UK Commercial – December 2022

SPOTLIGHT
Savills Research

UK Retail Warehousing

- UK retail consumer trends
- Occupational market trends
- Investment market trends

UK retail consumer trends

Tightened consumer wallets and more selective spending is expected this winter, as high inflation and low consumer confidence continues.

As the UK gets to grips with the ever-changing economic climate, consumer sentiment has remained pessimistic to say the least. GfK's November consumer confidence index remains in low, with the index at -44. The climate for major purchases index dropped three points to -41. Meanwhile, the personal financial situation outlook index reported marginal improvement to -34 (albeit still 35 points below October 2021).

In turn, spending habits have begun turning to more typical recessionary behaviours, with consumers cutting back where possible. This downward momentum was evidenced in the September ONS retail sales volume index, which reported declines of -6.9% year-on-year (YoY) and -1.4% compared to August 2022. In October, sales grew 0.6% on a month-on-month basis (due to the additional bank holiday in September, and store closures for the Queen's funeral) however, on a year-on-year basis, sales also fell by as much as -6.1%, below pre-Covid equivalent levels by -1.7%.

What's the outlook for the retail sector?

All eyes are now fixed on the crucial Golden Quarter for retailers and consumers alike. Retail Economics recently forecast a £4.4 billion drop in non-essential spending this Christmas, representing a 22% year-on-year fall in UK spending as almost 60% of customers suggest they will be cutting back. While all sectors are likely to feel the effect, previous downturns suggest bigger ticket items such as household goods/appliances, and non-essential goods such as clothing and footwear could experience a more pronounced squeeze.

As a result, retailers are downgrading their sales expectations, with some issuing profit warnings despite a relatively robust Q2-Q3 performance across the sector. Next, for example, recently trimmed its full-year 2022/2023 sales and profit forecasts, despite its half-year 2022 group sales exceeding expectations, reaching +14.9% year-on-year.

While inflationary headwinds are likely to stunt consumer spend across most sectors this winter, there are still some opportunities for spend across certain subsectors to surprise on the upside.

Firstly, it's likely this winter will deliver the first Christmas period unaffected by Covid-restrictions, meaning more events and pre-Christmas socialising will occur compared to the last two years. Meanwhile, the first-ever winter FIFA World Cup is likely to generate additional food and drink sales through November-December. Similarly, international travel is likely to remain unrestricted, which, when coupled with the weak value of the pound, could support inbound tourist spend, particularly across international gateway cities such as London and Edinburgh.

In terms of the timing of winter shopping, we could be faced with a longer lead-in to Christmas as UK households look to spread their spending more strategically across paychecks, supporting sales as early as October. In a similar manner, monthly repayment methods such as Klarna can expect an uptick in transactional activity.

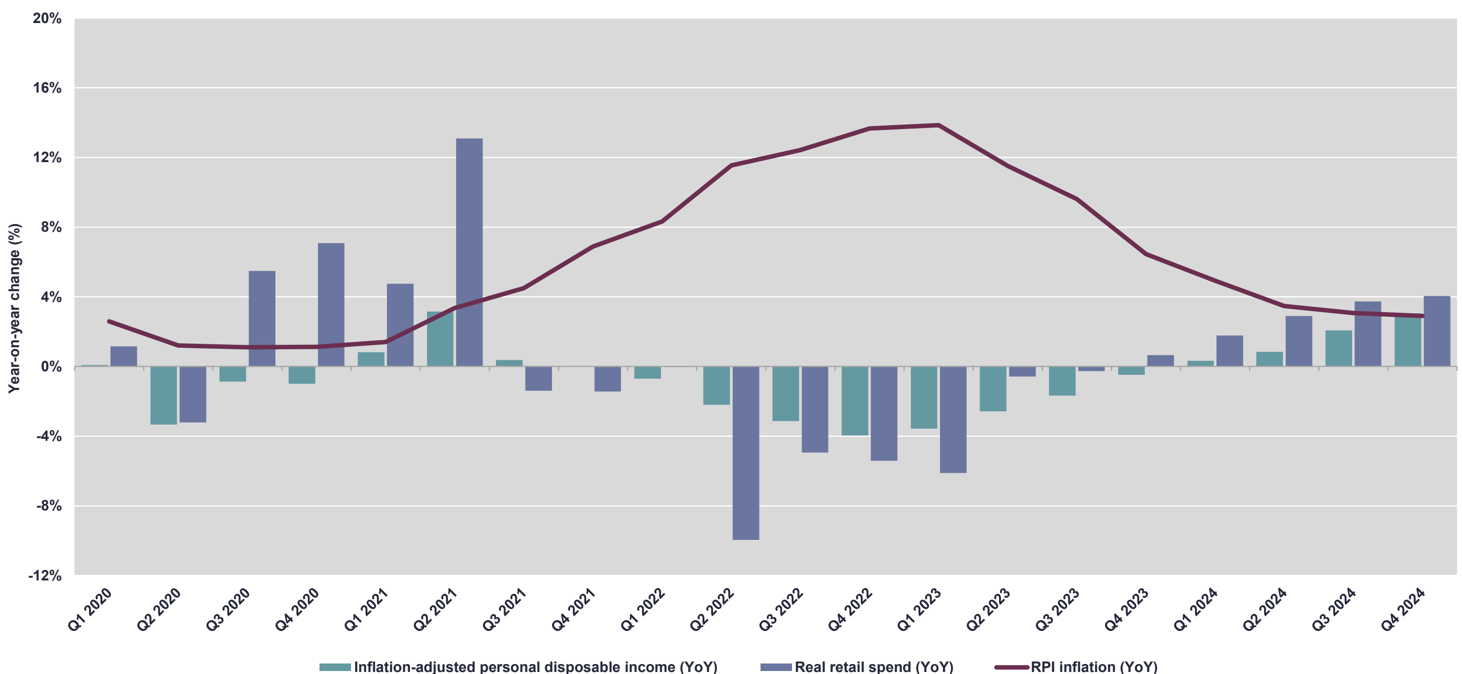
Where we envisage a more pronounced decline in discretionary spend is in early 2023, when inflation is expected to remain in double-digit figures, whilst fuel/energy usage costs are due to remain high (and potentially growing further depending on what measures replace the energy price cap in April 2023).

