UK Commercial – June 2024

SPOTLIGHT
Savills Research

UK Retail Warehousing

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UK retail consumer trends

With easing inflationary pressure positively impacting the direction of consumer confidence, the retail market has seen the disparity between the volume of products sold and the value of retail sales begin to retract

In arguably the most significant financial challenge to the consumer since the global financial crisis (GFC), the cost of living increased sharply across the UK during 2021 and 2022. The annual rate of inflation reached 11.1% in October 2022 - the highest it had been in 41 years - before it subsequently started to ease.

More recently, the Consumer Prices Index (CPI) rose by 2.3% in the 12 months to April 2024, down from 3.2% in the 12 months to March. Inflation therefore continues to trend downwards; the latest figure represents a 0.9% improvement on the previous month and a 1.7% fall since the start of the year. As a result, inflation is back to where it was in the summer of 2021, albeit higher than the sub-1% seen in March of that year, a position it had enjoyed for each of the previous 12 months.

While the 2.3% figure was a significant fall from March's 3.2%, moving inflation much closer to the Bank of England's 2% (BOE) target, market forecasts had expected CPI to come in at 2.1%. The most recent fall was driven largely by slowing food price rises and steep falls in gas and electricity prices (due to the reduction in the Ofgem energy price cap). However, sticky services inflation suggests the BoE may delay even further a cut in interest rates currently expected for June, having raised them to a 15-year high of 5.25% in August 2023.

Speaking after May's decision to keep interest rates at the current level, the Bank's governor, Andrew Bailey, said he was "optimistic that things are moving in the right direction". However, he has since said a June interest rate cut was being considered but not a 'fait accompli'.

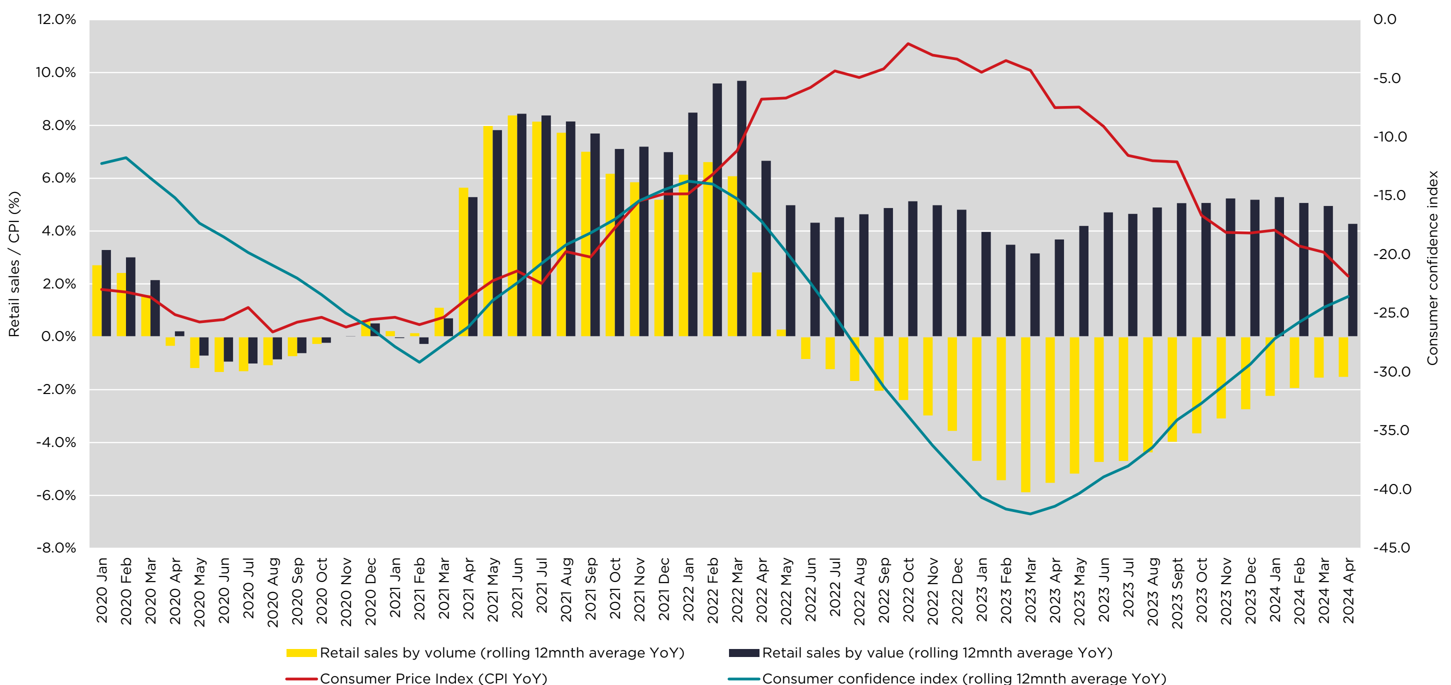
Nevertheless, despite inflation still running higher than the BoE's target of 2%, the direction of travel is clear, which is undoubtedly a positive result for the UK consumer. As a result, we have seen continued improvement in consumer confidence.

Currently the GfK index stands at -23.6 on a rolling 12-month basis, below the -15.1 average of the last two decades but 3.6 points higher than the start of the year and a 18.5 point improvement on April last year, the lowest point the index has fallen in the last 20 years (figure 1).

With easing inflationary pressure positively impacting the direction of consumer confidence, we have also seen the disparity between the volume of products sold and the value of retail sales begin to retract. June 2022 marked the point at which consumers began spending more but buying less; retail sales by volume entered negative growth territory and have remained there ever since, despite year-on-year (YoY) sales by value continuing to grow (figure 1). The most recent YoY retail sales figures from the ONS saw values grow 4.3% in April on a rolling 12-month basis, while sales by volume shrank -1.5% over the same period (figure 1). Positive sales growth alongside negative growth in volumes, therefore, still remains, which ultimately means consumers are getting less value for money whilst, at the same time, retailer profit margins continue to depreciate.

Nevertheless, although still in negative territory, the most recent figure does mark a significant 440 basis point (BPS) improvement on the most recent trough in retail volumes, seen in March last year (-5.9%). This suggests the market is very close to addressing the imbalance between the price of goods and how much that gets you as a consumer.

Figure 1: Retail sales volume vs value and how it compares to CPI / consumer confidence



Source: Savills Research, ONS, GfK

2.3%
Consumer Price Index (CPI) rise in the 12 months to April 2024

Occupational market trends

Retailer performance has varied by sector over the last 12 months; however, as austerity begins to ease, some operators are beginning to point to a more positive outlook

The impact that squeezed consumer budgets has had on retailer performance has varied from operator to operator over the last twelve months. The data in figure 1 from Barclaycard covers nearly half of the nation's credit and debit card transactions and highlights a disparity in consumer spend growth by sector.

Whilst it points to positive sales growth for grocery (+5.5%), hospitality and leisure(+7.5%), as well as a number of travel-related sectors, it also highlights a tempering of average month-on-month spend over the last year for more expensive or 'big-ticket' purchases, including household goods (-4.5%), home improvements and DIY (-5.6%), electronics (-3.0%) and furniture (-4.6%).

GlobalData's UK Retail Consumer Sentiment Tracker supports these findings and underlines the trepidation that has surrounded some discretionary spend categories. The monthly survey, covering a UK nationally representative sample of 2,000 consumers, asks the question, ' is now is a bad time to make a big-ticket purchase like a new TV or furniture?'

