H1 2023

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Retail Investment Update

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RETAIL INVESTMENT AT A GLANCE...

Retail Warehousing

- The best performing traditional real estate subsector in H1 2023 (Jan-May), generating a total return of +4.10%.
- Yields diverging – polarisation within the market is causing the best to harden, and the rest to soften.

Foodstores

- The only Retail subsector to see increased transaction volumes in H1 2023 vs H1 2022, though skewed by several portfolios.
- Rental growth, arguably not seen for 10 years in the subsector, is underway, driven by development viability following increases in build costs and capitalisation rates.

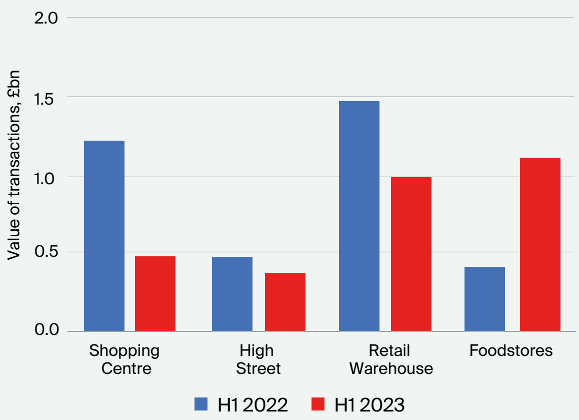
Shopping Centres

- Very selective demand for larger assets, with several £50m+ deals underway, but most deals are taking place at <£15m.
- Growing buyer pool now includes retailers and Local Authorities alongside private investors, property companies and private equity groups.

High Street

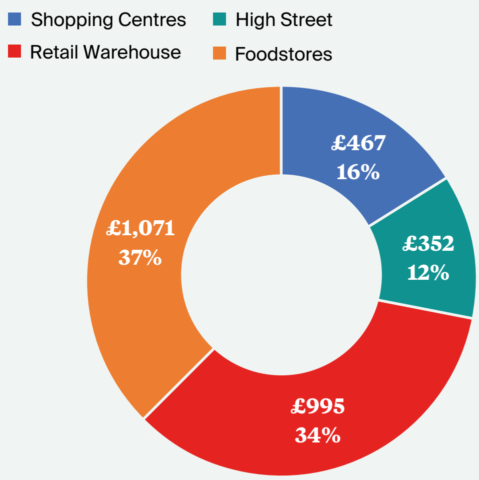
- Low stock levels holding back transaction volumes, despite reasonable investment demand.
- Having repriced yet again following the September 2022 mini-budget, yields are now high enough to appeal to a range of investors.

H1 2022 vs H1 2023 Transaction Volumes



Source: Knight Frank LLP

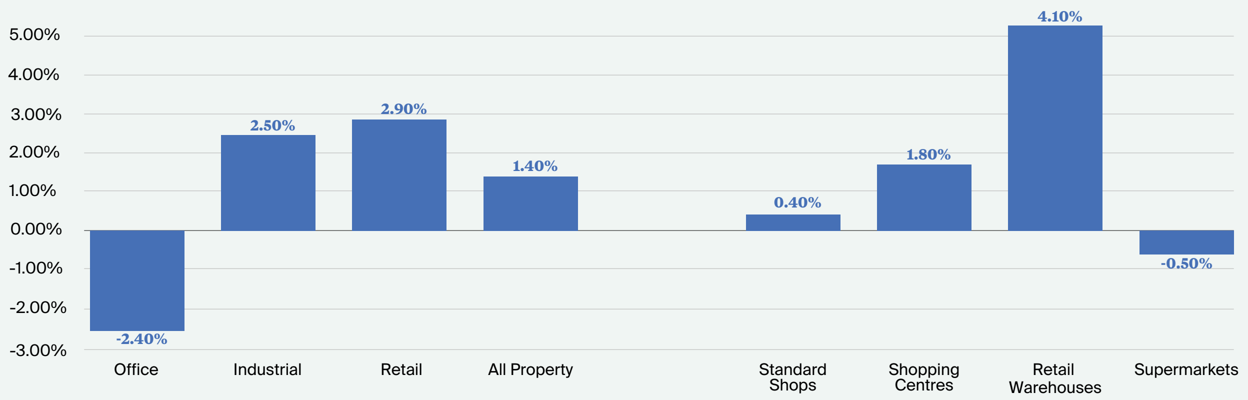
H1 2023 Transaction Volumes (£m)



