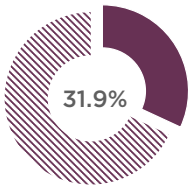
UK Commercial – Q4 2020

SPOTLIGHT
Savills Research

Shopping Centre and High Street Spotlight

savills

- Christmas trading overview
- Q4 2020 trends in leasing and investment
- Outlook for 2021



31.9%
Share of total UK retail sales made online in Q4 2020 on average, according to ONS

UK retail consumer and occupational trends

Retailer trading statements delivered a much expected mixed bag of results over the Christmas period.

Early footfall improvements in December were quickly reversed with the introduction of new tiered restrictions, damaging in-store sales once again. Christmas trading results were therefore very mixed, with total retail sales down -0.8% on average, compared to the +5.1% growth recorded in 2019. It's worth noting that fewer retailers reported full Christmas trading updates this year; however, a deeper dive into the individual statements reveals some interesting trends.

Sales growth through online channels averaged 66.5% this Christmas compared to an average in-store decline of –30.1%, for those retailers that report a breakdown. As a result, online sales penetration has continued to reach new heights, accounting for a 31.9% share of total UK retail sales in Q4 2020.

A surge in online sales mitigate some of the challenges facing many retailers

Some retailers saw online sales rise enough to counteract losses from in-store transactions. For example, Joules saw a marginal 0.3% total sales growth, with the 66% growth in online outweighing the -58% fall in in-store sales. Similarly, Next sales beat expectations, with total sales decreasing by a marginal -0.5% year on year, held up largely by online sales growth of 38%. However, for many, this does suggest a further squeeze on margins, due to the incurred costs of delivery/returns.

Fashion and footwear retailers continued to be disproportionately impacted by the ongoing restrictions, with relatively downbeat total sales performance of -12.0% year on year, on average.

Homeware retailers continued to report promising growth figures despite store closures, owed to a very strong residential sales market and homeworking triggering additional home improvements. On average, total sales increased 15.7% year on year for homeware retailers, up on the 11.6% growth reported in 2019. Ongoing growth has cemented objectives regarding store expansion for some, including B&M, who opened 16 new stores in the period, with an additional 18 expected in the current quarter.

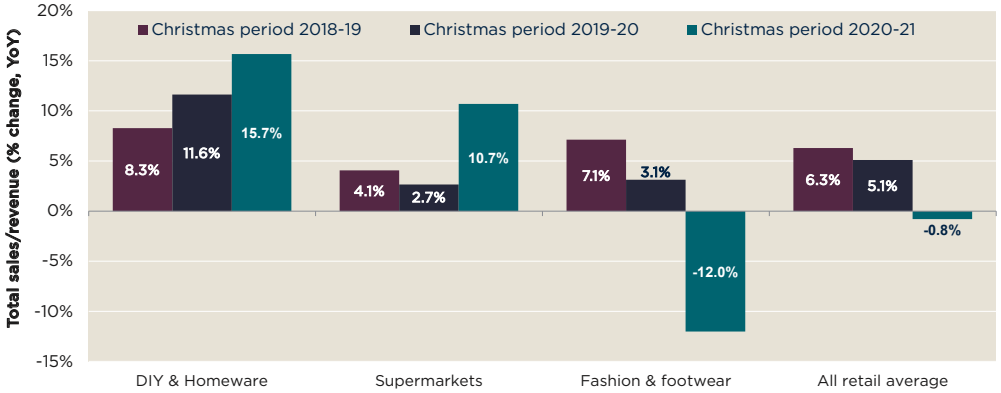
Unsurprisingly, supermarket sales saw a strong Christmas period in line with the transference of spend from people unable to eat out or travel. Discount supermarkets Aldi and Lidl each reported record sales, alongside growth to their UK store portfolios. Sainsbury's, Tesco and Morrisons also reported strong sales growth, despite mentions of increased costs incurred by tighter Covid restrictions and rising online demand.

Outlook

Oxford Economics is projecting total household spend to decline -11.2% in Q1 2021, in line with Lockdown 3.0 and the challenging consumer environment. Further financial implications can therefore be expected, prompting rent deferments and potential insolvency activity which could apply pressure to some schemes, particularly those more exposed to fashion and F&B.

However, there is reason to believe this lockdown is slightly different. Tight restrictions now coupled with the mass vaccine rollout is likely to result in a relatively less disruptive summer. The rise in household saving, together with a low inflationary environment, also provides strong household spending power in which to generate growth in UK domestic spend, once restrictions begin easing.

Christmas trading by subcategory emphasises the polarising results, with DIY and homeware significantly outperforming the UK average, while the fashion segment remains challenged.



Source Savills Research

Homeware & DIY retailers reported the strongest average year on year sales by subsector for the Christmas period.

