UKIT

UK Investment Transactions Bulletin Q4 2015

Lambert Smith Hampton

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Record year for investment volume

- **2015 was a record year for investment volume,** with £66.3bn of assets changing hands. Following a subdued Q3, Q4 volume was £15.7bn, up 23% quarter-on-quarter.

- **Investment in alternative assets was instrumental to 2015's record.** While volume for the three core sectors was 5% short of its 2006 peak, investment in alternatives was three times the ten-year average.

- **Offices volume highest since 2007.** South East offices had a record year with 2015 volume totalling £3.4bn, while volume for Rest of UK offices was 30% above its annual average.

- **Portfolio deals were a prominent feature of 2015,** accounting for 30% of total volume. This largely comprised alternative assets acquired by North American buyers.

- **Overseas buyers made up a record 50% of total volume in 2015.** While overseas investment in London was down 10% on 2014, investment in regional assets and portfolios was up 29% and 33% respectively.

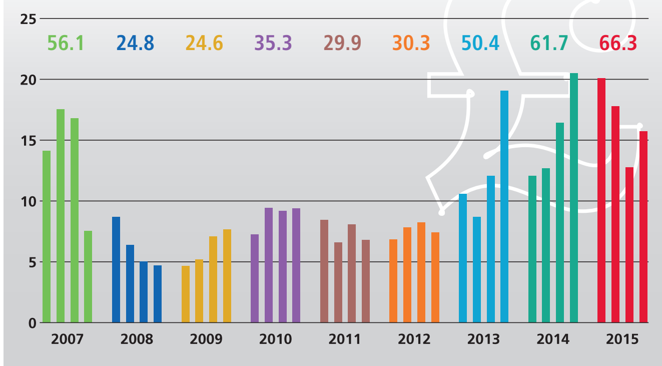
- **UK institutions were marginal net sellers for the second quarter in succession.** Except for industrial assets, institutions were net sellers of all main sectors during the second half of the year.

- **Q4's All Property transaction yield was 5.62%,** edging in by three basis points during the quarter. Offices saw the strongest inward movement to stand at an historic low of 4.60%, driven by Central London offices.

Investment volume (£bn)

Sectors	Q4 15	vs Q3 15	vs Q4 14
Shops	£1.04	33%	-41%
Shopping Centres	£0.62	-39%	-41%
Retail Warehouses	£0.86	-30%	28%
All Retail	**£2.52**	-17%	-28%
Central London Offices	£4.62	25%	-41%
Rest of South East Offices	£1.39	98%	138%
Rest of UK Offices	£0.96	1%	-4%
Office Parks	£0.46	-3%	11%
All Office	**£7.42**	28%	-24%
South East Industrial	£0.31	271%	-38%
Rest of UK Industrial	£0.52	97%	-18%
Distribution Warehouses	£0.41	-55%	-63%
All Industrial	**£1.25**	-3%	-45%
Hotels & Leisure	£2.13	56%	29%
Specialist	£0.40	-10%	-48%
Mixed-use (single assets & portfolios)	£2.01	143%	-21%
All Property	**£15.73**	23%	-23%

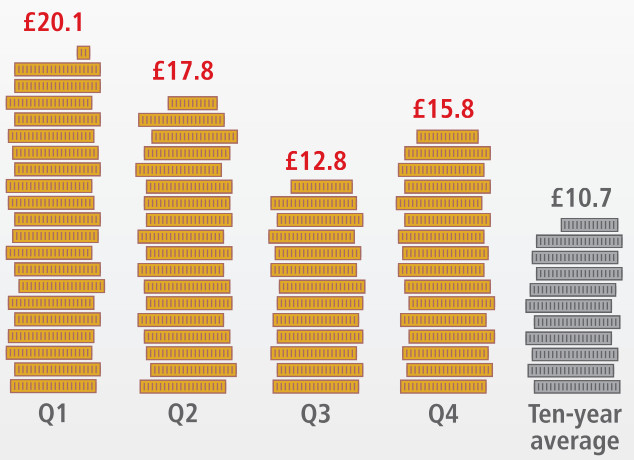
UK Investment market activity (£bn)



