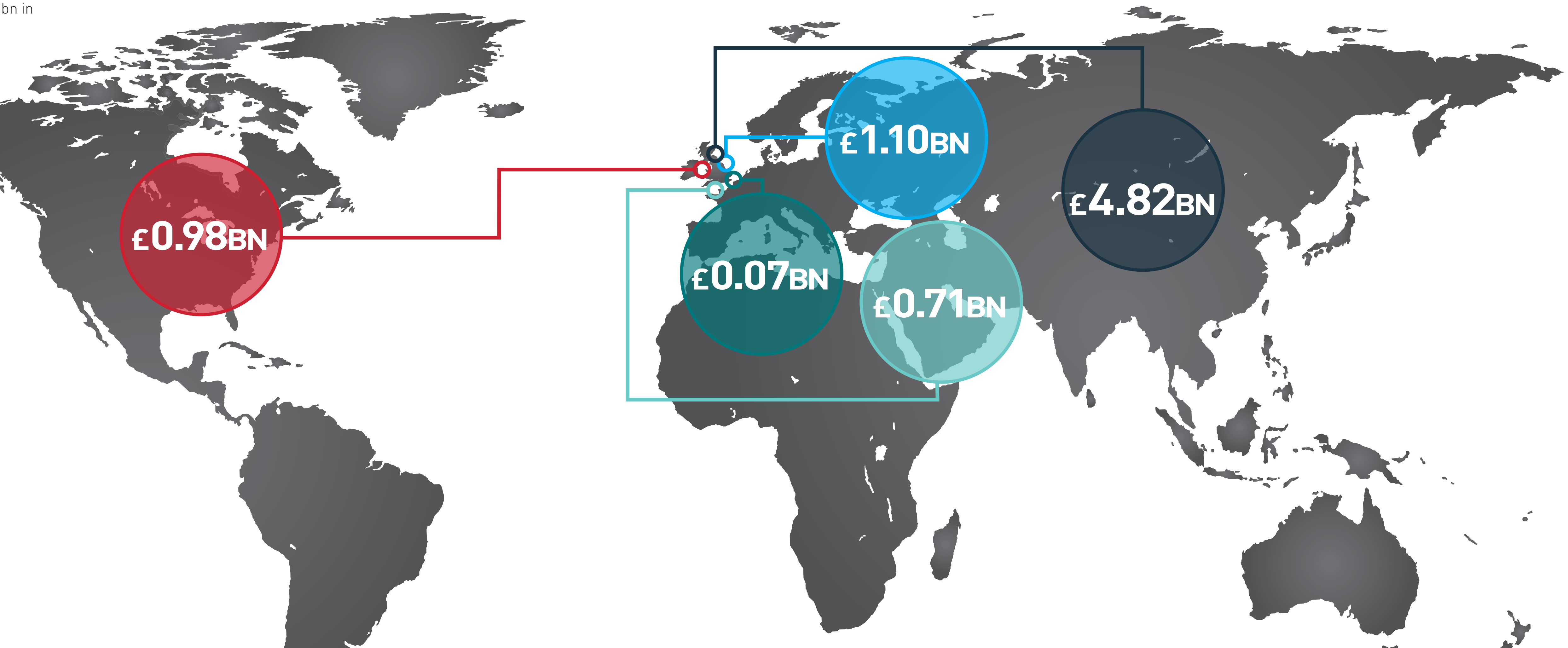
RECORD LOCAL AUTHORITY INVESTMENT

Eclipsing last year's record, local authorities invested a new high of £2.2bn into UK commercial property in 2018. Local authority acquisitions amounted to £749m in Q4 alone, the largest deal comprising the City of London Corporation's £125m purchase of the Barking Power Station site, which is being considered for the relocation of the London wholesale markets.

Q4 2018 VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive



Q4 2018: GLOBAL INVESTMENT FLOWS INTO UK CRE (£BN)

ORIGIN	£BN	NET £BN
NORTH AMERICA	0.98	-0.98
FAR EAST	4.82	2.62
MIDDLE EAST	0.71	0.24
GERMANY	0.07	-0.24
EUROPE	1.10	0.09
OTHER	0.47	-0.14

Source: LSH Research, Property Data, Property Archive

OUTLOOK FOR 2019

HANGING IN THE BALANCE

UK ECONOMY

As the UK's legislated exit date from the EU approaches ever nearer, avoiding a no deal outcome is central to the UK's economic fortunes in 2019.

TICK TOCK, TICK TOCK ....

Increasing Brexit uncertainty appears to be weighing on the economy. Following healthy expansion of 0.6% in Q3 2018, Capital Economics expects that UK GDP slowed to around 0.3% in the final quarter. This would take growth for 2018 as a whole to circa 1.3%, the lowest since the global financial crisis in 2008.