Source: Knight Frank

Total Retail Transaction Volumes totalled £2.89bn in H1 2023 but this metric masks softening markets in most subsectors. Despite investment demand/ liquidity improving across nearly all retail subsectors, transaction volumes are underwhelming in all but the Foodstore market as a result of low stock levels. Stripping out Foodstores, transaction volumes are down -43% versus H1 2022 and -24% versus H2 2022.

Commercial Property Total Returns H1 2023 (Jan-May)



Source: MSCI

REVIEW OF THE YEAR

- Perhaps surprisingly, consumer markets have remained largely positive despite the many challenges facing the market - ever rising base rates, the US debt ceiling and 19.10% annual food inflation, to name but a few. Retail sales values (amount spent) showed +5.60% year-on-year growth in Q1, reflecting heightened inflation, but year-on-year volumes (number of items purchased) at -3.80% suffered at the hands of the 'cost of living crisis' (albeit markedly better than Q4 2022: -6.30%).

- There remains very little occupier fallout over the year to date, as we predicted in our Retail Property Market Outlook for 2023. The only major household retailers to go into administration - Paperchase and M&Co - are both 'repeat offenders' with chequered histories of private equity ownership and a track record of previous administrations. The impending Wilko CVA (CBRE advising) is being closely monitored by landlords and agents alike and will provide a test-case of the judgements of the Debenhams CVA in 2019; namely whether landlord can exercise forfeiture and pursue alternative demand where this exists.

- Investor sentiment towards the Retail sectors is largely positive, despite the obvious macro-economic challenges, and it continues to improve, with rents and values appearing to have turned a corner and a growing buyer pool across the markets. This is supported by MSCI's H1 2023 (Jan-May) results showing Retail as the best performing of traditional sectors: Retail +2.90%, Offices -2.40%, Industrial +2.50%, All Property +1.40%.

- Retail Investment sales have principally been driven by vendors under pressure to dispose and the lack of distress, and thus lack of stock, in the market continues to constrain transaction volumes, even with the growing weight of capital looking to be deployed. Debt is (selectively) available for all subsectors but is typically low leverage and expensive, meaning Net Initial Yields remain elevated.

- Retail's strong MSCI H1 2023 performance has so far been driven by the buoyant Retail Warehouse market. Total returns for Jan-May 2023 were +4.10%. Evidence of rebased rents, reduced rates liability and low void rates has sparked an increase in institutional activity within the subsector, with UK Funds now serving as the principal buyers accounting for 52% of acquisitions in H1 2023. This improved demand has driven yields downwards over the half year but only for truly prime, well-located product,

Key Transactions - 2023

Address	Sector	Purchaser	Vendor	Price	NIY %
Bath Road Retail Park, Slough	Retail Warehousing	Segro*	RLAM	£120m	–
4M Portfolio (Morrisons)	Foodstore	PIMCO	M&G	£118.4m	6.25%
St David's, Cardiff (50%)	Shopping Centre	Landsec	Intu's Lenders	c.£113m	c.9.70%
Purley Cross Retail Park, Croydon	Retail Warehousing	DTZ Investors	Oval	£59m	5.48%
The Mall, Luton	Shopping Centre	Frasers	Capital & Regional*	£58m	12.00%
Westwood & Westwood Gateway Retail Parks, Thanet	Retail Warehousing	British Land*	Receivers	£54.5m	8.20%
Tesco, Worcester	Foodstore	Supermarket Income REIT	British Steel	£38.3m	6.00%
16-18 Market Street & 7-11 Rose Crescent, Cambridge	High Street	Gonville & Caius College	CBREIM	£20.7m	6.10%
Lidl, Guildford	Foodstore	Weybourne	RLAM	£17.2m	4.75%
376-378 & 382/384, Chiswick High Road	High Street	Private Investor	APAM	£11.9m	7.00%
36-38 High Street & 3-7 Grays Brewery Yard, Chelmsford	High Street	Evolve Estates	Tesco Pension Fund	£10.9m	8.75%

causing polarisation between prime and secondary to widen. This has created three distinct buyer pools:

