MARKET IN MINUTES
Savills Research

Market in Minutes

Strong year end ahead

Investment volumes for the year to date currently stand £42bn, meaning it is all but certain that final year volumes will exceed 2020 and exceed the £50bn mark. Investor sentiment in the industrial sector remains high, as by the end of Q3 volumes have reached £12bn, already exceeding the previous annual record of £10.9bn, accounting for 29% of the total market, again the highest ever level.

September saw inward yield movement of 25bps in the retail warehouse (open A1), provincial office and distribution sectors, which has meant that the Savills average prime yield now sits at 5.04%, a shift of 5bps and the lowest level since the onset of the Covid-19 pandemic. With no sectors reporting outward pressure and further yield compression expected in the foodstore and retail warehouse (restricted) sectors it is likely that our average prime yield will compress further before year end.

With rising inflation and discussions now taking place as to when interest rates will, rise rather than if, many commentators are discussing if further inward yield movements can be maintained. The most important thing to remember is that commercial property prices have a relatively loose link with inflation, and a much stronger one with economic growth. With UK GDP forecast to rise by c.5% in 2022 it is hard to justify wholesale upward yield movement in the near term.

Savills prime yields

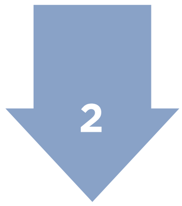
	September 2020	August 2021	September 2021
West End Offices	3.75%↓	3.25%	3.25%
City Offices	4.00%	3.75%	3.75%
Offices M25	5.25%↑	5.50%	5.50%
Provincial Offices	5.00%	5.00%↓	4.75%
High Street Retail	6.25%↑	6.75%	6.75%
Shopping centres	6.75%↑	7.50%	7.50%
Retail Warehouse (open A1)	6.75%	6.00%	5.75%
Retail Warehouse (restricted)	7.00%	6.00%	6.00%↓
Foodstores (OMR)	4.50%	4.50%↓	4.50%↓
Ind/ Distribution (OMR)	4.25%↓	3.50%↓	3.25%
Industrial Multi-lets	4.00%	3.25%	3.25%
Leisure Parks	6.75%↑	7.50%	7.50%
London Leased (core) Hotels	4.00%↑	3.50%	3.50%
Regional Pubs (RPI)	4.75%↑	5.25%	5.25%

Source Savills

Key Stats

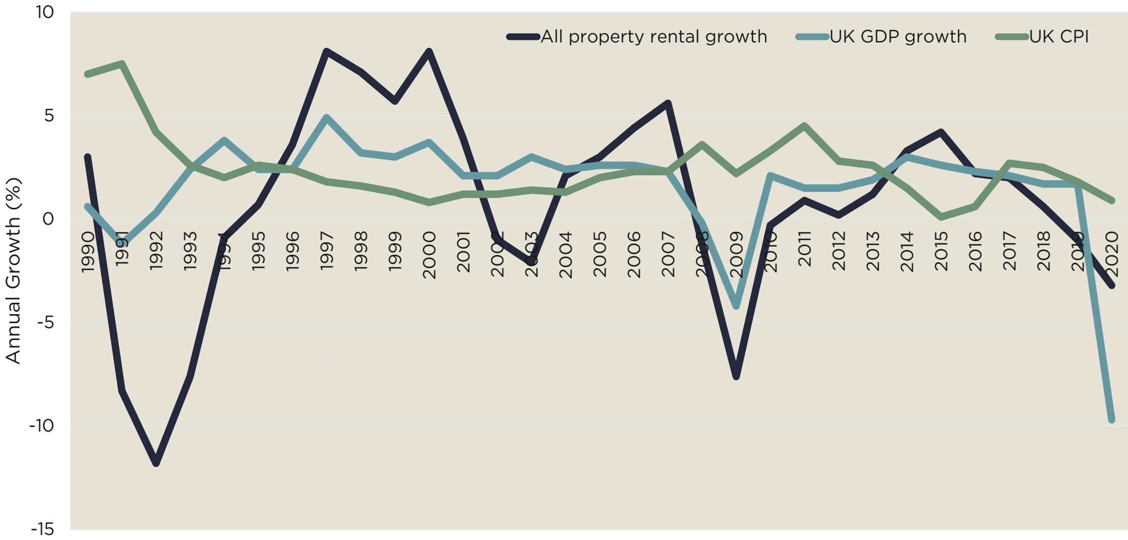
The UK average prime yield compressed by 5bps to 5.04%

Share of the total investment market for industrial, the highest proportion ever



Number of sectors that saw a downward prime yield movement

Commercial property has a stronger link to economic growth rental growth in the occupational market is strongly linked to GDP growth



Source MSCI, ONS

New planning policies will increase costs to logistics developers

As the world readies itself for the upcoming COP 26 summit in Glasgow, it is worth noting that buildings currently contribute some 19% of global greenhouse gas emissions, but this could treble by 2050 if action is not taken now, according to Intergovernmental Panel on Climate Change research.

New development will be forced to take on more of a share of ambitious targets and the planning system will be key to enforcing such targets.Local authorities will be central to the functioning of the new duties being imposed by Government through the forthcoming Environment Act.

