Market in Minutes

savills

Yields return to pre-pandemic level

The end of 2021 saw investment volumes reach £19.7bn, not only was this a record Q4, but it was also the highest quarter for investment volumes ever recorded beating the previous high watermark for £19.4bn set in Q4 2013. Given most occupational markets are continuing to report positive metrics it is no surprise that this positive sentiment has continued into 2022.

Indeed, January has seen £3.7bn transacted exceeding the long term January average by 37%. The office sector has made up 51% of total volumes with notable transactions including the purchase of Central St Giles by Google for £762.5m. The change in sentiment in the retail sector continues to feed through into investment volumes with figures for January reaching £924m, the highest January investment volume since 2016.

The more positive sentiment in the retail sector has fed through into pricing with yields moving in over the last two months for out of town retail, leisure and foodstores, meaning that the average prime yield for retail now stands at 5.8%, a fall of 45bps over 12 months.

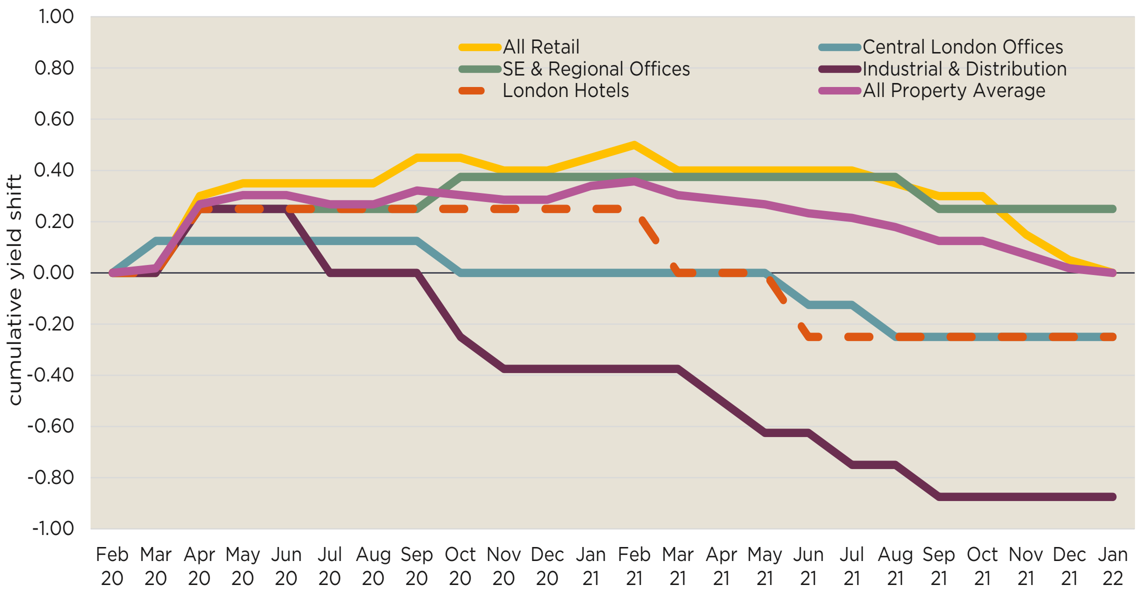
These inward movements now mean that the all property prime yield now stands at 4.91%, which means, for the first time yields have reached their pre-pandemic level.

Savills prime yields

	January 2021	December 2021	January 2022
West End Offices	3.50%	3.25%	3.25%
City Offices	4.00%	3.75%	3.75%
South East Offices	5.50%↑	5.50%↓	5.50%↓
Provincial Offices	5.00%	4.75%	4.75%↓
High Street Retail	6.75%	6.50%	6.50%
Shopping Centres	7.00%↑	7.50%	7.50%↓
Retail Warehouse (open A1)	6.50%	5.25%	5.25%
Retail Warehouse (restricted)	6.50%	5.50%	5.50%
Foodstores (OMR)	4.50%	4.50%	4.25%
Ind/ Distribution (OMR)	3.75%	3.25%	3.25%
Industrial Multi-lets	3.75%↓	3.25%↓	3.25%↓
Leisure Parks	7.50%	7.50%	7.25%
London Leased (core) Hotels	4.00%↑	3.50%	3.50%↓
Regional Pubs (RPI)	5.25%	5.25%	5.25%

Source Savills

Prime yields Retail and the all property average have returned to the same level as before the pandemic started



Source Savills

Key Stats

4.91%
The UK average prime yield

£19.7bn
2021 Q4 UK commercial investment volume. Highest quarter ever recorded

4
Number of sectors with downward yield pressure

How are rising interest rates impacting the debt market?

In February the Bank of England Monetary Policy Committee voted to raise the base interest rate to 0.5%. A number of committee members were also advocating a further rise to 0.75%, sending a clear signal that further rates rises are imminent. Indeed, with Oxford Economics forecasting that the base rate will hit 1% by May 2022 it is worth examining how the debt market is reacting and how this could impact commercial investment volumes and pricing.

