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Savills World Research
UK Commercial

UK Commercial Market in Minutes
A quiet first quarter, but some fundamentals are improving

April 2018

Prime yields stable but investment volumes are down (or are they?)

■ The Savills all property prime yield was stable this month at 4.50%, its lowest level since November 2007.

■ Industrial property continues to face downward pressure on yields, with the only other sector under downward pressure being M25 offices. Yields in the M25 are now looking attractive in comparison to the major regional cities and it is increasingly on the radar of both domestic institutions and non-domestic private investors.

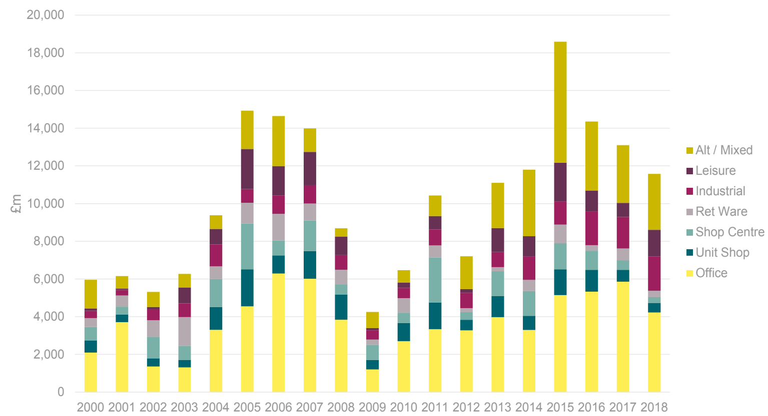
■ The shopping centre market, where prime yields are now 50 basis points higher than they were a year ago, is facing further upward pressure on yields due to weakening investor sentiment around failures and CVAs, as well as the expectation that more stock is going to come to the market as the result of mergers and restructurings. With town centre dominant shopping centres now yielding 7.50%+ we expect to see more activity in this sector in the remainder of 2018. Indeed, we estimate that there is just under £900m of shopping centres currently under offer, with a further £1.5bn in the market.

■ The first quarter of every year often ends with advisers and owners making cautious noises about trading volumes, but 2018 has definitely started with more caution than we expected. Total investment turnover for the first three months of this year was just under £12bn, which is 11.6% down on the same period last year.

■ While this is causing some bearish commentators to suggest that investor demand is weak, we should not forget that the last few years have been very strong. If we compare Q1 2018 with the longer term average (Graph 1) for the same period it is actually 9.2% up on the ten year average and 14.1% up on the 19 year average. To paraphrase Mark Twain's famous telegram, reports of the market's demise have been greatly exaggerated!

GRAPH 1

Q1 Investment turnover is down on the five year average, but 14% above the long-term



Graph source: Savills, Property Data

TABLE 1

Prime yields

	Mar 17	Feb 18	Mar 18
West End Offices	3.25%	3.25%	3.25%
City Offices	4.00%	4.00%	4.00%
Offices M25	5.25%	5.00%↓	5.00%↓
Provincial Offices	5.25%	4.75%	4.75%
High Street Retail	4.00%	4.00%	4.00%
Shopping Centres	4.50%	4.75%	4.75%↑
Retail Warehouse (open A1)	5.25%	5.00%	5.00%
Retail Warehouse (restricted)	5.75%	5.25%	5.25%
Foodstores	5.00%	4.50%	4.50%
Industrial Distribution	5.00%	4.25%	4.25%
Industrial Multi-lets	4.50%	4.25%↓	4.25%↓
Leisure Schemes	5.00%	5.00%	5.00%
Regional Hotels	5.00%	4.50%	4.50%

Table source: Savills

Brexit and London jobs

■ With Theresa May finally, and unsurprisingly to us, admitting that there was no point in currently pursuing the EU to agree to sustain the UK's rights to passport financial services, one might imagine that the prospects for City jobs have worsened?

