BNP PARIBAS REAL ESTATE

Real Estate for a changing world

At a Glance

RETAIL FOCUS

Q1 2018

RESEARCH

The Stats... At a Glance

GDP

1.5%

▲ Forecast '18

CPI

2.5%

▼ March '18

GfK Consumer Confidence

-7

▲ March '18

Real Earnings

0.2%

▲ Feb '18

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

The Retail Market

The first quarter of 2018 could potentially be considered one of the most turbulent periods of recent times for the UK retail sector. From an occupational standpoint, the sector witnessed several administrations and numerous announcements regarding store consolidation programmes under CVAs. The highest profile of these failures were Toy'R'Us and Maplin, resulting in the closure of 105 and 211 stores respectively. Perhaps more significantly for the wider economy, the failure of just these two businesses resulted in the loss of around 5,500 jobs. Whilst consumer and economic pressures might have sped up the collapse of both retailers, it is more likely that failure to keep up with changing consumer preferences and a lack of investment in the physical store environment were factors contributing to their downfall.

The list of retailers either seeking a CVA or issuing profit warnings has also provided worrying signals for the health of the wider sector. New Look, Mothercare, Carpetright and Moss Bros have all made negative announcements. The F&B sector has also been adversely affected - Byron, Prezzo and Jamie's Italian have all announced plans to close restaurants. The introduction of the National Living Wage, rising costs of ingredients and increased business costs have all been cited as some of the main pressures on operators. However, after years of extremely strong growth in the sector, excessive expansion in the mid-market has also contributed to the sectors' current woes.

However, despite the dark clouds hanging over the sector and the freezing weather during the 'Beast from the East' in March, retail sales increased at the tail end of Q1 2018. The BRC-KPMG retail sales monitor found that like for like sales grew by 1.4% in March 2018 compared to the same period in 2017, with food performing particularly strongly.

Positively, this could be an indication that the strain on household finances might be easing. With the period of inflation triggered by the Sterling devaluation almost entirely washed through and with nominal wages increasing, February was the first time for over a year in which real earnings grew. On the upside real wage growth may result in increased consumer confidence and boost retail sales, the downside risk though is that with the economic outlook remaining ambiguous, extra earnings may well convert into savings.

Contacts

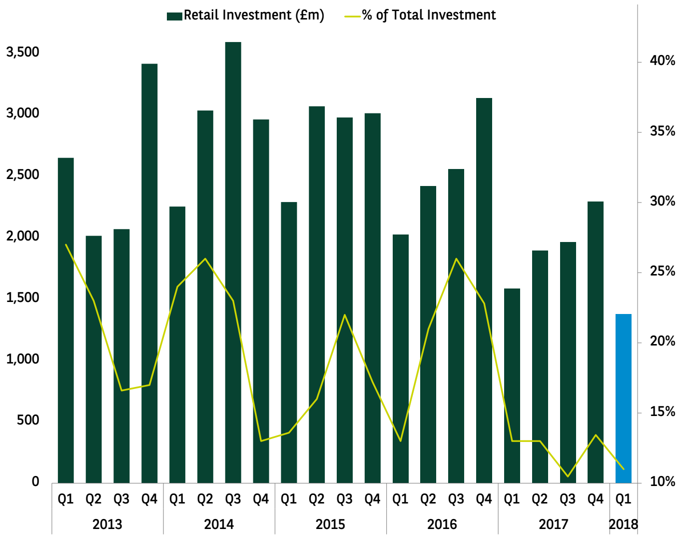
Nick Robinson
Research
020 7338 1016
nick.robinson@realestate.bnpparibas

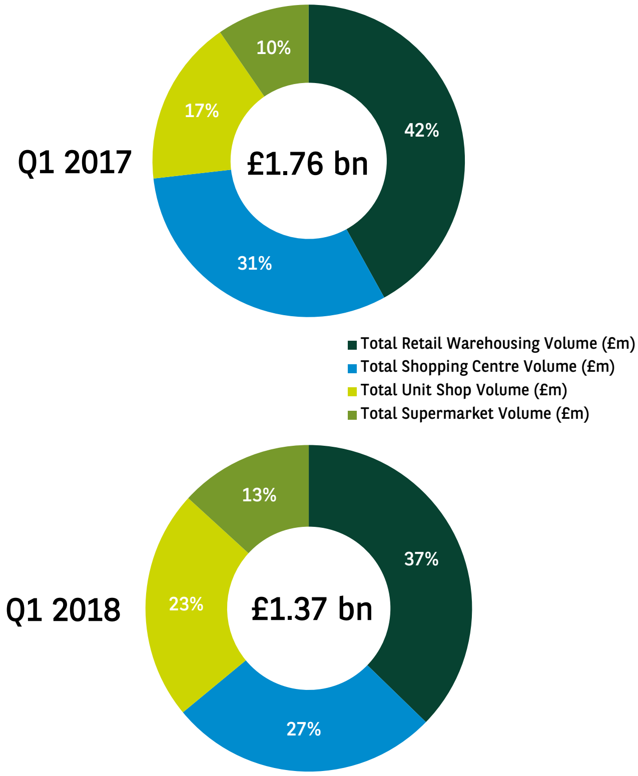
Rob Williams
Retail Agency & Development
020 7318 5153
rob.williams@realestate.bnpparibas

