UK Commercial – Q4 2021

SPOTLIGHT

Savills Research

Shopping Centre and High Street Spotlight

- Christmas trading overview
- 2021 leasing and investment trends
- Outlook for 2022

> Strong financial performance during Christmas 2021 compared to the same period in 2019 points to a promising position of recovery for many operators.

UK retail consumer and occupational trends

Christmas trading statements revealed a largely positive set of results despite ongoing headwinds and a cautious outlook.

The UK's consumer spend environment remained relatively stable in the build up to Christmas, despite the initial rise in Omicron cases. Barclaycard data reported that spend on non-essential items in December rose +11.5% compared to 2019 levels, albeit a deceleration following the +17.7% growth reported in November. Bank of England also revealed that December experienced the lowest level of monthly household savings since April 2019, reflecting the rise in discretionary household spend during the comparatively less restrictive festive period in 2021, and following almost two years of heightened savings.

On the face of it, retailers enjoyed a particularly strong 2021 Christmas period. Strong year-on-year revenue growth (up +12.4% on average) is perhaps unsurprising following the December 2020 lockdown, while the double-digit average growth rate of +12.7% when compared against 2019 levels points to a promising position of recovery for many operators.

Fashion/footwear reported a strong rebound, driven by omnichannel

Fashion retailers reported the strongest average sales growth by sector on a year-on-year basis, off the back of the widespread temporary store closures in December 2020. The likes of Seasalt, Next, JD Sports and FatFace all posted double-digit growth, with many retailers in the sector raising their full-year revenue forecasts as a result of strong final quarter trading.

This year once again emphasised the importance of an omnichannel offer, with online sales propelling total revenue growth for many retailers. Online sales compared to 2019 levels experienced an uptick of +56.0% on average across all sectors, while total in-store sales averaged -2.7% over the same period, for those who reported the breakdown.

For the case of the clothing and homeware tranche of M&S, in-store sales fell -10.8% compared to 2019 levels in the 13 weeks to December 28, while online sales recorded a sizeable +50.8% growth. However, M&S did note that in-store sales aren't uniformly negative, with sales across retail parks up against 2019 levels, whereas challenged footfall continues to hinder city centre store sales.

Retailers lacking a strong omnichannel position struggled to recover at the same pace. Primark, for example, reported year-on-two-year total revenue declines of -5% in the 16 weeks to January 8, despite adding a further 25 new sites to its portfolio over the period.

Homeware sales robust against 2019 levels

Omnichannel-related growth hasn't been limited to the fashion sector. Dunelm reported record Christmas sales (up +13% year-on-year and +26% against 2019 levels), in line with its new ecommerce facility enabling shorter lead times for online orders.

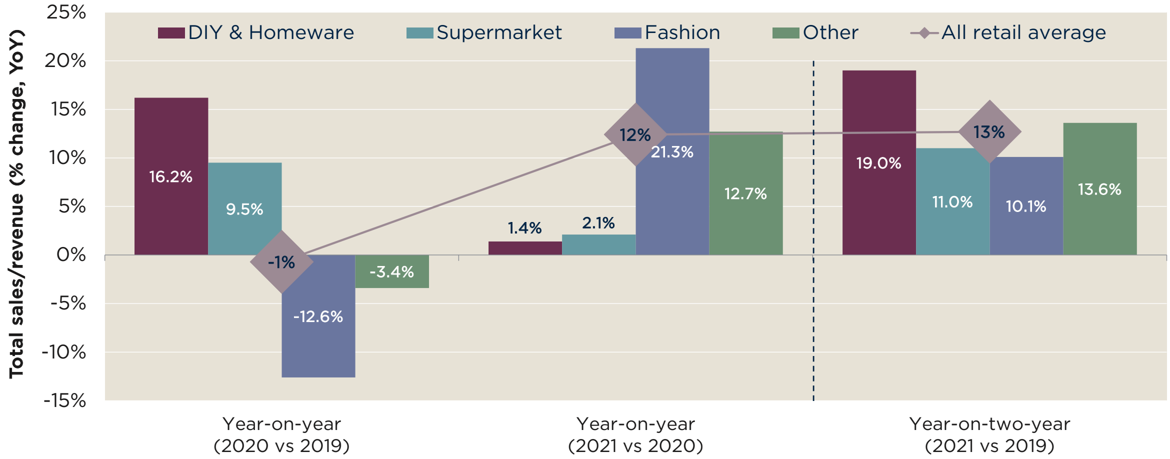
On average by sector, the DIY and homeware sector reported the strongest growth compared to

