MARKET IN MINUTES
Savills Research

Market in Minutes

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Core and opportunistic yields facing downward pressure

While the all sector prime yield remained broadly stable in February, the arrows indicating the likely forward trajectory for prime yields are pointing to a Q2 hardening in some core and opportunistic sectors.

The fact that we expect to see further downward pressure on prime logistics and foodstore yields will come as no surprise, given that these have been sectors of choice for most types of investor throughout this crisis.

Retail warehousing, however, is rising in popularity with investors who are increasingly viewing it as a segment of retail that is not only more defensive against internet shopping, but also from the negative impacts of Covid-19.

Given these fundamentals, and the fact that prime retail warehouse yields are now 125bps higher than they were two years ago, we expect to see more opportunistic investors entering this sector over the next 12 months.

Transactional volumes across all the commercial property sectors remained muted in January & February 2021, with the biggest impact on the overall 67% fall in activity being the quiet central London office market. We continue to expect a recovery in office investment activity as social distancing measure ease.

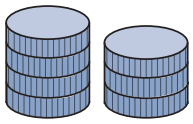
Savills prime yields

	February 2020	January 2021	February 2021
West End Offices	3.50%	3.50%	3.50%
City Offices	4.00%	4.00%	4.00%
Offices South East	5.00%↑	5.50%↑	5.50%↑
Provincial Offices	4.75%↑	5.00%	5.00%
High Street Retail	5.50%↑	6.75%↑	6.75%
Shopping centres	6.00%	7.00%↑	7.00%↑
Retail Warehouse (open A1)	6.25%	6.50%	6.50%↓
Retail Warehouse (restricted)	6.50%	6.50%	6.50%↓
Foodstores (OMR)	4.75%	4.50%	4.50%↓
Ind/ Distribution (OMR)	4.25%	3.75%	3.75%↓
Industrial Multi-lets	4.00%	3.75%↓	3.75%↓
Leisure Parks	5.75%	7.50%	7.50%
London Leased (core) Hotels	3.75%	4.00%	4.00%
Regional Pubs (RPI)	4.50%	5.25%	5.25%

Source Savills

Key Stats

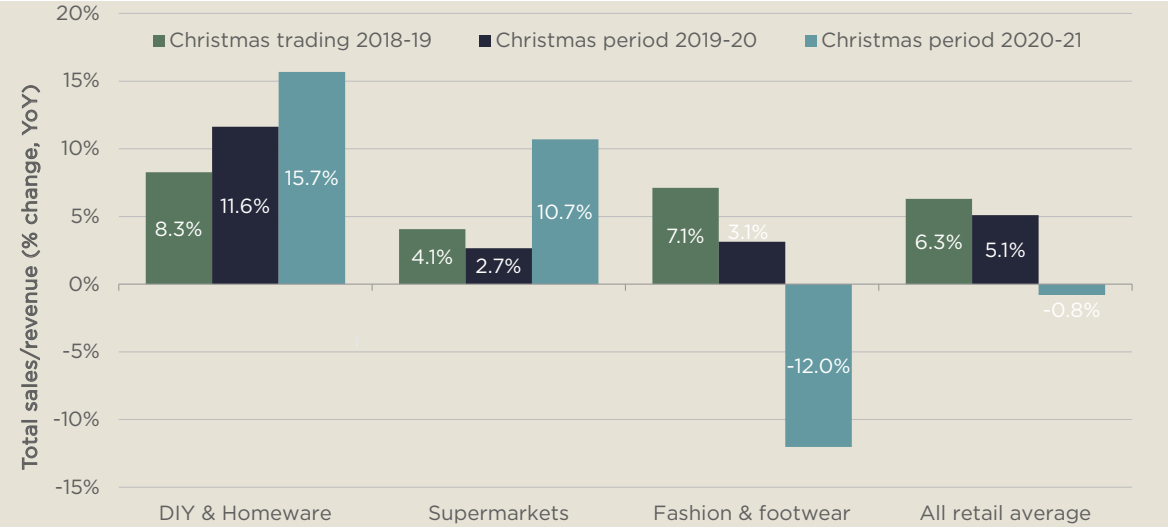
The rise in prime shopping centre yields over the last 12 months



£3.8bn
Jan & Feb 2021 UK commercial investment volume. 67% lower than the same period in 2020

Number of sectors that are expected to see downward pressure on prime yields in the short term

Retail warehouse strength: Sales of retail warehouse-type goods were notably stronger over December and January than other parts of the retail economy



Source MSCI

Offices Flex for the future

While investment activity in the office sector remains muted as investors wait to see how the economy and its office workers emerge from lockdown, in the background there is a lot of activity going on to ensure that portfolios are match fit for the 'new normal'.

Savills recently completed a survey of office landlords across the UK to gauge their views and attitudes towards the flexible workspace sector. Three out of four landlords that responded to the survey expected that their tenants would require more flexible lease terms in the future than they had in the past, and it is clear that many landlords are well advanced in flexing their offer to suit this need.

