UK Commercial – Q2 2024

SPOTLIGHT
Savills Research

Shopping Centre and High Street Spotlight

- Disinflation sees further improvement in consumer confidence and retail sales performance
- Investment volumes are recovering in line with confidence in retail

> **"Prices in the UK rose by 2.0% in the year to June 2024, unchanged from May, which was the lowest it had reached since July 2021."**

UK retail consumer and occupational trends

Disinflation, coupled with a strong mandate following a decisive Labour election victory, sees further improvement in consumer confidence and subsequently, retail sales performance

In broad terms there is undoubtedly a growing sense of optimism as we approach the mid-point of 2024. One that sees an improvement in consumer fortunes positively impact overall sales performance in the retail market.

Inflation has continued to fall since the end of the last quarter. Prices in the UK rose by 2.0% in the year to June 2024, unchanged from May, which was the lowest it had reached since July 2021.

This is a significant improvement on the 8.0% growth we saw only a year ago, as well as further progress on the rates seen earlier this year. The Consumer Price Index (CPI) was double its current standing in January and was still at 3.2% at the end of Q1 (figure 1).

The positive news is inflation has remained at the Bank of England's (BoE) target of 2.0% for the last two months. This suggests the door is open to cutting interest rates in August.

Last month marked the seventh time that interest rates have been left unchanged. The BoE put interest rates up to 5.25% in August 2023 – its highest level for 16 years - to help slow escalating price rises.

However, the BoE's governor Andrew Bailey, suggested in June that the reason for the latest hold was to be sure inflation stays low. If July sees inflation remain at 2% or indeed fall any lower, optimistic economic analysts are suggesting we will see the first fall in borrowing costs for more than four years.

As a result of the recent disinflation, the UK consumer has seen its overall confidence continue to improve and do so significantly. GfK's index stands at -14.0 on a rolling twelve-month basis, slightly above the -14.6 average of the last decade, 5.0 points higher than the start of the year and a 10.0 point improvement on June last year. (figure 1).

Interestingly, consumer outlook on the UK's general economic situation over the next twelve months has also improved. It now sits at -11.0, significantly better than the -24.6% average for the last ten years and a 10.0 point improvement over the last six months. This may have as much to do with the recent general election result as it does with the pattern of disinflation.

