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UK Shopping Centre and High Street Spotlight

Quarter 1 2017

Image: Vancouver Quarter, King's Lynn

SUMMARY

■ While the current level of retail sales growth remains robust, we question whether shoppers can continue to spend at this level by dipping into their savings or taking on more unsecured debt.

■ In the occupational market there are signs that retailers are becoming increasingly cautious about expansion. Retailer's margins are likely to remain under rising pressure over the next quarter as import inflation rises.

■ We are moderately optimistic about the remainder of the year for the shopping centre investment market. While the volume of transactions in Q1 was lower than average, there is a lot of stock being prepared for sale. Rising yields away from the primest end of the market may well attract some more opportunistic buyers into this sector.

■ The investor base in the high street shop market has definitely broadened. Private investor demand for the best of the best remains strong, and we definitely expect to see more institutional competition at this end of the market in the remainder of 2017.

"2017 is expected to be a challenging year for retailer's margins. Import and operational costs are all experiencing upward pressures."

The consumer economy

Consumer confidence has remained broadly stable over the last three months, with the GfK survey pointing to British shoppers being marginally less pessimistic about their personal financial situation than normal. However, their responses about the wider economic situation have become more negative, and this is often a leading indicator of a potential change in the overall measure of consumer confidence.

February's retail sales data showed a strong rebound in year-on-year growth (3.7% yoy) following January's very weak data, and we expect this to be sustained in March's figures. However, the forward picture will see increasing inflationary headwinds as this year progresses. While some surveys are pointing to the fact that the inflationary impact of sterling's devaluation may already have peaked, other factors such as rising utility bills are expected to push CPI close to 3% over the summer.

With wage growth not likely to keep in step with inflation, the key question for UK retailing is how shoppers will continue to fund spending. Household savings ratios are now at their lowest ever level, indicating that saving less is one way that shoppers are funding purchases.

Furthermore, the Financial Policy Committee (FPC) has recently started to make worried noises about the level of unsecured borrowing that is going on. This is being driven by a combination of longer interest-free periods on offer on credit cards, and lower interest rates on loans. The FPC's concern is that underwriting of this credit is weak, and any action by them or the PRA to correct this could negatively impact on consumer spending growth.

All this having been said, we still expect household spending to grow by around 4% this year, with the slowdown in the rate of growth more likely to be in 2018 and 2019.

The retail occupational market

As we alluded to in the last Spotlight, 2017 is expected to be a challenging year for retailer's margins. Import and operational costs are all experiencing upward pressures and this has already resulted in some casualties. The latest date from the Centre for Retail Research shows that 12 retailers have gone into administration in the first quarter of 2017, affecting 771 stores across the UK. This is a sharp uptick on last year, when 30 retailers went into administration in the whole year.

Cost pressures are also affecting retailers who remain in an expansionary frame of mind, and we have definitely noticed that transactions are taking longer this year. We are also seeing a downgrading of the number of planned store openings from plans that were announced last year.

This caution is most evident in markets outside London and the South East where we had expected that the impending falls in business rates might have resulted in an uptick in the number of store openings. However, this has not been the case so far this year, with a general air of retailer caution around store openings. That having been said, we do expect to see a net increase in store openings this year, albeit against a background of more forensic analysis of locations.

Strong trading locations will continue to do well, and there is still a steady flow of new entrants into these markets. Recent significant announcements include the first stores for October's Very Own and L'Oréal's NYX, as well as new out-of-town concepts from Superdry and Smiggle.

In a world of rising costs and tightening margins, one of the few pieces of good news for retailers is that shop rents are unlikely to experience much upward pressure in the foreseeable future. Indeed, our latest forecast for average annual retail rental growth is less than 0.5% pa over the next three years, with continued falling rents in secondary locations outside Greater London.

Shopping centre investment

The UK shopping centre investment market began 2017 in sluggish fashion, but momentum gathered throughout the first three months of the year ahead of what we expect will be a much busier second quarter.

In spite of robust macroeconomic performance in the UK economy and better than expected Christmas trading by many retailers, the glass is seen as half empty for the sector. The Brexit outcome, re-emergence of the prospect of Scottish devolution, or 'the neverendum,' and perceived retailer failure concerns, all dragged on the UK shopping centre investment market in the early part of 2017.