With the clock ticking towards the EU exit date in March and still little sign of political resolution following the heavy defeat of Theresa May's Brexit deal in Parliament, it stands to reason that growth could be weaker still in Q1 2019. That said, while the UK's economic prospects in 2019 hinge on Brexit, a rebound is perfectly conceivable, assuming a 'no deal' exit is avoided.

RESILIENCE IN BUSINESS SERVICES

The recent slowdown has been largely accounted for by falling output in the UK's productive industries. Rolling 3-month output in the production sector fell from 0.1% in October to -0.8% in November, with a slowdown in the UK car industry on the back of falling exports being partly responsible.

The UK service sector is more resilient, in particular business services, where latest figures show growth accelerated to 1.7% over the same three-monthly period. UK firms are also more profitable; net profitability of UK businesses is higher than the pre-financial crisis years of 2006-2007, returning 12.6% on capital in Q3 2018.

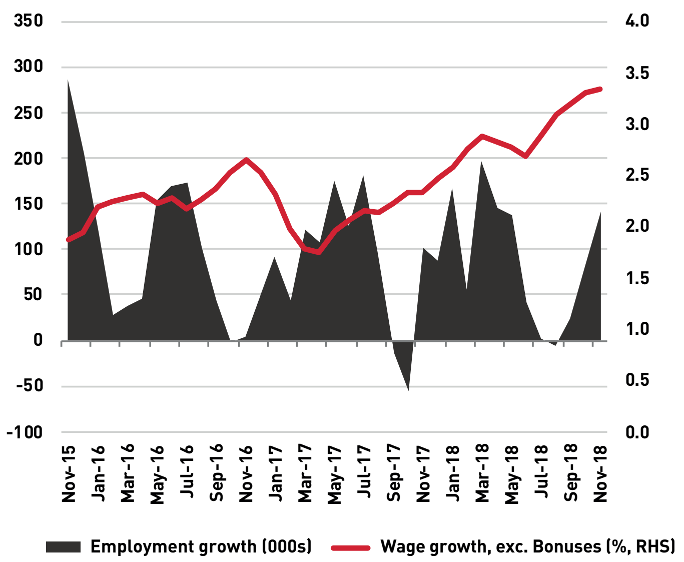
The fall in industrial output is a telling reminder that the impact of Brexit partly depends on conditions in the global economy. While the IMF forecasts UK GDP growth to run marginally ahead of France and Germany in 2019, global growth expectations have also been tempered, in particular China, where growth has slowed to its lowest in a decade

HOPE FOR CONSUMERS

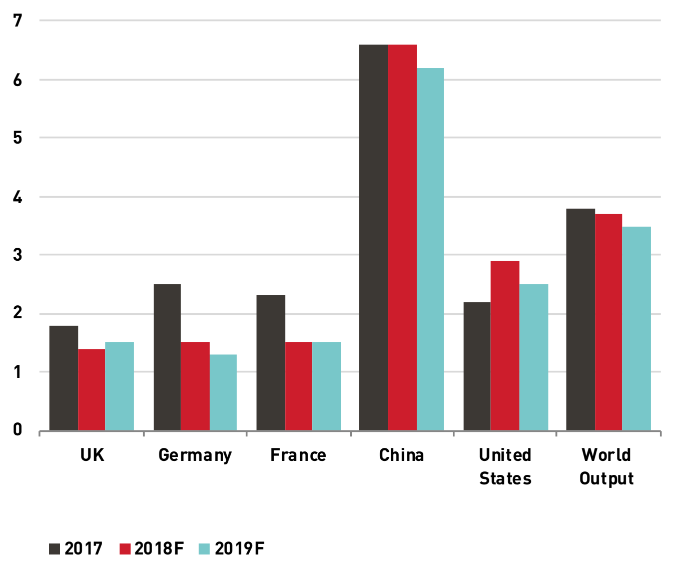
Well documented troubles on the high street have been exacerbated by increasing caution among consumers. Following a strong Black Friday-fuelled November, Christmas trading was more disappointing than many had feared. According to the BRC, last December was the worst in a decade for UK retail sales, with like-for-like sales falling by 0.7% year-on-year.

Yet, if not for the Brexit anxiety, UK consumers are in a stronger position than this time last year. Alongside an unwaveringly strong employment market, wage growth is rising at a decade high rate of 3.3%, which, combined with slowing inflation, ought to bode well for consumer spending over the coming year.

