UK Commercial – June 2019

MARKET IN MINUTES

Savills Research

Market in Minutes

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Yields shift outwards

Investor attitudes towards the retail sector continue to be main driver of the Savills average prime yield shifting outwards in May to 4.87%, a level last seen in December 2016. Both the high st retail and shopping centre sectors saw outward shifts of 25bps with future outward pressure maintained along with the leisure sector. With only the regional hotels sector displaying any downward pressure it is likely that our average prime yield will continue its outward trend in 2019.

Continued Brexit uncertainty has meant we have seen a abnormally slow start to the year in terms of investment volumes, particularly by UK institutions. By the end of May £15bn had been invested into commercial real estate, meaning that a further £5bn would need to be transacted in June to avoid being the slowest half year since 2013. Given that the UK is looking for its third Prime Minister in four years and both a general election and an unintentional no deal Brexit remain possibilities it is difficult to see investment volumes reaching the five year average of £63bn.

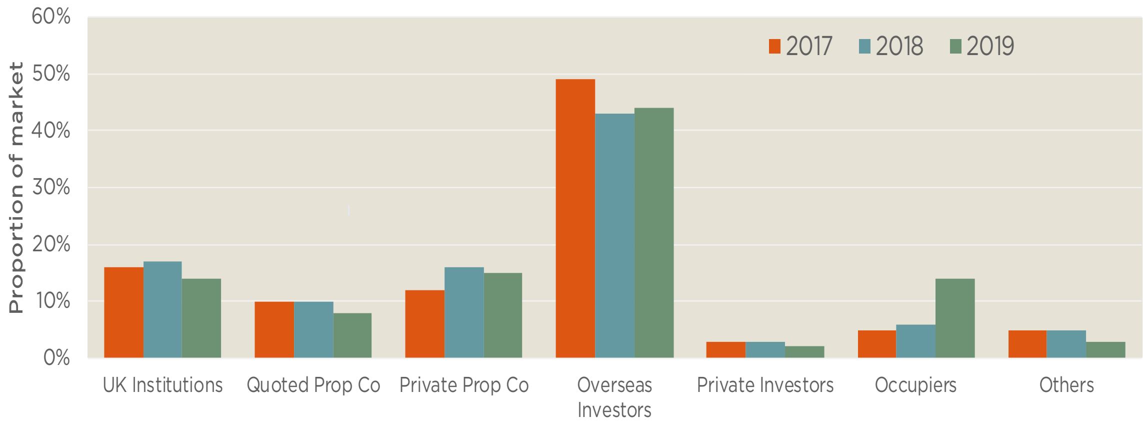
One new driver of demand in 2019 has been a surge in investment by occupiers buying in freeholds, accounting for 14% of the market. Whilst distorted by the purchase of 25 Canada Square by Citigroup for £1.1bn it is clear that the changes brought into lease accounting by IFRS 16 will start to see occupiers change their leasehold/freehold strategy. This trend is also manifesting itself in the supermarket sector as a number of freeholds have recently been purchased by operators for the same reason.

Savills prime yields

	May 18	Apr 19	May 19
West End Office	3.25%	3.75%	3.75%
City Offices	4.00%	4.25%	4.25%
Offices M25	5.00%	5.00%	5.00%
Provincial Offices	4.75%	4.75%	4.75%
High Street Retail	4.25% ↑	4.75% ↑	5.00% ↑
Shopping centres	4.75% ↑	5.25% ↑	5.50% ↑
Retail Warehouse (open A1)	5.25%	6.00% ↓	6.00%
Retail Warehouse (restricted)	5.50%	6.25%	6.25%
Foodstores (OMR)	4.50%	4.75%	4.75%
Industrial Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.00%	4.00%	4.00%
Leisure Parks	5.25%	5.50% ↑	5.50% ↑
Regional Hotels	4.25%	4.25% ↓	4.25% ↓

Source Savills

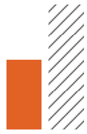
Investment volumes by purchaser type Occupiers up their share



