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Spotlight
UK Retail Warehouse Market

October 2015

Image: Abbotsinch Retail Park, Paisley

SUMMARY

■ The combination of a recovering housing market and strong consumer confidence bodes well for Christmas and New Year trading.

■ The investment performance of retail warehousing as an asset class has weakened over the last six months. Investor demand has become increasingly binary on quality. However, we expect to see more interest in secondary assets in 2016.

■ This issue's occupier overview focuses on Scotland, where vacancy rates are falling and retailer demand is improving. Investor confidence in the prospects for the Scottish retail warehouse market is improving, and we expect to see more development activity and rental growth in this market in 2016.

"We expect to see more opportunistic money entering the market in 2016, attracted by the higher yields on offer."
Jaime Dunster, Savills

Economic and consumer outlook

As retailers become increasingly focused on the crucial Christmas trading period, it is looking likely that sales will be stronger this year than last.

The GfK consumer confidence indicator has averaged +4.5 over the last six months, compared to a long-run average of -8. Inflationary pressures are almost non-existent still, despite strong pay growth. Indeed, the latest ONS data on pay shows that wages rose by 3.2% in the year to July, the strongest growth since November 2008.

After sustained period of falling real wages it looks likely that the consumer could enjoy this level of wage growth for some time to come. The ratio between unemployment and job vacancies is back to pre-crisis levels, and this is likely to stimulate further wage rises in the year to come.

However, the recent data on retail sales has been weaker than expected. This probably has a lot to do with the fall in food sales, attributed by several retailers to bad weather and a rise in the number of people going away on holiday. Also, the fact that the late August Bank Holiday fell outside the period covered by the latest retail sales data may be of relevance. We expect that the September data will show a marked recovery in retail sales growth.

Looking slightly further ahead the latest comments by MPC members indicate that the first hike in the UK base rate is still some way off, and this also bodes well for a strong Christmas.

A final metric that is particularly relevant to parts of the retail warehouse market is the state of the housing market. While house price growth slowed around the election period, there are signs that the rate of growth has picked up a bit over the summer. Housing transactions, which are often a good leading indicator for sales of bulky goods in particular, have recovered from their cyclical lows, but as the chart below shows they are still far off the pre-crisis levels.

Investment market overview

The investment performance of the retail warehouse sector has weakened over the last six months, both on an absolute basis and compared to other retail segments.

The annualised total return has fallen from 15% in December 2014, to 9.4% in August 2015. This is primarily due to a sharp slowing in the rate of capital value growth that the sector has been delivering, though rental growth has remained slightly positive at 0.5%pa for the 12 months to the end of August 2015. Our regular monitor of prime yields (Table 1), shows that retail warehousing is one of the few sectors of the UK commercial marketplace that has seen rising yields in 2015, with a 25bps rise this year.

However, investor demand remains strong with institutional investors heavily biased towards the best schemes in the best locations.

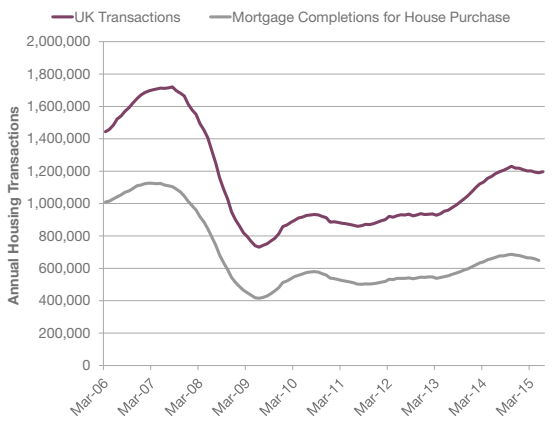
Once again there have been and will continue to be very few high calibre schemes on the market, as these tend to be owned by the same handful of institutions that are currently trying to increase their holdings of retail warehousing. This has forced the institutional demand to stretch their buying criteria further down the qualitative spectrum. As the level of demand has eased, it is apparent that the funds are not prepared to stretch this too far. This has led to the emergence of a "two-tier" market with strong demand for the very good assets and softening yields for poorer assets where investor demand is weaker.

Looking ahead we expect to see more opportunistic money entering the market in the final quarter of 2015 and into 2016. These investors are likely to be attracted by the higher yields on offer, as well as focusing on the secondary but still successful parks and schemes.

