MARKET IN MINUTES

Savills Research

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Cautiously optimistic

Concern had been building throughout October, given the sombre messaging that preceded the new Labour government's first budget in 14 years. Having ruled out hikes to income tax, employee national insurance and VAT, it was widely considered the Chancellor, Rachel Reeves, was likely looking at options on employer national insurance, capital gains tax, inheritance tax and various duties, in order to raise funds to fill what the prime minister has described as an "economic black hole" left by the previous Conservative government.

Nevertheless, October saw no change in pricing across any commercial asset class, with Savills average prime yield holding at 6%. In fact, eight sectors are now seeing a downward pressure on yields. Both Open A1 and Restricted Retail Warehousing added to the six sectors that experienced the same in the month prior, potentially pointing to further yield hardening going forward, similar to that seen in August and September.

In terms of transactional activity, the market is ahead of where it was this time last year. According to figures from RCA, investment volumes for the first three quarters of 2024 reached £24.1bn, with 2023 achieving £22.3bn for the same period. Of course, not all sectors perform equally. Office (-17.7%) and industrial (-7.5%) volumes remain subdued, whilst retail (-0.3%) transactions remain flat. Hotels see a significant 269.5% uplift in transactional activity by the same comparison.

Retail warehousing is a sub-sector of retail that warrants a special mention when it comes to its most recent transactional performance. Volumes for the year have already reached £2.2bn, with more than half of that coming in Q3 alone, putting the YTD trade up by 35.9%. Given the continued strength of the occupational market and potential for rental growth, it is of little surprise the IPF consensus forecast published at the beginning of September picked retail warehousing as the top performing commercial property sector over a five year period, with an average total return of 9.3% per annum. At Savills, we have moved in our prime equivalent yields three times this year to reflect changes in sector pricing over the course of 2024.

The minimum wage increases in the Budget will arguably improve the spending power of some consumers; however, despite the government committing not to increase income tax, the burden continues through the stealthy tax collector that is 'fiscal drag'. That is assuming wages continue to rise, which is no certainty given the cost implications of minimum wage increases and the rate of national insurance businesses will now pay. With more than half of the Chancellor's £40bn total tax rise being paid for by employers, cost implications for businesses look stark and will undoubtedly be passed on to the consumer where possible.

In addition, yields for 10-year UK bonds have gone past 4.5% for the first time in a year, halfway towards the danger zone identified by the Office for Budget Responsibility (OBR). An increase in the cost of borrowing could of course have implications for investment transactions; however, Deloitte's CFO sentiment survey, which can be used as a proxy for investor sentiment, has tended to pre-empt changes in commercial investment by four quarters. With CFO confidence still in positive territory following a sustained period of improvement, we are cautiously optimistic volumes will continue to grow well into 2025.

Savills prime yields

	October 2023	September 2024	October 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	6.50%↑	7.00%↓	7.00%↓
High Street Retail	6.75%↑	6.50%	6.50%
Shopping centres	8.25%↑	8.00%	8.00%
Retail Warehouse (open A1)	5.75%	5.25%	5.25%↓
Retail Warehouse (restricted)	6.25%	5.75%	5.75%↓
Foodstores (OMR)	5.25%↑	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

Key Stats

6%

Savills average prime yield remains at 6% for October

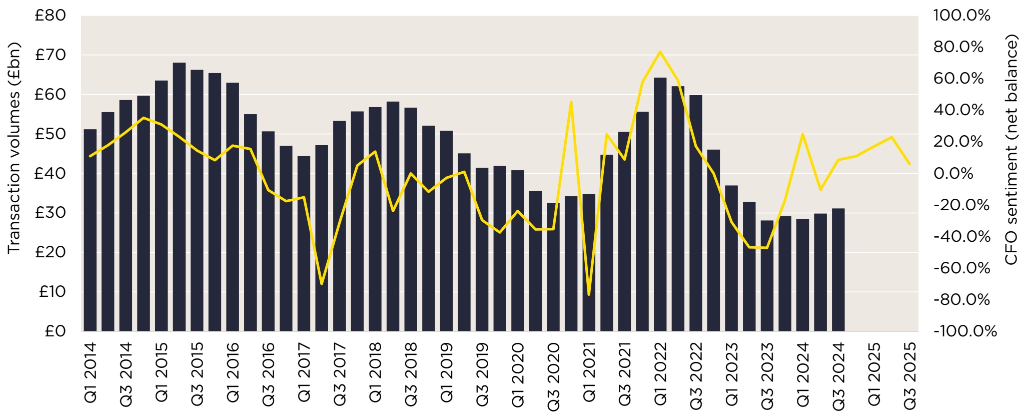
8

Number of sectors currently with a downward trend arrow for pricing

£2.2bn

2024 Retail Warehouse investment volumes are already £260m ahead of the 2023 total

UK Commercial transaction volumes Does improving CFO sentiment point to continued growth in transactional activity?



Source Savills Research, RCA, Deloitte CFO Survey,

High Street and Shopping Centre rents continue to edge northward as key occupational bellwethers for market performance show further evidence of stabilisation

Although there is still some way to go before vacancy is at a level that breathes widespread investor confidence in the strength of the 'in-town' occupational market, the fact both it and consumer footfall remain stable, coupled with plenty of evidence of operators looking for new space, can be considered a positive result for the sector. According to LDC, high street vacancy is currently at 14.0% , where it has remained for the last four quarters. Shopping centre vacancy sits at 17.6%, showing only marginal fluctuations since the start of 2023.

