MARKET IN MINUTES

Savills Research

Market in Minutes

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Yields remain static

As summer draws to a close in normal circumstances we would expect to see an autumn bounce in transaction activity. But given that we remain no closer to establishing if the UK leaves the EU with or without a deal it is difficult to see that bounce occurring in 2019.

This is evidenced by the fact that we have seen no movement in pricing in August meaning that the Savills prime yield remains unchanged at an average of 4.9%, its highest level since November 2016.

In the most part this is driven by a lack of transactional evidence which moves pricing one way or another with Property Data recording just 287 deals so far this quarter, compared to a quarterly average of 574. Indeed, even taking into account an average September which usually sees 208 transactions, deal counts for the quarter will not impress.

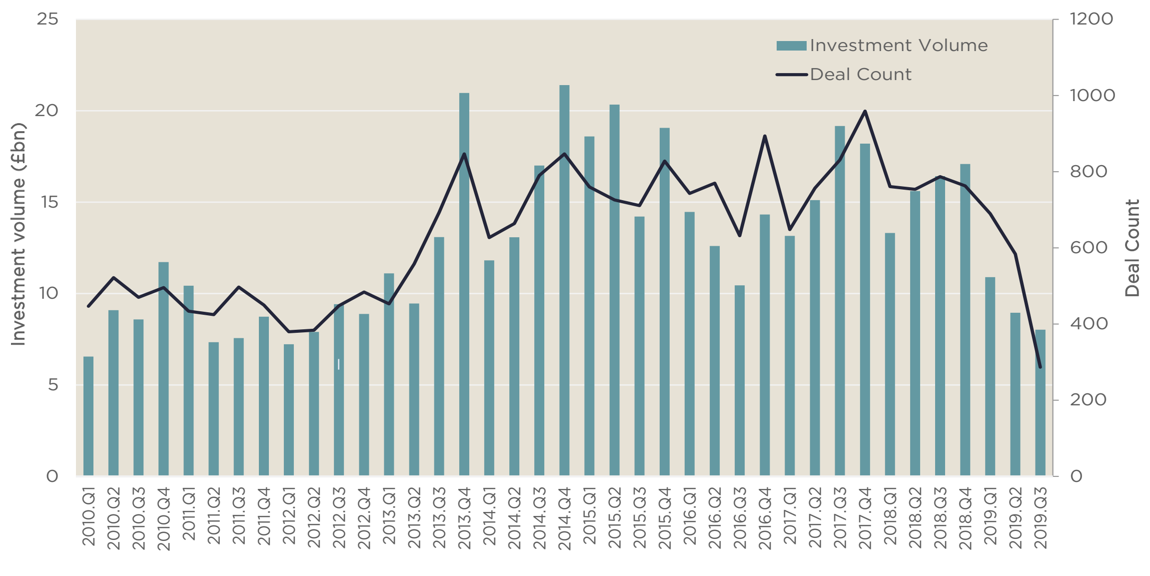
Interestingly whilst investment volumes are lower compared to recent averages Q3 should surpass the Q2 figure of £8.9bn although 56% of the capital deployed has been in the alternatives sector demonstrating the perceived appetite for more stable income streams. Post October 31st we expect greater clarity to emerge which will stimulate investor demand but in all likelihood 2019 will be the lowest level for investment since 2012 when £33bn was transacted.

Savills prime yields

	August 2018	July 2019	August 2019
West End Office	3.25%	3.75%	3.75%
City Offices	4.00%	4.00%	4.00%
Offices M25	5.00% ↑	5.00%	5.00%
Provincial Offices	4.75%	4.75%	4.75%
High Street Retail	4.50% ↑	5.00% ↑	5.00% ↑
Shopping centres	5.00% ↑	5.50% ↑	5.50% ↑
Retail Warehouse (open A1)	5.50% ↑	6.25%	6.25%
Retail Warehouse (restricted)	5.75% ↑	6.50%	6.50%
Foodstores (OMR)	4.50%	4.75%	4.75%
Ind/ Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.00%	4.00%	4.00%
Leisure Parks	5.25%	5.75%	5.75%
Regional Hotels	4.25% ↓	4.25%	4.25%

Source Savills

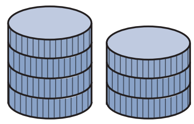
Investment volumes capital deployed and deal counts continue to fall to 2012 levels



Source: PropertyData.com

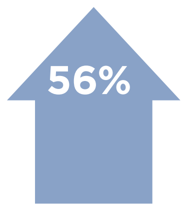
Key Stats

Average prime yield rises to its highest level since November 2016



£27.9bn

Commercial property investment volumes for 2019 to date



The proportion of investment volumes made up by alternatives in Q3

287

The number of transactions recorded in the third quarter of 2019

Where will rental growth come from in the event of a "no deal" Brexit?

