Lambert Smith Hampton

WTF!* Q

* WHAT A TREMENDOUS FINAL QUARTER

UKITQ417

UK INVESTMENT TRANSACTIONS BULLETIN

Q4 17 VOLUME HIGHEST SINCE Q2 2015

2017 VOLUME £58.8BN: UP 25% ON 2016, +38% ON AVG

INSTITUTIONS RETURN AS NET BUYERS IN Q4

SPECIALIST SECTORS MAKE UP 17% VOLUME

RECORD YEAR FOR EAST, SOUTH EAST, SOUTH WEST, WALES

NEW RECORD FOR INDUSTRIAL VOLUME

Ezra Nahome
CEO

Judging by the tremendous finish to 2017, the market is clearly taking all the political noise and uncertainty firmly in its stride. The emphatic return of domestic investors also confirms that there is far more to UK property investment than a mere currency play in London.

Before thinking about what lies in store, let's first toast the year that was 2017. If we cast our minds back to 12 months ago, anyone who had correctly predicted volume of around £60bn and double-digit returns would have been open to ridicule.

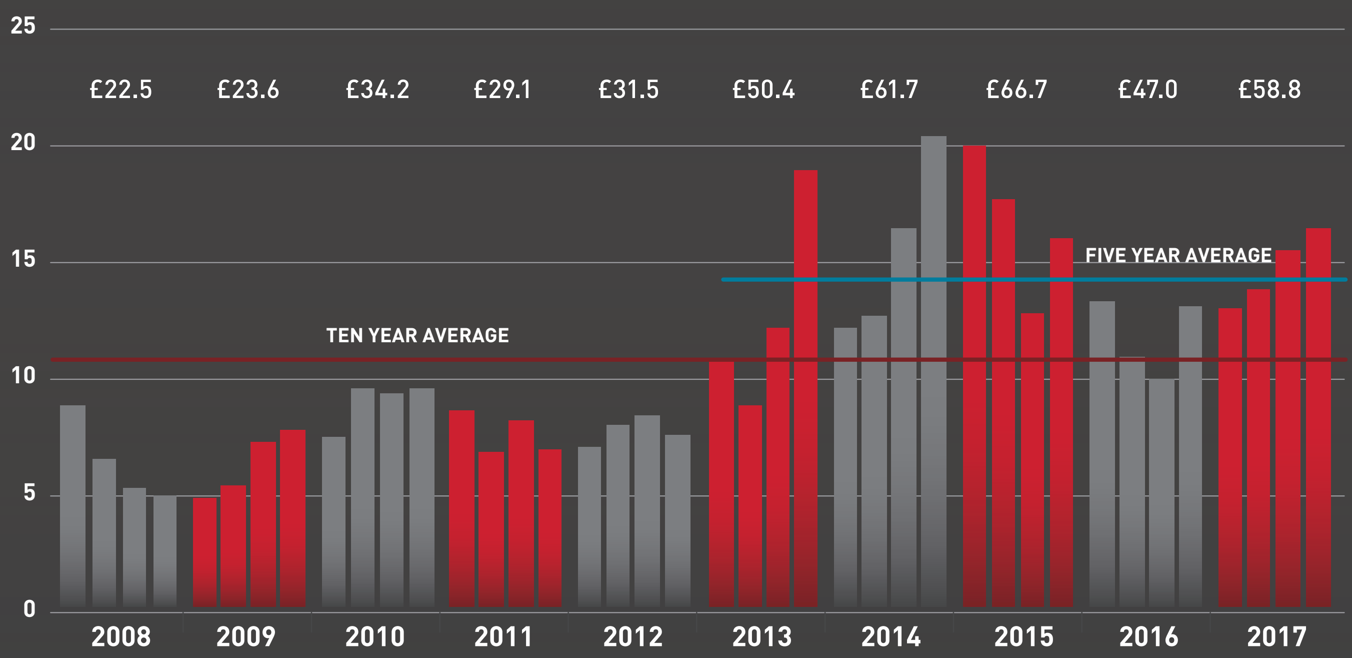
2017 was more than just a good year for some parts of the market. A number of UK regions saw record activity, while investment into industrial and the specialist sectors climbed to new highs, a clear reflection of investor focus on structural change and secure income.

So, if 2017 is anything to go by, my glass is definitely half full for the year ahead, even if uncertainty and risk abound. Alongside a decent showing for the UK economy in Q4 and signs that inflation is now subsiding, there is a growing sense that Brexit is moving towards a softer departure from the EU, all of which should alleviate some concerns around the occupier markets.

But, with interest rate rises on the cards, further compression in yields is hard to envisage, save for perhaps core, annuity product. For those looking for more of a return, we see the gulf in pricing between core and secondary as a clear opportunity for asset management plays.

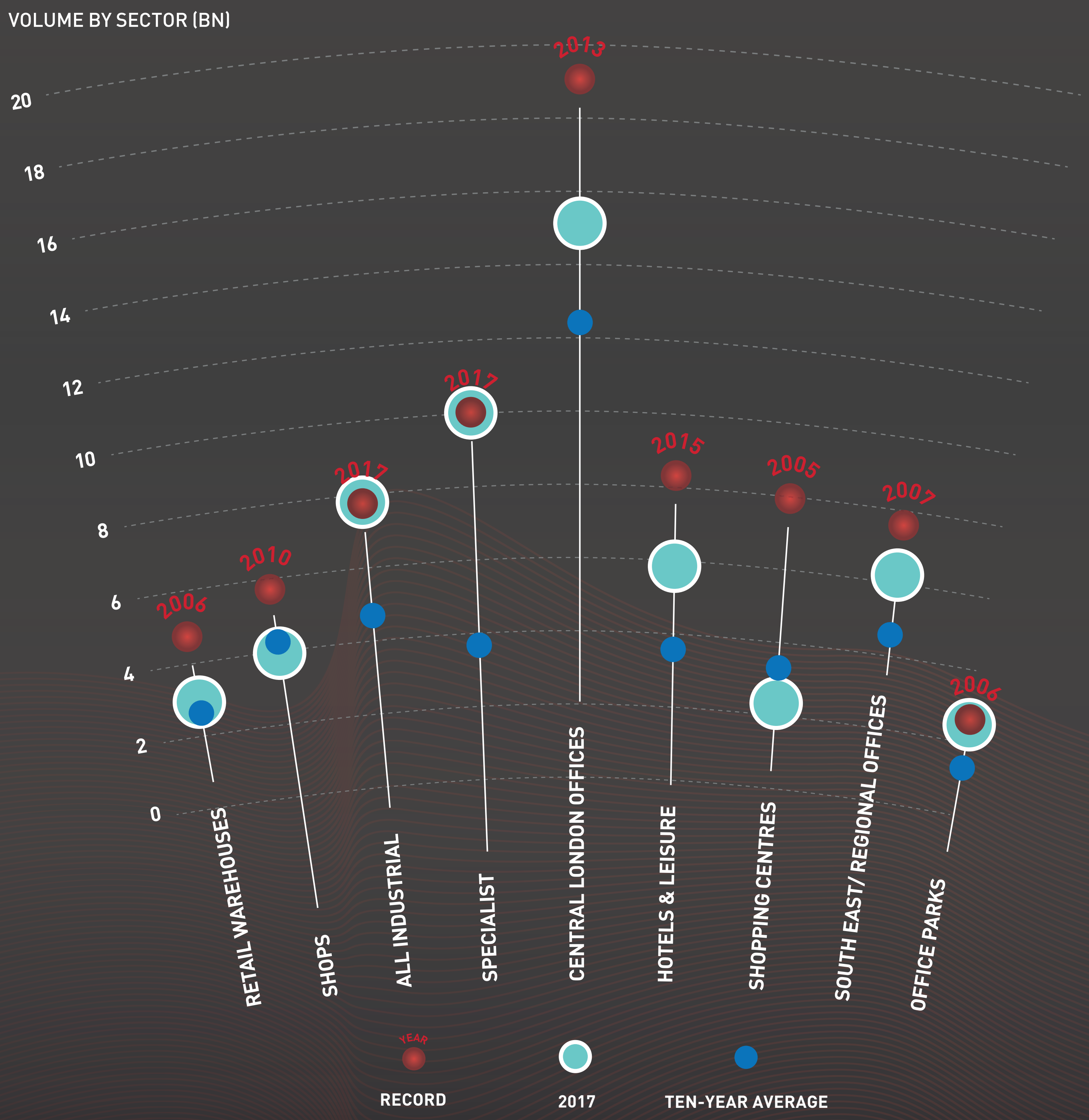
Meanwhile, the structural shift towards flexible, 'on-demand' occupier solutions potentially represents the start of a fundamental change in the traditional landlord and tenant relationship. Increasingly, those investors that can partner successfully with best in class operators will outperform the traditional model.