Online sales grew +66.5% year on year on average from retailers Christmas trading results in 2020, up from +13.8% in 2019.

Based on 2020 Christmas trading updates, in-store sales averaged -30.1% year on year.

> **Lease lengths have continued to fall to new record lows, with high street deals averaging 7.6 years in 2020, whilst shopping centre deals averaged 5.1 years.**

A surge in deal activity in Q4 reveals the ongoing pressure on retail rents

The occupational trends experienced through 2020 appeared to accelerate in the final quarter, with a fresh wave of restrictions applying additional pressures on retailers and landlords alike.

This has been emphasised within rent collection data, with many landlords receiving a lower proportion of their December rent collection compared to previous quarters. British Land and Hammerson, for example, received just 46% and 41% of their December retail rent respectively, down on previous quarters in 2020.

Despite this, leasing activity witnessed a rush of activity in Q4 with deal count largely in line with the same quarter in 2018-19. This perhaps revealed the truest extent to which various lockdowns and temporary closures have impacted rental tone. On a rolling four-quarter average, headline shopping centre and high street rents decreased -14.7% year on year in Q4, surpassing the -12.5% fall in Q3 2020.

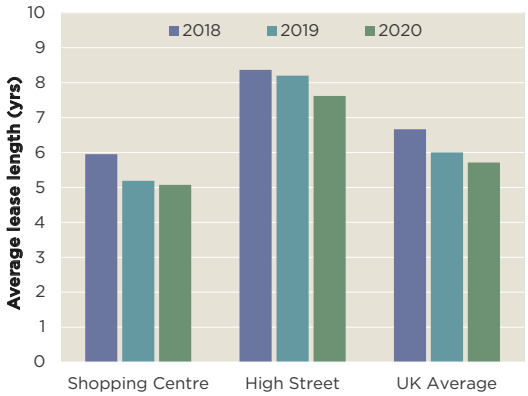
Landlord incentives remain vital for enticing retailers and preventing vacancy issues. On average, rent-free periods on shopping centre and high street deals averaged 6.4 months and 7.9 months respectively in 2020, logging year on year increases of 28.7% and 2.7%. Incentives will continue to be a firm feature of leasing deals going forward; however, there are question marks over the level at which they can continue to rise, with landlords under increasing pressure to manage their own debt obligations. Alternatively, some negotiations have involved discussions regarding rent-free periods being divided over the length of the lease, rather than at the start, in order to protect initial rental income.

At the same time, lease lengths continued to drop to record lows. On new high street deals, leases averaged 7.6 years in 2020, down -7.1% on the 2019 average. Meanwhile, shopping centre leases averaged 5.1 years, representing a more marginal decrease of -2.3% year on year, albeit off the back of an already sizeable decline between 2018 and 2019 of -12.7%.

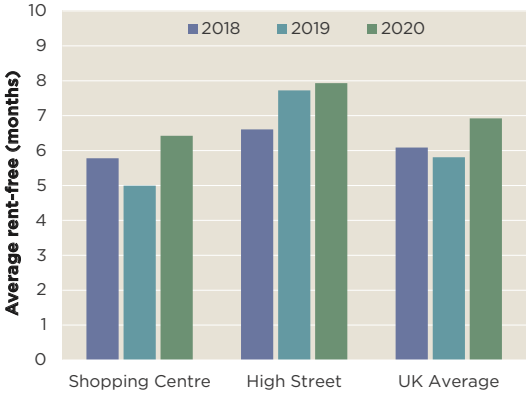
Shrinking lease lengths coupled with growing incentives has resulted in an acceleration in net effective rental decline, recording -15.4% year on year in Q4 2020 on a rolling four-quarter basis, exceeding the -10.1% fall in the year to Q3 2020.

Lockdown 3.0 and tighter restrictions lasting until spring will no doubt continue to damage footfall, sales and, therefore, occupational sentiment. The initial response is likely to give rise to ongoing rental declines. However, once the mass vaccination process advances and restrictions begin to ease, we could gradually begin experiencing some recovery to the consumer environment across certain submarkets.