Average year-on-year sales growth reached +12.7% over the Christmas 2021 trading period

Total in-store sales declined -2.7% compared to 2019 levels on average across those retailers that report a breakdown

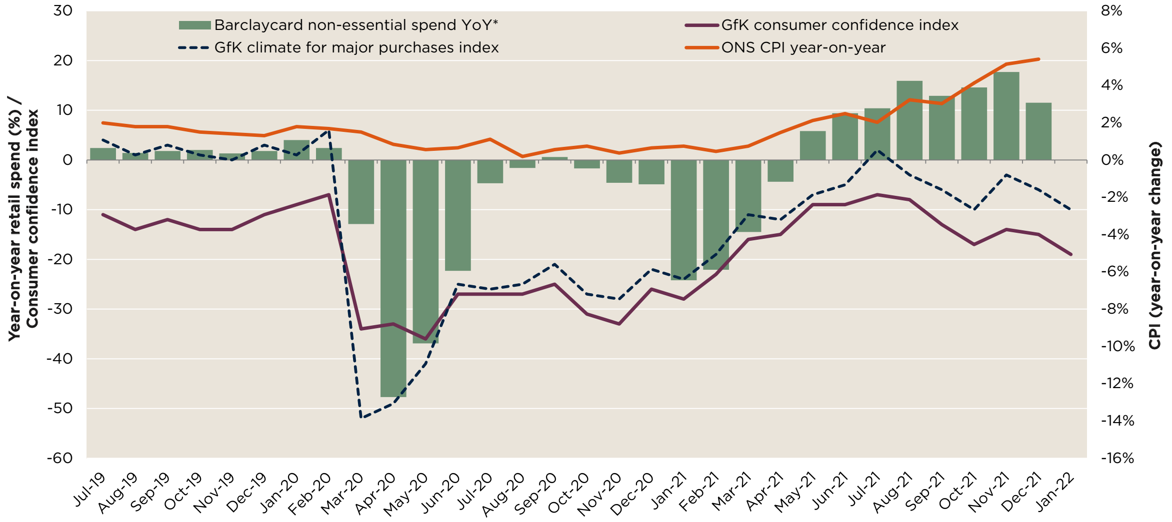
Homeware retailers reported the highest average Christmas sales growth compared to 2019 equivalents, averaging +19.0%

Graph 1: Christmas trading performance comparing 2021 against 2020 and 2019 equivalent levels reflects varying results by retail type, albeit largely positive vs 2019 levels.



Source Savills Research, Retailer trading statements.
Note: Total sales/revenue used where LFL not available. 'Other' includes variety products, confectionary, pets, books and stationary.

Graph 2: UK non-essential consumer spend, consumer price inflation and consumer confidence



Source Savills Research, Barclaycard, GfK, ONS.
***Note:** 2021 year-on-year spend figures are based off 2019 data

Christmas 2019, averaging +19.0%, albeit the bumper sales recorded in 2020 resulted in more borderline year-on-year figures. Wickes reported group like-for-like sales decline of -5.0% year-on-year, but a healthy +14% uptick compared to equivalent 2019 revenue, in line with the launch of its new DIY app, which is reportedly experiencing strong conversion rates.

Grocery spend remains heightened

Grocery spend over the Christmas 2021 period exceeded 2019 levels across every major UK chain, according to Kantar data, although reporting relatively flat sales off the back of heightened 2020 levels. Less restrictions in 2021 supported celebratory food and drink sales as consumers enjoyed time with friends and family.

Most grocery chains are utilising their widespread store networks to enhance online fulfilment from larger format physical stores. For example, Tesco are extending their one-hour delivery service, Whoosh, to 200 stores by February, while traditionally in-store-only chain, Aldi, opened Click & Collect capabilities to over 200 stores in 2021.

Outlook for retailers is particularly cautious amidst ongoing headwinds

Despite an inherently positive trading period on the whole, there was a clear sense of caution amongst trading statements as the sector tackles multiple headwinds.

