Lambert Smith Hampton

FLIGHT TO QUALITY

UKITQ218

UK INVESTMENT TRANSACTIONS BULLETIN

Q2 VOLUME: £13.5BN

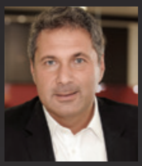
NO. OF DEALS +13% ON AVG

AVG YIELD AT DECADE LOW 5.45%

INSTITUTIONS LARGEST NET BUYERS

SPECIALIST SECTOR VOLUME +22% ON AVG

FAR EAST DOMINATES OVERSEAS BUYING



Ezra Nahome
CEO

Q2's respectable volume underlined the continuing strong appetite we are seeing for UK real estate, although the sharp fall in the average transaction yield points to a clear focus of demand towards quality assets.

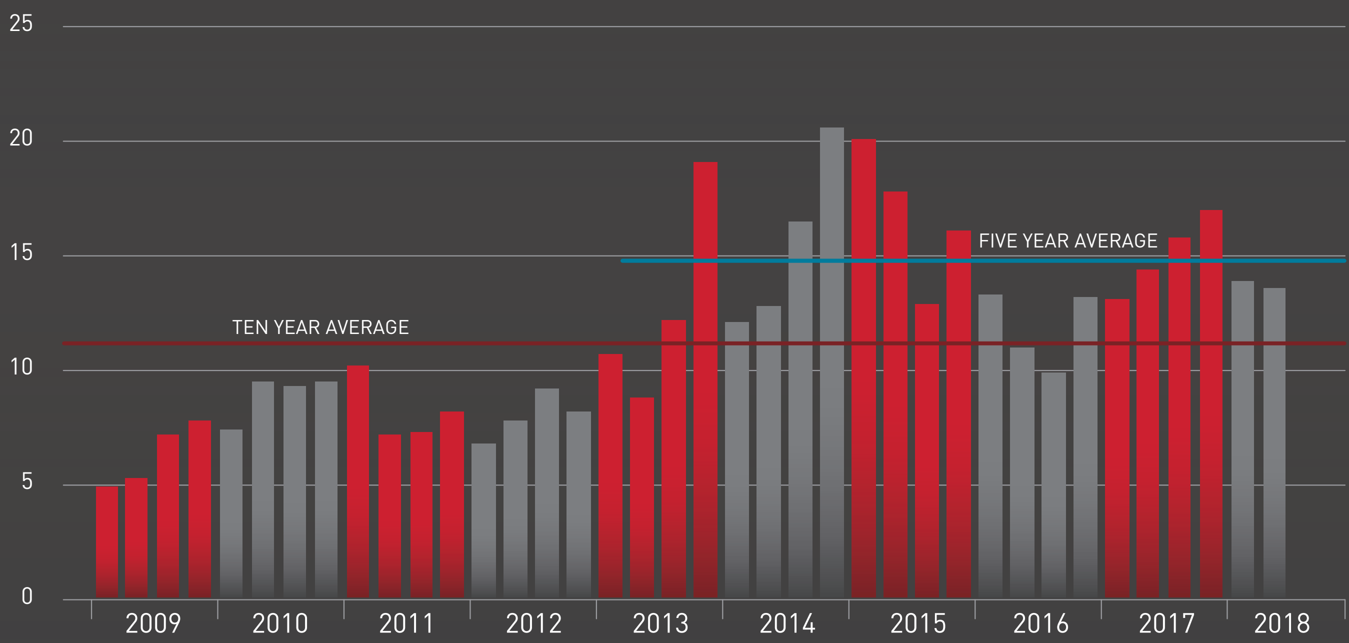
Security of income is evidently paramount in today's market. The tidal wave of capital flowing into the alternative sectors is testimony to this, with such assets typically benefitting from longer lease structures and a degree of insulation from the vagaries of economic risk.

But the flight to quality has been most of all clear to see in the retail sector, with the average transaction yield for high street assets dipping to an all time low. With structural changes in consumption leaving the UK significantly over-shopped, it's hardly surprising that activity has become so risk averse.

That said, we should be careful not to throw the baby out with the bathwater. Although it's true that the retail landscape is consolidating, it's also evolving rapidly, a fact which is sure to generate exciting opportunities for the shrewd investor.

Although the dial on Brexit uncertainty has been turned up in recent weeks, I am confident that the resilience of the UK market will not diminish in the second half of 2018. Arguably, the deepening issue around global trade with the US is no less a factor in the market, and may even sharpen the focus of overseas buyers towards the UK.

UK INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive

SECTOR FOCUS

YIELDS HIT DECADE LOW

Amid another busy quarter in Q2, an investor focus on quality assets saw the average All Property transaction yield dip to its lowest level in over ten years.

ANOTHER BUSY QUARTER

£13.5bn worth of assets changed hands during Q2, closely in line with Q1's volume albeit 8% down on the five-year quarterly average. Although volume was below par, there remains considerable depth to the market, with the number of deals in Q2 comparable with Q1 and 13% above average.

CENTRAL LONDON OFFICES RETURN TO FORM

Investment in Central London offices rebounded in Q2 following relatively subdued volume in the previous three quarters. At £4.3bn, volume was its strongest since Q2 2017 and underpinned by the UK's largest deal of 2018 to date, namely CK Asset Holdings' £1.0bn (3.95% NIY) acquisition of 5 Broadgate, EC2 from British Land and GIC.

The above deal somewhat flattered UK-wide office volume in Q2, which stood at £6.1bn and almost exactly in line with the quarterly average. Regional office volume was notably below, albeit this was due entirely to an absence of major transactions, with the number of deals 20% above the five-year quarterly average.

Meanwhile, investment in South East offices remained strong, with volume surpassing £500m for a fourth successive quarter in Q2. This included DWS's £240m acquisition of S9 in Stratford's International Quarter, London from Lendlease and LCR.

