UK Commercial Market in Minutes
Market focus shifts as Brexit clarity is expected

March 2017

Yields shift inwards

■ Prime yields in February sharpened slightly reaching an average of 4.79%. This was the sixth month in a row where pricing improved and we are now in the longest sustained period of lowering yields since early 2014. The only shift was in the City office market, where falling supply and continued international investor demand saw yields move to 4.00%.

■ A current barrier to liquidity in the market is the lack of investment stock being considered for sale. As Article 50 is triggered this month further dates for the diary include the EU Summit on April 29th, which will outline the negotiating terms, and the French Presidential Election on May 7th. Following these events we expect to see greater deal churn across all sectors and geographies.

■ However, whilst some investors are adopting a wait and see attitude this has not led to inertia in the market as most sectors are reporting steady, if not spectacular, investment volumes.

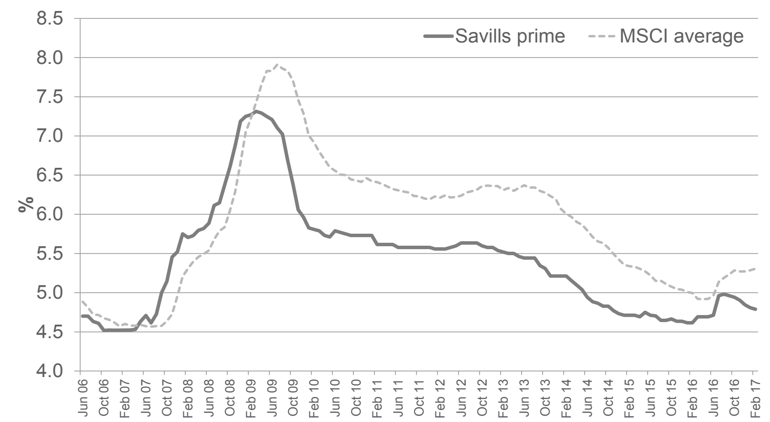
■ With a number of trophy assets exchanging contracts this quarter in the City we expect that Nationwide investment volumes will comfortably beat the long term quarterly average of £9.8bn. Indeed, in the City alone Savills Research estimates that there is currently £2.7bn worth of stock currently under offer.

■ There is however very little pressure on yields one way or another across many sectors and geographies. Only the High Street Retail sector currently sees an upwards pressure on yields, in many ways explained by the continued shift to online retailing.

■ The only downward pressure on yields is in the South East and Regional office market. This has been assisted by the fact that overseas investors have increased their exposure to the regional market to 29%, the highest level since 2012, and is a trend we examine overleaf.

GRAPH 1

Savills prime yield continues inward movement



Graph source: Savills/MSCI

TABLE 1

Prime yields

	Feb 16	Jan 17	Feb 17
West End Offices	3.00%	3.25%	3.25%
City Offices	4.00%	4.25%	4.00%
Offices M25	5.00%	5.25%↓	5.25%↓
Provincial Offices	4.75%↑	5.25%↓	5.25%↓
High Street Retail	4.00%	4.00%	4.00%↑
Shopping Centres	4.25%	4.50%	4.50%
Retail Warehouse (open A1)	4.50%	5.25%	5.25%
Retail Warehouse (restricted)	5.75%	5.75%	5.75%
Foodstores	5.00%	5.00%	5.00%
Industrial Distribution	4.50%↑	5.00%	5.00%
Industrial Multi-lets	4.75%	4.75%↓	4.75%
Leisure Parks	5.00%	5.00%	5.00%
Regional Hotels	5.50%	5.25%	5.25%

Table source: Savills

Overseas and European investors increase exposure

■ Overseas investors deployed £5.8 billion into the UK's regional commercial property market in 2016, growing to account for almost one third (29%) of the total investment outside of London with particular interest in Edinburgh, Manchester and Cardiff. This was a rise from 27% in 2015 and 10% above the long term average of 19%.

