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Spotlight
Central London Retail: Spread of Luxury Intensifies

Q1 2015

SUMMARY

■ Rental growth continued with Zone A rents reporting a 7.2% increase over 2014.

■ Twenty-four international retailers opened their first UK stores in London last year.

■ Areas that have offered greater leasing opportunities have reported more significant uplifts in rents.

■ Dover Street leads with a 57.1% increase in Zone A rents over 2014.

■ Central London's retail landscape becoming more closely aligned with New York, which is made up of a series of luxury 'retail villages' each with their own distinctive character and brand profiles.

■ Investment volumes for 2014 totalled £2.5 billion, its highest ever level.

■ Constrained availability has seen investment activity beyond the prime pitches pick up, with some investors looking for value add opportunities.

■ Overseas investors continue to dominate, however, the UK institutional funds and private investors increased spend volumes last year.

"Lack of stock facing retailers and investors is opening up new pitches and opportunities helping to create a more varied and distinctive luxury retail landscape." Anthony Selwyn, Head of Central London Retail

Prime rental growth slows due to availability constraints

■ Rental growth across Central London continued in 2014 on the back of robust occupier demand and availability constraints.

■ For example, 24 international retailers opened their first UK stores in London last year with a further 15 in the pipeline. This was marginally down on the 29 that opened stores in 2013, however, this was a reflection of lack of supply rather than diminished demand.

■ While Regent Street and Covent Garden lead in terms of total new entrants since 2012, Westfield Stratford was the top destination for new international brands this year. No doubt its greater leasing opportunities helped to push it up the ranking with American Eagle and Inditex's Stradivarius opening their first UK stores in the centre.

■ This demand from new international entrants and existing occupiers, means that Zone A rents reported a 7.2% increase in 2014.

■ This is marginally down on the 9.3% reported for 2013 but is being restrained by availability constraints.

■ For example, the dearth of availability on Bond Street, particularly on prime segments of Old Bond Street, is restricting any market shifts in Zone A rents despite strong occupational demand. As a result prime Zone A rents have grown by only 4.0% over 2014 to £1,300 per sq ft.

■ In contrast those areas that have offered greater leasing opportunities have reported more significant uplifts in rents. These include Dover Street, Conduit Street and James Street (Covent Garden) who have seen Zone A increases of 57.1%, 38.9% and 25.0% respectively in 2014 (see Graph 1).

■ Some of this uplift reflects growth off a relatively low base. However, it has been the influx of luxury brands onto these streets that has been the real driver of rental growth.

The spread of luxury

■ This expansion of luxury retailing has been most prevalent within Mayfair giving rise to its 'luxury quarter'.

■ Availability constraints and demand for Bond Street units has meant luxury brands are having to look beyond Bond Street in order to satisfy requirements.

■ But its not a case of being forced beyond Bond Street. For some the relative 'off pitch' nature of these streets means they are more attractive from a brand perspective.

■ The expanding variety in luxury pitches reflects the changing nature of the luxury retail environment and the desire from brands to differentiate themselves. As a result Central London's retail landscape is becoming more closely aligned with that seen in New York, which is made up of a series of luxury retail 'villages' each with their own distinctive character and brand profiles.

■ It is not just fashion brands that are on the hunt for new pitches. Galleries and high-end restaurants, the traditional residents of these 'off pitch' locations, have been particularly acquisitive within the 'luxury quarter' attracted by the influx of ultra-wealthy second home owners and tourists to the Capital. For example, Caprice Holdings secured the former Natwest Bank site on Berkeley Square which set a new benchmark for restaurant values at £190 per sq ft.

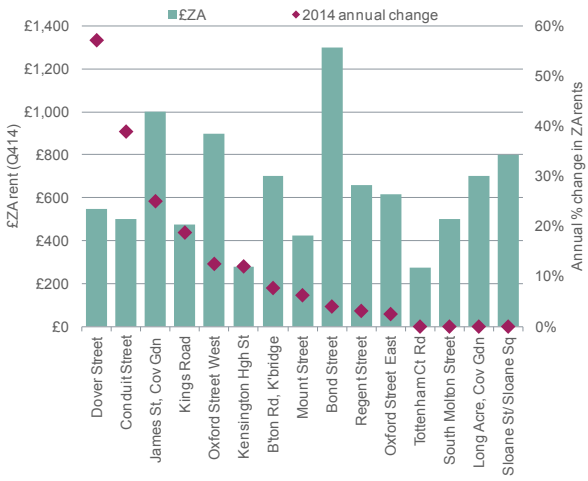
■ Mount Street was one of the first streets in Mayfair to emerge as an alternative luxury destination. Since 2012, the street has attracted five new international entrants, with Céline opening their first UK boutique on the street last year. As availability has become more constrained so to has its rental growth. Zone A rents have increased by an average of 6.7% per annum over the last three years as opposed to 15.6% over the last 10 years.