29% of landlords told us that they already operate a flexible offer, and a further 29% stated that they were planning to develop a flexible offer.

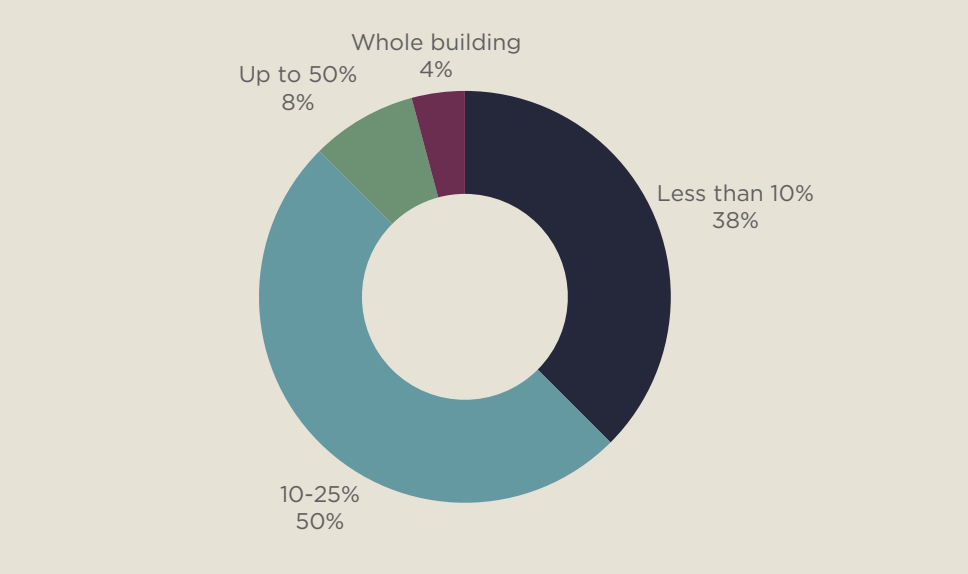
Given that those 29% who are planning to develop a flexible office offer currently own nearly 304m sq ft of office space, the scale of the change that is coming is significant.

Our survey, and our own views on what is best, suggest that a mix of offers in individual buildings will be the way forward. As the chart below shows, half of all landlords would be prepared to let 10-25% of a 50,000 sq ft office building to a flexible workspace provider - an interesting statistic in the context of the trends of the last 12 months when providers have generally been less acquisitive than they have been at any point in the last five years.

Landlords are also increasingly likely to consider some form of management agreement, with 54% saying they were more likely to consider some kind of partnership with an operator.

What is clear from this survey is that the move towards a more flexible offer in the office sector has not been curtailed by Covid-19. Indeed, our survey found that landlords are rapidly evaluating and implementing the best ways for their organisations to deliver what tenants want.

Flexing office portfolios What percentage of a single building would you be comfortable being let to a flexible workspace provider?



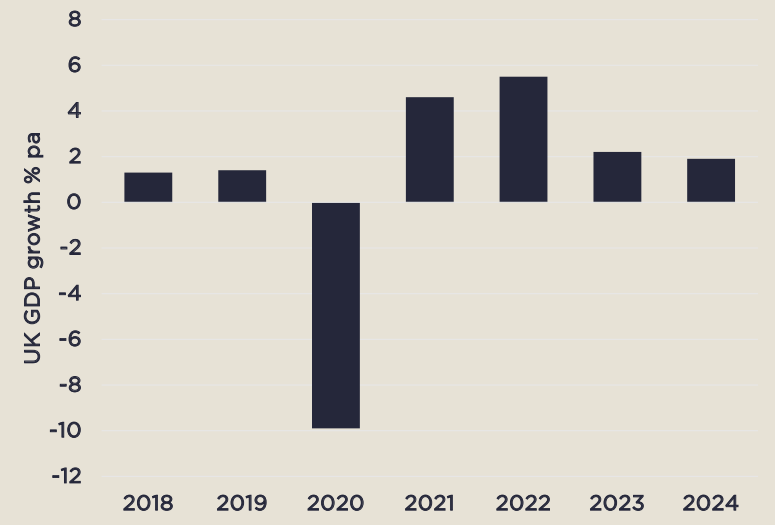
Source Savills

While the UK's Budget earlier this month definitely had a whiff of 'buy now, pay later' about it, there is no doubt that many areas of support needed to be extended until lockdowns end.

The OBR's official forecast that accompanied the Budget suggested that the extra fiscal support and the roadmap out of lockdown would slightly raise the level of output this year. However, their latest forecast for UK GDP growth in 2021 remains a very modest 4% (down from 5.5% last November).

Our view is that the recovery is likely to be faster than this, as an element of pent up and 'relief' spending enters the economy with each stage of the roadmap to normality. This should deliver GDP growth this year and next of around 5-6%, a view that is broadly in line with the latest consensus forecast published by Focus Economics.

UK economy to recover strongly from Q2 2021



Source Focus Economics

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