■ This has been driven forward by continued strength in regional business space markets with 4.3m sq ft of office space transacted in the key big six regional markets, 17% above the long term average. The logistics market saw almost 36m sq ft of space transacted, making it the best year ever for occupier demand.

■ A noteworthy trend has been the increased prevalence of European investors in regional markets who have accounted for 32% of overseas investment in the regions, with German investors accounting for almost half of this. Key deals include AGP funding the St James's Quarter in Edinburgh and Deka Immobilien acquiring One St Peter's Square in Manchester.

■ For this trend to continue opportunities to deploy significant amounts of capital will need to emerge. However, with very little speculative development in the office or logistics sector, and with continued occupational demand, pre-let fundings or refurbishment opportunities will push investment volumes forward.

■ Investors will continue to examine the regions for the foreseeable future as, according to RealFor, total returns between 2017 through to 2021 will reach up to 8.4% per annum for some regional office markets, outpacing what is forecast for many Central London sub-markets.

Clarity soon to be expected on Brexit negotiations

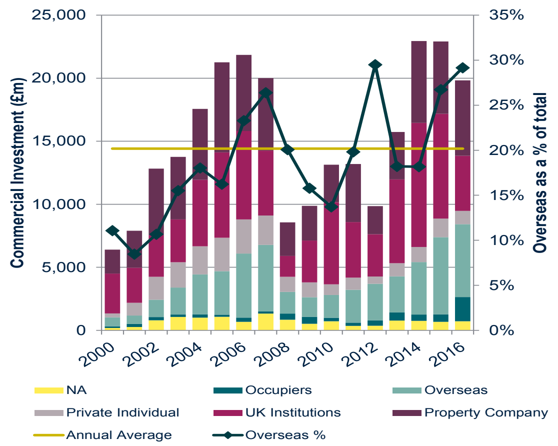
■ Much of the column inches afforded to Brexit coverage thus far has focussed on the potential implications of passporting rights and the impact on City and Docklands. However the jury remains out as to how occupier requirements will be affected with estimates varying wildly as to how many jobs could be relocated should the UK negotiate a "hard" or "cliff-edge" Brexit.

■ Indeed, forecasts from Oxford Economics for office based employment demonstrate that in Central London total employment is in fact set to rise to 2.8m people by 2025, up from 2.5m currently. Furthermore, within the next five years, the proportion of employees in the tech sector will soon outweigh the financial sector.

■ A key negotiating point will also be the movement of goods and labour. Modern retail supply chains demand the free flow of product and a significant amount of labour to work in the warehouse units that support the retail and manufacturing networks in the UK. Should we see significant barriers placed at our borders UK retailers may aim to store more inventory in the UK and therefore a by-product of Brexit may be a further surge in the amount of warehouse space required in the UK

GRAPH 2

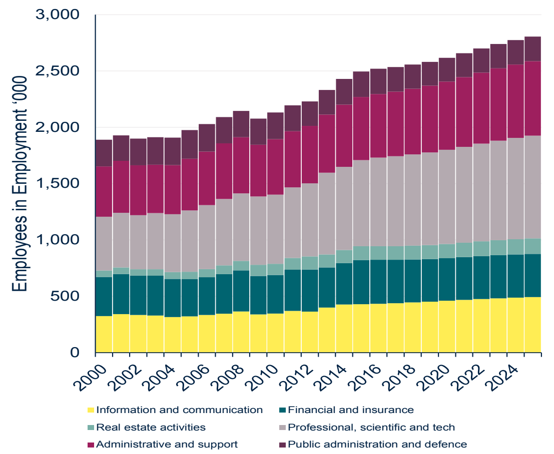
Total regional investment stable as overseas proportion increases



Graph source: Property Data/Savills

GRAPH 3

London office based employment continues to rise



Graph source: Oxford Economics

Please contact us for further information

Mark Ridley
Chief Executive Officer UK & Europe
+44 (0)20 7409 8030
mridley@savills.com

Kevin Mofid
Research
+44 (0)20 3618 3612
kmofid@savills.com