MARKET IN MINUTES
Savills Research

Savills ProgrammE and Cost Sentiment Survey

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“As global economies and capital markets remain volatile we have seen a material impact on the amount, and nature, of new build projects. This excess capacity is now starting to feed into more competitive build cost estimates, for some sectors, when we are tendering for new projects. We expect more sectors to follow the same path into 2024.”

SIMON COLLETT, HEAD OF PROFESSIONAL SERVICES

Early signs of build costs starting to fall

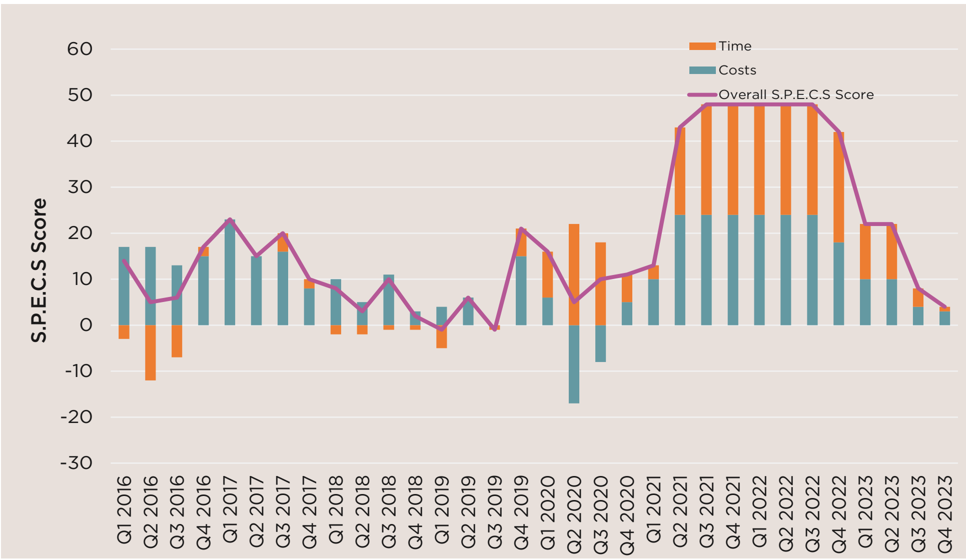
With a continued difficult and uncertain economic backdrop combined with a challenging debt market we are starting to see early signs of softer pricing and greater capacity in the wider construction supply chain. The logistics sector, for example, has seen new speculative development announcements fall dramatically and build-to-suit transactions fall by 80% year on year. With this much activity removed from the market we have started to see a fall in build costs on projects that have been recently tendered. This is the first fall in the logistics sector since 2020.

With central banks guiding that markets should expect base rates to be “higher for longer” economic forecasters are suggesting that we should not expect falls in interest rates until the middle of 2024. This would suggest that construction capacity will remain at elevated levels until this barrier to development is removed as 2024 progresses.

We expect to see continued bifurcation in the market as investors and developers grapple with re-purposing existing stock to better meet ESG requirements. When new build construction rebounds it may be that any construction supply chain capacity will already be working on refurbishment projects, thereby pushing costs higher for new build projects.

This is reflected in our latest S.P.E.C.S index with a score of 4 which is the lowest score since Q2 2020 at the onset of the Covid-19 pandemic. This suggests that we are now seeing price falls in some sectors both in terms of project costs and timescales. With development activity expected to remain constrained, on the whole, it is likely that we will see further falls in the index as 2024 progresses.

S.P.E.C.S Q4 2023



Source Savills Research

Q4 2023 S.P.E.C.S Indicators

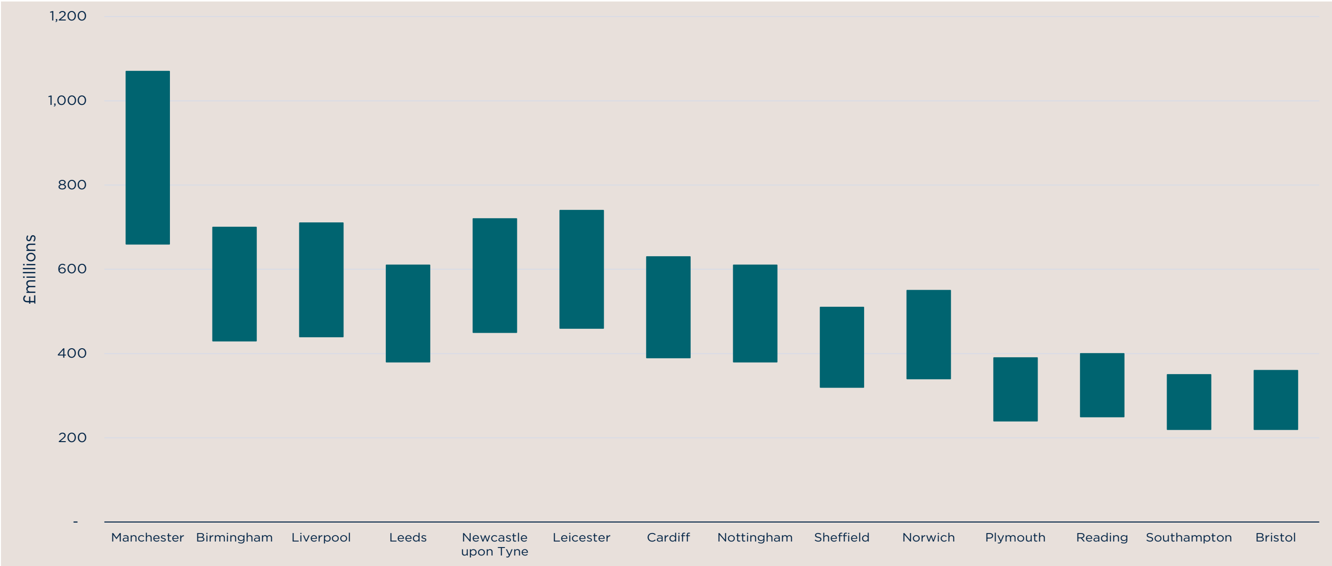
	New build and refurbishment costs	New build and refurbishment timescales*	Occupier fit-out costs	Occupier fit-out timescales*
Offices - Central London	↑	↔	↑	↔
Offices - Regional	↑	↔	↑	↔
Warehousing <100,000 sq ft	↓	↓	↔	↔
Warehousing 100,000 - 500,000 sq ft	↓	↓	↔	↔
Warehousing 500,000+ sq ft	↓	↓	↔	↔
Central London prime residential	↔	↔	↔	↔
Central London mid-market residential	↔	↔	↔	↔
Regional mid-market residential	↔	↔	↔	↔
Foodstores	↑	↑	↑	↔
High street retail	↓	↑	↔	↔
Out of town retail	↓	↑	↔	↔
Shopping centre	↓	↑	↔	↔