Oxford Economics is currently forecasting a year-on-year drop in real retail spend of -6.1% Q1 2023, accelerating from the -5.4% fall predicted for Q4 2022.

-44
GfK's November consumer confidence index remains low

-41
The climate for major purchases index also fell a further 3 points in November

Figure 1: Inflation vs real disposable income vs consumer spend



Source: Savills Research, ONS, Oxford Economics

-5.8%
Footfall in November is only marginally below equivalent levels pre-pandemic for retail parks

Occupational market trends

With retailers' costs rising and a squeeze on consumer budgets, is there any optimism left in the retail warehouse sector for continued positive occupational performance?

The last iteration of this spotlight, written in June of this year, was full of optimism for the sector. The positivity was reflective of the resilience it had shown throughout the pandemic and its continued improvement across a number of performance measures, allowing the sector to stand out positively, particularly when benchmarked against shopping centres and high streets.

Investment volumes in the retail warehouse sector were high, having reached £3.76bn in 2021 (the most active the market has been since 2015 and the fourth highest turnover of the last 21 years). Footfall continued to outperform the rest of the UK retail market and, on many occasions throughout the year, reached levels in excess of those seen pre-pandemic.

Appetite for new units from retail and leisure operators across all product categories was as strong as ever, reaching a total of 1,021 for 2021, the joint highest recorded over the last decade. Furthermore, the strong acquisition activity was subsequently driving vacancy downwards, reaching 5.4% by the summer months, down from 6.1% at the start of the year. This, of course, contributed to net effective rental growth across the sector – 2021 saw a YoY increase of 10.3% on average, on the agency deals Savills was involved in.

As a result of high demand for portfolio expansion and the falling availability of additional space, there was some real optimism surrounding the potential for continued rental growth going forward. This was supported further by the consideration that the majority of the large, arguably unsustainable, rental agreements that were signed 10 to 15 years ago had now been rebased in the sector (only 26% of tenants across retail and shopping parks have a lease expiry sometime in the next three years).

Consumer spend had also been elevated for some time, with a number of retailers' fortunes significantly improving as a result of the pandemic. Barclaycard consumer spend figures were demonstrating distinctly that those sectors pertinent to the out-of-town market – namely grocery, household goods, DIY, discount stores, and sports and outdoor retailers – were those sectors in the last few years that have seen significant positive average spend growth, versus 2019. The trading statements of some of the sector's key operators supported these findings. Kingfisher and Wickes remained confident of positive consumer spend going forward, off the back of results well ahead of pre-pandemic trade levels, for example.

So, everything in the retail warehouse market looked rosy, it seemed. Or did it? A cursory look back at our report in June and it is evident we were already well aware of the headwinds the sector was facing. The report's headline stated the following:

"Retailer performance has been strong, driven by strong acquisition activity, falling vacancy and rental increases; however, with both consumer and retailers' costs rising, external headwinds may temper occupational performance going forward".

The rising cost of living, building materials and energy were all acknowledged as having the potential to constrict occupational performance going forward, suggesting any outlook in the short term should be handled with some trepidation. However, what wasn't evident at the end of H1 this year was just how strong these headwinds could and would get.

The cost of living has increased at its fastest rate in 40 years in the last six months. The Consumer Prices Index including owner occupiers' housing costs (CPIH), rose by 9.6% in the 12 months to October 2022, up from 8.8% in September 2022.

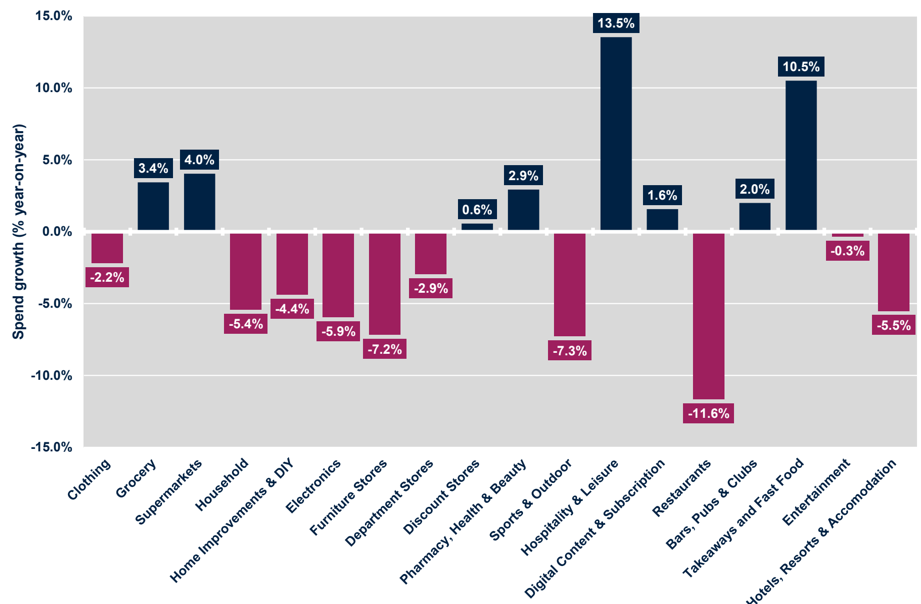
Oil and gas prices increased due to greater demand for energy as life got back to normal post-Covid. At the same time, the war in Ukraine has meant less is available from Russia, putting further pressure on prices.

Furthermore, the war in Ukraine has also led to food prices going up by reducing the amount of grain available in Europe. The price of food and non-alcoholic drinks rose by 16.2% in the year to October, up from 14.5% in September.

In response, the Bank of England has also increased interest rates by 0.75 percentage points to 3% in recent months, the biggest hike in more than three decades.

The question for the retail warehouse market is therefore an obvious one. Has the positive occupational performance of the sector continued, or has its fortunes changed with the tide as quickly as we have seen a squeeze on both operator costs and consumer spending? In addition, what does this mean for the sector over the next 12 months?

Figure 2: Barclaycard – average year-on-year spend growth (August to October) – key categories



Source: Savills Research, Barclaycard

Early tapering of consumer spend suggests the market should tread cautiously however; some operators remain more positive than others off the back of strong trading results.

The most recent Barclaycard data suggests some sectors pertinent to the retail warehouse market should indeed prepare themselves for a leaner period of consumer spending. However, others may fare much better.

