UK retail sales continue to grow

UK retail sales grew for the 30th consecutive month in October 2015, although volume growth remains driven by discounting.

£2.8bn on market or under offer

Despite volumes being down compared to 2014, we are aware of £2.8bn currently under offer or on the market.

Shopping centre rents growing

Solid levels of occupier demand are driving rents in UK shopping centres. However, on a regional basis, it is likely that this recovery in rental values is patchy.

UK Retail Economy

UK economic growth slowed to 0.5% in the third quarter, down from a 0.7% expansion seen in the previous quarter. On a yearly basis, the economy grew by 2.3%. The latest data marks 11 consecutive months of positive growth in the UK and its longest stretch of growth since the 2009 financial crisis. While growth continued in the three main sectors: services, manufacturing and agriculture, industrial output was weaker than expected and growth in the construction sector declined by 2.2%. Looking ahead, domestic demand is expected to remain robust, buoyed, in part, by low inflation and a pickup in wage growth. As a result the UK economy will remain healthy in the final quarter of the year, bringing overall GDP growth of a respectable 2.3% in 2015.

After several years of strong economic growth, BNP Paribas are forecasting a slight slowing in the rate of GDP growth to 1.7% for 2016. For the same period, household spending is expected to grow at 2.3%.

Unemployment has continued to fall, reaching 5.2% for the 3 months to October 2015, its lowest level for 7 years. We still anticipate that this level will fall further by the end of the year.

The tightening in the labour market has meant a reduction in the pool of available labour, ensuring that wages have continued to increase. Average earnings (excluding bonuses) increased by 2.1% in the 3 months to October 2015. We are forecasting that this will increase to 2.9% in 2016.

UK retail sales grew for the 30th successive month in October 2015, growing by 3.8% y-o-y. It is still unclear as to the effect Black Friday will have on total UK retail sales in November, but it is expected to have been online sales that will have profited most from the event.

The growth in sales continues to be driven by falling prices. Average store prices saw their 16th consecutive month of y-o-y decreases. The supermarket sector has also been affected by falling prices with the volume of sales growing by 1% in the past year, but with the amount spent decreasing by 1.5%.

Consumer confidence fell for the third consecutive month in November 2015, according to the GfK Index (Fig 1). Despite the majority of personal economic fundamentals moving in the right direction, the UK consumer is being affected by wider economic and political issues.

Footfall across the UK declined by 2.1% in November 2015. Shopping centres and high streets saw falls of 2.8% and 3.4% respectively. Retail parks continued to see solid increases with footfall growing by 2% y-o-y. Black Friday failed to attract the numbers to the high street which it did last year, as consumers preferred to look for bargains online.
Occupier

The latter half of 2015 has been largely encouraging for shopping centre occupiers. Despite a slight slowdown in the broader economic market, the UK consumers’ propensity to shop seems to have been relatively unaffected. Retailers including Ted Baker, Jigsaw, Next and Supergroup have reported very positive like-for-like figures on the run up to Christmas.

Black Friday has been the focal point of pre Christmas strategies for many retailers. For many, this came down to a decision of whether to participate or not. Asda’s recent admission that not being involved with the melee of retail sales was one of their best decisions this year was a fairly damning indictment on the event. In terms of sales, the only winners from the event were the online operators. Physical stores struggled, with footfall for the week of the event down by 2.6% according to Springboard. Whilst the poor weather may have played a slight part in this, consumers’ decision to participate online rather than braving the crowds on the high street is more likely to have been the cause.

Occupational conditions have remained positive at the end of 2015. Expansion plans are still focussed on the top UK towns with strong demographics. This years’ new additions, such as Friars Walk, Newport and Grand Central, Birmingham opening with low levels of vacancy has illustrated that tenants remain very keen on modern centres, where units correlate directly with current spatial requirements.

As has been the case for the past couple of years, we anticipate that F&B will continue to represent a large segment of both tenant demand and landlord mix requirements. This will come in the form of existing operators such as Restaurant Group (whose brands include Frankie and Benny’s, Chiquito and Coast to Coast) which planned to open a further 50 restaurants over the course of the year and newer players such as Le Bistrot Pierre which has opened its 15th restaurant in Newport in November 2015.

This has ensured that vacancy rates generally within shopping centres have continued to fall across the UK. The total shopping centre vacancy rate for the UK fell by 0.2% to 15.6% in Q3 2015. Significant regional disparities do still exist. Centres in the South East and London unsurprisingly boasted the lowest vacancy rates of 12.8% and 10.5% respectively. Conversely the West Midlands and the North East had the highest of 20.1% and 18.4%.

Although very moderate, shopping centres have seen a return to rental growth in the past two quarters according to IPD. The Index grew by 0.4% in Q2 and 0.1% in Q3. This has been largely in line with other retail subtypes, indicating a generally healthy sector.
Investment

The momentum which picked up in the first 6 months of the year has not been replicated in the second part of 2015, with £1.55bn invested into the sector (Fig 2). Whilst total investment was down by 42.1% compared to H2 2014 (albeit with 2 weeks left of the year), slightly soft volumes were experienced across all retail subsectors, with total retail investment down by 38.7%.