UK INVESTMENT VOLUME (£BN)

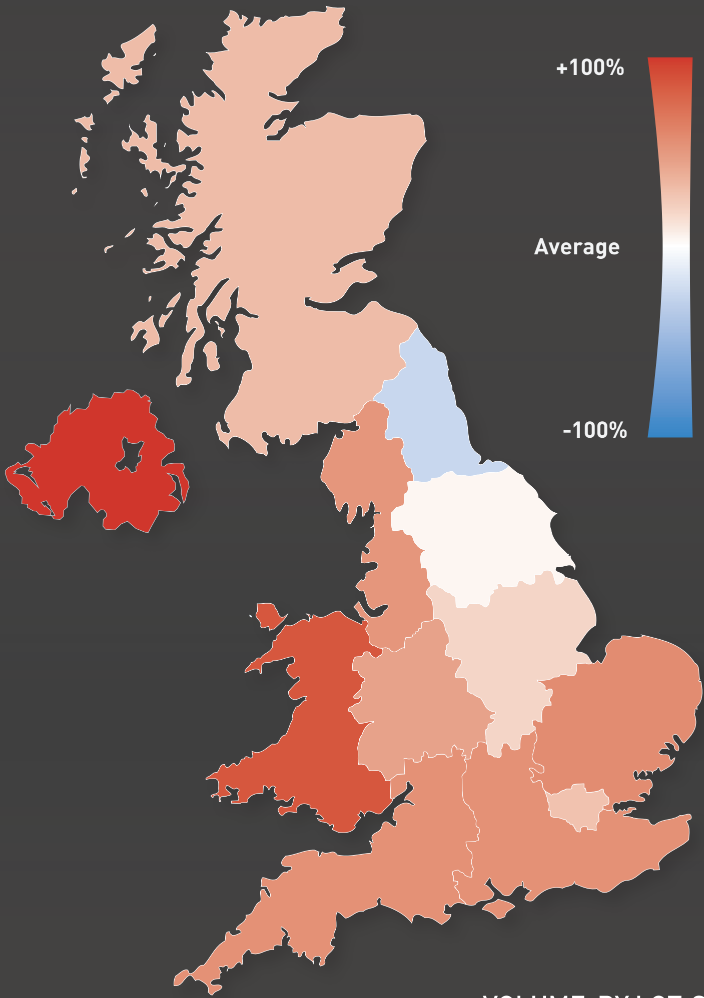


Source: LSH Research, Property Data, Property Archive

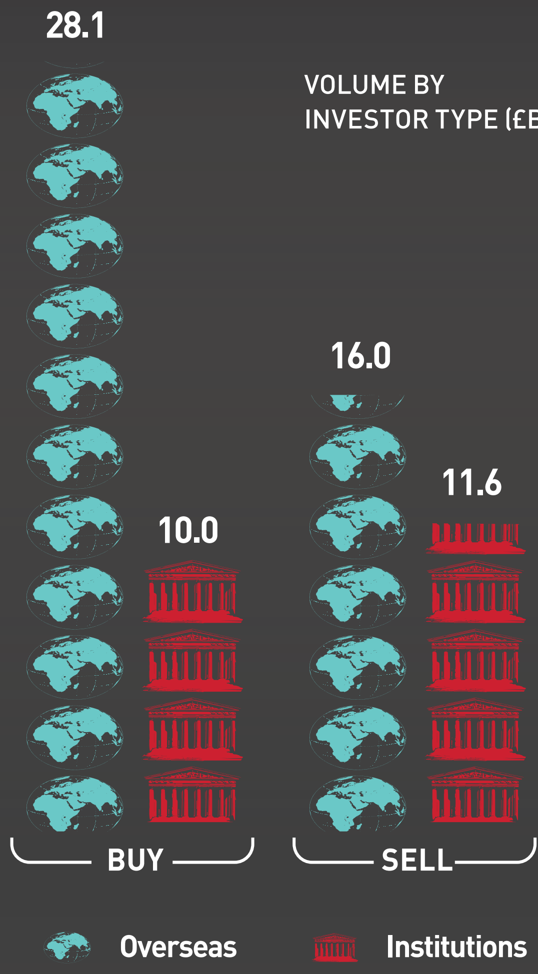
2017 HIGHLIGHTS



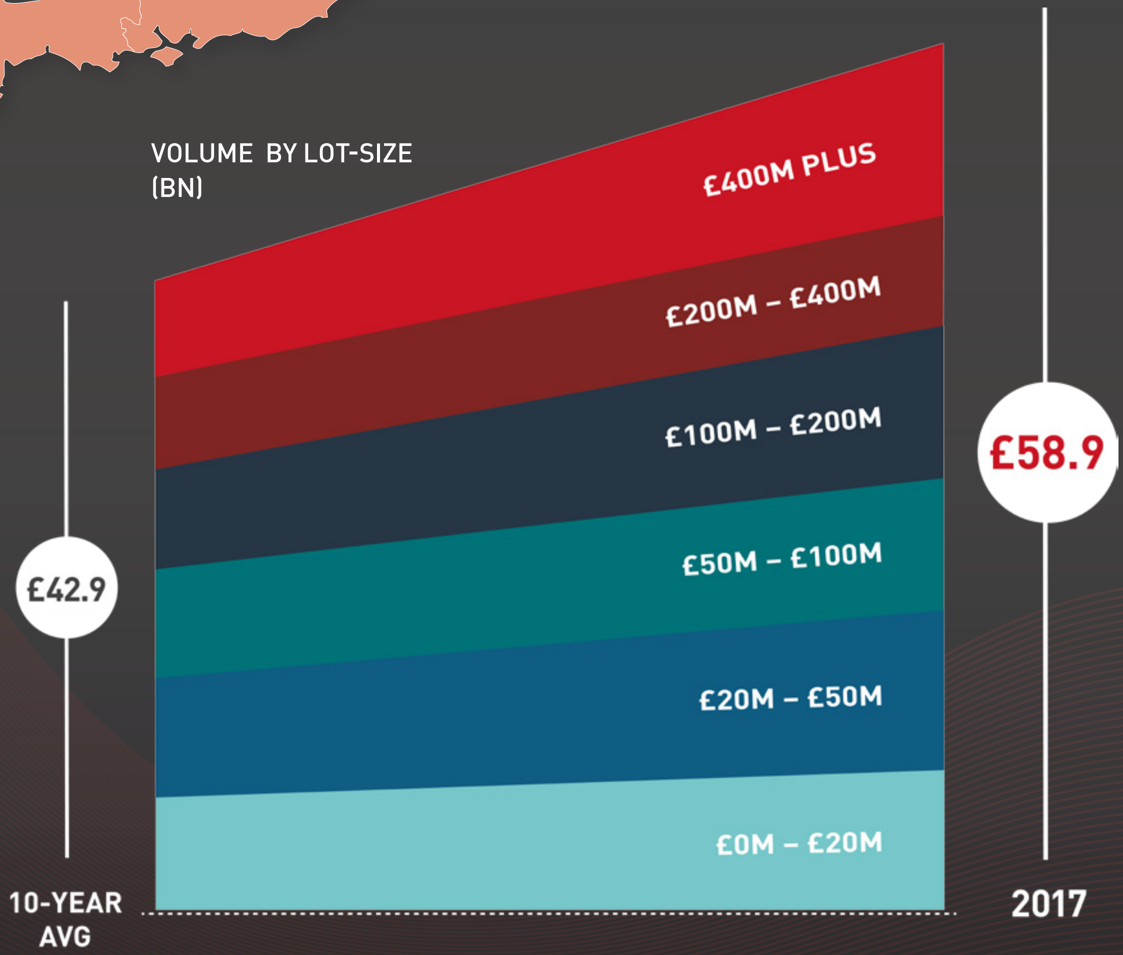
REGIONAL VOLUME
VS 10-YEAR AVERAGE



VOLUME BY
INVESTOR TYPE (£BN)



VOLUME BY LOT-SIZE
(BN)



SECTOR FOCUS

INDUSTRIAL STRENGTH

2017 ended with a flourish. Q4 volume of £16.5bn was the highest since Q2 2015 and pushed the annual total to £58.8bn, up 25% on 2016 and 38% above the ten-year annual average.

The final quarter also demonstrated real depth in the market, with the number of deals increasing by 39% on Q3 and standing 40% above the five-year quarterly average.

A RECORD YEAR FOR SPECIALIST SECTORS

Q4 saw £3.3bn of investment into the specialist sectors, taking the total for 2017 to a massive new annual high of £10.0bn. Collectively, the specialist sectors also accounted for a record 17% share of total volume, surpassing both retail and industrial for the first year ever.

The record year was underpinned by a series of major student accommodation deals, including volume of £1.9bn in Q4 alone. The sector also boasted Q4's largest deal; IQ Student Accommodation's £869m acquisition of the Regent Portfolio from LetterOne Treasury Services.

DITTO FOR INDUSTRIAL & LOGISTICS

The groundswell of demand for industrial continued into Q4, with volume of £2.0bn the strongest since Q4 2014. This took 2017's volume to a record £7.5bn, reflecting insatiable appetite across all subsectors and asset qualities.

Q4's largest industrial deal was a private buyer's £100m (NIY 6.75%) acquisition of Dominvs' portfolio of 16 industrial assets. Portfolio deals were key to 2017's new annual high, the largest being Blackstone's £559m purchase of 130 assets from Brockton Capital in Q3.

AVERSION TO TRADITIONAL RETAIL SECTORS

Investment in retail continues to reflect deep structural challenges. Q4 was another subdued quarter for shopping centres, with annual volume of £2.2bn the lowest since the depth of the recession in 2009. That said, increasing global consolidation was reflected by two major corporate deals in Q4; Unibail Redamco's and Hammerson's takeover of Westfield and Intu respectively.

Meanwhile, retail warehouses, a sector which lends itself well to the structural changes in shopping patterns, saw £889m of investment in Q4, its strongest quarter since Q3 2015. Q4's largest deal was EPIC-REIT's £144m acquisition of a portfolio of four retail parks from Stadium Group.

