UK Commercial Market in Minutes
Busy final quarter ahead?

September 2014

UK institutions return to the regions

■ With August being a traditionally quiet month for investor activity, only one sector saw a hardening of yields, with Leisure Parks moving in by 25 basis points to reach 5.5%.

■ As a result the UK average prime yield moved lower by two basis points during August to 4.75%. Downward trend arrows now only apply to a small number of markets. For many sectors the prime yield is now at levels not seen since early 2007.

■ As confidence in the regional office occupational market has grown, investor sentiment has also shifted towards these markets. On an annual basis provincial office yields have come in by 75 basis points with further hardening expected.

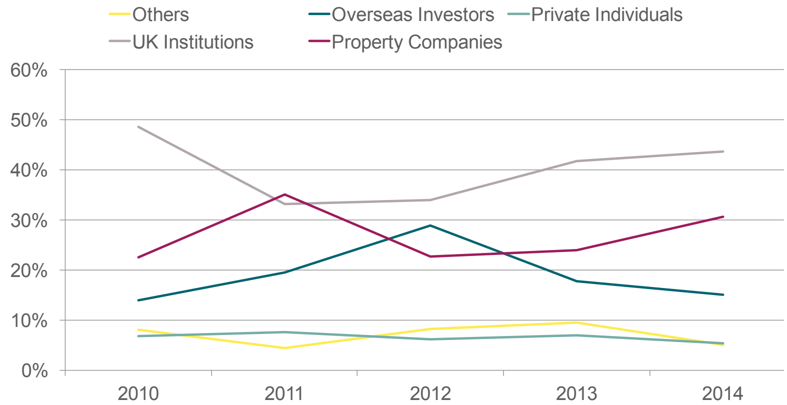
■ Analysis by Savills shows that £18.7 billion has been invested in the UK commercial property market at the midpoint of 2014, up from £15.2 billion at the halfway point of the year. Interestingly 51% of the market is now in the regions compared to London, at the midpoint of 2013, just 34% of the market was outside of London.

■ In the August issue of Market in Minutes, we suggested that the regional markets will come to the fore to absorb the inflow into the property funds, and this has clearly now begun.

■ UK institutions have now started to move up the risk curve to take advantage of the differential between London and regional yields (which in some sectors is normalising fast), as well as to capture the beginnings of the regional leasing market recovery. UK institutions now account for 43% of all investment outside of London compared to just over a third in 2012. We expect this trend to continue into the final quarter, with many institutions reporting significant shortfalls between what they have spent and what they wish to deploy this year.

GRAPH 1

UK institutions have increased their share of the total invested outside London



Source: Savills Research

TABLE 1

Prime equivalent yields

	Aug 13	Jul 14	Aug 14
West End Offices	3.50%	3.25%	3.25%
City Offices	4.75%	4.50%	4.50%
Offices M25	6.00%	5.25%↓	5.25%↓
Provincial Offices	6.00%↓	5.25%↓	5.25%↓
High Street Retail	4.75%	4.50%↓	4.50%↓
Shopping Centres	5.00%↓	4.50%↓	4.50%
Retail Warehouse (open A1)	5.25%↓	4.25%	4.25%
Retail Warehouse (restricted)	6.00%↓	5.25%	5.25%
Foodstores	4.25%	4.50%	4.50%
Industrial Distribution	6.00%↓	5.00%	5.00%
Industrial Multi-lets	6.00%↓	5.00%	5.00%
Leisure Parks	6.25%↓	5.75%↓	5.50%
Regional Hotels	7.00%	6.75%↓	6.75%

Source: Savills Research (Arrows indicate expected short-term movement)

Will constrained supply deliver rental growth?

■ The buoyant occupier market in the UK logistics sector has started to impact on supply levels drastically. At the midpoint of the 2014 take-up has already reached 13.5 million sq ft, 71% of the total for 2013. Given the large scale requirements Savills are currently tracking we estimate that 2014 take-up will comfortably surpass 2013 levels.

