RESEARCH

OUT-OF-TOWN
RETAIL & LEISURE

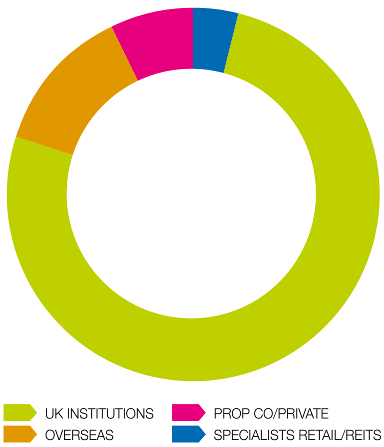
- Overall out-of-town retail transaction volumes increased to nearly £3 billion in 2014, up from c.£2.6 billion in 2013 – a marked increase, but not as substantial as the office market at £4.6 billion (excluding Central London) and £7 billion in the industrial sector, which was up over 30% from 2013.
- Of the £2.95 billion traded, this was dominated by UK buyers, especially UK institutions, who made up around 75% of the market. About 10% was transacted by overseas investors, but the majority of this volume was made up of Gingko Tree's stake in Fosse Park.
- Looking at the buyers' profiles in 2014, the ability to drive performance from asset management would suggest that the specialist REITS/owners should make up a higher proportion; this "creativity" may also act as a barrier of entry to new players. We would therefore expect more effective joint venture arrangements, especially for large assets and portfolios, to encourage a broader spectrum of purchaser.
- There was significant yield compression in 2014, mainly driven by weight of money, rather than property fundamentals or growth prospects. This resulted in a reduction in prime yields of around 100 bps for open A1, whilst secondary open A1, prime bulky parks and solus bulky moved in by around 50 bps.

12 month highlight and outlook

Knight Frank believes the reduction in prime yields has now plateaued, however we can foresee further hardening of yields for some perceived secondary assets (backed up by local growth forces) and also some solus product with appealing lease terms.

IPD total returns for the sector showed a 15.0% growth over the 12 months to December, principally driven by capital growth. Rental growth recorded a 0.2% increase for the same 12 month period. These total return figures are better than the equivalent high street and shopping centre returns, but significantly below the performance of offices and industrial in 2014 (23.5% and 24.0% respectively).

FIGURE 1
Retail warehouse transactions in 2014



Source: Knight Frank LLP

Looking ahead, capital growth will decrease across all sectors during 2015/16, but perhaps less markedly in the out-of-town retail sector. Pockets of renewed tenant demand will improve the prospects for some rental growth, but this will be countered by a significant proportion of lease expiries over the next 2/3 years, which occupiers will use to re-base rents.

But, the economic outlook for the consumer, and therefore some retailers, looks as good as it has done for years. Consumers and retailers will benefit directly from rising employment (which is at record high at the moment) and positive wage inflation, low oil prices, and the little prospect of an imminent interest rate rise.

While house price growth may be slowing, the improvement in the housing market will provide an additional boost to the retail sector. This is particularly true of the out-of-town market, much of which remains based around home-related products such as furniture, floorings, electronics and DIY.

All these factors have resulted in a steady growth of consumer confidence, which appears to be reflected in positive retail sales, healthy retail footfall, and another 10% year-on-year expansion of internet sales.

Despite concerns over re-based rents, the ability to downsize and re-gear is a much more positive story in 2015. Landlords may have to swallow some rent reduction, rent free and/or CAPEX, but in theory, they will have a happier tenant on a longer lease, thus improving the capital value.