Antony Nickalls
In Town Investment
020 7318 5071
antony.nickalls@realestate.bnpparibas

Andrew Hulme
Out of Town Investment
020 7318 5008
andrew.hulme@realestate.bnpparibas

The Investment Market





CRE investment held up fairly well in the opening quarter of 2018. The total volume of £12.69 bn represented a 3.1% decline on Q1 2017.

Unsurprisingly, with the negative sentiment surrounding the sector presently, the retail market experienced a weaker quarter than expected with a total of £1.37bn invested, representing an 22% decline on the same period in 2017. Additionally, the percentage of total investment of which retail represents has been in decline over the past 5 quarters.

Retail Warehousing

The out of town investment market was the most active of the retail subsectors in Q1, with £512.7m invested over the period. That said, the volume perhaps looked a little inflated with several deals completing in Q1 actually being hangover from 2017.

Whilst the total volume represented a sizeable decline on Q1 2017, the decrease was due to a drop in average lot size - in keeping with the trend which we have witnessed over the past couple of years. indeed, there were only six deals over £30m in Q1 2018.

The increase in retail casualties in the first quarter has adversely affected the retail warehousing market. The failure of Toys'R'Us has resulted in a large number of closures - around two thirds of the retailer's stores were out of town. The failure of Maplin plus serious concerns hanging over Bunnings, Carpetright and Mothercare have all contributed to increased investor caution in the out of town subsector.

PropCos were the most active investor group within Q1, placing £217m into the sector, 43.3% of the total volume.

Tellon Capital's purchase of Chineham Shopping Park was the largest transaction of the quarter. The UK based PropCo paid £59m, reflecting a NIY of 5.85%. The 171,000 sq ft out of town centre is anchored by Tesco, M&S, Boots and Matalan.

Demand for solus stock remains very strong. A good indicator of the current level of pricing in Q1 was Aberdeen Standard's purchase of a Wickes sale and leaseback at Betts Way Crawley at a NIY of 4.50%. Subsequently, two further Wickes sale and leasebacks have been launched and are both currently believed to be under offer ahead of quoting, clearly demonstrating appetite for low risk, secure income product.

Indicative Prime Yields (NIY)

	Q1 2017	Q4 2017	Q1 2018
Open A1	4.50	5.00	5.00
Bulky Goods	5.75	5.50	5.50

Key Deals

Address	Price (£m)	Yield (%)	Purchaser	Vendor	Date
Chineham Shopping Park, Basingstoke	59.00	5.85	Tellon Capital	LGIM	Feb-18
North Worle Distict Centre, Weston-Super-Mare	37.50	5.92	North Somerset Council	British Land Plc	Mar-18
Wrekin Retail Park, Telford	32.25	7.42	Ediston RE	Hammerson Plc	Mar-18
Wickes, Betts Way, Crawley	10.40	4.50	Aberdeen Standard	Travis Perkins Plc	Mar-18

Shopping Centres

Shopping Centres had a continued quiet Q1 2018 with £367.9m invested in the first three months of the year.

The flow of deals was steady although with no prime / regional schemes trading the average lot size was a mere £38.78m. Occupational uncertainty within the sector has made the prospect of buying shopping centre assets more challenging for all investors.

Whilst the F&B sector has supported shopping centres over recent years the headwinds of occupational costs, competition and spend has significantly reduced demand and is now leading to increased vacancy.

Councils continue to be the dominant buyer of shopping centre stock with Q1, representing 69.3% of the total volume invested. Councils have only bought within their own jurisdiction and their rational is either town centre regeneration or income replacement for loss of government subsidies.

