MARKET IN MINUTES
Savills Research

Market in Minutes

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Not quite at the pricing plateau yet

This month's yields present a very mixed story, with downward pressure on parts of retail, stability in logistics, and softening in prime office yields. This means that our average prime yield softened again to 5.68%, its highest level since 2008.

January is always characterised by a lack of transactional evidence, and we expect this to continue through the first quarter of the year. Overall, our expectation for transactional volumes in 2023 is a reversal of 2022's strong start and weak finish, but volumes are likely to be similar at around £54bn.

This month's most interesting bellwether for the future is the stabilisation in the prime logistics yields, and we believe that this is the first sign that the pricing plateau might have been reached in some sectors. While the short-term occupational outlook for logistics will be affected by a weak consumer economy, the sector came into this growth shock with near record low vacancy rates, and we expect this state to reassert itself through 2024 and beyond. This will increase upward pressure on rents for the best space in the best locations.

Offices remain the most binary of asset classes, but shortages of "prime" and "green" will bring stronger rental growth.

Savills prime yields

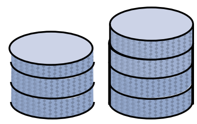
	January 2022	November 2022	January 2023
West End Offices	3.25%	3.75%	4.00%
City Offices	3.75%	4.25%↑	4.50%
South East Offices	5.50%	6.00%↑	6.25%↑
Provincial Offices	4.75%	5.75%↑	6.00%
High Street Retail	6.50%	6.50%↑	6.50%↓
Shopping centres	7.50%	8.00%↑	8.00%↑
Retail Warehouse (open A1)	5.25%	5.75%↑	5.50%
Retail Warehouse (restricted)	5.75%	6.00%↑	6.00%↓
Foodstores (OMR)	4.25%	5.25%	5.25%
Ind/ Distribution (OMR)	3.25%	5.00%↑	5.00%
Industrial Multi-lets	3.25%	5.00%↑	5.00%
Leisure Parks	7.25%	7.50%↑	7.50%
London Leased (core) Hotels	3.50%	4.25%	4.25%↑
Regional Pubs (RPI)	5.25%	5.75%	5.75%

Source Savills

Key Stats

+77 bps

The change in our average prime yield since January 2022



£54bn
Forecast commercial property investment turnover in 2023

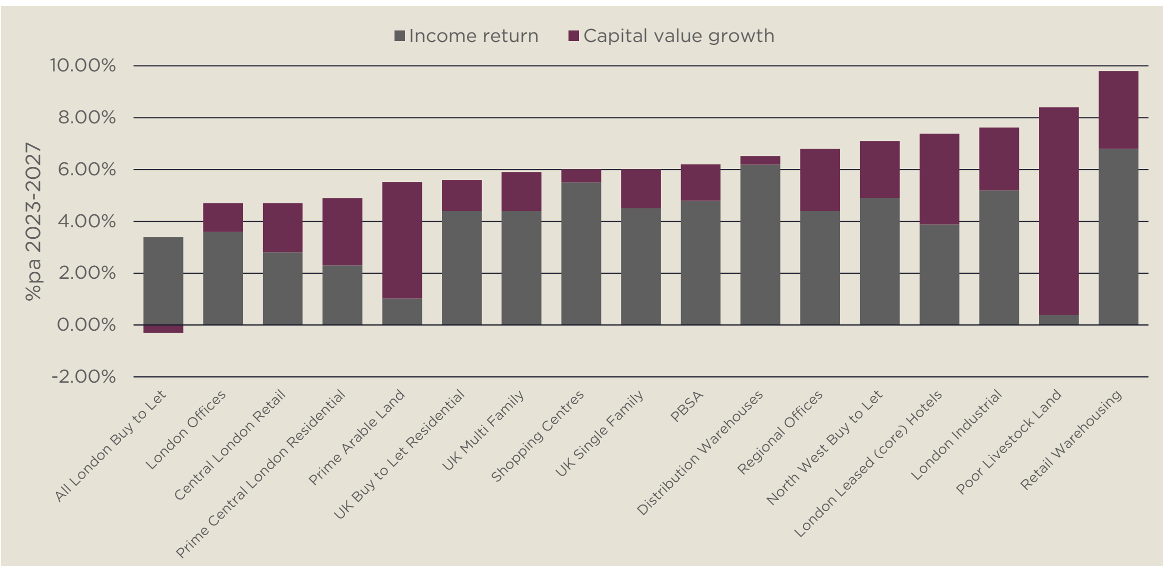
6% pa

The forecast growth in prime logistics rents over the next five years

3.4% pa

The forecast growth in prime London office rents over the next five years

Forecast average total returns show the importance of income over the next five years



Source Savills

Modest recession and weak economic recovery ahead

The latest forecast from the IMF makes for grim reading for our new Prime Minister. The fund upgraded its forecasts for most leading economies, but suggested that the UK would be the only leading economy to slip into recession this year due to energy prices, mortgage costs and a high tax burden.

However, even if the IMF are correct with their latest forecast of a 0.5% contraction this year, this is a very modest recession compared to any in modern history.

