RESEARCH

SHOPPING CENTRES

INVESTMENT QUARTERLY **Q2 2017**

Outlook

In a continuation of last quarter's theme, turnover volumes have remained very low for the year to date, borne out of a lack of investment demand as opposed to a lack of supply. We expect that, with institutional cash seeking only the most prime assets, and limited investor depth in the market as a whole, the remainder of 2017 will remain challenging. There will come a point soon after, however, when relative to other sectors and other geographies, UK shopping centres will start to look attractive once again.

Key Themes

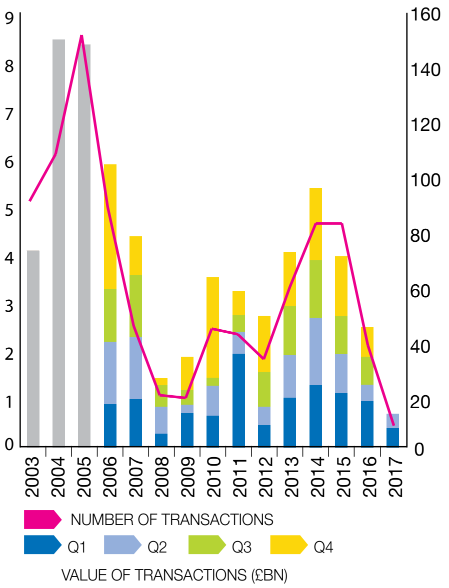
Total volumes this year are less than £720m, which, relative to average annual turnover in this sector of ca. £4bn, is exceptionally low. Those centres that have been marketed have often struggled to generate good pricing and that has deterred other owners from formally offering their schemes to the market. Where there have been exceptions and pricing aspirations have been achieved, individual buyers are often significantly ahead of market pricing and it remains to be seen whether they perform. Many centres on the market have been out for a number of months, with some being re-priced, and others ultimately being withdrawn and many refinanced.

The best sales have been those of centres in London and the South East, for example Southside Wandsworth, Stratford Centre Stratford, and The Exchange Ilford, where demand has remained relatively strong, buoyed by a positive occupational and rental growth story, residential development angles and/or wider infrastructure improvements.

FIGURE 1

Shopping centre transactions

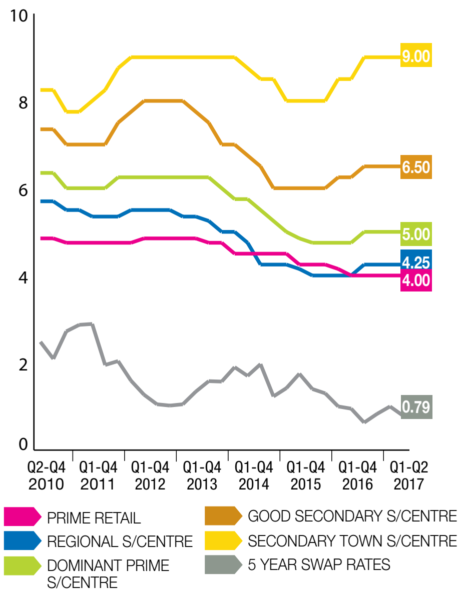
(LHS – Value of transactions, £bn)
(RHS – Number of transactions)



Source: Knight Frank LLP

FIGURE 2

Retail & shopping centre equivalent yields Q2 2010 - Q2 2017



Source: Knight Frank LLP

Q2 2017 shopping centres transactions

Shopping centre	Status	Purchaser	Vendor	Price (£m)	NIY %
Waverley Mall, Edinburgh	Sold	Moorgarth	Catalyst / Starwood	£23.25m	8.00%
Southside, Wandsworth	Sold	Invesco	Land Securities / Delancey	£150m	4.40%
The Strand, Bootle	Sold	Sefton Council	Ellandi / Avenue Capital	£32.5m	8.70%
Friars Walk, Newport	Sold	Talisker	Queensberry	£83.5m	5.66%

Source: Knight Frank LLP

Erratic retail sales performance

A year on from Brexit, the UK consumer is continuing to spend. This is despite mounting political uncertainty and a growing gap between retail price inflation and wage growth. For the three months to end of May, the ONS reported that retail sales values grew year-on-year by 4.9%. Even stripping out inflation, retail sales volumes were still up 2.6%. These largely robust numbers masked a more erratic monthly picture, with a very strong Easter period in April counterbalancing more modest growth in March and May.

Headwinds become stronger in Q2

Retail sales growth is only one side of the equation for retail occupiers. While enduring consumer spend is providing some relief on the top line, much of the pressure is currently on the bottom line. Two of this year's three key headwinds kicked in during Q2, namely the increase in the National Living Wage and business rate revaluations, which both took effect from April. In the latter case, those retailers most exposed to Central London are the most affected. The former is more a nationwide issue and there is ongoing evidence of retailers looking to cut overall staff costs to counteract wage increases.

The third headwind, higher input costs on the back of Sterling's post-Brexit devaluation, is already in force. The obvious net effect of this has been rising inflation, with RPI climbing to 3% during Q2. Much has been made of this in the media, particularly in reference to lower wage inflation, but these economics have yet to filter through to retail spending. Pricing pressure is likely to intensify further in the second half of the year, but will then ease as earlier increases annualise and drop out of the equation.

The mood amongst retailers generally is of caution, rather than distress. Occupier fall-out during Q2 was fairly limited and any would-be casualties (Jaeger, Joy, Theo Fennell, Jacques Vert) were bought out or sold, rather than liquidated. Despite widespread pressure, the UK retail market is again demonstrating the resilience it is seldom given credit for.

Debt Market

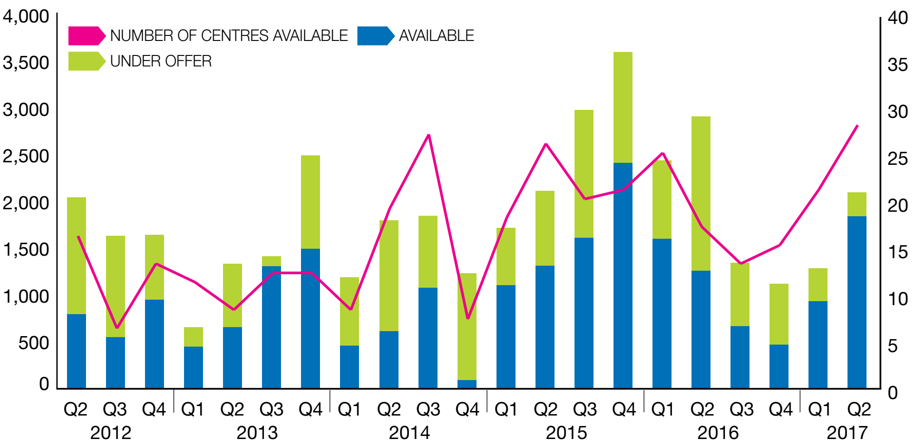
Finance continues to be available for the right borrower and product, with lending margins ranging from 150 bps for a super prime centre and nearer to 175bps for a prime centre. Senior debt remains generally available with average loan to value ratios at 50-55% LTV on an interest-only basis, and up to 60% with some amortisation.

Knight Frank advised the purchaser of Southside Shopping Centre, Wandsworth

- April 2017
- Long Leasehold
- Price: £150m
- Size – 530,000 sq ft
- Vendor – Land Securities / Delancey
- Purchaser – Invesco
- NIY – 4.40%

FIGURE 3

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



Source: Knight Frank LLP

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