Lambert Smith Hampton

DEAL OR NO DEAL

UKITQ318

UK INVESTMENT TRANSACTIONS BULLETIN

Q3 VOLUME AT £17.0BN: HIGHEST SINCE Q2 2015

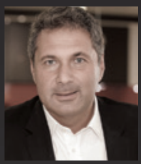
NO. OF DEALS UP 28% Y-O-Y

PRS VOLUME AT RECORD HIGH

SHOPPING CENTRE VOLUME AT RECORD LOW

AVG TRANSACTION YIELD UP 25BPS

EUROPEAN BUYING HIGHEST SINCE 2007



Ezra Nahome
CEO

In spite of the stream of political noise from the Brexit negotiations, Q3's volume and sheer number of deals are clear testament to the ongoing confidence in the core fundamentals of UK commercial property.

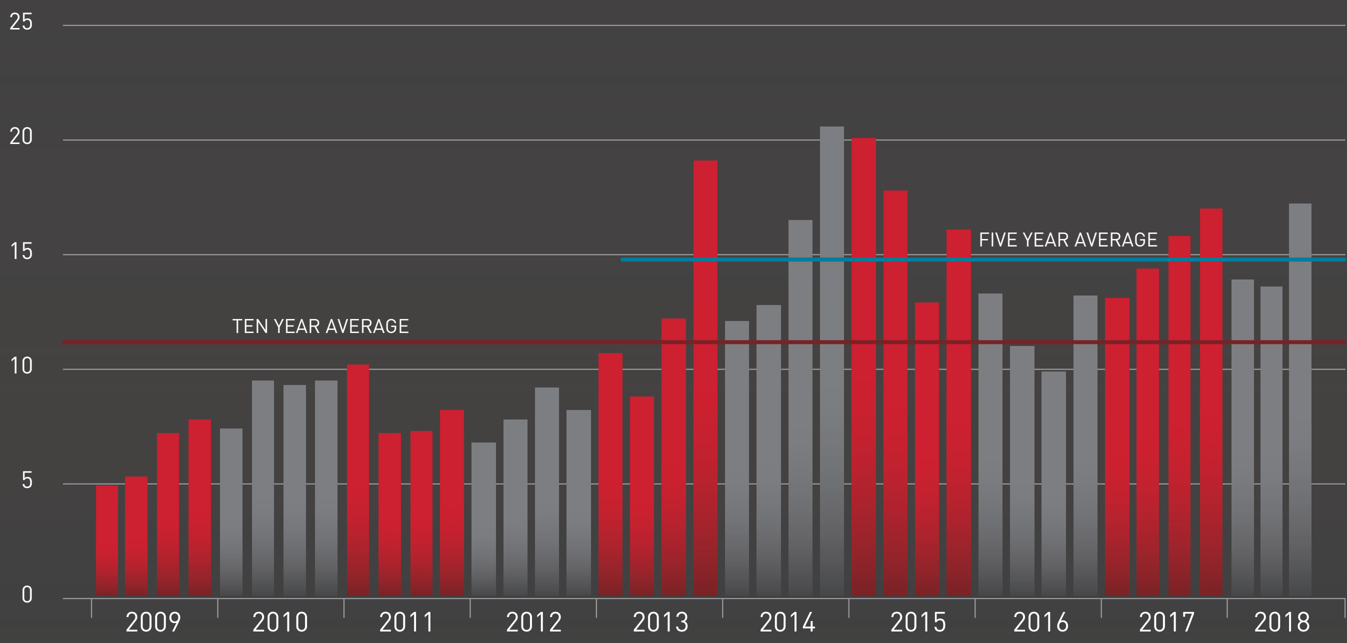
Q3's activity underscored the extent to which UK real estate remains in favour from overseas buyers. Evidently, the risks around Brexit are being viewed in a wider global context, with the UK offering relative value compared with other core markets while continuing to benefit from its enduring reputation as a safe haven for international capital.

The signs so far indicate that Q4 will deliver another strong quarter for volumes, taking the UK total for 2018 as a whole to circa £60bn, exactly in line with our forecast made at the beginning of the year. However, we cannot be complacent. Sentiment in the early part of 2019, particularly among the UK funds, will depend heavily on the success or otherwise of the negotiations.

That said, with limited potential for distress in this cycle, Brexit difficulties are more likely to result in intertia than material price corrections. At the All Property level, we are forecasting a levelling off in values next year but, as always, the devil is in the detail, with variable rental growth prospects between sectors and locations determining next year's winners and losers.

For some, the next few months will be seen as the right moment to batten down the hatches and see what unfolds. However, deep rooted structural changes in occupier demand are helping to open up new, exciting avenues of opportunity. An ability to see through Brexit uncertainty, or better still to capitalise on it, may provide the key to outperforming the market in 2019.

UK INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

SECTOR FOCUS

SUMMER SPLURGE

Q3's volume of £17.0bn, the highest in three years, suggests the Brexit impasse has hardly interfered with the UK investment market. Not yet at least.

MEGA DEALS DRIVE VOLUME

Characterised by strong overseas appetite, Q3 volume of £17.0bn was the strongest quarter since Q2 2015 and 14% above the quarterly average.

Two £1bn-plus deals were a key factor behind Q3's impressive volume, namely Telereal Trillium and Blackstone's £1.46bn purchase of Network Rail's arches portfolio; and South Korean National Pension Scheme's £1.16bn (4.10% NIY) acquisition of Goldman Sachs' Plumtree Court, London EC4.

Nonetheless, the quarter was also remarkably busy. The number of deals was a record high for the third quarter period and 28% above the same quarter in 2017.

RECORD QUARTER FOR PRS

As expected, the market is now seeing real traction in PRS investment. Q3 volume in PRS was £1.8bn, the highest on record and boosted by Oxford Properties' £600m acquisition of a 39% stake in the Get Living portfolio, the third largest deal of Q3.