Q4 INVESTMENT VOLUME (£BN)

SECTOR	Q4 2017	Vs Q3 2017	Vs Q4 2016	Vs 5-year avg
Shops	£1.37	71%	35%	19%
Shopping Centres	£0.34	-26%	-70%	-63%
Retail Warehouse	£0.89	58%	23%	26%
ALL RETAIL	£2.60	42%	-10%	-7%
Central London Offices	£3.61	24%		-9%
Rest of South East Offices	£0.94	8%	44%	41%
Rest of UK Offices	£1.50	73%	209%	96%
Office Parks	£0.34	-82%	99%	-40%
ALL OFFICE	£6.39	-2%	29%	7%
South East Industrial	£0.42	-6%	40%	66%
Rest of UK Industrial	£0.53	-49%	59%	19%
Distribution Warehouse	£1.01	136%	-5%	27%
ALL INDUSTRIAL	£1.96	2%	16%	31%
Hotels & Leisure	£1.51	-15%	17%	15%
Specialist	£3.30	39%	173%	132%
Mixed-use (single assets & portfolios)	£0.72	-35%	-29%	-41%
ALL PROPERTY	£16.49	6%	27%	16%

Source: LSH Research, Property Data, Property Archive

Q4 2017 YIELDS

SECTOR	TRANSACTION YIELDS Q4 2017	TRANSACTION YIELDS 3 MONTH MOVEMENT (BPS)	TRANSACTION YIELDS 12 MONTH MOVEMENT (BPS)	PRIME YIELDS Q4 2017	PRIME YIELDS 3 MONTH MOVEMENT (BPS)	PRIME YIELDS 12 MONTH MOVEMENT (BPS)	YIELD SENTIMENT
Shops	4.52%	▼ -57	▼ -44	4.00%	◀▶	◀▶	▲
Shopping Centres	7.22%	▲ 90	▲ 142	6.00% *	▲ 25	▲ 25	▼
Retail Warehouse	6.19%	▼ -43	▼ -22	4.50%	▼ -25	◀▶	◁▷
ALL RETAIL	6.11%	▲ 2	▲ 30				-
Central London Offices	4.13%	▲ 1	▲ 6	3.50%	◀▶	◀▶	◁▷
Rest of South East Offices	6.27%	▲ 12	▲ 45	5.00%	◀▶	◀▶	◁▷
Rest of UK Offices	6.05%	▲ 24	▼ -147	4.75%	▼ -25	▼ -25	▼
Office Parks	6.30%	▼ -96	▼ -15	5.25%	◀▶	◀▶	◁▷
ALL OFFICE	4.92%	▼ -2	▼ -2				-
South East Industrial	4.88%	▼ -11	▼ -145	4.00%	▼ -25	▼ -75	▼
Rest of UK Industrial	7.27%	▲ 36	▼ -28	5.00%	▼ -25	▼ -75	▼
Distribution Warehouse	5.32%	▼ -104	▼ -47	4.00%	▼ -25	▼ -25	▼
ALL INDUSTRIAL	5.49%	▼ -29	▼ -102				-
Hotels & Leisure	5.03%	▲ 9	▼ -67	4.75%	▼ -25	▼ -50	▼
Specialist	5.66%	▲ 2	▲ 32	5.25% **	◀▶	▼ -25	◁▷
Mixed-use (single assets & portfolios)	4.64%	▲ 40	▼ -159	-	-	-	-
ALL PROPERTY	5.56%	▼ -1	▼ -8	-	-	-	-

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

Source: LSH Research, Property Data, Property Archive

A BIG QUARTER FOR REGIONAL OFFICES

Regional offices volume of £1.5bn was particularly strong in Q4, almost double the quarterly average. Major deals included Schroder's £200m (NIY 5.00%) acquisition of 1 Spinningfields, Manchester from Allied London Properties and L&G's £105.7m (NIY 4.29%) purchase of New Waverley, Edinburgh from Artisan Real Estate.

