**BNP PARIBAS REAL ESTATE**

Real Estate for a changing world

*At a Glance*

# RETAIL FOCUS
Q3 2017

RESEARCH

## The Stats... At a Glance

| | | |
|---|---|---|
| GDP | 1.50% | ▼ Forecast '17 |
| CPI | 3.0% | ▲ September '17 |
| GfK Consumer Confidence | -9 | ▲ August '17 |
| Unemployment | 4.4% | ▼ June '17 |

Source for all charts BNP Paribas Real Estate//Property Data/ BRC Nielsen/ ONS


## The Retail Market

Inflation hit its highest level since April 2012 at the end of Q3 2017, with CPI rising to 3.0%. We expect this to rise further, peaking by end of 2017. BNP Paribas is forecasting that the BoE will leave the rate unchanged until late 2018. However, with CPI inflation likely to exceed 3.0%, in the coming months, the likelihood of a rate rise in the first half of 2018 has now increased, particularly in light of Governor Carney's recent comments.

Consumer confidence remained muted in September, with the value of the GfK Index falling by only 1 point. Whilst confidence in personal finances fell, two of the major components of the Index increased in September, including consumers' future propensity to spend on big ticket items. Overall, this ensured that the Index witnessed an improvement. We do not anticipate that consumer confidence will increase hugely in the coming months, with rising prices and sluggish wage growth sustaining pressure on household incomes.

Retail sales within the UK fell shy of expectations in Q3, with volumes growing by only 0.6% over the period, the weakest growth in four years. In addition, sales volumes declined by 0.8% in September, compared to August 2017. This weak performance was driven by 3.3% growth in shop prices, the highest y-o-y rate witnessed since March 2012. Non-food store sales were the biggest contributor to the decline in sales, whilst food store sales also witnessed a downturn.

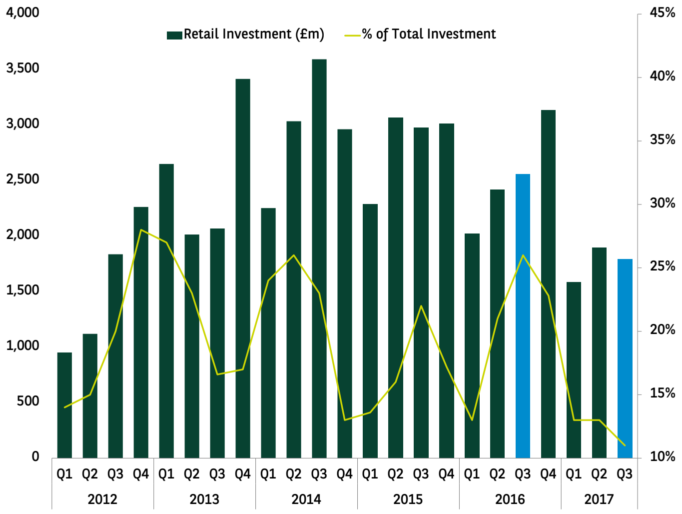
Online sales remain the most rapidly growing segment of the retail market. In August, the IMRG/Capgemini Online Retail Sales Index recorded growth of 16.4% y-o-y. Home goods and Clothing recorded strong sales in August, whilst Electricals saw sales fall for the fifth month in a row.

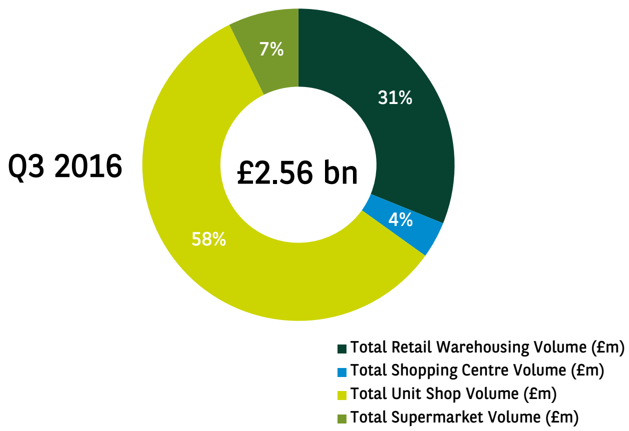
Footfall across the UK decreased by 1.2% in September, according to the Springboard/ BRC Footfall Index. High streets saw the biggest fall with shopper numbers dropping by 2.2%, with declines witnessed in every region in the UK, with the exception of the East of England. Shopping centres also saw footfall decrease with a decline of 1.0%. Positively, retail parks saw shopper numbers increase with an uptick of 1.1%.