OFFICE VOLUME HITS THREE-YEAR HIGH

At £6.7bn, Q3 office volume was its strongest since Q4 2015. While the Plumtree Court deal certainly lifted the figure, each of the sub-sectors saw strong activity. Central London saw nine other deals above £100m, including Pontegadea's £550m (4.37% NIY) purchase of the Adelphi building, WC2 from Blackstone.

At £906m, Rest of South East offices recorded its highest volume since Q1 2016, albeit boosted by two major portfolios, the largest of which was Spelthorne Borough Council's £285m (6.14% NIY) acquisition of the Western Corridor portfolio from Brockton and Landid.

The Rest of UK Offices sector also had a busy quarter, with volume of £966m across 81 deals. Each of the UK's core regional markets saw deals in excess of £20m, the largest being Railways Pension Trustees' £95m (6.40% NIY) purchase of 2 Colmore Square and Cannon House, Birmingham.

ANOTHER MASSIVE QUARTER FOR INDUSTRIALS

Investors' ceaseless appetite for industrial was reflected in volume of £2.2bn in Q3, the third strongest quarter on record, alongside a record number of deals.

Volume was underpinned by a flurry of portfolio deals, the largest being Ascendas REIT's £207m (5.22% NIY) acquisition of Project Owl from Oxenwood Real Estate and Catalina Holdings. Indicative of a search of value, Rest of UK industrial was the best performer relative to trend, with Q3 volume 81% above its average.

Q3 2018 INVESTMENT VOLUME (£BN)

VOLUME VS 5YR QTY AVG

-50% | -25% | AVERAGE | +25% | +50%

SECTOR	Q3 2018	Q2 2018	Q1 2018	Q4 2017	VS Q2 2018 (%)
Shops	**£0.67**	£1.10	£0.73	£1.51	-39%
Shopping Centres	**£0.04**	£0.22	£0.39	£0.39	-83%
Retail Warehouse	**£0.77**	£0.63	£0.37	£0.89	22%
ALL RETAIL	**£1.47**	£1.95	£1.49	£2.80	-24%
Central London Offices	**£4.50**	£4.67	£3.46	£3.69	-4%
Rest of South East Offices	**£0.91**	£0.75	£0.85	£0.77	20%
Rest of UK Offices	**£0.97**	£0.71	£1.10	£1.51	36%
Office Parks	**£0.40**	£0.34	£0.35	£0.42	17%
ALL OFFICE	**£6.77**	£6.48	£5.76	£6.39	5%
South East Industrial	**£0.31**	£0.31	£0.44	£0.42	1%
Rest of UK Industrial	**£0.96**	£0.64	£0.90	£0.53	50%
Distribution Warehouse	**£0.92**	£1.00	£0.60	£1.01	-7%
ALL INDUSTRIAL	**£2.19**	£1.94	£1.95	£1.97	13%
Hotels & Leisure	**£1.24**	£1.33	£1.69	£1.54	-7%
Specialist	**£3.51**	£2.02	£2.35	£3.37	74%
Mixed-use (single assets & portfolios)	**£1.85**	£0.37	£0.88	£0.84	404%
ALL PROPERTY	**£17.04**	£14.07	£14.13	£16.90	21%

Source: LSH Research, Property Data, Property Archive

Q3 2018 YIELDS

SECTOR	TRANSACTION YIELDS Q3 2018	TRANSACTION YIELDS 3 MONTH MOVEMENT (BPS)	TRANSACTION YIELDS 12 MONTH MOVEMENT (BPS)	PRIME YIELDS Q3 2018	PRIME YIELDS 3 MONTH MOVEMENT (BPS)	PRIME YIELDS 12 MONTH MOVEMENT (BPS)	YIELD SENTIMENT
Shops	3.89%	-25	-119	4.25%		25	
Shopping Centres	7.20%	27	89	6.25%*	25	50	
Retail Warehouse	6.65%	89	2	4.75%			
ALL RETAIL	6.00%	26	-9				-
Central London Offices	4.51%	20	39	3.50%			
Rest of South East Offices	6.26%	71	11	5.00%			
Rest of UK Offices	6.56%	16	76	4.75%		-25	
Office Parks	7.02%	-22	-24	5.25%			
ALL OFFICE	5.29%	25	36				-
South East Industrial	4.72%	42	-27	3.75%		-50	
Rest of UK Industrial	6.49%	-28	-42	4.75%		-50	
Distribution Warehouse	5.29%	12	-106	3.75%		-50	
ALL INDUSTRIAL	5.20%	21	-57				-
Hotels & Leisure	5.77%	-308	82	4.25%**		-25	
Specialist	5.90%	63	26	4.75%***		-25	
Mixed-use (single assets & portfolios)	6.79%	175	255	-	-	-	-
ALL PROPERTY	5.66%	22	9	-	-	-	-

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

Source: LSH Research, Property Data, Property Archive

RETAIL AT ROCK BOTTOM

Heightened aversion towards retail is clearly reflected in volume. Only £1.5bn of retail assets changed hands in Q3, the lowest quarterly volume since Q2 2012. Shopping centres had its quietest quarter on record, with only £38m transacting across four assets.

However, retail warehouses are bucking the wider trend to some extent, with volume of £769m standing 7% above average. This included the largest retail deal of the quarter, Hana Financial's £175m (5.2% NIY) purchase of Gallagher Shopping Park, Wednesbury from KKR and Quadrant Estates.

