UKIT

UK Investment Transactions Bulletin Q1 2016

Lambert Smith Hampton

www.lsh.co.uk

Uncertainty weighs on London

- **At £11.9bn, Q1 volume appeared robust** given the level of speculation and uncertainty around June's Referendum on the UK's membership of the EU. While investment was down 26% on the previous quarter it was closely in line with the five-year quarterly average.

- **However, 50% of Q1's volume was in January,** indicating that market sentiment changed during the quarter in preparation for the Referendum. This was most evident among institutions, where 70% of their activity took place in January.

- **Pricing held firm during Q1 despite increasing caution.** The average All Property transaction yield moved in by 13 basis points to 5.49% during Q1, while prime yields remained broadly steady.

- **Central London offices bore the brunt,** with Q1 volume of £2.2bn substantially down on Q4 2015's £4.6bn and the lowest since Q4 2011. Meanwhile, UK industrial volume increased quarter-on-quarter and stood 24% above the quarterly average.

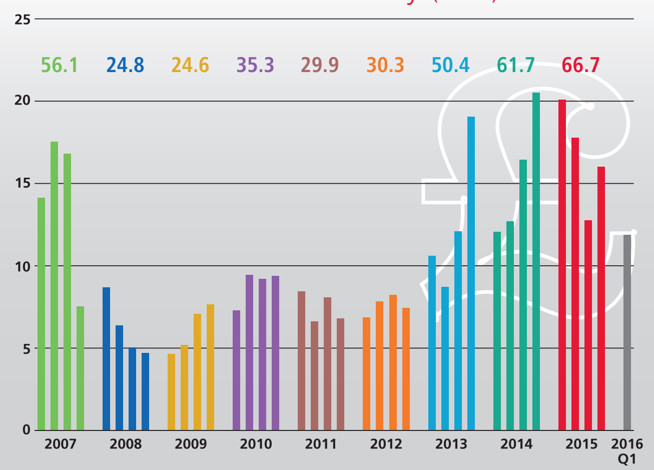
- **Overseas buyers largely accounted for the fall,** with volume halving quarter-on-quarter to £4.7bn, its lowest since Q3 2013. In contrast, activity from private and quoted property companies rose quarter-on-quarter and was ahead of average.

- **Activity in the UK regions held up well,** with volume outside London reaching £4.5bn in Q1, up 16% on the five-year average. While overseas investment fell sharply in London, it was 65% above the quarterly average across the rest of the UK.

Q1 Investment volumes (£bn)

Sectors	Q1 16	vs Q4 15	vs Q1 15
Shops	£0.98	-7%	-43%
Shopping Centres	£0.94	48%	-8%
Retail Warehouses	£0.50	-41%	-23%
All Retail	**£2.42**	-5%	-29%
Central London Offices	£2.23	-52%	-49%
Rest of South East Offices	£0.82	-41%	60%
Rest of UK Offices	£1.37	26%	15%
Office Parks	£0.11	-77%	-80%
All Office	**£4.53**	-40%	-31%
South East Industrial	£0.18	-41%	-5%
Rest of UK Industrial	£0.62	-29%	19%
Distribution Warehouses	£0.60	9%	-29%
All Industrial	**£1.41**	5%	-10%
Hotels & Leisure	£1.08	-50%	-59%
Specialist	£1.17	144%	-70%
Mixed-use (single assets & portfolios)	£1.27	-34%	-36%
All Property	**£11.88**	-26%	-41%

UK Investment market activity (£bn)



Source: LSH Research, Property Archive, Property Data

Sector focus

Considering the amount of speculation around the impact of June's Referendum, Q1's volume of £11.9bn could be interpreted as respectable, and reflecting a natural easing in activity from the 'bull-run' of 2014 and 2015.

That said, as Q1 unfolded, hiatus became increasingly apparent in the market. January's volume was in fact a record for that particular month, with activity tapering off significantly in the following two months, while anecdotal evidence also linked the slowdown directly to the approaching vote.