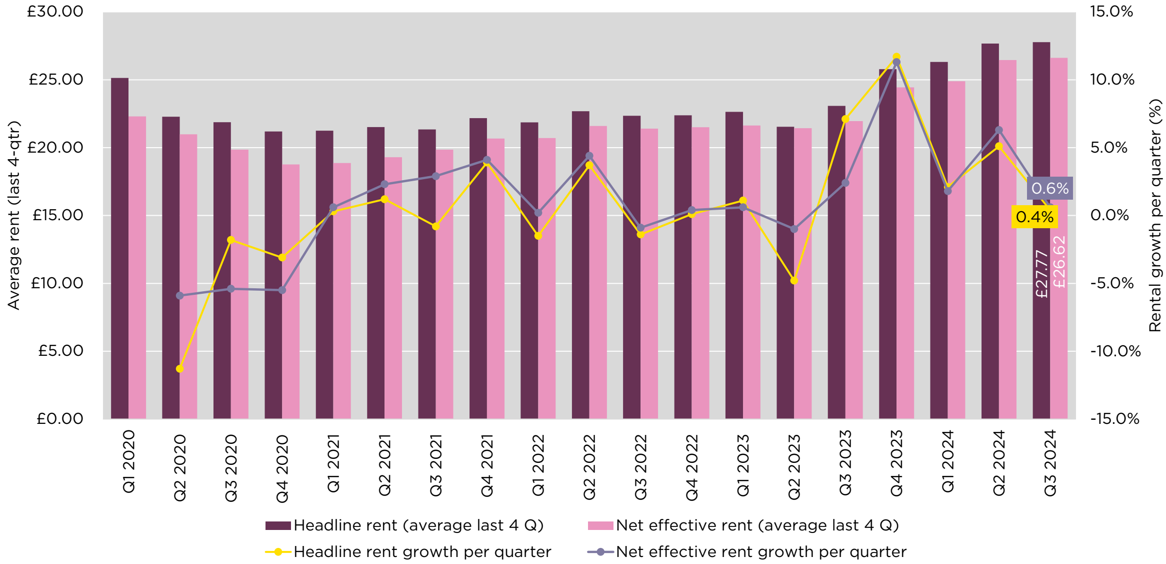
In turn, we continue to see a positive uptick in rents on new deals across high streets and shopping centres, according to Savills in-house data. In September, our headline rents reached an average of £27.77 psf over the last four quarters, a marginal improvement on Q2 with 0.4% growth, but an improvement nonetheless, and off the back of positive quarterly growth over the last five (the height of the cost of living crisis was the last time we saw average rents fall slightly). This suggests some competitive tension is beginning to build between operators looking to expand, particularly in well-occupied locations to which Savills book of new transactions is undoubtedly skewed toward.

PMA's average 'top rents' for mid-2024 sits at £27.80 psf across the key markets it analyses, a 0.9% increase on 2023. The similarity to the results across our open market letting and regears provides further confidence in the fact the market is seeing gradual and sustained rental growth, across the UK's key shopping locations at least.

In reality, we could see a further rental divergence between prime assets and weaker locations exposed to higher vacancy as operators continue to reposition their portfolios or look more strategically at growth opportunities. The polarisation that is evident in the investment market when it comes to pricing between prime assets and secondary locations is rooted in similar differences in occupational performance, particularly void rate and rental tone.

For further analysis on the topic, please read our latest High Street and Shopping Centre Spotlight for Q3 2024

Savills high street & shopping centre deals analysis



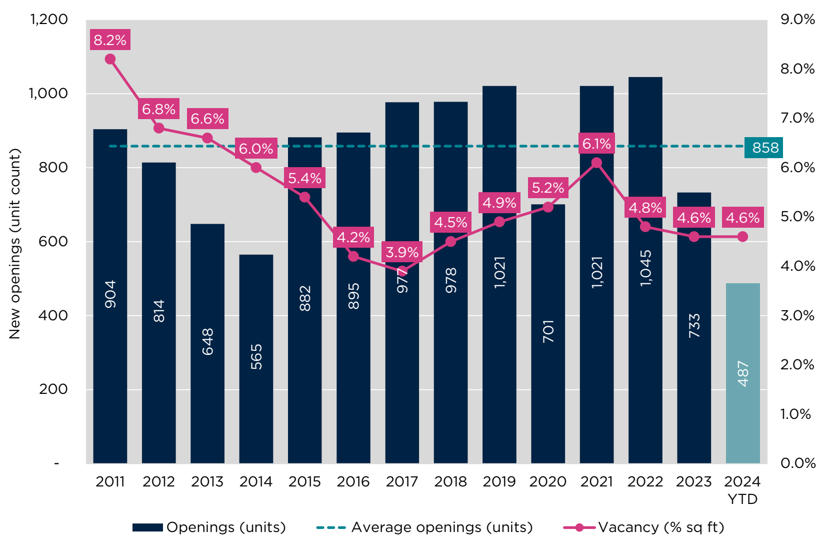
Source Savills Research based on TeleGeography

It is true that the number of new openings in the retail warehouse market is trending below the long-term average for 2024. However, it is important to stress the reduction in take-up is not emblematic of a rescinding appetite for space from retailers in the market; it is simply down to a lack of supply (voids are currently at 4.6% across the market).

Desire for expansion remains strong from a wide variety of operator types creating competitive tension in the market which has seen net effective rents grow by 8.1% on Savills open market lettings and regears thus far in 2024.

The administration of Carpetright has proved advantageous for some landlords, especially those with fully let schemes who previously have found it difficult to prove rental growth.

Below-average new openings belies occupational strength in Retail Warehousing



Source Savills Research

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