UK Commercial – Q4 2023

SPOTLIGHT

Savills Research

Shopping Centre and High Street Spotlight

savills

- Solid Christmas trading as inflationary pressures reduce
- Investor attitudes to retail still to be tested by large mall sales

> “Since last April, inflation has been trending steadily downwards”

UK retail consumer and occupational trends

Improving consumer fortunes suggests a turning point in occupational sentiment; however, retailer outlook for 2024 remains mixed

When headlines regarding the cost of living, surging product prices and a recessionary environment took hold in 2022, we saw a dramatic uptick in inflation; the Consumer Prices Index (CPI) reached double-digits for the second time in September that year and remained there until the end of Q1 2023.

Since last April, however, inflation has been trending steadily downwards. Most recently, CPI rose by 4.0% in the 12 months to December 2023, up from 3.9% in November. Despite the marginal increase, it remains a significant improvement on its most recent peak in October 2022 at 11.1% and represents the first time the rate has increased at all since February of last year.

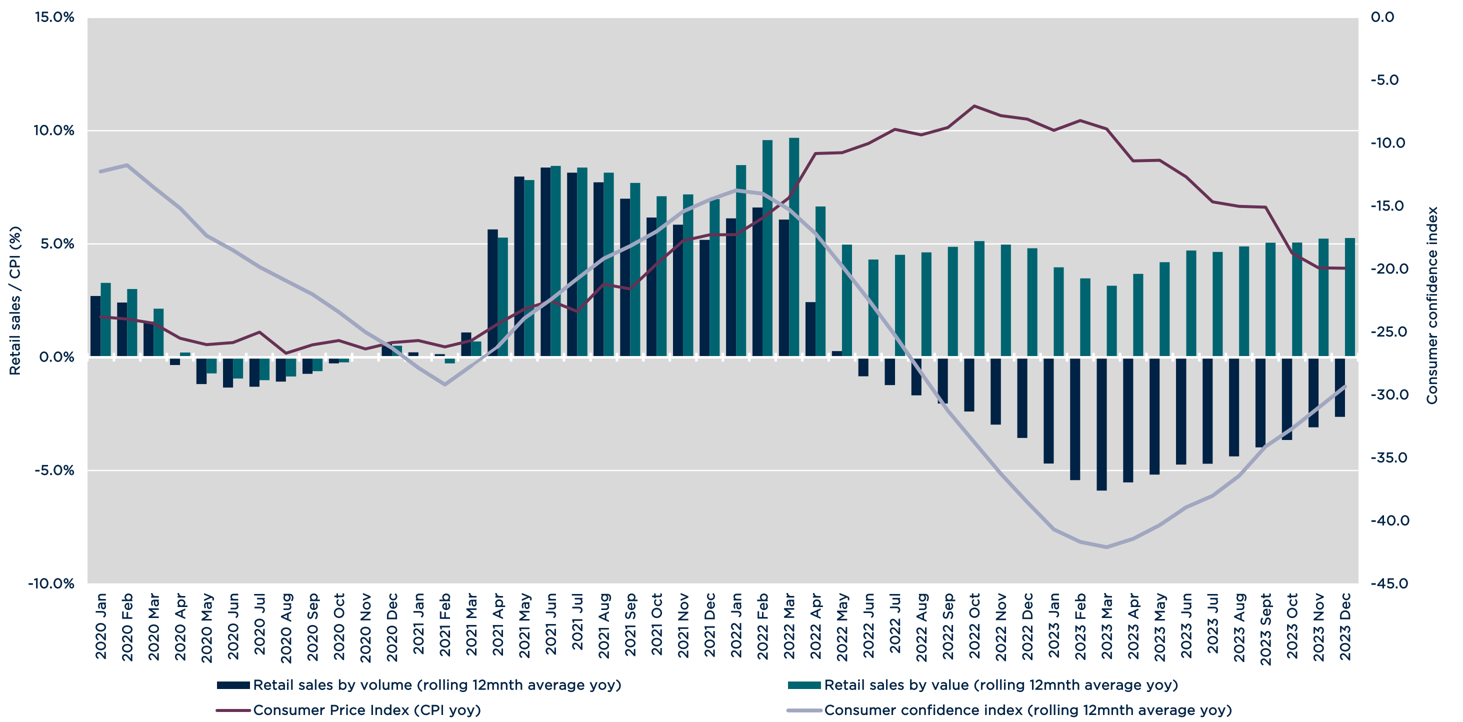
At the same time we have seen a steady rise in consumer confidence. Currently the GfK index stands at -29.3 on a rolling 12-month basis, below the -10.9 average of the last two decades but 12.8 points higher than in March last year, the lowest point the index has fallen in the last 20 years.