Most of the sectors that had seen such positive growth in the last few years have seen a decline in average YoY spend between August and October, including clothing, household goods, home improvements & DIY, electronics, furniture stores and, sports and outdoor goods (figure 2). Previous downturns suggest big-ticket items and non-essential goods are the first to go. A fall of 7.2% on spend in furniture stores and 2.2% on clothing, respectively, suggests the market should certainly keep a watchful eye on performance across those sectors in the short term.

However, it wasn't until summer 2021 that the UK consumer was free of all restrictions on their movement, which is why a year-on-year comparison of spend is most appropriate between August and October. It is likely that the most recent downturn in consumer spend can be attributed, in part, to its comparison to a post lock-down-driven period, where the UK consumer once again was able to spend much more freely. As a result, there was a lot of pent-up consumer demand in the market. In addition, this was off the back of the high lockdown-driven performance that many sectors saw prior to the end of restrictions.

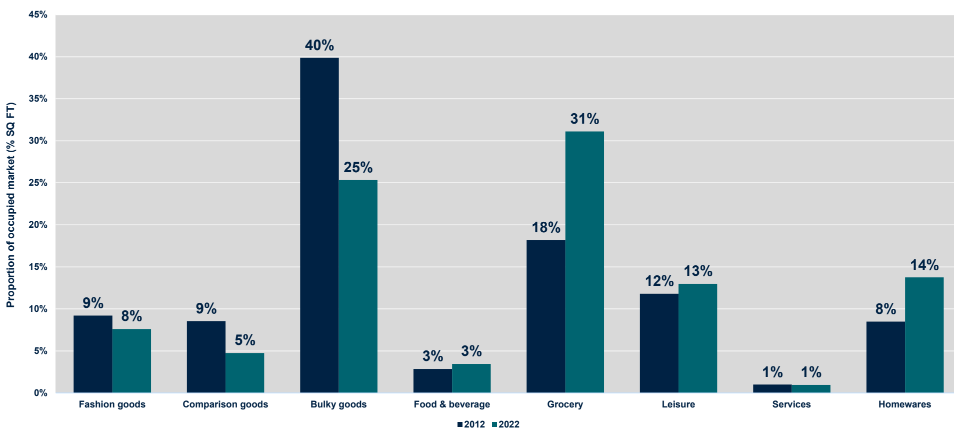
The most recent findings should, therefore, perhaps be viewed as a gentle warning of a more challenging winter than we have seen in recent years rather than the beginning of Armageddon, as some more pessimistic commentators may have you believe. The performance of much of the retail warehouse sector has been sufficiently strong prior that most of the key operators should weather the storm with a relative degree of comfort.

Figure 2 highlights further how supermarkets have seen continued growth despite a pandemic-fuelled uptick in performance in recent years. The same is true of spend in discount stores, where we have seen additional year-on-year growth between August and October, despite such high comparatives with the performance over the same period the previous year (albeit only 0.6% on average).

As is always the case when consumers have swung into belt-tightening mode, there are always winners and losers. October sees YoY spend growth of 5.7% on essential items, for example; however, non-essential spend is also still seeing some growth versus last year at 2.5% last month.

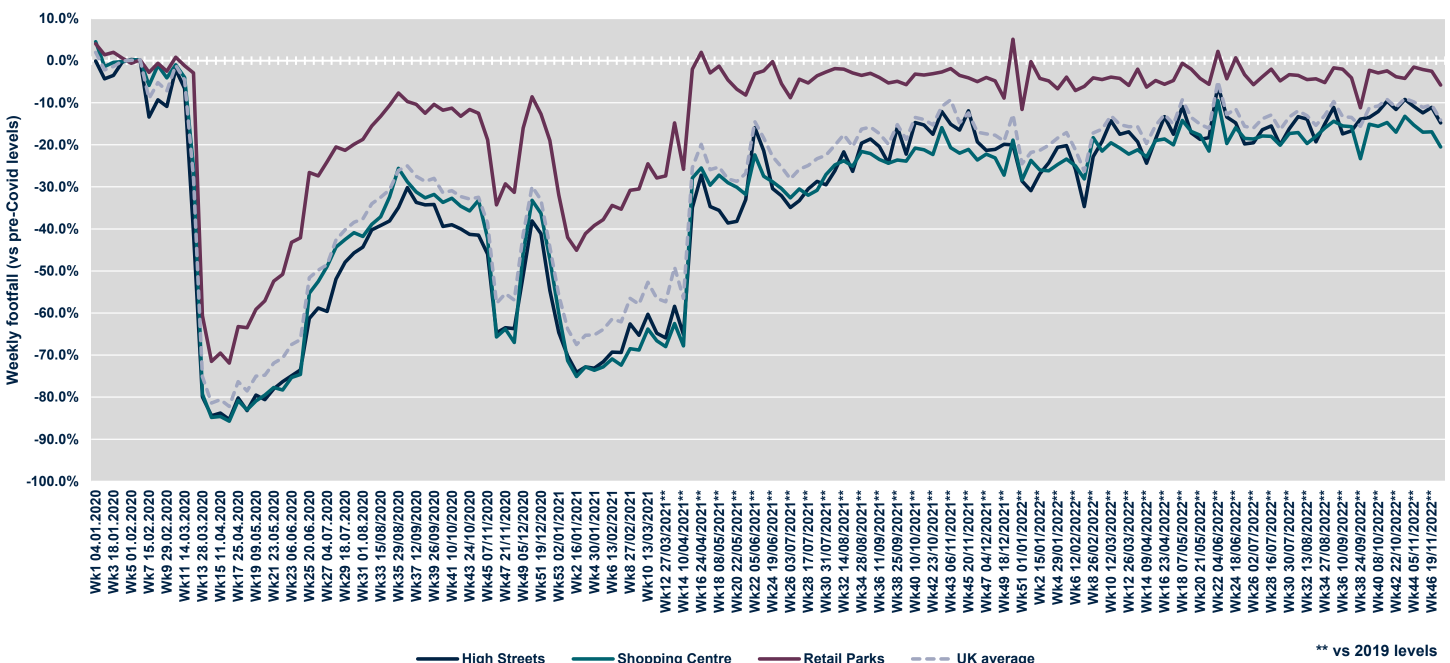
As a result, it is clear the value end of the market, now a sizeable part of the retail warehouse sector, will likely continue to fare better through this period of austerity, as many consumers look to trade down in order to make savings when money is tight. According to GlobalData's monthly survey, 79% of consumers will continue to switch to cheaper retailers over the next three months in response to rising prices and squeezed household budgets, so it is no surprise that it will be the

Figure 3: Retail warehouse market by category (proportion on occupied floorspace – sq ft)



Source: Savills Research

Figure 4: UK footfall by retail sector (vs pre-pandemic)



Source: Savills Research, Springboard

discounters that prosper most and steal share in 2022.

