UK Shopping Centre and High Street Bulletin

Quarter 4 2015

Image: Telford Shopping Centre

SUMMARY

■ While the new year might have started with a wave of negativity around the global economy, we do not believe that this will feed through into UK consumer sentiment or behaviour in 2016.

■ Broadly we expect that the positive consumer environment will feed through into stable or improving turnover for most retailers in 2016. However, the story around margins is less solid, with the minimum wage and the business rates review likely to be drags on profitability.

■ In the shopping centre and high street shop investment markets we expect that the majority of requirements will continue to cluster around prime and dominant schemes.

■ However, there are signs of rising investor interest in secondary high street shop assets and pitches, where rents have rebased and yields are yet to reflect the recovering occupational story.

“The recovery is no longer confined to just London and the South."

The consumer economy

While the overwhelming fashion in economic comment so far this year has been to be deeply negative, we still believe that the fundamentals of the UK consumer economy are strong for 2016.

While the outlook for global economic growth is undeniably weakening,we should remember that it was only a few years ago that we were worried that we didn't trade enough with the BRICS countries - now this may well be a benefit, with our major trading partners of the USA and Europe doing well and better than expected.

Furthermore, however bad the global picture, it will take a while to filter into the consciousness of the UK consumer, who is currently on a bit of a caffeine high due to the sharp recovery in real earnings growth. While the latest ONS data for retail sales showed a 1% fall in volumes month-on-month, the year-on-year growth remained a very healthy 2.6%.

Consumer confidence remains well above its long term average, and the household saving ratio continues to fall. Furthermore, while the latest pay data show a slowing in the rate of growth, average weekly earnings were still 2.0% higher for the three months to the end of November than they were for the same period in 2014.

This rush of positivity will undoubtedly cool as the combination of public sector austerity and macro-turbulence drag on confidence. However, until then we expect to continuing steady growth in retail sales and consumer spending, particularly since the potential drag on house price growth from rising interest rates still remains some way off. Indeed, the latest implied consensus is pointing to the first rise in the UK base rate not coming until October 2017.

The retail occupational market

While the trading statements for Christmas 2015 are not all in yet, some clear trends in retailer performance over the crucial final quarter have already emerged.

The first, and possibly least surprising, is that the more money was spent on the internet than last year - particularly around Black Friday. With both the ONS and BRC data pointing to a flat Christmas in terms of sales volumes, and the Experian footfall data showing a sharp downturn in footfall in December, the data from Visa showing 2 3% pick-up in sales in December leads us to conclude that most if not all of that pick-up was online.

However, now that most retailers are firmly in the omnichannel world, the argument over whether it was a good or bad Christmas for online or offline is relatively irrelevant - they key thing is whether sales and margins improved across the board.

The second trend that is becoming apparent is that the gentle housing market recovery is feeding through into improving sales in the DIY and bulky good sectors. While this segment is often more focused on Easter than Christmas, there have been some strong trading number recently from Homebase, Topps Tiles, Dunelm and Robert Dyas. We delved into the linkage between housing turnover and retail warehouse sales in more detail in our last retail warehouse bulletin, but this looks like a sector to watch in 2016.

Broadly we expect that the positive consumer environment will lead to steady growth in spending and retailer turnover in 2016. However, the question around margins is more tricky. Low oil prices will undoubtedly help retailers a little, whether they manage their own distribution networks or not. But the hangover of unsold Autumn stock, the new minimum wage and impending business rates revaluation will however act as drags on margins in both the short and medium term.

This will place further pressure on some segments of the market, and we do expect to see more retailer failures this year than last. However, vacant units in the right locations will not stay vacant for long, and we expect to see a steady trickle of new entrants to the UK high street, either from the internet (as retailers like Pink and The White Company open stores) or from international markets.

Shopping centre investment

Activity in the shopping centre investment market remained strong throughout 2015. At year end a total of 86 shopping centres had been traded, representing a capital value of £4.30 billion, above the long term average of £3.98 billion. The investment volume for Q4 2015 was £1.11 billion.

