MARKET IN MINUTES

Savills Research

Market in Minutes

savills

April yields hold steady

Similar to the Brexit stasis, April yields provided no surprises with prime yields across all sectors holding on the previous month. Where we did see change was in the number of sectors expecting some potential downward shifts going forward.

UK regional hotels joined retail warehouse (open A1) by adding a downward arrow in April indicating mounting pressure for yield hardening. Indeed we have seen some forward funding deals for Premier Inn's in some regional markets in the region of 4.1 to 4.2%.

On the flip side, we also saw an increase in sectors expecting prime yields to move out further. Leisure was added to the list, alongside high street retail and shopping centres, where investor sentiment was weaker particularly for multi-let leisure parks.

While yields held in April the softening in London office yields reported the previous month has meant the spread to regional offices has been squeezed to its lowest level since March 2010 (75bps). Does this mean London is looking cheap or are the regions looking expensive?

With stronger rental growth prospects in a number of regional office markets, with Edinburgh forecast to be the lead performer of the large regional cities with average annual growth of 2.5% through to the end of 2023, they continue to offer good value. But, with the West End reporting its strongest Q1 take-up in six years and rental growth starting to make a come back, investor appetite for London offices will continue.

Savills prime yields

	Apr 18	Mar 19	Apr 19
West End Office	3.25%	3.75%	3.75%
City Offices	4.00%	4.25%	4.25%
Offices M25	5.00% ↓	5.00%	5.00%
Provincial Offices	4.75%	4.75%	4.75%
High Street Retail	4.25%	4.75% ↑	4.75% ↑
Shopping centres	4.75% ↑	5.25% ↑	5.25% ↑
Retail Warehouse (open A1)	5.00% ↑	6.00% ↓	6.00% ↓
Retail Warehouse (restricted)	5.25%	6.25%	6.25%
Foodstores (OMR)	4.50%	4.75%	4.75%
Industrial Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.25% ↓	4.00%	4.00%
Leisure Parks	5.00% ↑	5.50%	5.50% ↑
Regional Hotels	4.25%	4.25%	4.25% ↓

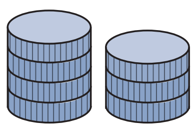
Source Savills

Key Stats

Outward shift in All property average prime yields since Febuary 2018

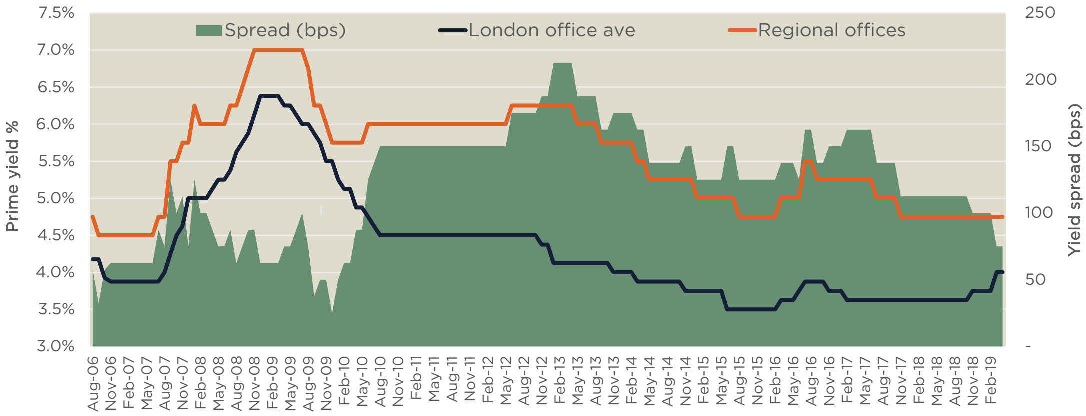
1.2m sq ft
West End office take-up in Q1 2019, 30% above the long term average.

