MARKET IN MINUTES

Savills Research

Market in Minutes

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All change and no change

After what feels like more than a year of talking about the first cut, the MPC voted last week to lower the Bank Rate by 25 bps to 5%. The committee was clearly deeply divided on this, though the MPC's new forecast suggests that further rate cuts are on the cards.

All of our prime yield indicators remained stable in July, though Provincial Offices now has a downward arrow beside it, suggesting that the next move is likely to be one of hardening. This leaves us with five of the 14 sub-sectors with a downward arrow beside them, hardly an overwhelming sign that a turning point for the whole market is imminent (even at the prime end of the spectrum).

This caution aligns closely with the cautious tone of the latest MPC announcement, with the expectation being that further rate cuts will come, but not in consecutive months. The most interesting point in the latest forecast is that the MPC expects inflation to come in below target on both the two and three year horizons, which suggests that the markets are currently underestimating the likely scale of rate cuts.

Given that a Budget date has now been set for October 30th, we expect that prime commercial property yields will remain relatively stable until then. After that, we expect one 25bps cut in the Bank Rate in November, and 100 bps of cuts in 2025. This, combined with rising confidence about the economic fundamentals that drive tenant demand, should feed through into yield hardening from Q4 2024.

Savills prime yields

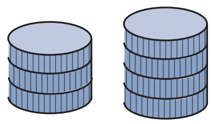
	July 2023	June 2024	July 2024
West End Offices	4.00%	4.00%	4.00%
City Offices	5.00%	5.25%	5.25%
South East Offices	6.75%↑	7.75%↑	7.75%↑
Provincial Offices	6.00%↑	7.00%	7.00%↓
High Street Retail	6.50%↑	6.75%↓	6.75%↓
Shopping centres	8.00%↑	8.25%↓	8.25%↓
Retail Warehouse (open A1)	5.50%↑	5.50%	5.50%
Retail Warehouse (restricted)	6.00%↑	6.00%	6.00%
Foodstores (OMR)	5.00%	5.50%↓	5.50%↓
Ind/ Distribution (OMR)	5.00%↑	5.00%	5.00%
Industrial Multi-lets	4.75%↑	5.00%	5.00%
Leisure Parks	7.25%↑	8.00%	8.00%
London Leased (core) Hotels	4.25%	4.50%↓	4.50%↓
Regional Pubs (RPI)	5.75%	6.50%	6.50%

Source Savills

Key Stats

6.07%

The UK average prime yield stayed stable in July



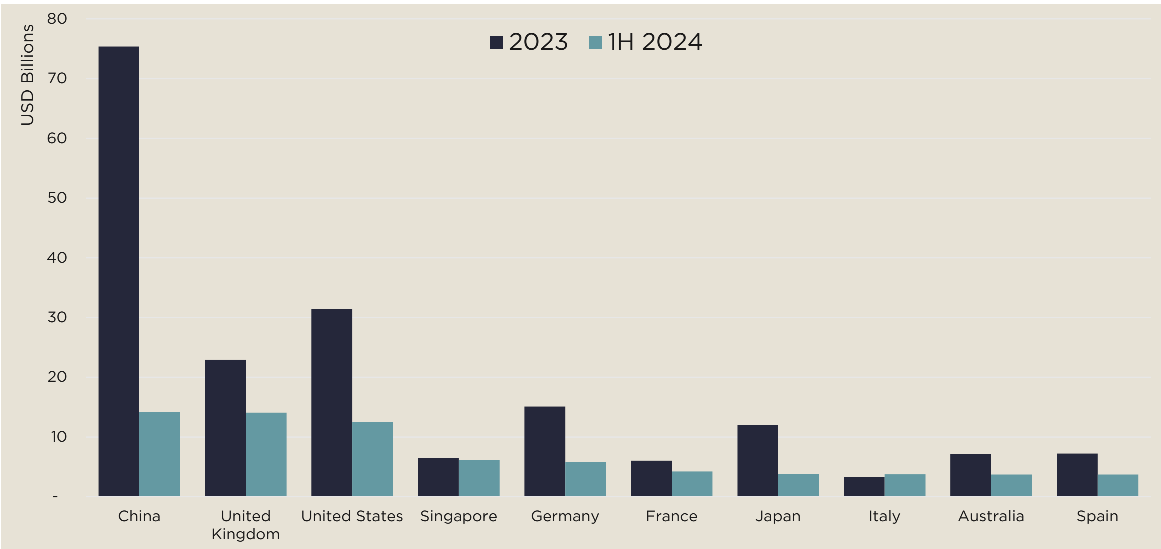
£14bn

The volume of cross-border investment into commercial property in the first six months of 2024

+21%

The rise in office take-up in the major regional UK cities in the first half of 2024

Cross border investment into real-estate: The UK attracted almost as much non-domestic investment as China in the first half of 2024



Source Real Capital Analytics

UK plc - Open for business?

The to-do list for the new government is substantial, but at the heart of it all is the fact that both GDP and productivity growth in the UK have been pretty underwhelming for some time. The Labour Party manifesto was firmly focused on growth, and some of this growth could come from a rise in inward investment into the UK now that we might look more politically stable than we have for a long time.

