

# UK Shopping Centre and High Street Bulletin

Quarter 1 2015



## SUMMARY

■ The election period is unlikely to have a significant impact on the UK consumer economy. Indeed, some sectors of the retail world may actually see an improved trading period during this time.

■ The retail occupational market is continuing to strengthen, and there are encouraging signs that not only is retailer demand improving, but it is also deeper and more diverse than many commentators were predicting a year or two ago.

■ The shopping centre investment market remains strong, and this has stimulated a very strong sales pipeline. We estimate that there are currently 31 schemes in the market, with a further 18 centres being readied for sale.

■ The high street shop investment market still remains heavily polarised between areas where investor demand outweighs supply, and those that investors perceive as too risky. We expect this polarisation to diminish over the remainder of the year.

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 “The challenge for the canny investor is to find those towns and cities that are about to benefit from the recovery, yet are still priced as high risk.”  
 Ben Tyack, Savills  
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## → The consumer economy

Behind the fog of pre-election claims and counter claims about the state of the economy the consumer economy has generally continued to improve.

The Misery Index (compiled by adding unemployment to the rate of inflation, see Graph 3) is now at its lowest ever level, and similarly the more commonly quoted consumer confidence data is pointing to a spring in the step of the UK shopper, despite a slight dip this month in shopper's attitudes towards now being the time to consider a major purchase.

While retail sales dipped unexpectedly in March, primarily due to a fall in fuel sales, the volume excluding fuel rose by 0.2% month on month, and 2% quarter on quarter. Of course, a lot of this strong spending growth is being driven by heavy discounting across both the food and comparison goods sectors and this is by no means a sustainable strategy for retailers.

Ultimately the key metric for us this quarter remains the fact that the "noflation" is providing a substantial boost to household's spending power, and there is no sign that good price deflation is becoming bad deflation where households start to defer spending in the expectation of lower prices next month.

The low level of inflation, whether it is marginally positive or marginally negative, is very important in the current environment where earnings growth remains weak. Indeed, despite a further drop in unemployment, average weekly pay only rose by 1.3% in the year to February, well down on the levels seen at the back end of 2014.

We are pretty sanguine about the impact of the election on consumer spending and retail sales. Indeed, there is some good evidence that some areas of the retail world benefit from election ennui, with cinema attendance for example up 20% in the two months prior to the 2010 election. Electoral decisions are always presented as overly binary, we suspect that whatever the result the consumer recovery will remain on-track.

## The retail occupational market

Two quarters ago we suggested that retailer demand was becoming stronger than many commentators were saying, and even used the term 'space race'. The last three months has brought more evidence of this, with rising demand both for prime and secondary locations.

The news that several major UK retail grandees are rolling out new concepts at opposite ends of the spectrum, has further strengthened this view. Adrian Mountford's Pep&Co (advised by Savills) is planning on opening 50 stores this year, focusing on value hotspots. Their ultimate plan is to have a UK portfolio of 500 stores offering fashion and homewares to markets that have perhaps been passed over by Primark's national roll-out.

While you might think that finding 3,500-5,000 sq ft stores in non-core markets would be easy in today's environment, the competition has been intense for some locations as other retailers are also looking to expand into these markets.

Pep&Co is one example of a number of retailers who are pursuing a substantial expansion at the moment, and this indicates the strength of demand for a variety of locations, as well as retailer's rebuttal of the much talked about trend that online has meant that you only need a handful of physical stores to cover the country. We expect this to feed through into a drop in vacancy rates in both prime and secondary locations.

The other trend that we have noticed over the last few months is a broadening of the recovery in retailer requirements away from London and the South, to the rest of the country. This is mirroring the ripple outwards from these areas of house price growth. Indeed, we believe that the market is on the verge of seeing premiums being paid by retailers in very select cases outside London as competition in those prime pitches heats up.

Of course, as usual in retail not everything is rosy. The major food retailers are stuck in a spiral of negative newsflow and debates on precisely

how over-stored they might actually be. We definitely expect to see further downsizing in store numbers amongst the big three food retailers. However, with the UK population forecast to grow by a further 4.2m people over the next decade it seems undeniable that we will be buying more food from more locations.

While the food retailers are probably in a period of decreasing store sizes, the same is not true in the fashion sector. The rise of click-and-collect is having a substantial impact on typical stores sizes, and we have noticed that requirements from some of the midmarket clothing retailers have doubled in size over the last 12 months as they adapt their needs to fit in larger storage areas in store. Another factor behind this expansion in requirement size is the desire to open stores that can offer all or the majority of the SSU's that are available on the retailer's website.

Looking ahead we believe that as the consumer economy continues to recover, the competition for stores in strong trading locations across the demographic spectrum will intensify. In the medium term this will make some stalled shopping centre developments more viable, but in the short term we expect to see rising pressure on inducements and rents.

## Shopping centre investment

Q1 2015 has seen the shopping centre investment market pick up where it left off at the end of 2014, with investors' insatiable hunger for shopping centre assets continuing into the new year. Fourteen deals completed in the three months to the end of March, with a total capital value of £828.9m being transacted. Although this does not compare to the bumper quarter witnessed at the start of 2014, when 24 schemes were transacted in the first quarter, representing a total capital value of £1,494.4m, all indications are that 2015 will be another busy year in the shopping centre market. What sets 2015 to date apart from 2014 is the fact that, of the transactions completed in these respective first quarters, schemes have traded at a lower net initial yield during 2015 than 2014, with the average net initial yield for the first quarter of 2015 standing at 7.19% compared to 7.98% in 2014.

