MARKET IN MINUTES
Savills Research

Market in Minutes

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Steepest outward yield movement since July 2016

As lockdown continues the UK commercial investment market is largely on hiatus. Transactions are still occurring, but these are for units that were already in advanced stages of negotiation before lockdown began. This is reflected in the latest reporting from PropertyData which shows transaction volumes of £808m for April. Whilst accepting this could rise as more transactions are reported this is the lowest monthly volume recorded since November 2008, when the market was reacting to the Lehmann Brothers collapse.

The lack of transactional evidence has meant it has proved difficult to set yields. However, based on current market sentiment of anticipated pricing for prime stock the Savills average yield has shifted outwards by 25bps and now stands at 5.31%, its highest level since October 2013 and the largest monthly move since July 2016, when the market reacted to the EU referendum. Whilst some sectors are continuing their outward trajectory there is no reason why yields will not stabilise for sectors where the occupier fundamentals remain strong, which we examine overleaf.

As lockdown conditions are relaxed we expect liquidity to return for prime units as potential buyers are better able to validate their assumptions on voids and rental growth. For value add opportunities it may be a slower process as investors have to contend with more uncertain underwriting inputs and more expensive financing.

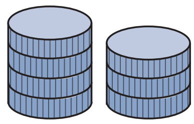
Savills prime yields

	Apr 2019	Mar 2020	Apr 2020
West End Offices	3.75%	3.75%	3.75%↑
City Offices	4.25%	4.00%	4.00%
Offices M25	5.00%	5.00%	5.25%
Provincial Offices	4.75%	4.75%	5.00%
High Street Retail	4.75%↑	5.50%↑	5.50%↑
Shopping centres	5.25%↑	6.00%↑	6.50%↑
Retail Warehouse (open A1)	6.00%	6.25%	6.75%↑
Retail Warehouse (restricted)	6.25%	6.50%	7.00%
Foodstores (OMR)	4.75%	4.75%	4.75%↓
Ind/ Distribution (OMR)	4.25%	4.25%	4.50%
Industrial Multi-lets	4.00%	4.00%	4.25%
Leisure Parks	5.50%↑	6.00%	6.50%↑
London Leased (core) Hotels	3.75%	3.75%↑	4.00%
Regional Pubs (RPI)	4.50%	4.50%↑	4.75%↑

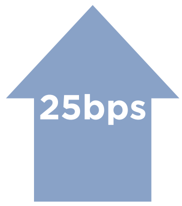
Source Savills, Yield meeting held on 29/04/2020

Key Stats

The UK average prime yield

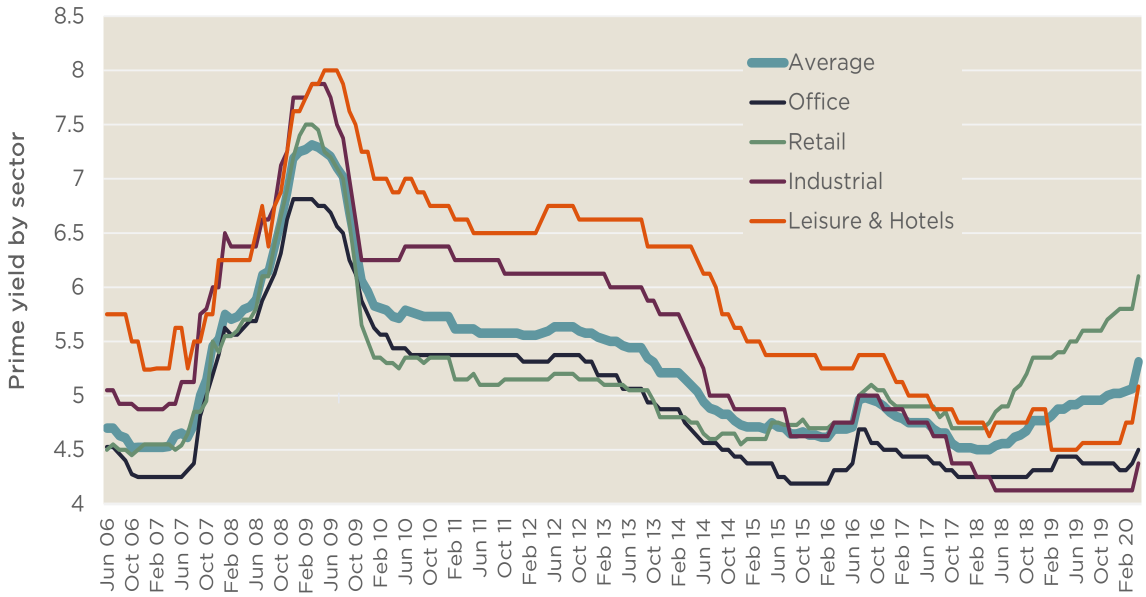


£808m
Investment volume in April 2020



Outward shift in the average prime yield. The largest outward jump since July 2016

Savills Prime Yields by sector Retail sector continues to drag the average out



Source Savills

Vacancy rates are cause for optimism

One of the most over used phrases in economic times of stress is “this time its different”, however when it comes to the vacancy levels in every business space market we cover it really is very different when compared t and the time around the Global Financial Crisis (GFC).

Indeed, taking the year before the previous vacancy peak we have identified that, on average, vacancy rates are 616bps lower today than they were before they started to rise around the GFC.