PRS DRIVES ALTERNATIVES

Collectively, the specialist sectors recorded the strongest volume relative to trend. At £2.0bn, Q2 volume was 22% above its five-year quarterly average and featured an abundance of PRS deals, including USS and PfP Capital's £150m JV acquisition of the PRS portfolio from Places for People.

Elsewhere, at £1.3bn, hotels & leisure volume was below average for the first time in five quarters. This was despite one major deal in Q2, namely Foncière des Régions' £858m purchase of the Starwood's hotel portfolio, comprising 12 Principal hotels and two De Vere hotels.

REGIONS ATTRACT INDUSTRIAL DEMAND

Strong appetite for industrial and logistics assets was sustained into Q2 despite strong upward movements in prices over the past two years. While Q2's industrial volume of £1.8bn was in fact the lowest in five quarters, it was still strong by historic standards.

As with Q1, Rest of UK industrials was again the most active subsector relative to trend, with volume of £636m standing 28% above its quarterly average. This included a flurry of portfolios, the largest of which was Westbrook Partners' £162m (6.75% NIY) acquisition of the Sterling portfolio from Mansford LLP.

Q2 2018 INVESTMENT VOLUME (£BN)

VOLUME VS 5YR QTY AVG

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

SECTOR	Q2 2018	Q1 2018	Q4 2017	Q3 2017	VS Q1 2018 (%)
Shops	**£1.07**	£0.71	£1.51	£0.81	52%
Shopping Centres	**£0.22**	£0.39	£0.39	£0.47	-43%
Retail Warehouse	**£0.58**	£0.37	£0.89	£0.58	56%
ALL RETAIL	**£1.87**	£1.47	£2.80	£1.85	28%
Central London Offices	**£4.29**	£3.26	£3.69	£2.92	32%
Rest of South East Offices	**£0.75**	£0.85	£0.77	£0.87	-11%
Rest of UK Offices	**£0.71**	£1.02	£1.51	£0.97	-30%
Office Parks	**£0.34**	£0.35	£0.42	£1.86	-0%
ALL OFFICE	**£6.10**	£5.49	£6.39	£6.62	11%
South East Industrial	**£0.31**	£0.44	£0.42	£0.45	-31%
Rest of UK Industrial	**£0.64**	£0.90	£0.53	£1.05	-29%
Distribution Warehouse	**£0.88**	£0.60	£1.01	£0.43	45%
ALL INDUSTRIAL	**£1.82**	£1.95	£1.97	£1.92	-7%
Hotels & Leisure	**£1.33**	£1.63	£1.54	£1.79	-19%
Specialist	**£2.02**	£2.35	£3.37	£2.47	-14%
Mixed-use (single assets & portfolios)	**£0.37**	£0.88	£0.84	£1.11	-58%
ALL PROPERTY	**£13.50**	£13.77	£16.90	£15.77	-2%

Source: LSH Research, Property Data, Property Archive

Q2 2018 YIELDS

SECTOR	TRANSACTION YIELDS: Q2 2018	TRANSACTION YIELDS: 3 MONTH MOVEMENT (BPS)	TRANSACTION YIELDS: 12 MONTH MOVEMENT (BPS)	PRIME YIELDS: Q2 2018	PRIME YIELDS: 3 MONTH MOVEMENT (BPS)	PRIME YIELDS: 12 MONTH MOVEMENT (BPS)	YIELD SENTIMENT
Shops	4.14%	-71	-34	4.00%			
Shopping Centres	6.93%	17	-41	6.00%*		25	
Retail Warehouse	5.76%	-67	-73	4.75%	25		
ALL RETAIL	5.74%	-37	-51				-
Central London Offices	4.31%	9	-3	3.50%			
Rest of South East Offices	5.55%	-106	-71	5.00%			
Rest of UK Offices	6.40%	28	-72	4.75%		-25	
Office Parks	7.25%	78	49	5.25%			
ALL OFFICE	5.04%	-3	-18				-
South East Industrial	4.30%	-88	-18	3.75%		-25	
Rest of UK Industrial	6.77%	10	-59	4.75%		-50	
Distribution Warehouse	5.17%	-56	-52	3.75%		-50	
ALL INDUSTRIAL	5.00%	-61	-41				-
Hotels & Leisure	8.85%	308	416	5.00%	25		
Specialist	5.27%	-53	-35	4.75%**	-25	-50	
Mixed-use (single assets & portfolios)	5.04%	-9	-159	-	-	-	-
ALL PROPERTY	5.45%	-22	-20	-	-	-	-

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

Source: LSH Research, Property Data, Property Archive

PRIME CENTRAL LONDON BOOSTS RETAIL VOLUME

Retail investment remains subdued amid profound challenges in the occupier markets. While Q2 investment of £1.9bn rebounded by 28% from Q1's six year low point, it was 31% below the five-year quarterly average.

The pick-up owed much to two major trophy asset deals in Central London, namely Motcomb Estates' £297.5m (3.20% NIY) purchase of Burlington Arcade and a Singaporean investor's £180m (3.00% NIY) acquisition of 135-137 New Bond Street from Oxford Properties and Richemont.

Elsewhere in the retail sector, the strong aversion to UK shopping centres was once again clearly reflected in volume. Only £120m of shopping centre assets changed hands in Q2, one of the lowest quarterly totals on record and 74% below the quarterly average.