AVERAGE YIELD SNAPS BACK

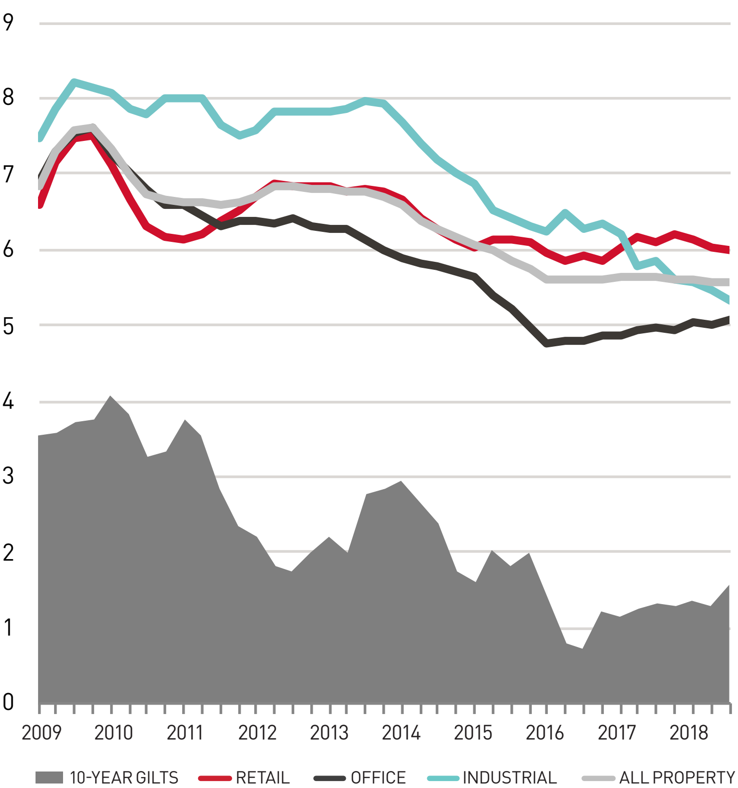
The All Property average transaction yield moved out by 22bps during Q3 to stand at 5.66%, effectively reversing the downward movement seen in Q2 and moving back into line with the level seen over much of the past two years.

Each of the three core sectors saw the average yield move out, with offices moving to its highest level since Q1 2015 at 5.29%. The movement reflects healthy appetite for secondary stock for asset management plays as opposed to price movements.

While downwards pressure remains on prime industrial yields, the average transaction yield moved out by 21 bps in Q3 to 5.20%, reflecting a greater focus on the UK regions during the quarter.

Across the sectors, notional prime yields remained broadly stable during Q3. Shopping centres were the only exception, reflecting the occupational risks and deteriorating sentiment, with prime yields softening by 25bps.

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



Source: LSH Research, Experian

REGIONAL FOCUS

PORTFOLIOS APLENTY

Q3's robust volume reflected healthy activity across the UK. Office investment was strong throughout the major cities, while a flurry of portfolios transacted in the alternatives and industrial sectors.

PORTFOLIOS PROPEL Q3 VOLUME

At £4.6bn, Q3 investment into portfolios was robust, up 70% on Q2 and 31% above the five-year quarterly average. This was significantly boosted by the £1.46bn Network Rail arches portfolio.

A flurry of specialist sectors portfolios also boosted Q3 volume, comprising £1.4bn of assets across 15 deals. This was largely from overseas investors acquiring major PRS portfolios.

OVERSEAS APPETITE HEALTHY FOR LONDON

Despite uncertainty in the market, volume in Greater London climbed to £7.2bn in Q3, 12% above the five-year quarterly average. Overseas investors evidently remain confident in the capital, investing £4.8bn in Q3, the highest level since Q4 2014.

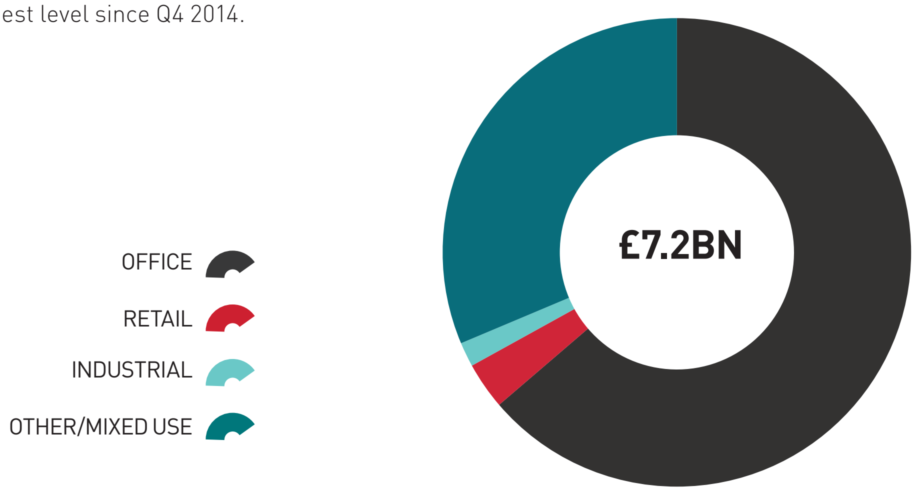
Offices made up the lion's share of investment at 64%, although collectively specialist sectors was the highest on record at £1.2bn. Hotel & leisure investment in the capital was a substantial £858m, boosted by Cola Holdings' £260m acquisition of Hilton London Kensington from administrator AlixPartners.

YORKSHIRE & THE HUMBER STARS

Volume for single asset deals across the rest of the UK was £5.2bn in Q3, up 16% on Q2 and 3% above the five-year quarterly average. The largest single asset transactions in the UK regions were the previously mentioned Gallagher Shopping Park, Wednesbury (£175m) and PRS asset West Tower, Manchester (£110m).

It was a healthy picture across most regions in Q3, although Yorkshire & the Humber was the standout performer, with total volume at its highest level since Q3 2015. This included a number of prominent office deals, such as Canada Life Assurance's £89.95m (2.91% NIY) purchase of Riverside House and Legal & General's £50m purchase of Steel Vulcan House, Sheffield.

