UK Commercial – January 2021

MARKET IN MINUTES
Savills Research

Market in Minutes

Beds and Sheds help 2020 finish strongly

In what has been a tumultuous year for the investment market, it finished with a relatively strong Q4 where £12.4bn was transacted. This meant that total investment volumes for the year reached £41.8bn, a fall of 22% on 2019, but a strong performance given the market was in all but hiatus in Q2 which saw the lowest quarterly investment volume since 2009, at £4.2bn.

The year has seen sentiment from the occupational market carry over directly into trading volumes as historic norms for capital allocation have changed dramatically. For example, the industrial and logistics occupational market has seen record take-up at 50.1m sq ft, driven in the most part by online retailers securing space as a result of Covid-19. This has seen investment volumes rise to £8.2bn, which whilst not a record in volume terms, does account for 20% of the whole market proportionally, the highest level ever recorded. Alternatives also set a new record at 35% of the market, whereas the office and retail sectors had their lowest share of the market ever at 30% and 15% respectively.

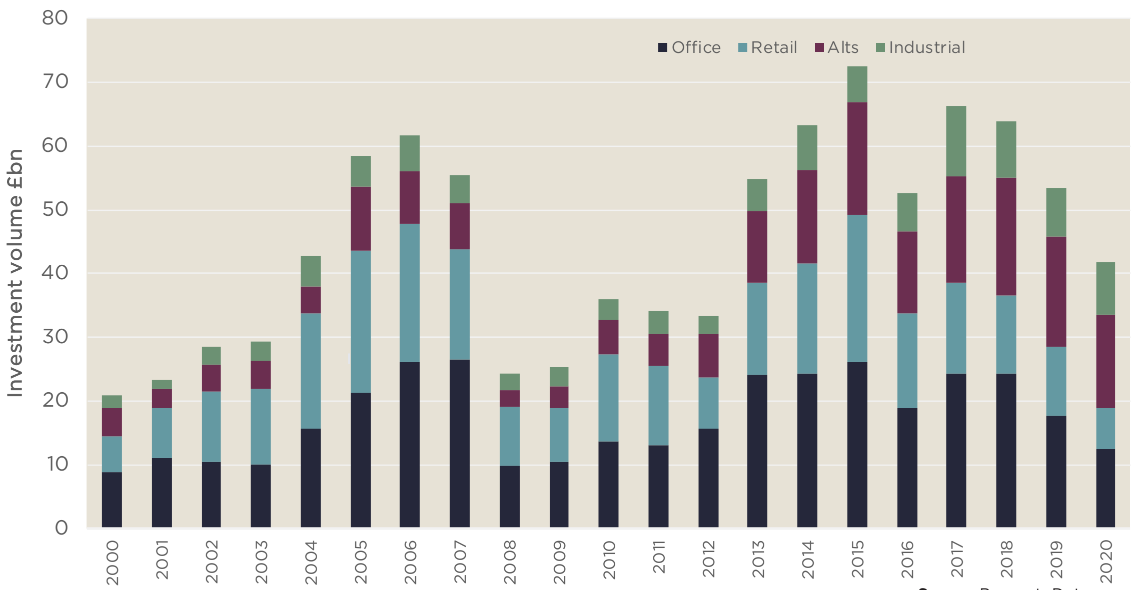
The retail warehouse sector continues to offer investors value, but is also expected to perform strongly in an occupational sense post Covid-19. Q4 saw Railpen purchase Cambridge Retail Park for £100m (6% NIY) helping set a new yield tone in the process. This meant our prime Retail Warehouse yield moved to 6.25% which, in turn, brought the Savills average yield down to 5.18%, a fall of 29bps over the last 12 months.

Savills prime yields

	December 2019	November 2020	December 2020
West End Offices	3.75%↓	3.50%	3.50%
City Offices	4.00%	4.00%	4.00%
Offices M25	5.00%↑	5.50%	5.50%
Provincial Offices	4.75%↑	5.00%	5.00%
High Street Retail	5.50%	6.50%	6.50%
Shopping centres	5.75%↑	7.00%	7.00%
Retail Warehouse (open A1)	6.50%	6.50%	6.25%
Retail Warehouse (restricted)	6.50%	6.75%	6.50%
Foodstores (OMR)	4.75%	4.50%	4.50%
Ind/ Distribution (OMR)	4.25%	3.75%↓	3.75%↓
Industrial Multi-lets	4.00%	3.75%↓	3.75%↓
Leisure Parks	5.75%	7.25%	7.25%
London Leased (core) Hotels	3.75%	4.00%↑	4.00%↑
Regional Pubs (RPI)	4.50%	5.00%	5.00%

Source Savills

2020 Investment Volumes Under £50bn for the first time since 2012



Source PropertyData.com

Key stats

29

Savills average prime yield fallen by 29bps in 12 months

£41.8bn
was invested into UK commercial property in 2020, a fall of 22% from 2019

20%

Industrial & Logistics accounted for 20% of the market, the highest proportion ever

Global and local issues mask fundamentals

Given that the UK and EU have agreed terms on a trade deal, it is tempting to agree with Boris Johnson that "Brexit is done". However, as we have seen in the first weeks of 2021, companies are finding the adjustments difficult to navigate with delays at the border already being reported. It should also be noted that the agreed deal does not touch financial services, a vast part of the UK economy and highly relevant to many office occupiers. The documents published state an aim to sign a co-operation agreement to cover financial services regulation by March. The market moves faster than policymakers, however, and the financial sector has already implemented plans to continue working with EU clients by gaining regulatory licences in EU jurisdictions and moving certain operating functions there. Some 7,000 jobs have shifted from the UK to the EU in support of these arrangements, according to the Bank of England.

