MARKET IN MINUTES
Savills Research

Market in Minutes

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No change in February

In terms of yields movement, considering the "wait and see" impact of Brexit, it is no surprise to have seen a static month in February, across the board. Another rejection of the Governments' deal for leaving the EU reflects the degree of stasis in the UK investment market - neither upward nor downward movements or even a change in the trend arrows.

The beginning of 2019 will continue to be dominated by the political events. The impact on the occupational market will feed through over time, but immediate headline news such as car manufacturers ending or reducing production the UK deals an immediate blow to sentiment.

The economy is forecast to grow more slowly this year, compared to expectations at the end of 2018. In the recent Spring Statement, UK GDP growth has been revised down from 1.6% in 2019 to 1.2%. Slower growth will have a negative impact on the occupational markets, driven by lower corporate activity and growth. Investment volumes, as at mid-March 2019 are currently 49% below the same period in 2018. The first couple of months was reported as being 40% below, so clearly the last couple of weeks has shown further weaker investor sentiment in the UK. However, 2019 is likely to represent the 'peak risk' to the UK property markets, assuming an orderly exit from the EU. Looking further out and considering current sentiment, forecasts for UK annual average total returns are shown below.

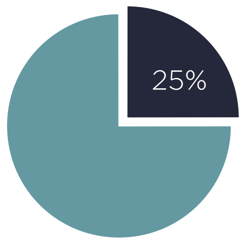
Savills prime yields

	Feb 18	Jan 19	Feb 19
West End Office	3.25%	3.50%	3.50%
City Offices	4.00%	4.00%	4.00%
Offices M25	5.00% ↓	5.00%	5.00%
Provincial Offices	4.75%	4.75%	4.75%
High Street Retail	4.00%	4.50% ↑	4.50% ↑
Shopping centres	4.75%	5.25% ↑	5.25% ↑
Retail Warehouse (open A1)	5.00%	6.00%	6.00%
Retail Warehouse (restricted)	5.25%	6.25%	6.25%
Foodstores (OMR)	4.50%	4.75%	4.75%
Industrial Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.25% ↓	4.00%	4.00%
Leisure Parks	5.00%	5.50%	5.50%
Regional Hotels	4.50%	4.25%	4.25%

Source Savills

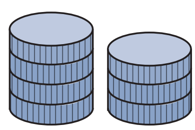
Key Stats

Outward shift in Savills average prime yield during the past 12 months



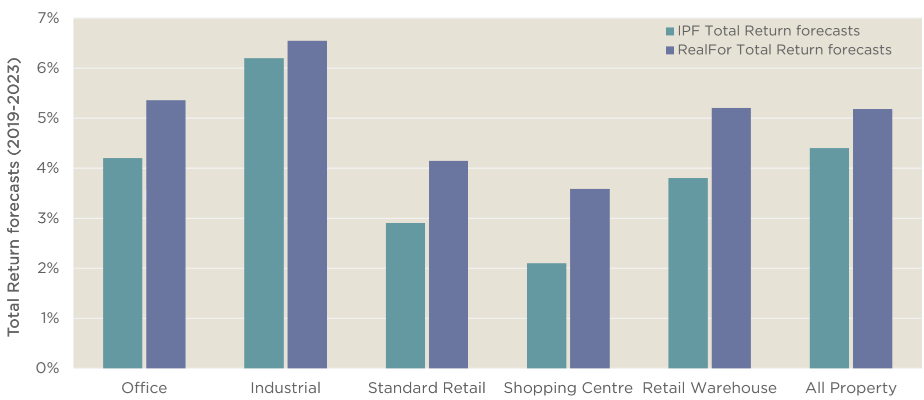
Office sector share of total UK investment in 2019