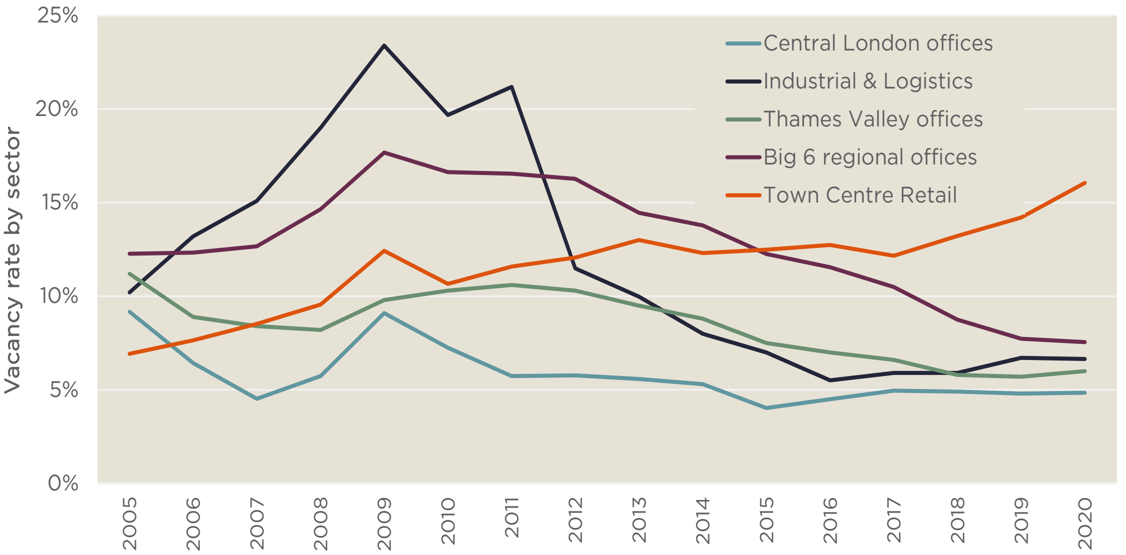
Perhaps justifying the continued interest from the investment community is the industrial and logistics sector where vacancy rates have fallen from a peak of 23% and now stand at 7%. Using data from MSCI demonstrates that rents have always increased when vacancy has been below 12%. This will mean that the sector remains well insulated as its would take an additional 40m sq ft of supply to come forward to reach the 12% tipping point.

Whilst Central London office vacancy hasn’t been as volatile over the last decade, it currently stands at 4.85%, which is 88bps lower than 2006. Whereas in the regions office vacancy has fallen from 18% to 8% over 10 years. As with the industrial market much of the space currently under construction is already pre-let to tenants and further speculative development, at least in 2020, is unlikely, meaning that it is possible that grade A vacancy rates will actually move inwards and create further supply shortages for occupiers.

The outlier is the retail sector where data from PMA shows that town centre vacancy has been trending upwards ever since the GFC and it is likely that the current situation will amplify this trend further.

To conclude, the lower levels of vacancy should mean that pressure on prime rents, with the exception of retail, is not as intense as in the aftermath of the GFC

Vacancy rates by sector on average currently 616bps lower than the year before previous peak



Source Savills, PMA

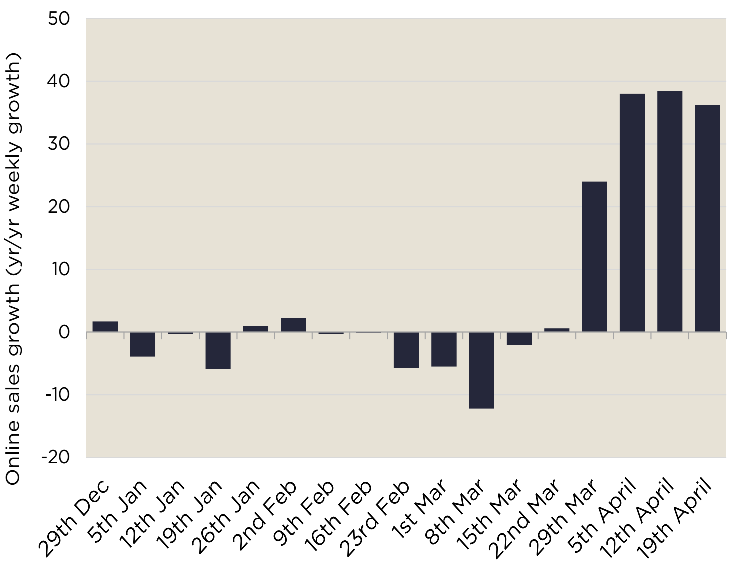
One of the clear winners of the current crisis have been online retailers who have managed to continue trading with socially distant procedures in place.

Online retail trade body IMRG have been tracking weekly sales volumes which show that for the last four weeks sales have been 34% above the corresponding weeks in 2019, growth levels not seen since 2008.

We anticipate that online retailers will come to the market with requirements for more warehouse space. However this may not be for some time as, in the most part, most retailers are still in crisis mode and not yet considering their longer term strategies.

Moreover any increase in demand will have to be offset against the increase in availability that will inevitably come as the crisis pushes more retailers into administration.

Online sales grow at 2008 levels



Source IMRG

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