UK Commercial – August 2024

MARKET IN MINUTES

Savills Research

Market in Minutes

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More positive sentiment?

In the UK, the post-summer sentiment seems to be more positive. All of the sectors saw yields stay the same or move lower by 25 basis points in August. The MSCI UK total return performance data was positive across all sectors. Offices are the only sector showing a year-on-year negative total return, but on the current trend, the office sector is also expected to be back in positive territory in Q1 next year. Despite the lower UK investment volumes, to date, it is worth noting that a quarter of commercial investment in 2024 has been offices. Prime rents will continue to grow as the choice for occupiers continue to diminish, with extremely limited future supply.

In a European context, the latest data shows the UK has benefitted from the speed of its initial price adjustment. The result has been the UK dominating European H1 activity with a 29% share of investment volumes, above its five-year average of 24%. Notably, there has been an uptick in activity from French SCPI funds. These investors have targeted the UK regional markets with the structural characteristics of the region appealing to this purchaser type. The smaller lot sizes prevalent in the market are aligned with their investment strategy and they have more capital to deploy.

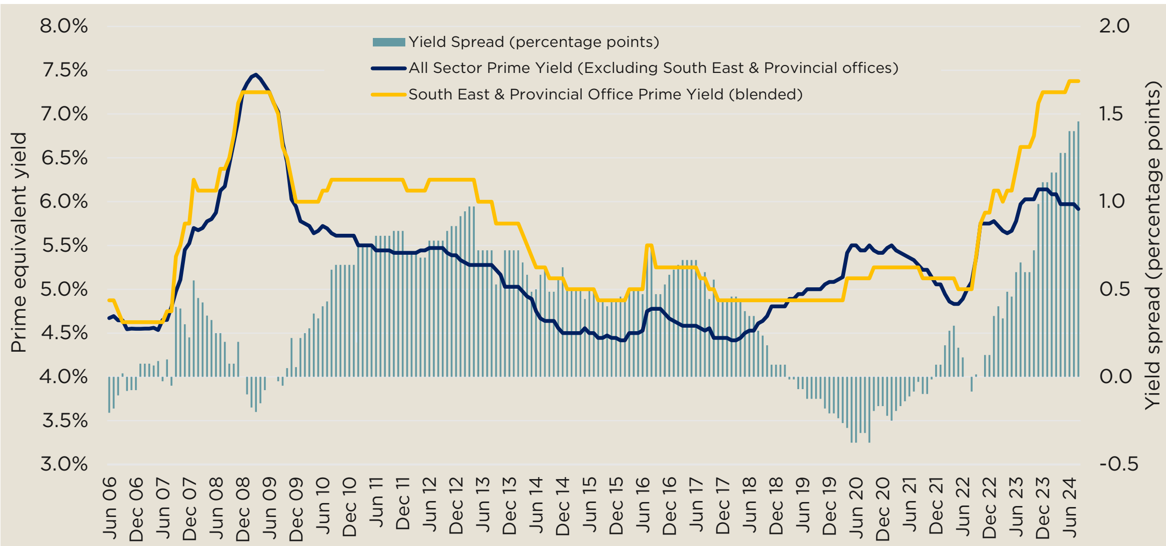
Following the UK base rate cut last month, the US Federal Reserve has now followed suit as it is more confident on the outlook for inflation. The larger than expected 50 basis point cut will help boost corporate growth, which will permeate occupational markets globally.

Savills prime yields

	August 2023	July 2024	August 2024
West End Offices	4.00%	4.00%	4.00%↓
City Offices	5.25%	5.25%	5.25%
South East Offices	7.00%	7.75%↑	7.75%↑
Provincial Offices	6.25%↑	7.00%↓	7.00%↓
High Street Retail	6.75%↑	6.75%↓	6.50%
Shopping centres	8.25%↑	8.25%↓	8.00%
Retail Warehouse (open A1)	5.75%	5.50%	5.50%
Retail Warehouse (restricted)	6.25%	6.00%	6.00%
Foodstores (OMR)	5.00%	5.50%↓	5.50%↓
Ind/ Distribution (OMR)	5.25%	5.00%	5.00%
Industrial Multi-lets	5.25%	5.00%	5.00%↓
Leisure Parks	7.50%↑	8.00%	8.00%
London Leased (core) Hotels	4.50%↑	4.50%↓	4.50%↓
Regional Pubs (RPI)	6.25%↑	6.50%	6.50%↓

Source Savills

Have prime office yields outside of Central London peaked? South East and Provincial office yields look out of step with the improving occupational market



