Market in Minutes

savills

Prime pricing stable for now

We maintained our average prime yield at the same level for end March as it was at end February. However, while the Q1 investment volume was up year-on-year, and very sharply up in some retail segments, there is very little evidence of "post lock down" pricing in the UK market yet.

Those deals that did complete in March had been underway for some time, and we expect that UK commercial property investment volumes will now fall to the kind of levels not seen since 2008 in Q2 and Q3.

This will mean that there will be very limited evidence on whether prices are moving for some time to come. However, at present our house view is that yield hardening is off the table for the short-term (we were predicting that City offices would harden in Q1 2020 for example), but softening is not likely to occur to the degree that it happened in the Global Financial Crisis (GFC).

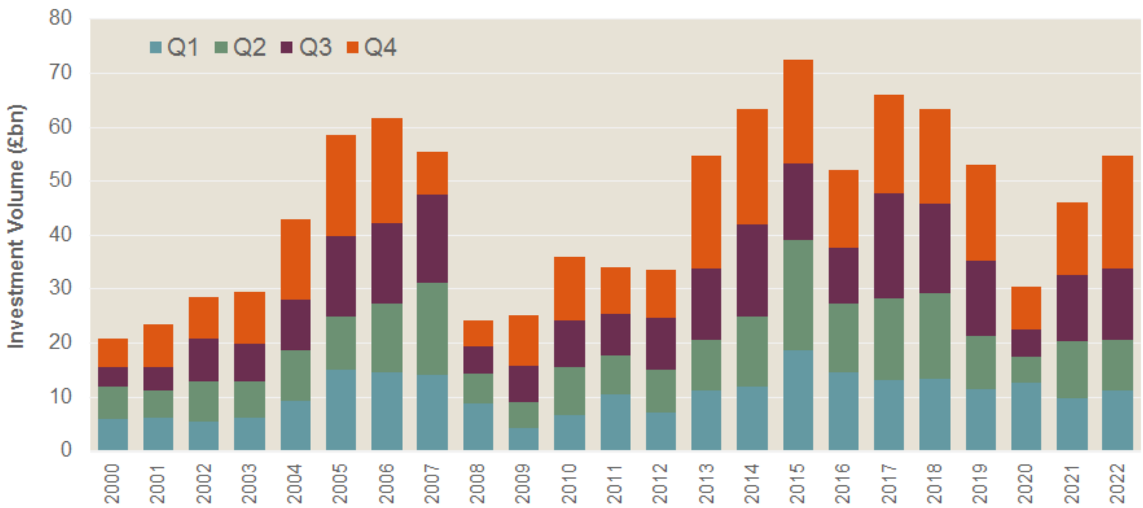
This is because that generally the level of indebtedness across the sector is significantly lower than it was in 2006/7. This means that a sharp rise in bank-led selling is not likely, and thus a rise in yields on the scale that was seen in 2008/9 is also unlikely. Sectors that were under pressure prior to the current crisis will remain under pressure, and we do expect to see further bank-led sales of retail assets.

Savills prime yields

	Mar 2019	Feb 2020	Mar 2020
West End Offices	3.50%	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	4.75%	5.50%	5.50%↑
Shopping centres	5.25%	6.00%	6.00%↑
Retail Warehouse (open A1)	6.00%	6.25%	6.25%
Retail Warehouse (restricted)	6.25%	6.50%	6.50%
Foodstores (OMR)	4.75%	4.75%	4.75%
Ind/ Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.00%	4.00%	4.00%
Leisure Parks	5.50%	6.00%	6.00%
London Leased (core) Hotels	3.75%	3.75%	3.75%↑
Regional Pubs (RPI)	4.50%	4.50%	4.50%↑

Source Savills

Investment volumes will recover in line with economic growth, from Q4 2020 in our base case, and from Q2 2021 in our downside scenario



Source Savills

Key Stats

5.04%
The UK average prime yield

£12.7bn
Investment volume in Q1 2020

10%
Rise in 2020 investment activity (Q1 compared to same period in 2019

U, V or Swoosh shaped recovery ahead?

The current consensus view amongst economic forecasters about the impact of this crisis is one of a very sharp downturn in GDP growth followed by an equally sharp upturn.