Central London offices bore the brunt

Offices saw a significant fall in activity, with Q1 volume of £4.5bn down 40% on Q4 2015. This was due entirely to a very quiet quarter for Central London Offices, where volume halved quarter-on-quarter to £2.2bn, its lowest quarterly total since Q4 2011. Given that financial services is widely regarded as the most exposed sector to a possible 'Brexit', this sector appears to have suffered most from investor caution.

In marked contrast, investment in Rest of UK Offices has remained buoyant, with Q1 volume of £1.4bn the highest quarterly total since Q2 2007. Manchester was home to the largest office deal outside the South East, namely Ares Management LLC's £115m acquisition of 3 & 4 Piccadilly Place from Carlyle Group (6.05% NIY).

Industrial fares best

Industrial was the one core sector where volume was up on the previous quarter. Q1 volume reached £1.4bn, up 5% quarter-on-quarter and 24% above the five-year average. However, a significant proportion of this was accounted for by two portfolio deals; Malaysian Employees PF's £200m purchase of Phoenix portfolio from IM Properties and Legal & General's £176.5m portfolio switch sale of 47 trade parks from its income fund (UK PIF I) to its investment fund (IPIF).

Inflow into specialist sectors continues apace

In keeping with recent trends, investment in specialist assets also remained strong into 2016, surpassing £1bn in Q1 and accounting for over 10% of total volume. Student accommodation accounted for the vast majority of this, with volume of £0.8bn including Q1's largest deal, namely Mapletree Investments' £417m purchase of Project Ardent from Mansion House Student Fund.

Pricing holds firm despite increased caution

Despite signs of increased caution among certain investors, the average transaction yield moved in by a further 13bps during Q1 to stand at 5.49%, its lowest level since Q4 2007. Meanwhile, evidence suggests prime yields were broadly steady during Q1, standing at or near to historic lows for the majority of sectors.

Of the main sectors, retail saw the strongest downward shift in the average transaction yield, moving down 44bps during Q1. Meanwhile, reflecting a limited number of major deals in Central London, the average office transaction yield moved up by 19 bps in Q1 to 4.79%.

Yields

	Transaction yields			Prime yields		
Sector	Q1 2016	3 month movement bps	12 month movement bps	Q1 2016	3 month movement bps	12 month movement bps
Shops	4.45%	-34	-43	4.00%	◀▶	-50
Shopping Centres	6.00%	-87	-70	5.25%*	◀▶	◀▶
Retail Warehouses	6.08%	-12	-40	4.25%	◀▶	-25
All Retail	**5.62%**	-44	-50		–	–
Central London Offices	3.80%	13	-108	3.25%	◀▶	-25
Rest of South East Offices	6.28%	44	-115	5.00%	◀▶	◀▶
Rest of UK Offices	6.56%	47	4	4.75%	◀▶	-50
Office Parks	7.32%	-22	-91	5.75%	◀▶	-25
All Office	**4.79%**	19	-67		–	–
South East Industrial	5.96%	4	-5	5.00%	◀▶	-25
Rest of UK Industrial	6.95%	14	-167	6.00%	◀▶	◀▶
Distribution Warehouses	6.18%	-34	71	4.25%	◀▶	-50
All Industrial	**6.25%**	-2	-25		–	–
Hotels & Leisure	5.35%	12	-90	5.00%	◀▶	-25
Specialist	5.49%	-43	7	5.50%**	◀▶	◀▶
Mixed-use (single assets & portfolios)	7.33%	118	179	–	–	–
All Property	**5.49%**	-13	-43	–	–	–

Source: LSH Research, Property Data, Property Archive

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

Regional focus

Investment in the UK regions held up well in the first quarter, with Q1's fall in volume resulting from subdued investment in both London and UK portfolios.

Subdued investment in offices weighs on London

Investment in the capital was relatively subdued in Q1, with volume of £4.8bn down almost 30% on the previous quarter and 15% below the five-year quarterly average. This primarily reflected the poor quarter for Central London offices, with robust activity being maintained for other assets, most notably mixed-use.

