UK Commercial – Q2 2021

SPOTLIGHT

Savills Research

Shopping Centre and High Street Spotlight

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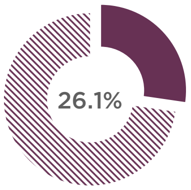
- Consumer market overview
- Q2 leasing and investment trends
- Outlook for 2021 and 2022



Online sales accounted for a 26.1% share of total UK retail sales in June 2021, a significant reduction compared to the peak 36.3% recorded in January.

UK retail consumer and occupational trends

The phased reopening of the retail and leisure market has prompted significant footfall improvements, albeit the gap to 2019 levels persists

Confidence across the consumer environment has improved in line with widespread vaccination and pent-up demand

The various reopening phases throughout Q2 2021 triggered significant improvements to the consumer environment. Consumer confidence data, as per GfK's monthly index, points to an inherently positive outlook following 14 months of restrictive measures. The index for personal financial situation (for the next 12 months) remained at +11 in July; its highest level since October 2007. The climate for major purchases also improved by seven points in July, as it pushed closer to pre-Covid levels.

Despite the delay to the final easing of restrictions, the UK retail market has been well-poised to benefit from the gradual return to normality, driven by pent-up demand and heightened household savings over the course of the last year. The reopening of non-essential retail from April 12 followed by indoor hospitality from 17 May generated two major boosts to footfall recovery. According to Springboard data, average weekly footfall across the UK in June 2021 improved to its highest level since the start of the pandemic, when compared to 2019 equivalent levels.

By retail type, retail parks continue to outperform, with a gap to 2019 levels of just -4.1% on average in June. Over the same period, footfall across shopping centre and high street locations remains very closely aligned, recording -27.2% and -29.1% respectively.

Weekly footfall growth has generally seen a plateauing in the latter half of June across most retail place types. The anomaly to this trend remains staycation markets, which continue to track strong week-on-week growth, rising +3.9% in the final week of June.

The easing of all final restrictions from 19 July is expected to begin allowing the gap to pre-Covid levels to shrink, although hesitancy over mass travel in light of the most recent Covid-positive case numbers might continue to cause marginal delays.

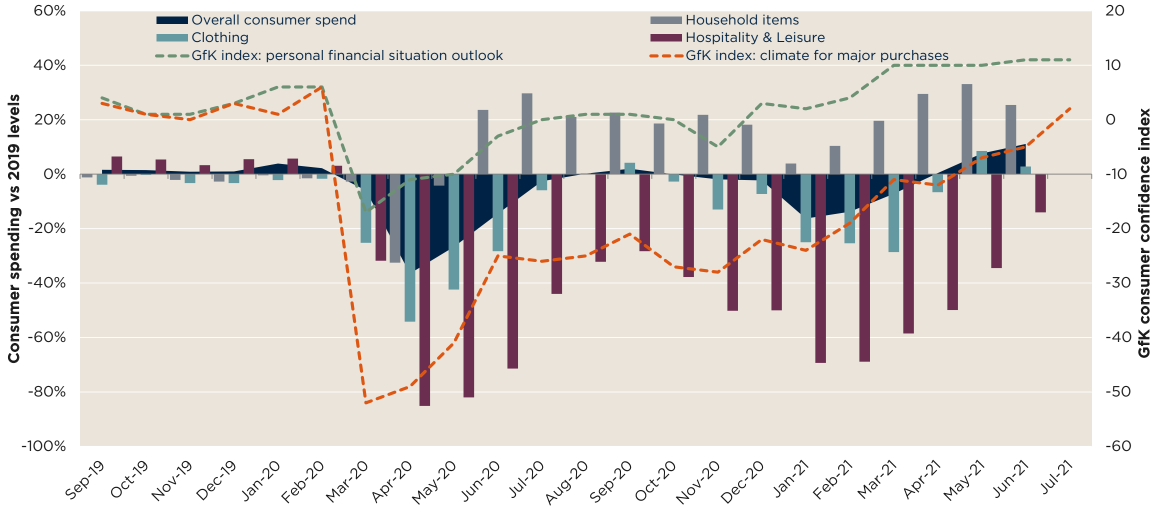
Retail sales continue to highlight ongoing disparity by subsector

Since reopening, retail sales have shown a mixed bag of results. While the reopening of physical stores is unquestionably positive for the sector, there are still substantial operating costs associated with reopening which will be affecting retailer margins.

The boost in household sales during the stamp duty holiday continues to support homeware retailers. According to Barclaycard, spend on household items enjoyed another month of significant growth in June, recording +25.4% compared to equivalent 2019 levels (see chart below). This has been reflected by individual retailer results, with the like of Topps Tiles and B&M each posting double-digit like-for-like profit growth in their most recent half-year and annual financial announcements, respectively.