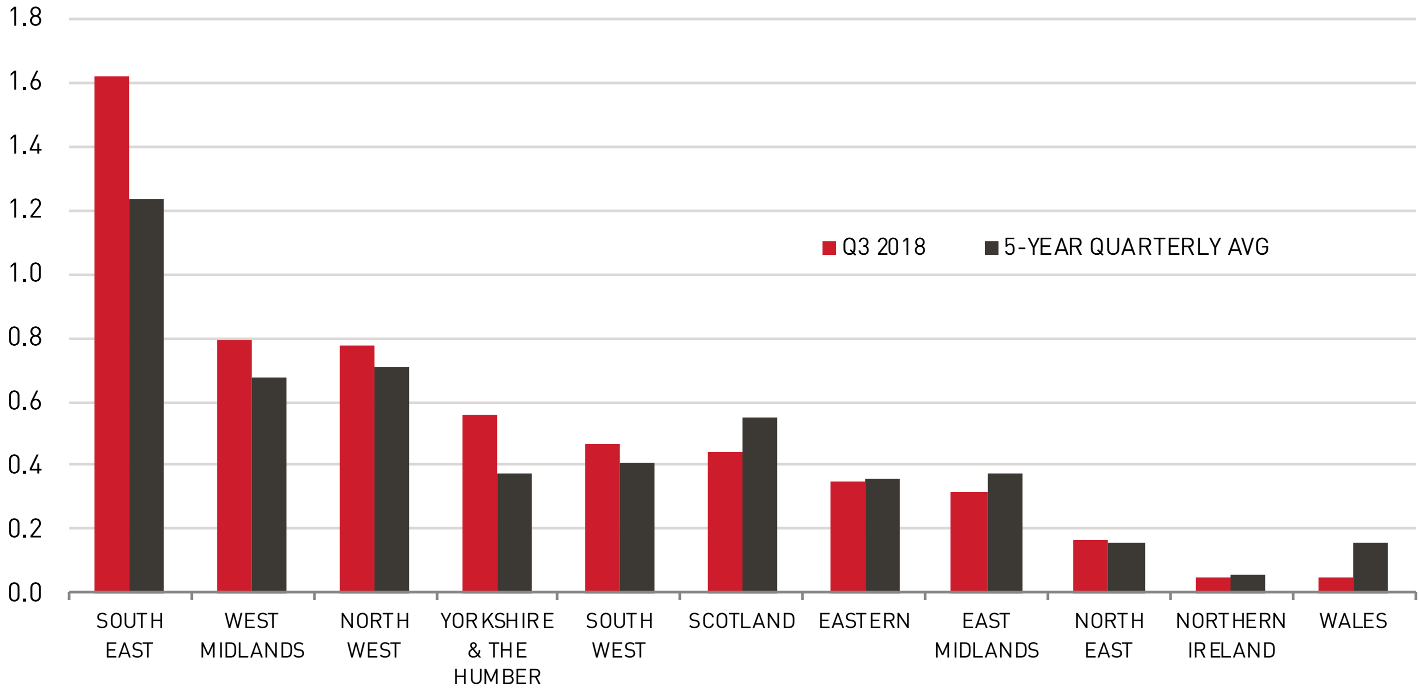
Q3 2018 LONDON AND REGIONAL BREAKDOWN (£BN)



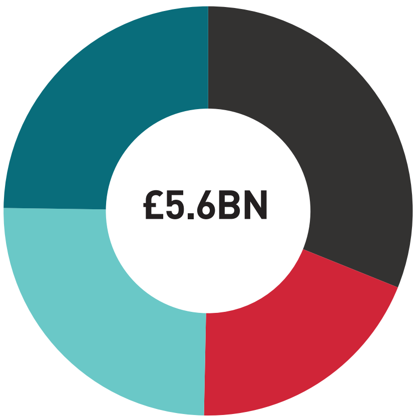
GREATER LONDON

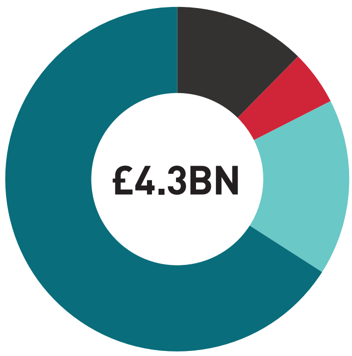
VS Q2 2018	▲ 5%
VS Q3 2017	▲ 21%
VS 5-YEAR QTY AVG	▲ 12%

Q3 REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive





UK REGIONS	PORTFOLIOS
16%	70%
-3%	4%
3%	31%

Source: LSH Research, Property Data, Property Archive

BUYERS & SELLERS

INCREDIBLE INFLOWS

Judging by the scale of overseas activity in Q3, Brexit risks are evidently being trumped by the attraction of scale, value and transparency associated with the UK real estate market.

OVERSEAS CAPITAL DRIVES VOLUME

At £8.6bn, overseas investment was up 38% on the previous quarter and 20% above the five-year quarterly average. The Far East continues its reign as the dominant source of capital inflows, acquiring £2.6bn in Q3. Notably, however, £2.3bn of investment from Europe was its strongest in 11 years.

As ever, almost half of overseas capital was targeted at Central London offices; however, industrial investment was notably high at £602m, 91% above average and the second strongest quarter on record. This was boosted by two major portfolio deals; Ascendas REIT's purchase of Project Owl (£207m) and Blackstone's purchase of the Column Portfolio (£108m).