Notable transactions completed in Q4 2015 included:

- Meadows Shopping Centre, Chelmsford for £46 million, reflecting a NIY of 7.75%. The purchaser was Benson Elliot.
- Forge Shopping Centre, Glasgow for £83.6 million, reflecting a NIY of 6.95%. The purchasers were Pradera and Tristan Capital.
- Monument Mall, Newcastle for c.£87 million, reflecting a NIY of 4.30%. The purchaser was Standard Life.
- Lion Walk, Colchester for £76.5 million, reflecting a NIY of 6.00%. The purchaser was a client of CBREGi.
- Festival Place, Basingstoke for c.£290 million, reflecting a NIY of 6.50%. The purchaser was a client of AEW.

There are 13 shopping centres currently under offer, accounting for circa £1 billion and 20 centres in the market accounting for an additional £1.64 billion which will flow into Q1 2016.

Notable deals expected to flow into Q1 2016 include:

- Grand Central, Birmingham for £345 million, reflecting a NIY of 3.50%.
- Freehold stake in Metrocentre, Gateshead for £115 million, reflecting a NIY of 4.00%.
- 50% stake in Whitefriars, Canterbury, reflecting a NIY of 5.50%.
- 50% stake in Bury St Edmunds, reflecting a NIY of 5.35%.
- St Enoch, Glasgow for c.£225 million, reflecting a NIY of 6.50%.
- The Lanes, Carlisle for c.£95 million, reflecting a NIY of 6.00%.
- Friars Walk, Newport for £117 million, reflecting a NIY of 5.75%.

The average NIY for assets transacted in 2015 was 7.19%, compared to 7.65% in 2014, demonstrating that demand for shopping centres has remained strong and that there is a growing investor preference for higher quality prime / town centre dominant assets.

2015 really was a year of two halves.

The momentum from 2014 pushed through into early 2015 with some notable prices being paid, specifically:

- 4.68% NIY for the Nicholson Centre, Maidenhead (without top ups) acquired by Vixcroft with Cheyne Capital, reflecting £35 million.
- 6.50% NIY for Telford Shopping Centre acquired by Orion, reflecting £250 million.
- 5.20% NIY for Grafton Centre, Cambridge acquired by L&G with Wrenbridge, reflecting £99 million.
- 6.02% NIY for Ayr Central acquired by M&G, reflecting £34.3 million.
- 4.25% NIY for Kings Mall, Hammersmith acquired by Schroders, reflecting £153 million.
- 3.46% NIY for W1 Shopping Centre, London acquired by Norges, reflecting £240 million.
- 3.90% NIY for N1, Islington acquired by clients of CBREGi for £171 million.

As the year progressed vendors' pricing aspirations increased and valuations "firmed up". However, the "London Effect" was not reflective of the wider UK market. More stock came into the market, particularly at the secondary end as individual assets and portfolio sales, resulting in 47 secondary assets being available by September / October 2015.

Wider global macro-economic worries continued particularly in Asia with significant currency devaluations and wild stock market fluctuations. The early part of Q4 2015 saw secondary values move out 100 basis points and the Sovereign Wealth Funds pull up stumps on their UK investment programme to focus on domestic issues. This trend has continued to the year end. Much of the secondary stock has now been withdrawn and we are seeing much less activity from the Sovereign Funds in the second half of 2015. We suspect that they will cautiously return in 2016 but only for the very best assets.

TABLE 1

Shopping centre yields

	Q3 2015	Q4 2015
Super-Prime	4.00%	4.00% ↑
Prime	5.00%	5.00% ↑
Town Centre Dominant	6.00%	6.00% ↑
Secondary	8.00%	8.25%↑
Tertiary	12.00%	12.00%↑

Source: Savills

We predict that the trend for super prime, prime and good town centre dominant assets will remain in 2016 as we return to a more "normalised market". Secondary and tertiary yields have moved out c.100 - 150 basis points in the last 6 months and this has created issues with valuations which remain "historic". In some instances the outward yield movement has been too aggressive, and has been reflective of the wider market and not asset specifics.

The REITs have now mostly balanced their portfolios and as such we expect to see fewer, bigger, more strategic plays from them in 2016, and perhaps some merger and acquisition activity?

Recent years have seen "stakes in centres" being sold down, we believe this will continue but at a decreasing rate. The market has changed to the extent that the Sovereign Funds are now focussed on much larger, core strategic holds and have exited / are exiting their smaller positions under £100 million in joint ventures. The issue for the remaining joint venture partner is who the new equity joint venture partner will be. In all likelihood this will be from funds under the management of the big fund management houses, such as LaSalle Investment Management and CBREGi etc. The issue of course is that their clients will not pay "double fees" and, as a consequence the new joint venture partners will only enter these assets on a straight joint venture basis.