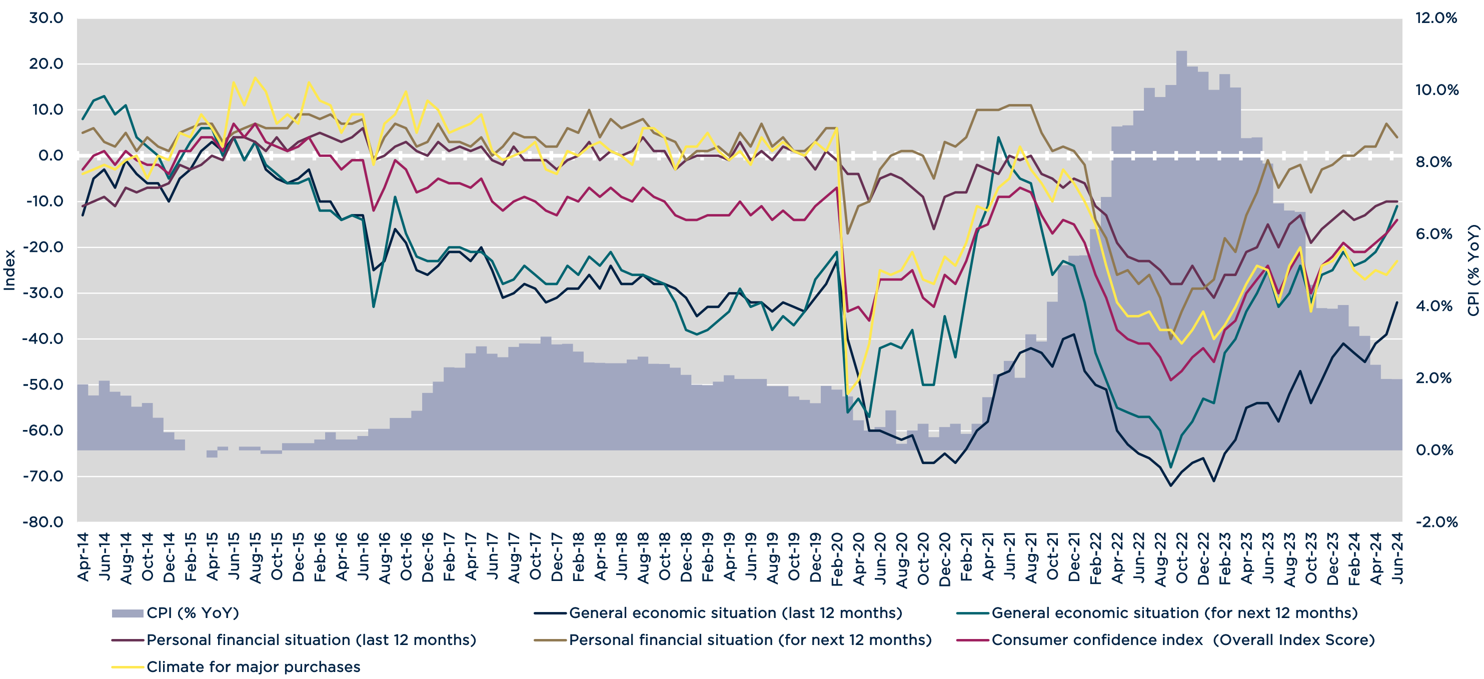
The Labour Party's historic landslide victory - winning 218 new seats and 411 seats overall - gives them a comfortable majority in the House of Commons. This, for now at least, removes the uncertainty that has surrounded UK politics towards the end of the previous government's final term. Furthermore, it gives the incoming party a strong mandate, allowing it to pursue its policy priorities with some vigour.

The resultant improvement in the consumers' perception of the UK finances over the next twelve months has also translated into a similar outlook on their personal finances going forward. This index is actually in positive territory with a score of +4.0, a 36.0 point improvement on September 2022 when the index reached -40, the lowest point it has reached in the last ten years.

This improvement is likely to continue in the short term, whilst the Labour government enjoy a honeymoon period. Analysis of consumer confidence following previous general election results shows this to be true. The Conservative Party victory in December 2019, itself also a landslide with a majority of 80 seats, saw both overall consumer confidence and general and personal economic outlook trend above their lon-term averages in the months that followed, before the onset of the pandemic saw them plummet.

Following the most recent election, political discourse suggests public expectations are

Figure 1: Consumer Price Index versus UK Consumer Confidence measures



Source Savills Research, ONS, GfK

highest for improvement in NHS funding, growing the economy and reducing the cost of living. Voters will give the new government some grace to deliver on these pledges; however, they must make the most of the coming years when their political capital will be highest. If the government can achieve this then only time will tell how positive such an impact will be on sales performance across the retail market.

For now, the recent improvements in both the cost of living and political sentiment has coincided with continued growth in overall retail sales by value. Barclaycard credit and debit card spend for H1 2024 has seen both essential and non-essential spend grow by 1.9% and 1.3%, respectively.

Meanwhile, the latest data from the ONS suggests we have seen the disparity between the volume of products sold and the value of retail sales continue to retract. June 2022 marked the point at which consumers began spending more but buying less; retail sales by volume entered negative growth territory and have remained there ever since, despite year-on-year (YoY) sales by value continuing to grow.

However, the most recent YoY retail sales figures saw values grow 3.8% in May on a rolling twelve-month basis, while sales by volume shrank -1.3% over the same period. Positive sales growth alongside negative growth in volumes still remains, which ultimately means consumers are getting less value for money whilst, at the same time, retailer profit margins continue to depreciate.

