UKIT

UK INVESTMENT TRANSACTIONS BULLETIN

Q2 2017

SHED RUSH

Ezra Nahome
CEO

As predicted, the investment community largely took June's snap election in its stride, with both volume and the number of deals in Q2 actually improving on Q1's level.

While uncertainty abounds in the market, there remains a substantial weight of money from both domestic and overseas buyers for UK Real Estate. Income is king in this market, and it was notable that the alternative sectors accounted for almost a third of volume in Q2.

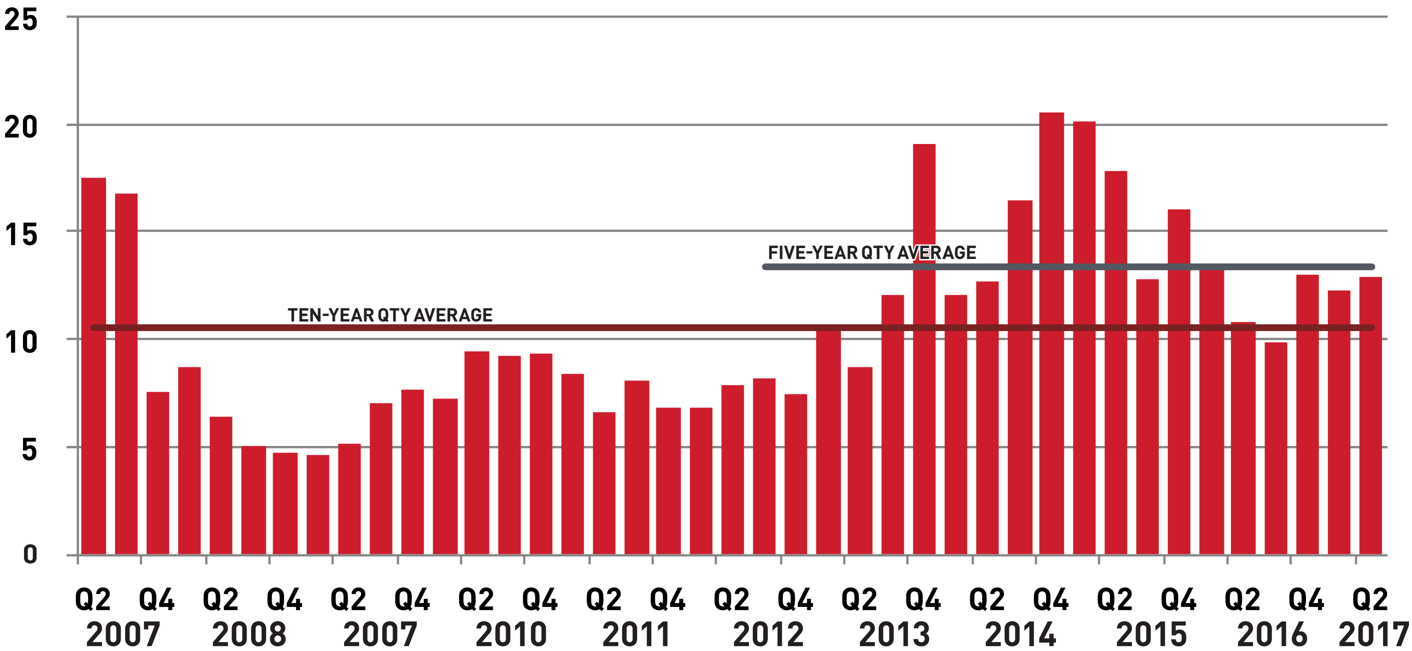
Yes, there were instances of deals being put on hold in the immediate period running up to the vote, but they still went through afterwards in spite of the government's failure to secure a majority. Significantly, there were no adjustments in pricing either.

One immediate upside to the election result is that demand has increased tangibly in Scotland, reflecting the SNP's postponement of any attempt to force another Independence Referendum. Another perceived, longer-term, upside is the greater likelihood of a softer Brexit. While negotiations have commenced, we can only speculate as to what will happen at this stage.

With rental levels holding up relatively well, or even growing strongly in the case of industrial, investors' return forecasts for 2017 as a whole have been upgraded since the start of the year.