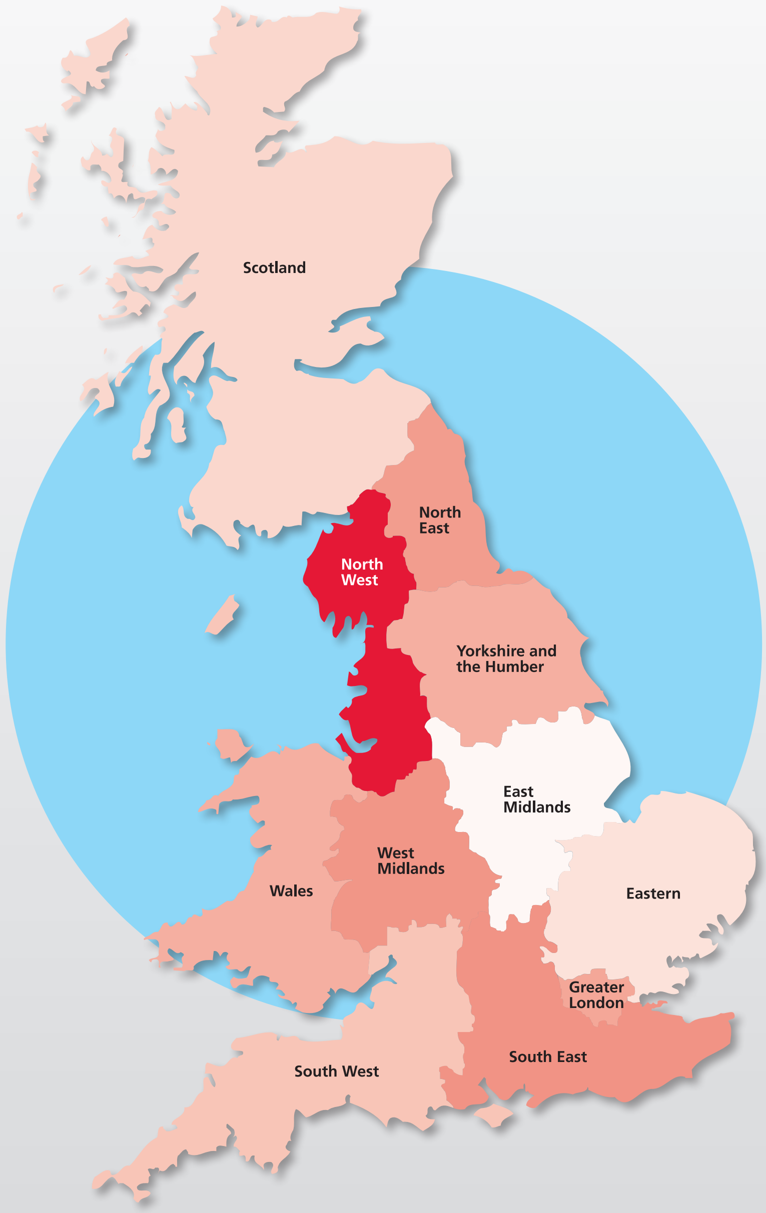
Source: LSH Research, Property Archive, Property Data

2015: A record year reviewed

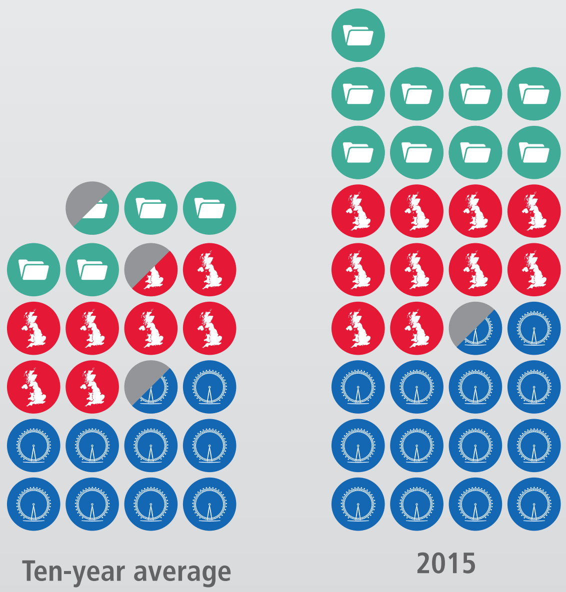
How 2015 unfolded – quarterly volume (£bn)

