

Shopping Centre and High Street Spotlight



- Rents continue to edge northward as key occupational bellwethers for market performance show further evidence of stabilisation
- While Q3 was quiet in terms of investment turnover, investor confidence in the asset class is building

🗨️ The Consumer Price Index has dropped sharply to 1.7%, down from 2.3% in August 🗨️

UK retail consumer and occupational trends

Consumer confidence improvement takes a U-turn with apprehension over the new government’s first Budget

The UK retail market experienced a second consecutive year of high inflation in 2023, leading to a focus on essential items and a challenging environment for discretionary categories. As a result, we saw a growth in retail sales in value terms which masked an underlying decline in retail sales volumes.

The good news is the disparity between how much consumers pay and how much product they take home has been narrowing throughout 2024 in line with falling inflation. The Consumer Price Index (CPI) has dropped sharply to 1.7%, down from 2.3% in August, a larger fall than the financial markets anticipated and the first time headline inflation has dropped below the Bank of England’s (BoE) 2% target since April 2021.

In turn, September marks the first month we have not seen negative growth in volumes since May 2022 on a rolling 12-month basis. In other words, as of last month, consumers have tangibly taken home no less on average over the last year, despite continued, albeit falling growth in the cost of goods (Figure 1 highlights a 2.5% growth in retail sales by value for September on a rolling 12-month basis, down from 5.2% at the beginning of the year).

As a consequence of recent economic improvements, the GfK’s consumer confidence measures have, until very recently, also seen steady growth (Figure 2). Data covering the last decade highlights a clear nadir in Q3 2022 at the height of the recent cost of living crisis. Since that time,

consumer outlook greatly improved. General consumer confidence, for example, increased more than sixfold, climbing from -68.0 in September 2022 to as low as -11 in June of this year (above the long-term average of -14.6).

Consumer outlook also saw positive improvements. Indicators on the perception of both their own personal finances, as well as the UK’s general economic situation over the next 12 months, each rose above their respective long-term averages by early summer this year. In fact, the former saw the index reach as high as +6 in August, suggesting more optimism than pessimism with regard to consumers’ own financial balance sheets. Perhaps even more promising for the fortunes of the UK retail market was an improvement in sentiment on the climate for major purchases, suggesting consumers were becoming increasingly less concerned with splashing out on a ‘big-ticket’ item or making an expensive discretionary fashion or comparison goods purchase.

However, as economic stress events have proven over the years, consumer confidence and the financial outlook remains fragile, and in the run-up to the new government’s first Autumn Budget, set to be held on 30 October 2024, we have seen each of the barometers measuring consumer sentiment take a negative turn in terms of growth, with each outlined in figure 2 falling below their long-term averages.

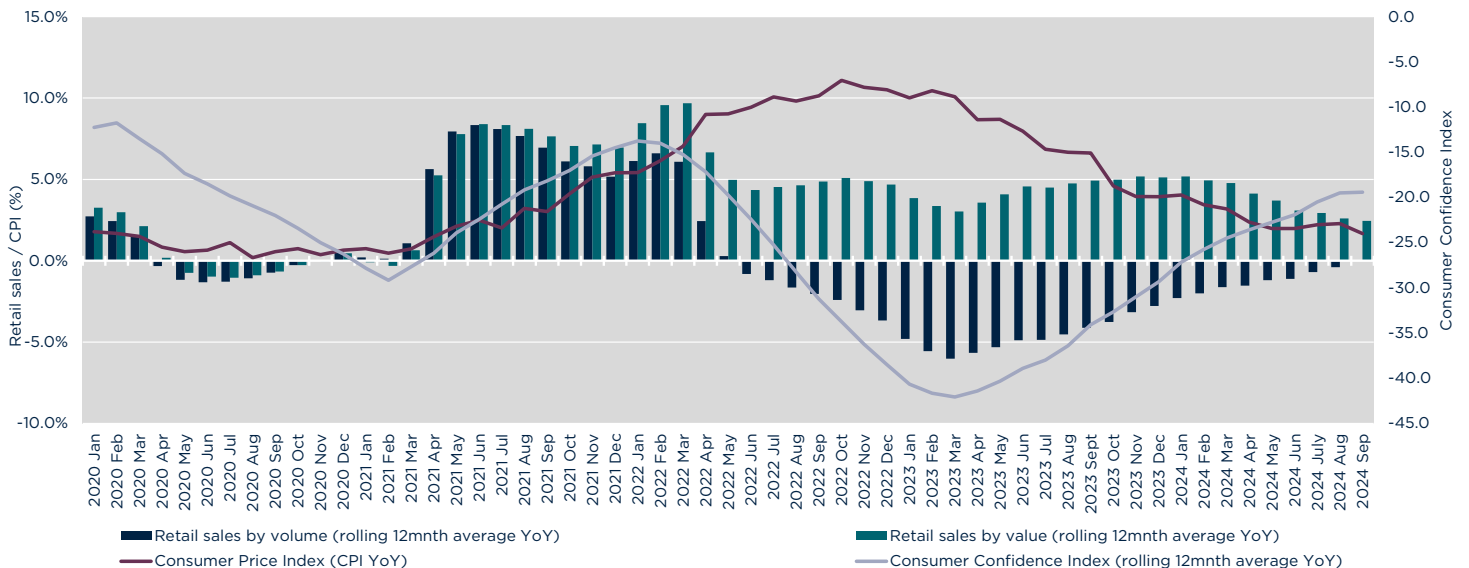
The Labour government has already signalled that the Budget will be “painful”, with Sir Keir

