MARKET IN MINUTES
Savills Research

Market in Minutes

Bottom yet?

High inflation, higher interest rates and lower economic growth continue to dominate the UK headlines. The resulting impact on the investment markets is a period of stasis creating a lack of liquidity as buyers and sellers remain apart on pricing.

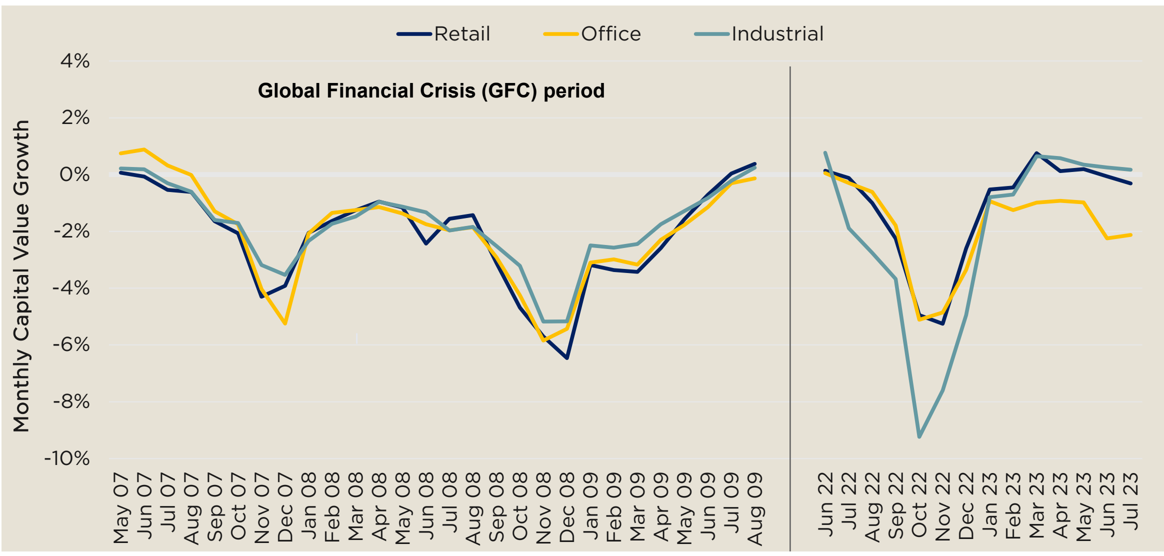
It is already approaching a year since the UK's 'mini budget', and it is worth reviewing the trend in values since then in comparison to value movements during the Global Financial Crisis (GFC). Looking at the chart below, are we going to see another 12 months of negative capital value growth, or will we reach the bottom much sooner? Prime yields moved slightly higher to 5.95% in August, the highest since the end of the Global Financial Crisis (Q4 2009). Only three sectors saw an increase in yields last month, but there are now six upward trends arrows, an increase from the three reported in July. Perhaps a bit longer until the 'bottom' is reached. The GFC was a two-year period, but in September 2009 we were starting to see the recovery period following five quarters of falling GDP growth. Thankfully, we are not in that type of economic environment today, albeit base rates were only 0.5% then. Any lessons to learn today? Post GFC, during the decade to end-2019, the 'all property' index delivered 42% capital value growth; for total returns, "buying the index" delivered 162%. The past should not be relied upon to predict the future, but the commercial property market is cyclical and is always likely to be.

Savills prime yields

	August 2022	July 2023	August 2023
West End Offices	3.25%	4.00%	4.00%
City Offices	4.00%	5.00%	5.25%
South East Offices	5.25%↑	7.00%	7.00%
Provincial Offices	4.75%↑	6.25%	6.25%↑
High Street Retail	6.00%	6.75%↑	6.75%↑
Shopping centres	7.50%↑	8.25%	8.25%↑
Retail Warehouse (open A1)	5.25%	5.75%	5.75%
Retail Warehouse (restricted)	5.25%	6.25%	6.25%
Foodstores (OMR)	4.75%	5.00%	5.00%
Ind/ Distribution (OMR)	3.75%↑	5.25%	5.25%
Industrial Multi-lets	3.75%↑	5.00%	5.25%
Leisure Parks	7.00%	7.50%↑	7.50%↑
London Leased (core) Hotels	3.50%↑	4.50%↑	4.50%↑
Regional Pubs (RPI)	5.25%	6.00%	6.25%↑

Source Savills

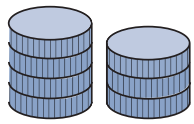
Comparing the movement of capital value growth in the GFC versus the current cycle (including the 'mini-budget' of 2022) Offices remain decoupled from the other sectors



Source MSCI

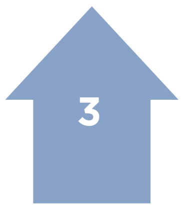
Key Stats

The UK average prime yield edged slightly higher in August



5%

Inflation prediction from the Bank of England for Q4 this year



City Offices, Industrial Multi-lets and Regional Pubs were the three sectors to see a yield shift in August (+25 basis points)

