

# Spotlight Retail Myths Exploded

2015



## OVERVIEW

- At the height of the recession a number of potential structural shifts in the way we shop and how retailers would respond to these were identified.
- The overwhelming message was that the physical store would lose out to online and that retailers would need to rationalise portfolios.

- Five years on, and the economy back in recovery, some of these shifts, or rather 'myths', have not taken hold.
- This report explores some of these 'myths' and what has actually taken place. We also explore what these evolving trends mean for UK retail property going forward.

"The rental growth outlook is positive with the smaller affluent centres and core secondary pitches expected to lead."



# MYTH 1

## Online retailing killing off the need for physical stores

There is growing consensus that the rise of online retail is not killing the UK high street. In some cases, it is actually aiding its revival as the boundaries between online and bricks & mortar become increasingly blurred.

Retailers are becoming more aware of the role physical stores can play showcasing product and the brand, even though the transaction may take place online. This is often observed in sales performance data with multi-channel retailers (those with stores) tending to report stronger online sales than their pure play counterparts; 21% year-on-year as of June 2015 as opposed to 13% for the latter. Anecdotally some retailers have found in those markets where they have opened a new store there is a corresponding increase in online sales.

One driver of this has been the growth in click-and-collect. This segment of the online retail market has been the fastest growing accounting for an estimated 18% of total online sales last year, four times what it was in 2010. Some commentators suggest that its expansion will soon outpace home delivery particularly for non-food where it accounts for a smaller share of online. This has coincided with an increase in the number of 'traditional' retailers offering in-store click-and-collect. Forty-four percent of retailers in 2014 offered this service, the previous year it was 32%. For larger retailers with a more extensive store network the participation rate is 57%.

The relationship between online performance and physical stores is starting to attract pure play retailers into physical space.



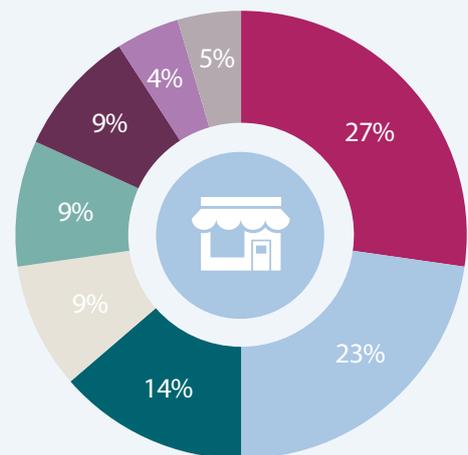
Twenty-two retailers have already made the transition from pure-play to multi-channel either with stand-alone units or concessions such as Screwfix and more recently Misguided with their Selfridges concession.

One of the biggest moves into bricks & mortar has been the announcement that China's biggest online retailer, Alibaba, has taken a 20% stake in the 'physical' retailer Suning. It is envisaged the deal will allow Alibaba customers to experience the product first-hand and collect the item from store but with the whole transaction process taking place on-line.

We expect this trend, known as online-to-offline (O2O), will gather pace meaning that we are likely to see more pure play-play retailers enter the occupational market in some form over the coming years. ■

FIGURE 1 Original pure-play retailers operating with physical stores

- Furniture and Homewares
- Fashion
- Tools
- Electrical
- Childrens
- General merchandise
- Jewellery and watches
- Food and drink



Source: Savills Research

### MULTI-CHANNEL RETAILING IN NUMBERS

**21%**

year-on-year sales growth to June 2015 as opposed to

**13%**

for pure play counterparts



**18%**

of total online sales last year were click-and-collect, four times what it was in 2010



**22**

retailers have made the transition from pure-play to multi-channel





## MYTH 2

### New international entrants are not interested in regional centres

Over the last five years new international entrants to the UK have focused their attention purely on London with 119 international brands opening their first ever store in the Capital between 2011 and August 2015. London's relatively affluent residents and large number of overseas tourists, particularly high spending visitors, were the major attractions for these new entrants. Few of these looked beyond Greater London for new stores. This is slowly starting to change as economic conditions and spending across the UK start to improve.

Last year four international brands opened their first stores outside London including Sandro and Calzedonia; in 2013 it was only two. By the end of this year we expect to see at least another seven international brands open their first regional stores.

The top regional centres for these new openings have been Brighton and Manchester with three apiece since 2011.

These are not huge numbers but it does point to improving confidence in the regional retail markets with many of those who have established their first regional stores now looking to other centres for opportunities.



## MYTH 3

### You just need 50 to 80 stores to be a national retailer

During the height of the recession it was often stated that to be a national player a retailer needed between 50 to 80 stores, as the growth in online suggested reduced store portfolios. For some sections of the market this has been the case. However, for others a store portfolio in excess of this is now increasingly being considered as the optimum in order to deliver adequate returns and to ensure a 'true' national coverage.