Starmer warning it will have to make “big asks” of the public - messaging that suggests the new government is laying the groundwork for a combination of spending cuts and tax increases. Having ruled out hikes to income tax, employee national insurance and VAT, it is widely considered the Chancellor, Rachel Reeves, is likely looking at options on employer national insurance, capital gains tax, inheritance tax and various duties, including that on fuel, in order to raise funds to fill what the prime minister has described as an “economic black hole” left by the previous Conservative government.

This is undoubtedly a fly in the ointment for the retail market whilst consumers remain apprehensive about what the results of the Budget will mean for their finances. However, until the impact of any fiscal changes can be truly measured, it remains unclear if the U-turn on consumer sentiment is a temporary blip, or whether it will lead to a significant uptick in the volume of consumers that swing into belt-tightening mode once more.

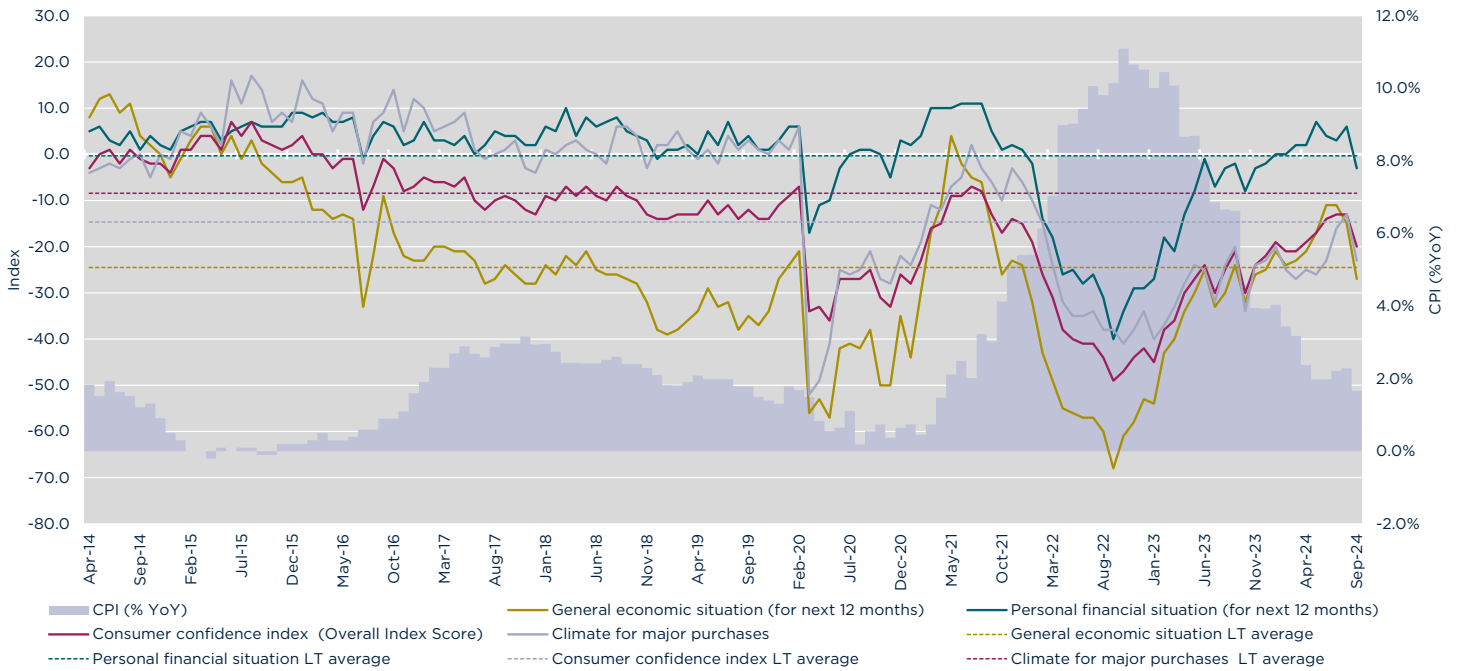
Elevated household savings are usually an indication from consumers that they are concerned at the potential of sustained austerity. If the ONS data on household savings is anything to go by, this concern is growing. Households’ savings ratio grew to 8.9% in Q1 this year, increasing even further to 10% at the end of H1. This level of saving is above the long-term average at 7.7% (covering the last two and a half decades).

