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Savills Research
UK Commercial

Spotlight
UK Retail Warehouse Market

June 2012

Image: Brotherhood Shopping Park, Peterborough. One of the few new fashion parks due to open this year.

SUMMARY

■ While the Jubilee and Olympics might provide a brief upward blip to consumer confidence, they are unlikely to positively impact sales in the retail warehouse sector. Lower inflation from early 2013 will provide a more solid base for a real recovery in retail spending.

■ Retailer demand is by no means as weak as some pundits are saying. Active management and expansion, particularly around London and the South are driving vacancy rates downwards.

■ The volume of investment into the sector fell sharply in the first quarter of 2012. However, we believe that is more reflective of an unwillingness to trade rather than a loss of interest in the sector.

■ Our retailer profile in this issue is on CSL Sofas.

"Valuers are under increasing pressure to ease values out, especially on secondary."
Jaime Dunster, Savills Retail Warehouse Investment

Will 2012 be a better year for the shopper?

2011 was undoubtedly a spectacularly bad year for the consumer, with the the double hit of a weak economy and the effects of high inflation on real average earnings.

The recently released national accounts show that 2011 saw the steepest fall in real household incomes since 1977, and it should be no surprise that this led to a sharp fall in comsumer spending. However, recent data has started to indicate that maybe the shopper is feeling more willing to spend, or perhaps less focused on precautionary saving.

The uptick in consumer spending in Q4 2011 was attributed by many as a function of aggressive discounting by retailers, though the official data on the retail price deflator indicated that while discounting was taking place it wasn't actually all that aggressive.

This comparative strength appears to have continued into the first quarter of 2012 with the March data showing the biggest rise in retail sales for more than a year. Clearly there are some temporary factors at work in this data, with fuel sales up 4.5% in March following the flash of panic over the potential of a strike amongst tanker drivers. However, even excluding that data retail sales were up 1.5%.

So is the UK consumer beginning to feel more optimistic about the future? If they are, they certainly aren't telling the pollsters, and the GfK consumer confidence index actually fell in March to -31, and then stayed at that level in April.

There are undoubtedly reasons why consumers should be feeling more positive, with recent improvments in the labout market and more importantly inflation continuing to drift downwards (albeit not as fast as some expected). On the flip side we have the spectre of "double-dip" becoming a reality. The argument as to whether the preliminary estimate of Q1 GDP will be revised upwards or not will continue for some time, and equally its a fairly reasonable point that a fall of 0.2% is barely significant.

However, in the world of retail, consumer confidence is more important than governments statistics, and we believe that the fact that the UK has gone back into recession will be another drag on retail sales, and further delay the recovery in the overall retail sector.

The twin summer events of the Golden Jubilee and the Olympics could provide a boost to consumer confidence, but the experience of the Royal Wedding last year, and trading patterns over previous Olympics doesnt lead us to expect a corresponding bounce in retail spending (though ticket sales will be counted in the Q3 2012 GDP figures and could add 0.1% to that number). Our analysis of consumer spending during the Athens and Sydney Olympic games shows that the only sector of spending that tends to see an uplift is in bars and restaurants, and spending in other areas tends to be down on seasonal norms.

As summer moves into Autumn we do expect to see the inflationary impact of fuel prices continuing to fall, and this will lead to the headline rate of inflation heading steadily downwards towards its 2% target. Earnings growth has been running at between 1.5% and 2% for much of the last two years, and this is unlikely to pick up dramtically in the face of a public sector pay freeze. However, there are indications that private sector wages will continue their very gentle recovery, and thus we continue to expect that the collapse in real earnings will be reversed by the end of 2012.