UK EMPLOYMENT AND WAGE GROWTH

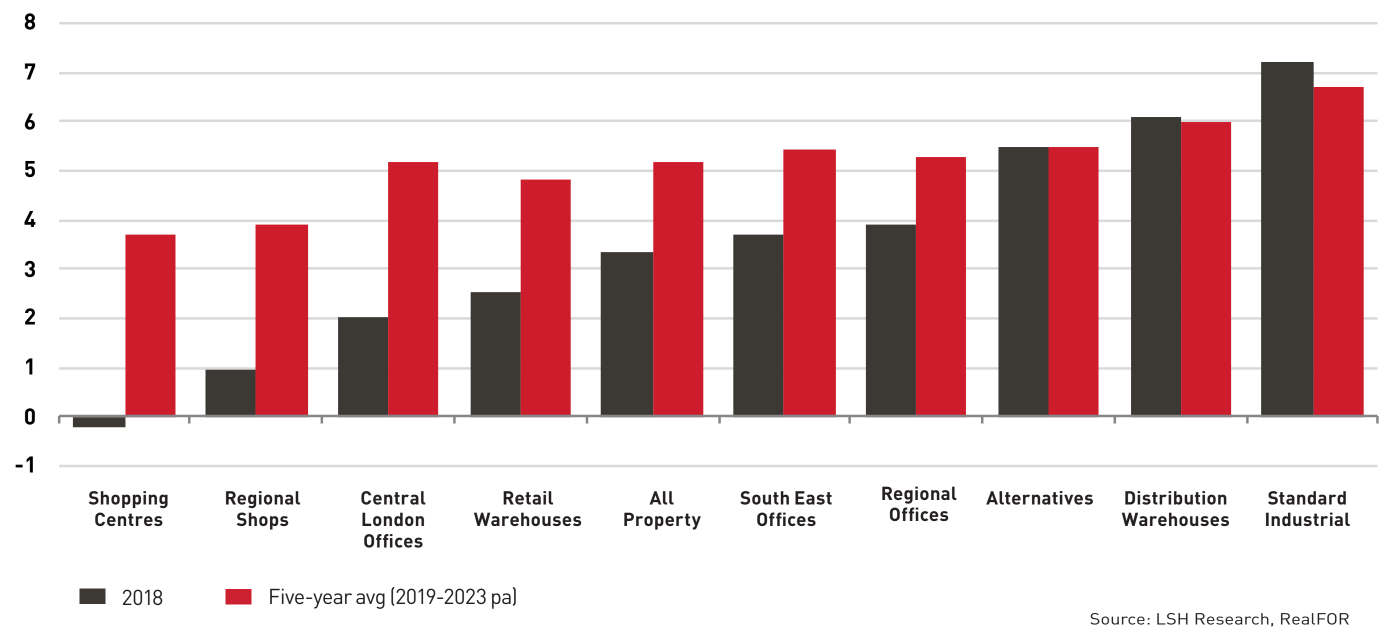


INTERNATIONAL GDP GROWTH RATES (%)



Source: ONS, Experian

TOTAL RETURN FORECAST (%PA)



Source: LSH Research, RealFOR

PROPERTY MARKET

While investors face increasing headwinds in 2019, the key underlying fundamentals of UK property investment remain in good shape, even if returns are easing down.

THE GREAT WALL OF MONEY

Brexit or otherwise, UK CRE is set to be a major draw to overseas capital in 2019. Of the various investment asset classes, allocations to real estate are on the increase, with dozens of global funds looking to increase their exposure to property. Alongside China and Malaysia, other parts of the Far East expected to make waves in the UK in 2019 include Japan and South Korea.

True, prime yields may be at or near historic lows, but, in a global context, the UK continues to offer relative value and security compared with other locations, whilst also providing investors with the liquidity and transparency long-associated with investing in the UK, and particularly London.

GROWING RIFT BETWEEN PRIME AND SECONDARY

Ongoing demand for secure and/or long income streams and a limited supply of stock should preserve pricing levels for prime product over the coming year. Alternative assets will continue to gain from this focus, with real momentum expected in the 'living' sectors including student accommodation, hotels, healthcare and PRS.

In contrast, while the business space occupier markets have performed particularly well in 2018, Brexit concerns and medium term expectations of an upward creep in interest rates are generally expected to drive marginal falls in pricing for secondary product. However, the tight supply at this point in the cycle will create opportunities for investors to drive value through asset repositioning and change of use angles.

ALL ABOUT THE INCOME

All Property returns for 2018 are set to be closely in line with our initial forecast 12 months ago, at circa 6.5%. Based on a no deal Brexit being avoided, our forecast for 2019 sees All Property returns moderate to circa 3.5%, characterised by a slight downward readjustment in secondary values alongside limited scope for yield compression at this stage in the cycle.

Much has been made of the possible impact of a disorderly Brexit on the market, not least Governor of the Bank of England Mark Carney's worst case scenario of a 48% fall in commercial property values. Given the market is relatively deleveraged, global appetite for property is strong and UK supply is tight, the likelihood of such a scenario appears remote.

