MARKET IN MINUTES

Savills Research

Market in Minutes

Retail yield compression broadens

High street retail joined retail warehouses (open A1 and restricted), in reporting a 25bps downward shift in prime yields in March. This was the first compression in yields for this sector since November 2021. Shopping centres may join the fray in the coming months in light of mounting investor appetite. Improving footfall, renewed occupier demand, the yield play against other sectors and potential repurposing angles have all culminated to boost investor interest across the wider retail property spectrum, albeit the focus remains very much on prime assets with robust fundamentals.

March also saw an increase in the number of sectors reporting downward yield pressure, up from seven in February to nine. Despite this, deal activity for Q1 slowed significantly. Deal count for Q1 was 42.1% below the 5-year quarterly average, the largest differential since Q2 2020 when deal activity fell 43.1% in response to the pandemic. In value terms however, volumes were only 2.5% below the 5-year average. We suspect this slowdown was in response to Omicron and reluctant sellers rather than reduced buyer appetite as data for March points to improved activity. However, geopolitical tensions, inflationary pressures and its read through for the global economy will no doubt exert an influence on investor confidence over the coming months.

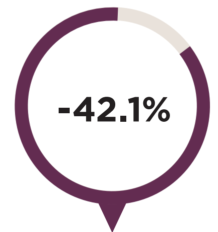
Savills prime yields

	March 2021	February 2022	March 2022
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	6.75%	6.50%↓	6.25%↓
Shopping centres	7.50%	7.50%↓	7.50%↓
Retail Warehouse (open A1)	6.00%	5.00%	4.75%↓
Retail Warehouse (restricted)	6.25%	5.00%	4.75%↓
Foodstores (OMR)	4.50%↓	4.25%	4.25%
Ind/ Distribution (OMR)	3.75%↓	3.25%↓	3.25%↓
Industrial Multi-lets	3.75%↓	3.25%↓	3.25%↓
Leisure Parks	7.50%	7.00%	7.00%↓
London Leased (core) Hotels	3.75%	3.50%↓	3.50%
Regional Pubs (RPI)	5.25%	5.25%	5.25%

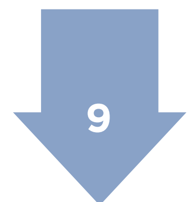
Source Savills

Key Stats

The UK average prime yield compressed by 5bps to 4.79%

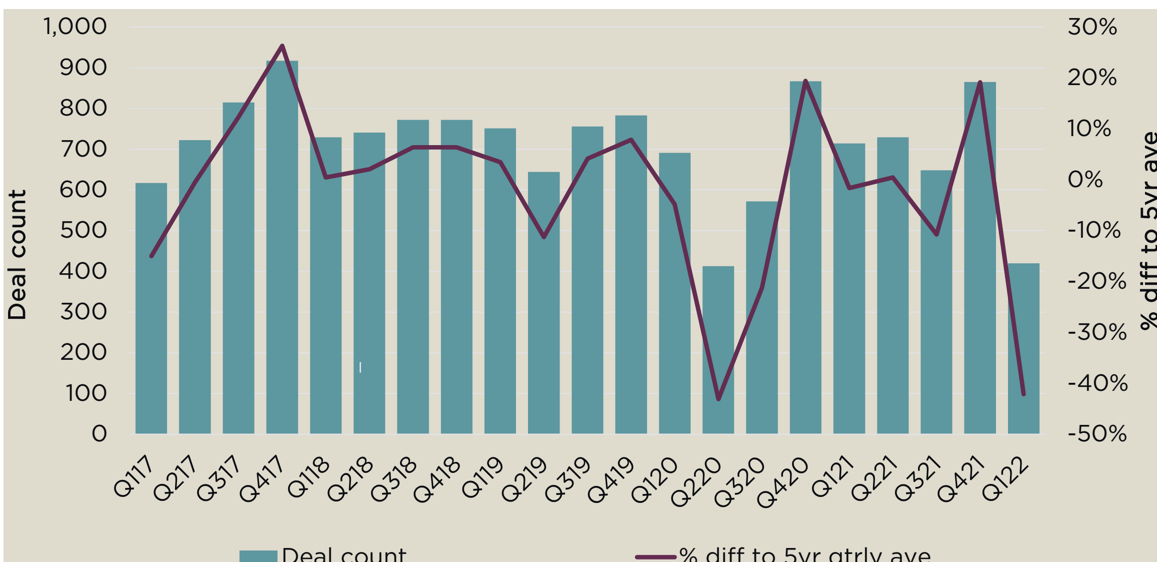


Q122 differential in investment transaction deal count to the long term quarterly average



Number of sectors that have a downward prime yield expectation

Short term blip or the start of a sustained slowdown? Investment activity slowdown in Q1 more indicative of reluctant sellers rather than lack of buyers



