Knight Frank

Retail News

RETAIL WAREHOUSING: CATCH A FALLING STAR

ISSUE 11

THE EYE OF A PERFECT STORM

An increasingly compelling investment case

ALTERNATIVE USE

Not necessarily a slam-dunk

KEY CLIENT INTERVIEWS

M7 Real Estate and Halfords

Key Takeaways

- HUGE VOLUMES OF CASH (MAINLY FROM PRIVATE EQUITY) ARE TARGETING THE RETAIL WAREHOUSING SECTOR.
- THE SECTOR IS CAUGHT IN A PERFECT STORM OF FALLING CAPITAL VALUES, A VERY CHALLENGED OCCUPIER MARKET AND RETAIL INDUSTRY STRUCTURAL CHANGE.
- OOT OCCUPIERS ARE NOT IMMUNE TO WIDER RETAIL STRUCTURAL FAILINGS, BUT ARE ALREADY SHOWING SIGNS OF STABILISATION.
- RETAIL WAREHOUSING RENTS REMAIN SUBJECT TO DOWNWARD PRESSURE – NO RETURN TO RENTAL GROWTH UNTIL 2022.
- RETAIL WAREHOUSING IS MORE 'ONLINE COMPLIANT' THAN IN-TOWN RETAIL AND IS MORE READILY ABLE TO FULFIL A NUMBER OF MULTI-CHANNEL FUNCTIONS.
- TUMBLING CAPITAL VALUES AND RE-PRICING INCREASINGLY BRINGING RETAIL WAREHOUSING INTO PLAY AS ALTERNATIVE USE (PREDOMINANTLY INDUSTRIAL AND RESIDENTIAL).
- THE FLIGHT TO ALTERNATIVE USE IS ONLY FINANCIALLY VIABLE IN VERY SELECT LOCATIONS – WITHIN THE M25 AND CERTAIN AREAS OF THE SOUTH EAST.
- INVESTMENT CASE FOR RETAIL WAREHOUSING AS A "GOING CONCERN" IS STRONG FUNDAMENTALS (E.G. TENANT AFFORDABILITY), OFFERING STRONG INCOME RETURN (6.1%).
- STOCK SELECTION IS KEY AND INVESTMENT DECISIONS (FOR BOTH "GOING CONCERN" AND ALTERNATIVE USE) REQUIRE VERY FORENSIC APPRAISAL.
- INVESTMENT MARKET MAY BE CLOSE ENOUGH TO THE BOTTOM FOR INVESTORS TO SEE BEYOND THE STORM - AND ACT NOW.

Introduction

Catching a falling star amidst a perfect storm. Or, catching a falling knife against a backdrop of shifting structural change.

Either metaphor is an apt summation as to where the retail warehousing market is right now. The out-of-town retail sector is as exposed to retail headwinds and deeper structural change as its in-town counterpart, albeit with the competitive advantage of being more online compliant (an opportunity that has yet to be exploited to the full).

After a couple of tumultuous years in which CVAs have dominated the narrative, occupier markets are slowly returning to something like a degree of stability. But expectations of a return to rental growth are little more than a pipe dream for the foreseeable future.

Retail warehousing capital values have already rebased significantly and investors are increasingly circling the sector for alternative use, be that industrial or residential, to name but two. The transfer of assets from an over-supplied sector to higher performing under-supplied ones may seem a no-brainer, but the reality is often far less clear cut. Only within certain geographies (largely the M25) do the financials stack up to make the repurposing process financially viable.

There is still an investment case for the right retail warehousing stock as a "going concern" – its "raison d'être" as a low cost, affordable, flexible, easily accessible alternative to the high street undiminished in the current retail environment. Income remains one of the sector's key selling points.

The level of cash (predominantly Private Equity) waiting on the sidelines for retail warehousing is astounding. The key question is whether the bottom of the market is in sight and when the time is right to invest.

How soon is now?

We would be delighted to discuss any issues raised in this report with you.

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Retail warehousing dashboard

Occupier Markets

194m
Total Retail Warehousing floorspace in 2019 (sq ft)

+351%
Total growth in Retail Warehousing rents 1981-2019

20%
Proportion of Retail Parks with peak rents >£30/sq ft

4.5m
Combined Retail Warehouse space of Toys 'R' Us, Maplin, Poundworld and Mothercare (sq ft)

-3.5%
Decline in Retail Warehousing rents in 2019

Alternative Use

457
Total identified Retail Park schemes in London & South East

6.7%
Retail Warehousing vacancy rate in London & South East

6.50%
Investment yields for Open A1 / Fashion Parks Retail Warehousing

-250bps
Discount of Open A1 / Fashion Parks to prime distribution sheds

£51.1m
Price paid by Prologis for Ravenside RP in Edmonton Jan 2020

Investment Markets

£1.7bn
Retail Warehousing investment volumes in 2019 across 116 deals

£4.9bn
Retail Warehousing investment volumes in 2015 across 190 deals

-12.2%
Decline in Retail Warehousing capital values in 2019

+10.6%
Average annual total returns for Retail Warehousing 1981-2019

+6.1%
Forecast annual income returns for Retail Warehousing over next 5 years

The Occupier: bedrock of the retail warehousing market

WORDS: STEPHEN SPRINGHAM – HEAD OF RETAIL RESEARCH

Totally immersed or completely immune? Where does retail warehousing sit in the well-documented retail storm? Or is it actually one of the root causes of wider malaise?

The very British tendency of referring to the retail market under the generic term of "the High Street" affords the retail warehousing market a slightly curious position. Given the constant "High Street" narrative, a casual observer could be forgiven for thinking that all the challenges and distress the retail sector is undergoing is restricted to the town centre based channels of standard shops and shopping centres. But they would be wrong.

But flying under the radar also has its negative sides. Consumers are far less precious about their local retail warehousing than they are their town centre. We often hear narrative around "saving the High Street". When was the last time anyone outside the property investment community talked about "saving the retail park"? Retail warehousing is far less emotive than its town centre counterpart channels, yet it faces many of the same challenges.

The 10 Key Structural Failings of UK Retail

We have previously identified and referenced '10 Key Structural Failings' in the UK retail market (see Retail News Issue 10 – 'The Price of Change'). To what extent, lesser or greater, do these apply to the retail warehousing sector?

The out-of-town retail market is unquestionably **over-supplied** – there is too much retail warehouse space in this country. While the rise of online has added infinite capacity and irreversibly changed traditional supply metrics, retail warehousing has also played its own part in creating structural imbalances. Retail warehousing was pioneered in the UK in the 1960s.

However, it was only as recently as the 1980s that widespread OOT development took hold. According to TW Associates, there is currently ca. 194 million sq ft of retail warehousing space in the UK. From a virtual standing start, the majority of this has come onstream in the last 30 – 40 years.

Top 12 Locations in the UK by Total Retail Warehousing Supply

Rank	Centre	Total RW Floorspace ('000s sq ft)
1	Glasgow	4,760
2	Belfast	3,064
3	Cardiff	3,035
4	Liverpool	3,012
5	Newcastle upon Tyne	2,912
6	Leeds	2,905
7	Edinburgh	2,818
8	Bristol	2,693
9	Birmingham	2,516
10	Manchester	2,434
11	Nottingham	2,259
12	Southampton	2,013

Source: PMA PROMIS, Knight Frank

Allied with the pace of retail warehousing development, many retailers have clearly **over-expanded**, seduced by a race for space. At the same time, many have not been ruthless enough in **managing the ugly tail** of under-performing outlets. There are exceptions to this – the 'new breed' of predominantly value operators such as The Range, Home Bargains, B&M and Dunelm are still acquiring – but the direction of travel amongst most of the other retail warehousing operators is to weed out under-performing stores and to retrench, rather than expand. New space requirements are limited and there is continued downward pressure on rents.