This could well be a very canny time to enter that segment of the market, as we believe that the recent softening in yields is only a temporary blip, and that the fundamentals of the sector will deliver good rental growth over the next five years. This will drive an improved return, with our five year forecast for retail warehousing returns remaining stronger than most other parts of the retail sector.

GRAPH 1

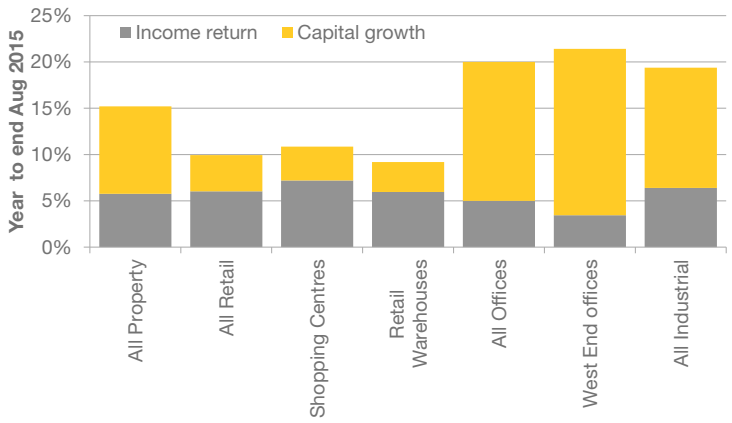
UK housing transactions



Source: HMRC, CML

GRAPH 2

Components of total returns



Source: Investment Property Databank

Occupier market overview - Scotland

The Scottish out of town retail warehouse market has demonstrated a reasonably strong recovery over the past couple of years aided by a number of new entrants to the market, an improving economy and the residential transaction market picking up. The passing of the Independence Referendum last year has also lent a greater perceived stability to the retailing and development environment. A recent study, published by the Scottish Retail Consortium and data firm Springboard, found that footfall within retail parks north of the border rose 8% in August, well ahead of the year-on year average of 1.7% for the UK as a whole.

Particular encouragement should be taken from a number of notable and potentially exciting new entrants to the Scottish market. The Range, Sofaworks and Nike all opened their first Scottish out of town stores in 2013 and all have since opened further stores. The most notable and latest entrant to the Scottish bulky goods market is Tapi Carpets & Flooring which is aiming to open 12-14 stores in Scotland alone over the next 12 months concentrating upon the leading retail parks which Carpetright have historically traded well upon.

Another new entrant considering fairly rapid expansion in Scotland is Homesense who will hopefully open their first standalone store in Scotland in the coming months They opened a combined store alongside TK Maxx at Fort Kinnaird Shopping Park, Edinburgh in the autumn of 2014 which had an exceptional start. DFS, whilst already fully established in Scotland, chose Springkerse Retail Park, Stirling to successfully trial their first UK small format pilot store (10,000 sq ft) in late 2012 and have subsequently opened a similar store on Heathfield Retail Park, Ayr during November 2014 and are currently in solicitor's hands for their third 10,000 sq.ft format store in the central belt. Sofaworks, often targeting DFS type locations, also currently have three priority requirements in Scotland for 10,000 – 15,000 sq ft.

Elsewhere within the bulky goods sector, Wren Living and Oak Furnitureland are selectively acquiring with Wren also increasingly looking at store extensions to accommodate larger format stores in the order of 15,000 sq ft. Dreams are also expanding again following their administration two years ago and have opened a number of new stores in Scotland in the past 12 months. Pets at Home are targeting smaller catchments such as Lanark and Linlithgow to continue their expansion within Scotland as well as continuing to target infill stores in larger catchments such as Aberdeen. Steinhoff, who operate the Harveys and Bensons Bed fascias, are seeking to integrate Bensons at mezzanine level within several existing Harveys stores. DSG continue to try and right size their portfolio with Currys/ PC World 2-in-1 stores which often requires a surplus store disposal - the requirement for Scotland is now between 10,000-15,000 sq ft unless in larger catchments.

Within the DIY sector, in spite of B&Q's announcement to close 60 stores UK wide, they have only closed one store in Scotland at Kingsway East Retail Park, Dundee which had come to the end of it's lease. They have no plans for other closures in Scotland at present but are working on downsizing certain stores, especially within the greater Glasgow area where they have seven Warehouse format stores. Homebase, who announced in October 2014 that they would close 25% of their stores by February 2018, have already closed a number of stores in Scotland some of which have gone to The Range and B&M usually in group assignation deals. Within certain stores, Homebase are creating Argos digital concession outlets to diversify their offer. Wickes aren't currently actively acquiring new stores in Scotland despite talk of looking at smaller formats.