The most recent result for April 2024 records an index of -30.4 (calculated by subtracting those who agree with the statement from all those who disagree). This affirms the period of sustained austerity the UK consumer has experienced to this point - the more negative the index, the more pressured households are in terms of their finances. Nevertheless, the direction of travel is a positive one. April's figure represents a +4.1 point recovery versus the same time last year and a +3.6 point improvement on the average for the last 12 months.

Inflationary pressure has been steadily easing, and with the peak now in the rearview mirror, coupled with continued growth in consumer confidence, there are some early signs of an improvement in fortunes for the year ahead, particularly for a handful of the big-ticket operators. Operators that have, until very recently, posted results evident of the economic challenges both they and the consumer have faced.

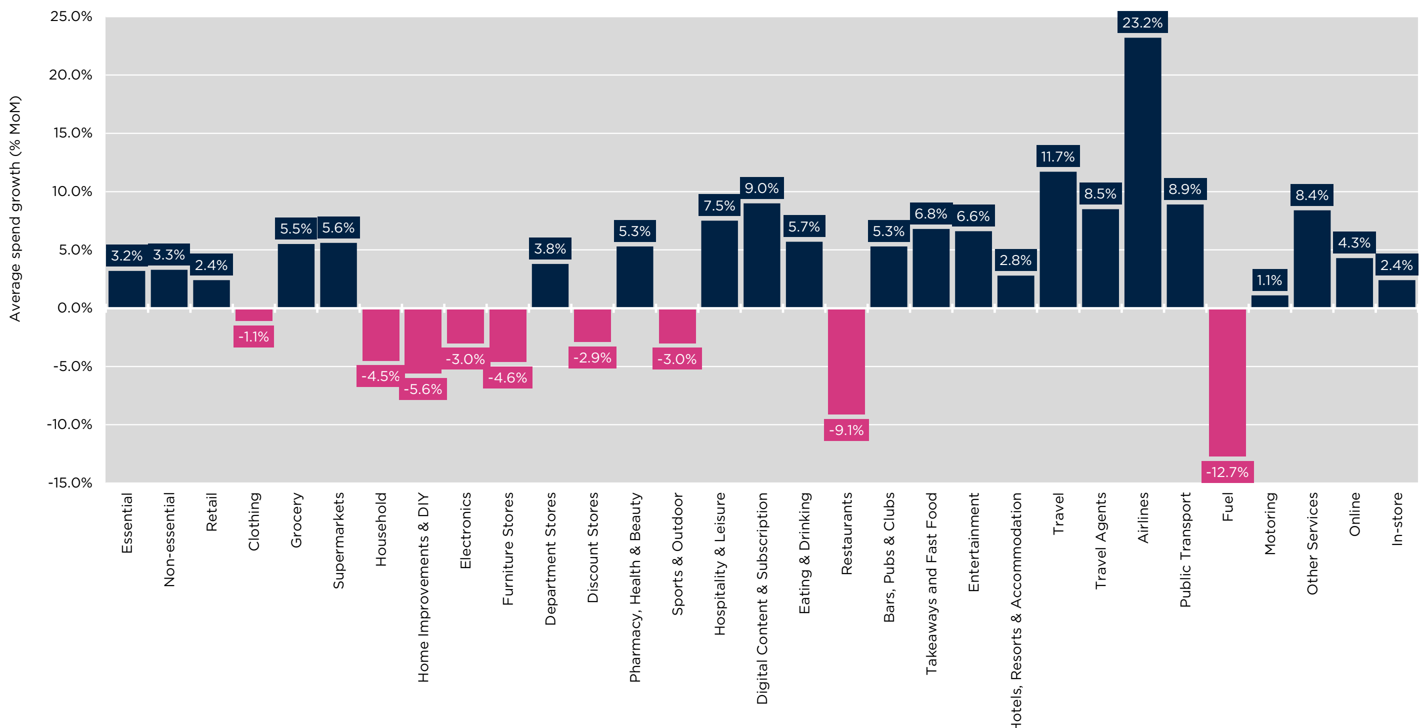
Currys, for example, saw its UK & Ireland like-for-like (l-f-l) sales fall -2% for the year up to the end of April, a result compounded further by the fact it is off the back of weak comparatives given the length of time the UK consumer has been experiencing a degree of economic turmoil.

Nevertheless, its most recent fall in annual sales were predominately frontloaded; the results belie the positive trend that has been in place since early January this year, where sales have increased by 2%, aligning with the wider group's decision to upgrade its full-year profit before tax guidance from £105m to between £115m and £120m.

By comparison, Kingfisher's sales in the UK and Ireland have appeared resilient over the last year, growing by 3.0% to £6.4bn for the 52 weeks ending 31 January 2024. Nevertheless, Q4 2023 saw a -1.6% decline in like-for-like (l-f-l) sales as consumer economics remained challenged, especially in the run-up to Christmas.

In terms of the group's individual fascias, B&Q was able to maintain growth despite a challenging

Figure 2: Barclaycard sales – average spend growth over the last 12 months



Source: Savills Research, Barclaycard

> "...when the housing market remains subdued for an extended period of time, it is true that consumers begin to increase their investment in the repair, maintenance, and renovation of their existing homes..."

consumer environment. Sales increased by 0.4% in full year 2023/24, allowing the retailer to stay on course to meet its flat growth expectations for the financial year ahead. Nevertheless, B&Q did see weaker performance in big-ticket categories, with consumers making small improvements to their homes, instead of investing in larger projects or moving house altogether.

Indeed, DIY/home improvement sales have always been intrinsically linked with the strength of the housing market. In the year to March 2024, total housing transactions reached 1.09 million in the UK; -34% below the peak we saw in 2021-22 following the stamp duty holiday, -16% below the decade average, and -17% below the same period in 2023 (year to March 2023).

Kingfisher, therefore, remain cautious on its performance for the year ahead. Its Q1 2024 l-f-l sales were down -2.3%, as a weaker housing market continues to impact demand for home improvement goods.

That said, when the housing market remains subdued for an extended period of time, it is true that consumers begin to increase their investment in the repair, maintenance, and renovation of their existing homes, which should at least partially counter the reduction in spend brought about by reduced housing transaction volumes.

In fact, in Q1 2024, the wider business saw group revenue grow by 2.7%, largely driven by trade, suggesting this is beginning to ring true. For B&Q, investment in its store portfolio will prove crucial to driving sales forward, particularly its smaller format high-street-focused B&Q Local stores, that are designed to make the retailer more accessible to a larger audience who continue to seek value and convenience in a challenging economic environment.

Screwfix, Kingfisher's other UK brand, has indeed been investing in both its stores as well as its online offering, which has been the primary contributor to its total sales increasing by 7.3% for the year up to the end of January, albeit with sales up just 1.4% on a l-f-l basis. Screwfix opened 51 new stores over the last financial year, with a further 40 planned for 2024/25. In Q1 2024 (three months to the end of April), the brand saw further growth with a 6.4% uplift in sales and a 2.4% uplift on a l-f-l basis, highlighting how investment in both stores and its online proposition is continuing to resonate with consumers.

Meanwhile, Wickes saw its annual performance tempered by a restricted environment for big-ticket spending. Total revenue of £1.56bn was down -0.6% in the 52 weeks to 30 December and contributed to an 8.6% decline in Wickes' operating profit to £62.9m.

However, l-f-l retail revenue (which includes DIY and trade) gained 0.1% over the same period, whilst the first eleven weeks of 2024 have seen retail sales remain in line with last year. Like B&Q and Screwfix, Wickes will need to invest in strategies that prioritise value and convenience in order to gain traction among non-trade customers.

