UK Commercial – October 2024

MARKET IN MINUTES
Savills Research

Savills ProgrammE and Cost Sentiment Survey

"Following the outcome of the general election, a decrease in base rates and a more positive economic outlook the stage is set for an increase in construction activity, for both new builds and refurbishments, after a tepid 18 months. We expect continued volatility in our S.P.E.C.S index, particularly at a sub-sector level"

SIMON COLLETT, HEAD OF PROFESSIONAL SERVICES

Costs increasing in line with inflation

After six quarters of our S.P.E.C.S index either falling or remaining stable, the most recent data points into the index have pushed the overall score to 19, the highest level of the index since Q2 2023.

In the most part, however, we are not witnessing dramatic rises in build costs but more stable and predictable rises in line with the wider inflationary environment in the wider economy.

Following the general election and the first inward base rate movement, investors and developers will be hoping that a more stable political and economic environment will translate into an uptick in new construction starts after a tepid 18 months.

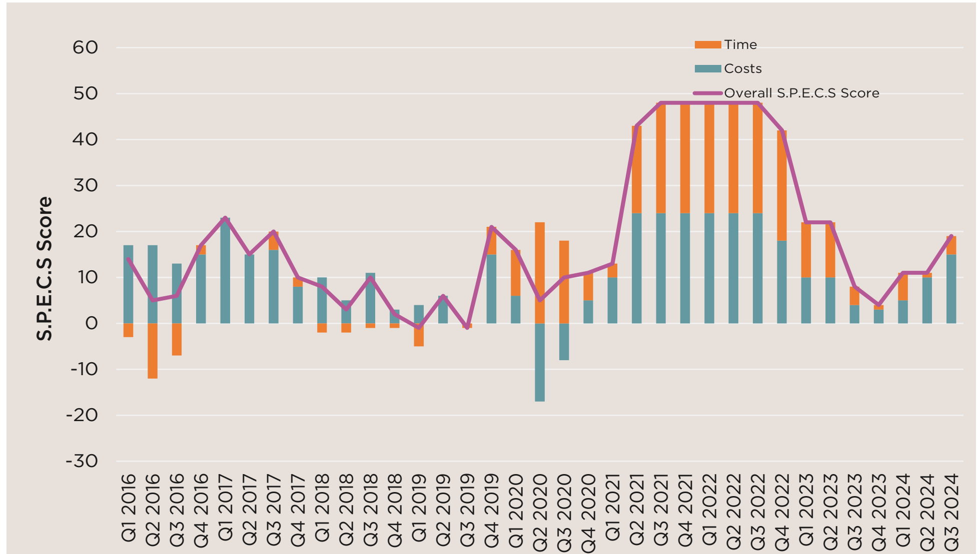
Early evidence of this is already apparent with the S&P Global UK Construction Purchasing Managers' Index (PMI) reaching 57.2 in September, up from 53.6 in August and above the neutral 50.0 threshold for the seventh successive month.

The survey suggests a strong upturn in total construction activity and the steepest rate of growth since April 2022. Civil engineering was the best-performing sub-sector but commercial building, at 55.2, had its highest score since May 2024 and house-building's 54.3 was its highest since March 2022.

As we progress into 2025 all eyes will be on the levels of occupier demand we witness, particularly in the mainstream commercial markets of industrial, offices and retail, which in turn will impact the development and refurbishment pipelines in those sectors.

Any increase in activity in those sectors is likely to increase volatility within our S.P.E.C.S index, particularly at a sub-sector level as supply chains gear up to service increased demand. This could mean that greater pressure is evident, particularly on the timescales associated with new builds.

S.P.E.C.S Q3 2024



Source Savills Research

Q3 2024 S.P.E.C.S Indicators

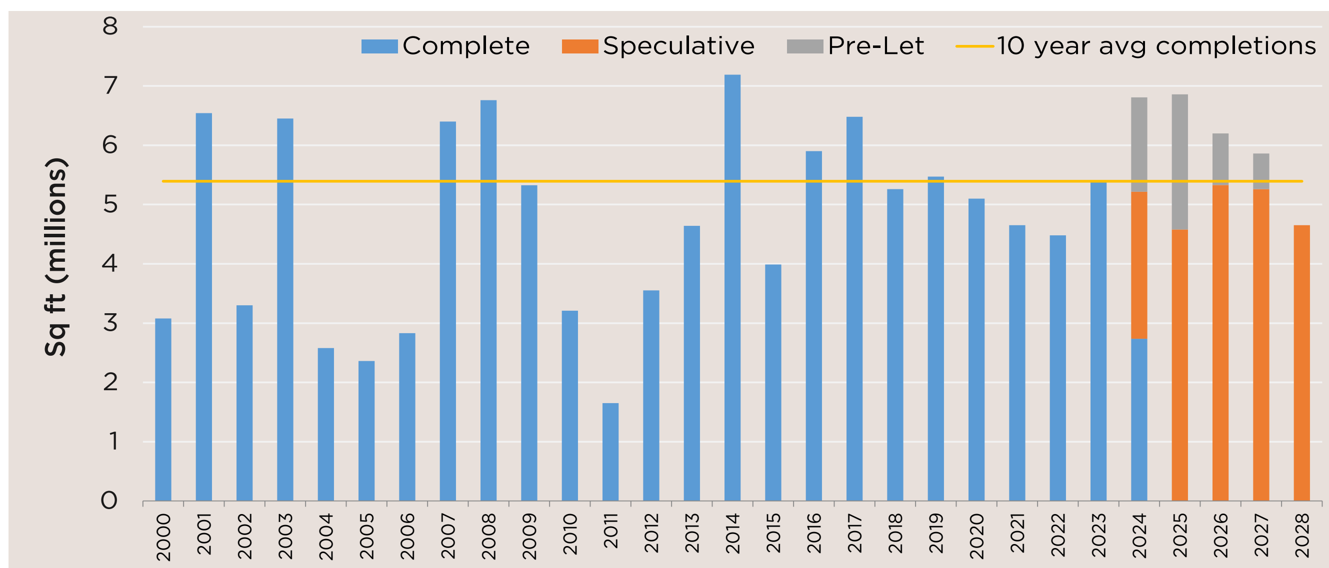
	New build and refurbishment costs	New build and refurbishment timescales*	Occupier fit-out costs	Occupier fit-out timescales*
Offices - Central London	↑	↔	↑	↔
Offices - Regional	↑	↔	↑	↑
Warehousing <100,000 sq ft	↔	↑	↔	↔
Warehousing 100,000 - 500,000 sq ft	↔	↑	↔	↔
Warehousing 500,000+ sq ft	↔	↑	↔	↔
Central London prime residential	↔	↑	↑	↔
Central London mid-market residential	↔	↑	↑	↔
Regional mid-market residential	↔	↔	↑	↔
Foodstores	↑	↔	↑	↔
High street retail	↑	↔	↑	↔
Out of town retail	↑	↔	↑	↔
Shopping centre	↑	↔	↑	↔