January has also seen the inauguration of Joe Biden as President of the United States. Whilst his policies relating to commercial real estate remain unclear, we can expect a more far-reaching policy agenda now that the Democrats hold both legislative chambers. Indeed, prior to inauguration, plans have been published for a $1.9tr fiscal stimulus and more can be expected if the US economy doesn't rebound as planned post Covid-19. And whilst keen to strengthen the UK/US special relationship, there is no suggestion that a Biden administration would expedite talks relating to a UK/US trade deal.

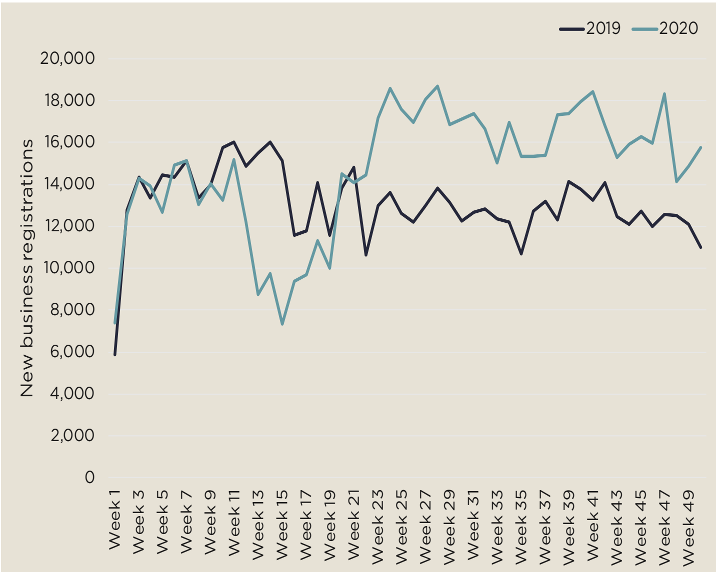
Closer to home, ESG will continue to rise up the agenda as the UK will host the postponed COP 26 Summit in November where new ambitious global emissions targets are expected to be agreed. Also not currently gaining much airtime are the Federal Elections in Germany planned for September 2021 which will see Chancellor Merkel step down after 15 years in power. Uncertainty reigns as to which candidates will emerge for the Chancellorship and whoever emerges could take Germany in different policy directions to their predecessor.

Whilst it seems there is so much macroeconomic uncertainty, the fundamentals of UK real estate remain strong with vacancy rates across sectors and geographies remaining historically low. In central London, whilst vacancy has risen by 230bps to 7.2% in 2020, it remains some way off the last high watermark of 9.6% in 2009. In the regional market, a lack of development and continued take-up of prime buildings has seen Grade A vacancy fall to just 3%. In the logistics sector, vacancy has reached its lowest point for three years at 5.7%, and perhaps surprisingly, given the sentiment around the retail sector, the vacancy rate for retail warehousing remains lower than logistics at just 5.5%.

Another reason for optimism is the fact that new business registrations have increased by 30% in the four weeks to mid-December compared with the same period last year, and the annual growth rate has been above 10% since June. Whilst these new registrations show economic promise , it will take time for any meaningful growth to show in floorspace requirements.

When those requirements do emerge, it is unlikely they will find an oversupplied market, which ever sector they are in.

New business registrations trending higher than 2019

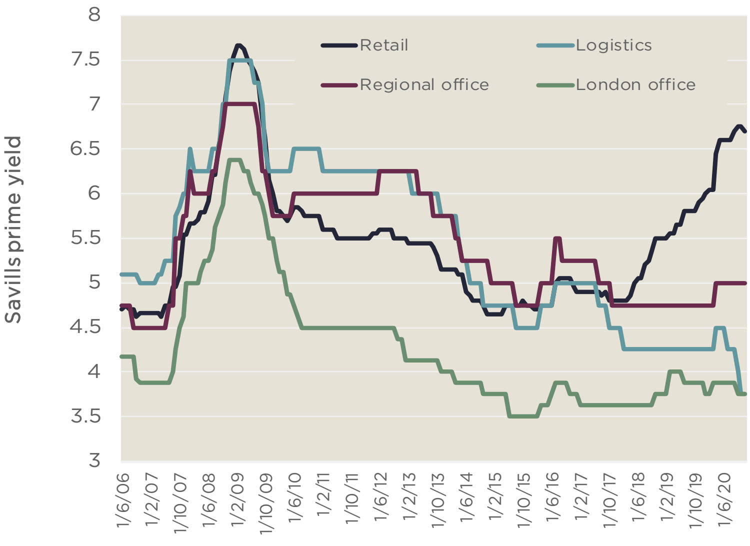


Source ONS

The uniqueness of the Covid-19 period has led many commentators to suggest that things will be markedly different going forward. However, the performance of most commercial occupational and investment markets this year has been typical of past recessions, and this leads us to conclude that 2021 and beyond will be very recognisable to anyone who has worked through previous recovery phases of the UK property market.

This does not mean that changes will not take place, but that many will be a continuation or acceleration of trends that were already present in the market before Covid-19. As the chart highlights, 2020 has seen an acceleration of the divergence between logistics and retail yields that has been happening for much of the past decade. The record-high levels of leasing activity in the logistics market in 2020 will drive even more investor interest in an already crowded sector, and thus put further downward pressure on yields. For more information on our picks for 2021, please see our recently released [Spotlight: UK Cross Sector 2021.]

Prime yield divergence A trend accelerated, not started, by Covid-19



Source Savills

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