This rings true when you consider that falling inflation does not mean prices overall are coming down; they are just rising less quickly. The goods in the shops are still much more expensive than they were two years ago.

Nevertheless, despite negative volume growth, the most recent figure does mark a 0.2% improvement on the previous month and a significant improvement on the most recent trough in retail volumes, seen in March last year (-6.0%). This suggests the market is much closer to addressing the imbalance between the price of goods and how much that gets you as a consumer.

Despite the positive shoots of recovery both in the economy and the outlook of the consumer, any positivity is often nuanced and can vary significantly by sector. The GfK's index on the climate for major purchases remains low at -23.0, significantly below the decade average of -8.2. This may explain the negative sales growth in the 'big ticket' spend categories evident in the Barclays credit and debit card transaction data for H1 2024, including household goods (-5.0%), home improvement and DIY (-7.7%), electronics (-1.3%) and furniture (-3.6%).

Footfall has a varying impact on retail recovery

Analysis of recent footfall data suggests any recovery in retail sales can often be tempered by any number of micro factors. In this case, unseasonal wet weather has hampered progress versus the previous year. According to MRI, annual high street footfall for Q2 2024 was 1.7% below 2023 levels whilst shopping centres saw a 2.1% decline versus the same quarter last year.

Nevertheless, monthly footfall rose 3.8% from May to June across shopping centres, whilst high street footfall was lifted 3.1% - footfall improved in the second half of June driven by the men's European Championships, Taylor Swift's Eras tour coming to the UK and some warmer weather. This is an example of the ebb and flow nature of the recovery in consumer spending across the in-town retail market.

Retail and leisure operators continue to look for space

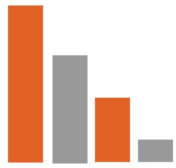
Our previous edition of this Spotlight (Q1 2024) took a in-depth look at the relationship between openings and closures across high streets and shopping centres and concluded that despite the press rhetoric around a series of 'high-profile' insolvencies, the basket of operators looking to expand their portfolios remained high and diverse. This suggests that, at present, the market is simply experiencing its usual churn brought about by the varying fortunes of the UK's operators.

In fact, overall insolvency activity remains low for 2024. The Centre for Retail Research suggests there have been only 328 stores that have so far actually been impacted by insolvency in H1 2024. This represents only a third of the total for 2023, which itself saw significantly less than each of the previous five years. Insolvency activity for brands that have not only been around a long time but are household names, can be as much about the management of their finances, investment in their stores, brand development, marketing strategies and their continued relevance as it is a symbol the wider market is struggling.

As a result, there has been no significant uptick in vacancy. High streets were the only location type to see an increase in voids in 2023, increasing from 13.8% to 14.0% by the end of the year where the latest data suggests it remains; high streets saw a net change of -1.3% in units last year as closures outpaced new openings, albeit marginally.

Shopping centres fared even better, with only a 0.5% YoY decrease, which meant the net change in units remained flat. With retail park vacancy also improving, now at only 4.6%, the latest data on voids suggest much of the net loss of stores were standalone units or smaller shopping parades.

In fact, data from LDC tells us high streets saw 519 new openings across the UK in Q2 this year, covering all retail and leisure multiples, whilst shopping centres saw an additional 219 in the same period. Of the 738 total, 19% were in the top 50 ranked retail locations in the UK for consumer spend, according to Geolytix 2024 Retail Ranking methodology.



The Centre for Retail Research suggests there have been only 328 stores that have been impacted by insolvency in H1 2024

519
New openings across UK high streets in Q2 2024, covering retail and leisure multiples

219
New openings across UK shopping centres in Q2 2024, covering retail and leisure multiples

> “On a YoY basis, headline and net effective rental growth improved significantly in Q2 2024”

What does retailer acquisition activity mean for rents across the sector?