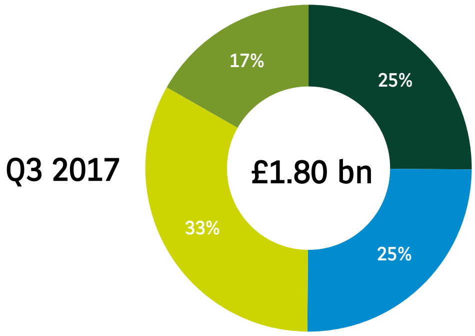
## Contacts

**Nick Robinson**
Research
020 7338 1016
nick.robinson@bnpparibas.com

# The Investment Market




On an overall basis, commercial property investment witnessed a strong performance in Q3 2017, with just shy of £16bn invested - the highest quarterly volume since Q4 2015. This was predominantly driven by the central London office market which saw some extremely large lot size transactions over the period. In contrast, investment into the retail sector fell by 30% y-o-y and by 3% compared to the previous quarter. Investors remain cautious over a sector which over recent months has continued to be plagued by uncertainty over both occupier intentions and macro-economic pressures.

# Retail Warehousing

Investment into the retail warehouse sector continued at a steady pace in Q3 2017, with £451m invested over the period. In Q3, similarly to the rest of the year, investment has been moderate due to a shortage of stock as opposed to a lack of demand for the product. Occupiers expansion plans have remained cautious, especially in the DIY and home improvement sectors, where a slowdown in the housing market have caused slowing sales.

There is currently a quite large divergence in demand for different lot sizes. At the prime end of the spectrum in particular, there is very strong demand in the £10m-£20m size bracket. Recent transactions include Collingwood Retail Park, Fareham, which was purchased by Columbia Threadneedle for £17.22m, reflecting 5.40% NIY which represented a 85bps premium.

At the larger lot size end of the spectrum in the £30m+ bracket, the potential number of buyers is relatively steady. There were however several transactions at this level in Q3 2017. Royal London's purchase of Pipps HIll Retail Park, Basildon was the largest transaction of the quarter. The 225,000 sq ft was bought from Hermes REIM for £86.60m, reflecting 5.62%

Prime yields for the retail warehouse sector remained fairly static in Q3 2017. Over the course of the last year, yields for the prime Open A1 segment of the market have drifted by 50 bps to 5.00%.

# Indicative Prime Yields (NIY)

| | Q3 2016 | Q2 2017 | Q3 2017 |
|---|---|---|---|
| Open A1 | 4.50 | 5.00 | 5.00 |
| Bulky Goods | 5.75 | 5.75 | 5.50 |

# Key Deals

| Address | Price (£m) | Yield (%) | Purchaser | Vendor | Date |
|---|---|---|---|---|---|
| Pipps Hill Retail Park, Basildon | 86.60 | 5.62 | Royal London AM | Hermes REIM | Sep-17 |
| Riverside Retail Park, Chelmsford | 53.00 | 5.50 | M&G Real Estate | BA Pension Fund | Sep-17 |
| Collingwood Retail Park, Fareham | 17.22 | 5.40 | Columbia Threadneedle | Eskmuir Properties Ltd | Sep-17 |
| Exe Bridges Retail Park, Exeter | 31.00 | 6.20 | Legal & General I.M | LaSalle I.M | Aug-17 |

# Shopping Centres

Shopping Centre investment remained fairly sluggish in Q3 with only £448.8m invested over the period. This represented a large increase compared to Q3 2016, albeit an extremely weak quarter in the wake of the vote to leave the European Union.

Concerns over the occupational side of the market has meant that some investors have remained ambivalent on the shopping centre segment. With occupier expansion strategies primarily focussed on large cities and good quality centres, it is the secondary segment which has witnessed declining demand. Demand exists for the prime end of the market, though it is a lack of supply which is repressing investment.

This sentiment has been reflected in pricing for the shopping centre market. Yields for prime, regional centres have remained at 4.50% though there has been very little evidence for this part of the market. Over the course of the year, pricing for secondary assets has softened markedly.

## Indicative Prime Yields (NIY)

| | Q3 2016 | Q2 2017 | Q3 2017 |
|---|---|---|---|
| Prime | 4.25 | 4.50 | 4.50 |

Royal London's purchase of a 7.5% stake in Bluewater for £155m was the largest investment of Q3. The stake purchased from Hermes REIM, values the centre at over £2bn. The purchase came in advance of GIC and Lendlease relaunching their combined stakes of 17.5% and 25% in the shopping centre, which are reportedly being marketed at £870m, c.4.5% NIY.

Hermes REIM also sold Castlecourt, Belfast in Q3, with Wirefox Investments paying £125m for the centre, reflecting 6.50% NIY. In 2009, the centre had been marketed at £350m, but was not sold.

## Key Deals

| Address | Price (£m) | Yield (%) | Purchaser | Vendor | Date |
|---|---|---|---|---|---|
| Bluewater (7.5% Stake) | 155.00 | 4.50 | Royal London AM | Hermes REIM | Sep-17 |
| Castlecourt, Belfast | 125 | 6.50 | Wirefox Investments | Hermes REIM | Jul-17 |
| Livingston Designer Outlet | 100 | 6.50 | Blackstone | LaSalle I.M | Sep-17 |

# High Street

The High Street investment market had a relatively quiet third quarter, with a noticeable summer "lull" and transaction volumes of £594m, down significantly on the same period in 2016. Demand continues to be split depending on lot size, with private investors in general, continuing to dominate the market for assets under £5m.

