UK Commercial – May 2021

SPOTLIGHT
Savills Research

UK Retail Warehousing

savills

● Investment transactional appetite is ahead of pre-pandemic levels with the highest volumes in Q1 since 2017

Consumer trends

A successful inoculation process and roadmap to reopening the economy has boosted the UK's consumer environment and outlook.

Following the one year anniversary of the initial UK lockdown, it's clear to see the long-lasting damage across the retail market caused by the pandemic. However, not all retail has been affected evenly and while headwinds do still persist, there are a growing number of reasons to be optimistic.

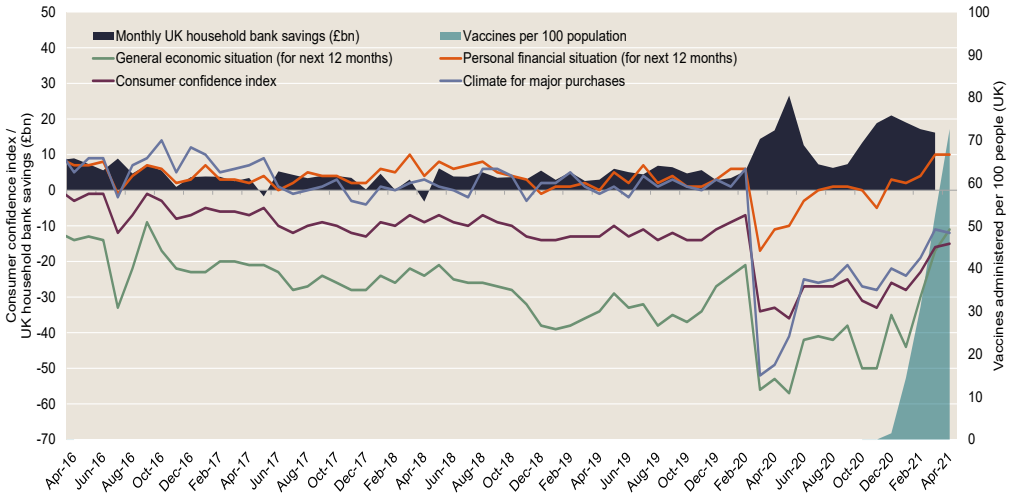
The successful vaccine rollout process across the UK has allowed the government to release a roadmap to reopening the economy, with perhaps the most important date for the retail diary being 12th April, when non-essential retail reopened.

A clearer picture of when other parts of the economy will begin to reopen, coupled with the expectation that this will be the final lockdown, has improved the consumer environment substantially. According to GfK's March consumer confidence survey, the index regarding general economic outlook for the next 12 months improved to -17, the highest level since October 2016 (figure 1).

Importantly for the retail market, the index relating to climate for major purchases experienced an eight point improvement compared to February levels, albeit still relatively subdued at -11.

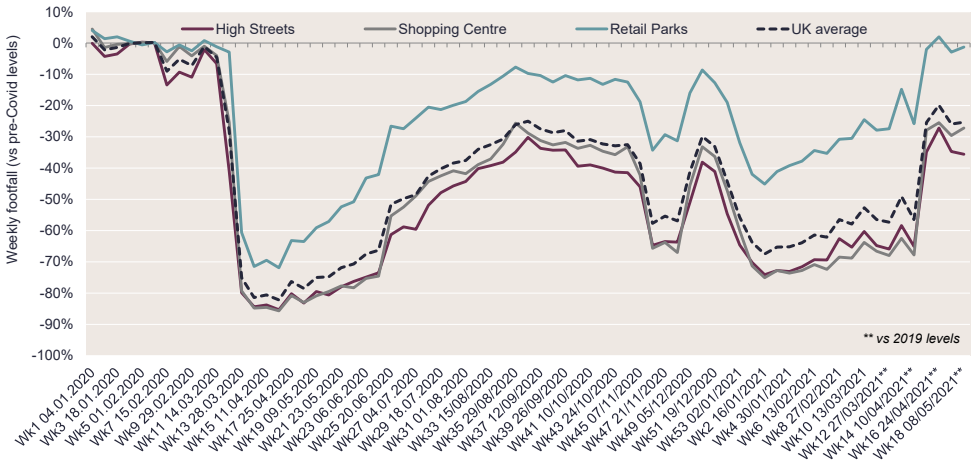
What's particularly promising from the survey is the index for personal financial situation for the next 12 months, which has improved dramatically since March 2020, now matching the post-GFC peak of +10. This is in line with a significant growth in household savings over the same period, with Bank of England data suggesting UK households have saved over £180 billion during this time.

Figure 1: Consumer confidence boost in response to the vaccine rollout with household saving continuing to exceed the long-term average for now.



Source: Savills. Bank of England, GfK, Our World in Data

Figure 2: UK weekly footfall by retail sector highlight how retail parks continue to be far more resilient, with levels just -1.3% below the equivalent week in 2019.



Source: Springborad

Early footfall improvements point to promising reopening recovery

As the UK approached the retail reopening date, footfall had been steadily improving each week, helped largely by a cocktail of better weather, Bank Holidays, easing of social mixing and vaccination confidence.

The reopening of hospitality and non-essential retail on the same date provided high street and shopping centre locations with a substantial kick-start to support their recovery. During the week beginning the 12th April, footfall on high streets and shopping centres increased 93.2% and 126.6% respectively, compared to the week prior, according to Springboard. For retail parks the increase was more modest at 35.3%. However, this outlines the resilience of the sector further, pointing to the fact the retail warehouse sector has much less distance to travel to reach the performance it enjoyed pre-pandemic.

This has been the case for some time, with retail park footfall not only performing consistently better throughout the pandemic but also recovering much quicker post lockdowns. Clearly the ability to social distance across large retail parks has been an important factor in the public's consciousness. At its peak last September, before the tier restrictions and third national lockdown, retail park footfall was only 7.7% down on 2019 levels, outperforming highstreets (-30.2%), shopping centres (-26.1%) and the UK average (-25.0%). While the removal of the pre-determined 'essential' and 'non-essential' retail categories will begin to help balance footfall levels across each retail type, it's likely that retail warehouses will continue to outperform due to the drive-to convenience, outdoor setting and therefore perceived COVID-safety. Retail parks' footfall levels currently sit just -1.3% below the equivalent week in 2019.

