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Savills World Research
Commercial, Residential & Rural

Spotlight
Key Themes for UK Real Estate in 2015

THE UK REAL ESTATE MARKET IN 2015

Strong capital value growth was undoubtedly the key theme of 2014, with growth across all sectors stronger than we were forecasting at the beginning of the year. We expect to see continuing capital value growth across all prime sectors in 2015, albeit at a slower rate.

The general election in spring 2015 will definitely have some effect on sentiment, though in the agricultural and commercial sectors we expect the effects to be relatively muted. In the residential markets the threat of mansion tax, combined with the Mortgage Market Review could lead to a more sustained hiatus in capital value growth in 2015.

Generally we expect that the macro-economic story for the UK will remain benign, with base rates remaining unchanged until early 2016, and the combination of low oil prices and recovering incomes giving a boost to the UK consumer.

The high returns that will be thrown off by all property sectors in the UK will continue to attract attention, and we expect that UK real estate will continue to deliver high returns in comparison to other asset classes.

This will mean that domestic and international demand for prime and good secondary assets will be strong, though we expect to see more focus on supply and demand fundamentals in 2015, rather than just the potential for yield shift.

Our top picks across all sectors are for markets with structural or impending undersupply. We also expect to see more investors looking to the next stages of the recovery, and local markets and regions that will benefit next from the ripple of economic growth away from the south of the country.

Investors who are looking for the highest returns will continue to look for development opportunities, and we particularly favour outer London and the key regional cities as development opportunities in 2015. Speculative development activity will remain sparse, due to investor and lender caution, but those who are brave enough to undertake it will do well.

Overall, we expect that 2015 will be another strong year for UK real estate, but investors are going to have to work harder to identify markets and sectors that will deliver high returns.

Commercial view

The commercial markets in 2015 will still offer opportunities for both risk-averse and risk-embracing investors, though the stronger than expected bounce in capital values in 2014 will diminish.

In London offices, the low level of availability will continue to deliver strong rental growth. We expect to see continuing strong demand from risk-averse international investors for

GRAPH 1

Returns matrix The relationship between income and capital returns by property sector

Source: Savills Research

the best quality stock, with the City of London still looking comparatively cheap, as are some edge of core West End submarkets that are still starved of new-build office stock.

Regional office markets are still very early in the cycle, and this will continue to drive a steady growth in investor interest. 2014 saw the largest proportion of asset purchases outside London since 2006, and we expect this trend to continue.

In the retail markets we expect retail warehousing to perform well due to its internet-friendly nature, and strong high streets and dominant shopping centres will also start to out-perform.

We continue to favour logistics hubs in the centre of the country and around the M25, as well as local multi-let estates close to affluent suburbs.

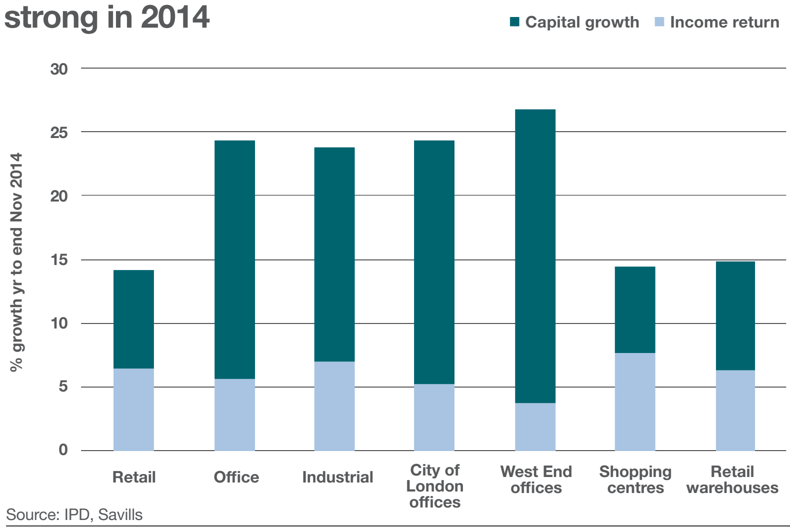
Residential outlook

Returns will be less driven by yield shift in 2015, with the best performance coming from understanding where local markets and sectors are in the rental cycle.