METHODOLOGY & APPROACH

Savills Building and Project Consultancy sector experts track build cost and programme timescales sentiment across 48 separate markets and sectors. A high S.P.E.C.S score would mean that most sectors are experiencing upward cost and timescale pressure whereas a highly negative score would suggest that most markets and sectors are experiencing downward pressure. A score around zero suggests that build costs and programme timescales are largely static.

UK CONSTRUCTION PMI REACHED 57.2 IN SEPTEMBER, UP FROM 53.6 IN AUGUST

Source Savills Research **Note** *Time taken from project sign off to commencement including procurement and delivery of building components



Central London offices development pipeline ahead of average for the time being. **Source** Savills Research

London offices: strong pipeline aims to keep pace with occupier demand

As the central London office market continues to recover from the shock brought on by the Covid-19 pandemic, investors and developers continue to grapple with the requirement to deliver modern stock and upgrade legacy stock to meet the needs of the modern occupier.

Minimum energy efficiency requirements (MEES) currently require that leased commercial projects in England and Wales have a minimum EPC rating of E. This is anticipated to increase to a minimum rating of C in 2027 and B in 2030 with estimates suggesting that up to half of central London offices will be "unlettable" by 2027.

This continues to pose a dichotomy for the owners of central London offices as there continues to be a clear preference from occupiers for office space with better sustainability credentials, with over half of take-up in 2024 (55%) consisting of lettings in BREEAM-rated Excellent or Outstanding buildings. A further 16% of take-up was in BREEAM-rated Very Good buildings.

The good news is that the industry is starting to make progress, indeed, the City of London approved a record number of retrofit planning applications in 2023, which accounted for half of all permissions granted across London.

The rise in demand for, and shortage of, "prime and green" office space means that we are currently forecasting continued positive year-on-year (YoY) rental growth. Combined with the fact that occupiers are accepting of the fact that higher rental levels are required to secure the best space and the fact that tender costs are stabilising should make such schemes more viable to take from the drawing board to construction.

Currently we are anticipating development completions this year will reach 6.8m sq ft. This is up 26% on the 10-year annual average and would be the highest level of development completions in over a decade. However, over the last year we have seen the timing on 51% of schemes pushed out by at least 1-3 quarters so in reality completions are unlikely to reach this level. 41% of space scheduled for delivery this year has already been pre-let and around 5% is currently under offer.

New developments account for 45% of the overall sq ft that will be delivered between H1 2024 and 2028, (40% by number of schemes), this is down from 60% in H1 2023, reflecting increased viability challenges for new developments and we expect to see more refurbishments as a result.

Regardless of whether the central London office development pipeline moving forward is predominantly new build or retro-fit, it is clear that a significant increase in the availability of construction workers will be required. If we combine that with the fact that we have witnessed a significant number of contractor insolvencies in recent months it is likely that we will see a rise in labour cost inflation in the short to medium term.

In turn this will continue to feed into our S.P.E.C.S index meaning that continued volatility related to both build costs and timescales will impact the delivery of projects to satisfy the continued occupier demand for best-in-class space.

BOOMING DATA CENTRE MARKET TO AID CONSTRUCTION SECTOR

There are approximately 1,900 active data centres in Europe, representing a power capacity of around 8,000 megawatts (MW). 67% of this capacity is concentrated in just five countries: the UK, Germany, Ireland, the Netherlands, and France.

Looking ahead, expansion plans are set to accelerate. Over the next four years, Europe is expected to add 3,110 MW of data centre capacity, averaging a 9% growth rate and bringing the total to around 11,400 MW by 2028. Greenfield data centre construction costs have risen notably since last year, propelled by multiple factors, including supply chain limitations, inflationary trends, labour scarcities, and land availability challenges. Globally, they surged by over 6% YoY compared to 2022. In Europe, the average construction costs for 2023 surged by 6.5% annually, reaching $9.1 million per MW.

For our latest research and a deeper dive into data centres please click here.

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