RESEARCH

UK MARKET OUTLOOK MARCH 2015

RETAIL AND THE RECOVERY

For office and industrial property the new cycle is firmly underway, and investor interest has broadened to engulf the near entirety of both sectors. However, for retail the figures remain patchy, and comparatively disappointing. What could bring about a convincing sector-wide upturn?

The market in a minute

All property capital growth index rose by 0.4 % in February m-on-m, which is little changed on January*

Offices saw the highest capital growth (0.6%), and retail the lowest (0.1%)*

12 month total return fell to 18.6%*.

Investment volume for February 2015 was £3.5 bn, up from £3.1 bn in January**

* Based on IPD figures
** Based on Property Data figures

Retail has been consistently the worst performing IPD sector on capital growth, total return, and rental growth for nearly three years now. This is not to say the whole sector is moribund – far from it. Central London standard shops were one of the first areas of real estate to rebound from the dark days of 2008-2009. All the retail sub-sectors covered by IPD are reporting capital growth on a 12-month comparison, although on a month-on-month basis some are losing momentum or even falling again.

However, it is the comparative performance where retail has been lacking, as shown by figure one. Retail has markedly underperformed offices and industrial. Of the twelve sub-sectors that make up IPD's office index, nine recorded double digit capital growth on a twelve month basis, and three saw high single digit increases. Of the 25 sub-sectors that make up the retail index, only one achieved double-digit growth, and 13 are in the low single digits.

What is particularly worrying about figure 1 is that the retail line seems to be plateauing, despite the underperformance. This is surprising given that there has been a rebound in buyer interest in UK commercial property, which is shown in rising investment volumes and more money flowing into unit funds.

Nevertheless, one has to wonder whether the pessimism surrounding retail has been so bad for so long that it is now looking overdone. The UK public have put the recession far behind them and are shopping again. The retail sales figures have been strong for some time, while inflation is very low and unemployment is falling. Yes, the supermarkets have a struggled lately, but non-food store sales have more than compensated.

JAMES ROBERTS
Chief Economist

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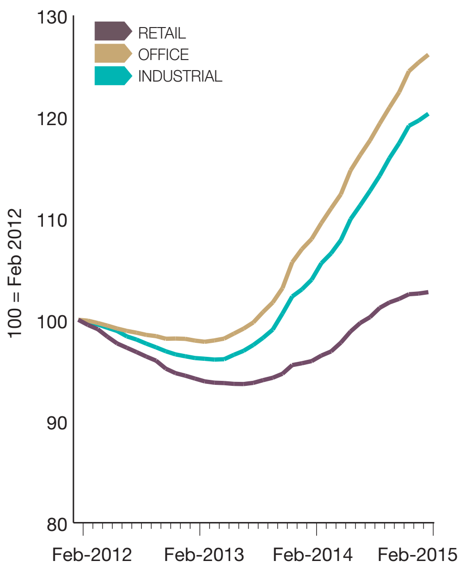
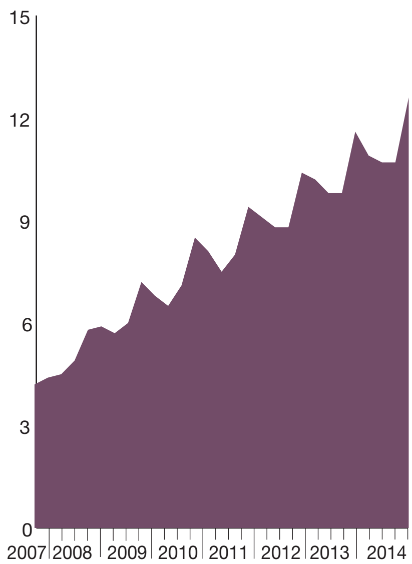
FIGURE 1
IPD capital growth by sector



Source: IPD

FIGURE 2
Internet as % of retail sales



Source: ONS

Moreover, with the economy widely expected to grow by a similar level in 2015 as last year, and wage rises now positive again in real terms, there is reason to feel confident on the outlook.

Yes, there is the issue of the continued rise of internet shopping, although retailers are now becoming more adept at using the internet and physical shops to support each other. Click-and-collect is increasingly being promoted ahead of home delivery, and Apple has shown us how successful the shop can be as a showroom and customer service centre.

As figure 2 shows, internet as a share of total retail sales tends to spike in Q4, with the monthly figures indicating the surge mainly occurs in November and December. This could support the argument that the public are shopping strategically, using the internet to avoid crowds or get around stock shortages. Consequently, those retail locations that are successfully evolving towards being ‘destinations’ with food and drink outlets and leisure facilities, should be well placed to serve a future consumer who views shopping as part of a day out; but is happy to make the actual purchases online.

There is also the issue of over-capacity of retail property stock. Both the IPD figures and footfall data from BRC/Monitor paint a worrying picture for shopping centres. This is probably the mature centres dampening the figures and it is difficult to see where investment for rejuvenation will come from.

This brings greater clarity to the underperformance for retail in the IPD figures. There remain distinct pockets of bad news, which despite an economic recovery are not dissipating as quickly as one would expect. However, from an investor perspective if one knows what to avoid, this allows you to concentrate on where opportunities are found.

A buyer’s tick list is now in evidence that favours destination, convenience, modern malls, shopping parks, food & drink, and leisure. While on geographic spread we have moved away from the London versus the rest polarisation of three years ago, to recovery in the South East, Midlands, major regional city centres and modern out-of-town parks.

If we add on the weight of money effect, as property investors struggle to source appropriate assets in the office and industrial sectors, then there is a compelling case for price growth in large parts of retail. The day one could hang a ‘buy’ sign over the whole sector is still a very long way off, and careful stock selection is needed, but there are opportunities.

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