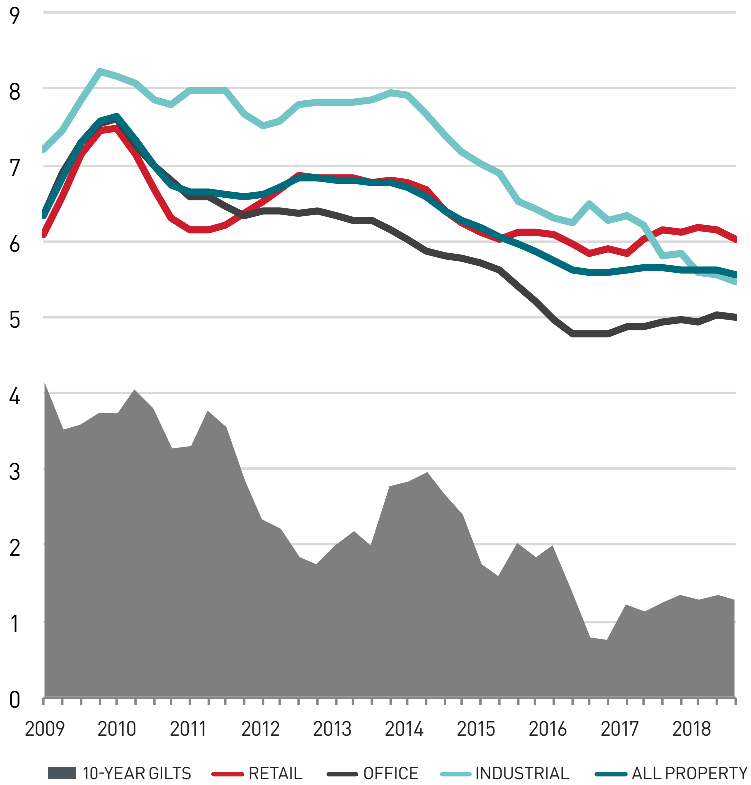
AVERAGE YIELDS DRIVEN TO DECADE LOW

Indicative of a flight to quality, the All Property average transaction yield moved down by 22 basis points during Q2 to stand at 5.45%, its lowest level since Q4 2007. The movement was also the sharpest quarter-on-quarter shift in average prices for four years.

A number of sectors saw average transaction yields dip to all time record lows, albeit due to entirely different reasons. With the clamour for industrials showing no sign of abating, average yields for South East industrials dipped to 4.30% on the back of high demand and strong rental growth expectations.

In contrast, the average transaction yield for shops reached a new of low 4.14% in Q2. This movement better reflects a flight to quality and the focus of volume in Central London, with investors keeping a wide berth from occupational risks throughout the sector.

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



Source: LSH Research, Experian

REGIONAL FOCUS

THE CAPITAL GAINS

Volume in London gained significantly on the back of a single major deal in Q2, while the opposite was arguably true of the regional markets, where major lot sizes were few and far between.

LONDON REBOUNDS ON QUIET Q1

Greater London saw volume of £6.5bn in Q2, up 22% on Q1 and ahead of the quarterly average for the first time since Q2 2017. However, the rebound owed much to CK Asset Holdings' £1.0bn (3.95%) acquisition of 5 Broadgate, EC2, alongside two trophy purchases of Central London retail assets.

The recent ebb and flow of Greater London volume has been largely dictated by the occurrence - or otherwise - of major headline deals. Over the past few quarters, the number of deals taking place in the capital has actually been broadly consistent, ranging between 135 and 145.

MIXED PICTURE IN THE REGIONS

Beyond London, the rest of the UK collectively saw £4.4bn worth of single asset deals in Q2, the lowest since Q1 2017 and 11% below the five-year quarterly average. However, the number of deals in Q2 was in fact 18% above average, with only three deals over £100m at the root of the shortfall.

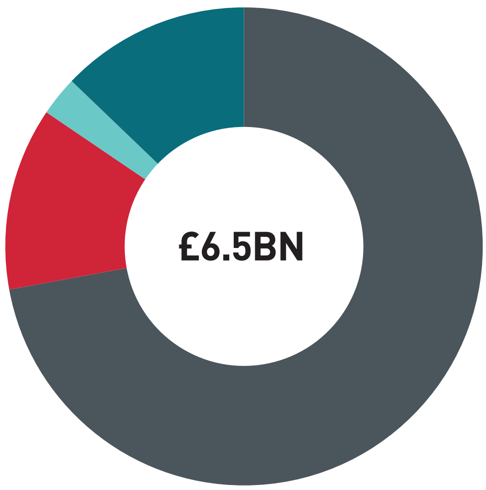
Unsurprisingly, retail was the main drag on regional volume in Q2, amounting to only £1.0bn and among the lowest on record. That said, the largest regional deal in Q2 was a retail asset, M&G's £167m purchase of Fort Kinnaird Retail Park from The Crown Estate.

It was a very mixed picture between the regions in Q2. At £262m, the North East recorded its highest volume since Q3 2013 while volume of £523m in Yorkshire & The Humber was the highest since Q3 2015. Conversely, investment in Wales was down 74% on its average, while in the South East it was down 28%.

BUSY QUARTER FOR INDUSTRIAL PORTFOLIOS

At £2.6bn, investment into UK portfolios was relatively subdued in Q2, down 22% on the five-year quarterly average but broadly in line with Q1's level.

However, Q2 was another very active quarter for industrial portfolios, with £723m transacting across 17 deals up 40% on the five-year quarterly average. Meanwhile, for a second successive quarter, there was a virtual absence of portfolio deals in the office and retail sectors.



Q2 2018 LONDON AND REGIONAL BREAKDOWN (£BN)