Although it is early days, with easing inflationary pressure positively impacting the direction of consumer confidence, we have also seen the disparity between the volume of products sold and the value of retail sales begin 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 sales by value continuing to grow (figure 1). The most recent YoY retail sales figures from the ONS saw values grow 5.3% in December on a rolling 12-month basis, while sales by volume fell -2.6% over the same period. However, this marks a significant 300 basis point improvement on the most recent trough in retail volumes, seen in March last year (-5.9%).

Although it seems we have passed the nadir in the diverging relationship between value and volume of retail goods, the gap still exists. Consumers are still ultimately getting less bang for their buck than was true prior to the onset of the cost of living crisis. The likely result for retailers is that overall sales figures may be improving, but their margins are still, in fact, thinning.

CPI +4.0%
in the 12 months to December 2023

Figure 1: UK retail sales volume vs value



Source Savills Research, ONS, GfK

Reading between the lines of Christmas trading results 2023-24

On the face of it, Christmas trading was generally positive. Total sales reported a 2.8% YoY uptick on average and 3.0% on a like-for-like basis for those who report it. This is significantly less than the previous festive period at 13.7% and 9.7%, respectively however; a positive result considering the strong comparatives off the back of the Omicron concerns that plagued demand over Christmas 2021. However, with the growth in retail volumes still in negative territory, positive sales growth for some is arguably more of a reflection of operators passing on the increase in the cost of getting goods to market than any significant uptick in profits.

Of course, retailer performance often varies by sector. Foodstore operators have continued to perform well throughout 2023 despite current consumer austerity as groceries remain an essential purchase. Barclaycard credit and debit card spend highlights a 6.2% increase in average month-on-month grocery spend for 2023 versus the previous year (figure 2). Over the festive period, the discount grocers fared particularly well as many consumers attempted to cut costs. Aldi has recorded its best-ever Christmas - total sales were up 8% YoY, topping £1.5bn for the first time in the run-up. Lidl also recorded strong trading performance this festive period, with a 12% revenue growth YoY.

In contrast, fashion sales saw a -4.1% decline, on average, across those operators that published their Christmas results, whilst Barclaycard data suggest a 0.9% fall in clothing spend for all of 2023. However, retail performance can differ significantly even between those retailers operating within the same sector, depending on their approach and their target audience, which of course means the impact on the high street has been nuanced.

Next is considered a bellwether for Christmas performance on the high street and performed well despite the overall decline in fashion spend seen across the market. Its total full-price sales were up 5.7% in the nine weeks to the end of December, which outperformed its previous guidance of 2.0% growth YoY for the period. At the same time, its total online sales rose 9.1% YoY. Similarly, M&S saw its UK clothing & home revenue up 4.8% to £1.2bn. The retailer continues to successfully appeal to a broader demographic of shoppers thanks to its continued transformation strategies.

What is clear from the Christmas trading results is those operators with a strong omnichannel presence outperformed once more, with consumers favouring in-store shopping experiences. This contributed to the success of physical locations outperforming online pure plays, whose results were lower than previous years.