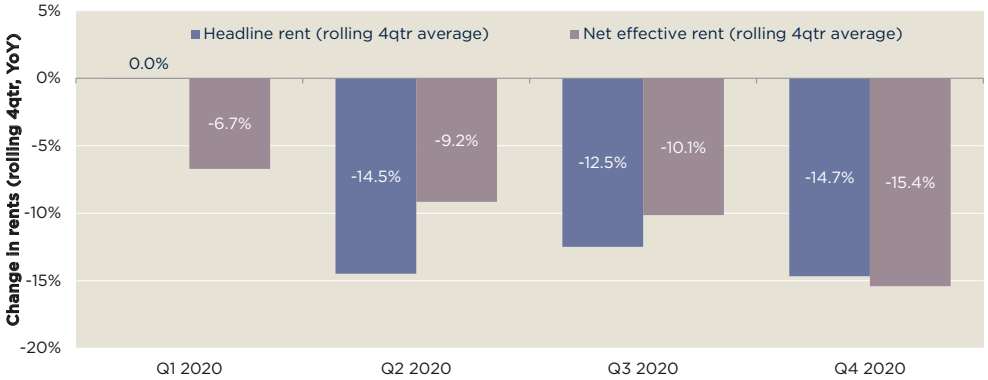
Average lease lengths 2018-2020



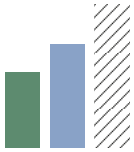
Average rent-free periods 2018-2020



Change in average high street and shopping centre rents emphasises the increased downward pressure on net effective rents experienced since Covid-19.



Source Savills Research **Note:** Based on Savills UK retail deals, excluding London & SE



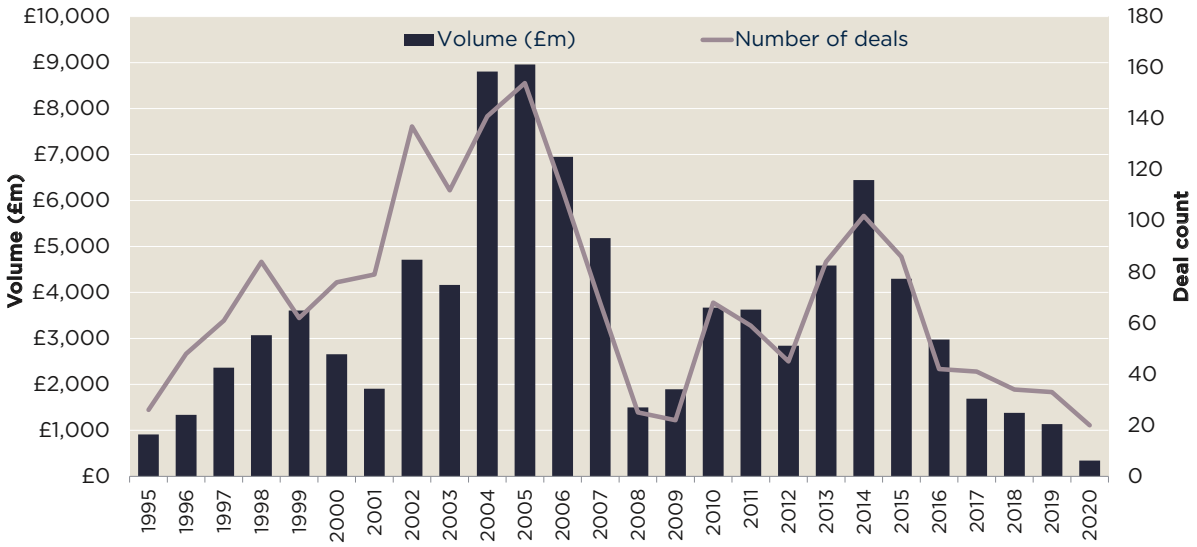
Average rent-free periods of UK shopping centre and high street deals collectively reached a record 6.9 months in 2020

Lease lengths averaged 5.7 years for 2020 deals, down 4.8% compared to 2019 levels

Average net effective rents declined -15.4% year on year across shopping centre and high street deals in 2020

> 38% of all shopping centre investment purchases last year were by local authorities

Shopping centre investment



Source Savills Research

UK retail investment market

Continued low investment volumes expected in 2021, but bargain-hunters are beginning to emerge

The retail investment market was not unique in terms of 2020, seeing substantially lower than average investment volumes. However, while some sectors saw a slight recovery in activity in Q4, this was not the case for shopping centres in particular.

Shopping centre investment

Twelve months ago, we highlighted the fact that 2019 had been the worst year for investment into shopping centres in the UK since 1995. At that time, we definitely did not imagine that 2020 would prove even worse.

The combination of the all-sector impact of Covid-19 on investment activity and continued investor reticence about shopping centres, in particular, led to full-year investment turnover of only £341m in 21 schemes. This was a 69% year on year fall in the value traded, and a 36% fall in the number of schemes sold - as well as making 2020 the worst year on record for shopping centre investment.

The trend that had the biggest impact on last year's investment volume was the size of asset traded, with the average lot size falling to £16.3m. Indeed, while 2019 had three transactions of over £100m, 2020 saw none.