OFFICE

RETAIL

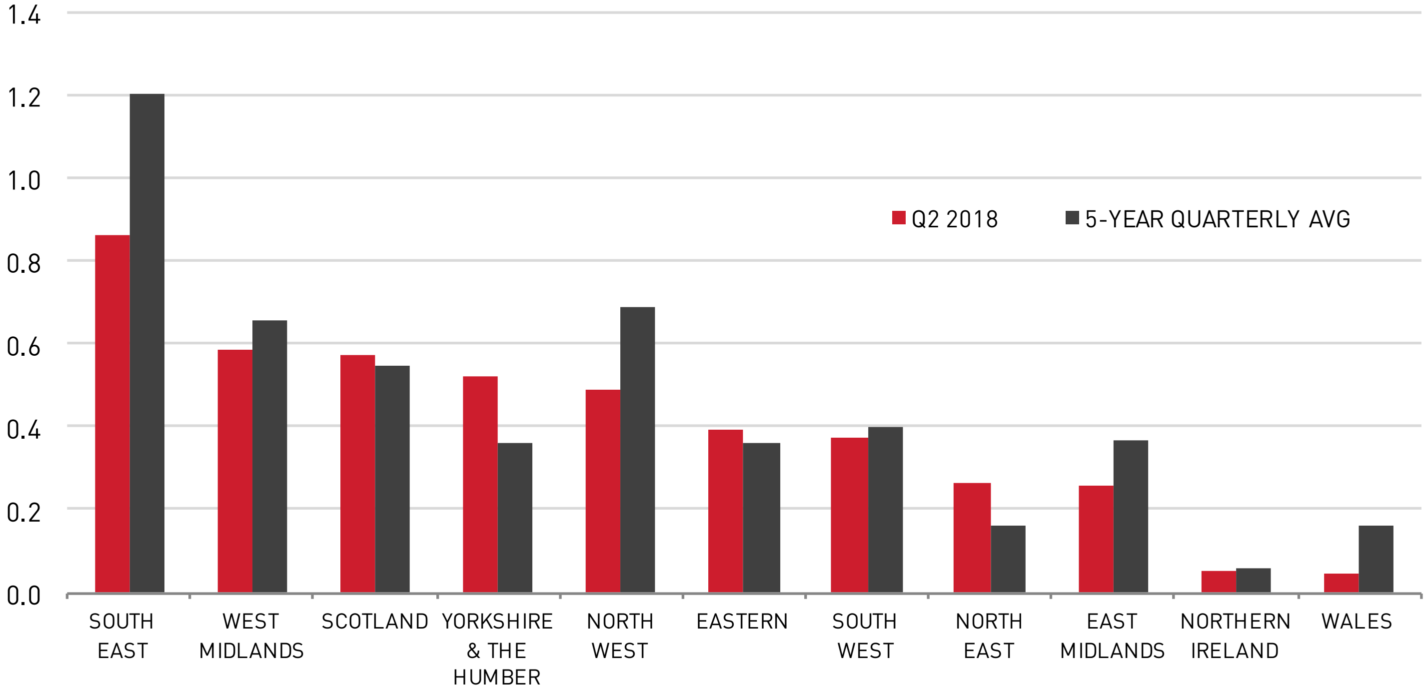
INDUSTRIAL

OTHER/MIXED USE

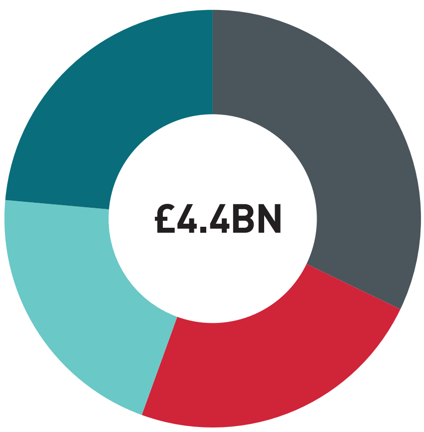
GREATER LONDON

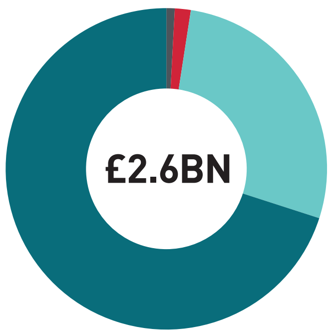
VS Q1 2018	22%
VS Q2 2017	-11%
VS 5-YEAR QTY AVG	2%

Q2 REGIONAL INVESTMENT VOLUME (£BN)



Source: LSH Research, Property Data, Property Archive





UK REGIONS	PORTFOLIOS
-25%	0%
-7%	13%
-11%	-22%

Source: LSH Research, Property Data, Property Archive

BUYERS & SELLERS

FAR EASTERN PROMISE

Q2 heralded the emphatic return of institutional buying, while overseas activity was dominated by Far Eastern buyers and heavily focused on the capital.

INSTITUTIONS BACK IN FORCE

Having been net sellers in Q1, UK institutions were the largest net buyers of UK real estate in Q2, a feat last seen in Q2 2014. This partly reflected limited disposals amounting to £1.5bn worth of assets, with only one sale of over £100m compared with an average of six per quarter.

Industrial was a clear focus for institutional capital, accounting for 40% of their purchases in Q2. Institutions acquired £767m of industrial assets in the quarter, the strongest investment into the sector since Q4 2014 and the fourth highest on record.

M&G was by far the most acquisitive institutional buyer in Q2, purchasing almost £1bn worth of assets. This included the £265m (3.94% NIY) forward funding of 17 Charterhouse Street, EC1, along with Selly Oak Retail Park (£94m) and Fort Kinnaird Retail Park (£167m).