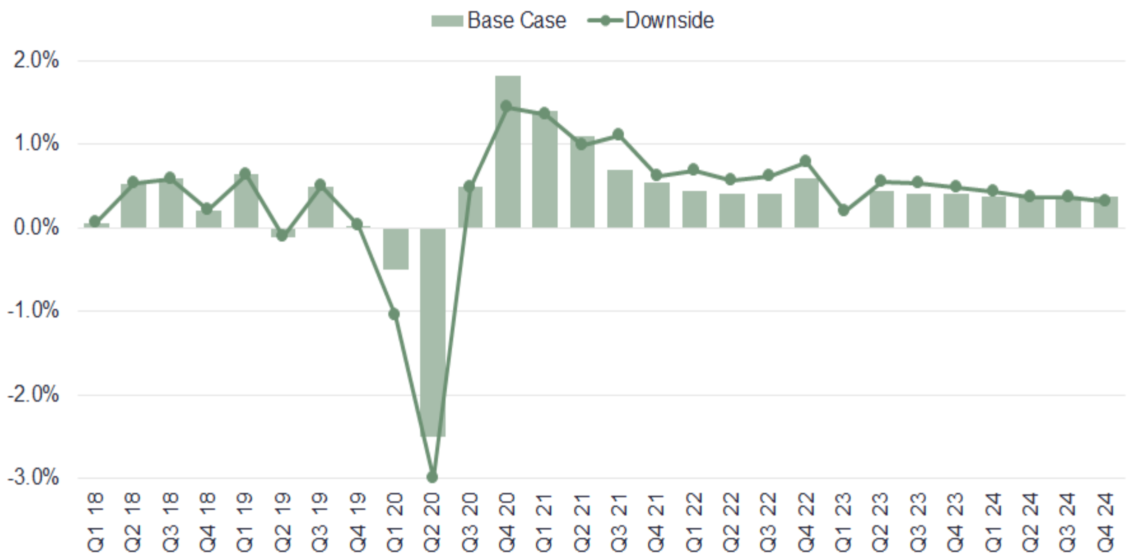
For example, the April consensus forecast compiled by Focus Economics has a 1.5% quarter on quarter contraction in the UK economy in Q1 2020, followed by a 6.6% fall in Q2. The economy then returns to growth in Q3, expanding by 3.4%. This leads to annual growth of -3.1% in 2020 and +3.3% in 2021.

While this will be painful, it is also a relatively short, and sharp shock in economic terms. In our opinion this is very much a best-case scenario, as it rules out a second winter of rising infection rates as well as underplays the sheer scale of the governmental response to the current crisis.

While the monetary policy measures such as the BoE taking rates down to 0.1% and announcing £200bn of asset purchases could be argued as not having a particular hangover effect, the fiscal stimulus measures announced in recent weeks such as tax cuts and deferrals, general public spending increases and more targeted welfare transfers will result in more borrowing or less spending in future. Furthermore, while most of them have been presented as time-limited, nobody know when they will be able to be withdrawn at this stage. As they currently stand we estimate that the various safety nets amount to around 4-5% of GDP, and will take the debt to GDP ratio to around 90%.

A combination of longer lock downs, a secondary surges in infections, and the fiscal measures that have been put in place will result in the recovery being less steep than the downturn, though even under this swoosh scenario both the economy and property market are back to normal levels by the middle of 2021.

Our base case for UK GDP growth is a very short V-shaped shock

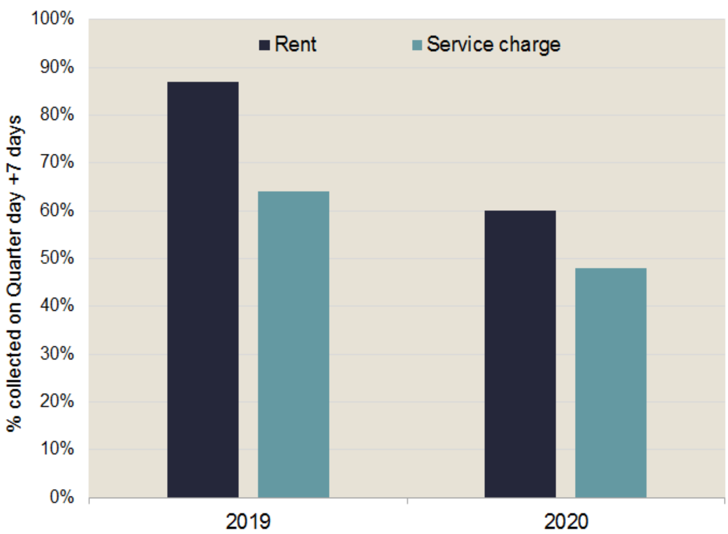


Source Oxford Economics

With the property market hungering for real data on what has happened in March it should be no surprise that a lot of attention has been given to the REIT's announcements on what proportion of their rent they have managed to collect since the latest quarter day.

The overall tone of announcements has generally been much as we expected, with those who are most exposed to fashion and leisure reporting that less than 50% of their expected rent was paid, while those with an office bias reportedly collecting between 60% and 80%. There were exceptions to both rules, with retail warehouse specialists out-performing the retail average, and office specialists with heavy exposure to smaller tenants and shorter leases under-performing. Savills data for the properties which we manage shows a similar story, with a sharp fall in both rent and service charge collections.

Collection of rent & service charge at March Quarter Day +7 days versus 2019



Source Savills

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