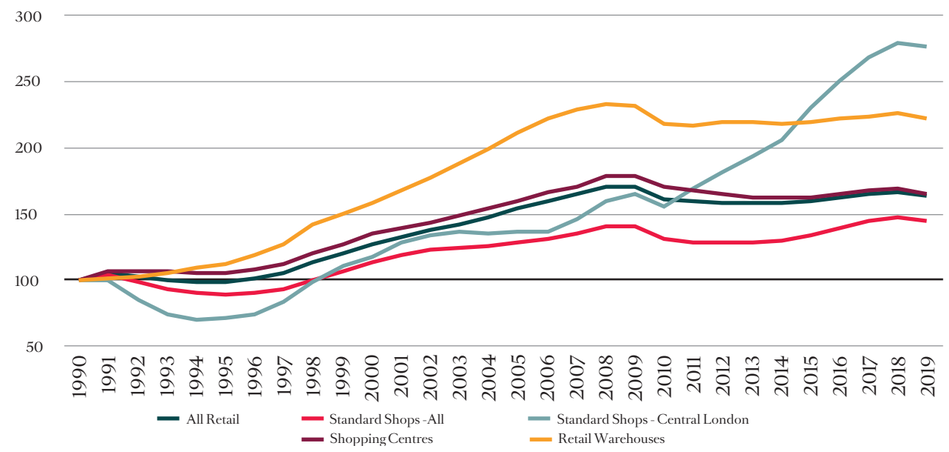
Top 12 Locations in the UK by Retail Warehousing Supply per Household

Rank	Centre	Total RW Floorspace ('000s sq ft)	Number of HHs ('000)	RW Floorspace per HH
1	Merthyr Tydfil	631	19	33.2
2	Llanelli	458	16	28.6
3	Stockton-on-Tees	1,291	57	22.6
4	Grantham	554	25	22.2
5	Harlow	778	38	20.5
6	Farnborough	597	33	18.1
7	Rugby	546	31	17.6
8	Penrith	155	9	17.2
9	Warrington	1,443	86	16.8
10	Neath	721	43	16.8
11	Stevenage	732	44	16.6
12	Llandudno	439	27	16.3

Source: PMA PROMIS, Knight Frank

Retail warehousing operators are as exposed to **cost inflation** pressures as their high street counterparts. Increases in the minimum wage, for example, are a major headache for retailers universally. In April 2020, the minimum wage will increase again, from £8.21 to £8.72. Cumulatively, this represents an increase of £2.53 since 2012, or 40% - how many retailers have seen their top line grow by 40% over the last eight years?

Rental Growth Index 1990 - 2019 (1990=100)

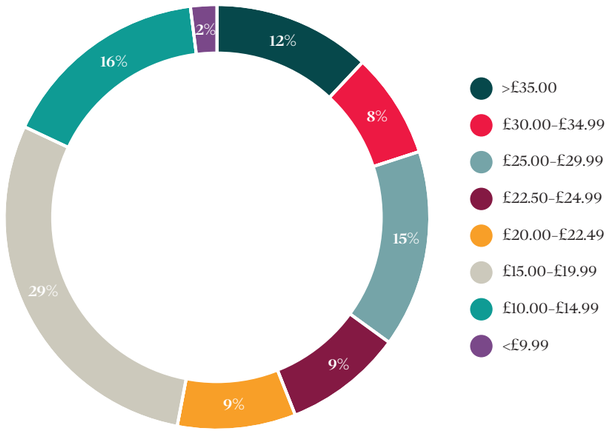


Source: MSCI, Knight Frank

Similarly on **total property costs**. One of the founding principles of retail warehousing is lower occupational and operating costs compared to high street retailing. But OOT rents have risen dramatically over the years. Figures from MSCI (formerly IPD) show that retail warehousing rents have grown at an annual average rate of 4% since the inception of the index in 1980. This is despite more recent re-basing, which has seen rents decline by an annual average -0.5% over the last decade. In very base terms, retail warehousing rents have more than quadrupled over the last 40 years (2019 index vs 1980 = 451).

'Headline' retail warehousing rents paint an even more sobering picture. Figures from TW Associates suggest that 12% of retail parks historically achieved 'headline' rents of more the £35/sq ft, while 53% achieved rents of more than £20/sq ft. Whether rents above £20/sq ft are 'affordable' and indeed sustainable in the current retail market is a very moot point. Again, anecdotal evidence would suggest otherwise. Brookfield Shopping Park in Cheshunt was once regarded as one of the pre-eminent schemes of its kind in the country and achieved peak rents of £75/sq ft. Recent re-gears and letting would suggest a current tone closer to £20/sq ft.

Highest Achieved Retail Park Rents by Band 2018

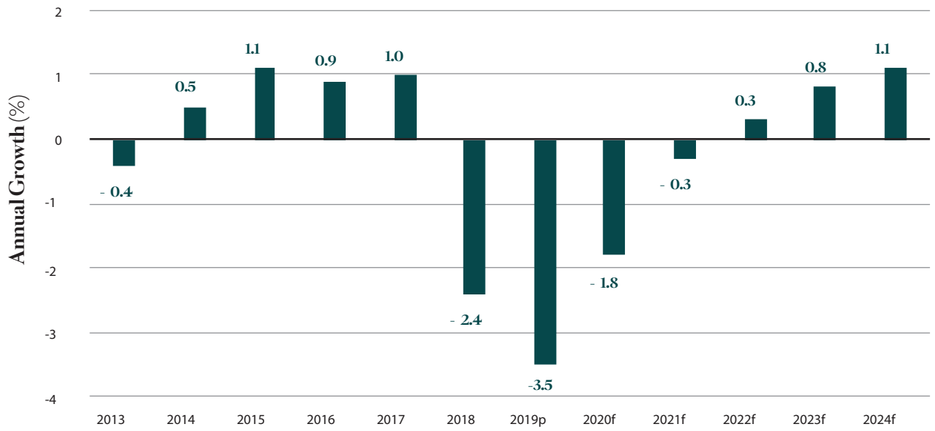


Source: Trevor Wood Associates

Rental correction will take considerable time to wash through and zero rental growth (at best) is a market reality for the retail warehousing market for the foreseeable future. Our forecasts suggest less steep declines in underlying retail warehousing rents in 2020 (-1.8%) and 2021 (-0.3%) than in recent years (e.g. -3.5% in 2019), but only from 2022 do we expect full stabilisation and a return to any sort of growth, however modest.

"Private equity ownership (past or present) is often the monkey on the back of the elephant in the room."

Retail Warehousing Annual Rental Growth 2013 - 24f



Source: MSCI, Real Estate Forecasting, Knight Frank

Structural failings of retail operators also apply to the retail warehousing market. Many OOT retailers are guilty of **brand devaluation** through constant discounting, too many promotions and foolhardy embrace of Black Friday. Interestingly, this is a charge that cannot be levelled at the aforementioned OOT value operators and it can surely be no coincidence that they continue to thrive while others toil. Similarly, a number of retail warehousing operators have fallen victim to **over-geared balance sheets**, usually (but not always) a sad by-product of current or previous private equity ownership.

In a similar vein, the spectre of fall-out through CVAs and administration looms as large over the retail warehousing market as it does over town centres, as we will go on to discuss.

Less exposed to other failings?

Retail warehousing's exposure to other 'structural failings' is more nuanced.

The **rise of online** is as much an opportunity as it is a threat for retail warehousing operators. The level of online penetration varies dramatically between OOT sub-categories. At one extreme, it is very high (>55%) in electricals, but minimal (<1%) in carpets. It is also relatively low (but growing) in other stalwart OOT categories such as DIY (ca. 11%) and furniture (ca. 7%). The value operators (with the notable exception of Dunelm) also make a limited play for the online channel.

In very general terms, retail warehouses are far more compliant with multi-channel retailing than many of their in-town peers. By their very nature, retail sheds are larger and more accessible for both delivery lorries and customers than high street stores/shopping centre units. On the one hand, this makes them ideal locations for click & collect orders (which is growing at a significantly faster rate than home delivery). But on the other hand, it makes them a much more powerful asset in a wider multi-channel offensive.

Little wonder that industrial shed operators are increasingly running a slide rule over retail sheds in their quest for 'last mile logistics' locations. In reality, the future need not be so binary – less 'either/or' (either retail sheds or industrial sheds) more 'both'. Hybrid sheds fulfilling both functions, with seasonality a strong factor. An opportunity that is still embraced by too few (Argos perhaps being the exception).