For some retailers, it seems sales performance is at least beginning to stabilise; however, not all operators are out of the woods just yet. The challenges that big-ticket retailers have faced have been further reiterated by DFS, with total revenue growth falling -7.2% in the last six months of 2023. With warmer-than-expected weather bringing weaker than anticipated autumn sales as well as a poor start to the year as consumers cut back post-Christmas, the retailer has revised its revenue forecast for the full year from between £1.06bn and £1.08bn to between £1.00bn and £1.02bn.

Dunelm, however, is an example of a furniture and household goods operator that has seen a marginal recovery, with total sales growing by 2.6% to £434.5m in the first quarter of 2024. The retailer reported that although this growth was driven primarily by volumes, it delivered it profitably as its gross margin grew by 60 bps off the back of a strategy to place convenience and value for money at the heart of its offer.

Pets at Home is perhaps the most succinct example of the juxtaposition in which those operators that are the purveyors of both essential goods and discretionary products have found themselves. The retailer has achieved positive sales growth largely through the demand for essential goods with group sales increasing 5.2% for the 52 weeks ending 28 March, and l-f-l retail sales up 4.1% over the same period.

Nevertheless, it reported a 12.7% decline in operating profit to £119.3m. This is its second year of declines as customers have cut back on the discretionary products and pet accessories they sell. That said, profits this year were also impacted due to short-term product availability issues during the transition to its new distribution centre which, in contrast, should aid store stock availability going forward.

-2.0%
UK & Ireland like-for-like (l-f-l) sales fall for the year up to the end of April

+0.4%
increase in sales in full year 2023/24

+7.3%
total sales increase for the year up to the end of January

-0.6%
total revenue fall in the 52 weeks to 30 December 2023

-7.2%
fall in total revenue in the last six months

+2.6%
total sales growth in Q1 2024

+5.2%
sales growth for the 52 weeks ending 28 March

> "What is quite clear is those operators with a focus on bulky goods and big-ticket purchases, are those that have felt the most pressure in recent years."

The out-of-town market is less dependent on big-ticket discretionary spend and increasingly focused on essential and value-based retail

What is quite clear is those operators with a focus on bulky goods and big-ticket purchases are those that have felt the most pressure in recent years. Despite signs of an economic recovery, it is still early, thus improvements in operator performance and, subsequently, their optimism for the year ahead remain mixed. As a result, the casual observer may have assumed the worst for a sector with a traditional focus on furniture, carpet, kitchen and electrical operators.

However, it is important to remember that much less of the market is exposed to these subsectors than was the case a decade ago. Back in 2014, 46% 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). At present, that has fallen to a quarter of all occupied space.

In its place, we have seen growth in value-orientated operators. Discount variety stores (including the likes of B&M, Home Bargains, The Range, Poundland and most recently OneBeyond) accounted for 5% of floorspace in 2014 and now account for 11%. Discount grocery saw the largest growth of 7% in the last decade, now accounting for 9% of all floorspace off the back of the aggressive growth strategies of operators such as Aldi, Lidl and Iceland / The Food Warehouse (figure 3).

The decline in consumer spend has, therefore, not impacted all occupiers across the out-of-town market in equal measure. Retail warehousing is now much more focused on essential product categories, so despite seeing a retraction in discretionary spend, it is operators in this space that have, in fact, been best positioned to mitigate the impact of the economic headwinds.

B&M saw its UK revenue grow by 8.5% to £4,410m for the full year ending March 2024, against an already impressive 4.0% comparative versus the year before. Crucially, B&M has managed to deliver this growth profitably. The brand's l-f-l sales growth of 3.7% over the same period points to the fact the success is not simply a result of new store openings but an indication of the demand for its extensive offer of value products and the execution of its strategy to deliver value for money for its consumers (B&M opened 19 new stores in the out-of-town market in 2023 – figure 5a).

Foodstore operators have adapted to compete with the discounters

Unsurprisingly, many of the UK's leading supermarket operators have also posted positive sales growth over the last 12 months as groceries remain an essential spend category for all consumers, regardless of any economic uncertainty.

However, with food and non-alcoholic beverage inflation peaking at 19.2% in March last year, for many operators, this growth has been driven by increases in the value of goods rather than improving volumes.

According to the ONS, foodstore volumes have seen negative growth since December 2021, reaching its lowest point at -5.6% growth in December 2022, on a rolling 12-month basis (it currently remains in negative territory at -2.0% as of April 2024). Conversely, the value of goods sold in foodstores has grown over the same period, peaking at 9.2% in October last year, whilst in April they saw growth of 6.6%.

The disparity between volume and value has been reflected in individual operator performances. Tesco's UK sales (excluding fuel) grew 8.1% up to the end of February according to its full-year results, with l-f-l sales up 7.7% over the same period. However, with double-digit food inflation prevalent for much of 2023, it does suggest the operator saw a decline in volumes during this time as shoppers traded down.

That said, in early 2022, Tesco did make the conscious decision to forgo any significant profit growth and commit to prioritising investment in its customer offer. The brands 'Aldi Price Match', 'Clubcard' and 'Low Everyday Prices' initiatives were designed to relieve cost of living challenges for its consumers and thus mitigate the impact of the discount operators in order to retain market share.

The latest results from Kantar suggest the brand has done just that. Tesco maintains its leading position with a UK market share of 27.6%, up from 27.1% a year ago. Meanwhile, Aldi maintains fourth spot with a market share of 10.0%, and despite Lidl seeing the biggest growth, up to 8.1% from 7.7%, it has done so at the expense of other operators in the grocery market.

Sainsbury's also saw positive sales growth with an uplift of 6.8% in total retail sales and as much as 9.4% in grocery in the 52 weeks ending 2 March 2024. As a result of its performance, Sainsbury's has achieved a 0.3% uplift in market share versus the same time last year, reaching 15.1% as of the end of May 2024 and thus fending off the pricing competition from the discount food operators.

Like Tesco, the last few years have seen Sainsbury's invest in initiatives that focused on keeping prices low and reducing costs across its business, which have subsequently been passed on to the consumer. Its 'Low Everyday Prices' offering has allowed it to compete with the discounters whilst at the same time it has been driving its own-brand sales through its 'Taste the Difference' range. This has allowed the retailer to not only focus on value but also quality,