Despite the £1.28bn sale of the 'Walkie Talkie' in Q3, Central London office volume actually climbed 24% to £3.6bn in Q4, with far more depth to the market also evident. Q4's largest deal was WeWork's £580m purchase of Devonshire Square from Blackstone.

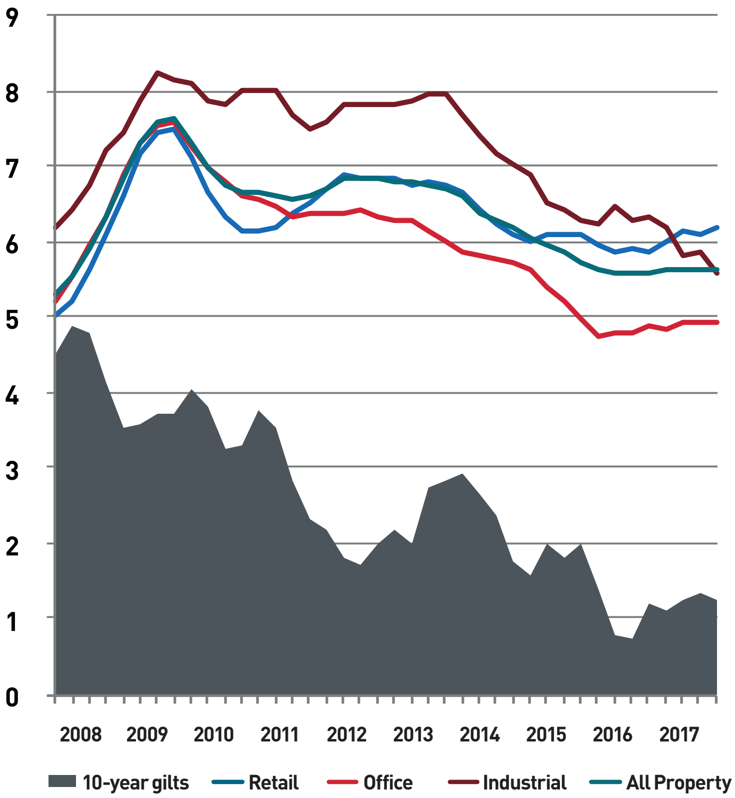
STABLE ALL PROPERTY YIELD MASKS SECTORAL DIVERGENCE

The All Property average transaction yield was virtually unchanged during Q4, moving in by a single basis point from Q3 to 5.56%. While the last six quarters have seen relatively minor movements at the All Property level, it has masked notably diverging patterns between sectors.

Industrial saw the largest movement, with average yields moving in by 29 bps to an all-time low of 5.49%. The divergence of investor demand from retail to industrial has been reflected in the industrial transaction yield moving lower than retail during the course of 2017.

The above pattern was also clear in the notional pricing of prime assets, with a further 25bps inward movement being seen across all industrial sub-sectors. While prices remain under pressure in shopping centres, a recent pick-up in demand for retail warehouses saw prime yields harden to 4.50% during Q4.

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



Source: LSH Research, Experian

REGIONAL FOCUS

REGIONAL RESURGENCE

Q4's strong volume owed much to large-scale purchasing in the regions. Indeed, regional volume eclipsed that seen in the capital for only the second quarter on record.

OUTSTANDING YEAR FOR REGIONAL INVESTMENT

Excluding portfolios, investment volume in the regions outside London was £7.0bn in Q4, the second strongest quarter on record, behind Q4 2006. This also brought the annual total for 2017 to £20.9bn, its best year since 2006.

Except for the North East, all regions outside London also saw Q4 volume above their respective five-year quarterly average. Scotland was the strongest performer relative to trend; Q4 volume of £930m was almost twice its quarterly average and spurred by six office deals each in excess of £50m. The North West also enjoyed a very strong Q4, with volume hitting the £1bn mark for only a third quarter on record.

Major office deals were the platform for a record £5.3bn of investment into the South East in 2017 as a whole, the latest example being Frasers Centrepoint's £175m (NIY 6.80%) purchase of Farnborough Business Park from Harbert/XLB in Q4. 2017 was also a record year for volume in the East (£1.7bn) South West (£1.9bn) and Wales (£0.9bn).

QUIET END TO THE YEAR FOR THE CAPITAL

At £5.2bn, Q4 investment in Greater London was the quietest quarter of 2017. London accounted for only 31% of UK volume in Q4, the lowest proportion since Q1 2009. However, over 2017 as a whole, Greater London volume of £24.5bn was 28% above the ten-year average.

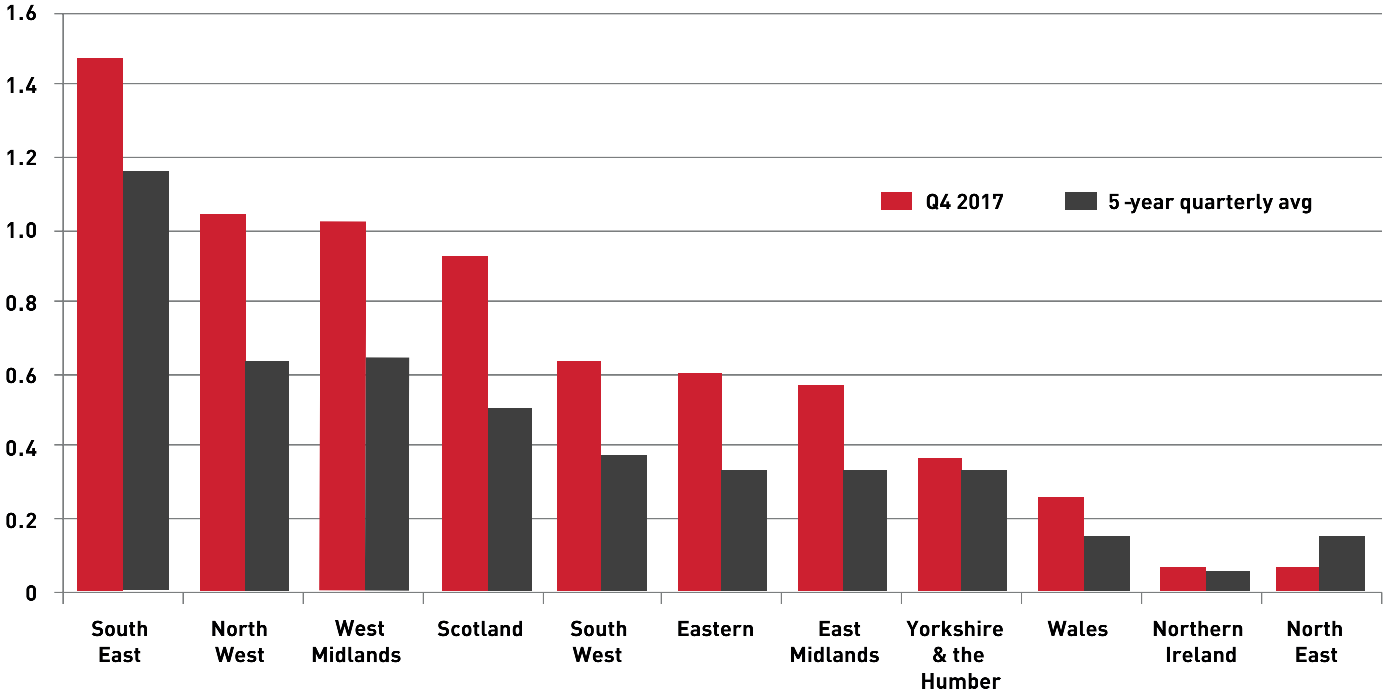
STRONG FINISH TO THE YEAR FOR PORTFOLIO DEALS

£4.3bn of portfolios transacted during Q4, up 29% on the five-year quarterly average. Despite relativity subdued activity in the first half of the year, 2017 volume reached £13.4bn, up 50% on 2016 and 42% above the ten-year average.