Other trends that we have commented upon in the last five years continued to be prevalent in 2020, with a continued southern bias (the South East and South West accounted for 54% of trades), and 38% of all purchases of shopping centres last year being by local authorities. While there was some suggestion last year that local authorities might be less active investors in commercial property due to the changes in the PWLB criteria for loans, this does not seem to have affected their appetite for shopping centres. This is because virtually all of the local authority activity in this sector over the last decade has been about buying their local centres, and thus it can be justified as a regeneration-focused decision rather than a purely income-focused one.

However, while the rationale amongst local authorities has definitely swung towards "social return" being more important than income return, we expect that these assets will also be good income generators while their new owners focus on supporting the continued viability of that particular town or high street's retail offer.

A trend that firmly accelerated in 2020 was the acquisition of shopping centres for redevelopment or repurposing. We estimate that nearly 30% of all the deals last year were motivated by the purchaser looking to refocus the scheme away from a purely retail offer, and this is definitely a trend that we expect to accelerate through 2021 and 2022.

Institutions continued to be the dominant sellers of shopping centre assets in 2020, with councils and property companies being the dominant buyers; the latter with the aforementioned heavy bias towards repurposing. Food-anchored schemes remained popular last year, with 43% of the schemes traded being convenience-focused. Only two of the schemes that were sold last year were anchored by department stores, again a continuation of the trend that we have seen evolving over the last few years.

Looking ahead to the rest of this year, we expect that the tone of 2021 will be broadly similar to that of 2020, with the first and second quarters being restrained by the lockdown and lack of debt and then a much stronger second half.

At the time of writing this report, there were 17 schemes under offer, with a total capital value of £176m, and 29 schemes being actively marketed, with a total value of £745m.

When it comes to pricing, we continued to see softening in both prime and secondary yields last year, and we expect this to continue this year. However, there is now evidence that vendors are being more realistic on pricing, and we expect that this will lead to more opportunistic buyers entering the market in the second half of 2021. That said, further CVAs and corporate failures in fashion and leisure will mean that investor concerns about lettability and the trajectory for rents will remain high, and this is likely to delay any substantive recovery in transactional activity until 2022.

High street shop investment

At a macro level, there was a slight resurgence in investment activity in unit shops in the final quarter of 2020, with £1.1bn of assets traded (up from around £500m in each of the preceding three quarters). However, 55% of the transactions were on foodstores which remain in demand as a low-risk, Covid-defensive segment of the market.

The overall volume of shop assets traded in the second half of 2020 does indicate that there is some confidence amongst investors that pricing is getting close to the right level for the best assets, but this does not mean that the nadir has been reached.

The trends that were evident in 2020 are expected to continue through 2021, with a heavy bias towards or assets that are either food or bank-anchored, inside the M25, or offering redevelopment opportunities being at the top of most private investor's shopping lists.

In common with the shopping centre investment market, we expect this activity to be biased towards the second half of the year, once social distancing measures have reduced and non-essential retail has reopened. There will still be sizeable questions to be answered around retailer viability and how rent holidays are priced in, but where there is a clear discount available on supportable income streams in the right locations, there will be an increasing level of private investor interest. Property companies will continue to be more focused on assets where there is an opportunity for conversion, typically to residential uses.

SC equivalent yields:
Revo centre classifications

	Q3 2020	Q4 2020
Dominant Prime	8.50%	8.75%
Regionally dominant	6.75%	7.00%
Sub regional scheme	8.25%	8.50%
Neighbourhood scheme	10.00%	10.25%
Local scheme (successful)	9.75%	10.00%
Local scheme (challenged)	15.50%	15.75%

Source Savills Research

SC equivalent yields: Savills classifications	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Super-prime centre	5.50%	5.75%	6.25%	6.25%	6.75%	7.00%
Prime centre	7.25%	7.50%	8.00%	8.00%	8.50%	8.75%
Town centre dominant	9.00%	9.25%	9.50%	9.50%	10.00%	10.25%
Community & convenience	8.75%	9.00%	9.50%	9.50%	9.75%	10.00%
Secondary	11.25%	11.50%	12.00%	12.00%	12.50%	12.75%
Tertiary	14.50%	14.50%	15.00%	15.00%	15.50%	15.75%

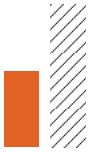
Source Savills Research

£341m
2020 investment in shopping centres

43%
of shopping centres bought in 2020 were food-anchored.

10%
were department store anchored

125bps
The rise in prime shopping centre yields over the last 12 months



100bps
The rise in prime unit shop yields over the last 12 months

Savills Commercial Research
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team

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)7787 795 506
stuart.moncur@savills.com

Research

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

Marie Hickey
Commercial Research
+44(0)20 3320 8288
mlhickey@savills.com

Josh Arnold
Commercial Research
+44(0)20 7299 3043
josh.arnold@savills.com