Figure 1: Retail sales volume vs value



Source Savills Research, ONS, GfK

Figure 2: Consumer Price Index versus UK Consumer Confidence measures



Source Savills Research, ONS, GfK

Footfall remains stable, increasing the level of confidence operators have in high streets and shopping centres

Whether the Autumn Budget will have a long-term impact on consumer spending remains to be seen which, in turn, suggests it is much too early to hit the panic button on any subsequent negative impact this may have on the high street and shopping centre market from an occupational standpoint.

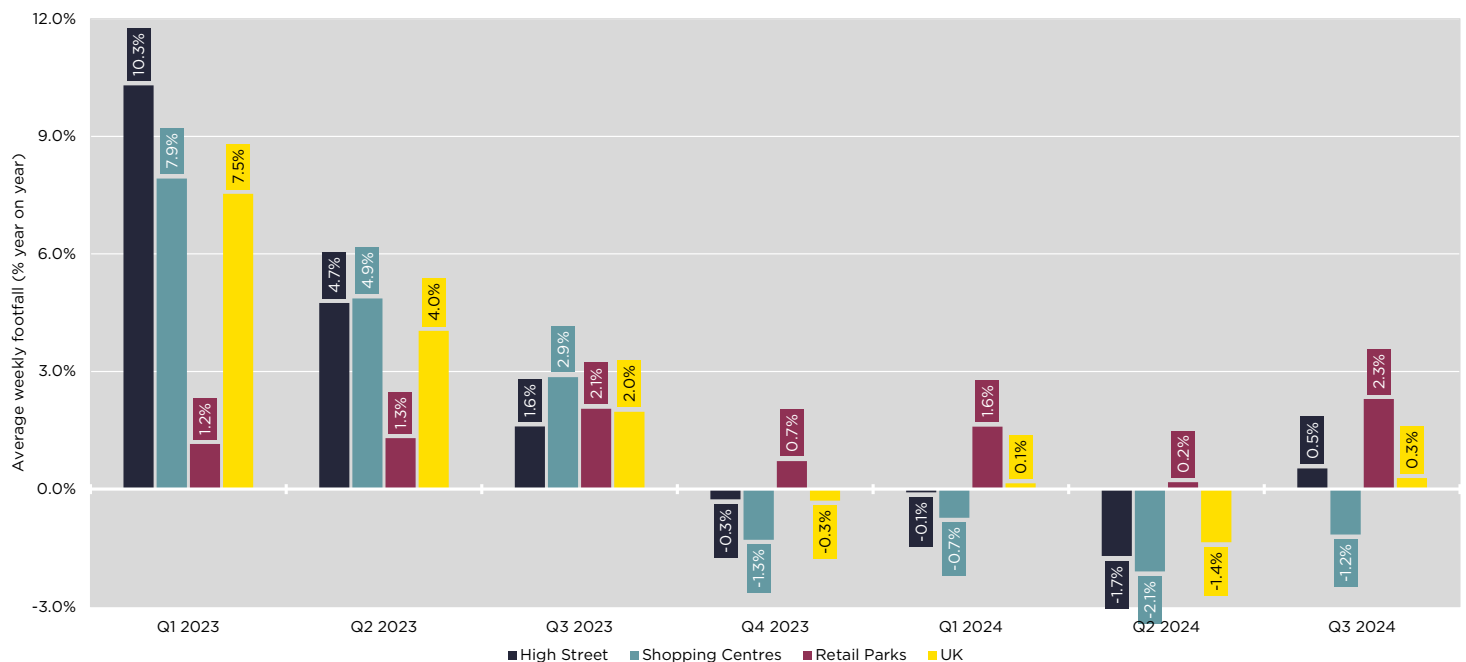
Average weekly footfall across both asset classes improved year on year (YoY) in each of the first

three quarters of 2023. For each quarter over the last 12 months, both high streets and shopping centres have broadly remained near parity with the same period the year before. Q3 2024 sees a negligible 0.5% increase in high street footfall and a minimal decrease in shopping centre footfall of -1.2% - small fluctuations such as this are typically a result of seasonality, timings of public holidays and so on (figure 3).

