savills

UK Commercial Market in Minutes
Positive outlook to support further yield compression

September 2015

Yields resume their downward trajectory

■ August reported a further downward shift in average prime yields with three sectors reporting a 25 basis point (bps) compression; Provincial Offices, Industrial Distribution and Industrial Multi-let.

■ This brings average prime yields 14bps off their previous 2007 peak with seven of the 13 sectors that we track now at or below 2007 levels.

■ Stock availability, which has been particularly constrained in London, is improving which could pose an interesting market test to pricing over the coming months. However, with appetite remaining strong in light of the continued inflows into property funds and interest from overseas buyers we expect the downward pressure on prime yields to continue. For example, High Street Retail and M25 Offices are already earmarked for additional yield compression.

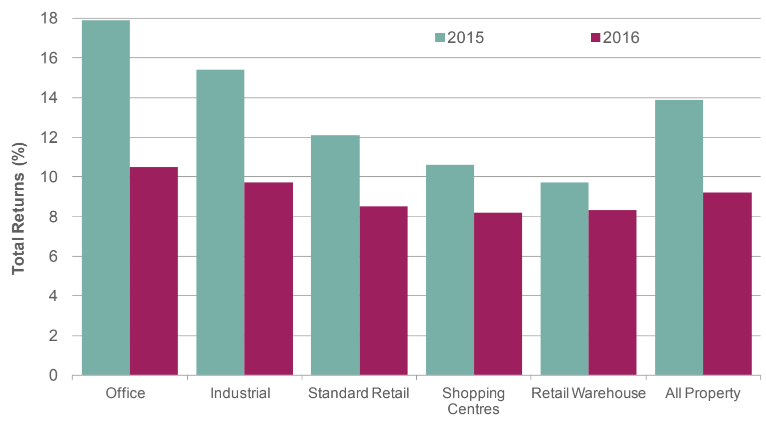
■ The search for value has led an increasing number of investors to look beyond London for opportunities. Close to 59% of investment activity last year took place in the regions, its highest level since 2006, with a similar volume share expected this year.

■ Improving confidence is feeding into consensus forecasts for UK property returns. The IPF's latest consensus forecasts (August 2015) point to Total Returns of 13.9% for UK property this year, up on the 13.0% noted in May. Likewise the outlook for 2016 has increased 40bps to 9.2% (Graph 1).

■ Capital value growth forecasts also remain positive with 8.5% expected for 2015 with a slower rate of growth forecast to come into effect in 2016 and beyond. Current consensus from IPF points to 2.4% per annum through to the end of 2019, although there will be sectors and geographies that will outperform this national average.

GRAPH 1

Outlook for Total Returns remain positive



Graph source: IPF

TABLE 1

Prime yields

	Aug 14	July 15	Aug 15
West End Offices	3.25%	3.00%	3.00%
City Offices	4.50%	4.00%	4.00%
Offices M25	5.25%↓	5.00%↓	5.00%↓
Provincial Offices	5.25%↓	5.00%↓	4.75%
High Street Retail	4.50%↓	4.25%↓	4.25%↓
Shopping Centres	4.50%	4.25%	4.25%
Retail Warehouse (open A1)	4.25%	4.50%	4.50%
Retail Warehouse (restricted)	5.25%	5.50%	5.50%
Foodstores	4.50%	5.15%	5.15%
Industrial Distribution	5.00%	4.75%↓	4.50%
Industrial Multi-lets	5.00%	5.00%↓	4.75%
Leisure Parks	5.50%	5.25%	5.25%
Regional Hotels	6.50%	5.50%	5.50%

Table source: Savills

Retail in recovery

■ Much has been written about how evolving shopping trends are killing the high street. While it is true that some retail centres may never truly recover new trends suggest that there is still a healthy future for the physical store.