With continued interest in high street and shopping centre locations - particularly for prime shopping destinations in our major towns and cities - we have subsequently continued to see positive growth in rents on new deals, according to Savills leasing data.

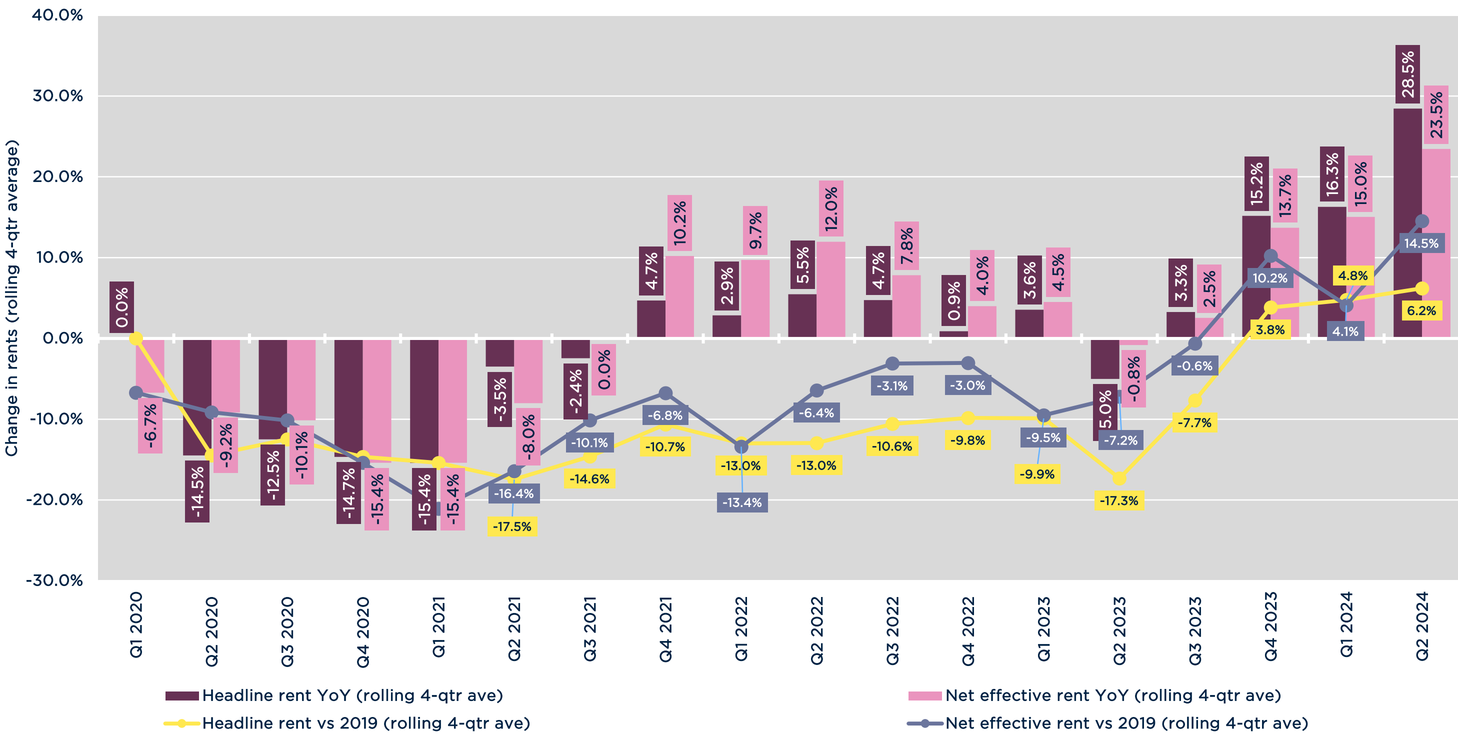
On a YoY basis, headline and net effective rental growth improved significantly in Qs 2024. Perhaps even more positively, both headline and net effective rents continued to see positive growth versus the new deals we saw in the same period pre- Covid. This suggests some competitive tension is beginning to build between operators looking to expand, particularly in well-occupied locations, to which Savills book of new transactions is undoubtedly skewed toward.

