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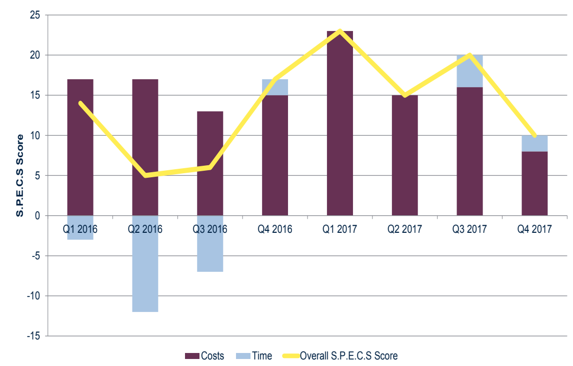
S.P.E.C.S
Savills ProgrammE and Cost Sentiment Survey

January 2018

Falling development pipelines see costs flatline

- Commercial occupational markets have, in the most part, defied expectations in 2017. Central London office markets, regional offices and the industrial and logistics market have all seen take-up either in line, or above long term averages.
- Given that there are still considerable uncertainties around our future trading arrangements with the European Union this can be seen as a vote of confidence in UK plc. However, the logistics and regional office markets have been dominated by large single unit transactions which have skewed take-up numbers. Developers have therefore scaled back plans with the development pipeline in all commercial markets and sectors falling in 2017/18.
- This in turn has seen new construction contracts fall and pricing has reacted accordingly with more contractors bidding for a slowing workload.
- This is reflected in our S.P.E.C.S index for Q4 2017 with a score for the fourth quarter of 10, which is the lowest quarterly score since the third quarter of 2016 when the market was still comprehending what the impacts of Brexit would be on tenant demand and future development.

GRAPH 1
S.P.E.C.S Q4 2017



Graph source: Savills Research

"Given the lagging nature of construction and market cycles, Brexit could start to see pricing fall and construction time scales decrease, which in turn will present opportunities for developers prepared to build in under supplied markets." Simon Collett, Head of Division

TABLE 1
Q4 2017
S.P.E.C.S Indicators

Sector	New Build & Refurbishment Costs	New Build & Refurbishment Timescales*	Occupier Fit-out costs	Occupier Fit-out Timescales*
Offices - Central London	↑	↔	↑	↔
Offices - Regional	↔	↔	↔	↔
Warehousing <100,000 sq ft	↔	↔	↔	↔
Warehousing 100,000 - 500,000 sq ft	↔	↔	↔	↔
Warehousing 500,000 sq ft +	↔	↔	↔	↔
Central London Prime Residential	↑	↔	↑	↔
Central London mid market Residential	↑	↑	↑	↔
Regional mid market Residential	↑	↑	↑	↔
Foodstores	↔	↔	↔	↔
High St Retail	↔	↔	↔	↔
Out of Town Retail	↔	↔	↔	↔
Shopping Centre	↔	↔	↔	↔

*Timescales definition: The time taken from project sign off to project commencement including the procurement and delivery of building components

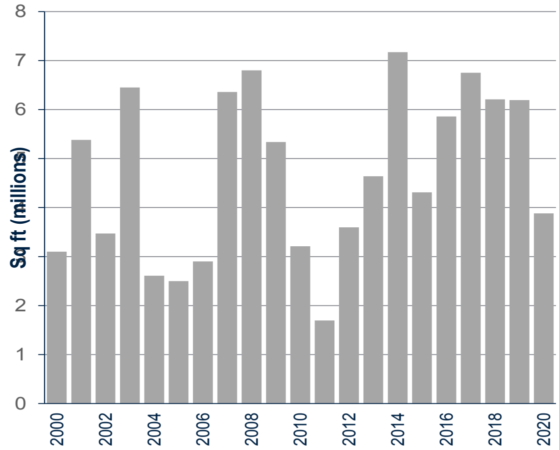
Table source: Savills Building and Project Consultancy

Central London construction costs softening amidst exceptional occupier demand.

- By the end of November 2017 both the City and West End markets had exceeded their long term average annual take-up levels, suggesting that occupier demand remains strong and not adversely impacted by the uncertainty surrounding Brexit.
- Indeed the West End is forecast to have its second strongest year on record and the City is forecast to be 8% up on the long term average.
- Both markets also are currently seeing supply levels and vacancy rates stabilise. Given these occupational dynamics history would point to increased development. However, as uncertainty around commodity prices, currency fluctuations, labour supply and potential future tenant demand persist it is no surprise to note that development pipelines are falling.
- This is borne out in our S.P.E.C.S scores as recent tenders for office fit outs and refurbishments in London support the first evidence of a general softening in construction costs and this is an indication of contractors reacting to a reduction in volume of new orders coming through.
- In respect of London fit out the market remains tight and has been for the last three months, contractor declared profit margins are down at about 1% and fit contractors are chasing work. There are, however, still some inflationary trends within mechanical, electrical, public health and joinery trades.
- With regard to London refurbishment, as these projects are normally tendered by tier two contractors there is definitely more capacity in this area than there was, however, this has not materialized yet in lower margins or prices. On the contrary there is still pressure from the weak pound, a possible diminishing pool of Eastern European labour and potentially any import tariffs, if these come into place. One area to watch out for will be cladding prices, especially the local UK market, whose capacity may be soaked up by post Grenfell facade replacement work.
- Using data from Gardiner & Theobald the forecast for 2018 remains at average 1% tender price inflation across the UK, with northern regions experiencing stronger growth than London and the South East. Into 2019 we forecast London and the South East to be broadly flat, with the rest of the UK at 1% average.

GRAPH 2

Development Pipeline falls*



Graph source: Savills Research *including refurbishments

"During 2018 we can expect to see a continued softening of construction costs for fit out and refurbishment projects in central London and into 2019 we are anticipating that tender price inflation in London and the South East will be broadly flat" Paul Davies, Director, London

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