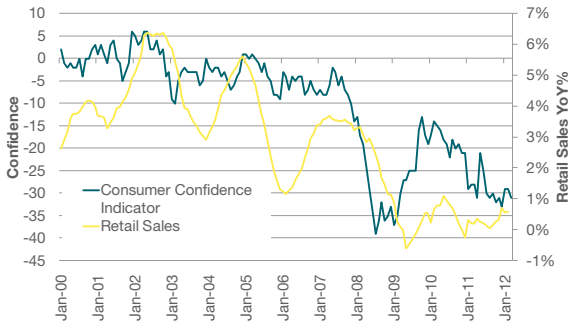
2013 should start with consumers in a more positive frame of mind than they were in in 2012, and the beginnings of a house price recovery will add fuel to this in London and the South East. Interest rates will remain low, and this combined with below target levels of inflation should stimulate a gentle recovery in both real incomes and household spending next year.

Investment market overview

A year ago our investment comment led on the fact that retail warehousing was delivering a better 12 month average return than offices or shopping centres. This was a function of both yield hardening and the fact that it was one of the few UK property segments that was delivering upward rental growth outside London. This picture has changed over the last nine

GRAPH 1

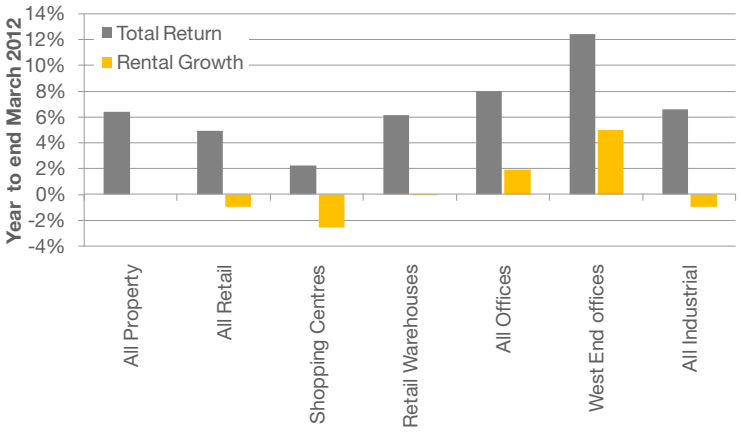
Consumer confidence and retail sales



Source: ONS, GfK

GRAPH 2

Comparative total returns and rental growth



Source: Investment Property Databank

months, with the average annual total return on retail warehousing slowing to 6% and falling back in comparison to All Offices.

However, as Graph 2 shows, the sector is still showing the best rental growth and total return of the three main retail segments. Furthermore, if we strip out central London offices from the "All Offices" index, then retail warehousing is also outperforming the non-central London office market.

According to the latest IPD monthly indices retail warehouse rents in London, the South and the Midlands continue to rise (albeit at a slower rate than last year), and we believe that this a correct reflection of retailer's continuing focus on margins, and the relative undersupply of retail warehouse space in these more defensible catchments.

Recent trends in pricing have been far more stable, with our monthly assessment of prime retail warehouse yields showing no movement for 12 months with Restricted Parks at 5.75% and Open A1 Parks at 5.25%. So why have retail warehouse yields been so stable? The first point to make is that this isn't unique to this asset class, we are seeing very similar stories across the prime end of all the property sectors that we monitor. Perhaps vendors and purchasers pricing expectations are in line with each other, though the likelihood of this type of stasis being sustained for such a long period is fairly small.

The most likely answer to this price stability would seem to be a general lack of activity. While retail warehouse investment volumes recovered strongly in 2010 to nearly £3bn, since then they have fallen back to downturn levels. Indeed, the first quarter 2012 turnover level of £183m was the weakest quarter in the retail warehouse market since 2000.

Are investors losing interest in the sector? This doesnt appear to be the case from the low levels of stock being marketed, what is increasingly clear is that many investors are just unwilling to trade.

Funds' unwillingness to trade is being exacerbated by the development drought, as the traditional flow from developer to investor has ceased in line with the cessation of new development completions.

Where we are seeing some yield movement is on the spread between prime and secondary yields. We estimate that this has widened from 150bps to 175bps over the last 12 months (see Table 1), some reflection of the investor risk-aversion that is prevalent across all UK commercial property sectors. However, this gap is actually much narrower than the 300bps and higher yield spreads we are seeing in the shopping centre and other markets, and this might indicate that there is still an imbalance between vendor and purchaser expectations, and more to the point that secondary/tertiary yields have further to rise.