This is apparent in the expansion in average store portfolios seen over the last five years, particularly for those retailers operating with over 50 stores.

Figure 2 details the average portfolio change between 2009 and end of 2014 for multiple retailers across a range of portfolio size bandings (excluding those retailers who have permanently left the high street due to administrations). All brand categories, bar those with under 25 stores, have expanded their portfolios. The most significant expansion has been for those retailers with 75+ stores. Of these, the average increase in store count has been 36.

For the Value and Mass retail sectors, who tend to operate with average portfolios in excess of 100 stores, the expansion has been even more pronounced. Each of these sectors reported average portfolio increases of 88 and 49 respectively.

This trend is likely to continue as an increasing number of retailers, particularly those under private equity ownership such as Pure Gym, Evans Cycles, Byron Burger and Poundworld, require further portfolio expansion in order to drive investment returns. For those centres that 'fit the bill' for those expanding retailers this will feed positively into occupational demand and rental growth. ■

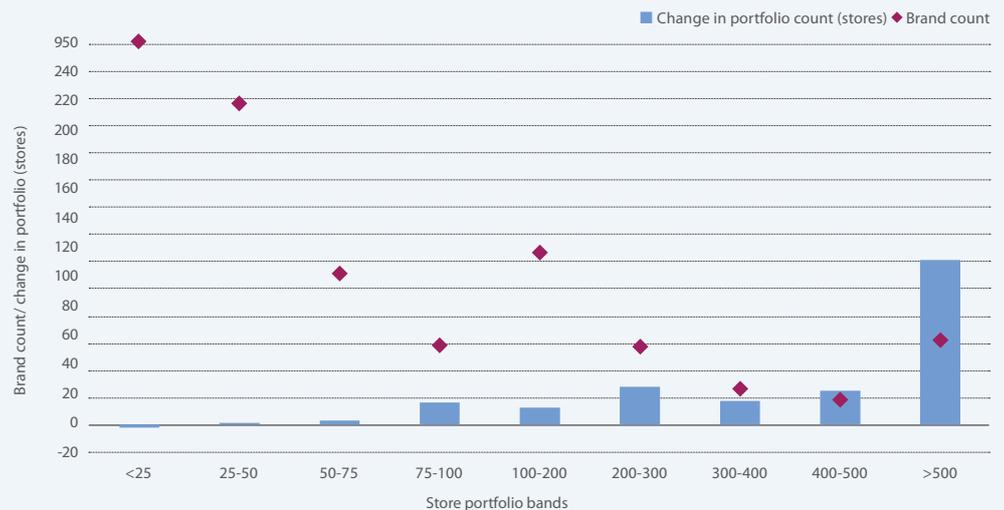
# 36

Average increase in store count for retailers with 75+ stores since 2009



Increasing number of retailers require further portfolio expansion in order to drive investment returns

FIGURE 2 Change in average portfolio count by retailer size



Source: Savills Research

“Top regional centres for new international entrants have been Brighton and Manchester”



## MYTH 4

### Only value retailers are expanding

Value retailing has certainly stolen the limelight since the downturn helped by lower consumer confidence, the associated changes in shopping behaviour and retailers ability to capitalise on the large portfolios that became available due to administrations.

As a result value retailers have altered the UK retail landscape rapidly and comprehensively with almost a quarter of them now having portfolios greater than 100 stores.

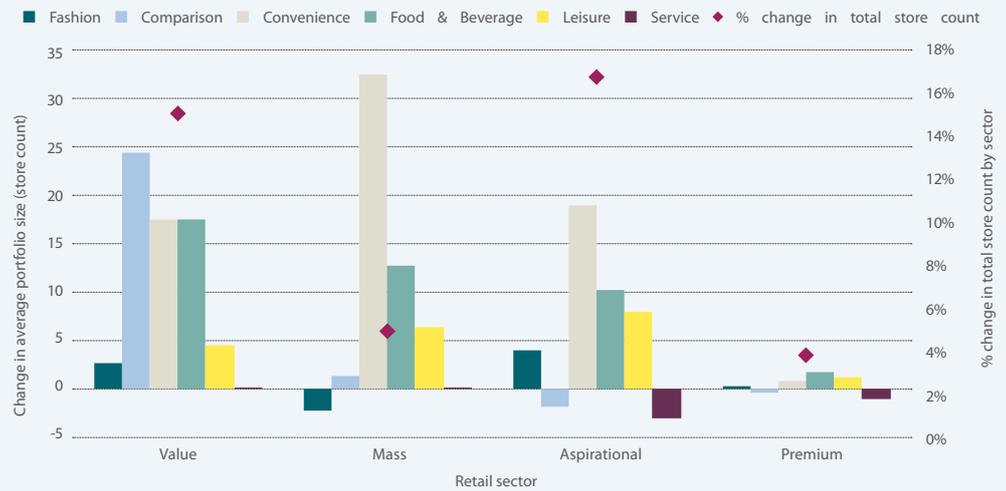
Value, however, has not been the only part of the retail market that has expanded. Figure 3 details the change in average portfolio size across the various retail sectors and product classifications since 2009.