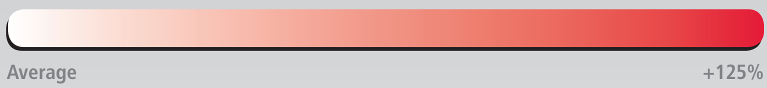


Regional investment vs ten-year average

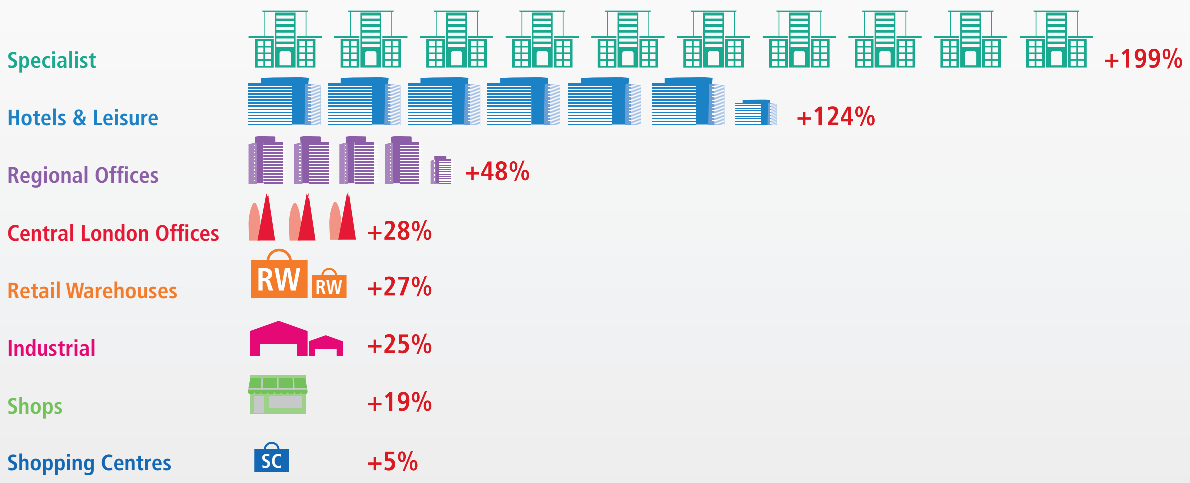


UK breakdown of investment

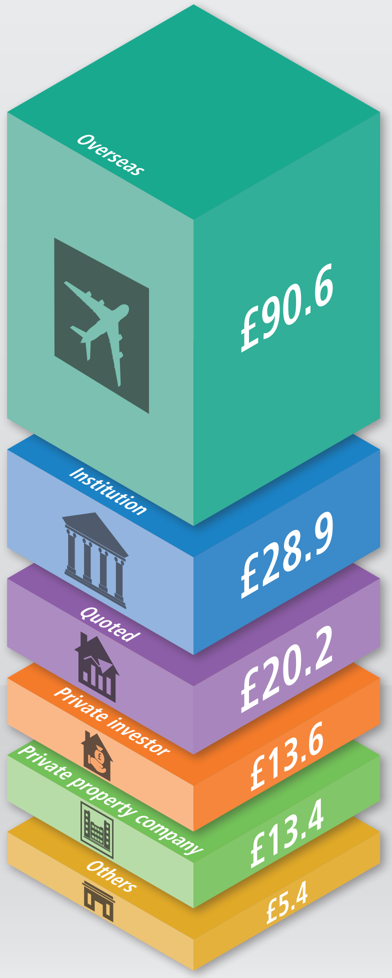




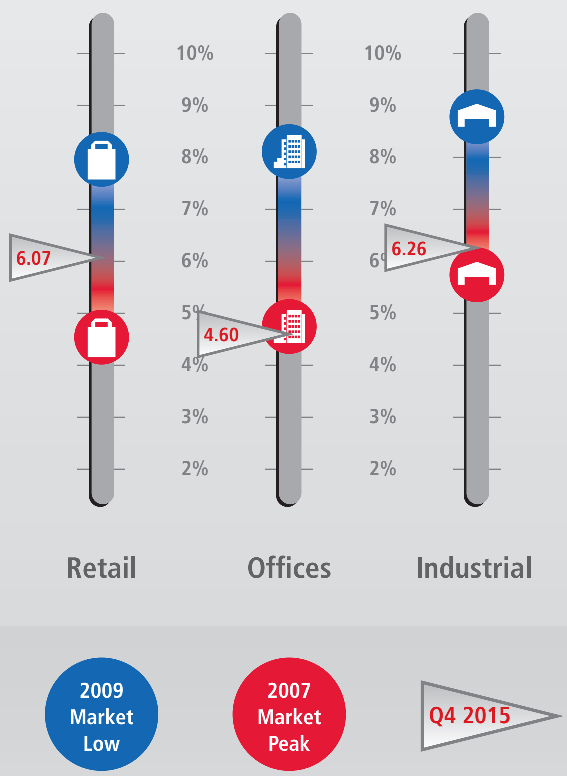
Sector volume vs ten-year average



Average lot-size by investor type (£m)



Average transaction yields



Sector focus

Substantial investment in alternative assets was instrumental to 2015's record volume of £66.3bn. Of 2015's ten largest deals, eight were portfolios comprising alternative assets.

Alternatives drive record year for investment

2015 saw a record £7.5bn of investment in specialist sectors, with student accommodation making up £4.6bn of the total. Notably, the vast majority of specialist volume transacted in the first half of 2015, with the second half of 2015 relatively quiet in comparison.

2015 was also a new annual high for hotel & leisure investment, with record volume of £8.2bn, more than twice the ten-year average. The headline deal in Q4 was Apollo Global Management's £1.0bn purchase of the Holiday Inn/Crowne Plaza portfolio of 22 hotels from LRG Acquisition Ltd.

Offices lead the core sectors

At £26bn, offices was the only core sector to see 2015 volume surpass 2014's level. While investment in Central London offices slipped by 4% year-on-year, South East offices saw record volume of £3.4bn in 2015, almost twice the ten-year average. This was boosted in Q4 by AEW Europe's £325m (5.6% NIY) acquisition of SEGRO's portfolio along Bath Road, Slough.

Distribution warehouses boost industrial volume

Industrial volume of £5.6bn in 2015 was down on the high of 2014 but 25% above the ten-year average. Distribution warehouses accounted for over half of industrial volume, with the year's largest deal comprising Logicor's £358m purchase of Oaktree Capital Management and Anglesea Capital's logistics portfolio in Q2 2015.

Retail warehouses volume highest since 2006

At £12.2bn, investment in retail property was also down on 2014's level. While 2015 was the weakest year for shopping centre volume since 2012, retail warehouses had its best year since 2006, with investment up 14% on 2014. Q4's largest retail deal was AEW Europe's £290m (6.0% NIY) purchase of Festival Place Shopping Centre, Basingstoke from TH Real Estate.

Offices drive marginal All Property yield movement

The All Property average transaction yield was 5.62% in Q4, its lowest level since Q4 2007. However, the rate of downward movement has slowed, edging down by a marginal 3bps during Q4. This was also largely driven by offices, where the average yield fell by 24bps during Q4 to 4.60%, its lowest level on record.

Sentiment indicates that prime yields were broadly stable in Q4 2015. The one notable exception was retail, where prime shop yields hardened by 25bps to stand at 4.00%. More specifically, prime Central London shop yields are the lowest of any sector, at 2.75%, a level entirely driven by strong overseas demand.