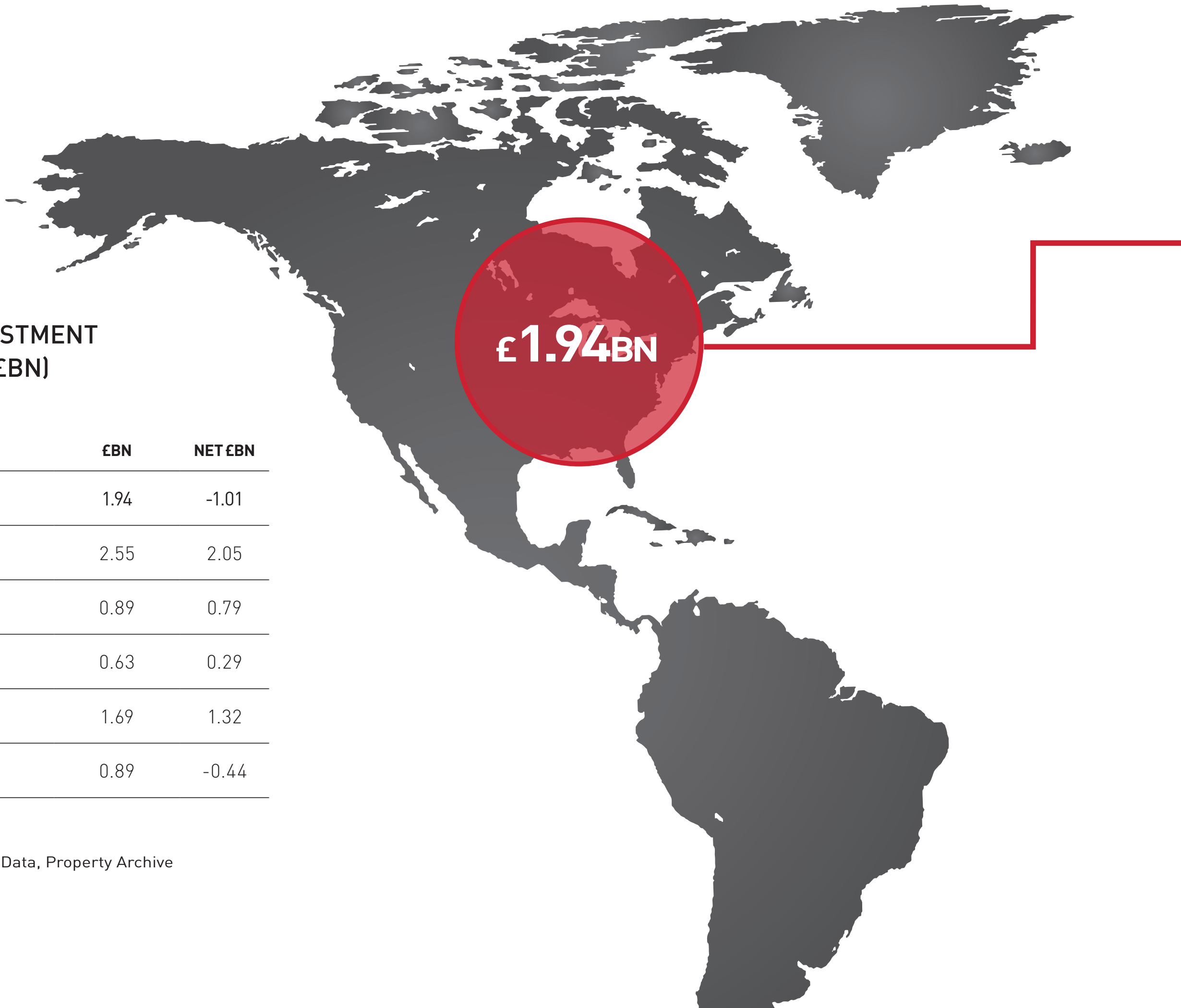
INSTITUTIONS TARGET PRS

Investment from institutions was relatively subdued at £2.6bn, albeit they remained net buyers of UK property to the tune of £402m. Institutional buying was negligible for retail and central London offices, with a clear focus around the specialist sectors, regional offices and industrial.

Indeed, at £697m, institutions' investment in the specialist sectors was the highest on record. This was underpinned by PRS, with the two largest deals being Legal & General's purchases of Macbean, Woolwich (£300m) and West Tower, Manchester (£110m).

SPELTHORNE STRIKES AGAIN

Local authorities continue to invest in commercial property, with 24 councils acquiring £548m worth of assets in Q3. Over half of this comprised Spelthorne Borough Council's £285m (6.14% NIY) purchase of the Western Corridor Portfolio, taking their total investment in commercial property to £890m in two years.

