MARKET IN MINUTES
Savills Research

Market in Minutes

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Altered priorities ahead?

With two retail segments showing a 25 bps hardening last month, and the overall fall in prime retail yields this year being 40 basis points, it is clear that things are beginning to turn for what has been the most unloved part of the commercial property universe in recent years.

These latest changes mean that our average prime property yield is now 4.98%, 21 bps lower than it was this time last year.

The strongest downward shift in yields during 2021 has been in the sectors that have seen the largest YoY increase in investment activity, with industrial and logistics volumes for the 11 months to the end of November being 36% higher than the full year in 2020, and retail warehouse investment volumes 40% higher.

Looking ahead to 2022 and beyond, we expect to see the enthusiasm for prime assets at high yields that drove retail warehouse activity this year to spread to other parts of the retail market.

Further yield hardening in London offices and national logistics is harder to rationalise (though it might happen due to sheer weight of money). However, if these trends continue, then the huge spread between the returns on offer from industrial and those from retail could well close. Indeed, as the chart below shows, retail has gone from the worst MSCI total return to the second best in 12 months.

Savills prime yields

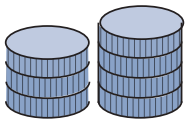
	November 2020	October 2021	November 2021
West End Offices	3.50%	3.25%	3.25%
City Offices	4.00%	3.75%	3.75%
South East Offices	5.50%	5.50%↓	5.50%↓
Provincial Offices	5.00%	4.75%	4.75%
High Street Retail	6.50%	6.75%	6.50%
Shopping Centres	7.00%	7.50%	7.50%↓
Retail Warehouse (open A1)	6.50%	5.75%	5.50%
Retail Warehouse (restricted)	6.50%	6.00%↓	5.75%
Foodstores (OMR)	4.50%	4.50%↓	4.50%
Ind/ Distribution (OMR)	3.75%	3.25%	3.25%
Industrial Multi-lets	3.75%	3.25%	3.25%↓
Leisure Parks	7.25%	7.50%	7.50%
London Leased (core) Hotels	4.00%	3.50%	3.50%
Regional Pubs (RPI)	5.00%	5.25%	5.25%

Source Savills

Key stats

4.98%

The UK average prime yield



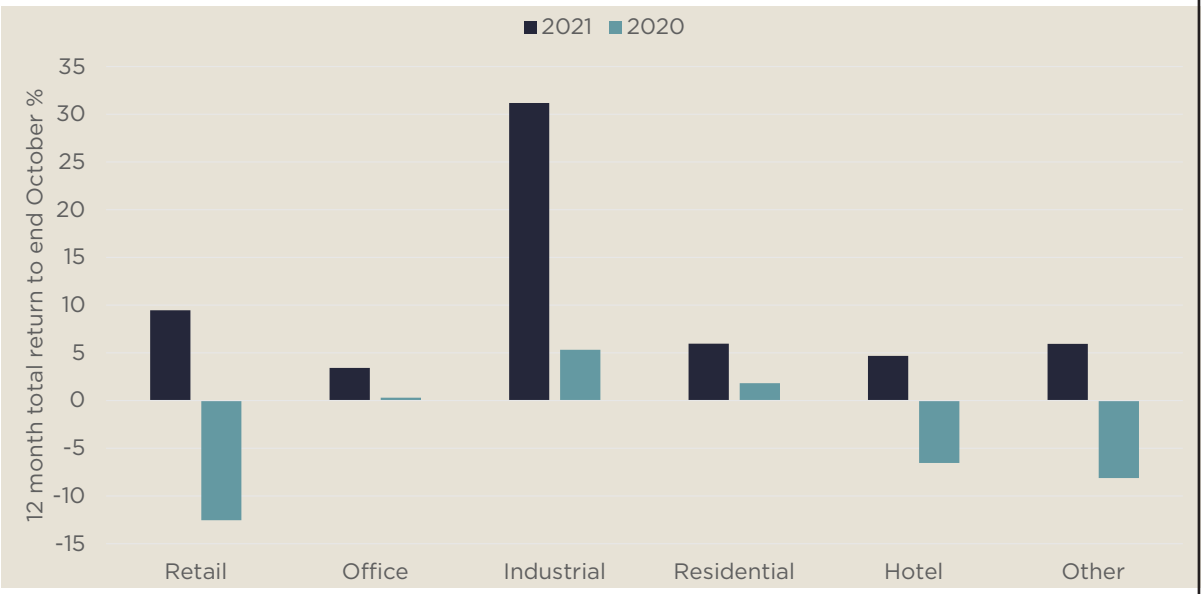
5.0%

The consensus forecast for UK economic growth in 2022

75 bps

The fall in prime restricted retail warehouse yields this year

Average UK total returns: Retail has gone from the worst to second best in 12 months



Source MSCI

The biggest question for 2022 is around offices, but the forward-looking indicators are positive for the markets outside London in particular

While the latest date on average office occupancy across the UK doesn't point to a surge back into the office in November, there are definitely signs that tenant demand is poised to recover strongly in 2022.

The average occupancy in UK offices in the week ending 26th November was 23.3%, the highest level since the start of Covid. This peaked mid-week at 27%, with a consistent trend now established that Tuesday, Wednesday and Thursday are the busiest days of the week.

The challenge for heads of real estate and tenant rep advisers is how to plan for growth with no idea of whether these occupancy rates will rise, or how much they will rise.

The chart below shows that 80% of CFOs plan on increasing headcount over the next 12 months, a dramatic change from a year ago when 79% were planning on cutting staff numbers.

