

UK Commercial Market in Minutes

Uncertainty keeps yields on hold

May 2016

Value beyond prime

■ The upward 'blip' in prime yields noted in March held last month with no movement reported in any of the sectors tracked by Savills, albeit upward pressure was noted for Shopping Centres.

■ The upcoming EU Referendum and fears surrounding the strength of the global economy are generating uncertainty leading to some upward pressure on yields as investors put investment decisions on hold. Concerns that some markets are 'overpriced' is further tempering confidence.

■ It is true that yields in some prime markets are below their 2007 peak. Eight of the prime sectors we track have yields at or below their 2007 level. However, these yields remain highly attractive when compared to other assets. For example, the current spread between Savills average prime yield and five-year Government Bonds is close to 390 basis points (bps), back

in 2007 the spread averaged only 77bps.

■ Yield compression beyond previous peak levels however, is not universal. Based on MSCI's quarterly index only four of the 21 segments they track have yields in line or below where they were in Q2 2007 (Graph 1).

■ In light of rental growth forecasts some of these segments still present good 'value'. Fashion Parks, which have average yields 88bps off from where they were in 2007, are forecast to see rental growth of 3.2% per annum through to end of 2020 exceeding the 2.4% per annum projected for Central London Retail.

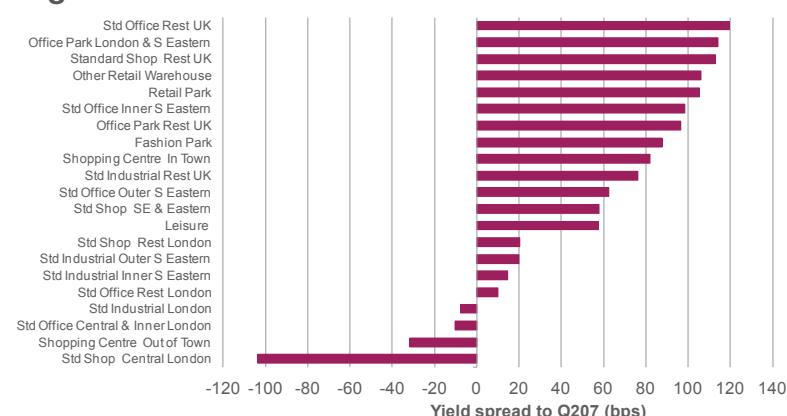
■ In the face of wider investor uncertainty some prime segments may be considered 'overpriced' relative to 2007 pricing. But value remains for a number of segments and geographies where rental growth is forecast to continue.

TABLE 1
Prime yields

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

Table source: Savills

GRAPH 1
Significant yield spread remains for a number of segments



Graph source: Savills Research; MSCI

→ London is top Global Retail Destination....

■ London's Global City status is becoming increasingly apparent in its retail offer, for example 120 international brands have opened their first ever UK store in London since 2012. A key draw for these new entrants has been London's international reputation and its attraction to international tourists. This was clearly highlighted in our Global Retail Destination Index.

■ The Index benchmarked seven key Global Retail destinations (London, New York, Paris, Milan, Dubai, Hong Kong and Singapore) on a range of metrics related to retail spend, tourist flows, property costs and retail mix. This was supplemented with store manager surveys across all seven markets asking them to rate the retail experience and general environment.

■ London's West End topped the quantitative ranking, scoring well in terms of retail offer, visitor and retailer attractiveness (see Graph 2).

■ For retail brands the scale of retail sales transacted in London, and with it the volume of tourist spend, is a major attraction. The fact that total property occupational costs are lower, ranking fourth behind New York, Hong Kong and Paris, is a further draw. London's leading appeal is reinforced by the fact that 96% of survey respondents in the West End would recommend it as a place to trade, the highest proportional response across the seven cities.

...but, retail sales growth slowing

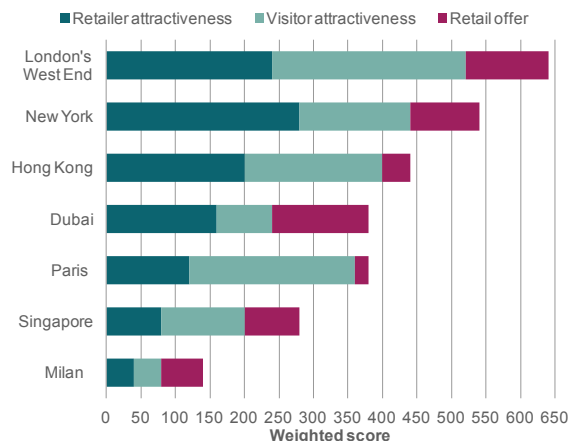
■ While London may be high on the agenda for international shoppers its rather a mixed picture nationally when it comes to sales.

■ While all retail sales (based on value) improved in April with an annual increase of 1.2%, the trend points to weakening growth on the back of waning consumer confidence due to the upcoming vote on EU membership and concern regarding global economic conditions (Graph 3). Clothing & footwear sales in particular have been one of the hardest hit reporting its fifth month of consecutive annual declines, although April's return of -5.9% was marginally better than the -6.1% fall reported in March.

■ Unsettled weather and the early Easter have been touted as exacerbating the general slowdown in clothing sales. Looking at periods where the value of clothing retail sales moved into negative territory the majority have coincided with unseasonal weather. For example, in October 2005 the 3-month average max temperature was nine degrees higher than the long-term average, delaying winter wardrobe purchases and subsequently resulting in a -1.5% fall in clothing sales.

■ Improving weather is likely to result in an upturn in clothing sales over the coming months but with economic and geopolitical concerns continuing to generate downward pressure on consumer confidence the level of this bounce back could well be muted. ■

GRAPH 2 Global Retail Destination ranking: quantitative analysis



Graph source: Savills Research; Oxford Economics

GRAPH 3 Weather and confidence generating the perfect storm for clothing sales



Graph source: ONS; GfK NOP

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