■ The same level of buoyancy can also be applied to the regional office market with take-up rising to just over 9 million sq ft in 2013, a rise of 32% on 2012. Expectations are that 2014 will exceed 2013 as take-up levels for the year to date are 22% up on last year. The strongest growth this year has been in Manchester and Cardiff, where take-up has risen by 38% and 69% respectively.

■ These levels of take-up have had a dramatic impact on the levels of supply in most markets. Of the eight regional office markets Savills cover all but two have seen supply levels fall. The largest fall in supply has been in Leeds, while Manchester and Cardiff are the two centres where supply has risen due to development completions.

■ Within the logistics market Grade A stock levels have fallen by 17% year on year and now stand at 12.5 million sq ft. Given that three deals in 2014 have all been close to one million sq ft it is clear to see that some markets will have less than a years worth of supply

■ With the occupational market pointing to what seems like the perfect conditions for speculative development it remains surprising that more schemes have not been committed to. In the logistics market we are currently tracking 14 schemes under construction that total just 2.7 million sq ft. The office market too is displaying similar characteristics with just 13 schemes under construction totalling 1.28 million sq ft.

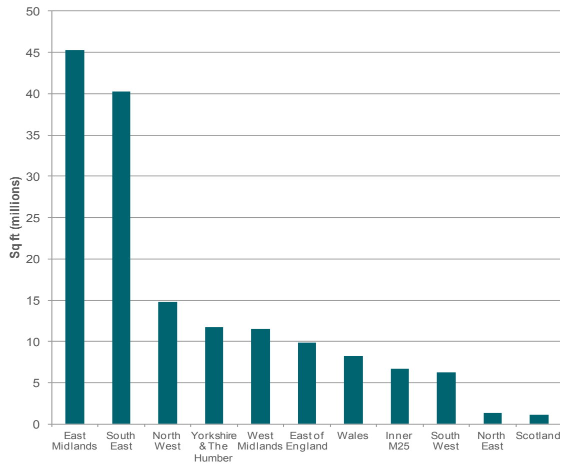
■ In turn this has seen a large portion of the logistics market return to design and build opportunities as developers prepare land for development. Indeed 75% of all Grade A take-up in the logistics sector in 2014 has been classified as design and build. We expect this figure to rise even further into 2015, especially given that we are currently tracking development sites for logistics that have the long term potential to accommodate up to 157 million sq ft of development. However it should be noted that many of these schemes remain in the planning process and years away from delivery.

■ With these supply and pipeline constraints it is clear to see the potential for strong regional rental growth. Indeed, Leeds, Manchester, Bristol and Birmingham are all expected to see office rental growth of over 3% pa to 2018.

■ Even the industrial sector with previously unheard rental growth is now forecasting almost 2.5% per annum in the Midlands, Yorkshire and the North West.

GRAPH 2

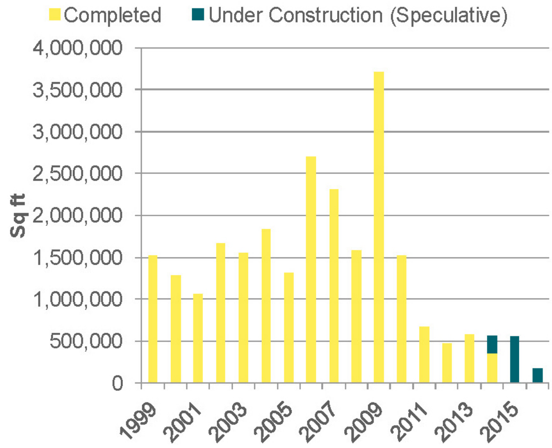
UK logistics development pipeline is healthy, but delivery is long term



Source: Savills Research

GRAPH 3

Regional office development pipeline remains very restrained



Source: Savills Research

Please contact us for further information

Mark Ridley
Chief Executive Officer Savills UK
+44 (0)20 7409 8030
mridley@savills.com

Kevin Mofid
Research
+44 (0)20 3618 3612
kmofid@savills.com