Total spend on clothing in June saw its second consecutive month of positive growth, reaching +2.8% compared to June 2019 levels. This follows

UK consumer spend recovering in line with the staggered reopening as spend on clothing in June 2021 remains in positive territory for the second consecutive month.



Source Savills Research, GfK, Barclaycard

Footfall improved to its highest post-pandemic level in June 2021, when compared against 2019 equivalent levels

GfK's personal financial situation outlook index increased to its highest post-GFC position in July 2021

+2.8%

UK consumer spend on clothing increased +2.8% in June 2021 compared to 2019 equivalent levels

> “Total deal count in the first half of 2021 increased by 18.9% compared to the same period in 2019, according to Savills UK retail leasing deals.”

the heightened growth of +8.5 experienced in May, following the first full month of non-essential retail opening and in line with the early summer period. However, individual retailer results are far more varied in this subsector depending on their online provision and physical retail positioning. Online sales continue to account for a large portion of total UK retail sales in June, reporting a 26.1% share, however this does represent a significant reduction compared to the peak of 36.3% recorded in January 2021.

Hospitality and leisure spend remains subdued following the delays made to the easing of social distancing restrictions coupled with limited cross-border travel opportunities. However, spend levels in June did represent the smallest gap to 2019 levels since the start of the pandemic, with government confirmation of the removal of all restrictions as of 19 July pointing to further recovery within this space.

Availability opens significant opportunities in the leasing market

Various retailers have reassessed their physical portfolios since the onset of the pandemic. This, combined with numerous high profile CVAs and administrations, has resulted in a vast increase in availability, leading to some locations recording record highs.

In terms of floorspace, vacancy, as per MSCI's sample, averaged 11.7% in June 2021 for UK high streets (excluding South East), and 17.4% for shopping centres, indicating a marked increase compared to the 6.9% and 12.9% recorded in June 2020, respectively.

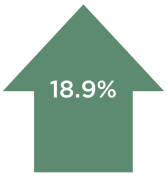
Ongoing governmental support packages are likely to help limit further significant jumps in vacancy in the near-term. Most notably, the extension of the eviction moratorium to March 2022 will undoubtedly go some way to protecting operators currently facing operational headwinds, particularly those continuing to operate well below usual trading levels. This new date will apply significant pressure on the vital summer and Christmas periods to allow these retailers to improve balance sheets in preparation for a return to full rental payments by March 2022.

High availability across the UK together with the reopening of the sector and an improved consumer environment has sparked a significant uptick in leasing enquiries. As a result, total deal count in the first half of 2021 increased by 18.9% compared to the same period in 2020, according to Savills UK leasing deals.

Recently announced growth plans amongst both new international entrants and existing UK retailers emphasises this point. To name a few, Russian supermarket, Mere, has recently announced a 300-store rollout UK-wide, while newly formed MaxiSaver is aiming to open 20 more stores this year. B&M revealed a further 45 stores to be added to its UK portfolio following strong annual profit growth, while Itsu is looking to expand into 100 new sites across key UK cities following investment from Bridgepoint.

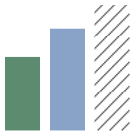
In line with demand beginning to creep back into the leasing market, we've experienced a slight softening in rental decline (albeit following a full year of more significant rental falls). On a rolling four-quarter average, headline rents in Q2 2021 reported -3.2% year-on-year, marking a significant improvement compared to the double-digit declines reported in Q1 2021. As rent free periods continue to exceed pre-Covid averages and lease lengths shorten, net effective rents continue to show slightly more pronounced year-on-year falls, recording -7.2% on average, in the four quarters to Q2 2021.

While this does present promising early signs of operational confidence, the vacancy landscape will remain a cause for concern for some landlords. Additionally, the gradual unwinding of government support packages is likely to cause further casualties across the sector in the upcoming 12 months.



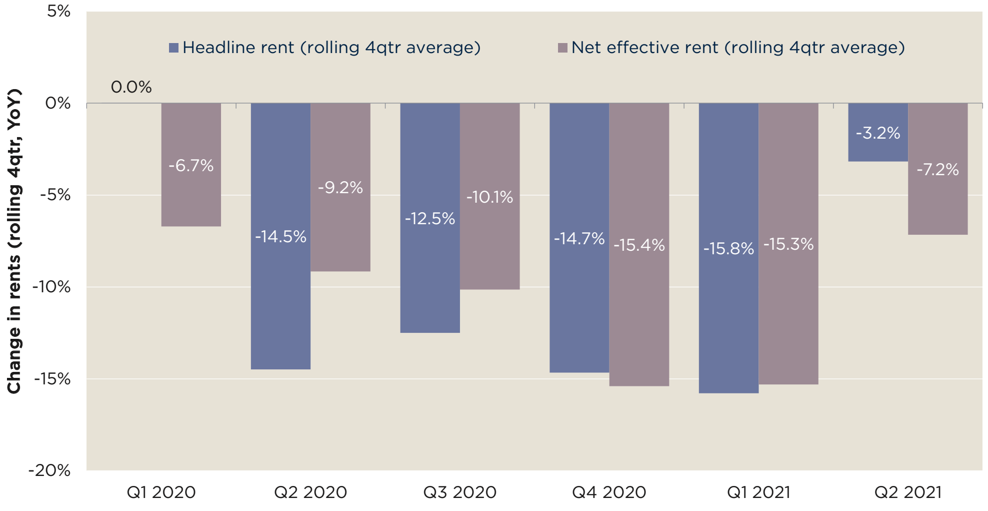
Retail leasing deal count in H1 2021 grew by 18.9% compared to the same period in 2020