What of the final two 'structural failings', the more general issues of **under-investment** and **complacency?** One of the premises of retail warehousing is that it is less capital intensive than town centre retailing and requires less ongoing investment than other retail channels. That said, it cannot be starved of investment altogether and too many retail parks have befallen this fate under a general sense of complacency.

In an oversupplied market, consumers have considerable choice in where to shop. Retail warehouses may not always be the most 'experiential' shopping locations (to reference the most over-used buzzword in retail), but there are no excuses for very tired retail shed environments, an all too common sight across the country.

CVAs: still the elephant in the room

Over the last couple of years, retail warehousing has been at the very sharp end of occupier fall-out, arguably more so than the high street generally. This is largely co-incidental and more a reflection of the ownership structures of the operators that have failed, as opposed to any higher degree of structural weakness OOT than in-town.

The CVA process remains a controversial one, not least because in many cases it merely represents a stay of execution, rather than a path to recovery. Ironically, all the major retailers that have been liquidated completely over the last couple of years have been largely/exclusively retail warehousing operators – Toys 'R Us, Maplin Electronics, Poundworld in 2018 and Mothercare in early 2020.

Collectively, these four retailers operated ca. 420 retail warehouse units and occupied ca. 4.5 million sq ft of retail space. Only a proportion of this space (ca. 1.9 million sq ft) has been re-occupied by other retailers, led by the value operators (e.g. B&M, Home Bargains, The Range, Poundland) and others still on the acquisition trail (e.g. Tapi, Smyths Toys, Wren Kitchens, Oak Furnitureland, JD, Dreams).

Fastest Growing vs Fastest Retrenching RW Tenants 2018

Fastest Growing Tenants			
Rank	**Retailer**	**Y-on-Y Space Increase (sq ft)**	**Y-o-Y Change (%)**
1	B&M	650,000	15%
2	Home Bargains	380,000	16%
3	The Range	280,000	11%
4	Tapi	160,000	23%
5	Smyths Toys	120,000	10%
6	Wren Kitchens	90,000	11%
7	Poundland	90,000	9%
8	Oak Furnitureland	60,000	7%
9	JD Sports	50,000	10%
10	Dreams	50,000	5%

Fastest Retrenching Tenants			
Rank	**Retailer**	**Y-on-Y Space Increase (sq ft)**	**Y-o-Y Change (%)**
1	Toys 'R Us	-1,520,000	-100%
2	Homebase	-1,120,000	-27%
3	Poundworld	-870,000	-100%
4	Maplin Electronics	-610,000	-100%
5	Carpetright	-400,000	-16%
6	Fabb Sofas	-190,000	-100%
7	Mothercare	-150,000	-12%
8	Next	-100,000	-3%
9	B&Q	-90,000	-1%
10	Harveys	-90,000	-6%

Source: Trevor Wood Associates

The CVAs of Carpetright and Homebase have been equally damaging as the failures of those that have disappeared completely. Carpetright's CVA saw the closure of 80 stores (ca. 0.6 million sq ft), while the Homebase's portfolio was reduced by 47 outlets (ca. 1.1 million sq ft). But there is ongoing negotiation on rents in stores that remain open. Carpetright reportedly secured rent-free terms on 23 outlets and is leveraging the fact that around 50% of its residual sites have a lease expiry in the next two years. Homebase renegotiated rents on 70 stores initially and further landlord discussions are presumably ongoing.

The CVAs of Homebase and Carpetright (plus ongoing rationalisation at B&Q) have done little to stabilise retail warehousing occupier markets. As well as the tangible impacts e.g. void units and rental decreases, there is also the issue of "CVA contagion", whereby other operators seek comparable terms with those negotiated by their distressed peers. This is probably a bigger issue in multi-let shopping centres, but can still manifest itself in the OOT market.

Will there be further CVAs going forward? Inevitably there will be, but probably on a smaller scale than we have seen to date. And as landlord resistance to the CVA process mounts, we could see a move back towards pre-pack administrations, only marginally the lesser of evils. In terms of retailers on the 'watch list', history would suggest that ownership structures are the first thing to assess and private equity is still a major red flag.

The Carpetright and Homebase closure lists have been very revealing and, at times, highly surprising. Above all, they highlight the fact that there are no 'sacred cows' in retailers' store portfolios, and that affordability and profitability (current and in the future) are the overriding concerns for future viability and ongoing occupation. Homebase's closure list included several high profile locations, including Purley Way in Croydon, Wimbledon, Canterbury, Southampton and Solihull, while Carpetright's included supposedly well-heeled towns such as Guildford, East Grinstead, Reading and Maidenhead.

The reason? Those stores didn't make enough money, in some cases because the rent was too high, in others because sales volumes were too low (or indeed, both). The lesson? Retail warehousing is at its most sustainable where it is at its most affordable, however apparently unglamorous the town or location.

Key questions

When will occupier markets fully stabilise is the wrong question to be asking. It implies that we are merely in the midst of a downturn in a cycle when the reality runs far deeper. All retail markets (including retail warehousing) are subject to permanent change that will take many years to play out.

More pertinent are questions around remedial action to address wider structural failings. What can be done to ease over-supply and reduce the national footprint of retail? Simply converting 'surplus' retail warehousing space to other under-supplied property use classes may seem a no-brainer, but in reality, it is anything but in most locations.

At the same time, there is still a tendency to tar all retail assets with the same brush. The vast majority of retail warehousing space will neither change use nor become obsolete. How then to distinguish between a sustainable and a struggling asset? And how to make sense of the fundamentals of catchment strength, trading story and affordability, and pay less heed to the more superficial considerations of geography and park/asset aesthetics?

What of the investment case for retail warehouses? Values may have fallen dramatically, but the logic of buying retail warehouse stock purely on the basis that it is cheap is questionable - particularly without informed analysis as to whether the income is sustainable as a going concern - or whether the figures stack up fully as an alternative use.

These questions are addressed in greater depth in the following sections of the Newsletter.

The Ten Key Structural Failings of UK Retail

The Retailer View

WORDS: PHILIP BELL-BROWN – PRINCIPLE AT BB ELEMENTS (ADVISOR TO HALFORDS)

1.

The UK retail market is undeniably tough at the moment, but Halfords is more than holding its own. What are the factors behind the business' enduring success?

Halfords is a specialist retailer with great brand heritage and consumer awareness. The business is completely customer-focused, adaptable to a changing consumer and continue to developing its product and service propositions accordingly. For example, the business is able to tap into the consumer trend of "DIFM - Do It For Me" with its core blades, bulb and batteries service. Not only do we carry all these parts for most cars, we are able to fit it there and then. This service proposition is highly valued by the customer, a reason to visit the store and a significant part of the future growth of the business.

There are also tremendous opportunities within the business, especially in motoring, where we can better align the products and services we offer in our 370 autocentres and 450 retail units. We want to present the customer with a consistent and convenient range of services whether they arrive online, in-store or in an autocentre.

2.

The challenges of the UK retail sector generally have been well-documented. To what extent is the retail warehousing market exposed/incubated from these challenges, compared to the high street?

Today's more successful retailers understand their customers and the customer journey required to sell their products and services. Convenience and accessibility are usually an integral part of many customer journeys and if you have the need for physical real estate, out of town naturally outperforms the high street here.

If your customer journey is built on a price differential, then the convenience and efficiencies of "big box" retailing are important and we can see the success of value retailers over the past decade continuing to support this.

For those comparison good retailers out of town offers the opportunity to showroom, deliver enhanced services or provide additional distribution points which are increasingly important financial drivers for many.

As good as this may be as a "general" rule, there is always the need to understand each local market, the catchment it serves and the other opportunities that may exist to serve that catchment more effectively. At a macro level there is too much physical retail real estate in the United Kingdom and this can manifest locally both in and out of town.

3.

The original premise of retail warehousing was to offer easily accessible, large scale units at cost-effective rental levels. The OOT sector has obviously evolved significantly, but to what extent do these fundamentals still ring true in the modern market?