Yields

Sector	Transaction yields			Prime yields		
	Q4 2015	3 month movement bps	12 month movement bps	Q4 2015	3 month movement bps	12 month movement bps
Shops	4.79%	-3	-21	4.00%	-25	-50
Shopping Centres	6.87%	53	-6	5.25%*		-25
Retail Warehouses	6.20%	-34		4.25%		-25
All Retail	**6.07%**	5	9	–	–	–
Central London Offices	3.68%	-7	-91	3.25%		-50
Rest of South East Offices	5.84%	-106	-60	5.00%		
Rest of UK Offices	6.09%	-63	-221	4.75%		-50
Office Parks	7.53%	59	48	5.75%		-25
All Office	**4.60%**	-24	-92		–	–
South East Industrial	5.92%	-4	-75	4.75%		-50
Rest of UK Industrial	6.80%	-66	-17	6.00%		-75
Distribution Warehouses	6.52%	43	-8	4.25%		-50
All Industrial	**6.26%**	-9	-46	–	–	–
Hotels & Leisure	5.23%	-135	-114	5.50%		
Specialist	5.92%	56	-17	5.50%**		-75
Mixed-use (single assets & portfolios)	6.16%	156	-246	–	–	–
All Property	**5.62%**	-3	-50	–	–	–

Source: LSH Research, Property Data, Property Archive

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

Regional focus

Although 2015 volume for single assets in the regions was down slightly on 2014, record activity for UK portfolios confirms that investor appetite for regionally located stock remains strong. In addition, the number of transactions for single assets in the regions was 6% higher than in 2014, indicating increasing depth to market activity.

Portfolio deals are a key feature of 2015

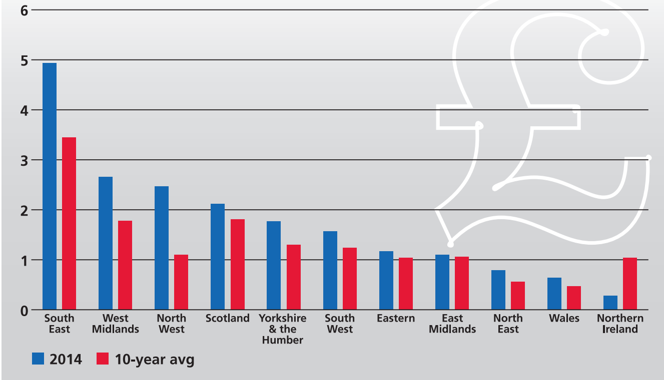
At £19.9bn, portfolio volume in 2015 was by far its highest annual total on record, standing 39% above the previous high of 2014. On average, portfolios account for 20% of annual UK volume, but in 2015 its share of activity soared to 30%, as overseas investors seized on opportunities to acquire substantial UK assets offering relatively attractive income.

Notably, alternative assets accounted for over half of portfolio volume in 2015, accounting for eight of 2015's 10 largest deals. Two of these deals were in excess of £1bn; Apollo Global Management's £1.0bn purchase of the Holiday Inn/Crowne Plaza portfolio and Canada Pension Plan Investment's £1.1bn purchase of the Brandeaux Student Accommodation Fund.

London volume ticks up on 2014

Following a strong Q4, total investment in London reached £26.9bn in 2015, up 4% on 2014 but narrowly short of 2013's record level. Q4's headline deal in the capital was GAW Capital's £500m (5.3% NIY) acquisition of 123-151 Buckingham Palace Road, SW1, let to Google, from Divco West. This was the largest deal in the West End in over two years.

Volume by region, excluding London (£bn)