There is selective institutional demand for assets of the right quality, providing they are in the right location, with reversionary potential and let to strong covenants. Other sectors including industrial and alternatives have taken focus away from High Street retail, as some fund managers are looking to redistribute their sector allocations. Some institutions have sold much of their smaller high street assets to private investors in the past year to capitalise on strong pricing for the lower lot sizes.

The market for department stores had another active quarter, at the prime end, Jenners (House of Fraser) in Edinburgh transacting for a yield ahead of 4.75% and the Debenhams in Manchester has also been placed under offer. As locations weaken, buildings that are let on long leases, often with fixed uplifts, continue to be attractive to High Net Worth overseas investors as they are compensated with an inflated yield profile.

## Indicative Prime Yields (NIY)

| | Q3 2016 | Q2 2017 | Q3 2017 |
|---|---|---|---|
| Prime | 4.00 | 4.00 | 4.00 |

The most notable deal of the quarter was the purchase of 129-132 North Street in Brighton (let to Boots, Krispy Kreme and TUI) by Merseyside Pension Fund from John Lewis, it was originally earmarked for occupation by John Lewis, but a change of strategy resulted in the property being sold.

We have held prime yields on the high street at 4%, though demand is a little thinner than at this stage a year ago in the aftermath of the referendum. The secondary market is continuing to see a softening as investor demand is weak for assets which are located in weaker occupational markets.

## Key Deals

| Address | Price (£m) | Yield (%) | Purchaser | Vendor | Date |
|---|---|---|---|---|---|
| 129-132 North Street, Brighton | 31.55 | 4.52 | Merseyside Pension Fund | John Lewis Partnership | Jul-17 |
| 72-80 Clarence St, Kingston | 5.15 | 5.35 | Mountcharm | APAM Ltd | Aug-17 |
| House of Fraser, 47-52 Princes Street, Edinburgh | 53 | 4.68 | Anders Holch Povlsen | Glen Properties Ltd | Sep-17 |

# Supermarkets

With the economic and political situation in the UK remaining uncertain, a major focus for capital targeting the supermarket sector has been assets with long let secure income with index linked leases. A lack of new development coming online within the supermarket sector, combined with the dearth of sale and lease back activity has meant that product with unexpired terms in excess of 20 years is a rarity.

Generally speaking, this period of uncertainty in the wider retail investment market has meant a pick up in activity within the supermarket sector - the volume of £301.1m was an improvement on Q2 investment and represented a 61% increase on Q3 2016.

However, interest in the sector is very polarised. Pricing for either right sized, strong trading assets or South East units assets with high residual site values where residential development represents higher values are achieving yields of around 4.25%.

A recent example of this was Supermarket Income REIT's purchase of a Sainsbury's in Ashford Kent for £80m, reflecting 4.50% NIY. Supermarket Income REIT are one of only a few investors within the supermarket sector at this level of both pricing and lot size. In Q3 2017, the specialist investor also purchased a 55,000 sqft Tesco in Bristol (£28. 5m, 4.90% NIY) and a 78,000 sqft Tesco In Thetford (£43.2m, 5.35%).

## Indicative Prime Yields (NIY)

| | Q3 2016 | Q2 2017 | Q3 2017 |
|---|---|---|---|
| Supermarket | 4.75 | 4.50 | 4.25 |

Where supermarket investments fall away from prime attributes, with negatives such as location, suspect trading, over sized or over rented, the yields move out significantly. This can be seen on L&G's acquisition of the Tesco Extra in Kettering, which was bought off a very full rent at £51.55m, 5.85% NIY.

We anticipate increased appetite in the market for long dated investments with rents subject to open market rent reviews. The Sainsbury's in South Woodford is reportedly under offer at a price representing a yield in the region of 4.00% (25 years to J Sainsbury PLC). Other assets with a similar review structure look likely to trade in the coming quarter.

# Key Deals

| Address | Price (£m) | Yield (%) | Purchaser | Vendor | Date |
|---|---|---|---|---|---|
| Sainsbury's, Simone Weil Avenue, Ashford | 80.00 | 4.50 | Supermarket Income REIT | NFU Mutual Insurance | Aug-17 |
| Tesco, Kilverstone, Thetford | 43.20 | 5.35 | Supermarket Income REIT | M&G Real Estate | Aug-17 |
| Tesco, Lime Trees Road, Bristol | 28.50 | 4.90 | Supermarket Income REIT | Private Investor | Aug-17 |
| Tesco, Kettering | 51.55 | 5.85 | Legal & General I.M | Aviva Investors | Sep-17 |