GRAPH 3

Retail warehouse investment volume

Source: Savills, Property Data

Investment snapshot

Jaime Dunster looks behind the low levels of investment turnover.

The desperately low level of turnover can not be attributed to a lack of interest from buyers but at the door of the lack of desire, or ability, of current owners to sell. The similarity of the ownership within the sector, not enough differentiation of DNA amongst the funds and REITS, has resulted in those with good assets not wanting to sell. This particular attribute is unlikely to change quickly as the institutional and REIT led owners have no great pressures to sell and in most instances are sitting on cash.

The plentiful number of buyers with significant amounts of cash are thus stymied as the risk profile for secondary assets doesn't suit, or possibly not at the current pricing, and the bid/offer spread sought by current owners makes agreement on pricing extremely difficult. Add in covenant concerns, lack of development stock pipeline, a fear that assets will be cheaper in the second half of the year, and the cash available gets extremely cautious unless it is for the unattainable prime open A1 stock.

Valuers are under increasing pressure to ease values out, especially secondary assets, but this always takes time, and is not an easy or welcomed message to deliver to owners. Buyers are appearing in the previous "property company space" prepared to take the risks the funds can't, but the secondary market is not for the faint hearted, especially when yield levels are priced comparatively to the double digits, and teens yields, in the shopping centre arena. The continuing slide of that secondary market will have an impact on ours thereby increasing the diversity of yield between prime and secondary. The weight of cash for prime will act as a good defence to anything other than a mild easing of price.

Despite renewed concerns about Eurozone defaults there is beginning to be a feeling that the domestic picture could get better from here. How quickly and by how much is a moot point, and with retailer requirements low and retailers taking advantage of their over supplied markets, they can be equally choosy. Good landlord deals are being done on good parks. The cash is cautious for good reason, but not afraid to pay the right price for the right asset. However the odds on 2012 arriving at quarter 4 with three record low quarters are pretty short. Greater differentiation amongst owners is difficult to see happening, but other calls on the money, realistic valuations and a reduced bid/offer spread, may loosen the fingers wrapped around the assets.

Retailer profile: CSL Sofas

We begin a series of profiles of new, expansive or evolving retail warehouse retailers with this issue's focus on CSL Sofas. Many thanks to CSL's management including David Hodgson, their property manager, for all their assistance in preparing this feature.

CSL are a family owned business based in Wigan, having originated in Clayton-Le-Moors, Lancashire. They originally sold only their own brand of sofas, but when they ceased to manufacture sofas in 2002 they diversified into products sourced from all over the world. The company is currently led by Jason Tyldesley, who is the second generation of his family to run the business. Their most recently reported figures showed a 14% increase in full year overall sales in 2011.

CSL seek to be different from their competitors in a number of ways, not least by being the only national multiple in this sector that is still privately owned. Their brand is heavily protected, and is arguably slightly higher specification than some of their peers. This is seen in both the internal and external store environment, as well as the product range they sell. One interesting theme is a general embracing of all things technological, perhaps a reflection of Mr Tyldeseley's background in TMT. Not only does CSL have an iphone app, but it also offers shoppers the ability to visualise the sofa on top of an image of their own room, or to "colour my room" and upload a photo of your room to be analysed for complimenting colour matches and styles. This vision even extends to their product line, and we were very taken by the Sound Sofa, a sofa with built-in bluetooth connectivity!

While CSL was originally heavily focused on its birthplace in the North West of England, recent years has seen its stores spread across the country to Lincoln and Hull, and southwards to Croydon and Brent Cross. The opening of Croydon brought their portfolio to 21 stores, and four distribution centres, and the businesses expansion plans are continuing. We understand that CSL are currently under offer on a new store in the North East, and one in the East Midlands, and they expect to open five further stores over the next 12 months. The next store will be in West Thurrock, which opens in August 2012. In particular we would expect to see more store openings in the south of England, as Croydon and Brent are already amongst the group's top five best-performing stores.