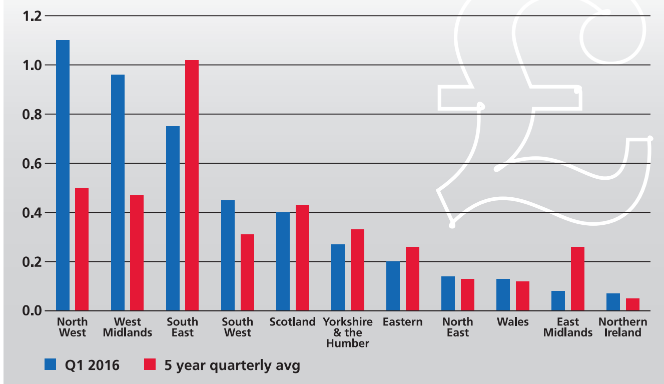
Q1's largest deal in the capital was AustralianSuper's £371m acquisition of a 36.5% stake in King Cross Central, from London & Continental. Elsewhere, Saudi Investor Rassmal Group paid circa £100m for a site at Vauxhall Cross, Nine Elms, where plans are in place to develop two mixed-use towers.

No let-up in regional activity

In contrast with London, investment in the rest of the UK remained buoyant in the first quarter. Across the UK regions combined, Q1's volume of £4.5bn was closely in line with Q4 2015's total and 16% above the five-year quarterly average.

The North West had a stand-out first quarter. £1.1bn of assets changed hands, twice the five-year quarterly average and surpassing South East volume for only the second quarter on record. The region's headline deal in Q1 was ADIA's £300m purchase of an additional 35% stake in Liverpool One shopping centre, taking its stake to 65%.

Quarterly regional investment volumes (£bn)



Source: LSH Research, Property Data, Property Archive

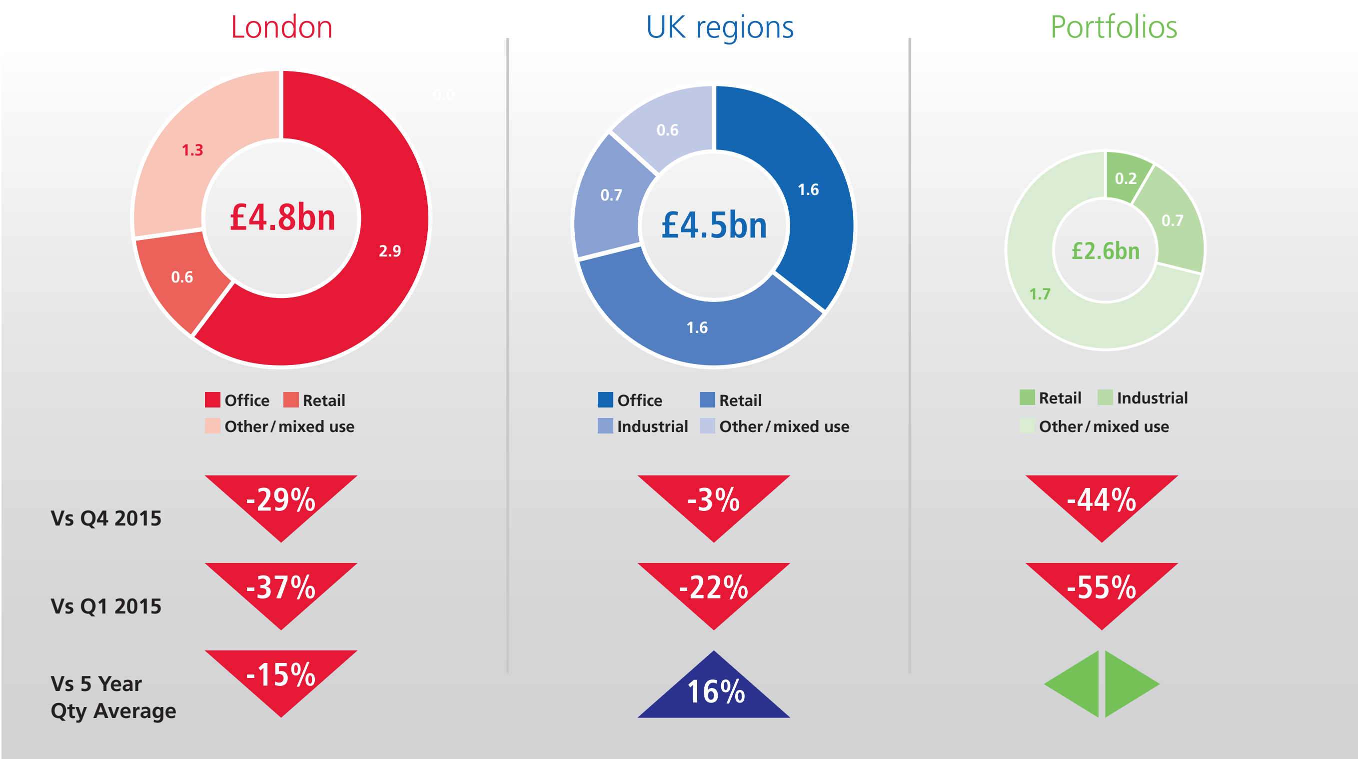
With volume of £1.0bn in Q1, the West Midlands also made an impressive start to 2016. However, half of this was accounted for by Hammerson's £335m purchase of Grand Central from Birmingham City Council, and its subsequent sale of a 50% stake in the scheme to Canadian Pension Plan Investment Board.