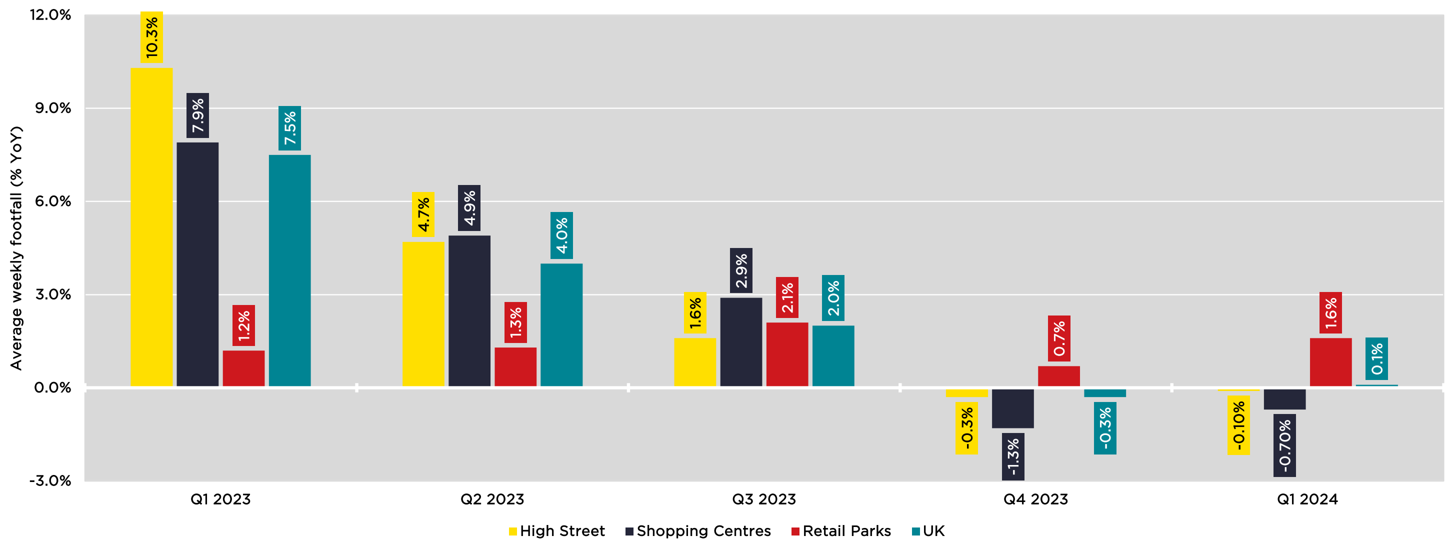
Figure 3: UK Retail Warehouse floorspace (%) by sector – 2014 v 2019 v 2024

% of UK floorspace				
Sector	2014	2019	2024	2014 - 24 Change
Bulky & Homewares	32%	26%	23%	-8%
Electrical	4%	2%	2%	-2%
Discount Variety	5%	9%	11%	6%
Discount Grocery	3%	7%	9%	7%
Grocery	22%	21%	21%	-1%
Fashion & Comparison	18%	17%	15%	-3%
F&B & Leisure	15%	16%	17%	1%
Services	1%	1%	1%	0%

Source: Savills Research

> "...retailers with a focus on essential product categories that have continued to drive footfall to out-of-town schemes over the last year."

Figure 4: MRI UK footfall (YoY) by asset class



Source: Savills Research. MRI

recognising that despite constrained disposable income, some consumers still look for premium ranges in order to treat themselves.

This two-pronged approach may give Sainsbury's a competitive edge going forward as it looks to capture consumers trading up to branded and premium products as food inflation continues to fall. However, with that inflationary pressure easing, we do expect to see a normalisation of sales growth for both brands as the gap between the value and the volume of groceries sold closes further.

Waitrose saw a significant improvement in its performance for the full year ending in January, reporting a 19% uplift in operating profit versus a fall of -12.5% the previous year. Much of the enhancement was down to improved productivity in its supply chain; however, like Sainsbury's, as a premium-focused operator, Waitrose has more recently also enhanced its high-end ranges to appeal to its core customer base – a clear reaction to improving food inflation.

Prior to this, Waitrose launched its 'Lower Prices' campaign in a bid to combat cost of living increases. However, this strategy was only implemented in February 2023 - later than other operators - thus, total revenue saw a moderate 5.8% increase whilst l-f-l reached only 5.0% - falling short of competitor performances and resulting in flat market share growth (the brand's total market share remains at 4.6%, the same as twelve months ago).

Marks & Spencer's has arguably seen the most impressive performance over the last twelve months, with four quarters of double-digit growth that has seen its UK food revenue increase by 13.0% to £8.2bn for the 52 weeks ending 30 March. Although it may seem counter-intuitive, it has achieved these results by staying true to its core values and brand identity as a supplier of premium, high-quality products. Unlike competing brands, it hasn't implemented initiatives that look to compete with the discounters on price – a strategy that has paid off by placing it at the forefront of the consumers' mind when they have looked to treat themselves or seek a more economical alternative to restaurant quality meals at home.

In contrast, Asda's results were the most disappointing. It achieved only moderate growth of 5.4% in l-f-l sales in 2023, with limited performance in Q4 in the run-up to Christmas and a l-f-l sales growth of only 2.2%. As a result, it is Asda that has lost most ground to the discount operators; its market share fell to 13.1%, from 13.9% a year ago.

This is perhaps a stark reminder that despite deflation broadly bringing with it a welcome improvement in consumer fortunes, in reality, the UK's leading grocers that cater to a broad demographic will undoubtedly want to maintain a cautious outlook for some time yet. As such, they may feel the need to continue their investment into lower prices for the time being as many consumers still remain sensitive to price.

Nevertheless, grocery price inflation has fallen for the fifteenth month in a row to 2.4%, the lowest level since October 2021, which is undoubtedly a positive result for forward-looking operators. This trend indicates that grocery price inflation is gradually normalising, which, according to Kantar, is now only 0.8 percentage points higher than the ten-year average of 1.6% between 2012 and 2021, just before prices began to climb.

Operators that sell essential goods continue to drive strong footfall numbers which, in turn, generates further appetite for growth

What is clear, whether they sell household goods or food and groceries, it is retailers with a focus on essential product categories that have continued to drive footfall to out-of-town schemes over the last year. What is more, it is the discounters, or indeed those operators that offer value for money across a significant proportion of their products lines that have been best positioned to mitigate the impact of the economic headwinds in recent years. Positively, a decade ago, just over a quarter (28%) of the brands in the out-of-town market were solely value-based or discount-led. Today, that figure has risen to 38% and is increasing all the time (a third of all new openings in 2023 have been value-led brands).

As a result, weekly footfall in 2023 remained at near parity with 2019, averaging at just -2.1% below pre-Covid levels. For high streets, the weekly average was -13.7% down for the year, versus -15.6% for shopping centres. This is interesting in the context of figure 4, which considers average weekly footfall over the last five quarters. Retail parks are the only asset class to see a positive growth in each, versus the same period the previous year. High

"It is those operators that sell essential goods and/or focus on value that have been driving new openings in the market over the last 18 months"

streets and shopping centres have seen mixed results, posting greater increases in early 2023, but off the back of much lower comparatives when you consider the level to which they are below those seen pre-pandemic. The shift to hybrid working suggests town centres will perhaps never see numbers return to those seen in 2019, albeit they have seemingly stabilised, providing a touch more certainty on how the market will perform for both retailers and investors alike (read our latest Spotlight for Shopping Centres & High Streets for Q1 2024).

It is indeed those operators that sell essential goods and/or focus on value that have been driving new openings in the market over the last 18 months. Figure 5a highlights the most acquisitive brands in 2023 (excluding F&B). The budget gym operator PureGym tops the league table, having opened 34 new units across retail, leisure and shopping parks. The new sites have helped increase membership, with a 16% rise in the UK which, in turn, has driven a rise in revenues in 2023, growing by 15% to £549 million for the year compared with 2022.

The discount grocers and value homeware brands also continue to feature strongly in the list of the top 15 most acquisitive brands for 2023, much like they have done for the last five years. Aldi (20 stores), Home Bargains (20), Lidl (20), B&M (19), Poundland (17) and Farmfoods (10) have all seen the number of new stores enter double digits for 2023.

What is more, this trend looks set to continue, undoubtedly a positive sign of the confidence retailers have in the sector. PureGym remains the most acquisitive brand with 13 new stores in Q1 2024, whilst Home Bargains (6), Lidl (6), Farmfoods (5), Poundland (5), B&M (4) all feature in the top 15 (figure 5b).