On the face of it, the performance over the last two quarters may feel underwhelming, especially when you consider these levels are undoubtedly below those seen pre-Covid. However, it is

important to remember that the shift to hybrid working suggests town centres will perhaps never see numbers return to those seen in 2019. The positive news is average footfall levels have seemingly stabilised, providing a touch more certainty on how high streets and shopping centres will perform going forward and giving the sector a more solid foundation on which to build. This should provide retailers with some comfort, and be their key consideration in assessing the fortunes of the sector going forward.

Figure 3: MRI UK average footfall (YoY) by asset class



Source Savills Research, MRI

Insolvency activity remains comparatively low whilst vacancy plateaus, characteristic of typical market churn instead of significant financial stress in the market

The Local Data Company suggests we saw 28,543 new openings across the whole UK retail landscape in H1 this year, alongside 25,115 closures, representing a net loss of 3,428 stores. The positive news is this net loss of stores has improved by 16% on the same period the previous year and has not resulted in a significant uptick in vacancy across high streets and shopping centres.

In fact, vacancy across both asset classes remains stable. High street voids were at 17.7% at the end of 2023 and currently sit at 17.6%, whilst shopping centre voids have remained at 14.0% throughout that time period, suggesting the net loss of stores we have seen were predominately across standalone units or smaller shopping parades, rather than across high streets and shopping centres.

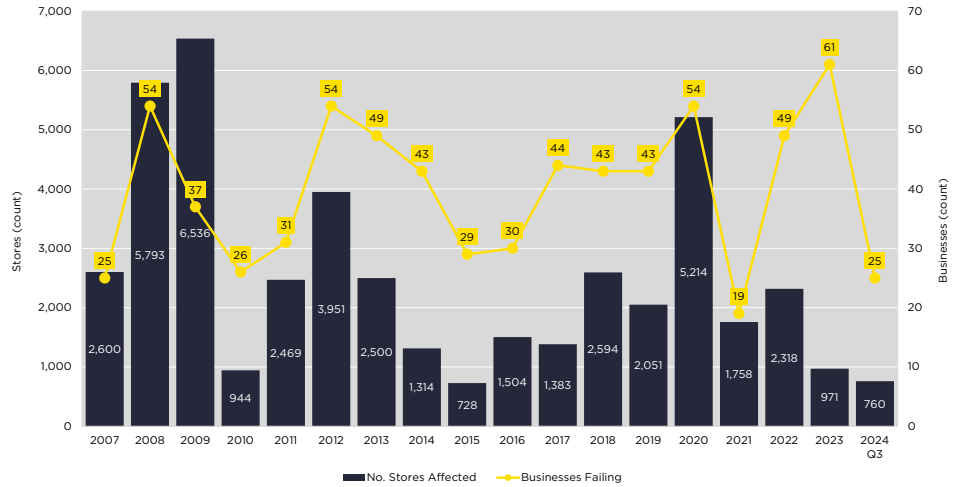
The Centre for Retail Research supports this; only 760 stores have been impacted by insolvency so far in 2024, suggesting the market is maintaining a similar pace in terms of its operator distress as that seen in 2023, significantly less than each of the previous five years (figure 4) and below the long-term average of c.2,500 stores a year. This suggests that, at present, the market is merely experiencing its usual churn, characterised by the ebb and flow of the fortunes of different operators, rather than any significant activity related to widespread financial stress.

Figure 5 provides a deeper dive into UK retail vacancy across high streets and shopping centres. Interestingly, both asset classes see similar rates of long-term vacancy, characterised as units that have been empty for three years or more; 32.8% and 38.9% of current voids meet this criteria, respectively. Any unit that has been without an operator for this length of time is either likely going through a lengthy planning process or is no longer fit for purpose and may be suitable for repurposing. Either way, the 'operational' vacancy rate may well be lower than the national averages suggest.