The performance of the DIY, furniture, homewares and home improvement operators will, of course, need to be monitored closely and in isolation in order to fully understand how much consumers are likely to make additional savings by going without these products. However, the market shouldn't be quick to assume the worst. The most recent performance of some of the key operators seems to reflect the wider market. Those brands that have done well, not simply by virtue of being a 'discounter', are those that have implemented strategies to tackle the rising cost of their operations, as well as those that have adapted their offer to continue to remain relevant to the consumer, at a time when their budgets are getting tighter.

The individual trading results of key retailers in the sector suggest some operators will feel the impact of a rising cost of living more than others; however, many have implemented coping strategies or are sufficiently positioned financially to weather the storm over the next 12 months.

Kingfisher produced a resilient set of results for the three months to October 2022, with growth of 0.1% in the UK & Ireland and group sales growth of 1.7% to £3.3 billion. This has been helped, in part ,by consumers looking to make improvements to their homes in order to keep them warm over the winter months as the price of energy continues to increase. However, the retailer has also begun to offer shoppers greater value through its own brand ranges, which accounted for 45% of sales and focused more on trade customers, driving TradePoint like-for-like sales through its B&Q stores to rise 1.9% on last year.

ASDA's investment in its loyalty program, fresh produce and a value-driven range targeting price-sensitive shoppers, has also resulted in positive results in Q3 of this year with like-for-like sales up 4.7% – the best performance ASDA has seen since Q1 2021. Its recovery following H1's negative revenue growth trend is promising (Q1 -9.2% and Q2 -1.2%), suggesting the retailer laid the groundwork for any challenging months that may lie ahead.

Alongside Aldi, Lidl will make the strongest share gains in the UK food & grocery market this year – estimated to rise 0.3ppts to 5.0%. While Lidl has reported a modest revenue growth for its 2021/22 financial year of 1.5%, UK sales have reached £7.8bn (£41.1m profit before tax). This is an improvement even against high Covid-19 comparatives and is in line with the wider UK grocery market – ensuring its market share remains stable.

It is expected that Christmas will be a crucial period for the discount food operators as consumers face greater financial pressure and shoppers look for more affordable solutions and alternatives to enable their festive celebrations. If both Lidl and Aldi can continue to promote product quality and food provenance, they should secure customers for the long term – not just for Christmas. This is great news for landlords of retail parks. Both these operators have a strong presence in the out-of-town retail market (both operators have more than 900 out-of-town stores). They have consistently topped the charts in terms of new openings over the last five years, each acquiring c.50 new stores on an annual basis - a growth strategy both operators are keen to continue with for the foreseeable future.

B&M is also on course to be one of the winners during the cost-of-living crisis as constrained shoppers migrate to the discounter as its low prices and value for money appeal. Overall, group revenue increased 1.8% to £2,309m aided by double-digit growth at its discount grocery division, Heron Foods. Sales through its core UK fascia declined marginally but improved throughout the half – rising from -6.1% in its Q1 to +5.0% in Q2, with UK like-for-like sales following a similar pattern, down -9.1% in Q1, but up 2.0% in Q2. This momentum has continued into its Q3 with B&M's UK like-for-like sales +2.5% for the first six weeks of the period, as the ratcheting inflation encourages shoppers to trade down.

Higher levels of pet ownership following the pandemic, coupled with Pets at Home's ability to recruit and retain shoppers, has helped the brand record a buoyant top-line performance during its H1 2022/23 trading period, with like-for-like growth going from 6.0% in Q1 to 6.8% in Q2. The brand's loyalty programmes have helped push revenue through its VIP members, which have increased 13.4% over the last 12 months.

M&S has also exceeded sales expectations with a strong trading performance in H1 FY2022/23, achieving a pre-tax profit of £208.5m, an 11.3% increase on last year. Its food division has outperformed the wider UK grocery market, with sales up 5.6%. This can be attributed to increased footfall in stores outweighing a decrease in basket value, as the retailer's focus on value for money, product innovation and high quality. This, in turn, has attracted customers trading down from food service operators and restaurants and appeals to those wanting a treat in times of more considered spending. However, operating profits for M&S food are down 50% following this investment in pricing and increased running costs related to inflation.

Tesco's H1 performance for FY2022/23 has also been pleasing amid a challenging backdrop. UK food sales like-for-likes are up 1.6%, contributing to market share gains over the period. Tesco's share of the UK grocery market is set to rise 0.2 percentage points over the full calendar year, meaning it now stands with Aldi and Lidl as the only major UK grocers to grow share in 2022, as

+0.1%

UK & Ireland sales growth for Q3 FY2022/23

+1.5%

revenue growth for FY2021/22 up to the end of February

+6.8%

retail sales growth for H1 FY2022/23 up to the end of October

> **"Barclaycard saw in-store spend increase by 5.6% in October versus the same month the previous year, outstripping the 1% growth in online spending over the same time period"**

customers stay loyal following investment in price and value.

However, despite the top-line sales improvement, retail operating profit declined 10% to £1,248m. This has been caused by a combination of factors, including softer volumes versus elevated pandemic levels, a drop in demand for non-food categories (UK like-for-likes dropped 6.0%), and high inflation. In addition, the ongoing investment in value and price-matching schemes to protect against the competition, as well as increasing salaries for its employees to cope with the cost-of-living crisis, have also had an impact.

As is evident in the wider market, operators in some sectors have therefore found navigating a path through the recent headwinds more challenging than others. Up against a strong comparative, Dunelm has started its FY2022/23 with a decline in sales. Indeed, with tightening consumer budgets, total sales in Q1 FY2022/23 were down 8.3% on the same period last year to £356.7m.

Halfords also reported underlying profit before tax fell 54% in H1 FY2022, compared to last year. This was due to significant inflationary pressures and low consumer confidence, as spend in discretionary areas, such as its cycling products, have softened.