Nevertheless, it is important to note it is not just the same operators looking to take space year after year. Farmfoods (10), JD Sports (9), Hobbycraft (8), Jollyes (8), OneBeyond (8), JD Gyms (7) and Superdrug (6) are all examples of operators that are new to the top 15 league table for 2023. What is particularly encouraging for the sector is the increasing desire for space from operations such as JD Sports and Superdrug which have typically taken space on the high street but are now recognising the advantages of trading in the out-of-town market.

Jollyes is an example of proposition that is looking to accelerate its new store opening programme and strengthen its position in the retail warehouse market. The retailer has secured significant backing from investment funds managed by TDR Capital LLP to continue its expansion, having grown its estate by 50 percent in three years; opening 33 stores in the last 26 months. Its approach is to drive down prices for pet owners, one that has clearly boded well for them during recent cost of living uncertainty and will continue to do so as many consumers remain sensitive to price. The retailer plans to open an additional 12 new stores over the next twelve months and already has agreements secured for locations in Northampton, Nuneaton, Chester and East Kilbride.

M&S has also increased its expansion in the out-of-town market as its 'Reshaping for Growth' strategy concluded its second year of implementation. In 2023, the retailer just missed out on the top 15 acquisitive operators (highlighted in figure 5a), but made the top 20 with five additional stores. These include food halls at Barnsley Retail Park, Stockport Retail Park and Plas Coch Retail Park in Wrexham, as well as general format stores at Purley Cross Retail Park in Croydon and Stockbridge Retail Park in Linlithgow.

As well as the success it has seen in its grocery division, the retailers clothing operations has made a conscious effort to shift consumer perception and appeal to a much wider demographic that includes younger audiences as well as its traditional older customer base. As such, the operator has seen its UK clothing & home revenue increase by 5.3% in the 52 weeks ending 30 March.

As part of its commitment, M&S has embarked on a renewal programme alongside its acquisition strategy. The operator completed the renewal of eight standalone foodstores in the concluding financial year and, more recently, its department store at Fosse Park in Leicester, which includes an expansion to its food area.

In addition, M&S has suggested it will open up to nine stores this year alongside the continued refurbishment of its existing store portfolio. Q1 2024 has so far seen it open six stores out of town, placing it in the top 20 operators taking space this year (figure 5c).

Figure 5: Retail warehouse market most acquisitive brands

Full Year 2023

(a) Most acquisitive brands (excl. F&B)

Fascia	Units	Total sq ft	Av. unit size (sq ft)
PureGym	34	412,900	12,100
Aldi	20	368,200	18,400
Home Bargains	20	511,500	25,600
Lidl	20	384,300	19,200
B&M	19	597,500	31,400
Poundland	17	301,500	17,700
Farmfoods	10	163,900	16,400
Bensons	9	54,000	6,000
JD Sports	9	84,200	9,400
Hobbycraft	8	61,600	7,700
Jollyes	8	55,100	6,900
OneBeyond	8	68,800	8,600
JD Gyms	7	94,300	13,500
Iceland/Food Warehouse	6	78,100	13,000
Superdrug	6	46,200	7,700

(b) Most acquisitive F&B brands

Fascia	Units	Total sq ft	Av. unit size (sq ft)
Starbucks	26	55,500	2,100
Greggs	25	48,100	1,900
Costa	14	28,600	2,000
Burger King	7	19,800	2,800
Taco Bell	7	13,400	1,900
KFC	6	8,800	1,500
McDonald's	6	11,400	1,900
Nando's	6	21,300	3,600
Tim Hortons	5	12,800	2,600
Five Guys	4	14,600	3,700
Loungers	4	17,800	4,500
Dunkin' Donuts	3	6,900	2,300
Popeyes	3	9,000	3,000
Domino's Pizza	2	3,500	1,800
Wagamama	2	7,900	4,000

Q1 2024

(c) Most acquisitive brands (all sectors)

Fascia	Units	Total sq ft	Av. unit size (sq ft)
PureGym	13	140,300	10,800
Starbucks	12	20,900	2,000
Greggs	8	11,100	1,900
Costa	7	12,200	2,000
McDonald's	7	29,800	3,300
Hobbycraft	6	66,100	11,000
Home Bargains	6	125,500	20,900
Lidl	6	103,600	20,700
M&S	6	128,600	22,800
Nando's	6	19,900	4,000
Farmfoods	5	57,100	11,400
KFC	5	8,800	2,200
Poundland	5	75,600	15,100
B&M	4	84,900	30,700
Five Guys	4	12,500	3,100
Sports Direct	4	85,300	19,800
Burger King	3	5,400	2,700
Iceland/Food Warehouse	3	37,100	12,400
Cancer Research UK	3	22,700	7,600
Smyths Toys	3	48,400	16,100
Wagamama	3	11,300	3,800

Source: Savills Research

> "...the reduction in take-up is not emblematic of a rescinding appetite for space from retailers in the market, it is simply down to a lack of supply"

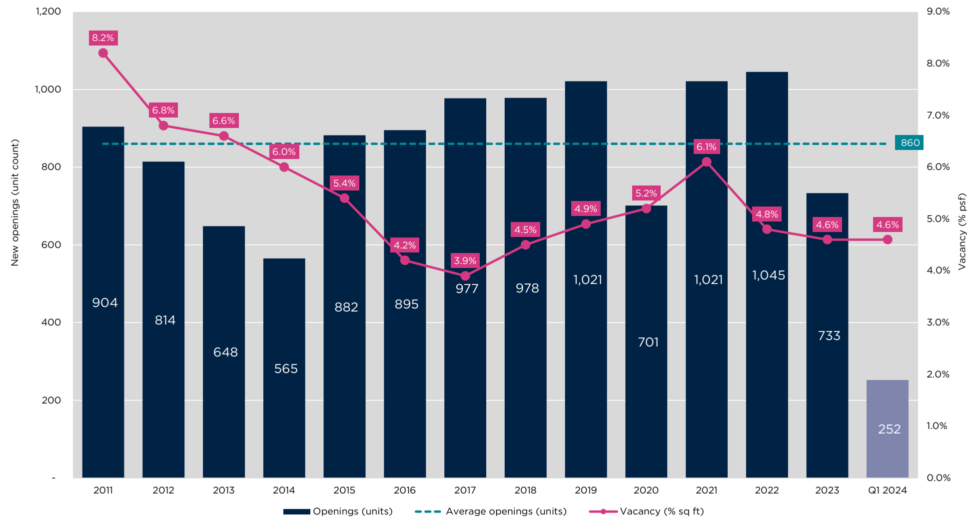
A lack of available space is stifling retailers' desire to open new stores

On the surface, a wealth of operators looking for space is a welcome problem for landlords. The thinking being that a sustained period of demand creates competitive tension and has the ability to drive up rents. However, finding the space to meet that demand is not always easy. As figure 6 demonstrates, despite the appetite, the retail warehouse market only saw 733 new openings in 2023, a 15% reduction on the long-term average and 30% less than the previous year.

However, it is important to stress the reduction in take-up is not emblematic of a rescinding appetite for space from retailers in the market; it is simply down to a lack of supply. The desire for new stores has been sustained for some time and has come from a wide variety of operators, and this has continued to drive down voids in the retail warehouse sector (figure 6). Having peaked at 6.1% in 2021, vacancy has continued to gradually fall, reaching 4.6% at the end of 2023, where it currently sits.