Occupational market

Despite a pandemic driven shift toward ecommerce, the retail warehouse market has demonstrated strong retailer performance and subsequently displays comparatively strong occupational statistics, compared to other parts of the UK retail market.

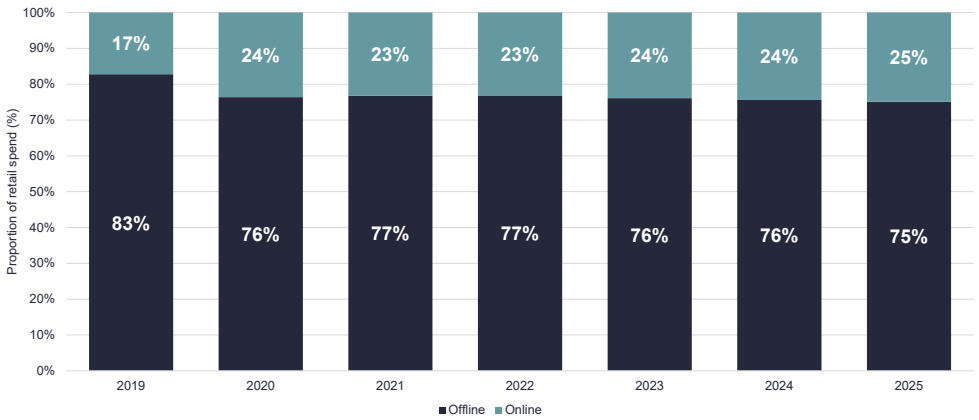
There have been a number of challenges facing the retail market over the last few years, no more so than in the last twelve months, which has seen a global pandemic that has resulted in large parts of the retail and leisure sectors being closed for much of that time. Retail Warehousing has not been immune to these challenges. However, as a house, we have been banging the drum for the sector for some time, predominately in response to its positive occupational performance comparative to other parts of the retail market, and indeed commercial property as a whole. The sector has been well placed to cope in what has been a period of unprecedented challenge to retailer performance during the COVID crisis, continuing to display remarkably strong resilience from an occupational standpoint, akin to how it performed pre-pandemic with the growth of online retailing.

2020 saw significant, additional and inevitable growth in the proportion of goods sold online across the retail market as a whole. In a year when non-essential retail was closed for large periods, consumers were forced to buy goods over the internet, therefore making many purchases online they may typically have made in-store prior to the pandemic. For example, 15.4% of consumers started food shopping online for the first time during the crisis, overcoming the perceived barriers and thus making future purchases with the same retailer much easier, subsequently creating a permanent rise in the sector's online penetration.

According to GlobalData 17% of all retail goods were sold online in 2019. This rose dramatically to 24% on average across the year for 2020, as a direct result of the impact of COVID-19 on the UK retail economy (figure 3). The increase of 7% in just twelve months is considered to be an acceleration of about 5 years based on pre-pandemic forecasts.

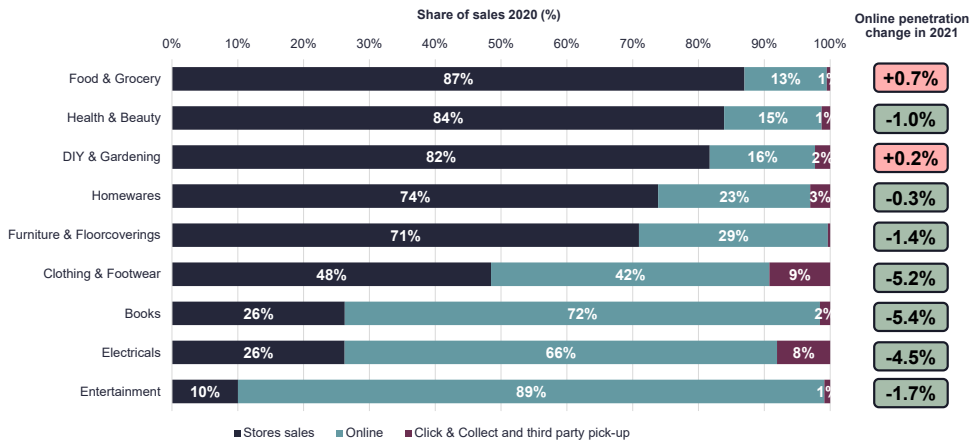
A swing from offline to online sales of this

Figure 3: Physical retail is still king!



Source: GlobalData

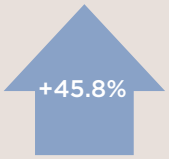
Figure 4: Traditional out-of-town retail sectors were still more insulated from ecommerce in 2020, despite the pandemic



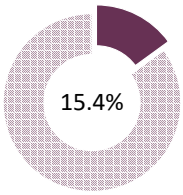
Source: GlobalData

Online retailing rose dramatically to 24% of all retail goods sold in 2020, up from 17% the previous year

More than three quarters of retail spend is still expected to be conducted through offline channels, equating to £260bn in 2021



Click-and-collect spend is forecast to increase by £3.1bn in the next five years, rising 45.8% to reach £9.8bn by 2024



15.4%
of consumers started online food shopping for the first time during the pandemic.

magnitude may seem like a cause for significant concern, particularly for those in the wider market concerned with the transaction of physical retail space. However, perspective is important. Analysts surveying current and future consumer spending behavior, the mix of operator sentiment toward ecommerce across all subsectors, as well as the logistical cost and practicalities of fulfilling online orders, suggest overall online sales growth is beginning to reach its natural plateau, albeit earlier than originally anticipated.