Following a year of strong mainstream house price growth in 2014 that ran well ahead of the economic recovery, we expect much more subdued price growth in 2015. This is particularly the case in London, which has now outperformed the rest of the

GRAPH 2

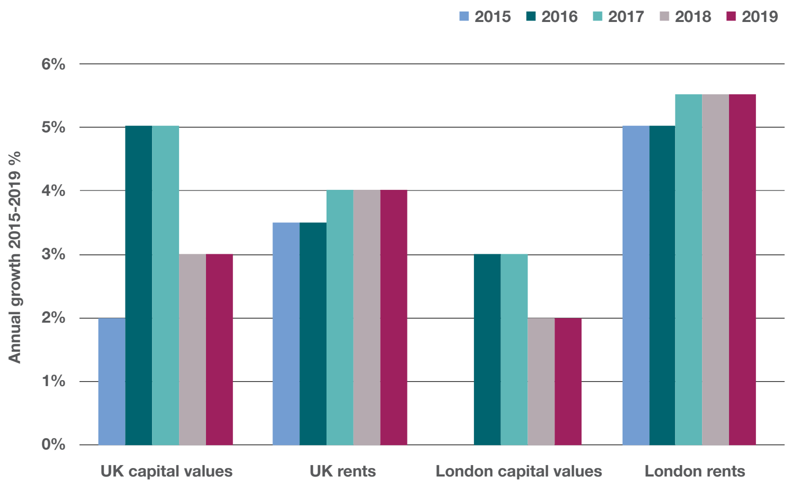
Commercial property returns were exceptionally strong in 2014



Source: IPD, Savills

GRAPH 3

Residential price forecasts



Source: Savills Research

ELECTION IMPACT

Uncertainty could lead to a slight uptick in commercial yields in April and May, but investor demand will bring these back down post-election

Biggest political concern for the commercial markets will remain the referendum on EU membership

Investor opportunities are likely to be influenced by political approaches to incentivisation and regulation in the private rented sector

The threat of a Mansion Tax is likely to subdue prime housing markets in the run up to the election

Uncertainty surrounding further taxation of wealth may reduce buyer activity of those whose primary motive is transfer of wealth from one generation to the next

EU farm subsidies provide a significant income stream, future relationships with the EU and alternatives offered by UK Government will be closely watched

UK for over nine years and where correspondingly, affordability is likely to look increasingly stretched as interest rates rise.

In addition, the mortgage market review is likely to restrict the amount which people are able to borrow. In turn, this is likely to restrict mortgaged buyers' ability to get on or trade up the housing ladder, thereby continuing to drive demand into the private rented sector and underpinning rental growth.

The ongoing debate around the taxation of high value property is likely to mean a relatively muted prime market in the run up to the election. While the mainstream market may receive a one off fillip from the stamp duty changes in the 2014 Autumn Statement, prime markets that are bearing an increased tax burden will also have to contend with political rhetoric regarding a potential mansion tax, even though the medium term prospects remain positive.

Agricultural perspective

We expect further growth in UK farmland values in 2015 but the market will continue to be diverse and a clear understanding of local market conditions will be critical to both buyers and sellers to ensure realistic expectations. There will be factors that are likely to dampen the rate of growth.

Agricultural incomes are inversely correlated to economic growth and continued improvements in the economic climate will put some pressure on farm incomes and therefore capital and rental values across all sectors.

We are already seeing pressure on commodity prices and this is likely to continue into this year affecting farm profits and cash flows and may lead to increased supply at a local level.

Uncertainty will be a key market factor in 2015. During 2014 the Scottish Referendum and proposed Land Reforms had a significant effect on the Scottish market, both in terms of reduced activity and stifled value growth. No doubt these political concerns in Scotland will continue into 2015, and across the UK the outcome of the General Election will create additional market uncertainty.

However, the fundamental factors driving UK farmland value growth remain. Supply is historically low, the product is finite, competing land uses and diverse ownership motives all ensure value growth remains positive.

GRAPH 4

Agricultural forecasts

Source: Savills Research

Please contact us for further information

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Agricultural

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Savills Research Dept
The Savills research team is unique in providing advice and analysis to clients across all commercial, residential and agricultural sectors of the property market. The established team has a strong reputation for producing accurate, well-informed and, above all else, independent analysis and commentary. External clients include developers, landlords, investors and occupiers.

