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Savills World Research
UK Retail
21st July 2016

THE IMPACT ON THE UK RETAIL MARKET
Brexit Briefing

BREXIT BRIEFING

CONFIDENCE IS EVERYTHING

SUMMARY

Retailer activity largely unaffected to date.

■ The impact of the Brexit vote on the retail market is yet to be felt. The coming months will provide greater insight into how the British consumer has, and is, reacting and what this means for the occupational markets.

■ Consumer research suggests confidence has dipped, but its decline post the Brexit vote could be a 'knee-jerk' reaction rather than reflecting a longer term retrenchment of confidence.

■ It is too early to identify any clear trends in occupational demand but to date there has at least been no negative reaction albeit some smaller retailers are adopting a certain degree of caution.

■ There is considerable speculation in the investment market and impact on pricing. How this plays out will be subject to how the Brexit vote impacts on consumer spending and in turn occupational demand.

"The real test will be to see how consumer confidence and spend performs over the next few months and ultimately over the all important Christmas trading period."

Marie Hickey, Savills Research

The impact of Brexit on all of the UK's property markets will be very dependent on the macro-economic background, and this in turn is partly dependent on how the UK consumer responds to the news and the evolution of the story over the next two to three years.

This paper is our first analysis of how this new world might affect the UK retail market. It, and its sister papers on other UK and European asset classes, will be updated on a regular basis over the following months as hard data, anecdotal news and our forecasts evolve.

Macro-economic backdrop

Nearly one month on from the EU Referendum result and we are still some way from having a clear insight to how UK consumers have reacted to the result.

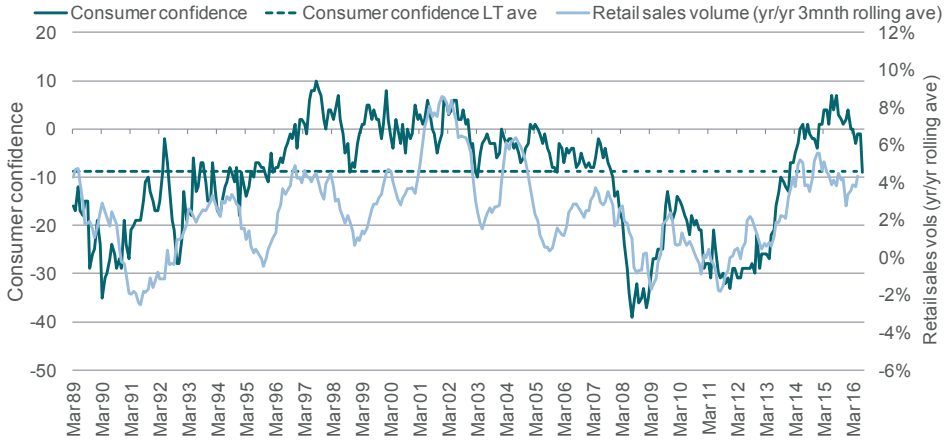
One viewpoint is that given the majority of the UK electorate voted for the result it should be less of a 'shock' than that of the external impact of the Global Financial Crisis (GFC). However, a special 'post Brexit' consumer survey by GfK carried out six to 10 days after the result found that UK consumer confidence reported its largest single drop in almost 22 years to -9. While this is significant, it is important to put this into the context of its longer term average of -8.7 and that this still places confidence well above where it was during the 2008 GFC (Figure 1).

The real question is whether this fall in confidence is a 'knee jerk' reaction to political events or reflects the start of a longer term retrenchment of confidence and in turn retail spend. Similar sharp drops in confidence were seen following the 9/11 attacks in 2001 and the start of the Iraq War in 2003. However, these resulted in a slowdown in retail sales growth rather than a decline.

Indicative national footfall data for the week commencing 11th July (three weeks post the Brexit vote) pointed to a marginal decline of -0.9% on an annual basis. While week-on-week also reported a marginal 0.6% fall this was on the back of a 2.4% increase the previous week. This is supported, in some cases, by retailers weekly sales performance data. For example, John Lewis, the barometer of middle