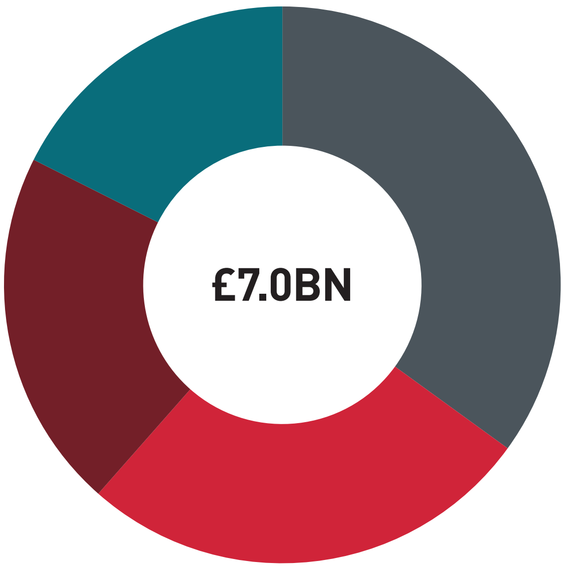
Q4 LONDON AND REGIONAL BREAKDOWN (£BN)

	GREATER LONDON
VS Q3 2017	-12%
VS Q4 2016	-12%
VS 5-YEAR QTY AVG	-17%

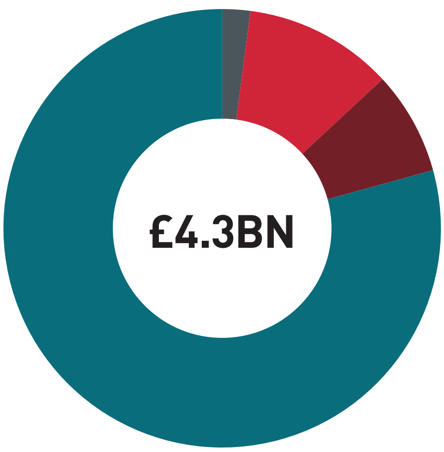
Q4 REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive



UK REGIONS



PORTFOLIOS

UK REGIONS	PORTFOLIOS
34%	-4%
27%	163%
50%	29%

Source: LSH Research, Property Data, Property Archive

BUYERS & SELLERS

DOMESTIC BLISS

Q4 2017 was characterised by a key shift in the buyer composition. UK institutions made an emphatic return to the market while overseas investment was its quietest quarter of the year.

INSTITUTIONS ARE BACK WITH A BANG

UK institutions acquired £3.9bn worth of assets in the quarter, the highest since Q2 2015. For the first time in six quarters, UK institutions were also net buyers in Q4, amounting to almost £1bn. This brought institutions' annual total for 2017 to £10.0bn, only 2% below the ten-year average.

Institutional activity in Q4 also included a tentative return to the Central London market, albeit within its fringes. One notable example was UBS Asset Management's £51m purchase of 42 Southwark Bridge Road, SE1.

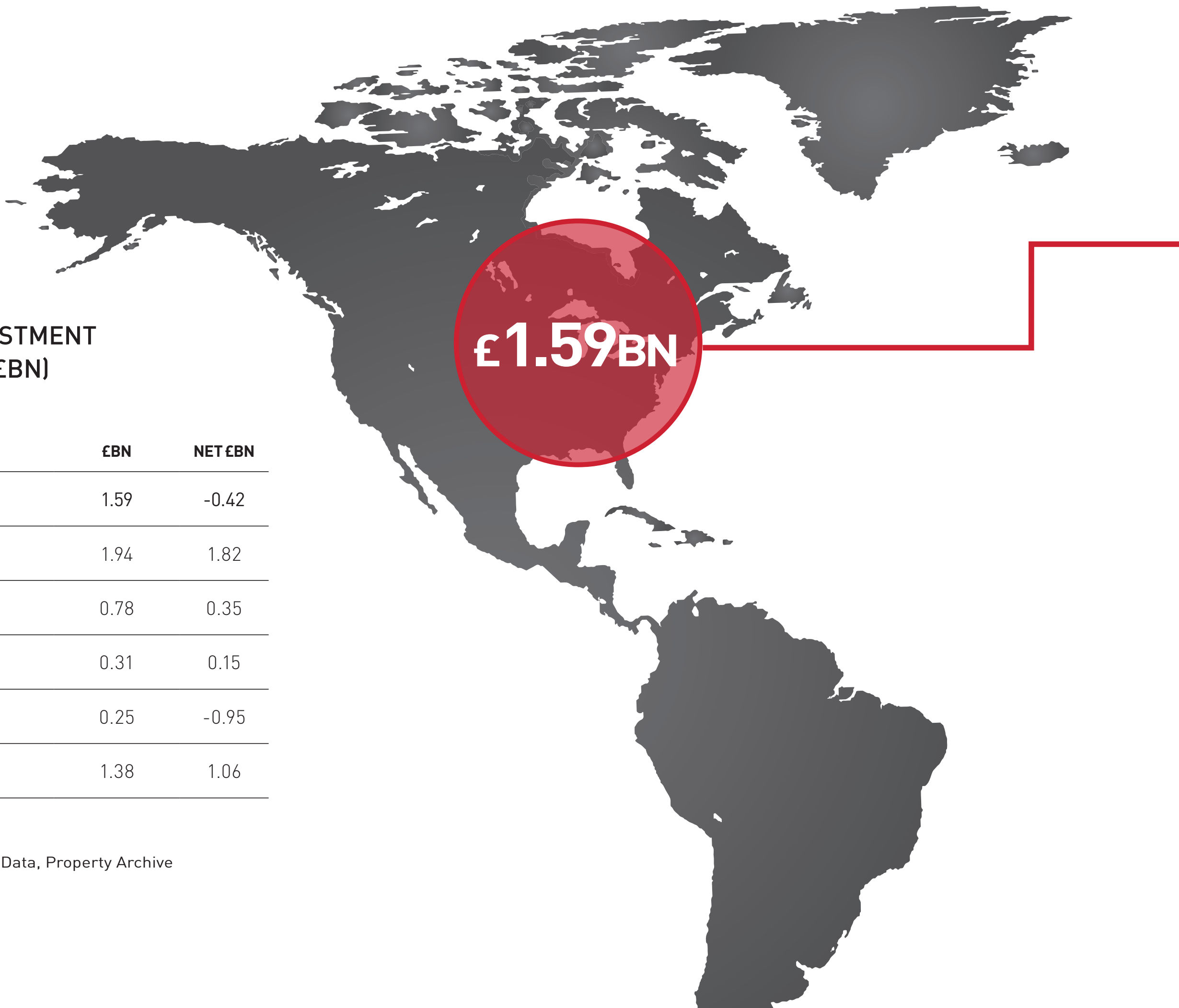
TAME END TO A STRONG YEAR FOR OVERSEAS BUYERS

At £6.4bn, Q4 overseas investment was the lowest quarter of 2017. This largely reflected a lack of major deals, with the number of deals broadly unchanged from Q3. Furthermore, they remained the largest net buyer of UK property at £2.0bn.