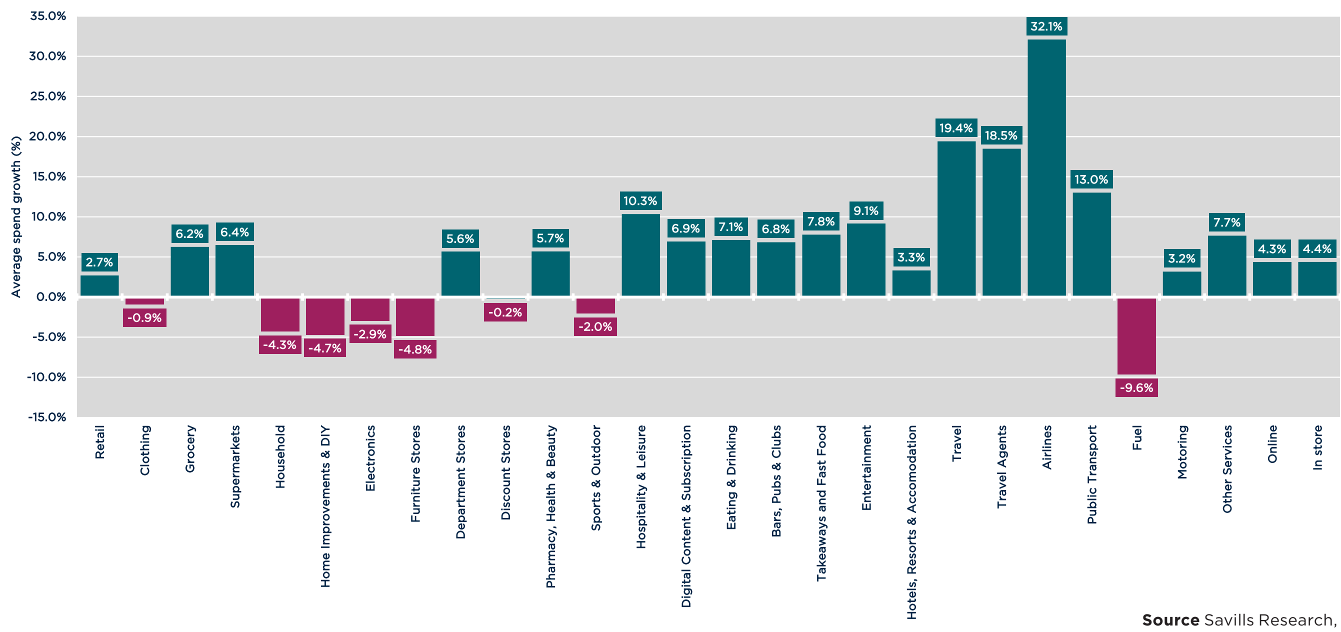
Similarly, value operators saw a strong uptick in revenues. Primark is an example of another fashion retailer with positive Christmas trading results. Its UK revenue saw an increase of 4.5% YoY. Meanwhile, B&M, purveyor of discount comparison goods and homewares, saw UK revenue up 3.7% to £1,350m in the same period.

Although it may seem counter-intuitive, in a period of consumer belt-tightening an increased focus on value shopping goes some way to explaining the elevated performance across some leisure activities. Consumers look to make savings in their everyday, essential purchases to elevate their disposable income. Figure 2 highlights an increase in Barclaycard spend in 2023 of 6% or more across a number of leisure activities, including eating and drinking (7.1%), pubs, bars and clubs (6.8%) and takeaways and fast food (7.8%) – undoubtedly a positive result for the high street. Meanwhile, it was the bigger-ticket and non-essential spend that saw the largest declines, including DIY (-4.7%), electronics (-2.9%) and furniture sales (-4.8%), operators that are much less common across high streets and in-town shopping centres.

+2.8%
Average total sales increase YoY over Christmas 2023

-4.1%
Average decline in fashion sales YoY over Christmas 2023

Figure 2: Barclaycard sales – average spend growth in 2023



Source Savills Research, Barclays

> "Footfall has been steadily improving year on year across high streets and shopping centres"

Have we seen a turning point in occupational sentiment?