A steady Q1 for portfolio buys

Following a very strong run of activity over the past two years, Q1's portfolio volume of £2.6bn was comparatively modest, but nevertheless exactly in line with the five-year quarterly average. It was notable that North American investors made no portfolio acquisitions in Q1, having been key to that strong run.

The two largest portfolio transactions in the quarter comprised Q1's largest deal, Mapletree's £417m purchase of Project Ardent, and M&G's £350m purchase of 44 David Lloyd Leisure health & racquet clubs.

Q1 2016 London and regional breakdown (£bn)



Source: LSH Research, Property Archive, Property Data

Buyers and sellers

In addition to the fall in volume, the underlying share of activity between the main types of buyers in Q1 differed from 2015's pattern. Overseas investment was down significantly quarter-on-quarter, while private and listed property companies were more active than usual.

UK institutions move to the sidelines

Despite being marginal net investors into property in Q1, institutional volume of £2.8bn was the lowest quarterly level for almost three years. Tellingly, 70% of this activity came in January, suggesting that the announcement of the Referendum marked a change in appetite during the quarter.

Alongside anecdotal evidence, this demonstrates how many institutional investors have opted to sit on their hands and await the outcome of the vote, none more so than the retail funds. Furthermore, a large proportion of Q1 institutional volume was attributed to hotels & leisure and specialist sectors, with the share of activity taken by retail and offices limited compared to trend.

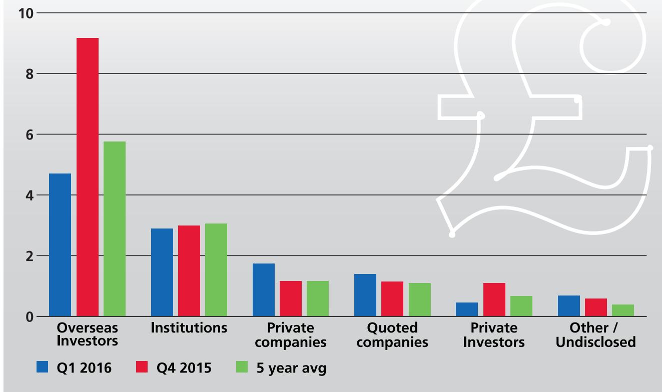
Overseas investment halves

While overseas investors retained their status as the dominant buyer of UK commercial property, Q1's volume of £4.7bn was half that of the previous quarter and the lowest since Q3 2013. The drop was largely applicable to portfolios and Central London offices, where overseas activity was 48% and 70% below the respective five-year quarterly average.

In sharp contrast, overseas investment in regional assets remained buoyant, reaching £1.6bn in Q1 and standing 65% above the quarterly average. Overseas investors dominated at the larger end of the market, accounting for eight of Q1's 10 largest regional deals.

It was also the first time that overseas investment in the UK regions surpassed institutional investment for a second quarter in succession.

Investment by buyer type (£bn)



Source: LSH Research, Property Archive, Property Data

Evidence suggests that overseas investors are competing increasingly aggressively for prime regional assets, attracted to the relatively higher yields on offer compared with London.

