savills

Spotlight
UK Commercial Leisure

Q1 2016

Image: Gravity Trampoline Park, Maidstone

SUMMARY

■ We remain optimistic on the outlook for consumer spending on leisure over the next five years.

■ Occupational demand for leisure remains strong. In particular we are seeing expansion and new concepts from the cinema and restaurant industries, as well the rapid growth of entirely new subsectors such as trampoline parks.

■ Investor demand for the sector continues to far exceed the supply of units and parks coming to the market. We do expect to see a greater focus on income and liquidity going forward, but generally we expect investor demand to remain resilient.

"Leisure remains one of the most sought after sectors in the property market but stock availability is tempering investment volumes."

The Leisure Economy

The UK consumer has remained remarkably unmoved by the ebbs and flows of global economic confidence. Indeed, the latest Family Spending Survey (FES) that was released in December 2015, showed that we are now spending around 13% of our total spending on Recreation & Culture and 8% on Restaurants & Hotels. This means that we spend more on leisure services than all housing related goods and services combined.

While consumers are often accused of behaving irrationally, the fact that consumer confidence and retail sales growth are both pretty solid points to a far more rational attitude to the UK economic situation than that of many expert commentators. Indeed, with unemployment falling, real earnings growth firmly positive, household debt to income ratios falling, inflation flat, and the first rise in the interest rate still a long way off, the consumer should be feeling fairly positive about life, shopping and going out.

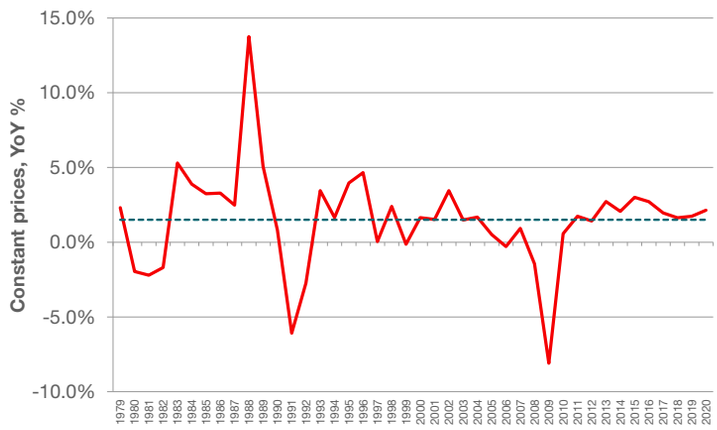
This is clearly what is happening, whether one looks at the backward-looking FES data, or the forecasts in Graph 2. Spending on leisure services is rising and currently forecast to continue to rise at better than average levels. What could derail this positive story? Obviously an unexpected economic slowdown would, but as past Leisure Spotlights have shown, spending on leisure is more resilient in a downturn than spending on more mainstream retail goods and services.

One challenge that we do not hear much about in the leisure sector is the threat from the internet. While this is an overdramatised theme in the retail sector relatively few analyses have been done of what leisure pursuits might move onto the internet. However, with many tech pundits predicting that 2016/17 will be the year of virtual reality, we should not overlook the potential for technology to replicate some out-of-home leisure pursuits in the future. Indeed, if you look at what the typical British person is currently using the internet for, arguably 20% of clicks are for experiences that previously we would have to have left the home for.

Generally we remain optimistic on the outlook for spending on leisure over the next five years, though competition for both leisure time and the leisure pound will undoubtedly continue to intensify.

GRAPH 2

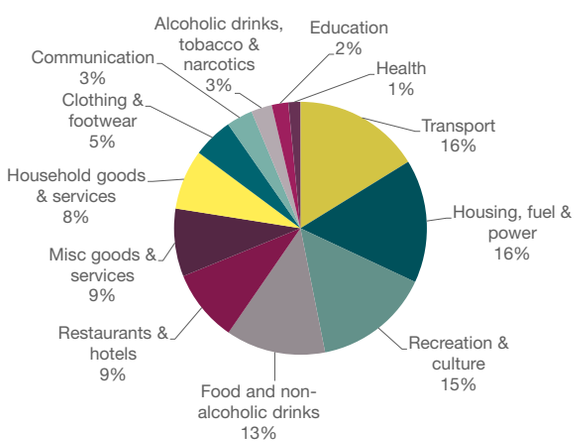
Outlook for spending growth on leisure services