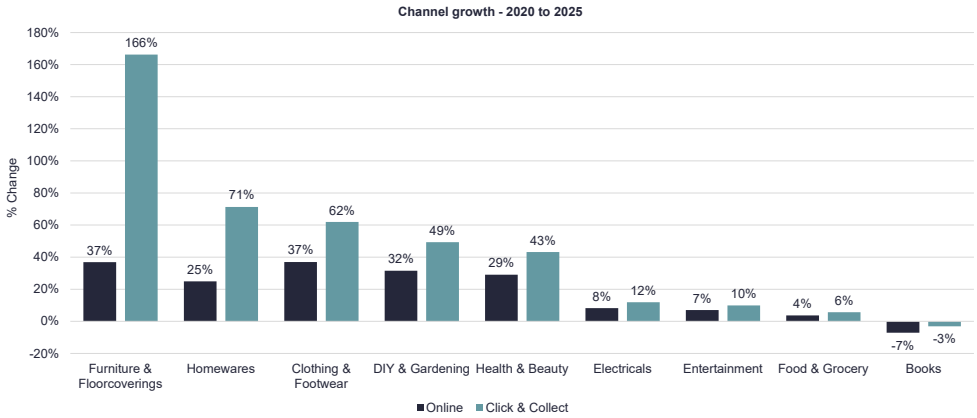
GlobalData has forecast online spend to level out and remain at around a quarter of all sales for the next 5 years. Conversely, and perhaps most importantly, three quarters of retail spend is therefore still expected to be conducted through traditional offline channels, i.e. the physical store. This will equate to c.£260bn in sales in 2021 across the retail whole market and, significantly, that figure is set to grow to nearly £276bn by 2025. Clearly the store is still the most important facet in today's omni-channel retail environment (figure 3).

Retail warehousing however, finds itself in an advantageous position in its relationship with online purchasing. Firstly, what is most comforting is that the products typically sold out-of-town are still those more defensive to online retailing than is true of a number of goods traditionally sold on the high street. That was the case before the pandemic and remains so despite it. Food & Grocery (87%), DIY & Gardening (82%), Homewares (74%) and Furniture and Floorcoverings (71%) all have the majority of sales fulfilled directly in-store (figure 4). For many occupiers in the OTR sector the consumer still in the main, wants to see and touch items, especially those with a higher price point. Furniture operators in particular are showroom retailers and therefore operate differently to those where product is going out through the front door.

Secondly, where online retailing has made an impact, click-and-collect has proven itself to be the feather in the cap for out-of-town retail destinations, the large and comparatively low-rented units, combined with high car parking provision, means the sector has proven itself to be ideally suited for servicing click-and-collect orders, customer returns and home deliveries.

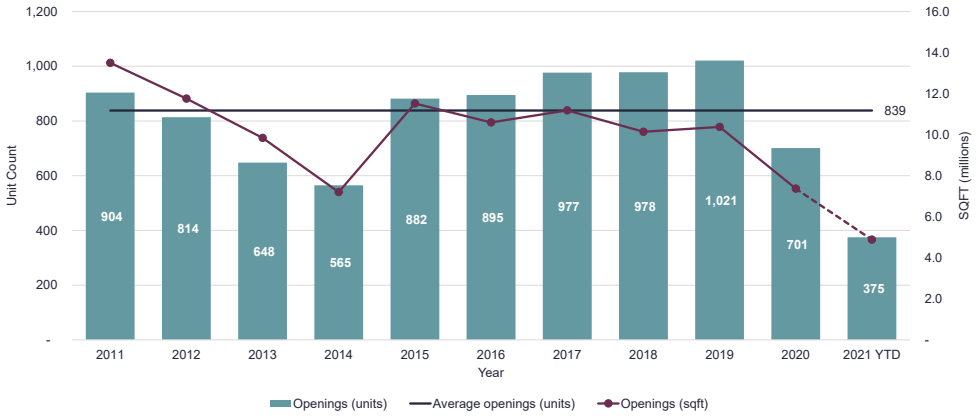
When you consider spend in this arena is forecast to increase by £3.1bn in the next five years, rising 45.8% to reach £9.8bn by 2024, the outlook for a physical store presence remains positive in the sector, notwithstanding the fact click-and-collect is also a significant driver for

Figure 5: The pace of growth for Click & Collect is greater than that for Ecommerce, across all sectors



Source: GlobalData

Figure 6: Annual new store openings, suggests 2021 could be a bumper year



Source: Savills Research

Figure 7: Top 15 acquisitive retailers by unit count

(a) 2020

Ranked by units			
Rank	Operator	Units	Total Floorspace
1	Lidl	55	1,071,900
2	Aldi	42	692,600
3	Costa Coffee	30	50,600
4	B&M Bargains	27	714,200
5	The Co-operative	22	55,800
6	Home Bargains	20	546,700
7	Iceland	18	241,400
8	Wren Kitchens	17	192,700
9	Starbucks	17	31,300
10	PureGym	16	156,100
11	M&S	11	272,400
12	Greggs	10	13,200
13	TheGym	10	96,800
14	Burger King	8	24,900
15	Sainsbury's	7	36,800

(b) 2021 YTD

Ranked by units			
Rank	Operator	Units	Total Floorspace
1	Lidl	35	670,000
2	Sports Direct	22	674,400
3	Home Bargains	21	402,200
4	Aldi	18	330,700
5	Costa Coffee	12	19,600
6	PureGym	11	111,200
7	B&M Bargains	10	348,300
8	TheGym	8	72,000
9	Starbucks	8	13,600
10	Tim Hortons	8	27,400
11	Gourmet4	7	30,200
12	Greggs	7	10,900
13	Iceland	7	86,600
14	Farmfoods	5	62,100
15	JDSports	5	51,700

Source: Savills Research

226%
Kingfisher click-and-collect growth in FY2020/21, now accounting for 78% of group online sales

capturing additional sales in the market at the point of order fulfilment. The true value of the store in the retail warehouse sector can therefore not be underestimated. Operators that have adopted a clear and structured omni-channel approach to their business models, are those that have recognised the importance of a well-placed store network to truly fulfil both their online business, as much as is necessary for the traditional off the shelf transactional side of their operations. In this regard, the store continues to play a key role in providing customers with a seamless and connected shopping experience. Figure 5 highlights how the growth of click-and-collect is set to significantly outpace that of ecommerce over the next 5 years, across nearly all retail sectors, particularly those pertinent to the out-of-town market. This is unsurprising considering the online market is maturing and leveling out at a quarter of all retail spend, whilst click-and-collect growth is starting from a much lower base. However it does make the point that this is considered to be a key growth area for many retail operators in the retail warehouse sector going forward.