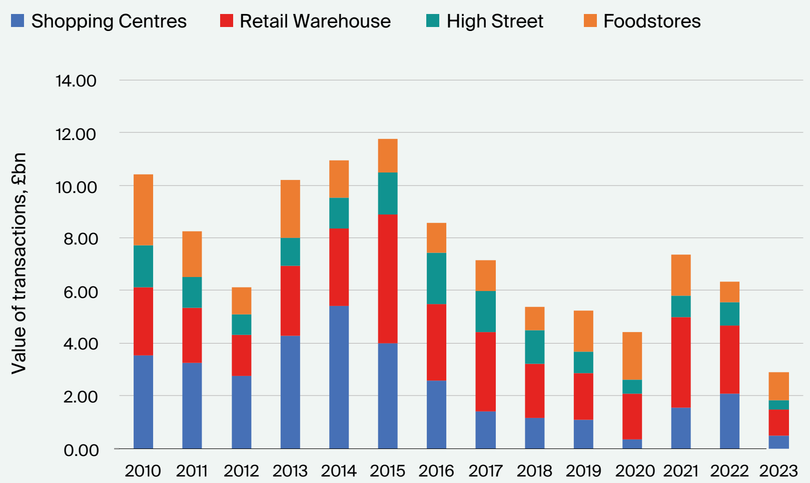
1. Institutional Investors (Funds/REITs) - seeking 'best in class' assets typically (though not exclusively) within the South East. ESG credentials are becoming of increasing important in this space.
2. Middle Money (primarily Overseas Investors) - seeking core plus yields of 7.50%+.
3. Leveraged Purchasers – need yields above 8.50%+ given the cost of debt. Therefore, forced to target secondary assets / weaker geographies.

- The resilience of the Foodstore subsector was well documented during the pandemic and preliminary 2022/2023 results for Tesco and Sainsbury's show they are also weathering the 'cost of living' storm, with both reporting Group Sales +5.30%. The sector's relativity to fluctuating gilt yields has however impacted the Foodstore Investment market, with prime yields currently estimated at 5.00% NIY, up 150bps from their 3.50% NIY peak last summer.

- Foodstore transaction volumes appear healthy at £1.07bn for the first half, up 255% on H1 2022; however, this includes two trades of the Sainsbury's Reversion Portfolio (combined £627m). A number of Morrisons-backed investments have been marketed, with Asda also understood to be under offer on a sizeable sale and leaseback package. Availability of the 'superior' covenants of Tesco and Sainsbury's has been lower and a clear premium is starting to emerge for the non-private equity owned groups.