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company, established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 600 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

Forecast values

WHERE TO INVEST IN 2015

Savills growth forecasts for the commercial, residential and agricultural sectors for 2015

Sector	Subsector	2015			Average 2015-19	
		Gross Yield	Capital Growth	Rental Growth	Capital Growth	Rental Growth
Retail	Prime	↑ 4.5%	↑ 7.0%	↑ 5.6%	↑ 2.0%	↑ 2.5%
	Secondary	↑ 7.0%	↑ 9.0%	↑ 0.4%	↑ 1.3%	↑ 1.5%
Office	Prime	↑ 4.75%	↑ 7.0%	↑ 6.0%	↑ 2.0%	↑ 4.0%
	Secondary	↑ 7.5%	↑ 10.0%	↑ 0.3%	↑ 1.5%	↑ 3.0%
Industrial	Prime	↑ 4.5%	↑ 10.0%	↑ 3.0%	↑ 1.5%	↑ 2.5%
	Secondary	↑ 7.5%	↑ 6.6%	↑ 0.5%	↑ 1.5%	↑ 1.0%
Residential	Prime London*	↑ 3.2%	↓ -0.5%	↑ 2.5%	↑ 4.5%	↑ 3.4%
	UK Mainstream	↑ 5.1%	↑ 2.0%	↑ 3.5%	↑ 3.9%	↑ 4.1%
	London Portfolio	↑ 4.3%	↑ 0.0%	↑ 5.0%	↑ 2.1%	↑ 5.9%
	Regional Portfolio	↑ 7.7%	↑ 2.5%	↑ 2.0%	↑ 3.9%	↑ 3.0%
Agricultural	Top Quality	↑ 1.5%	↑ 8.0%	↑ 5.0%	↑ 8.0%	↑ 6.0%
	All Farmland	↑ 1.3%	↑ 4.0%	↑ 4.0%	↑ 5.4%	↑ 5.0%
	Poor Quality	↑ 1.4%	↑ 0%	↑ 3.0%	↑ 2.2%	↑ 4.0%

Source: Savills Research

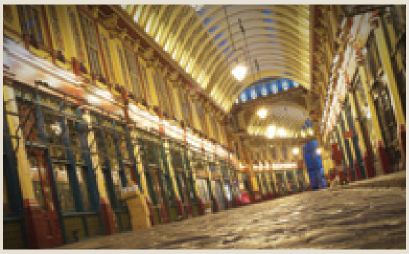
*Assumes no further changes in the taxation of high value property

WHAT ARE THE TOP PICKS FOR 2015?

Commercial

■ London offices and retail
Low vacancy rates and strong rental growth prospects support the low yields. Best growth to come in "future core" locations and high quality transport nodes.

■ Retail
Secondary pitches in prime locations, and London suburbs. Secondary markets with affordable rents to witness rental growth from mid 2015 as housing markets recover.



■ Industrial
Lack of supply investment stock across the country will see investors move up the risk curve so units let to strong covenants outside of core locations will become attractive.

Residential

■ London commuter towns
The price differential between London and these towns widened further in 2014 and is likely to present opportunities for those looking to upsize without incurring significant additional cost.

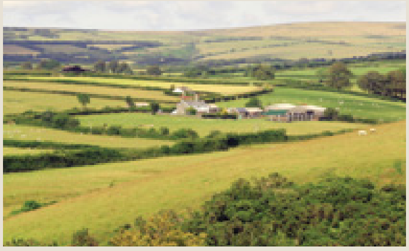
■ The £750k-£1.5m market
Largely unaffected by risks of mansion tax and less dependent on mortgage finance than the mainstream, this sub-market can benefit from those looking relocate and buy a property below potential tax thresholds.

■ 3 bedroom investment stock
Increasingly households are renting in later life stages, which enables investors to buy small family housing to bring diversity to their residential investment portfolio.

Agricultural

■ Large quality commercial farms
Scale and the opportunity for top quartile income potential whilst owning a tax efficient asset for the transfer of wealth will ensure demand remains strong for these properties.

■ Quality rural estates
A diverse portfolio of property assets offering good income potential, that is free of commodity price volatility, will continue to be a safe purchase.



■ Residential farms
These may offer opportunities as the economy improves and especially so where recognised as good value when compared to arable land and where improvements will enhance future value.