UK Commercial – Q3 2021

SPOTLIGHT
Savills Research

Shopping Centre and High Street Spotlight

savills

- Consumer market overview
- Q3 leasing and investment trends
- Outlook for Q4 and 2022

ONS RPI inflation rose to 4.9% in September, representing the highest year-on-year growth since November 2011

UK retail consumer and occupational trends

Retail sales remain elevated compared to pre-Covid levels, despite consumer concerns over inflation and supply chain shortages.

After six months of post-lockdown improvement, the UK's consumer sentiment has begun to be hindered by anticipated rising living costs amidst headlines of fuel shortages, supply chain disruption and surging energy bills. Subsequently, GfK's overall consumer index dropped five points in September, to -13. Despite month-on-month declines, this is still largely in line with the 2019 monthly average of -12.6.

Meanwhile, the major purchase index dropped three points to -6, as high inflation begins to take its toll on spending habits. The ONS Retail Price Index (RPI) reported a 4.9% year-on-year rise in September 2021, the highest growth recorded since November 2011. This heightened inflation is expected to be temporary, in line with disruption to supply chain and staffing shortages, however, Oxford Economics are currently forecasting that year-on-year UK RPI levels will remain above 3% until at least Q2 2023.

Retail spend remained elevated in September, despite rising consumer caution

In September, non-essential retail spend grew +12.9% compared to equivalent 2019 levels, representing a smaller growth than the +15.8% recorded in August, according to Barclaycard data. While still inherently positive, this month-on-month softening in growth in September does highlight the early beginnings of consumer concerns and perhaps points to a further reduction in discretionary spending looking ahead.

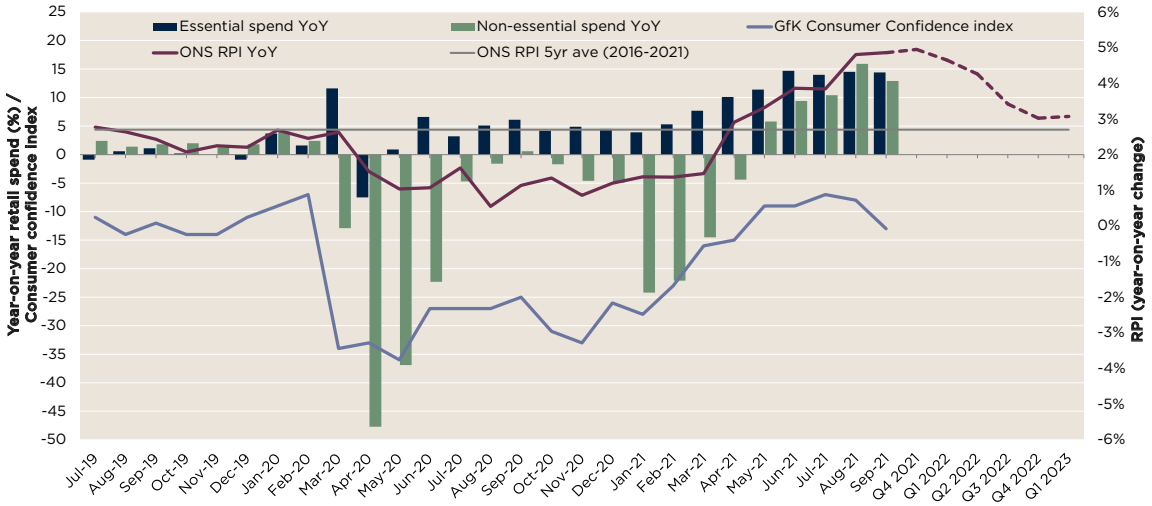
Meanwhile, concerns over shortages and pricing hikes have generated strong consumer spend growth across essential items, with fuel and supermarket spend reporting +11.1% and +14.7% respectively in September, compared to the same month in 2019.

The leisure sector continued to improve in September, with pubs, bars and clubs reporting +43.5% spend growth against 2019 levels, while the entertainment segment reported its strongest growth for over two years, of +28.0%. This has been driven by a return to events, gigs and cinema releases, along with a return to post-work socialising.

Clothing spend softened slightly on a month-on-month basis, albeit still reporting double-digit growth of +10.1% compared to September 2019. Footfall recovery across Q3 2021 has supported significant improvement to in-store sales for some retailers. Next announced that retail stores serviced 44% of sales in September 2021, settling between the 34% recorded in March 2021, and the 55% share reported pre-Covid. Meanwhile, Inditex suggests store sales are largely returning to 'normal' levels, as of H2 2021.

Looking ahead, the headwinds currently facing retailers could become more acute as we head towards the Christmas period. Supply chain issues could both restrict stock levels and cause further price inflation, particularly during the heightened Christmas period, while difficulties staffing the busy period could further limit operations. This has the potential to apply significant pressure on margins for some retailers during the period which ordinarily has great bearing on annual reporting figures.