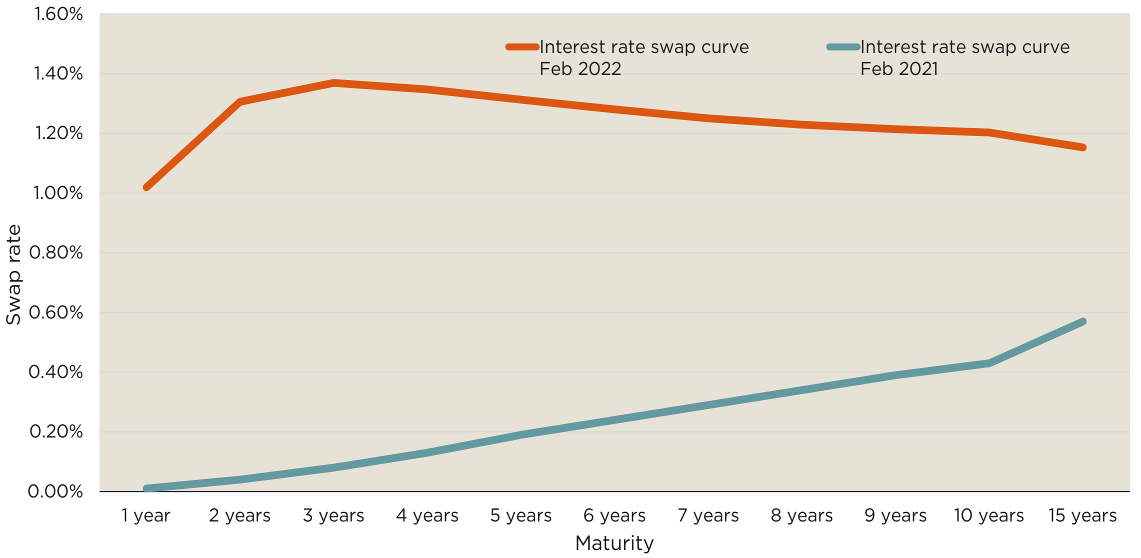
Given the strong occupational market fundamentals there has been a significant increase in lender appetite over the last 6 months with the majority of real estate lenders now actively pursuing new opportunities, leading to strong competition for prime assets in core sectors and a re-emergence of the banks after a period of limited new activity.

Where bank financing is available, some lenders may still be slightly more conservative compared to pre COVID-19 levels, although our latest debt processes are showing that 60% loan-to-value (LTV) is rapidly becoming the norm for high quality opportunities.

For the most resilient sectors, pricing has tightened over the course of 2021, for example for London offices our Debt Advisory team are securing margins of SONIA+150bps at 60% LTV. However rising GBP swap rates over Q3 & Q4 2021 have more than offset any margin reduction, resulting in the overall cost of debt increasing. We would therefore expect interest rate risk management to become a key point of consideration for borrowers going forward as from a pure interest rate perspective the funding of new investment deals is likely to have risen compared to where the market was six months ago. For the best opportunities, some lenders are willing to consider offering financing without hard covenants. Generally, this has been limited to non-bank lenders for all but the very best sponsors, however competition to lend may see this feature becoming more widespread.

We expect that the impact of rising debt costs will play out on a sector by sector basis. In the industrial sector, where the weight of capital remains high, the occupational metrics remain strong and with lenders keen to increase their exposure may not see a rise in yields driven by rising debt costs. Sectors where the occupational and rental growth story is weaker, combined with less competition from lenders, may start to see upward pressure on yields as the cost of debt rises throughout 2022.

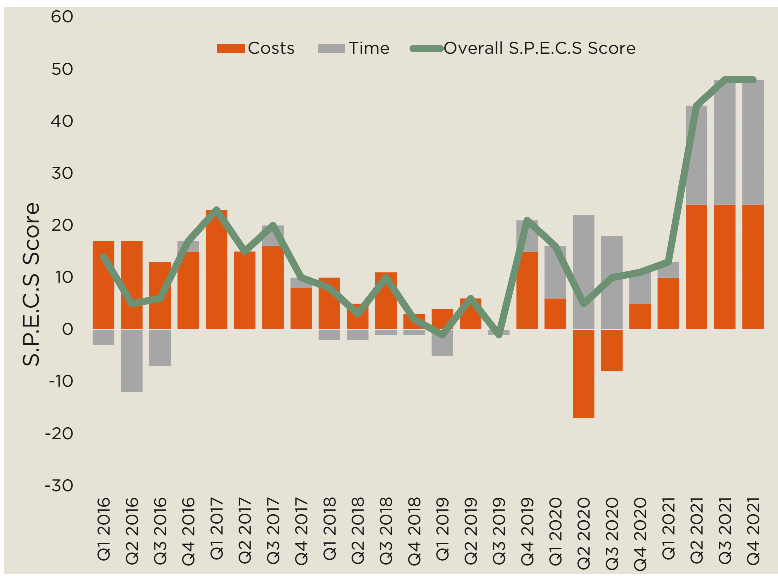
Swap rates Have increased by an average of 81bps over 12 months



Source Bloomberg

The Savills ProgrammE and Cost Sentiment Survey (S.P.E.C.S) tracks the latest data on build costs and project duration from our Building and Project Consultancy division. The latest data from our index shows that build and fit-out costs continue to rise and project durations are increasing. Indeed, in January the index reached its highest recorded level. With no obvious quick-fix solution to current global material supply issues, many expect that upward pressure on lead times will be maintained. This year may also see issues around labour supply become more pronounced as the combination of Brexit and the pandemic has led to many European workers leaving the country and it is unclear whether they can or will return. This will leave the UK short of labour and the challenge will be securing workers for construction projects and keeping them on site in an improving market. The latest S.P.E.C.S report can be viewed here.

Build costs and timescales Continue to rise



Source Savills

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