In addition to positive sales growth in some areas, the UK high street has seen other shoots of positive occupational performance begin to emerge. The Centre for Retail Research highlights a -58% decrease in the number of stores affected by insolvency in 2023 compared to the previous year across the whole of the UK retail market. Insolvency impacted less than a thousand stores overall, the lowest number since 2015; the caveat to this positivity is the increase in the number of businesses impacted overall, suggesting insolvency had much more of a negative effect on independent operators with fewer stores (figure 3).

Nevertheless, the recent administration of the Body Shop and the potential loss of almost 200 stores across UK high streets is a stark reminder of the ebb and flow in the fortunes of operators in this sector. At the same time, Savills is aware of a number of operators actively seeking space in this market over the next 12 months, including Peacocks, Bonmarche and Edinburgh Woollen Mill looking for 60 stores across the three brands, Trespass (30 stores), Suit Direct (15 stores), Wingstop (15 stores) and Age UK (10 stores). M&S, B&M, Superdrug, Greggs and Costa are also all continuing to pursue a growth strategy across UK high streets.

Footfall has also been steadily improving on a YoY basis across high streets and shopping centres. Although not at the levels seen pre-Covid, with average weekly footfall -13.7% and -15.6% down, respectively, compared to 2019, YoY performance has been steadily improving. Both asset classes posted positive growth in average weekly footfall in the first three quarters of 2023 versus the previous year, with Christmas at near parity with 2022 levels (figure 4).

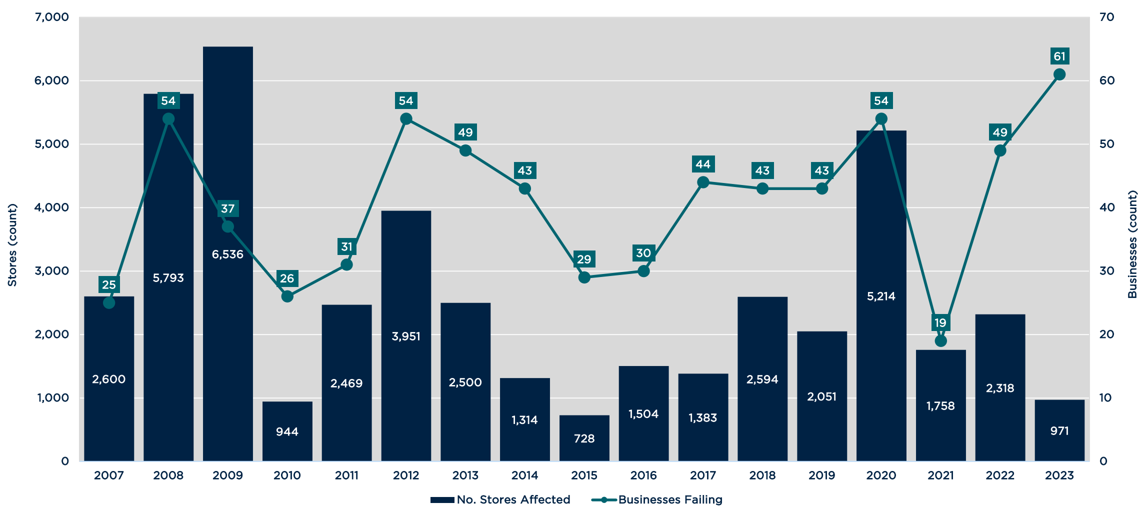
Reduced insolvency activity and renewed expansion plans for 2024, which promisingly are not restricted to just discount operators, have in turn seen vacancy across the sector continue to fall. National shopping centre and high street vacancy reached their highest point in the last 20 years at 19.4% and 14.5%,