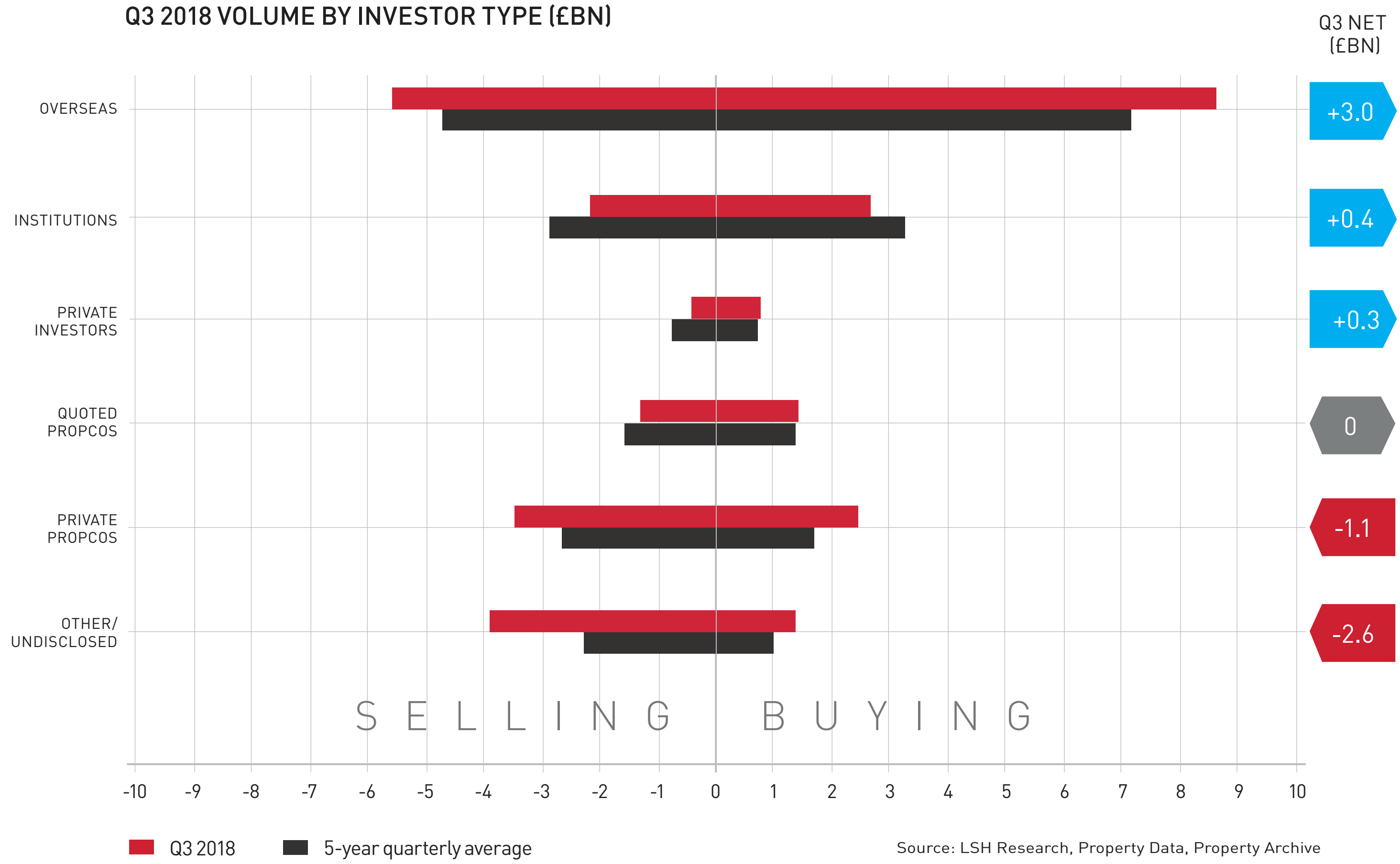


Q3 2018: GLOBAL INVESTMENT FLOWS INTO UK CRE (£BN)

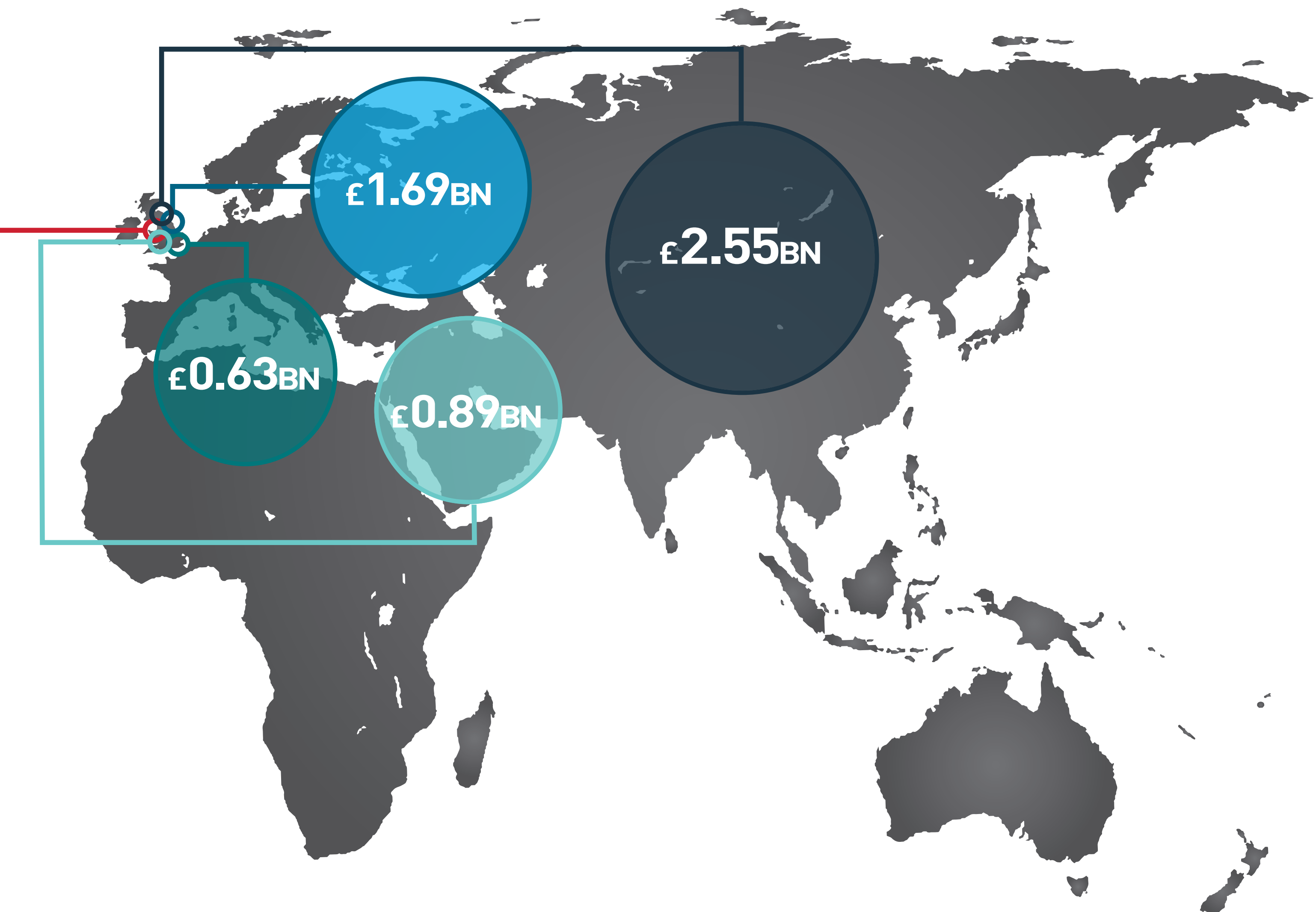
ORIGIN	£BN	NET £BN
NORTH AMERICA	1.94	-1.01
FAR EAST	2.55	2.05
MIDDLE EAST	0.89	0.79
GERMANY	0.63	0.29
REST OF EUROPE	1.69	1.32
OTHER	0.89	-0.44

Source: LSH Research, Property Data, Property Archive

Q3 2018 VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive



OUTLOOK
DEAL OR NO DEAL?