The Government's failure to tackle business rates in the 2017 revaluation also represented a spectacular missed opportunity to drive optimism in the sector. These factors led to some investors waiting for a clearer outlook on the future of the UK economy and wider retail sector, with hesitancy reflected in below average transaction volumes at the start of the year. The announcement that the UK will have a General Election on the 8 June is likely to enhance this hesitancy in the short term.

In total, shopping centre transactions in Q1 2017 equated to £358 million in seven deals. This reflects a 56% decrease compared to £810 million in 12 transactions in Q1 2016 and a 58% decrease on £845 million in 14 transactions in Q1 2015.

The wait-and-see approach was prevalent among vendors and purchasers alike, and led to an almost complete dearth of new stock during the first months of Q1.

TABLE 1

Shopping centre yields

	Q4 2016	Q1 2017
Super-Prime	4.50%	4.50%↓
Prime	5.50%	5.50%
Town Centre Dominant	6.50%	6.75%↑
Secondary	9.00%	9.25%↑
Tertiary	12.00%	12.00%↑

Source: Savills Research. ↑ indicates forward trend

Notable completed deals in the quarter included the sale of Stratford Shopping Centre in East London to Frogmore by Blackstone/Catalyst for £141.5 million, reflecting 4.94% net initial yield, and the acquisition of The Exchange in Ilford by Capital & Regional from vendors Meyer Bergman for £78 million, reflecting 6.70% net initial yield. Savills advised on both transactions, acting for the vendor in Stratford and on behalf of Capital & Regional during their acquisition of The Exchange, Ilford.

Despite Q1 transaction levels being down, there is a sense that momentum is building as we move forward into Q2, driven in part by a narrowing of the previous gulf that emerged between market pricing and vendor expectations seen during 2015 and much of 2016. Competitive bidding processes for Morgan Arcade in Cardiff, and the re-launched King's Walk Shopping Centre in Gloucester also demonstrated a depth of buyers for two very different assets.

Whilst total completed transactions in Q1 were lower than recent years, 13 centres are currently under offer, accounting for an investment volume of circa £770 million, which once complete will provide an improved start to the year, especially following Delancey's sale in early April (therefore excluded from Q1 statistics) of its 50% stake in Southside Shopping Centre, Wandsworth to Invesco for in the region of £148 million.

We also foresee that there is significant stock being prepared for the market and owners are assessing their options and strategy, including refinancing. They want to see how those assets that are currently in the market go before they make their decision on launching sales.

We estimate that there is still circa £1.4 billion in the market, including large lot sizes such as the 50% stake in intu Chapelfield.

Given the extensive pipeline, after a slow start, our view on the year ahead is one of moderated optimism, and we expect total volumes for the year to reach £2.5 billion – £3 billion, so not far off the £3 billion traded in 2016. There are also far more deals going on quietly rather than openly. This volume prediction is dependent on the weight of money raised for new core and core plus requirements actually coming into the market. At the moment it is currently the 'Scarlet Pimpernel' money. The emergence of local authorities as shopping centre purchasers in 2016, blending a need for sustainable income streams and opportunities to drive retail-led regeneration in their constituencies, has continued into 2017 following an active year in 2016 where local authorities, and their investment vehicles, accounted for 44% of shopping centre deals below £100 million.

High street investment

The volume of high street shop investment sales outside London was 28% lower in Q1 2017 than in the same period last year, and 46% down on the long-term quarterly average (Graph 4). This begs the question of whether investors have fallen out of love with the sector, or whether a lack of supply of the most in-demand types of asset is limiting the level of transactional activity?

Our reading of the market so far this year is that the latter explanation is the more credible of the two. There has definitely been a reduction in the number of prime units that are being actively marketed, and this has coincided with a rise in off-market approaches from potential buyers.

The primary reason that we are hearing for the lack of stock being marketed is that the round-trip costs of selling and buying are becoming increasingly unattractive. However, the weakening occupational story that we have alluded to earlier in this Spotlight must also be a contributing factor.

