MARKET IN MINUTES
Savills Research

Market in Minutes

Slow, but poised?

It has been yet another month of static yields, but with an addition of two downward trend arrows. The market remains in a period of stasis, with a slow start to the year and limited evidence to move yields.

At present, there are fewer sellers at current pricing, but going forward, with falling interest rates, lower debt rates will bring in more geared capital. The UK investment volume data for the first quarter, albeit subject to upward revision, is showing c.£8bn. At this trend rate, for the remainder of this year, would show a 12% increase on the £28.4bn total recorded for 2023. A driver of increased investment volumes could be regional offices. Despite, historically sitting in-line with retail and industrial yields, long-term, the current office prime yield is higher than both sectors, for all the reasons that have impacted on the office sector since the pandemic. Additionally, the current yield gap between London and the rest of the UK, is 2.6 percentage points and the highest for over 32 years. As UK office occupancy rates continue to climb, albeit slowly, the question is whether the office sector outside of Central London is showing the most interesting opportunity. A driver would also be an acceleration of a return to the office. The higher productivity discussion of home working versus office work, which has been on-going since the pandemic, is turning towards performance, i.e. not just what is being done, but how well. Employees may say their best performance is at home, the C-suite is not so sure.

Savills prime yields

	March 2023	February 2024	March 2024
West End Offices	4.00%	4.00%	4.00%
City Offices	4.50%	5.25%	5.25%
South East Offices	6.25%↑	7.50%	7.50%
Provincial Offices	5.75%	7.00%	7.00%
High Street Retail	6.50%↓	7.00%	7.00%
Shopping centres	8.00%↑	8.25%	8.25%
Retail Warehouse (open A1)	5.50%	5.75%	5.75%↓
Retail Warehouse (restricted)	6.00%↓	6.25%	6.25%↓
Foodstores (OMR)	5.25%	5.50%	5.50%
Ind/ Distribution (OMR)	4.75%	5.25%↓	5.25%↓
Industrial Multi-lets	4.75%↓	5.25%↓	5.25%↓
Leisure Parks	7.00%	7.75%	7.75%
London Leased (core) Hotels	4.25%↑	4.75%	4.75%
Regional Pubs (RPI)	5.75%↑	6.50%	6.50%

Source Savills

Key Stats

6.14%

The UK average prime yield showed no change in March

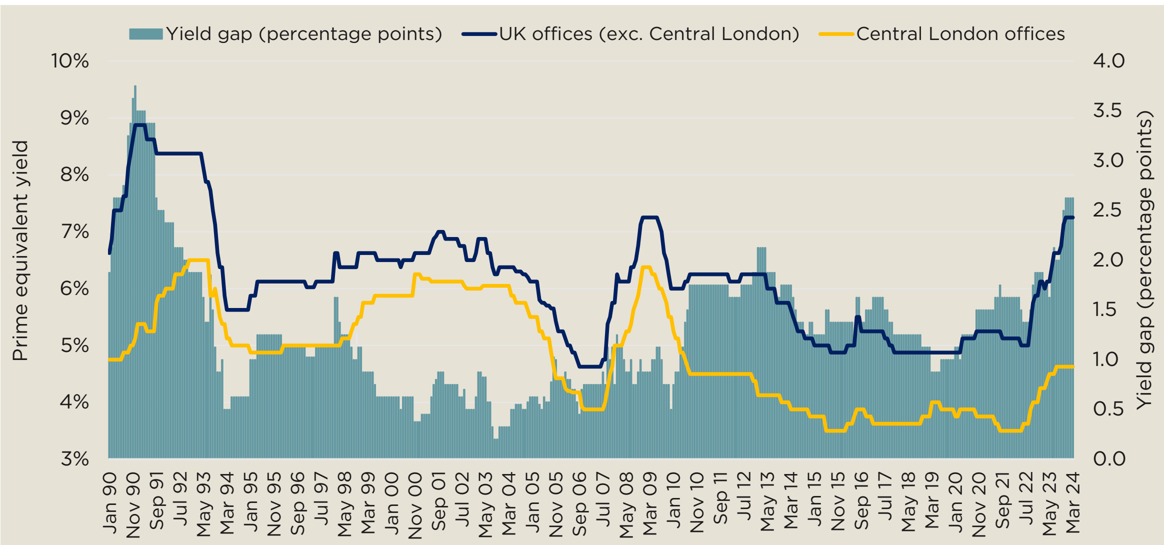
c.£8bn

Current estimate for the Q1 2024 UK investment volume

+2.6

Percentage point yield gap between 'rest of UK offices' and Central London offices

UK office yield gap When comparing Central London and the rest of UK offices, it is showing the largest yield gap since the end of 1991