It is clear that big-ticket, non-essential or discretionary items will likely see the greatest contraction on spend over the coming months; however, the performance of specific retailers who operate in these sectors will vary, dependent on the respective coping strategies they implement and how much of a financial cushion they have in place. What is comforting, however, is the out of town retail market is perhaps less exposed to any one sector as much as it once was – the market is now less reliant on sectors where spend is more discretionary and more exposed to brands that provide consumers with their essential goods shopping.

Figure 3 highlights how, back in 2012, 40% of occupied floorspace in the market was attributed to bulky goods brands (including DIY, electrical, motoring, furniture and fixtures and fittings, such as kitchens, tiling, carpets and other floor coverings). In 2022, that has fallen to a quarter of all occupied space. As a result, we have seen growth in the coverage of grocery, particularly with the expansion strategies of Aldi and Lidl – grocery now occupies 31% of all occupied floorspace, up from 18% a decade ago.

We have also seen a number of discount homeware brands significantly increase their exposure in the retail warehouse sector. The growth of the likes of The Range, B&M, Home Bargains and Poundland has helped the exposure of homewares increase from 8% of the market in 2012, to 14% of the market in 2022.

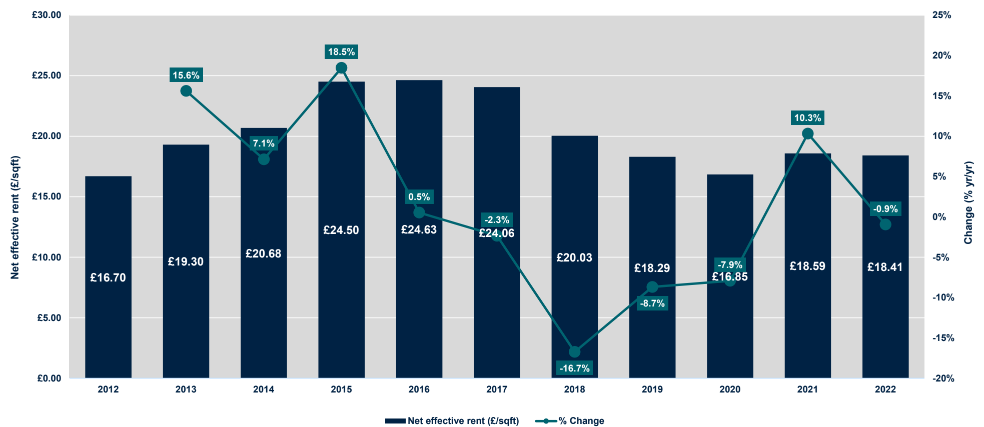
The growth of value-orientated operators in the last decade will also go some way to mitigate the challenges the retail warehouse sector faces in a period of consumer recession. In 2012, just over a quarter (28%) of the brands in the market were value-based or discount-led. Today, that figure has risen to 38% and is increasing all the time (half of all new openings so far in 2022 have been value- led brands).

Additionally, and what is undoubtedly a positive result for retail warehousing from a market perspective, is the increasing prevalence of in-store spending seen in recent months. Barclaycard saw in-store spend increase by 5.6% in October versus the same month the previous year, outstripping the 1% growth in online spending over the same time period. Many of the products traditionally sold out-of-town are more defensive to online retailing, or at least require the store in some way in order to make an informed decision on a purchase or indeed fulfil an order through click-and-collect (potentially driving additional sales to the store).

Increasing overall store sales, along with a strong exposure to brands at the more price-conscious end of the market will certainly help buffer the retail warehouse sector from the impact of a rising cost of living, more so than is true of high streets and shopping centres.

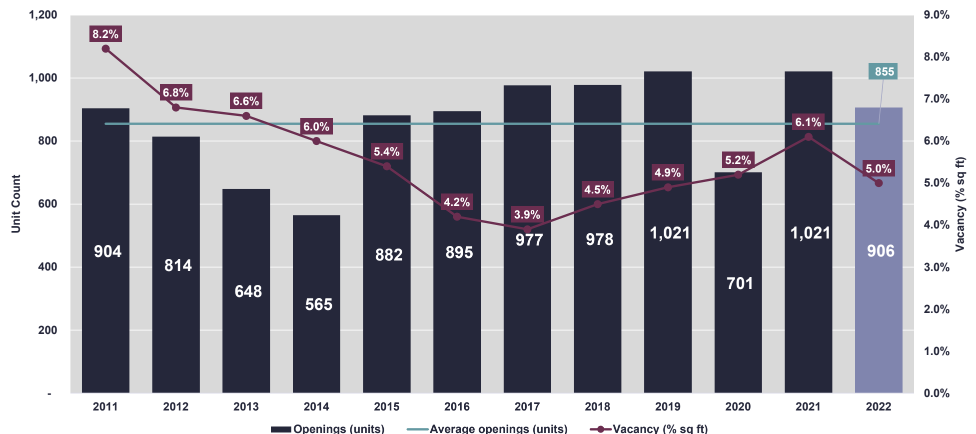
Figure 4 highlights how retail park footfall continues to outperform the rest of the UK retail market. In the summer, footfall peaked at 2.2% above the levels we saw at the same time in 2019, pre-pandemic. In the most recent weekly figures (w.b. 19/11/22), high street footfall was down -14.8% compared to 2019 equivalent levels, while shopping centre footfall recorded a -20.5% gap. Retail parks continued to outperform, with footfall levels only -5.8% below 2019 levels (having fallen slightly from only -2.5% at the beginning of the month).

Figure 5: Annual average net effective rents (up to Q3 2022)



Source: Savills Research

Figure 6: Annual new openings by unit vs vacancy (by sq ft)



Source: Savills Research

Have we seen continued rental growth in the retail warehouse market?

With the record number of new openings last year and a vacancy rate continuing to fall, as a house we were relatively bullish about the possibility of continued net effective rental growth. That said, nobody quite predicted the severity of the headwinds we were beginning to experience. As a result, average YoY growth on all of the agency deals Savills has been involved with up to the end of Q3 remains flat (figure 5).

On reflection, this in itself is a positive result. Despite spiralling energy costs, record levels of inflation and interest rate rises, retailers are still looking to expand their reach and are doing so on terms no worse than they would have 12 months ago. What is most important, however, is it hasn't so far led to a lack of appetite for deals or a desire to only do a deal at a reduced cost, in order to better safeguard their return on their investment.