This improving picture should encourage more stock to the market. While Q3 may prove to be quiet, as it often is over the summer, we are confident that Q4 will be a busy quarter, taking total volume for 2017 into line with our initial forecast of £50bn, an improvement on 2016's total.

UK INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

Q2 ACTIVITY

Sector focus

Healthy activity in Q2 confirmed that June's snap election had relatively little impact on the investment market.

Total Q2 volume was £12.9bn, up 5% on Q1 and 2% above the five-year average for the second quarter. Q2 also saw evidence of an improved depth to the market, as the number of deals was up 10% on the previous quarter. However, it was a very mixed pattern across the sectors.

Record volume for distribution warehouses

Strong investor sentiment towards industrial was reflected in volume of £1.9bn in Q2, up 40% on the five-year quarterly average. This was driven by distribution warehouses which had its strongest quarter on record with volume of £1.3bn.

This was boosted by Oxenwood Real Estate's £286m (NIY 5.4%) acquisition of the Ultrabox portfolio comprising of nine assets from Lone Star. The West Midlands also saw two major deals: a consortium of Korean investors' £100m (NIY 4.77%) purchase of a Sainsbury's warehouse at Hams Hall; and Tritax Big Box's £92m (NIY 5.25%) purchase of Ocado's warehouse at Birch Coppice.

Under par volume for offices and retail

Meanwhile, reflecting perceptions of weaker growth prospects, Q2 office and retail volume was down across every sub-sector against the five-year quarterly average. For the first time ever, combined retail and office volume accounted for less than half of Q2's total volume.

Q2 office volume of £4.3bn was down 24% on the five-year quarterly average. South East offices had a particularly subdued quarter, with volume of £230m standing 61% below the average level.

While retail volume in Q2 was up 9% on Q1, it was 27% below the five-year quarterly average. The largest retail deal was Land Securities' £332.5m acquisition of a portfolio of three factory outlet centres from Hermes Investment Management.

Continuing momentum in the specialist sectors

At £2.2bn, the specialist sectors recorded its highest quarterly volume since Q2 2015. Half of this was student accommodation, including Liberty Living's £460m purchase of Union State portfolio comprising 13 assets from Blackstone Real Estate.

Elsewhere, a consortium of German institutional investors comprising BVK, Deutsche Finance Group and Yoo Capital acquired the Olympia exhibition centre, London from Capco for £296m.

Q2 2017 INVESTMENT VOLUME (£BN)

SECTOR	Q2 2017	VS Q1 2017	VS Q2 2016	VS 5-YEAR AVG
Shops	£0.87	44%	-18%	-20%
Shopping Centres	£0.76	35%	-3%	-22%
Retail Warehouse	£0.36	-45%	-40%	-46%
ALL RETAIL	**£2.00**	**9%**	**-18%**	**-27%**
Central London Offices	£3.36	-21%	-5%	-13%
Rest of South East Offices	£0.23	-25%	-47%	-61%
Rest of UK Offices	£0.45	-31%	-6%	-37%
Office Parks	£0.26	33%	-71%	-44%
ALL OFFICE	**£4.30**	**-20%**	**-20%**	**-24%**
South East Industrial	£0.22	-21%	71%	-3%
Rest of UK Industrial	£0.40	12%	132%	6%
Distribution Warehouse	£1.27	10%	101%	71%
ALL INDUSTRIAL	**£1.88**	**5%**	**102%**	**40%**
Hotels & Leisure	£1.51	78%	47%	26%
Specialist	£2.23	18%	176%	83%
Mixed-use (single assets & portfolios)	£0.97	99%	234%	-18%
ALL PROPERTY	**£12.89**	**5%**	**19%**	**-3%**

Source: LSH Research, Property Data, Property Archive

Transaction yield remains stable

Average prices have remained remarkably stable over the 12 months since summer 2016, with the All Property average transaction yield standing at 5.65% in Q2, edging in by a single basis point during the quarter and identical to the Q2 2016 figure.

