savills

UK Commercial Market in Minutes
Stock starvation pushing yields lower

August 2014

Further falls to come

■ The UK average prime yield moved lower by seven basis points during July to 4.77%, a level not seen since August 2007. Downward trend arrows were applied to a couple of markets during June and these have now resulted in a 25 basis point hardening.

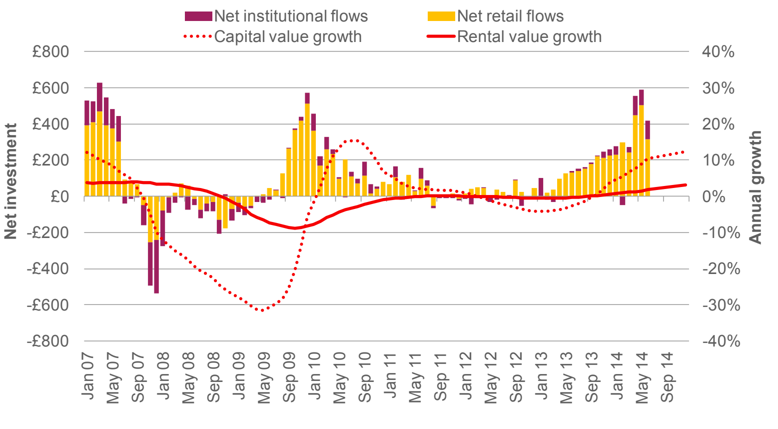
■ In total, the past 12 months has seen a softening of the yield in just one sector, foodstores. In comparison, there have been 30 instances of yields falling by 25 basis points. Three sectors, retail warehouse (open A1), distribution warehouses and multi-let industrials have fallen by a full percentage point over the year. There is an expectation of further falls in some sectors as downward trend arrows have been applied, or remain, on six of the 13 sectors in Table 1.

■ The UK Investment Managers Association (IMA) data of total retail and institutional sales show a net increase of £1.56bn in Q2, a level last seen in Q2 2007 (Graph 1). The IMA data for May presented property as the highest net change of any asset class. This inflow is the response to improved capital value growth and the return of rental growth.

■ The regional markets will come to the fore to absorb the inflow into the property funds. The clear message for investors is that the markets outside of London will show significant returns and catch-up with the recent outperformance of London and the South East. The shift is vital to achieve outperformance in the UK.

■ Some property investors have assets where the value is at a point to take profits, perhaps earlier than they had anticipated. We expect some portfolio 'weeding' during the remainder of summer and into the autumn, which will bring much needed stock to the market and will capitalise on the level of demand from investors.

GRAPH 1
Inflows have increased significantly as capital value and rental growth improves throughout 2014



Graph source: Investment Managers Association / Investment Property Databank / RealFor

TABLE 1
Prime equivalent yields

	Jul 13	Jun 14	Jul 14
West End Offices	3.50%	3.25%	3.25%
City Offices	4.75%	4.50%	4.50%
Offices M25	6.00%	5.25%	5.25%↓
Provincial Offices	6.00%↓	5.25%↓	5.25%↓
High Street Retail	4.75%	4.50%	4.50%↓
Shopping Centres	5.00%↓	4.50%↓	4.50%↓
Retail Warehouse (open A1)	5.25%↓	4.50%	4.25%
Retail Warehouse (restricted)	6.00%↓	5.25%	5.25%
Foodstores	4.25%	4.50%	4.50%
Industrial Distribution	6.00%↓	5.25%↓	5.00%
Industrial Multi-lets	6.00%↓	5.25%↓	5.00%
Leisure Parks	6.25%↓	5.75%	5.75%↓
Regional Hotels	7.00%	6.75%↓	6.75%↓

Table source: Savills. Arrows indicate expected short term movement

Looking beyond the South East

■ Investors that bought the tenant demand recovery story early are getting 'pay back' over a relatively short time frame. Rental improvement and reduction in voids has driven this. We expect to see more investors capitalising on short term gains as occupational markets improves.