Nevertheless, benefitting from the weak pound, overseas volume in 2017 as a whole was £28.1bn, 49% above the ten-year average. Reflecting greater sectoral diversity of demand, overseas buyers invested a record £1.8bn into industrial in 2017, 51% ahead of the previous high in 2007.

RECORD YEAR FOR LOCAL AUTHORITY INVESTMENT

Having emerged in 2016, local authorities invested a record £1.8bn into UK property in 2017. While they accounted for only 3% of UK volume over the year, they were very active in certain sectors, making up 16% and 12% of South East office and shopping centre volume respectively.

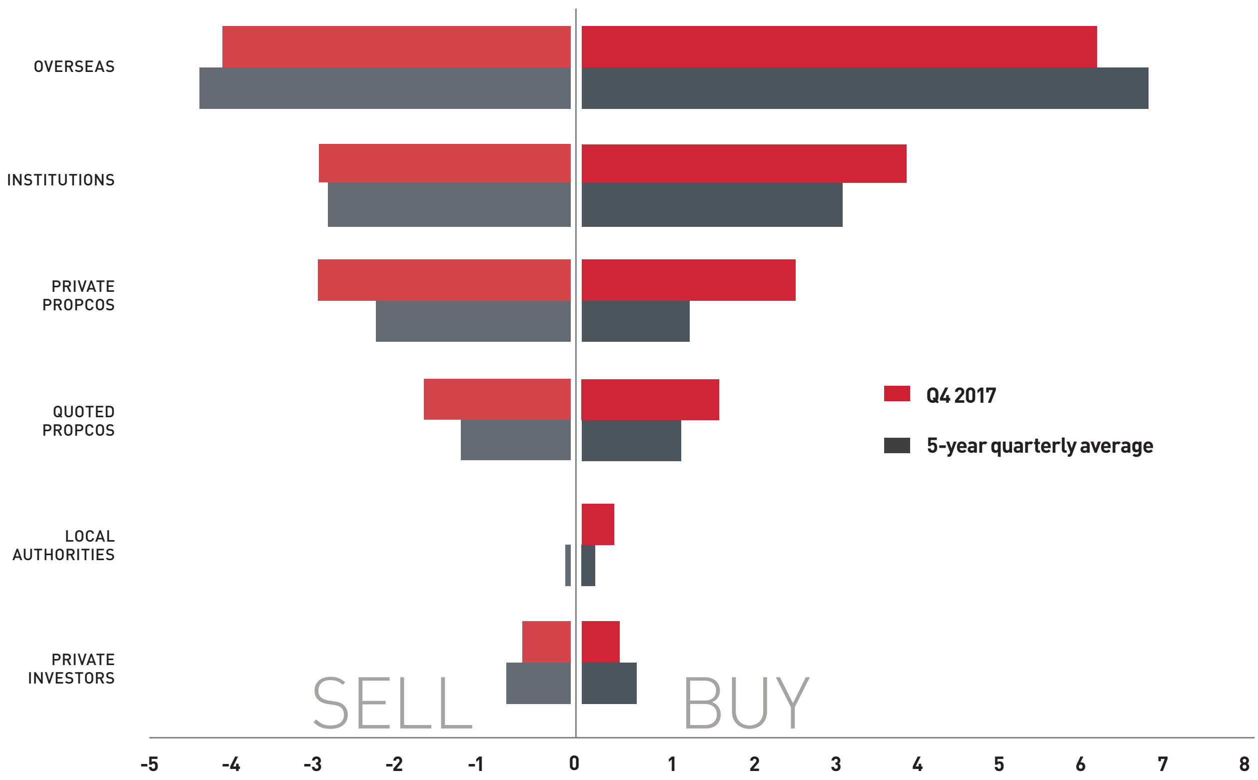


Q4 2017: GLOBAL INVESTMENT FLOWS INTO UK CRE (£BN)

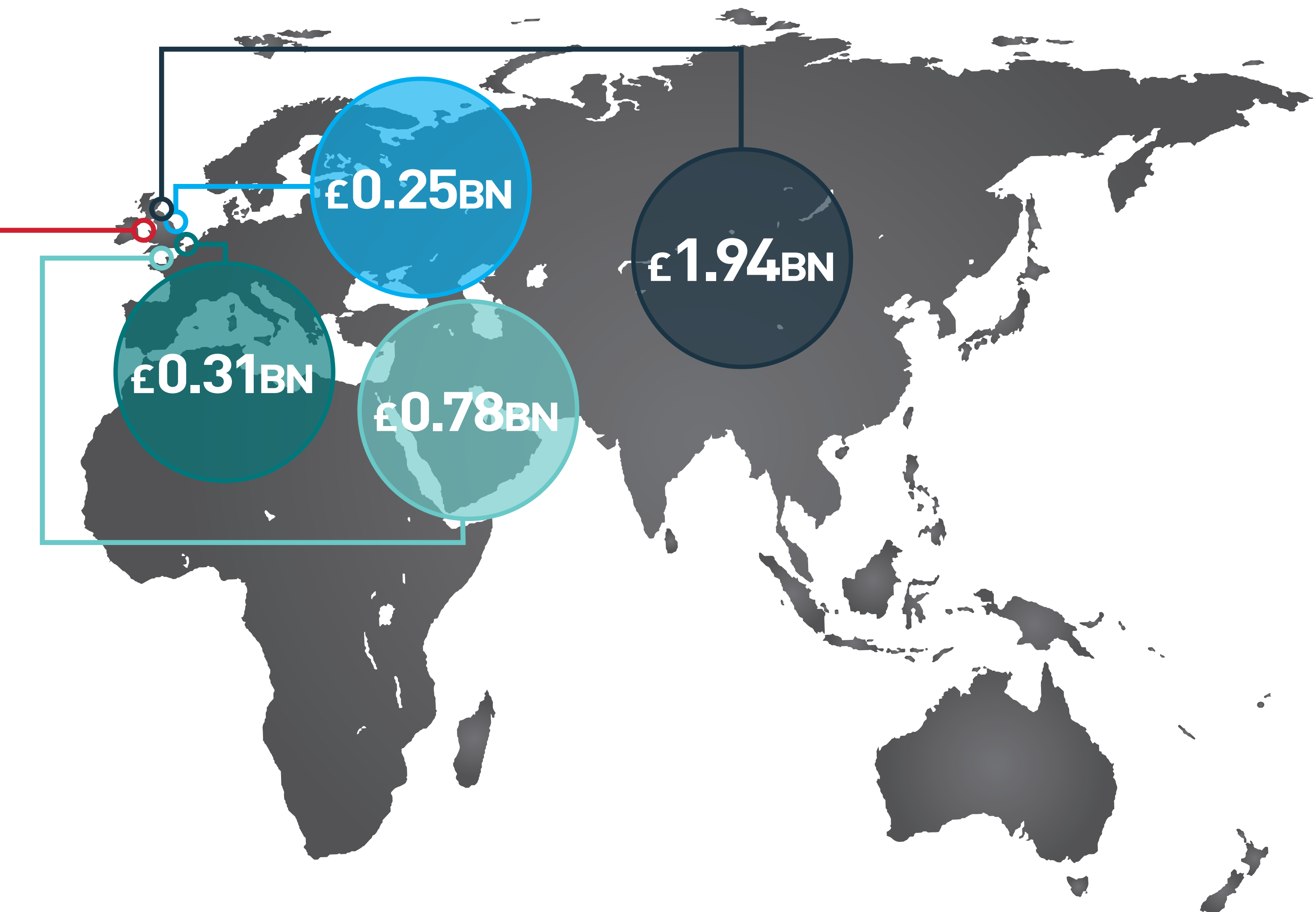
ORIGIN	£BN	NET £BN
NORTH AMERICA	1.59	-0.42
FAR EAST	1.94	1.82
MIDDLE EAST	0.78	0.35
GERMANY	0.31	0.15
EUROPE	0.25	-0.95
OTHER	1.38	1.06

Source: LSH Research, Property Data, Property Archive

VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive



OUTLOOK FOR 2018

GLASS HALF FULL

UK ECONOMY

While Brexit casts a shadow of uncertainty over the coming year, healthy global demand bodes well for more balanced economic growth during 2018.