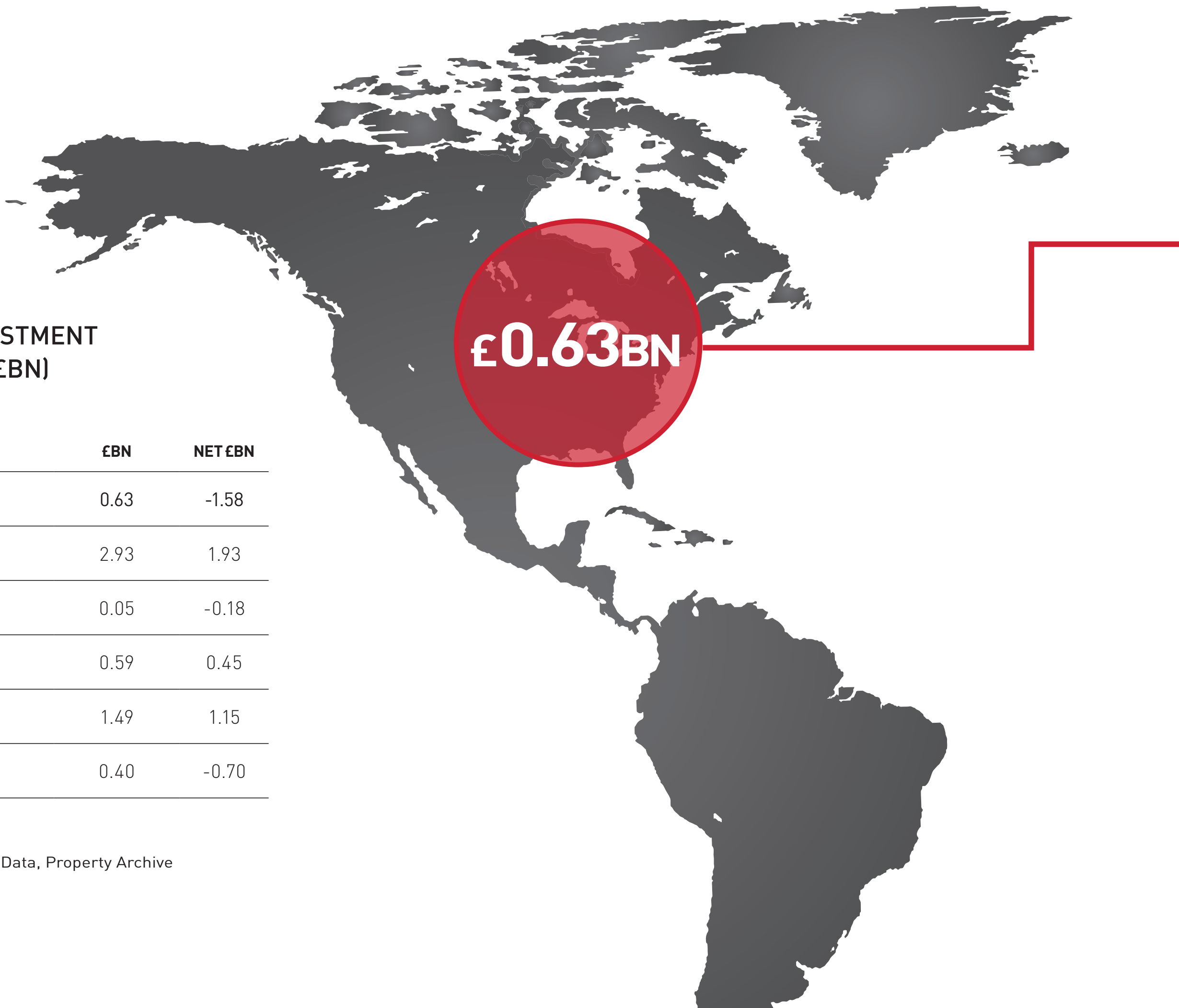
FAR EAST DOMINATES OVERSEAS VOLUME

Overseas investment was £6.1bn in Q2, up 7% on Q1's level but 12% below average. While volume was healthy in London, overseas investment into the UK regions was the lowest since Q2 2014. This partly reflects the lack of major lot-sizes on the market outside of London.

Far Eastern investors continued to command the leading share of overseas volume, with investment of £2.9bn in Q2 accounting for 42% of the total. Meanwhile, investment from Middle Eastern investors was notably subdued, with inflows at their lowest since Q1 2011.

LOCAL AUTHORITIES ACTIVE AS EVER

Local authorities remain very active in the market. While Q2 volume of £331m was its lowest in five quarters, it nonetheless saw 29 separate acquisitions among 21 local authorities. Runneymede Council was the most active buyer, investing £162m across four deals.