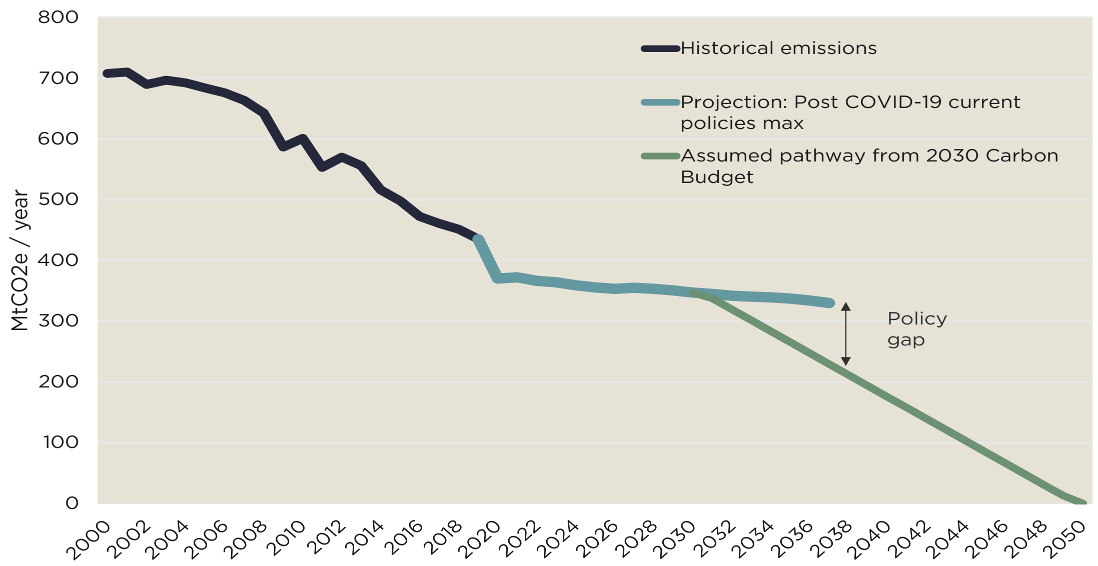
Many authorities already apply the DEFRA Biodiversity net gain (BNG) and local nature recovery strategies Impact Assessment (October 2019), where it is assumed that a significant proportion of costs imposed on developers by the requirements of BNG, will be 'passed through' to developable land prices, thereby affecting landowners. These costs cover both promotion and impact assessment, but are not always being factored into development appraisals.

Speculative development accounts for 22% of all of the warehouse space taken in the UK as occupiers need the flexibility to take speculative buildings when they are in rapid expansion mode as build to suits take longer to procure. Developers with a business plan to deliver speculative buildings will have little option but to accept these costs, and if possible recover them from the occupiers through rental growth. There could also be longer term implications for land values as developers appraise new sites based on assumptions that comply with the legislation.

Larger corporate occupiers are now more aware than ever of their own ESG targets and many newly constructed warehouses are achieving net zero status. The ability to move from older buildings, with low EPC's, to modern accommodation may present them with a quick ESG win that more than offsets any changes to the rental levels paid.

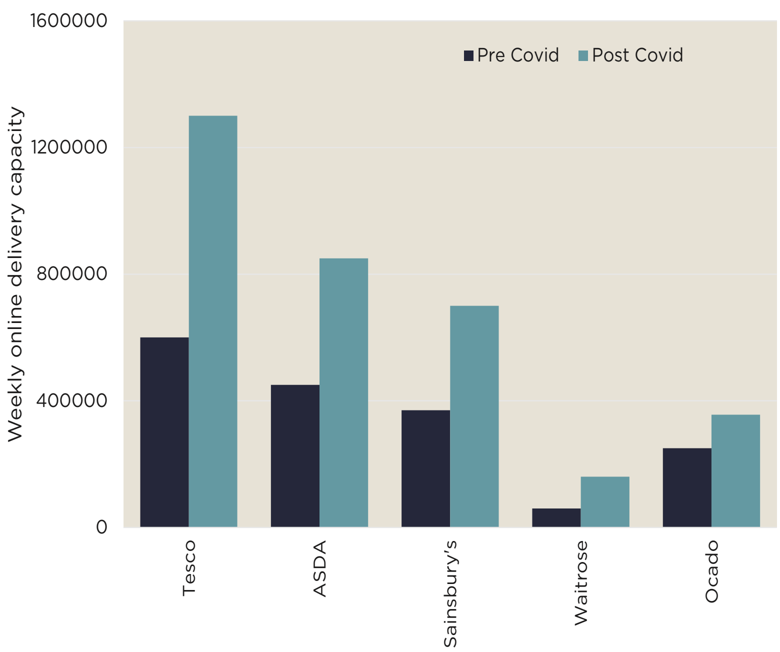
More detail is provided in our recent report on biodiversity net gain here.

UK Carbon Emissions Falling - but current policies will not meet net zero obligations



Since the onset of Covid-19 online grocery retail has surged by a huge 86.5 per cent to reach £20.9 billion, compared with just 10.8 per cent growth seen in 2019. The significant rise in online sales was only achieved due to the network of stores already in place, which allowed orders to be picked and then delivered to a local catchment. Tesco has recently alluded to 'owning the last mile' in this way, as a means to scale up deliveries without heavy capital expenditure. It has been pointed out that in-store micro-fulfilment centres can be installed in just a few months at a much lower capital cost, as opposed to up to two years for a large automated warehouse. This means that investor interest has returned once to more to the large, out-of-town supermarkets that may have previously been considered no longer fit for purpose due to their very large floorplates. These stores now offer brands the opportunity to combine a traditional customer-facing foodstore with semi-automated picking centres for online delivery located at the back of house. Read more on this subject via our recent blog here.

Weekly online grocery delivery
Capacity has increased dramatically since the onset of Covid-19



Source Atrato Capital

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

Kevin Mofid
Director
Commercial Research
020 3618 3612
kmofid@savills.com