So what type of store and location does CSL look for? It should come as no surprise to anyone that rent is a significant factor for CSL when they are considering locations. After all, the lower rents out-of-town are the major reason why most retailers chose retail warehousing over the high street. However, getting the right location is just as important, and while the group does not have rigid demographic criteria, they have a pretty firm understanding of the type of location they trade well from and what they want to do with their sites.

Site visibility is highly important, and this leads them towards standalone sites or prominent units on terraces or parks. Stores are required to have a minimum frontage of 20 metres, and be able to offer 10-15,000 sq ft over a ground and mezzanine.

Our experience shows that CSL tend to spend more on fit-out than other retailers in the sector, both in terms of the internal fit-out and the level of glazing. This is all seen as part of the protection and projection of the brand, and is another reason for their preference for standalone stores. Where they do go onto parks we understand that they prefer to be close to other furniture retailers as they echo the widely held view that furniture is a true comparison product. As far as retailers whom they don't like to be located close to, the answer "food and DIY" came back quickly.

So, what does the future hold for CSL? Their strong customer-focus should continue to serve them well in the remainder of this difficult downturn, as well as into the recovery phase of this economic cycle. We will definitely see more stores being opened across the UK, perhaps leading or mirroring the ripples of a housing market recovery outwards from London?

The furniture market is always highly competitive on price, and the last few years have been particularly tough for all retailers in this sector as housing turnover and household incomes have collapsed. Verdict are forecasting the out-of-town furniture sales will fall again in 2012, before recovering at nearly 5% per annum over the period 2013-2016. These kinds of growth rates will support a good deal of profit-rebuilding and expansion across the sector, and we expect that CSL will capitalise on the recovery well with its focus on price and innovation.

The last word in this piece goes to CSL's managing director Jason Tyldesley. We asked him to sum up in one sentence the group's future property strategy, and he said "In my opinion CSL's aim to be brand of choice in the Specialist Sofa Retail Market means we require units of presence with major prominence and aesthetic appeal. Moving forward we are committed to ensuring our customers instantly recognise a CSL Store with or without signage."

CSL, Croydon

Leasing market overview

Tenant demand remains sparse across alll types of retailer who trade on retail warehouse parks, though a universally downbeat view on leasing prospects would be overly pessimistic. The last three months has seen a number of retailers actively managing their portfolios, and this doesnt just mean downsizing!

The DIY sector had a pretty horrendous first quarter, with bad weather getting in the way of the usual spring rush to tidy gardens, build decks etc. Comments from Homebase and Wickes indicate that Easter was better than the preceding months, and more in line with expected trading for that crucial period for DIY retailers. Homebase continue to do deals and manage their portfolio, while Wickes' announcement that they planned to offload 17 stores is looking like wishful thinking as the actual costs of vacating or dividing these units becomes apparent.

We do expect DIY retailer's fortunes to improve in line with consumer confidence, and this recovery is likely to come sooner in the curve than the recovery in the bulky goods sector. Savills estimate that by 2016 seven million households will have delayed a potential house move, and this not only implies an eventual bulge in transactional activity, but also a pick-up in home maintenance while they are staying put, and in home enhancement prior to selling.

Retailer comments from the electrical goods sector are very mixed. Argos and Currys are sounding more positive, particularly due to the withdrawal of Best Buy from the UK market (the majority of whose units were acquired by Morrisons for Kiddicare). Indeed, the latest LFL sales figures from Dixons for the UK were suprisingly strong at +8% for their most recent 16 week period. One interesting snippet from their latest IMS is the fact that internet sales now represent 18% of Dixons total sales. We would imagine that a significant proportion of this will be click and collect which is becoming increasingly popular with consumers who are shopping with retail warehouse type retailers.

We anticipate a fairly strong Q2 for the electricals sector, as experience from both the Athens and Sydney Olympics points to a pre-games pick-up in electricals sales.