The reason for this simply comes down to supply and demand. Figure 6 shows the number of new openings in the retail warehouse market this year, up to the beginning of November. At 906, the market has already surpassed the decade average of 855 and looks set to at least match last year's record of just over a thousand, with two months of openings still to be accounted for.

As a result of this continued appetite for new space from brands of all sector types, vacancy continues to fall, now at 5.0%, down from 5.4% six months previous (having fallen from 6.1% at the turn of the year). With very little space coming to market by way of new development, supply will only continue to tighten. As a result, and despite an initial pause as the markets take a breath over the immediate impact of the cost of living crisis, we do expect net effective rents to begin to climb, albeit modestly, as we move through the final quarter of 2022 and into 2023.

Interestingly, the average net effective rent of £18.41 highlighted in figure 5 is for units above 2,500 sq ft and therefore excludes any drive-to or drive-thru deals Savills has been involved with. The level of competitive tension for new space at that format is so high it skews the level of growth we are seeing across the rest of the market. Average net effective rent for units under 2,500 sq ft is £41.26, a further 2.7% growth over the last 12 months, in addition to the 10.6% growth we saw the previous year.

Figure 7a highlights just how active the food and beverage sector has been in the retail warehouse market again this year. When ranked by number of units, 7 of the top 20 most acquisitive operators for this year are F&B brands. These include Tim Hortons (28 units, ranked 4th overall), Costa Coffee (26 units, 5th), Starbucks (17 units, 10th), McDonald's (13 units, 13th), Burger King (11 units, 14th), KFC (11 units, 14th), and Five Guys (10 units, 15th). In fact, F&B operators have accounted for 30% of all new openings so far in 2022 on a unit basis (which equates to 9% on a sq ft basis). As F&B operators generally take smaller units, it is only Tim Hortons that appears in the top 20 most acquisitive brands ranked on floorspace. Figure 7b highlights the retailers that take larger floorplates in the market and therefore are the most acquisitive in terms of overall space.

Figure 7: 2022 new openings – top 20 operators

(a) ranked by units

Rank	Operator	Pitch	Units	Total Floorspace	Average Unit Size
1	Lidl	Value	40	756,400	21,600
2	PureGym	Value	31	350,400	11,300
3	Greggs	Mass	30	41,500	1,700
4	Tim Hortons	Value	28	91,600	3,700
5	Costa Coffee	Mass	26	55,300	2,600
6	B&M	Value	24	614,100	28,000
7	Home Bargains	Value	21	549,600	26,200
8	Aldi	Value	19	329,200	20,000
9	TheGym	Mass	18	159,800	9,400
10	Iceland	Value	17	216,200	12,700
10	Starbucks	Mass	17	32,900	2,000
11	Poundland	Value	15	222,000	14,800
12	Bensons	Mass	14	110,400	7,900
13	McDonalds	Value	13	26,900	5,100
14	Burger King	Mass	11	33,300	3,700
14	KFC	Mass	11	32,200	3,900
14	Tapi	Mass	11	100,200	9,100
15	Five Guys	Mass	10	27,000	3,000
15	Mountain Warehouse	Mass	10	69,600	7,700
26	Easy Bathrooms	Mass	9	45,400	5,000

(b) ranked by SQ FT

Rank	Operator	Pitch	Units	Total Floorspace	Average Unit Size
1	Lidl	Value	40	756,400	21,600
2	B&M	Value	24	614,100	28,000
3	Home Bargain	Value	21	549,600	26,200
4	PureGym	Value	31	350,400	11,300
5	M&S	Mass	5	338,800	60,200
6	Aldi	Value	19	329,200	20,000
7	Poundland	Value	15	222,000	14,800
8	Iceland	Value	17	216,200	12,700
9	The Range	Value	7	206,200	24,400
10	Go Outdoors	Mass	7	196,900	28,100
11	TheGym	Mass	18	159,800	9,400
12	JD Gyms	Mass	7	146,900	21,000
13	Sports Direct	Value	5	129,100	23,600
14	Tesco	Mass	7	128,600	14,700
15	M&S Food	Mass	7	114,600	16,400
16	Bensons	Mass	14	110,400	7,900
17	Smyths Toys	Mass	5	100,500	20,100
18	Tapi	Mass	11	100,200	9,100
19	Tim Hortons	Value	28	91,600	3,700
20	Dunelm	Value	3	91,500	30,500

Source: Savills Research

Business rates reform will provide welcome financial relief, particularly for retail warehouse operators with larger units, strengthening further the optimism around net rental growth over the next 12 months.

The long-awaited business rates reform has been largely welcomed by the retail property sector, with an average reduction across England and Wales of -10% when coming into effect on April 1st 2023. While there have been different levels of rateable values across different property sectors, retail categories and geographies, most aspects of retail have seen reductions. Furthermore, there is no transitional relief, which means occupiers will see the full benefit from day one.

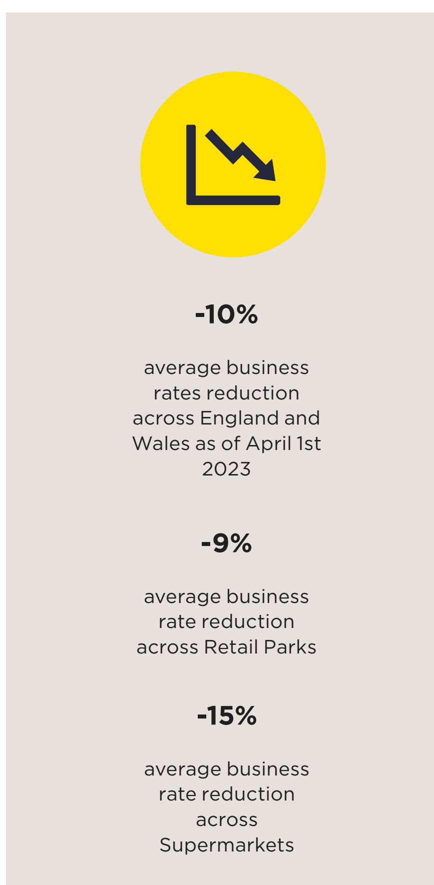
The retail park sector is due to see an average -9% reduction. As a consequence, we have seen an uptick in deal activity since the announcement, with retail occupiers gaining confidence despite ongoing economic and occupational headwinds.