In reality, we could see a further rental divergence between prime assets and weaker locations exposed to higher vacancy as operators continue to reposition their portfolios or look more strategically at growth opportunities.

That said, MSCI’s latest figures also point to rental growth. Shopping centres, for example, recorded a 0.5% increase in gross rent passing in June, the third consecutive month of increases. This suggests that rents are beginning to trend upwards across the board and not just on new deals in the most competitive markets, as is the focus of the Savills data.

Nevertheless, with operator appetite for new openings continuing to grow, we focus on what has happened to Wilko stores across high streets and shopping centres since its administration in the case study opposite.

Figure 2: Average headline and net effective shopping centre and high street rents



Source Savills Research

CASE STUDY: What has happened to Wilko stores across high streets and shopping centres

Wilko, the hardware and general merchandise retailer, fell into administration on 10 August 2023, making a loss of £36m in 2022 and owing nearly £70m to suppliers. With 402 outlets, this was the largest retail failure since Woolworths in 2008.

Increased competition from other low-cost sellers such as B&M, Poundland, The Range and Home Bargains played a significant part in the brand's demise, particularly throughout the pandemic. These competing brands have focused their ambitious growth strategies in the out-of-town market, which was favoured by the consumer during social restrictions and continues to be the sector of choice for this type of shopping. 47% of Wilko's portfolio at the time of its administration was based on the high street, with a further 38% in shopping centres.

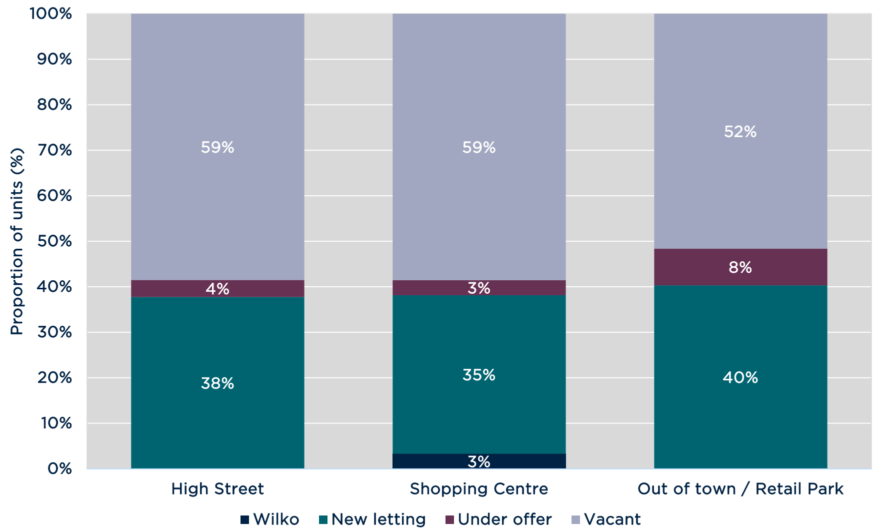
Nearly a year on, voids across both asset classes, respectively, account for 59% (totalling 110 units for high streets and 89 units in shopping centres).

Nevertheless, there has been some significant progress across both high streets and shopping centres in letting former Wilko stores. High streets have seen 71 stores let (38%), with a further seven currently under offer (4%). Shopping centres have seen 53 lettings in the last twelve months (35%), with 5 stores currently under offer (3%) and five stores (3%) trading under the Wilko brand (figure 3).

Why are some stores still trading as a Wilko? The Range agreed a deal to buy the Wilko brand website and intellectual property for a reported £5m back in September last year, after a rescue bid for the wider business fell through. It rebranded a few stores with its own fascia, including one in Cwmbran Shopping Centre in Gwent, Wales. However, the new owner opened its first Wilko-branded stores at the beginning of December 2023, starting with the Plymouth Armada Shopping Centre, the Guildhall Shopping Centre in Exeter, and the Arndale Centre in Luton. Since then the Maltings Shopping Centre in St. Albans has also been reopened under the Wilko's fascia, whilst Dolphin Shopping Centre in Poole is an example of The Range taking a completely new letting and opening under the Wilko banner.