The furniture sector has been broadly stable over the last six months, with CSL trading well (see the retailer feature earlier in this report). DFS are also still acquisitive, as are Oak Furnitureland and Wren Kitchens. The majority of expansion amongst the furniture retailers is focused on London and the South East, in reaction to or anticipation of a pick-up in house prices and hence housing turnover.

The floorcoverings sector remains subdued with Allied withdrawing again, and Carpetright rumoured to having second thoughts about their beds initiative. Again this is a sector that we expect to see a recovery in line with local housing market recoveries as they ripple outwards from London.

Away from the bulky goods retailers the story continues to be more positive, and the discounters/value retailers continue to have significant aspirations for further expansion. The landlords now seem to have got over their initial caution about value brands and covenant strength and some of retailers in this segment are now reporting that their expansion is being slowed down by a logjam of opportunities as they are offered too many new stores and locations. With discounters now typically happy to sign ten year leases they will be a major part of the UK retailing scene long after the current downturn has passed.

There are fairly divergent stories coming out of the sports and fashion sectors. Sport Direct have veered away from retail warehousing and back into town centres where they are being offered very cheap edge of centre units at lower rents than they would be paying on parks in the same catchment. Go Outdoors appear to have hit a bit of a hiatus as they have done all the cheap deals that they can, and are now evaluating whether they can continue their national expansion at higher rents.

The fashion retailers remain broadly expansionary, with Debenhams.

Leasing view

Johnny Rowland, from Savills retail warehouse leasing team looks to the future

It's time for the fringe Out of Town retailers to make their push.

With this weeks Retail Week reporting that M&S are the latest retailer to signal the end to the space race, one may fall into the trap of believing there is no-one out there taking space. Nothing could be further from the truth - it's just you might need to look a little further for the solution to your vacant space issue.

There are still many good retail businesses looking for retail space out of town, as a number of the traditional retail park occupiers have reached saturation. This leaves the door open to fringe occupiers to steal a march on the competition now. With so little town centre development taking place the likes of Debenhams, H&M and Primark have begun putting greater emphasis on out of town opportunities. Where a developer may have had a scheme anchored by M&S, anchor retailers have realised there are good deals to be done where they are in effect kickstarting the scheme.

And it not just the anchor tenants who've realised this opportunity. The Discount operators continue to acquire aggressively, whilst a number of the well run, smaller retail businesses like Jollyes, Maplin, Hobbycraft, AHF (the Co-op's furniture arm) are taking space which normally would have gone to Currys, Carpetright or similar.

This has even spread into the food market where Whole Foods Market are taking new sites ahead of the competition, and even at the other end of the spectrum Lituanica are beating Lidl and Aldi to the discount food space.

We are now in 2012...the fascias in retail are changing, and as agents we need to change with them!

Arcadia, and Hennes still acquiring units. Marks & Spencer appear to be reassessing some deals and locations that looked like obvious new markets for them, and Debenhams have been capitalising on this. Next continue to acquire units out-of-town, predominantly in the 25-35,000 sq ft range for their Home and Garden offer.

Finally, the food sector is still actively expansionist although demand has cooled slightly from the peaks of 2010/11.

Key sites with limited competition, large catchments and dated stores remain highly sought after, but we have noticed that fewer fringe locations are getting the attention or approval they might have done in the past.

If our analysis of the prospects for the consumer economy is right then the trading environment for retail warehouse retailers will start to improve from the second half of this year. Many of the sector's retailers are now in fairly dominant positions in their markets, and the likelihood of new entrants in the short to medium term is minimal. Furthermore, the impending bulge in lease expiries will enable retailers to retain the upper hand in lease negotiations and re-negotiations.

TABLE 1 **Prime retail warehouse yields**

	May 2009	May 2010	May 2011	May 2012
Shopping Park	6.50%	5.00%	5.25%	5.75%
Prime Open A1	6.75%	5.00%	5.25%	5.25%
Prime Restricted	8.50%	6.00%	5.75%	5.75%
Secondary Open A1	8.00%	5.75%	6.00%	6.50%
Secondary Restricted	9.00%	6.50%	6.75%	7.5%

Source: Savills

Savills out-of-town retail team

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