METHODOLOGY & APPROACH

Savills Building and Project Consultancy sector experts track build cost and programme timescales sentiment across 48 separate markets and sectors. A high S.P.E.C.S score would mean that most sectors are experiencing upward cost and timescale pressure whereas a highly negative score would suggest that most markets and sectors are experiencing downward pressure. A score around zero suggests that build costs and programme timescales are largely static.

LATEST IMF FORECAST SHOWS 0.6% UK GDP GROWTH IN 2024

Source Savills Research **Note** *Time taken from project sign off to commencement including procurement and delivery of building components



Retail Estimated cost range for key UK cities to reach EPC Grade B by 2030

Source Savills Research

Retail rebuild or retrofit - Is it cheaper to redevelop, or are the economics moving in favour of reuse?

Whilst the latest data from our S.P.E.C.S index highlights a growing level of stability in build costs it is worth remembering that they have risen dramatically. And with rental growth not being a given across the board in the retail sector all investor landlords will be faced with a fundamental economic and moral dilemma for ageing retail stock: whether to replace or refurb?

Even in recent times, when retail repurposing has become a hot topic due to significant occupational headwinds in some quarters, rebuilding has often been seen as more viable because redeveloped schemes are able to seek value from expansion and densification. Retrofitting on the other hand can require significant compromises due to the existing building configuration and structure that tinkering with can, at times, feel like driving a square peg into a round hole.

However, this is not always the case. Retail park and larger shopping centre units tend to lend themselves well to adaptation, whether to fitout the needs of a new tenant, or to upgrade environmental performance. Small high street units are however an entirely different proposition.

From our experience, any new building retail stock is high performing from a sustainability perspective; although the embodied carbon remains considerable. But, how many brand new-build retail schemes are actually being constructed? In the UK, the number of new significant retail schemes in the last decade can almost be counted on one hand.

Instead, most retail development is happening to existing schemes. Repurposing of redundant retail stock is starting to gather pace, with different places seeing units reconfigured or wholesale demolished and rebuilt.

This question is increasingly being decided by one big factor: the climate crisis. Before any financial case can be understood, investors should first be appraising their retail standing assets against their ESG strategy—if they have one—and, as a minimum, against the UK Government's Net Zero Carbon strategy to eliminate emissions by 2050.

This can be done by undertaking an ESG due diligence appraisal of a retail building or portfolio to help understand the current ESG versus the potential performance (i.e. the ability to influence).

The EPC challenge faced by landlords is also a considerable headache if they're to reach MEES grade B by 2030. We estimate that the cost to upgrade a retail shell from an E to a B is likely to be around £40-80 per sq ft. This is a significant challenge for landlords with huge estates and the capex is massive, but equally for owners of small shops (where, in fact, a larger proportion of 'problem' stock lies) this presents an almost impossible proposition.

Ultimately, there's no straightforward answer whether to demolish and rebuild or retrofit. The financial case therefore should be predicated on the ESG Strategy. In many cases, the more environmentally-friendly option is to retrofit a building using materials that are as sustainable as possible, while at the same time maximising its energy efficiency.

For more information on repurposing retail please visit here.

BIODIVERSITY NET GAIN – THE EFFECT ON CAR DEALERSHIP DEVELOPMENT

New planning applications for car dealership developments or extensions will shortly have to provide a minimum 10% biodiversity net gain (BNG) to achieve planning permission, unless the scheme proposed is below 25 square metres (269 sq ft) of habitat or less than 5 metres of linear habitat such as hedgerow.

Whilst BNG requirements will be site specific and depend on local habitat requirements, thought will have to be given to measures such as additional landscaping or green roofs. In order to meet the 10% requirement on-site, it could lead to a reduction in the developable area or vehicle display and parking, or require larger sites.

Most developments tend to be on brownfield sites which are likely to have a lower BNG baseline position than undeveloped land. However, allowance will still need to be made for 10% uplift which may conflict with proposals that do not have capacity to accommodate habitat creation.

For more insight on this topic and to download our research please visit here.

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