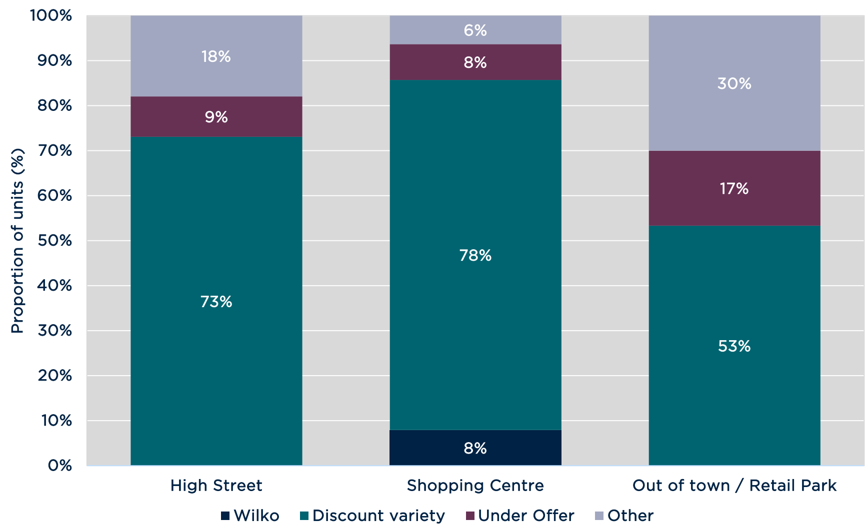
Figure 4 highlights what has happened to all the other Wilko stores that have since been let. What is abundantly clear is it is those operators Wilko struggled to compete with in the first place that have benefited most in terms of store acquisitions. Discount variety operators, including The Range, account for 73% (or 57) of those units that have been let or are under offer. This includes Poundland (44 units), B&M Bargains (8), OneBeyond (2), Poundstretcher (2) and Boyes (1). Shopping Centres saw similar results, with 78% of occupied stores attributed to discount variety brands including Poundland (25), B&M Bargains (7), OneBeyond (4) and Poundstretcher (2).

Figure 3: Wilko units as of June 2024 by asset classes



Source Savills Research

Figure 4: Wilko units that have been let / under offer as of June 2024 by asset class