UK consumer spend growth despite hindered consumer confidence as rising inflation and supply chain shortages dampen consumer sentiment.



Source Savills Research, GfK, ONS, Barclaycard, Oxford Economics. **Note:** 2021 consumer spend is compared to 2019 levels

GfK's UK consumer confidence index dropped five points in September, to -13

Non-essential consumer spend increased 12.9% in September 2021, compared to 2019 equivalent levels

Fashion spend reported double-digit growth of +10.1% in September 2021 vs September 2019 levels

> **Total deal count this year-to-date (Q3 2021) increased by 28.4% compared to the same period in 2020, according to Savills UK retail leasing deals**

Post-summer footfall points to a return to city centres

Recent footfall data points to a return to high streets as employees begin to make their way back to the office more regularly. In the first full week of October, UK high street footfall improved dramatically, recording just a -14.7% deficit compared to 2019 levels over the same period, representing the smallest gap since the onset of the pandemic.

It's no coincidence that this has coincided with the end of the summer holidays and alongside a return to the office for many employees, with key city centres experiencing the highest weekly uplifts. In the final week of September, footfall across large UK cities (excluding London) increased +6.1% compared to the week before, whilst Central London saw a +6.5% growth, both outperforming the UK average of +2.7%.

Despite still being hampered by limited international tourism and subdued levels of overnight corporate demand, this recent growth is a promising start to more meaningful recovery across larger UK cities.

Retail leasing market improves, off the back of a challenging period

Since the reopening of the sector, the net balance of openings/closures has improved dramatically. According to Local Data Company, retail openings reached 22,256 in H1 2021, up 4.7% compared to the historical five-year average. This has been driven primarily by convenience retail, boasting a net growth of +332 stores over the same period. With the number of closures falling, the net change also improved across the comparison and leisure sectors in H1 2021, compared to the same period in 2020.

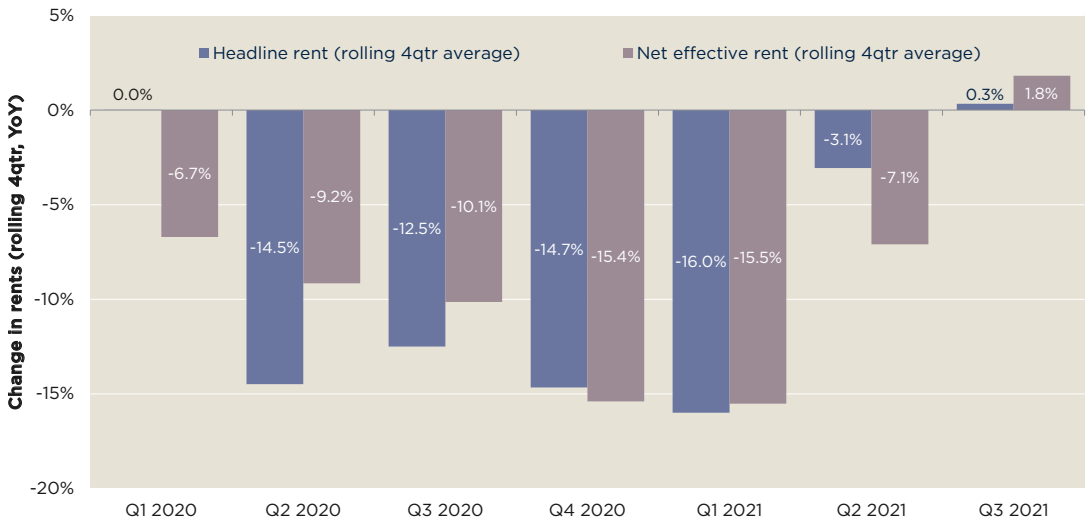
This has been evidenced further by Savills latest retail leasing data. The number of new retail leasing deals was up 28.4% this year-to-date (to Q3 2021), compared to the same period in 2020, despite a slow start to the year. Q3 alone was a particularly strong quarter in terms of new leases, with deal count up by a third year-on-year, whilst reporting a 28.3% increase compared to the same period in 2019.

Rental tone has also somewhat improved over the last two quarters, with Q3 headline rents up +0.3% and net effective rents up 1.8% year-on-year, on a rolling four-quarter average basis. However, it is worth noting that this is off the back of the severe disruption recorded during the previous quarters in 2020, amidst the height of the national lockdowns. So, while improvement compared to 2020 levels is promising, current rental levels do remain somewhat downbeat compared to pre-pandemic equivalents. In the year to Q3 2021, headline rents reported a -12.2% decline compared to the equivalent period to Q3 2019, while net effective rents record a decline of -8.5% over the same timeframe.