Mass convenience retailing, including names such as Greggs and Holland & Barrett, has seen the largest increase in average portfolio count, increasing by 33 to 315 stores. On a broad sector basis, however, Value retailing stands out with robust expansion across all subsectors with total store expansion of 15.1%.

This increase in total store count, however, has been outpaced by the 16.8% growth reported for the Aspirational retail sector albeit from smaller average portfolios.

Fashion brands within the Aspirational sector have been expansive with a 574 increase in total store count since 2009, although average portfolios have only increased by four over the same period. Even within the Aspirational Comparison goods subsector, which on the whole has shrunk since the downturn, there have been a number of specialists that have performed very well and in turn grown their portfolios accordingly; Cath Kidston, Hotel Chocolat and Lakeland have all grown their store network

FIGURE 3 Change in portfolio and total store count by sector and product

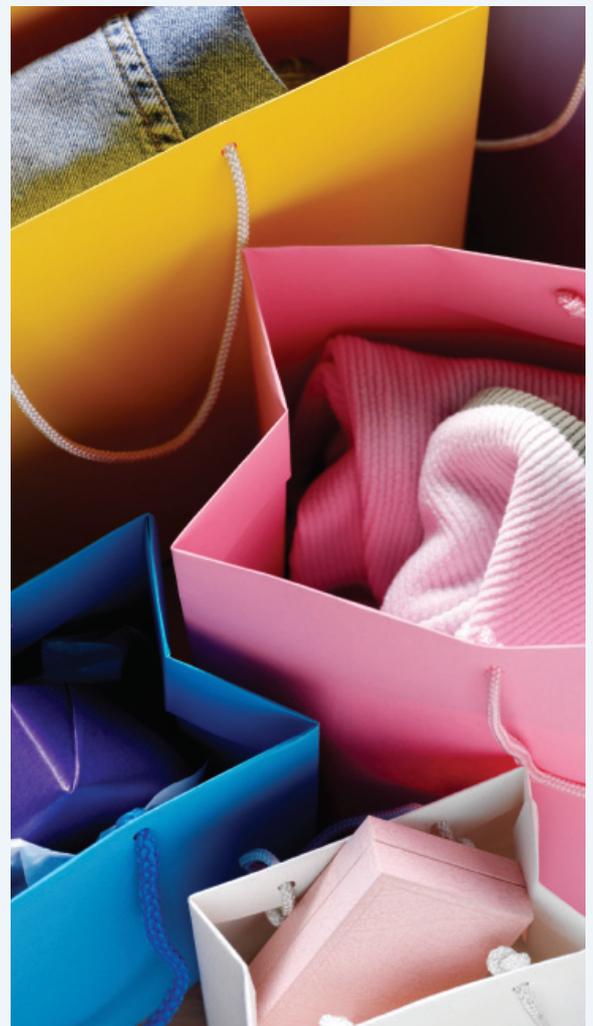


Source: Savills Research

by at least 50% since 2009. In light of improving economic conditions we expect the Aspirational retail sector will continue to see growth. We are already aware of a number of retailers within this segment, such as White Stuff, Hotter Shoes, Carluccio's and Côte who aspire to have store portfolios in excess of 100. There are many more, given the opportunity, who would also like to expand in order to better penetrate the UK market. ■

**16.8%**  
Increase in total store count for the Aspirational retail sector

“In light of improving economic conditions we expect the Aspirational retail sector will continue to expand”



# Summary

## WHAT DOES THIS MEAN FOR UK RETAIL PROPERTY?

The retail myths being espoused during the height of the recession reflected a particular point in time, promoted primarily by wider macro-economic conditions. The return of economic growth, with the associated improvements in consumer confidence however, does not mean we expect the UK high street to return to what it was pre-recession. Things have changed, namely in the way consumers shop and with it how retailers look at their store portfolios. While some centres will bounce back, others may never truly recover.

On the whole, however, rental growth has returned. Seven of the 11 UK regions, covered by MSCI, reported positive annual growth in Q215 with a slowing in rental decline across the remaining regions.