Historically, if you could provide an offer that would attract customers away from the High Street, then Out of Town was a more cost-effective way to do this and well suited to the "bulky goods" retailers that drove the early retail park development. This convenience and accessibility attracted a wider range of retailers and genuine shopping destinations have been created in many markets. I believe this trend will only continue and as High Streets will adapt more into entertainment, dwellings and services to survive, Out of Town will continue to service retail in the many different forms that have emerged over the last 10 years.

There are, however, a number of challenges for the market, oversupply and the challenge of pricing will be around for a while. Also, energy efficiency will become more of an issue – heating the air to a typical 6m eaves height underneath an uninsulated metal profile roof is expensive and inefficient.

4.

Online is obviously one of the key drivers of structural change in the retail industry, but it's clearly not a binary 'online vs physical stores' issue. What is Halfords' multi-channel stance and strategy?

As the Halfords business continues to develop its services business, improving our customer journeys is critical to this success. Many customers today start their shopping or services mission online and Halfords is investing in its own website to be able to direct our customers to the best way to meet their needs. Whether this is a direct product sale, booking a MOT, arranging a bike service or booking a slot to replace your windscreen wiper, the website will guide you on that journey, point you to the best local branch, be that retail or Autocentre, book a time slot if required and generally help with the process.

When you offer the level of services we do in both our retail and branch network, the web journey becomes an enabler of the physical real estate, not an alternative.

5.

Talk us through your current UK store portfolio – are you at capacity or is there scope for further expansion? What will a 'right-sized' Halfords store portfolio ultimately look like?

The group operates ca. 450 Halfords stores, ca. 370 Halfords Autocentres and 22 Cycle Republic stores. We benefit from a relatively short average lease expiry which gives us future portfolio flexibility. We typically close around six stores a year at lease expiry.

We are planning to run some trials this year which will better join retail and autocentre services within some specific retail markets. The future shape of the portfolio will be informed by this and other work ongoing. At this time it is difficult to say what a "right-sized" portfolio would look like and in my experience a retail property portfolio plan is never static, it is constantly refreshed to reflect both customer trends and local retail property markets.

6.

The notion of affordability has risen up the retail agenda across the board. Stores in 'less celebrated' locations are often more affordable, more profitable and therefore more sustainable. What is your experience?

All retailers need to look to drive operating efficiency through their offer and retail is increasingly "Darwinian" as more channels are available for customers.

For most retailers with a leasehold estate, occupancy costs will be the second-highest cost after people. And for occupancy costs, you need to read rent, rates, service charge, utility and maintenance costs. These are all growing faster than the top line except rent and (outside of store closures) rent is the only lever a retail property director has to pull when it comes to reducing occupancy costs. As with many other retailers Halfords will increasingly use lease expiry to set a rent that is proportional to the business generated in that location.

Generally, rental pricing is a real problem for the market and there is no easy solution. If you ask most retailers to plot store contribution against rent, there will be little or no correlation. Having to pay a higher rent does not mean you make a better return.

Factor in shorter leases driven by both market forces and accounting standards and the inherent inefficiency of the Landlord and Tenant Act to deal with pricing at lease renewal, then this is a problem that will be around for some time.

7.

CVAs amongst retailers are understandably a very contentious issue. Landlords clearly have their view, but how do you see it from the retailer side?

I don't believe any occupier would enter into a CVA process willingly, I know it is very difficult for all involved. However, it further undermines the rental pricing model and can effectively penalise those retailers who have better managed their businesses. As I have said, retail is very "Darwinian" and the CVA could be viewed as an unwelcome antibiotic!

The reality of UK retail can also be that the customer has moved faster than the retailer is able to keep up. The eternal challenge of a retail property director is keeping a very inflexible physical portfolio up to date with fast-moving customer habits, this can catch even the best retailers out.

So, my personal view is that if your customer offer is good enough, a CVA may help you ride through this inflexibility, if it isn't, then it simply delays the inevitable.

8.

The relationship between some landlords and tenants can, at times, be a strained one. What opportunities and mutual benefits do you see through closer collaboration between landlords and retailers?

I don't see any alternative to closer collaboration. With the challenges of oversupply, pricing and reduced lease lengths then an investor can no longer buy an asset simply from an income point of view. The well-advised investor will need to understand the underlying strength of the retail location and its long-term ability to efficiently serve the customers in its catchment.

The landlord also has to understand the individual retailers trading from their assets and support their customer strategy. This is still not universal, for example, Halfords still has issues with landlords not allowing the business to operate the "WeFit" service from the car park, an integral part of its service proposition.

I believe in the medium term fewer retail locations will serve any given catchment. This will provide opportunities for certain locations to consolidate their position, whereas others will have to find an alternative use. Retailers and landlords will have to collaborate to better understand which is which and put plans in place accordingly.

9.

Will people still be shopping on retail parks in 10 years time?

The simple answer is yes but there will be fewer parks. Also what we now understand as "shopping" will evolve. There will still be purely transactional stores whose appeal will be value-driven by being focused on the physical channel only.

The rest will have a degree of simple transactions but will have to adapt more of their physical space to offer enhanced services, "showroom" their own or other brands' products or as a useful extension to their physical distribution network. Many, of course, will do a combination of the above and those that don't adapt to the changing consumer are unlikely to survive, along with the retail parks they occupy.

Philip Bell-Brown is the principle at BB elements, a retail consultancy specialising in Corporate Real Estate strategy and solutions, as well as retail real estate investment advice. One of his principal clients is Halfords Group PLC where he is advising on property portfolio strategy, amongst other things.

What's the Alternative?

WORDS: FREDDIE MACCOLL – ASSOCIATE, RETAIL WAREHOUSING CAPITAL MARKETS

When a retail shed's not a retail shed, what is it? No punchlines, just a string of alternative use options, ranging from industrial sheds through to residential.

In the face of an increasingly multi-channel consumer, retail warehousing is arguably the most defensive retail sub-sector against the rise of online. That remains one of its key selling points as a 'going concern'. Additionally, retail warehousing space offers flexibility and is often underpinned by alternative uses. We are currently exploring a number of opportunities for our clients, some infinitely more complex than others.

Oversupply and falling values

The flight to potential alternative use has three key drivers: tumbling capital values, widespread retail malaise and oversupply. In the 12 months to December 2019, retail warehouse capital value growth has declined by 12.86%, according to MSCI (formerly IPD). The occupational challenges of the retailers are well documented and until there is some stabilisation within the occupational market, this decline in capital values will continue.

Supply issues are not clear cut and the retail warehouse market is perhaps not as oversupplied as some may believe/suggest. Although the vacancy rate is up to 7.5%, it is still lower than the peak vacancy rate in 2009 of 11.8%. OOT vacancy rates generally are much lower than in-town equivalents.

"OOT vacancy rates generally are much lower than in-town equivalents."

The case remains that stock selection is key - there will be some assets that see values continue to tumble, but there are also others that are under-priced and offer exciting opportunities. The fall in retail warehousing values, set against other real estate sectors that have continued to perform strongly, has created pricing mismatches and with them, an opportunity to explore alternative uses.

Knight Frank's extensive Residential and Industrial capabilities have enabled us to target these avenues of alternative use in particular. In both instances, retail parks may present excellent opportunities, in the right locations, for these uses.

Industrial / 'last mile' distribution

The ongoing evolution of the online retail market will continue to drive the pursuit of the 'last mile' logistics. Demand for 'urban logistics' facilities continues to exceed current supply, as much from online only 'pure-plays' such as Amazon, as multi-channel operators looking to optimise delivery efficiencies.

Retail park locations and formats are well suited to aid this process. By their very nature, they offer locations close to the customer, with the added benefit of good surrounding infrastructure. As part of our focus on the sector, Knight Frank has developed a geospatial mapping tool which plots all the retail parks across the country, identifying schemes/assets that are of a certain acreage and are located on key arterial/distribution arteries.