Prime yield spread between London and regional offices



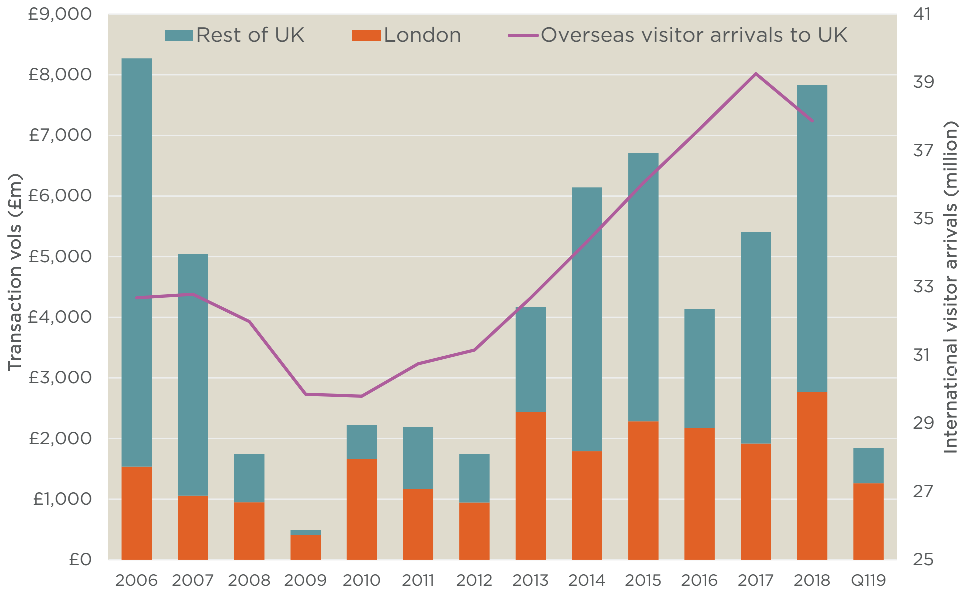
£13.1bn
Total, all sector, 2019 investment volume to end April, 16% down on same period in 2018

London vs regional office yields Prime yield spread at its lowest level in nine years



Source Savills Research

Hotel transaction volumes have been supported by increasing demand



Source Savills; ONS

HOTELS CONTINUE TO BUCK WIDER INVESTMENT TRENDS

Last year total, all sector, investment volumes reached £62.4bn 4.8% down on 2017 as Brexit uncertainty and cyclical trends tempered investor confidence. This has continued into 2019 with volumes to the end of April 15.7% down on the same period in 2018. In contrast UK hotels have bucked this wider trend.

Total hotel transaction volumes reached £7.8bn in 2018 up an unprecedented 45.0% on the previous year, helped by the acquisition of a number of large portfolios. This meant transaction volumes were in excess for that seen for all UK retail.

The first quarter of 2019 has seen a more modest 2.7% year-on-year increase on Q118 boosted by the c.£1bn acquisition of the Grange portfolio by Queensgate Investments, albeit deal count is down. As noted previously, this appetite for hotels, in particular in the leased/institutional part of the market, is generating downward pressure on prime yields.

Key to this investor appetite are the fundamental drivers supporting operational performance. International visitor arrivals to the UK peaked at 39.3 million in 2017, boosted by the weaker Pound, 15.5% above the pre-GFC 2007 peak. While provisional figures for 2018 point to a 3.5% softening, Q4 numbers were up 1.4% year-on-year. Even with this apparent softening in international tourist arrivals hotel operational performance, as measured by revenues per available room (RevPAR), continued to report growth in 2018 with London up 3.1% and the regions reporting a 1.4% growth. For London this growth has continued into 2019 with Q1 2019 RevPAR up 3.6% year-on-year. Its worth noting that even during the height of the GFC London only saw only one year of RevPAR decline.

In the regions performance has become more mixed with the more corporate reliant markets, particularly those that have seen significant stock growth, reporting RevPAR softening as Brexit concerns temper corporate travel budgets.

For London and the stronger destination regional cities the continued growth in operational performance highlights that it is not just international visitors that are driving demand. Domestic leisure demand is also supporting growth. UK household spend on holiday accommodation in the UK has increased 61%, inflation adjusted, since 2009 primarily driven by the under 30's and over 50's.

As seen with the retail sector the shifts in consumer spending are having a direct impact on hotel demand, albeit in this instance the impact is largely positive. However, profitability challenges, particularly in terms of staff availability and in turn wage growth, plus the scale of the development pipeline seen in some markets, are generating issues for operators and investors. Understanding these nuances is key as not all hotels are created equal.

ARE RATE RISES ON THE CARDS?

The Bank of England recently suggested that more and faster rate rises could materialise if a Brexit solution is reached. At present the markets are currently factoring in just one interest rate increase by 2021 and at this point it is too early to call any rate impact until Brexit is resolved. With the yield spread between All UK prime property and 10 year Gilts still significant against the long term average any immediate and direct read through to real estate pricing when and if rates rise is likely to be minimal. However, it will be something that we will be watching closely in the coming months.

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

Marie Hickey
Director
Commercial Research
020 3320 8288
mlhickey@savills.com