The retail warehouse sector is increasingly being seen as a hybrid operation by both operators and investors in the sector, providing traditional in-store retailing with last mile delivery fulfilment options.

Online grocery sales have seen the largest increase across all sub-sectors in the last 12 months, with expenditure increasing by 86.5% to £20.9bn in 2020, compared to 10.8% growth to £11.2bn in 2019. This significant shift in consumer demand has resulted in the online grocery market changing the most since the outbreak, with penetration jumping by 5.1 ppts to 12.5%, with this rise expected to be sustained in 2021 (figure 4).

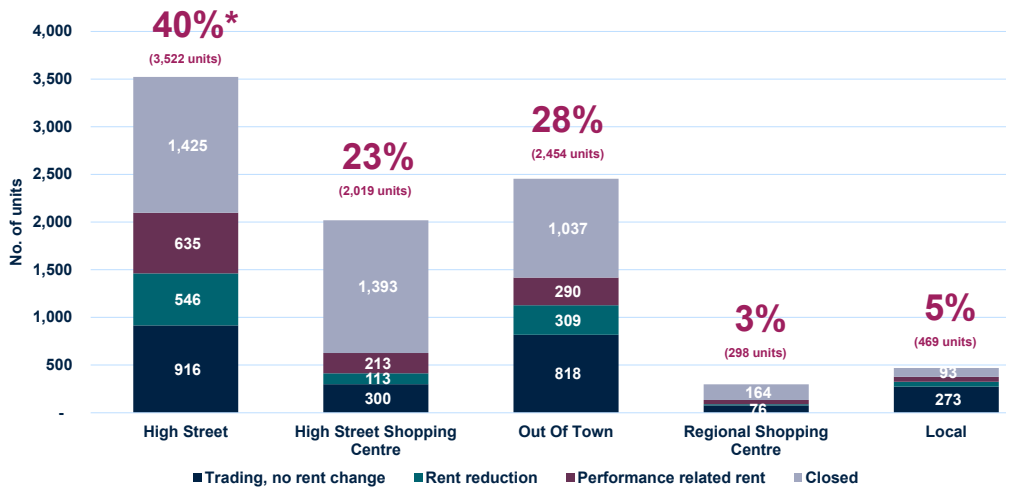
However, despite this, food and grocery is still the sector with the strongest store sales, accounting for 87% of the overall expenditure in the sector (figure 4). Furthermore, the significant rise in online grocery sales in the last 12 months has only actually been achievable due to the network of stores already in place for those operators with an online purchasing and delivery platform. The extensive and widespread store networks of operators such as Tesco, Sainsbury's, Morrisons, Asda and Waitrose is what puts them close to their customers and enables them to get their products, particularly those that need to be temperature-controlled, on our doorsteps quickly and easily.

Tesco have recently alluded to 'owning the last mile' in this way, as a means to scale up deliveries without heavy capital expenditure. They have pointed out that in-store micro-fulfilment centres can be installed in just a few months at a much lower capital cost, as opposed to up to two years for a large automated warehouse. Anecdotally, interest has returned once more to out-of-town supermarkets with the largest floorplates, as operators look to combine a traditional customer facing foodstore with a semi-automated picking centres for online delivery, located at the back of house. Sainsbury's decision to close its 'dark store' in Bromley-by-Bow in London would suggest online fulfilment is better served from trading stores. By March next year, more than 20 stores in and around the capital are expected to expand their online packing capabilities, enabling Sainsbury's to deliver thousands more orders each week. Asda have also announced plans to shut two of its online warehouses, switching from its dark stores in Dartford, Kent, and Heston, west London, to picking grocery orders from the shelves of local stores.

It could be argued that fulfilling online orders in this way essentially translates to store sales anyway; at the very least it relies on the relationship with the physical store, highlighting its true value and continued importance going forward. It is not just supermarket operators that have begun to recognise the importance of their out-of-town store network in fulfilling online consumer demand. For Kingfisher (including B&Q and Screwfix), growing online sales is a key strategic priority, with investment in the channel allowing them to respond quickly and effectively to changing consumer behaviour during COVID-19. Online sales rose 158% during FY2020/21, driven by strong growth in click-and-collect (+226%) which now accounts for 78% of group online sales, up 16ppts on last year. In other words, more than three quarters of their online sales require their network of stores for fulfillment, which of course has the added bonus of driving additional consumer sales to the store at the point it is collected.

The propensity of retail operators to recognise retail warehousing as a solution the their 'last mile' customer fulfillment requirements is becoming increasingly common and will undoubtedly gain more traction in the coming months and years. It is why we have begun to see much more interest from investors, many exploring the sector for the first time, who typically have had portfolios much more weighted toward logistics than they have been towards retail.

Figure 8: 2020 insolvency activity by asset class, highlights the resilient nature of the out-of-town market



Source: Savills Research

701
new store openings in 2020, across the UK retail warehouse market

The number of acquisitive retailers and their appetite for new openings in the sector has helped keep voids low and negate the impact of retail insolvency over the last 12 months.

Despite the unforeseen reduction in consumer activity across our physical retail environments, retail operators have still been keen to take space. 2020 saw 701 new openings across the market, some way short of the decade average at 839 but certainly not a disaster when you consider the perilous position some retailers found themselves at the onset of the pandemic. Many found themselves unable to trade for large periods, which subsequently meant, expansion plans were put on hold for much of the year.

For the retail warehouse market however, the fact that so many deals were agreed for 2021 by the end of 2020, provided the sector with significant comfort that this was only a temporary reduction in the positive pattern of growth we have seen over the last few years. 145 deals were in place for the upcoming year by the end of Q4 2020. That figure is usually much lower. Only 36 deals had been agreed by the end of Q4 2019 for the following year, for example. This tells us there were a number of retailers keen to do deals and agreeing terms in 2020, but not quite able to finalise those deals due to the various physical restrictions that were in place toward the end of the year as a result of various lockdown measures.