Source: Oxford Economics

GRAPH 1

Household spending by category



Source: ONS

Cinema

The UK cinema market is in good health, in spite of threats from piracy and the rise of on-demand streaming services. The resilient Cinema Industry continues to draw in customers which is testament to the improvement the majority of operators have made in terms of look, feel and fit out. A string of blockbusters that included James Bond's 'Spectre', the final installment of The Hunger Games and Star Wars: The Force Awakens proved to be a boom for fourth quarter sales in 2015. Odeon regained its number one slot among cinema chains in 2015 from rival Cineworld, boosting hopes for owner Guy Hands that it could be sold this year. Odeon's revenues increased by 21.2 % last year to £321.5 million, giving it the largest market share in Britain since 2012 and nudging it ahead of Cineworld.

Cineworld claimed the rise in admissions alongside the diverse range of films on show contributed to a rise in retail revenues too – up 13.7%. The operator has also been expanding their food and beverage offer by rolling out 17 Starbucks outlets within its UK multiplexes. In 2016, Cineworld plans to open a further 13 sites on the back of a record breaking 2015 where 18 new cinemas were opened.

Whilst the admissions for the sector have been recently buoyed, the multiplex operators are becoming more discerning when it comes to growing their existing estates, with a significant divergence of requirements. The market will undoubtedly consolidate further with the potential merger of Vue

and Odeon. There are lots of whispers amongst the cinema elite of whether this transaction will actually come to fruition. As a consequence both operators have recently been muted in terms of acquisitions, and being very selective in relation to new sites.

Cineworld are actively searching, with the main point of difference being the size and scale of their new formats, with the preference being larger cinemas of circa 50,000 sq ft +. With significant swathes of the country already being over screened, and the incentives required moving quickly upwards. Time will tell how many cinemas of this size will actually be delivered.

As the larger operators jostle for position, there is also a growing trend for audiences to visit the growing number of smaller independent establishments, as these operators tend to focus on providing a relaxing, intimate and a more personal atmosphere, which is proving more and more popular. The idea is to provide more comfortable chairs, better quality food or something completely unique whether this means moving the location for each film such as Secret Cinema, or creating a cinema outside!

However, it's not just the independent cinemas that are focusing in on this unique experience. Everyman are also on the rise, separating themselves from the larger operators by serving food at your personal sofa in front of a big screen. Picturehouse, the largest arthouse chain, has recently acquired its largest cinema yet, a grand seven screen cinema a stones throw away from Leicester Square. Whilst it is a flagship no doubt, the essence of the format has not changed. The Picturehouse Central site was a multiplex cinema until a year ago and has been given a makeover with more legroom, raked seating and an entrance on the theatreland thoroughfare of Shaftesbury Avenue. As these independent/boutique picture houses are slightly more expensive due to fewer screens, higher overhead costs and better food, the audiences tend to be those looking for more of an experience from their visit to the cinema, as well as the more serious cinephiles.

Social media is also beginning to have a much larger part to play in deciding what films will be shown in local cinemas. As a result Picturehouse has created Ourscreen, which offers the cinema equivalent of video on demand. Adopting a concept first utlilised in the US, Ourscreen allows enthusiasts to choose the film, the venue, the date and the screening time, and when enough people sign up, the screening takes place.

Restaurants

The UK restaurant market remained strong in 2015 with restaurant spend increasing quarter on quarter throughout the year. However, with the increased choice and variety, consumers are looking for value for money. This does not necessarily mean cheap or budget meals ,but consumers are more market aware of what represents quality and value.

The market has seen a number of major new schemes and restaurants transactions, including:

- Acquisition of Cote by BC partners for £250m.
- Opening of Sexy Fish – Richard Caring opened his much anticipated restaurant Sexy Fish on Berkeley Square, which set a ground breaking rent and premium, but has been a thriving success.
- CDG acquisition of Las Iguanas (£85m) and La Tasca (£25m).
- New entrants to the market: Smashburger.
- Opening of Grand Central with operators including Carluccios, Tapas Revolution, MOD Pizza, Brewhouse & Kitchen, Shoryu, Ivy Grill and Pho.