2019 UK investment volume change compared to 2018



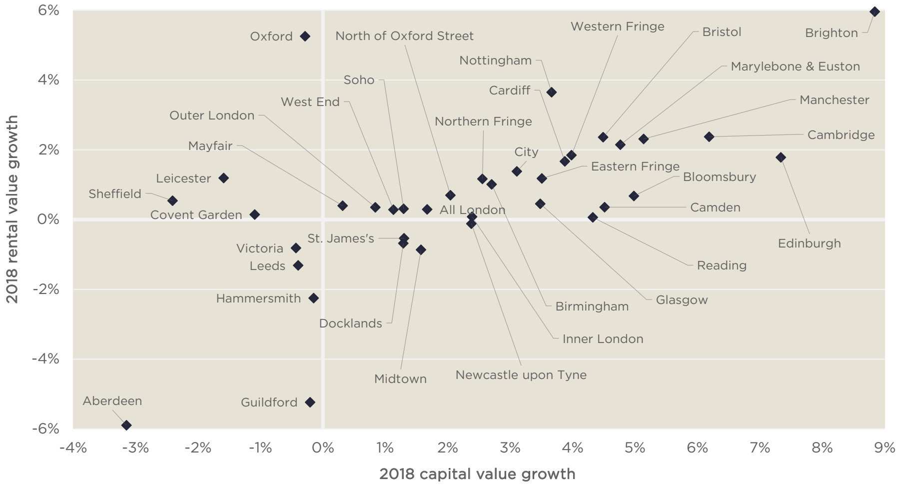
£5.2bn
Total, all sector, 2019 investment volume to mid-March

UK Sector Forecasts Industrial still leads the total returns expectations



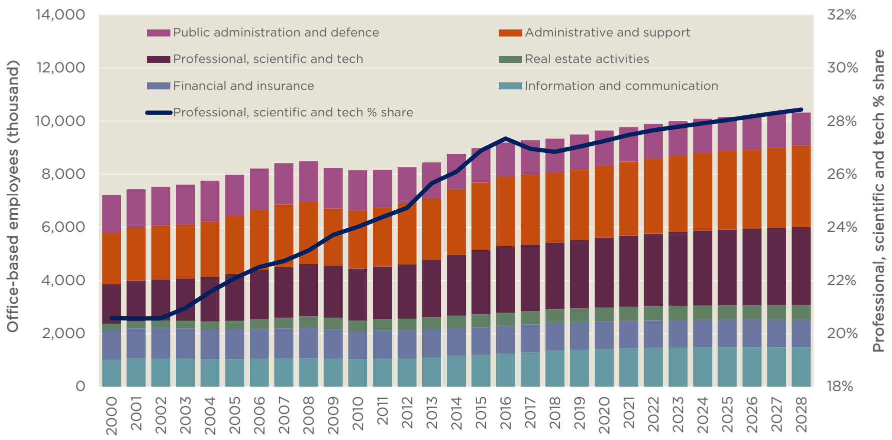
Source Investment Property Forum, RealFor

Mix of performance for office markets in the UK



Source MSCI, Savills

Office-based employment still on a rising trend



Source Oxford Economics

OFFICE PERFORMANCE VARIED SIGNIFICANTLY ACROSS THE UK IN 2018

Last month was a focus on retail, so this month we have moved to the office sector to review the most recent property performance trends, for values and rental growth and a look at the future for employment. The performance data is based upon the MSCI quarterly index and represents average property, in terms of quality.

Analysis of the UK office investment volumes show that £1.3bn has been invested so far in 2019, which is 62% lower than the same period in 2018. This is also lower than the 49% fall for all commercial sectors.

Now that the 2018 MSCI performance data for specific office markets is available, it is interesting to understand the varying performance of these across the UK. The differential in capital growth and rental growth has been shown in the top chart and it is important for investors to identify where specific markets are in their cycle and which have seen significant under/over-performance. The eye is drawn to the 'outliers'. Clearly, Brighton, Edinburgh and Cambridge, with positive occupational markets, having low office availability and limited choice for occupiers, has resulted in valuers applying higher rental value growth and above average increases in capital values. In direct comparison to Cambridge, Oxford has seen limited growth in capital values but the strengthening occupational market has pushed rental growth relatively higher - this will feed through to income return in the medium-term and have a positive impact on values.

Overall, the top chart shows that some markets are at different points in the wider office property cycle. For example, some have been 'hit' with a short-term structural shift impacting from a weaker local occupational market, e.g. Aberdeen. However, for Aberdeen, despite having been a lower performing office market, in the current cycle, it is still a key city is expected out-perform as sentiment recovers.

OFFICE-BASED EMPLOYMENT FORECASTS STILL POSITIVE FOR THE NEXT 10 YEARS

The 10-year forecasts for UK office-based employment, as shown in the chart above, shows a rising trend. Despite the notion of automation/AI replacing human activity for specific tasks, there still remains a need for additional office space in the future. In a post-Brexit world, the UK will increasingly play to its strengths and the rising percentage share of employees within the 'professional, scientific and tech' sector is key. Office space for these sub-sectors should be an investor's focus.

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