Recent corporate experience of the difficulties in recruiting post-Covid will mean that many employers will shy away from lay-offs, and this is good news for both the economy and occupational markets.

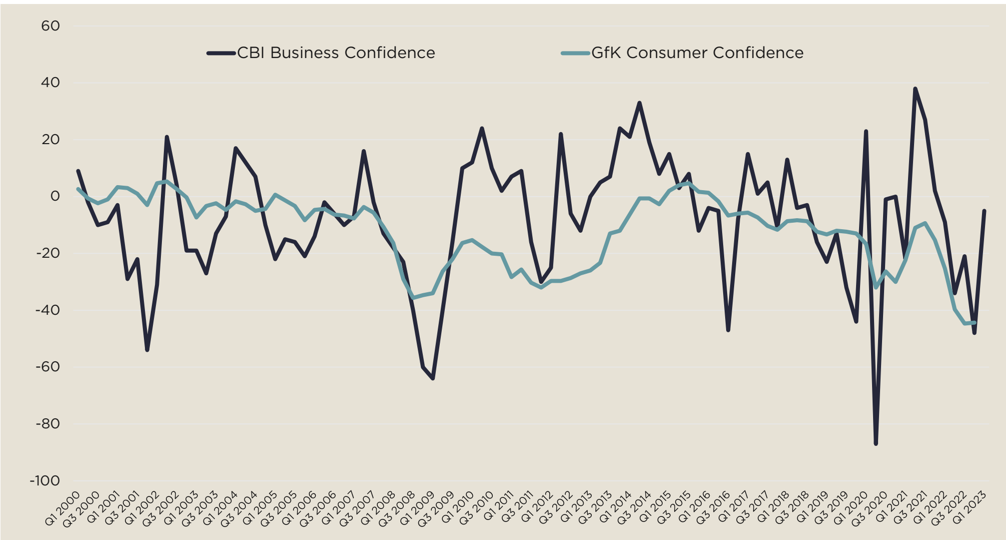
Our biggest concern remains about the further impact of higher base rates on both households and businesses. In the domestic sector, while less than a third of households have a mortgage, the higher cost of borrowing will impact on house prices and rents this year. In the corporate sector, while large companies both in the real-estate sector and outside it are well capitalised, the SME sector has taken on a considerable amount of debt in the post-Covid period, and refinancing or repaying this debt will present a problem for some in 2023 and 2024.

We believe that the tail of this interest shock will negatively impact on some parts of the occupational markets, and generally we are forecasting rises in vacancy rates across all of the main commercial property sectors this year.

The upside impact of the higher cost of borrowing is that development finance will become scarcer and more expensive. This means that we will see a very typical 50-60% reduction in development starts this year, and thus a similar reduction in completions in two to three years time.

This will exacerbate shortages of supply that were present in prime office and logistics markets, just at a time when corporate occupiers are demanding better and greener premises. So, while it might seem odd to be revising rental growth forecasts upwards when the economic outlook is being revised down, that is exactly what we have done. This means that the plateau in pricing may come sooner than some expect.

New year resolutions to be more confident about the future appear to be being made in businesses, but there is not much evidence yet of the worst being over in the consumer economy



Source CBI, GfK

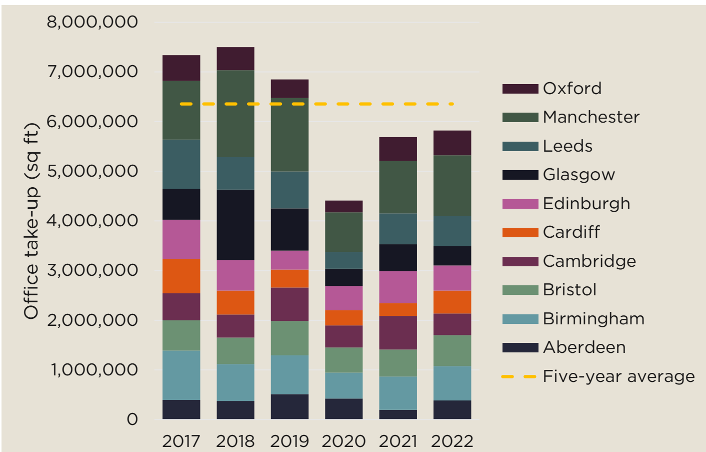
The debate around the future of the office shows no sign of ending. While agile working is undeniably having an impact on take-up (our 2021 model suggested a likely 8% reduction in need), some investors seem stuck in a mindset that a seismic shock akin to the rise of internet retailing on shops is underway.

Office take-up in the large regional cities last year was 8% down on the five year average, but still up year-on-year. In central London, office take-up was 13% up on 2021 and exactly in line with the ten year average.

There is no doubt that numbers are being flattered by a short-term surge in companies choosing to upgrade the environmental rating of their building sooner than they might have normally moved, and this is coming through in a higher propensity to move on both break and lease expiry.

However, what is also apparent is that despite agile working, there is still a strong demand for good quality office space across the UK. The challenge for tenants will be the lack of supply.

There is a 'new normal' for office leasing volumes, but the sector is far from in crisis



Source Savills

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