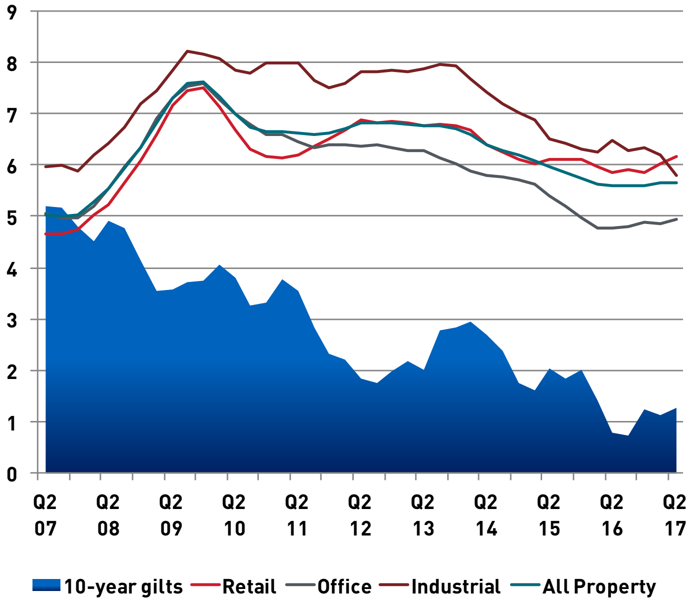
Stability of the All Property yield masked notably diverging patterns between sectors. Q2's average yield for shopping centres, retail warehouses and regional offices stands at least 80 bps higher than 12 months ago, while average yields for industrial, particularly South East multi-lets, are considerably lower.

Industrial transaction yields have historically always been higher than retail. However, reflecting better growth prospects and structural change, for the first time the rolling annual average yield for industrial now stands lower than retail.

Pressure on prime industrial continues

At the prime end of the market, prime yields were broadly steady in Q2 although industrial yields remain under downward pressure. UK South East and regional multi-lets moved in by 25 bps and, while distribution warehouses remained stable at 4.25%, sentiment indicates continuing downward movement.

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



Source: LSH Research, FT.com

Q2 2017 YIELDS

SECTOR	Transaction yields			Prime yields			PRIME YIELD SENTIMENT
	Q2 2017	3 MONTH MOVEMENT (BPS)	12 MONTH MOVEMENT (BPS)	Q2 2017	3 MONTH MOVEMENT (BPS)	12 MONTH MOVEMENT (BPS)	
Shops	4.48%	-26	-5	4.00%			
Shopping Centres	7.35%	49	84	5.75% *		25	
Retail Warehouse	6.49%	-35	84	4.75%		25	
ALL RETAIL	**6.26%**	**-4**	**60**	-	-	-	-
Central London Offices	4.34%	53	27	3.50%		25	
Rest of South East Offices	6.25%	30	7	5.00%			
Rest of UK Offices	7.12%	93	102	5.00%			
Office Parks	6.76%	-81	-24	6.00%			
ALL OFFICE	**5.23%**	**50**	**35**	-	-	-	-
South East Industrial	4.48%	-114	-293	4.25%	-25	-25	
Rest of UK Industrial	7.36%	19	-22	5.25%	-25	-75	
Distribution Warehouse	5.69%	111	11	4.25%			
ALL INDUSTRIAL	**5.41%**	**-35**	**-164**	-	-	-	-
Hotels & Leisure	4.68%	-23	-93	4.50%		-25	
Specialist	5.61%	-24	-2	4.50% **		-25	
Mixed-use (single assets & portfolios)	6.64%	-21	78	-	-	-	-
ALL PROPERTY	**5.65%**	**-1**		-	-	-	-

Source: LSH Research, Property Data, Property Archive

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

Regional focus

Healthy volume in the Capital in Q2 largely reflected record activity for alternatives, while a weaker showing in the regions reflected subdued volume in retail and offices.

Alternative sectors drive London volume
At £6.5bn, Greater London volume in Q2 was up 6% on both the previous quarter and five-year quarterly average. This was driven by a record quarter of alternative sector investment in London, boosted by Q2's largest deal, namely Ashkenazy Acquisition Corporation's £600m purchase of Grosvenor House Hotel, Mayfair.

Other alternative sector assets to trade were the £296m acquisition of Olympia exhibition centre and CBRE Global Investors' £160m (NIY 3.30%) purchase of the Park Plaza Waterloo hotel from PPHE Hotel Group.

Central London office volume was 13% below the five-year quarterly average and 21% down on Q1.