This optimism is already starting to feed through into both the central London and regional office leasing markets, with the level of under offer space in central London now 75% above its long-run average, and Q3 take-up outside London at its highest level since Q3 2019.

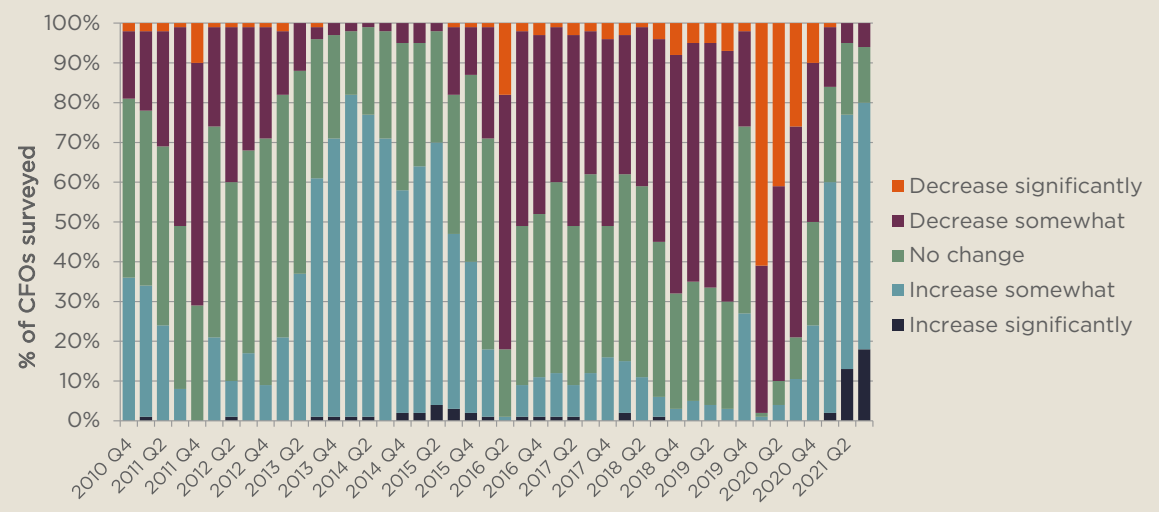
While we do not expect that flexible working will (or indeed should) disappear post-Covid, we do believe that the negative impacts of this change on gross floorspace needs will, to a degree, be balanced out by both employment growth and a reduction in occupational densities as companies reconfigure their office space to deliver a high performing working environment.

These trends, combined with a steadily rising occupier bias towards prime and green office space, will mean that office markets across the UK will see a sharp fall in the availability of Grade A office space in 2022, exacerbating the shortage of such space that was present in many cities prior to the Covid crisis.

2021 has seen this beginning to put some upward pressure on prime office rents in Manchester, Leeds and Glasgow, and we expect that this trend will spread out across most major office markets next year.

Grade B rental growth is expected to be harder to prove, particularly as occupier demand will be heavily skewed towards prime. However, while there has been much debate over the last few months about 'stranded assets', we expect that this will become more of an opportunity than a challenge, with developers chasing the best located Grade B assets with a view to make them prime.

80% of companies are planning on hiring in 2022, which should drive office occupational demand and a reduction in sub-leasing once post-Covid occupancy levels have been established



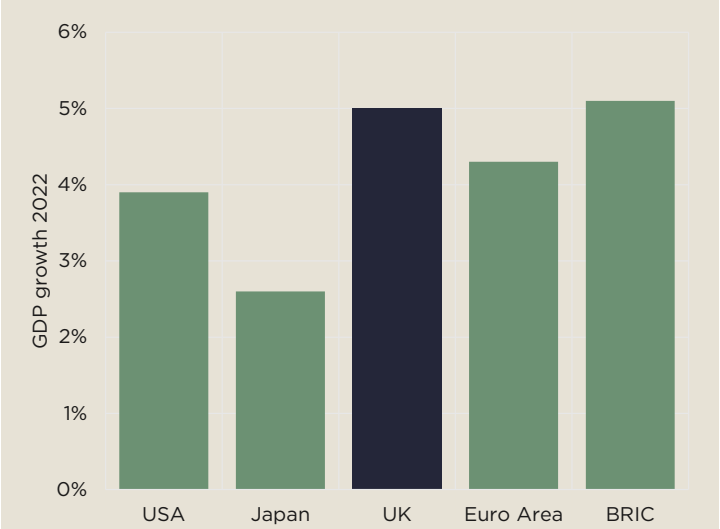
Source Deloitte CFO Survey

The UK economy is forecast to grow as fast as the BRIC countries in 2022

The classic trend of economies that contracted the most then growing the strongest will be firmly in the favour of the UK in 2022.

The latest consensus forecast for the world's major economies has the UK expanding by 5.0% next year, which is almost as much as is forecast for China. While GDP growth in the UK is forecast to slow towards more normal levels in 2023, this still means that the next five years will see an average annual growth rate of 2.4% per annum, which is very respectable given the twin drags of fiscal tightening and Brexit that will be present for much of the forecast period.

Given that GDP growth is generally a more significant driver of demand and pricing for commercial property than inflation, we believe that the outlook for commercial property demand in the UK is positive. Inflation will remain a challenge in 2022, though we concur with the widely held view that higher than target levels of CPI will prove to be relatively transitory.



Source: Focus Economics - Dec 2021 consensus

Savills team

Please contact us for further information

James Gulliford
Joint Head of UK Investment
020 7409 8711
jgulliford@savills.com

Richard Merryweather
Joint Head of UK Investment
020 7409 8838
rmerryweather@savills.com

Mat Oakley
Director
Commercial Research
020 7409 8781
moakley@savills.com

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