Average year-on-year net effective rents declined -7.2% on a rolling four quarter average in Q2 2021



Vacancy, by floorspace, averaged 11.7% for UK high streets (excluding South East) in June 2021, up from 6.9% in June 2020

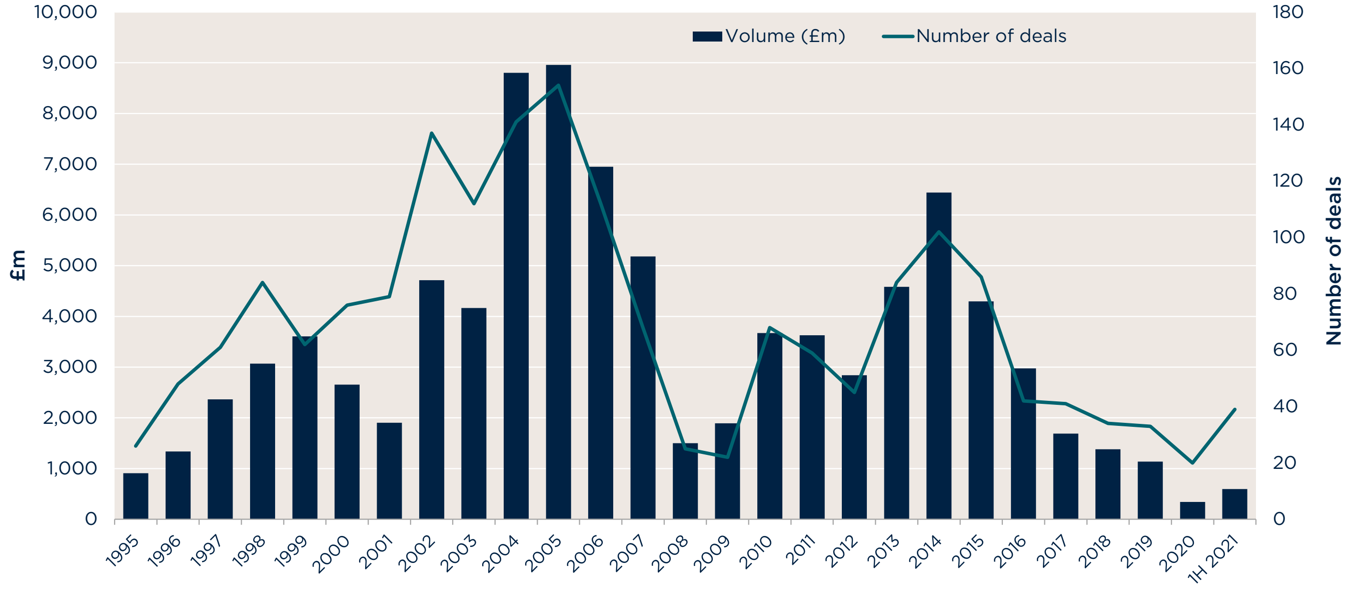
Change in average high street and shopping centre rents emphasises the easing in rental decline compared to the first four months following the onset of the pandemic.



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

> “The sheer scale of the consumer recovery that is currently underway must support a more optimistic view on retailing.”

Shopping centre investment



Source Savills Research

UK retail investment market

Buyer pool has started to look at more than just re-purposing opportunities

Shopping centre investment
While any comparison with 2020 is going to flatter on the upside, it is still worth noting that the volume of shopping centre investment transactions in the first half of 2021 was 73% higher than the total for the whole of 2020, at £594.6m. Furthermore, with 39 transactions taking place in the first six months of this year we are back to levels not seen since 2015.

Clearly something has changed over the last three months, and while the roadmap out of lockdown has undoubtedly played its part we also believe that the buyer pool and the rationale for buying has broadened over the last quarter.

The tone in the shopping centre investment market in 2020 and early 2021 was either one of a risk-averse focus on foodstores or a view that shopping centre purchases could only be justified in terms of alternative use values. More recently, while these factors are still prevalent in the market, we are definitely seeing a rise in opportunistic interest in parts of the sector just because it looks cheap. This view is notably one held by a number of non-domestic investors, particularly Israeli.