FIGURE 1

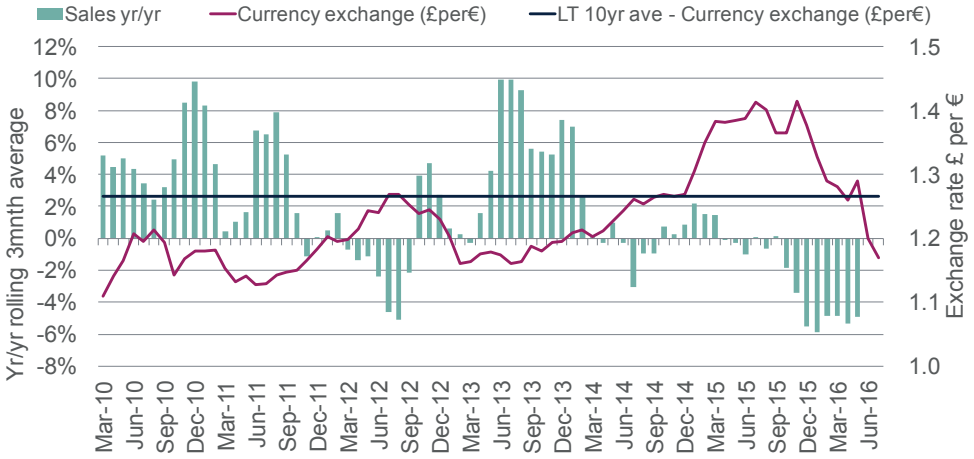
Consumer confidence, down but still in line with the long term average



Source: GfK; ONS

FIGURE 2

Currency flucuations to boost Central London retail sales



Source: New West End Company; Oanda

England spending, reported that sales for the week ending 9th July were up 3.1% on the same week in 2015 across the partnership. While this data may be positively skewed by the summer sales and improving weather, it does provide some reassurance.

In Central London, the outlook is perhaps more positive from a retail spend perspective. International visitors to London are key consumers, accounting for almost 60% of shoppers in some parts of the West End. As a result retailer performance is closely linked to currency flucuations with periods where Sterling (£) has weakened typically corresponding with strong growth in retail sales (see Figure 2). The weakening in the Pound post the Brexit vote suggests we could see a corresponding boost in retail sales in Central London, and primarily within the West End, over the coming months.

Going forward, the real test to consumer confidence and retail spend will be perceptions of a possible recession. Consumer consumption accounts for approximately 60% of the UK economy, a tightening of consumption and a corresponding jump in the UK savings rate, could in fact nudge the economy into negative growth territory. The recent appointment of Theresa May as Prime Minister should help mitigate recent political uncertainty, potentially mitigating recessionary concerns over the short term. However, this will be dependent on future news flow surrounding employment and the outcome of negotiations with the EU.

Over the coming weeks we will be closely tracking retail sales, household finances and footfall in order to garner a better insight into how consumers and retailers are faring post the Brexit vote. But, it will be Christmas trading performance that will provide the greatest insight to the confidence of the British shopper and with it the resilience of the UK's retail market.

Occupational markets

As with the consumer market it is too early to identify any clear trends in occupational demand. As yet, demand, on the whole, has not reacted to the referendum result. Rather retailers are adopting a 'wait and see' approach before revisiting expansion strategies. This is reflected by the fact that leasing deals have continued to be signed post the Referendum. Ellandi reported 19 deals across its portfolio with lettings agreed to Pandora and H&M, with Hammerson announcing the signing of seven lettings post the Brexit vote. Savills alone have agreed over 50 deals since the result, including lettings to Pret a Manger, White Stuff and Yours Clothing.

At a national level we expect no significant change in letting activity over the remainder of this year. As has been the case over the last 12 to 18 months, this will remain focused on key regional centres and destination shopping centres, albeit we expect a certain degree of caution from some smaller retail brands.

Below we set out how different parts of the UK retail market may react if weaker domestic consumer confidence was to become entrenched:

- Central London: over the short term demand from international brands opening their first ever store to remain robust, helped in part by improving international visitor numbers and spend due to the weak Pound. Demand to be focused on core established pitches.

- Value retailing: value retailer demand likely to be the most robust if consumer confidence and spend was to weaken. Demand will remain focused on prime opportunities in key markets. We may see some retailers capitalise on potential future uncertainty to secure new sites.

- Premium & Mass retailing: resilience in the sector is likely to be mixed and dependent on brand strength in the face of potential weakening in consumer confidence and spend. Spending by 'baby boomer' generation likely to be the more resilient over the short to medium term in the face of potential recessionary concerns, suggesting demand from those brands more popular with this segment should be the more resilient. Occupational demand to remain focused on key regional centres, destination shopping centres and affluent market towns where the underlying operational fundamentals are the most robust.