With the London market being fiercely contested and premiums and rents continuing to rise, we believe that many operators will be looking more to regional cities to expand their portfolios, taking comfort from the strong trading performances at St David's - Cardiff, Trinity – Leeds, Grand Central – Birmingham, Corn Exchange – Manchester and Liverpool One – Liverpool. Examples of recent restaurants moving to regional cities include Burger and Lobster (Cardiff), Cabana (Leeds), Café Concerto (Birmingham), Hawksmoor (Manchester), The Breakfast Club (Brighton) and Franco Manca (Brighton).

As operator's focus starts to turn to the regions it is likely that we will see a slow down in growth and possibly a softening of rents and premiums in London.

The restaurant industry as a whole will continue to grow and whilst consumer spending appears to be resilient to the wider economic concerns at the moment there is a nervousness about the effect of these events in the relatively near future, especially once these events start to impact on disposable income.

Longer term, a rates revaluation carried out in 2015, effective from 2017 will likely increase rates payable significantly for Central London operators (broadly based on rents, which have sky rocketed since the last valuation period) and will undoubtedly be a consideration for new acquisitions going forward.

There is continued interest from the private equity market and we have seen Crowd Funding start to play a part in the set up of new brands. This helped the setting up of Som Sea - London Fields, Clove Club – Camberwell and Good Egg – Stoke Newington. The success of this model and source of funding should see an even greater variety of restaurants enter the market.

Trampoline parks

The trampoline park sector is already big news in America, and it is a trend that is rapidly gathering pace in the UK with a growing number of operators seeking sites. The industry has evolved in recent years since Rick Platt, founder of Sky Zone, opened the first park in June 2004 in Las Vegas under the name of Sky Mania. So much so that in 2012, the International Association of Trampoline Parks (IATP) was formed to guide the growth of these leisure facilities and make today's parks far more safety conscious. Participants are required to sign a waiver acknowledging health and safety rules. Now, the trampoline industry as a whole seems to echo the idea of safe, healthy, family fun and fitness – encouraging people of all ages, shapes and physical abilities to visit trampoline parks.

Trampoline park operators are now targeting the UK with the hope to replicate their success across the Atlantic. However, they all have extremely sizeable minimum

Image: Hollywood Bowl

requirements to house their needs, and the options for such spaces are not abundant. Operators typically target large units from at least 10,000 sq ft to 40,000 sq ft with a minimum six metre floor to ceiling height. The sites can range from standalone retail warehouse units to leisure schemes and shopping centres.

Rents being paid across the sector are very varied. Rents may be as low as £4 - £6 per sq ft in industrial-type locations, which can offer lower occupational costs for fledging start-ups, relying on the 'destinational' draw of the offer. Competitive tension has driven rents on stronger leisure parks up to £12 - £15 per sq ft+, where the trampoline operators offer a fresh and new concept, complementing any existing key leisure offer such as a cinema, bowling or restaurants. Admission figures of 250,000+ per annum are not uncommon, which provides an additional 'anchor' for any scheme, driving footfall and having a significant knock-on effect on the F&B operators' turnover.

Today's trampoline market is made up of a number of local, individual site operators, however the following operators are the most active in the market:

- Gravity
- Jump In
- Jump Arena
- Oxygen Freejumping

As operators jostle to gain credibility in order to secure the best sites and compete with budget Health and Fitness operators with superior covenants, group deals offer one way to get ahead of the pack. Oxygen, which opened their first unit in West Acton, followed by Southampton in 2015, secured five sites through a deal with Lucozade Powerleague in Derby, Wigan, Blackburn, North Shields and Trafford Park, Manchester. The group have further secured £10m of funding to acquire further sites.

Gravity, advised by Savills, have equally garnered a strong relationship with a key leisure landlord, Land Securities, opening 3 sites in their centres (Xscape Castleford, Maidstone Lockmeadow* and Norwich Riverside). A further three sites are under offer.

With now over 50 centres open across the UK, the market is made up of a number of different operators, mostly running individual sites in distinct locations. However, these operators all have ambitious plans to grow and take advantage of the positive market response and we would expect to see some consolidation in the next 12 – 18 months.

*Lockmeadow has since been sold to Kames Capital.

Health & fitness

The UK health and fitness industry continued its rapid expansion throughout 2015 with a 5.6 % increase in the number of fitness facilities. This performance was once again driven by the low cost sector with the key operators still progressing an aggressive acquisition programme.

Pure Gym, The Gym, Xercise4Less and Anytime Fitness proved the most active in the market and Pure Gym's acquisition of LA Fitness further enhanced their position as the market leaders.