Green Street's analysis on what has happened to units belonging to previous major players on the UK's high streets provides an interesting case study. Debenhams, the oldest retail chain in the UK at the time, announced on 1 December 2020 that it had no alternative except to go into liquidation, which meant all 124 stores became vacant almost overnight. In the four years since, just under half (45%) have a new operator, either live or confirmed. As a large department store operator, it is no surprise that as much as a quarter of the operator's former units have since been repurposed. Significantly, four years on, just under a third remain vacant and still require careful consideration to find a successful suitable alternative - one that supports the needs of the respective towns they can be found in.

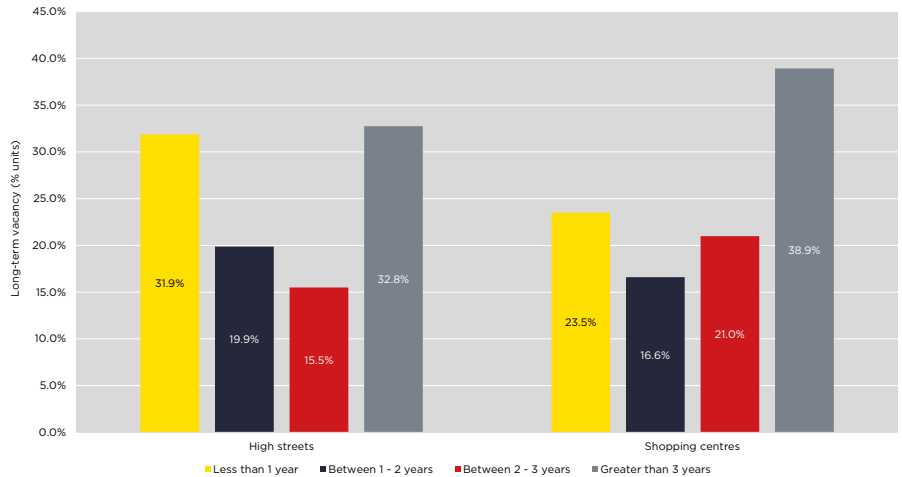
The administration of Arcadia in 2020 also saw a flurry of units return to the market (c.440). With generally smaller floorplates than is true of the Debenhams portfolio and, often in prominent high street locations, these have been arguably easier to fill - just under two-thirds of units now have a new operator; however, a further third remain vacant.

Figure 4: UK retail and leisure insolvency activity



Source Centre of Retail Research

Figure 5: Long-term vacancy by scheme type (% vacant units)



Source Savills Research, GOAD

Figure 6: Reoccupation of major store sites, H1 2024 (% units)



Source Green Street

Rents continue to edge northward as key occupational bellwethers for market performance show further evidence of stabilisation

Although there is still some way to go before vacancy is at a level that breathes widespread investor confidence in the strength of the occupational market, the fact both it and consumer footfall remain stable, coupled with plenty of evidence of operators looking for new space, can be considered a positive result for the sector.

In turn, we continue to see a positive uptick in rents on new deals across high streets and shopping centres, according to Savills in-house data. In September, our headline rents reached an average of £27.77 over the last four quarters, a marginal improvement on Q2 with 0.4% growth, but an improvement nonetheless, and off the back of positive quarterly growth over the last five (the height of the cost of living crisis was the last time we saw average rents fall slightly). 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.

PMA's average 'top rents' for mid-2024 sits at £27.80 across the key markets it analyses, a 0.9% increase on 2023. The similarity to the results across our open market letting and regears provides further confidence in the fact the market is seeing gradual and sustained rental growth, across the UK's key shopping locations at least.

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. The polarisation that is evident in the investment market when it comes to pricing between prime assets and secondary locations is rooted in similar differences in occupational performance, particularly void rate and rental tone.

High street and shopping centre outlook

The golden quarter can make or break annual trading performance for operators. Although retailers have continued to build margins in recent months after the economic challenges of 2022 and 2023, the indications are that the deflation we have witnessed will be reflected in some of their pricing of consumer goods as 2024 draws on, which could mean an elevation in consumer spend in the run-up to and over the festive period.

John Lewis is certainly optimistic on Christmas trading outlook. The employee-owned partnership, which runs the John Lewis department store business alongside the Waitrose supermarket chain, remains so despite the prospect of the new Labour government announcing tax rises in the Budget scheduled for the end of the month.

Peter Ruis, the brand's executive director, points to the fact that both of the partnership's brands are trading ahead of expectation, noting sales in John Lewis' Christmas shop are up 18% YoY, while Waitrose's appointment bookings for online deliveries are "way ahead" of last year.