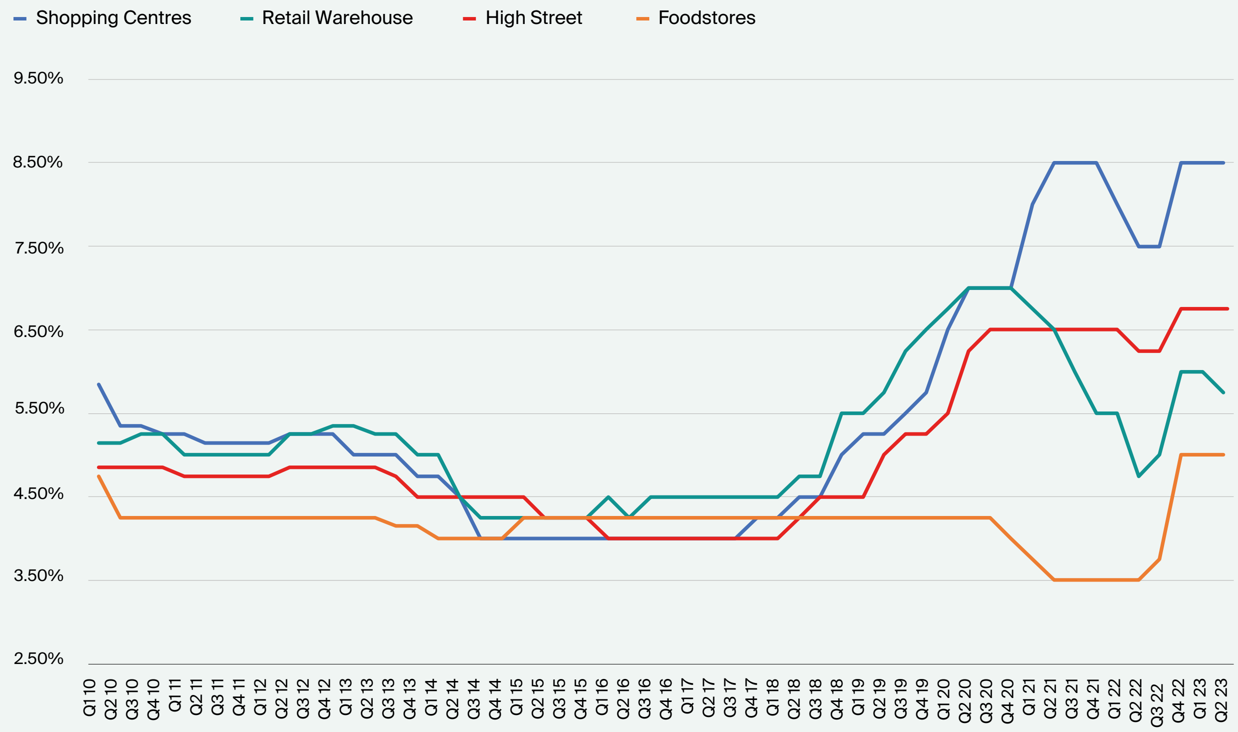
- Many Foodstore developments are now unviable as a result of build cost inflation and heightened capitalisation rates. Therefore, to enable schemes to come forward, we have witnessed examples of supermarket tenants materially increasing the rents payable. This is leading to signs of rental growth, arguably not seen in the subsector for 10 years.

Transaction Volumes



Source: Knight Frank

Prime Retail Yields



Source: Knight Frank

- Until recently, Shopping Centre investment liquidity has been confined to smaller lot size sales. This year we have seen a step change with a handful of bigger ticket transactions taking place. Notable activity includes Landsec's off-market acquisition of the remaining 50% in St David's, Cardiff (c.£113m) and the separately owned Debenhams department store (Knight Frank sold); Frasers's acquisition of The Mall, Luton (£58m – Knight Frank sold) and Churchill Square, Brighton (under offer – Knight Frank selling). Crucially, these buyers are all utilising existing cash reserves to acquire these assets, so outside of the few purchasers able to make cash investments of this scale, the cost of debt will mute larger transactions for the foreseeable future.

- We have advised on an extensive list of Shopping Centre sales through 2023 so far. Initially, we were surprised by the growing list of prospective buyers, with most trades being taken to bids and multiple proposals received (albeit from a very low base). Small private equity investors, property companies, overseas investors and even occupiers dominated bidder lists and combined to generate reasonable demand in the subsector. However, despite this modest improvement in demand, there is no evidence of pricing improvement with the subsector remaining the hunting ground for the opportunist investor.

- It is clear that the ongoing economic turmoil, combined with the realities of managing complex retail investments, is slightly reducing the buyer list. Local Authorities, often seen as buyers of last resort, are having to step in once again to secure the future of town centre assets where regeneration is greatly needed. Other, larger investments such as Festival Place, Basingstoke and Highcross, Leicester, have been withdrawn with asset managers appointed to provide interim stability where demand is limited. We expect supply to increase once the owners of these assets (typically lenders with no desire to hold beyond the short term) sense an improvement in the markets.

- The investment case for the High Street subsector is sound in core markets. Rents and yields have rebased by broadly 33% and 250bps respectively but stock selection remains critical. There is value to be found here but careful consideration needs to be given to pitch, covenant and ERV.

- Demand for the High Street subsector principally stems from domestic and overseas (namely Hong Kong and Israel) property companies and private investors. In the main, these are cash buyers making the most of what they perceive to be a counter cyclical buying opportunity and attractive yields, relative to other subsectors.

- Demand in the Outlet sector remains high with investors attracted by favourable consumer shopping trends, the transparency of trade and the ability to curate tenant mix. We expect stronger deal volumes in this specialist market with ongoing processes for J32, Castleford, Livingston Designer Outlet and the London Designer Outlet in Wembley all ongoing and attracting interest from a range of institutional and private equity investors.