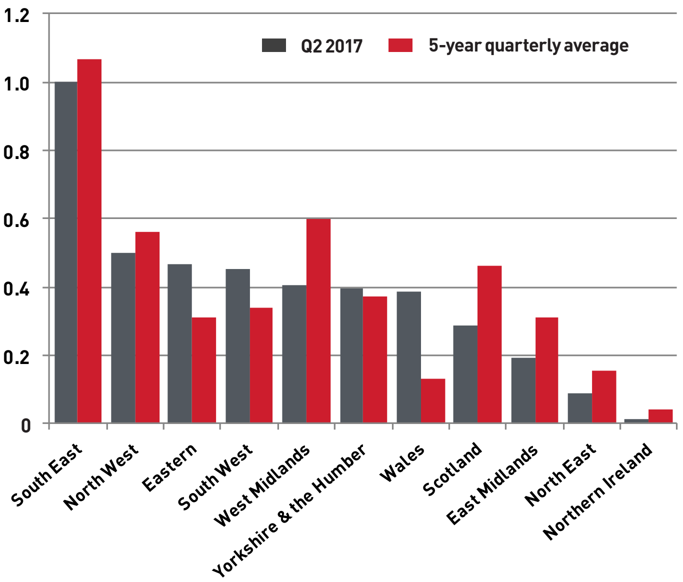
Appetite for large lot sizes nonetheless clearly remains, with for example DEKA Immobilien's £485m (NIY 4.40%) purchase of 78 Cannon Street, EC4.

Regional volume in line with average
Volume for single asset deals outside London totalled £4.2bn in Q2, up 10% on the previous quarter. Despite notably subdued activity in offices and retail, across the UK regional markets volume was only 4% below the five-year quarterly average.

Regional investment in industrial and alternatives surpassed their five-year quarterly averages, by 39% and 69% respectively. The largest single asset deal outside the capital was UPP Holdings' £155m purchase of student accommodation at Kingston upon Hull University.

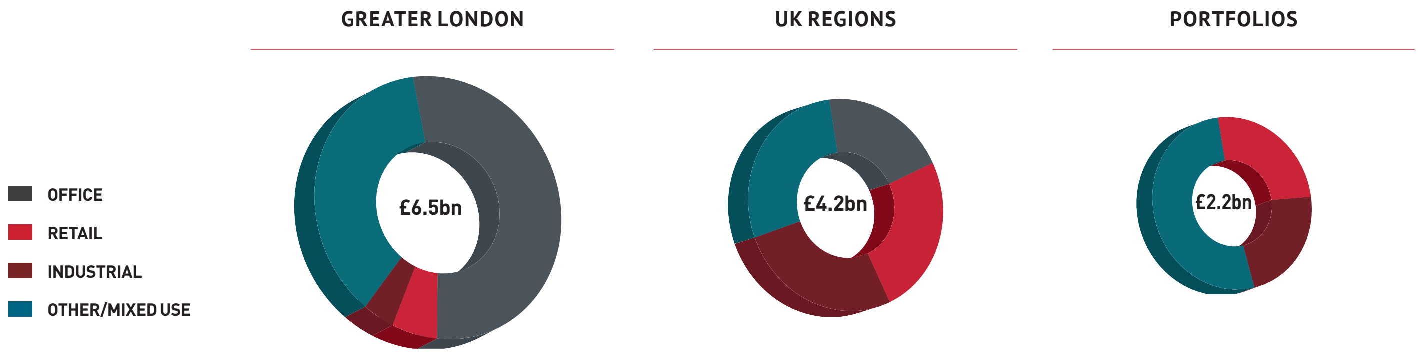
Portfolio activity subdued
At £2.2bn, Q2 portfolio investment was down 3% on the previous quarter, and 25% down on the five-year quarterly average. Q2's largest portfolio deal was Liberty Living's £460m purchase of Union State portfolio from Blackstone Real Estate.

REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

Q2 2017 LONDON AND REGIONAL BREAKDOWN



	GREATER LONDON	UK REGIONS	PORTFOLIOS
VS Q1 2017	6%	10%	-3%
VS Q2 2016	32%	-7%	56%
VS 5-YEAR QTY AVG	6%	-4%	-25%

Source: LSH Research, Property Data, Property Archive

Buyers and sellers

Q2 activity confirmed that overseas investors continue to have faith in the UK market, while UK institutions turned their attention to the alternative sectors.