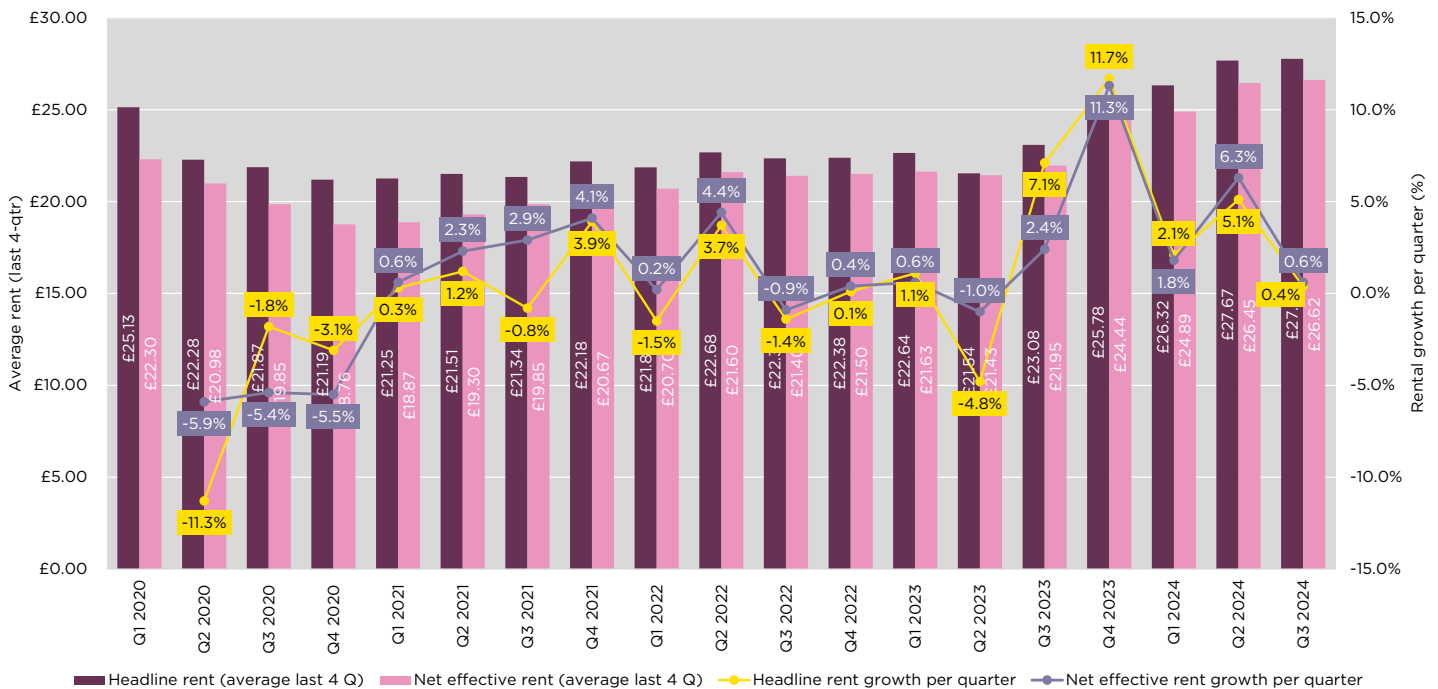
An expectation of another interest rate cut next month, coupled with steady deflation to below the BoE target of 2%, gives a sense that consumers are in a better place economically than this time last year, which John Lewis suggests is evident in their customers' spending behaviours.

Research from GlobalData on Black Friday retail shopper penetration backs this up, suggesting that despite some caution, there is strong appetite for spending this year. Its consumer survey studies the difference between intended and actual purchases on Black Friday. With 40.1% of those surveyed 'intending' to make a purchase this year, GlobalData is able to estimate 'actual' purchase penetration based on the average difference between the two seen over previous years – suggesting between 53% and 62% will make a black Friday purchase this year.

However, other retailers have said shoppers remain nervous about spending on discretionary items ahead of Finance Minister Rachel Reeves' Autumn Budget statement. Although a further cut is expected in November, the BoE kept interest rates on hold at 5% in September which obviously affects mortgage, credit card and savings rates for millions of people across the UK. Despite the first drop in rates for more than four years in August, the reduction was only 0.25%, meaning borrowing costs remain high for many consumers.

Sainsbury's Chief Executive Simon Roberts shares this view in so much as consumers impacted by the cost of living crisis will not start spending strongly again until the new Labour government sets out its tax and spending plans, and interest rates fall further as despite falling inflation, higher wages, and solid employment levels, UK shoppers remain nervous about spending on bigger ticket items.