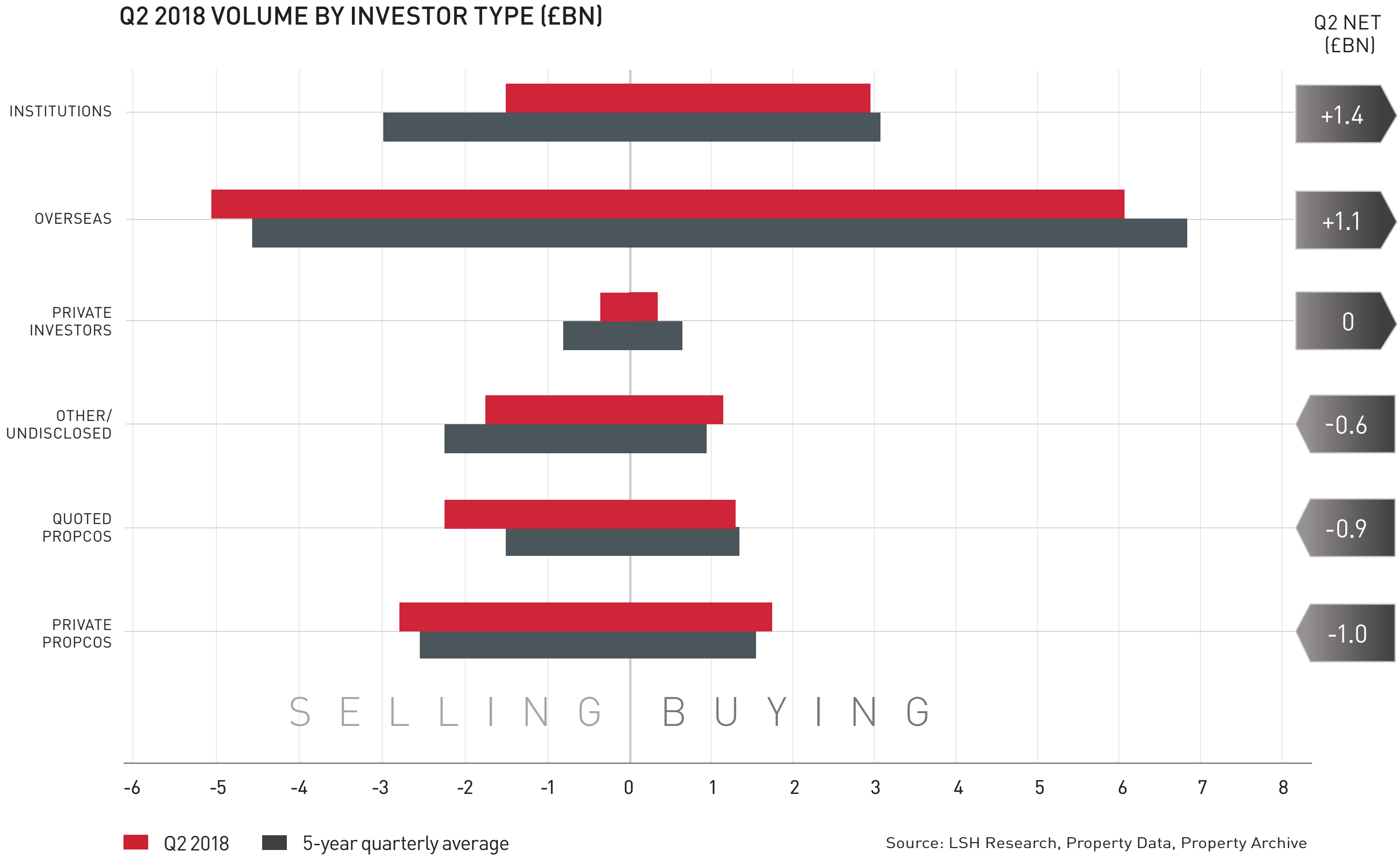


Q2 2018: GLOBAL INVESTMENT FLOWS INTO UK CRE (£BN)

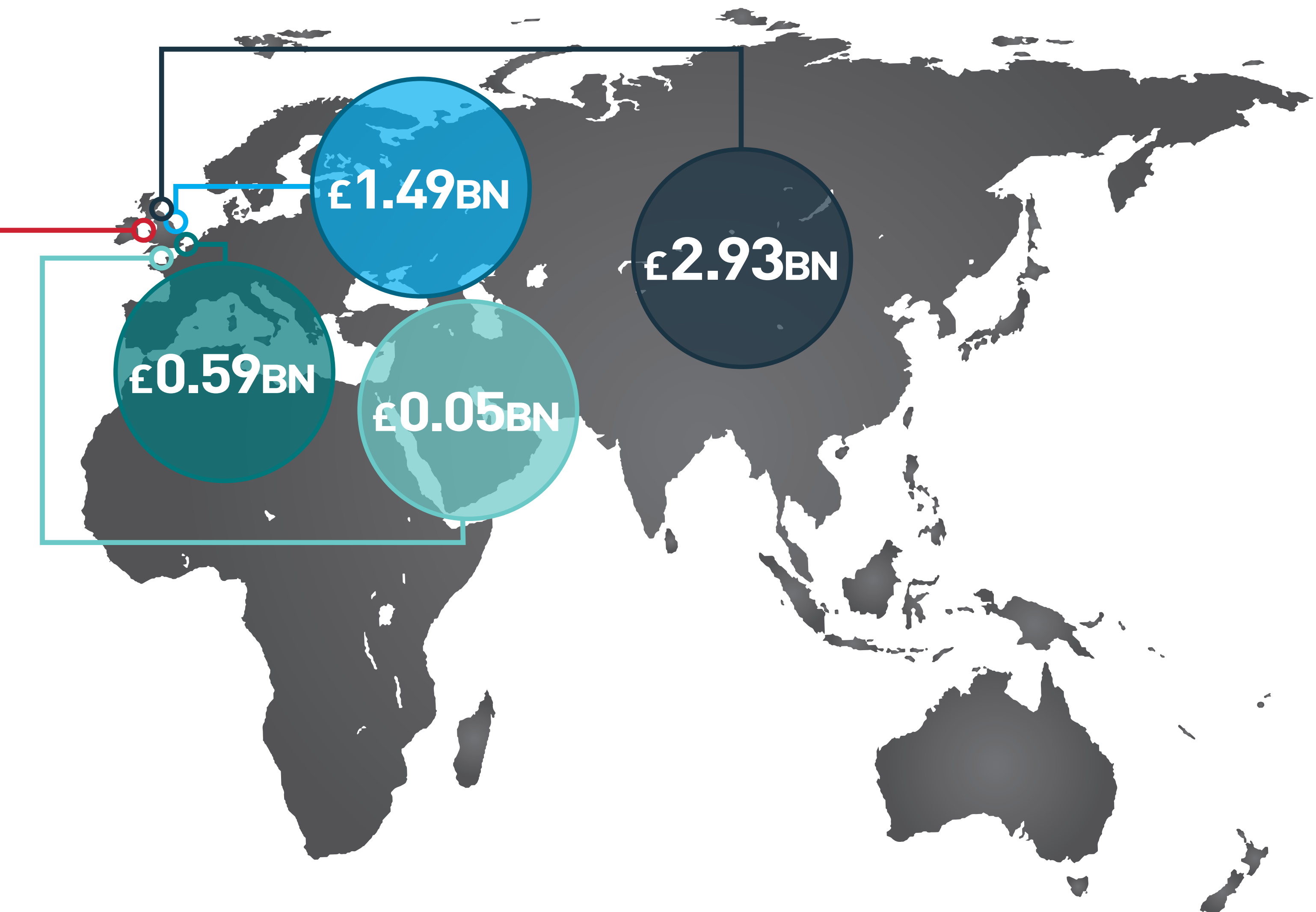
ORIGIN	£BN	NET £BN
NORTH AMERICA	0.63	-1.58
FAR EAST	2.93	1.93
MIDDLE EAST	0.05	-0.18
GERMANY	0.59	0.45
EUROPE	1.49	1.15
OTHER	0.40	-0.70

Source: LSH Research, Property Data, Property Archive

Q2 2018 VOLUME BY INVESTOR TYPE (£BN)



Source: LSH Research, Property Data, Property Archive



OUTLOOK

FEELING THE HEAT

As the UK basks in its hottest summer since 1976, the economy's drab, weather affected start to the year now seems a distant memory. Politically, however, the heat has also been rising around Brexit.