Reference to supply chain disruption/uncertainty featured heavily amongst statements. Next reported that stock was "materially lower than planned" in the lead up to Christmas, while the general merchandising segment of Sainsbury's suffered year-on-year sales decline of -16%, reflecting delays and limited product availability experienced across Argos.

As retailers struggle to absorb the rising costs associated with manufacturing, freight and wages, retail prices have subsequently begun increasing. The ONS Consumer Price Index rose 5.4% in December, its highest annual rise since March 1992. Retailers have reiterated this point, with Next expecting to see like-for-like price increases of 3.7% in H1 2022, and up to 6% in H2 2022.

Consumer behaviour is also likely to adapt in the face of rising inflation, with a potential shift back to more cautious spending patterns. GfK's consumer confidence index dropped four points in January 2022 to reach -19, representing its lowest level since February 2021 and reflecting the impact of the rising cost of living alongside the Omicron outbreak. Further caution could spark more aggressive pricing wars amongst some retailers (adding further pressure on margins), albeit potentially supporting sales amongst those at the more value/budget end of the retail spectrum.

Staffing shortfalls remain abundant, both in the form of temporary shortages related to positive Covid cases, as well as rising vacancies for permanent positions. In Q4 2021, ONS reported 158,000 job vacancies in the UK wholesale and retail sector, reflecting its highest recorded quarterly figure.

Online pureplay retailers have historically been more resilient to the headwinds facing the sector, however the current challenges appear to be hampering both online and physical operators alike. Supply chain disruption and port congestion impacted service ability for ASOS, while AO World noted similar constraints, alongside driver shortages.

+11.5%

UK non-essential consumer spend reached +11.5% in December 2021, compared to equivalent 2019 levels

ONS consumer price inflation rose to 5.4% year-on-year in December, its highest level since March 1992

158k

UK job vacancies in the Wholesale & Retail sector reached 158,000 in Q4 2021, its highest recorded quarterly figure

> "Savills reported a 17.5% year-on-year uptick in retail leasing deal count in 2021, while also overtaking 2019 levels by 1.9%."

Year-on-year rents have increased, albeit the gap to 2019 levels remains

Using the latest Savills retail leasing data, we observe the relative recovery to rents across the UK. Both net effective rents and headline rents returned to year-on-year growth in Q4 2021, on a rolling four-quarter basis (Graph 3). This is, however, off the back of a period of significant decline immediately following the onset of Covid-19 UK lockdowns in 2020.

Hence, Graph 4 identifies rental tone compared to the same period in 2019 as a comparison against pre-pandemic levels. While still in negative territory compared to 2019, net effective rental decline did decelerate in Q4 2021, moving into single-digit decline on a four-quarter average basis for the first time since Q2 2020. It remains unlikely that rents will improve on pre-pandemic levels in the near term, however the relative improvement across 2021 does suggest the worst of rental declines has passed.

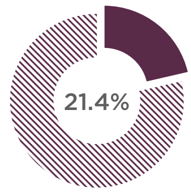
In turn, retail vacancy (in floorspace terms) improved through H2 2021, according to MSCI data. UK high street (excluding South East) and shopping centre vacancy rates reached 10.4% and 14.2% respectively in December, reflecting a marked improvement compared to the 11.7% and 17.4% recorded in June 2021.

Similarly, Savills data reported a 17.5% year-on-year uptick in deal count in 2021, while also overtaking 2019 levels by 1.9%. This follows some retailers beginning to progress with store expansion following a period of reassessment, while rising availability has opened attractive leasing opportunities.

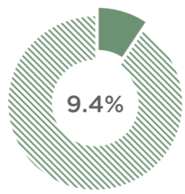
The share of deals by sector reveals the changing retail landscape. F&B operators accounted for the largest portion of deals in 2021, accountable for a 21.4% share of new lettings, compared to 20.8% in 2019. The largest growth between 2019 and 2021 came from the Retail Services segment, which saw a 4.2ppts increase over the period, to now account for 19.2% of new lettings. Over the same period, clothing and footwear saw the largest drop in market share, from 13.5% in 2019, to 9.4% in 2021. However, this isn't uniform across all clothing subsectors - following the success of athleisure sales through the pandemic, the sports and outdoor segment saw a rise in deal share, forming 3.4% of new deals in 2021.