As highlighted, we expect 2016 to return to a more "normalised market". Revaluations at year end will help to bring pricing expectations back in line. We will see more selective disposals from all categories of the vendor spectrum and to that end we anticipate a healthy year of transactions in the £4 - 5 billion range. There remains strength and depth across the purchaser spectrum, over-renting is now for the most part behind us, retailers are trading profitably and the debt markets remain competitive.

High street investment

Early last year we predicted that the prime high street shop yield would fall to 4% by the end of the year, and November 2015 saw this prediction come true.

This quarter point downward shift in the prime yield was enabled by an increase in good quality assets coming to the market in the second half of the year, following the relative drought of such product in the first half of 2015.

Investor demand for prime assets in the South remains very strong, and we expect that the first half of 2016 will see a steady stream of prime assets being brought to the markets as vendors seek to capitalise on the recent rise in the achievable capital values.

However, the recovery in the high street shop market is no longer confined to just London and the South. Investor confidence in the top regional cities has steadily improved over the second half of 2015, driven both by comparative pricing to London and the South, and the increasing acceptance that the rental cycle is now turning in the landlord's favour in these markets. The recent sale of the Lloyds unit on Market Street in Manchester is typical of this trend, there was a significant level of investor demand from both UK institutions and foreign buyers with the final sale price reflecting a NIY of 4.14%.

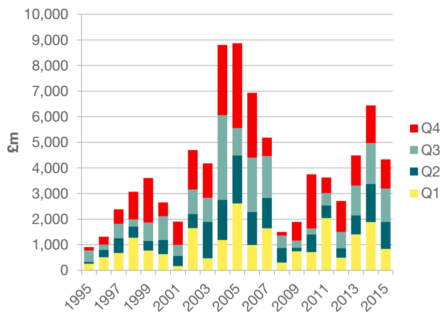
Late 2015 also saw secondary yields begin to follow prime inwards in some locations, both in anticipation of a recovery in the occupational story around secondary pitches and locations, and as a play on the 70bps wider than normal spread between prime and secondary shop yields.

2016 will see a continuation of this trend, with rising confidence in the occupational market delivering steady investor demand for secondary assets, and strong demand for prime. While demand for truly opportunistic opportunities such as voids and development opportunities is currently very limited, we also expect to see a slight uptick in interest in these types of investment in 2016 - so long as the catchment is of a suitable quality to support retailer demand.

We do not expect prime yields to harden any further this year, but a further 25-50bps hardening in secondary yields is beginning to look inevitable.

GRAPH 1

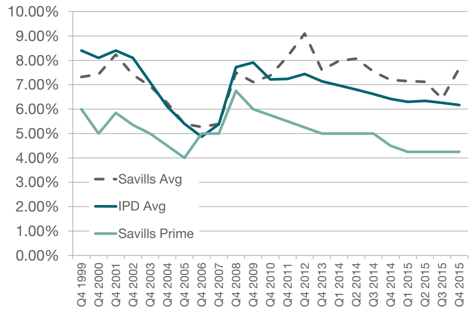
Shopping centre investment volume



Source: Savills

GRAPH 2

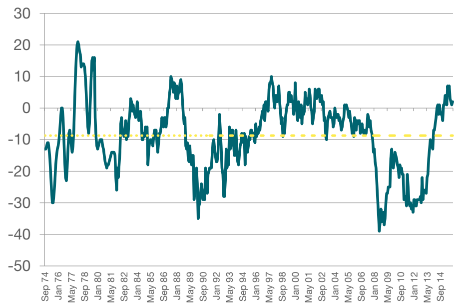
Shopping centre yields



Source: Savills, Investment Property Databank

GRAPH 3

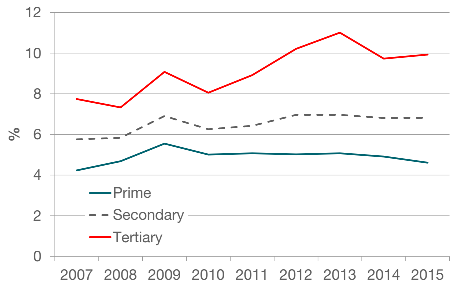
Consumer confidence



Source: Gfk

GRAPH 4

High street yields outside central London



Source: Savills

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