savills

Savills World Research
UK Commercial

Market in Minutes
2013 will be better than 2012 (but not much!)

November 2012

Mixed outlook for 2013

■ The story of the commercial property investment markets in 2012 has undoubtedly been the widening gaps between prime, secondary and tertiary yields, with the latter now comfortably over 1,000 bps in some sectors.

■ This month's prime yield survey shows the start of a bifurcation amongst the sectors, with upward pressure on high street retail and regional offices, and downward pressure and yield hardening on London offices. Does this hint at a rise in risk-aversion that will carry over into 2013?

■ While the global economic outlook for 2013 is broadly ok, we expect that lurking concerns about the US fiscal cliff and Eurozone will continue to drive the majority of cross-border property investors towards safe-havens like London offices and prime UK retail. This will continue to support the current low prime yields in both sectors, and we expect that 2013 will see a slight hardening in the City of London office market.

■ Elsewhere in the market we expect that there will be further softening in secondary and tertiary yields as concerns about rental growth prospects and bank deleveraging drive risk-aversion.

■ However, we believe that 2013 will see a pick-up in investor interest in asset management and refurbishment opportunities outside London, a gradual ripple outwards of the bottom-feeding that we have seen in the London office market this year.

■ Overall, our outlook for commercial property performance in 2013 is fairly similar to 2012, but with slightly better rental and capital value growth outside London. Prime regional office and retail rents will stabilise and in some locations rise a little, but generally there wont be enough rental impetus to deliver a proper recovery in total returns until 2014. However, we expect that the All Property total return in 2013 will be around 6%, a significant improvement on 2012's expected outturn of around 2%.

GRAPH 1

2013 will see the beginnings of a recovery in total returns

Graph source: Savills (forecast), IPD (history)

TABLE 1

Prime equivalent yields

	Nov 11	Oct 12	Nov 12
West End Offices	3.75%	3.75%	3.50%
City Offices	5.25%	5.25%↓	5.25%↓
Offices M25	6.50%	6.25%	6.25%
Provincial Offices	6.00%	6.25%↑	6.25%↑
High Street Retail	4.75%	4.75%	4.75%↑
Shopping Centres	5.25%	5.25%	5.25%
Retail Warehouse (open A1)	5.25%	5.25%	5.25%
Retail Warehouse (restricted)	6.00%	6.00%	6.00%
Foodstores	4.50%	4.50%	4.50%
Industrial Distribution	6.25%	6.25%	6.25%
Industrial Multi-lets	6.00%	6.00%	6.00%
Leisure Parks	6.25%	6.25%	6.25%
Regional Hotels	7.00%	7.00%	7.00%

Table source: Savills

Will the tills be ringing this Christmas?

■ Consumer behaviour remains hugely important to both the UK economy and property market, and a strong Christmas period this year will be beneficial to retailers and landlords alike. So, can we expect that Christmas 2012 will be better or worse than last year?

■ The majority of forecasters, including us, were expecting that inflation would have fallen further by now. However, external factors such as the drought in the US this summer, as well internal factors like the rise in student fees, have kept CPI stubbornly above its target rate of 2.0% (2.7% at present).

■ The flip side of the economics equation is the 1% rise in UK GDP in Q3, which while it wont be repeated in Q4, does appear to have had a positive effect on consumer confidence (Graph 2), with the overall level picking up to -20 in November.

■ Of course, consumer behaviour isn't all about economics, and the last three Christmas periods have taught us that after 11 months of austerity the UK consumer likes to loosen his or her belt. Generally, we expect that like-for-like sales will be marginally up on last year, but volumes will continue to be delivered by some deep discounting by retailers. Indeed, it is starting to feel that the UK retail sector is moving to a more US "black Friday" and "cyber Monday" model, with the discounting starting in November.

UK Autumn statement

■ The prevailing fiscal and monetary theme in the UK seems to be that Plan B is just to do Plan A for longer. Economic conditions have worsened since the last time the OBR published their official forecasts for the UK economy back in March, and this leaves the Chancellor with very little wiggle room when it comes to his Budget in Spring 2013.

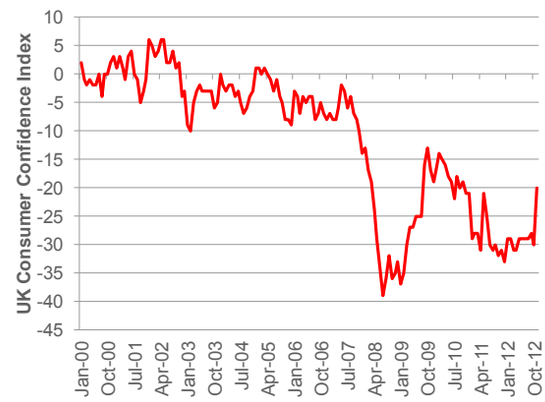
■ In particular, net trade has not recovered as strongly and as soon as expected, and inflation has not come down as quickly as we were all forecasting earlier this year. Ironically one of the few areas of spending that has gone up is government spending, not exactly in line with Mr Osbourne's desire to control the deficit!

■ The relaxation of empty rate taxes on new developments is good news for the handful of projects due to complete over the next three years, but it is more a lack of debt that is holding the development industry back.

■ Thus, while we do expect 2013 to better than 2012, the main story is one of jam tomorrow for the UK economy. Consumer spending should start to compensate for reduced government consumption next year, but the real rebalancing is probably a year away when both the consumer side of the economy and trade will be in more robust health. This view is broadly in line with Sir Mervyn King's "long and winding road to recovery", but at least we can reach the end of 2012 knowing that we are at least one step closer to the light at the end of the tunnel.

GRAPH 2

Consumer confidence picked up sharply in November



Graph source: GfK

Please contact us for further information

Mark Ridley
Chairman & Chief Executive
+44 (0)20 7409 8030
mridley@savills.com

Mat Oakley
Research
+44 (0)20 7409 8781
moakley@savills.com