German investment highest in 12 years

At £6.5bn, overseas volume in Q2 was the highest in six quarters. They purchased the largest five deals in Q2 and were overall net buyers to the tune of £2.7bn.

German investors recorded their largest quarterly volume since Q4 2003, of £1.4bn in Q2. This comprised five major assets located in Central London. However, the Far East was the dominant overseas buyer for the second consecutive quarter, acquiring £2.4bn worth of UK real estate.

Institutions dispose of Central London offices

Closely In line with Q1, UK institutions acquired £1.8bn of UK real estate in Q2, remaining net sellers for the fifth consecutive quarter.

Institutions continue to cash in on Central London offices once again, disposing of £1.1bn worth of the assets in Q2. Meanwhile, their acquisition focus was on hotel & leisure and specialist sectors, with net buying of £319m and £148m respectively

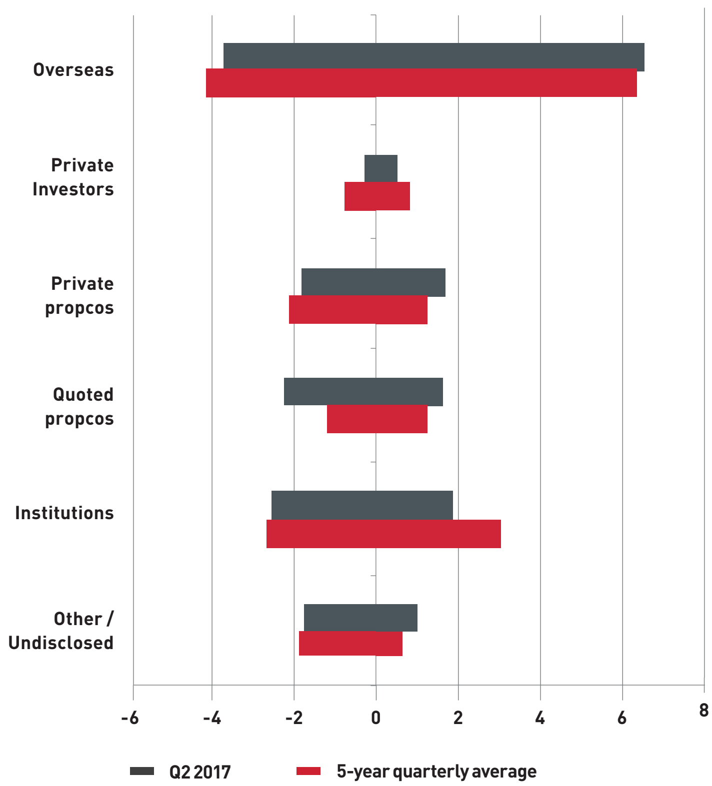
REITS cash in on demand for alternatives

At £0.8bn, quoted property companies continued to be net sellers in Q2, albeit to a lesser degree than the £1.3bn net sell off in Q1. They disposed of a number of major specialist assets amounting to £696m. This included Capital & Counties' £296m disposal of Olympia exhibition centre and Watkin Jones' £165 disposal of a student accommodation portfolio.