Some retailers have already announced commitment to physical store growth, with Primark set to open 100 new sites over the next five years, while Kurt Geiger are planning a new UK store each month in 2022. Discount grocery retailers have continued with their sizeable UK portfolio growth, as have strong performing homeware retailers such as B&M, who have scheduled 13 new store openings in Q1 2022.

Looking ahead, other retailers will be weighing up their approach to physical retail. On one hand, there's the assumption that there will be no further full lockdowns requiring retail to close, whilst relatively low rents and higher availability could support leasing demand. On the other hand, ongoing headwinds in the market (including high inflation, cautious consumers and supply chain costs) are likely to postpone decision making for some operators.



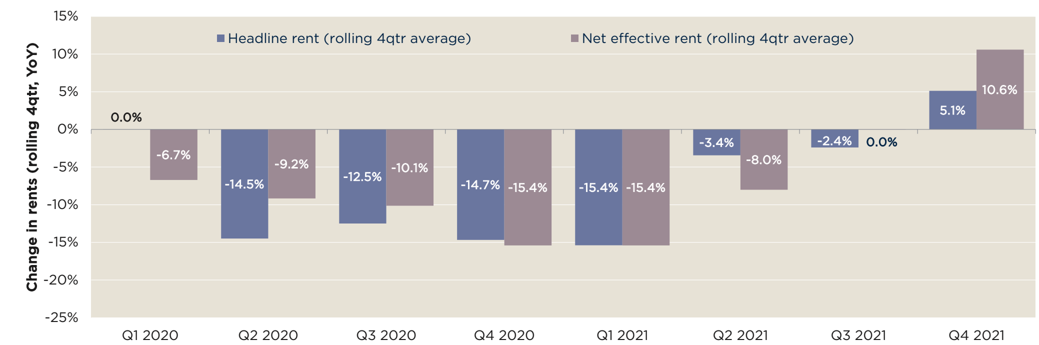
F&B operators accounted for the largest share of retail leasing deals in 2021, by retail type



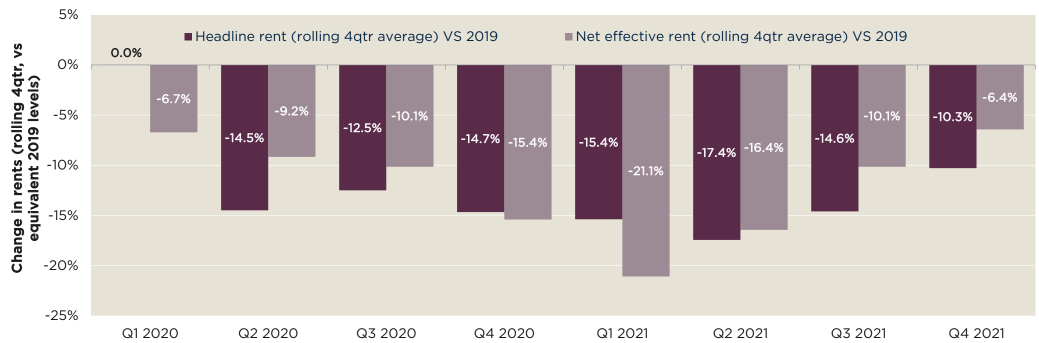
The clothing & footwear segment saw its share of leasing deals fall from 13.5% in 2019 to 9.4% in 2021

Average net effective rents in the year to Q4 2021 remain -6.4% below the same period to Q4 2019