Competition in the low cost sector has further increased with the larger operators often taking multiple gyms in a town or city to secure their customer base. This has resulted in some locations reaching saturation point with little scope for further occupiers to enter the market. There has been a direct impact on the membership fees in these locations with operators offering discounted rates in an attempt to secure improved market share.

The more established operators such as Virgin, Nuffield, David Lloyd and Fitness First have primarily focused on their existing estate and have recognised the necessity to differentiate themselves from the low cost gyms by enhancing the wider health & fitness club offer. Their point of difference being the luxury element to their facilities (including swimming pools, spas, treatment rooms) that are unsustainable products in the low cost sector.

The London market has further developed, new entrants are looking at smaller format gyms to broaden the scope of available properties and the high end operators have performed extremely well. 2015 also saw a further emergence of small studios dedicated to a specific offer; Bootcamp & Spinning Studio's (Barry's Bootcamp, Psycle & Boom Cycle) continue to perform well and following success in the US, exclusive Kickboxing studio's such as KoBox have now arrived in the central London market.

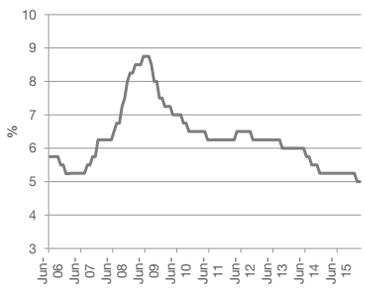
Investment

The Leisure Investment market in 2015 saw no change to the ongoing trend of very strong demand from across the investor base constrained by a lack of supply. The vast majority of institutions continue to have multiple requirements for the sector, which has led to any prime stock trading at record levels and all other leisure stock generating strong interest from property companies and active value investors. The market feels frustrated though as the majority of landlords are resisting the temptation to sell for a number of reasons including the difficulty in sourcing replacement stock and the continuing good performance of their assets through both rental growth and yield compression.

Transactions volumes in 2015 for core leisure assets totalled £915m for the year across 40 deals. The most significant transactions included the

GRAPH 3

Prime leisure yield



Source: Savills

Crosstree acquisition of a 50% share in the O2 at Greenwich for £120m and M&G's £350m sale and leaseback of 44 health and fitness clubs which combined, accounted for 51% of the total market. Whilst total volumes were marginally up from 2014 (£875 million), the figures are slightly skewed by these larger transactions. The larger long income deals aside transaction volumes in 2015 were 12% down on a like for like basis to the year previous.

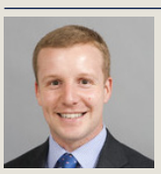
Such large scale portfolio transactions that have made up a significant proportion of the leisure market in recent years are predominantly led by investors looking for inflationary linked long income. The ability to secure this against the trading performance of an asset and relatively low capital values per sq ft compared to other uses makes the leisure sector particularly attractive to these investors and demand for this transaction structure will continue.

With a drop in transaction volumes of core leisure assets and such strong demand it wasn't surprising that prime yields moved in a further 25bp through the year to 5.25% for out-of-town leisure schemes and 5.00% for in-town schemes with a premium for central London. As well as the O2 the notable deals of the year at the prime end included LaSalle's acquisition of Regents Court, Leamington Spa and M&G's acquisition of The Royal Baths, Harrogate. However, the year as a whole is better represented by the activity in trade of value add opportunities with the sale of The Castle Quarter, Oxford demonstrating the depth in demand across the investor base for the right opportunity. For higher yielding opportunities there was also good demand and there was an emergence of specialist leisure property companies in this space with Otium completing their first leisure park acquisitions in Wakefield and Newport.

The wider economic outlook remains positive but there has been a change in sentiment amongst investors and consumers. We believe that leisure as a sub-sector of the commercial property market should be relatively resilient to this dip in confidence but there is a degree of caution. Most investors have low levels of exposure to the sector and the growth of the occupational markets is set to continue. In addition total returns are forecast at 8.2% for the next 5 years (Source: RealFor) making leisure the second best performing sub-sector behind central London retail. We therefore anticipate that the strong levels of demand, that have set the trend in the sector for the last 3-4 years, will continue but there will be a focus on income and liquidity and perhaps transaction volumes will increase as Landlords capitalise on the performance of the last few years.

Savills Leisure team

Please contact us for further information



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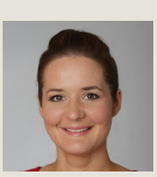

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