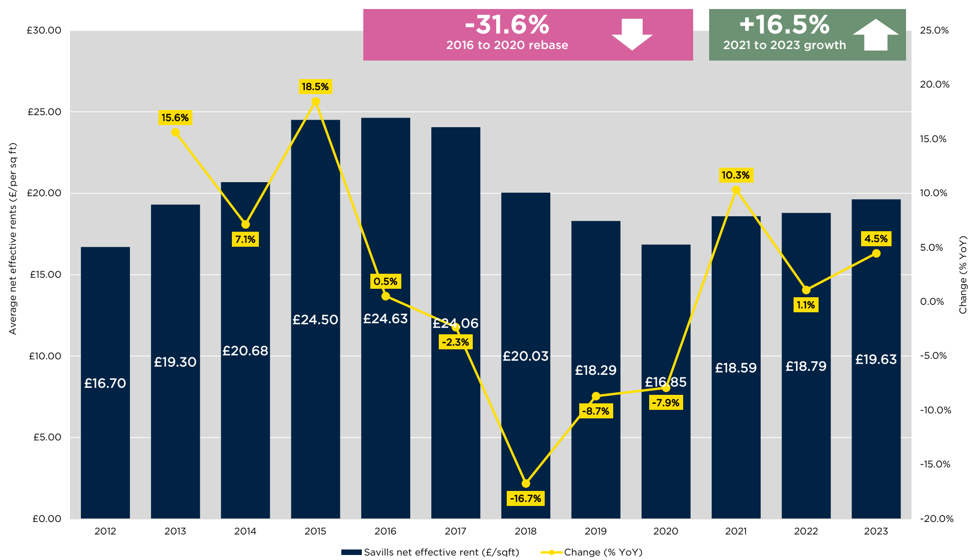
However, vacant space is even more scarce than you might think. The current void rate suggests there is 17.9m sq ft of available space nationally. However, 62% of this space has been vacant for three years or more, either due to lengthy planning obligations or suggesting it is no longer fit for purpose (11.1m sq ft). If we remove this from the space that is theoretically available, vacancy falls to 1.7% nationally, equating to only 6.8m sq ft of available space at this moment. When you consider net take-up in recent years has averaged 4.8m sq ft per annum, we essentially have less than 18 months of supply left in the market, assuming we see no significant retail warehousing development or failures from a number of the market's leading operators. An additional 252 new openings in Q1 2024 is only likely to compound the problem further.

Figure 6: Retail warehousing new openings (YoY)



Source: Savills Research

Figure 7: Savills annual average net effective rents (excl. Drive-to & Drive-Thru)



Source: Savills Research

Will competitive tension lead to further rental growth?

With the lack of available space in such high demand, it therefore seems logical that the market will have seen some growth in terms of its net effective rents over the last 12 months. This is indeed true and in fact, no commercial real estate sector has ever seen vacancy at less than 5% and not witnessed subsequent rental growth.

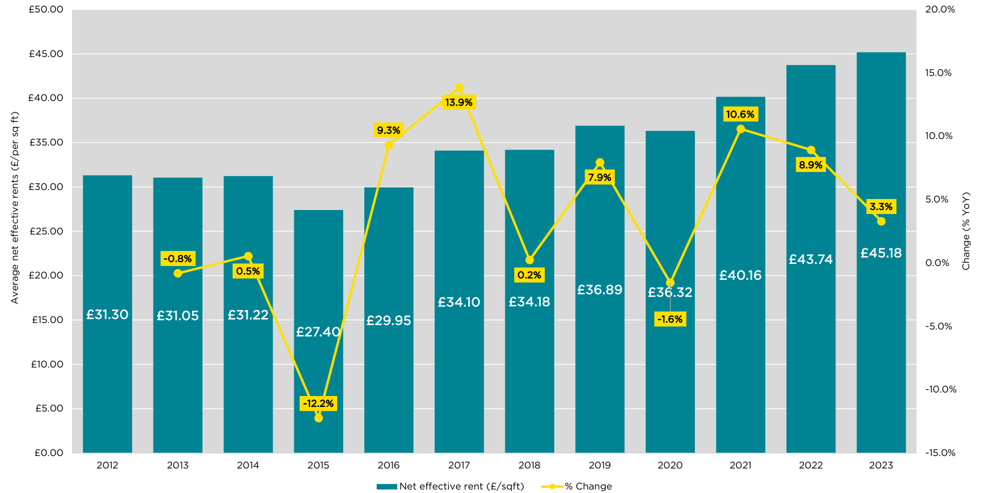
Savills has seen net effective rents grow by 4.5% in 2023 on average across all our open market lettings and regears, placing the current average rent per sq ft at £19.63 (all units excluding F&B). Having seen net effective rents rebase between 2016 and 2020, falling by 31.6% in that time, the retail warehouse market has seen steady growth. Since the nadir in 2020, net effective rents have increased by 16.5%.

However, it can be argued that average market rents, on prime assets at least, are in many cases artificially lower than they perhaps should be. Fully let schemes seldom present an asset manager with the opportunity to justify an increase in rental value on a new deal. Lengthy WAULTs following the rebasing of rents, strong revenue performance and therefore the majority of retailers choosing to regear rather than vacate, are all contributing factors. As a house, Savills remain relatively bullish to the fact we will continue to see positive rental growth this year but, with some landlords reporting vacancy of less than 1%, it will likely prove to be less steep than the strength of the occupational market suggests it should be.

> **Drive-thru & Drive-to net effective rents now stand at £45.18 psf on average, an increase of 22.5% versus pre-pandemic**

F&B rents have increased dramatically following the sustained depth of demand for new space; however, construction cost increases may see the sector reach a ceiling on what it can pay

Figure 8: Savills annual average Drive-thru & Drive-to net effective rents



Source: Savills Research

Food & beverage operators have also continued their strong appetite for growth in the out-of-town market. Figure 5b outlines the top 15 F&B operators that have opened units in 2023. Of the 733 new openings across the whole of the retail warehouse market, F&B accounted for 20%.

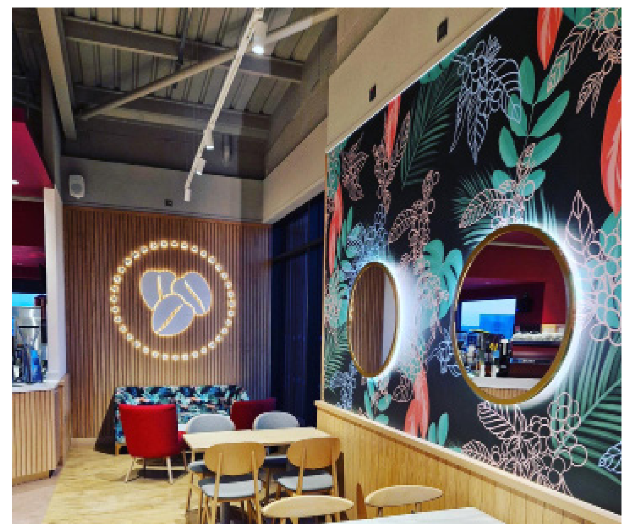
Starbucks, Greggs and Costa have consistently topped the charts in the last five years, opening 26, 25 and 14 new units in 2023, respectively. Burger King (7 in 2023), KFC (6), McDonald's (6), Nando's (6) and Five Guys (4) also regularly feature in the most acquisitive F&B operators, but newcomers to the market are also expanding the aspirations of the sector including Taco Bell (7), Dunkin Donuts (3) and Popeyes (3).