- Food & Beverage (F&B): household expenditure on 'eating out' bounced back quickly post the GFC and has continued to increase. As a result we expect occupational demand from operators will remain robust. This is supported by the fact that occupational demand is largely coming from food operators aimed at the value and mid priced categories, those which may be more resilient to tightening spend. Considering a number of F&B brands/ operators are still in the early stages of expanding into regional markets may mean expansion efforts will be focused on those areas where competition is relatively constrained but where the underlying operational drivers remain robust.

Structurally you could argue the UK retail landscape is in better shape than it was ten years ago to weather any potential shock brought about by the Brexit vote. Firstly there are fewer 'challenged' retailers in the market than there were in 2007. As a result we do not expect to see a flurry of administrations if the trading environment was to soften. Also the evolution and growth in online retailing has highlighted the importance of a store network as part of a Total Retailing strategy, apparent in the number of 'Pure Play' online retailers who have/are looking to acquire physical stores.

This, coupled with the already constrained development pipeline, should mean that vacancy rates, on the whole, should hold. Thus prime rents, particularly for key retail locations, should remain at their current level over the remainder of 2016.

The picture is less clear looking into 2017. Brexit has undoubtedly intensified the challenges that were already facing retailers. For some, the upcoming Business Rate revaluation will place an upward pressure on operating costs, already under mounting pressure due to the rise in the minimum wage. Likewise, the value of the Pound, while providing a boost to retail areas that attract significant numbers of international visitors, could generate added costs for retailers buying and ordering in US dollars. However, anecdotally, we are hearing that many of the major retailers had hedged against currency movements this year. In a potentially weaker trading environment, it can be difficult to pass these rising costs to consumers, ultimately squeezing margins. It is this potential squeeze in 2017 that could have the most significant bearing on future requirements.

Investment market

There has been considerable speculation in the market about fire sales from some of the large retail funds, although this has not materialised on any significant scale. A number of these funds are still closed to redemptions and this should enable a more structured sales process. Considering that these retail funds only account for a small proportion of ownerships (between 5-10%), should further limit potential future instances of fire sales.

The weakening in the Pound post the Brexit vote could mean, that in some instances, we see an expansion of the buyer pool as it has enhanced the attractiveness of UK real estate to overseas investors. Currency movements will have also improved overall returns for this group of investors.

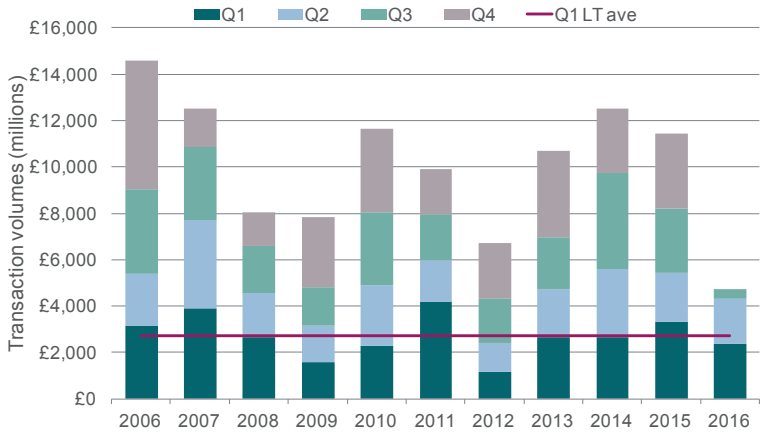
Overseas investors have been the largest net investors in Central London retail over the last five years, and have continued to be active post the Brexit vote. We are also seeing investor appetite for smaller lot sizes in Central London remain relatively robust as recent smaller sales have been well received.

It is still too early for much real evidence to have come through in regards potential impacts on pricing. Subject to how the Brexit vote effects consumer spending and in turn occupational demand, means any repricing in retail should be relatively contained. Market conditions post Christmas trading, plus the start of negotiations with the EU, may deliver a new outlook.

Transaction volumes are likely to be subdued over the remainder of 2016, as expected prior to the EU Referendum. Volumes across the wider retail market had already started to slow in 2015, down 8.8% per annum on the 2014 post GFC peak. Having said this, activity over the first quarter of 2016 was still in range of the Q1 long term 10 year average (see Figure 3). This slowing in volumes was a reflection of a lack of stock, particularly of the larger shopping centre lots, rather than a lack of investor appetite. It also reflected a move away from a capital growth driven strategy to a focus on income security, a trend we expect to intensify over the coming months.

FIGURE 3

Transaction volumes were already slowing prior to the Referendum



Source: Savills; PropertyData

MORE ON BREXIT: We will be publishing further reports on specific topics, see our website for details

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