- Buoyant Retail Warehouse and Foodstore markets and recovering In-Town markets mean that there is liquidity across the breadth of the retail sector, but a lack of stock across all markets is likely to mute total deal volumes for 2023. A stable or improving economic picture will give investors the confidence to push acquisitions and disposals forward. When it will arrive is the question.

Retail is back in investor shopping baskets as the value of high income yields prevails against stubborn interest rates, which are proving to be higher for longer.

KNIGHT FRANK OUTLOOK…

- The consumer will continue to be resilient and retailer performance to improve as inflation moderates through the second half of the year. We expect occupier fall out to continue to be minimal as a result.

- Rental growth is possible in pockets of the market – this is most applicable to Foodstores and Retail Warehouses but some In-Town markets to benefit too.

- Institutional interest will further shape the Retail Warehouse sector, with the consequent emergence of an 'ESG premium' for compliant assets (and conversely some discounting where assets do not fit this criteria).

- Foodstore investment demand and the weight of capital targeting the subsector will increase, however, pricing will remain volatile, mirroring the volatility seen in the UK gilt market.

- The appeal to a largely private audience of high yields high yields on offer in High Street assets relative to pricing in other sectors will put yields under downwards pressure as the year progresses.

- Deal volumes to remain low in the Shopping Centre sector as most trades take place at <£15m lot sizes. A handful of larger, £100m+ deals will support year-end totals, but these will still be significantly lower than 10-year averages.

- Elevated debt costs to continue to hold back pricing for secondary assets but availability of debt to improve for better quality assets, driving further polarisation.

REIT Share Price Tracker

	Landsec	British Land	Hammerson	NewRiver	Capital & Regional	Supermarket Income REIT	London Metric
Latest Share Price (p)	566.00	297.00	25.00	87.00	57.00	74.00	163.00
H1 2023 Movement	-12%	-27%	+1%	+10%	-2%	-28%	-7%
NAV per share (p)*	945.00	588.00	53.00	132.00	106.00	92.00	203.70
Premium to NAV	-40%	-49%	-53%	-34%	-46%	-20%	-20%

*Latest available published NAV per share

KNIGHT FRANK DEALS

A selection of our recent transactions are shown below. Thank you to all of our clients who have worked with us.

Westwood Retail Park & Westwood Gateway Retail Park, Thanet

Tenure: Freehold
Client: Acquisition on behalf of British Land
Price: £54,500,000
NIY: 8.20%

Morrisons, Welwyn Garden City

Tenure: Freehold
Client: Acquisition on behalf of Abrdn
Price: c.£18,000,000
NIY: Confidential

7-19 Amhurst Road, Hackney

Tenure: Freehold
Client: Acquisition on behalf of Brydell Partners
Price: £12,200,000
NIY: 6.84%

The Mall, Luton

Tenure: Leasehold
Client: Disposal on behalf of Capital & Regional
Price: £58,000,000
NIY: 12.00%

Bath Road Retail Park, Slough

Tenure: Freehold
Client: Acquisition on behalf of Segro

Price: £120,000,000
Price per acre: £10,500,000

The Pyramid & Grange Precinct, Birkenhead

Tenure: Freehold
Client: Disposal on behalf of AEW

Price: £10,000,000
NIY: 10.50%

Morrisons, Plymouth

Tenure: Leasehold
Client: Acquisition on behalf of Fiera Real Estate

Price: C £18,000,000
NIY: Confidential

Project Willow – Boots Portfolio

Tenure: Freehold & Leasehold
Client: Acquisition on behalf of a US Investor

Price: £61,000,000
NIY: 10.00%

The Belfry, Redhill

Tenure: Freehold
Client: Disposal on behalf of Private Investor

Price: £17,500,000
NIY: 12.00%

9-13 Foregate Street, Chester

Tenure: Freehold
Client: NFU Mutual

Price: £3,700,000
NIY: 8.88%

"Knight Frank are highly active across all of the retail sub-sectors, with specialists focused on each market.

Please do not hesitate to get in touch if we can assist with your Retail Investments."

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