The good news, however, is nuanced, with the rate changes differing significantly depending on retail category, retail sector and geography. For example, large supermarkets can expect average reductions of -15%, while small convenience stores are set to increase by +13%.

The revaluation also favours larger stores (>1850m2), which will see business rates reduce by more than a third, compared to small stores (<750m2), with reductions of -8%. This should be met with enthusiasm within the out-of-town market where store sizes are much larger than high street units on average.

However, the celebrations will not be felt throughout the sector; the thriving drive-thru market is perhaps a victim of its own occupational success with average increases of +14%. The question is whether this will slow rental increases in this sub-sector, or whether demand for space will continue to drive rental growth unabated. Either way, it is anticipated that the drive-thru market will appeal against the VOA's decision.

The relief felt by retailers is tempered somewhat for those exposed to large tracts of logistics space, with retail logistics warehouses seeing an average increase of +38%. However, most retail brands' store portfolios significantly outweigh their warehouse space.



"The investment market started the year strongly with £862m of transactions in Q1, the highest Q1 we have seen since 2010 and well in advance of the £549m we saw in Q1 the previous year"

Investment market trends

Despite a strong start to 2022, the investment market retracted somewhat as concerns over economic headwinds began to grow. Nevertheless, the occupational market has remained resilient and as a result retail warehousing is once again beginning to look sensibly priced versus other asset classes.

The investment market started the year strongly with £862m of transactions in Q1, the highest Q1 we have seen since 2010 and well in advance of the £549m that we saw in Q1 the previous year. This followed on from the momentum we saw the previous year when volumes grew as the year progressed, peaking at over £1.4bn in Q4. In fact, investment volumes reached £3.76bn in total in 2021, the most active the market has been since 2015 and the fourth highest turnover of the last 21 years.

It is therefore fair to say, retail warehousing saw strong recovery in investor interest in 2021, with the realisation the sector had proved to be much more durable in the face of the pandemic, than was the case with the rest of retail. It is our view that, despite the current economic turmoil in the UK, and what that means for consumer spending and operators' profits, the retail warehouse sector will once again prove its resilience off the back of its strong occupational performance, which will have a positive impact on investor interest in the sector going forward.

Despite the positive start to the year, it is no secret that transactional activity slowed considerably by the end of H1, with Q2 volumes two fifths of what they were the previous quarter, at only £347m. At this juncture, market valuations were still broadly reflecting the sector's most recent success; however, the UK's economic headwinds were quickly increasing in severity. This led to a disparity between vendor aspirations and purchaser pricing requirements, which ultimately resulted in an immediate and significant reduction in retail warehouse transactions as we essentially hit an impasse – there was no great push from purchasers as they paused to see if assets were going to get cheaper still, as a result of the instability in the UK economy.

With UK retail perceived to be at the sharp end of the economy and directly affected by consumer budgets, it is often the case that economic uncertainty will impact the sector quite quickly. However, the good news is the occupational story has remained a strong one in the retail warehouse market. As we learnt when the sector first proved its resilience in the face of the growth of e-commerce, it is important not to tar all types of retail with the same brush. The relative naivety of some investors in doing so in previous years was based on the assumption that retail was increasingly being fulfilled online, thus eroding the relevance of the physical store.

However, the products typically sold out-of-town proved to be much more defensive to online-only transactions. Consumers prefer to sit on a new sofa and get a feel for it before they make a purchase. Furthermore, retail warehousing proved to be a convenient solution for click-and-collect, which of course, has the added advantage of driving additional sales at the point of collection. Even with the exponential growth of online grocery orders throughout the pandemic, retail warehousing proved invaluable – grocers were only able to service their consumers due to the pre-existing network of out-of-town stores throughout the UK, close to where consumers live for last-mile delivery.

It is the same story this time around. Retail parks continue to appeal to consumers for the reasons they grew in prominence in the first place. That is by virtue of their convenient, easily accessible, highly visible roadside locations with large units and adjacent free parking. As a result, the fundamentals of the market remain solid, which should give potential investors some comfort going forward. With record numbers of new openings across a diverse range of retail and leisure operators, and full occupancy across much of the market as vacancy continues to fall to its lowest point since 2019, there remains some competitive tension in the occupational market.

As a result, we have seen no significant negative rental growth on new deals, despite the speed and severity of operator cost increases. Couple that with the business rates reform due in April next year, which will lead to significant and much needed reduction in operating costs for many operators, there is real optimism for rental growth over the next 12 months. A position which would see the market pick up from the positive growth we saw in 2021, the first time we had seen growth in five years, before the cost of living crisis brought about a pause in the progress we were seeing.

In terms of pricing, it is the speed at which we saw yield hardening that led to a sudden pause in transactional activity. From May of this year we essentially lost just over a year of yield compression. Prime Open A1 and Prime Restricted yields increased from 4.75% back in the spring, to the levels we see currently, namely 5.75% and 6.00% respectively - the position the market was in back in October 2021.

