

UK Commercial Market in Minutes

Investment volume bounce for second half of 2016?

March 2016

Yields remain static

■ Prime yields in February remained static for the second month in succession at 4.62%. With a paucity of prime stock for sale in all sectors there is limited scope to see further evidence of yield compression in the short term.

■ Indeed the lack of deal volume in the Industrial Distribution sector and the Regional Office market has seen an outward pressure added to our prime yields.

■ With all eyes now on the 23rd June 2016 and the in/out referendum on Europe, it is interesting to see how the markets are reacting, both in terms of pricing and investment volumes.

■ As graph one demonstrates, total investment volumes for all property in January and February 2016 are 25% lower than the same period in 2015. However fears that volumes are falling drastically are yet to be proven as volumes are 10% higher than the long term average of £5.7bn.

■ There is a case to be made that, whilst the EU referendum may cause a short term liquidity issue, that the second half of the year could prove to be exceptional.

■ Whilst on a smaller scale, the experience of the Scottish referendum on investment markets should be noted. Following the vote to remain as part of the United Kingdom in September 2014, investment volumes into Scottish real estate increased by 85% in the second half of the year. Whilst the second halves of years are generally stronger the post referendum bounce was particularly strong as over the long term average second half volumes are just 45% stronger.

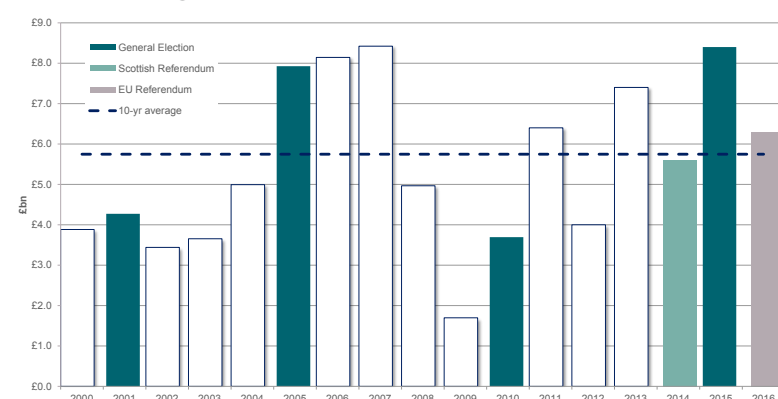
■ Moreover, as we examine overleaf, the combination of high allocations to UK real estate, strong sentiment amongst investors, record levels of occupier demand, falling supply and rental growth could all combine to see investors return to market with a bang post referendum.

TABLE 1
Prime yields

	Feb 15	Jan 16	Feb 16
West End Offices	3.25%	3.00%	3.00%
City Offices	4.25%	4.00%	4.00%
Offices M25	5.00%	5.00%	5.00%
Provincial Offices	5.00%	4.75%	4.75% ↑
High Street Retail	4.25%	4.00%	4.00%
Shopping Centres	4.25%	4.25%	4.25%
Retail Warehouse (open A1)	4.25% ↑	4.50%	4.50%
Retail Warehouse (restricted)	5.25% ↑	5.75%	5.75%
Foodstores	5.00%	5.00%	5.00%
Industrial Distribution	4.75%	4.50%	4.50% ↑
Industrial Multi-lets	5.00%	4.75%	4.75%
Leisure Parks	5.25%	5.00%	5.00%
Regional Hotels	5.75%	5.50%	5.50%

Table source: Savills

GRAPH 1
UK investment volumes fall but are still above long term averages



Graph source: PropertyData

→ Investors still targeting UK real estate

■ Within a highly globalised investment market localised geo-political risk will undoubtedly have implications for when and how investors deploy capital. However despite the impending risk of the UK vote on membership of the EU, investor sentiment to UK real estate is still strong.

■ As graph two demonstrates, fund managers in all parts of the world have been increasing their allocations to real-estate, with UK-based fund managers being particularly supportive of an increased weighting to the asset class, which has increased by 242bps in the last 12 months.

■ A further benchmark of investor intentions, The Lloyds Bank Investor Sentiment Index, also demonstrates that UK real estate compares favorably to other asset classes. The February 2016 index demonstrated that 49% of investors were positive to UK real estate compared to the average sentiment of just 3%.

■ Combined, these indicators demonstrate that there is both capital allocated to UK real estate in 2016 and, indeed, the intention to invest in what is still perceived as a safe and stable market. Therefore whilst the short term lull in transactional markets may give the opportunity for some investors to purchase with less competition in the first half of the year there remains a weight of capital ready to be deployed after the short term uncertainty of the referendum is removed.

Occupational markets are strong

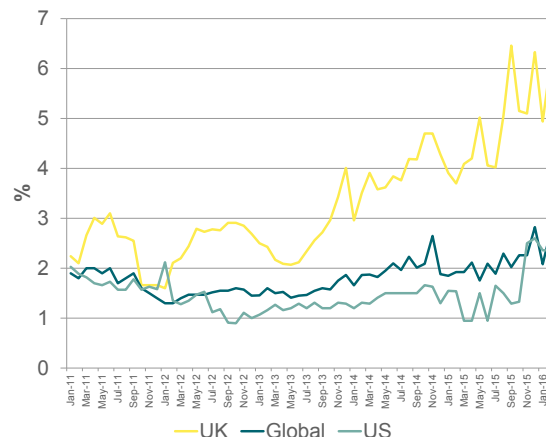
■ Whilst the short term uncertainty is causing a pause for thought in the investment market, many occupational markets have posted record take-up levels which combined with real rental growth, forecast to be 3.2% in 2016, may account for the strong sentiment to UK real estate.

■ The logistics market, which is feeling the full impact of structural change in retail habits, has seen take-up for the first two months of 2016 rise an astonishing 66% as online retailers and parcel delivery companies compete to take space to serve consumers in urban locations.

■ On the retail front in Central London alone 14 new international brands have plans to open and the out of town markets are seeing particularly strong demand as bulky goods retailers look to capitalise on the housing recovery.

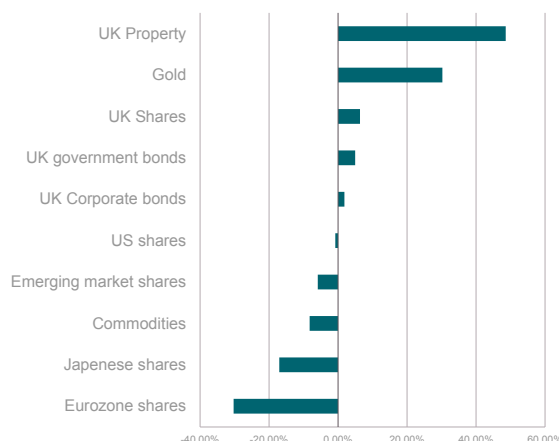
■ In the office markets take-up in the City is 23% ahead of the long term average and the West End broadly in line, although occupiers are clearly committing to capital expenditure with pre-lets accounting for 20% of the market. Regionally, the story is the same with take-up for South East offices reaching its highest level since 2007 and new rental tones being set. Manchester, Birmingham Cardiff and Edinburgh have seen take-up increases of 39%, 105%, 41% and 44% respectively, on the ten year average, with Birmingham and Cardiff finishing the year with the best take-up figures ever recorded. ■

GRAPH 2 Fund Manager allocations to UK real estate are high



Graph source: Reuters

GRAPH 3 Investor sentiment to UK real estate outperforms other assets



Graph source: Lloyds Bank Investor Sentiment Index

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