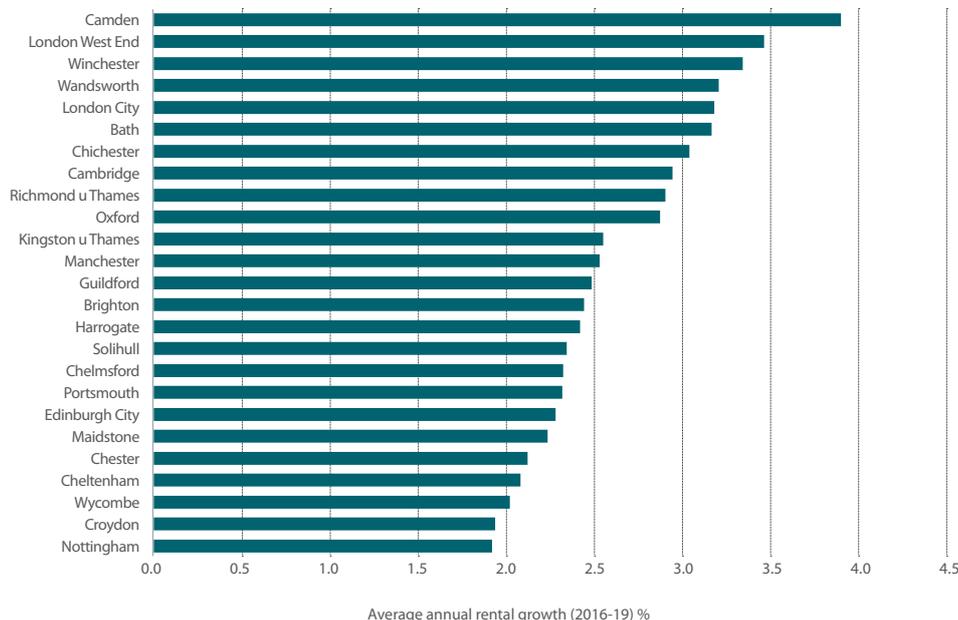
For 2016 we expect all UK regions will report positive rental growth, with average annual growth of 2.3% per annum through to the end of 2019 nationally.

Yet, on a centre basis, it will be a relatively mixed bag. Central London is expected to top rental growth projections over the next four years (see Figure 4). The other major regional centres do not feature particularly highly with Manchester forecast to be the top performing major city ranking 12th across the 92 centres we track with 2.5% per annum.

Rather it is the smaller affluent centres that are expected to report the greatest uplift in rents including some London suburbs. Outside of Greater London the top performers are forecast to be Winchester, Bath and Chichester with 3.4%, 3.2% and 3.1% per annum respectively.



FIGURE 4  
Top 25 retail centres by rental growth projections (average annual growth 2016-19)



Source: RealFor

REGIONAL GROWTH

**7 of 11**  
UK regions, covered by MSCI, reported positive annual growth in Q215

Top rental growth performers outside London to 2019

**3.4%**  
Winchester

**3.2%**  
Bath

**3.1%**  
Chichester

Yet, the core secondary pitches, particularly in the key regional cities, may see rental growth in excess of this. Prime Zone A rents across the major UK cities have reported average annual increases of 7.3% per annum over the last two years. However, as availability constraints on these prime pitches intensify we expect some overflow demand to core secondary pitches and in turn rental growth.

On the lead up to the recession rental growth on core secondary pitches in the major cities outperformed the prime pitch by an average of 160 basis points per annum. We may see a similar pattern emerge over the next 18 months due to its more affordable rental profile and slower recovery seen to date.

With occupational demand and in turn rental growth finally making a come back, the question is what will support this going forward? Improving consumer confidence and in turn retail spend will be key. However, the slowdown in the Chinese economy and its potential impact on the UK economy may temper this.

The continued growth in online retail and the rising importance of physical stores in supporting this will also be a potential driver. As a result we could see more pure-play retailers enter physical stores. Others may explore a network of smaller stores that act as 'shop windows' that allow consumers to test product and pick up orders. A format Argos is currently trialling.

For some locations it may mean store size requirements may increase. Click-and-collect could see retailers accommodating an ever growing volume of stock in-store. However, this is likely to be confined to those key retail centres that are more likely to act as click-and-collect hubs.

Value retailing will continue to be the powerhouse of occupier expansion. The recession has had a long lasting impact on UK shopping habits, which has meant consumers remain enamoured with Value. As a result Value retailers are pursuing significant portfolio expansion.

For example, Poundland and Lidl are planning on doubling their UK portfolios. It will be this sector that will offer the best lifeline to those high streets that are yet to see any recovery.

Aspirational retailing will provide an added boost to occupational demand in key regional centres and market towns. Continued economic growth will encourage brands to expand store portfolios, particularly those international entrants who are looking beyond London and the South East for opportunities. However, unlike what we saw prior to the advent of online retailing, this expansion will be more considered and restrained. ■

**2.3%**  
Average annual rental  
growth forecast to  
end of 2019

“The role of the physical store in supporting online sales growth is rising”

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