UK Commercial – Q1 2020

MARKET IN MINUTES

Savills Research

Central London Retail Market in Minutes

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Rental declines accelerated in Q1

The impact of Covid-19 and the lockdown on the Central London retail market is unprecedented and its effects will continue to shape the market even once we exit lockdown. While the UK did not enter lockdown until the 24th March, social distancing was already shaping footfall, occupier appetite and rents from mid March and is apparent in the Q1 data. Going forward, we expect Covid uncertainty will continue to affect the market and corresponding values over the next six to nine months with some brands anticipating that there will be a return to more normal conditions by the end of Q1 2021 (assuming a vaccine is in place).

In terms of Q1 performance, average weekly footfall across the West End for the first 13 weeks of this year was down 16.6% year-on-year, with double digit declines reported from the 9th March (NWEC).

The operational uncertainty that was starting to creep into the market in March placed a downward pressure on Q1 prime headline rents as occupier confidence waned. Prime headline ZA rents for Central London fell 8.4% year-on-year in Q1, an acceleration on the 5.8% decline reported the previous quarter; a level of softening that was not even seen during the Global Financial Crisis (GFC). Much of this decline was driven by more peripheral pitches in the West End. However, lack of transactional evidence meant that some locations, such as prime pitches in the West End, reported no quarterly change in headline rents in Q1.

Looking to Q2 we expect to see a stronger degree of rental re-basing across Central London, particularly as the vacancy backdrop will be better understood in light of recent insolvencies. This should provide attractive opportunities for international retailers and consumer brands who are now looking at London as an opportunistic play.

Headline Central London Retail Indicators

	Q1 2019	Q4 2019	Q1 2020
West End Footfall weekly average year-on-year (first 13 weeks of 2020)	-1.6%	-3.3%	-16.6%
New International Entrants*	8	10	1
Prime West End vacancy rate**	3.2%	4.6%	N/A
All Central London Prime ZA Rental Growth (year-on-year)	-4.1%	-5.8%	-8.4%
Oxford Street West Prime ZA Rent	£915 psf	£850 psf	£850 psf
Bond Street Prime ZA Rent	£2,500 psf	£2,400 psf	£2,400 psf
Central London investment volumes (quarterly figure)	£694.2m	£257.2m	£332.0m
Prime Central London Yield (Bond Street)	2.50%	2.75%	2.75%↑

Source Savills Research; NWEC

Note: new international entrants added retrospectively*

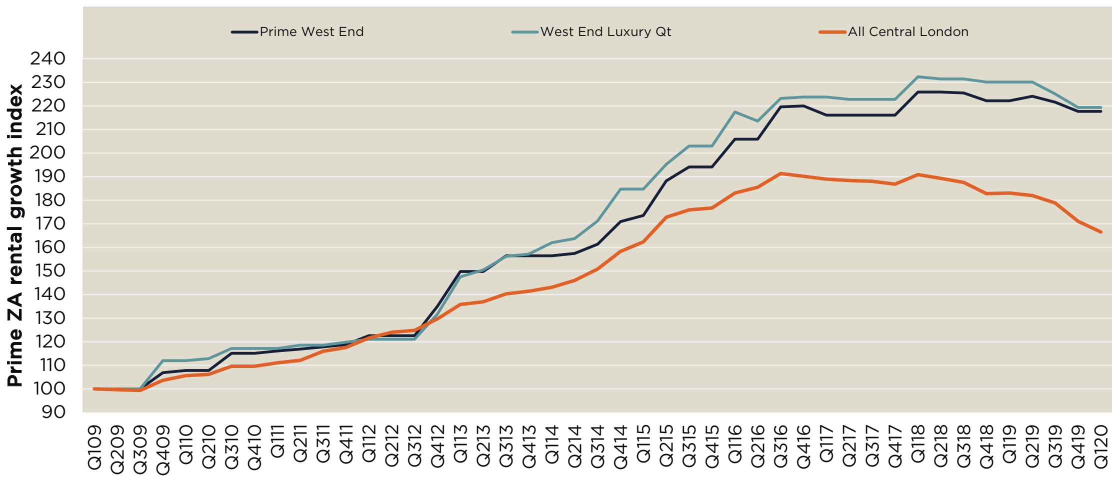
*Note**: based on unit vacancy and not floorspace*

£332.0m
Central London investment volumes in Q1 2020, an increase of 29.1% on Q419.