The results for Q1 2021 certainly seem to suggest the strong appetite for opening new stores has returned. So far we have seen 375, suggesting that if the same velocity persists we could potentially achieve results similar to those seen in 2019, a record year in terms of the number of new store openings in the sector (figure 6).

It is of course the value oriented operators that continue to drive the acquisition activity, with many of the same names taking space that have been doing so for the last few years. As much as 40% of units taken in Q1 2021 have been for value oriented brands. Figure 7b highlights the top 15 acquisitive operators so far this year. Lidl remain top of the leaderboard having required as many as 35 stores already, looking to take advantage of the space that has come back to the market with the recent insolvency activity, on more favourable lease terms.

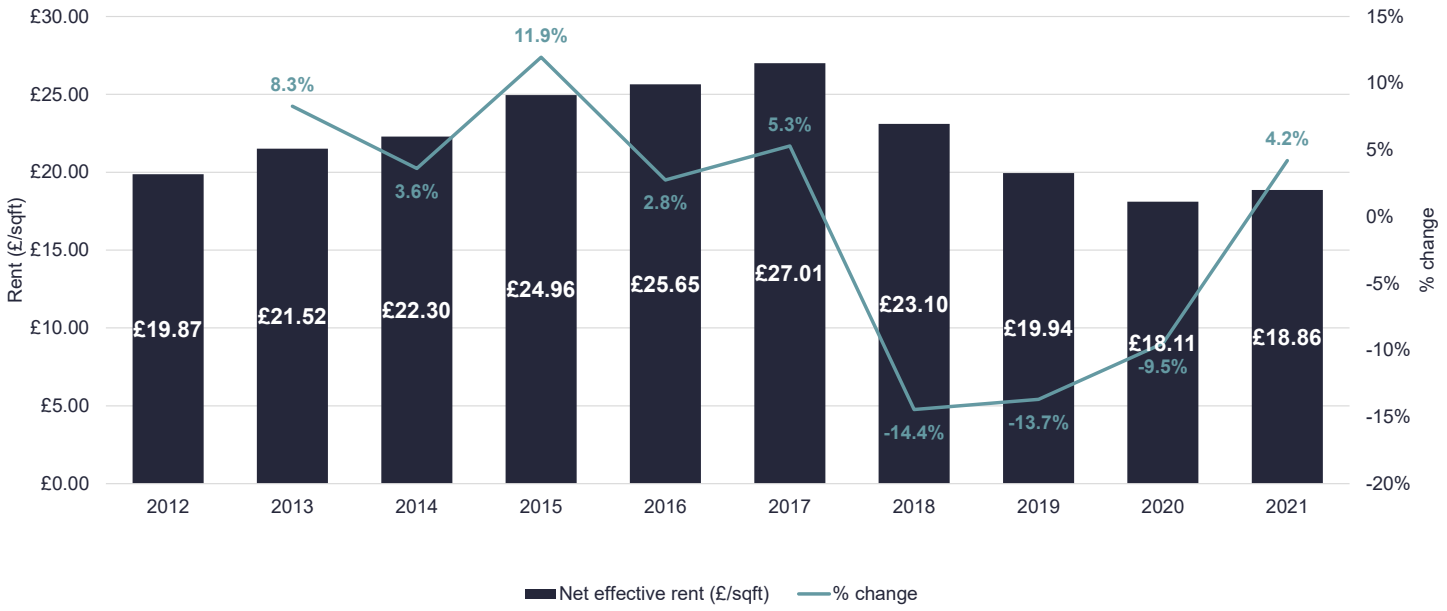
Of course, strong performance in terms of new openings has had a positive knock on effect in terms of vacancy in the market. Retail warehouse vacancy remains comparatively low at 5.9%, just over a third of what it is for shopping centres (16.3%) and less than half of what we are seeing on the high street (14.4%, MSCI). Interestingly, the low base in retail warehousing is particularly reassuring in comparison to the industrial market who have seen unprecedented demand for space with the growth of ecommerce in recent years, not to mention the recent surge since the onset of COVID-19 and the resultant uptick in online retailing as a result. UK logistics vacancy currently stands at 5.4%, not too dissimilar to retail warehousing, in a year when take up totalled 50m sq ft – the sector's best year ever and the reason why this sector remains the current asset of choice in the UK investment market.

Retail warehouse vacancy however, has increased in recent months, whereas at the end of Q4 2020 it was as low as 5.2%. The rise in Q1 2021 is undoubtedly the direct result of the return of the Arcadia units to the sector all at once, following the closure of all their physical stores, encompassing the Topshop, Topman, Dorothy Perkins, Burton and Outfit brands.

In terms of insolvency 2020 saw nearly 9,000 multiple retailer units pass through a CVA, administration or liquidation across the whole retail market, double that seen in each of the previous two years. However, retail warehousing continued to show its robustness, with the weight of that insolvency activity much more heavily skewed toward high streets and shopping centres than it has the out-of-town market. The positive performance of some of the more traditional out-of-town retailers has played its part, particularly the bulky goods and grocery operators that have been deemed as essential and allowed to trade throughout the pandemic. So too has the strong footfall performance as a result of greater perceived COVID-safety.

Analysing the impact by asset class, it is the high street that has accounted for the largest slice of insolvent activity; high street stores (40%, 3,522 units) and high street shopping centres (23%, 2,019 units) collectively accounting for 63% of all insolvency activity. This compares to 28% of units for the

Figure 9: Net effective rents have fallen c.£9 since 2017 (last positive growth)



Source: Savills Research

> **Data from all Savills open market lettings and regears has seen net effective rents fall by a third on average across the market since the onset of the decline, from £27 per sq ft in 2017, to £18 per sq ft by the end of last year**

out-of-town market, with a third of those seeing no disruption in trade and no reduction in their rental income, (figure 8). More significantly, insolvency-related closures have been much more pronounced in the in-town market than they have out-of-town. 2020 has seen 1,037 closures in the retail warehouse sector. High street and high street shopping centre units have seen 2,818 closures, equating to a third of all insolvency activity.