Graph 3: Year-on-year change in average high street and shopping centre rents



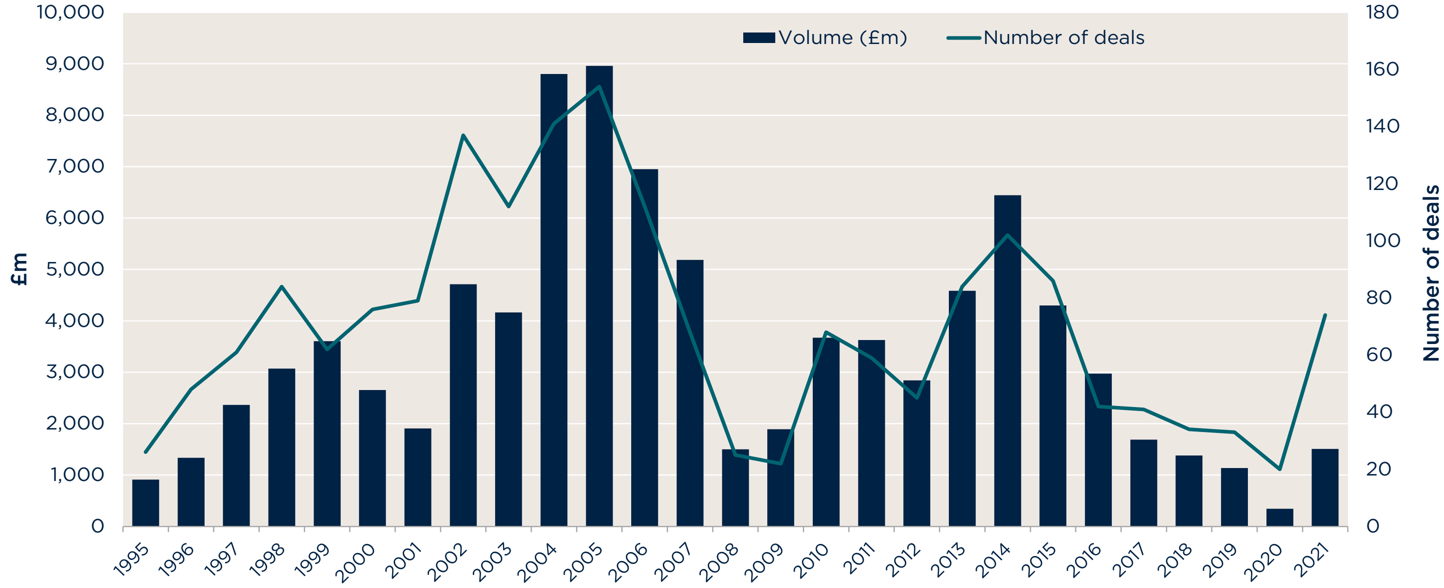
Graph 4: Change in average high street and shopping centre rents vs 2019 levels



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

“The most important factor that will define prime in 2022 is the occupational health of the scheme”

Graph 5: Shopping centre investment



Source Savills Research

UK retail investment market

Was 2021 a turning point for retail investment?

Shopping centre investment
2021 was in some ways a transformational year for the shopping centre investment market, though the drivers behind this remained broadly unchanged in terms of repurposing or a desire to capitalise on pricing in an oversold asset class.

While levels of turnover last year were by no means normal, 74 schemes were sold, resulting in a turnover of £1.5bn. These were the highest levels since 2014 and 2017 respectively, and a dramatic improvement on 2020's £341m in 20 deals.

One of the key changes in the final quarter of 2021 was the return of larger deals, with two assets of over £100m being traded in December, compared to none in the whole of 2020. There was also substantially more activity in the mid-sized scheme bracket, with 16 deals between £20m and £50m, compared to only four in 2020.

The drivers behind these acquisitions were broadly unchanged, though only 14% of the centres sold last year had some kind of short-term redevelopment angle, compared to 29% the preceding year. Opportunism also remained rife, with 55% of the sales being to some degree bank-related, and as such attracting the opportunistic investors looking for attractively high yields. This tone was echoed by the types of buyers in the market last year, with less than one-third of all purchases being by institutions and local councils, and the bulk of the remainder being developers in some shape or form.

The opportunistic tone of the market kept prime yields high, with our headline prime yield ending the year 50 basis points higher than it was at the start of 2021 at 7.50%. However, if the tone of occupational news continues to improve during the first half of 2022 then we do expect selective downward pressure on some prime shopping centre yields to emerge in the second half of 2022.

The key word in the preceding paragraph is “prime”, and we believe that the definition of prime in the shopping centre space remains highly focused. Where assets are not perceived as prime, then the softening has, and will continue to, take place. This spectacularly wide spread between the best and the worst is apparent when we look at the deals that took place last year, which ranged in Net Initial Yield terms from 4.20% to 36.00% (compared to 4.69%-26.50% in 2020).