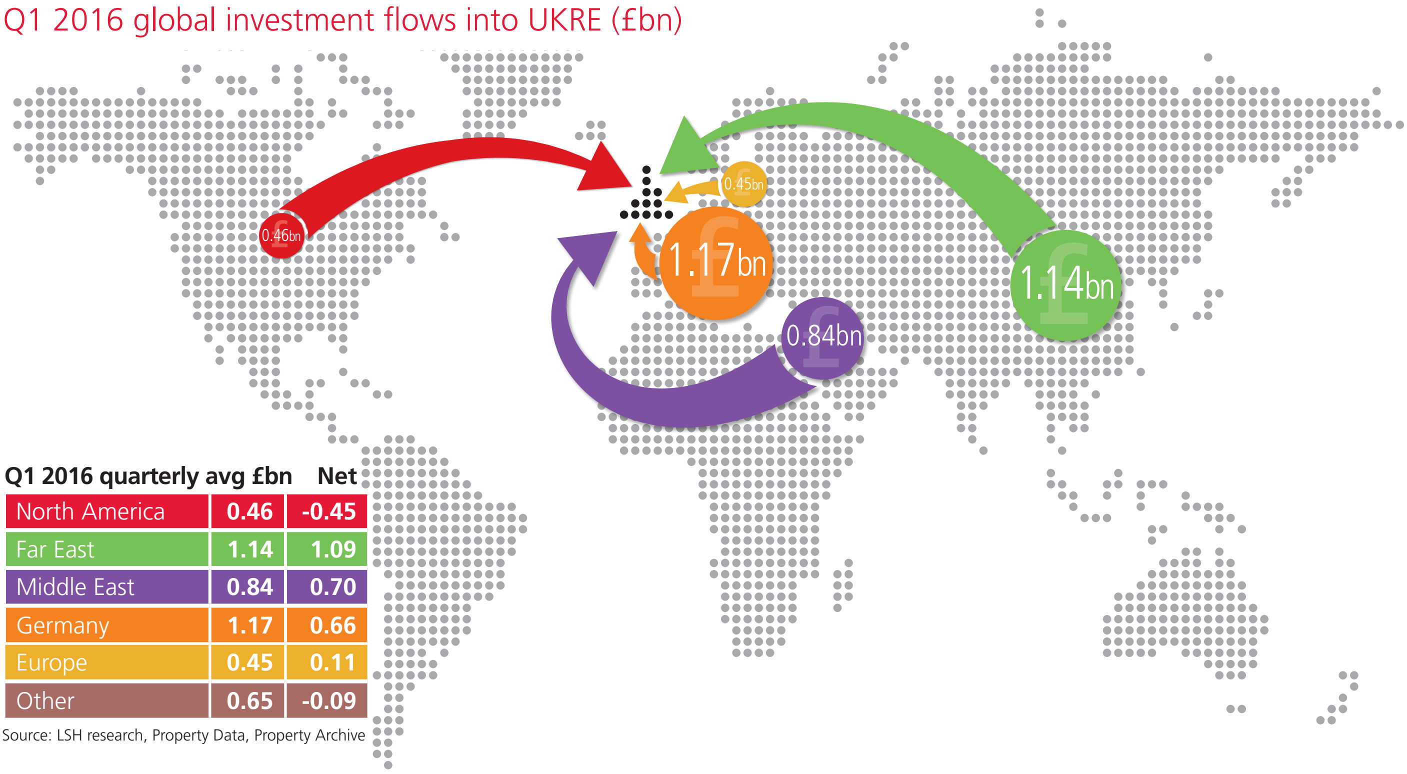
Having been dominant during 2015, North American buyers were relatively inactive in Q1, investing only £0.5bn. Meanwhile, German buyers invested £1.2bn, their highest quarterly volume since Q3 2013. They predominantly focused on regional offices, accounting for 61% of their volume.

Private and listed companies remain active

While an element of the market appears to be awaiting the outcome of the Referendum, many investors are still active. Investment from private companies reached £1.7bn in Q1, the strongest volume in six quarters. This included one of Q1's largest deals in London, Resolution Property's £300m purchase of Thomas More Square from Land Securities (5.5% NIY).