UK ECONOMY REBOUNDS IN Q2

It increasingly appears that Q1's subdued growth was more of a blip than the start of something more serious. The pace of economic activity has picked up, with May's monthly estimate of GDP at 0.3% and the latest Markit/CIPS PMI surveys pointing to Q2 growth of 0.5%, up from only 0.2% in Q1.

While many high street retailers grapple with profound structural change, perhaps some comfort can be drawn from a revival in consumer spending. UK retail sales climbed by 2.1% in Q2, the sharpest quarterly rise since 2004, with The Royal Wedding and the World Cup providing the necessary impetus.

EMPLOYMENT GROWTH CONTINUES

Another positive surrounds the labour market. The UK's strong run of employment growth has continued, a fact which bodes well for occupier demand in the face of Brexit uncertainty. Employment rose by 137,000 in the three months to May, while unemployment remains rooted at a 40 year low. However, despite very limited slack in the labour market, wage growth has eased down from a high of 2.8% in February to 2.5% in May.

FINGER OFF THE TRIGGER?

Counter to expectations, CPI inflation was unchanged at 2.4% in June, with rising energy prices offset by a sharp fall in clothing prices on the back of a summer sales drive among fashion retailers. Alongside easing wage growth, the unexpected result will be food for thought for the MPC, meaning the widely tipped rate rise in August may no longer be a foregone conclusion.

That said, lower inflation may provide the justification to press ahead with a rate rise. Evidence that momentum in the economy has picked up and an overriding desire to get on with the job of gradual rate 'normalisation' may still prompt a decision before the summer is out.

DEAL OR NO DEAL?

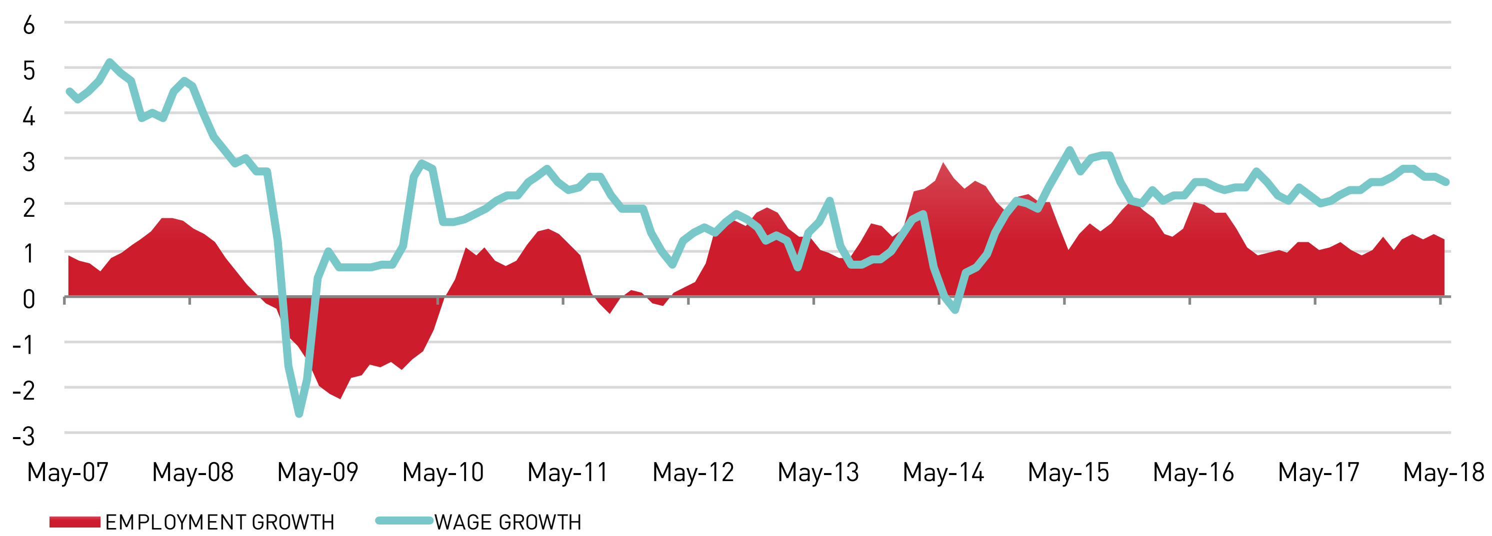
So far, the markets appear to have taken the fresh bout of Brexit-related uncertainty in their stride. However, with the months counting down to find a suitable deal on trade, businesses are rightly warning of the possible impacts to the UK economy should a deal not be reached.

That said, it is easy to lose sight of the bigger picture, and there are other political risks at the global level which could potentially be more instrumental to growth. The ramping up of the trade spat between the USA and China has the potential to restrict growth at the global level, but may perversely work in favour of inward investment from emerging economies into the UK.

VOLUME ON TRACK

Returning to the property market, investment volume remains on track to hit our forecast of circa £60bn for the year a whole. On the home front, positive net inflows to the UK funds seen over the year to date bodes well for a fuller restoration of institutional activity, while the Chinese government's recent easing of restrictions on overseas buying could spark a fresh wave of both buying and selling of UK real estate.

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



Source: LSH, RealFOR

ENDURING HUNT FOR INCOME

Despite the real prospect of an interest rate rise, intense competition for secure income will preserve prime yields at or near their current historic lows. By the same token, fears around Brexit's possible implications for the occupier markets and limited upside potential in capital values at this point of the cycle make a weak case for investing in secondary stock without asset management.

Indeed, the substantial flow of capital into sectors such as healthcare, PRS and student accommodation partly reflects the long-income appeal of their typical lease structures. Consequently, it remains a very distinct possibility that 2018 will set a new high watermark for annual volume into the alternative sectors.