The dial on Brexit may have turned up a notch, yet the fortunes of the UK economy picked up significantly during the summer. Nonetheless, as the negotiations move towards a critical phase, there can be no room for complacency among investors.

SUMMER PICK-UP

The UK economy grew by 0.7% over the three months to August, its strongest outturn in almost two years. Much of this has been credited to the hot summer and the consumer spending stimulus arising from the World Cup. That said, while the monthly GDP figures tend to be volatile, it is notable that growth in August itself was flat, possibly indicating a softening in business and consumer sentiment.

WORKERS REJOICE!

Latest figures reveal a slowing in the rate of UK job creation albeit this has more to do with the tight conditions in the UK labour market than anything more sinister. Unemployment remains rooted at a 43-year low of 4.0%, while the number of UK job vacancies (i.e. unfilled positions) moved to a record high of 832,000 in September, all of which bodes well for occupier demand.

At last, the limited slack in the labour market also appears to be feeding through into wage growth. Average earnings increased by 3.1% over the year to August, its fastest rate in almost 10 years. Moreover, with annual CPI inflation falling from 2.4% to 2.2% in September, consumers are now benefitting from a tangible improvement in real earnings.

BUSINESS SENTIMENT: IMAGE VS REALITY

By and large, anecdotal media coverage of big business views on Brexit has been negative, such as that of car manufacturers and financial institutions. However, the official statistics reveal a more sanguine picture, at least until the mid-point of 2018. While fixed capital formation from businesses slipped by 7% in Q2, it was nonetheless 3% above the five year average, implying ongoing confidence to invest in spite of heightened political uncertainty.

OUTSIDE THE BREXIT BUBBLE

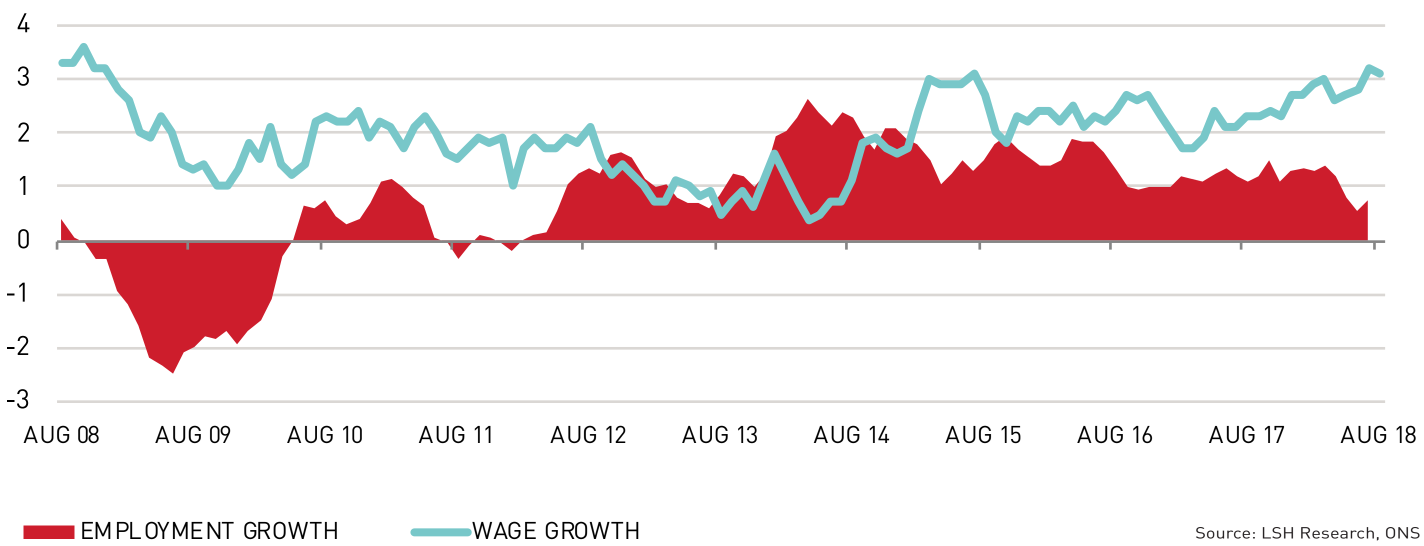
If nothing else, October's global stock market tailspin is a timely reminder that Brexit is not taking place within a vacuum. In the US, strong economic growth and rising bond yields, alongside the growing tit-for-tat trade dispute between the US and China, sparked October's global sell-off, underlining the significance of the US economy in shaping the global economic context. By the same token, the Italian government's bellicose stance with regard to its budget underlines that the EU has other potentially disruptive forces to deal with than just the UK Brexit negotiators.

THINNER ACTIVITY IN EARLY 2019....

Turning to the commercial property market, volume in 2018 as a whole is comfortably on target to reach our initial forecast of circa £60bn, 35% above the ten year annual average. While the signs are promising for Q4, activity in the early part of 2019 may be contingent on the deadlock being broken on the Brexit negotiations. Elevated levels of uncertainty at this critical stage could see would-be sellers temporarily opt for the sidelines.

Taking Brexit and other prevailing factors into account, our latest forecast reveals a levelling off in All Property values in 2019, leaving returns wholly dependent on income in driving performance. However, the impact will be felt asymmetrically; secondary retail assets will take the brunt, while expectations of continuing rental growth should support values in most parts of the office and industrial markets.

UK WAGE GROWTH AND EMPLOYMENT GROWTH (% Y-O-Y)



Source: LSH Research, ONS

A 'NO DEAL' CRASH?

Our forecast for 2019 rests upon an EU exit deal being difficult to reach but ultimately achieved. However, in the unlikely event of a 'no deal' scenario, or if consensus around the deal is lacking, negative investor sentiment could have a more detrimental impact on values, save for prime, long-leased assets, where security of income will remain highly prized.