Meanwhile, quoted property companies were also more active than usual in Q1, with volume of £1.4bn standing 26% above the five-year quarterly average. Great Portland Estates' £119m acquisition of 50 Finsbury Square from DEKA was the largest deal in the capital from a FTSE 250 listed buyer in Q1.

Q1 2016 global investment flows into UKRE (£bn)



Q1 2016 quarterly avg £bn		Net
North America	0.46	-0.45
Far East	1.14	1.09
Middle East	0.84	0.70
Germany	1.17	0.66
Europe	0.45	0.11
Other	0.65	-0.09

Source: LSH research, Property Data, Property Archive

Outlook

Following record January volume, the announcement of the Referendum date coincided with a step change in appetite among a number of investors. While the market is set to remain subdued throughout Q2, the outcome of June's Referendum will be pivotal to expectations for the second half of 2016.

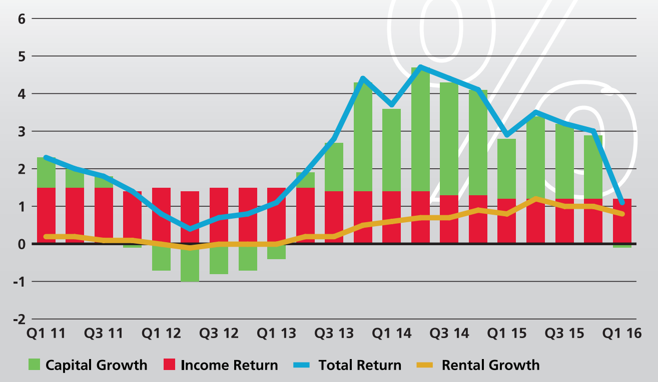
Q1's fall in volume was not all about the Referendum

Considering all the media speculation around the possible impacts of a 'Brexit', Q1 volume was arguably relatively robust. The 'bull-run' of 2014 and 2015 was not expected to be sustained indefinitely and, ultimately, volume was on a par with the average.

Furthermore, Q1's fall in volume was largely down to a sharp dip in overseas investment, a trend which affected volumes in continental Europe and North America in similar measure. Thus, while a possible 'Brexit' is one consideration, other factors have also influenced demand, such as China's economic slowdown, falling commodity prices and financial market volatility.

However, the Referendum's impact on sentiment cannot be dismissed entirely. Both the IMF and Monetary Policy Committee recently warned that delayed decision-making among businesses is already impacting on economic activity. For commercial property, this appears to have weighed most on institutional investors.

All Property quarterly performance (%)



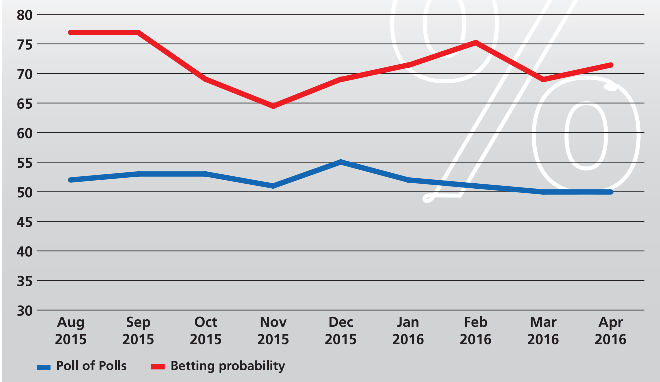
Source: MSCI (IPD Quarterly Index)

A vote to 'Bremain' will put the market back on track

We expect Q2 to remain relatively subdued as the lead-up to the vote deters sellers from placing stock into the market. However, if the UK electorate votes to remain within the EU, we expect a rebound in activity in the second half of the year, as pent-up demand is released and liquidity is restored, particularly among the institutions.

Similarly, any adverse impact on values in the lead-up to the vote should be reversed in the aftermath, putting All Property back on course to deliver returns of circa 8% during 2016.

Remaining within the EU: Polls vs Bookmaker odds (%)



Source: Oddschecker, What the UK Thinks.