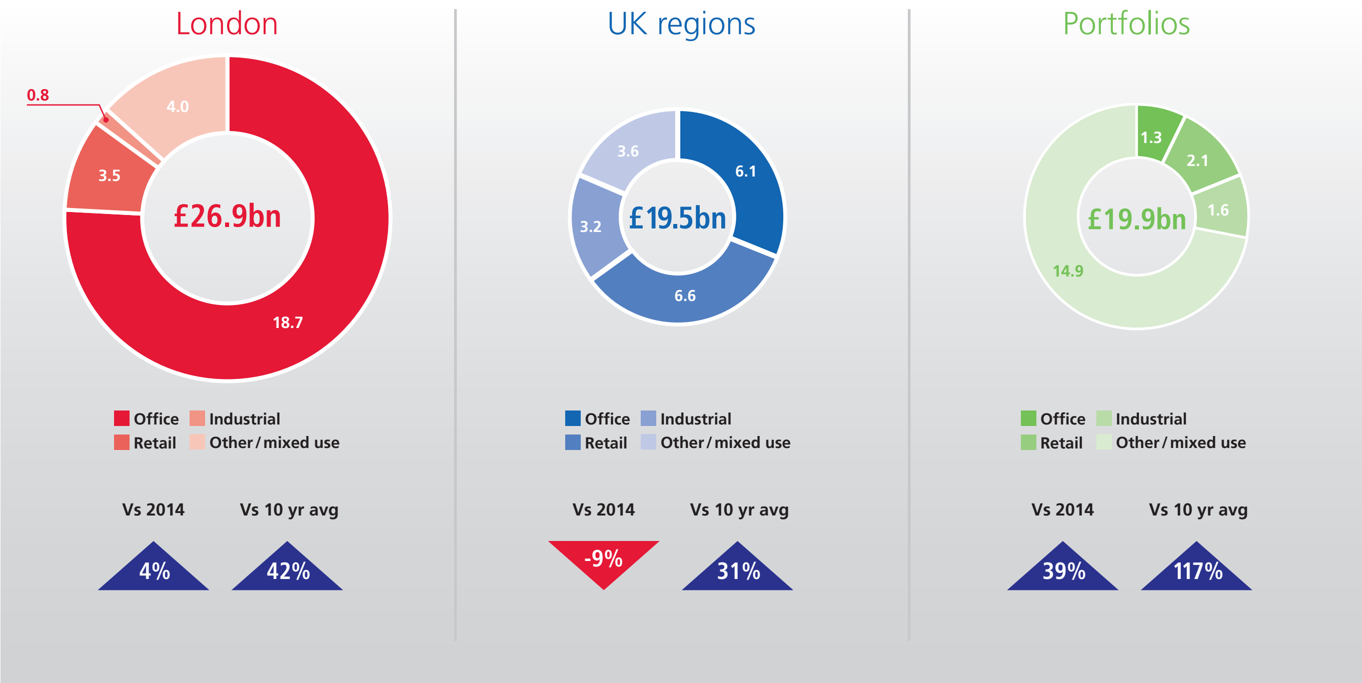
Source: LSH Research

North West sees strongest volume relative to trend

Outside London, the South East continues to attract the largest volume of investment into the UK regions. At £4.9bn, the region accounted a quarter of all regional investment in 2015 and was 43% above the ten-year average.

Relative to trend, the North West had the strongest year of any region, with 2015 volume of £2.5bn, more than twice the ten-year average. Although Manchester accounted for much of this, Liverpool was home to Q4's largest deal in the region, namely Tritax Big Box's purchase of Matalan's distribution centre for £42m (6.3% NIY).

2015 London and regional breakdown (£bn)



Source: LSH Research, Property Archive, Property Data

Buyers and sellers

Overseas activity in the UK increased again in 2015, rising 12% year-on-year. Notably, while overseas investment in London property was down 10% on 2014, volume into single regional assets and portfolios was up 29% and 33% respectively.

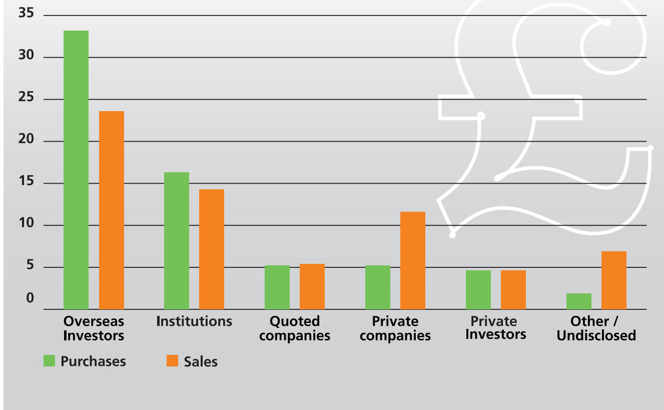
Overseas buyers make up a record 50% of total volume

For the eleventh year running, overseas buyers have been the leading investor by volume in UK commercial property, accounting for a record 50% share of volume in 2015. Of the £33.2bn of overseas investment in 2015, almost half was in London. However, overseas investment in London was down 10% year-on-year, but increased by 29% for single assets in the UK regions, suggesting increasing confidence to look beyond the capital.

North America was the dominant overseas buyer in 2015, accounting for 46% of overseas volume and eight of the ten largest deals of the year. The majority of North American investment was tied up in portfolios, predominantly of alternative assets.

The ongoing strength of appetite among overseas investors for UK property is gradually changing the make-up of the UK property market. According to IPF, overseas investors now hold over a quarter of total UK commercial property by value, rising from 14% in 2002.

2015: Purchases & sales by type of investor (£bn)



