MARKET IN MINUTES

Savills Research

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Yield hardening?

The biggest news on our prime yield table this month is the return of a downward arrow indicating that the near-term trend for Open A1 retail warehousing is for falling yields. This projection is supported by recent evidence in Brighton, Basingstoke and Bath. Yields on this segment have softened by 175bps since their last low point 2015, and there are definitely signs that opportunistic investors are selectively returning to the retail warehousing sector.

These investor's rationale is sound, and not only driven by the prospect of a bargain. We believe that retail warehousing is the most defensive segment of retail against the structural change of omnichannel retailing.

One segment of retail property pricing seeing a pick-up in investor interest is probably not a harbinger of the rest following soon after. Investor confidence in retailer demand and rental growth remains weak, and we expect that this will continue to push even prime retail yields further upward for the remainder of this year.

Overall this month the prime yield story has been more of the same, with the average prime yield softening to 4.81% (its highest level since 2016), and average prime industrial yields remaining below office and retail for the 11th consecutive month.

Savills prime yields

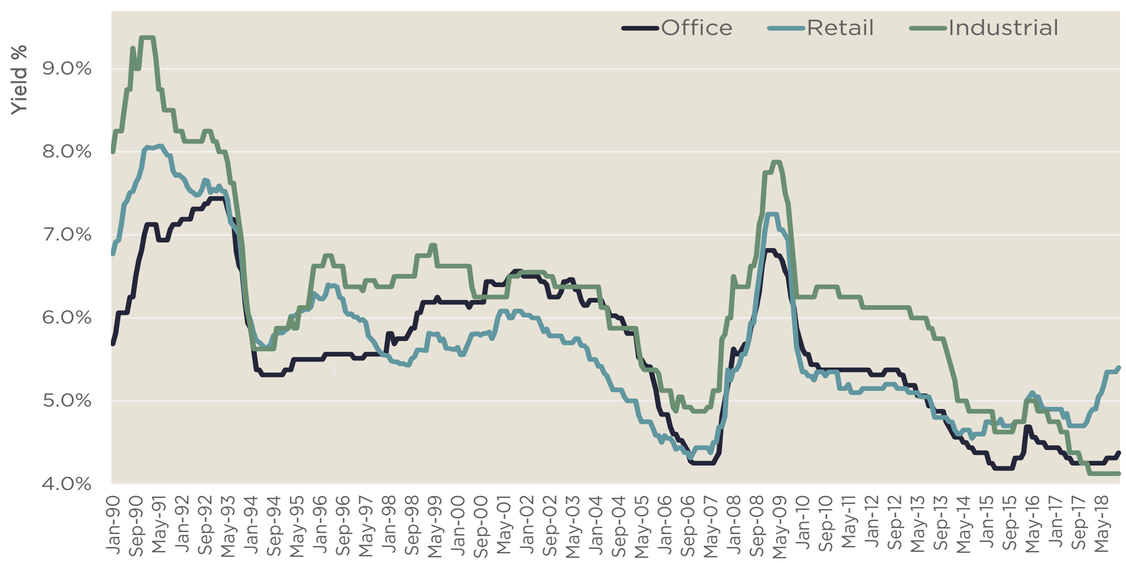
	March 2018	February 2019	March 2019
West End Office	3.25%	3.50%	3.50%
City Offices	4.00%	4.00%	4.25%
Offices M25	5.00%	5.00%	5.00%
Provincial Offices	4.75%	4.75%	4.75%
High Street Retail	4.00%	4.50% ↑	4.75% ↑
Shopping centres	4.75%	5.25% ↑	5.25% ↑
Retail Warehouse (open A1)	5.00%	6.00%	6.00% ↓
Retail Warehouse (restricted)	5.25%	6.25%	6.25%
Foodstores (OMR)	4.50%	4.75%	4.75%
Ind/ Distribution (OMR)	4.25%	4.25%	4.25%
Industrial Multi-lets	4.25%	4.00%	4.00%
Leisure Parks	5.00%	5.50%	5.50%
Regional Hotels	4.50%	4.25%	4.25%

Source Savills

All property average prime yield rises to 4.81%

Retail warehouse yields have risen by 175bps since 2015

Average prime yield on industrial has now been lower than retail and offices for 11 months, the first time this has ever happened



Source Savills

Industrial yields are lower than office and retail for the first time ever

Where are the bargains?

The last nine months has definitely seen the return of the bargain hunter to the UK commercial property market, driven both by the rise in yields and the prospects of further Brexit-related price or currency changes. However, finding real evidence of price falls (or yield rises) in the secondary end of the market has been challenging.

Logically one would expect that if prime yields have risen by a certain amount, then secondary should have risen by more. However, neither the valuation-based indices, nor our own analyses of actual transactional evidence actually show this story. Indeed, as the chart below shows, the spread between the yield quartiles has actually narrowed over the last 15 months, rather than widened.