The fact that retail warehousing has been comparatively less affected by retailer failures than is true of other retail segments, is largely due to their lower exposure to mid-market fashion. Fashion operators accounted for as much as 57% of units to pass through an insolvency process in 2020. The Arcadia and Debenhams administrations led to the largest proportion of closures in both the in-town and out-of-town markets. However, of Arcadia's c.6m sq ft of retail space, the out-of-town market accounts for only 18%, predominately through their 'Outfit' brand, going someway to explaining the difference in fortunes between the two asset classes. Overall, it is fair to say the out-of-town market has seen an increase in insolvency activity in 2020, accounting for 2,454 units compared to 598 the previous year. However, the most recent activity has been as a result of the struggling fashion and leisure sectors as opposed to the more traditional retail park operators. The loss of the Arcadia stores, the Casual Dining Group administration and The Restaurant Group CVA, is where the bulk of the insolvency activity has been in the retail warehouse sector in 2020.

Declines in net effective rents are slowing, with the retail warehouse sector having rebased a greater proportion of rents than is true of other parts of retail, albeit with a divergence in performance across different occupier types.

With the challenges the retail sector has faced over the last decade, including the growth of ecommerce and more recently the COVID crisis, retailers have increasingly been keen to seek more affordable rent agreements. 2017 was the last time we saw positive rental growth in the retail warehouse market. Data from all Savills open market lettings and regears has seen net effective rents fall by a third on average across the market since the onset of the decline, from £27 per sq ft in 2017, to £18 per sq ft by the end of last year (figure 9).

However, the retail warehouse market has increasingly shown itself to be more resilient than other asset classes when it comes to rental decline. 2020 saw a fall in net effective rents of -9.5% on average in the sector. By comparison net effective rents in shopping centres fell by more than double that at -20.1% in the same period. For shopping centres and highstreets combined, net effective rents fell by -16.8% in 2020 and have continued to show a similar pattern of decline in the first quarter of 2021, with a decline -14.8% on average.

Significantly, for the retail warehouse sector declines in net effective rents have been slowing year on year. So far, Q1 2021 has even recorded a slight growth in average rents of around 4.2%, taking the overall average figure for the market up slightly to £18.86 per sq ft (figure 10). The evidence therefore suggests we are perhaps once again seeing the early shoots of a recovery in rental terms, similar to that first witnessed in March 2020, before the impact of the pandemic delayed proceedings and the inevitable questions of further rental decline and even operator survival began to emerge.

The optimism surrounding future rental growth is further supported by the consideration that only 26% of tenants across retail and shopping parks have a lease expiry sometime in the next 3 years. The evidence suggests we are close to the end of the lease expiry cliff in the retail warehouse sector, having renegotiated most of the large, arguably unsustainable, rental agreements that where were signed 10 to 15 years ago. As much as three quarters of the out-of-town market has already been rebased in terms of rents, much further along in the process of dealing with rental encumbrance it would seem, than is true of shopping centres or high streets.

Although the headline statistics point to some resilience in terms of rental decline, particularly in comparison to shopping centres, it is important to understand that the retail warehouse sector has seen a divergence in performance across different occupier types, as a direct result of the pandemic. 2020 saw the most significant fall in rents in the fashion and leisure sectors, recording declines of -18.0% and -20.6% respectively. This is unsurprising considering these sectors have been those most affected by the impact on COVID-19, their physical stores closed for the longest periods since the government-imposed measures began.

Discount variety however, perhaps surprisingly, has bucked the trend and has seen an average increase of 14.4% on 2019 rental levels. This makes sense when you consider that B&M and Home Bargains collectively took as many as 47 stores in 2020 (figure 7a). Their appetite for growth over the last few years has consistently seen them in the top 10 of acquisitive operators and has resulted in their having already taken a lot of the low hanging fruit when it comes to finding new stores. This has therefore begun to drive rents upwards in that sector, particularly when coupled with the fact they are also seeing increased competition from the value-oriented foodstore retailers, also leading the charge in terms of

5.9%
vacancy remains low in the retail warehouse sector

375
stores let in Q1 2020 across the UK retail warehouse market

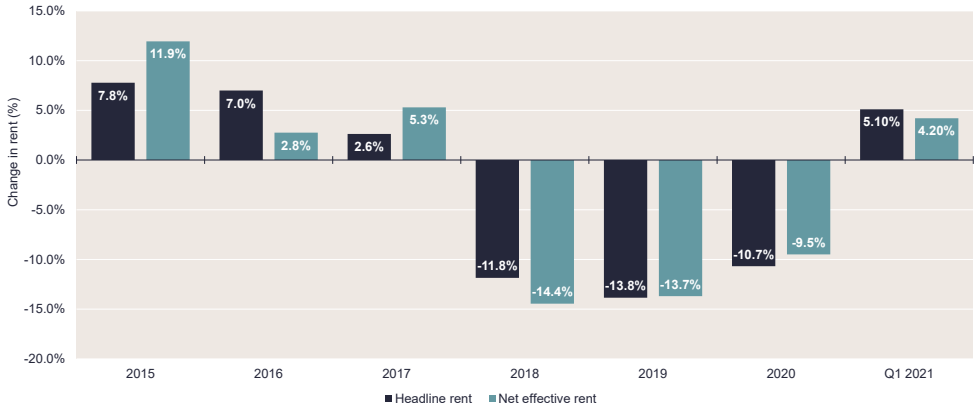
4.2%
growth in average net effective rents in Q1 2020

28%
of units to pass through an insolvency proceedure have been out-of-town

16.1%
Fall in term certain periods to 8.9 years on average in 2020

30.2%
Fall in total incentives to 8.4 months on average in 2020,

Figure 10: Declines in net effective rents are slowing, in the retail warehouse sector



Source: Savills Research

new openings, who have increasingly been looking for units of a similar size and format. Furthermore, discount variety operators have also, very simply, been taking more space of late in the South East, the region of the UK where rents are generally higher.