Source: LSH Research, Property Archive, Property Data

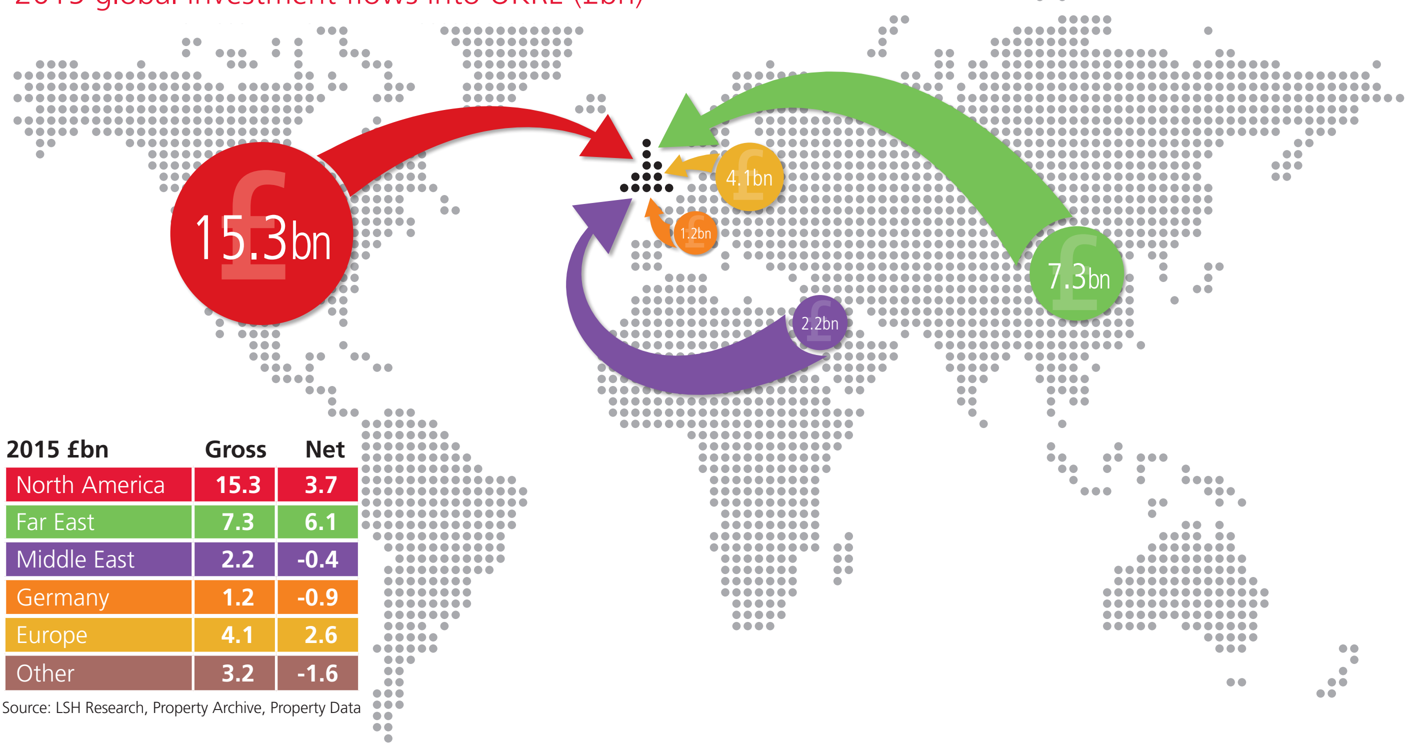
Institutions were net sellers in the second half 2015

After overseas investors, UK institutions were the second largest net buyer of UK property in 2015. However, institutions were net sellers in each of the last two quarters and were net sellers in all sectors bar industrial in the second half of the year.

Standard Life was the largest institutional buyer in the final quarter, purchasing nine assets totalling £463.3m. However, Legal & General was the largest institutional buyer in 2015 as a whole, with purchases totalling £3.3bn (and net buying of £1.8bn).

Private property companies were the largest net seller in 2015, amounting to £6.5bn of divestment. They appear to be cashing in on institutional and overseas demand for alternative sectors, having sold £2.4bn worth of these assets in 2015 while purchasing only £0.5bn.

2015 global investment flows into UKRE (£bn)



2015 £bn	Gross	Net
North America	15.3	3.7
Far East	7.3	6.1
Middle East	2.2	-0.4
Germany	1.2	-0.9
Europe	4.1	2.6
Other	3.2	-1.6

Source: LSH Research, Property Archive, Property Data

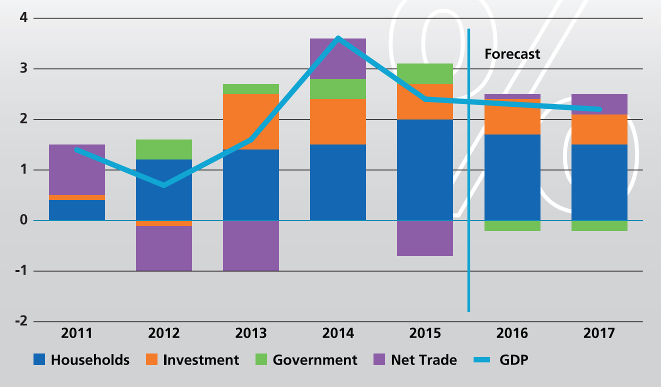
Economic outlook

Despite increasing concerns over the outlook for the global economy, the UK is relatively well placed to deliver trend level growth in 2016, with consumption and business investment providing the main drivers to expansion.

Trend level growth in 2016

UK economic growth is expected to be 2.4% in 2015, moderating from the 2.8% expansion seen in 2014. Although growth has softened year-on-year, the UK outperformed all the world's advanced economies except for the US and Spain in 2015. Continuing low interest rates and inflation, alongside rising employment are expected to support growth of 2.5% in 2016, which is closely in line with the historic trend.

Contributions to UK GDP growth (%)

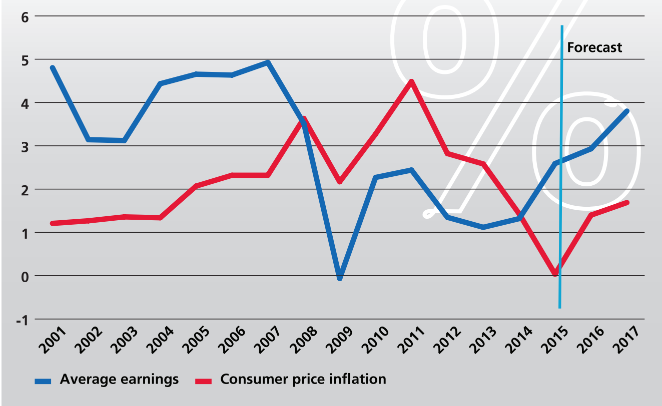


Source: Experian

But growth remains unbalanced

The unbalanced nature of the UK's economic trajectory persists, with consumption again set to provide the main driver of growth in 2016. The UK's dominant services sector continues to forge ahead, while UK manufacturing is currently in recession with output standing 5% below its 2008 pre-crisis peak. Furthermore, weakening growth prospects in the world's emerging markets will not help to reverse this pattern.

