UK Commercial – January 2022

MARKET IN MINUTES
Savills Research

Market in Minutes

savills

Well poised for a stronger 2022?

Rising commercial property investment levels in the UK, with yields beginning to trend downwards again, the market is poised for a positive 2022. The occupational drivers, notably hiring intentions by companies and lower unemployment figures, are positive news. However, political issues, energy costs and rising prices more generally have dominated the conversations for the start of this year.

Looking through these (hopefully) transitory issues, which will pass sooner rather than later, there are pockets of good news. In the retail warehouse sector, with no major insolvencies, growing consumer spending and the additional sales driven by click and collect, the sector is showing much lower yields compared to 12 months earlier. Despite the onset and acceptance of hybrid working, there remains confidence in the office sector with some very strong locations, e.g. Oxford and Cambridge. Overall, initial analysis shows that the office occupational demand data was relatively positive for 2021, with some markets around their five-year average.

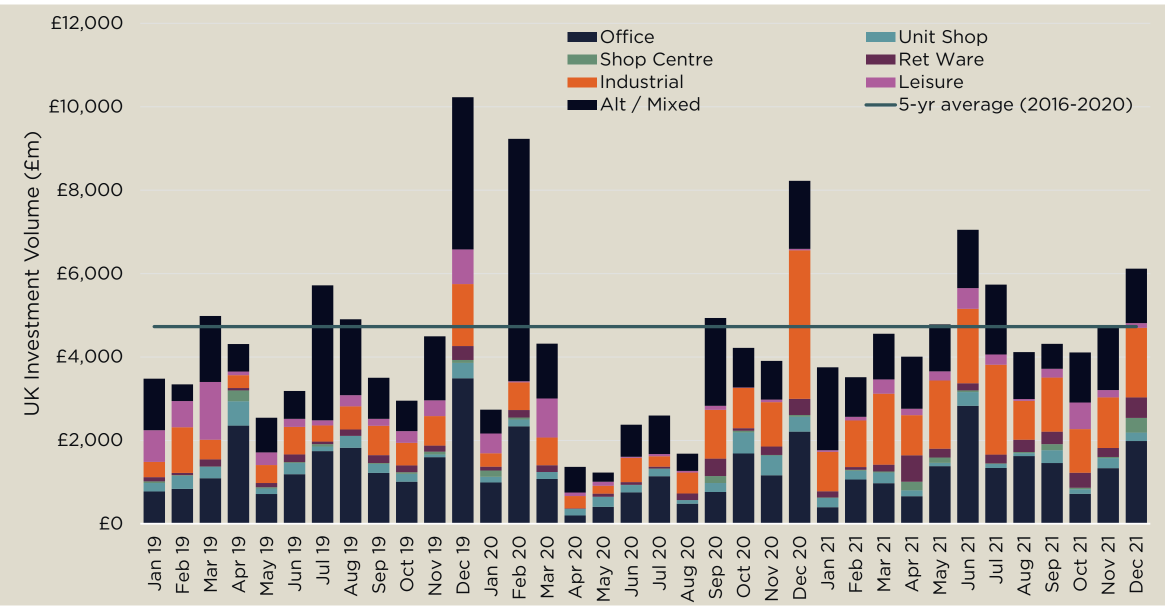
In terms of investment volumes, the latest data for 2021 shows that c.£57bn was invested in the UK last year, which is slightly above the five-year average, but a 21% increase on 2020. We expect a 10% increase, compared to 2021, this year.

