UK Commercial – January 2020

MARKET IN MINUTES

Savills Research

Market in Minutes

savills

Uncertainty hits volumes

Whilst the December election and subsequent political certainty brought by having a stable government may have assisted some investment transactions reach a conclusion before year end, the overall effect did not boost investment volumes dramatically, as the year finished at £48.4bn for total commercial property investment volumes, a fall of 23% on 2018.

As investors wait to see how the new political environment will impact sentiment, there were no changes to the Savills prime yield, which remained unchanged at 4.94%. Given the continued outward pressure in some retail and office markets it seems only a matter of time before the average yield pushes through the 5% mark, a level not seen since May 2014.

Overseas investors continued their dominance of the market and actually increased their market share to 49% of the market, up from 44% in 2018. However the geographical source of capital changed somewhat in 2019 as Far Eastern investors decreased capital deployed by 56% to £4.93bn where as North American investors increased by 96% to £8.42bn.

There is every reason to believe that 2020 will see volumes rise as we reach the nadir for retail values and investors look to cash in on a strong London office market. We have witnessed a marked uplift in offers received on assets where bids have been called in the first weeks of 2020.

Savills prime yields

	Dec 2018	Nov 2019	Dec 2019
West End Office	3.50%	3.75%↓	3.75%↓
City Offices	4.00%	4.25%	4.00%
Offices M25	5.00%	5.00%↑	5.00%↑
Provincial Offices	4.75%	4.75%↑	4.75%↑
High Street Retail	4.50%	5.25%↑	5.25%↑
Shopping centres	5.25%	5.75%↑	5.75%↑
Retail Warehouse (open A1)	6.00%	6.25%	6.25%
Retail Warehouse (restricted)	6.25%	6.50%	6.50%
Foodstores (OMR)	4.50%	4.75%	4.75%
Ind/ 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

4.94%

Second month of static average prime yield

£14.6bn

The fall in UK commercial property investment volumes between 2018 and 2019

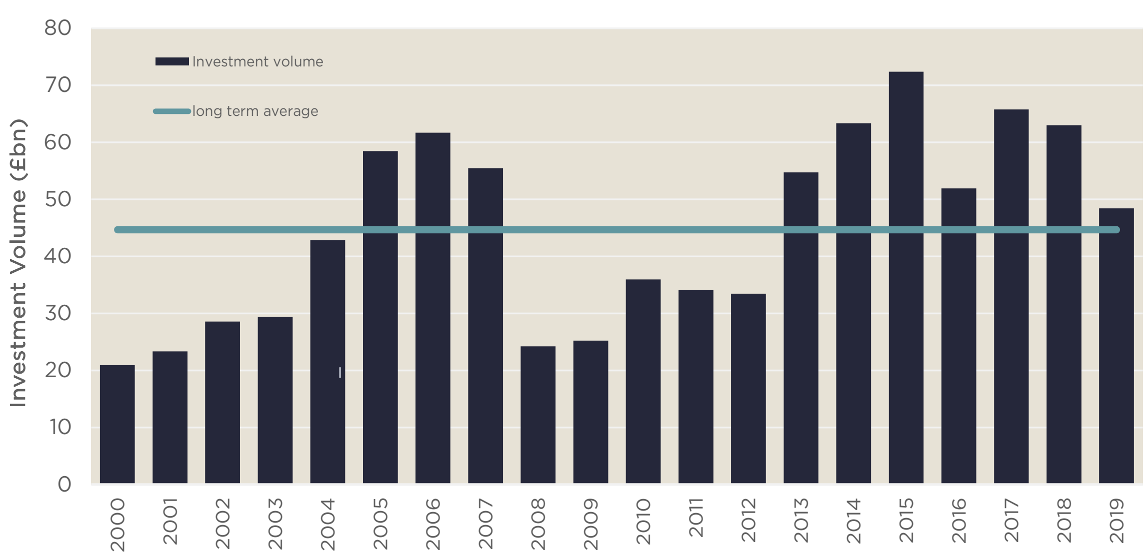
96%

The rise in investment by North American investors in 2019

23

The number of consecutive months logistics yields have been static at 4.25%

Investment volumes above the long term average but a fall of 23% year on year



Source PropertyData

Commercial assets to perform comparatively well

The recently released Savills Cross Sector Outlook examines trends and performance forecasts across the UK real estate spectrum. Since the EU referendum and combined with continued structural change, particularly in the retail market, traditional investment rational has been severely tested.