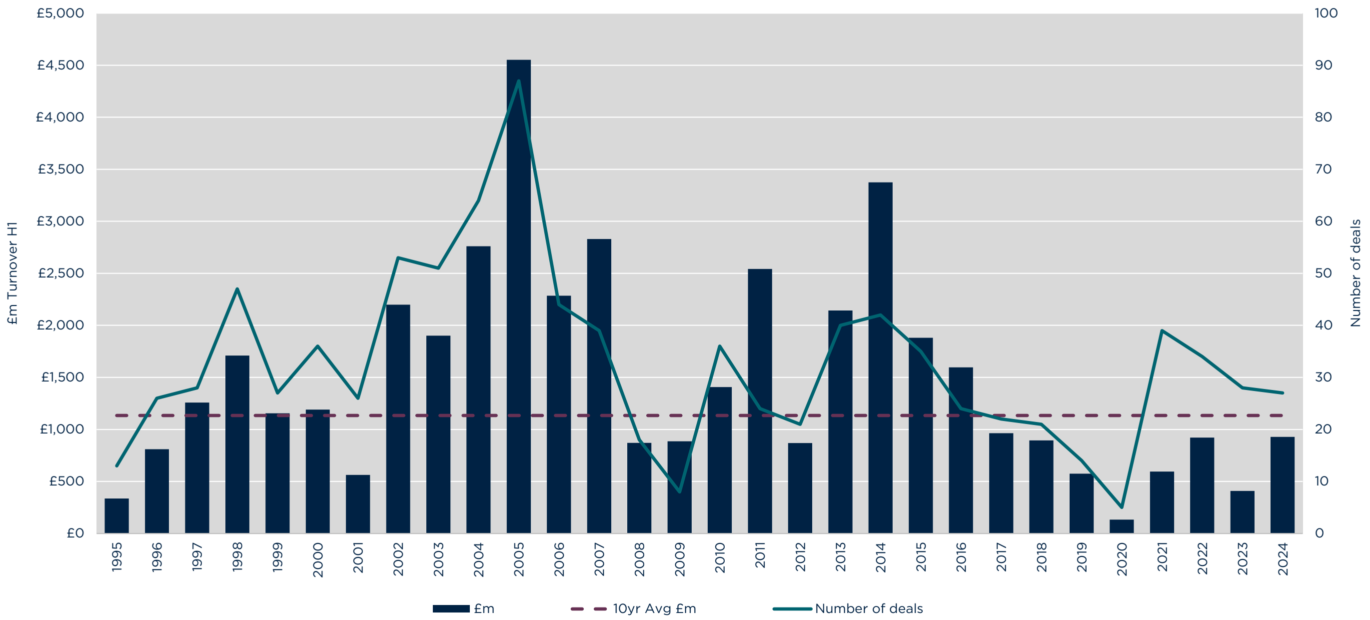


Source Savills Research

London, UK - September 6 2023: Wilko store on Kensington High Street (VV Shots)

> "Investment turnover in the first six months of 2024 was more than double the same period in 2023"

Figure 5: Shopping centre investment volumes for the first half of the year



Source Savills Research

UK retail investment market

Investment volumes are recovering in line with confidence in retail and the desire to capitalise on record high yields

Shopping centre investment

Investment turnover in the first six months of 2024 was more than double the volume traded in the same period of 2023. £928m was traded in the first half in 27 deals, which is 82% of the ten-year average for the first half of the year.

The stories behind this pick-up in activity are diverse, ranging from a perception that we might be at the peak moment to capture weak pricing to a rise in the number of institutional quality assets being bought to the market. The latter point is the most significant one in terms of the trading volume with Norges' acquisition of the remaining 50% stake in Meadowhall and Landsec's purchase of GIC's 17.5% stake in Bluewater accounting for 52% of the investment volume in the first half of 2024.

We are currently tracking £510m of shopping centre assets that are under offer and a further £350m that are in the market. A quarter of the total value of those assets available in the market is attributed to Nuveen's 25% stake in St James Quarter, Edinburgh; one of the best quality retail-led schemes made available for a number of years. Savills is running this process and can report a very positive interest from the market, indicating the above-mentioned appetite in the sector for the highest quality of asset. We anticipate further top 25 shopping centre assets (or interests therein) to be made available to the market over the next twelve months on the back of successful sales of super national shopping centre assets over the last twelve months.

While it might be tempting to extrapolate the institutional interest in three recent asset sales as the beginning of a reversal in the fortunes of the shopping centre investment market, it would probably be more accurate to point to it as a moment in the cycle rather than a trend. Institutional quality shopping centres have always been a rare commodity in the UK, and the number of prime centres that might be tradeable is limited.

This supply will become even more limited as time goes by, due to the lack of development that we have seen in the sector over the last 20 years. The last twelve months have definitely seen a change in investor perceptions of the risk attached to owning a prime mall, and the desire to do a deal has been further enhanced by prime yields being at their highest-ever levels. This means that where prime assets do come to the market they will be closely examined by both opportunistic and income-focused investors, at least until yields start to harden.