However, we are aware of £2.8bn worth of centres which are either under offer or currently on the market, which should bolster the total volume for the year and will certainly deliver decent volumes for the first half of 2016. If the sale of Grand Central, Birmingham goes to plan then it will be the largest retail transaction in the second half of the year in the UK.

Secondary centres made up around half of investment for the latter part of 2015. This has been driven by a combination of lack of availability and extremely sharp pricing for prime/ regional product.

Shopping centre prime yields began to diverge in the second half of 2015 (Fig 4). Prime centres saw yields for the best stock move inwards by 25 bps to 4.25%. At the other end of the spectrum, secondary and local centres saw their yields move out by 25 bps.

Norges Bank Investment Management’s purchase of West One Shopping Centre, Oxford Street, London was the largest transaction within the second half of 2015. The centre was purchased from Orchard Street for £240m at a 3.46% initial yield.

Outside of London, LGIM’s purchase of the Grafton Centre, Cambridge was significant, with the fund manager paying M&G Real Estate £99m, at an initial yield of 5.25%.

The profile of buyers in the second half of 2015 was quite different to the corresponding period in 2014 (Fig 3). Overseas buyers made up 51% of the total volume, though this was primarily driven by the purchases of the chunkier lot sizes in the period - West One Shopping Centre, W1, the Eastgate Centre, Inverness and Houndshill Shopping Centre, Blackpool. Property companies involvement was more limited in the second part of the year, due to the lack of availability of super prime regional stock.

<table>
<thead>
<tr>
<th>Address</th>
<th>Size (000’s sq ft)</th>
<th>Vendor</th>
<th>Price (£m)</th>
<th>Yield (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>West One Shopping Centre, W1</td>
<td>90</td>
<td>Norges Bank Inv Mgmt</td>
<td>240.0</td>
<td>3.46</td>
</tr>
<tr>
<td>Angel Central, N1</td>
<td>151</td>
<td>CBRE Global Investors</td>
<td>171.2</td>
<td>4.10</td>
</tr>
<tr>
<td>Eastgate Centre, Inverness</td>
<td>350</td>
<td>Harbert European RE Fund</td>
<td>127.0</td>
<td>6.7</td>
</tr>
<tr>
<td>Houndshill Shopping Centre, Blackpool</td>
<td>302</td>
<td>New Frontier Properties</td>
<td>105.0</td>
<td>6.5</td>
</tr>
<tr>
<td>Grafton Centre, Cambridge</td>
<td>500</td>
<td>L&amp;G UK PIF II</td>
<td>99.0</td>
<td>5.25</td>
</tr>
</tbody>
</table>

Source: BNPPRE Research, Propertydata

Outlook 2016

Whilst the majority of fundamentals are improving in the retail sector, with both rising rents and occupier sentiment buoyant, challenges will still remain.

Firstly in terms of retailer demand, the regional divide still exists. For those centres outside either the South East or the top 100 towns within the UK, tenant demand is patchier, which can be seen in the regional shopping centre vacancy rates.

Secondly, the level of pricing for the secondary market will be of great importance. With several deals at the tail end of 2015 stalling or being sold at much softer yields than quoting such as Aylesbury and Stockton, the issue was clearly that some investors did not feel that pricing was in line with the quantum of risk being taken on and also the combination of low yields and potentially higher future borrowing costs raises doubts about exit prices.

Alongside these wider market based risks, the ongoing challenge will remain good stock selection. Solid availability of secondary stock going into the new year will ensure that investors are not forced into taking on more challenging schemes at the wrong price, but site specific risks continue to exist in areas outside of core UK retail locations which investors must be aware of.

Stuart Cunliffe, Head of Shopping Centre Investment, provides his predictions on the 2016 market

2016 will be another busy year for shopping centre investment.

Sales in the coming year will still include a good proportion of bank loan related stock, with several large loan portfolios and several consensual sales being likely. A prime example is the imminent marketing of Merseyway in Stockport which is to be sold by Societe Generale.

Other sellers will be those that bought wisely in 2010-2014 and will now looking to crystallise that profit. Intu stated earlier this year that it would be selling in order to refurbish and extend Lakeside. I expect other REITS to follow suit and to look to upgrade their portfolios.

2016 will also be a busy year for letting agents and asset managers as they look to create new units, lease vacant space and grow income. A good proportion of the UK shopping centre stock is now old, with smaller retail units and a low leisure component. Rental levels in many centres are now low enough for schemes to be reconfigured to provide larger units in line with current retailer and leisure operator requirements.

The improved letting and funding market should also see the viability for new schemes improve and I would hope that new city centre schemes in Chester, Guildford, Sheffield, Swansea and Coventry may finally start to move closer to reality.
Fig. 1
GfK Consumer Confidence

Fig. 2
Shopping Centre Investment volumes (to date)

Fig. 3
Shopping Centre Investor Type Breakdown

Fig. 4
Prime Shopping Centre Yields

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