MARKET IN MINUTES
Savills Research

UK Commercial – February 2023

UK Regional Office Investment Market Watch

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Yield softening continues across the market

Pricing has been significantly impacted by the rising cost of debt and the turbulent economic outlook which has been evident in all submarkets across the regional office market. The prime regional office yield has moved out by a further 25 basis points to currently stand at 6.00%, reflecting a 125 basis point outward movement in the last six months. All the prime yields across the larger regional office markets have softened, most notably in the South East region where the prime yield has moved out to 6.25%, with additional upward pressure.

The investor demand in the market is primarily for prime assets with strong ESG credentials, there has however been scare opportunities to acquire stock of this standard in the last six months. Conversely, the demand for secondary properties is thin with limited appetite for these assets which have been brought to the market. These two factors have combined to result in a reduction in investment volumes with £714 million of turnover recorded in Q4 22 which was the lowest quarterly total since 2012. It is expected that investment activity will continue to remain subdued in the short term until there are signs of price stabilisation. Science and innovation related assets continue to experience strong investor demand with over £1.65 billion invested into the Oxford and Cambridge knowledge arc in 2022. The buyer pool for these assets remains deep with over 20 different purchasers in 2022, underlining the resilience of this sub sector despite the headwinds present in the market.

Regional Office Yields January 2023

	Year	Prime	Secondary	Spread
Birmingham	Jan-23	5.50%	7.50%	200 bps
	Jan-22	5.00%	6.75%	175 bps
Bristol	Jan-23	5.50%	7.50%	200 bps
	Jan-22	4.75%	6.50%	175 bps
Cardiff	Jan-23	6.25%	9.00%	275 bps
	Jan-22	5.50%	8.50%	250 bps
Edinburgh	Jan-23	5.75%	7.50%	175 bps
	Jan-22	4.50%	6.25%	175 bps
Glasgow	Jan-23	6.00%	8.50%	250 bps
	Jan-22	5.00%	7.00%	200 bps
Leeds	Jan-23	6.00%	9.00%	300 bps
	Jan-22	5.00%	7.50%	225 bps
Manchester	Jan-23	5.75%	7.75%	200 bps
	Jan-22	4.75%	6.50%	175 bps
M25	Jan-23	6.25%	10.00%	375 bps
	Jan-22	5.50%	8.50%	300 bps

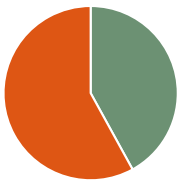
Source Savills Research

*Secondary yields refer to buildings in core locations of both a lower quality and rental price point

Key Stats

6.00%
Average prime regional office yield

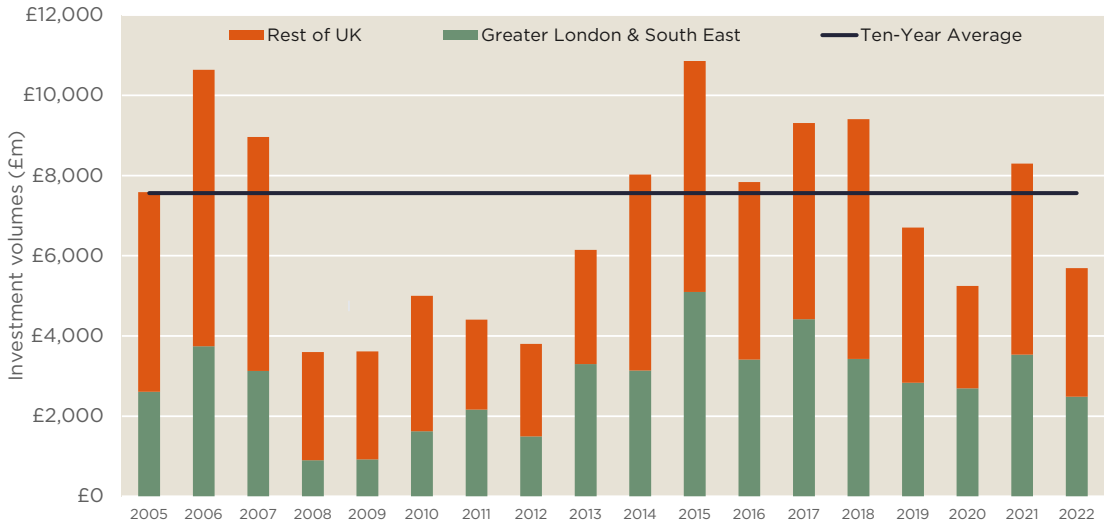
£5.7bn
Office investment volumes outside of central London at the end of 2022



49%
Overseas investors accounted for 49% of total investment in 2022, which was the highest proportion amongst all investor types

79%
The number of deals below £20 million over the last five years

Office investment volumes Total turnover recorded in 2022 was 25% below the long-term average