Savills prime yields

	December 2020	November 2021	December 2021
West End Offices	3.50%	3.25%	3.25%
City Offices	4.00%	3.75%	3.75%
South East Offices	5.50%	5.50%↓	5.50%↓
Provincial Offices	5.00%	4.75%	4.75%
High Street Retail	6.50%	6.50%	6.50%
Shopping Centres	7.00%	7.50%	7.50%
Retail Warehouse (open A1)	6.50%	5.50%	5.25%
Retail Warehouse (restricted)	6.50%	5.75%	5.50%
Foodstores (OMR)	4.50%	4.50%	4.50%
Ind/ Distribution (OMR)	3.75%	3.25%	3.25%
Industrial Multi-lets	3.75%↓	3.25%↓	3.25%↓
Leisure Parks	7.25%	7.50%	7.25%
London Leased (core) Hotels	4.00%↑	3.50%	3.50%
Regional Pubs (RPI)	5.00%	5.25%	5.25%

Source Savills

A strong finish to 2021 Looking at the UK commercial investment volumes, there were five months in 2021 at or above the five-year average

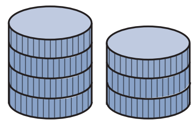


Source Property Data, Savills

Key Stats

4.93%

The UK average prime yield



£57bn
2021 UK commercial investment volume. In line with the five-year average

3

Number of sectors that saw yields move lower in December

How have yields moved during the Covid-19 period?

At the start of the year, it is sensible to examine where we believe we are in the current cycle. A review of the recent prime yield shifts is especially relevant.

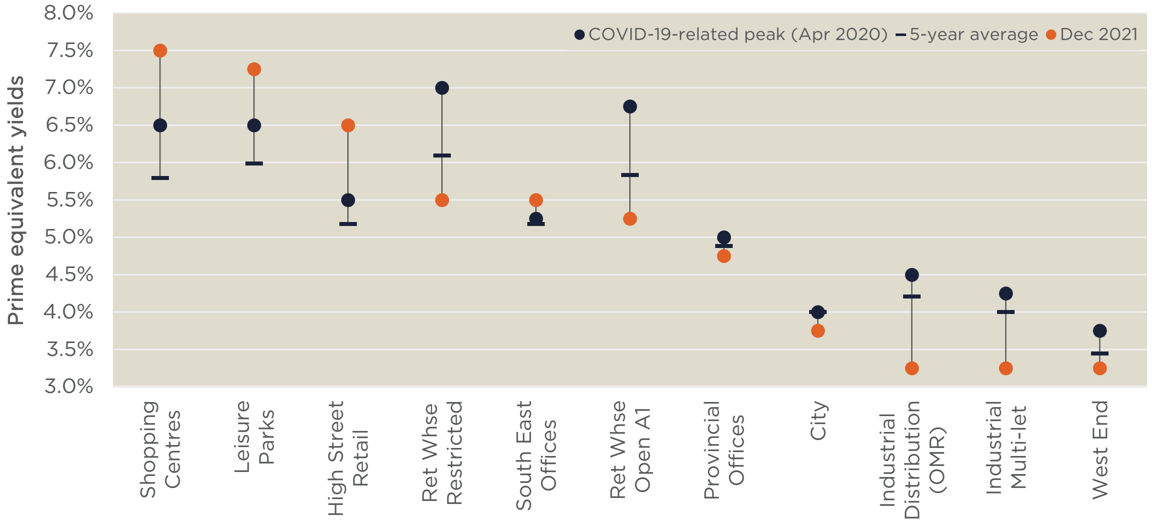
Before diving into this analysis, it is worth noting that the UK commercial property market is supported by relatively healthy demand and supply fundamentals. As we all know, there remain headwinds on many fronts, but investors remain vigilant for the best opportunities to meet their investment objectives. Their strategies will have been reviewed in the past 24 months, but will now form the backbone of their intentions for the next few years.

As was discussed overleaf, the investment volumes for 2021 were more positive than would have been expected at the start of last year. This reflects the more positive investors' sentiment towards the commercial property sector following the significant upward yield shift in April 2020. The chart presents the highest to lowest sector in terms of the current prime yield and the comparison is to both the 'Covid peak' and the preceding five-year average.