Only 971
stores affected by insolvency in 2023

17.7%
Shopping centre vacancy Q4 2023

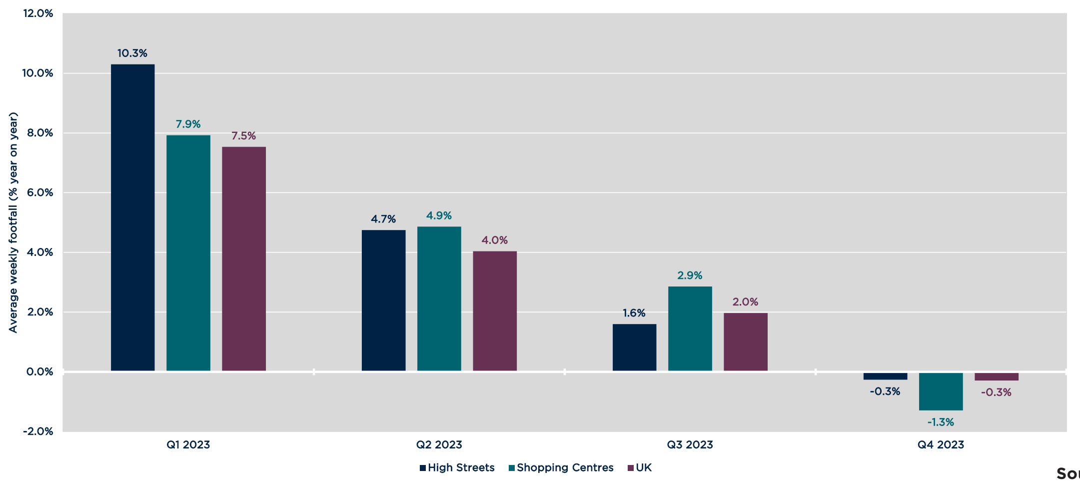
14.0%
High street vacancy Q4 2023

Figure 3: UK retail and leisure insolvency activity



Source Centre for Retail Research

Figure 4: High street & shopping centre footfall 2023



Source MRI

> "Competitive tension is beginning to build between operators looking to expand"

respectively, in Q1 2022, but have gradually fallen ever since. 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 downward trajectory is a positive one (currently, shopping centre and high street vacancy is at 17.7% and 14.0%, respectively, according to the Local Data Company).

