MARKET IN MINUTES
Savills Research

Market in Minutes

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A question of confidence

There have now been several months of yields sitting tight for most asset classes and the question is not whether the bottom has been reached, but how quickly the market will improve. We've highlighted the investment bottlenecks before in terms of stock and capital availability, or cost of debt and construction, but the bottom line appears to be one of investor confidence. Business optimism tends to fluctuate more than consumer confidence, but has proven increasingly volatile since 2020 and more consistent positive sentiment is needed to push yields in the right direction.

For investors primed for action, it's a good time to buy if you have the cash, but a bad time to sell if you are waiting for an improved inflationary environment, or the outcome of the election. History tells us that investment activity is usually improved on the back of a change of government, but also that political uncertainty can delay decision making. The expectation of base rates moving towards 2% and a labour win towards the end of the year means that patience may be required over the next few months. While other headwinds remain, it seems likely that resolving these two factors is key to moving into the next cycle.

Savills average commercial prime yield has now been within 2bps of 6.25% since October. As anticipated in our Jan MiM, retail warehousing saw a 25bps inward movement over the last month, while every other sector has held its position. Industrial yields are expected to follow and move inwards in the coming months as more deal evidence accumulates.

Savills prime yields

	February 2023	January 2024	February 2024
West End Offices	4.00%	4.00%	4.00%
City Offices	4.50%	5.25%	5.25%
South East Offices	6.25% ↑	7.50%	7.50%
Provincial Offices	6.00% ↓	7.00%	7.00%
High Street Retail	6.50% ↓	7.00%	7.00%
Shopping centres	8.00% ↑	8.25% ↑	8.25%
Retail Warehouse (open A1)	5.50% ↓	6.00% ↓	5.75%
Retail Warehouse (restricted)	6.00% ↓	6.50% ↓	6.25%
Foodstores (OMR)	5.25%	5.50%	5.50%
Ind/ Distribution (OMR)	5.00% ↓	5.25% ↓	5.25% ↓
Industrial Multi-lets	5.00% ↓	5.25% ↓	5.25% ↓
Leisure Parks	7.00%	7.75%	7.75%
London Leased (core) Hotels	4.25%	4.75%	4.75%
Regional Pubs (RPI)	5.75% ↑	6.50%	6.50%

Key Stats

6.2%

UK average prime yield broadly static since 2023 Q4

7

Number of sectors holding their yields for the last 6 months

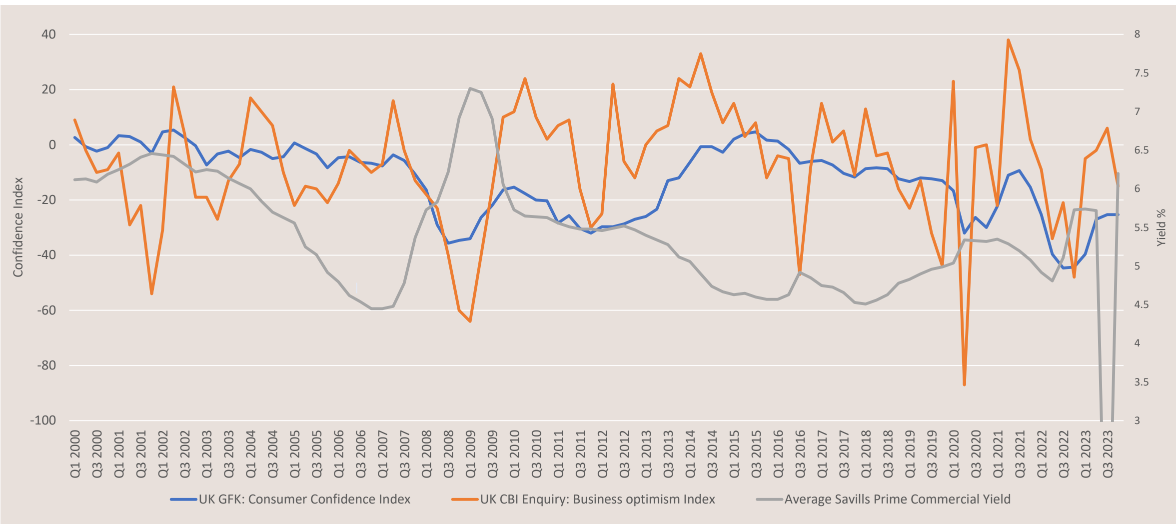
-40%

less commercial investment in Q4 than previous 2 years

-25bps

Retail Warehousing improved in February

There tends to be an inverse correlation between business and consumer confidence and prime yield movement, but events since 2020 have resulted in this relationship being more volatile.



Source Savills; GFK; CBI

Which consumer-led asset classes will recover most quickly?

The occupational markets, driven by consumer sentiment, continue to shape the performance of retail, leisure and warehouse investments. The trend for 'experiences over things' is impacting how consumers are channelling discretional spend, which in times of belt-tightening has an impact on retail sales.

'Essential' and convenience goods have consistently seen strong yoy growth. Grocery saw sales up 4.1% in 2023 (6.2% in 2022) and the largest brands reporting Xmas trading up 7.5% yoy. This ties to yields for supermarkets and Open A1 Retail Warehousing (particularly food anchored) outperforming other retail sectors.