Outside the bulky sector, a flagship new entrant during the same period has been Nike who have opened four new stores - two in Edinburgh and two on the outskirts of Glasgow in Bishopbriggs and East Kilbride and they are actively considering several more. M&S continue to roll out their Simply Food format quite aggressively both on retail parks and on standalone / cluster developments and in addition they have just opened their new 80,000 sq ft flagship GM store at Glasgow Fort Shopping Park in May 2015 in the latest extension to the park. Next have continued their expansion of the home and fashion superstore format with the opening of their new store at Fife Central Retail Park, Kirkcaldy and rumour has it they are about to commit to the Homebase at Straiton Retail Park, Edinburgh for this larger format relocating from the 20,000 sq ft home and fashion store they only opened just under three years ago elsewhere on the park.

The discount sector remains the most active sector of the market. In addition to The Range, B&M and Home Bargains have probably been two of the most active retailers in Scotland both in terms number of stores acquired and by floorspace. The discounters have competed for space on may occasions, particularly B&M and The Range, as both have been in dialogue with Homebase to take on a number of their leasehold liabilities in Ayr, Falkirk, Kilmarnock and Kirkcaldy to name a few. Home Bargain are now hooking up with the likes of Aldi to secure space where they view themselves as complimentary retailers. TK Maxx and other 'pound' retailers have continued to be active, as have Sports Direct and Brantano. Smyth's Toys remain reasonably active having opened in Inverness last autumn and they are due to open in Kilmarnock this autumn. Toys R Us, despite vacating their flagship store at Fort Kinnaird last October to facilitate it's redevelopment

TABLE 1

Retail warehouse yields

	Dec 2013	Dec 2014	May 2015	Sep 2015
Shopping Park	5.25%	5.00%	5.25%	5.00%
Prime Open A1	5.00%	4.25%	4.25%	4.50%
Prime Restricted	6.00%	5.25%	5.25%	5.50%
Secondary Open A1	6.00%	5.00%	5.25%	5.50%
Secondary Restricted	7.25%	6.00%	6.25%	6.50%

Source: Savills

for Primark, had taken temporary lets in a number of locations around Edinburgh but are still searching for a permanent outlet in the city.

The majority of the space that came back onto the market 2-3 years ago has now been re-let and indeed this facilitated the arrival some new entrants into the Scottish market. For the first time since the downturn we are starting to see the return of financially viable asset management opportunities on retail parks.

Whilst the asset management opportunities might not necessarily lead to immediate rental growth it is at least allowing landlords to improve their tenant mix which in turn will lay the foundations for future rental growth. This will however have to be tempered with the prospect of lease expiries or break options looming where, in certain cases, landlords will need to be prepared to concede on the level of rent they charge in return for re-gearing leases.

In conjunction with the diminishing levels of vacant accommodation in the market, the key trend we are witnessing is the increase in development activity picking up quite strongly across the spectrum of planning consents. This has been evident at Abbotsinch Retail Park, Paisley where Hammerson have developed out the second phase of 54,000 sq ft which opened in September 2014 and they are on site with a third phase of 20,000 sq ft which will complete imminently and has seen ERV grow by close to 15% in the past year. The next phase at Port Glasgow looks like it will soon be developed out following Ediston's site acquisition in 2014 where they are currently in the process of securing pre-lets. Elsewhere, Ediston are also onsite developing a further 35,000 sq ft extension at Heathfield Retail Park, Ayr and the new 58,500 sq.ft Edinburgh West Retail Park, Edinburgh. Royal London are in the process of securing detailed planning for a third phase of approximately 70,000 sq ft at Halbeath Retail Park, Dunfermline where the majority of the space is all accounted for and which should go on site in 2016.

A further sure sign of the development sector picking up is London & Scottish Investments recent unconditional purchase of the Scottish Tesco development portfolio which includes sites in Aviemore, Cupar, Crieff, East Kilbride and Paisley to name a few where it is expected they will mainly be anchored by discount food, or M&S Simply Food in certain cases, and will aim to attract other discounters alongside. We expect that development activity will continue to pick up as the economy improves and the stock of vacant space diminishes further.

Looking forward to 2016 and beyond, we expect current positive trends in the sector to continue as retailer confidence strengthens further. This, in turn, will filter through to rental growth within existing assets and drive development activity in locations where appropriate accommodation is not currently available.

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