Rent payments on existing leases shines more light on how well the retail warehouse sector is performing versus other asset classes in response to the pandemic. Many retailers have of course struggled to make payments due to prolonged trade inactivity throughout the lockdowns. However, with much more of the retail warehouse sector considered to be 'essential' during these periods the sectors' resilience has been further reflected in the proportion of rent and service charge payments that have been made over the last 18 months. The most recent statistics highlight tenants on Savills managed retail parks paid 68% of the rent and 51% of service charge due in Q1 2021. Shopping centres however, remain much lower at 40% for both rent and service charge collection.

Non-payment of rent puts significant pressure on landlord's own income streams, while forcing the issue on whether current rental levels and leasing formats are sustainable. As a result, performance related or 'turnover deals' have begun to receive much more attention since the onset of the pandemic. CACI's 'Halo Model' and Colliers 'Five Point Plan' are both examples of leasing models that look to take a multitude of variables into account including footfall, online uplift, returns, click-and-collect, store sales, incentives and even fit out costs. However, they rely on honest input from both occupier and owners and as such have been much more prevalent across high streets and shopping centres than they have in the retail warehouse sector.

Of all the out-of-town deals Savills were involved with in 2020, less than 3.5% had a turnover element attached to them. The performance of some of the traditional out of town retailers, in particular the foodstore and bulky goods operators who have posted significant uptick in their in store performances since the onset of COVID-19, has meant they have been much more able to make their rent payments and less willing to share individual store performance data required with a turnover deal. Those proportion of tenants that haven't been making rent and service charge payments in the retail warehouse sector are those who also have significant in-town store portfolios and who have chosen not to pay across the board.

For operators struggling to pay their high street and shopping centre rents, a turnover deal at present is often proving to be the most appealing way of maximising the amount they can save. However, for retail warehousing the simple fact is the ability to acquire space on much more favourable lease terms is generally proving more attractive than a deal that would link payment to their performance. Unsurprisingly, the Savills deals data has highlighted the fact retailers are acquiring shorter lease lengths in the retail warehouse sector. Term certain periods fell by 16.1% to 8.9 years on average, a fall of 1.7 years in 2020. Nevertheless, as a result total incentives have also begun to shorten considerably, down -30.2% on average in 2020, a reduction of 4 months to 8.4 months for an average deal. Landlords are much less keen to give incentives when negotiating a new deal as retailers have increasingly been securing more favourable deals on the overall rent and length of contract.

3.5%
Only a small proportion of Savills deals had a turnover element attached in 2020

-18.0%
fall in Clothing & Footwear rents in 2020

-20.6%
fall in Leisure rents in 2020

+14.1%
increase in Discount Variety rents in 2020

Investment market

The notable pandemic related pause in transactional activity was short lived with investment volumes improving beyond those seen prior to 2020 and yields starting to fall, albeit with a hint of caution as the width and depth of the demand is thinner than the activity in the market would suggest.

The retail warehouse investment market got off to a good start at the beginning of last year. At £476m it posted the largest volume of Q1 transactions since 2017 when we last saw occupational rental growth in the sector (up 47% on the same period in 2019).

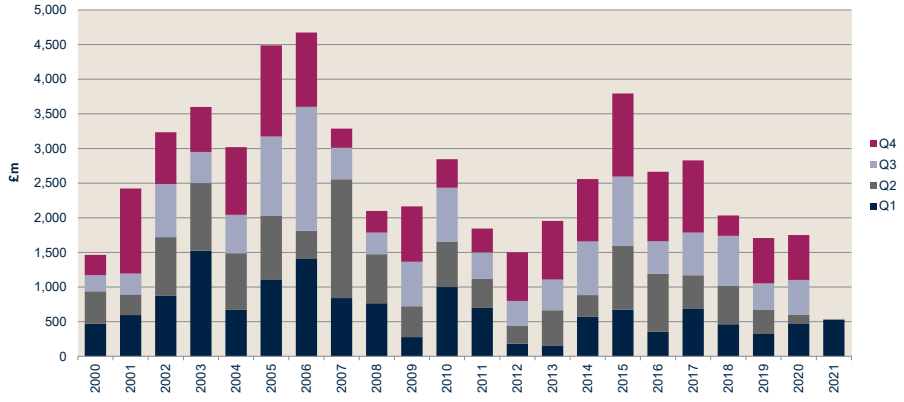
Unsurprisingly, around the time of the first lockdown in March last year, the market paused to assess the impact of the pandemic and occupiers' ability to pay rent. This gave investors time to reassess the sustainability of ERVs, with many concluding the sector was only worthy of investment where the alternative use value was higher than that for retail warehousing itself. As a result Q2 2020 investment activity took a nose dive, recording the smallest uptake of any quarter in the last 20 years at only £122m, a -65% fall on the same period the previous year.

This position proved palpably wrong and very short lived, as the occupational resilience in the sector remained apparent. Q3 2020 was undoubtedly the point we saw a swing in investor attitude from a potential change of use play, to buying into the sector based on its own merits. A higher proportion of retailers have remained open during the crisis than is the case in shopping centres or on high streets, and as a direct result rent and service charge payments have been higher. Furthermore, with less exposure to mid-market fashion the sector has also seen less insolvency activity than the rest of retail, whilst its large units and ample car parking provision have also meant it has proven to be more social-distancing-friendly, culminating in stronger footfall recovery and more robust trading performance across a number of retail warehouse focused subsectors.

As a result investment activity in Q3 and Q4 2020 recovered swiftly. Q3 saw £505m worth of transactions, a 24% increase on the same period the previous year. The year also ended strongly with £648m transacted, similar to the same period the previous year and just short of the quarter average for the last two decades at £664m.

Despite the marked improvement in transactional activity in the latter half of last year, the market had still not perhaps seen the anticipated flood of activity it was expecting before the pandemic prompted a more cautious approach. In previous editions of this spotlight, we have highlighted the comparative appeal of retail warehousing as an asset class with the expectation that a number of overseas investors in particular, all with plenty of liquidity, were on the precipice of pulling the proverbial trigger and significantly expanding their exposure to UK retail warehousing. Q1 2021 suggests we are perhaps finally seeing this come to bear, with £530m transacted in the sector, the highest Q1 since 2017 and an uptick of 11% on the transactional volumes recorded at the same time the previous year, before the pandemic took a hold. These figures suggest the retail warehouse investment market is not just back to normal, but ahead of pre-pandemic levels in terms of transactional appetite and market liquidity.