RETAIL ON THE ROPES

A rash of company voluntary agreements and a stream of negative media publicity around UK retail have, understandably, left investor sentiment towards the sector close to rock bottom. According to one recent study, significant structural change has left the UK with as much as 40% more retail floorspace than it actually needs, a fact which is understandably weighing on demand and pricing.

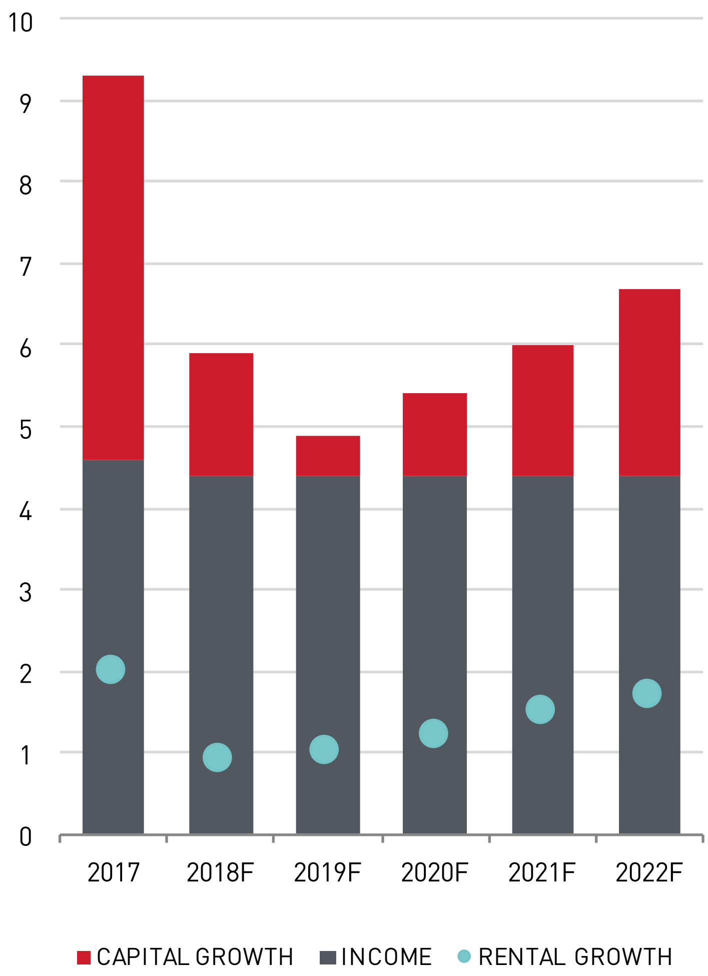
However, as Q2's investment activity demonstrated, high quality retail assets remain in demand, particularly as retailers opt to consolidate their footprint to the most profitable locations. With better rental growth prospects at the prime end of the market, there will be an opportunity to capitalise on asset repositioning in the very best locations.

REGIONAL OFFICES A GOOD BET?

The staggering performance of the UK industrial and logistics sector over the past two years has left value extremely hard to find, and many investors will be relying on sustained rental growth to achieve their desired returns.

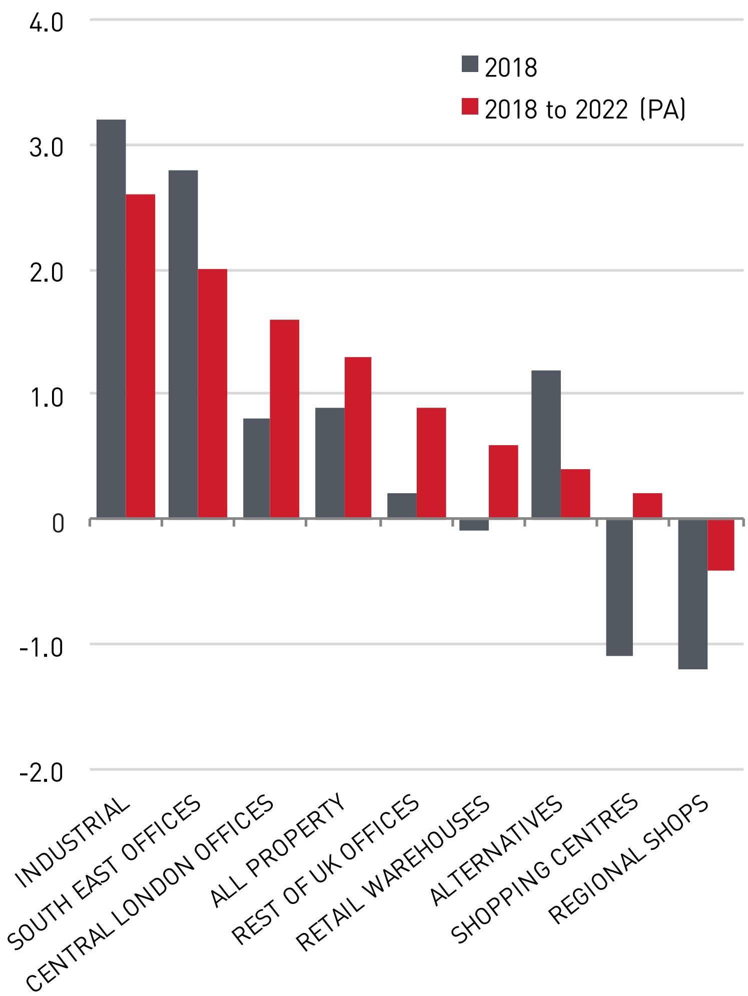
For investors seeking both value and up-front return, well located regional offices may become increasingly appealing in the current market. Relaxation in permitted development and a relatively weak development cycle has kept supply levels in check and, provided investors can accommodate to the structural changes to occupier demand, this sector may be the sector of choice for the IRR-seeking investor.

FORECAST COMPONENTS OF ALL PROPERTY TOTAL RETURN (%)



Source: LSH, RealFOR

RENTAL GROWTH FORECASTS (%)



Source: LSH, RealFOR

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