It is increasingly emerging as a key competitive advantage in the wider multi-channel offensive for retailers to have a network of physical stores. Within this framework, the role of the store is evolving rapidly. In addition to their traditional role as transactional 'shops', retail parks offer the opportunity to fulfil an increasing number of multi-channel functions:

- shipping from warehouse
- shipping from store
- providing click & collect facilities
- serving online returns
- providing national retailers with a distribution network that can rival Amazon

Where the service yard is large enough, the sheds can even serve dual purposes, offering both 'traditional retail' (i.e. sales direct from the unit) and distribution capability, a good example being Argos' hub model.

Conversion (full or partial) to industrial uses can intensify the land use through increased site coverage and even multi-storey.

Retail parks in or near to large urban areas tick most of the boxes for 'last mile' logistics, but they face significant competition from other uses.

Self-storage

As retail parks tend to be in high traffic locations, they can make attractive self-storage facilities. Self-storage has often traditionally been located within industrial properties. However, 2018/2019 has seen a lack of stock of industrial property space and this has placed pressure on self-storage to relocate.

Moving self-storage units to retail parks where there is perhaps an oversupply of square footage or a large car park / service yard could provide efficient use of the land.

"Too much retail floorspace, a lack of housing – the logic may be overwhelming, the realities actually far more complex."

Residential

Too much retail floorspace, a lack of housing – the logic may be overwhelming, the realities actually far more complex.

Increasing pressures to deliver more housing combined with a shortage of available land, particularly in the South, have created higher residential values, which in some cases makes a compelling case to redevelop retail parks.

Retail parks offer low site coverage, typically circa 30%, and redevelopment allows for an increase in density. Planning authorities are normally positive on residential development due to a desperate need for more housing in many areas.

Institutions own a significant amount of retail parks and a number are currently looking to reduce their exposure, whilst also seeing an expansion into the build-to-rent sector as a lucrative alternative.

A tightening of retail warehouse supply in London and other urban areas will also lead to more stable values / rental growth going forward. Where there is a viable alternative use, we expect to see an increase in the divergence of pricing between prime and secondary schemes / locations.

Geography remains key – the values between residential and retail warehousing only currently align to make redevelopment viable in Greater London and very select areas of the South East.

Understanding locations

It is more important than ever in the retail world to understand the market in terms of location, the supply and demand dynamics, how retailers trade but also what alternative uses potentially underpin the site. As well as input and intelligence from our Residential and Industrial colleagues, our dedicated planning team are able to guide us on likely use and densities when exploring alternative angles.

Despite all negative narrative, retail parks clearly have a purpose and for the majority, this will continue, but there are select opportunities for existing owners, developers and local authorities to consider their development potential.

A final thought. As we have seen in the office market through permitted development rights, could we in five years begin experiencing a real lack of good quality retail warehouse in certain urban markets? Certainly not beyond the realms of possibility.

Embracing Change: our forensic approach to site/stock selection

WORDS: DAN SERFONTEIN – SENIOR SURVEYOR, RETAIL WAREHOUSING CAPITAL MARKETS
DEWI SPIJKERMAN – SENIOR GEOSPATIAL ANALYST

Technology is constantly evolving and to remain competitive, so must we. How we have developed new methodologies to appraise retail warehousing assets, primarily to uncover buy-side opportunities.

Any developments in the field of Geographical Information Systems (GIS) and Spatial Data are of great interest and relevance to the property industry. However, it would be fair to say that real estate has tended to be slow in adopting new technologies, certainly compared to early adaptors such as the public sector or the insurance industry.

Whilst technology can improve efficiency, people still have a desire for human contact. This is especially true in a sector that is underpinned by trust and personal relationships. At Knight Frank, we look to combine new data solutions with up-to-date market knowledge and long-standing relationships to bring best in class advice to clients.

Structural Change and Change of Use

Whether you read the headlines, our Knight Frank retail research or have recently been shopping you will be well aware that the sector is undergoing major structural changes. The last two years have undeniably been very turbulent for the retail property market. We have seen a string of Company Voluntary Arrangements (CVAs) and administrations, wider occupier unrest, tumbling capital values and negative investor sentiment. This volatility has been reflected in the pool of buyers, with traditional buyers often heavily discounting retail as an asset class.

Although reduced, there is still demand for prime retail warehouse investments. From institutional buyers, there is demand for prime retail warehouse investments with an attractive weighted average unexpired lease term (WAULT), strong covenant, situated in locations underpinned by alternative use. An example of this demand is the acquisition of the B&Q store in Croydon by Royal London.

However, these prime assets are only a fraction of the retail warehouse offering in the UK. Outside prime, landlords have to work harder to make returns on their retail assets and many are undertaking increasingly active asset management. Strategies include Pod development, re-letting vacant retail units or repositioning assets which are no longer fit for purpose. Alternative use value is becoming increasingly important, if not as a primary direction of intent, then at least as a safety net.

The matching process of appropriate retail stock with these new alternative buyers is, however, not as straightforward as it may seem. Sellers need to understand the underlying value of their land for alternative use. At the same time, without the stock being openly marketed, new entrants will find it hard to navigate the market, identify the right opportunities and establish true value.

> "The matching process of appropriate retail stock with these new alternative buyers is, however, not as straightforward as it may seem."

Visualising Opportunities

To support our clients through the site selection minefield, we have developed an interactive tool to filter and identify all retail parks, foodstores and leisure schemes across the country. The tool allows us to filter on relevant criteria by potential use and identify which space is fit for purpose.

The tool has been built using a variation of traditional real estate and alternative data sets. Visualising data spatially and interactively provides a new opportunity to search for assets and gives clients the chance to identify their hotspots and select their personal assets of interest.

The tool is intended to be flexible rather and prescriptive and can be used to assess retail parks as 'going concerns', as well as potential alternative uses.

A step-by-step approach

Using this tool, we have been able to deliver to our clients a host of interesting off-market opportunities. Applying the client's bespoke requirements and specifications, we are able to identify prospects by filtering on location, accessibility, number of units and size, as well as several demographic layers (e.g. residential base, worker population, socio-economics etc).

Once a select group of assets is identified, we can undertake further investigation into individual assets through a step-by-step approach. We would look to:

- Identify who owns the asset (likely to be one of our long-standing relationships).
- Analyse current tenants and vacant units and use our extensive market knowledge to advise on covenant strength and estimated rental value.
- Consider surrounding land uses and liaise with our market-leading Residential and Industrial teams to establish the potential for alternative use underwrite or development.
- Explore demographics to identify potential customers, residents or employees for our clients (depending on proposed use).

Once a shortlist has been created, we revert to our networks and advise on the best strategy to acquire the identified properties.

> "All locations are different and retail warehousing assets offer varying degrees of potential – our tool offers a customised approach to forensically assess these nuances."

Scenario: Be like Investor A

By way of example, Investor A believes there is an opportunity to acquire retail warehouse accommodation and convert it for alternative use to industrial. Investor A provides us with their requirements as follows:

Location: Within M25
Units: 1-4
Size > 50,000 sq ft

We input these requirements into our dashboard and it identifies all retail warehouse accommodation that fits these parameters. We then filter out sites suitable for residential use. This filter alone reduces the list from nearly 9,000 to 99 properties. We then have the ability to apply additional filters including catchment demographics and population drive times – this process generates a final list of 43 properties.

We then review the ownership details and lease terms of all 43 properties and this results in a shortlist of 10 assets. We then provide Investor A with a summary of each asset and why we believe it is suitable for their requirement. Investor A has now been provided with 10 potential off market opportunities.

All locations are different and retail warehousing assets offer varying degrees of potential – our tool offers a customised approach to forensically assess these nuances.

Interested to know how we can help you find your unique property? Contact Daniel Serfontein or Dewi Spijkerman for more information.

The Landlord View

WORDS: WILL HUNTING – DIVISIONAL DIRECTOR – UK ACQUISITIONS, M7 REAL ESTATE

1.

M7 is a very active investor in retail warehousing. How much have you invested recently and what are your plans going forward?

In the UK, the majority of the retail warehousing owned by M7 vehicles is in our first dedicated retail warehousing fund, M7 Real Estate Investments Partners VIII (REIP VIII). We acquired £126m across 20 assets between August 2018 and April 2019. We also have other retail warehouse assets in other funds/mandates acquired as part of portfolios over the previous five years.