Source Savills

Key Stats

A slight fall in the average prime yield in August

Number of sectors currently with a downward trend arrow

Percentage point yield spread between South East/Provincial Offices and the 'all other sectors' average

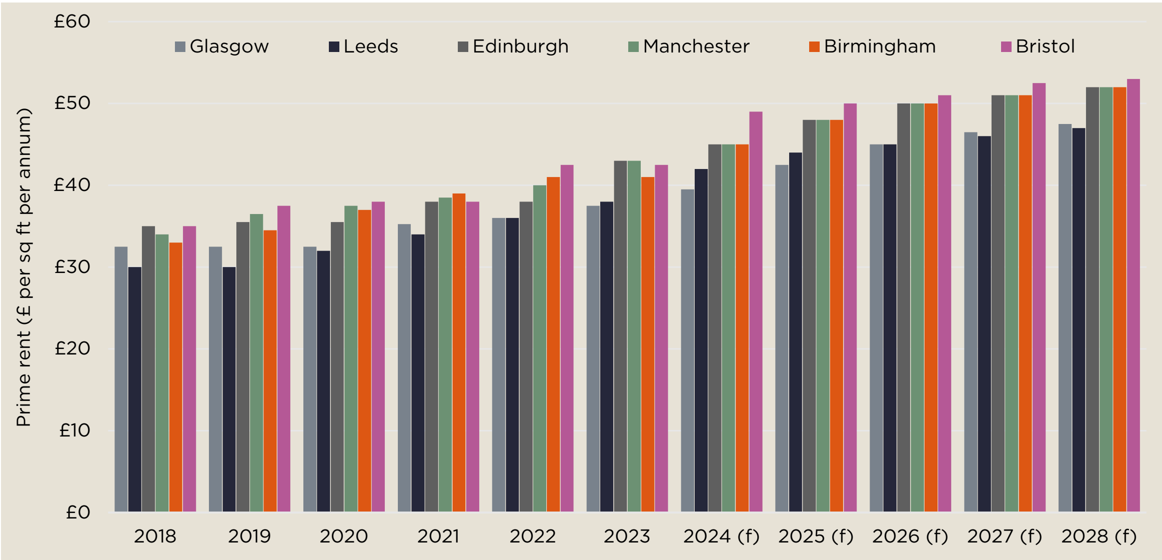
Key office markets outside of London continue to improve

The office occupational market fundamentals remain robust. A supply and demand imbalance is present in both the Greater London & South East and Big Six Regional City markets. Take-up in H1 2024 was 45% above H1 2023 and on par with the five-year average in the Greater London & South East region. An uptick in leasing activity has also been evident in the Big Six Regional city market with take-up for the same time period being 10% above H1 2023. The increase in take-up is putting pressure on existing supply levels with the development pipeline limited across the regional markets, resulting in rental growth for both prime and standard grade A space. Ten submarkets have achieved record rents in H1 2024 in the Greater London & South East region and the average prime rental growth forecast across the Big Regional city centre markets for 2024 is 9%. These trends make the regional office market an attractive investment proposition at current pricing levels.

As shown in the chart below, we are forecasting rental growth in the six key markets, outside of the South East, of between 21% and 27% for top quality space by the end of 2028. Given the price rises in construction and the higher average wage growth of office employees, the cost of office space, in comparison, is worth reviewing. Some markets have been constrained by perceived rental ceilings, but there is growing acknowledgement that the very restricted supply of space that meets the high standards most corporate occupiers now require, the increased cost of providing this, and the softer yield regime we are in, will require rents of over £50psf.

The structural shift to hybrid working may cause a reduction in space requirements for some companies, but not all. In support of this fact, a recent KPMG CEO survey indicates a reversion to pre-pandemic office trends. CEOs have become further entrenched in their view with 83% of them expecting a full return to the office over the next three years.

Rising rents required for future office supply to be delivered



Source Savills

To finish off this office themed Market in Minutes, and with another forward-looking analysis, the latest forecasts for office-based employment shows an expectation of more employees working for companies rather than less. Today, there are around 8.9 million office-based employees in the UK, but this will rise closer to 10 million in 10 years (end-2033).

Across Europe, according to Oxford Economics, there will be a net additional 1.2 million jobs by the end of 2028. As shown in the chart to the right, during the next 10 years, UK office employment, outside of Greater London, will grow by 10%, but 14% in London.

Overall, based upon these forecasts, a conservative estimate of net additional office space, accounting for hybrid working, would be in the region of 50 million sq ft during the next decade.

Employment in offices will rise, not fall

Source Oxford Economics

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

Steven Lang
Director
Commercial Research
020 7409 8738
slang@savills.com