MORE RESILIENT THAN EXPECTED

The UK economy has entered 2018 on the front foot. UK GDP growth picked up to 0.5% in Q4 2017, the strongest showing of any quarter last year, taking growth for 2017 as whole to 1.8%, significantly ahead of consensus 12 months ago. Granted, UK growth was the weakest of any G7 nation in 2017, but this partly reflects the improved global economic environment, not least in the resurgent Eurozone.

BETTER BALANCED

Economists have long bemoaned the UK's reliance on consumption over production in driving growth. However, benefitting from expansive global demand, a direct upside of sterling's post-Referendum fall is the competitive pricing of UK goods. In the latest three-month period, goods exports have grown by an impressive 12.3% year-on-year, double the growth rate of imports.

This is also reflected in the underlying sector-level growth. UK manufacturing is expanding at its fastest in ten years, with further growth of 1.3% in Q4. Assuming positive conditions in the global economy remain as expected, net trade could make its strongest contribution to UK growth in seven years.

RESPITE AHEAD FOR CONSUMERS?

To date, one clear consequence of 2016's Brexit vote has been the steep rise inflation stemming from the pound's fall. With wage growth failing to keep pace, consumer spending has been squeezed, reflected in weakening retail sales figures and, more recently, a flurry of disappointing Christmas trading results from many of big names on the UK high street.

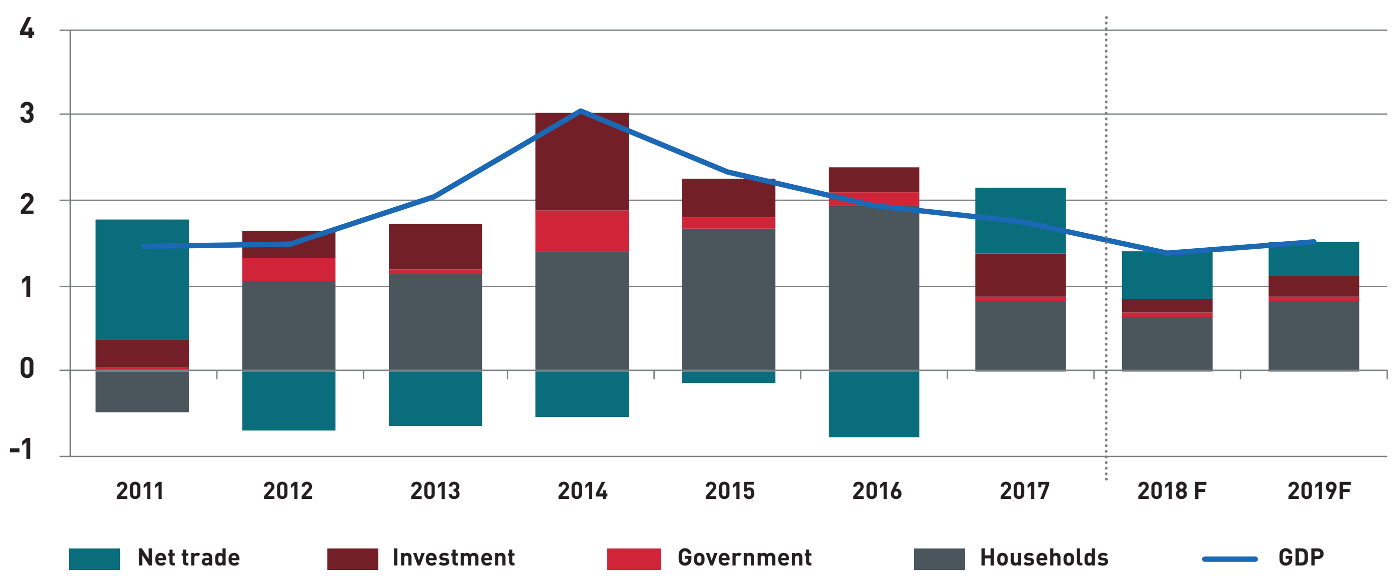
Positively, however, evidence suggests that the worst of the inflation assault could now be behind us; CPI inflation dipped to 3.0% in December from a five-year high of 3.1% in November. There are also hopes of improving wage growth ahead, as employees' power to demand higher pay is supported by the lowest level of unemployment since the 1970s.

BREXIT NEGOTIATIONS COULD BE PIVOTAL

As Brexit negotiations turn to the UK's future trading relationship with the EU, ongoing uncertainties mean the Bank of England is sure to take a cautious stance towards monetary tightening. At most, interest rates may be nudged up from 0.5% to 1.0% in 2018, a move which should be relatively manageable for borrowers and home-owners alike.

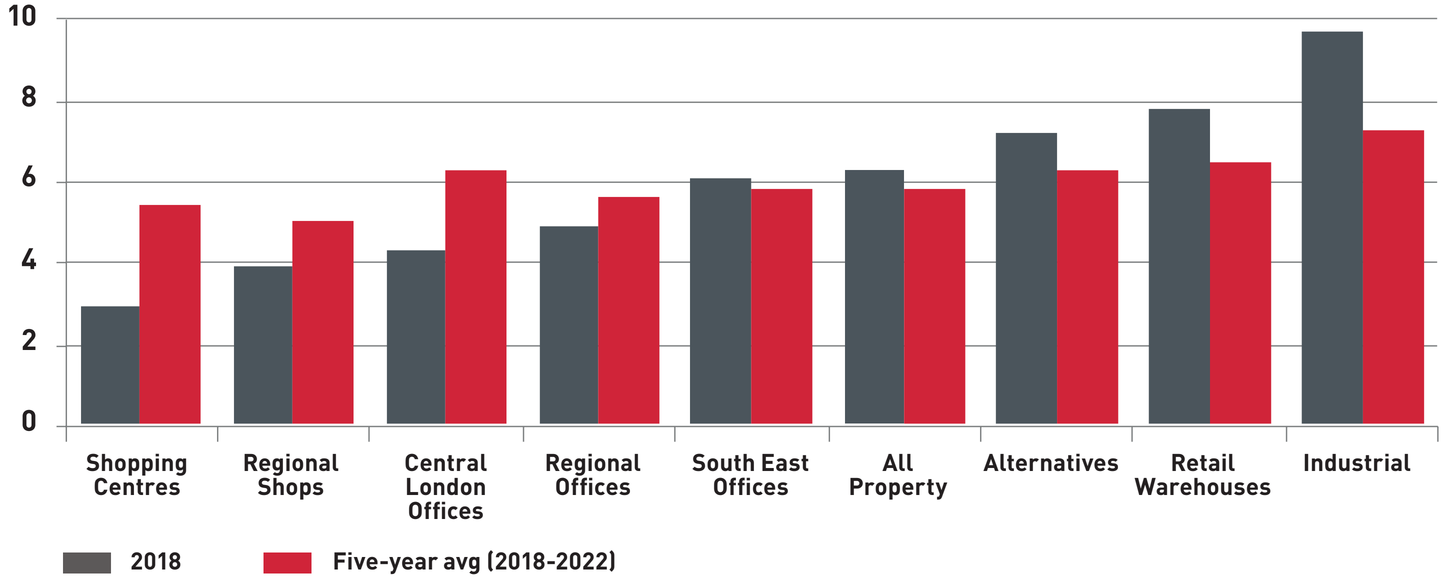
The progress of the negotiations could have an important bearing on how the UK economy performs over the coming year. A smooth process which leans towards a soft Brexit will reassure the financial markets and encourage businesses to take investment decisions. Coupled with an improving consumer environment, the current consensus view of a modest 1.5% growth in 2018 could be significantly bettered.