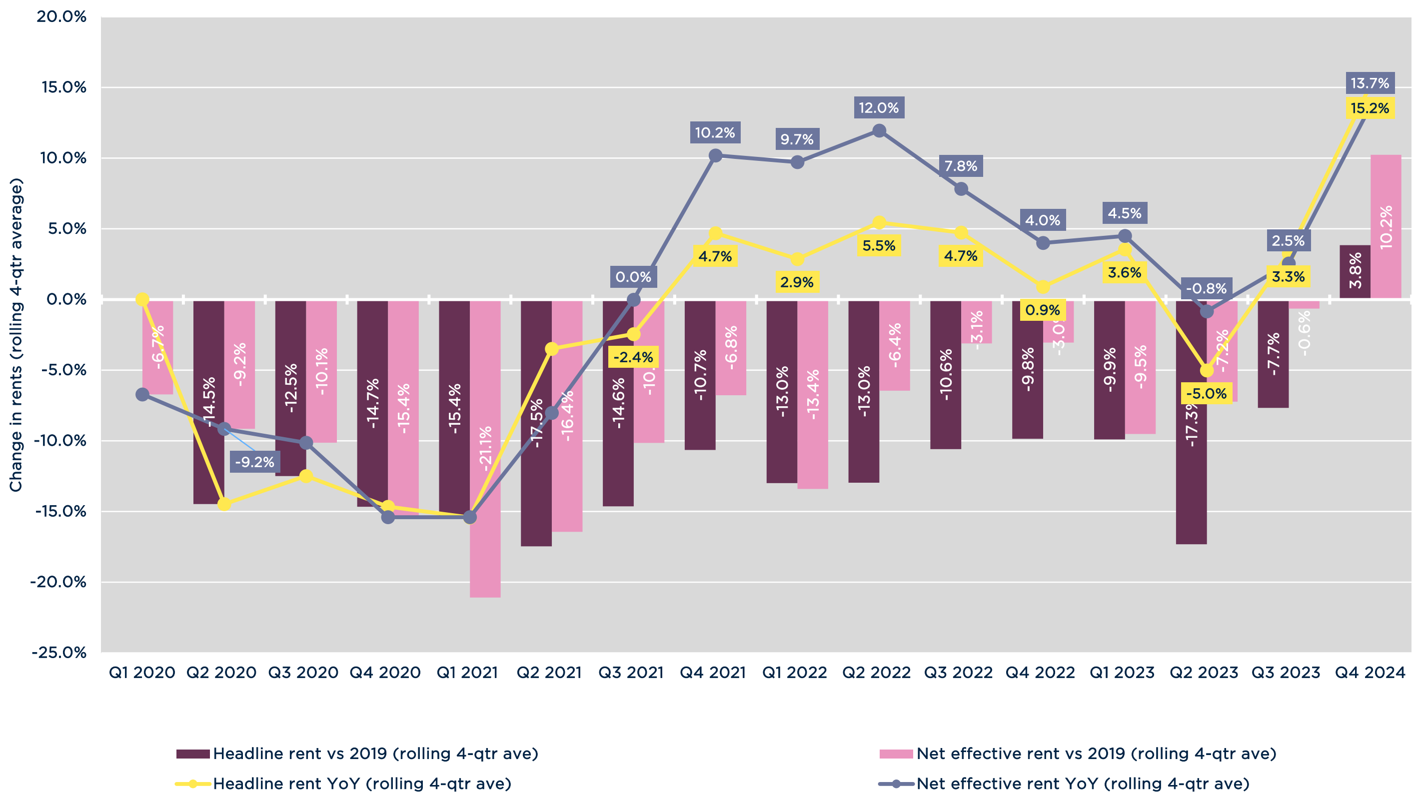
In turn, we have subsequently seen a positive uptick in rents on new deals across high streets and shopping centres, according to Savills data. On a YoY basis, headline and net effective rental growth hardened significantly in Q4 2023. Perhaps even more positively, both headline and net effective rents saw positive growth for the first time versus the new deals we saw in the same period in 2019. 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 high vacancy as operators continue to reposition their portfolios or look more strategically at growth opportunities.

Looking ahead - what does 2024 have in store for retail?

With interest rates at more than double what they were only 18 months ago (5.25%, where they have been since August), and the Bank of England (BoE) still someway off its inflation target of 2%, consumer budgets are likely to remain squeezed for some time yet. However, if inflation at the very least remains stable throughout 2024, alongside low unemployment and a return to real wage growth, retail sales by volume should continue to tick northward - welcome news for retailer operators looking to improve their profit margins. In fact, GlobalData suggests we saw a 4.8% increase in total market size for the UK high street in 2023, equating to £107.8bn. It forecasts this will continue to grow by a more modest 1.4% in 2024 as the impact of squeezed consumer budgets slowly continues to ease.

+10.2%
High street and shopping centre net effective rents Q4 2023 versus Q4 2019