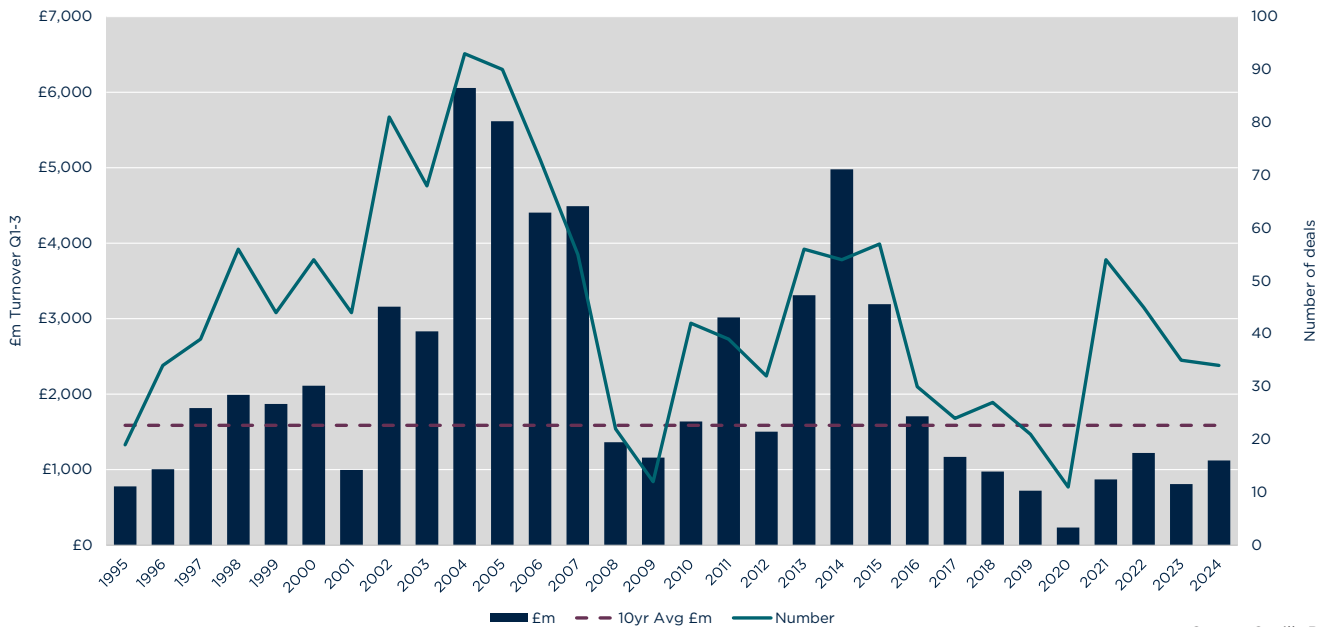
Figure 7: Savills high street & shopping centre deals analysis



Source Savills Research

“We expect to see modest yield hardening in 2025”

Figure 8: Shopping centre investment volumes for the first three quarters of the year



Source Savills Research

UK retail investment market

Quiet summer hides a steady increase in investor interest

Shopping centre investment

With only £171m of shopping centre investments traded in the third quarter, some regular readers of this Spotlight might comment that we were a little overly optimistic on the outlook in our Q2 Spotlight. However, the volume of stock in the market and the broadening pool of buyers suggests that our earlier prediction that turnover would reach nearly £2bn this year is still achievable.

The relatively quiet summer still brings the total turnover for the first three quarters of the year to £1.1 billion, 39% higher than the same period in 2023. However, it is still 29% lower than the ten-year average for the first nine months of the year.

Looking ahead to the final quarter of this year, £114m of centres have already traded and £520m are under offer. Interestingly, the average size of centres in the market has steadily risen over the course of this year, with the first quarter average being 238,000 sq ft and the final quarter likely to reach 400,000 sq ft.

The increasing size of assets that are being brought to the market has broadened the pool of buyers, with lot sizes of over £100 million beginning to pique the interest of domestic and international institutions. This has moved institutional investors into the position of being the dominant buyer group over the first three quarters of 2024, accounting for 52% of the

transactional volume (though only 13% of the deals by number). The other dominant buyer groups continue to be those that have led the market for the last few years, with property companies and retailers being the next most active groups by volume.

