RESEARCH

SHOPPING CENTRES
INVESTMENT QUARTERLY **Q1 2017**

Outlook

It has been a slow start to the year, with supply remaining a key constraint to transactional activity in the shopping centre market. With Brexit negotiations now underway, investors will remain cautious, with a continuation of the gap between vendors' and purchasers' aspirations

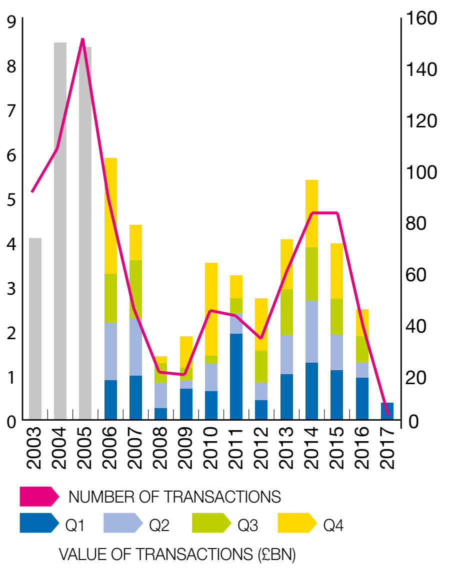
However, as retail assets become cheaper their value relative to offices and industrial property is starting to look appealing. We expect to see stock and sales volumes improve in the latter half of the year with appropriately priced stock finding reasonable liquidity.

Key Themes

As in Q4 last year, buying activity was subdued with just five shopping centres transacted in the first quarter. Geographically, we currently have a two-tier market with London and the South East benefitting from a stronger local economy, creating greater liquidity and currently providing the only transactional evidence for the quarter compared to the rest of the UK.

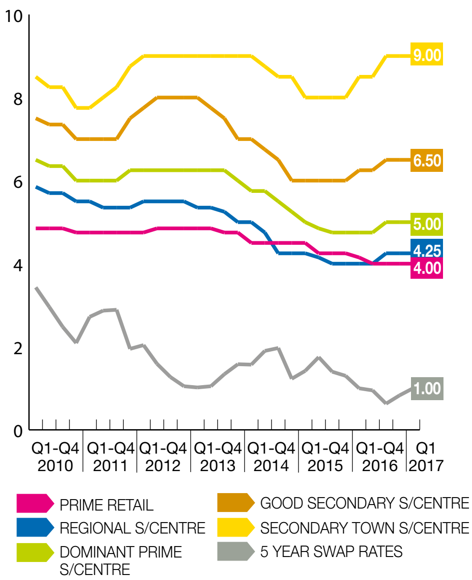
The occupational market remains flat, making an understanding of retailer motives and drivers even more vital. Landlords can greatly benefit from an understanding of their tenants' business model, especially the relationship between their physical stores and online presence. Evidence of a stronger working relationship between landlord and occupier becomes obvious in schemes where collaboration has helped to create a retailing environment that works for both parties, based on an understanding of what drives their tenants' profitability and thus sustaining rental and occupancy levels.

FIGURE 1
Shopping centre transactions
(LHS – Value of transactions, £bn)
(RHS – Number of transactions)



Source: Knight Frank LLP

FIGURE 2
Retail & shopping centre equivalent yields Q1 2010 - Q1 2017



Source: Knight Frank LLP

Q1 2017 shopping centres transactions

Shopping centre	Status	Purchaser	Vendor	Price (£m)	NIY %
The Belfy, Redhill	Sold	Milestone Trust	Bank of Ireland & KBC	£40.75m	7.50%
Buttermarket, Ipswich	Sold	DTZ IM	Capital & Regional	£54.7m	5.90%
Stratford Centre, Stratford	Sold	Frogmore	Catalyst / Blackstone	£141.5m	5.25%
The Exchange, Ilford	Sold	Capital & Regional	Meyer Bergman	£78m	6.70%

Source: Knight Frank LLP

Subdued retail sales performance

The heady growth in retail sales since the Referendum inevitably stalled somewhat in Q1. For the three months to end of February, the BRC reported retail sales growth across all categories of just 0.1%. Food sales growth (+2.0%) offset a decline in non-food categories (-2.6%), although both were subject to contrasting inflationary pressures. There is marginal inflation in grocery, but the anticipated price increases in non-food have yet to materialise.

Q1 – a shape of things to come for retail occupiers

Q1 was sobering for UK retailers, rather than universally bad. A more challenging quarter generally provides a telling foresight of the direction of travel for the rest of the year.

Consumer demand inevitably softened. Retail sales growth remains in positive territory, but is decelerating. Some, but not all retail sectors, have returned to an inflationary environment, an inevitable by-product of the devaluation of Sterling. There is still only marginal inflation in food, while non-food remains deflationary. For all the media speculation, inflation remains at manageable levels and there is still volume growth as consumers continue to spend.

The other two headwinds faced by the retail sector this year are coming to a head far more immediately. From April, UK retailers will have to contend with the double-whammy of business rate revaluations and an increase in the National Living Wage. In the former instance, those most heavily exposed to Central London will be the hardest hit. To combat the latter, there is already significant evidence of major retailers restructuring their respective workforces in order to trim costs.

As anticipated, Q1 has also seen a degree of occupier fall-out in the shape of Blue Inc's CVA and Jones the Bootmaker's and Brantano's likely administration. These are relatively isolated instances of retailer difficulty rather than universal distress and we maintain that retail casualties for the year as a whole will be fairly minor in scale.

Debt Market

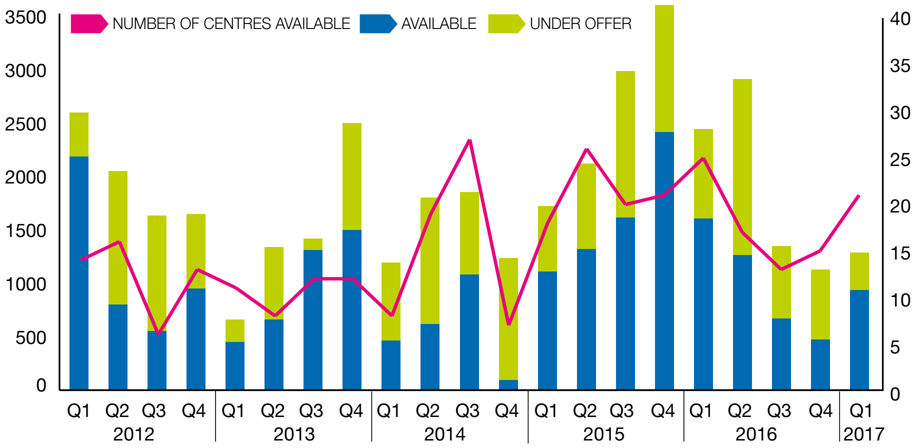
The terms lenders would provide for a prime shopping centre and borrower with whom a lender has a good relationship, shows margins ranging from 150 bps for a super prime centre up to about 200bps for prime. Average loan to value ratios have moved in to around 50-55% from around 60% last quarter, and up to 60% with some amortisation.

Knight Frank advised the purchaser of Belfry Shopping Centre, Redhill

- February 2017
- Freehold
- Price: £40.75m
- Size - 250,000 sq ft
- Vendor – Bank of Ireland & KBC
- Purchaser - Milestone Trust
- NIY – 7.50%

FIGURE 3

Shopping centre availability (LHS – Value of availability, £m. RHS – Number of centres available)



Source: Knight Frank LLP

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