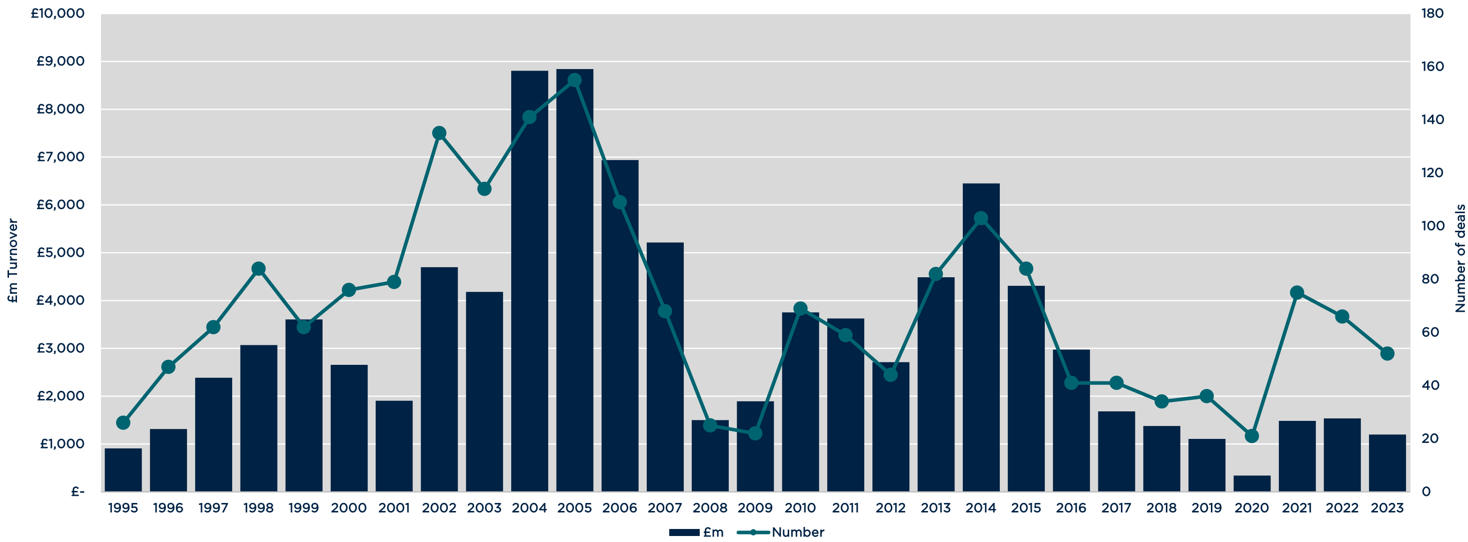
Figure 5: Average headline and net effective shopping centre and high street rents



Source Savills Research.
***Note:** Based on Savills UK retail deals outside London and the SE.

> "There is definitely a feeling of heightened optimism in the market this year..."

Figure 6: Shopping centre investment volumes full year 2023



Source Savills Research

UK retail investment market

Will 2024 be the last chance for a prime bargain in the retail investment market?

Shopping centre investment

The final quarter of 2023 did not see a substantial pick-up in either investor confidence or transactional volumes. Indeed, our yield indices indicate that value-focused investors continued to chase pricing downwards in the last three months of last year.

The muted final quarter led to the overall volume of shopping centre investment in 2023 reaching £1.19bn, 22% lower than 2022's turnover and the lowest level since the Covid-driven doldrums of 2020.

The full-year total would have been very different had any of the large centres that were in the market at the back end of last year traded. Certainly the prospects for the first half of 2024, both in terms of volumes and sentiment, will depend heavily on whether Liverpool ONE, Meadowhall or Centre: MK are sold.

There is definitely a feeling of heightened optimism in the market this year, and this is chiefly orientated around the attractive income returns that are on offer at cyclically low prices. There is just under £2bn of stock in the market, and no longer can we suggest that volumes will be held back by a lack of "institutionally acceptable" assets.

There are also signs that institutional investors might be cautiously testing the shopping centre market for the first time in more than five years.

The rationale behind rising institutional interest in shopping centres is threefold: income returns of over 10%, falling vacancy rates, and yields that are the highest they have ever been. It is too early in the year, and the recovery, to call whether this is a one-off or a trend, but there is no doubt that a little less institutional resistance to retail is a good thing for the market. However, we expect the majority of the buyers in 2024 to be similar to the trends of all of the last five years i.e. opportunistic private and property companies, and those motivated by partial or total change of use.

Two other investor groups that are worthy of a mention from 2023 are local authorities and retailers. While much of the commentary on local authority property investing last year was negative, they remained fairly active buyers of shopping centres in their operational areas, and accounted for 6% of all purchases in 2024. We expect this trend to continue in 2024, motivated both by income and social returns. Retailers were a much more significant buyer in 2023, accounting for 23% of all acquisitions. Three of the four deals were by Frasers Group, and the fourth was by Ingka Group. Again, this is a trend that we expect to continue into 2024, and falling debt costs might even spur some more activity. However, generally, we expect this group of buyers to reduce over the medium term as prices start to rise.

