UK Commercial Market in Minutes
Yields remain level but upward pressures emerging

September 2018

More yields to rise?

■ The average yield across all thirteen sectors is currently 4.62%, which is slightly below the same time last year. Following on from July, a key trend for the August data is the addition of more upward trend arrows.

■ What a difference a year makes. During August 2017, four sub-sectors had downward pressure on yields; last month, five sectors had upwards pressure arrows applied.

■ Three retail sectors saw yields move 25 bps higher in August. This includes Retail Warehouses, which has the weakest institutional demand for a couple of decades.

■ In the space of the past year, M25 offices have seen yields move from downward to upward pressure, despite a lack of prime stock in the market at present. Institutional demand remains, but only for the "right" product.

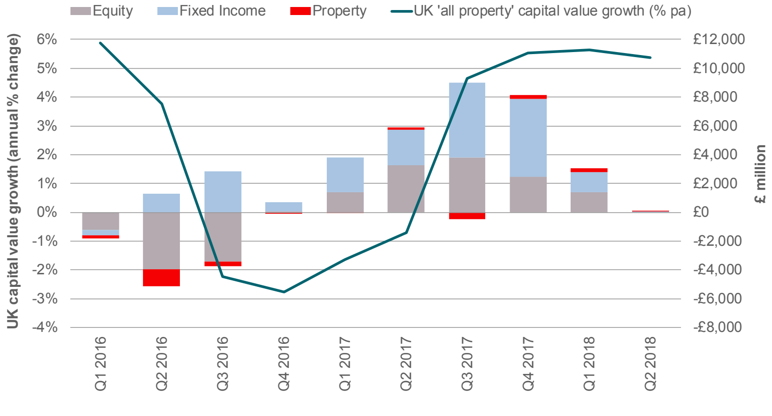
■ As shown in Graph 1, data from The Investment Association shows the net retail sales for the three main asset classes, reflecting investor sentiment.

■ During the last eight quarters, which includes the quarter when the EU Referendum took place, the average quarterly net sales across all three asset classes were positive and just over £1 billion. The last quarter data shows only a £22m positive net sales and shows neutralizing impact of Brexit and uncertainty for the investor in the UK.

■ The neutral stance on property is a reflection of capital values, which has seen lower growth in Q2, the first time for a couple of years. Year-on-year capital growth, at the end of Q2 2018, was around 5.4%, but lower than the 5.6% in Q1 this year. The data presents a peak in the current cycle.

GRAPH 1

All investment sectors were only slightly positive in the second quarter of this year



Graph source: The Investment Association, MSCI

TABLE 1

Prime yields

	August 17	July 18	August 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	5.00%	4.75%	4.75%
High Street Retail	4.00%	4.25%↑	4.50%↑
Shopping Centres	4.50%	5.00%	5.00%↑
Retail Warehouse (open A1)	5.25%	5.25%↑	5.50%↑
Retail Warehouse (restricted)	5.50%	5.50%↑	5.75%↑
Foodstores	4.75%	4.50%	4.50%
Industrial Distribution	4.75%	4.25%	4.25%
Industrial Multi-lets	4.50%↓	4.00%	4.00%
Leisure Parks	5.00%↓	5.25%	5.25%
Regional Hotels	4.75%↓	4.25%	4.25%

Table source: Savills

Monthly growth slowing

■ Graph 2 illustrates the MSCI data for 'all property' capital value growth performance on a rolling monthly and annual basis.

■ This mixture of two short-term growths provides a good indicator of the 'direction of travel' for UK commercial values.

■ The latest data for the monthly growth is showing only a 0.09% growth over the month, which is a quarter of what it was in the same month a year earlier.

■ From looking at the past few months, the annual growth year-on-year change has begun to slow and the current cycle peaked earlier this year in February. The previous peaks were, July 2010 and October 2014, suggesting that the UK market is in a four-year peak-to-peak cycle.

■ Where do the market forecasters expect the market to go? The latest Investment Property Forum (IPF) forecasts for the next five years (2018-2022) provides some direction.

■ According to the IPF, the office and retail sectors are both faced with an expectation of falling capital values over the next five years. Of course, there is the uncertainty from Brexit but there are also 'structural shift ' impacts for the office and retail sectors that will be weighing on the minds of the forecasters. The 'All Property' capital value growth view is 0% for the next five years, on average. Total returns are around the 5% level per annum during the same period.

■ However, these forecasts present a blended view of the whole sector and specific assets performance may be significantly different.

■ Despite increasing woe in the retail property sector, the latest measure of consumer confidence by GfK shows a negative balance with a score of -7. However, this score has improved and general consumer outlook remains relatively buoyant considering the uncertain impact of Brexit.

"Proptech" investment still growing

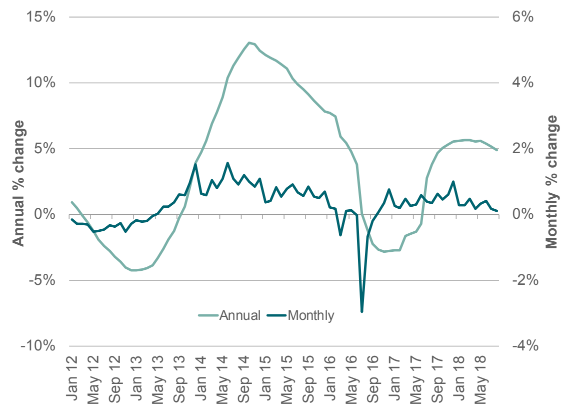
■ The buzz around proptech or (real estate tech) has emerged much more significantly in the last couple of years. This will drive efficiencies within the sector and arguably enhance the investability within commercial real estate. We shouldn't lose sight of this fact. Many commentators talk about proptech, but they don't make it clear why we should all care.

■ Savills has deal information for over 2,600 corporate investment transactions involving companies of all sizes within the real estate sector. These transactions include M&A, Venture Capital and Private Equity. In total, Savills has reviewed the last 10+ years and this is presented in Graph 3.

■ The US dominates the real estate technology investment accounting for 57% in the last 10 years, by value of deals. In comparison, the UK headquartered companies accounted for 11%. It is encouraging to see a dominance in Europe by the UK headquartered companies.

GRAPH 2

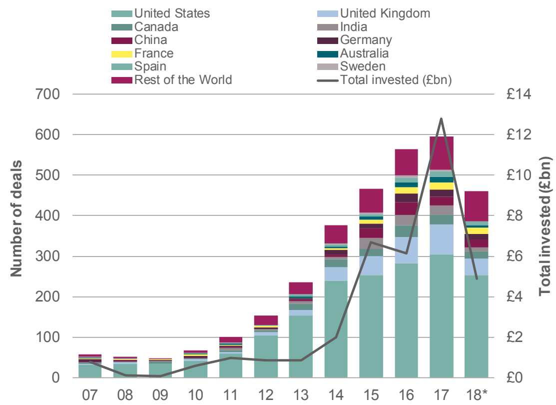
Monthly growth slowing; a four-year cycle has emerged



Graph source: MSCI

GRAPH 3

The US dominates the number of real estate tech corporate deals



Graph source: Savills, Pitchbook (country of HQ location). *As at end-Sept

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