Figure 11: UK retail warehouse investment volumes



Source: Savills Research

The market is indeed alive, with investment demand coming from across the whole spectrum of assets, including all geographies, all lot sizes and all yield profiles. This is a much healthier investment market than we were seeing 12-months ago, with more cash buyers than there have been, a number of funds returning and continued interest from the old guard, as well as some overseas investors that have been circling for some time.

In fact, the portfolio sale of Hammerson's seven retail park assets to Brookfield was seen as a bellwether test of the ability to complete large investment transactions, particularly retail ones. In May of last year, Orion formally walked away from the £400m acquisition of the parks, with the £21m deposit passing to Hammerson because of its failure to complete. The deal was knocked off course by the pandemic and the market valuation uncertainty it brought. It is therefore a good example of investor appetite returning to the sector. Having exchanged unconditional contracts in April, the sale of £330m represents an 8% discount to the year-end book value of £357m and sees Hammerson exit altogether from the UK retail parks sector.

Debt availability certainly got the ball rolling, particularly for prime assets. Its availability has improved over the last twelve months with more lenders coming to the party than has historically been the case, primarily as a result of the low loan to value ratios and high margin potential, coupled with the strong occupational story of resilient consumer behaviour and the defensibility of income across the sector. We do however remain cautiously optimistic the uptick in transactional activity will continue, as despite the funds returning and the continued interest from overseas investors, the width and depth of that demand across the market is perhaps thinner than the recent performance would suggest.

In terms of pricing, prime open A1 consented retail warehouse yields have continued the gentle downward trend that has been seen over the last twelve months, now standing at 6.25%, a full 75 bps lower than this time last year. Prime restricted assets have followed a similar trajectory, also hardening by 75 bps from a year ago to the 6.0% yield we are seeing currently. This is indicative of investors that have begun to move in the sector, now comfortable they can assess what the correct ERV is on a particular asset or portfolio, and supported by the belief in the performance of the discounter operators acquiring space at a rate of knots, rather than the fashion retailers who have been struggling the most during the pandemic. The number of lease transactions in the occupational market provides enough comfort to investors that the retail warehouse sector is much further through its pre-COVID structural change and the process of resetting rents than is true of shopping centres for example, with only a year or two left before the evaporation of the 15 year lease agreements signed back in 2008/09.

Inevitably as interest returns, it is prime stock that moves first with secondary and tertiary assets still having some way to go. There is a distinct gap forming between prime and secondary assets, as well as Shopping Parks. Yields have moved outwards to 9.50% on Secondary Restricted and to 9.25% on Secondary Open A1. Meanwhile Shopping Parks have softened by more than 100 bps to 8.50% from last year, unsurprising considering the fashion sector has been one of the hardest hit since the pandemic with the most insolvency activity to date.

Outlook for 2021

Schemes that are dominant or convenient will continue to be top of investors' wish lists, particularly those with a foodstore anchor. Rent payment has obviously been the big question mark in the last year or so but this is not expected to throw a spanner in the works when it comes to investor appetite. Firstly, the payment of rent and service charge has been far in excess of the proportions we have seen across other retail asset classes, shopping centres in particular. Furthermore, where rent hasn't been paid it is generally considered to be the problem of the vendor rather than the potential purchaser. Many such vendors with assets to sell are often dealing with arrears prior to putting them on the market, regearing a tenant's lease, and either adding as a rent free period going forward or writing the debt off and adding a few additional years to the existing lease term. When the moratorium ends on the right to evict tenants over non-payment of rent, the balance of power is expected to swing back in favour of the landlord and actually help with liquidity in the market.

One potential issue on the horizon could be a lack of supply in the investment market going forward. Many landlords that have sold assets in recent years have done so either because they have needed to raise capital, wanted to reduce their portfolio weighting towards retail or eliminate it all together. Pricing, not unsurprisingly, moved as the market went from almost zero turnover to current levels. Owners that had been looking to sell for the last 12 to 18 months now had an audience to sell to.

However, once those predominately pre-COVID disposal strategies come to an end there may well be an undersupply, of prime stock in particular, for those investors looking to enter the sector as landlords understand the value of what they have and don't necessarily need to sell. Having lived through falling values and non rent payment scenarios the temptation to hold will increase as values recover and rents get paid. This could create some competitive tension for those coming to the market in the short-term, which could in turn start to steepen the yield curve. In this scenario it is important to remember the mistakes of the past where owners have held on to assets too long. If there is a buoyant market to sell in to, and assets previously earmarked for an exit are still unloved but have been retained, it may well be prudent to take advantage of the current market dynamics.

These dynamics have changed from the now very historic traditional prime, secondary and tertiary referring to fashion, open a1, restricted and bulky schemes, to now defining those parks best suited for their audience and size. This has had the added but less observed impact of the 'best possible demographics' not being the be all and end all. Of greater importance is the tenant line up being fit for its catchment audience, levels of trade, rental levels and scheme size. Personal preferences may desire food or food adjacency and geography will always have value implications, as high alternative use values are seen as a great comfort blanket which favours southern and metropolitan schemes. However, the market recovery has meant regional assets are being priced much more appropriately and as functioning retail locations in their own right.

Retail warehousing is much further along its journey of the often used "structural change" phraseology and is rightly attracting investor interest for this stability over other retail asset classes. Time will tell how far progressed the non retail asset classes are on their particular post Covid structural change journeys and some of them are likely to have further to go than they anticipate as they start to adapt now. The travails of the retail market pre Covid has meant that it is in better shape to return to a new normal quickly with retail warehousing leading the pack.

Occupationally, with foreign travel restrictions expected to remain in place this summer and perhaps even longer, it is expected that many consumers will continue to instead spend their disposable income on investing in their homes, through furniture and DIY sales. The stamp duty holiday introduced in July last year saw a meteoric rise in the number of people moving house in the second half of last year which translated very positively into above average performance for these retailers, which of course are a very key part of the retail warehouse sector.

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