The retail warehouse assets we are targeting are M7's highest conviction theme in the UK at the moment and our aspiration is to grow this strategy over the next 12 months.

2.

The trials and tribulations of the retail sector have been well-documented. To what extent is the retail warehousing market exposed/incubated from wider retail occupier malaise?

M7's view is that retail warehousing is the most defensive retail sub-sector to the current malaise in the retail market.

We believe that the building construction (steel portal frame warehousing), site configuration (large, free car parks, rear loading, very low site cover) and micro locations (away from congested town centres, surrounded by residential) provide better fundamentals than most high streets and shopping centres, and will help the occupiers adapt to continued online penetration, rather than hinder them.

3.

In the current market, the main rationale for investment in retail warehousing amongst some investors is alternative use (industrial sheds/resi/hotels). What is your view?

I think a lot of people think that we started buying retail warehousing with the view that we would be planning to convert everything to industrial, given our background in the sector.

Whilst we do see the potential for doing this in select cases, for M7 this is more about how we see the retail market changing; the way retailers will continue to adapt to the march of online, and our view that these assets are the best prepared to service this going forwards. Retail warehouse assets are well suited in terms of both location and specification to fulfilling other uses including physical retailing, click & collect and last mile delivery.

We also have one eye on land values and what this means for potential future residential use, but this is an underpinning factor, rather than a strategy.

4.

What is the case for investment in retail warehousing as a going concern? How important is income return, as opposed to rental growth?

One of the factors we really like in the sector is the income return it provides. REIP VIII was acquired for an attractive blended NIY with less than 1% void, a WAULT of eight years and of an average rent of £9.90/sq ft.

This has the ability to provide a great cash on cash return with virtually no leakage and, given the profile of the tenants in the portfolio, we believe this is also a stable, defensive income profile.

In the context of the wider real estate market and other asset classes, this is an attractive income return that is very hard to find in the industrial market and we believe, again given the profile of our tenants, is less volatile occupationally than parts of the regional office market. However, we are conservative on rental growth and are not underwriting any short-term uptick in rents.

The investment case is underpinned by the income return, but the capital growth will come as the asset class becomes ever more important to the retailers and evolves with the retail market.

5.

What are you own key investment criteria?

The buildings must be conventional steel portal frame, low site cover and be located in larger towns and cities, with strong residential catchments. We look at both parks and solus units and our lot size is generally sub-£15m.

Rental levels are very important to us. Whilst we are obviously very keen on the sector, we also think that rental levels are generally too high and there is a lot of re-basing that will need to happen across the market. We aim for rents that are low and already stabilised, as mentioned above, our average rent across REIP VIII is £9.90/sq ft. Not only does this protect the downside versus competition in the local markets, it is also a level of rent that is more attractive to the occupiers we like, which are discount and value-orientated.

Capital value per square foot is also important. One of M7's key investment criteria, regardless of sector, is to be buying below replacement cost, to protect the downside against the development of competing stock. Our average capital value per square foot for REIP VIII fitted this criteria well when considering the cost of land and development.

Income return is obviously important as already noted and is a function of these rental levels and the capital value and vice versa.

6.

Retail warehousing comes in a variety of guises – shopping parks, clusters, solus, open A1, food-anchored, convenience-based etc. What is your view on the prospects for these various sub-sectors and relative pricing?

Our strategy is currently focussed on one sub-sector – the smaller lot size, discount-led assets e.g. REIP VIII featured tenants such as B&M, The Range, Home Bargains and Matalan as well as DIY tenants such as Wickes and B&Q. We are more comfortable with this sub-sector than with others, mostly as a result of the low rental levels and the performance of many of the tenant credits, but also because of the synergy between the retailers and the demographics.

We haven't spent too much time on the other sub-sectors but the pricing of the larger, shopping park-style assets looks like it has to continue to move out. The rental levels are quite high in places and have moved against one of the original reasons retail warehousing came to prominence – its affordability for occupiers versus the high street.

7.

In retail generally, affordability increasingly appears to be trumping geography. As a landlord, how important is understanding tenant affordability and trading performance?

In our sub-sector, we think affordability and geography go hand in hand. Generally, the levels of rent we are targeting are paid by the discounters and retailers associated with them, and they are located in geographies where there is strong consumer demand.

An understanding of tenant affordability and trading performance is very important to us. Whilst we believe in the multi-channel future of the sector, we still need our income return to be defensive and protected. One of the first questions we are asked by investors, particularly our US-based investors who have better access to this information in their home market, is around effort ratios and tenant affordability. This isn't always readily available, for understandable reasons, so we leverage the relationships of our agents and our developing relationships with the retailers to understand affordability and performance.

8.

Online is clearly one of the key drivers of structural change in the retail industry. In your view, how does retail warehousing sit within the multi-channel equation, in contrast to, say, high street retailing?

It sits right at the centre of it and is the antithesis of high street retailing in this sense.

One of the key tenets of our strategy is that the sector provides the best real estate for retailers to adapt to the structural changes associated with online. We think that the buildings are ideally placed to be at the heart of a true multi-channel operation.

The advantages over the high street in this sense are mostly physical, they provide everything that the high street doesn't – uniform steel portal framed buildings suitable for racking, simple loading, large, free car parks and surrounding chimney pots.

As a house, given our exposure to the industrial/warehouse sector, we are acutely aware of the shortage of warehouse space in the UK, whether it be multi-let, mid-box or big-box, and the impact this is having on voids and rents.

Whilst we believe that many of these retail warehouse units will continue to trade as they currently do, we think that the natural evolution, given the shortage of traditional warehouse space, is that retailers will come to utilise their retail warehouse units as part-physical retail, part-click & collect and part-same day last mile delivery.

You will end up with units with a smaller physical retail presence, say 30-40% of the unit, with the rest of the unit racked out, almost trade counter-esque, for click & collect and last mile delivery.

We actually call the asset class Enhanced Warehousing – B2/B8-style warehousing with the benefit of an enhanced planning consent – retail.

The other interesting comparison with the High Street, and one of our underpinning factors, is that as Local Authorities continue to try to protect the High Street, it is going to be increasingly hard to get consent to build retail warehousing, which feels at odds with the structural changes the sector is going through.

9.

CVAs continue to cast a negative shadow over the retail market generally and remain a very contentious issue. What is your view as a landlord?

Fortunately, we haven't been exposed to many CVAs and, where we have, the outcome hasn't been negative for our assets. For those that have been exposed, there is a feeling of frustration, which is down to the fact that landlords feel that their hands are tied with very little choice.

We can understand how a CVA can benefit a tenant when it is part of a genuine restructuring, but increasingly it feels like the tide has shifted towards the use of the process to shed non-performing stores.

Hopefully, our approach to rental levels will go some way to protecting us from the affordability element of any future CVA processes.

10.

Will people still be shopping on retail parks in 10 years time?

Yes, but the way they will be shopping will be different. They won't all be shopping in a traditional sense, some will be, but others will be picking up and returning online orders, as the true last mile is serviced by vans loading at the rear of the units.

The Eye of a Perfect Storm?

WORDS: DOMINIC WALTON – HEAD OF RETAIL WAREHOUSING CAPITAL MARKETS

Having enjoyed 20 years as the darling of the property market, retail warehousing, along with the wider retail sector, is enduring a value decline which perhaps started slowly but soon gained momentum. And some.

But are we now close to the bottom of the market and when is the right time to invest? Or even, how soon is now?

In September 2018 I debated with a client when might be the right time to 'buy' retail warehousing – at the time we felt the year-end valuations would possibly offer potential in the first half of 2019. Here we are in early 2020, that client is still on the sidelines, so where is the market and what would the same conversation look like today?

A Perfect Storm

All free markets are largely shaped by demand and supply factors and current market characteristics have substantially increased the supply side of the retail warehousing equation. The woes of the retail sector have been well documented and are covered elsewhere within this report, but they form perhaps only half of what we could describe as the perfect storm – one that was somewhat different to the effects of the Global Financial Crisis some 10 years ago.

