MARKET IN MINUTES
Savills Research

Market in Minutes

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Outward shift restricted to retail

The average prime yield softened in November by four basis points (bps) reflecting outward yield shifts across a number of retail sectors. High street and shopping centres both reported yield softening of 25bps placing yields at least 125bps above their pre-GFC peak.

This softening is evident in the volume of retail assets coming to the market particularly as a number of funds are looking to exit in order to reduce exposure to retail and service outflows. The key question now is whether we will see a run of redemptions following one of the leading funds temporarily suspending trading. As seen post the EU referendum, however, fund outflows could bring some attractive assets to the market at very competitive pricing.

Retail's weakening occupational market has been the main driver of yield softening with IPF's latest consensus forecasts pointing to further rental declines through to 2021, albeit at a slowing rate (see chart below). However, for some stronger retail locations we could see rents plateau next year subject to the outcome of the general election and Christmas retailer performance.

The election is amplifying headwinds across the board, not just for retail. For example, financing has become more challenging with indicative terms having a much shorter shelf life. We will have to wait and see whether the election result dissipates or intensifies this uncertainty.

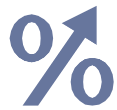
Savills prime yields

	Nov 18	Oct 19	Nov 19
West End Offices	3.50%	3.75%	3.75%↓
City Offices	4.00%	4.00%	4.00%
Offices M25	5.00%	5.00%↑	5.00%↑
Provincial Offices	4.75%	4.75%↑	4.75%↑
High Street Retail	4.50%	5.00%↑	5.25%↑
Shopping Centres	5.25%	5.50%↑	5.75%↑
Retail Warehouse (open A1)	6.00%	6.25%	6.25%
Retail Warehouse (restricted)	6.25%	6.50%	6.50%
Foodstores (OMR)	4.75%	4.75%	4.75%
Industrial Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.00%	4.00%	4.00%
Leisure Parks	5.50%	5.75%	5.75%
Regional Hotels	4.25%	4.25%	4.25%

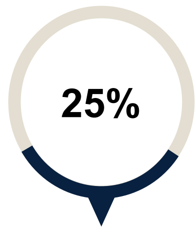
Source Savills

Key Stats

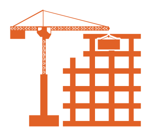
Outward shift in prime yields for high street and shopping centres.



4.94%
Savills all property average prime yield.

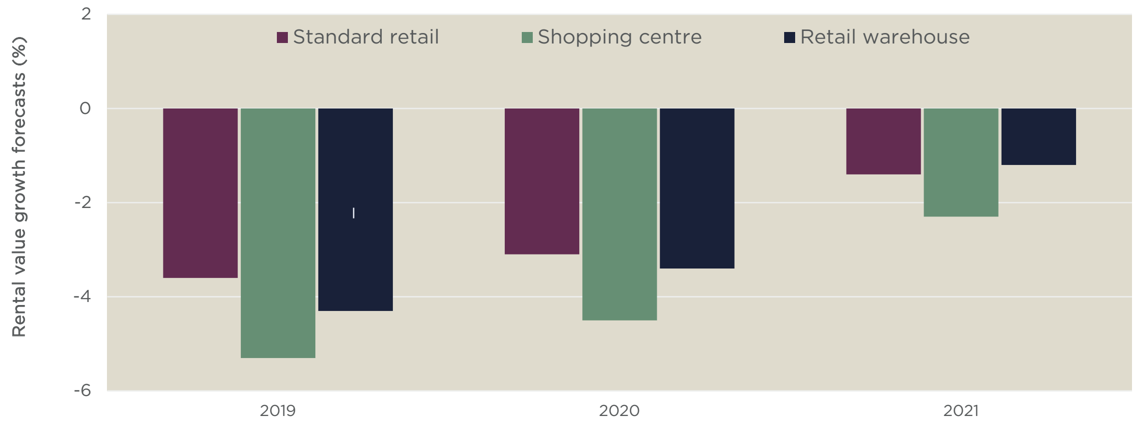


Respondents who cited construction costs as a main concern for 2020.