→ Aside from a busy first quarter, the continued momentum present in the market is demonstrated by the fact that there is a staggering amount of stock currently in the market with in the region of 31 schemes currently available with asking prices totalling approximately £1,284m. Indeed, the perception that the market will slow down in the run up to the election appears to be unfounded as Savills are aware of at least 18 centres being prepared for the market in the coming months. In addition, Savills research indicates that there are currently 23 schemes under offer, accounting for an additional £673m.

As in 2014, large portfolio sales remain prevalent. 2014 saw the high-profile sales of the Swallowtail and Tiger portfolios, among others, whilst 2015 has already seen the 7-scheme Project Charlotte released to the market by LaSalle Investment Management, along with three schemes being sold as a package by Moorfield, and the Principal Trust portfolio (also known as Project Bolt), which contains three shopping centres as part of a 12-scheme mixed use portfolio, also in the market.

Aside from Telford, which remains the largest single transaction completed in 2015 to date, other notable deals that have completed in Q1 2015 include the sale of a 50% stake in the Bentall Centre, Kingston-upon-Thames, which was sold to NPS and Gingko by Aviva for £185.0m, reflecting 4.75% NIY, the £35.0m acquisition of the Nicholson's Centre in Maidenhead by Vixcroft and Cheyne Capital, reflecting 5.25% NIY, and £75.0m acquisition of St. George's Shopping Centre, Preston by Infrared and Hark from Aviva, reflecting 6.41% NIY.

TABLE 1 Shopping centre yields

	Q4 2014	Q1 2015
Super-Prime	4.25%	4.25%
Prime	5.00%	5.00%
Town Centre Dominant	6.50%	6.25%
Secondary	8.00%	7.75%
Tertiary	10.00%	10.00%

Source: Savills

Having captured c.30% of the market during 2014, Savills has continued to lead the charge in the market during 2015, having transacted almost 50% of deals completed in the first quarter, including the high-profile acquisition of Telford Shopping Centre for £250.0m on behalf of Orion. Moreover, of the 23 schemes currently under offer, Savills are advising on 11, with a capital value of £294.8m.

### High street investment

The investment market for high street shops remains heavily polarised between areas of strong investor demand but with shortages of supply, and those that are still perceived (perhaps incorrectly in some instances) as too risky.

Currently the strongest demand, albeit coupled with the greatest shortages of supply, is for midsized lots of £10m and above in strong towns. Typical of this would be the recent sale of the Sainsbury's, Sports Direct and Poundland block on North Street in Brighton which was marketed at £12.5m - 5.15%. It attracted a great deal of institutional interest and is under offer well in excess of asking. Similarly, Aviva recently acquired the 37,000 sq ft block at 1-7 Spurriergate in York for £38m, reflecting a yield of just under 4%. The attractions of a strong location like York, and the imminent rent reviews for H&M and Zara, were enough to satisfy the fund that the block was worth £6m more than when it was acquired by BP in 2009. Both of these assets have good growth potential.

Last quarter we predicted that yields would harden in the key regional cities as occupier demand starts to recover, and the last three months has started to prove this prediction true. Investors who six months ago were uncomfortable with regional voids, or impending breaks, are beginning to see them as an opportunity to move the rent or ERV.

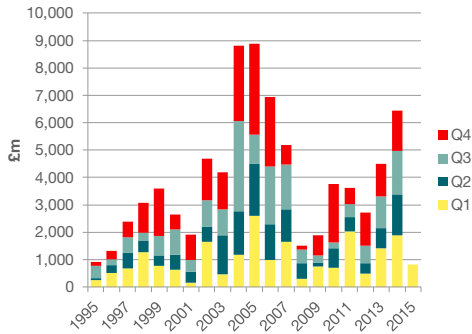
However, this positivity is still patchy with the majority of investor demand focused on the best floorplates in the best pitches in the best regional towns and cities, as per Brighton and York above. Away from these locations yields are still high, often in excess of 10%, and these areas may well offer

the best returns for retail property investors who are looking to enter the market in 2015/2016. Many of these markets have been blighted by high vacancy rates, and an investor perception that retailers need far fewer stores. However, as our comments in the occupational market section of this reports show, some secondary markets may be on the cusp of seeing a sharp fall in voids as retailer demand recovers.

The challenge for the canny investor is to find those towns and cities that are about to benefit from the recovery, yet are still priced as high risk. In particular we like town centre parades where there is an opportunity to knock several small units together, as well as locations where the overall vacancy rate might be high, but there is a strong trading scheme or parade on the prime pitch. These will be the opportunities that will deliver the best mix of capital and rental growth, as well as having the added advantage of a more limited pool of potential buyers (though there are signs that demand for these is beginning to intensify).

Another reason to promote certain secondary locations as an investment target is the rental affordability. It is undeniable that retailing is getting tougher, and that retailer's margins are going to remain under pressure. For retailers and investors alike, finding a store and pitch where the Zone A is affordable with some growth prospects may well be a better strategy than focusing on prime markets where Zone A rents are already high and unlikely to go higher. ■

GRAPH 1 Shopping centre investment volume



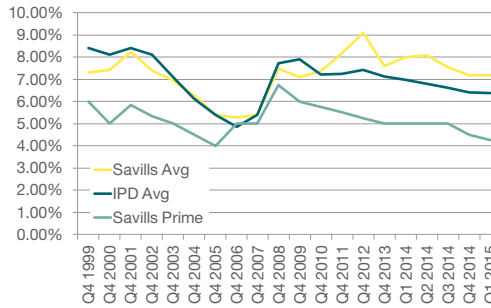
Source: Savills

GRAPH 3 Misery index



Source: ONS, Savills

GRAPH 2 Shopping centre yields



Source: Savills, Investment Property Databank

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