MARKET IN MINUTES

Savills Research

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Silient spring?

As we edge towards spring and a recovery, it feels like much of the latent investor and lender sentiment we've reported on in recent few months will be holding off a little longer to see how things turn out, but capital is becoming more available for deployment when the winter fog lifts. The issue, as it has been for some months, is lack of stock, with multiple bidders being seen when good stock comes to market.

Rachel Reeves' NIC increase comes into effect next month, and as the date looms, the business community seems split on how increased costs will impact profitability and growth prospects this year. It's true that there will be severe headaches for some sectors, retail & hospitality for instance, but business leaders appear equally focussed on wider geopolitical headwinds and the impact these will have on supply chains, global economic security and inflation.

Despite these concerns, British businesses exhibited renewed optimism for the first time in seven months in February, according to the Lloyds Bank Business Barometer, which rose to 49% from 37% in January - the largest increase since late 2020. The improved confidence reflects companies' ability to manage higher costs and uncertainty, following almost a decade of post-Brexit turbulence, and even suggests that hiring plans have increased despite budgetary fears. Conversely, two-thirds of businesses anticipate raising prices in the coming year to mitigate the budget's impact on profitability, which is unlikely to fill those reliant on consumer and construction spending with cheer.

President Trump's narrative continues to keep economic forecasters on their toes. We've probably never seen so many significant moving parts that could accelerate or decelerate the recovery, or vanish from speculation to irrelevance in a breath of hot air. With this level of uncertainty, it is understandable that investment activity remains sticky. We look at how trade tariffs could impact the UK, over the page. What is important from a commercial property perspective is that our expectations remain confident that improvement is coming, but we might have to wait until H2 2025 to see it. Or to take the spring analogy, the buds are out, but are not quite ready to bear fruit.

For all of these reasons, our prime yield expectations are exactly where they were last month, with nine sectors anticipated to see a yield hardening. The exception is offices in major regional UK cities, which have come in 25 bps since January – proving that offices, albeit in the right categories, remain in favour with investors.

Savills prime yields

	February 2024	January 2025	February 2025
West End Offices	4.00%	4.00%	4.00%↓
City Offices	5.25%	5.25%	5.25%
South East Offices	7.50%	7.50%	7.50%
Provincial Offices	7.00%	7.00%	6.75%
High Street Retail	7.00%	6.50%	6.50%
Shopping centres	8.25%	7.75%↓	7.75%↓
Retail Warehouse (open A1)	5.75%	5.25%↓	5.25%↓
Retail Warehouse (restricted)	6.25%	5.75%↓	5.75%↓
Foodstores (OMR)	5.50%	5.50%↓	5.50%↓
Ind/ Distribution (OMR)	5.25%↓	5.00%	5.00%
Industrial Multi-lets	5.25%↓	5.00%↓	5.00%↓
Leisure Parks	7.75%	8.00%↓	8.00%↓
London Leased (core) Hotels	4.75%	4.50%↓	4.50%↓
Regional Pubs (RPI)	6.50%	6.50%↓	6.50%↓

Source Savills

Key Stats

Number of sectors with a downward trend arrow for pricing

25bps

Yield hardening for key regional office markets

5.93%

Average prime yield back at levels not seen since July 2023

Business confidence is on a slow upward trajectory

Source PWC Emerging Trends Europe Survey 2025

Would US trade tariffs on the UK, bite?

Tariff speculation has rocked investor confidence at a point in the cycle when certainty is badly needed. The focus has so far been directed to the US's closest neighbours and China, but the tariff threat still overhangs in Europe. Much of the geopolitics of the last month have been routed in the future of Ukraine, the future of the relationship between the UK and US, and the relationship between the UK and Europe. The plan from the Prime Minister is that he can leverage both, provide a bridge between both, and avoid tariffs imposed by Trump. On the negotiation table is a commitment to increase military spending, diverting funds from other public services that the Chancellor was hoping would be available to support UK growth, infrastructure and development.

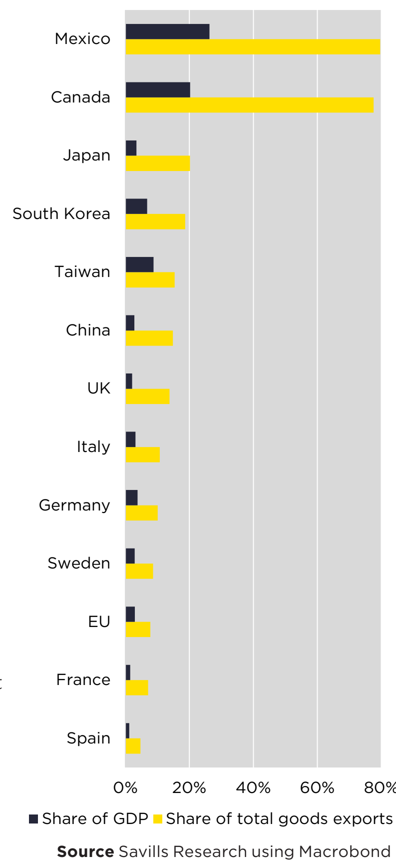
The key concerns for real estate from tariff increases are any inflationary impact, which could weaken spending power and consumption, while broader uncertainty will weigh on business investment and keep construction costs high. However, this is likely to be felt most acutely in the US and other nations where the import-to -GDP ratios are significant.