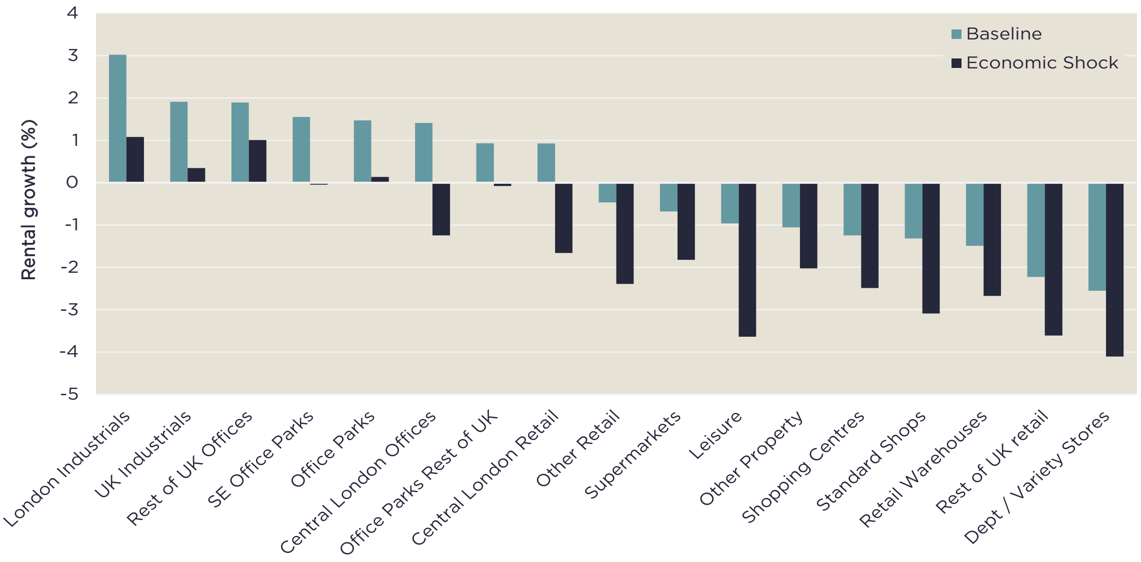
With most sectors and geographies forecast to show minimal or indeed negative capital growth over the next five years opportunistic investors are still keen to access markets where rental growth remains a possibility to drive total returns. However, in the event of a "no deal" divorce from the EU and the potential economic upheaval that would bring where will any rental growth come from?

Savills use an econometric forecast model provided by Realfor which covers all MSCI UK sectors and geographies. Tweaking the economic assumptions in this model to forecast rents into 2020 and beyond has provided some interesting results. Taking into account the latest OBR "no deal" stress test which shows a GDP fall of 1.4% whereas Oxford Economics are slightly more positive we have assumed 0% growth for GDP, consumer spending and employment which would result in a short technical recession, which for context would be less than the 5 consecutive quarters of GDP decline during the 2008/9 financial crisis.

This shows us that the baseline forecast shows 16 segments of MSCI index achieving positive rental growth in 2020 which reduces to just seven in the amended model.

At the top of the pack remains London industrial with a forecast 2020 rental growth of 1.1% down from 3% in the baseline forecast, closely followed by Rest of UK offices at 1% down from 1.9%. In the amended model the already downward trend for retail is amplified and reaches -3% compared to -1.9% in the baseline. Looking further forward positive rental growth returns to nearly all MSCI segments by 2023.This is in line with data on vacancy which shows that London industrials have a vacancy rate of just 2.4% and that the regional office markets are also under-supplied with a vacancy rate of 7.8%.

Before and after 2020 rental growth baseline forecast Vs a economic shock driven by "no deal" for selected MSCI segments



Source: Savills Research, Realfor

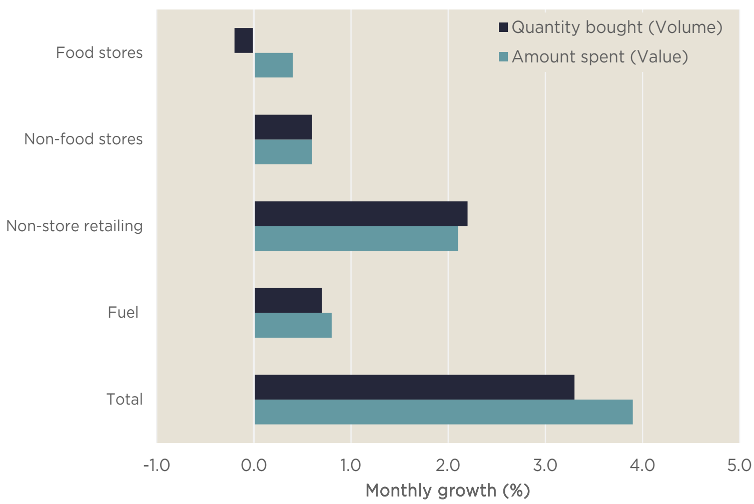
According to the latest data from the ONS UK retail sales in July 2019 rose unexpectedly, with online spend contributing 19.9% of total retailing, compared with 18.9% in June 2019.

The data shows an increase in online spend at an overall growth of 12.7% when compared with the same month a year earlier.

Whilst it is tempting to say that online will continue to rise and rise it is worth pointing out that Amazon Prime Day took place in July and many other retailers took the opportunity to launch discounting initiatives of their own.

According to Hitwise Amazon recorded 8.6m transactions over Prime Day and added a further 85,000 Prime subscribers, an increase of 147% on the previous year.

Online retail reported the largest year-on-year contribution to both the amount spent and quantity bought in July 2019



Source : ONS

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

Kevin Mofid
Director
Commercial Research
020 3618 3612
kmofid@savills.com