MARKET IN MINUTES

Savills Research

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February prime yields present a mixed bag

The UK has moved through the first two months of 2023 with headlines of snow, strikes, high rates of inflation and rising interest rates, with the Bank of England raising interest rates for the tenth consecutive time from 3.5% to 4% in February. Positively though, inflation may have now peaked, and the UK economy grew by 0.3% in January, partially bouncing back after shrinking by 0.5% in December. Prime yields have moved in slightly to 5.64% in February, however, they continue to present a very mixed story across the board. Outward pressure can be seen in four sectors. However, six sectors (up from three in January) have downward arrows this month, with Leisure Park yields hardening by 50 bps returning to the February 2022 position of 7%. £3.2 billion was invested into commercial property in January and February 2023, 64% down on the five-year average for the first two months of the year. The overarching approach of investors in the first quarter of 2023 remains 'wait and see', although more investors are feeling confident about investing in the industrial and retail warehouse sectors with a perception that yields have bottomed out in the industrial market. Institutions also continue to look favourably on real estate as an asset class, with many increasing their target allocations in 2023 with the year likely to be a year of two halves in terms of volumes.

Savills prime yields

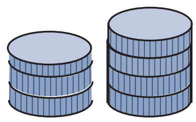
	February 2022	January 2023	February 2023
West End Offices	3.25%	4.00%	4.00%
City Offices	3.75%	4.50%	4.50%
South East Offices	5.50%↓	6.25%↑	6.25%↑
Provincial Offices	4.75%↓	6.00%	6.00%↓
High Street Retail	6.50%↓	6.50%↓	6.50%↓
Shopping centres	7.50%↓	8.00%↑	8.00%↑
Retail Warehouse (open A1)	5.00%	5.50%	5.50%↓
Retail Warehouse (restricted)	5.00%	6.00%↓	6.00%↓
Foodstores (OMR)	4.25%	5.25%	5.25%
Ind/ Distribution (OMR)	3.25%↓	5.00%	5.00%↓
Industrial Multi-lets	3.25%↓	5.00%	5.00%↓
Leisure Parks	7.00%	7.50%	7.00%
London Leased (core) Hotels	3.50%↓	4.25%↑	4.25%↑
Regional Pubs (RPI)	5.25%	5.75%	5.75%↑

Source Savills

Key Stats

80 bps

The change in our average prime yield since February 2022



4%

The Bank of England raised interest rates for the tenth consecutive time from 3.50%- 4.00% in February

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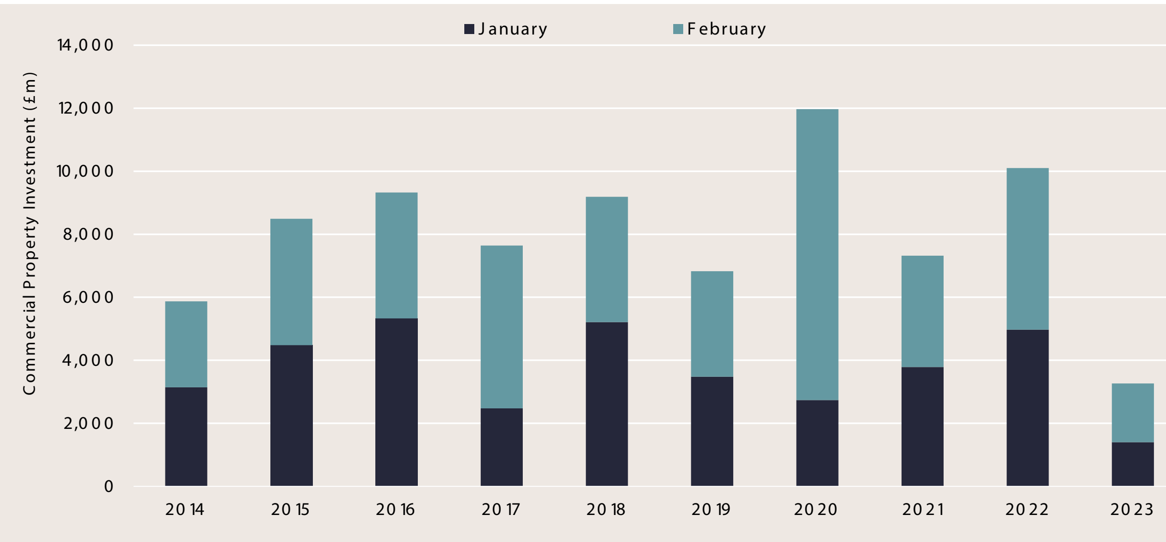
There is downward yield pressure on six sectors at the end of February 2023

Investment Volumes in January and February indicate a slow start to 2023 as investors consider where and when to deploy their capital



Source Savills

To what extent has the transition to hybrid working affected occupiers' office needs in the UK Big 6 markets?

The challenge for occupiers post-Covid has been to work out what space they need in their next office acquisition. One method of measuring this impact is through the analysis of leasing activity to build a comparison of new leases, signed since the end of lockdown, and what this represents as an increase or decrease when compared to the space that was previously occupied.