It would seem that the peak of bad news in the retail space was the outgoing tide uncovering some unpalatable structural issues and failings. In the wider property market discussion and debate was growing about 'top of cycle' – this further focused attention on the retail sector and the portfolio imbalances and over-weight to retail many REIT and Institutional investors were exposed to. To rub salt into the wound, the PR and corporate governance issues, resultant from the Woodford Fund events, began to further affect motivation and strategy of many, particularly the retail funds.

As if all that wasn't enough, our celebrity-seeking politicians have done their level best to whip whatever remaining carpet was beneath the market in promoting uncertainty, causing significant redemptions from retail funds – perhaps also bolstered by broader global economic weaknesses. The General Election in December has eliminated a degree of uncertainty, but we are still a long way from total clarity. Not to mention rather biased media coverage of retail in general.

The 20 years of growth enjoyed by the retail warehouse sector was fundamentally fuelled by retailer expansion and has created an oversupplied and, in large part, overrented market. Combined with the structural challenges of the retail sector, prospects for growth appear slim at best. Until, that is, the market falls to 'current value' levels - whether that movement will result from the valuation fraternity or open market is the subject of fierce debate.

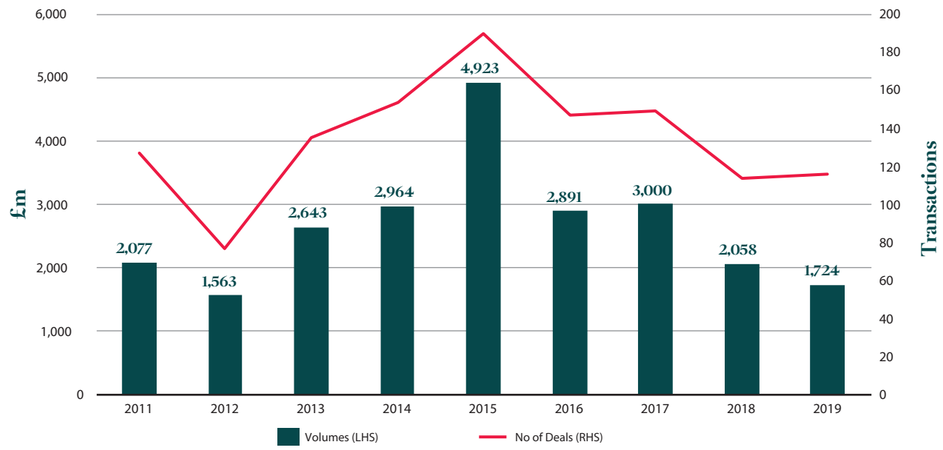
> "As ever, where there is perceived distress, there is Private Equity, for whom distress equals opportunity."

Volumes vs sector interest

Trading volumes speak for themselves. In 2019, there was just ca. £1.7bn transacted, a -16% reduction on 2018 (ca. £2.05bn). Compare this to ca. £5bn as recently as 2015. Significantly, 2019 marked the first time investors other than UK Institutions were the larger buyer in the sector, made up of Property Companies, Private Wealth, Councils and Private Equity.

As ever, where there is perceived distress, there is Private Equity, for whom distress equals opportunity. Most investment agents worth their salt should have been spending recent months making 'new friends' in the PE world. However, the varied nature and motivation of the global investor today means PE investors are now joined on the starting grid (or is it the pit lane?) by Private Family Offices, Property Companies and a wide array of Asset Managers through whom domestic and global wealth are navigating their way to income and returns.

Retail Warehousing Investment Volumes and Deals 2011 - 2019



Source: Property Data, Knight Frank

Key Retail Warehousing Deals (>£30m) in 2019

Town	Property	Price (£m)	Yield (%)	Date	Purchaser	Vendor
Portfolio	Three retail parks	190.0	7.00	Dec-19	Tritax Management LLP	Standard Life UK RP Trust
Oxford	Seacourt Tower/Retail Pk	80.0	-	Nov-19	Brockton Everlast Inc	BA Pension Fund
Paisley	Abbotsinch Retail Park	67.0	7.80	Sep-19	AshbyCapital LLP	Hammerson Plc
Gloucester	St Oswalds Retail Park	54.0	8.50	Nov-19	Gloucester City Council	Hammerson Plc
Portfolio	B&Q Portfolio	53.3	6.60	Jun-19	Palmer Capital Partners	B&Q Plc
London N18	Ravenside Retail Park	51.5	-	Dec-19	ProLogis UK Ltd	M&G Property Portfolio
London SE26	Bell Green Retail Park	50.0	5.90	Apr-19	West Midlands Pension	Kier Property
Poole	Poole Retail Park	44.7	8.00	Sep-19	Pimco Bravo Fund	Landsec Plc
London NW2	Broadway Retail Park	44.5	-	Mar-19	Montreaux Ltd	Kingfisher Plc
Manchester	Hulme High St Retail Park	42.8	5.30	Aug-19	Warrington Bor Council	Nuveen Real Estate
Lisburn	Springfield Retail Park	40.0	8.70	Nov-19	NewRiver REIT Plc	Intu Properties Plc
Leeds	Westside	38.0	6.75	Mar-19	AshbyCapital LLP	British Land Plc
Croydon	Hesterman Way	37.3	4.71	Jan-19	Royal London Asset Man	B&Q Plc
Aberdeen	Kittybrewster Retail Park	35.2	8.90	May-19	NewRiver REIT Plc	Zurich Assurance
Hove	Goldstone Retail Park	34.0	5.10	Nov-19	Oxford Uni Endowment Fund	Aberdeen Standard Invest
Knaresborough	St James Retail Park	33.0	6.25	Aug-19	Private investor	Aviva Investors
Brighton	Pavilion Retail Park	32.0	5.53	Mar-19	CCLA Investment Man	Aviva Investors
Londonderry	Crescent Link Retail Park	30.0	11.50	Oct-19	David Samuel Properties	Lotus Group

Source: Property Data, Knight Frank

Whilst it would be wrong to totally ignore the Institutional investors on the buy side - indeed there are savvy fund managers who find themselves under-weight to the sector and with cash to invest - the fact the majority of buyers are non-institutional does in itself somewhat direct pricing in order that their returns criteria are met – these typically being rather higher than those of Institutions.

In fact, the combined cash waiting on the sidelines focused on the sector is quite astounding. Most PE investors are seeking to build considerable platforms – a factor which has motivated some sellers to offer portfolios to the market, rather than piecemeal assets.

Key Retail Warehousing Purchasers 2019

Purchaser	Value (£m)	% of Total
Tritax Management LLP	190.0	11.0%
AshbyCapital LLP	105.0	6.1%
NewRiver REIT Plc	100.4	5.8%
M7 Real Estate	82.5	4.8%
Brockton Everlast Inc	80.0	4.6%
NFU Mutual Insurance	59.3	3.4%
Gloucester City Council	54.0	3.1%
Palmer Capital Partners	53.3	3.1%
ProLogis UK Ltd	51.5	3.0%
West Midlands Pension	50.0	2.9%
CCLA Investment Man	48.1	2.8%
PIMCO BRAVO Fund	44.7	2.6%
Montreaux Ltd	44.5	2.6%
Greenridge Regional UK	42.9	2.5%
Warrington Borough Council	42.8	2.5%
Royal London Asset Man	37.3	2.2%
Oxford Uni Endowment Fund	34.0	2.0%
Corum Asset Management	33.0	1.9%
David Samuel Properties	30.0	1.7%
Other	540.6	31.4%
Total	1,723.7	100.0%