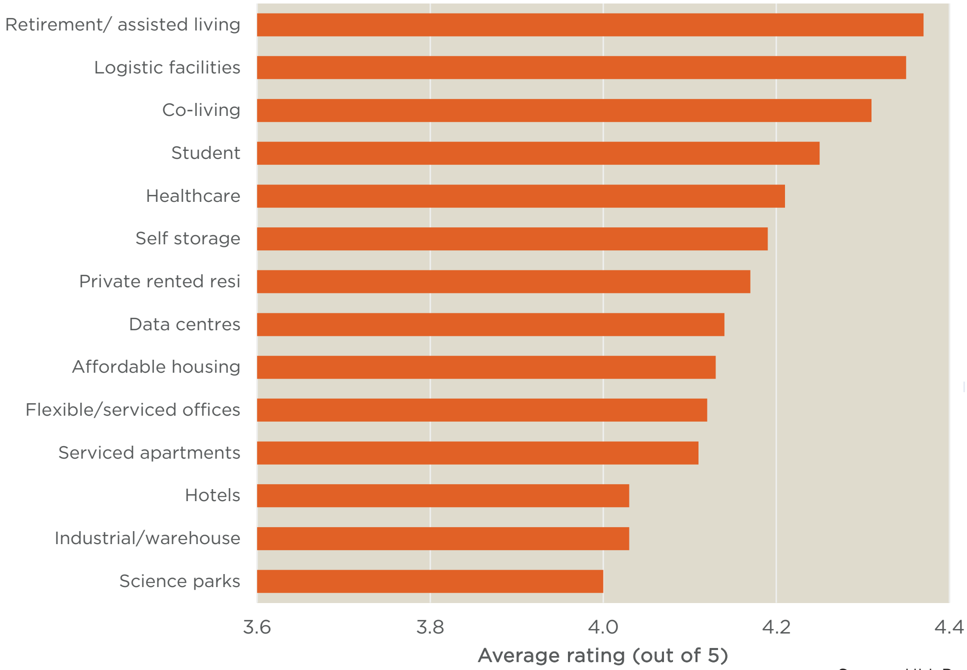
4.0% per annum
Forecast average growth in the BCIS All-in TPI index to Q421.

Retail rental growth prospects The consensus points to further declines but at a slower pace



Source IPF consensus forecasts November 2019

2020 sector prospects 'Alternatives' moving up the agenda for investors



Source ULI; PwC

WHAT ARE INVESTORS FAVOURING IN 2020?

The big theme in the recently launched ULI and PwC Emerging trends in European Real Estate report was the 'climate of change', and this change was very apparent in those sectors investors were tipping for investment in 2020.

Looking at those sectors that received an average rating of four or above (investors rated each sector out of five in terms of preference for investment) there is a clear dominance by the 'beds and sheds' sub-sectors. Beyond the logistic and residential related sectors however, there is a clear favouring of the more 'alternative' commercial sectors. Self storage, data centres, serviced offices and science parks all received an average rating of four or above. Hotels, albeit now considered a more mainstream asset class, also featured highly despite moving down the ranking compared to 2018/19. Likewise, serviced apartments ranking also slipped but still achieved an average rating of 4.11 placing it ahead of hotels.

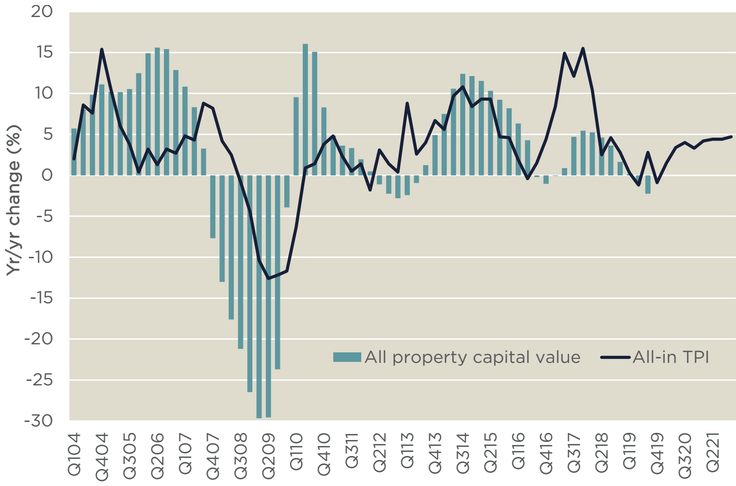
The biggest challenge to investors in terms of realising these intentions will be access to purpose built stock. UK serviced apartments, for example, only represent 3.6% of total hotel stock. While we have seen some notable acquisitions such as Deka's purchase of the 166 unit Native aparthotel in Manchester for a reported £80m, the most common route to access for investors has been through platform and corporate acquisitions.

As a result, exposure to some of these alternative sectors may require investors to take on more development risk. Likewise, gaining exposure to some of these sectors may also require a shift towards more operational exposure, which in turn will require more in-house expertise. What is clear is that a more hands-on and intensive asset management approach by investors may increasingly become the norm.

A shift towards development strategies by some investors as a means to deliver returns, and gain exposure to target sectors, could face mounting pressure from rising construction costs.

Construction costs ranked top as an issue expected to impact business in 2020 in the ULI/PwC emerging trends report with 25% of respondents stating that they were very concerned. Last year it ranked second with 20% of respondents stating they were very concerned. It would appear that this concern is justified. The BCIS All-in Tender Price Index (TPI) is forecasting average annual growth of 4.0% per annum over the next two years against a two year historical average of 0.9% per annum. In light of previous historical trends this could generate additional headwinds to capital value growth in 2020.

Construction tender costs forecast to accelerate in 2020



Source BCIS; MSCI

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