Source Savills, PropertyData

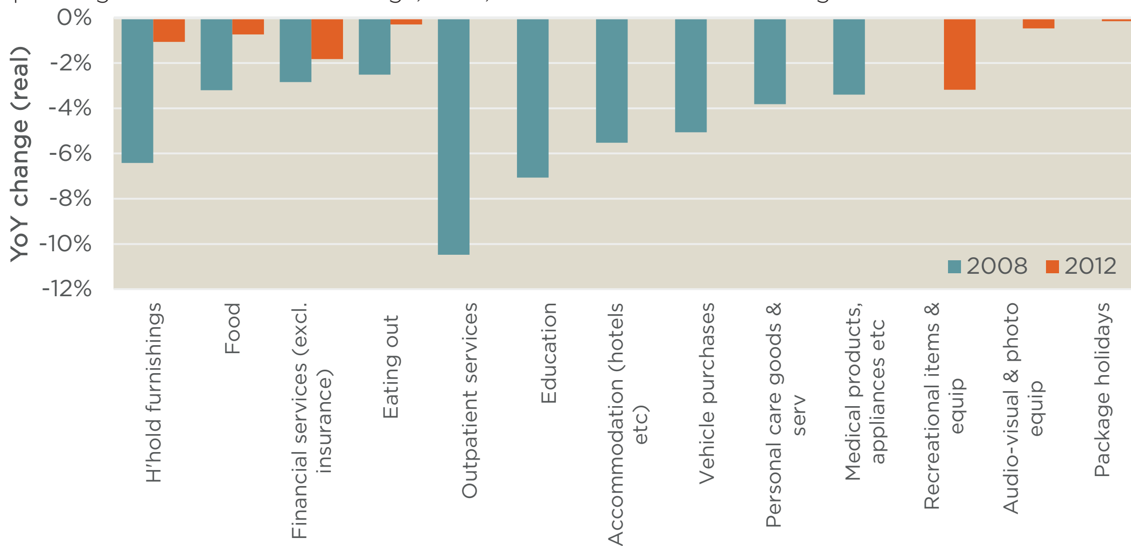
What parts of discretionary spend are most exposed to the inflation squeeze?

UK inflation is currently running at a 30year high due to spiralling energy costs, initially in response to the global emergence from the pandemic, then exacerbated by the Ukraine crisis. This is placing unprecedented pressures on household budgets. But, what parts of discretionary spend most exposed to this inflation/ energy cost squeeze?

One way to answer this is to look at historical spending trends during previous high inflation periods where other background elements, such as consumer confidence, GDP and unemployment rate were broadly similar. This is easier said than done considering that we have not experienced this degree of inflation in recent history. But, we did see significant increases in household energy costs in 2008 and 2012 (+19% and +13% in nominal terms respectively) at a time when consumer confidence was at an all-time low, albeit annual RPI inflation was almost half that of current levels at 4.0% and 3.2%, respectively. So, what did consumers cut back on in 2008 and 2012?

There are a number of differences in spending trends across these two years. For example, more parts of consumer spending reported declines in real terms in 2008 than in 2012. There were also differences in those categories that reported declines; in 2008 spending on out-patient services saw the largest fall (-10.5%) whereas in 2012 it grew 5.3% in real terms. While there were differences, there were segments that reported declines in both years. And, it is these segments that are likely to be the most exposed to the current inflation squeeze. These include spending on household furnishing, household equipment and other housing expenditure which fell in 2008 and 2012 by 6.4% and 1.1%, respectively. Likewise, spend on food shopping, financial services (excl. insurance) and eating out also saw declines in both 2008 and 2012. Considering the scale of the current inflationary environment, we suspect more elements of discretionary spend will see declines, including those segments impacted by previous inflation squeezes.

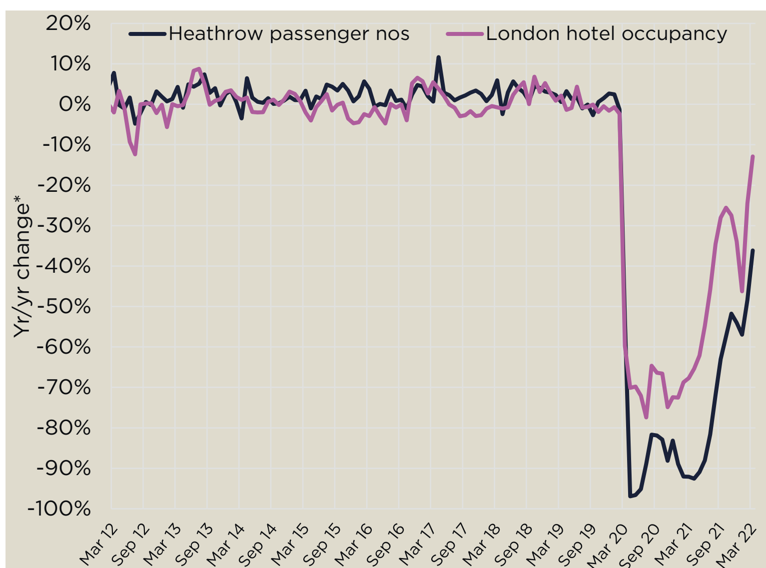
Analysis of previous declines in consumer spending 2008 and 2012 both saw declines in spending on household furnishings, food, financial services and eating out.



Source Savills, OE

There is a close correlation between Heathrow passenger numbers and London hotel occupancy, albeit airport passenger numbers are a mix of outbound/ inbound travellers. The recovery that began in mid 2021 took a hit from Omicron at the end of last year but this has been reversed in recent months with March reporting another improvement. For example, March passenger numbers at Heathrow were 36% below equivalent 2019 levels, the smallest differential since the onset of the pandemic. This is a promising improvement considering the geopolitical and inflationary headwinds that persist. This has had a positive read through to hotel occupancy which is now 13% below equivalent 2019 levels. Headwinds continue but does suggest the recovery in international visitors to London, and that of its hotel and West End retail markets, is becoming more entrenched.

Recovery in London hotel occupancy back on track



Source Savills; Heathrow data; STR (*note: 2021 and 2022 compared to 2019)

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