The outlook for retailers in Q4 remains heavily pinned on the level of disruption caused by supply chain issues and inflationary-related spending habits. Meanwhile, the remaining government support packages could continue to provide a lifeline for more challenged operators.

The end of the eviction moratorium in March 2022 could pose as a potentially significant moment in the retail sector. While many retailers who relied on the moratorium may have significant time to recover revenue and trade profitably again, the end of the moratorium could still be a catalyst for retail vacancy for those unable to pick up trade over the next six months. Local Data Company is therefore forecasting that UK retail vacancy will rise to 16.5% by H1 2022, up 0.7 percentage points from the 15.8% reported in H1 2021.

Change in average high street and shopping centre rents emphasises the return to rental growth compared to 2020, albeit still reporting declines against pre-pandemic levels.



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

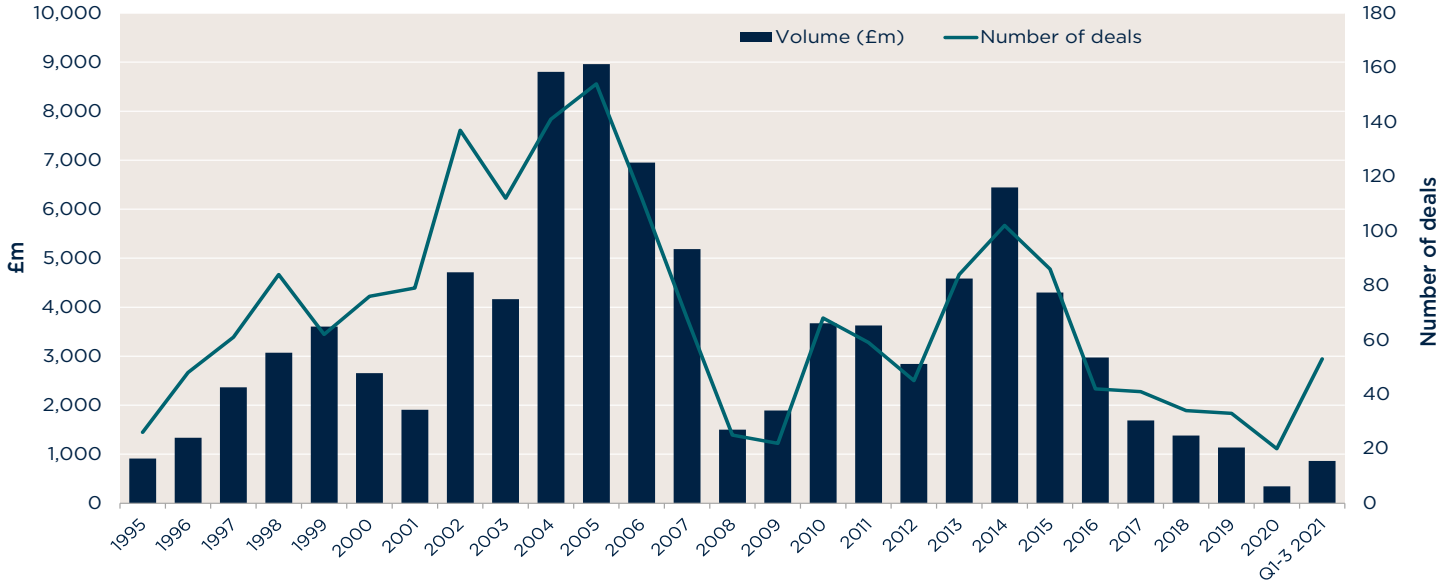
UK high street footfall improved, with the gap to 2019 levels just -14.7% in the first week of October

Average net effective rents increased by +0.3% year-on-year in Q3 2021, on a rolling four quarter average basis

Average net effective rents in the year to Q3 2021 remain -8.5% below the same period in 2019

> Some downward pressure on prime shop yields may be about to emerge

Shopping centre investment



Source Savills Research

UK retail investment market

Prime yield hardening ahead?

Shopping centre investment

£266m of shopping centre investments were sold in Q3 2021, bringing the total for this year to £885m. This compared very favourably with £233.8m for the same period in 2020, but perhaps more importantly is more than £100m higher than the first nine months of 2019.

Generally the themes that we commented up in our Q2 Spotlight remain common, with a strong investor focus on repurposing opportunities, and a steady rise in investor interest in the sector just as a counter-cyclical play.

This quarter we have also seen the beginnings of a pick up in investor interest in larger lot sizes, perhaps spurred on by the sale of Touchwood, Solihull for £90m in the preceding quarter.