5.0%

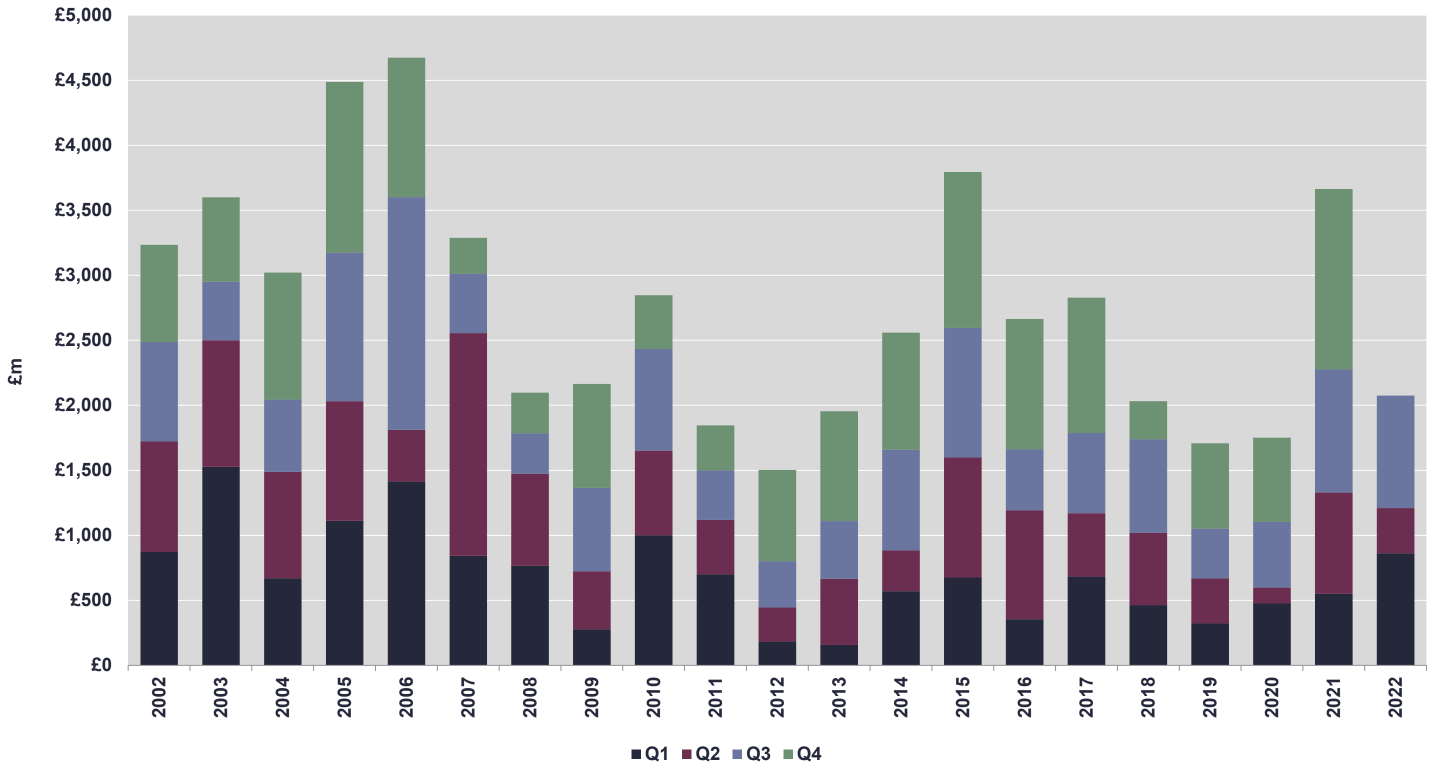
vacancy (by sq ft) has fallen from 6.1% at the start of the year

906

New openings have already exceeded the decade average of 855 (up to the beginning of November)

> Prime Open A1 and Prime Restricted yields increased from 4.75% back in the spring, to the levels we see currently, namely 5.75% and 6.00% respectively - the position the market was in back in October 2021

Figure 8: UK retail warehouse investment volumes



Source: Savills Research

Many investors seemingly decided to wait. With plenty of economic uncertainty, those sitting around the decision table found it difficult to convince stakeholders that the time to buy was now because it was likely to be when prices were at their best in the short term.

However, although we expect yields may oscillate around the levels we see currently over the next 12 months, we do expect them to remain broadly stable and be somewhat similar this time next year. It is true that consumer budgets will tighten further post-Christmas. However, they are expected to improve as the year moves on (particularly as we require less energy to heat our homes as we approach the summer months). This will undoubtedly provide small fluctuations in retail warehouse yields; however, now the fireworks that were 'Truss-economics' have been extinguished and interest rates have settled, we have a market environment much more conducive to trade. With the occupational market still holding strong, pricing once again begins to look attractive, a position it was in last year when the investment market was particularly strong.

Of course, with the cost of debt having risen, net income returns are likely to be lower for investors. The cost of borrowing in order to buy an asset has increased - the Bank of England's current interest rate is 3%, having risen from 0.25% at the start of the year. However, investors in the sector may arguably need a dose of realism on the level of returns the sector can realistically offer going forward. The perfect storm, evident over the last 12-18 months, of a strong occupational market, sensible yields and very cheap debt may not happen again for at least five years or more. It is rare that the planets align this way in any market; however, a strong occupational market and sensible yield levels remain, and in the words of the late singer Meat Loaf, "two out of three ain't bad" - suggesting the market can still deliver a favourable return on investment moving forward.

As a result, retail warehousing is once more seemingly well-priced versus other asset classes. Industrial yields are currently at 5.0% by comparison, suggesting investing in retail warehousing gives you an additional fifth more for your pound. Shopping Centres look well priced at 8.0% yield, but, the occupational story is nowhere near as strong, and sustained rental growth much less likely, meaning they are much more of a gamble.

The current scenario may mean we see an increased return of more institutional investors to the retail warehouse buyer pool, looking for a stable, predictable income over the next few years. MSCI is suggesting the current level of income return for retail warehousing is 1.4% at the end of Q3, greater than that seen for offices at 0.8% and industrial at 0.7%, for example.

In summary, the current investment market is now looking much more stable than it did at the start of Q2. Even with the rise in debt costs we have seen this year, the sector has repriced to a sensible level. The occupational market remains strong in so much as it is broadly fully let. It has also seen the majority of its rents rebased over the last three to four years and has since seen rents on new openings improve, the appetite for which remains unabated. As such, the market has a much more stable outlook as we move into 2023 - the current entry-level pricing increasingly peaking investor interest and fostering a favourable environment for vendors, too, that have assets they want to dispose of. A consensus view on where pricing is breeds confidence in buyers and investors alike and, as such, results in a market that is more conducive to trade. As a result, we are seeing funds returning to the negotiation table as a greater degree of comfort returns to the sector both in terms of pricing and the continued performance of the sector occupationally moving forward.

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Retail warehouse services

Dominic Rodbourne
Leasing
+44(0)20 7409 9945
drodbourne@savills.com

Jaime Dunster
Investment
+44(0)20 7409 9929
jdunster@savills.com

Charlie Mocatta
Professional
+44(0)20 7409 8726
cmocatta@savills.com

Matthew Whiteley
Management
+44(0)161 277 7232
mwhiteley@savills.com

Research

Sam Arrowsmith
Research
+44(0)161 277 7273
sarrowsmith@savills.com

Mat Oakley
Research
+44(0)20 7409 8781
moakley@savills.com

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