■ We have discussed this a few times here during the past six months, but it is worth reiterating the drive of investment outside of the South East.

■ For UK institutions, using a 5-year average (excluding portfolio sales), 49% of UK investment, by value, had been outside of the South East. So far this year, this has increased to 55%. Historically, and unsurprisingly, overseas investors remain cautious about the regions at around 15% in last 5 years but this has increased to 20% in 2014. This increase is despite the negative of Sterling being the best performing major currency. During Q2, for all investor types, around 32% of investment was outside of the South East (Graph 2).

■ The markets throughout the UK will continue to recover and the Government is determined to rebalance the economic inequalities. It is a long-term solution, but the recent release of the One North report outlining the alliance of five cities - Leeds, Liverpool, Manchester, Newcastle and Sheffield and the £15bn transport plan linking ports, airports and the city centres, is vital.

■ In the South East, Crossrail has provided significant economic benefit and regeneration along its route at a cost of £15bn. The One North £15bn transport plan will deliver significant benefits for the north and will impact positively on the property markets. Existing owners will benefit, but we can also expect further inward investment.

Occupier confidence is the key driver

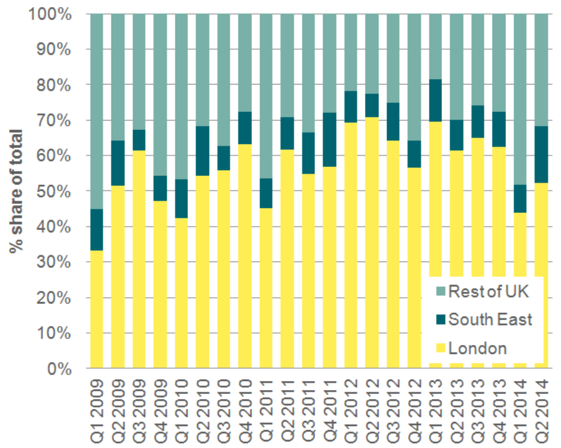
■ Despite geopolitical issues, which knocks global confidence, the UK is on a strong path of occupational demand recovery. News flow, both positive and negative, has come in equal waves during the past few months including the largest wobble on Wall Street for two years during the start of August.

■ However, analysts remain bullish and suggest that the corrections are due to the markets adjusting to the anticipation of higher interest rates. A recent survey shows that UK finance officers' risk appetite, which will include hiring, new products and higher property demand, is the highest for over seven years. UK property does not reflect this sentiment yet, but there is increasing levels of corporate demand, which is yet to crystallise into take-up of new/additional floorspace.

■ A helpful indicator of UK tenant demand, by sector, is the IPD monthly data for void rates (Graph 3). Both the retail and industrial sectors have void rates around the 10-year average and well below the 2009 peak. The office market has behaved differently with a peak last year, but this includes stock with a high degree of obsolescence.

GRAPH 2

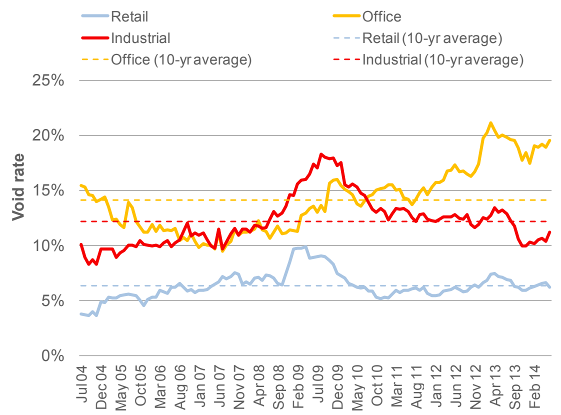
UK investment: Rest of UK taking increasing share in recent quarters



Graph source: Property Data

GRAPH 3

Retail and industrial void rates are well below peak; offices remain higher



Graph source: Investment Property Databank

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