Indicative Prime Yields (NIY)

	Q1 2017	Q4 2017	Q1 2018
Prime	4.50	4.75	4.75

Two examples of these strategies were witnessed in Q1 2018. Firstly, Shropshire County Council purchased the three shopping centres in Shrewsbury (Darwin / Pride Hill / Riverside) where regeneration plans have been long delayed and where the Council has decided to take control. Secondly, Canterbury City Council purchased Whitefriars Shopping Centre which is the city's primary scheme, providing the prime retail pitch. Conversely, Whitefriars was bought predominantly for its secure income.

Key Deals

Address	Price (£m)	Yield (%)	Purchaser	Vendor	Date
Whitefriars, Canterbury (50% Stake)	75.50	6.50	Canterbury CC	TH Real Estate	Feb-18
Palace Gardens, Enfield	51.50	6.50	Deutsche AM	Aberdeen Standard	Jan-18
Darwin / Pride Hill / Riverside Centre, Shrewsbury	50.75	6.00	Shropshire CC	Aberdeen Standard	Jan-18

High Street

Wider market sentiment regarding High Street retail has been impacted in light of recent retailer CVA's. The likes of New Look, Maplin and East all have a large presence on the UK high street and the result is likely to be a softening of the High Street investment market.

There is still robust demand for the best high street assets, those with reversion and strong re-letting probability are likely to be more protected from the occupational market. In comparison, pricing appears to be moving out for more secondary assets, where significant threats to the income stream from the occupational market have deterred investors.

Investment volumes for Q1 2018 were underwhelming; with a total volume of £313.3m, this is not surprising in the current context of retailer trading and a trend which we foresee continuing in the short term until the occupational market stabilises.

Institutions and PropCo's represented the dominant sellers in Q1, representing 63% of the total volume. With many funds now attempting to reach their allocations in industrial, retail assets, particularly on the High Street, are often being sold to balance their portfolios.

Strong demand still does exist for trophy assets in prime Greater London locations, where there is a stronger occupational market and also alternative uses for high street retail. There have been examples of assets being placed under offer below 4% in this market within Q1, although the frequency with which this has happened has been reduced in comparison to Q4 2016.

Indicative Prime Yields (NIY)

	Q1 2017	Q4 2017	Q1 2018
Prime	4.00	4.00	4.00

Key Deals

Address	Price (£m)	Yield (%)	Purchaser	Vendor	Date
74-80 North End, Croydon	10.25	5.14	TH Real Estate	Square Asset Management	Jan-18
303 High Street, Lincoln	5.67	5.00	West Berkshire Council	CBRE Global Investors	Mar-18
84 The Promenade, Cheltenham	3.35	4.31	Alterity Investments	Private Investor	Feb-18

Supermarkets

Occupationally, the UK foodstore sector appears to be in a better state than it has been over recent years. Tesco's annual results announced at the beginning of April provided investors with a sense of renewed optimism - it was the retailer's first reporting period since its merger with food wholesaler Booker and significantly outperformed forecasts. After several years of management restructuring and reduction of rental liabilities, the UK's largest retailer appears to be bucking the downward trend for the wider retail sector in 2018.

Investors seeking long let, secure income continue to keep demand for supermarkets robust. The total quarterly volume of £181.8 represented a 7% uplift on the opening quarter of 2017. That being said, investment into the supermarket sector remains significantly below the 10 year quarterly average of £391.7m

One of the key issues affecting the sector currently is rental affordability being experienced on some RPI linked leases. As a result of rental growth driven by index linked leases, there is a degree of uncertainty as to where ERV's within the foodstore market currently stand, especially considering the lack of open market rental evidence from recent years. This unknown has resulted in some investors becoming increasingly wary of stock with shorter unexpired leases terms.

A distinct lack of prime stock has meant that pricing now stands at 4.25%, although this is still 25 bps off the sector's historic low of 4.00% seen in 2014.

The largest deal of the quarter was Invesco's purchase of a Morrisons store located at 399 Edgware Road, NW9. The store, which has 18 years of unexpired lease remaining, was purchased for £43.70m, at a 4.57% NIY. The pricing reflected the strong underlying residual values.

Indicative Prime Yields (NIY)

	Q1 2017	Q4 2017	Q1 2018
Supermarket	4.75	4.50	4.25

Key Deals

Address	Price (£m)	Yield (%)	Purchaser	Vendor	Date
Morrisons, 399 Edgware Road, NW9	43.70	4.57	Invesco	Aberdeen Standard	Mar-18
Morrisons, Church Street, Hunslet	31.3	4.48	Aviva Staff Pension Trust	Palmer Capital Dev Fund	Feb-18
Sainsbury, 181 High Street Beckenham	15.5	5.60	Odyssey Partners	CBRE Global Investors	Jan-18