So, what is prime in today's shopping centre market? It is undoubtedly freehold and not too large a lot size, as well as having the opportunity to densify or diversity the mix of uses on the site. Food and convenience anchors remain highly sought after, particularly since yields on standalone food stores remain low at 4.50% or below. Over-exposure to fashion and department store income remains a negative in investor's minds, as does a catchment where there is competition from a strong retail warehousing offer.

However, the most important factor that defined prime in 2021 (and that will define it in 2022) is the occupational health of the scheme, and whether or not it has delivered a positive rent collection story during the Covid crisis. This need for clarity and transparency is one of the reasons why outlet centres remained popular with investors last year, due to the high level of turnover data that is available to their owners. We have no doubt that 2022 will continue to deliver a challenging occupational environment for all of retail, though it is becoming apparent that some retailers fared very well over Christmas. We also have the end of the moratorium on evictions to contend with, as well as the end of business rates relief. Some investors are definitely choosing to stay out of the market until more clarity around retailer profitability after these supportive measure emerges, and there will undoubtedly be some retailer failures once all safety nets have been withdrawn.

We believe that this clarity will have begun to emerge by the second half of 2022, and this will lead to more trading activity in the mid to large size scheme market, as well as amongst the top 50 centres in the UK.

There remain willing vendors of such stock, particularly amongst the REITs, and the buyers are likely to become less focused on alternative uses and more focused on the opportunity for recovery at the prime end of the market. While we are not quite ready to predict that prime yields will be lower in January 2023 than January 2022, we do expect to see another step up in the volume of trade in the market this year as investors buy in anticipation of yield hardening. This should mean that the total volume of shopping centre investments traded in 2022 is likely to surpass £2.5bn for the first time since 2016.

High Street investment

The final quarter of 2021 had broadly similar tones to the rest of year, with private buyers dominating the market and institutions being net sellers. Secure income remained very sought after, with foodstore yields hardening by a quarter point to 4.25%, and banking halls also in demand.

Unlike the shopping centre investment market the overall volume of shops traded in 2021 was marginally down on 2020 at £2.6bn, which makes it the lowest year for the last decade.

The most notable change in tone in the recent months was the return of the income-focused buyer to the market, typified by Federated Hermes' purchase of 4-13 Long Row in Nottingham (let to Primark, Greggs, Tui and Tesco) for £21.6m.

Rising investor interest that is not just about change of use led us to move our prime high street yield in from 6.75% to 6.50% in November 2021. However, even with this move the prime yield remains substantially above its long term average of 4.85%, as well as a full 100bps higher than the equivalent retail warehouse yield.

Looking ahead, we do not expect to see a dramatic change in investor attitudes to high street shops. However, there will be more evidence that rents have rebased, and that agile working has boosted footfall and trade in some locations. These factors, combined with the comparatively attractive prime yields on offer, should bring more opportunistic investors back into the market. However, the limited number of larger assets that are available in this sector will mean that institutional buyers will remain less active than private investors. Further selective yield hardening will happen, and we expect that our sector yield will be 6.00% by the end of the year.

SC equivalent yields:
Revo centre classifications

	Q1 2021	Q4 2021
Dominant Prime	9.00%	8.75%
Regionally dominant	7.25%	7.50%
Sub regional scheme	8.75%	8.75%
Neighbourhood scheme	10.50%	10.00%
Local scheme (successful)	10.00%	9.50%
Local scheme (challenged)	16.00%	16.00%

Source Savills Research

SC equivalent yields: Savills classifications	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
Super-prime centre	6.75%	7.00%	7.25%	7.25%	7.50%	7.50%
Prime centre	8.50%	8.75%	9.00%	8.75%	8.75%	8.75%
Town centre dominant	10.00%	10.25%	10.25%	10.25%	10.00%	10.00%
Community & convenience	9.75%	10.00%	10.00%	9.75%	9.75%	9.50%
Secondary	12.50%	12.75%	13.00%	13.00%	13.00%	13.00%
Tertiary	15.50%	15.75%	16.00%	16.00%	16.00%	16.00%

Source Savills Research

£343m
2020 Full Year investment in shopping centres

£1.5bn
2021 Full Year 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

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