POCKETS OF GROWTH

2018 was remarkable for the scale of divergence between industrial and retail returns, at circa 18% and 0% respectively. Ongoing structural change in shopping patterns will see this trend continue into 2019 and beyond, although to a more limited extent given the high value already associated with industrial assets on the one hand, and the degree of correction already observed in retail on the other.

Industrial's ongoing outperformance is underpinned by expectations of continuing, albeit moderating, rental growth. Meanwhile, even if occupier demand does soften in 2019, tight supply will continue to support a degree of rental growth in a number of UK office markets.

2019 PREDICTIONS

Strategies aimed at securing income and minimising occupier market risk look set to characterise the market in 2019. In typical UKIT tradition, here we set out our key predictions for 2019.

1

NICK LLOYD
HEAD OF CAPITAL MARKETS

2018 VOLUME TO HIT £50BN AFTER QUIET START

Ongoing weight of money from both overseas and domestic investors should ensure another good year is in store. We predict UK volume to break the £50bn mark for 2019, some way down on 2018 but still ahead of trend. Uncertainty in Q1 will create a window of opportunity for some buyers although volume will be back-loaded in the second half of the year, once greater clarity over the timing and manner of Brexit is provided.

2

MARTIN MCCLOY
DIRECTOR – CAPITAL MARKETS

INVESTORS TO EXPLOIT VALUE IN RETAIL

In recent years, the challenges felt on the high street have been reflected in weaker investment appetite for retail assets. However, there is a growing sense that well-let retail units in proven locations now offer relative value, particularly against industrial assets, where yields are typically 100 basis points keener. As for secondary assets, in many cases an opportunity exists to capitalise on asset repositioning to enhance value.

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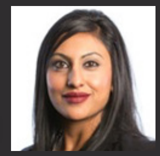

AASIA MOHAMMED
DIRECTOR – OFFICE AGENCY

TIGHT SUPPLY DRIVES INTEREST IN REGIONAL OFFICES

Regional offices, particularly the UK's core markets, represent something of a happy medium between the expense of industrial and the risks around retail. The regional occupier markets are arguably less exposed to Brexit risks, while tight supply and ongoing rental growth will continue to support value-add propositions. Manchester is already well-understood in this respect, but we expect the Scottish markets of Edinburgh and Glasgow to offer real opportunity in 2019.

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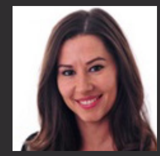

IZZY WATTERSON
SENIOR ANALYST

ALTERNATIVES VOLUME TO RIVAL OFFICES

Volume and pricing for assets offering secure, index-linked income will hold up very well over the coming year. Motivated by a desire to diversify portfolios and avert short-term risks, the alternative sectors – which are typically long-leased - are collectively expected to rival the office sector as a major share of volume for the first time in 2019.

5

IAN SCOTT
DIRECTOR – CAPITAL MARKETS

EVOLUTION OF BUILD TO RENT

Build to rent schemes delivered over the last two years will soon be trading maturely, and this will assist hugely in the market's understanding of pricing, performance and development specification. The next phase of build to rent's evolution will include more conventional forms of housing and, in view of the weakening housing market in 2019, we anticipate a growing number of suburban housing developments to be made available to institutional buyers.

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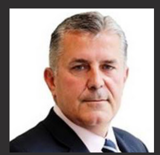

DAVID CREAMORE
DIRECTOR – CAPITAL MARKETS

GROWING DEMAND FOR MANAGED HOTELS

While the increase in new rooms raises supply concerns in certain locations, hotel investments will be keenly sought after in 2019. The sector offers upside risks to sterling depreciation, in London with regard to overseas visitors and in the regions through increased staycations. We envisage growing demand for managed hotels, a model which channels income to the investor with an appointed team managing the operation in conjunction with a franchise brand to maximise returns.

7

SIMON EDDY
DIRECTOR – CAPITAL MARKETS

INCOME STRIPS TO DRIVE REGENERATION

Local authorities will increasingly make use of income strips as a means of driving regeneration on land they own while providing annuity inflation-linked income for investors. These arrangements are key to generating development finance for new projects deemed unviable in the private sector, while the uncertain property value at the end of the lease is removed (typically 30 to 50 years) for the investor, making it easier for actuaries to model as part of a liability hedging profile.

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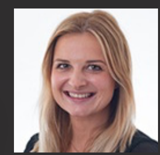

EMILY OSMOND
SURVEYOR – CAPITAL MARKETS

SCOPE FOR MORE SHED DEVELOPMENT

While Brexit casts a shadow over logistics, such strong appetite for industrial assets and a lack of ready-built stock will continue to drive development and forward funding deals in 2019. However, we do expect the rate of new starts to ease down from 2018 levels, while the steep growth in land values over the past few years means existing land owners hold all the aces.

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