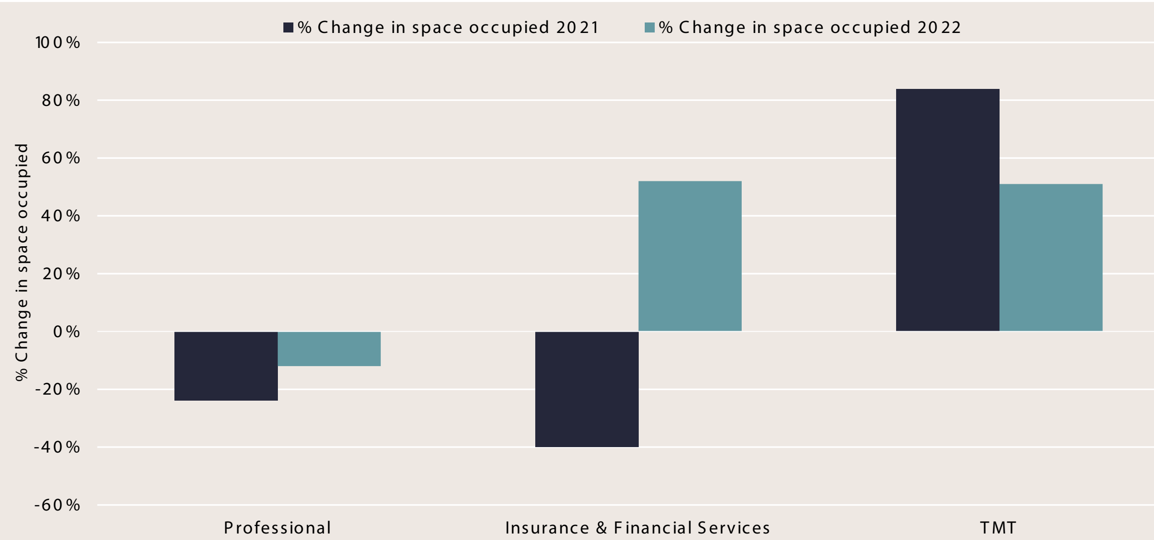
Savills latest research has found that there was in fact a marginal increase in the total space occupied in 2021 and 2022. The initial 2021 data suggested a trend towards occupier downsizing, with the total space occupied decreasing by 5% during the year. 2022 was a more positive year for office movers who increased their total space occupied by 8% in the Big 6 which combined with 2021 produced a marginal overall increase for the two-year period.

This analysis compared newly leased space over 10,000 sq ft with the size of the office space where the tenant previously occupied in the city to produce a net square footage of space occupied. This does not include tenants that have completely shut down offices in individual markets.

Considering specific business sectors, some sectors have shown a trend towards an increase in office space occupied during this period. Despite the recent press coverage surrounding redundancies in Big Tech organisations, particularly in London, regional occupiers in the 'TMT' sector have in fact increased the sq ft of total office space occupied by 64% through office moves in 2021 and 2022 when compared to the size of the space where they were previously located. 2022 was a particularly strong year for 'Insurance and Financial Services' movers who increased their space occupied by 52%, however, some other sectors, such as 'Professional' continue to see a bigger trend towards downsizing (-21%).

The data also shows a positive rental story. In many cases occupiers who are downsizing are willing to pay an average of 54% more rent per sq ft to secure a higher quality of space. 46% of the occupiers analysed increased their total rent roll by an average of 20% even though the space they were occupying decreased.

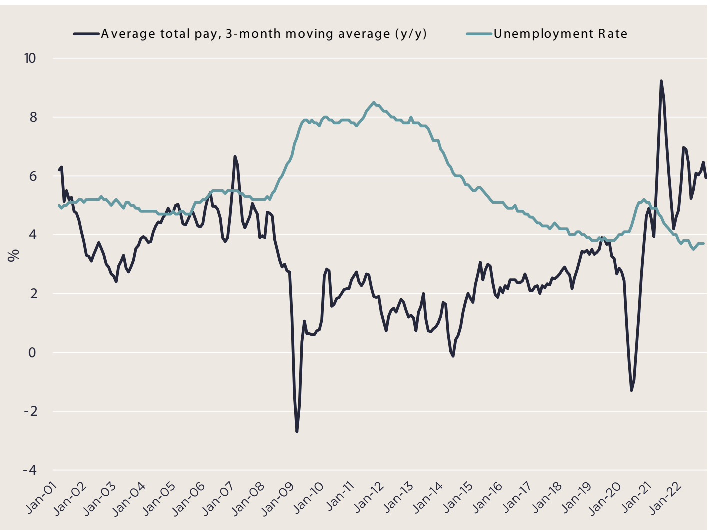
The change in office space requirements post-Covid-19 2022 was a particularly strong year for 'Insurance and Financial Services' movers who increased their space occupied by 52%



Source Savills Research

A key trend in 2023 will continue to be the performance of the labour markets – and how they stack up against weaker economic growth – for the scale of the economic slowdown, will be determined by the scale of job losses. Labour markets have been resilient to economic slowing so far - in part due to a rapid rebound in hiring post-Covid. While hiring is likely to slow, it's coming down from record highs and the slowdown in output growth in 2023 is not generally expected to be reflected in large rises in unemployment. In fact the CIPD highlight that recruitment struggles still persist - over half of employers have hard-to-fill vacancies and a third anticipate significant problems in filling roles. Skill shortages are a particular problem and currently outnumber labour shortages. The CIPD's latest Labour Market Outlook survey finds that the median base pay rise expectation among employers has reached 5%. This is a new record high for CIPD's quarterly employment barometer which goes back to 2012. The survey also suggests that further pay increases could be in store this year, with 55% of employers saying they expect to raise base pay further in 2023 to better recruit and retain staff.

While hiring is likely to slow in 2023, it is coming down from record highs



Source ONS via Macrobond

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