■ More recently Dover, Albemarle and Conduit streets have all moved up the agenda for luxury brands attracted by their proximity to Bond Street without the Bond Street price tag.

■ The most high profile opening has been that of Victoria Beckham's

GRAPH 1

2014 prime Zone A rental growth



Source: Savills Research

GRAPH 2

New international entrant locations (since 2012)

Source: Savills Research

first store on Dover Street in 2014. Alexander Wang is expected to open on Albemarle Street this year in the former post office site. This influx of luxury fashion brands has seen Zone A rents move from £135 in 2008 to their current £550-600 per sq ft level.

■ This transformation as a luxury brand destination has been facilitated by a change of use at ground floor level.

■ Office and service uses on Dover Street have fallen 60.0% since 2007 and now account for 15.0% of units. Change on Albemarle Street has been relatively slower with a 42.1% decline over the same period.

■ Based on known refurbishment projects in the pipeline and future availability we expect fashion retailers and galleries will account for 43.6% of units on both streets by the end of 2015 up on the current 36.7%.

Emerging pitches outperforming

■ The transformation of these 'emerging' locations is highlighted by their strong rental growth profiles. The map below details prime Zone A rental growth per annum over the last three years for a number of key pitches in Mayfair's 'luxury quarter'.

■ All the 'emerging' pitches, bar Mount Street, have seen prime Zone A rental growth in excess of Bond Street. Dover and Albemarle streets have reported a 30.1% uplift per annum since Q4 2011, almost double the 16.4% reported on New Bond Street.

■ High profile openings on both Dover and Albemarle Street will further enhance their profiles as alternative luxury pitches, attracting further international retailer interest. This, combined with greater conversion opportunities at ground floor level, will place further upward pressure on rents.

Where next?

■ As these 'emerging' luxury destinations become established and availability more limited, retailers, galleries and restaurants will start to look to the next tranche of streets in the 'luxury quarter' for opportunities.

■ These 'future' destinations, some of which are detailed on the map below, are already on the radar for some due to their close proximity to established and emerging pitches.

■ South Audley Street, already well established as a retail location, is set to have its luxury fashion credentials boosted with the opening of the first UK Balmain and Erdem stores on the street this year.

■ Cork Street will see demand from gallery occupiers intensify as competition for units on Dover and Albemarle streets strengthens.

■ Overspill demand is expected to feed through to Maddox and Berkeley streets although rental growth is likely to be fuelled by high end restaurant lettings. For example, Alan Yau and his backers paid a reported £9m premium for the former Automat site, which will also front Berkeley Street.

■ With Westminster Council reluctant to issue licenses on new sites, the competition for existing restaurant units within Mayfair is likely to remain fierce.

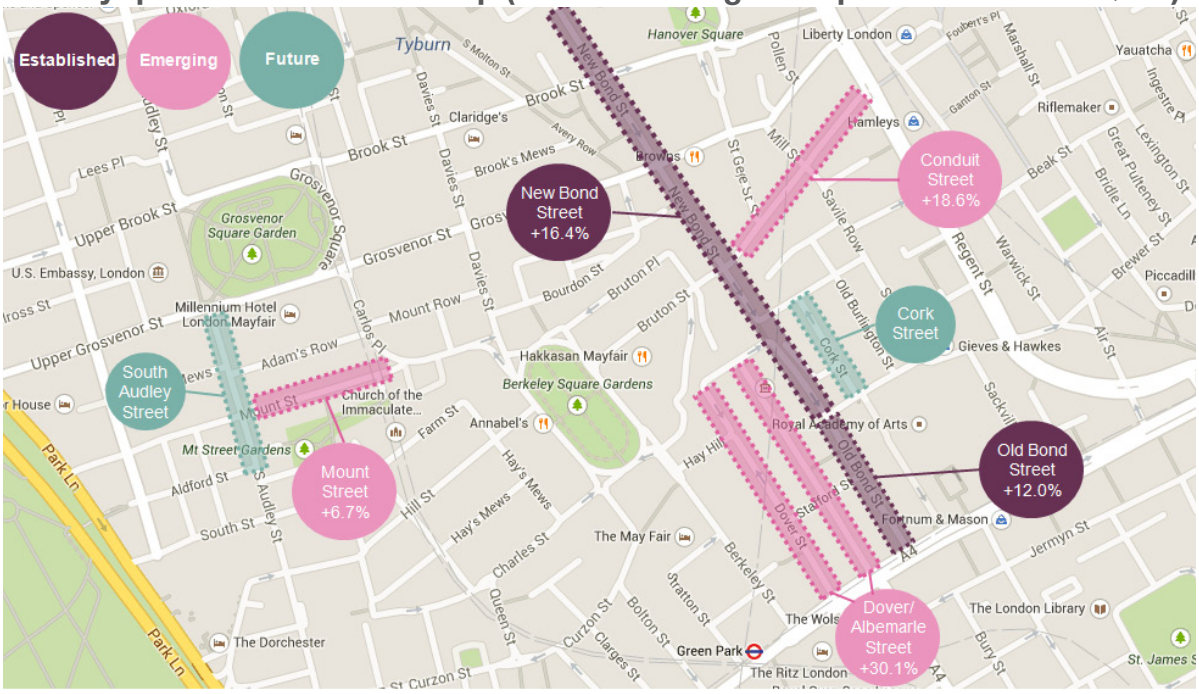
Investors also looking beyond Bond Street