According to MSCI, capital growth was negative for the first quarter in three years in Q1. However, this largely reflected the Government's recent changes to commercial stamp duty, with yields holding steady.

Indeed, while pricing is at or close to the historic peak for many property sectors, the underlying fundamentals in the market remain supportive. Rental growth is a familiar story across the UK, concerns on oversupply are largely confined to City offices, while UK property continues to display an attractive risk-adjusted return relative to competing assets.

And if we do vote to leave?

The latest Referendum 'Poll of Polls' suggests the UK electorate is completely polarised, split 50:50 at the time of writing. However, as 2015's UK election showed, polls can prove an unreliable indicator of the outcome. An alternative - and historically more reliable indicator - is to look at bookmakers' odds. These lean heavily towards an in-vote, with latest odds translating to a 70% probability of remaining with the EU.

Yet, regardless of the current odds, an unforeseen event in the run-up to the vote is quite capable of switching public opinion. If there is a vote to leave, current uncertainty in the market will be extended while the terms of the UK's new relationship with Europe is set out. In the short term, the upheaval will stifle activity and may well impact on pricing. That said, a probable weakening of sterling may tempt a number opportunistic overseas investors into the market.

In the long term, investment performance will reflect how the economy and its occupier-base fare in a world outside the EU. With a range of potential 'Brexit' scenarios, gauging whether the UK will be better or worse-off outside the EU is a matter of conjecture. Ultimately, whichever scenario plays out, the fundamentals of the UK property market, such as its size, legal framework and transparency, will remain in place regardless of whether the UK finds itself inside or out of the EU.

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.

For further information please contact:

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

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

Paddy Brennan
Head of Capital Markets
+44 (0)28 9026 9206
pbrennan@lsh.co.uk

Abid Jaffry
Director – Manchester
+44 (0)161 242 7099
ajaffry@lsh.co.uk

Ewen White
Director – Glasgow
+44 (0)141 226 6777
ewhite@lsh.co.uk

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

www.lshinvestmentsales.co.uk

Our national office network

Belfast
Tel: +44 (0)28 9032 7954

Birmingham
Tel: +44 (0)121 236 2066

Bristol
Tel: +44 (0)117 926 6666

Cambridge
Tel: +44 (0)1223 276336

Cardiff
Tel: +44 (0)29 2049 0499

Chelmsford
Tel: +44 (0)1245 215521

Dublin
Tel: +353 (0)1 673 1400

Edinburgh
Tel: +44 (0)131 226 0333

Exeter
Tel: +44 (0)1392 880 180

Fareham
Tel: +44 (0)1489 579579

Galway
Tel: +353 (0)91 865 333

Glasgow
Tel: +44 (0)141 226 6777

Guildford
Tel: +44 (0)1483 538181

Leeds
Tel: +44 (0)113 245 9393
Tel: +44 (0)113 245 8454

Leicester
Tel: +44 (0)116 255 2694

Lincoln
Tel: +44 (0)1522 698888

Liverpool
Tel: +44 (0)151 236 8454

London
Tel: +44 (0)20 7198 2000

Luton
Tel: +44 (0)1582 450444

Maidenhead
Tel: +44 (0)1628 676001

Manchester
Tel: +44 (0)161 228 6411
Tel: +44 (0)161 833 1197

Milton Keynes
Tel: +44 (0)1908 604630

Newcastle upon Tyne
Tel: +44 (0)191 232 6291

Northampton
Tel: +44 (0)1604 664366

Nottingham
Tel: +44 (0)115 950 1414

Oxford
Tel: +44 (0)1865 200244

Reading
Tel: +44 (0)118 959 8855

St Albans
Tel: +44 (0)1727 834234

Sheffield
Tel: +44 (0)114 275 3752

Solent
Tel: +44 (0)2380 461 630

Southampton
Tel: +44 (0)23 8033 0041

Southend-on-Sea
Tel: +44 (0)1702 417 951

Swansea
Tel: +44 (0)1792 702800

Details of Lambert Smith Hampton can be viewed on our website www.lsh.co.uk

Lambert Smith Hampton

www.lsh.co.uk