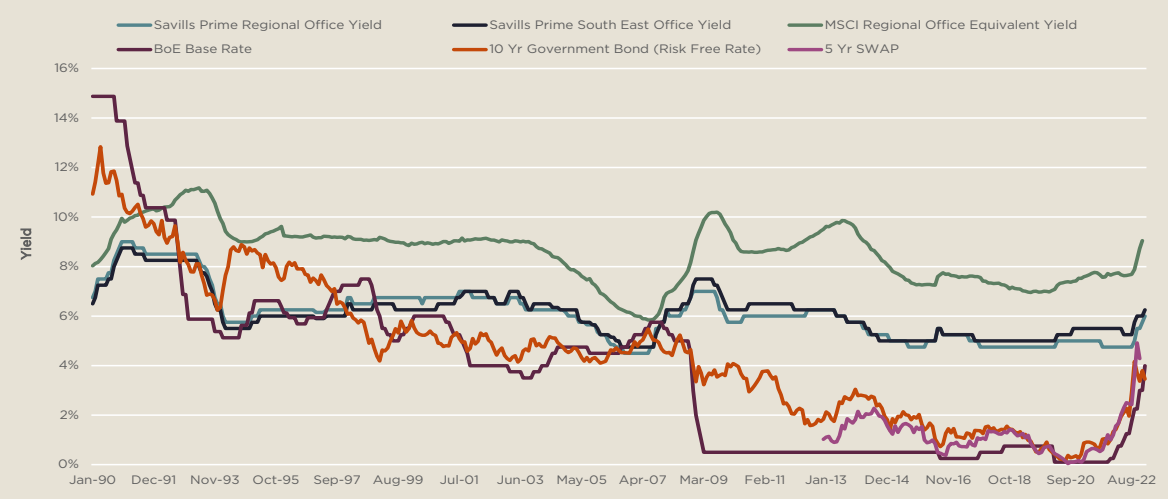
Source Property Data/Savills

Occupational market fundamentals remain robust amidst yield softening

The Bank of England recently announced an increase in the base rate to 4.00%, however the mood amongst investors was more upbeat as the FSTE 100 index hit its highest level ever recorded on 3rd February 2023. The cautious optimism has arisen from a hope that this may signal the end of sustained base rate rises and easing inflation. The IMF are still however forecasting a recession for the UK economy with a 0.5% contraction in GDP expected in 2023. This would though prove to be a modest recession when compared to previous downturns.

Sentiment in the property market has reacted rapidly to base rate rises and the worsening macro-economic outlook with the prime regional office yield moving out by 125 basis points in the last six months to stand at 6.00%. The last time the base rate was at a level higher than 4.00% was in October 2008, when the prime regional office yield stood at 6.75%. This would initially indicate that there is further yield softening to come in the regional office market. The occupational market dynamics are however markedly different from 2008 with the existence of a two-tiered market far more pronounced in 2023. There is currently an imbalance in the supply and demand of ESG compliant office space that offers multiple amenities with all of the Big Six regional city office markets having below two years of grade A supply. Furthermore amidst rising build and finance costs, the development pipeline is limited across the market, Glasgow is currently the only market across the Big Six to have a new building scheduled to complete after 2024. These dynamics have resulted in the market experiencing strong prime rental growth with record rents achieved across the regional market despite a challenging economic environment. Further rental growth is expected despite a recession forecast with the demand for prime grade A office space set to intensify notably amongst corporate occupiers in a low supply environment. These factors may therefore result in prime pricing plateauing faster than may be expected given the current economic outlook.

Yield Comparison The prime regional office yield has moved out to its highest level since 2013

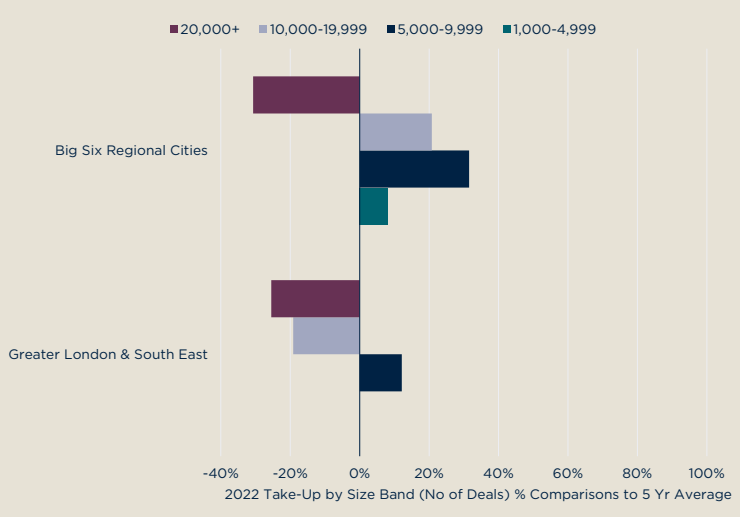


Source: Savills Research, Bank of England, MSCI, Refinitiv Datastream

Leasing activity across the regional office market has been boosted by an uptick in the number of transactions recorded. This has been notable across the smaller size bands. There were the highest number of deals recorded in the 5,000-9,999 sq ft size band in 2022 when compared to the last five years in both the Greater London & South East region and the Big Six regional cities. There was also above average activity from occupiers leasing below 5,000 sq ft in the Big Six regional cities. There was however below average activity for deals recorded over 20,000 sq ft, in both market areas.

The majority of existing stock requires significant intervention to appeal to current tenant requirements who are seeking modern aspirational workspaces that can help attract and retain staff. We therefore, expect deal volumes to remain high in 2023, with occupiers more likely to relocate rather than renew at lease expiry.

Flight to Quality There has been above average deal volumes in the smaller size bands across the regional office market



Source Savills Research

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