Wages vs inflation (%)



Source: Experian

UK consumption boosted by global factors

Recent momentum in the UK economy has partly resulted from global economic trends. A slowdown in China, the world's second largest economy, has prompted significant falls in commodity prices, with increasing supply forcing oil prices to a 12-year low. Despite negative implications for the UK's North Sea oil and steel industry, low prices have maintained UK inflation at low levels, with rising real incomes supporting robust domestic consumer spending.

Interest rates to rise as late as 2017?

However, recent volatility in the stock markets indicates that sentiment around the global economic outlook has turned increasingly negative. In view of these risks, and with inflation expected to remain below the Treasury's 2% target during 2016, the Bank of England is minded to keep interest rates unchanged in the short term.

Indeed, the financial markets are now expecting interest rate rises to come in late 2017. However, many commentators believe there remains a realistic chance of a first hike before the end of 2016, particularly if sentiment around the global economy improves.

A dose of political uncertainty in 2016

One risk to the UK's economic outlook is political in nature, with a referendum over the UK's membership of the EU expected to take place this summer. If opinion polls in the run-up to the vote suggest there may be a chance of an 'out vote', uncertainty may delay decision making among businesses, investors and consumers, potentially impacting growth.

Property market outlook

While the economic outlook is more uncertain compared with last year, the market fundamentals are broadly supportive for property in 2016. Below is our assessment of the main risks, together with our predictions for the year ahead.

The market can accommodate rising interest rates

In light of the weakening global outlook, the Federal Reserve's recent move to tighten monetary policy has fuelled the debate as to if and when the Bank of England will follow suit. However, regardless of the timing, commercial property should take this in its stride, provided that rate hikes are undertaken gradually, as is assured by the Monetary Policy Committee.

Property remains an attractive asset class

In today's equity driven investment market, arguably of more relevance than interest rates is the spread between average property yields and government bonds, which currently stands at a substantial three percentage points. Despite two years of yield compression, there is reasonable scope for gilt yields to rise without adversely impacting property yields.

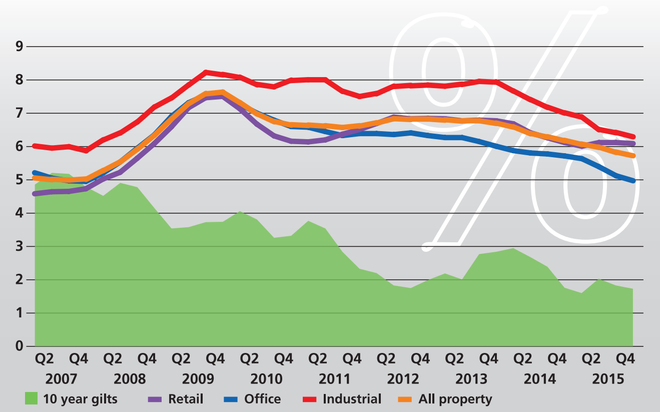
2016 promises to be another good year for commercial property. However, the market is reverting back to investment fundamentals, with capital growth giving way to an increasing focus on maximising income to drive performance. Here are our core predictions for 2016.

Property returns to moderate in 2016

2015 was a very strong year for performance, with continuing inward yield movement supporting All Property returns of circa 13% (IPD Quarterly Index). We forecast returns to moderate to circa 9% in 2016, with capital growth contributing 4%. While this is down on 2015, this is healthy against both its historic trend and those of competing assets.

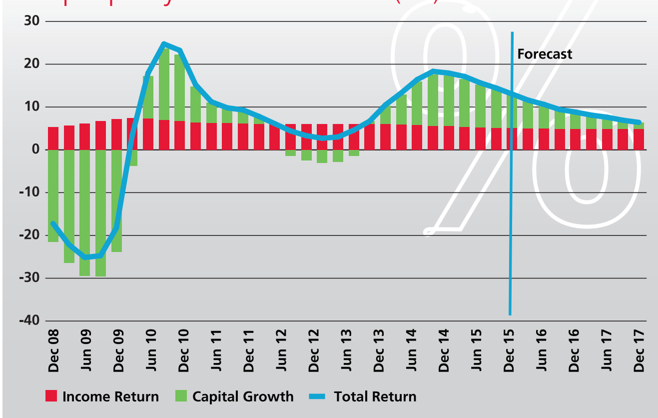
Our forecast reflects a tailing off of yield compression, which in 2016 is likely to be largely confined to selected sectors and markets where there remains perception of value. Crucially, rental growth, which is now firmly back on the agenda across much of the UK, will be key to driving performance moving forward.