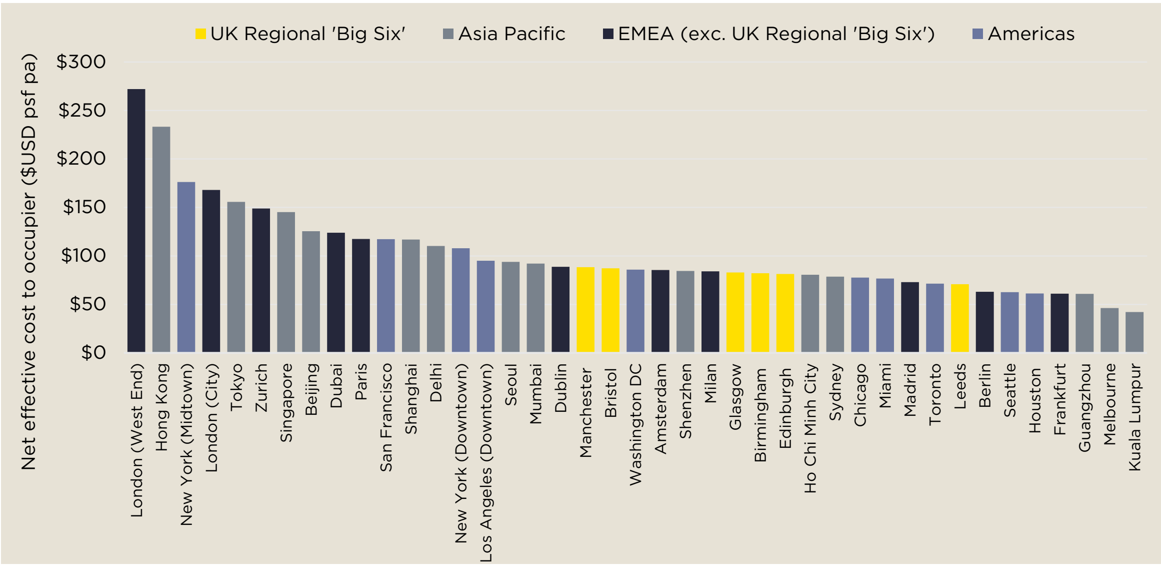
Source Savills

The UK offers an office solution to fit all corporate budgets

Central London continues to have a relatively high net effective cost for occupiers, with both London City and West End in the top 4 (see chart). For the UK Regional 'Big Six' office markets, the relative pricing shows its cost effectiveness for occupiers, both compared to London and the rest of the world. However, will this remain the case? Despite office take-up at the end of 2023 being 10-15% below pre-pandemic levels across the UK, the Prime Office Costs index showed net effective costs to occupiers increased by 2.6% compared to year-end 2022, as competition for the best-in-class space continues to drive prime costs up. Also, rental growth across the 'Big Six' is to average 5% over the course of 2024. In comparison, EMEA is likely to see a 2% average growth during 2024 and North America to see no rental growth. The main driver of the UK rental growth is the lack of prime office stock available. This has created heightened competition in the market with this set to grow as occupiers continue to seek the most sustainable, top-quality office spaces.

With office occupancy beginning to rise, offsetting costs by reducing space is becoming less feasible. Rising occupancy in the UK, with a higher propensity for office workers to go to the office, may also see the UK emerge as a more attractive destination for corporates. Of course, the key driver of the differential between London and the 'Big Six' prime office costs is the rental premium of being in the capital. Many corporates will not compromise on location, but there will be office occupiers that seek the best-in-class space, but at a discount to other office markets across the world, including London, and this is a future driver for the 'Big Six' office markets in the UK. This, coupled with the high yield gap as shown on the first page, presents an attractive investor proposition for UK regional offices.

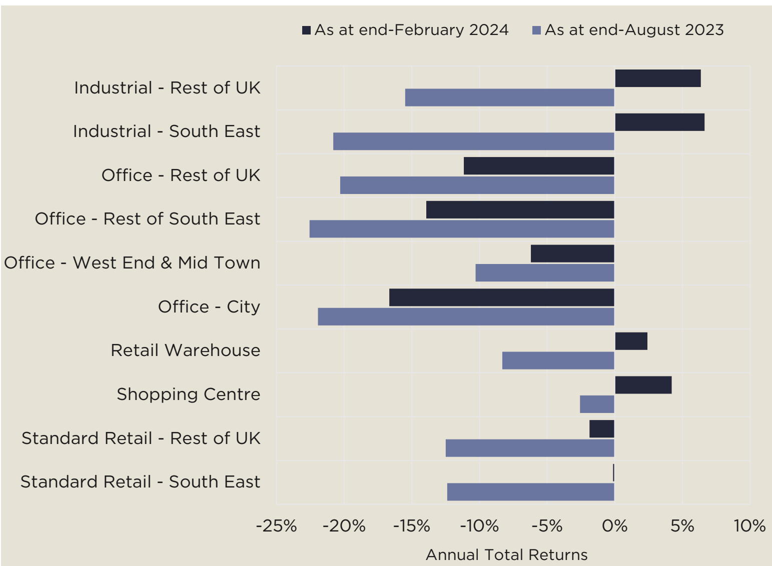
Prime Office Costs How do UK office occupier costs compare across the globe?



Source Savills

An assessment of the momentum and direction of total returns for UK commercial markets is shown in the chart. Based upon the valuation indices from MSCI, it is worth reviewing the most recent annual total return performance for the broad UK sector/locations. The annual return is shown for the most recent datapoint (12 months to end-Feb 2024) versus six months previous (12 months to end-Aug 2023). Across the board, despite the majority of the ten sector/locations currently showing negative total returns, there has been an improvement in valuers' opinions. The property cycle momentum is evident, regardless of the sector, as all have shown a rolling improvement in the past six months. Industrials, retail warehouses and shopping centres have all seen negative total returns move back into positive territory - Industrials showing a sharp bounce back. This may also happen for the office sectors going forward. First movers will be rewarded.

Total return performance is improving



Source MSCI

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