Another reason why volumes have fallen is the small size of the transactions that have taken place so far this year, with the average lot size being only £4 million. While this is up on the last quarter of 2016, it does not point to the pick-up in institutional activity that we suggested might be about to happen in our last Spotlight. Indeed, only 18% of the acquisitions by value this year have been by UK institutions (12% by number). Continuing the trend of last year, private investors have accounted for 37% of the deals by number, and 50% by value.

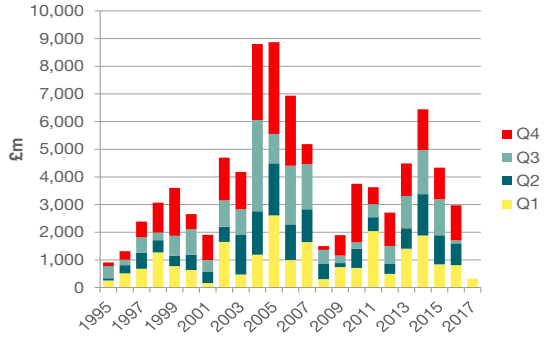
UK institutions are definitely poised to become more active in the high street retail sector, but their aspirations have also been curtailed by the lack of larger assets in prime locations that have been marketed. Where such assets have been available, for example the recent sale of a £17.9 million retail block on George Street in Richmond, institutional interest has been strong and bids have been competitive.

We remain of the view that yields on prime assets, particularly in Greater London and the Home Counties, are experiencing downward pressure. However, the story is the exact opposite at the other end of the market. Where the occupational story is less persuasive, or longer term voids are present, yields have probably softened by 50bps over the last six months, and we expect this trend to continue over the remainder of 2017.

While the easiest strategy for those investors who hold prime assets might be just to hold them to avoid the hassle of round-trip costs, the increasing depth of investor demand for small and medium-sized prime assets might well stimulate a few more sales in the rest of 2017 as owners decide to take profits.

GRAPH 1

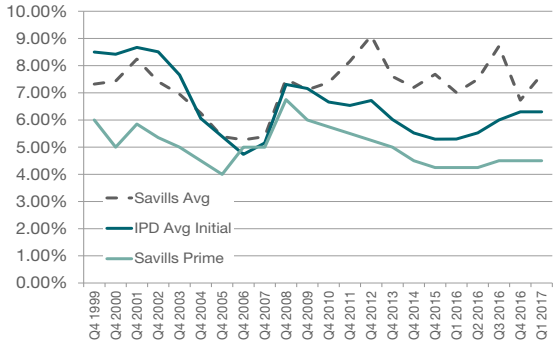
Shopping centre investment volume



Source: Savills Research

GRAPH 2

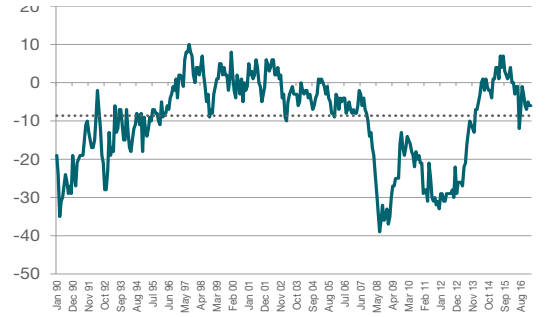
Shopping centre yields



Source: Savills Research, Investment Property Databank

GRAPH 3

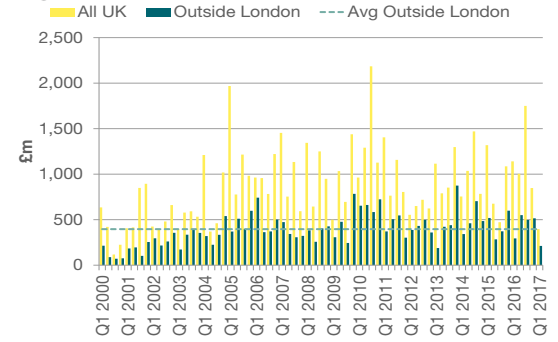
Consumer confidence



Source: Gfk

GRAPH 4

High street investment volume



Source: Savills Research, PropertyData

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