Source Savills Research & PropertyData

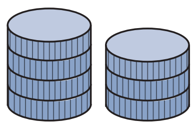
Key Stats

Increased inflows into real estate retail funds



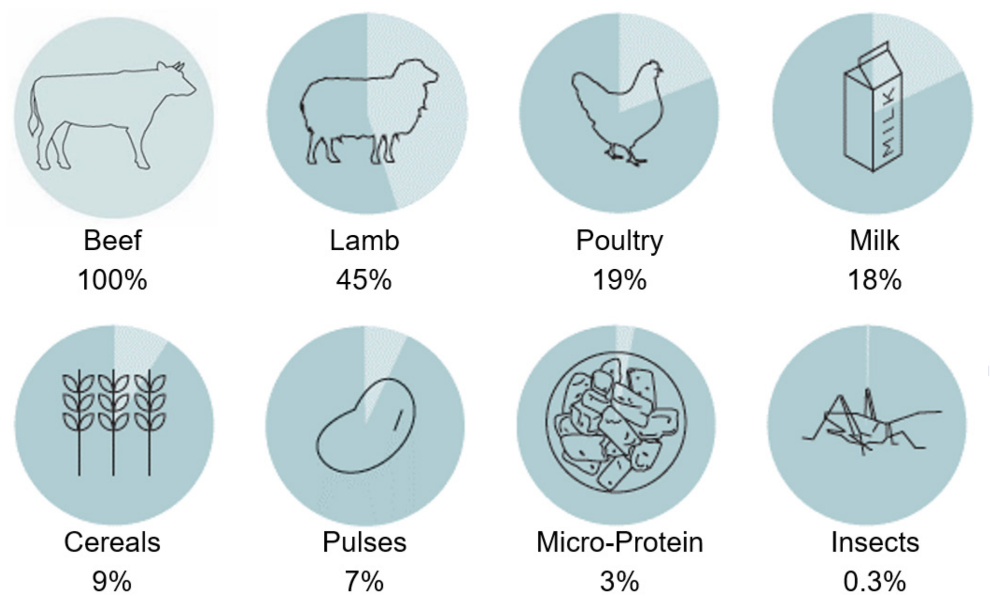
14%
Occupiers account for highest part of investment market in recent times

£5bn needed to transact in June to reach long term average H1 levels



£15.0bn
Total, all sector, 2019 investment volume to end May

Protein production varying impact by source



Source FAO, WRI, Poore (2010 & 2018), Halloran (2017), Finnigan (2016), Mekonnen & Hoekstra (2010) – analysed by Savills Research

HOW WILL WE FEED PEOPLE AND WHAT IS THE IMPACT FOR REAL ESTATE?

The latest edition of IMPACTS focuses on disruption around the world and the long term impact on global real estate markets. The following article is an extract from the report which discusses how will we be able to feed the 9bn people on the planet by 2050 and what that means for real estate capital markets.

Agriculture sustainability is a global concern. One country cannot export its problems to another and claim a successful reduction of an issue such as carbon emissions or water use. Countries need to explore the tensions between consumer demand and productive capacity. Two key issues are around the use of water and our production of protein.

Consumers in developed nations are now accustomed to accessing a wide selection of fresh produce, regardless of seasonality. Imports have been the only way to meet this demand. For these countries, this trade in so-called 'blue water', net imports of water in food, is a major concern in achieving sustainable agriculture targets.

Research from the Economist Intelligence Unit shows that the UK is one of the worst offenders for importing high levels of water contained in fresh produce to meet off-season demand. If this is to change then new methods of food production must be explored.

Savills Research has created a single metric to evaluate the sustainability of protein sources, taking into account greenhouse-gas emissions, and land and water use. Looking at eight sources of protein – poultry, milk, beef, lamb, cereals, pulses, insects and synthetic protein – we compared the water and land required to produce one gram of protein, as well as the resulting greenhouse-gas emissions.

Our research shows that, to produce the equivalent amount of protein, the water demand of lamb is less than half that of beef. Poultry is 19%, cereals 9% and insects almost zero.

What does this mean for real estate? In the commercial real estate world the impact has the potential to felt predominantly in the industrial sector. Synthetic protein production i.e commercial lab-grown protein is gaining credence in consumer and innovation communities, with serious investment in the US in particular. It will require a new type of food manufacturing & R&D premises.

Vertical farming, already common in Asia sees the shifting of off-season production of salad and vegetable crops into controlled environment agriculture systems. Typically these could be existing warehouse facilities located near food distribution centres. Also possible will be micro production facilities in and around supermarkets and population centres.

For more information on this and articles on other factors disrupting real estate please visit savills.com/impacts

NEW DATA FROM ONS TO PROVIDE EARLY WARNING ON ECONOMIC HEALTH?

New experimental data sets released by the Office of National Statistics may provide an early warning on the health of the UK economy previously missed by traditional statistics. Using "big data" the ONS has looked at VAT returns and traffic data. The VAT data shows that slightly more firms are reporting an decline in turnover in Q1 and the traffic data shows that the number of HGVs on the road are broadly stable demonstrating that international trade remains robust. Continued monitoring may point to an economic downturn before official indicators do.

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