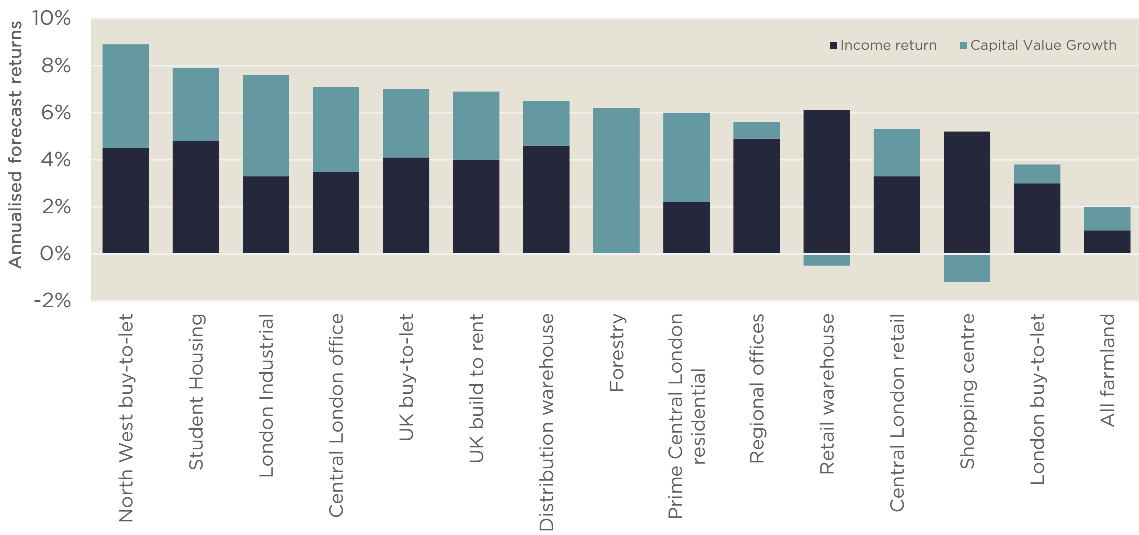
During that period, national house price growth has slowed dramatically, agricultural land values that peaked in 2015 have softened by a further 2%, and commercial investors have become far more selective in both the sectors and individual assets they will acquire.

As we look forward to the next five years, we believe that greater political and economic certainty will underpin positive investment returns across the different property asset classes. However, the scale of those returns will reflect where we sit in the property cycle and some of the structural changes we are seeing in different sectors.

Within the residential sector, buy-to-let and build to rent both offer higher income returns and prospects for capital appreciation at this stage in the cycle. Commercially, structural change in the way we use the high street will continue to influence where the weight of investment falls. But, those who adopt a simple logistics good/retail bad mentality risk throwing the baby out with the bath water. Meanwhile, whatever the travails of WeWork, the underlying shortage of good-quality office space, especially in London, is set to underpin the rental growth prospects in that sector.

From a structural perspective, agriculture faces a great deal of regulatory change over the coming five years, though indications are that policy evolution will be gradual rather than sudden. Continuity in the support and trading business environment, and scarcity of supply, in the medium term at least, is likely to underpin land values. However, competition from other land uses is likely to be the key driver

Comparative returns forecast for the next five years

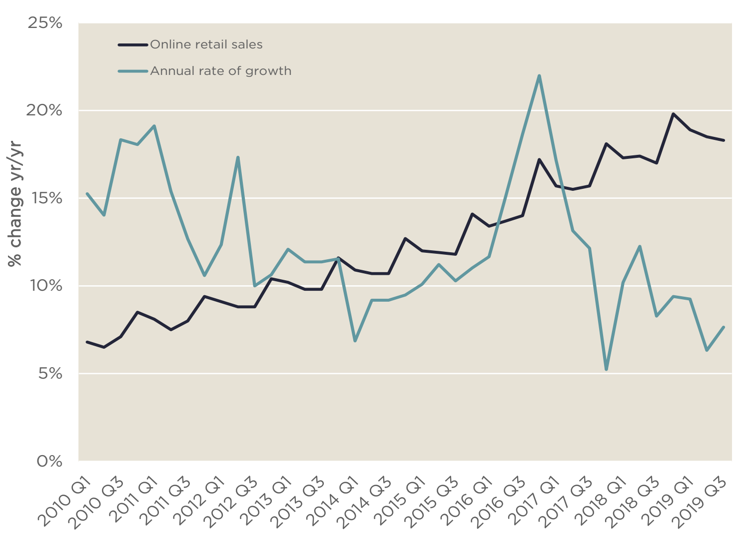


Note In a world of data, it is surprisingly difficult to arrive at comparative income returns for different asset classes. For residential buy-to-let investments, our model uses a combination of data from the valuation office, the Land Registry and Rightmove. We have then had to take into account that while commercial property income streams will often be underpinned by full repairing and insuring leases, in the residential markets these are the responsibility of the landlord. Agricultural tenancy obligations sit somewhere in the middle. For consistency, we provide figures net of all irrecoverable costs in line with IPD industry standards. No account has been taken of the restricted tax relief available to private buy-to-let investors using mortgage finance (which would reduce effective income returns for some investors). **Source** Savills Research

The latest data from the Office of National Statistics shows that whilst the level of online retail in the UK continues to grow, the pace of growth has started to slow in recent years. At the start of the decade growth of close to 20% a year was common but from 2018 this has slowed to under 10%. At this stage there has been no impact on the logistics market as online retailers continue to take space and legacy retailers adapt their supply chains to compete.

Moreover the highest growth rate ever recorded was in the second half of 2016 in the immediate aftermath of the Brexit vote. This could suggest that in times of low consumer confidence people turn to online as they perceive it to be cheaper than the high street. Therefore, if as economic forecasts suggest, the UK is set for a period of lower consumer confidence then the logistics sector could stand to be the net beneficiary.

Online retail growth still impressive growth but at a lower pace than recently seen



Source ONS

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