For the UK, 16% of goods exports went to the US last year; mostly cars, pharma, and machinery. While the US is our largest trade partner on an individual country basis, UK exports to the US only account for around 2% of GDP. Any tariff-induced slowdown in exports would therefore likely have a modest impact on the economy. This impact could be offset with closer European relations. Likewise, UK goods imports from the US account for around 10% of total imports, and 25% of this is energy -related, so in the event of a trade war, it's unlikely that we'd target energy goods with tariffs. The rest is made up of similar goods to those we export. This is largely substitutable, and not related to final consumer demand.

Clearly, there are wider spillovers from weaker business sentiment, equity market shocks, currency etc. But generally, the UK is not too leveraged to the US in the event of trade war escalation (assuming it remains a bilateral US vs. rest of world). So far, Keir Starmer has managed to keep both our US and European allies onside, but these days, 24 hours is a long time in politics.

The wider risk is whether US policies lead to a more fragmented global economy, where all countries reduce globalisation and adopt protectionist policies. The IMF estimates that a broad-based increase in trade restrictions could reduce global GDP by up to 7% over the long term - equivalent to losing the output of France and Germany.

Share of exports to the US



Source Savills Research using Macrobond

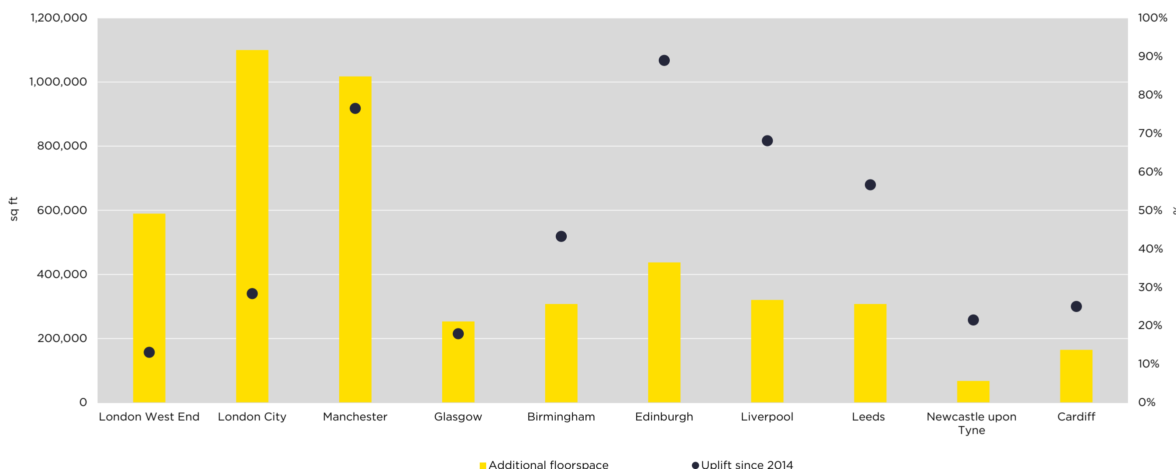
City centres are becoming more leisure-orientated

The decline of retail has been well reported and often overstated in recent years, because it implies that all town and city centres lack purpose and are no longer relevant to consumers. While there is no doubt a significant number of towns are still struggling with their identity and need to reduce their exposure to traditional high street retail, major city centres have been on a path of evolution for well over a decade and are already significantly more leisure focussed as a consequence.

Manchester and the City of London have seen an increase of over 1 million sqft devoted to F&B and leisure uses in the decade to 2024. That's a 76% and 28% increase in units since 2014, respectively. Growth in the West End has been just 13%, but this is based on the fact that it was already biased to these uses. Other cities have been playing catch up and it provides some indication of the opportunity still present in key regional cities. Around 75% of this growth has been through conversion of existing units rather than new development, so is a clear sign of repositioning in action.

This evolution is not simply driven by the need to replace empty retail units, though vacancy has certainly provided ample opportunity. The period coincides with an explosion of new food & beverage operators and leisure concepts, driven by consumers that are increasingly looking to seek new 'real life' experiences and satisfy new tastes.

Uplift in F&B/leisure space 2014-2024



Source Savills Research

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