CONTRIBUTIONS TO UK GDP GROWTH (%)



Source: ONS, Experian

TOTAL RETURN FORECAST (%PA)



Source: LSH, RealFOR

PROPERTY MARKET

The investment market was relatively unperturbed by all the political twists in 2017, reflected in healthy volume and performance. While last year's capital growth is unlikely to repeated, many of the key themes are set to continue into 2018.

POLARISATION TO CONTINUE

2017 will deliver an All Property return of in excess of 10%, a level almost unthinkable 12 months ago. With the exception of several retail sectors, capital values have been restored to their pre-Referendum levels and, in the case of industrial, charged ahead. However, reflecting greater aversion to risk, values between core and poorer quality secondary assets have diverged post Referendum, a theme which is expected to continue into 2018.

SOUND FUNDAMENTALS FIRMLY IN PLACE

As ever, the investment rationale for UK commercial real estate remains sound relative to other asset classes. The spread between the All Property transaction yield and 10-year gilt yields currently stands well in excess of 400 basis points, comfortably ahead of the long-term average. Even if anticipated interest rate rises in the US and UK prompt a softening of gilt yields, there is sufficient margin to ensure UK property retains its fair value status.

INCOME TO DRIVE RETURNS

At the All Property level, the recovery in capital values in 2017 arguably counts against a repeat of the same in 2018. Our All Property total return forecast is circa 6% for 2018, with income providing the main component of return alongside a slight improvement in capital values. However, capital value movements will be wide-ranging at the sector level, with further falls reflecting risks around the occupier markets.

UNWAVERING DEMAND FOR CORE PRODUCT

A cocktail of global weight of money and an aversion to risk will continue to drive demand for core, long-income assets. The emphatic emergence of the specialist sectors such as student accommodation, healthcare and PRS into the mainstream investment universe is testament to this, whereby risks are shielded by very long leases and / or supported by structural, as opposed to strictly economic, demand drivers.

More difficult to predict is whether yield compression for this type of product has further to run. The strength of demand for secure income is such that a degree of further inward shift cannot be entirely ruled out in 2018.

TIGHT SUPPLY DRIVES VALUE-ADD OPPORTUNITY

The modest level of development seen over the current property cycle stands in stark contrast with those of the past. Tight supply conditions and the relative value available in the secondary market provides a clear opportunity to acquire and reposition assets towards prime in two to three years, by which time Brexit-related uncertainty may have largely abated. As ever, location is key.

Technological advances and societal change are having a profound structural effect on the nature of property demand. While inherently more risky, arguably the most lucrative opportunities over the medium-term will be those that exploit the relaxation of the UK planning system, transforming obsolete assets into entirely different uses.

1

NICK LLOYD
HEAD OF CAPITAL MARKETS

VOLUME TO HIT CIRCA £55BN

Despite the ongoing uncertainty in the market, we expect another decent year of investment activity. We forecast volume of circa £55bn in 2018, falling a little short of 2017's total but significantly above trend. While UK institutions should be more active, much hinges on how overseas investors perceive the UK, and in particular central London offices. The pattern of volume is also expected to mirror that of 2017, with greater activity coming in the second half of the year.

2

OLIVER DU SAUTOY
HEAD OF RESEARCH

FAR EASTERN BUYERS TO REMAIN PRO-UK CRE

Much has been made of the Chancellor's planned removal of Capital Gains Tax exemptions from overseas buyers from April 2019. While coming at an unhelpful time, it ultimately puts the UK regulations on an even playing field with elsewhere in the world. The long term appeal of UK real estate as a safe haven and the ongoing currency play should preserve overseas' interest, with new sources of capital expected to be unleashed next year, such as Japan and South Korea.

5

TONY FISHER
HEAD OF OFFICE ADVISORY

CO-WORKING TO RIPPLE OUT FROM LONDON

The impact of co-working providers on the Central London office markets was nothing short of staggering in 2017, accounting for almost a fifth of take-up. We can see their reach extending more meaningfully into the UK's key regional markets during 2018, to include both the repositioning of existing serviced offices and an expansion into other premises hitherto leased conventionally.

6

GARY PHILLIPS
DIRECTOR – CAPITAL MARKETS

RECORD VOLUME FOR HEALTHCARE INVESTMENT

Strong demand for the specialist sectors will continue, and we expect Healthcare to be particularly active during 2018. Underpinned by demographic changes, the sector's characteristics of long, index-linked income return and increasingly trusted operator covenants will attract interest from both domestic institutions and more experienced overseas investors alike.

3

SIMON EDDY
DIRECTOR – CAPITAL MARKETS

INCOME OPPORTUNITIES IN RETAIL

Retail will increasingly appeal to income seeking investors as income returns are now markedly above those of other sectors, particularly industrial, where yields are at all-time lows. While larger bulky consented units may well have to be reinvented, retail warehousing is arguably the most adaptable to changing shopping patterns. While industrial is set to lead sector performance again in 2018, an income-seeking shift in demand for retail warehouses will drive healthy returns in the sector, forecast at 7.5%.

4

STEVE WILLIAMS
HEAD OF INDUSTRIAL AGENCY

LAND VALUE GROWTH WILL EASE

The clamour for industrial & logistics has driven substantial increases in land values over the past few years. While there remains scope for value rises in sites targeted at urban logistics in and around the M25, we believe growth will slow markedly in 2018, reflecting a better balance of demand and supply in the market and more tempered assumptions over further rental growth potential.

PREDICTIONS

An intriguing year lies ahead for UK real estate, one characterised by both risk aversion and clear pockets of opportunity. In classic UKIT tradition, here we set out our key predictions for 2018.

7

CRIONA COLLINS
DIRECTOR – HEAD OF RETAIL AGENCY

LEISURE TO CAPITALISE ON RETAILER HEADWINDS

Against a backdrop of consumer squeeze, the winds of structural change passing through the high street will generate both risks and opportunities in 2018. Retailer demand will be resilient in the dominant top 50 UK locations while, elsewhere, pressure to consolidate will be reflected in very tenant-friendly packages. We expect leisure and community uses to take advantage of these conditions and increase their presence.

8

RYAN DEAN
DIRECTOR – OFFICE ADVISORY

OFFICES REPOSITION TO CAPTURE CHANGING DEMAND

In tightly-supplied city centre markets, investors have an opportunity to transform existing space to suit the changing nature of demand sweeping through the occupier market. Differentiated space designed to provide occupiers with a sense of community and amenity will have the best letting prospects.

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
Research
+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