Life sciences: Oxford, Cambridge and London markets performing well

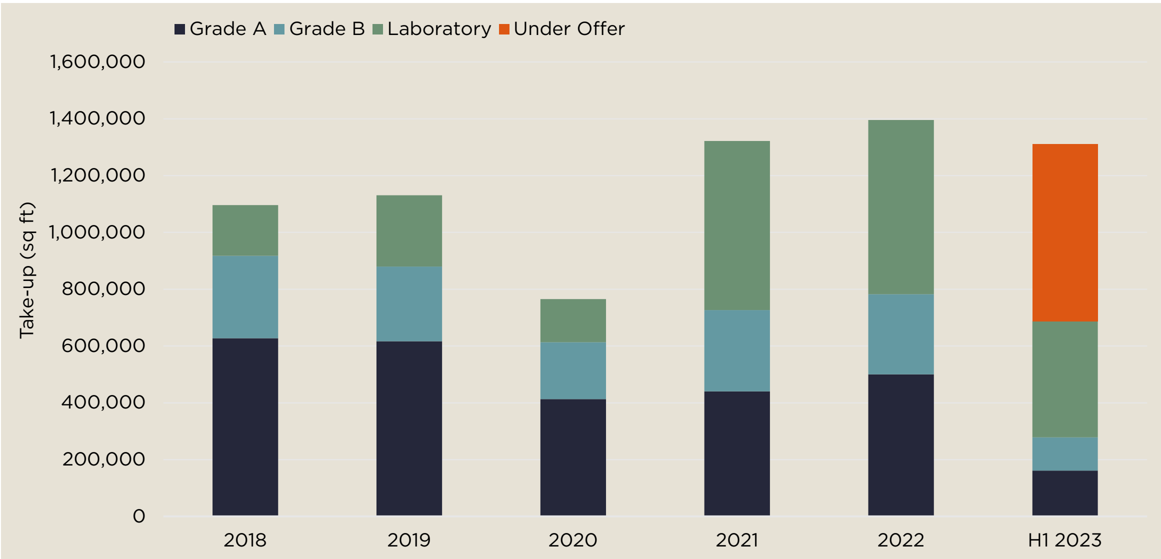
A positive occupational story in the commercial property markets has been scarce in the past few quarters. However, the life science, laboratory (and tech) sector is showing a positive trend. For those investors/developers that created the 'right' space in the 'right' place, and were early to the renewed interest in the sector, have experienced good letting activity and achieved exceptional rental growth in some markets.

The types of occupational deals reflect the impact of companies raising venture capital (VC), particularly in the London market, but the larger deals have been driven by M&A activity and inward investment from overseas. For example, Moderna signing a significant pre-let at Harwell Campus in Oxfordshire. Outside of the so-called 'golden triangle' of Oxford, Cambridge and London, the market is more opaque, but deals are occurring in many aspects of the life science industry, including the Medical Technology (MedTech) sector.

The decision for the UK to remain a key partner of the European Horizon funding programme for scientific research remains an outstanding issue to solve and will be a critical factor in driving future company growth. Collaborating with European partners is critical and the UK will continue to be the most attractive location, within the European global region, for companies to (re)locate and grow. To accommodate this growth, there is new delivery of stock over the next few years and despite a considerable proportion still being 'subject to planning', there will be a much healthier supply to meet the anticipated growing occupational demand. Competition is increasing from international markets in Europe.

For the investment market, the current prime yield is around 4.75%, which sits above West End offices, but below City offices. This puts the science sector as one of the lowest sectors in terms of prime yield. The limited level of supply, within the key markets, coupled with the expected tenant demand/requirements and rental growth, ensures that the sector will remain on the 'buy list'.

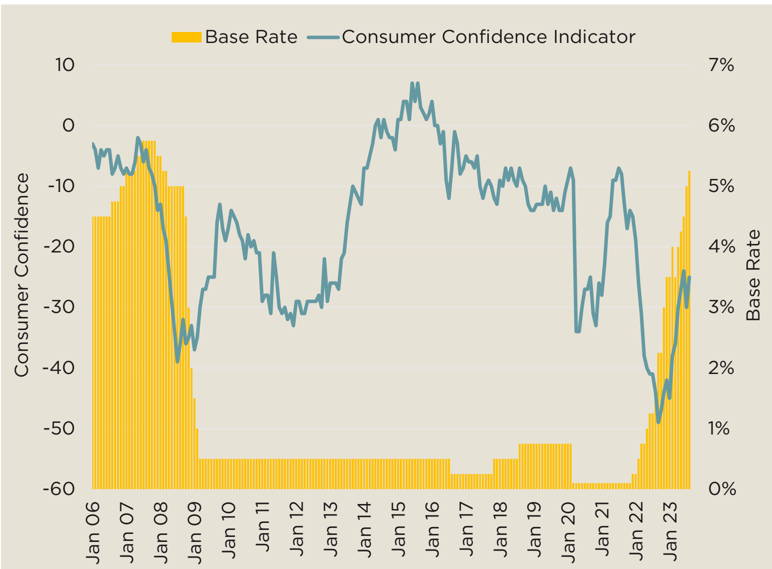
'Golden Triangle' Science/lab/tech-related take-up for the half year looking strong



Source Savills

Consumers remain the key part of the UK economy. A comparison of the consumer confidence indicator from GfK shows a more positive sentiment, despite the rising interest rate in the UK. Perhaps consumers are more positive and are ahead of the Bank of England or base rates do not affect mortgages, in a negative way, as much as the positive impact on savings. Overall, the good news is that inflation continues to fall and is on course to hit the Government's expectation/hope of halving by the end of this year. The CPI rate of 6.8%, for July (latest data available), is approaching the halfway point of the peak 11.1% recorded last October. The Prime Minister's promise equates to 5% CPI, which is in-line with the Bank of England's expectation. With a fall in inflation from 7.9% in June to 6.8% in July, a chartist approach to the August figure suggests around 5.7%. This would be timely progress and bring us closer to an all-round more favourable base rate environment.

Confidence improving despite interest rate rises



Source GfK, Bank of England

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