-8.4%
Year-on-year decline in headline ZA rents across Central London in Q1 2020.

-16.6%
Decline in average weekly year-on-year footfall across the West End over the first 13 weeks of 2020

Prime ZA rental growth index rents on the West End's prime streets held in Q1 albeit significant softening was seen across Central London as a whole



Source Savills Research

WHAT COULD RETAILING LOOK LIKE ONCE LOCKDOWN EASES?

The big question is how will the Central London retail market recover once lockdown is eased and non-essential retailers are able to re-open. One thing is clear, it won't be an immediate return to pre-lockdown conditions. Rather continued social distancing will have a significant bearing on the market over the short-term, meaning that its recovery may lag that of other retail locations nationally. However, this may not be mirrored across all parts of the retail market. It is also important to bear in mind that these are relatively short term considerations and that the longer term fundamentals of the Central London retail market, from both a retailer and investor perspective, remain robust.

So what could be the short term implications? Drawing on the experience seen in China, and more recently Germany, post lockdown, the expectation is that the initial recovery in footfall is likely to be relatively sluggish. For example, the German trade association reported that average store turnovers were 40% of typical pre-covid levels in the first week post lockdown. However, stronger performance has been reported anecdotally for luxury and aspirational retailers with mass market retailers, particularly fashion, more exposed. A trend that was also seen in China. The stronger performance of luxury stores reflects, in part, their ability to better mitigate the impact of social distancing on store performance as they typically have lower customer volumes. For customers, this means the change to the luxury store experience with social distancing should be limited.

We expect to see a similar recovery trajectory in Central London. Albeit, the greater reliance on international shoppers on prime, high footfall locations may mean a slower recovery than seen in other retail markets globally where spend is more domestic focused. Yet, we could spend in these locations rebound in late 2021 in line with the forecast bounce in international arrivals into Europe next year. For those London pitches where spend is more locally driven, such as Kings Road and Marylebone High Street, we may see a faster improvement in spend.

Prior to the return of international visitors, initial spend and footfall across Central London may also be constrained by the social distancing measures placed on businesses in terms of re-opening workplaces. Detailed Government guidelines are yet to be released but could involve workplaces operating at reduced capacity, encouragement of continued home-working where appropriate and staggered working hours. This could be exacerbated by consumer concerns surrounding train/tube travel meaning the ability to draw domestic shoppers from the wider London area into the West End and the City could also be reduced.

In some cases, however, fewer people in the West End, could create more appealing retail environments and experiences that may in fact improve conversion rates.

Where we expect to see the slowest recovery will be in the F&B and leisure sectors, largely because they are expected to be the last consumer sectors to exit lockdown. In addition, they are likely to face the most significant operational challenges from social distancing. Germany is yet to ease lockdown for restaurants and bars, but looking to China the capacity constraints placed on businesses there in response to social distancing is having a material impact on cash-flow and profitability. In light of this a number of London F&B operators have already suggested that they are unlikely to re-open sites for 'sit-in' customers until there is a more generous easing of social distancing measures that ensures sites can be operated profitably.

The outlook and trajectory of the recovery in footfall and spend across Central London will become clearer once non-essential retailing is able to re-open and the social distancing measures required are better understood. However, what is key to remember is that social distancing measures will not be in place forever, and the features that make London an attractive place to visit, shop and work in remain unchanged.

STRONG START TO 2020 INVESTMENT ACTIVITY BUT OUTLOOK IS MUTED

Central London retail transaction volumes reached £332.0m in Q1 2020, up 29.1% on the previous quarter, albeit down 52.2% year-on-year largely in response to a large single transaction in Q119. This is reflected in deal count, with Q120 deal activity up a third year-on-year to total 12 individual deals. This includes notable transactions such as Hines acquiring 80 New Bond Street and 325 Oxford Street from Aviva Investors for £135.2m in February. This highlights the confidence that existed for prime, high footfall pitches in the West End earlier in the year. Considering the occupational challenges facing retailing in Central London under lockdown, and the impact social distancing will have on performance over the short to medium term, investor confidence and activity is expected to be muted over the remainder of the year. This is likely to place upward pressure on prime yields going forward and is reflected in the upwards arrow added to the prime yield in Q1. However, for the opportunistic investor this may present an attractive opportunity.

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