■ The growth in click-and-collect, and with it the blurring of the boundaries between online and bricks & mortar, is perhaps the most significant recent lifeline. Retailers are increasingly seeing the benefit of a physical store network in driving online sales. According to IMRG Capgemini e-Retail Sales Index online sales growth by multi-channel retailers tends to outpace their pure-play online counterparts with the former reporting a 21% annual growth in sales in June as opposed to 13% for the latter.

■ This trend is feeding positively into overall occupational demand with an increasing number of pure-play retailers taking stores. For example, we have identified 22 original online retailers who have since moved into physical stores including Screwfix and more recently Missguided with their Selfridges concession.

■ This trend, combined with improving economic conditions, means the overall outlook for rental growth for the sector looks positive. Nationally, forecasts point to average growth per annum of 2.3% between 2016-19. However, it is a relatively mixed bag on a centre basis with the more affluent regional centres expected to outperform. Outside London, these include Winchester, Bath and Chichester (see Graph 2).

China slowdown, risk to London luxury retailing?

■ News coming out of Mainland China and Hong Kong is that some luxury brands are renegotiating rents due to weak sales in the face of a China slowdown. This comes on the back of the initial challenges brought about the crack down on corruption and 'gifting' that came into force in 2013.

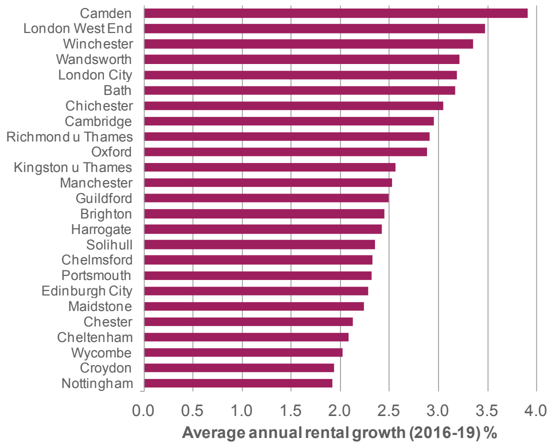
■ The question is, could this become an issue here? Estimates from HSBC suggest that Chinese tourists account for approximately 20% of luxury spend in the UK. While this is a significant share, it is smaller than the 35% estimated for France pointing to a greater degree of insulation from a possible China slowdown (Graph 3).

■ However, the China slowdown alone may have a very limited impact on Chinese luxury spend in Europe. Global Blue, a tax-refund service, reported a 72% increase in Chinese retail spend in Europe in August. This was the same month the Chinese currency was devalued and there was a slump in equities. The driver of this pick up in spend in the face of a relatively weaker outlook back home was the weakness of the Euro meaning that products remained cheaper than at home.

■ In the UK, the strong Pound could pose potential issues to London luxury spend but this could be offset by the strengthening Dollar. This, and the fact that total overseas visitor numbers to London continue to expand, suggests that any potential impact directly associated with the China slowdown would be relatively negligible. ■

GRAPH 2

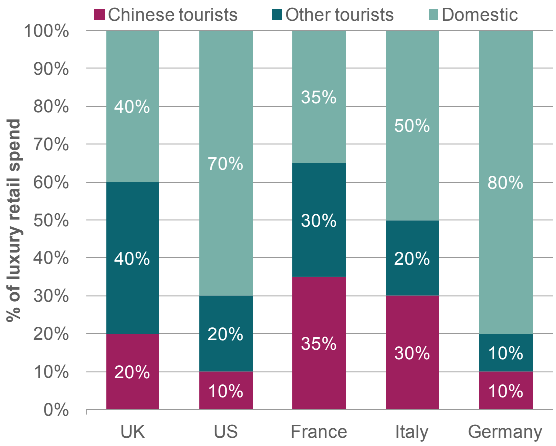
Top 25 retail centres by rental growth projections (avg annual 2016-19)



Graph source: RealFor

GRAPH 3

Luxury retail spend by purchaser type



Graph source: HSBC estimates

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