MARKET IN MINUTES
Savills Research

Market in Minutes

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Early signs of rising activity

Whilst economic data remains volatile, there remains a general consensus that a path to a 'soft landing' is achievable. The narrative regarding base rate cuts remains a cause for debate within economic circles but, all things being equal, markets are expected inward movements this year, which should therefore stimulate higher investment volumes in the second half of the year.

That said, with many markets reaching their expected low points in pricing, it is pleasing to report that investment volumes for March reached £4.7bn, the highest level since March 2023 and representing a 56% increase month on month. This places Q1 at £10.7bn, exceeding previous expectations, and is the second quarter in a row with rising volumes.

With regard to pricing, April saw an inward movement of yields in the retail warehouse, industrial, distribution and London leased hotels segments, meaning our average prime yield now stands at 6.05%, an inward movement of 13 bps since the start of the year.

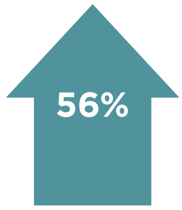
As things stand, no sectors are displaying downward arrows, and the South East office sector is showing further upward pressure. This suggests that we should expect further volatility with our overall average prime yield until greater clarity emerges on the timing of future inward movements of the Bank of England base rate later this year.

Savills prime yields

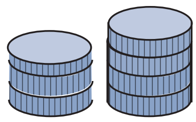
	April 2023	March 2024	April 2024
West End Offices	4.00%	4.00%	4.00%
City Offices	4.75%	5.25%	5.25%
South East Offices	6.50%	7.50%	7.50%↑
Provincial Offices	5.75%	7.00%	7.00%
High Street Retail	6.50%	7.00%	7.00%
Shopping centres	8.00%↑	8.25%	8.25%
Retail Warehouse (open A1)	5.25%	5.75%↓	5.50%
Retail Warehouse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

Source Savills Research

Key Stats



The increase in monthly investment volumes



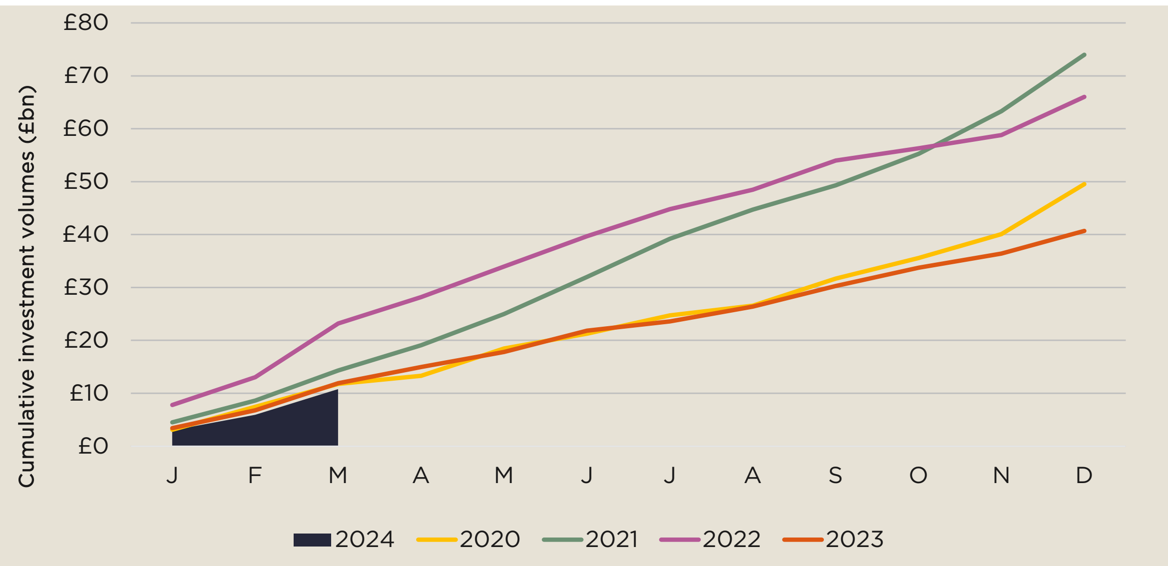
£4.7bn
Investment volumes for March, the highest level for 12 months

There is upward yield pressure on just the South East office sector

£10.7bn

UK commercial investment volume by end of March 2024

Investment volumes higher volumes in March deliver a better than expected Q1, but overall volumes are muted compared to recent years



Source Savills Research using RCA

Is the historical link between rents and vacancy decoupling for industrial?

One of the forces fuelling investment into industrial and logistics in recent years has been the solid fundamentals of the sector, with the market characterised by acute supply shortages even before take-up surged in the pandemic.

Data from MSCI shows that rental growth has averaged 6.5% per annum over the five years to 2023, exceeding all other asset classes in the MSCI universe. Indeed, even as take-up fell and the vacancy rate rose in 2023, rents grew by 6.7% year on year (YoY) for industrial and 7% for logistics. This is the second fastest rate of growth in the series for logistics, only exceeded by 2022's record growth of 12.8%.