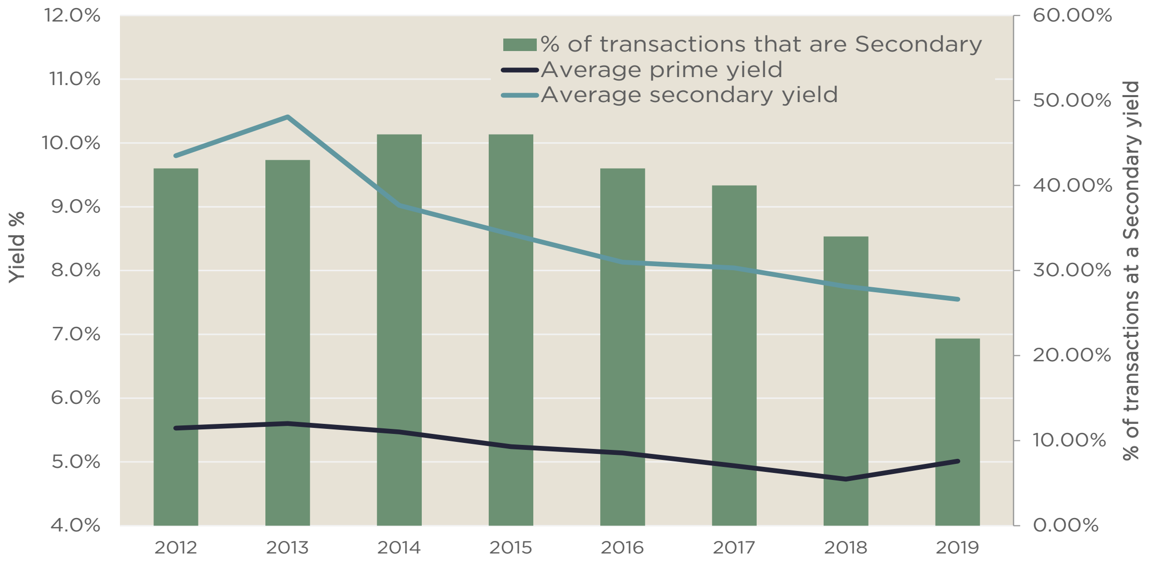
This could indicate a slightly worrying trend where investors who cannot or choose not to pay prime yields are convincing themselves that secondary is "almost as good as prime". This was very much the story in the 18 months running up to the Global Financial Crisis, when the spread between the prime and secondary yield narrowed to a record low level.

However, a more forensic analysis of the number of deals that have taken place in the different yield quartiles shows a more comforting story of investor caution.

The bars in the chart below show what proportion of investment deals achieved a yield above the weighted average yield for that year. This has fallen significantly over the 2018 and 2019, from an average of 43% in 2012 to 2017, to 34% in 2018 and 22% so far this year.

This shows that investors are approaching the secondary end of the market with a healthy degree of scepticism, and it is the comparative lack of transactions at that end of the market that is causing the tightening of the yield spread, not over-exuberance.

The spread between prime and secondary yields appears to have narrowed, but this has more to do with lack of secondary evidence than mis-pricing



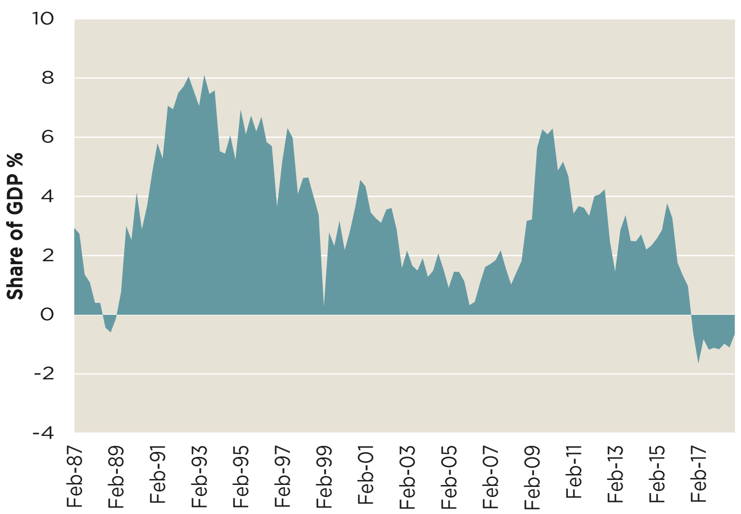
Source Savills. **Note** "Prime" refers to deals achieving top quartile yields, "Secondary" to all others

Consumer confidence is fragile, and the latest national accounts data shows that we have been spending more than we earn for an unprecedented period.

This started when real earnings growth was in negative territory, but has not corrected now that growth is positive. Part of this story can be attributed to structural changes such as the rise of car leasing over ownership, and the overall data is not in itself particularly worrying when borrowing rates are low.

However, it does imply a degree of fragility in household accounts that could rapidly correct in the face of future shocks. For example, a sudden swing towards precautionary saving (similar to that seen in the period soon after the global financial crisis) would have a dramatic negative effect on retail sales growth, and hence wider economic growth.

UK households have been net borrowers for nine consecutive quarters. This has never happened before



Source Thomson Reuters

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