■ Central London retail investment volumes last year totaled £2.5bn, 9% up on 2013. This was its highest ever level.

■ Like the occupational market, the lack of opportunities on the prime pitches of Bond, Oxford and Regent Street, has meant investors have looked within the wider 'luxury quarter' and beyond in order to satisfy demand.

MAP 1

'Luxury quarter' streets rent map (Zone A rental growth per annum since Q411)



Source: Savills Research

■ Activity outside the prime pitches accounted for 75% of total volumes, highlighting strong investor confidence in the wider central London retail market.

■ There was activity on the prime pitches in 2014 with the purchase of 130/137 New Bond Street by Oxford Properties, with Savills acting for the vendor, being the largest at over £300m. Yet, in terms of total volumes activity was down 35.5% primarily due to a significant decline in Oxford Street activity.

■ This decline on the prime pitches was expected following strong activity over the preceding four years as owners capitalised on strong interest. While stock availability may have fallen, demand has not. This continues to place downward pressure on prime yields, although they are currently holding at 2.5% to 3.0%. However, we would expect yields below this level if an exceptional asset came to market.

■ Some argue that current prime yields, being already below their 2007 level, will mitigate investor demand. This shows no sign of materialising considering the scope for rental growth at rent review, particularly in light of London's relative rental affordability compared to other Global retail destinations such as New York, Hong Kong and Paris.

■ The increasing occurrence of transactions with upcoming rent reviews where yields are below the 2.5-3.0% tone demonstrates this. Although for some it will be the trophy nature of the asset and the capital protection play that will be the primary attraction.

■ Overseas investors continue to dominate, although the scale of this has diminished as UK institutional funds and private investors doubled their 2013 spend.

■ European investors continue their robust interest spending close to £700m in 2014 only 2.6% down on 2013. Asia Pacific investment activity has contracted slightly due to a lack of trophy assets despite continued interest.

■ European investors and the UK institutional funds focused activity this year beyond the prime pitches as they look to asset management in order to enhance returns.

■ Some investors are looking to achieve this through estate creation. This approach provides greater control over tenant mix helping to create a more cohesive retail destination, ultimately enhancing overall values.

■ As a result we should see further investment beyond the prime pitches and the emergence of new more cohesive retail destinations across Central London over the next five to 10 years. n

TABLE 1

Key investment transactions 2014

Address	Date	Capital value	Yield (NIY)
181/183 Oxford Street	Nov-14	£35m	2.6%
130/147 New Bond Street (Savills selling agent)	Jul-14	£300m+	2.52%
97 New Bond Street	Jul-14	£18.75m	2.86%*
26 Albemarle Street	Jul-14	£17m	1.5%

Note*: 2.86% equivalent yield on retail element

2015 OUTLOOK

The alternatives to Bond Street to become more established

■ Upward pressure on rents to continue although the rate of growth is expected to slow due to availability constraints on the prime pitches.

■ The 'emerging' luxury pitches will continue to outperform the Central London rental growth average although Bond Street will continue to top the list for the majority of luxury brands.

■ Investment activity outside the prime pitches expected to continue as investors look for value add opportunities.

■ Downward pressure on prime yields to continue. However, we are unlikely to see any significant downward shifts in tone from 2.5-3.0% although we would expect yields below this level if an exceptional opportunity came to the market.

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