As far as deals to watch go, the current bellwether for prime continues to be the stake in Edinburgh St James Quarter that is on the market alongside the W Hotel in the same scheme. While this will not be the largest deal of the year, it will be a strong indicator of both the depth of demand for prime shopping centres and the yield. It is by no means guaranteed that the sale will complete in 2024, but whenever it does, we expect the underbidders to remain poised to look at any similarly prime shopping centres that might come to the market in 2025.

This raises the question of whether 2025 will see more sales, as it is beginning to feel that the drag in the shopping centre investment market is no longer the limited buyer pool. We have now moved our prime shopping centre yield in by 25 basis points this year, but this only takes them back to where they were in 2023. This limits the prospect of investors who bought at the very nadir of the cycle in 2022/23 starting to look at potentially taking profits in 2025. However, if further yield hardening is expected on the back of the falling

cost of borrowing over 2025 to 2027, then it could start to become a reason to sell by then.

Typically, we expect to see a pick-up in bank-led sales of assets after the recovery has begun, though this is less likely in the shopping centre sector as much of the pain has already been taken over the last few years. This could change some investors' rationale for buying away from just the high yield on offer. Prime shopping centre yields remain high in a historical context, but other asset classes (particularly offices) are now looking higher yielding and thus might seduce some of the yield-driven buyers away from this sector. Opportunistic buyers who are interested in the sector for repurposing or change of use reasons are expected to remain active next year, particularly in the face of a government that is keen to make it easier to deliver new housing in the parts of the country that need it. However, at present, we are challenged to make the numbers stack up on a large scale retail-to-residential development even in the South East.

For current or aspirational, owners of shopping centres, the rationale will be the same in 2025 as it has been for years. The improving occupational story, return of rental growth, high yield and non-existent development pipeline should ensure that income returns will remain attractive for the foreseeable future. While we expect that

Just over one billion pounds of shop investments have been traded this year outside central London

Figure 9: Shopping centre yields

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

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

Source Savills Research

the most sought-after assets, such as mid-size foodstore anchored schemes, will see modest yield hardening in 2025, we do not expect to see a return of investment volumes to the £3bn to £4bn range that was common a decade ago.

High street shop investment

While the volume of shop investments traded so far this year remains 15% lower than the same period in 2023, the trend is clearly moving in the right direction. Just over one billion pounds of shop assets have been sold this year, 21% of which were in the third quarter.

The recent trend of foodstores dominating trade has continued this year, though the cyclically high proportion of 65% was heavily skewed upward by the portfolio of Waitrose stores that M&G bought back in March. What is more worthy of note is that in the second and third quarters of 2024, non-foodstore assets accounted for 64% of the transactions by volume, a return to the long-term dominance of the “standard shop” in the retail investment numbers.

There is no doubt that the sector has seen some new entrants over the last nine months, though the rationale for buying remains the same as it

has been. We expect that turnover will steadily increase over the next 12 months, in line with the improving investor sentiment towards retail and the wider economic recovery.

Furthermore, we are beginning to see an increase in the number of £10-£15m parades and blocks coming to the market, and this should also bring high street retail onto a wider group of investor’s radars. While there is definitely rising institutional interest in retail as an asset class, we do not expect this to materially impact on the high street retail investment market, due to the lot sizes on offer generally being too small for institutional investors. One consequence of this increased interest, however, might be that we see fewer institutional sales of retail assets in 2025 than we have seen in recent years.

We do expect to see some further hardening in prime shop yields next year, though this is more likely to be in the region of 25-50 bps, rather than the 100+ that might be seen in other sectors. This is not a comment on the attractiveness of the subsector, but more a reflection of the fact that yields are already back to 2021 levels.



8.00%

Super prime shopping centre is now back to its end-2022 level



64%

of high street shop investments this year have been non-food



£1.1bn

of shopping centre investments traded so far this year



-50 bps

The movement in prime shop yields in Q1-Q3 2024



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Retail

Mark Garmon-Jones

Shopping Centre
Investment
+44(0)7967 555 593
mgjones@savills.com

James Stratton

High Street Investment
+44(0)7787 513 060
james.stratton@savills.com

Toby Ogilvie Smals

Investment
+44(0)7972 000 045
tosmals@savills.com

Alan Spencer

Occupational Advice
+44(0)7967 697 905
aispencer@savills.com

Stuart Moncur

Occupational Advice
+44(0)7887 795 506
stuart.moncur@savills.com

Research

Sam Arrowsmith

Commercial Research
+44(0)1612 777 273
sarrowsmith@savills.com

Mat Oakley

Commercial Research
+44(0)20 7409 8781
moakley@savills.com