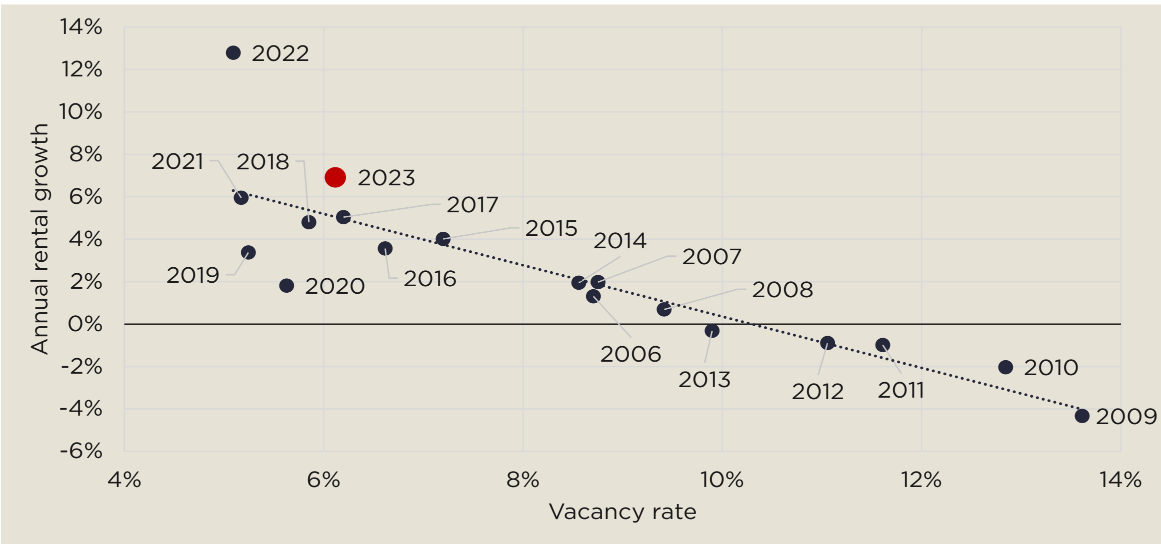
Plotting historical rental growth for distribution warehouses against the vacancy rate tells an interesting story. Using a line of best fit, we can use the prevailing vacancy rate to roughly calculate the expected rental growth in a year. Considering MSCI's vacancy rate of 6.1% at the end of 2023, we would have expected rental growth of 5.04% YoY. In this regard, rental growth is actually outperforming its historical trend, with the question being is this an anomalous reading capturing a post-Covid lag or a fundamental decoupling of the relationship between vacancy and rental growth.

Rising vacancy rates bring the sustainability of this rental growth into question as we move into 2024; however, using data from the monthly index shows that this trend has continued in the first three months of the year with annualised rental growth of 6.3% in March 2024, only marginally down from March 2023 at 6.6%.

Based on our analysis, for rental growth to flat-line the vacancy rate would need to reach 10.3%. This would require total availability to reach c.71m sq ft of space, an increase of roughly 17m sq ft. Whilst it is possible that supply will rise further from its current level of 54m sq ft, our in-house forecasting model suggests that vacancy rates for units greater than 100,000 sq ft will peak later in 2024 before slowly trending downwards, a scenario we think likely as speculative development announcements have also tailed off.

Last year, 70% of all new leases were for Grade A buildings, and with occupiers continuing to place greater emphasis of ESG, it is likely this combined impact will see rental growth maintained across many submarkets and sub-size ranges within the wider industrial sector.

Rent and vacancy rental growth remains higher for industrial than we would expect given the prevailing vacancy rate



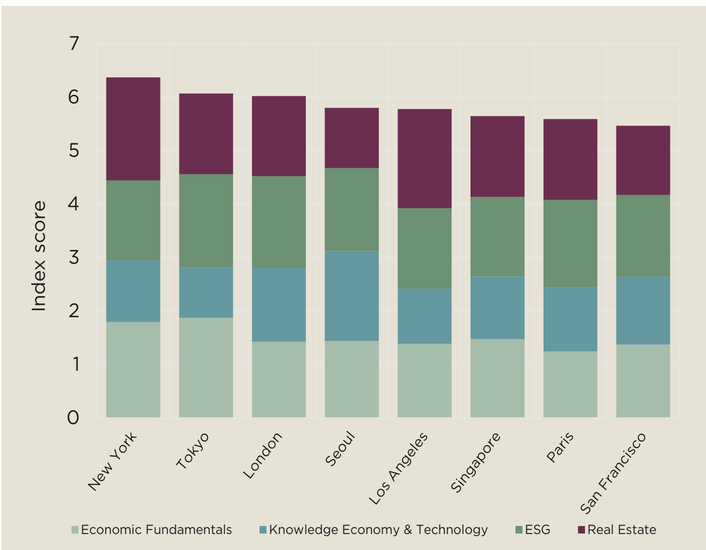
Source Savills Research using MSCI

In the latest update to the Savills Resilient Cities index, London has been named the top-ranked city in Europe, and only comes behind New York and Tokyo globally. London performs particularly strongly on its knowledge economy and tech ecosystem, coming second on this metric only to Seoul, and is ranked in sixth place globally for both its economic fundamentals and the strength of its real estate market.

Savills examined 490 cities in total using metrics around four core areas: economic strength, knowledge economy and technology, ESG, and real estate investment. A Savills resilient city supports the well-being and success of its residents and workers against the backdrop of economic, social, environmental and technological change, and is attractive to real estate investors and occupiers, particularly as investment and business expansion criteria encompasses a wider range of factors, including ESG.

More can be read on this topic in our latest update to the Savills Impacts series.

London is the world's third most resilient city in the Savills Resilient Cities Index



Source Savills Research

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