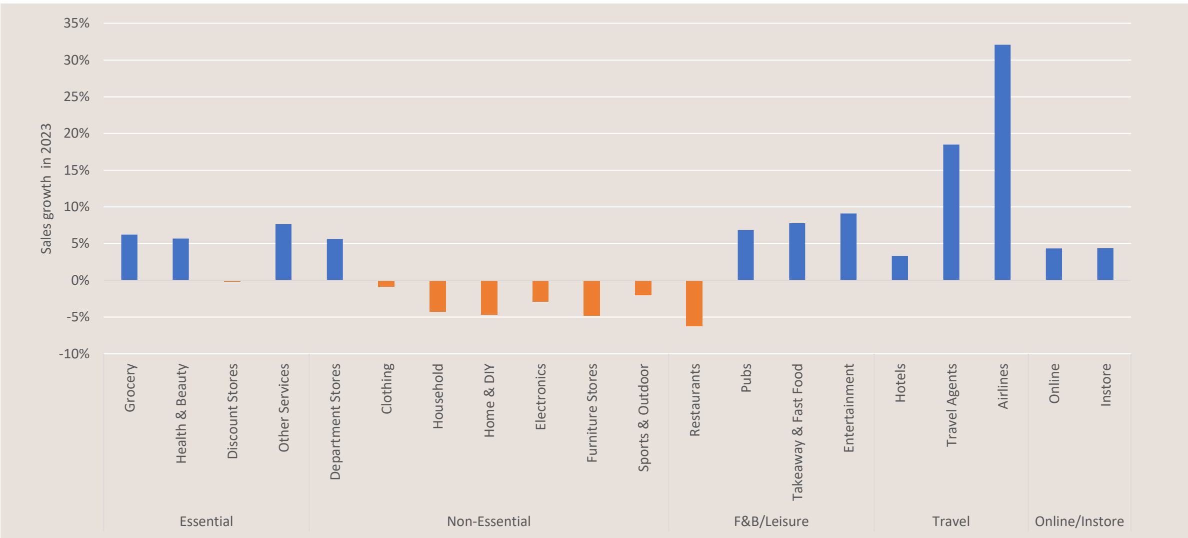
Most non-essential retail goods saw a fall in sales in 2023. Clothing growth was broadly flat, while sports and outdoors fell slightly. The strongest retailers in these categories have been those that have increased their retail park presence. Consumers continue to reign in 'big ticket' purchases, with a fall in spend on bulky goods categories close to -5%. This is translating to restricted retail warehouse yields 50bps behind open-A1. However, with low retail park vacancy nationally and limited supply, they remain attractive compared to high streets and shopping centres, particularly if targeted asset management can navigate planning restrictions and diversify the offer.

Counter to the usual narrative on department stores, the sector saw spend increase above 5% in 2024. This is largely attributed to the strategic growth and investment from Frasers Group, Next and M&S. Recent expansion of several of these brands and growth in their ecommerce businesses has both benefitted prime high streets and retail parks, as well as driving continued demand for Industrial/ distribution networks either from direct growth or the further need for 3PLs in servicing this offer.

A boom in foreign holidays (primarily from cost inflation, but consumer demand is also extremely positive) is having an impact on spend in other categories. There is a sense of trading down in F&B to more affordable eating and drinking behaviour, a hangover of the cost of living crisis influenced by a post-pandemic desire to eat out or order in.

Spend on entertainment grew 9.1% and we are seeing an increase in occupational demand for 'experiential' leisure spaces; several significant repurposing projects have brought prime high street assets back into usage. Cinema performance has been disappointing and coupled to a decline in restaurant spend goes some way to explain the level of yields seen on leisure parks.

Barclaycard sales – average spend growth in 2023

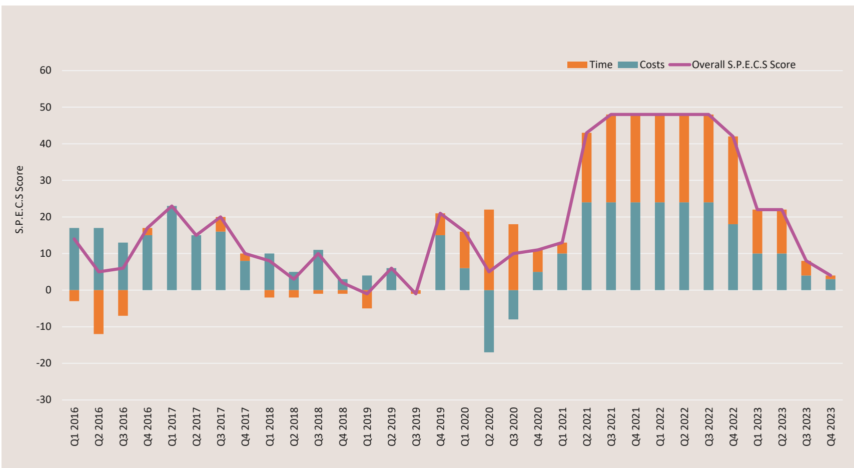


Source Savills Research, Barclays

When will construction become affordable?

There is a shortage of new or upgraded prime commercial supply coming to market in all sectors. However, there is no shortage of stock that needs to be improved to modernise distressed or stranded assets, or to bring green certification in line with EPC or ESG targets. Much of this potential development pipeline is held up by planning, available capital and/or construction costs. The latter has been a particular barrier to development and has impacted on retail repurposing and upgrading of office and logistics space.

There are signs that this is beginning to ease. Savills SPECS index has tracked sentiment around cost of materials and length of programme since 2016, with the lowest score since 2018 recorded in 2023 Q4. This suggests we are moving back towards a more 'normal' cost growth environment.



Demand for grade-A offices and industrial is having a positive impact on rental income in several prime markets, to the extent that as construction costs ease it is likely to unlock redevelopment viability. Additionally, the balance of rental income growth and a soft yield environment is making some assets look good value, particularly if there is a development play. However, with only some sectors reporting construction cost declines, there is some way to go to bring back to parity across the board.

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