It is also worth noting that local authorities, who were very active buyers of shopping centres prior to the crisis, have begun to return to the market, with the latest transaction being AEW's sale of the St Nicholas Centre in Sutton to the local council for £26m. This brings local authority acquisitions over the first nine months of 2021 to £61m.

There remains a shortage of prime assets for sale in all size bands, and this continues to make benchmarking of prime yields difficult. Our typical prime shopping centre yield has now been stable at 7.5% for seven months, though some segments have seen modest yield hardening, and this is the highest level since our records began and 25bps higher than the peak that was reached in the Global Financial Crisis.

The future trajectory of prime yields will depend on the availability of stock, debt, and confidence around retail covenants.

We do not expect to see a sharp rise in the volume of assets that are being marketed over the final few months of 2021, though it is worth noting that there is currently £570m of assets in the market £398m of which are under offer.

We do expect to see a slight improvement in the availability of debt in 2022, albeit only at 40-50% loan-to-values. This is more likely to be obtainable for assets that could be classed as both counter-cyclical and offering a repurposing or densification story.

As the occupational section of this Spotlight shows, we are beginning to see some more positive data from the leasing market. We also expect this improvement in retailer performance and confidence to improve through 2022. Many investors are still concerned about the impact of the end of the rent moratorium in the first quarter of 2022, though we believe that while this will throw out some negative stories, it will not be a seismic shock to the sector. At the moment, we are typically seeing that landlords are seeking to be repaid all of the rent that they are owed, but are prepared to negotiate a slight discount around the mutual legal costs that would be incurred by both landlord and tenant should the settlement go to the courts.

Assuming that our optimism about the outlook for the occupational market is correct, then we do expect to see more investor demand for prime shopping centres and repurposing opportunities to emerge in 2022. This, combined with better availability of debt, should lead to a stabilisation of prime yields in early 2022, and possibly even the beginnings of some competitive tension in more sought-after locations.

High street shop investment

We commented in last quarter's Spotlight that the bulk of investor demand for high street retail is focused on either long-income plays (such as banks and foodstores), or redevelopment opportunities. This sentiment has broadly remained true in third quarter of 2021, though the volume of activity has continued to improve.

Q3 saw £478m transacted in 91 deals, bringing the total for 2021 to £1.7bn. While this is 12% higher than the volume that was sold in 2020, it is still 29% below the same period in 2019.

As the figures above suggest, the average deal size in the high street shop market remains small, with the bulk of buyers being private investors from both the UK and abroad. This was very much the trend pre-Covid, with a very limited pool of buyers for £10m plus lot sizes, unless they were in affluent Greater London submarkets.

That having been said, the pool of potential buyers of high street shops has widened over the last three months, and investors are no longer just looking for food or change-of-use opportunities. In common with the shopping centre market there is definitely more counter-cyclical investor interest in the this subsector, attracted not just by the high yield it offers against its own history, but also the comparative pricing between high street shops and some other parts of the retail market.

As at the end of September 2021, our prime yield for shops outside central London stood at 6.75%, the same level that it has been since the start of the year. While the best comparison might not be foodstores (where prime yields are 4.5% at present), the spread to retail warehousing is now 100bps, up from 25bps at the start of 2021.

Looking ahead, we believe that the beginnings of some downward pressure on prime shop yields may be about to emerge, not just because of the yield differential, but also because some investors are beginning to judge that the occupational risks may not be as significant as they had expected earlier in 2021. In particular, the return of new store openings and some positive net effective rental growth is suggesting that retailers continue to see that traditional shops still have a place in their post-Covid omnichannel strategies, and this bodes well for investor demand in 2022.

SC equivalent yields: Revo centre classifications

	Q1 2021	Q3 2021
Dominant Prime	9.00%	8.75%
Regionally dominant	7.25%	7.25%
Sub regional scheme	8.75%	8.75%
Neighbourhood scheme	10.50%	10.00%
Local scheme (successful)	10.00%	9.75%
Local scheme (challenged)	16.00%	16.00%

Source Savills Research

SC equivalent yields: Savills classifications	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Super-prime centre	6.25%	6.75%	7.00%	7.25%	7.25%	7.25%
Prime centre	8.00%	8.50%	8.75%	9.00%	8.75%	8.75%
Town centre dominant	9.50%	10.00%	10.25%	10.25%	10.25%	10.00%
Community & convenience	9.50%	9.75%	10.00%	10.00%	9.75%	9.75%
Secondary	12.00%	12.50%	12.75%	13.00%	13.00%	13.00%
Tertiary	15.00%	15.50%	15.75%	16.00%	16.00%	16.00%

Source Savills Research

£343m
2020 Full Year investment in shopping centres

£885m
Q1-Q2 2021 investment in shopping centres

150bps
The rise in prime shopping centre yields since January 2020

100bps
The fall in prime shopping centre yields between May 2009 and May 2010

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