With a strong depth of demand following a pandemic-fuelled explosion in popularity for convenience F&B, we have seen a more dramatic increase in rents than is true for the rest of the market in recent years. However, rents have also climbed in order to make a development viable to the landlord, due to the recent and significant increase in construction costs. Drive-thru & Drive-to net effective rents now stand at £45.18 psf on average, an increase of 22.5% versus pre-pandemic (figure 6). This pattern of growth is unlikely to be infinite; there will, of course, be a ceiling to what operators can pay in this subsector which may begin to explain the smaller increase of only 3.3% in net effective rents in 2023. That said, high rents are likely to be sustained in the long-term owing to the huge growth in delivery platforms such as Deliveroo and Just Eat that so successfully connect operators in this space to their local consumers.

The truth is the most acquisitive F&B operators would like to do more were it not for scheme configuration and planning constraints. With Drive-thru and restaurant vacancy so low, there is very little opportunity to satisfy further demand, which is why many of the new openings, particularly for Drive-thru's, are newly constructed roadside developments rather than the reparation of voids.

Drive-thru's, in fact, made up 31% of all new F&B openings across the market in 2023, slightly above the average annual number of drive-thru openings over the last decade (42). However, it is less than half the number of drive-thru openings seen in 2022, which is a consequence of a lack of supply and difficulties and delays in delivering new developments rather than a reduction in operator appetite. Delays in the planning system, financial viability challenges due to rising development costs and more stringent restrictions imposed by existing retail tenants preventing development in car parks are reducing the pipeline of opportunities. Operators are therefore finding it increasingly difficult to find and secure appropriate space to expand on existing retail and leisure schemes. As a result, the competition for drive-thru space, in particular, has become increasingly fierce, with fast food operators innovating to develop smaller format drive-thrus to compete with other 'grab and go' and coffee operators in the smaller format size range of 1,800-2,000 sq ft.

Costa Coffee Drive Thru - South Lakeland Retail Park, Kendal (opened August 2023).



Costa Coffee Drive Thru - Warrington (opened July 2023).

"The market has already seen sufficient improvement, is set fair, moving in the right direction and at a sensible price"

Investment market trends

A lack of stock has led to a thin first quarter for transaction volumes; however, pricing hardened regardless, highlighting a gradual improvement in investor sentiment and growing confidence in returns for schemes both in the South East and increasingly further afield

It is hard to argue the UK retail warehouse investment market has seen anything other than a thin first quarter in terms of transaction volumes. Q1 2024 saw £451m transacted, 16% less than the same period the previous year and a 33% reduction on the long-term quarter average since the turn of the millennium.

Nevertheless, the movement in pricing seen this year suggests the negativity that has impacted volumes since the second half of 2023 has given way to a more optimistic investor mindset, albeit still with a pinch of caution around lot size and geography.

The improvement in sentiment amongst the buyer pool has almost certainly closed the gap between the traditional 'core' purchaser and the opportunistic or value add buyer, those that were looking to secure assets at a yield of 8% plus and build capital value as pricing improved.

This gap was prevalent as little as five months ago; however, all Savills yields have moved in 50 bps since the start of the year, including Prime Open A1 (now at 5.50%), Prime Restricted (6.00%), Secondary Open A1 (8.25%), Secondary Restricted (8.50%) and Shopping Parks (7.00%). Clearly confidence is beginning to build in the market, particularly amongst savvy investors who recognise the strength of the occupational market and prospects for continued rental growth.

Lothbury's sale of Silk Bridge Retail Park in Hendon to Delta Properties is a good example of how quickly yields hardened as investor enthusiasm improved in the New Year. Pre-Christmas, this scheme was for sale and received two offers at a net initial yield (NIY) of 7.00%. Following the advice to hold, the vendor completed the transaction in March at an improved pricing level, achieving 5.87% NIY and exchanging at £16.25m.

Although investor optimism has seen pricing harden in recent months, experience tells us that subsequent transaction activity tends to build from a trickle rather than come all at once in great waves.

It is therefore still early days in terms of a recovery. Q2 has so far seen only £142m transacted, with purchaser interest dominated by prime schemes in London and the South East.

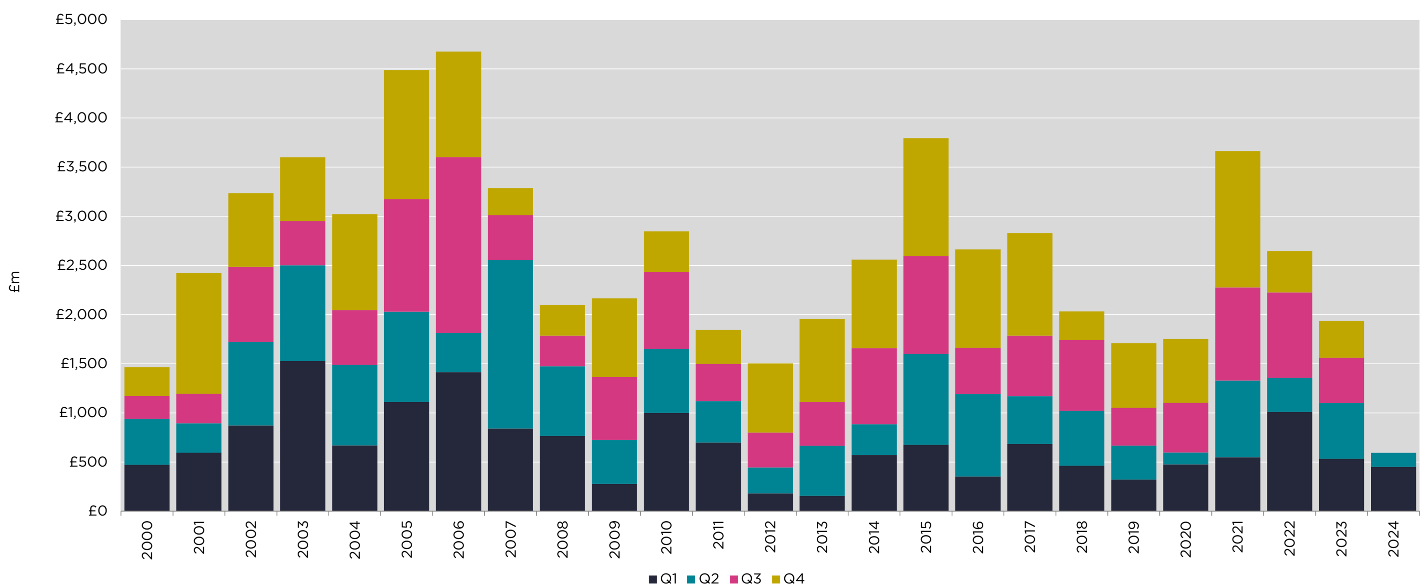
However, although there is some way to go yet, as the year rolls on and confidence builds, we expect to see investors grow increasingly comfortable with the sector, resulting in an expansion of requirements in terms of their geography, as well as a growth in appetite for larger lot sizes - a fairly typically scenario for an improving retail warehouse investment market when you take a cursory look at previous cycles.

This rings true when you consider there is c.£500m of stock in the market that is currently under offer. This would bring volumes in line with those seen in H1 2023, assuming those deals all came to fruition.

The Tandem Centre in Colliers Wood is a good example of a London-based asset that has added another degree of certainty to the buyer's barometer. The asset was marketed early on in 2023 and went under offer to Aviva but subsequently fell out of bed. Following some strategic occupational deals, the scheme was relaunched in March 2024 at a renewed price of 6.5%, with La Salle/ BPF selling. The competition for the asset was strong - in the end, abrdn won out and placed it under offer over asking at £61m, which is just shy of 6.00% NIY.