Key Retail Warehousing Vendors 2019

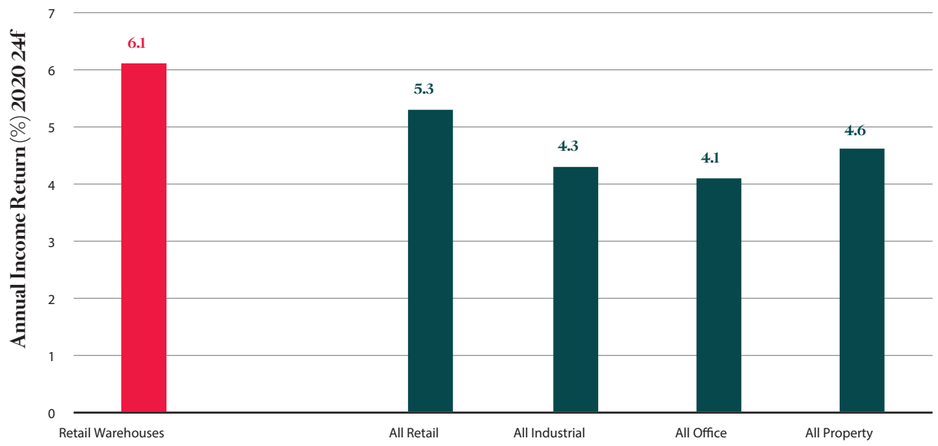
Purchaser	Value (£m)	% of Total
Standard Life UK RP Trust	190.0	11.0%
Hammerson Plc	144.9	8.4%
Aberdeen Standard Invest	125.6	7.3%
B&Q Plc	115.8	6.7%
BA Pension Fund	80.0	4.6%
Aviva Investors	73.4	4.3%
British Land Plc	69.8	4.0%
Zurich Assurance	60.4	3.5%
M&G Property Portfolio	51.5	3.0%
Kier Property	50.0	2.9%
Landsec Plc	44.7	2.6%
Kingfisher Plc	44.5	2.6%
Nuveen Real Estate	42.8	2.5%
Intu Properties Plc	40.0	2.3%
FI Real Estate Management	36.4	2.1%
Columbia Threadneedle	34.1	2.0%
Lotus Group	30.0	1.7%
Other	489.9	28.4%
Total	1,723.7	100.0%

Source: Property Data, Knight Frank

Directions of travel?

With little rental growth to hope for, investors seem to be playing a relatively simple game – buy off motivated sellers at 'discounted' pricing, enjoy the income, perhaps a re-gear or two and wait for the funds to return to the fray enjoying the resultant yield compression.

Forecast Income Returns 2020 - 24f



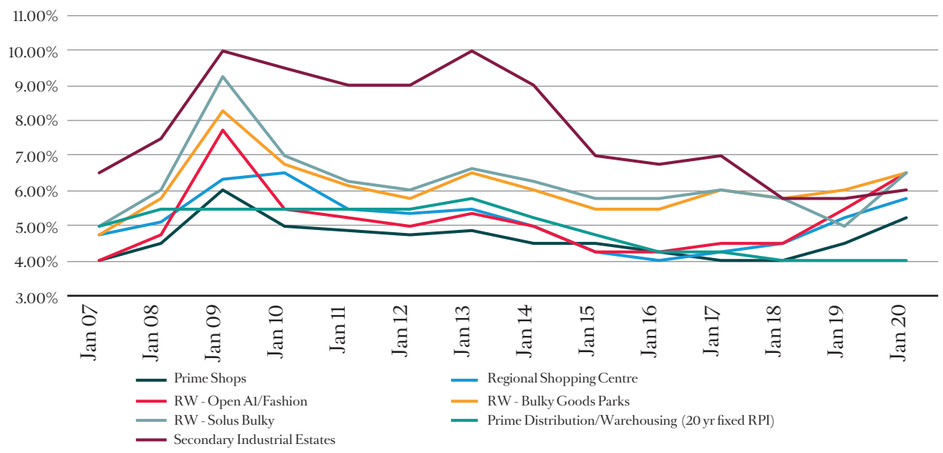
Source: MSCI, Real Estate Forecasting, Knight Frank

Crucial at this stage is to underline the fact that the sector is incredibly fragmented – not every retail warehouse is a 150,000 sq ft scheme. As a sub-sector, retail warehousing comprises large-format Regional Shopping Parks to solus Halfords stores and everything in-between. Each retail warehousing asset is different, be that in terms of sizing, geography, rental tone and tenant composition. Historical classifications are looking increasingly outmoded. Prime – what does that describe in today's market?

At the same time, we find ourselves in a low interest rate environment. Other property sectors are experiencing historic low yields and other investment media even lower returns. A more settled political environment has clearly refreshed investors perception of the UK and retail warehousing now offering yields (by and large) of 6% plus. There is a school of thought that now is the time to invest.

Structural issues in the sector also result in a greater perception of risk – and that demands reward for those early pioneer investors. In January 2009 the Prime Yield for Open A1 retail parks was 8% (Jan 2007 – 4% and today 6%). All will recall the effects of the GFC on the whole property market, but the pioneers of that market could perhaps see through the mist to a retailer expansion story which still had legs – as at the time, did the 10-15 year leases. Today, to a greater or lesser extent, the economy would be considered perhaps more stable, but even the moving parts of the retail market have changed and greater skill in assessing them is demanded from an investor.

Retail Warehousing Yields vs Other Property Segments 2007 - 2020



Source: Knight Frank Yield Guide

Pricing aside, investors generally like retail warehousing. Simple, flexible buildings, low site coverage, easily accessible assets with large car parks, where occupational costs compare favourably certainly to shopping centres. And, of course, retail warehousing remains highly 'online compatible'.

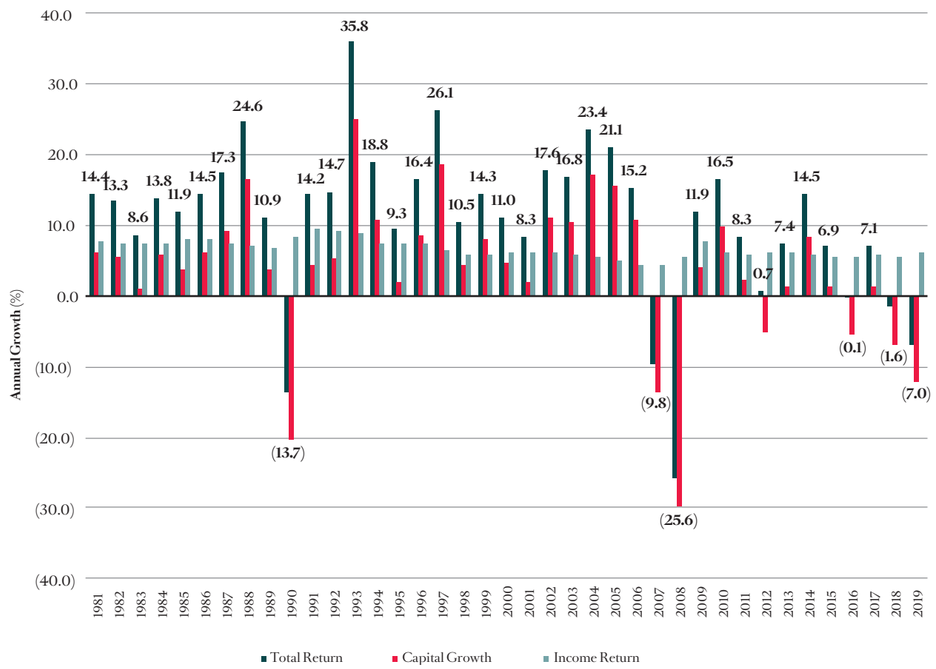
Alternative use offers the potential to offset risk and derive greater returns and remains a major attraction to some investors. But any scheme much removed from the clasps of the M25 simply fails to offer comparable land values to be viable for conversion. Even within the M25, redevelopment into other uses (industrial sheds/residential) is far from the 'slam dunk' many believe.

Deals during 2019 have demonstrated two main themes – alternative use underwrite and income. Nervousness still prevails as does poor PR if investing other people's cash! Looking ahead we see a steadying of the occupier market – fewer CVA's / failures and greater transparency of sustainable rental levels.

Post the GFC early pioneer investors into the sector were perhaps betting on economic recovery. In 2020 life is more complicated, retail has changed and flexibility and protection against high rents means short lease terms.

So, 15 months on from that chat with that client we may not be at the bottom – but close enough to see beyond the storm to a slightly more certain future. And with values having moved to where they are currently, how soon is now?

Retail Warehousing Historic Performance Metrics 1981 - 2019



Source: MSCI

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