Local Authority investment continues apace

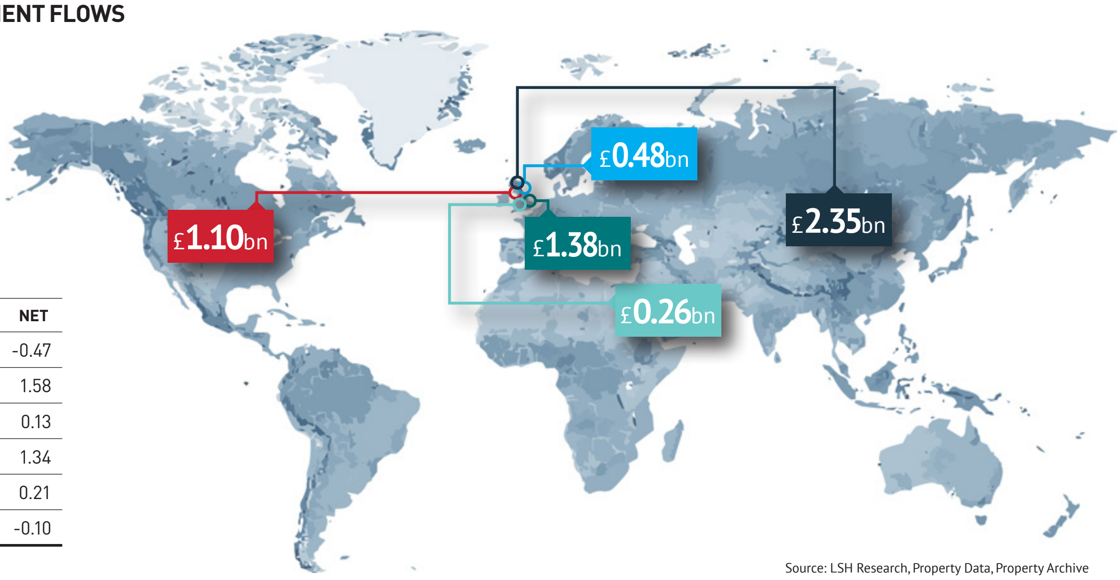
Local Authorities invested £440m into UK property in Q2, more than double Q1's volume. Industrial was a key focus of this invested, boosted by Enfield Council's £70m acquisition of Urban Logistics.London, a 32-acre development site with a long leasehold industrial estate.

Q2 2017 VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive

Q2 2017: GLOBAL INVESTMENT FLOWS INTO UK (£BN)



ORIGIN	£BN	NET
North America	1.10	-0.47
Far East	2.35	1.58
Middle East	0.26	0.13
Germany	1.38	1.34
Europe	0.48	0.21
Other	0.91	-0.10

Source: LSH Research, Property Data, Property Archive

OUTLOOK

As the dust settles on another bout of political upheaval, the commercial property market continues to move tentatively in the right direction, despite the uncertainty ahead over Brexit.

Growth improves in Q2, but only just

At 0.3%, the first estimate of UK GDP growth in Q2 represents only a marginal improvement on Q1's lacklustre 0.2%. While it suggests that last summer's Brexit vote is now starting to bite, the tepid performance was down to very different reasons in each quarter.

The largest contributor to growth in Q2 was retail trade, which improved after a notable contraction in Q1. However, the manufacturing sector, which has the possibility to benefit from enhanced export competitiveness linked to sterling's weakness, suffered a surprise 0.5% contraction in output in Q2.

Income squeeze to keep interest rates on hold

The UK workforce continues to expand steadily, while unemployment has edged down to 4.5%, its lowest level since 1975. However, the tightness of the labour market is at odds with wage growth, which, at 1.8% year-on-year, continues to lag inflation, despite June's surprise fall in CPI to 2.6%.

In response to the squeeze, consumers are saving less and borrowing more. The Bank of England recently expressed concern at consumer lending practices and, should lenders tighten their criteria, access to credit may get tougher in the coming months.

While consensus suggests that inflationary pressures will continue to persist in the wake of sterling's fall, weak pressure on wage growth is likely to keep the majority of the Bank's nine committee members in favour of keeping interest rates on hold over the remainder of 2017.

Occupier markets holding up

Despite signs of moderating growth in the economy, the occupier markets have confounded many initial expectations of a downturn in the wake of last year's Brexit vote. Relatively tight supply conditions have nullified the risk of rental falls in some of the more exposed-looking sectors and, generally speaking, demand has held up.

Indeed, despite the heightened uncertainty, the UK corporate landscape appears in rude health. Latest statistics reveal that non-financial corporates achieved a 12.7% rate of return in Q1, the highest since Q3 2014, while UK manufacturers' rate of return reached a decade high of 14% in Q1.

