UK Commercial Market in Minutes
Don't believe the hype

November 2018

Brexit hiatus ahead?

■ Last month saw few changes to our prime yields, with the overall average creeping up 4bps due to the expected rise in retail warehouse yields.

■ As we have touched on in previous Market reports, we increasingly feel that pricing is becoming divorced from actual prospects, and we touch on why speculation about the demise of both London offices and UK retail might be overplayed overleaf.

■ However, a more pressing issue for the UK investment market is the annual question that happens around this time of year of how strong the final quarter will be. Traditionally the fourth quarter of the year accounts for 30% or more of the annual activity, as investors (and agents) rush to complete deals by the year end. However, this year with March 30th 2019 very much at the forefront of many investor's minds, the question of whether it is worth delaying deals is coming up a lot.

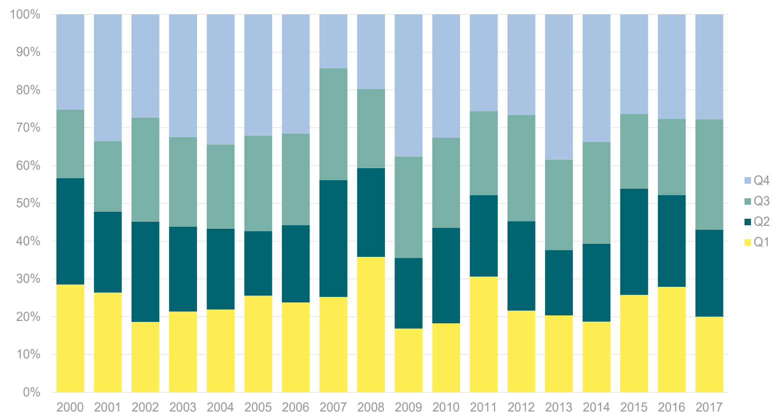
■ For buyers, particularly those who do not have to hedge the currency, the reasons to wait and see look clear. There is little prospect of prices rising over the next six months (other than perhaps in London logistics), and a disorderly Brexit would undoubtedly result in further falls in the Pound. Some investors might even be hoping for distressed selling (as was briefly seen in Q3 2016). Vendors might also be tempted to hold back open marketing of assets to avoid poor levels of interest or even low bids.

■ We think that some, but not all, of these arguments hold water. Distressed selling is probably the least likely scenario given the low LTVs that have been prevalent in the market since 2008, and the high cash balances that the retail funds have built up since 2016.

■ However, this year more than most, it may be worth not spending on Black Friday if you think a better deal will be available in the Spring sales!

GRAPH 1

All eyes swing to final quarter investment volumes - could things be different this year?



Graph source: Savills

TABLE 1

Prime yields

	Oct 17	Sep 18	Oct 18
West End Offices	3.25%	3.25%	3.25%
City Offices	4.00%	4.00%	4.00%
Offices M25	5.00%	5.00%↑	5.00%↑
Provincial Offices	5.00%	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)	5.25%↓	5.50%↑	5.75%
Retail Warehouse (restricted)	5.50%↓	5.75%↑	6.00%
Foodstores	4.75%↓	4.50%	4.50%
Industrial Distribution	4.75%↓	4.25%	4.25%
Industrial Multi-lets	4.50%↓	4.00%	4.00%
Leisure Parks	5.00%↓	5.25%	5.25%↑
Regional Hotels	4.75%↓	4.25%	4.25%

Table source: Savills. Arrows indicated expected forward trend

London office 'Brexodus'?

■ As recently as the beginning of 2017 some quite serious pundits were speculating the London could lose as many as 200,000 financial services job to the EU due to the loss of passporting. However, a recent Reuters survey of more than 100 companies in that sector came to the conclusion that only 630 had moved or been created in the EU to date.

■ The same survey suggested that in the event of a "hard" Brexit the total job losses would be around 5,800.

■ While it could be argued that survey results are equally at risk of positive hype than negative, the metrics on the ground in the London office market point to a dramatically more positive story than anyone expected back in 2016.

■ In the City investment market the volume of transactions over the first ten months of 2018 reached its highest ever level for that period (£9.47bn, 7.6% up on the same period in 2017).

■ Looking across all commercial property sectors London has retained its crown as the world's most popular destination for cross-border investment into real-estate, with inward volumes more than 50% higher than Manhattan.

■ Finally, the occupational market has also remained strong, with 8.9m sq ft leased in the first nine months of 2018. This is only 4% down on the same period in 2017, which was the strongest ever year in the central London occupational market.

■ Given the low vacancy rates and restrained development pipeline, what is probably most surprising is the lack of upward rental growth. Perhaps sentiment has overcome reality?

Retail catastrophe?

■ All retail segments on our prime yield series have softened by 50 basis points over the last 12 months, and many commentators are suggesting that this might only be the tip of the iceberg.

■ However, once again there is a probably a need for a little more rationality (or less generalisation). Has prime retail in the UK really fallen in value by more than 10% over that period, or is a lack of evidence leading to sentiment driven pricing?

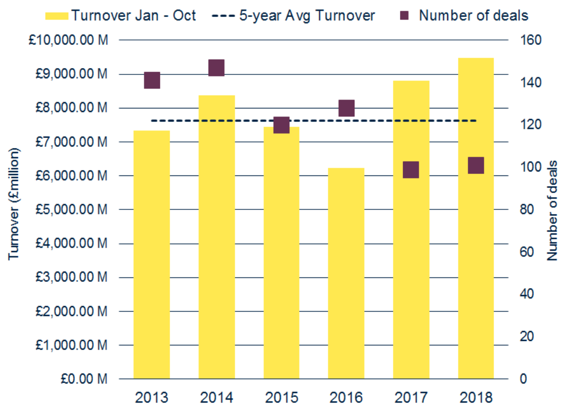
■ There are undoubtedly large scale cyclical and structural challenges to UK retail, but even at the apex of these challenges where retailers are failing or enacting CVAs, only 1.27% of the shops in the UK have been affected (and only 25% of those units will actually close).

■ If you accept that there is good and bad retail, then you should expect the bad retail to be performing worse than the good. However, looking at the MSCI rental growth data it appears that rents on the best and worst schemes are falling in lockstep.

■ The negative noises that have been prevalent around both these sectors over the last 24 months will definitely present an opportunity in 2019. ■

GRAPH 2

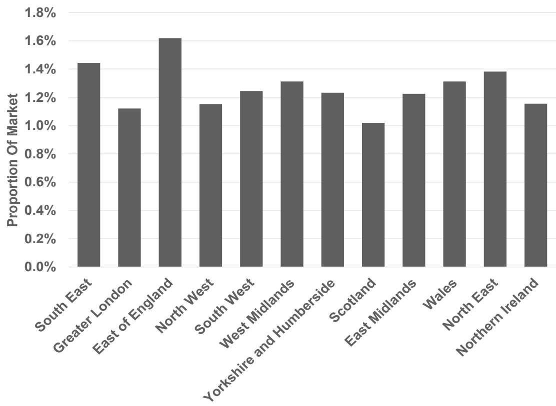
City investment volumes have been at their highest ever level so far this year



Graph source: Savills

GRAPH 3

CVAs and administrations have affected relatively few stores



Graph source: Savills

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