The first three sectors are showing current yields much higher than both the peak and the five-year average. Shopping centres have the highest yield, but with a 121% increase for shopping centres investment volumes in 2021 (albeit off a low base from 2020), which shows the opportunities in the current cycle. Clearly, some investors have a new or renewed appetite to buy into the cycle at the right time to attain future growth. The retail warehouse sectors were discussed overleaf, but the chart does show the extent of relative attractiveness of the sector with the yields now currently below the five-year average. Office yields, mainly at the prime end of the spectrum (as shown in the chart), as shown in the chart, have remained broadly unchanged despite the commentary in 2020 regarding the death of the office. The industrial sector, driven by another record-breaking year of occupational demand, has seen yields move significantly and are currently well below the 5-year average, in-line with West End offices.

As shown in the recently published *Savills UK Cross Sector Outlook 2022* report, now available on the Savills website, the sectors covered in the report have return expectations ranging from 4% (shopping centres) to 11.5% (London industrials), per annum on average, during the next five years. Assuming inflation recedes during the course of 2022, which is very likely, this shows commercial property to be an attractive investment.

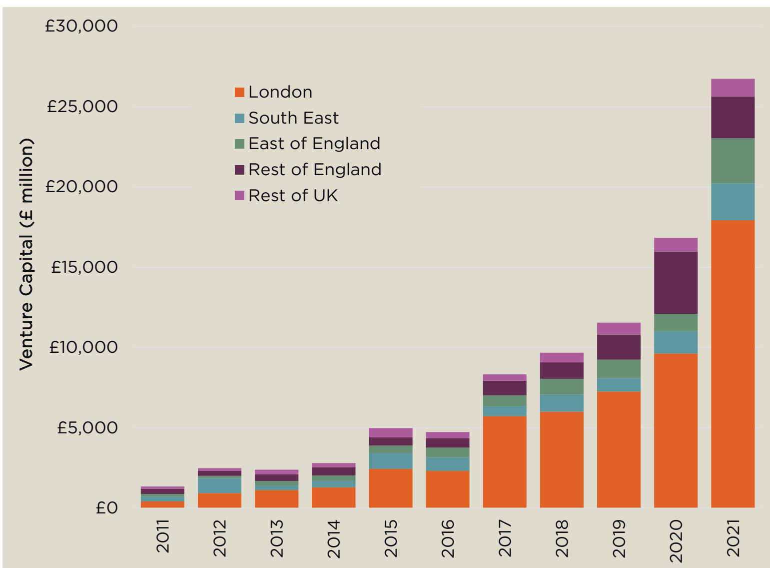
Where are we now? Significant variation of the yield levels compared to 'Covid-peak' and the five-year average



Source Savills

Any metric that helps us to understand the future drivers and/or scale of demand is, of course, important. There are many metrics available, but an analysis of the venture capital (VC) raising activity in the UK is of particular interest. For the recipient companies, VC is often the vital first step to get its business on a stronger growth trajectory. There is corresponding headcount and revenue growth, which results in real estate demand. There are two main takeaways from the chart to the right. Firstly, despite the pandemic, there was a 59% increase in the total level of VC raised by UK-headquartered companies. This will drive additional short-to medium-term demand for commercial property, mainly offices. Secondly, there is a significant share in London, but there is also a 'rippling out' to other areas of the UK, where the VC level will impact positively on demand for space in the regional markets.

UK companies attracting more capital Demand will grow



Source PitchBook, Savills

Savills team

Please contact us for further information

James Gulliford
Joint Head of UK Investment
020 7409 8711
jgulliford@savills.com

Richard Merryweather
Joint Head of UK Investment
020 7409 8838
rmerryweather@savills.com

Steven Lang
Director
Commercial Research
020 7409 8738
slang@savills.com

Savills plc: Savills plc is a global real estate services provider listed on the London Stock Exchange. We have an international network of more than 600 offices and associates throughout the Americas, the UK, continental Europe, Asia Pacific, India, Africa and the Middle East, offering a broad range of specialist advisory, management and transactional services to clients all over the world. This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. While every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.

savills