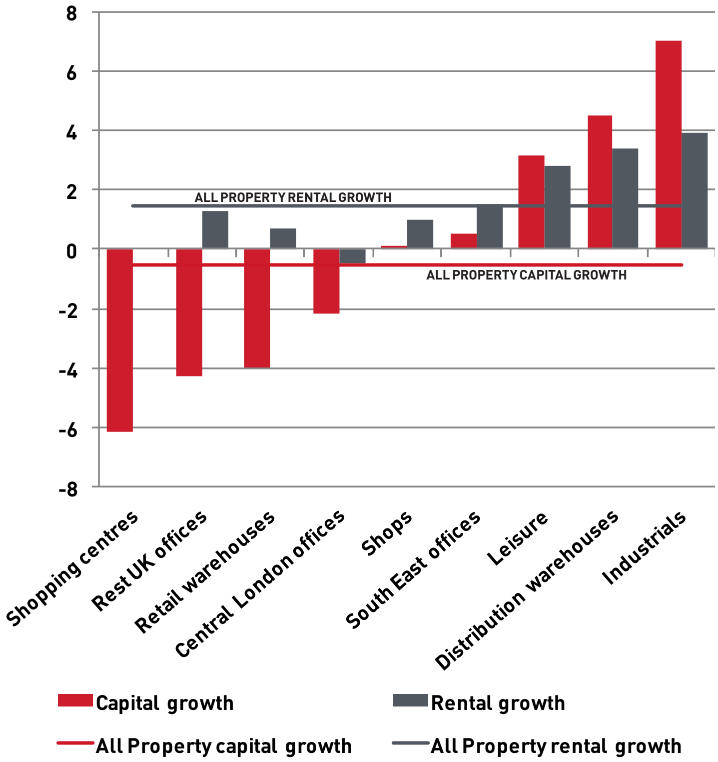
Investors buoyed by improving picture

Despite an uptick in 10-year gilt yields at the beginning of July, in relative terms UK real estate pricing remains extremely attractive by historic standards. With little prospect of an immediate or sharp increase in interest rates and strong demand from both overseas and domestic investors for secure income, prime yields are relatively settled.

On first glance, the market has fought back from the initial shock of the Referendum result. According to IPD figures, All Property rental values have continued to edge up after the vote; standing 1.5% higher than the eve of the Referendum, while capital values have recovered after an initial wobble to stand only 0.5% lower.

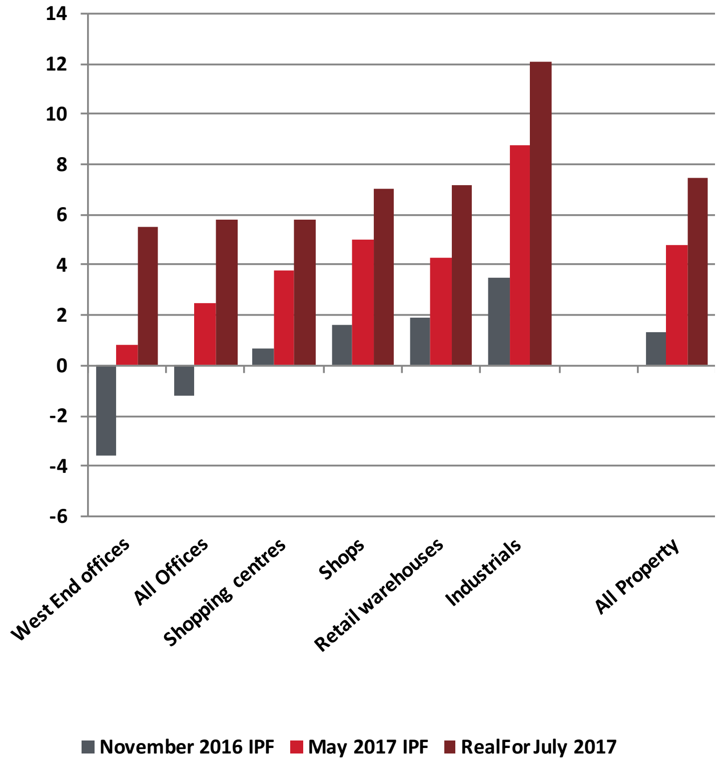
However, as the chart below left shows, the All Property figures belie considerable divergence in performance between sectors in the secondary market. Evidence of rental resilience across a range of sectors, not least industrial, is prompting many investors to upgrade their return aspirations for 2017, which should translate into a more active, liquid market later in the year.

12 MONTH CHANGE (%)



Source: MSCI

2017 TOTAL RETURN FORECAST (%)



Source: IPF, RealFor

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