■ However, the overriding tone of Brexit-related announcements from the banking sector over the last quarter has been the exact opposite of this. Four major banks have recently announced that their initial assessment of thousands of jobs having to relocate to within the EU has now been downgraded to hundreds, and the latest Reuters poll of 119 firms in the City concluded that the likely total number of jobs lost or moved would be around 5,000.

■ While we were never in the 'uber-bear' camp on the impact of Brexit on the City, we have now revised down our view on its likely impact on City and Docklands employment (Graph 2). This means that even our worst case scenario implies a rise in overall employment in those locations, albeit with around 13,000 jobs lost in Finance and Insurance.

■ Our core view remains that much of the continuing contraction of that sector in London has more to do with post-GFC margin management and the rise of AI than with Brexit.

■ Continuing strong growth in other business sectors will however more than compensate for this structural change, with overall Greater London office-based employment forecast to rise by 162,000 jobs between 2017 and 2022.

Is the consumer gloom about to begin to lift?

■ 2017 was a torrid year for UK retailing, and the flurry of failures and CVAs that have been announced in the first quarter of 2018 pay testament to how bad last year was.

■ Retailer's margins, which can be slim at the best of times, were put under further pressure from rising import costs, staff costs, and the return of negative real earnings growth for the first time since the GFC.

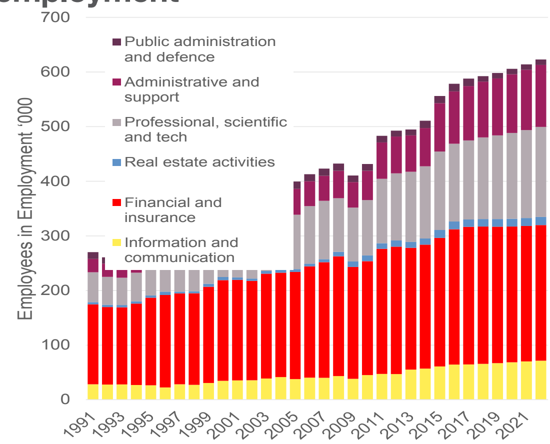
■ With inflation now standing at 2.5% pa and regular pay growth at 2.8% pa, real earnings growth is now positive. Indeed, with unemployment now at 4.2% people should be feeling positive not just about job security but also the prospects for wage growth.

■ While consumer confidence last year was not particularly weak (with the GfK headline measure tracking its long-term average level for the whole of the year), it has been weaker over the last six months than the preceding period.

■ Looking ahead, the question in the regular GfK survey on people's perceptions of their personal financial situation over the next 12 months rose from +2 in December 2017 to +10 in March 2018 (Graph 3). This is the highest level for that forward looking measure since late 2007. This suggests that spending will pick up in the remainder of 2018, thus removing one of the negatives around UK retail that were present last year.

GRAPH 2

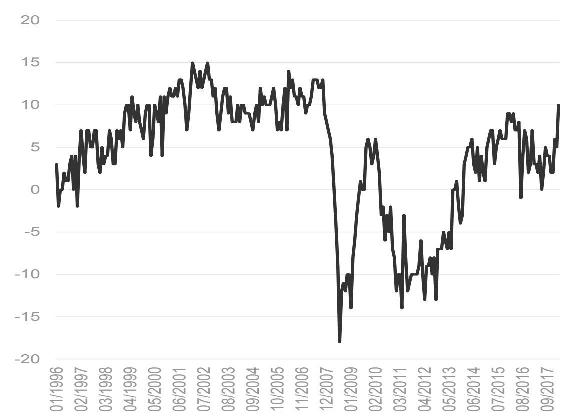
City & Docklands office-based employment



Graph source: Savills Research

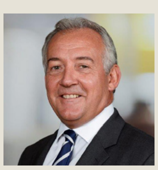
GRAPH 3

Confidence in the 12 month outlook for personal financial situations



Graph source: GfK

Please contact us for further information



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