Meanwhile, Phoenix Retail Park in Corby in the East Midlands provides the market with some evidence of how investor confidence is beginning to grow beyond the South East. This scheme was sold to Columbia Threadneedle for £26m in May, achieving a NIY of 7.48% for the vendor, Peel Holdings (a c.120,000 sq ft Open A1 scheme).

Figure 9: UK retail warehouse investment volumes



Source: Savills Research

Who is buying retail warehouse assets?

In the market currently, there is only a handful of thematic buyers looking to build scale. Institutional investors make up the majority of those interested in the sector and include UK pension funds, each looking to do one or two deals in this cycle rather than a blanket buy of assets.

However, the key message to any investor should be wrapped up in the fact that we have seen a 50 bps fall in pricing across the sector, despite a relatively limited volume of activity. This has brought with it an improvement in capital values for those that chose to move and, with rental growth evident and set to continue as competitive tension in the occupational market builds, the savvy investor would be wise to increase its exposure to the out-of-town market beyond the odd solo deal.

As we have discussed, there remain some question marks around how you capture some of that rental growth. Fully let schemes, length of deals and regears rather than vacating units evidently slow the growth in rent the market could achieve. As a result, we are likely to see a more moderate increase of c.5% YoY, rather than any steep climb across the market.

Capturing rental growth obviously requires an investor to be in the right space, with prime assets likely to offer the strongest opportunities. However, as a house, it is our opinion that continued rental growth is almost certain, given the strength of the occupational story, lack of available space and continued appetite for retailer expansion.

The reason we perhaps don't see deeper investment interest from buyers is, therefore, twofold; the first being opportunity-led, the second potentially linked to historic sentiment.

Firstly, despite increasing interest, there has simply been a lack of stock available in the market to satisfy even average demand levels. It would be too strong to suggest vendors are holding on to assets for the time being in anticipation that yields will harden further and secure them a more competitive price. However, sellers are sellers only at the right price rather than motivated by distress or a need to sell regardless, in order to satisfy shareholders or secure funds for investment elsewhere. Lion Retail Park in Woking, for example, received bids in February at a NIY of 5.75%; however, British Land is willing to hold unless it achieves a bid at its desired 5.50%.

Having said that, our advice to sellers is not to hold indefinitely in the anticipation the market will increasingly get better. The market has already seen sufficient improvement, is set fair, moving in the right direction and at a sensible price. Those who want to sell should not be afraid to do so now – having had the value accretion over the last six to nine months, the opportunity to capture uplift is upon us.

The second reason investment in the sector hasn't come in the volumes it perhaps should is arguably longer term and engrained into investor psyche – that with a finite number of operators, the sector is overexposed to a potential failure. Furthermore, some owners of property may indeed view other sectors with rose-tinted spectacles based on the simple premise they make up the majority of their investor portfolios.

However, with such a strong appetite for space and, from such a broad array of brands in terms of their operational focus, this mindset somewhat over-eggs the pudding. INCANS Tenant Global Score, which is a measure of the financial strength and stability of a retailer based on its public accounts, tells us the financial stability of the sector's top operators is solid. Of the top 25 larger format operators, in terms of the number of units they have across retail, leisure and shopping parks combined (excluding F&B and gyms), 20 are considered 'low risk' or 'very low risk' in terms of failure. It is, therefore, our belief that the risk and return relationship looks much more favourable for retail warehousing than it does other sectors, which don't have such strong occupational fundamentals.

We would suggest the retail warehouse market as an investment opportunity is therefore a better one than many think it might be. This may go some way to explain why the sector has never truly been viewed as an international asset class. The reason is perhaps again linked to geography. It is easier for a foreign investor to understand investment opportunities in traditionally more prominent asset classes across key major European cities. From a UK perspective, by the time a scheme reaches the table with the key decision makers, it is less likely that the senior managers making that decision will have the local site-specific knowledge and, ultimately, the confidence to invest in the sector outside of the UK's top 10 retail destinations.

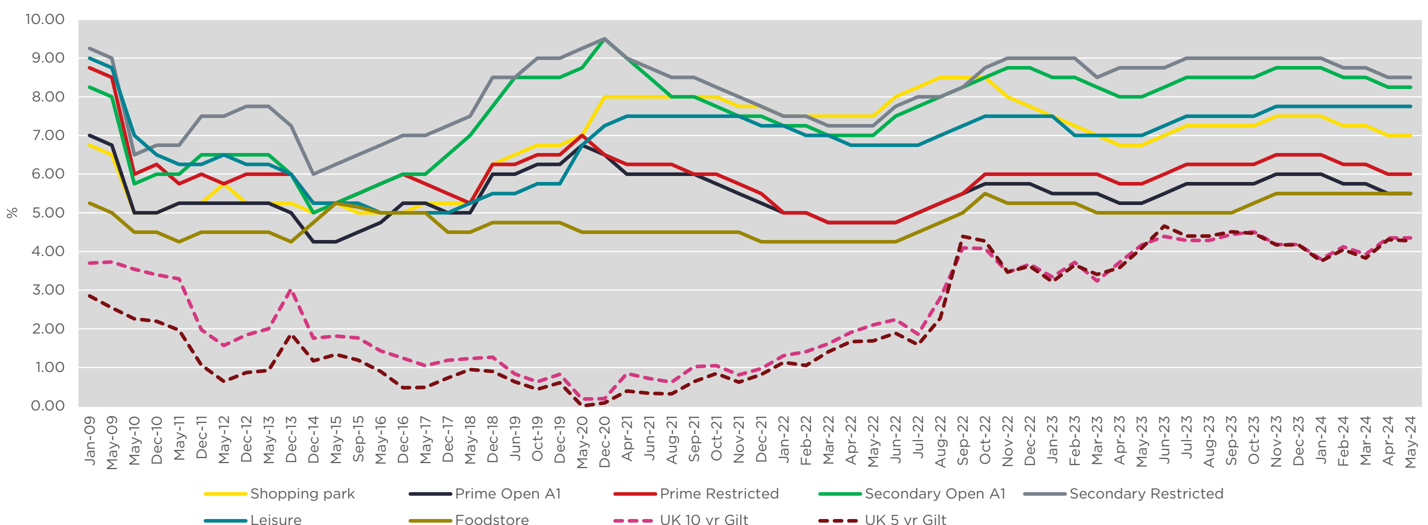
Of course, the promise of a general election and the likelihood of a new Labour government begs the question 'What will happen to market activity in the coming months'? We have tracked volumes across all asset classes at each of the general elections going back as far as June 2001. Historically, there tends to be a small fall in activity in the quarter before a general election: -3.7% on average as investors 'wait and see' if there is any dramatic change in the status quo immediately following the result.

However, typically volumes then recovery strongly by 13.0% on average, which coincides with an increase in positive consumer sentiment surrounding the optimism that comes with a new era of government.

This is then closely followed by a dip in the first quarter after the general election of -8.4% on average as investors wait for the dust to settle and markets to stabilise. That said, this typically lays the groundwork for a strong second quarter of growth post the result, where investment volumes see an average 27.8% uptick, as confidence in the investment markets returns.

If history is anything to go by, the retail warehouse sector will therefore see volumes dip once more, immediately following a post-election bounce. However, any fall is likely to be offset by stronger returns soon after, essentially ironing out the fluctuation in activity over the longer term. We therefore don't see the potential vagaries to the expected election outcome being price specific to the market but, wouldn't be surprised to see a few exchanges delayed to just after the result, just in case.

Figure 10: UK retail warehouse investment yields



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