However, fears of a materially significant correction arising from a 'no-deal' are overblown. Firstly, tighter lending criteria in this cycle means there is limited potential for distress in the current market, the one possible exception being secondary retail, where structural change has already driven an erosion in capital values over the past few years. Secondly, supply levels in the business space markets are generally tight, which should support rental levels even if occupier sentiment is affected.

OVERSEAS BUYERS KEEP THE FAITH

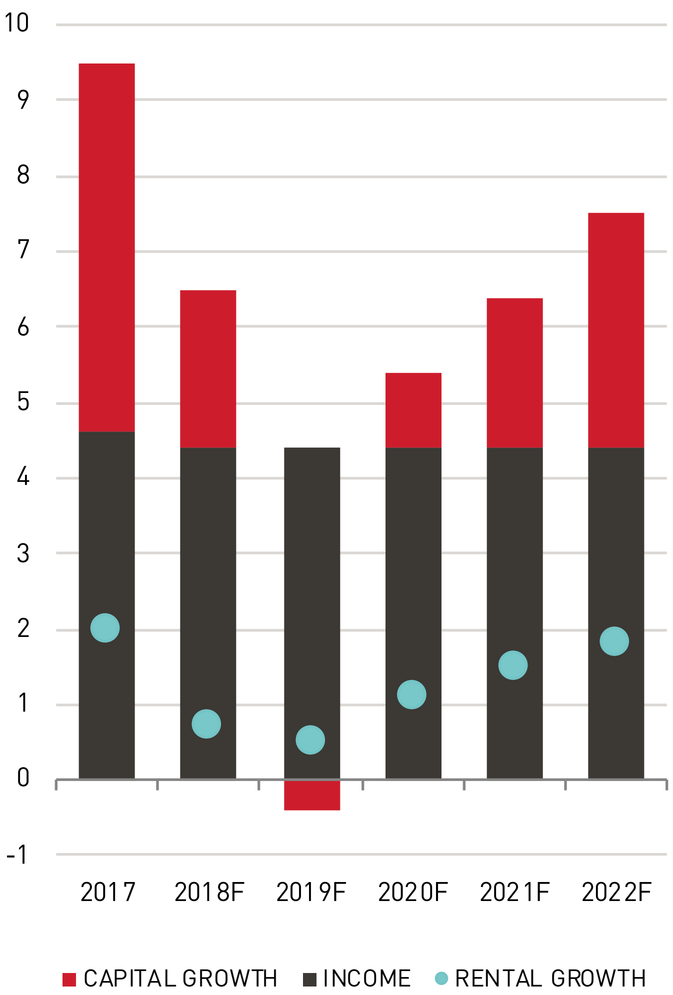
To overseas buyers, Brexit is merely one of a huge number of factors when considering their global capital allocations. Indeed, whatever happens, UK real estate will remain high on the shopping list for overseas capital; Brexit risks will be considered alongside the relative value of the UK market in a global context and its enduring attractions of scale, transparency and typical lease structures.

Moreover, additional sources of overseas capital are expected to enter the fray in 2019. The Far East stands to remain the dominant source of inflows, with South Korean, Chinese and Malaysian capital set to be joined by Japanese pension funds.

OPPORTUNITIES ABOUND FOR THE BRAVE

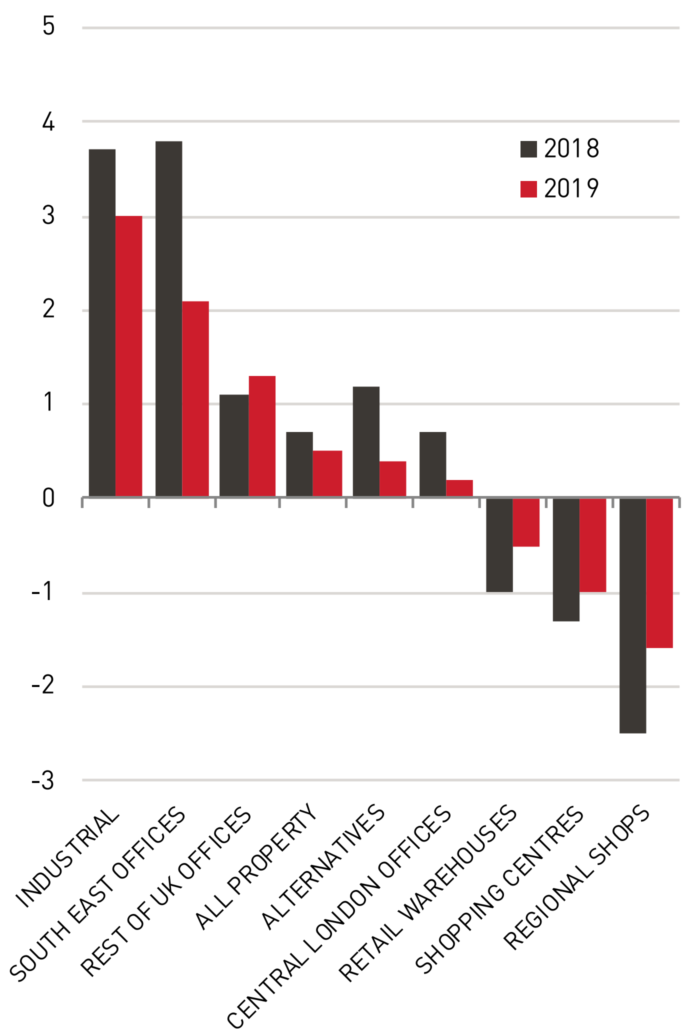
Nautically speaking, the waters may be choppier for the markets on the back of Brexit, but there are currents of structural change sweeping through the occupier markets which are creating real opportunities to add value. Though inherently more risky, change of use or intensification of use angles may well prove to be among the most successful strategies for maximising returns at this late stage in the cycle.

FORECAST COMPONENTS OF ALL PROPERTY TOTAL RETURN (%)



Source: LSH, RealFOR

RENTAL GROWTH FORECASTS (%)



Source: LSH, RealFOR

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