While we have moved most of our shopping centre yields out by 25 bps over the last nine months, Q2 2024 has seen the return of a downward arrow on the prime yields. The perception that yields will harden over the next six months is not unique to shopping centres, being linked more to the expectation that interest rates will be cut than an expectation of accelerating rental growth. However, it does raise the question in our minds of how much yield hardening it will take before shopping centres drop off the radar of opportunistic investors.

Repurposing and change of use have been drivers of

£928m
of shopping centres traded in H1 2024

£860m
of shopping centre stock under offer or in the market

> “Prime shop yields in prime locations will harden over the next year”

Figure 6: Shopping centre yields

SC equivalent yields: Revo classifications	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Dominant Prime	9.25%	9.50%	9.50%	9.50%	9.75%	9.75%	9.75%↓
Regionally Dominant	8.00%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%↓
Regional Scheme	8.50%	8.75%	8.75%	8.75%	9.00%	9.00%	8.75%↓
Sub-regional Scheme	9.00%	9.25%	9.25%	9.25%	9.50%	9.50%	9.50%
Neighbourhood Scheme	10.50%	10.75%	10.75%	10.75%	11.00%	11.00%	11.00%
Good Secondary	11.50%	11.75%	11.75%	11.75%	12.00%	12.00%	12.00%
Secondary	13.50%	13.75%	13.75%	13.75%	14.00%	14.00%	14.00%↑
Local Scheme (Successful)	10.00%	10.25%	10.25%	10.25%	10.50%	10.50%	10.50%
Local Scheme (Challenged)	16.75%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%

SC equivalent yields: Savills classifications	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Super-prime centre	8.00%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%↓
Prime centre	9.25%	9.50%	9.50%	9.50%	9.75%	9.75%	9.75%↓
Town centre dominant	10.75%	11.00%	11.00%	11.00%	11.25%	11.25%	11.25%
Community & convenience	10.00%	10.25%	10.25%	10.25%	10.50%	10.50%	10.50%
Secondary	13.50%	13.75%	13.75%	13.75%	14.00%	14.00%	14.00%↑
Tertiary	16.50%	16.50%	16.50%	16.50%	17.00%	17.00%	17.00%↑

Source Savills Research

opportunistic investor interest in the sector for the best part of a decade, and the recently tweaked PDR legislation should give this a bit of a boost. It is also possible that the new government might make housing delivery even easier on town centre sites as part of its supercharging of the planning system. However, at the moment, the cost of debt and construction is making conversions challenging, so a surge in change-of-use-motivated purchases is unlikely in the short term.

All this having been said, there are definitely more motivated buyers in the market than we have seen for some time, and this should deliver a turnover of over £2bn in 2024, which will be the most active year since 2016.

High street shop investment

High street shop investment has not seen the injection of new buyers into the market that shopping centres have, but the remainder of the trends remain similar. Overall, the volume of shops traded in the first half of 2024 was 21% down on the same period in 2023. However, turnover in Greater London was only 4% down YoY, a sign that investor confidence in both the occupational story and market pricing is beginning to improve in London. Previous cycles suggest that investor confidence always recovers first in London, and then ripples out to regional prime markets thereafter, and the last few weeks has definitely seen a pick-up in confidence and a widening of the buyer pool.

Purchaser and vendor profiles and motivations remain much as they have been in recent years, with continued sales out of institutional portfolios and purchases by private investors.

In a similar tone to the shopping centre market, we expect to see some downward movement in prime shop yields in prime locations across the UK over the next year. Once this has happened, the rationale for opportunistic buying of shop investments might reduce for some investors, but this will be balanced by the stronger narrative around the improving consumer economy and its implications for retailer performance and future expansion plans.

We also expect to see a resurgence in investors looking at high street retail as a change of use opportunity once borrowing costs have fallen and the government's plans around accelerating the planning process have solidified.

Prime shopping centre yields have now been stable at 8.25% since Q1 2023

+700 bps
The movement in Tertiary shopping centre yields since 2015

£846m
of high street investment in H1 2024

-25 bps
The movement in prime high street yields this year

Savills Commercial Research

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