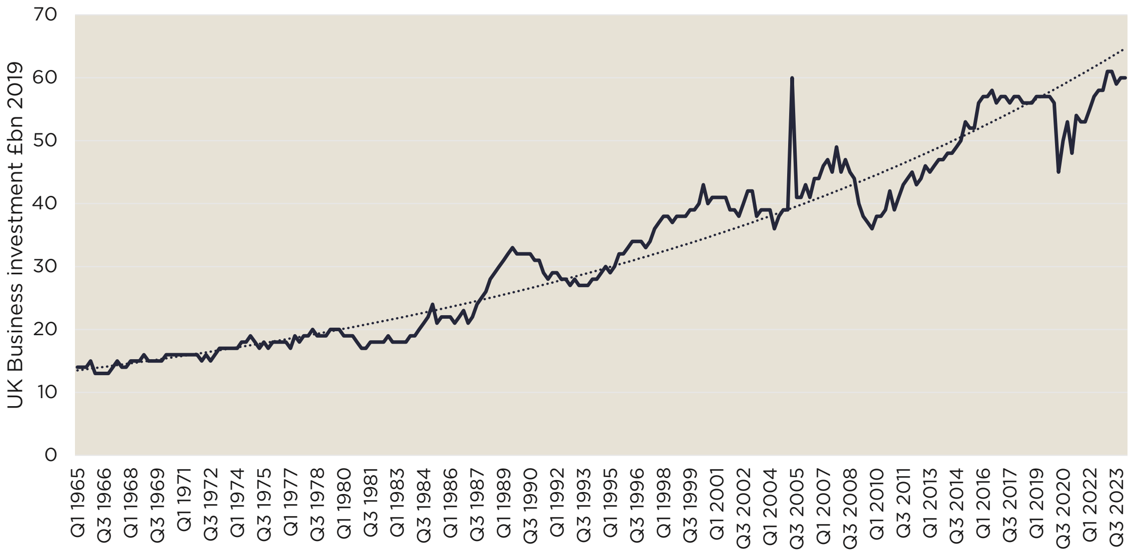
The chart below looks at UK business investment, and suggests that if it had continued its pre-Brexit trend, then it would have been 15% higher than it is today. Interestingly, the same is not true of property investment volumes, which, up to the end of 2022, were exactly in line with trend. However, what did change in 2023 and the first half of 2024 is the composition of the buyers of UK property investments.

In the decade up to the end of 2022, the average was for 53% of the purchases by value to be by non-domestic buyers, but in 2023 and 2024 this fell to 48%. This was, in part, due to the global reduction in interest in property investments as inflation and base rates spiked, but we believe that it was also connected to a reasonable perception globally that the UK was more economically and politically risky than some of its peers.

This leaves the new government with a relatively low bar to reach i.e. to look less chaotic than its predecessors! The return to a focus on creating an environment where growth can take place is a solid strategy, though the risk is that overtaxing the profits from that growth could nip it in the bud.

While reversing the macro trend that has been in place since 2016 will be slow, a recovery in international real-estate investors' perceptions of comparative risk and return will be easier, and more likely to evolve naturally from a return to low inflation, stronger economic growth, and a more centrist government. Thus, we expect to see a return to normal levels of inward investment in property from late 2024. In a European context, UK real-estate now looks cheap, and that alone tends to drive capital flows.

UK business investment has been lower than trend since Brexit



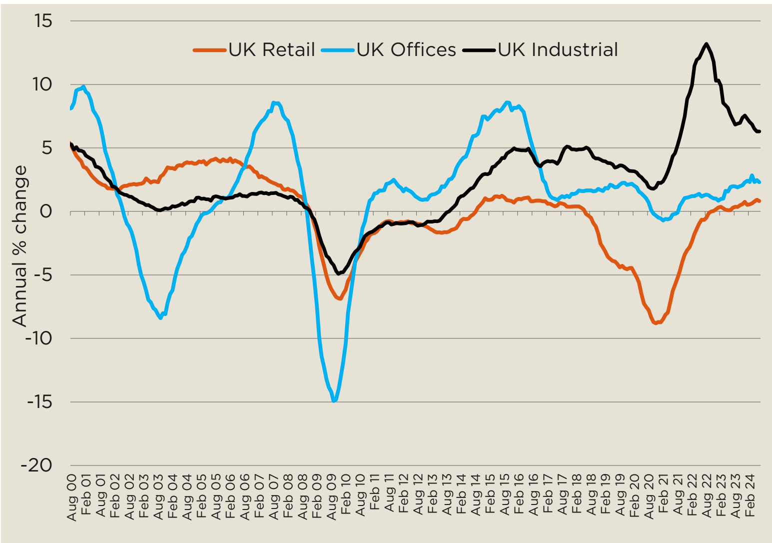
Source Office for National Statistics

Something that has received relatively little comment in recent months is the fact that for the first time since 2017 all of the main MSCI average rental growth indices are showing positive year-on-year rental growth.

Much has been written about the stellar rental growth that has been delivered by industrials, and also about the risks (or otherwise) around office rental growth. However, the biggest change in recent months has been the return of retail rental value growth. Our latest High Street and Shopping Centre Spotlight goes into this in more detail, as well as examines what is happening to net-effective rents, but the short version is that a typical retail rental cycle is still underway, with rents reaching affordability peaks and then crashing, before beginning to rebuild.

Positive average rental growth across the board is another reason why we expect investor confidence to return.

Average rental growth is positive for all sectors



Source MSCI

Savills team

Please contact us for further information

James Gulliford
Joint Head of UK Investment
020 7409 8711
jgulliford@savills.com

Richard Merryweather
Joint Head of UK Investment
020 7409 8838
rmerryweather@savills.com

Mat Oakley
Director
Commercial Research
020 7409 8781
moakley@savills.com