As we commented upon in our last Spotlight, the chartist view supports now as being a good time to look at the best shopping centres in the UK. Our current prime shopping centre yield stands at 6.75%, the highest it has been since the Global Financial Crisis (GFC). Back in the Summer of 2009 this reached 7.25%, and then within six months had fallen to 6.0%. In a world where high yields are increasingly hard to find (whether in real-estate or outside), good UK shopping centres where there is a credible story around tenant demand and consumer need are starting to look cheap.

While we do not believe that the recovery this time around will be as strong as it was after the GFC, the sheer scale and speed of the impending consumer recovery in the UK must support a more optimistic view on retailer performance and covenants in some locations going forward.

At the moment the challenge for any investor looking to enter the market to capitalise on the cycle might well be finding the right product. Liquidity has definitely picked up at the smaller end of the market, as the chart above shows, but examples of truly prime shopping centres that have been marketed are scarce. Many investors who might be attracted to the larger and primer end of the market are still quite rightly cautious about the forward trajectory for rents, rent collection and retailer failures. However, as the occupational section of this Spotlight shows the story is definitely moving in the right direction.

A bigger challenge to liquidity at the prime end of the market lies in finding willing vendors. The response to the marketing of both Barton Square and Touchwood Solihull was positive with multi bids. The rationale for selling at or close to the nadir of a cycle is difficult to form unless it is part of a wider fund or corporate strategy to sell down exposure to the sector, and thus we do think that finding evidence that prime pricing has stabilised or even started to recover will be challenging for the next six to twelve months. However, returning the chartist frame of mind, one thing that past cycles tells us is that eventually an asset does come to the market that proves that a turning point has been reached, and it is then that a wider pool of buyers suddenly appears.

This may not happen in the next six months, as thus we see the remainder of 2021 as more of the same that we saw in the first half. Local authorities, developers and private investors will continue to be the main buyers of shopping centre investments, and their rationale for doing so will vary. Re-purposing will continue to be a major driver where residential values are high enough to justify the costs, and for the local authorities the key driver will be social return rather than total return.

Prime shopping centres yields will remain hard to prove, though our gut feel now is that they are at or close to their peak level for this cycle. Elsewhere in the market yields will continue to rise as investors react to an increasingly polarised story around locations that have or do not have a future as a pure retail destination.

High street shop investment

Investment turnover in the second quarter of 2021 was £448m, down from £689m in the first quarter. This brings the total for the first half to £1.1bn, which is almost exactly the same as the same period in 2020.

Unlike the shopping centre investment market there has been little change in the make-up of the investor base over the first half of this year, with 39% of purchases being by property companies and 30% by domestic and international private investors.

The majority of these buyers remain focused on one of two areas, either redevelopment plays or long-income plays such as foodstores and banking halls. However, the last quarter has seen rising investor interest in prime assets at significantly discounted values.

Institutional investors have accounted for only 8% of all unit shop purchases this year, a continuation of the decade long trend that has seen them fall from accounting for nearly 60% of all purchases in 2013.

However, given the bias towards long-income that many institutions have developed there are still opportunities in the high street shop sector that might be of interest to risk-averse investors.

Typical of this type of asset would be the recently marketed Primark in Nottingham which has 39 years unexpired and a target NIY of 5.26%. Given the 200 basis point yield differential between this kind of asset and similar lease lengths in offices and industrials it could be of interest to both private and institutional investors who can look beyond the wider problems in the sector.

Generally there remains a lack of liquidity at the prime end of the high street shop market, and in a similar vein to our comments around shopping centres we believe that this will make it hard to call the moment where prime yields have topped out.

While wider macro trends suggest that this could be reached in the next six months, concerns about further CVAs, the extension of the moratorium on evictions, and the aforementioned lack of activity at the prime end of the market will inhibit activity for the remainder of this year.

Investor demand for foodstores will remain strong, and might even put some downward pressure on the current prime yield of 4.5%. If that happens then it could well be the catalyst that causes some investors to look beyond that risk-off subsector and towards long-income opportunities on the rest of the high street.

SC equivalent yields: Revo centre classifications

	Q1 2021	Q2 2021
Dominant Prime	9.00%	8.75%
Regionally dominant	7.25%	7.25%
Sub regional scheme	8.75%	8.75%
Neighbourhood scheme	10.50%	10.25%
Local scheme (successful)	10.00%	9.75%
Local scheme (challenged)	16.00%	16.00%

Source Savills Research

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

Source Savills Research

SOLD

£343m
2020 Full Year investment in shopping centres

SOLD

£594m
1H 2021 investment in shopping centres

25bps
The fall in prime shopping centre yields over the last quarter

75bps
The rise in prime shopping centre yields over the last year

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