

UK Commercial Market in Minutes

New entrants to a stabilising market

November 2016

Yields remain static

■ As referenced in table one, pricing remained static in all sectors in October as negative sentiment regarding Brexit has receded. This kept the Savills all property average prime yield at 4.83% for the second successive month, having shifted out by 30bps since October 2015.

■ Following a lull in August investment volumes, the capital deployed in September rose 167% to reach £5.1bn meaning total investment volumes for the year to date stand at £38.7bn, a 27% fall compared to the same period in 2015.

■ An immediate impact of the vote to leave the EU has been the falling value of the pound as referenced in graph one. This has made UK real estate more attractive to overseas investors with pricing for some London properties having effectively fallen by up to 20% over the last three months, when currency devaluation is taken into account. This is clearly demonstrated in Central London where overseas investors account for 78% of all purchasers in the last three months. Moreover investors are

deploying significant amounts of capital with 39% of overseas deals in the City for assets over £50m.

■ Another active purchaser group has been local authorities who have seen their share of the market increase and now account for 2.9% of the entire investment market. We examine this trend in more detail overleaf.

■ In the immediate aftermath of the vote to leave the EU many indicators have been increasingly volatile with the MSCI all property capital growth index falling by 3% in July and subsequently rebounding.

■ The market should be braced for further volatility as the UK prepares to work through the process of triggering Article 50 and what that means for financial markets and the position of UK real estate in the global asset class hierarchy. At the time of writing a further layer of uncertainty has also been added with the election of Donald Trump as US President with many indices, such as the S&P 500 initially falling but subsequently rallying.

GRAPH 1
Sterling falls in value compared to the Euro and US Dollar



Graph source: UKForex

TABLE 1
Prime yields

	Oct 15	Sep 16	Oct 16
West End Offices	3.00%	3.50%	3.50%
City Offices	4.00%	4.25%	4.25%
Offices M25	5.00%	5.25%	5.25%
Provincial Offices	4.75%	5.25%	5.25%
High Street Retail	4.25% ↓	4.25%	4.25%
Shopping Centres	4.25%	4.50%	4.50%
Retail Warehouse (open A1)	4.50% ↑	5.25%	5.25%
Retail Warehouse (restricted)	5.75%	6.00%	6.00%
Foodstores	5.15%	5.50%	5.25%
Industrial Distribution	4.50%	5.00%	5.00%
Industrial Multi-lets	4.75%	5.00% ↓	5.00% ↓
Leisure Parks	5.25% ↓	5.25%	5.25%
Regional Hotels	5.50%	5.50%	5.50%

Table source: Savills

→ **Local Authorities make a welcome addition to the market**

■ As Central Government funding to local authorities reduces, the pressure on local authorities to find additional methods of funding expenditure has become ever more important.

■ Driving the ability of local authorities to purchase direct real estate have been legislative changes which allow local authorities to create property trading subsidiaries and the ability to borrow money at lower interest rates from the Public Works Loan Board (PWLB).

■ Thus far local authorities have focused their efforts in their boundaries as they seek to create social and economic benefit for residents and drive regeneration projects. However, as a method of diversifying risk, local authorities are not restricted from investment in other geographies or sectors.

■ Examples include Spelthorne Borough Council purchasing the BP business centre for c.£350m reflecting a net initial yield of c.4.5% and Northumberland Council purchasing Manor Walks Shopping Centre from Hammerson for £78.2m at net initial yield of 7.06%, both financed by loans from the PWLB.

■ Further analysis of the BP deal highlights the merits of this form of capital raising for local authorities. According to Spelthorne Borough Council a 50 year deal with the PWLB at an interest rate around 2.5% has been negotiated with BP subsequently signing a 20 year lease back deal. The Council will have to pay back an additional c.£11m to the PWLB in interest per year, but this will still generate around £3m in net income each year after costs, which in turn can fund council services.

■ This has started to have an impact on the make-up of the overall investment market. In the shopping centre sector, for example, local authorities have purchased eight of the 30 schemes traded this year and we are aware local authorities are under offer on a further three schemes with values totalling c.£144.5m.

■ In the wider market the local authority spend has increased to just over £1bn for the year to date, 868% above the long term average and now accounting for 2.9% of the total market, as referenced in graph two.

■ All things being equal it would seem local authorities are going to be active investors in the near future. However, should government policy change local authorities may no longer have access to capital at such attractive rates or could become constrained as to what they can invest in.

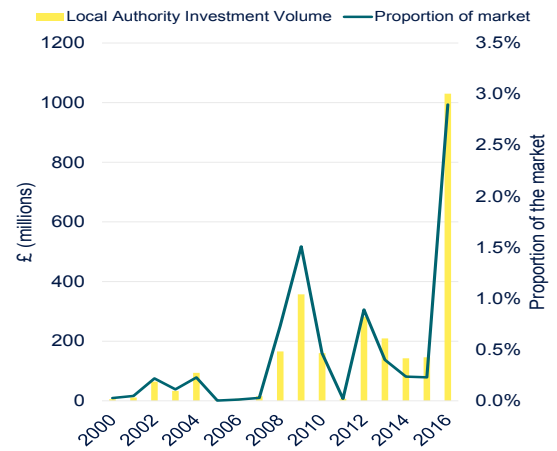
Fluctuating forecasts are forecast

■ In our last edition of Market in Minutes we demonstrated how total return forecasts were revised downwards in the aftermath of the Brexit vote.

■ However, as more data points became available showing more positive economic news these forecasts have been revised upwards as demonstrated in graph three.

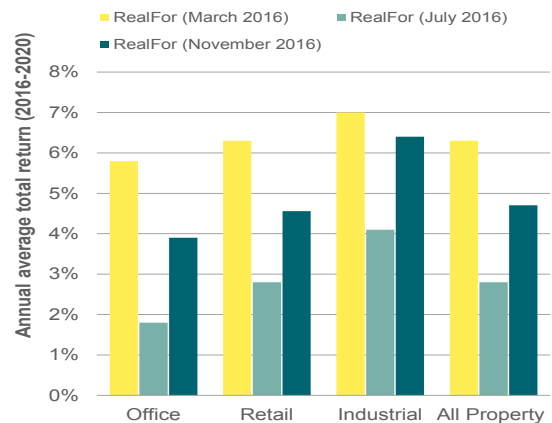
■ With the election of Donald Trump as American President and the March 2017 triggering of Article 50 we expect these forecasts to be volatile into 2017 and beyond. Indeed, the 2017 elections in France, Germany and the Netherlands, along with the implementation of the first Trump policies could see the UK re-emerge as a safe haven market ■

GRAPH 2 Local authorities increase their share of the UK investment market



Graph source: Property Data & Savills Research

GRAPH 3 Total return forecasts fluctuate over time

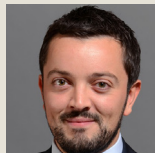


Graph source: Realfor

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

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