Out-of-town retail yields

Retail warehouse asset	Q1	Q2	Q3	Q4	Q4 15 (forecast)
Open A1 Fashion Parks	5.00%	4.75%	4.25%	4.25%	▲
Secondary Open A1	6.00%	6.00%	5.50%	5.50%	▶
Bulky Goods Parks	6.00%	5.75%	6.25%	5.50%	▶
Secondary Bulky Goods Parks	7.25%	6.50%	6.25%	6.25%	▼
Solus Open A1 (prime)	5.75%	5.50%	5.00%	4.75%	▼
Solus Bulky (prime)	6.25%	6.25%	6.00%	5.75%	▶

Source: Knight Frank LLP

12 month highlights

Asset	Planning	Purchaser	Price	NIY
Next, High Wycombe	Open A1 (Solus)	Orchard Street	£19.70m	3.95%
Wickes, South Ruislip	Bulky (Solus)	Aviva Investors	£13.50m	5.75%
Blackwater, Farnborough	Open A1	Lothbury	£78.0m	4.25%
Leamington Spa	Open A1	Ignis	£72.0m	4.40%
Parc Trostre, Llanelli	Open A1	M&G	£156.0m	5.00%
Fosse Park, Leicester	Open A1	Crown Estate/ Gingko Tree	£345.0m	5.20%
Rom Valley, Romford	Bulky	IM Properties	£20.50m	6.10%
St Andrews Quay, Hull	Bulky	Orchard Street	£95.50m	6.10%
Winterhill, Milton Keynes	Bulky	RLAM	£21.80m	6.10%
Staples Corner	Bulky	Blackrock	£59.55m	5.90%

Source: Knight Frank LLP

Occupier market

The out-of-town sector has some serious challenges ahead, not least of which will be a continuing trend to rationalise space made possible by a significant number of lease expiries and breaks over the next 3 to 5 years. However, out-of-town is trending well against its high street and shopping centre competitors, achieving a 1.5% increase in footfall in Jan 2015, compared to negative stats for its rivals. Majority of retailers reported y-on-y sales up in January 2015 with volumes especially strong in clothing and furniture & carpets.

Two factors continue to drive out-of-town retailing namely housing and technology. The housing market, whilst "cooling" slightly, remains buoyant, both in terms of house prices and sales volumes (663,075 in 2012; 792,100 in 2013 and 836,026 in 2014), a trend which is set to continue in 2015 and 2016. House prices are affecting the relative wealth of the consumer and thus the likelihood of "investing" in their home. Technology comes in 2 forms: Firstly, rapid product innovation which has driven significant sales growth, especially in the electrical sector. However, over 40% of these transactions are now occurring online. Sales densities in this sector have halved since 2004, recognised by the likes of Dixons who have reduced their physical selling space by over 10% since 2009 whilst embracing new forms of retailing such as 'showcasing'. Secondly, the technology of retailing i.e. ease of purchase for the consumer ("can we have it cheaper and quicker") increasingly measured by the success of the multi-channel platform and efficiency of the retailers logistics.
It is estimated that retailers will require an additional 50 million sq ft of logistics space over the next 5 years, with nearly 60% of all new logistics take up being absorbed by online, general and food retailers.

There are mixed messages for the retail park owners. On the one hand, the release of space will continue (Argos and Homebase alone have over 300 lease expiries/breaks between them over the next 5 years) especially in the electrical and DIY market. The trend for 'softer' retailers is now well established, driven by the discounters (including Lidl and Aldi where planning permits), but increasingly by more 'high street' brands such as M&S, Next ('department' store concept) and Debenhams. The 'win-win' opportunity is in leisure, often cinema, but ideally A3 (restaurants) which has the double bonus of broadening the appeal of a park and also improving dwell time and footfall.

In the next bulletin, we will consider the importance of the housing market for out-of-town retailers. Home-related sectors continue to be robust, reflected in the extraordinary success of Dunelm, who now have a market cap of nearly £2 billion, have doubled their profits in the last 5 years and increased their store numbers by more than 60%. We will also explore the likely trends and impact of multi-channel retailing. With online retailing set to grow by 45% over the next 5 years and account for over 20% of all non-food spending, the reaction of the retailer, alongside the landlord, will be crucial.

RETAIL RESEARCH

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