Rolling annual transactional yields (%)



Source: LSH Research, Experian

All property annual returns (%)



Source: IPD, LSH Research

Global concerns will maintain strong overseas demand

While the UK economy and property market will not be immune to a possible escalation of a global economic slowdown, recent volatility in the stock markets is likely to fuel already strong overseas demand for UK property. That said, the UK's reputation as a 'safe haven' for international capital may be seriously put to the test if the UK electorate votes to end its membership of the EU in the referendum.

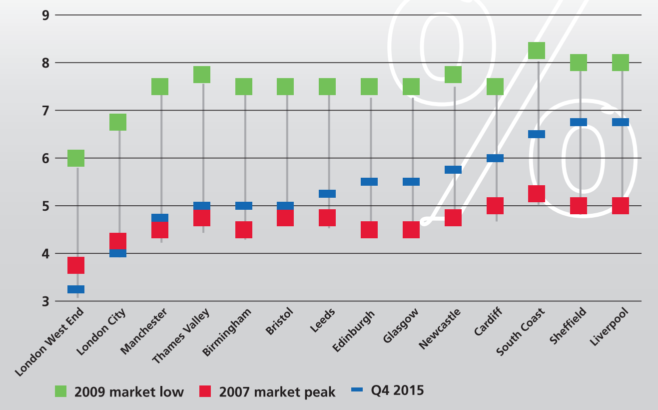
2016 volume won't surpass 2015's record

A substantial weight of capital from both institutions and overseas investors suggests 2016 activity will be significantly above the 10-year average. However, with arguably less value in the market now compared with a year ago, and a real prospect that sentiment could be affected by the referendum, 2015 is likely to prove the high watermark for volumes in the current cycle.

Further movement into regional offices

With the London markets looking increasingly expensive, we expect institutional investors to move further into the UK regions in search of yield. A notable pricing differential has opened up between the key regional offices markets themselves, with Northern Powerhouse centres such as Sheffield and Liverpool looking increasingly good value in relative terms.

Prime office yields (%)



Source: LSH Research

Growth in asset management plays

The emergence of meaningful rental growth across various markets and sectors will tempt more investors to reposition assets through active management. In the office markets, a combination of robust occupier demand and further relaxation of Permitted Development for conversion to residential, will continue to put pressure on supply across all grades, making refurbishment and redevelopment opportunities increasingly attractive in selected markets.

More scope for logistics development

Speculative development in the logistics sector soared in 2015, with 9m sq ft currently under construction across the UK. Despite this, the steady growth of ecommerce means the sector remains structurally undersupplied with modern logistics space. We see scope for more development to come forward in 2016, albeit increasingly at 'off-prime' locations where site values remain attractive and occupiers can locate more affordably.

Build to Rent finally makes its mark

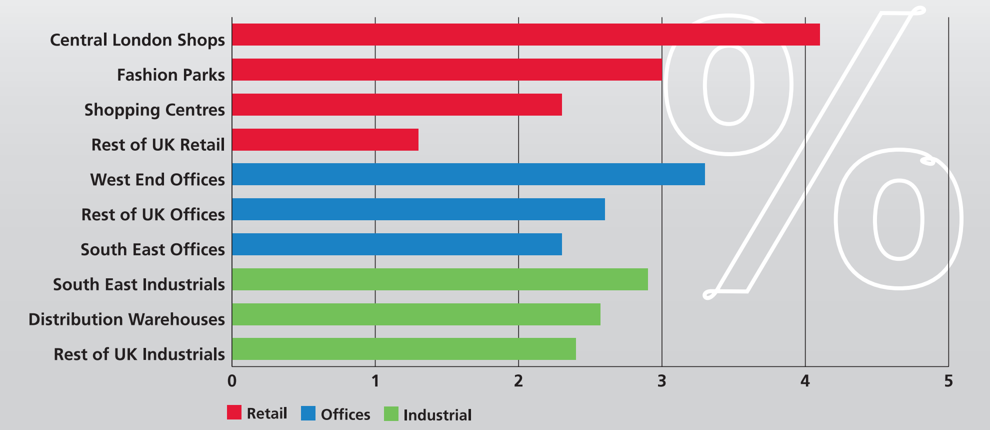
Despite compelling fundamentals around the private rented sector, investment in Build to Rent is yet to genuinely materialise. However, we expect its emphatic arrival in 2016, with UK institutions and experienced overseas players now seeking out opportunities with significant capital ready to deploy. This is supported by a recent survey of our investor clients, which revealed that Build to Rent is regarded as the most attractive alternative property sector for investment in 2016.

Retail – focus on convenience or experience

With 14% of UK retail sales now undertaken online and increasing every year, growth prospects are relatively bleak for retail on many of the UK's tertiary high streets. But structural change brings real opportunities. Crucially, retail property which can accommodate rising demand for convenience - or provide an experience for consumers - has the best prospects.

Retail parks are currently seeing steady growth in footfall, reflecting advantages of free parking, good accessibility and convenience for click and collect. Planning constraints on developing out of town retail will support rental values and encourage investment in this sector. Meanwhile, the opportunity for shopping centre landlords is to provide consumers with an experience to increase dwell times and ultimately spending in-store. Provided the demographics are suitable, this can be achieved through setting aside more space for catering and leisure uses within the scheme.

Rental growth forecasts 2016-2019 (% p.a.)



Source: Real Estate Forecasting, LSH Research

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.

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Due to space constraints within the report, it has not been possible to include both imperial and metric measurements.

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