Looking ahead, we do expect to see some modest prime yield hardening in shopping centres over the next two years, though this has more to do with the forward path for interest rates than any fundamental change in the property assets. The definition of prime is always evolving, but we are most confident in the recovery prospects for locally dominant schemes with high-income returns.

£1.19bn
of shopping centres traded in 2023

£2bn
of shopping centre stock in the current market

"We expect the buyer pool to remain broadly the same in 2024…"

Figure 7: Shopping centre yields:

SC equivalent yields Savills classifications	Q3 2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023
Super Prime	7.75%	8.00%	8.25%	8.25%	8.25%	8.25%
Prime	9.00%	9.25%	9.50%	9.50%	9.50%	9.75%
Town Centre Dominant	10.50%	10.75%	11.00%	11.00%	11.00%	11.25%
Secondary	13.50%	13.50%	13.75%	13.75%	13.75%	14.00%
Tertiary	16.50%	16.50%	16.50%	16.50%	16.50%	17.00%
Convenience & Community	10.00%	10.00%	10.25%	10.25%	10.25%	10.50%
SC equivalent yields REVO classifications	**Q3 2022**	**Q4 2022**	**Q1 2023**	**Q2 2023**	**Q3 2023**	**Q4 2023**
Dominant Prime	9.00%	9.25%	9.50%	9.50%	9.50%	9.75%
Regionally Dominant	7.75%	8.00%	8.25%	8.25%	8.25%	8.25%
Regional Scheme	8.50%	8.50%	8.75%	8.75%	8.75%	9.00%
Sub-Regional Scheme	9.00%	9.00%	9.25%	9.25%	9.25%	9.50%
Neighbourhood Scheme	10.50%	10.50%	10.75%	10.75%	10.75%	11.00%
Good Secondary	11.50%	11.50%	11.75%	11.75%	11.75%	12.00%
Secondary	13.50%	13.50%	13.75%	13.75%	13.75%	14.00%
Local Scheme (Successful)	10.00%	10.00%	10.25%	10.25%	10.25%	10.50%

Source Savills Research; REVO

High street shop investment

Data from Real Capital Analytics suggests that high street retail investment volumes hit £2.2bn last year, 37% higher than the previous year. The single largest component of this turnover was foodstores, with strong acquisition activity, from both retailers and specialist investors. However, even without foodstore activity the story on YoY investment volumes was much better than other commercial property sectors at only 1% down on the previous year.

2024 has started slowly in terms of the volume of stock that has been brought to the market, as well as the volume carried over from last year. We expect this to increase over the first six months of 2024, though the expectation of falls in the base rate is causing some vendors to question why they would bring their assets to the market now. The same might also be true in terms of delaying or deferring distressed sales.

We expect the buyer pool to remain broadly the same in 2024 than it has been in recent years i.e. either focused on income or change of use. If we were to see any larger lots coming to the market this year then we do think that there might be some institutional investor interest. However, at present, this seem2 unlikely, particularly given that many institutions are still dealing with legacy issues in their retail portfolios.

Occupational concerns will continue, and debt-servicing costs for independent retailers and leisure operators, in particular, will lead to a higher-than-normal level of business failures in 2024. As a result of this, we expect that buyers will be more enthusiastic about assets with corporate covenants.

In a similar tone to the shopping centre investment market, we do expect to see some prime yield hardening in the high street shop sector this year, though this will depend on the timing and pace of the fall in the UK base rate. Given the tendency of private investors to be more debt-focused, it is arguable that high street shop pricing may see a more dramatic fall in prime yields over the next two years as interest rates fall.

Super prime shopping centre yields have now been stable for four quarters

+46bps
The average movement in shopping centre yields in the last 12 months

£2.2bn
of high street investment in 2023

37%
increase in high street investment in 2023 versus 2022

Savills Commercial Research

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